

PUBLIC POLICY REPORT

A STATE-MANDATED PROPERTY TAX CAP ON MUNICIPAL REVENUE: A CURE WORSE THAN THE DISEASE

JANUARY 2008



**CONNECTICUT
CONFERENCE OF
MUNICIPALITIES**

CCM — THE VOICE OF LOCAL GOVERNMENT

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OVERVIEW

Governor Rell is again proposing — and some state legislators are supporting — a State mandated cap on the revenue municipalities can raise from property taxes.

While attractive at first blush, a property tax cap by itself does not constitute property tax relief or reform. A cap would have dire adverse consequences for towns and cities and the state as a whole.

Further, a cap is simply not appropriate in Connecticut: local residents have ample ability to decide the sizes of their local budgets — a state-imposed cap would be the ultimate “nanny-state” act; it would tell local taxpayers that the State knows better than they how much their town should tax and spend.

A cap on local property tax revenues could hurt the state and local economies. It could hamstring municipalities as they seek to make investments or



grant tax incentives that would encourage economic growth.

There is no question that the property tax is too high in too many of our communities. It's inherently unfair and regressive. It's a tax from yesterday that is no longer up to doing all of the jobs it's being asked to do today — including carrying the lion's share of education costs. But an artificial, state-mandated cap on local revenue would make things worse.

Property tax caps take various forms, for instance they can limit (a) property tax rates, (b) property assessments, or (c) growth in local revenue. While many states have property tax caps, there is a wide variety of ways in which they are applied, for example in Maine the cap can be exceeded by a simple majority vote of a municipal legislative body.

This Public Policy Report examines the impacts that a property tax cap could have on our state — and why it's wrong for Connecticut.

THE SITUATION IN CONNECTICUT

Local Budgets Should Be, And Are, Determined By Local Taxpayers

Municipal budgets in Connecticut should be, and are, decided by local taxpayers — the people who have to live with the decisions they make, and the impacts those decisions have on the quality of life in their communities.

Residents in at least 144 municipalities have the opportunity to hold a referendum on their budgets either automatically (52) or by citizen petition (92). Further, the legislative body is a town meeting in 106 municipalities.¹ Through the democratic process the residents of their communities vote directly on their budgets. Why should the State dictate to them that they have to abide by some arbitrary limit?

The remaining municipalities have representative legislative bodies that decide on their budgets, **just as the General Assembly and Congress do.** They are directly accountable to the voters in their communities for the decisions they make, most run for re-election every two years. Given that 53 municipalities changed leadership in 2005 and 45 did in 2007, the public seems perfectly capable of deciding when they want a change in leadership and direction.

Moreover, some of the towns without referendum fall into one or more categories of municipal fiscal distress. They are less-affluent communities with high service needs. For the State to put an artificial cap on them would be to dictate fewer services (whether police, fire, social services, education or others) than the people of that town deem necessary or desire.

Citizens are more than able to hold their local budgets in check when they see fit. The Connecticut Advisory Commission on Intergovernmental

¹ CCM survey, 160 responding municipalities, 12/07.

Relations (CACIR) found that **of 73 municipalities that held budget referenda this year, only 45 budgets were approved on the first vote.**

“Considering multiple budget referenda in numerous towns, **there has been a total of 160 budget referenda held this year, fifteen more than [2006] and thirty-three more than in 2005.**” The report also found that 17 municipalities adopted their budgets after the start of the fiscal year, compared to 12 in 2006 and 14 in 2005.² (emphasis added)

Towns and cities are the most accountable and accessible level of government in Connecticut.

State Aid Levels Directly Affect Property Tax Rates and Service Levels

Property taxes account for, on average, 69% of local government revenues in Connecticut. Federal aid and user fees, two revenue streams that seldom fluctuate, account for only about 8%. The remaining 23% comes from State aid.³

Some Connecticut municipalities are almost totally dependent on property taxes to fund local government. Nine towns depend on property taxes for at least 90% of all their revenue. Another 48 municipalities rely on property taxes for at least 80% of their revenue.

Simply put: when state aid goes down, property taxes go up.

Without increased state aid, the ability of local governments to provide necessary public services, including education, will be strangled.

The combination of inadequate state aid and high property taxes already hurts the ability of towns and cities to provide needed services. For example, little more than half of the municipalities have full-time police departments (53%, or 90

of 169). Just 13% (22 of 169 municipalities) have full-time fire departments, while another 18% (30 towns) have combined volunteer and full-time fire departments.

History shows that state aid increases that are enacted in good fiscal times may not last during tough times. In 2003 the General Assembly and the Governor dramatically cut aid to municipalities in several areas – in the middle of the budget year. In some areas, such as the Town Aid for Roads and Pequot-Mohegan grants, the levels of aid have never returned to pre-2003 levels.

GRANT PROGRAM	FY 2001-02	FY 2007-08
Town Aid Roads	\$35 million	\$30 million
Pequot-Mohegan Grant	\$135 million	\$93 million
PILOT state property	41% reimbursement	35% reimbursement ⁴
PILOT colleges and hospitals	73% reimbursement	55% reimbursement

Experience in other states with property tax caps shows this same pattern. In Massachusetts “there were significant increases in public education funding during the 1990s, [but] general local aid has been stagnant for more than a decade and non-school expenditures have been flat.”⁵

It’s true that in dollar terms state aid has grown in several areas – and local officials appreciate that. But state aid increases have not kept up with local cost drivers: energy, health insurance, energy, personnel and other areas (see the next section).

Moreover, historically, the state’s Education Cost Sharing (ECS) aid for the public schools has failed to keep pace with the rising costs of education or ever to meet the goal of funding 50 percent of total statewide education costs. When all types of state aid are included (for operating expenses, payments to the teachers’ retirement fund, school construction, and more) the State is paying 43.1% of all statewide costs in FY 07-08.

The state’s FY 05-06 ECS grant (the last year for which data have been released) represented a 2.7% decline in the state’s share of schools’ net operating costs (shown in parentheses in the chart on page 3),

² “Municipal Budget Adoption Experiences,” FY 2007-08, Connecticut Advisory Commission on Intergovernmental Relations, November 2007.

³ “Municipal Fiscal Indicators,” Office of Policy and Management. Figures are for 2006, latest available.

⁴ PILOTs are payments-in-lieu-of-taxes for certain real estate property mandated by the State to be property tax exempt. The statutory reimbursement for state property is 45%, for colleges and hospitals it is 77%. This does not even take into account the personal property of these institutions, for which there is no reimbursement.

⁵ “Local Communities At Risk”, Municipal Finance Task Force, (Massachusetts) Metro Mayors Coalition, Sept. 2005.



Total Education Aid (share of statewide cost)

	FY 01-02	FY 05-06
Regular programs	\$1,315 million (31%)	\$1,449 million (29%)
Special education	\$357 million (35%)	\$412 million (31%)
Pupil transportation	\$55 million (30%)	\$60 million (26%)
Total of above	\$1,727 million (31.8%)	\$1,921 million (29.1%)⁷

failing to even keep pace with inflation over the previous four years.⁶

It must also be noted that the State has committed to a substantial increase in the FY 07-08 ECS allocations, followed by a 4.4% increase in FY 08-09 and promises of additional increases over the following three years (to fully phase in changes to the ECS formula enacted this past legislative year, an increased 5-year investment by the state of some \$1.1 billion). However, the Connecticut Coalition for Justice in Education Funding points out that even if/when the revised formula is “fully funded” according to the new changes, the State will only then be investing what it should already have been investing in the public schools as of 2007 according to the old, broken ECS formula. Moreover, no legislative provision was made to index state funding to inflation or overall rising school district expenditures.

⁶ Connecticut State Department of Education, Bureau of Grants Management, Connecticut Public School Expenditures Report, Table 2, “Current Expenditures for Regular Education, Special Education and Pupil Transportation by Source,” available at <http://www.sde.ct.gov/sde/cwp/view.asp?a=2635&q=320576>.

⁷ Note that this is of ‘net operating costs’ and does not include certain state contributions mentioned above (e.g. school construction, teachers’ pension that are included in the 43.1% figure).

⁸ Connecticut Public Sector Healthcare Cost & Benefit Survey, 2006 Edition, Ovation Benefits (survey of 57 municipal governments and board of education contracts). The previous (04-05) edition found that “the average cost increase for FY 2005 was 13.5%, with 37% of survey participants experiencing an increase of 15% or more...”

⁹ CCM survey, partial results, survey is ongoing.

¹⁰ Electricity Price Trends in Deregulated vs. Regulated States, Marilyn Showalter, Power in the Public Interest, November 7, 2007.

¹¹ 81% in CT Natural Gas and Southern CT Gas service areas, 75% in Yankee Gas service areas.

State Mandates

Beyond lower-than-needed financial aid, the State continues to pass unfunded and under-funded mandates on towns and cities. The 2007 General Assembly passed, and the Governor signed, over 30 new ones — adding to an ever-growing list that has a large cumulative impact. **The Connecticut Advisory Commission on Intergovernmental Relations reports that there are 1,203 such state mandates on towns and cities in our state.**

Included are 75 state-mandated property tax breaks codified in the Connecticut General Statutes. The great majority of these mandated exemptions are not even partially reimbursed by the State.

When Massachusetts passed its property tax limitation, “Proposition 21/2”, it also passed a constitutional amendment prohibiting new unfunded mandates. The Connecticut General Assembly has repeatedly refused to pass even a *statutory* prohibition on such enactments.

Towns and cities will again face many proposals for new state mandates in the 2008 General Assembly session, including costly special workers compensation benefits for local public safety personnel.

Municipal Costs Are Rising

Connecticut’s municipal cost-drivers don’t go away because there is a property tax cap. For example,

➤ **Health insurance** costs rise each year — 6.3%, on average, in FY 06-07, 8.3% in FY 05-06 and 13.1% in FY 04-05. Municipal health insurance costs are 46% higher than private sector norms.⁸ Many municipalities are reporting cost increases of between 10% and 20% over last year.⁹

➤ **Energy costs:** The cost of **electricity** in Connecticut has gone up almost 60% in Connecticut since 1999.¹⁰ In the past year the price of **natural gas** increased between 75% and 81%.¹¹

The price of **heating oil** in Connecticut has risen from \$2.51 per gallon to \$3.31 per gallon in one year. Five years ago (December 2002) it was \$1.29 per gallon.¹²

➤ **Special Education** costs have risen from \$1.04 billion in 2001-02 to \$1.3 billion in 2005-06.

➤ **Employees' salaries** rose 6.3% from 2002 to 2003, another 7.6% in 2004, 8.5% in 2005 and 2% in 2006.¹³

Property tax caps don't magically make these types of cost increases go away: in Massachusetts, municipal spending for health insurance increased 63 percent between 2001 and 2005.¹⁴

A cap also doesn't stop the growth in post-employment benefits, such as pensions. Municipalities now face strict new rules for accounting for those post-employment benefits issued by the Government Accounting Standards Board ("GASB



45"). These rules mean that municipalities must record liabilities for retiree health coverage on an accrued basis — i.e., they must be recorded and counted as they are earned rather than as they are collected.

Credit-rating agencies will rate local governments according to the size of this liability and their plans to address it. Unless costs for retirees are brought under control, the size of this



liability will drive up the cost of borrowing, hurting other sections of town budgets.

Rising pension obligations have become a problem in states where there are property tax caps. In Illinois, for example, rising pension costs for police and fire personnel are consuming a larger portion of the amount municipalities can effectively levy under the cap. Municipalities have gone to the state legislature to exempt those pension costs from the cap.¹⁵

■ **Bond Ratings Could Be Affected**

A property tax cap could have negative impacts on municipal bond ratings.

Moody's Investor Services recently issued a document concerning New Jersey's new property tax cap in which it stated the cap

*"will increase fiscal pressure on municipalities with larger reliance on property tax revenues and further reduce financial flexibility of municipalities already faced with an existing cap on expenditure growth...Moody's expects many communities will budget use of more fund balance. Budgets may be prepared in a less conservative manner than in the past with some municipalities assuming a higher rate of tax collections than they have before—again leading to less opportunity to replenish any use of fund balance. Overall, Moody's expects the Property Tax Reform Act to reduce municipal financial flexibility and to create challenges for municipalities' efforts to balance their budgets."*¹⁶

¹² U.S. Energy Information Administration, 12/12/07.

¹³ Local Public Employment Data for Connecticut, US Census (local governments only).

¹⁴ John Hamill, "Communities At Risk", MassBenchmarks Volume 8 cited in "Property Tax Cap The Wrong Solution To Connecticut's Rising Property Taxes", Iris Lav, Center for Budget and Policy Priorities.

¹⁵ Illinois Municipal League.

¹⁶ "New Jersey Property Tax Reform Expected to Place Fiscal Pressure on Some New Jersey Municipalities", Moody's Investor Services Special Comment, April 2007.

THE EXPERIENCE IN OTHER STATES

Municipalities Have Other Sources Of Revenue

Most of the states with strict property tax caps allow local governments other sources of revenue. Connecticut’s municipalities only have the property tax and the real estate conveyance tax – and in recent years have had to fight to protect existing levels of the conveyance tax.

For example, at least 32 states now authorize local option sales taxes, including our neighbors Vermont and New York.¹⁷ Ten states allow at least some municipalities to levy income taxes.¹⁸ Local taxes on motor vehicle fuels, such as gasoline, are authorized in 15 states, and have been adopted in ten.¹⁹ Some states allow towns to assess franchise fees on public utilities and excavation fees for utility damage to roadways. Others allow restaurant and lodging taxes to be levied by local governments.

The following chart below shows a comparison of the types of taxes that can be levied in Connecticut by the State and municipalities:

TAXES THAT CAN BE LEVIED BY:	
<p>THE STATE</p> <ul style="list-style-type: none"> • Personal Income Tax • Sales and Use Tax • Corporate Income Tax • Public Service Corporation Tax • Inheritance/Estate Taxes • Insurance Companies Taxes • Cigarette Tax • Petroleum Companies Tax • Alcoholic Beverage Tax • Admissions, Dues, and Cabaret Taxes • Motor Fuels Tax • Real Estate Conveyance Tax • Nine Other Miscellaneous Taxes 	<p>MUNICIPALITIES</p> <ul style="list-style-type: none"> • Property Tax • Real Estate Conveyance Tax

Although it may be tempting to consider local option taxes for Connecticut municipalities, caution must be used. Those options may work best on a regional, rather than town-by-town basis, or it may be best to impose alternative taxes on a statewide basis. The National Conference of State Legislatures found that:

Just as states compete with one another on the basis of tax policy, local option taxes may lead to competition among local governments. This competition may create an adversarial relationship between cities and suburbs, as both try to use a competitive tax policy to lure businesses and residents. Such competition does not improve the state's overall economic performance and may divert resources from more productive uses. Competition also may place poorer localities and inner cities at a disadvantage in relation to their wealthier neighbors because property wealth usually is correlated with income and consumption. Thus, local governments with strong property tax bases may have less need for revenue and can levy local option taxes at lower rates than their poorer neighbors.²⁰

Growth in Fees and Bonding

When property tax growth is capped, local governments in other states have also turned to non-tax methods to finance vital services – for example, user fees go up and municipalities increasingly use bond funding to pay for operations (causing a subsequent increase in interest on bonded indebtedness).

A tax cap would encourage towns to expand their non-residential grand lists (e.g., “big box” developments, etc.) – and discourage towns from attracting housing for families. This will exacerbate intermunicipal competition for economic development. This is the *opposite* of what Connecticut should be doing as it seeks to embrace “Smart/Responsible Growth” principles and to expand affordable housing opportunities across the state.



¹⁷ National Conference of State Legislatures, “Local Option Sales Taxes”, September/August 1998.

¹⁸ National League of Cities.

¹⁹ “Local Option Transportation Taxes in the United States,” Goldman, Corbett and Wachs, University of California Institution of Transportation Studies, March 2001.

²⁰ *A Guide To Local Option Taxes*, National Conference of State Legislatures, November 1997.

■ Disparities Increase

In states with tax caps, disparities between municipalities get worse. Affluent communities are more likely to override the cap to get better quality public services. The residents of poorer communities simply cannot afford to do so. The result is that schools, parks, public safety and other services improve in wealthier towns – and deteriorate in poorer places. The more-affluent towns become more attractive places to live and do business, while the less-affluent municipalities become less attractive.

A recent report by the Center on Budget and Policy Priorities found that in the neighboring state of Massachusetts (a) more affluent towns passed more overrides, (b) smaller municipalities passed more overrides than larger ones and (c) municipalities with more school-age children were more likely to approve overrides than those with fewer children.²¹ In Connecticut – a state that has been fighting disparities between affluent and less-affluent school systems – a similar outcome would only hurt efforts to bridge gaps in education opportunities and would cement the reality that where a child lives will determine his or her education opportunities.



■ Services Hurt

Several Massachusetts communities, after passage of Proposition 21/2, closed schools, libraries and firehouses.

A recent study in Massachusetts found that

*...municipal workforces lost 14,200 jobs, or 5.2% of all municipal employees, between February 2002 and August 2004. According to Economy.com, a Pennsylvania research firm, municipalities in Massachusetts cut their workforces more steeply than in any other state in the nation between 2001 and 2005. **That reduction in staff often has translated directly into service cuts, such as shortened library hours, fewer health and human services offered to residents, closed fire houses, or fewer police patrols in neighborhoods.***²²

(emphasis added)

In the wake of passage of Proposition 21/2 Springfield (a city similar in size and demographics to several Connecticut cities) closed four schools, cut athletic programs by 60 percent, stopped all textbook purchases, and increased the cost of school lunches by 24% (among other things).²³

In a survey conducted in Collar County, Illinois 121 of 145 (83%) responding schools reported problems due to that state's property tax cap, including increased class size (80 schools), cuts in equipment purchases (70), cuts in library services and materials (69), reductions in teachers (49) and more.²⁴

²¹ "The Problem With Property Tax Revenue Caps", Karen Lyons and Iris Lav, Center on Budget and Policy Priorities, June 2007.

²² "Local Communities At Risk", Municipal Finance Task Force, (Massachusetts) Metro Mayors Coalition, Sept. 2005.

²³ *Proposition 21/2, Its Impact on Massachusetts*, Massachusetts Institute of Technology, Lawrence Susskind, 1983.

²⁴ "Tax Cap: Expect Diminished Local Services in the Future," Nick Greifer, reported American Federation of State, County and Municipal Officials, 2007.