EXECUTIVE SUMMARY

DETOUR AHEAD

The Milwaukee County Transit System's Fiscal Cliff and Options to Avert It

WISCONSIN POLICY FORUM

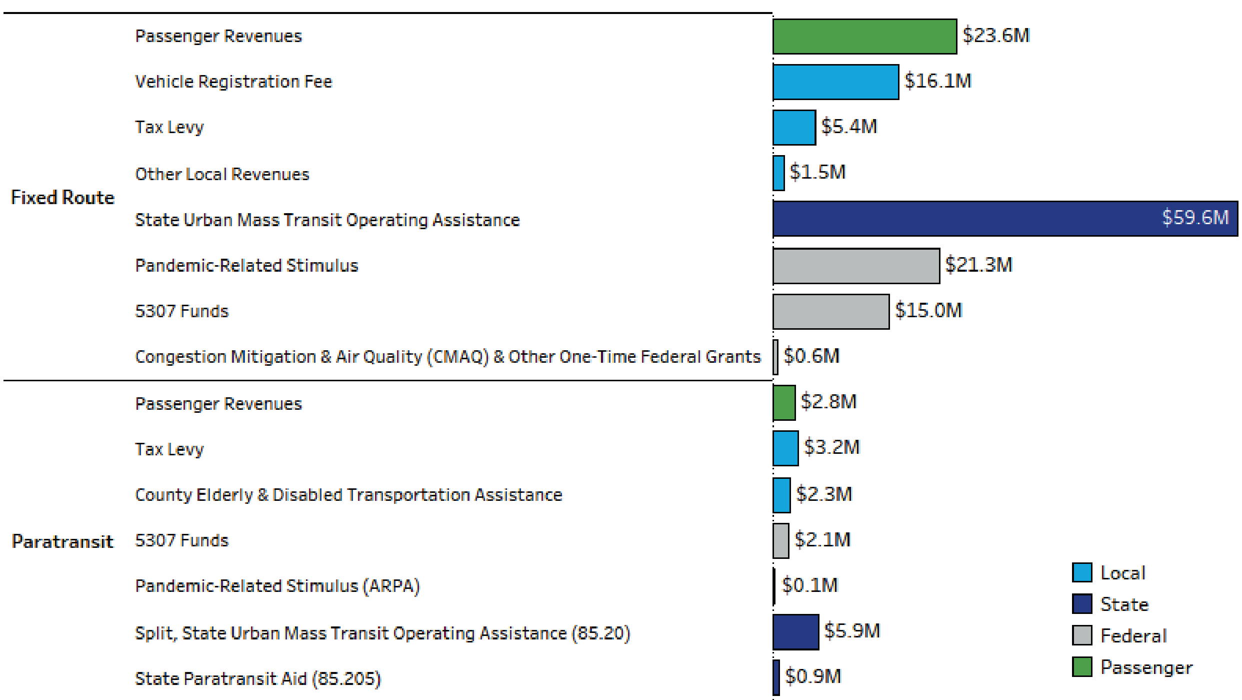
The financial challenges facing the Milwaukee County Transit System (MCTS) have been well-documented in numerous reports by the Wisconsin Policy Forum over the past several years. In fact, as far back as 2008, in *Milwaukee County's Transit Crisis: How Did We Get Here and What Do We Do Now?*, we warned that the financial outlook had grown so grim that devastating service cuts appeared imminent without prompt action.

Remarkably, that day of reckoning has largely been delayed, but deep structural problems that have been masked recently by federal pandemic relief funds now appear certain to re-emerge. In this report – commissioned by the Milwaukee County Department of Transportation – we assess the nature and scope of MCTS' financial challenges and the future of Milwaukee County's transit services in a post-pandemic world.

MCTS Budget Overview

As shown in **Figure 1**, MCTS's $160.4 million fixed route operating budget in 2023 is funded by a combination of four primary revenue sources: federal aids; state operating assistance; revenue collected from riders (also known as "farebox revenue"); and local revenue from the county (comprised of property tax levy and vehicle registration fee, or VRF revenues). Paratransit services also are funded via a combination of these four primary revenue sources, with passenger-related revenue accounting for a similar percentage as in the fixed route budget (approximately 16%).

Figure 1: Milwaukee County Transit System Revenues, 2023 Budget



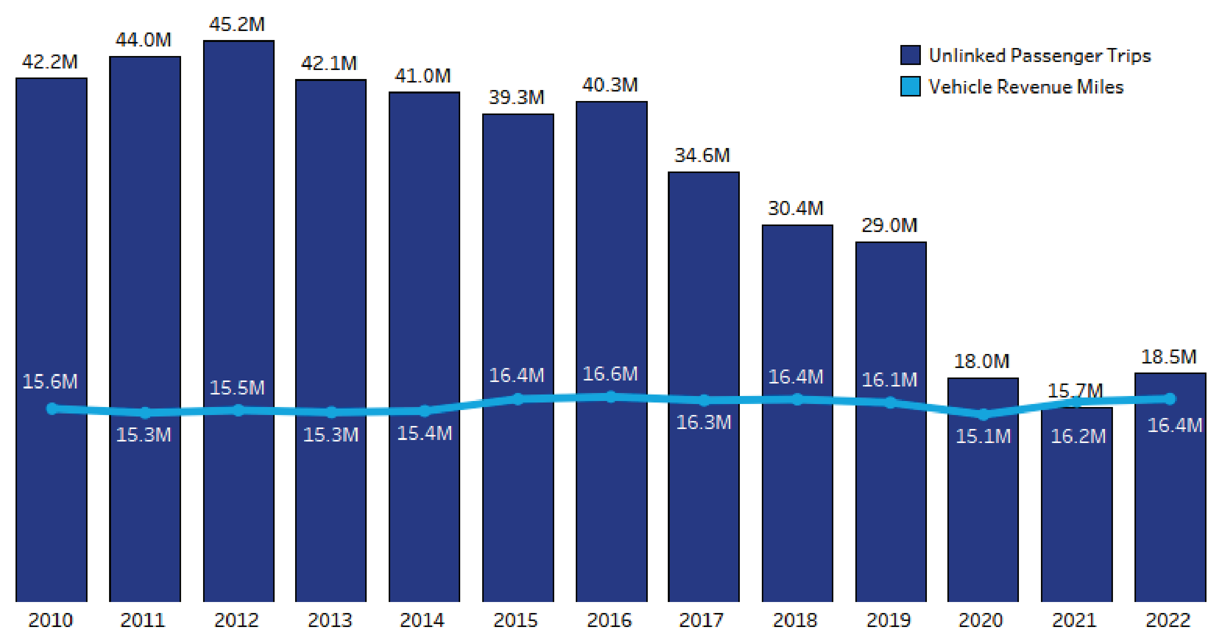
To understand why MCTS faces ominous financial challenges, it is important first to consider the critical role of two major sources of federal aid. The first is the Urbanized Area Formula Funding program, which provides federal resources to large transit systems across the United States. MCTS received about $24.5 million of these federal dollars, known as "5307 funds," in 2022.

The 5307 funds are restricted to use on capital items, including up to 80% of the cost of "capitalized maintenance." Because maintenance funding is included in the operating budget, this has allowed MCTS to use the funds to support fixed route operations, though in doing so it must forsake their usage for bus purchases. These federal capitalized maintenance dollars have become a critical source of revenue in MCTS's operating budget over time, with $15 million allocated for that purpose in the 2023 fixed route budget and $2.1 million for paratransit. However, the need to use these monies for operations creates challenges for MCTS's bus replacement program.

Another critical – but temporary – source of federal revenue for MCTS is special pandemic relief aid. MCTS has received $191 million in such aid since 2020, including $83.6 million in the latest batch from the American Rescue Plan Act (ARPA). The 2023 budget allocates $21.3 million of ARPA funds to the fixed route operating budget and an additional $134,250 to paratransit. It is expected that similar sums will be available to support MCTS operations in 2024, but after that time the funds will be exhausted, thus creating a sizable hole in the fixed route operating budget.

MCTS's upcoming challenges also are attributed, in part, to declining farebox revenues, which have corresponded with falling bus ridership that preceded the pandemic. From 2010 to 2019, unlinked passenger trips on MCTS's bus routes fell by 31.3% (13.2 million), with much of the drop-off occurring between 2016 and 2019 (**Figure 2**). COVID-19 caused ridership to plummet by another 45.7% in 2021 relative to 2019 levels, though it rebounded somewhat in 2022. Transit system officials expect ridership to continue to recover modestly but to remain below pre-pandemic levels for at least the next several years.

Figure 2: MCTS Fixed-Route Bus Ridership and Service Levels (Bus Miles)

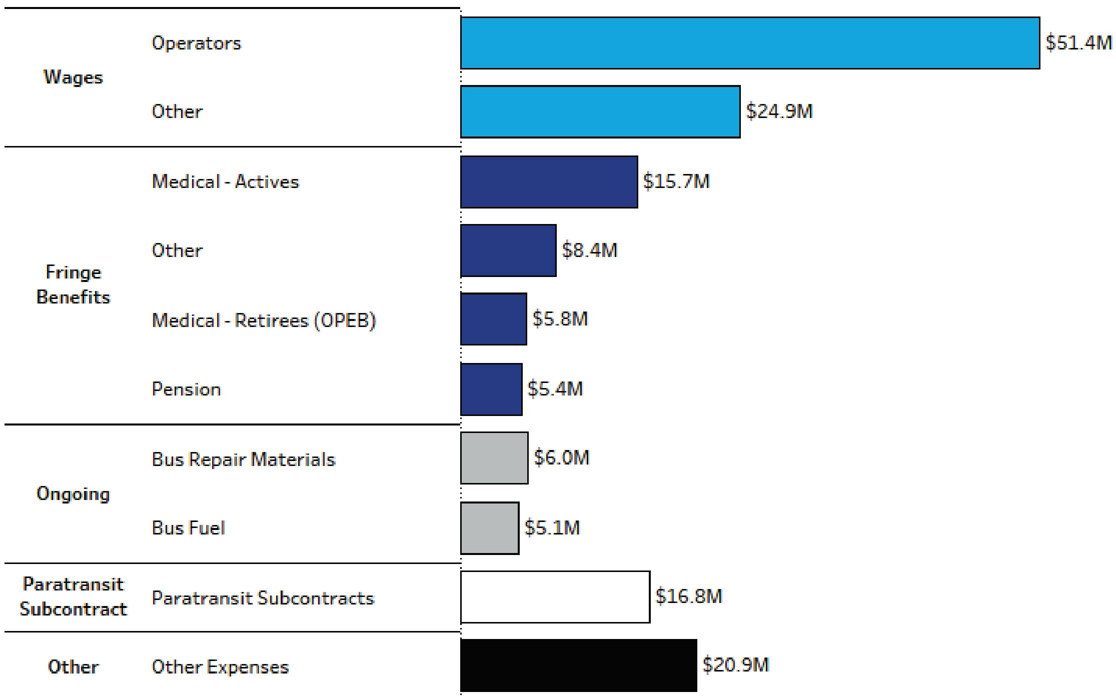


Source: National Transit Database

In the 2023 operating budget, MCTS is budgeting $23.6 million in fixed route ridership revenue, which is an increase of $1.4 million from the 2022 budget and about $2 million higher than the 2022 actual amount. That estimate remains about $5.3 million (18%) lower than the pre-pandemic total of $28.9 million in 2019, however. Paratransit passenger-related revenue has similarly failed to rebound since the pandemic, with the 2023 combined budgeted total from passengers and agency fare payments totaling about $2.8 million, or about $1 million (36%) lower than in 2019.

On the expenditure side of the ledger, salaries and fringe benefits for MCTS's more than 1,000 active employees represent a substantial share (57%) of the system's operating budget in 2023, as shown in **Figure 3**. However, retirement benefits, as well as fuel and bus repair costs and charges from county government, also are important cost centers. On the paratransit side, the major costs are associated with subcontracts with shared ride van and taxi providers.

Figure 3: Milwaukee County Transit System Expenditures, 2023 Budget



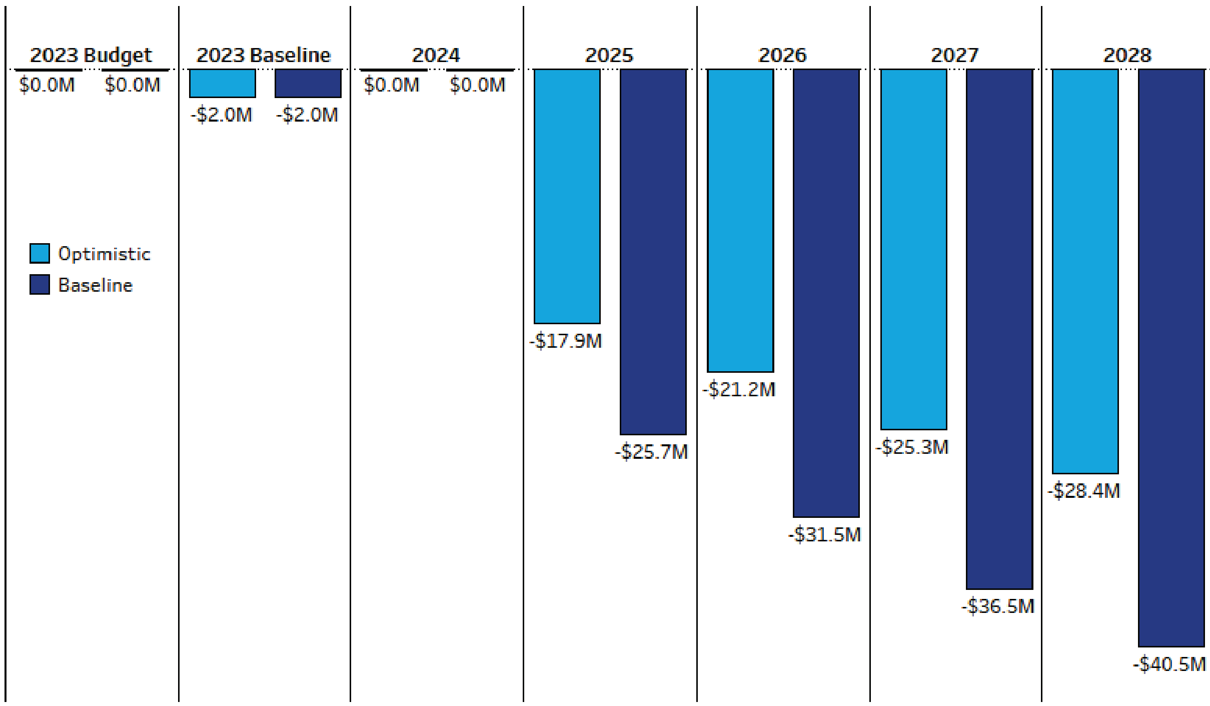
Forecasting the future

This overview sheds light on MCTS's concerning fiscal outlook. The obvious near-term problem is the exhaustion of federal ARPA dollars, which sets the stage for a $21 million gap in the 2025 budget. But on top of that, there are signs that MCTS's long-term structural challenges are worsening, as passenger revenue remains depressed and it would be unwise, based on past trends, to count on increases in state aids. Meanwhile, although MCTS expects to see an increase in federal 5307 funds, the amount it can use on operations is capped by its total maintenance costs of about $25 million annually, and it will continue to have pressure to preserve sizable portions for new buses.

In theory, MCTS could turn to greater local sources of revenue like other urban transit systems. In practice, however, Milwaukee County itself faces fiscal challenges of its own that make it difficult to deliver that local funding.

To quantify the upcoming fiscal "cliff" caused by the exhaustion of ARPA monies, we created a forecasting model that projects MCTS operating expenditures and revenues from 2024 to 2028. We developed a "Baseline" and an "Optimistic" model based on slightly different sets of revenue assumptions (full details are contained in the full report). **Figure 4** shows the results of our modeling.

Figure 4: MCTS Operating Deficit, Projected 2024-2028



Both models show a $2 million deficit in the 2023 baseline, which results from the under-budgeting of operator and mechanic salaries this year linked to a recently-approved labor agreement. For 2024, both show balanced budgets. Because MCTS should have about $20.6 million in ARPA funds remaining for next year, the gap heading into the year will be far smaller than in 2025, but it still would total more than $9 million according to our models. Both models assume the gap would be offset largely with additional use of 5307 funds for capitalized maintenance.

With the elimination of ARPA funds in 2025 and the use of 5307 funds for operations largely tapped out, a sizable gap emerges that year in both models – about $25.7 million in the baseline model and $17.9 million in the optimistic model. The difference in the two stems largely from our assumptions, in the optimistic model, that MCTS's state operating assistance will be increased by 2% and that county policymakers will adopt a $10 increase in the existing $30 VRF in 2025. Both models assume that 5307 funding in the operating budget will be maximized at $25 million.

From there, the models show that the operating gap will grow to $40.5 million in the baseline model and $28.4 million in the optimistic model by 2028. That gap likely would have to be filled by local revenue increases (either property tax levy or VRF revenue), expenditure and service reductions, or a combination of the two.

MCTS's Capital Needs Also Would Suffer

Our modeling also sheds light on the enormous challenges MCTS faces with regard to its capital program. Because our model assumes county leaders will prioritize use of 5307 funds for capitalized maintenance to shore up the operating budget once ARPA funds disappear, a sizable gap in capital funding for bus replacements would emerge in 2026 (see **Table 1** on the following page). That gap would need to be filled with other sources of federal funds, increased county borrowing, or both.

Table 1: Projected Capital Funding Gap, 2023-2028*

	2023 Budget	2024	2025	2026	2027	2028
Capital - 5307	$10,800,000	$7,800,000	$10,800,000	$4,602,248	$441,763	$1,077,807
Capital - 5339	$3,600,000	$3,600,000	$3,600,000	$3,600,000	$3,600,000	$3,600,000
Capital Gap				**$6,197,752**	**$10,358,237**	**$6,842,193**

* The capital need each year is based on MCTS's current bus replacement schedule, which assumes the purchase of 30 clean diesel buses annually from 2024-2027 and 24 in 2028 (the amount is lower in 2024 because of the availability of $3 million in pandemic relief funds). Amounts shown for 5307 funds equal amounts available after maximum allowable amounts are used for operations. Section 5339 funds are another source of federal formula funds restricted to capital needs and projected amounts are based on recent experience.

Policy options

In our 2008 report, we suggested that county and state leaders faced three potential paths forward. We consider the same three scenarios when contemplating MCTS's options today.

Year-to-Year Approach

Without additional boosts to major revenue streams, the county would have limited choices to plug the projected budget holes. One option would be to seek to fill some or all of the gap with property tax levy, which today comprises only about 5.4% ($8.7 million) of MCTS's total budgeted revenue, but once accounted for closer to 20% of the total. Another would be to boost fares.

The county's other fierce financial challenges likely preclude a sizable increase in its levy allocation to transit, however, and the many societal factors that already are depressing transit ridership could make fare increases counterproductive. Consequently, it appears likely that MCTS and county leaders would need to implement expenditure reductions to address much of the funding gap.

For contextual purposes, we consulted with MCTS officials to gain insight into what $15 million of annual service reductions would look like. Under one such scenario (see **Table 2**), MCTS would need to cut seven of its least productive routes and eliminate some service on one other (Route 60 – shown in yellow). This scenario would affect nearly 4,500 riders each weekday, impacting and perhaps precluding their ability to get to jobs, medical appointments, etc.

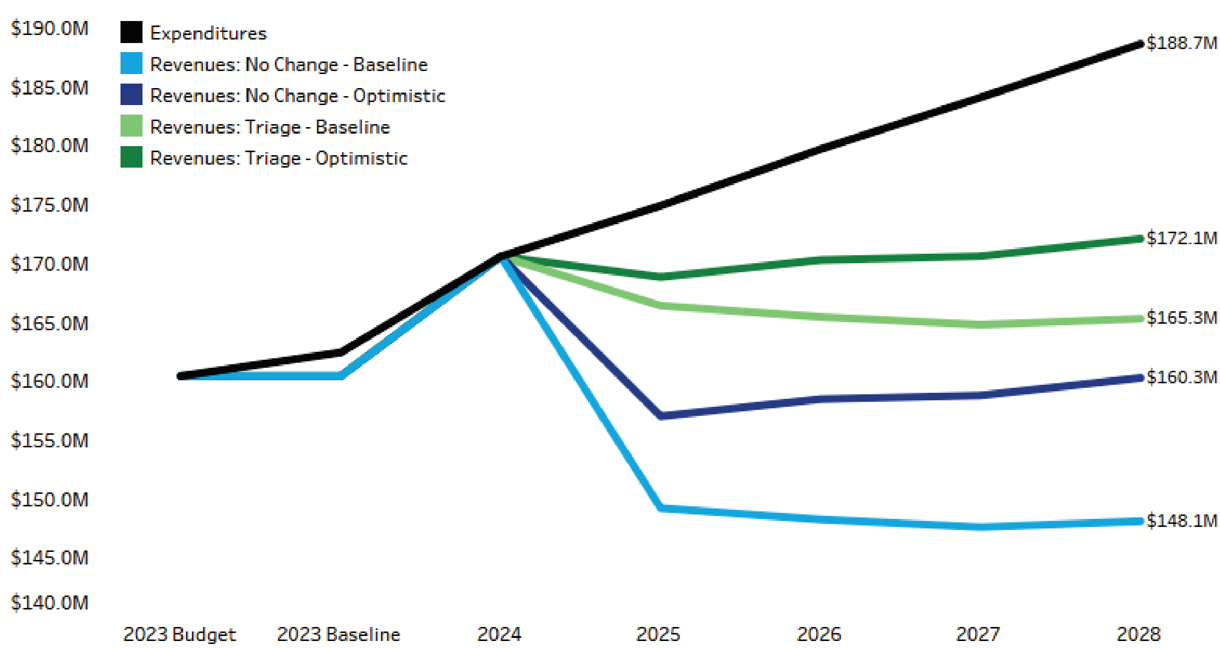
Table 2: MCTS Route Eliminations and Reductions Under Hypothetical $15 Million Cut Scenario

Route	Name	Rides	Hours / Weekday	PBH
20	S. 20th	359	29.7	12.3
68	Port Washington	314	27.6	12.1
60	60th	1,943	170.3	11.8
28	108th	756	68.0	11.6
34	Hopkins	791	70.7	11.5
88	Brown Deer	568	52.1	11.4
92	92nd	941	93.2	10.5
58	Villard	506	51.7	10.3
52	Clement	247	28.5	8.8
Total Weekday		**4,482**	**391.8**	

Triage Approach

A Triage Approach would involve doubling the size of the current $30 VRF, coupled with modest increases in the amount of property tax levy allocated to MCTS. If the $30 increase took place in 2025 and all of the additional proceeds were directed to MCTS, then the gap that year would shrink to a more manageable $8.5 million in our baseline model and $6.1 million in our optimistic model (see **Figure 5**). These smaller gaps ostensibly could be filled with a combination of more modest allocations of increased property tax levy and more limited service reductions than would be required under the year-to-year approach.

Figure 5: Triage Option Revenue/Expenditure Projections, 2023-2028



Source: Wisconsin Policy Forum projection model

While a doubling of the VRF would provide considerable short-term relief, the revenues it would generate would be unlikely to increase much from year to year. In the meantime, after the initial surge in revenue, MCTS's structural gap would continue to grow by roughly $3 million to $5 million annually. Consequently, unless county leaders are willing to increase the tax levy dedicated to MCTS by that same amount each year or commit to regular VRF increases, the triage approach likely would not be sufficient to avert substantial service reductions after the first year or two.

State-Enabled Solution

In contrast to the pessimism surrounding the prospects for a state-enabled solution in 2008, today such a solution is already under discussion by state legislators from both parties. That solution is a 1% countywide sales tax increase, with the roughly $190 million in annual revenues it would produce at the outset divided equally between the county and city. If the proposed sales tax is adopted and county leaders have discretion to allocate the bulk of the resources as they see fit, then MCTS's financial challenges could diminish significantly, particularly if coupled with the triage options.

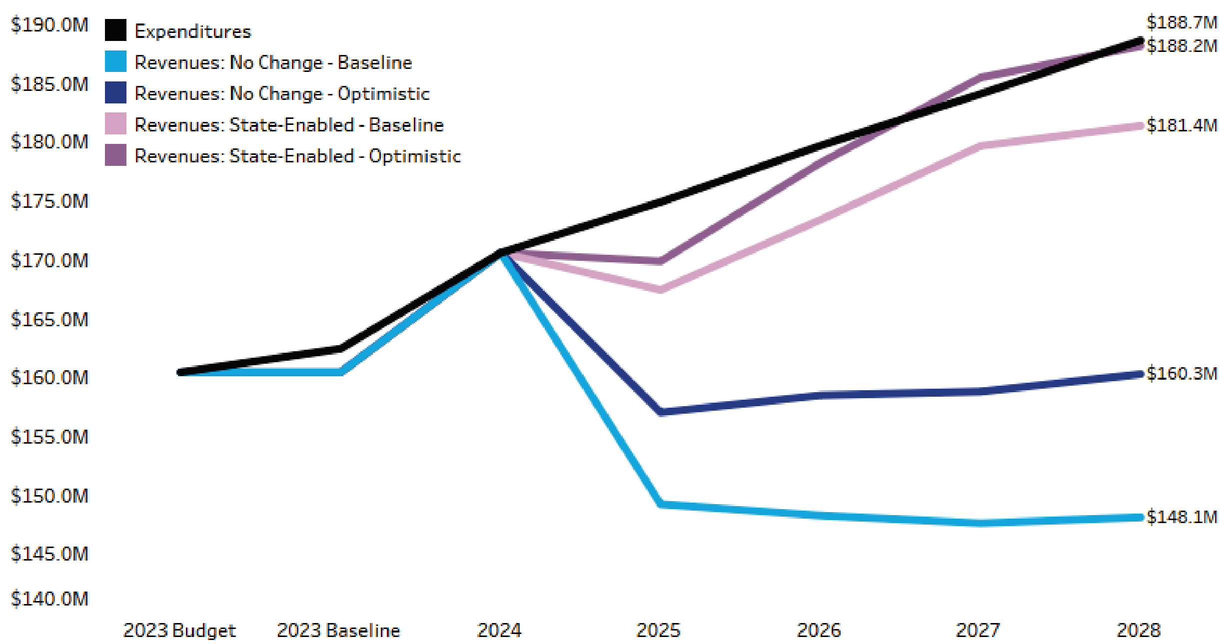
In **Figure 6**, we show one hypothetical model of how that scenario might play out by adding a portion of the proceeds from a 1% county sales tax increase to some of the elements from our triage approach. In our model, we assume:

- County leaders would allocate one-tenth of their projected $95 million share of new sales tax revenues (i.e. $9.5 million) to MCTS operations in 2025. That allocation would then grow by 2% each year reflecting estimated growth of sales tax revenues.

- Per one variation of the triage approach, they would also implement successive $10 increases in the VRF in 2025, 2026, and 2027.

- Also per the triage approach, they would dedicate an extra $3 million of property tax levy to MCTS beginning in 2025, followed by increases of $1 million annually from 2026 to 2028.

Figure 6: State-Enabled Option Revenue/Expenditure Projections, 2023-2028



Source: Wisconsin Policy Forum projection model

When we apply these assumptions to our optimistic model, which also includes 2% increases in state operating assistance in 2024, 2026, and 2028, we find that **MCTS would face a relatively manageable $5 million deficit in 2025 that ostensibly could be filled with modest service reductions or efficiencies or perhaps a larger property tax levy increase than we have assumed. The deficit would then be erased completely by 2027 when the final $10 VRF increase kicks in and remain at less than $500,000 in 2028.** For our baseline model, the annual gap would range from $4.4 million to $7.5 million, which again likely would require some service cuts to address, but of much lesser magnitude than shown in the year-to-year approach.

It is important to note that MCTS's improved fiscal outlook would deteriorate over time after the $30 VRF increase is fully phased in and that larger deficits ultimately would emerge once again in light of a continued structural imbalance. However, that smaller imbalance could be at least partially addressed by somewhat regular VRF increases based on inflation or consistent inflationary increases in state operating assistance. Also, the county would continue to face challenges with regard to MCTS's bus replacement and other capital needs.

Summary

Our modeling verifies the likely occurrence of a substantial fiscal cliff for MCTS in 2025 and provides insight into whether county leaders can confront it with only minimal impacts to riders and the local economy.

On the one hand, some might argue that even the extensive service reductions we hypothesize in the year-to-year approach will not have grave impacts, as they eliminate relatively low-ridership routes and reflect a need for MCTS to respond to a new post-pandemic world of lower transit usage with a justifiable reduction in its footprint.

Yet, the impacts of such cuts on mostly low-income citizens must be recognized, as well as what they would portend for the county's efforts to add new and faster service that is designed to recapture riders. Also, at a time when employers are struggling to find the workers they need, and in an era when volatility on the global stage can produce sharp spikes in gasoline prices, some would question the wisdom of cutting any important transportation option for area residents.

In our triage scenario, we show how county leaders might use the one local revenue tool in their toolbox to preserve most service in the near term. However, unless they wish to commit to regular, substantial increases in the VRF, that tool only will buy a short amount of time.

Finally, the state-enabled solution approach shows that, for perhaps the first time in recent memory, there is real hope for a lasting solution. Our aim here is not to portray this approach as a panacea, nor to disregard the impact of the modest service reductions that still may be required. We recognize the uncertainty surrounding approval of the 1% county sales tax proposal in the first place, let alone the capacity and willingness of county leaders to devote one-tenth of the proceeds to transit, double the size of the VRF, and commit substantial additional tax levy to MCTS.

By presenting this approach, however, **we are able to show that a long-term solution to the current fiscal crisis is within the grasp of state and local policymakers,** and that would particularly be the case if regular, inflationary increases in state operating assistance are added to the state-enabled solution package.