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MEMORANDUM

To: Katherine Schad
Chief Administrative Officer
City of Burlington

From: Thomas Melloni
Kathy Zhou
Paul Frank + Collins P.C.

Date: December 19, 2023

Re: City of Burlington - Downtown Tax Increment Financing District

Introduction

This memorandum addresses the City of Burlington (the "City") and its Downtown Tax Increment Financing District ("Downtown TIF District") and the draft report of the Vermont State Auditor ("State Auditor") with respect to issuance of the City's General Obligation Downtown Tax Increment Financing District Bonds (the "TIF Bonds").

Specifically, the draft report of the State Auditor questioned whether issuance of bonds at a premium are permitted.

The creation, implementation, administration, and operation of TIF districts in Vermont is primarily governed by the statutes located at 32 V.S.A. § 5404a, Title 24, Chapter 53, Subchapter 5 (the "TIF Statute") and the Tax Increment Financing Districts Adopted Rule, adopted by the Vermont Economic Progress Council (VEPC) on May 6, 2015 (the "TIF Rule").

The TIF Statute and TIF Rule provide that bonds may be used to finance improvements with a TIF district and may be issued at "**not less than par**." Accordingly, given such express authority, and in light of the overall purpose of the TIF Statute, it is our view that the City was legally permitted to issue the TIF Bonds at a premium to finance improvements that serve the Downtown TIF District.

Background

The City issued its TIF Bonds in several series. The City received voter authorization on two occasions for indebtedness to finance improvements that serve a public purpose and fulfill the purpose of its Downtown TIF District as provided under applicable law.

The first voter authorization occurred at the annual meeting of the City held on March 3, 2015 (the "2015 Voter Authorization") when the voters approved issuance of bonds or notes in a principal amount not to exceed $10,000,000 for improvements to the Downtown TIF District.

The second voter authorization was at the annual meeting of the City held on March 1, 2022 (the "2022 Voter Authorization") when the City voters authorized pledging of the credit of the City for bonds or notes in a principal amount not to exceed $25,920,000 for funding one or more public improvements serving the Downtown TIF District and related costs. The ballot items and the related warning and public notice described the projects that serve the Downtown TIF District and for which debt was to be incurred.

As part of the public notices published prior to each vote, the City provided estimates of costs for the improvements intended to be financed by the voter authorized indebtedness. The public notices described these project costs as estimates and did not designate them as a "not to exceed" limit to the amount of indebtedness that the City could issue. In particular, the public notice preceding the March 1, 2022 annual meeting further informed voters that due to inflation, the actual costs would likely be higher than what was currently budgeted. Interest rates were indicated as being determined based upon market conditions at the time of issuance.

Bond Issuances

The following TIF Bonds were issued to finance improvements with respect to the Downtown TIF District:

- Series 2017D issued December 20, 2017 in the original principal amount of $3,400,000;
- Series 2018D issued November 28, 2018 in the original principal amount of $1,570,000; and
- Series 2022B issued August 31, 2022 in the original principal amount of $30,120,000.

The total voter authorization received from both the 2015 Voter Authorization and the 2022 Voter Authorization was for indebtedness in a principal amount of up to $35,920,000.

In the ballot questions presented to the voters, the voters approved an aggregate principal amount of bonds or notes. The notices issued prior to the meetings informed the voters that, upon voter approval, the City Council would have the power to determine how to sell and issue the bonds or notes, whether in competitive sale, a negotiated sale or through the Vermont Bond Bank. Voters were informed that the terms of repayment would not exceed twenty years and the interest rate of any bonds or notes would be determined based upon market condition at the time such debt was incurred. Each bond issuance was approved by resolutions of the City Council adopted at public meetings.

At the time that the City published the public notices, the City did not indicate a maximum interest rate or the specific manner of sale of the proposed indebtedness other than describing the City's historical process for selling its bonds either through a negotiated offering or through a competitive bid process, all of which would need to be subsequently authorized by the City Council.

In each issuance, the TIF Bonds were issued and sold along with other City of Burlington general obligation bonds. By combining the offerings of these bonds in a single transaction, the City saved transaction costs, such as rating agency fees, bond counsel fees and financial advisor fees, thereby benefitting the State's Education Fund and the City's General Fund. This has been the City's historic practice. It is our understanding that, by aggregation of several bond issue into a single offering, investor demand is greater, thereby providing better terms for the City than if a smaller bond size was offered.

The Series 2017D Bonds and the Series 2018D Bonds were issued through negotiated sales with selected underwriting firms. At the time the Series 2017D and 2018D bond issuances, the City's credit rating was Moody's "A2." The Series 2022B Bonds were sold in a competitive bid process of sale. The City's credit rating at that time was Moody's "Aa3." Through steps undertaken by the City Administration and City Council the City's credit rating improved from A2 in 2017 to Aa3 in 2022, resulting in significant interest savings to the City. The State Auditor's draft report makes no mention of the interest rate savings and cost reductions the City achieved through the historic practice of aggregating several bond issues into one financing or the City's efforts and work on improvement of its credit rating.

Market Conditions – Premium Bonds

During a historic low interest rate environment, investors typically seek a higher interest rate or coupon rate for their bonds. This is particularly important when financial markets indicate a movement to higher interest rates. This was the general market between 2017 and 2022 – the time frames for the issuance of the TIF Bonds. In a rising interest rate environment, the principal value of a bond can decrease significantly if its stated coupon rate is below the then current market rate. Over the last several years with the low interest rate environment, it was fairly customary in the municipal market for issuers, not only the City of Burlington, to issue bonds with a 4 or 5 % coupon rate in exchange for a premium in addition to the principal amount of bonds being issued. The State of Vermont recent bond issues in 2021 and 2023 were sold with a premium. The Vermont Bond Bank, including bonds issued for other Vermont TIF Districts, issues bonds at a premium[1].

Given the nature of the municipal capital markets, the City was often required to act quickly to secure favorable interest rates for its bonds, including the TIF Bonds. For example, the Federal Funds rate as set by the Federal Reserve increased by 1.25% between the March 2015 bond vote and issuance of TIF Bonds in December 2017 and increased another .75% when the City issued the 2018 Series of TIF Bonds. In January 2022, when the public notice for the 2022 Vote was

[1] For the Bond Bank, such premium was used to pay costs of issuance as well as funding the loans to local government issuers. As the Bond Bank sold at an interest rate that created premium, its overall costs of financing were embedded in the rate charged to local government issuers.

issued, the Federal Funds target rate was 0.0 to 0.25%. At the time the TIF Bond was issued in August 2022, the Federal Funds target increased to 2.5%. Over the following two to three month period, the Federal Funds Rate was raised another 2.0%. While these are short term rates, it shows that any delay in issuing the TIF Bonds would have likely increased the overall costs to the City in interest.

Over the last ten years, the City has issued its general obligation bonds at premium. As identified above, the premium bonds were commonplace in the market. The State Auditor draft report attempts to make a distinction between the City's general obligation bonds and the TIF Bonds. That is not a fair characterization as the TIF Statute provide that if the TIF increment was ever insufficient, the City remains liable. The City's TIF Bonds are a full faith and credit obligation. Moreover, the City followed its general and customary practices for the TIF Bonds in the same manner as its non-TIF Bonds in order to finance capital assets with the best and most favorable terms available under then current market conditions.

PFM, the City's municipal advisor reported that in the case of the Series 2022 TIF Bonds, the interest rate scales, coupons, reoffering yields and underwriting compensation received for the Series 2022 TIF Bonds are fair and favorable to the City. PFM stated that the final all-in true interest cost of 2.9262% for the Series 2022B Bonds was favorable to the City in light of prevailing market conditions.

Analysis.

24 V.S.A. § 1898, the general statute authorizing the issuance or incurrence of financing for TIF improvements expressly provides that bonds issued for any particular TIF district shall be "sold at not less than par." Given this plan and clear language in the statute, bonds may be issued at or above par amount (*i.e.* a premium). This makes sense given the legislative purpose of the TIF Statute is to fund public improvements to stimulate economic development, improve and broaden the tax base, and enhance the general economic vitality of the issuing municipality and the region and the State. Moreover, Charter 53 of Title 24, the general statute for municipal financing of capital assets, provides that the legislative body of the municipality sets the terms and interest rates for its bonds. The general tenor of the TIF Statute provides the legislative body of the municipality with authority and significant flexibility in funding TIF development projects. This makes sense given the legislature's stated purpose of the TIF Statute of promoting economic development, economic vitality and job creation.

For example, such flexibility is contained in Section 1898(d) of the TIF Statute which states that bonds issued for financing improvements within the TIF district "shall be authorized by resolution or ordinance of the local governing body and may be payable upon demand or mature at such time or times, bear interest at such rate or rates, be in such denomination or denominations, be in registered form, carry such conversion or registration privileges, have such rank or priority, be executed in such manner, be payable in such medium or payment, at such place or places, and be subject to such terms of redemption, such other characteristics, as may be provided by such resolution." Considering the requirement that bonds shall not be sold less than par means premium bonds are permitted. Neither the TIF Statute nor the TIF Rule impose any limit on the interest rate. While the issuance of premium bonds may result in a higher interest rate for the bonds, determining the interest rates of bonds issued for TIF district improvements is within the authority of a municipality's legislative body.

Under the 2015 and 2022 Voter Authorizations, the City's voters approved the issuance of bonds in a total principal amount not to exceed a particular amount. The City was not required by the TIF Statute or TIF Rule to specify a maximum interest rate in the ballot question or the warning. General state law on indebtedness provides that unless a maximum interest rate is submitted to the voters by the municipality, the interest rate is to be approved by the legislative body. *See* 24 V.S.A. § 1759(a)(1). As voters were not required to approve a maximum interest rate, it was within the authority of the City, through its City Council, to determine the interest rate at which to sell the TIF Bonds.

Furthermore, under the TIF Statute, indebtedness may be retired over any period authorized by the legislative body. Again, this shows the legislative intent to provide flexibility in structuring TIF related financing as general law for municipal bonds requires principal payments in equal or diminishing amounts over a period not to exceed 20 years. Under the TIF Statute, a legislative body could defer principal payments until at or near maturity (i.e., a balloon payment). Accordingly, if a municipality selects a longer period within which to repay the bonded debt, it will, over the longer life of the debt, pay more in interest. That is permissible under the TIF Statute. The City, however, in issuing its TIF Bonds, selected a shorter period of time within which to pay its bonded TIF indebtedness, which was less than the twenty years indicated in its public notices. Principal payments started in the year after bond issuance. I think this is important in showing how the City works diligently with its advisors to manage its debt issuance to provide for the lowest cost of capital reasonably available in the market. This was not noted in the State Auditor draft report. Moreover, the City has the right under certain terms to refinance its TIF Bonds and thereby reduce overall debt service. This is a valuable tool for the City to potentially reduce total borrowing costs. Other TIF Districts that go through the Vermont Bond Bank pool program do not have that option.

The TIF Statute does not limit the use of tax increment to repay debt service on the TIF Bonds, whether issued at par or at a premium. As noted above, the TIF Statute explicitly allows bonds to be issued above par. Amounts of tax increment that exceed the amounts needed to pay for the financing of improvements may be retained and used for financing payments or even prepayment of the principal and interest on the financing. *See* 24 V.S.A. § 1900. Financing is defined as the debt incurred, including principal, interest and any fees or charges related directly to that debt. The tax increment may be used to repay the financing whatever the debt is incurred and issued with a premium or whether it is issued at par, and whether it is issued for a short term or for a longer term. *See* 24 V.S.A. § 1894(2) and 24 V.S.A. § 1898(d). This makes sense particularly when viewed in light of the purpose behind the TIF Statute – to fund public infrastructure and stimulate economic development, thereby increasing property values and generating property tax revenue.