

Approved: February 4, 1998
date

MINUTES OF THE SENATE COMMITTEE ON COMMERCE.

The meeting was called to order by Chairperson Alicia Salisbury at 8:00 a.m. on February 3, 1998 in Room 123-S of the Capitol.

Members present: Senators Salisbury, Barone, Brownlee, Donovan, Feleciano, Gooch, Jordan, Ranson, Steffes, Steineger and Umbarger.

Committee staff present: Lynne Holt, Legislative Research Department
Bob Nugent, Revisor of Statutes
Betty Bomar, Committee Secretary

Conferees appearing before the committee:
Dan Hermes, Director of Governmental Affairs, Office of the Governor
Jamie Clover Adams, Legislative Liaison, Office of the Governor
Tom Blackburn, Executive Vice President, Kansas Venture Capital, Inc.
Elmer Ronnebaum, Kansas Rural Water Association
Chuck Stones, Kansas Bankers Association

Others attending: See attached list

The following information was distributed to the Committee:

Memorandum from Lieutenant Governor/Secretary Sherrer, regarding Housing Projects, response to Committee questions. (Attachment 1)

Kansas Universal Service Fund Flow chart. (Attachment 2)

Fiscal Note for SB 487 (Attachment 3)

Article from State Legislatures Publication on *Federal Court Struggles with Telecommunications Act*. (Attachment 4)

SB 487 - Privatize Kansas Venture Capital, Inc.

Bob Nugent, Revisor of Statutes, stated **SB 487** and its companion bill, **SB 554**, provides for the privatization of Ad Astra I and II funds. On Page 3, subsection (j) sets out a plan by which the Kansas Venture Capital, Inc. (KVCI) Board can redeem \$5 million which the Pooled Money Investment Board (PMIB) has invested in KVCI and allows them to pay off the \$5 million over a period of 5 years. Subsection (j) allows the Board to make whatever installments it chooses as long the total is paid off within 5 years. This subsection also directs that the money returned to the state treasury be deposited in the public water supply loan fund. On Page 1, subsection (a) eliminates the state's contingent liability to KVCI. Section 2 allows banks and insurance companies to take tax credit for investment in KVCI. Section 3 allows anyone with tax liability to take the same credit. Page 6, new subsection (c) provides for ability of KVCI to reduce investment in Kansas businesses to less than 100%. Mr. Nugent submitted a table which sets out the remaining investment capacity in the statewide risk capital system. (Attachment 5)

Don Hermes, Director of Governmental Affairs, Office of the Governor, stated **SB 487** contains three main components: 1) provides a mechanism for KVCI to return the \$5 million provided by the state; 2) extends unused tax credits of \$1.4 million for future investments in KVCI; and 3) credits the repayment of the \$5 million to the Kansas Public Water Supply Loan Fund. Mr. Hermes stated as a result of KVCI's success, the state has benefited from creation or retention of more than 2,800 jobs. (Attachment 6)

Tom Blackburn, Executive Vice President, Kansas Venture Capital, Inc., appeared in support of **SB 487**. Mr. Blackburn stated **SB 487** eliminates the state's additional \$5 million investment commitment to KVCI; provides a means for the repayment of the state's existing preferred stock investment; provides for sunset of KVCI upon full redemption of state's preferred stock investment; re-authorizes up to \$1.5 million in unused venture capital tax credits to encourage the private sector to make new investments in KVCI; and provides that the proceeds from KVCI redemptions be earmarked for the public water supply loan fund. (Attachment 7)

Mr. Blackburn stated **SB 487** is consistent with the public policy position of eliminating direct public funding of venture capital companies and of maintaining current initiatives in providing incentives for private sector venture capital investments in Kansas companies. **SB 487** benefits the state in that the state would be repaid the \$5 million invested in KVC; reinstatement of unused venture capital tax credits may assist in attracting new private capital to KVC; additional economic development returns from future investment activity of KVC in Kansas-based companies; future economic development returns from infrastructure investments from the public water supply loan fund as a result of KVC repayments and leveraged federal funds; and retention of a "homegrown" venture capital firm with a continued commitment to Kansas businesses. Mr. Blackburn stated the Board of Directors of KVC supports **SB 487**.

Jamie Clover Adams, Legislative Liaison, Office of the Governor, testified in support of crediting \$5 million to the Public Water Supply Loan Fund.. Ms. Adams stated Section one makes available an additional \$5 million to leverage \$20 million in loans to provide more communities with critical water system upgrades. The additional funding mechanism is supported by Governor Graves. (Attachment 8)

The Safe Drinking Water Act requires water suppliers to deliver water at the tap that meets national safety guides. The Kansas Department of Health and Environment (KDHE) has surveyed Kansas needs and indicated they will need nearly \$190 million to finance 181 projects over the next five years to ensure public water supply infrastructure projects to meet the Safe Drinking Water standards. An Environmental Protection Agency (EPA) survey shows that Kansas municipalities will need nearly \$2 billion over the next 20 years to meet system needs. The additional funding provided in **SB 487** moves the State towards meeting those needs.

Elmer Ronnebaum, General Manager, Kansas Rural Water Association, appeared in support of crediting \$5 million to the Public Water Supply Loan Fund. Mr. Ronnebaum stated the 1996 amendments to the Safe Drinking Water Act provided federal grants to states to establish revolving loan funds for public water systems. Kansas is to receive approximately \$14.6 million in funds from EPA and after certain set-asides are taken out, the state has leveraged the remaining \$11.350 million by 4:1 ration. In December the Kansas Development Finance Authority (KDFA) issued \$45 million in bonds for this program. The need for funds is apparent, KDHE estimates a need for \$479,220,000 for capital expenditures for publicly owned water suppliers. The Kansas Rural Water Association supports the public water supply loan fund as it provides below-market interest rates and can be utilized to leverage a larger amount of money to provide for water system upgrades. (Attachment 9)

Chuck A. Stones, Kansas Bankers Association (KBA), appeared in support of **SB 487**. Mr. Stones stated that as a result of the poor economy in the mid-1980's, the Legislature became involved in a series of economic development initiatives. The investment by the State provided stability, credibility and liquidity. The KVC has served our state well, but now is the time to privatize. Mr. Stones stated the KBA is of the belief that KVC is now at a point where it can operate more effectively without direct state money and will continue its commitment to businesses in Kansas. Allowing KVC to privatize will allow it to continue to grow and will remove some of the burden placed on it by the involvement of state money. (Attachment 10)

Upon motion by Senator Feleciano, seconded by Senator Jordan, the Minutes of the January 30, 1998 Meeting were approved as corrected.

The next meeting is scheduled for February 4, 1998.

SENATE COMMERCE COMMITTEE COMMITTEE GUEST LIST

DATE: February 3, 1998

NAME	REPRESENTING
Bill Sneed	KUCI
Roger Trautw	Nationsbank
Dave Waldo	KDFE
Chris McKay	League of Ks. Municipalities
Tom Black	KUCI
Mike Meyer	KUCI
Marshall Parker	✓
John Dalton	KUCI
Annette M Witt	KDFA
Elmer Rounbaum	Ks Rural Water Assoc.
Chuck Stone	KBA
RICH BENDIS	RTEC
Mike Miley	KANSAS INC
Mark Basellina	KDOCTH
Bob Totten	Ks Contractors Association

KANSAS

DEPARTMENT OF COMMERCE & HOUSING

MEMORANDUM



TO: Senator Alicia Salisbury, Chairwoman
Senate Commerce Committee Members

FROM: Gary Sherrer, Lt. Governor/Secretary

DATE: January 27, 1998

SUBJ: Housing Projects

Bill Graves, Governor
Gary Sherrer, Lt. Governor / Secretary

Several questions were raised during the Committee's meeting on January 22 about Low Income Housing Tax Credit projects. Senator Gooch had a concern about the vacancy rate at one of the newer projects in Wichita and asked about occupancy rates in general. While we do not maintain records on average occupancy rates, we do receive periodic reports on occupancy. We also monitor these projects and obtain information on occupancy during these visits. We estimate overall occupancy at about 90 percent, with a few isolated exceptions. Occupancy will also be lower during the initial year or so following completion of new construction, particularly for elderly housing. This circumstance applies to the project Senator Gooch mentioned.

Another question was whether "pre-fab" housing qualified for tax credits and the answer is, "Yes." The regulations stipulate only that the structure must be permanently affixed.

Finally, we were asked for a breakdown of the mix between new construction and rehabilitation. At the present time, about ten percent of tax credits are used on rehabilitation projects. This relatively low allocation to rehabilitation is because we have chosen to allocate annually between \$20 to \$30 million in private activity bond authority to finance residential rehabilitation projects. The combination of tax credits and tax-free bond financing gives appropriate focus to the rehabilitation needs.

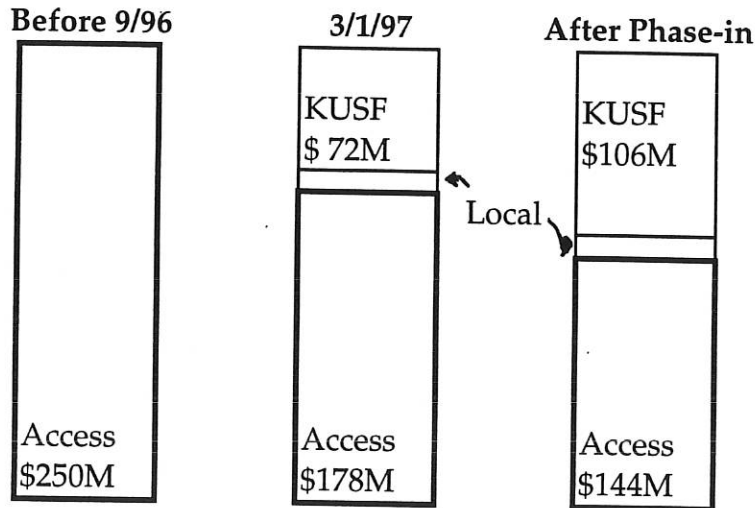
I hope this answers your questions. Please feel free to call our Director of Housing, Randy Speaker (296-2954) if you would like additional details.

Senate Commerce Committee

Date 2-3-98

Attachment # 1

Description of the Access Reduction



PROCESS: The Intrastate Access rates are being reduced and the amount of the reduction is being made up by local service increases and KUSF support payments.

Access Revenue is for 12 months ending 9/96 and includes a comparable amount of access for SWBT's intraLATA long distance.

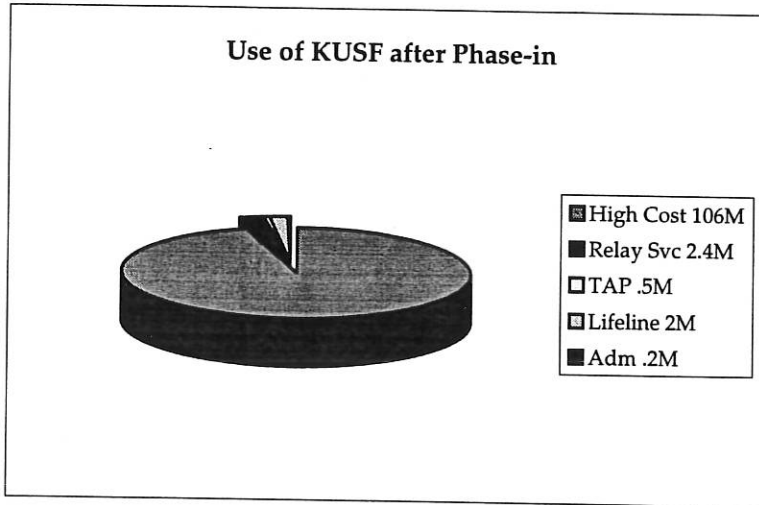
Local is the amount access shifted to local to reach the statewide rural company average
This is \$.5M in 1997 and \$1.1M after the phase-in.

Senate Commerce Committee

Date 2-3-98

Attachment # 2-1 thru 2-6

Sizing of the KUSF



In addition to High Cost support, the Kansas Universal Service Fund will provide for the Kansas Relay Services, Telecommunications Access Program for terminal equipment, Lifeline for low income, and Administration.

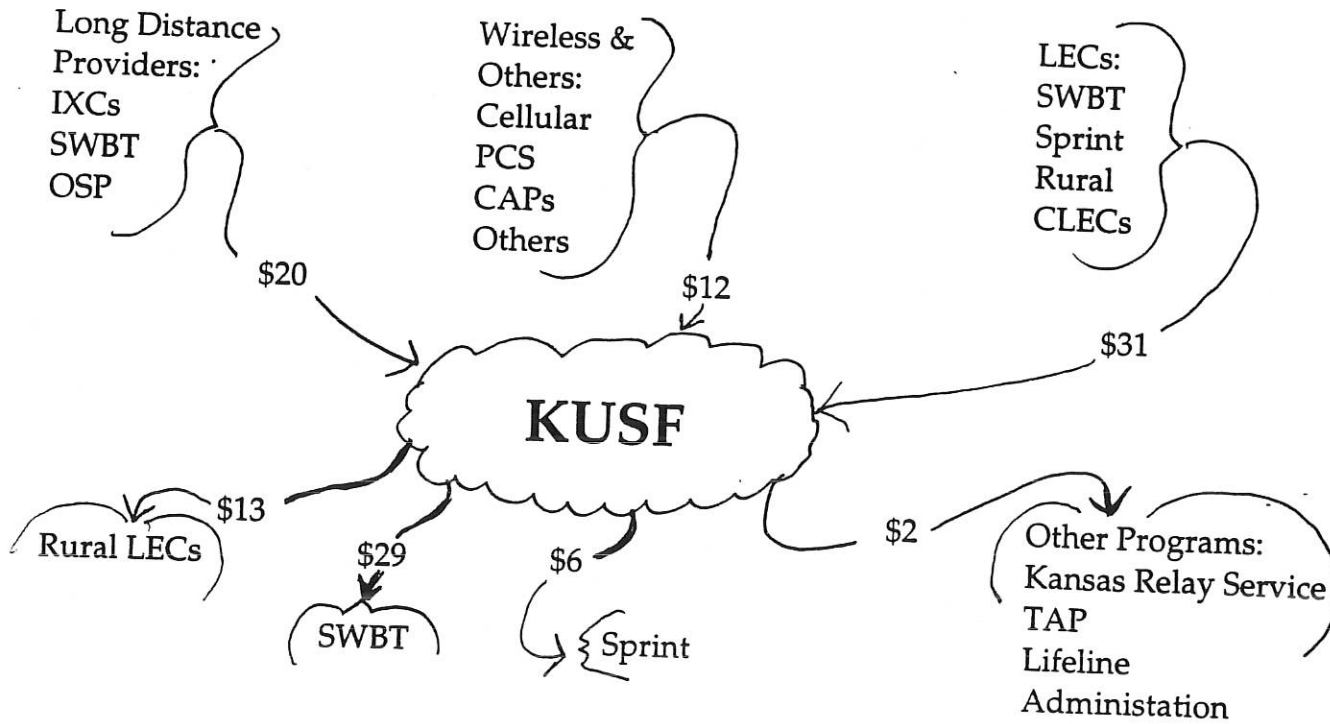
This is the size of the KUSF based on conditions in 1996. Increases to the fund may result from additional investments for universal services, or enhanced universal services, loss of funding from Federal support programs, and from redetermination of the fund as a result of further access reductions due to lower interstate access rates.

Reductions to the fund could occur if other sources to cover the access reduction are used, such as a local rate increase. If a review of the costs for providing local service is undertaken, then the level of support could be reduced.

Flowchart of KUSF Receipts and Payouts

Amounts shown are for 9 months (Mar-Nov 97)

Amounts are in Millions



Amount Collected	\$63
Amount Paid Out	<u>\$50</u>
Reserve (see notes)	\$13

Notes:

The Reserve will reduce the 1998 assessment percent. The 1997 assessment percent is 9%.

More access reductions are scheduled for 1998. These can be completed, and the assessment percent remain at or below 9%.

Amounts shown exclude any estimate for those who are delinquent. This is a significant amount for the wireless providers.

Amounts paid to the LECs are the gross amounts. Information about net payments has also been furnished to Legislative Research.

NET SUPPORT DETERMINATION FOR COMPANIES WHO ARE RECEIVING SUPPORT

9 Months Mar - Nov 97

		<u>Paid into KUSF</u>	<u>Support Received</u>	<u>Net Support after Long Dist*</u>	
Cooperatives	Co-Op	604,481	6,444,214	5,839,733	5,803,509
Private Corp	Pvt Corp	259,371	3,017,753	2,758,382	2,758,382
Private Holding Cos.	Holding	157,173	2,930,637	2,773,464	2,768,715
SWBT & Sprint	Public	29,608,074	35,537,983	5,929,909	(2,893,307)
		30,629,099	47,930,587	17,301,488	8,437,299

* This recognizes the additional KUSF support paid for long distance service for those LECs that provide long distance

Local Rates 1_98

Local Rates 1/98

State of Kansas

Revised 2/3/98

Local Service Rates for ILEC's Sorted by Business Rate

Uses composite/average rates
where necessary

Jan, 1998

COMPANY	LOCAL RATE		Range of Rates (R=Residence, B=Business)
	RESIDENCE	BUSINESS	
Blue Valley	6.94	9.25	
Columbus	4.50	6.00	
Council Grove	6.30	9.80	
Craw-Kan	7.50	11.00	
Cunningham	7.25	11.40	
Elkhart	10.10	16.30	
Golden Belt	7.40	10.54	
Gorham	6.80	10.45	
H&B Comm.	5.80	8.30	
Haviland	5.70	8.70	
Home	7.61	7.79	R6.94-9.29,B7.19-9.29
JBN	10.09	15.23	R9.42-10.78,B14.21-16.26
KanOkla	7.35	10.50	R6.94-7.75,B10.25-10.75
LaHarpe	6.94	10.00	
Madison	7.90	12.70	
MoKan	6.94	10.54	
Moundridge	7.20	10.95	
Mutual	8.20	11.50	
Peoples	9.15	13.05	
Pioneer	4.92	7.77	
Rainbow	7.80	11.85	R7.50-8.30,B11.45-12.25
Rural	6.95	10.54	
S&A	7.95	10.23	R6.94-8.95,B8.05-12.40
S&T	11.60	18.60	
So. Central-Kiowa	11.59	20.00	
South Central	6.30	10.00	
Southern KS	6.94	9.95	
Sunflower	6.72	11.00	R6.50-6.94,B10-12
Totah	7.25	10.54	
Tri-County	7.20	11.93	R6.94-7.40,B11.65-12.15
Twin Valley	7.85	10.85	
United Tele. Assoc.	5.50	10.50	
Wamego	8.10	12.00	
Wheat State	8.85	13.50	
Wilson	7.00	11.25	
Zenda	8.85	11.35	
ILEC Average Used as Statewide Avg for Legislation	6.94	10.54	
Sprint Average	9.40	15.36	R6.35-14.69,B9.33-25.23
SWBT Average	11.16	23.89	R8.95-12.05,B13.80-28.95

In addition to above charges:

Customers pay:	RESIDENCE	BUSINESS
Interstate Access Charge	3.50	6.00-9.00
KUSF Assessment	1.35-2.00	1.35-2.00
Vertical Svcs(call waiting etc) and Long Distance.		

Sprint and SWBT Local Rates by Rate Group

Sprint Telephone Company Local Rates (selected examples)

Residence	E-Untd	United	A-South Cen	A-Eastern*	A-Southeast*
1- 1-500	6.90	6.35	10.99	10.99	10.91
2- 501-1000	6.95	6.44	11.58	11.58	11.62
3-1001-2000	7.05	6.54	12.16	12.16	12.28
4-2001-4000	7.20	6.69	12.52	12.52	
5-4001-8000	7.50	6.99	13.11	13.11	
6-8001-16000	7.65	7.14			
Metro >50000				14.69	
Business					
1- 1-500	9.84	9.33	18.97	18.97	20.02
2- 501-1000	10.14	9.63	20.00	20.00	21.43
3-1001-2000	10.64	10.13	21.08	21.08	22.48
4-2001-4000	11.29	10.78	22.16	22.16	
5-4001-8000	12.19	11.68	23.25	23.25	
6-8001-16000	13.29	12.78			
Metro >50000				25.23	

* Number of Lines in each rate group are different

SWBT**	Rate Groups	Residence	Business	Multiline
0-499	1	8.95	13.80	15.15
500-1799	2	9.40	15.05	16.55
1800-5999	3	9.80	16.80	18.60
6000-15999	4	10.05	18.55	20.60
16000-99999	5	10.70	21.00	23.40
100000-229999 Topeka	6	11.00	22.00	24.55
230000-549999 Wichita	7	11.25	23.75	26.60
> 550000 Kansas City	8	12.05	25.80	28.95

Publicly used Rate by SWBT	11.16		
Estimated Rates for Business		23.89	26.81

** Local rates for extended area service is higher and are not shown in the table.

STATE OF KANSAS



DIVISION OF THE BUDGET
Room 152-E
State Capitol Building
Topeka, Kansas 66612-1575
(785) 296-2436
FAX (785) 296-0231

Bill Graves
Governor

Gloria M. Timmer
Director

February 2, 1998

The Honorable Alicia Salisbury, Chairperson
Senate Committee on Commerce
Statehouse, Room 120-S
Topeka, Kansas 66612

Dear Senator Salisbury:

SUBJECT: Fiscal Note for SB 487 by Senate Committee on Commerce

In accordance with KSA 75-3715a, the following fiscal note concerning SB 487 is respectfully submitted to your committee.

SB 487 amends current law related to state investments in Kansas Venture Capital, Inc. and tax credits related to investment in venture capital funds in Kansas. Current law authorizes the Pooled Money Investment Board (PMIB) to match private investment in Kansas Venture Capital, Inc., up to \$10.0 million dollars. SB 487 would disallow any further investment by PMIB in Kansas Venture Capital, Inc. Further, the bill would mandate that PMIB's stock in Kansas Venture Capital, Inc. be sold for \$5.0 million. The proceeds from the sale of PMIB's stock in Kansas Venture Capital, Inc. would be deposited in the state treasury and credited to the Public Water Supply Loan Fund. Since the PMIB presently holds stock in Kansas Venture Capital, Inc., current statute disallows out-of-state investment by Kansas Venture Capital, Inc. SB 487 would remove this restriction following sale of the PMIB's stock.

Current law provides tax credits of up to \$2.6 million dollars for taxpayers who invest in the state's technology-based venture capital company (Sunflower Technology Ventures, Inc.). This bill would eliminate such tax credits and use the funding to provide credits for the investor who purchases the state's stock in Kansas Venture Capital, Inc.

Senate Commerce Committee

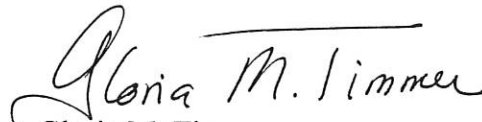
Date 2-3-98

Attachment # 3-1 thru 3-2

The Honorable Alicia Salisbury, Chairperson
February 2, 1998
Page 2

Neither the Kansas Technology Enterprise Corporation nor the Pooled Money Investment Board indicate that SB 487 would have any fiscal or operational impact. The tax credits which would be offered through this bill have been funded previously, and would have a neutral impact upon state revenues. Finally, the bill would transfer \$5.0 million of the state's investment in Kansas Venture Capital, Inc. to the state treasury, which is also a revenue neutral transaction.

Sincerely,

A handwritten signature in cursive script that reads "Gloria M. Timmer". The signature is written in dark ink and is positioned above the printed name and title.

Gloria M. Timmer
Director of the Budget

cc: Diane Gates, Pooled Money Investment Board
Sherry Brown, Commerce & Housing
Lori Rost, KTEC



ALICIA L. SALISBURY

VICE PRESIDENT • KANSAS SENATE

STATE CAPITOL, 120-S

TOPEKA, KANSAS 66612-1504

(785) 296-7374 • asalisbu@ink.org

<http://skyways.lib.ks.us/kansas/salisbury>

it has no storage facility or shipping casks, but it did suggest that a potentially adequate remedy might exist. Whether that will include a financial settlement to the utilities and

lated in the Nuclear Waste Fund; approximately half has been spent on the repository program and the remainder is held in the U.S. Treasury to offset the federal deficit.

money would be from the Nuclear or general revenue until later in 1998. the Nuclear Energy interest group for ies), \$13 billion in interest have accumu-

Federal Court Struggles With Telecommunications Act

State regulatory commissions will be busy this winter overseeing plans to govern local telephone competition, following a federal court decision issued last summer.

The three-judge panel of the U.S. Appeals Court for the 8th Circuit in St. Louis, Mo., ruled that the Federal Communications Commission (FCC) did not have jurisdiction to issue pricing rules that preempted state regulations. The court criticized the FCC for trampling states' rights in order to implement the Telecommunications Act of 1996.

The act requires local telephone companies to open their markets to competitors. Following its passage on Feb. 8, 1996, the FCC issued rules regulating what local telephone companies could charge their competitors for the use of their networks. Long distance competitors have stated that it is too costly to get into the \$100 billion per year local telephone market and invest in their own infrastructure. Instead, they have relied upon access to competitors' existing networks. The cost for this access has historically been

determined by the states with guidelines issued by the state regulatory commissions.

The court's ruling was initiated by several lawsuits that were filed around the country in 1996 by the National Association of Regulatory Commissioners, a number of state regulatory boards, GTE Corporation, Southern New England Telephone Company and the United States Telephone Association. The plaintiffs argued that the FCC exceeded its authority.

Experts claim that the decision permits state interconnection rules, established by state utility commissions, to remain in effect, and it permits other states to create their own rules. According to some industry analysts, the court's decision may cause delays in implementation of sections of the Telecommunications Act of 1996 and may delay true competition within the telecommunications market. The four recently confirmed members of the FCC will decide whether or not to appeal the decision to the U.S. Supreme Court.

Senate Commerce Committee

Date 2-3-98

Attachment # 4

REMAINING INVESTMENT CAPACITY IN STATEWIDE RISK CAPITAL SYSTEM

	<u>CAPACITY</u>	<u>CREDIT</u>
KVCI	\$3,417,109	\$ 854,277.25
SUNFLOWER	\$8,607,582	\$2,151,895.50
PRIVATE	\$ 552,110	\$ 138,027.50
TOTAL	\$12,576,801	\$3,144,200.25
PUBLIC TOTAL	\$12,024,691	\$3,006,172.75
KVCI/KTEC SPLIT	\$6,012,345.50	\$1,503,086.38
KVCI SHARE OF KTEC CREDITS	\$2,595,236	\$648,809

Senate Commerce Committee

Date 2-3-98

Attachment # 5

STATE OF KANSAS

BILL GRAVES, Governor
State Capitol, 2nd Floor
Topeka, Kansas 66612-1590



(785) 296-3232
1-800-748-4408
FAX: (785) 296-7973

OFFICE OF THE GOVERNOR

LEGISLATIVE TESTIMONY

TO: Senate Committee on Commerce
FROM: Dan Hermes, ^{Dan} Director of Governmental Affairs
DATE: February 3, 1998
BILL: SB 487 -- Privatization of Kansas Venture Capital, Inc.

Madam Chairman and members of the committee, thank you for the opportunity to appear this morning on behalf of the Governor in support for SB 487.

The bill has three main components:

- Provide a mechanism for Kansas Venture Capital, Inc. (KVC) to return the \$5.0 million provided to KVC by the state
- Extend unused tax credits of \$1.4 million for future investments in KVC
- Credit the repayment of the \$5.0 million to the Kansas Public Water Supply Loan Fund

With the indulgence of the committee, I will turn over explanation of the details of the bill to Tom Blackburn for the portions related to KVC and Jamie Clover-Adams of my staff for some specifics about the public water supply loan fund.

Before doing that, I think it is important to highlight KVC's success for a moment. The state has a myriad of economic development programs to assist in job creation in our state. The majority of these programs are expenditures. This is a rare instance where the state has benefited from creation or retention of more than 2,850, can expect continued job creation in the future and will have the funds provided by the state to the program returned.

With that, I will turn it over to Tom and Jamie and would be happy to stand for questions at the conclusion of the testimony.

Senate Commerce Committee

Date 2-3-98

Attachment # 6



Kansas Venture Capital, Inc.

TESTIMONY

Senate Bill No. 487

**Senate
Committee On Commerce**

February 3, 1998

By: Tom Blackburn
Executive Vice President

Senate Commerce Committee

Date *2-3-98*

Attachment #*7, thru 17-31*

KVCI Testimony

Senate Bill No. 487

Introduction

Introduction of colleagues.

Summary of handouts.

Outline of KVCI Testimony

Selected Financial Data and Financial Disclosures (Exhibit A)

Fourth Quarter Shareholders Report (Exhibit B)

Company Overview (Exhibit C)

Request that a copy of the handouts be made a part of the record.

Bill Provisions

- Eliminates the state's additional \$5.0 million investment commitment to KVCI (contingent liability).
- Provides a means for the repayment of the state's existing preferred stock investment.
 - KVCI would have the opportunity to redeem the state's 500,000 shares of preferred stock for \$5.0 million (\$10.00 per share). The \$10.00 per share price is the same price as the state's original cost.
 - The redemption could occur in installments on or before July 1, 2003 as the KVCI Board deems appropriate.
- Provides for sunset of KVCI statutes upon full redemption of state's preferred stock investment.
- Re-authorizes up to \$1.5 million in unused venture capital tax credits to encourage the private sector to make new investments in KVCI. These tax credits could only be used pursuant to existing Kansas Venture Capital Company Act statutes.
- Proceeds from KVCI redemptions would be earmarked for the public water supply loan fund.

Public Policy Objectives

- The provisions of SB487 are consistent with the public policy position of eliminating direct public funding of venture capital companies - a position supported by many legislators, the administration, public policy advisors and many in the private sector.
- The provisions of SB487 are consistent with the public policy position of maintaining current initiatives (such as KVCI) and providing incentives for private sector venture capital investments in Kansas companies - positions supported by many who favor eliminating direct public funding and other public and private sector participants who support the current initiatives (such as KVCI).

KVCI Objectives

- The KVCI Board developed a privatization plan primarily in response to the following:
 - 1) Public policy concerns raised by legislative and administration officials over the compatibility of public funding of venture capital companies.
 - 2) Market concerns as a result of negative publicity.
- A financial feasibility model was developed to determine a financial scenario that could accommodate the following:
 - 1) Retirement of the state's entire \$5.0 million preferred stock investment.
 - 2) Preservation of KVCI's ongoing operations and new investment activity.
- The KVCI Board approved plan projects a redemption of \$1.0 million per year over five years, while preserving ongoing operations and new investment activity.
- The provisions of SB487 are within the parameters established pursuant to the privatization plan approved by the KVCI Board.

Benefits to the state

The primary benefits to the state of the proposed legislation are as follows:

- 1) The state would be repaid the \$5.0 million invested in KVCI, in addition to the economic development returns and dividends received to date. This represents a 100% return of the state's original preferred stock investment in KVCI - a financial result unmatched by most, if not all, other state economic development programs.
- 2) The state's additional \$5.0 million investment commitment to KVCI would sunset. This would keep the state from getting more involved in the direct funding of venture capital - a public policy that has lost favor with many in both the public and private sector.
- 3) The reinstatement of unused venture capital tax credits may assist in attracting new private capital to KVCI. Additional private capital could provide the cash resources necessary to allow an accelerated state preferred stock payoff. Additional capital would also allow KVCI to increase investment activity and the related benefits.
- 4) Once KVCI is privatized, the challenging issues related to the appropriate balance between adequate disclosure, accountability, oversight and portfolio company confidentiality would be removed.
- 5) The state would receive additional economic development returns from future investment activity of KVCI in Kansas-based companies in addition to the economic development returns from the ongoing operations of past and present Kansas-based companies assisted by KVCI financing and management assistance.
- 6) The state would receive future economic development returns from infrastructure investments from the public water supply loan fund as a result of KVCI repayments and leveraged Federal funds.
- 7) The state would retain a "homegrown" venture capital firm with a continued commitment to Kansas businesses. As a private company, Kansas-based investment activity will likely increase because of an ability to focus full time on investing, an increased risk appetite, a broader investment authority and an enhanced market perception.
- 8) The state would have an economic development success story to celebrate with a negative cost (positive return) to Kansas taxpayers. KVCI's track record detailed in Company Overview (Exhibit C) of the handout.

Financial Feasibility

- KVCII anticipates funding the state redemption through a combination future return of capital and realized gains on KVCII portfolio investments.
- The timing and amount of future realized capital gains ultimately determine the financial feasibility and timing of the state preferred stock redemptions.
- Prospects are favorable for significant portfolio repayments and realized capital gains over the next two years.
- Based on current market conditions, portfolio fundamentals and projected exits, 1998 will likely be a record year for KVCII.
- Based on the current financial feasibility model, a repayment schedule of \$1.0 million per year for five years is achievable.
- Portfolio performance significantly less than projected may not prudently support a \$1.0 million per year redemption. Conversely, performance superior to projection may permit an acceleration of the projected redemption.
- While there is no assurance of future portfolio company performance, KVCII management believes that performance will exceed projections and financial resources will be sufficient to complete the projected redemption on schedule.
- Selected historical and projected financial data is presented in more detail in Exhibits A and B of the handout.

Summary

- Providing incentives for continued private sector venture capital investment in Kansas are important.
- Initiatives to preserve and privatize the current state-sponsored venture capital funds such as Kansas Venture Capital, Inc. are good public policy.
- KVCII has been an economic development success story and remains the primary conduit for importing institutional venture capital to Kansas-based small businesses.
- SB487 provides KVCII with the necessary flexibility and affordable repayment terms to preserve continued operations and new investment activity.
- The Board of Directors of KVCII supports SB487 without reservation.

Stand for questions

EXHIBIT A

Financial Data and Disclosures

Kansas Venture Capital, Inc.

Selected Historical and Projected Financial Data

7-6

	----- Audited -----									Preliminary	----- Projected ⁽¹⁾ -----					
	1988	1989	1990	1991	1992	1993	1994	1995	1996		1997	<u>Mgmt. Case</u>	<u>Best Case</u>	<u>Management Case</u>		
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1998	1999	2000	2001	2002
Net Income	\$148,170	\$172,270	\$(859,880)	\$421,845	\$50,164	\$1,474,945	\$(588,131)	\$215,518	\$219,235	\$(683,327)	\$1,984,108	\$2,921,608	\$529,242	\$(7,924)	\$375,660	\$(335,255)
Net Income/Share	\$0.13	\$1.40	\$(0.74)	\$0.36	\$0.04	\$1.27	\$(0.51)	\$0.19	\$0.19	\$(0.59)	\$1.71	\$2.52	\$0.46	\$(0.01)	\$0.32	\$(0.29)
Book Value ⁽²⁾	\$8,781,579	\$9,970,148	\$11,590,950	\$11,438,519	\$11,671,972	\$13,222,866	\$13,431,120	\$13,458,553	\$14,140,515	\$13,911,520	\$15,875,969	\$16,813,469	\$16,880,211	\$17,422,287	\$18,122,947	\$18,256,691
Book Value/Share	\$9.91	\$10.44	\$10.01	\$9.88	\$10.08	\$11.42	\$11.60	\$11.62	\$12.20	\$12.01	\$13.71	\$14.52	\$14.57	\$15.04	\$15.65	\$15.76
Dividends Paid ⁽³⁾																
Preferred Stock			\$21,675				\$ 50,000						(3)	(3)		(3)
Common Stock			<u>26,063</u>				<u>65,828</u>									
Total			\$47,738				\$115,828									
Per Share			\$ 0.05				\$0.10									

Notes and Disclosures:

⁽¹⁾ The 1998-2002 projections were prepared by KVC I management for the purpose of determining the financial feasibility of a proposed redemption of the state's preferred stock. The company's business is highly volatile and these forecasts are necessarily subject to a high degree of uncertainty. KVC I makes no express or implied representation or warranty as to the accuracy, completeness or attainability of the projections or the assumptions from which they were derived.

1998 Projection: Both projected scenarios for 1998 anticipate the realization of significant capital gains and some realized loss during the year on portfolio company investments. Both cases would result in net realized capital gains in excess of capital gains realized in any prior year.

Management Case: Based on financial model utilized by management and KVC I Board of Directors in determining the financial feasibility of the preferred stock redemption proposal.

Best Case: Best Case scenario anticipates net realized gains to KVC I at the upper end of achievable range on portfolio company investments for the year.

⁽²⁾ Book value includes common stock, preferred stock, retained earnings and net unrealized appreciation of investments.

⁽³⁾ Based on past history, if such results were achieved, the KVC I Board of Directors might declare a modest dividend in the following year.

Per share amounts calculated based on common shares outstanding and preferred stock "as if" converted to common stock.

7-6

FINANCIAL DISCLOSURES

Historical Financial Information

- Based on KVCII December 31, 1997 unaudited financial statements, the book value of the state's KVCII preferred stock was \$12.01 per share (\$6.0 million). The original cost of the state preferred stock was \$10.00 per share (\$5.0 million). This represents book value growth of \$2.01 per share (\$1.0 million).
- Since 1988, the state has received a total of \$71,675 in dividends on its preferred stock investment.
- The total return on the state's preferred stock (compound annual growth rate of book value plus dividends) for the 10 year period ending December 31, 1997 has been slightly less than 2.0% per year.
- The PMIB has foregone an estimated \$3.7 million in interest on funds used to purchase the state's preferred stock investment. (based on historical average annual PMIB returns through December 31, 1997)
- Historical financial statements are audited for each year through December 31, 1996 and unaudited for the year ended December 31, 1997.

Projected Financial Information (assumes no state redemption)

- Assuming a historical (2%) total return, the book value of the state preferred stock would be \$13.00 per share (\$6.5 million) at December 31, 2002.
- Based on KVCII's financial feasibility model, the book value of the state preferred stock is projected to be \$15.76 per share (\$7.9 million) at December 31, 2002.
- Based on KVCII's financial feasibility model, the book value of the state's preferred stock is projected to be \$13.71 per share (\$6.9 million) at December 31, 1998. This projection is based primarily on assumed net income of \$2.0 million or \$1.71 per share for 1998.

FINANCIAL DISCLOSURES (continued)

Projected Financial Information (continued)

- Recent developments concerning its portfolio investments indicate that KVCII's financial feasibility model may be conservative. KVCII management now believes that net income may be as high as \$3.0 million based on realized capital gains in excess of that projected in the financial feasibility model. Under such a scenario, the book value of the state's preferred stock could be as high as \$14.52 per share (\$7.3 million) at December 31, 1998, and could approach \$16.85 per share (\$8.4 million) at December 31, 2002.
- While there is no requirement to pay dividends to stockholders, past history would suggest a modest dividend might be declared by the KVCII Board in 1999 in the event of performance that equals or exceeds the financial feasibility model.
- The 1998-2002 projections were prepared by KVCII management for the purpose of determining the financial feasibility of a redemption of the state's preferred stock. The company's business is highly volatile and these forecasts are necessarily subject to a high degree of uncertainty. KVCII makes no express or implied representation or warranty as to the accuracy, completeness or attainability of the projections or the assumptions from which they were derived.

Other Considerations

- There is currently no public market available to provide liquidity for KVCII common or preferred stockholders. KVCII has been made aware of past private market transactions involving KVCII common stock.
- Dividend and capital distributions to KVCII common and preferred stockholders are restricted pursuant to Federal SBIC regulations.
- Due to the highly speculative nature of projecting KVCII's future performance, no prediction can be made as to the timing or amount of dividends paid with respect to the preferred stock or the amount of realizable distributions with respect to the preferred stock if KVCII were ever liquidated.

PRIVATIZATION FINANCIAL CONSIDERATIONS

The KVCI Board has evaluated the feasibility of privatization in response public policy concerns raised by legislative officials, the administration and others over the compatibility of the public funding of venture capital companies and market concerns related to negative publicity of such public policy. Based on the analysis, a plan to privatize KVCI over time and maintain ongoing operations and new investment activity has been developed.

- The key assumptions in the financial feasibility model are as follows:
 - 1) KVCI would continue to operate at investment activity levels slightly above historical levels and generate portfolio returns consistent with historical levels with the exception of an expectation of 1998 performance superior to historical levels.
 - 2) KVCI may not be successful in raising additional new capital.
- Based on the above assumptions and KVCI's current and projected financial conditions, the plan projects that at a price of \$5.0 million, payable at \$1.0 million per year for five years, privatization is financially feasible. This represents a 100% return of the original cost of the state preferred stock.
- KVCI will rely exclusively on future repayments and realized capital gains from portfolio company investments to fund ongoing operations and redeem the state preferred stock investment over the five year period.
- If the State elects to have its preferred stock redeemed, its equity interest in KVCI represented by such redeemed shares of preferred stock will terminate. No prediction can be made as to the timing or amount of dividends paid with respect to the preferred stock or the amount of realizable distributions with respect to the preferred stock if KVCI were ever liquidated. Accordingly, no forecast can be made as to the return the state would receive if it continued to hold its interest in KVCI.

EXHIBIT B

Quarterly Shareholder's Report

Kansas Venture Capital, Inc.

January 23, 1998

**To: SHAREHOLDERS
of Kansas Venture Capital, Inc.**

Fourth Quarter Shareholders' Report - December 31, 1997

Financial Condition

Kansas Venture Capital, Inc. reported an unaudited \$683,327 net loss for the year ended December 31, 1997 compared to \$219,235 net income for 1996. The Company's unaudited stockholders' equity at December 31, 1997 stood at \$13.9 million or \$12.01 per share versus \$12.20 per share at December 31, 1996. KVC's book value at December 31, 1997 remains above the original \$10.00 per share cost basis of our shareholders, particularly shareholders that used the 25% state tax credits.

Contributing to the loss for the year was a \$1,657,000 write off of one troubled investment. This loss, however, was partially offset by \$871,000 of capital gain income realized during the year from the sale of equity securities of two successful portfolio investments.

We consider the write off of any investment disappointing and unacceptable, but recognize and anticipate that KVC, like other small business investment companies, will incur losses on investments from time to time. Our strong capital base, however, gives us the ability to withstand occasional losses while continuing to make investments that we believe will generate capital gains similar to those we have experienced in the past. In addition, we have made several improvements in our investment process and monitoring activities that we believe will improve our future performance.

Overall, we believe that KVC's portfolio of thirteen Kansas-based businesses is in healthy condition and expect to realize net capital gains from the portfolio in 1998. Three companies currently performing below expectation are being monitored closely and have been valued accordingly. Most of our investments, however, are meeting or exceeding our expectations. We will continue to concentrate on balancing our dual objectives of economic development and return on investment while increasing our portfolio of Kansas-based businesses.

Our annual report, to be distributed in March, will detail 1997 results and highlight KVC's positive impact on the Kansas economy.

Investment Activity

KVCI invested \$1.4 million in Kansas-based companies during 1997. We expect 1998 to be a more active investment year and, in fact, our first investment for 1998 was completed on January 6th. KVCI was one of three institutional investors participating in the acquisition and expansion of a flexible packaging manufacturer in Kansas City, Kansas.

Since 1987, KVCI has invested more than \$19 million throughout Kansas. We look forward to the redeployment of our capital into other Kansas-based businesses in our continuing effort to accomplish our objectives.

Portfolio Company Highlight

Transline Communications, Inc.
Prairie Village, Kansas

On November 14, 1997, KVCI completed an investment in Transline Communications, Inc. ("TCI"). TCI provides specialized, international long distance services to financial companies. From its primary office in Prairie Village, Kansas, TCI sells voice and data circuits and private networks to brokerage and trading companies with multinational operations. Proceeds of KVCI's investment are being used to add personnel, purchase equipment and additional transatlantic bandwidth and for working capital to expand the company's network capabilities and customer base.

We are excited to add an investment in our portfolio in the rapidly growing telecommunications field and look forward to the continued success of TCI in its specialized niche of this global industry.

Economic Development

We continue to play a meaningful role in the economic development efforts of Kansas. Since 1987, KVCI has invested in 24 companies located in 13 counties throughout the state of Kansas. These companies have created and preserved more than 2,800 jobs, over 35% of which are a result of investments in businesses located in Kansas communities less than 15,000 in population. Cumulative payrolls in excess of \$310 million and state and local taxes exceeding \$9 million have been paid by these companies since our involvement.

**Proposed Redemption
of the State of Kansas' Preferred Stock Investment in KVC**

The controversy over the role of state government in seed and venture capital escalated throughout the 1997 legislative interim hearings. The Joint Committee on Economic Development recently conducted public hearings concerning the compatibility of public funds and venture capital. We have been closely monitoring the legislative proceedings and have had many discussions since mid 1997 with members of the state legislature and administration, KVC stockholders and the Kansas Bankers Association regarding the impact on KVC of the current public policy concerns.

In response to these recent events and the current negative environment concerning the direct investment of state funds in seed and venture capital companies, KVC management and Board of Directors are pursuing a course of action to redeem the state's preferred stock and privatize the operations of KVC. Many members of the Kansas legislature and the administration support the privatization proposal and the Kansas Bankers Association has adopted a resolution supporting KVC's privatization effort. The Board of Directors of KVC also adopted a resolution to facilitate the privatization proposal with the state. We believe that such a move will best serve the interests of all stockholders, common and preferred. We expect legislation will be passed during the 1998 session that will define the terms and conditions of the redemption. We will keep our stockholders informed of significant events relating to this transition.

Referrals

We appreciate the referrals that our shareholders have provided us and hope you will continue to contact us with potential investment opportunities or concerning equity financing activities in general. As you know, we rely heavily on a broad referral network and we encourage your assistance in that regard. Thank you for your continued support of KVC. Please feel free to contact me or any of our officers or directors with any questions you may have concerning your company.

**John S. Dalton
President**

EXHIBIT C

KVCI Overview



Kansas Venture Capital, Inc.

COMPANY OVERVIEW

February 1998



Kansas Venture Capital, Inc.

MISSION

Operating Mission

“To provide equity capital, loans and management assistance to Kansas-based small businesses having potential for significant growth and long-term equity appreciation.”

Operating Goals

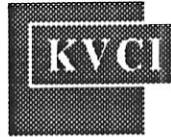
- Build long-term shareholder value
- Enhance the Kansas economy
- Establish a self-sustaining entity
- Largest and most active Kansas-based venture fund



Kansas Venture Capital, Inc.

HISTORY

- 1976** - KVCII incorporated as a private, for-profit licensed Small Business Investment Company (SBIC). Initially, KVCII existed as a subsidiary company of the Kansas Development Credit Corporation (KDCC).
- 1987** - KVCII restructured subsequent to 1986 risk capital formation initiatives passed by the Kansas Legislature.
- 1988** - KVCII raised private capital of \$4.3 million through the efforts of the Kansas Bankers Association (KBA).
- 1988** - KVCII received initial State of Kansas preferred stock investment of \$4.3 million from the Pooled Money Investment Board (PMIB) pursuant to the Kansas Statewide Risk Capital Act (KSRCA).
- 1990** - KVCII raised additional private capital of \$2.3 million and received additional preferred stock investment from the PMIB of \$700,000 pursuant to KSRCA statutes.
- 1992** - KVCII surpassed the 75% investment activity requirement established by the Kansas Venture Capital Company Act (KVCCA), well ahead of statutory guidelines.
- 1994** - KVCII recognized by the Inspector General of the SBA as one of nine SBICs nationally in a "Best Business Practices" report.



Kansas Venture Capital, Inc.

MANAGEMENT TEAM

Executive Management

John S. Dalton, President

Thomas C. Blackburn, Executive Vice President

Marshall D. Parker, Executive Vice President

Collective Credentials:

- Over 45 years of investment industry experience
- Over 30 years of venture capital and investment banking experience
- Kansas natives with a wealth of Kansas business community and civic relationships
- Served on or continue to serve on the Board of Directors of over 20 private and two public companies in varied industries
- Directly involved in the closing of over 50 venture capital or corporate finance transactions

Staff

Carole J. Ladish, Corporate Secretary and Office Manager

Ellyn M. Tyrell, Treasurer and Assistant Secretary



Kansas Venture Capital, Inc.

BOARD OF DIRECTORS

H. James Bartels, Chairman,
Commerce Bank
Hays, Kansas

Terry C. Matlack
Private Investor
Shawnee, Kansas

John S. Dalton, President
Kansas Venture Capital, Inc.
Overland Park, Kansas

Michael J. Meyer, Managing Dir.
Holden Capital Advisors, LLC
Prairie Village, Kansas

R.A. Edwards, President
First National Bank
Hutchinson, Kansas

Derek L. Park, President
P.M.S. Foods
Hutchinson, Kansas

Gordon W. Elliott
Private Investments
Pittsburg, Kansas

Reed A. Peters, Chairman
The First State Bank and Trust
Larned, Kansas

John R. Elmore, President
Mercantile Bank of Lawrence
Lawrence, Kansas

Paul D. Stephenson, Exec. V-P
NationsBank, N.A.
Wichita, Kansas

Donald R. Landoll, Chairman
Landoll Corporation
Marysville, Kansas

John C. Taylor, President
Deines Manufacturing Corp.
Ransom, Kansas

John J. Luerding, Sr. V-P
Intrust Bank, N.A.
Wichita, Kansas

Wendell L. Wilkinson, Chairman
City National Bank
Pittsburg, Kansas



Kansas Venture Capital, Inc.

OPERATING STRATEGY

Financing Provided To Kansas-Based Businesses

- Flexible, equity oriented investment structures
- Intermediate investment time horizon
- Unsecured loans and equity securities
- Risk adjusted pricing

Diversified Investment Profile

- Company type
 - Predominantly manufacturing
 - Selected construction, service, retail and distribution
- Company revenue size at initial investment
 - Start-up to \$30 plus million
 - Predominately \$2.0 million to \$10 million
- Company stages
 - Higher risk profile: early stage, turnarounds
 - Lower risk profile: expansions, acquisitions
- Co-investment with other regional or national venture capital firms on large or specialized transactions
 - Risk diversification
 - Specialized expertise
 - Financial leverage

Balanced Investment Philosophy

Value Added Management Assistance



Kansas Venture Capital, Inc.

CAPITALIZATION

December 31, 1997 Capitalization

Common stock	\$ 6,582,791
Preferred stock	5,000,000
Retained earnings	141,070
Net unrealized appreciation	<u>2,187,659</u>
Total Equity	13,911,520

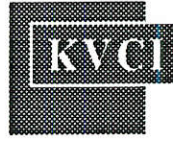
Stockholder Profile

- Common stockholder profile:
Approximately 350 strong as of December 31, 1996. Originally, 100% of the common stock owned by Kansas-based financial institutions, corporations or individuals. Currently, over 40% of the common stock owned by non Kansas-based financial institutions.
- Preferred stockholder:
The State of Kansas through the PMIB investments.

Book Value Per Share - \$12.01

Note: The State of Kansas' \$5.0 million of Preferred Stock was protected by \$13.9 million in equity reserves.

(Based on the December 31, 1997 balance sheet - subject to year-end audit verification)



Kansas Venture Capital, Inc.

OVERSIGHT AND REPORTING

General Corporate Governance

- Kansas General Corporate Code
- Kansas Statewide Risk Capital Act (KSRCA)
- Kansas Venture Capital Company Act (KVCCA)
- Federal Small Business Investment Company Act (SBIC)

Specific Corporate Reporting and Oversight

- Monthly reporting to Board of Directors
- Quarterly Board of Directors' Meetings
- Annual financial audit by independent accounting firm
- Annual financial report to the Investment Division of the SBA
- Bi-annual audit by the Investment Division of the SBA
- Annual and periodic reporting requirements to the Governor, the Kansas Department of Housing and Commerce, the Joint and Standing Economic Development Committees, the State Treasurer, and Kansas, Inc.
- Annual and Quarterly Shareholders' Report to all common and preferred shareholders

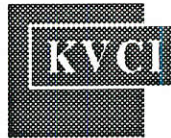


Kansas Venture Capital, Inc.

INVESTMENT ACTIVITY

- \$19.1 million invested (165% of initial capitalization)
- 24 companies in 13 counties throughout the State of Kansas
- 9 companies located in smaller Kansas communities under 15,000 population (35% of dollars invested)
- 5 of 6 regions throughout the State of Kansas

(Based on investment activity through December 31, 1997 - subject to year-end audit verification)

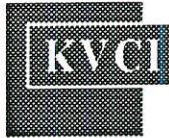


Kansas Venture Capital, Inc.

INVESTMENT PROFILE

<u>PROFILE</u>	<u>BY COMPANY (#)</u>	<u>BY DOLLARS (%)</u>
<i>Sector</i>		
Manufacturing	16	72%
Service	5	11%
Construction	1	6%
Retail/Distribution	2	11%
<i>Company Size</i>		
Start-up to \$2.0 Million	8	27%
\$1.0 to 5.0 Million	5	13%
\$5.0 to 10.0 Million	8	43%
\$10.0 Million or more	3	17%
<i>Company Stage</i>		
Start-up/Early Stage	6	17%
Recapitalization/Turnaround	6	28%
Expansion/Acquisition	12	55%
<i>Community Size</i>		
Population under 15,000	8	39%
Population over 15,000	16	61%

(Based on investment activity through December 31, 1997 - subject to year-end audit verification)



Kansas Venture Capital, Inc.

STATE INVESTMENT IN KVCI

Cost of tax credits (25% of \$6,600,000)	-	\$1,700,000
Opportunity cost for PMIB investment (<i>est.</i>)	-	<u>3,700,000</u>
Total gross cost to state	-	5,400,000
Less:		
State and local taxes paid by portfolio companies	-	<u>(9,000,000)</u>
Net negative cost (positive return) to state⁽²⁾	-	\$3,600,000

(1) assumes \$5.0 million invested at PMIB average annual rate of return through December 31, 1997 less dividends received.

(2) assumes \$5.0 million preferred stock investment as an asset

Ancillary Returns

- Portfolio company trade with other Kansas-based manufacturers and service providers
- Preservation of Kansas-based ownership
- Attraction of additional venture capital from outside Kansas
- Other traditional multiplier effects

(Based on activity through December 31, 1997 - subject to year-end audit verification)



Kansas Venture Capital, Inc.

FINANCIAL LEVERAGING

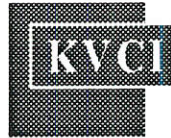
Financial leverage on the State of Kansas' Preferred Stock investment

- \$6.6 million of private-sector common stock
- \$29.4 million of private-sector bank debt
- \$26.6 million of private-sector venture capital
- \$11.0 million of public market equity
- \$1.4 million of CDBG funding

Financial leverage \$75.0 million
 State Preferred Stock investment \$ 5.0 million

**Total financial leverage
 on State Preferred Stock investment15 to 1**

(Based on activity through December 31, 1997 - subject to year-end audit verification)



Kansas Venture Capital, Inc.

ECONOMIC DEVELOPMENT HIGHLIGHTS

Since KVCI's initial investment

- 2,850 jobs created or retained by KVCI portfolio companies (35% with companies located in smaller Kansas communities under 15,000 population)
- \$55.0 million of capital expenditures made by KVCI portfolio companies
- \$310.0 million of cumulative payrolls paid by KVCI portfolio companies
- \$50.0 million of taxes paid by KVCI portfolio companies
- \$9.0 million of state and local taxes paid by KVCI portfolio companies
- \$45.0 million annual payroll run rate of the 14 existing portfolio companies

(Based on activity through December 31, 1997 - subject to year-end audit verification)

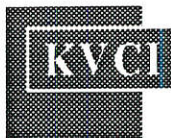


Kansas Venture Capital, Inc.

INVESTMENT IMPACT

- 88% of KVCI portfolio companies increased sales subsequent to initial investment
- 88% of KVCI portfolio companies increased employment subsequent to initial investment
- 100% of KVCI portfolio companies invested in additional capital equipment or facilities subsequent to initial investment
- 83% of KVCI portfolio companies continue as going concerns
- 100% of KVCI portfolio companies leveraged KVCI investments with other private sector financing sources
- Four KVCI portfolio companies have transitioned to the public markets. (2 initial private offerings (IPO), 2 mergers)
- KVCI was the sole or lead investor in 73% of all portfolio company investments

(Based on investment activity through December 31, 1997 - subject to year-end audit verification)

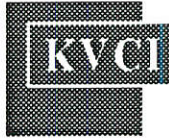


Kansas Venture Capital, Inc.

RESEARCH SURVEY RESULTS

- 100% response rate from 15 companies surveyed in 1995 by Kansas, Inc. pursuant to its "Analysis of Kansas Business Assistance" study
- 80% reported KVCI financing made an "essential or critical contribution" to their business
- 80% reported that their projects would have "stopped or not proceeded" without KVCI assistance
- 73% reported employment growth of 10 or more
- 33% reported employment growth of 50 or more
- 93% reported sales increased of \$100,000 or more
- 67% reported sales increased of \$1.0 million or more
- 33% reported sales increased of \$5.0 million or more
- KVCI had the highest customer satisfaction rating of all programs surveyed (4.67/5.0 - 93%)
- 93% reported they would recommend KVCI to other businesses

(Based on information provided by Kansas, Inc. from independent research conducted by Central Research & Consulting)



Kansas Venture Capital, Inc.

SUMMARY

- KVCI has and will continue to fulfill its mission of building long-term value for our shareholders and enhancing the economy of Kansas
- KVCI's financial condition is sound and our strong management team and Board will ensure that we will remain a self-sustaining entity well into the future
- KVCI's reporting and corporate governance structures provide significant checks and balances at the Federal, State and Board levels to ensure appropriate accountability and oversight
- The cost of the State's investment in KVCI has been negative and portfolio company investments will continue to provide financial returns through increased tax collections well into the future
- The financial leverage exceeding 15 to 1 on the State Preferred Stock investment is significant
- The economic development record is strong and will continue to build as KVCI's capital is redeployed into other Kansas businesses
- The impact on the portfolio companies has been direct and real
- KVCI continues to be focused on growth and is committed to funding future operations with a capital structure that best serves the interests of all stockholders - common and preferred



Kansas Venture Capital, Inc.

A Venture Capital firm dedicated to Kansas-based businesses

Acquisition Financing ♦ Stockholder Liquidity ♦ Expansion Funding
Ownership Transitions ♦ ESOPs
Early-Stage Capital Formation ♦ Turnarounds ♦ Recapitalizations

Recreation Vehicle Products, Inc.
Wichita, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Organized Living, Inc.
Lenexa, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Visual Components, Inc.
Lenexa, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Guidon, Inc.
Paola, Kansas

The undersigned structured a financing package and made a direct investment in the company

Kansas Venture Capital, Inc.

Hancock Electric Motor, Inc.
Lyons, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Plains Plastics, Inc.
McPherson, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Taylor Products Co., Inc.
Parsons, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Tru-Circle Corporation
Wichita, Kansas

The undersigned structured a financing package and made a direct investment in the company

Kansas Venture Capital, Inc.

Central Fiber Corporation
Wellsville, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

CSU Holdings, Inc.
Overland Park, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Cutler Repaving, Inc.
Lawrence, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

WEBCO Mfg., Inc.
Olathe, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Jones & Mitchell Sportswear, Inc.
Overland Park, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

A.R.E. Industries, Inc.
Wichita, Kansas

The undersigned structured a financing package and made a direct investment in the company

Kansas Venture Capital, Inc.

TABS, Inc.
Topeka, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Electronic Processing, Inc.
Kansas City, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

MacDiesel Power of Kansas, Inc.
McPherson, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Crossroads U.S.A., Inc.
Hoisington, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Biomune, Inc.
Lenexa, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Airport Systems International, Inc.
Overland Park, Kansas

The undersigned assisted in forming and finding the acquisition company

Kansas Venture Capital, Inc.

Kan-Build, Inc.
Osage City, Kansas

The undersigned structured a financing package and made a direct investment in the company

Kansas Venture Capital, Inc.

Calido Chile Traders Systems, Inc.
Merriam, Kansas

The undersigned made a direct investment in the company

Kansas Venture Capital, Inc.

Peerless Products, Inc.
Ft. Scott, Kansas

The undersigned initiated, structured and negotiated this transaction, arranged mezzanine financing and made a direct investment in the company

Kansas Venture Capital, Inc.

Thomas C. Blackburn
Executive Vice President

John S. Dalton
President

Marshall D. Parker
Executive Vice President

6700 Antioch, Suite 460 ♦ Overland Park, Kansas 66204 ♦ (913) 262-7117 ♦ Fax (913) 262-3509

STATE OF KANSAS

BILL GRAVES, Governor
State Capitol, 2nd Floor
Topeka, Kansas 66612-1590



(913) 296-3232
1-800-748-4408
FAX: (913) 296-7973

OFFICE OF THE GOVERNOR

MEMORANDUM

TO: Senate Commerce Committee

FROM: Jamie Clover Adams, Legislative Liaison *Jamie*

DATE: 3 February 1998

SUBJECT: Support for Senate Bill 487

Madam Chair and members of the Committee, thank you for the opportunity to appear this morning in support of Senate Bill 487. I will limit my comments to Section one of the bill dealing with the Kansas Public Water Supply Loan Fund. Dave Waldo, Chief of the Public Water Supply Section of the Bureau of Water at KDHE is here today to help answer any questions you may have.

S.B. 487 makes available an additional \$5 million to leverage \$20 million in loans for providing more communities with critical water system upgrades. Governor Graves voiced his support for this additional funding during his State of the State message for two important reasons. First, effective public water supply systems are critical to protect public health. The Safe Drinking Water Act requires water suppliers to deliver water at the tap that meets national safety guidelines. Loans from the fund will assist water suppliers in meeting these requirements. Secondly, a safe and quality water supply is important for economic development and community growth. Growing communities need increased water supply infrastructure to meet the needs of new industry and their citizens.

The Kansas Public Water Supply Loan Fund was established by the Legislature in 1994 so the state could receive capitalization grants from the federal government under a national revolving loan program for public water supply infrastructure. The national program was funded with the passage of the 1996 amendments to the Safe Drinking Water Act. Kansas received its initial capitalization grant of a little more than \$14 million from the Environmental Protection Agency (EPA) in December, 1997. Another \$10 million is expected in federal fiscal year 1998. Federal capitalization grants are authorized by the Safe Drinking Water Act through federal fiscal year 2003. The initial \$14 million has been used to leverage more than \$45 million to finance 26 public water supply infrastructure projects.

Senate Commerce Committee

Date *2-3-98*

Attachment # *8-1 thru 8-2*

Capitalization grants received from EPA are credited to a reserve account within the loan fund. The assets of the reserve account are then pledged as security for repayment of state issued revenue bonds. The investment earnings on the reserve account are used to buy-down the effective interest rate charged to the loan recipients. The interest rate last month was 4.25 percent.

Both KDHE and EPA have identified needs that outstrip the money leveraged from federal capitalization funds. According to a 1997 KDHE survey of needs, Kansas municipalities indicated they will need nearly \$190 million to finance 181 projects over the next five years. An EPA survey shows that Kansas municipalities will need nearly \$2 billion over the next 20 years to meet system needs. The additional funding provided in S.B. 487 moves the State forward toward meeting these needs.

On behalf of the Governor, I urge favorable consideration of S.B. 487. Thank you for the opportunity to appear before you today. I would be happy to answer any questions you may have on the program.



P.O. Box 226 • Seneca, KS 66538 • 785/336-3760
FAX 785/336-2751 • <http://www.krwa.net>

COMMENTS ON SENATE BILL No. 487
BEFORE THE SENATE COMMITTEE ON COMMERCE
February 3, 1998

Madam Chairman and Members of the Committee:

Thank you for the opportunity to present comments on Senate Bill No. 487. I am Elmer Ronnebaum, General Manager of the Kansas Rural Water Association. Kansas Rural Water is a non-profit industry association which provides a variety of training opportunities for operators, board and council members and on-site assistance to public water and wastewater utilities. The Association's membership includes 290 rural water districts and 340 cities and over 250 supplier/vendor associate members. Our service to systems is not contingent on membership in the Association.

As you may be aware, the 1996 Amendments to the Safe Drinking Water Act provided federal grants to states to establish revolving loan funds for public water systems. Enabling legislation was passed already by the 94 Legislature. The actual loan program was developed over a period of 17 months of discussions and development led by KDHE and KDFA and various interest groups including the League of Municipalities and Kansas Rural Water. Kansas will receive some \$14.6 million in funds from EPA and after certain set-asides are were taken out, the state has leveraged the remaining \$11.350 million by 4:1 ratio. In December, KDFA issued \$45 million in bonds for this program. The first loan agreements were recently signed between the state and City of Salina, City of Garden City and the City of McLouth.

Eligible activities of the new loan program are include:

- * Projects to consolidate water supplies or restructure systems
- * Planning or design costs
- * Projects to replace aging infrastructure, including source improvement projects; and installation or upgrades of treatment facilities, storage facilities or distribution systems

The need for funds is apparent. Early in 1997, KDHE sent a letter to all the state's 845 publicly owned water suppliers asking about their planned capital expenditures for 1997-2001. KDHE received 464 responses indicating a need for \$52,505,491 for 1997; through 2001, the total was \$479,220,000. Kansas Rural Water suggests that the actual need is even higher. Some systems did not respond to the survey because they were not fully aware of the purpose of the survey or just missed the communication.

Kansas Rural Water is enthusiastic about this loan program because it provides below-market interest rates. Both rated cities and non-rated rural water districts have access to the program. The application process is streamlined. We know that many of the projects which are proposed for funding are making the improvements because of the attractiveness of the loan program. Having a good water supply and sound water delivery system in place are essential for public health, safety and welfare. The City of McLouth as an example of one of the first loans is financing a connection to a rural water district; McLouth is excited to finally have a water supply with a reasonable iron quantity and additional quantity. The economic impact on communities is immeasurable.

Cities and rural water districts which will be approved for loans through this fund are realizing savings. We hope you will favorably consider ways to enable that program to reach as many more towns and rural water districts as possible.

Respectfully submitted,

Elmer Ronnebaum
General Manager

Senate Commerce Committee

Date 2-3-98

Attachment # 9-1 thru 9-9

New SDWA \$\$\$ help small systems

It's finally here! The much-heralded 1996 Safe Drinking Water Act's state revolving loan fund has come to Kansas.

Two giant steps took place in September, 1997:

#1. First priority list.

KDHE submitted a draft project priority list of 48 projects -- cities, rural water districts and public wholesale water supply districts to the U.S. Environmental Protection Agency for funding. The list is part of a federally-required state intended use plan that must be approved by EPA before FY97 federal dollars are available.

#2. Bond ratings.

Meetings were held in New York with Moody's and other national

Kansas anticipates an "A1" rating from Moody's. What does that mean? Less interest will be paid by the state. In turn, more dollars will be available for loans.

Rome wasn't built in a day. And behind those two huge steps in September were years of fighting in Congress, careful preparation in Topeka anticipating the SDWA's passage and building a unique partnership among KDHE, K DFA and the Kansas Rural Water Finance Authority (KRWFA). "I feel that we have this loan fund structured in a way to keep it investment grade and yet make the bonds saleable," said William Caton, President of K DFA .

SRF ABCs

The 1996 amendments to the Safe Drinking Water Act included new money to help public water systems -- a state revolving loan fund (SRF). The SRF's purposes are compliance with the SDWA and protection of the public's health. Each participating state establishes a revolving loan fund comprised of its EPA grant plus state matching funds. As the loans are paid off, money is "revolved" out to other approved systems for loans.

Major aspects of the SDWA SRF:

- Nearly \$1.3 billion is available nationally in the first year, FY97
- A state must contribute at least 20 percent in matching funds
- 15 percent of the loan funds must go to systems serving

fewer than 10,000 people "to the maximum extent possible"; Kansas law requires 20% funds to systems serving fewer than 5,000

- Up to 30 percent of the EPA grant can be used for "disadvantaged" communities
- Set asides for administration (4 percent maximum), technical assistance to small communities (2 percent maximum), etc. are allowed
- A state must get EPA approval for its plans, priorities and process before its EPA grant is awarded

Eligibility. While the SDWA permits both publicly and privately owned community water systems -- and nonprofit noncommunity water systems -- to be eligible, some states have laws or a regulation that exclude privately-owned systems. A majority of the SRF working group under EPA's National Drinking Water Advisory Committee voted in September that states should not be allowed to categorically exclude systems from applying based on ownership, unless state law prohibits.

Eligible activities per federal guidelines:

- ✓ Projects to consolidate water supplies or restructure systems
- ✓ Planning or design costs
- ✓ Projects to replace aging infrastructure, including source improvement projects; and installation or upgrades of treatment facilities, storage facilities or distribution systems

Projects ranging from dams to O&M expenses aren't eligible



bond rating agencies on a \$45 million bond issue. The bonds would supply state funds needed to match the federal grant from EPA. Led by the Kansas Development Finance Authority (K DFA), KDHE and others provided details on the proposed 48 projects and payback plans. The higher the bond rating given, the lower the interest rate to the state fund.

Draft Project Priority List submitted to EPA

(see sidebar for details).

However, some otherwise ineligible projects may be included if they ensure compliance with the water quality regulations and/or technical, managerial and financial capability. "Ensure" in this case requires the system to get state approval for its improvement plan.

State steps. To receive an EPA grant under the 1996 SDWA, states must:

1. Pass legislation authorizing the state to operate a drinking water SRF (Kansas status: Completed)

2. Prepare an intended use plan how funds will be used, including a priority list of projects to be funded (Kansas status: Submitted to EPA in September, 1997)

3. Provide assurances, including a minimum 20 percent state match (Kansas status: Exceeds requirement by matching every federal dollar with four state-procured dollars, making much more money available for loans)

4. After EPA's approval, the state sells bonds (Kansas status: Approval is anticipated during the Fall, 1997)

5. Funds go to projects (Kansas status: First loans anticipated by end of 1997)

Kansas moves quickly

Early in 1997, KDHE sent a letter to all the state's 845 publicly owned water suppliers asking about their planned capital expenditures for 1997-2001. The 464 responses showed a need for \$52,505,491 for 1997; through 2001, the total was \$479,220,000.

Municipality name	Loan requested	Project description
Finney 1*	\$2,400,000	RWD serving MHP around Garden City
Spivey*	\$ 75,000	Interconnect to Harper CO RWD 5
Abilene	\$1,000,000	New water treatment plant
Newton	\$2,000,000	Water treatment plant rehab, corrosion control, etc.
Dickinson CO RWD 2*	\$ 465,000	Share of WTP upgrade, booster pump rehab, etc.
Garden City	\$2,950,000	1.0 MG ground storage reservoir & by-pass piping
Kirwin*	\$ 595,412	New public water supply source
Raymond*	\$ 60,000	Two new wells
Colwich*	\$3,000,000	New water system to serve city
Garden City	\$2,350,000	2.0 MG ground storage reservoir and standby gen.
Goodland*	\$2,600,000	Waterline replacement, storage tank, new wells
McLouth*	\$1,105,412	Interconnect
PWWSD 17	\$4,051,875	PWWSD 17
Protection*	\$ 350,000	New water supply wells
Saline CO RWD 4*	\$ 148,610	New well, chlorination system, transmission line
Shawnee CO RWD 3*	\$1,250,000	Storage tank and transmission line
Shawnee CO RWD 5*	\$ 320,000	Storage tank
Johnson CO RWD 7*	\$ 300,000	Two miles of water line
Johnson CO RWD 7*	\$ 700,000	Joint project with Miami CO 2 for plant upgrade
Stockton*	\$2,500,000	Replace water treatment plant
Johnson CO RWD 6C*	\$ 515,000	Loop lines
Leavenworth CO RWD 1C*	\$ 500,000	Transmission mains
Parsons	\$9,500,000	New water treatment plant
Shawnee CO RWD 2C*	\$1,200,000	Water line; 200,000 gal. elevated storage tank
Valley Center*	\$3,100,000	Interconnect
Baxter Springs*	\$2,300,000	WTP rehab, upgrade; distrib. rehab; etc.
Hugoton*	\$ 400,000	Loop lines; new well to replace abandoned one
Miami CO RWD #2	\$4,804,000	Plant rehab and transmission lines
PWWSD 4	\$1,200,000	New filters and sludge lagoons
Pittsburg	\$3,185,000	New water tower, rehab. of existing storage, etc.
Severy*	\$ 290,000	Water source improvements, low water dam, etc.
Alma*	\$1,100,000	Water storage tank, line looping, rehab filters
Burden*	\$ 480,000	New water wells to replace old ones
Clifton*	\$ 500,000	New wells and standpipe
Emporia	\$4,918,995	Phase 2 plant upgrade
Franklin CO RWD 5*	\$ 120,000	Replace well, chlor. facility; new replacement well
Geary CO RWD 4*	\$1,000,000	Filter system, interconnect
Independence	\$1,200,000	Improve supply in town; replace old serv. pumps
Marion CO RWD 4*	\$1,977,000	Transmission and storage
Mitchell CO RWD 2*	\$1,020,000	Rehab and expand WTP
Nickerson*	\$ 275,000	New well, pump station, transmission line
Osage CO RWD 3*	\$ 280,000	Distribution line, loop
Osage CO RWD 7*	\$ 135,000	Construct four miles of line
PWWSD 15	\$2,575,000	Construct 20" line Pfeifer-Schoenchen
Rice CO RWD 1*	\$ 135,000	Transmission lines
Salina	\$3,600,000	Air strippers
Sylvan Grove*	\$ 308,000	Replace 12000 lf PVC
Syracuse*	\$ 220,000	Paint and clean tower, replace river crossing

* = Systems serving population less than 5,000

923

What's out

Here's the list of ineligible projects per EPA (2/97):

- Dams or rehabilitation of dams
- Water rights except if the water rights are owned by a system that is being purchased through consolidation as part of a capacity development strategy
- Reservoirs, except for finished water reservoirs and those reservoirs that are part of the treatment process and are located on the property where the treatment facility is located
- Laboratory fees for monitoring
- Operation and maintenance expenses
- Projects needed mainly for fire protection
- Projects for systems that lack adequate technical, managerial and financial capability, unless assistance will ensure compliance
- Projects for systems in significant non-compliance, unless funding will ensure compliance;
- Projects primarily intended to serve future growth

The EPA grant for Kansas is \$14,095,000 for FY97. After setasides for allowable items like small systems technical assistance and administration, Kansas allocated \$11,354,800 for its new state revolving fund (SRF). But how to get the total up to match needs from the 464 responses?

Leveraging federal dollars. State matching dollars brought the FY97 total up to the needed \$45,419,000 -- an aggressive 4:1 ratio. The grant from EPA is not loaned to systems. Some states are aiming at a smaller 2:1 ratio which would only double their EPA grant. And some will contribute only the mandatory 20¢ for each federal dollar. In contrast, Kansas quadrupled its EPA grant, a 4:1 ratio. This means much more money available for loans

Criteria. Proposed projects received through August, 1997 were reviewed by KDHE. Top criteria include issues such as compliance with the SDWA, regionalization of systems and reliability. Another important criteria is readiness to proceed. A public meeting to discuss the priority ranking system was held in late May.

FY97 priority list.

Forty-eight projects were on the draft project priority list appended to the intended use plan submitted in September, 1997 to EPA. The projects had to comply with (a) SDWA requirements and (b) other federal and state laws and with executive orders dealing with environmental and socio-economic requirements. A public hearing on the intended use plan was held early in September.

Loan rate. Only after EPA approves the intended use plan can loans be made. "We'll make loans at 80 percent of market rate, with all recipients paying the same rate," said David F. Waldo, Chief, Public Water Supply Section in KDHE's Bureau of Water. The 80 percent is based on the average three months' 20 Bond Index as published in *The Bond Buyer*. Interest earnings from the federal grant are used to subsidize the interest rate charged to borrowers.

Approved set asides

The 1996 SDWA permitted states to set aside part of their grants for four major activities:

- Administration of the fund -- 4 percent
- Technical assistance to systems serving 10,000 or fewer persons -- 2 percent
- For any of (a) supplement the public water supply

supervision grant; (b) source water protection programs; (c) capacity development strategies; and (d) operator certification programs -- 10 percent

- For any of (a) loans for land or a conservation easement to protect the system's source water from contamination; (b) loans to implement local, voluntary source water protection measures; (c) loans for source water petition programs; (d) technical or financial assistance to a system under the state's capacity development strategy; (e) from funds appropriated through FY97 only, to delineate and assess source water projection areas -- 15 percent

In Kansas, the setasides for FY97 total \$2,740,200. Per the intended use plan submitted to EPA, they are for:

- ✓ Program administration: \$563,800 or 4 percent. This includes financial reviews, project review and approval, project ranking, priority list management, tracking of loan repayments, construction inspection and updating the needs survey.

- ✓ Small system technical assistance (TA): \$281,900 or 2 percent. TA will be provided to systems serving less than 10,000 population by the Kansas Rural Water Association under third-party contract. It includes systems using surface water sources to prepare for the enhanced surface water treatment rule.

- ✓ Capacity development strategy: \$485,000 or 3 percent. Capacity development (see article in the March, 1997 *The Kansas Lifeline*) refers to the ability of a drinking water system to have enough money, technical know-how and

David K. Shupe employed by KRWFA



David K. Shupe has been employed as a full-time financial advisor to the Kansas Rural Water Finance Authority (KRWFA).

Shupe has worked as financial advisor to the Authority since 1991, where he personally coordinated the issuance of 37 bond issues. KRWFA has issued \$44 million in bonds since its inception in 1988.

As financial advisor to KRWFA, he will assume the role of Senior Financial Analyst for the Kansas Public Water Supply Loan Fund. He will conduct on-going review for financial compliance with loan agreements.

The Kansas Rural Water Finance Authority is under contract to the Kansas Development Finance Authority for that work (see related articles).

In his tenure with KRWFA, Shupe has assisted hundreds of communities and rural water districts across Kansas on financing options. He has participated in dozens of seminars discussing the benefits of bidding interest rates and underwriting discounts vs. negotiating bond issues.

"The KRWFA has provided invaluable services to rural water districts and small towns in Kansas. David has been instrumental in saving money on financing for many entities," said Maurice Meirowsky, President of KRWFA's board of representatives. "KRWFA looks forward to working in partnership with state agencies on the new Public Water Supply Loan Fund."

Shupe holds a master's degree in public administration from Wichita State University and a Bachelor's degree from Kansas State University. He can be reached at PO Box 3608, Wichita, KS 67201-3608. The Wichita phone is 316-265-4855; fax is 316-265-5403. KRWFA's general offices are maintained in conjunction with KRWA's office at Seneca, KS. Write to KRWFA at PO Box 111 or call 785-336-3760.

managerial skill to comply with the SDWA's requirements.

✓ Source water assessment and delineation: \$1,409,500 or 10 percent (available only for the FY97 federal grant, it can be spent over the next four years). This program is required if Kansas is to qualify for approval of its own contaminant monitoring program, which will substitute for EPA monitoring requirements.

Three-way partnership unique

A three-way partnership makes the Kansas SDWA SRF unique. Three organizations are working together to make the Kansas Public Water Supply Loan Fund work for large and small systems.

• **KDHE** is the primacy agency for the entire Safe Drinking Water Act, responsible to EPA for carrying out the Act and its state revolving loan fund.

• **KDFA**, the Kansas Development Finance Authority, is responsible to the state for creating and managing the loan fund in a cost-effective manner that protects both taxpayers and investors.

• **KRWFA**, the Kansas Rural Water Finance Authority, is under contract to KDFA to (1) conduct financial analyses for all SRF loan applicants and (2) manage the Financial Integrity Assurance Contracts of non-rated rural water districts and towns identified as needing management and reporting assistance. These steps will help assure that the water utility is well managed and the public health protected – and that the loan is repaid.

In Kansas, it made sense for the three organizations to mesh their expertise. "The three-way

partnership is unique," said KDFA's President Bill Caton. "Kansas does not need to hire expertise at the state level when we have an organization [KRWFA] that has the mission, organization and track record. It's a good way not to create more government."

"I feel we have this loan fund structured in such a way to keep it investment grade and yet make the bonds salable," said Caton.

Return on investment

The bottom line: The Kansas Public Water Supply Loan Fund is win-win for everyone.

✓ The state's major water industry entities are cooperating to get funding to qualified systems -- larger cities, small towns and rural water districts.

✓ Kansas has selected an aggressive 4:1 ratio that matches

state to federal dollars, creating a much larger fund to loan out

✓ The bond pool concept includes rated and non-rated water systems in a structure that makes bonds an attractive investment

✓ Participating systems have demonstrated their technical, managerial and financial capacity to operate a strong utility today and in the future

✓ Set asides permit special attention to important issues like source water protection

✓ By using the proven expertise of existing organizations like KRWFA, state government stays lean

Prediction: For water utilities, the new Kansas Public Water Supply Revolving Loan Fund may well become as important as Farmers Home funding was 30+ years ago.

9-5

Getting SRF dollars in Kansas

What's the gateway to SDWA SRF dollars? The state's priority project list; the first one was submitted by KDHE to U.S. EPA for FY97 funds. Forty-eight water projects were named.

The September 1997 list covered 28 municipalities, 17 rural water districts and three public wholesale water supply districts. Out of the 48 projects, 35 (73 percent) serve less than 5,000 population.

Steps to take

If your system didn't make KDHE's FY97 draft project priority list submitted to EPA, now's the time to start on the FY98 cycle. Here's how.

Step 1. A municipality or rural water district submits to KDHE a project description (but not an engineering report) including problems addressed and preliminary costing.

Step 2. Projects with the highest rank listed on the Intended Use Plan are ranked by KDHE. Top criteria include water quality issues such as compliance with the SDWA, regionalization of systems and reliability. Readiness to act is also a top criteria.

Step 3. KDHE sends the higher ranked systems an official application package.

Step 4. The system completes its official application (including environmental impact reports and a financial analysis made by the Kansas Rural Water Finance Authority), requesting review and clearance from federal and state agencies.

Step 5. If appropriate, based on agencies' review and if the utility meets financial requirements, KDHE issues a Finding of No Significant Impact (FONSI) on the environment, permitting the loan to be made.

Step 6. Presuming the applicant holds a public hearing, etc., SRF funding is available in a few months.

The key to SDWA SRF dollars? Getting on KDHE's annual project priority list.

Wanted:

A water conservation plan

Each SRF applicant needs an approved water conservation plan, pointed out KDHE's David F. Waldo, Chief of KDHE's Public Water Supply Section. "That's one thing that's somewhat unique in Kansas," Waldo stated. "If they anticipate submitting an SRF application, they need to apply to the Kansas Water Office."

Per materials handed out by Darrel L. Eklund, Kansas Water Office, at training in July 1997, to be eligible to participate in the new SRF, a water utility must:

"1. Have a current municipal water conservation plan that has been approved by the Division of Water Resources or the Kansas Water Office and has been adopted and implemented by the water utility, or

"2. Prepare a new municipal water conservation plan which must be approved by the Division of Water Resources

or the Kansas Water Office and the plan must adopted and implemented by the water utility."

Keeping up to date

Four main methods are being used to get the word out about the Kansas SRF.

Training. Over 350 people from cities and rwds attended four SRF training seminars in July, 1997. Speakers from KDHE, KRWFA, the Kansas Water Office, Acord Cox & Company and KRWA presented basic information and fielded questions. KRWFA is responsible for providing these training seminars, which will also be held for the FY98 cycle.

Mailings. A mailing about the SRF will be sent to 845 Kansas public water supplies by the end of December 1997. Last summer, over 5,000 notices were sent out by KRWFA notifying systems of the four SRF seminars.

KRWA website. If you're not on the Internet yet, go to your local library and check www.krwa.net. You'll find out the latest on the revolving loan fund plus much, much more (see related article in this issue).

Telephone. For further information, contact Dave Waldo at 785-296-5503 or the Kansas Rural Water Finance Authority at 785-336-3760. KRWFA's new full-time senior financial analyst, David Shupe, can be reached at 316-265-4855. His fax is 316-265-5403; the mailing address is PO Box 3608, Wichita 67201-3608.

SRF application form

Since the Kansas SRF is a new program, it's understandable that the official application form (see step 4 above) isn't cast in concrete. "The form is final



Something old, something new

enough for this first year," said Dave Waldo, "and we can modify and improve it due to experience."

Information to be provided includes:

- ✓ Project type, such as emergency, plant rehabilitation, line construction or water storage
- ✓ Brief narrative of the proposed project
- ✓ Estimated costs for construction, inspection, engineering, audit/legal, other
- ✓ Amount requested from the Kansas SRF fund; amount from other sources
- ✓ Proposed project schedule
- ✓ Major expansions and/or improvements in the past 10 years
- ✓ Number/type of customers for the past five years
- ✓ Present sources and/or contractual agreements (attach copies)
- ✓ List of customers providing 5 percent or more of revenue from water sales
- ✓ Status of approved Water Conservation Plan
- ✓ Water production history for the past five years
- ✓ Financial information such as most recently adopted and proposed water rates; financial statements from the last three years; taxing powers; outstanding debt; leases; assessed valuation

A copy of the governing body's resolution approving submittal of the application must accompany the form, along with copies of the last three years' financial statements and other attachments.

You thought you had finally mastered all the jargon? Think again, because some things have changed.

EPA -- *U.S. Environmental Protection Agency.* The regulatory agency in charge of assuring compliance with the 1996 Amendments to the Safe Drinking Water Act.

FIAC -- *Financial Integrity Assurance Contract.* Kansas water systems that have neither taxing powers nor the ability to get bond insurance must sign a FIAC if they are selected for SRF funding. That contract, part of the SRF loan agreement, means the water system opens its books to KDFA. In return, KDFA takes care of all SRF reports for the system. A one-time, one percent fee on the outstanding balance is charged for a FIAC. It is included in the total amount loaned.

KDFA -- *Kansas Development Finance Authority.* The state agency responsible for forming and administering the Kansas Public Water Supply Loan Fund. That fund consists of (1) the EPA grant and (b) matching state-procured dollars. It also takes the lead in procuring the highest possible national bond rating for each bond issue. The higher the rating, the lower the interest rate Kansas' borrowers will pay.

KDHE -- *Kansas Department of Health and Environment.* The primacy agency responsible to EPA for carrying out the SDWA and EPA regulations and guidelines.

KRWFA -- *Kansas Rural Water Finance Authority.* Established in 1988 as a non-profit corporation, it is under contract to KDFA to (1) conduct financial analyses for all prospective borrowers and (2) manage the FIAC contracts of the non-rated rural water districts and towns identified as needing management and reporting assistance.

Kansas Public Water Supply Loan Fund. -- The official name of the reserve account made up of the EPA capitalization grant plus matching state dollars. For FY97, the EPA grant totals \$11.3 million after allowable set asides. Kansas is matching that amount with another \$45 million via revenue bonds. The result is an aggressive 4:1 ratio that provides a much larger fund to be loaned to approved state water systems.

Adequate rates are "must do"

Be sure you do a thorough rate analysis. "You have to make sure that your rates will cover debt service and operations and maintenance," stated David Shupe of KRWFA. "Systems need a 1.25 coverage ratio. That means that for every dollar of expenses, you need to have \$1.25 in operating revenue. That's the minimum coverage ratio required for a system to qualify for a loan." In addition, there is a 10 percent loan reserve (funds sitting in escrow which earn interest).

The situation may be different for municipalities if

they elect to use general obligation bonds.

How do you find out your ratio? Look at your recent audits. Also check out Section 8, "Financial analysis and ratios," in *Financial Accounting Guide for Small Water Utilities*, volume four in the *Water Board Bible* series published by KRWA.

But beware, because not all auditors want to tell you bad news. Recently a rural water district contacted KRWA because it was having a hard time paying bills. It turned out that over the past five years, the rwd didn't even have a 1.10 coverage ratio (for every \$1.00 owed it must have a \$1.10 in

9-7

Getting SRF dollars in Kansas

Getting on the FY97 SRF list: *The view from McLouth*

The City of McLouth had its first experience with a state revolving fund (SRF) when it sought funding from the 1987 Clean Water Act's SRF for sewers. At that time, seeking Community Development Block Grant (CDBG) funding for a water project was on the back burner.

Changing priorities. A crisis reversed the priorities: Three new dry holes in June, 1996 followed the 18 dry ones that had been drilled in 1989.

"We had to do something," said Operator Carl Chalfant. The priority shifted from sewer to water. Kansas Rural Water Association told McLouth that there might be funding available from the then-pending Safe Drinking Water Act's state revolving loan fund.

As more information emerged, it looked like the SDWA SRF might provide the financing that would be the most affordable. While it was too early for specifics, conversations with KDHE staff fueled McLouth's interest in the forthcoming SRF.

Necessary paperwork. In January, 1997 KDHE sent out questionnaires statewide about possible capital expenditures for the years 1997-2001. Having already prepared the CDBG proposal saved time. McLouth drew heavily on that earlier document, preparing a project description that was appended to the KDHE questionnaire.

When the Kansas Rural Water Finance Authority, KDHE, the Kansas Water Office, Acord Cox & Company and KRWA presented seminars in

July, 1997, McLouth was ready to complete its preliminary application for SRF funding.

The Bank of McLouth offered a donation of \$100,000 when the city first applied for the CDBG. When the CDBG grant was delayed, Stan Braksick, owner, offered to transfer the gift to the new drinking water project so less money needed to be borrowed. "The Bank of McLouth sees this as an investment in the community. No community can survive, much less thrive, without water" he said.

Outcome. The City of McLouth was included in KDHE's intended use plan submitted to EPA in September, 1997. An interconnect, pipeline and storage tanks are listed for \$1,105,412.

Want to know more about applying for SDWA SRF funds? Chalfant advises systems to:

- ✓ Show your need; be able to explain the project and its scope.
- ✓ Make sure you have financial records from the last five years handy and up to date. It takes time to get all the records -- for example, financial and production -- together.
- ✓ "Be patient. Even though some things seem frustrating and redundant, there's a reason for it."
- ✓ Get all the help you can.

"KRWA's Elmer Ronnebaum and KRWFA's Dave Shupe pitched in. The City of McLouth really appreciates their help throughout the process."

revenue). Their margin (.74) was far less.

Because this auditor didn't reveal to the board what he should have, he had some liability. Rather than pay legal fees to take the auditor to court or pay for restructuring the debt, this system opted to raise rates in

order to get into compliance with bond issue covenants.

The outcome? A whopping 51 percent rise in water rates. Not surprisingly, the public meeting on this increase included very spirited comments.

"But what if we're not rated?"

Kansas has gone out of its way to help smaller municipalities and rural water districts that have no bond rating or that can't afford bond insurance. Rwd's don't have taxing authority.

Question: How to help small systems while attracting investors who don't like risk?

Answer: A bond pool that includes both rated and non-rated entities.

"We have taken great pains to make sure that small water utilities are included in our program," said William Caton, President, Kansas Development Finance Authority. The Kansas bond pool requires non-rated borrowers and those that can't afford bond insurance to get a Financial Integrity Assurance Contract (FIAC). A FIAC is a one-time, one percent fee on the outstanding loan balance and is built into the total loan. The goal of the FIAC is to provide necessary information and reporting to the state. Systems should find the ongoing review by an outside entity, KRWFA, to be a helpful management tool.

KRWFA manages the FIAC contracts. During the application process, this includes reviewing the financial statements and operational/historical information from each utility. There will also be an annual review to ensure compliance with loan covenants. The outcome? Heightened overall financial integrity of the entire loan fund.

The SRF in other states

What's going on nationally? In March, 1997, Georgia was the first to receive its EPA capitalization grant of \$25.7 million for FY97; the state added another \$5 million.

In September, Moody's gave the first-ever rating under the SDWA SRF to Colorado. Its Aa2 rating (which is a high one with associated lower interest rates for the borrowers) will help fund loans to the cities of Englewood and Fort Collins plus Arapahoe Estates Water District.

The crucial step is getting federal funding. "As of October 1, 18 states had received their capitalization grant according to EPA officials," stated Vanessa Leiby, Executive Director of the Association of State Drinking Water Administrators.

The 10-year experience of states with the earlier Clean Water Act State Revolving Fund has both helped and hindered. Under that earlier SRF, virtually only municipalities received loans -- and often just the larger ones that already had high bond ratings and/or could afford bond insurance. That made their bond issues much safer for the investor.

In contrast, the SDWA SRF mandates participation of small systems and disadvantaged areas. Many of them are non-rated and don't have taxing authority and can't afford bond insurance . . . and thus are riskier for investors.

"Many states are just beginning to identify how they will operate and give grants," said James Smith, Executive Director of the Washington-based Council of Infrastructure Financing Authorities. "The common wisdom is that states will have to lend to rural systems and communities not as financially healthy as with the Clean Water Act SRF. There were probably about 5000 loans made under that SRF and there's not been a single default yet. Drinking water may not be as strong, but that will cause states to carefully structure their assistance to these small communities."

This fund's for you

Kansas has gone out of its way to assure that smaller municipalities and rural water districts can participate in the new SDWA state revolving loan fund. Yes, it takes preparation. But here's new money that combines federal and state dollars.

The goal was to have a loan program which would be accessible to small and non-rated systems. As a result, Kansas has one of the most innovative and aggressive programs nationally.

The SDWA SRF is not the only solution. There's not enough funding to meet all the state's water capital improvement needs. But the program helps. Take advantage of this opportunity for reasonable-cost financing to help your customers and your community.

Kansas Bankers Association

800 SW Jackson, Suite 1500

Topeka, KS 66612

785-232-3444 Fax - 785-232-3484 e-mail - kbacs@ink.org

2-3-98

TO: Senate Commerce Committee
FROM: Chuck Stones, Director of Research
RE: SB 487

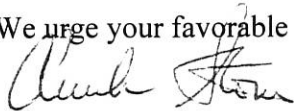
Madam Chair and Members of the Committee:

The Kansas Bankers Association is supportive of SB 487. During the 1986 Legislative Session the KBA became very involved in a series of economic development initiatives. We became particularly involved in the formation of a venture capital company that would fill a financial niche that was not currently being served. Banks from all over the state, large and small, invested in Kansas Venture Capital, Inc.. They invested their money mostly out of loyalty to the State of Kansas and to the KBA since there was no precedent and certainly no assurance that such an entity could survive in those difficult times. Another crucial part of the plan was the participation of the State. The investment by the State provided stability, credibility and liquidity. It was crucial at the time.

The KBA does not want to get involved in the actual payback method, nor does it want to imply it represents the common stockholders. The KVIC Board of Directors represents the stockholders and is a very capable group of individuals. Under their direction KVIC has become an economic development success story. You have heard from the company about the economic benefit their investments have provided to the State's economy. The State can be proud of the foresight it showed with its support of KVIC.

However, the KBA, as the group instrumental in the founding of KVIC, wants the Committee to know that we believe that KVIC is now at a point where they can operate more effectively without direct State money. If SB 487 passes, the State can either put its money to better use or return it to the taxpayers. We are assured that KVIC will continue its commitment to businesses in Kansas. We feel SB 487 is the next step. Allowing KVIC to privatize will allow it to continue to grow and will remove some of the burden placed on it by the involvement of State money. We believe this is the best path to follow for all involved. We would urge you to allow KVIC to keep doing what they have been doing, but with a capital structure that does not have direct state involvement.

We urge your favorable consideration.



Charles A. Stones
Director of Research

Senate Commerce Committee

Date 2-3-98

Attachment # 10