



MEMORANDUM

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TO: Members, House Committee
FROM: Scott Frank, Legislative Post Auditor
DATE: March 24, 2016
SUBJECT: Neutral Testimony Regarding Senate Bill 474

I appreciate the opportunity to provide neutral testimony on Senate Bill 474, which would amend the state's STAR bond statutes to address the proviso requirements of House Substitute for Senate Bill 161. In the process, the bill would address several areas of concern from our 2015 audit of the Heartland Park STAR Bond project in Topeka. Attachment A summarizes the issues raised in our audit report and the proviso requirements of Senate Bill 161, and shows how this bill (as well as House Bill 2738) addresses those requirements. My testimony will focus primarily on how the bill addresses our recommendations, as well as a provision for additional oversight by the Post Audit Committee.

Background on the Heartland Park Project

In 2006, the City of Topeka issued \$10.4 million in full faith and credit sales tax and revenue (STAR) bonds to make improvements to the Heartland Park racetrack. The full faith and credit backing made the city responsible for debt service payments in the event the STAR bond district did not generate enough revenue to retire the bonds that were issued. At that time, the STAR bond district was limited to the area directly surrounding Heartland Park with the expectation that a commerce park would develop around it. That development did not happen and as a result the district did not generate enough revenue to pay off the bonds.

In 2014, the City of Topeka developed a proposal to expand an existing STAR bond redevelopment district and issue new bonds to purchase Heartland Park. Under the proposal, the city was seeking to amend the earlier project to raise additional revenue and keep the park out of foreclosure. If approved, the city would have issued an additional \$5 million in STAR bonds to purchase Heartland Park and expand the district to encompass a number of nearby businesses. However, in May 2015, the Topeka city council reversed course and voted against pursuing additional STAR bonds, which effectively ended this proposal.

Summary of the Audit Findings and LPA Recommendations

Legislators expressed concerns about Topeka's proposal to amend the original STAR bond project and purchase Heartland Park. In December 2014, the Legislative Post Audit Committee

responded to those concerns and directed us to conduct an audit to determine whether the city's proposal meets the intent of the STAR Bond Financing Act and its requirements.

We issued our final report in March 2015. In conducting our audit work, we evaluated eight areas of the proposal and found that each area appeared to meet legal requirements. However, based on our work and subsequent discussion of the audit, we noted several concerns and areas where statutes could be strengthened or clarified. Some, but not all of these issues, are addressed in Senate Bill 474.

- **Current law has no provision to claw back the bond proceeds if a project fails to meet the “50% requirement.”** State law limits the amount of STAR bonds that may be issued to no more than 50% of the total costs of the project. If and when additional STAR bonds are issued, state law also limits the amount of additional bonds that may be issued to no more than 50% of the total costs of the addition to the STAR bond project. However, because the spending on a STAR bond project occurs over a period of many years, actual compliance with the 50% requirement cannot be assessed until the end of the project. More importantly, there are no consequences for not meeting the requirement because state law does not include any claw-back provisions.

LPA Recommendation:** Consider amending the statute to include a claw-back provision for projects that fail to meet the 50% requirement. **Section 2(k) of SB 474 addresses this with regard to initial bonding authority. SB 474 does not appear to address the clawback issue with regard to additional bonding authority.

- **Current law requires all projects to have an economic impact study, but that study does not have to be an independent assessment.** State law requires an economic impact study as part of the STAR bond project application. The impact study must estimate the financial benefit the project will have on both the state economy and the local economy. For the Heartland Park STAR bond project, a pair of economic impact studies were submitted as part of the application, as is required under current law. However, both of the studies were commissioned by the private firm that would directly benefit from the project. Allowing an impact study to be commissioned by a party with a strong vested interest in the project creates a strong risk of bias in the study.

LPA Recommendation:** Consider amending the statute to require the economic impact be commissioned and directed by a state agency, conducted by an independent consultant, and paid for by the local government. **Section 3(b)(6) of SB 474 addresses this.

- **Current law also requires all projects to have a marketing study, but that study also does not have to be an independent assessment.** We did not address the marketing study as part of the Heartland Park audit, but this issue was brought to our attention by a local citizen after the report was released.

LPA Recommendation:** Consider amending the statute to require the marketing study be commissioned and directed by a state agency, conducted by an independent consultant, and paid for by the local government. **Section 3(b)(6) of SB 474 addresses this.

- **Current law is not clear as to which year should be used as the base for sales tax calculations for an expanded redevelopment district.** The requirement is clear for the original STAR bond district—the 12 months preceding the establishment of the district. However, the current version of the law does not specify the appropriate base year for an expanded STAR bond district. In conducting our audit of the Heartland Park project, we learned that the law previously used the same base year for both the original and expanded districts, but that

language was dropped when the law was revised several years ago.

LPA Recommendation: Consider amending the statute to clarify what should be the base year for an expanded district. **SB 474 does not appear to address the base year for expansions.**

- **The proposed boundaries for the Heartland Park project were being drawn beyond the scope of the project to capture revenue from existing businesses.** The original Heartland Park STAR bond district was limited to the area directly surrounding the track with the expectation that a commerce park would develop around it. That development never took place and as a result the district did not generate enough sales tax to pay off the bonds. In 2014, the city proposed an expanded district that would be more likely to generate enough sales tax to pay off the bonds. The city's proposal for an expanded district included the original Heartland Park area and would have added a nearly seven-mile stretch of Topeka Boulevard and would have encompassed existing businesses along this stretch. In September 2014, the Department of Commerce preliminarily approved this expanded district.

LPA Recommendation: Consider amending the statute to more closely align the boundaries of the STAR bond district with the redevelopment itself. **Section 1(y) and Section 5(a) of SB 474 address this.**

- **No state agency is explicitly charged with assessing the impact a STAR bond project will have on the State General Fund.** The statutes require the Secretary of Commerce to review the STAR bond project plan, feasibility study and market study, and other supporting documents to determine whether to approve the request and set the limit on the total amount of bonds that can be issued. In making these approvals, the Secretary is to consider whether the project sufficiently promotes, stimulates and develops the general and economic welfare of the state. While this could include the impact the project will have on state revenues, it is not explicitly listed.

LPA Recommendation: Continue to have Commerce evaluate STAR bond projects to assess their viability and determine if they meet the statutory requirements. Consider amending the statute to have KDOR assess the impact the projects will have on the SGF. Could further consider having KDOR certify that the project will not reduce sales tax revenues to the SGF. **Section 2(i) of SB 474 addresses this.**

Provisions Regarding Additional Post Audit Oversight of STAR Bond Projects

Senate Bill 474 includes a provision for an annual performance audit by our office of each STAR bond project, with the cost of the audits to be paid for by the local government. Section 6(d) on page 19 of the lays out this requirement. The audits would determine (1) the current status of each STAR bond project, (2) any significant changes to each project during the previous year, (3) whether each project has complied with all requirements pursuant to the STAR bond financing act, and (4) any other issues as determined by the Legislative Post Audit Committee. We would be required to develop a reasonable methodology for charging the costs of the audits back to the local governments, with that method being subject to approval by the committee.

There are a couple of issues I would like the committee to keep in mind with regard to this requirement:

- **Because we have never conducted these audits, it is difficult to know how much time and expense would be involved.** I would expect the first year to be the most expensive, as we

would need to audit all of the projects in some detail. My best guess is that the cost would be similar to a large performance audit for our office typically around \$250,000, The cost in future years should be much less as we would primarily be focused on changes to the projects.

- **We would take care to ensure the performance audits do not duplicate the current CPA audits that are required by the STAR bond statutes.** Government auditing standards require us to consider the work of other auditors. In this case, we would look at the work conducted by the CPA firms and use their findings wherever possible. While we might conduct additional work to follow up on problems they identified, we would not replicate the same testwork.

**Comparing the Bill Sections that Address the STAR Bonds Proviso Language in House Substitute for Senate Bill 161
HB 2738 (as introduced) vs. SB 474 (as amended by the Senate Committee of the Whole)**

Proviso Requirements in H Sub for SB 161		Bill Sections that Address the Proviso	
		HB 2738 (as introduced)	SB 474 (Sen COW)
Clawback Provision – A clawback provision for projects that fail to meet the 50% requirement; <i>[LPA Recommendation]</i>	Initial Bonding Authority	Sec 4(j) [p. 16]	Sec 2(k) [p. 8]
	Additional Bonding Authority	Sec 6(d) [p. 21]	Not Addressed
Independent Impact and Marketing Studies – a requirement that the economic impact and marketing study be commissioned and directed by a state agency, conducted by an independent consultant and paid for by the local government; <i>[LPA Recommendation]</i>		Sec 5(o) [p. 20]	Sec 3(b)(6) [p. 9]
Clarify the Base Year – a clarification as to what should be the base year for an expanded district; <i>[LPA Recommendation]</i>		Sec 2(hh) [p. 14] Sec 8(a) [p. 27]	Not Addressed
Restrict “Gerrymandering” of Project Boundaries – a requirement that the boundaries of the STAR bond district closely align with the redevelopment itself; <i>[LPA Recommendation]</i>	General Requirement	Sec 2(cc) [p. 13]	Sec 1(y) [p. 5]
	Overlay Districts	Sec 2(cc) [p. 13]	Sec 5(a) [p. 17]
Assess Project Viability and Compliance – an evaluation by the above agency [Dept of Commerce] to assess any project’s viability and a determination that the project meets the statutory requirements;		Sec 4(i) [p. 16]	Sec 2(i) [p. 8]

Proviso Requirements in H Sub for SB 161		Bill Sections that Address the Proviso	
		HB 2738 (as introduced)	SB 474 (Sen COW)
<p>Assess Impact on the State General Fund – an assessment by the above agency [Dept of Commerce] on the impact the projects will have on revenues into the state general fund and a certification by the above agency that the project will not reduce sales tax revenues to the state general fund;</p> <p><i>[LPA Recommendation]</i></p>		Sec 4(i) [p. 16]	Sec 2(i) [p. 8]
<p>Clarify Approval for Project Changes – a clarification as to the above agency’s [Dept of Commerce] authority to approve substantial changes to the project;</p>		Not Addressed	Not Addressed
<p>Address “Poaching” of Existing Businesses – an evaluation of the practice to minimize the effect of existing businesses moving into the district; and</p>	Criteria for Moves	Sec 4(e) [p. 16]	Not Addressed
	Base for Tax Increment	Sec 2(hh) [p. 14]	Not Addressed
<p>Sharing Incremental Tax Revenue – an evaluation of the method of revenue sharing on incremental sales tax growth above the base year</p>		Sec 7(a)(1)(F) [p. 23]	Not Addressed
<p>Post Audit Oversight – SB 474 requires annual performance audits of all projects by LPA with the cost to be paid by the local government. HB 2738 expands the annual reporting requirements for projects and includes the Post Audit Committee on the recipient list.</p> <p><i>[Not included in H Sub for SB 161 proviso]</i></p>	Audits by LPA	Not Addressed	Sec 6(d) [p. 19]
	Reporting to LPAC	Sec 7(c) [p. 26]	Sec 6(d) [p. 19]