MEMORANDUM

TO: TIF Policy Committee

FR: Joe Gromacki, TIF Coordinator

DATE: November 19, 2007

RE: TIF Job Creation Clawback Scenarios, Recommendations

Background

Staff has followed up with the Wisconsin communities concerning their use and enforcement of clawbacks in the event that a business loan recipient does not comply with job creation requirements in return for receiving city financial assistance. Only one community, Wausau, responded to this inquiry, noting that they recently had a situation where a company was given 3 acres of land in return for creating 5 jobs, but the jobs were unable to be filled. Wausau is not enforcing its clawback provision opting to "work with the business" to remedy the situation.

In light of this scarcity of data, staff has outlined the clawback issue in greater detail, giving examples of typical business assistance scenarios, based upon professional experiences in other places and other times, in galaxies far, far, away...

Example 1: ABC Company

ABC Company approaches the City requesting assistance to construct a 50,000 SF building that will be valued at $3,000,000. The project supports about $300,000 that may be provided as loan assistance. ABC's owner and family members have formed ABC Family, LLC for the purpose of owning the real estate. ABC employs 50 people and proposes to create 20 jobs within 2 years of receiving City funds.

The Deal

The City proposes the following deal structure:

ABC Equity	$300,000
Bank Loan	$2,400,000
City Loan	$300,000
Total Sources	$3,000,000

ABC Company and ABC Family, LLC must guaranty that 20 jobs are created within two years of the closing date. The City will claw back $15,000 for every job that is not created ($300,000 / 20 jobs). The City takes a second mortgage on the property to secure its loan interest.

The Clawback

Two years later, a City job audit of the company discovers that only 61 people are employed at ABC. The City chooses to pursue its clawback provision for the nine jobs, amounting to $135,000.

The City discovers that to date, $2,000,000 of bank loan remains outstanding on the property. In light of the default on the City's 2nd mortgage loan, the City must buy-out the bank's interest in order to enforce the clawback, i.e. pay the bank $2,000,000 in order to pursue a $135,000 clawback. The City cannot afford the $2,000,000 outlay. In addition, ABC Family, LLC disputes its responsibility because it is the property owner and landlord for ABC, receiving only rent payments, not the controlling body of its operations. Further, ABC has taken the high road with the media, a district alder and announces that markets are slow, qualified people have been hard to find and ABC has been a good corporate citizen. ABC's skilled attorney, Harry Hemlock, argues publicly that rather than focusing on the nine jobs ABC didn't create, the City should focus on the eleven jobs his client did create. Sounding reasonable, the City backs down.

Example 2: DEF, Inc.

Learning something from the ABC endeavor, the City adopts a new policy that as long as 60% of the promised jobs are created, the City won't enforce its clawback provision. It also extends responsibility for job creation to both the property owner and the business.

About a year later, DEF, Inc. requests assistance to construct a 100,000 SF building on land it has owned for 20 years. Times are great and DEF is a leader in the market and proposes to add 100 jobs paying $18 per hour. The building is valued at $8,000,000, being eligible for $800,000 of City assistance. DEF is owned by Ownital Industries, a multi-national conglomerate based in Stuttgart, Germany. Excitement is high--Ownital hints that it may locate other subsidiaries to the City if DEF continues to succeed.

The Deal

The deal looks thus:

DEF Equity	$1,000,000
Ownital Industries (Inter-company loan)	$6,500,000
City Loan	$500,000
Total Sources	$8,000,000

DEF must guaranty that 60 of the 100 jobs (the new 60% job rule) are created within 3 years or pay a claw back of $8,000, per job.

The Clawback

Three years pass and Ownital announces that it is selling its interest in DEF, Inc. to Buyital Partners, LLC a New York investment group with a record of breaking up companies for intellectual property (i.e. patents and contracts) and selling off the rest. All 100 jobs will be lost.

The City responds by informing DEF of its obligation to repay the entire $480,000 (60 jobs x $8,000) but is not sure what to do if DEF doesn't comply. DEF's general manager, who has since been re-assigned by the new owner, indicates that the situation is fluid and the new owner does not believe it owes any obligation to the City, because DEF no longer exists as a corporate entity. The cost of litigating will be time-consuming, expensive and publicly controversial, ultimately costing more than the amount of funds clawed-back. The City opts out, not having confidence of a win.

Example 3: GHI Industries

Learning something from the DEF example, the City adopts a policy that hereafter, the job clawback provision will be transferable to any new owners of the company receiving City assistance. The 60% job rule is still in force.

GHI Industries, a local firm with a 70-year history in the City requests assistance as it is contemplating a 70,000 SF expansion that may happen in the City or in nearby Bedford Falls. The project is valued at $7,000,000, eligible for $700,000 of City assistance. The company will retain 200 jobs with a promise that an additional 70 jobs will be created within two years.

The Deal(s)
The City proposes the following:

GHI Equity	$1,000,000 (Value in land)
Bank Loan	$5,600,000
City Loan	$ 400,000
Total	$7,000,000

The City requires that GHI retain the existing 200 jobs, and 60% of the 70 new jobs (42 jobs) within two years or pay $10,000 per job that is not created.

Bedford Falls, meanwhile offers GHI a similar package with no clawbacks. As the nearness to markets, materials and services are about equidistant between the City and Bedford Falls, Bedford Falls is chosen.

The Clawback
There isn't a project to claw.

Example 4: JKL & Son, Inc.

JKL is a third-generation contracting firm that is planning a major expansion of its headquarters. JKL owns property in the City adjacent to its current location or property out in the Town of Hogg's Corners. They employ about 100 full-time administrative personnel, and are well-paid professional jobs. JKL will create 30 new jobs as a result of the expansion project that is valued at $10,000,000.

The project is eligible for up to $1,000,000 of TIF assistance. JKL must guarantee that 18 jobs (60% of 30) are created within two years or pay a clawback of $55,000 per job. The Town of Hogg's Corners cannot provide any financial assistance to compete with the City's proposal.

<u>The Deal</u>

JKL & Son	$1,000,000
Bank Loan	$8,000,000
City Loan	$1,000,000
Total	$10,000,000

<u>The Clawback</u>

The City discovers at the end of two years that JKL has opened an office in Bedford Falls and has moved some of its employees there. Overall, the company has created about 15 jobs, but 10 of them are located in Bedford Falls. The remaining 5 jobs created in the City are temporary workers, termed as "independent contractors", who receive pay but no benefits.

The City contacts JKL to notify them of the problem but a number of issues exist. Henry Hemlock, Harry's brother, represents JKL and makes the following assertions:

1) The City never identified what a "full time job" would entail or defined a difference between temporary, independent contractors and actual full time hires.
2) The City never stipulated where the jobs would be created, many of the Bedford Falls employees live in the City.
3) If the City wishes to press the matter, they are welcome to buy out the bank's $8,000,000 mortgage interest.
4) JKL will dispute that the actual job shortfall is 3 jobs and not 18.

JKL's president is president of the City's Chamber of Commerce. It's an election year. The City drops the matter.

Example 4: MNO Hury Corp.

The City learns from JKL and makes a finite definition of job creation to include full-time jobs created within the corporate limit of the City, supported by a living wage and benefits as defined by the state's Dept. of Human Services, and may not include independent contractors. The 60% rule and new-owner transferability clause are still in force.

MNO Hury Corp., a pharmaceutical manufacturer located in the City's industrial park contacts the City that they are purchasing a Cincinnati, OH based firm and moving it to the City. MNO will create 150 new jobs paying wages averaging $12 per hour. The expansion supports about $500,000 of TIF assistance to support the cost of moving the company to the City. The company funds the expansion through a stock offering. The City files a mortgage lien against MNO's real estate, but because MNO is funded by a venture capital firm, all of the corporate assets are tied up by the venture firm.

Shortly after closing on the loan the City learns that the jobs created are actually corporate executives, engineers and chemists that are being relocated to the City from Cincinnati. No new jobs are being created for City residents.

<u>Example 5: PQR Data Systems, Inc.</u>

PQR is a local success story. Three area communities are vying for the company to locate their $300 million world headquarters within their boundaries. Although the competitive offers are better than the City's loan package, PQR chooses the City site based on some rather unique location objectives. The City's comprehensive TIF package includes about $5,000,000 of infrastructure improvements, $5,000,000 in direct loan assistance and a commitment to provide more infrastructure and loan assistance when subsequent phases are initiated. The company will relocate 300 technicians and executives to the new facility and create an additional 200 tech jobs within 3 years. They will guaranty that 120 of those jobs are created at the end of the period.

Continual monitoring of PQR indicates that the company is experiencing hiring fluctuations, surging from 300 to 450 employees in by the end of Year 1, dipping below 400 at the mid point of Year 2, rising slightly above 400 at the beginning of year, and then dipping below 400 again at the end of Year 3. The reason? PQR's business is project-based. Their employment fluctuates due to the amount of software design projects that they take in during the year. Some projects require more programmers, some less. Hiring and laying-off is an accepted fact within the computer industry.

<u>The Clawback</u>
Although currently 20 jobs short of the guaranty, PQR argues that it exceeded the 120-job mark in Year 1. Moreover, even if the company agreed to the shortfall, PQR is unable to pay the $800,000 clawback as the market is in a downturn. City inspection of PQR's books reveals this to be the case. No clawback is paid.

<u>Conclusion and Recommendation</u>

In staff's experienced opinion, unless the City is sole first mortgage lender, it is not possible to enforce a job creation clawback provision by virtue of the mortgage as a security instrument. In most cases, the City is a subordinated lender and buying out the first mortgage is an expensive endeavor.

It is possible to sue the borrower on the terms of the note (and not the mortgage) however, it would require that the bank agree to forego its customary "stand still clause" i.e. requiring among other things, that no subordinated lender can be repaid earlier than the bank as first mortgage holder. Banks are not likely to agree to this provision.

Staff also considered a mechanism similar to a special charge against the real estate, similar to a delinquent water bill, etc. This is basically a long-term lien that isn't paid until the property is sold. In the City Attorney's viewpoint, this would in effect make the loan non-recourse, i.e. an alternative to the personal guaranty required in TIF Policy. It would not serve as a bona fide clawback if the "clawing" part of it were long-term.

Recommendation: Twelve-Month End-Loan, Job Creation Percentage Threshold, Maximum TIF Per Job

The only other possibility is an end-loan, wherein funds are provided only when job creation thresholds are met. An obstacle to this is that TIF loans are not phased over more than one year--as it is the City's objective not to bind over future Common Councils with fiscal obligations from previous years. Therefore, the job creation period could be no longer than 12 months. Most companies agree to job creation periods of up to three years from project completion.

However, similar to condominium or commercial rental underwriting, the City could establish a percentage threshold (i.e. 60%-70% of the jobs created before funding) that may be more agreeable to the borrower. It is therefore staff's recommendation that if job creation clawbacks are a desirable policy that the 12-month end-loan be the mechanism. Staff also recommends that a TIF per job maximum be established wherein TIF funding represents no more than $30,000 (or some number) per job created.

Issues yet to be resolved are:

1) Policy on retained jobs (Do they count? If so, when?)
2) Definition of created job (i.e. prevailing wage, full-time with benefits, located in City)
3) Policy on relocated jobs (Are jobs moved here from elsewhere desirable?)