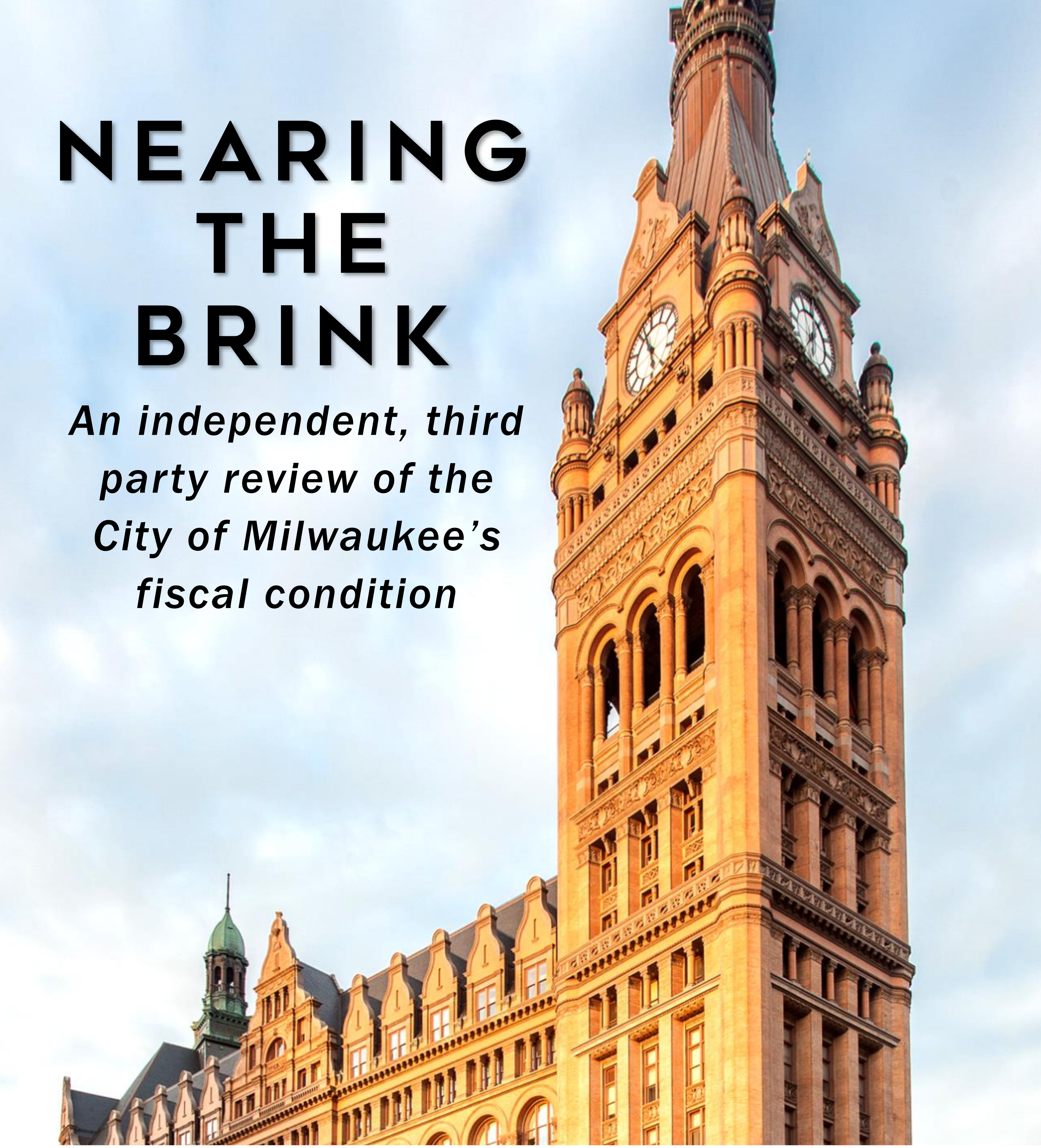
NEARING THE BRINK

An independent, third party review of the City of Milwaukee's fiscal condition



WISCONSIN POLICY FORUM

ABOUT THE WISCONSIN POLICY FORUM

The Wisconsin Policy Forum was created on January 1, 2018, by the merger of the Milwaukee-based Public Policy Forum and the Madison-based Wisconsin Taxpayers Alliance. Throughout their lengthy histories, both organizations engaged in nonpartisan, independent research and civic education on fiscal and policy issues affecting state and local governments and school districts in Wisconsin. WPF is committed to those same activities and that spirit of nonpartisanship.

PREFACE AND ACKNOWLEDGMENTS

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

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

In addition, we wish to acknowledge and thank the Greater Milwaukee Committee, which commissioned and helped fund this research. We also thank the Northwestern Mutual Foundation for its long-standing support of our local government finance research.

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September 2022

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INTRODUCTION

In 2009, a Wisconsin Policy Forum analysis of the city of Milwaukee's fiscal condition (*Between a Rock and a Hard Place*) generated front page news by concluding that city government was "on the precipice of serious fiscal and programmatic disorder." That conclusion was based on our assessment that "despite outstanding bond ratings, a comparatively well-funded pension system, and healthy reserves, Milwaukee has exhausted the capacity of its existing revenue streams to support its expenditure needs."

Seven years later, after several difficult budgets, we revisited the city's long-term outlook in *Making Ends Meet*. We found that city leaders had effectively used tools provided by 2011 Wisconsin Act 10 to dramatically lower health care costs, allowing it to meet pension obligations, replenish reserves, and avoid major service cuts. Still, we warned that the revenue structure allowed by the state "remain(ed) broken" and that "until it is modified to reduce the city's reliance on property-related revenue…city finances will continue to be stressed."

In this report, again commissioned by the Greater Milwaukee Committee, we revisit Milwaukee's fiscal condition. The task has taken on new urgency following the economic impacts of a global pandemic, six more years of struggle with the same "broken" revenue structure, and worsening liabilities from pensions and long-term debt.

As in our previous two assessments, we lean on metrics developed by the International City/County Management Association (ICMA) to analyze both the city's short-term and long-term fiscal health. In this update, however, we organize our analysis around the city's four main financial challenges, and we boil down the 12 metrics used in our earlier reports to specific groupings linked to those challenges.

Over the years, we have discussed the four – Milwaukee's unsustainable revenue mix, shrinking resources for core functions, diminishing reserves, and escalating long-term liabilities – with increasing alarm. Unfortunately, this new and closer look does little to ease our concern.

Still, the news is not all bad for the city. The infusion of $394 million in federal pandemic relief aid from the American Rescue Plan Act has allowed city leaders to push back the damage from their newest and perhaps most serious fiscal threat – a huge increase in employer pension payments – for two years. The aid also has allowed the city to avoid service cuts for now and build up its pension fund reserve to help forestall the pain from its budget and pension challenges once the federal funds are exhausted. Nevertheless, those funds provide only a short-term patch, not a permanent response, and there is risk that using them in this manner also will dampen the sense of urgency needed to develop long-term solutions, both in Milwaukee and Madison.

In the pages that follow, we seek to provide policymakers and citizens with a clear-eyed view of a city government that has struggled to stave off severe service cuts in the face of a longstanding and growing structural imbalance. A key change since we first highlighted this imbalance 13 years ago is that all of the symptoms that are prone to emerge when a government is under prolonged fiscal duress – withering reserves, growing liabilities, deferred capital investment, inability to sustain core service levels – are now plainly evident in Milwaukee's city government. We hope that a greater understanding of the city's financial predicament will better equip and motivate policymakers, civic leaders, and citizens to chart a course of action to address it.

KEY CHALLENGE 1: AN INCREASINGLY UNHEALTHY REVENUE MIX

With the exception of a recent influx of federal pandemic aid, the city of Milwaukee has seen the growth in its revenues flatten over the past decade and fail to keep pace with the rate of inflation. That is particularly true if we look at the revenues that are most important to financing core city services such as police, firefighting, street maintenance, public health, and libraries. As shown in Figure 1, the two main traditional sources of revenue that flow into the city's governmental funds (those that are supported by taxes) are the local property tax and state aid payments, and both have faced tight constraints.

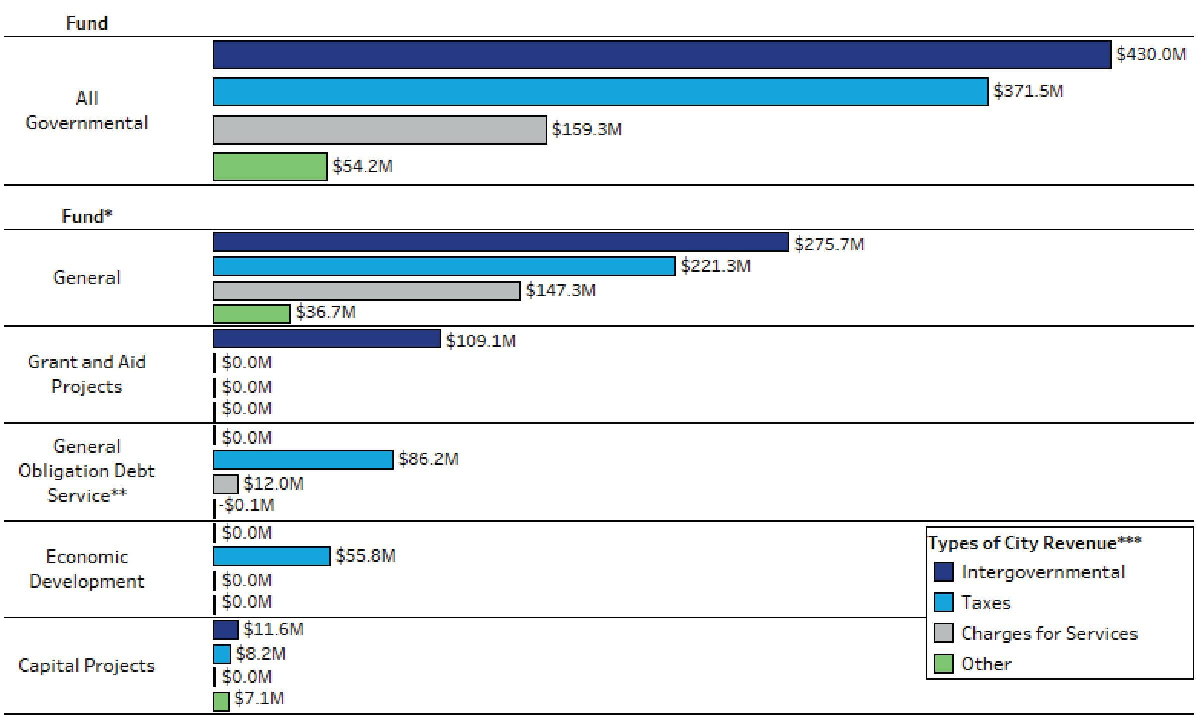
Sources and Approach

To produce this report, we have drawn on the city of Milwaukee's annual financial statements, budget documents, pension fund statements and actuarial reports, and figures reported by the city to the state of Wisconsin. Each provides a partial view of the city's finances and together they provide a fuller picture of the challenges ahead.

To paint the fullest picture of this change in revenues over time, we start with data reported by the city to the state Department of Revenue (DOR) for the past two decades. These data cover general revenues for the city, or revenues that flow into the city's general fund as well as certain other tax-supported governmental funds, including funds devoted to debt service, capital projects, economic development, and grants. Not included are enterprise funds that support city operations that are run more like businesses, such as the city's water and sewer utilities.

Figure 1: Milwaukee Heavily Dependent on State Aid and Local Property Taxes

Revenues in tax-supported city funds for 2021 with all governmental funds combined at top and broken out at bottom



Source: City of Milwaukee financial statements; *Does not include nonmajor funds. **Includes public debt amortization fund. ***Taxes include property taxes for the city, tax increment districts, payments in lieu of taxes, and interest and penalties. Other revenues include fines and forfeitures, licenses and permits, and special assessments.

The revenues flowing into these governmental funds grew by 42.7% between 2000 and 2010, an increase that was well above the 26.6% rise in inflation over those years. Yet in the next decade, growth in these revenues almost stalled, rising only 6.2%, or less than one-third of the 18.7% increase in inflation during that time.

State Aid Slows

The single biggest reason for this shift since 2011 has been the stagnant growth in state aid to the city. Because of its relatively low per capita property values and the previous design of the state's shared revenue program (the largest single source of state aid), Milwaukee has traditionally relied much more on state payments than other wealthier communities, such as Madison. In 2000, Milwaukee received 40.7% of its general revenues from state aid and only 21.1% from local property taxes.

Yet, as the state experienced budget challenges of its own, the governor and lawmakers made three cuts to the overall shared revenue appropriation for local governments in 2004, 2010, and 2012. Since then, funding for shared revenue has been largely flat, and **the impact on Milwaukee, the local government that is the largest single recipient of shared revenues, has been dramatic.**

By 2020, overall state aid had fallen to 27.6% of Milwaukee's general revenues. That was just below the 28.4% of revenues that came from the local levy – the first time in the state data that local property taxes had contributed a larger share of the city's general revenues than state aids (see Figure 2 on the next page). The one bright spot for the city has been the recent surge in federal pandemic relief aid, which we will discuss in greater detail later.

Taxes Rise But Mostly for Debt

The increased reliance on property taxes poses a challenge for the city's many low-income residents, who pay property taxes directly if they own property or indirectly through their rent. It may also have a marginal impact on efforts to recruit and retain businesses in the city, though other

ICMA Fiscal Indicators: Revenues

ICMA Rationale – Steady revenue generally is associated with stable operations and service levels. ICMA emphasizes a government's need for annual revenue growth (which ideally should at least mirror the rate of inflation), as well as the ability to access and to some degree control revenues that are not restricted to specific uses.

ICMA Warning Signs – In our 2009 and 2016 reports, we cited concerning ICMA metrics that included lack of overall inflation-adjusted revenue growth, shrinking state aid and other intergovernmental revenues (over which the city has little control), and local tax revenues (over which it does have some control) increasingly devoted to long-term obligations such as pensions.

City of Milwaukee Findings – The warning signs are flashing brightly for Milwaukee in each of these areas, the city's financial statements show. Between 2011 and 2021, revenues grew by only 12.8% in the city's tax-supported governmental funds, which was substantially lower than the 20.5% increase in the Consumer Price Index over that period. Meanwhile, intergovernmental revenues would have been flat or even fallen before adjusting for inflation if not for a major one-time influx of pandemic relief funds. Even with that, their growth fell just short of keeping pace with inflation. While this has diminished the city's dependence on these revenues, this is a significant problem for the city given that its state-imposed revenue structure creates a heavy reliance on state aid. Finally, property taxes dedicated to governmental funds (including general city purposes, debt payments, and the pension contribution) grew by 50.1%, more than doubling growth in CPI. The downside there, however, is that all of the growth was on the pension and debt side; as we discuss in the next section, the amount of tax levy devoted to core city operations actually declined over the period without even adjusting for inflation.

For this set of indicators, we issue a red light, which indicates a **significant threat** to the city's financial health.

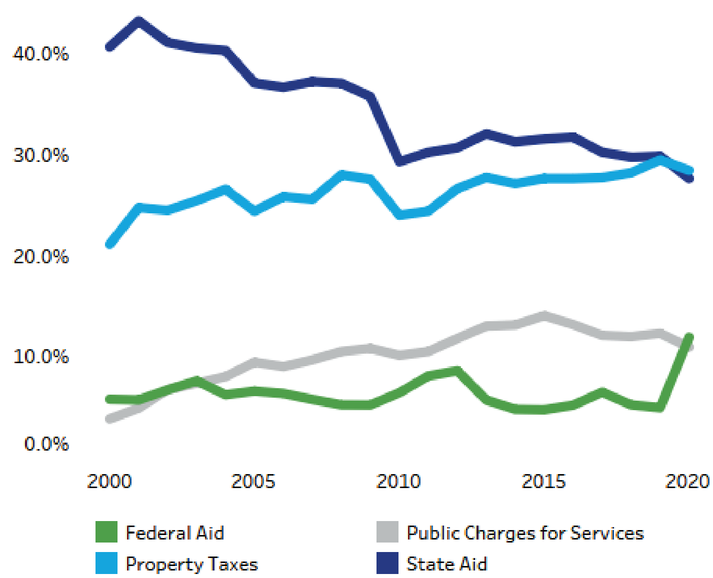
communities in southeastern Wisconsin also depend heavily on the property tax.

Milwaukee's reliance on the property tax has risen despite tight state caps that since 2011 have limited annual increases in property taxes used for operations to the rate of net new construction in a municipality. The rule has proved challenging for all local governments in the state but has been particularly burdensome for Milwaukee, where the rate of net new construction has lagged the state average in recent years. For example, the net new construction rate for the city as of January 2022 was 1.2%, which was a big improvement over the previous year but still roughly one-third less than the statewide average of 1.7% (see Figure 3) and also well below the rate of inflation.

For the city of Milwaukee as well as other local governments in Wisconsin, the only major exception to the state's levy limit is for property taxes used to make debt payments. As WPF has noted in other reports, that provides an incentive for local governments to borrow for spending on items that in the past they might have paid for in cash. In the case of Milwaukee, the data suggest the city is being pushed down this path.

Figure 2: Property Taxes Overtake State Aid

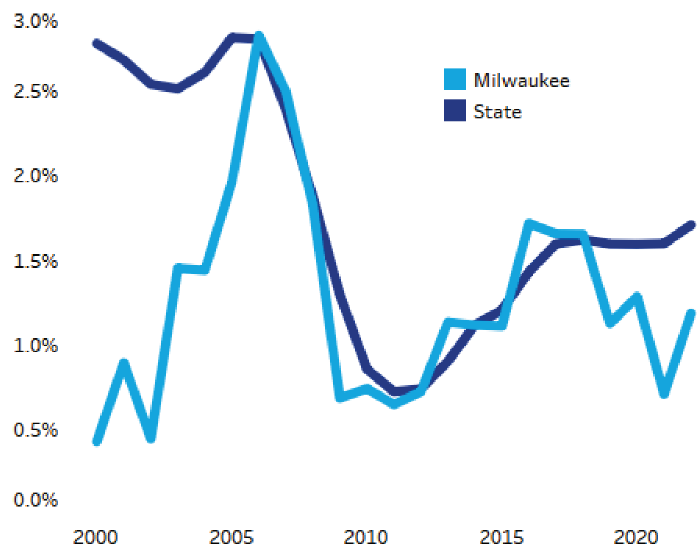
Key sources as a share of Milwaukee general revenues by type and year



Source: Wisconsin Department of Revenue

Fig. 3: New Construction in Milwaukee Falls Behind State

Increase in property values due to net new construction by year



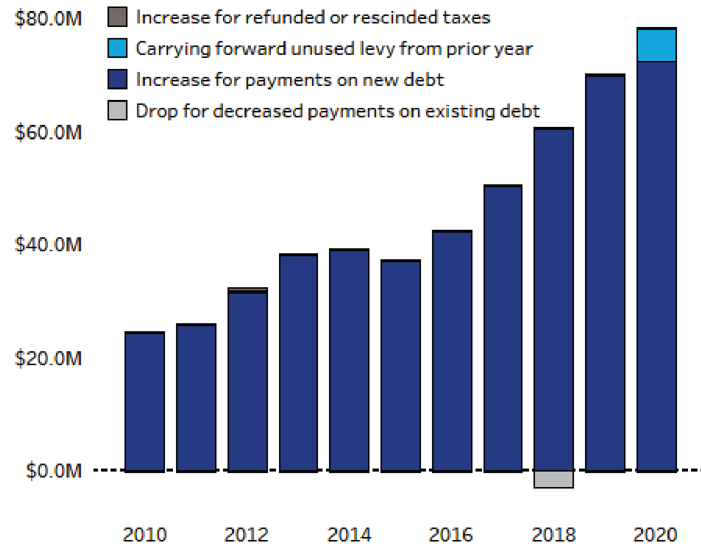
Source: Wisconsin Department of Revenue; percentage equals value of net new construction divided by prior year's equalized property value.

In 2000, the city's tax levy provided $14.1 million in cash to support its adopted capital budget compared to $37.4 million in borrowing that would be repaid using revenues from the levy, according to budget documents. In the intervening years, the amount of cash from the tax levy going to capital projects has dropped to nearly zero. The 2022 general city capital budget includes just $315,000 in levy dollars out of total funding of $136.7 million, or just 0.2%. Borrowing has made up the difference, with debt payments from the tax levy rising to $85.4 million in 2022.

Figure 4 on the next page shows the trend toward borrowing in another way using data from the state worksheets used by the city to calculate its annual property tax increases. Besides the annual increase in net new construction, debt payments are the only other factor that really matters for calculating the yearly levy increase allowed under state law. The city used the state exemption for debt payments to levy $72.4 million in property taxes on December 2020 tax bills, or nearly double the $37.4 million exemption for debt payments in 2015.[1]

Figure 4: Milwaukee Property Taxes Rise to Pay Debt

City exemptions to state levy limits by type and year (nominal $)



Source: Wisconsin Department of Revenue; not shown is a small 2018 increase for unused levy.

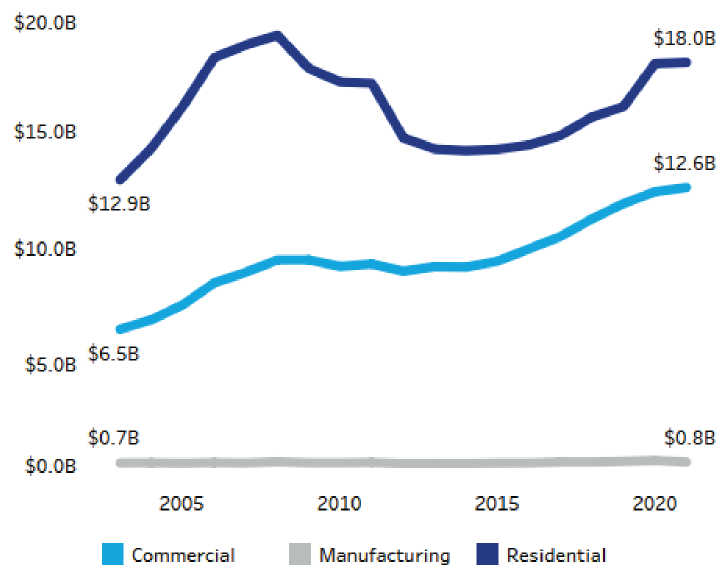
This trend means that **the majority of the overall increase in city property taxes over those five years went not to increased spending on ongoing city operations and services, but to debt payments for expenditures that had already been made.** In fact, state figures show the city's property tax levy grew by $50 million between 2015 and 2020, with the exemption for debt payments in state law accounting for 70% of that growth. The rising debt payments also reflect an increase in outstanding city debt, as we will discuss in a later section.

Greater Reliance on Commercial Property Taxpayers

One other property tax trend for the city is worth noting – the rise in Milwaukee's dependence on commercial property taxpayers. After peaking in 2008, the Great Recession and home foreclosure crisis precipitated a fall in residential property values in the city for six straight years (see Figure 5). Even after several recent years of growth, overall residential values remained lower in 2021 than they were prior to the economic downturn.

Figure 5: Commercial Property Looms Larger in Milwaukee

City property assessments* by property type and year (nominal $)



Source: Wisconsin Department of Revenue; *does not include personal property.

Meanwhile, commercial property values remained somewhat more stable during the Great Recession and have seen strong growth since. The result has been a greater dependence on commercial property taxpayers to pay the overall levy in the city. State data show that in 2003 (the earliest

[1] Note these figures represent only the city's exemption for debt service under state law, not its full debt levy.

year available), commercial real estate in Milwaukee (not including personal property) was assessed at $6.5 billion, or 32.2% of the total. By 2021, commercial real estate had grown to $12.6 billion, or 40.2% of the total assessed value in the city.

Housing values in the city have recovered somewhat in recent years and surged in 2022, closing some of the gap with commercial property. Yet commercial property still accounts for a larger share of the overall property tax levy than it did prior to the Great Recession. Though this is a benefit to home owners, it raises property tax bills for commercial property owners and might have a marginal impact on efforts to keep and attract businesses in the city.

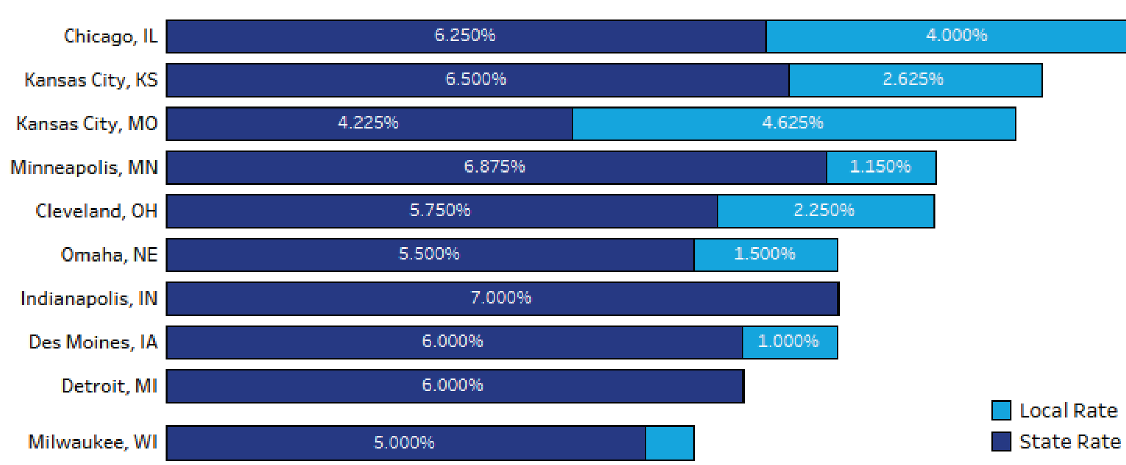
Other Revenue Options Largely Absent

The city has few options for increasing its revenues, making its stagnant state aids and property tax levy restrictions even more difficult to accommodate. As we have noted in "On the Money?," our 2017 report on Milwaukee's unique revenue mix, and "Dollars and Sense," our 2019 look at municipal revenues across Wisconsin, Milwaukee is different from most similar-sized cities in not having the legal authority to collect a municipal sales tax.

The sales tax rates are also relatively low for the state at 5% and Milwaukee County at 0.5%, giving Milwaukee the lowest sales tax rate of any large city in the region (see Figure 6). Total sales tax rates for Milwaukee would remain the second-lowest in the group of cities even if the local rate were raised by an additional 1 percentage point. In light of the ongoing constraints on its two primary revenue sources – and to shift some of the responsibility for supporting city services away from property owners and toward commuters and visitors – some area elected and business leaders have called on the Legislature to allow an increase in sales taxes for both the city and Milwaukee County.

Figure 6: Sales Taxes in Milwaukee Lower Than in Other Major Midwestern Cities

Combined state and local sales tax rates by city as of mid 2021



Sources: Tax Foundation and Wisconsin Policy Forum research

Unlike most other municipalities in the state, the city also does not keep any of its room tax on hotel stays and other overnight lodging. Those revenues instead go to the Wisconsin Center District to help finance its exposition facilities.

State law allows the city to collect a vehicle registration fee on motor vehicles kept in Milwaukee, and the city could increase it to bring in more money for transportation. However, the city raised the fee in 2021 from $20 to $30 and Milwaukee County also collects a $30 fee in addition to the state fee of $85 for the typical vehicle. The flat fee is also applied regardless of a vehicle's value, limiting the amount city officials might wish to further increase it given the impact on low-income motorists.

Federal Pandemic Aid Eases Pain for Now

One major exception to the slow growth in city revenues has been the massive infusion of federal aid to help the city cope with COVID-19. Both in payments directly from the federal government and money passed along by the state of Wisconsin, the city has used these one-time revenues mostly to plug short-term budget holes, though it also has dedicated some to long-term investments.

The largest single federal grants included $103 million through the Coronavirus Relief Fund created by the 2020 Coronavirus Aid, Relief, and Economic Security (CARES) Act as well as $9.6 million from the state's share of CARES funding. Among other uses, the city drew on the Relief Fund aid to assist businesses and residents (39.3% of the funding); support public health efforts such as vaccination clinics, free facemasks, and a residential isolation center for low-income individuals who tested positive (28.6%); cover agency expenses (13.3%); and pay for other costs such as hazard pay, COVID-related leave, and IT and facility upgrades (18.8%), according to city budget officials.

The city also received $394.2 in funding from the Coronavirus State and Local Fiscal Recovery Funds created by the federal American Rescue Plan Act (ARPA), with half of that paid in May 2021 and the other half in June 2022. As we explained in an April brief, these funds must be obligated by the end of 2024 and spent by the end of 2026 and can be used to replace lost revenues; protect public health; assist affected families, businesses, and nonprofits; upgrade water, sewer, or broadband infrastructure; or provide premium pay for essential workers.

The city has allocated most but not all of the ARPA funds. According to the city budget office, the first half of the funds is being used as follows:

- $86.6 million for city services and operations
- $37 million for housing improvements
- $26.3 million for lead abatement
- $15 million for COVID-19 mitigation
- $10 million for upgrading street lighting
- $8.1 million for workforce programming
- $7.2 million for addressing reckless driving
- $7 million for early childhood education

With the second half, the city is seeking to use $150 million to plug budget holes over the next two years, with $75 million already approved for 2023 and $75 million more for 2024 that still needs city council approval. In addition, the city is proposing $9.4 million for housing projects, $10 million for street lighting, and $2.5 million for administration, leaving $25.2 million that is not yet allocated.

As part of its ARPA plans, the city has directed $50.8 million to the Milwaukee Fire Department to free up $36 million in tax levy funding. That move is allowing the city to put an additional $30 million into a reserve fund to help deal with a looming pension crisis.

Going forward, the city can continue to use the ARPA funds to ease some of its short-term financial pressures. However, doing so would mean foregoing capital investments that could pay dividends for years and even decades to come. In addition, while the need to temporarily plug budget holes that have arisen from rising pension payments is understandable, **the city will have to confront the same difficult financial decisions once the ARPA funds are depleted**.

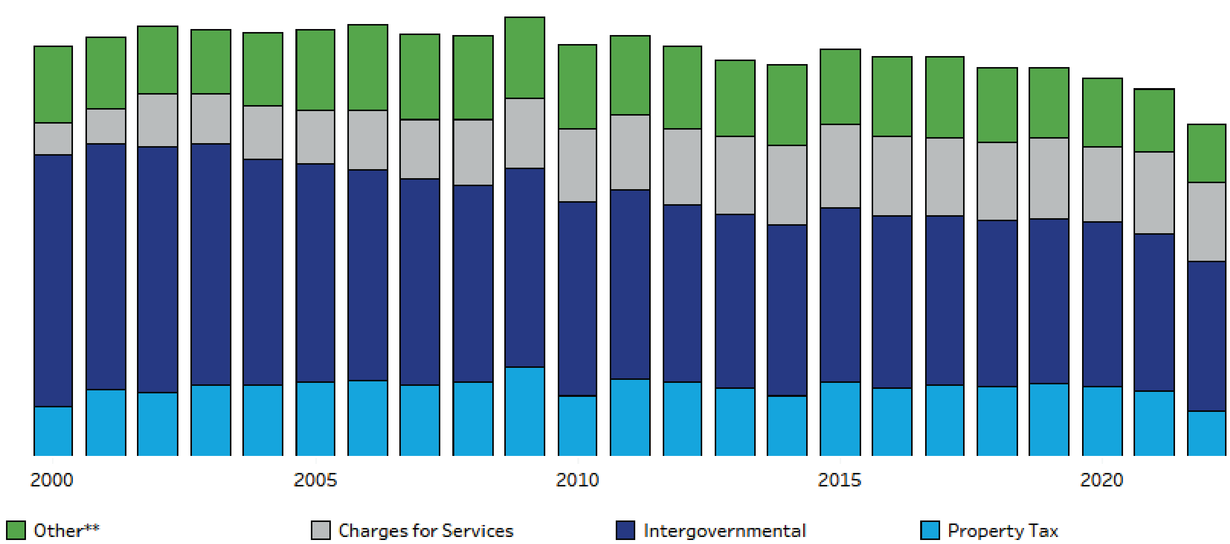
KEY CHALLENGE 2: DIMINISHED CAPACITY TO SUSTAIN CORE SERVICES

The data presented so far draw on financial statements to provide a broad look at the taxes and other revenues flowing into the city's governmental funds, which encompass its main tax-supported activities, projects, and services. Much of the attention during city budget deliberations, however, focuses on the narrower general city purposes budget. This portion of the budget does not include debt or pension payments, capital projects, economic development, or enterprise funds, but instead supports core city services such as police, firefighting, emergency medical services, public works, and public health.

In the 2000s and through the Great Recession, budgeted revenues supporting general city purposes spending roughly tracked the rate of inflation (as measured by the Consumer Price Index, or CPI). Adjusted for inflation, general city purposes revenues totaled $754 million in 2000 and almost the same amount in 2012 at $755 million (see Figure 7).

Figure 7: Pension and Debt Payments Leave Less Funding for Services

Gen. city purposes revenue* (excludes funds for pension & debt payments) by year (2022$)



Source: City of Milwaukee adopted budgets; *Revenues for 2021 and 2022 are as adopted. **Other includes transfers from the Tax Stabilization Fund.

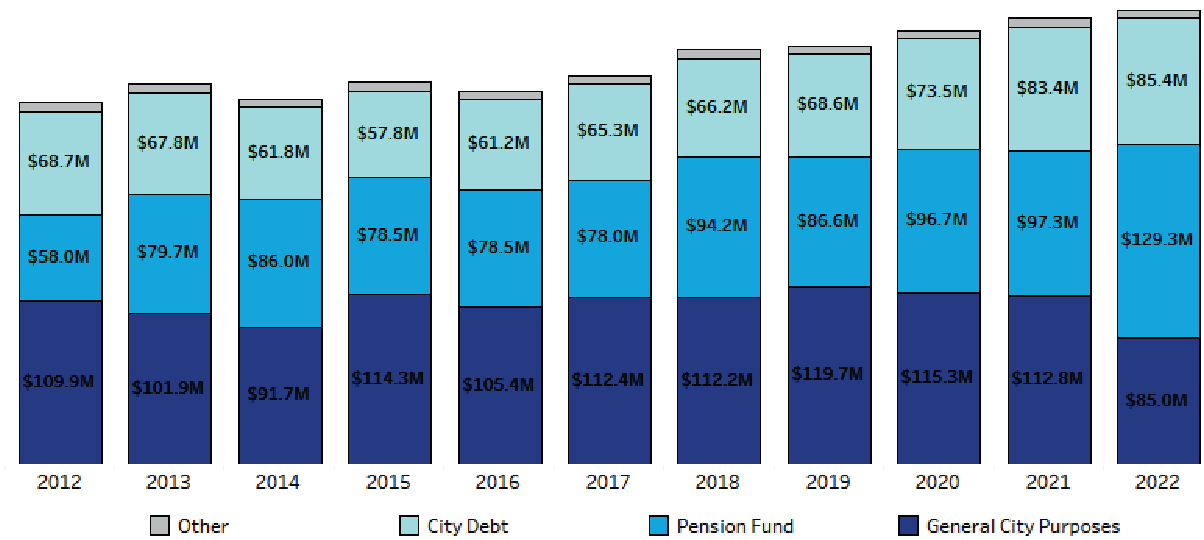
Between 2012 and 2022, however, nominal general city purposes revenues barely budged while inflation has grown and done so rapidly over the past two years. That left the city with just $610.9 million budgeted for general city purposes revenues in 2022, or 19% less than in 2000 after adjusting for inflation. It should be pointed out, however, that the dip in 2022 was due in part to the use of ARPA funds for the Milwaukee Fire Department as noted above.

This troubling trend is attributed both to the tight constraints on the overall levy and demands to devote greater shares to other needs. One of those needs, as discussed above, is debt service, which required a $85.4 million tax levy allocation in the 2022 budget compared to $68.7 million in 2012. For the first time, the share of the property tax going to debt payments was slightly larger than the $85 million going to the general city purposes budget.

Yet an even bigger problem has been the city's tax levy contribution to support its Employee Retirement System, or pension fund. That contribution grew from $58.0 million in 2012 (before adjusting for inflation) to $129.3 million in 2022 and is about to swell even larger (we discuss the city's pension challenges in much greater detail below).

Consequently, while the city's property tax levy has grown over the past decade at a rate that has outpaced inflation, **the amount available to finance core city services after adjusting for inflation has plummeted** (see Figure 8).

Figure 8: Property Taxes Increasingly Pay for Pensions and Debt
Uses of common council-controlled property tax revenue, 2012-2022* (nominal $)



Source: City of Milwaukee budget documents. *2021 and 2022 numbers are adopted budget amounts; 2012-2020 amounts are actuals; other includes capital projects and common council contingency.

Meanwhile, as also discussed above, revenue flowing into city coffers from state aid and other intergovernmental payments has lagged inflation to an even greater degree, compounding the problem for core city services. In fact, the city's budgeted intergovernmental revenues were slightly lower in 2022 at $273.5 million than the actual revenues in 2000 ($278.4 million) even before adjusting for inflation. When adjusted for the rise in consumer prices, overall intergovernmental aid fell by 41%, from $463.1 million in 2000 to its current total.

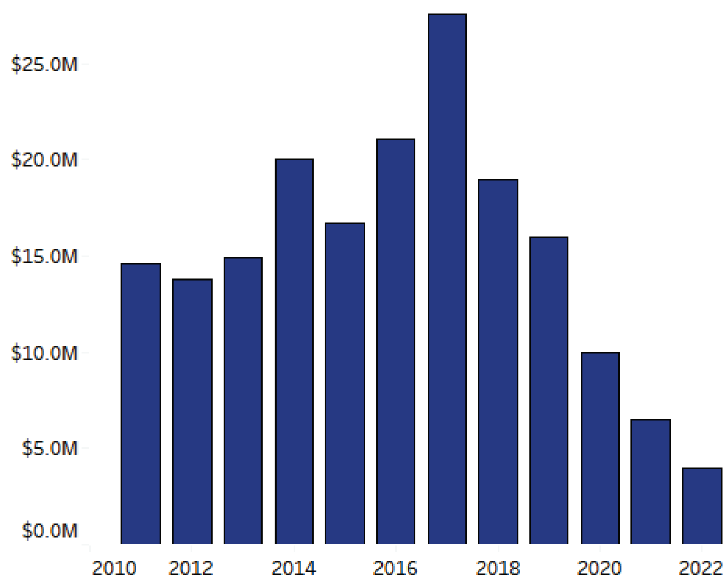
One area of rapid revenue growth for general city purposes has come from city charges for service. In fact, the city has typically increased its major fees charged to property owners for stormwater management, snow and ice removal, and solid waste by 2% to 4% annually, and it adopted a new street lighting fee in late 2020.

Even after adjusting for inflation, these fee revenues more than doubled over the past two decades, from $59.3 million in 2000 to $144.7 million in 2022. Charges for services have gone from being a much smaller part of the general city purposes budget than the property tax to being a much larger one. However, their growth has not been enough to offset other lagging revenues. In addition, a 2013 state law limits new types of fees by prohibiting the use of revenues raised from them to pay for certain services that were funded previously through the property tax.

Another key challenge for the general city purposes budget has been a decline in annual transfers from the tax stabilization fund, a form of reserve for the city, which dropped from $27.6 million as recently as 2017 to $6.5 million in 2021 and $4 million in 2022 (see Figure 9). This decline came as annual efforts to replenish the reserve with year-end surpluses were hampered due to the city's growing fiscal challenges (we discuss the city's diminishing fund balances and reserves in a later section).

Fig. 9: Tax Stabilization Fund Contributes Less to Budget

Transfers to city general fund from tax stabilization fund (nominal $)



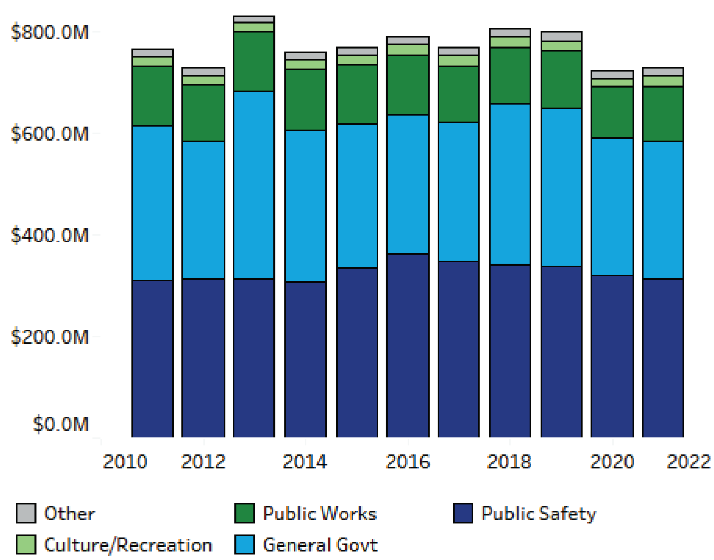
Source: City of Milwaukee financial statements

Expenditures Slow

Given these restrictions on revenues available to support core city functions, it is not surprising that over the past decade, the city's spending on core services has failed to keep pace with inflation. Though expenditures for certain key functions such as public safety have increased at roughly the rate of the CPI, spending on other areas – such as public works, administration, and other general government spending – has grown much more slowly.

Figure 10: City's Core Spending Relatively Flat

City of Milwaukee general fund spending by year in millions (2021$)



Source: City financial statements; excludes debt payments and capital projects.

To analyze these trends, we begin by looking at the city's actual general fund spending on operations, which covers core services and the pension fund contribution but excludes spending on debt payments, interest expense, and capital projects. Between 2011 and 2021, general fund spending rose from $636.7 to $730.7 million, or 14.8% -- less than the 20.5% increase in CPI and notably less than the $756 million spent in 2019, according to the city's financial statements (see Figure 10). Spending over those years increased from $1,069 per capita in 2011 to $1,243, an increase of 16.2% that likewise lagged inflation.

Public safety spending rose 20.8% over those years, or just a bit more than the rate of inflation. The city's spending on health and culture and recreation rose by more than the rate of inflation but those areas represent modest portions of the overall budget.

Spending on streets and other public works rose only 11.2% and spending on general government functions such as administration rose only 8.4% -- despite the fact that the city reports spending on fringe benefit costs such as pensions and health coverage within the general government category. Over the past decade, the city made considerable strides in controlling its health care costs, benefiting in part from the fact these benefits no longer had to be negotiated with public employee unions to the same degree as in the past. Moving forward, however, the city will see extensive spending pressure from increases to its pension contributions (see further discussion below).

Spending did rebound with a 5.8% rise in 2021, increasing from $690.8 million in 2020 to $730.7 million last year. In its 2021 financial statements, the city says the increase is "due mainly to an overall increase in employment costs due to wage inflation caused by hiring shortages."

In short, the city's spending **raises concerns that it has been unable to maintain service levels on functions besides police and fire protection.** That could prove an even larger issue as federal pandemic aid runs out in 2024 and inflation and increased pension contributions add to the city's costs. A look next at the drop in the number of city employees over time further highlights that concern.

The City's Workforce Shrinks

Over the past two decades – a period when Milwaukee's population has been relatively stable – the city has cut a substantial share of its staffing, including in the key area of public safety where it has sought to maintain spending. To track the changes, we looked at full-time equivalent (FTE) positions authorized in the city's adopted budgets (these budgeted figures are larger than the actual number of workers employed by the city). Total budgeted positions fell from 8,225 in 2000 to 7,202 in 2022, a decrease of 12.4% or 1,023 positions (see Figure 11 on the following page).

ICMA Fiscal Indicators: Spending and Workforce

ICMA Rationale – ICMA emphasizes the need for a government's expenditures to grow at or slightly above the pace of inflation as well as at a rate that corresponds with its revenue growth. Also, in light of the significant portion of government spending that goes to personnel costs, growth in a government's workforce should not exceed growth in its revenues. Finally, ICMA stresses the importance of tracking expenditures by function to assess the impacts of overall revenue and expenditure challenges on different types of services.

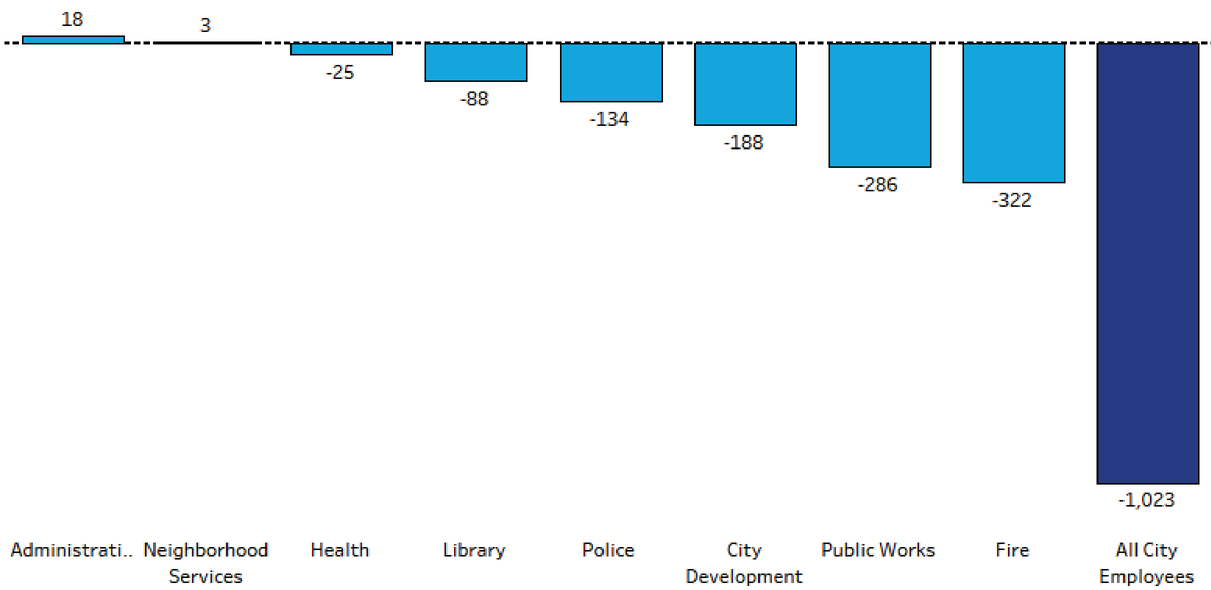
ICMA Warning Signs – In our 2009 and 2016 reports, we used ICMA metrics to gauge potential concerns due to an imbalance between expenditures and net operating revenues, workforce growth that was out of line with long-term fiscal capacity, or an increasing proportion of spending on one or two functions at the expense of others.

City of Milwaukee Findings – The findings here are nuanced. At first glance, it is encouraging that the city was able to hold increases in tax-supported governmental fund spending from 2011 to 2021 to 14.8%, which was lower than the 20.5% increase in inflation and largely consistent with its revenue growth. It also has made difficult decisions to shed positions as fiscal challenges have grown, reducing total FTEs by 1.1% (from 7,280 to 7,202) over the past decade and even more over 20 years. However, success on those two ICMA indicators – which mirrors our findings in 2009 and 2016 – directly conflicts with a strong warning sign for the third. Public safety spending continued to outpace overall governmental spending from 2011 to 2021, rising 20.8% and continuing a trend that precipitated a warning in our 2016 report that the city is increasingly unable to maintain service levels on functions outside of police and fire. As we will discuss in the next section, this concern will grow as additional resources must be dedicated to the pension fund beginning next year.

For this set of indicators, we issue a yellow light, which indicates a set of trends that **requires careful monitoring**.

Figure 11: City Loses More than 1,000 Workers Over Two Decades

Change in budgeted city full-time equivalent positions by department, 2000 to 2022



Source: City of Milwaukee Budget Office

The number of budgeted police department positions dipped from 2,694 in 2000 to 2,560 in 2022, a loss of 5%, or 134 positions. Meanwhile, fire department staffing dropped by 26.8%, or 322 positions, from 1,202 in 2000 to 880 in 2022. The decreases in both departments would have been even greater, but the city added civilian staff who partially offset the decreases in sworn personnel.

Other areas of city government also have taken hits. The Department of Public Works decreased its budgeted positions from 1,739 in 2000 to 1,453 in 2022, a drop of 16.4% or 286 positions. Heading into the pandemic, the Milwaukee Health Department had fallen from 352 positions in 2000 to 271 in 2019. The number rose back to 328 in 2022 but is still down from previous levels and could fall further once federal pandemic relief funds are exhausted. Department of Administration employees have grown 14.5% from 2000, but that is only an increase of 18 positions.

The savings from these position cuts have been critical to helping the city balance its budget despite limited revenue growth. **Yet they also raise questions about the potential impacts to public safety and other critical services,** particularly if the city's rising pension costs and the depletion of the ARPA funds force another major round of cost cutting in the future.

In addition, the city faces challenges moving forward in retaining those workers that it still employs and in hiring qualified staff to replace those who do leave. A recent WPF brief examined reports from the city, Milwaukee County, and state pension systems and found in all three cases that employee turnover was at the highest levels seen in the available data, which for the city stretched back over the past five years.

City officials also have grappled with how to pay their employees fairly given their different roles and the fact that unions for city police and firefighters still have broad collective bargaining powers, while those for general employees were repealed by 2011 Wisconsin Act 10. Comparing employee compensation across time is admittedly difficult. The pension system, for example, treats these groups of workers differently and in some years, city management and general employees have been subject to a pay-for-performance plan that police and firefighters were not.

Nevertheless, a clear trend emerges for across-the-board pay increases. A memo from the city budget office shows that from the 1990s through much of the 2000s, wage increases for general city and management employees tracked the rate of inflation and were only modestly less than the increases provided to police and firefighters. That changed, however, in 2008, with the onset of the Great Recession and the subsequent passage of Act 10.

At first, wage growth stalled for all employees, but in subsequent years gross wage increases for police and firefighters exceeded inflation – at least before factoring in changes to pension and health insurance and before the rapid jump in inflation in 2021. That has not been the case for the city's general and management employees, whose wages have lagged consumer prices. These workers, for example, saw no across-the-board wage increase in either 2020 or 2021 despite the rapid inflation last year.

With recent challenges from COVID-19 and violent crime, city officials may feel a need to prioritize pay for public safety workers, who now are also seeing their salaries eroded by rapid inflation. Yet, in an historically tight labor market and with many vacant positions, leaders may also need to consider whether the city is doing enough to attract and retain staff in its other departments, as well.

KEY CHALLENGE 3: DEPLETED RESERVES

A key question for finance officials is whether the city has the cash and other liquid assets it needs to weather unexpected shocks such as a recession or the rise of a dangerous variant of COVID-19. A related question is whether reserves are sufficiently stocked to allow for steady usage to provide some property taxpayer relief and to mitigate service reductions in particularly difficult budget years.

The good news, in the short term, is that in 2020 the city benefited from a sizable increase in the overall balance in its general fund, or main set of accounts, because it issued more than $100 million in debt that will come due in 2030. (The move also locked in a lower interest rate for the city on the borrowing it uses to ensure adequate cash flow, which was the main reason for the action.) After four straight years of rapidly declining general fund balances starting in 2015, the city's total general fund balance of assets minus liabilities more than tripled from $52.5 million at the end of 2019 to $176.4 million at the end of 2021 (see Figure 12 on the following page).

However, this increase in the overall general fund balance may be somewhat misleading since it primarily reflects the proceeds from what is known as a revenue anticipation note, a form of debt that will eventually have to be repaid. The note has provided the city with additional liquidity and helped both to limit short-term borrowing and allow the city to gain a better interest rate when it does need to borrow. Yet these funds do not represent an improvement to the city's long-term finances.

For a look at true reserves with no strings attached, we examined the city's unassigned general fund balance and find it has fallen from a high of $61.7 million, or 8.9% of annual operating revenues, at the close of 2015 to just $9.1 million at the end of 2021, or 1.3% of operating revenues.

ICMA Fiscal Indicators: Reserves and Liquidity

ICMA Rationale – Key measures of a city's short-term and long-term fiscal health involve liquidity and reserve balances. Liquidity refers to a government's ability to draw upon its cash and short-term investments to meet its near-term financial obligations, while ICMA cites trends in a government's general fund balance as an important indicator of its reserve capacity to meet unanticipated fiscal challenges or emergencies.

ICMA Warning Signs – In our 2009 and 2016 reports, we employed ICMA metrics to determine whether the city faced any challenges from a decreasing amount of cash and short-term investments as a percentage of current liabilities or a falling general fund balance as a percentage of operating revenues.

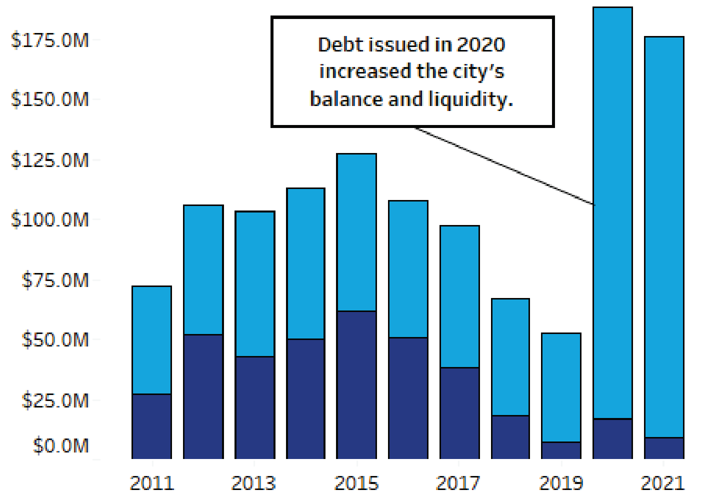
City of Milwaukee Findings – Our findings here constitute some of the most important negative changes in the city's fiscal condition from our 2016 analysis, when both received green lights. Milwaukee's liquidity is still strong (total general fund liabilities amounted to about 61% of cash and short-term investments at the end of 2021), but only because in 2020 the city issued a more than $100 million revenue anticipation note, which is a form of debt that will have to be repaid after 10 years. The city's liquidity had actually deteriorated substantially in 2018 and 2019 (liabilities grew to nearly 100% of cash and short-term investments) before recovering after the debt was issued. In addition, the year-end general fund balance had fallen to $52.5 million by 2019 after exceeding $100 million each year from 2012 through 2016, though the revenue anticipation note did help to boost that balance to $176.4 million by the end of 2021. Moreover, the city's *unassigned* general fund balance – which is a better barometer of reserve capacity – fell from $61.7 million (8.9% of annual operating revenues) at the close of 2015 to just $9.1 million (1.3% of operating revenues) at the end of last year.

For this set of indicators, we issue a yellow and red light based on the need for **careful monitoring** of the recent trend in liquidity (which is still strong but has declined absent the borrowing) and the **significant threat** to the city's reserve capacity posed by a diminished unassigned general fund balance.

This drop in the unassigned balance hints at the challenges the city may face once it spends the rest of the federal pandemic relief funds.

The decrease in reserves has not gone unnoticed by national bond rating agencies, which assess the city's financial condition and capacity to repay bondholders. In April, Fitch Ratings noted that "reserves have been drawn on to fund operations for the past three years, which has reduced (the city's) financial resilience." S&P Global Ratings noted that same month that the city had stabilized reserves and still had adequate flexibility in its budget but that "the city's reserve position is still significantly weaker than it had been in previous years."

Figure 12: City Gains Liquidity but True Reserves Limited
Unassigned & other general fund balances by year in millions (nominal $)



Source: City of Milwaukee financial statements

A similar metric is the tax stabilization fund reserve (TSF) within the city's general fund, which represents the fund's unassigned balance plus amounts that city officials have decided to use in the coming year for the next year's general fund budget and for an advance to the city's capital projects fund. The TSF balance available for the following year has dropped in a similar fashion, from a recent high of $56.5 million at the end of 2016 to just $14.7 million at the close of 2021, the lowest level in at least a decade. As noted earlier, the decrease in this reserve has meant that the city has had to sharply decrease the draw it takes every year to help finance core city services.

The city does have some additional financial cushions, including the Public Debt Amortization Fund. Created in 1925, this fund is intended to smooth out the fluctuations in debt payments and serves as a partial reserve for these payments. Though the fund still had $43.1 million at the end of 2021, its balance has fallen steadily over the past decade and is now at its lowest level in at least 20 years even before adjusting for inflation.

As we will discuss in the next section, the city has been more successful in recent years at building up its pension reserve fund, which by the end of 2022 will have a balance of more than $80 million. Yet this balance may be rapidly depleted once ARPA funds are exhausted as it is used to blunt the impact of a skyrocketing pension contribution.

A final consideration in thinking about the city's finances from a short-term perspective is whether it has sufficient liquidity, or enough cash and investments on hand to pay its expenses as they arise. Here, the city is in a relatively strong position because of the revenue anticipation note issued in 2020.

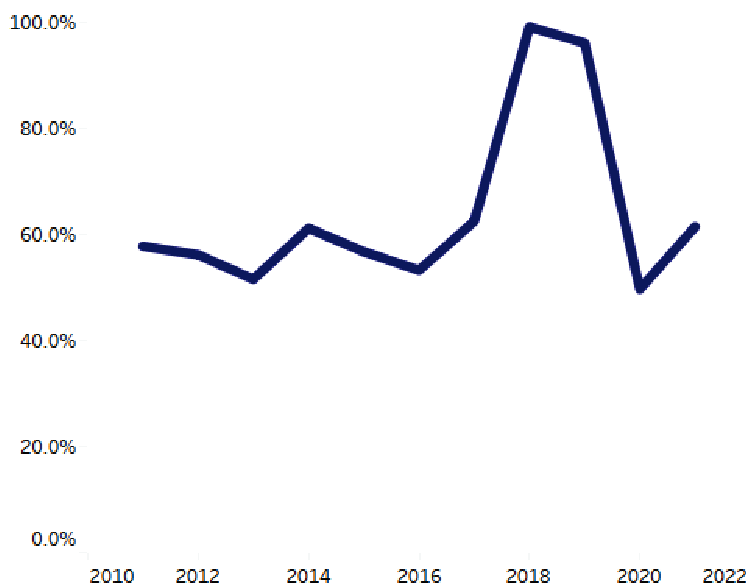
For example, at the end of 2021, the city's general fund had total liabilities of $84.1 million, which amounted to about 61% of the $137 million in cash and investments held by the fund at that time.

As shown in Figure 13, that was a big improvement over 2018 and 2019 and is similar to the city's ratio over the past decade. It helps explain why S&P Global praised the city's "very strong liquidity position" in its latest bond rating report. In addition, the city for now at least has additional ARPA dollars in its separate grants fund.

However, the increase in the general fund's cash and investments is due primarily to borrowing that will have to be repaid in 2030. In short, though the city is in a better cash position for now, **it has little in the way of true reserves that will outlast the ARPA funds**, creating concern here as well.

Figure 13: City Regains Liquidity Needed to Cover Liabilities

Ratio of liabilities to assets in city general fund by year



Source: City of Milwaukee financial statements

KEY CHALLENGE 4: SUFFOCATING LONG-TERM OBLIGATIONS

At present, no financial challenge looms larger for the city than its pension costs and their steep expected rise next year. The difficulty is by no means unique to Milwaukee; in fact, the city's pension fund has long maintained higher funding levels than most other public pension systems nationally. However, that advantage has eroded over time as the plan has acknowledged that it may not be able to meet its investment targets, which in turn has led to a need for growing contributions from the city and other local public employer participants as its funding level has dipped to just over 83% as of January 1 of this year (see Figure 14 on the following page).

The city of Milwaukee Employees' Retirement System provides retirement, disability, and death benefits to 10,094 active worker members, 5,512 former workers who are not yet retired, and 13,758 beneficiaries. They include current and former police officers, firefighters, and other city workers as well as employees in the Metropolitan Milwaukee Sewerage District (MMSD), the Wisconsin Center District, the city housing and redevelopment authorities, and certain Milwaukee Public Schools (MPS) staff who are not teachers or administrators. So though the city bears the brunt of the pension challenges, they will affect other public employers in Milwaukee as well.

Pension systems make estimates about whether they have enough assets to invest and then use to pay the benefits that will be owed to future retirees. During the 2000s, estimates for the city pension plan showed it had more than enough assets on hand, but that started to change with the Great Recession, as the plan's investments took heavy losses, turning a surplus into an unfunded liability. Since then, the city system has faced further headwinds, including investment losses in some years and a broader acknowledgement that the fund appears unlikely to achieve rates of return that it expected to earn on its investments during the 2000s. That has

ICMA Fiscal Indicators: Long-Term Liabilities

ICMA Rationale – Significant increases in annual payments to support long-term obligations – like pension liabilities and capital debt – can threaten a local government's ability to maintain service levels and pose a threat to future taxpayers. ICMA urges governments to assess this threat by tracking growth in pension and OPEB liabilities (and in the case of pensions, comparing plan assets to liabilities) as well as growth in long-term borrowing as a percentage of property values.

ICMA Warning Signs – In our 2009 and 2016 reports, we drew on ICMA metrics to look for any drop in the pension funding level (the value of assets to liabilities as determined by an actuary), or an increase in general obligation debt as a percentage of equalized property value.

City of Milwaukee Findings – We warned of big trouble ahead on the pension front in both our 2009 and 2016 reports, but even in 2016 the threat of huge spikes in the city's pension payments was tempered by the pension system's 97% funded ratio. That has now changed considerably, as the funding level has dropped to 83.4%. Though that percentage still compares favorably with many other public pension funds nationally, the city faces a possible $50 million increase in its employer contribution in 2023, constituting the greatest fiscal challenge it has faced this century. The city's OPEB, or retiree health and life insurance liabilities, also continue to grow, rising from $1.21 billion to $1.68 billion over the past three years. Meanwhile, Milwaukee's capital debt burden is increasing, with net direct debt rising from 2.4% of equalized values in 2015 (earning a yellow light in our 2016 report) to 3.6% at the end of 2021. We note that the city generally is staying on top of its major infrastructure needs despite the imperative to control this growing debt load, but signs of a substantial backlog of necessary capital projects are beginning to emerge.

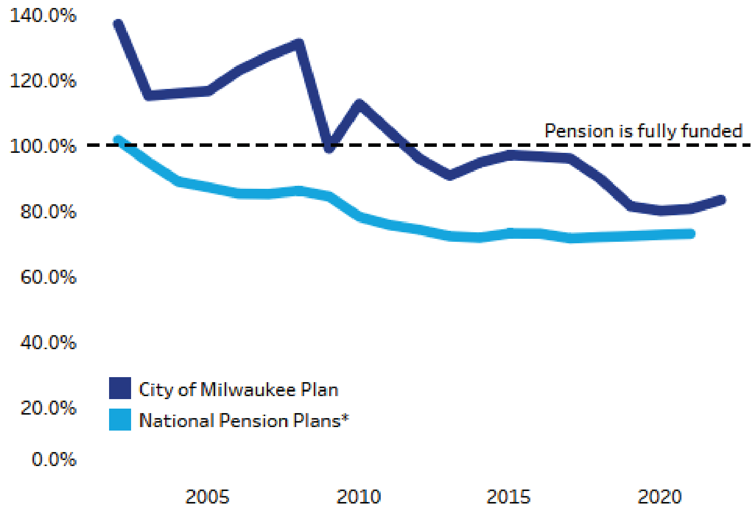
For this set of indicators, we issue a red light, which indicates a **significant threat** to the city's financial health.

increased the size of the unfunded liability and the pressure on the city to contribute more to the fund in the coming years to close the gap.

As of Jan. 1, 2022, the fund's actuaries estimated that its assets would be enough to cover 83.4% of its expected liabilities, an improvement from 80.7% the previous year and a somewhat better level than comparable public pensions nationally.[2] Still, that was down from 137.2% in 2002, a stunning reversal that has been somewhat worse than the negative trend for all pensions nationally. (For more on the city system's challenges and potential solutions, see our March 2020 brief on the pension plan.)

Figure 14: Funding Levels Fall for City Pension System

Pension system funding percentage by year

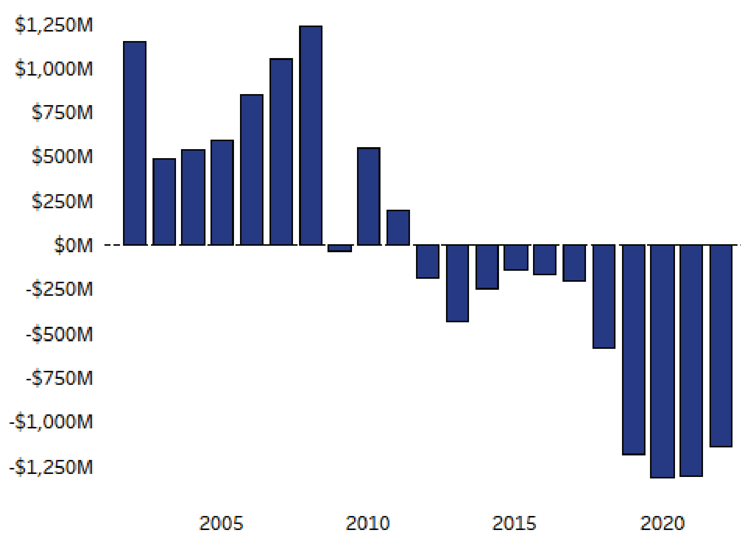


Sources: City of Milwaukee Employees' Retirement System and Public Plans Data; Milwaukee values are for Jan. 1 of each year. *National pension average has been weighted for plan size.

As Figure 15 shows, this decline in funding levels has meant a massive liability for the city and other employers in its pension plan. The plan's estimated unfunded liability on January 1, 2022 was $1.14 billion, an improvement of $163.5 million from the previous year that reflected the plan's investment gains in 2021. Still, the unfunded liability has grown by $937.3 million in just five years and the current level represents a $2.37 billion swing from the peak of the plan's estimated surplus in 2007. Worse, the numbers below do not include investment losses that have occurred so far in 2022.

Figure 15: City Pension Liability Surpasses $1 Billion

Pension system surplus or liability by year* in millions (nominal $)



Sources: City of Milwaukee Employees' Retirement System; Public Plans Data; * values are as of Jan. 1 of each year.

Besides the investment losses in certain years, one of the key reasons for the increased liabilities was a decision by the pension board to lower its assumed rate of

[2] The unfunded liability figures cited here are calculated by the pension plan's actuary using smoothed asset values that help to lessen the swings in the estimated funding level from year to year. Normally, these figures are reasonably close to the funding levels as calculated using market values of investments, but there is a larger-than-typical difference this year as the funding level for the plan using market values is 93.5%.

investment return from 8.5% to 7.5%. While that decision was made in 2018, its real impact will not be felt until the 2023 budget, because for planning purposes the city sets its annual pension contributions for five-year periods and the next re-set comes in that year. The 7.5% rate is equal to the assumption used for the Milwaukee County pension plan but still greater than the 7% rate used by the Wisconsin Retirement System.

This drop of one percentage point may appear small, but it has added substantially to the city's projected unfunded liability, since the plan is now essentially expecting smaller investment returns each year for decades to come. Estimates in the pension plan's most recent actuarial report show that returning the investment rate assumption to 8.5% would lower the city's projected liability by nearly $700 million.

Because the plan's projected liability has grown, both employees and the city and other employer in the plan must contribute more each year to eventually close the gap. In 2021, the employer contribution was $83.2 million (including about $71 million as the city's share and the remainder from other employers). This is an enormous increase compared to the early 2000's, when the plan's surplus meant that employers generally had to contribute less than $100,000 per year.

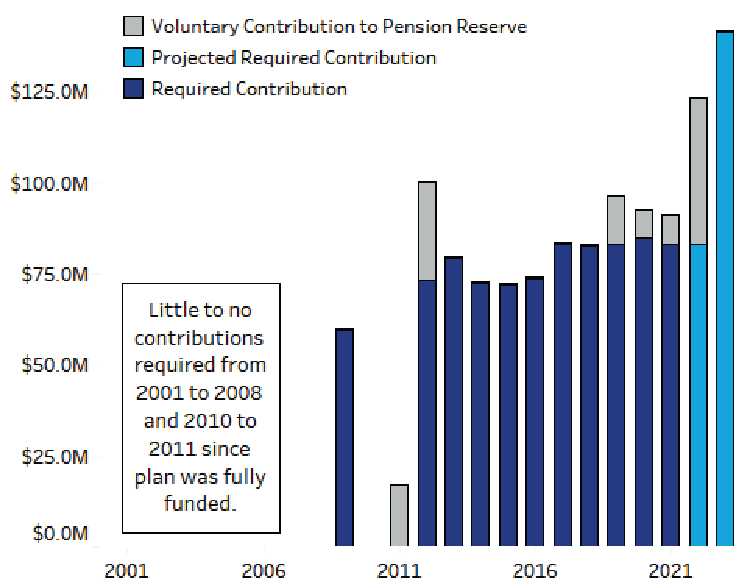
The city's 2,325 active police and firefighters accounted for 80.2% of the cost of the city's share of the overall pension contribution even though they make up only 42.8% of the city's workforce. That's notable given that unlike other city employees, the unions representing police and firefighters have full rights to collectively bargain for their pay and benefits, including pensions.

When the employer pension fund contribution is reset for the next five years in 2023, the contribution is projected to rise from the roughly $83 million for all plan employers to $142 million (see Figure 16), with the city's share projected to rise from about $71 million to $121 million. That sets up a daunting fiscal cliff for the city, which is responsible for about 83% of the overall employer contributions.

In recent years, city leaders have sought to prepare for the increase by voluntarily transferring substantial property tax levy into a pension reserve fund, a strategy that was bolstered last year by federal pandemic relief aid. By the end of 2022, the city will have set aside more than $80 million that it can use to help make the higher payments. Yet the higher contributions may exhaust this money in no more than two years, forcing the city to look at other options, such as those outlined in a [September 2021 report] by a city task force and our March 2020 [report].

Figure 16: Required Pension Contributions to Skyrocket

City pension plan employer contributions* by year in millions (nominal $)



Sources: Public Plans Data, City of Milwaukee Employes' Retirement System; *required contributions are for all employers and voluntary contributions are from the city only.

Most of the 12 city task force options involve increased city revenues (most of which would require state approval), borrowing or the sale of city assets, or cuts in spending outside of the pension system. Other options specifically related to the pension system generally fall into two main buckets: changes that would lessen the city's immediate budget crisis but add to its long-term pension costs; and changes that would make the city's pension costs more affordable over the long term but leave the current budget challenges untouched or even add to them because of upfront costs.

The bottom line is that there is no easy solution to this problem given that pension benefits that have been promised to current retirees and vested active workers cannot be legally taken away. The city will need to meet its financial obligations, and barring any relaxation of its current revenue restrictions, **that is almost certain to produce substantial reductions in personnel and city services in the coming years.**

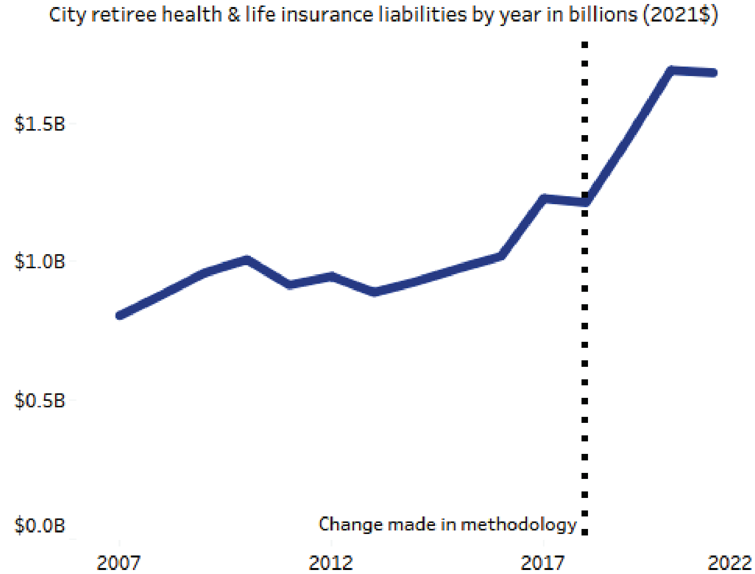
Retiree Health Care and Other Benefits Also Pose Challenge

Though the city's pension liabilities pose a more immediate challenge, Milwaukee has an even larger unfunded obligation to retirees that gets relatively little attention. The city has promised other post-employment retirement benefits known as OPEB (mostly health care coverage) to current and former employees, but it is not obligated to set funds aside to pay for them. Like many local governments, it has so far not had the capacity to do so. Meanwhile, many of its current workers continue to earn and retire with some form of these benefits. As a result, the size of this long-term liability and actual year-to-year costs have increased over time, with the city forced to cover the annual expense of OPEB payments to retirees out of its regular operating budget.

At the close of 2007, when national accounting standards first required governments to start tracking these costs, the city's actuary projected that this unfunded liability totaled $806.3 million. That year, the city paid $29.4 million to provide health and life coverage to its retirees. By the end of 2021, the city's projected OPEB liabilities totaled $1.68 billion (see Figure 17), or more than double the 2007 amount, and the city paid $41.3 million in annual OPEB costs for retirees, a 40.4% increase over 2007 that outpaced the rate of inflation.

Figure 17: Projected Retiree Health Care Liabilities Rising

City retiree health & life insurance liabilities by year in billions (2021$)



Source: City of Milwaukee financial statements; the method for projecting the liability changed in 2018, which added substantially to the total liability at that time.

Currently, general city employees can qualify for coverage if they were hired before January 2017 and meet the guidelines for a full retirement. If so, then they are eligible for an 88% subsidy of their health coverage in retirement until they reach age 65 and qualify for federal Medicare coverage (at that time they can still receive a partial subsidy).

General employees hired before Jan. 1, 2014 can potentially qualify for this benefit at age 60 (or at age 55 with 30 years of service), with the ages moved back five years for employees hired on or after that date. Police and firefighters can qualify for the benefit even earlier, leaving them and their spouses many years to receive a relatively costly benefit.

Projecting the liability associated with these promised benefits over time is a difficult task, and a change in accounting standards contributed substantially to an increase in the overall liability in 2018. Since then, however, the liability has risen further, confirming that the problem is not merely a product of accounting rules.

The city can take some solace in the fact that changes it has made in its health insurance plan and its retirement age and benefits have limited the growth in the annual cost of these OPEB benefits to at least some extent. Yet this yearly cost is still hefty, with the 2021 expense amounting to more than the city's budgeted general city purposes spending for that year on its libraries, health department, and municipal court.

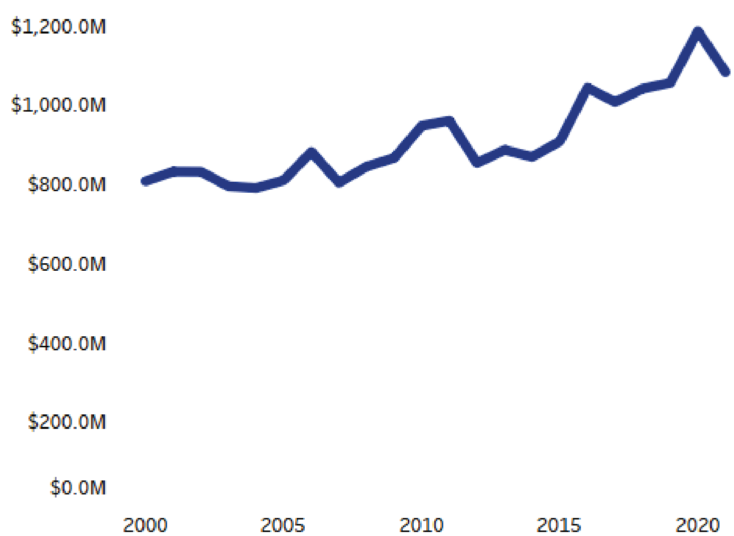
The city has a greater ability to reduce its OPEB liabilities than it does for pensions. In 2008, the Wisconsin Supreme Court ruled unanimously in *Loth v. City of Milwaukee* that the city was allowed to reduce the plaintiff's retiree health benefit. Previously, Milwaukee had paid the full health care premiums for workers who retired at age 60 or older with at least 15 years of service. But the city changed its policy to require that part of the premium be paid by qualifying workers who retired after Jan. 1, 2004. To reduce its costs going forward, the city could consider a further reduction in OPEB for retirees or in health benefits for all employees, though in either case policymakers would need to consider the effect on employee recruitment and retention.

City Debt Grows

Debt levels for the city have risen substantially in recent years, making them a concern for the city's long-term finances as well as for its ability to borrow for capital projects and purchases. At the close of 2020, both the city's main form of debt and its ratio of debt to overall property values were at their highest points in at least 20 years, though the total had dropped somewhat by the close of 2021. The share of the city's property taxes going to debt payments is also growing, as detailed earlier.

Figure 18: City Debt on the Rise

City of Milwaukee general obligation debt* by year (2021$)



Source: Wisconsin Department of Revenue; *includes tax increment financing debt but not debt issued by the city on behalf of Milwaukee Public Schools.

The challenge should not be overstated, as the city currently pays off the majority of its debt within 10 years and so far has maintained reasonably strong bond ratings. Yet, as discussed earlier, state property tax limits incentivize local governments to borrow more than they otherwise might, making the recent rise in Milwaukee's debt load an issue to watch.

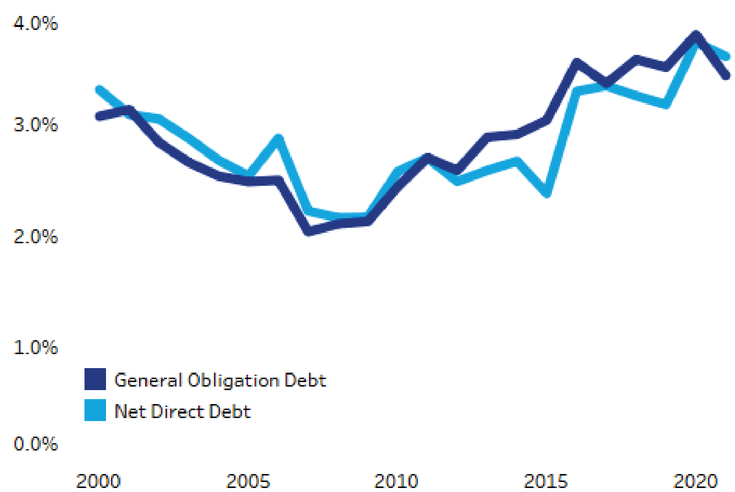
Over the past six years, the city has seen a 36.4% increase in its general obligation (G.O.) debt – that is debt backed by the city's full taxing authority – from $794.6 million at the end of 2015 to $1.08 billion at the end of 2021, according to data from DOR and the city's financial statements. Even after adjusting for inflation, the amounts for 2020 and 2021 were the highest and next-highest level for the city in at least two decades (see Figure 18 on the previous page). The city issues a limited amount of G.O. debt for the Milwaukee Public Schools, and to isolate the city's own borrowing, this MPS debt has been netted out of those figures.

Notably, the increase in the city's overall G.O. debt came despite a drop in the amount issued for tax increment districts, from $170.6 million at the end of 2015 to $159.7 million at the end of 2021. In other words, the rising debt level reflected the city's borrowing for its own capital needs rather than for new economic development.

Another way to track the city's borrowing is to look at it as a share of its property tax base. That ratio also has risen in recent years. The city's G.O. debt rose from 3% of its equalized property values in 2015 to a peak of 3.8% in 2020 – the highest level in two decades – and then dropped to 3.4% in 2021 (see Figure 19). A related measure of city borrowing known as net direct debt[3] rose from 2.4% of equalized values at the end of 2015 to 3.7% at the end of 2020 and then dropped to 3.6% by the close of 2021. Strong growth in property values into 2022 could also help hold this ratio down next year.

Figure 19: Growth in Debt Outpaces Property Values

City of Milwaukee debt as a share of equalized property values*



Sources: Wisconsin Department of Revenue, City of Milwaukee; *Equalized property values are lagged by one year to match conventions of city financial statements, G.O. debt does not include Milwaukee Public Schools debt, and net direct debt includes all city general obligation debt minus amounts in debt service funds.

Last, as discussed in an earlier section, it is important to consider the amount of property tax levy required annually to make principal and interest payments on the city's G.O. debt. As noted earlier, that payment of $85.4 million in 2022 was the highest in more than a decade even after adjusting for inflation. It also amounted to 28% of the overall property tax levy going for programs under Common Council control, which was up from 22.5% in 2015 and the most since 2011.

Despite the dip in G.O. debt in 2021, the city stepped up borrowing in other areas, such as bonds financed with specific revenue streams like water and sewer fees. The city's overall debt totaled $1.48 billion at the close of 2021, up slightly from $1.46 billion at the close of the previous year to its highest amount ever.

[3] Net direct debt accounts for funds that have been set aside for debt payments in the city's debt service funds.

There are some bright spots for the city with respect to debt. As noted above, the Public Debt Amortization Fund had $43.1 million at the end of 2021. That was a $1.3 million decline from 2020 that was part of a multi-year slide in assets but still a substantial sum that can be used to help make debt payments. Also, as noted previously, part of the increase in borrowing was the note that locked in lower interest rates and provided the city with a larger general fund balance and better liquidity.

In April, the bond ratings agencies S&P Global and Fitch Ratings rated the city's G.O. debt as "A" and "AA-" respectively. Earlier this month, however, Moody's Investors Service modestly downgraded Milwaukee's bond rating to Aa3, citing the city's "persistent structural deficits, compounded by its limited revenue-raising flexibility, extremely high leverage and fixed costs, and pension costs which are expected to grow significantly." These bond ratings still remain relatively high for Milwaukee, but the outlook for all three is negative, which means that they could be downgraded further.

In addition, as we noted earlier, state property tax limits provide an ongoing incentive to the city to borrow more since the taxes used for debt payments are outside the state caps. That combination could lead to greater debt levels and greater risks for the city. Particularly at a time of rising interest rates, **the city runs the risk that growing debt payments could crowd out other priorities.**

Total Liabilities Rise

Considered in isolation, all of these individual long-term liabilities present reason for concern. Taken together, however, their potential risk is magnified. All of the major liabilities – outstanding bonds and other debt and unfunded pension and retiree health care liabilities – are at or near historic highs for the city. Their collective total has grown every year since at least 2015 and, though the increases have moderated over the past two years, they have not reversed.

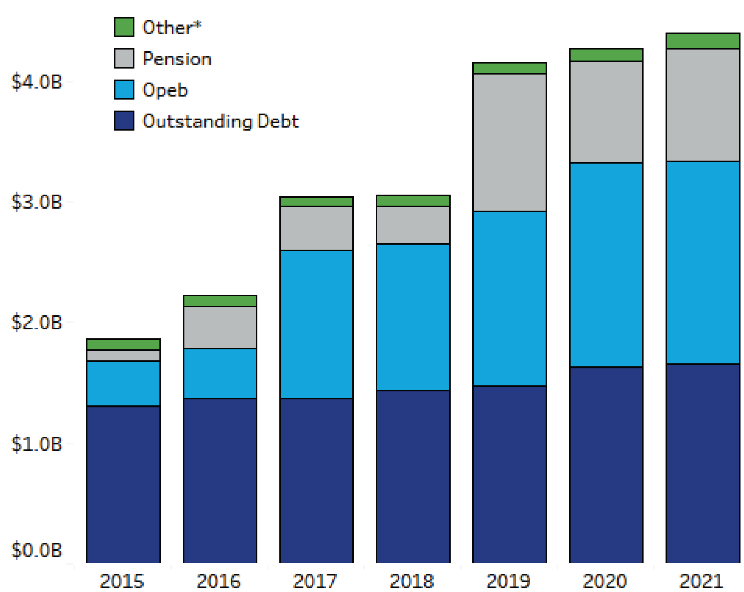
In addition, the city saw a notable jump in its potential liability for legal claims and judgements to $87 million at the close of 2021 (from $44 million at the end of 2020). That reflects potential liability from lawsuits such as those brought against the city for alleged actions by Milwaukee police officers (though in the end, the city may not actually face a judgement in these cases).

The sum total of these liabilities at the end of 2021 was $4.4 billion, which was 78.7% more than the $2.5 billion in estimated liabilities for the city at the close of 2015 (see Figure 20). In addition, this total does not include the city's outstanding maintenance and infrastructure projects, which the Forum chronicled in our June 2019 report "Picking Up the Pieces."

S&P Global has highlighted these liabilities, noting in its April ratings

Figure 20: Longterm Liabilities Rising for Milwaukee

Actual and projected city liabilities by type and year in billions (nominal $)



Source: City of Milwaukee financial statements; *Other includes compensated absences, claims, and judgements.

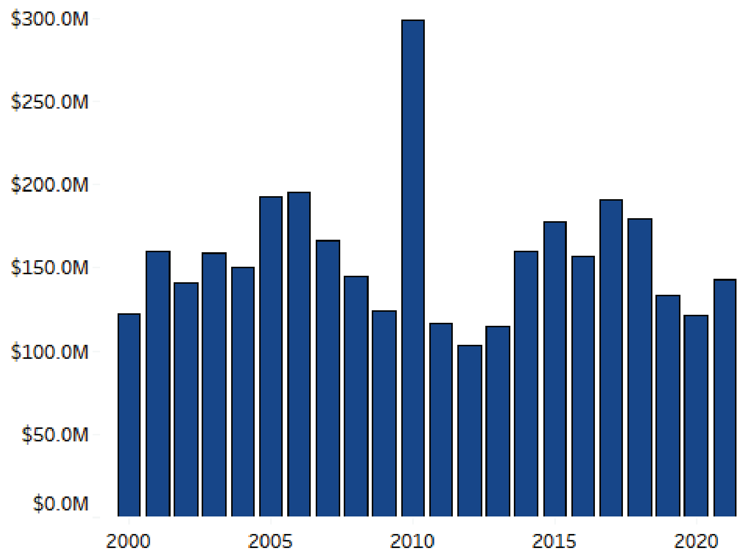
report, “A significant credit weakness affecting Milwaukee's overall debt and pension profile is the city's large pension and other postemployment benefits (OPEB) obligation, without a plan in place that we think will sufficiently address the obligation.” Taken together, the rise in long-term liabilities has put the city on a **path that is not sustainable for Milwaukee residents.**

Impacts on Capital Program

Last, growing debt and long-term liabilities pose a real threat to the city’s ability to invest in its capital assets. Up until now, the city has maintained reasonable investment levels. Though the city’s capital outlays on projects such as streets and key repairs of city hall have fallen from recent highs, they are still well above the low point hit following the Great Recession.

Figure 21: Capital Investments in Infrastructure Hold Up

City of Milwaukee capital outlays by year in millions (2021$)



Source: City of Milwaukee financial statements

In 2021, the city spent $142.7 million on capital outlays, a 22.9% increase over 2020. After adjusting for inflation, that was in the middle of the city’s 20-year range – below the $190.4 million spent in 2017 and an outlier year in 2010 but still well above the low point of $103.2 million in 2012 (see Figure 21).

The city’s 2022 capital budget represents only a modest decline from 2021. Major projects include $10 million for repairing the foundations of City Hall, which have required reinforcement to prevent the structure from sinking. At $74.6 million, budgeted spending on core infrastructure programs in 2022 is a 4.9% increase from 2021 and the most since 2016.

To keep up with its multi-year plan for capital projects, the city needs to maintain roughly this same level of investment through the coming years. That could prove challenging as debt levels have increased and the city runs out of ARPA funds, which have helped support capital spending for affordable housing and upgrades to street lighting.

On the positive side, the city likely will benefit from additional federal support through the Infrastructure Investment and Jobs Act of 2021. The city has also taken steps on its own to help fund infrastructure while limiting debt, shifting from using borrowing to finance stormwater projects to using cash generated by stormwater fees paid by property owners.

On the other hand, Milwaukee is an older city with aging infrastructure, and its already formidable debt and ominous operating budget challenges will limit financing for capital repairs. As the city heads into 2023 budget deliberations, officials recently noted that capital project requests from department heads for the coming year were nearly double the amount deemed affordable given the city’s limits on its annual borrowing. **The need to defer tens of millions of requested projects each year – if it continues – will add another dire dimension to Milwaukee’s overall fiscal challenges.**

INSIGHTS AND CONCLUSION

As our analysis has made clear and our report title suggests, the city of Milwaukee is once again on the brink of a financial crisis. The city does possess two critical resources – its remaining federal ARPA funds and newly bolstered pension reserve – that should allow it to stave off substantial service cuts in the short term. Yet in almost every other respect, the key fiscal indicators for the city point to daunting days ahead.

For more than a decade, the Forum has warned that Milwaukee's growing structural imbalance would cause it to reach a breaking point without comprehensive fiscal restructuring. Now, that time is nearly here. These facts tell the story:

- State aid and other intergovernmental revenue used for general city purposes was lower in 2022 at $273.5 million than it was in 2000 at $278.4 million – without even accounting for inflation. After factoring in the rise in consumer prices, these intergovernmental revenues fell 41% over the period.

- Though property taxes have risen in recent years, most of the increase has gone toward payments on pension and debt, leaving a diminished pool of resources for city services. Even before adjusting for inflation, the property tax revenues available for general city purposes were roughly the same in 2021 at $112.8 million as they were in 2011 ($111.6 million) and actually fell even further in 2022.

- As their two largest revenue sources to support core city services have failed to grow, city leaders have prioritized preserving public safety while other important services, like libraries and public health, have suffered. Yet, despite these efforts, public safety positions have still been reduced. Total budgeted positions for the city fell from 8,225 in 2000 to 7,202 in 2022, a decrease of 12.4%, or 1,023 positions. The number of budgeted police department positions dipped from 2,694 in 2000 to 2,560 in 2022 and fire department staffing dropped from 1,202 to 880.

- Not long ago, one of the city's primary fiscal strengths was its healthy stock of reserves, which could be tapped into for at least some relief during particularly difficult budget years. Now, the city's unassigned general fund balance – the best measure for true reserves – has fallen from a high of $61.7 million, or 8.9% of annual operating revenues, at the close of 2015 to just $9.1 million at the end of 2021, or 1.3% of operating revenues.

- Meanwhile, the pressure from the city's long-term obligations has intensified, with both outstanding liabilities and their annual cost at or near all-time highs. While the most urgent issue is the city's pension contribution, which is projected to increase from $71 million to $121 million next year, the cost of the city's outstanding debt and unfunded retiree health care benefits also has grown, making it harder to fund ongoing city services.

The city's substantial remaining ARPA funds and more than $80 million in its pension reserve fund will help delay into 2024 at least the worst of the coming crisis from the rising pension contribution. However, that is not a lot of time to pursue the types of far-reaching solutions that will be required to preserve the city's current services and workforce while still protecting property taxpayers.

For example, several of the city's top elected and business leaders have called for an increase in the Milwaukee County sales tax, with the revenues allocated for both county and city budget needs and property tax relief. Doing so would require the approval of the next state Legislature and governor and could include a requirement for a binding local referendum. The soonest such a bill could be introduced in the Capitol would be January 2023 and final passage would take weeks if not months, making it a challenging task to pass a piece of legislation and put any potential referendum to voters in the 2023 spring elections. After that, there would be no regularly scheduled statewide election to simplify holding a local referendum until early 2024.

Some leaders have also discussed the possibility of reforming the city's pension system in a variety of ways, including a gradual shift of new city employees into the Wisconsin Retirement System (WRS). Such a move could offer a number of advantages, but in the short term simplicity is not among them. Making such a change ultimately could require negotiation and approval – or at least discussion – by several elected bodies and unelected boards, including the Common Council, the board of the city pension system, boards of the system's other public employers, the state Legislature and governor, and various bodies involved with the WRS. Though this path could prove fruitful, it will not be short.

Last, the Wisconsin Policy Forum has frequently pointed out the opportunity to improve services and produce sizable budgetary savings throughout Milwaukee County via local government service sharing and consolidation. Once again, however, such action would involve considerable analysis, deliberation, and negotiation to identify and flesh out potential changes and ensure they would be beneficial and palatable to the public.

Our warning, therefore, is that city and state leaders must begin to talk and act almost immediately if they wish to avoid untenable budget cuts. Given that public safety accounts for more than 60% of the general city purposes budget, it would be difficult if not impossible to shield the police and fire departments from cuts to cover the projected $50 million increase in the pension contribution and to fill the sizable gaps that will be created when the ARPA funds are exhausted. As context, to cut $50 million in 2022 without affecting public safety, city leaders would have needed to eliminate the entire general city purposes budget for Milwaukee's libraries, health department, and neighborhood services department or take some other similarly difficult step.

In short, the terrain ahead is steep and treacherous and Milwaukee and state leaders cannot delay for long the work that will be needed to chart a path to safety. With this report, we hope we have provided them a clearer picture of the dangers to come and a sense of urgency in negotiating them.