



# 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 Mayor's proposed City of Milwaukee 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 fiscal officials and staff – including the Budget Director and his staff – for their assistance in providing information on the City's finances.

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





# BUDGET BRIEF:

*2020 Proposed City of Milwaukee Budget*

October 2019

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# INTRODUCTION

In our conclusion to last year's city of Milwaukee budget brief, we warned that the "relative tranquility" associated with the 2019 budget was "likely the calm before the storm." Little did we know that the storm would hit so quickly and with such intensity.

The key fiscal challenge for the city in most years is accommodating public safety pay and benefit increases and other costs to continue within the confines of its constrained revenue streams. For 2020, however, that challenge is leapfrogged by the need to prepare for a huge jump in the employer pension contribution. A growing list of requested capital projects and diminishing reserve balances add to the financial stress, making the 2020 budget one of the most difficult in recent years and likely the first in a long string of increasingly difficult budgets.

It is not unusual for the city's pension fund contribution to be a leading story line in the proposed budget, but the problem is more serious this year. With a possible \$87 million increase in the contribution forecast for 2023, the proposed budget starts to adjust now by allocating \$8 million to the pension reserve fund. While fiscally prudent, the move eats up most of the proposed \$9.8 million (3.5%) property tax levy increase (which would be the second largest percentage increase in the past decade), thus requiring most city departments to find ways to absorb cost-to-continue increases without added resources.

Perhaps hardest hit is the Milwaukee Police Department (MPD), which is not surprising given that it consumes nearly half of all general city purposes spending. Yet, here too the consequences are far more serious than in previous years. The proposed budget cuts police officer sworn strength by 60 positions, far exceeding the only other sworn strength reduction in recent memory of 27 positions in 2018.

A number of other concerning fiscal trends continue in 2020 and show little sign of abating. For example, the balance in the Tax Stabilization Fund continues to shrink, thus decreasing capacity for annual withdrawals. Also, the gap between capital project requests and financing capacity is expanding, with roughly \$67 million in capital project requests deferred in the proposed budget.

In the pages that follow, we provide additional detail on these important elements of the 2020 proposed budget, as well as other factors that will influence the city's immediate and longer-term fiscal fortunes. Our intent is to promote more informed discussion and debate as 2020 budget deliberations continue.

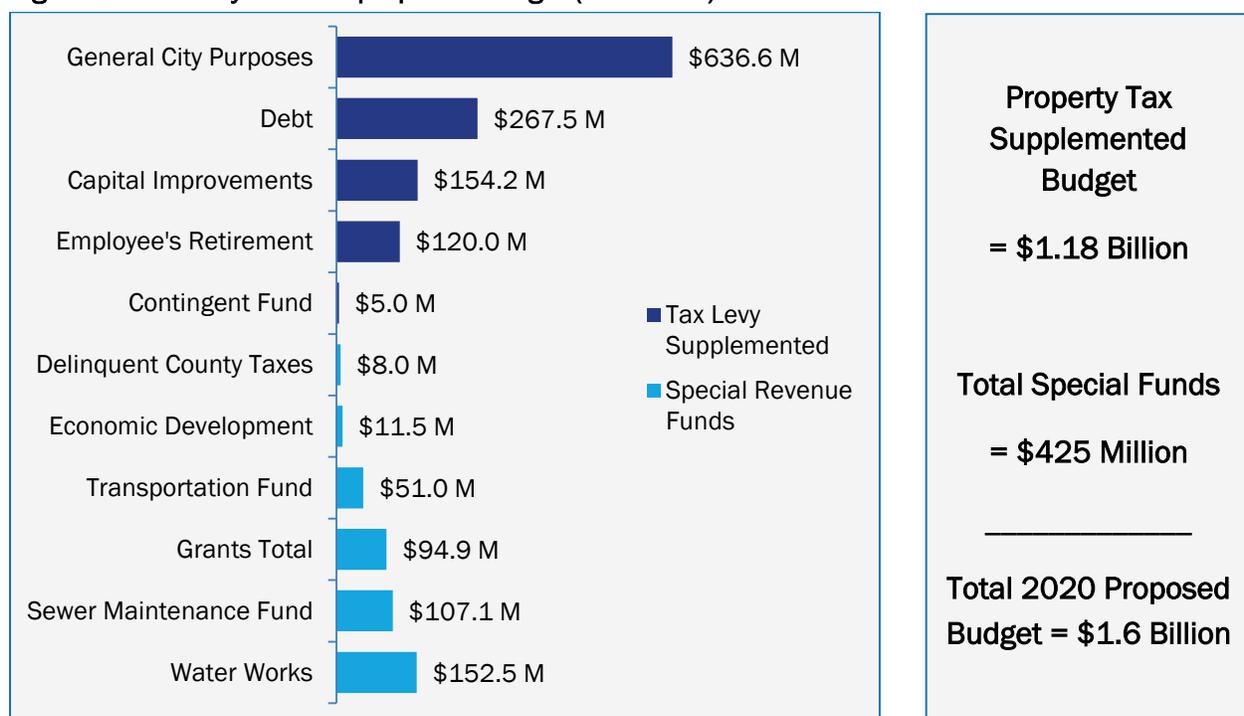


# 2020 PROPOSED BUDGET OVERVIEW

The City of Milwaukee’s 2020 proposed budget totals a little over \$1.6 billion, which is \$68 million higher than the 2019 adopted budget. Most of the 4.4% increase is attributable to special revenue funds, which have dedicated fees or other revenues to support specific functions such as sewer, water, and transportation. For example, the Milwaukee Water Works budget would increase \$16.2 million as the utility’s capital program continues to expand (with a corresponding increase in debt service) to address growing infrastructure needs, including replacement of lead service lines. The overall spending increase also reflects anticipation of a \$50 million grant to offset costs associated with the city’s hosting of the July 2020 Democratic National Convention.<sup>1</sup>

The “property tax supplemented” portion of the budget refers to those components that receive at least partial support from the city’s property tax levy and that generally are controlled by the mayor and the Common Council. As shown in **Figure 1**, that portion totals about \$1.2 billion and represents an increase of \$2.3 million over the 2019 adopted budget.

**Figure 1: Summary of 2020 proposed budget (in millions)**



Source: City of Milwaukee budget documents<sup>2</sup>

<sup>1</sup> Approximately \$2.5 million of the Democratic National Convention grant will support overhead costs related to the convention. The majority of the grant will be spent on one-time activities such as bringing in extra police and fire support, equipment, and overtime for public safety employees. It will also support the purchase of equipment that will be used at the convention and which the city will then keep, such as defibrillators.

<sup>2</sup> Unless otherwise noted, the source for all figures, tables, and charts in this report is city of Milwaukee budget documents.

In this brief, we focus most of our attention on the portions of the budget controlled by the Mayor and Common Council, with particular emphasis placed on the general city purposes budget. That portion of the budget totals a little over \$636.6 million in the 2020 proposed budget.

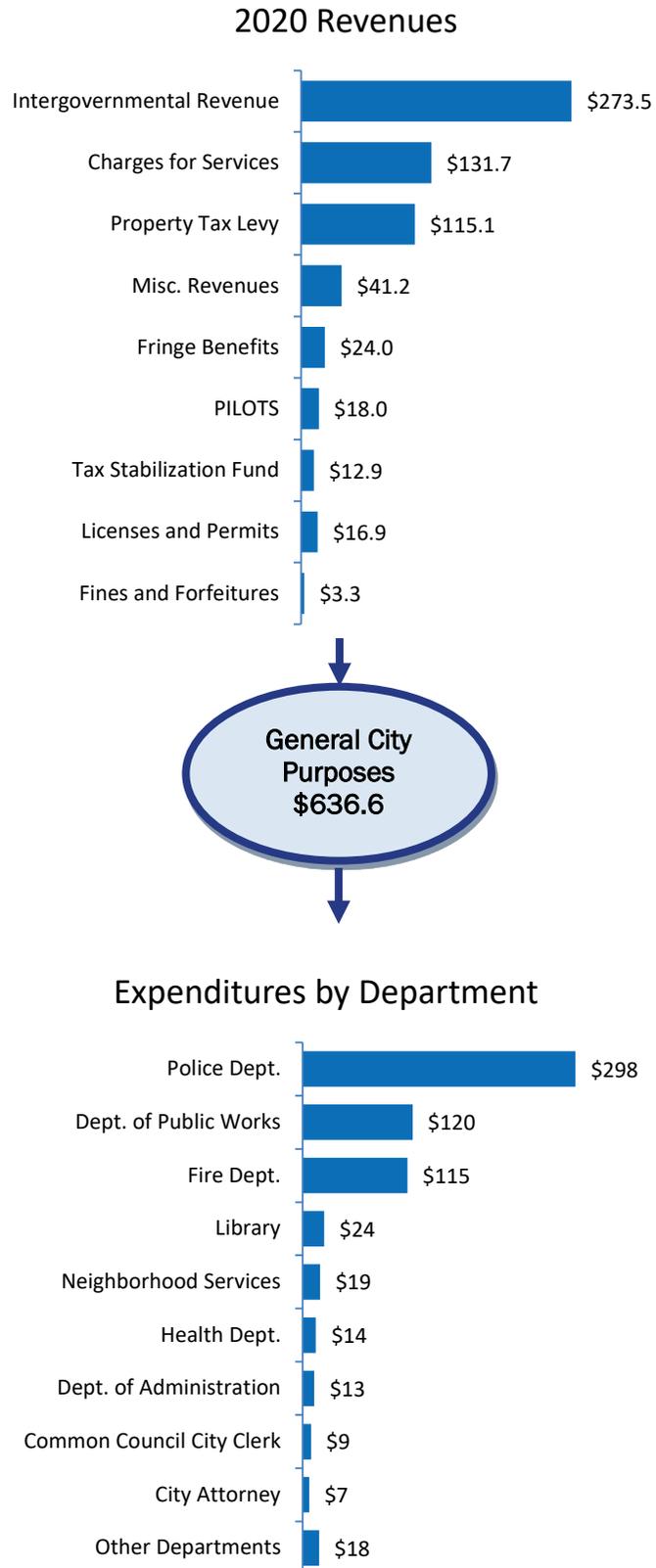
## GENERAL PURPOSE SPENDING

The city's general purpose expenditures support most of the core functions of city government, including police, fire, public works, libraries, neighborhood services, and public health, as shown in **Figure 2**. The \$636.6 million allocated to general city purposes in the 2020 proposed budget is a \$2.5 million (0.4%) increase over the 2019 adopted budget.

Most city departments would see spending reductions, although the fire department would receive a \$2.5 million (2.2%) increase and the library a \$600,000 (2.7%) increase. The Department of Public Works would see the largest decrease, at \$1.4 million (-1.2%), while the police department and neighborhood services budgets would see reductions of \$600,000 and \$500,000, respectively.

The decrease to the police department's budget and its proposed loss of 85 full-time equivalent (FTE) positions (including a reduction in sworn strength of 60 positions) marks a sharp turn from most previous budgets, which have sought to prioritize the maintenance of sworn strength levels. We discuss police staffing in greater detail later in the report. Also, it should be noted that the increase to the fire department budget reflects the need to account for union-

Figure 2: 2020 General City Purposes Budget (in millions)



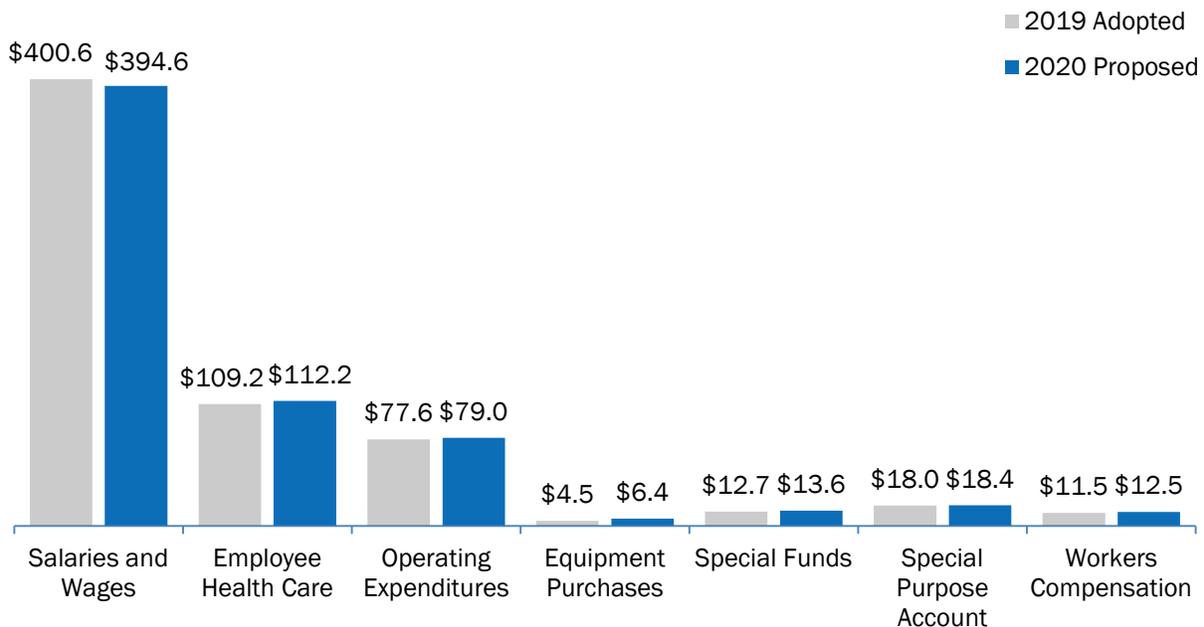
negotiated salary settlements, and not the addition of staff (this also explains why total police spending declines only minimally despite the reduction of 85 FTEs).

Despite the need for many departments to accommodate spending decreases in the 1-2% range, service levels generally would not be impacted in significant ways. The Department of Public Works Operations Division is a notable exception; the proposed budget decreases FTEs by 60 positions, including a reduction of 30 auxiliary operations driver positions and 15 driver positions associated with apartment garbage collection and street sweeping services. Garbage collection for apartments with four or more units will no longer be offered due to the city’s inability to fully recover costs. Also, street sweeping service levels in certain areas will be reduced from twice to once per month.

**Chart 1** breaks down proposed 2020 general city purposes spending by expenditure type and compares 2019 adopted to 2020 proposed amounts. The chart shows that the \$2.5 million increase in 2020 is attributed mainly to minor increases across all non-salary categories of spending, which are mostly offset by a \$6 million decrease in salary costs. Those costs are compressed by a reduction of 82 funded positions city-wide as well as no wage increase for general city workers. Nevertheless, at 62%, salaries and wages are the largest operational cost.

Employee health care is anticipated to increase by approximately \$3 million (2.7%). While the increase is small in the context of typical health care inflation, it comes on the heels of another small (1.9%) increase in 2019 and shows that the city no longer can count on health care savings to offset other cost pressures and replenish reserves, as it did for much of the 2011-2018 time frame.<sup>3</sup>

**Chart 1: General city purposes spending by expenditure type, 2019 adopted vs. 2020 proposed (in millions)**



<sup>3</sup> While health care costs are increasing, department budgets across the board show a reduction in fringe benefits. This is because of lower city-wide FTE levels as well as anticipation of lower claim amounts than occurred in recent years.

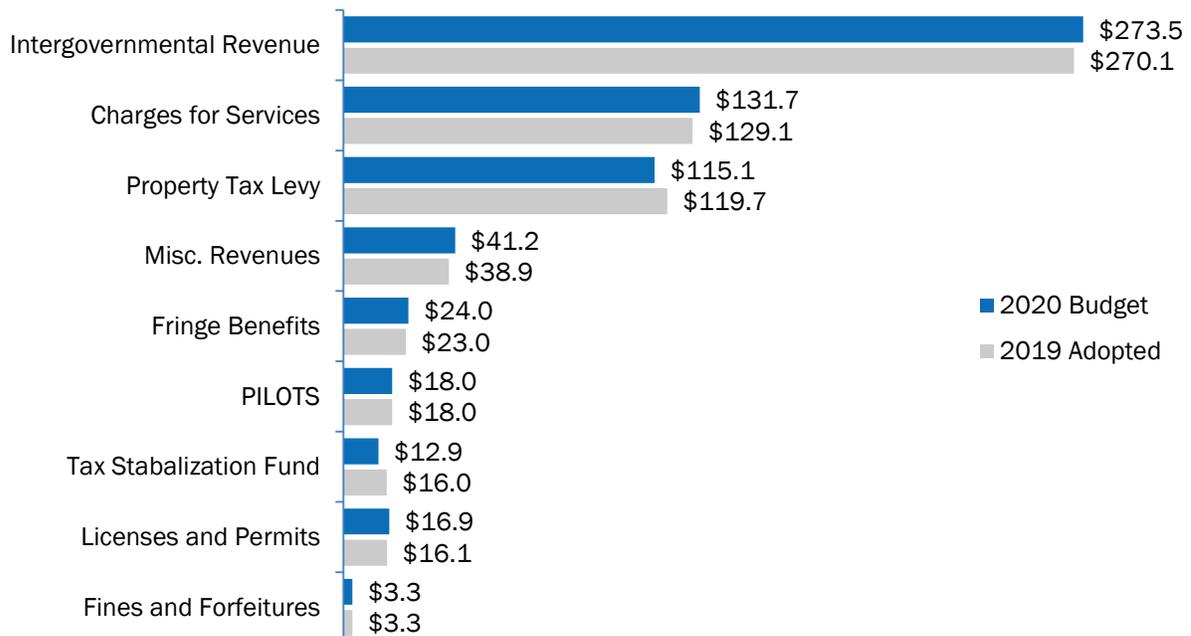


## GENERAL CITY PURPOSE REVENUES

Spending for general city services is supported by three major sources of revenue: intergovernmental revenue, charges for services, and property tax levy. Together, these three revenue streams comprise 82% of proposed general city purpose budget revenues in 2020.

**Chart 2** shows that the amount of property tax revenue allocated to general city purposes decreases by \$4.6 million (-3.9%) in 2020, which is a major story line in the 2020 budget and beyond. The mayor proposes a 3.5% (\$9.8 million) property tax levy increase for city government as a whole, but the increased revenues are needed for pension and debt payments, with the general fund's share requiring a reduction. Small increases in other revenue areas, including a \$3.4 million increase in intergovernmental revenue and \$2.6 million in charges for services, offset the reduced use of property taxes and allow general city purposes to see a small (0.4%) total revenue increase. However, the minimal increase creates challenges for most departments in their efforts to absorb inflationary costs-to-continue.

**Chart 2: Sources of general city purpose revenue, 2019 adopted vs. 2020 proposed (in millions)**



The 1.3% (\$3.4 million) intergovernmental revenue increase shown in **Chart 2** is largely attributed to a \$2.5 million increase in local street aids, a \$331,000 increase to expenditure restraint aid, and \$350,000 in increased payments for municipal services. The city is also receiving a new form of state aid that replaces revenue from certain types of personal property the state exempted from the property tax beginning in 2019. That aid is anticipated to total \$1.4 million in 2020.

Charges for services revenue for general city purposes would increase by \$2.6 million (2.1%). This increase is attributed in part to a 7% increase in the solid waste fee, a 3% increase in the stormwater

fee, and a 3% increase in the snow and ice removal fee, as shown in **Table 1**. Those increases would cost the average residential property owner an additional \$18.84 annually. The 7% proposed increase to the solid waste fee is higher than previous projections of 3-5% annual increases in major service fees. This is largely due to the division’s plan to purchase an additional five refuse packers.

**Table 1: Proposed increases to major service charges**

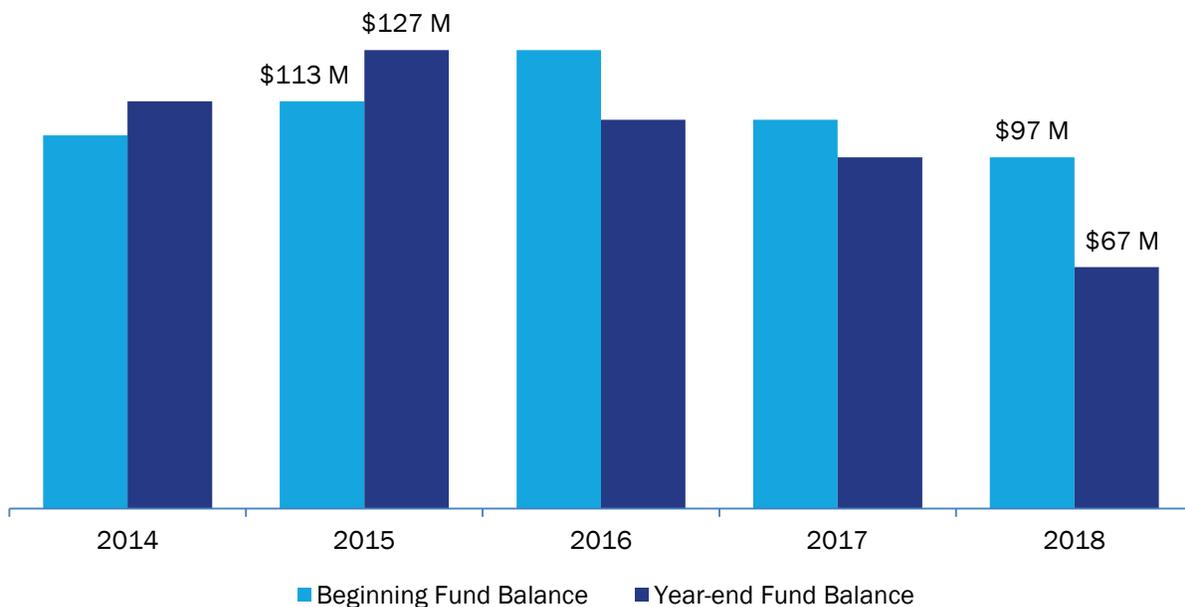
Charge for Service	Rate Increase	Cost Increase for Average Home	Total Average Home Cost
Solid waste fee	7%	\$15.08	\$230.28 per year
Stormwater fee	3%	\$2.56	\$88.20 per year
Snow and ice removal fee	3%	\$1.20	\$41.20 per year

### General fund balance declining

The term “general fund” applies to revenues, expenditures, and changes in balances of general city purpose, pension, and contingent fund budgets. The general fund balance is a running total of the amount of money remaining after all expenditure obligations have been satisfied in a given year. By law, municipal governments must adopt balanced budgets, but actual circumstances result in pluses or minuses in the general fund balance from year to year.

In an ideal world, a government’s fund balance would grow annually – at least up to a point – as it takes in more money than it spends. As shown in **Chart 3**, that was the case in both 2014 and 2015. However, beginning in 2016, the city’s year-end balance (which was quite healthy at that time) began to decline and dropped to a low of \$67 million by the end of 2018.

**Chart 3: Beginning and year-end fund balances for the general fund, 2014-2018 (in millions)**



The city's increasingly slim fiscal margins and declining fund balance have been on the radar of national credit rating agencies for some time. In April 2019, Standard & Poor's downgraded the city's long term rating to A+/Stable and GO rating to AA-(SPUR)/Stable. The accompanying report suggested that a material worsening of budgetary flexibility could further lower the rating, although the outlook is "stable" given the city's strong liquidity and management. Credit ratings play a large role in the interest rates paid on G.O. bonds; higher interest rates can harm the city's ability to address its infrastructure challenges and may exacerbate the shift of property tax levy resources from the general fund to debt service.



# FIVE KEYS TO UNDERSTANDING THE 2019 BUDGET

## KEY #1 - INCREASED PENSION CONTRIBUTION COULD HAVE DEVASTATING BUDGETARY IMPACTS FOR YEARS

The city's annual employer pension fund contribution – which is determined based on actuarial calculations – often has a substantial impact on the difficulty of that year's budget. Heading into 2020, it originally appeared that the need for an increased contribution would be minimal, as the city's stable contribution policy<sup>4</sup> indicated a required \$71 million contribution, which was an increase of only \$1 million over the 2019 amount.<sup>5</sup>

However, earlier this year, the pension board voted to reduce the assumed rate of return for pension fund investments from 8% to a more realistic 7.5%. While the change in the assumption technically takes effect this year, it will not be factored into the required contribution until 2023 per the stable contribution policy, which “re-sets” employer contributions every five years. At that time, however, the employer contribution is anticipated to need to increase by an astounding \$87 million over the 2020 amount to a total of \$158 million.

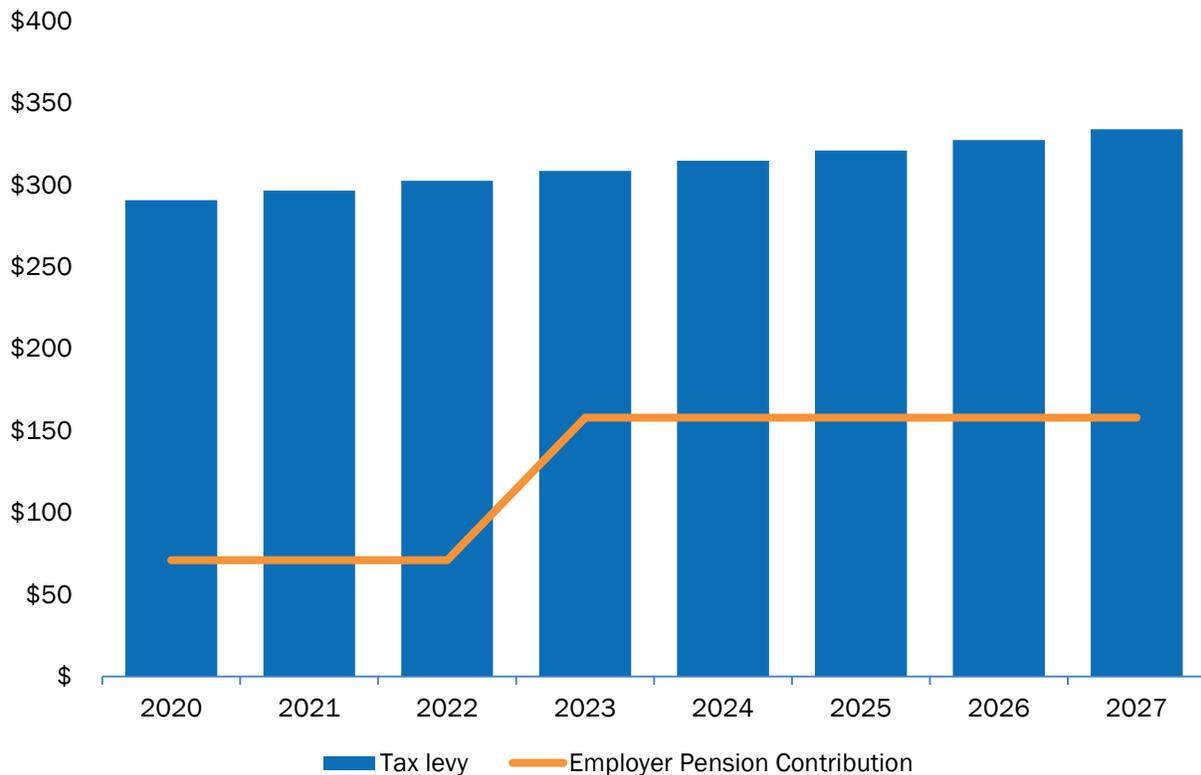
To demonstrate the impact of such a leap, **Chart 4** shows how the growth in the employer contribution would impact the use of city property tax levy, which is assumed to grow at a modest 2% annually for purposes of this illustration. Whereas in 2022 the projected \$71 million employer contribution would comprise about 23% of the \$303 million property tax levy projected for that year, **the \$158 million contribution in 2023 would require use of a whopping 51% of that year's levy.**

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<sup>4</sup> The stable contribution policy estimates the city's anticipated actuarially required employer contributions for a five-year period and “smooths” the amount over the five years to avoid sharp swings in annual contributions. The five-year period was last “re-set” for the 2018 contribution and re-setting will occur again for the 2023 contribution.

<sup>5</sup> The \$70 million contribution in 2019 actually consisted of a \$56.6 million contribution to the pension fund and a \$13.4 million contribution to the pension reserve. This resulted from an actuarial error the previous year that had caused the 2018 contribution to exceed the amount actually required. The reserve contribution was made to avoid sharp swings in the contribution from year to year.

**Chart 4: Pension contributions as a proportion of projected property tax levy, 2020-2027 (in millions)**



Knowing that a pension contribution increase of that magnitude in a single year (2023) would be devastating to that year’s efforts to produce a balanced budget, the mayor and his budget team instead are proposing a strategy that would gradually increase contributions to the pension reserve from 2020 through 2022. This would produce the dual benefit of spreading the “shock” of future higher contributions among each of the intervening budgets; and building the reserve so that the much larger contributions in 2023 and the immediate years beyond could blend both reserve withdrawals and increased levy, thus further smoothing the impact on the levy in those years.

The strategy would be initiated by making an \$8 million contribution to the pension reserve fund in 2020, thus increasing the combined employer and reserve contribution to \$79 million in the proposed budget, or an increase of \$9 million from 2019. The hope is to increase the reserve contribution by an additional \$12 million in both 2021 and 2022.

While this is a prudent strategy to attempt to manage the anticipated fiscal crisis, it is clear that the need for such a vastly increased employer contribution ultimately could cripple the city’s use of property tax levy for general services unless steps are taken to somehow avoid such a steep increase. Options could include measures to adjust employee pension contributions, reduce pension benefits for new employees, modify or eliminate cost of living adjustments for retirees, or re-examine actuarial assumptions or funding policies and practices to seek a more gradual rise in the required contribution.

None of these strategies would be easy to implement or desirable in an ideal world. For example, increased employee contributions and reduced benefits for new employees could negatively impact employee recruitment and retention, while reductions to COLAs for retirees likely would be challenged in court. Also, efforts to apply benefit modifications to public safety employees likely only could be achieved through collective bargaining. Finally, while changes to funding policies and actuarial assumptions might smooth out anticipated increases over a longer period of time, such changes would not alter the city's overall need to pay a great deal more in the future to support its pension fund.

As budget pressures intensify over the next three years, city leaders may be tempted to reject the mayor's proposal to build the pension reserve to begin preparing for the huge increase in 2023 and instead spend the \$8 million elsewhere. Or, over the longer term, they may be tempted to underfund the actuary's recommended contribution. Pursuit of either of those options would be inadvisable, however, particularly given the likelihood that the stock market's recent remarkable run of good fortune eventually will come to an end (thus eroding the value of pension fund investments and requiring even larger employer contributions); and that even the new 7.5% investment return assumption is on the high side when compared to public pension systems nationally.

In sum, **it is difficult to overstate the severity of the challenge posed by the anticipated huge increase in the city's employer pension contribution.** With growth in the city's major revenue sources continuing to hover at or below the rate of inflation, the need to build the pension reserve and then accommodate the surge in the contribution will eat up all likely annual revenue growth and then some. That, in turn, will create the need for significant reductions in general fund spending. In other words, the 2020 proposed 60-officer reduction in police sworn strength – which we discuss in the next key – **could be just the harbinger of several successive years of workforce and service reductions that likely will extend across all of the city's levy-supported functions.**

## **KEY #2 - PRIORITIZATION OF POLICE MAY HAVE RUN ITS COURSE**

As we have discussed in detail in past budget briefs, the police department is by far the largest spending category across city departments. Generally speaking, it also is one of the departments that has been most protected from workforce and budget reductions during difficult budget years. The 2018 budget took a step away from that tradition, with 27 FTEs cut from the sworn officer force. Ten of those officers were replaced in 2019, however, as MPD received \$5.9 million of the \$11.1 million general city purposes revenue increase budgeted for that year.

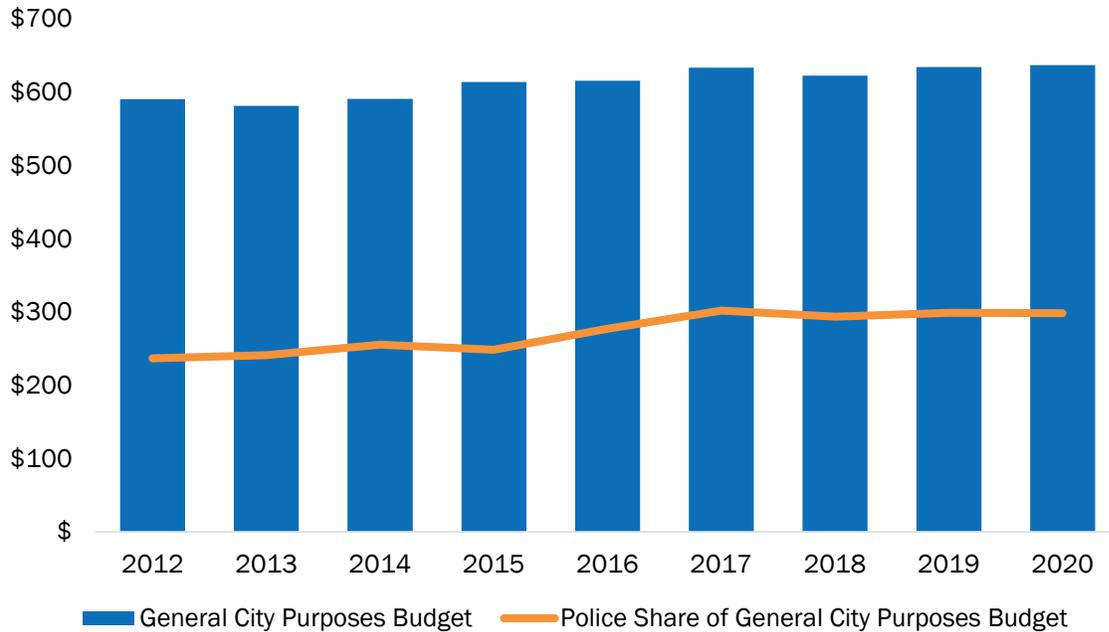
In the 2020 proposed budget, MPD is not protected. The budget proposes to cut the police force by 60 sworn officer positions and a total of 85 FTEs, including 18 Community Service Officer positions.<sup>6</sup> All of the position reductions would occur through vacancies and attrition; no layoffs would occur. Overall, operational expenditures would be reduced by \$577,000, as the savings from the FTE cuts are offset by the need to increase budgeted salaries in light of recently settled labor agreements.

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<sup>6</sup> Community Service Officer (CSO) numbers will shrink from 25 to 7 positions. CSOs perform support in activities such as crime prevention, investigation, and responses where full police powers are unnecessary.

As shown in **Chart 5**, despite the proposed reduction, police spending still would comprise almost half (47%) of total general city spending. By comparison, that is seven percentage points higher than MPD’s share of the general city purposes budget in 2012.

**Chart 5: MPD budget as a share of the general city purposes budget, 2012 to 2020 (in millions)**



In *Making Ends Meet*, the Forum’s comprehensive analysis of city finances published in 2016,<sup>7</sup> we found that by earmarking the majority of annual increases in revenue for public safety spending during the previous five years, the city had required other departments to bear the brunt of budget cuts. Whether the proposal to reduce police sworn strength will mark a permanent reversal of the city’s prioritization of police sworn strength levels over other departments and departmental needs remains to be seen.

It is worth noting, however, that in his recent call (in conjunction with Milwaukee County officials and area business leaders) for a binding referendum for a one-cent county sales tax increase, one of the mayor’s primary arguments is that the new revenue that would flow to the city would allow for restoration of the 60 sworn officer positions. That is counter to a suggestion from a newly formed citizens group that \$25 million be diverted from MPD’s budget for use for violence prevention and other programs in city neighborhoods.

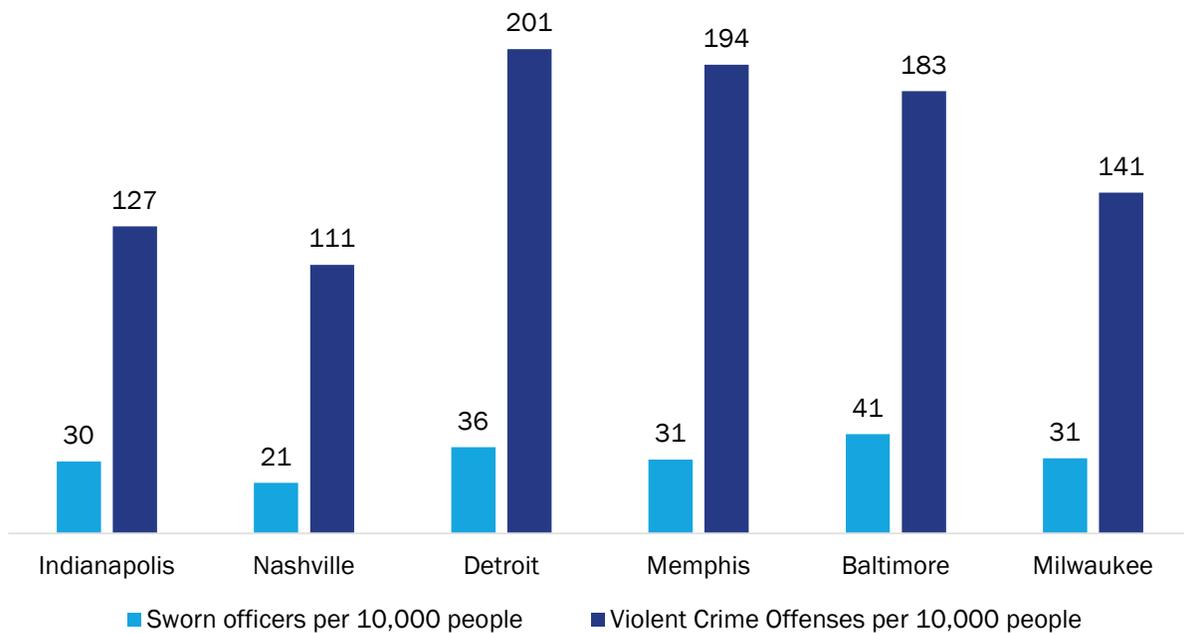
We take no position on the referendum, potential uses of new sales tax revenue, or the diversion of police resources to other needs, but **what appears to be lacking is analysis and discussion of what is the appropriate MPD sworn strength level from a public safety, as opposed to a budgetary**

<sup>7</sup> The report can be accessed at <https://publicpolicyforum.org/research/city-milwaukee%E2%80%99s-fiscal-condition-making-ends-meet>.

**perspective.** Given the likely need to reduce *all* areas of levy-supported general city purpose spending in the coming years, and notwithstanding the fact that individuals will disagree on how to define an “appropriate” sworn strength level, a better understanding of how officers on the street impact crime rates and how MPD’s sworn strength compares to that of peer cities would be useful as this contentious but critical policy discussion continues.

To that end, **Chart 6** shows a comparison of peer cities that contain population sizes and violent crime rates<sup>8</sup> similar to those seen in Milwaukee based on 2018 data. This is only a cursory analysis that does not take into account other important factors such as police cost per capita, property crime rates, population demographics, or violence reduction strategies; we acknowledge that more comprehensive study is needed and that there is not necessarily a correlation between police sworn strength levels and violent crime rates. Notwithstanding those caveats, our analysis shows that in 2018, Milwaukee’s sworn police levels were in line with the selected peer cities.

**Chart 6: Comparison of sworn police and violent crime per 10,000 people (2018)**



Sources: FBI 2018 Offenses Known to Law Enforcement and 2018 FBI Police Employee Data

As shown in the chart, five of the six cities had more than 120 violent crimes per 10,000 people, and of that group, each had at least 30 officers per 10,000 people. Milwaukee was tied for the third

<sup>8</sup> There are 20 police departments in the U.S. that service populations between 500,000 and 1 million. Of those shown in **Chart 6**, five have populations that are within 80,000 of Milwaukee’s population. Indianapolis has the greatest variance, with 282,000 more citizens than Milwaukee. Also, the six cities shown in the chart are the only cities of the 20 with violent crime rates that exceeded 100 per 10,000 residents in 2018.

highest level of sworn officers per 10,000 residents at 31. That number would diminish to 30.3 if the 60-officer reduction in the proposed budget is adopted.

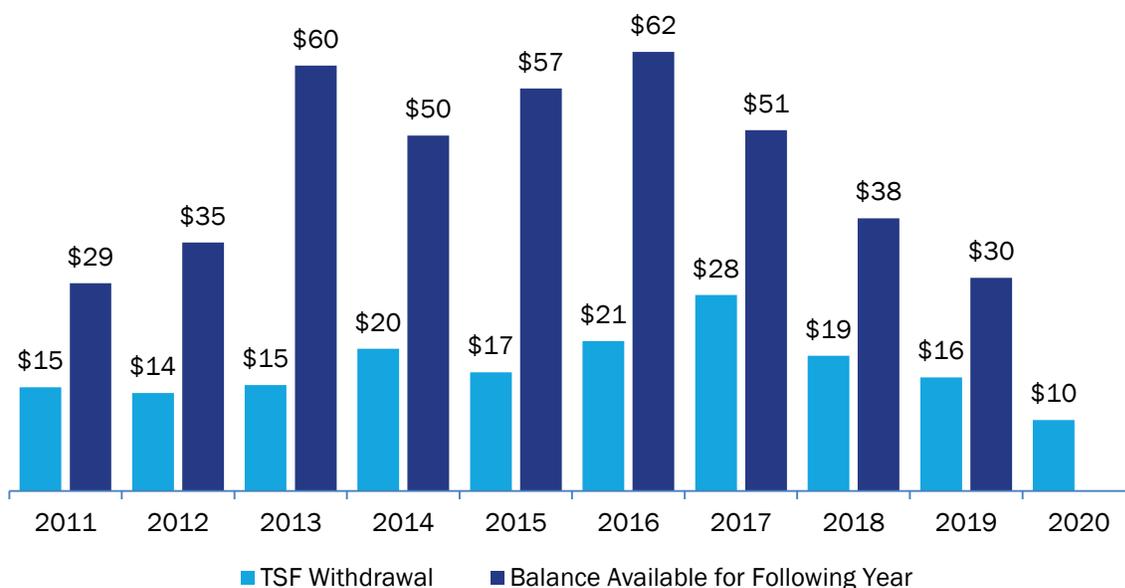
### KEY #3 - OPPORTUNITY FOR RELIEF FROM RESERVE WITHDRAWALS CONTINUES TO DIMINISH

The Tax Stabilization Fund (TSF) is used to reduce fluctuations in the city's property tax rate. The TSF is built via deposits of unexpended appropriations and revenue surpluses in a given year. As part of the budget process, an amount is set aside annually for transfer from the TSF to the general city purposes budget.

Over time, the city generally has been able to replenish the TSF at about the same rate that it has made withdrawals, and it was even able to sharply increase the fund balance earlier this decade. However, its ability to continue to replenish at desired rates – and, consequently, its ability to make substantial annual withdrawals – has been diminishing, thus leaving it with less capacity to address difficult budgets and the need for higher annual property tax increases in the years ahead.

To provide additional historical perspective, the anticipated year-end balance of \$30 million in 2019 is on par with the \$29 million fund balance at the end of 2011, as shown in **Chart 7**. At that time, this was a somewhat normal TSF fund balance. The years 2013 through 2016 saw year-end balances grow to the \$60 million range, largely due to larger-than-anticipated health care savings in those years. However, those savings could not last indefinitely, and in recent years their absence – combined with additional stresses on the general fund – have impacted the city's ability to replenish the TSF. In fact, as shown in the chart, the year-end balance has decreased annually since 2016. (A similar dynamic has negatively impacted the general fund balance, as discussed earlier.)

**Chart 7: TSF withdrawals 2011-2020 and fund balances available for the following year (in millions)**



The proposed 2020 budget withdrawal is \$10 million,<sup>9</sup> which comprises 33% of the unassigned TSF balance at the end of 2019. This is in line with the percentage withdrawn over the past eight years, which ranged from 33% to 44%.

Nevertheless, the gradual reductions in the TSF withdrawal (from \$28 million in 2017 to the \$10 million proposed for next year) have impacted the city's ability to hold down the amount of annual property tax levy increases and to use the withdrawn funds to address its broad variety of expenditure needs. Furthermore, in light of its increasingly tight fiscal margins, it is questionable whether the city can maintain TSF year-end balances in the \$30 million range as was previously the norm. **Unless the balance remains at or above that range, it is likely that the amount the city could reasonably withdraw will fall even further.**

It should also be mentioned that transfers from the Transportation Fund (formerly known as the Parking Fund) provide general fund budget relief, but amounts available for transfer from this fund also may be diminishing. A \$16 million transfer is proposed from the Transportation Fund to the general fund in 2020 (the same as in 2019), but the budget notes that as parking and transportation-related costs-to-continue increase over time, less revenue may be available for transfer in future budgets.

The bottom line is that without an increase in revenue or some unforeseen windfall like the health care savings enjoyed earlier in the decade, it is likely that the city will have less ability in the future to lean on Tax Stabilization Fund and (possibly) Transportation Fund transfers to address annual budget challenges. Given the alarming increase in the severity of the city's fiscal challenges that is likely to occur in the coming years, the timing could not be worse.

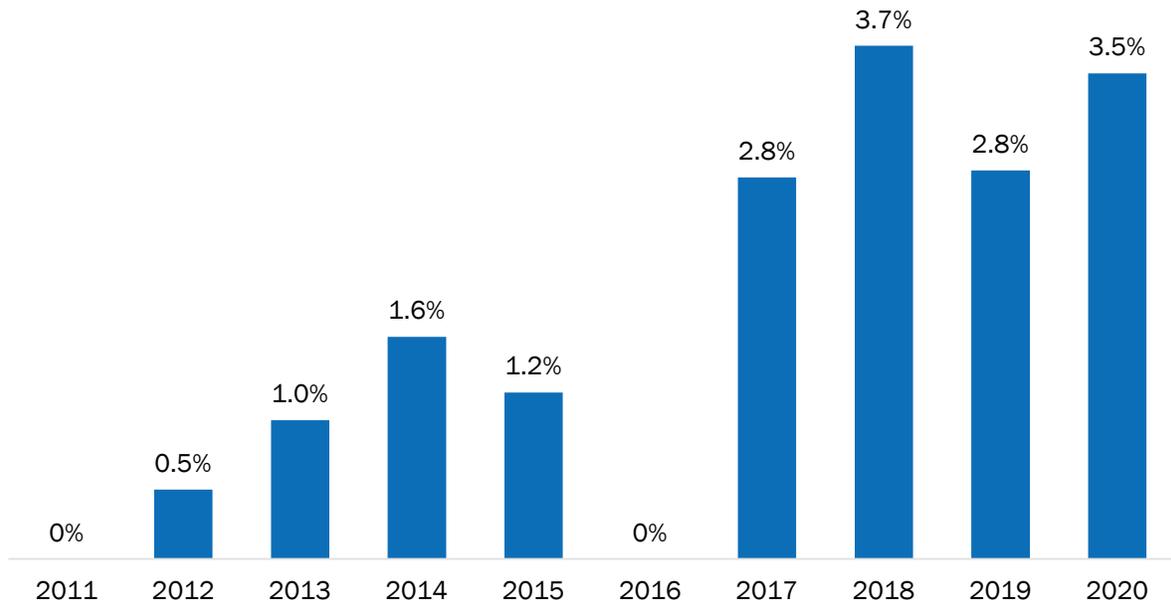
## **KEY #4 - PRESSURE TO RAISE PROPERTY TAXES UNLIKELY TO DISSIPATE**

An unfortunate byproduct of the reduced TSF balance discussed above, as well as escalating pension costs and the continued stagnant nature of intergovernmental revenues, is increased pressure to raise property taxes beyond the rate of inflation. That pressure is exemplified by the proposed \$9.8 million (3.5%) increase in 2020, which would be the second largest percentage increase in the past decade. As shown in **Chart 8**, from 2011 through 2016, average annual levy increases ranged from 0% to 1.6%; since then, they have ranged from 2.75% to 3.7%.

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<sup>9</sup> The budget document shows a withdrawal of \$12.9 million, but \$2.9 million of that total reflects the amount of revenue anticipated from various revenue increases that have not yet been certified by the comptroller.

Chart 8: Annual property tax levy increases, 2011-2020



The city's ability to raise property taxes from year to year is constrained by levy limits established by state government, which for operating levies are linked to annual growth in equalized property values resulting from net new construction. Milwaukee's growth in net new construction has been well below its levy growth in recent years, but exceptions in the levy limit for debt service and other factors have allowed for the higher levy amounts.

It is difficult to determine for how long that scenario will continue and what the city's levying capacity will look like in future years. There is little question, however, that upcoming expenditure pressures and limited alternative revenue options will create a need for levy increases that at least approximate the range seen since 2017 and that perhaps will need to soar even higher. As noted above, the 1% countywide sales tax proposal advocated by the mayor – which would generate about \$38 million annually for the city – would greatly reduce that need (and would also provide for some property tax relief), but the proposal's adoption is uncertain.

In the meantime, short-term expenditure pressures will grow. Those will include the need for increased pension fund or pension reserve contributions, increased salary and benefit appropriations in accordance with public safety labor agreements, a likelihood of higher overall health care expenditures in line with health care inflation, and the likely need and desire to resume cost-of-living pay adjustments for general city workers in light of the challenging labor market.

While the inflation rate per the Consumer Price Index is a typical benchmark for determining appropriate growth in property taxes, desired service levels and taxpayer capacity also come into play. With regard to the former, it is clear that, **barring an infusion of sales tax or state revenues, property taxes will need to increase at a rate exceeding the typical 1.5 to 2% growth in inflation for the foreseeable future** if city residents wish to see core services maintained at existing levels.

The issue of taxpayer capacity is a more difficult question to answer, but it must be noted that Milwaukee faces high levels of poverty and there is a limitation to how much its property taxpayers can bear. The levying decisions of other levels of government also must be taken into account. The 2.5% levy increase proposed by the county executive for 2020 is the largest that government would experience in recent memory, and Milwaukee Public Schools leaders are considering a spring ballot question to allow the district to exceed its levy limits. Those factors will also need to be considered by city leaders as they consider the appropriate levy amount for 2020 and beyond.

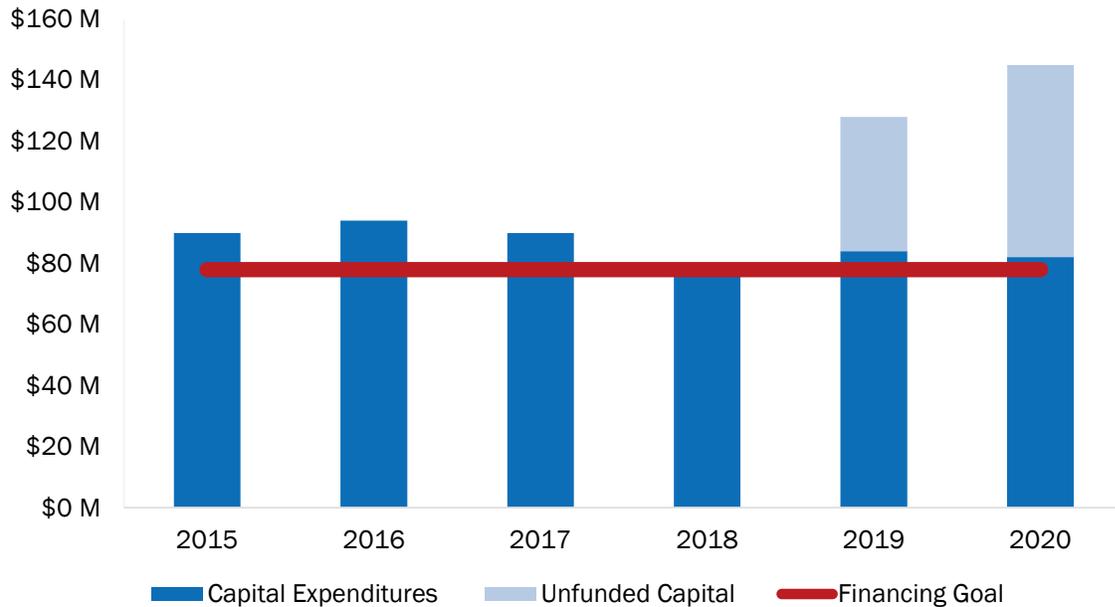
## **KEY #5 - THE BEGINNING OF A CAPITAL INFRASTRUCTURE BACKLOG**

As noted earlier in this report, the amount of property tax levy dedicated to the general fund in the 2020 proposed budget is attributed not only to the additional \$9 million dedicated to pensions, but also to a \$4.9 million increase in the amount of levy allocated to debt service. This shows how the amount of levy-backed general obligation (G.O.) debt the city issues in a given year to address its capital needs – and the annual principal and interest payments that result from that debt – can impact the amount available to support general city services.

To try to ensure the proper balance between needed borrowing and the preservation of tax levy resources for operations, the city has established a policy goal of limiting the amount of new levy-supported borrowing each year to no more than the amount of levy-supported debt coming off the city's books. That amount is generally around \$75 to \$78 million annually. As we have stated in past reports, this policy – while fiscally prudent – creates a tension between keeping future debt payments low and taking care of priority capital projects.

As shown in **Chart 9**, the city exceeded the financing target in most years since 2015. For example, with levy-supported G.O. bonding at \$84.7 million, the 2019 budget was nearly \$7 million over the target. The proposed 2020 budget includes an appropriation of \$82 million for new G.O. borrowing, which is slightly above the policy goal assuming \$78 million of typical debt retirement.

**Chart 9: City of Milwaukee new levy-supported G.O. borrowing vs. capital finance capacity and unfunded capital project requests, 2015-2020.**



While consistently issuing new debt at a higher level than debt retirement would cause the city’s debt service levels to grow to potentially unaffordable levels, an equally concerning issue is developing: the beginning of a backlog of capital projects requested by departments.<sup>10</sup> For example, requested projects for 2019 exceeded the financing target by about \$44 million, which caused many projects to be deferred as city leaders tried to stay close to the \$78 million policy goal. While budget officials say this is fairly typical and not all of the deferred projects were essential, the problem escalates in the proposed budget. In 2020, capital budget requests would have required \$145 million in new G.O. bonding, which means \$63 million in projects would need to be deferred if a capital budget containing \$82 million in G.O. bonding is approved.

Again, not all of the deferred projects may be pressing, though some, like major renovation work on the Police Administration Building, have been requested and deferred for a number of years. Furthermore, an emerging backlog of deferred projects exacerbates the city’s challenges in keeping up with needed street repairs.

The proposed capital budget for major streets in 2020 is estimated to cover 26.3 miles of major, local, and high traffic commercial corridor street repaving and reconstructing, which is nearly five miles less than budgeted for 2019. The decrease is attributed mainly to a reduction in the number of projects eligible for state and federal aid next year, but increased street projects likely will be needed

<sup>10</sup> The emerging backlog is discussed in greater detail in Picking Up the Pieces, the final installment in our five-part series of local government infrastructure challenges released in June. The report can be accessed at <https://wispolicyforum.org/research/picking-up-the-pieces-what-will-it-take-to-address-local-government-infrastructure-challenges-in-metro-milwaukee/>



in future years to maintain the current 60-year street replacement cycle, which is lower than the general industry standard of a 50-year replacement cycle.

The proposed capital budget also would issue \$8.5 million of levy-supported debt for the fourth phase of the city hall foundation repair project. The magnitude of that project, which will approach a total cost of \$60 million through its completion around 2023, has been one of the causes for the deferral of other projects in recent years. City officials hope to catch up on the backlog when that project is completed.

Another primary capital budget challenge involves lead service line replacements. While water utility user fees back the debt issued to repair and replace the city-owned portions of the lines, levy-supported G.O. debt is issued to finance the city's commitment to help home owners afford replacement of their portions, which typically extend from the curb stop to the home. For 2020, \$4 million of city financing is proposed to assist eligible property owners with lead service line replacement. Only \$1.5 million of that total would use G.O. bond financing, however, because of a one-time \$2.5 million payment from the city of Waukesha under a new water service agreement. That's good news for 2020, but bad news for 2021 when the \$2.5 million will need to be replaced with borrowing if the city wishes to adhere to its goal of replacing 1,100 lead service lines annually.

**The pressure to borrow to appropriately address the city's core infrastructure needs has clearly intensified, as exemplified by the size of next year's unfunded project request list.** Yet, the pressure to limit levy-supported borrowing also has intensified in light of the need to plow millions of additional dollars into the pension fund.

Given the inevitably heavy focus on police and pensions in this and future budget years, capital infrastructure could easily take a back seat in the conversation of how best to allocate limited resources. However, that would be a regrettable oversight, as the specter of a growing backlog and its associated impacts is something to be avoided.

# CONCLUSION

The city of Milwaukee has benefited from a long history of conservative and prudent fiscal management that has produced healthy reserve balances, a fully funded pension system, and affordable levels of debt. Those feats have been accomplished despite a revenue structure that often does not provide sufficient growth to meet cost-to-continue needs, and they have allowed the city to weather the storm of past fiscal challenges, such as the huge spike in the pension contribution that occurred earlier this decade.

**The 2020 budget is ominous not only because it reveals another huge pension-related challenge, but more importantly because it shows the city now lacks the tools it once possessed to respond to a budgetary crisis.**

As we have pointed out in this report, substantial withdrawals from the TSF and possibly the Transportation Fund are likely to diminish as TSF replenishment becomes more challenging and the Transportation Fund's debt and pension pressures grow. Meanwhile, a capital project backlog is beginning to accrue, leaving city leaders with the dilemma of either watching it grow or taking on levels of debt service that will exacerbate operating pressures. Also, the savior of previous budgets – enhanced health care savings – seems to have run its course; and after reducing the workforce by more than 100 positions over the past decade, it will be difficult for city leaders to achieve further reductions without impacting service levels.

With few other tools in the budget balancing toolbox and a commitment to prepare for the pension storm to come, the proposed budget leans on a 60-officer reduction in police sworn strength and a 3.5% property tax levy increase. While neither proposal is ideal and both merit scrutiny and debate, it is important to recognize that the alternatives are limited, and that efforts to instead reduce the proposed pension reserve allocation, withdraw more from other reserves, or otherwise take steps that will exacerbate long-term challenges are not real solutions.

Another dismaying consequence of the city's growing financial challenges is the reality that as budget discussions necessarily focus on where to cut staff or services or raise revenues, the question of where to newly invest becomes far more difficult to entertain. That consequence also is evident in the proposed budget, which cobbles together grant dollars to maintain lead abatement and affordable housing efforts but is otherwise limited in its ability to spend in needed areas like violence prevention and neighborhood improvements.

If there is a bright spot in the 2020 proposed budget, it is that despite these rising challenges, resources are identified to spare most departments from significant cuts, finance a broad range of capital needs, and start to address the longer-term pension problem. Those accomplishments will be far more difficult to attain in the years to come. As bad as the present may seem, the worst of the storm clouds remain on the horizon.