

Community Economic Analysis: A Basic Guide and Supplemental Resource

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A Basic Guide

Kentucky communities are facing the challenges of a global economy: out-migration of young people, lack of entrepreneurial activities, shifting economic base, decline of agriculture, and the competitive pressures of international trade. These forces take on a tangible form in communities such as the locked gate of an abandoned manufacturing facility, the fallow farm fields and tobacco barns, and the locked and barred doors of a downtown merchant. Local economic development is an attempt to transform a community's economic base, respond to global forces, create new economic opportunities, and generate new life in a community.

In undertaking local economic development programs, a number of different approaches can be used to answer the question, "What is the best strategy for our community?" Community Economic Analysis (CEA) represents one approach to answer this question. This approach has three key elements: *strategies*, *tools*, and *data*. *Strategies* refer to the specific set of actions and focus that will be used to create new economic opportunities. *Tools* refer to the set of analytical ideas used to identify trends, opportunities, and strengths and weaknesses in the local economy. *Data* are the raw material used in the tools. The objective of this Extension publication is to present a basic guide to community economic analysis and provide information on state and federal economic development programs that are available to implement strategies.

In community economic analysis, a community uses these tools and data to create information. This information, combined with other types of information, serves as the basis for deciding which economic development strategy (or strategies) is best suited to the community. Using this approach, a community is better able to answer two questions: (1) "Which economic development strategy should we choose?" and (2) "How do we best target or implement such a strategy?" In fact, community economic analysis should be viewed as a form of asset mapping. It should be utilized in the context of other asset mapping tools.

The North Central Rural Development Center (<<http://www.ncrcrd.iastate.edu>>) provides a training manual for community economic analysis titled "Community Economic Analysis: A How-To Manual," authored by Ron Hustedde of the University of Kentucky and others. The Community

Figure 1

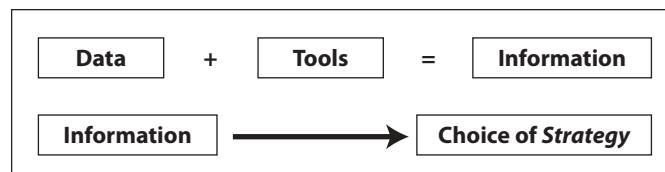


Figure 2

Community Economic Analysis Terms

Data: Number of jobs, sources of private and public income, local imports and exports, size, and distance to nearby communities; industry mix.

Tools: Location quotient, shift-snare analysis, economic multiplier, retail trade analysis.

Information: Answer to questions such as:

- "What are our major imports and exports?"
- "Are local industries growing faster or slower than their counterparts in the rest of the nation?"
- "Are we losing retail sales to nearby communities?"
- "What types of retail and service sales are we losing?"
- "What is the economic impact of our major industries on the local economy?"

Strategy: Attract new firms, capture existing markets, encourage startup firms, retain existing firms, obtain aid from broader levels of government.

Asset Mapping: Process of identifying individuals and institutions in a community that serve as the basis for current and future community vitality.

Economic Analysis training manual, available by ordering at <<http://www.ag.iastate.edu/centers/rdev/pubs/contents/141.htm>>, is designed to educate you about the strategies, tools, and data available to identify economic trends in your community and decide which economic development strategy is the best fit for a community.

As discussed in the training manual “Community Economic Analysis: A How-To Manual” (Hustedde et al., 1997), there are five major economic development *strategies*:

- attracting new firms
- capturing existing markets
- encouraging startup firms
- retaining and expanding existing businesses
- using aid from state and federal government.

Each one of these strategies requires assembling a different set of local assets. In order to be successful, a community should be willing to take a hard look at the existing set of assets, resources, and institutions in the community. The training manual provides the tools that allow you to assess and evaluate each of these options for your community. It helps answer the first question mentioned earlier about which economic development strategy we should choose. After studying and using this manual, you may be asking, “What now?” or “How do we actually undertake one of these strategies?”

Supplemental Resources: State and Federal Economic Development Programs

State and federal programs can play a role in implementing any one of these strategies for local communities and governments. State and federal programs can assist a community in attracting new business, retaining business and jobs, or fostering new entrepreneurs. An understanding of specific opportunities afforded to local communities through regional, state, and federal economic development programs can provide one way in which a community can undertake one or more of the five specific economic development strategies.

Many economic development programs are available to local communities in the Commonwealth of Kentucky. Some of these programs are designated at the state or federal level, while others are an option for local governments. Each of these programs can be used to enhance a community’s economy. It is important that a community decide on its economic development strategy before utilizing these programs. Program implementation should follow strategy development and not the other way around.

The programs have a common theme: they are targeted directly at businesses or indirectly at a community’s ability to attract businesses. Business incentives directly reduce the cost of doing business in a particular place or assist in raising the productivity of businesses. For example, tax breaks are aimed at reducing the cost of doing business for mostly large existing companies. Many small companies have small or no tax liability. Capital financing programs are targeted to help small businesses gain an advantage in the marketplace.

At times, the government tries to indirectly affect businesses through infrastructure investments. Water access, sewers, industrial parks, and telecommunications are all part of the fabric of a community that affects business location and competitiveness. By addressing gaps in infrastructure, communities can more effectively compete for business or enhance new business development.

Programs that assist individuals, such as welfare, Social Security, Medicaid, and workforce training, are not covered in this publication. Those programs do assist in economic development but do not target community infrastructure or businesses.

Attracting New Business: Tax Breaks and Workforce Development

Tax Breaks

The Commonwealth of Kentucky has six major tax incentive programs to attract new businesses or assist expanding businesses. Tax incentive programs lower the cost of doing business in the state by lowering a company’s state and local tax bill. The six programs are:

- Kentucky Industrial Development Act (KIDA)
- Kentucky Rural Economic Development Act (KREDA)
- Local Government Economic Development Fund
- Kentucky Jobs Development Act (KJDA)
- Kentucky Enterprise Zone program
- Tax Increment Financing (TIF) districts.

These programs are primarily targeted toward large capital investments by manufacturing, agribusiness, and some service- and tourism-oriented businesses. In general, these businesses must serve out-of-state clients or customers. This criterion is based on the principle of attracting basic industry into the state.

Kentucky Industrial Development Act (KIDA)

The KIDA program is a tax credit program that allows companies to recover costs associated with buildings, land, and some equipment. The credit is in the form of either a state income tax credit of 100 percent against costs of a project or a wage assessment of up to 3 percent against total salaries and wages paid. Eligible firms are new and existing manufacturing firms. The proposed project must create at least 15 new jobs and involve a minimum \$100,000 capital investment.

Kentucky Rural Economic Development Act (KREDA)

There are more aggressive programs for regions of the state suffering from economic decline or higher-than-average unemployment rates. The KREDA program allows for three possibilities: (1) the recovery of all costs associated with a project, (2) wage assessment equal to 4 percent of total salaries and wages, and (3) tax credits that last for 15 years. This program is restricted to new or existing manufacturing plants. Projects must create a minimum of 15 new jobs, and total capital investment must be a minimum of \$100,000.

Kentucky Jobs Development Act (KJDA)

The KJDA program offers service-based companies the potential to recoup up to 50 percent of startup costs and 50 percent of lease costs. The mechanism for cost recovery is (1) a corporate income tax credit of up to 100 percent and (2) a wage assessment of up to 5 percent of total wages and salaries. The wage assessment allows employers to withhold up

to 5 percent of employees' wages to repay debt used to finance the project. Employees are in turn eligible for a state income tax credit of the same amount. Any local government affected by a loss of revenue from the wage assessment must officially endorse the granting of the credit and wage assessment. Service and technology firms are eligible under this program. Retail firms are not eligible. Companies must prove that at least 75 percent of their services are provided to out-of-state clients. In addition, proposed projects must create at least 25 new full-time jobs.

The KIDA, KREDA, and KJDA are all based on reductions in state taxes; however, cities and counties also have options to reduce local taxes. Cities can exempt new manufacturing facilities from city property taxes for up to five years. Also, if a city or county has been designated an enterprise zone, the community (both city and county) can exempt qualified businesses from increases in assessed value for up to a five-year period, and city/county property tax rates can be set as low as 0.10 cent per \$100 of valuation. For all cities and counties, a moratorium may be granted on commercial buildings older than 25 years following their rehabilitation or repair by owners.

The primary form of city and county tax incentives is through the use of industrial revenue bonds (IRBs) issued by state and local government to finance economic development projects. Bond funds may be used for engineering, site-preparation, and land-acquisition costs typically related to industrial parks or speculative industrial buildings. Bondholders receive interest and principal payments tax free under state and federal guidelines. Because of their tax-free status, these bonds are issued with low interest rates. Local government bonds must be approved by the Kentucky Private Activity Bond Allocation Committee. The benefit to companies is in the form of reduced state and local property taxes. Private lessees, through property owned and financed by local government entities under industrial revenue bonds, are taxed at a state and local property tax rate of \$0.015 per \$100 of leasehold value. This is compared to a rate of \$0.14 per \$100 of leasehold value under normal conditions.

Kentucky Enterprise Zone Program

The Kentucky Enterprise Zone program is another program targeted at specific areas in the state. To be eligible, 50 percent or more of a business's employees must be located within specific boundaries. Currently, the program is operated in the cities of Louisville, Ashland, Covington, Owensboro, Lexington, Paducah, and Hopkinsville and in Hickman, Knox, and Campbell counties. A business may receive up to a 10 percent tax credit against an employee's wages up to \$1,500. To be eligible, the employee must have been unemployed up to 90 days prior to being hired or receiving public assistance aid. Local government may offer additional incentives within enterprise zones.

Tax Increment Financing

Tax increment financing represents another tool for local governments. Tax increments are revenues that are collected

in the designated area after the designation period. These governments may designate up to 80 percent of the revenues generated by the district to finance economic development projects. The funds may be disbursed to a nonprofit agency, city or county agency, industrial development corporation, or urban renewal agency.

Kentucky Tourism Development Act

The Kentucky Tourism Development Act is an example of state-sponsored efforts at encouraging cultural, historical, and recreational site development. In this act, lodging and retail facilities unlikely to serve out-of-state visitors are excluded from incentives. A minimum \$1 million investment restricts the act to larger entities and projects.

Workforce Development

Programs in this category support financial and nonfinancial incentives to encourage employers to invest in human capital. Human capital is the accumulated skills, knowledge, and training of an individual or a company's workforce. In the 21st century, many consider human capital to be far more important than fixed assets, infrastructure, or other forms of capital. By improving their own base of training and learning, people become a more valuable asset to their community. Today's employers are often searching for motivated and skilled workers to compete in the global marketplace. Also, individuals with training are better able to start businesses and succeed in the marketplace.

The Bluegrass Skills State Corporation (BSSC) is the primary vehicle for human capital investments and workforce development. An employer may receive reimbursements for up to 50 percent of the cost of training for employees. This may include pre-employment training, retraining, and occupational upgrade. Eligible projects are new and existing manufacturers, qualified non-manufacturers, and public or nonprofit hospitals. Training must be approved by the BSSC.

Kentucky's community college and vocational school system also provides training for employers. Although these institutions do not provide financial incentives, they can develop company-specific training.

Capturing Existing Markets and Encouraging Startup Firms: Small Business Financing and Management Assistance

Small Business Financing

Besides tax breaks, the commonwealth and federal governments provide business financing to encourage new and small business development. Small businesses are the best place to capture existing markets or to be the target of new business development. Similar to tax-break programs, these programs are focused on financing related to fixed capital investments. Typically, they are intended to bridge the gap between private financing and the realization of a capital investment. In some cases, business owners are unable to provide full financing for a project either through their equity

investments or bank financing. State and local governments may provide some funding to bridge this gap. At times, this financing may be provided through grants rather than loan programs.

The commonwealth provides partial business financing for service, tourism, and other non-retail businesses through the Kentucky Economic Development Finance Authority (KEDFA). KEDFA may provide up to 25 percent of the fixed capital costs of a project. The maximum loan amount is \$500,000, and the minimum is \$25,000. Project owners must invest at least 10 percent equity into the project. Further, projects must demonstrate that they will have a significant economic impact on the community involved. Interest rates are quite low through this program, generally below market rates.

Cities and counties in the commonwealth receive funding from the federal government program called Community Development Block Grants (CDBG). Kentucky businesses can obtain low-interest loans from these funds. Generally, these loans are used for fixed-asset investment. Interest rates are usually below market rates and fixed for life. The federal government requires that at least 51 percent of the funds be used to assist low- or moderate-income individuals.

Revolving loan funds represent another source of financing for new business ventures. These funds are raised through various private entities and represent a pool from which new and expanding businesses in the community can participate. These loan funds are not intended to replace bank or other private sources of funding but rather to be used as “gap” financing for projects that would not have occurred otherwise. Typically, requirements are placed on these funds as to the amount of jobs that must be created or saved per some dollar amount.

The Local Government Economic Development (LGED) program provides coal severance and processing tax revenues to coal-producing counties for use in economic development projects. It was created to help attract manufacturing and service-based businesses to coal counties. The funds can be used to create sites for new industrial or business parks or for workforce development.

The federal government also offers business financing programs primarily through the Small Business Administration (SBA). Generally, the SBA acts as a guarantor of small business loans. The business entity must apply for the loan through a commercial bank. If the bank agrees to the terms, the loan is extended to the business at prevailing market rates. The benefits of an SBA loan are an extended repayment program that lowers monthly payments and a fixed interest rate. The SBA 7a program is the primary loan vehicle for small businesses. The SBA can guarantee a loan of up to \$1 million. Generally, these loans can be used for typical business expenses. A business must meet many other criteria under this program. The SBA has many loan programs, including pollution control loans, export promotion loans, and others.

The SBA 504 program is organized to allow certified development corporations (CDC) to fund small business investments. Funds under this program may be used for fixed-asset

investments, such as purchasing land, renovating buildings, or landscaping. The Commonwealth Small Business Corporation, Capital Access Corporation, Community Ventures Corporation, and Purchase Area Development District are CDCs under the SBA 504 program in Kentucky. This program is used to finance small businesses in Kentucky and enhance entrepreneurial activities. The private sector must cover 50 percent of project funding, the community development corporation can finance up to 40 percent, and project owners must invest 10 percent. Generally, the project must create at least one job for every \$35,000 dollars of SBA-backed investments. The loans are limited to \$1 million.

The Agricultural Development Fund in Kentucky has reminded producers of the importance of value-added agriculture. The Farm Bill authorizes a program called Value-Added Agricultural Product Market Development grants of up to \$500,000 to producers and producer groups to engage in value-added activities. The program is funded for \$40 million a year for the next six years.

The Rural Business Investment program provides equity funding for businesses in rural areas. It will grant up to 10 percent (or \$1 million) of the total received in private funding to a particular entity. In essence, this program could be called gap financing, where a business entity is seeking additional funds for which the private sector has been unwilling to come forward. This program has been authorized for up to \$280 million in loan guarantees and \$44 million for grants.

Management Assistance

A number of state government agencies provide technical assistance to small and existing businesses in order to ensure business success and garner new jobs. The Kentucky Small Business Development Center offers business-planning consultations with new and existing small businesses in the commonwealth. This form of technical assistance is provided to raise the productivity and management skills of small firms in order to ensure their survival and prosperity. The International Trade Division within the Kentucky Cabinet for Economic Development provides export counseling and export assistance to Kentucky firms. This type of assistance is oriented toward helping firms secure new sales opportunities and eventually convert sales into new job opportunities.

Aid from Broader Levels of Government: Infrastructure Development

Infrastructure is a critical element of economic development programs. To be competitive, businesses require water and sewer hookups, road access, and telecommunications. The Kentucky Department of Transportation has a program called “Economic Development Access Roads Program.” Local communities must apply for the funds, and several criteria must be met, including (1) money must be used to facilitate development that would not have occurred in its absence and (2) funding must have a significant and demonstrable impact on the local economy.

At the federal level, the 2002 Farm Bill and other legislation provide the basis for federal rural development activities. These activities can be utilized by local communities to achieve economic development objectives. Wastewater and water-treatment facilities grants are authorized under this Farm Bill. These grants can be provided to qualified nonprofit entities in communities to capitalize revolving loan funds. These funds can be then be used to construct or repair water and wastewater facilities in rural communities.

Given the importance of Internet access in today's economy, the Farm Bill authorizes new loans and loan guarantees for rural broadband access. Local governments are eligible for such loans. This program has been funded at \$20 million for the first four years and \$10 million for the last two years. Under this program, a rural local government could apply for a loan or loan guarantee to construct or improve telecommunications and broadband access.

Even in the information age, some residents do not have access to local television service. The Rural Local Television Broadcast Signal program provides funds for underserved residents in rural areas to receive local television channel access. This program has been funded at the level of \$80 million.

Another example of broader government support is the Kentucky Heritage Council and Renaissance Kentucky. These programs act to provide financial and technical support to encourage downtown development and redevelopment. This assistance may include Community Development Block Grant money for façade and building redevelopment and an assessment of current housing and commercial space. By focusing resources on downtown revitalization, it is believed that new jobs will be created and the core of many communities' economic base will be reestablished.

Examples in Kentucky

Perhaps the most important issue in local economic development is combining these different types of programs that can be used to strengthen a community's economy. It is unlikely that any one of these programs will be the "silver bullet" to success, but sometimes they can be combined into new and creative economic development tools.

Some examples may help to clarify these points. The city of Paducah, Kentucky, has offered tax incentives to attract artisans to downtown housing and business space. The idea is to create a lively environment mixing both residential and business space. In Hindman, Kentucky, local community groups have teamed up with the community college to offer training for potential and aspiring artists. This initiative was funded by the state through the Community Development Initiative. Other communities are turning to industrial parks and business recruitment. In many parts of the state, regional industrial parks, combining the resources of several counties, have been built to attract larger employers using available land, speculative buildings, and tax breaks.

As counties, cities, and regions engage in community economic analysis and the broader process of asset mapping, an inventory or assessment of current economic development activities is useful. Best practices support the idea of combining existing economic development efforts, a form of community assets, and new ideas and programs. Another idea is to look for similar communities and uncover their local economic development efforts.

