

TASK FORCE ON LOCAL GOVERNMENT ANNEXATION

Minutes of the Fourth Meeting of the 2023 Interim

October 27, 2023

Call to Order and Roll Call

The fourth meeting of the Task Force on Local Government Annexation was held on October 27, 2023, at 1:00 PM in Room 169 of the Capitol Annex. Senator Robby Mills, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Jonathan Dixon Co-Chair; Senator Robby Mills Co-Chair; Senators Michael J. Nemes, Phillip Wheeler, and David Yates; Representatives Randy Bridges, Beverly Chester-Burton, and Michael Meredith.

Guests: J.D. Chaney, Executive Director and CEO of the Kentucky League of Cities.

LRC Staff: Mark Mitchell, Christopher Jacovitch, and Logan Schaaf.

Approval of Minutes

Upon the motion of Representative Bridges, seconded by Representative Chester-Burton, the minutes from the September 29, 2023, meeting were approved.

Kentucky League of Cities' Perspective on Annexation

J.D. Chaney, Executive Director and CEO of the Kentucky League of Cities (KLC), stated that a study from 2018, published in *The Economist*, showed that cities that are unable to annex territory are poorer, more segregated, have less growth, and have lower bond ratings among other things. Overall, annexations and growing cities are a benefit to both cities and counties. Annexation is an important part of advancing economic development in Kentucky.

The primary issue is not annexation but county tax revenues, and that annexation changes would come at the expense of cities. There are more pressing issues that local governments should address together.

Sixty percent of the population and 75 percent of the economic activity occurs in cities, but cities represent 3.6 percent of the state's geographical area. Expansion has been intentional and conservative concerning growth for the most part. Primarily, the opinion of property owners will determine whether an annexation will go forward. These decisions are not haphazard, but are judicious, because annexation results in the provision of services in new areas.

Kentucky annexation law puts property owners' rights at the forefront through annexation. Ninety-two percent of all annexations were done at the property owner's request. Non-consensual annexations are a much more difficult process that requires waiting periods, the ability to petition in opposition, etc. Property owners have many reasons for desiring annexations, including more services, such as police and fire, and the coverage for planning and zoning.

City boundaries are often not aesthetically pleasing, but this can occur due to natural growth, geographic and other natural boundaries, and other reasons. Mr. Chaney referenced several fast-growing cities throughout the country that have shapes that are not compact or geometrical. This "ugliness" shows that these cities have not been limited regarding annexation, but this has benefited their ability to grow in terms of population and in economic development. City governments are not static, and change based on population changes. Property owners have the controlling interest in how their property is used and should be able to determine if they want to be annexed.

Kentucky law does not permit the annexation of barren land, without a plan for development in order to reach desirable areas. Territory must have concrete developability at the time the annexation is commenced. The shape of cities should be considered contextually on a case-by-case basis, and usually the property owners desires determine the shape. Mr. Chaney listed several examples where corridor annexations were explained by the desire to increase services in the area.

Most annexations provide revenue benefits even to counties even where occupational taxes do not stack. Mr. Chaney provided a hypothetical example, where a city expends resources in an annexed area to develop the property, which leads to higher property valuations and increased property tax revenue for the city and county. These increases can be larger enough to offset or even outpace the tax revenue lost by the county from prior occupational and insurance premium taxes. The county reaps these rewards without any investment of its own in the property. Mr. Chaney pointed to real examples of this situation, where development of residential areas following annexation by a city resulted in tenfold or greater increases in property values and property tax revenue for the county.

The perspective of city tax payers should be considered and the services that they receive from both cities and counties. All city residents pay property taxes to both cities and counties, and ensure that all residents are paying the same for the base level county services. Some counties have lowered their property tax rates below the compensating rate or failed to use the 4 percent increase permitted by statute. The compounding

effect of these decisions result in large losses in revenue for counties that have made those decisions.

Mr. Chaney pointed to Daviess County which has lowered its property tax rate below the compensating rate, and resulted in a \$2.1 million dollar loss in revenue. Madison County had also lost out on \$900,000 in revenue due to not taking the four percent increase over the previous five years. This is not meant to cast aspersions on the counties, but it is important because the annexation changes contemplated by the counties are an effort to take revenue from the cities which it can use to spur growth and investments. Counties that have not made hard decisions on property tax rates should not be able to make that up by taking tax revenue from cities.

KLC has several proposed ways to reach a resolution.

1. An amendment to the Kentucky Constitution that would open the options for city revenue generations.
2. Jail reform that will relieve the severe burden jails place on county budgets.
3. A limited reprieve from the recall provisions of HB 44 to allow counties that have relatively low property tax rates due to prior decisions concerning the compensating rate, to make up ground over a short period.
4. A revenue hold-harmless calculation for annexations that would determine revenue loss due to an annexation offset by the benefits received by the county due to increased property tax revenue.
5. A limited exception to occupational tax crediting in newly annexed areas, where a county has provided investment in the area.
6. Strengthen property owners' rights concerning non-consensual annexations by allowing petitions to defeat an annexation without the need for the issue to go to the ballot.
7. Amend the statute of limitations by reducing the time to challenge, while expanding legal standing to additional parties that may challenge an annexation.
8. Clarify ownership of city utility infrastructure.

Mr. Chaney stated that he hoped to work with his colleagues in KACo to bring reasonable proposals by the next meeting. Annexation is critical for allowing cities to prosper and grow and important for allowing the state to grow.

In response to a question from Senator Wheeler, Mr. Chaney stated that all fifty states are different regarding annexation and that KLC would not be supportive of any proposal that would require cities to receive permission from counties to annex territory. The examples of other cities were meant to demonstrate that cities are often "not pretty" and are constantly changing and growing.

In response to another question from Senator Wheeler, Mr. Chaney stated that courts have already considered the rational basis for the 30,000-population distinction regarding occupational license crediting. Mr. Chaney provided a case citation and quoted from the opinion which held there was a rational basis for the classification.

In response to a question from Senator Nemes, Mr. Chaney stated that the increases in population and GDP due to annexations comes from a combination of taking territory where that population/activity already existed and from investing in undeveloped property. Cities that do not have the ability to annex, end up poorer and see declines in population.

In response to a question from Representative Chester-Burton, Mr. Chaney stated that services provided by cities during annexation include utilities, but that often in the case of industrial development, cities provide development incentives that do not result in revenue for many years, but provide jobs.

In response to a question from Representative Chester-Burton, Mr. Chaney stated that during annexation residents can choose whether the city will take over fire service from a fire district, but this does not result in indebtedness for the fire districts.

In response to a question from Senator Wheeler, Mr. Chaney stated that the crediting statute is very complicated, but that KLC would have issues with stacking in areas that were already a part of municipalities. Mr. Chaney stated that removing the population threshold may be politically difficult because it would result in millions of dollars in tax increases, if stacking were allowed to occur. KLC would be open to allowing stacking for future annexed territory where cost sharing between the city and county occurs.

In response to a question from Representative Bridges, Mr. Chaney stated that the bill which established the taskforce was not a moratorium on annexations and merely required some notice be provided to the counties. Multiple annexations have occurred since the bill was passed, and KLC withdrew its objections because it did not halt the ability of cities to annex. Cities have provided the necessary notice, and the system seems to be working.

In response to a question from Representative Bridges, Mr. Chaney stated that concerning fire services in islands of non-annexed territory within a city, that those services and others are frequently provided by the city without those areas contributing via taxes.

In response to a question from Representative Bridges, Mr. Chaney stated that cities would be opposed to revenue sharing or stacking unless there has been cost sharing by the counties.

Representative Bridges stated that he would encourage cities and counties to work together, rather than seeing it as an effort to require cities to seek permission. He hopes that KLC and KACo could work together to bring a solution to the legislature.

Representative Meredith stated that jail costs, pension costs, limited revenue options under the Kentucky Constitution, and offset provisions, are not the fault of cities or counties, but were things that occurred in the distant past. This has created conflict between cities and counties, but both organizations have shown a strong willingness to work together to fix this issue.

Representative Dixon thanked all the involved parties for their participation with the task force.

Senator Mills announced that the next meeting was scheduled for November 17, 2023. There being no further business, the meeting was adjourned at 1:15 p.m.