



PERFORMANCE AUDIT REPORT

Sales Tax and Revenue Bonds: Evaluating the Heartland Park STAR Bond Project

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
March 2015**

Legislative Division of Post Audit

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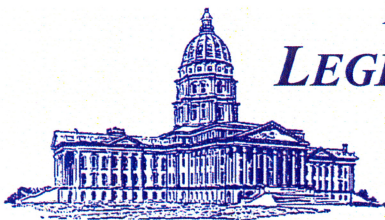
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March 4, 2015

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Sales Tax and Revenue Bonds: Evaluating the Heartland Park STAR Bond Project*. The audit was requested by Senator Hensley. We would be happy to discuss the findings, recommendations, or any other items presented in this report with any legislative committees, individual legislators, or other state officials.

Sincerely,

Scott Frank
Legislative Post Auditor

This audit was conducted by Kristen Rottinghaus, Brad Hoff, Heidi Zimmerman, Michael Shelton, and Daniel McCarville. Chris Clarke was the audit manager. If you need any additional information about the audit's findings, please contact Kristen at the Division's offices.

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Sales Tax and Revenue Bonds: Evaluating the Heartland Park STAR Bond Project

Sales Tax and Revenue (STAR) bonds create a mechanism for local governments to finance certain types of development and redevelopment projects. The STAR Bond Financing Act allows cities and counties to create project districts and to sell bonds to generate money to acquire land and pay for certain project costs. Cities and counties pay off those bonds over a period of time with the new revenues generated from sales taxes, transient guest taxes, and other taxes generated by businesses that are located within the STAR bond project districts.

K.S.A. 12-17,160 et. seq. specifies the actions that local governments and the Department of Commerce must take in order to fund a project through STAR bonds. For example, cities or counties proposing to establish a STAR bond project must describe the proposed boundaries of the project and conduct a study that evaluates whether revenues generated by the project will be sufficient to cover project costs. The Department of Commerce must determine that the project sufficiently promotes, stimulates, and develops the general and economic welfare of the state before approving STAR bond funding.

In 2006, the Topeka City Council issued \$10.4 million in STAR bonds to finance improvements at Heartland Park. However, revenues generated by that project were insufficient to make the bond payments, leaving the city with a remaining debt of about \$9 million as of June 2014. Currently, the city has prepared a proposal for submission to the Department of Commerce to issue additional STAR bonds to purchase Heartland Park and expand the project district. Although this action would raise the debt total to nearly \$17 million, the city estimates that the revenues generated would be sufficient to cover the project's increased cost.

Legislators have expressed concern that the recent proposal by the City of Topeka to purchase Heartland Park shifts the burden of bond repayment from the local government to the state and fails to meet other provisions of state law.

This performance audit answers the following question:

- 1. Does the City of Topeka's proposal to purchase Heartland Park meet the intent of the STAR Bond Financing Act and its requirements?**

A copy of the scope statement for this audit approved by the Legislative Post Audit Committee is included in ***Appendix A***.

To answer the question, we reviewed the STAR Bond Financing Act and its earlier versions to determine the legal requirements of STAR bond projects. We then spoke to City of Topeka and Department of Commerce officials and examined the city's STAR bond application to learn more about the current proposal. Finally, we compared the current proposal to the legal requirements and evaluated whether it appeared the proposal met those requirements. This evaluation should not be construed as a legal opinion.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We did not perform any work on internal controls because such work was not necessary to answer the audit question.

Our findings begin on page 7, following a brief overview of the Heartland Park STAR Bond project.

Overview of Heartland Park STAR Bond Project

STAR Bonds Allow Local Governments to Use Future Sales Tax Revenue to Pay Current Redevelopment Costs

Sales Tax and Revenue (STAR) bonds are an economic development tool that allows local governments to establish a redevelopment district and finance the redevelopment with bond proceeds. STAR bonds can help pay for property acquisition, site preparation, and infrastructure costs. A portion of the state and local sales tax revenue generated from the businesses in the district are diverted to the local government and used to pay off the bonds. The creation of a STAR bond district is a collaborative effort between state and local government because it uses both state and local sales tax revenue to pay off the bonds. According to statute, STAR bond projects are required to be paid off in 20 years. After that time, the project should be self-sufficient and the full amount of sales taxes from the district should revert back to state and local jurisdictions. The Department of Commerce is responsible for approving a STAR bond district and STAR bond projects.

In 2006, the City of Topeka Issued \$10.4 Million in STAR Bonds to Make Improvements to the Heartland Park Racetrack

The City of Topeka has owned Heartland Park since it opened in 1989. In 2003, the City of Topeka reached an agreement with Jayhawk Racing to operate Heartland Park. As part of this agreement, Jayhawk Racing inherited reversionary rights to Heartland Park from the previous operator. When STAR bonds were subsequently issued, this interest allowed Jayhawk Racing to obtain ownership of the track upon completion of the redevelopment project (2025).

In 2005, Jayhawk Racing and city officials identified several improvements necessary to establish Heartland Park as a major tourist destination for drag racing events. They requested STAR bonds to pay for these improvements, which included resurfacing the road course, adding additional grandstand seating, building garages, and developing a commerce park. At that time, the Kansas Legislature passed legislation that made Heartland Park eligible for STAR bonds and allowed the bond proceeds to pay for the project costs at the site. The Department of Commerce approved the project and the associated district, which was limited to Heartland Park.

In March 2006, the City of Topeka authorized the issuance of \$10.4 million in full faith and credit STAR bonds. The full faith and credit backing made the city responsible for debt service payments in the event the sales tax increment revenue of the businesses in the district were not enough to pay off the bonds. As required by law, these STAR bonds are to be paid off within 20 years or by 2025.

The City is Seeking to Amend the 2005 Project to Raise Additional Revenue and Keep the Racetrack Out of Foreclosure

The original Heartland Park STAR bond district did not generate enough sales tax increment revenue to pay off the bonds. In June 2014, city officials stated that because of this shortfall the city is responsible for about \$9 million in bond payments over the next 12 years. Also in that year, city officials worked with the Department of Commerce to propose an amendment to the original STAR bond project. If approved, the city will issue \$5 million in STAR bonds to purchase Jayhawk Racing's reversionary interest and pay off other debt obligations related to the property. Jayhawk Racing would no longer operate the racetrack and city officials would find a new manager for it.

The current proposal would also expand the original Heartland Park STAR bond district to encompass nearby businesses. Under the proposal, the state and local sales tax increment revenues from those existing businesses will be diverted and used to pay off both the original and new STAR bond debt. Additionally, the proposal includes several anticipated improvements, including the construction of a new banquet facility, new concessions buildings, and new bathrooms.

As of February 2015, the Department of Commerce had not made a final decision on whether to approve the proposed expanded Heartland Park STAR bond project. However, in September 2014 Department of Commerce officials issued preliminary approval of the project if certain conditions were met. Those conditions included providing a final line item budget for all STAR bonds, submitting project expenses to the Department of Commerce before payment is made, and demonstrating that the STAR bond financing will not exceed 50% of total project costs upon completion. If STAR bonds have not been issued by February 28, CoreFirst Bank & Trust is allowed to foreclose on Heartland Park. However, a mutual agreement between the City of Topeka, Jayhawk Racing, and CoreFirst Bank & Trust could allow for up to a 90-day extension.

The proposed expansion of the Heartland Park project is different from other STAR bond projects. STAR bond projects typically develop land and attract new businesses to locate within the district. Then, a portion of the state and local sales tax from these new businesses are used to pay off the bonds. The proposed plan put forth by the city does not require additional development of the Heartland Park area, but is intended to keep Heartland Park from entering foreclosure. Further, it diverts a portion of the sales tax from existing businesses to the project.

***As of February 2015,
the Current Proposal
Was on Hold Due to a
Legal Challenge by
Topeka Citizens***

After the City of Topeka authorized the purchase of Heartland Park and proposed expanding the redevelopment district, a citizen's group organized a petition drive to put the proposed purchase to a citywide vote. The city challenged the petition's validity and in November 2014, a Shawnee County district judge ruled that the petition was invalid. In response, petition supporters appealed the ruling to the Court of Appeals. The Court of Appeals was scheduled to hear arguments regarding the validity of the petition in late February 2015. As of the time of this report, it had not issued its final ruling.

Question 1: Does the City of Topeka’s Proposal to Purchase Heartland Park Meet the Intent of the STAR Bond Financing Act and Its Requirements?

We evaluated eight areas of the City of Topeka’s current proposal to purchase Heartland Park and expand the STAR bond district, and we found that all eight areas appeared to meet the requirements of the STAR Bond Financing Act. However, we also identified several issues based on that review. For example, we noted concerns about whether the current Heartland Park STAR bond proposal is the type of project the Kansas Legislature envisioned for STAR bonds and about the independence and reliability of the studies that demonstrate Heartland Park’s statewide economic impact. Additionally, we identified several areas where current statutes could be strengthened or made clearer.

We limited our work to the eight areas of the current proposal listed below. We selected these areas due to the amount of discussion they appeared to generate in newspaper articles and other publicly available information.

- **Purpose of the current proposal** – the current proposal is to retain Heartland Park rather than develop or expand the park. (page 8)
- **Use of the STAR bond proceeds** – the current proposal is to spend the additional STAR bond proceeds on acquiring clear title to the park, which involves buying the current operator’s reversionary interest and paying off debt obligations. (page 10)
- **Economic impact of the current proposal** – the current proposal must demonstrate that the project benefits the local, regional, and state economies. (page 11)
- **Expansion of the district boundaries** – the current proposal is to expand the boundaries of the original STAR bond district to capture additional revenue for repaying the original and new bonds. (page 13)
- **Base year for sales tax increment calculations** – the current proposal uses 2005 as the base year for sales tax increment calculations. (page 17)
- **Financial solvency of the current proposal** – the current proposal must demonstrate that it will generate enough sales tax increment revenue to retire the STAR bonds associated with the original project and proposed amendment. (page 18)

- **Share of project costs paid for with STAR bonds** – the current proposal must demonstrate that the amount of additional STAR bonds in the proposal will be less than 50% of total additional costs. (page 20)
- **Selling or leasing Heartland Park to a third party** – the current proposal includes selling or leasing the park to a third party after acquiring it. (page 23)

I. PURPOSE OF THE CURRENT PROPOSAL

A. Description of Current Proposal

The purpose of STAR bonds is to provide financing for unique entertainment and tourism areas that have the potential to draw significant numbers of visitors from outside the state. Further, STAR bond projects should have statewide economic benefits. Cities seeking STAR bond project financing must submit a project plan to the Department of Commerce. The department then determines whether the plan meets the criteria for a STAR bond project.

In 2014, the City of Topeka prepared the current proposal as an amendment to the original 2005 STAR bond project. The original 2005 project involved \$10.4 million in STAR bonds to make improvements to the park. The current proposal includes an additional \$5 million in STAR bonds to purchase clear title to Heartland Park. Although the city owns Heartland Park, the racetrack's current operator, Jayhawk Racing, has a real property interest (called a reversionary interest) in it that prevents the city from having complete ownership of it. In addition, the park is currently facing significant financial difficulties and is in danger of entering foreclosure.

The city plans to use the additional \$5 million in STAR bonds to buy Jayhawk Racing's reversionary interest, pay off its debts, and then sell or lease Heartland Park to a different racing management company. This plan will prevent Heartland Park from closing and the City of Topeka from having to raise property taxes for the payment of an estimated \$9 million in debt associated with the original 2005 project.

B. Issue

Concerns have been raised about whether it is appropriate to treat the current proposal as an amendment to the original Heartland Park project. Concerns have also been raised that the current proposal is not an allowable use of STAR bonds because it does not involve the creation or expansion of a new project.

C. Statutory Requirements

Although statute does not specifically mention amendments to projects, “substantial changes” to projects are permitted. K.S.A. 12-17,162(cc) defines substantial change as a substantial change to the intended purpose of the original STAR bond project. Further, K.S.A. 12-17,160 states that the purpose of the STAR Bond Financing Act is “to promote, stimulate, and develop the general and economic welfare of the state of Kansas...” The statute gives the Department of Commerce significant discretion in interpreting the meaning of this statutory language.

D. LPA Conclusion

Amending the original STAR bond project plan appears to meet the requirements of the STAR Bond Financing Act, although it is not clear the Legislature envisioned using the bonds to save an existing attraction.

Treating the current proposal as an amendment to the original Heartland Park project appears to be permissible because of the statutory language allowing for substantial change. However, the law is less clear about the types of projects for which STAR bonds may be used. It does not define the types of activities that promote, stimulate, and develop the state’s economy. Further, the law does not expressly identify retention as an activity that accomplishes such goals. However, the law gives the Department of Commerce significant discretion in determining whether the current proposal meant to prevent the closure of Heartland Park is an appropriate use of STAR bonds.

Additionally, it is not clear whether the current Heartland Park proposal is the type of project the Kansas Legislature envisioned for STAR bonds based on a comparison to the other projects the Department of Commerce has approved. Heartland Park is an anomaly because STAR bond projects typically involve creating a new attraction. For example, other STAR bond projects include the Kansas Speedway in Kansas City, the Kansas Underground

Salt Museum in Hutchinson, and the Flint Hills Discovery Center in Manhattan. Rather than creating a new attraction, the current proposal will use STAR bonds to prevent an existing attraction from entering foreclosure and to pay off the original STAR bond debt. This does not appear to be prohibited by statute, and the Department of Commerce has given preliminary approval to this proposal as a STAR bond project.

II. USE OF THE STAR BOND PROCEEDS

A. Description of Current Proposal

Currently, the City of Topeka owns Heartland Park and contracts with Jayhawk Racing to operate the racetrack. A stipulation of that contract allows Jayhawk Racing a future reversionary interest in Heartland Park. This means ownership of the racetrack would revert to Jayhawk Racing at the conclusion of the original Heartland Park redevelopment project (2025). However, Jayhawk Racing is facing significant financial difficulties and is willing to sell its reversionary interest to the city. The city plans to purchase the reversionary interest and secure clear title to the racetrack. Once purchased, the city plans to either sell the track or find a new operator.

B. Issue

Concerns have been raised that purchasing Jayhawk Racing's reversionary interest in Heartland Park is not an allowable use of STAR bond proceeds.

C. Statutory Requirements

K.S.A. 12-17,162(r)(1) states that STAR bonds can be used to acquire real property within the designated STAR bond area.

D. LPA Conclusion

Using STAR bonds to purchase Jayhawk Racing's reversionary interest and secure clear title to Heartland Park appears to meet the requirements of the STAR Bond Financing Act.

Kansas statutes permit the use of STAR bonds to acquire real property. Although reversionary interest is not real property per se, purchasing the reversionary interest is necessary for the city to secure clear title of Heartland Park, which is real property.

III. ECONOMIC IMPACT OF THE CURRENT PROPOSAL

A. Description of Current Proposal

City of Topeka officials submitted two studies to demonstrate that Heartland Park promotes the economic welfare of Kansas. The first was a 2005 report by a small team of economists, which provides a general framework for how Heartland Park could have increased economic activity in Topeka. It also provides estimates that show the racetrack would have generated sufficient sales tax revenue to pay off STAR bonds based on the activities that were proposed at that time. This report was originally submitted with the first STAR bond application for Heartland Park, and was resubmitted with the current proposal. Department officials told us the 2005 report was useful in the current proposal for making the general argument that Heartland Park generates economic benefits for the state, but that they did not consider its sales tax projections as documentation of the park's current economic impact.

The second was a 2012 report by a marketing research and strategic planning firm, which estimates the racetrack generated \$160 million in economic activity in 2011, including \$138 million in the Topeka area. It is based on a survey of individuals who attended events at Heartland Park. The survey asked respondents to estimate how much they spent on tickets and merchandise at the racetrack as well as food, drinks, hotels, and entertainment outside the park. The study applied a multiplier to these estimates to project Heartland Park's total economic impact.

B. Issue

Concerns have been raised about whether these studies accurately reflect the economic activity generated by the track. Opponents of the project have claimed the studies overstate its effects and may be biased because they were commissioned by Jayhawk Racing, the current operator of Heartland Park.

C. Statutory Requirements

The purpose of the STAR bond act is to “promote, stimulate, and develop the general and economic welfare of the state of Kansas.” In 2005, K.S.A. 12-1770a(k) required projects to include documentation describing fiscal and economic effects. These included whether the project would generate enough sales tax revenue to pay for the bonds and a statement of how jobs and taxes from the project would contribute to economic development in the

state. Current law, K.S.A. 12-17,162(e), has expanded that documentation to include a study that projects "...the financial benefit of the project to the local, regional, and state economies." Finally, K.S.A. 12-17,167(a) stipulates that the Department of Commerce "...shall review the STAR bond project plan, feasibility study, and market study, along with other supporting documentation and determine whether to approve a request."

D. LPA Conclusion

The current proposal includes a study of Heartland Park's economic impact that appears to meet the requirements of the STAR Bond Financing Act, although we noted some concerns about the studies submitted.

The current proposal includes an economic impact study as required by law. Specifically, current statutes require the proposal to include a study of Heartland Park's impact on the Topeka and statewide economies. The city submitted a 2012 report that surveyed visitors to Heartland Park and ultimately estimated the racetrack's total annual economic impact at \$160 million. This report appears to satisfy the city's legal obligation under the STAR Bond Financing Act. The city also submitted a 2005 report and although it does not quantify the projected economic impact of Heartland Park, it satisfied the legal requirements that were in place at the time.

While the two studies appear to meet the legal requirements, the studies do not represent an independent assessment of the proposal's economic impact. Both of the reports were commissioned by Jayhawk Racing who, like the City of Topeka, has a strong vested interest in seeing the proposal approved. Allowing the beneficiary to contract for these reports and provide future projections creates a strong risk of bias in the finished report. Given the investment the state is asked to make in foregone tax revenue, it is likely more appropriate to require an independent assessment of such proposals.

Finally, we identified several concerns with the two studies during our review. The 2005 report does not provide a quantitative analysis of the economic effects Heartland Park generates and much of the information it provides is outdated or based on inaccurate assumptions. Specifically, the information about sales tax revenues uses outdated projections and assumes certain improvements would be made at the track and that a more diverse scheduling of events would occur. Neither has actually happened.

Further, the methodology in the 2012 report was not described in enough detail for us to thoroughly review its assumptions and calculations. Even given those limitations, we identified two concerns from the information that was provided. First, the report estimated that visitors spent about \$18.7 million on tickets and merchandise at Heartland Park in 2011. That would equate to about \$1.4 million in state and local sales tax revenue. We used information from the Kansas Department of Revenue and determined actual spending on tickets and merchandise at Heartland Park was about \$5.7 million in 2011. This equates to about \$413,000 in state and local sales tax revenue—about one-third of the spending estimated in the report.

Second, the report does not account for the portion of visitor spending that would have occurred in Kansas even without Heartland Park. That is problematic because it is likely that many of the Kansas visitors would have spent money on food, gas, or sources of entertainment in Kansas even had they not attended an event at Heartland Park. Based on our rough calculations as described on pages 15 and 16, we estimate that Kansas residents account for a little more than half of the track's economic impact. In combination, these two problems suggest the 2012 report significantly overstates the economic impact of the track.

E. Recommendation for Legislative Consideration

To ensure state officials have an independent and unbiased economic impact assessment when considering future STAR bond proposals, the Legislative Post Audit Committee should consider introducing legislation to amend K.S.A. 12-17,166(b) to require the economic impact study to be directed by someone other than the local government or its private partners.

IV. EXPANSION OF THE DISTRICT BOUNDARIES

A. Description of Current Proposal

STAR bonds allow Kansas municipalities to issue bonds to finance entertainment or tourism areas and then use sales tax revenue to pay off those bonds. The sales tax revenues to pay off the bonds come from businesses within the specific STAR bond project district. The boundaries of the district are established jointly by the city or county and the Department of Commerce. Further, department officials told us that generally the district is drawn in such a way to produce sufficient sales tax revenue that the bonds can be paid off within 20 years.

When the original Heartland Park district was established in 2006, Department of Commerce and City of Topeka officials expected the increased activity at the racetrack would produce enough sales tax revenue to pay off the \$10.4 million in STAR bonds the city 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 never took place and as a result the district has not generated 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. Department officials told us they negotiated with the city to set boundaries that ensure the area is large enough to capture enough sales tax to pay the bonds, but not excessively large. The city's proposal for an expanded district includes the original Heartland Park area and adds a nearly seven-mile stretch of Topeka Boulevard from Heartland Park north to just past Southeast 37th Street. The new district would encompass existing businesses on Topeka Boulevard along this stretch. If the project is approved by the Department of Commerce, a portion of the state and local sales taxes from these existing businesses would be used until 2025 to pay off the bonds related to the project. In September 2014, the Department of Commerce preliminarily approved this expanded district.

B. Issue

Concerns have been raised about whether a STAR bond district can be expanded and for what reasons.

C. Statutory Requirements

Kansas statutes make reference to adding property to a district and substantial changes to a STAR bond plan. K.S.A. 12-17, 171(a) describes the process the city must follow when adding area to a STAR bond project district. However, the STAR Bond Financing Act, K.S.A. 12-17,160 et seq., does not describe how district boundaries should be drawn or the reasons for which they can be expanded. Therefore, the statute appears to give the Department of Commerce significant discretion in determining district boundaries.

D. LPA Conclusion

Expanding the boundaries of an existing STAR bond district appears to meet the requirements of the STAR Bond Financing Act.

The redrawn boundaries for the redevelopment district appear to meet the statutory requirements. The current proposal will significantly expand the boundaries of the existing district to include numerous businesses along Topeka Boulevard. This will allow the district to capture significantly more in sales taxes than under the original district boundaries. Statutes allow the expansion of a STAR bond district, but are silent as to how district boundaries are to be determined and the reasons for which they can be expanded. This would appear to give the Department of Commerce discretion in making those decisions, and because the expanded boundaries were agreed to by the City of Topeka and the department, the expanded boundaries appear to meet statutory requirements.

With the expanded boundaries, the Heartland Park STAR bond district will capture sales tax revenues that are not related to activity at Heartland Park. Because the original district boundaries only included Heartland Park, all sales tax revenues captured from within the district were clearly related to activity at Heartland Park. However, the expanded district will include existing businesses outside Heartland Park, and will capture those sales tax revenues year round, including days when there are no events at Heartland Park.

City of Topeka and Department of Commerce officials acknowledge that the Heartland Park STAR bond district will include some activity that is not attributable to the park. However, they also point out that the activities at Heartland Park have an economic and tax impact that extends far beyond the STAR bond district. Heartland Park attracts thousands of visitors on race weekends and those people patronize restaurants, shopping centers, and hotels throughout Topeka. Officials contend that most of this activity occurs outside the district, which means those sales tax revenues are not captured by the STAR bond district. Further, city and department officials told us the sales tax revenues captured within the district on non-event days are more than offset by the sales taxes the district does not capture on event weekends.

We calculated a rough estimate of Heartland Park's annual sales tax impact. Based on those calculations, city and department officials' argument that the sales tax revenues collected year round

in the district are comparable to the sales tax revenues generated on race weekends appears reasonable. First, we used the city's financial analysis (page 18) to estimate the annual incremental sales tax revenue that would be collected from the expanded district. We then used the 2012 economic impact study (page 11) to estimate the annual amount of state sales tax revenue Heartland Park generates (both within and outside the expanded district). To do this, we made some adjustments to the projections in the 2012 economic impact study to account for where the visitors came from (in state or out of state) and to make them more consistent with actual sales tax data from the Department of Revenue. The results of that work indicate the state sales tax revenues Heartland Park generates on race weekends are about two or three times larger than the state sales tax revenues the Heartland Park STAR bond district will collect year round. These results lend support to the argument that the foregone tax revenues from within the expanded district will be offset by the total taxes generated on race weekends.

There are two very important caveats to this analysis. First, this is only a rough analysis and includes a lot of assumptions. For example, we assumed all Heartland Park visitors (Kansas residents and non-Kansas residents) spend the same amount of money on their visit and that if Kansas residents had not spent their money at Heartland Park, they would have spent it on other entertainment activities within Kansas. If these assumptions are wrong, it could affect the results.

The second and equally important caveat is that our analysis is based on the 2012 economic impact study commissioned by Jayhawk Racing. As discussed on page 12, Jayhawk Racing has a strong interest in seeing the Heartland Park proposal approved, which creates a substantial risk that the study may be biased. However, this is the only information that exists. One point that may mitigate this concern is the magnitude of the results we found. Given that our rough estimate indicated the park generates about two or three times as much tax revenues as would be taken from the expanded district, the 2012 study would need to be off significantly to invalidate the results.

Given these caveats, the results of our analysis should be viewed only as an indicator that the city's and the department's contention appears reasonable, and should not be construed as absolute fact.

V. BASE YEAR FOR SALES TAX INCREMENT CALCULATIONS

A. Description of Current Proposal

STAR bonds allow local governments to issue bonds to finance entertainment or tourism areas and then use state and local sales tax revenue to pay off those bonds. Kansas law is specific about what portion of sales tax revenue generated from a STAR bond project district can be applied toward paying off the bond debt. That portion is the amount of sales tax generated in the district that is more than the amount generated during a specified base year. For example, a district established in January 2014 would have a base year of 2013. If the businesses in that district generated \$1 million in state and local sales tax revenue in 2013 and \$1.5 million in sales tax revenue in 2014, then the city could apply the difference of the sales tax, \$500,000, toward paying off the bonds. In this example, the state and local jurisdictions would continue to receive the \$1 million base amount.

Among other things, the current proposal includes expanding the Heartland Park STAR bond district to capture the sales tax increment revenue of existing businesses. The current proposal uses 2005 as the base year for determining the portion of sales tax the city could use to pay off the bonds. Department of Commerce officials consider 2005 as the appropriate base year for those calculations because it was the year prior to the original establishment of the district. The City of Topeka conducted a financial analysis using 2005 as the base year. That analysis showed the expanded district would generate an estimated \$18 million over the next 11 years to pay off the Heartland Park STAR bonds. Opponents of the current proposal have argued the base year should be 2013 because the expanded STAR bond district was proposed in 2014. Using 2013 as the base year, the expanded district would only generate an estimated \$3.2 million over the next 11 years for payment of STAR bonds debt, which would not be sufficient to pay off the bonds.

B. Issue

Concerns have been raised about whether it is appropriate for the current proposal to use 2005 as the base year for determining the sales tax increment revenue.

C. Statutory Requirements

At the time the original Heartland Park project was approved in 2005, K.S.A. 12-1771(f) specifically identified the base year of an expanded district as the date the original district was developed. Current statute, K.S.A. 12-17,162(dd), requires the base year to be the 12 months immediately prior to the month the STAR bond district was established. However, current statutes no longer address what the base year should be for an expanded district.

D. LPA Conclusion

Using 2005 as the base year for sales tax increment calculations appears to meet the requirements of the STAR Bond Financing Act, although those requirements are not as clear now as they were in 2005.

The 2005 base year for the expanded STAR bond district appears to meet the statutory requirements. In 2005, the law clearly identified the base year for an expanded district as the date the original district was developed. Absent any additional guidance about the appropriate base year in current statutes, it appears the department's interpretation to use 2005 as the base year for the expanded district is reasonable.

However, current law is less clear about the appropriate base year for an expanded STAR bond district. Although the law was clear in 2005, it was later modified, eliminating the language about the appropriate base year, but leaving the provision for an expansion to a district. It is unclear if that language was dropped inadvertently.

E. Recommendation for Legislative Consideration

To make the base year for an expanded STAR bond district clear, the Legislative Post Audit Committee should consider introducing legislation to clarify K.S.A. 12-17,162(dd).

VI. FINANCIAL SOLVENCY OF THE CURRENT PROPOSAL

A. Description of Current Proposal

As supporting documentation for the original Heartland Park STAR bond project in 2005, city officials submitted a financial analysis of the project. That report was conducted by a small team of economists and concluded that the original Heartland Park

STAR bond district would generate a sufficient amount of sales tax revenue through 2025 to pay off the \$10.4 million in STAR bonds issued. The report stated that the STAR bond district would attract additional racing events, concerts, and benefit from the establishment of a commerce park at Heartland Park. However, the original STAR bond district has not generated enough sales tax revenue to cover the debt service. Because the project was backed by the full faith and credit of the City of Topeka, the city is now responsible for those bond payments. The city estimates the amount needed is approximately \$9 million over the next 12 years.

Because of this debt, city officials worked with the Department of Commerce and developed the current proposal. This proposal significantly expands the Heartland Park STAR bond district to include enough businesses to pay off the original bonds. The current proposal also allows the city to acquire clear title to Heartland Park and pay off all other debt obligations with the property through an additional \$5 million in STAR bonds.

As supporting documentation for the current proposal, city officials updated the 2005 financial analysis to include information about the expanded district and additional STAR bonds debt service costs. The updated analysis used historical sales tax revenue from businesses in the proposed district from the Department of Revenue and assumed 1% annual growth. City officials concluded the proposed expanded district would generate sufficient state and local sales tax revenue to pay off \$16.6 million in STAR bonds debt by 2025. The city hired an independent accounting firm who reviewed the city's financial analysis and agreed with its conclusion.

B. Issue

Concerns have been raised about whether the current proposal of expanding the STAR bonds district will generate enough sales tax revenue to pay off the city's STAR bonds debt. That is because the original STAR bonds district has not generated enough sales tax revenue to cover debt service costs.

C. Statutory Requirements

K.S.A. 12-17,166(b)(1) requires the city to prepare a feasibility study, which shows that the project's sales tax increment revenue will be sufficient to pay for project costs. The current proposal uses 2005 as the base year for determining the portion of sales tax that the city could use to pay off the bonds. Department of

Commerce officials consider 2005 as the appropriate base year for those calculations because it was the year prior to the original establishment of the district. In its analysis, the city is required to show that the state and local sales tax increment revenue of the expanded district will pay for both the existing and new debt obligations within 20 years, or by 2025.

D. LPA Conclusion

The current proposal includes an analysis of the Heartland Park expanded STAR bond district's ability to pay off bond debt, which appears to meet the requirements of the STAR Bond Financing Act.

We reviewed the city's financial analysis and found that the calculations were correct and the city's assumption of 1% annual growth was reasonable. That is because the proposed expanded district's sales tax revenues have increased 30% between 2005 and 2013, or an average of about 3% per year. Based on the amount of incremental growth since 2005, and assuming 1% annual future growth, the current proposal appears to generate enough revenues to pay off the original and new bonds.

We also found that recent increases in state sales tax rates are included in the sales tax increment calculations for the proposed district. The state sales tax rate has changed twice since 2005 when the original Heartland Park district was established. In July 2010, the state sales tax rate increased from 5.3% to 6.3% and decreased to its current rate of 6.15% in July 2013. The changes in the state sales tax rate would account for 8%, or about \$4 million, of state sales tax revenue generated by the expanded Heartland Park STAR bond district from 2005 through 2014. Statute does not prohibit the city from including the sales tax rate increase since 2005 in its projections, although this means the proposed district's historic growth in sales tax revenue cannot be solely attributed to growth in the economy or attributed to the activity at Heartland Park.

VII. SHARE OF PROJECT COSTS PAID FOR WITH STAR BONDS

A. Description of Current Proposal

Under state law, Topeka can fund no more than 50% of the total costs of the project through STAR bonds. In order for the current proposal to be approved, city officials must submit a plan that

demonstrates that at least half the total project costs will be paid for from other sources by the time the project is completed in 2025. The current proposal requests \$5 million in additional STAR bonds to purchase the current operator's financial interest in Heartland Park. To meet the 50% requirement, city officials need to identify at least an additional \$5 million in other project costs that are to be funded through a different revenue source.

City officials have submitted a plan that outlines two ways the current proposal will meet the 50% requirement. First, the plan will require the new operator of Heartland Park to invest at least \$5 million in the park for improvements such as resurfacing the track, building banquet facilities, and expanding the public address system. Second, the plan will require the current operator to match the \$5 million in STAR bond proceeds by releasing its entire financial interest in Heartland Park. According to the plan, the current operator's financial interest is valued at \$15.3 million based on the 2013 appraised value of Heartland Park. The plan identifies the difference (\$10.3 million) between the value of the financial interest (\$15.3 million) and the price at which the city will be allowed to purchase that interest (\$5 million) as a project cost. According to city officials, the \$10.3 million is a contribution to the project from a source other than STAR bonds and therefore factors into the 50% calculation.

B. Issue

Concerns have been raised about whether the current proposal includes enough project costs to meet the legal requirements of the STAR Bond Financing Act.

C. Statutory Requirements

K.S.A 12-17,168(c) limits the amount of additional STAR bonds that may be issued to no more than 50% of the total costs of the addition to the STAR bond project.

D. LPA Conclusion

The city's current proposal appears to meet the requirement that STAR bonds do not finance more than 50% of the total costs of the project, although we noted some concerns about the statute.

The city's plan to require at least a \$5 million investment in Heartland Park by the new park operator appears to meet the 50% requirement. Statute prohibits the Department of Commerce from

approving STAR bonds in an amount greater than 50% of the total cost of the project. To comply with this statutory requirement, the department required the city to provide a plan detailing the total costs of the project. The city provided a list of improvements they expect will be made to the park that totaled \$7 million (\$5 million in necessary costs plus \$2 million in optional costs). Because the \$5 million in STAR bonds used to secure clear title to Heartland Park is also a project cost, the department's issuance of \$5 million in bonds is less than 50% of the total costs (\$10 to \$12 million) and so complies with the law.

However, there is no guarantee the city will be able to find an operator that is willing to make such an investment, which highlights a problem with the current law. City officials have said they do not plan to operate the racetrack but will hire a racing management company to do so. Officials told us the new operator will be contractually obligated to invest \$5 million in the facility, but because a contract has not been executed, there is a risk that may not occur. While the law requires that STAR bonds be used to finance no more than 50% of total project costs, whether the city achieves that cannot be fully determined until the end of the project in 2025. However, if in 2025 it is determined that the city did not meet this requirement, statute does not have a provision that would require the city to pay any amount back to the state.

It is less clear whether the city's plan to count the excess value of Jayhawk's reversionary interest would meet the 50% requirement. The city of Topeka already owns Heartland Park, but plans to use the \$5 million in STAR bonds to buy Jayhawk Racing's reversionary interest so the city can own clear title to the park. The property is currently valued at \$15.3 million. City officials have proposed that the excess value of this reversionary interest (over and above the \$5 million purchase price) be counted as a project cost.

Using the excess value of the reversionary interest to satisfy the 50% requirement is problematic for two reasons. First, it is not clear that an intangible contribution like the reversionary interest is an appropriate project cost for meeting the 50% requirement. Even if it is appropriate to count this as a cost, it does not seem appropriate to value it at \$15 million. That is because what the city is buying back is the reversionary interest in a \$15 million property, not the \$15 million property itself. It is unclear what that interest is actually worth, but it is likely to be far less than \$15 million. It seems unlikely that an investor would pay \$15 million now for an opportunity to own the park 10 years from now (when the STAR bonds are paid off).

However, it does not appear to matter if this approach satisfies the 50% requirement because the city's plan to require the new operator to invest \$5 million does appear to satisfy the requirement.

E. Recommendation for Legislative Consideration

To help ensure the 50% requirement is enforceable, the Legislative Post Audit Committee should consider introducing legislation to amend K.S.A. 12,17-164 and K.S.A. 12,17-168 to require cities or counties that do not meet the 50% requirement at the end of the STAR bond period to repay a portion of that amount to the state.

VIII. SELLING OR LEASING HEARTLAND PARK TO A THIRD PARTY

A. Description of Current Proposal

Heartland Park is currently owned by the City of Topeka and operated by Jayhawk Racing. Jayhawk Racing has reversionary interest in the property, which means it will take future title to the property. The current proposal will allow the city to acquire clear title to the park by purchasing the reversionary interest from Jayhawk Racing. The proposal would also relinquish Jayhawk Racing from managing the racetrack.

City officials have stated the city does not plan on operating the racetrack and instead plans on selling or leasing it to another company with racing experience. Officials stated they are currently seeking a company to manage the track.

B. Issue

Concerns have been raised that statutes prohibit STAR bond financing to be used for purchasing or constructing property and then selling that property to a third party.

C. Statutory Requirements

At the time the initial Heartland Park project was approved in 2005, statutes prohibited STAR bond funds from being used on the construction of buildings to be sold to a third party developer. However, those same statutes (K.S.A. 12-1780b(c)) gave Heartland Park a specific exemption to that requirement.

Since 2005, the law has been amended several times. Current state law, K.S.A. 12-17,162(r)(20)(A), prohibits the use of STAR bonds on building construction. However, the current version of the law does not have the provision prohibiting sale or lease to a developer. Further, K.S.A. 12-17,162(r)(18) and K.S.A. 12-17,162(k), continue to identify Heartland Park as an exception to certain statutory requirements.

D. LPA Conclusion

Selling or leasing Heartland Park to a third party appears to meet the requirements of the STAR Bond Financing Act.

Although current state law does not explicitly allow the sale or lease of buildings to a developer, it also does not explicitly prohibit this. Further, although 2005 statutes prohibited the use of STAR bonds for buildings sold to a developer, Heartland Park was given a statutory exemption.

APPENDIX A

Scope Statement

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on December 18, 2014. The audit was requested by Senator Hensley.

Department of Commerce: Evaluating the Heartland Park Racetrack STAR Bonds Project

STAR bonds create a mechanism for local governments to finance certain types of development and redevelopment projects. The STAR Bond Financing Act allows cities and counties to create project districts and to sell bonds (commonly referred to as STAR bonds) to generate money to acquire land and pay for certain project costs. Cities and counties pay off those bonds over a period of time with the new revenues generated from sales taxes, transient guest taxes, and other taxes generated by businesses that are located within the STAR bond project districts.

Although STAR bond projects are initiated at the local level, a significant portion of the money used to pay back the bonds are through forgone state sales tax revenues. For example, our 2005 audit of the Kansas Speedway and Village West development in Wyandotte County found that about two-thirds of the money used to repay STAR bonds for that project would come from forgone state sales taxes. That is because the majority of all sales tax revenues are remitted to the state.

K.S.A. 12-17,160 et. seq. specifies the actions that local governments and the Department of Commerce must take in order to fund a project through STAR bonds. For example, cities or counties proposing to establish a STAR bond project must hold a public hearing, describe the proposed boundaries of the project, and describe the project plan. These local governments must also conduct a feasibility study that, among other things, evaluates whether revenues generated by the project will be sufficient to cover project costs. The Department of Commerce must determine that the project sufficiently promotes, stimulates, and develops the general and economic welfare of the state before approving STAR bond funding.

In 2006, the Topeka City Council issued \$10.5 million in STAR bonds to finance improvements at the Heartland Park Racetrack. However, revenues generated by that project were insufficient to cover its costs, leaving the city with a remaining debt of about \$10 million as of December 2014. At that point in time, the city was still considering whether to issue additional STAR bonds to purchase the Heartland Park Racetrack. Although this action would raise the debt total to \$17 million, the city estimates that the revenues generated would be sufficient to cover the project's increased cost.

Legislators have expressed concern that the recent proposal by the City of Topeka to purchase the Heartland Park Racetrack shifts the burden of bond repayment from the local government to the state and fails to meet other provisions of state law.

A performance audit in this area would address the following question:

- 1. Does the city of Topeka's proposal to purchase the Heartland Park Racetrack meet the intent of the STAR Bond Financing Act and its requirements?** We would work with Department of Commerce and Topeka city officials to better understand details of the current proposal to purchase the Heartland Park Racetrack and whether it meets the intent of the STAR Bond Financing Act and its requirements. Specifically, we would evaluate how the project's district boundaries are drawn, how the base year for revenue projections has been set, and whether only 50% of the project is to be funded through STAR bonds as required by law. We would also evaluate the anticipated economic benefits for the state as a whole. We would perform additional work in this area as necessary.

Estimated Resources: 3 LPA staff

Estimated Time: 3 months (a)

From the audit start date to our best estimate of when it would be ready for the committee.

APPENDIX B

Agency Response

On February 13, 2015, we provided copies of the draft audit report to the Department of Commerce and the City of Topeka. Their responses are included in this appendix.

The Department of Commerce and the City of Topeka generally agreed with the report's findings and conclusions. The report did not include any recommendations to the agencies. We made a few minor clarifications to the report as a result of the agencies' review of the draft report, but those changes did not affect any of our findings or conclusions.

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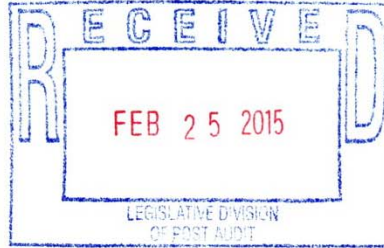


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Pat George, Secretary

Sam Brownback, Governor

February 24, 2015



CONFIDENTIAL

Scott Frank
Legislative Post Auditor
Legislative Division of Post Audit
800 SW Jackson St., Suite 1200
Topeka, KS 66612

RE: Sales Tax and Revenue Bonds: Evaluating the Heartland Park STAR Bond Project

Dear Mr. Frank:

We have received the final audit report and thank you for your efforts. We agree with LPA's finding of compliance with the STAR Bond process and pertinent legal requirements. There are inherent difficulties in performing an audit prior to completion of the project and before all the facts are available. Your team performed well under these circumstances.

Thank you again for your work on this report. We enjoyed working with your staff and appreciate their professionalism.

Sincerely,

Pat George
Secretary



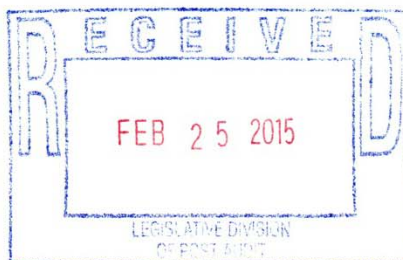
CITY OF TOPEKA

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Wednesday, February 25, 2015

Legislative Division of Post Audit
C/O Scott Frank, Legislative Post Auditor
800 Southwest Jackson Street, Suite 1200
Topeka, Kansas 66612



Dear Mr. Frank,

I want to thank you and your team for your work in auditing the ongoing Heartland Park STAR bond project and am pleased that you found that the City of Topeka met all of the legal standards outlined in the scope of work assigned to your auditing team as stated on page D-7 of the report. As discussed in our numerous meetings, we agree that Heartland Park is an important economic driver for both the State of Kansas and the City of Topeka.

I wanted to make a special point of thanking you and your staff for the professionalism and expediency in delivering a comprehensive report regarding a complex topic. This is especially true as you were tasked with evaluating a project that is still developing. I believe at all times the City and staff of the Legislative Division of Post Audit Division worked collaboratively and professionally to address the Scope of Work which you were assigned.

I look forward to attending the meeting of the committee on March 4, 2015 to hear feedback on this exciting ongoing project.

Sincerely,

Jim Colson
City Manager

