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# PERFORMANCE AUDIT OF THE ECONOMIC DEVELOPMENT DEPARTMENT'S BUSINESS AND INDUSTRY INCENTIVES PROGRAM

Significant Improvements in Outreach,  
Tracking, and Evaluation are Needed to  
Ensure that Incentives are Distributed  
Appropriately and More Equitably

Office of the  
City Auditor

City of San Diego



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## THE CITY OF SAN DIEGO

January 16, 2017

Honorable Mayor, City Council, and Audit Committee Members  
City of San Diego, California

Transmitted herewith is a performance audit report of the Economic Development Department's Business and Industry Incentives Program. This audit was conducted in accordance with the City Auditor's Fiscal Year 2017 Audit Work Plan, and the report is presented in accordance with City Charter Section 39.2. The Results in Brief are presented on page 1. Audit Objectives, Scope, and Methodology are presented in Appendix B. Management's responses to our audit recommendations are presented after page 95 of this report.

We would like to thank staff from the Economic Development Department. All of their valuable time and efforts spent providing us information both in the office and in the field is greatly appreciated. The audit staff members responsible for this audit report are Kevin Christensen, Andy Hanau, and Kyle Elser.

Respectfully submitted,

Eduardo Luna  
City Auditor

cc: Scott Chadwick, Chief Operating Officer  
Stacey LoMedico, Assistant Chief Operating Officer  
David Graham, Deputy Chief Operating Officer  
Rolando Charvel, Chief Financial Officer  
Scott Clark, Interim City Comptroller  
Andrea Tevlin, Independent Budget Analyst  
Erik Caldwell, Director, Economic Development Department  
Lydia Moreno, Deputy Director, Economic Development Department  
Christina Bibler, Program Manager, Economic Development Department  
Russ Gibbon, Community Development Coordinator, Economic Development Department  
Kevin Sullivan, Community Development Specialist, Economic Development Department  
Gail Granewich, City Treasurer  
Robert A. Vacchi, Director, Development Services Department  
Ken So, Deputy City Attorney



OFFICE OF THE CITY AUDITOR  
1010 SECOND AVENUE, SUITE 555 • SAN DIEGO, CA 92101  
PHONE (619) 533-3165 • FAX (619) 533-3036

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## Results in Brief

The City of San Diego (City) has a variety of economic development goals, including generating jobs; promoting small, local businesses; encouraging economic development in older, underserved areas of the City; and generating tax revenues to support critical City services.

Economic development incentives are a key strategy local governments use to help achieve their economic development objectives, and, to that end, the City Council created the Business and Industry Incentives Program (BII) via Council Policy 900-12. Through the BII, which is administered by the City's Economic Development Department (EDD), the City provides a range of incentives such as technical assistance, expedited permitting, and financial assistance, to certain businesses that help the City reach its economic development goals.

**Robust Outreach is Needed to Ensure that Businesses Across the City are Aware of Incentives Available Through the BII**

Many different types of businesses across all areas of the City contribute to the City's economic development and potentially qualify for BII incentives. Therefore, a robust outreach program is needed to ensure that businesses that can generate the greatest benefit to the City are aware of the program and seek to use it. However, we found that many businesses that likely meet program eligibility criteria are unaware of the BII, which limits its effectiveness. In addition, although the City Council intended the BII to encourage development in older, underserved areas of the City, we found that, in many of these areas, very few businesses have received BII incentives during FY 2011 to FY 2016.

We recommend that EDD develop a comprehensive outreach strategy for the BII, which specifically includes outreach to businesses that may locate in the older, underserved areas targeted in the City's Economic Development Strategy (EDS).

**A Comprehensive Management Control Framework Including Documentation and Analysis is Needed to Ensure Incentives Are Justified and Effectively Support Economic Development Goals**

The provision of economic development incentives can be controversial because benefits to the City can be difficult to measure and because incentives benefit some private businesses but not others. Therefore, in addition to robust outreach, it is critically important for economic development incentive programs to establish a comprehensive documentation and analysis framework to provide program management, policymakers, and the public with the assurance that economic development incentives are being distributed appropriately, and are generating maximum economic benefits for the City.

Specifically, for an economic development incentive program such as the BII, program management should document, analyze, and be able to show the following:

1. What businesses have requested and received available BII incentives and the incentives provided to each business;
2. Documentation of business characteristics, including analysis showing how each business met the BII eligibility criteria and how the business furthers the City's economic development goals;
3. For financial incentives, sophisticated analysis attempting to determine the amount of money likely needed to entice the business to act;
4. Applications and agreements with recipients of more extensive and valuable BII incentives that contain adequate performance requirements to protect the City's investment and allow access to basic information to monitor performance; and
5. BII monitoring reports indicating how the program is performing on a variety of indicators related to the City's economic development goals.



**Significant  
Improvements in  
Documentation and  
Analysis Are Needed to  
provide Assurance that  
BII Incentives are  
Awarded Appropriately**

For the period we reviewed—Fiscal Year (FY) 2011 to FY 2016<sup>1</sup>—EDD was not able to demonstrate that any of the above items were being adequately performed. As a result, we found that in some cases the BII was not being operated in accordance with the guidelines established by the City Council in Council Policy 900-12 and the City's EDS; overall, it was not possible to determine whether the program was effective. Specifically, we found:

- EDD had no formal tracking system, had no internal policies or procedures on what information should be collected from businesses receiving BII incentives, and did not consistently document which businesses received assistance under the BII or which specific incentives those businesses received. As a result, EDD was unable to produce a complete list of businesses that benefitted from the BII, and the information that was provided was frequently unreliable.
- EDD had no internal policies and procedures to perform or document any analysis showing how each beneficiary met BII eligibility criteria or any anticipated benefits the City would receive, such as jobs, capital investments, and/or tax revenue. As a result, EDD could not demonstrate that incentives were justified, and, in several cases, we found businesses that were assisted provided questionable economic benefits to the City and may not have qualified.
- EDD only performed basic cost-benefit analysis on substantial financial incentives that were awarded in return for a business remaining or expanding in the City, and did not document or perform more sophisticated 'but for' analysis seeking to determine whether the amount of money offered was sufficient to entice the business to act. Therefore, the City has limited assurance that the financial incentive was effective, creating a significant risk that the City has awarded financial incentives to businesses that would have remained or expanded in the City without the incentive.

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<sup>1</sup> As noted in Finding 1, business tax certificate information from CY 2011 to early CY 2017 was used for one analysis. FY 2011 – FY 2016 was the scope period for the remainder of the audit.

- EDD only enters into agreements with businesses receiving financial incentives and does not require recipients of other valuable types of incentives to provide any information on business performance after the incentive is awarded. Therefore, EDD does not have sufficient information and does not attempt to measure the BII's overall performance in generating jobs, promoting small businesses, encouraging investment in older, underserved areas, or generating tax revenue.

For much of the period we reviewed, the City's economic development functions, including the BII, were in a significant state of flux and subject to several relocations within the City bureaucracy. During this time, management of the BII was transferred from the Mayor's Office to the Development Services Department, and EDD was subsequently established as a standalone department in FY 2016. Since becoming a standalone department, EDD has taken several steps to improve its documentation and analysis framework. For example, during the course of the audit, EDD was in the process of implementing a Customer Relationship Management (CRM) system to record information on the BII. Therefore, EDD is well-positioned to implement comprehensive management controls to enable program oversight moving forward.

To address the issues we identified above, we recommend that EDD develop policies and procedures to record all business contacts in the tracking system; require that applications include sufficient information to determine BII eligibility from recipients of more valuable incentives; analyze business information and document the justification for providing each incentive in the case management system; perform more sophisticated "but for" analysis on all financial incentives of \$100,000 or more to provide more assurance that the incentive is effective; and revise Council Policy 900-12 to require recipients of more valuable incentives to enter into agreements and periodically provide basic information on business performance to allow EDD to monitor and report on the BII's effectiveness.

**The BII Should be  
Modernized via an  
Update to Council Policy  
900-12**

As discussed above, EDD has not conducted sufficient quantitative analysis or monitoring of the BII to determine whether it is effective. However, EDD believes the incentives in Council Policy 900-12 are outdated and should be modernized, and, based on information provided by EDD and recent trends in economic development, we believe this is likely the case. Therefore, EDD and the City should confer with industries targeted by the EDS, including base sector industries as well as businesses located in older, underserved areas of the City, to determine which incentives would be the most effective. These incentives should be incorporated into a revised Council Policy that reflects current economic development incentive trends as well as the needs of businesses in the City.

**Auditor Review of  
Management Response**

We made a total of 10 recommendations to address the issues identified above. Management agreed to fully implement eight of these recommendations. However, in some cases the management response did not contain sufficient detail to describe how each recommendation will be implemented; provides conflicting responses between recommendations; and in some cases establishes what we believe are excessive implementation timelines, with no interim measures identified. In addition, EDD did not agree to fully implement Recommendations #5 and #6.

Specifically, in Recommendations #8 and #9, we recommended that EDD propose an amendment to Council Policy 900-12 which requires at least a basic form application/agreement for businesses that receive more valuable expedited permitting, or other incentives of more substantial value, even if the business is not receiving direct financial assistance. In response, EDD expressed agreement, but provided little detail on implementation, simply stating that they will propose an update to the Council Policy 'which will address these specific recommendations.' However, in response to Recommendation #5, EDD states that they will only require applications when direct financial assistance is provided, e.g., they do not intend to require applications for businesses receiving other incentives of substantial value. This is in conflict with EDD's responses to Recommendations #8 and #9.

In addition, EDD proposed response timelines of approximately 18 months for Recommendations #5 through #9. EDD does not plan to implement these recommendations until July 1, 2019. While full implementation of two of these recommendations (#8 and #9) requires City Council action, EDD did not identify any steps to be taken in the interim. Furthermore, Recommendations #5 through #7 could be implemented via EDD action alone, yet extended implementation timelines were still provided. For example, EDD does not plan to implement internal policies and procedures to track how businesses receiving incentives met program eligibility criteria until July 1, 2019.

Finally, EDD did not agree to fully implement Recommendations #5 and #6. The response to Recommendation #5 indicates that EDD only plans to require applications from businesses receiving direct financial assistance. We maintain that EDD should require applications from other businesses receiving more valuable expedited permitting or other incentives of substantial value, in order to provide the City with assurance of the business' intentions. The response to Recommendation #6 lacks specificity, but appears to indicate that EDD only intends to analyze and document how businesses receiving incentives meet program eligibility criteria if the project has 'significant relevance or direct value to the City.' We maintain that this analysis should be performed and documented for all businesses receiving incentives. BII incentives benefit some private businesses but not others, and it is critical that the City be able to demonstrate that each incentive recipient meets BII eligibility criteria, and how the incentive award benefits the City.

# Background

In accordance with the Office of the City Auditor's (OCA's) Fiscal Year 2017 Audit Work Plan, we conducted a performance audit of the City of San Diego's Business and Industry Incentive Program (BII) as operated by the City's Economic Development Department.

The overall objective of this audit was to assess the efficiency and overall effectiveness of the BII. To achieve this objective we:

- Assessed the City's overall control framework related to any services, benefits and incentives offered through the BII, including the Business Cooperation Program,<sup>2</sup> fee reimbursements, and additional incentives discussed in Council Policy 900-12.
- Assessed the effectiveness of outreach, offered incentives, and opportunities to improve incentives provided by the BII, including fee reimbursements and additional incentives discussed in Council Policy 900-12.

A detailed Objective, Scope, and Methodology statement is found in **Appendix B**.

## Program Overview

Economic development refers to the concept of increasing the size of the regional economic base to expand the distribution of wealth and improve the regional standard of living. More plainly, economic development can be characterized as the retention and creation of jobs and wealth and the improvement of quality of life.

To that end, the BII was created by the San Diego City Council through the adoption of Council Policy 900-12, following a severe recession in 1993. The goal of the program was to improve the business climate of the City by providing certain financial incentives and permit assistance to a variety of business investors citywide. At that time, the City did not have

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<sup>2</sup> As part of this objective, we issued a separate audit of the Business Cooperation Program in September 2017. See the *Performance Audit of the Business Cooperation Program* available at [https://www.sandiego.gov/sites/default/files/18-007\\_business\\_coop\\_program.pdf](https://www.sandiego.gov/sites/default/files/18-007_business_coop_program.pdf).

a program to offer assistance to "major revenue and job creating projects" throughout the City.

The original Council Policy included specific types of businesses targeted for assistance: "Commercial developments such as auto malls and shopping centers as well as point of sale businesses." To determine whether an incentive was justifiable, the company was reviewed by "staff and/or the City's financial consultants." Finally, projects recommended for financial assistance were brought before the City Council for approval.

The City Council approved a series of changes in May 2001 to update the program, and these changes remain in place. The BII is currently operated by the City's Economic Development Department (EDD) under the Business Expansion, Attraction and Retention (BEAR) team.

The stated purpose of the Council Policy is to "provide for a Business and Industry Incentive Program designed to attract and retain major revenue, job generating, and revitalization projects throughout the City, along with the criteria and procedures to ensure that the Program is equitably and efficiently administered." In order to qualify for the program, a company must provide significant revenues and/or jobs; promote stability, growth, and revenues; encourage business and development in older parts of the City; or respond to other jurisdictions' efforts to induce businesses to relocate from San Diego. In addition, the business must be consistent with the City's current Economic Development Strategy.

**The Business and Industry Incentive Program Provides for the Different Services, Benefits, and Incentives**

The business support and economic incentives available through the BII program are divided in two paths, which offer entirely different benefits to a qualifying business. These include: (1) incentives authorized by the City Council, and (2) incentives authorized by the Mayor.<sup>3</sup>

First, Council Policy 900-12 empowers EDD to initiate, negotiate, and draft economic development incentive agreements with companies to award financial incentives.

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<sup>3</sup> The Council Policy refers to "City Manager." Pursuant to section 260(b) of the City Charter, all executive authority, power and responsibility conferred on the City Manager and under the City Charter have been transferred to the Mayor, in accordance with the current "Strong Mayor" form of government.

These incentive packages, because they involve the distribution of public funds, require City Council approval. These benefits include:

- Reimbursing all or a portion of City permit processing fees;<sup>4</sup>
- Rebating all or part of the City's portion of real and personal property taxes,<sup>5</sup> consistent with the provisions of authorizing state law; and/or
- Providing tax-exempt bond financing through the issuance or approval of certain financing instruments.<sup>6</sup>

Second, Council Policy 900-12 empowers EDD<sup>7</sup> to initiate contact with businesses and provide certain benefits as they deem appropriate. These benefits include:

- The provision of assistance in securing required City permits and approvals;
- The provision of due diligence assistance in advance as a potentially valuable project is under consideration, and the provision of preliminary reviews;
- The expediting of required Development Review Department permits;

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<sup>4</sup> These include: Development Impact Fees, Facilities Benefit Assessments, Housing Impact Fees, Water/Sewer Capacity fees; fees collected pursuant to Developer Reimbursement Agreements, and/or costs of public improvements that are a required condition of the development, from future revenues to the City generated directly from the project after the City's receipt.

<sup>5</sup> Property tax revenue is collected by the San Diego County Tax Collector from a 1.0 percent levy on all real property. Prop 13 specifies that a property's assessed value may increase at the rate of the California Consumer Price Index but cannot exceed 2.0 percent per year. The 1.0 percent property tax is collected and distributed to a number of agencies, including the City. According to the City's FY2017 Adopted Budget, the City received \$502 million in property tax revenue, representing about 37.7 percent of General Fund Revenues.

<sup>6</sup> The bonds available include: Industrial Development Bonds, Non-Profit Bonds, or Enterprise Zone Bonds, pursuant to Council Policy 100-12.

<sup>7</sup> The Council Policy refers to "City Manager." Pursuant to section 260(b) of the City Charter, all executive authority, power and responsibility conferred on the City Manager and under the City Charter have been transferred to the Mayor, in accordance with the current "Strong Mayor" form of government.

- Crediting up to 45 percent of sales or use taxes<sup>8</sup> paid by the business against City business license taxes and/or development related fees, or rebating up to 25 percent of sales or use taxes paid by the business; and/or
- Reducing water and sewer capacity charges by \$1,000 per equivalent dwelling unit.

The provision of these incentives have been called a "powerful economic development policy" which serves "as the City's primary economic development platform."<sup>9</sup>

**Criteria for Admission to  
the Business and  
Industry Incentive  
Program**

Council Policy 900-12 also provides the eligibility criteria for businesses to qualify for BII incentives. In order to qualify for the program, a company must:

1. Either
  - a) Provide significant revenues and/or jobs that contribute to a sound and healthy economy;
  - b) Promote stability and growth and other revenues;
  - c) Encourage new business and other appropriate development in older parts of the City; or
  - d) Respond to other jurisdictions' efforts to induce businesses to relocate from San Diego;
2. And
  - e) Be consistent with the City's current adopted Community and Economic Development Strategy. The criteria in the Economic Development Strategy is discussed in the next section below.

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<sup>8</sup> Sales tax is the second largest General Fund revenue source. Collected at the point of sale, sales tax receipts are remitted to the State Board of Equalization, which allocates tax revenue owed to the City in monthly payments. According to the Bradley-Burns Sales and Use Tax law, the City is to receive one cent of the total statewide sales tax levied on each dollar of taxable sales. The total citywide sales tax rate in San Diego is 7.75 percent.

<sup>9</sup> As discussed in Finding 5, EDD believes the incentives in Council Policy 900-12 are outdated and may no longer be effective.



The Council Policy that governs the program states that company seeking assistance from the City of San Diego shall submit information "detailing how the business or project meets the required criteria, the type of assistance requested, and how the assistance may affect the development decision." In turn, representatives of EDD review the information provided to determine whether Council Policy criteria is satisfied. The policy further provides that, if necessary, EDD "may request additional information." Additionally, should EDD lack the resources to determine whether the criteria is satisfied, EDD may hire a consultant to perform the review at the applicant's expense.

**San Diego's Economic  
Development Strategy is  
Integrated into BII  
Criteria**

The City's Economic Development Strategy (EDS) guides and informs the City of San Diego's economic development efforts in improving the business climate. In other words, it is the City's playbook for achieving sustained economic success and fiscal stability. The EDS has been updated two times since the original version was adopted in 2001 and has significantly expanded the types of business the City seeks to assist.

The original version of the EDS, *Community and Economic Development Strategy 2002-2004*, was adopted in 2001 as a response to the economic downturn of the early and mid-1990's. The EDS identified six clusters as drivers of the local economy that should be targeted for public support. The clusters were selected because they represent a grouping of industries with an employment or gross revenue base that is greater than the national average. Additionally, these industries export more goods or services and import more dollars. The clusters included telecommunications, biomedical/biosciences, software, electronics manufacturing, financial and business services, and defense and space manufacturing.

Around the time of the passage of the EDS, the City Council adopted Council Policy 900-12 to serve as the primary economic development tool for providing advocacy support and financial incentives solely for the EDS's targeted industries. Incentives included advocacy and assistance on development permit applications, expedited permit processing, rebate of manufacturing personal property taxes, fee credits and reimbursements, and use tax credits.

An EDS update was not discussed until 2010, nearly a decade after its original passage. Per the urging of the City Council, the Mayor's office and members of the economic development staff led this effort. Two issues became critical to the update of the City economic development strategy and, in part, caused a delay in completion. First, the changing economic landscape in San Diego required policies targeting emerging industries, such as biotech and breweries. Second, the changing regulatory environment in Sacramento required a wider focus on local-based economic development and incentive efforts to include more types of business including small, locally-owned businesses.

While the EDS update was underway, Economic Development drafted a revised Council Policy 900-12 in an effort to re-focus business assistance and incentive efforts on these emerging industries. However, a City Council committee stated that the Council Policy update should be completed concurrent with or after the completion of the EDS update.

In September 2012, OCA issued a performance audit of the City's Economic Development Program titled, *City's Economic Development Program Needs Improved Strategic Planning*. The audit recommended the City update the EDS to include an assessment of current and economic business conditions; a clear mission; goals, objectives and actions to fulfill its mission; performance measures to evaluate programs; and alignment with General Plan, the City's Budget, and active Council Policies related to economic development.

In total, the revised EDS for 2014 – 2016 included four base sectors and more than 10 clusters. The EDS was updated again to cover 2017 – 2019 and identified similar industries to target, including the four base sectors below. For a complete list of the industries identified in the current 2017 – 2019 EDS, see **Appendix D**.

1. Manufacturing: (1) aerospace and defense; (2) biotech and medical devices; (3) cleantech and energy efficiency; (4) electronics and telecommunications; and (5) food and beverage.

2. International Trade and Logistics: (1) the International Border with Mexico; (2) The Port of San Diego; and (3) Logistics.
3. Military: (1) United States Navy through Naval Base San Diego, and the Space and Naval Warfare Systems Command (SPAWAR); (2) the United States Marine Corp through the Marine Corp Recruit Depot (MCRD) and the Marine Corp Air Station Miramar (MCAS Miramar).
4. Tourism: (1) Cultural Tourism; (2) Promotions, and (3) Public Benefit.

The BII remains a critical component in pursuing the goals established in the EDS. In fact, the EDS states the BII “serves as the City’s primary economic development platform.” Notably, the FY 2014-2016 EDS also listed updating Council Policy 900-12—which has not been updated since 2001—as an action in achieving the mission and strategic objectives.

**The Economic  
Development  
Department Operates  
the Business and  
Industry Incentive  
Program**

As noted above, the operation of the BII is currently conducted by the Economic Development Department’s Business Expansion, Attraction, and Retention (“BEAR”) team. According to EDD, the Economic Development function within the City bureaucracy has been moved under several different departments over the last 10 years. As a result, EDD stated the procedure and policies established to manage the work team members has been constantly in flux. Appendix C shows the various locations within the City bureaucracy where the Economic Development function has been placed since 2007.

According to the FY2017 Budget, the BEAR team is staffed with 19 full-time employees and has a budget of \$4.5 million. Notably, this is the first year the BEAR team was provided a separate line item in the City’s budget documents.<sup>10</sup> The following Key Performance Indicators related to the BEAR team and the BII were provided in the FY2017 Budget. Exhibit 1 provides some of the Key Performance Indicators related to the BEAR team and the BII included in the FY 2017 Adopted Budget.

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<sup>10</sup> According to EDD, in FY 2017, the budgets of three separate EDD work groups were consolidated into the BEAR team.

**Exhibit 1**

EDD Performance Indicators as Included in the City's FY 2017 Budget

Performance Indicator	Actual FY2015	Target FY2015	Actual FY2016	Target FY2017
6. Percentage growth in number and/or value of companies that are exporting	N/A	N/A	N/A <sup>(1)</sup>	50%
7. Percentage growth in jobs created or preserved by the expansion, attraction, and retention of base sector employers working with the Department. <sup>(2)</sup>	5,970	N/A	2,685 <sup>(3)</sup>	50%

<sup>(1)</sup> Actuals for FY 2016 will not be available until FY 2017. Counts are available one fiscal year after the reporting period.

<sup>(2)</sup> Historically, only raw numbers have been collected. The decision to use percentages instead of counts represents a new methodology in calculating growth and will be in use for Fiscal Year 2017.

<sup>(3)</sup> The decrease is due to the fact that only one-on-one interactions with companies were counted; this did not include event attendees.

Source: City of San Diego, Fiscal Year 2017 Adopted Budget

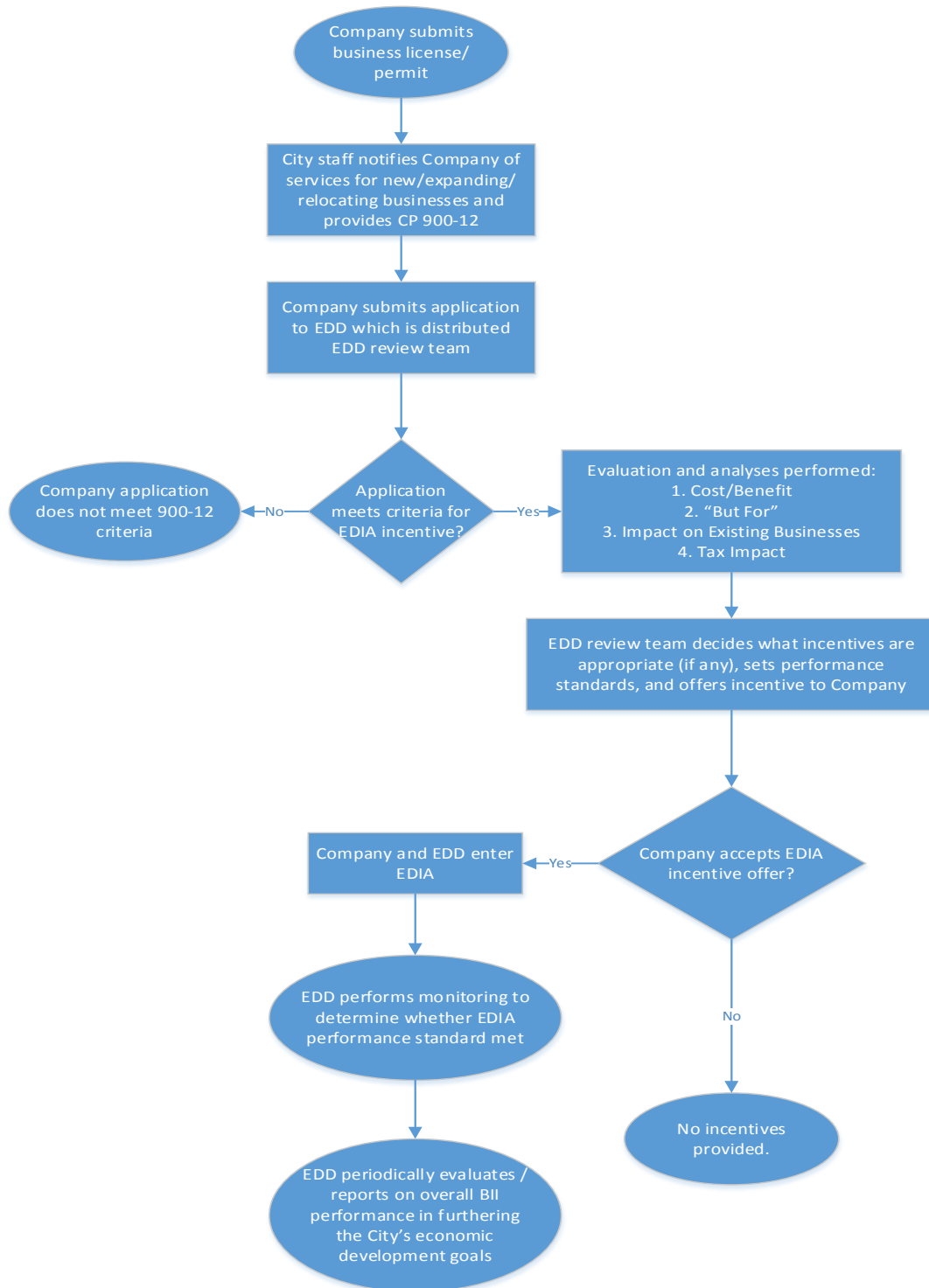
**Established Best Practices for Economic Development Recommend a Transparent and Analytic Framework to Determine Whether to Provide Incentives**

The Government Financial Officers Association (GFOA) has developed a set of best practices for government agencies that provide benefits and incentives in the hopes of stimulating increased economic activity. The use of financial and non-financial incentives to private parties, especially those that involve the transfer of public funds to private parties, introduces risk factors not generally present in other public financial management areas. As a result, the government agency should create policies that establish parameters for appropriate use.

According to GFOA, the economic development policy should include elements and procedures that set out goals and objectives; specify financial tools; establish a clear evaluation process; outline performance standards to test the success of the incentive; and monitoring and compliance procedures to ensure the incentives are working. The following is a flow chart depicting the steps for bestowing benefits in an economic development policy.

**Exhibit 2**

Procedures in an Economic Development Policy Based on GFOA Best Practices



Source: OCA based on Government Finance Officers Association's Best Practice Advisories.

First, the policy should establish clear goals and measurable objectives to create a context for accountability. Examples of program goals include target economic sectors, business retention and/or recruitment, geographic focus, job creation, blight mitigation, improving economically distressed neighborhoods, and environmental improvements.

Second, the policy should establish available financial incentive tools and specify their limitations by defining the incentives and the extent to which the jurisdiction will use them. For example, the policy may provide for the use of economic incentives but should also provide information on the limits of their use.

Third, the policy should clearly define an evaluation process that is designed to ensure consistency and transparency. The evaluation process should determine and document how a proposal measures up to established economic development criteria. Specific analysis should be required, including an evaluation of a tax base impact of the project, an analysis of the benefit to the City versus the cost of providing the incentive, and a determination of whether the project would have proceeded if the incentive was not provided, also called a "but for" analysis.

Fourth, the policy should require the inclusion of performance standards for each project receiving incentives. These performance standards are critical to help a jurisdiction gauge the effectiveness of its overall economic development program, but may also be used to recover promised financial benefits from recipients failing to fulfill their commitments.

Finally, a process should be established for regular monitoring of the incentives granted and the performance of the recipient. This should include an examination of performance standards relative to each incentive awarded and determine whether the goals for each project, as well as the incentive program as a whole, are achieved. For larger economic incentives, the government should perform separate analysis for overall projects, project benefits, and project costs.

## Audit Results

***Finding 1: A More Robust Outreach Program is Needed to Advertise the Incentives Available through the Business Industry Incentives Program and Ensure Program Benefits are More Equitably Distributed Across the City***

An effective economic development incentive program should include robust outreach to ensure all businesses that contribute to the City's economic development goals are aware of the incentives available. A comprehensive outreach strategy is especially important to achieve one of the key goals of the Business and Industry Incentives Program (BII) and the City's Economic Development Strategy (EDS), which is to encourage appropriate development in older, historically underserved areas of the City.

However, we found that knowledge of the BII is primarily relationship-based, and communicated mainly via presentations and networking events attended by BII staff. While those presentations have value, there is no comprehensive outreach effort to target businesses when they take the initial steps to locate in the City. For example, we found that businesses are not notified about the BII when new businesses tax certificates and development permits are applied for. We found that many consultants and architects are likely either unaware of the existence of the program, are aware of the program but do not know how to access it, or are unaware of the benefits available.

As a result, we found that program benefits were largely distributed to businesses who had learned about the program via "word of mouth" and which were clustered in employment hubs of the City, such as Sorrento Valley, Downtown and Otay Mesa. This is not surprising given that many of the businesses in these areas in base industries targeted by Council Policy 900-12 and the EDS. However, Council Policy 900-12 and the EDS also highlight the need to target businesses in older,

historically underserved areas of the City in order to improve equity.

We found a comparatively small number of businesses in older, historically underserved communities of San Diego had received incentives through the BII between FY 2011 and FY 2016. For example, using partial lists of program beneficiaries provided by the Economic Development Department (EDD), as well as our own research, we found that about 200 businesses received BII incentives between FY2011 and FY2016 – none of which were located in the area of the City south of I-8, north of SR-54, and east of I-805.<sup>11</sup> While the Council Policy 900-12 and the EDS are not designed to ensure an equal distribution of companies that receive incentives, they are intended to improve equity by extending the program's reach to older, underserved communities. The fact that so few companies in older and underserved communities received incentives indicates that increased efforts to reach out are needed in these areas.

We recommend that EDD develop a comprehensive BII outreach program that specifically targets businesses that may locate in older, historically underserved areas of the City. In addition, we recommend EDD work with the Office of the City Treasurer, the Development Services Department, and other applicable departments on an outreach strategy to include the provision of information to new business tax certificate applicants and development permit applicants.

**WHAT WE FOUND    The Majority of Businesses that Received Benefits through the Business and Industry Incentive Program are in the Northern Area of the City, with Other Clusters near Downtown and the International Border**

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<sup>11</sup> As discussed later in this report, EDD was unable to provide complete listings of program beneficiaries. Therefore, it is possible that some program beneficiaries were located in this area. According to EDD, there are several other programs offered by EDD that serve businesses in these communities that are unrelated to BII but provide a significant amount of focus and financial support but that was beyond the scope of this audit. These programs include Business Improvement Districts, Storefront Improvement Program, Revolving Loan programs, the Community Development Block Grant program, and Promise Zone program.



We found that uneven knowledge of the BII in the business community has led to a significant geographic imbalance in where incentive beneficiaries are located, and certain eligibility criteria targeting businesses in older, underserved areas of the City appear to be rarely used.

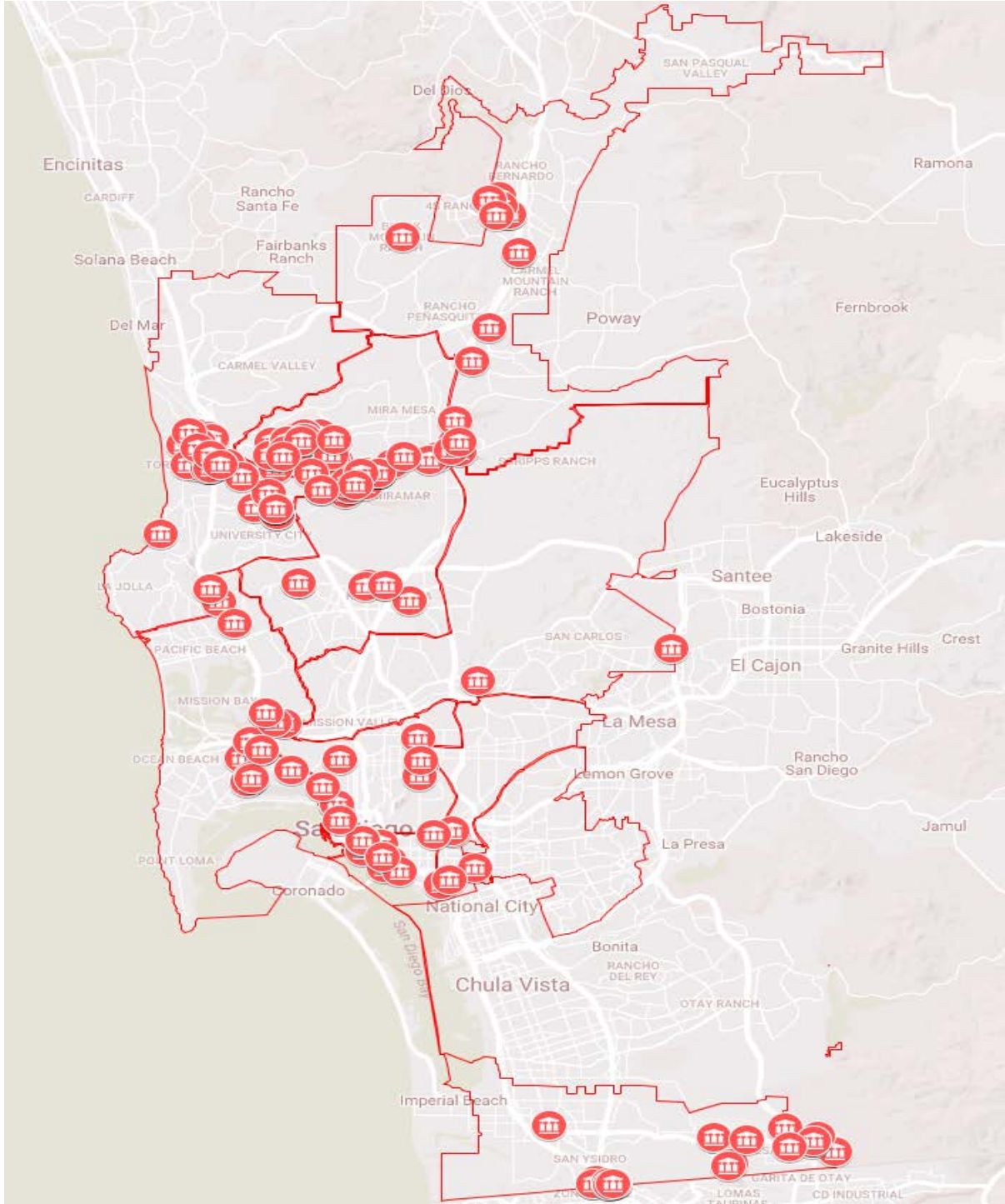
Based on an EDD-generated partial list of companies that received benefits through the BII and additional beneficiaries that OCA discovered in the City's Project Tracking System (PTS),<sup>12</sup> we found that the majority of companies that received BII incentives are located in parts of the City north of the 52 freeway, with other significant groupings near downtown or the border with Mexico. **Exhibit 3** shows the locations of businesses we identified from EDD's partial list and our research in PTS.

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<sup>12</sup> As discussed in Finding 2, EDD has not historically tracked which businesses received incentives under the BII, and was unable to provide a complete list of program beneficiaries. EDD provided a partial list of businesses which received BII incentives from FY2011-FY2016. OCA supplemented this list by researching the Development Services Department's Project Tracking System (PTS), which records whether a business was authorized to receive expedited permitting through the BII. Because expedited permitting is only one of the incentives authorized under the BII, it is likely that additional businesses received incentives, but were not identified by our review. Regardless, we believe the partial list provided by EDD, supplemented by the list additional businesses receiving expedited permitting identified in PTS, is sufficient to draw our conclusions.

**Exhibit 3**

**Most BII Incentive Recipients are Located in Northern Areas of the City, Near Downtown, or Near the International Border**



Source: OCA based on information provided by the Economic Development Department or identified by OCA via PTS.

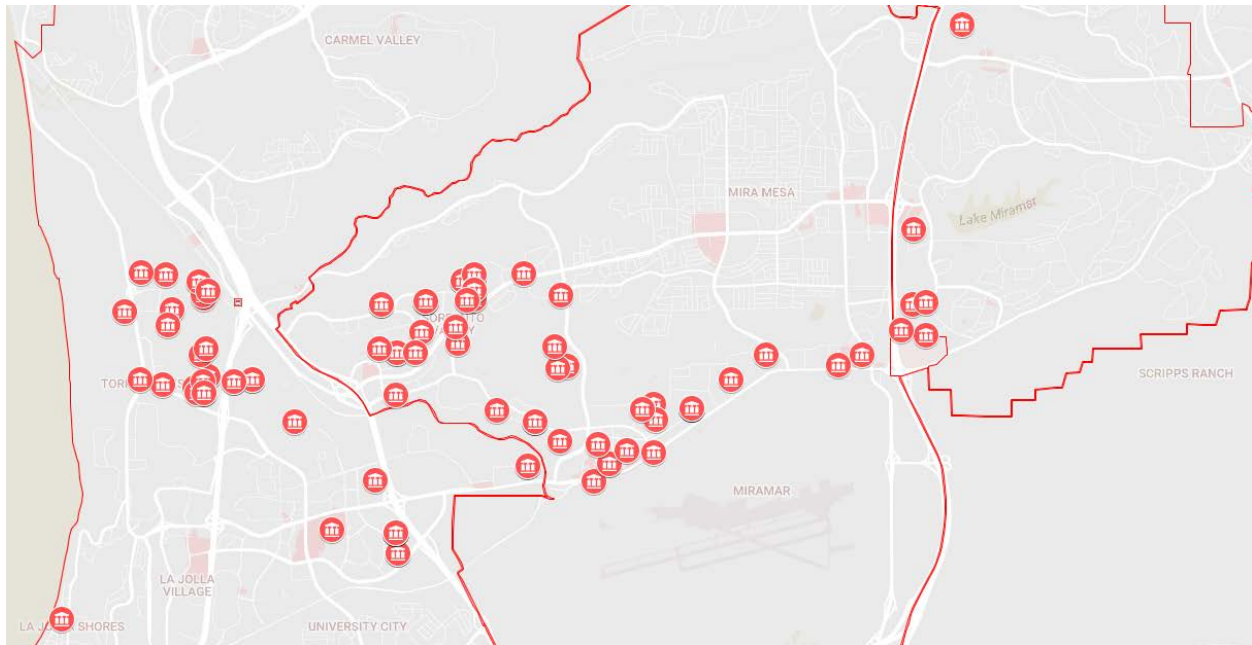
**Base Sector Businesses  
are Prevalent in the  
Areas of the City Where  
BII Provides Most  
Incentives**

Notably, most of the businesses receiving incentives appear to qualify because they are in one of the base sector industries identified in the EDS, shown in **Appendix D**. For example, **Exhibit 4** provides a closer look at the Torrey Pines, Sorrento Valley, and Miramar areas, which have the largest concentration of projects that have received assistance. Many of these incentive recipients include companies specializing in biotechnology and beer brewing. These projects fall into the manufacturing and innovation base sector, as specified in the EDS.

**Exhibit 4**

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**Biotechnology and Beer Brewing Industries in Northern Areas Frequently Receive BII Incentives**



Source: OCA based on information provided by the Economic Development Department or identified by OCA via PTS.

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Meanwhile, another large cluster of projects that have received incentives are located in the Otay Mesa, near the U.S.—Mexico border. Many of these projects include warehouse and manufacturing facilities, retail and the border mall. Additionally, many of these businesses fit within the City's Economic Development Strategies focused business: manufacturing, and international trade and logistics.

We identified<sup>13</sup> approximately 200 businesses that had received incentives through the BII between FY2011 and FY2016 and determined that none were located in neighborhoods south of I-8, north of SR-54, and east of I-805.

#### **WHY THIS OCCURRED**

#### **Current Outreach Methods are Primarily Relationship-Based, and Many Potentially Eligible Businesses are Unaware of the BII**

We found that EDD's current outreach methods are largely relationship-based, and information about the program is primarily distributed via presentations made by EDD or conversations with EDD staff at networking events. This information is then passed along via "word of mouth" to other individuals who interact with event attendees. EDD management stated that most companies hear about the BII program through networking, the current client base of companies, trade groups, real/estate brokers, and consultants. Further, EDD states that the program "builds upon itself."

While these outreach methods have value and should not be discontinued, we found that they are not sufficient to reach all of the many businesses across the City that potentially qualify for BII assistance.

We interviewed several businesses which received incentives through the BII, as well as several others which filed for business tax certificates in the past five years and potentially qualified for the BII, but did not receive incentives as part of the BII program. In addition, we interviewed several architecture and development permit processing firms because business owners often contract with architects and consultants to handle design and permitting, who then request BII incentives on the owner's behalf.<sup>14</sup>

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<sup>13</sup> As discussed above, EDD has not maintained complete listings of which businesses have received incentives through the BII. It is possible that additional businesses received incentives that were not identified; however, we do not believe this would change our conclusions regarding the geographic disparities in where beneficiaries are located.

<sup>14</sup> Interviewees who had received BII incentives were selected judgmentally from a partial list of BII participants provided by EDD, supplemented by OCA's research in the City's Project Tracking System (PTS). In order to determine the potential interviewees who had not received BII incentives, we needed to locate new or expanding businesses in the City that met the criteria for Council Policy 900-12 but were not included on either

Interviewees who received incentives through the program generally stated that their knowledge of the program exists through "word of mouth" and networking relationships within specialized industry trade groups. These interviewees reported the incentives, while modest, were substantially helpful in navigating the business start-up and permitting process. They were especially complimentary of EDD staff's expertise in providing assistance.

In contrast, we found that many of these business and consultants representing the businesses that had not received incentives stated that they had not been denied incentives – they were either unaware of the existence of the program, unaware of what businesses qualified for the program; or were aware of the program but unaware of the range of incentives available. Some of the respondents stated that while not all of the available incentives may have been valuable to them, they would like to know more about the program in order to request incentives or present it as an option for the client.

**WHAT SHOULD HAVE  
OCCURRED**

**Council Policy 900-12 and the City's Economic  
Development Strategy Establish Broad Criteria, Creating the  
Possibility to Provide Incentives to a Wide Array of  
Businesses**

BI guidelines provide the ability for a wide range of businesses across the City to receive incentives. The BI's governing policy, Council Policy 900-12, contains four separate criteria allowing businesses to seek incentives through the Business and Industry Incentive Program. While most of the criteria are focused on growing jobs and increasing sales tax revenue, one of the criteria focuses on incentivizing businesses to stimulate economic development in older parts of the City. Specifically, Council Policy 900-12 states that the City may provide assistance when necessary or appropriate to attract, retain, expand or assist projects or businesses which, "Encourage new business and other appropriate development in older parts of the City."

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EDD's list of businesses assisted or in the City's Project Tracking System. We identified these from a list of new business tax certificate applicants from 2011-2016, provided by the Office of the City Treasurer.

In addition, Council Policy 900-12 requires that the project is consistent with the City's current adopted Community and Economic Development Strategy. The City's Economic Development Strategy (EDS) was expanded in 2014 to broaden the types of businesses that can receive incentives. City Councilmembers and community leaders, in providing input during the drafting of the new policy, were explicit in their interest that the new policy also focus on smaller businesses in older and less socioeconomically affluent areas of the City.<sup>15</sup>

To that end, the City's current EDS, presented to City Council again in 2016, specifies three main strategic objectives:

1. **Economic Base Growth** – Attract, retain, and expand businesses in the City's economic base sectors.
2. **Middle-Income Jobs**-Increase the number of middle-income jobs, especially in economic base sectors.
3. **Neighborhood Businesses** - Increase the amount of neighborhood business activity, with a focus on underserved neighborhoods.

In addition, the EDS includes North American Industry Classification System (NAICS) code numbers to indicate the kinds of businesses the City is focused on assisting through the first two strategic objectives (Economic Base Growth and Middle Income Jobs). As shown below in Exhibit 5, the NAICS codes listed include the four base sectors contemplated in the EDS, which are 1) Manufacturing and Innovation; 2) International Trade and Logistics; 3) Military; and 4) Tourism,

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<sup>15</sup> Tony Young, Councilmember and Chair of the Committee on Rules, Open Government, and Intergovernmental Relations, stated to EDD staff at the May 19, 2010, Rules Committee meeting, "What I encourage you to think about . . . we want to be able to place jobs in communities like mine and also Mr. Hueso's, in the inner-City and the urban core. We want to have these individuals to be able to [start businesses in these areas]. We want investments to happen in some of our industrial lands that we have in the urban core. We want, when you think about ways to create jobs, we want you to think about all of San Diego, not just the Golden Triangle. I want you to think about us."

Councilmember Myrtle Cole, at the City Council meeting on June 24, 2014, where the updated EDS was being considered said, "It is unacceptable that we only have one major grocery store at the very southern end of my district. Several years ago the San Diego Regional EDC performed a retail analysis. The analysis showed that District 4 residents spent over \$1.6 billion dollars in one year; \$817 million of those dollars went outside of my district; \$131 million for groceries; \$110 million on restaurants. You know, it possibly went into the other districts . . . and other cities like National City and Lemon Grove. But I hope the implementation of this strategy will help to attract businesses and developers to our district."

as well as several other types of industries such as publishing and scientific research. See **Appendix D** for an exhibit showing the various businesses that are focuses for economic development in the City's Economic Development Strategy.

As illustrated in **Appendix D**, the criteria in Council Policy 900-12 and the EDS is broad enough so that a wide variety of business can be admitted and provided incentives, based on EDD's discretion. For example, a machinery manufacturer that provided middle-class jobs or generated tax revenues for the City would satisfy the eligibility criteria. In fact, because both Council Policy 900-12 and the EDS includes criteria for appropriate development in older, underserved areas of the City, many businesses in those areas may qualify, even if they are not one of the base industries shown in **Appendix D**.

**A Comprehensive Outreach Strategy Is Essential to Ensure that Potentially Eligible Businesses Are Aware of Incentives Available through the BII**

Given the breadth of Council Policy 900-12 and the EDS, potentially hundreds of new business tax certificate applicants across the City met BII eligibility criteria between calendar year 2011 and 2016. If only some businesses are aware of the incentives available, that gives them a competitive advantage over other businesses who were unaware. Therefore, a comprehensive outreach strategy is needed to ensure businesses across the City are unaware of the incentives available.

This appears to be especially important to reach businesses in the older, underserved areas of the City, which are targeted by Council Policy 900-12 and the EDS in order to improve equity. Furthermore, the effectiveness of the BII is dependent upon all potentially eligible businesses being aware of the incentives available, according to the Institute for Local Government. Regardless of where they are located, if businesses are not aware of incentives they could potentially receive, they may choose to locate, relocate, or expand elsewhere, or may not begin conducting business at all.

In addition, a comprehensive outreach strategy should reach the public across all areas of the City, including older, underserved areas of the City, according to the Institute for

Local Government. This outreach to older, underserved areas is also the intent of the City as Council Policy 900-12 and the EDS.

Therefore, a comprehensive outreach strategy is needed to make sure information about the BII reaches as many businesses as possible, which helps maximize the effectiveness of the BII and helps ensure that incentives are distributed more equitably to businesses in older, underserved areas of the City.

**IMPACT OF NOT TAKING  
ACTION**

**Businesses in Older, Underserved Areas of the City Rarely Receive BII Incentives**

While many businesses have benefitted from the BII in certain areas, the criteria allowing incentives for businesses in older, underserved neighborhoods appear to be rarely used. More specifically, there are large swaths of the City where businesses that may qualify for incentives through Council Policy 900-12 are applying and being denied BII incentives, or are unaware the program exists.<sup>16</sup>

For example, Exhibit 5 shows the area of the City south of I-8, north of SR-54, and east of I-805, which includes neighborhoods such as Normal Heights, City Heights, Rolando, Oak Park, Encanto, and Skyline. Many neighborhoods in this area are characterized by older developments, some of which could also be considered underserved. For example, many areas of Districts 4 and 9 contain fewer traditional supermarkets than other areas of the City, which is one common indicator of an underserved community.<sup>17</sup> Therefore, many types of businesses may qualify for BII incentives in this area, even if they are not in one of the base sectors identified in the EDS. And, as shown in **Exhibit 5** many businesses applied for

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<sup>16</sup> According to EDD, they do not turn businesses away. Rather, EDD asserts that they try to assist businesses in other ways even if they are not granted BII incentives. However, EDD has not historically tracked which businesses requested BII incentives. Therefore, we were unable to determine whether a specific business applied but was not approved for BII incentives, or did not apply at all. As discussed in Finding 2 and 3, we recommended enhanced tracking of company applications and awards to further address this issue.

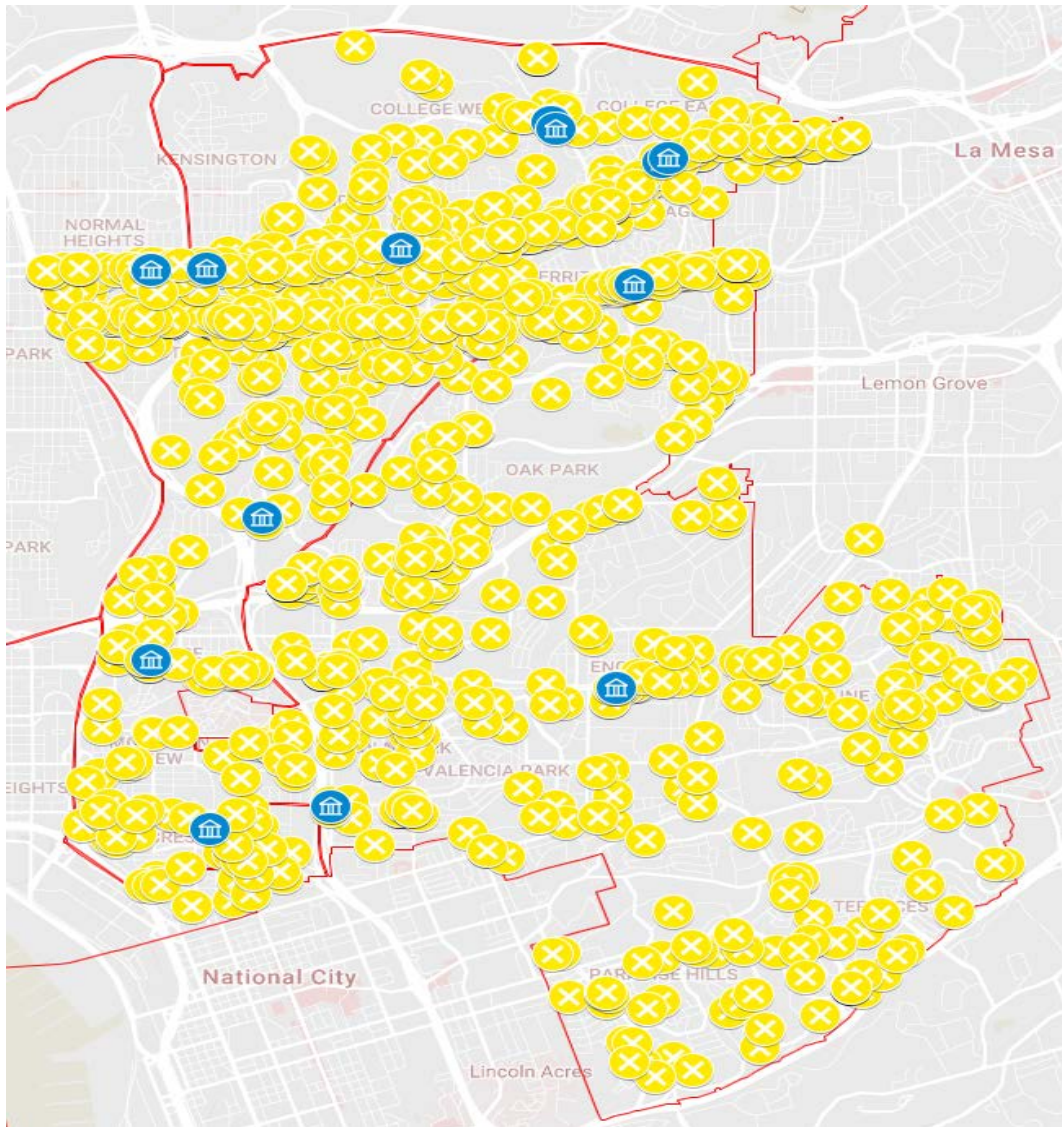
<sup>17</sup> One study indicates that there are multiple food retailers in Southeastern San Diego, although only one is considered a traditional supermarket. While most Southeastern San Diego residents have access to at least one small food store within a half-mile distance from home, there are numerous blocks where food retailers are not accessible without a car. Given the relatively high level of poverty and limited car ownership, the absence of food stores raises concern regarding people's ability to purchase fresh and healthy food.



new business tax certificates in this area between 2011 and early 2017, including businesses within the base sectors identified in the EDS (shown with blue building icons), as well as other types of businesses (shown with yellow "X" icons).

**Exhibit 5**

**Many Businesses in the Southeastern Neighborhoods of the City Applied for Business Tax Certificates and May Have Qualified for BII Incentives between 2011 and Early 2017**



Note: Yellow "X" icons indicate an active business that submitted a business tax application; Blue "Factory" icons indicate businesses that have NAICS codes listed as base sector industries in the Economic Development Strategy.

Note: The map encompasses businesses with ZIP codes located completely within these City Council Districts.

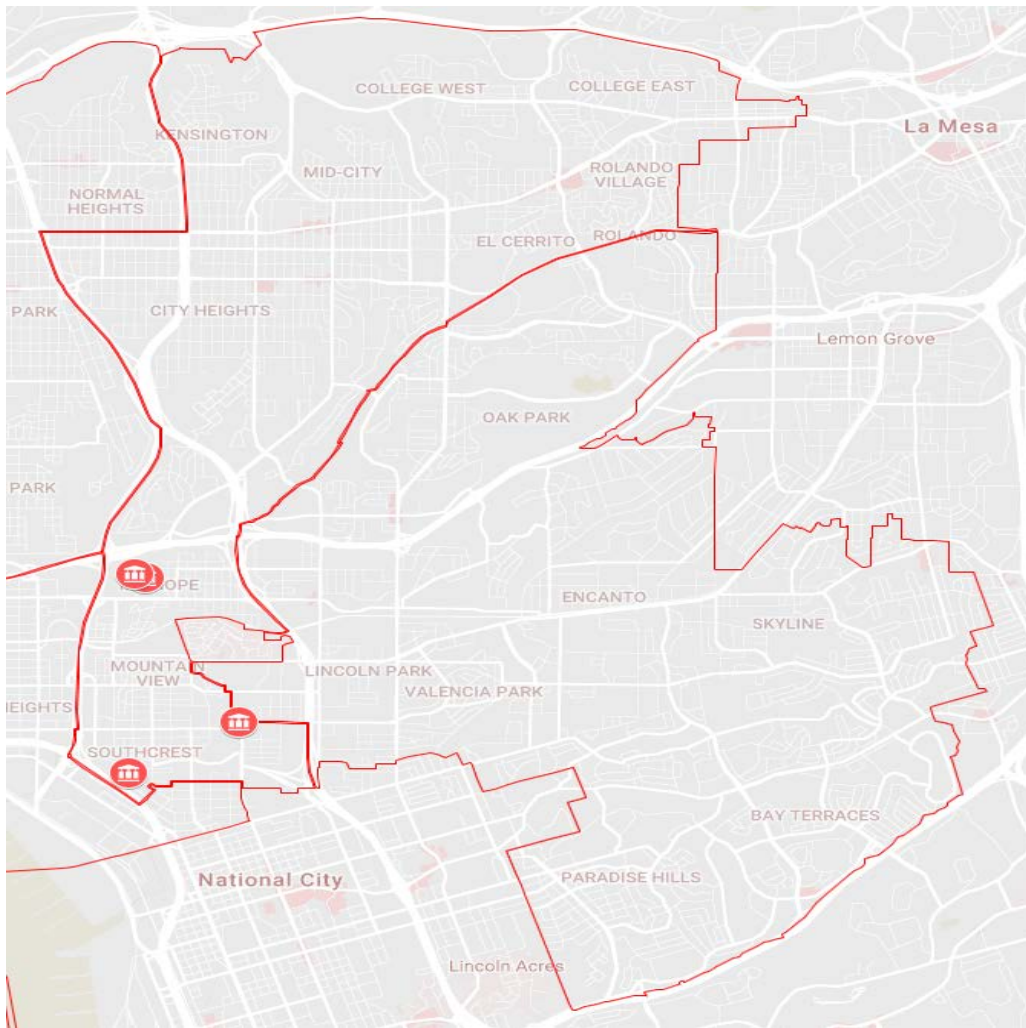
Source: OCA, based on business tax certificate application data provided by the Office of the City Treasurer.

As stated above, out of the approximately 200 businesses we identified<sup>18</sup> that had received incentives through the BII between FY 2011 and FY 2016, none were located in neighborhoods south of I-8, north of SR-54, and east of I-805.

**Exhibit 6**

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**Approximately 200 Businesses Received BII Incentives from FY 2011 - FY 2016, but Few Were Located in Southeastern Neighborhoods**



Source: OCA, based on partial lists of BII beneficiaries provided by EDD, and additional research in PTS.

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<sup>18</sup> As discussed above, EDD has not maintained complete listings of which businesses have received incentives through the BII. It is likely that additional businesses received incentives that were not identified; however, we do not believe this would change our conclusions regarding the geographic disparities in where beneficiaries are located.

As the map illustrates, there were four businesses assisted in Council District 9, and there was not a single business received BII assistance in Council District 4.

Many of these business may not have needed any assistance through the BII or would not have been considered good candidates based on business characteristics. In addition, EDD noted that businesses in this area benefit from other EDD programs, and that residents of older, underserved areas still benefit from BII-assisted businesses in other areas of the City via jobs and tax revenue generated. For example, EDD asserted that during part of the audit scope period, many businesses in this area were assisted via the state Enterprise Zone program, which was discontinued in January 2014. While this is likely true, the disparity between the number of businesses assisted in this area via the BII, versus the number of new business tax certificate applicants in this area is noteworthy and indicates that criteria targeting older, underserved areas are rarely used by EDD to assist projects through the BII.

**CONCLUSION    The City can be more Proactive in Educating New Businesses about the Assistance and Incentives Available through the Business and Industry Incentive Program**

As discussed in more detail in Finding 2 and Finding 3, EDD has not historically tracked when businesses have requested incentives under the BII and were determined not to qualify, or were provided other types of assistance. Therefore, it was not possible to determine whether factors such as favoritism, have contributed to the excessive geographic imbalance in where BII incentives are awarded.

Given our interview results and the geographic disparities shown above, it is clear that additional outreach efforts are needed to expand knowledge of the BII beyond EDD's current relationship network and reach businesses in older, underserved areas.

While EDD noted that both the City Treasurer's office and Development Services Department websites connect their clients to the EDD department website where information about EDD programs can be obtained, our results indicate a

more comprehensive outreach strategy is needed to reach additional businesses at their points of entry, in order to level the playing field and help ensure all businesses are aware of the assistance available through the BII and other EDD programs. Many business community interviewees stated the best time to notify a prospective business of potential incentives is when the business owner or consultant applied for a license to conduct business in the City or when development permits are filed for new construction or tenant improvements. However, at the time fieldwork was completed, the Office of the City Treasurer did not have a policy to communicate or distribute information about the BII program or other EDD services when companies apply for business tax certificates. According to EDD, the Development Services Department also did not have a policy to distribute or communicate information about the program when permits applications are filed. Providing information about the program at this time would allow the consultant or architect time to discuss the program with their client and time to contact EDD to discuss assistance options.

Therefore, in order to improve geographic equity in BII incentive distribution and help ensure that all potential beneficiaries are aware of assistance available through the BII and other EDD programs, we recommend:

**Recommendation #1**

EDD should develop a more comprehensive outreach strategy to spread information about the BII and other EDD programs, specifically incorporating outreach to potential businesses located in older, underserved areas of the City as stated in Council Policy 900-12 and the Economic Development Strategy. (Priority 1)

**Recommendation #2**

EDD should develop and implement a written internal process to ensure the Treasurer's Office, Development Services Department, and other applicable departments provide information about the BII to new business tax certificate and permit applicants. (Priority 2)

***Finding 2: The BII Has Not Maintained Adequate Records of Businesses that Have Requested Incentives through the BII, Or the Incentives that Were Provided***

The provision of economic development incentives can be controversial because incentives benefit some private businesses but not others. Therefore, in order to maintain the public trust, it is critical that the Economic Development Department (EDD) maintain records listing businesses that requested incentives, as well as what incentives were granted.

We found that over the five year scope of this audit (FY 2011 – FY 2016), EDD did not accurately track the businesses that requested assistance through the Business and Industry Incentive Program (BII), or what benefits were provided to them. As a result, we were unable to identify all of the businesses that have benefitted from the BII, and EDD is unable to demonstrate to elected officials, the business community, and taxpayers how BII incentives have been distributed or measure the effectiveness of the program.

After the start of the audit, EDD procured Customer Relationship Management (CRM) software that has the capability to track contacts with businesses and benefits provided. To ensure that appropriate information is tracked, we recommend that EDD's implementation of the CRM system include procedures requiring staff to document the requested incentives and incentives provided to each business.

**WHAT SHOULD HAVE OCCURRED**

**EDD Should Track BII Incentives Requested and Provided**

There are many points of entry for businesses seeking assistance through the BII, and according to EDD, they interact with thousands of businesses per year.

When EDD "touches," or interacts with a business seeking incentives through the BII, EDD staff stated they will converse with business representatives to learn about the business' characteristics, determine whether it will benefit from Council

Policy 900-12 incentives, and meets the eligibility criteria in Council Policy 900-12 and the Economic Development Strategy (EDS). EDD staff stated these conversations are typically done over the phone with subsequent follow-up meetings in-person, although interactions can take many other forms, such as via email or through leads from partner organizations.

According to guidance for governments, it is important that EDD track these contacts and business "touches," along with what assistance a business requested and what was ultimately provided, in order to demonstrate to elected officials, the business community, and taxpayers how BII incentives have been distributed. This is important not just to show which businesses received incentives and what they were granted, but also to show when incentives are requested that are not subsequently provided.

**WHAT WE FOUND**     **EDD is Unable to Demonstrate Which Businesses Requested Assistance and What Incentives They Received from FY 2011 – FY 2016**

As a result of a lack of policies and procedures for tracking incentives or an electronic tracking system to store this information, EDD was unable to provide us with a complete list of records for businesses that had requested and/or received incentives through the BII from FY 2011 – FY 2016.

For the purposes of the audit, we requested a list of companies that have received assistance, benefits, and incentives through the BII between FY 2011 and FY 2016. EDD provided two separate spreadsheets that each included a list of businesses that had received incentives.

The first list included businesses that had received expedited permitting incentives through the BII. The list covered the period between July 2011 and May 2016.<sup>19</sup> The list included the name of the business, the Project Tracking System (PTS) numbers for projects receiving assistance, addresses, and

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<sup>19</sup> The list of businesses receiving expedited permitting was provided in response to the initial Job Start letter sent to EDD in April 2016. The audit was subsequently postponed in June 2016, and was reinitiated in December 2016.

whether the projects received expedited permitting, broken out on an annual basis.

In December 2016, we requested a more comprehensive list of all businesses and the specific benefits provided through the BII from 2011-2016. The list, which EDD provided three months later in March 2017, included company names separated by year and listed the incentives provided to the company, such as expedited permitting, technical assistance, and/or monetary incentives. When this list was provided, we tested it for completeness and found it was incomplete and was missing a significant number of businesses that had received BII assistance, as described below. When we asked EDD why the list was not complete, EDD management stated the list was "not intended to be complete" and was not reflective of all projects that received benefits and incentives in the timeframe requested. EDD management stated that the list did not previously exist and was compiled in response to the audit request. EDD management stated the list was designed to "educate" the audit team on the range of assistance EDD provides to businesses via the BII and other similar programs.

We performed a series of comparisons to evaluate the completeness of each list, and found that both lists were missing a substantial number of businesses that received benefits through the BII. Specifically, the March 2017 list covered the period between FY 2011 and FY 2016 and included 122 business projects. In contrast, the list provided in May 2016 which listed all BII projects between FY 2011 and FY 2016 included 145 business projects – a difference of 23 projects. This supports a conclusion that the lists are not complete.

To evaluate the accuracy of the lists provided by EDD, OCA then conducted a search in PTS<sup>20</sup> to determine whether business that received incentives through the BII were not included on the EDD lists. Because EDD did not track incentives provided, conducting a search through PTS was the sole resource available to perform data reliability testing.

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<sup>20</sup> The Development Services Department's Project Tracking System (PTS) is an in-house software system used to manage and track the City's land development permit processing. PTS includes specific notations in searchable format for project permits that are expedited through the BII program by EDD.

We found a significant number of projects in PTS that were expedited at the direction of EDD that were not included on either EDD list. Specifically, we found 116 projects in PTS that were processed "Expedite" for "Economic Development" between FY2011 and FY2016. Of these 116 projects listed by DSD as "Expedite" for "Economic Development," EDD did not include 64 projects on the May 2016 and March 2017 list provided to OCA. In other words, the lists provided by EDD included just 45 percent of the total projects listed as "Expedite" for "Economic Development" in PTS.

**The Limited Information EDD Was Able to Provide on BII Beneficiaries Was Frequently Inaccurate**

Furthermore, in addition to being incomplete, we found the incentives listed for each business were not supported by information in the project files, and in many cases was inaccurate.

We selected a judgmental sample of 35 businesses that had received administrative incentives through the BII, such as expedited permitting and technical assistance, and found that most files contain minimal or no information on what incentives were provided, and files for several businesses were not created at all.<sup>21</sup> Specifically, EDD was unable to produce files for 10 (29 percent) of the 35 businesses in our sample. Furthermore, only 13 (37 percent) of the business files provided by EDD contained any information on what incentives were granted, and this information often appeared to be incomplete.

**Exhibit 7**

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**BII Project Folder Data collected from Economic Development**

Category	Totals
Number of files requested for projects that received administratively approved incentives.	35
Number of folders that included information illustrating how the business or projects meets Council Policy 900-12 criteria.	13
Number of projects folders that EDD did not provide	10

Source: OCA generated based on EDD files.

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<sup>21</sup> According to EDD, some files may have been created at the time the project was provided incentives, but could not be located in response to the audit request. However, as discussed below, EDD had no formal tracking requirements for staff to follow.



Therefore, the information EDD was able to provide on the lists of businesses receiving BII incentives was largely based on the recollections of EDD staff, and was frequently unreliable. We found that even when a business was included on one of the lists provided by EDD, that the incentives provided were frequently inaccurate. For example, on the March 2017 list provided by EDD, 102 businesses were listed as receiving expedited permitting for their development projects. We were only able to locate 70 of those projects in PTS, indicating that many of those businesses may not have actually had a project to expedite.<sup>22</sup> Furthermore, of the 70 projects we were able to locate, more than 15 percent were processed through the standard permit process at DSD, indicating that they had not actually been provided expedited permitting by EDD.

Therefore, we determined that EDD is unable to accurately report the incentives provided to specific companies.

#### **WHY THIS OCCURRED**

#### **EDD Lacked a Customer Relations Management (CRM) System and Had No Documented Policies for Recording Incentive Information from FY 2011 – FY 2016**

EDD management stated that its tracking processes for businesses seeking and being provided assistance are limited to maintaining a hard copy folder with documents related to Council Policy 900-12 criteria. However, EDD management stated there is no uniformly recognized trigger on when a folder should be started, and there are also no internal policies and procedures that specify what information should be collected and maintained. In fact, in interviews, three separate EDD staff stated three entirely different methods of assembling and updating the folders. What's more, we found that no folder existed for many companies that received benefits through the BII.

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<sup>22</sup> The list provided by EDD included the business name and timeframe that expedited permitting was granted. We used that information to search PTS for projects with that business name, or at the business address, during the general timeframe provided. It is possible that this test did miss some projects that were actually in PTS; however, given that nearly 30 percent of the projects identified by EDD were not found in PTS, it is reasonable to conclude that EDD's list is not accurate in terms of which businesses received expedited permitting.

EDD also stated that staff is not required to track staff time spent assisting a business. EDD staff noted that different companies have drastically different needs based on the size, location, or complexity of the project. Some companies are assisted with one phone call to the Development Services Department to clear up a permitting issue, while others require hundreds of hours of assistance.

**IMPACT OF NOT TAKING  
ACTION**

**Maintaining a List of Projects in a Case Management System is Critical to Analyzing the Effectiveness of the Business and Industry Incentive Program**

As a result, we determined that EDD is unable to accurately report the benefits provided by EDD to specific companies.

EDD acknowledged its lists of businesses receiving incentives are incomplete and inaccurate because EDD had no written processes or procedures related to tracking companies and incentives provided. Because EDD provides incentives and services at no cost—services which everyone else in the City pays for, or does not have access to—it is critical to maintain records of the companies receiving benefits and the benefits that are provided. This information is essential to demonstrating who has benefitted from the program, as well as measuring the program's effectiveness.

We recommend that EDD implement a Customer Relationship Management (CRM) tracking system to record information about which businesses have contacted EDD for assistance.

Specifically, to ensure that appropriate information is tracked in EDD's new CRM system, we recommend that EDD's CRM system documents contacts with various businesses, details concerning incentives that were provided and/or denied; and time spent assisting the businesses, if the time spent is significant and above and beyond what EDD would provide in the normal course of business. Additionally, we recommended that EDD create policies and procedures and train EDD staff to document this information in the CRM system.

As stated above, EDD has procured and implemented a CRM system. According to EDD, the system launched for staff's use in July 2017. EDD management stated the CRM includes project specific details, including the type of assistance provided, jobs created and retained, size of the project, staff time spent assisting, and the name of the business or project. In June 2017, OCA attended an EDD-hosted training for staff on the functionality of the new CRM. We found the CRM and the CRM Operations Manual require that EDD staff collect and input most of the information mentioned above. We will report on the program implementation and documentation of businesses receiving incentives as part of our normal recommendation follow-up process.

**Recommendation #3**

EDD should fully implement its Customer Relationship Management (CRM) tracking system. Specifically, EDD should ensure that the system documents: (1) business 'touches' (contacts with various businesses), business assists, and projects; (2) details concerning incentives that were requested and/or provided by the business; and (3) time spent assisting the businesses (e.g., EDD staff technical assistance), if the time spent is above and beyond what EDD would provide in the normal course of business. (Priority 1)

**Recommendation #4**

EDD should further define policies and procedures for the CRM, and enhance the training of EDD staff. The enhanced training should include how to document in the system additional information above (in Recommendation #3) pertaining to businesses seeking and receiving assistance. (Priority 1)

***Finding 3: The BII Collects Minimal Information from Most Businesses Requesting Incentives, and Performs Incomplete Document Analysis Justifying Why Incentives Were Granted***

In addition to tracking what incentives were granted to each business, it is essential that the Economic Development Department (EDD) also collect sufficient documentation and perform analysis showing *why* those were incentives were provided. Analyzing and documenting the justification for providing incentives is critical to allow managers, policymakers, and the public to ensure that incentives are distributed appropriately, and are effectively achieving the City's economic development goals.

**EDD Should Perform and Document Analysis Justifying Administrative Incentive Awards**

Whenever BII incentives are awarded, EDD should perform and document analysis showing that the incentive is justified, and that the project meets the criteria in Council Policy 900-12 and the current Economic Development Strategy (EDS). For more valuable administratively-approved benefits, such as expedited permitting for a large project, EDD should also require beneficiaries to complete an application and certify information showing how the project meets program eligibility criteria.

However, we found that EDD generally collects minimal or no information from the business receiving incentives, and does not engage in or record sufficient analysis to determine whether a company meets the criteria set forth in Council Policy 900-12 and the EDS. For example, out of a judgmental sample of 35 businesses, we found that EDD only collected sufficient information and documented the required analysis justifying the granting of incentives for 13 (37 percent). And, as noted in Finding 2, EDD could not produce any documentation at all for 10 (29 percent) of the 35 business files we requested.

As a result, EDD is unable to demonstrate to policymakers or the public that incentives are always granted to businesses that meet eligibility criteria and further the City's economic

development goals. In fact, we found that several businesses granted administrative incentives appear to provide questionable economic benefits according to the EDS, and may not have qualified for the benefits received.

**Significantly More  
Sophisticated Analysis  
Should be Performed  
When Offering Financial  
Incentives**

For financial incentives, which are typically much more valuable and require City Council approval per Council Policy 900-12, industry best practices require significantly more sophisticated analysis. In these cases, we found that EDD performs sufficient due diligence to ensure the companies meet the Council Policy 900-12 criteria, and performs a basic cost-benefit analysis comparing the cost of the incentives to the jobs and tax revenue estimated to result. However, we found that EDD does not perform analysis attempting to determine the amount of money required to entice a company to act. As a result, the City may be providing benefits when the company would have remained or expanded in the City without the incentive. Alternatively, the City may be providing unnecessarily large financial packages. In both cases, there is significant risk the City's costs to provide the incentive exceed the benefits received.

In order to demonstrate to policymakers and the public that businesses being incentivized are providing appropriate employment, tax, and/or development benefits to the City, we recommend, for smaller companies receiving lower value expedited permitting, that EDD staff collect basic business information from the company which would be certified by EDD. Additionally, for larger projects receiving more valuable expedited permits or other incentives of significant value, EDD should require the company to submit an application coupled with certified business information, such as the company's capital investment in the project, certain tax information, and the number of prospective jobs created by the project.

For all BII beneficiaries, EDD should use this information to perform and document analysis showing that the business furthers the City's economic development goals. In addition, for financial incentives, we recommend that EDD perform and document more sophisticated analysis showing that the amount of the financial incentive is sufficient to entice the business to act, but is not excessive.

**WHAT SHOULD OCCUR     Council Policy 900-12 and Industry Best Practices Require that EDD Collect and Document Sufficient Information and Analysis to Justify the Award of Administrative Incentives**

In 2014, the City Council approved an update to the EDS that significantly expanded the types of businesses the City seeks to assist. The expansion sought to increase focus on both high-paying jobs in base sector industries to ensure money and wealth flow into the region, and also smaller local businesses to help ensure residents and businesses purchase goods and services from local vendors rather than from vendors headquarters outside the region. The EDS was updated again in 2016.

Given that many types of businesses can meet the minimum eligibility criteria outlined in Council Policy 900-12 and the expanded EDS, EDD should maintain sufficient documentation and conduct appropriate analysis to show that businesses receiving BII incentives are driving economic development.

The Government Finance Officers Association (GFOA) provides best practices on establishing application collection and analysis methodologies for economic development incentives.

First, the GFOA stresses the importance of requiring specific documentation in an economic development application or proposal. Second, the GFOA highlights the need for City management to develop a clearly defined and transparent evaluation process for companies seeking incentives.

According to the GFOA, the typical evaluation process should include the following activities:

- How a proposal measures up to established economic development criteria.
- An evaluation of tax base impact, in terms of increases in taxable value.
- Analysis of the impact of a project on existing businesses.

In addition, Council Policy 900-12 states that EDD should review sufficient information from the business requesting incentives, and should conduct and document analysis justifying the incentives provided. According to best practices for economic incentive programs, the combination of the application and the documented analysis is intended to allow for oversight of the distribution of incentives by program management, as well as policymakers and the public, to ensure that incentives are equitably and justifiably distributed.

**WHAT WE FOUND**    **EDD Collects Minimal Documentation and Requires No Analysis to be Performed or Documented to Ensure Companies Receiving Administrative Benefits through the BII Comply with Council Policy 900-12 Criteria**

We found that for more than half of the files we requested, EDD acquired minimal or no documentation, such as applications including projected jobs created and taxes generated, from businesses requesting administrative assistance through the BII. When such information is provided, EDD rarely attempts to substantiate it by acquiring additional source documentation from applicant companies to ensure the Council Policy criteria is met.

We performed a judgmental sample of 35 project files maintained by EDD for companies that have received an administratively approved service, benefit, or incentive between FY2011 and FY2016. We found that EDD did not collect applications for 32 of these projects—about 90 percent of our sample—that received administratively approved services, benefits, or incentives through the BII.<sup>23</sup>

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<sup>23</sup> We found 3 of the 35 companies that received services through the BII completed an Economic Development Project Information (EDPI) form. These forms require the company/applicant to input the project site information; property ownership information; the architect, developer, or contractor; and a description of the project. The description of project includes the type of use of the project, such as manufacturing; the number of new or retained jobs associated with the project; the total capital investment; and the annual tax revenue paid to the City. The EDPI form provides sufficient information for EDD to perform an analysis to determine whether the company meets the Council Policy 900-12 criteria and would benefit from assistance.

EDD management stated this form was not used for incentives for the BII. EDD management stated the EDPI was a form created by EDD but they were used to collect information required by the state for the Enterprise Zone program—not BII projects. See **Appendix F** for an example of the EDPI form.

Furthermore, we found that more than half of the project files contained minimal or no documentation of business characteristics, and very few contained any evidence of analysis showing that the business met minimum BII eligibility criteria or that the incentive was justified.

According to EDD, when companies seek incentives through the BII, typically EDD engages in conversations with the applicant company to determine whether company meets criteria of Council Policy 900-12. Although Council Policy 900-12 requires specific documentation to be collected and analysis to be performed, EDD staff stated there is no list of basic questions to ask, no internal EDD requirement on the type or amount of analysis that should be conducted, and no "quantitative analysis" is performed.

Out of the judgmental sample of 35 project files we reviewed, only 13 files (37 percent) contained any documentation or analysis showing how the business met BII eligibility criteria. The most frequently applied analysis was an evaluation of the tax base impact of the company, which evidence in the folders indicated staff performed for 5 out of the 35 projects, or about 15 percent of the time. Typically, this analysis consisted of a print-out showing the last five years of a company's sales tax records.

Most of the folders contained only one or two documents, with no evidence of analysis showing the business met the minimum eligibility requirements or how the business would further the City's economic development goals. For example:

- The folder for Bitter Bros Brewery contained a partially completed "Zoning Affidavit" and a flyer advertising yoga classes (appears to be previous use of site).
- The folder for BioMed Realty Trust contained only a PTS printout showing the name of the project, the PTS number, and general information about the project reviewer comments. There were no materials indicating an analysis had been done.
- The folder for Kilowatt Brewing included only an article about the company from the San Diego Reader.



- We found that EDD did not have a folder for 10 (29 percent) of the 35 projects in our sample. In other words, EDD did not collect, analyze, or maintain any documentation at all for more than one-quarter of the projects in our sample which received incentives.

These results are summarized in **Exhibit 8** below.

***Exhibit 8***

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BII Project Folder Data collected from Economic Development

Category	Totals
Number of files requested for projects that received administratively approved incentives.	35
Number of projects where the file contained any documentation or analysis of how the business meets eligibility criteria	13
Number of files that included an application for incentives	3

Source: OCA, based on review of EDD project files.

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**WHY THIS OCCURRED    EDD Lacks Internal Policies and Procedures Mandating that Adequate Analysis Be Performed and Documented**

Outside of Council Policy 900-12, EDD lacks internal policies and procedures governing what types of documentation or analysis should be maintained to show how a business meets BII eligibility criteria and furthers the City's economic development goals. EDD management and staff stated documentation is not collected and analysis is not performed for most businesses receiving administrative BII benefits. First, they stated that when determining whether a company satisfies the criteria in Council Policy 900-12, EDD does not quantify tax revenue and/or jobs when providing technical assistance in securing permits or due diligence assistance because this is assistance that is now provided in EDD's "normal course of business." However, in addition to technical assistance, almost all businesses assisted via the BII receive free

expedited permitting, which Council Policy 900-12 clearly states is one of the incentives offered by the BII, and the Council Policy states that EDD should collect information from the recipient and analyze it to document that the business meets the eligibility criteria and the incentive is justified.<sup>24</sup>

Additionally, Council Policy allows for benefits to be approved when a business will attract, retain, or expand City revenues or promote tax growth. However, EDD management stated staff does not want to quantify tax revenue and/or jobs potentially created by the company because it would limit EDD's ability to timely assist companies.

**IMPACT OF NOT TAKING  
ACTION**

**EDD Cannot Demonstrate that Businesses Receiving BII Incentives Met Eligibility Requirements, and Several Businesses Receiving Assistance Do Not Appear to Align with the City's Economic Development Goals**

As a result of the lack of documentation and analysis, EDD cannot demonstrate that businesses receiving benefits meet the criteria of Council Policy 900-12 and the City's EDS, or that providing the incentive helped to further the City's economic development goals. This limits the ability of EDD management, policymakers, and the public to ensure that BII incentives are distributed appropriately and effectively.

In fact, in our sample of 35 businesses that received BII incentives through administrative discretion, we found several whose adherence to the criteria of Council Policy 900-12 and the EDS is questionable, and that may not further the types of economic growth envisioned by the EDS.

For example, EDD provided technical assistance and expedited permits for a Vons supermarket in the Mission Hills neighborhood in FY 2010 and FY 2011.<sup>25</sup> We estimated that the value of the assistance related to expedited permitting alone

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<sup>24</sup> As discussed in Finding 5, Council Policy 900-12 is outdated, and 'technical assistance' in obtaining permits is now something that EDD does provide in the normal course of business. We agree that Council Policy 900-12 should be updated for a variety of reasons to address issues such as these.

<sup>25</sup> This project was identified for our review because some assistance was provided during our scope period of FY 2011 – FY 2016. We later determined that the project had also received assistance beginning in April 2010. For the purposes of our review, we included all assistance received throughout the duration of the project.

totaled as much as \$57,000.<sup>26</sup> The amount of City staff time spent assisting the company was not tracked.

EDD's project file did not contain any information on the specifics of the project that were relevant to CP 900-12, other than that it was a supermarket. EDD stated they assisted the company after the company experienced difficulty receiving a site development permit. A review of DSD records showed that City officials encouraged the company to introduce additional uses into the project design—such as office or affordable housing—to comply with the Community Plan which designated the proposed project site for mixed-use, allowing high-density residential.<sup>27</sup> According to EDD, Vons officials reached out to EDD and warned of the potential that Vons would withdraw the project including the \$25 million capital investment due to the cost and difficulty related to the City's requests. Vons requested assistance to avoid providing office or residential uses as part of the project, and also requested expedited permitting.

We asked EDD to provide additional information on why the project qualified for BII incentives. EDD stated the project met the criteria in Council Policy 900-12 because the supermarket is a retail center that provides additional sales tax revenue, included the expansion of an existing 12,000 square-foot grocery store to nearly 60,000 square feet, and would generate approximately 70 new "middle wage, union" jobs, in addition to retaining the 50 jobs generated by the existing grocery store. EDD added the project contributed to the revitalization of an area and was appropriate development in an older part of the City.

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<sup>26</sup> This is not necessarily the City's cost of providing the expedited permitting services. The value we estimated is based on what other customers have to pay to receive similar services, such as DSD's express permitting service. This included the estimated value of expediting a portion of the site entitlements, as well as the subsequent building permits.

<sup>27</sup> According to DSD's Project Tracking System, the land use designation in the Uptown Community Plan indicates that pedestrian-oriented retail services are required on the ground floor, with either office or residential uses on the upper floors. The area was recommended to be a higher intensity use area. The company was encouraged to consider introducing other uses such as office and/or affordable housing over the retail space to implement the land use plan designation.

EDD provided two separate reasons why the project complied with the City's EDS. First, EDD pointed to the portion of the EDS discussing "developing the small business economy by encouraging micro-businesses such as home based businesses" and "programs aimed at revitalizing older neighborhoods in need of investment." Second, EDD cited the section of the EDS discussing the goals to support neighborhood businesses, increase "the number of locally owned businesses in San Diego" and increase "the amount of neighborhood-based business activity, with a focus on underserved neighborhoods."

We found EDD's justifications for compliance with the EDS problematic for several reasons. First, the EDS states that "retail" is a non-base industry that "rarely needs to be retained through economic development efforts as (retail business) mobility is severely limited." Rather, the EDS discusses the need to focus on the City's base sector industries: (1) manufacturing and innovation; (2) international trade and logistics; (3) military installations; and (4) tourism. The following table is provided to illustrate this point:

**Exhibit 9**

The EDS States that Base Industries, not Retail Businesses, Should be the Focus of Economic Development Efforts



Source: 2014-2016 Economic Development Strategy

The EDS goes on to state that certain small businesses should also be a focus of economic development efforts, even if they may not be in a base sector industry, because they retain money in the local economy, and they may be hurt by large corporate chain which funnels dollar out of the local economy. Additionally, the EDS sections cited by EDD focus on "micro-businesses", "home based businesses", and "locally owned businesses." However, far from being a small local business, Vons is part of a large corporate chain, headquartered in the San Francisco Bay Area, that has more than 2,200 stores across 33 states.

Second, we found no information to support EDD's claim that the Mission Hills neighborhood is an "underserved neighborhood" or that is an "older neighborhood in need of investment." Rather, we found that Mission Hills home prices are more than double the average median home price in the City, and at the time EDD assisted the project, there were at least five other grocery stores within a 1.5 mile radius, including an Albertson's located directly across the street.<sup>28</sup>

Third, Mission Hills Vons was the only grocery store we found that received BII incentives between FY2011 and FY2016. Meanwhile, during this time frame, approximately 95 other grocery stores filed for business tax certificates in the City, some of which may qualify for BII benefits because they are in areas in need of development – and in need of grocery stores in particular. Specifically, approximately 40 grocery stores filed for business tax certificates in older parts of the City located south of the I-8 freeway, including the neighborhoods of Southcrest, Mountain View, Mount Hope, Valencia Park, Skyline, Paradise Hills, Oak Park, and Bay Terraces—which are more traditionally considered older and underserved areas of the City.<sup>29</sup> More than half of these business tax certificates have been cancelled, likely indicating that the business did not successfully start up, or has ceased operation.<sup>30</sup>

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<sup>28</sup> These grocery stores included Albertson's, Ralph's, Whole Foods, Trader Joe's, and Sprouts.

<sup>29</sup> Zip codes: 92102, 92104, 92105, 92113, 92114, 92115, 92116, 92139

<sup>30</sup> According to the Office of the City Treasurer, in some cases business activity may be ongoing, but the business owner has failed to renew the business tax certificate.

Notably, many of these areas were identified as “food deserts” – lower-income areas where many residents do not live within easy access of a supermarket - according to an April 2014 report by the San Diego State University Department of Geography.<sup>31</sup> See **Appendix E** for a map of ‘food desert’ areas in the San Diego region.

In our judgmental sample of 35 BII beneficiaries, some other projects whose adherence to BII eligibility criteria and the EDS appeared questionable include:

- A restaurant in the Liberty Station redevelopment, which EDD justified as appropriate development in older parts of the City. EDD also stated that this project was expedited as it was a participant in the Local Agency Military Base Recovery Area (LAMBRA) program, which was intended to help revitalize areas affected by military base closures. However, the LAMBRA program was discontinued more than one year before this project was expedited. In addition, this was the only restaurant we identified that EDD incentivized via the BII during the time period we reviewed, FY2011—FY2016. Liberty Station itself is also a relatively new development that includes approximately 30 other restaurants.<sup>32</sup>
- A laundromat in Barrio Logan justified as an ‘anchor tenant’ that meets the ‘development in older parts of the City’ criteria. While Barrio Logan is an older part of the City (which, according to EDD, was located in an Enterprise Zone and Redevelopment Area at the time the assistance was provided), the laundromat is a tenant in a large, new development project. It is also adjacent to a large supermarket, which more closely fits the

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<sup>31</sup> The U.S. Department of Agriculture defines a food desert as a low-income neighborhood, or Census tract, which does not have a supermarket within 0.5 miles. The report found that most of the Census tracts in Southeastern San Diego are considered food deserts, because poverty rates are often above 20 percent and there is only one supermarket what meets the USDA definition of reporting as least \$2 million in annual sales containing all major food groups.

<sup>32</sup> We also found that the Liberty Station development is covered by a Disposition and Development Agreement between the City and the developer, which entitles the developer to expedited permitting for certain parts of the development. It is unclear if this would cover a restaurant. Of the approximately 30 other restaurants, the Backyard was the only restaurant we identified that received benefits through the BII between FY 2011 and FY 2016, although it is possible that other restaurants located in Liberty Station received BII benefits outside of this time period.

definition of an anchor tenant. EDD also asserted that when the Enterprise Zone was in effect, the City was required to provide free expedited permitting to all projects in the Enterprise Zone. However, we reviewed a variety of building permits for commercial projects in or near the same development as the laundromat, none of which received free expedited permitting.<sup>33</sup>

**CONCLUSION    EDD Should Require BII Beneficiaries to Complete Applications and Provide Documentation Attesting to Project Benefits, and Should Perform and Document Analysis Showing How Businesses Further the City's Economic Development Goals**

As discussed in previous findings, EDD reports that it has implemented an electronic 'Customer Relationship Management' (CRM) system to track its activities going forward. As part of this effort, EDD should significantly improve how it collects and stores documentation and analysis showing why economic development incentives have been awarded.

According to EDD, management is in the process of developing a tiered approach to application-related data collection based on the size and value of the incentive provided. For example, EDD providing a small company with lower value expedited permitting would not trigger the requirement to submit an application. Rather, in these instances, EDD staff would collect basic business information from the company which would be certified by EDD and stored in the CRM.

In contrast, for larger projects that will receive more valuable expedited permitting or other incentives of significant value, such as the Mission Hills Vons, EDD would require the company to submit an application coupled with certified business information, such as the company's capital investment in the project, tax information, and the number of prospective jobs created by the project. This application would be similar to the Economic Development Project Information (EDPI) form that was previously required for businesses receiving other BII

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<sup>33</sup> Several of the projects were processed as 'Express,' which is a fee-for-service expedite program open to all applicants.

services related to the former Enterprise Zone program. See **Appendix F** for an example of the EDPI form.

In order to allow managers, policymakers, and the public to monitor and ensure that BII incentives are awarded equitably and justifiably, we recommend:

**Recommendation #5**

EDD should develop policies and procedures governing application and information requirements for companies seeking BII incentives. Specifically, for businesses receiving lower value expedited permitting, EDD should collect and certify the information used to justify the incentive award. For businesses receiving more valuable expedited permitting or other incentives of more substantial value (such as the Mission Hills Vons), EDD should require application submittals from companies seeking services or incentives related to the BII. The application should be similar to the 'Economic Development Project Information' form that was previously required for businesses receiving EDD services related to the former Enterprise Zone program.

The information collected by EDD via self-certification or an application submittal should be input into the CRM system, and should include applicable supporting documentation used in the determination of whether to award an incentive such as: the location of the business; the number and types of jobs being created; potential tax revenue; estimated capital investment; the industry category of the business, and costs of doing business in San Diego compared to other jurisdictions competing for similar types of investments. (Priority 1)

**Recommendation #6**

EDD should implement policies and procedures requiring the following steps to be performed when analyzing and documenting applications or requests for incentives, including (1) the determination of whether the company satisfies the criteria established in Council Policy 900-12 and the current Economic Development Strategy; and (2) specific benefits the City expects the business to generate, including one or more of the following: evaluation of the tax base impact, number and type of jobs created, estimated capital investment, and/or benefits to the surrounding neighborhood. This analysis and



supporting documentation should be documented in the CRM system. (Priority 1)

**The City Also Awards Significantly More Valuable Financial Incentives, Which Require City Council Approval**

In addition to the administratively-approved benefits, EDD offers more substantial tax rebates and financial incentives via the BII, which require City Council approval. When the City has awarded these incentives, the cost to the City has ranged from \$160,000 up to \$1.5 million. These allowable incentives include:

- Reimbursing City permit processing fees including Development Impact Fees, Facilities Benefit Assessments, Housing Impact Fees, fees collected pursuant to Developer Reimbursement Agreements, and/or costs of public improvements that are a required condition of the development, from future revenues to the City generated directly from the project;
- Rebating all or a part of the City's portion of real and personal property taxes; and
- Providing tax-exempt bond financing.

**WHAT SHOULD HAVE OCCURRED**

**More Sophisticated Cost-Benefit Analysis Should Be Performed When Financial Incentives Are Awarded**

An economic development expert, best practices published by the GFOA, and Council Policy 900-12 all dictate that significantly more sophisticated analysis should be performed when considering whether to award these types of incentives, and how much money should be offered. This should be required on all financial incentives of \$100,000 or more, which require public noticing and City Council approval under state law.<sup>34</sup>

For example, Council Policy 900-12 requires that when an agreement that includes General Fund reimbursement of fees or rebate of taxes is presented to the City Council for its review and approval, it should be accompanied by a report that includes a cost-benefit analysis of the proposed incentive, including both the fiscal impact on the City as well as broader economic and social impacts, such as the number and type of

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<sup>34</sup> California Government Code section 53083(a).

jobs created or retained. The Council Policy states that the City may require the applicant to pay the City's cost to retain a consultant to perform this analysis, presumably in cases where City staff do not have the time or expertise to conduct it in-house. The Council Policy also allows EDD to refer the request to the City's financial consultant.

While determining the City's costs is relatively straightforward, according to EDD, prospective benefits are more difficult to calculate because of uncertainty about how the company would act without the incentive. Thus, the most critical component of a cost-benefit analysis, and the most challenging to perform, is called a 'but for' analysis.<sup>35</sup> This analysis uses various business characteristics, location needs, market realities, and development and relocation costs. The purpose of this analysis is to attempt to determine, to the extent possible, whether and how much incentive is required to entice a business to act in a specific way, such as relocation to, remain in, and/or expand in San Diego. Without this analysis, the City has limited assurance that financial incentives are effectively inducing business decisions that benefit the City and its residents.

**WHAT WE FOUND     EDD does not Perform Sufficiently Sophisticated Analysis when Offering Financial Incentives through the BII**

We found that EDD acquired, analyzed, and maintained significantly more information from businesses receiving City Council-approved financial incentives than for those receiving administratively-approved benefits between FY2011 — FY2016, but adequate documentation and analysis meeting industry best practices was still not present. Specifically, we found that while EDD did perform a basic cost-benefit analysis for each agreement comparing the cost of the incentive to various benefits such as jobs retained or created, none of the files contained any evidence that a 'but-for' analysis was performed.

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<sup>35</sup> Bartik, Timothy J., and George Erickcek. 2010. "The Employment and Fiscal Effects of Michigan's MEGA Tax Credit Program." Upjohn Institute Working Paper No. 10-164. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.  
[http://research.upjohn.org/cgi/viewcontent.cgi?article=1181&context=up\\_workingpapers](http://research.upjohn.org/cgi/viewcontent.cgi?article=1181&context=up_workingpapers)

EDD has provided financial incentives approved by the City Council to three companies between FY2011 and FY2016: Illumina, Ballast Point, and AleSmith.<sup>36</sup>

**Exhibit 10**

Companies Entered in Economic Development Incentive Agreements with City and Related Contract Terms

Company	Contract Benefit to City	Contract Provided Incentive by City
Illumina	<ul style="list-style-type: none"> <li>• Illumina to maintain San Diego location as "point of sale" for taxes for 10 years.</li> <li>• Maintain 308 manufacturing jobs; 26 sales jobs in City of San Diego</li> </ul>	<ul style="list-style-type: none"> <li>• Up to \$1.5 million tax rebate</li> </ul>
Ballast Point	<ul style="list-style-type: none"> <li>• Company will deliver building plans to EDD.</li> <li>• Company shall provide qualifying invoices for tax reimbursements.</li> </ul>	<ul style="list-style-type: none"> <li>• Priority permit and permit assistance</li> <li>• Approx. \$160,000 sales and use tax reimbursement of all fees paid to City.</li> </ul>
AleSmith	<ul style="list-style-type: none"> <li>• Company will deliver building plans to EDD.</li> <li>• Company shall provide qualifying invoices for tax reimbursements.</li> </ul>	<ul style="list-style-type: none"> <li>• Priority permit and permit assistance</li> <li>• Up to \$180,000 sales and use tax reimbursement</li> </ul>

Source: Economic Development Incentive Agreements between City and Illumina, Ballast Point, and AleSmith.

We found that EDD collected information in relation to the companies seeking incentives and performed analysis of projected job growth and projected tax revenues. However, EDD provided little evidence to support the assertions that the companies were considering leaving the City—the original pretext for offering the financial incentives. Most importantly, we found little documentation illustrating any analysis to

<sup>36</sup> Notably, the agreement with IDEC Pharmaceuticals was done in 2001 and is outside the scope of this audit.

determine the amount of financial assistance required to incentivize the company to act in a specific way, in this case, stay or expand in the City.

The City of San Diego entered into an Economic Development Incentive Agreement with Illumina in 2014. Illumina is a successful biotech firm specializing in genomics, founded and headquartered in San Diego, which has been referred to as "the world's smartest company." According to EDD, Illumina is one of the top employers and sales tax generators in the region. The agreement allowed for tax rebates to Illumina in the maximum aggregate amount of \$1.5 million in exchange for the company to locate a manufacturing facility in the City and maintain point of sales for tax purposes in the City for 10 years.<sup>37</sup> Illumina provided information stating that the manufacturing facility would retain 308 manufacturing and 26 sales force jobs.

In conformance with the direction of Council Policy 900-12, Illumina submitted information and EDD conducted a cost-benefit analysis on increased sales and use tax revenues. EDD performed basic analysis of the sales and use tax impact of Illumina's expansion and manufacturing facility, including job multipliers.<sup>38</sup>

However, although the Report to Council states that Illumina's real estate broker informed the City that the company was considering relocating, EDD did not provide any direct evidence, such as a written record of EDD's conversation with company representatives, to substantiate the claim that Illumina was considering locating its manufacturing center outside of the City, to either Memphis, Tenn., or Poway—a central justification for the need for an incentive. Evidence in the folder illustrated that the City of Poway did not have

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<sup>37</sup> The tax rebates are based on increased sales and use taxes generated by Illumina, above a baseline year. If Illumina generates additional sales taxes of \$1.5 million in less than 10 years, the company could relocate its manufacturing and sales functions outside the City and still be entitled to the \$1.5 million rebate.

<sup>38</sup> Economic research has found that new or expanded business activity and employment creates spillover effects for other related industries. This generates additional business activity and employment in the local economy. Based on industry characteristics, EDD determined that the types of jobs at Illumina's manufacturing facility have a multiplier effect of 4:1, meaning that for every job at the Illumina facility, 3 additional jobs are created in the local economy.

sufficient industrial square footage available to house Illumina's planned 60,000 square foot manufacturing facility.

Finally, EDD provided no evidence showing the City performed any 'but for' analysis to determine whether the \$1.5 million incentive offered to Illumina would have any impact on its decision to expand in the City or relocate elsewhere. However, EDD's Report to Council stated, "The proposed Economic Development Incentive Agreement (EDIA) would provide Illumina with a substantial financial incentive to retain its manufacturing jobs within the City", and stated the up to \$1.5 million rebate was "a reasonable inducement for Illumina to continue to optimize its efficiency by keeping its existing San Diego R&D, manufacturing, and product sales operations in close proximity within the City."

In the incentive package information we received from EDD, we found three references to the \$1.5 million. First, was a handwritten, unsigned note on a piece of notepad paper. Second, the Report to City Council requesting approval of the incentive noted the \$1.5 million was the estimated value of a full year worth of sales tax revenues paid by the company to the City.<sup>39</sup> Third, communications between City and Illumina officials stated that rebate would be a "payback" on "development related fees." We asked EDD for further information on this determination. According to EDD, the \$1.5 million was identified based on the fact that EDD officials believed that this was the maximum amount that the City Council would approve.

EDD stressed that, in addition to quantitative business analysis, analysis of proposed financial incentives must take into account the value of the relationship between the company and the City. According to EDD, San Diego, like other California cities, is limited in the amount of financial incentives they can offer in order to induce a company's business decision making. As such, EDD believes that sending the message to the company, "We care about you", or, "We value you", is an important tool in showing the City's appreciation to the

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<sup>39</sup> Notably, according to the City's Financial Management Department, Illumina has not submitted a request and the City has not paid any of the incentive funds promised to Illumina in the EDIA.

company. EDD believes these kinds of message play a role in a company's decision to relocate or expand in San Diego. EDD did not to provide any quantitative analysis to support this assertion.

We also reviewed project folders for financial incentives provided to AleSmith and Ballast Point, which are both successful breweries. Like the Illumina project, EDD collected ample information and performed sufficient due diligence in terms of calculating sales tax and projected jobs. EDD used this information to perform a basic cost-benefit analysis to show the benefit of the incentives. However, like Illumina, the folders did not contain analysis to determine the amount of funds needed to affect each company's decision to stay in the City.

**WHY THIS OCCURRED**

**EDD Lacks Internal Policies and Procedures Specifying that a 'But For' Analysis Should be Performed for All Financial Incentive Awards**

As with administratively-approved benefits, EDD lacks internal policies and procedures requiring certain analysis to be performed and documented when financial incentives are being contemplated.

Specifically, EDD lacks internal policies and procedures requiring a 'but for' analysis be performed in order to determine what amount of incentive is needed to entice a company to act in a specific way.

EDD management acknowledged that performing a 'but for' analysis is an essential practice, and stated their intention to perform this analysis whenever financial incentives of \$100,000 or more are awarded moving forward.

**IMPACT OF NOT TAKING ACTION**

**Without Sufficient Analysis, the City May Be Providing Financial Incentives That Are Excessive, or Are Not Needed to Influence Private Business Decisions**

As a result of the lack of more sophisticated analysis on how certain financial incentives may affect business decisions, the

City is exposed to two substantial risks. First, EDD is unable to show that a company seeking a financial incentive would not have located or expanded in the City without the incentive. As a result, the City may be providing incentives to influence business decisions that would have been made without the incentives. EDD officials conceded the dollar amount of the incentive likely was not the sole reason for these companies remaining in the City. However, EDD officials stressed the incentive provides significant value in nurturing a valuable relationship between the companies and the City which cannot be quantitatively appraised. While the value of this relationship may have some qualitative value, this information should be presented fairly to the City Council and the public when discussing the necessity and importance of the incentive.

Second, the City may be providing more money than needed to incentivize the company to change its course of action. Without the completion of an analysis to determine what monetary amount creates an incentive for the business to act, there is no way for EDD to know how much of a financial incentive it should offer, or whether a financial incentive should be offered at all. This creates a significant risk the City's costs of providing financial incentives significantly exceed the benefits received.

EDD stated they have begun to develop an analysis framework for financial incentives that includes a 'but for' analysis. EDD noted that certain non-quantifiable intangibles, such as maintaining a positive relationship with a company, also have value and may be influential in a business' location decision. Therefore, in order to ensure that the City only awards financial incentives when it has maximum assurance that the incentive will successfully influence private business decisions, and will generate employment and tax benefits that exceed the City's cost to provide the incentives, we recommend:

**Recommendation #7**

EDD should develop policies and procedures for analyzing significant potential financial incentives (\$100,000 or more) which require that a detailed 'but for' analysis be completed as a component of the cost-benefit analysis. The complexity of the 'but for' analysis should be scaled up or down based on the size of the incentive provided, and the analysis by EDD or a third

party should be designed to determine whether a financial incentive being considered, in combination with other factors and considerations, is likely to influence the business' decision-making regarding whether to relocate to, remain in, or expand within the City, and to determine a reasonable amount to be offered to influence the business' decision.

This analysis should include a quantitative analysis based on various business characteristics, location needs, market realities, development costs, and/or relocation costs, and may incorporate narrative discussion of other non-quantifiable intangibles, such as the value of maintaining positive relationships.

For incentive packages with an aggregated value in excess of \$1 million, EDD should require the business potentially requiring the incentive to assume the cost of an independent consultant selected and paid by the City to perform the analysis, consistent with Council Policy 900-12. Alternatively, the City could assume the cost of retaining the consultant, and include the cost of the consultant in the total incentive value reported to the City Council. (Priority 1)



***Finding 4: EDD Does Not Require Agreements Outlining Benefits the City should Receive From the Vast Majority of Businesses that Receive Incentives, and Does Not Conduct Any Monitoring to Evaluate the Overall Effectiveness of the BII***

EDD provides incentives through the Business and Industry Incentives Program (BII) with the intention of assisting in the development of the business and, in turn, stimulating economic growth in the City.

These incentives are provided to businesses free of charge. While EDD reported that most of the incentives bestowed are relatively modest in cost to the City, they are not available to the general public, and our interviews suggest businesses do find them valuable. Therefore, for more valuable incentives, it is important to document the business' intentions through an agreement, which allows the City to show what it expects the business to do in return for providing the incentive—such as creating or expanding a certain type of business. This is important not just for public perception, but potentially also for legal reasons.

In addition, an economic development incentive program should establish clearly defined performance metrics in order to evaluate whether overall program goals are being met. Agreements with businesses benefitting from program incentives should require the business to provide basic information to the City on a periodic basis, when needed by EDD to enable this analysis.

We found that EDD does not have any internal policies or procedures outlining when an agreement should be required, and they required agreements with very few of the businesses that received administratively-approved benefits through the BII from FY2011—FY2016. EDD did not believe the agreements were required based on an ambiguity in Council Policy 900-12, and only required agreements with businesses that were also receiving other types of assistance, such as through the state Enterprise Zone program. Furthermore, EDD believes that

program beneficiaries will be reluctant to provide business information to the City.

As a result, the City has limited assurance from most businesses receiving incentives about what benefits the City should receive, and EDD may not be able to collect meaningful new data on the status of the business to determine whether the incentive was beneficial to the business and, therefore, beneficial to the City. Thus, EDD cannot demonstrate that the BII's benefits to the City exceed its costs, or determine whether the incentives offered should be expanded, modified, or discontinued.

Therefore, in order to document the intentions of each business receiving incentives and evaluate the overall performance of the BII, we recommend that EDD propose an update to Council Policy 900-12 specifying that agreements should be required when awarding more valuable expedited permitting or other higher value incentives. Each agreement should provide the City access to information needed to evaluate the performance of the BII. In addition, EDD should establish performance measures for the BII and periodically report on program performance.

**WHAT SHOULD HAVE  
OCCURRED**

**Agreements Should be Required Whenever Significant  
Incentives Are Awarded in Order to Memorialize what the  
Business Intends to Provide the City**

Aside from three businesses who have received more lucrative tax incentives and rebates approved by the City Council, businesses benefitting from the BII receive other incentives that are approved administratively by EDD. Most businesses awarded incentives administratively receive free expedited permitting valued at between a few hundred dollars to more than \$10,000,<sup>40</sup> and in one case, we estimated the value of the

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<sup>40</sup> We estimated the value of the expedited permitting by using the amounts the Development Services Department charges for its Express service, which is available for a 50% permit fee surcharge. The Express service is roughly 50 percent faster than standard processing, and the expedited permitting offered through the BII is 25 percent faster than standard processing. Therefore, we estimated that the BII expedited permitting has a value equal to a 25 percent permit fee surcharge.

expedited permit assistance was up to approximately \$57,000. In addition, businesses typically receive technical assistance from EDD staff, which ranges from a few hours up to 50 hours of staff time or more, according to EDD estimates.

While these incentives are generally modest in cost to the City, our interviews with program users indicate that recipients find them to be valuable as they seek to start or expand business activities in the City. Furthermore, they are only awarded to a select group of businesses based on specific criteria and are not available to the general public. Therefore, the City should require at least basic agreements with these businesses, in order to demonstrate that the business intends to provide something of value in return for the incentive.

To that end, Council Policy 900-12 provides some guidance on when agreements are needed. The Council Policy directs representatives of EDD to review the business or project information and deny the requested assistance or negotiate an Incentive Agreement providing assistance. The Council Policy also states, "If assistance pursuant to this Policy is justified, an agreement shall be drafted incorporating the recommended assistance among the incentives described [in the Policy], as appropriate."

**WHAT WE FOUND    The Vast Majority of Projects that Received Administrative Benefits through the BII did not Enter Into an Agreement with the City**

We found that EDD did not enter into agreements with most of the businesses that were provided administrative benefits through Council Policy 900-12. We selected a judgmental sample of 35 projects that received administratively approved benefits through the BII. Of these, three companies entered into written agreements that specified what the company would provide in consideration for the benefits, services, and incentives provided by the City. EDD stated it only required these agreements because the businesses were receiving additional incentives outside the scope of the BII, because the business was also receiving benefits through the state Enterprise Zone program. The remainder of the projects had no

agreement or documentary record stating what the company would do in return for services, benefits, and incentives.

**WHY DID THIS OCCUR**     **Council Policy 900-12 is Vague in Direction Regarding When EDD is Required to Enter into an Agreement with Businesses in Exchange for the Provision of Incentives**

One reason why EDD has not required agreements for administratively-approved incentives is that Council Policy 900-12 provides unclear guidance on whether agreements are necessary for the provision of certain services, benefits, and incentives as part of the BII. As a result, EDD has interpreted the Council Policy to mean that EDD has the discretion to determine when an agreement should be required.

The Council Policy states, "The City Manager or his designee shall review the business or project information and may deny the requested assistance or negotiate an Incentive Agreement providing for assistance, as appropriate." The Policy continues, "If assistance pursuant to this Policy is justified, an agreement shall be drafted incorporating the recommended assistance among the incentives described in Paragraph B above, as appropriate."

The term 'as appropriate' in Council Policy 900-12 appears vague and thereby provides unclear guidance on whether agreements are necessary. EDD has interpreted the language in Council Policy 900-12 to require Economic Development Incentive Agreements only when financial incentives of \$100,000 or more are awarded, which under state law requires City Council approval, and it is possible Council Policy 900-12 intends to provide EDD with that discretion. Alternatively, it is possible that the Council Policy intends to require agreements in all circumstances where incentives are awarded, but that the form of the agreement may vary as appropriate given each circumstance.

**IMPACT OF NOT TAKING  
ACTION**

**Without the Agreement, there is nothing to Document the Exchange of Consideration and No Access to Information the City needs to Document Performance**

The provision of a service of considerable value in the absence of a document memorializing the public benefit received limits the City's assurance of the business' intentions, and may create the perception the City is gifting benefits to certain companies. Furthermore, State law prohibits making any gift or authorizing the making of any gift, of any public money or thing of value, unless a reasonable public benefit is being received by the municipality. While the City's legal risk is likely minimal in most cases, an agreement may also be important under State law, if the City is expecting some future action by the incentive beneficiary. For example, as discussed below, the City may require business information from beneficiaries at certain intervals after the incentive is granted, in order to monitor and report on the effectiveness of the BII.

As stated in Finding 2, we recommend EDD require companies receiving more valuable benefits to complete an application. In addition, we recommend that the City amend Council Policy 900-12 to require a contract or agreement for companies that receive incentives through the BII to include the goals that companies seek to achieve and the benefits that the City is providing. For these administratively approved benefits, because their value is generally modest, we believe the application can also serve as the agreement. In these instances, the business can submit a form similar to the Economic Development Project Information (EDPI) form, which EDD previously required for companies receiving incentives through the BII related to the Enterprise Zone program. See **Appendix F** for an example of an EDPI.

**Recommendation #8**

EDD should propose an amendment to Council Policy 900-12 to specifically require at least a basic form application/agreement for businesses receiving more valuable expedited permitting or other incentives of more substantial value through the BII. The application/agreement should include the requirement that the incentive recipient certify information EDD needs to verify program eligibility. (Priority 1)

**WHAT SHOULD HAVE  
OCCURRED**

**Best Practices Stress the Importance of Monitoring to  
Ensure Incentives are Producing the Intended Results**

In addition to memorializing a business' intentions and avoiding any conflicts with State law, an agreement is important to allow the City to periodically access basic information about the business in the future, in order to measure how the BII is performing. The Government Finance Officers Association (GFOA) and the *Standards for Internal Control in the Federal Government* provide best practices for internal controls and effective monitoring of economic incentive programs.

Specifically, for businesses receiving more modest, administratively-approved incentives, a process should be established for regular monitoring of economic development incentives granted and the performance of each project receiving incentives. Administratively-awarded incentives are generally provided up-front (i.e., the expedited permitting is conducted before the business begins operating or expands). The purpose of this monitoring process is not to seek recoupment of benefits awarded (unless the business misled the City to gain the incentive), but rather, to allow EDD to evaluate the effectiveness of the incentives being provided and determine if any changes should be made to the range of incentives offered. Examples of specific measures include: comparison of actual to estimated capital investment; number and type of jobs created; wage ranges; dollar amount of private investment; net increase in property tax base; and sales tax performance.

Larger, Council-approved tax incentives are typically provided on a refund basis, i.e., the business must show that it is meeting the performance measures established in the EDIA in order to receive the tax refund, such as by increasing sales tax revenues or jobs. For these incentives, the purpose of the review is to determine the effectiveness of the incentive, but also to determine if the refund is justified and to withhold payment if necessary.

**WHAT WE FOUND**     **EDD Performs Little Monitoring of Most Businesses that  
have Received Benefits Through the BII**

We found that EDD conducts different levels of review based on the type of incentive provided through the BII. EDD offers two packages of incentives to businesses as part of the Business and Industry Incentive Program, specified in Council Policy 900-12. First, we found that EDD performs little to no monitoring or follow-up with businesses that received administratively-approved benefits to evaluate whether the company is performing as expected. In contrast, we found that EDD conducts some monitoring of companies that receive more valuable financial incentives through tax rebates provided by the EDD through the BII.

**EDD Conducts Little to  
No Monitoring of  
Businesses that Received  
Administratively  
Approved Incentives**

The Council Policy establishing the BII authorizes EDD to administratively approve a series of incentives that are limited to smaller dollar and service amounts. We found that EDD does not generally monitor these businesses and documents little analysis to evaluate how businesses receiving incentives are performing.

We performed a review of 35 project files maintained by EDD for companies that have received an administratively approved service, benefit, or incentive through the BII. We prepared a questionnaire based on GFOA best practices for monitoring economic development incentives.

We found that EDD did not follow-up with companies to collect, analyze, or maintain any documentation for any of projects in our sample (34 of the 35 projects<sup>41</sup>) which received incentives. EDD did not collect any information after the incentive was provided to evaluate whether the business is providing the number of jobs, producing the tax revenue, or whether the company made the capital investment that was discussed when seeking the incentive.

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<sup>41</sup> Our sample consisted of 35 projects. However, one of the businesses failed prior to completion of the construction. This project was not included in this calculation.

EDD management stated staff does not conduct monitoring of companies that have received benefits. Rather, EDD stated their goal is to track the impact of the program by focusing on things like 'business touches,' which is when EDD interacts with a business.

**In Most Cases, EDD Performs Monitoring of Businesses Receiving Council-approved Tax Rebates**

The second package of incentives offered by EDD include more substantial tax rebates and incentives in order to incentivize businesses to remain in the City. These larger benefit packages require City Council approval. EDD has entered into EDIAs with three companies between FY 2011 and FY 2016 that received these incentives. In these cases, we found that EDD performs some monitoring to verify the companies are performing the goals stated in the EDIAs.

For the Ballast Point EDIA, EDD staff engaged in follow-up communications with Ballast Point to ensure the company was meeting its commitment for job production stated as a performance in the EDIA. Additionally, EDD staff conducted follow-up activities with Ballast Point to determine increases in sales taxes generated by the company prior to processing a rebate.

The City Council approved the EDIA for Illumina in August 2014. The company submitted an "Employment Survey" listing the number and classifications of jobs in January 2015. A follow-up employment survey has not been submitted by Illumina and EDD staff stated they have not followed up because the company has, to date, not submitted a request for the contractually entitled tax rebate.

For the AleSmith EDIA, AleSmith submitted an invoice for the City of San Diego in January 2017 seeking \$48,505 in reimbursements for sales and property taxes. EDD reviewed documentation related to the total sales tax paid by the company and EDD staff approved the payment.

**WHY THIS OCCURRED**

**EDD does not have Written Policies and Procedures Outlining Monitoring Responsibilities, Has No Performance Measures for the BII, and Requires Few Businesses to Provide Follow-Up Information to the City**



We found that very little monitoring has occurred because EDD does not have written policies and procedures to require EDD staff to monitor, track or follow-up with companies that received incentives to ensure they are providing a benefit to the City. Furthermore, because EDD does not require most BII beneficiaries to enter into an agreement providing the City periodic access to basic business information, EDD lacks the information needed to perform adequate monitoring and evaluation of program incentives.

**IMPACT OF NOT TAKING  
ACTION**

**EDD Cannot Measure the Impact that Incentives are Having on the City's Economic Development Progress Because Little Post-Award Monitoring is Conducted**

As a result of the lack of monitoring procedures, performance measures, or access to business information, the City is not in a position to make data driven decisions on whether to continue, expand, or discontinue incentives to specific types of businesses or geographic areas. EDD cannot demonstrate that its expenditures and resources – including staff time and expediting costs – related to the BII were exchanged for a commensurate public benefit of equal or greater value. And in one case, EDD did not document that a substantial tax refund was justified before paying it.

**EDD Stated Businesses will not want to Join Program from Fear of Having to Disclose Sensitive Business Information**

EDD management stated that companies may be hesitant to certify their intentions and provide periodic access to business information because they view this information as proprietary or fear that, for privately held companies, this information is business intelligence which would provide an advantage to their competitors. EDD management pointed to an example that a privately held biotech company would not want to reveal how many employees it had and salary ranges, because a competitor may glean valuable information about the progress of the company on certain product advances. It is understandable that businesses would not want their competitors to have access to such information.

However, certain business information collected by EDD, such as sales tax and capital investment information, and other information considered corporate financial records, which had not previously been publicly disclosed by the submitting company potentially qualifies for an exemption under the California Public Records Act (CPRA), and may remain confidential.<sup>42</sup> As a result, these records may not be viewed as a public record and thereby not released publicly. EDD should work with the City Attorney's Office to determine what information could be withheld from disclosure under the CPRA, and only require information that can be held confidentially, or that would not be considered sensitive by the business, as part of its agreements and monitoring process.

**Council Policy 900-12  
Should Be Amended to  
Require Monitoring of BII  
Performance**

According to the GFOA, municipalities are more likely to achieve their goals when they have a well-designed plan for evaluation, high-quality studies that measure impact effectively, and a process for using the findings inform policy. More simply put, any incentive evaluation is only good as the available data.

The BII is intended to further the City's economic development goals. In the process, the BII benefits certain businesses selected by EDD, but not others. Therefore, it is important that the City receive some assurance from beneficiaries that they intend to further the City's economic goals, and a commitment to provide basic business information on a periodic basis to allow EDD to evaluate the effectiveness of BII incentives. Furthermore, EDD should develop performance measures and monitoring procedures, and report the results of monitoring to the City Council on an annual basis so that program effectiveness can be evaluated and adjustments can be made as needed.

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<sup>42</sup> These exemptions to the CPRA are discussed in California Government Code Section 6254.15.

**Recommendation #9**

EDD should propose a revision to Council Policy 900-12 that:

- a) Specifies that the basic form application/agreement discussed above should require each program beneficiary to provide basic information about the business on a periodic basis, such as capital investments and jobs created, when necessary to allow EDD to analyze the effectiveness of the BII.
- b) Requires EDD to establish specific performance measures for the BII, and to report the BII's performance on the measures to the City Council annually, such as through EDD's annual report. In addition, EDD should document and implement a written, clearly defined monitoring process, using data acquired from businesses using the BII and from other sources, in order to evaluate and report on the BII's performance against the measures identified above. (Priority 1)

***Finding 5: Council Policy 900-12 Should be Updated to Reflect Current Economic Trends and Strategy***

The field of economic development is rapidly changing and evolving as economic trends shift and additional research becomes available on the effectiveness of various economic development practices. Ensuring that Council Policy 900-12, the guiding policy for the Business and Industry Incentives Program (BII), is up-to-date is critically important to allow the City to employ the most effective economic development incentives and strategies.

However, we found that Council Policy 900-12 has not been updated in more than 15 years and includes incentives that EDD staff believe are no longer effective and not reflective of emerging economic development strategies. Because the City Council did not approve an updated policy in 2010 and no recent discussions related to an update have occurred, EDD cannot employ the most effective economic development incentives and strategies.

We recommend that EDD propose an update to Council Policy 900-12 which reflects current economic development research and trends and is aligned with the City's current Economic Development Strategy (EDS).

**WHAT SHOULD HAVE OCCURRED**

**Economic Development Trends and Strategies Change Rapidly, and Council Policy 900-12 Should Be Frequently Updated to Reflect Current Economic Conditions**

There is a profound shift under way in economic development, from attracting jobs and talent from outside the region to a greater focus on growing from within. Economic development specialists note that conventional economic development remains largely misaligned to what really matters. Old strategies favor recruiting new firms over helping existing firms become more productive and expand. They rely too often on taxpayer-funded incentives geared to one-time job creation, rather than positioning industries and assets for long-term

growth. Many experts believe that tax incentives produce mostly marginal returns. However, as described in greater detail below, monetary incentives deployed the right way can yield positive results.

New trends in economic development prioritize building strong business ecosystems for core industries, improving the productivity of firms and people, and facilitating trade—the market foundations from which growth, prosperity, and inclusion emerge. Economic development experts suggest expanding the scope and metrics of economic development to reflect a more foundational and holistic understanding of how to expand the economy and opportunity. Economic development is most effective when it focuses on improving the shared assets that support clusters and advanced industries, rather than providing subsidies and solutions to individual firms. Three ways to increase productivity:

- Helping firms and industries innovate and invest in R&D and technology;
- Helping industries access skilled labor and training; and
- Improving the industry mix in the region to include more innovative, higher-value sectors in the economy.

Emerging economic development strategies stress prioritizing established and emerging firms and industries, growing from within, investing in the ecosystems of innovation, trade, talent, infrastructure, and governance to support globally competitive firms and enabling small businesses to start and grow in the market. Removing impediments to progress across the complex systems are a cost-effective way to expand regional economies, yielding larger benefits at lower costs than paying high-cost public subsidies that benefit a small group.

To employ the most effective economic development incentives and strategies, the City has two guiding documents operating in tandem – the Economic Development Strategy (EDS) and Council Policy 900-12. Council Policy 900-12 also acts as the guiding policy for the Business and Industry Incentives Program (BII), and outlines the specific eligibility criteria and the incentives that are available. Both the EDS and Council

Policy 900-12 should be frequently updated to reflect current economic conditions and economic development trends, to ensure the City is well-positioned to take advantage of economic development opportunities.

**WHAT WE FOUND**     **Council Policy 900-12 Is Outdated, and Does Not Reflect Changes in San Diego's Economy or the Updated Economic Development Strategy**

EDD appears to have embraced some of these newer models as is evidenced through the development and passage of the 2014-2016 Economic Development Strategy ("EDS") and the recently revised and adopted 2017-2019 EDS. These new strategies, as described above, include focusing economic development efforts and goals toward high-value base sectors and creating middle-class jobs with more skilled training. Recent updates to the EDS are also consistent with current economic development research and strategies, including focusing on international trade; developing workforce skills and aligning employers' needs with the needs of workers seeking opportunity; and focusing on regional-scale solutions, while seeking to stimulate investment in older and central neighborhoods.

However, we found that Council Policy 900-12 has not been updated in more than 15 years. Further, we found - and EDD officials agreed - that the BII guiding policy, Council Policy 900-12, is no longer the most effective tool and not reflective of emerging economic development strategies.

As stated in the Background section, the BII was created by the City Council following a severe recession in 1993. The goal of the program was to improve the business climate of the City by providing certain financial incentives and permit assistance to a variety of business investors citywide. At that time, the City did not have a program to offer assistance to "major revenue and job creating projects" throughout the City. The incentives offered by the program included expedited permit processing; formation of assessment districts; fee credits and/or reimbursement of costs for public improvements associated with a project; and reimbursement of fees through future revenues derived from the project. To be eligible for incentives,

a company needed to contribute to the City's economic base and be consistent with the City's Economic Development Policy and Strategic Plan and the community's needs and objectives. The economic sectors targeted by the policy included auto malls and shopping centers as well as point of sale businesses.

**The City Updated Council Policy 900-12 in 2001 to Reflect Changing Economic Base Sector Landscape in City at that Time**

The City Council last updated the Council Policy 900-12 in 2001, over 15 years ago. The update was concurrent with an update of the EDS, with the two documents intended to operate in tandem. The City Council sought to change criteria for admission to shift economic development focus to specific industry clusters, incorporate new incentives adopted by the City Council, and remove out of date provisions.

**Exhibit 11**

Comparison of Original Council Policy 900-12 and Most Recent Update

Original "Business and Industry Incentives Program" Criteria (est. 1993)	Updated "Business and Industry Incentives Program" Criteria (updated 2001)
<ul style="list-style-type: none"> <li>• Contribute to the improvement and growth of the City's economic base;</li> <li>• Demonstrate an established track record for high volume tax revenue generation;</li> <li>• Provide employment opportunities for city residents;</li> <li>• Eliminate or prevent blight;</li> <li>• Demonstrate a long term commitment to the community;</li> <li>• Are consistent with the City's Economic Development Policy and Strategic Plan and the community's needs and objectives;</li> <li>• Generate new or retained stabilized annual City tax revenues of at least \$500,000; create 200 quality jobs; provide for substantial new or expanded scientific research facilities.</li> </ul>	<p>Either</p> <ul style="list-style-type: none"> <li>• Provide significant revenues and/or jobs that contribute to a sound and healthy economy;</li> <li>• Promote stability and growth of City taxes and other revenues;</li> <li>• Encourage new business and other appropriate development in older parts of the City; or</li> <li>• Respond to other jurisdictions' efforts to induce businesses to relocate from San Diego;</li> </ul> <p>And</p> <ul style="list-style-type: none"> <li>• Are consistent with the City's current adopted Community and Economic Development Strategy.</li> </ul>

Source: City Council Policy 900-12.

**WHY DID THIS OCCUR**      **Council Policy 900-12 Was Not Updated in Parallel with the EDS**

Nearly 10 years after the last Council Policy 900-12 update, EDD<sup>43</sup> presented a draft update to a City Council Committee in October 2010. EDD officials at the meeting stressed that tremendous changes have occurred in San Diego's economy over this period. According to EDD officials at the meeting, the update represented an effort to redirect economic incentives to the emerging innovation economy including biotech, cleantech, and high technology. EDD leadership believed that development in these sectors should be reflected in the policies directing economic development in the City. However, members of the Committee stated any update to the Council Policy should occur in conjunction with or after the Economic Development Strategy is updated, and voted unanimously to table the issue until a revised EDS was proposed.

Subsequently, EDD has proposed, and the City Council has approved two updates the Economic Development Strategy—in 2014 and 2016—since the draft update to Council Policy 900-12 was presented, but a subsequent update to Council Policy 900-12 has not been proposed by EDD again.

**IMPACT OF NOT TAKING ACTION**      **EDD Cannot Employ the Most Effective Economic Development Incentives and Strategies**

As a result of Council Policy 900-12 being outdated, EDD officials stated that several incentives offered are no longer thought to be effective. EDD believes that the expedited permitting incentive is antiquated and out of date and that other programs offered by City are more effective than programs offered by EDD. As such, EDD officials stated that the program should be updated or eliminated.

For example, the City's Development Services Department (DSD) offers a plan check option—Express Plan Check—which advertises permits processing times about 50 percent faster in some cases than standard processing. This is available for most

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<sup>43</sup> At the time, the City's economic development functions, including the BII, were located in Mayor's Office.



projects and most review disciplines upon payment of an administrative fee plus 1.5 times the regular plan check fee. If the express timeline is not met, the fee is pro-rated. In contrast, the Expedite Permit incentive offered by EDD cut processing times by 25 percent. The incentive is offered by EDD at no cost and is typically coupled with EDD's assistance in troubleshooting issues early in the permit review process. EDD officials have stated that most developers will pay the higher fee for the Express Plan Check, rather than use the Expedite incentive with longer processing times<sup>44</sup>. EDD officials stated the popularity of the Express Plan Check has rendered the Expedite incentive a "dinosaur."

**Some Incentives Listed  
in Council Policy 900-12  
Are No Longer Offered,  
or Are Provided to All  
Businesses During the  
EDD's Normal Course of  
Business**

EDD also pointed to benefits that are listed in Council Policy 900-12 that are no longer offered by EDD, which should be removed from the Council Policy. This includes incentives EDD formerly helped to provide through the State Enterprise Zone program, which was discontinued in 2014.

An additional incentive – reduced water and sewer capacity charges – has not been offered since 2010, when the City Attorney's Office determined that any discounts needed to be offset from revenue sources outside the water and sewer funds based on applicable law, which establish certain restrictions on water and sewer rate charges.

And, some incentives listed in Council Policy 900-12 are vaguely defined, and are now provided to all businesses who request them as part of EDD's normal course of business. For example, one of the incentives listed is 'the provision of assistance in securing required City permits and approvals.' According to EDD, this typically consists of providing technical advice and contacting various City permitting functions to help the applicant get permits approved. An update to Council Policy 900-12 should define available incentives more specifically, and limit the list of incentives to items that are not

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<sup>44</sup> We reviewed 102 projects listed by EDD as receiving the Expedite incentive and compared the data to records in DSD's Project Tracking System. We found that of the 102 projects that EDD listed as Expedite, 24 projects—or 24 percent—were processed through Express Processing.

available to all businesses, and are only granted to businesses that meet certain criteria.

**EDD Does Not Have the Tools They Need to Most Effectively Execute the City's Current Economic Development Strategy**

EDD did not provide any direction on the kinds of incentives that should be offered by the City through an economic development policy like Council Policy 900-12, but highlighted that changes in the EDS shifted the focus of the kinds of businesses and project that should be targets of economic development activity. According to EDD, without an update of Council Policy 900-12, the EDD team does not have the tools to effectuate the newer goals.

Therefore, EDD and City should confer with industries targeted by the Economic Development Strategy, including the base sector industries as well as businesses located in older, underserved areas of the City, to determine what incentives would provide the greatest support. These incentives should be incorporated into a revised Council Policy that reflects current economic development incentive trends as well as the needs of businesses in the City of San Diego.

In order to ensure that the Bill has the tools to carry out the City's economic development mission most effectively, we recommend:

**Recommendation #10**

EDD and the City should consult with industries targeted by Economic Development Strategy, including base sector industries as well as business groups in older, underserved areas of the City, to determine what incentives would provide the greatest support and have the greatest impact in meeting economic growth goals. EDD should use feedback provided by these businesses, in conjunction with current research on successful economic development incentive practices used by municipalities, to propose an update to the incentives offered in Council Policy 900-12. EDD should ensure that the proposed update provides specific definitions of each incentive offered, and lists only those incentives that are not already provided during the normal course of business, or contemplated for inclusion in other business development programs. (Priority 1)

## Conclusion

The City of San Diego (City) has a variety of economic development goals, including generating jobs; promoting small, local businesses; encouraging economic development in older, underserved areas of the City; and generating tax revenues to support critical City services. To effectuate these goals, the City Council created the Business and Industry Incentives Program (BII) via Council Policy 900-12 to provide a range of incentives to certain businesses that help the City reach its economic development goals. We made a total of 10 recommendations for EDD to improve BII program outreach, tracking, and evaluation in order to ensure that incentives are distributed appropriately and more equitably, and are effective in promoting the City's economic development.

First, a more robust outreach program is needed to ensure that businesses that can generate the greatest benefit to the City are aware of the program and seek to use it. We recommend that EDD develop a comprehensive outreach strategy for the BII, which specifically includes outreach to businesses that may locate in the older, underserved areas targeted in the City's Economic Development Strategy.

Second, in order to provide program management, policymakers, and the public with the assurance that economic development incentive awards are justified and effectively support economic development goals, EDD should implement a comprehensive management control framework. Specifically, program management should document, analyze, and be able to show what incentives businesses have requested, and how each business met the BII eligibility criteria, and how the business furthers the City's goals. In addition, for financial incentives, we found that more sophisticated analysis attempting to determine the amount of money likely needed to entice the business to act should be completed, and that applications and agreements should be required for recipients of more extensive and costly BII incentives.

Third, we found that EDD had not developed performance measures for the BII, and does not collect sufficient information from businesses in order to perform this analysis. We recommend that EDD develop policies and procedures to perform sufficient quantitative analysis and monitoring of the BII to determine whether the incentives provided through the BII are effective in furthering the City's economic development goals.

Finally, because Council Policy 900-12 has not been updated in more than 15 years, it includes incentives that EDD staff believe are no longer effective and are not reflective of current economic development trends. We recommend that EDD and the City confer with industries targeted by the City's current Economic Development Strategy to determine what incentives would be most effective, and incorporate these into a revised policy to be proposed to the City Council.

# Recommendations

- Recommendation #1** EDD should develop a more comprehensive outreach strategy to spread information about the BII and other EDD programs, specifically incorporating outreach to potential businesses located in older, underserved areas of the City as stated in Council Policy 900-12 and the Economic Development Strategy. (Priority 1)
- Recommendation #2** EDD should develop and implement a written internal process to ensure the Treasurer's Office, Development Services Department, and other applicable departments provide information about the BII to new business tax certificate and permit applicants. (Priority 2)
- Recommendation #3** EDD should fully implement its Customer Relationship Management (CRM) tracking system. Specifically, EDD should ensure that the system documents: (1) business 'touches' (contacts with various businesses), business assists, and projects; (2) details concerning incentives that were requested and/or provided by the business; and (3) time spent assisting the businesses (e.g., EDD staff technical assistance), if the time spent is above and beyond what EDD would provide in the normal course of business. (Priority 1)
- Recommendation #4** EDD should further define policies and procedures for the CRM, and enhance the training of EDD staff. The enhanced training should include how to document in the system additional information above (in Recommendation #3) pertaining to businesses seeking and receiving assistance. (Priority 1)
- Recommendation #5** EDD should develop policies and procedures governing application and information requirements for companies seeking BII incentives. Specifically, for businesses receiving lower value expedited permitting, EDD should collect and certify the information used to justify the incentive award. For businesses receiving more valuable expedited permitting or other incentives of more substantial value (such as the Mission

Hills Vons), EDD should require application submittals from companies seeking services or incentives related to the BII. The application should be similar to the 'Economic Development Project Information' form that was previously required for businesses receiving EDD services related to the former Enterprise Zone program.

The information collected by EDD via self-certification or an application submittal should be input into the CRM system, and should include applicable supporting documentation used in the determination of whether to award an incentive such as: the location of the business; the number and types of jobs being created; potential tax revenue; estimated capital investment; the industry category of the business, and costs of doing business in San Diego compared to other jurisdictions competing for similar types of investments. (Priority 1)

**Recommendation #6**

EDD should implement policies and procedures requiring the following steps to be performed when analyzing and documenting applications or requests for incentives, including (1) the determination of whether the company satisfies the criteria established in Council Policy 900-12 and the current Economic Development Strategy; and (2) specific benefits the City expects the business to generate, including one or more of the following: evaluation of the tax base impact, number and type of jobs created, estimated capital investment, and/or benefits to the surrounding neighborhood. This analysis and supporting documentation should be documented in the CRM system. (Priority 1)

**Recommendation #7**

EDD should develop policies and procedures for analyzing significant potential financial incentives (\$100,000 or more) which require that a detailed 'but for' analysis be completed as a component of the cost-benefit analysis. The complexity of the 'but for' analysis should be scaled up or down based on the size of the incentive provided, and the analysis by EDD or a third party should be designed to determine whether a financial incentive being considered, in combination with other factors and considerations, is likely to influence the business' decision-making regarding whether to relocate to, remain in, or expand

within the City, and to determine a reasonable amount to be offered to influence the business' decision.

This analysis should include a quantitative analysis based on various business characteristics, location needs, market realities, development costs, and/or relocation costs, and may incorporate narrative discussion of other non-quantifiable intangibles, such as the value of maintaining positive relationships.

For incentive packages with an aggregated value in excess of \$1 million, EDD should require the business potentially requiring the incentive to assume the cost of an independent consultant selected and paid by the City to perform the analysis, consistent with Council Policy 900-12. Alternatively, the City could assume the cost of retaining the consultant, and include the cost of the consultant in the total incentive value reported to the City Council. (Priority 1)

**Recommendation #8**

EDD should propose an amendment to Council Policy 900-12 to specifically require at least a basic form application/agreement for businesses receiving more valuable expedited permitting or other incentives of more substantial value through the BII. The application/agreement should include the requirement that the incentive recipient certify information EDD needs to verify program eligibility. (Priority 1)

**Recommendation #9**

EDD should propose a revision to Council Policy 900-12 that:

- a) Specifies that the basic form application/agreement discussed above should require each program beneficiary to provide basic information about the business on a periodic basis, such as capital investments and jobs created, when necessary to allow EDD to analyze the effectiveness of the BII.
- b) Requires EDD to establish specific performance measures for the BII, and to report the BII's performance on the measures to the City Council annually, such as through EDD's annual report. In addition, EDD should document and implement a written, clearly defined monitoring process, using

data acquired from businesses using the BII and from other sources, in order to evaluate and report on the BII's performance against the measures identified above. (Priority 1)

**Recommendation #10**

EDD and the City should consult with industries targeted by Economic Development Strategy, including base sector industries as well as business groups in older, underserved areas of the City, to determine what incentives would provide the greatest support and have the greatest impact in meeting economic growth goals. EDD should use feedback provided by these businesses, in conjunction with current research on successful economic development incentive practices used by municipalities, to propose an update to the incentives offered in Council Policy 900-12. EDD should ensure that the proposed update provides specific definitions of each incentive offered, and lists only those incentives that are not already provided during the normal course of business, or contemplated for inclusion in other business development programs. (Priority 1)



# Appendix A: Definition of Audit Recommendation Priorities

## DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation taking into consideration its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

Priority Class <sup>45</sup>	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls exists.
3	Operation or administrative process will be improved.

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<sup>45</sup>The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher priority.

# Appendix B: Objectives, Scope, and Methodology

**Objectives** In accordance with the Office of the City Auditor's Fiscal Year (FY) 2017 Audit Work Plan, we conducted a performance audit of the Economic Development Department's Business and Industry Incentive Program ("BII"). The object of our audit was to assess the overall effectiveness of the program, which is examined in two ways:

- **Objective 1:** Assess the City's overall control framework related to any services, benefits and incentives offered through the Business and Industry Incentive Program, including the Business Cooperation Program, fee reimbursements, and additional incentives discussed in Council Policy 900-12.
- **Objective 2:** Assess the effectiveness of outreach, incentives offered, and opportunities to improve incentives provided by the Economic Development Department's Business and Industry Incentive Program, including the Business Cooperation Program,<sup>46</sup> fee reimbursements, and additional incentives discussed in Council Policy 900-12.

The audit scope period covered FY 2011 – FY 2016, with minor exceptions as described below.

## Scope and Methodology

*Preliminary Survey* In order to arrive at these objectives, we conducted an extensive preliminary review and scoping phase.

As part of this process, we located prior audits analyzing economic development programs in Clark County, Washington, the City of Lawrence, Kansas, the state of Texas, the City of San Jose, and the City of San Diego.

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<sup>46</sup> As part of this objective, we issued a separate audit of the Business Cooperation Program in September 2017. See the *Performance Audit of the Business Cooperation Program* available at [https://www.sandiego.gov/sites/default/files/18-007\\_business\\_coop\\_program.pdf](https://www.sandiego.gov/sites/default/files/18-007_business_coop_program.pdf).

We located relevant best practices for the operation of economic development programs from the Government Financial Officers Association (GFOA). We located relevant criteria on internal controls from the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* and *Government Auditing Standards*, and California State Controller's Office's *Internal Control Guidelines*.

We also interviewed key staff within the City's Economic Development Department who manage and review projects within the BII. We reviewed the City of San Diego's Council Policy 900-12 and the City's Economic Development Strategy. We also reviewed memorandums of law pertaining to economic development programs issued by the San Diego City Attorney's Office.

*EDD Documents and Data  
Reliability Testing*

As part of the FY 2016 Work Plan, we began an audit of the City's Development Services Department's Entitlements Division. At the time this audit was started, we began our project work focused on two program, the Development Services Department's Affordable-Housing and Sustainable Building Expedite Program and the Economic Development Department's Business and Industry Incentive Program. As part of our preliminary survey, we sent a Job Start Letter seeking lists of projects that received benefits from both programs. The Economic Development Department produced a series of lists of projects that received assistance through the BII from FY2011 through FY2016. In June 2016, we decided to conduct separate audits of these programs and the BII audit was postponed and included in our FY2017 Audit Plan.

As part of the FY2017 Work Plan, we re-initiated the audit of the BII in December 2017. As part of the Job Start letter, we request another list of all projects that received assistance through the BII and the specific benefits provided. EDD provided the list three months later, in March 2017.

We compared the two different lists provided by EDD and found discrepancies between the projects on the list. Specifically, we found differences in the companies and the benefits provided. In order to determine the number of projects that received benefits, we attempted to locate a data

source to verify the companies on the May 2016 and the March 2017 lists. We found that the City's Development Services

Department's Project Tracking System (PTS) contained a functionality to locate projects "Expedited" by "Economic Development." We ran a series of searches for the years FY2011 through FY2016. We used this list to compare the number of projects that DSD listed as expedited verses the projects listed in EDD's May 2016 and March 2017 lists. We also used this list to compare projects that EDD listed as expedited but that DSD processed under standard permitting time.

*Maps of Projects*

In order to create a map of all projects that received assistance through the BII, we then combined the projects from the May 2016, March 2017, and the DSD Expedite list into one file. We used the Google Maps application to upload all projects and addresses into one map to determine the geographic dispersion of projects.

In order to create a series of maps for all new businesses and potentially eligible projects that did not received assistance in Southeast San Diego through the BII, we requested from the Office of the City Treasurer for calendar 2011 through 2016 all projects that pulled business tax certificates, the company address, and the North American Industry Classification System (NAICS) code for each project.

Using the most recent version of the City's Economic Development Strategy, we located all NAICS codes that qualify for assistance through the BII in Southeast San Diego. These codes represent the businesses the City seeks to assist. We separated the NAICS based on the classification in the EDS.

We entered each of the separate categories into the Google Maps application to map and color coated all new projects in City Council Districts 4 and 9 and projects that potentially qualifies based on NAICS codes but did not receive benefits in order to compare the geographical disparity of these projects.

*Stakeholder Outreach*

In order to determine a list of stakeholders for outreach, we used the information provided by the Office of the City Treasurer covering calendar year 2011 to 2016. Using the most

recent version of the City's Economic Development Strategy, we located all NAICS codes that qualify for assistance through the BII. These codes represent the businesses the City seeks to assist. We separated the companies based on the manufacturing related NAICS classification in the EDS.

We used the May 2016, March 2017, and the DSD Expedite list and filtered out all projects that fit into these NAICS numbers. We performed a mechanical search and, based on name and/or address, separated from the list companies that received assistance versus those that did not receive assistance.

Based on the list above, we used the DSD's PTS to access information about the permit applications filed with the City. We pulled the contact information for companies that did and did not receive assistance. In some instances, the company owner was listed as the point of contact, in other cases either architects or developers were listed as the point of contact.

We developed a questionnaire for companies that received assistance to determine how the company heard about the program, the number of permits that were process through the BII, and the overall satisfaction with the assistance received.

We also developed a questionnaire for companies that did not receive assistance to determine if the company heard about the program, did the company contact EDD seeking assistance, and what would be the ideal method to conduct outreach for the program.

*EDD Project Tracking*

We then sought to determine the steps employed by EDD to maintain a data base of companies, the types of analysis conducted on companies seeking assistance, and the types of monitoring conducted on companies that received assistance.

Based on the May 2016, March 2017, and the DSD Expedite lists, we selected a judgmental sample of 35 projects. We submitted these 35 projects to EDD and requested the file folders on each.

We created a questionnaire seeking to address the issues above. The questionnaire was based on best practices for economic development programs promulgated by the

Government Financial Officers Association. We designed the questions and "yes", "no", or "no folder", for ease of tabulation and calculations. We reviewed the project files at the EDD offices and filled out the questionnaire in paper format and copied relevant supporting documentation. The information from the questionnaires was tabulated and analyzed.

We also requested project folders companies that received City Council approved within the scope of our audit, between FY2011 and FY2016. These included project folders for Illumina, Ballast Point, and AleSmith.

We reviewed these folders to determine all communication between the City and the company, the application procedure, the types of analysis EDD conducted to determine whether company met Council Policy 900-12 criteria, the type of analysis conducted to determine amount of incentive, the negotiation process, and the monitoring of the company after the incentive was awarded.

**Internal Controls**

We limited our internal controls testing to determining whether the City has established appropriate and effective controls over the award of incentives through the BII. This included testing whether the City collected sufficient information and performed analysis justifying each incentive award, and awarded incentives appropriately; required applications and agreements with incentive recipients when more significant and costly incentives were awarded; and established and tracked performance measures to monitor the overall effectiveness of the BII.

**Compliance with  
Government Auditing  
Standards**

We conducted this 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 this evidence obtained provides reasonable basis for our findings and conclusions based on our audit objectives.

## Appendix C: Reorganization of the City's Economic Development Functions

Fiscal Year	Organizational Structure
2007	<ul style="list-style-type: none"> <li>Community and Economic Development, Planning, and Development Services are part of the Land Use and Economic Development Department</li> </ul>
2008	<ul style="list-style-type: none"> <li>Planning, Urban Form, Redevelopment and Economic Development organized into City Planning and Community Investment (CPCI)</li> <li>The BEAR team, Office of Small Business, Enterprise Zone, and CDBG Program are included in CPCI</li> </ul>
2009	<ul style="list-style-type: none"> <li>Planning, Urban Form, Redevelopment, Economic Development and Facilities Financing Program organized into CPCI</li> <li>Economic Development includes the BEAR Team, Tourism Marketing District, Office of Small Business, CDBG Program, Enterprise Zone, and the Business Finance Program</li> </ul>
2010	<ul style="list-style-type: none"> <li>Economic Growth Services, including the BEAR team and Government Incentives team becomes part of the Mayor's Office through Community and Legislative Services</li> <li>CPCI is organized into Planning, Urban Form, Economic Development, Redevelopment, and Facilities Financing Program. Economic Development includes Office of Small Business, CDBG Program, and Business Finance section</li> </ul>
2011	<ul style="list-style-type: none"> <li>Economic Growth Services, including the BEAR team and Government Incentives team, becomes part of the Mayor's Office through Community and Legislative Services</li> <li>CPCI organized into Planning, Urban Form, Economic Development, Redevelopment, and Facilities Financing Program. Economic Development includes the Office of Small Business, HUD Programs Administration (CDBG and other federal entitlement programs), and the Business Finance Section</li> </ul>
2012	<ul style="list-style-type: none"> <li>BEAR and Government Incentives teams organized into Mayor's Office of Economic Growth Services</li> <li>CPCI dissolved with planning function moving to Development Services and Economic Development Division, including HUD Programs Administration, Business Finance, and Office of Small Business, under Assistant Chief Operating Officer</li> </ul>

2013	<ul style="list-style-type: none"><li>• Economic Development Division and Economic Growth Services, including all programs, moved to Development Services Department</li><li>• Development Services reorganized into Customer Service and Department Administration, Permit Issuance and Code Enforcement Division, Economic Development and Project Management Division, Advanced Planning and Engineering Division, and Building Construction and Safety Division</li></ul>
2014	<ul style="list-style-type: none"><li>• Economic Development and Planning are combined into one department, and are later split into separate departments.</li></ul>
2016	<ul style="list-style-type: none"><li>• City Council established a standalone Economic Development Department (EDD).</li><li>• As part of the change, the EGS was consolidated under the EDD. Economic Development is positioned within the executive branch of City of San Diego under the Deputy Chief Operating Officer for Neighborhood Services. This branch is under both the Assistant Chief Operating Officer and the Chief Operating Officer</li></ul>

Source: OCA generated.

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# Appendix D: The City's Economic Development Strategy Targets a Wide Range of Businesses

Term	EDS Base Sector Category				
	Manufacturing & Innovation	International Trade & Logistics	Military	Tourism	Appendix A Other Base Sector Industries
<b>Sector 31-33 Manufacturing</b>					
311 Food Manufacturing	X				
312 Beverage and Tobacco Product Manufacturing	X				
315 Apparel Manufacturing	X				
325 Chemical Manufacturing	X				
332 Fabricated Metal Product Manufacturing	X				
333 Machinery Manufacturing	X				
334 Computer and Electronic Product Manufacturing	X				
335 Electrical Equipment, Appliance and Component Manufacturing	X				
336 Transportation Equipment Manufacturing	X				
337 Furniture and Related Product Manufacturing	X				
339 Miscellaneous Manufacturing	X				
<b>Sector 48-49 Transportation and Warehousing</b>					
481 Air Transportation		X			
482 Rail Transportation		X			
483 Water Transportation		X			
484 Truck Transportation		X			
485 Warehousing and Storage		X			
<b>Sector 51 Information</b>					
511 Publishing					X
513 Broadcasting and Telecommunications					X

Performance Audit of the Economic Development Department's  
Business and Industry Incentives Program

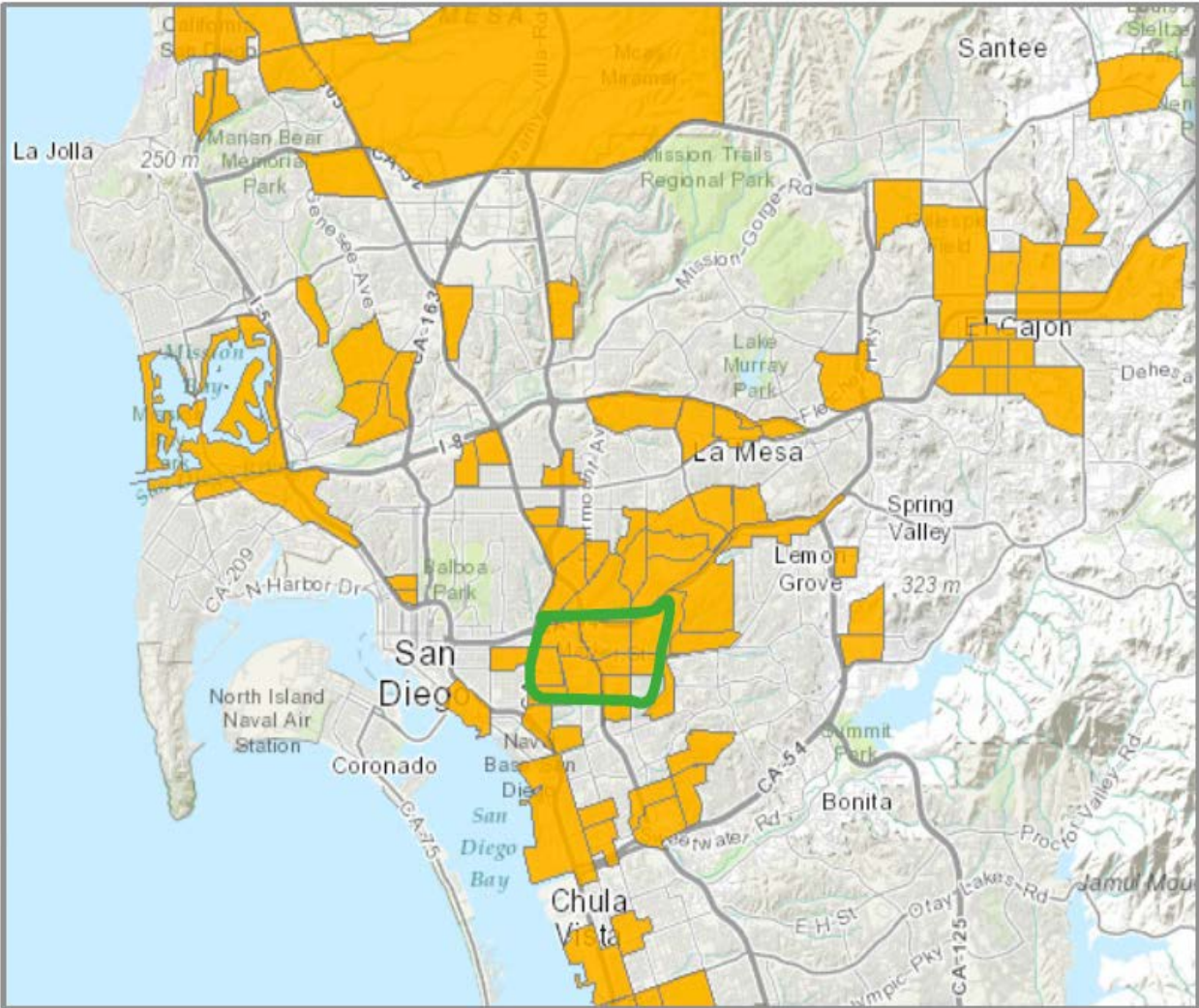
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514 Information Services and Data Processing Services					X
<b>Sector 54 Professional, Scientific and Technical Services</b>					
5417 Scientific Research and Development Services					X
<b>Sector 71 Art, Entertainment and Recreation</b>					
712 Museums, Historical Sites and Similar Institutions				X	
713110 Amusement and Theme Parks				X	
<b>Sector 72 Accommodation and Food Services</b>					
721 Accommodation				X	
722 Food Services and Drinking Places				X	
<b>Sector 92 Public Administration</b>					
928 National Security and International Affairs			X		

Source: 2017-2019 Economic Development Strategy


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## Appendix E: USDA Urban Food Deserts: Low Income and Low Access to Supermarkets



Source: USDA. 2013. Food Access Research Atlas. Economic Research Service. [Heept//www.ers.usda.gov/data-products/food-access-research-atlas/go-to-the-atlas.aspx#Um\\_1pRaLiaq](http://www.ers.usda.gov/data-products/food-access-research-atlas/go-to-the-atlas.aspx#Um_1pRaLiaq)

# Appendix F: Economic Development Project Information Sheet



**THE CITY OF SAN DIEGO**

**ECONOMIC DEVELOPMENT PROJECT INFORMATION SHEET**

PTS #:	Plan File No:	W.O. No:
<p>In consideration of Economic Development assistance the following information is being submitted. As a representative of the Project, the information presented is true and correct to the best of my knowledge.</p>		
Signature:	Print Name:	Date:
<b>PROJECT AND SITE INFORMATION</b>		
Project Name		
Address		
APN		
Contact Name	Phone #	
<b>PROPERTY OWNERSHIP INFORMATION</b>		
Property Owner Name		
Address		
Phone #	Fax #	
Contact	E-Mail	
<b>ARCHITECT, DEVELOPER OR CONTRACTOR INFORMATION</b>		
Name of firm		
Address		
Phone #	Fax #	
Contact	E-Mail	
<b>COMPANY INFORMATION (Company occupying facility)</b>		
Company Name		
Address		
Phone #	Fax #	





**The City of San Diego  
M E M O R A N D U M**

**DATE:** January 12, 2018

**TO:** Edward Luna, City Auditor

**FROM:** Erik Caldwell, Director, Economic Development Department  
via David Graham, DCOO Neighborhood Services Branch

**SUBJECT:** Management Response to City Audit of Council Policy 900-12,  
Business and Industry Incentive Programs

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The purpose of this memorandum is to provide the Economic Development Department's (EDD) response to the Audit Report entitled "Performance Audit of Economic Development Department's Business and Industry Incentive Programs." The Audit's primary findings were:

- A more robust outreach program is needed to advertise the incentives available through the Business Industry Incentives (BII) Program and ensure program benefits are more equitably distributed across the City.
- The BII had not maintained adequate records of businesses that have requested incentives through the BII or the incentives that were provided.
- The BII collects minimal information from most businesses requesting incentives, and performs incomplete document analysis justifying why incentives were granted.
- EDD does not require agreements outlining benefits the City should receive from the vast majority of businesses that receive incentives, and does not conduct any monitoring to evaluate the overall effectiveness of the BII.
- Council Policy 900-12 should be updated to reflect current economic trends and strategy.

The Audit Report evaluated projects between FY11-FY16 and provided recommendations for the Business and Industry Incentive Program (BII) targeting large construction projects and to improve internal controls over data collection. Below are the Department's responses to the Audit Recommendations.

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Edward Luna, City Auditor  
January 12, 2018

**Recommendation #1:** EDD should develop a more comprehensive outreach strategy to spread information about the BII and other EDD programs. Specifically incorporating outreach to potential businesses located in older, underserved areas of the City as stated in Council Policy 900-12 and the Economic Development Strategy. (Priority 1)

**Management Response: Agree with recommendation**

The BII was never intended to be available to all businesses throughout the city, as many businesses have different needs and various barriers to growth while many other businesses do not require assistance. Many of the offerings outlined in BII are no longer available to businesses due to changes in State law such as the end of the Enterprise Zone program and the passage of Proposition 218. EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address this specific recommendation. Once the Council Policy is updated, EDD will plan for a more concerted effort to share information with businesses eligible for this program. EDD will continue its efforts working with economic development organizations and industry associations to spread information about all EDD programs to the business community.

**Target implementation date: January 31, 2019.**

**Recommendation #2:** EDD should develop a written internal process to ensure the Office of the City Treasurer, Development Services Department, and other departments provide information about the BII to new business and permit applicants. (Priority 2)

**Management Response: Agree with recommendation**

EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address this recommendation. Once the Council Policy is updated a new administrative regulation may be required as a mechanism to ensure the Office of the City Treasurer, Development Services Department, and other departments provide information regarding the revised program and policy to new business and permit applicants.

**Target implementation date: January 31, 2019.**

**Recommendation #3:** EDD should implement a Customer Relationship Management (CRM) system that documents: (1) business 'touches' (contacts with various businesses); (2) details concerning incentives that were requested and/or provided by the business; and (3) time spent assisting the businesses (e.g. EDD staff technical assistance), if the time spent is above and beyond what EDD would provide in the normal course of business. (Priority 1)

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**Management Response: Implemented**

Prior to the beginning of the audit, EDD started working with Salesforce to develop and implement a CRM system. EDD's Salesforce CRM became active in July 2017. A step-by-step illustrative binder was created and given to each user in addition to multiple trainings and one-on-one sessions with staff members. The CRM is fully up and running for FY18. It does not track time spent on a project-by-project basis. However, if a project is of significant value and taking an overabundance of staff time to complete, time spent on the project will be tracked separately.

**Completion date: July 1, 2017.**

**Recommendation #4:** EDD should create policies and procedures and train EDD staff to document the information above pertaining to businesses seeking and receiving assistance in the case management system. (Priority 1)

**Management Response: Implemented**

After completing our CRM, a step-by-step CRM operations manual was provided to EDD staff and trainings were conducted.

**Completion date: July 1, 2017**

**Recommendation #5:** EDD should develop policies and procedures governing application and information requirements for companies seeking BII incentives. Specifically, for a smaller company receiving lower value expedited permitting and minimal technical assistance, EDD management should collect and certify the information used to justify the incentive award. For larger companies receiving more extensive technical assistance, more valuable expedited permits, or other incentives of more substantial value, EDD should require application submittals from companies seeking services or incentives related to the BII, similar to the 'Economic Development Project Information' form that EDD has required for businesses receiving other EDD services.

The information collected by EDD via self-certification or an application submittal should include supporting documentation that would be used in the determination of whether to award an incentive including: the location of the business; the number and types of jobs being created; potential tax revenue; estimated capital investment; and the industry category of the applicant. (Priority 1)

**Management Response: Agree with recommendation with modification.**

With the implementation of the CRM, EDD collects and maintains information from companies assisted on business location, number of jobs created, potential tax revenue, estimated capital investment and industry. This information is collected by talking to representatives of the business rather than asking them to complete an application. When a business is seeking assistance which does not take the form of direct financial



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assistance the Department provides this service without requiring the business to submit an application. EDD views the provision of this type of assistance as good customer service which we would provide to any business not just those eligible for assistance through Council Policy 900-12. EDD agrees when direct financial assistance is provided to businesses the Department should utilize a formal application. EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address many of the recommendation outlined in this audit.

**Target implementation date: July 1, 2019**

**Recommendation #6:** EDD should implement policies and procedures to require the performance of the following steps when analyzing and documenting applications or requests for incentives, including (1) the determination of whether the company satisfies the criteria established in Council Policy 900-12 and the Economic Development Strategy; and (2) Specific benefits the City expects the business to generate, including evaluation of the tax base impact, number and type of jobs created, estimated capital investment, and benefits to the surrounding neighborhood. This analysis and supporting documentation should be documented in the case management system. (Priority 1)

**Management Response: Agree with recommendation with modification.**

EDD sees value in developing policies to collect information and demonstrate the benefit of the incentives offered/used for projects with significant relevance either in value or direct benefit to the City. The information will be inputted into the CRM to the extent available. As such, policies will not be created to satisfy the existing Council Policy 900-12 but will be developed to implement when the updated Council Policy is adopted.

**Target implementation date: July 1, 2019**

**Recommendation #7:** EDD should develop policies and procedures for analyzing potential financial incentives which requires that a detailed 'but for' analysis be completed as a component of the cost-benefit analysis. The complexity of the 'but for' analysis should be scaled based on the size of the incentive provided and be designed to determine whether a financial incentive being considered is likely to influence the target business's decision-making regarding whether to remain or expand within the City, and to determine the ideal amount to be offered to influence the business' decision.

This analysis should include a quantitative analysis based on various business characteristics and location needs, and may incorporate narrative discussion of other non-quantifiable intangibles, such as the value of maintaining positive relationships.

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For incentive packages with an aggregated value in excess of \$1 million, EDD should require the business potentially requiring the incentive to assume the cost of an independent consultant selected by the City to perform the analysis, consistent with Council Policy 900-12.

**Management Response: Agree with recommendation**

EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address this specific recommendation.

**Target implementation date: July 1, 2019**

**Recommendation #8:** EDD should propose an amendment to Council Policy 900-12 which specifically requires at least a basic form application/agreement for larger companies receiving more extensive technical assistance, more valuable expedited permits, or other incentives of more substantial value through the BII. The application / agreement should include the requirement that the incentive recipient certify information EDD needs to verify program eligibility.

**Management Response: Agree with recommendation**

EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address this specific recommendation.

**Target implementation date: July 1, 2019**

**Recommendation #9:** EDD should propose a revision to Council Policy 900-12 that:

- a) Specifies that the basic form application / agreement discussed above should require each program beneficiary to provide basic information about the business on a periodic basis, such as capital investments and jobs created, when necessary to allow EDD to analyze the effectiveness of the BII.
- b) Requires EDD to establish specific performance measures for the BII, and to report the BII's performance on the measures to the City Council annually, such as through EDD's annual report. In addition, EDD should document and implement a written, clearly defined monitoring process, using data acquired from businesses using the BII and from other sources, in order to evaluate and report on the BII's performance against the measures identified above. (Priority 1)

**Management Response: Agree with recommendation**

EDD is working to provide the Council with an update to Council Policy 900-12 later this year which will address this specific recommendation.

**Target implementation date: July 1, 2019**

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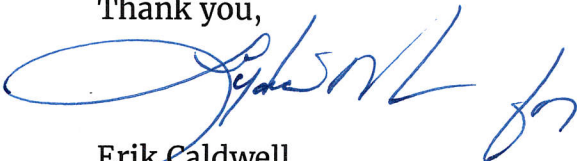
**Recommendation #10:** EDD and City should convene industries targeted by Economic Development Strategy, including base sector industries as well as business groups in older, underserved areas of the City, to determine what incentives would provide the greatest support and have the greatest impact in meeting economic growth goals. EDD should use feedback provided by these businesses, in conjunction with current research on economic development incentives and successful practices, to propose an update to the incentives offered in Council Policy 900-12. EDD should ensure that the proposed update provides specific definitions of each incentive offered, and lists only those incentives that are not already provided during the normal course of business. (Priority 1)

**Management Response: Agrees with recommendation**

EDD regularly participates in meetings coordinated by many business and trade organizations. These meetings are well attended by senior executives from a wide cross section of our business community. As EDD works to provide the Council with an update to Council Policy 900-12 later this year, we will engage these organizations along with nationally recognized research institutions, local universities, and community organizations.

**Target implementation date: January 1, 2019**

Thank you,



Erik Caldwell  
Director, Economic Development Department

cc: Scott Chadwick, Chief Operating Officer  
Stacey LoMedico, Assist Chief Operating Officer  
Amiee Faucett, Chief of Staff, Office of the Mayor  
Almis Udrys, Deputy Chief of Staff, Office of the Mayor  
Elyse Lowe, Director of Land Use and Economic Development Policy, Office of the Mayor  
Marshal Anderson, Director of Council Affairs, Office of the Mayor  
Lydia Moreno, Deputy Director, Economic Development Department  
Christina Bibler, Program Manager, Economic Development Department