BEST PRACTICE

Balancing the Costs and Benefits of Economic Development Projects (2010) (CEDCP) (new)

Background. The use of public funding or other forms of government assistance to provide incentives for individual projects, groups of projects, or an economic development plan, program, or policy compels an analysis of both the expected costs and benefits to the jurisdiction. This evaluation is an important decision-making tool for public officials. 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.

Recommendation. The Government Finance Officers Association (GFOA) recommends that a thorough analysis of the costs and benefits of publicly-funded economic development incentives and programs are performed in order to provide the best information possible for local officials to make informed decisions and policies.

For consistency in the economic development program, a clearly detailed methodology and assumptions should be outlined for each project. Other elements of a project 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, safety, pollution, and quality of life are considerations that affect the local economy but don't have an impact on the jurisdiction's operating statement. 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.

- 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.
- 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.
- 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.

References.

- Mike Mucha, *Fiscal Impact Analysis: How to Use It and What to Look Out for*, Government Finance Review, October 2007.
- GFOA Best Practice, *Developing an Economic Development Incentive Policy*, 2008.
- GFOA Best Practice, *Analyzing the Cost of Economic Development Projects*, 2009.
- Paul Harris and Ronald Berkebile, *A Financial Analyst's Toolkit: Analyzing the Fiscal Impacts of Economic Development Projects*, Government Finance Review, June 2008.
- ICMA Report, Preparing a Local Fiscal Benefit-Cost Analysis, Volume 37, Number 3, 2005.

Approved by the GFOA's Executive Board, March 5, 2010.