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Economic Impact Assessments: At the Crossroads of Economics and Real Estate Development

OPINION

What is an Economic Impact Assessment (EIA)?

Governments worldwide, including now in the Gulf, want to know what economic benefits they will receive from alternative policy settings as well as from developments beyond their control. Policy examples include changing visa or competition regulations, or creating free trade or enterprise zones.[1] Other developments that Governments may want to analyse include the impact of particular domestic industries,[2] wildfires[3] or travel restrictions[4] on the economy as a whole. At a project level, cities and public agencies want similar information when they make specific decisions, for example analysing the economic benefits of Expo 2020 in the UAE,[5] deciding on transportation projects in Hong Kong,[6] analysing Saudi smart cities,[7] and authorising real estate developments.[8]

Increasingly, too, real estate developers presenting their proposals to the public sector are required to justify them in economic terms. Some jurisdictions have now developed publicly available evaluation criteria for developers to follow.[9] The International Finance Corporation (IFC) also has a set of widely used assessment criteria. [10]

The only proven way to obtain answers to questions about the economic benefits (and, if they exist, the costs) of a projected development is by conducting an EIA. The methodologies for EIAs have been developed over several decades and aim at forecasting the whole range of economic benefits, typically including the projected increase in employment, both from construction and eventual occupation; the economic activity generated by the project; the impact on the value of existing and new real estate; and the future income to the public sector.

EIA benefits and limitations

Although every EIA is different, virtually every analysis uses, or is based on, economic modelling. Particular emphasis is placed on the economic multiplier – the way in which the ultimate impact of an investment project diverges significantly from the initial, first round impacts. At a minimum, the output multiplier must be 1 – this assumes all income leaves the geographical zone immediately.

Real estate investment multipliers have been estimated at relatively low levels, around 2,[11] but some estimates of real estate development multipliers are much higher, even as high as 16 for affordable housing. As a result, the economic multipliers modelled in EIAs usually separate the direct results of the project, for example the expenditure of construction workers and future occupiers, from the indirect impacts, such as the benefits to local materials suppliers and service providers, and finally from the induced effects across the relevant area of more disposable income and expenditure.[12] EIA methodologies, such as the input-output (I-O) models (for which Wasily Leotief became a Nobel Laureate as long ago as 1973), partial equilibrium modelling or computable general equilibrium models,[13] therefore focus on the multiplier effect of construction and operation. They examine how much income will be spent locally and within the region or country, and how this will in turn create new employment and economic activity.

The advantages of this approach are clear, especially when public agencies are examining alternative proposals for land use. What the private sector may deem the Highest and Best Use (HBU) of the plot may not necessarily deliver an optimal economic result from the more inclusive standpoint of the public sector. Only decision-makers in public sector institutions have the perspective to balance short and long-term effects, or to decide between employment and wealth benefits to the economy. EIAs can therefore drive modifications to developer project plans. This reinforces the incentive for developers themselves to use EIAs, both to meet public agency requirements and to demonstrate the benefits of their own proposals.

EIAs attempt to be as exact as possible. However, both the specific questions asked, and the extent and quality of available data, will constrain their effectiveness. Questions might include, for example, whether the marginal economic contribution of the development should include service charges raised or whether to deduct any subsidies paid to the developer, particularly in relation to land valuation.[14] Improvements over recent years in the quantity and quality of industry data provided by Gulf Governments are vital to ensuring EIA models match the real world. But if, for example, the relationships between industrial sectors are rapidly evolving or travel restrictions have increased residents' domestic spend, then multiplier values may become obsolete. As a result, the answers produced by the EIA will be inaccurate.

In addition, EIAs do not answer every question relevant to urban planners. They focus on measurable economic effects, usually within a specific geographic area. While this is appropriate for most real estate proposals, it does mean that an EIA has a more limited scope than a full cost–benefit analysis (CBA) or an impact assessment.[15] These assessments aim at analysing the total social welfare impact of a policy decision, integrating the output of an EIA with other analyses, including analysis of environmental impact.

Despite these limitations, however, EIA remains both popular and effective. It is striking to note how rapidly it is evolving in a Gulf context, especially in its project application to real estate development proposals.

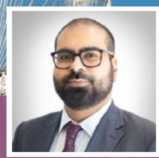
Which organisations can be tasked with performing an EIA?

Not only does an EIA require extensive data resources to be useful, it is also a technically complex process to do properly. Data must be correctly selected, analysed and projected, and then the model must be set up, calibrated, and run across numerous scenarios. This constrains the range of organisations that have the capability to perform EIAs.

Project EIAs that focus on the impact of real estate developments often fall to chartered surveyors with twin capacity: the necessary economic and model-building expertise as well as experience in gathering and evaluating both real estate and economic data for HBU and feasibility studies. Policy EIAs by contrast can be undertaken by a somewhat wider range of organisations, including development associations, management consultancies and independent economic consultancies.

Conclusion: EIA is a vital policy tool

The days when Gulf Governments regarded almost all potential real estate developments as positive, irrespective of their structure and economic contribution, are now behind us. There is now a much more focused approach, driven by a concern over how Gulf economies are reaching maturity paralleled by a realisation of how high real estate development multipliers can be. With land a largely fixed resource, the need to maximise the economic benefits from land releases to developers is clear. Over time, EIA may need to be augmented by social and environmental impact assessments. This may eventually lead to the adoption of CBA. For now, however, the incorporation of EIA into the urban planning system of states throughout the Gulf is definitely to be welcomed.



> *The Governments, through Economic Impact Assessments, measure how much value a real estate project generates for the wider economy, including job creation, productivity, and demand for public services. Even if a public infrastructure projects such as roads, metro lines, or utility expansion don't fully pay for itself directly, it may be justified when the economic uplift it enables far outweighs its cost. This is where real estate and national planning intersect, and where the true power of EIA lies.*

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