

Memorandum

TO: The Honorable Marvin Kleeb, Chair
House Committee on Taxation

FROM: Korb W. Maxwell

SUBJECT: S.B. 474

DATE: March 24, 2016

Mr. Chairman, Members of the Committee: Thank you for the opportunity to appear today before the Committee and to rise in opposition to SB 474. We appreciate the time and effort of the Chair and Committee to seriously study the issue of STAR Bond reform and to hold hearings on the subject. We believe several provisions in SB 474 are proposed to address the general consensus that the STAR Bond program should operate as intended; that is, that STAR Bond proceeds are efficiently and wisely spent, that the State is receiving its return on investment in STAR Bond projects, and that STAR Bond proceeds are utilized in a manner that fosters a true public-private partnership. These are all laudable goals that we support and commend. However, many of the provisions in SB 474 have the inadvertent effect in creating an unworkable STAR Bond program.

While we understand and respect the desire to bring a unique perspective and business acumen to management of the STAR Bond program, we have grave concerns with the statutory language as drafted. Many of the issues stem from the ability to finance STAR Bond projects. As such, we believe it would be beneficial to all to pursue additional study of these issues in future work sessions with stakeholders in the financing and underwriting community. Such discussions would serve to ensure that the reforms do not deter equity investment in STAR Bond projects, create obstacles to privately financing STAR Bond projects, and diminish the ability to attract investment in STAR Bonds. Further, many of the laudable objectives of the amendments (e.g., setting milestones for projects, requiring proof of private financing, etc.) are currently attainable administratively via the broad discretionary powers of the Secretary of Commerce to implement safeguards on a case-by-case basis. With this in mind, we ask the Chair and Committee to consider the amendments to SB 474 described below and in **Exhibit A**.

The first amendment is to K.S.A. 12-17,162(r)(21)(J), which provides for a 3% soft cost cap. Soft costs such as engineering and architecture are real costs to a project and often comprise 20% or more of total project cost. These “soft cost” expenditures allow Developers to lower hard cost expenditures (i.e., good engineering design saves construction cost). We recommend adoption of a 20% cap, which more reasonably represents the reality of such costs to a project but also levies a cap as desired.

The second amendment is to K.S.A. 12-17,166(c)(6), which requires a competitive bid process. Setting aside what competitive bidding means in the bill language, the intent of the provision is to prevent over-spending by a developer. Since typically 75% of the investment in a STAR Bond project is from private sources, the developer has significant motivation to keep costs as low as possible. Further, when City/public bidding is involved in a private construction

project it usually raises construction and design costs vs. private delivery methods, which frustrates the goal of the provision. As such, the language is unnecessary since the issue is addressed by the private financing stake in the project.

The third amendment is to K.S.A. 12-17,164(k), which requires the developer to contribute to an escrow account to ensure the project is at least 51% privately funded. This amendment should be deleted as it will create significant issues in privately financing a STAR bond project. Further, it is a solution for a problem that does not exist. No issue has ever arisen in the 15 plus years of STAR Bond history that this “solution” addresses. Further, the Secretary of Commerce possesses administrative powers to ensure the goals of this provision are met.

The fourth amendment is to K.S.A. 12-17,164(k), which provides that the Secretary of Commerce may condition approval on the state retaining a carried equity interest in the land or buildings financed by STAR Bonds and to receive a percentage of gross receipts received by the developer until the STAR Bonds have been repaid. Further, the proposed amendment provides that the developer will have a first right of refusal to buy back its own project from the state at fair market value. This proposed amendment should be deleted because the language will make it impossible to privately finance projects and will effectively eliminate the STAR Bond program from the State’s arsenal of economic development tools. In particular, the concept of a carried interest turns the STAR Bond program into an extremely complicated and expensive lending program. Moreover, it is a solution for a problem that does not exist. No issue has ever arisen in the 15 plus years of STAR Bond history that this “solution” addresses.

The fifth amendment is to K.S.A. 12-17,164(h) and K.S.A. 12-17,164(j)(1)-(2), which provide for the Secretary of Commerce to adopt rules and regulations concerning the initiation and completion of a STAR Bond Project under the threat of financial penalties and an automatic reversion to the State of the land and improvements financed with STAR Bonds if a STAR Bond Project is not completed by the Secretary’s imposed timeline. This amendment should be deleted as it will create significant issues in privately financing a STAR bond project. Further, it is a solution for a problem that does not exist. No issue has ever arisen in the 15 plus years of STAR Bond history that this “solution” addresses. The Secretary of Commerce possesses administrative powers to ensure the goals of this provision are met.

The sixth amendment is to K.S.A. 12-17,164(j)(1)-(2), which provides that the Secretary of Commerce may condition approval of a STAR Bond Project on the developer placing up to 10% of STAR Bond proceeds be placed in escrow. The Secretary of Commerce possesses administrative powers to ensure the goals of this provision are met.

The seventh amendment is to K.S.A. 12-17,162(y) and 12-17,171(a), which addresses district overlays. Inclusion of the raw ground adjacent to the Sporting KC stadium in a new STAR Bond district is critical to the future of the American Royal project. A hotel and convention center is planned for development upon that parcel in order to generate revenue to repay STAR Bond debt service for the American Royal project. Absolutely no base revenues from any other STAR Bond district will be transferred to pay STAR Bond debt service for the American Royal project—only new revenue from the hotel and convention center created by the activity of the American Royal. Further, the hotel will be entirely privately financed and the convention center will be financed by the Unified Government—neither will be financed from

STAR Bond proceeds. Lastly, in order to move forward with the American Royal project the date restriction in this provision must be moved forward in time for only a matter of months. We recommend July 1, 2016 as the trigger date for the restriction.

The eighth amendment is to K.S.A. 12-17,176(d), which requires the division of legislative post audit (“LPA”) to perform an annual performance audit at the developer’s expense. While we agree with the concept of oversight in STAR Bond projects, conducting such oversight through the LPA process on every project every year would be unduly burdensome in both expense and time for all parties. The development community is open to additional disclosure and oversight, we would ask that it be reasonable in its cost and time requirements. The proposed amendment to K.S.A. 12-17,169(c) contained in HB 2738, which calls for an annual report to the LPA committee, provides for oversight to STAR Bond projects while avoiding a burden upon those projects that would diminish the capacity to build first-grade regional and national attractions.

Based on the above, we recommend that SB 474 be amended as described above and as described in **Exhibit A**. I am happy to stand for any questions you may have.

Respectfully submitted,

Korb W. Maxwell

Exhibit A
PROPOSED REVISIONS TO SB 474

ISSUE #1: SOFT COST CAP

CURRENT SB 474 BILL LANGUAGE:

Section 1. K.S.A. 2015 Supp. 12-17,162 is hereby amended to read as follows: 12-17,162. As used in ~~this~~ *the STAR bond financing act*, and amendments thereto, the following words and phrases shall have the following meanings unless a different meaning clearly appears from the context:

(r) “Project costs” means those costs necessary to implement a STAR bond project plan, including costs incurred for:

(21)} except as specified in subsections {paragraphs} (1) through (19) {(20)} above, project costs shall not include:

(J) engineering, architectural, legal, consulting, accounting and other indirect costs that exceed 3% of the total STAR bond project costs}.

SUGGESTED AMENDMENTS TO CURRENT SB 474 BILL LANGUAGE (in bold, italics, strike-through and all caps)

Section 1. K.S.A. 2015 Supp. 12-17,162 is hereby amended to read as follows: 12-17,162. As used in ~~this~~ *the STAR bond financing act*, and amendments thereto, the following words and phrases shall have the following meanings unless a different meaning clearly appears from the context:

(r) “Project costs” means those costs necessary to implement a STAR bond project plan, including costs incurred for:

(21)} except as specified in subsections {paragraphs} (1) through (19) {(20)} above, project costs shall not include:

(J) engineering, architectural, legal, consulting, accounting and other indirect costs that exceed ~~3%~~ 20% of the total STAR bond project costs}.

ISSUE #7: OVERLAYS

CURRENT SB 474 BILL LANGUAGE:

Section 1. K.S.A. 2015 Supp. 12-17,162 is hereby amended to read as follows: 12-17,162. As used in ~~this~~ *the STAR bond financing act*, and amendments thereto, the following words and phrases shall have the following meanings unless a different meaning clearly appears from the context:

(y) "STAR bond project district" means the specific area declared to be an eligible area as determined by the secretary in which the city or county may develop one or more STAR bond projects. A STAR bond project district includes a redevelopment district, as defined in K.S.A. 12-1770a, and amendments thereto, created prior to the effective date of this act for the Wichita Waterwalk project in Wichita, Kansas, provided, the city creating such redevelopment district submits an application for approval for STAR bond financing to the secretary on or before July 31, 2007, and receives a final letter of determination from the secretary approving or disapproving the request for STAR bond financing on or before November 1, 2007. *No STAR bond project district shall include real property which has been part of another STAR bond project district unless such STAR bond project and STAR bond project district have been approved by the secretary of commerce pursuant to K.S.A. 2015 Supp. 12-17,164 and 12-17,165, and amendments thereto, prior to March 1, 2016. A STAR bond project district shall be limited to those areas being developed by the STAR bond project and any area of real property reasonably anticipated to directly benefit from the redevelopment project.*

SUGGESTED AMENDMENTS TO CURRENT SB 474 BILL LANGUAGE (in bold, italics, strike-through and all caps)

Section 1. K.S.A. 2015 Supp. 12-17,162 is hereby amended to read as follows: 12-17,162. As used in ~~this~~ *the STAR bond financing act*, and amendments thereto, the following words and phrases shall have the following meanings unless a different meaning clearly appears from the context:

(y) "STAR bond project district" means the specific area declared to be an eligible area as determined by the secretary in which the city or county may develop one or more STAR bond projects. A STAR bond project district includes a redevelopment district, as defined in K.S.A. 12-1770a, and amendments thereto, created prior to the effective date of this act for the Wichita Waterwalk project in Wichita, Kansas, provided, the city creating such redevelopment district submits an application for approval for STAR bond financing to the secretary on or before July 31, 2007, and receives a final letter of determination from the secretary approving or disapproving the request for STAR bond financing on or before November 1, 2007. *No STAR bond project district shall include real property which has been part of another STAR bond project district unless such ~~STAR bond project and~~ STAR bond project district ~~have~~**HAS** been approved by the secretary of commerce pursuant to K.S.A. 2015 Supp. 12-17,164 and 12-17,165, and amendments thereto, prior to ~~March~~**JULY** 1, 2016. A STAR bond project district shall be limited to those areas being developed by the STAR bond project and any area of real property reasonably anticipated to directly benefit from the redevelopment project.*