



The Governor's Proposed Property Tax Cap: The *Wrong* "Cure" for Connecticut's Relatively High Property Taxes Shelley Geballe, JD, MPH

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Connecticut's property taxes are high relative to other states, but also have been a relatively constant share of Connecticut's economy.

Connecticut ranks 3rd highest in property tax per capita and 6th highest in property tax as a share of total personal income. Connecticut also ranks 8th highest among states in the share of *total* state and local revenues that come from the property tax. However, since the early 1990s, property taxes also have been a *relatively constant* share of Connecticut's economy, increasing at a rate consistent with growth in personal income and gross state product. Property taxes also have been a relatively constant share of all state and local taxes: 40.7% in FY 90, 39.4% in FY 04, and 37.9% in FY 05.

Property taxes should not be viewed in isolation.

Property taxes are just *one* of the state and local taxes paid by families and businesses; our high state ranking on property tax as a share of personal income should not be viewed in isolation. According to the most recent comparative US Census data (2005), Connecticut is *lowest* among all states in fees, charges and miscellaneous revenues as a share of personal income, 11th lowest in general sales taxes, and 6th lowest in total "own source" revenues (the most comprehensive measure of all state and local taxes, fees, charges and other revenues). Although we also are 8th highest in personal income taxes, both the property tax and the personal income tax can be deducted from income in calculating federal income tax due. Hence, Connecticut's reliance on these two taxes to finance state and local government provides greater federal tax benefits to Connecticut residents than would a greater reliance on other taxes, fees and charges.

Families pay a relatively greater share of property tax than in years past. There has been a *shift* in *who* is paying the property tax. Since 1989, the residential portion of Connecticut's property tax base has *increased* from 58% to 67%, while property taxes on business and commercial interests have declined. This shifting of taxes from businesses to families also has occurred with state taxes. In FY 90, 8.9% of state revenues came from the dividends and capital gains tax. In FY 08, 46.8% of total state revenues are from the personal income tax. By comparison, corporate business tax revenues have declined as a share of total state revenues from 11.5% in FY 90 to 4.6% in FY 08. In short, Connecticut families are bearing an increasing share of the cost of state and local government. Because the inflation-adjusted incomes of Connecticut's middle- and lower-income families also have been stagnant, or declining, in the last five years, it is not surprising that families are feeling more of a pinch.

The Governor's New Cap Proposal

As part of a comprehensive property tax reform package,¹ the Governor again this Session proposes a

¹ The "reform" package also includes (but is not limited to): a) a statutory prohibition on new "costly" unfunded state mandates on cities and towns unless the mandates are enacted by a 2/3 vote of the General Assembly; b) an increase in the threshold for the prevailing wage requirements; c) an amendment of the Teachers' Negotiation Act; d) modifications to and additional funding for the Regional Performance Incentive Program that seeks to promote regional cooperation initiatives (with an additional \$5 million); e) a Municipal Operational Efficiency Study grant to support towns interested in doing operational efficiency studies (with \$500,000 appropriated for FY 09); f) upon request of the OPM Secretary, audits by the Auditors of Public Accounts of the budgets of municipalities that receive more than 35% of their budgets from the state; g) new funds to help towns adopt five-year health cost containment plans, "to be

cap on local property taxes.² The cap now proposed reflects some important changes from the cap proposed last year that would easily have been one of the most restrictive in the nation.³ Key provisions of the Governor's 2008 cap proposal (and differences from the 2007 proposal) are:

1. *Cap limit.* Last year the Governor proposed an immediate 3% cap on growth in a town's property tax revenues, subject to certain exceptions. Now, she proposes to phase in the cap (starting at 4% in FY 09, declining to 3.5% in FY 10, and reaching 3% in FY 11 and the years thereafter). As in last year's proposal, the levy "base" for the cap calculation after FY 09 is the amount of revenues that the town *could* have levied in the prior year, rather than the amount it actually *did* levy. This helps avoid the "ratcheting down" effect that Connecticut has experienced with our state spending cap, when cuts in the budget base in times of deficit are very difficult to restore in subsequent years when the economy recovers.

2. *Exemptions.* "Understanding that there are fiscal pressures on municipalities that are outside local leaders' control and cannot be absorbed in a single year," the Governor proposes a broader range of exemptions to the property tax cap than in her 2007 cap proposal.⁴ They include:

- An automatic exemption for regional school district increases above the cap limit and any new Education Cost Sharing (ECS) aid over the prior year;

developed in consultation with their employee collective bargaining units;" h) "targeted" changes to the binding arbitration statutes that would require arbitrators to irrefutably presume that a municipality or district can not exceed the tax cap, "notwithstanding the municipality's ability to seek approval for certain exceptions to the limit" and also "that a budget reserve of 10% or less is not available to pay for any award."

² The text of the proposed changes are in HB 5028, AAC Property Tax Limits, Relief from Unfunded Mandates, Regional Performance Incentives Municipal Operational Efficiencies, and Property Tax Credits for Certain Volunteers.

³ For a critique of the Governor's 2007 property tax cap proposal, see *The Governor's Proposed Property Tax Cap: The Wrong "Cure" for Connecticut's Relatively High Property Taxes* (CT Voices for Children, May 2007), available at www.ctkidslink.org.

⁴ Last year's proposed cap would have allowed growth over 3% if: a) the grand list grew more than 1.5% in a year (not through re-valuation), in which case growth could be 3% plus the growth in the grand list over 1.5%; b) needed to pay debt service; c) upon an override vote of the town legislative body and electors; and d) in the case of an emergency upon a supermajority vote of the town's legislative body and approval by the OPM Secretary.

- *With approval of the local legislative body*, an exemption for: a) increases in employee health insurance costs over 8% over the prior year (for the same or similar benefits); b) increases in utility costs over 8% over costs in the prior year; c) increases of more than 8% needed to fund actuarially-recommended contributions to pension and other post-retirement benefits (for the same or similar benefits); d) the amount by which certain state formula aid decreased over the prior year; e) debt service increases for capital projects over the FY 09 level; f) expenses related to an emergency such as a flood, fire, declared health emergency, or natural disaster (which would *not* be built into the levy base); and g) one-time costs associated with "regional service initiatives" (which would *not* be built into the levy base);

- "General" overrides that would require a 2/3rds approval of the local legislative body, with voters able to *reverse* any legislative action to override the cap limit.

3. *Opt-out.* The Governor acknowledges that a "common approach may not accommodate the diversity of municipalities in our State," so allows municipalities to "opt out of the cap for two-year periods." Towns can opt-out by a 2/3rd vote of the municipality's legislative body no later than the last day of September in every even-numbered year (starting with September 30, 2008), *subject to approval* by town voters by a majority vote in that November's election. The bill also proposes that each municipality that has *not* opted out of the tax levy limit "shall adopt a five-year employee health care cost containment plan" on or before June 30, 2009. Some funds are provided for grants to towns, administered by OPM, to help in the costs of preparing such a plan.

The Wrong "Cure" for High Property Taxes

While well-intentioned, the Governor's new proposal remains the wrong "cure" for high property taxes as it is based on a questionable diagnosis of the problem:

1. Relatively high property taxes result primarily from Connecticut's *nearly exclusive reliance on this tax to fund local services.*

Among states, Connecticut cities and towns are 2nd most dependent on property taxes to fund local government (next to New Jersey), with 98.2% of all local taxes coming from the property tax in FY 04.

Across all states, by comparison, property taxes were just 73% of total taxes collected by towns.

Property taxes are relatively high in Connecticut because the property tax is the only major tax Connecticut's towns can impose to fund their schools and town services. Indeed, Connecticut is one of just twelve states that does not also allow towns to collect a local sales and/or income tax.

2. Property taxes are relatively high because state aid to cities and towns is relatively low compared to other states, and has been declining over the long-term. Together, property taxes and state aid constitute close to 90% of the total revenues of Connecticut cities and towns. So when state aid declines, property taxes will necessarily increase. K-12 education is a town's largest expense. In FY 90, the state picked up 46.5% of the costs of K-12 education. The state's share declined to 38.3% in FY 93 (after the recession in the early 1990s), increased back to 42.3% in FY 00, and declined (again) to 38.0% in FY 04 (after our most recent recession).

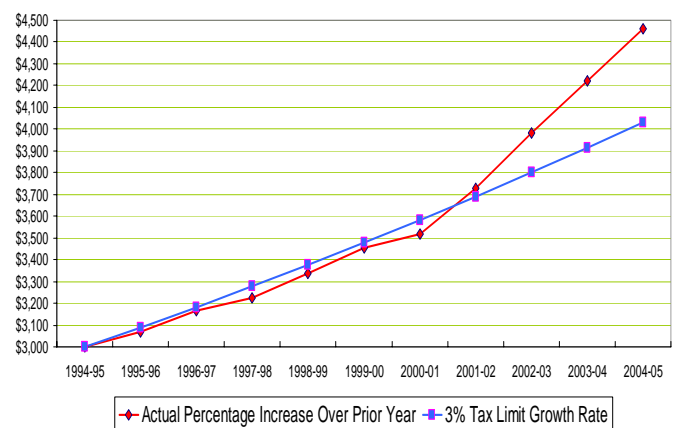
Further, a declining share of Connecticut's total state budget has been going to funding for its cities and towns – from more than 20% of the state budget in the 1980s to just 15.6% in FY 08. State aid to towns also has declined as share of total *town* revenues – from 28.6% in FY 91 to 26.5% in FY 04.

If Connecticut's state aid was 35% of Connecticut towns' budgets (in total), as has been the case in Massachusetts, our towns would receive at least a billion more in state aid. If a dollar-for-dollar reduction in property taxes resulted, Connecticut's property tax would be a *smaller* share of personal income than it is in Massachusetts (which has had a property tax cap since the early 1980s).

3. Recent growth in property taxes results from reduced growth in state aid to towns during the most recent recession, not from excessive new town spending. As the Governor's 2007 PowerPoint presentation stated, "increased state aid directly leads to *controlled* growth in property taxes." Indeed, based on Connecticut's experience over the last decade, additional state aid is likely the *only* thing that is needed to keep growth in property taxes below a 3% rate (on average).

The Governor's own data (as illustrated in the chart below) makes this point: "During the five year period from FY 1994-95 to FY 1999-00, state aid increased by an average of 4.65% per year, while property taxes increased by an average of 2.87% per year. Conversely, during the five year period ending FY 2004-05, state aid increased by an average of less than 1% per year, while property taxes increased by almost 6% per year."⁵ In short, it was only when state aid increases fell to less than 1% per year on average that property taxes began to increase faster than 3%.

Comparison of 3% Tax Levy Limit vs. Average Actual Tax Levy Increases FY 1995-96 to FY 2004-05



Governor Rell, *Investing in Our Future: Targeting Educational Excellence and Property Tax Relief in Connecticut* (PowerPoint Presentation, March 27, 2007)(embedded graph).

Indeed, in a letter to the Program Review and Investigations Committee about its 2006 *Connecticut Tax System* report, the OPM Secretary wrote, "We are opposed to any mandated limit on the allowable growth in revenues or expenditures of municipalities. As the report indicates, local property tax growth, which accounts for the vast majority of their revenues, is 'relatively slow but steady and adds stability to Connecticut's overall revenue structure.' We would prefer to assist municipalities in controlling spending growth by eliminating unfunded mandates." **The Governor's proposed cap would be one of the more restrictive in the nation.** Although many states have some sort of limit on property taxes, only five states have fixed caps that limit annual growth in

⁵ Governor Rell, *Investing in Our Future: Targeting Educational Excellence and Property Tax Relief in Connecticut* (PowerPoint Presentation, March 27, 2007), p.17.

property tax revenues to 3% or less per year (AZ, ID, MA, WA, and WV). Notably, all of these states except Massachusetts allow towns to collect their own sales tax to supplement property tax revenues. Eight other states limit property tax growth to inflation so may, in a given year, limit growth to 3% or less. Of these states, all except Montana allow towns to collect a local sales and/or income tax (and in Montana some communities can collect a resort tax). Connecticut, in contrast, has no such options: local governments in Connecticut cannot levy sales or income taxes.

A “Cure” With More Harm Than Good?

Although the Governor’s proposals to encourage regional cooperation and more efficient use of town funds are meritorious, and although the proposed new cap is far more flexible than the cap proposed by the Governor last year, there remain significant problems with the proposed cap:

- **The cap does not address the biggest factor contributing to high property taxes – insufficient state aid to cities and towns.** The Governor concedes, “property tax relief cannot happen without a commitment from the state” to substantial municipal aid. Yet, her proposed FY 09 budget revisions actually would *cut total payments to cities and towns by \$28.1 million* compared to funding approved last Session for FY 09.⁶
- **The cap is not conditioned on state aid staying at a given level, nor on maintaining the status quo in state exemptions of local property taxes and payments in lieu of taxes (PILOT).** The Governor’s new proposal includes an exemption from the 3% cap – assuming local legislative approval – in the “amount of any decrease in state grants-in-aid for any fiscal year” compared to the prior fiscal year.

While this is an improvement over no exemption at all for a reduction in state aid, the exemption still requires local legislative approval (which is harder to achieve in poor communities, as discussed below). The proposed cap also does not provide an escape valve if additional property is taken off the property tax rolls by state law and/or if state Payments in Lieu of Taxes (PILOT) for exempt property are reduced.

⁶ FY2009 Governor’s Midterm Budget Adjustments (February 6, 2008), p. E-3.

- **The cap’s interaction with the state spending cap must be fully understood.** Our state spending cap exempts certain aid to distressed municipalities. If not changed to exempt aid to *all* towns from the state spending cap, state spending constraints may result in towns that are not “distressed” municipalities receiving less aid over time (particularly during recessions), making it even harder for these town to stay within property tax cap constraints.

- **The cap’s exemptions for high growth in health care, utility, and pension costs would still leave towns in a quandary.** The Governor’s allows the cap to be exceeded (subject to town legislative approval) when the increase in town health care, utility, and/or pension costs is greater than 8% over the prior year. However, only those costs *in excess of 8%* are exempted from the cap. That is, towns with 8% growth in health care, utility and/or pension costs would need to absorb the 5% difference between the 3% cap on allowed growth and the 8% growth in these expenses, crowding out other spending.

- **The cap’s multiple exemptions and general override (through vote of the local legislative body), and its opt-out provisions – though increasing flexibility compared to the cap the Governor proposed in 2007 - will likely result in growing inequities across our cities and towns.** Research on the impact of spending caps in other states shows that override votes are more common in wealthy communities. Further, when override votes occur, they also are more likely to be *successful* in wealthy communities. If Connecticut’s wealthier towns vote to over-ride, or opt-out, of the cap, the disparities in educational and other public resources will further expand. Wealthier communities will see a further increase in their property values as their town services and schools excel relative to other towns, while Connecticut’s poorer towns and cities will continue to lose ground.

Research in other states with property tax caps documents other adverse consequences. Though caps differ in form and effect, the evolving research on the impacts of property tax caps also has found:

- A cap does not keep the cost of public services from increasing. As a result, other local taxes and non-tax fees and charges increase to balance the budget (though these revenue sources may be

even *more* regressive in their impact than property taxes);

- A growth in local debt; exempting debt service costs encourages “spending” through bonding;
- Ever greater dependence on state aid (though in economic downturns state aid to towns commonly is cut sooner and deeper than overall state spending);
- Increasing health insurance costs crowd out funding for other needed town services;
- Spending on police, fire, public works, parks, public health, libraries, and community development declines when a specific level of funding for education is mandated;
- When a specific level of funding on education is *not* mandated, student-teacher ratios increase;
- Towns turn to tax incentives to attract development to increase their Grand Lists.

A “one-size-fits-all” cap is too blunt an intervention and likely to lead to many unintended consequences. Connecticut’s 169 cities and towns vary greatly, including in the composition and value of their grand lists (and the proportion of property exempt from tax), in factors known to contribute to the need and demand for town services (e.g., age composition of the population, number of miles of roads, population density, age of infrastructure, rate of population growth), and in the extent of towns’ unfunded liabilities (health, pension). Given these differences, the impacts of a 3% cap on property tax growth will be experienced in 169 different ways that cannot be easily predicted.

A Better Solution

Instead of applying a one-size-fits-all solution on 169 Connecticut cities and towns, the Governor’s goals are better served by more precisely targeted interventions. To reduce property tax growth, it is essential to focus on the underlying causes of this growth. These include: a) municipal costs increasing faster than local grand lists (e.g., because specific costs, like health care, are increasing rapidly or because the number of residents needing town services, such as school-aged children, is increasing rapidly); b) the state deciding to exempt additional property from the local property tax; c) the state failing to reimburse towns 100% for property taxes lost through state-imposed exemptions, and failing also to reimburse at the full statutory rates (e.g., 45% for most state-owned property; 77% for

college/hospital property); c) the federal government imposing unfunded or partially funded mandates on towns (such as No Child Left Behind, special education); d) the state itself imposing additional unfunded mandates on towns; and e) the state reducing town aid.

The state should directly address the drivers of increasing property taxes (some of which the Governor mentions, see note 1) by:

- Creating more fiscal incentives for regional cooperation among towns to reduce the inefficiencies inherent in operating 169 separate towns and nearly as many school districts;
- Substantially increasing, and then maintaining at higher levels, state support for public education;
- Directly assisting towns with health insurance and utility costs (e.g., assuming some share of costs and/or create a larger purchasing pool to reduce cost);
- Repealing, modifying or fully funding all current state mandates on towns (e.g., special education);
- Imposing no new *unfunded* mandates on towns;
- Increasing state payments in lieu of taxes (PILOT) on exempt property;
- Maintaining the real estate conveyance tax at current levels;
- Expanding state revenue sharing with towns.

To reduce the property tax burden on families who are “property rich, but income poor,” provide better targeted property tax relief by:

- Increasing the current \$500 property tax credit against the state income tax and extending it to renters;
- Extending the property tax circuit-breaker program to *all* low- and fixed-income residents;
- Expanding the tax deferral program for elderly homeowners.