

Management's Comments Related to SAO Report

Introduction

The ability to form strong partnerships with the State of Vermont is an essential skill for local government managers. Strong partnerships produce successful projects; successful projects attract resources for the next project. An essential ingredient for successful projects is the ability to follow the rules.

Over the last five years, the City of St. Albans has formed a strong partnership with the State of Vermont through the Vermont Economic Progress Council (VEPC). We have kept VEPC informed and up to date on how our projects have developed and, when necessary, sought their formal approval. The City of St. Albans has followed the rules.

At all times, the City has relied in good faith on the applicable regulations, rules and procedures known to it. The City now finds itself charged with failing to comply with standards and mandates not found in any official guidance.

In government, we follow strict procedural requirements for changing the rules. This principle balances the enforcement powers that the government enjoys. Yet this report advances alternate interpretations of long-standing rules and practices – changes that threaten the viability of TIF districts across the State -- without any of the procedural requirements associated with wholesale rule changes that impact millions of dollars of investment based on the existing rules.

Of the 70 plus assertions in this report, there is not one requirement that our lawyers and consultants have not previously considered, evaluated, and advised. Their advice was not alternative or ground breaking; it was mainstream interpretations of tax increment finance as applied in Vermont for the last 20 years. In another context, one would describe the Auditor's proposed application of the rules as grounds for a breach of contract action.

But the ability to form strong partnerships is an essential skill for local government managers. Our quarrel is not with the State of Vermont as a whole, it is solely with the State Auditor's Office (SAO). We are confident we can reach swift resolution with the agencies of jurisdiction.

Notwithstanding the political grand standing that permeates this report, the SAO has four questions and we have four answers.

1. Were the City's improvements to the hotel site permitted within the TIF program as authorized by VEPC?

The City followed the plain meaning of the definition of *improvements* which explicitly authorize our actions. The City regularly updated VEPC with the latest information we had, as recently as February of 2019. VEPC has never had any concerns with the site improvements completed for the hotel. We have filed the paperwork for a final resolution with VEPC and await their determination.

2. Can working capital reserve funds be utilized and can TIF's reimburse funds advanced on its behalf if it has the funds to do so?

A working capital reserve fund is funds that are borrowed in excess of what is needed for the project to help service the debt until the increment is created. It is a ubiquitous public finance tool. Its use is part of the answer to the TIF approval criterion of *need*.

In the TIF application, communities must demonstrate that they cannot complete the public improvements without the TIF program; therefore, they often need some form of short-term borrowing. This aligns well with the general understanding that TIF's can reimburse funds advanced once the increment materializes. The suggestion that this tool cannot be used and those funds cannot be reimbursed through the TIF is in direct conflict with the purpose of tax increment financing, which is founded upon the nexus of public and private development projects.

3. Is there any taxable value to the parking garage and, if so, should the City true up the financials?

The City has ordered an independent appraisal and will work with the Tax Department to resolve any valuation issues.

4. Did the voters fully understand this was a 20-year commitment?

It is difficult to see how they could not. The City held extensive hearings and published thorough explanations, all of which contained in depth explanations of the 20-year repayment plan. The City prides itself on the transparency of financial reporting that is necessary to inspire and maintain public confidence. Nonetheless, the City Council has ratified any irregularities related to the call of the meeting so this is a moot point. The bonds passed by a large margin, with 559 voting *yes* 170 voting *no*.

In the pages below, the City demonstrates that we followed the rules that were in effect during the last five years and have already commenced resolution of any technical issues with the agencies of jurisdiction. In addition, we demonstrate that the SAO has exceeded its statutory authority; attempted to overturn long standing legal interpretations; and attempted to convert arcane, technical questions into headline grabbing sound bites.

Performance and Compliance

The Legislature charged the Auditor with conducting a performance audit. Performance audits are supposed to focus on outcomes. They are designed to answer the question, "Are we getting our money's worth?"

St. Albans' outcomes are off the charts: a \$52 million addition to the statewide grand list; a 65 percent increase in tax revenues in five years; and construction of a downtown hotel, parking garage, and award-winning streetscape that had been sitting on shelves *since 1981*.

During this same five-year period, the State Education Fund received \$660,000 in additional revenue the fund would not have received if the St. Albans TIF program were not in place. VEPC is projecting a 98 percent increase in Education Fund proceeds from St. Albans over the life of the TIF. A 98 percent increase in revenues with zero percent of the risk is a pretty good return on investment.

St. Albans has demonstrated how the State of Vermont can partner with local communities to strengthen rural Vermont and grow the education fund. We have demonstrated how to add good jobs and stabilize our education and municipal taxes. The *performance* of the St. Albans TIF is very strong. The State of Vermont is absolutely getting a positive return from the investments in the St. Albans TIF.

Instead of judging us by our performance the Auditor has conducted a compliance audit. Compliance audits focus on process. They are designed to answer the question, “Did you follow the rules?”

The City closely followed the rules as they were communicated and understood by VEPC. We sought extensive advice from multiple attorneys and consultants with the requisite experience in the field. Time and time again we circled back to VEPC and inquired if our actions required additional approval from VEPC. They never required additional approval. Every point offered by the auditor’s office had been reviewed by our own counsel, and by VEPC.

During the Audit, we became aware of the alternate interpretations of long-standing practices being advanced by the Auditor. These were novel interpretations of TIF statutes that upended 20 years of practice in the field. Five years into our program, the Auditor was proposing to change the rules of the game.

In response, we proactively applied to VEPC to affirm our understanding and await its final interpretation. This filing is available at www.stalbanvt.com.

The City believes the SAO exceeded its statutory authority when it unilaterally determined to conduct a compliance audit instead of a performance audit; the agency of jurisdiction has never identified any compliance issues with the City.

The venue for the report’s alternate interpretations of the TIF statutes and rules is the Statehouse and the rulemaking process. Accusing the City of unauthorized use of funds is purposefully incendiary and serves a policy objective of discrediting the TIF program. There is little evidence to support these claims and evidence to the contrary has been conveniently overlooked.

Eligibility of Hotel Development Costs

The report asks two questions regarding the hotel development. The first question is if brownfield and site improvement costs for the hotel are eligible for TIF expenses. The suggestion is that because the cleanup and site improvements were performed on property that was ultimately transferred to the hotel and not a public entity, they may not be eligible.

This interpretation is inconsistent with the statutory premise of TIF, namely the nexus between public improvements and private projects. The TIF statute defines improvements as “the installation, new construction, or reconstruction of infrastructure that will serve a public purpose and fulfill the public purpose of tax increment financing districts ... including utilities, transportation, public facilities and amenities, land and property acquisition and demolition, and site preparation.” The public purpose is the economic development and tax base growth envisioned by a TIF. It is hard to imagine a broader, more expansive definition and it aligns well with the nexus between public and private projects that is the essence of TIF.

The report also questions expenses for site preparation costs. The same definition of *improvements* is at play and specifically authorizes site preparation costs. During the pre-development phase, a site investigation revealed that some of the soils were characterized as “urban” and would need to go to a landfill and others, while not contaminated, would not support the loads of a 4-story building. This is common in urban redevelopment sites where the soils are comprised of diverse material. In these instances, clean fill must be brought in and the grades must be set according to the design and structural load of the new structure.

Based on the above definition for improvements, the City agreed to support the hotel project by addressing both the contaminated and the non-load bearing soils, all of which fit well within the definition of improvements and were necessary to make our urban site competitive with a greenfield site. We also note that any substantial building located on this site would have the same issue with urban soils.

A second question is whether the TIF statutes allow for a brokerage fee to be utilized as a form of payment for professional services. The City paid its primary real estate development consultant White and Burke a \$100,000 brokerage fee at the successful conclusion of the hotel transaction. This was in lieu of consulting fees, which would be paid regardless of whether we landed a hotel or not. The TIF statutes define *related costs* as “expenses, exclusive of the actual cost of constructing and financing improvements, that are directly related to the creation and implementation of the tax increment financing district.” 24 VSA Section 1891(6).

The advice we have received from White and Burke is one of the most essential elements of our program. Whether we pay this as a brokerage fee or an hourly rate is immaterial to the nature and function of the expense. It is hard to imagine an expense that is *more* directly related to the creation and implementation of the district than a brokerage fee paid upon completion of our largest source of increment.

Tax Status of Parking Garage

When the TIF was approved, the single largest public project was a parking garage. None of our projections included a tax liability and neither VEPC or the third-party evaluators suggested that it should. Nor should they have. Construction of a public parking garage to allow adjacent private development is the quintessential public/private partnership envisioned by the TIF statute. Why would a public parking garage, approved as part of a state economic development program, owned and operated by the municipality, not be tax exempt?

The taxable value has already been captured in the buildings’ appraisal. Suggesting that the City also must pay property tax is the proverbial “double dip.”

The two largest sources of increment on the private side are the office building and the hotel. Without construction of the parking garage, the hotel and the office buildings could not be completed. Without protecting their rights to park through deeded rights to the garage, these buildings could not be financed.

The Report suggests that by vesting those parking rights converts the garage into a taxable entity. The City has a solid legal foundation upon which its tax exemption is based. But exemption is different than value and there may be little value to litigate.

During the Audit the City agreed to have an independent appraisal of the garage using the income-based method. We agreed to open up a settlement discussion with the State Tax Department once the value is established. Since the operating expenses exceed the revenues by over \$500,000 per year, it is hard to imagine a large value.

It is not a question of cost recovery of lost funds. It is an arcane question about whether there is any taxable value for a publicly owned garage that loses hundreds of thousands of dollars per year and can only be paid for through tax increment finance.

This finding should reflect the true state of affairs among the parties and not the inflammatory assertion that was printed.

Repayment of Funds Advanced Using Increment

A common challenge in TIF districts is how to address the revenue shortfall in the first few years after the public improvements have been made but before the private investments have completed. Because the public improvements, by design, incent the private investment, TIFs are inherently back loaded. St. Albans chose to borrow a little more money than was needed for just improvements and use those funds to service the debt in the first five years. We called those funds a *working capital reserve* because they were intended to flow out in the first years of the TIF and be replenished (flow in) in the subsequent years. The working capital reserve was approved by our bond counsel, was featured prominently in our public information sessions, and was approved through the underwriting process with the Vermont Municipal Bond Bank. For a copy of this document, visit www.stalbansvt.com.

At the February 2019 VEPC meeting, VEPC approved our use of the working capital reserve and applied a condition that they be replenished by continuing at 100 percent of municipal increment. Since that meeting, the Report has asserted that funds advanced on behalf of a TIF cannot be replenished by the TIF in successive years if the TIF is able to. This assertion turns the TIF program on its head.

TIFs have always been analyzed over the life of the district – the 20-year retention period. Indeed, VEPC’s viability analysis that was performed in our 2012 application and was recently affirmed during the February approval, all use the full retention period as the basis for the analysis. The assertion that funds advanced on behalf of a TIF cannot be repaid using increment converts the TIF program from a 20-year program to a year-by-year program. This is a 180 degree turn from the way TIFs have always been administered by VEPC and understood by municipal attorneys and development consultants.

The report points to the language in 24 VSA 1894(i), which states that if the tax increment is insufficient to pay the principal and interest, in any year, the municipality remains liable for the full payment of the principal and interest for the term of indebtedness. This has always been interpreted through the lens of a 20-year program and to mean that the annual debt requirements never fell back on the education fund. Municipalities willingly accepted this condition as it reflected the inherent back loading of TIF districts. Municipalities are willing to accept the risk because they are utilizing a long-term strategy to expand the tax base for the community. It is unlikely municipalities would be willing to front the money if it couldn’t be repaid over time through increment.

Finally, it should be noted that at the time of St. Albans advancement of funds on behalf of the TIF, communities only had five years to issue all the debt for the TIF. It has since been expanded to ten. The five-year period created tremendous pressure to hit the ground running and advance the cash that was necessary to make the projects happen, lest the community waste the incredible opportunity offered by a TIF. This aligns well with the understanding and advice communities received that they had to front the funds, but they could be replenished if the TIF was successful.

This finding and the associated recommendations should be disregarded. It is wholly inconsistent with the purpose of the program.

Voter Education

The Report asserts that the City did not place enough emphasis on the term of the bonds and voters may not have understood what they were voting on. This assertion does not hold up to scrutiny. The City has never invested *more* heavily in the transparency and public outreach surrounding a bond vote. We used traditional methods such as public hearings, presentations at Rotary, and informal lunch meetings with small groups of citizens. And we used nontraditional methods such social media and weekly newspaper columns. We were criticized locally for spending too much emphasis explaining the vote and how the working capital reserve rose and fell over the 20-year life of the TIF.

In all of the presentations, we reviewed our financial model. We were (and are) proud of its conservative projections and numerous safety valves. In all of these presentations, we displayed 20 years of prospective financials. We displayed spreadsheets and PowerPoint slides showing how the TIF fund rose and fell over a 20-year term. This document is available at www.stalbansvt.com.

Therefore, on April 1, 2019, the City Council ratified any procedural defects associated with the call of the meeting. We forwarded this to VEPC for their approval under the substantial change process. We are waiting for VEPC's determination at the end of May.

This is a narrow issue concerning what voters did or did not understand, rendered obsolete the City Council's ratification.

Once again, the Report should reflect the true state of affairs among the parties and not assert that St. Albans failed to disclose matters to the voters. The vote passed by a more than three to one margin in a special election.

Conclusion and Counter Recommendations

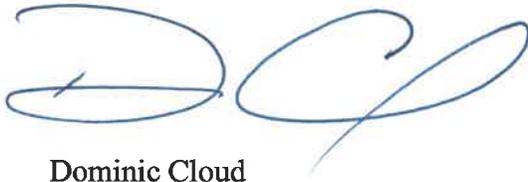
A great deal of public resources has been expended in this effort. For nearly a year, the Auditor has relentlessly pursued red herrings. Ultimately, the SAO released findings that can easily be addressed by the agencies of jurisdiction. The questions raised are the daily grist of inter-agency accounting and reporting.

They are akin to a new supervisor asking new questions about an old program. They are hardly worthy of the terms "Unauthorized Use," "Understatement of Increment", and "St. Albans Owes Education Fund" that was plastered on the title. All of the money is accounted for. There are no allegations of misappropriations.

It is unfortunate that one of the transactional costs of a TIF is enduring the State Auditor's efforts to discredit the program and those who use it. The Auditor will undoubtedly assert that his office is a team of professionals following professional standards that are subjected to a rigorous peer review process. That assertion is not mutually exclusive of the City's assertion that the Auditor's policy perspective on economic development programs influences the analysis that is performed.

In politics, as in life, where you stand depends on where you sit. The Auditor has made it clear where he stands on TIF districts - and this was clear before the audit was performed - and the Legislature should amend the statute for TIF audits to provide that these audits are performed by independent auditors instead.

Notwithstanding the uninspiring experience of the State Audit, the St. Albans TIF was the greatest thing to happen to our community since the Railroad. We would do it all again in a heartbeat.



Dominic Cloud
St. Albans City Manager
May 6, 2019