Milwaukee County

Five-Year Financial Forecast

2018 – 2022

Office of the Comptroller

Scott B. Manske, Comptroller

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EXECUTIVE SUMMARY

The five-year forecast for Milwaukee County is a tool for helping policymakers and the public understand the future challenges and opportunities of the County budget. Mandated by § 59.255 (2)(h) Wis. Stats., the Comptroller produces this annual report based on reasonable assumptions about general economic conditions and projected changes in County the revenues and expenditures. The goal of this forecast is to determine the extent of actions necessary to close the gap between revenues and expenditures, ensuring long term fiscal sustainability. The forecast assists policymakers in the County's financial decision making process to demonstrate the long range impact of courses of actions being considered by the County and to gauge the effect of past decisions.

Results of this year's forecast indicate an ongoing structural deficit with similar elements to five-year forecasts issued in prior years. The main findings of the report include:

- ***The projected structural deficit for the 2018 budget is approximately $31.0 million.*** Key assumptions contributing to the structural deficit in 2018 include larger than forecasted increases in pension, healthcare and mental health costs; elimination of reserve contributions; and stagnant or declining sales tax collections in 2017. Offsetting these increases is a surplus in forecasted wages, minimal growth in transit expenditures, forecasted increases in property tax levy, and increased revenues from earnings on investment.

- ***The 2018 structural deficit of $31.0 million is reasonable based on the forecasted cost-to-continue and use of one-time revenues in 2017.*** The County's prior year five-year forecast predicted that the County would have a structural deficit of $12.5 million for the 2018 fiscal year if the 2017 structural deficit of $36.9 million was solved with long-term solutions. The forecast further projected that if no long-term solutions were implemented, the 2018 structural forecast could reach $49.3 million. Given the one-time revenues used in 2017, as well as other unforeseen changes, the 2018 structural deficit of $31.0 million is reasonable.

- ***On average, the annual structural deficit will consist of a cost-to-continue of $13.6 million due to a greater increase in expenditures than what is generated in additional revenue.*** Expenditures will grow on average 2.5 percent while revenues will grow on average 0.7 percent. ***The County can also expect an increase in the structural deficit each year in which one-time revenues or expenditure abatements were used in the prior year.*** In 2017, the County utilized such one-time revenues and expenditure abatements of approximately $7.3 million, which increased the 2018 structural deficit by the same amount. While a structural deficit of $31.0 million seems daunting for 2018, if the County were to resolve this structural deficit with long-term solutions, it could expect a 2019 structural deficit of roughly $10.3 million, barring any unforeseen issues. Any use of one-time revenues or expenditure abatements in the 2018 budget will worsen the structural deficit.

- Other issues such as potential outsourcing of the BHD inpatient units, the State 2017-2019 biennial budget, the fate of the County's vehicle registration fee, and deferred maintenance

remain uncertain. Any of these issues may compromise the County's future fiscal outlook and should be monitored closely.

THE FRAMEWORK OF THE STRUCTURAL DEFICIT

The annual structural deficit consists of two elements:

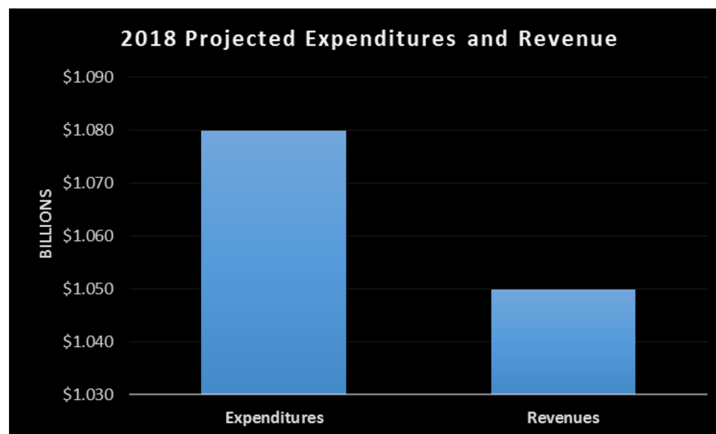
- Cost-to-continue increase
- One-time revenues and expenditure abatements utilized in the previous year

On average, the County can expect a cost-to-continue of $13.6 million annually due to a greater increase in expenditures than what is generated in additional revenue. The forecasted cost-to-continue dropped slightly from the prior year forecasted cost-to-continue of $14.1 million. On average, expenditures will grow 2.5 percent while revenues will grow 0.7 percent which generates the cost-to-continue amount. The amount is further adjusted by any changes to the assumptions used in previous forecasts as well as any unforeseen issues that arise during the fiscal year.

The structural deficit then further increases each year by any one-time revenues or expenditure abatements used in the prior year. So any one-time revenues, such as land sales or reserve contributions, and any expenditure abatements, such as one-time budgetary reductions, will increase the structural deficit by the same amount. In 2017, the County utilized such one-time revenues and expenditure abatements of approximately $6.5 million, which increased the 2018 structural deficit by the same amount.

THE 2018 PROJECTED STRUCTURAL DEFICIT

The use of one-time revenues and expenditure abatements from 2017 coupled with the cost-to-continue results in a $31.0 million structural deficit for 2018. Expenditures and revenues are projected to be $1.08 billion and $1.05 billion, respectively.



In comparison, the prior financial forecast projected that the County would have a cost-to-continue of $12.5 million for the 2018 fiscal year if the 2017 structural deficit of $36.9 million was solved with long-term solutions. The forecast further projected that if no long-term solutions were implemented, the 2018 structural deficit could reach $49.4 million.

The projected structural deficit in 2018 is largely comprised of the following changes from the 2017 Adopted Budget:

Expenditure Type	Amount (millions)
Healthcare	$ 9.3
Pension	$ 6.4
Other Purchase of Services	$ 4.5
Misc (1)	$ 3.2
Other Services	$ 1.8
Professional Services	$ 1.0
Debt Service Principle/Interest	$ (0.7)
Salaries & Overtime	$ (1.6)
Expenditure Change	**$ 23.9**
Revenue Type	
One-time Revenues	$ 7.3
Other Federal Revenue	$ 3.0
Employee Health Contributions	$ 1.3
Earnings on Investment	$ (1.7)
Property Taxes	$ (2.9)
Revenue Change	**$ 7.0**
Projected 2018 Gap	**$ 30.9**

Cost-to-continue items of significance include:

- **Employee Healthcare**. Costs are expected to grow by about 7.5 percent in 2018. Although the County experienced significant savings in healthcare costs in prior years which benefitted future years, 2017 healthcare costs are exceeding budget by nearly $6.0 million. Therefore, healthcare costs will increase by $9.3 million in 2018 and an additional 7.5 percent each year thereafter.

- **Pension**. Increases in the County's contribution to the Employee Retirement System are included due to the first reduction in the pension system's assumed rate of return in 2018. The first drop occurs in 2018 and lowers the assumed rate of return from 8.0 percent to 7.75 percent. The

[1] *Miscellaneous is mainly comprised of increases in costs for workers compensation, utilities, health and human services, commodities, capital outlay and other uses.*

second drop occurs in 2020 and lowers the assumed rate of return from 7.75 percent to 7.50 percent. The rate of return was reduced to be consistent with financial projections and reflects a more reasonable rate of return for what can be expected. Total pension-related expenses increase by $6.4 million in 2018.

Historically, the budget for employee retirement contributions has been equal to that of the actuary's estimate. Due to historically low increases in salary and employee counts, the actuary's projection has been higher than the actual contributions received. Therefore, in addition to the expenditure increase, there is a reduction in pension-related revenue by nearly $1.0 million in the "Other Revenue" account.

- **Other Purchases of Services.** This category is general catchall for purchases made throughout the County in all departments, with a majority of purchases coming from health and human services. Assuming that these expenditures will increase by a minimum of 2.5 percent, or annual CPI, results in a $4.5 million expenditure increase in 2018.

- **Other Services and Professional Services.** This account is used to track expenditures for Services not categorized elsewhere in the model. Assuming that these expenses will increase by a minimum of 2.5 percent, or annual CPI, results in a $2.8 million expenditure increase in 2018.

- **Salaries and Overtime**. For 2018, the forecast assumes that salary expenditures will only increase by 1.0 percent due to historically low increases in salary over the past several years and historically low employee counts. Due to an overall surplus in salaries and overtime for 2017, even with a 1.0 percent increase in 2018 there is an overall surplus of $1.6 million in Salaries and Overtime.

- **Other Federal Revenue**. The reduction in federal revenue in 2018 is largely due to a reduction in Urbanized Area Formula Funding Program (5307 funds) that the County had previously used to support transit operations. Transit will no longer draw on these funds for operating and will preserve this funding for future capital purchases.

- **Employee Health Contributions**. The County does not anticipate receiving the budgeted amount of employee health contribution revenue in 2017. Due to both a shrinking workforce and employees opting for other insurance, the County is covering fewer employees than it has in the past. This results in less contribution revenue. For 2018, this results in a reduction of $1.3 million in revenue.

- **Earnings on Investments.** Recent earnings on investments have exceeded expectations and result in a surplus of approximately $1.7 million in 2017. This revenue is included in 2018 to reduce the structural deficit.

- **Property Tax Levy**. The 2018 forecast assumes that the County will levy up to the net new construction which was 1.38 percent in 2017. This provides an additional $2.9 million in revenue.

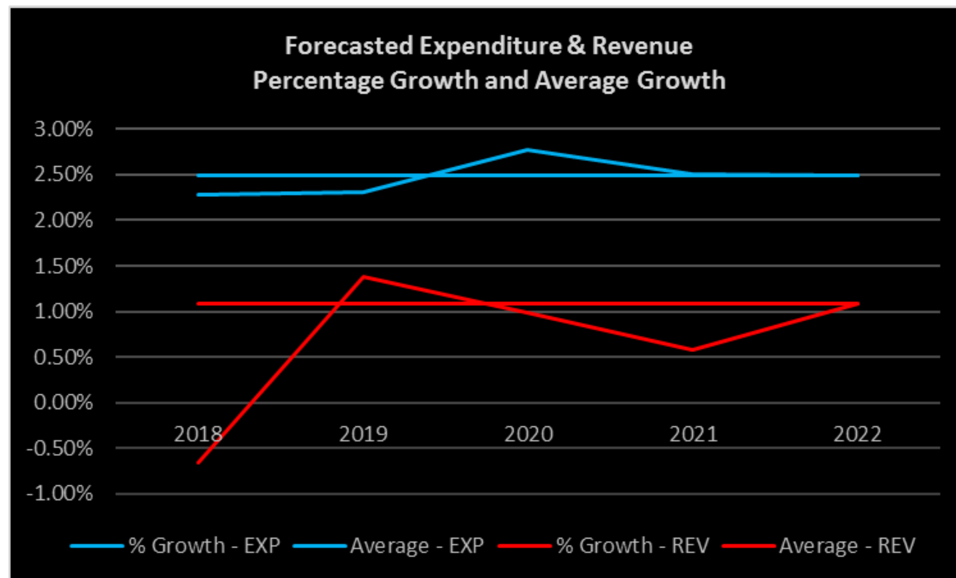
One-time revenue and expenditure abatement items of significance include:

- **One-time Revenues**. The $7.3 million miscellaneous revenue loss is from the elimination of one-time revenue appropriated in the 2017 Adopted Budget of $6.75 million from the Debt Service Reserve and $0.5 million from the Pension Obligation Bond Reserve.

THE FUTURE OF THE STRUCTURAL DEFICIT

When the model was first utilized after passage of the 2009 budget, expenditures were forecasted to grow by 6.1 percent annually while revenues would rise by only 3.7 percent annually. Expenditures are now forecasted to grow by an average of 2.5 percent annually, while revenues are forecasted to grow by an average of 0.7 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 originally forecasted. Since expenditure growth is forecasted to outpace revenue growth on annual basis, the County will continue to have a structural deficit each year in the forecast period absent any policy changes.



As discussed above, the previous model predicted that the County would have a structural deficit of only $12.5 million for the 2018 fiscal year if the 2017 structural deficit of $36.9 million was solved with long-term solutions. Due to the various factors affecting the 2018 budget, the model is now forecasting a $31.0 million structural deficit for 2018. While this amount may seem daunting, if the County resolves this structural deficit with long-term solutions, in each of the following years, barring any unforeseen issues, the County could expect much smaller annual structural deficits comprised mainly of the County's cost-to-continue. As shown below, the forecasted cost-to-continue ranges from $10.4 million to $17.2 million.

Year		Expenditure		Revenue		Structural Deficit		Cost-to-Continue*
2017	$	1,054,859,044	$	1,054,859,044	$	-		
2018	$	1,078,896,529	$	1,047,927,247	$	(30,969,282)		
2019	$	1,103,780,697	$	1,062,455,935	$	(41,324,762)	$	(10,355,480)
2020	$	1,134,414,917	$	1,072,880,717	$	(61,534,200)	$	(13,637,329)
2021	$	1,162,769,773	$	1,079,023,345	$	(83,746,428)	$	(13,156,370)
2022	$	1,191,743,177	$	1,090,775,218	$	(100,967,959)	$	(17,221,531)
						Average Gap:	$	(13,592,678)

*Cost-to-continue assumes that the prior year gap was eliminated with long-term solutions.

*For 2020, the increase in pension contribution is considered an outlier and removed from cost-to-continue.

*For 2021, the loss of Doyne Hospital revenue is considered an outlier and removed from cost-to-continue.

IMPACT OF THE COUNTY'S COST-TO-CONTINUE

One element of the annually recurring structural deficit is the County's cost-to-continue, that is the disproportion between annual revenue growth and annual expenditure growth. The County has controlled major expenditures related to salaries and healthcare, which have driven down the County's cost-to-continue. Other expenditures have been controlled through various service model changes and through historically low inflationary periods. With respect to revenues, the County has been severely limited in its ability to raise meaningful revenues due mostly to State restrictions. Furthermore, aside from the five-year forecast presentation, the County has not sought meaningful discourse on a long-term sustainable strategy to match revenue and expenditure growth, while also minimizing the impact of the current year structural deficit. 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. The following chart shows that even if the County adds an $18.0 million revenue source in 2018, the cost-to-continue still remains a problem in future years. Furthermore, it shows that if the County adds an $18.0 million revenue source in 2018 and increases its revenues by 0.8 percent to 1.5 percent, the cost-to-continue still is a problem, albeit at a lower amount.

	Current - No Changes			Add $18 M New Revenue			Add $18M New Revenue & Increase Growth by 0.8%		
	0.70%	2.50%		0.70%	2.50%		1.50%	2.50%	
	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue
	0.70%	**2.50%**		**0.70%**	**2.20%**		**1.50%**	**2.20%**	
2018	1,048	1,079	$ 31.0	1,066	1,079	13.0	1,066	1,079	13.0
2019	1,055	1,106	$ 19.6	1,073	1,106	19.5	1,082	1,106	11.0
2020	1,063	1,134	$ 20.3	1,081	1,134	20.1	1,098	1,134	11.4
2021	1,070	1,162	$ 20.9	1,089	1,162	20.8	1,115	1,162	11.9
2022	1,078	1,191	$ 21.6	1,096	1,191	21.4	1,131	1,191	12.3
2023	1,085	1,221	$ 22.2	1,104	1,221	22.1	1,148	1,221	12.8
2024	1,093	1,251	$ 22.9	1,112	1,251	22.8	1,166	1,251	13.3
2025	1,100	1,283	$ 23.6	1,119	1,283	23.5	1,183	1,283	13.8
2026	1,108	1,315	$ 24.4	1,127	1,315	24.2	1,201	1,315	14.3
2027	1,116	1,348	$ 25.1	1,135	1,348	25.0	1,219	1,348	14.9

Expenditure Elements: Personnel costs comprise about 43.2 percent of the County's total expenditures in 2018, which is immaterially less than the previous model. The County's percentage of total expenditures for personnel-related expenditures grows only 0.62 percent over the forecast period, suggesting that the County, through its 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 County's cost-to-continue 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:

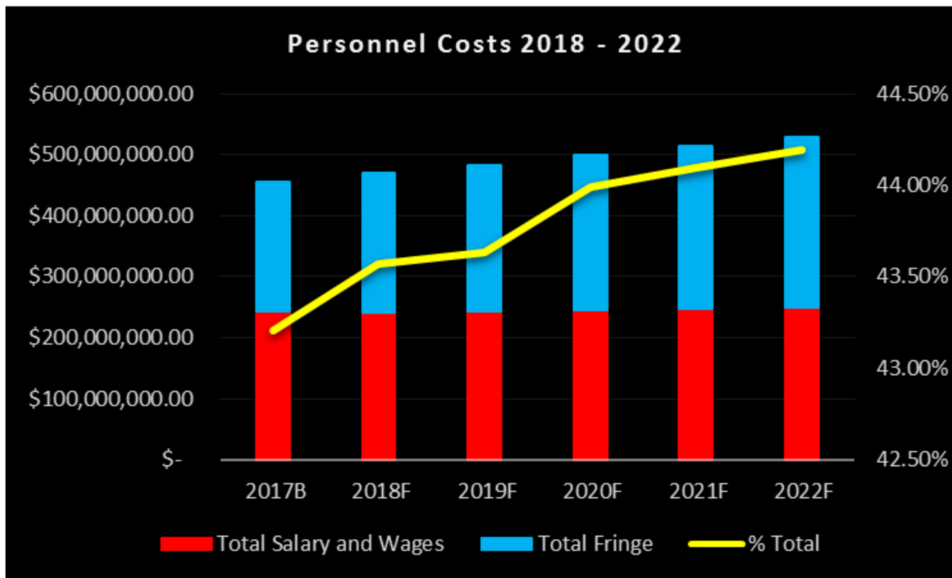
- Salaries and Wages, including overtime, are forecasted to grow by 3.7 percent over the five-year forecast period which is down from the prior year forecast of 6.5 percent. For 2017, this amount includes approximately 1.0 percent in additional salary dollars over projected 2017 costs for employee salaries. For the later years, salaries are forecasted to grow only at 1.0 percent due to historically low increases in actual salary costs the County has incurred. Prior year forecasts assumed salaries would grow at CPI or around 2.0 to 2.5 percent.

- Fringe benefits, including pension and healthcare, will grow by 21.4 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. It does, however, represent an increase from the 2015 and 2016 models due to an unanticipated increase in costs for healthcare.

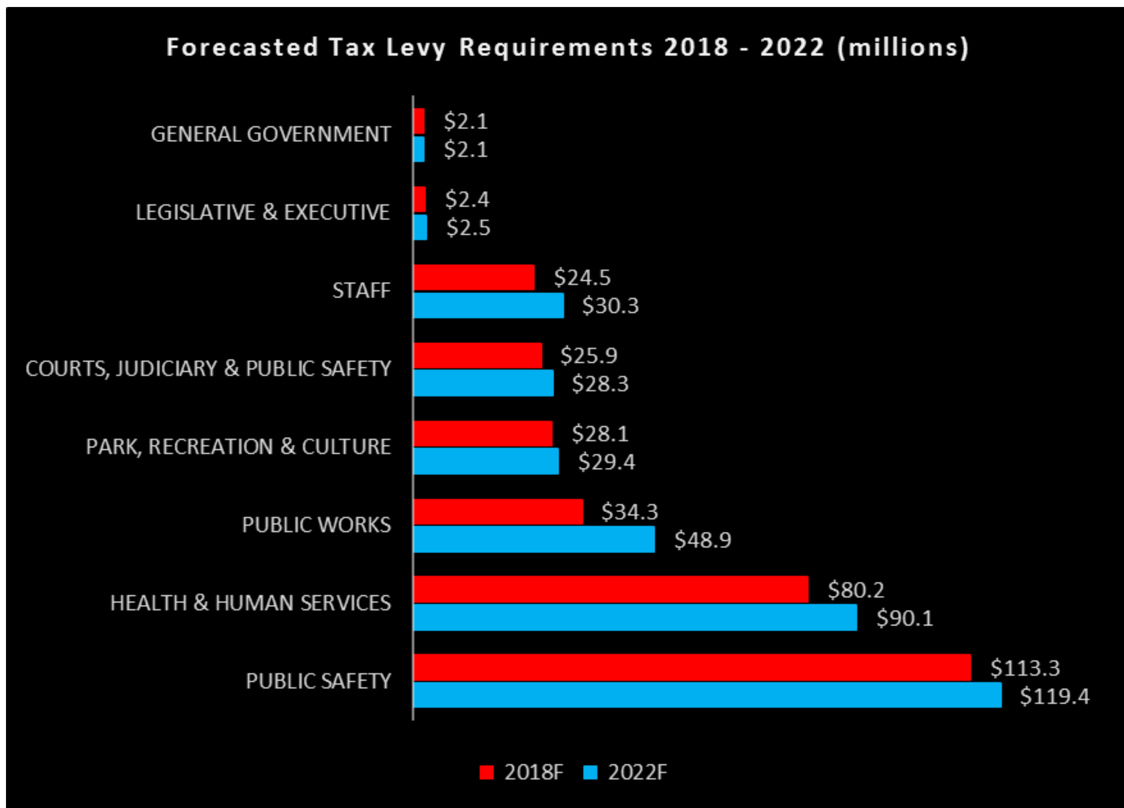
  - Due to a deficit in healthcare for 2017, the County will need to absorb both the amount by which it is deficiting this year and the forecasted growth of 7.5 percent in 2018. Assuming no additional changes to the current plan design or premiums, the County must

absorb approximately $9.3 million in healthcare costs for 2018. The forecasted growth results in a 33.6 percent increase in costs from 2018 to 2022.

- In the prior model, pension costs were forecasted to rise 16.9 percent over the five-year period. That trend has slowed and is now forecasted to rise 10.8 percent over the five-year period. In 2018, the County will grapple with a large increase due to the change in the assumed rate of return from 8.0 percent to 7.75 percent. The County will also confront another significant increase in 2020 due to a second planned reduction in the assumed rate of return from 7.75 percent to 7.5 percent. The rate of return was reduced to be consistent with financial projections and reflects a more reasonable rate of return for what can be expected. Any of the increases could be offset by investment returns that exceed 8 percent (or the assumed rate of return at the time) or other favorable changes in the actuarial estimate.



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



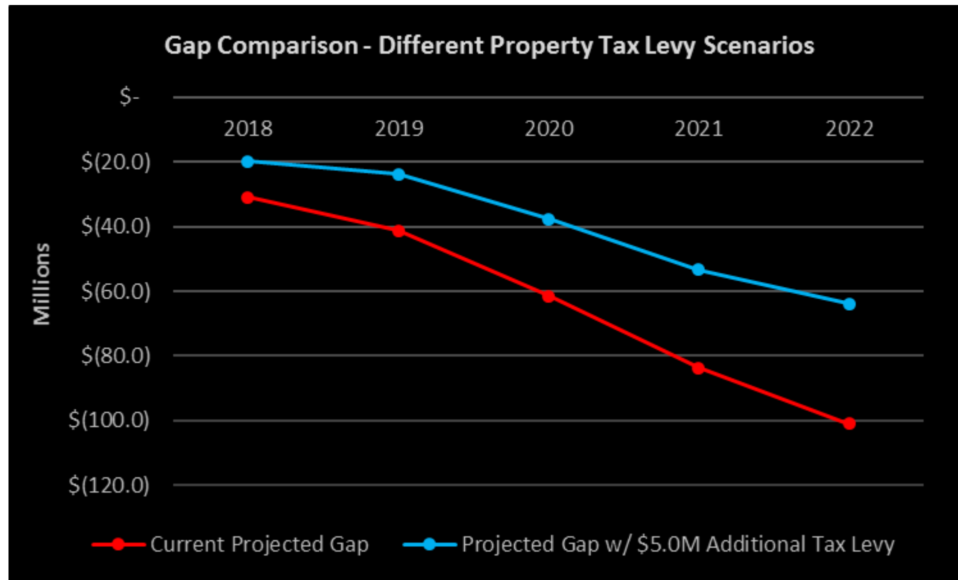
Inflationary Revenue Concerns: Over the forecast period, the County's revenue growth is projected to average 0.7 percent, which is unchanged from the previous model. Long-term, low growth rates are attributable to mostly flat revenue projections for State and Federal resources, as well as discretionary resources that are mostly forecasted to grow at the Consumer Price Index (CPI) over the forecast period.

In 2017, the County successfully grew its operational revenue base $13.4 million due to implementation of the vehicle registration fee. However, given overall changes in other revenue sources, the County was unable to increase its revenue growth rate for 2018. Further hampering the County's ability to increase its growth rate is the loss of a significant source of revenue when the Froedtert Hospital payment for the Doyne Hospital sale terminates in 2021.

The continuous, low growth rate suggests that even when the County grows its revenue base in a given year due to new revenue sources, it has little prospect for increasing those new revenues over time. Without larger increases in Federal and State funding, it will be difficult for the County to ease the cost-to-continue burden without larger increases in Federal and State funding.

The County operates under tax levy caps imposed by State Statutes. 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 $5.0 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 $101.0 million structural deficit in 2022 (assuming no long-term solutions are implemented over the five year forecast period), the structural deficit is less than $70.0 million, a $30.0 million difference in the County's fiscal outlook.



IMPACT OF ONE-TIME REVENUES AND EXPENDITURE ABATEMENTS ON THE STRUCTURAL DEFICIT

Another element of the structural deficit is the use of one-time revenues and expenditure abatements in the prior year. In any given year where the County adopts a budget using one-time revenues or expenditure abatements to resolve the cost-to-continue gap, the following year's structural deficit will increase by the amount of one-time revenues and expenditure abatements. This deficit is then compounded over the forecast period, until it is resolved by means of a long-term solution.

The 2017 Budget utilized approximately $7.3 million in one-time revenues to resolve the 2017 structural deficit of $36.9 million. This $7.3 million in one-time revenues as well as other unknown impacts are then added to the 2018 cost-to-continue component to arrive at the County's true structural deficit of $31.0 million. Had the County implemented $7.3 million in funding solutions that were sustainable, the forecasted structural deficit of $31.0 million for 2018 would have been reduced to $23.7 million.

Therefore, while the County is only projecting an average of $13.6 million in cost-to-continue annually for the County, any unsolved portion of the 2018 structural deficit will increase the 2019 structural deficit by the same amount.

OTHER ISSUES IMPACTING THE COUNTY'S FISCAL OUTLOOK

Other issues exist which may 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 approximately 1.4 percent; 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 $44.0 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 increasing the levy to the allowable amount under State law could result in worsened fiscal impacts in the future years as revenue growth is a factor in the County's annual cost-to-continue.

- **Future Biennial State Budgets:** The State is nearly finished with its budget deliberations on its biennial budget for the 2018 – 2019 fiscal years and there appears to be no changes that will either improve or worsen the County's overall current fiscal position. However, a significant increase in Juvenile Correction Institution (JCI) rate charges is proposed in the State Budget along with continue flat State aids. Although there has been minimal financial impact for the past few years, future budgets could affect the long-term fiscal health of the County. For purposes of this report, it is assumed that all local government aids will remain flat or nearly 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.

- **Vehicle Registration Fee:** In 2017, the County implemented a vehicle registration fee (VRF) of $30 per vehicle. The 2017 revenue was budgeted for transit operations and capital purchases. There has been discourse earlier this summer that suggests that some State policymakers might advocate for terminating the County's vehicle registration fee or requiring a referendum to retain it which would likely lead to its dissolution. If the County were to lose this revenue, it would create a gap of approximately $18.0 million in the County's budget. A gap of that magnitude coupled with the County's cost-to-continue scenario would likely lead to severe programmatic cuts and operational impacts throughout the County.

- **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 $506 million by 2022. 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. The County's Capital Improvements Committee has received requested five-year capital improvement plans from departments for 2018-2022 that total over $760 million, which includes an additional $200 million

over the prior year plan for a new criminal courthouse. Without increases of funding for capital projects along with greater diligence by the County in the timely completion of capital projects or decreases in the size of the County's asset portfolio, the County will encounter growing future liabilities.

- **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. The County charges the division approximately $26.1 million for legacy health and pension and County-related services. About $16.7 million of the $26.1 million is directly related to legacy health and pension charged to the division for costs related to former employees. 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 2017 budget as the basis for the 2018-2022 projection. The 2017 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 2017 base is further adjusted for one-time events particular to 2017, or programs/ revenues/ expenditures which end in a future year.

This exercise provides a first look at the 2018 budget challenge for Milwaukee County, before any adjustments are proposed by the County Executive to prepare the recommended budget. The forecast provides a projection of the 2018 financial "gap" that the County would face if it were to budget a cost-to-continue budget.

CONCLUSION

A general conclusion reached this year, as in past years, is 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. The County will then either have to cut expenditures, increase revenues or a combination of both.

With the prospect of future year structural deficits averaging $13.6 million, the projected 2018 structural deficit of $31.0 million, albeit overwhelming, can, in the context of future years be solved over multiple years. This is only possible now because the County has accumulated a sizable reserve. However, based

on past practice, the County tends to only focus on resolving the current year gap and rarely focuses on how to solve the future deficits.

For example, if a new revenue source is implemented in 2018, depending on the resulting revenue, future year structural deficits can be mitigated by setting aside a portion of the revenues received rather than solving the current year gap only. This essentially buys the County additional time to make larger structural changes that can reduce expenditures, such as reducing infrastructure or programming.

The County should be examining its service delivery models, one-time revenues, maintenance requirements and debt service requirements on a continual basis to find efficiencies and lower costs. But, the County's long-term financial viability cannot be solved without the County Board and County Executive working together to find mutually agreeable resolutions to the long-term structural deficit.