MIS REPORT

ANALYZING THE FISCAL IMPACT OF DEVELOPMENT

By Paul S. Tischler

Most states require local governments to prepare a balanced budget on an annual basis. However, most states do not require that jurisdictions conduct fiscal impact evaluations to help ensure that local officials understand the short- and long-term fiscal effects of land-use and development policies and of new developments that are approved. A fiscal impact analysis clarifies the financial effects of such policies and practices by projecting net cash flow to the public sector resulting from residential and nonresidential development. Such an analysis can enable local governments to address a number of short- and long-term planning, budget, and finance issues.

This report discusses the benefits of fiscal impact analysis and reviews common methodologies used to collect and analyze information. Five case studies are provided to illustrate how fiscal impact analysis can be used in different situations. The report concludes by recommending an approach for conducting fiscal impact evaluations.

Analyzing the Fiscal Impact of Development

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DEFINING FISCAL IMPACT ANALYSIS

A fiscal impact analysis projects the net cash flow to the public sector (the local government and, in many cases, the school district) resulting from new development – residential, commercial, industrial, or other. It is similar to the cash flow analysis a developer conducts in order to project costs and revenues likely to result from a proposed development for two to ten years in the future.

> **A fiscal impact analysis projects the net cash flow to the public sector**

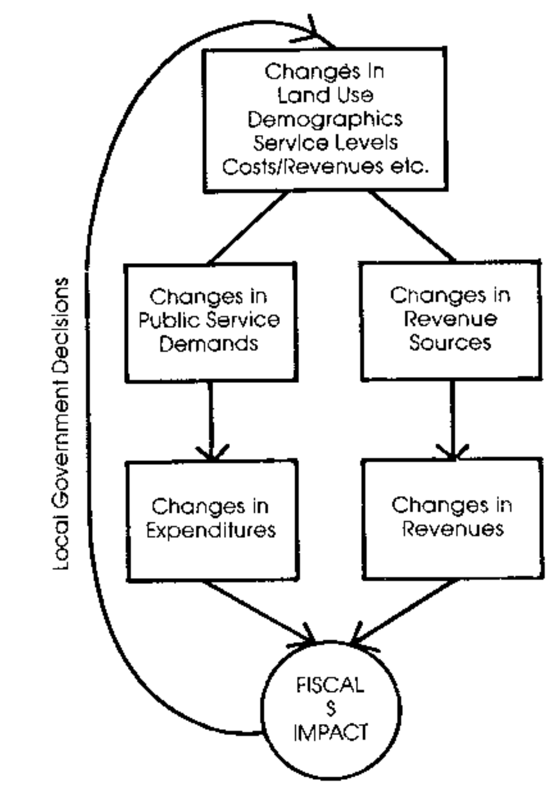
The dynamics of fiscal impact are shown in Exhibit 1. In evaluating the costs associated with providing the acceptable levels of service, the local government should consider existing unused capacities of public services and programs, especially of capital facilities. The new development, or new demand, will be expressed in terms of changes in population, employment, or land use projected to result from the scenarios being evaluated.

Since a fiscal analysis will indicate whether and when a jurisdiction could face deficit budgets, the local government is able to weigh land-use policy decisions, acceptable levels of service, plans for capital investments, and long-term borrowing needs. In addition, a projected fiscal deficit can prompt local officials to evaluate current and future revenue sources. Even if a fiscal evaluation indicates a surplus, the local government may wish to change its use of revenue sources to fund infrastructure replacement or higher levels of service.

> **The goal…is to forecast all relevant operating expenses, capital costs, and revenues**

Fiscal impact analysis identifies the increases in annual and cumulative expenses for all services that will result from new development. This includes annual operating expenses (including new staff needed per year) and capital expenses associated with constructing or expanding facilities. The fiscal impact statement can also summarize the jurisdiction's bonded debt; its bonding capacity as a percentage of the increase in the tax base; the increase in the tax base; and the fiscal surplus or deficit when general revenues are applied against the net of all special revenues and expenses associated with the development.

EXHIBIT 1 – The dynamics of fiscal impact.



Source: Tischler & Associates, Inc.

APPLICATIONS FOR FISCAL IMPACT ANALYSIS

Fiscal impact analysis is helpful in short- and long-range land-use policy planning and finance planning. Its applications for decision-making are discussed below.

Planning Issues

A fiscal impact evaluation can be used as an effective planning tool. Many local governments view the planning process as monitoring and enforcing land-use decisions and regulations, and pay too little attention to long-range planning issues, including whether future growth will be affordable. The six applications below indicate how fiscal analysis can be an effective policy tool for long-range planning.

Land-use policies. Should a jurisdiction encourage higher density land use or allow an overlay district in a certain subarea? Do its current land-use policies make sense? If costs, as well as other factors, are to be considered, then a fiscal impact evaluation will help in the decision-making process.

Demographic-economic changes. Many elected and appointed local government officials can tell interested parties how they think their community will look in ten or twenty years in terms of population, housing, and employment. But very few can say what the fiscal impact will be –whether service levels will remain the same or deteriorate under pressure from a growing population. Similarly, when making changes to land-use regulations, few jurisdictions evaluate alternative development policies from a fiscal perspective. Evaluating development alternatives is a valuable use of fiscal impact analysis.

Rezonings. A rezoning changes the density or type of use for a parcel; it may also be a signal of a change in development policy. Too often, significant rezoning cases are not sufficiently evaluated from a fiscal perspective. Fiscal analysis can be helpful in local government-developer negotiations.

Annexation. An area that may be annexed usually has some existing public services. One of the uses of fiscal impact analysis is to ascertain the cost of improving the services in the area proposed for annexation in order to make them comparable to the annexing jurisdiction's level of service. The analysis can calculate whether there will be an annual financial surplus or deficit from the proposed annexation during each year of the forecast period.

Infrastructure planning. One of the by-products of a good fiscal analysis is the forecast of infrastructure needs to meet anticipated changes in a community. Any change in land use, population, or employment will have an impact on a number of capital-intensive services, including streets and utilities.

> **A fiscal impact analysis helps identify the economic development strategy that makes the most fiscal sense.**

Leveraging public dollars. Local officials considering how to promote economic growth often face the question of how to invest limited funds so as to maximize the return. Fiscal evaluations can help them make their investments wisely. For example, different economic development strategies can be evaluated for their impacts on land use. Land use in turn affects services, costs, and revenues. A fiscal impact analysis helps identify the economic development strategy that makes the most fiscal sense. If a local government has $2.5 million for economic development programs and wants to decide whether to allocate it among several commercial districts within the community, a fiscal impact analysis can provide useful information on the potential financial effects.

Finance Issues

There are a number of ways in which fiscal impact evaluations can address budget and finance questions. As noted earlier, a fiscal impact analysis focuses on change, generally over a two- to ten-year period. Although the accuracy of the projections diminishes over time, the analysis can help to raise budget and finance policy issues and suggest alternative approaches for addressing them. Some of the issues are discussed below.

Capital improvement programming. Capital improvement planning takes on an extra dimension with the use of fiscal analysis, which enables a local government to forecast the need for additional capital facilities given projected increases in population or employment. Individual departments seldom incorporate market forces or land-use plans into their CIP requests. A fiscal analysis that looks at subareas of the community can help address this issue.

Fiscal analysis also clarifies the timing of infrastructure improvements. By incorporating future demographic and economic projections, the fiscal analysis will indicate the demand for capital facilities in the near as well as the longer term. One community discovered through fiscal impact analysis that the amount of park land included in its CIP was insufficient to provide the desired level of service even for existing development.

This approach can also be used to calculate the cost and timing for replacing existing infrastructure. Infrastructure replacement costs are one of the biggest fiscal problems facing many local governments. An inventory of existing capital facilities and their related future costs can be obtained by estimating the remaining useful life of each facility and its replacement or rehabilitation cost.

Revenue forecasting. For purposes of this discussion, a revenue forecast defines the projected change in revenues (assuming existing rates) due to land-use or demographic changes in the community. The revenue forecast is one of the results of a fiscal evaluation.

Fiscal planning. Fiscal planning is different from budget planning because fiscal planning focuses on change and uses a two- to ten-year time frame. Fiscal planning provides a long-term perspective on the costs and revenues associated with each department and activity of a local government, offering local officials the opportunity to reconsider plans and policies.

Budget projections. Fiscal impact analysis results in both short- and long-range budget projections for each department in the local government. For example, an increase in the intensity of land use will generate a higher level of demand for police services. The analysis offers a budget projection for the police department, based on these changes and assuming specified service levels, over the forecast period. Local officials can look at this information for alternative levels of service, and project the effects of those alternatives on the budget.

Level of service changes. A growing number of local governments are finding it useful to focus on policy discussions on the basic levels of public services that citizens want and are willing to pay for. The increasing use of impact fees and user fees also makes it important to clearly identify a level of service standard, so that appropriate fees can be set and collected.

What is the cost of providing different levels of service?

Quantifying existing levels of service and the costs of different service levels can help lead to more constructive discussions, since all parties will understand the fiscal consequences of changing the level of service.

Cost and revenue changes. A fiscal analysis will allow the local government to vary any number of cost and revenue assumptions. Police cars, utility plant additions, salaries and fringe benefits are just some of the items that can be reviewed for their financial impact at various rates. In a similar fashion, revenue rates and sources can be reviewed. Using a fiscal impact analysis computer model makes changes in assumptions easy to consider.

BENEFITS OF A FISCAL IMPACT ANALYSIS

Fiscal impact analysis has many benefits, whether it is used for budgeting or for land-use or capital or financial planning. *(See the full MIS Report for the narrative)*

METHODOLOGIES

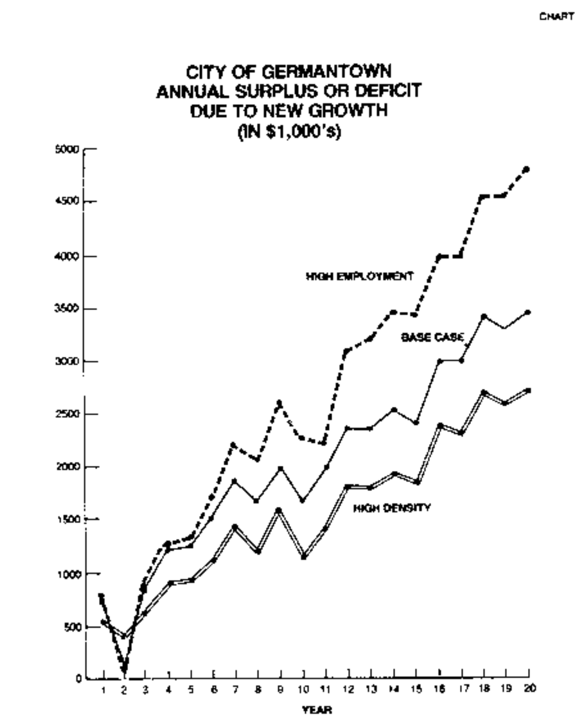
There are two basic approaches to fiscal evaluations: using average costs and using marginal costs. Average cost approaches are simpler and more popular – costs and revenues are calculated based on the average cost per unit of service times the demand for that unit. Average cost approaches assume a linear relationship and do not consider excess or deficient capacity of facilities or services over time. A per capita relationship is an example of an average cost approach.

Marginal cost approaches describe the unique characteristics of a jurisdiction's capital facilities. Although over the long term, average and marginal cost techniques will produce similar results, the real value of fiscal analysis is in the two- to ten-year time period. Marginal cost analysis is most useful in this time frame.

Selecting a Methodology

To get the most accurate information from a fiscal impact analysis, most local governments find the case study approach preferable. Although comparisons to regional and national standards can be helpful, each community is unique. It has its own levels of services, geographic service boundaries, cost and revenue factors, and available capacity of existing capital facilities. Given the potential benefits of fiscal impact analysis, it is worth the time and effort to use the case study approach. Where data is not readily available or where it is difficult to define the service level relationship

EXHIBIT 2 – Impact of new growth under three alternatives.



Source: Tischler & Associates, Inc.

on a true marginal basis, it makes sense to use the per capita average cost approach to supplement departmental estimates. The local government may wish to refine the data using marginal cost data if and when more detailed information becomes available.

CASE STUDIES

This section discusses five case studies that illustrate different applications of fiscal analysis. The first three case studies look at different land-use or growth alternatives and revenue strategies. The last two cases discuss economic development alternatives and capital improvement programs. *(See the MIS Report for a full discussion)*

Germantown, Tennessee – Evaluation of Land-Use Alternatives

Germantown (population 32,000), a suburb of Memphis, decided to review the fiscal impact of future land-use alternatives. As in any jurisdiction, one logical alternative was the continuation of present trends: an emphasis on low-density single-family housing with enough commercial activity to provide services to residents. Germantown officials were also considering two other alternatives: one was to encourage nonresidential, light-industrial and office uses; the other was to increase the density of residential development. The fiscal impact analysis focused on marginal costs and revenues based on local data factors –the case study approach was used wherever possible. Exhibit 2 indicates that all three alternatives would have positive financial results for the city.

The study confirmed that the current land-use alternative emphasizing low-density single-family housing will enable Germantown to remain in a positive fiscal posture for the foreseeable future. The projected cumulative surplus of $41 million is about 77 percent of the surplus that might be generated by the high employment scenario. Elected officials have found that the fiscal impact analysis has given them a more specific baseline against which to measure requests proposed by developers. The mayor and aldermen now are able to ask whether a proposal would have an economic impact over and above that projected based on the future land-use plan.

Germantown purchased a tailored software system for future fiscal evaluations. As quoted in the *Germantown News*, the administrator said, "We now have a tool. We can use this study to calculate what it will cost, both in the short and long term, to maintain and develop the city in various ways." The city has continued to use the program for three primary purposes: reviewing annexation questions, evaluating the impact of proposed large developments (both shopping centers and residential), and capital improvements planning.

Germantown has an annual annexation process through which it looks at the costs and revenues that would result from additional annexation. Faced with high growth pressures, the city has found the fiscal impact analysis software program worthwhile in helping the planning commission and the board of mayor and aldermen review the fiscal effects of new growth.

In the capital improvements planning process, Germantown uses the fiscal impact analysis program in planning for future fire and police service needs. Germantown has a five-year capital improvements program, and uses the fiscal impact analysis information for background in scoping out budget proposals and related capital improvements requests by departments.

Overall, fiscal impact analysis enables Germantown to maintain its land-use policies and understand and articulate the assumptions on which they are based and their fiscal ramifications.

Venice, Florida – Developing Strategies to Serve Future Growth

The city of Venice, Florida has a permanent population of about 15,000 and a seasonal population of 19,000. Located in Sarasota County on the booming Gulf Coast, Venice is experiencing growth pressures. Developers in the county are requesting annexation, in large part because the city can provide better services to future residents than can the county.

Venice decided to address several items in its 1987 fiscal impact analysis. It wanted to evaluate two growth alternatives, develop a capital improvement program that would identify existing facility deficiencies and project facility needs due to growth, and create a revenue development strategy.

The first alternative assumed growth would continue to the year 2000 as projected in the comprehensive plan. The second alternative assumed that additional growth would result from annexation of an area to the north and east of the existing city limits.

City department heads and the consultant agreed on service level, cost, and revenue factors, and these were used in the fiscal evaluation of the two alternatives. The fiscal evaluation forecast the need for new capital facilities to serve growth resulting from annexation.

Florida state law requires that local governments provide a five-year projection of facilities to serve new development. Consequently, these new facilities were incorporated into a preliminary Capital Improvement Element (CIE) for Venice. According to the state law, the CIE must also describe existing deficiencies in capital facilities to serve the present population and the direct operating expenses of those facilities, and discuss the revenue sources the local government intends to use to pay for the needed capital facilities. This last requirement was part of the reason Venice decided to develop a revenue strategy as part of its fiscal impact analysis.

The cumulative results of Venice's study indicated a fiscal surplus under both alternatives. An important reason for this was that the basic road network and schools are provided not by Venice but by Sarasota County. The alternative based on the comprehensive plan was slightly more beneficial from a fiscal perspective primarily because annexation would require that additional capital facilities be built within a few years of the annexation.

> **…the fiscal impact analysis has helped the elected officials express their vision for the future….**

Raleigh, North Carolina – Analyzing Economic Development Impacts

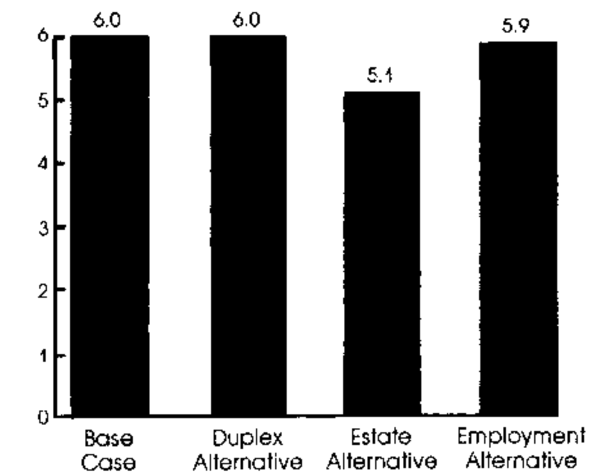
Evaluating subareas of a community is a valuable approach for fiscal impact analysis since, as in the case of southeast Raleigh, existing capital facility capacities can be specified and revenue strategies can be targeted. *(See the MIS Report for a full discussion)*

Plymouth, Minnesota – Analyzing Land-Use Alternatives and Costs for a Capital Facility Replacement Program

Plymouth is a Minneapolis suburb with a population of about 45,000. In 1984, a cost revenue subcommittee composed of private sector representatives requested that the city conduct a fiscal analysis of the impact of land-use plan alternatives. Four alternatives were evaluated: the existing land-use plan (the base case); a duplex or high-density residential alternative; an estate or low-density residential alternative; and a research and development, or employment, alternative. All four scenarios project an increase in the city's population of 16,300 over 15 years. The findings indicated that the base case was as fiscally beneficial as the other alternatives (Exhibit 3).

Once the city selected the base case as the alternative to pursue, the software program used by the City calculated the costs of a capital facility replacement program. Plymouth used the software to compile and analyze data on all capital facilities, including each item's projected remaining life and estimated replacement cost. The capital facilities needed to serve new growth added to the projected infrastructure replacement costs equaled the total dollars needed to continue to provide the citizens with service at existing levels.

EXHIBIT 3 – Surplus to Plymouth general fund due to growth between 1985 and 2000 (in millions of constant dollars).



Source: Tischler & Associates, Inc.

The city uses the fiscal analysis as a guide for budget forecasting, particularly for personnel projects by divisions within departments. The city has found it helpful in fostering discussions about the assumptions underlying the numbers in the budget and, to a lesser extent, the capital facility replacement program. City Manager Jim Willis estimates that 10 to 15 percent of the assumptions have been changed since Plymouth began using fiscal impact analysis. These changes reflect the evolution of needs and the gathering of new information since the program began to be used. Willis commented that a key to using fiscal impact analysis effectively is to understand your own operations and what needs to be measured. It is important to understand the full range of tasks for which people are responsible, so that levels of service can be estimated accurately.

USING FISCAL IMPACT ANALYSIS

This section discusses steps a local government can take in conducting a fiscal impact analysis and planning a revenue strategy based on its findings. There are many possible approaches but this section highlights the most important steps in the process *(See MIS Report for narrative)*

CONCLUSION

In summary, virtually all applications for fiscal impact analysis assist a jurisdiction in addressing financial management and planning issues. Whether the product is an evaluation of a change in level of service, a forecast of capital facilities to be replaced or added, or a picture of upcoming budget changes due to new development, fiscal impact analysis can be adopted as a regular procedure to improve management decisions.

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