The “But-For” Test – a.k.a. “Do they really need our help?”

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One of the first questions asked by policy makers and taxpayers about economic development incentives is whether such incentives are really needed for a proposed development to proceed. The question is often a statutory requirement for certain types of incentives, requiring that local government entities show that a proposed development would not proceed “but-for” the requested assistance. This is commonly referred to as the “But-For” test. By determining that a project would not otherwise proceed, policy makers can be assured that they are not unnecessarily incentivizing development, and that the investment of public money is necessary and reasonable. So, how do you go about making this determination, and answering the rather abstract idea of the “But-For” test?

Fortunately, there is a common factor central to every real estate development project – the return on investment. By examining a project on the basis of its financial feasibility, we are able to add an empirical basis for answering the “but-for” question. The feasibility threshold may vary depending on the nature of the development, but ultimately real estate projects are expected to generate cash flow on their own. Using financial feasibility as a benchmark, you can begin the process of answering the “but-for” question by requiring the developer to put together a detailed project pro forma or financial statement which illustrates their need for the requested assistance. You want the developer to articulate in their own words, on the basis of financial feasibility, why the assistance request is necessary.

Once the developer has presented their need for assistance, you need to review the reasonableness of their assumptions so that you can draw your own conclusions. In reviewing the developer’s pro forma, you can focus on three primary categories: the estimated costs for constructing the project, the projected revenues from operations, and the feasibility benchmark the developer needs to achieve to make the project worth pursuing. It is vital to verify that construction costs are not overstated or that lease rates are not understated in order to show an exaggerated need for assistance. Finally, you want to make sure that the financial feasibility threshold of a project, typically the return on investment, is reasonable, and that public assistance will not provide the developer with an excessive level of return.

Once you can independently verify that the project cost and revenue assumptions are reasonable and that the developer's return on investment without assistance would not be sufficient to justify the investment, then you can definitely answer that the project would not proceed "but-for" the availability of development incentives.