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JANUARY 14, 2020

STATE OF VERMONT
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Senate Finance Committee Testimony on S. 191 Debt Provisions

The State Auditor's Office provides the Senate Finance Committee with this memo to make the four main points that S.191 would:

1. Significantly change the TIF law as is it pertains to how TIF debt can be used;
2. Expand the allowable use of TIF debt to pay for service on the same debt;
3. Place all risk for the TIF program on the State Education Fund; and
4. Pose incentives that undermine the effectiveness of the TIF program.

We are, however, working on an alternative to S.191's debt provisions that would provide municipalities with added flexibility but would not put the risk of the TIF program solely on the Education Fund.

Change in Law
This proposal changes Vermont's law by expanding how TIF loan proceeds can be used. It is not a simple clarification of law.

Specifically, this legislation expands the law to allow TIF loan proceeds to be used to pay back the same loans, which is presently prohibited by statute. According to the Attorney General's Office, municipalities can currently use TIF bonds for infrastructure improvements and related costs that in theory attract private development and increase a tax base.

Using TIF Debt to Pay for TIF Debt
This proposal seeks to enlarge the definition of a TIF improvement to include "a debt service reserve fund," which expands the use of borrowed TIF dollars to pay for the principal and interest on those same borrowed dollars.

All Risk on the Education Fund
This proposal is counter to current law, which specifies that a municipality is liable for the full payment of TIF debt if tax increment is insufficient to service that debt in a given year. Current law places the risk of shortfalls in tax increment on the municipality, not the Education Fund. Current law encourages municipalities to invest this money strategically to generate incremental tax revenue expeditiously.

The proposed change puts all the risk of shortfalls in tax increment on the Education Fund and incentivizes imprudent investment. TIF is an inherently risky program because the anticipated new tax revenue may be insufficient to cover the money borrowed to pay for projects. To redirect borrowing away from direct investment in projects increases this risk. In addition, borrowing more to pay debt increases the cost of debt, which increases the cost to the Education Fund because more tax increment will be necessary to cover the increased cost of the debt.

Proposal Undermines Effectiveness of TIF Program

If we set aside the debate of whether the TIF program generates new development for the state at large, and we assume that it does, then this proposal undermines the effectiveness of the program and increase costs to the State Education Fund in three main ways:

1. **Infrastructure projects might not be built**

   If TIF bond dollars can be used to pay for debt, and therefore aren't used for infrastructure improvements, this proposal could decrease the dollars for development and therefore future Education Fund revenues.

   For example, in St. Albans, for every $1M invested in authorized projects, there was a projected benefit of nearly $3M in grand list value. That means that by allowing $1M to be used for debt service instead of development, that is nearly $3M in new property value that would not be generated. Based on this scenario, the cost of this proposal would add up quickly for the State across numerous TIF districts using this practice.

   Furthermore, as part of the TIF program, the Education Fund forgoes revenue for 20 years and then receives a windfall at the end of the period. Shifting borrowed money away from investments that increase property values, as S.191 could do, would compromise the return to the State's public education system.

2. **Infrastructure projects could be delayed**

   Municipalities could also be encouraged to delay investment in public infrastructure projects so that they can use TIF debt proceeds to pay debt service. Delays in constructing public infrastructure will delay growth in tax increment. Delays in tax increment growth create additional risk that tax increment will not be enough for repayment of TIF district debt. These delays would also translate to increased project costs as well as delayed economic activity and property tax revenue, which are important benefits of the program.

3. **Proposal opens the door to municipalities taking on more debt**

   Another scenario is that municipalities could borrow more than they otherwise would, which would increase the amount of tax increment needed to repay TIF district debt. This, in turn, would increase the cost to the Education Fund.

   For example: A municipality that intends to construct $15M of public infrastructure projects but estimates that tax increment will not cover $1M of debt service during the initial years of debt repayment, will borrow $16M instead of $15M. The municipality will have to at the very least pay additional interest costs on the additional loans. In St. Albans, those costs are just shy of half a million for the debt used to pay debt through FY17. Depending on the terms of the loan and repayment approach, there may be additional debt costs associated with this practice.

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