

MINUTES OF THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE

The meeting was called to order by Chairperson Lana Gordon at 3:30 P.M. on March 10, 2005 in Room 526-S of the Capitol.

All members were present except:

Don Hill- excused
Todd Novascone- excused

Committee staff present:

Kathie Sparks, Kansas Legislative Research Department
Susan Kannarr, Kansas Legislative Research Department
Rena Jefferies, Revisor of Statutes
Helen Pedigo, Revisor of Statutes
Carlene Maag, Committee Secretary

Conferees appearing before the committee:

Scott Frank, Legislative Division of Post Audit

Others attending:

See attached list.

A motion was made by Representative Carlin and seconded by Representative Grange to approve the minutes of the joint meeting with the Senate Commerce Committee held on March 4, 2005. The minutes were approved.

Chairperson Gordon recognized Scott Frank from Legislative Post Audit who gave a presentation on the Post Audit Report for STAR bonds.

STAR bonds allow local governments to raise money to acquire property to finance redevelopment projects. The bonds are paid back with the new sales taxes generated within the new development. Special provisions by the 1997 and 1998 Legislatures have allowed Wyandotte County to use STAR bonds to develop the Kansas Speedway and the Village West redevelopment projects.

Recently legislators express concerns about the use of bond moneys related to these projects. As a result, we were asked to conduct a performance audit to answer questions about the Wyandotte County redevelopment.

1. Were the issuance costs reasonable for the bonds that financed the development of the Kansas Speedway and the Village West tourism district?
2. Were the bond proceeds spent for allowable purposes, and were the costs associated with the items purchased reasonable?
3. Do the costs associated with a movie theater project being built in the tourism district exceed industry standards?

STAR Bonds allow for local governments to use future sales tax revenues to pay current redevelopment costs for major entertainment and tourism areas. STAR bonds are repaid solely with new sales, use, and transient guest taxes generated within the redevelopment. Approximately two-thirds of the money used to pay back STAR bonds comes from State sales taxes. STAR bonds can be used to pay for certain costs of the redevelopment project, including property acquisition, site preparation, and bond issuance and financing costs.

State law specifically prohibits using STAR bonds to pay for a building that will be owned by or leased to a developer, and since 2004, to purchase personal property.

Since 2003, STAR bond projects must be approved by the Secretary of Commerce. This is a two step approval process. 1) The local government must establish a redevelopment district that lays out where the

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redevelopment will be and describes what it will contain. 2) The local government must develop specific plans for one or more redevelopment projects within the district.

If the Secretary decides the redevelopment project is viable, he issues a formal letter authorizing the use of STAR bonds to finance the project. Although it isn't required by law, the Secretary's project approval letter now includes a limit on the amount of STAR bonds that may be used for the project. It is important to note that his limit was not in place when the Kansas Speedway and Village West projects were authorized for Wyandotte County.

The Wyandotte County redevelopment includes the Kansas Speedway and the Village West retail and tourism area. Current plans call for about \$300 million in STAR bonds to be issued to pay for the Wyandotte County redevelopment. These bonds will be issued in several groups. One thing that is important to note, even though \$305 million have been authorized, only \$227 million have been issued. More debt can be issued as the project continues and there is on-going construction in Village West.

Provisions for repaying the Wyandotte County STAR bonds vary by project. Sales tax revenues generated at the speedway are used to repay the speedway bonds. Within Village West, sales tax revenues from more profitable projects can be used to subsidize bond repayments for less profitable projects. Under a provision called "waterfall financing", if more sales taxes are generated in an area than are needed to repay that area's bonds, the "excess" can be used to pay other Village West bonds.

As of December 2004, more than \$40 million in sales taxes had been generated by the Speedway and Village West. The redevelopment has successfully promoted economic development in Wyandotte County.

One of the questions on the audit was "Were the issuance costs reasonable for the bonds that financed the development of the Kansas Speedway and the Village West Tourism District? Issuance costs are fees paid to a professional who draft bond documents and are involved in the sale of the bonds. Overall, the Unified Government's cost of issuing the STAR bonds was in-line with other bond issues looked at.

Almost 80% of the Speedway and Village West STAR bonds were privately sold to businesses within the redevelopment district. The bonds were sold privately because of uncertainty about how marketable the bonds would be without an established revenue history. Having Village West businesses buy their own bonds would increase their investment in the projects and give them a greater incentive for making their site profitable.

The Unified Government paid itself \$450,000 in bond origination fees. Kansas law allows the local government to charge a bond origination fee for issuing bonds. However, that fee must be used for economic development purposes. Even though these fees are legal it is thought they are unnecessary and redundant. The reason being, the purpose of using STAR bonds is to stimulate local economic activity.

The audit report recommends legislation be introduced to amend State law to eliminate local governments' authority to charge bond origination fees when they issue STAR bonds for their own redevelopment projects.

Another question asked in the audit report was "Were the bond proceeds spent for allowable purposes, and were the costs associated with the items purchased reasonable?"

As of December 2004, \$176 million from STAR bonds had been spent on the Kansas speedway and Village West projects, including \$1.5 million in expenditures that aren't eligible for STAR bond funding, and another \$28 million that appears to go beyond what legislators envisioned.

It was also found that the Unified Government had entered into a number of questionable agreements, including a complicated land lease that will provide \$14 million to Cabela's, and providing developers with "excess" land that they have sold for almost \$10 million in profits. Through various agreements, Cabela's essentially will have its store paid for by the Unified Government.

Oversights noted in the report were the Unified Government's oversight of Red Development's expenditures

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has been inadequate.

The State's oversights have also been inadequate in the following areas:

- No formal limit on the amount of STAR bonds that can be issued
- Definition of what STAR bonds can pay for is ambiguous
- State isn't a formal party to the major agreements
- Law does not require any independent audits to ensure that bonds are being used for allowable purposes
- Law does not include specific consequence for misusing STAR bond proceeds

The conclusion is, STAR bonds have been a successful tool for Wyandotte County. However, the bonds may have been spent for purposes not allowed and as intended.

It was recommended to help ensure that STAR bond moneys are used only for the purposes intended by the Legislature, K.S.A . 12-1770(a) should be amended. The legislature should consider directing the Secretary of Commerce not to issue final approval of any additional STAR bond projects until it has had an opportunity to clarify the STAR bond law.

Do the costs associated with a movie theater project being built in the tourism district exceeded industry standards? The costs of constructing the proposed theater in Village West are greater than what industry experts told us were typical. In reviewing the operating agreement with the Phoenix Theaters, we noted that the Unified Government appears to be bearing the financial risk, but the management company could reap significant financial rewards if the theater is successful.

The conclusion is, because the Unified Government wasn't able to attract a private company to locate and operate a theater in the village West development district, it has committed to spend \$20 million in STAR bond moneys to build an upscale movie theater itself. That decision has raised questions about the appropriateness of competing with private theaters in the region, the cost and profitability of the theater, the lease-back arrangement that will help Cabela's recoup the cost of building its store, and the management agreement that gives Phoenix Theaters a significant share of the profits without assuming any significant financial risk.

There was no recommendation.

An informative question and answer session followed the presentation. The entire report can be found at: www.kslegislature.org/postaudit

The meeting adjourned at 5:35 p.m. The next meeting is scheduled for Tuesday, March 15, 2005.