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Economic Development & the CFO

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The Good Old Days…

A $2 billion Mercedes manufacturing plant

$300 million in incentives for 1,500 jobs ($60,000/yr)

"All this community needs is…"

a professional football team or…

"All this community needs is…"

a new $1 billion football stadium or…

This is the existing 10-year old stadium.

"All this community needs is…"

a live, work, play development or…

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"All this community needs is…"

Porsche's North American Headquarters or…

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"All this community needs is…"

a new convention center or…

a performing arts center or…

"All this community needs is…"

a Bass Pro Shop!

"All we need is…"

a Public-Private Partnership *(aka P3)*

The PUBLIC provides the incentives while the PRIVATE makes the money.

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The "BUT FOR" test

<u>But for</u> the public incentives, the private development wouldn't occur.

Otherwise, the free enterprise system will provide adequate "incentives."

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The "BUT FOR" test

A self-fulfilling prophecy

***BUT FOR* even BIGGER incentives, the city/county/state next door will get the development.**

The "Bottom Line" is…

THE BOTTOM LINE

Do the benefits exceeds the costs?

The costs…

The INCENTIVES and

- *Increased service costs (public safety, public works maintenance, etc.)*
- *Other governmental costs (schools)*
- *Trade-offs (I scratched your back – now scratch mine!)*
- *Opportunity costs*
- *Project support*

The benefits…

- *Property taxes and sales taxes from the project*
- *Utility revenues*
- *Jobs*
- *Redevelopment ("de-blight")*
- *Reduced service cost (redevelopment)*
- *The "HALO" effect (???)*

Incentives *(vary by state)*

- ***Property tax abatement***
- ***Sales tax abatement***
- ***Real property***
- ***Infrastructure improvements***
- ***Credit enhancement***
- ***Tax-exempt financing***
- ***Other government incentives***

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Incentives

Property tax abatement –

- ***Exemption – property "owned" by tax-exempt entity (development authority)***
- ***Redirected to project/financing costs***
  - ***PILOT – payment in lieu of taxes***
  - ***TIF/TAD – tax increment financing or tax allocation district***

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Incentives

Sales tax abatement –

- ***Redirected to project/financing costs***
- ***Potential measurement issues***
  - ***Depends on sales tax reporting & payment processes***
  - ***Beware of "proxies" – require proof of payment***
  - ***CONSIDER "CANABALIZED" SALES***

Incentives

Real property –

- ***Structure depends upon state law***
  - ***Permanent transfer***
  - ***Long-term bargain "lease" (99 yrs of $1)***
- ***Works well for redevelopment of blighted areas***

Incentives

Infrastructure improvements –

- ***Raw land – site prep, roads & utilities***
- ***Environmental clean-up***
  - ***Old fuel tanks***
  - ***Dry cleaners***

Incentives

Credit enhancements –

- ***Structure dependent on state law***
- ***"Loan" money (directly or indirectly) to the developer***
- ***Provide credit support if project revenues are insufficient to pay debt service***

Incentives

Other government incentives –

- *Identify other available incentives (job tax credits, state incentives)*
- *Negotiate with related governmental entities to maximize incentives*
- *"Bundle" incentives to facilitate development*

Incentives

Other issues –

- *Coordinate with related entities*
- *Facilitate local approvals – planning, permitting, etc.*
- *Lead/manage public relations*

Step One - POLICY

Develop an economic development policy –

- *Identify goals & measurable objectives*
  - *Target sectors*
  - *Business retention & recruitment*
  - *Redevelopment of blighted areas*
- *Identify financial incentives available & define limitations*

Step One - POLICY

Develop an ED policy, continued –

- *Develop evaluation process*
  - *Ability to meet goals & objectives*
  - *Project cost/benefit analysis*
  - *Expanded cost/benefit analysis*
- *Develop performance standards*
- *Define monitoring & compliance*

Step One - POLICY

Develop an ED policy, continued –

- ***Define the "Development Team"***
  - ***MUST include the CFO (from policy development through implementation)***
  - ***Should include knowledgeable professionals from impacted departments***
- ***Be prepared to provide policy to potential developers***

Step Two - GO

Pursue development proactively –

- ***Identify development goals & alternatives***
  - ***MUST include the CFO (from policy development through implementation)***
  - ***Should include knowledgeable professionals from impacted departments***

Step Two - GO

Pursue development proactively –

- *Consider soliciting "Indication of Interest" in specific projects*

Step Three – Unsolicited Proposals

Consider the source –

- *REMEMBER – unsolicited proposals are prepared by the developers*
- *Often presented one-on-one to elected officials & upper management first*
- *Include big, pretty pictures & very favorable projections*

Step Three – Unsolicited Proposals

Consider evaluation alternatives –

- ***Do you evaluate the developer's projections or feasibility studies?***
- ***Do you prepare (or hire someone to prepare) independent projections or feasibility studies?***

UNDERSTAND & EVALUATE ASSUMP-TIONS CAREFULLY

Step Four – Cost Analysis

Consider all cost elements –

- ***Opportunity costs***
- ***Operational costs (direct AND indirect)***
- ***Multi-jurisdictional impacts***
- ***Market impact***
- ***Assessing intangible costs***

Step Five – Risk Analysis

Identify <u>all</u> risks & uncertainties on potential outcomes –

- ***Components included proposals***
  - ***Project performance assumptions***
  - ***Developer credit & performance risks***
- ***Risks & uncertainties NOT identified & potentially unknown to the developer***

Step Five – Risk Analysis

Risks & uncertainties to be considered –

- ***Market risk for the project***
- ***Government revenues (legislative changes, etc.)***
- ***Government cost & resource requirements (changes in service cost, etc.)***
- ***Government credit risk***

Step Five – Risk Analysis

Risks & uncertainties to be considered –

- ***Construction risk***
- ***Risk or uncertainty of achieving ED objectives***
- ***Legislative & regulatory risks***
- ***On-going government performance risk***

Simple Example

Company-wide ratios recommended by Wachovia Securities' analyst:
Can I get these ratios for the last five years?

Total Debt / EBITDA
(Total Debt + 8 x Rents) / EBITDAR
EBITDA / Interest
EBITDAR / (Interest + Rents)
(EBITDA – CapEx) / Interest
Total Debt / Capitalization
Trailing Twelve Months Gross Margin
Trailing Twelve Months Operating Margin

How do catalog & on-line sales compare to store sales & profit margin?
Do you think the current economy will significantly affect the sales & profitability of the company or individual
Do you expect a decline in the sales of "big ticket" items, e.g. boats?
Do those "big ticket" items have lower profit margins?
How do you decide to open a new store? What are your primary considerations?
Do you use a sort of "prototype" when you plan to open a new store?
Do stores have similar trends over time?
What has been your experience with new stores - projected v. actual?
Have you had to consider closing any stores?

PER STORE DATA:
Location
Square Footage
MSA Population
Opening Date
# of Employees
Annual Sales Since Inception
How was the building financed? (bonds?; synthetic fixed rate?; etc.)
Was there any tax abatement?
Net Revenues/Debt service coverage?

Simple Example

POINTS TO CONSIDER

TOTAL PROJECT COST (net debt service)	32,303,785
Project cost paid by City:	
LOST	11,969,631
prop tax & PILOTS	6,995,290
total	18,964,921
% cost paid by City	**58.71%**
net XXX cost	13,338,864
% cost paid by XXX	41.29%
MEMO: % cost paid by City with $4M XXX equity	*52.24%*

(1) The City is paying for more than 50% of the cost of the XXX project, which will be 100% owned by XXX.
(2) As sales increase, the LOST applied increases. Sales above projection will increase the % project cost paid by the City.
(3) City is at risk for XXX credit for pymt of net rent, LOST & prop tax (minus the value (??) of a big, empty bldg)
(4) The City isn't protected against, or compensated for, the increased risk of a decline in XXX credit
(5) XXX would be at risk for only increased interest cost if City credit declines
(6) If City is downgraded, XXX should pay increased interest cost of not less than the cost at XXX int rate (not at old City rate)
(7) XXX jobs aren't exactly high-tech manufacturing (neither are other total project jobs)

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