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To: House Appropriations Committee

Date: January 24, 2011

Subject: **HB 2014** – Opposition to the Language in Section 7 on Page 2 Proposing a 10% Shrinkage from the Kansas Real Estate Commission's Real Estate Fee Fund in FY 2011

Chairman Rhoades and members of the House Appropriations Committee, thank you for the opportunity to submit written comments on behalf of the Kansas Association of REALTORS® in support of the budget testimony provided by the Kansas Real Estate Commission. Through the comments expressed herein, it is our hope to provide additional legal and public policy context to the discussion on this issue.

KAR is the state's largest professional trade association, representing nearly 8,000 members involved in both residential and commercial real estate and advocating on behalf of the state's 700,000 homeowners for over 90 years. REALTORS® serve an important role in the state's economy and are dedicated to working with our elected officials to create better communities by supporting economic development, a high quality of life, sustainable communities and providing affordable housing opportunities that embrace the environmental qualities we value, while protecting the rights of private property owners.

As a starting point, we are extremely concerned about the extremely difficult budget challenges facing the Kansas Legislature in FY 2011 and FY 2012. Just like other citizens of this state, REALTORS® have family members who are enrolled in K-12 public education, attend public universities, depend on various disability and social service programs administered by the state and take advantage many other vitally important state services that have been and will continue to be cut by the Kansas Legislature.

Fee Fund Sweeps Have Severely Inhibited the Fiscal Soundness of the Real Estate Fee Fund and the Commission's Ability to Adequately Regulate the Real Estate Industry

However, we are also very concerned about the continuing devastating impact that unconstitutional fee fund sweeps by the Kansas Legislature are having on the Kansas Real Estate Commission's budget and the Commission's ability to adequately regulate the real estate industry during this difficult economic environment. If the Kansas Legislature continues to decrease the Commission's budget during the 2011 Legislative Session, it will have an extremely detrimental impact on the Commission's ability to properly regulate the real estate industry and protect consumers.

In the past six years, the Kansas Legislature has swept more than \$700,000 from the real estate fee fund to pay for other programs in the state budget funded through the state general fund. The Kansas Legislature approved a \$508,438 sweep from the real estate fee fund in FY 2005 and a \$195,671 sweep from the real estate fee fund in FY 2009. As you can see, the cumulative fee fund sweeps enacted by the Kansas Legislature nearly equal almost a year's worth of expenditures from the real estate fee fund.

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Although Division of Budget Determined that the Real Estate Fee Fund Could Afford Fee Fund Sweeps in Previous Fiscal Years, They Have Now Determined that the Fund Has Dangerously Low Cash Balance

During the debate on the FY 2009 and FY 2010 budgets, the Division of Budget proposed to sweep an additional \$633,095 from the real estate fee fund and the real estate recovery fund. Thankfully, we were successful in working with several other industry trade associations targeted for fee fund sweeps to pass an amendment that defeated the Division of Budget's proposals.

If we had not been successful, the Commission's budget would have been even more severely impacted by the fee fund sweeps. However, I am very confused as to how the Division of Budget could conclude that the Commission could withstand an additional \$633,095 in fee fund sweeps in 2009 and 2010 and the very next year conclude that the Commission now cannot support current operations and must shrink its budget by 10% to preserve the cash balance in the real estate fee fund.

At the least, this represents a gross misunderstanding and at worst a clear disregard of the particular fiscal challenges facing the Commission as they attempt to deal with the fallout from one of the worst real estate markets in recent history. The association strongly supports the Commission's efforts to reverse the decline of the real estate fee fund that was caused by the Division of Budget's recommendations to sweep the real estate fee fund and restore the Commission's funds to proper health and stability.

KAR Strongly Supports the Commission's Plan to Restore a Healthy Balance in the Real Estate Fee Fund through a Transfer from the Real Estate Recovery Fund and a Fee Increase on Real Estate Licensees

In order to address the funding shortage in the real estate fee fund, the Commission has adopted a recovery plan that would stabilize the fund over several years with a \$200,000 transfer from the real estate recovery fund and a small increase in the licensing fees paid by real estate salespersons and brokers. In the context of the challenges currently facing the Commission, the association believes they are acting in utmost good faith to address the challenges and provide for the proper regulation of the industry.

We believe that the current balance in the real estate recovery fund is more than sufficient to withstand the \$200,000 transfer to the real estate fee fund. When the real estate recovery fund was established many years ago, it was capitalized with a transfer from the real estate fee fund. In our opinion, the proposed transfer of funds from the recovery fund back to the real estate fee fund is simply a repayment of that initial transfer that will allow the Commission to stay afloat during these tough times.

In recent years, the amount of claims that have been paid to consumers from the real estate recovery fund have been minimal to nearly non-existent. As an increasing number of real estate licensees obtain errors and omissions insurance to cover liability for consumer complaints, the association believes that the number of claims from the fund will only continue to decrease over time.

Furthermore, the association reluctantly supports the Commission's request to increase licensing fees by a small amount for real estate salespersons and brokers to help stabilize the balance of the real estate fee fund. If the state had not chosen to sweep our fee fund we would not be in this position, but we believe that this is the only suitable course of action in this situation to help ensure that the Commission is not forced to dramatically reduce its operations at a time when they are desperately needed.

Since the statutory cap on the licensing fees for real estate salespersons and brokers has not been increased since at least 1988, we believe that the Commission has been very responsible stewards of our members' licensing fees and will use the fee increase responsibly to stabilize the real estate fee fund. Accordingly, we reluctantly support the Commission's fee increase request.

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If the Kansas Legislature does not reverse the recommendations of the Division of Budget, we believe that the Commission will be required to drastically scale back its operations in auditing real estate brokerages, investigating consumer complaints and processing requests from real estate licensees. At a time when the Commission is needed more than ever to help guide the industry through a protracted downturn, we believe that a failure to adopt the Commission's recovery plan will only make the current situation worse.

Commission Contributes a Significant Amount of Funding Each Year to the State General Fund, Which Further Compounds the Current Budgetary Limitations in the Real Estate Fee Fund

Under **K.S.A. 58-3074(a)**, the Commission is already required to transfer 20% of all real estate licensing fees, charges and penalties collected by the Commission to the state general fund to pay for unrelated programs in the state budget. In FY 2009, the Commission was forced to transfer \$199,725.41 in licensing fees, charges and penalties paid by real estate licensees to the state general fund to satisfy the obligations imposed by this statutory provision.

K.S.A. 75-3170a(a) provides that the purpose of this transfer is "to reimburse the state general fund for accounting, auditing, budgeting, legal, payroll, personnel and purchasing services, and any and all other state governmental services, which are performed on behalf of the state agency involved by other state agencies which receive appropriations from the state general fund to provide such services" [Emphasis added].

However, the Commission also paid various fees and charges totaling \$50,233.79 in the aggregate to the Kansas Department of Administration during FY 2009 for the following services ostensibly provided to the Commission (even though these services fall under the list of services that are supposed to be paid for by the 20% transfer under **K.S.A. 58-3170a**):

- (1) Annual central mail assessment (for maintenance of mail facility and equipment): \$5,627.10;
- (2) non-state building lease administrative fee (fee charged to administer the lease): \$142.89;
- (3) monumental building surcharge (for maintenance of the Capitol, Judicial Center and Cedar Crest mansion): \$11,050.16;
- (4) surety bond: \$13.50;
- (5) data services (for internet and router connectivity): \$3,381.00;
- (6) central mail (actual mail costs): \$14,061.73;
- (7) telecommunications (for voice switching service, long distance and directory): \$4,759.51;
- (8) annual FMS (cost of state's new accounting system): \$1,961.94;
- (9) enterprise application (based on the number of spending warrants issued): \$1,518.22; and
- (10) miscellaneous data processing (email system and computer services): \$7,717.74.

As a result, the Kansas Real Estate Commission transferred a grand total of \$445,630.20 from the real estate fee fund to the state general fund in FY 2009. Combined with the \$508,438 sweep from the real estate fee fund to the state general fund in FY 2005, you can see that the Kansas Real Estate Commission's budget has been severely and negatively affected by the past actions of the Kansas Legislature in sweeping fee funds.

Not surprisingly, the Division of Budget initially proposed further fee fund sweeps of \$39,758 in FY 2010 and \$99,634 in FY 2011. Although the Governor overturned this recommendation, we believe it is very likely this proposal will again come up during the budget process during the 2010 Legislative Session.

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Fee Fund Sweeps are Unconstitutional Since They are an Illegitimate Use of the Police Power Authority to Generate General Tax Revenue in Violation of Article 11, Section 1 of the Kansas Constitution

Fundamentally, the state government has the inherent power called the “police power” to regulate various businesses and industries for the protection of its citizens. While the term “police power” is difficult to define precisely, it basically “embraces the state’s power to preserve and to promote the general welfare and it is concerned with whatever affects the peace, security, safety, morals, health and general welfare of the community.” 16A Am. Jur. 2d *Constitutional Law* § 313 (June 2002) (citations omitted).

In regulating the real estate industry, the Kansas Legislature has chosen to exercise its police power to place certain requirements and restrictions on those individuals acting as real estate salespersons and brokers. In doing so, the Kansas Legislature promotes the general welfare of the public through a highly regulated real estate industry overseen by the Kansas Real Estate Commission.

While the police power provides the state with broad authority to regulate a particular business or industry, there is a definite constitutional distinction between a state’s police power and its power to levy taxes and other revenue mechanisms to defray general state budget expenditures. Under long-established precedent, the Kansas Supreme Court has explicitly recognized a clear distinction between the Kansas Legislature’s authority to exercise its police power and the ability to enact revenue raising measures.

At the outset, it is clear that under its police power the state may reimburse itself for the costs of otherwise valid regulation and supervision by charging the necessary expenses to the businesses or persons regulated. A statute, however, is void if it shows on its face that some part of the exaction is to be used for a purpose other than the legitimate one of supervision and regulation or if more than adequate remuneration is secured. *Panhandle Eastern Pipe Line Co. v. Fadely*, 183 Kan. 803, 806-07 (1958).

In *Executive Aircraft v. City of Newton*, 252 Kan. 421 (1993), the Kansas Supreme Court held that a fuel flowage “regulatory fee” assessed by a city and county was an illegal tax under the Kansas Constitution. In this decision, the Court addressed the distinction between a fee and a tax.

Thus, a tax is a forced contribution to raise revenue for the maintenance of governmental services offered to the general public. In contrast, a fee is paid in exchange for a special service, benefit, or privilege not automatically conferred upon the general public. A fee is not a revenue measure, but a means of compensating the government for the cost of offering and regulating the special service, benefit, or privilege. *Id.* at 427.

After a full analysis of the case law on this issue, it is possible to extract a basic rule of law regarding this issue. If an assessment, charge or fee paid by a regulated business or individual grossly exceeds the cost of regulating that business or individual and there is no reasonable relationship between the actual costs involved and the amount of the fee, the portion of that assessment, charge or fee that exceeds the actual costs involved in regulating that business or individual is an unconstitutional use of the state’s police power authority as a revenue raising mechanism or tax.

Conclusion

For all the foregoing reasons, we would urge the members of the House Appropriations Committee to delete the language in Section 7 on Page 2 of HB 2014. Once again, thank you for the opportunity to provide comments and I would be happy to respond to any questions from the committee members at the appropriate time.

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