

COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE : 2/21/2020

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

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

SUBJECT : 2021 Operating Budget Gap and Process

OVERVIEW

This report provides a preliminary operating budget gap estimate for 2021. A timeline for the 2021 budget process is also provided.

The Office of Performance, Strategy, and Budget (PSB) preliminarily projects a budget gap of \$21.3 million for Fiscal Year 2021. 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 2021 budget will be impacted by an estimated reduction of \$4.5 million in revenues related to the sale of Doyne hospital.

Potential options for closing the budget gap are also presented for consideration within this report. Additionally, the report provides relevant updates on strategic planning, revenues, and funding for Transit.

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 2020, policy makers have been required to close cumulative budget gaps of approximately \$261 million or an average of \$29 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 into the future. 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 2021 operating budget gap of \$21.3 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 2020, removal of

one-time revenue sources that are included in the 2020 budget, and increased revenue projections which are shown in the chart as negative values because they reduce the projected gap amount.

2021 Initial Operating Budget Gap Estimate	
Description	Amount
Compensation	\$ 4.6
Health Care	\$ 4.0
Pension	\$ 2.4
Debt Service P&I	\$ 1.0
Other Operating Cost to Continue	\$ 12.7
Total Expenditure Change	\$ 24.7
Revenue Change - Lost Revenues	
Debt Service Reserve	\$ 3.6
State Shared Revenue (VW)	\$ 0.4
Doyne Payment	\$ 4.5
Revenue Change - Increased Revenue	
Property Tax	\$ (3.9)
Sales Tax	\$ (3.3)
Unclaimed Revenue	\$ (1.3)
Other / Reimbursement Revenue	\$ (3.4)
Total Revenue Change	\$ (3.4)
Gap Total	\$ 21.3

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 2021 budget gap estimate assumes \$4.6 million in new costs related to compensation increases. This assumption includes \$2.2 million for a new 1% increase effective at the beginning of 2021 for most employees. An additional \$2.4 million is estimated to support the fully annualized cost of partial year increases which were funded in the 2020 budget. Partial year funding increases in the 2020 budget included additional funding for trades staff, corrections officers, and Departmental Other Salary Adjustment Allocations (DOSAA) which are provided for merit and equity increases. The 2021 budget gap estimate does not include new funding for DOSAA increases in 2021. In recent years these funds have been allocated in the 4th quarter of the budget. PSB is recommending that the County maintain the DOSAA funding structure but shift the cost to be on a fully annual basis, with the next round of DOSAA allocations to be implemented in January of 2022.

Health Care: Health care expenses are currently projected to increase by \$4.0 million over the

2020 budget, representing an increase of approximately 4%. Health care industry expenses have been subject to a high level of volatility. The County's health care actuary has commonly projected growth rates of 7% or higher, although actual growth rates have been below this in recent years and the County has experienced surpluses in the health care budget. Recent year experience factors into projecting 4% instead of 7% growth for the initial 2021 gap estimate. Health care projections will be closely reviewed in the coming months and during the budget process. A final health care amount for the 2021 budget will be decided in the summer of 2020 in consultation with the Comptroller's Office.

Pension: A pension growth estimate of \$2.4 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 2021 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.

Other Operating Cost to Continue: A \$12.7 million increase is estimated as needed for inflationary operating costs, excluding personnel and debt service costs already quantified in the above stated categories. The \$12.7 million increase estimate includes two main components:

- 1) \$10.7 million or approximately 2% of inflationary growth is estimated for operating costs including utilities, commodities, professional services, and other contract services. This estimate assumes that these costs will go up with inflation. Additionally, several of the County's contracts have inflationary escalators built in.
- 2) \$2.0 million of potential ongoing costs are estimated related to the County's Enterprise Resource Planning (ERP) system. The 2020 budget included over \$2.0 million in cost savings related to the County's mainframe and Ceridian systems, which were anticipated to be retired as a result of the ERP. However, implementation of the new ERP is delayed. Until the system implementation date is confirmed, this report assumes that a portion of Ceridian and mainframe costs will need to continue in 2021, and that this funding may need to be restored in 2021.

Revenues:

Lost Revenues:

Debt Service Reserve: The 2020 budget included \$3.6 million in funding from the Debt Service Reserve which is considered a one-time funding source.

State Shared Revenue: A \$409,000 reduction in State Shared revenue is anticipated in 2021 related to the Volkswagen Settlement grant. Milwaukee County received an award of \$5.5 million related to the first round of this grant program, which supports bus purchases. The grant is offset by a 75% or \$4.1 million reduction in State Shared revenue applied over ten years with

reductions expected to begin in 2021.

Doyne Hospital Sale Revenue: A \$4.5 million reduction related to the sale of Doyne hospital is expected in 2021. Based on the sale agreement between Milwaukee County and Froedtert hospital, the County receives annual payments over 25 years beginning in 1996 with the final payment expected in 2021. The 2020 payment was budgeted at \$9.0 million and is the final full year of the payment. This revenue is expected to be reduced in half in 2021 to \$4.5 million and eliminated in 2022, which creates a \$4.5 million gap in both the 2021 and 2022 budgets.

Increased Revenues:

Property Tax: Based on experience from the recent 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 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 \$3.3 million compared to the 2020 budget. This represents continued growth of approximately 2.0% per year over the past twelve months of actual revenue receipts.

Unclaimed Revenue: Every other year the County Treasurer advertises the possession of unclaimed funds. Unclaimed revenues of \$1.25 million are expected in the 2021 budget.

Other / Reimbursement Revenue: \$3.4 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.

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.

On the capital side of the equation, in some years the County has not been able to fund cash financed capital projects (which are not bond eligible) at desired policy levels due to competing needs for funding in the operating budget. Furthermore, the County's debt service reserve has also been used to support the operating budget in recent years, which is made possible as a result of year-end surplus.

The below chart demonstrates how some of these same strategies could impact the 2021 budget forecast, if they are applied in a manner that is comparable to previous years.

Projected Gap (\$ in millions)	\$ 21.3
Potential Gap Closing Options:	
Departments Self-Fund Operating Cost Increases	\$ 12.0
Cash Capital or Other Reduction	\$ 3.0
Debt Service Withdrawal equal to 2020 Budget	\$ 3.6
Other / TBD (balance)	\$ 2.7

- Requiring departments to self-fund operating cost increases within their existing budgets could reduce tax levy by an estimated \$12.0 million. This estimate includes \$9.1 million of savings that would result from containing inflationary cost growth on contracts, utilities, and services. In addition, \$2.9 million of tax levy savings could be realized by further requiring departments to self-fund certain salary increases within their budgets (1% and DOSAA 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 the 2020 budget this goal was slightly exceeded with a cash capital budget of \$11.6 million. 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 2021. For purpose of analysis and planning, this report assumes a \$3 million reduction in cash capital could be considered in 2021.
- 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. A \$3.6 million withdrawal would be consistent with the 2020 adopted budget.
- Even if the above tax levy savings scenarios were all applied, a remaining gap of approximately \$2.7 million would still exist. The Office of Performance, Strategy, and Budget will continue to seek solutions to these funding challenges and provide additional reports to the County Board and Finance and Audit Committee in the coming months.

Strategic Planning

Over the past year the County has worked to develop a new strategic plan which is also being presented to the County Board for adoption in March 2020. The strategic plan outlines the vision of the County to be: “By achieving racial equity, Milwaukee is the healthiest county in Wisconsin.”

In March of 2020 a resolution and ordinance are being presented to the County Board, which is “committing Milwaukee County to advancing the strategic priority of racial equity to improve the health of the entire community by eliminating any racism in the County’s policies, procedures, practices, and power structures.”

The strategic plan includes three-year objectives to achieve goals which are stated below, within each of the following focus areas:

- 1) **Diverse & Inclusive Workforce:** Milwaukee County leadership, management, and staff will reflect the diversity of its residents to better represent the experiences and ideas of the people it serves. The County resolves to build a collaborative, supportive, respectful workplace environment that increases the participation and contribution of all employees.
- 2) **Customer-focused Design:** Government services should meet the needs of its customers. Redesigning what, where, and how services are provided to meet customer needs should be done with customer participation. Defining customer populations and including those customer groups in the design and decision-making of services will help ensure that government services are meeting the needs of those using, or who could be using, County services. To this end, the County must focus on purposeful and meaningful community engagement on the front-end and throughout the process of decision making, which will produce more appropriate and equitable power-sharing between experts working in the government and the customers of County services.
- 3) **Employee Voice:** To enhance the health of Milwaukee County residents, County government should ensure that services meet everyone’s needs. Thousands of Milwaukee County employees directly serve residents each day, and their perspectives should be more-intentionally included to continually improve the equity of policies, procedures, and practices.
- 4) **Improved Performance & Equitable Practice:** Milwaukee County government must improve the quality of data it collects and analysis of the impact of services on customers. It is not enough to wish that a service is producing its intended outcome; the County should use qualitative and quantitative data to assess impact and continuously improve where services are falling short in order to improve the quality of life for all residents.
- 5) **Increased Revenue:** Over the past decade, Milwaukee County has cut an average of \$20 to \$30 million annually due to the structural deficit and has accumulated hundreds of millions of dollars in deferred maintenance. The harms to services caused by the structural deficit are largely due to the Wisconsin State Legislature not sufficiently funding mandated county services, the County’s limited options to raise

local revenue, and fiscally irresponsible decisions made decades ago. The County must find sustainable revenue sources and continue to pursue organizational efficiencies so the government can make meaningful investments to advance racial equity

Achieving goals within these objective areas is likely to require some strategic investment as well as prioritization of services. An effort is underway to analyze and quantify what resources may be needed to realize goals within these objectives. It will be recommended for policy makers to consider funding for strategic plan priorities during the budget process.

For additional information on the strategic plan, see File No. 20-174 which is also being submitted as part of the March 2020 County Board meeting cycle.

Focus on Transit Funding

Similar to 2020, the Milwaukee County Transit System (MCTS) is expected to be faced with significant budget challenges in 2021. Given the magnitude of budget issues impacting MCTS, this report provides further information specifically focused on the Transit budget.

State and Federal revenues represent approximately \$93 million or 60% of Transit's 2020 operating budget, while Property Tax Levy, Vehicle Registration Fee revenue, and passenger revenues comprise the remainder. For several years, State and Federal funding for Transit has declined. This trend is expected to continue in 2021. Following is a summary of the major challenges and issues impacting Transit's 2021 budget outlook.

- MCTS is faced with a \$2.4 million reduction in federal Congestion Mitigation Air Quality (CMAQ) funding that is currently used to support the Transit operating budget. This funding was initially granted to the County in 2012 for the purpose of introducing new express bus services. MCTS and the Milwaukee County Department of Transportation (MCDOT) have indicated that this CMAQ funding allocation expires in 2020 and the County will not have an opportunity for renewal due to federal limits on the number of years that CMAQ funds can be used for a new service.
- The 2020 MCTS operating budget included \$2.9 million of limited term 5307 federal grant carryover funding which is permissible by the Federal Transit Administration (FTA). This was a strategic yet short-term solution to support the Transit budget in 2020. MCDOT has indicated that these funds can be made available again in 2021, but that this is not an ideal long-term solution. Utilizing the same amount of funds for the operating budget in 2021 would result in a \$2.7 million gap for 2022.
- MCDOT has indicated that State Mass Transit Operating Assistance will remain flat at \$65.5 million in 2021. This revenue source was increased by \$1.2 million in 2020 as a result of the enacted 2019-21 State budget. The full value of the State biennial budget increase was already reflected in 2020 and there are no additional State funds expected for 2021. Flat funding of this revenue source also contributes to the budget gap because

this does not provide revenue to support inflationary cost increases. Mass Transit Operating Assistance is the single largest revenue source in the MCTS budget. State funding for Milwaukee County transit remains lower than it was a decade ago.

- MCTS is estimating approximately \$2 million in additional salary and fringe benefit costs in 2021, based on current contractual agreements and early fringe benefit estimates.
- MCTS is preliminarily projecting a further decline of \$650,000 in passenger revenue in 2021, which would continue a trend of declining ridership in recent years. The 2020 budget document shows that ridership levels are expected to be reduced to 27.7 million in 2020, which is a 13.5% reduction from 31.5 million riders in 2017.
- Property tax supports \$12.2 million of the MCTS operating budget. As indicated in this report, the County faces a \$21.3 million estimated budget gap for 2021, representing the variance between tax levy needs compared to funding that is available for County services. In past years, one of the strategies to close the budget gap has been to distribute levy reduction targets to departments in an across-the-board fashion. Any levy target amount would further add to Transit's gap for 2021.
- The Vehicle Registration Fee (VRF), which is currently \$30, currently provides \$16.1 million of annual funding to the Transit operating budget, plus \$1.1 million to the Highway Maintenance budget, for total annual amount of \$17.2 million. The current budget gap estimate assumes that this fee will remain flat in 2021. Under State statutes the County does have the ability to raise the VRF for transportation related services, including transit. For example, a \$10 VRF increase would generate an estimated \$5.7 million of added revenue. A \$20 VRF would add \$11.5 million of revenue. A \$30 increase would result in \$17.2 million. However, the Milwaukee County VRF is already higher than most jurisdictions across the State.

With the above factors combined, the Transit budget on its own has a projected gap in the range of \$5.0 million to \$7.7 million. The range is dependent upon decisions related to the use of federal 5307 carryover revenue. If the federal carryover revenue is used to support the 2021 budget, that will create a gap in 2022.

Revenue Update

Significant focus has been 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 this is the primary cause of the County's structural deficit.

The "Fair Deal for Milwaukee Workgroup" was created in 2018 to build a new partnership with the State of Wisconsin to protect services and invest in our future. This workgroup was co-

chaired by the County Board Chairman and the County Executive and included a diverse group of stakeholders, including community advocates to business interests. The workgroup provided a number of recommendations including: allowing Milwaukee County local control to generate revenue and reduce reliance on property tax; increased contributions from the state towards the provision of state-mandated services; fully reimbursing the County for the cost of patrolling freeways; adjusting shared revenue payments and other state aids to align with inflation; equally sharing Circuit Court and Register of Deeds fees collected by the County; and other recommendations.

In October of 2019 the State legislature introduced bills SB471 and AB521 which would allow Milwaukee County voters to decide if Milwaukee County should increase its sales tax by 1% and provide property tax relief. A 1% sales tax is estimated to generate over \$160 million in sales tax annually. Under the proposed bill, a minimum of 25% of that revenue would be set aside for property tax relief. The remaining revenue would be split between Milwaukee County and its 19 municipalities to meet critical needs.

SB 471 has been referred to the Senate Committee on Agriculture, Revenue and Financial Institutions. AB 521 has been referred to the Assembly Committee on Ways and Means. Legislative leadership, members of the respective committees, and Milwaukee area legislators have been working together, in a bi-partisan manner, to build support for the legislation and schedule a public hearing in the remaining weeks of the current legislative session.

The 2021 operating budget gap estimate does not make any assumptions regarding the additional sales tax rate.

NEXT STEPS: 2021 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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