**COUNTY OF MILWAUKEE**
**INTEROFFICE COMMUNICATION**

DATE : February 26, 2016

TO : Chairman Theodore Lipscomb, Sr.

FROM : Scott B. Manske, Comptroller

RE : Fiscal Analysis of the Proposed Compensation System for Milwaukee County

At the request of the Committee on Finance, Audit and Personnel, the Office of the Comptroller is submitting the following fiscal analysis of the proposed compensation system for Milwaukee County.

Scott B. Manske
Comptroller

cc: Supervisor Willie Johnson, Jr., Co-Chairman, Committee on Finance, Audit & Personnel
Supervisor James "Luigi" Schmitt, Co-Chairman, Committee on Finance, Audit & Personnel
Supervisor Jason Haas, Vice Chair, Committee on Finance, Audit & Personnel
Supervisor Michael Mayo, Sr., Committee on Finance, Audit & Personnel
Supervisor Peggy Romo West, Committee on Finance, Audit & Personnel
Supervisor Patricia Jursik, Committee on Finance, Audit & Personnel
Supervisor Martin Weddle, Committee on Finance, Audit & Personnel
Supervisor Supreme Moore Omokunde, Committee on Finance, Audit & Personnel
County Executive Chris Abele
Kelly Bablitch, Chief of Staff, County Board
Raisa Koltun, Chief of Staff, Office of the County Executive
Members of the Compensation Workgroup

## EXECUTIVE SUMMARY

As summarized in a report issued by the Compensation Workgroup on January 8, 2016, there are numerous issues that the County faces with respect to its current compensation system. To begin repairing and modernizing the County's current compensation system, the Department of Human Resources has proposed a new pay structure that is based on "ranges" rather than "steps." With the exception of a few unclassified positions, a majority of the County's unclassified positions have been migrated to the new pay ranges. The migration of classified positions to the new pay ranges requires County Board approval. Prior to such approval, the County Board has asked that the Office of the Comptroller provide a detailed fiscal analysis of the costs associated with the new pay range structure. This analysis is broken down into the following categories:

- **Annual Pay Range Adjustments.** Migrating all classified positions to the new pay range structure results in an immediate fiscal impact for 440 employees whose current salaries in the current system are less than recommended minimum in the proposed system. This will result in a cost of $1.0 million (offset by $0.1 million), of which sufficient appropriations were provided for within the 2016 Adopted Budget. Additionally, 42 unclassified positions have not yet been migrated to the new system because funding has not yet been appropriated. Migrating these employees will result in a cost of $0.2 million, of which sufficient appropriations were also provided for within the 2016 Adopted Budget. If the County maintains the new compensation system annually with pay range adjustments of approximately 0.5 percent, it is possible that the County will incur additional costs for annual pay range adjustments for those employees' with salaries at the absolute minimum. However, assuming that the County continues to provide annual increases of at least 1.0 percent, any costs related to annual pay range adjustments will be nominal at most.

- **Equity Adjustments.** Once the new compensation system is approved, the issues of equity and compression must be resolved. Equity and compression largely revolve around the issue of having many employees with differing levels of experience paid at the same amount. Best practices suggest that every employee, depending on position, earn an additional 0.5 - 1.25 percent above the minimum pay per year employed. A comprehensive review of Milwaukee County employees and years of service indicate that fully addressing equity and compression issues will result in additional costs of $2.7 for classified employees and $0.4 million for unclassified employees (offset by $0.3 million in revenue). The Department of Human Resources has been allocated an appropriation of approximately $1.3 million in the 2016 Adopted Budget to begin to address equity and compression issues.

- **Change in Average *Potential* Salary Liability.** As discussed in greater detail throughout the Compensation Workgroup report and Administrative Procedures, "mid-points" under the proposed system become the target "average" salary for employees in a certain pay range. For purposes of comparing the new and current systems, a mid-point becomes similar to the maximum step of the current system. Within the new system, most tenured employees will ideally cluster around the mid-point, whereas within the current system, most tenured employees cluster around the maximum step. Comparing every position's current pay grade and proposed pay range reveals that in most cases, mid-points are less than the current maximum step. Assuming that the new pay ranges did not extend beyond the mid-point, the County would be reducing its total ***potential*** salary liability by $9.6 million.

- **Change in Total *Potential* Salary Liability**. Because the proposed system goes beyond mid-points to include maximum pay amounts within the ranges, the County is actually increasing its overall *potential* salary liability. However, pay beyond the mid-point is meant to be earned or allocated for employees that continually exceed expectations, provide an invaluable benefit to the County or have significant tenure in a specific position with the County. These types of employees will have the ability to earn beyond the average pay in the new system ***and*** beyond the maximum pay in the current system. Although many employees will be paid between the mid-point and maximum point, it is unreasonable to assume that the County would ever pay every employee at the maximum point within the new pay structure. However, for illustrative purposes, should the County ever find itself in that position, the additional potential salary liability created under the proposed pay structure would be $17.0 million.

- **Impact on Pension Liability.** Actuarial analyses include a projection of pay increases for each individual that are used to develop the total benefits to be paid out by the pension system. This scale typically reflects expected inflation, productivity, seniority, promotion and other factors. Based on the actuarial valuation dated August 2015, the annual rate of salary increase used in the assumptions was 3.5 percent per annum. Based on the estimates provided here, it is not anticipated that the total payout for the migration to the new system will exceed 3.5 percent of the County's total current payroll for 2016 and therefore, will not have an impact on the County's pension liability.

This fiscal analysis provides the Office of the Comptroller's best estimate of the financial impact and potential salary liability of the proposed compensation system. The Office of the Comptroller consulted with the Department of Human Resources to determine positions affected, potential fiscal impacts and industry best practices. The actual tax levy impact to the County of full implementation will not be known because the County's workforce continues to turnover from day-to-day. It is also undeterminable which employees may retain employment with the County long-term and which employees may move through the proposed pay range structure quicker or which may move beyond the mid-point.

As noted above, the County has appropriated $2.4 million for costs associated with annual pay range adjustments and equity and compression issues. This document does not discuss options for funding any of the additional costs projected. Since no actual salary liability is increased or reduced by the new pay ranges, there is no fiscal cost associated with it. The Comptroller is confident that with budgetary controls and administrative controls the actual costs will remain within reason of the estimates provided here.

## OVERVIEW

The Department of Human Resources is proposing a new pay structure that utilizes "pay ranges" instead of "pay grades". The County's current pay grade system is based on steps, in which the pay grade has a certain number of steps that are arbitrarily assigned a dollar amount. Until about five years ago, employees within a pay grade advanced from step 1 through each step upon completion of 2080 hours. Once that reached the top step, they were no longer eligible for pay increases under the pay grade system, unless a general increase/cost of living adjustment was given to all employees.

The proposed pay structure is similar to how most private entities and some public entities administer compensation, utilizing a specific range with a minimum, mid and maximum point to determine appropriation compensation for employees assigned to that range.

The new system would be administered in such a way that fiscal impacts will be much higher in the first few years to resolve many of the ongoing minimum pay issues and equity and compression issues the County is experiencing. Thereafter, it is assumed that budgetary controls and administrative controls will limit any fiscal impacts of the system to those properly appropriated for. The overall administration of the system results in the following potential cost categories:

- **Annual Pay Range Adjustments**
- **Equity Adjustments**
- **Change in Average *Potential* Salary Liability**
- **Change in Total *Potential* Salary Liability**
- **Impact on Pension Liability**

## CAVEAT ON FINANCIAL IMPACT

Given the circumstances of how compensation is administered and the factors used in determining future compensation, long-term financial impacts of the new pay structure are not easily quantified. It is assumed that constant transformation of the County's workforce will reduce the likelihood that County will ever pay every employee at the mid-point or maximum point of the range simultaneously. It is also assumed that County Board oversight through budgetary provisions and management oversight through established administrative procedures will preclude the County from ever progressing near the maximum liability discussed here.

The Comptroller is confident that with budgetary controls and administrative controls the actual costs will remain within reason of the estimates provided here.

## ANNUAL PAY RANGE ADJUSTMENTS

Annual pay range adjustments are needed as 1) a one-time adjustment upon implementation to ensure all employees are making at least market minimums and 2) as an annual cost to maintain market minimums.

The initial pay range adjustment is based on the recommended pay ranges before the County Board. Migrating all classified positions to the new pay range structure results in an immediate fiscal impact for 440 employees whose current salaries in the current system are less than recommended minimum in the proposed system. This will result in a cost of $1.0 million (offset by $0.1 million), of which sufficient appropriations were provided for within the 2016 Adopted Budget. Additionally, 42 unclassified positions have not yet been migrated to the new system because funding has not yet been appropriated. Migrating these employees will result in a cost of $0.2 million, of which sufficient appropriations were also provided for within the 2016 Adopted Budget.

Annual pay range adjustments will be determined by reviewing average pay in the market for benchmark positions within each pay range and determining the appropriate percentage increase for the mid-point of that range, or the average pay. By adjusting the mid-point, the minimums and maximums also change, resulting in a potential cost increase for any employees at the absolute minimum of the pay range. *(Additional costs will occur as an employee once at the maximum pay will have additional room to advance once the maximum point is increased. However, this is very similar to today's system and is not a result of the pay range adjustment but rather the type of increase that may be given to that employee once additional salary dollars are earnable by that employee.)*

If the County maintains the compensation system annually with pay range adjustments of approximately 0.5 percent, it is possible that the County will incur additional costs for annual pay range adjustments for those employees' with salaries at the absolute minimum. However, assuming that the County continues to provide annual increases of 1.0 percent or more, any costs related to annual pay range adjustments will be nominal at most. Costs associated with pay range adjustments can also be reduced through timing of other salary increases as well.

## EQUITY ADJUSTMENTS

Equity and compression adjustments occur 1) when an employee's pay does not match some factor such as years of service (years of licensure can also be used, as well as years in current position) and 2) when a position's average salary in the market is increasing faster than the County's average salary for that position.

Due to lack of funding for step increases in previous budgets as well as obsolete pay grades, pay for many County employees' lags behind what it should be based on years of service. Once the system is approved by the County Board, costs to move employees' whose pay lags behind the market will be substantial. It is estimated that this cost will be $2.7 million for classified employees (offset by $0.3 million in revenue) and an additional $0.4 million for unclassified employees. The 2016 Adopted Budget includes an appropriation of $1.3 million to begin phasing in equity adjustments. Upon completion of the total investment in equity, costly one-time equity adjustments such as these would only be necessary if the County fails to maintain at a minimum general increases for employees over time.

Ongoing equity adjustments will be determined by the position's average pay in the market and the County's ability to attract and retain qualified employees based on the County's average pay. The costs of ongoing equity adjustments are undeterminable as they are driven by the market and the County's staffing needs. It is reasonable to assume that the County would pay no more for these equity adjustments then it currently pays for reclassifications or reallocations, which are used for similar purposes.

## CHANGE IN AVERAGE *POTENTIAL* SALARY LIABILITY

Average pay is considered the "mid-point" of the new range. Average pay or the mid-point is determined by the market and generally refers to the targeted average pay for a group of employees in that range. The mid-point concept, or average salary concept, has a similar function as the maximum step provided under the current system. In an environment where steps are provided for continually, employees move through the step system to some maximum point, which is similar to the average salary or mid-point in the new system. Comparing the maximum step to the mid-point of the new range creates on reference point for understanding how the County's potential salary liability is changing.

***There are a few very important caveats to the table below.***

1. ***Assuming no other salary increases are given, any across-the-board percentage increase set by the County Board will determine how quickly an employee moves to the average salary. In theory, merit increases would also move the employee through the range and reduce the time to get to the average salary.***
2. ***Although some positions have a lower mid-point than the current maximum step, employees have additional salary capacity that goes beyond the mid-point. This additional salary capacity generally exceeds the current maximum step amount and is discussed in further detail in the section below.***

| Position | Maximum Step | Years to Top Step | Mid-Point / Average Salary | Years to Mid (1.25% per Annum) | Years to Mid (2.5% per Annum) | Years to Mid (3.75% per Annum) |
|---|---|---|---|---|---|---|
| Accountant 3 | $51,572 | 5 | $53,985 | 17 | 9 | 6 |
| Auto and Equipment Service Tech | $48,355 | 5 | $46,284 | 17 | 9 | 6 |
| Principal Architect | $103,288 | 5 | $95,690 | 19 | 10 | 7 |
| Distribution Assistant | $34,792 | 9 | $31,512 | 15 | 8 | 5 |
| Fiscal and Budget Manager | $81,819 | 5 | $82,039 | 19 | 10 | 7 |
| Highway Maintenance Worker | $39,241 | 5 | $47,382 | 15 | 8 | 5 |
| Corrections Officer | $42,972 | 7 | $46,284 | 17 | 9 | 6 |

If the entire set of positions is reviewed as in the table above, the average potential salary liability for the County **decreases** by $9.6 million. That is, assuming that everyone in the County were paid at the mid-point of the range versus the maximum step, the County's total expenditure would be $9.6 million less under the new system.

## CHANGE IN TOTAL *POTENTIAL* SALARY LIABILITY

The new system goes beyond average pay to maximum pay. Pay beyond the mid-point is meant to be earned or allocated for employees that continually exceed expectations, provide an invaluable benefit to the County or have significant tenure in a specific position with the County. These exceptional or tenured employees will have the ability to earn beyond the average pay in new system ***and*** beyond the maximum pay in the current system. Comparing maximum step to the maximum of the new range creates another reference point for understanding how the County's potential salary liability is changing under the new system.

***There are a few very important caveats to the table below.***

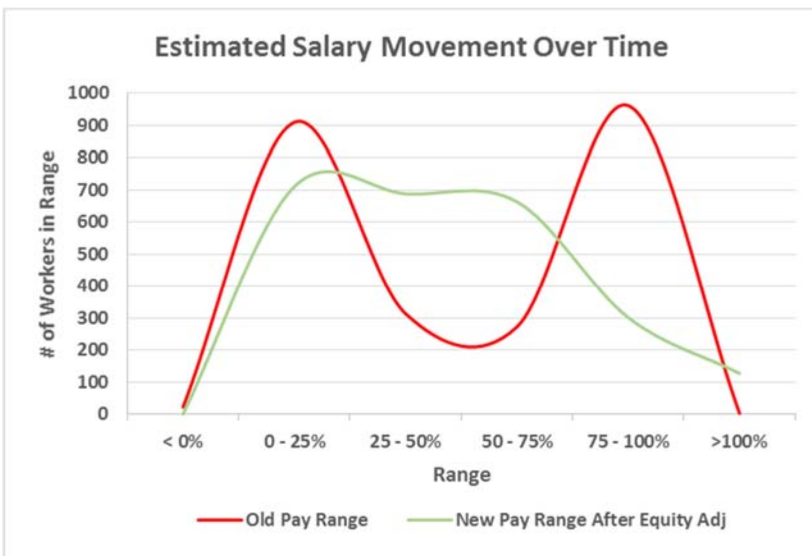
1. ***Assuming no other salary increases are given, any across-the-board percentage increase set by the County Board will determine how quickly an employee moves to the average salary. For illustrative purposes, the idea of an across-the-board percentage increase is carried out to determine how long it may take an employee to get to the maximum point.***
2. ***In theory, anything beyond the mid-point is meant to be earned through merit increases or to reward excellent employees. This projection assumes that employees would continue to receive increases due to years of service throughout their employment with the County, which is at the discretion of the County Board. Based on their budgetary authority, the County Board could restrict the amounts allocated to employees beyond the average salary to maintain budgetary control if needed. This too, would affect how long it may take an employee to get to the maximum point.***

| Position | Maximum Step | Years to Top | Maximum Point | Years to Max (1.25% per Annum) | Years to Max (2.5% per Annum) | Years to Max (3.75% per Annum) |
|---|---|---|---|---|---|---|
| Accountant 3 | $51,572 | 5 | $63,901 | 30 | 16 | 11 |
| Auto and Equipment Service Tech | $48,355 | 5 | $54,783 | 30 | 16 | 11 |
| Principal Architect | $103,288 | 5 | $114,829 | 33 | 17 | 12 |
| Distribution Assistant | $34,792 | 9 | $36,764 | 28 | 14 | 10 |
| Fiscal and Budget Manager | $81,819 | 5 | $98,447 | 33 | 17 | 12 |
| Highway Maintenance Worker | $39,241 | 6 | $55,279 | 28 | 14 | 10 |
| Corrections Officer | $42,972 | 7 | $54,785 | 30 | 16 | 11 |

If the entire set of positions is reviewed as in the table above, the total potential salary liability for the County **increases** by $17.0 million. That is, assuming that everyone in the County were paid at the maximum of the range versus the maximum step, the County's total expenditure would be $17.0 million more under the new system.

As noted in the Compensation's Workgroup report, "a healthy pay range model has fewer people at the low point and high point of the range. This means that fewer people are not at the maximum cap, and consequently more people have opportunity for career advancement." The report goes on further to say that "when budget constraints lead to step freezes, then both the lower range and higher range workers are stuck, with little opportunity for advancement."

As shown in the figure below, the County currently has a majority of its employees either "stuck" in the bottom quartile or the top quartile of the range (see red line – "Old Pay Range"). With frozen steps, all employees are only receiving minimal salary advances annually. The green line ("New Pay Range After Equity Adj") represents the change in quartiles once the full investment in the equity adjustment is made. The green line is nearly the same as the healthy pay range model discussed in the Compensation Workgroup report. In the healthy pay range model, more employees will move towards the average salary and more employees will have additional room for growth beyond the average salary.




In terms of the maximum potential liability calculated above, it is unreasonable to assume that at some point in time every County employee would be paid at the maximum point since salaries beyond the mid-point should be limited through budgetary and administrative controls. However, there is one major factor that will impact the actual financial cost of the additional salary capacity created under the proposed system: the County Board's budgetary controls.

The following examples help explain how the County Board's budgetary controls will play a pivotal role in limiting the actual cost.

1. Employees at the top step now continue to receive general increases. It is reasonable to assume that they will continue to do so under the proposed system. This is not a direct cost of the proposed system as the County would have paid those salary expenses under the current system. However, the County Board has the ability to appropriate for higher general increases for those under the average salary while appropriating lower general increases for those beyond the average salary.
2. Employees at the top step now are capped in the current system and are only eligible for general increases. Under the proposed system, many of those employees will have additional salary capacity which could allow them to exceed their current maximum salary. While general increases were discussed in the item above, the County Board in theory could limit any increases for employees beyond the average pay to one-time bonus payments or even limit the maximum merit pay allowed in that situation.

Ultimately, given the multiple factors that influence pay beyond the average salary, it is reasonable to assume that some portion of the $17.0 million in total potential salary liability will at some point become an actual expense of the County. However, it is not reasonable to assume that this will ever cost the full $17.0 million.

## IMPACT ON PENSION LIABILITY

Actuarial analyses include a projection of pay increases for each individual that are used to develop the benefit amount to be paid out by the pension system. This scale typically reflects expected inflation, productivity, seniority, promotion and other factors. Based on the actuarial valuation dated August 2015, the annual rate of salary increase used in the assumptions was 3.5 percent per annum. Based on the estimates provided here, it is not anticipated that the total payout for the migration to the new system will exceed 3.5 percent of the County's total current payroll for 2016 and therefore, will not have an impact on the County's pension liability.

Conversely, it should be noted that if the County chose not to invest these funds in salaries, costs would actually be lower for the pension system. For example, the 2016 budget contribution is based on an assumed 3.5 percent salary increase. When the liability is recalculated with actual experience, the 3.5 percent salary increase would be far less. This reduction in actual rate of salary increase would result in a lower contribution actually owed than was budgeted for.

## SUMMARY

The new compensation system as proposed by the Department of Human Resources will result in a direct financial impact of $3.9 million. However, what is not analyzed in this report are the opportunity costs associated with not fixing the current system. As the compensation system exists today, compression, equity and lower-than-market salary issues make it difficult to recruit and retain talented employees. Administration must deal with the costs of constant recruitment and often mediocre candidates. Additionally, flat wages have increased turnover, reduced productivity and increased training and hiring costs. It is unrealistic at this point to think that County can modernize its compensation system without some sort of financial investment. Based on the proposed implementation of the new system, the Comptroller is confident that the proposal provides the County with a strong framework to modernize the system, has appropriate financial controls in place to safeguard against any unreasonable future costs and will allow the County to attract and retain qualified employees while reducing other incalculable costs.