

# **Critical Issues in Corporate Real Estate: Developing a Better Understanding of Public Sector Project Impact Analysis Practices**

**By**

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## **Abstract**

Increasingly, corporate real estate projects are facing greater scrutiny and review from citizen and local units of government. The ability of corporate real estate specialists to successfully address and resolve perceived negative impacts resulting from a new development, expansion, renovation, merger, consolidation, closure and disposition activities, will determine whether the project will be built with what amount of incentives and what the facility will ultimately cost to operate. The corporate real estate community must have accurate insights as to how the public sector---including government agencies, politicians and citizens, view and evaluate economic development impacts.

Understanding the public sector perspective is important because it enables the corporate real estate professional to frame and present projects for maximum subsidies, highest public/community corporate image, and the most favorable terms in performance agreements, low assessments and other public sector concessions. This article investigates how U.S. municipal level development officials evaluate project impacts, public costs and public benefits. The data presented in this paper is based on a national survey of municipal level development officials working in U.S. cities with populations between 10,000 and 300,000. The paper examines public sector views on development costs, benefits and the analytical methods used by the public sector to evaluate project impacts.

## **Introduction**

Corporate real estate professionals, site selection specialists and real estate consultants interface with economic development administrators, planners and elected officials in multiple ways during the corporate site selection process. The alignment of corporate

facility needs with accurate community data, available sites, public incentives and information on the local political and business climate, can be a productive or unproductive experience. There are many community variables that need to be examined in the corporate site selection process. One of the most important variables is an assessment of the long term benefits of a community is an examination of the community's economic development goals, attitudes and impact cost/benefit measurement techniques.

Traditionally, quality of life, business climate and community analysis studies were used by corporate real estate and site selection specialists to ascertain community attitudes towards business and corporate citizens. Are these studies adequate in today's environment of growing fiscal problems facing local units of government? Can the once warm and welcoming community rich in site location incentives, tax abatements and free infrastructure maintain the honeymoon with the newly arrived corporate citizen? The political climate and public sector attitudes toward corporate citizens can change radically under fiscal and citizen pressures for tax and growth controls.

As a result of increasing long term risks from inadequate community analysis in the site selection process, the corporate real estate community must develop a more insightful calibration of the business and political climate among communities under site selection consideration. What is at risk?--- future fees for public services, property tax rates, infrastructure development (or lack thereof), and indeed the entire regulatory climate surrounding the selected site and its ongoing use.

This article presents survey data on local economic development administrators regarding their views and attitudes about their respective communities and how the costs and benefits of development are measured. It is critical that corporate real estate professionals understand as much as possible about the cost/benefit measures used by these officials to gauge the attractiveness of corporate citizens. By having greater insight into this area, corporate real estate decision makers can expand their skills in long term community analysis, corporate image building, dealing with local politics and most importantly, in negotiation of public subsidies. An understanding of the cost/benefit measures used by local officials to evaluate project impacts will enable a corporate real estate professional to supply the most relevant information to local decision makers and citizens and create community support for subsidies, project approvals, public services and regulatory controls. It is critical that we develop a better understanding of how communities evaluate the costs and benefits of business to include not only the site selection issues but also in the context of other corporate facility decisions including: expansion, renovation, merger, consolidation, closure and disposition activities.

### How the Public and Private Sectors Measure the Costs and Benefits of Location

Cities use a variety of direct and indirect tools to encourage development. Subsidies are often provided to the private sector with the understanding and anticipation that the

development activities will result in future public benefits. The exact analysis performed by municipalities to evaluate community costs and benefits resulting from commercial and industrial development are illusive. The factors involved in the decision-making and analysis of project financial outcomes encompasses a multitude of assumptions regarding fiscal community impacts, citizen and political considerations, and project delivery schemes. Unlike the empirical and objective regional modeling techniques (Bureau of Economic Analysis Regional Multipliers, 2003), applicable to industrial development impacts in large geographic settings, meaningful data at the municipal level is more difficult to acquire. The scarcity of impact data at the local level presents an opportunity for corporate real estate to identify and capitalize upon the future community benefits that will be created by corporate real estate activities.

Communities evaluate industrial development projects from a variety of perspectives as to how the project will impact a community by creating employment, generating additional tax revenue, and a multitude of other impacts, depending on the project and the community. The process undertaken by economic development officials to evaluate development impacts include the generic concepts of cost benefit analysis, risk assessment, decision analysis, fiscal impact analysis, and environmental assessment. For new development and plant expansion projects to be successful, corporate decision-makers and site selection specialists must formulate an accurate understanding of state and local economic development project analysis practices. An industrial developers understanding of community impacts resulting from a new project or plant expansion is critical. In most states the application process for Industrial Development Bond (IDB) financing requires (Skowronski, 2003) an analysis of new job creation and basic community impacts resulting from the project. Indeed, in some states (U.S. Chamber of Commerce, 1998) municipal and county approvals are also required in order to obtain IDB financing.

It is important that corporate real estate professionals understand municipal level land, political and regulatory environments. Thompson and Tsolacos (2001) in their study of U.K. industrial land values and rents for new industrial buildings, noted that “the amount of land zoned for industrial development *the local planning environment* (emphasis added) and alternative building uses are factors that largely influence the flow and price of industrial land and determine the share of land costs in total development costs across markets.”

Surprisingly, little has been written regarding project assessment and impact analysis practices at the local level. Previous research (Reese, 1997; Clinger & Feiloch, 1995; Elkins, 1995; Goetz, 1990; and Levy, 1990) has been directed to evaluating public subsidies associated with industrial development. There are many small how to publications addressing the subject of how to win public support (Stein, 1992; Urban Land Institute, 1985) for a project. Lastly, there are a few valuable resources (Peiser & Frej, 2003; and Miles, Behrens & Weiss, 2000) addressing project approval and analysis methods used by municipal level public administrators and citizen groups. There is little doubt that a community’s attitudes toward business and economic development play a substantial role in long term facility productivity. The contribution of a location to a

company includes tangible economic factors like tax rates, utility costs and labor costs. Location attributes also include factors influencing the education levels of workers, cultural and social amenities that contribute to worker and management well being.

Corporate real estate has traditionally (Brown et al, 1993 and Brown, 1979) evaluated community attributes in three ways during the site selection process.

#### Exhibit 1

#### Traditional Community Analysis in the Site Selection Process

- 1) *Community Analysis Studies*---evaluating the general advantages a community can offer a corporation. This comprehensive study is the starting point to evaluate community attributes (site availability, labor costs, image, tax rates, transportation, zoning, regulation, fees, etc.)
- 2) *Quality of Life Studies*---evaluating how local conditions affect employee attitudes and productivity. Areas under study include cost of living measures, employee preferences for recreation amenities, housing, tax and transportation costs.
- 3) *Business Climate Studies*---evaluating the views of community decision makers and how those views will affect corporate operations. The focus of this study is on future issues of fairness in regulation and property taxation, community attitudes towards business and how the community will provide public services such as police and fire protection.

Other studies that examine community variables (Rabianski, DeLisle & Carn, 2001 and O'Mara, 1999) are sub-studies of the above and focus, for example, on issues like community assessment practices, taxes, land use planning and regulation or employee relocation issues.

Site location studies are critical and need to be expanded to also include a study of how local economic development and public administrators measure the benefits and costs attributable to corporate citizens. In our current economic climate, local units of government are facing substantial decline in both federal and state aid. This shortfall, coupled with citizen pressures for property tax and growth controls, has resulted in increased pressure on local officials to increase fees for public services and ultimately will result in increased pressure for non-voting property taxpayers. For corporate real estate this will mean greater long term risk in the site selection process.

#### Measuring How Economic Development and Public Administrators View Development Costs and Benefits

The data in this article is based on a national survey of U.S. municipal economic development officials regarding their views on and practices in municipal economic development. Surveys were sent to a random sampling of economic development administrators in 1,500 of the 2,600 U.S. cities with populations between 10,000 and 300,000. The survey had a response rate slightly over 27 percent. The economic development administrators completing the survey were identified through the National League of Cities as having management responsibility for the economic development activities in their respective communities. The respondents to the survey fell into the following general categories: economic and community development managers, elected officials, planning and zoning officials and public development corporation managers.

The administrative setting where municipal economic development activities were based was considered in the survey. While an organization setting may appear as almost a random decision, much can be attributed from this decision regarding the long term implications of a community's future behavior toward business. Economic development organizational structure demonstrates community leadership and what the community envisions as their future. Harding (1991) noted communities with vision have a marketing advantage and the ability to put infrastructure in place to meet the needs of the corporate users.

An economic development agency's organizational setting can provide insight into organizational decision making. For example, if an economic development agency were located in a planning and zoning department, we could infer that the day to day staff motivations are highly structured in nature. Additionally, we also could infer that projects under their consideration would involve goals consistent with comprehensive land use plans. The approach to economic development by planners has been described as the "rational model." Economic development program administrators working under the "rational model" would tend to be highly focused on data collection, bureaucracy and organizational process related issues. This model is reactive in nature and corporate real estate professionals working in this context must understand the limitations created by this development model. The biggest limitation of the rational model is the ability for communities under it to develop creative solutions to corporate facilities problems.

If an economic development department is independent of other municipal departments, the underlying organizational motivation towards site selection projects and the reward structure would be based less on the defined goals of a rational planning model and more on a definition of success determined by the number of sites promoted and corporations contacted. Accordingly, independent economic development departments can be perceived as more sales oriented in nature. One article (Rubin, 1988) about economic development practitioners describes this mindset well--the article is entitled: *Shoot Anything that Flies; Claim Anything that Falls: Conversations with Economic Development Practitioners*. Public agencies in this context, usually will approach corporate real estate problems and constraints with responses like "we have a problem" versus the rational model's "you have a problem" response.

Economic development activities have also taken on an increased importance in terms of the contribution they make to community planning activities. Eisinger (1988) noted the "virtually universal institutionalization of the economic development function accompanied by a proliferation of policy tools and rapid intensification of their use". Indeed, a critical question regarding the effectiveness of a municipal economic development program in part rests with the organizational relationships that it has with other administrative units of government. The coordination of program interrelationships with other government (and non-government) functions contributes to the ability of an economic development agency to assist with corporate facilities and site selection problems. Examples include the resolution of disputes in zoning, land use/regulatory issues to the settlement of construction and fire protection matters. Clearly, independent departments will be much more aggressive in assisting with many issues and problems---most importantly in the negotiation of public subsidies and tax incentives.

I found the following composition of organizational settings for economic development departments.

Exhibit 2

Municipal Economic Development Organizational Setting

<u>Form/Placement</u>	<u>Percentage</u>
Independent Department	29.7
Part of Planning Department	23.6
Non-Profit Development Corporation	16.2
Other	13.5
Function of City Manager	10.6
Duties Carried out by Several Departments	9.8
Performed by an Outside Consultant	1.6

Survey respondents were asked to rank general industry groups by the degree of importance to their respective community's economic base. Retail was the leading industry group with almost 84 percent of economic development officials reporting that the retail industry was critically important or very important to their economic base. This can be attributed to the fact that retail development provides needed shopping opportunities to communities and in some cases, contributes to the public coffers with sales tax revenues. The major limitation of retail development is that it does little to import capital into a community, shifts local spending and it creates lower paying jobs.

Almost 82 percent of the survey respondents identified the service industry as critically or very important to their economic base. The corporate real estate community has witnessed a blossoming love affair between service industries and communities because of the "smokeless" nature and low infrastructure requirements of this industry sector. Surprisingly, manufacturing (the industry group with the highest

income multipliers for a community) was ranked third with only 73 percent of economic development administrators indicating that manufacturing was critically or very important to their community's economic base. Government/institutional industries were ranked by 58 percent, office/commercial by 54 percent recreation/tourism by 49 percent of survey respondents as critically or very important to the community's economic base.

Exhibit 3  
Industries Ranked as Critically and Very Important to the Municipal Economic Base

Industry	Percentage Response
Retail	83.8
Service Industries	81.7
Manufacturing	72.9
Institutional (Government)	58.0
Office/commercial	54.2
Tourism/Recreational	49.0
Warehousing/Distribution	42.7
Arts and Entertainment	27.6
Agriculture	26.3
Import/Export	18.2

Municipal level economic development officials rated the following community advantages as very important in attracting new businesses and retaining existing businesses. When reviewing Exhibit 4, keep in mind the rating of important community advantages from the corporate real estate perspective. The best articulation of corporate real estate's overall key location factors were identified in a survey by McKinley Conway (Conway, 1994) and included, most importantly: proximity to customers/clients, highway access, availability of skilled workers, cultural and recreational amenities, pro-business government officials and reasonable, real estate costs, tax rates, utility rates, business taxes and cost of living.

Exhibit 4  
Municipal Economic Development Officials Ratings of Community Advantages

## Community Advantage

## Community Rating as Very Important

1) Quality of life	72 %
2) Quality workforce	59 %
3) Good schools	55 %
4) Work ethic	52 %
5) Transportation access	51 %
6) Cost of Living	48 %
7) Close to markets	48 %
8) Public safety	46 %
9) Cost of housing	45 %
10) Government services	40 %
11) Recreational amenities	38 %
12) Proximity to housing	34 %
13) Environmental quality	33 %
14) Low labor costs	29 %
15) Cultural amenities	25 %

Economic development officials tended to value community advantages that are generally qualitative and abstract in nature. The community advantages rated as important by economic development officials are difficult to quantify especially in the sense of comparing one community with another. Highly rated community advantages like quality of life, quality workforce, work ethic and good schools are hard to measure. Community advantages that are valued from the private sector perspective have a substantially different composition. Indeed, community advantages to the corporate site selection decision maker include a multitude of other community variables that ultimately reflect the total cost of doing business in a community.

## Development Cost and Benefit Measurement

Economic development administrators were asked how frequently they used cost benefit and impact analysis techniques to evaluate projects. When asked the degree to which their respective agency or department performed a cost benefit or impact analysis study on projects, the following levels of use were reported.

## Exhibit 5

### Use of Cost Benefit and Impact Analysis Studies by Economic Development Administrators



<u>Degree Used</u>	<u>Percentage</u>
Never	7.9
Rarely	21.3
Sometimes	28.4
Usually	25.1
Always	17.2

Surprisingly, about 30 percent of the economic development program administrators did not use or rarely used any type of cost benefit or impact analysis studies to measure and evaluate projects. For communities that do not measure impacts, corporate real estate professionals have the advantage in negotiating with the ability to present their own documentation of corporate benefits. It is insightful to consider the tools and methods employed by the two-thirds of economic development administrators who did use some type of cost benefit or impact analysis study to evaluate projects.

Survey respondents were asked to rank seventeen types of analytical tools and methods that could be used to evaluate project impacts. Slightly over 50 % of the economic development administrators cited their own experience as the most frequently used tool and/or method used to evaluate community impacts. The following table shows the range of tools and methods used to evaluate project impacts. Note that the degree to which economic development administrators used the tools and methods declines from the moderate use of a few key measures to the infrequent use of several methods of evaluating and understanding project impacts.

Exhibit 6

Analytical Tools and Methods Most Frequently Used to Evaluate Community Impacts of Economic Development Projects

<u>Tools and Methods</u>	<u>Percentage</u>
Individual Experience and Knowledge	50.3
Open Public Meetings	41.7
Tax Impact Studies	38.1
Planning Commission Goals	35.1
Dollars of Private Capital Invested	35.1
Project Hearings/Board Review	34.7
New Business Starts	20.2
Company Sales Increases	16.9
Employment Impact Studies	15.5
Income and Wage Multiplier Impacts	14.8
Increases in Company Productivity	11.8
Worker Training Studies	10.8
Business Special Interest Group Views	10.6
Neighborhood Advisory Group Views	9.5
Citizen Special Interest Group Views	6.9
Survey of Citizens	6.7
Contribution to Firm's ROI	5.0

Survey respondents were asked to rate the importance of common impacts associated with economic development projects. As part of this rating, the survey sought information on the degree of importance the economic development program administrators felt that their respective municipality or agency placed on collecting and analyzing cost impact data. The following exhibit summarizes the project costs and impacts by the percentage ratings of very important and somewhat important development costs and impacts.

Exhibit 7  
Rating the Importance of Economic Development Costs

<u>Impact/Cost Area</u>	<u>Very Important</u>	<u>Percentage Rating</u> <u>Somewhat Important</u>
Infrastructure Costs	65.5	30.5
Environmental Quality	50.8	42.7
Traffic Congestion	44.7	41.0
Police and Fire Service	38.5	50.7
Financing Costs	35.3	46.4
Employee Training	21.6	49.7
Property Taxes Forgone	20.8	43.7
Assessments	19.8	51.8
Retention of Managers/Engineers	18.6	34.3
Transit Impacts	12.2	35.9
Social Service Costs for New Workers	4.9	29.2

Summary: How Corporate Real Estate Can Benefit from Understanding Community  
Economic Development Policies and Cost Benefit Analysis Practices

For corporate real estate executives and site selection specialists the importance of developing better insights into the practices of municipal level economic development officials cannot be understated. For some industries, projects and communities, this information may not be relevant—for now. However, things change and the once friendly pro-business community may become highly critical of corporate facility activities including: future expansion, renovation, merger, consolidation, closure and disposition projects.

By understanding how a community measures the costs and benefits of economic development, corporate real estate professionals can tailor facilities and business characteristics to the values and benefits important to the respective community. By understanding these relationships you are in a better position to negotiate a variety of agreements with local units of government, obtain greater subsidies, regulatory consideration, political and community support. In addition to corporate and third party studies (economic, fiscal impact, market value, infrastructure and environmental impact), the research activities and goal setting of local economic development administrators can prove to be a valuable resource to explain a firm’s position and contribution to a community.

The value of impact and cost benefit studies conducted (or not conducted) by the public sector can be critical in the identification of a corporation’s contribution to and compatibility with a community. The impact information collected and the analysis performed by public agencies provides a way for politicians and citizens to better

understand the value of corporate citizens as members of a community. The data on community impacts collected by economic development program administrators, can go a long way in changing negative public attitudes about a project, securing financing and can be a critical resource in both the early and long term identification of potential conflicts between the corporation and the community.

Because corporate real estate needs vary widely, there is no one formula or approach that determines the best impact measures (and corporate benefits) to be presented by corporate real estate professionals. There are, however, only examples of corporate/community honeymoons that have ended in costly divorces. The worst of which leave the corporation without a clean exit strategy and under a cloud of poor corporate/community relations. It is imperative that corporate real estate professionals understand community based economic development measures and processes. By having insight into this area you will be better able to present and negotiate with local public officials and citizens. The corporate image will be enhanced through better and more thoughtful practices and community image. This understanding will manifest itself in greater community support for subsidies, project approvals, public services and regulatory controls.

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