OLA
OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Iron Range Resources and Rehabilitation Board (IRRRB)

MARCH 2016

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STATE OF MINNESOTA • James Nobles, Legislative Auditor

March 2016

Members of the Legislative Audit Commission:

At your request, the Office of the Legislative Auditor evaluated the Iron Range Resources and Rehabilitation Board (IRRRB), a state economic-development agency in northeast Minnesota. This report presents the results of our evaluation.

We found that the IRRRB has not adequately overseen the use and impact of loans and grants it awards. We also found that Giants Ridge, a resort owned by the IRRRB, has had a large and growing operating loss for many years. In addition, we concluded that the law that establishes the membership and powers of the IRRRB Board is vulnerable to a constitutional challenge.

We make several recommendations to improve oversight, measure the agency's impact on northeast Minnesota, and evaluate the future of Giants Ridge. We also offer options that would eliminate a possible constitutional challenge to the IRRRB's governance structure.

Our evaluation was conducted by Jody Hauer (evaluation manager), Laura Logsdon, and Laura Schwartz. Elizabeth Stawicki, JD, conducted the legal analysis of the IRRRB's governance structure.

The IRRRB cooperated fully with our evaluation.

Sincerely,

Jim Nobles

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Report Summary

The Iron Range Resources and Rehabilitation Board (IRRRB) is a state agency that has focused on economic development of the Iron Range in northeast Minnesota since 1941. The iron ore industry employed more people on the Iron Range in 2014 than any other single industry. The region has a shrinking labor force and has habitually had higher unemployment rates than elsewhere in the state.

A large part of IRRRB's economic development work is awarding loans and grants. Businesses are the primary recipients of loans; municipalities and nonprofit organizations primarily receive the grants. IRRRB owns the Giants Ridge Recreation Area in Biwabik, which is a public resort that offers golf and skiing, among other activities. In addition, it owns the Minnesota Discovery Center in Chisholm, a museum highlighting the region's history.

IRRRB receives most of its funding from taxes on taconite mining in its service area. Its budget in fiscal year 2015 was $41 million. Beyond its annual budget, IRRRB also had access at the end of that fiscal year to $90.6 million in statutorily defined funds for grants and loans.

A governor-appointed commissioner heads the agency. A board of nine legislators approves agency spending and, by law, the governor also reviews and approves certain expenditures. The term "IRRRB" refers to both the agency and the board overseeing it.

Whether IRRRB provided loans to certain applicants that did not expressly need funding was unclear.

Academic literature suggests the public sector should finance economic development projects only when the development would not have occurred otherwise. This is important for certain IRRRB loans but impractical for loans to companies that can choose to locate outside the region. IRRRB has criteria for reviewing loan applications, but none determines whether a project could proceed without agency funding. IRRRB should make this determination when evaluating loan applications. In cases when the determination does not apply, the agency should document its rationale for giving financial incentives.

Many IRRRB loan contracts we reviewed did not adequately specify objectives for job growth. For many of these loan projects, businesses did not meet job-growth objectives specified in their applications.

State law requires loan and grant agreements over $150,000 to contain measureable and specific objectives, including numbers of jobs to be created. In addition, economic development literature establishes the importance of specifying detailed objectives in loan contracts. Companies for 10 of 16 loans we reviewed forecast job growth in their loan *applications*, but their loan *contracts* did not require job creation.

We reviewed 15 loans with contracts or applications containing job-creation objectives. Only 2 of the 15 showed job growth aligned with objectives. Seven loan recipients had not met their objectives. For six loans, it is still too early to tell whether they will meet their job-creation objectives.

IRRRB should redesign its loan program by adding incentives for companies to meet their job-creation objectives. In contracts for direct loans, IRRRB should specify thresholds for the number of jobs that companies are to create. IRRRB could also provide loans only after companies meet their targets for job creation.

IRRRB's practices for measuring job creation are inadequate.

For many loan projects, IRRRB does not have reliable records of the number of jobs created or retained. Staff do not regularly require companies to submit interim or final reports with job information. By contrast, for "forgivable" loans, in which IRRRB reduces or eliminates a company's debt in return for creating jobs, agency staff require companies to submit evidence of job creation.

To collect information on most loan recipients' employment levels, IRRRB e-mails a questionnaire to companies annually and asks them to report numbers of total full-time-equivalent employees and average hourly wages. The process is inadequate because IRRRB does not require companies to respond. For fiscal year 2014, nearly one in five of the companies queried failed to respond. Staff do not independently verify the job numbers self-reported by companies. In addition, wage information is not sufficiently specific to connect it to jobs created.

IRRRB should improve how it measures loan recipients' job creation. It could expand some of the techniques staff now use to verify job creation for forgivable loans. It should avoid relying solely on self-reported jobs and could use Unemployment Insurance program data in some cases to review numbers of employees before and after loans.

IRRRB cannot evaluate its loan program because it does not maintain an accurate database of loans.

Developed in 1987, IRRRB's existing loan database does not contain reliable data. Sometimes a single loan has been assigned multiple loan numbers, making it appear in the database as multiple loans. The database does not include fields for important data, such as number of jobs created. It contains codes that current staff neither use nor understand, and it does not reflect changes that should occur following certain events, such as a default.

IRRRB should either update or replace its loan database. IRRRB should maintain a database that the agency can use to evaluate loans' impacts on the regional economy.

In IRRRB grant files we reviewed, many contracts did not adequately specify project objectives, such as job creation. Many files contained limited evidence that grant projects actually achieved their objectives.

Not all IRRRB grants are intended to create jobs, but we reviewed grant files that referred to job growth in their applications. For grants, IRRRB typically incorporates the application and its contents into the contract. Many of the grant contracts we reviewed did not adequately specify project objectives. Of 17 grant applications with references to job creation, 7 contained vague or imprecise references to jobs or did not differentiate between job creation directly related to the project and other indirect job creation.

Moreover, many grants we reviewed had no clear evidence on whether they met objectives. As an example, one city applied for a highway construction grant that was to create 10 to 15 construction jobs and add new development in the city. However, the project file had no evidence of completed construction, job creation, or new development. IRRRB should more consistently determine how well its grants meet their objectives. It should require grant recipients to submit final reports specific enough to allow comparing objectives in the application with actual results.

Certain IRRRB grant programs did not consistently follow agency policies.

In fiscal year 2016, IRRRB had 13 grant programs, including one for Public Works grants and another for Culture and Tourism grants. Based on recommendations of Minnesota's Office of Grant Management, IRRRB policy requires staff to evaluate grant applications by rating them on how well they meet program criteria and then ranking them. Through fiscal year 2015, IRRRB had no system to do this. In mid-2015, IRRRB began a new system for evaluating grant applications. However, at the end of 2015, the agency submitted eight grants to the board for approval even though staff had not yet evaluated the applications.

A second IRRRB grant policy requires staff to monitor grant projects until they are complete. This includes filing annual progress reports and a final report at the project's conclusion. Only 3 of 20 grants we reviewed that were required to have progress reports actually had them. In addition, 5 of 19 grants required to have final reports did not.

A third IRRRB grant policy requires the agency to issue grant payments on a reimbursement basis instead of up front. Two IRRRB grant programs have not complied, even though the policy applies to all IRRRB grants.

IRRRB should ensure that all of its grant programs comply with its policies. This is a matter of fairness and accountability in awarding public money.

Giants Ridge operating losses grew substantially from 2006 through 2014. In addition, IRRRB has not set sufficient targets to evaluate how well Giants Ridge is meeting its goals.

Giants Ridge revenues for operations have not kept pace with its expenses since 2006 (in inflation-adjusted dollars). IRRRB has subsidized Giants Ridge operations by $17.4 million from 2006 through 2014—an average of $1.9 million annually. Over this period, IRRRB also paid $6.7 million for Giants Ridge capital investments and $19.8 million to retire bond debt.

IRRRB set four goals for Giants Ridge when it first purchased the resort in 1984: create economic development, attract private-sector development, provide recreational facilities to enhance quality of life for people of the Iron Range, and create a year-round recreation destination. However, IRRRB has not established sufficient targets to judge how well Giants Ridge is meeting its stated goals. The agency has looked at different performance measures, such as attendance and customer satisfaction, but by themselves, the measures cannot show progress toward Giants Ridge's goals. IRRRB should measure Giants Ridge's performance against its stated goals and determine whether the resort remains consistent with the agency's mission.

The state law that requires members of the IRRRB Board to be legislators is vulnerable to challenge under the Minnesota Constitution.

IRRRB is an agency in the executive branch led by a commissioner appointed by the governor. Yet, state law requires members of the agency's board to be legislators and grants the board substantial power over the agency's spending decisions. This arrangement is vulnerable to a challenge under the Minnesota Constitution's separation of powers clause and its prohibition against legislators holding another public office. We base our conclusion on our review of the plain language of the Minnesota Constitution, historical context from the state constitutional conventions, and opinions from the Minnesota Supreme Court and Attorney General.

Introduction

The Iron Range Resources and Rehabilitation Board, known as the IRRRB, is a state economic development agency in northeast Minnesota. IRRRB focuses largely on awarding grants and loans to eligible communities and businesses in the region; it also funds and operates a public year-round resort. A nine-member IRRRB Board of legislators, primarily from the IRRRB service area, oversees the agency. The agency controlled funds totaling $90.6 million at the end of fiscal year 2015.

IRRRB's service area is heavily dependent upon the taconite mining industry, in which global economic forces and production declines led to worker layoffs in 2015. In April 2015, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate IRRRB. Our evaluation addressed the following questions.

- **What is the IRRRB's mission and legal authority, and how is the agency organized? What are the board's structure and authority, and how have they changed over time?**

- **How effective has IRRRB been in economic development, trade, and tourism promotion?**

- **How does IRRRB measure its performance?**

- **Does IRRRB follow fair and transparent practices when awarding grants or loans?**

To answer these questions, we used a variety of research methods. One was an extensive review of documents, including the Minnesota Constitution, state laws, court cases related to IRRRB and its structure, and agency policies and reports. We also reviewed academic and other literature on economic development from around the country. From this literature review, we identified practices for effective economic development in the public sector and indicators for measuring success in economic development.

Another component of our research was analyzing data. We collected data from IRRRB to analyze its loan and grant programs. We also analyzed IRRRB data on the agency's revenues and expenditures over the last 13 years. Additional IRRRB data allowed us to analyze some of the agency's other operations, primarily the Giants Ridge Recreation Area in central St. Louis County.

To better understand IRRRB grant and loan programs, we selected samples of projects for review. For each case in our samples, we analyzed the project's application package; proposed objectives; funding sources; and, to the extent data were available, outcomes.

We conducted an extensive analysis of the status of northeast Minnesota's economic conditions and its evolution in recent years. Our research included comparing multiple measures of the IRRRB service area's economy with that in other Minnesota regions and the state as a whole.

We interviewed numerous people for this evaluation, including each member of the IRRRB Board and current and past IRRRB commissioners. We interviewed many IRRRB staff, including most of those who head the agency's multiple programs and operations. Outside of IRRRB, we interviewed others with expertise in economic development. This included pertinent staff from Minnesota's Department of Employment and Economic Development, Minnesota's State Demographic Center, and the University of Minnesota Extension's Community Economics Program.

IRRRB is headquartered near Eveleth in St. Louis County, and we traveled there a number of times to speak with staff and review documents. We observed the three IRRRB Board meetings that occurred during our evaluation and read minutes from past meetings. We also sent questionnaires to small numbers of communities that applied to IRRRB for grants and to companies that received IRRRB loans.

Chapter 1 provides background information on IRRRB and northeast Minnesota. Chapter 2 analyzes the performance of IRRRB's loan and grant programs. Chapter 3 focuses on the performance and funding of the Giants Ridge Recreation Area. The report has two appendices. One describes our analysis of potential constitutional issues related to the IRRRB Board. The second explains the methodology we followed in selecting loans and grants to review.

Chapter 1: Background

The Iron Range Resources and Rehabilitation Board is a state agency in the executive branch. It is unique for three key reasons. First, its mission involves providing economic assistance to only one region of the state—the Iron Range, a portion of northeast Minnesota.[1] Second, it is governed by both a commissioner appointed by the governor and a board composed of legislators. Third, the agency's primary source of funding is a tax on mineral production, instead of money from the state's General Fund. In this chapter, we provide an overview of the agency's history and mission, review the agency's governance structure and funding, and analyze the economic conditions in northeast Minnesota. The organization—both the agency and the board—is commonly called the Iron Range Resources and Rehabilitation Board (IRRRB), and that is the name we use in this report.

HISTORY

Minnesota has a long history of mining. Iron ore mining began in the northeast part of the state in 1884, and since then, iron ore has been mostly depleted. Much of the rock now mined in Minnesota is taconite, which has low iron content. In 1941, the Legislature created an executive branch agency called the Office of the Commissioner of Iron Range Resources and Rehabilitation to aid communities on the Iron Range suffering from economic decline and unemployment due to the removal of natural resources.[2]

To oversee the executive branch agency, the Legislature created a board in 1943, composed of six legislators and the state's Commissioner of Conservation.[3] Over time, the board's structure has changed in size and, for a period, also included nonlegislative members.[4] Currently, the board has only legislators as members; eight are from districts located at least in part on the Iron Range, while the Senate appoints a ninth member at large.[5]

MISSION AND PROGRAMS

According to the agency, IRRRB's current mission is to "promote and invest in business, community and workforce development for the betterment of northeastern Minnesota."[6]

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[1] Minnesota also has an agency—the Department of Employment and Economic Development—that administers economic development programs statewide. "Iron Range" is used to describe a region in northeast Minnesota with a long history of iron mining.

[2] *Laws of Minnesota* 1941, chapter 544, sec. 4.

[3] *Laws of Minnesota* 1943, chapter 590, sec. 4.

[4] From 1999 to 2013, the board had 13 members: 5 senators, 5 representatives, and 3 nonlegislators who resided in the Iron Range (1 appointed by the senate majority leader, 1 appointed by the speaker of the house, and 1 appointed by the governor).

[5] Legislators from districts with at least one-third of the residents residing in the Taconite Assistance Area, a region in northeast Minnesota, serve on the IRRRB Board. *Minnesota Statutes* 2015, 298.22, subd. 1a.

[6] IRRRB website, http://mn.gov/irrrb/about-us/what-we-do/, accessed December 8, 2015.

Statutes establish various areas on which the agency should work, for example:

- Developing resources and vocational training and rehabilitation for residents in counties impacted by natural resource removal.
- Targeting relief to areas with the largest job and population losses due to downturns in the mining industry in the 1980s.
- Promoting economic development, trade, and tourism.
- Granting funds to taconite companies for reinvestment in facilities and workforce and to higher education institutions.[7]

IRRRB offers a number of programs and manages facilities to promote economic development and tourism.[8] In fiscal year 2016, the agency had a budget of $33.2 million.[9] The agency develops and manages grant and loan programs that fund projects for local governments, businesses, nonprofit organizations, and interorganization collaborations in northeast Minnesota. Exhibit 1.1 describes each IRRRB grant and loan program operating in fiscal year 2016. Currently, the two programs with the largest budgets are Business Development loans ($5 million) and Public Works grants ($6 million). Through the Business Development program, IRRRB loans money to promote business development and attract new investment to the area. Through the Public Works grant program, the agency awards grants to local governments, airport authorities, hospital boards, and utility commissions to invest in infrastructure for community development and economic development.

The agency also owns and provides funding for two facilities, the Giants Ridge Recreation Area and Minnesota Discovery Center. Giants Ridge is a recreation facility with golf and ski activities that promotes economic enhancement of the IRRRB service area and improved quality of life for area residents. We describe Giants Ridge in greater detail in Chapter 3. The Minnesota Discovery Center is a museum dedicated to preserving, interpreting, and promoting the history and cultural heritage of northeast Minnesota. In fiscal year 2016, IRRRB budgeted $9.5 million for Giants Ridge and $1.4 million for the Minnesota Discovery Center out of the agency's total $33.2 million budget.

[7] *Minnesota Statutes* 2015, 298.22, 298.227, and 298.28.

[8] In 2015, the IRRRB had approximately 74 full-time-equivalent employees.

[9] The IRRRB annual budget does not represent all agency spending, which is discussed later in this chapter.

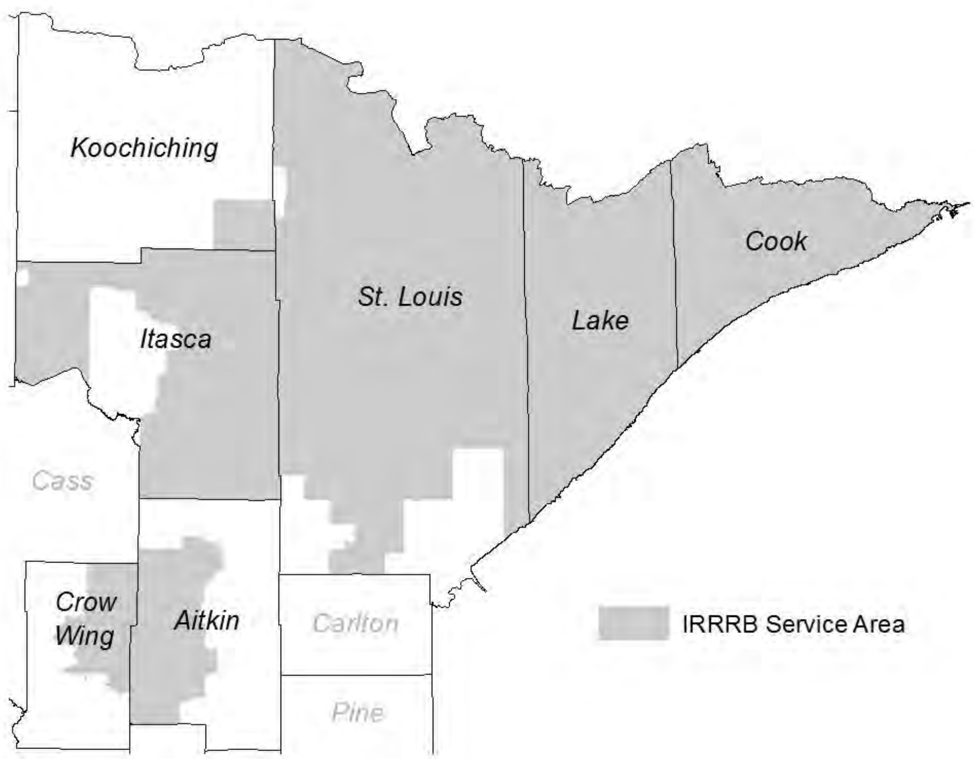
Exhibit 1.1: IRRRB Budgetary Program Descriptions, Fiscal Year 2016

IRRRB Programs	Budgetary Purpose	Eligible Applicants	Budget (in $000’s)
Grants			
Application Fund	Reimburse recipients for costs of applying for other state, federal, or private grants	Nonprofit organizations, cities, townships	$ 25
Business Energy Retrofit	Assist businesses with clean energy improvements to their buildings	Businesses	750
Commercial Redevelopment	Demolish and remove commercial or publicly owned structures, or clean up of brownfield sites, making way for new development	Cities, townships, counties	900
Commissioner Program	Respond quickly to emergency situations or support development opportunities that may not meet other program requirements	Not specified; funding granted at commissioner’s discretion	150
Comprehensive Plan	Develop and adopt comprehensive plans that provide a long-range vision for community growth and development	Cities, townships, tribal units of government	150
Culture and Tourism	Stimulate tourism and enrich communities through artistic, heritage-related, or recreational activities	Nonprofit organizations	185
Development Partnership	Research, education, and development-based initiatives that support economic growth	Collaborations with regional development entities	250
Education-Workforce Development	Fund training programs for industry, industry clusters, or schools to address workforce needs; fund development and delivery of curriculum to prepare students to transition into the workforce	Post-secondary education institutions or nonprofits partnering with corporate industries	300
Film Production Incentive	Projects that create jobs and result in economic impact in the IRRRB service area	Entities producing films, TV shows, commercials, music videos, or other media	200
Laurentian Vision Partnership	Preserve lands that sustain current and future mining, promote landscape options after mining, and identify new development	Cities, townships, nonprofit organizations, joint powers boards	200
Mining and Mineland Reclamation	Mine pit fish stocking, emergency safety projects and repair, proactively addressing community mining conflicts, stimulating mining exploration	Cities, towns, nonprofit organizations, drilling firms	435
Public Works	Infrastructure investment for community and economic development	Cities, townships, airport authorities, hospital boards, utility commissions	6,000
Residential Redevelopment	Demolish dilapidated residential structures to help create cleaner and safer communities and encourage new construction	Cities, townships, counties, tribal units of government	350
Loans			
Business Development Projects	Direct loans, loan guarantees, bank participation loans, and equity investments to promote business development opportunities and attract new investment to northeast Minnesota	Primary consideration for manufacturing/assembly, businesses attracting outside region money, and technological innovation	5,000
Giants Ridge Golf and Ski Resort	Promote tourism and recreational opportunities for the economic enhancement and diversification of the IRRRB service area and improve the quality of life for area residents	N/A	9,519
Minnesota Discovery Center	Collect, preserve, interpret, and promote the history and heritage of northeast Minnesota	N/A	1,350

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board, *FY 2016 Budget*, and grant and loan applications, November 2015.

IRRRB serves the area of northeast Minnesota defined in state law as the "Taconite Assistance Area." State statutes define the Taconite Assistance Area using the assessed value of unmined iron ore in school districts as of 1941, or the location of taconite mining or mining facilities as of 1977.[10] In this report, we refer to the Taconite Assistance Area as the "IRRRB service area." The area includes all of 15 school districts and all or part of 7 counties, as Exhibit 1.2 shows.[11] In 2014, the IRRRB service area had a population of about 156,500; it comprised 50 cities, 132 towns, and 28 unorganized territories.[12] Municipalities ranged in size from 30 to 16,300 people. The area's population made up approximately 3 percent of the state's population in 2014.

Exhibit 1.2: IRRRB Service Area, 2016



NOTE: The IRRRB service area is the Taconite Assistance Area, a region of northeastern Minnesota defined in statutes by the assessed value of unmined iron ore in school districts as of 1941 or the location of taconite mining or mining facilities as of 1977. This map represents county boundaries.

SOURCE: Office of the Legislative Auditor, analysis of *Minnesota Statutes* 2015, 273.1341.

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[10] *Minnesota Statutes* 2015, 273.1341.

[11] The school districts are: Aitkin, Chisholm, Cook County, Crosby-Ironton, Ely, Eveleth-Gilbert, Grand Rapids, Greenway, Hibbing, Lake Superior, Mesabi East, Mountain Iron-Buhl, Nashwauk-Keewatin, St. Louis County, and Virginia. The counties are: Aitkin, Cook, Crow Wing, Itasca, Koochiching, Lake, and St. Louis.

[12] Because the IRRRB service area is defined by school district boundaries, some of the municipalities and unorganized territories included here are only partially located inside the IRRRB service area's boundaries. The population estimates given here include only those living within the boundaries of the IRRRB service area.

GOVERNANCE

Most Minnesota executive branch agencies have a straightforward governance structure; they are under the control of a commissioner appointed by the Governor. Although it is an executive branch agency, IRRRB's structure is different.

The governance structure of IRRRB is unique in state government.

The governor appoints a commissioner of IRRRB, who is the chief executive of the agency. However, unlike other executive branch agencies, state law grants substantive power over the agency to a small group of legislators who are IRRRB Board members.[13] When first established, the IRRRB Board served in an advisory role, but the 1995 Legislature significantly increased the board's authority to control the agency. Since 1995, the law has *required* board members to approve or disapprove all expenditures and projects proposed by the commissioner as opposed to *recommending* approval or disapproval as was previously the case.[14] State law also requires the commissioner to submit an annual budget to the board for approval. After board approval, the budget is submitted to the governor for approval or disapproval.[15]

However, the IRRRB Board, not the governor, has final approval over many expenditures, depending on the funding source. For example, gubernatorial approval is not required for grants to mining companies for reinvestment in their plants and facilities.

Several current board members we interviewed expressed their belief that the board's control over agency spending is reasonable due to the uniqueness of IRRRB's funding, described more below. IRRRB's primary source of revenue comes from mineral taxes, the majority of which mining companies pay instead of property taxes.[16] Several board members said that because IRRRB uses money that is paid in lieu of local property taxes, it is reasonable for local legislators to serve on the board and make spending decisions.

Other state agencies have boards; for example, the Minnesota Board of Water and Soil Resources is an executive branch agency overseen by a governor-appointed board of state and local officials. However, the IRRRB's board is different because it is composed entirely of legislators, which has raised questions regarding the constitutionality of the IRRRB's governance structure.

The state statutes that establish IRRRB's governance structure are vulnerable to a constitutional challenge.

This vulnerability is based on the Minnesota Constitution's provisions on the separation of powers and its prohibition against legislators holding another public office. We address this vulnerability in detail in Appendix A of this report.

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[13] *Minnesota Statutes* 2015, 298.22, subd. 1a.

[14] *Laws of Minnesota* 1943, chapter 590, sec. 4; and *Laws of Minnesota* 1995, chapter 224, sec. 92.

[15] *Minnesota Statutes* 2015, 298.22, subd. 11.

[16] For more information on mineral taxes, see our report: Office of the Legislative Auditor, Program Evaluation Division, *Mineral Taxation* (St. Paul, 2015).

IRRRB FUNDING

IRRRB receives most of its funding from a mineral tax. Minnesota and other states tax mining differently than other types of industries. States with mineral deposits often use a "severance" tax, which they impose on the removal of natural products from the Earth, instead of a property tax.[17]

In Minnesota, revenue from the taconite production tax provides the majority of IRRRB's funding. The production tax rate is set in law and is $2.56 per taxable ton of taconite produced; it is levied in lieu of property taxes. IRRRB and counties in the IRRRB service area receive statutory allocations of the production tax revenue—some for their own use and some for distribution elsewhere. IRRRB also oversees the production tax revenue that is allocated into five funds, as described below. In 2015, IRRRB received $37.8 million, or 34 percent, of the total $111 million in production tax revenue. Counties keep a portion of the tax revenue and distribute the rest to municipalities, school districts, and a few small entities according to complex formulas in statute.[18] In this way, local governments use the production tax like local taxes to fund government functions.

Mining companies also pay an occupation tax of 2.45 percent of the companies' taxable income. Most occupation tax revenue goes to statewide purposes, such as the permanent school fund, although some goes to IRRRB for dedicated purposes.[19] In 2015, $3 million in occupation tax revenue was transferred to the IRRRB.

While IRRRB's primary source of funding is mineral tax revenue, it also receives some state General Fund revenue.[20] Since 2001, statutes have required the state to provide revenue from the General Fund to the total pool of taconite production taxes, as if the state were a mining company paying taxes.[21] Thus, IRRRB indirectly receives General Fund dollars. In 2015, the state General Fund paid $8.7 million, or 7.8 percent, of the $111 million in total taconite production taxes.

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[17] States tax mining with a severance tax instead of a property tax because property taxes depend on the value of a property, and estimating the value of an unmined mineral deposit is difficult. In addition, a property tax is due whether a mine is producing great quantities or not operating, which encourages accelerated removal of the mineral deposit.

[18] Statutes allocate a small amount of taconite production tax revenue to (1) the Range Association of Municipalities and Schools and (2) the Hockey Hall of Fame through the city of Eveleth. *Minnesota Statutes* 2015, 298.28, subds. 8 and 9c.

[19] IRRRB receives transfers of occupation tax revenue for (1) pass-through funding to Carlton and Koochiching counties and (2) the Iron Range School Consolidation and Cooperatively Operated Schools Account. Money transferred in is accounted for separately from total agency revenue. From fiscal year 2003 through 2015, occupation tax revenue transferred to the IRRRB totaled $12.2 million in 2015 inflation-adjusted dollars.

[20] When first formed in 1941, the IRRRB's funding source was state General Fund dollars collected from the occupation tax on mining. The 1977 Legislature amended the agency's primary source of funding to the taconite production tax.

[21] The Department of Revenue annually calculates an amount the state owes based on statutory requirements and the amount of taconite produced by mining companies. The state's amount is added to the amounts mining companies pay, and the revenue is then allocated to the IRRRB and counties as described above. *Minnesota Statutes* 2015, 298.285.

Budgeted and Supplemental Expenditures

IRRRB's annual spending can be grouped into two categories: (1) budgeted spending and (2) supplemental spending. These methods for spending funds are set in statute.

IRRRB's budget represents only a portion of the dollars it spends each year.

IRRRB receives production tax revenue for its own general use and for five statutory funds that the agency controls.[22] Each year, IRRRB uses its own mineral tax allocation and money distributed by law from some of these statutory funds to pay for its annual budgeted spending. Beyond that, IRRRB uses supplementary revenue from the statutory funds to pay for certain grant and loan projects that are not in the agency's annual budget. In fiscal year 2015, the agency's budget was $41 million but it spent $85.8 million, meaning 52 percent of the agency's spending was not budgeted and came instead from supplemental revenue out of some of the statutory funds.[23] For example, the agency spent $7.4 million more on loans than it budgeted in 2015. Exhibit 1.3 demonstrates how revenue from the statutory funds pays for budgeted and supplemental expenditures.

In almost every year since fiscal year 2003, IRRRB has spent more money than the agency budgeted because the agency accessed the statutory funds to provide more revenue for loans and grants than was in its annual budget. In 12 of the 13 years since 2003, the agency's expenditures ranged from 23 percent to 168 percent higher than its annual budget. Exhibit 1.4 compares IRRRB's annual budgeted amounts with actual spending from 2003 to 2015.

Of the five statutory funds, some funds finance both the agency's budgeted spending and supplemental spending, while some finance only supplemental spending. Below, we outline the statutory purpose of each fund and indicate whether IRRRB uses it for budgeted spending or supplemental spending.

- Douglas J. Johnson Economic Protection Trust Fund: The fund supports programs that create and maintain skilled employment; encourage economic diversification and the development of minerals, alternative energy, forestry, small business, and tourism; and develop projects for which technological and economic feasibility are demonstrated. IRRRB uses a statutory allocation from the fund for budgeted spending on loans to businesses and for the agency's administration of the fund.[24] It uses other money from the fund for supplemental loans to businesses.

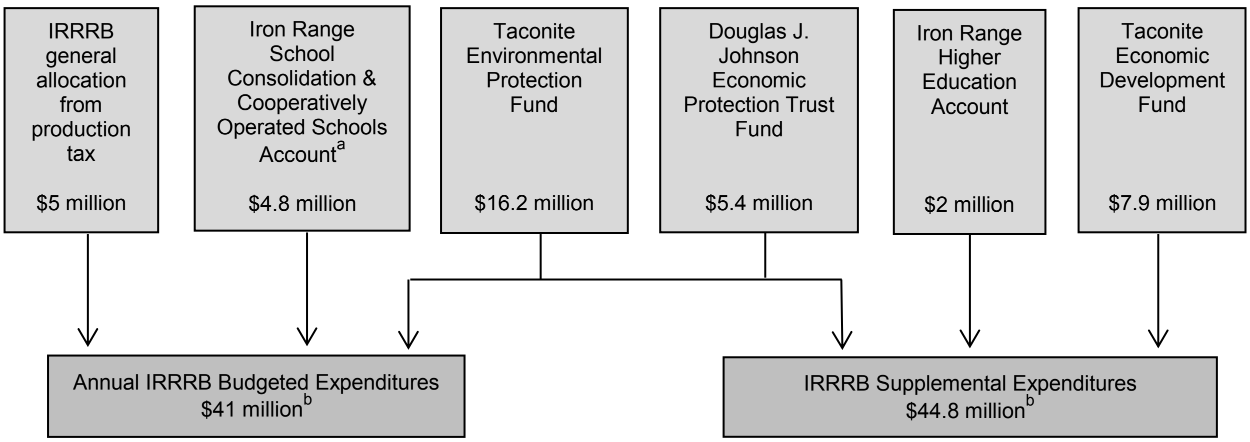
- Taconite Environmental Protection Fund: The fund supports reclamation, restoration, and enhancement of areas adversely affected by the environmentally damaging operations of mining taconite and iron ore, and it promotes economic

[22] Statutes define each of the five funds. Statutes also establish formulas for the proportions of the annual taconite production tax and occupation tax allocated to each fund. *Minnesota Statutes* 2015, 298.17(b)(3); and 298.28, subds. 7, 7a, 9, 9a, 9b, 9d, and 11.

[23] Data on IRRRB expenditures include encumbrances, which in some cases do not result in actual expenditures.

[24] According to statutes, the IRRRB may use revenue from the Douglas J. Johnson Economic Protection Trust Fund for its administration of the fund, not exceeding 5 percent of the net interest, dividends, and earnings of the fund in the preceding fiscal year. *Minnesota Statutes* 2015, 298.296, subds. 2(a) and (e).

Exhibit 1.3: Funding Sources for IRRRB Budgeted and Supplemental Expenditures, Fiscal Year 2015



NOTES: The chart shows amounts of mineral tax revenue allocated in 2015 to statutory funds that receive mineral taxes annually and are controlled by IRRRB. That year, the IRRRB also received $4.1 million of production tax revenue for educational revenue bonds, used for supplemental expenditures.

[a] The IRRRB included spending from the School Consolidation Account in its fiscal year 2015 budget but not in its fiscal year 2016 budget.

[b] IRRRB can use annual allocations of mineral taxes as well as balances in the statutory funds to pay for its expenditures.

SOURCE: Office of the Legislative Auditor, analysis of *Minnesota Statutes* 2015, 298.17, and 298.28; Minnesota Department of Revenue, *Mining Tax Guide*, 2014, 5; and Iron Range Resources and Rehabilitation Board fiscal year 2015 budget.

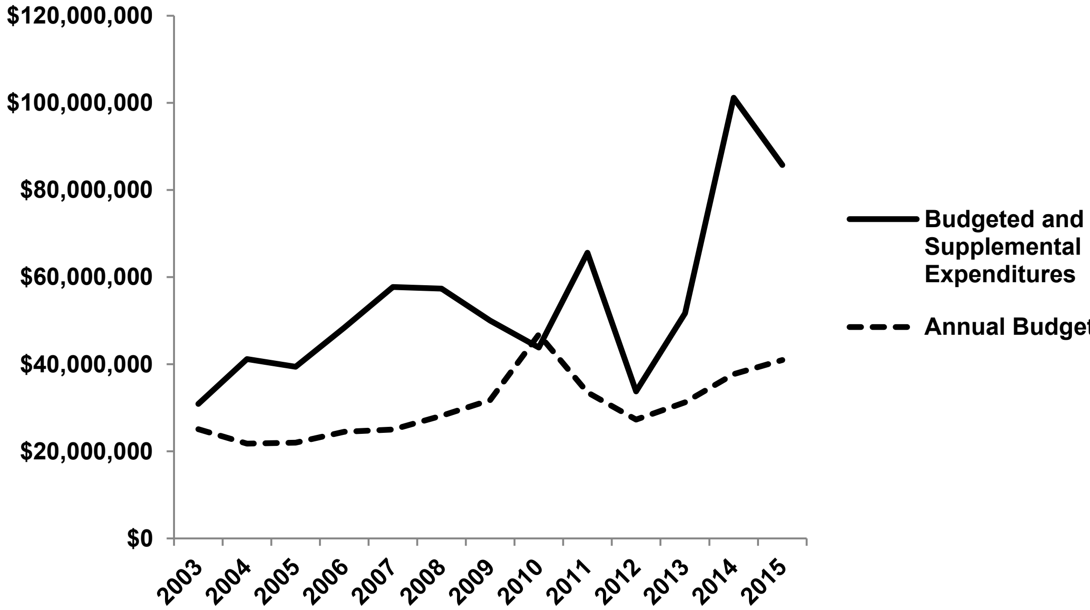
development in the IRRRB service area.[25] IRRRB uses a statutory allocation from the fund for budgeted loans to businesses, grant programs, Giants Ridge, the Minnesota Discovery Center, and agency operations.[26] It also uses other money from the fund for supplemental loans and grants.

- Taconite Economic Development Fund: From this fund, IRRRB provides money to taconite mining companies for workforce development and associated public facility improvement, acquisition of plant and stationary mining equipment and facilities, and research and development on new mining and production technology. A committee of company employees must review mining company proposals before companies bring them to the IRRRB Board for approval. The agency can redirect money from the fund to other projects if the IRRRB Board does not

[25] Statutes also establish the Producer Grant and Loan Fund that the IRRRB administers and that receives its own production tax allocation; however, since 2009, revenue in the fund has been statutorily designated for purposes specified for the Taconite Environmental Protection Fund.

[26] The agency may use up to 5 percent of the amount annually expended from the Taconite Environmental Protection Fund to administer the fund and projects and programs paid for by the fund. *Minnesota Statutes* 2015, 298.223, subd. 3.

Exhibit 1.4: IRRRB Annual Budget and Total Expenditures, Fiscal Years 2003-2015



NOTES: Amounts are in nominal dollars and are not adjusted for inflation. IRRRB's annual spending can be grouped two ways: (1) budgeted spending and (2) supplemental spending. Each year, IRRRB uses its mineral tax allocation and money from statutory funds to finance its annual budgeted spending. Beyond that, IRRRB has access to statutory funds to pay for certain grant and loan projects that are not in IRRRB's annual budget. Expenditure data include encumbrances, which in some cases do not result in actual expenditures.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board data, December 2015.

approve company proposals.[27] All spending from the fund is for supplemental expenditures.

- Iron Range Higher Education Account: The account supports higher education programs at educational institutions in the IRRRB service area. The Iron Range Higher Education Committee approves spending from the account before proposals are brought to the full IRRRB Board for approval.[28] Spending from the account is for supplemental expenditures.

- Iron Range School Consolidation and Cooperatively Operated Schools Account: The account is intended to assist school districts with bond payments for qualified school projects or any other distribution approved by IRRRB. As of 2015, the

[27] In 2011, the IRRRB Board voted to use about half of the Taconite Economic Development Fund revenue for mining companies' proposals and redirected the other half to the Taconite Environmental Protection Fund for public works project expenditures.

[28] The committee consists of one member appointed by each of the governor and the president of the University of Minnesota, four IRRRB Board members, the IRRRB commissioner, and the Northeast Higher Education District president.

agency had not yet distributed funds from the account.[29] The IRRRB included spending from the account in its fiscal year 2015 annual budget but not in its fiscal year 2016 budget, thus, if IRRRB spends money from the account in 2016 it will be for supplemental expenditures.

Expenditure Approvals

Depending on the funding source, IRRRB expenditures require approval from either the (1) IRRRB Board and governor or (2) IRRRB Board only. Board and governor approval are required for the annual IRRRB budget and for nearly all budgeted and supplemental expenditures from two of the statutory funds—the Taconite Environmental Protection Fund and the Douglas J. Johnson Economic Protection Trust Fund.[30] When the agency spends supplemental money from the other three statutory funds, the board approves those expenditures, but the governor does not. That is, governor approval is not required for IRRRB expenditures from the Taconite Economic Development Fund, the Iron Range Higher Education Account, and the Iron Range School Consolidation and Cooperatively Operated Schools Account.[31] Exhibit 1.5 summarizes who approves IRRRB expenditures by their funding source.

Revenue Trends

IRRRB's primary source of funding is production tax revenue, but it also receives revenue from other sources. The production tax made up 62 percent of the agency's total revenue from 2003 to 2015.[32] The lowest proportion of production tax revenue to total revenue was 45 percent in 2014, and the highest was 82 percent in 2010. Other sources that have provided significant revenue over time include loan repayments and interest earnings on special appropriations. Exhibit 1.6 summarizes the agency's sources of revenue from 2003 to 2015.

IRRRB's average annual revenue from 2003 to 2015 was $50.5 million, in 2015 inflation-adjusted dollars. Over this period, IRRRB's annual revenue increased 46 percent. Due to IRRRB's reliance on the production tax, fluctuations in annual revenue occur as a result of fluctuations in taconite production. However, to provide some revenue stability for IRRRB and other entities receiving production tax revenue, mining companies are taxed based on a three-year average of the tons of taconite they produce. During this 13-year period, IRRRB's lowest annual revenue was $25.8 million in 2011; its highest revenue was $87.5 million in 2014.

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[29] In addition to receiving revenue from the taconite production tax, the account receives revenue from the occupation tax on mining.

[30] Governor approval is not required to purchase or sell forest land with money from the Douglas J. Johnson Economic Protection Trust Fund. *Minnesota Statutes* 2015, 298.292, subd. 2(5); and 298.296, subd. 2(g).

[31] In fiscal year 2015, the Taconite Economic Development Fund comprised 14 percent of total agency spending and the Higher Education Account comprised 2 percent. Funds had not yet been spent from the School Consolidation and Cooperatively Operated Schools Account, but it received $4.8 million in mineral taxes in fiscal year 2015.

[32] Revenue and expenditure data have been adjusted for inflation and are reported in 2015 dollars.

Exhibit 1.5: Approval for IRRRB Spending, by Funding Source, 2015

Funding Sources	Board and Governor Approval	Board Approval Only
Douglas J. Johnson Economic Protection Trust Fund[a]	√	√
Giants Ridge recreation tax[b]		√
Iron Range Higher Education Account		√
Iron Range School Consolidation and Cooperatively Operated Schools Account		√
Allocation of production tax revenue for IRRRB annual budget[c]	√	√
Pass-through funding to Carlton and Koochiching counties	√	
Supplemental funding authority[d]	√	
Taconite Economic Development Fund		√
Taconite Environmental Protection Fund	√	
21st Century Fund match[e]		√

NOTE: The IRRRB oversees five funds that receive allocations of production tax revenue annually: the Douglas J. Johnson Economic Protection Trust Fund, Iron Range Higher Education Account, Iron Range School Consolidation and Cooperatively Operated Schools Account, Taconite Economic Development Fund, and Taconite Environmental Protection Fund.

[a] Expenditures from the fund must have board and governor approval, except for money used to purchase or sell forest lands and money used for a former wage subsidy program, which require only board approval.

[b] The city of Biwabik has authority, with approval of IRRRB, to impose taxes on activities within the Giants Ridge Recreation Area, from which the IRRRB would use money to pay for Giants Ridge construction, improvement, and maintenance.

[c] Some IRRRB expenditures (such as spending from its annual budget) must be approved by the board and the governor, while some (such as selling Giants Ridge or Minnesota Discovery Center) require board approval only.

[d] The supplemental funding authority refers to the commissioner's tax-increment funding authority.

[e] The fund, controlled by the Department of Employment and Economic Development, is used to make loans or equity investments in a region of northeast Minnesota for mining and renewable energy facilities, steel-production facilities, and manufacturing facilities for biobased products.

SOURCE: Office of the Legislative Auditor, analysis of *Laws of Minnesota* 2010, chapter 389, art. 5, sec. 7; *Minnesota Statutes* 2015, 116J.424, and chapter 298; and Iron Range Resources and Rehabilitation Board, *2016 Budget*, May 2015.

Expenditure Trends

IRRRB's annual expenditures fluctuated between 2003 and 2015, but increased overall by 92 percent, from $44.6 million to $85.8 million, in 2015 inflation-adjusted dollars. During this 13-year period, annual expenditures averaged $61 million; the lowest annual expenditure was $35.1 million in 2012, while the highest was $101.1 million in 2014. Exhibit 1.7 summarizes the agency's expenditures from 2003 to 2015.

Grants and loans made up the majority of IRRRB's expenditures from 2003 to 2015. Grants to nongovernmental entities—such as nonprofit organizations and mining companies—composed the largest share of expenditures in this period, at 26 percent. Other significant areas of spending included loans to businesses (21 percent) and grants to cities and towns (13 percent). Spending in both of these areas increased significantly during this

Exhibit 1.6: IRRRB Sources of Revenue, Adjusted for Inflation, Fiscal Years 2003 and 2015

Revenue Source	2003 Revenue (in $000's)	2015 Revenue (in $000's)	Percentage Change, 2003-2015	Percentage of Total, 2003 through 2015
Taconite Production Tax	$30,419	$43,120	42%	62%
Loan repayments[a]	3,686	2,687	-27	9
Interest earnings on appropriations[b]	2,981	615	-79	5
Miscellaneous revenue[c]	1,149	11,349	888	9
Other sources	5,930	6,625	12	16
Total	$44,164	$64,396	46%	100%

NOTES: Revenue is reported in 2015 inflation-adjusted dollars. The table displays revenue sources that consisted of at least 5 percent of total revenue from 2003 through 2015; it groups together the remaining 23 revenue sources. Revenue does not include transfers in to the agency, such as money from the occupation tax on mining, which totaled $12.2 million from fiscal year 2003 through 2015. The columns may not sum to the totals due to rounding.

[a] Loan repayments do not include interest earned on loans.

[b] The IRRRB earns interest on appropriations to the agency; these figures do not include interest earned on loans.

[c] Miscellaneous revenue includes, for example, loan guaranty fees and photocopy charges. In 2015, miscellaneous revenue included $8.4 million for educational revenue bonds.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board revenue data, December 2015.

Exhibit 1.7: IRRRB Expenditures, Adjusted for Inflation, Fiscal Years 2003 and 2015

Expenditure Category	2003 Expenditures (in $000's)[a]	2015 Expenditures (in $000's)	Percentage Change, 2003-2015	Percentage of Total, 2003 through 2015
Grants to nongovernmental entities/firms[b]	$19,338	$17,041	-12%	26%
Full-time salaries	7,941	4,470	-44	8
Loans[c]	4,691	17,244	268	21
Professional and technical services to vendors	3,131	4,685	50	6
Debt service	2,043	12,454	510	6
Grants to cities and towns	634	16,357	2,481	13
Other categories	6,814	13,508	98	20
Total	$44,591	$85,759	92%	100%

NOTES: Expenditures are reported in 2015 inflation-adjusted dollars. Expenditures may include open encumbrances. The table displays expenditure categories that consisted of more than 5 percent of total expenditures from 2003 through 2015; it groups together the remaining 36 expenditure categories.

[a] The column does not sum to the total due to rounding.

[b] Nongovernmental entities and firms include mining companies and nonprofit organizations.

[c] Loans includes all types of loans, such as loan guarantees or direct loans.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board expenditure data, December 2015.

period. Loan expenditures, which are for businesses primarily, increased 268 percent, to $17.2 million in 2015, and grants to cities and towns increased by 2,481 percent, to $16.4 million.

ECONOMIC CONDITIONS IN NORTHEAST MINNESOTA

Most of IRRRB's activities are rooted in economic development. Consequently, we assessed economic conditions in the IRRRB service area to better understand the need for such activities.

Economic conditions in northeast Minnesota are less robust when compared to other parts of outstate Minnesota or the state as a whole.

Northeast Minnesota faces a shrinking labor force, stagnant population growth, an aging population, low incomes, and chronic unemployment. The region has also experienced weak employment growth across industry sectors over the last 15 years and remains heavily reliant on the mining industry.

The labor force is shrinking in northeast Minnesota while growing statewide. The strength of a region's labor force affects its tax base, purchasing power, and competiveness as a business location. Between 2000 and 2014, the labor force in northeast Minnesota shrank by 1 percent.[33] Southwest Minnesota was the only other outstate region that experienced a shrinking labor force during this 15-year period, declining by 4 percent. The rest grew between 2 and 18 percent.

Between 2000 and 2014, the population of the IRRRB service area changed little, declining by 0.6 percent.[34] However, the 80 counties outside the metropolitan area saw population growth at 8.6 percent during this time, and statewide population grew by 10.8 percent.

The population of the IRRRB service area is older than the population of outstate Minnesota.[35] In all but two of the school districts in the IRRRB service area, a larger portion of residents had reached retirement age (65 years old) than in outstate Minnesota, according to estimates from the 2010-2014 American Community Survey.[36] Aitkin School District had the highest proportion of older residents at 29 percent, substantially larger than the proportion in outstate Minnesota at 17 percent, as Exhibit 1.8 shows. Aitkin School

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[33] Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Local Area Unemployment Statistics*, 2000-2014. Because these data were not available specifically for the IRRRB service area, we used data for Minnesota Workforce Service Area 3. This area, which we refer to here as "northeast Minnesota," includes all of Aitkin, Carlton, Cook, Itasca, Koochiching, and Lake counties, and St. Louis County except the city of Duluth. Parts of these counties, and all of Carlton County, are not inside the IRRRB service area, which makes the region an imperfect proxy. Workforce Service Area 3 also excludes Crow Wing County, parts of which are in the IRRRB service area.

[34] Minnesota State Demographic Center, "Annual population estimates for cities and townships in the state and for school districts in the Taconite Assistance Area," 2000 and 2014.

[35] For our analysis of population age, household income, and poverty levels, "outstate Minnesota" refers to the whole state except the Twin Cities metropolitan statistical area, which is defined by the U.S. Office of Management and Budget to include: Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Le Sueur, Mille Lacs, Ramsey, Scott, Sherburne, Sibley, Washington, and Wright counties.

[36] U.S. Census Bureau, "S0101: Age and Sex," *American Community Survey*, 2010-2014.

Exhibit 1.8: Population Characteristics, 2010-2014

Area	Population	Median Age (Years)	Age 65 and above	High School Diploma or Higher[a]	Bachelor's Degree or Higher	Median Household Income[b]	Below Poverty Level
Minnesota	5,383,700	38	14%	92%	33%	$60,800	12%
Outstate Minnesota[c]	2,085,200	40	17	91	23	52,600	13
IRRRB Service Area School Districts							
Aitkin	10,000	53	29	91	16	44,300	11
Chisholm	5,700	39	15	95	19	39,500	12
Cook County	5,200	51	23	95	41	51,900	9
Crosby-Ironton	10,600	51	26	91	18	41,800	14
Ely	5,100	49	23	93	34	42,000	13
Eveleth-Gilbert	8,800	47	18	94	20	46,600	14
Grand Rapids	27,800	47	21	93	26	49,100	13
Greenway	8,500	41	16	92	16	46,500	12
Hibbing	17,600	42	18	90	18	40,600	20
Lake Superior	13,200	50	23	95	26	49,900	13
Mesabi East	7,500	51	24	93	16	46,500	12
Mountain Iron-Buhl	4,500	48	19	92	21	47,800	13
Nashwauk-Keewatin	3,700	47	19	92	14	43,800	16
St. Louis County	17,800	51	22	92	18	49,300	12
Virginia	10,700	43	18	93	17	38,800	23

NOTE: The American Community Survey estimates shown here were produced from data collected over the five-year period between 2010 and 2014.

[a] Includes high school diploma equivalency.

[b] Median household income estimates are in 2014 inflation-adjusted dollars.

[c] Outstate Minnesota comprises the whole state of Minnesota except for the Twin Cities metropolitan statistical area, which is defined by the U.S. Office of Management and Budget and includes: Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Le Sueur, Mille Lacs, Ramsey, Scott, Sherburne, Sibley, Washington, and Wright counties.

SOURCES: U.S. Census Bureau, "S0101: Age and Sex"; "S1501: Educational Attainment"; "S1901: Income in the Past 12 Months"; and "S1701: Poverty Status in the Last 12 Months," *American Community Survey*, 2010-2014; and Steven Ruggles, Katie Genadek, Ronald Goeken, Josiah Grover, and Matthew Sobek, "American Community Survey, 2010, 2011, 2012, 2013, 2014," *Integrated Public Use Microdata Series: Version 6.0* [Machine-readable database] (Minneapolis: University of Minnesota, 2015).

District also had the highest median age at 53 years, which was much older than the outstate Minnesota median of 40 years.

Households in the IRRRB service area earn lower incomes when compared with outstate Minnesota.[37] Residents in Cook County School District had the highest median household income, at $51,900, among school districts in the IRRRB service area. However, this is still lower than outstate Minnesota's median of $52,600. The proportion of residents living in poverty varies by school district in the IRRRB service area when compared with the proportion in outstate Minnesota. Five school districts in the service area had greater proportions of residents living in poverty than did outstate Minnesota; four districts had the same proportion; and six districts had lower proportions. Two school districts in the service area, Hibbing and Virginia, had much higher proportions of residents living in poverty, at

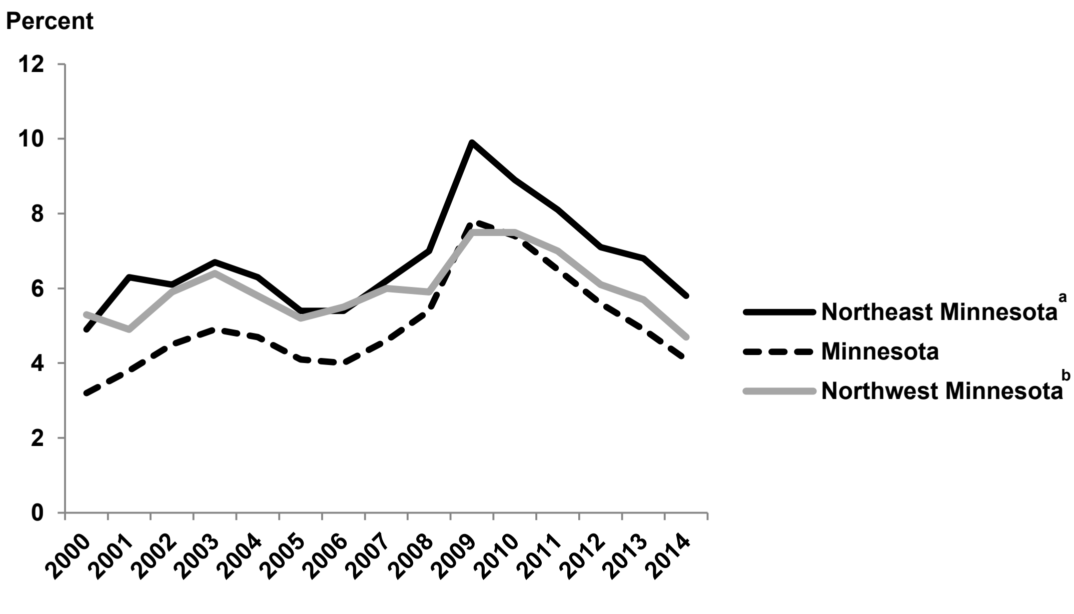
[37] U.S. Census Bureau, "S1901: Income in the Past 12 Months," *American Community Survey*, 2010-2014.

20 and 23 percent respectively, than outstate Minnesota's 13 percent, as Exhibit 1.8 shows.[38]

Northeast Minnesota has had a higher annual unemployment rate than any other region of the state for most of the last 15 years.

Only in 2000 and 2006 did another region of the state (northwest Minnesota) have a higher annual unemployment rate.[39] Since 2000, northeast Minnesota's unemployment rate has remained 1.3 to 2.5 percentage points higher than the statewide rate, as Exhibit 1.9 shows. In December 2015 (the most recent quarter with available data), the region had about 8,700 unemployed persons and a monthly unemployment rate of 7.3 percent. This rate was at least two percentage points higher than every other region in the state for the same month.

Exhibit 1.9: Unemployment Rates, 2000-2014



NOTE: The unemployment rates shown here are not seasonally adjusted annual averages because such data are not available for the regions.

[a] "Northeast Minnesota" refers to Minnesota's Workforce Service Area 3, an area that encompasses most of the IRRRB service area. It comprises all of Aitkin, Carlton, Cook, Itasca, Koochiching, and Lake counties, including parts that are not located in the IRRRB service area. It also includes all of St. Louis County, except the city of Duluth. This area excludes Crow Wing County, which is in the IRRRB service area.

[b] "Northwest Minnesota" refers to Minnesota Workforce Service Area 1, which includes Kittson, Marshall, Norman, Pennington, Polk, Red Lake, and Roseau counties.

SOURCE: Office of the Legislative Auditor, analysis of Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Local Area Unemployment Statistics*, 2000-2014.

[38] U.S. Census Bureau, "S1701: Poverty Status in the Last 12 Months," *American Community Survey*, 2010-2014.

[39] Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Local Area Unemployment Statistics*, 2000-2014. Here, "northeast Minnesota" refers to Minnesota Workforce Service Area 3 and "northwest Minnesota" refers to Minnesota Workforce Service Area 1.

Employment growth was weaker in the IRRRB service area than elsewhere in the state between 2000 and 2014.

Of 20 industry sectors, 14 experienced declines in employment in the IRRRB service area since 2000.[40] By comparison, only six sectors experienced declines in outstate Minnesota.[41] In most sectors, employment growth or decline was worse in the IRRRB service area than elsewhere in the state. For example, although employment in the health care and social assistance sector grew significantly in all geographic areas, its growth was smallest in the IRRRB service area, as Exhibit 1.10 shows. Similarly, although the manufacturing sector declined in each geographic area, the percentage of decline was greatest in the IRRRB service area.

The composition of industries in the IRRRB service area differs from the state overall in some respects.

At the state level, the mining sector accounted for only 0.2 percent of all employment in 2014. In the IRRRB service area, however, the iron ore industry (a subset of the mining sector) accounted for 7.7 percent of all employment. The iron ore industry employed 4,400 people in the area, more than any other individual industry in 2014. The mining sector also accounted for 18 percent of all wages in the IRRRB service area. Only one other sector, health care and social assistance, accounted for a larger share of wages, at 19 percent. Exhibit 1.11 compares the composition of industries in the IRRRB service area—in terms of employment by industry—with the state overall.

Another difference between the areas is that manufacturing makes up a smaller share of employment in the IRRRB service area than in the state overall. In 2014, the manufacturing sector employed the second largest share of workers in Minnesota, at 11.4 percent. In the IRRRB service area, however, it made up only the seventh largest share, at 6.3 percent.

Employment in northeast Minnesota fluctuates with the strength of the mining industry.

The mining sector in northeast Minnesota has been particularly vulnerable during economic recessions. Over the last 15 years, mining typically has accounted for only 1 to 3 percent of all Unemployment Insurance program claims in northeast Minnesota.[42] However, during

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[40] Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Quarterly Census of Employment and Wages*, 2000 and 2014. Data were not available specifically for the IRRRB service area. Consequently, we developed a proxy that includes all cities, towns, and unorganized territories that appear to have at least half of their geographic areas located within the IRRRB service area.

[41] In this section on industry sectors, "outstate Minnesota" is defined as all counties in the state except for Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington in the seven-county metropolitan area.

[42] Minnesota Department of Employment and Economic Development, *Unemployment Insurance Statistics*, 2000-2015. During this 15-year period, two sectors accounted for the largest shares of Unemployment Insurance claims in northeast Minnesota each year: construction, which generated 27 to 45 percent of claims, and manufacturing, which generated 6 to 19 percent of claims. The health care and social services sector typically generated the third largest share of claims, ranging from 5 to 9 percent of the total, except in 2015, when it accounted for only 1 percent of the total. Because these data were not available specifically for the IRRRB service area, we used data for Minnesota Economic Development Region 3, which we refer to here as "northeast Minnesota."

Exhibit 1.10: Employment Growth by Industry Sector, 2000-2014

Industry Sector	Employment, 2014: IRRRB Service Area	Percentage Change in Employment, 2000-2014: IRRRB Service Area[a]	Northeast Minnesota[b]	Outstate Minnesota[c]	Minnesota
Finance and insurance	1,900	50%	16%	19%	6%
Administrative and support services; waste management and remediation services	1,700	31	2	30	5
Health care and social assistance	11,600	30	39	38	45
Utilities	900	12	3	14	1
Educational services	4,300	6	3	12	19
Arts, entertainment, and recreation	1,300	3	0	-3	11
Professional, scientific, and technical services	1,200	0	24	30	11
Public administration	4,300	-1	1	10	11
Construction	2,800	-1	-3	2	-10
Retail trade	7,400	-7	-5	-4	-6
Accommodation and food services	6,000	-8	4	10	13
Wholesale trade	1,300	-9	-17	13	2
Real estate and rental and leasing	400	-14	1	0	10
Other services (except public administration)	1,800	-17	0	-1	-1
Mining, quarrying, and oil and gas extraction	4,600	-18	-18	-16	-11
Transportation and warehousing	1,400	-19	-28	7	-12
Agriculture, forestry, fishing, and hunting	300	-30	-15	45	37
Information	500	-31	-42	-14	-23
Manufacturing	3,600	-37	-34	-18	-21
Management of companies and enterprises	100	-65	-25	9	9

NOTES: This exhibit includes only data from firms mandated to participate in the Unemployment Insurance program, about 97 percent of national employment.

[a] Data include all cities, towns, and unorganized territories that appear to have at least half of their geographic areas located within the IRRRB service area.

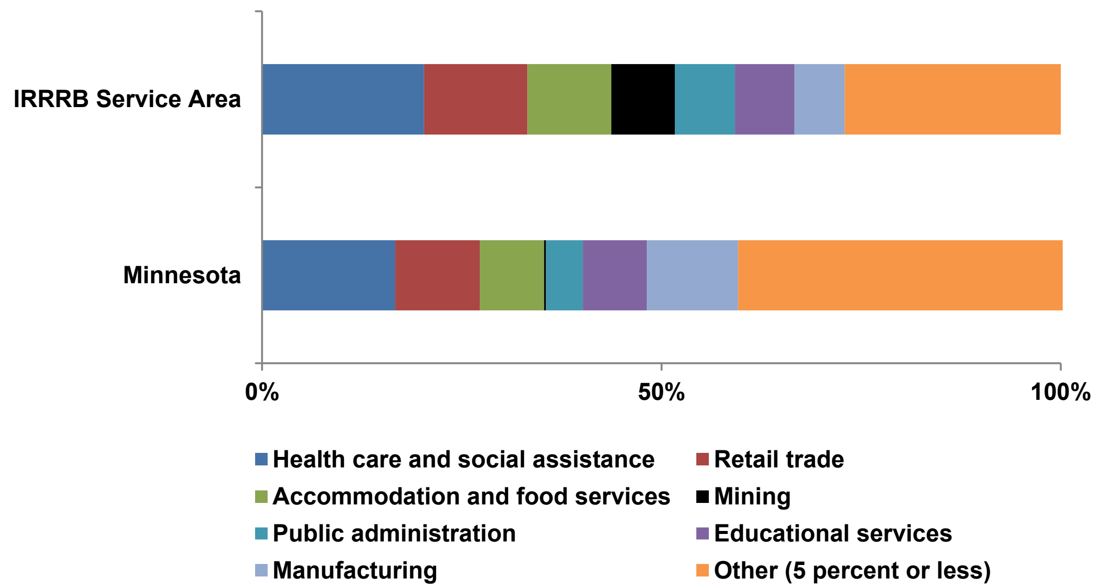
[b] "Northeast Minnesota" refers here to Minnesota Economic Development Region 3. This area is larger than, and encompasses most of, the IRRRB service area. It includes all of Aitkin, Carlton, Cook, Itasca, Koochiching, Lake, and St. Louis counties, and parts of these counties that are not located in the IRRRB service area. It excludes Crow Wing County, which is in the IRRRB service area.

[c] "Outstate Minnesota" includes all Minnesota counties except for those in the seven-county metropolitan area: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington.

SOURCE: Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Quarterly Census of Employment and Wages*, 2000-2014.

the recessions that peaked in 2001 and 2009, the mining sector generated the third largest share of claims among the region's industry sectors, at 11 percent and 10 percent, respectively. The mining sector also saw major layoffs in 2015 when 2,379 mining workers filed Unemployment Insurance claims, a 584 percent increase from 2014. Mining accounted for the second largest share of Unemployment Insurance claims in the region in 2015, which had not occurred in the previous 15 years.

Exhibit 1.11: Proportion of Employment by Industry Sectors, 2014



NOTES: This exhibit shows the industry sectors that make up more than 5 percent of employment for the IRRRB service area or for Minnesota as a whole. It includes only data from firms mandated to participate in the Unemployment Insurance program, about 97 percent of national employment. Data for the IRRRB service area include all cities, towns, and unorganized territories that appear to have at least half of their geographic areas located within the IRRRB service area.

SOURCE: Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Quarterly Census of Employment and Wages*, 2000 and 2014.

In addition, the area's mining sector is concentrated in a relatively small number of firms. In 2014, the mining sector in the IRRRB service area comprised only 21 mining establishments but accounted for 18 percent of the region's payroll.[43] By comparison, the health care and social services sector, which accounted for roughly the same share of payroll and a larger share of employment, consisted of more than 400 establishments. The difference means that closures in a small number of mining sector firms could have a bigger impact on the region's economy than closures in a similar number of firms in the health care and social services sector.

[43] Minnesota Department of Employment and Economic Development and U.S. Bureau of Labor Statistics, *Quarterly Census of Employment and Wages*, 2000 and 2014. Data include all cities, towns, and unorganized territories that appear to have at least half of their geographic areas located within the IRRRB service area. An "establishment" is a firm's physical location.

Chapter 2: IRRRB Loans and Grants

A large part of the Iron Range Resources and Rehabilitation Board's (IRRRB's) economic development work in northeast Minnesota is providing funding in the form of loans and grants. IRRRB focuses loans on new or expanding businesses that propose projects to increase or diversify the economic base of the region. Its grant programs assist local governments and nonprofit organizations.[1] In fiscal year 2015, IRRRB awarded 7 loans totaling $16 million and 151 grants totaling $22.2 million, as Exhibit 2.1 shows.[2] Amounts vary from year to year, but since fiscal year 2011, the total amount of loans increased by 32 percent or $3.9 million in dollars adjusted for inflation. The amount of grants increased between fiscal years 2011 and 2015 by 77 percent or more than $9.7 million.

Exhibit 2.1: IRRRB Loans and Grants, Adjusted for Inflation, Fiscal Years 2011-2015

	Loans		Grants	
	Number	Amount	Number	Amount
2011	11	$12.1	92	$12.6
2012	9	4.6	121	13.6
2013	10	6.7	147	18.3
2014	9	36.2[a]	147	13.2
2015	7	16.0	151	22.2

NOTES: All amounts are in millions of dollars and are adjusted for inflation in 2015 dollars. Data exclude loan "guarantees," for which IRRRB guarantees a loan made to a business by a traditional lender.

[a] Loans in 2014 included a $20 million loan to construct a commercial-scale bio-chemical plant.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board, grants inventory as of June 10, 2015; fiscal year 2015 grants data; Loan Status Report as of June 4, 2015; IRRRB, *Biennial Report Fiscal Years 2013-2014*, 45-46; and IRRRB, *Biennial Report Fiscal Years 2011-2012*, 46.

OVERALL CONCLUSION

In this chapter, we evaluate IRRRB's performance regarding its grants and loans. To do this, we measured how well IRRRB has performed in terms of (1) program objectives set in law or agency policy and (2) factors deemed important in economic development literature.

[1] IRRRB issues other grants that are not part of the analysis in this chapter. Excluded are: grants to mining companies from the Taconite Economic Development Fund; grants to Giants Ridge or Minnesota Discovery Center, both of which IRRRB owns; grants that by law simply pass through IRRRB to Carlton and Koochiching counties; and special, one-time grants to school districts.

[2] As noted above, we excluded certain grants from analyses for this chapter. Due to those exclusions, the dollar amount of grants reported in this chapter differs from that in Chapter 1.

A chief reason for government economic development is to encourage added private sector activity that increases employment, wages, or production, and benefits the public at large. Academic authors suggest that public spending on economic development should focus on what private markets are unable to do.[3] Examples include programs that reduce involuntary unemployment, supply critical infrastructure, or arrange capital for business when private capital markets fail to do so. Public economic development programs offer potential for positive outcomes when they increase economic outputs—such as added jobs—that would not have occurred on their own.

For our analyses, we reviewed applicable state laws and agency policies, interviewed IRRRB staff, and surveyed a small number of loan and grant applicants. We also selected 23 grants and 16 loans to review in detail.[4]

Overall, IRRRB oversight and evaluation of its loans and grants are inadequate.

IRRRB lacks reliable information on its own programs' impacts. It cannot consistently document whether loans and grants meet their objectives. IRRRB was also inconsistent in following certain practices related to managing grants, including how the agency reviews grant applications and monitors grantees. Details on our conclusion follow. In the remainder of this chapter, we analyze IRRRB loans, grants, and IRRRB programs' collective impact on the service area.

LOANS

We begin with background information on IRRRB loans and how IRRRB processes loan applications. Following that, we analyze whether IRRRB appropriately targets its loans. Based on our analysis of loan files, we review whether loan documents contain measurable and specific objectives. Exhibit 2.2 lists the loans we analyzed. We then assess how well IRRRB loan recipients are meeting their objectives. Finally, we examine issues IRRRB faces in measuring jobs created by loan recipients and in maintaining a loan database.

Type and Number of Loans

IRRRB's primary assistance to businesses is loans, which come in different forms: direct loans, bank participation loans, and loan guarantees. The agency also has authority to offer equity investments.

Direct loans are monies that IRRRB lends directly to an eligible business. IRRRB typically offers lower interest rates than other lenders.[5] *Bank participation loans* are IRRRB

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[3] Timothy J. Bartik, "The market failure approach to regional economic development policy," *Economic Development Quarterly* 4 (November 1990): 361-362. John P. Blair, "Local Economic Development and National Growth," *Economic Development Review* (Fall 1999): 94.

[4] While these numbers were too small to allow us to generalize our findings across all of IRRRB's grants and loans, our reviews provided valuable information about projects IRRRB has subsidized. Appendix B provides further details on how we chose files for review.

[5] IRRRB's rate for direct loans is 1 percent less than U.S. government securities of a similar maturity (defined as when the borrower pays back the principal and interest to the lender).

Exhibit 2.2: IRRRB Loans Reviewed for Evaluation, 2015

Applicant	Project Description	Amount	Loan Type[a]	Year
Birchem Logging, Inc.	Equipment purchase	$ 40,000	Bank participation	2009
Biwabik, City of	Building project for Laurentian Monument, Granite & Stone	1,940,000[b]	Direct loan	2014
Chisholm-Hibbing Airport Authority	Building improvements for business expansion	5,035,000	Direct loan	2013
Conveyor Belt Service, Inc.	Business renovation and expansion	500,000	Bank participation	2012
CrossUSA, Inc.	Equipment acquisition, leasehold improvements, employee recruitment, and other capital needs	500,000	Direct loan, forgivable	2008
Disability Specialist, Inc.	Office building construction	486,250	Direct loan (forgivable components)	2010
Ellefson Off Highway, Inc.	Business expansion	650,000	Bank participation	2012
Excelsior Energy, Inc.	Establish power plant	8,000,000	Direct loan	2004
Lutsen Mountains Corporation	Snowmaking equipment and facility upgrades	450,000	Bank participation	2013
Meyer Associates, Inc.	Establish call center	625,000	Direct loan, forgivable	2006
Niemi's, Inc. (Range Monument & Granite Company)	Building and equipment purchase for business expansion	200,000	Bank participation	2007
Northshore Manufacturing, Inc.	Business expansion	500,000	Bank participation	2013
PolyMet Mining, Inc.	Land acquisition	4,000,000	Direct loan	2011
Silicon Energy MN, LLC	Materials and supplies acquisition	1,950,000	Direct loan	2015
Silicon Energy MN, LLC	Establish solar panel manufacturing facility	1,500,000	Direct loan (forgivable components)	2010
Stone, Patricia[c]	Establish dental practice	93,333	Direct loan, forgivable	2010

[a] For bank participation loans, IRRRB purchases part of a loan that originates from a traditional lending institution and offers a lower interest rate on its portion. With forgivable loans, the agency offers to forgive a portion of the loan when the borrowing company reaches specified objectives, such as job creation thresholds.

[b] Although the original loan was for $1.9 million, $1.6 million was eventually cancelled.

[c] This loan was part of a special 2009 IRRRB Dentist Forgivable Loan program to attract dentists to practice in areas with a shortage of dentists. IRRRB forgave the loan after the borrower maintained a dental practice in the area for five years.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board loan files.

purchases of a part of a loan originating from a traditional lending institution. IRRRB offers businesses a lower interest rate for its portion of the loan.[6] Bank participation loans lower the risk to the lending institution and are less costly for IRRRB to administer. For *loan guarantees*, IRRRB offers to guarantee a loan made to a business by a traditional lender. Should a business default, IRRRB's guaranty requires the agency to repay the lender. IRRRB intends the guarantees to spur bank loans to local businesses, including some businesses (such as retail operations) that may not be eligible for IRRRB's other loan

[6] IRRRB's interest rate for bank participation loans is a minimum of 1 percent and is 3 percent less than U.S. government securities of a similar maturity.

programs. For *equity investments*, IRRRB makes direct investments in eligible companies that demonstrate extraordinary growth potential.

Loan to Patricia Stone

This $93,333 loan in 2010 was part of a special 2009 Dentist Forgivable Loan program that the IRRRB Board approved to attract dentists to practice in areas with a shortage of dentists. It was one of three such loans the IRRRB awarded.

Loans in this program differed from other IRRRB loans in that they had their own application process and were not subject to assessments of the applicants' repayment ability or adequacy of collateral. IRRRB forgave the loans after the borrowers maintained a dental practice in the area for five years.

The value of IRRRB's loan portfolio consists mostly of direct loans and, to a lesser degree, bank participation loans. From fiscal years 2011 to 2015, IRRRB awarded 17 direct loans totaling $63.1 million; it awarded 27 bank participation loans totaling $8.6 million. In fiscal year 2012, IRRRB also made a $2 million investment in a building it owned that an expanding company subsequently leased. Beyond that portfolio, IRRRB had 24 loan guaranty projects totaling $1.1 million as of August 2015. IRRRB staff said the agency had no equity investments in companies in 2015 and has rarely used this type of assistance in the past.

Loan Application Process

IRRRB has loan officers and related staff who assist businesses. They solicit companies to locate in the region using IRRRB loans or other business assistance as incentives. They also work with companies already in the IRRRB service area that want to expand their business or add equipment. IRRRB Board members may be involved in recommending potential companies to IRRRB staff.

When companies propose projects, such as a business expansion, for IRRRB business assistance, they complete a project summary form that allows loan officers to determine whether the business is eligible for assistance. On the other hand, loan officers sometimes work with eligible companies that have yet to decide whether to locate in northeast Minnesota. In these cases, staff may provide a nonbinding proposal that describes the type of assistance IRRRB might offer.

IRRRB gives priority for loans to certain business types, such as manufacturing, assembly, companies with technologically innovative projects, and companies that attract expenditures from outside the region. The agency specifies types of businesses, such as retail or service companies, that are ineligible.[7]

Eligible businesses that continue with the application process complete a full application and submit a business plan and financial reports, among other required documents. Staff review applications using board-approved criteria. Criteria include the project's anticipated economic activity and the applicant's "commitment to the business and project," which staff have defined to mean how much funding the applicant is contributing to the project.[8]

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[7] According to IRRRB's business assistance guidelines, other ineligible firms are those in transportation, media, speculative real estate, professional offices, agriculture, construction, and tourism. Prior to mid-2012, IRRRB guidelines said professional offices and retail/service businesses were eligible if they provided services that were exported from the region.

[8] Prior to June 2012, IRRRB's review criteria had a comparable criterion that was the applicants' "equity commitment."

Exhibit 2.3 lists IRRRB's criteria for reviewing loan applications. IRRRB has not set priorities among the criteria. Staff said the criteria are primarily to let an applicant know what the agency looks for during their review; they do not necessarily use the criteria as a check list when they review proposals.

Exhibit 2.3: IRRRB Criteria for Reviewing Loan Applications, 2016

Review Criteria

- Anticipated economic activity, including the creation/retention of quality jobs
- Creditworthiness of applicant including a demonstrated repayment ability
- Management capability and commitment to the business and project
- Ability to leverage other funding
- Adequate collateral coverage

NOTE: IRRRB guidelines say the agency will evaluate applications for IRRRB financial assistance using these criteria.

SOURCE: Iron Range Resources and Rehabilitation Board, "Business Assistance Guidelines," June 13, 2012.

After staff review and approve a loan application, the agency's Technical Advisory Committee reviews it. By law, the committee consists of people knowledgeable in business finance and development projects, such as bankers or investors.[9] The committee's purpose is to provide external guidance and technical advice on loan applications that IRRRB receives. In addition, the IRRRB Board and the governor must approve expenditures for loans.[10]

Following approvals, IRRRB staff negotiate contracts known as loan agreements. These contracts detail the terms of the loan, such as defining collateral, and specify obligations of IRRRB and the borrower. For example, the contracts may require borrowing companies to furnish employee data to IRRRB or maintain their business locations within the IRRRB service area. In addition, loan contracts define the conditions that would constitute default for the loan and the consequences of default. For bank participation loans, IRRRB contracts with the lender, not the borrowing company. The contracts specify legal requirements for the bank, as the lender, and IRRRB, as the participant.

[9] *Minnesota Statutes* 2015, 298.297. Although statutes require the committee to review loans funded from the Douglas J. Johnson Economic Development Fund, in practice IRRRB asks the committee to review all loans, regardless of their funding source.

[10] With consent of the IRRRB Board's chair, the commissioner can approve small loans of $500,000 or less.

"But For" Test

Economic development literature identifies the importance of determining whether a project funded with a public loan would have occurred without public assistance.[11] This concept is commonly referred to as the "but for" test; it refers here to whether companies could not complete projects but for IRRRB assistance. It is important in understanding whether public financing achieved job growth or private investment beyond what would have occurred without the public investment.

IRRRB loans go to two types of companies. One type is companies that can choose between locating within the IRRRB service area or locating outside it. A second is companies that are already in the service area, or are planning to expand there, but need assistance. For the first type, the "but for" test does not apply, as such companies can relocate elsewhere if offered incentives greater than IRRRB's. Staff at the Department of Employment and Economic Development (DEED) reported that one way they address this issue is to verify that such companies have serious, viable offers to locate elsewhere.

For the second type of companies—those located in the service area or planning to expand there—there are ways to address the "but for" test. To ensure that public programs increase the credit available to these businesses, rather than simply substitute for privately available credit, literature advises assisting creditworthy firms for which traditional lenders have denied credit.[12] The literature suggests that traditional lenders might deny credit for reasons unrelated to firms' creditworthiness. For instance, they may deny credit when information on loan viability is unavailable due to the applicant's plans to produce a new, untested type of product; when information is too costly for the lender to obtain, relative to the small size of a loan; or when loan decisions depend on characteristics, such as a business owner's race or gender, that do not relate to the viability of the loans. It is worthwhile to acknowledge that the question on availability of private credit is important but not sufficient for IRRRB loan decisions; the agency's other criteria, such as creditworthiness and collateral adequacy, also need to be part of the decision.

It was unclear whether IRRRB provided loans to certain applicants that may not have expressly needed agency funding to complete their projects.

IRRRB uses financial incentives to attract companies that are largely free to locate or expand elsewhere. IRRRB staff said such incentives are necessary for economic growth in northeast Minnesota. They also said that lending only to businesses that have been denied credit by traditional lenders would significantly limit the companies that IRRRB could potentially help retain or attract to the region. We recognize that economic development is particularly difficult in the IRRRB service area, which has stagnant population growth and lacks broad diversity in its industry sectors. Because of this, financial incentives to attract companies to the region may be a good use of IRRRB funds.

[11] Margaret E. Dewar, "Loans to Business to Encourage Rural Economic Development," *Policy Studies Journal* 20, no. 2 (June 1992), 231-232. Ben R. Craig, William E. Jackson III, and James B. Thomson, *SBA-Loan Guarantees and Local Economic Growth* (Cleveland: Federal Reserve Bank of Cleveland, April 2005), 3.

[12] Dewar, "Loans to Business to Encourage Rural Economic Development," *Policy Studies Journal*, 231; Allan Riding, Judith Madill, and George Haines, Jr., "Incrementality of SME [Small- and Medium-Sized Enterprise] Loan Guarantees," *Small Business Economics* 29 (2007), 47; and Craig, Jackson III, and Thomson, *SBA-Loan Guarantees and Local Economic Growth*, 1-3.

At the same time, IRRRB also serves companies that intend to stay or locate in the service area. However, IRRRB's stated review criteria for assessing loan applications do not include determining how much proposed projects depend on IRRRB loans to proceed. The 16 loan files we reviewed did not contain IRRRB analyses on business applicants' need for IRRRB financial help to proceed with their projects. In other words, it is not clear whether IRRRB funding was necessary for these companies to locate or expand in the region.

In response to a brief questionnaire we sent to a small number of companies that obtained IRRRB loans, some companies indicated they would have proceeded with their projects had they not received the loans. One company reported that, without the IRRRB loan, the company would have proceeded with its business expansion project, but it would likely have had to change the project's scale. A second company said that, had IRRRB assistance not been available, the company would have proceeded with the project as planned and diverted funds from elsewhere. The cases are interesting because they suggest that IRRRB's funding in these cases may have taken the place of other private sector financing, meaning the projects did not meet the "but for" test. However, responses came from a limited number of cases, and we cannot use them to generalize about other loan applications.

RECOMMENDATION

IRRRB should explicitly analyze to what extent loan applicants can complete projects without IRRRB funding.

Among its loan review criteria, IRRRB should include a criterion to address the degree to which proposed projects need public assistance. IRRRB should document whether loan applications meet this criterion, along with the agency's other loan criteria (such as creditworthiness). IRRRB should also explain the reasons why the need for public assistance mattered or did not matter in making its loan decisions.

In some cases, IRRRB awards loans with the intent of attracting business that could locate outside the region. When IRRRB determines that business applicants could readily locate elsewhere, the "but for" test would not apply. In these cases, the agency should still explain its rationale for providing financial incentives, as a matter of transparency and accountability.

For other applications, IRRRB should evaluate the necessity of public funding and focus loan approvals on companies that meet this and the agency's other loan criteria. Doing so allows IRRRB to assess whether its loans contribute to regional economic growth that would occur only with its loans. One way to do this is to target companies that are viable for credit but that were denied funding by other lenders. Such companies might include small businesses, start-up businesses, or companies that would help diversify the economy by using a new process or producing a new type of product.

Objectives for Loans

Both state law and economic development literature describe the importance of specifying objectives in loan contracts. State statutes require that "subsidy agreements" for loans to businesses contain measurable and specific objectives for the public subsidy.[13] In addition to any other objectives, statutes require that agreements include objectives for the number of jobs to be created.[14]

Economic development literature establishes the importance of writing explicit and detailed contracts with binding requirements conditioned on recipients meeting objectives, such as job growth.[15] Without such requirements, job creation can become a lower priority than other objectives, such as maximizing shareholder profits. As an example of binding contracts, staff at the Department of Employment and Economic Development reported that, for the department's Job Creation Fund, the department includes in its contracts with companies the number of jobs to be created, among other objectives.[16] They said that companies receive the business assistance only after the firms submit evidence (including payroll records) of having produced the promised jobs.

Most of the IRRRB loan contracts we reviewed did not adequately specify project objectives, such as for job growth, as state law requires.

Most IRRRB loan applications we reviewed included job creation as one of the projects' objectives, but the loan contracts did not specify numbers of jobs to create. Of 16 loans we reviewed, 10 companies had forecast job growth in their loan *applications,* but the loan *contracts* did not require them to create jobs.[17] The ten included four direct loans. For example, for a $1.9 million loan to a company seeking to expand its business and build a new facility, the loan contract did not include job creation objectives, even though application materials and IRRRB Board documents stated that the company expected to add 12 to 15 new jobs. The remaining six were bank participation loans. As stated earlier, for bank participation loans, IRRRB contracts with the lender, not the borrowing company, and none of these loan contracts included objectives for job retention or creation. The borrowing companies have no legal obligation to create or retain jobs, even though the companies' job estimates were in the application documents and related board materials.

Loan to PolyMet Mining, Inc.

The loan agreement for a $4 million IRRRB direct loan to PolyMet Mining, Inc., in 2011 included provisions for job creation. The loan was intended to help PolyMet Mining acquire land it could later exchange with the U.S. Forest Service for other land the company needed for its planned mining project. The loan agreement specified an objective that PolyMet would employ approximately 15 full-time employees, at wages of at least $15 per hour and paid leave and sick time, within two years of the term of the loan agreement. If the company did not meet the objective, the contract specified that IRRRB could seek repayment of the loan.

[13] *Minnesota Statutes* 2015, 116J.994, subd. 3(a)(3). The requirement applies to projects with subsidies of at least $150,000. Fourteen of the 16 loans we reviewed exceeded this amount.

[14] *Minnesota Statutes* 2015, 116J.994, subd. 4.

[15] Rachel Weber, "Why Local Economic Development Incentives Don't Create Jobs: The Role of Corporate Governance," *The Urban Lawyer* 32, no.1 (Winter 2000): 110-111, 116. Kary L. Moss, "The Privatizing of Public Wealth," *Fordham Urban Law Journal* 23, no.1 (1995): 141, 145.

[16] The Job Creation Fund is a state program providing incentives to eligible companies that meet certain targets for job creation and capital investment.

[17] One of the projects had no job-growth objectives and, therefore, we would not expect it to have a loan contract containing numbers of jobs to be created.

Loan contracts for forgivable loans we reviewed contained specific requirements on numbers and timing of jobs to be created. Five of the 16 loans we reviewed had loan contracts that specified the number of jobs to be generated. Four of these five were structured to forgive a portion of the loan if the company reached specified objectives, such as job-creation thresholds.

For some forgivable loans we reviewed, IRRRB amended loan contracts to lower job thresholds when companies did not meet the original job-creation objectives. As an example, the contract for a $625,000 loan to establish a business in the service area specified that IRRRB would forgive $25,000 of the loan if the business employed 70 qualified employees in 2009. IRRRB later amended the contract to forgive the same amount if the company employed just 50 qualified employees that year. IRRRB staff said accepting lower job creation is preferable to declaring a loan in default and possibly losing whatever jobs had been created.

Meeting Loans' Objectives

The success of IRRRB loans can be measured in part by how well the funded projects achieve their stated objectives. For IRRRB loans, the loan contracts specify certain objectives, while loan applications contain others. Agency staff typically track results as they monitor the ongoing projects, but IRRRB does not consistently require final reports on the projects. By contrast, for the Department of Employment and Economic Development's Minnesota Investment Fund, department staff said they require close-out forms, which compare projected and actual jobs and wages for the funded projects.

Many loan files we reviewed contained no evidence that businesses met job-growth objectives listed in their loan applications or contracts.

More of the loan projects we reviewed did not meet their job objectives than did, based on comparisons of loan contracts and applications with data that IRRRB collects on job growth.[18] Among 16 companies with IRRRB loans, 15 had contracts or applications with job-creation objectives, but 7 had not met their objectives.[19] Three of these seven companies went out of business without meeting their job objectives, and a fourth is on the verge of liquidating, according to IRRRB staff. One company that had received a $200,000 loan was planning to purchase equipment and expand its product line; when the company failed, IRRRB had to write off $7,900. The other three of the seven failed to create jobs by certain dates, as specified in loan contracts or application materials.

Only two companies of those we reviewed have shown job growth aligned with their objectives. One received a $4 million loan in 2011 for land acquisition. Data from the company showed three more employees in 2015 than 2012 (the first year of reporting). The second company with job growth received a $5 million loan in 2013 to modify a building for a business expansion. Jobs data reported by the company show an increase of 18 full-time-equivalent employees between 2014 and 2015. However, it is unclear how many of

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18 Data on job growth come from IRRRB's annual "jobs audit," which relies on loan recipients' self-reported job numbers. More information on the jobs audit follows later in this chapter.

19 As Appendix B describes, many, but not all, of the loans OLA reviewed were selected randomly. OLA selected four loans from 2007-2010 that were forgiven, foreclosed, delinquent, or written off. In addition, OLA selected three loans due to their high visibility—Excelsior Energy, Silicon Energy, and Meyer and Associates.

the reported jobs are attributable to the 2013 loan, because the company had also benefited from a loan the prior year, which may explain some part of the increase. The company occupied the refurbished building late in 2014 and expected to add jobs over the following three to five years; loan documents do not specify when the jobs are to be in place.

It is too early to know results for another 6 of the 15 loans with job-creation objectives. For these projects, companies are to meet job objectives sometime in future years (2017 or by dates unspecified). Four of the six, however, have so far reported declining numbers of full-time-equivalent (FTE) employees instead of job growth. As an example, one $500,000 bank participation loan in 2013 went to a business that planned to expand and had projected creating 6 new jobs while retaining 60 others. A year after receiving the loan, however, the company reported 55 FTEs—no job growth, and 5 fewer jobs than the original 60 to be retained.

The final loan of the 16 that OLA reviewed did not contain objectives for job growth, nor was it required to do so. The loan contract required only that the recipient establish and maintain a dental practice; when that objective was met, IRRRB fully forgave the loan.

State law says a borrowing company that fails to meet the terms of the contract may not receive another business subsidy from the granting agency for five years or until it meets its repayment obligation.[20] IRRRB's loan contracts for direct loans and bank participation loans contain no sanctions when job-creation objectives go unmet. IRRRB staff told us that the agency does not ordinarily prohibit loan recipients who were unable to create the promised jobs from applying for future assistance. One company among those we reviewed received a second IRRRB loan within five years of its first loan, despite not having met the original job-creation objectives.

RECOMMENDATION

IRRRB should redesign its loan program by adding incentives for companies to meet job-creation objectives.

Because job creation is a primary objective of many IRRRB loans, the agency should take additional steps to ensure its loans actually create jobs. For direct loans, contracts should include specific thresholds for the number of jobs the company is to generate. These provisions could be similar to the loan contract language the agency now employs for its forgivable loans. If a company does not meet all of its objectives for job creation or retention, IRRRB should amend the loan contract, such as reducing the public assistance accordingly.

As an alternative, IRRRB could impose conditions that allow loan advances only after companies meet job-creation targets. IRRRB would disburse the loan once it receives evidence that the company created the promised jobs. This makes job creation an obligation that must be met before the company receives assistance. A potential downside to this option is that certain businesses may need financial assistance immediately and cannot wait to receive it until after they create jobs. IRRRB should explore whether such businesses could either self-finance their expansion for the short-term or work with a

[20] *Minnesota Statutes* 2015, 116J.994, subd. 6(b).

traditional lending institution for capital that borrowers would repay once they receive the IRRRB loan.

For bank participation loans with job-creation objectives, IRRRB needs to take an additional step, because it does not have contractual relationships with the borrowing companies. This could require IRRRB to base such assistance on companies first meeting their stated objectives or to develop contracts directly with the companies in addition to the lending institutions.

Measuring Job Creation

State statutes require businesses receiving public loans to provide the lending agency with information on their projects' goals and results.[21] An accurate count of jobs created or retained with assistance from IRRRB-funded projects is important to understanding the agency's success. Department of Employment and Economic Development (DEED) staff reported that, for projects assisted through the department's Job Creation Fund, DEED requires payroll reports with job counts from the business over time. They also said staff analyze Unemployment Insurance program records and credit reports to ensure the company has met its job-creation objectives within the state.[22] DEED staff said they require six-month progress reports and annual reports on their funded projects.

IRRRB practices for measuring job creation are inadequate.

With the exception of forgivable loans, IRRRB does not have reliable records of numbers of jobs created or retained by projects it has funded. When applicants apply for loans, they estimate the number of jobs their projects will create or retain. IRRRB staff do not require companies to submit interim or final reports that could provide information on jobs created due to the project. By contrast, when IRRRB offers a forgivable loan, staff monitor job creation more closely. For loan forgiveness that depends on creating a certain number of jobs, staff require the company to produce employment rosters and other data (such as names and wages of individual new employees) needed to verify that the company met its obligations.

For loans without forgiveness provisions, IRRRB depends on an annual "job audit" to determine whether companies created jobs. The audit consists of a questionnaire sent annually via e-mail by IRRRB to loan recipients. The questionnaire asks for employment levels as of July 1 for part-time and full-time positions, as well as total full-time-equivalent staff, among other things.

The job audit does not produce useful and reliable data on job creation. First, IRRRB does not require companies to respond to the audit questionnaire. Some companies report one year, but not others, which makes it difficult to analyze trends. Other companies do not respond at all; for example, in fiscal year 2014, of 105 companies queried, nearly 1 in 5 either indicated they would not respond or had not responded by the end of the year. Second, staff do not verify the job numbers that companies self-report on the questionnaire. Third, the job audit does not indicate *when* a company created the jobs it reports.

[21] *Minnesota Statutes* 2015, 116J.994, subd. 7. The requirement does not apply to loans under $150,000.

[22] Unemployment Insurance records provide data on establishments' number of employees and wages paid; they can be used as a check on employment reports from companies.

Consequently, data do not show whether companies created jobs for the full year or a portion of it. In addition, the timetable for reporting jobs is not specific enough to determine whether jobs increased before or after companies completed their projects. Fourth, the questionnaire asks for general wage information, but its data lack the specificity needed to tie wages to jobs created. Finally, staff are not required to take action if they determine from the job audit that a company is not meeting its job-creation objective.

RECOMMENDATION

IRRRB should improve its methods of measuring loan recipients' job creation.

To make job-creation data more reliable, IRRRB should improve both the collection and analysis of IRRRB data. Possibilities include requiring loan recipients to provide interim and final reports containing job data and comparing the job numbers over time. Some of the same steps IRRRB now takes to monitor forgivable loans, such as requiring a company to furnish employee rosters and start dates, could be used more extensively for other direct loans.

Employment data should distinguish between jobs that have been retained or created since the loan; timing is important to understanding whether IRRRB's loan had an impact. Data should also distinguish between short-term jobs, such as construction jobs, and jobs that have more permanence. To the extent possible, IRRRB should avoid relying solely on self-reported data from loan recipients; it should verify job data that are self-reported. In some situations, IRRRB can do this using Unemployment Insurance data to review numbers of employees before and after a business receives a loan.

Improvements in data collection and analysis could take more time than IRRRB staff may have dedicated in the past. At the same time, the investment will provide IRRRB with reliable data on job creation as it begins efforts to measure its success in economic development. IRRRB could consider verifying a sample of the self-reported data to minimize the magnitude of the effort.

IRRRB staff voiced hesitation about requiring more data from private companies, fearing the agency's additional requests will deter companies that are contemplating building or expanding on the Iron Range. We acknowledge that some companies may be less willing to accept public assistance when they are required to report data in return. Nonetheless, accountability of public dollars requires an accurate and reliable tracking of public benefits gained from the business assistance provided. In addition, the agency could take steps to prepare loan recipients for the data request and ease the burden of responding. When negotiating loan contracts, IRRRB should make clear the need for follow-up data. This could be a requirement in loan contracts, just as contracts now require other information, such as a copy of the company's articles of incorporation.

Loan Database

IRRRB's loan database, created in 1987, contains the agency's inventory of loans. Currently, the database is used primarily by support staff and less so by loan officers.

IRRRB cannot systematically evaluate its loan program, because the agency does not maintain an accurate database of its loans and their status.

To evaluate the impact of its loans, IRRRB needs reliable data, which the existing loan database does not provide. IRRRB staff called the loan database archaic and said it needs to be improved if it is going to continue to be used to manage the agency's loan portfolio. Even staff who work with the loans daily said they did not know what certain loan numbers represent. The database contains codes that no current staff use or understand. Staff also said the loan database does not reflect changes that should occur following loan defaults. For instance, the database does not show that a loan in default means the borrower must pay a higher interest rate than originally set. Nor does it reflect that a loan in default consists of the balance of principal plus the accrued interest. Agency staff look to sources other than the loan database to compile a reliable number of loans for the agency's biennial reports. Furthermore, the database does not include fields for important data, such as number of jobs created, that the agency would need if it were to use the data to evaluate its loans or analyze impacts of IRRRB's loan program.

IRRRB's loan database contains duplicate records. Staff assign unique loan numbers to loans in the database, but in some cases, a single loan has multiple loan numbers. For example, IRRRB approved two loans with forgivable components in 2006 to a company establishing a new operation in northeast Minnesota. In the loan database, the project was assigned five loan numbers due to its forgiveness provisions, and it appeared in the database as five separate records.

RECOMMENDATION

IRRRB should maintain an accurate database for tracking its loans.

Because IRRRB staff can no longer rely on the existing loan database to track its loan portfolio, the agency should either update it or replace it. Staff told us the agency has been discussing the need to improve the database. Given the current database's age and lack of utility, we suggest making this a priority.

A successful option would accommodate the needs of both support staff (who record payments) and loan officers and others (who monitor activities related to loans). IRRRB should also develop a database that the agency can use to evaluate loan performance and the loans' impacts on the regional economy. This would require information such as previous loan history and number of verified jobs created. Analyzing such data would substantially improve the database's usefulness.

Technology-information systems often require significant investments of time and money. Because a workable database will need to accommodate complex IRRRB loan packages, the agency should plan now for the investment.

GRANTS

In this section, we first briefly describe IRRRB grant programs and the agency's process for grant application and approval. Then we analyze whether IRRRB grants we reviewed have measurable, specific objectives and how well the grants meet their objectives. Exhibit 2.4 lists the grants we reviewed. We also compare IRRRB grant policies with how staff manage grant programs. The final part in this section reviews the practice of many IRRRB grant programs to require matching funds.

Exhibit 2.4: IRRRB Grants Reviewed for Evaluation, 2015

Applicant	Project Description	Grant Program	Amount	Year
Aurora, City of	Street, water, sewer infrastructure reconstruction	Public Works	$ 250,000	2013
Bigfork Valley Community Foundation	Bigfork River Walk trail design and engineering	Culture and Tourism	15,650	2014
Calumet, City of	Emergency services building construction	Public Works	350,000	2014
Central Iron Range Sanitary Sewer District	Waste treatment facility and sewer line construction	Public Works	500,000	2012
Central Iron Range Sanitary Sewer District	Wastewater treatment facilities demolition	Commercial Redevelopment	150,000	2014
Chisholm, City of	Street infrastructure improvements	Public Works	245,000	2015
Chisholm-Hibbing Airport Authority	Hangar remodel for Life Link III	Public Works	100,000	2011
Clinton Township	Broadband expansion project	Public Works	1,500,000	2015
Cohasset, City of	Road and utility expansion for industrial park	Public Works	250,000	2015
Cook County Higher Education	Education and training programs development	Education-Workforce Development	50,000	2013
Effie, City of	Highway reconstruction	Public Works	20,000	2012
Eveleth, City of	Building demolition	Commercial Redevelopment	70,000	2010
Eveleth, City of	City auditorium improvements	Commissioner	50,000	2012
Friends of Sax Zim Bog	Welcome center construction	Culture & Tourism	12,500	2013
Iron Range Engineering	Higher education program	Higher Education Account	1,890,000	2012
Iron Range Engineering	Higher education program	Higher Education Account	1,000,000	2013
Iron Range Engineering	Higher education program	Higher Education Account	1,000,000	2014
Lake Superior-Poplar River Water District	Waterline construction	Public Works	250,000	2013
Mountain Iron, City of	Infrastructure for housing addition	Public Works	250,000	2013
Riverwood Healthcare Center	Expand and renovate hospital space	Public Works	250,000	2010
Strange Productions LLC	Film production	Film Production Incentive	21,500	2014
Virginia, City of	Infrastructure for Menards, Culvers, and Iron Trail Motors expansion	Public Works	300,000	2010
Virginia, City of	Infrastructure for Sundell Eye Associates	Public Works	150,000	2012

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board grant files.

Type and Number of Grants

IRRRB offered 13 grant programs in fiscal year 2016.[23] For example, Public Works grants fund municipalities' public works infrastructure projects. The Culture and Tourism grant program funds art, culture, heritage, and recreational projects proposed by nonprofit organizations to support the region's quality of life. Exhibit 2.5 lists grant programs for fiscal years 2011 through 2015. IRRRB has not offered each program every year; for instance, it offered a "Drilling Incentive" program for the first time in fiscal year 2016.

Exhibit 2.5: IRRRB Grant Programs, Adjusted for Inflation, Fiscal Years 2011-2015

Program	Number of Grants 2011-2015	Percentage of Total	Amount Awarded 2011-2015	Percentage of Total
Application Fund	70	11%	$ 125,925	< 1%
Commercial Redevelopment	43	7	3,678,143	5
Commissioner Program	62	9	2,356,248	3
Comprehensive Plan Updates	30	5	283,291	< 1
Culture and Tourism	88	13	827,288	1
Development Partnerships	16	2	471,090	1
Education/Workforce Development	32	5	14,678,870	18
Film Production Incentive	12	2	150,022	< 1
Laurentian Vision Partnership	8	1	694,308	1
Other[a]	52	8	9,236,158	12
Public Works	194	29	46,333,402	58
Residential Redevelopment	51	8	860,623	1
Total	658	100%	$79,695,366	100%

NOTES: Amounts are adjusted for inflation to 2015 dollars. Grant programs may differ from year to year; for instance, IRRRB offered a Mining Impact program in only fiscal years 2015-16. IRRRB also offered a Drilling Incentive program in fiscal year 2016, which had not been in place earlier. The exhibit excludes the Business Energy Retrofit program because, even though IRRRB provided funding, a different organization awarded the grants. Percentages do not sum to 100 due to rounding.

[a] "Other" is relatively large in part because it includes special public works grants approved by the Legislature for only fiscal year 2013. The category also includes renewable energy grants from fiscal years 2011-2012, among other one-time grants.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board grants inventory as of June 10, 2015, and fiscal year 2015 grants data.

In the period between fiscal years 2011 and 2015, IRRRB awarded the largest number of its grants through its Public Works grant program, including infrastructure grants for economic development and community development. During those five years, IRRRB issued 658 grants from all of its grant programs, and 194 (29 percent) were from the Public Works grant program. In terms of dollars, Public Works grants were also the largest, totaling $45.5 million, or 58 percent of the total awarded between 2011 and 2015.[24] Exhibit 2.5 displays the numbers and amounts of grants for this period.

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[23] IRRRB also funded an additional grant program called Business Energy Retrofit, but we do not include it here because another organization operated the program, and IRRRB did not award the grants.

[24] Sums are in nominal dollars that are not adjusted for inflation over that five-year period.

Grant Application Process

IRRRB announces the availability of program grants each year on its website. For most programs, applicants can download application forms from the site. In fiscal year 2016, most grant programs had application deadlines as of end of August 2015. However, IRRRB staff consider applications arriving after the deadline if program funds remain. Each grant program has an IRRRB grant administrator overseeing its administration. Although staff manage the application process, IRRRB Board members might identify potential projects in their legislative districts and recommend that their communities submit applications for IRRRB grants.

IRRRB staff review grant applications for eligibility. Each program has its own eligibility criteria for applicants. As an example, for the Commercial Redevelopment grant program, all cities, townships, and counties in the service area are eligible. By contrast, for the Culture and Tourism grant program, only nonprofit organizations are eligible. Many grant programs also have criteria that define types of eligible projects. For example, Commercial Redevelopment grants are available only for demolishing dilapidated commercial or industrial buildings and cleaning up brownfields.

After determining a project's eligibility, IRRRB grant administrators prepare the proposal for upper management review by describing the grant request and any issues it raises. Beginning in fiscal year 2016, grant administrators also scored projects to show that projects met eligibility requirements and to assign a numerical score for each of several review criteria that often varied by program.

Following staff assessments, upper management review the forms and sign off on projects they approve. For Public Works grants, projects also require IRRRB Board approval. After approval, program staff prepare a contract, known as a "grant agreement," which describes the project and the recipient's obligations; they submit the contract first for internal approval and then to the applicants for their signatures.

Objectives for Grants

As noted earlier, economic development literature emphasizes the need to write detailed contracts that require recipients to meet their projects' objectives. In addition, for businesses receiving public subsidies of more than $150,000, state law requires subsidy agreements to specify measurable and specific objectives as well as objectives for the number of jobs created.[25] This law applies to businesses, not municipalities. However, we believe the concept of specifying objectives is sound for all subsidies, regardless of the recipient.

[25] *Minnesota Statutes* 2015, 116J.994, subds. 3(a)(3) and 4.

Many grant contracts we reviewed for projects that included job-creation objectives did not adequately specify these objectives.

Not all IRRRB grant projects are intended to create jobs, but among those we reviewed, we looked for those with applications that referred to job growth or retention.[26] IRRRB's grant *contracts* do not themselves contain numbers of jobs the projects are expected to create or retain, even though *applications* often do. Unlike loan contracts, grant contracts contain language stating that the application is "incorporated into" the contract, and the recipient will perform its duties in "accordance with the plans and specifications" in its application. Thus, the application and its forecasted jobs (when specified) become part of the contract.

Of 23 grant applications we reviewed, 17 included job-creation objectives. Among those 17 applications, 7 contained only vague or imprecise references to jobs, or they did not distinguish jobs directly related to the project from indirect jobs. For example, an application for a water infrastructure project stated that the project "will protect jobs by providing needed irrigation water." In another example, a grant application for roadwork and utilities to an industrial park stated the project would create 75 to 100 jobs after new commercial operations were built in the industrial park. The job estimate was based on the possibility of job prospects in the distant future instead of jobs directly related to the project.

Meeting Grants' Objectives

The success of grant projects is measured in part by how well projects achieve their stated objectives. For IRRRB grants, application materials and grant contracts lay out objectives; final reports submitted by recipients provide information on what was actually achieved.

Many grant files we reviewed contained limited or no evidence that projects achieved their objectives.

Each grant file we reviewed included a grant contract that specified actions the applicant agreed to take in exchange for IRRRB funding. Not all grant files, however, had information on whether the actions were taken or objectives were met.

Eighteen of the 23 grant files we reviewed described projects that had been completed at the time of our analysis, of which 8 had no clear information on meeting objectives. As an example, one city received a $20,000 grant in fiscal year 2012 for highway reconstruction. Among project objectives in the city's application was the creation of 10 to 15 full-time-equivalent construction jobs at a payroll of $300,000. The city also expected the project to add new development. However, IRRRB's project file contained no evidence of whether construction was completed or objectives were met. IRRRB staff verified that the grant file did not contain the required monitoring form or final report to indicate whether the project met its objectives.

Another nine grant project files contained at least some evidence that objectives had been met. Of those, six grant files had reasonably complete evidence. As an example, a city

[26] For some IRRRB grant programs, applications specify that job creation is a criterion IRRRB uses to evaluate proposals; in some, IRRRB includes job creation in the definition of project eligibility.

received a $250,000 grant in 2013 for replacing street, sewer, and water infrastructure. The city estimated the project would create 3.5 full-time-equivalent construction jobs and correct a serious health and safety hazard caused by deteriorating utility lines. In a final report on the project, the city reported that the project had created 3.5 full-time-equivalent construction jobs and corrected the safety issue.

On the other hand, of the eight grant projects with performance data, three contained only partial evidence on how well projects met objectives. The three were grants for Iron Range Engineering, a MnSCU program offered at Mesabi Range College in Virginia to allow students to earn a Bachelor of Science degree through Minnesota State University-Mankato. The project's grant contracts state a single broad objective: continue to develop an engineering program that "will allow students to earn a Bachelor of Science degree in engineering from Minnesota State University at Mankato."[27] Files for the Iron Range Engineering grants contained program expenditure data but lacked specific targets to assess how well the program is meeting its objective. For instance, files included only partial enrollment and graduation data and did not include narrative information or targets for program enrollment, graduation rates, or the impact on industries seeking engineers.

The remaining grant of the 18 completed projects that we reviewed was for a project funded through IRRRB's Film Production Incentive Grant program. For this program, the application form does not require applicants to set targets for job creation or other objectives. However, the file contained evidence that the project created 1.8 full-time-equivalent jobs on a short-term basis.

RECOMMENDATION

IRRRB should more consistently determine how well its grants meet their objectives.

Tracking how well IRRRB grants meet their objectives is an important first step to understanding how well agency grants enhance economic development in the region. In most cases, this requires ensuring that final reports from grant recipients are sufficiently specific that IRRRB staff can compare actual results with forecasted results in grant applications. For grant projects that require staff to submit progress reports, IRRRB should ensure these reports address progress on the objectives specified in application materials and grant contracts.

IRRRB Policies on Managing Grants

Minnesota's Office of Grants Management has recommended practices to state agencies for appropriate management of state grants. Based on those recommended practices, IRRRB developed a *Grants Policy and Procedure Manual*.[28] Policies in the manual pertain to many aspects of managing IRRRB grants, including advertising the programs and paying

[27] Iron Range Resources and Rehabilitation Board, "State Of Minnesota Grant Agreement [between the State of Minnesota and the Northeast Higher Education District]," September 29, 2014, 1.

[28] Iron Range Resources, *Grants Policy and Procedure Manual*, (Eveleth, February 17, 2010). This manual was in place through fiscal year 2015; it was updated in August 2015, but in general we evaluated grants based on the 2010 edition because its policies applied to the grants we reviewed.

grant recipients. Exhibit 2.6 summarizes a select sample of IRRRB's grant policies. Some IRRRB policies apply to only competitive grants, while other policies apply to all types of grants.[29] We analyzed how IRRRB staff applied several grant policies. In addition, we asked a small number of grant applicants for their perspectives on the application process.[30] Some said they did not fully understand the criteria IRRRB used to evaluate their grant applications.

Exhibit 2.6: Select IRRRB Policies for Administering Grants, 2015

Policy	Type of Grant[a]
• Grant announcements are to be publicized throughout the service area.	Competitive
• Essential elements of a notice of a grant opportunity are to include: a description of the grant program, eligibility requirements for applicants, grant outcome expectations and reporting requirements, selection criteria and weights, and general information about the review process.	Competitive
• A ranking system is to be used to measure how well the application meets grant program criteria. Applications are ranked based on: criteria that meet the grant program priorities, reviewer observations, and reviewer meetings and discussion.	Competitive
• State employees are required to monitor the grant project through all phases of the project until it is complete. Monitoring includes the receipt and review of business plans, development agreements, bid tabulations, exhibits, media information, correspondence, and site visit reports.	All grants
• The grant recipient is to submit a final report and, if applicable, a site visit may be conducted upon completion of the project. The final report, staff evaluation comments, and the site visit form are maintained in the grant file.	All grants
• Grant payments are to be made on a cost-reimbursement basis, except where the grant agreement allows for the advancement of funds before the recipient actually incurs the expense.	All grants

NOTES: This exhibit provides information from IRRRB's grants manual used up to August 2015, when IRRRB updated the manual. We list policies and procedures from this manual because they applied to the grants the Office of the Legislative Auditor reviewed.

[a] IRRRB defines *competitive* grants as grants in a cyclic process involving a call for proposals, an application deadline, and published criteria. Minnesota's Office of Grants Management adds to this definition, saying competitive grants are awarded to applicants that are rated the highest against selection criteria, based on availability of grant funds. By contrast, *noncompetitive* grants are received throughout the year and are individually evaluated on a case-by-case basis using broad criteria that advance agency objectives and interests.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board, *Grants Policy and Procedures Manual,* February 2010.

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[29] IRRRB defines *competitive* grants as those in a cyclic process involving a call for proposals, an application deadline, and published criteria. Minnesota's Office of Grants Management's definition adds that competitive grants go to applicants who rate the highest against selection criteria, based on availability of grant funding. By contrast, agencies receive *noncompetitive* grant applications throughout the year and individually evaluate them on a case-by-case basis using broad criteria that advance agency objectives and interests.

[30] We sent questionnaires to six municipalities that had applied in fiscal year 2015 to IRRRB and been turned down; some reapplied in fiscal year 2016 and were subsequently awarded a grant. Five communities responded, which is a number too small to generalize conclusions across all applicants. At the same time, user perspectives are an important component to understanding IRRRB's application process.

Some IRRRB grant programs do not consistently follow agency policies on evaluating applications, monitoring project activities, issuing payments, or publicizing the programs.

IRRRB staff were inconsistent in following certain policies for grant files we reviewed, and we observed other inconsistencies for additional grants. We describe specific instances below.

Evaluating Grant Applications

One IRRRB policy requires the agency to evaluate grant applications by (1) rating how well applications meet grant program criteria and (2) ranking qualifying projects based on the criteria and staff observations. Standardized scoring is important to ensure that staff compare projects uniformly and that projects of a similar nature have an equal chance of being funded. Through fiscal year 2015, IRRRB did not require staff to score and rank applications for any of its competitive programs.[31] Instead, staff reviewed applications for eligibility and funded all eligible projects until funding ran out. In fiscal year 2016, IRRRB instituted a system for scoring competitive applications. However, some IRRRB staff said not all staff have been consistent in scoring program applications.

Our review of applications for Public Works grants showed that IRRRB had not consistently followed its own policy on evaluating grant applications. At the December 2015 meeting of the IRRRB Board, staff presented for board consideration eight Public Works grant proposals, none of which staff had scored or preapproved with funding recommendations, as policies required. Staff later scored the projects subsequent to the board meeting.

Monitoring Grant Projects

A second IRRRB policy requires staff to monitor grant projects through all of their phases until they are complete. Monitoring ensures that grantees make progress toward their goals and staff address problems prior to the end of the grant period. One provision of monitoring is that IRRRB staff are to file annual progress reports for each project. Only 3 of the 20 grants that we reviewed, and that were required to have progress reports, actually had them.

Furthermore, the monitoring policy requires grant recipients to provide a final report upon their projects' completion. Five of 19 grant files we reviewed that were required to have final reports did not. Not all of IRRRB's grant programs have required grantees to submit final reports, even though the policy applies to all grant programs. The Education-Workforce Development program did not have a final report form from at least fiscal year 2012 through 2014. In addition, IRRRB has not required a final report for grants awarded from the Iron Range Higher Education Account. IRRRB staff said the process differs for these grants because they receive a high level of scrutiny from the Iron Range Higher Education Committee; however, the policy makes no exception to the requirement for final reports.

[31] For criteria on how IRRRB evaluates its grant applications, we looked at policies in place for both fiscal years 2015 and 2016.

Paying Grant Recipients

A third policy requires IRRRB to issue grant payments on a reimbursement basis, except when a grant contract specifically allows funds to be advanced before project costs are incurred. Reimbursements are the preferred way to pay grants, according to the Office of Grants Management, because the state can compare each reimbursement against the project's approved budget and identify ineligible expenditures before making payments.[32]

Although the policy on reimbursements applies to all types of IRRRB grants, not all IRRRB grant programs have complied. For example, through June 2015, the Education-Workforce Development program did not provide funding based on reimbursements; instead, IRRRB paid the grants before grant recipients incurred expenses.[33] In addition, the Higher Education Account provided funds in advance, instead of on a reimbursement basis.

Publicizing Grant Programs

A fourth IRRRB policy requires the agency to publicize grant programs throughout the IRRRB service area. The policy also specifies the types of information, such as a program description and selection criteria, that should be in the publicized notice. Publication materials for some of the competitive programs do not contain all of the recommended information. For instance, web pages on the Residential Redevelopment grant program do not include information on the selection criteria and weights to be used in selecting applications, even though policies require this.

RECOMMENDATION

IRRRB should ensure that all of its grant programs comply with the policies that apply to them.

IRRRB intends its *Grants Policy and Procedure Manual* to present the guiding policy requirements that serve as the basis for the agency's grant making. Having policies in place is a necessary first step, but that is insufficient unless the agency implements the policies consistently. Doing so brings fairness and accountability to the distribution of public money. Policies that are consistently applied also offer a structure that all applicants can follow when applying for IRRRB's grants. IRRRB staff explained that the agency has been exploring new software for managing grants and expects to implement it in 2016.

Although IRRRB staff explained why some programs were administered differently from others, in our judgment, the program differences did not outweigh the need to consistently follow agreed-upon policies and procedures. If IRRRB believes it should administer certain grant programs differently, its grant manual should specify the differences.

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[32] Office of Grants Management, "Policy 08-08: Grant Payments," *Current Policies* (St. Paul: October 11, 2013), http://mn.gov/admin/government/grants/policies-statutes-forms/index.jsp, accessed February 8, 2016.

[33] In 2015, the IRRRB considered creating a system of quarterly reimbursements for grants from the Education-Workforce Development program; staff reported that the agency is awaiting the outcomes of this evaluation before proceeding.

Matching Funds for Grants

For many of its grant programs, IRRRB requires applicants to match the agency's grant with additional resources. For instance, the Public Works grant program required applicants to provide a one-to-one match in 2016. Statutes do not require matching funds for IRRRB grants, but applications did for nine IRRRB grant programs in fiscal year 2016. Exhibit 2.7 displays the matching requirements in fiscal year 2016 by grant program. Matching funds may come from multiple sources and need not come from applicants themselves.

Exhibit 2.7: Funding Match Requirements for IRRRB Grant Programs, Fiscal Year 2016

Program	Required Match to IRRRB Funds
Application Fund	Up to 1:1
Business Energy Retrofit	1:0.33[a]
Commercial Redevelopment	1:2
Commissioner Program	Unspecified[b]
Comprehensive Plan	1:1
Culture and Tourism	1:1
Development Partnership	1:1
Drilling Incentive	1:0.4[a]
Education-Workforce Development	Unspecified
Film Production Incentive	No match required
Laurentian Vision Partnership Innovation	Unspecified
Mining Impacts	Unspecified[c]
Public Works	1:1
Residential Redevelopment	1:0.75[d]

NOTE: Ratios indicate the size of the matching funds required of the applicant relative to the IRRRB grant. For instance, a 1:2 ratio means the applicant must provide at least one-half the amount granted by IRRRB.

[a] IRRRB funds are limited to a maximum of $20,000 per project. For the Business Energy Retrofit program, IRRRB provides funding, but a nonprofit agency awards grants.

[b] This is from the fiscal year 2015 application, because the Commissioner Program had no fiscal year 2016 application form.

[c] IRRRB funds are limited to $150,000.

[d] IRRRB funds are limited to the lesser of 75 percent of project costs or $3 per square foot of the building.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board grant program application forms, Fiscal Year 2016.

In project files we reviewed, IRRRB did not consistently ensure that grant applicants provided the required matching funds.

Of the 23 grant files we reviewed, 17 were required to match grant amounts. Four of the 17 projects were still underway at the time of our review, and we removed them from this analysis. Of the remaining 13 grants, 4 had insufficient data. Two of those four had no final reports and, therefore, contained no evidence that matching funds had been paid in the expected amounts. The other two had final reports with ambiguous or incomplete evidence about additional funding sources. The remaining nine grants had matching funds in amounts that met requirements.

IRRRB does not have a verification process for routinely following up on its grant projects to determine whether the applicants' matching funds are provided in the amount stated on the application. IRRRB staff rely solely on the final reports submitted by grant recipients. This method is problematic because not all grant recipients submit final reports, and policies do not require staff to independently verify data on matching funds in the final reports.

RECOMMENDATION

IRRRB should consistently verify that grant applicants pay the required matching funds to receive agency grants.

As a matter of fairness to grant applicants, IRRRB should clarify and consistently apply its policies on applicant-matching funds. At a minimum, the agency should amend its *Grants Policy and Procedure Manual* to clarify IRRRB's policy regarding matching funds for grants. The policy should cover what staff should do when (1) grant recipients fail to provide a final report and (2) final-report data are ambiguous or inadequate. It should also specify how staff are to verify that the applicant provided the promised match. IRRRB should also describe the implications for grant recipients who do not provide a final report or provide an incomplete report. Staff should make such implications clear in grant contracts.

EVALUATION OF PROGRAMS

Literature on evaluating economic development stresses the need for rigorous evaluation to understand how to improve programs and analyze whether the programs made a difference on state or regional economies.[34] Evaluation also provides data needed to judge the outcomes achieved with public dollars, which is necessary for accountability.

IRRRB has not systematically evaluated its programs or its overall impact on the region it serves.

Despite spending millions of dollars on grants and loans each year, IRRRB does not fully evaluate its outcomes. The agency collects limited performance data on the projects it funds and little to no data on collective program results. In its biennial reports, IRRRB often lists the number of jobs that funded projects are *projected* to create, but it does not compare projections with *actual* jobs created. The reports also list the dollar amount IRRRB has invested in each project. However, since at least 2003, the biennial reports have not evaluated the performance of individual projects—such as whether job objectives were met—or overall agency impact of its projects on the IRRRB service area. Additional

[34] Timothy J. Bartik and Richard D. Bingham, "Can Economic Development Programs Be Evaluated?" Upjohn Institute Working Paper No. 95-29, (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1995) 2-3; Jeffrey Smith, "Evaluating Local Economic Development Policies: Theory and Practice," (College Park, MD: University of Maryland, January 12, 2004) 1-2, 50; and Sara Hinkley and Fiona Hsu, *Minding the Candy Store: State Audits of Economic Development,* (Washington DC: Institute on Taxation and Economic Policy, September 2000), 3.

periodic reports on IRRRB programs have listed the jobs expected and amounts of dollars invested without describing how many jobs materialized or analyzing whether investment could have occurred on its own without IRRRB assistance. In our interviews, IRRRB staff verified that the agency has not used quantitative data to measure how well overall agency performance meets its goals.

In 2015, the agency initiated a standard method intended to annually evaluate each grant and loan program. As of the fall of 2015, staff members had completed their first evaluation of the Commercial Redevelopment grant program and were in the process of evaluating two more programs.[35] Prior to this, the agency did not have a process to evaluate program performance. IRRRB had not begun to evaluate its loan program as of 2015.

RECOMMENDATION

IRRRB should regularly evaluate its loan and grant programs. IRRRB should also analyze the collective impact of its programs on IRRRB's service area.

IRRRB should evaluate its loan program and complete evaluations it has begun of its grant programs. Beyond that, IRRRB should regularly collect and analyze actual outcomes of its programs and report on the results. It should collect data that would explain its programs' economic impacts in the IRRRB service area. IRRRB should identify impacts, such as increases in jobs and investments, that would not have occurred without its programs. Evaluations of this nature are a significant undertaking. However, they are needed to provide accountability as well as demonstrate how well IRRRB is performing and achieving its goals.

[35] The completed review described the Commercial Redevelopment program's purpose and strengths and reviewed examples of how municipalities have used program grants. It also highlighted program challenges and presented recommendations for possible changes.

Chapter 3: Giants Ridge Recreation Area

The Iron Range Resources and Rehabilitation Board (IRRRB) operates a public resort called Giants Ridge Recreation Area, located in central St. Louis County. The agency also supports private real estate development within the recreation area. The area encompasses 11,500 acres of land in the municipal boundaries of the city of Biwabik and the town of White.[1] In this chapter, we provide a brief overview of Giants Ridge's history, offerings, management structure, and financial performance. We also review IRRRB's goals for Giants Ridge and the measures the agency uses to judge its performance.

HISTORY

Resort Development

Giants Ridge was developed as a ski hill by local families in the late 1950s. In 1984, during a downturn in the local mining industry, the facility fell into bankruptcy. IRRRB purchased the resort and 1,300 acres of land for $68,000 as a means to diversify the local job market.[2] IRRRB established four goals for Giants Ridge when it reopened under the agency's control:

1. Create economic development.
2. Provide recreational facilities to enhance the quality of life for people of the Iron Range.
3. Attract private sector development.
4. Create a year-round recreation destination.

Over the following decades, IRRRB improved and expanded the resort. For example, in 1984, it bought new equipment for the ski operation and built a new chalet. In 1997, Giants Ridge became a multiseason resort when IRRRB opened its first 18-hole, par-72 public golf course, called the Legend. The course received national critical acclaim. In 2000, Giants Ridge opened one of the largest disc golf courses in the country. In response to high demand for its first golf course, IRRRB opened a second course, called the Quarry, in 2003. It also received critical acclaim. The agency's most recent addition to Giants Ridge is a $9.9 million event center. When completed in mid-2016, it will replace the resort's 32-year-old chalet.

By 2015, Giants Ridge offered a wide range of amenities and programs. Its winter-season amenities included: 35 downhill runs for skiing and snowboarding, 60 kilometers of trails for cross-country skiing and fat-tire biking, 5 snowshoeing trails, 2 terrain parks, a snow

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[1] *Minnesota Statutes* 2015, 298.22, defines the specific sections of Biwabik and White that are in the Giants Ridge Recreation Area.

[2] IRRRB also paid off the facility's debt.

tubing park, and snowmobile trails. Its summer amenities included: two golf courses, a disc golf course, extensive hiking and biking trails, and outdoor equipment rentals. It also provided a number of related programs, such as ski and golf lessons and biking and hiking groups, as well as catering and several food, beverage, and event venues.

Real Estate Development

As IRRRB developed the resort's amenities, it also promoted private development in the Giants Ridge Recreation Area. The 1997 Legislature established the Giants Ridge Recreation Area to "foste[r] economic development and tourism."[3] As of 2015, IRRRB owned 1,850 acres of the area's land. The remaining acres in the area were owned by private individuals, companies, or governments, including St. Louis County and the U.S. Forest Service.

To promote private development in the Giants Ridge Recreation Area, IRRRB has purchased and sold land, invested in infrastructure, and coordinated development between local governments, developers, and private landowners. For example, in 1989, IRRRB purchased land near the resort and developed infrastructure for a lodging complex, called the Villas. The Villas are privately owned and provide on-site lodging for Giants Ridge visitors. In 1998, IRRRB developed infrastructure for a single-family and vacation housing development on the Legend Golf Course, called the Woodlands. The agency contracted with a local real estate agency to market the sale of the Woodland lots. IRRRB invested in a second lodging property, called the Lodge, which opened in 1999. Like the Villas, the Lodge is privately owned and provides on-site lodging for Giants Ridge visitors. In 2005, IRRRB helped facilitate the creation of Voyageurs Retreat, a development that includes both vacation and year-round homes. In 2009, IRRRB sold some of its land and provided grant funds for the infrastructure of the Residence Club, another vacation home development. The Residence Club is structured according to a fractional ownership model, which is similar to a time-share in that each house is shared among multiple owners. IRRRB also established an umbrella association for residential and commercial property owners' associations within the Giants Ridge Recreation Area to promote and protect their collective interests.[4]

IRRRB staff said the slow recovery of the real estate market has forced the agency to shift its strategy at Giants Ridge away from large real estate development projects. Land values in the Voyageurs Retreat development plummeted during the real estate crash that began in 2006, and the company developing the property fell into bankruptcy. Since 2005, only 44 homes have been constructed on the 240 lots in the Voyageurs Retreat development. Similarly, although all 19 of the lots on IRRRB's Woodlands development have been sold, houses have been built on only 6 of them since the development began in 1998. Finally, since 2009, only one unit has been built on the 27 lots in the Residence Club development. According to staff, the fractional ownership model used by the Residence Club development has not been successful.

[3] *Laws of Minnesota* 1997, chapter 200, art. 1, sec. 71.

[4] This umbrella property owners' association, authorized by *Minnesota Statutes* 2015, 515B.2-121, is called the Giants Ridge Master Association. It was first formed in 1999. Its members are property owners' associations that represent owners of the Lodge, the Woodlands, Voyageurs Retreat, and the Residence Club. IRRRB is a nondues-paying member.

In 2013, IRRRB hired a firm to create a plan for developing the resort's smaller-scale amenities, such as improvements to hiking trails, instead of the large-scale real estate developments outlined in a 2010 component of its development plan. The agency's strategy shift has not been in place long enough to demonstrate whether or not it will help fulfill Giants Ridge's goals. IRRRB plans to use revenues from the Giants Ridge Recreation Area special local taxes, which were first collected in 2011, to implement the plan. An advisory committee met in mid-2015 to prioritize spending from the tax revenues. As of that time, none of the $366,000 in taxes that had been collected through 2014 had been spent.

MANAGEMENT

IRRRB and three contracted vendors manage and operate Giants Ridge. The resort's managing director is an IRRRB employee who oversees all areas of operations. Although the IRRRB Board approves a high-level annual budget for Giants Ridge each year, it does not set the strategic direction for the resort and is not involved in its management. In fiscal year 2014, IRRRB directly employed 32 full-time-equivalent staff at Giants Ridge at a cost of $1.9 million. IRRRB staff handle most of the resort's outside ski operations, including its buildings and grounds, and its accounting, legal and human resources, and information technology services.

Since 1985, IRRRB has contracted with the firm Northern Lights Sports to operate the resort's year-round rental equipment shop, winter season retail shop, and Snow Sports School.[5] The firm leases space from IRRRB and pays the agency a portion of its sales. Its total rental and sales payments to IRRRB in fiscal year 2014 equaled $54,000. That year, the firm paid $232,000 in payroll to its eight full-time-equivalent employees at Giants Ridge.

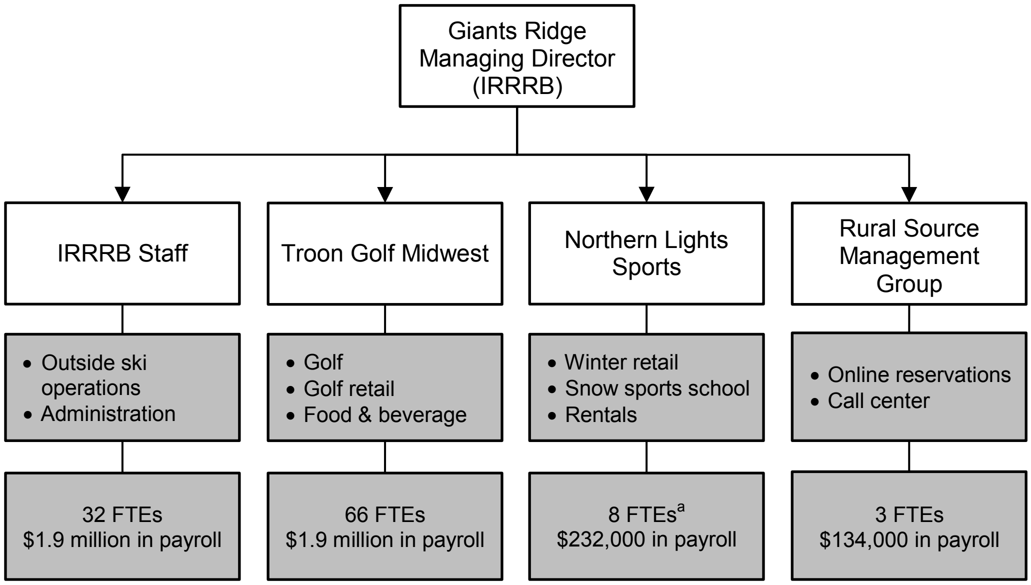
Since 2001, IRRRB has contracted with another firm, Troon Golf Midwest (Troon), to manage Giants Ridge's golf, golf retail, and food and beverage operations.[6] IRRRB pays Troon a management fee and reimburses it for certain eligible expenses, such as payroll. In fiscal year 2014, IRRRB paid Troon $90,000 and reimbursed it for $3.7 million in eligible expenses. Of those reimbursements, $1.9 million paid for 66 full-time-equivalent employees.

In 2011, IRRRB began contracting with a third firm, Rural Source Management Group, to develop, manage, and operate the Giants Ridge Central Reservation Service. The service includes an online reservation system and toll-free phone number, supported by a small number of call center staff. The service takes reservations for IRRRB amenities as well as for private lodging in the area. In fiscal year 2014, IRRRB paid Rural Source Management Group $40,000 to manage the service and reimbursed it for $160,000 in eligible expenses. Of those reimbursements, $134,000 paid for three full-time-equivalent employees. Exhibit 3.1 illustrates the areas of the resort's operation handled by IRRRB and each of its contractors, as well as the number of full-time-equivalent staff each employs and the corresponding payroll.

[5] The Snow Sports School provides ski and snowboard lessons on a fee-basis for adults and children, including lessons for people with disabilities.

[6] Between 1997 and 2001, a different firm managed Giants Ridge's golf operations.

Exhibit 3.1: Giants Ridge Management and Operational Structure, Fiscal Year 2014



NOTE: "FTE" means full-time-equivalent employee, which represents 2,080 hours of work for one year.

[a] IRRRB's financial arrangement with Northern Lights Sports differs from its arrangements with the other two contractors. Northern Lights Sports pays IRRRB a portion of its sales revenue to operate at Giants Ridge. IRRRB does not pay for the cost of the vendor's employees, as it does for the employees of Troon and Rural Source Management Group. We include the employees and payroll for Northern Lights Sports to show the total employment that is generated in the area as a direct result of Giants Ridge.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board data, 2016.

OPERATING LOSS AND SUBSIDY

The annual revenue that Giants Ridge generates from its ski, golf, and retail operations, and occasional land sales, does not cover the resort's cost of operations.[7] As a result, IRRRB provides Giants Ridge with an annual operating subsidy from its production tax revenue. We reviewed Giants Ridge budgets from 2006 through 2014.[8] In each of those years, IRRRB budgeted for an operating loss at Giants Ridge; the agency also budgeted for a subsidy to cover the balance of the resort's budget.

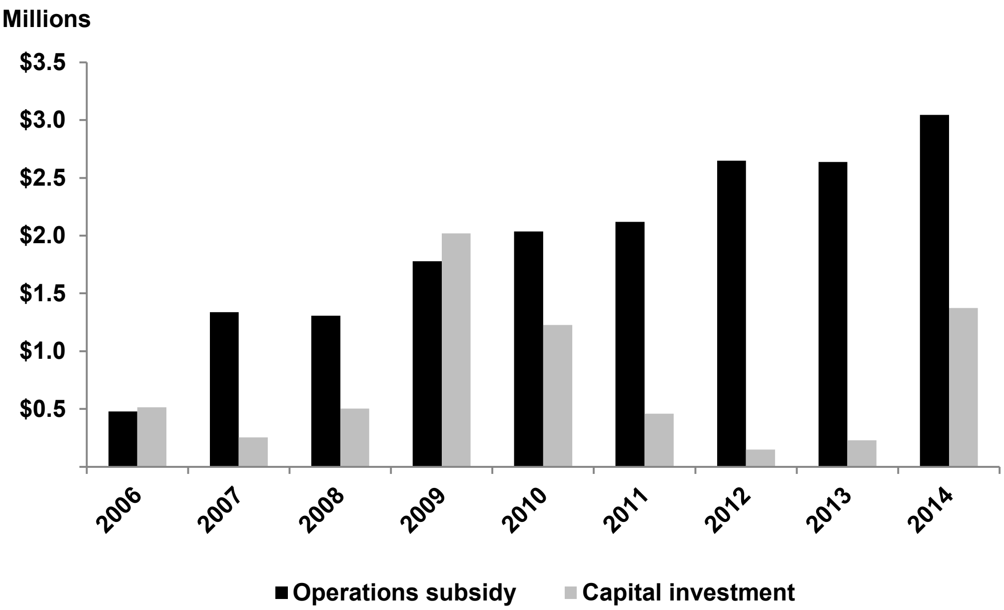
Giants Ridge's operating loss has grown 535 percent over the past nine years.

[7] Starting in 2011, IRRRB also began collecting special taxes on certain recreation admissions and equipment rentals, food and beverage sales, and lodging in the Giants Ridge Recreation Area. The proceeds may be used to fund certain development in the area.

[8] Giants Ridge's financial statements were based on different accounting practices prior to fiscal year 2006, making the data less comparable.

Between fiscal years 2006 and 2014, Giants Ridge's annual operating loss grew from $479,000 to $3 million.[9] During this time, IRRRB gave Giants Ridge a total of $17.4 million to cover the operating losses, an average of $1.9 million per year. Over this nine-year period, the agency spent another $6.7 million in capital investments at Giants Ridge and $19.8 million to pay for the resort's bond debt. Exhibit 3.2 shows the annual cost to IRRRB to cover Giants Ridge's operating losses and capital investments.

Exhibit 3.2: IRRRB Spending on Giants Ridge, Adjusted for Inflation, Fiscal Years 2006-2014



NOTES: Spending is shown in 2015 inflation-adjusted dollars. This exhibit does not include spending on Giants Ridge that was financed by the resort's earned revenue. For example, in fiscal year 2014, Giants Ridge's earned revenue paid for $4.1 million of the resort's $7.1 million operating expenses that year. The remaining $3.0 million of operating expenses in fiscal year 2014 were covered by IRRRB's operations subsidy, which is shown in this exhibit. This exhibit also does not include the $19.8 million IRRRB spent on Giants Ridge debt service from fiscal years 2006 to 2014.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board data, 2006-2014.

The operating loss at Giants Ridge has grown in part because of a widening gap between revenues and expenses in each of the resort's key areas of operation. From fiscal year 2006 through 2014, the resort's ski expenses declined by 3 percent, but its revenues declined by 34 percent. Although golf expenses declined by 12 percent, revenues also declined, by 42 percent. Through 2011, the same was true for the resort's food and beverage operations; revenues declined by 10 percent, and expenses grew by 2 percent. From 2012 to 2014, however, Giants Ridge temporarily took over food and beverage operations for the Lodge. Although revenues grew significantly from fiscal year 2011 through 2014, expenses grew even more. Exhibit 3.3 shows the change in operating revenues and expenses for each of these areas over the period from fiscal year 2006 through 2014.

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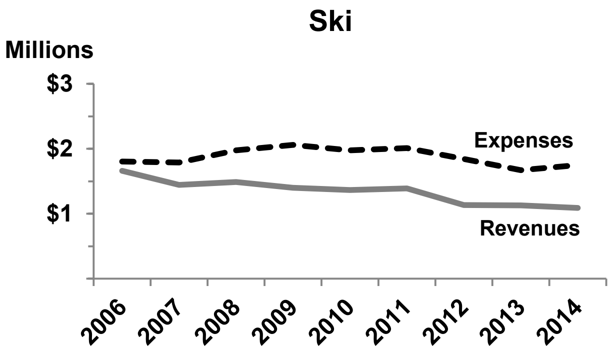
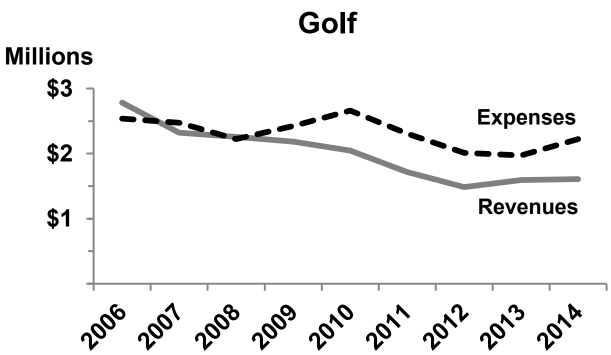
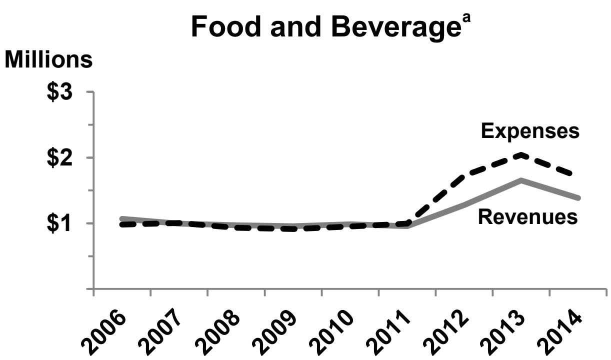
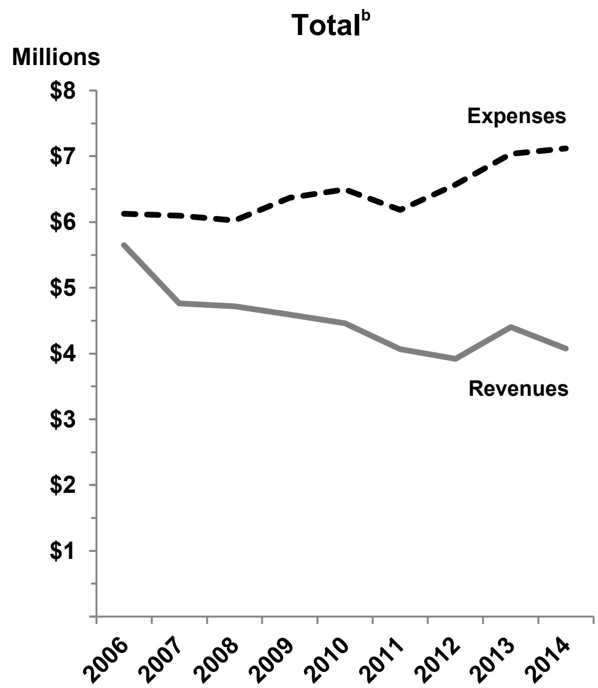
[9] We report values in this section in 2015 inflation-adjusted dollars.

Exhibit 3.3: Giants Ridge Operating Revenues and Expenses by Area of Operation, Adjusted for Inflation, Fiscal Years 2006-2014









NOTE: Revenues and expenses are shown in 2015 inflation-adjusted dollars.

[a] Food and beverage expenses and revenues increased in 2012 through 2014 because Giants Ridge temporarily took over food and beverage operations at the Lodge.

[b] Data for total operating revenues and expenses include ski, golf, and food and beverage operations, as well as some additional administrative, advertising, and real estate revenues and expenses. The $366,000 in revenue generated from Giants Ridge's special recreation tax between 2011 and 2014 is not included in this exhibit.

SOURCE: Office of the Legislative Auditor, analysis of Iron Range Resources and Rehabilitation Board data for Giants Ridge, 2006-2014.

In 2015, a group of IRRRB staff assessed Giants Ridge to make recommendations about the resort's future and its growing operating loss. One recommendation in the group's final report, which was released in February 2016, was to make capital investments in Giants Ridge's downhill-ski and golf facilities.[10] The report concluded that the resort's aging facilities can no longer compete with competitors' offerings, such as high-speed chair lifts. In addition, the report recommended reorganizing Giants Ridge's management model. The report also assessed the viability of selling Giants Ridge to a private firm. However, because Giants Ridge is not currently profitable as a resort, the report concluded that selling is not an attractive prospect, and Giants Ridge would be at risk of closure if sold. Staff said it is important for the agency to preserve Giants Ridge's economic and quality-of-life benefits.

PERFORMANCE

We reviewed the measures IRRRB uses to judge Giants Ridge's performance in relation to its four stated goals. The measurable goals the agency sets for Giants Ridge each year are contained within its annual budget, according to interviews with staff. Giants Ridge's annual budget includes revenue targets, such as targets for ski admissions, retail sales, golf course green fees, and advertising sales. It also includes expenditure targets, such as for the cost of merchandise, salaries, and fees paid to management firms. Staff explained that these budget targets relate back to the resort's four original goals. For example, when setting annual revenue targets, staff consider the strategies they will use to introduce people to the sports of skiing or golf, which can improve the quality of life for people on the Iron Range (one of the four goals). Staff may, for instance, lower ski lesson prices so that more people can afford to participate.

To determine how well Giants Ridge met its 2014 budgetary goals, we compared its actual operating revenues and expenditures with its major budget targets. In 2014, the resort's operating revenues totaled \$4.2 million—9 percent short of the budget. Its operating expenses totaled \$8.5 million, 5 percent under budget. Its overall operating loss totaled \$4.3 million, 16 percent under its budgeted operating loss. Although the resort's actual operating revenues came in short of its budget targets, its operating expenses also came in short, allowing the overall operating loss to come in under budget.

We do not think Giants Ridge's financial performance is a sufficient measure of how well the resort is meeting its goals. If the resort were judged solely by how well it met the financial goals in its annual budget, then its performance could be judged as adequate in 2014 because its operating loss was slightly under budget. If Giants Ridge's performance were judged solely on its ability to financially sustain itself as an enterprise, however, then it could be judged to be performing poorly, due to its increasing annual operating loss. As a public-purpose enterprise, however, the subsidy to operate the resort (an average \$1.9 million each year between 2006 and 2014) must also be judged against whether Giants Ridge has made satisfactory progress toward achieving its goals. As stated earlier, the four goals are:

[10] Iron Range Resources and Rehabilitation Board, *Reinvestment for the Future: A Report of the Giants Ridge Strategy Group* (Eveleth: February 2016).

1. Create economic development.
2. Provide recreational facilities to enhance the quality of life for people of the Iron Range.
3. Attract private sector development.
4. Create a year-round recreation destination.

IRRRB has not established sufficient targets to judge how well Giants Ridge is meeting its stated goals.

Over time, IRRRB has used a variety of nonbudgetary measures to assess the performance of Giants Ridge. However, IRRRB uses few measures consistently and, in most cases, IRRRB has not set benchmarks or criteria to judge the measures. In the remainder of this chapter, we review the performance measures for Giants Ridge that IRRRB has included in its published reports and internal documents. Where possible, we analyze what the measures indicate about how well the resort has met its four stated goals.

Biennial and Board Reports

We looked for performance measures IRRRB has used to assess Giants Ridge in the agency's regularly published public reports from 2005 to 2014. First, we reviewed IRRRB's biennial reports. State agencies' biennial reports to the Legislature and governor are often the primary, formal mechanism agencies have to communicate their performance to the public and state officials. Second, we reviewed IRRRB's annual budget requests to the IRRRB Board. Staff told us that the board's primary involvement with Giants Ridge is through the annual budget process; therefore, budget request documents show the key measures the agency provides to the board to evaluate the resort.

In these reports, IRRRB has not established sufficient criteria to judge the performance of Giants Ridge. For example, in the budget requests, IRRRB consistently reported only one nonbudgetary quantitative measure each year from 2007 to 2014—the number of annual visitors. In the budget requests, attendance was not consistently compared over time or with other similar recreational facilities. In addition, the budget requests did not establish the level of attendance that would signify Giants Ridge had made progress toward its stated goal of creating a "recreation destination." Furthermore, the reports did not indicate the level of attendance that would help justify the $1.9 million average annual subsidy to operate the resort.

Overall, the biennial reports listed mostly qualitative measures for Giants Ridge. For example, each report from 2005 to 2014 mentioned the resort's wide scope of amenities and awards. In some years, the reports included measures that could be quantified but were not. For example, the biennial reports noted that Giants Ridge has hosted events, attracted new customer markets, and maintained customer loyalty. However, these measures were not quantified or compared over time. In select years, the reports included additional quantitative measures, other than attendance, such as the results of an economic impact study commissioned by the agency, the number of private real estate lots sold, or the rental capacity its event venues achieved. However, the reports did not include criteria to judge these ad hoc measures in terms of the resort's goals.

We also reviewed a sample of internal agency documents and other ad hoc, published reports for measures of Giants Ridge's performance.[11] These documents show greater analysis of the measures listed in IRRRB's biennial and board reports. However, overall, they also lack sufficient criteria for judging the resort's performance in terms of its four stated goals. Below, we review a sample of measures we found, shown in Exhibit 3.4, and where possible, we use them to judge Giants Ridge's performance in relation to its stated goals.

Exhibit 3.4: Giants Ridge Goals and Sample Performance Measures

IRRRB Goals for Giants Ridge	Sample Performance Measures[a]
1. Create economic development 2. Attract private sector development	Attendance Economic ripple effects Job creation Ratio of public-to-private investment Tax base growth
3. Provide recreational facilities to enhance the quality of life for people of the Iron Range 4. Create a year-round recreation destination	Attendance Customer satisfaction Scope of programs

[a] This exhibit lists only a sample of the measures IRRRB uses to assess the performance of Giants Ridge.

SOURCE: Office of the Legislative Auditor, 2016.

Attendance

As noted previously, IRRRB tracks attendance as a measure of the resort's performance. We reviewed Giants Ridge attendance data over the last ten years. The number of rounds of golf played at Giants Ridge declined by 25 percent between fiscal years 2005 and 2014. This trend alone, however, does not demonstrate Giants Ridge is failing to meet its goals of providing recreation facilities for local residents or creating a recreation destination. In fact, external reports suggest the sport is on decline nationally. However, IRRRB would need to compare the rate of decline at Giants Ridge with state or national growth rates to judge the resort's attendance.

The data also show that the resort's winter attendance has declined. In 2014, Giants Ridge sold around 37,000 ski, snowboard, and snow tube passes, down 30 percent from a decade earlier. However, like the trend for golf, this trend alone does not demonstrate poor performance on the part of Giants Ridge because snow sports participation has also declined nationally. A one-time report produced for IRRRB discussed Giants Ridge's market share. According to the report, despite its declining ski visits, Giants Ridge continued to draw the

[11] Examples include an IRRRB internal annual financial report, internal meeting materials, and outside reports commissioned by IRRRB.

same 6 percent proportion of Minnesota's ski visitors between the 2003-2004 and 2013-2014 seasons.[12]

According to staff and agency documents, the majority of the resort's attendance occurs during peak weeks in the summer and winter. During these times, on-site lodging at the resort is insufficient to meet demand. Conversely, few people visit the resort in the interim seasons, during which lodging vacancy rates are high. This suggests that Giants Ridge has not been fully successful in drawing attendance *year-round*, which is part of one of its stated goals.

Scope of Programs

Staff told us in interviews that they consider Giants Ridge's scope of programs a measure of the resort's performance. IRRRB's biennial reports also frequently mention Giants Ridge's scope of programs, but they do not include criteria to judge its offerings. Giants Ridge offers a wider scope of programs and services than it did in 1984, which staff said provides many opportunities for health and wellness. For example, for many years, Giants Ridge has hosted the state's high school ski championships. Programs such as this arguably have the potential to enhance local residents' quality of life through recreation, which is one of Giants Ridge's stated goals. However, because IRRRB has not established criteria to judge the scope of Giants Ridge offerings, it is difficult to determine how well Giants Ridge is meeting this goal.

Customer Satisfaction

IRRRB regularly measures customer satisfaction at Giants Ridge. IRRRB staff conduct annual surveys of a sample of Giants Ridge winter and golf visitors. The 2014 survey results show that 88 percent of golf visitors said they would recommend Giants Ridge to a colleague or friend, and 71 percent of winter visitors said they would recommend it.[13] A document summarizing the survey results characterizes the golf responses as "high," but makes no characterization of the winter survey results.[14] The 2014 survey results also show that a high percentage of visitors were repeat customers—75 percent of golf visitors were repeat customers as were 72 percent of winter visitors. These measures seem to indicate satisfaction, but without a benchmark, it is difficult to judge how well the resort is meeting its goals of providing recreational facilities to enhance quality of life and creating a year-round recreation destination.

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[12] SE Group, *Giants Ridge Multi-Season Recreation Plan Concept* (October 14, 2014), 35.

[13] IRRRB uses the "Net Promoter Score" methodology to measure customer satisfaction. This tool assumes that only respondents who choose the highest scores (9 or 10) would recommend the resort to others. It also assumes that those who choose low or mid-range scores (0 to 6) are dissatisfied customers; their responses are "subtracted" from the total. The tool assumes that respondents who choose scores 7 or 8 are vulnerable to competitive offerings, and their responses have no impact on the final result.

[14] Iron Range Resources and Rehabilitation Board, "Giants Ridge Golf Season 2014," 8. Iron Range Resources and Rehabilitation Board, "Giants Ridge Snow Sports Season 2014/15," 9.

Economic Ripple Effect

A 2012 economic impact report about Giants Ridge commissioned by IRRRB did not include sufficient criteria for measuring the resort's performance.[15] Using modeling software, the report estimated the economic ripple effects Giants Ridge made throughout the St. Louis County economy. For example, the report estimated the number of restaurant jobs that existed in the county as a result of Giants Ridge and the spending the resort induced in tourism-related industries. It also estimated the economic value of the real estate developments at Giants Ridge, including their potential property taxes. However, the report did not indicate, for example, whether the estimated number of jobs Giants Ridge generated was sufficient to conclude the resort was meeting its goal of creating economic development. Similarly, it did not indicate whether the increase in property taxes suggested that Giants Ridge was meeting its goal of attracting private sector investment.

Job Creation

According to agency staff and documents, IRRRB considers job creation an objective for Giants Ridge. This objective is most related to the resort's goal to create economic development. Agency staff said Giants Ridge provides local high school and college students with work opportunities and exposure to industries like agronomy and sports management. However, the agency has not established a threshold for the number of jobs Giants Ridge should generate to meet its economic development goal.

Because IRRRB has not established a threshold for this measure, we chose to compare Giants Ridge's payroll against its operating subsidy from the agency. In 2014, Giants Ridge directly supported 109 full-time-equivalent employees with a total payroll of $4.2 million, as Exhibit 3.1 illustrated earlier.[16] That year, IRRRB's operating subsidy for Giants Ridge was $3 million. If job creation were the only measure of Giants Ridge's performance, we could say that IRRRB paid $3 million in 2014 to leverage $4.2 million worth of jobs. This is a cost to IRRRB of $28,000 per full-time-equivalent position. It is worth noting that this per-job cost would be lower if it included employment for the Lodge, the Villas, and another private, on-site lodging facility, called Green Gate Guest Houses. However, because these facilities are privately owned, data about the number of full-time-equivalent employees they employ are not available for this analysis. IRRRB was able to estimate the number of part-time or seasonal staff and full-time staff employed by these facilities. If we include these crude estimates, and assume that each part-time or seasonal employee worked half-time, the per-job-cost to IRRRB drops to $21,000. However, without more detailed data on full-time-equivalent employees, this estimate is unreliable.

Real Estate Development

One measure IRRRB has used to assess how well Giants Ridge is meeting its goal of attracting private sector investment is the ratio of IRRRB's total capital investments to total

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[15] University of Minnesota Duluth, Labovitz School of Business and Economics, Bureau of Business and Economic Research, *The Economic Impact of Giants Ridge on St. Louis County for Giants Ridge and the Iron Range Resources and Rehabilitation Board: Consulting Report* (Duluth: University of Minnesota Duluth, Labovitz School of Business and Economics, 2012).

[16] IRRRB does not pay for Northern Lights Sports' employees who work at Giants Ridge, but we include them in this analysis because their jobs exist due to Giants Ridge.

private sector investments in the Giants Ridge Recreation Area. One IRRRB document shows that between 1984 and 2013, IRRRB invested $46.4 million in the development of lodging and vacation home properties and other fixed assets in the recreation area.[17] The document also reports that during this time, the private sector invested another $43.7 million in the development of those properties. This equates to a nearly 1:1 ratio of public-to-private investment. However, the document does not include a corresponding benchmark for leveraging private investment to judge the 1:1 ratio that it reports. In addition, the document does not assess whether the private investment would have been made (1) outside the region or (2) on other projects within the region, had it not been spent on Giants Ridge. In the latter case, Giants Ridge would not have generated economic development in the region because the private investment would have been spent in the region anyway.

IRRRB considers growth in the local tax base as another measure of Giants Ridge's performance. Staff said Giants Ridge has attracted private developers and individuals who have purchased year-round or vacation homes around the resort. Data show that between 2006 and 2015, the total taxable net tax capacity of the city of Biwabik grew 90 percent.[18] However, this growth rate is insufficient evidence of Giants Ridge's impact because the data do not isolate the effect of Giants Ridge on the local tax base from other factors. In addition, it is not clear whether the resort drew in money from outside the region or simply from elsewhere inside the IRRRB service area. The latter case would indicate no net effect on the economy in the IRRRB service area.

RECOMMENDATION

IRRRB should set criteria to measure how well Giants Ridge's performance meets the resort's four stated goals. IRRRB should also analyze the performance in light of the facility's increasing operating losses and determine whether Giants Ridge remains consistent with IRRRB's mission.

Because Giants Ridge is a public enterprise, IRRRB should evaluate the resort not only in terms of its financial performance, but also in terms of its four stated goals. The agency should determine whether the $1.9 million average annual operations subsidy produces more public value at Giants Ridge than it would if the money were used for other IRRRB programs. IRRRB should also establish to what extent Giants Ridge's outcomes justify the average $1.9 million it spent on the resort each year from 2006 to 2014. To do this, the agency should establish clear benchmarks or criteria to measure progress toward its goals, and balance that progress against the public cost to operate the resort. For example, if the agency continues to use job creation as a measure of its economic development goal, it could set a threshold for the minimum number of jobs needed to help justify its subsidy. Similarly, it could set a threshold for the minimum number of jobs in the private sector that

[17] Iron Range Resources and Rehabilitation Board, "The History and Current Giants Ridge," materials from August 8, 2015, strategic planning meeting in Biwabik, Minnesota, 15. These properties include the Lodge, the Villas, Voyageurs Retreat, and the Residence Club. IRRRB's financial contributions to Giants Ridge's operating expenses are not included in this amount, and while these residential and lodging properties are not owned or operated by IRRRB, they house the resort's visitors.

[18] St. Louis County Auditor-Treasurer, "Taxable Net Tax Capacity," 2005-2014. As noted previously, Giants Ridge is located within the municipal boundaries of the city of Biwabik. Tax capacity is a measure of a property's tax rate multiplied by its estimated market value. Taxable net tax capacity reflects a local taxing jurisdiction's tax capacity but excludes specific properties, such as those in tax-increment financing districts.

result directly from Giants Ridge (at the Lodge and the Villas, for example) that would help justify the subsidy. Although such analyses may require additional time and cost, we think it is crucial for IRRRB to analyze how well Giants Ridge is meeting its four goals, and whether its performance can justify the agency's annual subsidy and the resort's increasing operating loss.

List of Recommendations

- The Iron Range Resources and Rehabilitation Board (IRRRB) should explicitly analyze to what extent loan applicants can complete projects without IRRRB funding. (p. 27)
- IRRRB should redesign its loan program by adding incentives for companies to meet job-creation objectives. (p. 30)
- IRRRB should improve its methods of measuring loan recipients' job creation. (p. 32)
- IRRRB should maintain an accurate database for tracking its loans. (p. 33)
- IRRRB should more consistently determine how well its grants meet their objectives. (p. 38)
- IRRRB should ensure that all of its grant programs comply with the policies that apply to them. (p. 41)
- IRRRB should consistently verify that grant applicants pay the required matching funds to receive agency grants. (p. 43)
- IRRRB should regularly evaluate its loan and grant programs. IRRRB should also analyze the collective impact of its programs on IRRRB's service area. (p. 44)
- IRRRB should set criteria to measure how well Giants Ridge's performance meets the resort's four stated goals. IRRRB should also analyze the performance in light of the facility's increasing operating losses and determine whether Giants Ridge remains consistent with IRRRB's mission. (p. 56)

Constitutional Question

APPENDIX A

As part of our evaluation of the Iron Range Resources and Rehabilitation Board (IRRRB), some legislators asked us to address a constitutional question: Is the law that establishes the membership and powers of the board constitutional?

We understand that courts decide constitutional questions. On the other hand, legislators often ask legislative offices—including the Office of the Legislative Auditor (OLA)—to research whether a law might be vulnerable to a constitutional challenge. They also ask for options that would lessen or eliminate the possibility of a challenge. On that basis, we decided to address the constitutional question that legislators asked about the IRRRB.

Our research led us to conclude that the state law that requires members of the board to be legislators and grants the board significant power over an executive branch agency's spending decisions is vulnerable to a challenge based on two provisions in the Minnesota Constitution.

First, the law is vulnerable under the constitution's "separation of powers" doctrine. The Minnesota Constitution divides state powers among three separate branches and explicitly bars officials in one branch from exercising powers constitutionally assigned to another branch. Second, the law is vulnerable under the state constitution's prohibition against legislators holding another public office while serving as a senator or representative. This is known as the "dual office holding" prohibition.

The Board's Decision-Making Power

A constitutional challenge based either on the "separation of powers" doctrine or the "dual office holding" prohibition would focus on the board's decision-making power. We summarized our understanding of the board's power in Chapter 1, as follows:

> The governor appoints a commissioner of IRRRB, who is the chief executive of the agency. However, unlike other executive branch agencies, state law grants substantive power over the agency to a small group of legislators who are IRRRB Board members.[1] When first established, the IRRRB Board served in an advisory role, but the 1995 Legislature significantly increased the board's authority to control the agency. Since 1995, the law has *required* board members to approve or disapprove all expenditures and projects proposed by the commissioner as opposed to *recommending* approval or disapproval as was previously the case.[2] State law also requires the commissioner to submit an annual budget to the board

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[1] *Minnesota Statutes* 2015, 298.22, subd. 1a.

[2] *Laws of Minnesota* 1943, chapter 590, sec. 4; and *Laws of Minnesota* 1995, chapter 224, sec. 92.

for approval. After board approval, the budget is submitted to the governor for approval or disapproval.[3]

However, the IRRRB Board, not the governor, has final approval over many expenditures, depending on the funding source. For example, gubernatorial approval is not required for grants to mining companies for reinvestment in their plants and facilities.

In the following sections, we explain why we believe this governance structure is vulnerable to a constitutional challenge.

Separation of Powers

The law that establishes the board's membership and powers is vulnerable to a challenge based on the state constitution's separation of powers clause. Specifically, a person could argue that legislators serving on the board are exercising executive branch powers.

Minnesota's Constitution Supports a Strong Division Among Its Branches of Government

Separation of powers is a bedrock principle in American government. The framers of both the United States Constitution and the Minnesota Constitution believed it was an essential safeguard against the concentration and misuse of power.[4] As a result, they established a system in which the legislative branch enacts the laws, the executive branch carries out the laws, and the judicial branch interprets the laws.[5]

The Minnesota Constitution strongly separates the powers of each of the three branches. Unlike the U.S. Constitution, which merely *implies* the separation of powers, the framers of Minnesota's Constitution left no doubt as to its importance. They explicitly listed three separate branches (also called "departments") and said:

> The powers of government shall be divided into three distinct departments: legislative, executive and judicial.[6]

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[3] *Minnesota Statutes* 2015, 298.22, subd. 11.

[4] Buckley v. Valeo, 424 U.S. 1, 122 (1976) (framers regarded the system of separated powers and checks and balances established in the Constitution as "a self-executing safeguard against the encroachment or aggrandizement of one branch at the expense of the other").

[5] Bowsher v. Synar, 478 U.S. 714, 722 (1986) ("That this system of division and separation of powers produces conflicts, confusion, and discordance at times is inherent, but it was deliberately so structured to assure full, vigorous, and open debate on the great issues affecting the people and to provide avenues for the operation of checks on the exercise of governmental power").

[6] *Minnesota Constitution*, art. III, sec. 1. There is another part of the Minnesota Constitution that further cements the importance of separation of powers, sometimes called the dual office-holding clause, which we address in the next section. *Minnesota Constitution*, art. IV, sec. 5 ("No senator or representative shall hold any other office under the authority of the United States or the state of Minnesota, except that of postmaster or of notary public"). Other states have versions of this clause. See http://www.ncsl.org/research/ethics/restrictions-on-holding-concurrent-office.aspx, accessed February 23, 2016.

But the framers did not stop there. They went further than the federal constitution and some other state constitutions by mandating that:

> No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others except in the instances expressly provided in this constitution.[7]

These clauses serve as the basis for our conclusion that the IRRRB statute is vulnerable to a separation of powers challenge.

In addition, written transcripts of the 1857 constitutional conventions provide insight into why the framers considered the strong separation of powers language important. Unlike some other states that have replaced their constitutions over time,[8] Minnesota's original 1857 constitution is still in effect today.[9] So although the framers' debates took place more than 150 years ago, their comments provide guidance in answering today's questions, such as whether the IRRRB statute is vulnerable, constitutionally.

Debate in the Constitutional Conventions

With an eye toward statehood in 1857, members of the Minnesota Territory attempted to convene a group to write a constitution. But as constitutional scholar and Hamline University Professor Mary Jane Morrison writes, "Democrats and Republicans in the 1850s were such bitter enemies they could not cooperate in drafting the constitution."[10] As a result, each group held its own separate convention in St. Paul and drafted its own version.[11]

During the Democrats' constitutional convention, there was debate about whether the Minnesota Constitution's separation of powers section needed a statement that went beyond just listing the three branches of government. Should the constitution include a clause outlawing a person in one department (i.e., branch) from exercising another branch's

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[7] *Minnesota Constitution*, art. III, sec. 1. The Minnesota Constitution has several provisions that expressly grant power to one branch of state government over another branch. These provisions provide for what is often called "checks and balances" between and among the three branches. For example, Article IV, sec. 23, authorizes the governor to veto legislation enacted by the Legislature, including the power to "line-item" veto appropriations. Article V, sec. 3, provides that the governor may appoint people to fill positions created by law with the "advice and consent of the senate." Article VI, sec. 2, allows the Legislature to create a court of appeals, sec. 4, allows the Legislature to establish the number and boundaries of judicial districts, and sec. 10, allows the Legislature to provide for the retirement of judges.

[8] Georgia, for example, has had 10 constitutions. Voters ratified the most recent constitution in 1982, which replaced the 1975 Constitution. See http://sos.ga.gov/admin/files/Constitution_2013_Final_Printed.pdf, accessed February 23, 2016.

[9] League of Women Voters Minn. v. Ritchie, 819 N.W.2d 636, 678 (Minn. 2012) (Page, J. dissenting). Minnesota's Constitution has been amended several times and underwent a major revision in 1974 but that revision did not replace the 1857 constitution. As a result, "the 1857 Minnesota Constitution remains the source of original intent and the final authority in matters of state constitutional law."

[10] Mary Jane Morrison, *The Minnesota State Constitution: A Reference Guide* (Westport, CT: Greenwood Press, 2002), 1. The two political parties were sharply divided over a number of issues including: apportioning congressional, legislative, and judicial districts; whether the right to vote extended to all races; and the location of the state capitol.

[11] William Anderson and Albert J. Loeb, *A History of the Constitution of Minnesota* (Minneapolis, Minnesota: University of Minnesota, 1921), 88-92.

powers? During the debate, Territorial Supreme Court Justice Bradley Meeker explained why he thought the additional clause was important:

> The man who makes the law must not expound the law, and the man who executes the law must not be the law maker. These are maxims of government, which we have been taught from our boyhood, and I am opposed to their being broken down by this body.[12]

Willis Gorman, a lawyer and former territorial Governor from St. Paul, supported Meeker's position.[13] He said the purpose of the separation of powers article was to ensure that no one exercising functions in one department (i.e., branch) of the government should exercise any of the functions that belong to another department. Gorman said:

> If a man belongs to the Legislative department for instance, this Article is intended to prevent him from exercising the duties of Governor, or Auditor, or Attorney General, or any of the duties…in the Executive department. If he desires to fill an office belonging to another department of government, he must first resign the office he already holds.[14]

Toward the end of the discussion on this section, Henry Setzer, a lumberman from Stillwater, said Minnesota's Constitution should clarify not only that officers of one department not serve as officers in other departments but also that different departments not interfere with each other.[15] He said:

> Now sir, I want to provide against any such possible occurrence in the future. I think the Judiciary should not be allowed to interfere with the Legislature, nor the Legislature with the Judiciary, nor the Executive with either department.[16]

The Republican version of the state constitution contained the same separation of powers clauses as the Democratic version.[17]

Minnesota Supreme Court

The Minnesota Supreme Court has not considered whether the current IRRRB's governance law violates the Minnesota Constitution's separation of powers. In addition, we could not

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[12] Francis H. Smith, official reporter, *The Debates and Proceedings of the Minnesota Constitutional Convention*, St. Paul, Minnesota (1857), 191.

[13] Minnesota Legislative Reference Library, *Legislators Past and Present, Gorman, Willis Arnold*. See http://www.leg.state.mn.us/legdb/fulldetail.aspx?ID=13633, accessed January 27, 2016.

[14] Smith, *Debates and Proceedings*, 199.

[15] *Ibid*., at 201.

[16] *Ibid*., at 202.

[17] Minnesota Historical Society, *Minnesota's Constitution(s) – Republican Version*. See http://www.mnhs.org /library/constitution/r-06.php, accessed January 27, 2016.

find any case where the court addressed the constitutionality of a law designating legislators as voting members of an executive branch board.[18]

Nevertheless, the Minnesota Supreme Court has ruled on a few cases that indicate how it approaches challenges based on the constitution's separation of powers clause. For example, in 2010, the Minnesota Supreme Court struck down Governor Tim Pawlenty's cancellation of certain legislative appropriations (a process called "unallotment") and in doing so, the court stated plainly that the state's constitution defines distinct roles for the legislative and executive branches. The court said:

> The legislative branch has the responsibility and authority to legislate, that is, to make the laws…and the executive branch has the responsibility and authority to execute, that is, to carry out the laws.[19]

In a 2013 case, the Minnesota Supreme Court faced a challenge to the power of the state's judicial branch. It ruled that courts do not have the power to expunge criminal records held by the executive branch.[20] More importantly for the issue addressed here, Associate Justice David Stras reinforced the view that Minnesota is a strong separation of powers state. He said separation of powers does "not mean an absolute division of our government's function" but went on to note that the Minnesota Supreme Court has never allowed one branch to exercise the power exclusively assigned to another.[21]

Even with these rulings and general statements as guidance and Minnesota's strong separation of powers clause, we cannot know how the Minnesota Supreme Court would decide a constitutional challenge involving the IRRRB. First, the Minnesota Supreme Court has not established an explicit judicial rule or test it would apply to separation of powers disputes.[22] Second, the outcome of any case depends on specifics—how an attorney frames the case legally, the alleged harm done and remedies sought, as well as other factors the court would weigh. Finally, we know at least one court in a state with a

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[18] Even though the following cases are not on point directly with the issues raised in the IRRRB statute, they are worth considering as separation of powers cases involving the Legislature. For example, State ex rel. Mattson v. Kiedrowski, 391 N.W.2d 777 (1986) (while the Legislature has the power to modify executive officers' duties, it cannot authorize legislation "that strips [a constitutional office] of all its independent core functions"). See also, State ex rel. Univ. of Minn. v. Chase, 220 N.W. 951 (1928) (holding that the regents' power was akin to executive branch power. The court held that legislative and executive powers were separate, and as a result, the Legislature could not "transfer the constitutionally confirmed power from the regents to any other board, commission, or officer whatsoever").

[19] Brayton v. Pawlenty, 781 N.W.2d 357, 364 (Minn. 2010) (unallotment statute "does not shift to the executive branch a broad budget-making authority...").

[20] "Expunge" means to remove from a record; to erase or destroy. Bryan A. Garner, Editor in Chief, *Black's Law Dictionary* (St. Paul: Thomson Reuters, 2014), 702.

[21] State v. M.D.T., 831 N.W.2d 276, 284 (Minn. 2013) (Stras, J. concurring) citing Holmberg v. Holmberg, 588 N.W.2d 720, 723 (Minn. 1999) (Legislature wrongly delegated an administrative child support process to an executive branch agency, which infringed on the court's original jurisdiction). See also Quam v. State, 391 N.W.2d 803, 809 (Minn. 1986). In M.D.T., the court held that the judicial branch did not have authority to expunge criminal records held in the executive branch.

[22] Reserve Mining Co. v. State, 310 N.W.2d 487, 492 (Minn. 1981) (noting that the U.S. Supreme Court has rejected the argument that the activities of each branch of government must be limited so as to prevent an overlap of the functions). For example, Nixon v. Administrator of General Services, 433 U.S. 425, 443 (1977); Buckley v. Valeo, 424 U.S. 1, 121 (1976).

strong separation of powers clause similar to Minnesota has held that legislators performing executive branch functions were constitutional in some situations.[23]

While it is impossible to know with any degree of certainty how the Minnesota Supreme Court would rule on a challenge to the law that establishes the membership and powers of the IRRRB board, we are comfortable concluding that the law is vulnerable to a challenge based on the Minnesota Constitution's separation of powers clause.

Next, we consider an additional constitutional provision that could also be the basis for a challenge—the provision that bans legislators from holding another public office.

Dual Office Holding Prohibition

The law that establishes the board's membership and powers is vulnerable to a constitutional challenge based on the Minnesota Constitution's provision that prohibits legislators from holding "another office." Serving on the board could be considered another public office because board members exercise power over an executive agency's spending and policy decisions independent of the full Legislature's approval or disapproval.

The "Dual Office" Prohibition in the Minnesota Constitution

With minor exceptions, the Minnesota Constitution prohibits state legislators from holding another public office while serving as a legislator. Often called the "Dual Office" prohibition, it says:

> No senator or representative shall hold any other office under the authority of the United States or the state of Minnesota, except that of postmaster or of notary public. If elected or appointed to another office, a legislator may resign from the legislature by tendering his resignation to the Governor.[24]

During the 1857 constitutional convention, Territorial Supreme Court Justice Bradley Meeker explained why Minnesota's Constitution included the provision:

> [It] is our business in framing the fundamental law of the land…to see that one man does not hold two, four, or six offices in different departments of the Government.[25]

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[23] S.C. Pub. Interest Found. v. S.C. Transp. Infrastructure Bank, 403 S.C. 640 (2013) (Supreme Court of South Carolina held that legislators performing executive branch functions on the Legislature-created Transportation Infrastructure Bank's board of directors did not violate separation of powers because of the state's unique constitutional history). Our work papers include more detail about this case, and other state and federal cases that have considered whether the legislative branch (or its appointees) usurped executive branch's powers when members served on certain boards and commissions. While these rulings do not bind Minnesota's courts, they often seek guidance from federal and other state court decisions when considering a challenge under the Minnesota Constitution.

[24] *Minnesota Constitution*, art. IV, sec. 5. An earlier version required legislators to wait one year before serving in "another office."

[25] Smith, *Debates and Proceedings*, 192.

The McCutcheon Test

Neither the state constitution nor state law defines what constitutes "another office" under the dual office prohibition. But, in 1974, the Minnesota Supreme Court provided some guidance to answer that question in *McCutcheon v. St. Paul*.[26] The court said an appropriate test is:

> [W]hether that person has independent authority under law, either alone or with others of equal authority, to determine public policy or to make a final decision not subject to the supervisory approval or disapproval of another.[27]

The *McCutcheon* test appears to dovetail with the general practice and understanding within the Legislature. For example, some legislators are employed in a government position outside the legislative branch (for example, as a public school teacher, government administrator, or law enforcement officer), where they are subject to supervision.[28] On the other hand, legislators who have been appointed a commissioner or other high-ranking officials in a state agency, appointed a judge, or elected to another public office (e.g., county commissioner or mayor) have resigned from the Legislature.[29]

Applying the McCutcheon Test to the IRRRB Board

To apply the *McCutcheon* test to legislators serving on the IRRRB board, we need to address a central question: Does the board make final decisions? If the board's decisions are final, the court would likely hold that a position on the board does constitute "another office." If the board's decisions are subject to approval or disapproval by "another" (for example, the Legislature or the Governor), a court would likely conclude that membership on the board does not constitute another public office.

The IRRRB law does not require the full Legislature to approve board decisions. But as we discussed earlier, some board decisions are subject to the Governor's approval or disapproval depending on which Iron Range fund is involved.[30] We do not believe the limited power the Governor has over board decisions eliminates the possibility of a "dual office" challenge to the IRRRB statute.

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[26] McCutcheon v. St. Paul, 298 Minn. 443 (1974) (St. Paul police officers were not required to resign their positions in order to serve as legislators).

[27] McCutcheon, at 447, 449 (The name "police officer" does not mean they hold a public office under the dual office-holding prohibition).

[28] *Minnesota Statutes* 2015, 43A.32, subd. 2, requires an employee in the state's civil service to take a leave of absence if elected to the legislature "during times that the legislature is in session."

[29] If a legislator is appointed to be a judge, he or she would be required to resign from the Legislature by Article VI, section 6, of the *Minnesota Constitution*, which prohibits a judge on the state supreme court, court of appeals, or district court from holding any other state office, as well as any federal office except a commission in the U.S. military reserve.

[30] See Exhibit 1.5, on page 13 of this report.

The Attorney General Burnquist IRRRB Opinion

Although not binding as a court decision, a 1949 Minnesota Attorney General opinion provides added legal guidance for assessing whether the statute conflicts with the dual office holding ban. The opinion provides us with insight that is relevant to today's law.

In June 1949, then-IRRRB Commissioner Ben P. Constantine wrote Minnesota Attorney General J.A.A. Burnquist asking whether the statute prohibited him from moving forward with projects or spending money if the board disapproved his actions.[31] Burnquist told the commissioner he had the authority to move ahead with projects and spending even if board members disapproved because to do otherwise would render the law unconstitutional under the dual office holding clause.[32]

> To hold that the commission was vested with power to make the final determination of "method, manner, and time of payment," which is an administrative operation to be performed by the executive branch of the state government, would compel us to hold the provision unconstitutional. To so hold would also entail requiring the legislative members of the commission to violate the constitution by holding in addition to their legislative offices another office, namely, that of member of the commission.[33]

Again, Attorney General Burnquist issued this opinion in 1949. But we think it is relevant because he was essentially saying that if legislators had the kind of power they were in fact granted in 1995, their membership on the board would constitute another public office in violation of the constitution's dual office holding prohibition.

Options for Change

The language in Minnesota's Constitution, the comments of those who drafted the constitution, case law, and the Burnquist opinion led us to conclude that the governance structure of the IRRRB is vulnerable to constitutional challenge. We now offer four options that would reduce or even eliminate that vulnerability.

Option 1. The Legislature could eliminate the board and retain the executive agency.

Having an office (or department) administered by a commissioner, without a board, would be consistent with the design of other state agencies. Virtually all of the other departments of state government (for example, Transportation, Health, Human Services, Commerce, Education, Natural Resources, and Labor and Industry) are governed by a commissioner

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[31] Iron Range Resources and Rehabilitation – Commissioner – Commission Exercises Advisory Powers Only, Opinion Minn. Attorney General 416-B (July 11, 1949).

[32] *Ibid*. See also Incompatible Offices – Members of Legislature and Members of Legislative Emergency Committee, Opinion Minn. Attorney General 291 (April 7, 1941).

[33] Iron Range Resources and Rehabilitation – Commissioner – Commission Exercises Advisory Powers Only, Opinion Minn. Attorney General 416-B (July 11, 1949).

appointed by the Governor (with Senate confirmation); they do not have governing boards.[34]

Option 2. The Legislature could make the board an advisory commission.

This alternative would create a commission similar to the Lessard-Sams Outdoor Heritage Council[35] and the Legislative-Citizen Commission on Minnesota Resources[36] (except it could still be restricted to Iron Range legislators).

While such an advisory commission could be left in the executive branch, we think it would be more appropriate to move the commission into the legislative branch and codify its membership and duties with Chapter 3 of *Minnesota Statutes* (to be consistent with other legislative advisory groups). Such an Iron Range Resources and Rehabilitation Legislative Advisory Commission would review and recommend projects funded with money raised from mineral tax revenues. The commission would submit its recommendations to the legislative process for enactment into law.

Option 3. The Legislature could retain the board and have the Governor appoint its members.

Under the Minnesota Constitution, the Governor is the state's chief executive and, with rare exception, is empowered in state law to appoint all officers in the executive branch, including board members.[37] Therefore, having a board with members appointed by the Governor would be unquestionably constitutional.

That does not mean the Legislature would relinquish all control, since the Legislature frequently—and we think constitutionally—establishes relevant qualifications for people the Governor may appoint to boards.[38] Therefore, the Legislature could require the Governor to appoint residents of the Iron Range to the board and even require that they be elected local officials on the Iron Range as long as they are not legislators (for example, mayors, city council members, school board members, etc.). Finally, the Legislature could require board appointees to be confirmed by the Senate.

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[34] Historically, Minnesota state government did have a number of boards with significant power over state agencies, but over time they were eliminated in favor of a single agency head. The most recent boards to be eliminated were the Board of Education (eliminated in 1998) and the Pollution Control Agency's Citizen Board (eliminated in 2015). The most significant agency with a governing board is the Board of Water and Soil Resources, which is composed of 15 local government officials appointed by the Governor, 4 state agency commissioners, and the director of the University of Minnesota Extension Service. See *Minnesota Statutes* 2015, 103B.101.

[35] *Minnesota Statutes* 2015, 97A.056, establishes the membership of the Lessard-Sams Outdoor Heritage Council as follows: two public members appointed by the Senate Rules and Administration Subcommittee on Committees; two public members appointed by the speaker of the House; four public members appointed by the governor; two members of the Senate appointed by the Senate Rules and Administration Subcommittee on Committees; and two members of the House of Representatives appointed by the speaker of the House.

[36] *Minnesota Statutes* 2015, 116P.05, establishes the membership of the Legislative-Citizen Commission on Minnesota Resources as follows: five members of the Senate, five members of the House of Representatives, five public members appointed by the Governor, one public member appointed by the Senate, and one public member appointed by the House of Representatives.

[37] The Governor does not appoint the executive director of the Board of Water and Soil Resources; the director is appointed by the board.

[38] For example, the Minnesota Board on Aging, Minnesota Board of Medical Practice, and the Minnesota Board of Teaching.

Option 4. The Legislature could establish the IRRRB as a regional government organization and have voters from the Iron Range elect its board members.

We understand that current members of the board believe that mineral tax revenue is local revenue because it is "in lieu of" having a property tax imposed within the taconite tax relief area.[39] Based on that belief, board members assert that the revenue ought to be under the control of officials elected from the Iron Range. Indeed, one board member described his role on the board as analogous to a county commissioner or some other local official.

To achieve stronger local control and eliminate the possibility of a constitutional challenge, the Legislature could create a regional government organization with board positions elected by voters on the Iron Range. The legislation could specify whether board members would be elected "at large" by all voters in the Taconite Assistance Area or by districts created within the area. In addition, the Legislature could maintain some control over the organization by establishing the qualifications and terms of office for serving on the board, as well as other requirements for how the organization and board would operate.

[39] Johnson v. Carlson, 507 N.W.2d 232, 234 (Minn. 1993) (holding that the taconite tax is a state-imposed tax, not a local tax).

Methodology for Selecting Loans and Grants

APPENDIX B

This appendix provides additional information about IRRRB grants and loans that OLA selected to review as part of this evaluation. The first section describes in detail the methodology we used to select loans; the second describes our selection of grants.

Selecting Loans to Review

Using IRRRB's loan status report, we grouped loan projects by age and size of loan as well as payment "status"—whether a loan was current or had been paid off, written off, foreclosed, or become delinquent. To select loans for review, we grouped the larger loans (those more than $215,000) and those more recent (from fiscal year 2011 through 2015). Because all of the loans from 2011 forward had a "current" payment status, we also grouped together loans from fiscal year 2007 forward to allow us to select some loans with a status of delinquent, foreclosed, forgiven, or written off. From this latter grouping, we randomly selected 4 loans, and from the former group, we randomly selected 13. To the 17 randomly selected loans, we deliberately added three projects with particularly high visibility: Meyer and Associates call center, Silicon Energy solar panels, and Excelsior Energy's Mesaba project. Due to time constraints during the course of our work, we set aside four of the randomly selected bank participation loans, leaving 16 loans for analysis.

Selecting Grants to Review

From IRRRB's grants inventory, we randomly selected 20 grants based on their size and age and the grant program from which the grant was awarded. To select grants for review, we grouped grants of at least $10,000 in size and discarded smaller grants. We limited the grants to those awarded during the last five years, which included fiscal year 2011 through 2015. Finally, we grouped the grants in such a way that a substantial number of those to be selected (13 of 20) would come from IRRRB's Public Works program. This was because IRRRB awards a larger number of Public Works grants than other grant programs. After randomly selecting the Public Works grants, we chose the rest of the grants randomly from the following IRRRB grant programs: Commercial Redevelopment, Commissioner, Culture and Tourism, Development Partnership, Film Production Incentive, Laurentian Vision Partnership (called Innovation grants in earlier years), Renewable Energy, and Workforce Development. Following this random selection, we deliberately added three grants that had been approved by the Iron Range Higher Education Committee because IRRRB's grant process for awarding such grants differs from that for other IRRRB grant programs.

March 4, 2016

Iron Range Resources &
Rehabilitation Board

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building, Room 140
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and comment on the Office of the Legislative Auditor's (OLA's) evaluation report regarding the Iron Range Resources and Rehabilitation Board, which addresses both the agency and the board that approves the agency's programs and expenditures. I want to commend your staff for their thoroughness and professionalism throughout the information gathering process that began in earnest in July, 2015 and continued into February this year.

I believe your report contains valuable insights regarding the IRRRB. The agency intends to implement many of your recommendations, which will lead to significant improvements in our business processes and operations, and ultimately should result in better functioning programs. One of your best suggestions is to upgrade our loan database, which we intend to do as soon as possible.

In total the OLA evaluation contains six key recommendations. I will briefly address each recommendation.

1. IRRRB should explicitly analyze to what extent loan applicants can complete projects without IRRRB funding.

   The IRRRB applies many criteria when determining whether to provide financial assistance to businesses interested in either locating in our service area or expand existing operations here. Given the complexities and competition for business subsidies from other states and communities throughout the country, there are economic development opportunities that would not be realized if the agency disqualified businesses that could complete projects without IRRRB funding. We have three vibrant call center operations located in our service area with over 1,000 jobs between them that are here largely because of the economic incentives our agency was able to provide to them, not because they couldn't complete projects without IRRRB funding. Nevertheless, we recognize that there are also situations in which analyzing the importance of agency funding relative to whether a project would otherwise be viable could be valuable, and we intend to add your suggested analysis to our evaluation process for business assistance applications.

2. IRRRB should take steps, such as specifying in loan contracts the number of jobs that companies are to create, to ensure its loans actually help create jobs. It should also improve how it measures job creation.

   We appreciate your recommendations regarding job creation. Based on your analysis, the agency intends to consider making some changes in our direct loan contracts and will seek to improve our employer surveying process to get more and better job measurement information than we are currently obtaining.

3. IRRRB should more consistently determine how well its grants meet their stated objectives, including job creation.

   We agree with your recommendation. The agency is in the process of developing and implementing new grants management software, and through that process we expect to implement changes that will play a big part in helping us improve in this area.

4. IRRRB should ensure that all of its grant programs comply with agency policies.

   We agree with your recommendation and are already taking steps to improve. During 2015 the agency adopted the Minnesota Office of Grants Management policies. In addition, the agency is in the process of implementing new grants management software that will help ensure agency policies are followed by all grant programs. We will also consider reassigning some employees into roles that focus on grants compliance to ensure the new grant policies are followed by agency grant managers.

5. IRRRB should regularly analyze the collective impact of its loan and grant programs on the area it serves.

   We agree with your recommendation and will undertake a strategic initiative to determine the most efficient and productive ways to conduct such an analysis.

6. IRRRB should measure Giants Ridge's performance against its stated goals and determine whether the resort remains consistent with the agency's mission.

   We agree with your recommendation that the agency should improve how it measures Giants Ridge's performance against its goals and operating objectives. In fact, the insights noted in the OLA's findings and your recommendation coincides with analysis and long-term planning work that is currently being done by the agency regarding Giants Ridge. We expect that work will lead to the development of a strategic plan that will likely result in changes to the management and operations at Giants Ridge.

   The agency has invested in a new Event Center, one of several infrastructure improvements that will include lifts and seasonal amenities that are critical to keeping the facility competitive, and improving market share, attendance, and revenue. Sales goals, audience development goals, financial goals and performance targets will be incorporated into growth plans to track the outcome of these investments.

Improved economic impact measures about Giants Ridge provide clarity around investment and returns that are consistent with the agency's economic development policies. Ongoing Giants Ridge economic measures would also demonstrate long term outcomes important to East Iron Range communities that have been hit hard by job losses over the last few decades.

As you noted in your findings, a new combination of economic, financial and operational performance measures could really help Giants Ridge improve and become a more effective and integral part of the agency's economic development efforts within its service area.

Thank you again for the opportunity to respond to the OLA program evaluation of the IRRRB. While this response focused on your recommendations, be assured that we will take to heart all of the content of your report with the goal of making the agency more effective at meeting its mission to promote and invest in business, community and workforce development for the betterment of northeastern Minnesota.

Sincerely,

Mark R. Phillips
Commissioner

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