CITY OF MILWAUKEE'S FISCAL CONDITION:

MAKING ENDS MEET

AN INDEPENDENT THIRD-PARTY ANALYSIS

PUBLIC POLICY FORUM

About the Public Policy Forum

The Milwaukee-based Public Policy Forum, established in 1913 as a local government watchdog, is a nonpartisan, nonprofit organization dedicated to enhancing the effectiveness of government and the development of Southeastern Wisconsin through objective research of regional public policy issues.

Preface and Acknowledgments

This report was undertaken to provide citizens and policymakers in the Milwaukee region and across the state with an independent, comprehensive and objective analysis of the fiscal condition of the City of Milwaukee government. We hope that policymakers and community leaders will use the report's findings to inform discussions during upcoming policy debates and budget deliberations at both the City and State level.

Report authors would like to thank Milwaukee fiscal officials and staff – including the City Budget Director and his staff and the City Comptroller and his staff – for their assistance in providing information on the City's finances and for patiently answering our questions.

In addition, we wish to acknowledge and thank the Greater Milwaukee Committee, which commissioned and helped fund this research as part of its Downtown Task Force and Downtown Action Agenda. We also thank the Northwestern Mutual Foundation and the Rockwell Automation Charitable Corporation for their long-standing support of our local government finance research.

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Table of Contents

Executive Summary

In 2009, the Public Policy Forum's deep dive into the finances of the City of Milwaukee revealed a government with "serious, deep-seated fiscal problems." As suggested by the report's title – "Between a Rock and a Hard Place" – the City found itself in an untenable and virtually unmanageable situation, facing daunting expenditure needs associated with fringe benefits and aging infrastructure on the one hand, yet locked into a revenue structure that yielded little hope for growth on the other.

Today, after conducting another comprehensive assessment of the City's finances, our prognosis is not nearly as alarming. City leaders *were* able to deftly manage their recession-induced challenges, thanks largely to health care restructuring. Changes in the City's health care offerings and administration yielded tens of millions of dollars of annual savings that were used to meet pension obligations, replenish reserves, and spare departments from significant service reductions.

Yet, as shown in the comparison box on the following page, while Milwaukee has made considerable progress with regard to several of the fiscal indicators used for our analysis, two glaring red lights remain. The first is intergovernmental revenue, which consists largely of shared revenue from the State of Wisconsin. This is the City's largest revenue source, but it declined by nearly 4% in nominal terms and 9% in constant dollars over the 2011-2015 timeframe. The second is expenditures by major function, where our analysis revealed that the public safety function consumed $35 million of the City's overall $38 million increase in general purpose expenditures during that same timeframe just to maintain existing police staffing levels.

If, as expected, these contradictory trends of flat intergovernmental revenues and fierce public safety expenditure pressures continue, then it is difficult to see how City leaders will be able to spare non-public safety departments from service reductions, especially when health care expenditures again begin to rise. Furthermore, the City's wherewithal to make and sustain *increased* investment in additional police officers, community development, and/or other measures in response to the recent unrest in Sherman Park will be extremely challenging barring some new source of revenue.

ICMA fiscal indicators, 2009 vs. 2016

Specific findings from our updated assessment of the City of Milwaukee's fiscal condition include:

- **Milwaukee remains far too reliant on property taxes and fees**. A 10 million (3.6%) decrease in intergovernmental revenue from 2011-2015 necessitated a $23 million (14%) increase in property taxes for the General Fund and a $17 million (17%) increase in charges for services to allow overall revenues to keep pace with inflation. Meanwhile, substantial future growth in property-related revenues – even if deemed politically palatable – will be limited by state property tax levy restrictions and the reality that service-related fees only can be used to pay for the services with which they are associated, as opposed to general operating needs.

- **Health care savings soon will be exhausted**. Annual employee/retiree health care expenditures dropped from $139 million in 2011 to $96 million in 2015 (31%). Those savings were central to the City's ability to accommodate a $60 million spike in pension obligations, avoid workforce reductions, and maintain police staffing levels. By 2018, the City again will have to budget for modest annual health care increases, which will exacerbate its other expenditure pressures.

- **Police service needs could threaten service solvency in other areas of City government**. The Milwaukee Police Department spent $59 million more in 2015 than in 2011, even though it had two fewer officers (1,876 vs. 1,878). This was caused, in part, by the need to replace expiring federal stimulus grants with local resources. Maintaining sworn strength levels will not require as big a financial commitment in the future now that grant dollars have been supplanted and police union members contribute to their pensions; however, the pressures associated with replacing retiring officers, modernizing technology, and accommodating natural growth in police salaries and benefits still could crowd out other needs.

- **Retirement liabilities and debt are manageable today but growing**. The City's unfunded actuarial liability for Other Post-Employment Benefits (OPEB) stood at $976 million in 2015, which is $60 million higher than in 2011; and its pension fund – while in far better shape than many cities – still requires an annual contribution of $60 million, a number that could rise beginning in 2018. Meanwhile, property tax levy-supported debt grew from $561 million in 2011 to $629 million in 2015. Increasing retiree liabilities and debt payments can be managed in the short term, but may pose substantial long-term fiscal challenges.

It is important to consider Milwaukee's fiscal strengths, as well. Our analysis reveals that the City has well-stocked reserves and strong liquidity, and that it has made progress in addressing its infrastructure needs. Also, the resilient manner in which City finances emerged from an historic economic recession should not be understated and conveys hope for similar resiliency in the future.

Nevertheless, our 2009 conclusion that Milwaukee needs "fundamental fiscal change" has not been altered. The City's revenue structure – which has been imposed upon it by the State of Wisconsin – remains broken. Until it is modified to reduce the City's reliance on property-related revenue, and to provide wherewithal for total annual revenue increases that mirror the rate of inflation, then City finances will continue to be stressed, and substantial *new* investment in public safety and community development-related programs will be highly difficult to achieve.

Introduction

In August 2009, the Public Policy Forum published "Between a Rock and a Hard Place,"[1] a detailed examination of the City of Milwaukee's finances that was designed to provide an objective, third party assessment of the fiscal condition of Milwaukee's city government. The report was released just weeks after Milwaukee Mayor Tom Barrett had proclaimed the City's upcoming 2010 budget "by far the most difficult" he had faced in his nearly 25 years of public service. Our intent was to provide greater public understanding of the confluence of factors that had created such severe budget challenges for the City, and to determine the extent to which they were linked to the 2008-09 economic recession, as opposed to deeper structural problems.

Our conclusion was not encouraging:

> *What we find is a city government on the precipice of serious fiscal and programmatic disorder. Despite outstanding bond ratings, a comparatively well-funded pension system, and healthy reserves, Milwaukee has exhausted the capacity of its existing revenue streams to support its expenditure needs. We also find that this reality is not solely the consequence of economic recession, but one that has been building for more than a decade despite the efforts of city leaders to manage it.*

Seven years later, the City's financial affairs appear to be much improved. Successful efforts to dramatically reduce health care costs, stabilize pension contributions, and trim the active workforce – combined with a recovering economy – have produced relatively calm budgets in each of the past three years. And, while City leaders still bemoan the stagnant nature of their shared revenue allocation from the State of Wisconsin, they have been able to maintain service levels without depleting reserves or unreasonably deferring needed infrastructure repairs.

Does this recent improvement signify long-term fiscal stability, or are the City's deeply-rooted structural issues only temporarily concealed? Given escalating challenges related to public safety and infrastructure – and a desire to invest in economic development initiatives that will address longstanding problems of poverty and unemployment – this is a critical question that we seek to answer in this updated assessment of the City of Milwaukee's fiscal condition.

As with our 2009 analysis, the backbone of our assessment is a set of local government financial evaluation metrics developed by the International City/County Management Association (ICMA). This methodology requires the selection and tracking of fiscal indicators to assess the underlying forces that may affect municipal finance. It focuses on four types of solvency:

- Cash solvency, which refers to a government's ability to pay its bills and meet its payroll.
- Budgetary solvency, defined as "a government's ability to generate enough revenues over its normal budgetary period to meet its expenditures and not incur deficits."
- Long-run solvency, which examines future costs incurred by current fiscal decisions.

[1] The report can be accessed at http://publicpolicyforum.org/research/city-milwaukees-fiscal-condition-between-rock-and-hard-place.

- Service-level solvency, which is the “ability to provide services at the level and quality that are required for the health, safety, and welfare of the community and that its citizens desire.”

In addition to providing a concise and objective means of considering the overall fiscal condition of Milwaukee's city government, application of the ICMA metrics can raise broader considerations that require more detailed analysis. Where appropriate, we provide such examination.

In many ways, the City of Milwaukee is at a crossroads. Development of a new basketball arena, downtown streetcar, a new headquarters for Northwestern Mutual, and thousands of new downtown residential units have established unprecedented levels of excitement and optimism among many citizens regarding Milwaukee's future. Yet, important questions linger regarding the long-term financial impact of the public investment that has been required to support those developments.

In addition, maximizing the benefits of downtown development opportunities and ensuring that they spread to impoverished city neighborhoods may require new and creative investment in service areas ranging from public safety to public health to public works. Whether City government has the financial wherewithal to support such investment needs to be considered.

In the pages that follow, we seek to provide policymakers and citizens with a data-driven analysis of the City of Milwaukee government's recent financial past and its projected future. With greater understanding of the City's financial strengths and weaknesses, we hope that policymakers, civic leaders, and citizens will be better equipped to debate the city's economic development objectives, and to consider whether the basic municipal services that are required to underpin such development can be appropriately provided and sustained.

Methodology and Data

In seeking to provide an objective assessment of the City of Milwaukee's fiscal condition, this report leans on the ICMA's Financial Trend Monitoring System, the purpose of which is to:

- *Examine local government financial condition—the forces that affect it and the obstacles to measuring it*
- *Identify existing and emerging financial problems*
- *Develop remedies for these problems*

The ICMA system relies heavily on trend analysis to offer the kind of evaluation that rarely is possible during time-sensitive budget deliberations. The system helps a government better understand the nature of its revenues and expenditures, as well as its long-term and current budget solvency. It also examines the government's cash position and how revenues and expenditures influence service levels.

The heart of the ICMA system is the selection of a group of indicators critical to local circumstances and the collection of information relevant to those indicators. The analysis tracks trend results for the selected indicators over a five-year period.

ICMA does not provide a formula for interpreting the gathered information. Rather, the format organizes and frames the data, providing a context by which to reach informed judgment. As the ICMA handbook says:

> *Evaluating a jurisdiction's financial condition is a complex process…Not only are there large numbers of factors to evaluate, but many of them are also difficult to isolate and quantify. Relationships between the factors add to the complexity. Some are more important than others, but often this cannot be determined until all the factors have been assembled…No single indicator is conclusive.*

This City of Milwaukee analysis, as the ICMA system intends, is wide-ranging with indicators specifically selected to address all four forms of solvency cited in the introduction to this report. Indicators on fiscal liquidity and fund balances demonstrate cash solvency. Indicators on retirement spending, debt, and the condition of city assets shed light on long-term solvency. Indicators on revenues and expenditures reveal underlying factors that affect budget and service solvency. Environmental indicators explore the broader forces influencing fiscal health. Trends are tracked from 2011 to 2015; on issues deemed worthy of deeper analysis, the report examines more recent budgeted data.

In addition to using the ICMA indicators as a primary evaluative tool, this report utilizes a multitude of related data to create a context and an analytical framework that complements indicator information. City of Milwaukee Comprehensive Annual Financial Reports (CAFRs), budget documents, actuarial reports, and other select studies were the major data sources consulted. The report also draws upon demographic, economic, social, and housing data from the U.S. Census and other national sources. The Consumer Price Index was used to assess the impact of inflation.

Milwaukee's Fiscal Environment

Analyzing the environment with the ICMA system

Before considering key financial indicators that speak to a local government's fiscal condition, it is important to have a basic understanding of the government's economic and socioeconomic environment. In this section, we review a small set of environmental indicators to further such understanding.

ICMA cites an array of environmental indicators that a financial analysis should contemplate, including changes in community needs and wealth, economic and demographic conditions, disaster risk, and the nature of existing political structures and relationships. These "external" factors can affect citizens' needs and demands for government services and programs, as well as the ability of a government to pay its bills, sustain programs, and maintain long-term solvency. Under the ICMA system, the ultimate purpose of an environmental analysis is to assess whether "environmental factors provide enough resources to pay for the demands they make."

Analysis

One of the most fundamental environmental indicators that can influence a city's financial condition is the size of its population and the direction of population change. A city with an expanding population often can access a growing base of tax revenue to support core services. Conversely, a city with a shrinking population often must spread the cost of such services among fewer people, which can impact its capacity to maintain service levels and which can hamper efforts to attract new residents. Population decline also makes it more difficult to undertake and afford new initiatives.

Milwaukee's population reached its peak in 1960 at 741,324. The population declined precipitously in the next two decades to 636,212 in 1980 and more gradually to 596,976 in 2000. Since that time, the city's population has stabilized, with the most recent Census count in 2015 showing a population of 600,155.

Another critical aspect of municipal fiscal health is the overall vitality of the local economy. Like many U.S. cities, Milwaukee's economy took a considerable hit during the 2008-09 recession. Since 2011, however, several key indicators have shown improvement. As shown in **Table 1**, median household income grew and unemployment and poverty rates declined over the 2011-2015 timeframe.

An important outlier is property values, which are central to the City's ability to generate property tax revenue, and which fell by 11% over the period. While not shown in the table, that indicator also shows signs of recovery, as the slight increase in 2015 was followed by a 4.1% increase in equalized value in 2016. However, property values in Milwaukee remain about 15% below their 2008 peak. (For the other indicators shown in **Table 1**, 2015 was the last year for which data were available.)

Table 1: Trends in Select Environmental Indicators, City of Milwaukee, 2011 to 2015

Year	Median Household Income	Taxable Value	Percent in Poverty	Unemployment Rate (16+)
2011	$33,122	$29,521	29.4%	15.8%
2012	$34,042	$27,955	29.9%	13.1%
2013	$35,186	$26,422	29.0%	11.3%
2014	$35,049	$26,090	29.0%	10.5%
2015	$37,495	$26,138	26.8%	8.7%
5-yr difference	**$4,373**	**($3,383)**	**n/a**	**n/a**
5-yr % change	**13.2%**	**-11.4%**	**n/a**	**n/a**

* Equalized value, in millions
Source: U.S. Census, American Community Survey, 2010 to 2014; 2014 City of Milwaukee Comprehensive Annual Financial Report (CAFR)

Despite signs of improvement, the city's median household income and poverty and unemployment rates remain stubbornly out of line with state and national averages. Those indicators can produce added stress on the City budget given that high levels of poverty can place greater demands on certain municipal services, such as public safety and public health. By any measure, the city's poverty rate of 26.8% in 2015 was exceptionally high. This rate compared with the state average of 12.1%; nationally, Milwaukee ranks as the third most impoverished among the 50 largest cities.[2] Meanwhile, its median household income of $37,495 was about two thirds the state average of $55,638, and its 8.7% unemployment rate was more than double the state's rate of 4.3%.

National bond rating agencies have expressed concern about the city's economy. In April 2016, Standard & Poor's reported that it considered Milwaukee's economy "weak," citing low per capita effective buying income and low property values when compared to the larger region. Moody's similarly cited a "weak demographic profile and recent declines in tax base valuation" as key challenges.[3]

Additional perspective on Milwaukee's environmental challenges can be gained by comparing its environment with similar cities in the Midwest and elsewhere. **Table 2** provides perspective on financial capacity (i.e. the ability of city government to generate tax revenues) and **Table 3** looks at indicators that speak to financial demand for municipal services. The peer cities selected are those used by the City Comptroller in his annual comparable analysis of City revenues and expenditures.[4]

[2] "Wisconsin incomes up, poverty down," Milwaukee Journal Sentinel, September 15, 2016.
[3] As will be explained later in this report, despite these concerns about Milwaukee's economy, the ratings agencies continue to give the City strong credit ratings.
[4] American Community Survey (ACS) data for 2015 were released just as this report was going to press. Those data are reflected in **Table 1**. We did not have time to update our peer comparison tables (**Tables 2** and **3**), however, so those tables use ACS data from 2014.

Table 2: Environmental indicators related to financial capacity, City of Milwaukee and comparable cities, 2014

City	Median Household Income	Mean Household Income	Per Capita Property Value
Charlotte	$55,178	$82,032	$111,897
Cleveland	$24,701	$38,405	$45,035
Columbus	$46,481	$59,508	$48,111
Kansas City	$44,173	$62,430	$60,732
Memphis	$34,704	$52,479	$55,498
Milwaukee	***$35,049***	***$49,923***	***$43,507***
Oklahoma City	$49,119	$67,544	$67,622
Omaha	$48,410	$65,198	$64,845
Portland	$54,624	$77,277	$79,134
Raleigh	$53,475	$79,401	$119,779
Milwaukee rank	***8***	***9***	***10***

Source: U.S. Census, American Community Survey, 2014; and 2014 CAFR

Table 3: Environmental indicators related to financial demand, City of Milwaukee and comparable cities, 2014

City	Annual Unemployment Rate	Percent in Poverty	Less than H.S. Diploma	Crimes Per 10,000**		Housing*		
				Violent	Property	Units (per 10,000)	% Owner Occupied	Built Prior to 1950
Charlotte	6.7%	16.7%	11.9%	59	357	4,129	53.0%	6.5%
Cleveland	10.8%	39.2%	23.4%	162	605	5,387	39.5%	65.2%
Columbus	4.5%	21.5%	11.8%	55	425	4,565	44.1%	18.3%
Kansas City, MO	4.6%	17.8%	10.9%	125	483	4,805	52.4%	28.6%
Memphis	6.3%	29.8%	15.6%	174	599	4,577	47.5%	18.0%
Milwaukee	***6.8%***	***29.0%***	***17.1%***	***148***	***458***	***4,355***	***42.0%***	***48.8%***
Oklahoma City	4.1%	18.5%	14.4%	77	441	4,301	57.0%	15.6%
Omaha	4.2%	15.8%	13.7%	56	435	4,253	56.5%	27.0%
Portland	5.2%	18.3%	8.0%	47	523	4,367	51.4%	40.7%
Raleigh	4.0%	16.6%	7.9%	39	306	4,376	49.1%	4.7%
Milwaukee rank	***2***	***3***	***2***	***3***	***5***	***7***	***5***	***2***

* For housing, a higher incidence of home ownership relates to lower financial demand. A lower incidence of units per 10,000 people reflects higher population density but also fewer units per capita to maintain.

** Latest available crime data for Cleveland is 2011 and Raleigh is 2013.

Source: U.S. Census, American Community Survey, 2014, FBI Crime in the United States Report, 2011, 2013, 2014

The two tables show that the City of Milwaukee generally does not compare favorably with its peers for these indicators of financial capacity and demand. In other words, **the demand on Milwaukee's city government for certain municipal services likely is higher than in most big cities, and the capacity of city taxpayers to support that demand likely is lower**. For the purpose of this fiscal condition analysis, that suggests responses to budget challenges that involve increasing local taxes and fees and/or cutting services may produce harsher ramifications in Milwaukee than in other comparable cities.

Budgetary Solvency: Revenues

Analyzing revenues with the ICMA system

A key feature of any fiscal assessment is to determine whether revenues are increasing at a rate sufficient to sustain existing levels of services and program operations. The ICMA handbook states that "under ideal conditions, revenues would grow at a rate equal to or greater than the combined effects of inflation and expenditure."

Since local governments rely upon multiple revenue sources, ICMA emphasizes that solvency may reflect decisions not just about whether or how much to increase taxes and fees, but also about the nature and relative proportion of different types of revenue streams. Whether a government relies mainly upon the property tax or the sales or income tax, or is able to de-emphasize local taxes because of sustained support from higher levels of government, can have a significant impact on its fiscal circumstances.

The ICMA system, therefore, encourages close examination not only of total revenues, but of a government's revenue *characteristics*. In fact, two primary considerations are revenue flexibility and dependability. In the organization's professional judgment, **a local government's fiscal condition is strongest when it has diverse revenue sources that are not overly dependent upon external factors; when a significant portion of its revenues grow with the rate of inflation; and when its revenues are flexible and free from spending restrictions**.

Summary of revenue findings

While our 2011-2015 trend analysis indicates that Milwaukee's revenue picture has improved since our last examination in 2009, the same structural problems remain. The City continues to rely much more than its peers on a limited number of revenue sources, namely the property tax and intergovernmental revenues (comprised mostly of state aids). Intergovernmental revenues declined both in nominal and inflation-adjusted terms, requiring the City to lean even more heavily on property taxes and charges for services to bridge the gap.

To ease the impacts of reduced intergovernmental revenues, City leaders also shifted additional property tax resources away from debt service and capital outlays and into the General Fund. This shift may not be sustainable in the long run.

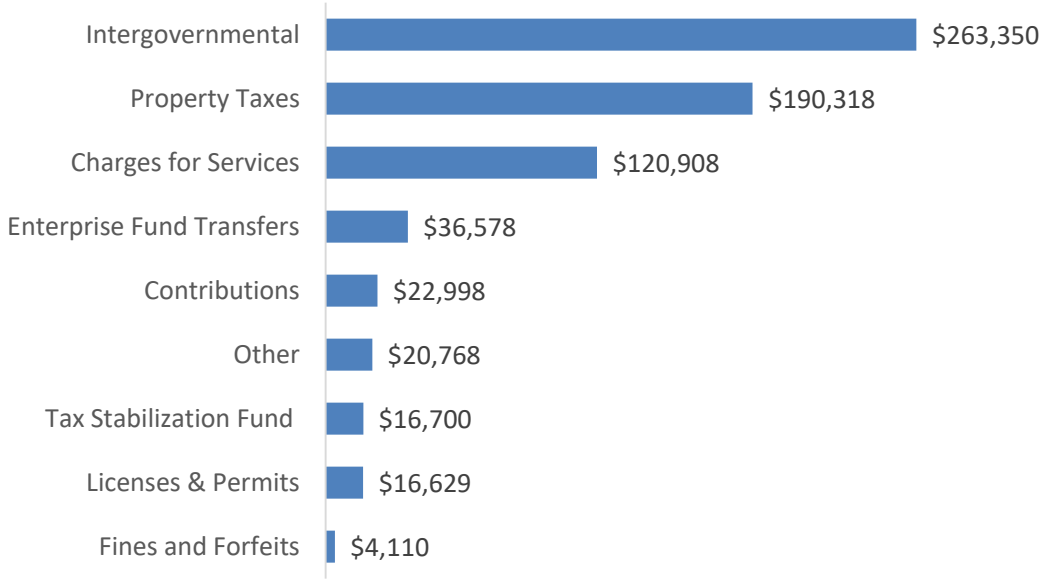
Overall, while substantial improvements on the expenditure side have eased the sense of crisis we conveyed seven years ago, the City's revenue structure remains in need of "rebalancing." In light of the unlikely prospect of increases in state aids, it would appear imperative that City officials be given the ability to consider other local revenue sources both to ease the reliance on property taxes and fees and ensure inflationary growth in total General Fund revenues.

Analysis

Major revenue sources

Chart 1 presents Milwaukee's actual operating revenues in 2015 for general City purposes categorized by eight major sources.[5] We then provide a basic description of each, including 2016 budgeted amounts for additional context.

Chart 1: City of Milwaukee operating revenues, 2015 (in thousands)



Source: City of Milwaukee CAFRs

Intergovernmental Revenues are grants and aids that come from the State and, to a much smaller degree, the federal government. About 83% of the City's intergovernmental revenues used for general government expenditures come from state "shared revenue" ($219 million of the $263 million budgeted in 2016). Other major state funds include local street aids ($26 million) and expenditure restraint aids ($8.7 million).

Property Taxes are designated as the primary source of municipal tax revenue per Wisconsin statutes.[6] The State has established property tax "levy limits" through the biennial state budget; those limits – which can be modified during State budget deliberations – currently restrict annual increases for municipalities to no more than the percentage increase in equalized value from net

[5] 2015 revenue totals in this chart and elsewhere in this report differ from those found in the City's 2015 CAFR because of a change in the 2015 CAFR regarding the treatment of employee contributions to the Employee Retirement System. In previous years, such contributions were treated as "Contributions," but in 2015 they were treated for the first time as "Charges for Services." For the sake of accurate trend analysis, in this report we continue to treat those contributions (totaling $20,410,000 in 2015) as "Contributions."

[6] Local governments also are allowed an "add-on" to the State Motor Vehicle Registration fee (the so-called wheel tax) that only can be used for transportation purposes, and they are authorized to levy a hotel/motel room tax of up to 8% (which in Milwaukee flows to the Wisconsin Center District). In 2008, Milwaukee implemented a $20 wheel tax that is budgeted to generate an estimated $6.4 million in 2016.

new construction. Property taxes collected by the City are allocated to four government funds: the General Fund ($190 million budgeted in 2016, including $82 million for employee retirement); debt service ($61 million); capital projects ($949,000); and the contingent fund ($5 million).

Charges for Services are revenues received for services delivered by City departments. State statutes specify the types of services for which user fees can be assessed and prohibit the establishment of fee amounts that exceed the cost of service (i.e. snow and ice fees only can be used to support the cost of snow and ice removal, as opposed to general government expenditures). Major charges for services include the solid waste fee; street sweeping, leaf collection and tree pruning fees; and the snow and ice fee. Charges for services are projected to produce $127 million in revenue in 2016.

Tax Stabilization Fund (TSF) is used to reduce fluctuations in the City's property tax rate. The TSF is built via deposits of unexpended appropriations and revenue surpluses in a given year. Each year, as part of the budget process, an amount is set aside for transfer from the TSF to the General Fund. In the five-year period we examined, TSF transfers ranged from a low of $13.8 million in 2012 to a high of $20 million in 2014. A $21.1 million TSF transfer is budgeted for 2016.

Enterprise Fund Transfers are monies that are not needed for operating or capital purposes by the City's "enterprises" or that reimburse costs incurred by City departments for those enterprises. The City has three major enterprise funds: water works, sewer maintenance, and parking. These funds are entirely self-sufficient and supported by charges for services. The parking fund generates a substantial transfer to the General Fund each year ($16.6 million budgeted in 2016), while the water works also generates a substantial amount ($12.4 million) in the form of a payment in lieu of taxes, and the Sewer Maintenance Fund will transfer $18.1 million for street sweeping, leaf/brush collection, and pruning.

Licenses and Permits are revenues that accrue from charges assessed by City departments that grant a person legal permission to engage in a business, occupation, or other regulated activity. Of the $16.1 million in license and permit fee revenue budgeted for 2016, building permits ($4.3 million), food and health licenses ($2.7 million), and street excavation-related permits ($1.1 million) yield the greatest revenue.

Fines and Forfeitures constitute revenues received by the Municipal Court from individuals violating municipal laws. The City is budgeted to receive $4.1 million in such legal payments in 2016.

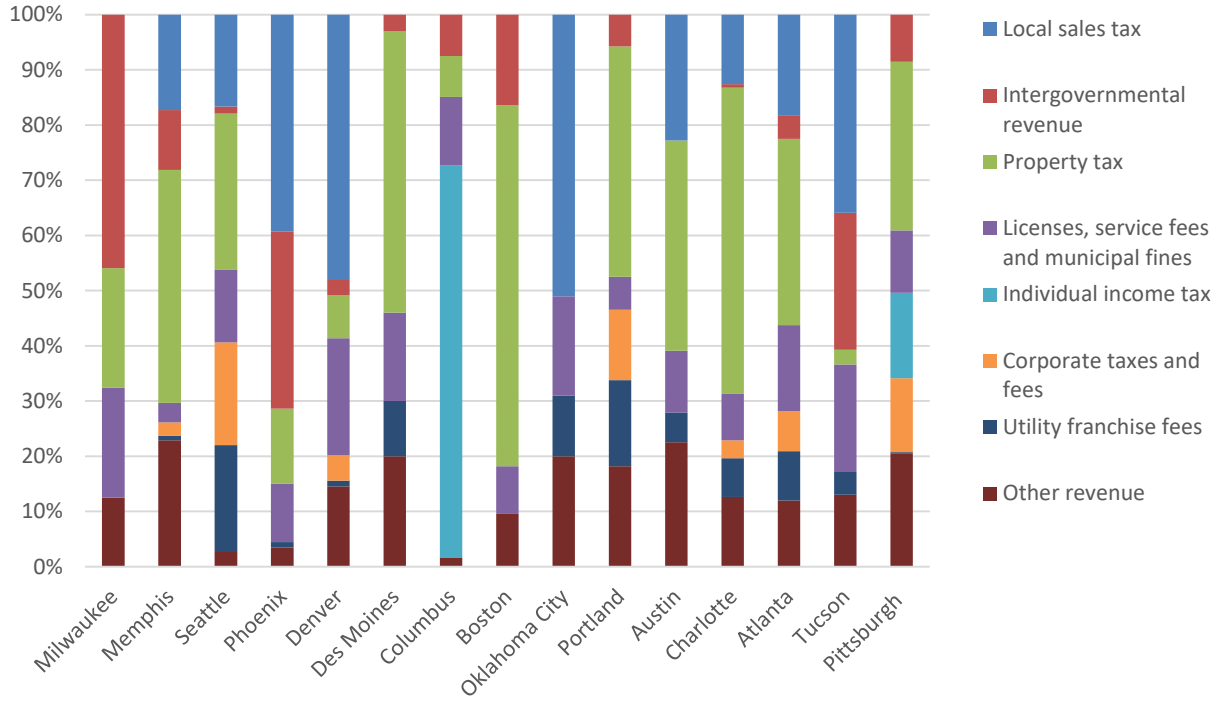
Contributions are revenues received by the City through reimbursement or donation for various municipal purposes. These revenues primarily are reimbursements from the Employee Retirement System for pension-related costs.

Others Revenues include revenues from interest earnings and property tax-related payments. This category also includes rental revenues and monies from the sale of properties.

Milwaukee's distinctive revenue characteristics

The Public Policy Forum has previously researched and articulated the unique nature of Milwaukee's revenue structure when compared to peers. In a 2011 report – *The Tools in Milwaukee's Revenue Toolbox*– we examined the general operating budgets of 15 peer cities. As shown in **Chart 2**, we found that Milwaukee was the only one that relied on intergovernmental revenue for more than 40% of its general operating budget; and one of only three (Boston and Des Moines were the others) that did not employ either a local sales tax, income tax, or corporate taxes/fees as part of its local revenue mix to complement the property tax.[7]

Chart 2: Types of municipal revenues as percentage of total city budget, City of Milwaukee and comparable cities, 2010

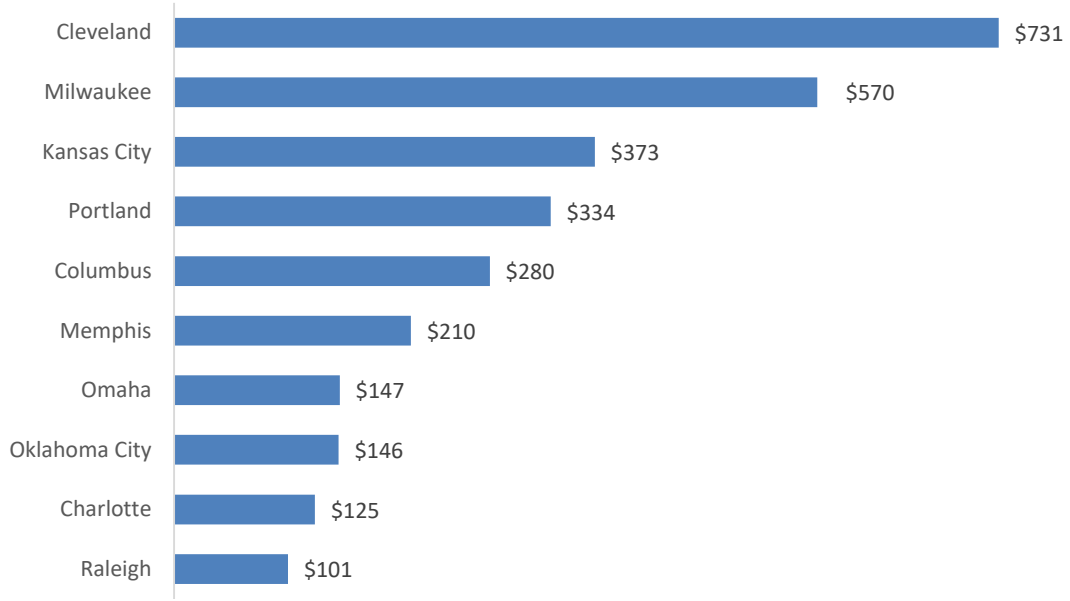


Source: Public Policy Forum analysis

The Milwaukee Comptroller produces an annual report that compares Milwaukee's expenditures and revenues to those of a 10-city peer group. The latest report – which analyzes 2014 municipal finance data – reinforces Milwaukee's heavy reliance on intergovernmental revenues when compared to peers, as shown in **Chart 3.** Milwaukee's receipt of $570 per capita in intergovernmental aids in 2014 exceeded the average of the comparable cities by $268 (89%). Also, while not shown in the chart, the report found that Milwaukee's municipal property tax levy of $475 per capita exceeded the comparable city average by $107 (29%); and that its total revenues per capita were 11% lower than the comparable city average.

[7] The report can be accessed at http://publicpolicyforum.org/sites/default/files/MilwaukeeRevenueStructure.pdf.

Chart 3: Per capita intergovernmental aids, City of Milwaukee and comparable cities, 2014



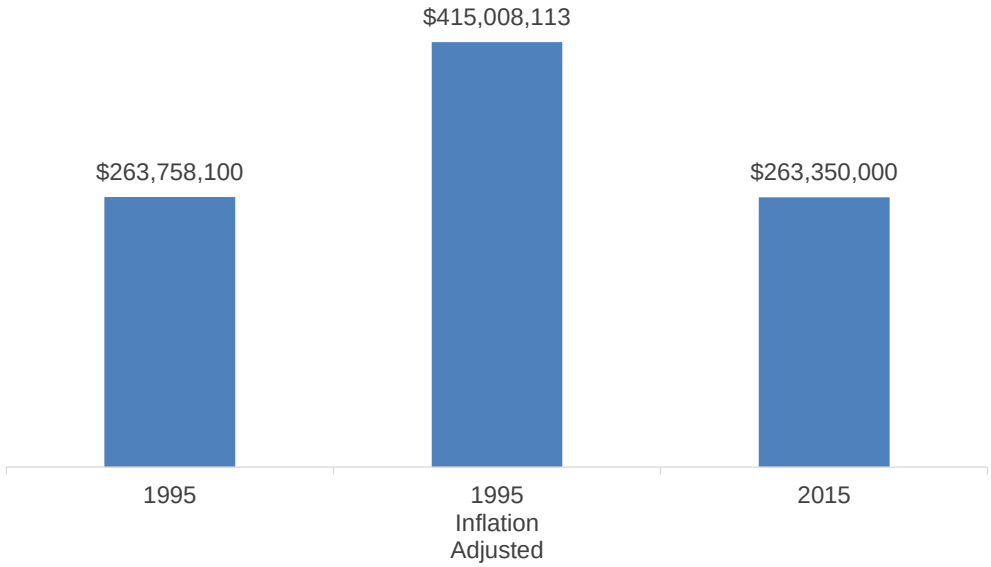
Source: City of Milwaukee Comptroller

On its face, Milwaukee's heavy reliance on intergovernmental revenue (the bulk of which is state shared revenue) should not necessarily be considered problematic. Wisconsin's shared revenue program was created in 1911 as a means of reimbursing local governments for property tax exemptions adopted by the state. Over time, the distribution formula has been modified to reflect the "needs" of municipalities, under the rationale that areas with low per capita property values require greater assistance from the State to maintain services and programs.

The notion that Milwaukee should be receiving assistance from taxpayers across the state to address its unique municipal service needs likely would not be opposed by City leaders. What has sparked considerable objection, however, is the State's failure to *increase* the City's shared revenue appropriation in concert with the growth of State tax collections from year to year while also refusing to provide additional local revenue options to address this lack of growth.

The problematic nature of this situation is best illustrated by looking back over the past 20 years. As shown in **Chart 4**, the City was budgeted to receive a little more than $263 million in intergovernmental revenue in 1995; in 2015, its intergovernmental revenue allocation totaled roughly the same $263 million. If the City's intergovernmental revenue had increased at the rate of inflation from 1995 to 2015, then that allocation would have stood at $415 million last year, or $152 million (58%) more than the actual revenue amount.

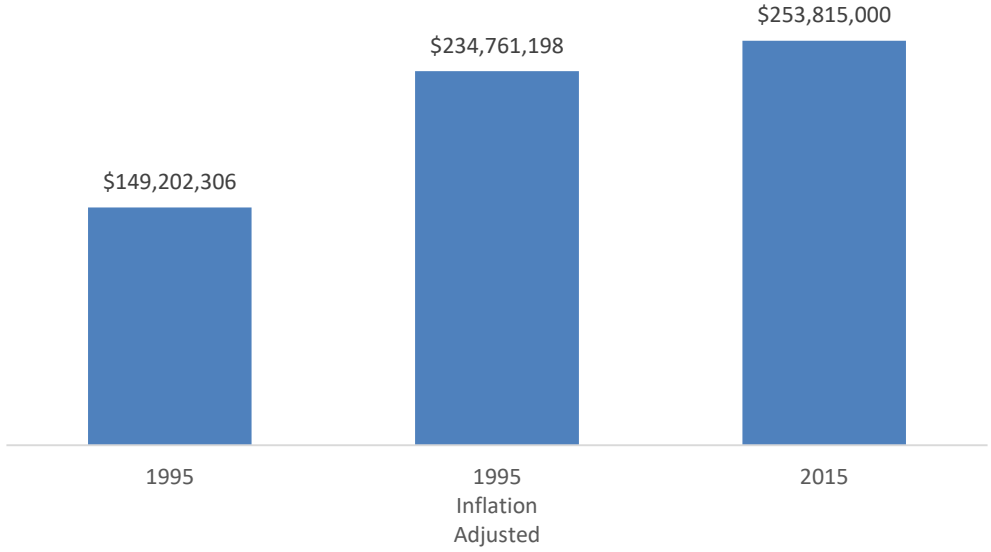
Chart 4: City of Milwaukee intergovernmental revenue, 1995 vs. 2015



Source: City of Milwaukee financial documents

With no other local tax options available, City leaders have turned to the property tax to offset some of this lost purchasing power. As shown in **Chart 5**, total property tax collections (for both General Fund and other purposes) grew by about $105 million (70%) between 1995 and 2015, or $19 million (8%) when adjusted for inflation. This inflation-adjusted growth in property taxes made up for less than 20% of the inflation-adjusted decline in intergovernmental revenues.

Chart 5: City of Milwaukee property taxes, 1995 vs. 2015



Source: City of Milwaukee financial documents

Revenue trends

The ICMA system relies on trend analysis over a shorter timeframe than that referenced above. It follows fiscal changes over a five-year period to provide a more complete perspective than can be obtained from a single year's slice of data, but through a more focused lens than can be gleaned from longer-term analysis. ICMA's five-year trend indicators also signal whether a government's finances are stable, improving, or deteriorating. To analyze the City of Milwaukee's revenue picture, we use three indicators: operating revenues per capita in constant dollars; intergovernmental revenue as a percentage of operating revenue; and local tax revenue in constant dollars.

Table 4 offers an overview of Milwaukee's operating revenues from 2011 to 2015. Per the ICMA system, monies that are related to debt service and financing are excluded from this analysis and not considered operational. The various individual revenue sources that appear in the table were described earlier in this section.

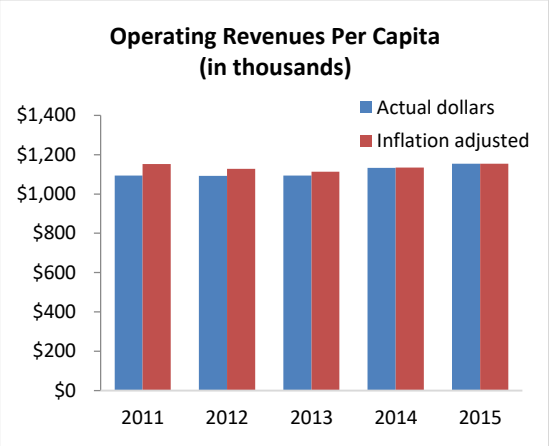
As **Table 4** shows, Milwaukee's total operating revenues increased 5.9% from 2011 to 2015. Our measure of inflation – the Consumer Price Index – increased by 5.4%, which means the City's revenue growth essentially mirrored inflation. That trend – which is considered an indicator of fiscal health – also is reflected in per capita operating revenues, as seen in **ICMA Indicator 1**.

ICMA Fiscal Indicator 1 – Net Revenues Per Capita

Why it is Important – Steady revenue generally is associated with stable operations and level of service, although total revenue changes may mask sizeable variations in individual revenue sources.

ICMA Warning Sign – Decreasing net operating revenues per capita in constant dollars.

City of Milwaukee Finding – The City of Milwaukee enjoyed modest per capita operating revenue growth (5.4%) from 2011-2015, which largely mirrored the rate of inflation and is a sign of fiscal health. However, a continued decline in intergovernmental revenues has placed severe pressure on property taxes and charges for services, the effects of which **require monitoring**.



Source: U.S. Census and City of Milwaukee financial records

Table 4: City of Milwaukee operating revenues, 2011 to 2015 (in thousands)

Revenues	2011	2012	2013	2014	2015	5-yr difference	5-yr % change
Intergovernmental	$273,240	$260,141	$259,735	$260,886	$263,350	($9,890)	-3.6%
Property Taxes	$166,841	$167,927	$172,594	$179,269	$190,318	$23,477	14.1%
Charges for Services	$103,493	$108,190	$111,881	$114,743	$120,908	$17,415	16.8%
Tax Stabilization Fund	$14,600	$13,767	$14,900	$20,000	$16,700	$2,100	14.4%
Enterprise Fund Transfers	$35,688	$36,383	$35,614	$36,192	$36,578	$890	2.5%
Contributions	$24,021	$21,826	$21,871	$23,752	$22,998	($1,023)	-4.3%
Other	$17,758	$26,846	$20,522	$24,887	$20,768	$3,010	17.0%
Licenses & Permits	$13,289	$14,410	$15,030	$16,063	$16,629	$3,340	25.1%
Fines and Forfeits	$5,076	$5,042	$4,492	$4,587	$4,110	($966)	-19.0%
Total	**$654,006**	**$654,532**	**$656,639**	**$680,379**	**$692,359**	**$38,353**	5.9%

Source: City of Milwaukee CAFRs

Examining the City's revenue trends in greater detail reveals a more disconcerting picture, however. Turning again to the City's two largest revenue sources, we see that intergovernmental revenues declined by 3.6%, while property taxes increased by 14.1%. In constant dollars, the combined total decreased by 2.2%. This loss was partially offset by 16.8% growth in charges for services.

As shown in **ICMA Indicator 2**, the decline in the City's intergovernmental revenue continues to place considerable pressure on its other sources of revenue to keep pace with expenditure needs. On the one hand, it is a sign of fiscal health that the City is growing less reliant on intergovernmental revenue as a share of its total operating revenues; yet, the increased pressure on local taxpayers and service users to bridge the gap has negative ramifications given the limited taxpayer capacity and low household incomes described in the previous section.

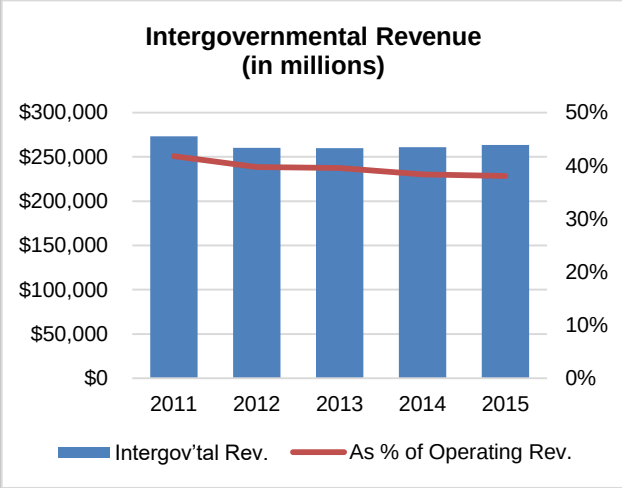
The long-term trend in intergovernmental revenue also has impacted Milwaukee's service solvency. Prior to 2010, when annual increases in employee and retiree health care costs were vastly exceeding inflation; and more recently, when the City's pension fund contribution spiked, the lack of growth in its foremost revenue stream necessitated difficult decisions with regard to departmental staffing and programs. Expenditure trends and implications are discussed in greater detail in the next section of this report.

ICMA Fiscal Indicator 2 – Intergovernmental Revenue as a Percentage of Operating Revenue

Why it is Important – Milwaukee depends to a great degree upon intergovernmental revenue, which is derived overwhelmingly from State funds. The City Comptroller has found that Milwaukee relies upon intergovernmental revenues more than similar cities.

ICMA Warning Sign – An increasing percentage of intergovernmental revenue as a proportion of operating revenues.

City of Milwaukee Finding – As a percentage of the City's overall operating revenue, intergovernmental revenue declined from 41.8% in 2011 to 38.1% in 2015. While this would appear to be a sign of fiscal health given ICMA's warning about over-reliance on a single revenue source, the fact that the City's revenue structure essentially requires this reliance makes this trend highly problematic. Specifically, City leaders lack alternative major revenue options outside of the property tax and charges for service to make up for the decline in intergovernmental revenue, making the continued decline of such revenue a **significant threat** to the City's financial health.



Source: City of Milwaukee financial records

In regard to local tax revenue, ICMA Indicator 3 indicates that this resource – which primarily consists of the City's total property tax levy and payments in lieu of taxes – grew by 5% in nominal dollars from 2011 to 2015 but declined by 0.5% in constant dollars. This slight inflationary decline ordinarily would signal concern given the much larger decline in intergovernmental revenue.

When we isolate only the property tax revenue dedicated to the General Fund, however, a different picture emerges. In this case, the total grew by 14% in nominal dollars (from $167 million to $190 million) and 5% in constant dollars. In contrast, property taxes allocated to other governmental funds – such as debt service and capital outlays – decreased by $12 million (16% in nominal dollars and 20% in constant dollars), from $76 million to $64 million. As we will discuss in a later section on capital spending and debt, this approach may not be sustainable.

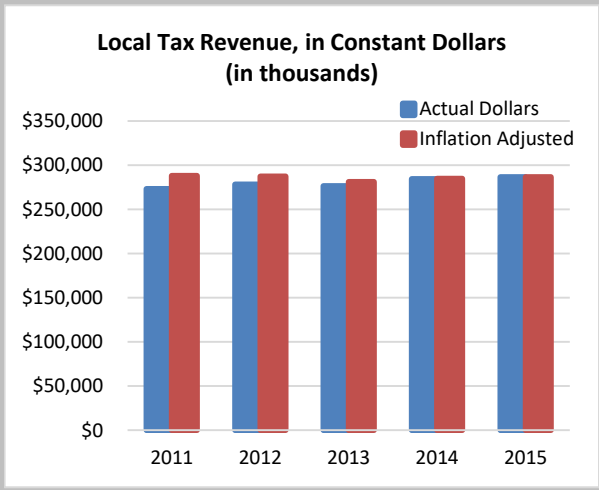
Overall, we see that the City has been able to partially offset the impacts on its general operations of a continued decline in intergovernmental revenue by shifting additional property tax resources to the General Fund. This shift and a $17 million increase in charges for services (17% in nominal dollars and 11% in constant dollars) have been the primary strategies used over the past five years to meet expenditure needs while accommodating the loss of intergovernmental revenue.

ICMA Fiscal Indicator 3 – Local Tax Revenue in Constant Dollars

Why it is Important – Local tax revenue typically consists of property, sales, and income taxes. These funds are of fundamental importance to local governments in the resources they provide and in the budget control and flexibility they afford. A decline in this indicator may reflect structural problems, such as a loss of population, a depressed economy, and/or decline in local property values.

ICMA Warning Sign – Decline in tax revenues in constant dollars.

City of Milwaukee Finding – The City experienced a 5% increase in local tax revenues from 2011 to 2015, which equates to a slight (0.5%) decline in constant dollars. While this modest growth is good news for property taxpayers, it is a situation that may pose a threat to City operations and that **requires monitoring** in light of the substantial decline in intergovernmental revenues.



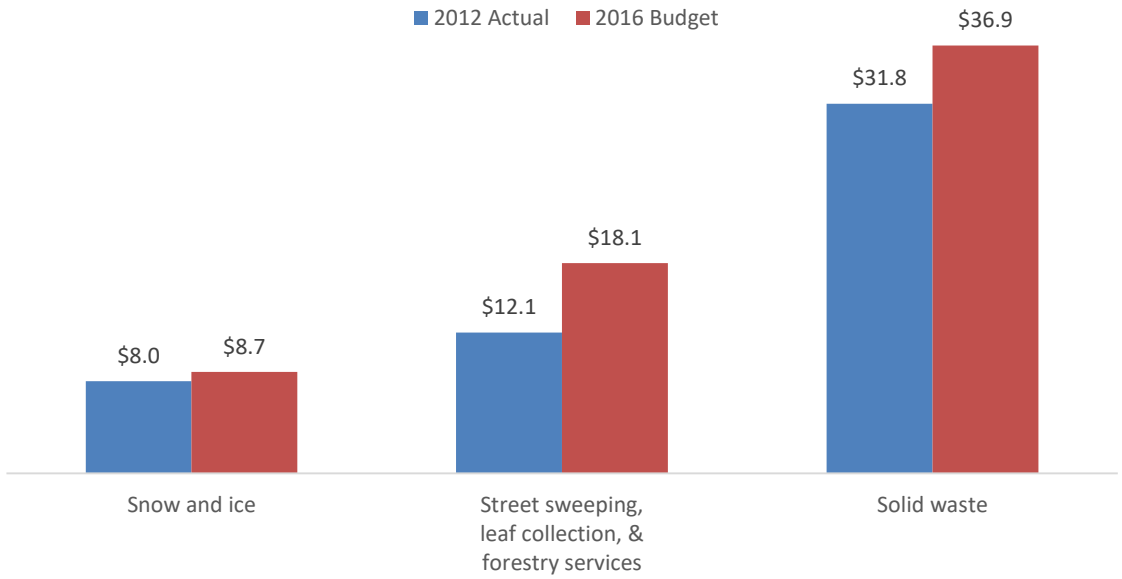
Source: City of Milwaukee financial records

Major issue: high degree of dependence upon property taxes and property-related fees

The growth in service charges was a highlight of our 2009 fiscal assessment and continues to merit discussion today. In our 2009 report, we pointed out that charges for services had grown from $23 million to $63 million (174%) from 1995 to 2008. When we fast forward to 2015, we see that service charges have grown to $121 million – another 92% increase since 2008. Adjusted for inflation, the increases would be 94% and 74% respectively.

It is important to note that some service charges, such as those assessed by the Harbor Commission and Department of Neighborhood Services, affect specific users, as opposed to the general population. Many fees, however, simply are added on to the property tax bill and essentially represent another type of property-related payment. **Chart 6** shows that the three largest of those property-related fees are generating 23% more from property owners today (17% when adjusted for inflation) than they were five years ago.

Chart 6: Three largest property-based charges for service, 2012 vs. 2016 (in millions)



Source: City of Milwaukee budget documents

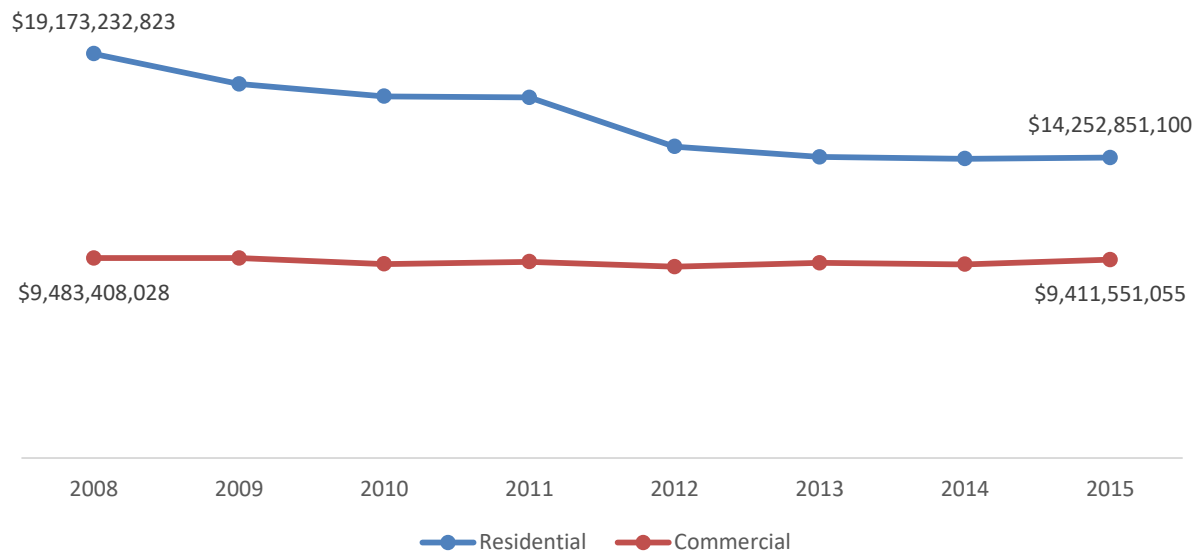
Charges for services do differ from property taxes in that all property owners, including nonprofit organizations, pay for these services. Consequently, these charges can be beneficial to property taxpayers because they reduce the amount they have to pay for designated City services by spreading such costs among all property owners. On the other hand, since charges for services are uniform and not related to property value, some might argue that they may be more regressive than property taxes.[8]

[8] A 2013 analysis conducted by the City budget office challenged the notion that service charges are regressive when compared to property taxes for the average-valued city property.

When viewing the City's overall revenue trends during the past five years, it is the combination of increases in property taxes dedicated to the General Fund and service charges that are cause for concern. The City's lack of alternative local revenue options requires its leaders to lean on property tax and property-related fee increases to offset its stagnant shared revenue allocation and ensure inflationary revenue growth to support departmental operations.

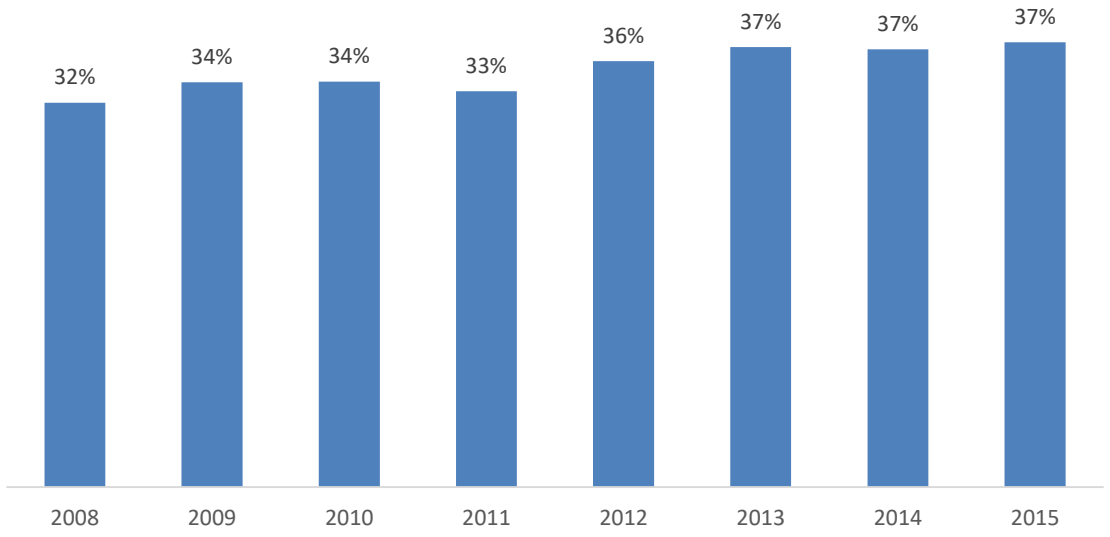
A deeper dive into the property tax issue reveals another dynamic that merits consideration by policymakers. As noted earlier, the 2008-09 recession caused property values in the city to decline sharply; in fact, total assessed value fell from $29.4 billion in 2008 to $25.1 billion in 2014, before increasing slightly in 2015. As shown in **Chart 7**, particularly hard hit was the city's residential sector, where assessed values declined from $19.2 billion to $14.2 billion before also showing a slight increase in 2015. Commercial values have fared better, however, falling from $9.5 billion in 2008 to $9.1 billion in 2012, but rebounding back to $9.4 billion by 2015.

Chart 7: Assessed residential and commercial property values in Milwaukee, 2008 to 2015



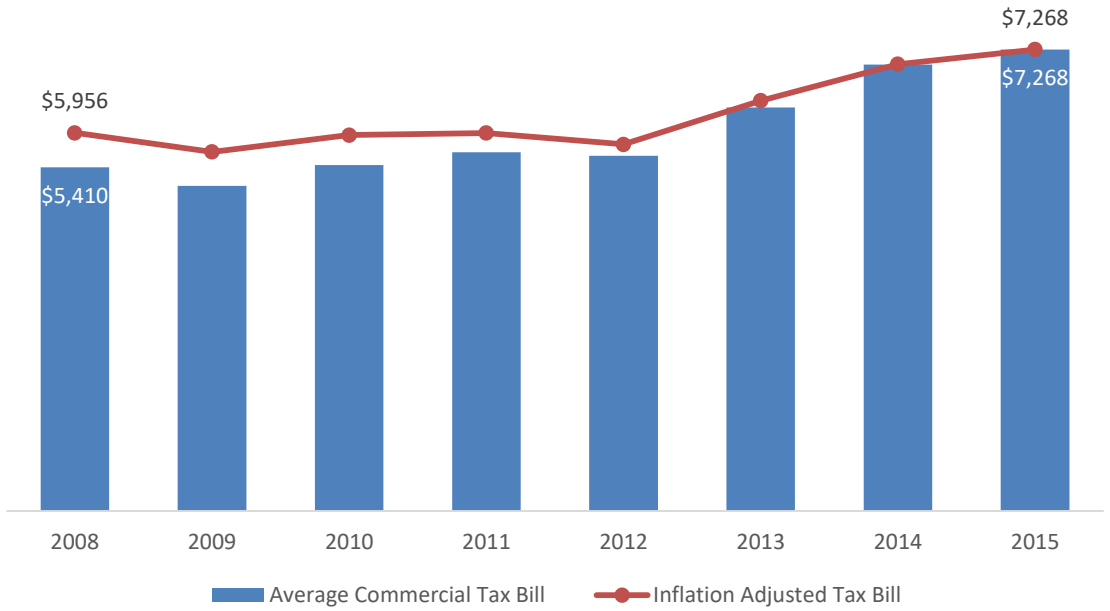
Because commercial property values stayed relatively flat in the wake of the recession while residential values decreased dramatically, the percentage of the overall property tax levy paid by commercial property owners has increased substantially. As shown in **Chart 8**, the city's commercial property owners now pay 37% of the property taxes levied by City government, as compared to 32% in 2008.

Chart 8: Percentage of total property taxes paid by commercial property owners, 2008 to 2015



Examining this trend a different way, we see in **Chart 9** that the annual property tax bill paid by the average commercial property owner that is attributed to the City's share of the levy increased from $5,410 to $7,268 during the same period – a 34% increase in nominal terms and 22% when adjusted for inflation. This increase was mostly attributed to an increase in the property tax rate during the period (from $8.01 to $10.71 per $1,000 of assessed value); the rate increase was offset somewhat for residential property owners by the decline in property value, but that was not the case for the average commercial property owner, whose value remained about the same.

Chart 9: City portion of the annual property tax bill for average commercial property, 2008 to 2015



It is important to note that this shift in the property tax burden to commercial properties could be seen as a benefit for residential property owners, whose share has been reduced. Also, despite this growth, the City of Milwaukee – and particularly its downtown and adjacent areas – has proved to be very attractive to developers of commercial property in recent years. City budget officials also point out that a look further back would reveal that commercial properties once regularly accounted for 40% of the City's property tax collections.

Yet, given the lack of alternative local revenue options and the unlikely prospects of growth in shared revenue, it should be recognized that the trend of increasing commercial property tax bills is likely to continue. That, in turn, raises the question of whether commercial property tax bills will become an impediment at some point to attracting and retaining businesses, despite other advantages the city may have to offer.

This situation – particularly when considered in the context of the importance placed by ICMA and most other government finance professionals on revenue diversity – **begs the question of whether it is time for State leaders to consider steps to "rebalance" the City's revenue structure**. Other types of local option taxes could be added to the mix as a means of spreading the cost of city services beyond property owners and residents to non-residents who work in or visit the city. A city sales tax, for example, not only would provide greater balance in the City's revenue picture, but it also would provide a means of collecting revenue from daily commuters and visitors – in recognition of their consumption of City services – when they make purchases within city limits. Similarly, various visitor/tourism-related taxes or fees in the downtown area could attempt to capture revenue from the increased numbers of visitors expected to frequent the new amenities that are being added to that area.

It is important to note that any new local taxing options could be combined with modifications to existing property tax limits if State lawmakers wish to restrict total revenue growth. In fact, from an ICMA-based financial perspective, even if a change in the mix of local taxes was implemented in a way that it did not produce any immediate growth in total revenue, the greater diversity of taxes would provide far better opportunity for inflationary growth in the long run.

Conclusion

In our 2009 assessment of the City's finances, we warned that "only a major restructuring of existing revenues and development of new revenue sources seem capable in the long run of maintaining incoming revenue at the level of inflation, a key indicator for maintaining existing levels of City services and budget solvency." Since that time, the inflation rate has diminished and, more important, efforts to reduce the cost of health care have greatly eased expenditure pressures (as will be described in detail in the next section). Those factors have allowed City leaders to effectively manage their revenue challenges during the past five years, making it difficult to view the City's revenue picture with the same dire perspective we had in 2009.

Yet, if not cause for immediate alarm from a financial perspective, the same underlying problems that characterized the City's revenue structure in 2009 may raise warning flags from an economic development standpoint. In addition, when combined with factors that emerge from our analysis of expenditure and debt trends later in this report, **these structural problems in the City's revenue portfolio continue to raise significant concerns about its long-term financial health**.

Budgetary Solvency: Expenditures

Analyzing expenditures with the ICMA system

A key element of any assessment of fiscal stability is the extent to which a government's expenditure patterns are consistent with its revenue-generating capacity. The ICMA system uses indicators that measure expenditure growth and display how that growth follows revenue trends. The ICMA indicators also demonstrate a municipality's ability to manage resources over time and can reveal expenditure patterns that suggest long-term instability.

The essence of the ICMA system is an in-depth examination of expenditures and how they contribute to budgetary solvency. ICMA suggests, for example, that fiscal analyses look at the factors driving expenditure increases and their implications for a government's overall fiscal condition. The ICMA system also encourages examination of whether expenditure increases are tied to fixed costs or adding to levels of future costs that place long-term budgetary solvency at risk.

Summary of expenditure findings

Our analysis of City expenditures shows that overall growth was slightly above the rate of inflation from 2011-2015. In light of the need to accommodate a $60 million spike in the employer pension fund contribution, this growth is reasonable. In fact, the City's ability to fully fund its pension obligations has maintained the pension system in sound condition and is highly commendable.

A deeper examination, however, indicates two prominent and related concerns. One is the prioritization of the Milwaukee Police Department, which received a vast proportion of the overall increase in expenditures over the five-year period. While this prioritization did not noticeably erode support for other functions of City government, it may threaten to do so in the future.

The City's ability to make its pension payments and maintain Police staffing levels without sacrificing service solvency in other departments was attributed largely to the redesign of its health care benefits structure, which produced huge savings that were directed toward these other needs. Unfortunately, this highly significant accomplishment likely has run its course. That creates red flags for the future, as annual health care savings likely will not be available to offset flat revenues and ensure sufficient departmental funding while also meeting pension fund obligations.

Analysis

Milwaukee's overall net operating expenditures (total expenditures minus debt service, interest expense, and capital outlay) increased by 5.6% on a per capita basis from 2011 to 2015, as seen in **ICMA Indicator 4**. Meanwhile, overall net operating expenditures grew by 6%, as shown in **Table 5**. These rates exceed the 5.4% rate of inflation, but not by a large amount. Ordinarily, in a government that does not face Milwaukee's revenue challenges, this level of growth would be viewed as manageable.

There are several reasons why a government entity might increase expenditure levels, including population growth and implementation of new services. In the case of the City of Milwaukee, **Table 5** shows that the limited expenditure growth largely was driven by increases in the public safety function (and specifically the Milwaukee Police Department, as will be explained below). In fact, the table shows that public safety accounted for more than 90% of the $38.2 million increase in City operating expenditures over the period. We discuss the implications of this circumstance later in this section.

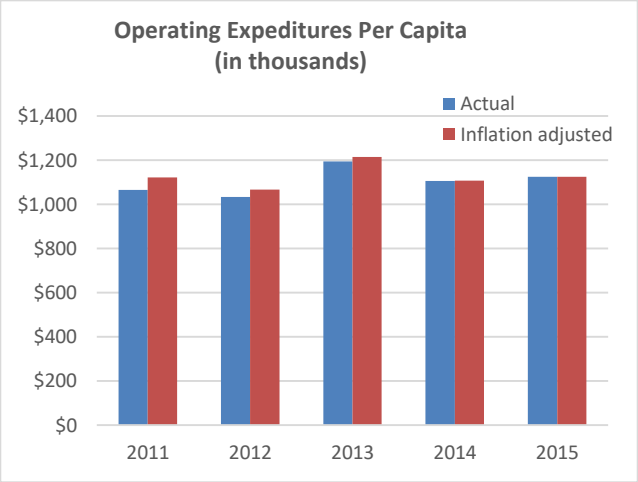
It is important to note that the year-to-year components of our trend analysis of net operating expenditures are skewed by a decision to move up the payment of the 2013 employer pension contribution from January 2014 to 2013. That decision resulted in two payments in 2013 (one for 2012 and one for 2013), which explains the substantial increase in General Government expenditures in 2013 that is shown in **Table 5**. According to budget officials, by accelerating the payment, City has saved close to $5 million per year in avoided interest costs after accounting for the cost of the five-year borrowing.

ICMA Fiscal Indicator 4 – Net Expenditures Per Capita

Why it is Important – In a state of fiscal health, a government's per capita expenditures in constant dollars should hold nearly level or increase slightly and should not exceed per capita operating revenues. A scenario in which expenditures increase too rapidly may cast doubt on long-term funding sustainability.

ICMA Warning Sign – Imbalance between expenditures and net operating revenues or a large increase in expenditures in constant dollars.

City of Milwaukee Findings – Per capita expenditures increased 5.6%, which is slightly higher than inflation and consistent with growth in revenues. This is indicative of overall fiscal restraint given the need to accommodate a $60 million spike in the employer pension payment. Nevertheless, the ability to maintain this modest growth level may be challenged once health care expenditures resume their ascent, and room to grow will continue to be limited by the City's stagnant revenue picture. Consequently, expenditure pressures and patterns are factors that **require monitoring**.



Source: City of Milwaukee financial records; U.S. Census

Table 5: City of Milwaukee net operating expenditures (in thousands)*

Expenditures	2011	2012	2013	2014	2015	5-Year Change
General Gov't	$252,677	$230,532	$317,356	$262,948	$249,029	-1.1%
Public Safety	$258,994	$265,900	$270,680	$268,426	$293,787	13.4%
Public Works	$96,557	$93,421	$99,907	$103,339	$101,086	4.7%
Health	$8,872	$8,656	$9,147	$9,171	$9,553	7.7%
Culture & Recreation	$15,566	$15,912	$15,900	$17,012	$17,624	13.2%
Conservation & Development	$3,991	$4,320	$3,379	$3,522	$3,816	-4.4%
Total	**$636,657**	**$618,741**	**$716,369**	**$664,418**	**$674,895**	**6.0%**

Source: City of Milwaukee CAFRs

* This breakdown of functional expenditures is taken from on CAFRs and includes fringe benefits expenditures in the General Government functional category. In budget documents, the City's fringe benefit expenditures are allocated to departments, but CAFRs do not include those allocations in the functional breakdown.

The size of the government workforce is another important fiscal indicator pertaining to government expenditures. Milwaukee's workforce stayed flat, with a gain of two full-time equivalent positions (FTEs) for general City purposes between 2011 and 2015 (from 6,636 to 6,638). As shown in **ICMA Indicator 5**, authorized positions per capita also remained essentially the same, at 11.1.

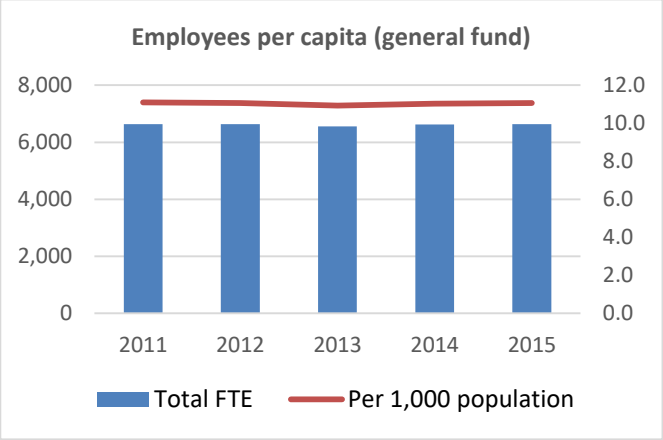
It is worth noting that in 2006, the City had 7,012 authorized positions. This shows that City leaders were able to hold the line on personnel reductions during the past five years after seeing substantial reductions in the five years prior to 2011. The City's efforts to reduce and subsequently stabilize growth in its workforce should be seen as a sign of fiscal health, particularly considering its revenue limitations and overall expenditure pressures. However, variations in individual functions and departments also need to be considered. Again, we provide such analysis later in this section.

ICMA Fiscal Indicator 5 – Employees Per Capita

Why it is Important – A government's employees per capita has implications for budget solvency because of the significant impact of personnel costs on local government budgets An increase in employees per capita may have long-term growth implications and may indicate that the government is expanding operations, becoming more labor intensive, or that productivity is declining.

ICMA Warning Sign – Increasing number of municipal employees per capita.

City of Milwaukee Findings – The City's budgeted workforce grew by only two FTEs and per capita employees remained the same. This is a **positive indicator** of fiscal health, particularly given the City's revenue and fringe benefits challenges. Still, care should be taken to analyze positions by function and/or department, as increases in certain departments may mask reductions in others that impact service solvency.



Source: City of Milwaukee financial records; U.S. Census

Fringe benefits

Fringe benefit expenditures are such a substantial driver of Milwaukee's budgetary solvency that they generally merit separate consideration from other portions of the expenditure budget. For no period is that more the case than the 2011-2015 timeframe.

As shown in **ICMA Fiscal Indicator 6**, annual fringe benefit expenditures experienced considerable volatility throughout the period. Yet, by its conclusion, they had grown by only $4.7 million (2.6%). That growth rate was about half the rate of inflation, and it compares to an increase of $25.8 million (17.9%) during the 2004-2008 timeframe considered in our previous assessment.

Understanding both the volatility exhibited during the past five years and the City's successful effort to control fringe benefit expenditures requires individual consideration of the two central components of the fringe benefits budget: pension and health care. On the pension side, as shown in **ICMA Fiscal Indicator 7**, the City's actuarially required employer contribution skyrocketed, from zero in 2011 and 2012 to $59.3 million in 2013, $61.6 million in 2014, and $60 million in 2015.

The City was able to accommodate this huge spike in spending without significant service reductions and reductions in personnel, a remarkable feat that primarily is attributable to two factors.

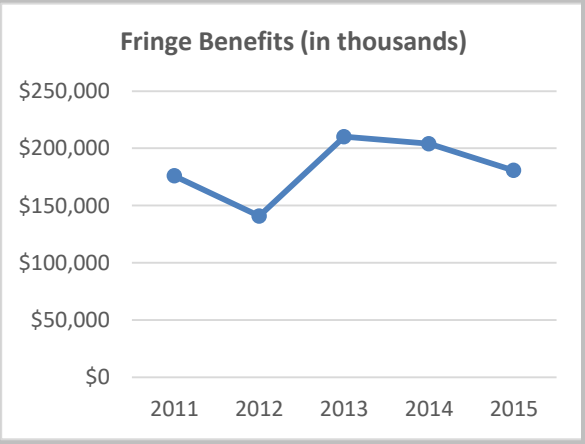
First, shortly after the severe 2008-09 stock market decline, City leaders became aware that a spike in the employer contribution would be required in 2013. The market decline had produced a substantial reduction in the actuarial value of pension fund assets, creating a sizable long-term actuarial liability. To prepare for the employer contributions that would be required to address the liability, City leaders prudently built the City's pension reserve with

ICMA Fiscal Indicator 6 – Direct Fringe Benefits

Why it is Important – Direct fringe benefits are comprised of employee health, pension, and life insurance benefits and represent one of the largest and fastest-growing items of expenditure in the public sector. In recent years, many local governments have seen increases in health care and pension costs far surpassing the rate of inflation, creating debilitating impacts on budgets and fiscal condition.

ICMA Warning Sign – Increasing fringe benefits as a percentage of salaries and wages, and operating expenditures.

City of Milwaukee Finding – If only viewed in the context of the past five years, the City's ability to limit growth in fringe benefits to less than 5% from 2011-2015 is perhaps it foremost **positive indicator** of fiscal health, particularly when considering the typical rate of health care inflation and the need to accommodate a huge spike in annual pension fund payments. However, if viewed with an eye toward the future, this is an area that **requires careful monitoring**, as health care savings likely have run their course and a re-setting of pension fund assumptions could cause another (but much smaller) spike in 2018.



Source: City of Milwaukee financial records

total contributions of $42 million made during 2011 and 2012. This provided the wherewithal to make reserve withdrawals that alleviated the impacts of the spike in 2013 and subsequent years.

It also should be noted – again as detailed in **ICMA Fiscal Indicator 7** – that the City's ability to meet its annual pension fund obligations has maintained the fund's strong financial condition, though that condition has weakened a bit from five years ago.

ICMA Fiscal Indicator 7 – Pension Plan Funding

Why it is Important – Significant increases in required pension fund contributions can place strong pressure on government budgets. Because of the long-term nature of pension plans, the difficulty of estimating the value of assets and liabilities, and the costs involved, local governments can be tempted to underfund the annual pension payment.

ICMA Warning Sign

- Underfunding of a government's annual required contribution
- Decreasing ratio of pension plan resources to pension plan liabilities
- Decreasing value of pension plan assets as a percentage of benefits paid

City of Milwaukee Finding – The sound condition of the City's retirement system is a **positive indicator** of fiscal health; its funded ratio would be the envy of most public sector pension systems, as would the City's track record of fully funding required contributions. A closer look, however, reveals potential challenges ahead. While still very healthy, both the funded ratio and the ratio of actuarial value to benefits paid have declined in recent years. Perhaps even more important, at least from a budgetary perspective, is that the City's stable contribution policy requires the pension fund's actuarial assumptions to be re-examined and re-set every five years. That process will occur in 2017, and a decision to substantially alter return-on-investment or other assumptions could produce the need for higher tax levy contributions to the fund beginning in 2018. Hence, this also is a situation that **requires monitoring**.

Pension contributions and actual expenditures (in thousands)			
Fiscal Year ending Dec. 31	**Annual required contribution**	**Actual expenditure**	**% of ARC**
2011	0	0	100%
2012	0	0	100%
2013	59,300	59,300	100%
2014	61,600	61,600	100%
2015	60,000	60,000	100%

Source: City of Milwaukee ERS actuarial reports, 2011-15

Pension assets (in thousands)			
Valuation as of Jan. 1	**Actuarial value of assets**	**Actuarial accrued liability**	**Funded ratio**
2011	4,641,425	4,447,548	104%
2012	4,404,635	4,587,915	96%
2013	4,259,889	4,689,814	91%
2014	4,580,729	4,831,689	95%
2015	4,797,437	4,935,482	97%

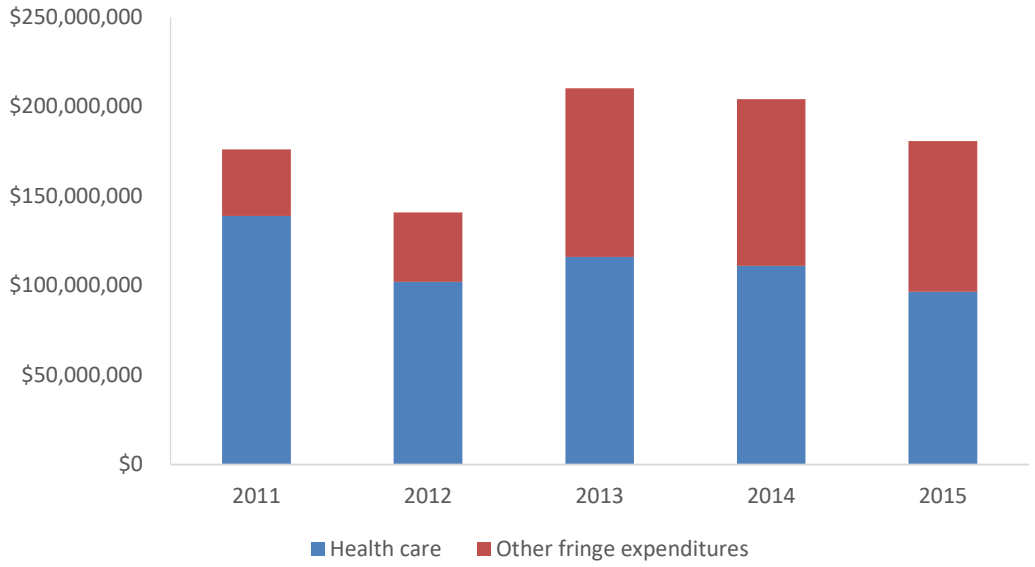
Source: City of Milwaukee ERS actuarial reports, 2011-15

Pension assets (in thousands)			
Valuation as of Jan. 1	**Actuarial value of assets**	**Benefits paid to retirees**	**Funded ratio**
2011	4,641,425	271,710	17 to 1
2012	4,404,635	285,565	15 to 1
2013	4,259,889	302,439	14 to 1
2014	4,580,729	334,858	14 to 1
2015	4,797,437	342,569	14 to 1

Source: City of Milwaukee ERS actuarial reports, 2011-15

The second factor involves health care spending, the other major component of the fringe benefits budget. **Chart 10** shows that the City was able to dramatically reduce employee/retiree health care spending in the 2011-2015 timeframe, both in actual amounts and as a percentage of overall fringe benefits spending. This steep decline in health care spending was central to the City's ability to absorb its much higher pension fund payments.

Chart 10: Health care and other fringe benefit expenditures, 2011-2015



Source: Milwaukee Budget Office

Major issue: health care savings have been a savior but soon will be exhausted

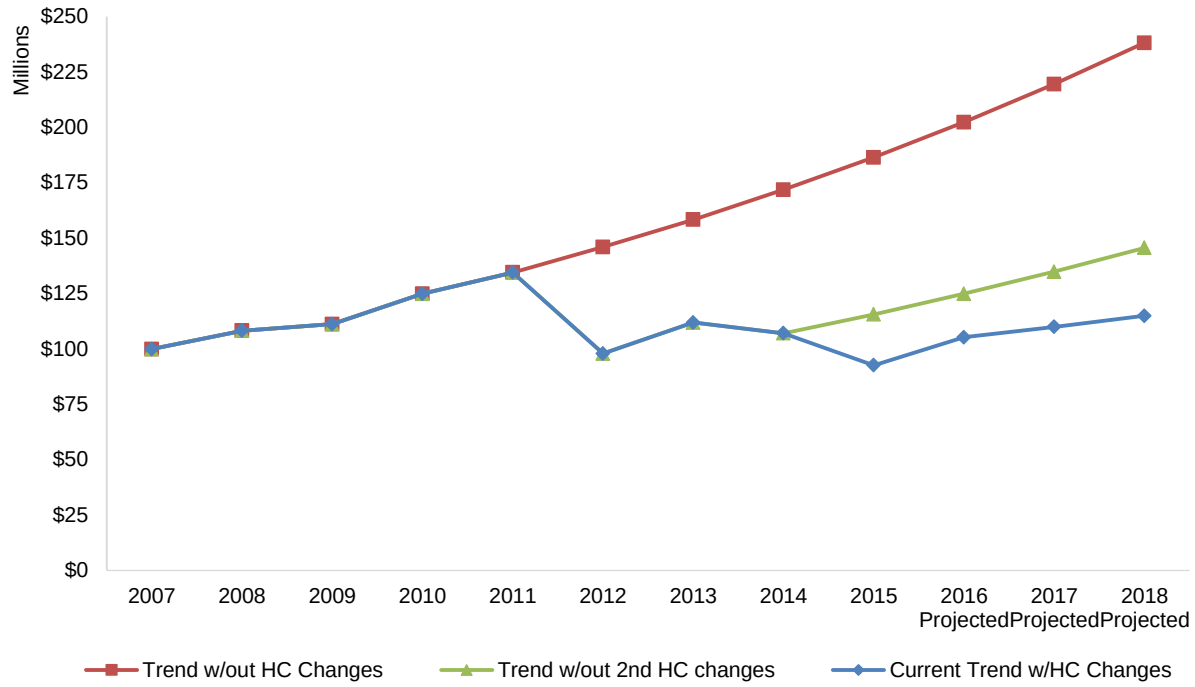
The remarkable drop in health care spending has been discussed in detail by the Forum in our last several annual City of Milwaukee budget briefs.[9] To summarize, the City implemented a series of changes to its employee/retiree health care plan and benefits structure, including decisions to self-fund all health benefit costs; increase the share of health care premiums paid by employees (a move that was assisted by the elimination of collective bargaining for non-public safety employees under Wisconsin Act 10); steer employees and retirees to lower-cost plans and providers; and implement a comprehensive wellness program.

Chart 11 –based on information provided by the City's Department of Employee Relations – shows the savings realized by the City from these major changes, the most comprehensive of which were

[9] The Forum produces an annual review of the Mayor's proposed city budget in mid-October of each year. These briefs can be accessed on our website, www.publicpolicyforum.org.

adopted in 2011 and 2014.[10] The chart indicates that the City's health care expenditures for 2015 would have exceeded the actual amount by nearly $94 million had those changes not been enacted.

Chart 11: City of Milwaukee health care expenditure trend



Source: City of Milwaukee Department of Employee Relations

For the 2011-2015 timeframe, the City's ability not only to eliminate the need to increase annual health care spending by 5% or more – as had been the norm in previous years – but also to *reduce* actual spending by sizable amounts was a budgetary savior. In addition to helping the City absorb its spike in pension payments, the reduction in health care spending also obviated the need to scrub departmental budgets for cuts (as shown earlier in **Table 5**, most major functions enjoyed inflationary increases over the five-year period).

Furthermore, the fact that actual savings regularly exceeded budgetary projections allowed for significant replenishment of the Tax Stabilization Fund each year, thus allowing for withdrawals in both 2014 and 2015 that exceeded typical withdrawal amounts. As shown in **Table 6**, at the end of 2015, the TSF had a balance of $89.2 million, which allowed the City to increase its transfer again in the 2016 budget to $21.6 million.

[10] There is a small discrepancy between the health care spending totals shown in this chart and the figures cited in **Chart 9** because this chart only includes direct health care spending and omits expenditures on dental care and wellness.

Table 6: Tax Stabilization Fund transfers and remaining fund assets, 2011-2015 (in thousands)

Year	Transfers To General Fund	Remaining Assets
2011	$14,600	$48,704
2012	$13,767	$74,700
2013	$14,900	$69,947
2014	$20,000	$73,299
2015	$16,700	$89,182

Source: City of Milwaukee CAFRs

Unfortunately, while health care reductions were the key to budget solvency for the City in the 2011-2015 timeframe (as well as in the 2016 budget), **continued reliance on annual health care savings to maintain desired departmental expenditure levels and finance the required pension fund contribution is impractical.** Lower-than-expected health care expenditures in 2016 likely will produce an opportunity to budget for decreased health care expenditures again in 2017; after next year, however, it is likely that the City again will have to budget for annual increases in health care spending. Even if those increases are kept to 2-3% per year – which would be a significant challenge given typical rates of health care inflation and which could require additional changes to the benefits structure – City leaders still would need to find an additional $3-$4 million annually from their stagnant revenue streams to support that cost.

Consequently, while City leaders should be applauded for their extraordinary success in reducing health care costs (in part with the aid of Act 10) and their prudent use of those savings, it is important for them and the general public to recognize that the likely exhaustion of this strategy will sharply exacerbate budget challenges in future years.

Departmental expenditures

As briefly discussed above, most of the City's expenditure growth from 2011 to 2015 occurred within the public safety function, which consists of the fire and police departments. Expenditures on that function grew from $259 million to $294 million (13%).

As displayed in **ICMA Indicator 8**, public safety's share of General Fund expenditures now stands at 44% -- up three percentage points from 2011. While most other functions did receive increases during the period, a scenario in which one function is obtaining the vast majority of the limited additional dollars available to support City services can be problematic. Indeed, ICMA suggests that such a situation bears watching in light of potential consequences to the level and quality of services (also referred to as service solvency) in other departmental budgets.

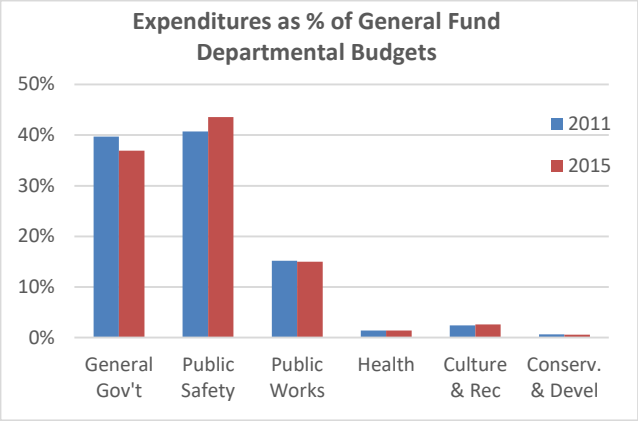
Chart 12 reveals that it was the Milwaukee Police Department (MPD) that was solely responsible for the increase in the public safety function. MPD expenditures were $59 million higher in 2015 than in 2011, while the Milwaukee Fire Department experienced a decrease of $3.4 million. (It should be noted that expenditure amounts shown in **Chart 12** were obtained from the budget office and include fringe benefit expenditures allocated to each department; fringe benefit allocations were not included in the functional breakdown shown earlier in **Table 5**.)

ICMA Fiscal Indicator 8 – Expenditures by Major Functions

Why it is Important – This indicator of relative funding by function helps explain the causes and impacts of revenue and expenditure changes.

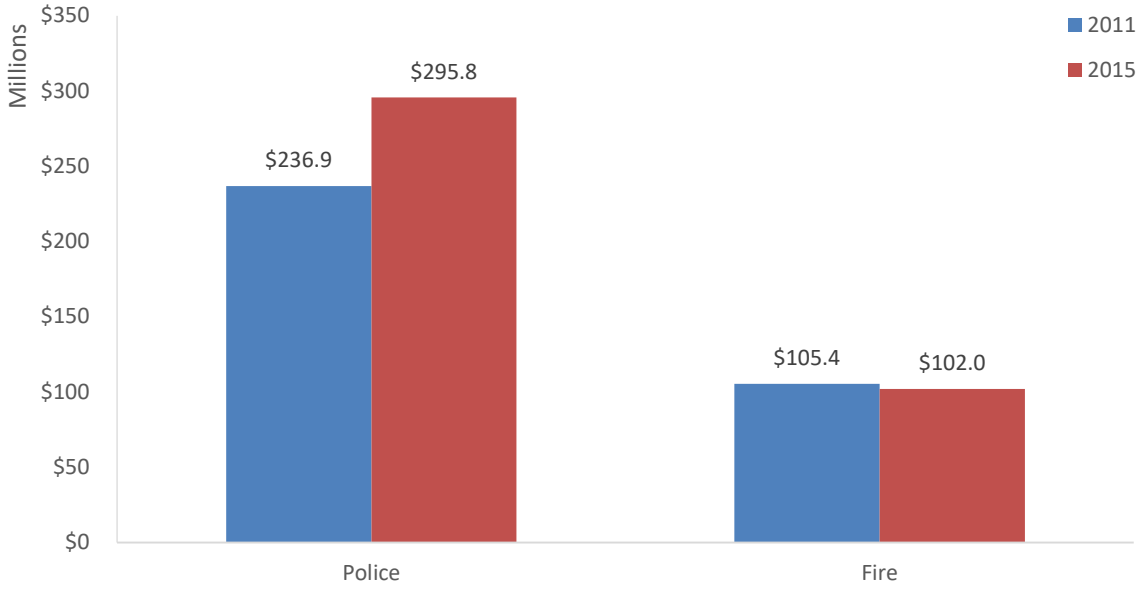
ICMA Warning Sign – An increasing proportion of operating expenditures by one or two functions.

City of Milwaukee Finding – More than 90% of the increase in expenditures for General Fund departments was attributed to the Public Safety function and, more specifically, the Milwaukee Police Department. While the other major functions avoided cuts, their ability to escape unscathed was attributed mainly to health care spending reductions that have run their course. The need to devote substantial resources to MPD simply to maintain existing staffing and service levels poses a **significant threat** to service solvency in other City departments.



Source: City of Milwaukee fiscal records

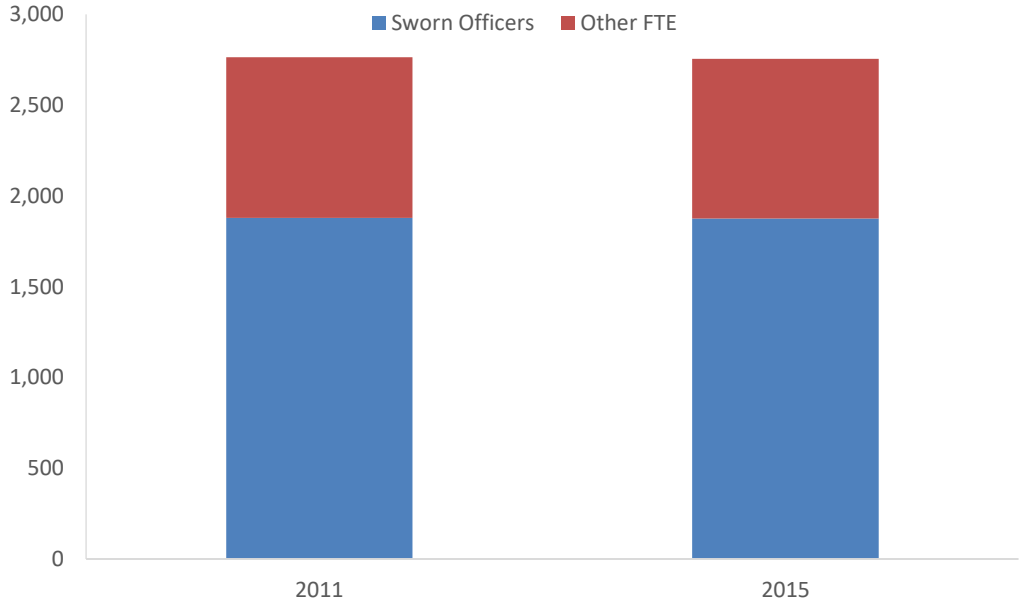
Chart 12: Police and Fire expenditures, 2011 vs. 2015



Source: City of Milwaukee budgets, Milwaukee Budget Office

It is important to note that the increase in MPD expenditures did *not* produce additional FTEs or officers on the street. **Chart 13** compares total budgeted FTEs and average sworn officers in 2011 and 2015, and reveals that the department budgeted for eight fewer FTEs in 2015 than it had in 2011 (2,763 vs. 2,755) and that its average number of sworn officers decreased by two – from 1,878 to 1,876.

Chart 13: Police Department staffing, 2011 vs. 2015



Source: City of Milwaukee budgets, Milwaukee Budget Office

Hence, MPD received the lion's share of additional City expenditures in the 2011-2015 timeframe, yet even that special treatment essentially only allowed the department to tread water in terms of staffing levels. The additional expenditures were required to meet annual growth in fixed costs (e.g. salaries/wages, fringe benefits, supplies, Information Technology) and to address equipment needs, but did not buy more police officers. We present this perspective not necessarily to argue that more officers are needed, but rather to make the point that **the City was required to devote most of its additional overall expenditure capacity during the 2011-2015 timeframe simply to maintaining a police staffing status quo for MPD.**

There are numerous potential implications associated with this finding. One is that it may reinforce the City's objections to the fact that Wisconsin Act 10 does not apply to public safety bargaining units, as that omission may be precluding the City's ability to control salary and fringe benefit costs for MPD as effectively as it has for non-public safety departments. The City has been able to *negotiate* substantial fringe benefit adjustments for unionized police personnel, however, so it is difficult to make a definitive judgment. Further analysis of this question is beyond the scope of this report but may be in order.

Another implication is the potential impact on service solvency for *other* City departments. **Table 7** breaks down the change in positions at the eight largest City departments from 2011 to 2015 using two measures: total FTEs and FTEs funded with Operating and Maintenance dollars (i.e. excluding positions funded via grants and dedicated outside revenue sources). We use both approaches because while total FTEs gives a broad picture of staffing levels, the amount of *local* resources the City is dedicating to departmental staffing provides better insight into how decisions on budget allocations among various departments are being made.

Table 7: FTE Changes in largest city departments, 2011-2015 (Budgeted)

	Change in Total FTEs	Change in O&M FTEs
Administration	37	37
City Development	-44	-3
Fire Department	-26	-21
Health Department	-18	-2
Library	-14	0
Neighborhood Services	42	46
Police Department	-8	36
Public Works	29	62

Source: City of Milwaukee budgets

Analysis of O&M positions also reflects the pressure the City often faces to use local resources to maintain positions after grants expire. In fact, the City's decision to use property tax dollars to retain dozens of MPD officer positions that originally were added after receipt of a three-year federal grant does not show up in the total FTE counts, but was a major component of MPD's budgetary story in the 2011-15 timeframe and is reflected in the O&M column.

This analysis shows that the Department of Administration (DOA), Department of Neighborhood Services (DNS), and Department of Public Works (DPW) gained substantial numbers of FTEs under both staffing metrics. For DNS, this was largely attributed to the transfer of the Development Center from the Department of City Development (DCD), as well as the creation of positions dedicated to the

City's foreclosure crisis and expanded inspection programs; for DOA, it was largely related to the transfer of several IT and telecommunications functions to the department; and for DPW, the ability to add positions largely reflected the City's ability to use increased service charges to support grant-funded positions after grants expired, as well as efforts to replace some contract work with City personnel.

DCD, meanwhile, stands out for its substantial reduction in total FTEs. This reduction is largely attributable to the Development Center transfer to DNS, as well as the transfer of several positions to the Housing Authority. The smaller loss of three O&M-funded FTEs is more reflective of how the department's staffing levels for its core responsibilities actually fared during the period.

While the position changes in these departments largely reflected organizational restructuring, the FTE changes for other departments were more reflective of the City's priority-setting during the 2011-2015 timeframe. In particular, the addition of 36 MPD positions funded with general operating revenues – which, as noted above, resulted in part from the desire to maintain existing sworn strength in the face of expiring federal grants – left little wherewithal to similarly maintain overall staffing levels at the Fire Department, Health Department, and Library.

While we have not conducted in-depth analysis, our impression from reviewing annual City budgets is that the impact on service solvency in 2011-2015 was not substantial. The reductions in Fire Department and Library FTEs were largely accommodated by new and different approaches to staffing and operations, while the loss of grant-funded Health Department positions only required the Department to conclude special programs and did not significantly impact core services. However, the implications going forward may be far more significant.

Conclusion

Our analysis of City expenditure trends and application of ICMA indicators reveals that Milwaukee experienced modest overall expenditure growth from 2011 to 2015. We also find that City workforce levels remained constant. The ability to limit expenditure growth to slightly above the rate of inflation (despite the surge in pension obligations) and to control workforce growth are indicators of sound fiscal management and fiscal health.

Our deeper dive into fringe benefits and departmental expenditures reveals a couple of prominent concerns, however. While four of the six General Fund functions enjoyed increases, the bulk of the overall growth occurred in the Milwaukee Police Department and was required simply to maintain existing staff capacity. Also, we find that the City's ability to accommodate a huge spike in the employer pension fund contribution (which will need to be sustained for the foreseeable future), as well as its ability to stave off personnel and service cuts in most City departments, were predicated largely on extraordinary health care savings that are highly unlikely to be replicated after 2017.

If maintaining MPD staffing levels continues to be a top priority – and if health care costs begin to rise and revenue streams continue to exhibit little growth – then it is likely that non-Police services will begin to suffer. Moreover, if City leaders wish to explore *increases* in MPD sworn strength – which some have suggested is a necessity in light of recent increases in rates of violent crime – then reductions in other City services would appear to be inevitable barring some new revenue source.

Long-Term Budgetary Solvency

Analyzing long-term budgetary solvency with the ICMA system

The ICMA system is an excellent tool for examining long-term solvency, an inherently complex topic. Central to ICMA's methodology is the question of whether a government is "currently paying the full cost of operating, or is it postponing costs to a future period when revenues may not be available to pay these costs." To address this question, ICMA emphasizes exploring three areas that can have a major effect on future spending levels: retirement; long-term borrowing; and maintenance of capital assets.

Summary of long-term solvency findings

Milwaukee's long-term budget challenges have stabilized but remain significant in light of the City's constrained revenue picture. Despite its remarkable efforts to control health care costs, the City retains an OPEB liability of nearly $1 billion and its annual retiree health appropriations likely will increase in future years. Similarly, while a new stable contribution policy for the City's pension fund provides greater budgetary certainty, the need to "re-set" actuarial assumptions could create a need for higher payments beginning in 2018.

With regard to long-term debt, the City has been engaging in responsible debt management policies. However, increased use of Tax Incremental Financing and the need to address major infrastructure issues (including the erosion of pilings underneath City Hall) are projected to contribute to sizable increases in overall and tax levy-supported debt. Growth in the latter could impact departmental operations given the competition for tax levy resources among departments, debt service, and pension obligations.

The impact of many of these long-term costs will start to be felt with the 2018 budget. Barring some upward movement in intergovernmental revenues, there may be a need to identify cuts in departmental expenditures or to further revamp health care benefits if City leaders continue to prioritize the maintenance of existing police staffing levels (and particularly if they wish to enhance sworn strength levels). Increases in charges for services and property taxes also can be anticipated.

Analysis

Employee Retirement System

The latest projection from the City's pension fund actuary shows that as of January 1, 2016, the fund had assets of about $4.9 billion and an unfunded accrued liability of about $141 million, meaning that it has a 97.2% funding ratio. As discussed earlier with regard to **ICMA Indicator 7**, that is a slight regression from pre-recession heights when the fund enjoyed an "overfunded" status.

Nevertheless, while a 100% funding ratio would be ideal, Milwaukee's pension fund is in very sound condition. As the Fitch ratings agency put it earlier this year, "the pension plans in which the city participates exhibit strong asset-to-liability ratios, even when adjusted by Fitch to reflect a lower investment rate of return."

Furthermore, as noted by Moody's, recent pension plan changes "should slow the rate of growth of plan liabilities." Those changes – which will have significant positive long-term impacts on the health of the pension fund – include an increase in the retirement age; a reduced pension escalator for certain new employees; and a change related to Act 10 that requires general City employees to pay a percentage of their salaries toward their pensions, along with negotiated changes that require such contributions for fire and police personnel beginning in 2016.

While the current condition of the pension fund is not an issue, the need to devote considerable local tax resources to support it is a long-term concern. The City successfully addressed the volatility of annual contributions recently by adopting a stable contribution policy. Previously, the City Charter prohibited employer contributions to the fund when the plan was overfunded, which created the possibility of sharp swings in required contributions from one budget to the next, as occurred in both 2010 and 2013. The new policy requires the City to contribute an actuarially-determined amount based on a percentage of payroll. The contribution amount is set for a five-year period, after which it is reviewed and re-set for another five-year period. The City is required to contribute regardless of the plan's funded level.

The good news is that City leaders can conduct budget planning with knowledge of the approximate scope of contributions at the beginning of each five-year period. The bad news is that the size of the contribution still has been immense (approximately $60 million per year from 2013 through 2017), and that it could grow even more by virtue of the re-setting process for the 2018-2022 timeframe.

Additional context can be provided by considering two points. First, it is important to understand that the City's $60 million employer contribution in 2016 is 23% of its total budgeted property tax levy and 56% of the amount of levy devoted to general City purposes. The need to devote such a large proportion of local tax resources to a fixed cost diminishes opportunities for investment in programs and services, particularly given the lack of growth in the City's revenue streams.

The second point is the budgetary risk associated with the stable contribution re-setting process. **Adjustments in actuarial assumptions – and/or a failure to meet the fund's anticipated annual rate of investment return – could produce a need for a substantial increase in the employer contribution as soon as 2018**. According to the National Association of State Retirement Administrators, the average assumed investment return for public pension funds is 7.67%,[11] as compared to the City's

[11] NASRA Issue Brief, February 2016, accessed at http://www.nasra.org/files/Issue%20Briefs/NASRAInvReturnAssumptBrief.pdf.

8.25%. As an example, a move to lower that assumption could have a multi-million dollar annual impact on the City's required employer contribution.

Retiree health care

From the perspective of long-term budget solvency, the challenge posed by retiree health care is as important as that posed by pension fund obligations. The City's health care expenditure budget is comprised of costs associated with both active and retired employees. In 2015, 31 % of the City's health care expenditures, or $29.1 million of the $92.6 million total (not including dental or wellness), supported retiree costs.

Like many other governments, Milwaukee faces significant unfunded post-retirement liabilities. According to the City's 2015 financial statements, its other post-employment benefit (OPEB) liability is $975.7 million. This total consists of both health and life insurance liabilities for retirees, though the most significant portion (by far) is for health insurance.

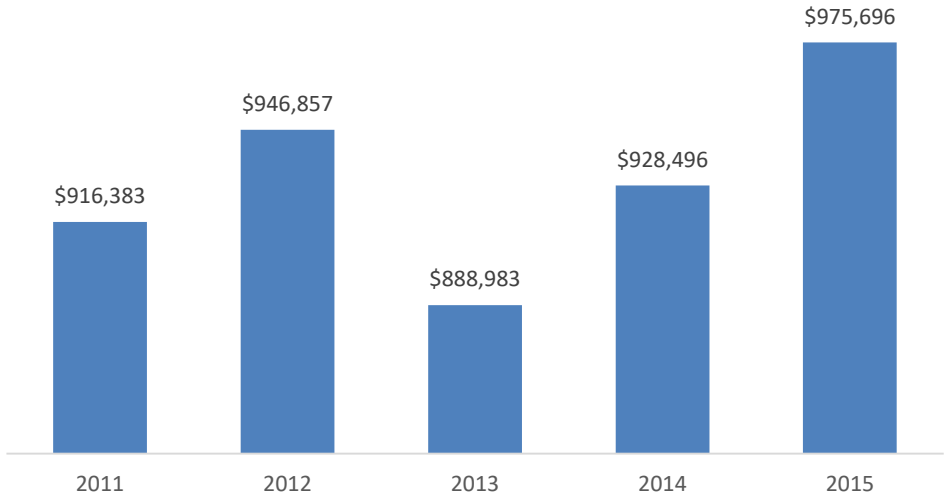
Unlike Milwaukee County, which in the early 1990s eliminated employer-paid health insurance for retirees hired after 1994, the City of Milwaukee provides some level of health insurance benefits to virtually all retirees who have attained at least 15 years of service. The level of benefit depends on the number of years of service, age of retirement, and the nature of occupation. At its most generous level, it includes full health insurance coverage for those with 30 years of service who retire at age 55 until they reach age 65.

Government entities are not required to pre-fund their existing OPEB liabilities as they must do for pension liabilities, though OPEB liabilities must be reported as part of the government's financial statements. The City of Milwaukee, like many other local and state governments, pays OPEB costs on a pay-as-you-go basis, meaning that it only pays retiree health care costs incurred in a given year and does not pay down future liabilities. According to the most recent CAFR, based on the size of its OPEB liability, the City would have needed to contribute an estimated $78 million in 2015 to address both the annual cost and the actuarially determined payment needed to fund the long-term liability, or $48 million more than it actually paid.

In light of other budget constraints, the City has not had the ability to pay down its OPEB liability, nor is it likely that it will identify the resources to do so in the future. The significant changes it made to its health care benefits structure during the past five years have reduced annual pay-as-you-go costs, but have had only a small positive impact on the size of the actuarial liability, which declined from a little over $1 billion as of January 2010 (the year that the first round of significant benefit changes were adopted) to the current $976 million.

Also, while the City's ability to afford its annual retiree health care outlays is much improved in light of its health care cost control measures, health care costs are likely to begin to rise once again by 2018. Meanwhile, as shown in **Chart 14**, the long-term OPEB actuarial liability already is on the rise. **As pointed out by the Moody's bond rating agency, which calls the City's OPEB liability "very sizeable;" and the Fitch agency, which labels it "large," this is a prominent long-term budgetary concern for City leaders.**

Chart 14: Actuarial accrued OPEB liability, 2011 to 2015 (in thousands)



Source: City of Milwaukee CAFRs

Long-term borrowing

Each of the three ratings agencies gives high rankings to the City's management of its debt program, with praise rendered for the rapid pay-down of debt (82% of the City's General Obligation debt is paid off within 10 years) and for a well-funded Public Debt Amortization Fund (PDAF). Created in 1925, the PDAF is intended to moderate the fluctuations in debt service payments and serves as a partial debt service reserve. At the end of 2014, the PDAF had nearly $62 million in assets.

Despite this sound management and strong bond ratings from all three agencies,[12] two of the three voiced concern earlier this year about the City's *level* of debt. Moody's cites the City's "elevated debt burden" as a "credit challenge," while S&P notes the City's "weak debt and contingent liability position." The third agency (Fitch) labels the City's debt load as "moderate."

The City issues debt for multiple purposes, including the purchase of vehicles and equipment to support its programs; repairing or replacing major assets like buildings, streets, and bridges; addressing the capital costs of its business enterprises (water, sewer, and parking); paying capital improvement costs incurred by tax incremental districts (TIDs); and short-term borrowing to address cash flow fluctuations. The City also issues debt on behalf of the Milwaukee Public Schools (MPS).

At the end of 2015, the City had total outstanding debt of $1.2 billion. Of that total, debt backed by G.O. bonds[13] amounted to $880 million, which is a decline of 4% from the $915 million in 2011. Revenue bonds amounted to $95 million, an increase of 28% since 2011.

[12] Earlier this year, Milwaukee received ratings for its latest G.O. bonds of AA from Fitch and S&P, and Aa3 from Moody's. This places the City in the second highest ratings category and conveys strong creditworthiness.
[13] General Obligation (G.O.) bonds are municipal bonds commonly used by local governments that are secured by the government's pledge to use its taxing power to repay bond holders. These differ from "revenue bonds" in that they are not secured with a specific form of revenue (such as fees from users of the capital project).

ICMA evaluates long-term debt by assessing whether overall borrowing endangers future ability to repay, as well as the impact of debt service payments upon current budgets. Under its standard, a local government's debt "is proportional in size and rate of growth to its tax base; does not extend past the useful life of the facilities that it finances; is not used to balance the operating budget; does not require repayment schedules that put excessive burdens on operating expenditures; and is not so high as to jeopardize the government's credit rating."

A common measure of long-term debt is its relationship to equalized property value. Under State statutes, Milwaukee's non-MPS general purpose debt cannot exceed 5% of its equalized value. In 2015, Milwaukee's net direct debt equaled about 48% of the state limit. On another measure, overall net debt as a percentage of equalized value, Milwaukee also is substantially below the ICMA warning threshold, as shown in ICMA Indicator 9.[14]

ICMA Fiscal Indicator 9 – Long-term Debt

Why it is Important – Net direct debt is bonded debt for which the local government has pledged its good faith and credit and which is supported by tax revenues. Overall net direct debt includes city debt plus all bonded debt issued by other governmental units in the city, such as MPS. It also includes city residents' relative proportion of debt for Milwaukee County, the Milwaukee Metropolitan Sewerage District, and the Milwaukee Area Technical College district. Credit agencies routinely examine a local government's debt load in setting a bond rating. Increasing debt is one possible indication of a deteriorating fiscal condition. Conversely, low debt may indicate an underinvestment in capital facilities.

ICMA Warning Signs

- Increasing net bonded debt as a percentage of assessed valuation.
- Overall net debt exceeding 10% of assessed valuation.

City of Milwaukee Finding – The City's ability to lower its long-term debt during the past five years is a positive sign of fiscal health. Unfortunately, the City's debt load increased in 2016, and estimates prepared by the budget office and Comptroller indicate potential for an upward trend in future years. Because increased debt service payments threaten the City's ability to meet departmental operating needs, this is a situation that **requires monitoring**.

Year	Equalized Value*	Net Direct Debt**	% of Equalized Value	Overall Net Direct Debt**	% of Equalized Value
2011	$29,521	$789,308	2.7%	$1,657,427	5.6%
2012	$27,955	$695,488	2.5%	$1,552,635	5.6%
2013	$26,422	$683,312	2.6%	$1,543,855	5.8%
2014	$26,090	$696,614	2.7%	$1,467,949	5.6%
2015	$26,138	$622,044	2.4%	$1,389,212	5.3%

Source: City of Milwaukee CAFRs
** in millions*
*** in thousands*

[14] The net direct debt figures in the ICMA Indicator box differ from the $1.2 billion total debt figure referenced above because net direct debt is a calculation of debt that is subject to the State's debt limit. Such debt is limited largely to debt issued for general city purposes and does not include debt related to enterprise funds or Milwaukee Public Schools.

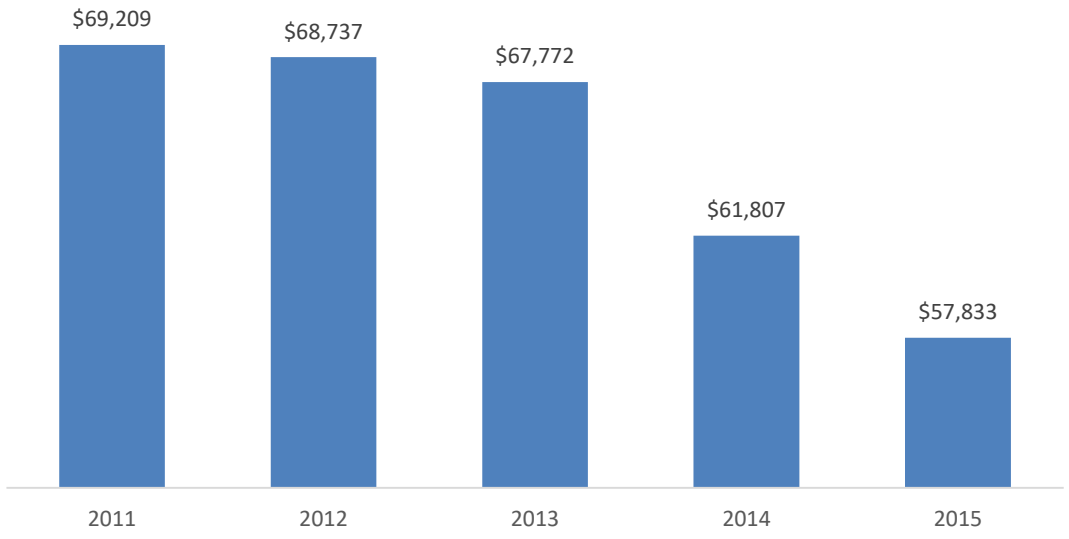
Major issue: Growth in long-term debt and impact on operating budget

While the City clearly has a manageable debt load when measured against commonly-used debt standards, it is also important to keep in mind that a local government's appropriate level of debt is linked to its specific fiscal circumstances.

As described in the previous section, the City faces significant pressure to use its property tax resources to address general operating needs in light of the stagnant nature of its intergovernmental revenues and its limited local revenue options. Consequently, of particular importance to City finance officials is the amount of property tax levy resources that need to be directed to debt service.

In 2015, the City dedicated $57.8 million of property tax levy – or 23% of its overall levy of $253.8 million – to debt service. While a substantial amount, **Chart 15** shows that it represents an $11 million (16%) reduction from the $69.2 million in levy allocated to debt service in 2011.

Chart 15: Tax-levy supported G.O. debt service payments, 2011 to 2015 (in thousands)



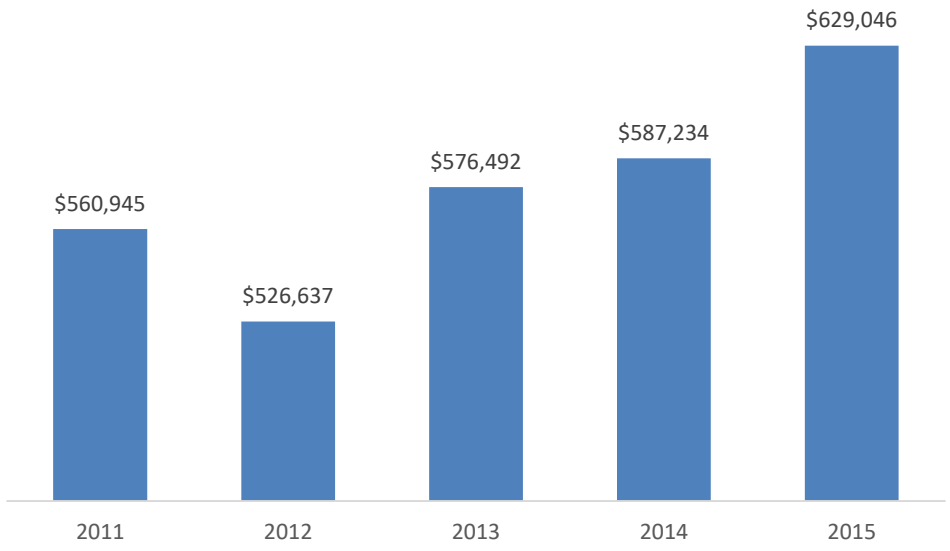
Source: City of Milwaukee CAFRs

Similar to the City's remarkable progress on health care, however, this accomplishment has a "good news-bad news" element to it. The effort to reduce tax levy expenditures on debt service – which, as described earlier, has allowed additional levy to be directed to the General Fund – has been accommodated for the past three years by tapping into unassigned fund balance from the City's debt service fund. The City was able to draw $11.5 million in 2014 from its debt service fund, $15.6 million in 2015, and $17.1 million in 2016, for the express purpose of reducing its debt service tax levy. While these draws by no means should be considered irresponsible, it likely will not be possible for the City to lean as heavily on this strategy in the future given that the debt service fund is unlikely to enjoy balances that are as robust as those experienced during the past few years.

It also should be noted that despite the substantial allocation from the debt service fund in the 2016 budget, the City's property tax levy allocation to debt service increased from $57.8 million to $61.2 million. That increase is a reflection of growing tax levy-supported G.O. debt which, as shown in **Chart**

16, grew by $68 million (12%) during the 2011-2015 timeframe.

Chart 16: Property tax levy-supported G.O. debt, 2011 to 2015 (in thousands)



Source: City of Milwaukee Official Public Statement for May 2016 bond issues

In light of the City's structural budget challenges, City budget officials have emphasized the need to control the growth of levy-supported debt, and have established a policy goal of limiting annual borrowing to the level of debt that is annually retired. Achieving that goal will be central to the City's ability to maintain desired tax levy allocations for General Fund departments, but it may be easier said than done. In fact, according to an annual report on debt and debt service prepared by the Comptroller, the City failed to reach its policy goal (i.e. it issued more tax levy-supported debt than it retired) in each of the past two years, and it is not anticipated to meet the goal again in 2016. Furthermore, both that report and projections prepared by the City's budget office indicate that the City likely will have a higher amount of levy-supported debt in 2020 than it maintains today.

As we discuss below, the City's capital assets face vast needs, and their repair and restoration will require substantial investment. It is evident that **identifying the wherewithal to invest in capital assets without saddling the operating budget with unaffordable debt service payments may be the City's foremost fiscal challenge over the next decade.**

Increased use of Tax Incremental Financing

Another potential long-term debt concern – when viewed both in the context of affordability and impacts on the property tax levy pressures discussed earlier in this report – is the City's increased use of Tax incremental Financing (TIF). TIF is an economic development tool used by Milwaukee and other local governments throughout the U.S.to redevelop blighted properties. When a new TIF district is created, the assessed "base" value of the property within the district is frozen and the development's impact on the future assessed value of the district is estimated. Based on the projected growth in assessed value, the increased tax revenue attributable to that growth is calculated. Those future property tax revenues then are used as up-front equity for the project.

Typically, the City will issue G.O. bonds at the beginning of the project and use the funds raised for public infrastructure improvements and/or developer incentives. During the TIF period, all new property tax revenue (referred to as the "increment"), including tax revenue that normally would go to other local taxing jurisdictions, is allocated toward repaying the TIF investment. Once the investment is fully repaid, the district is retired, at which point all new property tax revenue is distributed to the taxing jurisdictions as it would have been before the TIF district was created.

Milwaukee currently has 48 active TIF districts, including five that were established in 2015, as shown in **Table 8**. According to the Wisconsin Department of Revenue, the total property value within the 43 Milwaukee TIF districts that were active at the beginning of 2015 was about $1.7 billion.[15] Before those districts were created, the value of all property within them was about $698 million, meaning the total value has increased by more than $1 billion (roughly 150%).

The City's return on investment for each individual TIF district varies significantly. Some districts have experienced substantial development activity since their creation, which has generated tax increment revenue and put the City on track to pay back its investment well within the statutory limit of 27 years. For example, in 2004, the City approved $42 million in TIF expenditures for improvements in the Historic Third Ward neighborhood. That district ("Erie/Jefferson Riverwalk") is expected to recover its costs by 2021, a decade before it legally would be required to do so. It has done so well, in fact, that it has been used to "donate" to less successful TIF districts to help them close on time.

Other TIF districts have not fared as well. For example, a district created in 2005 for the area where Milwaukee's Amtrak Intermodal Passenger Station was planned has resulted in less development activity than expected, resulting in a need for that district to *receive* donations from other more successful TIF districts to pay back the City's $6.6 million investment.

The City's overall use of TIF has increased in recent years and may now be at an all-time high, yet it is still well within the standard set by State statutes, which stipulate the total *value increment* of all existing TIF districts within a city must not exceed 12% of the city's total equalized value of taxable property.[16] Milwaukee's TIF utilization rate has increased from 3.7% of the city's total property value in 2008 (a 20-year high at that time) to 4.2% in 2015.[17] Thus, it remains far below the 12% limit.

In recent years, the City has extended its use of TIF beyond the redevelopment of properties that typically would have been defined as "blighted" to support major downtown development projects and the City's planned streetcar system. These investments are viewed as entirely justifiable by some and as inappropriate uses of TIF by others.

For example, the highly successful Erie/Jefferson Riverwalk district was modified to add $18.3 million for the City's planned streetcar system, and a new TIF district created in 2015 (East Michigan) includes additional funding for the streetcar. Also, in 2015, the City approved a $20 million TIF district to finance a parking structure for the new Milwaukee Bucks arena.

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[15] All data on Milwaukee's TIF districts are from the Wisconsin Department of Revenue's "2015 Tax Incremental Financing (TIF) Value Limitation Report." https://www.revenue.wi.gov/equ/2015/15tiflim.html
[16]Wisconsin State Legislature.https://docs.legis.wisconsin.gov/statutes/statutes/66/XI/1105
[17]Kovari, John. "Too Much or Not Enough? A Statistical Analysis of Tax Incremental Financing in Wisconsin."Public Policy Forum. July 2009. http://publicpolicyforum.org/sites/default/files/2009TIFBrief.pdf

Table 8: Active City of Milwaukee TIF districts (2015)

TID Name	Base Year	Base Value	2015 TID Value Increment	2015 TID Current Value	Authorized Expenditures	Projected TID Cost Recovery Levy Year	Max Legal Life
27th & North Avenue	1991	$608,600	$2,857,000	$3,465,600	$2,000,000	2017	2018
Curry / Pierce Project	1992	$663,100	$1,283,400	$1,946,500	$750,000	2014	2019
New Covenant Housing	1992	$120,300	$0	$120,300	$655,358	2014	2019
Florida Yards	1993	$3,025,100	$18,330,800	$21,355,900	$5,790,820	2014	2020
Beerline B	1994	$41,210,300	$187,542,600	$228,752,900	$65,825,392	2019	2020
Clarke Square	1995	$1,669,800	$8,059,600	$9,729,400	$3,219,186	2014	2022
City Homes	1995	$1,017,400	$7,582,500	$8,599,900	$2,670,163	2012	2022
Grand Avenue Redevelopment	1998	$60,317,400	$68,317,600	$128,635,000	$23,106,000	2013	2025
Hilton Hotel	2000	$23,863,400	$24,420,900	$48,284,300	$6,325,000	2017	2027
Time-Warner	2000	$10,021,400	$98,176,800	$108,198,200	$29,666,000	2019	2027
Midtown	2001	$7,118,300	$54,692,300	$61,810,600	$12,225,000	2014	2027
Grand Avenue / New Arcade	2001	$14,759,500	$6,900,500	$21,660,000	$6,000,000	2024	2028
Park East Corridor Redevelopment	2002	$45,325,600	$140,794,000	$186,119,600	$44,929,549	2025	2029
Cathedral Place	2002	$2,052,700	$53,298,900	$55,351,600	$29,750,000	2020	2029
Solar Paints	2002	$300	$2,048,400	$2,048,700	$775,000	2016	2025
Granville Station	2003	$10,048,700	$12,527,800	$22,576,500	$4,591,000	2023	2030
Sigma-Aldrich Corporation	2003	$10,225,900	$15,680,300	$25,906,200	$5,000,000	2019	2026
Menomonee Valley Shops	2004	$4,752,300	$69,063,100	$73,815,400	$26,000,000	2027	2030
Stadium Business Park	2004	$1,148,000	$18,529,700	$19,677,700	$2,810,000	2016	2031
Erie / Jefferson Riverwalk	2004	$8,958,600	$122,731,400	$131,690,000	$41,824,059	2021	2031
Harley Davidson Museum	2005	$0	$18,996,600	$18,996,600	$5,965,000	2020	2031
20th / Walnut	2005	$4,753,200	($151,800)	$4,601,400	$2,630,046	2015	2032
Bronzeville	2005	$46,021,500	$2,063,100	$48,084,600	$3,288,500	2031	2032
Amtrak Intermodal Passenger Station	2005	$2,212,900	$5,637,800	$7,850,700	$6,250,000	2017	2032
Chase Commerce Center	2005	$4,089,700	$174,600	$4,264,300	$500,000	2015	2032
DRS Power & Technology	2006	$5,329,800	$1,820,000	$7,149,800	$1,700,000	2019	2032
Falk / Rexnord	2006	$8,871,100	$3,259,600	$12,130,700	$2,500,000	2028	2026
Direct Supply	2006	$14,358,000	$10,827,700	$25,185,700	$13,350,000	2025	2033
North 20th / West Brown Streets	2006	$3,220,700	($418,800)	$2,801,900	$3,250,000	2015	2033
Metcalfe Park Homes	2007	$50,443,300	($25,658,600)	$24,784,700	$1,475,000	2015	2033
Pabst Brewery / The Brewery Project	2007	$9,266,900	$43,208,500	$52,475,400	$29,002,272	2032	2033
Fifth Ward / First Place	2007	$28,171,000	$35,359,600	$63,530,600	$4,402,966	2017	2033
735 N. Water St.	2007	$14,904,700	$16,109,200	$31,013,900	$3,253,992	2020	2034
Mitchell Street	2008	$66,751,300	($6,570,200)	$60,181,100	$3,116,600	2034	2033
Bishop's Creek	2009	$24,474,700	($346,400)	$24,128,300	$1,585,000	2034	2033
City Lights	2009	$4,602,800	$4,695,900	$9,298,700	$2,038,000	2029	2036
N 35th & Capitol Dr	2009	$63,334,700	($8,689,700)	$54,645,000	$15,600,000	2035	2034
Reed Street Yards	2009	$26,470,500	$36,701,200	$63,171,700	$13,337,770	2030	2036
S 27th & W Howard	2010	$16,113,000	$0	$16,113,000	$200,000	2014	2036
Hellerman/Tyton	2012	$3,368,100	$5,458,500	$8,826,600	$795,000	2028	2032
Northwestern Mutual Life Insurance Co.	2013	$44,582,700	($7,558,200)	$37,024,500	$73,300,000	2038	2040
North Water Street Riverwalk	2013	$6,024,900	($2,280,700)	$3,744,200	$4,070,000	2023	2040
Posner Building	2014	$3,500,300	$137,900	$3,638,200	$2,650,000	2031	2041
Subtotal		***$697,772,500***	***$1,045,613,400***	***$1,743,385,900***	***$508,172,673***		
1st and Greenfield	2015	TBD			$5,313,000	2035	2041
East Michigan	2015	TBD			$49,550,000	2034	2042
Broadway & Michigan	2015	TBD			$2,972,500	2028	2042
West McKinley & Juneau	2015	TBD			$20,000,000	2040	2042
6th & National	2015	TBD			$2,500,000	2036	2042

The City's use of TIF undoubtedly has contributed substantially to the recent boom in downtown development and should be seen as a positive in that regard. Nevertheless, from a financial perspective, there are some cautionary elements. One is the aforementioned projected growth in the City's net direct debt, which includes anticipated TIF-related debt. While there is no threat that debt levels will run up against the State-imposed debt limit, higher levels of overall debt could be frowned upon by the bond rating agencies, which already have expressed modest concern about the City's debt burden.

Also, the increased use of TIF for items like the streetcar – while perhaps fully justifiable to the extent that development within the TIF district would be unlikely to occur *without* streetcar investment – is more difficult to justify when the development was occurring anyway, or when dollars to pay back the TIF investment come from successful districts that otherwise would have been retired. In such cases, the use of TIF arguably is adding to the City's general property tax rate, though many still may view it as a worthwhile economic development investment.

Maintenance of capital assets

According to the Government Finance Officers Association, "the performance of capital assets is essential to the health, safety, economic development, and quality of life of those receiving services."[18] Appropriately maintaining these assets requires a continuous long-term commitment. Yet, as ICMA has observed, many governments have not been willing to fully fund such costs and have seen underfunding of capital assets as "a relatively painless way to temporarily reduce expenditures and ease financial strain."

The City prepares a six-year capital plan, which was last updated to cover the 2016-2021 timeframe. In addition to the capital plan, the Department of Public Works catalogs the condition of bridges, streets, buildings, and other infrastructure and uses that information to update the plan and/or to make necessary capital requests outside of it as needs develop.

ICMA Indicator 10 shows trends in capital expenditures, as well as repair and maintenance expenditures in DPW's operating budget for facilities, fleet/equipment, street lighting, and streets. Those assets constitute a substantial portion of all City assets and provide the best available information for this indicator.

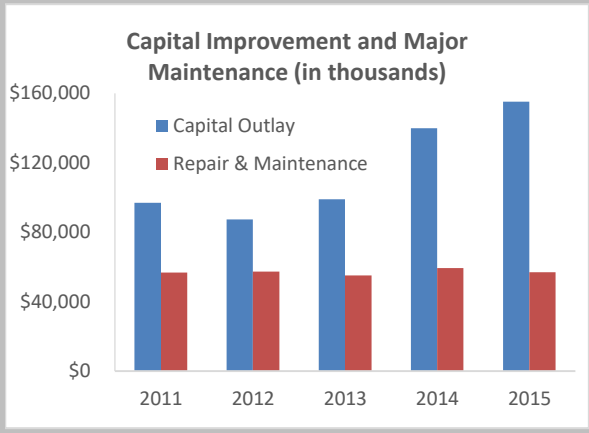
DPW's repair and maintenance expenditures reveal no clear trend, with $55-$59 million spent annually. Capital outlays, however, show a large spike in 2014-15, resulting largely from outlays associated with new TIDs. Beginning in 2016, capital outlays also will be affected by a major repair project at Milwaukee City Hall that may cost up to $60 million over the next decade.

ICMA Fiscal Indicator 10 – Capital Improvements and Repair and Maintenance

Why it is important? – Capital improvements and repair and maintenance expenditures provide an indication of whether capital needs are being addressed.

ICMA Warning Sign – A three year or more decline in capital improvement and maintenance expenditures.

City of Milwaukee Finding – The City's basic repair and maintenance expenditures within DPW have remained steady in recent years, despite its severe budget pressures. Meanwhile, capital outlays have increased, in part because of investments in new Tax Incremental Districts, but also reflecting a commitment to address existing capital needs, as demonstrated by investments in City streets that have dramatically reduced the replacement cycle. While **careful monitoring** is in order given the magnitude of future needs, the City's recent commitment to basic infrastructure repairs and replacement is a **positive indicator** of fiscal health.



Source: Milwaukee Financial Records, 2004 to 2008

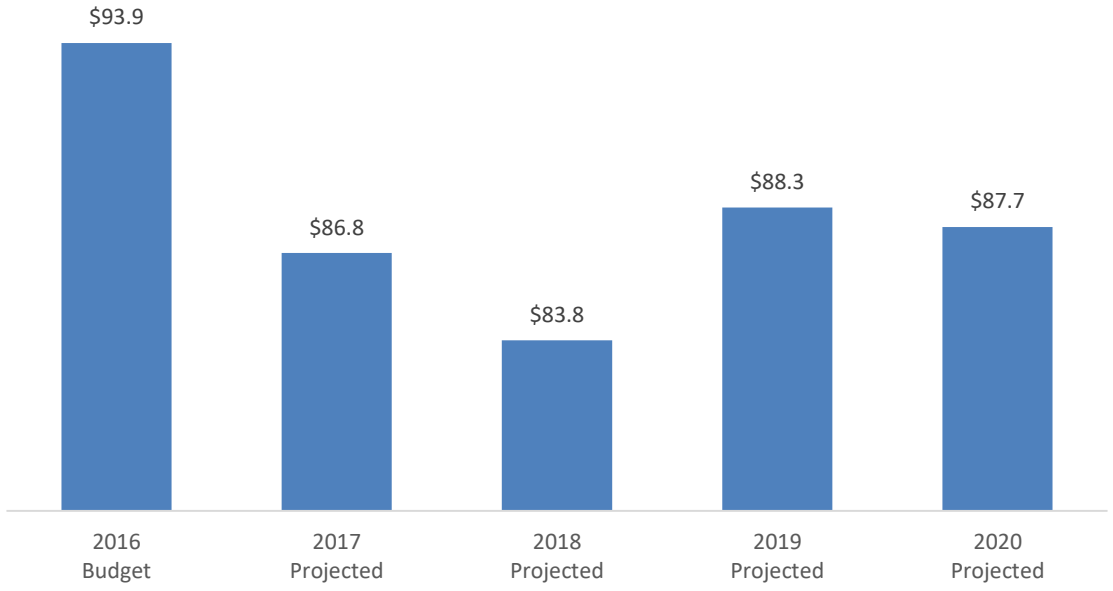
The City's willingness to increase capital expenditures to address emerging needs is considered an indicator of fiscal health under the ICMA system. It is also worth noting that the City has made substantial progress in reducing the replacement cycle for City streets, which had reached 106 years according to a 2008 audit. That cycle now has been reduced to approximately 60 years.

[18] GFOA, "Best Practice: Asset Maintenance and Replacement," 2010. Accessed at: http://www.gfoa.org/asset-maintenance-and-replacement

Nevertheless, the financial pressures caused by aging infrastructure continue to be a threat to the City's long-term fiscal health. As documented in the Forum's recent report on local transportation infrastructure, the City continues to face formidable challenges in keeping up with repair and replacement needs of City streets and bridges, which will require an average of $76 million per year in capital expenditures between 2017 and 2020. Other major projects that will need to be accommodated over the next four years include Police Administration building remodeling ($19.7 million), major capital equipment for the Milwaukee Fire Department ($9.9 million), new library construction ($5.2 million), and the aforementioned City Hall project ($42 million over the next four years and up to $60 million total).

As shown in **Chart 17**, the six-year capital plan anticipates between $82 million and $88 million of annual G.O. borrowing for General Fund departments between 2017 and 2020. At first glance, that would appear to suggest that capital spending needs will remain steady over the next several years and will be lower than the 2016 budgeted total. However, because the 2017-2020 totals do not include capital needs that will emerge (or already have emerged) since the plan's most recent update in 2015, it is quite likely that budgeted amounts will need to approach or exceed the 2016 level. That, in turn, would continue to place substantial pressure on the City's borrowing capacity and debt affordability.

Chart 17: Projected G.O. borrowing for capital needs, General Fund departments, 2016-2020 (in millions)



Source: City of Milwaukee

Long-term budget prospects

When we compare our ICMA "traffic light" assessments of City finances today to our 2009 assessments, we see marked improvement, as shown in **Table 9** (ICMA indicators 11 and 12 will be discussed in the next section). In particular, we see that the City's fringe benefits picture is much

improved and necessary investments have been made in City infrastructure. Furthermore, the City has enjoyed growing annual fund balances and it has emerged from the recession with reserves even healthier than they were seven years ago.

Table 9: ICMA fiscal indicators, 2009 vs. 2016

	2009	2016
ICMA FISCAL INDICATOR 1 NET REVENUES PER CAPITA	Red	Yellow
ICMA FISCAL INDICATOR 2 INTERGOVERNMENTAL REVENUE AS A PERCENTAGE OF OPERATING REVENUE	Red	Red
ICMA FISCAL INDICATOR 3 LOCAL TAX REVENUE IN CONSTANT DOLLARS	Green	Yellow
ICMA FISCAL INDICATOR 4 NET EXPENDITURES PER CAPITA	Yellow	Yellow
ICMA FISCAL INDICATOR 5 EMPLOYEES PER CAPITA	Yellow	Green
ICMA FISCAL INDICATOR 6 DIRECT FRINGE BENEFITS	Red	Yellow
ICMA FISCAL INDICATOR 7 PENSION PLAN FUNDING	Red	Green
ICMA FISCAL INDICATOR 8 EXPENDITURES BY MAJOR FUNCTION	Yellow	Red
ICMA FISCAL INDICATOR 9 LONG-TERM DEBT	Yellow	Yellow
ICMA FISCAL INDICATOR 10 CAPITAL IMPROVEMENTS AND REPAIR & MAINTENANCE	Yellow	Yellow
ICMA FISCAL INDICATOR 11 LIQUIDITY	Green	Green
ICMA FISCAL INDICATOR 12 FUND BALANCE	Yellow	Green

Yet, when we consider the underlying structural issues that caused us to raise major warning flags about the City's long-term fiscal prospects in our last comprehensive assessment, we see that those remain unresolved. Given the State of Wisconsin's budget challenges, it is difficult to imagine that shared revenue payments will increase in the near future; indeed, the City will do well just to maintain its current level of State aids in the next State budget. That will continue to place undue pressure on the property tax and property-related fees, which would need to increase above the rate of inflation to make up for stagnant intergovernmental revenues and allow the City to meet its wide range of expenditure needs.

Faced with even more pressing challenges seven years ago, City leaders embarked upon efforts to trim the workforce by developing new staffing frameworks and otherwise identifying efficiencies. Then, once such strategies were exhausted, they were able to reap the benefits of health care restructuring both to maintain existing service levels and to fortify reserves.

While it is possible that new operational efficiencies or fringe benefit modifications will be developed to help ease budgetary pain in the future, it is highly unlikely that the savings produced by such strategies will come anywhere close to those generated by recent health care changes. Consequently, if City leaders wish to preserve Milwaukee Police Department staffing, service, and technology levels over the next five years, it may be difficult to do so without transferring resources from other functions or depleting reserves.

Two other long-term budget issues that bear watching are pending lawsuits facing the City and the aforementioned streetcar development. With regard to the former, the City has been on the losing end or has been forced to settle a handful of recent police misconduct cases that have required several million dollars of payments to plaintiffs, and several additional cases still are in the pipeline. The monies to pay damages or settlements typically come out of annual fund balance and diminish the amounts available to replenish reserves. With regard to the streetcar, the City has not announced a long-term plan to finance the $1.8 million annual non-farebox operating cost of the initial 2.1-mile line (after a federal grant expires) or possible extensions. In both cases, these are costs that the City has the wherewithal to absorb, but doing so could come at the expense of other needs or could exacerbate its overall fiscal challenges.

In sum, while the 2017 budget does not appear overly problematic, beginning in 2018 the City again may be forced to choose between addressing the financial needs of the Milwaukee Police Department or reducing expenditures to other departments, a choice we labeled "police or potholes" in our last report. Inflationary growth in major revenue streams – the ICMA standard – would alleviate the problem, but is unlikely to be attained.

Cash Solvency

Analyzing cash solvency with the ICMA system

Cash solvency refers to the ability of a government to pay its bills. Two ICMA measures for cash solvency pertain to liquidity and General Fund balance. Liquidity examines the extent to which governments have cash available to meet immediate and short-term obligations. If a government has a sufficient flow of revenues to meet expenditure commitments, then it has positive liquidity or cash flow. A positive fund balance, meanwhile, provides an indication of a government's ability to maintain cash solvency, as well as meet unanticipated emergencies.

Summary of findings on cash solvency

Milwaukee maintains solid liquidity levels, a healthy and improved General Fund Balance, and several well-funded reserve funds to respond to fiscal challenges. Taken together, these factors convey a strong degree of cash solvency. On the negative side, General Fund operations have become reliant on annual reserve withdrawals, which may not be sustainable in the future at levels enjoyed during the past few years.

Analysis

We consider the City of Milwaukee's cash solvency by examining its cash liquidity, General Fund balance, and reserve funds. As shown in **ICMA Indicator 11**, Milwaukee has a liquidity ratio well within ICMA standards, and that ratio has remained relatively steady throughout the five-year period. S&P rated the City's liquidity "very strong" in its latest analysis.

ICMA Fiscal Indicator 11 – Liquidity

Why it is Important – A key measure of a city's short-term fiscal condition is its liquidity. ICMA defines liquidity as the ratio of cash and short-term investments to current liabilities. Assessing liquidity is complicated by the flow of payments in and out of government coffers in the course of the year. For this reason, evaluation of liquidity should take place at the same point in time, as we do here.

ICMA Warning Sign

- A decreasing amount of cash and short-term investment as a percentage of current liabilities
- Three or more years of a ratio of greater than 1 to 1.

City of Milwaukee Finding – The City's liquidity ratio is well within the ICMA standard and has been steady over the past five years. In fact, it has improved since examined in our last report (2008), when it stood at 1 to 0.8. This is a **positive indicator** of fiscal health.

Year	Ratio
2011	1 to 0.6
2012	1 to 0.6
2013	1 to 0.5
2014	1 to 0.6
2015	1 to 0.6

Source: City of Milwaukee CAFRs

The City's General Fund balance also has been deemed healthy by the bond rating agencies and has improved over the five-year timeframe. Its $127 million fund balance in 2015 represented 18% of its operating revenues. That is an increase of more than $55 million from 2011, when the City's $72 million fund balance represented 11% of its operating revenues, as shown in **ICMA Indicator 12**.

Strong liquidity and a growing General Fund balance have enabled the City to maintain several adequately-funded reserves, which it has used to prepare for downturns in the economy and unanticipated fiscal challenges. Those include the Tax Stabilization Fund, Public Debt Amortization Fund, and pension reserve discussed elsewhere in this report, as well as a small budget contingency fund.

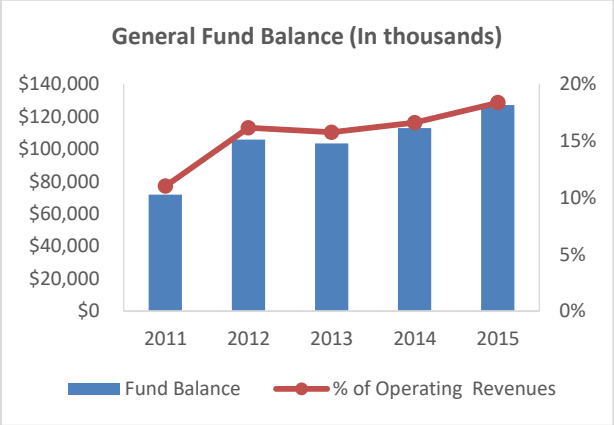
Taken together, the reserve funds buttress cash solvency. Moody's refers to the City's "satisfactory" reserve levels that "somewhat offset risks associated with the city's limited operating revenue flexibility and high fixed costs associated with debt, pensions, and OPEB." Fitch labels the City's reserves "nominally modest" but argues that they "represent a sufficient safety margin given...adequate budgetary flexibility and control."

ICMA Fiscal Indicator 12 – Fund Balance

Why it is Important – Fund balances are a form of financial reserve that affect a government's ability to meet unanticipated costs and emergencies.

ICMA Warning Sign – Declining General Fund balance as a percentage of net operating revenues.

City of Milwaukee Finding – The City has experienced a growing fund balance over the past five years, in part because actual savings produced by health care benefits changes regularly have exceeded budgeted projections. This is a **positive indicator** of fiscal health, though health care savings likely have run their course. That will add to the challenge of producing robust year-end fund balances and maintaining appropriate levels of reserves, particularly if the City needs to replicate the sizable reserve contributions it has made in recent years to maintain service solvency.



Source: City of Milwaukee CAFRs

As discussed earlier, the City has used its higher-than-budgeted health care savings to build its TSF, while also increasing the annual draw. The City also has increased its annual withdrawal from the PDAF in recent years, but the balance in that reserve similarly stands considerably higher (at about $61 million) than it was five years ago. The pension reserve has shriveled from a high of more than $50 million in 2013 to an anticipated $8 million at the end of this year, but that resulted from a deliberate effort to build the reserve to extraordinary levels in 2011-12 so that monies could be withdrawn over the 2013-16 timeframe.

Overall, it is hard to argue with the City's increased use of these reserves to address operating budget needs during the past five years given the responsible and strategic manner in which it built them. Nevertheless, this is an issue that bears watching in future years, as the size of recent TSF withdrawals may not be sustainable once health care savings disappear, and the size of recent pension reserve withdrawals certainly will not be sustainable now that the reserve has returned to its traditional level.

Conclusion

Using the Fiscal Trend Monitoring System of the International City/County Management Association, we find that the City of Milwaukee's financial condition and outlook have improved significantly since our last examination in 2009. Credit is due to City leaders for their responsible approach to financing their pension obligations, restructuring their health care offerings, and downsizing the City's workforce in the face of some enormous fiscal challenges. Also, the fact that those challenges were accommodated without depleting reserves or substantially deferring capital repair needs is further evidence of effective financial management.

Yet, given the extremely bleak set of circumstances we described in our last report, an "improved" outlook must be viewed in the proper context. That context includes the following key cautionary findings from our analysis:

- **Over-reliance on property taxes and fees**. Intergovernmental revenue – the City's largest revenue source – declined by nearly $10 million (3.6%) in the 2011-2015 timeframe. That decline necessitated a $23 million (14%) increase in property taxes for the General Fund and a $17 million (17%) increase in charges for services to allow overall revenues to keep pace with inflation. Meanwhile, substantial future growth – even if deemed politically palatable – will be limited by state property tax levy restrictions and a prohibition against using user fee revenues for general purposes (i.e. the revenues collected cannot exceed the cost of the services for which the fees are instituted).

- **Health care savings soon will be exhausted**. Annual employee/retiree health care expenditures dropped from $139 million in 2011 to $96 million in 2015 (31%). Those savings were central to the City's ability to accommodate a spike in pension obligations, avoid workforce reductions, and provide expenditure increases to the Milwaukee Police Department that allowed it to maintain officer staffing levels. By 2018, the City again is likely to have to budget for modest annual health care increases, which will exacerbate its other expenditure pressures.

- **Police service needs could threaten service solvency in other areas of City government**. Overall expenditures for general City purposes increased $38 million (6%) from 2011 to 2015, with the public safety function accounting for $35 million of that amount. MPD received nearly all of the overall increase, which was needed simply to maintain existing sworn strength levels in the face of expiring federal grants. Maintaining sworn strength levels will not require as big a financial commitment over the next five years now that grant dollars have been supplanted and police union members are contributing to their pensions; however, the pressures associated with replacing retiring officers, modernizing technology, and accommodating natural growth in police salaries and benefits still could crowd out other needs.

- **Retirement liabilities and debt are manageable today but growing**. The City's unfunded actuarial liability for Other Post-Employment Benefits (OPEB) stood at $976 million in 2015, which is $60 million higher than in 2011; and its pension fund – while in far better shape than most peer cities – still requires an annual contribution of $60 million, a number that

could rise beginning in 2018. Meanwhile, property tax levy-supported debt grew from $561 million in 2011 to $629 million in 2015. Increasing retiree liabilities and debt payments can be managed in the short term, but may pose substantial long-term fiscal challenges.

It is important to consider Milwaukee's fiscal strengths, as well. Our analysis reveals that the City has well-stocked reserves and strong liquidity, and that it has made progress in addressing its infrastructure needs. Also, the resilient manner in which City finances emerged from an historic economic recession – which featured a foreclosure crisis and several successive years of declining property values – should not be understated and conveys hope for similar resiliency in the future.

Nevertheless, our 2009 conclusion that Milwaukee needs "fundamental fiscal change" has not been altered. The City's revenue structure remains broken. Until it is modified to reduce the City's reliance on property-related revenue, and to provide wherewithal for total annual revenue increases that mirror the rate of inflation, then City finances will continue to be stressed, and any hope for substantial *new* investment in public safety, community development, and other needs could be out of reach.

The options for fixing the City's revenue structure are varied, but all have one thing in common: the need for legislative action in Madison. State law in Wisconsin gives only limited local revenue options to municipalities, and Milwaukee would need legislative approval to consider local sales, hotel/motel, or commuter taxes, which are common elements of the revenue portfolios of other major cities. The same goes for new business-related fees or special taxing districts that might be considered in light of the City's downtown economic development boom. Of course, a return to the days when the City could count on inflationary increases in its shared revenue allocation and other State aids could obviate the need for new local revenue options, but also would require action by the State.

The Forum plans to consider those options in subsequent research. In addition, we will reflect on how the Mayor's proposed 2017 budget addresses issues raised in this report in our annual City of Milwaukee budget brief, which will be released in mid-October.

In the meantime, Milwaukee officials, residents, and businesses should take comfort in the City's improved fiscal condition, but should contemplate even more strongly than ever before the need for change in the City's basic financial structure.