Secretary of State Audit Report

Jeanne P. Atkins, Secretary of State

Mary Wenger, Interim Director, Audits Division

Business Oregon Can Improve the Evaluation and Transparency of Economic Development Incentives and Loan Programs

Executive Summary

Business Oregon, the state's primary economic development agency, can strengthen its evaluation of incentives and loans given to private businesses, focusing on performance outcomes such as jobs created and retained, wages, and return on investment.

Business Oregon can also help improve the transparency of individual business awards by better reporting information about them to the public and policy makers. And it can improve its selection and modification of the Governor's Strategic Reserve Fund awards to private businesses.

These improvements would help the agency, policy makers, and the public ensure that business incentives and loans are as strategic, cost effective and productive as possible, important given high statewide competition for Lottery and General Fund dollars.

Business Oregon can better evaluate the results of its business incentive and loan programs

Awards to businesses that Business Oregon has some role in are estimated to total $680 million in the 2015-17 biennium. This includes $145 million of state loans, loan guarantees, grants and tax incentives, and $535 million in locally controlled property tax exemptions initially authorized by the state.

Business Oregon conducts some evaluation of these incentives and loans. But it does not regularly evaluate and publicly report some key program-level outcomes, such as jobs created and retained, wages and return on investment.

Business Oregon's economic development spending is low compared to some other states, and **competition for state dollars is high**. This puts a premium on strategic use of business awards.

We analyzed Oregon Employment Department data that Business Oregon already obtains to illustrate the potential benefits of more in-depth evaluation, and the value of reporting evaluation results to the public and policy makers.

We focused on the agency's top discretionary programs for private business: the Strategic Reserve Fund (SRF) and Business Expansion Program (BEP), and Business Finance loans and loan guarantees. Unlike Business Finance loans, SRF and BEP loans are forgiven if a business meets job goals. The Governor approves SRF loans.

Business Oregon focuses on assisting traded sector businesses. (Port of Portland © Rigucci | Dreamstime.com)

We analyzed 21 projects that received funding through the SRF or BEP, and an additional 210 Business Finance projects from 2011-12. These are the most recent years with at least three years of job and wage data after Business Oregon issued the award.

The analysis indicated both positive results and issues that need more examination and public discussion. The programs helped add new jobs for Oregonians, the analysis suggested, and workers filling those jobs generated positive returns to the state through their income tax payments.

However, the majority of 2011-12 awards went to businesses with average wages below that of the county they operated in, an important result given Business Oregon's mission to encourage living-wage jobs. Agency officials say they focused on saving all types of jobs in the down years of 2011-12.

Additional analysis of incentives and loans awarded from 2006-2015 indicated that most of them went to urban areas, which already have faster employment growth than rural areas.

Business Oregon's strategic plan and key performance measures do not have targets for rural investment and living wages, making it difficult to evaluate these results. Setting targets could facilitate deeper agency evaluation of award cost-effectiveness, the agency's investment in rural communities, and its ability to encourage projects that pay livable wages.

In general, **income tax incentives receive more scrutiny**, including "sunset" reviews when tax credits are scheduled to expire. But they also need more frequent objective evaluation.

The audit also focused on enterprise zone property tax exemptions, Oregon's broadest program of local incentives. Evaluation of enterprise zone performance is sporadic, and several issues need more attention.

Our analysis of 2015 enterprise zone data showed a high amount of zone job growth in the Portland metro area, which is relatively strong economically, and in non-distressed areas. Urban areas have economic development needs too, but the concentration of benefits in relatively well-off urban and non-distressed areas is at odds with the enterprise zone programs' original focus on lagging areas that have more economic need.

The analysis also found high tax exemptions per job in the long-term rural enterprise zone program -- $54,500 in 2015 versus $4,200 in standard zones. And it found high exemptions per job for data centers built by Apple, Facebook, Google, Amazon and others. These projects could be costing counties more than typical projects, though fees and other taxes paid by the businesses involved may help offset the property taxes foregone.

Oregon can improve the transparency of individual economic development incentives and loans

In recent years, Oregon has substantially improved its reporting of economic development awards to individual businesses, putting it near the top in various state rankings and improving public accountability.

But policy makers and the public still do not have enough information on many economic development incentive and loan programs to assess their value, determine which businesses are receiving awards, and review the jobs and wages generated by subsidized businesses.

The transparency reporting generally meets state statutes and guidelines. But 10 of the 15 programs we reviewed did not disclose outcome information, such as jobs and wages, for individual businesses receiving incentives and loans. For 11 of the programs, determining whether a particular business met program requirements given the information publicly reported was difficult or impossible.

Business Oregon does not identify which businesses receive SRF, BEP, and Business Finance loans, or how many jobs those businesses retain and create.

Agencies did not report the amount of the tax incentives given to individual businesses for four of the eight economic development tax credits and subtractions we evaluated, in part because of tax return confidentiality. And county tax assessor reports for enterprise zone tax exemptions often contain incomplete information on jobs and wages.

Business Oregon can further improve its selection process for Strategic Reserve Fund awards

Business Oregon has developed a new, more thorough selection process for SRF awards, typically forgivable loans. We reviewed a sample of business projects that received SRF awards, and found several areas for further improvement.

The agency should make sure it completes risk reviews before businesses begin their projects. It should also more directly incorporate risk reviews into decision-making, and evaluate the state's full investment in projects before sending proposed awards to the Governor for approval.

We reviewed seven large projects that included SRF awards from 2008 to 2015. Business Oregon calculated projected returns for those projects based solely on the SRF forgivable loan, and did not include other state investments in the return calculation.

For five of the seven projects, adding estimated state tax credits alone to the return analysis would have significantly reduced the estimated return. For the five projects, estimated worker income taxes were projected to pay back the SRF award amount in three years on average. Adding state tax credits would have increased the estimated payback period to 24 years on average, a substantially increased risk.

Recommendations

Our complete recommendations are included on pages 26 to 27 of this report. We recommend that Business Oregon develop additional metrics and targets for incentive and loan performance, using them to evaluate the awards and report performance to policymakers and the public.

We also recommend transparency improvements. They include reporting individual SRF, BEP and Business Finance loans, and working with the Legislature, other state agencies and counties to improve the quality of information reported.

And we recommend that the agency improve its selection and modification of the Governor's Strategic Reserve Fund awards to private businesses.

Agency Response

The agency generally agrees with our findings and recommendations. The full agency response can be found at the end of the report.

Background

Oregon's economy is improving, but still faces substantial challenges

Oregon's economy continues to recover from the Great Recession, which began in December 2007. Statewide employment now exceeds pre-recession levels and the rate of job growth since the recession has outpaced the nation as a whole.

Middle-wage jobs pay from $30,000 to $50,000 a year.

Although encouraging, this recovery is not complete. Employment in most rural areas of the state has yet to return to pre-recession levels. Middle-wage jobs accounted for about 80% of the jobs lost during the recession and have not yet recovered. Average wages, while increasing, continue to trail the national average.

Oregon's advantages in attracting business include its lack of a sales tax, low energy costs, and quality of life. However, state business leaders cite several broad challenges to Oregon's continued economic recovery. Among them:

- **Labor:** Shortages in key skilled occupations, from machine operators to engineers, were identified as a barrier to business expansion and recruitment. Oregon's higher minimum wage is also a concern to some business leaders.
- **Taxes**: Oregon has one of the lowest average business tax rates in the country. However, relatively high personal income and capital gains taxes make Oregon less attractive to some business owners and venture capitalists.
- **Supply of industrial land and timber:** An adequate supply of buildable industrial land is a concern, especially for urban areas. Access to natural resources, including federally owned timber, is a challenge for many rural economies.

Business Oregon is charged with developing Oregon's economic strategy

"Traded-sector" industries sell goods and services into markets with national or international competition. Examples include manufacturing, food and beverage processing and internet-based services.

Business Oregon is the state's primary economic development agency. Its mission focuses on supporting businesses that create and retain living-wage jobs for Oregonians. The Business Oregon Commission oversees agency operations and is charged with developing the state's economic development strategy. The current strategy, named "Grow Our Own," is focused on supporting "traded-sector" industries and businesses already located in Oregon.

The agency, with 137 employees, received nearly $700 million for the 2015-17 biennium, including a $200 million increase primarily for seismic rehabilitation projects. Three-quarters of the agency's budget is for local infrastructure projects. A significant portion of its budget comes from Lottery funds, including Lottery bonds.

This audit focused on 18 business incentive and loan programs:

Figure 1: Primary Business Incentive Programs

Incentive Program	2015-17 Estimated Incentive (Millions)	Description
Forgivable Loan, Loan and Loan Guarantee Programs		
Strategic Reserve Fund (SRF)	$15.1	Business Oregon's most flexible fund. Offers forgivable loans for job-related projects. Also used for research and other non-job projects.
Business Expansion Program	Included in SRF Budget	Provides a forgivable loan to businesses that expand operations in Oregon equal to the estimated increase in state income tax revenue.
Oregon Business Development Fund	$10.7	Revolving loan fund for traded-sector businesses. Requires private lender participation. Prioritizes rural or distressed areas.
Entrepreneurial Development Loan Fund	$1.5	Revolving loan fund to help startups, microenterprises, and small businesses expand. Fills niche not served by private lenders.
Credit Enhancement Fund	$5.0	Revolving loan insurance program that guarantees private sector loans. Designed to help businesses access private capital.
Capital Access Program	$1.1	Helps increase capital access for small businesses by matching lender loan-loss reserve contributions.
Innovation Grants		
Oregon InC	$17.9	Public-private partnership that funds individual innovation initiatives in areas where Oregon holds unique advantages.
Income Tax Incentives		
Qualified Research Income Tax Credit	$20.1	Tax credit for up to 5% of qualified research activities by private companies.
Manufacturing Business Energy Tax Credit	$22.6	Credit for manufacturers with product lines related to renewable energy. Program is expired, but some credits are still outstanding.
Oregon New Market Tax Credit	$11.4	Helps finance investments and job creation in low-income communities. Supplements an existing federal program.
Electronic Commerce Tax Credit	$2.5	Tax credit on up to 25% of business investments in any of the 15 designated E-Commerce Enterprise Zones.
Long-Term Rural Enterprise Zone Tax Credit	N/A*	Income tax credit up to 62.5% of business payroll costs in Long-Term Rural Enterprise Zones. Governor approves eligibility.
Oregon Investment Advantage	$13.3	Allows income from new operations to be subtracted from taxable income for up to 9 years. Must be in a low-income area.
Greenlight Oregon Labor Rebate	$0.9	Offers a cash rebate of up to 6.2% of Oregon payroll for film production. Film and Video Office distributes.
Oregon Production Investment Fund	$22.9	Tax credit funds rebates for film and television productions, covering a portion of goods and payroll. Film and Video Office certifies.
Property Tax Exemptions		
Strategic Investment Program	$406.3	Partial exemption on property taxes for new capital investments for up to 15 years. Intel, in Washington and Multnomah counties, receives about 80% of the property tax exemptions.
Standard Enterprise Zone	$71.9	Exempts property taxes in locally established zones for 3-5 years. State currently has 66 zones, 53 in rural areas.
Long-Term Rural Enterprise Zone	$56.8	Allows for extended enterprise zone benefits for large projects in rural areas. Has wage and job creation requirements.

*Estimate for the Long-Term Rural Enterprise Zone Tax Credit is unavailable because too few businesses are approved for disclosure.

Business Oregon's primary financial tools for private businesses include forgivable loans that convert to grants if job goals are met, low-interest loans, loan guarantees, innovation grants, and tax incentives established by the Legislature.

A 2011 SRF forgivable loan helped Ft. George Brewery expand its Astoria operations.

Through the Governor's Strategic Reserve Fund (SRF) and Business Expansion Program (BEP), Business Oregon provides loans that are forgiven if job targets are met. Several local economic development officials told us these funds are state government's most direct tool for helping generate jobs.

The agency's primary Business Finance programs – Oregon Business Development Fund, Entrepreneurial Development Loan Fund, Credit Enhancement Fund and Capital Access Program- use direct loans and loan guarantees – essentially loan insurance – to promote private business lending. Most of Business Finance's programs are "revolving," meaning principal and interest payments from borrowers help fund new loans and loan guarantees.

Business Oregon also oversees several business income tax incentives, mainly ensuring that applicants meet statutory requirements. The agency has limited authority over local property tax incentives. It confirms statutory compliance for new enterprise zones and zone expansions, but primarily focuses on supporting local government officials who administer these programs.

Business development officers met with nearly 500 companies between July and December of 2016 as part of Business Oregon's Priority Company Strategic Initiative.

Nine Business Oregon business development officers and three recruitment officers work with businesses across the state to discuss their needs and help them use the agency's programs, including available incentives and loans. Ten finance officers work with banks on loans and loan guarantees designed to help banks lend more to Oregon businesses.

Incentives and loans are not the only ways the agency supports economic development. It promotes exports with technical assistance and small grants to businesses. It also encourages investments in infrastructure—ranging from water treatment plant upgrades to seismic retrofits of public buildings—through grants and loans to local governments.

Economic development efforts extend beyond Business Oregon

Other state agencies directly support economic development. The Oregon Department of Energy administers tax incentive and loan programs, for example, and the Oregon Department of Transportation provides road and rail improvements that benefit business. Regional Solutions, operated by the Governor's Office, brings together local and state officials to address regional economic priorities.

The federal government's support of economic development is substantial. The Small Business Administration distributes millions of dollars in loans and loan guarantees to Oregon businesses. The U.S. Department of Agriculture's rural development agency operates a variety of programs that invest millions of dollars in Oregon's rural areas.

Routine state spending on education, transportation, and workforce development plays a critical role in long-term economic development. Total spending in these areas is far greater than Business Oregon's spending on direct economic development efforts.

Business Oregon's limited resources put a premium on strategic use of incentives and loans

Business Oregon's economic development spending is low compared to some other states. For example, the Texas Enterprise Fund, similar to Oregon's Strategic Reserve Fund, distributed nearly $86 million in fiscal year 2015, while Oregon's fund distributed about $4 million.

Business Oregon also has a limited ability to affect the statewide economy. Businesses supported by its incentive and loan programs added over 4,000 jobs during the 2013-15 biennium, according to agency reporting. Those jobs represent roughly 6% of private sector job growth during the same period.

Given its limited resources, Business Oregon uses its incentives and loans to target specific industries. It also responds to requests for assistance from businesses and local officials.

Economists struggle to pin down the "but for" question with incentives: whether they are instrumental for business to expand, or whether projects would have taken place without the subsidies. This audit does not address that but-for question.

Nationwide, incentives and loans are fueled by competition for business among states. In general, economic research and business surveys find that incentives play a smaller role in business location decisions than other factors, such as availability of skilled workers and labor costs. However, incentives may play a role when a business is considering similar locations or the subsidy is a large portion of the project cost.

Business Oregon's limited reach puts a premium on the strategic use of its incentive and loan programs. Statewide competition for Lottery and General Fund dollars is high, adding to the need for economic development programs to be as productive as possible.

Audit Results

Our audit objective was to determine whether Business Oregon regularly evaluates and reports on economic development incentives and loans given to businesses, including forgivable loans, low-interest loans, loan guarantees, and tax incentives.

The audit focused on forgivable loans from the agency's Strategic Reserve Fund (SRF) and Business Expansion Program (BEP) and loans and guarantees issued by its Business Finance unit – the award programs most under the agency's control. It also focused on enterprise zone property tax exemptions, Oregon's broadest program of local incentives.

We found that Business Oregon can strengthen its evaluation of business incentives and loan programs, from forgivable SRF loans to low-interest Business Finance loans to tax breaks for businesses.

The agency can also help improve the transparency of individual awards, enhancing public accountability. And, it can improve its selection and contract modification processes for Strategic Reserve Fund awards.

These steps would help the agency, policy makers, and the public ensure that business incentives and loans are cost effective and meet their economic development goals.

Business Oregon can better evaluate the results of its business incentive and loan programs

Business Oregon conducts some evaluation of its economic development incentive and loan programs, but the agency does not regularly evaluate and report some key program-level outcomes, such as jobs created and retained, wages and return on investment.

A Business Oregon loan supported construction of Face Rock Creamery's Bandon facility.

Business Oregon has also commissioned some relatively in-depth, onetime evaluations of its programs. Those onetime reports often did not include actual jobs created or retained and the state investment associated with those jobs.

Other states, some with larger staffs for program evaluation, evaluate outcomes for their incentive and loan programs more regularly and thoroughly. Business Oregon's more sporadic evaluation reduces the agency's ability to improve programs and communicate program performance to policy makers and the public.

Cost and outcome information is critical to identifying improvements and communicating program performance

Monitoring outcomes, or results, helps ensure programs meet their intended purpose and agencies achieve their mission. Comparing outcomes to performance targets, or "metrics," helps agency management determine how well programs are working, so they can make adjustments and improve performance.

Communicating outcome results is also important. Policymakers and the public need current and accurate performance information to determine if program benefits outweigh their costs.

Wisconsin, Florida, Illinois, Texas, and Michigan are among states that regularly communicate outcome results for their economic development programs. Wisconsin produces an annual report that details investment amounts and program outcomes for each of its economic development incentives. Florida uses a statistical model to evaluate the state's return on its incentive investments, rotating reviews to cover all programs once every three years.

Business Oregon can do more to assess outcomes for its discretionary programs

The Strategic Reserve Fund (SRF), Business Expansion Program (BEP), and Business Finance's low-interest loans and loan guarantees are the agency's main discretionary programs for businesses.

Discretionary means the agency can choose whether to make the award – their approval is not based on fixed, predetermined requirements. This gives Business Oregon more ability to target particular industries or geographic regions.

Private sector leverage is the amount of private sector lending and investment fostered by public investments.

Business Oregon conducts some evaluation of these discretionary programs, focusing on projected jobs created and retained for the SRF and BEP programs and on loan volume, fund health and private sector leverage for Business Finance programs.

But the agency does not regularly evaluate and report some key program-level outcomes, such as actual jobs created and retained, wages and return on investment. It also is not reporting on program performance over time, and its reporting of rural versus urban investment is inconsistent.

Business Oregon's annual Key Performance Measures (KPMs) report an agencywide total of jobs its programs helped create and retain, with the SRF, BEP and Business Finance programs contributing most of the estimated job growth.

However, the agency's KPMs do not account for the state's investments, which would allow the agency to report return on investment measures by program. They simply report lump-sum job totals with no information on forgivable loan costs or loan values.

The agency also estimates jobs created and retained by individual programs as part of preparing the KPM report, but does not release those program-level numbers publicly and does not use them internally.

Business Oregon recently developed dashboard metrics designed to provide real-time information on the agency's activities and results. Similar to the KPMs, the agency's dashboard metrics do not provide program-level information on investment and outcomes.

Business Oregon commissioned several evaluations of select programs, providing onetime snapshots on the program investments and results. Onetime evaluations can be valuable, but they do not provide current data needed to make periodic improvements. Past evaluations also did not assess actual jobs created or retained, or investments made to create or retain those jobs.

Data Business Oregon already obtains can be used for more in-depth assessment of discretionary programs

Business Oregon obtains job and wage data from the Oregon Employment Department to prepare its KPMs. We requested similar Employment data, then combined it with Business Oregon's own data on Business Finance, SRF and BEP loans to demonstrate a method for analyzing the outcomes of those programs – an approach Business Oregon's analysts could emulate and improve on.

A 2014 Business Expansion Program forgivable loan helped Garmin AT, Inc. expand in Salem. The company agreed to add 65 engineering jobs.

The results of the analysis suggest that Business Oregon's discretionary programs contribute to job growth. The results also indicate that more frequent and thorough evaluations of additional metrics, such as rural investment and wages paid, is warranted.

The analysis included the agency's own data for projects receiving Business Finance, SRF and BEP loans from 2006-15. It also included employment and wage data for businesses receiving one or more of these loans during 2011 and 2012, to estimate whether these businesses had net job growth by 2015.

We analyzed 21 SRF and BEP projects and 210 Business Finance projects from 2011-12, the most recent years with at least three years of job and wage data after Business Oregon issued the award.

The analysis suggests Business Oregon's programs helped add new jobs for Oregonians, and that workers filling those jobs generated positive returns to the state through their income tax payments. See Figure 2 on the next page:

Figure 2: Analysis of 2011-12 Business Finance, SRF and BEP Awards Estimates Positive Returns *

	Business Finance Programs				Forgivable Loans
Select Outcome Metrics	**Oregon Business Development Fund**	**Credit Enhancement Fund**	**Entrepreneurial Development Loan Fund**	**Capital Access Program**	**SRF & BEP**
Total Investment Amount (millions)	$6.0	$6.2	$0.8	$0.2	$4.6
Net Job Growth 2012-2015	310	270	40	170	2,100
State Income Taxes Returned for Each $ Business Oregon Invested	$1.20	$1.20	$1.20	$1.20	$3.60
Business Oregon Investment per Additional Job	$19,100	$23,300	$18,700	$1,400	$2,200
% of Awards to Businesses with Average Wages Higher than the County Average	40%	30%	10%	20%	50%

* These results are estimates – the data was not detailed enough to provide precise results.

Additional positive results included:

- About two-thirds of businesses had net job growth by 2015 resulting in about 2,900 new jobs, well above projected job growth. About 2,100 jobs (73%) were generated by businesses receiving SRF or BEP loans.
- SRF and BEP projects combined returned about $3.60 in estimated state personal income tax revenues for every dollar invested. This result did not include private investment and other state investments in the projects, such as tax credits.
- Business Finance loans returned about $1.20 in estimated income tax revenues for every dollar invested. This result assumed full repayment of the revolving loans and guarantees.

The positive results are not surprising. The period selected, 2011 through 2015, generally had strong job growth statewide. The analysis also included only two years of discretionary awards, too few to establish a definite trend. Business Oregon could carry this analysis forward, and publish it, to better inform the public and policy makers.

The analysis also highlighted issues that need further examination:

Business Oregon's mission includes supporting businesses that provide living-wage jobs.

- The majority of 2011-12 awards – and about half the funds invested -- went to businesses with average wages below that of the county they operated in, an important result given the agency's mission to encourage living-wage jobs. Agency officials say they focused on saving all types of jobs in the down years of 2011-12. The agency has not defined a living wage; we used average county wages as a proxy.
- From 2006 to 2015, some Business Finance programs focused heavily on specific parts of the state. For example, nearly half of the Capital Access Program's awards went to banks in just two counties, with no activity in the state's eastern region. A more detailed review could help identify reasons why banks in these areas are not using the program.
- In the same period, rural areas – which have had slower employment growth than urban areas -- received 45% of the Business Finance

investment and 30% of the agency's forgivable loan investment. See Figure 3 below:

Figure 3: Most Awards Go To Non-rural Areas

	Business Finance Programs					Forgivable Loan Programs		
	Oregon Business Development Fund	Credit Enhancement Fund	Entrepreneurial Development Loan Fund	Capital Access Program	Business Finance Total	Strategic Reserve Fund	Business Expansion Program	SRF/BEP Total
Number of Awards	162	319	76	438	995	146	6	152
% Rural Awards	39%	53%	34%	44%	45%	47%	0%	45%
Investment (millions)	$41.1	$24.2	$2.4	$1.3	$68.9	$28.8	$5.7	$34.5
% Rural Investment	43%	48%	33%	47%	45%	36%	0%	30%

The Credit Enhancement Fund was the only program with a majority of its awards given in rural areas, which include about 40% of Oregon's population. The agency says the BEP program was designed for urban investment, and urban investments are typically costlier.

By statute, rural areas are located outside the urban growth boundaries of the Portland area and any city with more than 30,000 people.

Business Oregon's strategic plan and key performance measures do not have targets for rural investment and living wages, making it difficult to evaluate these results. Regularly comparing results to targets would help further public discussion of investment in rural areas and in businesses paying living wages.

Tax incentives also need more frequent evaluation

In contrast to Business Oregon's discretionary awards, tax credits and other tax incentives, such as tax subtractions, receive more scrutiny and public evaluation. But the evaluation of tax incentives can also be improved.

The Oregon Department of Revenue provides aggregate information on tax incentives in the Governor's Tax Expenditure Report, released biennially. The report includes high-level evaluations of some specific tax incentives by Business Oregon and other agencies. However, agency evaluations often do not detail program outcomes, such as job growth, wages, distribution of benefits across the state, and cost effectiveness.

In recent years, the Legislature set "sunset" dates on tax credits and required that the Legislative Revenue Office (LRO) evaluate expiring credits to help the Legislature decide whether to renew them. LRO evaluates the credits in-depth, with assistance from Business Oregon and other agencies.

If information is adequate, sunset evaluations detail the tax credit's performance, including projected state returns on investment, jobs and wages paid by businesses receiving the award. They also note potential improvements if the Legislature opts to extend the credit.

The LRO sunset review is a nationally recognized improvement in Oregon's tax credit oversight. However, this review also has limitations:

- Several tax incentives do not have a sunset review. The omissions include the Strategic Investment Program, which provides hundreds of millions in property tax exemptions to select businesses such as Intel and windfarm companies.
- Not all tax incentives are reviewed. State law requires review of tax credits. But it does not require LRO to review tax deductions, such as the Oregon Investment Advantage.
- Reviews may not be timely. Enterprise zone property tax exemptions were last reviewed in-depth in 2009, and are not due for another review until 2025. Waiting until sunset may be too late to make necessary program adjustments.

Business Oregon has a limited role with tax incentives. Primarily, that role is administrative and advisory, though the agency is evaluating tax incentives for the Tax Expenditure Report. Business Oregon does have a substantial stake in how well the tax incentives work given its role as the state's leading economic development agency.

Enterprise Zone analysis highlights need for more frequent evaluation

Enterprise zones, which award property tax exemptions to certain businesses, are one of local governments' top tools for encouraging business investment. The state plays a significant role, too, setting requirements for the zones and requiring some oversight by state agencies of statutory compliance.

Zone exemptions are among the most widespread incentives Oregon offers, and economic development officials say they are a crucial tool for attracting business and encouraging business expansion. In some cases, local officials can add local requirements to the zones, such as requiring businesses to pay community service fees that partially offset their property tax breaks.

We focused on the two enterprise zone programs with the highest annual property tax exemptions:

- **Standard zones**, offering three- to five-year property tax exemptions to businesses that locate or expand in the zone and provide goods or services to other businesses.
- **Long-term rural zones**, with exemptions of up to 15 years for select businesses.

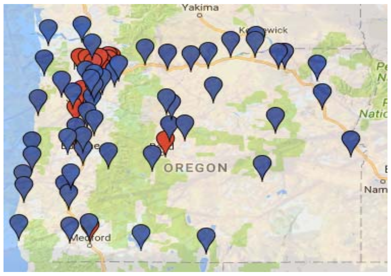
These two zone programs gave $66 million in local property tax exemptions to businesses in 2015.

Enterprise Zones

Standard:
- 3-year exemption.
- Business must increase jobs by greater of one employee or 10%.
- Exemptions up to 5 years if business pays at least 150% of county wage.

Long-Term Rural:
- 7- to 15-year exemption in standard rural zones.
- Large investment, $1 million to $25 million.
- Ten to 75 jobs required, depending on location, by third to fifth year.
- Wages and benefits at least 150% of county average wage by fifth year.

We contacted assessors to obtain complete information for the 2015 tax year, and analyzed outcomes. Our review showed a need for evaluation of three specific issues, and indicated that state and local evaluation of the zones has been sporadic:



Most of Oregon's 66 standard enterprise zones are in rural areas, (marked in blue above), but zones in Washington and Multnomah counties accounted for much of the new jobs reported for the program.

High job growth in urban and non-distressed areas. The Legislature established the standard zones in 1985, targeted to the state's "economically lagging areas." In recent years, the Legislature has allowed the program to expand substantially, particularly in urban counties that are relatively strong economically. Eleven of the 13 zones in Clackamas, Multnomah and Washington counties were added since 2005, including zones in Beaverton, Hillsboro, Portland, and Tigard/Lake Oswego.

In 2015, Multnomah and Washington counties accounted for 43% of the new jobs reported for the two programs combined. Counties considered "non-distressed" under state law reported nearly 60% of the job growth and tax exemptions under the combined programs.

Those numbers are consistent with the counties' share of Oregon's workforce population, and urban areas have economic development needs, too. But the concentration of benefits in relatively well-off urban and non-distressed areas is at odds with the enterprise zone programs' original focus on lagging areas that have more economic need. It could dilute the zones' benefits in distressed areas, depending on how many businesses consider both distressed and non-distressed areas as potential locations.

High exemptions per job in the long-term rural program. Assessors reported about $33 million each in 2015 property tax exemptions for both the standard and long-term programs. But the standard program includes far more projects and reports far more new jobs. As a result, the long-term program's 2015 exemptions per new job, based on assessor data, were substantially higher. See Figure 4.

Figure 4: Long-term Rural Zones Have Relatively High Tax Exemptions Per Job

	Standard Zones	Long Term Rural Zones
Projects Reported in 2015	184	9
New Jobs Created by those Projects	7,670	620
2015 Exemptions per New Job	$4,200	$54,500

High tax exemptions per job for data centers. Property tax exemptions per job were also particularly high for data centers – data storage and retrieval facilities built by Apple, Facebook, Google, Amazon and others.

Facebook's data center in Prineville.

The centers combine high investment in equipment, such as computer servers and cooling systems – and therefore relatively large property tax exemptions – with relatively few direct jobs at the facilities. In 2015, exemptions per job ranged from $87,000 to nearly $800,000. The centers have used both types of enterprise zone programs.

Fees and other taxes paid by the data centers can help offset the property taxes foregone.

Sporadic evaluation of enterprise zone performance. The Legislative Revenue Office, with assistance from Business Oregon and other agencies, last evaluated the standard zones in-depth in 2009. It concluded that, on average, local jurisdictions recovered property tax exemptions within seven years after businesses came back on the property tax rolls.

But that review did not include the long-term rural zones, a substantial program at $33 million per year. It focused on the overall standard zone program, not specific challenges or options for improving performance. And it analyzed periods before the recent rapid growth in urban zones and data centers.

Some local jurisdictions have evaluated zone performance in some depth. Others have not, focusing instead on reports that promote the zones but include limited analysis. Both programs are not due for another statewide sunset review until 2025.

State and local jurisdictions need to periodically examine the zones in-depth to identify potential improvements and weigh the tax breaks against the zone benefits. An evaluation of data center tax incentives could also include a broader range of community benefits and costs tied to these projects.

Lack of outcome metrics and goals, incomplete data, and limited staffing impede evaluation

Effective evaluation of incentives and loans requires clear, measurable program targets or goals and metrics that accurately assess program objectives and the agency's mission. The SRF and BEP programs focus on jobs generated. For Business Finance loans, the agency focuses on "leverage," the amount of private sector lending or investment that Business Oregon's loans and guarantees help foster.

However, Business Finance's metrics do not focus at the program level and do not focus on jobs. For all the incentives and loans, the metrics lack key outcome information that bears on economic performance, such as average wages, the split between urban and rural investment, and returns on investment.

Having good data is also important to evaluating the success of economic development programs. Business Oregon's internal data does not always include key fields, such as business identification numbers that allow the Employment Department to send actual job data for projects. Data limitations for tax incentives, as detailed in the transparency section below, also makes ongoing evaluation challenging.

Assessing whether a program is achieving its intended goals requires adequate time and resources. The agency has three staff who focus in part on assessing loan and tax incentives. In contrast, Michigan, which performs particularly detailed evaluations, has dedicated seven staff to the task. More resources to evaluate incentives and loans would help.

Oregon can improve the transparency of individual economic development incentives and loans

Within economic development, "transparency" means systematically disclosing both the incentives and loans given to individual businesses and the performance of businesses receiving awards, typically jobs and wages.

In practice, that means reporting tax credits, grants and other economic development awards given to individual companies on a state website, often within a database to facilitate research. If a company receives an award, the most complete sites report the amount, detail the project it helped fund, disclose performance requirements, such as jobs and wages, and report the actual results.

Oregon has established an Oregon Transparency Program and website. The state has strengthened disclosure in recent years, putting it near the top of several state transparency rankings and improving public accountability.

But policy makers and the public still do not have enough information on many economic development incentives and loans to assess their value, identify which businesses are receiving awards, and review the jobs and wages generated by subsidized businesses.

Filling those reporting gaps is important. Transparency promotes accountability for public dollars by spelling out the cost and performance of individual projects and giving policymakers and the public information about how funds are being used.

In a 2013 order requiring increased transparency for the Strategic Investment Program, the Oregon Attorney General's office noted that incentives "represent a sizeable public investment."

"The public has a correspondingly sizeable public interest in ascertaining the extent to which its investment is paying off," the Attorney General's office added.

Oregon's transparency efforts have increased substantially

Oregon's Legislature expanded transparency for economic development incentives, mainly tax credits, in 2011. It acted after the cost of the now-expired Business Energy Tax Credit surged far beyond initial projections, putting a spotlight on business incentives.

Some incentives given to individual businesses appear in the economic development section of the Oregon Transparency Program website, with Business Oregon or the Department of Revenue typically supplying the details. The Office of the State Chief Information Officer, within the Department of Administrative Services, runs the program.

In recent years, the U.S. Public Interest Research Group and the national policy group Good Jobs First, which tracks business subsidies, both rated Oregon among the best states for economic development transparency.

Disclosure of some substantial incentives and loans remains incomplete

Our review of transparency for 15 of Oregon's business incentive and loan programs found Business Oregon and other agencies are generally complying with state laws and guidelines when reporting awards. But some significant disclosure gaps remain. See Figure 5:

Figure 5: Award Reporting has Transparency Gaps

● Yes ○ No ◒ Partial

Subsidy Program	State Agency Reporting	Individual Awards Reported?*	Performance Requirements Listed?	Clear if Business Met Requirements?	Expected Outcomes Listed?	Actual Outcomes Listed?
Strategic Reserve Fund	Bus. Or.	◒	○	○	○	○
Business Expansion Program	Bus. Or.	◒	○	○	○	○
Business Finance Loans	Bus. Or.	◒	N/A**	N/A**	○	○
Oregon Innovation Council	Bus. Or.	◒	○	○	○	○
Qualified Research Activities Tax Credits	Bus. Or.	○	○	○	○	○
Manufacturing Business Energy Tax Credits	Bus. Or.	●	●	◒	●	○
Or. New Market Tax Credits	Bus. Or.	●	◒	◒	●	◒
Electronic Commerce Tax Credits	Revenue	○	○	○	○	○
Long Term Rural Tax Credits	Revenue	○	○	○	○	○
Oregon Investment Advantage Tax	Bus. Or.	◒	●	●	○	●
Greenlight Oregon Labor Rebate Tax Subtraction	Film Office	●	●	●	●	●
Oregon Production Investment Funds Tax	Film Office	●	●	●	●	○
Strategic Investment Program Property Tax	Bus. Or.	●	●	◒	○	●
Standard Enterprise Zones Property Tax break	Revenue	●	◒	◒	○	◒
Long Term Rural Enterprise Zones Property	Revenue	●	○	○	○	○

* Award program, amount, business recipient, and business location all reported.

** Other than timely repayment, Business Finance programs do not have specific performance requirements.

As the table indicates, overall disclosure was incomplete:

- Ten of the 15 programs did not report outcome information, such as jobs and wages, for individual businesses.

- For 11 of the programs, determining whether the business met program requirements given the information publicly reported on the transparency site was difficult or impossible.

Also, no programs published “clawbacks” – money recovered after a business falls short of subsidy performance requirements – or loan defaults. Our detailed audit work indicated the SRF and enterprise zone programs have clawbacks, and Business Finance programs have defaults.

In some states, transparency sites note when a particular project has received multiple state subsidies, an aid to users. Oregon does not.

Disclosure shortfalls also show up in specific programs.

The agency’s reporting of SRF, BEP, and Business Finance awards meets state laws, but includes little information.

SRF, BEP, and Business Finance loans: SRF, BEP and Business Finance loan disbursements to businesses are reported in the expenditure section of the Transparency website, which lists all agency expenditures. But the listing is a bare minimum. It does not indicate what program the money came from, the nature of the project, performance requirements, or how many jobs the businesses retain and create.

Income tax incentives: Awards to individual businesses are not reported for three income tax credits: electronic commerce credits, long-term rural enterprise zone credits, and qualified research activities credits.

Disclosure for the Oregon Investment Advantage tax subtraction details the businesses receiving it, but does not report the projected tax benefit for the business.

Property tax exemptions: County tax assessors submit reports for enterprise zone tax exemptions to the state, which the Oregon Transparency Program posts on the Transparency website. But the reports often lack information on wages and the number of jobs provided by individual projects.

Assessors’ enterprise zone reports often exclude job and wage data for projects.

About one-fifth of the standard enterprise zone projects assessors reported in 2015 had missing job or wage information. Reports for the long-term rural enterprise zone program include no information on wages and jobs created or retained.

The reports also include no information about local taxes, such as franchise fees, or community service fees paid by businesses in the zones. These are important benefits that would improve transparency if disclosed.

The long-term rural enterprise zone program highlights transparency challenges

The long-term rural enterprise zone program gives large businesses a property tax exemption for up to 15 years. It also allows businesses to take related income tax credits, if the Governor approves.

Assessors reported $33 million in property tax exemptions in 2015, distributed among nine companies in four rural counties: Crook, Douglas, Morrow and Wasco.

The long-term program has three significant transparency issues.

Lack of outcome information: The state posts assessor reports detailing exemptions for this program, as required by transparency statutes. But assessors are not required to report business jobs and wages even though the companies must meet job and wage requirements to receive the exemptions.

Lack of income tax credit eligibility information: Governors have approved four of the nine companies receiving long-term rural property tax exemptions to also take income tax credits. Those approvals are not posted publicly.

Lack of financial information on income tax credits: The total amount of tax credits taken is not disclosed, as it is for other tax expenditures, in the Tax Expenditure Report prepared by the Department of Revenue. DOR's tax confidentiality rules, which are based on federal rules and Oregon statutes, do not allow disclosure of even an aggregate amount if the number of taxpayers involved is less than 10. Similarly, DOR does not disclose state payments, tied to the tax credits, which are intended to reimburse local governments for lost property taxes. Doing so could allow a rough calculation of the income tax liabilities of businesses in the zone, DOR says.

Taken together, these restrictions prevent public examination of the program's costs and benefits.

Confidential income tax credit data we reviewed indicates that future credits claimed could be in the millions of dollars. This audit cannot further detail the costs and benefits due to confidentiality restrictions.

Statutory gaps, unclear lines of responsibility, and confidentiality concerns restrict disclosure

Officials with Business Oregon, the Department of Revenue and the Oregon Transparency Program cite three key reasons why economic development disclosure is not stronger:

Statutory gaps. The transparency statutes have been expanded, but they still do not require reporting for all economic development programs. Most notably, they omit Strategic Reserve Fund and Business Expansion Plan awards and Business Finance loans.

The confidentiality of tax return data and Employment Department job and wage data can limit transparency.

Even when the statutes require reporting, tax return confidentiality requirements in separate statutes prevent reporting actual business income tax credits taken. Similarly, the Oregon Employment Department's confidentiality restrictions on company-specific jobs and wages prevent reporting of this crucial outcome information, which decision makers and the public could use to evaluate incentives and loans.

A separate statute also bars disclosure of wages paid by businesses in standard enterprise zones, though wages are disclosed for other tax incentives – sometimes for the same companies also receiving enterprise zone tax incentives.

The statutes also include a specific provision restricting Business Oregon and other agencies from compiling new data or using additional staff time to comply with disclosure requirements. That provision is designed to save resources, but is a hindrance to improved transparency.

However, Business Oregon is already collecting much of the necessary data for transparency reporting on SRF, BEP and Business Finance awards, which reduces additional staff time needed for transparency efforts.

The transparency statutes also encourage agencies that report transparency information to add material for public use. However, to date, Business Oregon is disclosing only what statutes require.

Unclear responsibility. It is not clear which agencies are responsible for improving reporting of tax expenditures, both state and local. Reporting is spread between multiple agencies, including Business Oregon and the Department of Revenue.

Business Oregon and the Department of Revenue also both have administrative roles for local property tax incentives, with local governments responsible for initial reporting.

The Oregon Transparency Program has made significant improvements to the transparency website, but that effort is staffed by only one person and relies on the sometimes limited data agencies supply.

Confidentiality concerns: Business Oregon officials raised concerns with us about businesses not wanting some information published, and about disclosure of deals in progress. Making more information public could compromise projects, they said, and reduce demand for the incentive and loan programs.

Both Business Oregon and the Department of Revenue tend to be conservative about releasing business information. In two cases in recent years, the Attorney General's Office ordered the agencies to release more data on economic development programs.

Transparency can be adjusted to address confidentiality concerns

Discussions with other states – and Oregon's disclosure for some of its own incentives – indicate confidentiality issues need not prevent disclosure.

Officials from other states told us they do not think transparency requirements have reduced demand for their programs, and that transparency has helped them improve their programs.

Several states report information on business finance loans, “clawback” amounts, and “deal closing” subsidies, similar to Oregon’s Strategic Reserve Fund, without compromising business confidentiality.

One solution may be to require reporting after agreements are executed. And if confidential Employment data is used to verify jobs and wages, agencies can at least note whether a business met wage and job requirements, without disclosing the amount of jobs and wages the business reported to Employment.

For tax credits, agencies can pre-certify the credits, allowing them to publish the maximum a business could take. The Legislature could make sure a pre-certification process is included when establishing new credits. Several Oregon tax credits, including New Market Tax Credits and Oregon film rebates, already have pre-certification procedures in place, allowing for more complete disclosure.

Business Oregon can further improve its selection process for Strategic Reserve Fund awards

Business Oregon has developed a new, more thorough selection process for Governor-approved Strategic Reserve Fund (SRF) awards. A review of a sample of projects awarded indicates the agency can further improve project selection.

A 2010 SRF forgivable loan contributed to The Murphy Company’s refurbishment of a plywood mill in Rogue River.

The agency should make sure it completes project reviews before projects begin. It should also more directly incorporate risk reviews into decision-making, and evaluate the state’s full investment in projects before approving awards.

Carefully considering significant risks and weighing them against potential benefits is particularly important for the Strategic Reserve Fund program. Program awards are at the agency and Governor’s discretion -- they are not based on competitive applications that can be evaluated and objectively scored.

A clearly documented selection process is also important because Business Oregon had frequent turnover among top management and directors, including three different agency directors since 2014. Documenting risks can help ensure that new managers and directors take those risks into account.

Business Oregon has added more risk analysis to the SRF selection process

Strategic Reserve Fund awards are given to individual businesses to retain or grow jobs. They also fund economic research and broader projects, such as programs to develop rural entrepreneurs and to help Portland-area startups funded or run by underrepresented groups. We focused on awards to individual businesses, which are usually given as “forgivable” loans, essentially converting to a grant if the business meets contractual job goals for two years.

Business Oregon's director and the Governor approve each award, an important control in the process.

Business Oregon added more controls to its SRF review process in 2015. This was a prudent step. The additions came after several businesses that received large SRF awards closed or had deep layoffs after their two-year job requirement period expired.

Business Oregon's new process, implemented in spring 2015, includes measures designed to better flag risks:

- Loan officers from the agency's Business Finance unit review company financials, credit reports and other data about the business, and write a report on the business's ability to pay back the SRF loan if it fails to meet job goals. A summary is included in a memo to the Governor.
- Business Oregon staff calculate an "investment multiplier" early on and include it in the memo to the Governor. The multiplier is a return-on investment measure based on estimated state income taxes to be paid by new or retained employees.

Including assessments of financial condition and return, as Business Oregon now does, is consistent with best practices recommended by the Government Finance Officers Association and other authorities. These controls help offset the risk from the SRF program's lack of open applications or competition for the awards, a departure from best practices.

It is not clear whether the new risk analysis is improving award decisions

We reviewed files for 11 SRF projects awarded since June 2015, and found the agency is following its new procedures for the most part. However, we could not determine if the added analysis affected award decisions.

Business Oregon approved all projects proposed during that timeframe, including projects with unfavorable Business Finance reviews and low projected returns. Project documentation did not directly address why the forgivable loans should be approved despite the risks that Business Finance identified.

In two cases, businesses began work on their projects well before Business Oregon completed the review process and the Governor approved the award, raising questions about the value of the new process. One company received an SRF award for relocating to Oregon, but it moved to its new Oregon location months before Business Finance reviewed the project. Staff told us this was happening more often on SRF projects under the longer new process, with the agency assuring companies that they were still likely to get the award even if their projects started before the review process was complete.

Understandably, Business Oregon wants to move quickly on many of the SRF projects. Oregon is often competing against other states or trying to prevent an Oregon-based company from leaving, and evaluating project risks in more depth takes longer. But agency officials need to identify risks before projects are underway and better document how they are addressing them. Not doing so could expose the state to unnecessary risk.

Business Oregon can further improve the SRF selection process

Further improvements to the SRF selection process include better risk disclosure, better documentation of project referral sources, and including other state costs in return-on-investment calculations for SRF projects.

Disclose risks more thoroughly. The finance reviews appeared objective and valuable. However, for several projects, the Business Finance summary in the memo to the Governor did not include some significant risks Business Finance identified in its full review. In one project, for example, the finance memo noted that the business's balance sheet "indicates a past history of heavy losses." The summary in the memo to the Governor simply said the balance sheet showed "a mix of weaknesses and strengths."

Document and consider project referral sources. The agency does not require its business development and business recruitment officers to document project referral sources. When political officials or other politically influential stakeholders show an interest in project outcomes, it increases pressure on the agency and could lead to an unduly risky project being approved. Including the source in project documentation reviewed by management and the Governor would help ensure this risk is considered and promote accountability.

Include other state incentives in return calculations. Most SRF awards do not involve large projects with multiple state incentives. However, those that do pose more risk to the state overall. We reviewed seven large projects that included SRF awards from 2008 to 2015. Business Oregon calculated projected returns for those projects based solely on the SRF forgivable loan. This approach understates the cost to Oregonians and may overstate the project's benefit.

Adding estimated state tax credits alone to the return analysis would have dramatically reduced the state's projected return on five of the seven large projects. For those five projects, Business Oregon projected that state income taxes paid by workers would cover the SRF award costs in an average of just under three years. Adding estimated state tax credits for those projects to the analysis would have increased the estimated payback period to 24 years on average.

State laws and rules do not address whether Business Oregon is responsible for evaluating other investments on its SRF projects, though they do say the projects should be cost effective.

Business Oregon's expertise and its role as the state's lead economic development agency suggest it is best positioned to evaluate public investment as a whole and to share those results with the Governor's office.

A broader evaluation of returns would be an added safeguard, particularly on large projects.

Business Oregon needs to clarify procedures for changing SRF loan terms

Business Oregon has inconsistent practices for modifying SRF loan terms. The number of projects involved appears relatively small. But developing clear policies on how the agency modifies loan terms and pursues repayment would help ensure each business is treated fairly and consistently.

Most businesses receiving SRF forgivable loans appear to meet their job requirements – about 75% in the last 10 years, according to Business Oregon data. Those that do not are contractually obligated to pay back all or a portion of their loans.

We reviewed all 27 projects that did not meet job requirements from June 2006 to July 2016. In 12 of the 27 cases, the agency modified repayment terms to either reduce job requirements, extend time for repayment, or exclude interest charges.

The agency does not identify these modifications in its project database. As a result, it is not clear how often it modifies repayment terms or if all award recipients are given the same loan modification options.

Business Oregon officials told us they want to be flexible with businesses, particularly struggling businesses. It would undermine the SRF program's job retention and creation mission, they said, to force struggling businesses to pay off a loan and potentially reduce employment.

However, Business Oregon loan records often did not contain documentation to confirm business assertions of needing loan modification to retain jobs. And it was unclear if all loan recipients that were struggling were given the same opportunities.

Business Oregon does not have clearly defined policies and procedures governing how it modifies terms for these loans, a key contributor to the inconsistent practices.

Best practices recommended by the Government Finance Officers Association and the National State Auditors Association suggest establishing a systematic and independent process and documenting criteria for modifying repayment terms.

Developing processes and documenting criteria for modifications would help the agency meet its fiduciary responsibilities to taxpayers. It would also help ensure consistent and fair treatment of businesses.

Recommendations

To improve evaluation of business incentives and loans, we recommend Business Oregon:

- Identify key metrics and targets for evaluating program-level outcomes of economic development incentives and loans. Ensure metrics and targets align with the agency's mission and its "Grow Our Own" strategy.
- Use metrics to regularly evaluate and communicate incentive and loan performance to policy makers and the public. Recommend improvements to incentive programs to the Business Oregon Commission and the Legislature as needed.
- Work with the Legislature and the Legislative Revenue Office to require a sunset review of all tax expenditures.
- Work with county tax assessors and Department of Revenue to:
  - Ensure enterprise zone reports are complete and accurate.
  - Gather and report job and wage data for long-term rural enterprise zones.

To improve transparency of business incentives and loans, we recommend Business Oregon:

- Report awards and outcomes for SRF, BEP and Business Finance program loans.
- Work with state agencies and local officials to improve disclosure of recipient-level data for economic development loan and tax incentives, including both cost and outcome information.
- Work with other agencies and the Legislature to address disclosure limitations due to confidentiality rules and laws.

We also recommend the Legislature consider and try to resolve disclosure obstacles when adopting new economic development incentives, particularly tax expenditures.

To improve selection procedures for Strategic Reserve Fund awards, we recommend Business Oregon:

- Continue to evaluate the selection process to identify risks and determine if controls are working as intended.
- Complete the improved SRF selection process before the business begins activities funded by the SRF award.
- Document and directly address why a SRF project investment is still warranted when the selection process identifies significant risks.
- Disclose risks identified by Business Finance reviews more completely to the Governor in the SRF memo.
- Document SRF project referral sources and consider their potential impact on the selection decision.

- Include other state investments when determining state investment returns.

To improve modification procedures for Strategic Reserve Fund loans, we recommend Business Oregon:

- Develop policies and procedures for changing loan terms and ensure these policies and procedures are consistent with state laws and rules.
- Track loan modifications in the agency's project database.

Objectives, Scope and Methodology

Our audit objective was to determine whether Business Oregon regularly evaluates and reports on economic development incentives and loans given to businesses. We focused on the agency's efforts to evaluate and publicly report on the state's loans, grants and tax incentives, analyzing data for:

- Forgivable loans to businesses from the agency's Strategic Reserve Fund and Business Expansion Program.
- Loans and loan guarantees issued by its Business Finance unit.
- Enterprise zone property tax exemption programs.

We also reviewed Business Oregon's procedures for selecting and modifying repayment terms for Strategic Reserve Fund loans.

To address our audit objective, we interviewed Business Oregon staff and management to understand current program evaluation and reporting practices, challenges related to evaluation and reporting, and the selection process used for Strategic Reserve Fund awards. We also interviewed the current Business Oregon Commission chair and its Legislative members.

Photos used in this report were obtained from the Business Oregon website, unless noted otherwise.

We interviewed stakeholders from the Oregon Economic Development Association, the Oregon Business Council, Tax Fairness Oregon, Rural Development Initiatives, Association of Oregon Counties, League of Oregon Cities, the Oregon Bankers Association and the Strategic Economic Development Corporation. We interviewed representatives from the United States Department of Agriculture-Rural Development and Oregon Small Business Development Center Network. We interviewed other members of the Oregon Legislature, industrial site selection consultants and local enterprise zone managers and county assessors.

We interviewed staff from Oregon Department of Revenue, Department of Administrative Services, Legislative Fiscal Office, Legislative Revenue Office, Oregon Employment Department and Oregon Office of Economic Analysis.

We reviewed state laws, administrative rules and management best practices related to the agency and our audit objective. We also reviewed the agency's performance measures, annual reports, strategic planning documents, and website relevant to our audit objective. We reviewed agency budget documents prepared by the Legislative Fiscal Office. We also reviewed information available on the Oregon Transparency website to assess the transparency of economic development incentives.

We reviewed websites and other documentation from other state economic development agencies to assess their evaluation and reporting practices. We received detailed responses to our survey on economic development evaluation and reporting from Illinois, Michigan and Wisconsin.

We analyzed data from Business Oregon, the Oregon Employment Department, and the Oregon Department of Revenue to identify potential information that Business Oregon could use to evaluate and report program results and to illustrate the type of economic development incentive information the agency could disclose.

Specifically, we analyzed Business Oregon data for 1,147 Business Finance, SRF and BEP awards given from January 1, 2006 to December 31, 2015 to determine the distribution of these awards between urban and rural areas. We used 2010 census population data prepared by the Portland State University Population Research Center and the definition of "rural" in the statutes governing Business Oregon to conduct this analysis.

We also combined Business Oregon data with confidential data from the Oregon Employment Department to estimate net changes in employment, average wages and state income taxes returned for 231 Business Finance, SRF and BEP awards given to businesses in 2011 and 2012.

To analyze enterprise zone activity, we obtained 2015 assessor reported data for both the standard and long-term rural programs from the Oregon Department of Revenue. We contacted county assessors to fill in missing data before conducting our analysis.

We did not fully assess the reliability of data we obtained from Business Oregon, the Employment Department and Department of Revenue as our findings focused mainly on the lack of procedures for evaluating and reporting on incentives and loans. We did review the data for reasonableness and made recommendations to address data limitations that would help improve evaluation and transparency.

To test whether Business Oregon is following its selection process for SRF loans, we examined the 11 SRF awards directed to individual businesses since June 2015, when the agency's new selection process was implemented.

To evaluate how Business Oregon treats large projects in the SRF selection process, we examined the five SRF projects with the largest total state investment since 2006. We also examined the two additional projects among the 20 largest that received both SRF and BEP awards.

To examine how Business Oregon modifies repayment terms for SRF loans, we reviewed documentation for 27 projects for businesses that did not meet initial job creation or retention requirements.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained and reported provides a reasonable basis to achieve our audit objective.

Auditors from our office, who were not involved with the audit, reviewed our report for accuracy, checking facts and conclusions against our supporting evidence.

December 14, 2016

Mary Wenger, Interim Director
Oregon Audits Division
255 Capital St. NE, #500
Salem, OR 97310

RE: Recommendations for Improved Evaluation and Transparency of Business Oregon's Economic Development Incentives and Loan Programs

Dear Director Wenger,

Thank you for the opportunity to respond to the Secretary of State's Performance Audit for Business Oregon's Incentives and Loan programs. I would like to acknowledge the thorough and professional work of your Audit Division in preparing this report. We believe our agency's incentives and loan programs are important tools that improve the competitiveness of Oregon businesses and contribute to state economic prosperity in both rural and urban communities. We agree with the audit findings that indicate Business Oregon incentives and loan programs have had positive results in the form of job creation and increased income tax payments to the state. As such, we welcome your assessment and feedback as a means to help us improve the services we provide to Oregonians.

Business Oregon's new leadership team recently launched a comprehensive strategic planning process to identify agency priorities and improve implementation of programs and services. Our agency has a reputation for—and a strong track record of—making sure our programs add value and generate positive economic results for Oregon. The Secretary of State Audit Division's assessment and recommendations are valuable input as we work to continuously improve service delivery and communicate results to policy makers and the public.

Below you will find Business Oregon's response to specific audit recommendations. While the findings presented in this report are not limited to Business Oregon, we recognize the leadership role we play to inform economic development policy and program implementation throughout the state. We also agree that it is important to continue to seek opportunities to improve performance tracking, transparency, and communication across the board so we can collectively invest Oregon's limited resources wisely.

The report identifies some opportunities for improvement that are beyond Business Oregon's existing Legislative mandate or current ability to influence. Therefore, our planned actions must necessarily prioritize those recommendations that reside most closely within our control. However, we are pleased to contribute to any and all efforts that policy makers, as well as our state and local partners, engage in to evaluate and implement those recommendations that exceed our current scope of direct responsibility.

Business Oregon generally agrees with the audit recommendations. Any specific concerns we have identified are included in our responses below.

To improve evaluation of business incentives and loans, the report recommends that Business Oregon:

- *Identify key metrics and targets for evaluating program-level outcomes of economic development incentives and loans. Ensure metrics and targets align with agency's mission and its "Grow Our Own" strategy.*

775 Summer St. NE, Ste. 200 • Salem, OR 97301 • 503-986-0123 • fax 503-581-5115 • www.oregon4biz.com

- *Use metrics to regularly evaluate and communicate incentive and loan performance to policy makers and the public. Recommend improvements to incentive programs to Business Oregon's commission and the Legislature as needed.*

Business Oregon's ongoing strategic planning process is focused on: 1) establishing agency mission, vision, and values; 2) developing a five-year strategic implementation plan with clear goals, objectives, and priorities; and 3) identifying success metrics. As a final outcome of our strategic planning process, we expect to more fully articulate action plans that include robust program-level targets and goals (such as the usage of our programs by rural communities and underserved populations) that we can share with our stakeholders.

Business Oregon employs a thorough underwriting process that ensures we make good, defensible loan and incentive awards. We also worked closely with the Legislative Fiscal Office, the DAS Office of Transparency, and the Oregon Business Development Commission to identify and monitor Key Performance Measures, division/team performance targets and outcomes, and dashboard metrics focused on the overall health of and return on investment from Business Oregon's programs. As stated in the audit report, we are in compliance with all statutory reporting requirements, and routinely provide a wide array of reports, data, and testimony to Legislators to inform economic policy discussions.

The audit report primarily focuses on the impact Business Oregon incentives and loan programs have on job creation and income tax generation.. As stated in the report, "Business Oregon's programs helped add new jobs for Oregonians, and workers filling those jobs generated positive returns to the state through their income tax payments." While these are important measures and outcomes, we disagree in part that all of Business Oregon's incentives and loan programs are measured exclusively by these factors. We agree with the audit findings that we could do a better job of publicly providing and communicating program-level data and information; therefore, we commit to updating our web site to more clearly explain the purpose and result each program is designed to achieve and include relevant program-level results. As a first step toward this goal, we worked with the DAS Office of Transparency in October to create a web link on their page to our agency-specific outcome measures, as well as a reciprocal web link on Business Oregon's page back to the transparency page. This allows us to own and actively manage our datasets, upload timely relevant data, and it ultimately provides us more flexibility in data reporting than the previous transparency templates allowed.

- *Work with the Legislature and the Legislative Revenue Office to require a sunset review of all tax expenditures.*
- *Work with county tax assessors and Department of Revenue to:*
    - *Ensure enterprise zone reports are complete and accurate.*
    - *Gather and report job and wage data for long-term rural enterprise zones.*

While Business Oregon has a history of contributing to past evaluations of enterprise zones and sunset reviews of tax expenditures, and is pleased to participate in any future reviews, we are likely not in the best position to solely lead this effort. The Legislative Revenue Office, the Department of Revenue, and locally elected tax assessors share responsibility, have better access to data, and are staffed to implement these specific recommendations.

To improve transparency of business incentives and loans, the report recommends that Business Oregon:

- *Report awards and outcomes for SRF, BEP and Business Finance program loans.*
- *Work with state agencies and the counties to improve disclosure of recipient-level data for economic development loan and tax incentives, including both cost and outcome information.*

We concur with the finding that "Oregon has substantially improved its reporting of economic development awards to individual businesses, putting it near the top in various state rankings and improving public accountability." We also agree that there is room for improvement.

For SRF, BEP, and Business Finance loans, we commit to exploring ways to balance the public's right to know with individual businesses' rights to privacy within the constraints of Oregon's confidentiality laws. It should be noted, however, that in the past this has proven difficult given that businesses are often reluctant to make their financial (wage and jobs) information and tax records public, fearing that it will create a competitive disadvantage for them. As suggested in the audit report, other states could provide a blueprint for how we approach this issue. We are committed to adopting and implementing best practices whenever possible.

(As an aside, the report correctly notes that the Attorney General ordered us to release information on the Strategic Investment Program; however, it doesn't make clear that the information for that program is self-reported data versus legally protected information such as the information included in SRF, BEP, and Business Finance loans.)

- *Work with other agencies and the Legislature to address disclosure limitations due to confidentiality rules and laws.*

Business Oregon is ready and willing to engage in this discussion if and when the Legislature chooses to pursue it.

To improve selection procedures for Strategic Reserve Fund (SRF) awards, the report recommends that Business Oregon:

- *Continue to evaluate the selection process to identify risks and determine if controls are working as intended.*
- *Document and directly address why a SRF project investment is still warranted when the selection process identifies significant risks.*
- *Disclose risks identified by Business Finance reviews more completely to the Governor in the SRF memo.*
- *Document SRF project referral sources and consider their potential impact on the selection decision.*
- *Complete the improved SRF selection process before the business begins activities funded by the SRF award.*
- *Include other state investments when determining state investment returns.*

We generally concur, and have already made significant progress toward implementing most of the audit report's recommendations. In 2015, Business Oregon requested that Talbot, Korvola & Warwick, LLP (TKW)—the firm Business Oregon contracts with to conduct internal audits—perform a review of the agency's Strategic Reserve Fund processes and procedures. We specifically asked for recommendations for improving our internal control methodology.

TKW issued their report in December 2015, and as a result, Business Oregon rotated one of its senior Economic Strategies and Policy staff to this project with the goal of implementing SRF process improvements. To date, the agency has developed a streamlined work flow process that will decrease decision making time and require either Business Finance's endorsement of the project or its recommendations for contract modifications to mitigate the agency's risk. The revised work flow will be fully implemented beginning in January, 2017.

The last two recommendations on the list are the most difficult to implement, but we commit to exploring improvements. While Business Oregon consistently requires that recipients of SRF awards have a fully executed contract before beginning work on any project component that we are funding in order to receive payment, we do not have the ability to direct businesses to delay all elements of their projects (especially when other partners or the business itself is funding other discrete parts or phases of the project.) In a similar vein, we do note other state investments into large-scale business projects in our loan and incentive documentation, but we cannot always control the timing or amounts of other public investments when they are directed by other agencies, federal grants, local governments, or state tax law.

To improve modification procedures for Strategic Reserve Fund loans, the report recommends that Business Oregon:

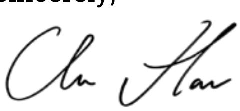
- *Develop policies and procedures for changing loan terms and ensure these policies and procedures are consistent with state laws and rules.*
- *Track loan modifications in the agency's project database.*

We generally agree with the recommendation to better define contract amendment conditions and terms. As a direct result of the SRF review findings we requested from TKW, we are in the process of: 1) defining the conditions under which we will offer contract amendments; 2) outlining a menu of contracting options and terms; and 3) establishing contract follow up procedures to ensure that businesses are on track with their job creation and other goals. And, while we would value the ability to track loan modification terms in our database, the information technology system (Portfol) that we currently use does not have this capacity. It would require a significant financial investment to make these programming changes. We commit to exploring alternative options, but in the meantime we will continue to keep complete documentation in our hard-copy files.

Conclusion

Thank you for the opportunity to work together to identify ways we can be a more effective and transparent economic development agency. We appreciate the thoroughness and professionalism that the audit team demonstrated throughout the review. We are committed to taking the feedback that was provided seriously and will continue to seek ways to improve as we provide critical services to Oregon businesses.

Sincerely,



Chris Harder
Director

About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of other agencies within the Executive, Legislative, and Judicial branches of Oregon government. The division is authorized to audit all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

Audit Team

William Garber, CGFM, MPA, Deputy Director

Sheronne Blasi, MPA, Audit Manager

Andrew Love, Audit Manager

Scott Learn, MS, Senior Auditor

Jonathan Bennett, MPA, Staff Auditor

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

website: sos.oregon.gov/audits

phone: 503-986-2255

mail: Oregon Audits Division
255 Capitol Street NE, Suite 500
Salem, Oregon 97310

The courtesies and cooperation extended by officials and employees of Business Oregon during the course of this audit were commendable and sincerely appreciated.