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FISCAL NOTE

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S.33 An act relating to project-based tax increment financing districts – Senate Finance Recommendation of Amendment

Summary

This bill makes changes to the existing tax increment financing (TIF) program as well as creates a new TIF program designed for single projects.

This bill proposes to create a new, smaller version of the existing Vermont TIF program whose focus would be on financing smaller projects that are too narrow in scope for the existing TIF program. This new program is similar to the broader TIF program with notable exceptions:

- It is a pilot program for 5 years beginning January 1, 2022 and ending December 31, 2026.
- The pilot program has a limit of 10 total projects, 2 per year.
- Each project has a debt limit of $5 million.
- Any project must incur debt within 3 years of creation, with the possibility of 3-year extension (as opposed to 5 in the existing TIF program).
- Projects only have to meet 1 of 4 statutory project criteria (as opposed to 3 of 5 in the existing TIF program).

Like Vermont's existing TIF program, these projects would be eligible to retain up to 70% of Education property tax increment and at least 85% of municipal property tax increment to financing related infrastructure costs.

Fiscal Impact

<u>Project-based TIFs:</u>

The fiscal impact of this new program depends on whether projects would have occurred but for the use of this tool. Because 32 V.S.A. Sect 305b requires the Joint Fiscal Office and Department of Taxes to treat the impact of the regular TIF program as a cost to the Education Fund, that same methodology will be used here.

Forecasting the exact cost is impossible because there are several unknown variables including:

- The number of municipalities that will use this program
- The size (and therefore, original taxable value) of the corresponding districts that they create

- The projected growth in tax increment that could occur as a result.
- The change in tax rates over the course of 20 years.

The maximum debt each project can incur is $5 million and the total overall number of projects VEPC is permitted to approve is capped at 10 districts over the 4-year pilot period. Therefore, the maximum debt that these districts could incur is limited to $50 million.

In Vermont's existing TIF districts, $274 million of debt is expected to be incurred, yielding projected grand list growth of $985.5 million, for an average return on investment of $3.60 for every $1 of debt incurred.[1] The return on investment for the projects in this bill are likely to be lower because the existing TIF program benefits from very large projects in the Chittenden County area (such as the Winooski TIF District, the Burlington Waterfront and Downtown districts). It is also likely the districts themselves will be smaller.

To get a sense of scale of the potential impact on the Education Fund, assuming a ROI of $3.50 and maximum take-up of the program, total grand lists within these districts could increase by up to $175 million. Because much of the building of these projects would occur between 2022 and 2027, it is likely that this $175 million increase would be fully realized sometime closer to 2030. Therefore, the fully realized Education Fund impact occurs for around 15 years (or between 2030 and 2045).

Assuming also that most of the development in these districts will be non-residential (as is the case in existing districts), using FY 2020's nonresidential tax rate of $1.594 for the next 25 years (as is the practice for existing TIF district applications) would imply that once the districts fully realize their growth increments, just over $2.89 million in Education Fund tax increment would be generated per year. 30% of this ($837,000) would be remitted to the Education Fund and 70% ($1.95 million) would be retained for the district. Using the assumption that most of the development would have occurred anyway, as is the methodology used for the Emergency Board estimate for TIF, this $1.95 million is the foregone revenue, and therefore, a cost to the Education Fund.

As such, this program could result in a cost to the Education Fund of between $1 to $2 million per year once the districts are matured (sometime around 2030), ramping up slowly to this level from 2022 through 2026, although the actual cost may be moderately lower or higher than this range.

Administrative costs to VEPC are expected to be minimal although it is likely some administrative costs will be borne by participating municipalities.

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[1] VEPC 2020 TIF Annual Report: https://accd.vermont.gov/sites/accdnew/files/documents/DED/VEPC/Tiff/AnnualReports/2020%20TIF%20Annual%20Report-FINAL.pdf

Other Potential Fiscal Impacts

Section 4 of the bill allows municipalities to use bond proceeds to fund debt service for a period of up to 5 years from when the debt is first incurred. Practically speaking, municipalities borrow beyond what is needed for infrastructure projects alone and put the extra bond proceeds into a debt service reserve fund. This fund is then used to pay debt service on that same debt in the early years of the district when tax increment as not yet materialized.

There is the potential for a negative impact on the Education Fund from this practice, largely stemming from the fact the municipality is borrowing more than it needs for infrastructure improvements. The additional cost of arises from the increased interest payments on this extra debt.

Based only upon the case of the St. Albans TIF district, JFO estimates that this practice will cost the Education Fund no less than $300,000 over the next twenty years. JFO is aware that other TIF districts have used this practice, but it is unclear how many, and the size of these debt service reserves. This cost is directly related to the increased interest costs accrued to fund debt services using bond proceeds.

Additionally, to the extent that borrowed funds are being used for debt service reserves as opposed to infrastructure development, and therefore, increased property values, the cost could be higher. This is because the municipality is foregoing future tax increment by not using the proceeds for public infrastructure.

However, if debt service reserves were not permitted, it is difficult to know with certainty whether a) the municipality would use these bond proceeds for investment, b) if they did use them for investment, how much in private development would they leverage and c) whether redirected municipal general fund dollars used to pay debt service would result in lower investments elsewhere in the town.