State of Vermont [phone] 802-828-3211
Agency of Commerce and Community Development [fax] 802-828-3383
One National Life Drive
Deane C. Davis Building, 6th Floor
Montpelier, VT 05620-0501
www.accd.vermont.gov

TO: John Davis, Chairman, Vermont Economic Progress Council
Megan Sullivan, Executive Director, Vermont Economic Progress Council

FROM: John Kessler, General Counsel

CC: Michael Schirling, Secretary

DATE: May 3, 2019

RE: Expanded Legal Opinion on TIF District Financing and Debt Service

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This memorandum is written to provide VEPC with legal advice and a broad perspective of the various statutes guiding its administration of the statewide TIF program and, in particular, on the whether or not a municipality my use debt proceeds to repay debt incurred to complete a VEPC-approved TIF improvement project.

To begin, the State Auditor of Accounts earlier this year requested guidance from the Attorney General's Office on several questions arising from a statutorily required audit of the City of St. Albans Tax Increment Financing District. In a Memorandum dated February 7, 2019, Assistant Attorney General Bill Griffin provided guidance on whether or not the TIF statutes allow TIF District bond proceeds to be used to pay debt service on those bonds. While the guidance considered the meaning of relevant TIF statutes in Title 24, the scope of the question necessitates a broader review taking into consideration the relevant tax statutes. Significantly, a number of pivotal TIF program elements are governed by those provisions in Title 32, including, among others, the freezing of grand list values on April 1, approval criteria administered by VEPC, and a municipality's use of incremental growth in education property tax revenue to finance TIF District improvements.

After seeking additional advice taking into account *all* of the statutes applicable to the question, we have received word from the AGO that although the statutes are less than clear, further advice on this question is not likely and that the matter now rests with VEPC. Accordingly, the following review and advice are offered to guide VEPC in

determining the its position on the issue concerning a municipality's use of debt proceeds to repay debt service.

Scope of First AGO Memorandum

The AGO's February 7, 2019 Memorandum focused on the municipal and TIF District financing statutes in Title 24 to determine the scope of permissible uses to which a municipality could apply bond proceeds secured to pay for approved TIF projects. The AGO made a fair comparison between the statutory authorization for general municipal financing outside of the TIF program and the specific statutory requirements for financing TIF District projects approved by VEPC and further governed by VEPC's TIF Rule adopted May 6, 2015.

In summary, the Memorandum concluded the traditional municipal financing statutes allowed bond proceeds to be used for the funding of reserves, but the TIF statutes provide more recent and narrower legislative intent concerning the permissible uses of a TIF District's debt proceeds. This is entirely understandable in light of the legislature's heightened sensitivity to the use of education fund revenue for any purpose other than education, as is the case with a TIF District's use of education property tax increment.

While the analysis of municipal borrowing statutes in Title 24 dutifully applied accepted rules of statutory construction, broader consideration of tax statutes in Title 32 appears necessary. In particular, the scope of inquiry should include the method and timing for establishing the education property tax grand list, key criteria governing VEPC's approval of TIF Districts projects, and the availability and permissible uses of education property tax increment.

The Education Property Tax

The enactment of Act 60 in 1997 achieved a comprehensive restructuring of the funding of public education in Vermont. Central to the new funding scheme was the creation of a statewide education fund comprised mainly of all revenue paid to the state from the education property tax established in chapter 135 of Title 32. *See* 16 VSA 4025(a). By taking control over what had once been local property tax revenues, the legislature significantly restricted a municipality's ability to use local property tax abatements to finance improvements that would promote downtown revitalization and economic development. *See* 32 VSA 5404a. With municipal property tax revenue constituting a minority of the local property tax revenues, a municipality's opportunity to use tax abatements has been limited to only the municipal portion of the property tax. As a result, creating a traditional municipal TIF District under subchapter 6 of chapter 53 in Title 24 offers far less support than a VEPC-approved TIF District and its ability to use education property tax increment as well.

Act 60 caused a number of other unintended consequences and the legislature responded *immediately* the following year with a major technical corrections bill to make course adjustments intended to save the new education funding law.

Act 71 in 1998, commonly referred to as the Act 60 Technical Corrections Bill, addressed a wide range of education financing issues that arose from the first year of implementation. More importantly for the instant discussion of TIF District financing, Act 71 overhauled the mission of the Vermont Economic Progress Council – converting it from a long-range economic development planning body into the state's leading administrator of economic development incentives. *See* Sec. 48 of Act 71 (1998). In addition, the legislature entrusted to VEPC the authority to allocate to an existing TIF District a portion of its education fund liability to finance infrastructure in support of new economic development. *See* Sec. 47 of Act 71. Protection of the revenue collected from the statewide education property tax has always been a paramount concern of the legislature. The success of the state's twenty-year old education funding scheme continues to depend on adequate and reliable revenues generated by local property tax payments.

VEPC's Approval Authority for TIF District Projects and "But For" Test

Over the years, the legislature has revisited provisions in Title 24 and Title 32 to maintain an effective balance between preserving adequate education funding and providing financial assistance for community and economic development. VEPC has played a vital role in administering both economic incentives and approving a municipality's use of a portion of the state's education fund to pay for TIF District improvements that support economic development and job creation. Numerous amendments over the years have reshaped the municipal indebtedness statutes in chapter 53 of Title 24 as well as to VEPC's responsibilities set forth in chapter 135 of Title 32.

Perhaps the foremost control placed on VEPC's approval of a proposed TIF District project is the evaluation commonly known as the "but for" test. Indeed, the "but for" test is listed first among the criteria in 32 VSA 5404a(h) that VEPC must consider before approving utilization of incremental revenues. To paraphrase the statue, the "but for" test requires VEPC to determine that the TIF District improvement would not occur or would occur in a significantly different and less desirable manner, but for the use of incremental tax revenues.

The legislature has been extremely cautious in granting access to education property tax revenue – only allowing VEPC to approve use of those funds where they would be vital, not just helpful, to construct needed public improvements. The legislature appears quite clearly to have set a high bar in requiring a TIF District to demonstrate financial need to the degree that "but for" the opportunity to use education tax increment, valuable public improvements would not be possible – or would only occur in a much less desirable manner. VEPC's responsibilities under this standard and other statutory provisions in chapter 135 of Title 32 stand in apparent conflict with the AGO Memorandum provided to the State Auditor concluding debt proceeds from a TIF bond could not be used to aid a municipality in meeting its obligation to repay that bond.

In the specific example of the St. Albans TIF, VEPC approved of the use of education property tax increment to finance certain projects in the TIF District after finding that St. Albans had met the "but for" test. In that case, VEPC determined the use of education tax increment was not

just helpful but essential to the projects going forward. The St. Albans application proposed additional borrowing to create project advances that would enable the City to make debt service payments as the early years elapsed and the grand list grew and began generating tax increment. Requiring a municipality to pay out of pocket for the first two or more years until adequate increment is generated to make the required debt service payments would seem antithetical to the legislative intent behind the "but for" test. The delay in increment becoming available is entirely foreseeable and a municipality must be able to compensate for initial shortfalls. The generation of increment for TIF purposes is explained below.

The Education Property Tax Grand List and Use of Increment

The starting point for the calculation of a municipality's grand list growth – or tax increment – is the April 1 determination of the equalized education property grand list by the Commissioner of the Department of Taxes. *See* 32 VSA 5405. The Commissioner's calculation is performed only once a year and all municipal grand lists are set based on that April 1 calculation.

A municipality must incur indebtedness during the five years following the creation of the TIF District which is considered as having been established April 1 of the calendar year so voted by the municipal legislative body regardless of the actual date of the vote. 24 VSA 1892(b). Education tax increment may be retained beginning with the education tax increment generated the year in which the first debt was incurred. 24 VSA 1894(b). Making April 1 the controlling date for three key factors: 1) determination of the education property tax grand list, 2) creation of a TIF District, and 3) the calculation of education tax increment available to repay TIF District debt, causes a significant gap in time where a municipality must repay debt incurred to pay for TIF District improvements before tax increment has been generated and become available. In many cases, the improvements may not induce growth in the grand list for one or more years, thereby requiring the municipality to have significant funds on hand in advance and earmarked for covering the early stage payments on TIF debt.

As noted above, requiring a municipality to have such a strong financial position up front would seem at cross purposes with the legislature's intent for VEPC to be circumspect in applying the "but for" test and other statutory criteria in 32 VSA 5404a(h). One perspective on the issue is aptly presented in the AGO Memorandum concerning 24 VSA 1894(1) and its requirement that a municipality notify voters of their ultimate liability for the TIF debt in any year the tax increment is insufficient. Knowledge of the risk to municipal taxpayers and the certainty that the April 1 grand list determination date will not generate meaningful increment until after improvements have been completed and factored into subsequent April 1 grand lists make it understandable -- if not foreseeable – that a municipality would borrow additional funds necessary to repay TIF debt until future grand lists generate tax increment. Indeed, 32 VSA 5404a(f) in pertinent part broadly provides, "*Any* use of education property tax increment approved [by VEPC] … shall remain available to the municipality for the full period authorized…." (emphasis added). Thus, delayed access to tax increment would not cause a net cost increase to the municipality where the municipality used bond proceeds to pay TIF debt in the beginning and repaid TIF debt with tax increment over the full retention period authorized.

A common example of a municipality's financial challenge related to the TIF District borrowing and repayment periods will illustrate the need to harmonize the provisions in Title 24 and Title 32 to fulfill the legislative intent for TIF financing in the post-Act 60 era to enable meaningful municipal investment in infrastructure and improvements necessary to promote community and economic development.

For illustration purposes, consider a VEPC-approved TIF District project estimated to cost $10 million. A municipality taking out a 20-year bond for $10 million will have only enough funds to pay the project costs. No money would be available to make debt payments while the municipality waits for the grand list to generate tax increment based on the annual April 1 determinations made by the state. In this simplified hypothetical, the municipality would owe $500,000 each year and potentially have little or no increment in the first one or two years to service its debt. A municipality possessing significant cash on hand to cover those early years would appear to offer a less than compelling argument that "but for" access to education tax increment it would not be able to undertake the proposed TIF District improvements.

Alternatively, under the above example, the municipality might consider borrowing $11 million under a 20-year bond to pay for the $10 million project, thereby creating an ability it would otherwise not have -- $1 million to pay debt service for the first two years. The municipality would retain its opportunity afforded by 32 VSA 5404a(g) to make use of education property tax increment *for the full period authorized*. The longest period VEPC may authorize a municipality to retain tax increment to repay TIF debt is 20 years pursuant to 5404a(f). Therefore, as long as $10 million in tax increment was generated during the 20-year retention period, the municipality would receive sufficient TIF revenue to pay the remaining TIF debt.

Perhaps the most important aspect of the above illustrations is that *no more* than $10 million in tax increment is made available to the municipality for the $10 million cost of its improvements.

Conclusion

In sum, the provisions in Title 24 and Title 32 stand in apparent conflict and present some challenge for VEPC to determine the overall legislative intent. There is no doubt about the purpose of TIF as described in 24 VSA 1893:

> *The purpose of tax increment financing districts is to provide revenues for improvements that serve the district and related costs, which will stimulate development or redevelopment within the district, provide for employment opportunities, improve and broaden the tax base, or enhance the general economic vitality of the municipality, the region, or the State.*

And there is equally no doubt about the emphasis the legislature placed on the first criteria VEPC must consider before approving utilization of incremental revenues – the "but for test." However, for VEPC to fulfill its duties under both of those directives, it must harmonize *all* of

the TIF statutes to ensure TIF serves as an effective financial tool for municipalities to finance improvements in support of community and economic development.

Taking the more restricted view of TIF borrowing as articulated by the AGO's examination of the narrower legislative intent expressed through statutes in Title 24 would not be without undesirable impact on the legislative intent evident through the many relevant provisions in Title 32 bearing directly on VEPC's duties for responsibly administering substantive and procedural requirements of the statewide TIF program. Specifically, VEPC would deprive the "but for" test of its essential meaning were municipalities required to have significant unrestricted funding on hand to pay debt service before adequate increment was generated from the improvements. Whereas by comparison, VEPC's approval of a TIF application proposing to use a portion of the debt proceeds to cover debt service as the improvements begin to generate increment would faithfully apply the "but for" test, not obviously conflict with any statutory prohibition or express statement of legislative intent, and advance the stated purpose of TIF.

Accordingly, a reasonable interpretation of all TIF statutes appears to allow VEPC to approve the utilization of debt proceeds to meet debt service obligations while the TIF improvements begin to generate increment in the early stage of the retention period.