FINANCE REPORT

2023–2024

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BACKGROUND

LOOKING BACK: HARTFORD'S BUDGET CRISIS: When the Bronin administration took office, Hartford was facing the greatest fiscal crisis in its history. Prior administrations had made many decisions that worsened the City's financial position, including borrowing heavily, restructuring debt to create short-term savings, relying on one-time revenue sources such as property sales, raising the property tax rate to levels that discouraged growth, and committing to unsustainable long-term liabilities. However, those decisions merely exacerbated the fundamental and persistent structural challenge: Hartford's property tax base was simply too small to sustain the core services required.

Like other Connecticut municipalities, Hartford's only significant source of locally generated revenue is property taxes. Approximately half of Hartford's property is tax exempt, with large concentrations of state-owned property, college and hospital property, and property owned by non-profits and religious institutions. In addition, while densely populated, Hartford is both geographically small and has an intense concentration of poverty. As a result, the City of Hartford must sustain a higher level of core services on a severely limited tax base, with a taxable grand list barely larger than that of small suburbs like Farmington and Glastonbury.

Facing a severe and urgent budget crisis, Mayor Bronin's administration made deep cuts, including eliminating more than 100 positions, or 15% of non-uniformed personnel, and reducing or eliminating a wide range of programs and services. It also began the process of negotiating substantial concessions from collective bargaining units. Following the city's cost reduction measures, Moody's Investors Service noted that, "[t]here is very little room for further cuts, given the reductions in services the city has already made and its fixed costs."

BUILDING A PATH TO FISCAL STABILITY: By 2017, the City had begun the process of preparing for a Chapter 9 Bankruptcy filing, believing that the City of Hartford deserved an opportunity to rebuild on a new foundation, rather than rely on temporary measures that would have merely prolonged the crisis.

At the same time, as an alternative to a Chapter 9 filing, Mayor Bronin proposed and advocated for the creation of a Municipal Accountability Review Board (MARB), authorized to pair financial support for distressed municipalities with stringent oversight and transparency. The State passed bipartisan legislation to create the MARB, and in 2018, the City entered into a contract assistance agreement, under which the State assumed responsibility for the City's existing general obligation debt.

In addition to financial assistance from the State, the City pursued and reached agreements with its labor unions that provided significant cost savings. In FY2019, the City projected $10 million in savings from the labor agreements it reached, with similar savings through the life of those contracts.

The City also engaged Hartford's largest companies, obtaining a $50 million commitment over five years from The Hartford, Aetna (now CVS Health), and Travelers.

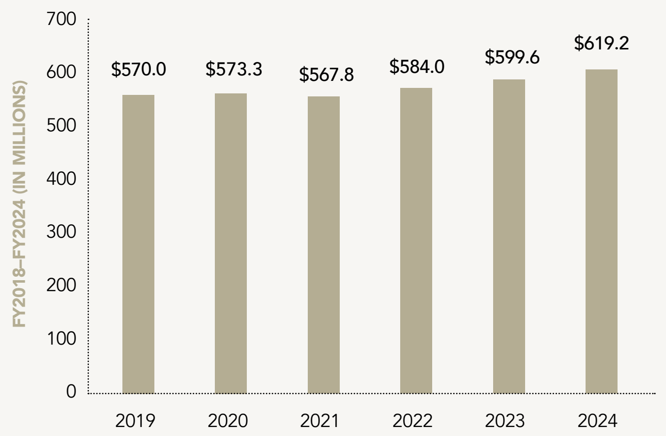
Taken together, the deep and difficult cuts, negotiated labor savings, the corporate contributions, and the State contract assistance agreement created a path to longer-term financial stability for the City. The City built a five-year recovery plan that relied on those components, as well as continued budget discipline and aggressive pursuit of grants and philanthropic funding.

RECENT BUDGETS: Rigorously adhering to its long-term plan, the Bronin administration's budgets have been built on several fiscal principals: no new long-term borrowing; no reliance on one-time revenue sources to balance the budget; adopting a pay-as-you-go capital investment program, funding capital investments with general fund appropriations, surplus allocations, and grant funding; fully funding its actuarially determined pension obligations; and protecting education funding, with consistent increases in per-pupil spending due to decreasing enrollment, driven by the Sheff v. O'Neill settlement.

The City has prioritized funding core services, slowly and carefully rebuilding capacity after deep cuts to personnel that harmed services, while avoiding unnecessary spending and prioritizing rigor and discipline. Overall, the City budget has increased at an average rate of 0.2% per year since implementing its financial sustainability plan in FY2018.

Since FY2018, the City of Hartford has generated annual operating surpluses that have been utilized strategically a) to rebuild the city's unassigned fund balance, which today sits at approximately 6% of the city's annual budget, b) to fund critical capital investment without new issuance of debt, c) to provide support to the city's most vulnerable residents, and d) to support economic development that will help to grow the city's grand list and promote more economically vibrant neighborhoods.

ADOPTED GENERAL FUND BUDGET



CURRENT BUDGET: The City's FY2024 budget totals $619.17 million. Revenues are derived primarily from property taxes (49%) and state municipal aid (47%). All other General Fund revenue sources make up just 4% of the total budget. Education comprises the largest portion of the City's expenditure budget at 46%. The remaining non-education portion of the budget is largely allocated to Payroll and Benefits which make up 70% of non-education expenditures.

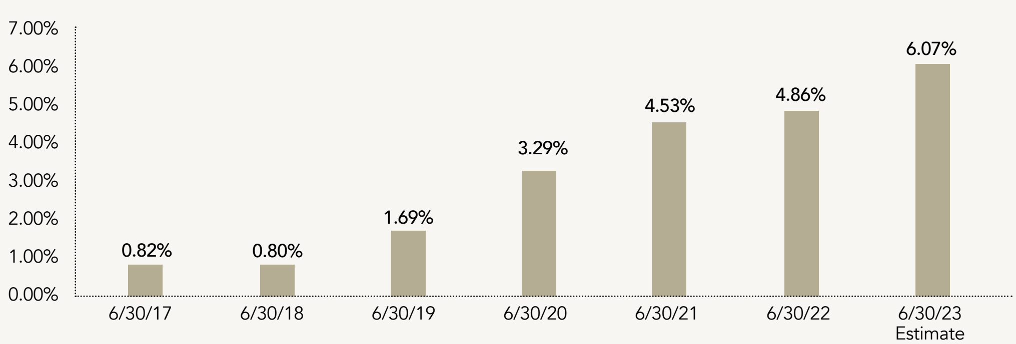
Current projections estimate a year-end surplus of $6.3 million in the General Fund. Revenues are currently projected to be $8.3 million favorable to budget, with additional favorability likely to be recognized after the January tax billing and related collections. Similarly, potential favorability in other revenue sources are not factored into projections until sufficient trend data is established.

Expenditures are currently projected to exceed budget by about $2 million, driven largely by overtime costs and legal settlements. However, the projected expenditure overage is expected to diminish over the course of the year as vacancy savings are recognized. As is the case with many revenue sources, potential favorability in other expenditure accounts is typically not reflected in forecasts until sufficient trend data has been established.

In short, the current estimate of a $6.3 million surplus for FY24 is conservative, allowing the City to continue its established practice of using surplus funds to build up its fund balance and invest in priority capital improvements.

GROWING FUND BALANCE: The City's unassigned fund balance has grown steadily and consistently after dipping below 1% of budgeted expenditures in FY2017, at the height of the fiscal crisis. The City's unassigned fund balance is currently estimated at just above 6%, or $36.4 million as of the end of FY2023. In addition, the City has built up reserves for specific purposes, including in the Capital Improvement Projects Reserve, reserve funds set aside to support neighborhood economic development, and a reserve for Vehicles, Equipment and Technology acquisition.

GENERAL FUND BALANCE – UNASSIGNED



RATINGS ACTIONS: As Hartford has continued to maintain fiscal discipline and adhere to its fiscal recovery plan, ratings agencies have consistently upgraded their assessments of the City. Since 2017, Moody's has upgraded its ratings five times, and Standard & Poor's upgraded its ratings three times. Both agencies now rate Hartford's debt as investment grade. In its latest ratings action in August of 2023, Moody's cited "[t]he city's improved governance" as a "key driver."

MOODY'S RATINGS HISTORY

Ratings as of 12/17/2017	Rating 4/4/2018	Rating 3/21/2019	Rating 2/25/2020	Rating 8/26/2021	Rating* 8/27/2023
Caa3	B2	B1	Ba3	Ba2	Baa3

STANDARD & POOR'S RATINGS HISTORY

Ratings as of 12/17/2017	Rating 4/13/2018	Rating 7/3/2019	Rating* 11/18/2021
CCC	BB	BB+	BBB

*Debt rated as investment grade.

PROPERTY TAXES: By state statute, the City of Hartford is subject to a unique property tax structure, with commercial property taxed at the full statutory assessment ratio of 70% and residential properties assessed currently at 36.75% of value. The residential ratio is calculated annually, using a formula based on the relationship between CPI and the year over year tax levy change. Under the formula, the residential assessment ratio may increase, but may not decrease.

In FY2023, the City reduced its mill rate for the first time in many years, and by the largest amount in more than 30 years, reducing the mill rate by 7.2%, from 74.29 to 68.95. However, the 2021 revaluation, which took effect in FY23, resulted in a shift from commercial property to residential property, as the values of commercial properties declined while residential properties increased. It is likely that the city will continue to see continued pressure on the commercial property market.

SHIFT TO TIER II MUNICIPALITY UNDER MARB & TERMS OF CONTRACT ASSISTANCE: In light of the City's improved fiscal performance and consistent adherence to its long-term fiscal plan, the MARB voted in November of 2023 to recognize that the City had satisfied all conditions of Tier III supervision. While the Connecticut General Statutes do not provide a clear path for a municipality to continue a relationship with the MARB after a municipality satisfies the requirements to end a designation, the Bronin administration made a voluntary request to be redesignated as a Tier II municipality. That request was formally accepted by the Municipal Finance Advisory Commission in December of 2023, and the City of Hartford is now designated as a Tier II municipality under MARB.

As a Tier II municipality, the City will provide monthly financial reports to the MARB and update its five-year financial projections. The MARB will also continue to review and approve certain assumptions in the City budget, including State Aid, the tax collection rate, and the mill rate.

Regardless of the City's status under MARB, the City is also subject to certain reporting requirements and constraints under the contract assistance agreement, including: (1) annual submittal of three-year financial plans and assumptions for those financial plans; (2) monthly financial reporting and cash flow projection; (3) a requirement to provide additional financial information to the State when requested; and (4) while the assistance is in place, the City faces restrictions on the issuance of new debt.

RECOMMENDATIONS

- **MAINTAIN STRINGENT BUDGET CONTROLS:** Hartford's progress towards fiscal stability and strength has been substantial, but it is also fragile. The City still faces long-term challenges, including pension obligations, the inadequacy of the property tax base, and the continuing challenges in the commercial real estate market. The incoming administration should maintain its focus on core services, and must remain disciplined and careful in avoiding new costs.

- **CONTINUE TO AVOID NEW DEBT ISSUANCE:** The City of Hartford has not issued any new long-term debt since 2016, and as noted above, has funded its capital investments with a combination of general fund appropriations, surplus allocations, grants, and philanthropic contributions. To avoid the accumulation of new debt service obligations, the City should continue to refrain from new debt issuance, and where the budget allows, should seek to meet its capital needs through increased annual appropriations from the general fund.

- **PURSUE CREATIVE SOLUTIONS TO THE CHALLENGE OF POST-PANDEMIC COMMERCIAL REAL ESTATE:** Commercial office space is unlikely to return to its pre-pandemic value in the near term. Occupancy rates in the largest markets before the pandemic were at or close to 100%. Now, only one city in the top 10 is above 50%. For a city like Hartford, which was steadily building occupancy before the pandemic, plummeting commercial real estate value represents a significant risk. The City must continue to find ways to activate these spaces in ways that bring energy, activity, and revenue. That includes conversions to residential uses where possible.

- **PREPARE FOR ONGOING TAX APPEAL RESOLUTION:** The years following a revaluation tend to see the most tax appeal activity. Since the 2021 revaluation, there have been 336 appeals. The pace of court action on those appeals has been slower than anticipated. The City should consider preparing for those appeals to be adjudicated in the coming years by setting aside additional revenues to offset the impact of tax appeals in future years.

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RECOMMENDATIONS CONT.

- **AGGRESSIVELY PURSUE GRAND LIST GROWTH:** In addition to remaining disciplined, the City of Hartford must continue to aggressively pursue the growth of its tax base through economic development. Tax abatements will be necessary to incentivize new economic development, and the city should take a long-term view of the benefits of incentivizing growth. A continued commitment to building residential density in and around the downtown will be particularly important not only as a means of adding new property to the grand list, but also as a way to protect the value of the existing commercial real estate, which will maintain its value far better if the central business district is perceived to be active, vibrant, and growing.