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CONNECTICUT CITY PENSIONS: THE AFFORDABILITY GAP

An Analysis of Bridgeport, New Haven, Hartford, Stamford, and Waterbury

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Executive Summary

Connecticut state government's pension struggles are well understood: deep levels of underfunding have led to credit-rating downgrades, tax increases, recurring budget deficits, and an inability to fund essential services. What has been overlooked, though, is the challenge that the state's five largest cities by population—Bridgeport, New Haven, Hartford, Stamford, and Waterbury—face in paying for their own retirement benefit promises.

Key Findings:

- All five of these cities have promised hundreds of millions of dollars in benefits, a promise that is backed, ultimately, by their tax base. With the exception of Stamford, however, they all have weak economies and elevated rates of poverty.

- While the state's record of pension mismanagement is well documented, cities have been guilty of mismanagement as well. However, for the state's five biggest cities, the question of *affordability* is more important than *mismanagement*.
  - Despite rate increases, property tax revenues have not been keeping up with pension costs in New Haven, Hartford, and Stamford. Hartford's property tax revenues, for example, grew by $2.8 million from FY08 to FY17 in real terms, while its pension costs grew by $16.7 million.
  - Though annual costs for retiree health care have not risen as dramatically, they are still high, totaling $132 million for all five cities combined. This is a questionable expenditure, considering that the private sector has largely phased out health-care benefits for retired workers.

- The case for dramatic retirement benefit reform—phasing out retiree health care and transitioning workers from a defined-benefit to a defined-contribution plan—may be more urgent for Connecticut's biggest cities than for the state.

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Introduction

Connecticut state government's pension struggles are well understood: deep levels of underfunding have led to credit-rating downgrades, tax increases, recurring budget deficits, and an inability to fund essential services.What has been overlooked, though, is that Connecticut cities face pension struggles of their own. This report will survey the retirement benefit programs of the state's five largest cities by population: Bridgeport, New Haven, Hartford, Stamford, and Waterbury.

Hartford, New Haven, Stamford, and Waterbury operate their own independent pension systems. Bridgeport participates in a statewide system (but the city is responsible for meeting its own pension obligations). All of these cities also offer retiree health-benefit programs that are run locally. All five cities have promised hundreds of millions of dollars in benefits, a promise that is backed, ultimately, by their tax base. The health of that tax base is essential to understanding the health of the cities' retirement benefits.

Connecticut is often described as a "blue state," a term that, in addition to its political connotations, indicates high levels of taxation and government spending. Many in Connecticut embrace this model, in contrast to what public officials have described as that of "low public investment states" elsewhere. But rising retirement benefit costs are substantially the costs of the past: government spending is rising, but levels of "investment" are not. Thus, escalating legacy costs pose a direct challenge to Connecticut's "high services" model—for cities as well as for state government.

Connecticut Public Retirement Benefits: An Overview

When Standard & Poor's downgraded Connecticut's credit rating this past April from A+ to A, it cited the state's "high unfunded pension liabilities" as a major reason.[1] In its most recent nationwide survey of state governments' pension systems, the Pew Center on the States ranked Connecticut fourth-to-last in funding. Only Illinois, New Jersey, and Kentucky had lower funded ratios.[2] Connecticut devotes a greater share of its revenues to servicing its debt and retirement benefit liabilities than all but two states.[3] Since the Great Recession, Connecticut has raised personal income taxes three times (2009, 2011, 2015)[4] but continues to face deficits. Slow rates of GDP and income growth have forced a debate over the state's economic competitiveness,[5] but its massive liability totals will limit Connecticut officials' ability to bring down taxes.

Amid these concerns about the state, the pension situation at the local level has largely escaped notice. Public pensions in Connecticut are unusually decentralized. A total of 212 public pension plans are in Connecticut—the sixth-highest total of any U.S. state[6]—and 206 of them are local plans. Of the state's five largest cities—Bridgeport, Hartford, New Haven, Stamford, and Waterbury—all except Bridgeport operate their own independent systems. Bridgeport active employees participate in the statewide Municipal Employees Retirement System.[7]

Connecticut's five largest cities owe hundreds of millions of dollars in retirement benefit obligations (**Figure 1**). Retirement benefits, in each case, comprise pensions and health care. The latter is often referred to in government financial statements as OPEB (other post-employment benefits). Benefit levels, eligibility, and worker contributions vary between cities and, to some extent, between employee cohorts within the same municipal workforce.[8] Generally speaking, however, retiree health care entails providing full coverage between the time a worker becomes eligible for a defined-benefit pension and retires, and when he becomes eligible for Medicare (public employees, particularly police and firefighters, often retire before age 65) and then supplemental coverage (including payment of Medicare Part B premiums) for some out-of-pocket costs not covered by Medicare.

The retirement benefit liabilities in Figure 1 are expressed in absolute terms and also in per-capita terms, so that cities can be compared with one another and with state government, and against cities' bonded debt obligations.

On a per-capita basis, each city owes thousands of dollars in retirement benefit liabilities, and the total exceeds the total owed for bonded debt. (Amounts for pension obligation bonds—debt issued to pay off

FIGURE 1.

Connecticut State and Major City Retirement Benefits and Bonded Debt

	Bridgeport	Hartford	New Haven	Stamford	Waterbury	Connecticut
Population	147,022	124,320	130,405	127,410	109,211	3,588,570
Net Pension Liability	$601,411,149	$428,476,000	$777,124,811	$178,774,375	$222,384,000	$37,192,071,000
Outstanding Pension Obligation Bonds	$244,040,000	N/A	N/A	N/A	$255,045,000	$2,215,392,000
Unfunded Retiree Health-Care Liability	$804,740,362	$295,193,000	$556,889,000	$250,590,000	$894,014,000	$21,887,500,000
Total Retirement Benefit Liability	$1,650,191,511	$723,669,000	$1,334,013,811	$429,364,375	$1,371,443,000	$61,294,963,000
Outstanding Primary Government Debt	$442,732,000	$672,337,000	$639,035,000	$555,614,000	$200,074,000	$22,875,827,000
Per-Capita Net Pension Liability	$4,091	$3,447	$5,959	$1,403	$2,036	$10,364
Per-Capita Unfunded Retiree Health-Care Liability	$5,474	$2,374	$4,270	$1,967	$8,186	$6,099
Per-Capita Retirement Benefit Liability	$9,564	$5,821	$10,230	$3,370	$10,222	$16,463
Per-Capita Primary Government Debt	$3,011	$5,408	$4,900	$4,361	$1,832	$6,375

Source: American Community Survey, 2012–16; "City of Bridgeport, Connecticut, Comprehensive Annual Financial Report for the Fiscal Year July 1, 2016 to June 30, 2017," Bridgeport Department of Finance, Jan. 10, 2018; "Comprehensive Annual Financial Report of the City of Waterbury, Connecticut, Fiscal Year Ended June 30, 2017," Waterbury Department of Finance, Dec. 21, 2017; "City of New Haven, Connecticut Comprehensive Annual Financial Report, Fiscal Year 2017 July 1, 2016–June 30, 2017," New Haven Department of Finance, Mar. 15, 2018; "Comprehensive Annual Financial Report, City of Hartford, Connecticut, Mayor-Council Form of Government, for the Fiscal Year July 1, 2016 to June 30, 2017," Hartford Department of Finance, Jan. 10, 2018; "City of Stamford, Connecticut, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2017," Stamford Office of the Director of Administration, Dec. 29, 2017; "Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 2017," State of Connecticut Office of the State Comptroller, Dec. 29, 2017

FIGURE 2.

Connecticut State and Major City Pension Systems Funded Ratios and Discount Rates, FY17

	Funded Ratio	Discount Rate
Hartford Municipal Employees Retirement Fund	72.2%	7.50%
Waterbury Retirement System	63.1%	8.00%
New Haven City Employees' Retirement Fund	34.2%	7.75%
New Haven Policemen and Firemen's Retirement Fund	41.3%	7.75%
Stamford Classified Employees' Retirement Fund	80.6%	7.50%
Stamford Policemen's Pension Trust Fund	78.7%	7.20%
Stamford Firefighters' Pension Trust Fund	67.6%	7.25%
Stamford Custodians' and Mechanics' Retirement Fund	82.3%	7.50%
Connecticut State Employees' Retirement System	31.7%	6.90%
Connecticut Teachers' Retirement System	52.3%	8.00%

Source: Government Comprehensive Annual Financial Reports (CAFRs), cited in Figure 1 supra

pension liabilities—are included under Total Retirement Benefit Liability.) Retirement liability costs are ultimately the responsibility of city governments, even when, in the case of Bridgeport, they are managed at the state level. The liabilities reflect benefit promises made to city workers for which assets are currently inadequate. Thus, each of New Haven's citizens will, in effect, have to come up with $10,230 to ensure that that city's retired workers receive the pension and health-care benefits they were promised throughout their retirement years.

The state government has the largest per-capita total. One reason: pensions for Connecticut public school teachers, who constitute the largest government employee cohort in the state (and the nation, for that matter), are funded by state government. During the 2017 budget debate, when lawmakers had to close a $5.1 billion two-year deficit, Governor Dannel Malloy proposed shifting one-third of the costs of teacher pensions onto localities. However, this proposal was blocked by the legislature, and teacher pension funding remains a state responsibility.

Figure 1 expresses the "unfunded" portion of the state's liability—the gap between how much it has on hand versus how much it has promised—in absolute terms. **Figure 2** expresses the unfunded liability of major city systems in relative terms, as a ratio of assets to liabilities. Four out of the eight systems have funding levels below 70%.

The "discount rate" column in Figure 2 shows the assumed investment rate of return on assets that each system uses in evaluating the size of its liability in present value terms. The higher a discount rate, the more optimistic a system is about its return on investment. Overly aggressive discount rates—8% and higher—have come in for criticism for overstating the financial health of pension plans and allowing government sponsors to contribute too little (the more a system expects to earn through investment return, the less it has to ask taxpayers each year to contribute). In response to this criticism, many systems have reduced their rates in recent years. For public pension systems nationwide in 2016, the median discount rate was 7.5%, down from 8% in 2010.[9]

Figure 2 also shows that several city systems have higher funded ratios than Connecticut state government. These include the system of Hartford, which was last year placed under state oversight as part of a package of financial assistance to save that city from insolvency.[10]

A government's retirement benefit program depends substantially on the strength of that government's tax base, just as a corporate pension plan is backed, ultimately, by the health of its sponsor's business. Connecticut has faced economic headwinds of late; but by most conventional measures, it still has a strong tax base. At $71,755, the state's median household income ranks fifth among all American states; and at 10.4%, its poverty rate is fourth-lowest.[11] It boasts a higher concentration of millionaires (measured by the proportion of federal income tax filings reporting income of $1 million or more) than any other northeastern state.[12] It is host to 17 Fortune 500 companies' headquarters,[13] and its hedge-fund industry is second only to New York's, measured by assets under management.[14] The state, in the phrase of Endicott College's Joshua McCabe, has a high "fiscal capacity."[15] It has more resources to tap, in an economic sense, to fund the cost of government than most other states.

Connecticut's major cities, however, have low fiscal capacities (**Figure 3**). Compared with the statewide average, for example, all but Stamford generate low levels of income tax revenue and have elevated poverty rates. Hartford's per-capita retirement benefit burden may be one-third that of the state's (Figure 1), but

FIGURE 3.

Connecticut State Government Tax Base Versus Its Major Cities

	2012–16 Poverty Rate	2012–16 Median Household Income	Personal Income Tax Revenues, 2016	Income Tax Revenues per Capita, 2016
Bridgeport	22.1	$43,137	$61,465,266	$1,029
Hartford	31.9	$32,095	$51,242,224	$1,044
New Haven	26.1	$38,126	$89,388,902	$1,820
Stamford	8.9	$81,634	$253,612,830	$4,156
Waterbury	25.4	$39,681	$54,183,281	$1,171
Connecticut	10.4	$71,755	$6,366,488,750	$3,974

Source: American Community Survey 2012–16; Connecticut Department of Revenue Services

Hartford has a poverty rate roughly three times that of the state as a whole (Figure 3). Among the roughly 300 U.S. localities with a population of 100,000 or more, only 14 have a poverty rate above 30%, and Hartford is one of them.[16] Clearly, it's one of the poorest major cities in the nation. New Haven and Waterbury, whose poverty rates among cities with a population of 100,000 or more are 36th and 41st, respectively, are not far behind.

State and Local Government Pension Mismanagement

Connecticut state government's pension struggles reflect a combination of poor management and lack of will. As several studies have detailed,[17] state government declined to make adequate budgetary appropriations into its pension system over the course of decades. Informed observers knew what would eventually happen. In his audit of state finances for FY 1992, State Comptroller William E. Curry, Jr. warned that a recent decision to forgo more than $200 million in pension contributions out of the "normal funding requirement" would, "like deficit financing … burden future generations with taxes for services they will not receive."[18] A 1993 report on the status of the State Employees Retirement System (SERS) plan by Deloitte & Touche noted that its funded ratio was the third-lowest among all state pension systems and that "Connecticut SERS is being funded using less conservative economic assumptions than are being used by most other state employee retirement systems."[19] When state officials had access to more revenues, such as after the introduction of the "gross income tax" in the early 1990s, they opted to support other services and programs with funds that could have gone to fully fund the actuarially required contribution.[20] Now liabilities have swelled dramatically, and state officials have little choice but to fund pensions instead of other services and programs. Rising pension costs, according to the Connecticut Commission on Fiscal Stability and Economic Growth, a blue-ribbon state task force, have "crowded out" funds available for infrastructure, local aid, and the social safety net.[21]

In February 2017, state officials agreed to shift $14–$21 billion in costs for SERS onto the next generation of taxpayers (2033–47).[22] They did this out of a fear that without some sort of "refinancing," annual costs could spike to $6 billion within the next 15 years (annual costs currently stand at about $2 billion). Governor Malloy and the Connecticut Commission on Fiscal Stability and Economic Growth have called for taking a similar approach to the state Teachers' Retirement System (TRS).[23]

Are Connecticut cities' pension management records superior to those of state government? The higher funded ratios noted in Figure 2 indicate that, in some cases, this is indeed the case. A pension-funding requirement placed in Hartford's city charter in the 1940s has imposed fiscal discipline on the state capital.[24] The city's funded ratio is almost exactly the same as the median for systems nationwide, whereas SERS and TRS ratios are well below the national median. As recently as 2008, Hartford's Municipal Employees' Retirement Fund (MERF) was overfunded (**Figure 4**). The state plans have trailed the national average since at least the 1980s.[25]

Nevertheless, measuring a city's pension management record against that of the state government's may not be the most useful standard. At 8%, Hartford's discount rate was long the industry standard and lower than the state's plans, which have been higher than national averages since at least 1990.[26] Even so, Hartford's current funded ratio is not 100% (Figure 2), despite a respectable record of making its pension contributions. This indicates that it, like the state, has not exhibited strong discipline in pension management. Using a lower discount rate would have required Hartford to make larger contributions, but funding levels at present would have been more robust. A more concrete example of pension mismanagement recently occurred during its 2016 budget cycle, when Hartford transferred a city park to its pension system, to save on its annual contribution.[27]

FIGURE 4.

Funded Ratios and Discount Rate: Connecticut, Hartford, and National Median

	Plan: Connecticut SERS		Plan: Connecticut Teachers		Plan: Hartford MERF		Plan: Median, All Systems	
Fiscal Year	Funded Ratio	Discount Rate	Funded Ratio	Discount Rate	Funded Ratio	Discount Rate	Funded Ratio	Discount Rate
2002	61.64%	8.50%	75.90%	8.50%	108.70%	8.00%	93.3%	8.00%
2003	56.66%	8.50%	70.38%	8.50%	104.70%	8.00%	88.5%	8.00%
2004	54.46%	8.50%	65.30%	8.50%	99.60%	8.00%	85.8%	8.00%
2005	53.28%	8.50%	62.26%	8.50%	101.70%	8.00%	84.9%	8.00%
2006	53.19%	8.50%	59.50%	8.50%	101.90%	8.00%	84.2%	8.00%
2007	53.58%	8.50%	65.43%	8.50%	100.10%	8.00%	85.9%	8.00%
2008	51.92%	8.25%	70.00%	8.50%	102.20%	8.00%	82.7%	8.00%
2009	43.61%	8.25%	65.57%	8.50%	96.60%	8.00%	77.4%	8.00%
2010	44.40%	8.25%	61.40%	8.50%	88.60%	8.00%	74.9%	8.00%
2011	47.90%	8.25%	58.24%	8.50%	83.50%	8.00%	73.2%	7.75%
2012	42.30%	8.00%	55.20%	8.50%	79.00%	8.00%	71.6%	7.75%
2013	41.20%	8.00%	57.18%	8.50%	74.70%	7.75%	72.7%	7.75%
2014	41.50%	8.00%	59.00%	8.50%	76.88%	7.75%	73.7%	7.59%
2015	43.30%	8.00%	57.41%	8.50%	77.60%	7.75%	74.1%	7.50%
2016	36.90%	6.90%	56.00%	8.50%	74.80%	7.50%	73.1%	7.50%

Source: Author calculation based on data from "Public Plans Data," Center for Retirement Research at Boston College

In 2009, Waterbury, whose retirement system was funded at a rate below 10%, issued $315 million in pension obligation bonds.[28] Pension obligations are a financial instrument that is viewed with wariness by the Government Finance Officers Association, among others.[29] By issuing bonded debt and then putting the proceeds into its retirement system, the government issuer of pension obligation bonds hopes that the rate of return on investment will exceed the interest rate that it must pay on the bonds. That does not always happen.[30] Bridgeport has twice issued pension obligation bonds[31] since 2000. The city also recently sought and received special permission to reduce its pension contributions,[32] over the objections of the state treasurer, who warned that such a maneuver "could put the integrity of the plan at risk."[33] New Haven, whose systems have the lowest funded ratios among all five cities (Figure 2), recently considered issuing pension obligation bonds.[34]

There may be a relation between fiscal capacity and mismanagement. True, affluent jurisdictions can be guilty of fiscal mismanagement. But when a city has a weak tax base, it is going to be tempted to engage in more short-term-oriented fiscal practices. Funding a pension bill that won't come due in full for decades will come to seem like an unaffordable luxury when revenues to support current municipal service levels are inadequate. Some of the fiscal maneuvers taken by Connecticut cities may have been justifiable as the more preferable between two highly unattractive options. But they do raise pertinent questions about the basic affordability of retirement benefit commitments.

The Emergence of a High Tax / Low Services Government Model

To raise revenues, the major tool that cities in the Nutmeg State can use is the property tax: there is no general local sales or income tax in Connecticut.[35] Connecticut local governments rely on the property tax more than in any other state (**Figure 5**). (In the aggregate, local governments nationwide rely on property taxes for only 46.6% of their general own-source revenues.)

Figure 6 shows that cities have been making active use of their main revenue lever: property tax rates have been rising, in recent years, in all the cities, with the exception of New Haven (where tax rates have remained around a narrow range). Major Connecticut cities' revenue needs would be far less pronounced if their liabilities were not so onerous. Waterbury estimates that it is "paying the equivalent of 23.57 mills" for pension and retiree health-benefit liabilities that were previously incurred, and its mill rate could be over 20 points lower if not for those costs.[36]

Despite tax increases, property tax revenues have not been keeping up with pension costs in the case of New Haven, Hartford, and Stamford (**Figure 7**).[37] On an inflation-adjusted basis, Hartford's property tax revenues grew by a modest amount—$2.7 million—from FY08 to FY17. But pension costs grew by $16.7 million in real terms, or about 600% of the increase in property tax revenue. The disparity is not as stark for Stamford and New Haven. Still, because pension costs grew more rapidly than property tax revenues, pension costs reduced the amount of new revenue that New Haven and Stamford could devote toward other purposes by 45.5% and 17%, respectively.

In FY08, contributions for Hartford's main MERF system represented 12.4% of payroll. Now they are 26.1%.[38] The contribution rate to Stamford's police plan, measured as a share of payroll, has increased by five times (7.4% to 35.4%).[39] The city of New Haven, for its public safety plan members, is now contributing 45 cents for every dollar of salary.[40] These increases have not occurred because benefits have become more generous; they have not. They have occurred because these governments have had to increase their contributions to pay off unfunded liability. In short, whether benchmarked against payroll or property tax revenues, pension costs in major Connecticut cities have risen dramatically over the last decade.

Rising pension payments have contributed especially to Hartford's fiscal distress. Fearing that Connecticut's capital city would face insolvency, and potentially bankruptcy, state government agreed to provide financial assistance (a "bailout") in exchange for oversight.[41] State officials established the Municipal Accountability Review Board (MARB), from which, last December, Hartford formally sought designation as a Tier III municipality (Tier IV being the most deeply distressed).[42] MARB's oversight regime requires Hartford to submit its annual budget for approval to the state agency as well as provide regular reporting on current cash flow and long-term financial outlook. The city is currently projecting balanced budgets over the next five years.[43]

An annual pension contribution has two main components: the "normal" cost—payment to cover benefits accrued in the current year (equivalent to a private employer's 401(k) contribution); and the payment to cover benefits earned in past years but not adequately funded. Of the $44.4 million that Hartford's actuary claimed that it needed to contribute in FY18, roughly

FIGURE 5.

States Where Local Governments Rely the Most on Property Taxes, 2015

State	Property Tax as Share of Total Local General Revenues
Connecticut	84.8%
New Hampshire	83.5%
Rhode Island	80.2%
New Jersey	79.7%
Maine	78.6%
Massachusetts	76.7%
Wisconsin	63.4%
Illinois	60.3%
Vermont	60.2%
Montana	58.3%

Source: U.S. Census Bureau, State, and Local Government Finances by Level of Government and by State: 2015

FIGURE 6.

Recent Mill Rate Trends, Major Connecticut Cities, FY08–FY17

	Bridgeport	Hartford	New Haven	Stamford	Waterbury
FY08	41.28	63.39	42.21	17.14	55.49
FY09	38.74	68.34	42.21	16.10	39.92
FY10	39.64	72.79	42.21	16.73	39.92
FY11	39.64	71.79	43.90	17.04	41.82
FY12	41.11	71.79	43.90	17.37	41.82
FY13	41.86	71.79	38.88	17.79	41.82
FY14	42.20	74.29	40.80	23.73	56.98
FY15	42.20	74.29	41.55	24.41	58.22
FY16	54.37	74.29	41.55	25.11	58.22
FY17	54.37	74.29	38.68	25.77	60.21

Source: Government Comprehensive Annual Financial Reports (CAFRs). The mill rate is $1.00 of tax for each $1,000 of a property's assessed value. The property tax on a house in Bridgeport in FY 2017, for example, is $54.37 for every $1,000 of its assessed value. Mill rates fluctuate with a city's budgetary needs but also with the assessed (and market) values of properties in the city.

FIGURE 7.

Pension Spending Versus Property Tax Revenues, Three Connecticut Cities ($ Millions)

	Hartford		Stamford		New Haven	
	Pension Contribution (all systems)	Property Tax Revenue	Pension Contribution (all systems)	Property Tax Revenues	Pension Contribution (all systems)	Property Tax Revenues
FY08 (in FY17 $)	$24,727	$249,877	$5,001	$405,733	$28,922	$211,699
FY17	$41,410	$252,670	$21,111	$500,394	$46,987	$251,493
$ Change	$16,684	$2,793	$16,110	$94,661	$18,065	$39,794
Change	67.5%	1.1%	322.2%	23.3%	62.5%	18.8%
Pension Increase as Share of Revenue Increase	597.2%		17.0%		45.4%	

Source: Government CAFRs

two-thirds, or $29.9 million, was required to pay for benefits earned in past years (in other words, to amortize the system's unfunded liability).[44] The vast majority of Connecticut state government's bill is also devoted toward its unfunded liability.[45] But the state is not on the verge of true insolvency.

When combined with its annual OPEB bill—about $14 million last year—Hartford's spending on the promises of the past total about the cost of the $40 million state-financed "bailout" that it claimed it needed to avoid bankruptcy last year.[46] Without a retirement benefit burden, Hartford would still likely be a distressed city and certainly a poor one, but it might not be a city on the verge of insolvency.

Figure 8 looks at the change in cities' OPEB costs over recent years. In many cases, they have not risen dramatically. That is because most of these cities do not "pre-fund" their retiree health-care programs as they do their pension plans. Annual pension contributions go into a trust that, when combined with contributions from workers and decades of investment return, is intended to be sufficient to pay off workers' benefits throughout their retirement years. OPEB, though, is generally funded on a pay-as-you-go basis. Cities budget only for the cost of those benefits received by retirees in a given year. The cost of health care does not change as much on an annual basis as pension costs, which are determined substantially by the volatility of financial markets. Thus, there is less of a "crowd out" effect related to OPEB costs than pension costs. Stamford, which recently enacted a plan to fully pre-fund its OPEB obligation, is the exception. Accordingly, its contributions have increased much more rapidly since FY08 than the other four cities.

But if crowd-out is less of a concern with OPEB, the larger question is whether it is a justifiable expense in the first place. Collectively, Connecticut's five largest cities spent $132 million on retiree health care in FY17. Unlike cash retirement benefits and health insurance for active workers, retiree health care is not a standard benefit offered by private-sector employers. Less than 10% of private firms in Connecticut that provide health insurance to active workers also offer it to retirees.[47] It is therefore questionable whether Connecticut cities truly need to take on this obligation that is not only expensive but also tempts them into transferring compensation costs for services provided in the present onto future taxpayers. Though Stamford is, in many respects, doing the right thing in trying to pre-fund its OPEB obligations, there is an argument that the wiser path would be to try to phase out of the benefit as promptly as possible.[48] Pre-funding is, in a way, redoubling a government's commitment to a gratuitous expense. Gratuitous public expenditures should be scrutinized especially carefully in the case of poor cities.

Retirement Benefits: Fiscal Capacity, Management, and Affordability

This year's election for state office is competitive, and some gubernatorial candidates are running on platforms of bold action on pension reform. But, in practice,

FIGURE 8.

Connecticut's Major City OPEB Spending, FY08 and FY17

	Bridgeport		Hartford		New Haven	
	Contribution	Share of Actuarially Recommended Contribution	Contribution	Share of Actuarially Recommended Contribution	Contribution	Share of Actuarially Recommended Contribution
FY08	$29,605,000	62.6%	$15,425,000	51.2%	$14,350,000	34.1%
FY17	$29,153,378	43.1%	$14,859,000	53.9%	$27,820,000	58.0%

	Stamford		Waterbury	
FY08	$12,316,000	63.1%	$28,011,000	43.6%
FY17	$26,617,000	100.0%	$33,729,000	46.7%

Source: Government CAFRs

the reform of retirement benefits is a complex issue: What priority, if any, should be placed on changes to current workers' plans versus those of future workers? Should government pursue OPEB reform as well as pensions?

The preceding analysis suggests that retirement benefit reform at the local level should not be neglected and should possibly be prioritized over state-level reforms. While Connecticut's record of mismanagement should raise doubts about whether it can ever be trusted to responsibly *manage* a defined-benefit pension program, Connecticut's major cities' economic fundamentals should raise doubts about whether they can *afford* a defined-benefit system even if they can responsibly manage it.

The state government's fiscal capacity—its ability to raise sufficient revenues to support the cost of government—has faced constraints of late. Connecticut's economy has contracted in three of the last four years and, in 2017, ranked 49th among all states, according to the Bureau of Economic Analysis.[49] High-profile corporate relocations have created political crises for state officials;[50] and IRS data show that each year, billions of dollars in income leave for other states, some of which have lower taxes and/or no income tax.[51] Concerns over the health of the state's economy have weakened political support for tax increases. A further check on the state's revenue-raising abilities may come from the recently enacted federal tax reform, one of the most notable provisions of which was a limit on how much income tax filers can claim through the state and local tax deduction (SALT). Connecticut taxpayers have been one of the largest beneficiaries of SALT. In 2015, the most recent year for which IRS data are available, the 726,000 filers who claimed the "taxes paid" deduction claimed over $19,000, on average. The recently enacted federal law caps that amount at $10,000.

Though some have claimed that the new cap on SALT will also complicate Connecticut cities' fiscal policies,[52] their revenue problems are more straightforward. As the state's Office of Legislative Research notes, SALT usage declines with income.[53] Given their low income levels (Figure 3), relatively few households in Hartford, New Haven, Bridgeport, and Waterbury itemize; and with the new tax law's expansion of the standard deduction, still fewer will itemize in coming years. The new tax law may limit how much state government can redistribute from wealthy suburban taxpayers to the general treasuries of bigger and poorer Connecticut cities. But poor cities' revenue-raising capacity has always been constrained and will remain so.

All of Connecticut's five largest cities, in their annual financial statements, express optimism about their economic development prospects.[54] But their recent histories provide little evidence that an economic revival is impending for Bridgeport, Hartford, New Haven, and Waterbury. (Stamford has never truly known decline.)

All five of Connecticut's largest cities have experienced increased poverty rates over recent decades (**Figure 9**). Technically, the statewide poverty rate has increased more than that of all its major cities except for Waterbury, but that is partly because those cities were beginning from a higher base: a poverty rate of over 20% in 1980 in the cases of Bridgeport, Hartford, and New Haven. (The nationwide poverty rate in 2012–16 was 15.1%.) Hartford's poverty rate was roughly three times that of Connecticut's in 1980, and that same proportion remains today.

Some local officials have expressed interest in developing an urban revitalization strategy centered on attracting more young, educated, millennials. But that cohort is expected to decline over the near-term. Between now and the early 2030s, the number of graduating high school seniors in Connecticut will drop by 7,815, or 19.2%; and by 7.9%, or 48,153, throughout the Northeast.[55] That is to say, in coming years, Hartford, New Haven, and Connecticut's other major cities face a zero-sum competition for millennials with Boston and New York. As for families, while most of these cities have managed to retain some of their single-family building stock,[56] continued weakness in Connecticut's urban school systems, particularly relative to those of suburbs and towns, will make attracting and retaining middle-class families a challenge.

The ability of some of Connecticut's biggest cities to raise revenue has been hampered by the high proportion of tax-exempt property. About half of Hartford's tax base is owned by nonprofits and governments. This is due partly to policy decisions such as a significant investment in public school buildings over the last 15 years but also to an unusual valuation system. Residential properties in Hartford—a large proportion of its taxable tax base—are valued at only 33.82% of market value for tax purposes.[57] (The standard assessment ratio for all properties for Connecticut local governments is 70% of market value.)[58] In a larger sense, though, the low proportion of taxable property in Hartford is a function of the weakness of the local economy.

Fiscal capacity is not simply a function of a tax policy.[59] While Connecticut's municipal finance system is unusually reliant on property taxes (Figure 5), it is doubtful that more local fiscal autonomy or increased "revenue diversification" would help cities much. A local income tax[60] could easily harm Connecticut cities' competitiveness. Boston has no local income tax, and Massachusetts's state rate is about 2 percentage points higher than Connecticut's top marginal rate. Indeed, the larger state context must be kept in mind. Theoretically, lower state taxes could free up more fiscal capacity for city governments. However, because of Connecticut's massive liabilities, state sales and income taxes are unlikely to significantly decline anytime soon.

Conclusion

The fundamental question this paper raises is: How wise is it for Connecticut cities with weak tax bases—low fiscal capacity—to operate defined-benefit retirement programs? The prospect of transitioning state workers to a defined-contribution retirement benefit plan has been raised frequently in debates over Connecticut's pension crisis. Given that the state government's record of retirement benefit mismanagement stretches back across the generations and continues into the present, and that both parties share the blame, we can reasonably doubt whether the state should ever be trusted to manage a long-term defined-benefit program.

However, the challenge for Connecticut's major cities has less to do with mismanagement than it does with their ability to pay. Not even prudent management and a sincere will to fund pensions adequately can overcome inadequate fiscal capacity. It may, therefore, be more urgent to consider a shift to defined contribution for city workers in Connecticut than for state workers.

FIGURE 9.

Trends in Connecticut Poverty Rates, 1980–2000 and 2012–16

	Hartford	New Haven	Waterbury	Bridgeport	Stamford	Connecticut
1980	25.2	23.2	14.1	20.4	7.7	8.0
1990	27.5	21.3	12.1	17.1	6.3	6.8
2000	30.6	24.4	16.0	18.4	7.9	7.9
2012–16	31.9	26.1	25.4	22.1	8.9	10.4

Source: County and City Data Book 1988, U.S. Department of Commerce, U.S. Government Printing Office, "Table C. Cities: Police Officers, Education, Money Income, and Housing," p. 628; 1994 County and City Extra: Annual Metro, City and County Data Book, ed. Courtenay M. Slater and George E. Hall, 3rd ed. (Bernan Press, 1994), "Table C. Cities: Poverty and Housing," p. 871; U.S. Census Bureau, American FactFinder, "Community Facts," and "Poverty Status in the Last 12 Months, 2012–2016 American Community Survey 5-Year Estimates"

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Abstract

Connecticut state government's pension struggles are well understood: deep levels of underfunding have led to credit-rating downgrades, tax increases, recurring budget deficits, and an inability to fund essential services. What has been overlooked, though, is the challenge that the state's five largest cities by population—Bridgeport, New Haven, Hartford, Stamford, and Waterbury—face in paying for their own retirement benefit promises.

Key Findings

- All five of these cities have promised hundreds of millions of dollars in benefits, a promise that is backed, ultimately, by their tax base. With the exception of Stamford, however, they all have weak economies and elevated rates of poverty.
- While the state's record of pension mismanagement is well documented, cities have been guilty of mismanagement as well. However, for the state's five biggest cities, the question of *affordability* is more important than *mismanagement*.

  Despite rate increases, property tax revenues have not been keeping up with pension costs in New Haven, Hartford, and Stamford. Hartford's property tax revenues, for example, grew by $2.7 million from FY08 to FY17 in real terms, while its pension costs grew by $16.7 million. Though annual costs for retiree health care have not risen as dramatically, they are still high, totaling $132 million for all five cities combined. This is a questionable expenditure, considering that the private sector has largely phased out health-care benefits for retired workers.

- The case for dramatic retirement benefit reform—meaning phasing out retiree health care and transitioning workers from a defined-benefit to a defined-contribution plan—may be more urgent for Connecticut's biggest cities than for the state.

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