Milwaukee County

Five-Year Financial Forecast

2017 – 2021

Office of the Comptroller

Scott B. Manske, Comptroller

September 2016

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.

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 2017 budget is approximately $36.9 million.*** Key assumptions contributing to the structural deficit in 2017 include a loss of transit passenger revenue, increases in pension and healthcare costs and elimination of budget abatements and reserve contributions. Offsetting these increases is a surplus in forecasted wages and transit expenditures, forecasted increases in property tax levy, and increased revenues from sales tax and employee pension contributions.

- ***The 2017 structural deficit of $36.9 million is reasonable based on the forecasted cost-to-continue and use of one-time revenues and expenditure abatements in 2016.*** The County's prior year five-year forecast predicted that the County would have a structural deficit of $12.5 million for the 2017 fiscal year if the 2016 structural deficit of $26.2 million was solved with long-term solutions. The forecast further projected that if no long-term solutions were implemented, the 2017 structural forecast could reach $38.7 million. Given the one-time revenues used in 2016, as well as other unforeseen changes, the 2017 structural deficit of $36.9 million is reasonable.

- ***On average, the annual structural deficit will consist of a cost-to-continue of $14.1 million due to a greater increase in expenditures than what is generated in additional revenue.*** Expenditures will grow on average 2.2 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 2016, the County utilized such one-time revenues and expenditure abatements of approximately $19.3 million, which increased the 2017 structural deficit by the same amount. While a structural deficit of $36.9 million seems daunting for 2017, if the County were to resolve this structural deficit with long-term solutions, it could expect a 2018 structural deficit of roughly $12.5 million, barring any unforeseen issues. Any use of one-time revenues or expenditure abatements in the 2017 budget will worsen the structural deficit.

- Other issues such as potential outsourcing of the BHD inpatient units, the State 2017-2019 biennial budget and deferred maintenance remain uncertain and may compromise the County's future fiscal outlook and should be monitored closely.

THE FRAMEWORK OF THE STRUCTURAL DEFICIT

The structural deficit consists of two elements every year:

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

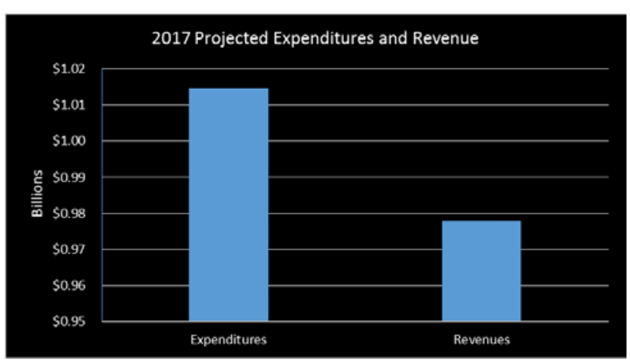
On average, the County can expect a structural deficit of $14.1 million annually due to a greater increase in expenditures than what is generated in additional revenue. Expenditures will grow on average 2.2 percent while revenues will grow on average 0.7 percent which generates the cost-to-continue to component. The component 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 2016, the County utilized such one-time revenues and expenditure abatements of approximately $19.3 million, which increased the 2017 structural deficit by the same amount.

THE 2017 PROJECTED STRUCTURAL DEFICIT

As has been the case for several years, the use of one-time revenues and expenditure abatements from the previous year coupled with a cost-to-continue results in a $36.9 million structural deficit for 2017. Expenditures and revenues are projected to be $1.01 billion and $0.98 billion, respectively.[1]

In comparison, the prior model predicted that the County would have a cost-to-continue of $12.5 million for the 2017 fiscal year if the 2016 structural deficit of $26.2 million was solved with long-term solutions. The forecast further projected that if no long-term solutions were implemented, the 2017 structural deficit could reach $38.7 million.



1 Expenditures and revenues are reduced in 2017 by approximately $300 million due to the separation of the Department of Family Care from the County.

The projected structural deficit in 2017 is largely comprised of the following changes from the 2016 Adopted Budget:

Expenditure Type	Dollar Change	
Healthcare	$	6.1
Pension	$	6.0
Expenditure Reductions	$	7.3
HHS Service	$	3.8
Salaries & Overtime	$	3.4
Transit Expenditures	$	(2.9)
Expenditure Change	**$**	**23.7**
Revenue Type		
One-time Revenues	$	12.0
Transit Passenger Revenue	$	5.0
Fees & Permits	$	2.0
Doyne Hospital Sale	$	(1.3)
Sales Tax	$	(1.6)
Property Taxes	$	(2.9)
Revenue Change	**$**	**13.2**
Projected 2017 Gap	**$**	**36.9**

Cost-to-continue items of significance include:

- **Employee Healthcare**. Costs are expected to grow by about 7.0 percent in 2017. Although the County experienced significant savings in healthcare costs in prior years which benefitted future years, 2016 healthcare savings are expected to be minimal. Therefore, healthcare costs will increase by $6.1 million in 2017 and an additional 7.0 percent each year thereafter.

- **Pension**. Increases in the County's contribution to the Employee Retirement System are included due to amortization of the increased pension liability for additional pension members, and amortization of investment losses in 2015. Total pension-related expenses increase by $6.0 million in 2017. Increases in the County's pension contribution beyond historical trends will also occur in 2018 and 2020 as the investment return assumption is lowered from 8.0 percent.

- **Transit Passenger Revenue**. Due to reductions in transit passenger revenue attributable to a decline in ridership and the GO Pass, it is forecasted that passenger revenue will decline by $5.0 million in 2017.[2]

[2] Transit passenger revenue is reflected as a negative expenditure in the departmental budget.

- **General Health and Human Services (HHS) Expenditures**. Costs related to health and human services are projected to grow by CPI annually over the forecast period, which results in a $3.8 million expenditure increase.

- **Wages**. Significant savings in salaries are available in 2016 to offset the ongoing overtime deficit as well as forecasted increases in countywide salary costs. Therefore, total salary and overtime costs are forecasted to grow only 1.0 percent in total for 2017. This assumption includes a salary increase for inflation of 2.4 percent.

- **Transit Expenditures**. Unanticipated healthcare and fuel cost savings are driving savings in the Transit budget for 2016. These savings result in a $2.9 million dollar savings in 2017.

- **Sales Tax**. Sales tax received is expected to be on budget for 2016, and is anticipated to grow at CPI in 2017 for an additional $1.6 million in revenue.

- **Property Tax Levy**. The 2017 forecast assumes that the County will levy up to the net new construction which was 1.0 percent in 2016. This provides an additional $2.9 million in revenue.

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

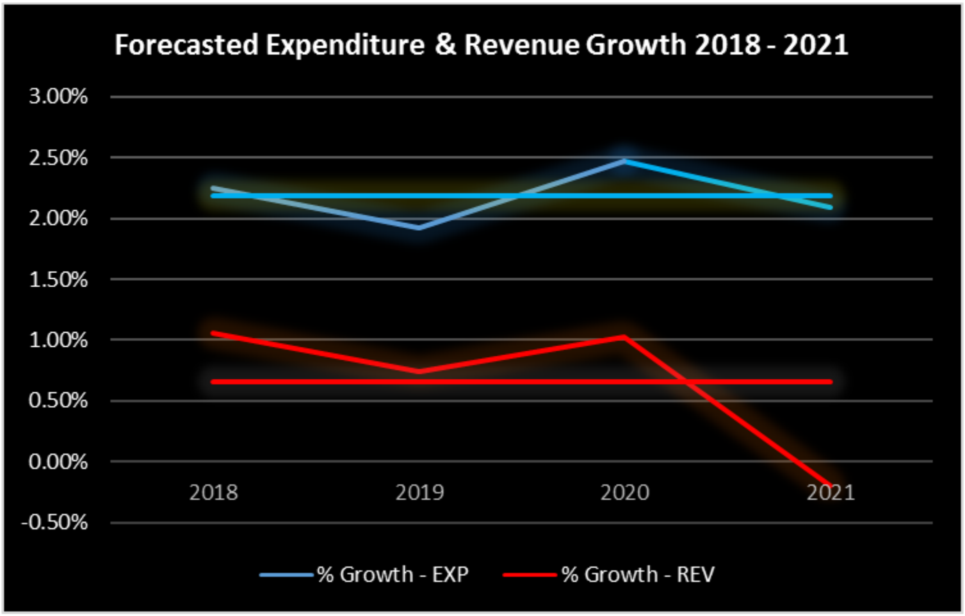
- **One-time Revenues**. The $12.0 million miscellaneous revenue loss is from the elimination of one-time revenue appropriated in the 2016 Adopted Budget of $10.5 million from the Debt Service Reserve and $1.5 million from the Pension Obligation Bond Reserve.

- **Expenditure Reductions**. The 2016 Budget included abatements to various budgets, including approximately $5.6 million to the Office of the Sheriff and $1.7 million to other County departments. These abatements were excluded from the forecast based on the assumption that departments would be unable to manage to these expenditure reductions.

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 2.2 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 original 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 2017 fiscal year if the 2016 structural deficit of $26.2 million was solved with long-term solutions. Due to the various factors affecting the 2017 budget, the model is now forecasting a $36.9 million structural deficit for 2017. 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 $12.5 million to $15.5 million.

Year	Expenditure	Revenue	Structural Deficit	Cost-to-Continue*
2017	$ 1,014,717,983	$ 977,811,962	$ (36,906,021)	
2018	$ 1,037,492,423	$ 988,133,140	$ (49,359,283)	$ (12,453,261)
2019	$ 1,057,464,537	$ 995,437,982	$ (62,026,555)	$ (12,667,272)
2020	$ 1,083,570,747	$ 1,005,683,974	$ (77,886,774)	$ (15,860,218)
2021	$ 1,106,181,395	$ 1,003,697,876	$ (102,483,519)	$ (15,540,887)
			Average Gap:	$ (14,130,410)

*Cost-to-continue assumes that the prior year gap was eliminated with long-term solutions. For 2021, the loss of Doyne Hospital revenue is removed as an outlier.

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 a $30.0 million revenue source in 2017, the cost-to-continue still remains a problem in future years. Furthermore, it shows that if the County adds a $30.0 million revenue source in 2017 and increases its revenues by 0.8 percent to 1.5 percent, the cost-to-continue still is problem, albeit at a lower amount.

	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue	Revenue (Millions)	Expenditure (Millions)	Cost-to-Continue
	0.70%	2.20%		0.70%	2.20%		1.50%	2.20%	
2017	$ 980	$ 1,010	$ 30	$ 1,010	$ 1,010	$ -	$ 1,010	$ 1,010	$ -
2018	987	1,032	15.4	1,017	1,032	15.2	1,025	1,032	7.1
2019	994	1,055	15.8	1,024	1,055	15.6	1,041	1,055	7.3
2020	1,001	1,078	16.3	1,031	1,078	16.0	1,056	1,078	7.6
2021	1,008	1,102	16.7	1,039	1,102	16.5	1,072	1,102	7.9
2022	1,015	1,126	17.2	1,046	1,126	17.0	1,088	1,126	8.2
2023	1,022	1,151	17.7	1,053	1,151	17.5	1,104	1,151	8.5
2024	1,029	1,176	18.2	1,061	1,176	17.9	1,121	1,176	8.8
2025	1,036	1,202	18.7	1,068	1,202	18.5	1,138	1,202	9.1
2026	1,043	1,229	19.2	1,075	1,229	19.0	1,155	1,229	9.4

Expenditure Elements: Personnel costs comprise about 44 percent of the County's total expenditures, up about 9 percent from 35 percent in the previous model. The increase can be attributed to the reduction in total County expenditures due to the loss of Family Care, which was nearly $300.0 million. The County's percentage of total expenditures for personnel-related expenditures grows only 1.5 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.

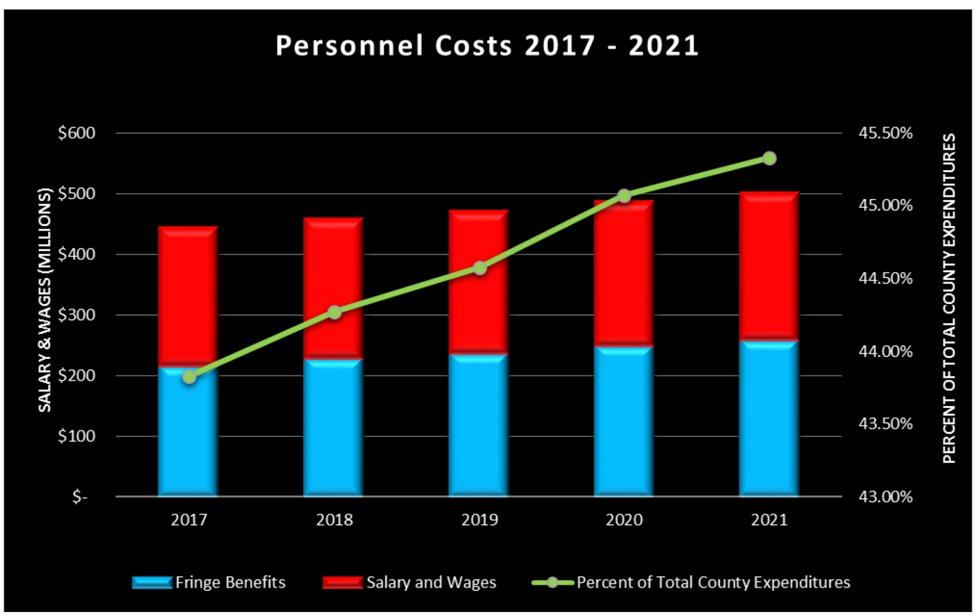
Main expenditure items of significance include:

- Salaries and Wages, including overtime, are forecasted to grow by 6.5 percent over the five-year forecast period which is virtually unchanged from the prior model. For 2017, this amount includes approximately 2.4 percent in additional salary dollars over projected 2016 costs for employee salaries. For the later years, salaries are forecasted to grow at CPI.

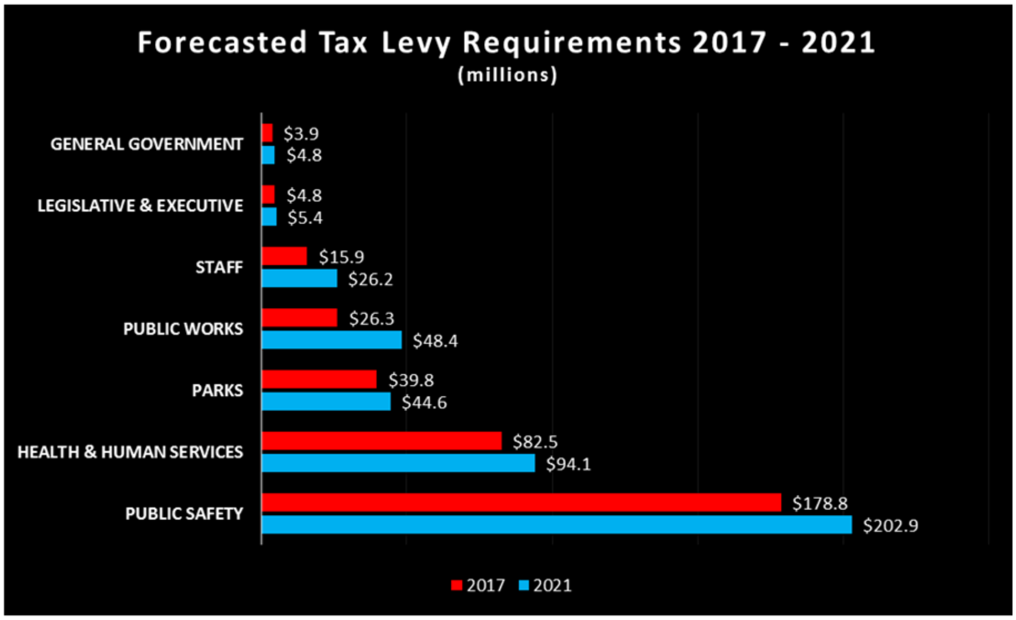
- Fringe benefits, including pension and healthcare, will grow by 19.4 percent during the five-year forecast period. This is less than the five-year forecast projections in 2012, 2013 and 2014 of 36 percent, 29 percent and 22 percent, respectively. It does, however, represent an increase from the prior model due to an unanticipated increase in costs for pension.

    - With a breakeven projection for 2016 actual healthcare costs, without additional changes to the current plan design or premiums, the County must absorb the full 7.0 percent cost increase in healthcare for 2017, or approximately $6.1 million. The forecasted growth results in a 31.1 percent increase in costs from 2017 to 2021.

    - In the prior model, pension costs were forecasted to rise 29.3 percent in 2016 and then flatten out over the forecast period. However, costs are now increasing at 16.9 percent over the five-year period. The changes in 2017 are due to investment losses in 2015 and the reinclusion of previously excluded pensioners. In 2018 and 2020, the County must also absorb the increase in costs due to the change in the investment assumption. Any of the increases could be offset by investment returns that exceed 8 percent 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 over time. The chart below shows the change in tax levy requirements for functional units over the five-year period.

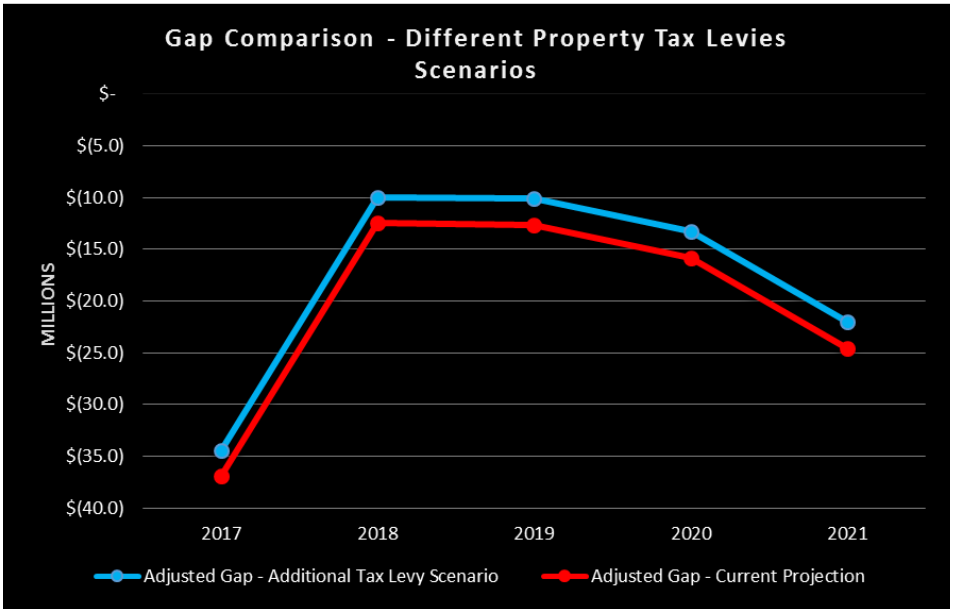


Inflationary Revenue Concerns: Over the forecast period, the County's revenue growth is projected to average 0.7 percent[3], which is down less than a half-percent from the previous model. Long-term, low growth rates are attributable to mostly flat revenue projections for State and Federal resources, as well as discretionary resources that are mostly forecasted to grow at CPI over the forecast period. In 2021, the County will lose a significant source of revenue when the Froedtert Hospital payment for the Doyne Hospital sale terminates. The continuous, low growth rate suggests that the County has not been successful in growing its revenue base, which impacts the County's cost-to-continue estimate annually.

Although the County operates under tax levy caps imposed by State Statutes, the County has judiciously levied amounts that commonly 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-

[3] The loss of revenue due the transfer of Family Care is not included in these estimates due to the outlier effect it creates. If the loss of Family Care revenue were included, the long-term revenue growth rate would be -4.3 percent.

term structural deficit is even more favorable under these conditions. As opposed to a $24.6 million structural deficit in 2021, the structural deficit in each year is reduced by a little more than $2.5 million.



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 2016 Budget utilized approximately $19.3 million in one-time revenues and expenditure abatements to resolve the 2016 structural deficit of $26.2 million. This $19.3 million is then added to the 2017 cost-to-continue component to arrive at the County's true structural deficit of $36.9 million. Had the County implemented $19.3 million in funding solutions that were sustainable, the forecasted structural deficit of $36.9 million for 2017 would have been reduced to $17.6 million.

Therefore, while the County is only projecting an average of $16.0 million in cost-to-continue annually for the County, any unsolved portion of the 2017 structural deficit will increase the 2018 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 1.0 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 $43.6 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 factor in the County's annual cost-to-continue.

- **Future Biennial State Budgets:** The State will soon begin deliberations on its biennial budget for the 2018 – 2019 fiscal years. Although there has been minimal County 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 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 $587 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. The County's Capital Improvements Committee has received requested five-year capital improvement plans from departments for 2017-2021 that total over $560 million. 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 $24.0 million for legacy health and pension and County-related services. About $14.7 million of the $24.0 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 2016 budget as the basis for the 2017-2021 projection. The 2016 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 2016 base is further adjusted for one-time events particular to 2016, or programs/ revenues/ expenditures which end in a future year.

All of this effort provides a first look at what a 2017 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 2017 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 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. 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 $14.1 million, the projected 2017 structural deficit of $36.9 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 2017, 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.