Memo

To: Tim Sheehy, President, MMAC

From: Rob Henken, President, Wisconsin Policy Forum

Date: February 27, 2023

Re: City of Milwaukee and Milwaukee County Fiscal Outlook

This memo responds to your request for the Wisconsin Policy Forum to share its insights regarding the 5-year fiscal outlooks for both the City of Milwaukee and Milwaukee County. Specifically, given our experience analyzing city and county budgets and financial challenges over the past 15 years, you asked us to assess what the overall financial prognosis would look like for each government if their recent revenue and expenditure trends continue for the 2024-2028 timeframe and once special federal pandemic relief funds are exhausted. A continuation of these trends would mean no increases in state shared revenues, continued restrictions on property tax levy increases from state-imposed limits on operating levies, and no new sales tax or other local tax authorization.

In the pages that follow, we provide such insights. We would emphasize that in light of the short (three-week) timeframe requested for our analysis, these insights are based on a very high-level review of city and county financial trends and future needs. We also note that much more detailed and rigorous five-year projections currently are being formulated by the comptrollers of each government and will provide you with a more reliable assessment. Nevertheless, given the fast-moving nature of state budget deliberations in Madison, we are pleased to share our thoughts to provide your organization and others with whom you share this information a clearer picture of the current state of city and county finances in Milwaukee.

City of Milwaukee

As we have detailed in several recent reports – including our September 2022 comprehensive review of the city's fiscal condition (*Nearing the Brink*) – Milwaukee's city government has been suffering from a severe structural imbalance for at least the past decade. The roots of this imbalance are the lack of growth in the city's two largest revenue streams – state shared revenue and the

property tax – coupled with fierce expenditure pressures in the areas of pension fund and retiree health care obligations, debt service, and public safety.

This imbalance began to pose a severe threat to the city's core services in 2010, when investment losses in the pension fund during the Great Recession created unfunded liabilities that required the city to increase its tax levy-funded employer pension contribution from zero to $60 million. Despite no growth in its shared revenue allocation and only limited growth in its property tax levy (22% between 2013 and 2022 as compared to 25.6% growth in the Consumer Price Index), the city was able to largely avoid severe cuts in expenditures and services in the immediate aftermath by generating substantial health care savings and drawing upon its ample reserves.[1] More recently, the receipt of $394 million from the federal American Rescue Plan Act (ARPA) has allowed the city to keep most services largely intact, although some noticeable cuts have occurred in virtually all city services, including fire and police.

Today, with the ability to generate health care savings and draw from non-pension reserves largely exhausted, ARPA funds set to expire by the end of 2024, and a need to again increase the employer pension contribution by more than $50 million in 2023, city leaders appear to have run out of options to avert severe position and service cuts across the government's core functions.

We have constructed a basic five-year forecast model (for 2024-2028) to illustrate the impact of these converging negative developments. Our model focuses almost exclusively on the city's General City Purposes (GCP) budget, which totals about $640 million in 2023. Our intent is to show the size of the projected structural gap in the GCP budget over the five-year period if nothing changes with regard to the city's stagnant major revenue streams and if expenditure growth approximates recent 10-year trends. Two major changes that we do include, however, are the existence of ARPA funding in the 2023 and 2024 budgets and the elimination of those funds after 2024, as well as the increase in the employer pension contribution beginning in 2023.

A full description of our model is available upon request but the following are important highlights:

- The model focuses on eight key GCP revenue streams and 10 large departments and largely projects future revenue and expenditure growth on the basis of the average annual increases seen for each area over the past 10 years. It blends together all remaining revenue and expenditure line items in respective "other" categories and similarly uses average growth over the most recent 10-year period for those combined categories to project annual growth in each of the next five years.

- ARPA funds technically fall outside of the GCP budget but we add them to our model in light of the extent to which they are supporting GCP functions in 2023 and (presumably) 2024. We assume that $84 million in ARPA monies are used for that purpose in both 2023 and 2024.

- The model also projects levy-supported debt service and pension payments for each of the five years in order to determine the amount of property tax levy available for the GCP budget. Our

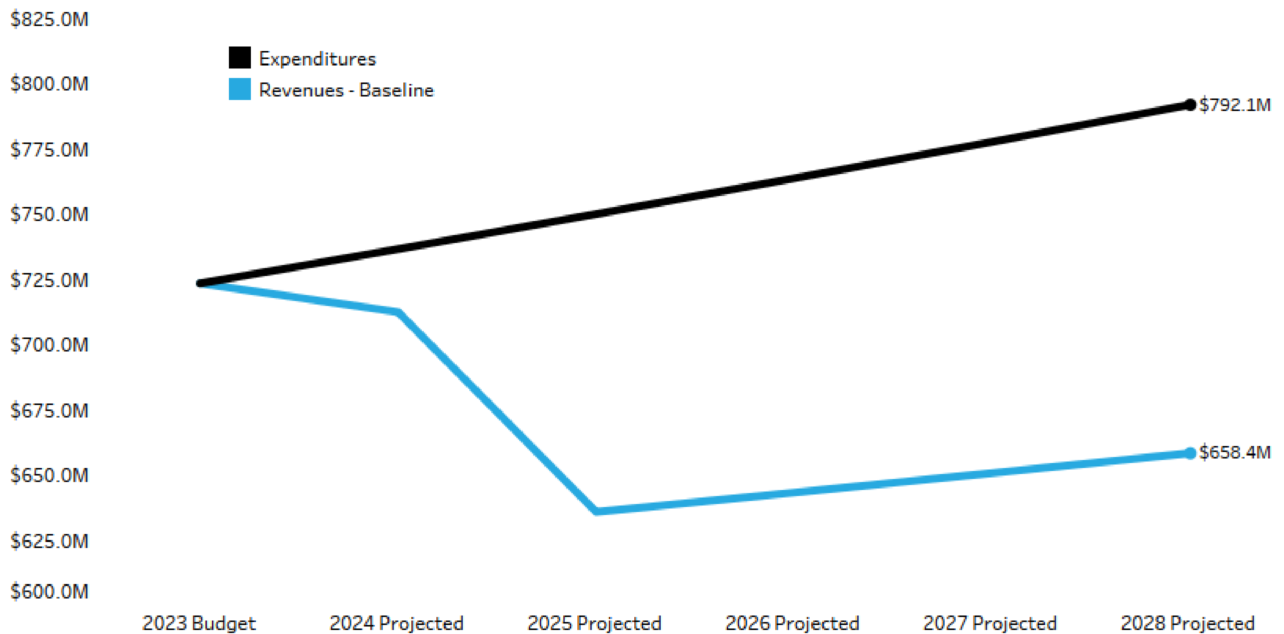
[1] The health care savings were achieved, in part, because of increased ability to modify benefits as a result of 2011 Wisconsin Act 10.

assumption for growth in debt service mirrors the methodology we use for other GCP expenditures (i.e. we apply the average growth rate over the previous decade of 4.1% to each of the next five years). For the employer pension fund contribution, we assume that it will rise to $123.5 million in 2023 and remain at that level through 2028, as that is the current estimate provided by budget officials (the precise amount will be determined later this year).

The results of our model are shown in both the table and the figure below. They show an initial structural gap of $24.2 million in 2024 despite the continued use of $84 million from ARPA, with subsequent growth to $114.3 million in 2025 and $133.7 million by 2028.

Table 1: Modeled Growth in City of Milwaukee GCP Expenditures and Revenues, 2023-2028

Year	General City Purposes Revenue (Includes ARPA)	General City Purposes Expenditures (includes ARPA)	Deficit
2023 Budget	$723,535,129	$723,535,129	$ -
2024 Projected	$712,541,290	$736,711,385	($24,170,095)
2025 Projected	$635,863,155	$750,151,869	($114,288,714)
2026 Projected	$643,280,207	$763,862,128	($120,581,922)
2027 Projected	$650,791,650	$777,847,834	($127,056,185)
2028 Projected	$658,396,545	$792,114,779	($133,718,234)



It is important to note that in only taking into account past expenditure trends, our model does not incorporate newer spending needs and other important developments that have emerged recently, including the potential inability to maintain a $10 million annual transfer from the city's parking fund to the GCP budget and the need to fully fund the new office of Emergency Communications (the

office's 43 positions were only half-funded in 2023). Furthermore, our trend-based expenditure projections do not reflect the recent shift from a low- to a much higher-inflation environment.

However, while these and other recent expenditure-related factors may understate the size of our modeled structural gap, we also do not project any use of the city's pension reserve fund, which currently stands at just over $80 million. More than $20 million of reserve funds may be required in 2023 to offset an underfunding of the employer pension contribution in the adopted budget, but there should still be close to $60 million available heading into 2024. It is likely that a significant portion of the remaining funds would be used over the 2024-2028 period to preserve property tax levy for the GCP budget, but we cannot predict that usage so our model does not incorporate it.

Finally, our model assumes the city will not have the capacity to allocate any funds from its Tax Stabilization Fund to the GCP annually. City leaders were able to lean on annual TSF transfers in the $20 million range just five years ago, but the TSF currently does not have the capacity to allow any withdrawals. The city strives to replenish it each year so transfers into the GCP budget may be possible in future years, but we assume that the inability to include a TSF transfer in the 2023 budget will continue over the next five years.

Overall, despite the relatively rudimentary nature of our model and the unknown circumstances that could impact its reliability, we feel confident in asserting that **the city's GCP structural gap would be in excess of $100 million annually in 2025 should the status quo set of revenue and expenditure conditions that we describe above remain in place.**

If that is the case, and city leaders are unable to meaningfully increase existing revenue streams or meaningfully reduce expenditures through efficiency initiatives and other reforms, then that could produce the need to shrink the size of the GCP budget by 15% to 20%. That, in turn, would produce the need for hundreds of position cuts and significant service reductions. The police and fire departments likely would take on the brunt of those cuts given that they comprise more than half of the GCP budget and – unlike the public works and health departments – are supported largely by the property tax and other locally allocated revenues, as opposed to user fees and grants.

Milwaukee County

Milwaukee County also has been struggling with a severe structural deficit that stems from several similar factors to those that have precipitated the city's fiscal crisis. Those include high reliance on state aids that have not kept pace with inflation over time and on property tax revenues that have been heavily restricted by state-imposed levy limits, as well as pension fund obligations that have required substantial property tax allocations to support.

Two significant differences, however, are that the county's intense struggles have been in place for about two decades – or about a decade more than the city's – and the county is reliant on several additional forms of state aid besides shared revenue to support several service areas mandated by the state. Because those areas (like various human services and the courts) have not seen their corresponding state revenue streams increase with inflation over time, the county has been required to devote increased shares of its local property and sales tax revenues to support them, leaving fewer resources for discretionary functions like parks, culture, and transit. Also, unlike the city, the

county has had few reserves to draw upon to alleviate annual challenges until recently, when it has been able to build an impressive debt service reserve.

Back in 2009, in a report titled "*Crisis on the Horizon*," we warned that the county had "attempted to manage in the status quo for too long given its atmosphere of exceptional costs and restricted revenues" and suggested that a "solvency plan" was required that ideally would:

…contemplate all alternatives, from implementing new or enhanced local revenue sources to reduce its reliance on external sources and augment flexibility; to eliminating, transferring or outsourcing programs and services that are not essential to its core mission and that could be performed just as well by others; to selling or leasing assets to generate capital as a means of paying down liabilities or re-investing in other assets that must be retained. Most likely, it would implement a mix of those approaches.

Since that time, while not developing a formal plan, Milwaukee County leaders have indeed implemented such a mix of reforms by necessity, including the adoption of a $30 vehicle registration fee; outsourcing behavioral health inpatient and crisis care; and selling or abandoning major facilities at 27th and Wells in Milwaukee and on the Milwaukee County Grounds in Wauwatosa.

Nevertheless, while such actions have improved the county's fiscal outlook dramatically, and while the county, like the city of Milwaukee, has benefited significantly from health care and pension savings in the wake of Act 10 and its receipt of substantial federal pandemic relief aid, it retains a sizable structural imbalance in its operating budget. Meanwhile, its aging infrastructure and efforts to control debt service have created an even more challenging predicament with regard to its capital needs.

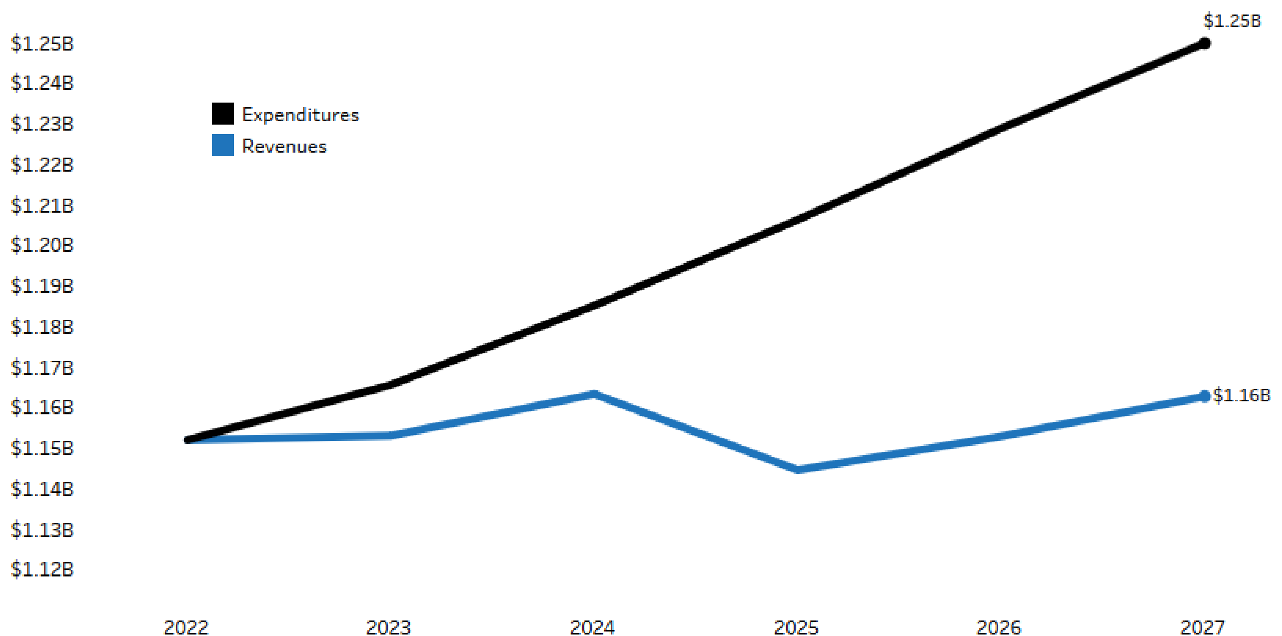
To assess the scope of the county's structural imbalance, we did not construct our own forecasting model, but instead rely on the county's own data that it has gathered as part of its annual five-year fiscal forecast modeling. To conduct that modeling, the county comptroller's office uses a software platform called "Municast" that employs dozens of assumptions on expenditure and revenue line items to arrive at a five-year forecast. The primary difference between the Municast approach and the approach we used in our city of Milwaukee model is the far greater number of individual expenditure and revenue line items used to construct the Municast model. However, the two approaches are similar in their extensive use of previous spending and revenue trends to project the future.

The county comptroller will be releasing the most recent five-year forecast encompassing the 2024-2028 period within the next two to three weeks. For the purposes of this memo, we use the five-year forecast that was released in March 2022. The table and figure on the following page show that the operating budget's structural imbalance was projected to grow from $12.6 million in 2023 to $87.2 million in 2027. That projection stemmed from an estimate that total expenditures would grow by an average of 1.6% annually while revenues would grow by an average of 0.2%.

Table 2: Municast Estimate of Milwaukee County Expenditure and Revenue Growth, 2023-2027

Year	Revenues	Expenditures	Deficit
2023	$1,153,035,230	$1,165,589,552	($12,554,322)
2024	$1,163,318,932	$1,185,186,729	($21,867,797)
2025	$1,144,562,638	$1,206,344,503	($61,781,865)
2026	$1,152,886,936	$1,228,911,884	($76,024,948)
2027	$1,162,732,677	$1,249,945,147	($87,212,470)

Figure 2: Milwaukee County Projected Structural Deficit, 2022-2027



Source: Milwaukee County projections

Several points are worth noting about this forecast:

- The county's much smaller structural gap when compared to the city's results, in part, from the fact that the county has been successfully undergoing rigorous budget cutting for a much longer period of time. It was forced to confront a huge spike in its employer pension contribution back in 2002 and while steady growth in the contribution has occurred since that time, it has been spread out over many years and was also alleviated by the issuance of pension obligation bonds in 2009 and the receipt of employee contributions beginning in 2012.[2] Despite the smaller size of the structural gap, however, the fact that so much cutting already has occurred at Milwaukee

[2] It is also worth noting that Milwaukee County has managed to stabilize its employer contribution while also lowering its actuarial assumption on pension fund earnings from 8.5% in the early 2000s to 7.5% currently. The county's pension board also recently voted to lower the assumption to 7.0% by 2026, which likely will have a negative impact on the size of projected deficits in the five-year fiscal forecast.

County means that the current structural deficit represents a tremendous challenge that is arguably somewhat akin to that facing the city, which may still have more options at its disposal.

- A key driver of the county's structural deficit is the longstanding set of financial challenges facing the Milwaukee County Transit System, which had seen dwindling passenger revenue even prior to the pandemic as well as flat state aids. About $21 million of ARPA funding is propping up the MCTS budget in 2023 and will likely do so again in 2024. However, after that time the transit system faces a gap in excess of $20 million of its own, which is a large factor in the overall projected jump in the county's structural deficit from $22 million in 2024 to $62 million in 2025.

- The March 2022 forecast did not take into account the possible impact of high inflation on the county's salary structure, as wages may need to grow at a much faster pace than in previous years in light of the need to attract and retain employees in an historically tight labor market. On the other hand, the high numbers of vacancies the county is currently experiencing – which may ultimately result in the elimination of positions that it cannot or no longer deems critical to fill – are not taken into account.

Based on other positive factors that have materialized over the past year – including some permanent deficit reduction efforts employed in the 2023 budget and an expected surge in earnings on investments given recent increases in interest rates for various conservative investments – it is likely that the 2023 forecast will show modest improvement. Still, **we would surmise that the county likely is facing a structural gap in the $10 to $15 million range in 2024 and that the gap likely will grow to exceed $60 million by 2028 under the comptroller's modeling assumptions.**

Finally, perhaps the most important point to note about the county projections is that they apply only to the operating budget. Milwaukee County faces an even larger financial challenge on the capital front, with a backlog of needed repairs and replacements that may be nearing $1 billion. If the County is unable to obtain new sources of revenue to address its capital needs, **then it likely would need to double or even triple the amount of borrowing currently permitted under its self-imposed annual borrowing cap of about $46 million for non-airport projects over the next several years** to address its most urgent needs. That, in turn, would create significant upward pressure on levy-supported debt service payments, which currently stand at about $36 million per year.