



JOHNSON COUNTY FIRE DISTRICT 2
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www.jcfd2.org



February 15, 2013

Via Email: steve.huebert@house.ks.gov

Chairman Steve Huebert
Committee on Local Government
Kansas House of Representatives
State Capitol, Room 149-S
300 SW 10th Avenue
Topeka, Kansas 66612

Re: House Bill No. 2249
Outline of Proposed Testimony of Johnson County
Fire District No. 2
Tuesday, February 19, 2013, at 1:30 p.m.

Dear Chairman Huebert:

In anticipation of testifying in support of House Bill No. 2249, I submit the following summary of my proposed testimony.

BACKGROUND

Johnson County Fire District No. 2 is a rural fire district with four (4) fire stations fully staffed 24/7, providing the full complement of fire protection and paramedic services.

Our territory covers much of southern Johnson County, a large portion of northern Miami County, and the City of Spring Hill, Kansas. We strive to provide outstanding services to our patrons and have the best ISO rating of any surrounding fire departments.

ANNEXATIONS AND DETACHMENTS

Our Fire District has been under continuous financial pressure as a result of annexations and detachments of our territory by adjoining cities (i.e. they are eroding our tax basis with each annexation), yet often times the cities cannot provide the same level of service to the annexed areas as we can.

When a city annexes into fire district territory, the area annexed remains subject to fire district ad valorem taxes until the annexed area is "detached" from the fire district.

In other words, there is a two-step process: (1) First, a city “annexes” the property into the city; and (2) secondly, the city must “detach” the property from the fire district. Until the detachment occurs, the property remains subject to the ad valorem taxes of the fire district.

PAYMENT FOR GENERAL OBLIGATION BONDS

Fire districts issue general obligation bonds for acquisition or construction of fire stations and buildings, and to purchase firefighting equipment, just as other governmental entities, issue bonds for acquisition or construction of improvements.

To assure there will be adequate funds to provide fire protection and make future bond payments many years ago, the legislature passed K.S.A. 19-3623f(e) (1991), which provides that in the event of an annexation and detachment of fire district territory by a city, the annexed and detached property would no longer be a part of the fire district (i.e. not subject to payment of ad valorem taxes to the fire district), **except** if the fire district had issued general obligation bonds prior to the “detachment” the annexed property would remain obligated for payment of ad valorem taxes for payment on the existing bonds.

K.S.A. 19-3623f(e) reads as follows:

“(e) When the land annexed to such city is detached and excluded from such [fire] district the governing body of the district shall redefine the new boundaries of the [fire] district to exclude the land so detached. **All general obligation bonds issued for the acquisition or construction of fire stations or buildings, the acquisition sites therefore and the purchase of firefighting equipment by a fire district which are issued prior to the detachment of such land shall continue as an obligation of the property subject to taxation for the payment thereof at the time such bonds were issued.**
(Emphasis added)

Similar historical protections have been provided counties, townships, hospital districts, drainage and levee districts, sewage districts, etc.

K.S.A. 12-546’s ADOPTION

K.S.A. 12-546 was introduced in 2011 by Representative Kinzer, pursuant to a request by a resident in Olathe, Kansas. This resident of Olathe (Arlene Briggs) resided in another rural fire district, but was annexed into the City of Olathe. The City of Olathe failed to detach the Briggs property from the fire district territory pursuant to K.S.A. 19-3623f(e).

In the meantime, the rural fire district issued general obligation bonds. When Mr. Briggs subsequently received his property tax bill he discovered he was being assessed taxes by both the City and the fire district, including taxes for general obligation bonds of the fire district.

Yes, this was “double taxation” and would have never occurred had the City detached the property. Thus, we got K.S.A. 12-546, a well-intended piece of legislation, with one flaw.

Interestingly enough, this is the **only** occasion this ever occurred. Mr. Briggs, who had complained to Representative Kinzer, subsequently moved from Olathe and informs us he **supports** House Bill 2249. .

Representative Kinzer also supports the amendment to K.S.A. 12-546 found in House Bill No. 2249. In fact, in the 2011 Legislative Session he introduced House Bill 2778, a bill identical to current House Bill No. 2249, but could not get a Committee hearing on the same last year.

PROBLEMS WITH THE CURRENT VERSION OF K.S.A. 12-546

a) It Conflicts With a Long-Standing Statute

K.S.A. 12-546 currently reads:

12-546. City annexation of land in fire district; dual taxation; refund.

(a) If any land located within a fire district is annexed by a city and such land remains a party of the fire district beyond the current tax year, the owner of such land shall be entitled to a refund of all ad valorem taxes paid for fire service, **including any tax levy for bond and interest payments** from either the city or the fire district, whichever entity levies taxes for fire service against the land but does not provide such service.

(b) Cities and fire district shall establish procedures for landowners to obtain refunds of ad valorem property taxes as required by this section.

History: L.2011, Ch.101, §12; June 2 (emphasis added).

This directly conflicts with a longstanding law found at K.S.A. 19-2623(f)(e) dealing with the same issue.

“(e) When the land annexed to such city is detached and excluded from Such [fire] district the governing body of the district shall redefined the new Boundaries of the district to exclude the land so detached. **All general obligation bonds issued for acquisition of sites therefore and the purchase of firefighting equipment by a fire district which are issued prior to the detachment of such land shall continue as an obligation of the property subject to taxation for the payment therefore at the time such bonds were issued.** (Emphasis added)

In other words, the historical law is if the general obligation bonds were issued by a fire district prior to detachment, the subsequently detached property would remain subject to taxation for payment on the bonds. The law was intended to protect bond holders, who upon purchasing fire district bonds rely upon the assessed valuation of property in the fire district, and the ability of the fire district to repay the bonds. If property can be annexed and detached out of the fire district, then no longer be subject to taxation for payment on the previously issued bonds, potentially the bond holders will not be repaid.

b) Historical Protection for Bond Holders

Attached hereto is a letter from our bond counsel, Dorothea K. Riley of Kutak Rock LLP, dated August 5, 2011, explaining the adverse consequences of K.S.A. 12-546, and how the statute “...runs counter to the historical protections that Kansas and other states have provided for the payment of general obligation bonds.” As she states:

“Historically, Kansas law has protected the interest of bond owners in situations where property is annexed and, apart from K.S.A. 12-546, I am unaware of any Kansas statutes that disregard the security relied upon by bond owners to receive principal and interest payments on their bonds issued before the detachment.”

c) K.S.A. 12-546 Shifted the Tax Burden to Remaining Property Owners

The effect of the current version of K.S.A. 12-546 is to exempt the detached property from any further obligation to pay on fire district bonds, and shifts to the remaining property owners in the fire district the burden of making up for the lost taxes. The interest and principal payments still need to be made, and to accomplish this the mill levy of the remaining property owners must be increased.

d) Increases Costs

K.S.A. 12-546, as presently exists, has the effect of increasing the cost of issuing fire district general obligation bonds, which results in higher taxes of the fire district patrons.

Prospective bond holders, aware of the effect of K.S.A. 12-546, will see the inability of a fire district to meet its bond obligations. Because of this additional risk, prospective bond holders will demand a higher interest rate. That, in turn, results in additional costs to the fire district, which translates into higher property taxes to property owners.

e) K.S.A. 12-546 is Unconstitutional

The final reason K.S.A. 12-546 must be amended is because it may be unconstitutional as originally written.

When investors purchase general obligation bonds of a fire district it is represented that, pursuant to K.S.A. 19-3623f(e), if fire district territory is annexed/detached, the detached territory will continue to be subject to taxation for the payment of bonds issued prior to detachment. Thus, the fire district will continue to have the ability to make future interest and principal payments on the bonds, even in the event of future annexations by cities. This is a contractual covenant between the fire district and its bondholders.

Article I, §10 of the U.S. Constitution in its “Contract Clause” provides that no state shall pass any ex post facto law that impairs contract obligations. It is the contract between the fire district and bondholders which is impaired by the current version of K.S.A. 12-546.

A case on point, *U.S. Trust Company of New York v. State of New Jersey*, 431 U.S. 975 (1977), discussed this issue. It is a lengthy and difficult case to read, but in the footnotes the Court cites a long line of cases where state laws authorizing the impairment of municipal bond contracts have been held unconstitutional under the Contract Clause.

Currently K.S.A. 12-546 may violate the Contract Clause of the U.S. Constitution because it attempts to repeal the statutory covenant made to bond holders at the time the fire district bonds are issued (i.e. detached property would remain subject to taxation for payment of the bond obligations).

CONCLUSION

The solution to the current K.S.A. 12-546 is House Bill No. 2249, which is identical to the Bill introduced in the 2012 Session by Representative Kinzer.

This proposal would eliminate "double taxation" on property annexed by a city, but exclude taxes paid for general obligation bonds issued prior to detachment.

This amendment would result in K.S.A. 12-546 being compatible with K.S.A. 19-3623f(e), provide needed assurance to bond holders, and there would no longer exist an issue regarding constitutionality of the statute.

On behalf of Johnson County Fire District No. 2, I would ask the Committee to pass House Bill No. 2249.

Respectfully,

JOHNSON COUNTY FIRE DISTRICT NO. 2

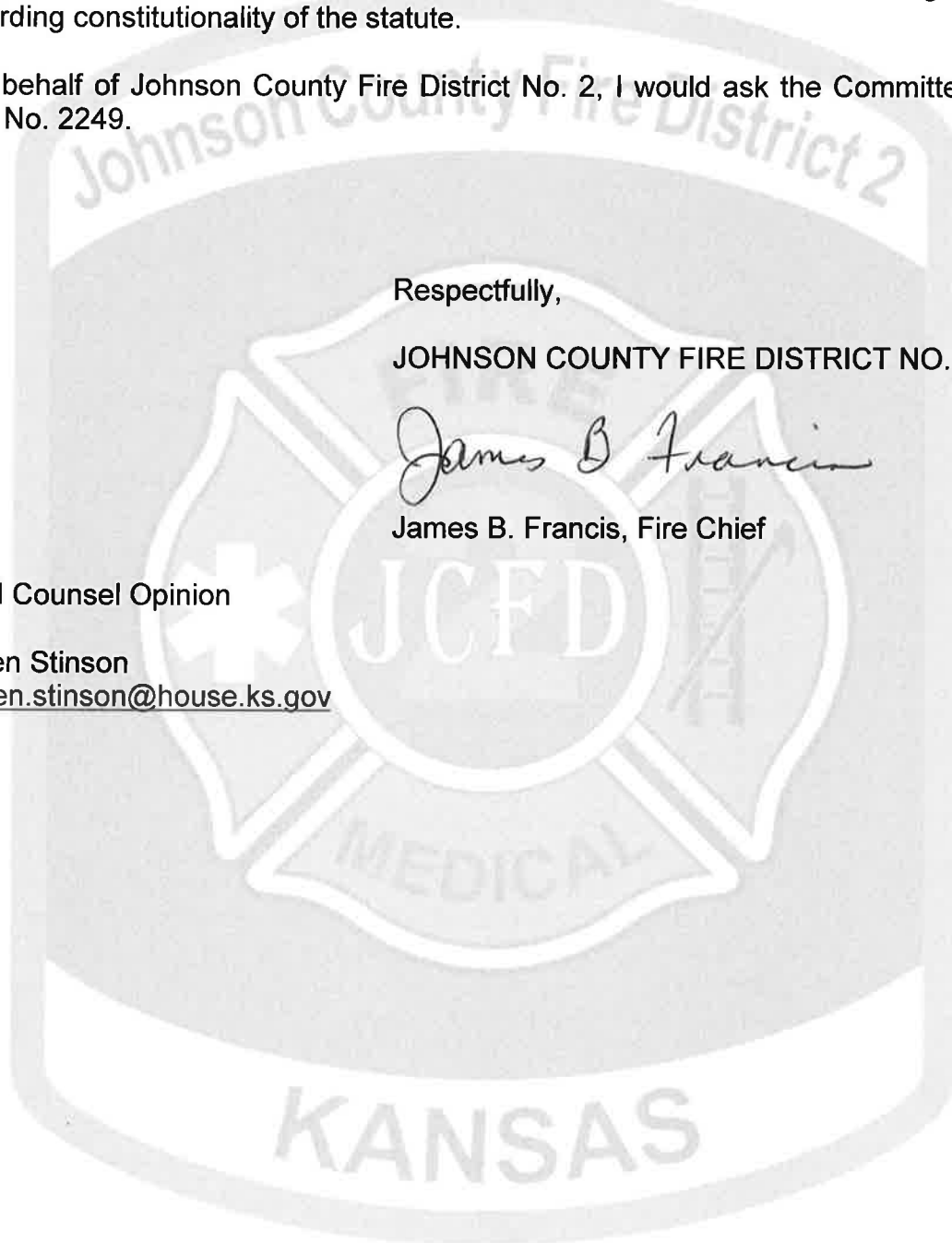


James B. Francis

James B. Francis, Fire Chief

Enc. Bond Counsel Opinion

cc: Maureen Stinson
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Chairman Rod L. Richardson
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10111 West 87th Street
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Re: Section 12, Senate Bill 150

Dear Rod:

In response to your letter of July 19, 2001, regarding Senate Bill No. 150 ("SB 150"), I reviewed the bill and share your concerns about the impact of this on the ability of Fire District No. 2 of Johnson County, Kansas (the "District"), to sell general obligation bonds in the future. As you know, general obligation bonds are payable from the full faith and credit of the governmental entity that issues the bonds. That obligation requires the governmental entity to levy unlimited ad valorem taxes to pay the debt service on the bonds unless other funds are available to repay the debt. Part of the standard disclosure in offering documents for the sale of bonds is a description of the source of revenue that is pledged to repay the debt. In the case of general obligation bonds, that description includes the current and historical assessed value of property within the taxing jurisdiction and the overall debt burden, *i.e.*, the dollar amount of outstanding bonds payable from ad valorem taxes, against property in the jurisdiction. These are relevant factors for an investor to consider in determining whether the investor is interested in purchasing the bonds being offered for sale, and, if the investor is interested, what price and interest will offer to purchase the bonds. Generally, the higher the assessed value and lower the debt burden within the taxing jurisdiction, the lower the risk is to the bond owner and, therefore, the lower the cost is to the taxing jurisdiction to sell their bonds. Issues of debt burden have also been addressed in numerous Kansas statutes that limit the amount of general obligation bonds an entity may issue based on the ratio of outstanding bonds to the assessed value of the jurisdiction. (*See*, for example, K.S.A. 10-306, K.S.A. 10-308, K.S.A. 12-1106, K.S.A. 17-1338, K.S.A. 24-1220 and K.S.A. 80-2513, all setting limits of bonded indebtedness in relationship to assessed value.)

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Under the provisions of SB 150, if any portion of the District's territory is annexed by a city and the city assumes fire service for the annexed property, the debt burden for the District's outstanding general obligation bonds is essentially reallocated to the remaining property in the District thereby increasing the ratio of debt burden to assessed value. Depending on the extent of the annexation and the relative values of the property annexed versus those remaining in the District, the debt burden for individual properties in the District could be increased substantially. In a worst-case scenario, all or virtually all of property in the District could be annexed resulting in no source of revenue to repay the outstanding bonds. Under federal securities law, the District is required to disclose this possibility to potential investors. I have visited with the District's financial advisor, David Arteberry of George K. Baum & Company, who indicated that, for the reasons previously mentioned, the reallocation of the tax burden described in SB 150 will, in his opinion, adversely affect the ability of the District to sell its general obligation bonds. David indicated this is likely to be a particular concern to investors considering the purchase of the District's bonds due to the District's prior annexations and future potential for annexation. SB 150 will require potential bond investors to assess if they are willing to invest in bonds that may have an unpredictably decreasing taxing territory (or even no taxing territory) to repay the debt service on the bonds.

In my opinion, the provisions of SB 150 also run counter to the historical protections that Kansas and other states have provided for the payment of general obligation bonds. In addition to SB 150 conflicting with the express provisions of the District's own statutes (K.S.A. 19-3623(f) which require property that is detached from the District to remain subject to taxation for the payment of bonds), SB 150 is inconsistent with the general bond law provisions which requires property that is detached from the territory of any municipality to remain liable for its proportion of the principal and interest on bonds that existed prior to detachment (K.S.A. 10-119). Historically, Kansas law has protected the interests of bond owners in situations where property is annexed and, apart from SB 150, I am not aware of any Kansas statutes that disregard the security relied upon by bond owners to receive principal and interest payments on their bonds issued before the detachment. There are numerous other Kansas statutes that deal with the payment of bonds by territory that is detached/annexed from a taxing jurisdiction and, to my knowledge, none of them follow the result prescribed by SB 150. In all other Kansas statutes on the subject that I am aware of, the property detached from an entity remains liable for the payment of bonds previously issued. See K.S.A. 10-1003 which provides that real estate detached by a change of boundary lines from any county or township remains subject to taxation for the payment of bonds "as though no change of boundary lines had been made;" K.S.A. 13-17,100 which provides that taxes to retire bonds shall continue to be levied on property detached from a fire district; K.S.A. 19-4603 which provides that property detached from a hospital district remains liable for payment of bonds issued during the time the territory was attached to the hospital district; K.S.A. 24-1107 which provides that the lien of bonds issued by a former Missouri drainage or levee district continues to operate on land annexed to a Kansas drainage or levee district and vice versa; K.S.A. 24-138 which provides that bonds issued by a drainage

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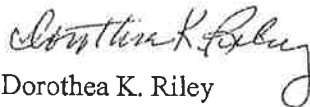
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district prior to annexation remain the liability of and lien against property to which the liability attached prior to annexation; K.S.A. 80-1513 which provides that territory within a fire district that is annexed by a city still continues to be liable for the payment of any outstanding bonded indebtedness existing at the time the annexation became effective; and K.S.A. 80-2022 which provides that sewage districts shall continue to levy special assessments against property annexed by a city which are necessary to retire bonds. I believe that this long history of legislation (excepting SB 150) requiring detached property to remain liable for taxes necessary to pay outstanding bonds demonstrates a clear historical recognition of the need to provide reasonable protection to bond owners to prevent defaults on Kansas general obligation bonds which, in turn, permits Kansas local government entities to successfully market their bonds and to do so at competitive rates.

One further note, the mechanics of SB 150 require a "refund" of the bond and interest tax levy to the owners of property no longer in the District and not being served by the District. K.S.A. 10-117 provides that any person who uses, aids or abets in using funds raised by taxation for the purpose of paying the principal or interest on bonds for any other purpose than paying the principal and interest on such bonds shall be deemed guilty of a misdemeanor and, on conviction, is subject to a fine and may be sentenced to imprisonment. Any officer of a municipality who is convicted under the statute must also forfeit his or her office. It is not clear to me if the "refund" concept nonetheless violates the requirements of K.S.A. 10-117 because funds levied to pay bonds are being used to pay property owners. Given the consequences of a violation, the District may want to seek further guidance on this question.

If you have any more specific questions or if I can be of any further assistance, please let me know.

Very truly yours,



Dorothea K. Riley