

COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE : February 19, 2021

TO : Supervisor Marcelia Nicholson, Chair, County Board of Supervisors

FROM : Joe Lamers, Director, Office of Performance, Strategy, and Budget

SUBJECT : 2022 Operating Budget Gap and Process

OVERVIEW

This report provides a preliminary operating budget gap estimate for 2022. A timeline for the 2022 budget process is also provided.

The Office of Performance, Strategy, and Budget (PSB) preliminarily projects a budget gap of \$20.3 million for Fiscal Year 2022. This gap is part of an ongoing structural deficit, whereby growth in revenue is not sufficient to keep pace with inflationary operating cost growth on an annual basis. In addition to the ongoing imbalance between revenue and expenditure growth, the 2022 budget will be impacted by a reduction of \$4.0 million in revenues related to the sale of Doyne hospital and potential ongoing impacts of the covid-19 pandemic.

PSB will continue to monitor fiscal conditions and will provide updates to the County Board when there are significant changes to budget estimates. Projections in several areas of operations remain particularly volatile and subject to change due to covid-19 impacts.

Potential options for closing the budget gap are also presented for consideration within this report.

BACKGROUND

Milwaukee County has been operating with a structural deficit dating back to the early 2000's. County officials and policy makers have repeatedly been required to focus budget planning efforts on where to reduce expenditures while opportunities to raise revenue and make new investments are limited. The ongoing imbalance is caused by stagnant revenue growth which is limited by State statutes and is not sufficient to keep pace with inflationary operating cost growth, or with increases in legacy healthcare and pension expenses.

Between 2012 and 2021, policy makers have been required to close cumulative budget gaps of approximately \$300 million or an average of \$30 million per year. While the budget has been balanced as legally required on an annual basis, the structural deficit persists and is projected to continue. The most recent five-year financial forecast prepared by the Comptroller's Office projected an operating budget gap of \$79.6 million by 2024.

ANALYSIS

Based on preliminary estimates, the County will be facing a 2022 operating budget gap of \$20.3 million. Major factors contributing to the projected budget gap are shown in the chart below. These amounts reflect: projected increases in expenditure items compared to 2021, removal of one-time revenue sources that are included in the 2021 budget, and increased revenue projections which are shown in the chart as negative values because they reduce the projected gap amount.

2022 Initial Operating Budget Gap Estimate	
Description	Amount
Compensation	\$ 4.3
Health Care	\$ 4.5
Pension	\$ 1.7
Debt Service P&I	\$ 1.0
Transit	\$ -
Other Operating Cost to Continue	\$ 7.8
Total Expenditure Change	\$ 19.3
Revenue Change - Lost Revenues	
Debt Service Reserve	\$ 5.3
Unclaimed Revenue	\$ 1.3
Doyne Payment	\$ 4.0
Revenue Change - Increased Revenue	
Property Tax	\$ (4.0)
Sales Tax	\$ (3.0)
Investment Revenue	\$ -
VRF	\$ -
Other / Reimbursement Revenue	\$ (2.6)
Total Revenue Change	\$ 1.0
Gap Total	\$ 20.3

The following descriptions provide additional information regarding assumptions used to develop the estimated gap. The numbers presented here are based on estimated changes for the 2021 budget and are subject to variability as the budget process continues.

Expenditures:

Compensation Increases: The 2022 budget gap estimate assumes \$4.3 million in new costs

related to compensation increases. This assumption includes \$1.1 million to annualize the mid-year 2021 salary increase, \$2.2 million for a new 1% general increase effective at the beginning of 2022 for most employees, and an additional \$1.0 million for targeted increases related to race and gender equity. The 2022 budget gap estimate does not include any funding for Departmental Other Salary Adjustment Allocations (DOSAA).

Health Care: Health care expenses are currently projected to increase by \$4.5 million over the 2020 budget, representing an increase of approximately 5%. \$3.0 million of this cost is due to the standard annual growth rates. Many employees have delayed optional health care services in 2020 and 2021, so a one-time increase of \$1.5 million in health care costs is currently projected for 2022.

Health care projections will be closely reviewed in the coming months and during the budget process. A final health care amount for the 2022 recommended budget will be decided in the summer of 2021 after receiving updated projections from our actuaries, and in consultation with the Comptroller's Office.

Pension: A pension growth estimate of \$1.7 million is projected for 2021. This is a preliminary estimate. The County is expected to receive its annual pension actuarial valuation in May, which will outline the 2022 budget contribution.

Debt Service: An increase of \$1.0 million is a preliminary estimate of growth in debt service principal and interest costs. This report also projects a corresponding increase in property tax to coincide with the increase in debt service expenses, meaning that this cost increase is not expected to add to the budget gap.

Transit: Tax levy costs for transit are currently projected to remain flat in 2022. Inflationary expenditure increases and potential revenue losses due to low ridership are assumed to be offset by additional federal covid-19 relief funding. This additional funding is one-time revenue and is not expected to remain in the budget in future years. It provides relief to the 2022 budget but is not a sustainable long-term solution for transit funding.

Other Operating Cost to Continue: A \$7.8 million increase is estimated as needed for inflationary operating costs, excluding personnel, debt service, and other costs already quantified in the above stated categories. This 1.4% inflationary growth is estimate for operating costs including utilities, commodities, professional services, and other contracts services. This estimate assumes that these costs will go up with inflation.

Revenues:

Lost Revenues:

Debt Service Reserve: The 2021 budget included \$5.3 million in funding from the Debt Service Reserve which is considered a one-time funding source.

Unclaimed Revenue: Every other year the County Treasurer advertises the possession of

unclaimed funds. In 2022, no revenue is expected, which is a decrease of \$1.3 million from the 2021 budget.

Doyne Hospital Sale Revenue: A \$4.0 million reduction related to the sale of Doyne hospital is expected in 2022. Based on the sale agreement between Milwaukee County and Froedtert hospital, the County received annual payments over 25 years beginning in 1996 with the final payment expected in 2021. The 2021 payment was budgeted at \$4.0 million and is the final payment. The revenue is eliminated in 2022 which creates a \$4.0 million gap in the 2022 budget.

Increased Revenues:

Property Tax: Based on experience from the recent years, the gap estimate includes approximately 1% growth or a \$3.0 million increase in property tax related to net new construction. In addition, a \$1.0 million increase is projected directly related to the estimated growth in debt service expenditures. The State of Wisconsin releases property tax levy limit worksheets and guidance in or around September of each year which confirm the amount of allowable property tax increases each year.

Sales Tax: County sales tax receipts are projected to grow by \$3.0 million compared to the 2021 budget. Sales Tax was budgeted at \$82.5 million in the 2020 budget and decreased to \$77.0 million in 2021 due to the fiscal impacts of the covid-19 pandemic. The 2022 budget projection brings the sales tax amount to \$80.0 million – restoring slightly more than half of the reduction in the 2021 budget. In recent months, there have been improvements in sales tax revenues, although the monthly disbursements remain highly volatile since the outbreak of the pandemic. Sales tax collections will be monitored closely by PSB and the Office of the Comptroller.

Other / Reimbursement Revenue: \$2.8 million of other revenues are projected. This is primarily based on an estimate that approximately 15% of cost increases can be covered with outside reimbursement revenue, primarily for services in the airport and health and human services.

Budget Items to Monitor

There are several other budget items that PSB is monitoring and may be included in future budget gap estimates.

State Budget: The Governor released the recommended state 2021-2023 biennial budget on February 16 and there are several proposals that would impact Milwaukee County. The Governor's budget is the first step in the state budget process. The legislature has an opportunity to amend the budget and the final budget is expected in the summer of 2021.

The most significant proposal in the Governor's budget that could impact Milwaukee County is a half-cent sales tax option for counties and large cities, requiring voter referendum. This half-cent sales tax option would generate approximately \$80 million on an annual basis.

Other proposals in the state budget that could impact the County include changes to property tax

levy limits, approximately 2% increases in transportation aids, transit aids, and state shared revenue. This budget gap report does not assume any revenue changes based on the state budget. PSB will continue to analyze the state budget and any potential changes from the legislature in the upcoming months and including more detailed information in subsequent budget reports.

Federal Relief Bill: Congress is currently deliberating on new round Coronavirus Relief Funds, which has the potential to result in additional funds for local governments including Milwaukee County. The current bill which is being considered as of 2/19/21 includes \$350 billion for State and Local governments, including \$130 billion for local government. Local governments of all sizes would receive allotments to address pandemic relief or its negative economic impacts. The bill in its current form as of 2/19/21 would provide \$185 million to Milwaukee County. However, it is important to note that the bill has not relief bill has not been approved and that details are subject to change. Congress is working towards incorporating Coronavirus Relief Funds through budget reconciliation, with the potential for an approval in March.

Investment Revenues: The 2021 Budget projected a decrease of approximately \$3 million in general investment revenue. After the impacts of the Covid-19 pandemic in the first half of 2020, investment performance picked up very strong in the second half of 2020. There may be an opportunity to increase the budget for investment revenues which would decrease the tax levy gap. At this point the budget gap analysis does not assume a change in investment revenues. However, PSB will be monitoring investment revenues with the Treasurer's Office and the Office of the Comptroller for potential budget changes.

Departmental Revenues: There is a risk that program revenues in departments such as Parks, Zoo, and Transit may not return to pre-pandemic levels. The current budget projection assumes that revenues in these areas stay the same as the 2021 Budget. PSB, the Office of the Comptroller, and the departments are closely monitoring revenues.

Closing the Budget Gap

The County has applied various strategies which have helped to close out budget gaps in previous years. Some examples include: restructuring of Worker's Compensation benefits, restructuring of health care and Other Post Employee (OPEB) benefits, and reducing the County's footprint by over 1.6 million square feet. Various reforms have been applied to the County's pension system. The County's salary step structure has been frozen since 2010 with limited increases in the range of 1% to 2% applied per year. On the revenue side, the County now requires employee health and pension contributions that did not exist in the past, resulting in \$21 million per year. A \$30 Vehicle Registration Fee was implemented in 2017 and generates approximately \$17 million per year.

In addition, due to the County's ongoing structural deficit, County departments have historically been tasked with identifying year-over-year savings within their budgets. This has come in two forms including: 1) requiring departments to self-fund inflationary and other cost increases within their budgets and 2) through application of levy reduction targets that have further reduced department budgets.

For the 2022 Budget, a combination of the following options are available as strategies close the budget gap and achieve a balanced budget:

- Requiring departments to self-fund operating cost increases within their existing budgets. This includes savings that would result from containing inflationary cost growth on contracts, utilities, and services. Additional savings could be achieved by further requiring departments to self-fund certain salary increases within their budgets (across the board salary increases and equity funding). The task of containing inflationary cost growth becomes more challenging for departments each year.
- The County has a goal of cash financing 20% of its capital projects. In some previous years the 20% goal was not met due to competing operating budget demands and priorities. Until the full list of capital project requests is received and reviewed it is difficult to determine if cash capital savings can be achieved in 2022.
- Although the Debt Service Reserve (DSR) should not be considered a permanent funding source, the County has utilized a portion of the DSR for the operating budget in previous years. The 2021 adopted budget included a \$5.4 million withdrawal from the debt service reserve. This amount is larger than the \$3.6 million withdrawal in 2020 due to the revenue loss associated with the covid-19 pandemic.
- Each year, PSB and the Office of the County Executive issues guidance to departments on how much tax levy is available for their requested budget. Due to the County's structural deficit, the tax levy target for departments in recent years has a reduction based on a percentage of expenditures or tax levy.

NEXT STEPS: 2022 Budget Process

Resolving the operating budget gap will be done through the budget process which takes place through the following timeline:

Forecasting and Budget Strategy Phase:

- January–April – DAS-PSB prepares forecasts for the upcoming fiscal year and develops budget assumptions with the County Executive and County Board

Department Request Phase:

- March or April – Departments receive operating budget instructions
- April - July – Departments develop their budget requests
- July – Departments submit their budget requests to the Office of Performance, Strategy, and Budget

Recommended Budget Phase:

- August-September – County Executive works with DAS-PSB and departments to finalize the Recommended Budget
- October 1 – County Executive submits the Recommended Budget

County Board Phase:

- October-November – Finance and Audit Committee reviews and requests information on the Recommended Budget
- November – The County Board adopts the budget

Throughout this process, DAS-PSB will provide additional information and updates.

RECOMMENDATION

This report is for informational purposes only. No action is needed. DAS-PSB will continue to provide information throughout the budget process. The administration looks forward to continuing work with the Board to develop a long-term fiscal sustainability plan for the County.

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