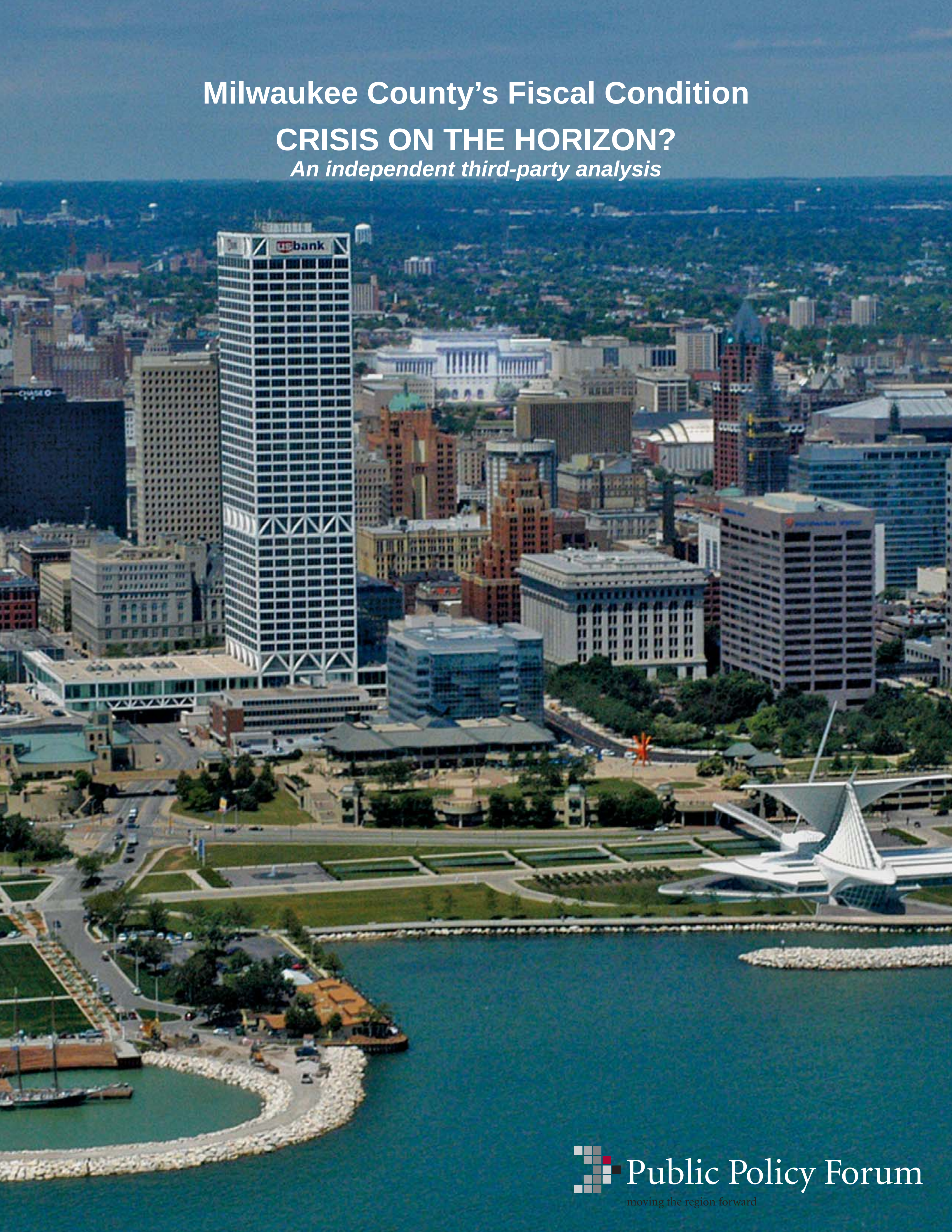
Milwaukee County's Fiscal Condition

CRISIS ON THE HORIZON?

An independent third-party analysis



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ABOUT THE PUBLIC POLICY FORUM

Milwaukee-based Public Policy Forum – which was 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 Milwaukee County 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 state and county level.

Report authors would like to thank Milwaukee County fiscal officials and staff – including the Milwaukee County Controller, Deputy Controller, Fiscal and Budget Administrator, Deputy Fiscal and Budget Administrator and Director of Audits – for their assistance in providing information on the county's finances.

We wish to thank the Greater Milwaukee Committee for commissioning and funding this research.

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MILWAUKEE
COMMITTEE

Milwaukee County's Fiscal Condition:

CRISIS ON THE HORIZON?

An independent third-party analysis

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THE GREATER MILWAUKEE COMMITTEE

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EXECUTIVE SUMMARY

In May 2006, following the launch of a “reality tour” by the Milwaukee County executive to warn citizens about his government’s deteriorating financial situation, and a month-long investigation into Milwaukee County’s finances by two of its reporters, the *Milwaukee Journal Sentinel* editorial board declared that “without bold steps and aggressive political leadership on all levels…the county is sure to face a fiscal crisis more severe than most people might now imagine.”

Almost three years later, it is clear that bold steps have not been taken. Yet, the fiscal crisis predicted by editorial writers and top county and civic leaders has not materialized. **This report examines how the crisis has been avoided so far, and at what price.**

Utilizing a commonly used and respected fiscal monitoring system, and conducting perhaps the most rigorous examination of Milwaukee County fiscal data ever undertaken, we assess the county’s current fiscal condition.

What we find is a government that, on the surface, appears to be in reasonable fiscal shape. Revenues and expenditures have grown steadily. Budgets have balanced, at least since 2004. Cash position and fund balance have improved.

Yet, a closer look reveals a more complex and alarming picture – even before the current economic downturn – that has grown worse with each successive year, and that may now be so severe that radical solutions are required.

Key findings from our analysis of the fiscal condition of Milwaukee County government:

- Milwaukee County’s over-reliance on external and inflexible sources of revenue has weakened its fiscal position and left it extremely vulnerable to budget cuts at higher levels of government. Between 2003 and 2007, in inflation-adjusted dollars, each of the six major state aid programs declined between 9% and 22%, while the local property tax has decreased by 3% and the sales tax by 6%. Increasing in their stead have been charges for service revenues that are less flexible and allocated to specific program operations, such as Family Care and the Airport. To improve the county’s fiscal health, greater revenue diversification is needed.

- The county’s fringe benefit expenditures increased $73 million between 2003 and 2007, an amount equal to nearly one-third of its tax levy. These exceptional cost increases have been spread across all departmental budgets with little strategic focus, leaving virtually all in vastly diminished fiscal condition. This diminished condition clearly has impacted service delivery across all county functions, but the nature of such impacts, in most cases, has not been quantified nor addressed. Meanwhile, despite these constrictions, the breadth and scope of county operations remains unchanged.

- While Milwaukee County's budget technically has been in balance in recent years, short-term measures have been utilized and structural problems have worsened. The county has depleted reserves and deferred bus purchases to postpone its transit funding crisis, built a significant backlog of deferred maintenance and infrastructure repairs, reduced debt service payments in the short-term by restructuring debt (while increasing obligations in the long-term), and utilized one-time revenues to fill holes in various budgets.

- Long-term solvency, as measured by commonly used indicators, is questionable at best. Unfunded retiree health and pension liabilities have topped $2 billion and likely are still expanding, even with the issuance of pension obligation bonds. As a result, fringe benefit cost increases in the next five years may surpass those experienced from 2003 to 2007. The county soon will face an estimated $21 million gap in its transit system budget. The county's own most recent long-term projection – calculated before the onset of the recession and a precipitous decline in pension fund assets – shows a widening imbalance between revenues and expenditures reaching $87.9 million in 2013, despite years of annual budget cutting.

- Because the county engages in little performance measurement, sufficient data does not exist to evaluate trends in the level and quality of county services. There are signs, however, that give rise to significant concern, including a sharp reduction in funding in core administrative units such as corporation counsel, fiscal affairs and human resources that are essential to the operation of all county functions.

In summary, a picture emerges of a local government that has attempted status quo management for far too long in an atmosphere of exceptional costs and restricted revenues. While the county maintains cash solvency and a reasonable debt service level – indicators that insolvency is not imminent – it is clear that annual reductions have not achieved financial equilibrium, and that its long-term fiscal outlook is grim. Indeed, perhaps most disconcerting is that the precarious steps taken to balance budgets during the past five years have left the county with few options to address the challenges of the next five years, which promise to be at least equally arduous.

We conclude from this analysis that while year-to-year budget balancing has staved off crisis so far, Milwaukee County now must develop more comprehensive solutions. A solvency plan is required – one that considers all alternatives, from implementing new or enhanced local revenue sources to reduce its reliance on external sources and augment flexibility; to eliminating, transferring or outsourcing programs and services that are not essential to its core mission and that could be performed just as well by others; to selling or leasing assets to generate capital as a means of paying down liabilities or re-investing in other assets that must be retained.

The key question is whether county elected officials are willing to acknowledge and act upon this assessment. The natural inclination of elected officials – at all levels of government both locally and nationally – is to address annual budget issues with short-term solutions that do not solve structural problems, but simply put them off to the next budget. The magnitude of the county's long-term liabilities – combined with the deep budget cuts in individual departments that already have occurred and a worsening short-term outlook caused by the national recession – strongly suggests that such an approach in Milwaukee County is no longer tenable, and that outside intervention is required if the county is unwilling to face up to its problems itself.

INTRODUCTION

During most of this decade, the financial condition of Milwaukee County government has been a matter of serious concern for government officials, private citizens and the press, and a subject of critical inquiry for specially convened local task forces and a governor-appointed commission.

In 2006, the Milwaukee County executive and his top fiscal officials launched a “reality tour”, designed to warn state and local political leaders and citizens of the county’s dire fiscal condition. These officials predicted the county would “face annual [budget] shortfalls between $23 million (in 2006) and $157.3 million (in 2009)…assuming no corrective actions.” A 2006 Greater Milwaukee Committee task force made similar observations and concluded that state intervention and jurisdictional restructuring might be the best answer. The task force recommended that if the county did not “resolve its budget crisis” within the year, then the state should “empower a Fiscal Control Board chosen by the Governor and approved by the Legislature to take over financial management of Milwaukee County.”

Nearly three years later, it is difficult to ascertain from the public discussion whether the situation has grown better or worse. Significant concern still abounds regarding the county’s ability to adequately fund and maintain its parks, cultural institutions and transit system, but the overall tone from county elected leaders is more optimistic. Both the county executive and county board cite successful efforts to control health care costs, and both talk of far-reaching solutions, such as sale or lease of General Mitchell International Airport or an increased sales tax to pay for certain county functions.

This report seeks to re-assess and clarify the fiscal condition of Milwaukee County government. The basis of our analysis is the Financial Trend Monitoring System of the International City/County Management Association (ICMA). First developed in the 1980’s, this analytical methodology is routinely used by municipalities and counties to assess fiscal health. Milwaukee County itself produced an annual financial report based on the ICMA format from 1983 to 1998.

The ICMA indicators focus on four types of solvency issues:

- 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 the impact of future costs incurred by current fiscal decisions.
- 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.”

Using the ICMA guidelines as context, we explore the key factors driving the county’s revenues and expenditures during the past five years, how the county has responded to its fiscal challenges, and its long-term prospects. The intent is to be sufficiently comprehensive and complete to provide critical insight into two bottom-line questions**: How serious is the county’s**

fiscal crisis, and can it be resolved through skillful management? That is, can Milwaukee County restore its fiscal health by making relatively minor budget and program decisions as part of annual budget deliberations, or are major policy changes regarding the county's revenue sources, programs and/or governance required to right the ship?

In the end, we hope this report will provide county policymakers and civic leaders with baseline information that can serve as the factual underpinning for discussion of strategies to address the fiscal challenges facing Milwaukee County government. Despite inevitable disagreement about the nature of those strategies, there should be no disagreement over the need to act now.

METHODOLOGY AND DATA

To assist in examining various aspects of local government solvency, ICMA has developed a Financial Trend Monitoring System. Under the ICMA system, financial analysis begins with the selection of a group of indicators seen as critical to local circumstances and fiscal problems, and for which adequate data is available. The analysis then tracks trend results for these indicators over the previous five years.[1]

This approach produces a more comprehensive and finely grained review of fiscal condition than is contained in a standard budgetary evaluation. Analysis is broad ranging with indicators relating back to fundamental solvency concerns. Thus, in this case, indicators on fiscal liquidity and fund balances demonstrate the impact that Milwaukee County's budgetary problems have had on cash solvency. Indicators on debt, pension funding, and deferred maintenance shed light on long-term fiscal health. Indicators on revenues and expenditures reveal underlying factors that may or may not be contributing to a sustainable, balanced budget.

In sum, ICMA offers a professional, easy-to-understand method with which to organize a considerable amount of financial data and evaluate fiscal condition. The system does not provide a formula for reaching a final conclusion on the state of an individual government's finances. Rather, it organizes and presents data and provides a context by which to reach considered opinion. As the ICMA handbook says:

> *Evaluating a jurisdiction's financial condition is a complex process…Not only are there large number 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.*

The main sources of data utilized in this report are Milwaukee County financial reports, budget documents, and financial records. We wish to thank officials from the county's Administrative Services and Audit departments for helping us gather much of this information. The study also relies upon data from the U.S. Census of Governments (collected in 2002 and published in 2005), select studies of interest, and the financial reports of four "benchmark" counties. The national Consumer Price Index is used to assess the impact of inflation.

The selected benchmark counties—Allegheny County (Pittsburgh), Cuyahoga County (Cleveland), Franklin County (Columbus), and Wayne County (Detroit)—were chosen because they are in the Midwest and similar in many respects to Milwaukee County. Each has an annual budget in excess of $1 billion, a major city within its borders, and comparable levels of income and poverty. Despite such commonalities, county-to-county comparisons have been used judiciously given differences in governmental and financial structures, scope of operations, and environmental influences.

[1] This report tracks indicators beginning in 2003 and ending in 2007, the last year when complete expenditure data is available. On a few key issues, such as pension costs, more recent data from 2008 and 2009 is also discussed in order to assess recent fiscal changes and the impact of the ongoing national recession upon the county's budget.

MILWAUKEE COUNTY'S ENVIRONMENT

Analyzing the environment with the ICMA system

A local government's environment, or "external influences," profoundly affect and shape its fiscal condition. The ICMA system lists an array of environmental indicators that an analysis may choose to incorporate, including changes in community needs and wealth, economic and demographic conditions, disaster risk, and the nature of existing political structures and relationships. These outside forces can affect citizens' needs and demands for government services and programs, as well as the ability of a government to pay its bills and maintain long-run 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."

Summary of environmental findings

Our analysis tracks changes in key ICMA demographic and economic indicators such as population, income, property value, and poverty rate. Positive findings include a substantial increase in equalized property value, which rose by 42% in current dollars and by 26% in inflation-adjusted dollars from 2003 to 2007. Also, review of recent evaluations by Moody's Investors Services suggests that Milwaukee County's economic picture is brighter than three of the four benchmark counties (though it did have a higher poverty rate than three of the four). Analysis of Milwaukee County's position vis-à-vis the rest of the state indicates cause for concern, however. A decline in key economic and demographic variables may lead to increased difficulty in the struggle to compete successfully for state resources, even though residents' demands and needs for these resources continue to rise.

Analysis

This report focuses on Milwaukee County government's finances. An in-depth evaluation of environmental factors would require a separate study. However, any fiscal analysis must give more than a nod to outside forces that can have either a positive or negative influence. On the positive side, steady growth in population, income, and economic activity are favorable signs for most local governments. Such changes generate resources and opportunities, although they can also stimulate a government to grow too large and ultimately undermine sustainability. Conversely, it is difficult for local units of government to stand apart from community stagnation. Amidst distressed conditions, fewer opportunities arise and greater fiscal prudence is required.

Table 1 presents trends in five ICMA environmental indicators from 2003 through 2007. While the county has seen growth in property values, there has been no population or labor force growth. In addition, the median income has inched down as the poverty rate has ticked upward.

Table 1: ICMA environmental indictors - Milwaukee County

Year	Population	Median household income	Equalized property value*	Percent living in poverty	Civilian labor force
2003	949,188	$39,067	$47,266	18.0%	467,617
2004	950,323	$38,303	$51,153	16.1%	463,740
2005	949,511	$37,808	$56,680	18.5%	456,915
2006	952,315	$41,308	$63,609	18.2%	453,137
2007	951,252	$42,790	$67,119	18.5%	456,542
5-yr difference	**2,064**	**$3,723**	**$19,853**	**n/a**	**-11,075**
5-yr % change	**0.2%**	**9.5%**	**42.0%**	**n/a**	**-2.4%**
Inflation adjusted	**n/a**	**-2.8%**	**26.0%**	**n/a**	**n/a**

* In millions
Source: U.S. Census; Milwaukee County, Comprehensive Annual Financial Reports; State of Wisconsin, Department of Workforce Development

To place this information in context, we compare Milwaukee County with four Midwest "benchmark" counties (see **Table 2** for comparative data on these counties). Milwaukee County stands out in that it is in less obvious decline than most and more economically vital. Research from Moody's Investors Services (published at the time of bond sales within the past 18 months) succinctly describes the state of these metro areas. Moody's notes Milwaukee County's "sizeable and diverse" tax base and strong valuation increases and it projects that impacts in the housing market will be "more moderate than national trends." Moody's macro-economic judgment is that Milwaukee's "manufacturing base appears to have stabilized, focused more on smaller and more specialized industries. The overall decline of the manufacturing base also has had the beneficial impact of forced diversification, resulting in a growing service sector that provides additional employment opportunities to metropolitan area residents in the financial, governmental, and health care areas."

Moody's is less sanguine about three of the benchmark counties. For instance, it predicts Cuyahoga County's "tax base will continue to stagnate as the local economy and employment base remain heavily dependent on the declining durable goods sector." The analysis for Wayne County is similar as the "local economy continues to absorb industry cutbacks and restructuring" and "ongoing challenges are expected [from] persistent automotive manufacturing pressures and a stressed residential housing market." In Allegheny County, Moody's predicts "modest growth," albeit noting past population declines and the fact that the "mortgage-lending and consumer finance sectors are aggressively shedding jobs." Moody's is the most positive in regard to Franklin County, whose "economic diversity…drives continued growth."

Milwaukee County does have some comparative weaknesses, particularly the size of its disadvantaged population, which contributes to strong demand on the county's social service programs. According to the U.S. Census, Milwaukee County has the second highest poverty rate among the benchmark group. In 2000, the Census counted 15% of residents below the poverty line, compared with a high of 16% for Wayne County and a low of 11% for Allegheny County. Milwaukee County also had the second highest unemployed rate among this group.

Table 2: Milwaukee and benchmark counties: Comparative data, 2006

County	Population	Median household income	BA or higher	Living in poverty*	Unemployed**
Milwaukee	952,315	$41,308	25.1%	15.3%	5.7%
Allegheny	1,224,993	$43,691	32.4%	11.2%	4.4%
Cuyahoga	1,309,262	$41,522	27.0%	13.1%	5.6%
Franklin	1,109,067	$45,803	34.0%	11.6%	4.7%
Wayne	2,012,376	$41,784	19.5%	16.4%	8.4%

* 2000 data

** Average annual rate

Source: U.S. Census; Bureau of Labor Statistics

Examining Milwaukee County in a different context – its changing position in the state of Wisconsin – yields additional insight. As **Table 3** shows, over the past two decades, Milwaukee County has come to represent a smaller portion of the state's population and labor force, and it now has a lower family income and higher poverty rate than the rest of the state. Using ICMA's language, Milwaukee generates fewer resources yet greater social demands than it did two decades ago. It could be argued that this changing relationship means that state government can better respond to Milwaukee's rising needs. It might also be asserted, however, that Milwaukee County operates from a weakened demographic and economic position in making a case for more resources.

Table 3: Milwaukee's declining position in the State of Wisconsin

Key indicators	***1990***	***2007***
Milwaukee population as a % of WI population	19.6%	17.0%
Milwaukee civilian labor force as a % of WI civilian labor force	18.4%	14.8%
Milwaukee median family income as a % of WI median family income	94.7%	81.7%
Milwaukee % in poverty	15.4%	18.5%
Wisconsin % in poverty	8.5%	10.8%
Rate of change 1990 to 2007	***Milwaukee County***	***State of Wisconsin***
Population	-0.8%	14.5%
Civilian labor force	-3.6%	19.7%
Median family income	48.2%	71.8%

Source: U.S. Census; State of Wisconsin, Department of Workforce Development

Collectively, this summary of key environmental factors and the analysis by Moody's indicates that Milwaukee County government may be slightly better equipped than other major Midwestern county governments to grapple with its key fiscal challenges in light of its stronger property values, relatively diverse tax base and shelter from the extremes of the recent housing boom and bust. It is apparent, however, that its significant poverty rate and dwindling share of the state's population put Milwaukee County government in a precarious situation, as the demand for safety net services is likely to grow, but a potential loss of influence in Madison due to underlying demographic factors may make it more difficult to secure state resources necessary to meet that demand.

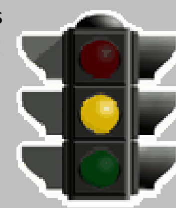
BUDGETARY SOLVENCY: REVENUES

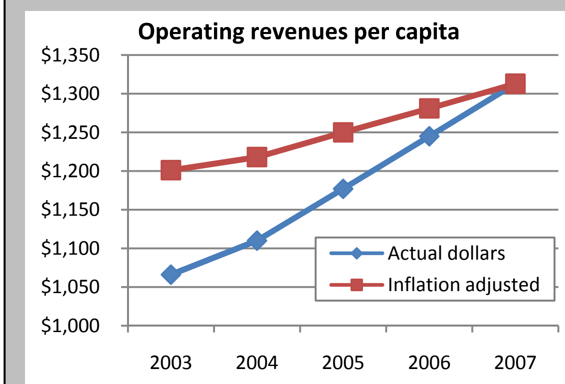
ICMA Fiscal Indicator 1 – Net Revenues per Capita

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

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

Milwaukee County Finding – Milwaukee County experienced a 9.3% growth in operating revenues per capita when adjusted for inflation, a positive overall trend that masked sizeable variations in individual revenue sources. In light of the inflexible nature of revenue sources that have exhibited growth, and the stagnant nature of flexible revenue sources, this is an area that **requires monitoring**.





Source: Milwaukee County, Comprehensive Annual Financial Reports (CAFR); U.S. Census

Analyzing revenues with the ICMA system

A key feature of any fiscal assessment is 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."

While steady revenue growth is of paramount concern, a government's fortunes also can turn on the *characteristics* of its revenues. Consequently, ICMA encourages analysis that examines aspects such as revenue flexibility and dependability. A local government's fiscal condition, ICMA points out, is strongest when it has diverse revenue sources that are not overly dependent upon external factors, when a significant portion of its revenues vary with the rate of inflation, and when its revenues are flexible and free from spending limitations.

A summary of revenue findings

Milwaukee County experienced positive revenue growth in the past five years. Per capita net operating revenues grew by 23% in current dollars and 9% in inflation-adjusted dollars. This growth was driven by a substantial increase in revenue derived from charges for service, including admissions fees, parking charges, bus fares and, most prominently, reimbursements for Family Care, inpatient mental health and other health care services. Local tax revenues derived from the property tax and sales tax showed a decline in inflation-adjusted dollars. Major state aids remained flat over this period and displayed a significant decrease when factoring in the effects of inflation.

The overall growth in revenue enhanced the county's ability to address some of its financial problems. However, the county's revenue picture remains troubled because of the inflexibility of charges for service revenue and the limited growth in more flexible fiscal resources. In fact, our analysis indicates underlying revenue warning signs the ICMA system was designed to uncover. The county's revenue base became more rigid—since charges for services typically cannot be used for general purposes, as can the property or sales tax—precisely at the time the county needed flexibility to address a dramatic increase in fringe benefit costs affecting all portions of its budget. The county did become slightly less dependent upon intergovernmental revenue, which is a positive development in the long run. In the short run, however, the decline in major state aids has greatly aggravated budgetary problems.

Analysis

Milwaukee County's revenue trends present a complicated mosaic in which the big picture is less relevant than the changes in individual revenue sources. **Table 4** demonstrates that Milwaukee County had more available resources in 2007 than five years before.[2] Gross operating revenues increased by $206 million (19%) in actual terms, and about 6% when adjusted for inflation. Net operating revenues (gross operating revenues minus revenues dedicated to debt service and capital outlays) per capita grew by 23% (as shown in **Fiscal Indicator 1**).

Table 4: Milwaukee County gross operating revenue

	2003	2004	2005	2006	2007**	Actual dollars Difference	Actual dollars % change	Inflation adjusted Difference	Inflation adjusted % change
Gross Oper. Revenues	**$1,071,601**	**$1,111,797**	**$1,161,897**	**$1,217,219**	**$1,277,531**	**$205,930**	**19.2%**	**$70,233**	**5.8%**
Intergovernmental	$429,832	$442,391	$439,448	$451,272	$485,433	$55,601	12.9%	$1,171	0.2%
Charges for Services	$133,191	$145,006	$166,392	$167,351	$190,576	$57,385	43.1%	$40,519	27.0%
Property Tax	$221,265	$220,612	$228,628	$234,317	$243,144	$21,879	9.9%	($6,140)	-2.5%
Sales Tax	$59,788	$61,123	$62,673	$63,654	$63,613	$3,825	6.4%	($3,746)	-5.6%
Family Care	$103,844	$125,898	$138,493	$158,997	$176,311	$72,467	69.8%	$59,317	50.7%
Airport	$42,960	$47,223	$50,824	$57,260	$59,490	$16,530	38.5%	$11,090	22.9%
Other	$80,721	$69,544	$75,439	$84,368	$58,964	($21,757)	-27.0%	($31,979)	-35.2%

* In thousands

** To provide equivalency for analytical purposes, the table counteracts a 2007 accounting change which shifted funds in the General Assistance Medical Program ($29,106,000 in 2007) from intergovernmental revenues to charges for services

Source: Milwaukee County, Comprehensive Annual Financial Reports

[2] The table lists Airport revenues separately because the Airport is a proprietary fund or "business enterprise." The Milwaukee County Transit System (MCTS) also is a business enterprise, but because it depends upon property tax funding and in this respect is indistinguishable from other county programs, it is not listed separately. Revenues of the Behavioral Health Division, prior to 2007 a proprietary fund, are included with other county funds for the same reason. Family Care is budgeted to a designated account that is separate from the county's General Fund because, like the Airport, its revenues fall under the category of "charges for services."

Intergovernmental revenue represents the largest source of revenue in Milwaukee County's budget, amounting to slightly less than $500 million in 2007 (see **Fiscal Indicator 2**). Direct federal revenues account for about 15% of the intergovernmental total, or roughly $75 million per year. The other funds come from the state as aids and contract dollars, or are combined with federal funds and distributed to counties under a state formula.

Historically, Wisconsin has appropriated a larger share of its revenue to support local governments and school districts than other states. This can be attributed in part to the fact that the state specifically created county governments to deliver certain services on the local level on its behalf. Many other states administer and provide more services themselves, particularly in the area of social services.

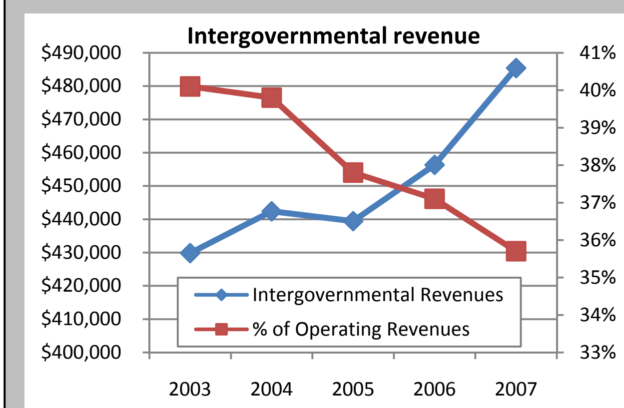
Table 5 spotlights the county's historical revenue profile. The data come from the 2002 U.S. Governmental Census of State and Local Governments, which has its own financial typology. As the table indicates, Milwaukee County at that time was less dependent upon local taxes and its own sources of revenue (which include charges for services) and more dependent upon intergovernmental revenue (mainly federal and state funds). These comparisons hold when Milwaukee County is compared with all Wisconsin counties, all counties in the United States, all U.S. counties with a population of more than 500,000, and two of the four Midwest benchmark counties (Wayne and Allegheny).

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

Why it is important – As an administrative agent of the state and, indirectly, the federal government, a county government depends upon the receipt of intergovernmental revenue. In the short run, a decline in intergovernmental revenue places pressure on operating budgets and local resources. In the long run, however, overdependence upon such aid can be harmful since federal and state governments can reduce local aid in order to manage their own budgetary problems.

ICMA Warning Sign – Increasing amount of intergovernmental operating revenues as a percentage of gross operating revenues.

Milwaukee County Finding – Milwaukee County government saw a drop in intergovernmental revenue as a percentage of gross operating revenues from 40.1% in 2003 to 35.7% in 2007. As noted in **Table 4**, a 2007 accounting change of $29,106,000 contributed to some of this decline. Without this reporting change, intergovernmental revenues would have represented 38.0% of all gross operating revenues in 2007. This trend is positive in the long run since the county has lessened its dependence on external revenue sources. In the short-run, however, limited intergovernmental revenue growth, especially in state aids, has greatly exacerbated budgetary problems. This is an area that **requires monitoring**.



Source: Milwaukee County, CAFR

Table 5: Milwaukee County: Major revenue sources compared with other counties

	Local taxes	Intergovernmental	Other
Milwaukee	23.4%	48.9%	27.7%
All Wisconsin	29.5%	46.3%	24.2%
All U.S.	34.6%	38.0%	27.4%
U.S. > 500,000	33.2%	41.1%	25.7%
Allegheny	20.9%	64.2%	14.9%
Cuyahoga	26.8%	45.9%	27.3%
Franklin	37.9%	37.4%	24.7%
Wayne	12.6%	45.0%	42.4%

Source: U.S. Census of Governments, Finances of County Governments, 2002, Vol. #4, No. 3

Milwaukee County's reliance on intergovernmental revenue is contrary to ICMA's warnings against over-reliance on external revenue sources and is particularly troubling because it leaves the county susceptible to fiscal problems at other levels of government. Indeed, during the past decade, the state has not funded its major county aid programs across the state, and in Milwaukee County in particular, even at inflationary levels (see **Tables 6 and 7**).

The state's funding decisions have had considerable financial impact. Insufficient growth in major state aids not only has affected total funding, but also has constricted the county's financial management. These state aids are more flexible than many other county revenues. With the exception of mass transit assistance, they support general costs associated with state mandated services and are unlike other state and federal revenues that reimburse specific program costs. The major aids listed in **Table 7** totaled $186.1 million for Milwaukee County in 2007, or 77% of the county's property tax revenue. From 2003 to 2007, these aids declined by 1% in current dollars, and by 12% after adjusting for inflation.

Table 6: Major county aids: State funding for all Wisconsin counties

Year	Youth aids	Community aids	Urban transit systems	Income maintenance**	Shared revenue*	Total
2003	$88,737,931	$260,503,842	$98,700,000	$57,362,530	$193,500,000	$698,804,303
2004	$88,362,477	$260,310,880	$98,700,000	$54,629,518	$174,300,000	$676,302,875
2005	$88,290,200	$260,163,558	$98,700,000	$50,692,560	$174,400,000	$672,246,318
2006	$88,290,200	$261,118,416	$100,600,000	$51,585,061	$176,800,000	$678,393,677
2007	$88,290,200	$261,118,416	$102,600,000	$51,497,561	$176,600,000	$680,106,177
5-yr difference	**($447,731)**	**$614,574**	**$3,900,000**	**($5,864,969)**	**($16,900,000)**	**($18,698,126)**
5-yr % change	**-0.5%**	**0.2%**	**4.0%**	**-10.2%**	**-8.7%**	**-2.7%**
Inflation adjusted	**-11.7%**	**-11.0%**	**-7.7%**	**-20.3%**	**-19.0%**	

* County payments only

** Administrative allocations; does not include funds DHFS provides to counties for other IM functions

Source: State of Wisconsin, Legislative Fiscal Bureau

Table 7: Major county aids: State funding for Milwaukee County

Year	Youth aids	Community aids	Mass transit fixed route	Income maintenance	Shared revenue	Court support*	Total
2003	$31,566,398	$44,298,655	$49,284,220	$18,253,941	$37,129,675	$7,352,100	$187,884,989
2004	$31,333,869	$44,317,198	$49,284,220	$15,829,372	$37,158,572	$5,399,845	$183,323,076
2005	$31,528,585	$44,290,607	$47,684,220	$15,829,372	$37,119,068	$5,568,577	$182,020,429
2006	$31,463,988	$44,340,432	$49,763,550	$16,083,320	$37,102,054	$5,578,149	$184,331,493
2007	$31,369,948	$44,340,432	$50,806,000	$16,058,198	$37,094,446	$6,430,139	$186,099,163
5-yr difference	**($196,450)**	**$41,777**	**$1,521,780**	**($2,195,743)**	**($35,229)**	**($921,961)**	**($1,785,826)**
5-yr % change	**-0.6%**	**0.1%**	**3.1%**	**-12.0%**	**-0.1%**	**-12.5%**	**-1.0%**
Inflation adjusted	**-11.8%**	**-11.2%**	**-8.5%**	**-21.9%**	**-11.3%**	**-22.4%**	

* 2007 amount adjusted to create comparable year to year payment pattern

Source: Milwaukee County, Financial Records

In the past five years, Milwaukee County's receipt of intergovernmental revenue, as a percentage of its overall operating revenue, *has* been reduced (see **Fiscal Indicator 2**). This reduction, however, occurred at a time when the county could least afford a drop in revenue because of the rapid increase in expenditures it was experiencing (as will be explained in the following section). In addition, as discussed below, modestly reduced dependence on intergovernmental revenue was replaced not with greater reliance on local revenue sources, but with charges for service revenue that also is largely dependent upon external sources.

Finally, it should be noted that intergovernmental revenue as a whole did increase during the five-year period in actual dollars (though it was flat when adjusted for inflation). Further analysis indicates, however, that this growth is mainly attributable to three unique areas in human services and is unlikely to last: a three-year, $22 million grant for alcohol and substance abuse programs that already has been reduced and ultimately is likely to disappear; an increase in net Youth Aids revenue produced by a sharp reduction in commitments to state juvenile corrections institutions[3], which has proved to be unsustainable; and an increase in "waiver service" revenue from the federal government that is linked exclusively to the growth in costs associated with long-term care for persons with disabilities, and that also will be eliminated when this population is transferred to Family Care.

The county's second largest source of revenue is charges for services. These funds are collected from users and clients of the county's wide-ranging programmatic operations. Golf fees and marriage fees are categorized as a charge for service, as are zoo admissions, clerk fees, filing fees, parking fees, small claims payments, transit fares and other forms of business income. The county's most significant source of charges for service revenue comes from mental health and other health care programs, including reimbursement for services under the federal Medicaid program. In fact, health and social service revenue was the force that drove the significant

[3] As indicated in **Table 7**, the state's Youth Aids allocation to Milwaukee County decreased. However, the county only budgets as revenue the net amount of Youth Aids it receives, which consists of the gross allocation minus the amount withheld by the state as reimbursement for institutional charges.

overall increase in charges for service from 2003 to 2007, which in turn drove the county's overall revenue growth during the period.

As **Table 4** (see page 12) shows, charges for services under the Family Care program, which provides a variety of health care and supportive services for functionally eligible low-income residents age 60 and older, increased by $72 million (70%), from $104 million in 2003 to $176 million in 2007. This increase was spurred by significant program growth in terms of both the number of clients served and the cost of providing services. The county does not contribute local revenue to the Family Care program, but instead is reimbursed with state dollars derived from Medicaid under a "per member per month" rate negotiated with the state.

Combining charges for service revenue from the Airport and Family Care with those of other county operations demonstrates how this funding source drove overall revenue growth. Total charges for services amounted to $426 million when including Airport and Family Care revenue, or about one third of the county's $1.3 billion in total revenue in 2007, yet growth in this single revenue source constituted nearly three quarters of the county's $206 million overall revenue increase from 2003 to 2007. Or, put a different way, charges for services increased 52% during this period, considerably more than the 12% increase in inflation. All other types of revenue, totaling $851 million in 2007, increased by 7%, or slightly more than half the rate of inflation. **Table 4** suggests, therefore, that revenue growth was highly uneven, an important characteristic from ICMA's standpoint.

In general, charges for services provide limited flexibility, since they primarily support specific operational costs. Some charges for service revenue, such as that received under the Family Care program, cannot be used for other purposes. This contrasts with property tax revenue, which is highly flexible and can be transferred among programs without restriction. Management, however, does have prerogatives in the use of some charges for service revenue, as subsequent discussion will show. A few departments generate sufficient income or surplus from charges for services that allows them to support all of the costs associated with the service and still have excess left over to help reduce the total county property tax levy. Revenues from fees charged by the Register of Deeds, for example, lowered the county's tax levy by $4.2 million in 2007.

Since charges for services fund direct operational costs, this resource might be viewed as more secure or more dependable than other resources. County operations funded by charges for services but not supported by state or local taxes are more sheltered from non-departmental influences and more open to pure "business" considerations in the setting of fees. On the other hand, for those operations funded by a variety of revenues, a downturn in charges for service can place pressure to increase other sources of funds to prevent a cut in service. In addition, some charges for services are not divorced from intergovernmental funding. A significant reduction in Medicaid funding, for instance, would have major repercussions for the county's finances since Medicaid provides resources that support many of the county's health care programs.

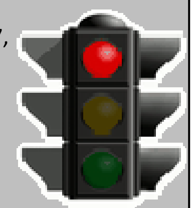
As noted above, ICMA points out that a local government ideally should have a diverse mix of revenue sources, and particular importance is given to sources that are not dependent upon other governmental entities and that are flexible and free from spending limitations. Property and local sales tax revenue are the two county revenue sources that fit that description, but these represent only about one quarter of Milwaukee County's funding (the property tax constitutes about 19% of the county's total operating revenue while the sales tax accounts for 5%). **Our analysis indicates that Milwaukee County generally receives a smaller share of its revenue from local taxes than many other counties in the state and nation** (see **Table 5).** Undoubtedly, the level of taxes at "overlapping" districts, such as the Milwaukee Public Schools and the City of Milwaukee, have played some role in keeping property taxes flat in recent years. Other contributing factors include the current county executive's opposition to any tax increases and the public outcry against past county spending decisions, such as the increases in pension benefits approved in 2000.

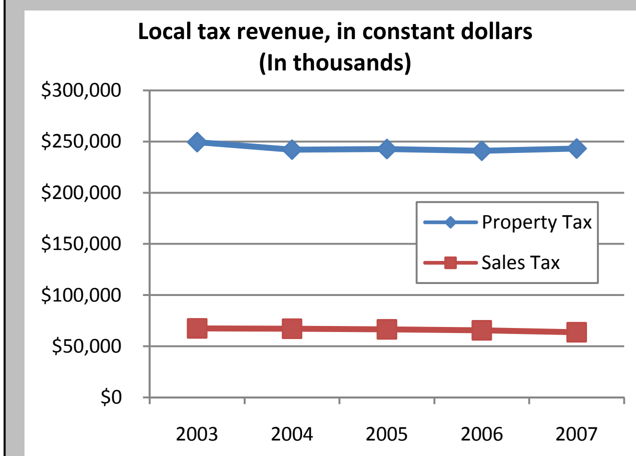
ICMA Fiscal Indicator 3 – Local Tax Revenue

Why it is important – Local tax revenues consist 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.

Milwaukee County Finding – From 2003 to 2007, local tax revenues declined by 3.1% in constant dollars, posing a **significant threat** to the county's fiscal condition when combined with extraordinary expenditure pressures.





Source: Milwaukee County, CAFR

As **ICMA Fiscal Indicator 3** indicates, local tax revenues have not quite kept pace with increases in inflation. In Wisconsin, property tax increases are "capped" by 1993 and 2005 state law. However, at the current time, this cap is moot for Milwaukee County since its levy falls below the state permitted maximum.

Sales tax revenue has shown the slowest rate of increase, growing by 6% over the five years but remaining flat in 2005 and 2006. In constant dollars, sales tax revenue fell by 6%. Most sales tax revenues are allocated for debt service payments in keeping with the original intent of this tax. {**Note**: In November 2008, voters approved an advisory referendum that proposed broadening the use and increasing the rate of the sales tax. The approval of the legislature and governor would be needed before a sales tax increase could take effect. Specifically, the referendum asked voters whether they favored an increase in the county sales tax from 5.6% to 6.6%, with proceeds to fund parks, transit, emergency medical services and property tax relief. The proposed sales tax increase would generate approximately $130 million annually. The referendum also proposed cutting the property tax levy by $67 million, as services previously funded by property taxes instead would be funded with the increased sales tax revenue.}

In summary, Milwaukee County's overall revenue growth during the past five years is consistent with ICMA's emphasis on maintaining steady revenue growth. **That finding, however, should not mask the warning signs generated by the composition of the county's revenue streams and the worrisome negative trends in certain key revenue sources.**

Milwaukee County is far more reliant on external revenue sources – in particular the State of Wisconsin – than is deemed healthy by the ICMA guidelines, and it can be argued that it also is not reliant enough upon local tax revenue. Both of those areas have trended negatively since 2003, with revenue from major state aid programs down considerably in inflation-adjusted dollars, and revenue from property and sales taxes down moderately. The county has been able to increase revenue from charges for services, which constitutes a positive step as defined by the ICMA guidelines, but which affords limited flexibility to address key fiscal issues. In fact, a sizeable portion of the growth in charges for service revenue comes from Family Care and cannot be used to replace other revenue sources. All of this adds up to cause for concern as Milwaukee County looks to the future.

BUDGETARY SOLVENCY: EXPENDITURES

Analyzing expenditures with the ICMA system

As with revenue, the ICMA system examines expenditure activity not only in regard to growth, but also to provide insight into underlying fiscal conditions. Obviously, trends in expenditures cannot exceed trends in revenues without dire consequences for budgetary solvency. Yet, other expenditure patterns also can present financial complications. For instance, a sharp rise in expenditures can create problems of long-term sustainability, even if revenues are available in the short-run to cover such costs.

The ICMA system encourages in-depth examination of expenditures and how they contribute to budgetary solvency. ICMA suggests, for example, that fiscal analyses look at the forces 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 county expenditures reveals that the vast majority of Milwaukee County's expenditure growth from 2003 to 2007 is attributed to charges for service and fringe benefit expenditures. The county's overall operating expenditures and net expenditures per capita grew at a rate that maintained budgetary balance. However, 83% of the total expenditure increase occurred in the operating budgets of just six departments that have sizeable charges for service revenue. Departments that depend upon other revenue streams experienced limited expenditure growth and considerable financial strain.

County fringe benefit expenditures – consisting primarily of health care and pension costs – increased by $72.6 million, or 72%. By 2007, expenditures on fringe benefits constituted 17% of all operating expenditures and 69% of salaries and wages. Meanwhile, the rising cost of health care in general and poor investment returns on pension fund assets caused the unfunded liability for retiree benefits to grow to more than $2 billion. The need to fund retiree costs has placed severe strain on other areas of the budget. For instance, budgeted salary and wage expenditures declined 6% from 2003 to 2007. Despite these fiscal pressures, the county continues to provide virtually all of the same programs and services it did five years ago.

Table 8: Milwaukee County net operating expenditures

	2003	2004	2005	2006	2007	5-yr change
Total Expenditures	**$937,274**	**$998,034**	**$1,036,990**	**$1,084,303**	**$1,157,507**	**$220,233**
Leg, Ex, & Staff	$39,257	$38,246	$38,774	$37,729	$36,094	($3,163)
Courts & Judiciary	$52,862	$55,748	$57,456	$56,964	$61,120	$8,258
Gen Gov't	$6,775	$6,608	$8,203	$7,731	$7,886	$1,111
Public Safety	$126,758	$135,596	$136,398	$136,634	$147,082	$20,324
Pub Works & Transpor.	$180,181	$191,333	$199,102	$207,413	$219,071	$38,890
Human Services	$458,933	$491,250	$519,050	$564,464	$617,455	$158,522
Parks, Rec & Culture	$65,749	$61,640	$62,026	$63,366	$65,638	($111)
Other	$6,759	$17,613	$15,981	$10,002	$3,161	($3,598)

Source: Milwaukee County, CAFR's, 2003-07

Analysis

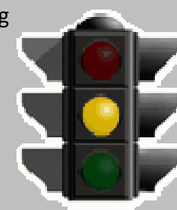
Milwaukee County net operating expenditures (total expenditures minus debt service and capital outlay) increased by $220 million from 2003 to 2007, or slightly less than the increase in net operating revenues. **Table 8** breaks down net operating expenditures during this period by government function. With little change in population, per capita expenditures displayed a similar increase, as seen in **ICMA Fiscal Indicator 4**.

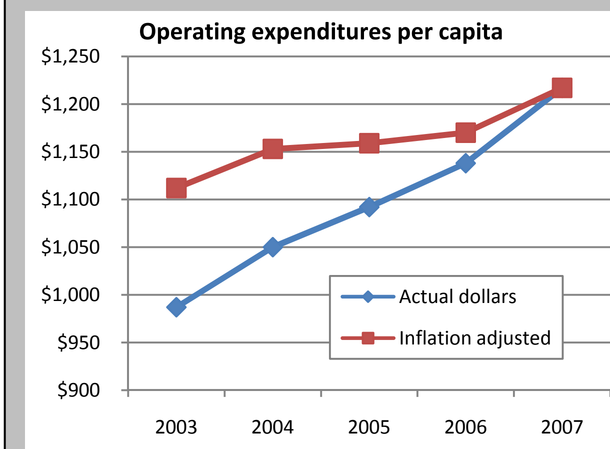
ICMA Fiscal Indicator 4 – Net Expenditures Per Capita

Why it is important – In a state of fiscal health, a government's per capita expenditures in constant dollars are holding nearly level or increasing slightly and should not exceed per capita operating revenues. Expenditures that increase too rapidly may surpass long-term funding sustainability.

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

Milwaukee County Findings – Net operating expenditures per capita increased by 9% in constant dollars from 2003-07. While an increase of this magnitude is not cause for alarm, the fact that it is attributed substantially to two areas (fringe benefits and human services) **requires monitoring**.





Source: Milwaukee County, CAFR, U.S. Census

Expenditures can rise for many reasons, including establishment of new programs, rising costs, or a change in productivity or population. In the case of Milwaukee County, increases in a few large departments, funded mostly by charges for services, and escalating fringe benefit costs drove the overall expenditure increase.

Charges for services

Table 9 – compiled with information from the county's financial records – demonstrates how a few large units generated most of the expenditure increases during this period. **The greatest gains occurred in health and social service programs funded primarily by charges for service revenue.** For example, Family Care expenditures rose by $72 million (58%), Department of Health and Human Services by $33 million (21%), Behavioral Health Division by $30 million (22%) and County Health Related Programs by $27 million (73%). In total, these units accounted for more than $160 million of the county's total expenditure growth.

When the two units with the next highest rise in expenditures are added—the Airport (a $13 million increase or 24%) and the Milwaukee County Transit System (a $10 million increase or 7%)—the resulting group of six departments and divisions accounts for $184.7 million, or 83%, of the $220 million expenditure increase from 2003 to 2007. These two divisions also rely heavily on charges for services. In contrast, the other 30-odd units in county government, which are funded mostly by property tax levy and intergovernmental revenue, and which together constituted one third of total county spending, saw their expenditures grow by 9% over five years, just two-thirds the rate of inflation.

Table 9: Health, social service, and business enterprises drove expenditure growth

	2003-2007 difference	2003-2007 % change
Department on Aging	$71,819,600	58%
Department of Health & Human Services	$33,228,700	21%
Behavioral Health Division	$30,181,300	22%
County Health Related Programs	$27,163,800	73%
Airport	$12,676,400	24%
Milwaukee County Transit System	$9,630,300	7%
Total Expenditure Increase for Six Units	**$184,700,100**	**--**
Six Units Percent of All County Expenditure Increase	**83.4%**	**--**

Source: Milwaukee County, Financial Records

Fringe benefits

Fringe benefit increases were the second major factor driving growth in county spending from 2003 to 2007, resulting from a dramatic rise in health care and pension costs. As shown in **ICMA Fiscal Indicator 5**, Milwaukee County's fringe benefit expenditures grew from $101 million in 2003 to $174 million in 2007. By 2007, fringe benefits constituted 17% of all County net operating expenditures (compared with 13% in 2003) and 69% of wage and salary expenditures (compared with 41% in 2003). **The total fringe increase of $73 million amounted to about one third of the overall increase in county expenditures.**

Remarkably, when fringe benefit increases are combined with the expenditure increases of the six units shown in **Table 9**, the total of $226 million exceeds the overall expenditure increase for the county by $6 million (this total subtracts fringe benefit increases in the six units to avoid double counting). In other words, the remainder of county government saw expenditures decline during this period.

Health care costs rose precipitously between 2003 and 2005 before the county made a concerted and largely successful effort to control them. Costs increased by 17% in 2004 and 21% in 2005, before the growth was reduced to 3% in 2006 and close to zero in 2007. Nevertheless, by 2007, health care costs had climbed to $122 million, or 49% of budgeted salary and wages.

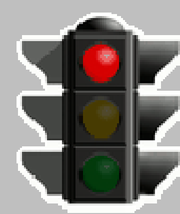
The single biggest factor in controlling these expenditures was the county's decision to convert from a fully insured to a self-insured health insurance model in 2006. Other contributing factors were changes in labor agreements and creation of a new Division of Employee Benefits within the Department of Administrative Services to manage the fringe benefits program. In addition, the county has initiated a Wellness and Disease Management Program and, effective January 1, 2009, has a new third party administrator contract that is expected to save nearly $10 million in the 2009 budget. Nevertheless, the county expects health care costs to begin increasing again at approximately 10% per year in future years, which would necessitate adding more than $13 million annually to the operating budget.

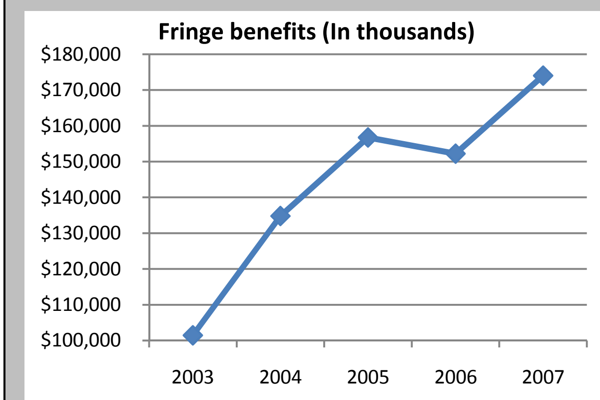
ICMA Fiscal Indicator 5 – Direct Fringe Benefits

Why it is important – Direct fringe benefits constitute 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 and this expenditure rise has had a debilitating effect upon budgets and fiscal condition.

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

Milwaukee County Finding – From 2003 to 2007, direct fringe benefits grew by $72.6 million or 71.5%, posing a **significant threat** to the county's fiscal health. By 2007 fringe benefits had become 69.4% of salaries and wages and 17.4% of all operating expenditures.





Source: Milwaukee County, Financial Records

The rapid increase in Milwaukee County health care expenditures during the early part of the decade reflected not only the general increase in health care costs throughout southeast Wisconsin and the nation, but also growth in the number of Milwaukee County retirees, most of whom enjoy a generous health benefits package. Those retiring from Milwaukee County government who began employment with the county prior to 1994, and who accrued 15 or more years of service (a group that includes most new retirees), continue to receive county health insurance and do not have to pay a monthly insurance premium.

The fiscal impact of this benefit is substantial and has created a situation in which nearly half of the county's health care costs are attributed to retired workers. In addition, because of the methodology utilized by the county to distribute health care costs across departments, the per-worker cost for health care is sizeable. In the 2008 budget, for example, the county attributed a health care cost of $27,169 for each budgeted full-time employee. Of that amount, $13,898 represented the cost for an active employee, while the remaining $13,271 was the per-worker cost of providing health care to retirees.

Even that cost is minimized by the fact that Milwaukee County largely funds its retiree health care costs on a "pay-as-you-go" basis, i.e. it pays for the annual health care costs incurred by retirees but, for the most part, does not fund its future health care liabilities. In contrast, the county makes a substantial annual contribution to fund future liabilities in its Employee Retirement System, otherwise known as its pension fund.

Substantial non-pension retirement benefit liabilities are not unique to Milwaukee County. In 2004 the Governmental Accounting Standards Board (GASB) issued a rule known as GASB #45, which requires local governments to include in their financial statements "the total amount that will be owed to all employees when they are retired." GASB #45 does not state that these Other Post-Employment Benefits (OPEB) must be pre-funded. Rather, the idea is that, by shining light on the problem and making governments identify all future OPEB costs, GASB #45 will facilitate the development of corrective policies and practices.

In accordance with GASB #45, Milwaukee County's Comprehensive Annual Financial Report (CAFR) included for the first time in 2007 an estimate of its OPEB unfunded liability, which was based on a 2006 actuarial analysis and identified at $1.3 billion. Under pay as you go, the County spent $60 million for retiree health care in 2007. However, as the 2007 CAFR shows, fully funding OPEB costs by amortizing the unfunded liability over 30 years would have required an additional OPEB payment of $50 million in 2007, resulting in nearly $110 million in total expenditures for retiree health benefits. *(See the section of this report on long-run budgetary solvency for additional discussion of the implications of this unfunded liability.)* It should be noted that GASB #45 requires business enterprise units within governments to make actuarially determined payments for their unfunded OPEB liability, and starting in 2007 the Milwaukee County Transit System, the Airport and some smaller internal service departments began to do so.

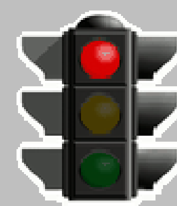
ICMA Fiscal Indicator 6 – Pension Plan Funding

Why it is important – Pension funding represents a significant cost for governments that participate in state plans and, especially, governments such as Milwaukee County that have their own plan. Significant increases in required government contributions can place strong pressure on government budgets. Because of the long-term nature of these plans, the difficulty of estimating the value of assets and liabilities, and the costs involved, local governments also 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

Milwaukee County Finding – From 2003 to 2007, Milwaukee County's annual required contribution rose from $23 million to $53 million. Actual payments were roughly equal to these contributions except in 2006, when the county underfunded the plan by $25 million. Throughout this period, the county's unfunded liability has been at about 20%. Stated differently, assets (actuarially determined) constitute about 80% of estimated future costs (actuarially determined). The ratio of the value of assets to benefits paid has improved from 9 to 1 in 2004 to 12 to 1 in 2007. The county's inability to fully fund its required contribution and the growth in the pension fund's unfunded liabilities represent a **significant threat** to its fiscal health.



Pension contributions and actual expenditures			
Year	Annual required contribution	Actual expenditure	% of ARC
2003	$23,131	$15,003	see text
2004	$33,248	$35,249	106.0%
2005	$37,438	$35,415	94.6%
2006	$52,638	$27,435	52.1%
2007	$53,063	$49,291	94.1%

Source: Milwaukee County, CAFR

Pension obligations: funding ratio			
Year	Actuarial value of assets	Actuarial accrued liability	Funded ratio
2003	$1,446,726	$1,707,999	84.7%
2004	$1,424,918	$1,782,884	79.9%
2005	$1,454,302	$1,909,321	76.2%
2006	$1,525,532	$1,931,220	79.0%
2007	$1,627,288	$2,024,923	80.4%

Source: Milwaukee County, CAFR

Pension assets			
Year	Actuarial value of assets	Benefits paid to retirees	Funded ratio
2003	$1,446,726	$111,110	13 to 1
2004	$1,424,918	$161,369	9 to 1
2005	$1,454,302	$148,308	10 to 1
2006	$1,525,532	$130,731	12 to 1
2007	$1,627,288	$139,991	12 to 1

Source: Milwaukee County, CAFR

The county's Employee Retirement System expenditure trajectory resembles that of health care. In 2000, the county paid only $629,300 into its pension fund because the "over-funded" nature of the fund (i.e. excess of fund assets over liabilities) offset annual growth in pension obligations to active employees. By 2002, due to poor investment returns and the pension enhancement package adopted in 2000, the county budgeted a $15 million pension fund contribution, and by 2007 its pension fund contribution was $49.3 million, or 20% of budgeted salary and wage expenditures. Both pension fund and retiree health care spending also were significantly impacted by a huge spike in county retirements in the 2002-2004 period. County retirements totaled 350 in 2002, 290 in 2003, and 750 in 2004 before dropping to a more typical 186 in 2005.

Even with the dramatic increase in property tax levy-funded pension fund contributions, the county could not meet all its pension obligations, and a growing unfunded liability resulted (see **ICMA Indicator 6**). The ratio of assets to liabilities, as determined by actuarial analysis, dropped from 130% in 1999 to 80% in 2007. By the end of 2007, the county's unfunded liability amounted to $397 million, and a new estimate at the end of 2008 fixed it at more than $900 million. Also, a report from the county's pension fund actuary in November 2008 estimated that the market value of the fund had decreased to $1.12 billion – down more than $400 million from the $1.55 billion reported as of July 1, 2008.

In sum, the rise in fringe benefit expenditures experienced by Milwaukee County from 2003 to 2007 is best put into perspective as follows:

- The unfunded liability of the Employee Retirement System rose to $397 million at the end of 2007 and then again to more than an estimated $900 million in late 2008. The unfunded OPEB liability is at $1.3 billion. Taken together, the county's total unfunded liability for retiree benefits was roughly $2.2 billion at the end of 2008.

- The actuarially determined annual pension fund contribution fluctuated greatly, forcing sizeable and yearly budgetary adjustments. The county contribution grew by $22 million from 2002 to 2003, fell by $8 million from 2005 to 2006, and then climbed by $22 million from 2006 to 2007. Such spending swings are difficult for the county to accommodate since it has few reserves and is prohibited from carrying over annual departmental surpluses to the following year.

- The rise in fringe benefit costs placed severe restraints upon the county budget and, as a result, few other types of expenditures rose during this period. For example, while fringe benefits grew by $73 million, budgeted salary and wage expenditures actually *declined* by 6%, from $254 million in 2003 to $239 million in 2007.

- An increasing share of the county's budget was devoted to retiree costs; while health care and retiree payments provide real benefits to former employees, by definition, they contribute nothing to current operations.

- The rise in health care costs meant that fixed costs composed a greater proportion of the county's operating expenditures. These are costs that officials and administrators have limited ability to reduce or shift to other purposes. Health care costs may vary in their rate of increase, but the base amount rarely goes down. The rise in fixed costs is particularly challenging for the county given the number of programs and services it is mandated by state government to administer or deliver, regardless of its fiscal challenges. A 2003 internal county study estimated that 54% of the county's property tax levy funds were either for mandated services or were committed in accordance with outside funding agents such as state government.

As the preceding discussion has demonstrated, retiree costs represent an enormous and growing share of county expenditures. These cost increases not only have placed pressure on other expenditure categories, such as wages and salaries, but they also have placed pressure on the ability of the government to deliver services and respond to citizens' demands and needs.

In light of the pressures Milwaukee County has experienced, it is reasonable to expect that it would have cut back on the range and type of services it delivers, thereby reducing demand and controlling costs. The county has, indeed, made some decisions on priorities, reworked programs, and shifted tax funds, as will be shown later in this report.

Yet, for the most part, the county has maintained all of its existing programs and services during this time and, in many areas, service activity has increased. **Table 10** presents service information related to major state aids. This information, coupled with revenue data for state aids in **Tables 6** and **7**, suggests that despite both a decrease in state assistance and increased fringe benefit costs, more citizens are being served. This is in part attributed to the fact that the county is mandated by state or federal law to provide service to citizens based on their eligibility for most of these programs, without regard to the county's fiscal constraints.

This finding begs the question as to whether the effort to serve growing numbers of eligible citizens with fewer resources has come at the expense of a decline in the quality of services provided. Unfortunately, the county collects little performance data, which makes an analysis of service quality virtually impossible to undertake. A Public Policy Forum survey undertaken in June 2008 found that slightly more than half of the respondents believed Milwaukee County services were "good or excellent." Fewer than 10% believed services were "poor." The Airport and Zoo received the highest approval, corrections and mental health services the lowest.

Table 10: Milwaukee County government: Service activities related to major state aids

Income Maintenance		
Year	Food Stamps*	Day Care*
2003	56,959	12,109
2004	48,418	13,236
2005	58,546	12,510
2006	59,910	13,141
2007	60,089	13,420
5-yr difference	**3,130**	**1,311**
5-yr % change	**5.5%**	**10.8%**

* Average cases in a month

Mass Transit-Bus Service		
Year	Miles of Service	Hours of Service
2003	19,745,234	1,468,383
2004	19,341,298	1,432,220
2005	19,267,476	1,433,523
2006	18,934,841	1,419,603
2007	18,494,513	1,376,762
5-yr difference	**-1,250,721**	**-91,621**
5-yr % change	**-6.3%**	**-6.2%**

Youth Aids			
Year	Before Deposition*	After Disposition*	Total
2003	3,169	1,273	4,442
2004	2,678	1,393	4,071
2005	2,853	1,513	4,366
2006	2,828	1,632	4,460
2007	2,598	1,748	4,346
5-yr difference	**-571**	**475**	**-96**
5-yr % change	**-18.0%**	**37.3%**	**-2.2%**

* Number of youth served

Courts	
Year	Cases Filed
2003	139,840
2004	142,427
2005	140,242
2006	158,104
2007	162,994
5-yr difference	**23,154**
5-yr % change	**16.6%**

Behavioral Health Division: Work Volume Statistics*				
Year	Acute Adult Inpatient Admissions	Community Support Program Patients	Targeted Case Management Patients	Psychiatric Admissions
2003	2,253	468	382	11,981
2004	2,483	422	386	12,383
2005	2,520	426	377	12,391
2006	2,713	436	354	13,018
2007	2,729	415	333	12,568
5-yr difference	**476**	**-53**	**-49**	**587**
5-yr % change	**21.1%**	**-11.3%**	**-12.8%**	**4.9%**

* Relates to Community Aids

Source: Milwaukee County, Adopted Operating Budgets and Program Records

BALANCING THE BUDGET: IMPLICATIONS FOR BUDGET AND SERVICE SOLVENCY

Analyzing budgetary and service solvency with the ICMA system

The ICMA system pays close attention to how a local government balances its budget and considers the impacts of budgetary action upon both immediate and long-term solvency. ICMA wants to know whether budgetary practices are strengthening or weakening fiscal condition. One concern is the balancing of a budget through one-time measures that avoid red ink but do not fundamentally correct an imbalance between revenues and expenditures.

Going beyond the budget, ICMA also emphasizes that expenditures and budgetary actions are a lens through which to view levels of service. While ICMA does not prescribe specific service solvency indicators, it does strongly suggest that fiscal assessments not ignore service impacts that result from budgetary management strategies and decisions.

Summary of budgetary and service solvency findings

The county's fiscal actions over the past five years have had varied effects upon budgetary solvency. While some actions have been positive, Milwaukee County's fiscal condition has worsened in major respects and serious problems exist. Milwaukee County deliberately has controlled expenditure growth and budgetary pressure through cutbacks in personnel, a strategy that has produced fiscal benefits. Other strategies and practices, formulated either by design or happenstance, have been less beneficial.

One negative approach is the county's use of one-time revenues and accounting changes to maintain a positive fund balance. It also has depleted reserves and used federal capital funds to plug a widening gap in the operating budget of the Milwaukee County Transit System, creating an impending deficit exceeding $20 million. Understandably, the county has made use of its varied financial resources, including use of charges for service revenue when possible, to attempt to accommodate the tidal wave of rising fringe benefit costs. Yet, the approach to funding fringe benefits largely has reflected past practice, rather than attempting to respond to the exceptional nature of these costs in ways that maximize financial resources and reflect strategic goals.

The budgets of most Milwaukee County departments and divisions look fundamentally different than they did five years earlier. Many have seen their budgets grow or shrink in dramatic ways. Meanwhile, the impact of rising fringe benefit expenditures has eaten away at the purchasing power of many departments and divisions, including some delivering core, internal services.

Overall, the county's response to its fiscal challenges has been largely short-term and non-strategic, leaving it in a weakened fiscal condition and far less capable of addressing unresolved structural issues, unforeseen developments, and rising future costs. Furthermore, the lack of strategic focus has eroded programmatic and operational capabilities sufficiently to bring into question not only the county's budgetary solvency, but its service solvency as well.

Analysis

While this report relies upon detailed fiscal analysis, the county's sense of mission and history may offer context to help explain recent developments. It is important to understand, for example, that the size and scope of county program operations are not recent creations, but reflect long-standing commitments. For instance, social service programs, or "relief" as they were once known, have been a major part of the county's operations for more than 100 years. In 1931, for instance, relief occupied one half of the county's budget. Also, the county's extensive parks system, which in most other metro areas is the responsibility of local municipalities, became a county responsibility in the 1930's when the City of Milwaukee transferred ownership of most parks to the county. The county's' transportation responsibilities have similar deep-seated roots, especially for highways and aviation.

In order to understand today's county government, it also is important to recognize the extensive capital infrastructure it has built over the years to support program operations. In the 1960's, the City of Milwaukee annexed major areas, especially on its northern borders, but other parts of the county rejected annexation and instead chose to incorporate as cities or villages to keep their jurisdictional independence and improve their level of service. To meet the latter need, the county responded aggressively in providing facilities and programs. For instance, park expenditures, which totaled $5 million in 1955, grew to $34 million in 1978, and the county built new facilities for the Mitchell Conservatory and the Milwaukee County Zoo.

Today, the slow disappearance of Milwaukee's robust industrial economy, as well as population decline and stagnation, has put an end to the unimpeded growth of many county programs and generated interest in cost efficiency. The county has assumed no new functional responsibilities in several decades, and tax reduction initiatives have gathered momentum. In response to rising budgetary pressures, the county sold Milwaukee County Stadium to the Milwaukee Brewers in 1992 and closed Doyne Hospital in 1995. Nevertheless, the County's fundamental responsibilities remain unchanged and citizens continue to voice demands for improved and more responsive service.[4]

In sum, the county's budget is a reflection of its own unique history, a heritage that county officials have modified and adapted, but whose scope remains in most aspects unaffected. Elected officials' inability or preference not to reformulate this mission – despite the revenue and expenditure challenges detailed in previous sections – has inevitably led to a reliance on incremental budget-balancing strategies, including the use of short-term strategies to delay difficult budget choices.

The seriousness of the county's fiscal condition is hardly news. Indeed, county administrators have made this case for a number of years. For example, the county executive's "Reality Tour" in the spring of 2006 seemed eager to dispel the notion that easy answers might resolve the fiscal crisis and predicted an impending deficit of $80 million in the next fiscal year. Documents from

[4] The State of Wisconsin's recent announcement that it plans to assume responsibility for the county's public assistance programs represent a change in management, but the plan proposed by the state still would utilize county front-line workers.

county presentations declared that "eliminating discretionary funding… and property tax growth will not close the gap," that "the state cannot afford to bail out Milwaukee County," and that "business as usual is not an option." A five-part investigative series by the *Milwaukee Journal Sentinel* in May 2006 gave supporting evidence to such claims. The *Journal Sentinel* concluded that, while talk of insolvency was exaggerated, county government was "running out of options and time."

Despite these somber, if not dire, assessments, a financial collapse has not occurred. Why not? What has the county done to avoid the impending fiscal crisis, or has it merely been postponed?

Budget balancing policies and practices

In order to respond to these questions, it is first necessary to look at the major policies and practices the county has used to balance its budget in the past five years. These are:

- Spreading of retiree costs across departmental units
- Reordering of priorities funded by local taxes
- Cutting back on county personnel
- Reducing annual debt service payments
- Delaying action on the structural deficit facing the Milwaukee County Transit System
- Using one-time revenues, accounting changes and other short-term measures

Spreading Retiree Costs. One of the least discussed, yet critical budget-balancing practices has involved the manner in which the county has funded its massive increases in fringe benefit costs. By traditional budgetary practice, fringe benefit costs are budgeted as part of a departmental unit's personnel costs and are allocated by assigning a fringe benefit cost to each full-time position. The logic behind this approach is that decisions about position levels should reflect their true costs, not merely salary and wages.

A question arises, however, as to whether fringe benefit costs associated with retired workers should similarly be attached to active positions. This is especially pertinent in the case of Milwaukee County, in light of the size of its retiree liabilities and the fact that these costs are unconnected to current operations and position levels. Hypothetically, the county could elect to fund retiree costs centrally or allocate them to units in a different manner. However, the county has decided to combine retiree costs with active employee fringe costs and spread them to all units based on the number of full-time employees in the unit.

The county's method of funding retiree costs therefore distributes them across all types of operations and funding sources. The reasoning behind this approach is that multiple funding sources supported retirees during their employment and should do so in retirement. However, **the reality is that each department head must face a stark choice when confronted with a sizable increase in the department's fringe benefit allocation each year: either increase operations related to program revenue and/or charges for service to fund increased fringe benefit costs (if possible), or cut back on other expenditures and reallocate the resulting savings to the fringe benefit budget line**.

A positive impact of this approach is that those departments that can tie cost increases to increased charges for service or contracts with other levels of government can pass on an increasing share of the county's retiree payments to users of services or other governments. Given the costs involved, however, it is not surprising that there also are negative impacts, not the least of which are budgetary changes that have little relationship to the priorities of policymakers or the needs of citizens.

Many county departments and divisions, for instance, are funded either entirely or primarily by the tax levy and do not have access to other revenue sources. Others find it difficult to incorporate higher fringe benefit costs in ongoing operations for various reasons, including the fact that raising service charges may risk a loss in demand and base revenue or may be protested by the client. Such additional costs also make it harder to undertake new program or service ventures.

Also, creating a fringe benefit allocation that combines retiree and active worker costs can create distortion and confusion about the marginal cost of adding a new employee, an important consideration when the growth of program revenue operations is a piece of the funding puzzle. This distortion also can obfuscate consideration of potential outsourcing or privatization plans.

Finally, it is worth noting that a department or division can lower its retiree costs by reducing its position total and is incentivized to do so; yet, the savings for the county as a whole are much less significant. Each position eliminated saves only the health care and pension costs associated with the active employee. The retiree costs attached to the position are allocated elsewhere when the position is eliminated. In fact, the net effect of a position reduction is to increase the fringe benefit cost associated with remaining positions.

The current method of funding retiree costs based on number of active employees has had distributional effects among the county's administrative units. **One consequence is that units that have a smaller proportion of personnel costs as part of their budget are comparatively better off—that is, they have lower retiree costs—than units that have more employees**.

Table 11 shows those departments that incurred the largest fringe benefit expenditures in 2007. The group of ten accounted for $145 million (83%) of the $174 million total for the County. As explained above, fringe benefit allocations varied with personnel costs, and thus the listed expenditures represented varying percentages of each department's budget. For example, fringe benefits represented 40% of the Sheriff Department's budget, while the Department on Aging, which utilizes the bulk of its funding to pay community-based care providers and therefore has fewer county personnel, had only $4.7 million in fringe benefit expenditures out of its total $194.6 million in expenditures.

Table 11: County departments w/largest fringe benefit expenditures, 2007

	Unit fringe benefits	Fringe benefits as % of expenditures
Sheriff	$30,410,300	40.5%
Behavioral Health Division	$28,157,300	16.7%
Health and Human Services	$24,450,500	12.6%
House of Correction	$16,284,700	32.2%
Combined Court Related Operations	$10,009,400	23.4%
Public Works	$9,592,900	20.3%
Parks	$8,303,200	21.5%
Airport	$6,640,200	10.3%
District Attorney	$5,678,600	32.2%
Child Support Enforcement	$5,634,400	30.7%
Ten Unit Total	**$145,161,500**	**--**
All County Total	**$173,898,000**	**--**

Source: Milwaukee County, Financial Reports

Smaller departmental units also felt the budgetary impact of fringe benefit cost increases, and fringe benefit increases and rates also varied considerably among these units. For example, in 2007, the Corporation Counsel had $1.3 million in total expenditures, of which fringe benefits costs comprised $731,000 (56%). In contrast, the Treasurer’s office had $1.3 million in total expenditures, of which fringe benefits comprised $321,000 (24%).

Shifting of local tax support. A second county budget-balancing strategy has involved the shifting of local tax funds. Ostensibly, this should have occurred in accordance with the fiscal needs of certain departments and the county's policy priorities, but as noted above, it is not clear that has been the case.

As shown in **ICMA Indicator 7**, when *all* revenue sources are considered, the overall shift has been modest and favored human services functions because of their increased charges for service revenue and some unique increases in intergovernmental revenue described in an earlier section. Below this broad trend, however, an active movement of *local* property and sales tax revenue has taken place that significantly affected individual departmental budgets.

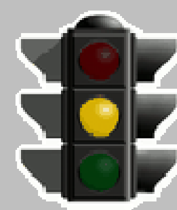
From 2003 to 2007, the county's local tax revenue (property and sales taxes) increased by $26 million (9%). Yet, few departments and divisions saw their budgets grow by this average rate. Rather, as shown in **Table 12**, many units experienced large budgetary changes in their local tax support, either positively or negatively. For instance, the Behavioral Health Division's local tax expenditures grew by $11 million, the Sheriff's Department's grew by $9.2 million and the House of Correction's by $6 million. In contrast, the county decreased local tax support for Human Services by $8.6 million, for the Department on Aging (which includes Family Care) by $4.5 million and for County Health Related Programs by $4.1 million.

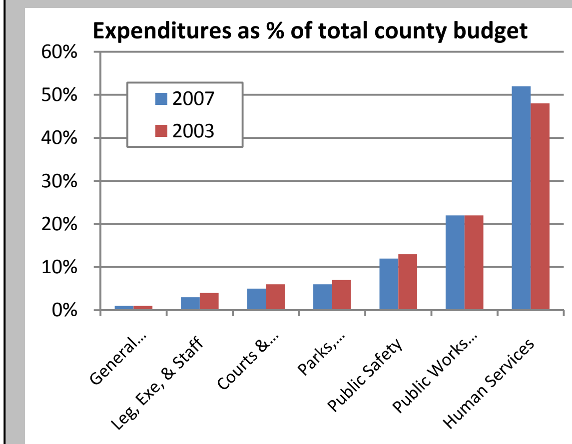
ICMA Fiscal Indicator 7 – Expenditures by Major Functions

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.

Milwaukee County Finding – An increase in human service expenditures with slight decreases for most other functions. While this modest trend does not represent cause for alarm, the potential for continued growth in human services that exceeds growth in other areas **requires monitoring**.





Source: Milwaukee County, Financial Records

The latter reductions represented an opportunity to reduce local tax funding for some large units whose fiscal circumstances had improved through a growth in charges for services. **In other cases, such as the $1.8 million decrease in tax levy support for the Parks Department and the $1.3 million decrease for cultural organizations, the reductions may have reflected the reality that growing costs in mandated service areas such as corrections and mental health care had to be addressed before discretionary areas**.

Table 12: Units with largest changes in local tax-funded expenditures, 2003-07

	Change in local tax funding
Largest increases	
Behavioral Health	$11,046,400
House of Correction	$9,214,700
Sheriff	$6,083,300
Combined Court Related Operations	$4,020,200
District Attorney	$3,318,900
Transit	$3,196,700
Largest decreases	
Health and Human Services	($8,569,200)
Department on Aging	($4,496,900)
County Health Related Programs	($4,109,700)
Parks	($1,837,200)
Cultural Organizations	($1,376,200)
Corporation Counsel	($404,000)

Source: Milwaukee County, Financial Records

Cutting back on personnel. Another of the county's budget-balancing strategies has been to reduce the size of its workforce. This began in 2001, when the number of budgeted full-time-equivalent positions (FTE's) dropped from 7,395 to 7,121 (due in large part to the state's takeover of the child welfare system). In 2002, the county eliminated an additional 415 FTE's, and from 2003 to 2007 it reduced its workforce by an additional 965 FTE's, as shown in **ICMA Fiscal Indicator 8**. **By 2007, the county's workforce had dropped 21% from the beginning of the decade.**

Restructuring debt service payments. Another budget balancing strategy was the county's decision to refinance a considerable portion of its long-term debt in 2003. This move took advantage of historically low interest rates to lower debt service payments in the near term, thereby freeing up funds in the operating budget to offset increasing fringe benefit costs. The county restructured $100 million of outstanding debt and structured its new debt service payments to front-load some of the savings during the first four years, at the expense of having payments increase thereafter. It was projected this measure would reduce debt service costs by an average of roughly $20 million per year from 2004 to 2007.

In a companion measure, the county adopted a policy to issue no more than $30 million in general obligation bonds through 2008, and then to increase bonding no more than 3% annually after that date. By limiting future borrowing, the county sought to counteract the impact of the higher payments in future years that would result from the refinancing. This overall approach was justified on the grounds that Milwaukee County had a favorable bond rating, its overall long-term debt was not excessive, and it would continue to rapidly pay off its long-term debt. On the other hand, **concerns were expressed at the time that the new debt issuance policy did not take into account the county's future capital requirements and, therefore, might ultimately make it difficult to maintain existing infrastructure**.

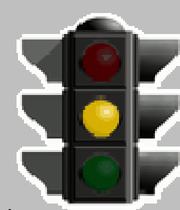
Delaying action on MCTS. Milwaukee County elected officials also have balanced the budget by postponing a decision on the structural deficit in the Milwaukee County Transit System (MCTS), one of its most serious fiscal problems. The Public Policy Forum's May 2008 analysis, *Milwaukee County's Transit Crisis: How Did We Get Here and What Do We Do Now?* provides comprehensive analysis of this issue.

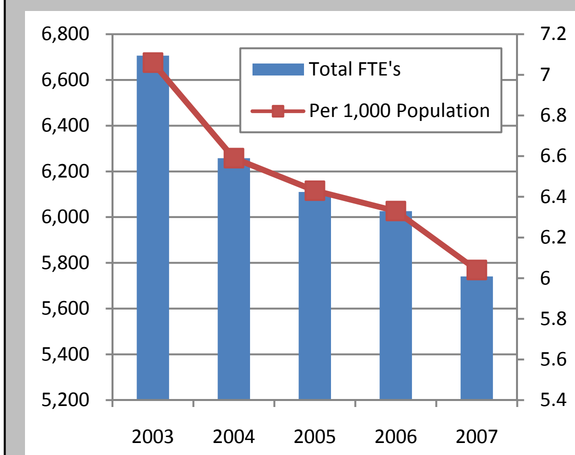
ICMA Fiscal Indicator 8 – Employees Per Capita

Why it is important – Employees per capita has implications for budget solvency because of the importance of personnel to local government budgets. A rise in employees per capita often has 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.

Milwaukee County Findings – The total number of Milwaukee County budgeted full-time-equivalent employees fell by 965 employees, or 14%. This trend was **positive** and helped to relieve immediate and long-run budgetary pressures, but may have had implications for service solvency and **requires monitoring** from that perspective.





Source: Milwaukee County, Financial Records; U.S. Census

To summarize, the county used a reserve of federal capital funds as well as annual federal *capital* appropriations to plug significant holes in MCTS' *operating* budget. These funds were intended for capital expenses such as new bus purchases, which were deferred. Today, only about $1 million remains of the original $44 million federal capital reserve, while a third of the system's fleet of 450 buses is in need of replacement. MCTS estimated late in 2008 that if **bus replacement began in 2010 as scheduled, the system would experience a potential estimated budget hole of $16.9 million, growing to $28.6 million in 2011.** An influx of dollars from the federal stimulus package now may delay that problem for a year or two, but the fundamental structural hole in the transit system's operating budget will remain.

MCTS is a business enterprise whose budget is separate from the county's general fund. However, local taxes constitute 15% of its funding, and MCTS depends upon the county to adjust tax funding to maintain fiscal balance as other revenues rise and fall. By tapping into the federal capital funds, the county was able to preserve property tax revenues for other purposes.

Use of one-time revenues and other short-term measures. In addition to the above budget-balancing practices, county officials have pursued a series of one-time adjustments to remain in the black. In each case, **the effect of these accounting or funding shifts has been to postpone rather than solve an annual budget imbalance**. The October 2008 Public Policy Forum report, *Budget Brief: Milwaukee County 2009 Executive Budget*, offers examples of the kinds of one-time adjustments that have been made. For instance, in the 2009 budget, the county uses accounting changes and under-accrued revenue from previous years to maintain existing levels of service in a number of human services programs. In addition, it changes the classification of its Fleet Maintenance and Facilities Management divisions from business enterprises to general fund departments to avoid funding nearly $2 million in OPEB liabilities, which nevertheless still exist. Similar tactics were utilized in each budget during the 2003-2007 period.

Effects of budget balancing

The differing rate of growth of major revenue sources and vigorous budget-balancing policies and practices from 2003 to 2007 produced different impacts for county departments and divisions. In fact, the impact upon the county as a whole was almost the antithesis of the stereotype of public sector budgeting, whereby an entire government moves in lock step, enjoying the benefits of uniform pay increases and budgetary increases when times are good, and position freezes and across-the-board mid-year cutbacks when times are bad.

Table 13 documents the large fiscal swings of departmental units during this period by showing those with the largest expenditure increases and those with the largest reductions. The total represents roughly half of all units. In the positive group, percentage increases in expenditures ranged from 22% for the Behavioral Health Division to 73% for County Health Related Programs. In the negative group, expenditures fell from 4% for the Parks Department to 51% for the Department of Transportation and Public Works (DTPW) Director's Office.[5] The changes have been adjusted for inflation.

This report has previously discussed the factors contributing to growth in various budget units. For example, Family Care and County Health Related Programs saw a strong rise in their charges for service revenue, while the District Attorney, House of Correction, and Behavioral Health Division received sizeable boosts in their local tax support (see **Table 12**). Four of the units that experienced large increases received no local tax funding, but instead contributed funds that offset the county's property tax levy. Only the District Attorney and House of Correction had more than half of their expenditures funded by the tax levy.

In contrast, all budgetary units (except the DTPW Director's Office) with a large expenditure reduction received more than half of their support from the tax levy. Many of these units had little revenue besides local taxes. Some are small, such as the Civil Service Commission, Veterans Services, and UW-Extension. Others perform internal service functions, such as Procurement, Corporation Counsel and, to a lesser extent, the County Executive's Office.

[5] This decrease is overstated to some extent due to the fact that funding attached to certain positions was not eliminated, but was transferred along with the positions to other budget units.

Table 13: Change in unit expenditures, 2003 to 2007

	2003	2007	5-yr difference	5-yr % change	% of levy*
Units with largest increases					
County Health Related Programs	$37,458,900	$64,622,700	$27,163,800	72.5%	29.3%
Department on Aging	$123,140,100	$194,959,700	$71,819,600	58.3%	>0%
County Clerk	$496,200	$729,300	$233,100	47.0%	37.7%
District Attorney	$13,259,700	$17,645,600	$4,385,900	33.1%	53.0%
Risk Management	$5,956,700	$7,530,900	$1,574,200	26.4%	1.8%
Register of Deeds	$4,154,700	$5,250,000	$1,095,300	26.4%	>0%
Airport	$51,949,400	$64,625,800	$12,676,400	24.4%	>0%
House of Correction	$41,295,300	$50,547,200	$9,251,900	22.4%	87.1%
Highway Maintenance	$13,047,600	$15,925,600	$2,878,000	22.1%	>0%
Behavioral Health	$137,925,400	$168,106,700	$30,181,300	21.9%	23.8%
Units with largest decreases					
DTPW Director's Office Admin	$441,000	$216,100	($224,900)	-51.0%	>0%
Procurement	$813,200	$488,900	($324,300)	-39.9%	92.2%
Election Commission	$898,600	$579,200	($319,400)	-35.5%	88.2%
UW-Extension	$377,500	$261,700	($115,800)	-30.7%	69.4%
Veterans Services	$330,800	$238,400	($92,400)	-27.9%	94.5%
Corporation Counsel	$1,600,000	$1,256,200	($343,800)	-21.5%	86.4%
Cultural Organizations	$8,449,600	$7,073,400	($1,376,200)	-16.3%	100.0%
Civil Service Commission	$55,200	$50,400	($4,800)	-8.7%	100.0%
County Ex--General Office	$965,800	$883,000	($82,800)	-8.6%	98.1%
Parks	$40,267,600	$38,550,700	($1,716,900)	-4.3%	56.5%
Human Resources	$4,298,100	$4,197,500	($100,600)	-2.3%	78.5%

* Percent of expenditures funded by the tax levy

Source: Milwaukee County, Financial Records

What **Table 13** does not reveal are the changes that were taking place within each departmental unit as overall budgets were being shaped. As noted previously, because the county allocates fringe benefit costs to departments based on the number of FTE's, and because of specific allocation methodologies that differed from year to year, the county's huge increase in fringe benefit expenditures impacted each differently, and created "winners" and "losers" based not necessarily on the priorities of policymakers, but on the fringe benefit allocation methodology prepared by the central budget office.

Table 14 shows the expenditures that remain after deducting fringe benefit expenditures for various budget units, examining this total in 2003 and again in 2007 and comparing the resulting change. The table shows all departmental units that experienced a decrease in this measure of more than 20%. This information indicates that when deducting the "artificial" expenditure increases in individual departmental budgets caused by the county's fringe benefit increases, **some of the units that were most severely impacted by the county's budget challenges were those that perform core services integral to all county operations, such as Human Resources, Fiscal Affairs, the Corporation Counsel, and Procurement**.

Table 14: Total expenditures minus fringe benefit expenditures, 2003 to 2007

	2003		2007		% change in total w/o fringe	
	Total exp.	Total w/o fringe	Total exp.	Total w/o fringe	Actual dollars	Inflation adjusted
DTPW Dir.'s Ofc.	$441,000	$244,300	$216,100	$76,400	-68.7%	-72.2%
Veterans Serv.	$330,800	$275,900	$238,400	$131,200	-52.4%	-57.8%
Procurement	$813,200	$620,300	$488,900	$314,000	-49.4%	-55.1%
Corp. Counsel	$1,600,000	$981,700	$1,256,200	$525,200	-46.5%	-52.5%
Election Com.	$898,600	$846,000	$579,200	$466,600	-44.8%	-51.0%
UW-Extension	$377,500	$363,800	$261,700	$261,700	-28.1%	-36.2%
Fiscal Affairs	$3,256,900	$2,272,800	$3,184,500	$1,741,400	-23.4%	-32.0%
County Ex Off.	$965,800	$692,200	$883,000	$536,700	-22.5%	-31.2%
Human Resources	$4,298,100	$3,219,900	$4,197,500	$2,772,200	-13.9%	-23.6%
Parks	$40,267,600	$34,270,100	$38,550,700	$30,247,500	-11.7%	-21.7%

Source: Milwaukee County, Financial Records

In summary, several important policy implications and questions arise from the analysis contained in this section:

- The growth in charges for service revenue eased the burden of fringe benefit increases and budget balancing (particularly in human services), an especially important consideration at a time of limited increases in local and state funding. Yet, what would have happened to the county's finances had this program growth not occurred? Is such growth integral to the county's budgetary solvency and is it likely to continue?

- The significant decrease in non-fringe benefit funding for many core internal service units suggests the need to evaluate the real impact on the county's quality and level of service. For example, in recent months, significant staff shortages at the House of Correction, the Mental Health Complex and the Economic Support Division call center have been linked to a host of problems, including increases in overtime spending and problems in meeting fundamental responsibilities with regard to prison security, nurse and patient safety and benefit eligibility determination. To what extent are these shortages attributable to the reduction in funding for the Human Resources division? Likewise, to what extent is the significant reduction in funding for the Fiscal Affairs division linked to the county's failure to plan strategically, conduct performance measurement, and provide appropriate long-term fiscal analysis to policymakers? County service data does not currently permit satisfactory analysis of this issue, but given the trends observed in **Table 14**, **the county should give high priority to evaluating whether it possesses sufficient administrative infrastructure to appropriately manage its internal affairs**.

- The method by which fringe benefit costs are allocated to departments has great importance. The consequences of the county's existing methodology – which allocates fringe benefit costs for retired workers based on each budget unit's number of active employees – and the potential impact of alternative allocation methodologies should receive intense scrutiny and policy consideration.

LONG-TERM BUDGETARY SOLVENCY

Analyzing long-term budgetary solvency with the ICMA system

The ICMA system is an excellent tool for examining long-run 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 three types of costs that have a major effect on future spending levels: pension and OPEB, long-term borrowing, and deferred maintenance.

Summary of long-term solvency findings

Milwaukee County's long-term budget solvency clearly is threatened by the magnitude of its pension and OPEB liabilities, now totaling more than $2 billion. Another escalating problem is the county's daunting deferred maintenance backlog, which has grown in recent years as attention has been directed toward severe operating budget pressures, and away from capital improvement needs. One bright spot is the county's long-term debt position, which is positive and improving by ICMA standards. A review of these issues collectively, as well as potential strategies to address them, reveals that long-term budget prospects are not good, and **there is a strong likelihood of future budget imbalance and continued fiscal crisis, especially in program operations financed by local taxes and state aids.**

Analysis

Employee retirement system

Milwaukee County's annual budgeted pension fund contribution consists of two components: the "normal cost," currently about $22 million, which is the actuarially determined charge for benefits earned by active employees in the upcoming year; and an actuarially determined portion of the fund's unfunded liability. At the end of 2007, the county's unfunded actuarial accrued liability (UAAL) was $397 million, and the ratio of its assets to its liabilities was approximately 80%. The amount required to fund this liability in 2008 was slightly less than $30 million. However, **at the end of 2008, the unfunded liability was estimated at more than $900 million, a rise attributable to a decline in the value of fund investments**.

Other local governments also experienced a growth in unfunded liabilities in their retirement system even prior to the recent precipitous decline in the stock market, largely because of a drop in investment earnings during the past decade. The Public Fund Survey, which encompasses 85% of all public plan assets nationally, reports that the average funded ratio of these retirement plans was 86% in June 2007.

Comparisons with the benchmark counties yields limited comparative information on retirement systems, in part because Franklin and Cuyahoga counties in Ohio do not have their own plans and instead participate in their state's retirement system. In 2007, Allegheny County's pension fund was funded at 79%, and Wayne County's was funded at 92%. The Ohio PERS system was at 89%. Some Milwaukee County officials considered the possibility of joining Wisconsin's retirement system earlier this decade, but the state's Legislative Audit Bureau found in a 2003 study that such a move would face a variety of financial, legal, and administrative obstacles.

The county's annual payment to fund its UAAL is projected to continue to rise for more than a decade.[6] In September 2008, the county, in conjunction with its financial advisers, produced an analysis of the retirement system's projected UAAL payments, which appears in **Table 15**. Note that these estimates were based on an unfunded liability of $397 million as of December 31, 2007 (before the 2008 stock market decline reduced the market value of the pension fund by more than 25%), and that the dollar amounts listed do not include the estimated annual payment for the normal cost. Consequently, approximately $22 million would need to be added each year to the amounts listed below to produce the total pension fund payment for that year.

Table 15: Projected UAAL payments

Year	Payments
2009	$25,129,900
2010	$27,830,200
2011	$30,522,600
2012	$34,287,400
2013	$37,688,400
2014	$38,996,900
2015	$40,350,600
2016	$41,751,000
2017	$43,199,600
2018	$44,698,200

Source: Milwaukee County, Financial Records

More recently, in March 2009, the county's financial advisor estimated that because of the huge decline in the value of the pension fund, the total annual pension fund contribution (both UAAL payment and normal cost) could increase to $77 million in 2010 (compared to roughly $50 million in **Table 15** when the normal cost is added to the UAAL payment), and to approximately $99 million in 2013.

Milwaukee County elected officials recently approved the issuance of approximately $400 million in Pension Obligation Bonds (POBs) to fund a portion of the retirement system's unfunded liability. This strategy is intended to generate financial savings while also providing stability in year-to-year payments. Cost savings would be produced if the invested bond proceeds grow at a greater rate than the rate of interest the county must pay on the bonds. The 2009 budget estimated that the total debt service payments on a 30-year POB issuance would

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[6] It is possible that the long-term prognosis for the county's Employee Retirement System could be impacted by a pending lawsuit in which the county is seeking damages from its former pension fund actuary stemming from adoption of the 2000 pension enhancement package. The case is currently scheduled for trial in May 2009. County policymakers have indicated a desire to utilize any damages awarded to the pension fund to reduce pension fund liabilities.

amount to $777 million, which would constitute a savings of $319 million over the life of the bonds, assuming an 8% return on the invested bond proceeds and a 6% interest rate on the bonds.

Greater stability would be achieved by structuring the debt on a level payment schedule, which means the county would pay the same annual amount for a period of 30 years to service the debt on the bonds, as opposed to having the payment for the UAAL recalculated each year by the pension fund actuary. However, **full stability only would have been achieved had the full UAAL been paid off with the bond proceeds; because a significant UAAL exists after the issuance of the bonds, the county still is required to pay an additional amount as determined annually by the actuary to fund that additional liability**.

The bottom line is that POBs could help the county reduce its long-term pension fund liability and stabilize its annual payments, but this strategy produces only modest short-term budget relief after 2009. This strategy could prove beneficial for long-range budget planning, but per the amortization schedule proposed by county budget officials, annual debt service payments on the POBs and other pension-related payments still would total about $71 million in 2010 and grow to $98 million by 2013. Those amounts would be a significant increase even over the pension-related payments the county was required to accommodate during the 2003-2007 period.

Finally, the issuance of nearly $400 million of POBs increases the county's overall outstanding debt obligation, which stood at $452 million in general obligation bonds and $184 million in revenue bonds in 2007. The degree to which a near-doubling of long-term debt might limit the county's ability to borrow or threaten its bond rating is difficult to assess. It does appear that if borrowing otherwise continues at existing levels, the rating agencies likely will not take exception to a POB issuance. Moody's, for instance, seems untroubled by such potential action and noted in its ratings analysis of the county's proposed general obligation bond issuance in May 2008 that "while this would increase the county's debt burden…the fixed debt would be financing a soft liability and results in net cost savings in pension cost projections."

OPEB

Milwaukee County has an unfunded liability of $1.3 billion arising from health care obligations owed to retirees who began employment with the county prior to 1994 and accumulated at least 15 years of service. Milwaukee County is one of many state and local governments across the country that has accumulated a large non-pension, or OPEB liability. The Wisconsin Policy Research Institute – in a September 2008 report entitled *Government Retiree Health Benefits: Wisconsin's Ticking Time Bomb* – found that local governments in southeastern Wisconsin now carry $6 billion in such unfunded costs. Milwaukee County's OPEB liability ranks second in the region behind Milwaukee Public Schools at $2.2 billion and ahead of the City of Milwaukee at $806 million.

To manage its OPEB costs, Milwaukee County could opt to continue a "pay-as-you-go" approach, attempt to reduce benefits, or establish a separate fund to pay some or all of the $1.3 billion unfunded liability. Some combination of these options also is possible. Deliberations on these choices should consider the following:

- A 2006 analysis by the Cambridge Advisory Group found that under a pay-as-you-go scenario, retiree health care payments will continue to increase, but at a slower rate in light of the termination of the “free” retirement health care benefit for employees hired after 1994. In 2007, the county spent approximately $60 million on retiree health costs. According to the Cambridge analysis, the annual cost will increase by about $5 million from 2008 to 2009, and grow at a slower rate in subsequent years until growing $2.8 million from 2014 to 2015. The total annual payment will top out at roughly $116 million in 2028. Thereafter, annual costs will slowly decline for an estimated 40 years.

- Cambridge Advisory Group estimated that fully funding the $1.3 billion unfunded OPEB liability would require an annual required contribution of $50 million in the first year. **If the County had made the actuarially determined payment for this liability in 2007, total OPEB payments would have amounted to $110 million—the $50 million for the unfunded liability portion plus the $60 million in actual payments for retiree health care costs**. This sum is only slightly below the top payment of $116 million in 2028 estimated by the Cambridge Advisory Group under the pay-as-you-go approach.

- In 1994, Milwaukee County eliminated free health care in retirement for new employees. Consequently, Milwaukee County is not accruing OPEB costs and liabilities in the same manner as local governments that offer OPEB benefits as an ongoing commitment to active employees. For this reason, the county’s unfunded OPEB liability must be considered differently than the unfunded liability in its pension program, for which a pay-as-you-go approach would have much greater impact on the accumulation of unfunded liabilities.

- Milwaukee County could limit the costs or rate of increase of retiree health care by a variety of potential actions such as raising deductibles, out-of-pocket maximums, or co-pays. Any such strategies would have to apply equally to both active employees and eligible retirees in order not to violate retiree rights. Potential changes, therefore, would be subject to bargaining under the county’s labor agreements and, consequently, are difficult to assess.

- The county could explore issuing bonds to pay off some or all of its OPEB unfunded liability. Using bonds for such a purpose is becoming more common across the country. This option carries potential benefits and risks similar to those discussed for pension obligation bonds, though it must be recognized that the additional debt service obligations incurred for OPEB bonds would be considerably more substantial than the significant additional obligations for the proposed POBs.

The bottom line is that if the county were to establish a segregated account and amortize and fund the costs associated with the unfunded liability over 30 years, it would shorten the duration and total amount of OPEB obligations, shielding future taxpayers from significant costs, but at considerable immediate expense. In contrast, under the existing pay-as-you-go approach, costs are paid over a much longer period of time according to the life span of eligible retirees, but an assumption is made that resources will be available to pay those costs when they come due.

Long-term debt

Despite the county's protracted fiscal crisis and utilization of debt restructuring as a budget-balancing strategy, **Milwaukee County's long-term debt position remains strong by most any measure**. ICMA evaluates long-term debt according to whether overall borrowing endangers future ability to repay, and according to the impact of debt service payments upon current budgets. Under the most favorable circumstances, ICMA points out 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."

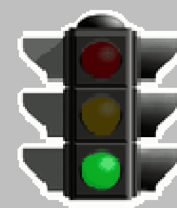
ICMA Fiscal Indicator 9 – Long-Term Debt

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 county debt plus all bonded debt issued by other governmental units in the county, such as municipalities and school districts. Credit agencies routinely examine a local government's debt load in their 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

Milwaukee County Finding – From 2003 to 2007, Milwaukee County's net direct debt declined as a percentage of equalized value. Also, the overall direct debt issued by all governmental units in the county declined to 4% of equalized value, substantially below the ICMA warning threshold. This is a **positive** indicator of fiscal health.



Long-Term Debt*

Year	Equalized Value	Net Direct Debt	% of Equalized Value	Overall Net Direct	% of Equalized Value
2003	$47,266,665	$467,444	0.99%	$2,299,384	4.90%
2004	$51,153,360	$482,859	0.94%	$2,418,988	4.70%
2005	$56,680,686	$473,723	0.84%	$2,503,407	4.40%
2006	$63,609,182	$456,597	0.72%	$2,635,607	4.10%
2007	$67,119,283	$452,326	0.67%	$2,715,459	4.00%

* In thousands

Source: Milwaukee County, CAFR

A common measure of long-term debt is its relationship to equalized value. Under state statutes, a county's total general obligation debt may not exceed five percent of the equalized property value in the county. At the end of 2007, Milwaukee County had issued $452 million in bonded debt and $184 million of revenue bonds for the Airport. The general obligation bonds amounted to 13% of the state-imposed debt limit. Also, as shown in **Fiscal Indicator 9**, Milwaukee County government's general obligation debt and the overall net debt for all governmental entities in the county have declined as a percentage of equalized value over the past five years.

Milwaukee County's long-term debt compares favorably in most respects to the benchmark counties as evaluated by Moody's Investor Services. Moody's finds that Milwaukee County has a "rapid" payout of its direct bond obligations, with 89% being repaid over 10 years, and that the debt service proportion of core expenditures at 5% is "manageable" for the county. Milwaukee County has a somewhat higher amount of direct bond debt per capita at $479, compared with a high of $490 for Allegheny County and a low of $108 for Franklin County. Yet, Franklin's overall direct debt as a percentage of equalized value is nearly the same as Milwaukee County's, as is Wayne County's. Allegheny County's overall direct debt is higher at 7%, as are its debt service payments as a percentage of operating expenditures (8%). Allegheny pays off only 63% of its bonded debt in 10 years. Cuyahoga County relies more on cash financing than the other counties and its ratio of overall direct debt to equalized value is the lowest of the group. Cuyahoga repays 70% of its debt principal within 10 years.

Capital assets

A local government's wealth is mainly reflected in the value of its capital assets, i.e. its streets, buildings, land, utilities, vehicles, networks, and equipment. 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 discovered that underfunding capital assets is "a relatively painless way to temporarily reduce expenditures and ease financial strain." The ultimate consequence of sustained inattention can be severe and includes "1) decreasing usefulness of the asset; 2) increasing cost of maintaining and replacing them; and 3) decreasing attractiveness of the community as a place to live or do business."

Milwaukee County formulates a five-year capital plan annually based on capital funding requests submitted by departments to the central budget office. However, the county lacks a complete and comprehensive body of data to allow for a strategic assessment of what is required to prevent substantial capital deterioration.

Currently, Milwaukee County assesses the physical condition of major capital assets such as bridges, highways, some hard paved surfaces (such as parkways and trails), parks, and playgrounds every one to three years. Other infrastructure is assessed more intermittently. The county estimates that 70% of its buildings have been assessed in the past 15 years. Assessment of utilities is in its "early stages." There is no ongoing assessment of landscape facilities.

A Milwaukee County Deficiency Summary Report submitted to the county board in February 2008 estimates that repairs totaling $181 million are needed to remedy deficiencies in county buildings evaluated since 1995. Of this amount, about half are rated as currently or potentially critical, with the remaining buildings rated "necessary but not critical" (24%), "recommended" (16%), or "does not meet current codes or standard" (12%). This deficiency assessment is incomplete and does not include buildings operated by the House of Correction, Fleet Management, the Airport, and others. In 2006, an evaluation by the Parks Department calculated that Parks' buildings not included in the Deficiency Summary Report required another $129 million in repairs.

A Public Policy Forum analysis of county-owned parks and cultural facilities released in November 2008 found that "major maintenance and basic infrastructure repair needs are significant and growing at each of the county-owned assets, with the exception of the Milwaukee County Historical Society headquarters…Among the more significant deferred maintenance/infrastructure needs assessment totals are $10 to $15 million for the Milwaukee Public Museum, $5.5 to $8.5 million for the Milwaukee County Zoo (plus a $130 million capital improvements wish list), and $276.6 million in the Milwaukee County Parks."

In addition, the Forum's study of the Milwaukee County Transit System found significant bus replacement needs. The report indicated that "bus purchases that have been deferred for several years cannot be deferred much longer without running the risk of escalating maintenance costs and significantly decreased reliability….Officials have cited the need to replace those buses beginning in 2010 on a three-year schedule at a cost of approximately $56 million. Of that cost, roughly 83% would be covered with federal funds, while the county would need to issue bonds to cover the remainder."

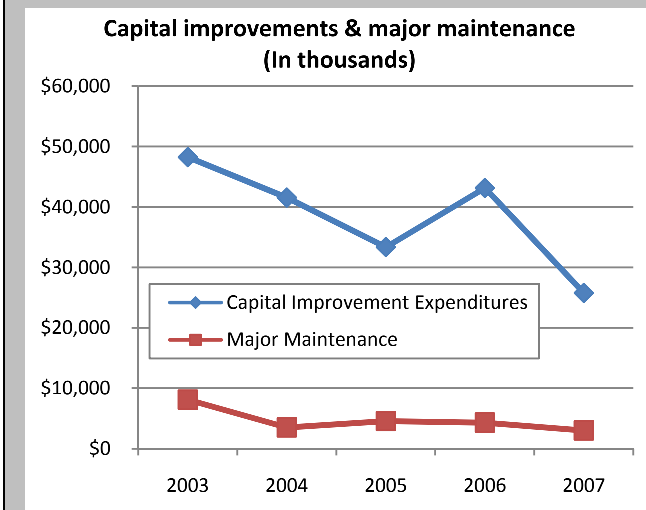
An analytical study of the county's future capital needs is beyond the scope of this report given the current state of information and the complexity and size of the county's capital assets—valued at $621 million in the 2007 CAFR. More modestly, this report draws on an ICMA indicator to ascertain whether the county's commitment to capital funding has suffered due to its extreme operating budget pressures. Capital costs are more prone to fluctuation and expenditure will rise and fall from year to year because of the costs of specific projects. Therefore, ICMA relies upon a steady three-year decline in capital outlay and deferred maintenance costs as its warning indicator.

ICMA Fiscal Indicator 10 – Capital Improvements and Deferred Maintenance

Why it is important – Capital improvement and maintenance expenditures from governmental operating revenues provide an indication of whether capital needs are being addressed.

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

Milwaukee County Finding – Maintenance expenditures have varied but generally trended downward during the period. Capital improvement expenditures also varied but reached their lowest level in 2007. Taken together, these trends indicate challenges in addressing capital needs and **require monitoring**.



Source: Milwaukee County, Financial Records

As shown in **ICMA Fiscal Indicator 10**, both capital improvement and major maintenance spending varied during the 2003-2007 period but generally trended downward. Because this five-year snapshot was inconclusive, we also examined the previous five years, and found that for capital improvement spending in particular, this lengthier analysis indicated a pronounced downward trend. Capital improvement expenditures totaled more than $50 million for each year between 1998 and 2002, with a high of $67 million in 2000. The average annual capital improvement spending amount from 1998 to 2002 was $56 million, while the average from 2003 to 2007 was only $38 million.

Long-term budget prospects

Predicting Milwaukee County's budget prospects even for the next five years is no simple matter. As discussed throughout this report, the county's $1.3 billion operating budget is large and complex. In any given year, there are unexpected developments that can have a major impact on available resources and demand for county services. Even apart from the randomness and unpredictability of yearly events, environmental shifts can force large-scale disruption and change.

While fiscal projections may constitute an inexact and risky business, the ICMA analysis permits identification of financial problems for which reasonable cost estimates can be made. The county's major fiscal burden in the last five years has been the increase in fringe benefit costs. **It is hard to see how Milwaukee County could weather a similar increase in fringe benefits over the next five years without making major program and/or revenue changes of an unprecedented kind**.

It appears evident that significant increases in fringe benefit costs indeed are likely to occur. If the county continues a pay-as-you-go approach for its retiree health costs, then it is possible to roughly predict the growth in those obligations. Health care costs for active employees and retirees will rise together, and growth at an estimated rate of 10% per year would produce an added annual cost beginning at $13 million in current dollars. Meanwhile, in light of the recent plunge in the value of the county's pension fund, total annual pension-related payments are estimated by the county's financial advisor to double to nearly $100 million within the next five years. **Even assuming that health care costs increase by an extremely conservative 5% per year, when combined with the projected increase in the pension fund contribution, the county's major fringe benefit costs would increase by $80 million between 2009 and 2013 – an amount that exceeds the $73 million increase experienced from 2003 to 2007**.

Another long-term fiscal issue is the rise in debt service payments resulting from the debt restructuring initiative in 2003. As noted previously, such an increase recently has occurred in part because the new debt service schedule lowered debt service costs in the first four years, but at the price of increasing payments in subsequent years (with the increase offset to some degree by limits on total borrowing). A recent county estimate of these debt service costs, which assumes the county will continue to borrow at the policy limit of $30 million plus the rate of inflation, shows total debt service payments rising from $53.4 million in 2008 to $60.9 million in 2009, but then remaining relatively flat until a sharp decline to $44 million in 2015. Consequently, these cost increases should not present a fiscal problem from a medium or long-term perspective as long as the county continues to limit annual bonding. That limitation, however, likely will conflict with the county's sizable infrastructure repair backlog.

A third financial problem is the sizeable future hole in the budget of the Milwaukee County Transit System, which the Public Policy Forum has previously estimated at about $21 million annually. This issue may be addressed with revenue from a regional sales tax recommended by the Southeastern Wisconsin Regional Transit Authority board or a county sales tax supported by voters in a November 2008 advisory referendum. Barring these or an alternative new revenue source, however, this structural problem will manifest itself when the county begins to replace its fleet of outdated buses. The use of $25 million of recently awarded federal stimulus dollars will help by allowing the county to purchase 40 to 50 new buses without tapping into other annual federal funding streams, but this is likely only to delay the impending crisis for a year or two.

The county also will experience inflationary pressures in the next five years, apart from growth in health care. Between 2003 and 2007, the need to accommodate the rise in fringe benefit expenditures forced departments to absorb inflationary cost increases in utilities, commodities and similar areas. Even more significant, expenditures for salaries and wages declined due to the severe cuts in the size of the county's workforce. Of course, there are limits to this approach. Negotiated salary increases and rising utility prices must be paid, and while there may be more opportunity to reduce the size of the workforce through privatization initiatives, ultimately that opportunity will disappear unless the county chooses to completely eliminate certain services. Failure to fund these typical "costs to continue" while attempting to maintain all existing services already has produced serious concerns about service solvency and likely is not sustainable.

On the revenue side, there seems little reason to think that the key feature of recent years—disparate rates of growth among major revenues—will not continue. It is probably imprudent, however, to expect the kind of escalating growth in charges for service revenue that characterized the past five years. Nevertheless, a rise in charges for service should be anticipated, if for no other reason than the county's financial system creates an incentive to grow these revenues. Perhaps the only scenario under which such resources would not increase would involve a substantial cutback in Medicaid funding and third party reimbursement.

The future of state aids is murky, at best, and difficult to forecast. On the one hand, the troubled national economy and the state's own fiscal difficulties likely will make it problematic to sustain even inflationary increases in state aid. On the other hand, the federal stimulus package could provide the county with an infusion of additional funds for infrastructure and related services. Also difficult to predict is the fiscal impact to the county of state decisions regarding the administration of public assistance functions and Family Care expansion.

Current economic conditions could diminish sales tax revenue, at least in the short-term. Even without the national economic crisis, growth in sales tax revenue has been nearly flat the past five years. Sales tax revenue would increase substantially, however, if the rate increased per the advisory referendum approved by voters in November 2008.

Milwaukee County's long-run budget solvency also may depend on whether it can continue to identify one-time sources of revenue to address budget holes on an annual basis. As the Forum noted in its analysis of the 2009 county budget, one-time revenue sources exceeding $6 million were utilized to prop up human services budgets in 2009, and the absence of these revenue sources could have a significant negative impact in 2010. There may be some other potential one-time revenue sources that could continue to help in the short-term – most notably the potential sale of land on the County Grounds to the University of Wisconsin-Milwaukee for a new School of Engineering – but use of such revenue to plug structural holes constitutes poor fiscal policy.

Because of the numerous variables cited above, this report does not attempt to forecast the size of the county's budget gap into the future. However, **Table 16** reproduces a projection prepared by the county budget office as part of the official statement for issuance of general obligation bonds in May 2008. This shows the excess of expenditures over revenues to be $26 million in 2009, which would grow to $87.9 million by 2013.

This projection uses the 2008 adopted budget as a baseline. It assumes the property tax levy will increase by 3.06 percent each year, other revenue streams will increase at inflationary levels or per recent experience, and the county will fund debt service based on the existing schedule and the new debt issuance policy limit. It also assumes wages and salaries will rise by approximately 3% and health care costs by 10% each year. Specific challenges described in this report – such as the MCTS deficit, the deferred maintenance and infrastructure backlog, and the likely major increase in the required pension fund contribution – are not incorporated in this projection.

The methodology used to create the table is somewhat artificial in that it assumes budget deficits accumulate from year to year while, in fact, the county is prohibited from adopting a budget that is not balanced. Nevertheless, it is useful to calculate the cumulative structural imbalance to ascertain the size of the county's funding problem and to show the degree to which internal reallocations or reductions in services might be needed.

Table 16: Five year projection of Milwaukee County annual budget gap

Year	Projected gap
2009	$25,900,000
2010	$35,600,000
2011	$49,800,000
2012	$67,400,000
2013	$87,900,000

Source: Official Statement, Milwaukee County, General Obligation Corporate Purpose Bonds, Series 2008A

To summarize, consideration of the revenue and expenditure trends observed and described for the 2003-2007 period, as well as budget-balancing practices utilized during that period and the county's own May 2008 five-year projections, suggests that Milwaukee County's long-term fiscal outlook is not appreciably better than it was when the "reality tour" was launched in 2006, and likely has deteriorated. Furthermore, because the analysis in this report was based almost exclusively on actual expenditure and revenue data through 2007 – well before the onset of the national economic downturn and sharp decline in pension fund assets – the outlook likely is even more alarming than that suggested in the pages herein. Finally, as if those cautions are not disturbing enough, it also is important to recognize that the 2008 and 2009 county budgets largely continue the unsustainable practices observed during the previous five years. It should come as no surprise, then, that the county executive already has warned of a projected $57 million budget shortfall for 2010 – another indicator that rather than improving, the county's fiscal outlook is growing worse.

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 flow of money in and out of the treasury. If revenues are on hand to cover expenditures, a government has a positive liquidity or cash flow. If such revenues are lacking, the government must borrow to pay its bills. A positive fund balance 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 County's ability to generate reserves is limited by a statutory provision that does not permit unencumbered revenues to be carried over from year to year. As a result, its cash position is not as robust as some counties. Despite this limitation, **during the period under review the county improved both its liquidity and fund balance**. This improvement is noteworthy since it occurred at a time of fiscal crisis. Yet, the county's limited reserves are not ideal given the fiscal challenges it continues to face.

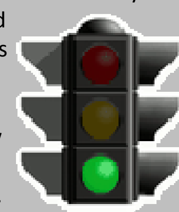
ICMA Fiscal Indicator 11 – Liquidity

Why it is important – A key measure of a county'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 is the information used below.

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 better than 1 to 1.

Milwaukee County Finding – Milwaukee County experienced a steady and marked improvement in the liquidity in its general fund from 2003 to 2007, and its ratio of cash and investments to current liabilities is now nearly 1 to 1, representing a **positive** indicator of fiscal health.



Year	Ratio
2003	1 to 6.2
2004	1 to 4.8
2005	1 to 1.8
2006	1 to 1.3
2007	1 to 1.2

Source: Milwaukee County, CAFR

Analysis

The county's liquidity, i.e. the relationship between cash/short-term investments and current liabilities, is affected by the statutory limitation prohibiting the generation of excess revenues in a fiscal year. Its liquidity, as measured in **ICMA Fiscal Indicator 11**, also is somewhat understated because a large portion of property taxes are received in January and February, which means that at the end of the year there is less cash in the treasury. The county's liquidity in both 2003 and 2004 did not meet the ICMA standard. Since that time, liquidity has improved and now falls within the ICMA suggested range.

The county's balance in its general fund—described by Moody's as "historically tight"—was at an unusually low level in 2003 and 2004 because of the operating deficits that occurred in those years. The county's end-of-the year position improved steadily thereafter, rising from $8.9 million in 2004 to $48.3 million in 2007, although some funds are reserved for specific purposes. The general fund's percentage of operating expenditures also rose from 2.3% in 2003 to 5.1% in 2007 (see **ICMA Fiscal Indicator 12**).

Table 17 shows the ending fund balance in 2006 of Milwaukee County and the benchmark counties. The table indicates the range that is possible in this measure and the effect of the limitation that prevents Milwaukee County from carrying over general operating funds and, thereby, generating larger fund balances.

Table 17: General fund balance as a proportion of general fund operating expenditures – 12/31/2006

Milwaukee	5.4%
Allegheny	2.9%
Cuyahoga	48.5%
Franklin	73.2%
Wayne	5.3%

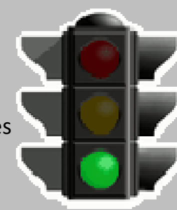
Source: 2006 Comprehensive Annual Financial Reports for Allegheny County, Cuyahoga County, Franklin County, Wayne County, and Milwaukee County

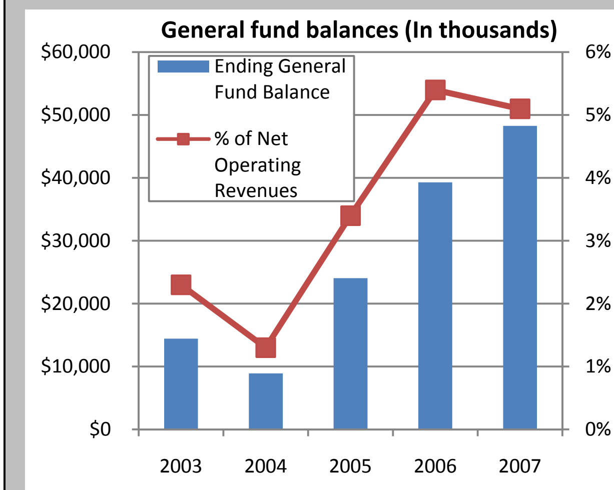
ICMA Fiscal Indicator 12 – Fund Balance

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 Signs – Declining general fund balance as a percent of net operating reserve.

Milwaukee County Finding – Improvement in this indicator of cash solvency during this period is a **positive** indicator of fiscal health, although the county's fund balances remain low by most standards, in part because of statutory limitations.





Source: Milwaukee County, CAFR

CONCLUSION

This report has used the Fiscal Trend Monitoring System of the International City/County Management Association as a basis for evaluating the fiscal condition of Milwaukee County. Rather than just looking at major trends in revenues and expenditures, the ICMA format examines the underlying factors that determine a government's short-term and long-term financial strength and vitality.

On the surface, it may appear that Milwaukee County has emerged from the rough fiscal waters of the past five years in reasonable fiscal shape. Revenues and expenditures have grown steadily. Budgets have balanced, at least since 2004. Cash position and fund balance have improved. Yet, a closer look utilizing the ICMA format reveals a more complex, turbulent and troubling picture. Here is what we have learned:

- ICMA warns against over-reliance on external and inflexible sources of revenue. Milwaukee County is guilty of both. While overall revenues have grown steadily, the revenues necessary to support key services and programs have not followed the general trend. Each of six major state aid programs has experienced declines between 9% and 22% in inflation-adjusted dollars, a huge factor given the county's dependence on state revenue. The local property tax has decreased by 3% and the sales tax by 6% in constant dollars. Increasing in their stead have been charges for service revenues that are less flexible and allocated to specific program operations, such as Family Care, mental health inpatient services and the Airport. To improve the county's fiscal health, greater revenue diversification is needed.

- ICMA analysis of expenditures looks first to ensure that trends in expenditures do not lead trends in revenues and, thereby, throw the budget out of balance. After that, the ICMA system seeks to understand what is driving expenditure increases and to assess long-term implications. Milwaukee County's overall expenditures properly follow overall revenues for the 2003 to 2007 period. However, expenditure increases can be attributed almost entirely to two factors—increases in human services expenditures reimbursed through charges for services, and increased fringe benefit costs. The $73 million rise in fringe benefit costs between 2003 and 2007 amounted to nearly one-third of the tax levy. Also, unfunded pension and retiree health liabilities grew sharply and now total more than $2 billion. Due to these exceptional cost increases, other key budget needs received minimal attention at best.

- The ICMA format has facilitated a close examination of charges for service revenues and expenditures. The growth of this resource has enabled some human service functions to reduce their dependence on local tax funds and absorb additional fringe benefit costs. It also enabled county officials to shift local tax resources from these units in favor of others with high need and priority. Whether or not this strategy has long-term viability is difficult to say. It is clear, however, that this resource not only is less flexible than other resources, but that it also may be more fragile since much of it is derived from Medicaid.

- ICMA guidelines ask how a budget is brought into balance. Even if the budget is not in the red, the guidelines inquire as to whether short-term measures have been utilized and whether structural problems exist. In Milwaukee County's case, the answer to both questions is "yes." The county has depleted reserves and deferred bus purchases to postpone its transit funding crisis, built a significant backlog of deferred maintenance and infrastructure repairs, reduced debt service payments in the short-term by restructuring debt (while increasing obligations in the long-term), and utilized one-time revenues and accounting maneuvers to fill annual budget holes.

- In terms of long-term budget solvency, ICMA considers whether a government recognizes and funds its true operating costs, or instead defers those costs to future taxpayers. In recent years, Milwaukee County's long-term costs have grown. Unfunded retiree health and pension liabilities are immense and likely still expanding, even with the issuance of POBs. The county soon may face an estimated $21 million annual budget gap in the Milwaukee County Transit System. The county's own May 2008 budget projection – developed well before the national economic downturn and plunge in pension fund value – shows a widening imbalance between revenues and expenditures reaching $87.9 million in 2013. A more recent estimate in November 2008 indicates a $57 million budget gap in 2010, and even this estimate likely is understated since it did not include the most recent calculation of future pension costs.

- ICMA also cites the importance of environmental factors that may affect government resources and demand for resources. Our analysis shows that Milwaukee County government may be slightly better equipped than comparable Midwestern county governments to grapple with fiscal challenges in light of its stronger property values, relatively diverse tax base and shelter from the extremes of the recent housing boom and bust. Nevertheless, its significant poverty rate and dwindling share of the state's population place it in a precarious situation. The demand for safety net services is likely to grow, but a potential loss of influence in Madison, caused by underlying demographic and socio-economic factors, may make it more difficult to secure state resources necessary to meet that demand.

- One of the distinctive features of the ICMA system is its incorporation of service solvency in its evaluation of fiscal condition. Unfortunately, there is not sufficient data to provide a satisfactory evaluation of whether the county is providing "services at the level and quality that are required for the health, safety, and welfare of the community and that its citizens desire." There are signs, however, that should give rise to concerns about the level and quality of service, and the direction in which the county is heading. One is the 14% reduction in full-time employees, which has not been accompanied by a similar reduction in programs and services. Another is the significant reduction in funding in core administrative units such as corporation counsel, fiscal affairs and human resources. Reductions of this scale are beyond what can be reasonably achieved through cost efficiencies and inevitably will have a programmatic impact. The professional judgment of ICMA is that level of expenditure provides a rough measure of level of service.

In summary, the picture that emerges from the accumulated trends in ICMA indicators and the other collected information is of a local government that has attempted to manage in the status quo for too long given its atmosphere of exceptional costs and restricted revenues.

While the county enjoys cash solvency and a reasonable debt service level, annual reductions have not achieved financial equilibrium, and the county's fiscal condition remains highly unstable. Budgets continue to be patched together by one-time measures and ad hoc arrangements. Issues of major consequence, such as the impending transit deficit, are deflected and decisions postponed. Future costs for unfunded retirement liabilities and deferred maintenance continue to rise. Administrative services function with far fewer resources. **Nevertheless, despite these constrictions, the mission and scope of county operations remains unchanged**.

This report's introduction asked whether Milwaukee County can resolve its fiscal crisis through good management, or whether major policy decisions about the county's future revenues, programs and/or governance are required to right the ship. The preceding pages discuss the county's strong determination to manage through this crisis without, for the most part, making such big decisions, and it is possible it can continue to do so for at least the next few years.

Perhaps, however, the question should be rephrased. Rather than *can*, it might be better to ask *should* the County remain focused on year-to-year budget balancing, or has it reached the point where it instead must contemplate more comprehensive solutions?

Experts in local government finance at times use the term "slack" in assessing fiscal condition. The idea is that each government has, to a greater or lesser degree, untapped resources and capabilities that it can call upon in response to unanticipated events and fiscal crisis. While a government's slack can be hard to quantify, the term is useful in encouraging broader thinking and fiscal innovation.

Today, without question, Milwaukee County has far less slack than it did five years ago. Departmental budgets have been scrubbed and personnel and positions eliminated. With the issuance of POB's, the county will stretch its borrowing limits. The low hanging fruit has been harvested, and now the county's ladder rests at the top of the tree.

How would a reasonable and rational $1.3 billion corporation react to such a predicament? In all likelihood, it would develop a solvency plan. That plan would contemplate all alternatives, from implementing new or enhanced local revenue sources to reduce its reliance on external sources and augment flexibility; to eliminating, transferring or outsourcing programs and services that are not essential to its core mission and that could be performed just as well by others; to selling or leasing assets to generate capital as a means of paying down liabilities or re-investing in other assets that must be retained. Most likely, it would implement a mix of those approaches.

Do Milwaukee County's elected leaders have the political will to research, develop and agree on such a plan? If they do not, then it is time to contemplate outside intervention to address the county's structural problems and preserve quality services for its citizens.