

Challenge

Connecticut distributes municipal aid through a variety of statutory grants to all of its 169 municipalities, regardless of each municipality's wealth or resident need. Municipalities face stark disparities in both their ability to raise revenue, exclusively through local property taxes, and in their costs of delivering services.

As a result, many municipalities are not receiving the necessary state support to properly pay for a common level of government service, and are facing fiscal challenges. Recently, municipalities have engaged the Municipal Accountability Review Board (MARB) for additional state fiscal support.

Solution

A solution to this municipal funding problem is employing the needs-capacity formula that was developed by the Federal Reserve Bank of Boston's New England Public Policy Center. The needs-capacity formula distributes state non-education municipal aid based on underlying socioeconomic and physical characteristics of the municipality and its capacity to raise revenue.

A needs-capacity formula achieves this goal by considering a municipality's costs of delivering a common level of service and its capacity to raise revenue to pay for those services. Under a needs-capacity formula, municipalities with the greatest level of fiscal disparity receive a greater level of state funding, while municipalities with the capacity to pay for services through their own revenue raising capacities receive less or no state funding.

Solution Key Features

- A needs-capacity formula provides resources to municipalities based on their costs to deliver services and their capacity to raise revenue locally; providing more aid to municipalities that face high costs for delivering services and have low capacity to raise local revenue.
- Municipal cost is measured by: unemployment rate, population density, private-sector wage index, town maintenance road mileage, and total jobs per capita. It does not reflect actual spending, which is a result of the decisions of local governments.
- Municipal capacity is determined by the Equalized Net Grand List, reflecting resources that governments are authorized to tax and not actual revenues raised, because municipalities can choose to tax at different rates.
- Municipal gaps are determined by subtracting municipal capacity from municipal cost. The municipal gap is then multiplied by the municipality's population to determine the grant from the needs-capacity model.
 - A municipality with a positive gap indicates the municipality does not have sufficient revenue-raising capacity to pay for a common level of government.
 - A municipality with a negative gap indicates the municipality has more than enough revenue-raising capacity to fund a common level of government.
- Provides municipalities with stability by being responsive to economic growth and recessions: an historical analysis of the model showed the fully-funded grant totals decrease over time as Connecticut's economy recovered. Conversely, if Connecticut experiences a recession, municipal costs would likely increase across many municipalities, resulting in a higher calculated grant amount to stabilize municipalities.
- Allows fiscally distressed municipalities to provide higher-quality services to their residents and businesses that rely on them, or reduce their mill rates to encourage development.

Q: How was the needs-capacity formula developed?

A: In 2015, the Federal Reserve Bank of Boston's New England Public Policy Center (NEPPC) produced a report, titled *Measuring Municipal Fiscal Disparities in Connecticut*, at the request of the Connecticut General Assembly's Municipal Opportunities and Regional Efficiencies (MORE) Commission. The NEPPC's report specifically analyzed non-education aid because Connecticut's Education Cost Sharing (ECS) formula for distributing education aid has been examined far more frequently than other forms of municipal aid. The School and State Finance Project has utilized the research and underlying model from the NEPPC's report with up-to-date data to measure the needs of a municipality and the capacity of the municipality to fund those needs.

Q: How is the needs-capacity formula calculated?

A: The formula consists of three primary components: the Municipal Cost, the Municipal Capacity, and the Municipal Gap. The Municipal Cost is made up of the following factors: unemployment rate, population density, private-sector wage index, town maintenance road mileage, and total jobs per capita. The Municipal Capacity is made up of the Equalized Net Grand List, which is a value estimate of all taxable property within all cities and towns within Connecticut, equalized across assessment cycles. The Municipal Gap is determined by subtracting the Municipal Capacity from the Municipal Cost. Finally, the grant is determined by multiplying the Municipal Gap by the municipality's population.

Q: How much is necessary to fully fund a needs-capacity formula?

A: The State of Connecticut, through its various non-education statutory municipal aid programs, currently provides approximately \$485 million — made up of General Fund appropriations and bonding allocations — to its 169 municipalities. A fully funded needs-capacity formula would require roughly \$863 million, or about \$378 million in additional funding.

Q: Can a needs-capacity formula be implemented with the current level of municipal aid?

A: If the formula were funded at the current \$485 million non-education statutory municipal aid level, grants would be roughly 40 percent less than a fully-funded formula. While grants to those municipalities that have a "positive" gap, meaning the municipality does not have sufficient capacity to pay for a common level of government services, would be less than if the grant was fully funded, the dollars available would be allocated in an equitable manner resulting in a redistribution of resources.

Q: Can a needs-capacity formula result in less state spending on non-education municipal aid?

A: Employing a needs-capacity formula could eliminate the need for the MARB to disseminate municipal aid, which is in addition to statutory non-education aid, to municipalities that have a "positive" gap and are in fiscal distress. Three municipalities are currently under MARB's tiered system: Hartford, West Haven, and Sprague. MARB has provided over \$32 million since fiscal year 2018 to these three municipalities. In addition, the Office of Policy and Management (OPM) and the state treasurer committed the State to pay for the City of Hartford's debt service on outstanding General Obligation bonds, which is scheduled to be \$754.7 million, over almost 20 years. The OPM has identified 10 other municipalities whose financials makes them eligible to go under MARB oversight, and therefore eligible for additional state support. If a needs-capacity formula were employed, the need for these additional state resources may be eliminated.

Q: Don't a lot of these municipalities only need more money because they are mismanaged?

A: The needs-capacity formula does not consider local decision-making, such as political decisions, municipal mill rates, revenues, and expenditures, and instead measures the cost to each municipality from providing a common level of government service — based on socioeconomic and physical factors as compared to available taxable resources. As a result, questions regarding the management of a municipality should be nullified.