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**MEMORANDUM**

December 1, 2010

To: Michael Jordan, Chief Operating Officer  
Scott Robinson, Deputy Chief Operating Officer  
Margo Norton, Director, Finance and Regulatory Services  
Robin McArthur, Director, Planning and Development  
John Williams, Deputy Director, Planning and Placemaking

From: Suzanne Flynn, Metro Auditor

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**RE: Suspension of Construction Excise Tax Grants audit**

**Summary**

My office has completed our survey work of the Construction Excise Tax Grants program. I have decided not to proceed with the audit at this time. Based on the preliminary review of the program, the timing for a full audit is not appropriate. The work completed thus far provides a valuable framework to audit the outcomes resulting from CET grant projects or other planning activities in the future.

We considered two possible tracks for the audit, one focusing on administrative procedures and the other on an evaluation of the outcomes of the projects funded by the tax revenue. We believe neither track would benefit from an audit at this time. It is premature to audit the program's outcomes because the projects that were completed are based on outputs not outcomes. Future grants will focus on creating outcomes in the form of new development, but funding for those projects had not been disbursed at the time of this memo. An audit at this stage would be limited to compliance and process administration issues, neither of which would justify a full audit.

**Background**

Metro established a Construction Excise Tax (CET) in March 2006. The tax is collected at the rate of 0.12% of the value of building permits issued in the Metro region. Proceeds from the tax were to be used to help local governments meet planning requirements for areas brought into the Urban Growth Boundary (UGB) in 2002 and 2004. The tax ordinance was set to expire when collections reached \$6.3 million. The Finance and Regulatory Services Department oversaw the tax collections, which were gathered by county and local government permit staffs and remitted to Metro on a quarterly basis. The Planning and Development Department (Planning) oversaw project selection and signed off on milestones before funds were released.

In 2007, Oregon's State Legislature passed a law that prevented any government entity other than school districts from levying new construction excise taxes until 2018. Existing CETs would not be affected as long

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as they did not change the existing tax rate. In response to the new law, Metro decided to extend the CET rather than let it sunset when \$6.3 million was collected.

In the ordinance extending the tax, Metro changed the eligibility criteria for CET grants in two ways. It allowed more areas to apply for funds and it made a broader set of planning activities eligible for funding. The Home Builders Association opposed the extension of the tax and sued Metro to stop it. Metro prevailed at the trial court level in August 2010, but the Home Builders Association appealed the judge's decision. The Office of the Metro Attorney predicted it could take up to 18 months for the appellate process to run its course unless the Home Builders Association dropped the appeal.

Metro disbursed funds from the tax collections for planning new areas brought into the UGB (round one). In June, it awarded grants to 17 more planning projects totaling \$3.73 million (round two), but no money for them has been distributed yet because of the legal appeal.

The method Metro used to identify projects to receive funding differed between the two rounds. Disbursement decisions in the first round were based on the self-reported needs of each government to produce plans for new areas as required by Title 11 of Metro's Functional Plan. Metro used a competitive grant application process to determine how the second round of funds would be distributed. Metro announced the second round grant recipients in June 2010.

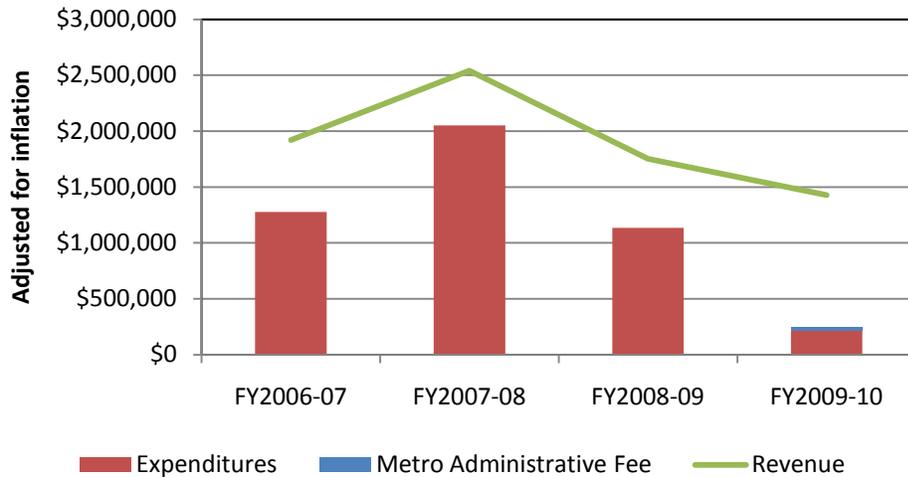
Additional uncertainty about whether to distribute funds for the second round of projects arose because tax collections have been lower than expected. The Chief Operating Officer asked staff in September for information about legal, financial, and project risks should Metro proceed before the legal appeal is decided. If Metro decides to disburse funds, it will have to determine how to prioritize recipients so projects are not jeopardized because of delays in collecting sufficient revenue to fund all projects. Planning was in the process of identifying projects that were time sensitive or had other funding partners who might back out if grant money was not immediately available. The Chief Operating Officer had not decided yet whether or how to proceed.

### **Expenditures and Staffing**

Program expenditures for staff were not tracked separately in Metro's accounting system. Based on our interviews, the program had two employees serving as the project managers in Planning, one for round one and one for round two. Three employees in the Finance and Regulatory Services Department (FRS) had responsibilities for parts of the program. None of these employees worked full time for the CET.

The ordinance that extended the CET included a provision for Metro to use 2.5% of tax revenues to cover its costs of administering the Program. FY09-10 was the first year that Metro was able to collect these administrative fees, which totaled just under \$30,000. Expenditures for grants were lower than the total of CET revenue collected, resulting in a fund balance. The fund balance was committed to grants but had not been paid out because of delays in some round one projects and the legal challenge to the extension of the tax, which suspended round two disbursements. Information about tax revenue, grant expenditures and Metro's administrative fees are summarized below.

### CET Revenue and Expenditure



#### Scope and Methodology of Survey Activities

This audit was included in the FY10-11 audit schedule. Although we didn't complete a full audit of the program, our survey work resulted in sufficient evidence to make conclusions about some elements of the program. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

*Documentation:* Program files contained appropriate documentation. Project files for the first round of projects included signed agreements, milestones, and extension requests and approvals. There was evidence that Metro had reviewed invoices to ensure milestones were completed before making payments. When the Council extended the program, the ordinance required that administrative rules be drafted to outline procedures for tax collection and grant-making. It also included a provision for a screening committee to review applications. The committee's decisions were documented in meeting summaries and scoring matrices. We reviewed records from the second round of grants, including applications, meeting summaries, and other information about the application and selection process. Staff developed an applicant's handbook when the program switched to a competitive application process for the second round, and Planning published a performance review of the program in 2009.

*Collections and Payments Process:* Although the focus of the audit was on the grants side of the program, we interviewed FRS staff to understand its role in tax collections and grant payments. Their responsibilities are outlined in the Expenditures and Staffing section above. The point of interaction between FRS and Planning occurred at the payments stage. Funding recipients provided evidence of progress and an invoice for payment to the Planning project manager, who signed off on it after confirming a milestone had been reached. The manager then forwarded the invoice to FRS for payment. The FRS employee responsible for monitoring the program's cash flow checked the invoice against the tracking spreadsheet set up at the start of the grants cycle. If it matched, the payment was made. The spreadsheet was also used to anticipate invoices, and communicate with the project manager when they were not forthcoming. The FRS employee expressed no concerns about the payments process. We found documentation in Planning's grant files that review and approval of milestones had been done as outlined in the contracts.

*New Areas Grants (First Round):* We interviewed the project manager and the Chief Operating Officer about the initial grants, which were distributed through contracts rather than a competitive application process. We also reviewed a judgmental sample of program files for the 25 funding recipients. The documents confirmed what staff stated as one of the challenges in the process: multiple requests for more time to complete the plans. Other issues included:

- One jurisdiction completed its plan but had not submitted an invoice for payment of \$7,500.
- A handful of governments were slow to start their planning processes, which prevented Metro from closing out the first round projects before the second funding cycle began.

Reasons for the delays varied by jurisdiction. Metro approved requests for more time and adjusted the milestones accordingly. We found evidence in the files of content and progress monitoring by the project manager. The manager retained responsibility to oversee the completion of the first round projects even though he was not assigned to the program's second round projects.

*Existing Areas Grants (Second Round):* Seventeen projects for the second round had been chosen when this audit began but no funds had been distributed, so we focused on the selection process. We interviewed the Metro Council liaison and four of the nine members of the selection committee. Their expertise included banking, urban design and sustainability, retail development, and economic development. All four spoke highly of their experience on the committee and the Metro employees who staffed it. Their suggestions for improvement would involve minor adjustments by staff, including:

- Limiting the maximum length of the application and attachments
- Visiting application sites
- Categorizing applications so that similar projects are compared against each other
- Clearly defining terms in the program's application, such as equity
- Adding committee members to provide views from the neighborhood level, low-income areas, and minority groups
- Revisiting the decision-making timeline so reviewers can evaluate, visit and discuss all the applications in a less-hurried manner

Given the backgrounds of the committee members, we thought there could be a potential for conflict-of-interest issues if they were connected to projects being considered. The Office of the Metro Attorney stated that it talked with the committee on this topic before the selection process started. Meeting summaries documented members with self-reported actual and perceived conflicts of interest. We found no evidence that those with actual conflicts scored projects, per the procedures they agreed to follow. Members said those with actual conflicts also left the room during discussions of projects they were connected to.

Second round grants focused on projects that would help achieve growth management goals and lead to development. The program's administrative rules listed the criteria for evaluating project proposals that aligned with those two objectives. Six criteria were used to score the projects: expected development outcomes; regional significance; location; potential to model best practices; equity; and leverage/matching potential. In general, the criteria were effective in getting the type of information needed to make informed decisions, but some of the criteria could have been more clearly defined to avoid confusion by applicants and reviewers.

In interviews with selection committee members, we learned that only a few of the applications could realistically result in development within five years. After the committee decided to fund those projects, it

could have rejected the rest because they had longer time horizons for development and, therefore, carried more risk. The committee instead opted to fund the longer-term plans. The Chief Operating Officer was aware of the committee's decision and supported it. He stated that the demand for planning was high and there were limited funds to pay for it. Although these projects might not lead to development in the desired timeframe, they were aligned with the region's growth management goals.

Selection committee meetings were not subject to open meetings laws because the committee was designed to advise the Chief Operating Officer rather than the Metro Council. Instead of minutes, Planning staff prepared meeting summaries that described the committee's general direction and overall actions. Planning provided a summary of each member's total project scores for our review. We concluded that the committee reasonably balanced its need to discuss the pros and cons of the applications against the public's right to know how the funding decisions were made.

*Mini Case Study:* To explore the possibility of auditing program outcomes, we conducted a review of planning and development literature and used the City of Gresham as a mini case study. Our review of the literature led us to a theoretical model of the planning process and the potential barriers that might prevent development from occurring. Based on the theoretical model, we created a decision tree to help sort through the potential barriers to realizing development goals. We next researched information about the City of Gresham and its two CET applications. The data we gathered focused on Gresham's Planning Department, its historical plans, and the market feasibility of the proposed project sites. We reached conclusions about the availability of data and whether that type of information would be useful as a screening tool for CET applications. In general, we determined that the data could be obtained but it would require interviews with staff and records requests at each jurisdiction. Similarly, we found that information about the market feasibility of the proposed project areas could be obtained, but further refinement of program criteria and goals would be required to reach conclusions objectively.

## **Results**

Based on our work in the survey phase of the audit, we concluded that administrative processes and program documentation generally were effective. The timelines for completion of first round projects had taken longer than expected, but there were processes in place to ensure the projects would result in plans that met regional requirements. Our review of the selection process for round two grants found minor adjustments that could make the evaluation process more efficient and effective, but in general no major risks were identified.

Delays that resulted from the legal challenge to the extension of the tax made it premature to evaluate the outcomes of round two projects. Nevertheless, the theoretical model and decision tree framework present a solid foundation to conduct this type of evaluation in the future. The CET Program and Community Investment Strategy indicate Metro's willingness to take a larger role in implementing regional growth management plans. We believe the methodology developed in this audit will prove to be valuable in evaluating plans and their resulting outcomes in the future.