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To: House Appropriations Committee

Date: March 29, 2011

Subject: **SB 229** – Supporting the Partial Repeal of the Requirement for Fee-Funded Agencies to Annually Remit 20% of Fee Revenues to the State General Fund

Chairman Rhoades and members of the House Appropriations Committee, thank you for the opportunity to appear today to offer testimony on behalf of the Kansas Association of REALTORS® in support of **SB 229**. 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 home owners. 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, and providing affordable housing opportunities, while protecting the rights of private property owners.

As currently drafted, **SB 229** would reduce the required transfer to the state general fund from fee-funded agencies from 20% (up to $200,000) to 10% (up to $100,000) beginning in FY 2012. In addition, **SB 229** would require the Division of Budget to deliver a report to the House Appropriations Committee and the Senate Ways and Means Committee detailing the actual cost of providing "any and all" services provided to fee-funded agencies by other state agencies that receive funding from the state general fund (SGF).

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

As a starting point, we are 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In addition to the annual 20% transfer of fee revenues that would be partially repealed by **SB 229**, the Kansas Legislature has swept more than $700,000 from the real estate fee fund into the state general fund over the past six years to pay for unrelated state programs. In that same time, the 20% annual transfer has resulted in the transfer of nearly $1.2 million from the real estate fee fund to the state general fund, which equals a total loss of $1.9 million (or over 170% of the Commission's annual budget) in that time span.

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As Currently Enforced, the 20% Transfer Required by the Statutes is Arguably Unconstitutional Since the State Has Not Detailed the Services Provided by Other State Agencies to the Fee-Funded Agency

Contained within the statutes for each fee-funded agency, there is a provision that requires each agency to annually transfer 20% of all licensing fees, charges and penalties collected, up to a statutory maximum of $200,000, to the state general fund to pay for unrelated programs in the state budget. The Kansas Real Estate Commission is obligated to the 20% annual transfer by the provisions of **K.S.A. 58-3074(a)**. Under **SB 229**, the annual transfer would be reduced to 10% of all licensing fees, charges and penalties collected, up to a statutory maximum of $100,000.

Originally enacted in 1973, the current language in **K.S.A. 75-3170a(a)** was a legislative response to a Kansas Supreme Court decision in *Panhandle Pipeline Co. v. Fadely*, 183 Kan. 803 (1958), where the court had invalidated an earlier appropriation calling for the 20% transfer to the state general fund from a fee-funded agency. In this case, the court determined that the 20% transfer of fee funds to the state general fund was unconstitutional since the funds were used as general revenue instead of to regulate and supervise the industry from which they were collected. *Id.*

The original intent of the 20% transfer was to reimburse the state for the cost of services that were provided to fee-funded agencies by other state agencies that were funded through the state general fund. While these funds were originally funneled to the Kansas Department of Administration, these funds have been diverted directly to the state general fund and no services have been provided to fee-funded agencies from other state agencies in return for the 20% transfer since 2003.

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]. Under this language, the 20% transfer required by each of these statutory provisions is intended to offset the cost of "any and all other state governmental services" provided to the fee-funded agency.

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. However, the Commission also paid various fees and charges totaling $50,233.79 on top of the 20% transfer 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.

According to the language in **K.S.A. 75-3170a(a)**, the 20% transfer required by each of these statutory provisions is again intended to offset the cost of "any and all other state governmental services" provided to the fee-funded agency. However, it is explicitly clear that several of the services on the list above for which the Commission is directly billed by other state agencies fall within the meaning of the term "any and all other state governmental services."

If the funds collected by the state general fund through the 20% annual transfer from fee-funded agencies are not currently being used to provide services back to the fee-funded agencies, then the case law would establish that the transfer of those funds to the state general fund is an unconstitutional "fee fund sweep." Accordingly, we believe the Kansas Legislature should partially repeal these unconstitutional requirements and by reducing the required transfer to 10% (up to $100,000) of fee revenue to the state general fund.

In addition, the new language in Section 1 on page 1 of the legislation would instruct the Division of Budget to deliver a report to the House Appropriations Committee and the Senate Ways and Means Committee detailing the actual cost of providing "any and all" services provided to fee-funded agencies by other state agencies that receive funding from the state general fund (SGF). We absolutely support this language and strongly believe that the Commission should be statutorily obligated to pay for the actual cost of any and all services provided to the Commission by other state agencies.

If the Kansas Department of Administration or another state agency provides a legitimate service to the Commission and charges the Commission a fee based on the reasonable value of those services, we believe that the Commission has an obligation to continue to pay for the actual cost of those services. Accordingly, the required report that will be produced by the Division of Budget will allow the Kansas Legislature to further study this issue during the 2012 Legislative Session.

<u>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</u>

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 this respect, it is clear that the 20% annual transfer required by **K.S.A. 75-3170a(a)** is not merely providing the state with an avenue to "reimburse itself for the costs of otherwise valid regulation and supervision." When no actual services are being provided to the fee-funded agency in return for the 20% transfer of funds, the transfer becomes a simple revenue raising mechanism for the state general fund.

In order to determine whether a charge is a fee or a tax, it is first necessary to determine whether the particular charge is an exercise of the police power or is a tax imposed for the purpose of raising general revenue. If the Kansas Legislature attempts to exercise its policy power by enacting a fee on a regulated industry, the amount of the fee must be reasonably approximate to the cost of regulation because once "adequate remuneration has been secured the police power is exhausted." *State ex rel. Brewster v. Cumiskey*, 97 Kan. 343, 352 (1916).

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. *Kansas Attorney General's Opinion 2002-45 (2002).*

<u>If the Obligation to Annually Transfer 20% of Fee Revenues to the State General Fund is Not Partially Repealed, then the Commission Will Have No Choice but to Increase Real Estate Licensing Fees</u>

Due to the nearly <u>$1.9 million</u> that has been transferred from the real estate fee fund to the state general fund from fee fund sweeps and the 20% transfer requirement over the last six years, the Commission has now been placed in the very difficult position of being unable to fully enforce the provisions of our state's real estate laws and running a substantial budget deficit beginning in FY 2013. If **SB 229** does not pass, the Commission will have no choice but to increase real estate licensing fees over the next few years to stabilize the real estate fee fund and avoid extremely severe reductions in agency operations.

In the context of the challenges currently facing the Commission, the association believes they are acting with the utmost good faith to address the challenges and provide for the proper regulation of the industry. When faced with the amount of revenue improperly transferred to the state general fund, the Commission has responsibly and prudently reduced spending in a good faith effort to avoid licensing fee increases.

If the Commission is forced to increase real estate licensing fees, then real estate professionals will be faced with the objectionable task of paying licensing fees that are unreasonably too high and go to offset governmental expenses that provide no benefit or regulation to the real estate industry. This is clearly unconstitutional under the established case law and a glaring example of extremely poor public policy.

<u>Conclusion</u>

For all the foregoing reasons, we would respectfully request that the House Appropriations Committee support **SB 229**. 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.