
Background. State, provincial and local jurisdictions utilizing incentives defined by an economic development policy do so to promote and grow the local economy through job creation, wage and compensation growth, or tax base expansion. However, 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, who in many cases have come to rely on incentives and subsidies, are focused on maximizing profits.

To reach the goals identified in the policy and ensure local government accountability, local jurisdictions need to measure the benefits of projects receiving economic development incentives against the cost of the public expenditure, or willingness to forgo future revenue. While there is no single best method for conducting analysis and it is impossible to predict all impacts a project will have on a community, providing a thorough and rigorous analysis of each project is critical for the purposes of government accountability and long-term revenue impacts. Responsible use of public funding requires that projects funded provide a suitable return for the jurisdiction, are consistent with overall community goals and priorities, and require that investments are made in a transparent manner with full understanding of all short- and long-term costs and benefits.

This best practice will give the finance officer guidance on what elements and methods to consider in a detailed cost/benefit analysis.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state, provincial and local government officials examine the specific benefits and costs associated with economic development projects, programs, and policies. Such an examination should also include an analysis of the assumptions, cost/benefit elements and methodologies being used to justify the incentive.

Overall analysis of projects
An analysis of each project or group of projects should, at a minimum, include:

1. A clear understanding between financial and non-financial costs and benefits.
   Economic development projects will most likely result in both financial costs and benefits and non-financial costs and benefits. Financial costs and benefits are those that will impact the jurisdiction’s bottom line. For example, additional property tax revenue, payments made on the project, and maintenance expenditures over time are items that will be reported on the jurisdiction’s operating statement. Non-financial costs and benefits are realized and have value, but do not translate directly into increases in revenues or expenditures of the jurisdiction. For example, consider public safety,
pollution, cultural impact and quality of life components. Economic costs and benefits would include both financial and non-financial costs and benefits.

2. Consideration of the timing of costs and benefits.
   Economic development projects will generally occur over multiple years and ideally provide benefits over an even longer period. As part of the analysis, it is important to define when expected costs and benefits will occur to calculate the net cost/benefit for each year as well as a total net cost/benefit. When comparing costs and/or benefits from different years, it is important to discount future year impacts to compensate for the time value of money.

3. Scope of the analysis.
   The area for which the analysis will be conducted needs to be identified. Depending on the incentives, multiple jurisdictional levels – counties, townships, school districts, park districts, social service agencies, and water/sewer districts – should be considered in the scope of the project. Consideration should be given to these other jurisdictions because the host of the project may receive a positive net impact while other levels of government experience a negative net impact.

4. Identification of all cost and benefits.
   Within the scope of the analysis, direct and indirect costs and benefits that will result from the project, program, or policy need to be identified and addressed, again giving consideration to other jurisdictions that may be impacted.
   a. Direct Costs: Costs, from the upfront capital expenditures to the long-term ongoing operating expenditures that will result, should be identified. Existing infrastructure (utilities, roads, public transportation, and recreational services) and services (police, fire, schools, social services) that may be impacted from additional need should be projected as well.
   b. Direct Benefits: Revenues can range from increases in real estate, gross receipts, sales, lodging, utility, or other tax streams to increases in permitting or water and sewer fees.
   c. Indirect Impacts: Identifying and enumerating indirect costs and revenues is a difficult task most frequently accomplished with more sophisticated econometric models or more simplistic multiplier calculations.

5. Assessment of the chance that each cost and benefit will occur.
   Projecting future costs and benefits of an economic development project involves some level of uncertainty. Not all project benefits are guaranteed and this must be accounted for in the cost/benefit analysis. For each cost and benefit and for each year the finance officer should explicitly state the probability of the impact occurring and include these costs in the overall calculation.

6. Communication of Results.
   Communicating the assumptions that were involved in developing the net impact is just as important as the impact itself.

Analysis of project benefits
Analysis of the benefits of a project or group of projects should, at a minimum, include:

1. Growth and Diversification of Revenue Base.
   Jurisdictions have a vested interest in realizing expected direct benefits of economic development through revenues from development activity. An analysis should include items such as:
   • estimates of income, sales, property, and transactional taxes
   • the impact of employment or income multipliers or other indirect economic effects
any additional demand for new or remodeled business properties as a result of economic activity and the ability for existing housing stock to accommodate new resident workers.

It is important that the revenue analysis measure the impacts from business displacement and the "new" revenue generated within a jurisdiction rather than the result of business activity that is moved from one existing business to another.

2. **Multi-jurisdictional Benefits.**
   The full benefit of the economic development project may not be captured solely by the local jurisdiction. An analysis of project benefits should take into account other jurisdictions and the overall project impact.

3. **Assessing Intangible Benefits.**
   Other project benefits may be incurred by the local jurisdiction that, while not exactly quantifiable, can be estimated for the purpose of providing the jurisdiction’s decision makers with the most thorough information. Examples of these intangible benefits include donated facilities or infrastructure, quality of life amenities, community prestige or pride, and corporate citizenship.

4. **Net Present Value Consideration.**
   Determining the benefit of a project requires assumptions about the timing of benefit streams that will take place in the future and are based on conditions like employment, occupancy, etc. These benefits will most likely be received in a period other than the one in which the costs are incurred, requiring the calculation of the net present value of the project. 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 benefit streams, a net present value analysis should be performed. The analysis should contain a clear description of the adjusted 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.

_Analysis of project costs_
An analysis of the cost elements of a project or group of projects should, at a minimum, include:

1. **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?

2. **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.

3. **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.
4. **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.

5. **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. 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.

6. **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**