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FEASIBILITY STUDIES AND PUBLIC FINANCE

A summary of remarks presented by Mr. Thomas J. Martin, President of ConsultEcon, at the National Federation of Municipal Analysts Seminar in Los Angeles, California.

My presentation today will focus on the uses of feasibility studies, with particular emphasis on public finance for special uses such as visitor attractions and recreation venues. I will also discuss feasibility study inputs as well as findings. I will conclude with particular issues related to special use project feasibility studies.

The Uses of Feasibility Studies

Feasibility studies have many uses and are prepared by a wide variety of professionals. Some of the more common uses of feasibility studies are as follows.

Identifying Development Opportunities – This is a common use of feasibility studies, particularly for real estate development projects. This is similar to the highest and best use evaluation.

Formulating Development Proposals – This is commonly accomplished in the context of urban planning initiatives to test various types of development proposals or combinations of land uses.

Establishing Rent Levels – This is a common use of studies for the real estate industry, and in business plans for real estate portfolios.

Designing Marketing Strategies – The marketing of a product is essential to its success, and often feasibility studies will focus on the competitive environment for

the project and the necessary marketing strategies to sell the product.

Project Economic Justification – The most common use for feasibility studies is to provide an economic justification for a project. This economic justification can take many forms, depending upon the nature of the project and the funding sources. A study for a museum may be very different in this regard from a study for a private real estate project.

Cash Flow Forecasts – Many feasibility studies contain cash flow forecasts which help to show the dynamic nature of a project. These are obviously very important to understanding how a project will perform over time.

Project Marketing & Refinement – Within a competitive environment, feasibility studies are often used to sell a project to a larger constituency. This may be particularly true in an urban planning context or in a case where private outside investors are involved.

Economic and Fiscal Impact Evaluations – Another key use of feasibility studies is as input into fiscal and economic impact evaluations. These evaluations are becoming more common, particularly where public funds are sought for projects.

Input into Appraisals – A significant number of feasibility studies are used as input into formal appraisals, particularly in real estate projects.

Economic Justification for Debt Financing – Most important for this audience is the use of feasibility studies as economic justification for debt financing. In this case, feasibility studies are used as a part of the debt offering document to illustrate the market support

ConsultEcon, Inc.

Economic and Management Consultants
545 Concord Ave, Suite 210
Cambridge, MA 02138 U.S.A.

T: +1 617 547 0100
F: +1 617 547 0102
info@consultecon.com
www.consultecon.com

for the project, and often its financial performance.

What a Feasibility Study Contains (Inputs)

Given all of these varied uses for feasibility studies, we may ask what the relevant inputs to a good feasibility study should be. These inputs include:

Evaluation of Proposed Concept – A careful evaluation of the proposed project including any characteristics of the project that may make it unique.

Location and Accessibility Characteristics – An evaluation of the site, accessibility and any other factors in the local setting of the project that will either enhance or detract from its marketability and financial performance.

Resident and Tourist Market Characteristics – Evaluation of the size and nature of the resident market base for the project including definitions of the geographic reach of the project. Resident characteristics such as household size, income and mobility may be important indicators of project success. Evaluating the tourist or visitor market may be more difficult because of the way such statistics are often developed. Reliability may be a problem with these statistics, as they are often developed by agencies to support their funding and therefore, the higher the number of visitors, the better. The use of such statistics in feasibility studies needs to be carefully evaluated.

Experience of Local Attractions – The experience of similar local products will be important to understand and will become an important input into any projections of performance. Factors such as levels of entry fees, potential competition and location of these other local attractions need to be evaluated.

Factors that are Changing in the Local Context – Any factors that are changing in the local environment are important to describe. These might include the development of new roads, major marketing initiatives of a local Convention and Visitors Bureau that may draw a greater number of customers, or any number of factors that may influence the success of the project.

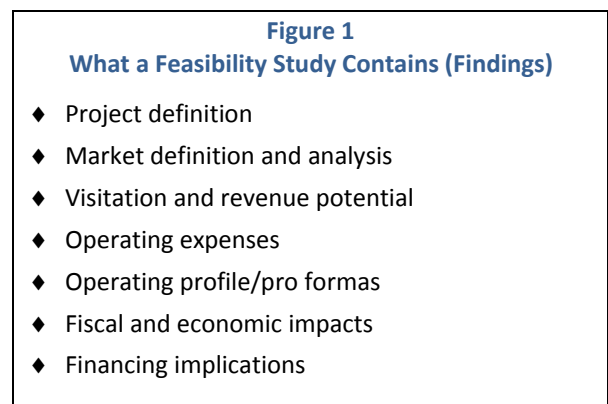
Experience of Comparable Projects – Comparable

projects evaluation is always crucial — that is, what is the industry experience? If condominiums don't sell in this marketplace then great caution is needed in predicting how such a product would fare. If admission prices at certain kinds of attractions — say, theme parks — are universally similar across the country then there is a market benchmark that is important to take into consideration.

Statistical and Qualitative Analysis – A good feasibility study will always contain statistical and qualitative analysis. We sometimes see feasibility studies that contain significant statistical manipulation of data with very little understanding of the basic product or industry being evaluated. Conversely, a feasibility study that contains no statistical analysis may also be flawed.

Primary Market Research – A feasibility study may also (but not always) include primary research — that is, data collected directly from the marketplace regarding a customer's propensity to buy the particular product or visit the particular attraction. These primary market data are typically derived from consumer intercept surveys, telephone surveys or focus group research.

Based on these inputs, **Figure 1** outlines what a complete feasibility study will cover.



Particular Issues with Special Use Project Feasibility Studies

There are particular issues with feasibility studies for special uses such as theme parks, visitor attractions,

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sports venue facilities and similar uses. Some of these issues are discussed below.

Poor Concept/Product Definition – A major shortcoming is the lack of a specific project concept or a poor concept definition. This is particularly true for new products or ideas that investors may have for a new project. The project may only be defined in the most conceptual way, which may make feasibility testing more difficult.

Inaccurate Market Area Definition – Inaccurate market area definition is another problem with many projects. Most of us know that the market for a supermarket is generally a neighborhood, but defining the market for a racetrack or a theme park may be more challenging. If we draw our market area large, we will have extensive markets to draw upon, but there is the question of the reasonableness and accuracy of such a market definition.

Market Population Double Counting – Market area population double counting is often seen in feasibility studies. This is particularly true when trying to distinguish between resident and visitors markets. Since there is no standard way to count visitors and/or to distinguish them from residents, it is very easy to overestimate the size of the available market, which invariably leads to inflated estimates of market support. Typical errors involve double counting visitors to a destination (the 32 million visitors to Las Vegas, for instance, represent fewer individuals because of the multiple trips that visitors typically make to Las Vegas). Another example would be to assume that the 30 million annual vehicles that pass by a site represent that number of individuals. They may, in fact, represent 50,000 people who are commuting every day!

Misapplied Comparable Analysis – Misapplied comparable analysis is also typically noted in special use feasibility studies. A project that represents a \$100 million investment will not likely perform the same as a \$10 million investment. Often, in feasibility studies, the best performing example in an industry is used as the benchmark — even though the scale and location of the project under consideration may be very different.

Unrealistic Pricing Assumptions – Pricing for a project

and the level of market support are linked. That is, the higher the entry price the lower the number of customers. This relationship is often overlooked in feasibility studies, but it is crucial to project success. If we price our product above the market acceptance levels then we are very likely to experience reduced market support.

Unrealistic Operating Costs – This is often observed in feasibility studies where the operating costs are understated or major cost items are left out. A mass public attraction may have high insurance costs as well as high labor costs due to staff requirements to service large numbers of customers. An attraction with long operating hours will need shifts of workers. A good feasibility study will develop the operating cost profile in enough detail to reveal all of the operating costs.

Reinvestment Not Considered – For attractions such as theme parks there is the need for a significant level of reinvestment in new rides and attractions over the course of a decade. These costs can be quite high, but are necessary to keep the attraction competitive.

Lack of Sensitivity Analysis – Sensitivity analysis is often lacking in feasibility studies. This simply addresses the question of the effects of lower prices or lower than expected attendance. A good feasibility study will address these issues with alternative pro formas.

Data is Out of Date – Another key shortcoming is that the data used in the study are out of date. This is often true of data related to the comparable projects that may be used in the study. But it may also be true of demographic data or other data used in the study. In the financing context, the feasibility study itself may be out of date. The shelf life of feasibility studies is sometimes very short, particularly in very dynamic markets.

Poor Project Implementation – The most difficult task for the feasibility author is evaluating the likelihood of superior project execution. Often from the time the first feasibility work is completed until a project opens various decisions are made by the owner that negate the findings of the feasibility study. For instance, the project is built differently than originally conceived; the ticket price is increased above that used in the

feasibility study; major exhibits or attraction content is left out because of construction cost over-runs; marketing is not adequate, or any number of other actions are taken that effectively negate the original findings of the feasibility study.

SUMMARY

In summary, a good feasibility study will be current in its information base, will carefully define available markets, discuss the industry trends through the use of realistic comparable projects, and will include sensitivity testing for the key project variables.

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545 Concord Avenue, Suite 210

Cambridge, MA 02138 U.S.A.

T: +1 617 547 0100

F: +1 617 547 0102

info@consultecon.com

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