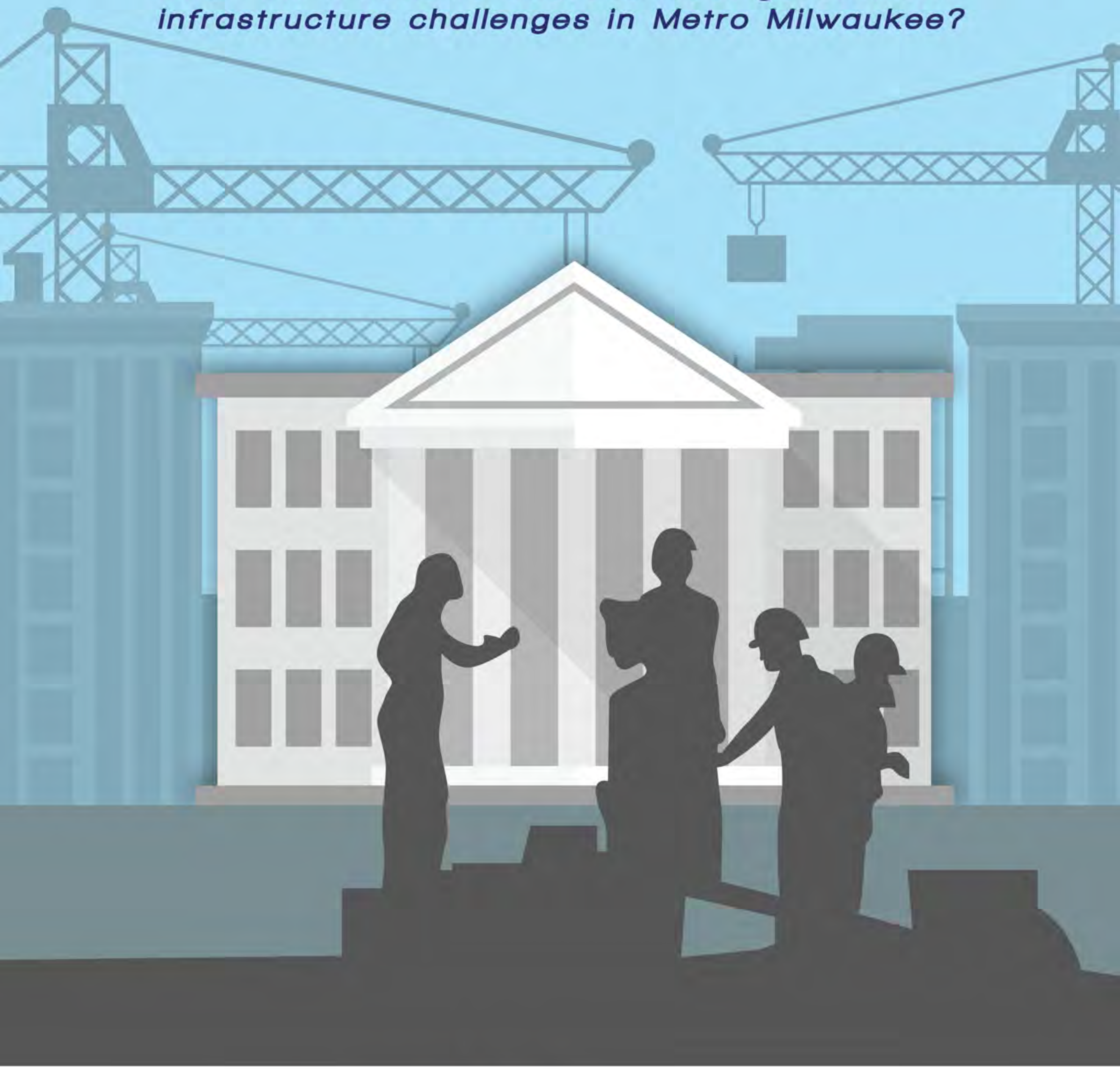
REPORT BRIEF

PICKING UP THE PIECES

What will it take to address local government infrastructure challenges in Metro Milwaukee?



WISCONSIN POLICY FORUM

Over the past three years, the Wisconsin Policy Forum has painstakingly collected and synthesized condition assessment data on hundreds of buildings, roadways, buses, sewer pipes, water mains, cultural assets, and other assorted infrastructure owned by Milwaukee's city and county governments and the Milwaukee Metropolitan Sewerage District (MMSD).

We have analyzed capital financing and debt management policies and practices, and we have considered the pressures on these local governments to balance needs for capital projects and ongoing operations.

As a result of this work (which includes four previous reports), we have arrived at one inescapable conclusion: ***the cost of appropriately maintaining much of the public infrastructure on which Greater Milwaukee's economy and quality of life depend exceeds the financial capacity of local governments to meet it***.

Research findings that lead us to this conclusion include:

- To maintain an appropriate replacement cycle for its 400-plus fleet of buses – a quarter of which were in need of near-term replacement as of 2016 – Milwaukee County should be spending more than $13 million annually in local funds to buy new buses. Doing so would exhaust nearly a third of its annual borrowing capacity.

- Over half (57%) of City of Milwaukee streets were rated in poor or fair condition in 2016. While the city is using a high impact streets repaving program to alleviate issues on some of its most heavily traveled streets, there is still a need for dozens of potential major reconstruction projects within the next 10 to 15 years.

- The Milwaukee Water Works' aging water mains prompted a Public Service Commission directive to increase the pace of replacement to 20 miles of mains per year at an annual cost of more than $20 million. Meanwhile, the need to eventually replace its 76,000 lead service lines may require hundreds of millions of dollars of ratepayer and taxpayer-financed investment over several decades.

- Based on departmental requests, the county should have doubled its spending on building-related projects in 2018 (from $12 million to $24 million) and almost quadrupled it to $45 million in 2019. Instead, it only was able to muster $6 million in its 2018 budget and $8 million in 2019. Meanwhile, by 2023, the county needs to find the resources for a new, $300 million criminal courthouse to replace its outdated Safety Building.

- Despite a backlog of projects that demands $39 million of annual capital spending in county parks from 2019-2022, the county's 2019 capital budget appropriates only $1.6 million for that purpose. Reflective of the backlog, 85% of parks parking lots and service yards, 75% of walkways, and 73% of parkways are now projected to need full and costly reconstruction within the next 10 years.

To understand the problem, one first has to understand how capital budgeting works at the city and county. Every year, departments request funds for capital projects based on inspections, data assessments, and evaluation of functional performance. These requests must then be considered and prioritized amid constraints on annual borrowing and on the amount of locally generated resources available for cash financing and debt payments.

For 2019, county policy allowed borrowing of about $44 million for non-airport capital and an $11 million cash match, even though departmental requests exceeded $94 million.

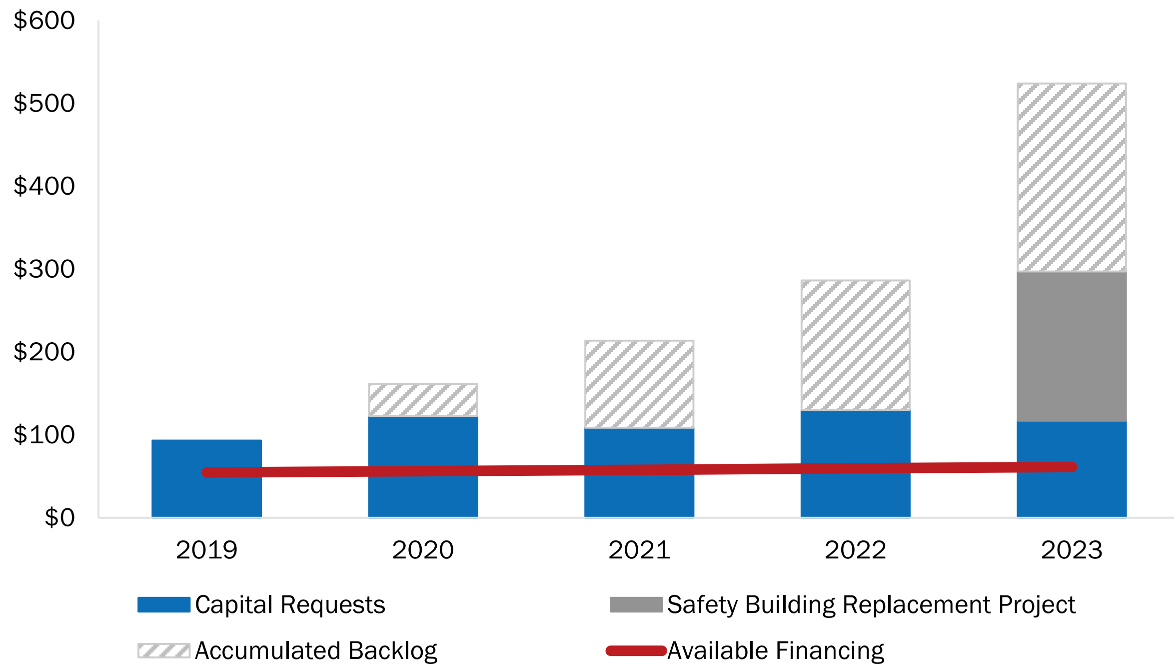
The city, meanwhile, has established a goal of borrowing no more than $78 million in property tax-supported debt, yet its departments requested nearly $124 million in borrowing to support capital needs for this year.

Even MMSD – which we have found to generally be meeting its short- to medium-term infrastructure needs – projects that it may need to increase its property tax levy by 4% annually for the foreseeable future to maintain that status.

As capital requests are denied for lack of funding, the need to address those projects does not go away. Instead, the backlog builds, with seemingly no solution in sight.

The problem is particularly acute for Milwaukee County, as shown in the chart below. The accumulating backlog of capital projects is projected to ***exceed $226 million by 2023***, a figure that does not include the $180 million slated to initiate the Safety Building replacement that year.

Milwaukee County capital requests vs. capital finance capacity, 2019-2023 (in millions)



Source: Milwaukee County 2019 approved capital budget

Now, the question is what to do about this set of daunting challenges. In this, the final report in our infrastructure series, we explore a series of policy options.

NEW FINANCING MECHANISMS

Debt financing is the typical method local governments use to address their capital needs. It provides governments with the up-front funding to complete their projects while spreading the cost to those who will benefit from the infrastructure over the course of many years.

The traditional way of financing capital budgets is through the issuance of property tax levy-backed general obligation (G.O.) bonds. These bonds are less expensive than other sources of capital since they generally are federal tax-free and carry a lower interest rate. An alternative form of publicly-issued debt is revenue bonds. While revenue bonds can be backed by general revenues like sales or property taxes, they are more commonly backed by revenue streams generated by the specific project that is being financed or by user-related fees.

We explored several alternatives to these traditional means of local government capital financing. New **credit assistance tools** include loans, loan guarantees, or lines of credit that may be more financially attractive to a local government than typical G.O. bonding. For example, the Wisconsin Clean Water Fund Program combines federal grants and state funding to offer subsidized loans (and in some cases principal forgiveness) that local governments or utilities can access for wastewater and storm water infrastructure projects. We also examined **alternative forms of bonds**, including green bonds and social impact bonds.

These tools may be useful in allowing local governments to borrow at lower interest rates (in the case of loan funds) or in helping them to remain below statutory debt limits. In addition, some can be used to attract private sector investment in local infrastructure projects. However, their uses are limited and, in Milwaukee County, none currently have the financial capacity to provide a comprehensive solution to either the city's or county's overall infrastructure financing challenges.

NEW FINANCIAL ARRANGEMENTS

New financial arrangements would involve the use of outside partners to support the financing of needed capital projects. This can range from simple project-specific donations from philanthropic entities to much more complicated formal partnerships that involve full private sector financing.

Philanthropic support of public infrastructure needs through donations, grants, and program investment is already widespread in Milwaukee County with regard to cultural institutions and likely will continue as a crucial component of Milwaukee County's capital program for the cultural institutions and parks. Meanwhile, pursuit of **public-private partnerships** (P3s) is an approach that might be used for major projects like a new Milwaukee County justice center or perhaps the renovation or replacement of the Domes.

There is no question that new or expanded financial arrangements will have to be pursued by Milwaukee County (and perhaps the city as well) in light of the magnitude of their capital needs. However, the ability to attract support from private donors typically is limited to large, visible capital projects, as opposed to the hundreds of smaller repair and replacement needs for roofs, HVAC systems, etc., that exist throughout the county and city.

Similarly, P3s would largely be limited to major projects. While this option could spread the costs associated with such projects over a lengthier period of time and create operations and maintenance efficiencies, it may not significantly reduce the overall public sector financial commitment that will be required to pay for the projects over time. Furthermore, a P3 approach may create an even bigger competition with operating budget needs because P3 payments would be subject to state-imposed property tax levy limits in operating budgets.

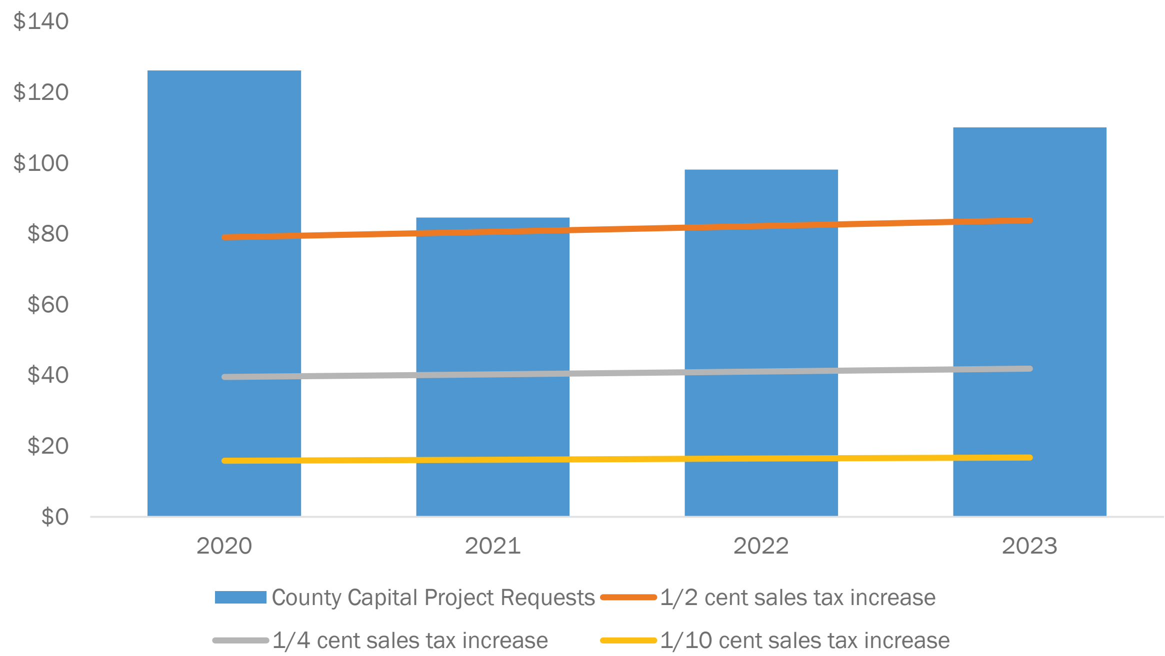
New Funding Sources

Our analysis finds that while new financing mechanisms and arrangements may offer some relief, new sources of funding still are likely to be needed to generate adequate funds to support bond financing and associated cash matches for the two governments' considerable infrastructure challenges.

Precedence would indicate that a **sales tax** is the most logical option. Indeed, when the state of Wisconsin authorized counties to consider a 0.5% (half-cent) local option sales tax in the late 1980s, Milwaukee County leaders responded by adopting the full tax and earmarking the proceeds both for cash financing of capital projects and principal and interest payments on capital debt. A similar strategy could be effective today, though any additional increase in the sales tax by Milwaukee County or its municipalities would require authorization from the state.

An additional 0.5% sales tax in Milwaukee County would generate about $79 million annually. As shown in the chart below, the revenues from such a tax – if allocated entirely to county government – would allow the county to cash finance a significant portion of its list of requested projects from 2020 to 2023 per the current five-year capital plan with the exception of the new justice center, which still would be far too expensive to fit into the county's regular capital plan.

Potential annual revenues from new sales taxes compared to requested county capital projects, 2020-23 (in millions and not including new justice center)



Another option would be to use the new sales tax revenue stream to service the debt on additional bonding. For context, if the county issued $900 million in 15-year G.O. debt at a 3. 5% interest rate, then the annual debt service payments would be about $78 million, which is roughly $1 million less than the 0.5% sales tax would generate annually. Revenues from a 0.25% sales tax could service the debt on a one-time $450 million bond issue, while a 0.1% sales tax could do the same for a $185 million bond issue.

Other considerations surrounding use of a new county sales tax to address local government infrastructure challenges include the following:

- **Should a share of the tax be distributed to municipal governments?** While the infrastructure challenges facing Milwaukee County far exceed those of the city of Milwaukee, policymakers could consider sharing a portion of a potential Milwaukee County infrastructure sales tax with municipalities within the county to help them with their infrastructure needs. Such a move also could broaden the political appeal of such a tax.

- **Should the tax be limited to specific geographic boundaries and/or apply only to specific items within the county?** Instead of considering a general countywide sales tax to support infrastructure needs in Milwaukee County, policymakers could consider variations targeted at the growth of visitor and entertainment spending in Milwaukee's downtown.

- **Should the tax be time-limited, voter-approved, and designated to specific projects?** We found examples of other states that allow local governments to use special, voter-approved sales taxes imposed over a finite period of time to finance the cost of major capital projects or groups of projects. For metro Milwaukee, the notion of time-limited taxes to pay for specific sets of capital projects may be more politically palatable than a general sales tax that would last indefinitely.

The sales tax is not the only alternative to the property tax that could be considered by state and local leaders to finance infrastructure needs in Milwaukee County. Two additional taxation options that are currently used by local governments in Wisconsin and that potentially could be expanded to help address infrastructure needs are the **room tax** and the **wheel tax**. Those options would be likely to generate lesser amounts of revenue than a sales tax but still may be applicable to efforts to create new revenue streams to service capital debt.

TRIMMING THE LIST OF CAPITAL NEEDS

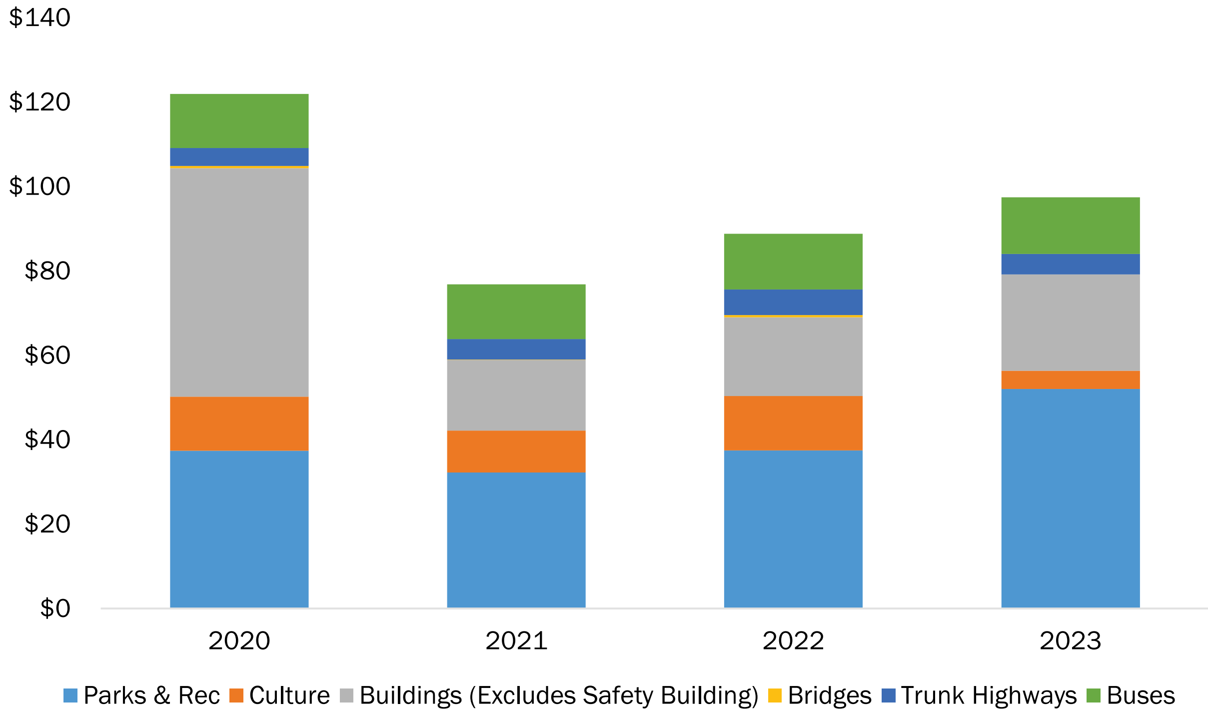
In the end, if new financing mechanisms, financial arrangements, and funding sources are not sufficient or palatable to address the region's capital needs, then policymakers could opt to reduce those needs by liquidating assets or otherwise crossing requested projects off the list. It is important to recognize, however, that the cut lists for both governments could be limited, as certain infrastructure must be retained.

For example, some city street and county trunk highway needs can be deferred for short periods of time but ultimately will have to be initiated if policymakers wish to keep the streets, highways, and bridges open to vehicular traffic. It would be similarly difficult to permanently defer or eliminate most of the building, vehicle, and equipment needs related to core public safety and judicial functions housed by both governments. Meanwhile, the size of the Milwaukee County Transit System bus fleet possibly could be reduced, but only if policymakers are willing to cut routes and reduce service frequency.

The area that would most logically be examined to reduce the list of capital needs is the county's parks, recreation, and culture function. Not only is that one of the few areas of discretionary capital spending for the county, but our research also has found that it is the biggest contributor to the list of requested projects from 2020 through 2023, as shown in the chart on the following page.

The question of which parks and cultural projects to cross off the list is a difficult and subjective one that we cannot answer. Clearly, such discussion would benefit from in-depth analysis of the usage of various parks and recreational amenities and the extent to which there may be overlap in cultural and recreational offerings in certain parts of the county.

Breakdown of requested Milwaukee County capital projects by function, (2020-23)



MODIFYING DEBT POLICIES AND PRACTICES

If local and state policymakers ultimately determine that new funding sources are not palatable and that the list of necessary projects cannot or should not be significantly reduced, then they could consider some less controversial changes to existing G.O. debt policies and practices to potentially fit additional infrastructure projects into current capital programs.

The most obvious modification would be to lengthen the term of G.O. debt from the current 15 years for most G.O. bonds typically issued by the county and city to the statutory limit of 20 years. Limiting bond terms to 15 years ensures debt is rapidly repaid and reduces the amount of total interest paid by taxpayers when compared to lengthier terms. However, this practice also increases *annual* debt service payment amounts for the life of the debt, which reduces the number of projects that can be squeezed into annual capital budgets without exceeding desired caps on debt service payments.

Unfortunately, while extending the life of G.O. debt from 15 to 20 years would provide some annual debt service reductions, the relief may not be substantial. For example, the county would reduce its annual payments only by about $800,000 for a $50 million G.O. bond issue (assuming a 20-year repayment period at a 3.5% interest rate). Meanwhile, total interest costs over the life of the bonds would grow by about $5.3 million.

A more significant benefit could be produced if the county used a lengthier repayment period for a large, one-time G.O. bond issue. Using our earlier example of a $185 million bond issue (the amount that could be supported by a 0.1% sales tax), a 20-year repayment period would create an annual reduction of $3.1 million. If state leaders changed the law to allow 30-year debt, then the annual reduction would grow to $6 million. Again, however, the downside would be significantly higher total interest costs (ranging from $19 million for 20-year debt to $61 million for 30-year debt) as well as potential negative impacts on bond ratings.

OBSERVATIONS AND CONCLUSION

Our review and consideration of potential new financing mechanisms and financing arrangements to address the daunting infrastructure challenges facing Milwaukee County and the city of Milwaukee reveals that several options exist, but also that very few would generate the resources required to comprehensively address the magnitude of the challenge. In fact, a clear takeaway is that a new *funding source* is required to appropriately address the county's (and quite possibly the city's) infrastructure needs.

While our research leads us squarely to that conclusion, the need for new funding should not be used as an excuse to avoid addressing other elements that helped create and perpetuate the problem. For example:

- **Both Milwaukee County and the city of Milwaukee should undertake more comprehensive assessments of their multi-year infrastructure needs and costs.** While both governments engage in basic long-term capital planning, it is too easy for policymakers to defer projects because they are largely unaware of the consequences. Capital planning documents should indicate those projects that *must* occur and the timeframe within which the work must be initiated. Furthermore, multi-year plans should specifically detail the borrowing required for all truly needed projects and the impacts on annual debt service and property tax levies.

- **Milwaukee County leaders must recognize that they cannot afford all of their necessary projects.** The enormity of the county's infrastructure backlog indicates that both new funding *and* liquidation of assets will be required. Previous discussions among county leaders about trimming their inventory of capital assets have been difficult. However, these discussions must be reinvigorated, particularly with regard to assets that do not involve mandated services. Also, when they do take place, these deliberations must be guided by data-driven factors (such as usage and revenue generation) that allow for objective cost-benefit analysis.

- **There must be greater urgency among all local governments in the region to pursue service sharing and consolidation.** While not the subject of our infrastructure series, we have found in numerous other studies that sharing or consolidation in areas like fire and rescue and public safety dispatch can produce a dramatic reduction in equipment and building costs. In fact, our 2015 report reviewing the results of fire department consolidation in Milwaukee County's North Shore found that the seven communities had collectively saved $3.4 million in capital expenditures since the merger occurred 20 years earlier.

The infrastructure problem facing metro Milwaukee's largest local governments has built over several decades. While there are multiple causes, a primary one is that the infrastructure is old, and the need to repair and replace large portions of it comes at a time when local government financial structures no longer are equipped to bear the cost.

Local government officials can continue to shrug their shoulders and take care of as much work as is deemed affordable each year, which will never be enough to keep the list of needed projects from growing. State policymakers can continue to insist that this is a locally created problem that merits a locally derived solution. A better approach, however, would be for leaders from both levels of government to collectively recognize that an effective response is critical to the economic health of the state's largest metro area and work collaboratively to get the job done.