



NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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November 17, 2015

Daniel E. Geary
Chairman
Norfolk Airport Authority
4100 South 13th St., P.O. Box 1343
Norfolk, NE 68702-1343

RE: Barnstormers Lease Agreement

Dear Chairman Geary:

As you know, the Nebraska Auditor of Public Accounts (APA) received a concern regarding the current lease agreement between the Norfolk Airport Authority (NAA) and Barnstormers Bar and Grill (Barnstormers), which currently occupies space in the old terminal building of the Norfolk Airport. In response to that concern, the APA began limited preliminary planning work to determine if a full financial audit or attestation of the NAA was needed. Pursuant thereto, the APA requested certain information regarding the NAA's lease agreement with Barnstormers.

Based upon the outcome of the preliminary planning work, the APA has determined that a separate financial audit or attestation of the NAA is unnecessary at this time. However, during the course of the preliminary planning work, we noted certain internal control or compliance matters, or other operational matters within the NAA, that are presented below. The following information is intended to improve internal controls or result in other operational efficiencies.

The lease agreement at issue was entered into on December 8, 2010. Language found in Section 19(B) of that document authorizes the NAA, at its discretion, to "make any payment required of LESSEE or do anything necessary to correct any default of LESSEE under the provisions of this Lease" Despite its discretionary nature, this provision might still give rise to some concern regarding Article XIII, § 3, of the Nebraska State Constitution, which serves "to prevent the State or any of its governmental subdivisions from extending the state's credit to private enterprise," thereby "acting as a surety or guarantor of the debt of another." *Haman v. Marsh*, 237 Neb. 699, 718, 467 N.W.2d 836, 850 (1991).

More to the point, however, the Nebraska Supreme Court has recognized a longstanding principle of constitutional law that not only emanates from but also serves as an important corollary to the prohibition in Article XIII, § 3 – namely, that public funds may not be expended for a private purpose. *State ex rel. Beck v. York*, 164 Neb. 223, 225, 82 N.W.2d 269, 271 (1957). In fact, the NAA has exercised its discretion under Section 19(B) of the lease agreement by making certain payments on behalf of Barnstormers.

Neb. Rev. Stat. § 3-511 (Reissue 2012) declares "the creation of an authority and the carrying out of its corporate purposes" to constitute "a public purpose and a matter of statewide concern" and "aviation projects operated by authorities" to be "essential parts of the public transportation system." That same statute

concludes by saying, “This section shall not be construed to affect the obligation of a lessee to pay taxes if taxes are due under sections 77-202, 77-202.11, and 77-202.12.”

It is our understanding that Barnstormers pays property taxes on the space that it leases in the old terminal. Neb. Rev. Stat. § 77-202(1)(a) (Cum. Supp. 2014) exempts from property taxes “[p]roperty of the state and its governmental subdivisions to the extent used or being developed for use by the state or governmental subdivision for a public purpose.” Section 77-202(1)(a)(ii), which defines “public purpose,” says, as is relevant, “Public purpose does not include leasing of property to a private party unless the lease of the property is at fair market value for a public purpose.” In light of these statutory provisions, the fact that Barnstormers pays property taxes on the leased space indicates that the restaurant serves a private purpose, not a public one.

In a well-reasoned letter, as enclosed, written to APA Audit Manager Cindy Janssen on October 12, 2015, Clint Schukei, the NAA’s legal counsel, explained Section 19(B) of the lease agreement as follows:

I believe that this is a common provision in a triple net lease. Furthermore, I believe that while this may not be a triple net lease, it certainly has many characteristics of such a lease. This sort of provision would be included in a lease to assure that if a tenant fails to pay the taxes, insurance or utilities, the owner of the property can do so. By doing so, the owner can make sure that insurance remains in force to cover the property or that utilities serving the property are not shut off exposing the property to damage from freezing temperatures. Real estate taxes are not applicable to this situation because of the special rules in place for governmentally-owned property leased to a private entity. However, such a provision would be appropriate in a typical lease where the property is not owned by a governmental subdivision.

While appreciative of Mr. Schukei’s description of the utilitarian purpose served by Section 19(B), the APA remains unconvinced that, despite its beneficial intent, such a provision passes constitutional muster under Article XIII, § 3.

If, as indicated by its property tax status, Barnstormers is indeed a private business that serves something other than a public purpose, it appears improper for the NAA to agree to expend public funds on the restaurant’s behalf to correct any default of the lease terms. Regardless of the apparently sound impetus for doing so, acting upon Section 19(B) of the lease agreement with Barnstormers could risk the improper expenditure of public funds for a private purpose.

Finally, in the concluding section of his letter, Mr. Schukei explains the difficulty occasioned by the fact that various NAA Board members and Norfolk City Council members has business relationships with Barnstormers. The Nebraska Political Accountability and Disclosure Act (Act), which is set out at Neb. Rev. §§ 49-1401 to 49-14141 (Reissue 2010, Cum. Supp. 2014), addresses matters involving actual or potential conflicts of interest on the part of public officials.

Of particular importance is Neb. Rev. Stat. § 49-14,100 (Reissue 2010) of the Act, which authorizes the Nebraska Accountability and Disclosure Commission (Commission) to issue advisory opinions regarding matters falling within its purview:

Any person who is in doubt as to the propriety of action proposed to be taken by him may apply to the commission for an advisory opinion relating thereto, and the commission shall have authority to render such opinions. When an advisory opinion is issued pursuant to a complete and accurate request, such opinion shall be a complete defense to any charge of violation of sections 49-1493 to 49-14,104 as to any action taken strictly subject to the terms of such opinion.

While it can be acceptable for Board or Council member’s personal business to conduct business with NAA, whenever faced with the possibility of taking action that could result in a violation of any provision of the Act, seeking an advisory opinion from the Commission is a prudent course of action.

We recommend that the NAA consider the propriety of Section 19(B) of its lease agreement with Barnstormers, eliminating that provision if it is determined to be in conflict with Article XIII, § 3, which prohibits extending the credit of the State or any of its political subdivisions, or the common law corollary thereto, which prohibits the expenditure of public funds for private purposes. We recommend further that the NAA seek guidance from the Commission regarding how to deal with any actual or potential conflicts of interest on the part of its Board members.

* * * * *

Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the NAA to make comments and suggestions that we hope will be useful to its Board members.

This communication is intended solely for the information and use of the NAA and its management. It is not intended to be, and should not be, used by anyone other than the specified parties. However, this letter is a matter of public record, and its distribution is not limited.

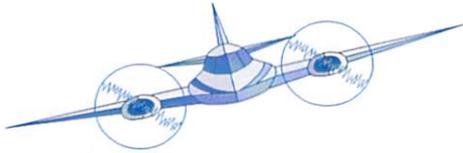
If you have any questions regarding the above information, please contact our office.

Sincerely,



Mary Avery
Special Audits and Finance Manager
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Enclosure



NORFOLK AIRPORT AUTHORITY

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October 12, 2015

Ms. Cindy Janssen
Audit Manager
Nebraska Auditor of Public Accounts

Dear Ms. Janssen:

This response is being provided to your email of September 23, 2015 to the Norfolk Airport Authority. That correspondence posits several questions to the Authority. I will endeavor to address each of your questions. I will respond to your number 2 and 3 questions together in number 2 below.

1. Your first question asks why paragraph 19, specifically subsection (b), was included in the lease. I did not write the lease or advise the Authority as they approved the lease. However, I believe that this is a common provision in a triple net lease. Furthermore, I believe that while this may not be a triple net lease, it certainly has many characteristics of such a lease. This sort of provision would be included in a lease to assure that if a tenant fails to pay the taxes, insurance or utilities, the owner of the property can do so. By doing so, the owner can make sure that insurance remains in force to cover the property or that utilities serving the property are not shut off exposing the property to damage from freezing temperatures. Real estate taxes are not applicable to this situation because of the special rules in place for governmentally-owned property leased to a private entity. However, such a provision would be appropriate in a typical lease where the property is not owned by a governmental subdivision.
2. I am not aware, as part of the process of approving the lease, of any particular discussion by the Authority about the constitutionality or specific statutory authority related to providing public funds to Barnstormers. As you note in your email, there is authority for the Authority to lease property. It seems that there is a logical argument to be made that during the term of a lease an owner may need to step in and take actions, in light of a situation that has developed, to protect the property that they own. As noted in the previous paragraph, this may be necessary to keep insurance or utilities in place. The Authority, since the inception of the lease, paid the electric bill when received, allocated a portion of the electricity to Barnstormers and awaited reimbursement by Barnstormers to the Authority for the electricity that was used. That worked successfully for a time. Eventually, Barnstormers quit reimbursing the Authority for the electricity that

Barnstormers used. The Authority worked diligently to get Barnstormers to pay their obligation for the electricity. Concern about extending the credit of the state or expending public funds for a private purpose was brought up as the Authority considered its options related to Barnstormers. The Authority considered termination of the lease, renegotiation of the lease, and after a number of months of delinquency, the Authority authorized Barnstormers to pay the delinquency off over an 8-month period that will end in December of 2015.

3. The terminal lease has been a challenge for the Authority, Barnstormers, and the community. Since the inception of the lease, there has been at least one member of the 5-member Authority Board that has been a shareholder in Barnstormers. Since December, 2014, three members of the Board have been investors. So the Board now has a majority of its members having a conflict of interest. Barnstormers' principles, at the beginning of the lease, were made up of two individuals who held elected office as members of the Norfolk City Council. Barnstormers has seen some changes and one of its principles is no longer involved in it. The president of Barnstormers remains a Norfolk City Councilman. In that elected capacity, he and the other members of the City Council must each year approve the real estate tax request of the Authority. Additionally, there has been discussion about the possibility of renegotiating the lease between Barnstormers and the Authority.

It would be of great benefit to learn whether this response has adequately addressed your concerns or if you have other comments or questions.

Thank you.

Sincerely,



Clint Schukei
Norfolk Airport Authority Attorney

Letter sent by email transmission to Cindy.Janssen@nebraska.gov