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TO: Senate Committee on Finance

FROM: Doug Hoffer, State Auditor, Vermont State Auditor's Office

DATE: February 24, 2023

RE: Observations: S.83 An act relating to the creation of a project-based tax increment financing program

Multiple proposals for a project-based tax increment financing (TIF) program have been considered by the Legislature since H.642 was introduced in January 2020. The most recent iteration, S.83, has the least protections offered to-date, and thus the greatest potential impact to the Education Fund.

Because of the program's seeming focus on a single project, it may also represent the greatest risk to municipalities. Contrary to the more ambitious TIF district program, which generally includes multiple public improvements, and forecasts a range of private development types (e.g., housing, commercial, retail), it appears that project-based TIFs rely on a single type of private real property development such as housing to generate the growth in property values needed to repay debt incurred to pay for public improvements. If this type of growth doesn't occur, there may not be a realistic alternative for some of the small communities this program is intended to assist.

For context, consider this. Over the years, VEPC has considered 141 VEGI applications. Of those, 63 (46%) were either cancelled or terminated.[1] That is, not all business plans come to fruition, regardless of the size, experience, and success of the business, or the thoroughness of the plan.

If a planned development didn't occur, the existence of the new or enhanced infrastructure might help attract a different entity, but a multi-year delay would force the municipality to cover the total cost of the debt incurred with no new tax increment. In such instances, if history is a guide, negatively affected municipalities will come before the Legislature and/or VEPC requesting either financial or regulatory aid to mitigate the risk they'd agreed to in exchange for the benefit of diverting funds from the Education Fund.

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[1] 2022 VEGI Annual Report. See Tables 1E, 1F and 2A.

The following observations are offered for your consideration:

S.83 introduces unchecked expansion of the Vermont Economic Progress Council (VEPC) authority to approve the use of education tax increment

S.83 provides VEPC with authority to approve an unspecified number of tax increment financing projects over an unspecified period. Additionally, there is no cap on the total amount of education tax increment that may be approved for use by municipalities.

Lacking these parameters, the potential impact on the Education Fund is unclear.

SAO suggestion: If the committee proceeds with the bill, specify a maximum number of project-based TIFs and a cap on the cumulative dollar amount of education tax increment that VEPC may authorize so that the financial impact will have an upper limit and the impact of the TIF indebtedness on the Education Fund can be properly forecast.

Low or no guardrails for retention of education tax increment

Under S.83, municipalities determine the length of time that education tax increment is kept to repay debt and keep 80 precent of education tax increment each year.

This is more permissive than the existing TIF district program which specifies a 20-year retention period and allows only 70 percent of education tax increment to be kept each year.

Since municipalities may choose the period that tax increment is kept, some municipalities may elect debt repayment terms longer than 20 years which would cause interest costs to increase. Thus, the proposed parameters for project-based TIFs will divert more education property taxes from the Education Fund and possibly for longer time periods.

SAO suggestion: If the committee proceeds with the bill, specify the period that education tax increment may be kept and limit the percent that may be kept each year to 70 percent.

Greater financial risk for municipalities

As proposed, without additional parameters to counter the risk that the value of real property development does not generate sufficient taxes to repay debt, the financial viability of project-based TIFs will be less certain.

SAO suggestions to mitigate that risk:

- *Use a co-funding model and limit the percentage of total project costs that may be covered with tax increment financing (i.e., require TIF to be one of multiple funding sources and that TIF represent 20 percent or less of total funding).*

- *Restrict public improvement projects to those with greatest tangible nexus to real property development such as wastewater/drinking water infrastructure, brownfield remediation, and roadway improvements.*

- *For public improvements with less than $3 million TIF funding, require a documented development agreement with at least one private developer for a specified amount of taxable real property sufficient to generate tax increment needed to repay debt.*

- *For public improvement projects with greater than $3 million of TIF funding, require documented development agreements with multiple private developers pledging to construct different types of real property development for a specified amount of taxable real property sufficient to generate tax increment needed to repay debt.*

Additional technical comments
SAO staff continues to review S.83 and I anticipate we will provide additional technical comments next week to address areas that could benefit from clarification.

Consideration for the Committee

Whether one is a supporter or a critic of the TIF program, the annual requests of the Legislature and VEPC for changes and accommodations surely suggest an administratively complex program. And whether one believes the Education Fund would not receive additional funds without TIF (and therefor doesn't treat the Education Fund like an infrastructure bank) or that it's unlikely or unknowable (and therefor the Education Fund is being used as an infrastructure bank), the net effect on the Education Fund is the same – the incremental value associated with the TIF improvements is, at the end of the day, not in the Education Fund. For simplicity and transparency, and to get past the philosophical debates, perhaps it would be simpler to create a line-item expense in the Education Fund for "Municipal Infrastructure Grants" and authorize a certain amount of money to be granted to eligible municipalities for eligible activities each fiscal year, with a guarantee to awardees of a set number of years from which they may receive grant funds to repay debt incurred for municipal infrastructure projects.