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February 3, 2009

The Hon. Arnold Fielkow
Chairman
Special Projects and Economic Development Committee
New Orleans City Council
1300 Perdido St., Room 2W40
New Orleans, LA 70112

Re: Economic Development Fund

Dear Councilmember Fielkow:

In response to your request, the Bureau of Governmental Research has reviewed the city's Economic Development Fund (EDF) grant program. We are writing now to suggest reforms.

BGR previously analyzed the EDF in a 2004 report entitled *On the Right Track? New Orleans Economic Development in Perspective*, which is available on our web site, www.bgr.org. In preparing this letter, we built on the research for that report and other research we have conducted on economic development policies and procedures. We reviewed current city laws and program materials for EDF grants. We also attended recent public meetings and reviewed Jefferson Parish's incentive fund policy. We did not examine, and we make no comment on, the individual grant applications in the 2007 or 2008 EDF funding rounds.

EDF Background

In 1991, Orleans Parish voters approved a 2.5-mill ad valorem property tax for economic development purposes and a 2.5-mill tax for a neighborhood housing improvement program. In 1995, voters rededicated half of each tax to a fund for capital improvements. The remaining 2.5 mills were rededicated to the Housing and Economic Development Trust Fund (Trust Fund). That trust fund is available for both economic development projects and neighborhood housing improvement and blight alleviation. In 2008, the total Trust Fund millage of 1.82 mills generated approximately $4.2 million. (In 2008, the millage was rolled back from 2.5 mills.)

The City's 2009 budget has $9.9 million for the EDF program. The budgeted revenue includes unspent revenues from prior years, approximately $2.3 million to fund EDF grants approved in December

2008, and $2 million to establish a new public-private partnership to handle certain economic development functions for the city.

Lack of Strategic Focus

Current grant-making suffers from several problems. First and foremost, the city administration and City Council have not established a clear strategy for the use of the EDF.

In 1991, voters dedicated EDF revenues to funding economic development purposes in accordance with a specific city ordinance. The City Council has amended this ordinance several times. The current version allows funding for projects and activities that serve a broad range of purposes, including business attraction and retention, workforce development, the creation of new jobs and wealth, and improvement to the city's entrepreneurial climate. The ordinance does not prioritize any particular purpose, and the program has for the most part operated without a discernible focus.

In BGR's 2004 report, we found that the grants awarded from 1998 to 2002 went to a wide range of purposes. They included funding for the Super Bowl, festivals and private, nonprofit organizations seeking to assist small businesses. The city also tapped the EDF to fund certain city economic development programs, the master planning effort under way at that time, and city obligations to the New Orleans Tourism Marketing Corporation, the New Orleans Museum of Art and other organizations. Between 2002 and Hurricane Katrina, the city directed the bulk of the grants to private, nonprofit organizations seeking to assist small businesses and technology-related start-up companies. For a list of the grants approved by City Council in December 2008, see Appendix A.

In the current context, the absence of clear strategic focus has led to vague, conflicting views among City Council members, interested applicants and members of the public of how the money should be spent. At public meetings, BGR has observed some parties calling for the grants to assist businesses, particularly small businesses, and others urging a mix of business and nonprofit organizations focused on economic development. In addition to these demands, the city administration is seeking EDF revenue for the new public-private partnership for economic development. Other economic development entities are also seeking funds. Defining the strategic focus for EDF revenue is a critical first step to an effective program.

An Alternative Strategy

The current approach to the EDF program – bestowing grants to a handful of chosen entities – is badly flawed. It creates unnecessary risks of waste, political favoritism and giving chosen businesses unfair competitive advantages. We believe that the approach should be abandoned and replaced with a program that will serve a broader base of businesses. Instead of directing EDF funds to individual business ventures or nonprofit activities, the City Council should use them to fund economic development functions and initiatives that benefit multiple businesses. By way of illustration only, such functions and initiatives could include the proposed public-private economic development partnership; entities that provide support services to small or disadvantaged businesses; and economic development entities that currently receive no city funding but provide broad-based services. The EDF fund could also pay for city economic development operations that are currently supported by the General Fund.

Supporting broad-based economic development functions and initiatives offers several advantages over individual grants. First, the City Council avoids having to pick winners from among dozens of EDF grant applicants. Even with cost-benefit analyses, this is a difficult task that risks wasting money. Second, the program would benefit a larger number of businesses. Third, using the funds to pay for existing city economic development functions would free up General Fund money for other purposes.

We note that the ordinance you recently introduced takes a step in the direction we are proposing by requiring the Economic Development Advisory Committee to include in its initial five-year plan a recommendation for appropriations to a Public/Private Partnership (presumably the one that's been under discussion as a result of the Horizon Initiative) and to Community Development Financial Institutions. (Both Public/Private Partnership and Community Development Financial Institutions are undefined terms in the ordinance.)

In pursuing a strategy that focuses on broad-based economic development functions and initiatives, the city should act with transparency and accountability. It should carefully evaluate proposals from eligible participants, using an objective and transparent scoring and ranking system. It should provide the funds through cooperative endeavor agreements that clearly spell out the goals and objectives of the initiative and the responsibilities of the recipient. Each agreement should include performance measures with appropriate penalties for nonperformance.

Reforming the Current EDF Grant Program

As discussed above, we believe that the current approach to the EDF program should be abandoned. Instead of directing EDF tax dollars to individual business ventures and nonprofit activities, the city should use them to support economic development functions and initiatives that benefit multiple businesses. If the city nonetheless persists in providing funds to individual businesses and nonprofit initiatives, it should first address the numerous weaknesses that plague the program. Among other problems, the EDF program lacks a strategic focus. It is short on eligibility criteria and has no established scoring or ranking system for evaluating grant requests. The current requirement for cost-benefit analyses is proving costly and expected to consume almost $500,000 in the 2008 funding round. Moreover, the City Council has full discretion in selecting grant recipients.

Mitigating the EDF program's multiple weaknesses will require an overhaul of the way in which it is conducted. We have set forth in Appendix B a set of reforms that would help to improve the troubled program.

Reinstating the Five-Year Plan

The ballot propositions that voters approved in 1991 and 1995 to authorize the EDF tax incorporated into their terms Ordinance Cal. No. 17,219. Among other things, that ordinance established the Economic Development Advisory Committee and required a five-year “master plan” for EDF expenditures. The City Council eliminated the latter requirement in 1994. Such a plan is essential for the effective use of EDF dollars, regardless of the chosen strategy. It would provide a vehicle for setting priorities, planning future expenditures and establishing benchmarks for performance.

Not only is this appropriate: it was required by voters in the ballot propositions approving the program. Those propositions required that the tax revenues to be spent in accordance with Ordinance Cal. No. 17,219, which was adopted on June 20, 1991. The terms of that ordinance were amended. We question the authority of the city to conduct the program in a manner that varies significantly from the terms of the 1991 ordinance.

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In conclusion, we have serious misgivings about the city’s current program for awarding EDF grants. We believe that the EDF grant program, which provides grants to individual businesses and nonprofit activities, should be eliminated and the tax dollars redirected to economic development functions and initiatives that benefit multiple businesses. However, if the city insists on continuing the grant program, the City Council should implement reforms to define strategic focus, more fairly and objectively evaluate grant requests, and minimize the chances of waste, political favoritism and creating unfair competitive advantages. Whatever the strategic focus, the City Council should reinstate the five-year master plan requirement and develop a system for evaluating, scoring and ranking proposals.

We appreciate the opportunity to comment on the EDF grant program. If you have any questions about our recommendations, please feel free to contact me. Thank you for your attention to this important matter.

Sincerely yours,

Janet R. Howard
President & CEO

Attachments: Appendices A and B

APPENDIX A: EDF Grants Awarded in 2007 Round

In December 2008, the City Council approved 19 EDF grants totaling approximately $2.3 million to projects that applied in the 2007 funding round. The following table summarizes the grant awards as stated in the Council's ordinance:

Recipient	Project Title	Grant Amount
Crescent City BIDCO	Bonding Assistance	$250,000
DMK Acquisitions, Inc.	Lake Terrace Shopping Center Rehab	250,000
Duplain W. Rhodes Funeral Home, Inc.	Rhodes Funeral Home	250,000
Rhodes Commercial Development, LLC	Broadmoor Business Center	250,000
Dorsey Development Companies, LLC	University Retail Center	200,000
Lakeview Fine Foods	Lakeview Fine Foods	200,000
Lower 9th Ward Neighborhood Empowerment Network	Business Incubation and Workforce Development	150,000
3923 MLK, LLC	Crescent Palms Hotel	100,000
Circle Food Store, Inc.	Circle Food Store	100,000
Mid-City Neighborhood Organization	Old City Building Center	100,000
Vinson Dental Office	Vinson Dental Office Reconstruction	90,000
Zulu Social Aid and Pleasure Club, Inc.	Lundi Gras Festival	90,000
Equipco, LLC	Equipco	75,000
Perrault Kiddy Kollege, Inc.	Perrault Kiddy Kollege	60,000
Beacon of Hope Resource Center	Harrison Avenue Marketplace	45,000
C&A Real Estate Investments, LLC	Read Lane Strip Mall Rehab	44,000
Great Ideas Unlimited	Big Shirley's	40,000
New Orleans Regional Business Park	Educational Seminar and Networking Session	25,000
Preservation Resource Center of N.O.	Marketing Campaign	20,000
TOTAL		**$2,339,000**

Source: New Orleans City Council, Ord. Cal. No. 27,150, adopted December 18, 2008.

APPENDIX B: Reforming the EDF Grant Program

As discussed above, BGR believes that the EDF program should be reoriented to support broader-based initiatives. If the city persists in providing grants to individual businesses and nonprofit initiatives, we recommend that it institute the following reforms:

- *Determine a clear strategic focus.* The City Council should clearly define the objectives of the grants program and develop a specific strategy. It should also reinstate the five-year master plan discussed in this letter. The objectives, strategies and master plan should advance the economic development goals of the city's master plan.

- *Focus on business development.* The program should focus on business development and job creation, rather than community development.

- *Avoid excessively risky investments*. Assistance to start-up businesses should be provided through intermediaries with the necessary expertise to provide financing or technical support, rather than directly. Businesses receiving direct grants should have an established track record and a clear business plan for expansion.

- *Avoid grants that confer an unfair competitive advantage.* Certain types of businesses operate within highly competitive local markets. Examples include hotels, motels, retail stores, shopping centers and restaurants. To avoid creating unfair competitive advantages, grants to these types of businesses should be limited to funding for public infrastructure, public amenities or environmental clean-up that cannot be financed through other means. Such improvements would provide the city with an inherent return on its investment by enhancing its land resources.

- *Give preference to businesses that invest the grant funds in public infrastructure.* The program should give preference to proposed uses of grant funds related to public infrastructure. As noted above, such investments enhance the city's land resources and create a long-term community asset, regardless of what happens to the business.

- *Give preference to businesses that expand the city's economic base.* The program should favor businesses that export their goods and services to customers outside Orleans Parish, or provide a new, local source for goods and services that city residents and businesses currently purchase from out-of-town suppliers. This would leverage EDF tax dollars by attracting new dollars to the parish economy and retaining local spending.

- *Require applicants to create a minimum number of new jobs.* The applicant should create and maintain a minimum number of new, full-time jobs, in addition to the existing jobs it retains. The applicant's business plan should describe the full-time job creation associated with the project. While some programs require major job creation – Jefferson Parish's incentive fund, for example, requires new projects to create at least 50 jobs within two years – this may be out of scale with the EDF program. A lower minimum may be appropriate. Similar to current EDF practice, 10% of the grant award could be withheld until job creation is verified.

- *Set caps on individual awards*. Grant requests should be subject to basic funding caps to encourage efficient use of the limited funds. There should be a maximum award per project and per job. Jefferson Parish has set caps of $500,000 per year and $3 million total per project, and $5,000 per job created or retained. Given the limited EDF revenue, it may be appropriate to set smaller caps.

- *Encourage all applicants to maximize private investment.* At present, an applicant cannot use an EDF grant as its sole source of funding for the project. However, the city may fund up to 60% of the project cost. The city could make more efficient use of EDF grant funds by setting a lower cap and encouraging applicants to make requests well below the cap.

- *Link awards to strategy*. Each funded project should advance the objectives and goals of the five-year master plan for EDF expenditures.

- *Create a binding system for scoring and ranking applicants.* A more comprehensive, less costly evaluation method than the cost-benefit analysis is needed. BGR recommends that the City Council replace the cost-benefit analysis with a scoring system. Each applicant would be scored by administrators of the EDF grant program. Each applicant would have to meet or exceed minimum program requirements and a minimum score. The applicants' scores would then be ranked against each other. The ranking would be publicly released, and applicants would have time to contest their scores. Final scores and rankings would then be submitted to the City Council, which would fund the grants starting with the highest-ranked project.

  The goal of this approach would be to evaluate and select projects in a fair, consistent and objective manner. Scoring criteria should be clear-cut, objective, transparent and consistent with the program's strategic focus and eligibility requirements. For example, if the program aims to create high-paying jobs, then the criteria could emphasize wages, salaries and earnings impacts. If the program targets geographic areas, then applicants could earn points for location. Scoring criteria should avoid subjective measures, such as the "public good." The choice of criteria should ensure a sufficient degree of distinction between scored projects in order to facilitate decision making.

  Other criteria worth considering include number of jobs created, grant efficiency (i.e., grant amount per job), and grant leverage (i.e., grant amount as percentage of total project budget). Points should be awarded on a linear scale, such as 1 point per X number of jobs created. This ensures fair treatment and discourages applicants from inflating numbers to reach a more valuable point range. Caps could be imposed on certain criteria, such as number of jobs created, if the strategic focus is on small business.

  The purpose of the minimum requirements and scoring is to emphasize that the EDF money should be awarded judiciously. If there are not enough eligible applicants, then the remaining funds should be reserved for future rounds.

- *Strengthen accountability for grant recipients.* The city and grantee set performance goals in the EDF grant contract. Once the contract is executed, the city pays out the grant on a quarterly basis. Most grants are paid out in 12 months. Each quarter, the grantee must submit an invoice for payment to the city, and include data on its progress in meeting its goals. The city withholds 10% of each quarterly payment for disbursement to the grantee at the end of the contract period. However, the penalties for the grantee's failure to meet performance goals are unclear. The city should impose appropriate penalties, such as reducing the grant in proportion to the shortfall in performance goals.