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HARTFORD TAX CLASSIFICATION AND TAX ABATEMENTS

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You asked a series of questions about Hartford's tax classification system and tax abatements. Specifically you asked about (1) the tax classification system's structure, history, and effect on small business; (2) a small business owner's suit challenging the system; (3) the city's Tax Abatement Committee; and (4) tax abatements proposed for businesses operating in the Adriaen's Landing project.

SUMMARY

Hartford's Tax Cap program gives owner-occupants of one- to three-family homes a tax credit equal to the amount by which their property tax exceeds 1.5% of the property's fair market value. Providing this credit requires the city to impose a 15% surcharge on all other property owners. The state law that authorizes Hartford to give this credit does not authorize tax breaks for other property owners, but other state laws do in specific situations. And Hartford reduced its assessments on some large commercial taxpayers that successfully appealed their 1989 revaluations.

A recent analysis of Hartford's tax structure by the Connecticut Center for Economic Analysis at UConn finds that it seems to have damaged the city economically and could distort the effects of

the 1999 revaluation. This distortion could encourage more businesses to leave Hartford and discourage others from locating there. We could find no information on the relationship between the tax structure and Hartford's welfare caseload.

In 1991, Robert and Lorraine McKay, owners of the Municipal Cafeteria, sued Hartford alleging, among other things, that the residential property tax cap program was unconstitutional. They claimed it was a public emolument for residential property owners, was a conspiracy to inequitably and unlawfully redistribute the property tax burden, and discriminated against non-residential property owners. The parties stipulated to a court judgment in November 1999. The McKay's withdrew their lawsuit, the city reduced their property assessment and used the lower assessment to reduce the amount the McKay's owed for unpaid back taxes, and the McKay's made a partial payment and agreed to pay off the balance by June 30, 2000.

Hartford's charter and ordinances authorizes a three-person tax abatement committee to abate property taxes on government-assisted residential property targeted solely to low- and moderate-income people. Through the assessor's office the city also abates taxes over 10 years for owners who rehabilitate vacant commercial or residential property.

Waterford, the developer selected to oversee the Adriaen's Landing project, is asking the Hartford City Council for a 15-year abatement on real property taxes for the private improvements that are part of the project: the convention center hotel, residences, retail and entertainment sites, and offices. The proposal calls for annual private payments in lieu of the abated taxes (PILOT) equaling 2% of the hotel's room revenues and 4% of the rent revenues at the other sites. The hotel's personal property taxes would be set at 45% of its real property PILOT payment while the other business would pay normal taxes on their personal property.

The council approved a somewhat different arrangement on April 24th. The details are not yet available, but the *Hartford Courant* reports that (1) the hotel payment would begin at 1% of room revenues and grow to 3% in years 13 to 15, (2) the retail and entertainment facilities would pay 6% of base revenue after year six, and (3) the housing complex would pay 4.5% of rents.

HARTFORD TAX CAP PROGRAM

Description

Residential Tax Relief. Hartford instituted its "Tax Cap" program in 1990 after it revalued all properties. It instituted the cap under CGS Sec. 12-62d, which authorizes tax relief for only *owner occupied one- to three-family houses*. Hartford is the only city that has used this statute.

Tax Credit. Under the statute, towns continue to tax all properties at a uniform rate, but credit residential property owners for a portion of their tax bill. Towns must make up the difference by taxing nonresidential property owners more, which they do by imposing a surcharge. Towns can do this if the post-revaluation effective tax rate on residential properties exceeds 1.5%. The credit continues for five years, including the year that the revaluation took effect. (Hartford has been providing credits since 1989, the year of its last physical revaluation.)

Towns can provide an equal flat credit to each residential property or link the size of the credit to the tax paid on the property. Under the first option, the maximum credit cannot exceed \$750. Under the second, which Hartford uses, the credit is the amount by which the property tax exceeds 1.5% of the property's fair market value. But the maximum credit under this option cannot exceed 2½ times the average credit.

Tax Surcharge. Towns must recover the cost of the credits by imposing a surcharge on non-residential properties. The surcharge can be for up to 15% of the tax on these properties and, like the credits, must continue for five years. The surcharge applies to commercial, industrial, and public utility real and personal property. It does not apply to motor vehicles, lodging houses, and multifamily structures that are more than half residential and that contain more than three units.

Administrative Requirements. Towns must conduct a management study of their assessment, finance, and expenditure practices within one year of providing the credits. They must hold public hearings and develop a management plan, which they must file with the Office of Policy and Management. Towns that do not comply with these requirements risk forfeiting 10% of their statutory formula grants.

Legislative Changes

The legislature changed the law since 1989 mainly by exempting certain types of properties from the surcharge. PA 90-148 exempted from the surcharge buildings that are more than half residential and that contain more than three units. PA 90-262 required towns to include these properties in the base on which the towns calculate the surcharge, thus transferring the properties' share of the surcharge to the remaining commercial, industrial, and utility property. PA 92-17 May Special Session exempted lodging houses from the surcharge.

Impact

Hartford plans to continue providing residential tax relief, but apparently wants the legislature to raise the effective tax rate threshold from 1.5% to 2% (*Hartford Courant*, March 15, 2000).

“The cap/surcharge structure seems to have damaged the City of Hartford economically, creating a hostile environment for businesses and apartments by distorting the tax burdens of different classes of property,” the Connecticut Center of Economic Analysis (CCEA) claimed in its December 1999 study of the economic effects of revaluation and tax policy on Hartford. (*The Economic Effects of Revaluation and Tax Policy on the City of Hartford*, December 1999, Attachment1).

The combination cap and surcharge structure does not necessarily increase tax revenue, but it shifts the tax burden placed on different types of properties. “Adding up to a 15% surcharge on top of the regularly calculated tax bill is the same as adding up to 15% of the mill rate onto the mill rate for specific categories of property owners” (p. 29).

CCEA stated that the cap and surcharge structure would distort the aggregate tax burden after revaluation:

If 23% of the grand list is eligible for the cap in 1999, at the mill rate of 58.88, that 23% will only pay 14% of the total tax bill under the cap/surcharge system. Under the same circumstances, the 62% of the grand list subject to the surcharge would be responsible for 71% of the total tax bill. This tax burden distortion increases as the mill rate increases (which it must in order to account for declining property values): if the mill rate ends up higher, the tax burden distortion will become even worse (pp. 36-37).

The distortion could encourage businesses to leave Hartford or discourage businesses from relocating there, CCEA stated. CCEA saw “a clear difference between the nearly imperceptible decrease in residential properties (-0.03%), and the significant decrease in commercial properties

and apartments (-3.81% and -9.86%, respectively). *Hartford has lost nearly 4% of its businesses, and nearly 10% of its apartments, in only eight years.* In addition, vacancies have increased by nearly 12%, and 158 properties have disappeared altogether” (p. 40, emphasis in the original).

Apparently, CCEA is the only group to have studied the impact of the cap and surcharge structure. But Hartford planning officials cited anecdotal evidence supporting CCEA's findings. Merchants throughout the city consistently cite the property tax burden as their main concern, followed by a lack of affordable parking and crime or the perception of crime.

But the planning officials also suggested that other factors besides the property tax could have influenced business and residential property owners to close or abandon their properties since 1990. These include people leaving the city for the suburbs during the economic recession of the early 1990s. The CCEA study did not discuss these or other factors that could have mitigated or reinforced the cap and surcharge structure's impact.

Impact on Welfare Rolls

We could find no studies examining whether the cap and surcharge structure increases welfare rolls in Hartford. The average monthly caseload for state-funded welfare in Hartford increased from almost 9,900 families in 1990 to almost 11,700 families in 1995 before dropping to 6,600 families by 1999. During this period, the legislature reformed the welfare system and the state's unemployment declined to the point where businesses complained about a labor shortage. These factors illustrate why it is difficult to isolate how the cap and surcharge structure affects welfare rolls.

LEGAL CHALLENGE TO TAX CAP PROGRAM

In 1991, Robert and Lorraine McKay, owners of the Municipal Cafeteria, sued Hartford and the city's tax assessor and tax collector. Among other things, the 15-count state court complaint alleged that the residential property tax cap program was unconstitutional. Basically, they claimed that:

1. the tax cap constitutes an “exclusive public emolument or privilege” for residential property owners by authorizing a surcharge on commercial, industrial, and public utility property to recover the revenue shortfall from capping taxes on one, two, and three family homes (in violation of Article One, Section One of the Connecticut Constitution and the Fifth and Fourteenth Amendments to the US Constitution);
2. the city and tax officials conspired to inequitably and unlawfully redistribute the property tax burden, which by law must be equal, by reducing residential property owners' tax burden and increasing that of business property owners (in violation of the federal civil rights conspiracy statute and the Fifth and Fourteenth Amendments); and
3. the residential property tax cap discriminates against the class of non-residential property owners (in violation of the state and federal constitution's Equal Protection Clause).

Michael Collins, who handled the case for the city, reports that the McKay's stopped paying their property taxes shortly after filing suit. They also filed a traditional state court appeal challenging the assessment amount. The parties stipulated to a court judgment in November, 1999 with the following terms: (1) the McKay's withdrew the civil rights lawsuit; (2) the city reduced their property assessment from \$604,240 to \$245,000; (3) the city used the lower assessment to

reduce the amount the McKay's owed for unpaid back taxes, interest, and penalties (from October 1, 1989 through Sept. 30, 1999) to \$79,781.81; and (4) the McKay's made a partial payment and agreed to pay off the balance by June 30, 2000.

HARTFORD TAX ABATEMENTS

The city charter establishes a three-person committee that is authorized to provide partial or total abatement of real property taxes for residential dwellings intended solely for low-and moderate-income people. The committee is composed of the city treasurer, finance director, and corporation counsel. The abatement is for housing constructed or rehabilitated using state or federal funds and in which rents or sales prices are regulated. The abatements can extend for up to 40 years and are subject to annual review by the committee. The state reimburses the city for the abatement (Hartford City Charter, ch. Viii, §7; Code of Ordinances §32-12, CGS § 8-202c, 215-216).

The city also abates taxes when a property owner renovates a commercial or residential building that has been abandoned for one year or more. The abatement is 100% of the value of the improvement in the first year and is reduced by 10% a year over the next nine years. To qualify, a renovation must cost 30% of a residential building's value or 40% for a commercial building.

ADRIAEN'S LANDING TAX ABATEMENTS

Real Property Taxes

The state is purchasing all of the property that comprises Adriaen's Landing, which will exempt it from Hartford property tax. The state anticipates making payments in lieu of taxes (PILOT) for 45% of the foregone taxes. Based on Hartford's current mill tax rate, those payments would be \$3.3 million annually.

The state anticipates leasing to private parties air rights over parts of the site for the convention center hotel, retail and entertainment space, apartments, and offices. These improvements would be taxable. The Waterford Group, the developer selected for the overall Adriaen's Landing project, has asked Hartford for a 15-year abatement on the real property taxes for these sites in return for private PILOT payments. After the 15 years end, Waterford's proposal calls for a review of each component and negotiations over a “fair and equitable real estate and personal property tax structure.”

Waterford's proposal calls for paying no taxes from the date the state acquires the property through the second year after the otherwise taxable buildings receive a certificate of occupancy. Beginning in the third year and running for 15 years, Waterford proposes private PILOT payments on each respective component, based on a “percentage based agreement.” The proposal calls for the hotel to pay 2% of its room revenues, while the entertainment/retail, residential, and office components pay 4% of their base rental revenues.

Table 1 shows Waterford's analysis of payments to Hartford over the first five years of operations.

Table 1: Proposed Adriaen's Landing PILOT Payments

PILOT Source	Year 1	Year 2	Year 3	Year 4	Year 5

Hotel	\$0	\$0	\$313,340	\$332,240	\$342,200
Entertainment	\$0	\$0	\$239,000	\$239,000	\$239,000
Office	\$0	\$0	\$59,410	\$61,193	\$63,208
Residential	\$0	\$0	\$152,770	\$157,353	\$162,073
Total Private PILOT	\$0	\$0	\$764,523	\$789,786	\$806,481
State	\$3,300,000	\$3,300,000	\$3,300,000	\$3,300,000	\$3,300,000
Total PILOT to Hartford	\$3,300,000	\$3,300,000	\$4,064,520	\$4,089,786	\$4,106,481

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Personal Property Taxes

Waterford is proposing that the retail/entertainment, residential, and office uses pay tax on personal property (furniture, fixtures, and equipment) at current rates beginning in their first year of occupancy. The hotel's personal property tax would be set at 45% of its PILOT payment (which would be 2% of its room revenues). The hotel would begin paying in its third year of operation.

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