PDC ECONOMIC DEVELOPMENT LOANS:
Loan programs improved, but tracking major borrowers limited

March 2012

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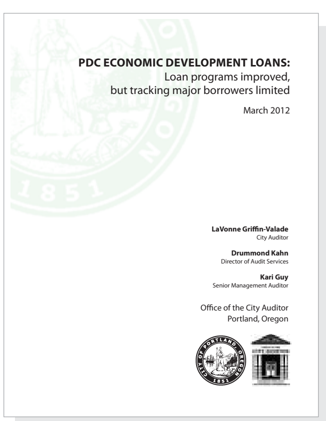
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CITY OF PORTLAND, OREGON 1851

March 14, 2012

TO: Mayor Sam Adams
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Randy Leonard
Commissioner Dan Saltzman
Scott Andrews, PDC Commission Chair
John C. Mohlis, PDC Commission Secretary
Charles A. Wilhoite, PDC Commissioner
Steven Straus, PDC Commissioner
Aneshka Dickson, PDC Commissioner
Patrick Quinton, PDC Executive Director

SUBJECT: Audit Report – *PDC Economic Development Loans: Loan programs improved, but tracking major borrowers limited* (Report #419)

The attached report contains the results of our audit of Portland Development Commission (PDC) economic development loans.

Our audit demonstrates a number of improvements to PDC loan programs, including tightened loan standards and a stronger performance measurement system. However, we also found that PDC does not consistently track or report the loans to major borrowers, and performance measurement of large loans is limited. Without this tracking and reporting, PDC may be less able to ensure a fair allocation of public funds or ensure that individual loans are contributing towards meeting PDC goals. We make a number of recommendations to build on the recent improvements, and to strengthen tracking and oversight of major borrowers.

We ask the Portland Development Commission to provide us with a status report in one year, through the Office of the Mayor, detailing steps taken to address our recommendations in this report.

We very much appreciate the cooperation and assistance we received from Portland Development Commission staff as we conducted this audit.

L. Griffin-Valade

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City Auditor

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Attachment

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Summary

The Portland Development Commission (PDC) provides loans to businesses to help achieve the City's economic development and urban renewal goals. We conducted this audit to determine whether PDC is following sound financial policies in approving and servicing loans, whether PDC has systems in place to measure and report performance, and whether loans are meeting performance goals.

We found that over the last three years, PDC made several improvements as it developed sound policies to approve and service loans. Specifically, PDC:

- Undertook a comprehensive review of loan programs
- Tightened loan standards
- Linked loan programs to the City's Economic Development Strategy, and
- Improved loan tracking and servicing.

PDC policy is to ensure a fair allocation of resources and diversification of the total loan portfolio. We reviewed the current policy and practice for tracking borrowers holding greater than 5 percent of outstanding loans, and found both that these major borrowers are not consistently tracked and reported, and that PDC oversight has been limited for some large loans. We identified five major borrowers that account for 55 percent of outstanding loan dollars, with the remaining 45 percent of loan dollars held by over 200 smaller borrowers. Without consistent information on major borrowers, the PDC Board may be less able to ensure a fair allocation of public funds, and a high concentration of loans held by few borrowers may increase the risk of loss of public funds.

We also found that PDC improved performance measurement for most small business loans. These loans contribute directly to job growth and help leverage private investment. However, PDC is still in the process of developing performance measures for larger loans. Clear performance measures would help PDC evaluate how these larger projects contribute to urban renewal goals, and help guide future financial investment decisions.

We make a number of recommendations to PDC to ensure that recent improvements in loan program administration continue, to review and report on major borrowers, and to clarify performance measurement for all loans.

Chapter 1 **Background**

The Portland Development Commission (PDC) serves as the urban renewal agency of the City of Portland, charged with implementing the City's urban renewal and economic development goals. In carrying out economic development duties, the PDC may promote business and industrial retention, expansion, and recruitment, and conduct other urban renewal and redevelopment activities.

PDC and the City Council adopted an Economic Development Strategy to promote job creation and economic growth. The Strategy focuses on enhancing competitiveness in target industries, investing in innovative urban projects, and encouraging neighborhood business vitality. In addition to the overall City Economic Development Strategy, the City Council adopts a plan for each urban renewal area at the time the urban renewal area is created.

One method PDC uses to accomplish the goals of the urban renewal and economic development plans is to provide business loans. These loans are intended to fill financial gaps when private financing is not available, and make a project financially feasible. Loans fall generally into two categories: *Business Finance* loans and *Commercial Property Redevelopment* loans.

Business Finance loans are focused on the creation and retention of jobs, primarily within urban renewal areas. These loans are made directly to a benefiting business, for physical improvements to owned or leased properties. This program also provides some City and Federal funds for businesses citywide, with those funds used for working capital, equipment purchase, or building acquisition. Some recent examples of Business Finance loans include rehabilitation of a building for an electrical supply company in the Interstate Corridor, tenant improvements for a new restaurant in the Central Eastside, and development of a food processing facility in the Lents neighborhood.

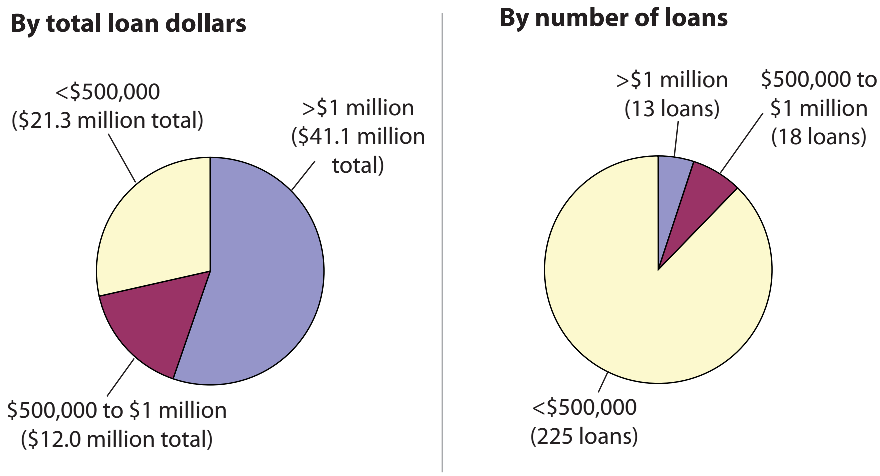
Commercial Property Redevelopment loans (referred to here as *Property Redevelopment* loans) are intended for development or rehabilitation of blighted property within urban renewal areas. Generally, Property Redevelopment loans are for larger projects with a longer construction period and more complex financing structure than Business Finance loans. Unlike Business Finance loans, the borrower is not necessarily a tenant of the completed project. Property Redevelopment loans are funded with urban renewal area funds. Some recent Property Redevelopment loans include renovations of a Pearl District warehouse for office space, renovation of a hotel in the South Park Blocks urban renewal area, and renovation of a two-story building in the Oregon Convention Center urban renewal area for storefronts and office space.

Before 2011, the PDC Board could approve "Special Authority Loans" outside of the Property Redevelopment or Business Finance guidelines. These loans were typically larger, and often associated with the sale of PDC property. There were no guidelines governing these Board-approved loans.

PDC policy prioritizes a fair allocation of resources, with a requirement to report to the PDC Board on any loans to an entity and its affiliates that would exceed 5 percent of PDC's total loan portfolio. Diversifying the loan portfolio also helps minimize the risk of loss of public funds. The policy does not ban loans to borrowers exceeding the 5 percent limit, but the reporting requirement helps to inform the Board of the total composition of its loan portfolio, and whether it is concentrated among a small number of large borrowers.

Over the last five fiscal years (from FY 2006-07 through FY 2010-11), PDC made over 250 loans totaling $74 million. The loans range from under $10,000 to over $8 million, with the majority of loans (88%) less than $500,000. While most *loans* are for less than $500,000, the majority of loan *dollars* are for large loans of greater than $1 million (55%). Figure 1 shows the allocation of loans by number of loans and loan dollar amount.

Figure 1 **New loans issued July 2006 - June 2011, by loan size**



Source: Audit Services analysis of PDC loan data

Almost 93 percent of loans in the last five years were from urban renewal area funds. Distribution of loan dollars is shown in Figure 2.

Figure 2 **New loans issued July 2006 - June 2011, by Urban Renewal Area or other funding source**

Urban Renewal Area	Loan amount
River District (Pearl District)	$19,445,596
Downtown Waterfront	$13,823,268
Convention Center	$11,590,462
Interstate	$10,384,503
Non- URA (Federal or City General Fund)	$4,956,474
Airport Way	$4,884,500
Central Eastside	$3,821,500
Lents Town Center	$3,776,312
South Park Blocks	$1,548,000
Gateway	$150,000
North Macadam (South Waterfront)	$37,235
TOTAL	$74,417,850

Source: Audit Services analysis of PDC loan data

The premise behind urban renewal financing is that investments in an urban renewal area will result in increased property values. The taxes generated from the increase in property values – the tax increment – are then used to pay off the initial investment. Due to property tax limitation measures, assessed values can only rise 3 percent annually except in the case of certain property improvements. Economic development and redevelopment loans are intended both to improve the assessed value of specific properties, and also to serve as catalysts for other redevelopment in the urban renewal area that would lead to a broader increase in assessed values.

Our 2006 audit of PDC found that Business Finance loans appeared to have a positive impact, but that due to issues of PDC data reliability, it was difficult for PDC to verify specific outcomes. That audit also looked broadly at the results of PDC's economic development efforts.*

PDC conducted an internal audit of loan policies in 2004 that revealed a lack of clear financial policy from the Board, and no centralized or coordinated oversight of the loan portfolio. Over the last three years, PDC has reviewed the loan products and updated loan guidelines. PDC also transferred housing loans totaling almost 80 percent of the loan portfolio to the Bureau of Housing, which increased the focus on remaining economic development loans.

In October 2010, the PDC Board adopted a Financial Investment Policy to guide future investments:

> *"When investing public resources to achieve its strategic plan, PDC will apply sound financial guidelines, and accountable and transparent processes. PDC will measure its performance by jobs retained and created, community and stakeholder satisfaction, dollars leveraged, assessed value increases, and customer satisfaction."*

We conducted this audit to determine whether PDC is following sound financial policies in approving and servicing loans, whether PDC has systems in place to measure and report performance, and whether loans are meeting performance goals.

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* *Portland Development Commission: Economic development efforts effective, but improvements needed to measure and manage future success* (Report 322) - 6/6/06

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Chapter 2 PDC follows sound loan management practices

Recent policy changes improved the loan program

In 2010 and 2011, the PDC Board approved changes to the financial guidelines for PDC's two categories of loans – Business Finance loans and Property Redevelopment loans. The changes specifically linked the loan programs to the City's adopted Economic Development Strategy and to the PDC Strategic Plan, and narrowed the range of loan products offered. For example, some loan products were eliminated, including loans called 'conditional grants' that were forgiven if certain loan conditions were met, and cash flow loans that were repaid only if a project reached a certain level of cash flow. The revised guidelines also tightened standards for interest rates, increased the required borrower contribution, and increased loan fees.

The new policies require that loans tied to sale of PDC property be approved through the Property Redevelopment program. Both Business Finance and Property Redevelopment loan guidelines allow loans of up to $2 million to be approved by the PDC Executive Director, while loans of greater than $2 million must be approved by the PDC Board. For two loans approved by the Board after the guideline changes, public documents submitted to the Board described the variations from Property Redevelopment guidelines.

The policy changes help PDC manage risk, but do not eliminate all high risk loans. For example, the guidelines retain "predevelopment loans" that may be forgiven if the project does not move forward. In addition, Board approval of specific loans with terms different than those in loan guidelines may increase risk in these large loans. However, the changes in loan products offered and the improved loan standards increase the chances of positive returns on the public investment for most loans.

PDC follows sound and consistent underwriting and loan servicing practices

We reviewed a sample of loans either approved or written off in Fiscal Year 2010-11 to determine whether the new financial guidelines were being followed. We found a number of positive practices, including the following:

Loan origination and underwriting is thorough and well documented

In our review of loan files we found complete loan application materials, loan evaluations, and closing documents. For larger loans, construction advisors reviewed cost estimates, and reviewed each invoice before loan funds were disbursed. The Business Finance program updated the loan procedures manual to be consistent with new loan guidelines, and the Property Redevelopment program developed procedures for the first time.

Financial Investment Committee provides central oversight

In 2010, the PDC Board merged the existing Loan Committee with the Investment Committee to create one internal group to recommend approval or denial of all requests for financial assistance. Committee members are appointed by the PDC Executive Director, in consultation with the Board chair. The Financial Investment Committee reviews all loan approvals, modification, and write-offs. Standard loan reports provided to the Financial Investment Committee include an analysis of borrower finances, credit, and collateral, and an analysis of how the loan meets urban renewal area and loan program objectives. Actions of the Committee are then reported to the PDC Board in monthly and quarterly summaries. The monthly summaries detail every loan action, and specify any exceptions granted to loan program guidelines.

Loan information systems updated

One of the issues we identified in our 2006 audit was a lack of reliable data for reporting performance. PDC used two information systems: one for loan origination that included client data and data on projected benefits (ACT!); and a separate system for loan servicing (MITAS). Linking information between the two systems was difficult, which made it difficult for PDC to validate performance information.

As of July 1, 2011, PDC implemented a new loan management system (called Portfol) to replace MITAS, and as of January 2012, PDC replaced the ACT! system with Portfol. As part of the transfer of data to the new system, PDC conducted a full review of loan data, and validated information against paper loan documents as needed. Staff demonstrated benefits of the new system, including linking all loans or projects for a client, improving reporting capabilities, and leaving an 'audit trail' of all changes made to a loan in the system. The changes also add more data fields and stronger performance reporting capabilities to the Portfol system. While the changes are too recent to have a demonstrated impact, they appear to improve data reliability for both loan servicing and performance reporting.

New loan recovery process implemented

Beginning in March 2011, PDC's system for pursuing recovery of loans in default changed significantly. Rather than contracting with outside counsel, PDC Legal Department is now the lead for tracking and monitoring loans in default. If a loan in default is to a viable business, PDC may work with the borrower to modify loan terms. If the business is no longer viable or loan modification is not an option, the loan will be written off. Loans are written off for accounting purposes, to remove the asset from PDC's books, but after a loan is written off PDC will continue pursue recovery of loan assets. If there are no assets at the time of loan write-off, legal staff will revisit the loan in three or four years. PDC legal staff research bank accounts and assets of borrower to determine if there are assets to pursue, and work closely with other PDC staff to continue to monitor borrowers.

Loan recovery methods include cash payments, receipt of property, and sale of equipment. Of the loans written off from July 2006 to June 2011, PDC recovered funds or property from 45 percent, and continues to pursue recovery from 35 percent. The remaining 20 percent of borrowers did not have assets to recover.

Strong loan origination, underwriting, loan servicing, and loan recovery help protect the investment of public funds. We calculated the rate of loans either in default or written off for the loans issued in the last five fiscal years, and found a default/ write-off rate of 4.5 percent.

While it is difficult to find a direct comparison to PDC loan programs, the Federal Economic Development Administration loan program has a similar goal of stimulating business development in economically distressed areas. A study of Federal Economic Development Administration business loans in 2002 found a default rate of 8.6 percent nationwide. PDC's default rate compares favorably to this national rate.

Positive loan practices not all reflected in PDC policy

PDC's loan practices are not all reflected in current policy. For example, although the PDC Board adopted a policy creating the Financial Investment Committee, there are no administrative policies or procedures governing committee authority or criteria for approving loan exceptions. PDC began drafting an administrative policy in 2010, but the policy was not completed at the time of our audit. In another example, the current system for managing loan recovery is not documented in policies or procedures. A change in staff could result in the loss of recent improvements. Documenting the policies for the Financial Investment Committee and loan recovery would help ensure current practices continue.

Chapter 3 Tracking major borrowers limited

PDC policy requires tracking major borrowers, both to ensure a fair allocation of resources and to minimize the concentration of risk in the total loan portfolio. We reviewed the current policy and practice for tracking major borrowers, and found both that major borrowers are not consistently tracked and reported, and that PDC oversight has been limited for some major loans. Without consistent information on major borrowers, the PDC Board may be less able to ensure a fair allocation of public funds.

Reporting on major borrowers incomplete

In 1991, PDC established a policy that the sum of loans to any entity could not exceed five percent of the total PDC loan portfolio without Board approval. In 2006, the Board eliminated 5 percent as a specific limit, noting that all requests to the Board to exceed the 5 percent limit had been approved, and that there were now collaborative processes in place to mitigate allocation concerns. However, the 2006 policy requires the Executive Director to report to the Board on a quarterly basis on any financial assistance to an entity or related affiliates whose consolidated outstanding debt exceeds 5 percent of PDC's total loan portfolio.

When housing loans were transferred from PDC to the Bureau of Housing in July 2010, the total loan portfolio decreased by almost 80 percent. The PDC to Housing transfer lowered the threshold for loans to meet the 5 percent limit from over $18 million to $4.3 million. The change also highlighted the larger loans in the composition of the economic development loan portfolio.

PDC finance staff prepare an internal report that lists major borrowers with greater than 5 percent of the loan portfolio. This report uses tax identification numbers to link affiliated borrowers. As of June 30, 2011, PDC identified five major borrowers holding 43 percent of the total loan portfolio. While calculated and reported internally, this information is not reported to the PDC Board as is required by PDC policy.

We expanded on PDC's linking of loans by tax identification number to include loans made to identical addresses or similar names. Under current PDC practice, if single borrowers hold different loans under different tax identification numbers, PDC might not identify the impact that these single major borrowers might have on diversification or fairness. We found that 55 percent of the value of PDC's outstanding loan portfolio as of June 30, 2011 is held by five major borrowers and related entities. The remaining 45 percent is held by over 200 borrowers.

One major borrower, the Portland Family of Funds, is a controlling entity on 10 loans totaling over $18 million dollars, or 18 percent of PDC's outstanding loan portfolio. PDC staff told us they do not consider these loans as affiliated because Portland Family of Funds acts as an intermediary and loans the funds to sub-borrowers. Tracking and reporting this loan concentration is important because if there were financial problems with any of the 10 loans, those problems could have a negative impact on the other loans held by Portland Family of Funds.

In another case, a developer controls three loans totaling 6 percent of PDC's loan portfolio, but through a different partnership on each loan. One of these loans is unusual in that it is a pass-through loan of City general funds directed to a specific project and developer. In addition to these three loans, there are seven additional loans to tenants for improvements to buildings owned by the same developer. PDC does not consider loans to tenants as affiliated with the developer who owns the buildings. When a new loan was approved by the PDC Board to this developer after the June 30, 2011 date of our review, there was no mention in the public Board documents of the existing loan concentration. This concentration of loans under the control of any single borrower presents risks to PDC that should be considered by the Board when approving additional loans.

Current practice does not provide adequate information to the PDC Board on major borrowers, limiting the Board's ability to ensure a fair allocation of public funds. PDC has also not defined related parties and affiliates, meaning that some borrowers exceeding the 5 percent threshold may not be identified. PDC should revisit this 5 percent allocation policy to ensure the Board has the necessary information to guide future loan decisions, and ensure the original intent of the policy – including portfolio diversification and fairness – is met.

Public benefits of leverage loans for New Market Tax Credits unclear

All of the loans to the Portland Family of Funds (PFF), the largest borrower at 18 percent of PDC's total loan portfolio, were provided to leverage federal New Market Tax Credits (NMTC). Because of this high concentration of risk in PDC's loan portfolio, we selected a sample of PFF loans for further review.

The NMTC program was created by the U.S. Congress in 2000 to encourage investors to make investments in low-income communities that traditionally lack access to capital. PDC encouraged the creation of PFF as a private sector entity to apply for a NMTC allocation for Portland, and PDC and the PFF then collaborated in the allocation of $100 million in federal tax credits. Loans related to this allocation were issued in 2006 and 2007.

Positive returns for private investors

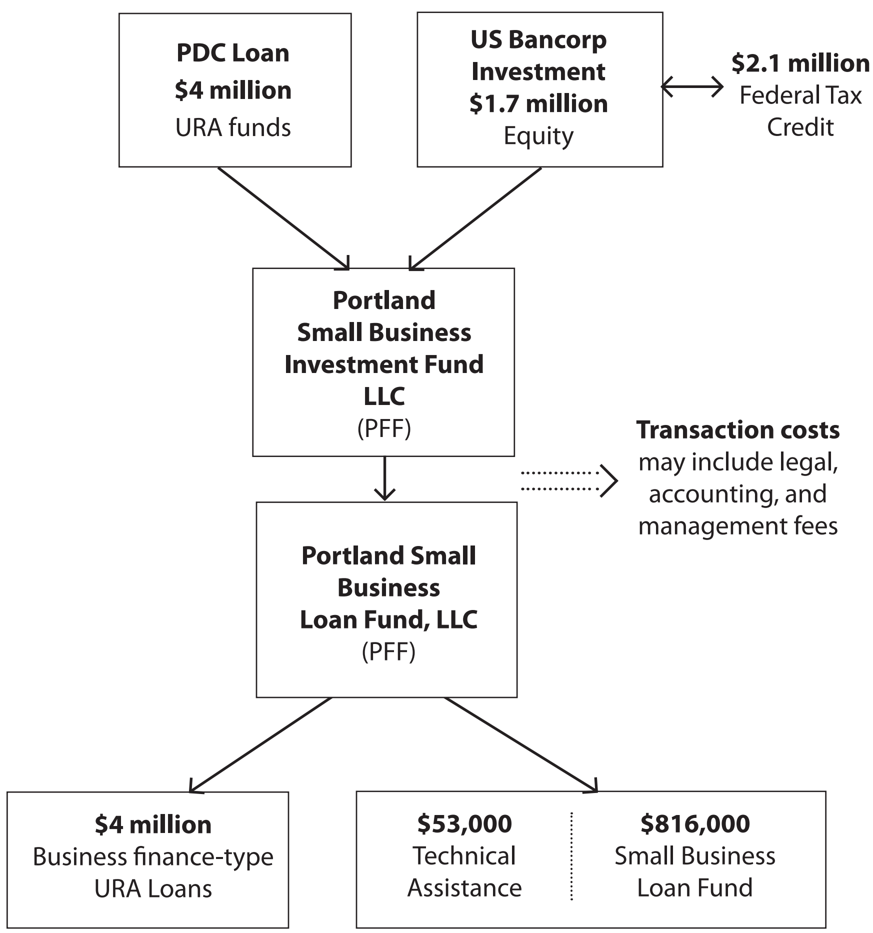
Once tax credits are allocated to a project, the private investor can claim 39 percent of the total investment as a credit against federal taxes over a period of seven years. The PDC loans increase the total investment, and therefore increase the base for calculating the tax credit for the private investor. Because of this, the PDC loan makes the tax credits much more attractive to a private investor and makes the project feasible.

One NMTC loan we reviewed was approved by the PDC Board to meet the needs of small businesses. The goal of the program was to create a continuum of services and funding for small businesses citywide, from technical assistance to small and micro-loans of $5,000 to $50,000, particularly for businesses not served by existing PDC loan programs.

PDC loaned $4 million in urban renewal area funds to a subsidiary of PFF, and those funds were used to make six loans to businesses that qualified under the existing Business Finance program. During the seven year NMTC period, these six loans are managed by PFF. At the end of seven years, the loans return to PDC for management.

The PDC loan was used to leverage a $1.7 million private equity investment, with those funds intended for a small business technical assistance and loan program. The private investor, in this case US Bancorp, then claims $2.1 million in credits against federal taxes over seven years, based on the combined PDC and private investment. The structure is shown below in Figure 3.

Figure 3 Portland Small Business Loan Fund structure



Source: Audit Services depiction based on PFF and PDC documents

No oversight or reporting of program outcomes

The small business loan program was defined in an agreement between PDC and PFF. Loans were to be approved by a loan committee consisting of a PDC manager, PFF legal counsel, and community members, and loans were to be serviced by PFF. PFF was charged with reporting quarterly to the PDC on the effectiveness of the small business loan fund and technical assistance activities for the seven-year tax credit compliance period.

However, no quarterly reports were provided by PFF, and PDC's involvement with the small business loan and technical assistance programs appears to have lapsed shortly after the PDC loan was made. We contacted PFF for a current list of loans and technical assistance activities. According to information PFF provided, as of June 30, 2011 PFF had issued 19 loans totaling $816,000 for the small business loan fund, ranging in size from $5,000 to $275,000. Four loans totaling $146,000 were subsequently written off. Technical assistance was originally provided by Portland State University, but is now contracted to Micro Enterprise Services of Oregon.

Based on the limited information provided, and without the required monitoring and quarterly reporting, it would be difficult for PDC to evaluate whether the program met the initial goals of benefiting small businesses. In developing new programs to benefit small businesses PDC could benefit from an understanding of the successes or challenges of the existing PFF small business loan and technical assistance program.

The small business loan program, and other loans associated with other NMTC transactions, may have provided public benefits. However, without a system for tracking project outcomes or performance, the public benefits are unclear.

Complexity increases transaction costs

Other PDC to PFF loans also created challenges for oversight. Estimates of loan balances for other NMTC loans vary slightly between PDC and PFF, based on differing dates of when loan funds were disbursed. Calculation of loan payments to PDC for another NMTC loan is based on the project's cash flow, which requires annual assessments of project financial information and extensive coordination between PDC and PFF.

The U.S. Government Accountability Office reviewed the national NMTC program in 2010, and found that while the NMTCs have increased investments in low-income communities, the complexity of the structure reduces the amount of the federal subsidy reaching low-income community businesses.* In PDC's case, the complexity of the structure may also create challenges in loan servicing and oversight of loan activities.

All of the Portland Family of Funds loans were issued prior to the recent changes in loan guidelines, but the loans will return to PDC management when the 7-year New Market Tax Credit compliance period ends. A complete review of these loans would help ensure that existing conditions of the loans are being met, and that PDC is prepared to assume responsibility for the loans. A review could also evaluate the benefits and costs of participating in a NMTC transaction as a public leverage lender, so the PDC Board will have the information necessary to evaluate future NMTC proposals.

* *New Markets Tax Credit: The Credit Helps Fund a Variety of Projects in Low-Income Communities, but Could Be Simplified*, January 2010

http://www.gao.gov/assets/310/300423.pdf

Chapter 4 Loan performance measurement improving

PDC tracks loan performance to ensure loans meet program goals and contribute to overall urban renewal area goals. Although not exclusive to loans and grants, the PDC Board established a clear policy on performance measurement for financial investments, including five performance measures, as shown in Figure 4.

Figure 4 PDC Board financial investment policy performance measures

Measure	PDC Methodology	Results
Jobs created and retained	Jobs tracked for Business Finance Loans using Oregon Employment Department data; not currently tracked for Property Redevelopment Loans	Demonstrated jobs created and retained for Business Finance loans
Dollars leveraged	Leverage calculated and reported at loan application and approval	Loans leverage private dollars at a rate consistently higher than 1:1
Customer satisfaction	Surveys provided to each Business Finance loan recipient; recent survey of all PDC customers	Borrowers report high level of satisfaction with PDC loan programs
Assessed value growth	Assessed value growth per acre calculated using Multnomah County Assessor data for each urban renewal area, in comparison to areas of the City outside of urban renewal areas	Mixed results – assessed value per acre of most urban renewal areas grew faster than other areas of the City from 2006-2010
Community and stakeholder satisfaction	No system for evaluating community and stakeholder satisfaction.	Unknown

Source: Audit Services Division

Three of the Board performance measures are direct measures for specific loans: jobs retained and created; dollars leveraged; and customer satisfaction. Two are indirect measures of performance: assessed value increases; and community and stakeholder satisfaction. We found systems in place to track four of the five measures, but performance was not tracked for all loans.

Demonstrated direct benefits from Business Finance loans

Business Finance loans accounted for 207 loans, totaling $21.7 million, in the last five fiscal years. PDC has defined methodologies for tracking direct benefits of these loans by jobs created and retained, dollars leveraged, and customer satisfaction.

PDC verifies projections of jobs created and jobs retained against actual data using Oregon Employment Department data. Beginning two years after the loan is granted, PDC checks reported job numbers against projections made when the loan originated. Total job numbers are included in the PDC annual report. Generally, PDC has found that projections of jobs retained are fairly accurate, while projections of jobs created have varied more significantly. PDC provided us with jobs information for $9.8 million in Business Finance loans for FY 2006-07 and FY 2007-08, documenting 1,667 jobs retained (105 percent of projected), and 328 jobs created (45 percent of projected). This data highlights both the success in job retention, and the challenge of making accurate projections of jobs created.

Business Finance loan guidelines require borrowers to submit information annually on jobs created and retained. This is not currently done, and does not appear needed if the more accurate Oregon Employment Department data is used.

The Business Finance program calculates and reports leverage for each loan, to quantify the private investment that may not have occurred without the PDC loan. The leverage is used to determine the interest rate for most loans, which provides an incentive to the borrower to invest more private funds. According to Financial Investment Committee reports, in FY 2010-11, Business Finance loans leveraged almost six private dollars for every one PDC dollar. When

PDC staff calculate and report leverage for the PDC annual report, they include both private and other investments leveraged by PDC funds.

The program also surveys all customers after a loan is granted. Borrowers consistently report a high level of satisfaction with the Business Finance loan program.

Limited measurement of performance for Property Redevelopment loans

Property Redevelopment or Board Special Authority loans accounted for 49 loans, totaling $52.7 million, for the last five fiscal years. Board Special Authority loans were approved independently of Property Redevelopment loans prior to 2011.

In prior years, PDC tracked only dollars leveraged as a direct measure of the effectiveness of Property Redevelopment loans. According to Financial Investment Committee reports, in FY 2010-11, Property Redevelopment loans leveraged almost four private dollars for every one PDC loan dollar. Customer satisfaction was measured for all PDC financial assistance customers in a one-time survey in 2009, but is not tracked annually for Property Redevelopment borrowers. PDC has not measured job growth for Property Redevelopment loans.

The result is that for the majority of loan dollars – 71 percent in the most recent five year period – PDC has little or no measure of direct project outcomes. Without a system of measuring and reporting project-level performance, PDC is not able to learn from these large loan projects to focus and improve future Property Redevelopment loans.

When the PDC Board revised the Property Redevelopment guidelines in 2011, it expanded program objectives to include job creation, green and sustainable practices, and providing contracting opportunities to diverse populations. Any of those goals provides for more measurable outcomes.

PDC staff noted that permanent jobs may not be a primary indicator of performance for Property Redevelopment loans, as many projects are developed for future, unknown tenants. Other indicators such as construction jobs, tenant occupancy, businesses in target industries that are benefited, or business income tax revenue may be more relevant to this type project, but these other measures are not tracked either. Also, performance measures may vary by project.

PDC began an effort to improve performance measures, methodologies, data collection and reporting for all loans in the fall of 2010, with an initial focus on jobs. However, this effort was shelved due to changes in staff and other workload. During the course of our audit work, PDC again began discussions of how to track jobs information for Property Redevelopment loans, but this work was not complete at the time of our audit.

Contribution of loans towards meeting urban renewal area or economic development goals difficult to verify

The PDC Financial Investment Policy includes two measures to evaluate how financial investments contribute to meeting broader City and urban renewal area goals: changes in urban renewal area assessed value, and community satisfaction. Both measures may be difficult to link directly to loan programs, but are important indicators of overall PDC performance.

Assessed value growth
PDC tracks changes in assessed value per acre in urban renewal areas, in comparison to areas of the City outside of urban renewal areas, based on data provided by the Multnomah County Assessment and Taxation. This information is included in the PDC Annual Report for each urban renewal area.

Figure 5 **Assessed value growth by Urban Renewal Area**

Urban Renewal Area	Assessed value growth per acre 2006-2010
North Macadam (South Waterfront)	219 %
River District (Pearl District)	47 %
Airport Way	38 %
South Park Blocks	37 %
Downtown Waterfront	26 %
Interstate	24 %
Gateway	22 %
Lents	20 %
Citywide, other than urban renewal areas	*18 %*
Central Eastside	15 %
Oregon Convention Center	9 %
Willamette Industrial	- 4 %

Source: Audit Services analysis of PDC data

Urban renewal area assessed value growth was mixed. Compared to areas outside of urban renewal areas, 8 of 11 urban renewal areas had a higher growth in assessed value per acre over a 5-year time period, as shown in Figure 5.

We compared assessed value growth per urban renewal area with loan dollars provided in the last five fiscal years and did not find a consistent link between higher amounts of loans and higher growth. The district with the highest assessed value growth in the last five years (North Macadam) had the lowest dollar value of loans. One district with high dollar value of loans (Oregon Convention Center) underperformed other areas in the City for assessed value growth in the same time frame.

Linking assessed value growth to specific urban renewal area programs such as PDC loans may not be possible. The assessed value growth is a reflection of all activities in an urban renewal area, both those that PDC contributes to and other activities outside of PDC control. PDC loan dollars do not appear to be an independent driver of urban renewal area growth, but may trigger reinvestment in an urban renewal area in combination with other PDC programs, or other economic trends independent of PDC actions.

Assessed value changes are an important indirect indicator of overall urban renewal area success. PDC has developed a reliable methodology for determining assessed value growth per acre, and reports this information to the PDC Board annually.

Community satisfaction

PDC does not currently track community satisfaction with PDC financial investments. In prior years, PDC used neighborhood level questions related to development in the Auditor's Office Community Survey as a proxy for community satisfaction with PDC, and also commissioned periodic phone surveys of general community satisfaction with PDC.

Since community satisfaction is one of the performance measures identified by the PDC Board, PDC will need to develop a mechanism for measuring it. Options may include focus groups; surveys of urban renewal area advisory committees, neighborhood associations, business associations; or more general surveys.

Chapter 5 **Recommendations**

PDC recently made numerous improvements to its economic development loan programs. Loans are more clearly linked to the City's Economic Development Strategy and to the PDC Strategic Plan, and loan terms have been strengthened to improve the return on public investment. PDC also improved the loan information systems and loan servicing, and continues to work on developing and reporting performance information for all loans.

To further strengthen the loan programs, we recommend that the City's Commissioner-in-Charge and the PDC Board of Commissioners to direct PDC to:

1. **Review the existing administrative policies and procedures related to the loan programs to ensure current improvements continue.**

   In particular, review and update as needed the policies, and establish procedures related to Financial Investment Committee and the loan write-off and recovery process.

2. **Review and update the policy regarding allocation of the total loan portfolio to determine whether loan portfolio composition is consistent with the original intent, and to provide the PDC Board with the necessary information to guide future loan decisions.**

   Routine reporting to the Board will help ensure the intent of the policy – to diversify the loan portfolio and ensure a fair allocation of resources – is met. To ensure reporting of all major borrowers, PDC should define how affiliated or related borrowers are determined.

3. **Review all loans to Portland Family of Funds and affiliates that were used to leverage NMTC tax credits, to ensure compliance with loan agreements. Prepare a report to PDC Board on status of NMTC programs including total program costs and benefits.**

   This will bring current loans into compliance, prepare PDC to assume responsibility for loans at end of the seven-year NMTC period, and provide the Board with necessary information to evaluate future NMTC proposals.

4. **Continue current work to refine performance measures for all loans, and document the methodology and responsibility for reporting performance measures identified in the PDC Board Financial Investment Policy.**

   For Business Finance loans, PDC should clarify and document the responsibility for jobs tracking and reporting, and eliminate the reporting requirement in loan guidelines if it is no longer needed.

   For Property Redevelopment loans, PDC should consider defining project-specific performance measures and the PDC program responsible for tracking performance in the Board resolution or loan agreement. This will help ensure PDC is able to evaluate whether individual projects contribute to meeting urban renewal area and economic development goals.

   For all loan programs, PDC needs to develop a methodology for tracking and reporting community satisfaction consistent with Board policy.

Chapter 6 Objective, scope, and methodology

The objective of this audit was to determine whether PDC is following sound financial policies in approving and servicing loans, whether PDC has systems in place to measure and report performance, and whether loans are meeting performance goals.

To accomplish this objective, we interviewed various staff at the Portland Development Commission. We interviewed staff in PDC's Urban Development Department for background on loan origination and underwriting, and information on how PDC loans implement urban renewal area programs. We also interviewed staff in the Finance and Business Operations Department regarding loan servicing and asset management, and PDC's Performance Measurement Program Manager to gain an understanding of the methodologies for collecting, analyzing, and reporting loan performance information.

We also reviewed research on best practices for measuring performance of economic development programs, and audits of other economic development programs.

To characterize the loan portfolio, we reviewed loans granted or written off from FY 2006-07 through FY 2010-11. We then reviewed a sample of project files for new loans to determine whether the loan review, approval, and loan servicing were consistent with PDC policy. We reviewed a sample of loans written off to evaluate methods used to determine settlement and loan forgiveness. Because the loan policies had changed in 2010 and 2011, we focused our review on projects from the most recent fiscal year.

Based on a list of all outstanding loans we completed an analysis of borrowers and related affiliates, to identify concentration in the loan portfolio. We matched loans with related tax identification numbers, addresses, or names based on publicly available corporations records.

We relied on PDC for loan program data. We did not perform specific tests of data reliability as part of our review, but we did review the data for reasonableness and validate data against source documents during our file review. We requested and received additional information from PDC as needed.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESPONSES TO THE AUDIT

OFFICE OF MAYOR SAM ADAMS
CITY OF PORTLAND

March 9, 2012

Ms. LaVonne Griffin-Valade
Office of City Auditor
Audit Services Division
1221 S.W. 4th Avenue, Room 310
Portland, OR 97204

Dear Ms. Griffin-Valade,

My office thanks you and your staff for the time and energy put forth in preparing the recent audit of the Portland Development Commission (PDC). The report, *PDC Economic Development Loans: Loan programs improved, but tracking major borrowers limited*, provides insight regarding PDC's improved loan tracking and servicing activity, and makes valuable recommendations for continued loan servicing and performance reporting success.

I have reviewed PDC's letter of March 8, 2012, detailing their management's response to the above-referenced audit. I find their response to be sufficient, and I concur with the steps they have outlined to implement corrective actions. Thank you again for all your efforts.

Sincerely,

Sam Adams
Mayor, City of Portland

SA:cam

Cc: Patrick Quinton
Executive Director, PDC

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March 8, 2012

Ms. LaVonne Griffin-Valade
Office of City Auditor
Audit Services Division
1221 SW 4th Avenue, Room 310
Portland, OR 97204

Dear Ms. Griffin-Valade:

We thank you for the opportunity to respond to your recent audit, *PDC Economic Development Loans: Loan programs improved, but tracking major borrowers limited*, and for the work put into this audit by your staff. It was a pleasure working with them and we appreciate their patience and dedication as they learned how the Portland Development Commission (PDC) does business.

Over the past three years, PDC has substantially updated its policies for approving and servicing loans. Specifically, PDC undertook a comprehensive review of loan programs, tightened loan standards, linked loan programs to the city's Economic Development Strategy, and improved loan tracking and servicing. PDC management is pleased to know that these changes, as well as the improved performance measures implemented over the past few years, are viewed as effective in the audit and that the audit has identified only a few items requiring some additional corrective action.

As noted in the audit report, PDC follows sound and consistent underwriting and loan servicing practices. The Business Finance and Property Redevelopment loan origination and underwriting processes are thorough and well documented. The Financial Investment Committee (FIC) reviews loan approvals, modifications, and write-offs. Actions of the FIC are reported to the PDC Board in monthly and quarterly summaries. Additionally, as part of PDC's new loan management system implementation, PDC conducted a full review of loan data and linked client data resulting in improved data reliability for both loan servicing and performance reporting.

This letter details management's response to the recommendations resulting from your recent audit and the steps we will be taking to implement corrective actions.

1. ***Review the existing administrative policies and procedures related to the loan programs to ensure current improvements continue.***

   In particular, review and update as needed the policies and established procedures related to Financial Investment Committee and the loan write-off and recovery process.

In December 2010, the PDC Board approved Resolution 6832, adopting a Financial Investment Policy and establishing a process for internal review and approval of financial investments. Resolution 6832 states:

> *"When investing public resources to achieve its strategic plan, PDC will apply sound financial guidelines, and accountable and transparent processes. PDC will measure its performance by jobs retained and created, community and stakeholder satisfaction, dollars leveraged, assessed value increases, and customer satisfaction."*

The Resolution delegated authority to the Executive Director to establish an internal Financial Investment Committee (FIC) and delegated certain responsibilities to the FIC regarding the review of requests for financial assistance; review of new or revised financial assistance guidelines and review of acquisitions and disposition of real property prior to providing recommendations to the Board or Executive Director as appropriate. The Executive Director has established an FIC, which has been operating in accordance with the guidelines provided in Resolution 6832. Additionally, PDC Board and Management adhere to and support the guidance provided in the board policy direction.

PDC agrees with the audit recommendation to review and update as needed the policies, and administrative procedures related to the FIC and loan programs to ensure current improvements continue. Additionally, PDC is nearing completion of an update to its Loan Servicing Operating procedures to document its current practices related to loan write-off and recovery processes.

2. ***Review and update the policy regarding allocation of the total loan portfolio to determine whether loan portfolio composition is consistent with the original intent, and to provide the PDC Board with the necessary information to guide future loan decisions.***

   Routine reporting to the Board will help ensure the intent of the policy – to diversify the loan portfolio and ensure a fair allocation of resources – is met. To ensure reporting of all major borrowers, PDC should define how affiliated or related borrowers are determined.

In October 2006, the PDC board adopted Resolution No. 6396, which stated that at least quarterly, the Executive Director shall provide the Board with a report on any financial assistance to an entity (or its related affiliates) whose consolidated outstanding debt to PDC exceeds five percent of PDC's total loan portfolio (including federal and tax increment funds). Resolution 6396 states that the five percent threshold was not a legal lending limit but instead was established monitor the fair allocation of resources.

PDC agrees with the audit recommendation to review this policy regarding allocation of the total loan portfolio and will do so prior to calendar year-end. Additionally, any new guidelines will be incorporated into the existing loan program procedures, and include review, approval, and reporting requirements.

3. ***Review all loans to Portland Family of Funds and affiliates that were used to leverage NMTC tax credits, to ensure compliance with loan agreements. Prepare a report to PDC Board on status of NMTC programs including total program cost and benefits.***

   This will bring current loans into compliance, prepare PDC to assume responsibility for loans at end of seven-year NMTC period, and provide the Board with necessary information to evaluate future NMTC proposals.

PDC's formal relationship with the Portland Family of Funds (PFF) revolved around the successful applicant, Portland New Markets Fund I, LLC, of a $100 million New Market Tax Credit (NMTC) allocation in 2003, where PDC was the Controlling Entity and PFF was the Managing Member of the LLC. The entire NMTC allocation has been allocated to projects, including the loan fund referenced in the audit.

Subsequent to the audit fieldwork, PDC has reviewed all loans to PFF and affiliates that were used to leverage NMTC tax credits to ensure compliance with loan agreements. PDC's Loan Servicing Department remains in frequent contact with PFF. In addition to reviewing yearly financial statements from the various NMTC Funds, PDC began meeting internally to review the assumption of these loans which begins in the summer of 2013 and continues through 2016. PDC, its legal team, and PFF will work in conjunction to facilitate the assumption of these loans by PDC.

Additionally, PDC will review reports requested of PFF to determine the outcomes and benefits of the NMTC partnership. The PDC Board will be presented these findings upon completion. Since the joint PDC/PFF NMTC allocation in 2003, the NMTC regulations have changed to require that the Controlling Entity and the Managing Member be one in the same. PDC is no longer able to participate directly in the NMTC program given the need for the Managing Member to hold equity and the State prohibition of governmental entities holding equity. In the case where an unrelated party is providing a NMTC allocation to the developer as part of a project that is receiving PDC funding, this information is covered in the documentation provided to FIC and the subsequent Board documents if Board approval is required.

4. ***Continue current work to refine performance measures for all loans, and document the methodology and responsibility for reporting performance measures identified in the PDC Board Financial Investment Policy.***

   For Business Finance loans, PDC should clarify and document the responsibility for jobs tracking and reporting, and eliminate the reporting requirement in loan guidelines if it is no longer needed.

   For Property Redevelopment loans, PDC should consider defining project-specific performance measures and the PDC program responsible for tracking performance in the Board resolution or loan agreement. This will help ensure PDC is able to evaluate whether *individual projects contribute to meeting urban renewal area and economic development goals.*

For all loan programs, PDC needs to develop a methodology for tracking and reporting community satisfaction consistent with Board policy.

As the Auditor describes in this audit, PDC has developed repeatable and sound methods to evaluate leverage, customer satisfaction, job growth and assessed value.

PDC verifies job growth for businesses receiving business finance loans using Oregon Employment Department (OED) data. As the Auditor points out, with the exception of PDC's Quality Jobs Program, PDC has not consistently collected information about job growth *directly* from the business after a loan has closed because the OED method provides readily available and reliable data. PDC will review the job reporting language in it loan guidelines and update if appropriate, however, for some very small businesses whose employment cannot be tracked through the OED data, PDC needs to retain a policy of obtaining job reports directly from the business.

While PDC verifies job growth for business directly receiving funding from business finance loans, obtaining job information from tenants residing in its funded projects is much more difficult. In the past, PDC's efforts were largely aimed towards redevelopment and not necessarily towards the employment of the tenants who occupied the buildings. Therefore, job information for the businesses in these projects was not collected. With the adoption of the Economic Development Strategy, PDC began to strategically match redevelopment sites with specific industries. As part of its current effort to assess all the measures used to report on its Strategy Plan and other guiding strategies, PDC will discuss the practicality of methods to track tenants in strategic redevelopment projects. Additionally, PDC will begin to consistently track assessed value of properties assisted through property redevelopment loans to demonstrate the substantial increased property values these projects often drive. Finally, PDC will continue to track other public and private dollars (what PDC calls "leverage") in the development projects supported by PDC redevelopment loans.

At the time PDC drafted its Financial Investment Policy, PDC used the Auditor's neighborhood-level resident and business surveys to gauge community and general business satisfaction. Subsequently the Auditor discontinued these surveys. As part of its effort to assess all measures used to report on its Strategic Plan and other guiding strategies, PDC will evaluate possible methods and related expenses to gauge community satisfaction within the specific geographies and among the business communities PDC serves. This evaluation will help PDC determine whether-or-not the measurement of community satisfaction should remain in the policy.

On behalf of the PDC Audit Committee, please extend our appreciation to the Audit Services staff for their effort on this audit and for considering our feedback during the process.

Sincerely,

Patrick Quinton
Executive Director

PQ:crk

c: Mayor Sam Adams
PDC Audit Committee

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PDC Economic Development Loans: Loan programs improved, but tracking major borrowers limited

Report #419, March 2012

Audit Team: Kari Guy

LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

Portland Development Commission: Financial transaction review reveals areas warranting management attention (#406B, February 2012)

DNA Testing: Turnaround time must improve to meet national guidelines (#427, January 2012)

City of Portland 21st Annual Community Survey Results (#409, December 2011)