Milwaukee County

Five-Year Financial Forecast

2015 – 2019

Office of the Comptroller

Scott B. Manske, Comptroller

May 2014

EXECUTIVE SUMMARY

The five-year forecast for Milwaukee County has been prepared as a tool for understanding the future course of the County budget, given certain assumptions about general economic conditions and growth in the revenues and expenditures that comprise the County's budget. The purpose of utilizing a forecast is to determine the extent of actions necessary to close the gap between revenues and expenditures, ensuring long term fiscal sustainability. The forecast is available to be incorporated in the County's routine decision making process to demonstrate the long range impact of courses of actions being considered by the County.

In using the information contained in the projection, it is important to understand that an indicated surplus or deficit reflects the model's assumptions and shows what could happen in the absence of policy direction to cut costs or increase funding. Surpluses or deficits are compounded over the forecast period. In reality, the annual budget process eliminates the gap in the current year, and in taking steps to eliminate the gap that are sustainable long term, the deficits in the out years will be much less.

Results of this year's forecast indicate an ongoing structural deficit that worsens slightly from five-year forecasts issued in prior years. The main findings of the report include:

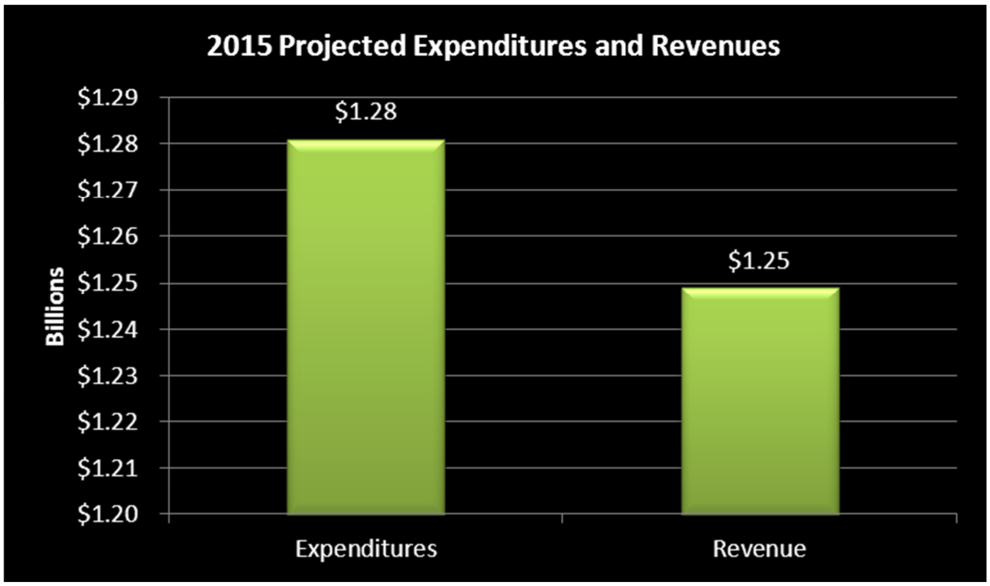
- The projected gap for the 2015 budget is approximately $31.9 million. Key assumptions contributing to the gap in 2015 include substantial tax levy increases for the Behavioral Health Division, Office of the Sheriff and pension contribution, as well as increases in personnel costs for wages, overtime and healthcare. The $31.9 million gap assumes that a one-time contribution from the Debt Service Reserve is discontinued and that Congestion, Mitigation and Air Quality (CMAQ) transit grant funding is no longer available to offset costs of the Red, Green and Blue Line Express Routes. Offsetting these increases is a significant drop in the annual debt service payment due to full amortization of the 2003 bond refunding.
- The County's structural deficit for 2015, 2016 and 2017 has worsened slightly from the previous five-year forecast. The expenditure forecast for 2015 got slightly better from the prior five-year forecast, resulting in an expenditure reduction of $46.5 million. However, the revenue forecast for 2015 got slightly worse from the prior five-year forecast, with a reduction of approximately $52.7 million. Therefore, the overall structural deficit for 2015 worsens by about $6.2 million.
- The chief components of the structural deficit continue to be personnel cost increases and stagnant revenues.
- Other issues such as pending litigation, the State's Biennial Budget and deferred maintenance persist that may compromise the County's future fiscal outlook and should be monitored closely.

ACKNOWLEDGEMENTS

The evaluation of five-year forecast depends on the generous assistance of many individuals and departments. The Comptroller would like to thank all of those who participated in the review and discussion of the assumptions within the model.

MILWAUKEE COUNTY'S PROJECTED GAP FOR 2015

Critical services provided by Milwaukee County rely on the ability of the County to raise sufficient revenues to continue meet current service levels. Highways and public transportation, public safety, parks and recreation, services to the elderly and disabled and many more services rely on federal and state funds, taxes and fees and the property tax levy. As has been the case for several years, the County's expenditure growth will outpace revenue growth resulting in a $31.9 million gap for 2015.



The projected gap in 2015 is comprised of the following changes from the 2014 Adopted Budget:

- An anticipated tax levy increase for the Behavioral Health Division and Community Services Division of nearly $7.0 million, which includes personnel cost increases discussed below. Based on State Statutes adopted in March 2014, the County is required to contribute a tax levy for these programs between $53.0 million and $65.0 million, which is determined at the sole discretion of the County Executive based upon a request from the newly created Milwaukee County Mental Health Advisory Board. The model predicted that based on forecasted expenditures and revenues, nearly all of the tax levy allowable under State Statute would be necessary.

- A projected tax levy increase for the Office of the Sheriff of nearly $6.0 million, which includes personnel cost increases discussed below.

- The end of the amortization of the Mercer lawsuit settlement within the Employee Retirement System (ERS) results in a substantial increase in the County's contribution to the ERS. Total pension-related expenses increase by $7.8 million in 2015.

- Projected increases in salary and overtime costs of $14.4 million. Salaries are anticipated to rise by 2.5 percent while overtime was significantly adjusted to account for under budgeting in prior years and increased use of overtime by the Office of the Sheriff and the House of Correction. Overtime costs alone account for $7.2 million of the increase.

- Employee healthcare costs are expected to grow by about 7.5 percent in 2015. Because actual healthcare expenditures for 2013 were better than originally forecasted, a 7.5 percent increase in actual costs results in a $4.2 million budget increase in 2015.

- Projections were modified to account for expenditures related to worker's compensation that have been higher than budget. These expenditures, coupled with an anticipated increase in property insurance deductibles result in an increase of $2.5 million.

- Loss of Federal CMAQ transit grant funding of $5.0 million for the Red, Green and Blue Line Express Routes. The model assumes that Red, Green and Blue Line Express Routes will continue to operate. This results in a projected tax levy increase of approximately $5.0 million for the Department of Transportation – Transit Division.

- Loss of one-time revenue appropriated in the 2014 Adopted Budget of $12.1 million from the Debt Service Reserve, which reduced the tax levy required for annual debt service payments.

- Reduction of $14.4 million in the annual debt service payment mainly resulting from the completion of the payments on the 2003 debt refinancing.

The 2015 gap of $31.9 million is based on certain assumptions within the model. There are actions that could be taken to offset a portion of the $31.9 million which are not included within the model. These include:

- The current projection assumes no contribution from the Debt Service Reserve. The County could budget revenue of $12.1 million from the Debt Service Reserve again in 2015, as it did in 2014. Based on preliminary financial results of 2013, it is likely that the Debt Service Reserve will contain sufficient funding to make this contribution again. However, depending on the 2013 final year-end surplus, such a contribution may cause the County to take an action that conflicts with its own policy of maintaining a Debt Service Reserve minimum of $10 million. It should be noted that such an action in 2015 does not eliminate the $12.1 million impact on the structural deficit, but instead delays the impact by one or more years.

- The County could repurpose some portion of current Contingency Fund dollars. The current model assumes an ongoing contribution of $7.8 million to the Contingency Fund. However, the Comptroller recommends that no more than $2.8 million be repurposed in 2015 to offset the gap. A minimum funding of $5.0 million should be budgeted annually in the Contingency Fund.

- The 2014 Adopted Budget includes a sales tax contribution of $9.4 million to capital projects. Based on current financial policy, the County has a goal of 20 percent cash financing of the net County commitment (net of reimbursement revenues) for capital projects. Depending on other cash financing sources available or the level of cash financed projects approved, the County may be able to reinvest a portion of the $9.4 million sales tax allocated to the capital budget back into operations.

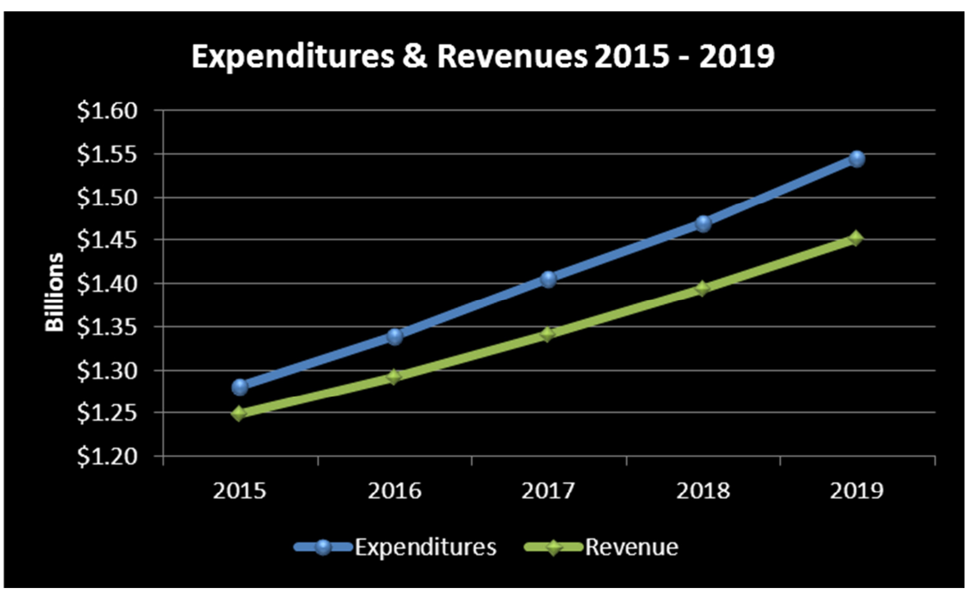
- The County could limit departmental tax levy increases forecasted within the model. For example, the current projection assumes nearly the maximum levy increase for the Behavioral Health Division and Community Services Division. The County Executive may limit the tax levy increase for the Behavioral Health Division and Community Services Division. As mentioned earlier, the County Executive, under State Statute adopted in March 2014, is only required to provide a tax levy contribution up to $65.0 million. There is no requirement to budget the entire increase between the current tax levy ($57.5 million) and the maximum tax levy ($65.0 million) in 2015. Additionally, the County could limit some of the larger projected tax levy increases in other departments such as Transit or the Office of the Sheriff.

STRUCTURAL DEFICIT GROWS FROM PREVIOUS FORECAST

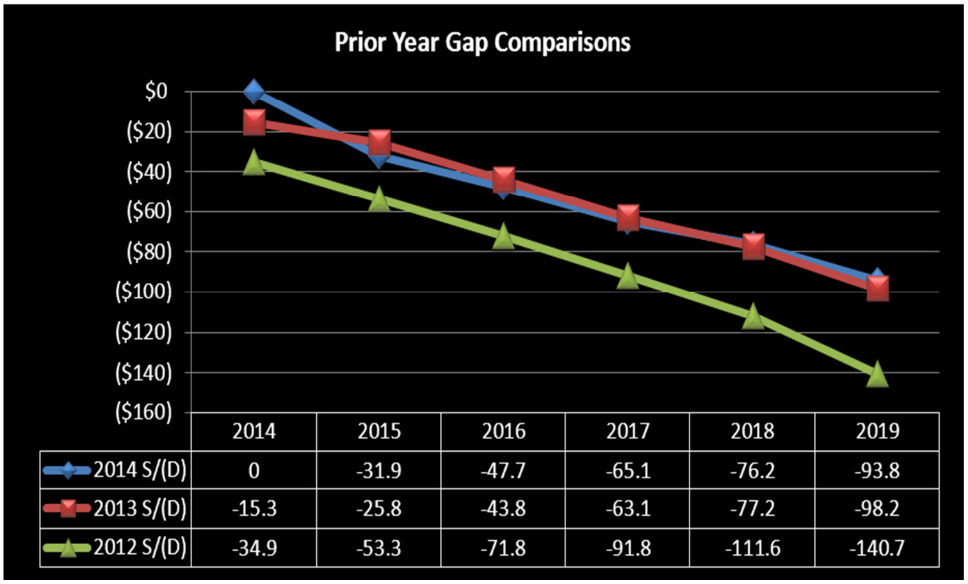
Because expenditure growth is anticipated to outpace revenue growth for the next five years, the County will continue to have a structural deficit in the forecast period absent any policy changes.

Five-Year Projected Structural Deficit				
Year	Expenditures	Revenues	Gap	Adjusted Gap*
2015	$ 1,281,038,536	$ 1,249,097,033	$ 31,941,503	
2016	$ 1,339,778,467	$ 1,292,081,451	$ 47,697,016	$ 15,755,513
2017	$ 1,406,214,357	$ 1,341,124,150	$ 65,090,207	$ 17,393,190
2018	$ 1,470,276,406	$ 1,394,104,886	$ 76,171,520	$ 11,081,314
2019	$ 1,545,514,127	$ 1,451,717,841	$ 93,796,286	$ 17,624,766

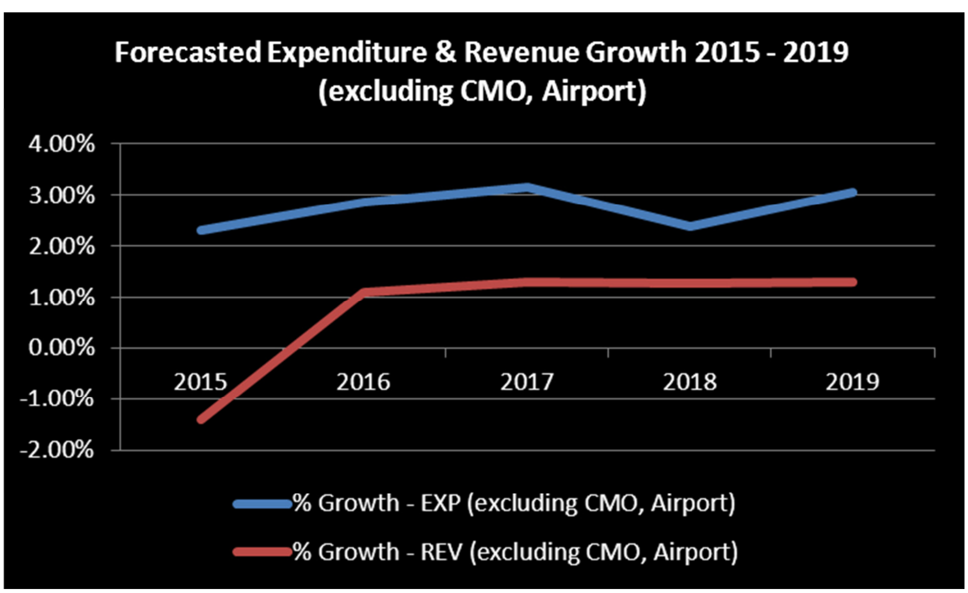
*Adjusted gap assumes that the prior year gap was eliminated with long-term solutions.



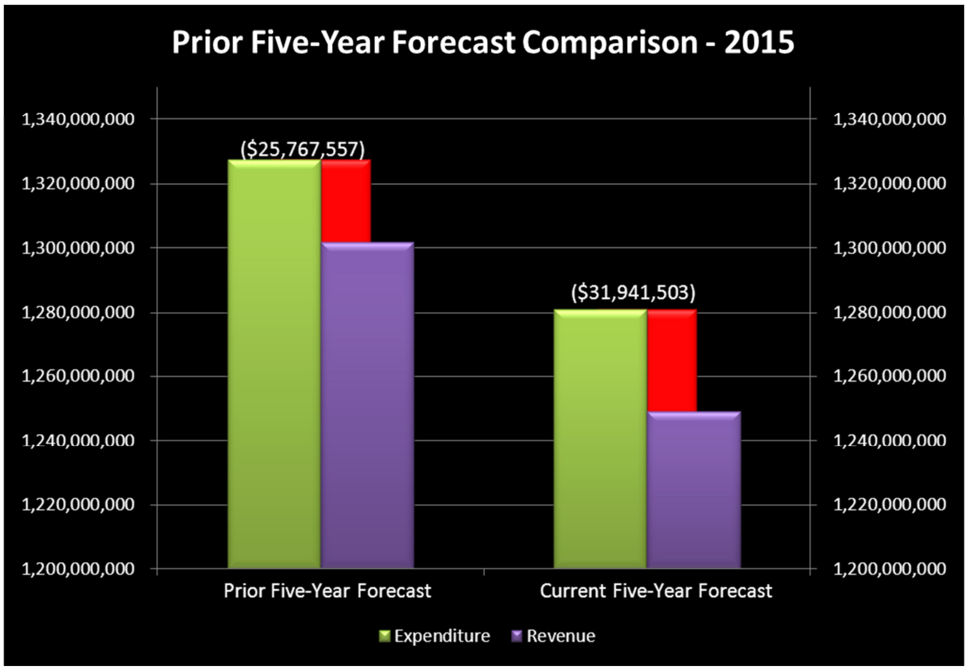
It is important to note that even with the ongoing structural deficit the County continues to maintain strong financial policies which have reduced the structural deficit from past years. The impact of these structural changes is shown in the table below, which compares the forecasted structural imbalance for the five-year period of 2015-2019 after the passage of each annual budget since 2012.



When the model was first utilized after passage of the 2009 budget, it projected that if annual budgets were balanced using only one-time measures, the County would face a $79 million deficit in 2010 that would grow to $153 million by 2014. Expenditures were forecasted to grow by 6.1 percent annually while revenues would rise by only 3.7 percent annually. Even with the fundamental changes the County has made to lessen the structural deficit, it continues to persist. Expenditures are now forecasted to grow by an average of 4.7 percent annually, while revenues are forecasted to grow by an average of 3.4 percent annually. However, these numbers are skewed slightly higher due to the growth rate allowed in the County's Family Care and the Airport. When adjusting the forecast to exclude Family Care and the Airport, expenditures grow at an average annual rate of 2.8 percent and revenues grow at an average annual rate of 0.7 percent.



The previous model projected a structural deficit of $25.8 million in 2015. The new model estimates that the structural deficit has grown to $31.9 million. The increase in the structural deficit between the previous and current forecast results from the County's revenue growth being worse than previously forecasted. Expenditure growth improved between forecasts but not enough to completely offset the forecasted revenue loss.



PERSONNEL COSTS AND STAGNANT REVENUES CONTINUE TO DRIVE STRUCTURAL DEFICIT

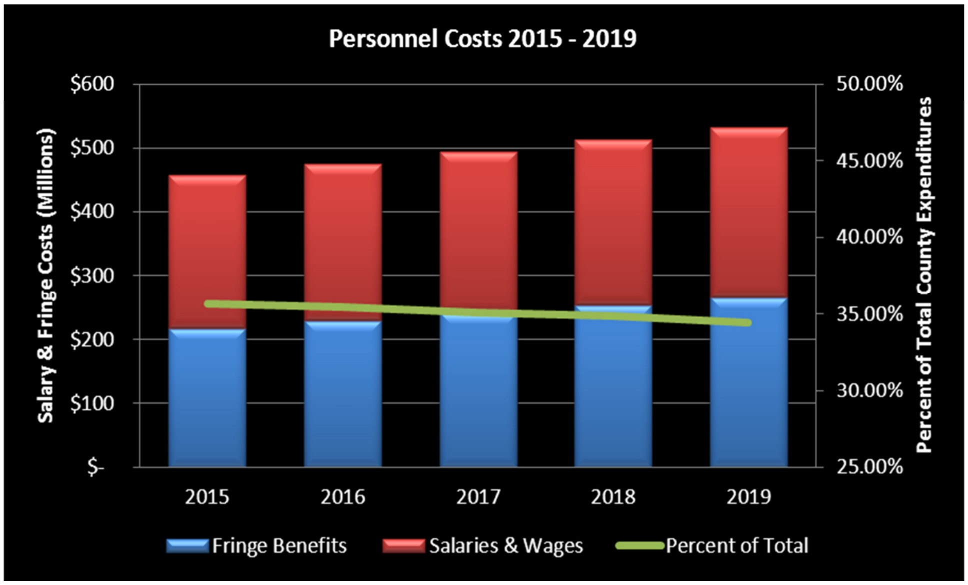
The ongoing drivers of the structural deficit continue to be personnel costs and stagnant revenue. Considering that personnel costs comprise nearly 40 percent of the County's total expenditures, it is reasonable that increases in personnel costs together with minimal revenue growth will continue to create a structural imbalance within the County.

- **Personnel Costs:** The County's percentage of total expenditures for personnel-related expenditures is decreasing over the forecast period, suggesting that the County, through its significant changes in the last several years, has meaningfully restrained expenditure growth in this area. However, given the proportion of County expenditures that are personnel costs, these costs will inherently always be a factor in the structural deficit if the County is to remain a competitive employer in the marketplace by providing competitive wages and benefits package.

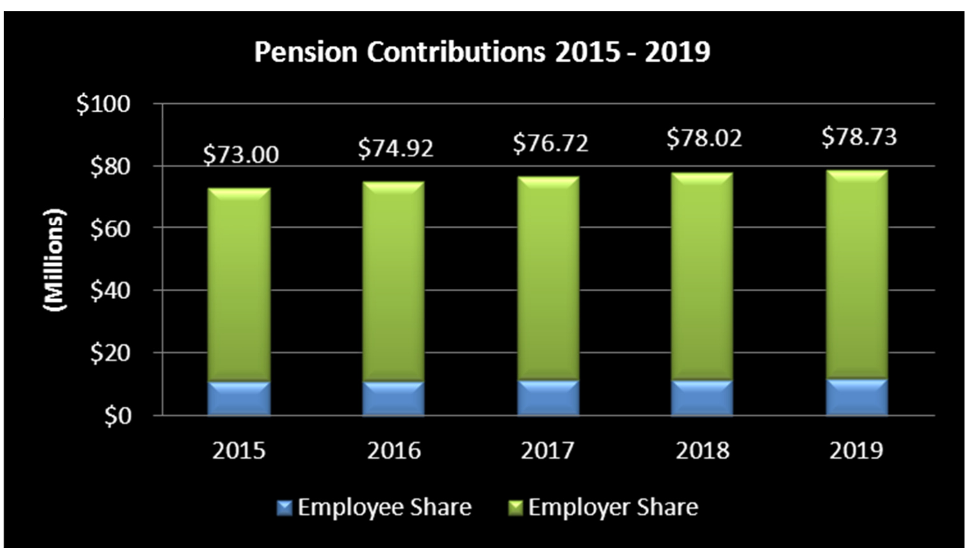
  Salaries and Wages are forecasted to grow by 11.5 percent during the five-year forecast period. For 2015, this includes approximately 3 percent in additional salary dollars over projected 2014 costs for employee salary increases.

  Fringe Benefits including pension and healthcare will grow 21.8 percent during the five-year forecast period. This is less than the five-year forecast projections in 2012 and 2013 of 36 percent and 29 percent, respectively, but still remains a significant financial obligation for the

County. Fringe benefits for healthcare are projected to grow annually by about 7.5 percent, totaling $102.9 million or 31.5 percent over the five-year period.

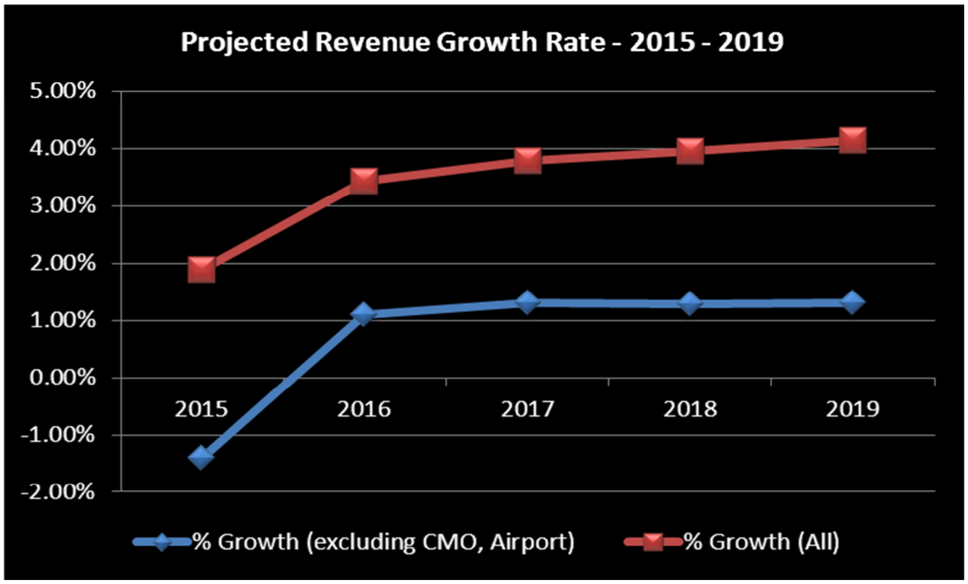


The County's pension-related costs spike substantially in 2015 due to the full amortization of the Mercer lawsuit settlement within the Employee Retirement System (ERS). The County intended the full amortization of the settlement to coincide with the drop in the annual debt service payment in 2015 so that the savings in the debt service payment would be available to offset the increase in the pension contribution. The total increase in pension costs from 2014 to 2015 is nearly $8 million. Expenditures will continue to rise over the forecast period resulting in a total increase of $55.5 million over the five-year period or 7.9 percent. The portion of these costs which are attributable to active employees will be offset by an increase in active employee pension contributions of approximately $10.0 million.



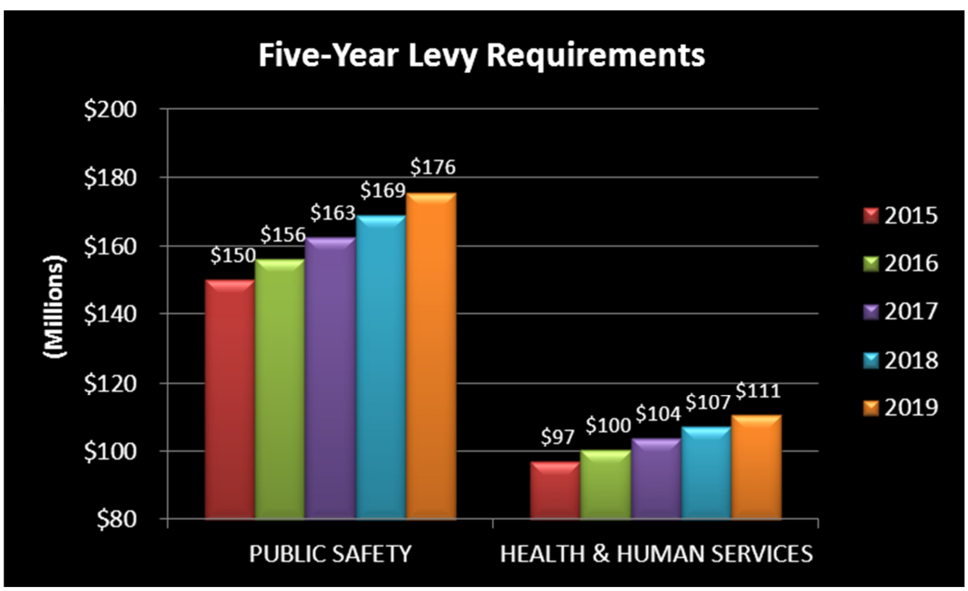
- **Revenues:** The County operates under strict tax levy caps imposed by State Statutes, and new sources of revenue are limited. In total, the County's revenue growth is projected to average

3.4 percent. However, as shown below, when Airport and Family Care revenues are removed, the County's 2015 revenue growth is negative and the average annual revenue growth over the five-year period is only 0.7 percent. Low growth rates are attributable to mostly flat revenue projections for State and Federal resources, as well as discretionary resources that are mostly forecasted to grow at CPI over the forecast period. This suggests that the County will be able to do little with respect to revenue and managing the structural deficit, unless new revenue sources become available.



DEPARTMENTAL LEVY REQUIREMENTS

Generally, growth in expenditures mandated by other levels of government continues to outpace the revenues that support those functions requiring greater tax levy contributions over time.



In situations where growth in expenditures outpaces growth in revenues, the County must dedicate a greater share of its discretionary resources to support these mandated functions. As shown in the chart above, levy requirements for Public Safety and Health and Human Services, mostly mandated functions, grow considerably over the forecast period.

Transit operations will also require additional tax levy dollars in the future as expenditures grow and revenues remain essentially flat.

OTHER ISSUES IMPACTING THE COUNTY'S FISCAL OUTLOOK

Other issues exist which may or will have any impact on the structural deficit and County finances in the future. The fiscal outlook presented in this report does not include any assumptions relating to these issues.

- **Freezing the Levy:** Generally, the forecast carries forward current policies in its assumptions. However, this model assumes that property taxes will grow by 0.7% over the five-year period, mainly due to limits within Wisconsin State Statutes. This is different than current policy which in 2014 was to hold the property tax levy flat. Holding the property tax levy flat over the forecast period would increase the deficit over the next five years and would result in the County having to collect an additional $27.8 million in revenues from other sources or find non-service impacting expenditure reductions to continue to provide the same level of service over the forecast period.

- **Pending Litigation:** The County currently has outstanding litigation issues relating to various issues including the pension multiplier and Medicare Part B reimbursement. If the County were unsuccessful in its lawsuits, the County's health and pension costs could increase in future years. Any possible increase in pension costs would be partially offset by employee contributions.

- **Froedtert Payment Relating to the Sale of Doyne Hospital:** The final payment from Froedtert Hospital for the sale of Doyne Hospital will occur in 2020. This will result in approximately $7.0 million in lost revenues in 2021. (This issue is addressed within the forecast, but the impact is beyond the five-year scope of this report.)

- **2015 – 2017 Biennial State Budget:** The State will begin its biennial budget work in early 2015, with an adopted budget expected by July 1, 2015. Although the State has been reported to be in a sound fiscal position at this time, it is unknown what cuts, if any, might be passed on to the County. Therefore, for purposes of this report, it is assumed that all local aids will remain flat, including Youth Aids, State Shared Revenue, General Transportation Aids, and others.

- **Debt Service and Infrastructure Needs:** The County's debt service has been steadily declining for several years, with the exception of 2010 which was due to the issuance of pension obligation bonds. In 2010, debt peaked at $885 million and is projected to decline to $585 million by 2019. Although the debt service has been declining, the County also faces significant infrastructure needs that outpace the County's current level of cash and debt financing for its capital assets. As documented in the Public Policy Forum December 2013 report "Pulling Back the Curtain: Assessing the needs of major arts, cultural, recreational, and entertainment assets in Milwaukee County", the County has over $246 million in projected capital needs between 2013 and 2017 for Milwaukee County-owned arts and cultural facilities and parks alone. Without increases of funding for maintaining or improving its capital assets or decreases in the size of the County's asset portfolio, the County would encounter growing future liabilities. Therefore, the likelihood of reinvesting debt service appropriations into other operating expenditures without a significant reduction in the County's asset portfolio is minimal within the forecast period.

  In addressing the County's infrastructure needs, it is possible that the Cultural and Entertainment Capital Needs Task Force, convened to identify funding options to preserve and enhance key cultural and entertainment facilities in the four-county metro area, could propose a recommendation that included some component of funding for the County's arts and cultural facilities and parks. It could also propose some contribution from the County to help fund a new arena. No recommendation is expected from the group until the fourth quarter of 2014.

- **Sheriff Staffing:** The Sheriff is projecting a 2014 deficit of approximately $3.8 million as of the first quarter. This forecast makes assumptions for salary and overtime that resolve this deficit in part, but because the cost of the Sheriff's actual staffing needs is not known at this time, additional resources may be necessary. Any additional financial resources which include significant staffing increases would increase the structural deficit over the forecast period.

ABOUT THE MODEL

The five-year financial forecast for Milwaukee County provides a projection of the financial results for future budget years using the current budget year as a base, adjusted for known factors specific to Milwaukee County. The forecast uses the 2014 budget as the basis for the 2015-2019 projection. The

2014 budget expenditure base is then adjusted for inflation in most cases. For certain expenditures or revenues including wages, benefits and certain programs, inflationary increases are based on recent increases specific to Milwaukee County. The 2014 base is further adjusted for one-time events particular to 2014, or programs/ revenues/ expenditures which end in a future year.

All of this effort provides a first look at what a 2015 budget could look like for Milwaukee County, before any adjustments are proposed by the County Executive to prepare a balanced budget. The forecast provides a projection of the 2015 financial “gap” that the County would face if it were to budget a cost-to-continue budget.

In the five-year financial forecast, the 2015 forecast then becomes a base for the 2016 budget, again making all the adjustments for inflation, County specific cost increases, or the adjustment for one-time charges, and the conclusion of programs. The process repeats itself for each of the years under forecast.

CONCLUSION

A general conclusion reached this year, as has been reached in every recent year the forecast has been prepared, is that annual average inflationary cost increases associated with Milwaukee County, will not be offset by projected revenue increases. In other words, annual revenue increases for Milwaukee County cannot pay for projected cost increases specific to Milwaukee County. As a result, the projected financial gap in 2015 will become added to the 2016 financial gap. The 2015 and 2016 financial gap then becomes added to the 2017 financial gap. This goes on from year to year, which results in an increasing financial gap. That leaves the County with a challenge of balancing stagnant revenues and increasing expenditures with little relief in sight. Overcoming this structural imbalance will require proactive strategies beyond those the County has already undertaken.