

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 needs. 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 would distribute state non-education municipal aid based on underlying socioeconomic and physical characteristics of the municipality and its capacity to raise revenue.

The 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 the 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

- The 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 and modeling of the needs-capacity formula 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.

How was the needs-capacity formula developed?

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 used the research and underlying model from the NEPPC's report, coupled with up-to-date data, to measure the needs of municipalities and the capacity of municipalities to fund those needs.

How is the needs-capacity formula calculated?

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 for each Connecticut city and town that is equalized across assessment cycles. The Municipal Gap is determined by subtracting the Municipal Capacity from the Municipal Cost. Finally, a city or town's grant from the needs-capacity formula is determined by multiplying the Municipal Gap by the municipality's population.

How much state funding is necessary to fully fund the needs-capacity formula?

The State of Connecticut, through its various non-education statutory municipal aid programs, currently provides approximately \$807 million — made up of General Fund appropriations and bonding allocations — directly to its 169 municipalities. A fully funded needs-capacity formula would require roughly \$839 million, or about \$32 million in additional funding.^{1,2}

¹ These figures do not include aid to special districts and boroughs, or municipal restructuring funds.

² The figures in this analysis were calculated based off the biennial state budget for fiscal years 2024 and 2025 and use 2021 municipal fiscal data.

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

If the formula were funded at the current level of \$807 million for non-education statutory municipal aid, grants would be roughly four percent less than a fully-funded needs-capacity formula. The state budget for FY 2025 includes large increases in both General Fund and bonded municipal aid to the point where current expenditures are nearly at the level of spending called for by the needs-capacity formula. However, current expenditures are still not entirely distributed in an equitable, needs-based manner.

Can the needs-capacity formula be implemented with a “hold harmless” provision for current municipal aid levels?

If the needs-capacity formula was fully funded with a “hold harmless” provision in place for towns that would lose funding under the formula, the cost would be approximately \$1.13 billion or approximately \$324 million more than current funding levels. Under this framework, municipalities would receive the greater of their calculated needs-capacity grant or their estimated total FY 2025 non-education municipal aid. Adding a hold harmless provision increases the cost of the needs-capacity formula by approximately \$292 million over the formula’s original cost of \$839 million.

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

Employing the needs-capacity formula could eliminate the need for the MARB to disseminate additional municipal aid, which is in on top of 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. For FY 2025 the State of Connecticut budgeted approximately \$55 million in Municipal Restructuring Funds to be distributed in consultation with the MARB to assist fiscally distressed 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 make them eligible to go under MARB oversight and therefore eligible for additional state support. If the needs-capacity formula were employed, the need for these additional state resources may be eliminated.

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

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 of 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.