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Progress on Costly Promises:

Schools, Counties Make Headway on Retiree Liabilities

Since 2013, the state's biggest school districts and counties have decreased by hundreds of millions of dollars their sizable commitments to provide retiree health benefits, a review of their financial statements shows. Billions of dollars in liabilities remain, however.

Over the past five years, Wisconsin's largest school districts and counties combined have shed more than $779 million in projected liabilities to pay for health benefits to their retirees. Though the projections for these largely unfunded future costs still total nearly $3.3 billion, many districts and counties have made progress in addressing them, including large districts like the Milwaukee Public Schools (MPS) and large counties like Racine.

Milwaukee County stands out as a notable exception. Because of more conservative assumptions, projections of its unfunded commitments to provide health and life insurance to retirees rose $210.7 million between 2013 and 2018, not counting a separate increase in liabilities for the county transit system.

These obligations, known as "Other Post-Employment Benefits" (OPEB), include any retirement benefit offered to workers except for pensions. School districts and counties have built up these liabilities over the years by promising health and other benefits to current and future retirees and their family members, generally for the years before they qualify for federal Medicare coverage at age 65. These future costs matter to the public because they could lead to higher local taxes—or reduced services.

In several reports, the Wisconsin Policy Forum has monitored the projected cost of these largely unfunded liabilities, which rose in recent decades for local governments along with the cost of health care. Last year, the Forum reviewed financial statements from the largest 25 cities in the state and published figures on their OPEB liabilities. This latest issue of *The Wisconsin Taxpayer* extends the review to OPEB liabilities held by the state's 15 largest school districts (by enrollment) and 10 largest counties (by population).

Between the 2012-13 school year and 2017-18, financial statements for the largest school districts report their unfunded OPEB liabilities fell to a projected $1.31 billion, a decrease of over $930 million, or 42%. From 2013 to 2018, net liabilities also fell for almost all of the largest counties, their financial reports show. The increase in Milwaukee County projections, however, was so great that overall county obligations rose more than 8%.

Some local governments in Wisconsin started addressing the problem prior to Act 10, the 2011 state law that repealed most collective bargaining for most public workers and allowed local leaders to make unilateral changes to health benefits. Those have included ending the benefit for new hires, requiring retirees to pay more or all of their insurance premiums, and taking steps to reduce overall health costs.

The efforts appear to have accelerated in the wake of Act 10 and perhaps benefited from the federal Affordable Care Act providing greater access to insurance to retirees too young for Medicare. In addition, many local governments such as Dane County and the suburban counties around Milwaukee have avoided taking on unsustainable liabilities in the first place.

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GLOSSARY

OTHER POST-EMPLOYMENT BENEFITS (OPEB): Retirement benefits other than pensions. These benefits are mainly for health coverage but sometimes include life insurance.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): Annual financial statements from states, counties, school districts, and municipalities that detail OPEB and other long-term liabilities.

TOTAL OPEB LIABILITY: The present value of projected retiree benefits already earned by retirees and active employees.

PLAN FIDUCIARY NET POSITION: The market value of any assets set aside to cover OPEB liabilities. Many local governments have no such assets.

NET OPEB LIABILITY: The total OPEB liability minus any assets set aside to cover it. This figure represents the unfunded liability.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD: Independent board that started requiring governments a decade ago to disclose OPEB liabilities (but not to pre-fund them). The board recently issued additional requirements for OPEB reporting under what are known as Statements 74 and 75 (which replace the previous standards in Statements 43 and 45). All 15 school districts reviewed here used these new standards to report their 2017-18 finances and all the counties used them for 2018.

Not all Wisconsin communities were so fortunate. In some counties, projected retiree health care liabilities remain more than $1,000 per resident. While Milwaukee reduced benefits for new hires 25 years ago, costs are driven by those already in the system—a more difficult challenge to address. The county had nearly 1,700 more retirees and family members receiving health insurance payments in 2018 than it did full-time employees and has projected annual OPEB, pension, and debt costs could consume nearly the entire county property tax levy within a decade. MPS likewise reported more retirees and family members receiving health benefits during the 2017-18 year than it had current teachers and other instructional staff.

A few words of caution about these figures are in order. Retiree liabilities represent projections made by actuaries, not the final word. These complex forecasts can rise or fall from year to year for a variety of reasons not entirely within employers' control, including the growth in health care costs, the age at which workers retire or die, and the rate of return on investments.

Still, some local governments have been able to lower their projected obligations by changing their health plans for all enrollees or by reducing or eliminating the benefits offered to future retirees. The Forum's report last year on the state's largest cities found that between 2013 and 2016, most of them also made progress in reducing or controlling the growth in their liabilities. That progress, however, was more than canceled out by increases in the liabilities for the cities of Milwaukee and Racine.

While progress has been made in reducing projected costs, few local governments are setting aside much money to pay the remaining liabilities in the way they do for pension benefits. Though 10 of the 15 school districts reviewed had some assets to cover these commitments, just over 86% of the total liability remained unfunded. The unfunded share for counties was even higher.

Instead, the local governments are paying for the cost of retiree health care benefits as the expenses come due, meaning in essence future taxpayers are being asked to help pay for benefits that were earned in the past. Given lagging state aid and state restrictions on city, county, and school property taxes or revenues, these rising costs also could affect services.

THE GOOD NEWS—AND BAD

When it comes to pension and other liabilities for retiree benefits, this state is in much better shape than most. Wisconsin has a stable and fully funded pension system that covers nearly all eligible state and local government workers, with the main exceptions being the separate pension systems for employees of the city of Milwaukee and Milwaukee County.

State retirees can keep state health coverage but pay the full premium. They can draw on the value of their unused sick leave to cover insurance premiums after retirement—a substantial cost—but the state has set aside assets to cover it, putting Wisconsin in an unusually strong position nationally for its overall liabilities for retirees.

That leaves local retiree health coverage—and to a lesser extent life insurance—as the main unfunded obligation for public employers in the state. As far back as the early 1970s, some local governments in Wisconsin began to offer retiree health care benefits as a way to hold down salary increases or help employees who retire before age 65, the threshold for Medicare coverage. For example, qualifying public safety workers such as sheriff's deputies may retire at 53. Over time, the commitment to these local retirees has ballooned in size as health care costs have risen and more baby boomers have retired.

Milwaukee County provides a sobering look at what this means for taxpayers and public services. The county's latest financial statement shows 5,672 retirees and family members received health insurance payments in 2018—far more than the county's 3,983 current employees as reported in its financial statements (the comptroller's count of current employees is even lower).

While the county ended its practice of providing retiree health care for new workers several years ago, this imbalance has gotten worse over the past decade as more eligible employees have retired and the county has reduced its workforce. Figures from the comptroller's office show the county's active workforce shrank 61% between 1993 and 2018 due to budget challenges, the transfer of certain social services to the state, and the 1995 closure of the county's John L. Doyne Hospital, which two years before employed 1,800 workers.

Between 2013 and 2018, Milwaukee County's unfunded health and life obligations grew from a projected $1.13 billion to $1.35 billion. That doesn't include the Milwaukee County Transit System, which saw its separate unfunded obligations grow by $44.2 million, or 18.3%, to $285.3 million. Among the 10 largest counties in 2018, Milwaukee County and its transit system accounted for 29.8% of the population but 83.6% of the OPEB liabilities.

In one bright spot, the growth in Milwaukee County's projected obligation does not stem from new benefits but instead reflects new assumptions and accounting standards. (See Glossary on page 2.) In the biggest change, the county for 2018 lowered its so-called "discount rate" from 4% to 3.2%, meaning the county is not reducing its projected OPEB obligation as much as before when characterizing this future liability in terms of today's dollars.

In 2008, Milwaukee County used a 6% discount rate, making its projected liability significantly smaller than it would have otherwise been. Officials say if the county had been using a 4% rate this whole time its statements would show a $790.3 million decrease in its liability over the decade.

The irony is that years ago Milwaukee County took many of the steps now being used by other local governments to help control retiree health care liabilities. However, the problem had already grown to the point where these usual steps can do only so much.

Previously, Milwaukee County committed to pay all health insurance premiums for eligible retirees, though it ended that benefit for most workers hired after January 1994. Eligible workers hired after that date could still draw on unused sick leave to buy health insurance, though they stopped accumulating leave days after June 2012.

In addition, the county also pays some premiums for certain retirees who have reached the age to qualify for Medicare. This particularly far-reaching benefit was ended for workers retiring after January 2012.

Not counting transit workers, Milwaukee County in 2017 spent more than $47 million to pay for the various retiree health benefits after subtracting retiree contributions and $1.7 million for life insurance. To put those figures in context, the county's 2017 budget anticipated that 52% of the health care benefits paid with property tax dollars would go to retirees, compared to just 48% for its current workers. To frame it another way, the county's initial projected budget gap in 2017 amounted to $36.9 million—less than the cost of these retiree benefits—and led to difficult decisions that included the approval of a $30 vehicle registration fee for county residents.

A report from the Center for Retirement Research at Boston College confirmed the unusually large impact of

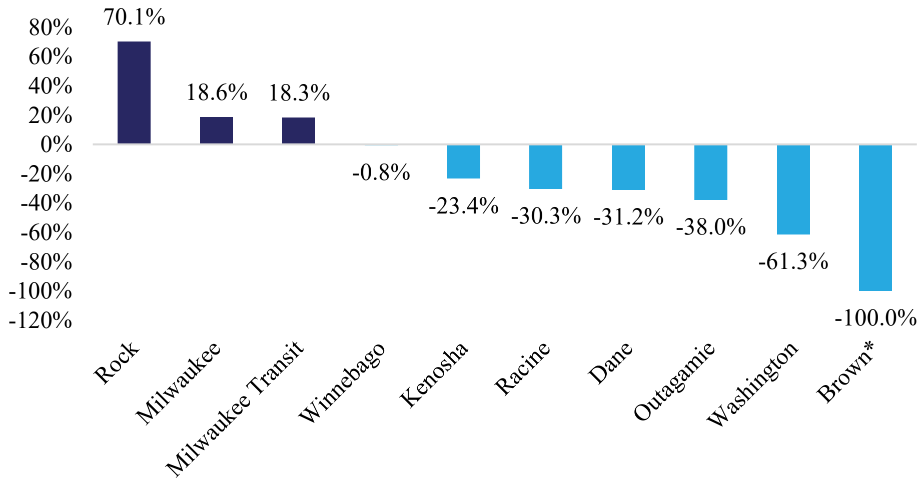
Table 1: County Liabilities Mostly Fall, Rise in Milwaukee
Unfunded OPEB Liabilities by County, 2013-2018

County	2013 Unfunded Liability	2018 Unfunded Liability	2013-18 Change
Milwaukee	$1,134,995,000	$1,345,670,000	$210,675,000
Racine	$253,640,311	$176,863,475	-$76,776,836
Milwaukee Transit	$241,115,000	$285,310,000	$44,195,000
Kenosha	$56,252,528	$43,087,316	-$13,165,212
Dane	$67,857,534	$46,675,430	-$21,182,104
Rock	$23,579,600	$40,112,873	$16,533,273
Winnebago	$6,131,766	$6,082,018	-$49,748
Outagamie	$10,231,970	$6,340,830	-$3,891,140
Brown*	$4,537,992	$0	-$4,537,992
Washington	$1,502,682	$581,286	-$921,396
Waukesha	$0	$0	$0
Total	**$1,799,844,383**	**$1,950,723,228**	**$150,878,845**

***Brown Co. had a small life insurance liability for 2018.**

Sources: Financial statements, WPF research

Fig. 1: All but Two Counties See Drop in Liability
% Change in Retiree OPEB Liabilities by County*, 2013-2018



Sources: Financial statements, WPF research
* Waueksha County had no liability in 2013 or 2018. Brown County had a small life insurance liability in 2018.

these costs on county finances. The report found Milwaukee County's 2014 payments for pension, OPEB, and debt service ranked among the top 20 for counties nationally when measured as a share of county revenues net of state and federal aid.

LIABILITIES FALL FOR OTHER COUNTIES

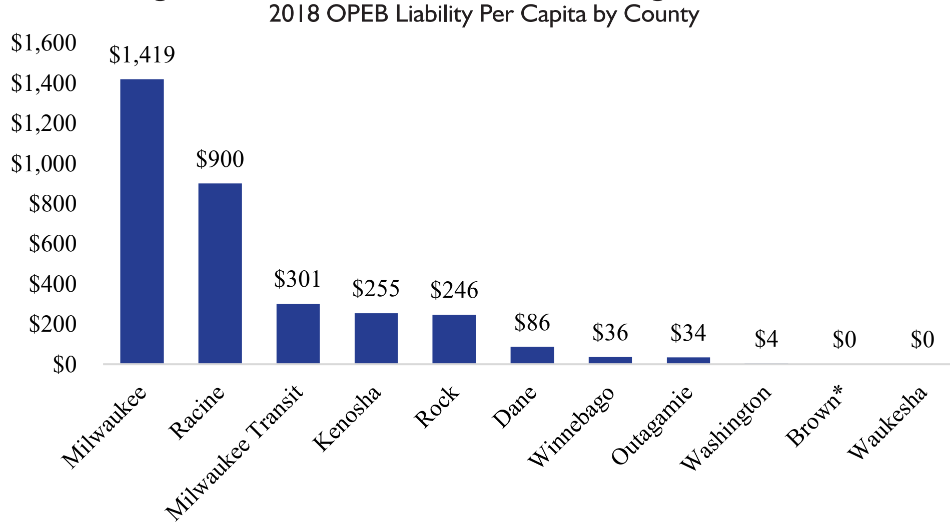
Almost all other large counties reduced their OPEB obligations between 2013 and 2018. (See Figure 1.) Racine County's liability, for example, decreased by $76.8 million, or 30.3%. Dane County's liability, which was relatively low already, also dropped by nearly one third. Dane County allows retirees to remain on its health plan until they become eligible for Medicare but requires they pay the full premium. Even this more modest benefit can still add to the county's costs. Retirees on average are older and less healthy than current employees, raising the expense of insuring the overall group.

Rock County was the only other county besides Milwaukee to see its liabilities increase over the period, with its obligation rising by $16.5 million, or 70.1%, between 2013 and 2018. Rock County still pays the same share of healthcare premiums for retired deputy sheriffs, deputy sheriff supervisors, and their spouses through age 65 as it does for active employees. As noted earlier, the cost of this benefit can be substantial given that deputies can retire as early as age 53, setting up the county to pay more than a decade of benefits for each of them before they qualify for Medicare. Other Rock County retirees must pay the full premium to keep their health coverage.

Of all the counties that still have OPEB liabilities, Washington and Outagamie counties saw the largest percentage drop between 2013 and 2018 at 61.3% and 38.2% respectively. Retirees in Outagamie County can remain on the county health plan but have to pay the full premium.

Meanwhile, Brown County eliminated its health insurance liability. (It still has a small life insurance obligation). Like Outagamie, Brown County currently allows retirees to keep their health plan if they pay the premium. To ensure retirees pay the full amount, the county set up a separate risk pool for the retirees to avoid any taxpayer subsidy to the plan. The last county retiree dropped the coverage in April 2018, removing the liability.

Fig. 2: Milwaukee, Racine Counties Have Highest Liabilities
2018 OPEB Liability Per Capita by County



Sources: Financial statements, WPF research * Brown had a small life insurance liability in 2018.

Table 2: Many School Districts See Large Dollar Decreases in Unfunded Liabilities
Change in Unfunded OPEB Liability (or Asset) by School District, 2013-2018

School District	2012-13 Unfunded Liability	2017-18 Unfunded Liability	Change
Milwaukee	$1,384,117,997	$764,979,521	-$619,138,476
Racine	$77,914,206	$91,161,723	$13,247,517
Oshkosh	$66,326,859	$83,493,552	$17,166,693
Eau Claire	$85,933,971	$73,602,559	-$12,331,412
Kenosha	$162,300,000	$72,940,211	-$89,359,789
West Allis-West Milw.	$107,761,748	$58,156,021	-$49,605,727
Waukesha	$58,081,659	$42,542,882	-$15,538,777
Janesville	$49,688,530	$27,128,735	-$22,559,795
Green Bay	$23,527,345	$25,606,493	$2,079,148
Appleton	$123,932,422	$24,226,147	-$99,706,275
Madison	$37,592,110	$23,453,741	-$14,138,369
Wausau	$17,381,170	$21,066,483	$3,685,313
Sun Prairie	$10,054,030	$14,659,821	$4,605,791
Middleton-Cross Plains	$4,394,247	$7,718,710	$3,324,463
Sheboygan*	$30,464,686	-$605,643	-$31,070,329
Total	**$2,239,470,980**	**$1,330,130,956**	**-$909,340,024**

Sources: Financial statements, WPF research
* Sheboygan has a net asset rather than a liability.

Despite the progress in many counties, some liabilities remain substantial. The unfunded obligations in Milwaukee and Racine counties both total more than $1,000 per capita, and the Kenosha and Rock County liabilities are each much more than $200 per capita. (See Figure 2.) Those liabilities are particularly serious in communities like Milwaukee and Racine where multiple units of government have unfunded commitments.

SCHOOLS MAKE STRIDES

Within the 15 largest school districts in Wisconsin, net OPEB liabilities from the 2012-13 to 2017-18 school years fell by over $930 million, or 42%, to $1.31 billion. (See Table 2.) Additionally, cumulative liabilities in 2018 decreased by about 12% from the previous year, suggesting ongoing progress overall.

Still, even though total unfunded liabilities fell over the period, they rose for several districts. (See Figure 3.) Other districts have obligations that have shrunk but remain a concern.

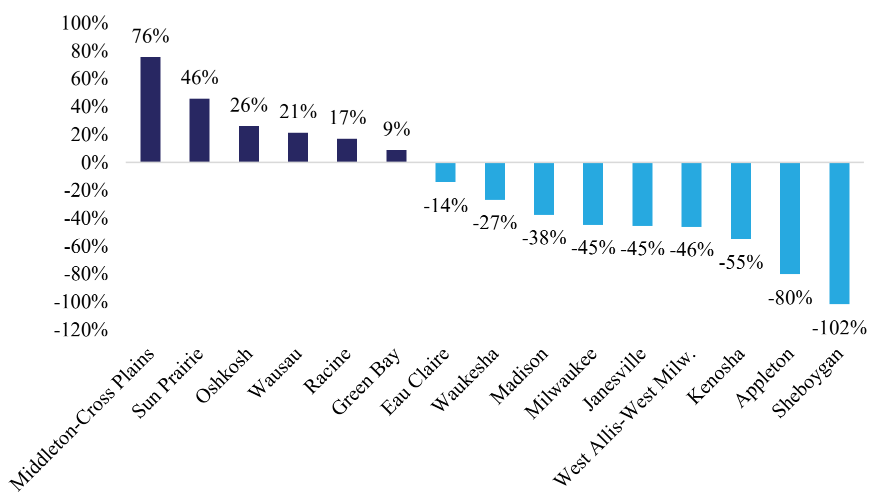
Milwaukee Public Schools reduced its liability by 45% from 2012-13 to 2017-18 through OPEB and overall health plan changes. Given that the state's largest district may ask voters to raise property taxes, it is worth considering how MPS has managed this major cost.

The outstanding liability for MPS remains hefty at almost $765 million, more than eight times larger than that of any other district. Among the 15 largest districts, Milwaukee Public Schools accounted for 28.3% of the student enrollment but 58.4% of the OPEB liabilities. (See Fig. 4 on page 6.) Even though MPS closed the retiree healthcare plan for employees hired after July 2013, the district still provides benefits to other qualifying retirees and covers the full premium for some.

Over the period, the Oshkosh Area School District posted the largest dollar increase in unfunded liability—$17.2 million. The liability for medical and dental coverage increased 25.9% to $83.5 million from 2013 to 2018. Oshkosh retirees pay a portion of the premium but may use accumulated sick leave to do so.

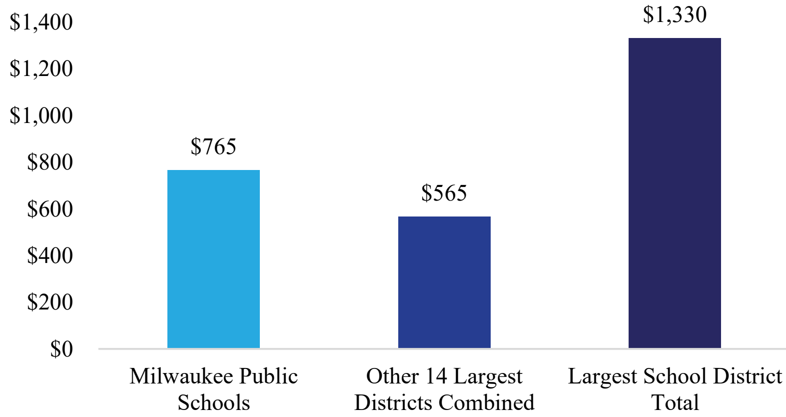
Other school districts, however, have cut their OPEB liabilities over the past five years, often by reducing

Fig. 3: Retiree Liabilities Fall for Most Districts
% Change in OPEB Liabilities by School District, 2013-18



Sources: Financial statements, WPF research

Fig. 4: Milwaukee Liability Exceeds Other School Districts Combined
2018 Unfunded OPEB Liability for School Districts in $Millions



Sources: Financial statements, WPF research

retirement benefits for current or future employees. As mentioned earlier, this trend appears to have accelerated after the 2011 passage of Act 10.

In a series of changes over many years, the Appleton Area School District, for example, reduced its share of the health insurance premium for eligible teachers who retired after June 30, 2007 and then stopped covering any of the premium for those retiring after June 30, 2015. This move contributed to an 80.5% decrease in the district's unfunded liability since the 2012-13 school year.

Among the districts examined, only the Sheboygan Area School District had a fully funded retiree health care benefit, with assets exceeding liabilities by about $606,000. In 2013, the district had an unfunded liability of more than $30 million, but stopped allowing new retirees to remain on its health insurance plan. Instead, the district has funds set aside to cover contributions to a health reimbursement account for certain retirees moving forward. Teachers hired after June 2003 but before July 2013 can receive $1,000 per year of service up to $35,000.

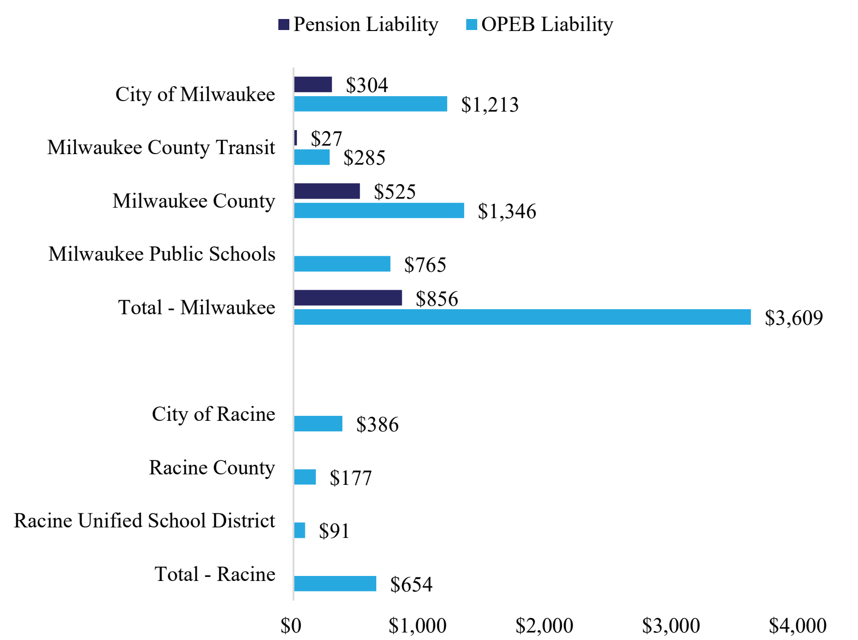
GREATEST CHALLENGES IN MILWAUKEE, RACINE

Our separate OPEB reviews for the state's largest cities, counties, and school districts allow us to calculate a combined liability for citizens in different communities. We find that residents of Milwaukee and Racine face the highest combined liabilities at the city, county, and school district level. Figure 5 shows these combined obligations for the core urban units without counting the additional unfunded liabilities for some suburban entities such as the West Allis-West Milwaukee School District. The chart does not account for any liabilities the city of Racine might face for Racine Transit System workers, who belong to a severely underfunded private pension plan that does not break out separate figures for the multiple transit systems with participating employees.

Despite progress in both communities in reducing these unfunded commitments, they remain quite high on a per capita basis. Separate unfunded pension liabilities held by Milwaukee County ($525 million not counting transit workers) and the city of Milwaukee ($303.6 million) compound the burden for taxpayers in those areas as well as residents who depend on services from these local governments.

As with those of other communities, these liabilities are only projections that may turn out better or worse than expected depending on factors such as growth in the cost of health care. The Milwaukee Public Schools, for

Fig. 5: Liabilities Add up for Milwaukee and Racine Taxpayers
2018 Unfunded Liabilities in County, Municipality, and School Districts in $Millions*



Sources: Financial statements, WPF research * Racine governments and MPS part of fully funded state pension system; city of Racine OPEB liability is from 2017.

example, estimates that if health care costs end up growing one percentage point faster each year than expected, the district's projected long-term liability would be about $33.5 million more, or 4.4% larger. The Racine Unified School District expects that the same one percentage point increase in health care costs over expectations would enlarge its projected liability by $18.7 million, or 20.5%.

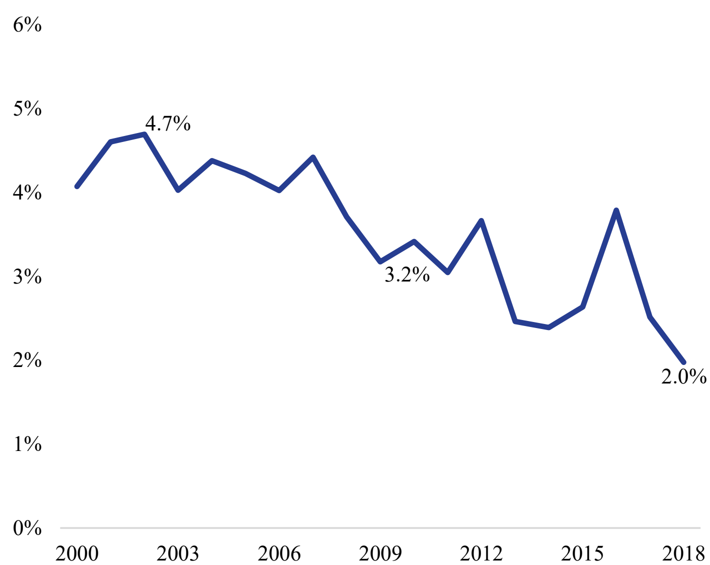
Ultimately, local governments could benefit if health care costs across the country grow more slowly than expected or if they take steps to control their own individual costs. The slower recent growth in national health care costs shown in Figure 6 has eased some of the budget pressures on local governments from covering both current and retired employees.

Even if health care inflation is relatively modest, however, the cost of past promises may continue to grow for some governments. In Milwaukee County, for example, the 2018 budget projected that within the next 10 years pension and OPEB benefits would consume "between 81 cents and 97 cents of every dollar" from the property tax that is left over after making debt payments.

POTENTIAL RESPONSES

Local governments have many potential responses to unfunded OPEB liabilities. First, in the communities still offering to pay insurance premiums for future retirees, officials could stop doing so as most local governments have already done. As we noted in last year's report, policymakers typically have more legal flexibility to alter retiree health insurance benefits for current employees than they do for pensions.

Fig. 6: Annual Growth in Medical Costs Slows Since 2000
% Change in Medical Care Component of Consumer Price Index



Source: U.S. Bureau of Labor Statistics

Another option used by many local governments is to continue allowing retirees to stay on their health plans, but require them to pay the premiums. This approach typically will make the local government's insurance pool at least somewhat more expensive, however, since on average retirees are older and more likely to need medical care than active employees. As noted earlier, Brown County avoided those additional costs by setting up a second health insurance pool with separate premiums for any retirees who want county coverage. A second option used by the Sheboygan Area School District would be to provide a set amount of money that retired employees can use to obtain health insurance on their own.

Local officials could also take steps to lower the costs of providing health coverage to current and retired employees. Potential options range from wellness plans to improve patient health to reduced benefits and higher copays. Some local governments have partnered with clinics to pay a flat fee per employee so their workers can receive primary care at no cost to them. The city and school district in La Crosse as well as the city, county, and school district in Racine all employ this form of direct primary care.

For its part, the state has made little effort either to help local governments and school districts to address their OPEB liabilities or require them to do so. If lawmakers chose to do so, they could incentivize changes by tying them to increases in state aid or additional options for raising local taxes or other revenue. The state also could mandate that local governments set aside money to cover any new liabilities as they are accrued.

Both local and state officials will have to weigh whether reducing OPEB benefits might add to local governments' challenges in attracting and retaining good employees at a time of low unemployment. Leaders might also consider if channeling a large portion of employee compensation into retiree benefits is the right way to attract younger workers who may switch jobs frequently and be decades away from retirement.

Communities will have to decide what they can afford based on their other spending needs and the growth in their tax base and revenues. State-imposed limits on their property tax levies and lagging state aid may lead many local officials to conclude they have to act. It can be difficult enough to pay for public services in the present without tacking on the cost of benefits earned years in the past.

The Wisconsin Taxpayer **is published by the Wisconsin Policy Forum. The Wisconsin Policy Forum was created on January 1, 2018 by the merger of the Madison-based Wisconsin Taxpayers Alliance and the Milwaukee-based Public Policy Forum. 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.**