

**REPORT OF ECONOMIC INCENTIVES  
TO PROMOTE DEVELOPMENT  
TO THE  
CITY OF UNION, KENTUCKY**



**Prepared By:**

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**December 1, 2011**

**City of Union, Kentucky**

**Elected Officials**

**Don Kirby, Mayor**

**John Adams, Commissioner**

**Bob Kelly, Commissioner**

**John Medford, Commissioner**

**Bryan Miller, Commissioner**

**Appointed Officials**

**Kathy Porter, City Clerk/Treasurer**

**Greg Voss, City Attorney**

**Barry Burke, City Engineer**

**Union Economic Development Committee**

**Dr. Bryan Turner  
Committee Chairman  
Turner Family Dentistry PSC**

**B. Stephen Harper  
Harper Oil Products, Inc.**

**Deanna Kline  
Citizen**

**Kristen Lovett  
Northern Kentucky University**

**John Mefford  
Union City Commissioner**

**Staff to Committee**

**Kevin P. Costello, AICP  
Boone County Planning Commission**

# **ECONOMIC INCENTIVES REPORT**

to the

**UNION ECONOMIC DEVELOPMENT COMMITTEE**

and

**CITY OF UNION, KENTUCKY**

I.

## **Introduction**

The City of Union (the “City”) has appointed the Union Economic Development Committee (the “Committee”) with the responsibility to review and recommend action steps to encourage new development within the City, and in particular, development in accordance with the Union Town Plan. The City has retained Taft Stettinius & Hollister LLP (“Taft”) to work with the Committee to provide a detailed report (this “Report”) describing incentives and other tools available under Kentucky law to promote new development, including incentives available through the Commonwealth of Kentucky (the “State”). This Report will list each economic development incentive available to the City under State law, including the steps to implement each incentive. This Report will also include a list of issues or pitfalls the City should consider when deciding whether to grant economic incentives to promote development.

II.

## **Description of the City**

The City is a municipal corporation of the 4<sup>th</sup> class organized under the laws of the State. The City is 3.41 square miles in area; and as of 2010, had a population of 5,379, which represented a net increase of 2,486 (or 86%) over the 2000 Census figures for the City of 2,893 residents. This significant population increase has been fueled by housing demand in Boone County (the “County”) caused by the growth of the County as a commercial center; the population shift away from the urban areas of the region; and due to the improved transportation access to the area. The City should see continued population growth as a result of the construction of new U.S. 42 and the future construction of KY 536, which will provide improved access to I-75.

The City is primarily developed as a residential community with limited commercial development. Based upon the 2011 taxable real property assessment for the City of \$457,401,773, 93.6% of the City’s taxable assessment was from residential development, and only 5.9% (or \$27,006,960) was from commercial development.

Tax revenues to support City services are derived from ad valorem (property taxes). The City, although authorized to do so as a city of the 4<sup>th</sup> class, has not established an occupational license tax (business gross or net profits tax and payroll

tax) or an insurance premium tax.<sup>1</sup> The property tax rates for the City for 2011 are \$.216 per \$100 of valuation for real property and \$.188 per \$100 of valuation for tangible property.

### III.

#### **Proposed Development – Union Town Plan**

The Boone County Comprehensive Plan and Zoning Ordinance calls for the City to develop as a mix of residential, commercial, office, public facilities and green space. The Union Town Plan, adopted in 2000, provides a more detailed development concept for approximately 1,850 acres located along the U.S. 42 corridor in the City and adjacent unincorporated area. The Plan recommends a mix of housing types and densities, mixed-use development, and the establishment of a town center at the intersection of new U.S. 42 and KY 536. Neither the Comprehensive Plan nor the Union Town Plan supports industrial development within the City. As a result, incentives specifically targeted to manufacturing will not be addressed in this Report.<sup>2</sup>

### IV.

#### **Legal Authority to Grant Incentives**

Unlike our neighboring states, State law prohibits, with few exceptions, cities or counties from granting a direct exemption<sup>3</sup> of taxes as an economic incentive. However, State law does permit a city or county to use the general taxes imposed to provide an incentive for a specific project or to promote development within an area. The Kentucky Constitution mandates that taxes be spent for a “public purpose.” However, in several reported cases, the Kentucky courts have held that using taxes to promote the creation of jobs or new development, even to pay for “private” costs associated with a development, constitutes a valid public purpose.<sup>4</sup>

### V.

#### **Incentives Available**

The State has adopted several different incentive programs that may be used by the City to promote development as follows:

A. **Industrial Revenue Bonds**. An important incentive tool available to the City that has been used extensively throughout Northern Kentucky to promote development is Industrial Revenue Bonds (IRBs). These bonds are not limited to providing financing for true “industrial” projects as IRBs may be utilized to finance varied

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<sup>1</sup> These other available revenue sources provide the City with a lot of flexibility to fund future programs or projects to assist in the development of the City consistent with the Union Town Plan.

<sup>2</sup> Section 170 of the Kentucky Constitution and KRS 92.300 authorizes cities to grant a five year tax exception on city taxes for new manufacturing business locating in the city.

<sup>3</sup> IRB financing discussed below is an indirect method of granting a property tax exemption.

<sup>4</sup> *Dannheiser v. City of Henderson*, 4 S.W.3d 542 (Ky. 1999) (approved use of tax revenues to develop industrial park); *Hayes v. State Property and Buildings Comm.*, 731 S.W.2d (Ky. 1987) (approved buying land and giving it to Toyota).

types of development projects from conventional industrial projects to housing and commercial developments as follows:

1. Permitted Uses for IRBs. KRS 103.200(1) lists the type of projects that may be financed by a city, county and the State as follows:

- (a) Any activity, business, or industry for the manufacturing, processing or assembling of any commercial product, including agricultural, mining, or manufactured products, together with storage, warehousing, and distribution facilities in respect thereof;
- (b) Any undertaking involving the construction, reconstruction, and use of airports, mass commuting facilities, ship canals, ports or port facilities, docks or wharf facilities or harbor facilities, off-street parking facilities or of railroads, monorails, or tramways, railway or airline terminals, cable television, mass communication facilities, and related facilities;
- (c) Any buildings, structures, and facilities, including the site thereof and machinery, equipment, and furnishings suitable for use as health-care or related facilities, including without limitation hospitals, clinics, nursing homes, research facilities, extended or long-term care facilities, including housing for the aged or the infirm and all buildings, structures, and facilities deemed necessary or useful in connection therewith;
- (d) Any nonprofit educational institution in any manner related to or in furtherance of the educational purposes of such institution, including but not limited to classroom, laboratory, housing, administrative, physical educational, and medical research and treatment facilities;
- (e) Any facilities for any recreation or amusement park, public park, or theme park, including specifically facilities for the use of nonprofit entities in making recreational and cultural benefits available to the public;
- (f) Any facilities involving manufacturing and service industries which process raw agricultural products, including timber, provide value-added functions, or supply ingredients used for production of basic agricultural crops and products;
- (g) Any facilities incident to the development of industrial sites, including land costs and the costs of site improvements thereon, such as grading, streets, drainage, storm and sanitary sewers, and other facilities and structures incidental to the use of such site or sites for industrial use;

- (h) Any facilities for the furnishing of water, if available on reasonable demand to members of the general public;
- (i) Any facilities for the extraction, production, grading, separating, washing, drying, preparing, sorting, loading, and distribution of mineral resources, together with related facilities;
- (j) Any convention or trade show facilities, together with all related and subordinate facilities necessary to the development and proper utilization thereof;
- (k) Any facilities designed and constructed to be used as hotels and/or motels, together with all related and subordinate facilities necessary to the operation thereof, including site preparation and similar facilities;
- (l) Any activity designed for the preservation of residential neighborhoods, provided that such activity receives approval of the heritage division and insures the preservation of not fewer than four (4) family units;
- (m) Any activity designed for the preservation of commercial or residential buildings which are on the National Register of Historic Places or within an area designated as a national historic district or approved by the heritage division; and
- (n) Any activity, including new construction, designed for revitalization or redevelopment of downtown business districts as designated by the issuer.<sup>5</sup>

IRB financing works best for the development of a specific project as opposed to an incentive to promote the overall development of an area that will include projects owned and financed by several different owners. This process can be used as an effective incentive for the development of a shopping center or strip development that will be commonly owned and leased to separate businesses. The Buttermilk Crossing development in Crescent Springs is an example of using IRBs as an incentive for that type of development. Examples of other projects that used IRBs include the Newport Aquarium, Newport on The Levee, The Ascent, the Citibank expansion, FedEx Ground project, and the Toyota Distribution Building.

IRBs may also be used to promote charitable projects like hospitals, private education buildings, etc. Those projects don't need a property tax exemption, but can benefit from lower cost financing as for those types of projects the interest paid on those bonds are exempt from federal and state income taxes.

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<sup>5</sup> One specific step that I recommend is that the City establishes the area of the City available for commercial development as being within the downtown business district to enable the City to issue, if needed, IRBs for these type of projects.

2. Property Tax Exemption. IRBs are used in lieu of conventional financing for the project. This method to finance projects was originally used to obtain tax exempt financing for projects, but with the federal tax amendments adopted in 1986, tax exempt financing for private projects was severely limited. Today, developers in Kentucky use IRBs as a method to obtain property tax relief for a project. KRS 132.200(7) provides that projects financed with IRBs, where the title to the property is held with the issuer (normally a city or county) and then leased to a private entity, are exempt from all property taxes, except for State taxes on the leasehold value of the property. The State rate on that value has been set at a miniscule amount, which creates almost a complete property tax exemption. IRBs can be issued to finance all or part of the project, including any tangible or personal property purchased as part of the project. The applicable property tax benefit will apply to real and personal property acquired with the proceeds of the IRB issue so long as the property acquired and developed with the proceeds of the bonds is owned by the issuer and leased for the life of the bonds to the private entity. In addition, the property tax exemption will continue for the life of the bonds, which may be as long as a thirty (30) year period.

**It is important to note that IRB financing is the only incentive program that may impact school property taxes.** This is significant as school taxes normally constitute 50% to 70% of the total property tax bill. Being able to exempt all or a portion of the school property tax may be critical to a project's financing, especially for those projects that primarily generate property taxes, as opposed to business taxes.

In addition, using IRBs as an incentive represents one of the ways that the City may partner with the County and other taxing districts to encourage development in the City since the use of IRBs will impact all taxing districts.

3. PILOT Agreements. Since the use of IRBs creates a property tax exemption for the property acquired or developed with IRBs, the taxing districts impacted by the issuance of the IRBs (especially the school district) will need to be contacted to determine whether they object to the property tax exemption, and to determine if IRBs are issued the amount of the taxes each respective taxing districts will agree to exempt or forgive for the project. As part of the approval process, a payment in lieu of taxes agreement ("PILOT") is negotiated with the impacted taxing districts, which provides for the payment of a percentage of the taxes that would have normally been generated from the project but for the use of IRBs, to provide certain "contractual" tax payments in-lieu of the regular tax payments. Some PILOT agreements provide for set annual payments to each respective taxing district.

The County and the Boone County Schools have significant experience with using IRBs and PILOT Agreements. The Boone County Schools have been willing to participate with forgoing some of its taxes through an IRB process, since the payment received by schools under a PILOT Agreement do not impact the SEEK funding from the State.

4. Process to Issue Bonds. Using the IRB process, a city, a county or the State acts as the issuer of the bonds to provide the conduit for the financing. **The issuer issues the bonds, but has absolutely no responsibility for their repayment.** The developer arranges the financing and negotiates the purchase of the bonds by a bank or other financial institution. The financial terms are dictated through negotiations with the financial institution and, like conventional financing, are dependent upon the



financial strength of the developer and the project's economic soundness. Please note that all of the required documents and the approval process to issue the bonds under State and/or federal law will be handled by the bond counsel selected by the developer of the project.

5. Other Approvals. In addition, pursuant to KRS 103.210, any IRBs issued that impact State property tax revenues must be reviewed and approved by the Kentucky Economic Development Finance Authority ("KEDFA"). KEDFA has promulgated an application process relating to its review. However, for purposes of this Report, the KEDFA process does not need to be addressed, as KEDFA will only approve a State exemption for projects eligible for an incentive under the Kentucky Business Investment ("KBI") program addressed below, and most of the types of residential and commercial projects supported in the Union Town Plan are not eligible for KBI incentives.

Also, IRBs issued for eligible projects under KRS 103.200(k) through (n) and certain projects under KRS 103.200 (b) will require approval of the State Local Debt Officer. The review by the State Local Debt Officer will be guided by:

- (a) Whether the project creates long-term economic growth, creates or retains jobs in a previously designated empowerment or enterprise zone, or aids in the prevention or elimination of slums or blight;
- (b) Whether there is substantiating documentation to demonstrate that the project places unjustified competitive disadvantage on existing businesses in the area;
- (c) Whether there is substantiating documentation to demonstrate that normal commercial financing is unavailable for this project or, if available, at what rates it must be secured and under what terms and conditions;
- (d) If the project is in accord with the intent of KRS 103.200 to 100.285, KRS 103.2101, and KRS 103.2451; and
- (e) The project's economic soundness.

B. Tax Increment Financing. Tax Increment Financing ("TIF") is another important tool available to the City to promote development consistent with the Union Town Plan. TIF may be used to assist a specific development project, or to promote the overall development of a large area.

TIF was originally adopted to finance large development projects in Louisville, such as the Downtown Marriott Hotel and the Yum Arena. However, with the revision of the TIF legislation in 2007, KRS 65.7041 to 65.7083; KRS 154.30-010 to KRS 154.30-090 (the "Act"), TIF has become an important tool to promote projects across Kentucky.

1. Concept of TIF. Establishment of a TIF district does not impact the local tax process or the way property or businesses are taxed. It does not create any tax exemption. TIF is simply a process to capture a portion of certain taxes after they are paid and establishes a process to use those taxes to support projects or provide

assistance to promote the financing of a project or the development of an area. **TIF does not impact any existing City taxes, as it only impacts the incremental increase in future tax revenues.**

2. What Projects Are Eligible for TIF.

The definition of “project” eligible for TIF is very broad and includes:

Any property, assets, or improvement located in a local development area or development area and certified by a governing body as (1) being for a public purpose; (2) being for the development of facilities for residential, commercial, industrial, public, recreational, or other uses, or for open space, including the development, rehabilitation, renovation, installation, improvement, enlargement, or extension of real estate and buildings; and (3) contributing to economic development and tourism.

3. Establishment of a TIF District. Only a city or county (or both entities acting together) may establish a TIF District. The Act provides for two types of TIF Districts – a local development area (for undeveloped property), and a development area (for previously developed property). **For purposes of the City, the local development area is the type of district for which the Union Town Plan area qualifies.** The old U.S. 42 section of Union may be appropriate as a development area.

4. Local Development Area. Local development areas are for previously undeveloped land and are:

- (a) Limited to 1,000 acres per county per any 12 month period.
- (b) The total real property assessment in all local development areas and development areas may not exceed 20% of the total real property assessment of the establishing jurisdiction.
- (c) Requires a public hearing and the adoption of an ordinance that contains in accordance with KRS. 65.7047.
- (d) Local taxing districts (except for school districts and fire districts<sup>6</sup>) that agree to pledge their revenues to local development areas, execute a local development area agreement.
- (e) Local development areas are only eligible for a pledge of local incremental revenues.
- (f) Local development areas may be established very quickly.

5. Development Area. Development areas are primarily intended to promote redevelopment of urban areas and are:

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<sup>6</sup> That school districts may not pledge taxes to a TIF area is a negative, as school property taxes normally constitute 50-70% of the total property tax bill.

- (a) Limited in size to 3 square contiguous miles.
- (b) Intended for redevelopment of previously developed property, but there are exceptions (projects with an arena, mixed-use developments in a university research park or mixed-use developments located within three (3) miles of a military base that houses, deploys, employs 25,000 persons).
- (c) The total real property assessment for all development areas and local development areas may not exceed 20% of the establishing jurisdiction's total real property assessment.
- (d) The development area must meet at least 2 of 7 factors of blight, **or** it has a mixed-use project in a university research park or mixed-use project located within three (3) miles of a military base that houses, deploys, and employs 25,000 persons. The factors of blight are:
  - i. Substantial loss residential, commercial, industrial activity or use;
  - ii. 40% of the residents of area are low-income;
  - iii. 50% or more of structures are deteriorating or deteriorated;
  - iv. Substantial abandonment of structures within the area;
  - v. Substantial presence of environmentally contaminated land;
  - vi. Inadequate public improvements or substantial deterioration of public infrastructure; or
  - vii. A combination of other special factors.
- (e) There must be a finding that the development area is not reasonably expected to be developed without public assistance; the public benefits of the development area justify the public costs; and the area surrounding the development area has not been subject to private investment, or if it has, the special circumstances that prevent the development area to be developed without public assistance.
- (f) Requires a development plan to be prepared in accordance with KRS 65.7051.

- (g) Requires a public hearing on the development plan and the adoption of an ordinance meeting the requirements of KRS 65.7053.
- (h) Local taxing districts that agree to pledge incremental revenues execute a Local Participation Agreement.
- (i) It will take not less than three months to establish a “development area.”

6. Local Incremental Revenues and Their Use.

- (a) A city or county may pledge up to 100% of their incremental revenues from real property taxes and/or occupational taxes for up to a thirty (30) year period.
- (b) Other special taxing districts, except for schools and fire districts may pledge up to 100% of their incremental revenues from real property taxes for up to a thirty (30) year period.
- (c) City or county may impose a special 2% wage assessment fee within the area (KRS 65.7056), but note this will act as an offset to existing general payroll taxes. **This offset will not impact the City since it currently has no payroll tax.**
- (d) Incremental revenues may be used to pay debt service on increment bonds issued by the City for specific projects, or may be used to reimburse eligible costs over-time as incremental revenues are generated annually. **Note that increment bonds issued by the City are not a debt of the City, as they may be issued without a pledge of the City’s credit. The City only pledges incremental revenues that may be generated and to use such revenues to repay the bonds.**
- (e) City and/or county may impose special assessments.
- (f) Incremental revenues are determined by subtracting old revenues from new revenues in a calendar year with respect to a development area, a project within a development area, or a local development area.
  - i. “Old revenues” mean the local tax revenues from a development area or local development area for the calendar year prior to the commencement date (the date the area is established).
  - ii. “New revenues” means the local tax revenues received by a taxing district with respect to the development area or local development area in any calendar year beginning with the year in which the

activation date (the date the pledge of incremental revenues commences) occurs.

7. Administration of TIF District.

- (a) The ordinance establishing the local development area or development area will designate the agency responsible for the oversight, administration, and implementation of the ordinance. This agency will be the applicant if there is an application filed for state incremental revenues. **The agency chosen by the City (which may be the City itself) will hold the incremental revenues from the various taxing districts which have made a pledge, and will be required to use the incremental revenues as set forth in the participation agreements.**
- (b) The Act requires that the activation of the local development area or development area occur within two years of the commencement date, but this may be extended an additional two years.
- (c) A local development area or development area may not exist longer than forty (40) years.

8. State Participation Programs.<sup>7</sup> In addition to local incremental revenues, eligible projects within a development area<sup>8</sup> may qualify for a pledge of state revenues.

- (a) Commonwealth Participation Program for Real Property and Ad Valorem Tax Revenues – KRS 154.30-040 provides for a pledge of state real property taxes for projects within a development area that:
  - i. Have a minimum capital investment of \$10,000,000;
  - ii. Represent new economic activity for the state; and
  - iii. Are not more than 20% retail projects.
  - iv. Up to 100% of the State’s incremental revenues from real property taxes only may be pledged for up to a twenty (20) year period to pay for “approved public infrastructure costs” necessary to support private development. State revenues may not be used to recover financing costs.
- (b) Commonwealth Participation Program for Mixed-Use Redevelopment in Blighted Urban Areas (“Mixed-Use

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<sup>7</sup> The State programs are listed, but should not be seriously considered by the City, since the main development for the City will occur in the Union Town Plan area, most of which qualifies only as a local development area.

<sup>8</sup> Remember that only projects in “development areas” qualify for a pledge of state revenues through TIF.

Program) - KRS 154.30-060. The eligibility criteria for projects under the Mixed-Use Program are:

- i. The development area must meet three of the seven blight characteristics;
- ii. The project must have a capital investment of between \$20,000,000 and \$200,000,000;
- iii. The project must represent new economic activity to the State;
- iv. The project must be a mixed-use project with at least two different types of uses each representing at not less than 20% of the project's capital investment or square footage;
- v. No one retail establishment within the project may exceed 20,000 square feet;
- vi. The project must include pedestrian amenities and public space; and
- vii. The project must represent net positive economic impact to the state, verified by an independent consultant's study.

Projects that meet the above criteria are eligible to receive a pledge of up to 80% of the incremental revenues for up to a twenty (20) year period from sales taxes, income taxes, corporate taxes, and real property taxes.<sup>9</sup> State incremental revenues may be used to pay for:

Up to 100% of approved public infrastructure costs;

Up to 100% of expenses for land preparation, demolition, and clearance necessary for development to begin;

State revenues may not be recovered to pay for financing costs.

(c) Signature Project Program – KRS 154.30-050. The signature project programs allow state incremental revenues for a project:

- i. That has a capital investment of at least \$200M;
- ii. That represent new economic activity for Kentucky;
- iii. That not more than 20% of the capital investment or finished floor space is for a retail use; and

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<sup>9</sup> From a policy standpoint, the state has recently limited the incremental revenues pledged to sales taxes, property taxes, and employee withholding income taxes.

- iv. That represents net positive impact to the state verified by an independent consultant's study.

Projects meeting the above criteria are eligible for a pledge of up to 80% of state incremental revenues for up to a thirty (30) year period from sales taxes, income taxes, corporate taxes and real property taxes to pay for:

Up to 100% of approved public infrastructure costs;

- v. Up to 100% of the financing costs for the approved public infrastructure costs;
- vi. Up to 100% of the approved signature project costs, which are defined as: the acquisition of land for portions of the project that are for infrastructure; and costs associated with the acquisition, installation, development, construction, improvement, or reconstruction of infrastructure, including planning and design costs associated with the development of infrastructure, including but not limited to parking structures, including portions of parking structures that serve as platforms to support development above; and that are determined to represent a unique challenge in the financing of a project such that the project could not be developed without incentives intended by this chapter to foster economic development; and
- vii. Projects also eligible for an annual refund of 100% of sales taxes for materials for non-approved public infrastructure costs of a project.

(d) State Application Process – KRS 154.30-030.

- i. All local approvals must be in place.
- ii. Submit application to Department of Financial Incentives, Kentucky Economic Development Cabinet. The applicant to the State is the agency designated by the establishing city or county.
- iii. Kentucky Economic Development Finance Authority (“KEDFA”) will review and approve a tax incentive agreement (KRS 154.30.070) pledging state incremental revenues.
- iv. The tax incentive agreement will be between KEDFA and the agency, and state funds will be paid to the agency to be used in accordance with the terms of the tax incentive agreement.

- v. For Mixed-Use and Signature projects KEDFA will first grant preliminary approval, and thereafter undertake an independent consultant's study to determine "net new" tax impact to State.
- vi. Expect out-of-pocket fees to KEDFA to be approximately \$100,000 and approval process to take 9-12 months.

C. **Kentucky Business Investment Program ("KBI")**. The State's primary incentive program for new and expanding business is the KBI program set forth at KRS Chapter 154. This program grants an incentive to eligible companies that commit to create at least ten (10) new Kentucky residents' jobs created by a certain date. The amount of the incentive that a company may receive is negotiated and approved by KEDFA. This is the main program that the Tri-County Economic Development Corporation ("Tri-Ed") uses to promote new job creation across in Northern Kentucky.

The KBI program is not an incentive for development of property, but is available to new and expanding companies that will directly create jobs. The incentive granted to a company is achieved through a credit against local payroll taxes, state income tax withholding taxes, and corporate taxes. Since the City does not impose a payroll tax, the required local match to receive the State incentive will need to be granted by the County. Note that the County is very familiar with this program and regularly grants payroll tax incentives to companies. The City will not need to commit any taxes for eligible companies for eligible companies, but may be requested to submit an endorsement letter to KEDFA requesting the incentive be granted.

Eligible companies under the KBI program are any business entity engaged in one or more of the following activities:

- (a) Manufacturing;
- (b) Agribusiness;
- (c) Regional and national headquarters; and
- (d) Non-retail service or technology business:
- (e) That are designed to serve a multi-state, national or international market;
- (f) That have a customer base that includes more than 50% nonresidents; and
- (g) That may include, but are not limited to, call centers, centralized administrative or processing centers, telephone or internet sales order or processing centers, distribution or fulfillment centers, data processing centers, research and development facilities and other similar activities.

Eligible companies do not include companies where the primary activity to be conducted within the Commonwealth is forestry, fishing, mining, coal or mineral



processing, the provision of utilities, construction, wholesale trade, retail trade, real estate, rental and leasing, educational services, accommodation and food services, or public administration services.

In addition, to direct incentives that may be available through KBI, KEDFA has other incentive and loan programs to eligible companies. Training dollars for new and existing programs are also available through the Bluegrass State Skills Program.

While the KBI program is a great incentive for certain eligible companies, many of the businesses the City hopes to attract will not be eligible for the KBI incentive.

D. **Community Development Block Grants.** The Community Development Block Grant (“CDBG”) program is another tool available to the City that may be used to construct infrastructure or provide direct loans to businesses which commit to create new jobs. CDBG dollars are federal dollars from HUD that are intended to benefit low and moderate income individuals. While the income limits in the City are above the required income limits for certain programs eligible to be funded with CDBG funds, the City may apply for CDBG funds for loans to new businesses (whose employees are at or below low to moderate income levels at the time they are employed); or to use such funds to assist with public related projects, such as YMCAs or senior centers.

The CDBG program is administered by the Kentucky Department of Local Government (“DLG”) which has established procedures for the use of CDBG funds. A good percentage of DLG’s CDBG annual allocation is reserved to promote job creation for low and moderate income residents. Under this program, the City may apply for funds, and if awarded, use those funds to provide direct loans to a business to build and establish a business in the City. The City may apply for up to \$1,000,000 for each separate economic development project. The loan repayments to the City from the CDBG may be used by the City for other eligible projects. While this is a loan, and not a grant program, it is still attractive to small businesses, as the CDBG loan may be second and inferior to other financing needed for the program. Note, however, federal funds come with strings and regulations, including Davis-Bacon (prevailing wage) requirements. Therefore, some businesses may not want to be burdened with the requirements. Also, there is a fairly long lead time between applying for and receiving the funds.

In addition to loans to businesses, CDBG funds have been used extensively to assist public or semi-public facilities such as senior centers. Funds for these types of projects may be granted direct grants to the projects.

E. **Direct State Funding.** A funding option available to the City is to seek direct appropriations for public infrastructure from the Kentucky General Assembly. These types of funds are normally available for water, sewer lines, public amenities, or road projects. It is unclear at this point whether funds may be available in the upcoming “budget” session of the Kentucky General Assembly, but the City should be prepared with its “wish list” in the event local capital projects are funded.

F. **Local Programs.** The City is not limited to using the statutory programs discussed above to provide incentives for development consistent with the Union Town Plan. Since the expenditure of tax revenues to promote development is a valid public purpose, the City may establish its own program or may directly expend its tax revenues to promote development. Governments in the area, such as the Cities of Florence, Ft.

Mitchell, Newport, Covington, and Campbell County, have created local incentive programs to attract and/or retain jobs.

The City may directly expend tax funds to encourage or support development. An example of this would be the City constructing at its expense a parking garage or infrastructure needed to support private development. A specific example of this is the commitment the City of Newport made to attract the Newport Aquarium. For that project, the Newport agreed to acquire at its expense the land needed for the Aquarium, undertake site clearance to prepare the site for development, and construct a certain number of surface parking spaces for the project. However, while the expenditure of direct tax revenues to promote development is legal, before the City commits to such action, it should be carefully considered.

Please note that it is not suggested that the City should or needs to directly commit existing resources to promote development; but, only to indicate what may be done under Kentucky law. Section VII of this Report addresses the pitfalls of the City undertaking - at its expense - direct development projects to promote development.

## VI.

### **Development Scenario and Tax Impact**

The Committee requested Taft model a hypothetical development scenario on an approximate 12 acre development site to illustrate the local tax impact of the development and to quantify the total local taxes generated that may be available to be utilized as an incentive for development. For purposes of the model, the hypothetical development would include:

1. A 70,000 square foot, 3 story health facility (similar to a YMCA);
2. A 50,000 square foot, mixed-use commercial development with retail on the 1<sup>st</sup> floor and office on the 2<sup>nd</sup> and 3<sup>rd</sup> floors;
3. A 60,000 square foot, mixed-use commercial/residential development with retail on the 1<sup>st</sup> floor and apartments on the 2<sup>nd</sup> and 3<sup>rd</sup> floors;
4. A 25,000 square foot, mixed-use project with retail on the 1<sup>st</sup> floor and offices on the 2<sup>nd</sup> and 3<sup>rd</sup> floors;
5. A 40,000 square foot mixed-use project with retail on the 1<sup>st</sup> floor and apartments on the 2<sup>nd</sup> and 3<sup>rd</sup> floors; and
6. Related site amenities, surface and structured parking.

Based upon the local tax rates in effect in 2011, construction cost estimates available from RSMEANS and employment estimates available from various space calculator websites and related similar projects, the following scenario represents the annual local tax impact after the hypothetical development is fully constructed and opens for business:

### **Development Scenario & Tax Impact (12 Acre Development Area)**

**Assumptions:**

Mixed-Use Development with:

Health Facility-Community Center (YMCA)	70,000 sq. ft.
Office space	50,000 sq. ft.
Retail space	45,000 sq. ft.
Residential (apartments)	66,667 sq. ft.
Land Value:	\$1,032,300
Land Value: Community Center 3 acres	\$ 258,075

**Development Tax Valuation<sup>10</sup>**

<b>Project</b>	<b>Sq. Ft.</b>	<b>Price/Sq. Ft.</b>	<b>Cost</b>
Office	50,000	\$131	\$ 6,550,000
Retail	45,000	\$111	\$ 4,950,000
Apartments	66,667	\$124	\$ 8,266,708
TOTAL:			\$19,776,708
Site Costs/Parking, Etc. – 25%			\$ 4,941,677
Incremental Increase in Assessment			\$24,718,385

**Employment Payroll Impact**

<b>Project</b>	<b>Sq. Ft.</b>	<b>Sq. Ft./Emp.</b>	<b># Emp.</b>	<b>Avg. Salary</b>	<b>Total Salary</b>
Office	50,000	250	200	\$40,000	\$ 8,000,000
Retail	45,000	108	416	\$20,000	\$ 8,320,000
Health Facility	70,000		180 (full/p/t)		\$ 1,300,000 <sup>11</sup>
Apartments	66,667				\$ 200,000
TOTAL Incremental Increase in Payroll					\$17,820,000

**Increased Tax Impact  
- Real Estate -**

<b>Tax District</b>	<b>2011 Rate</b>	<b>Increased Assessment</b>	<b>Annual Tax</b>
City	\$.216/\$100	\$24,718,385	\$ 53,392
School	\$.579/\$100	\$24,718,385	\$143,119
County	\$.104/\$100	\$24,718,385	\$ 25,707
Fire	\$.160/\$100	\$24,718,385	\$ 39,549
Library	\$.051/\$100	\$24,718,385	\$ 12,606
Extension	\$.016/\$100	\$24,718,385	\$ 3,955
Health	\$.019/\$100	\$24,718,385	\$ 4,696
TOTAL Annual Increase in Real Estate Taxes:			\$283,024

<sup>10</sup> Does not include Health Facility assuming it would be exempt from property taxation.<sup>11</sup> Based on information received on the operation of R.C. Durr YMCA.

**Payroll Tax**

<b><u>Tax District</u></b>	<b><u>Rate</u></b>	<b><u>Payroll</u></b>	<b><u>Annual Tax</u></b>
County	.008%	\$17,820,000	\$142,560
County (MH/MR)	\$25/employee	806 (.75)	\$ 15,113
School	.005%	\$17,820,000 (.25)	<u>\$ 22,275</u>
TOTAL:			\$179,948

Total New Taxes Annually<sup>12</sup> - Real Property and Payroll Taxes **\$462,972**

**Tax Increment Financing Model**  
**Maximum Increment Available As Incentive**  
 - **Real Estate** -

<b><u>Tax District</u></b> <sup>13</sup>	<b><u>2011 Rate</u></b>	<b><u>Increased Assessment</u></b>	<b><u>Base Annual Increment</u></b>
City	\$.216/\$100	\$24,718,385	\$ 53,392
County	\$.104/\$100	\$24,718,385	\$ 25,707
Library	\$.051/\$100	\$24,718,385	\$ 12,606
Extension	\$.016/\$100	\$24,718,385	\$ 3,955
Health	\$.019/\$100	\$24,718,385	<u>\$ 4,696</u>
TOTAL Incremental Real Estate Taxes Available For Incentives:			\$100,356

**Payroll Tax**

<b><u>Tax District</u></b>	<b><u>Rate</u></b>	<b><u>Payroll</u></b>	<b><u>Base Annual Increment</u></b>
County	.008%	\$17,820,000	\$142,560
City	2% <sup>14</sup>	\$17,800,000	<u>\$356,400</u>
TOTAL Incremental Payroll Taxes Available For Incentives:			\$498,960

**Total Annual Tax Increment Available For Incentives: **\$599,316**<sup>15</sup>**

The Annual Tax Increment will grow over time and may be pledged for up to a thirty (30) year period as an incentive for development. As a point of reference, assuming bonds will be issued to finance projects within the local development area TIF district supported by the Annual Tax Increment, \$599,316, assuming a 5% interest rate over a thirty (30) year term, can support over \$9,000,000 in bonds. It should be noted that the Annual Tax Increment represents the maximum annual local tax incentive that may be granted under the Act. Most local governments that grant TIF incentives only agree to a percentage (50-80%) of the amount they may legally pledge, with the remainder being used for general purposes. In addition, all of the local governments may not agree to a pledge of their incremental revenues. Since economic development is not a mission of the special taxing districts it may be difficult to convince them to participate. Assuming the County agrees to join with the City in granting an incentive, requesting the County Judge/Executive to assist in contacting the special taxing districts may be helpful since the County Judge/Executive appoints the board members for the special taxing districts.

The portion of the Annual Tax Increment not pledged as an incentive, plus the amount of real estate taxes the property generated before the development, will be

<sup>12</sup> Only includes real property and payroll taxes; and does not include tangible taxes, business net profits, etc.

<sup>13</sup> Schools and Fire Districts may not pledge revenues for a TIF incentive.

<sup>14</sup> Assuming the City imposes the separate payroll tax within district as allowed.

<sup>15</sup> This is the maximum available during the first year. It is unlikely that the taxing districts will pledge the total amount as an incentive.

available for general government purposes by the City, County and respective taxing districts. Each taxing district will also benefit from the tangible taxes created by the project as tangible taxes are not subject to being pledged as a TIF incentive.

## VII.

### **Steps to Implement Incentives**

Many of the incentives referred to above are project specific and/or developer/employer driven and will not require significant action by the City in order to implement the incentive. Of the incentives discussed in Section V above, the three most likely incentives for which the City may need to better understand the implementation process are as follows:

A. **Kentucky Business Investment (“KBI”)**. Companies seeking KBI incentives must file an application to the Kentucky Economic Development Finance Authority (“KEDFA”). In our area, staff at the Tri-County Economic Development Corporation (“Tri-Ed”) assists companies through this process.

Depending upon the needs of the company or the importance of locating the company in Northern Kentucky, Tri-Ed may request the Mayor and other officials to attend preliminary meetings with company and/or site location representatives to assist with recruitment of the company. In many instances, a company considering locating or expanding in Kentucky will concurrently be evaluating other states to locate its business.

Since the City does not have a payroll tax in effect, any local payroll tax required to meet any KBI incentive<sup>16</sup> granted will need to be granted by the County. Tri-Ed may request a letter of support for the application from the Mayor; or depending upon how important the company is and the level of competition with other states, Tri-Ed may request some financial support from the City. Any commitment made by the City to assist the company will be included in the letter submitted by the Mayor.

Following the submission of the application to KEDFA, including any support letters from the City and/or County, and assuming staff of KEDFA supports the granting a KBI incentive, KEDFA will grant preliminary approval of the incentive for the company. After preliminary approval is granted, the company may move forward with binding contracts and other steps to construct the project. The company is granted up to two (2) years after preliminary approval to construct, open and employ the number of Kentucky resident employees committed in the application. At some point, after preliminary approval, if the City had committed to an incentive for the company, the Mayor will be contacted by Tri-Ed to obtain official City approval of the incentive by Council.

Once the project approved for KBI incentives is open and has met the minimum requirements for eligibility and has complied with what was committed in its application to KEDFA, KEDFA will approve an incentive agreement with the company which will

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<sup>16</sup> If a local payroll tax is in effect, the KBI incentive requires a local match of up to 1% of gross wages to from payroll taxes from new Kentucky resident jobs to match the maximum State incentive of 4% of gross wages from State income taxes from new Kentucky resident jobs.

authorize the company to utilize the incentive offered, and which starts the ten (10) year period for recovery of the incentive.

It is important to note that normal practice mandates that initial discussions with companies and local incentives offered be kept confidential up to the time KEDFA grants preliminary approval. Practically, this means that the Mayor will be requested to issue the support letter, including any incentive offered (that ultimately will require Council's approval), before the Mayor may publicly disclose and receive Council approval of the incentive offered. Because of this and to avoid any conflicts with Council or situations where Council may reject an incentive offered by the Mayor, it is advisable for the Mayor and Council to agree upon a process that respects the confidential nature of economic development discussions with companies while at the same time satisfying Council's ultimate approval and oversight responsibilities.

**B. Industrial Revenue Bonds ("IRBs").** As indicated above, IRBs are project specific and the process will be developer driven. The actual documents and legislation required to issue IRBs will be prepared by bond counsel selected by the project developer. The primary decision the City will need to make is whether the City will act as issuer of the bonds; and if so, the amount of property taxes the City is willing to forgo during the term of the bonds. Normally, the bond counsel or project developer will be responsible for negotiating the basic terms of the PILOT agreement among the City and other taxing districts.

Assuming the City is willing to be the issuer for the IRBs, bond counsel may request the City adopt an inducement resolution, which is simply a resolution expressing the City's intent to issue the bonds on behalf of the project. In the event the type of project requires State approval, the City as issuer will be the applicant to the respective state agency, but the application and other pertinent documents will be prepared by the developer - and at the developer's cost.

After all preliminary steps have been taken to issue the bonds, the City will adopt a resolution or ordinance officially issuing the bonds. After the bonds have been issued, the City will have little involvement. The City's Treasurer or Clerk may be contacted from time to time for information regarding the status of the bonds, etc. In addition, after the bonds are paid in full, the City should take steps to convey the project back to the project developer or as otherwise instructed.

Note that it is customary for any out-of-pocket expenses to the City, including advertising expense, expense of the City Attorney in reviewing documents, etc., be paid from the proceeds of the bonds. If the City is contacted to act as issuer, the payment of these costs should be verified with the project developer.

**C. Tax Increment Financing ("TIF").** Using TIF as an incentive will require greater City participation than the other incentive programs, especially if the City is the entity responsible for establishing the TIF area. Prior to establishing the TIF area, the City should negotiate any understanding with applicable project developers or determine the purpose for establishing the TIF area. Again, like the IRB process, it is customary for special counsel selected by the City and/or developer to prepare all the required documents and coordinate the process to establish the TIF area. If other local governments will be requested to participate with the City in a pledge of revenues, those entities should be contacted and there should be basic agreements reached with each

entity as to the amount of the pledge, term of the pledge of revenues, and how the pledged revenues will be utilized.

If establishment of the TIF is for a specific development, this process will be driven by the developer. However, if the TIF is driven by the City to improve an overall area, it will take more involvement by City officials and staff.

Assuming the preliminary agreements are reached with any developer and/or local governments regarding the TIF area, the actual process to establish the TIF area will differ depending whether the TIF area constitutes a “local development area” or a “development area” as follows:

Local Development Area. To establish a local development area (for undeveloped land), the City must conduct a public hearing advertised in accordance with KRS Chapter 424, to receive input regarding the proposed local development area. The advertised notice must include the time, place, and purpose of the hearing; a general description of the boundaries of the proposed local area; and a summary of the projects proposed for the local development area.

After the public hearing, the City establishes the local development area by adoption of an ordinance that contains:

1. A description of the boundaries of the local development area;
2. The establishment and termination date of the area;
3. The name of the area;
4. Approval of any agreements relating to the area (pledge of revenue agreement with taxing districts);
5. Establishment of a special fund to hold and disperse the pledged incremental revenues;
6. A requirement for periodic accounting to the City from entities that receive assistance;
7. A provision requiring periodic review by the governing body that established the area;
8. Designation of the agency responsible to administering and implementing the local development area ordinance; and
9. Any other relevant provisions.

As part of the adoption process, any other local governments, along with the City, that agrees to a pledge of tax revenues to support the area will grant a pledge of tax revenues through the execution of a local area development agreement that contains:

1. Identification of the parties to the agreement and the duties and responsibilities of each party;

2. Specific identification of the tax pledged by each taxing district;
3. Anticipated benefit to be received by each taxing district that includes a detailed summary of the old revenues collected from the area and the projected new revenues for each taxing district on an annual basis, and the maximum revenues pledged by each taxing district and the maximum number of years the pledge is effective;
4. A detailed description of the local development area;
5. A description of each proposed project, including an estimate of the costs of construction, acquisition and development;
6. A requirement that the tax revenues pledged by each taxing district will be held in a special fund, including the timing and procedure for deposits to the special fund;
7. Term of default and remedies, providing that no remedy shall permit the withholding of incremental revenues pledged if increment bonds are outstanding;
8. The commencement date, activation date and termination date for the local development area ordinance and pledge; and
9. Any other pertinent provision not inconsistent with the Act.

Following the establishment of the local development area, and assuming the area or project develops as planned, the City (or the agency designated by the City) will hold and use any incremental revenues held and pledged to support increment bonds or pay of project costs in accordance with the terms of the local area development agreement.

The actual process of paying pledged incremental revenues into the special fund begins only “activation” of the TIF, which may occur up to four (4) years after the TIF district has been established.

Development Area. The adoption of a development area (for development of previously developed property) is similar to the adoption of a local development area, except that establishing a development area requires the preparation of a “development plan” that contains the following information:

1. Assurances, along with supporting evidence and documentation, that the area meets the statutory requirements including:
  - (a) That the area meets the required blight conditions;
  - (b) That incentives are needed to redevelop the area; and
  - (c) That the amount of incentives pledged is justified based upon the expected return.
2. A detailed description of the existing uses and conditions of real property in the development area;



3. A map showing the boundaries of the proposed development area, a legal description of the development area, and geographic reference points;
4. A map showing proposed improvements and uses therein, including the identification of any proposed projects, along with a narrative description of the proposed improvements, projects, and uses within the development area;
5. A description of the redevelopment assistance proposed to be employed in the development area, including the manner and location of such assistance;
6. A detailed financial plan containing projections of the cost of the proposed redevelopment assistance to be provided, proposed projects to be funded, proposed sources of funding for these costs, projected incremental revenues, and the projected time frame during which financial obligations will be incurred;
7. Proposed changes of any zoning ordinance, comprehensive plan, master plan, map, building code, or ordinance anticipated to be required to implement the development plan; and
8. A certification of review by the planning commission for compliance with the comprehensive plan of the planning unit pursuant to KRS Chapter 100 after any necessary changes identified in paragraph (7) of this subsection are made.

After the development plan has been prepared, an advertised public hearing on the development plan must be conducted. Prior to the public hearing, copies of the development plan must be filed, and made available for public inspection with the City Clerk and the County's Fiscal Court Clerk. After the public hearing has been conducted, the ordinance establishing the development area may be adopted that contains information similar to what was listed for a local development area above. Also, the local taxing districts pledging tax revenues to support the development area execute a "local participation agreement," which is similar to the local area development agreement discussed above.

Finally, after a development area has been established, if a project within the development area qualifies for State participation, an application may be submitted to KEDFA to obtain a pledge of State revenues.<sup>17</sup>

## **VIII.**

### **Pitfalls to Avoid**

While most of the incentives discussed in this Report may be granted with little or no risk to the City, there are pitfalls to avoid in the event the City decides to offer

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<sup>17</sup> The process to receive a pledge of State revenues is not addressed in this Report as it is unlikely that any projects in the City will be eligible for a pledge of State revenues under TIF since projects within local development areas do not qualify for any of the State participation programs.

incentives or commit direct city funds to promote development. To avoid the pitfalls the City may experience when granting incentives, the City should:

A. **Support Projects that Match the City's Long-Term Goals.** As was indicated above, a number of the available incentives may be used for a variety of projects. However, simply because a project is eligible for an incentive does not mean it is good public policy to grant an incentive. Before the City commits any incentive for a project, it should be convinced (1) that the project is good for the City long-term; (2) that the project needs an incentive, *i.e.*, **but for**<sup>18</sup> the incentive, the project will not happen; and (3) granting the incentive supports the City's long-term goals for development.

B. **Do Not Grant More Incentive Than Necessary.** Developers often understand the incentive programs better than the City officials. They will understand the maximum amount of incentive the City may grant. Developers will often ask for the maximum incentive available when a lower amount will work. When granting incentives, the City needs to understand the actual incentive needed, balanced against the cost of the project to the City and long-term benefit. Local governments undertake economic development to increase revenues available to fund programs and to provide public and private services for its citizens. There is no reason to encourage development if all of the increase in taxes is pledged to the company or developer. Therefore, when considering an incentive a cost/benefit analysis should be undertaken to ensure that the incentive makes financial sense for the City.

In addition, when granting incentives, the City should not feel compelled to treat every similar project alike. Each project should be viewed independently. It may be appropriate to provide greater incentives to the "first" project in a development than later ones as the first project will encourage other development and will set the trend for the later development. This is especially true in areas where it is difficult to get development started. In addition, market conditions will be different depending on the timing of a development. In today's market, even projects in areas where no incentives were ever needed are difficult to finance. Incentives are more critical today to assist a project than they may be in the future when financial conditions improve.

C. **Be Very Cautious with Upfront or Direct Payment of City Funds to Promote Development.** Most of the incentive programs discussed herein are self-generating (the project generates the taxes for the incentive) and pose little to no risk to the City's finances when granted. However, as was discussed in Section IV above, the City may legally expend direct tax revenues to promote development including, but not limited to, purchasing property, constructing infrastructure, etc. If the City issues bonds to promote development, it may legally back or conditionally guarantee the payment of the bonds. Especially in today's financial market, developers are looking to local governments to take greater risks and commit greater resources in order to get a development started. There are times that it makes good sense for the City to be more directly involved to encourage development; but before the City commits any direct funds or agrees to undertake a capital project to promote development, the City should:

1. Consider any such investment "at risk" and be financially able to withstand the loss of the City investment or commitment in the event the project goes sour.

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<sup>18</sup> This is often referred to as the "but for" test.

2. Undertake projects that are important to the City regardless of whether a specific economic development project occurs or not. For instance, the City may want to expend its funds on infrastructure or public amenities that will benefit the entire City or promote the development of an overall area, as opposed spending its funds directly for or dependent upon one project. By doing this, if the one project fails to occur or defaults, the City investment will not be wasted.

3. When working with a developer to undertake a project, especially when the City is committing direct funds, it is critical for the developer to have the financial capacity and experience to undertake the development. The City should be very cautious in partnering with a developer with little development experience or who does not have the financial wherewithal to do the project. The City may want to condition its participation in the project pending clear evidence of the developer's financing for the project and other evidence to assure the project will occur. In addition, depending upon the project the City should consider negotiating a development agreement with the developer that sets forth each party's obligations to the project that contractually binds the developer to the project, and provides for the event of default.

## **IX.**

### **Conclusion**

In conclusion, there are a number of incentive tools available to the City to promote economic development. The most likely programs available to the City are IRBs, TIF, KBI and direct City funding. Utilization of IRBs and TIF allow the possibility of the City capturing tax revenues from other taxing districts and using those other revenues to support projects within the city. The City should only grant incentives for projects that meet the City's long-term development goals, and after cost-benefit analysis has been conducted that supports any incentive granted.