COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE : 12/19/18

TO : Supervisor Theodore Lipscomb Sr., Chair, County Board of Supervisors

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

SUBJECT : 2020 Operating Budget Gap and Process

OVERVIEW

This report provides a preliminary operating budget gap estimate for 2020. A timeline for the 2020 budget process is also provided.

The Office of Performance, Strategy, and Budget (PSB) preliminarily projects an operating budget gap of $26.5 million for Fiscal Year 2020. This gap is part of an ongoing structural deficit, whereby growth in revenue is not sufficient to keep pace with inflationary operating cost growth. In addition to an ongoing imbalance between revenues and expenditures, the County's 2020 budget is expected to be particularly impacted by a change in the Pension Fund's assumed rate of return from 7.75% to 7.5% as adopted by the Pension Board, as well as an expected increase in the cost to provide medical services to inmates. These and other expense and revenue impacts are described in more detail in this report.

Broad options for closing the 2020 budget gap are also presented for consideration and direction. PSB intends to provide follow up reports on this initial budget gap estimate to the County Board's Finance and Audit Committee in March and April, with a goal of reaching consensus on important operating budget planning decisions by April, which is when operating budget instructions are issued to departments.

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 2019, policy makers have been required to close cumulative budget gaps of approximately $245 million or an average of $31 million per year. While the budget has been balanced as required on an annual basis, the structural deficit persists and is projected to continue into the future. The most recent five-year financial forecast, prepared by the Comptroller's Office, projected an operating budget gap of $79.8 million by 2023.

ANALYSIS

Based on preliminary estimates, the County will be facing a 2020 operating budget gap of $26.5 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 2019, removal of one-time revenue sources that are included in the 2019 budget, and increased revenue projections which are shown in the chart as negative values because they reduce the projected gap amount.

Estimated 2020 Operating Budget Gap	
Description	**Amount**
Compensation Increases	$ 5.7
Health Care	$ 2.8
Pension	$ 6.6
Debt Service	$ 1.0
Other Operating Cost to Continue	$ 10.7
Inmate Medical Cost Increase	$ 5.0
Court Appointed Attorney Fee Increase	$ 1.5
Total Expense Change	**$ 33.3**
Revenue Change - Lost Revenues	
Debt Service Reserve	$ 3.3
Unclaimed Revenue	$ 1.3
Revenue Changes - Increased Revenues	
Property Tax	$ (3.9)
Sales Tax	$ (2.6)
GTA	$ (0.5)
VRF	$ (0.4)
Other/Reimbursment Revenue	$ (4.1)
Total Revenue Change	**$ (6.8)**
Gap Total	**$ 26.5**

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 2020 budget and are subject to variability as the budget process continues.

Expenditures:

Compensation Increases: An estimated $5.7 million is projected for the added cost of compensation increases in 2020. This includes $3.7 million to cover the fully annualized cost of increases included in the 2019 budget. The 2019 budget included funding for a 2% increase at mid-year, $500,000 for corrections officers at mid-year, and $455,000 for equity adjustments funded in the fourth quarter of 2019. In addition, the $5.7 million increase includes an estimate of $2.0 million for new compensation increases to be included in the 2020 budget. A $2.0

million increase could fund, for example, a 1% increase at mid-year plus approximately $800,000 of equity and/or other salary adjustments. This estimate of $2.0 million in new funding is included for forecasting purposes. A decision has not been made by policy makers regarding the level of new compensation increases to be included in the 2020 budget.

Health Care: PSB currently projects 2020 health care expenses to increase by $2.8 million over the 2019 budget. This is based on a review of current actuals, considers current Comptroller surplus projections for 2018, and applies a 3.5% expenditure growth estimate in both 2019 and 2020.

It is important to note that health care industry expenses have been subject to a high levels of volatility. The County's health care actuary has commonly projected growth rates of 7% or higher, although actual growth rates have not been this high in recent years. If actuary projections were used for this analysis, the health care growth estimate for 2020 would be approximately $8 million. Health care projections will be closely reviewed in the coming months and during the budget process. A final health care amount for the 2020 budget will be decided in the summer of 2019 in consultation with the Comptroller's Office.

Pension: A pension growth estimate of $6.6 million includes a $4.5 million cost increase for a change the pension fund's assumed rate of return, from 7.75% to 7.5% in 2020. This change has been adopted by the Pension Board. It has been past practice for the budget to fund the pension at the level adopted by the Pension Board. An additional $2.1 million cost increase is estimated in the pension fund for the normal cost and unfunded liability.

Debt Service: An increase of $1.0 million is a preliminary estimate based on 2020 debt service principal and interest growth projected in the Comptroller's 2018 five-year financial forecast. 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 projected to add to the budget gap.

Other Operating Cost to Continue: An estimated $10.7 million increase is needed for other operating costs, excluding personnel related costs and debt service budget changes stated above. The estimate equals approximately 2.3% inflationary growth for operating costs including utilities, commodities, professional services, and contracts. This amount is also consistent with what is projected in the Comptroller's five-year fiscal forecast. In the 2019 budget and in previous years, due to the County's structural deficit, departments have been asked to absorb most inflationary operating cost increases as a way to close the budget gap. In the absence of additional revenue streams in 2020, it is anticipated that departments will once again be asked to absorb these operating cost increases.

Inmate Medical Cost Increase: Changes to inmate medical services are expected to result in a significant cost increase. A new RFP for this service is nearing completion with vendor selection anticipated. In addition, an analysis of insourcing vs outsourcing of this service is being prepared. Regardless of who provides the service, it is anticipated that this cost will increase substantially above what is currently budgeted. A gap estimate of $5.0 million is approximately equal to the annualized cost of a three month extension for the current service provider, compared to what is budgeted in 2019.

Attorney Fee Increase: The Wisconsin Supreme Court has issued an increase in the court appointed attorney rate from $70 to $100 per hour. This 42% increase is effective in 2020 and is preliminarily estimated to result in a $1.5 million annual cost increase.

Revenues:

Lost Revenues:

Debt Service Reserve: The 2019 budget included $3.3 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. Revenue of $1.25 million is included in the 2019 budget. This amount is not expected to be included in the 2020 budget.

Increased Revenues:

Property Tax: Based on experience from the past two years, the gap estimate includes approximately 1% growth or a $2.9 million increase in property tax related to net new construction. In addition, a $1.0 million increase is projected directly related to the projected growth in debt service expenditures.

Sales Tax: County sales tax receipts are projected to grow by $2.6 million or 3.2% over the 2019 budget. In the second half of 2018, sales tax revenues have been trending above budget and the Comptroller is currently projecting a $1.5 million sales tax revenue surplus. At the same time, there is indication that the State has not aggressively pursued the collection of online sales taxes, which are a new source of sales tax revenue budgeted at $1.7 million in 2019. These factors were taken into consideration as part of the $2.6 million growth estimate for 2020.

General Transportation Aid (GTA): The 2019 budget included an amendment to increase GTA revenue by $1.16 million of which $662,000 was dedicated to Transit services for a modified version of Route 57 and $506,000 was put into the Debt Service Reserve. GTA revenue was increased in the 2019 amendment process because the State had not yet released the GTA allocation at the time the Recommended Budget was prepared. For 2020, this estimate assumes that the $506,000 of additional revenue put into reserves will be available to support the operating budget.

Vehicle Registration Fee (VRF): The 2019 budget includes $16.7 million of VRF revenue. Actual VRF receipts continue to trend modestly higher than the budget, and an updated analysis indicates the VRF budget could be increased by approximately $400,000. This projected increase is due to the number of cars being registered. It is not tied to a change in the fee.

VRF revenue can only be used for Transit and Transportation related costs. The Transit department in particular is a significant tax levy cost center. Transit's estimated cost to continue is $3.2 million for 2020, representing approximately 2% growth. In addition, Transit's 2019 budget included $1.6 million of one-time revenues which are not expected to be available in 2020. Between the cost-to-continue and one-time revenues, an additional $4.8 million of revenues and/or efficiencies will be required in order for Transit to maintain current services in 2020.

Other / Reimbursement Revenue: $4.1 million of other revenues are projected. This is primarily based on an estimate that 15% of cost increases can be covered with outside reimbursement revenue, primarily for services in the airport and health and human services.

Gap Closing Options

The 2019 budget introduced three broad options for closing the budget gap. These options included: Divest, Temporary Fix, and Sustain. Given that the 2020 budget outlook is similar to 2019, these options may once again be considered.

2020 Gap Closing Options	Divest	Temp Fix	Sustain
Dept's Self Fund Operating Cost-to-Continue	$ 10.7	$ 10.7	$ -
Debt Service Reserve Withdrawal Equal to 2019	$ 3.3	$ 3.3	$ -
Cash Capital or Other Reduction	$ 2.5	$ 2.5	$ -
Department Levy Targets	$ 10.0	$ -	$ -
New Revenues	$ -	$ 10.0	$ 26.5
Total	$ 26.5	$ 26.5	$ 26.5

Divest Option

The divest option relies on the following changes to close the gap:

- Inflationary operating cost containment of $10.7 million. Departments would be required to absorb inflationary increases in the cost of commodities, utilities, professional services, etc. This is essentially a reduction to departments because they will be required to identify cost savings in one area to offset increases another area which may be unavoidable.

- $3.3 million withdrawal from Debt Service Reserve. This amount is consistent with the 2019 budget. It would reduce the reserve down to approximately $20 million, which is well below policy levels recommended by the Government Finance Officers of America (GFOA). GFOA recommends governments of all levels maintain reserves equal to two months operating costs. By limiting this amount to two months of operating property tax and sales taxes alone, Milwaukee County would need a reserve of approximately $50 million to meet the GFOA standard.

- Reduce capital cash financing by $2.5 million, unless another funding source can be identified in the budget process. The 2019 budget increased capital cash financing by $5.4 million, back to adopted County policy levels. This was a positive development because the County has a significant backlog and need for cash financed capital projects, which are not bond eligible. However, there was no sustainable funding source identified to maintain this funding level for cash financed projects. This divest budget option assumes that capital cash financing would be reduced by $2.5 million, for the purpose of closing the operating gap. This limits the amount of reductions which need to be applied to department operating budgets.

- After the above options are taken into consideration, an operating gap amount of $10 million remains. The divest option assumes that this amount would be closed through departmental levy targets. $10 million amounts to approximately 1.5% of department's total budgets or 3% of tax levy. In March of 2019, DAS-PSB plans to provide a report to the County Board which will include draft departmental levy targets that will need to be applied under the Divest Option.

Temporary Fix

The Temporary Fix option includes the same strategies as the Divest budget option with one major exception. Instead of reducing department budgets by $10 million via approximately 1.5% levy reduction targets, the Temporary Fix option would add new revenues equaling this amount. DAS-PSB will provide additional information on revenues in a report on the budget planned to be presented to the Finance and Audit Committee in March.

Sustainability

The Sustainability option assumes that departments would be funded for inflationary cost increases. Debt Service Reserve and capital cash financing would not be reduced. Departmental levy reduction targets would not be issued. Instead, this option would require an additional $26.5 million of new revenues to be identified.

A sustainable option may require even more than $26.5 million in new revenue in order to fund various needs and changes including but not limited to:

- Revising Pension Rate of Return assumptions down to 7.0% instead of 7.5%
- Incrementally increasing reserves up to recommended policy levels
- Providing additional funding to capital infrastructure needs

In the absence of new revenues, each of these items would only add to the projected budget gap. Given the magnitude of this challenge, DAS-PSB recommends that the County Board continues to work with the County Executive on long term fiscal sustainability.

Levy Target Details

If the Divest Option strategy is followed for the 2020 budget process, the above chart indicates that levy reduction targets totaling $10 million will be distributed to departments. This amount is subject to change based on updates to the budget gap analysis, decisions around capital funding and use of debt service reserves, and other relevant factors. $10 million in levy reductions would amount to an approximately 1.5% reduction to the total budget for departments, or a 3%

reduction in tax levy.

As part of the 2020 budget process, DAS-PSB plans to share levy target details with the County Board and Finance and Audit Committee early on in the process. A report will be provided as part of the March 2019 committee cycle with an updated gap analysis, as well as draft levy targets for departments. DAS-PSB will follow up with the Finance and Audit Committee in April for input and decisions on levy targets, with a goal to reach a consensus on the direction that is provided to departments.

All departments will be expected to follow the levy target instructions in the requested budget process. If departments do not meet their levy target within their request, the County Executive's recommended budget will make adjustments accordingly to ensure that all departments participate in efforts to achieve a balanced budget. As has been the case in past years, most departments will be expected to participate in the levy target exercise. Some small departments and high risk departments may be exempted or held flat unless new information from the State is available indicating otherwise.

REVENUE ENHANCEMENTS

As part of the 2019 budget process, significant focus was placed on the need for revenue reforms for Milwaukee County and local governments across the State of Wisconsin. State statutes restrict the amount of revenues that Counties and other local governments are statutorily allowed to collect. For Milwaukee County, statutory restrictions have resulted in forecasted revenue growth of less than one percent per year which is not enough to support inflation, and is the primary cause of the County's structural deficit.

The "Fair Deal for Milwaukee County Workgroup" was created to identify and propose options for enhancing the long-term fiscal stability of Milwaukee County, and to increase State funding of mandated services. This workgroup is co-chaired by the County Board Chairman and the County Executive. Workgroup meetings are being held in December of 2018 and January of 2019 to develop recommendations which will become the focus of the County's lobbying activity during review and adoption of the State's 2019-2021 budget.

The State budget is scheduled to be adopted in July of 2019. DAS-PSB will monitor the State budget process for changes or impacts, and will update the County Board on relevant budget developments. For the 2020 budget process, DAS-PSB will operate under a status quo set of revenue assumptions unless new information is made available. This means that most State revenues will be projected to remain flat in 2020.

NEXT STEPS: 2020 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:

- 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

Finance & Audit Committee 2020 Budget Process Details

DAS-PSB intends to update the Finance and Audit Committee on the budget a regular monthly basis. The following items and reports are planned to be prepared as part of the 2020 budget process.

Items related specifically to the capital budget are stated in italics; a similar report providing details on the capital budget gap, process, and timeline will be presented in March.

- **January** – DAS-PSB provides initial operating budget gap estimates which also begins to explore funding options
- ***March*** *– DAS-PSB will present on capital budget gap, process, and timeline*
- **March** – DAS-PSB will provide a report with an updated operating budget gap estimate, initial draft levy targets will be shared, and possible revenue options
- **April** – DAS-PSB will follow up on levy targets and revenue options with a goal to reach consensus with the board on these items. Decisions are needed in April because budget instructions and levy targets will be issued to departments at this time.
- **July** – DAS-PSB will provide a high level summary of requested budgets. Note that requests are due July 15, three days before the Finance & Audit Committee meeting on July 18.
- ***July*** *– DAS-PSB and the Comptroller's Office will present a joint report on the County's bonding limit for capital projects, as required in 2019 budget amendment 1B002.*
- ***September*** *– DAS-PSB will present a report on the County's capital infrastructure and long-term capital financing needs.*
- **October** – Departments will present their requested budgets to the Finance & Audit Committee
- **November** – County Board adopts the budget

In addition to the reports stated above, DAS-PSB will provide additional information as needed. During the 2019 budget process, a standing budget item was included on the Finance & Audit Committee agenda for ongoing budget updates. It is requested that this item remain on the agenda for the 2020 budget process.

RECOMMENDATION

This report is for informational purposes only. No action is needed. DAS-PSB will be following up with the Finance & Audit Committee in March and April for input on funding strategies. 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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