Warning Signs

Assessing Municipal Fiscal Health in Connecticut

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Yankee Letter

It is our local governments that we look to for many of the basic functions of government - including education, public safety, and public health. But in Connecticut, the cost of municipal government is driven up by state mandates, inflating our property tax bills and making it harder for people to live here.

This study examines the fiscal health of Connecticut's 169 municipalities. It does so by measuring several factors -- including debt costs, pension and retiree healthcare liabilities, savings, and recent changes in property values and unemployment.

The findings are a warning that problems could lie ahead for many of Connecticut's cities and towns. Eight municipalities received a score that indicates they are in severe fiscal distress, while another 53 received scores considered marginal.

Most of Connecticut's largest cities fell below the red line. These cities have many things in common – including high poverty levels, relatively high unemployment, and greater union political power.

But it isn't just Connecticut's large cities that are struggling– the municipality with the lowest score was Hamden, home to Quinnipiac University. This town is plagued by high pension liabilities and high debt.

All municipal leaders in Connecticut need greater authority to limit the growth of local property taxes, which are among the highest in the nation. State lawmakers could provide meaningful relief by reforming the collective bargaining and binding arbitration laws that are hamstringing municipal budgets across our state.

We hope this report is both useful and instructive as we move forward in trying to restore fiscal sanity to Connecticut.

Introduction

Connecticut's municipalities were at the heart of the stormy 2017 state budget negotiations. Gov. Dannel Malloy argued that many municipalities were in better shape than the state, and most could handle the expense associated with the state handing off one-third of its teacher pension liabilities to cities and towns.[i]

Municipal leaders recoiled at this suggestion, pointing out that it was state -- not municipal -- lawmakers who had failed to fully fund the teachers' pension system, and that the payments necessary to make the pension system whole are expected to grow by five times over the next decade. The pension payments Gov. Malloy wanted to partially offload to municipalities would have become ticking time bombs in municipal budgets.

It is clear that Connecticut is in poor fiscal shape. Tax receipts have declined in recent years, and state revenues have consistently failed to meet projections. Fixed expenses have grown from 37 percent of the budget in 2006 to 53 percent of the budget in 2018.[ii] The state has two of the worst funded pension systems in the nation; significant unfunded liabilities in its retiree healthcare system; and the highest bonded debt per capita in the nation. Combined with declining population and recent job losses, the state's situation is dire.

But Connecticut's problems are not confined to state government. Municipalities face their own challenges, many of which mirror the state government's issues. Rising pension and labor costs, education costs, high debt, and declining populations affect towns and cities across the state, fostering local instability and tax increases. When Connecticut loses population and tax revenue, so do its municipalities.

The governor's unsuccessful effort to balance the budget by decreasing municipal aid and forcing municipalities to pay for part of the cost of teacher pensions could have both adversely affected the credit ratings of most municipalities, and destabilized up to one-third of cities and towns.

Municipalities At Risk

Sixty-one Connecticut towns and cities, home to 2.1 million people, were found to have elevated credit risk in an analysis performed for the Yankee Institute. The analysis assigned fiscal scores to Connecticut municipalities based on general fund balances, long-term obligations, actuarially determined pension contributions, and changes in unemployment rates and property values.

The results of this fiscal scoring - based on 2016 municipal Comprehensive Annual Financial Reports (CAFRs)[iii] - were surprising in some instances and expected in others.

A score of 70 or above is considered healthy; scores between 50 and 70 are marginal. The municipalities with scores below 50 face severe fiscal distress and are in danger of becoming insolvent.

Connecticut has eight municipalities that scored 50 or below.

Eight Lowest Scoring Municipalities
Hamden - 25
Waterbury - 32
Stratford - 36
Hartford - 44
Bridgeport - 46
New Haven - 48
West Haven - 50
Sprague - 50

Although much public focus has been on the issues confronting Hartford, the town of Hamden actually received the lowest score in the state. Hamden's high levels of long-term debt and pension liabilities have left the town facing severe financial difficulties. The town's credit rating was downgraded by Moody's in December of 2017.[iv] Hamden was failing to make the annually required $21 million contribution to its pension fund, which has a total unfunded liability of $294 million. Even without its pension liability, the town's long-term debt amounts to 209 percent of total revenues, and the general fund balance is little more than 1 percent of revenue. The town was forced to raise its mill rate in 2016 and 2018 amid falling property values.[v]

The challenges facing Hartford, Waterbury, and Bridgeport are well known and documented.[vi] Connecticut's largest cities are buried under debt, pension obligations, high taxes and low revenue; all three have faced the specter of bankruptcy. They are also burdened by high unemployment rates, low home values, and struggling schools.

Stratford is also challenged by high fixed costs in the form of debt and pension obligations. Stratford, like Hamden, has taken out pension obligation bonds[vii] to help shore up its long-term pension debt of $68 million. Stratford's total long-term debt of $494.8 million exceeds total revenue by 203 percent.

Stratford, however, has instituted reforms designed to improve its long-term financial situation. The town switched from a defined benefit pension system to a 401(k)-style defined contribution plan. Although savings are not immediate, this change prevents accumulating future obligations. Stratford nonetheless continues to underfund its OPEB obligations by more than $10 million per year and recently faced a credit-rating decrease by Moody's in December 2017.[viii]

Perhaps it's no surprise that the small and wealthy hamlet of Bridgewater received the state's highest ranking. The average home value in Bridgewater exceeds $300,000, and the town's population of only 1,700 residents keeps operating costs low. Bridgewater has zero pension and OPEB liabilities and only $27,030 in long-term debt.

Eastford, Warren, and Cornwall resemble Bridgewater with small populations, high real estate values, and little to no long-term debt and pension liabilities.

5 Highest Scoring Municipalities
Bridgewater - 99
Eastford - 98
Cornwall - 96
Warren - 96
Old Lyme - 94

Old Lyme, with a population of over 7,000 residents, is the largest town in the five top-scoring municipalities, maintaining zero pension and OPEB liabilities and total long-term debt of $3.3 million. Because the town offers employees only a defined contribution retirement plan, it does not accumulate pension and OPEB debt.

Unsurprisingly, small towns with manageable employee costs were best able to maintain their finances and keep their long-term debt extremely low. They are able to take in more revenue than they spend -- but this outcome is not restricted to small, wealthy enclaves.

East Windsor, for instance, has a population of more than 11,000 residents, a median home value of $164,483, and median household income of $69,000 -- lower than the state median income.

Even so, East Windsor achieved a score of 85 while maintaining a property tax mill rate of 30.93, much lower than Hamden's rate of 45.36, or Stratford's rate of 38.99.

Furthermore, small and/or wealthy towns are not immune from low scores. Sprague, with a population of little more than 2,984 people, received a score of 50, while some well-populated towns in prosperous Fairfield County received lower scores, including Brookfield (59) and Fairfield (61).

A New Type of Fiscal Scoring

This scoring system uses a different methodology than national credit ratings agencies, which have been accused of rating municipal bonds more harshly than corporate bonds, raising the cost of borrowing for cities and towns. This scoring method developed by Marc Joffe, now at Reason Foundation, offers a more balanced approach to determining the fiscal condition of a municipality.

In his study, *Doubly Bound: The Cost of Credit Ratings* published by the Haas Institute at University of California, Berkeley, Joffe determined that "significant cost savings are possible by replacing the current rating system with model-based assessments that yield higher ratings overall while still differentiating at-risk issuers."[ix]

This scoring method assigns a 0-100 rating for a municipality based on 5 factors:

1. The ratio of a city's general fund balance to its expenditures (40 percent weighting);
2. The ratio of its long-term obligations (including OPEB but excluding pensions) to total government-wide revenues (30 percent weighting);
3. The ratio of actuarially determined pension contributions to total government-wide revenues (10 percent weighting);
4. The change in local unemployment rate (10 percent weighting); and
5. The change in property values (10 percent weighting).

This scoring method results in better scores for municipalities and the potential for savings in the future.

Analysis

Connecticut's major cities fared poorly in the scoring and, as previously noted, Bridgeport, Waterbury and Hartford have all faced the prospect of bankruptcy in the past and required extra financial help from the state, including oversight boards that improved their ability to negotiate manageable labor contracts and control spending.

Of cities with populations over 100,000, Stamford scored the best with a 53. Its relatively low score is primarily due to its long-term debt, which is more than double its pension and OPEB liabilities combined. New Haven, Hartford, Waterbury and Bridgeport all scored below 50, meaning that they remain in severe financial distress even after the state's efforts to get them on track.

Stamford has the benefit of being a major hub for business, and its proximity to New York helps the city attract investment companies. Unlike the rest of Connecticut, Stamford's population is climbing and it enjoys higher real estate values, median income, and lower unemployment than its major city counterparts.

It is difficult to compare mill rates directly because of different land and home values. A better way to compare is by analyzing property taxes paid as they relate to local median income. A statewide analysis based on these data was completed by the Western Connecticut Council of Governments. (See online version of paper for full analysis.)

Among the major cities, taxpayers in New Haven pay 6.4 percent of their median incomes toward their property taxes, while in Hartford the rate is 6.6 percent. These are two of the highest rates in the state. Meanwhile, in Stamford, property taxes are 3.7 percent of the area's median household income.

Stamford has recently begun making full payments toward its OPEB liability and Stamford Mayor David Martin says he is "making progress" in negotiating with the city's labor unions to reduce long-term retirement costs.[x] However, total debt remains high.

Danbury, though slightly smaller than other Connecticut cities, scored markedly better than other cities with a 65 rating. Although its debt is not nearly as high as other cities, expenses were higher than revenues for the fiscal year examined. Danbury does have reserve funds in order to bridge deficits.

West Hartford, which combines a fairly large population, high real estate values and high income, scored a 63. Of particular note is West Hartford's pension liability of $239.3 million. West Hartford stopped paying into its pension fund during the early 2000s when the pensions were 120 percent funded, but the economic downturn of 2008 caused the ratio to plummet while pension system payments shot up. In 2007, the town paid $5.9 million toward its pensions; ten years later they paid $17.9 million and were saddled with $433 million in total debt.

Bristol has a similar number of people as West Hartford, but has a lower median income. The city's low debt, and nearly fully funded pension system earned the town a rating of 79. However, Bristol has begun to underfund its pensions and OPEB over the last three years. The city's pension system went from having a surplus of $28 million to having liabilities of $9 million during that time period.

The choice to pay less into the pension system may be due to Bristol's expenses outstripping revenues by $7 million due to rising education, general government, public safety and public works costs, combined with lower-than-expected revenue.[xi] Although the city has a healthy reserve to cover the deficit, it should fully fund its pension and OPEB costs to prevent a West Hartford scenario in the future.

As noted above, smaller municipalities fared better than larger, more populous cities and towns. The average population for municipalities scoring below 70 was 35,849 and totaled 2.1 million people, a majority of Connecticut's population. Towns scoring above 80 averaged 10,885 residents for a total of 348,351 people.

Obviously, larger municipalities have larger payrolls; higher benefit costs for employees; more infrastructure demands; more borrowing for projects; and higher demand for social services. However, these higher costs should be offset by a broader tax base, including more businesses. Unfortunately, most Connecticut cities have struggled to attract private investment.

Considering the significant challenges faced by Connecticut's largest municipalities, they should be leading the charge to reform the benefits offered to their employees. But the state's largest cities are also bastions of government union power, which can make it nearly impossible to negotiate sustainable, affordable contracts.

Hartford is a prime, well-documented example. Despite facing the very real possibility of bankruptcy, only the firefighter and police unions offered concessions to help the city out of its financial crisis. Indeed, Hartford was hit with retroactive wage increases for its administrative workers due to an arbitration decision, further weakening the city's already-deteriorating financial health.[xii]

Hartford is now being placed under the control of an oversight board, which will have oversight over union contracts, although several members of the board are also union officials.[xiii]

A number of Connecticut municipalities have switched from defined benefit pension plans to defined contribution plans in recent years in an effort to save money and reduce future debt, including Danbury (65), Norwalk (68), Stratford (36), and South Windsor (66).[xiv] Towns like Canton (76) have had defined contribution plans since 2001.[xv]

State Fiscal Woes = Municipal Fiscal Woes

But even those municipalities that have gotten their own debt and pension liabilities under control have not escaped the "pension tsunami" sweeping the nation. That's because they will face the consequences of state lawmakers underfunding the teacher and state employee pension systems. High pension liabilities at the state level have led to declining state transfer payments to municipalities, and this trend is likely to continue.

The state of Connecticut's pension and OPEB costs continue to grow, crowding out other spending priorities in the state budget. The extension of the SEBAC benefits agreement prevents the state from making any adjustments to pension contributions, cost-of-living adjustments or retiree health benefits without approval by union leadership for the foreseeable future.

As Connecticut confronts major deficits, aid to municipalities will most likely be cut further to compensate for the increasing fixed costs related to pensions, retiree benefits and debt service.

Connecticut's most vulnerable municipalities are heavily reliant on the state to balance their budgets. Hartford receives 50 percent of its budget from state funds; Bridgeport receives 41 percent; Waterbury 38 percent; Stratford 35 percent; and Hamden 20 percent.

Cuts to municipal aid could severely affect these municipalities, causing them to have to raise taxes, cut services, and lay off employees. It could also affect municipal credit ratings, as investors take note that a large part of a municipality's budget comes from an unstable source -- namely, the state of Connecticut -- and is subject to dramatic changes.

For example, during the 2017 budget stalemate, Bridgeport ran out of city funds for education, and nearly ran out of money completely on September 30, before receiving an influx of state funds two days later.[xvi] The state of Connecticut funds 74 percent of Bridgeport's board of education budget and had cut Bridgeport's education funds by $1.3 million in 2016, precipitating layoffs. Bridgeport requested an additional $15 million in education funds from the state for 2017, but due to the deficit, funding remained flat. Escalating costs due to collective bargaining agreements and insurance costs mean Bridgeport will likely have to make additional layoffs.

Such effects are not limited merely to the low performing municipalities. Scotland, which scored a 72, warned that it was in danger of becoming insolvent during the 2017 budget debate. Scotland, a very small town with a small tax base, would not have been able to withstand Gov. Malloy's cuts to municipal aid, which were made through an executive order. Although smaller towns have lower costs, they also have fewer resources to withstand major fluctuations in state aid.

Other towns, which may not currently be in a precarious position, will still be under added pressure to balance increasing costs with tax increases, service cuts and employee layoffs, including teachers.

The governor's plan to force municipalities to help cover the cost of teacher pensions will probably be revisited in the future. As the cost of teacher pensions continues to grow, the state legislature will face the unpalatable options of raising taxes, cutting municipal or other spending, or forcing municipalities to help pay the costs — or perhaps all of the above. Switching new teachers to a defined contribution retirement plan, or a hybrid system, could help stabilize Connecticut's teachers retirement system in the long-run[xvii] but costs are escalating in the near future and lawmakers will also be forced to look for other, more immediate solutions.

With the state unable to lay off employees at the state level due to protections guaranteed in the 2017 SEBAC agreement and with state employees set to receive 3.5 percent wage increases in 2021 and 2022, state lawmakers will likely look to save money by cutting transfers to municipalities. At $2 billion per year, it is the state's single largest non-fixed expense.

Another often overlooked aspect of the challenges facing Connecticut municipalities comes from the special districts – including school districts, transit districts, housing authorities, and fire and water districts. Although school and special districts were not scored in this report, the data gathered showed that such districts can accumulate significant amounts of debt. To cite just two examples, the Metropolitan Water District has total debt of $1.3 billion and the Housing Authority of Stamford has a total debt of $28.6 million.

This is not to suggest that these special districts face any difficulty in meeting their obligations, but special districts holding debt could present unforeseen difficulties for their host municipalities. In 2017, Middletown Area Transit Authority suddenly announced cuts to its bus schedule due to "serious financial difficulties," which had grown virtually unseen for several years.[xviii]

It is beyond the scope of this report to examine how much financial scrutiny these special districts receive, but they may be forced to present sizable bills to both the state and their host communities in the future.

Conclusion

With 60 percent of Connecticut's population living in municipalities determined to be fiscally marginal, and eight of those municipalities in severe distress, it is clear that the fiscal challenges faced by Connecticut's state government are not unique, but are issues faced by local governments and taxpayers as well.

Any effort to balance Connecticut's budget on the backs of municipalities must almost certainly be reevaluated in light of the data.

Many of the municipalities facing the greatest difficulties already have prohibitively high property tax rates that limit economic growth. Foisting teacher pension costs onto towns, and cutting Education Cost Sharing and other municipal grant programs in an effort to correct the state's fiscal problems are likely to put additional pressure on municipalities that already teeter on the brink of insolvency.

The fact that this scoring system is actually more lenient than the methodology used by ratings agencies should be alarming in light of the number of Connecticut municipalities scoring below a 70.

Stephen Eide of the Manhattan Institute wrote, "States have a responsibility to address (municipal) fiscal distress because all local decisions regarding debt, taxes and spending are ultimately regulated by the states. Almost by definition, municipal insolvency is evidence of a failed fiscal policy at the state level."[xix]

Education funding is the largest expense for municipalities, but with growing fixed costs at the state level, declining tax revenue and the restrictions in the 2017 SEBAC government union agreement, it is likely that a number of towns will see their state education funding decrease. This could lead to teacher layoffs, reduced services, and property tax increases.

This is unfortunate because the state already spends more on pensions and retiree healthcare for state employees and teachers than on grants to municipalities for education.

Barring any structural changes to the state's fixed costs, state government can nonetheless offer municipalities some flexibility and relief through reforms to prevailing wage, binding arbitration, and minimum budget requirements for education. These state mandates limit local governments' ability to balance their budgets, adjust to changing financial situations, save money, and decrease tax pressure on their residents.

Some Connecticut municipalities received less education funding from the state last year as a result of Gov. Malloy's ECS cuts, but there were also some reforms to municipal labor laws, including prevailing wage and binding arbitration, included in the 2017 budget.

Those changes were modest steps in the right direction, but much work remains to be done. Connecticut's fiscal ills will continue to trickle down to local governments as state lawmakers look to municipal transfer payments as a source of potential savings.

Municipal leaders should plan accordingly by taking proactive measures now -- and continue to press for changes at the state level, rather than waiting for the inevitable cuts in the future.

Scores Sorted*

Hamden	25	Brooklyn	62	Shelton	66	Woodbridge	70	Windham	74	New Hartford	76	Chester	80	Oxford	88
Waterbury	32	Seymour	62	Stafford	66	Darien	70	Ashford	74	Willington	77	New Milford	80	Washington	89
Stratford	36	Watertown	62	Marlborough	67	Westbrook	70	Greenwich	74	Woodstock	77	Suffield	80	Roxbury	90
Hartford	44	Trumbull	63	Wethersfield	67	Colchester	71	Franklin	74	Morris	77	Voluntown	81	Windsor Locks	92
Bridgeport	46	Guilford	63	Ridgefield	67	Bolton	71	Barkhamsted	74	Hampton	77	Killingly	81	Sterling	93
New Haven	48	Wolcott	63	East Hampton	67	Griswold	71	Southington	74	Windsor	77	Kent	82	Old Lyme	94
West Haven	50	Prospect	63	Farmington	67	Middlebury	71	Sherman	75	Madison	77	Newington	82	Warren	96
Sprague	50	West Hartford	63	Ledyard	67	Durham	71	Canaan	75	Cromwell	77	Sharon	82	Cornwall	96
Stamford	53	North Haven	63	Mansfield	67	Middlefield	72	Pomfret	75	Ansonia	77	Enfield	82	Eastford	98
Derby	54	Torrington	63	Bloomfield	68	Easton	72	Woodbury	75	Colebrook	78	Lebanon	82	Bridgewater	99
Naugatuck	55	Old Saybrook	63	Litchfield	68	Scotland	72	Weston	75	Harwinton	78	Winchester	82		
North Canaan	56	East Hartford	64	Groton	68	Coventry	72	Southbury	75	Burlington	78	Columbia	83		
Deep River	58	Monroe	64	Granby	68	Norwich	72	Essex	76	Orange	78	Stonington	83		
New London	58	Newtown	65	North Stonington	68	Plainville	72	Lisbon	76	Bethlehem	78	Preston	84		
East Haven	58	Danbury	65	Norwalk	68	New Fairfield	72	Canton	76	Hartland	78	Ellington	84		
Meriden	58	Clinton	65	Tolland	69	Beacon Falls	72	Glastonbury	76	Vernon	79	Killingworth	84		
Brookfield	59	Thomaston	65	Manchester	69	East Haddam	73	Canterbury	76	Portland	79	Somers	84		
Union	59	New Britain	65	Berlin	70	New Canaan	73	Redding	76	Plainfield	79	Killingly	85		
Milford	60	Rocky Hill	66	Thompson	70	Chaplin	73	Haddam	76	Bristol	79	Branford	85		
Waterford	61	South Windsor	66	North Branford	70	Norfolk	73	Lyme	76	Salem	79	Bethel	85		
East Lyme	61	Bozrah	66	Avon	70	Montville	73	Westport	76	Hebron	79	East Windsor	87		
Fairfield	61			Wilton	70	Bethany	74	Middletown	76	East Granby	79	Goshen	87		
Cheshire	62					Simsbury	74	Salisbury	76	Wallingford	79	Putnam	88		

*For full data set see www.YankeeInstitute.org/WarningSigns

End Notes

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The Yankee Institute for Public Policy develops and advocates for free market, limited-government public policy solutions designed to promote economic opportunity, prosperity and freedom for all of Connecticut's people.

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