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BUDGET BRIEF:

2016 Proposed Budget

Milwaukee Public Schools

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This analysis of MPS' 2016 Proposed Budget refers to the budget recently submitted to the Milwaukee Board of School Directors by the Milwaukee Public Schools Superintendent. The budget covers the school district's 2016 fiscal year, which takes effect on July 1, 2015, and runs through June 30, 2016. Also, it should be noted that while the School Board will adopt a tentative budget later this month and while the fiscal year will begin in July, the budget will be revisited by the Superintendent and Board in the fall after the district receives final aid amounts from the State of Wisconsin.

Introduction

In our 2012 analysis of the Milwaukee Public Schools' (MPS) fiscal condition, the Public Policy Forum cited MPS' overwhelming reliance on state funding – as well as its susceptibility to financial harm from changes in state education policy – and asked "whether any entity could be expected to effectively manage a fiscal predicament as challenging as that faced by MPS in an environment that is plagued with such uncertainty."

It is noteworthy, therefore, that a key story line of the MPS Superintendent's proposed 2016 budget is the district's ability to successfully navigate that uncertainty, at least for the near term. A possible $12 million cut in state aids – and an even larger cut in federal aids – are absorbed without significant impacts on existing staffing levels and services. Indeed, while many other districts around the state have been preparing for possible state revenue reductions and identifying the kinds of programs and expenses they will have to cut in the coming year, MPS has proposed a budget with *new* initiatives and *new* positions.

For example, the budget proposes a 1.6% salary increase for most staff, 39 new school-based positions, increased funding for reading and math interventions and afterschool activities, a new administrative unit for high schools, and a series of smaller program enhancements. While these do not represent the scope of investments that most school officials would desire to improve the district's educational outcomes, they stand in stark contrast to the cuts proposed in many previous budgets.

That is not to say that MPS' revenue challenges are not daunting. Budgeted revenues for school operations decrease by more than $11 million and total revenues by $29 million. Yet, MPS endures these projected revenue reductions – which are likely to be ameliorated somewhat based on recent action by State lawmakers – by managing savings generated in the current fiscal year in a manner that provides sufficient cushion for 2016.

The savings result from the transformation that has occurred in MPS' finances, operations, and personnel over the past five years due to the restructuring of its fringe benefits. The district has reduced annual fringe benefit costs by more than $100 million since 2011, and has reaped additional financial gains from a turnover in staff from older to younger employees. Even going forward, total expenditures are not projected to rise beyond an inflationary amount despite the anticipated resumption of annual health care cost increases.

The relatively tranquil nature of the 2016 budget should not mask the precarious nature of MPS' overall fiscal outlook, and its continued heavy reliance on the State. Indeed, the district's five-year forecast shows that without adjustment to current state-imposed revenue limits and further efforts to trim expenditures, MPS would face a deficit of $114 million in 2020. Hence, the ability of school officials to expand investments in successful programs and enjoy similar ability to cushion state aid cuts in future budgets appears uncertain.

In the pages that follow, we provide more detailed analysis of the major changes in revenue and expenditures in the 2016 proposed budget, and the manner in which MPS has responded to recent challenges. Our objective is to provide an independent assessment of the district's immediate fiscal circumstances – as well as its long-term outlook – that will encourage informed deliberations by policymakers in Milwaukee and Madison.

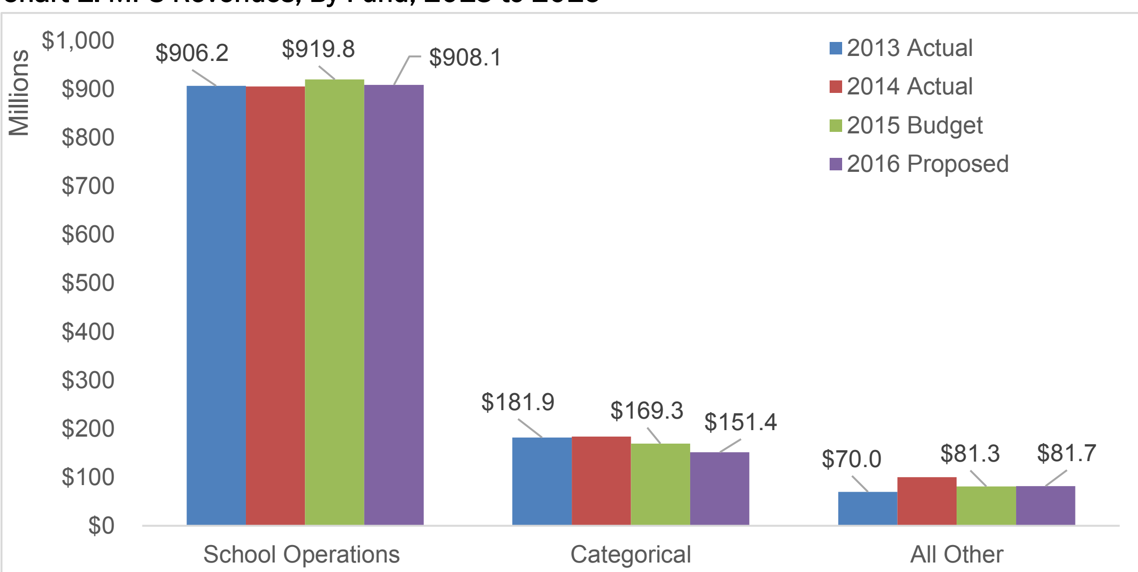
Revenues

Some uncertainty and complexity always is involved in the budgeting of school district revenues in Wisconsin. Indeed, it is an inherent part of the budget process since final state school aid payments are not known until October of the fiscal year to which they are applied. This year, however, that uncertainty is magnified by substantial cuts in state aids proposed by the Governor in his 2015-17 biennial budget. State aid is MPS' largest source of funding, and the outcome of state budget deliberations could impact MPS' 2016 budget by more than $12 million.

At the time the proposed budget was released, there was vast uncertainty regarding the amount of State school aid revenue to include in the budget. The Governor's proposed budget – released in February – included a $116 million reduction in state school aids in 2016. Since that time, the Legislature's Joint Finance Committee has voted to restore a $150 per-pupil allocation to local districts, but the net impact of that and other initiatives adopted by the Committee – as well as future actions to be taken prior to budget adoption – remain unknown. Per standard practice, the proposed budget's revenue projections reflect the Governor's original recommendations.

Overall, the proposed budget allocates $1.1 billion in revenues for 2016, or $29.2 million less than the district budgeted in 2015. **Chart 1** shows how the district's revenue is budgeted across its two major funds – school operations and categorical aid – as well as multi-year trends. The two funds are budgeted to lose significant revenue between 2015 and 2016, with school operations dropping by $11.6 million and categorical aid by $17.9 million.[1] The smaller construction, school nutrition, and extension funds – which we combine in the chart – increase slightly from 2015 to 2016.[2]

Chart 1: MPS Revenues, By Fund, 2013 to 2016



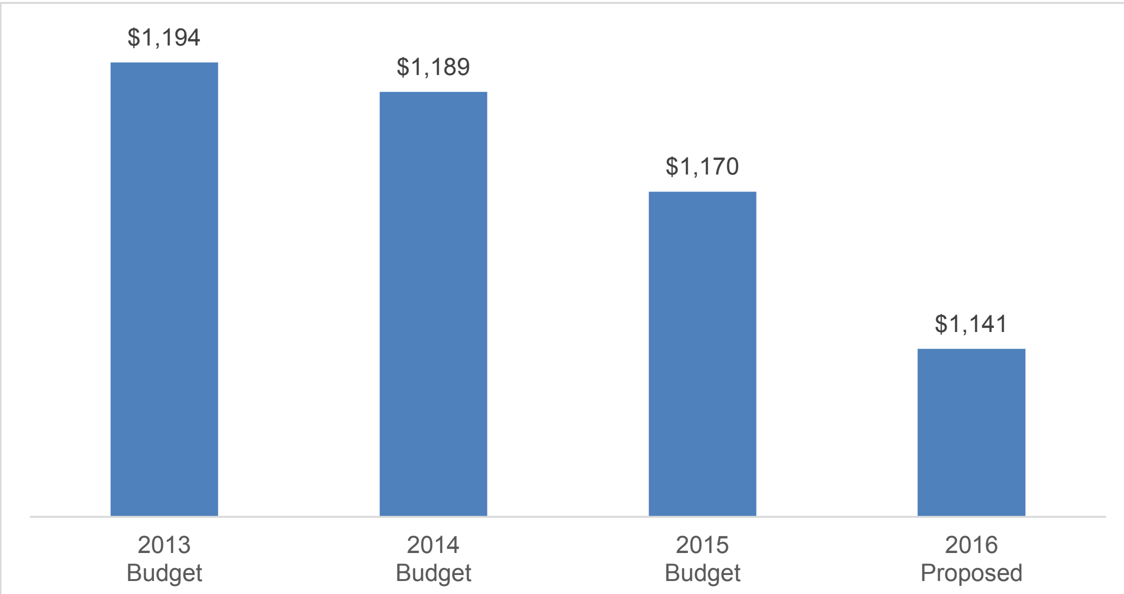
Source: MPS budget documents (this is the source for other charts/tables unless otherwise noted)

[1] Categorical aids are grants targeted specifically for special populations of students (such as those with disabilities or economic disadvantages) or special funding categories (such as class size reduction initiatives).

[2] MPS' extension fund includes adult education, social centers, playgrounds, and fee-based recreation programs for City of Milwaukee residents.

Chart 2 shows how MPS' total *budgeted* revenues have declined since the 2013 budget. We use budgeted revenues in this table to demonstrate the annual challenges faced by MPS officials as they have developed budgets over this timeframe. Budgeted revenues declined by $53.4 million (4.5 %), with the decrease almost entirely attributed to reduced categorical revenues. School operations revenues remained nearly flat during this period.[3]

Chart 2: MPS Total Budgeted Revenues, 2013 to 2016 (in Millions)



The district's revenue decline is larger when accounting for inflation. The Consumer Price Index for all urban consumers rose by 1.6% in 2014. The Congressional Budget Office predicts the CPI will increase by 1.1% in 2015 and 2.2% in 2016. Combining past and predicted rates results in a total increase of nearly 5% for the CPI from 2013 to 2016. If 2013 revenues had increased at that estimated inflationary rate, then MPS would have $37.8 million more in school operations and $63.3 million more in categorical aid in its 2016 budget.

Primary Revenue Funds: School Operations and Categorical

When combined, the school operations and categorical funds account for 93% of MPS' total proposed revenue budget in 2016. Below, we summarize the individual program revenue sources that comprise each of those funds. Revenue changes in individual programs – and the implications of actions by the state and federal governments – are described in greater detail later in this section.

[3] This analysis examines the trend in revenues starting with the year after the passage of Act 10. Act 10's impact on MPS revenues and expenditures in the 2012 budget was so large that including it within the table would obscure the district's more recent revenue changes. MPS expenditures fell by $105 million from 2011 to 2012 as the state reduced school funding while allowing districts the flexibility to attempt to offset lost revenue by reducing employee salaries and benefits (among other strategies) without being subjected to collective bargaining.

School operations

MPS' school and administrative expenses are financed through the school operations fund. As noted above, the other MPS funds have specialized purposes. **Table 1** shows the major school operation program revenues for 2015 and 2016.

No estimate is included in this table for MPS' revenues for state general aid programs or property taxes in 2016, which is consistent with past practice. In July, DPI provides each school district with estimates for state general aid payments. MPS receives four types of general aid from the State: equalization aid, integration aid, poverty aid, and computer aid. Because MPS' property tax levy will be based, in part, on its general state allocations, the district does not estimate property tax revenue until receiving the state aid estimates.

The district does project a combined amount for the four general aid programs and property taxes in the 2016 proposed budget, however. That combined amount is $2.7 million lower than budgeted in 2015 and contributes to the overall $11.6 million decrease in school operations revenue in the proposed budget.

Table 1: School Operations Budgeted Revenue, 2015 to 2016

	2015 Budget	2016 Proposed	Difference	% Change
State				
General equalization aid	$570,713,749	$821,301,821 (est)	*	*
Integration aid	$32,247,348		*	*
Poverty aid	$4,775,065		*	*
Computer aid	$5,962,892		*	*
Charter/Choice deduction	($65,349,248)		*	*
Subtotal	*$548,349,806*		*	*
Handicapped Aids	$52,691,850	$52,691,850	$0	0.0%
Transportation Aid	$2,474,500	$2,474,500	$0	0.0%
Library Aid	$3,521,381	$4,655,565	$1,134,184	32.2%
Bilingual aid	$1,937,800	$1,937,800	$0	0.0%
Tuition from state	$525,120	$525,120	$0	0.0%
State per pupil aid	$12,184,050	$0	($12,184,050)	-100.0%
Other state aid	$50,000	$50,000	$0	0.0%
Subtotal	*$73,384,701*	*$62,334,835*	*($11,049,866)*	*-15.1%*
State Total	**$621,734,507**	*	*	*
Federal				
Fed reimbursement	$2,316,271	$2,316,271	$0	0.0%
Indirect cost aids	$4,900,000	$3,754,768	($1,145,232)	-23.4%
Medicaid Reimbursements	$8,300,000	$8,300,000	$0	0.0%
Other	$50,000	$50,000	$0	0.0%
Federal Total	**$15,566,271**	**$14,421,039**	**($1,145,232)**	**-7.4%**
Local				
Property tax	$275,612,673	*	*	*
Tuition	$2,902,100	$4,600,000	$1,697,900	58.5%
Rental	$2,260,000	$3,776,545	$1,516,545	67.1%
Other	$1,700,000	$1,700,000	$0	0.0%
Local Total	**$282,474,773**	*	*	**-100.0%**
School Operations	**$919,775,551**	**$908,134,231**	**($11,641,320)**	**-1.3%**

* Because the 2015-17 State budget has not yet been finalized, these amounts are unknown at this time. As a "placeholder," the budget projects a total amount for the four state general aid programs and property taxes; that projection reflects a combined reduction of $2,660,667.

Categorical Aid

MPS' second largest fund is comprised of categorical aid. MPS uses the term "categorical" to refer to grant programs. **Table 2** shows how the substantial budgeted reduction in categorical aid noted above is distributed among the various grant programs. About 80% of MPS' grant revenues come from the federal government, and the single largest reduction is in the Title I program, which is targeted by the federal government to districts with large percentages of economically disadvantaged students.

Table 2: Categorical Aid Budgeted Revenue,* 2015 to 2016

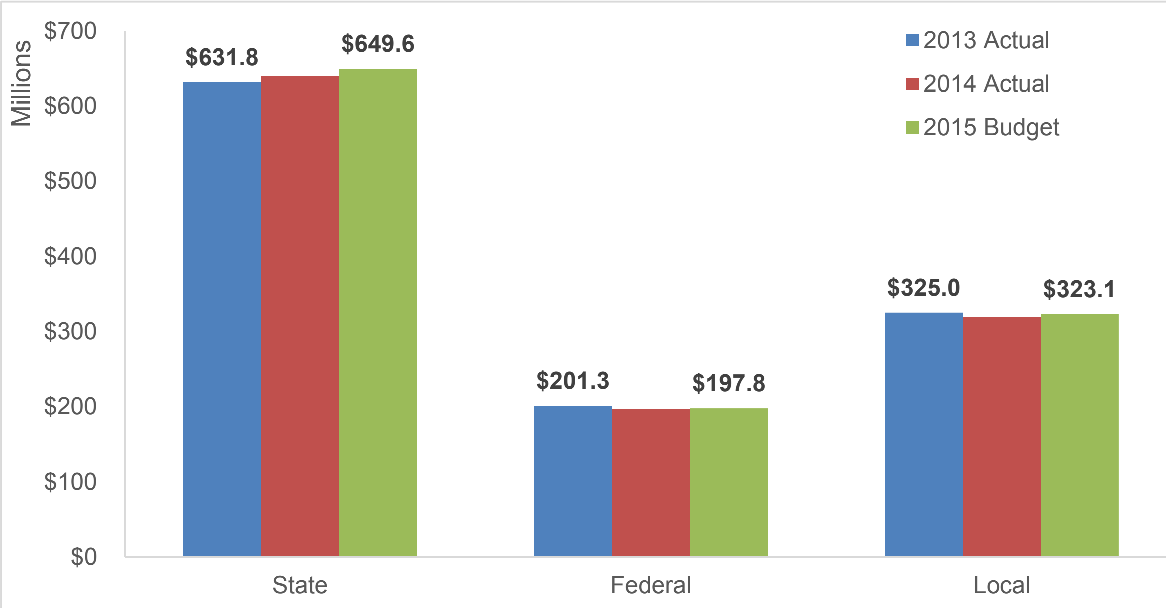
	2015 Budget	2016 Proposed	Difference	% Change
Federal				
Title I	$80,358,608	$68,605,911	($11,752,697)	-14.6%
Title II	$9,762,613	$9,366,125	($396,488)	-4.1%
Title III	$1,123,247	$1,123,247	$0	0.0%
School Improvement Grant	$3,884,312	$2,099,107	($1,785,205)	-46.0%
IDEA	$23,729,228	$24,808,026	$1,078,798	4.5%
Head Start	$8,557,574	$8,281,139	($276,435)	-3.2%
Other	$14,729,442	$10,024,006	($4,705,436)	-31.9%
Federal Total	**$142,145,024**	**$124,307,561**	**($17,837,463)**	**-12.5%**
State				
Student achievement guarantee (SAGE)	$26,047,707	$26,047,707	$0	0.0%
Other	$805,970	$593,105	($212,865)	-26.4%
State Total	**$26,853,677**	**$26,640,812**	**($212,865)**	**-0.8%**
Local (private)			$0	
GE Foundation*	$3,500,000	$3,171,000	($329,000)	-9.4%
Other	$1,540,222	$1,067,590	($472,632)	-30.7%
Local Total	**$5,040,222**	**$4,238,590**	**($801,632)**	**-15.9%**
Total Categorical	**$174,038,923**	**$155,186,963**	**($18,851,960)**	**-10.8%**

* Indirect aid of $4.7 million in 2015 and $3.8 million in 2016 not included

MPS' Revenue Mix from Different Levels of Government

A key to understanding MPS' financial challenges from year to year is the interplay between revenues from the three different levels of government that support the district. For broad context, **Chart 3** shows MPS' mix of state, local, and federal revenues for 2013 through 2015 (the unknown status of state general aids and property tax levy for 2016 prevents us from including that year in the chart). Following the table, we discuss the role of each level of government individually.

Chart 3: MPS State, Federal, and Local Revenues, 2013 to 2015 (in Millions)



State Revenues

MPS is highly dependent upon state funding. The district receives more than half of its overall revenues and about two-thirds of its school operations revenues from the State. The latter are mainly allocated through the state equalization aid formula.

State aid is based on a district's ability to pay as measured by its property wealth per student and its level of eligible expenditures as determined by the State (also known as "shared costs"). Districts with lower equalized value per student receive greater state aid under the formula. MPS ranked 389th in equalized value per pupil and 124th in equalization aid per pupil among Wisconsin's 424 school districts in 2013.

The Governor's proposed biennial budget would reduce general and categorical school aid for elementary/secondary education by $116 million (-2.2%) in 2015-16 but provide a $135 million (2.6%) funding increase in 2016-17. A key component of the 2015-16 reduction is the proposed elimination of a special per-pupil categorical aid allocation (amounting to $127 million) that had been adopted the previous year to provide property tax relief. Those funds – plus an additional $14.9 million – would be restored in the second year of the biennium. The elimination of this allocation in 2015-16 would reduce per-pupil aid by $150 for each school district in Wisconsin, and the increase the following year would increase funding by an estimated $165 to $170 per pupil. For MPS, elimination of the special aid allocation in 2015-16 would result in a $12.2 million revenue loss, as shown earlier in **Table 1**.

As noted above, the Legislature's Joint Finance Committee recently voted to restore the $150 per-pupil allocation, as well as to provide an additional $100 per pupil in the second year of the biennium. However, the net benefit of those actions may be reduced by other legislative actions involving the State's voucher program and other matters, making state aid for 2016 for MPS and other school districts difficult to predict.

Student enrollment also affects a district's receipt of state revenue, as the equalization formula and other types of program assistance are predicated on enrollment. MPS has experienced a nearly 15% decline in enrollment (as defined by the equalization aid formula) in the past decade, which has had fiscal repercussions. MPS estimates that district enrollment for state funding purposes will continue to decline over the next five years.[4]

Two other key sources of state aid and their treatment in the 2016 proposed budget are summarized below.

- **State Categorical Aid.** MPS receives more state categorical aid than most other school districts in Wisconsin. Indeed, categorical aid is the reason that MPS ranked 34th in total state aid per pupil in 2013 while ranking 124th in equalization aid. Most of the district's state categorical aid is from the Student Achievement Guarantee in Education program (SAGE). SAGE offers grants to certain schools that can be used to promote higher academic achievement through strategies that include lower class sizes. MPS receives about one quarter of all SAGE funds distributed statewide. For 2016, SAGE revenues are budgeted to remain unchanged at $26 million. The district's state categorical aid, overall, will decline by $213,000.

- **Chapter 220.** The Governor's budget phases out integration aids for the Chapter 220 program. Beginning in fall 2016, no new students would be admitted to Chapter 220, although students now participating will remain eligible until they graduate or leave their school district. The fiscal implications of this action are complex and not immediately discernible in the 2016 budget. One important factor involves the fact that integration aids are a "first draw" under state school aids. That means that any program funding reductions pertaining to the elimination of Chapter 220 will be redirected to the state equalization formula, and MPS would pick up a portion of this funding reallocation under its own equalization aid.[5]

Local Revenues

Local funds represent the second largest source of revenue in MPS' budget and 27% of all funds. About 94% of local revenue comes from the property tax, of which 90% is allocated to school operations. Property tax revenues also are allocated to the extension fund ($17.1 million in 2016) and the construction fund ($10.6 million).

Because of the district's low property value and higher level of state aid, MPS receives less property tax revenue *per pupil* under the equalization aid formula than most other districts in the state (ranking 349th on this measure in 2013). The district's mill rate (i.e. the amount of property taxes

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[4] MPS' downward enrollment spiral largely is attributed to competition from private and charter schools. Private school enrollment in Milwaukee – stimulated by the Milwaukee Parental Choice Program (MPCP), has climbed from 25,270 students in 2004 to 30,714 students in 2014. The city's independent charter schools also have experienced rapid enrollment growth in the past decade, more than doubling their student count. Those charter schools enrolled 7,969 students in 2014.

[5] As part of the Neighborhood School initiative in 1999, a "hold harmless" provision was established related to the amount of intra-district aid that would be received by MPS, which is generally equal to the greater of: a) the 1998-99 aid amount ($32.9 million); or b) the actual aid entitlement generated under the formula. This hold harmless provision applies until the bonds issued under the initiative are paid off in 2023-24.

levied per $1,000 of home value) far exceeds the state average, however. In fact, the 2014 mill rate of 12.36 ranked MPS 41st in Wisconsin, well above the state average of 10.36.

Under the equalization aid program, combined per-pupil state and local revenues cannot exceed an annual amount set by the State, which is known as the per-pupil "revenue limit." The purpose of this limit is to control annual property tax increases. The limit also affects the ability of local districts to increase their budgets to adjust to revenue changes from other levels of government, as well as expenditure changes. A district's expenditures can exceed its revenue limit only when approved by public referendum.

Under the Governor's 2015-17 budget recommendations, each district's per-pupil revenue limit will remain at the 2014-15 level. MPS' 2015 per-pupil revenue limit is $10,075, slightly above the state average. In recent years, revenue limits generally have shown small increases at about the rate of inflation. For example, MPS' revenue limit increased from $9,800 in 2012 to $9,921 in 2013 and to $10,075 in 2014.

Since the state revenue limit and overall state equalization aid will remain the same in 2016, MPS is unlikely to have any significant change in its property taxes outside of a $1 million increase for the construction fund. Under state regulations, MPS also may increase the levy to offset any additional cost for Milwaukee Parental Choice Program (MPCP) vouchers (also partly funded by the state), but whether or not there will be such an increase is not known at this time.

About $10.1 million of non-property tax revenues support MPS operations. Major changes in local revenues for 2016 include a decrease of $2 million in school meal sales associated with an increase in the number of students receiving federally subsidized school lunches; a transfer of $845,000 from the construction fund to the school operations fund for school repair and maintenance; and a $1.7 million increase in tuition payments under the Open Enrollment program from students from neighboring districts attending MPS schools.

Federal Revenues

Federal revenues comprise 16% of MPS' total funding. These monies primarily consist of categorical grants for disadvantaged students and students from special populations, as well as grants for the subsidized lunch program. The school operations budget receives only about 2% of its revenue from federal aid in the 2016 proposed budget.

Federal revenues represent a greater share of MPS' budget than those of other major local governments, such as Milwaukee County or the City of Milwaukee. MPS also receives more federal funds per pupil than most other school districts in Wisconsin (ranking 5th out of 424 in 2013) and more than most of its peer urban school districts in the U.S. The Forum's 2012 analysis of MPS' fiscal condition (*Passing the Test, But Making the Grade?*) found that the district has a higher level of per-pupil funding than many other districts in Wisconsin (ranking 64th in 2013) largely because of the amount of money it receives through federal categorical aid.

MPS' 2016 budget includes a $16.2 million (8.2%) decline in federal revenue from 2015 and a $19.7 million (9.8%) decline from 2013. Budgetary changes in federal revenue can arise for many reasons, such as the fact that the federal and state governments have separate fiscal years and different rules govern the carryover of funds from one year to the next. While technical explanations account for some of the district's 2016 revenue loss, it also has seen a real decline in federal funding since 2013.

The Title I program, which provides federal funds to local school districts and schools with high percentages of students from low-income families, is MPS' largest source of federal funding. In 2016, MPS' budgeted appropriation for Title I is $68.6 million, which is an $11.8 million reduction from the previous year. This decrease is partially attributed to a change in the district's carryover methodology, but it also reflects a decreasing federal allocation generated by the district's declining enrollment, as well as the fact that an increase in poverty outside the City of Milwaukee has led to a redistribution of Wisconsin's Title I funds.

Given the downward slope of MPS' Title I revenues and the use of these monies to improve student academic achievement, the future funding of this program will merit close attention. Most categorical grants are for a specific purpose and period of time, which means that reductions in revenue from such grants usually are less difficult to manage than revenue shortfalls for general school operations. That is not necessarily the case with regard to Title I, however. A few of MPS' most highly-touted reforms have been funded by Title I, such as the 2015 initiative to put a school support teacher and a parent engagement paraprofessional at each school.

Revenue trends are mixed with regard to other federally-funded programs, with MPS receiving more aid in some programs and less in others. For example, federal funding for the subsidized lunch program will increase by $1.9 million in 2016 because the district is employing a program option that allows schools that predominantly serve low-income children to offer free meals to *all* students, as opposed only to those who submit an application to receive a lunch subsidy.

In contrast, MPS has budgeted $1.8 million less for school improvement grants because of a decrease in the federal appropriation. The district's revenues for this program have plummeted from $23.1 million in 2013 to a budgeted $2.1 million in 2016 as the federal government phases out this program.

MPS also has budgeted a decrease of $1.0 million in 2016 for federal indirect cost aids. This assistance goes to offset the administrative costs of federally funded programs. Since MPS' federal revenues have fallen, so have its administrative aids.

Finally, it should be noted that a change in the budgeting of federal funds will extend MPS' 2016 purchasing power. In recent years, MPS' practice has been to carry over a substantial amount of federal program revenues from one year to the next. However, since the district is now more closely integrating federal categorical programs with school operations, it wants to eliminate this practice starting next year. In this way, the district will have more federal dollars to spend in 2016 and, thereby, lessen the impact of declining federal program allocations at least for one year.

Expenditures

Analyses of governmental budgets typically consider important fiscal characteristics over a period of time. For example, the Public Policy Forum's annual budget briefs compare key revenue streams and major expenditure line items from one year to the next and over a number of years, thus allowing the general reader to understand and anticipate the nature of program actions that a government will be pursuing in it next budget year. This type of analysis also often is used by governments to communicate whether the upcoming year will be a "tough" one characterized by program and expenditure reductions, or a growth budget characterized by new initiatives.

In many respects, the expenditure analysis in this section follows the general approach described above, examining MPS' proposed 2016 expenditures in the context of budgeted 2015 expenditures and actual expenditures in earlier years. However, we supplement this approach with discussion of the reductions in expenditures that MPS already has undertaken in the *current* fiscal year, even though expenditure data for 2015 is not complete.

We conduct our analysis in this way because the district has "carved out" $31 million in cost savings in 2015 from original budgeted amounts, a decline in expenditures that will continue into the coming year. This enables the district to withstand the sharp fall-off in federal and state revenue described above, while at the same time proposing targeted increases, such as for the creation of 42 new positions, a 1.62% salary increase for most staff, and a smattering of new or enhanced programs. If we were to compare only budgeted 2015 expenditures and 2016 expenditures, then it would leave the impression that the district plans to pursue significant expenditure reductions during the coming year, which is not really the case.

As noted previously, budgeted expenditures would fall by $29.2 million in 2016, with a decrease of $11.6 million in school operations and $17.9 million in categorical programs. A portion of the decline in categorical aid results from technical adjustments and not changes in program activity.

Table 3 presents a different perspective on expenditures, showing them by object, as opposed to fund category. As shown, budgeted personnel costs would drop by $7.4 million in the coming year, with about $3.9 million of that amount derived from lower fringe benefit spending. Based on this year's experience, the district might have proposed an even lower level of benefits spending in 2016, but ongoing changes in employee health care utilization (described below), and the fact that the district is self-insured, have necessitated a cautious approach.

By far the largest budgeted expenditure reduction in 2016 ($24.2 million) is in the "Other" category. This decline results from savings the district generated in 2015, which then were applied to outstanding retirement obligations, as will be described in detail below.

Table 3: MPS Expenditures by Object, 2015 and 2016

	2015 Budget	2016 Proposed	Difference	% Change
Salaries/Wages	$519,346,339	$515,915,442	($3,430,897)	-0.7%
Benefits	$267,624,668	$263,686,512	($3,938,156)	-1.5%
Purchased Services	$287,306,665	$290,611,551	$3,304,886	1.2%
Supplies	$62,637,210	$57,763,680	($4,873,530)	-7.8%
Debt	$16,740,546	$20,616,009	$3,875,463	23.2%
Other	$16,756,715	($7,409,483)	($24,166,198)	-144.2%
Total	**$1,170,412,143**	**$1,141,183,711**	**($29,228,432)**	**-2.5%**

Personnel Costs

MPS' ability to substantially decrease expenditures for both its active workforce and retirees has been the primary story line of recent budgets. Pressured by state policy changes and funding cutbacks, as well as rapidly accelerating costs, MPS has instituted substantive, far-reaching changes in its fringe benefit programs in recent years, generating significant cost savings in the process. The largest savings have come from health care and pensions.

In the latter part of the last decade, MPS' fringe benefit expenditures grew at a rate significantly above that of inflation, and health care and pension costs consumed an ever-increasing share of the district's budget. For example, fringe benefit increases consumed two-thirds of the district's total revenue growth from 2007 to 2011, while fringe benefit expenditures as a percentage of salaries rose from 57.7% to 65.4% during that timeframe. Escalating health care costs also pushed the district's unfunded Other Post-Employment Benefits (OPEB) liability to $2.8 billion, a figure exceeding the unfunded pension liabilities of other Milwaukee governments, such as the City of Milwaukee and Milwaukee County.

This situation began to change at the turn of the decade with the adoption of a new four-year teachers' contract. Under this 2010 agreement, the district redesigned its health care plan, hired a new third-party administrator, differentiated premium costs by creating low- and high-cost plan options, and undertook other expenditure reductions.

With the passage of Wisconsin Act 10 in 2011, school districts' fringe benefits were no longer subject to collective bargaining under union contracts. As a result, MPS was able to make additional changes in employee benefits unilaterally, further cutting costs. Actions taken in the aftermath of Act 10 included:

- Restricting benefits for part-time employees by raising the eligibility threshold from 20 to 30 hours a week
- Closing the district's supplemental teacher retirement plan to new employees
- Increasing employee pension contributions to levels required under Act 10
- Increasing the years of service and retirement age needed to qualify for retiree health care benefits
- Restructuring dental and pharmacy plans

The fiscal impact of these changes was immediate and substantial. From 2011 to 2013, annual benefit expenditures dropped from $372 million to $315 million. Remarkably, the district's unfunded OPEB liability was cut in half, plunging from $2.8 billion to $1.4 billion.

The benefit changes also impacted salary and wage costs, an indirect effect caused by the spike in retirements from employees who wanted to secure benefits that were being phased out, such as eligibility for retirement at age 55.

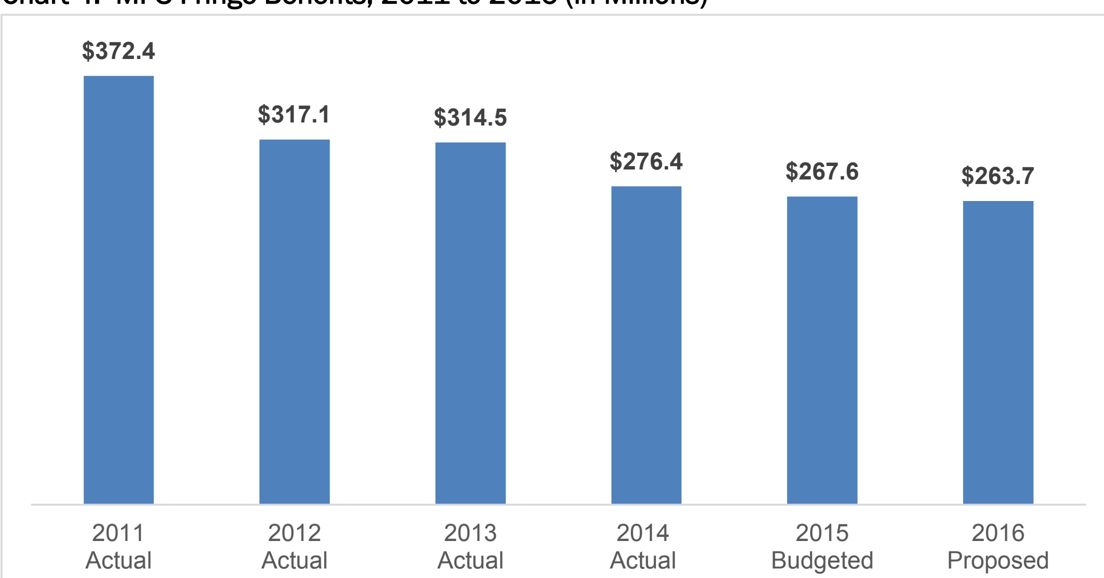
Employee departures reduced personnel costs in two ways. First, in many instances, lower-salaried, less experienced employees have assumed positions previously held by longer-tenured and higher-paid staff. Second, the district has delayed filling some vacated positions. (Of course, the volume of turnover, the loss of senior staff, and the influx of large numbers of beginning teachers present their own set of operational challenges.)

The magnitude of MPS' staff turnover is striking. From 2011 to 2015, 5,498 staff left or retired from the district, while 5,243 new staff were hired.

When MPS officials developed the 2015 budget at this time last year, they anticipated that the precipitous decline in benefit expenditures would end in 2015, and that those costs would rise again by 5% to 6% in 2016. Now, the district has budgeted another decrease in expenditures for 2016, the fifth year in a row that fringe benefits costs would fall. The district's changed expectations reflect actual fringe benefit cost behavior in 2015.

Chart 4 shows expenditures for each fringe benefit category from 2011 to the proposed 2016 budget. Comparing budgeted expenditures for 2016 to actual expenditures for 2011 somewhat underestimates the actual decline from a budgetary standpoint, as actual expenditures in recent years have not reached budgeted levels. Regardless, the savings are extraordinary, with employee medical insurance costs decreasing by $53 million (34%) and pension costs by $31 million (35%). Total fringe benefit costs are down $109 million over this period of time.

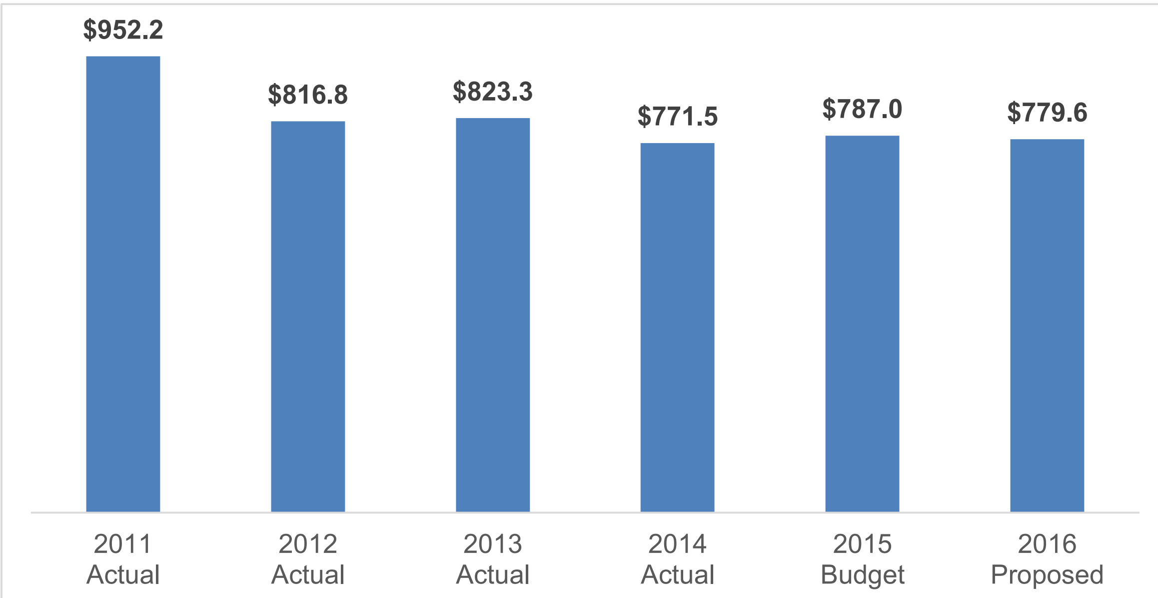
Chart 4: MPS Fringe Benefits, 2011 to 2016 (in Millions)



Source: MPS Office of Finance

Chart 5 provides a more comprehensive look at MPS' personnel-related costs by showing the expenditure trend from 2011 to 2016 for *all* district personnel costs (i.e. combined fringe benefit and salary expenditures). Here, we are able to see the substantial decline in total annual personnel costs over this timeframe, which declined by more than $172 million.

Chart 5: Total Personnel Costs, 2011 to 2016 (in Millions)



We also see that since 2013, total personnel costs fell by more than $43 million, which means that the cost reduction since that time was generated entirely by the cost savings in fringe benefits (though on the salary side, inflationary increases undoubtedly were curbed by the replacement of long-time staff with new employees, as described above). If 2013 personnel costs had risen by 4.9% – the past/projected rate of inflation from 2013 to 2016 – then the district's total personnel expenditures would have amounted to $85 million more than is budgeted in 2016.

As noted at the beginning of this section, MPS' ability to reduce overall expenditures by more than $29 million in 2016 while avoiding substantive service-level impacts is attributed not only to actions proposed in the 2016 budget, but also to personnel-related actions and savings realized in 2015.

MPS estimates that it will generate $31 million in personnel savings from original 2015 budgeted amounts during the course of the fiscal year. The district plans to allocate these freed-up monies toward the retirement of pension debt ($13.2 million) and the unfunded OPEB liability ($17.4 million). State rules governing equalization aid discourage the carrying over of funds since the amount of the carryover is deducted from the next year's revenue limit, thereby lowering future state aid payments. This largely explains why MPS is using the savings to pay off debt obligations.

The 2015 personnel savings are derived from a variety of factors. Among the contributors are lower-than-budgeted actual fringe benefits and salary costs; position vacancies; and expenditure reductions pursued by MPS after the Governor introduced his 2015-17 proposed state budget and revealed the potential for state funding reductions.

Further cost reductions will occur in the coming year through continued decline in average salary and fringe benefit costs. In 2015, the average teacher's salary and benefits were budgeted at $59,600 and $34,508, respectively; in 2016, those amounts are expected to drop to $59,320 and $31,677. This amounts to a total reduction in personnel costs of $3,111 per teacher. The decline in personnel costs has continued for a longer timeframe than expected because of the influx of junior (and often single) staff with lower health care premiums and expenditures.

District finance officials also report that a decrease in employee health care utilization has curtailed cost increases. This change in behavior reportedly is caused by lack of familiarity with new provisions of the district's health care plan, such as deductibles and co-pay requirements. Consultants advise that health care utilization soon will reverse course as employees become more comfortable with the plan.

2016 Expenditure and Program Initiatives

MPS will undertake a number of initiatives in 2016 that involve increased expenditures, despite the fiscal constraints posed by its revenue challenges. The most prominent of those initiatives are described below.

- **1.62% salary increase** – The district's salary increase applies to most staff and is aligned with the State's annual bargaining limits and subject to negotiation with the district's bargaining units. Many administrative staff have had no salary increase in six years, while other units have seen increases totaling 3, 4, and 6% over this time period. For competitive reasons, many units have hired new employees at salaries that are similar to, or greater than, those of existing staff. The proposed increase will address some of the resulting salary inequities. The district will pursue a salary distribution method that includes "an adjustment to the salary ranges and distribution of individual raises based on position within the employee's salary range".

  The cost of the 1.62% salary increase is $10 million, which is comprised of $8.3 million for salary increases and $1.7 million for those benefits that vary with salary, such as Social Security and pension costs.

- **42 new positions** – The proposed 2016 budget includes $2.9 million in additional funding for 42 new positions (salaries and benefits combined), including 39 school-based positions. **Table 4** shows the position changes by major employee category from 2015 to 2016.

Table 4: MPS Positions, All Funds

Type	2015 Budget	2016 Proposed	Difference*	% Change
Certified school administrators	239	236	-3	-1.3%
Principals & assistant principals	241	249	8	3.3%
Teachers	4,971	4,986	14	0.3%
Licensed support professionals**	355	351	-4	-1.2%
School nurses	67	67	0	0.0%
School aides	1,166	1,172	6	0.5%
Classified technical & administrative	323	337	14	4.3%
Trades & clerical	570	571	1	0.3%
Aides	554	561	7	1.3%
Building	612	611	-1	-0.2%
Food service	463	463	0	0.0%
Total	**9,562**	**9,604**	**42**	**0.4%**

* May not add up due to rounding
** Includes social workers, therapists, and psychologists

- **School and instructional support programs** – The district's budget features five program initiatives:
  - *New high school administrative unit*—MPS' administrative operations and services for school support currently are organized geographically. This initiative would remove responsibility for the administration of high schools from the existing regions and create a separate high school administrative entity. The new unit would develop strategies and services that meet the needs of the district's high schools. The 2016 budget adds $570,000 for a regional superintendent and two directors of school support.
  - *Part-time reading and math instructors*—MPS reports that while the academic achievement gap is closing in some schools, "the changes are not happening quickly enough nor impacting enough students." Under this initiative, the district will provide $487,000 for part-time staff in reading and mathematics to assist classroom teachers.
  - *School safety aides*—The budget includes $488,000 to hire 10 additional school safety aides, noting that "school safety is a high priority at MPS".
  - *Afterschool activity*—The budget provides $300,000 for transportation costs to provide greater student access to after-school clubs, associations, and organizations.
  - *Student attendance*—The district will undertake a series of initiatives to support improved school attendance. The effort will focus on select schools and employ part-time staff. This program is still under development and no cost estimate is currently available.

- **Strategic planning** – While not a 2016 budget initiative, MPS has initiated an ambitious strategic planning process that has substantial budgetary implications. The planning is organized around “eight big ideas” for improving student outcomes and a “regional development plan” for increasing the number of high-performing schools. The MPS board has encouraged staff to integrate the strategic plan into the budget process, and this past year the district began a fiscal review with that in mind.

  MPS has sponsored school and budget “carousels” to “identify challenges, current capacity to address those challenges, and school and department resource needs”. To date, MPS officials have held a total of 131 school budget carousels, as well as 26 department/division budget carousels and about 450 people have participated. The district reports that the purpose of these carousels has been to “repurpose existing roles and activities” and develop “recommendations for infrastructure changes”. Contemporaneously with these budget deliberations, MPS’ administration has begun restructuring offices and aligning individual job titles within Central Services.

Five-Year Budget Projection

In recent years, MPS has struggled mightily with the chronic fiscal dilemma of how to bring the budget into balance when costs are growing faster than revenues. The severity of these budget difficulties had prompted some to wonder whether the district could maintain the size and scope of its operations, or whether instead it would need to implement dramatic cuts or even comprehensive restructuring.

The remarkable reduction of personnel costs, described previously, has now brought long-term revenues and expenditures into greater balance and lessened the urgency of this issue. Whether and for how long revenues and expenditures can remain in sync remains an unanswered question, however. This precarious circumstance is based not only on the uncertainty of key state and federal revenue streams, but also the concern that key strategies used to hold expenditures in check – including keeping positions vacant, restructuring health care benefits, and replacing veteran staff with new employees at the low end of pay ranges – may not be sustainable over the long term.

Accurate long-term budget projections for school operations are notoriously difficult to achieve because of the uncertainties involved and the number of pieces in play. The difficulties inherent in fiscal forecasting are magnified in MPS' case because several of the major forces driving its revenues (e.g. state aid and the state revenue limit) and its expenditures (e.g. general health care inflation) are beyond the district's control.

Table 5 presents MPS' five-year forecast for school operations expenditures. The overall increase in projected expenditures is $88 million (9.5%), which amounts to an average annual expenditure increase of 1.85%. The estimate takes into consideration staffing efficiencies that will result from projected enrollment decreases.

Table 5: Five-Year Projection, School Operation Expenditures (in Millions)

	2015 Budget	2016 Proposed	2020 Projected	5-Year Difference	5-Year % Change
Salaries/other wages	$425.1	$422.6	$441.1	$16.0	3.8%
Benefits	$211.2	$212.5	$253.6	$42.4	20.1%
Purchased Services	$222.6	$235.4	$241.1	$18.5	8.3%
Supplies	$29.3	$26.3	$28.0	($1.3)	-4.4%
Debt Service	$16.7	$20.6	$26.7	$10.0	59.9%
Other	$20.1	$21.4	$22.6	$2.5	12.4%
Total Expenditures	**$925.0**	**$938.8**	**$1,013.1**	**$88.1**	**9.5%**

The district projects that benefit costs will rise by $42 million, which is almost one half of projected total expenditure growth. This five-year projection assumes that MPS health care costs will return to their historic pattern and grow substantially faster than the rate of inflation, at 4 to 5%. This anticipated increase is based on a projected 7% rise in health care costs and a rebound in employee and retiree medical care utilization rates starting in 2017.

The district's projected annual expenditure growth of 1.85% is about equal to recent rates of inflation. The Financial Trend Monitoring System of the International City/County Managers Association (ICMA), which the Public Policy Forum has used in previous local government financial analyses, says that long-term expenditure growth at the rate of inflation is a sign of fiscal health. Recent experience indicates, however, that MPS' future revenue growth may not equal even inflationary growth in expenditures.

MPS has taken a cautious approach in its revenue forecast and is estimating that school operations revenues will drop by $21 million from 2015 to 2020. This projection assumes that MPS' enrollment will fall by 556 students per year and that the state revenue limit will not increase at all over this period. It also assumes there will be a $12 million cut in state per-pupil aid in 2016 (an estimate that now appears conservative estimate given recent action by the Joint Finance Committee). Under those assumptions, MPS is left with a $114 million hole in its budget in the last year of the five-year forecast.

Projecting MPS' revenues is difficult, in part, because of the complexities involved in calculating enrollment under the state funding formulas. However, under an assumption that enrollment decreases occur as MPS projects and the state revenue limit allows for a $100 per-pupil increase from 2017 through 2020 — not an unreasonable assumption since recent increases in the revenue limit have been greater — MPS would receive roughly $40 million more a year in 2020 for school operations. That amount, in turn, would cover nearly 40% of the deficit the district now forecasts for that year.

MPS reports that it is now "pursuing options and alternatives to increase enrollment and contain cost, which will help MPS avoid the projected deficits if we otherwise maintain our status quo."

Conclusion

Placing the MPS 2016 proposed budget in a broad and futuristic context brings into focus two key issues. First, there is the matter of whether revenues and expenditures can be aligned over the long term to achieve structural balance; and second, there is the question of whether MPS' budget challenges may preclude its realistic ability to achieve its strategic planning goals and improve its academic and programmatic outcomes.

Since 2011, MPS has generated $109 million in savings in fringe benefits. The restructuring of fringe benefits also has had an enormous and positive impact on the district's salary expenditures, as junior, lower-salaried employees have replaced more experienced, higher-paid staff.

These two areas of personnel-related savings have had far-reaching consequences for MPS' 2015 and 2016 budgets. Remarkably, the district has been able to reduce expenditures in 2015 by a large enough amount ($31 million) that it would be able to withstand a potential $12 million cut in state per-pupil aid in 2016 and still have money to expand operations. Moreover, the district has proposed a salary increase of 1.62 % that will address some of the salary equities that arose during the six years it had foregone increases for many staff members to balance its budget.

Looking forward, MPS projects a possible $114 million budget deficit by 2020. This is a cautious estimate that assumes no increase in the revenue limit over the next five years, as well as the elimination of $12 million in state per-pupil aid in 2016. On the expenditure side, MPS estimates that nearly half of its cost increases ($42 million) will be for fringe benefits.

This long-term forecast shows that MPS' structural budget problems are far from resolved. Nevertheless, it is important to note that in contrast to a decade ago, it is hard to say the district has an expenditure problem. Indeed, overall expenditures are anticipated to rise by 1.85% annually over the next five years and MPS has indicated that it will be considering further savings to lower expenditures if that is necessary.

With regard to educational performance, while several factors play into the ability of a school district to successfully educate its children, it is necessary to ask whether MPS has the financial capacity to move forward to achieve its aims and objectives. MPS' new strategic plan is ambitious. Generally speaking, it sets out to address the social and educational challenges of teaching some of the district's most disadvantaged students, while at the same time broadening the appeal of its schools and programs to a larger swath of Milwaukee families as a means of reversing enrollment losses.

If the question is "Does MPS have the financial resources to fully implement its new strategic plan," then our analysis indicates that the answer is "No." If, however, the question is whether MPS has the resources to begin to implement this plan and build incrementally upon it, then the answer may be more positive.

For example, in its 2016 budget, the district reiterates its commitment to sustain recent funding increases for arts, music, and physical education programs and, at the same time, allocates new funding in 2016 to expand student participation in afterschool clubs, associations, and organizations. Both of these initiatives, MPS believes, will have widespread appeal and buttress its effort to increase the number of high-performing schools in the district.

MPS also reaffirms funding initiated last year for a school support teacher and parent coordinator in every building, and also proposes a variety of new steps to assist the academic achievement of all students, with a particular emphasis on low-performing students. These initiatives include adding part-time staff for supplementary instruction in reading and mathematics, improving school attendance, and creating a high school region.

Overall, MPS' fiscal outlook is far brighter than it has been in the past, and its ability to withstand reductions in state aids greatly enhanced, at least for the short term. But improved stability is one thing, and capacity to invest in needed and desired program initiatives is another. Whether MPS can maintain and achieve both stability and the capacity to make strategic programmatic investments still is questionable, and still is largely contingent upon decision-making at other levels of government.