BUDGET BRIEF:

MILWAUKEE COUNTY

2019 EXECUTIVE BUDGET

WISCONSIN POLICY FORUM

ABOUT THE WISCONSIN POLICY FORUM

The Wisconsin Policy Forum was created on January 1, 2018, by the merger of the Milwaukee-based Public Policy Forum and the Madison-based Wisconsin Taxpayers Alliance. Throughout their lengthy histories, both organizations engaged in nonpartisan, independent research and civic education on fiscal and policy issues affecting state and local governments and school districts in Wisconsin. WPF is committed to those same activities and that spirit of nonpartisanship.

PREFACE AND ACKNOWLEDGMENTS

This report is intended to provide citizens and policymakers with an independent, comprehensive, and objective analysis of the Milwaukee County Executive's budget. We hope that policymakers and community leaders will use the report's findings to inform discussions during upcoming budget deliberations.

Report authors would like to thank Milwaukee County fiscal officials and staff – including staff from the Department of Administrative Services and Comptroller's Office – for their assistance in providing information on the County's finances.

Finally, we wish to thank the Northwestern Mutual Foundation for generously supporting our local government finance research.

Northwestern Mutual®

BUDGET BRIEF:

Milwaukee County 2019 Executive Budget

October 2018

Report Author:
Rob Henken, President

TABLE OF CONTENTS

INTRODUCTION

While recent Milwaukee County budgets have been marked by fierce debate over a vehicle registration fee (VRF), severe cuts to the sheriff's budget, and changes to employee fringe benefits, the 2019 recommended budget stands out for its lack of controversial items. Property tax and fee increases are kept to a minimum, no departments are singled out for onerous cuts, and employee health care premiums are unchanged while salaries receive a small bump.

A primary contributor to this relatively tranquil budget is the county's continued progress in controlling the growth of health care and pension costs, which traditionally have been the primary drivers of its structural deficit. In fact, remarkably, gross health and dental costs and the employer pension contribution both *decrease* in the 2019 budget.

Still, it would be a mistake to view the relative sense of calm as evidence that the county has turned the corner in its quest for fiscal stability. Indeed, even in a year in which health care and pension costs don't grow, nearly $14 million of smaller departmental cuts and modest contributions from reserves still are required to hold the line on taxes and fees. Meanwhile, the decision to finance a handful of large projects and stay within self-imposed borrowing limits again precludes the capital budget from meaningfully addressing the county's huge backlog of needed infrastructure repairs.

For Milwaukee County, a "good" budget year is one in which major service reductions and tax or fee increases can be avoided; reserves do not have to be depleted; and maneuvers that may exacerbate the following year's budget hole are averted. Measured by those standards, the 2019 recommended budget can appropriately be viewed as one of the best in years.

Nevertheless, as we discuss in detail in this analysis, this year's lack of budget strife is likely to be an anomaly. In all likelihood, health care and pension costs *will* increase in future years, despite the county's successful efforts to curb explosive growth. Meanwhile, the county's reduced levels of reserves, enormous capital needs, and stagnant revenue streams signal that the road to long-term fiscal stability will be a long one.

In the pages that follow, we analyze the recommended budget's priorities and key features mentioned above, as well as other elements that are relevant to the County's immediate and long-term financial health. Our aim is to promote informed and thoughtful deliberations as policymakers consider the 2019 county budget in the weeks ahead.

2019 RECOMMENDED BUDGET SYNOPSIS

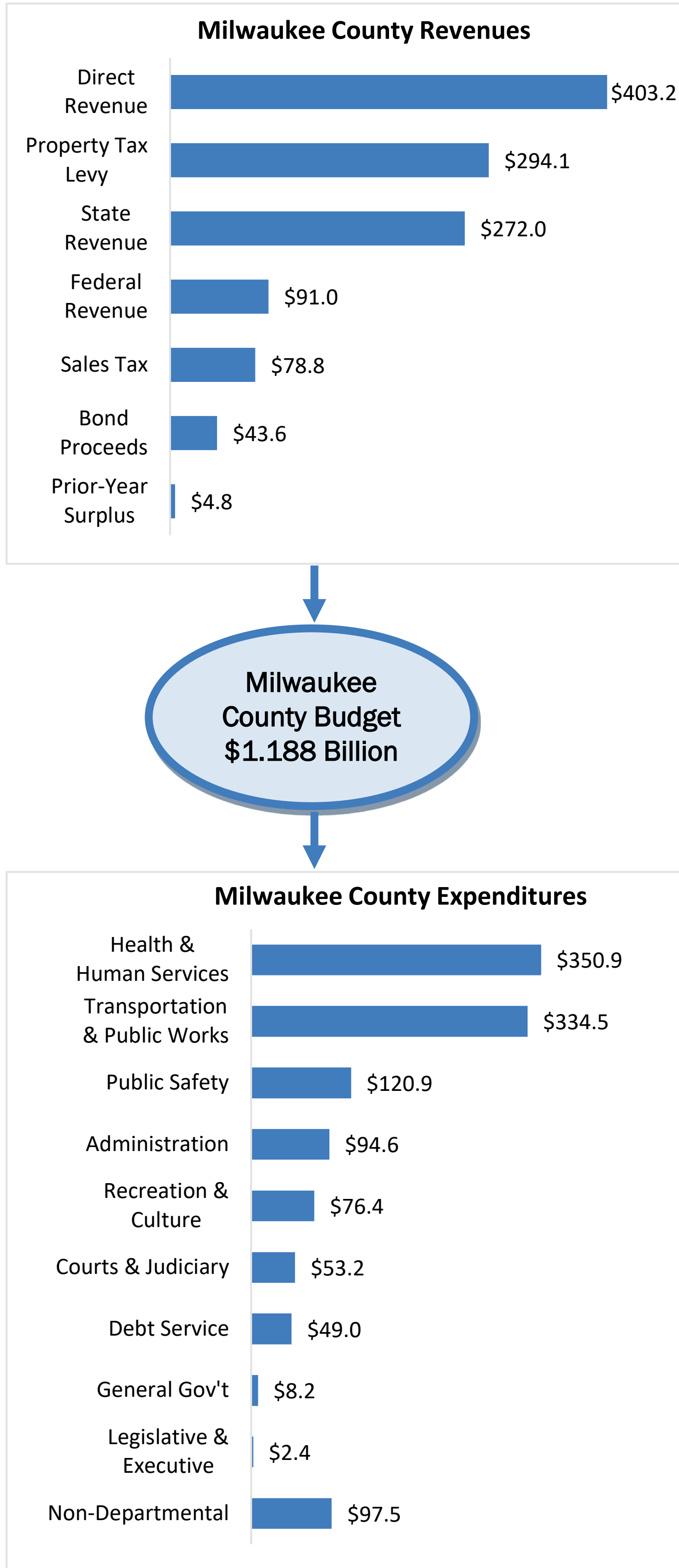
The 2019 Recommended Budget totals $1.2 billion, an increase of 3.4% ($38.7 million) from 2018. The operating budget totals $1.06 billion, while $124 million is recommended for capital improvements. The bulk of the 2019 increase is attributed to a single $31 million capital project (bus rapid transit) that is being financed mostly with federal dollars.

Figure 1 breaks down the recommended budget by major revenue and expenditure categories. The three leading areas of expenditure are health & human services at $351 million (including $207 million for behavioral health operations); transportation & public works at $335 million (including $156 million for transit operations); and public safety at $121 million.

The largest revenue source is "Direct Revenue," at $403 million. This category consists of service-related fees and reimbursement that range from zoo admissions to transit fares to Medicaid reimbursement. The property tax is the next largest revenue source at $294 million. The county also is budgeted to receive $272 million in direct grants and aids from the state and $91 million from the federal government.

Combined, the county's two primary sources of locally-generated revenue – the property tax and sales tax – are projected to generate $373 million in 2019, or 31% of total revenues. While various user and admissions fees and the VRF also generate close to $100 million, this indicates the extent to which the County relies on aids and reimbursements from other levels of government.

Figure 1: 2019 Milwaukee County Finances (Millions)

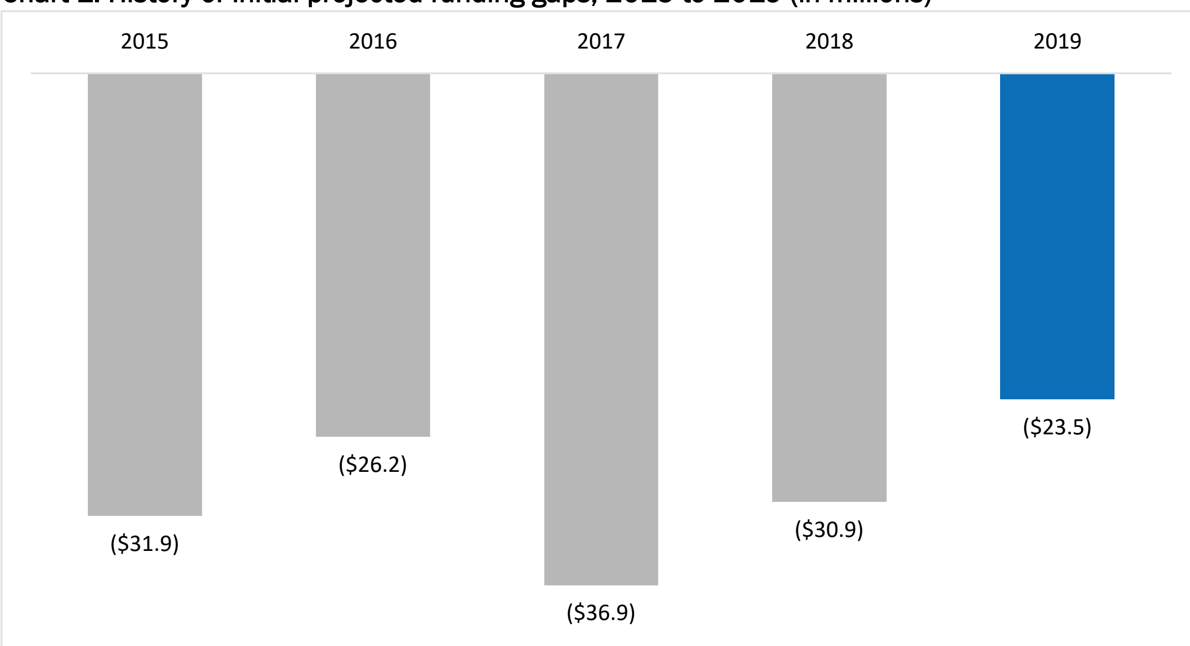


THE 2019 BUDGET GAP

Our annual budget brief always begins with a summary of the initial budget gap confronted by county officials as they began their preparations for the following year. The existence of a perennial gap reflects the county's unresolved structural imbalance. Simply put, its annual revenue growth is unable to keep up with the expenditure growth required to maintain current service levels from year to year (the "cost to continue"). The need for added expenditures typically is driven by personnel-related costs (for both active and retired employees), which comprise 44% of the overall budget.

The good news heading into the 2019 budget season was that the size of the gap had shrunk – from $30.9 million in 2018 to $23.5 million this year. As shown in **Chart 1**,[1] that is the smallest gap in the past five years. The gap is still sizable, however, and its existence again largely precludes county leaders from considering new programmatic initiatives or shoring up holes from previous years, and instead requires them to consider spending reductions or revenue increases to balance the budget.

Chart 1: History of initial projected funding gaps, 2015 to 2019 (in millions)



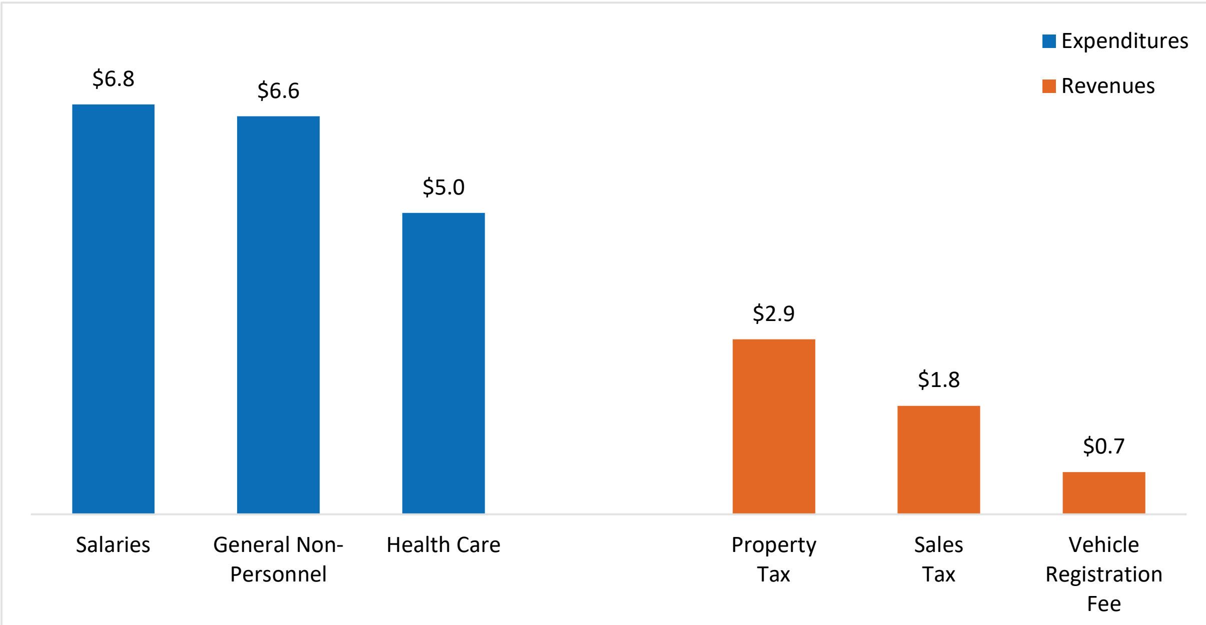
Source: Milwaukee County Comptroller's Office and Office of Performance, Strategy, and Budget

In a September 2018 briefing, the budget director laid out the components of the 2019 budget gap. As shown in **Chart 2**, inflationary increases in salaries, health care, and general non-personnel operating costs (e.g. fuel, other commodities, contracted services) alone were projected to add more

[1] The 2019 gap was estimated by the county budget director at the onset of the budget process in April. In past years, we have cited the "gap" projection derived from the County's Municast financial forecasting system, which is administered by the Comptroller's office. This year, the Municast projection took into account anticipated reduced health care costs for 2019 based on 2018 year-to-date experience in late summer. Consequently, the Municast gap was reduced to $16.8 million. We use the budget director's projection in **Chart 1** because it is more consistent with Municast figures from previous years, which similarly reflected projections made at the start of the budget process.

than $18 million to the county's expenditure budget in 2019. Meanwhile, those added costs were anticipated to be offset by only a $5.4 million combined increase in the county's largest sources of locally generated revenue – property and sales taxes and the $30 vehicle registration fee (VRF). **It is this incongruence between fixed cost and local revenue growth that defines the county's structural imbalance**, as its state and federal revenues also typically show little annual growth.

Chart 2: Projected salary, health care, general operating, and local revenue increases (in millions)



Source: Milwaukee County Office of Performance, Strategy, and Budget

Another notable component of the 2019 gap was the assumed avoidance of a withdrawal from the Debt Service Reserve (DSR). The DSR is the county's only significant reserve, with a current balance of about $27 million. The county has leaned on sizable annual DSR withdrawals for the past several years, including a $6.6 million withdrawal in 2018. The budget director has expressed a desire to build it back up to $50 million, which would be consistent with best practice guidelines recommending that governments carry reserves equivalent to at least two months of operating costs. The absence of a withdrawal in 2019 adds $6.6 million to the gap.

Meanwhile, the gap's shrinkage from 2018 to 2019 demonstrates the county's recent success in controlling the growth of fringe benefit costs. For example, the 2018 gap included a $6.4 million increase in the employer pension contribution, caused mainly by a lowering of the interest rate assumption for fund investments from 8.0% to 7.75%. With no change for 2019 and strong 2017 investment returns, only a $2 million pension increase was forecast originally for 2019.

Growth on the salary side has been restrained as well, with the 2019 increase attributed mainly to a modest 1% salary increase adopted for mid-year 2018 and an assumed similar increase in 2019. Yet, despite these successful efforts, the county's stagnant revenue growth still cannot keep pace. In fact, the Comptroller recently cited an ongoing annual structural deficit of $12.8 million caused by "a greater increase in expenditures than what is generated in additional revenue."[2]

[2] Five-Year Financial Forecast report issued by the Comptroller, August 2018.

HOW THE GAP WAS BRIDGED

County policymakers engaged in fierce debate during the past two budget cycles regarding the appropriate balance between spending reductions and revenue increases as the primary tools to eliminate large budget gaps. For 2019, however, the need for that debate was ameliorated by two factors that eliminated almost half of the original gap.

As shown in **Chart 3**, improved fringe benefit projections eliminated $6.7 million from the original estimates, while a decision to again make a withdrawal from the DSR erased an additional $3.9 million. With regard to the former, $1.7 million of improvement was derived from an updated pension fund contribution amount; and $5 million came from lower health care benefit estimates based on 2018 experience.

Chart 3: Major deficit reduction strategies in 2019 recommended budget (in millions)

Source: Recommended budget[3]

The chart shows other adjustments in the recommended budget that not only help fill the remaining $12.9 million gap, but also allow the county to devote an additional $5.4 million in cash to capital improvements, avoid a VRF increase, and limit the property tax increase to $1.3 million (0.4%). Various departmental reductions total nearly $14 million and reflect both absorption of costs to continue and real cuts (as well as some modest fee increases in the parks, zoo, and transit system). The budget also includes $1.7 million in additional revenue from online sales tax collections and $1.5 million in increased investment revenue from the Treasurer's office, as well as a potential $2.0 million withdrawal from Behavioral Health Division reserves.

[3] Unless otherwise noted, the source for all figures and charts in this report is the 2019 recommended budget or other Milwaukee County budget documents.

2019 RECOMMENDED BUDGET: OPERATIONS

The 2019 recommended operating budget totals $1.06 billion, an increase of $6.6 million (0.6%) from 2018. This minimal growth in overall operating expenditures – despite an increase of $6.9 million in salaries and wages and presumed inflationary growth for other operational needs – suggests many departments will have to absorb some portion of their “cost to continue” in 2019. Indeed, the recommended budget cites $13.9 million in savings generated by departments, which “were asked to absorb their inflationary increases and make additional cuts to reduce their tax levy funding by 1.1%.”[4]

The potential negative service-level impacts that may result from such departmental reductions should not be disregarded, particularly given that annual reductions of a similar magnitude have been the norm for county departments throughout much of the past decade. Yet, it is important to note that the 2019 recommended budget does not contain the types of large-scale, controversial reductions or outsourcing initiatives that have characterized several recent budgets. Moreover, it does not ask employees to pay more for their health care, nor does it recommend new or greatly expanded fees.

The avoidance of such strategies is made possible not only by asking departments to absorb salary increases with relatively minor cuts, but also by the county’s good fortune on health care costs and its continued use of reserves. The budget also contains some beneath-the-radar non-departmental reductions – like a $1 million cut to the Contingency Fund and increased vacancy and turnover savings – and some modest fee increases.

The bottom line is a recommended budget with few *major* changes for departments, though the following are worth noting:

- The **Behavioral Health Division** is asked to absorb a $4.1 million reduction to its cost-to-continue via several proposed savings, including elimination of 17 full-time equivalent (FTE) positions in management and support services, as well as cuts in overtime ($0.6 million) and professional services ($1.4 million). Partially offsetting those reductions is a $1.8 million levy increase for substance abuse programming. BHD’s budget also includes a $2 million general reduction that would have to be absorbed through unspecified means and/or by use of its substantial reserves.

- The **Milwaukee County Transit System** (MCTS) would see a $1.2 million property tax levy reduction, which necessitates some relatively modest route modifications and cuts in administrative positions. Also, the budget recommends a $1 increase (from 16.50 to $17.50) in weekly bus passes for students purchased by the Milwaukee Public Schools; and a $1 increase (from $1 to $2) in special passes for certain senior citizens and persons with disabilities. We provide greater detail on the MCTS’ budget later in this report.

- The **Office of the Sheriff** is spared from major proposed reductions for the second consecutive year, and instead receives a $2.2 million levy increase largely to meet its cost-to-continue needs. In addition, funds are provided for an increase in overtime expenditures ($500,000); salary increases to address pay equity issues ($300,000); and salary increases for corrections officer

[4] 2019 Recommended Budget, p.8.

positions to address recruitment and retention challenges ($200,000). A similar increase for corrections officer salaries is included in the House of Correction budget.

- The **Courts** receive a tax levy increase of $1.6 million, including continuation of a multi-year $200,000 appropriation to upgrade courtroom furniture. The bulk of the increase maintains the status quo by covering a reduction in child support revenue and rising outside attorney fees.

- The **Information Management Services Division** receives $1.3 million for new investment in personnel and services, including funding for six additional positions. A portion of the cost is offset by decreased depreciation costs.

Overall, the recommended operating budget is able to hold the line on most county services, which is no small feat for a government that faces a substantial annual structural imbalance. Nevertheless, most departments still are being asked to do more with less. Moreover, the budget affords little capacity for new investment to meet ongoing operating challenges or to finance new initiatives related to larger economic development or quality-of-life aspirations.

2019 RECOMMENDED BUDGET: CAPITAL IMPROVEMENTS

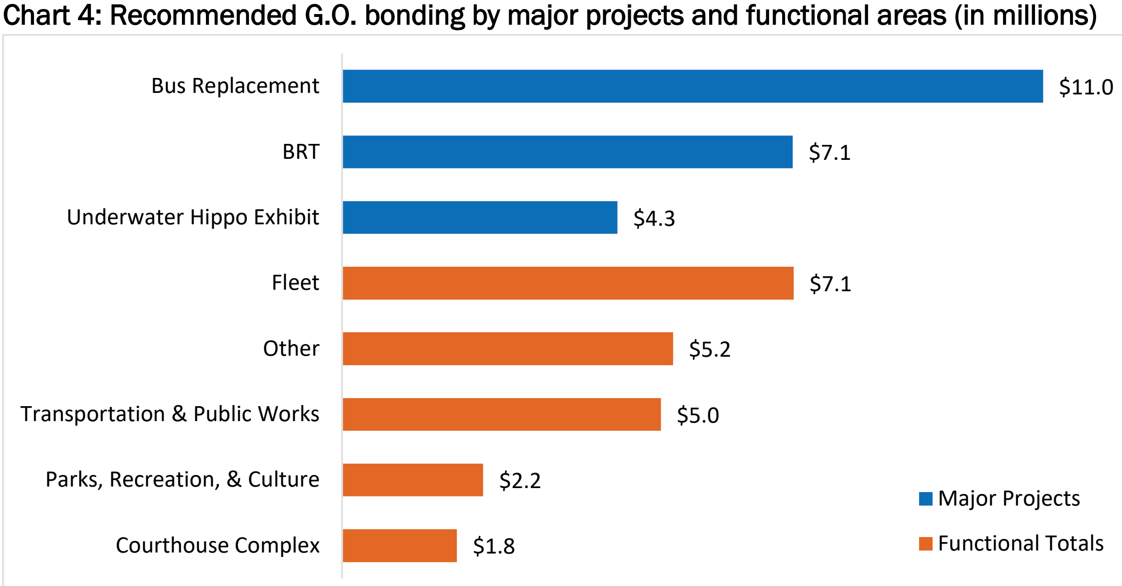
With recommended expenditures of $124.4 million, the capital improvements budget comprises 10.5% of the overall county budget for 2019. Of that amount, $31.2 million is for projects at the two county-owned airports, which are fully reimbursed by the airlines or outside revenue sources and do not directly impact county finances or fall within the county's borrowing limit. Non-airport projects total $93.2 million, which is an increase of $39.6 million compared to 2018. One project – bus rapid transit (BRT) – accounts for the bulk of the increase, as will be discussed below.

The major source of financing for the county's capital program is general obligation (G.O.) bond proceeds, while other sources include locally-generated tax and fee revenues and contributions from other governments or private sources. For 2019, of the $93.2 million recommended for non-airport projects, $24.5 million would be derived from other levels of government and $13.6 million from private contributions. The remaining $55.1 million of county financing would consist of $43.6 million in G.O. bonds, $10.8 million in sales tax revenue, $125,000 in property tax levy, and $570,000 from miscellaneous sources. The $43.6 million bond issue complies with the 3% annual increase allowed under a self-imposed bonding limit established by the county in 2003.

The recommended capital budget is dominated by three major projects, which comprise 62% of the non-airport total project costs: BRT ($31 million); bus replacement ($13.4 million); and an underwater hippo exhibit at the zoo ($13.4 million). Those projects also comprise more than half of the recommended G.O. bonding amount ($22.4 million, or 51%).

Chart 4 delineates G.O. bonding for those three projects and compares them to total recommended bonding for entire functional areas (the three major projects are excluded from their functional area totals). Despite outside funding to pay for substantial portions of the BRT project ($19.4 million in federal funds and $4.5 million from the Milwaukee Regional Medical Center) and the hippo project ($9.1 million from private donors), the chart shows that the bonding limit allows for allocation of comparably small amounts of borrowing to finance the county's vast array of other needs.

Chart 4: Recommended G.O. bonding by major projects and functional areas (in millions)



The bonding limit is not the only factor impacting the county's ability to afford its capital program needs. A significant number of requested projects are not eligible for bond financing and would require sales tax and/or property tax levy funding (cash financing) to implement. This poses a major challenge given the county's vast operating budget needs. The budget office points out that over the past three years, 31% of requested cash financed projects have been adopted, as compared to 55.3% of bond-eligible projects.

Perhaps most striking about the 2019 recommended capital budget is the amount allocated for the parks and culture function (outside of the hippo exhibit). Last month, the Forum released *Delay of Game*, the fourth in our five-part series on local government infrastructure challenges in Greater Milwaukee. We found the county's parks, recreational, and cultural facilities face a "seemingly insurmountable backlog of repair and replacement needs," a conclusion that was backed by the county executive, who cited a $200 million infrastructure backlog in the parks alone.[5]

The budget recommends only $2.2 million for parks and cultural facilities, including $1.3 million for four projects in the parks and $874,000 for a roof project at the Milwaukee Public Museum. This amount not only pales in comparison to the need cited in our report, but also is substantially lower than the $10.7 million for 15 projects requested by the parks director.[6]

Two other projects stand out in the 2019 recommended capital improvements budget:

- Planning and design of a **new building to house the Medical Examiner's office and the Office of Emergency Management** would be initiated with $940,000 in sales tax revenue. Preliminary plans call for the two agencies to be co-located in a forensic science center with the Medical College of Wisconsin (MCW). A preliminary cost of $23.8 million has been cited in the Five-Year Capital Improvement Plan, though specific financing details (including the cost distribution between MCW and the county) have not yet been developed.

- An appropriation of $6.9 million – consisting of $3.9 million in sales tax revenue and $3 million in G.O. bonds – is recommended to continue work on a **modernized enterprise platform** to upgrade technical support for county and MCTS business operations. This project – which received a combined $14.8 million in 2017 and 2018 – would be substantially completed by mid-2020. The budget notes that the $3 million in anticipated bond proceeds may not be permissible per bond financing guidelines, in which case monies would be sought from the Debt Service Reserve.

Overall, the 2019 recommended budget again illustrates the county's intractable capital finance dilemma. The need to finance a handful of major projects in 2019 leaves little capacity to address dozens of additional smaller needs, most notably in its parks. We provide additional analysis of this problem in a later section of this report.

---

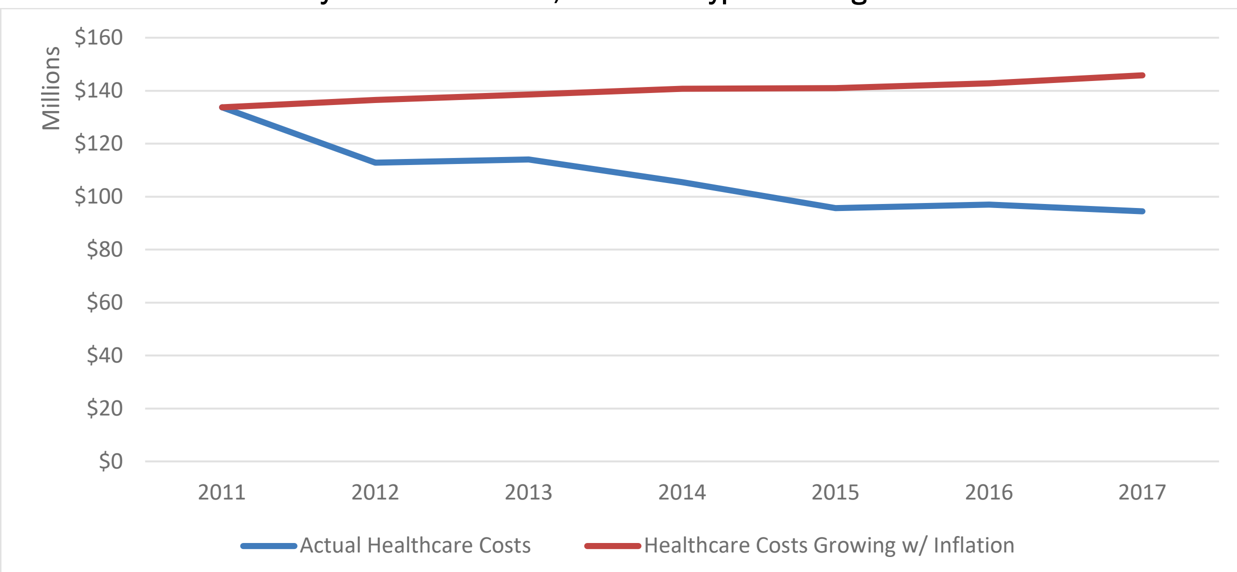
[5] Behm, Don, "Milwaukee County's maintenance backlog for parks now 'seeming insurmountable,' report says,"Milwaukee Journal Sentinel, September 21, 2018.
[6] August 17, 2018 memo from Parks Director Guy Smith to the County Board Chairman.

FIVE KEYS TO UNDERSTANDING MILWAUKEE COUNTY'S 2019 RECOMMENDED BUDGET

KEY#1: HEALTH CARE–THE GIFT THAT KEEPS ON GIVING

Perhaps the single biggest fiscal success story for Milwaukee County over the past several years has been its ability to control growth in health care costs. In fact, as shown in **Chart 6**, the county actually has been able to *reduce* its annual health care spending by $40 million from 2011 to 2017 in nominal terms. If the county's health care costs had grown at the rate of inflation, they would have been $51 million higher in 2017 than the amount the county actually spent.

Chart 6: Milwaukee County health care costs, actual vs. hypothetical growth with inflation



Source: Milwaukee County Municast Financial Planning System

The county's remarkable success in this area is attributed to a number of factors, including plan redesign, shifting certain retirees from Medicare to Medicare Advantage, and a reduced workforce. The bottom line is that year after year, the county has seen lower-than-expected utilization rates by employees and retirees, which has reduced total spending even as the cost of medical care and pharmaceuticals has grown.

Despite this trend of shrinking or flat year-to-year health care spending, the county has continued to budget conservatively. Typically, it applies at least 5% increases to projected actual spending amounts for the current year when establishing health care spending estimates for the following year's budget.

This conservative approach has produced two huge benefits. The first is the generation of huge year-end health care surpluses, which typically have been used to replenish the Debt Service Reserve and allow substantial withdrawals in the following year's budget.

In addition, as actual health care spending during the course of the year trends well below budgeted projections, fiscal officials can apply an inflationary percentage increase for the following year to a lower baseline, thus allowing for year-over-year budgetary savings even when accounting for inflationary cost increases in medical services and pharmaceuticals.

The 2019 recommended budget exemplifies how this dynamic has worked. The budget assumes a 5% inflationary increase in medical costs and a 10% increase in pharmaceutical costs, which ordinarily would have produced the need for more than $7 million in additional expenditures. However, because actual 2018 health care expenditures are anticipated to be about $8 million lower than budgeted, the increases are applied to a lower baseline, contributing to a $953,000 *savings* in gross health care and dental expenditures from the 2018 budgeted amount.

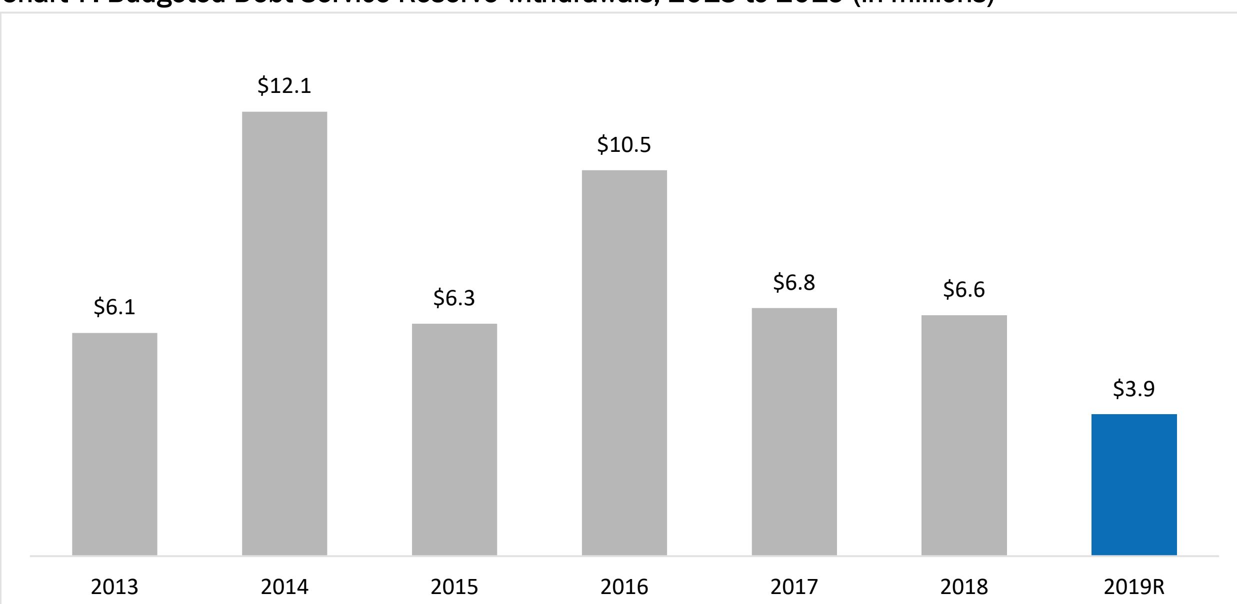
As we discuss in a subsequent section, this good fortune eventually is likely to run out, requiring the county to again budget for increased health care spending from year to year.

KEY #2: USE OF THE DSR CONTINUES, BUT FOR HOW LONG?

As noted above, the Debt Service Reserve (DSR) serves as the county's only major permanent general reserve. In recent years, county leaders have responsibly built the DSR by depositing into it a sizable portion of large year-end surpluses. Those annual surpluses have materialized from a variety of factors, the largest of which was annual health care savings, as discussed above.

County leaders deposited a combined amount of nearly $80 million from year-end surpluses into the DSR between 2013 and 2017. These deposits allowed the reserve to grow from near zero to a high of more than $47 million heading into 2016. In addition, as shown in **Chart 7**, they allowed county leaders to make sizable annual withdrawals (averaging about $8 million per year) from 2013 to 2018 to help alleviate budget challenges each year.

Chart 7: Budgeted Debt Service Reserve withdrawals, 2013 to 2019 (in millions)



As the county considers a withdrawal for 2019, however, it must take into account the inability to replenish the reserve this year. The 2017 year-end surplus was $4.8 million – a healthy amount, but lower than the $5 million anticipated in the 2018 budget – which leaves no additional surplus to contribute to the reserve. As a result, the DSR balance is projected to stand at $27.4 million at the end of this year, which would be the lowest year-end balance in six years.

While budget officials originally had hoped to avoid a DSR withdrawal next year, the recommended budget would withdraw $3.9 million to avoid further departmental budget cutting or revenue increases. This would be the smallest withdrawal since a $1.7 million withdrawal in 2012.

On the one hand, the 2019 withdrawal is defensible in light of the still healthy reserve balance. Moreover, the comptroller is projecting an $8.7 million surplus in 2018 which, if realized, could allow the county to replenish the DSR next year with an amount roughly equal to the $3.9 million.

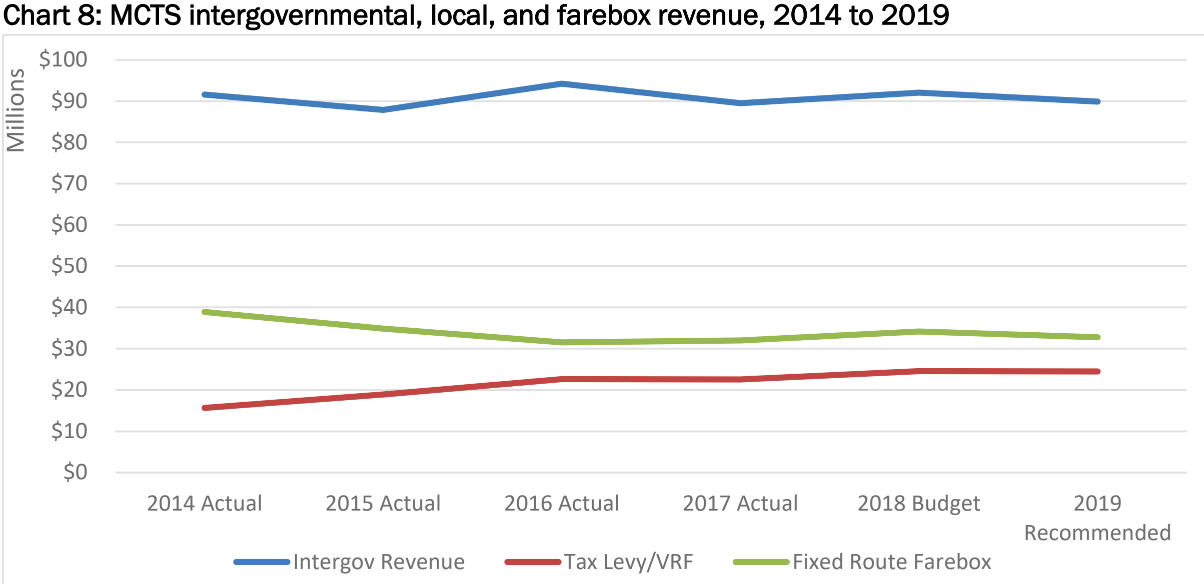
Still, given that the DSR is the county's only real reserve and has now shrunk by nearly $20 million since its peak, a case could be made that a relatively calm budget is not one in which the DSR ideally would be tapped. Also, even if a withdrawal is justified for 2019, county leaders must recognize that their ability to use large DSR contributions to address challenges in future years likely will be limited.

KEY #3: TRANSIT BUDGET REMAINS PRECARIOUS

Like Milwaukee County itself, MCTS faces a sizable structural deficit that has ebbed and flowed over the years but remains unresolved. Also like the county, this problem results from the fact that increases in MCTS' annual fixed costs – including salaries, benefits, and fuel – seldom are supported by equivalent growth in its revenue streams.

For 2019, about 58% of MCTS' revenue is projected to come from the state and federal governments, while 21% would come from fare revenue collected from fixed route riders and 16% from the county (from both the property tax levy and VRF). As shown in **Chart 8**, over the past five years, intergovernmental revenues generally have been flat, while farebox revenues have diminished. This has necessitated increased appropriations of local revenues – which have risen from $15.7 million in 2014 to a recommended $24.5 million in 2019 – to maintain service levels.

Chart 8: MCTS intergovernmental, local, and farebox revenue, 2014 to 2019



The establishment of a $30 VRF in 2017 allowed the county to decrease its use of the property tax for transit and has helped reverse an alarming trend in which increased property tax levy support was needed each year to counter declines at the farebox.[7] In MCTS' 2019 recommended budget, the $24.5 million in county funds would be comprised of $15.7 million of VRF revenue and $8.8 million of property tax levy.

Still, a downward trend in ridership may mean that the county's property tax levy commitment again will need to rise in future years to plug structural holes. Also of concern is that MCTS' recommended budget uses $1 million in one-time federal revenue and $1 million in insurance savings in 2019. Despite these one-time contributions and steady local funding, transit service would be reduced by 3% in 2019 (with the bulk of the reduction attributed to elimination of routes associated with expiring state grants from the Zoo Interchange litigation settlement).

Increased property tax allocations could be avoided if county leaders instead are willing to use annual increases in the VRF to maintain or even enhance service levels. Unlike most similar-sized transit systems, MCTS does not have a specific form of dedicated revenue to support its operations, but instead must compete for local funding each year with other county programs and services. The Southeast Wisconsin Regional Planning Commission (SEWRPC) has found that MCTS is "by far the largest transit system of its peers not supported by dedicated funding."[8]

The VRF is not technically a dedicated founding source because its proceeds must be directed to MCTS as part of the budget process each year. However, there is nothing to stop the county from treating it that way in practice and from adjusting it each year if additional local resources are needed to support MCTS' cost to continue or any desired service expansion.

Adjustments to the amount of the fee likely would be needed under such a scenario because the VRF has limited elasticity. Barring increases in population or major changes in citizen commuting habits, the growth in vehicles registered in Milwaukee County would not be expected to change much from year to year. Given the controversy that has erupted in previous years over use and expansion of the VRF, however, it remains to be seen whether such adjustments would be politically viable.

KEY #4: INFRASTRUCTURE CHALLENGES STILL NOT BEING MET

In Delay of Game, the fourth in our five-part series of reports assessing the condition of local government infrastructure, we again reviewed the apparent paradox between the county's self-imposed limits on borrowing and its long list of expensive capital needs. We acknowledged the important policy goals behind the limits, which aim both to prevent debt service obligations from interfering with the county's operating budget needs, and to ease the burden on future taxpayers.

Yet, we also noted that these "legitimate policy objectives" had led to unintended consequences:

---

[7] For more on this issue and how it has impacted other large transit systems in Wisconsin, see our June 2018 Focus entiled How Should Local Governments Respond to Declining Transit Ridership?

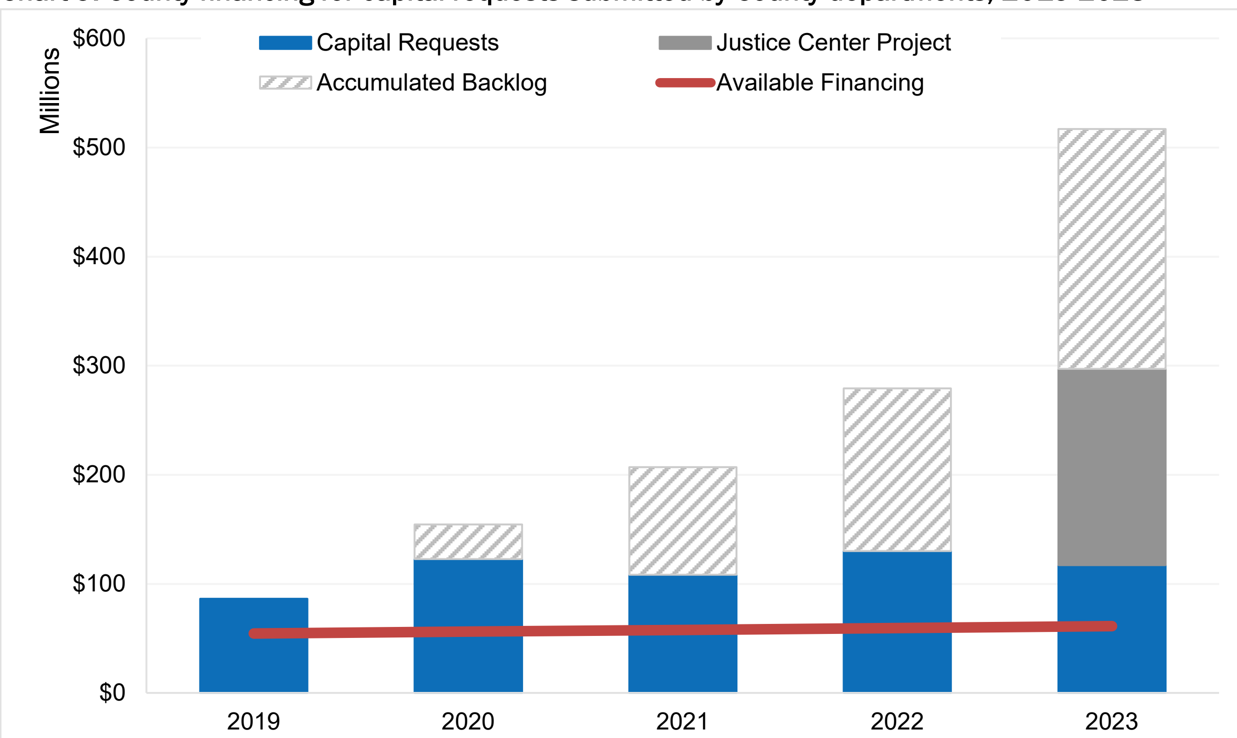
[8] SEWRPC Planning Report No. 55, July 2017, p. 325. Information can be accessed at http://www.sewrpc.org/SEWRPCFiles/LUTranSysPlanning/pr-55-vol-1-complete-final-reduced.pdf

As the cost of maintaining aging infrastructure has risen beyond the county's capacity to address it in any single year, policymakers repeatedly have deferred capital projects to future years, creating a seemingly insurmountable backlog of repair and replacement needs.

As discussed in our earlier summary of the capital improvements budget, little (if any) progress would be made in reversing this paradigm in 2019. Departments requested 99 non-airport projects requiring local appropriations of $91.2 million. Yet, in complying with next year's borrowing limit and associated 20% cash match, the recommended budget provides $55.1 million in local funds to finance 36 projects.

As shown in **Chart 9**, the problem is likely to grow far worse. The chart shows the local cost of non-Airport projects requested by departments each year from 2019 to 2023, and compares those costs to the county's capital financing capacity (as defined by each year's bonding limit plus a 20% cash match). In each year, the total amount of local funding requested exceeds the amount available by tens of millions of dollars. Meanwhile, projects not funded each year cause the backlog to grow, as shown in the chart.[9]

Chart 9: County financing for capital requests submitted by County departments, 2019-2023



Source: Milwaukee County Capital Improvements Committee

[9] County leaders may elect to remove certain projects from the list of requested projects that are deemed unnecessary or that become obsolete should assets be sold. However, it is also likely that new capital projects identified in the intervening years will widen the gap between now and 2023.

The chart shows a huge escalation in projected local capital financing in 2023, which stems from a $180 million appropriation for a single project – replacement of the Safety Building with a new criminal courthouse. Yet, even excluding that project, capital requests would far exceed available local resources in each of the next five years.

Potentially adding to the magnitude of the infrastructure problem is the emergence of a new major project in 2019 – a new facility to house the Medical Examiner and Office of Emergency Management as part of a potential new forensic science center on the County Grounds. The budget includes close to $1 million for planning and design, while the five-year capital plan includes $23.8 million for the county's potential share of construction costs in 2020. While that amount is just a placeholder given that a precise financing plan has yet to be developed, it is difficult to see how the county could afford a financing obligation in that range while addressing its other needs and staying within its borrowing limit.

A potential response to this escalating problem would be to ignore or modify the borrowing limits, which result from county policy, as opposed to state law. The downside is that if policymakers were to substantially exceed the limits over a prolonged period, then annual debt service costs likely would grow to the point that they would threaten other county services. In addition, the county currently lacks the staff capacity to administer and implement a vastly increased portfolio of infrastructure projects, and it would take some time to build that capacity even if county leaders did choose to substantially increase annual borrowing.

Nevertheless, given the magnitude of this problem, it would appear necessary to weigh the downsides of increased borrowing against the realities of what it would cost to finance a capital program that truly addresses the county's fundamental infrastructure needs. The current approach only considers what is affordable within the confines of the limits. In doing so, it fails to acknowledge that delaying projects does not make them go away, unless they are truly not needed or involve assets that can be liquidated. Development of a capital plan that more realistically addresses the totality of the county's needs and the cost of addressing them is long overdue, and would better equip county leaders to consider the efficacy of the existing limits.

KEY #5: THE COUNTY'S LONG-TERM PICTURE REMAINS CLOUDY

As we have emphasized throughout this report, the challenges associated with the 2019 recommended budget may be relatively mild, but most of the county's longstanding structural issues have simply eased for one year and are likely to re-emerge. So how bad *is* the longer-term prognosis?

The comptroller's latest five-year forecast projection cites an average annual structural deficit of $12.8 million, based on projections of 2.3% annual expenditure growth versus 0.9% anticipated revenue growth. Considering that the total budget is $1.2 billion and that the property and sales tax generate a combined $373 million in local discretionary resources, that would not appear to be an insurmountable problem.

However, it also must be recognized that the county has been cutting departmental expenditures to address such gaps for more than a decade, and that its ability to boost local revenue to fill a hole of any size is highly constrained by state levy limits and its lack of alternative state-authorized options.

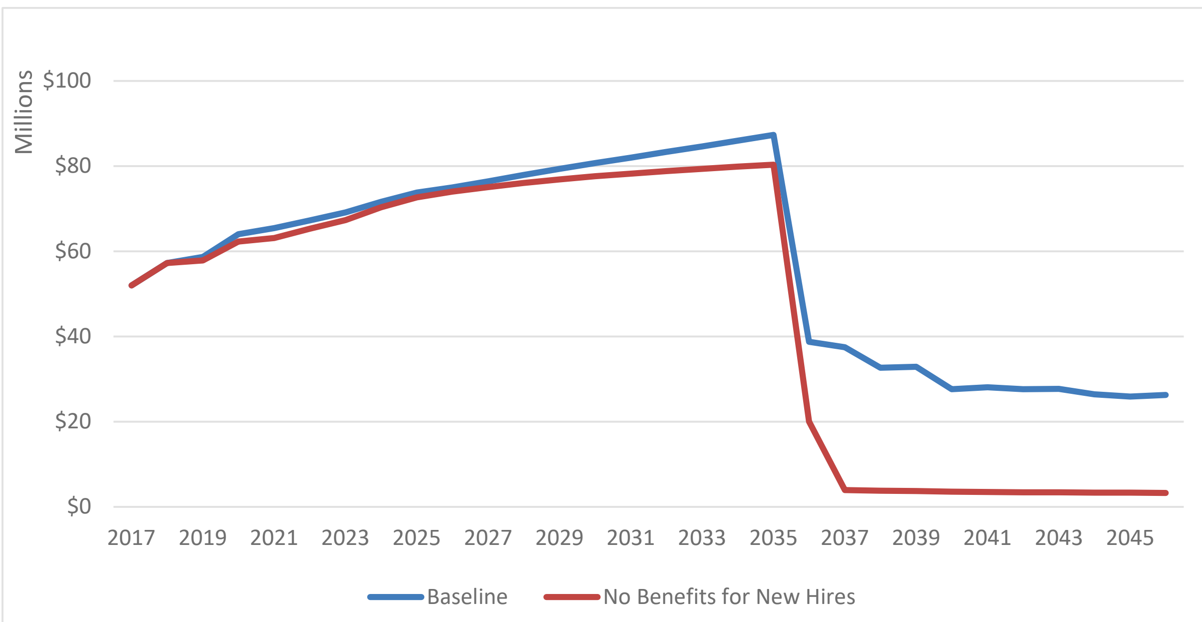
Furthermore, for 2020, add-ons to the base deficit already have been identified. Those include a $6.6 million increase in the pension contribution resulting from a decrease in the investment earnings assumption from 7.75% to 7.5%; presumed elimination of the $3.9 million DSR withdrawal; and $1.5 million in increased courts costs caused by higher outside attorney fees pursuant to a change in state law. Consequently, the early estimate of next year's gap is $22.5 million.

On a longer-term basis, the severity of the county's challenges likely will be determined by the two major issues that have driven its fiscal fortunes for years.

- **Pensions.** The increase in the employer pension contribution from near zero in 2000 to $67 million in 2011 posed huge fiscal challenges. However, since that time, the ability to collect contributions from employees ($12.8 million in 2019) and relatively strong pension fund investment returns have kept annual increases in the $2 to $4 million range, except for those years in which the county has modified actuarial assumptions to reduce long-term risk.

  Unfortunately, even increases in that range will be difficult to accommodate given the county's stagnant revenue streams. Even worse, there is no end in sight to such annual increases, even if investment return assumptions are met. In fact, as shown in **Chart 10**, prepared by researchers from The Pew Charitable Trusts for the county's Retirement Sustainability Taskforce, even if the county *stopped* offering a pension benefit to new employees, the employer contribution would decline only slightly over the next two decades.[10]

  Chart 10: Projected growth in employer pension fund contribution, baseline vs. no benefits for new hires*



  Source: Pew Charitable Trusts' public sector retirement systems project
  *The employer contribution amounts shown in the chart do not include roughly $33 million in pension obligation bond debt service. Also, the substantial drop in the contribution in 2036 reflects an assumption (per the 20-year amortization period) that the unfunded liability would be fully paid off by that time.

[10]This example is illustrative, as the taskforce was clear in its deliberations that an important objective was to offer workers a secure retirement.

Also disconcerting is the extent to which annual budget challenges will be linked to pension fund investment performance. County and retirement system leaders have wisely viewed a period of healthy investment returns as an opportunity to modify actuarial assumptions and practices to better align with national norms and to reduce risk. Yet, even the lower 7.5% investment earnings assumption could be deemed risky given that few expect the bull market to last indefinitely.

For example, Pew researchers estimate that if the pension fund generated an average 5.5% annual investment return over the next decade – which many would deem to be a relatively healthy return rate – then the county's annual employer contribution (not including POB debt service) would surpass $100 million by 2028, as opposed to roughly $75 million if the 7.5% investment return assumption is met.[11]

- **Health care.** As discussed earlier, the county has reaped substantial financial benefits from its efforts to reduce health care expenditures via plan design changes and increased employee contributions. Those savings have been instrumental in allowing it to meet other fiscal challenges in annual budgets since 2012.

  It appears inevitable, however, that health care costs again will begin to increase at the general rate of health care inflation in the region. If, for example, health care costs do again begin to grow by 3% to 5% annually, then that would produce the need for the county to come up with more than $3 million to $5 million annually each year to accommodate those costs.

  An option to offset some of that cost would be to share a portion of any increases with employees by raising premiums and/or co-pays. However, the ability to ask more from employees is limited by escalating numbers of retiring baby boomers and historically low unemployment rates, which make the attraction and retention of talent an important issue for the county.

Overall, the combination of these two deficit drivers – as well as the likely need to eventually begin spending considerably more to confront its deep infrastructure backlog – will place fierce expenditure pressure on the county for years to come. And, as currently constituted, there appears little chance that its revenue structure can accommodate such pressure.

In response, county leaders are launching a new effort to appeal to the state for additional state revenue sharing to meet the county's growing expenditure needs, many of which are associated with state-mandated programs and services. It should be noted, however, that similar calls for greater state support have been made in the past and have been largely ignored.

It remains to be seen how the new effort will be received, but one thing appears very likely: barring significant increases in state aids, county leaders will not be able to dodge difficult decisions on spending and revenues in future budgets as it appears they will be able to do for 2019.

[11] The Pew Charitable Trusts, *Fiscal Assessment: Milwaukee County Employees Retirement System,* https://county.milwaukee.gov/files/county/county-executive/Retirement-Sustainability-Docs/MilwaukeeCountyFiscalAssessmentFINAL.pdf

CONCLUSION

While it may be tempting for county leaders to trumpet the relatively non-controversial 2019 recommended budget as testimony to some newly found fiscal health, the budget document appropriately takes a different tone, asserting that "this budget provides only a temporary stopgap."

Our analysis supports that sentiment. We note that the lack of major service reductions is masked by smaller, across-the-board reductions impacting almost all departments. The capital budget finds room for a handful of big projects, but does little to address a backlog of dozens of smaller needs. Property tax and fee increases are kept to a minimum, but only because of continued use of shrinking reserves.

Even where good news emerges from the surprising ability to reduce health care and pension spending from the previous year, it is tempered by the knowledge that similar good fortune is unlikely to be repeated in the future. A similar state of affairs applies to the transit system, where the opportunity to use unspent federal monies and insurance savings provides some relief, but only for the near term.

That is not to say that progress has not been made. When pension and health care costs do start to rise again, the increases should be far more tolerable than in the previous decade because of commendable actions to control them. The imposition of a $30 VRF – while unpopular with citizens and policymakers – has provided greater revenue diversity and allowed MCTS to reduce its reliance on the property tax. Also, the fact that the county has a relatively well-funded DSR from which to withdraw is a major positive change from a decade ago.

Indeed, there is no question that the magnitude of the county's structural deficit has been reduced. Yet, after several consecutive years of asking departments to absorb their costs to continue, the prospects for avoiding larger service cuts or tax and fee increases in the future appear to be quite limited.

Leaders from both branches of county government deserve credit for acknowledging the severity of their long-term fiscal plight, and for agreeing to work together to solicit relief from Madison. This was particularly important given this year's temporarily mild budget climate, which otherwise may have sent a message to state lawmakers that the county's seemingly overwhelming financial challenges are manageable after all.

Yet, placing all of their hope on increased state aids would be a mistake given the poor track record of similar lobbying efforts in previous years. Moreover, even a return to inflationary increases in major state funding streams is unlikely to be sufficient to allow the county both to address its capital needs *and* to accommodate its fringe benefit pressures.

Overall, it is good news for policymakers and citizens that the 2019 county budget should avoid meaningful service reductions and onerous increases in taxes and fees. This one-year dose of good fortune, however, should not obscure the enormity of the challenges ahead.