BEST PRACTICE

Analyzing the Cost of Economic Development Projects (2009)(CEDCP)

Background. Jurisdictions utilizing economic development incentives have very different objectives from the businesses receiving them. Public bodies are responsible for providing services to citizens while businesses are focused on maximizing profits. Because of these competing interests, the best returns on public investment through economic development incentives are those that have been examined carefully against the cost of the public expenditure. To ensure government accountability and thoughtful long-term policymaking, an examination of the benefit to the local jurisdiction must be compared to the offered incentives, the need for those incentives, and the public cost or willingness to forgo future revenue.

Recommendation. The Government Finance Officers Association (GFOA) urges state and local government officials to examine the fiscal costs associated with economic development projects, programs, and policies. At a minimum, jurisdictions must examine cost elements and costing methodologies as part of their analyses.

Cost Elements:

Opportunity Costs. Evaluate other potential uses for the funds, land, and other incentives. This can also include one-time upfront developer subsidies. The evaluation should include uses discussed to date or that may develop in the future, recognizing that future uses inherently involve uncertainty. Is the considered project the highest and best use of the incentive(s)? Or, does a future project generate sufficient benefits to justify the risk that a more desirable project won't appear for some time?

Operational Costs. Within the scope of the project, direct and indirect costs should be identified, and whether these costs will be an expansion of ongoing operations that will require additional resources should be determined. Examples of additional costs include police, fire, social services, roads, public transport, utilities, and recreational facilities.

Multi-jurisdictional Impacts. Whether direct or indirect, cost impacts to multiple government levels – counties, townships, school districts, park districts, social service agencies, libraries, water/sewer districts – should be considered when possible within the scope of the project.

Market Impact. Whether direct or indirect, market impacts to the jurisdiction should be considered. Examples include market absorption or saturation, capacity for growth, and potential displacement or substitution of existing local businesses and service providers.

Assessing Intangible Costs. Project impact considerations may also take into account a variety of intangible factors. Such factors may include quality-of-life or amenities, and, while they may not be readily quantified, these factors can be very influential from the perspective of the taxpayers, neighbors, etc., who may be impacted by the project. Following the identification of applicable factors (e.g., noise, light pollution, traffic, and congestion), it is essential that jurisdictions understand and address the respective issues, while identifying mitigating factors if possible.

Cost Analysis Methodologies (See references below):

Net Present Value Consideration. The timing of the costs must be accounted for in the analysis, as additional revenue generated from a project will most likely be realized in the future. For example, a public investment may be required at the onset of a project with annual commitments to operational costs. To make appropriate comparisons between the costs and benefits, a net present value analysis should be performed.

Average/Marginal Methods. Two generally accepted methods for cost analysis are the average (or per capita) method and the marginal cost approach. Average or per capita approaches can be used when the scoped project is not anticipated to incur costs outside the typical average historical costs experienced by the jurisdiction. If costs vary significantly from historical averages, then employing the marginal cost method through a case study may be more appropriate. A case study analyzes the existing supply and demand for public services and projects the impact of the project on these services. Developing a case study requires interviews and data collection to understand current service levels and the impact a new project will have with respect to issues like infrastructure capacity.

Finally, when presenting the results, the analysis should contain a clear description of the net impact for the jurisdiction, the constructed methodology, and the assumptions employed. It is important to acknowledge the strengths, weaknesses, and limitations of results so that decision makers are fully informed.

References

- *Preparing A Local Fiscal Benefit-Cost Analysis*, International City/County Management Association (ICMA) Report, Volume 37, Number 3, 2005.
- "Fiscal Impact Analysis: How to Use It and What to Look Out For," *Government Finance Review*, GFOA, October 2007.
- "A Financial Analyst's Toolkit: Analyzing the Fiscal Impacts of Economic Development Projects," *Government Finance Review*, GFOA, June 2008.
- GFOA Best Practice, "Developing an Economic Development Incentive Policy," 2008.
- GFOA Best Practice, "Monitoring Economic Development Performance," 2009.

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