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Auditor

# SPECIAL ADVISORY REPORT

## Economic Development Partnership Considerations

### EXECUTIVE SUMMARY

In response to a request from the Mayor, this Special Advisory Report identifies some critical points City policy makers should consider when choosing an economic development partner.<sup>1</sup> These factors include an economic development partner's: sustainability, ability to provide technical assistance, and use of locally-based personnel. Additional factors include establishing measurable performance outcomes and implementing a robust City oversight structure. The report also discusses available tools for evaluating potential partners prior to entering into a contractual relationship.

### KEY ECONOMIC DEVELOPMENT PARTNER ATTRIBUTES

Based on our review of literature, an analysis of benchmarking survey responses, and interviews with experts, City policy makers should consider the following key factors prior to entering into an economic development partnership.

#### Economic Sustainability

Sustainability was the success factor referenced most often by applicable literature. Community Development

<sup>1</sup> Special Advisory Reports (SAR) provide information on limited reviews or time-critical assessments, investigations, or evaluations as requested by City management. SARs are non-audit services that further the accountability of the City by providing a reporting vehicle that is flexible, quickly issued, and focused on singular issues.

Financial Institution (CDFI)<sup>2</sup> sustainability can be thought of as operating costs compared to earned revenue, which in turn impacts the institution's "ability to maintain or increase impact over time."<sup>3</sup> Certain City personnel expressed concern that in light of the current economy, the City would likely need to subsidize a new partner's operating costs at a rate higher than what was required under the City's relationship with its prior economic development partner – Seedco Financial Services (Seedco).<sup>4</sup> Thus, prior to entering into a new partnership, City policy makers should consider explicitly assessing the economic condition and sustainability of potential partners.

#### High Quality Technical Assistance Capability

The capability of community-based lending institutions to provide high quality technical assistance to targeted populations, including financial advice and training

<sup>2</sup> Community Development Financial Institutions (CDFIs) are for profit and nonprofit private sector financial institutions whose primary mission is to facilitate community development, particularly within lower-income socio-economic areas. A CDFI facilitates the flow of lending and investment capital into distressed communities and to individuals who have been unable to take advantage of the services offered by traditional financial institutions.

<sup>3</sup> The Aspen Institute. 2008. *Approaches to CDFI Sustainability*, 20. Accessed December 2009 from <http://www.aspeninstitute.org/sites/default/files/content/docs/CDFISustainabilityStudy11.08.pdf>. The report provides an analysis of CDFIs.

<sup>4</sup> Seedco, a CDFI, was Denver's prior community development partner. The contract was initiated in 2007 and was terminated in 2009, due in part to Seedco's lack of performance. An audit report addressing Seedco's performance, conducted by our office, can be found at <http://www.denvergov.org/Audits19962009/Audits2009/tabid/433410/Default.aspx>.

activities, is a primary benefit for municipalities entering into community development partnerships. All experts interviewed emphasized the importance of having a partner who can provide high quality technical assistance. However, the City's contract with Seedco only included vague terms regarding technical assistance requirements and outcomes. As a result, City policy makers should consider assessing the capabilities of potential partners to provide technical assistance and should ensure that contract requirements and outcomes are clearly defined related to this key service area.

### **Establishment of Clear and Measurable Goals and Performance Outcomes**

The importance of developing a balanced mixture of performance indicators for evaluating CDFI or CBDO<sup>5</sup> performance is another key factor highlighted by research. Among the variety of performance measures, our benchmarking survey and interviews with experts suggest that City policy makers should include specific financial stability measures, including the ability to leverage funds, as key contract performance measures. Also, job creation is a performance measure often used in these partnerships. However, our research indicates that job creation as a performance measure can be problematic if not clearly defined.

The prior contract with Seedco did have a mixture of performance indicators, including some regarding leveraging fund requirements. However, the contract did not specify a clear methodology for defining jobs created, though job creation was a key performance measure in the contract. All

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<sup>5</sup> Community Based Development Organization (CBDOs) are private, for profit or nonprofit community organizations that serve low-income communities, engage in community-based economic development activities, and act as advocacy organizations by introducing and promoting specific public policies that they believe would enhance the area they serve.

performance measures in future contracts should be clearly defined.

### **Locally-Based Personnel**

All of the individuals interviewed by the audit team discussed the importance of having an economic development partner with a strong local relationship and community ties. Entities with strong local ties are more likely to be engaged in the community and to have better knowledge of community history and dynamics. The prior contract with Seedco had provisions specifying that a Local Advisory Board was to set policies and provide guidance on Denver projects. However, Seedco did not have any prior business experience in Colorado. Our benchmarking results indicate that the development partner's community reputation and past performance in the community were important to successful projects in other jurisdictions. Therefore, prior to selecting the new partner, the City should consider the extent to which it has operated in or is familiar with the Denver area.

### **Robust City Oversight Role**

The City has a critical role to play in ensuring the success of its economic development partnerships. Other cities surveyed reported that the extent to which they oversaw and enforced contracts between the City and its economic development partners was a key factor in the success of the partnerships.

If the City decides to partner with a CBDO as opposed to a CDFI, it will have implications for the City's oversight role. CBDOs usually operate more independently than CDFIs in economic development partnerships. In fact, CBDOs can receive CDBG funds directly, while a CDFI cannot. Therefore, the City's ability to oversee performance likely would be lessened in a partnership with a CBDO.

Another method of demonstrating good oversight is by ensuring that any Single Audit findings regarding Community Development Block Grant (CDBG) funds are addressed.<sup>6</sup> The City's 2008 Single Audit had findings specific to CDBG funds, which Seedco used for lending purposes. Single audit findings are a reflection of how well the Mayor's Office of Economic Development (OED) manages those federal funds, which includes oversight of sub-awards to entities like Seedco. To ensure effective stewardship for these funds, the City and OED should work to expeditiously remediate any CDBG Single Audit findings.

## TOOLS FOR REVIEW

The audit team identified three sources that can be used to obtain performance information regarding CDFIs prior to entering into a partnership.

### Rating Systems

Two of these sources are rating systems. Rating systems present a useful way to discern various aspects of a potential community development partner's performance. We identified two such rating systems: Comprehensive Ratings for CDFI Investments (CARS), which is an independent project of the Opportunity Finance Network, and the A.M. Best's credit rating system for CDFIs.<sup>7</sup>

CARS assesses the current financial position and future risk factors of CDFIs, based on five years of historical performance data. A.M. Best's methodology assesses financial strength and operational

performance, considering the unique characteristics of CDFIs.

### The Federal Audit Clearinghouse

The third source identified is the Federal Audit Clearinghouse. The Federal Audit Clearinghouse stores all Data Collection Forms for each single audit completed. CDFIs must undergo a single audit if they expend over \$500,000 in federal funds. The Data Forms contain a listing of findings by program and category.

The Data Forms reveal important information regarding the ability of the CDFI to handle federal funds properly, as well as the experience the CDFI has in expending federal funds. For example, Seedco's first large federal award was in 2006, only one year prior to entering a \$3 million contract with the City. An audit of Seedco's first federal award in 2006 had findings related to cash management and reporting, two issues that arose with the City's relationship with this organization.

## CONCLUSION

There are many considerations that the City and County of Denver can make when selecting a new economic development partner. The City can choose either a CDFI or a CBDO. Regardless of the type of partner the City chooses, factors for consideration include an economic development partner's: sustainability, ability to provide technical assistance, and use of locally-based personnel. Additional factors include establishing specific and measurable performance outcomes and implementing a robust City oversight structure. While evaluating a partner in light of these considerations is a complex task, there are some tools available for the City to use. Specifically, there are two national CDFI rating services, as well as a federal database of single audit findings. These tools should help the City's evaluation as it

<sup>6</sup> CDBG funds are awarded by the U.S. Department of Housing and Urban Development (HUD) to local governments to address a range of needs in low income areas.

<sup>7</sup> The Opportunity Finance Network is a network of financial intermediaries that target low-income groups. The Network provides services including CDFI financing, a third-party-generated CDFI rating service, policy advocacy at the federal level.

searches to find an economic development partner.

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