Milwaukee County

Five-Year Financial Forecast

2016 – 2020

Office of the Comptroller

Scott B. Manske, Comptroller

August 2015

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 improves slightly from five-year forecasts issued in prior years although the projection for 2016 has worsened since last year. The main findings of the report include:

- The projected gap for the 2016 budget is approximately $26.2 million. Key assumptions contributing to the gap in 2016 include a substantial increase in the pension contribution, a reduction in State shared revenue for the County's share of Bucks arena funding and elimination of the contribution from reserves. Offsetting these increases is a significant drop in annual healthcare costs, forecasted increases in property tax levy, and increased revenues from sales tax and employee pension contributions.

- The County's projected structural deficit for 2016 has worsened from the previous five-year forecast. The previous five-year forecast projected a structural deficit of $15.8 million for 2016, assuming that the 2015 structural deficit was resolved with long-term sustainable solutions. The current forecast is projecting a structural deficit of $26.2 million for 2016. Considering the increase in the County pension contribution and reduction in State shared revenue for the County's share of Bucks arena funding, as well as the one-time contribution from reserves budgeted for in 2015, the change in the structural deficit is reasonable.

- Long-term, the fiscal outlook of the County has improved. The previous five-year forecast predicted a gap of $93.8 million by 2019, assuming no long-term, sustainable solutions to prior year deficits. The current forecast predicts a gap of $58.8 million by 2019 and $74.7 million by 2020.

- The structural deficit will persist into the future until the County is able to match revenue growth with budgeted expenditure growth. The County has successfully managed its largest expenditures, and significantly reduced forecasted expenditure growth for the future, but has done little to increase revenues which continues to be the chief component of the structural deficit.

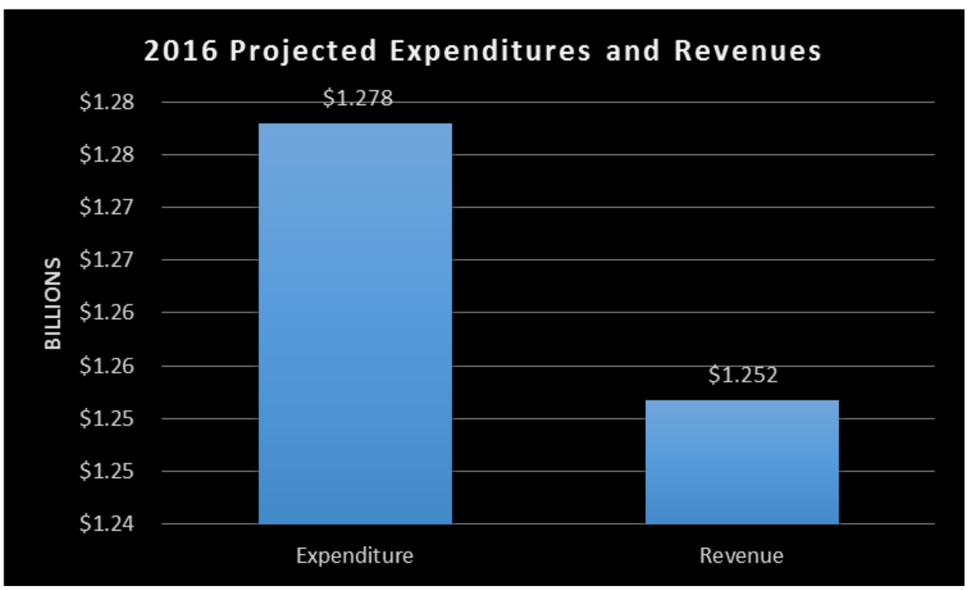
- Other issues such as potential outsourcing of the BHD inpatient units, Family Care design changes and deferred maintenance persist that may compromise the County's future fiscal outlook and should be monitored closely.

ACKNOWLEDGEMENTS

The evaluation of the 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 2016

Critical services provided by Milwaukee County rely on the ability of the County to raise sufficient revenues to continue to 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 $26.2 million gap for 2016.



The projected gap in 2016 is due to a gap between projected expenditure increases of $31.4 million and projected revenue increases of only $5.2 million. These increases are comprised of the following changes from the 2015 Adopted Budget:

Expenditure Type	Dollar Change
Pension	$ 20.4
CMO Purchase of Service	$ 3.8
Other	$ 3.6
Commodities & Services	$ 2.4
HHS Services	$ 2.3
Insurance-related Costs	$ 1.2
Debt Service	$ 1.1
Utilities	$ 1.0
Salaries & Overtime	$ 0.4
Contingencies	$ (1.1)
Employee Benefits	$ (3.7)
Total Change	$ 31.4
Revenue Type	**Dollar Change**
CMO Purchase of Service Revenue	$ 3.8
Employee Pension Contributions	$ 3.2
BHD Health Revenue	$ 3.0
Property Taxes	$ 2.5
Sales Tax	$ 2.4
CMO Other Revenue	$ 1.3
Airport Revenue	$ 1.2
Fees and Permits	$ 1.0
Highways Reimbursement	$ 0.5
Child Support Reimbursement	$ 0.3
Other Misc Federal Revenues	$ 0.3
Rental Revenue	$ 0.1
State Computer Aid	$ 0.1
Record & Filing Fees	$ 0.1
Fines & Forfeits	$ (0.7)
Human Services State Reimbursements	$ (0.9)
State Shared Revenue	$ (4.0)
Miscellaneous	$ (8.9)
Total Change	$ 5.2

Items of significance include:

- Substantial increases in the County's contribution to the Employee Retirement System are included due to reinclusion of the COLA liabilities that were not included in 2013 and 2014 calculations and implementation of funding policy changes. Total pension-related expenses increase by $20.4 million in 2016.

- Due to reductions in FTEs and limited salary increases over the past several years, total salary and overtime costs are projected to remain essentially flat from 2015 to 2016. This assumption includes a salary increase for inflation of 1.5 percent.

- Employee healthcare costs are expected to grow by about 7.0 percent in 2016. Because actual healthcare expenditures for 2014 were substantially less than originally forecasted, total costs in 2016 are anticipated to be $3.7 million less than in 2015.

- Due to an increase in the County's annual required contribution for pension, the employee portion of the contribution is expected to rise by about $3.2 million in 2016.

- Based on the budget proposed by the Behavioral Health Division (BHD), BHD anticipates approximately $3.0 million more in health revenues.

- The 2016 forecast assumes that the County will levy up to the net new construction which has averaged 0.9 percent. This provides an additional $2.5 million in revenue.

- Sales tax is exceeding budget for 2015, and is anticipated to grow at CPI next year for an additional $2.4 million in revenue.

- A majority of the $8.9 miscellaneous revenue loss is from one-time revenue appropriated in the 2015 Adopted Budget of $6.3 million from the Debt Service Reserve, which reduced the tax levy required for annual debt service payments. Additional revenue losses include unclaimed money for 2016[1] and revenue from TIF closures.

- State shared revenue is reduced by $4.0 million to account for a $4.0 million County contribution to the funding of the new Bucks arena. This contribution will be required for a period of 20 years.

The 2016 gap of $26.2 million is based on certain assumptions within the model. There are actions that could be taken to offset a portion of the $26.2 million which are not included within the model. These include:

- The current projection assumes no contribution from the Debt Service Reserve for 2016 and beyond. The County could budget revenue from the Debt Service Reserve again in 2016, as it has in past years. Based on the final financial results of 2014 and assuming all of the approved expenditures from the Debt Service Reserve are made, the Debt Service Reserve contains $25.5 million which is sufficient to make a contribution again. A similar contribution amount as 2015 would preserve the County's policy of maintaining a Debt Service Reserve minimum of $10 million and would reduce the 2016 deficit by the same. It should be noted that such an action in 2016

[1] Every other year, the County Treasurer publishes a notice of the fact that the Treasurer's Office possesses unclaimed money. If no legal claim is made within the time specified in such notice, all funds and interest earned are turned over to the General Fund of the County. The County will receive unclaimed monies in years 2017 and 2019 of the forecast.

does not eliminate the $6.3 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 a contribution of $7.5 million to the Contingency Fund. However, the Comptroller recommends that no more than $2.5 million be repurposed in 2016 to offset the gap. A minimum funding of $5.0 million should be budgeted annually in the Contingency Fund.

- The 2015 Adopted Budget includes a sales tax contribution of $9.3 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 $9.3 million sales tax allocated to the capital budget back into operations.

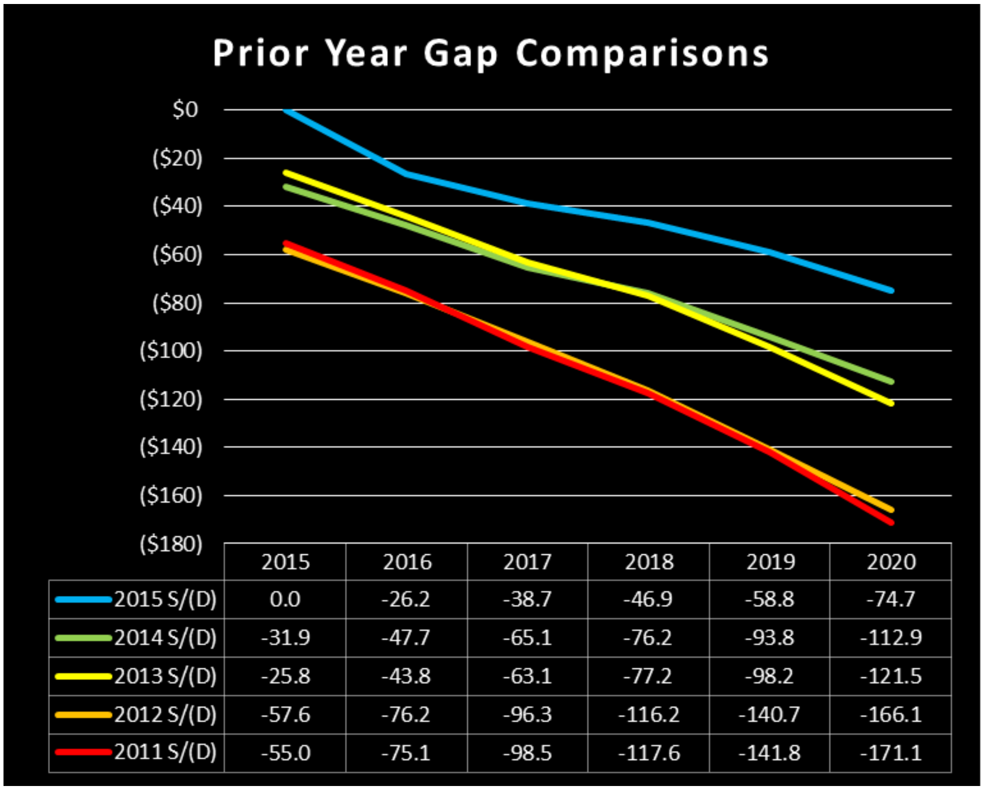
STRUCTURAL DEFICIT IMPROVES OVERALL FROM PREVIOUS FORECAST

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. The previous model projected a structural deficit of $47.7 million in 2016. If the entire structural deficit for 2015 had been fixed with long-term sustainable solutions, the County should have had a structural deficit of approximately $15.8 million for 2016. The new model estimates that the structural deficit for 2016 has grown to approximately $26.2 million. Three main factors contributed to the unanticipated increase for 2016: the increased pension contribution, elimination of one-time contribution from reserves and reduction in State shared revenue for the County's share of Bucks arena funding.

Year	Expenditure	Revenue	Gap 2016 - 2020	Adjusted Gap*
2016	$ 1,277,946,393	$ 1,251,706,895	$ (26,239,498)	
2017	$ 1,304,334,131	$ 1,265,625,388	$ (38,708,744)	$ (12,469,246)
2018	$ 1,327,745,906	$ 1,280,866,858	$ (46,879,048)	$ (8,170,304)
2019	$ 1,359,841,991	$ 1,301,056,259	$ (58,785,732)	$ (11,906,684)
2020	$ 1,394,344,145	$ 1,319,666,230	$ (74,677,915)	$ (15,892,183)

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

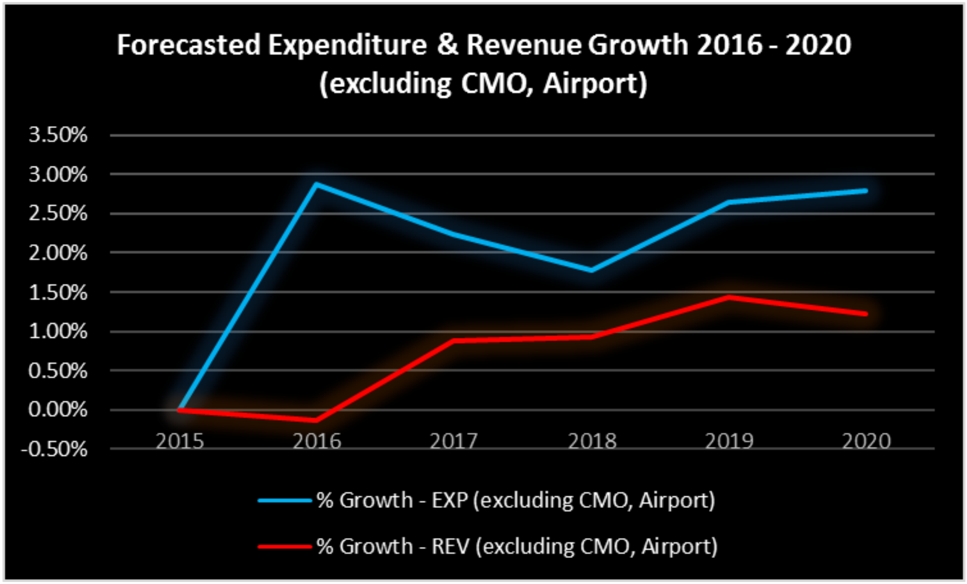
Although the outlook for 2016 worsened from the prior-year forecast, significant strides in employee salaries and healthcare have actually continued to reduce the structural deficit in the long-term. The impact of these structural changes is shown in the table below, which compares the forecasted structural imbalance for the five-year period of 2016-2020 after the passage of each annual budget since 2011.



	2015	2016	2017	2018	2019	2020
2015 S/(D)	0.0	-26.2	-38.7	-46.9	-58.8	-74.7
2014 S/(D)	-31.9	-47.7	-65.1	-76.2	-93.8	-112.9
2013 S/(D)	-25.8	-43.8	-63.1	-77.2	-98.2	-121.5
2012 S/(D)	-57.6	-76.2	-96.3	-116.2	-140.7	-166.1
2011 S/(D)	-55.0	-75.1	-98.5	-117.6	-141.8	-171.1

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 albeit at a much lower level than original forecasted.

Expenditures are now forecasted to grow by an average of 2.3 percent annually, while revenues are forecasted to grow by an average of 1.1 percent annually. However, these revenue numbers are skewed slightly due to the County's Departments of Family Care and Airport. When adjusting the forecast to exclude Family Care and the Airport, expenditures grow at an average annual rate of 2.5 percent and revenues grow at an average annual rate of 0.9 percent. For 2016, the revenue growth rate is actually a negative 0.1 percent.



MAIN DRIVER OF STRUCTURAL DEFICIT IS STAGNANT REVENUES

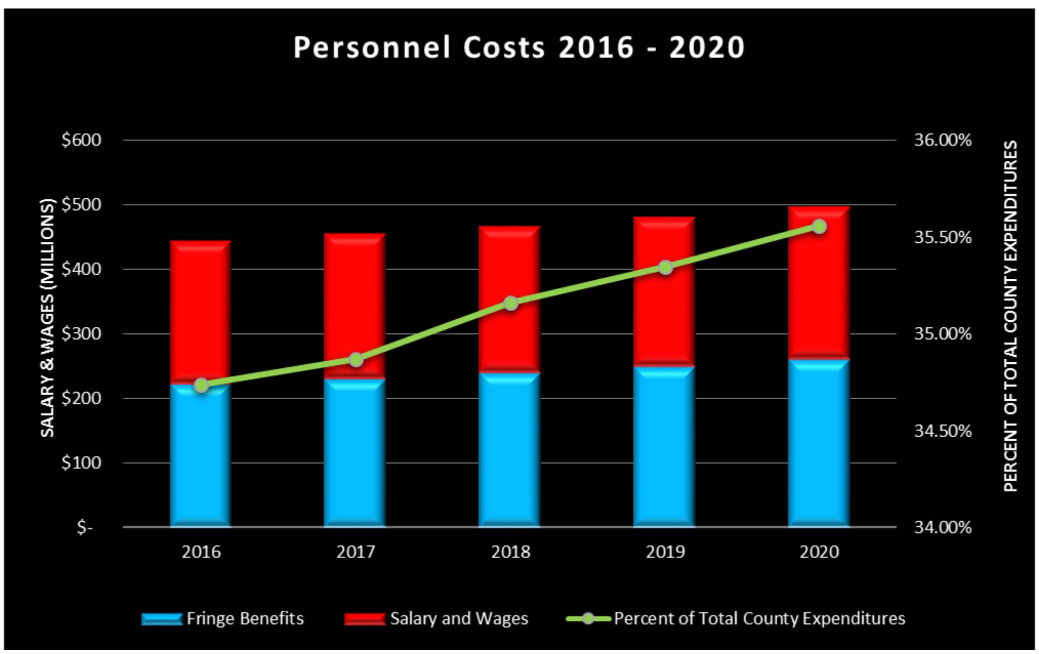
The ongoing driver of the structural deficit continues to be revenue growth that lags expenditure growth. The County has successfully controlled major expenditures related to salaries and healthcare, which have driven down the long-term structural imbalance. Other expenditures have been controlled through various service model changes and through historically low inflationary periods. However, the County has done little to address revenues, evidenced by the negative revenue growth predicted for 2016. Without addressing a long-term sustainable strategy to match revenue and expenditure growth, the County will continue to struggle with structural imbalances in the foreseeable future. It is important to note that this is not unique to Milwaukee County. Municipalities across the nation struggle to provide the same level of services under ever increasing costs and slow growing revenues.

Major Strides in Expenditure Restraints: Personnel costs comprise about 35 percent of the County's total expenditures. The County's percentage of total expenditures for personnel-related expenditures remains nearly flat 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 a competitive wages and benefits package.

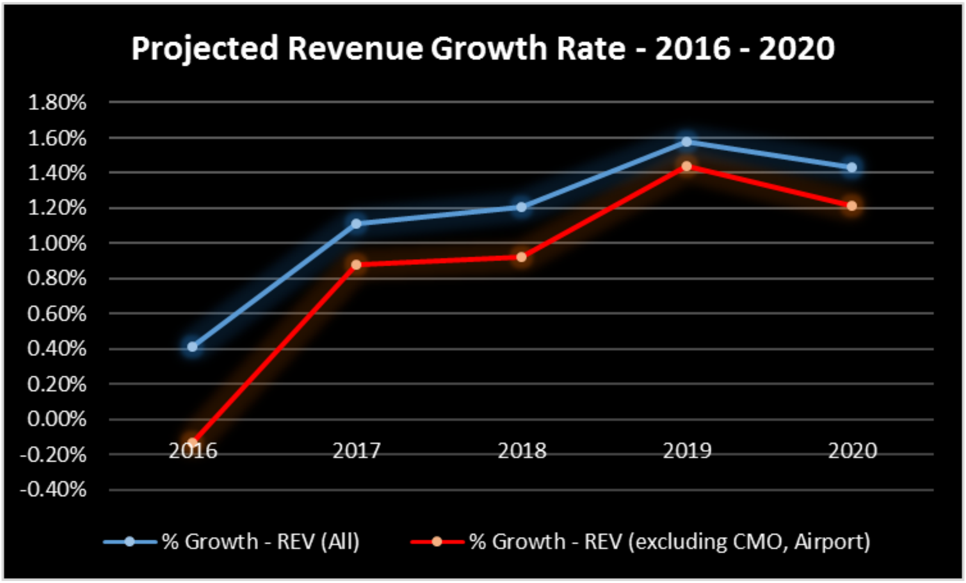
Main expenditure items of significance include:

- Salaries and Wages, including overtime, are forecasted to grow by 6.6 percent over the five-year forecast period. For 2016, this amount includes approximately 1.5 percent in additional salary dollars over projected 2015 costs for employee salary increases. For the later years, salaries are forecasted to grow at CPI.

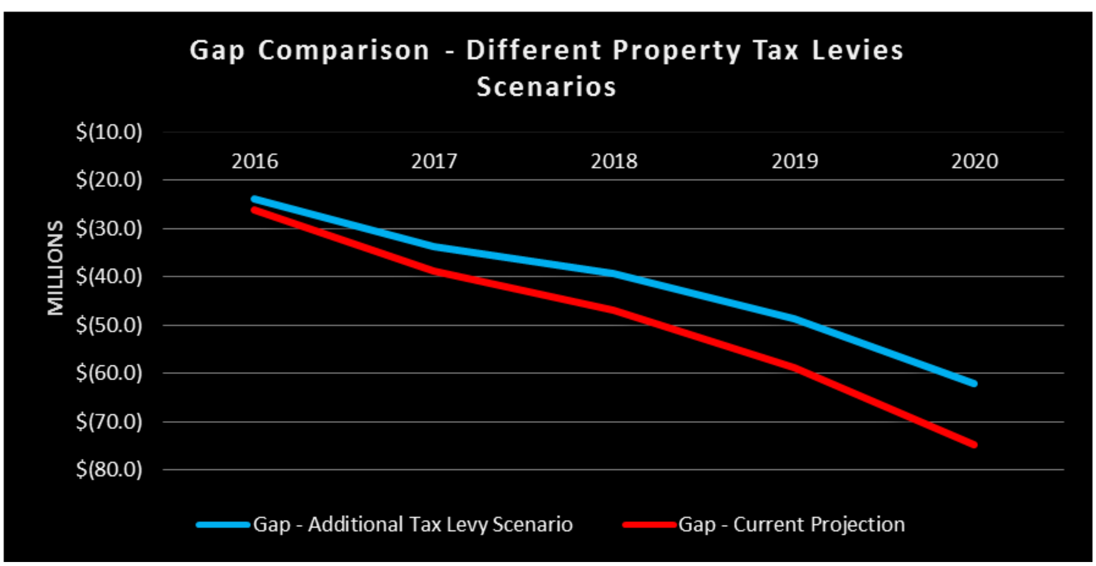
- Fringe benefits, including pension and healthcare, will grow by 16.8 percent during the five-year forecast period. This is less than the five-year forecast projections in 2012, 2013 and 2014 of 36 percent, 29 percent and 22 percent, respectively.
  - Healthcare costs actually fall in 2016 by about 4.3 percent due to large surpluses projected for 2015, and then grow at 7.0 percent thereafter. This forecasted growth results in an additional $56.7 million in expenditures over the five-year period.
  - Pension costs, on the other hand, rise 29.3 percent in 2016 and then flatten out over the forecast period. This increase in 2016 is due to reinclusion of the COLA liabilities that were not included in 2013 and 2014 and implementation of funding policy changes. Although the change is significant in 2016, the County's pension contribution is stabilized over the forecast period due to the funding policy changes. The total increase from 2015 to 2016 is projected to be $20.4 million. These changes result in an additional $111.4 million in expenditures over the five-year period. The portion of these costs which are attributable to active employees will be offset by an increase in active employee pension contributions of approximately $3.0 million annually.



Major Revenue Concerns: Over the forecast period, the County's revenue growth is projected to average 1.2 percent. However, as shown below, when Airport and Family Care revenues are removed, the County's 2016 revenue growth is negative and the average annual revenue growth over the five-year period is only 0.96 percent. The negative growth rate in 2016 is due to issues previously discussed, including elimination of a one-time contribution from reserves and $4.0 million in State shared revenue loss for the County's contribution to the Bucks arena funding. Long-term, 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 has done little with respect to revenue and managing the structural deficit.

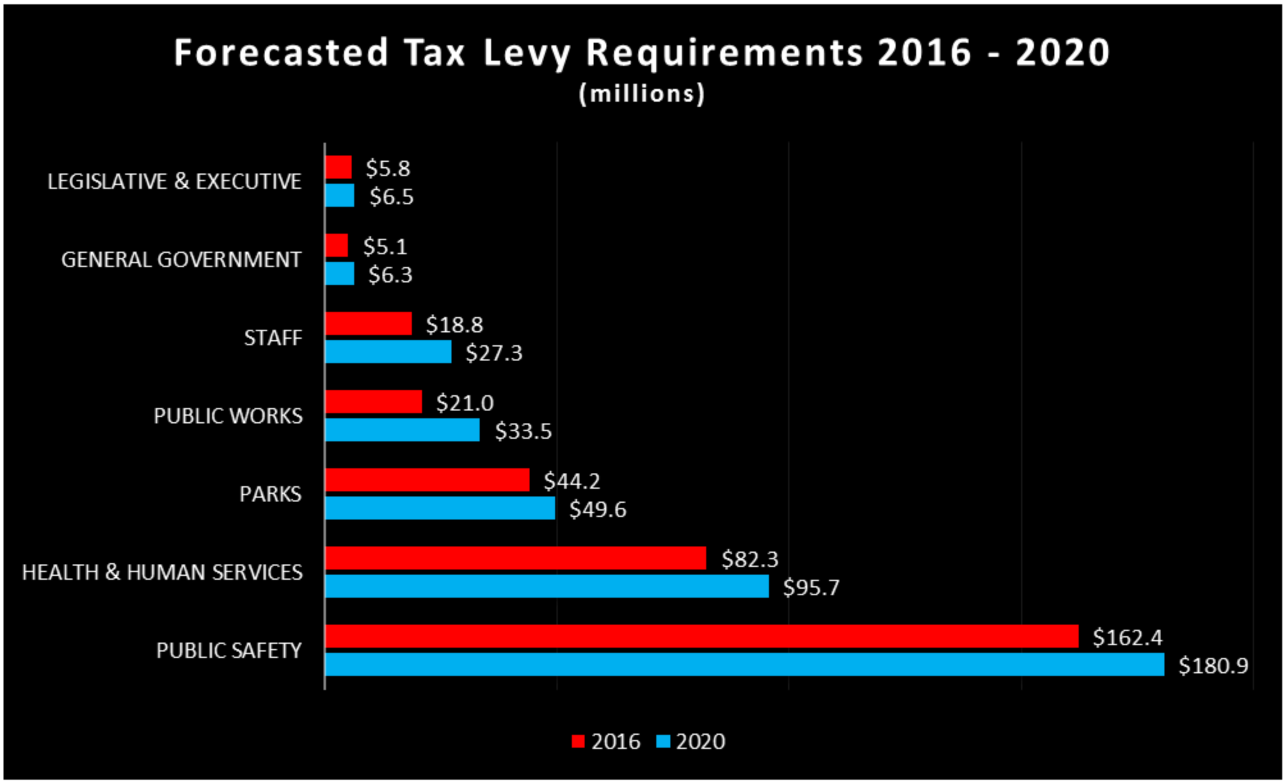


Although the County operates under tax levy caps imposed by State Statutes, the County has judiciously levied amounts that generally fall short of the total available levy. Generally speaking, the County is able to raise levy by an amount equal to net new construction and by an amount equal to the growth in debt service issued after July 1, 2005. Because these two factors change on annual basis, it is difficult to determine what the potential tax levy available will be in the future. However, for illustrative purposes, the chart below shows how the structural deficit would change if an additional $2.5 million were levied in each year of the forecast (assuming it were available under the levy cap). As the chart shows, the long-term structural deficit is even more favorable under these conditions. As opposed to a $75.0 million gap in 2020, the gap is reduced by $13.0 million to only $62.0 million.



DEPARTMENTAL LEVY REQUIREMENTS

Generally, growth in expenditures continues to outpace the revenues that support County functions requiring greater tax levy contributions over time. The chart below shows the change in tax levy requirements for functional units over the five-year period.



OTHER ISSUES IMPACTING THE COUNTY'S FISCAL OUTLOOK

Other issues exist which may or will have an 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. With respect to the property tax levy, the County has both frozen and increased tax levy in recent years. This model assumes that property taxes will grow over the forecast period by the average net new construction of the past five years which was 0.9%; the amount is limited mainly due to limits within Wisconsin State Statutes. 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 $38.6 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. Similarly, not levying a judicious amount could result in worsened fiscal impacts in the future years as revenue growth is a main contributor to the structural deficit.

- **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.)

- **Future Biennial State Budgets:** The State recently passed its biennial budget for the 2016 – 2017 fiscal years. Although there was minimal County impact, mid-year corrections or future budgets could affect the long-term fiscal health of the County. For purposes of this report, it is assumed that all local aids will remain flat, including youth aids, State shared revenue (with the exception of the $4.0 million reduction for Bucks arena funding), 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.

- **Future Changes to Family Care:** The 2015 – 2017 State Biennial Budget adopted changes impacting how Family Care programs will operate in the future. This could dramatically change how the department operates and impact the County-related programs that support the department. Based on the 2015 Adopted Budget, the County charges the department approximately $5.0 million for legacy health and pension and County-related services. Depending on the outcome of the changes, the County may need to generate revenues from other sources or find non-service impacting expenditure reductions to minimize the impact of the $5.0 million revenue loss over the forecast period.

- **Future Changes to the Behavioral Health Division:** The Behavioral Health Division, under direction of the Mental Health Board, is exploring options for the operations of its hospital. This could dramatically change how the division operates, as well as the County-related programs that support the division. Based on the 2015 Adopted Budget, the County charges the division approximately $24.7 million for legacy health and pension and County-related services. About $15.7 million of the $24.7 million is directly related to legacy health and pension charged to the division. Depending on the changes implemented, the County may need to develop additional revenues or find expenditure reductions elsewhere to absorb some or all of these costs if necessary in the future.

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 2015 budget as the basis for the 2016-2020 projection. The 2015 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 2015 base is further adjusted for one-time events particular to 2015, or programs/ revenues/ expenditures which end in a future year.

All of this effort provides a first look at what a 2016 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 2016 financial "gap" that the County would face if it were to budget a cost-to-continue budget.

In the five-year financial forecast, the 2016 forecast then becomes a base for the 2017 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 2016 will become added to the 2017 financial gap. The 2016 and 2017 financial gap then becomes added to the 2018 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.