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Municipal Aid and Revenues: The Impact of the Governor's Proposed FY12-FY13 Budget

Shelley Geballe, J.D., M.P.H.

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New Haven Office
33 Whitney Ave.
New Haven CT 06510
Phone: 203.498.4240
Fax: 203.498.4242

Hartford Office
53 Oak St. Suite 15
Hartford CT 06106
Phone: 860.548.1661
Fax: 860.548.1783

Web Site: www.ctkidslink.org
E-mail: voices@ctkidslink.org

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Governor Malloy, a former Mayor, stressed often during his election campaign and again in his budget address on February 16, 2011 that he would "simply refuse to balance the state budget on the backs of our local taxpayers."[1] His proposed budget – on average - keeps that pledge both by maintaining overall state funding for cities and towns, and also by providing them with new sources of revenues. The impacts of his proposed changes, however, would vary substantially among Connecticut's municipalities. This issue brief summarizes the primary changes to municipal aid and the new municipal revenues proposed by Governor Malloy in his FY2012-FY2013 biennial budget proposal.

I. MUNICIPAL AID

There are multiple ways in which Connecticut's state government assists its municipalities, including through formula grants, other grants, bond funds and other payments to, or on behalf of, local government. Grantees include cities, towns, boroughs, lesser taxing districts, and regional school districts that receive education program funding directly from the state.

Total payments in state funds to or on behalf of local government (excluding bond funds) totaled about $3,336.2 million in FY10, and are estimated to total $3,375.2 million in the current fiscal year. Governor Malloy proposes $3,628.6 million in payments in FY12 ($253.4 million more than FY11) and $3,713.4 million in FY13 ($338.2 million more than FY11),[2] a substantial investment in our municipalities in a time of state fiscal crisis. The proposed budget includes an overall net increase in education funding ($39.2 million in FY12, or 1.6%), but an overall reduction in non-education funding.

Review of proposed changes in payments to or on behalf of municipalities reveals, however, that Connecticut's cities and towns will not benefit, or be disadvantaged, equally – there will be municipal winners and losers.[3] In addition, though the total payments to or on behalf of municipalities would increase in FY12 and FY13, a part of that increase is attributed to proposed enhanced state payments to the Teachers' Retirement Board – for pensions, retirees' health service costs, and municipal retiree health insurance costs.[4] Though no funds the municipalities can use for operating expenses, they remain extremely important as there was *no* state funding provided for the health-related costs in FY10 or FY11, contributing to Connecticut's already substantial unfunded pension and other post-employment benefit liabilities.[5]

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[1] Governor Dannel P. Malloy FY2012-FY2013 Budget Address (February 16, 2011), available at: www.governor.ct.gov/malloy/cwp/view.asp?A=11&Q=474024/

[2] Governor Malloy's FY 2012-FY 2013 Budget Summary [Governor's Budget Summary], pp. E1-E3. Note, however, that the narrative about statutory formula grants on pp. E5-E13 discusses several grants that are not mentioned in the listing of payments to or on behalf of local governments in pp. E1-E3, so are not included in the totals mentioned in the text above. Omitted from these totals, for example, is the school-based child health grant ($10.5 million in FY11, $11.8 million proposed for FY12 and $12.0 million proposed for FY13), the Local Capital Improvement Program (LoCIP) grant ($30 million in FY11 and same amount proposed for FY12 and FY13), and the proposed FY12 and FY13 funding in the SDE budget for child day care ($5.4 million in each year).

[3] The Governor's budget estimates the changes in funding, by town, for the primary statutory formula grants, but about 20% of the municipal grant programs are not grantee-specific making it difficult to predict the impact of funding changes in these programs by town. The largest of the non-grantee specific grants are for Special Education – Excess Cost Student Based, School Readiness, Magnet Schools, and PILOT for Exempt Manufacturing Machinery and Equipment and Commercial Vehicles. See Governor's Budget Summary, p. E-34.

[4] The Governor proposes a $282 million increase in payments to the Teachers' Retirement Board for FY12 ($3,285.1 million in FY12 compared to $3,003.1 million in FY11), of which $175.7 million is for pensions ($757.2 million in FY12 compared to $581.6 million in FY11), $25 million for retirees' health service costs and $7.4 million for municipal retiree health insurance costs (compared to $0 for each in FY10 and FY11). Governor's Budget Summary, p. E-3.

[5] Connecticut's long-term obligations are among the highest in the nation per capita *or* as a share of Connecticut's economy. Office of Fiscal Analysis, *Comparative Debt Burdens,* 2011-R-0099 (February 18, 2011). These long-term obligations total $67.8 billion, with unfunded liabilities for state employee pensions ($9.3 billion), teachers' pensions ($9.1 billion), state employee post retirement health and other benefits ($24.6 billion), and teachers' post retirement health and other benefits ($3.0 billion) constituting the vast majority of these

The table below shows proposed changes in forty-four primary types of municipal aid, and illustrates not all grants would be changed by the same amount or percentage. Rather, Governor Malloy has proposed: a) maintaining FY11 funding levels in FY 12 and FY 13 for twenty-two grants; b) cutting funding for thirteen grants, and c) increasing funding for nine grants. Because half of the grants would either increase or decline under Governor Malloy's proposal, and municipalities benefit differentially from the various grants, his proposed changes would create municipal "winners" and "losers" even though, on average, total funding for municipalities remains essentially constant.

Municipal Grants That Would Be Unchanged	
	FY 11, FY 12, FY13 Funding
Education Grants	
Education Equalization Grants	$1,889,609,057
Special Education Excess Cost – Student Based	$139,805,731
School-Based Health Clinics	$10,440,646
Vocational Agriculture	$4,560,565
After School Program	$4,500,000
Health Services for Private School Pupils	$4,297,500
Youth Service Bureaus	$2,947,268
Bilingual Education	$1,916,130
School Breakfast Program	$1,634,103
School Readiness Quality Enhancement	$1,158,608
Young Parents Program	$229,330
School-to-Work Opportunities	$213,750
Non-Education Grants	
PILOT- Colleges and Hospitals	$115,431,737
PILOT – State Property	$73,519,215
Mashantucket Pequot & Mohegan Fund	$61,779,907
Town Aid Road Grants[6]	$30,000,000
Local Capital Improvement Program[7]	$30,000,000
Property Tax Relief for Veterans	$2,970,098
DECD PILOT – Housing	$2,204,000
DECD Tax Abatement	$1,704,890
Reimbursement Property Tax – Disability Exemption	$400,000
Venereal Disease Control	$195,210

obligations. Bonded indebtedness ($19.5 billion) and the GAAP deficit ($2.3 billion) constitute the balance. Office of Policy and Management, *Fiscal Accountability Report Fiscal Years 2011-2014* (November 15, 2010), p. 21.

[6] The Town Aid Road grants in FY11 are supported by bond funds, while in FY 12 and FY13 the Governor proposes a straight appropriation from the Special Transportation Fund.

[7] Bond funds would be used for the Local Capital Improvement Program grants in FY 12 and FY 13.

Municipal Grants With Proposed Reductions in FY 12 and FY 13			
	FY 11 Estimated	**FY 12 Proposed**	**FY 13 Proposed**
Education Grants			
Priority School Districts	$117,237,188	$112,595,033	$112,121,287
Public School Transportation	$28,649,720	$25,784,748	$24,884,748
Non-Public School Transportation	$3,995,000	$3,595,500	$3,595,500
Non-Education Grants			
PILOT – Exempt Manufacturing Machinery and Equipment and Commercial Vehicles	$47,895,199	$0	$0
Distressed Municipalities	$7,800,000	$5,800,000	$5,800,000
PILOT - Vessels	$1,224,811	$0	$0
Teen Pregnancy Prevention	$870,326	$56,567	$56,567
Housing/Homeless Services	$686,592	$634,026	$634,026
Property Tax Relief –Elderly Freeze Program	$420,000	$390,000	$390,000
Community Services	$116,358	$87,268	$87,268
Services to the Elderly	$44,405	$0	$0
Human Resource Development	$31,034	$0	$0
Human Resource Development-Hispanic Programs	$31,034	$0	$0

Municipal Grants With Proposed Increases in FY 12 and FY 13			
	FY 11 Estimated	**FY 12 Proposed**	**FY 13 Proposed**
Education Grants			
Magnet Schools[8]	$174,131,395	$215,855,338	$235,564,251
OPEN Choice Program	$14,465,002	$19,839,066	$22,090,956
Adult Education	$20,594,371	$20,612,980	$20,605,690
School-Based Child Health	$11,643,000	$11,800,000	$12,300,000
Interdistrict Cooperation	$11,127,369	$11,136,173	$11,131,935
Non-Education Grants			
Child Day Care	$5,263,706	**$18,422,653**	**$18,419,752**
Property Tax Relief – Elderly Circuit Breaker	$20,365,899	$20,505,900	$20,505,900
Capitol City Economic Development	$6,190,000	$6,300,000	$6,300,000
Local & District Departments of Health	$4,264,470	$4,294,470	$4,294,470

A. Many formula grants that would be level-funded have had little or no increase in prior years. Governor Malloy's proposal to level-fund half of the forty-four municipal grants listed above is to be applauded given the dire straits of

[8] Proposed FY 12 and FY 13 funding for the Magnet School grants includes $12.7 million transferred from SDE's Sheff budget account.

Connecticut's budget. However, it is important to also note that many of these grants have not been increased in some time. So, the Governor's proposed flat-funding results in a further erosion of real (inflation-adjusted) state support for the programs and services supported by these grants.

For example, the Town Aid Road grant has been $30 million since FY07. To keep pace with inflation, this grant would need to be funded at $31.9 million in FY11. This is close to $2 million more than what is budgeted now and the funding proposed by Governor Malloy in FY 12 and FY 13. The Mashantucket Pequot-Mohegan Grant, which the Governor proposes to fund in FY12 and FY13 at the same level as in FY10 and FY11 ($61.8 million), was $93.0 million in FY08, or $95.1 million in inflation-adjusted dollars (in2011 dollars). So proposed funding for this grant is about two-thirds what it would need to be if FY08 funding had merely been increased at the rate of inflation. The Excess Cost-Student Based grant [9] received $140.0 million in FY 09, but would receive $139.8 million in FY 12 (and FY 13) – a difference of just $0.2 million in nominal dollars, but $3.9 million less if the 2009 grant is adjusted for inflation. In addition, the Governor proposes capping education formula grants, resulting in an estimated current services savings of $76 million in FY12 and $96 million in FY13.[10]

B. Proposed reductions in municipal grants

The largest proposed reductions in municipal grants are to the PILOT grant for manufacturing machinery and equipment and commercial motor vehicles, grants for priority school districts, grants for public and non-public school transportation, grants for distressed municipalities, and teen pregnancy prevention grants.[11] Some greater detail about these proposed reductions follows.

1. Elimination of the manufacturing machinery and equipment and commercial motor vehicles PILOT grant.[12]
Governor Malloy's largest proposed reduction in municipal formula grants is the elimination of about $47.9 million in PILOT (Payment in Lieu of Taxes) grants related to exempt new manufacturing machinery and equipment and commercial vehicles.

Under current law, qualified new or newly-acquired manufacturing machinery and equipment[13] as well as commercial motor vehicles[14] are 100% exempt from local property taxes for a period of five years, but the state

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9 The Department of Education administers this grant program pursuant to Conn. Gen. Stat. §§10-76d, 10-76e, 10-76g, and 10-253. Costs in excess of 4.5 times the town's average per pupil cost in the prior year are paid for students placed in a special education program by a school district, while 100% of the costs of the placement above the town's per pupil cost are paid for children placed out of district by a state agency (e.g., DCF), a Superior Court, or a Native American tribe and for certain no nexus students and special education students who reside on state property. The grant is capped at the amount appropriated; if reimbursements total more than the amount appropriated, municipalities must absorb the difference (except that there is no payment cap for students eligible for the 100% reimbursement). Governor's Budget Summary, p. E-11.

10 Governor's Budget Summary, p. 10.

11 The Governor also proposes to eliminate the $5.26 million Child Day Care grant in the Department of Social Services budget, moving the funding to a single, current expense account in the State Department of Education budget, a transfer of funding.

12 See HB 6388, An Act Implementing the Governor's Budget Recommendations Concerning the Office of Policy and Management. Section 17 of this bill would repeal Conn. Gen. Stat. §§12-94b, 12-94c, 12-94f, and 12-94g which authorize a payment in lieu of taxes for not only new or newly-acquired manufacturing machinery and equipment that is exempt from the local property tax but also for exempt commercial motor vehicles (e.g., commercial trucks, tractor trailers, semis used to transport freight for hire). See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 22.

13 Qualified manufacturing and biotechnology firms can receive a tax exemption from local property taxes for a period of five years, so long as the new machinery and equipment is five or seven-year property (as defined by the Internal Revenue Service), is acquired within prescribed time periods, and is used predominantly for manufacturing and research and development purposes. Included in the program are not only traditional manufacturing and biotechnology activities, but also the production of motion pictures, video and sound recordings, and recycling. Conn. Gen. Stat. §§22a-260, 12-81(72), 12-81k, 12-94b, 12-94c. CT Office of Policy and Management, *Manufacturing Machinery and Equipment – Reimbursement of Tax Loss on Exemptions* (2009).

14 Current law provides a property tax exemption for a maximum period of five years for two classes of commercial motor vehicles depending on the date of registration, gross vehicle weight (GVW), and use: a) commercial vehicles used exclusively to transport freight for hire with GVW rating over 26,000 pounds subject to certain US Department of Transportation limitations re vehicle use or material transported; and b) commercial vehicles with a GVW rating over 55,000 pounds that do not qualify for the other exemption. The state reimburses municipalities where the vehicles are garaged and subject to the local property tax for up to 80% of the lost revenues. In FY

reimburses towns through PILOT grants in an amount up to 80% of the revenue loss as a result of these exemptions. Although state law calls for an 80% reimbursement rate, the total amount of PILOT payments is limited to the amount appropriated, even if the amount due municipalities exceeds this amount. As a result, payments to municipalities have fallen below 80% of the lost property tax revenues.[15] The appropriation for PILOT-MME has been $57.3 million since FY09.[16] In FY11, the state is estimated to pay out $47.9 million to 210 towns and other taxing authorities.[17]

To help mitigate the loss of revenues in FY12 and FY13 from the elimination of these PILOT grants, the Governor also proposes to *repeal* the property tax exemption on commercial motor vehicles, enabling municipalities to tax them. He proposes to maintain the property tax exemption for manufacturing machinery and equipment[18] "in order to assist businesses and the state's economy" although municipalities would no longer receive any reimbursement for these lost revenues.[19]

The impact of these combined proposals would vary greatly across cities and towns. Twenty-five cities and towns are expecting to receive PILOT-MME grants of $500,000 or more this year (FY11), and sixteen of them expect grants over $1 million.[20] Towns also will differ in the number of commercial vehicles subject to property tax under the Governor's proposal.

2. *Elimination of the vessel PILOT.* The Governor proposes to repeal the vessel PILOT[21] and, instead, allow municipalities to collect personal property tax on boats(see below). The Governor states that this "additional source of revenue will, once fully implemented, offset any reductions through the discontinuance of the Vessel PILOT program."[22]

3. *Priority school districts.* The Governor proposes to reduce FY 12 funding for the Priority School District program administered by the State Department of Education[23] by $4.64 million (from $117.24 million in the current year to $112.60 million in FY12). FY 10 spending was $115.9 million. These funds are distributed to districts with the greatest need, to improve student achievement and enhance educational opportunities. The grant has four component parts: Priority School District grants (Conn. Gen. Stat. §10-266b), the Early Childhood (School

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2010, Connecticut paid $2.94 million to 174 towns and other taxing districts for lost revenues on about 3,400 vehicles. Conn. Gen. Stat. §§ 12-81 (74), 12-81k, and 12-94b. CT Office of Policy and Management, *Commercial Motor Vehicles – Reimbursement of Tax Loss on Exemptions* (2010).

15 Connecticut Conference of Municipalities, *Governor's Proposed budget FY2012-FY2013: Impacts on Towns and Cities* (February 22, 2011), Appendix B, p. 2, available at www.ccm-ct.org.

16 See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 22.

17 Note that close to twenty municipalities and other taxing districts would receive no PILOT-MME payments in FY11, including Groton, Kent, Lyme, North Stonington, Sharon, and Westport.
Connecticut Conference of Municipalities, *Governor's Proposed budget FY2012-FY2013: Impacts on Towns and Cities* (February 22, 2011), pp. 2, 8-13, available at www.ccm-ct.org.

18 Conn. Gen. Stat. §§ 12-81(72) and 12-94(f)

19 Gov's Budget Summary, p. 22.

20 Municipalities expecting PILOT-MME grants of $1 million or more in FY11 are: Bloomfield ($1.44 million), Bristol ($2.07 million), Danbury ($1.53 million), East Hartford ($3.58 million), Hartford ($1.08 million), Middletown ($1.59 million), Milford ($1.11 million), New Britain ($1.18 million), New Haven ($1.09 million), North Haven ($1.19 million), South Windsor ($1.08 million), Stratford ($2.84 million), Wallingford ($1.59 million), Waterbury ($2.08 million), Windsor ($1.04 million) and Windsor Locks ($1.57 million). Municipalities expecting PILOT grants between $500,000 and $1 million are: Berlin ($0.65 million), Bridgeport ($0.84 million), Cheshire ($0.60 million), Killingly ($0.57 million), Manchester ($0.86 million), Meriden ($0.71 million), Newington ($0.76 million), New Milford ($0.63 million), Southington ($0.66 million), Watertown ($0.52 million), and West Hartford ($0.65 million). Connecticut Conference of Municipalities, *Governor's Proposed budget FY2012-FY2013: Impacts on Towns and Cities* (February 22, 2011), pp. 8-13.

21 In FY11, the CT Department of Motor Vehicles certified the PILOT for vessels in an amount equal to each grantee's property tax receipts for boats on the 1978 Grand List – the last year in which boats were subject to property taxation. The total grant in FY11 is $1.9 million, shared among eligible municipalities proportionately. Gov's Budget Summary, p. E-10

22 Gov's Budget Summary, p. 22.

23 The Priority School District grant provides supplemental funding to Connecticut's neediest school districts. The grant now also includes aid that was formerly provided separately for school readiness, school accountability, and extended school hours. See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 157, available at www.cga.ct.gov/ofa.

Readiness) grant (Conn. Gen. Stat. §10-16o through §10-16r and §10-266p), the Extended School Hours Grant (Conn. Gen. Stat. §10-266p, §10-266t, and §10-266u), and the School Year Accountability (Summer School) grant (Conn. Gen. Stat. §10-265m and §10-266m).

The Governor proposes to maintain FY11 levels of funding in FY12 and FY13 for the School Readiness grant[24] ($69,813,190), the Extended School Hours grant ($2,994,752), and the Summer School grant ($3,449,699). The reduction proposed is in the Priority School District grant ($40,319,325 in FY12 and $39,792,940 million in FY13, compared to $40,929,547 in FY11).

4. *School-transportation grants.* The Governor proposes 10% cuts in the FY12 and FY13 formula grants for public and non-public school transportation grant administered by the State Department of Education (i.e., cuts in FY12 and FY13 of $2,864,972 in the public school grant and $399,000 in the non-public school grant).[25] An additional $1 million reduction is proposed in FY13 in the public school transportation grant in anticipation of reduced energy costs "based on the outcome of the Connecticut Regional Service Center Alliance study."[26] The grant had been capped in both FY10 and FY11; if it had been uncapped, additional funding of $60 million in FY12 and $125.5 million in FY13[27] would have been required.

5. *Grants for distressed municipalities.* The Governor proposes a $2 million reduction (26% cut) in this grant in each year of the biennium. The grant, administered by OPM, reimburses distressed municipalities for up to 50% of the property tax revenue lost through an 80% exemption on the assessed values of manufacturing facilities acquired, constructed, substantially renovated, or expanded on or after July 1, 1978 in a distressed municipality. Also exempted are machinery and equipment installed in these manufacturing facilities.[28] Funding for this grant was $7.8 million in FY05 and FY06, as well as in the current year.

6. *Teen pregnancy prevention grants.* This grant, administered by the Department of Social Services, provides grants to local organizations to develop and implement community-based multi-disciplinary programs for the prevention of teenage pregnancies. [29]CGS 17a-851a Averaged just over $1 million from FY99 through FY03, and was just over $2 million in FY04 declining to about $0.3 million in FY09 then increasing to $0.87 million in FY10.

C. Additions

By far the largest proposed municipal aid increases in Governor Malloy's FY2012-FY2013 budget are in two education-related grants: the grant for magnet schools and the grant for OPEN Choice. The goal of these new investments is to "improve urban education and reduce racial isolation."[30]

1. *Magnet Schools.*[31] The Governor proposes to increase the magnet school grant substantially - from $174.1 million in FY11 to $215.9 million in FY12 and $235.6 million in FY 13. The proposed funding increase from FY11

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[24] For a detailed overview of the many changes proposed by Governor Malloy for early care-related funding, including transfer of funding for state-funded child care centers and for quality enhancement grants from the budget of the Department of Social Services to the State Department of Education budget, see A. Hillman & C. Oppenheimer, *Early Care and Education: The Impact of the Governor's Proposed FY 12-13 Budget* (CT Voices for Children, February 2011), available at www.ctkidslink.org.
[25] See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), pp. 152, 163.
[26] Governor's Budget Summary, p. E-8. The Governor proposes $50,000 for the Alliance to study ways for communities to regionalize transportation and save costs. Governor's Budget Summary, p 10.
[27] Connecticut General Assembly, Office of Fiscal Analysis, *Synopsis of Governor's FY 12 & FY 13 Budget and Revenue Plan* (February 17, 2011), p. 19.
[28] Conn. Gen. Stat. §32-95. See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 18.
[29] Conn. Gen. Stat. §17a-851a. See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 135.
[30] Governor's Budget Summary, p. 10. The Governor also proposes a $3 million increase in FY12 funding for charter schools (for 367 new seats) and $3.5 million more in FY13 (for an additional 380 seats).

to FY12 of $41.7 million is a 24% increase. The proposed funding increase would pay for about 5,400 additional seats in FY12 and 2,800 *more* seats in FY13.[32]

2. *OPEN Choice.*[33] The Governor proposes also to increase substantially the OPEN Choice program grant – from $14.47 million in FY11 to $19.84 million in FY12 and $22.09 million in FY13. The proposed funding increase from FY11 to FY12 of $5.37 million is a 37% increase. These additional resources would fund an estimated 960 seats in FY12 and an estimated 350 additional seats in FY13 to expand voluntary school transfer options. The Governor also is proposing legislation that would allow the Commissioner of Education to provide more bonus funds (within available funding) to communities that are willing to accept more OPEN Choice students.[34]

D. Other Changes. The Governor proposes various other changes in FY12 and FY13 that would impact municipal budgets.[35] They include:

a) Eliminating the STEAP (Small Town Economic Assistance) grants in both FY12 and FY13, based on a $20 million unallocated balance currently available in the program;

b) Providing bond funding for an additional $50 million in Urban Act grants in FY12 and $30 million more in FY13;

c) Providing "the largest infusion of funds in the history of the Clean Water Fund…to address a project backlog created by years of underfunding"[36] --$186.6 million for grants and $471.8 million for subsidized low interest loans over the biennium through increased general obligation and revenue bonds funds;

d) A modification in the reimbursement rate for new school construction, from the current range of 20% to 80% (depending on the wealth of the community in which the school is located) to 15% to 65% (the reimbursement rate for school renovations would remain unchanged at 20% to 80%). Proposed bond authorizations for school construction are $536.4 million in FY12 and $592.3 million in FY13;

e) A modification in the reimbursement rate for magnet schools, from the current 95% to 80% (excepting, by court order, a required 100% reimbursement rate for magnet schools in Hartford);

f) A requirement that municipalities with resident state troopers assume responsibilities for overtime costs, resulting in an estimated expense of about $840,000 per year for towns in the Resident State Trooper program;

g) $600,000 in each of year of the biennium for Regional Planning Agencies, of which half ($300,000) is a bonus pool for regional planning agencies to encourage the voluntary consolidation of planning regions. Bonus funds would be used to assist regions that voluntarily seek to combine in the transition to a new dues structure and make other necessary administrative changes.

In addition, as one element of the Governor's proposals for budget reform, the Governor proposes to double his rescission authority – from the current limits of 5% of any appropriation and 3% of any fund to 10% of any appropriation and 6% of any fund – and to remove the current restriction on rescissions of aid to municipalities.[37]

II. MUNICIPAL REVENUES

Connecticut's cities and towns currently rely nearly exclusively on the local property tax for their revenues. In 2008, 97.7% of Connecticut's local tax revenues came from the property tax, compared to a United States average of

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31 PA 98-168. Magnet school grant funds are allocated based on the percentage of students attending from outside the host school district and the ECS foundation rate. The grant has increased steadily since FY99 when it was $16.0 million, with double-digit percentage increases in every year since except FY02. See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 169.

32 Governor's Budget Summary, p. 10.

33 The OPEN Choice grant is allocated to towns participating in the OPEN Choice program based on the number of participating students and the annual appropriation level. This grant also has increased steadily since FY99 when it was $3.14 million. See Office of Fiscal Analysis, *2010 Summaries of Connecticut State Grants* (March 5, 2010), p. 167.

34 Governor's Budget Summary, p. 10.

35 Governor's Budget Summary, pp. 21, 37; Connecticut Conference of Municipalities, *Governor's Proposed budget FY2012-FY2013: Impacts on Towns and Cities* (February 22, 2011), p. 4.

36 Governor's Budget Summary, p. 37.

37 Governor's Budget Summary, p. 40. See SB 1000, An Act Concerning the State Budget Process, §7.

72.3%. This reliance has been longstanding; in 1977, 99.1% of Connecticut's local tax revenues were from the property tax (compared to 80.5% across the nation).[38]

Unlike many other states, Connecticut currently does not allow its cities and towns to levy local sales taxes,[39] local personal income taxes,[40] or other taxes that might reduce reliance on the local property tax, nor does it share revenues from state-imposed taxes, except for the real estate conveyance tax.

Governor Malloy's proposed budget would forge new ground in broadening and diversifying the revenue sources for municipalities in several ways.

A. Return some portion of additional or new state taxes to the town of origin. Governor Malloy proposes to increase the state sales tax, hotel occupancy tax, and tax on rental cars and also restore the state cabaret tax. A share of the revenues from the three increased taxes, and all the cabaret tax revenues, after collection by the state, would be returned to the town of origin. Specifically:

1. Increase in retail sales tax.[41] A 0.1% sales tax would be added to the proposed new state sales tax rate of 6.25% - for a total rate of 6.35% - for sales of products and services at retail establishments. The state would collect the tax, and remit the revenues from the 0.1% surtax to the municipalities in which the sales took place, generating a projected $24.0 million in FY 12 and $25.1 million in FY 13 in new revenues for these municipalities.[42] This would be an automatic levy, not a local option.

2. Increase in hotel tax.[43] A 1% tax on hotel and lodging house rooms to benefit municipalities would be added to the proposed 2% state tax rate increase (for a total hotel tax rate of 15% instead of the current 12%). The state would collect the tax and remit the 1% tax proceeds to host cities and towns, generating a projected revenue gain of $5.8 million in FY 12 and $6.1 million in FY 13. This would be an automatic levy, not a local option.

3. Rental car tax.[44] A 3% surcharge on short-term car rentals and leases (bringing the total rate to 9%), with one-third of the new revenue going to municipalities for an estimated total revenue gain of $1.6 million per

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38 The Urban Institute-Brookings Institution Tax Policy Center, State & Local Government Finance Data Query system, www.taxpolicycenter.org/slf-dqs/pages.cfm.

39 Thirty-three states have some county and/or city sale taxes: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Louisiana, Minnesota, Missouri, Nebraska, Nevada, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Washington, Wisconsin, Wyoming. Tax Foundation, *2011 State Business Tax Climate Index* (October 2010), Table 15, State and Local Excise Tax Rates (as of July 1, 2010), p. 49, available at: www.taxfoundation.org/files/bp60.pdf

40 Fourteen states allow local government to levy a personal income tax, with varying rates: Alabama (0.19%), Arkansas (0.6), Delaware (0.16%), Indiana (1.16%), Iowa (0.3%), Kentucky (0.76%), Maryland (2.98%), Michigan (0.44%), Missouri (0.12%), New Jersey (0.9%), New York (1.7%), Ohio (1.82%), Oregon (0.36%) and Pennsylvania (1.25%). Tax Foundation, *2011 State Business Tax Climate Index* (October 2010), Table 12, Individual Income Tax Rates (as of July 1, 2010), pp. 43-46.

41 See Governor's Bill No. 1007, An Act Concerning the Governor's Recommendations on Revenue, §§26, 28. The tax is imposed on all "described retailers," defined as "a retailer who is primarily engaged in activities that are included in Sector 44 or 45 of the North American Industrial Classification System, United States Manual, United States Office of Management and Budget, 2007 Edition."

42 The CT Conference of Municipalities (CCM) has contacted OPM concerning the accuracy of these revenue estimates; OPM already had been examining the issue. According to CCM, it "appears data associated with sales at large retailers may be skewed due to reporting methods." Connecticut Conference of Municipalities, *Governor's Proposed budget FY2012-FY2013: Impacts on Towns and Cities* (February 22, 2011), p. 3.

43 See Governor's Bill No. 1007, An Act Concerning the Governor's Recommendations on Revenue, §§26, 28. The tax is imposed on the amount received for occupancy of any room or rooms in a hotel or lodging house "for the first period not exceeding thirty consecutive calendar days." For a history of the hotel tax and how its revenue has been allocated historically, see Office of Fiscal Analysis, *Hotel Tax: History and Revenue Distribution*, 2010R-0031 (January 21, 2010).

44 See Governor's Bill No. 1007, An Act Concerning the Governor's Recommendations on Revenue, §§26, 28. This tax is imposed on the gross receipts of "any retailer from the rental or leasing of a passenger motor vehicle for a period of thirty consecutive calendar days or less." §25(D) of the Governor's Bill No. 1007 would increase the state tax on short-term rentals/leases to 8.25%, while §26(C) would impose a 1% tax on gross receipts from rental and leasing of passenger motor vehicles, with proceeds to be remitted to the municipality where the rental/lease occurred.

year. The state would collect the tax and remit the municipalities' share to cities and towns in which the rentals and leases were made. This would be an automatic levy, not a local option.

4. *Cabaret tax.*[45] A restored cabaret tax on venues with entertainment that serve alcohol equal to 3% of all amounts charged for admission, food, drink, service and merchandise, with an estimated revenue gain for municipalities of $0.9 million in each year of the biennium. The state would collect the tax and remit the *entire* amount to host cities and towns. This would be an automatic levy, not a local option.

B. *Increase the municipal share of the real estate conveyance tax.*[46] The Governor proposes to make permanent the current 0.25% municipal real estate conveyance tax. He also proposes to expand to *all* municipalities the option to levy an additional 0.25% conveyance tax. This would increase the total municipal real estate conveyance tax rate from 0.11% (the scheduled rate starting July 1, 2011) to 0.5% in each municipality that elects the option, and 0.25% in municipalities that do not. The estimated municipal revenue gain is $52.9 million in each year of the biennium.

C. *Eliminate the currently-mandated property tax exemption for boats, non-commercial aircraft, and certain large commercial vehicles.*[47] The Governor proposes to eliminate three property tax exemptions, enabling cities and towns to impose personal property tax on these items.

Boats and non-commercial aircraft would be subject in all cities and towns to a state-wide personal property tax at a rate of 20 mills on 70% of current value for assessment years on or after October 1, 2011. The tax would be collected by the municipalities, with an expected revenue gain starting in FY13 of $38.7 million for the tax on boats and $4.0 million for the tax on aircraft.

Large commercial vehicles now subject to tax would be taxed at the general mill rate in their respective cities and towns. Revenues also would be collected by the municipalities. There is no current estimate of the likely revenue gain starting in FY13.

D. *Impact on Connecticut's cities and towns.* Not surprisingly, the revenues that would be generated through these proposals vary across Connecticut's 169 cities and towns given the great variation in the distribution of retail sales, of taxable boats, non-commercial aircraft, and large commercial vehicles, of hotels and cabarets, and of real estate transactions and the value of real estate subject to the transactions.

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[45] See Governor's Bill No. 1007, An Act Concerning the Governor's Recommendations on Revenue, §39. The tax is imposed on cabarets or "similar places" defined as "any room in a hotel, restaurant, hall or other public place where music, dancing privileges or other entertainment, except mechanical music alone or the music of a single performer alone, are afforded the patrons in connection with the serving or selling of alcoholic beverages, even though the charge made for admission, refreshment, service or merchandise is not increased by reason of the furnishing of such entertainment."

[46] See Governor's Bill No. 1007, An Act Concerning the Governor's Recommendations on Revenue, §§35, 36. Currently, municipalities collect a 0.5% real estate conveyance tax that is remitted by the town clerk to the state, and an additional 0.25% tax that the municipalities can keep. This municipal part of the tax is, under current law, scheduled to fall to 0.11% for transactions on or after July 1, 2011. Also, under current law, certain municipalities (i.e., those with a "targeted investment community" or in which certain specified manufacturing plants are located) have the option to impose and keep an additional 0.25% conveyance tax. For greater detail in how the tax works, what it covers and does not cover, and its history, see Office of Legislative Research, *OLR Backgrounder: Real Estate Conveyance Tax*, 2010-R-0430 (October 22, 2010).

[47] See Governor's Bill HB 6387, An Act Concerning Personal Property Tax Exemptions.

Greatest Estimated Municipal Revenue Increases Under Governor's Proposed FY12-FY13 Budget		
	FY 12 Estimated Revenue Increase	FY 13 Estimated Revenue Increase
Greenwich	$7,167,908	$9,166,020
Manchester	$3,397,399	$3,823,738
Fairfield	$2,691,219	$3,867,841
Danbury	$2,657,707	$3,445,013
Westport	$2,587,365	$3,594,849
Stamford	$2,232,462	$3,480,517
Darien	$2,086,726	$2,823,320
North Haven	$1,890,671	$2,180,242
New Canaan	$1,687,645	$2,051,732
Milford	$1,673,280	$2,575,228
West Hartford	$1,580,808	$1,968,455
Norwalk	$1,540,457	$3,010,412
New Haven	$1,538,511	$1,859,001
Farmington	$1,311,371	$1,583,587
Hartford	$1,233,934	$1,519,185
Ridgefield	$1,213,768	$1,455,283
Stratford	$1,161,132	$2,310,702
Waterford	$1,119,118	$1,622,069
Trumbull	$1,062,317	$1,405,890
Wallingford	$992,768	$1,421,637
Branford	$987,755	$1,754,463
Shelton	$969,977	$1,391,595
Waterbury	$939,567	$1,161,809
Wilton	$905,690	$1,284,391
Stonington	$838,389	$1,762,604
Simsbury	$804,136	$1,037,294
New Milford	$651,689	$1,001,008
Madison	$650,744	$1,192,258
Guilford	$568,720	$1,247,685
Groton	$541,370	$1,629,476
Old Saybrook	$538,487	$1,162,704
Windsor Locks	$421,345	$1,376,636
Oxford	$236,960	$1,418,217
Source: Governor's Budget Summary, FY2012-FY2013, pp. E-25 through E-44		

Although the Governor's Budget Summary (pp. E-37 through E-44) provides some town-by-town estimates of possible municipal revenue increases under the Governor's proposal, it cautions that "these figures are strictly estimates based upon limited data and are for illustrative purposes only." (p. E-14). The table above shows the cities and towns with the greatest revenue increases under his proposals, but includes only the municipal shares of the real estate conveyance tax, retail sales tax, and hotel tax, as well as the personal property tax on vessels and non-commercial aircraft. *Not included* in these revenue estimates are possible additional revenues from the cabaret tax, the rental car surcharge, and the property tax on certain large commercial vehicles.

As can be seen in the table, cities and towns with the greatest estimated revenue gains under Governor Malloy's proposal tend to be Fairfield County towns (where much of the estimated gain comes from the increase in the real estate conveyance tax that would be levied on property that is highly valued) and towns with large shopping malls (e.g., Manchester, Danbury, North Haven, Milford).

Towns with large jumps in estimated revenues between FY12 and FY13 tend to be shoreline towns with boats that would be subject to property tax in FY13 (e.g., Greenwich, Fairfield, Stonington) or towns with airports serving non-commercial aircraft (e.g., Danbury, Oxford, Stratford, Windsor Locks).

C. Conclusion

Governor Malloy has kept his word in his biennial budget proposal: the budget – on average -- is not being balanced on backs of Connecticut cities and towns.

However, his proposed patchwork of cuts to some municipal grants (most notably the PILOT-MME), increases in other grants, and proposals that would expand and diversify municipal revenues would result in municipal "winners" and "losers." The diversity of Connecticut's 169 cities and towns makes this result inescapable. For the majority of the cities and towns, the net fiscal impact of the proposed cuts, increases, and new revenues appears to be no dramatic change from the status quo for the upcoming year. However, for some municipalities the difference could be quite substantial.

For example, East Hartford's PILOT MME grant in FY11 is $3.58 million, but its estimated revenue gain in FY12 would be just $0.69 million. That is, its revenue loss with the repeal of the PILOT MME is more than five times greater than its estimated revenue gain under the Governor's proposals. While increases in other grants may help offset some of this net loss, it would be a substantial "hit" for this one town.

Conversely, some cities and towns that would lose virtually no revenue if the PILOT MME grant were eliminated would benefit greatly from the Governor's revenue proposals. For example, Greenwich's FY11 PILOT MME grant is $70,905, and its estimated revenue gain in FY12 is $7.17 million, or sixteen times greater than the revenue loss if the PILOT-MME grant were eliminated.

The Office of Policy and Management did a town-by-town analysis of net gains or losses from the total new revenues proposed (property tax on commercial vehicles, vessels, and aircraft; municipal share of retail sales, room occupancy and real estate conveyance tax) offset by the loss of the PILOT-MME grant.[48] This analysis shows that twenty-seven municipalities would have a net loss of revenues in FY12;[49] for eight of these municipalities the loss would be more than $0.5 million in FY12.[50] Conversely, all other municipalities would have a net gain in revenues, with thirty-one of them gaining more than $0.5 million and nine of these gaining $1 million or more.[51] Fairfield County towns emerge as the biggest winners, while the biggest losers are among Connecticut's poorer towns, as the table below shows–depicting the top five winners and losers in net revenues from the OPM analysis (in $millions):[52]

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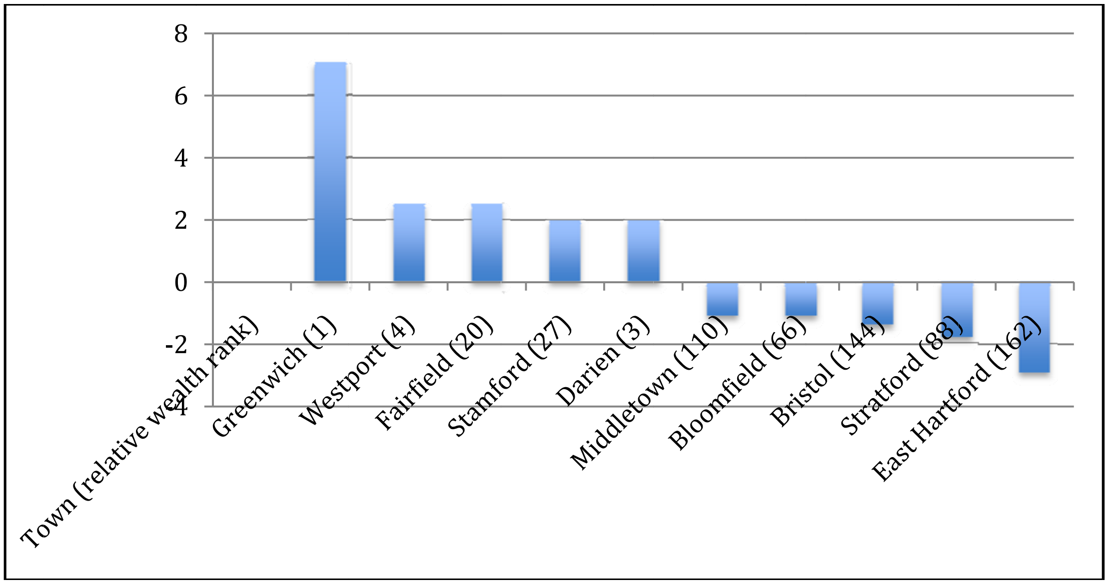
48 Undated and untitled analysis by the CT Office of Policy and Management, available at: http://ctmirror.org/sites/default/files/documents/keithwealth.pdf.

49 In order of loss (greatest to least), these municipalities are: East Hartford, Stratford, Bristol, Bloomfield, Middletown, Windsor Locks, Waterbury, New Britain, South Windsor, Wallingford, Meriden, Windsor, East Granby, North Canaan, Stratford, Thomaston, Killingly, Berlin, Sprague, Middlefield, Watertown, Bozrah, Winchester, Ledyard, Windham, Eastford, and Deep River.

50 In order of loss (greatest to least), these municipalities are: East Hartford ($2.9M), Stratford ($1.8M), Bristol ($1.4M), Bloomfield ($1.1M), Middletown ($1.1M), Windsor Locks ($1.1M), Waterbury ($0.9M), and New Britain ($0.7M).

51 The nine municipalities with net gains of more than $1 million are: Greenwich ($7.1M), Westport ($2.5M), Fairfield ($2.5M), Stamford ($2.0M), Darien ($2.0M), New Canaan ($1.7M), Norwalk ($1.6M), West Hartford ($1.1M) and Trumbull ($1.1M).

52 K. Phaneuf, Fairfield County is biggest winner under Malloy town aid plan (CT Mirror, March 8, 2011), available at: www.ctmirror.org/print/11779.



However, what seems most significant about the Governor's budget proposal (as it pertains to state support for municipalities) is the new ground it breaks in expanding and diversifying municipal revenue sources. Beginning as early as 1969, tax reform commissions in Connecticut have examined the state's reliance on local property tax to fund municipal services and made suggestions to reduce this reliance. Four of the nine commissions between 1969 and 2007 have recommended some revenue diversification for Connecticut municipalities.[53]

Benefits of revenue diversification for Connecticut's municipalities are evident. Allowed to have these other revenue sources, their reliance on the property tax can decline, helping – in particular – local taxpayers on fixed incomes, small businesses with little income and others whose ability to pay this tax is compromised. Further, as Connecticut's economy improves and revenues increase from retail sales, hotel stays, car rentals, real estate conveyances and other items that would now be taxable under Governor Malloy's plan, municipalities will be the beneficiaries of additional revenues without the need for a state appropriation. A portion of their budgets will no longer depend on state government (historically, a not particularly reliable partner) and their new resources would not be subject to constraints on state appropriations that are imposed by the state spending cap (which are likely to be substantial in the upcoming years).[54] Further, when the economy then sours and demand for many municipal services increases, and as state appropriations to municipalities are cut as state revenues decline, municipalities will have some supplemental income to help meet their local needs.

The challenges of municipal revenue diversification, akin to what Governor Malloy proposes, also have been highlighted in past tax commission reports, however. As the 2003 Blue Ribbon Commission on Property Tax Burdens and Smart Growth Initiatives stated, in discussing its recommendation for local revenue diversification:

> "The commission believes that local-option taxes on a municipality-by-municipality basis in a small state like

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[53] See J. Lohman & John Rappa, Office of Legislative Research, *Property Tax Review Commissions: 1969-2003* (PowerPoint presentation to Property Tax Cap Commission, October 29, 2007), p. 36. Their summary of the nine commissions indicates that the 1969 State Revenue Task Force and the 1972 Governor's Commission on Tax Reform both recommended diversification through new user fees. The 1991 State Tax Review Commission proposed regional tax sharing, while the 2003 Blue Ribbon Commission on Property Tax Burdens and Smart Growth Incentives proposed a combination of some regional revenue sharing and some increased taxes that benefit local municipalities.

[54] Because Connecticut's state spending cap applies a lagged five-year average of personal income growth or the rate of inflation (whichever if greater) to a budget base set by the level of appropriated spending in the prior year, the allowable growth in state spending when Connecticut recovers from a recession remains low for several years, despite an upswing in revenues. See S. Geballe, *Coping with the Cap: A Primer on Connecticut's State Spending Cap and its Impacts* (CT Voices for Children, April 2007), available at: www.ctkidslink.org/publications/bud07spendingcap.pdf,

> Connecticut are generally counterproductive – they tend to foster tax competition between communities and make high-tax towns that opt for additional taxes less competitive. The commission believes that regional sharing offers the best model.[55]

The Commission went on to recommend the imposition of a 15% surcharge on the hotel tax to be retained by host communities, as well as the continuation of the increase in the real estate conveyance tax to benefit municipalities – options Governor Malloy has embraced.[56] But it also recommended that the Councils of Government (COGs) be authorized to share a portion of the state sales tax and local property taxes, as well as be given other authority in bonding, regional land-use decisions, master teacher contracts, and regional cost-saving efficiencies to reduce inter-town competition and promote smart growth and strong regional planning.[57]

Although Governor Malloy's various proposals for municipal revenue diversification are automatic levies rather than local option taxes (with the exception of the supplemental 0.25% real estate conveyance tax), concerns remain about the likelihood of tax competition among towns for what would become newly-taxable goods, services and property. So, as the Connecticut budget begins to come into structural balance and the new Administration can turn more of its attention to other pressing concerns facing the state, it will be important to address this issue, and modify these new taxes in a manner that helps assure[58] regional revenue sharing, smart growth and strategic regional planning.

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55 *Report of the State of Connecticut Blue Ribbon Commission on Property Tax Burdens and Smart Growth Incentives* (October 2003), p. 31, available at: www.cga.ct.gov/pd/FullBlueRibbonCommissionReportFinal.pdf.

56 The January 2006 report of the Legislative Program Review and Investigations Committee, *Connecticut's Tax System,* also included as a policy option to make the tax system more balanced, expanding the taxing authority of local governments to levy and income or sales tax (though noting that this might "generate competition among municipalities and possibly encourage sprawl"). A second option proposed was a redistribution of a portion of the state sales tax to assist "targeted municipalities in providing property tax relief." Pp. 164-165. Available at: www.cga.ct.gov/pri/2005.asp#05Connecticuts_Tax_System.

57 *Report of the State of Connecticut Blue Ribbon Commission on Property Tax Burdens and Smart Growth Incentives* (October 2003), p. 37, available at: www.cga.ct.gov/pd/FullBlueRibbonCommissionReportFinal.pdf.

58 Conn. Gen. Stat. §7-148bb (PA 00-85, An Act Concerning Voluntary Municipal Revenue Sharing) permits the chief executive officers of two or more municipalities to negotiate an agreement to share real and personal property tax revenues, subject to approval of the final agreement by their legislative bodies. The agreement would identify the tax revenue to be shared as well as the collection and distribution mechanisms, and provide procedures for amending, terminating and withdrawing from the agreement. Proponents of the bill urged that it could reduce inter-town competition for development projects and sprawl. OLR reported that as of December 2006 no towns appeared to have elected this option. Office of Legislative Research, *Voluntary Municipal Revenue Sharing* (2006-R-0766).