COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

Date: November 7, 2014

To: County Executive Chris Abele

From: Josh Fudge, Director, Office of Performance, Strategy and Budget; Department of Administrative Services.

Subject: Preliminary Five-Year Analysis of the 2015 Budget, including the Recommended Budget and the Recommended Budget as Amended by the County Board Committee on Finance, Personnel & Audit

Issue

You have requested an analysis of the impact on the County's long-term fiscal outlook of both the 2015 Recommended Budget and the 2015 Recommended Budget as amended by the County Board Committee on Finance, Personnel & Audit.

Background

The Office of Performance, Strategy & Budget (DAS-PSB) has analyzed both versions of the 2015 Budget. DAS-PSB has utilized the same model as the Office of the Comptroller uses for its annual five-year financial forecast, known as Municast. This includes adopting the same assumptions on how groups of accounts will change (i.e. annual percentage increases or decreases). Any significant deviation from the assumed rates of change is explained below.

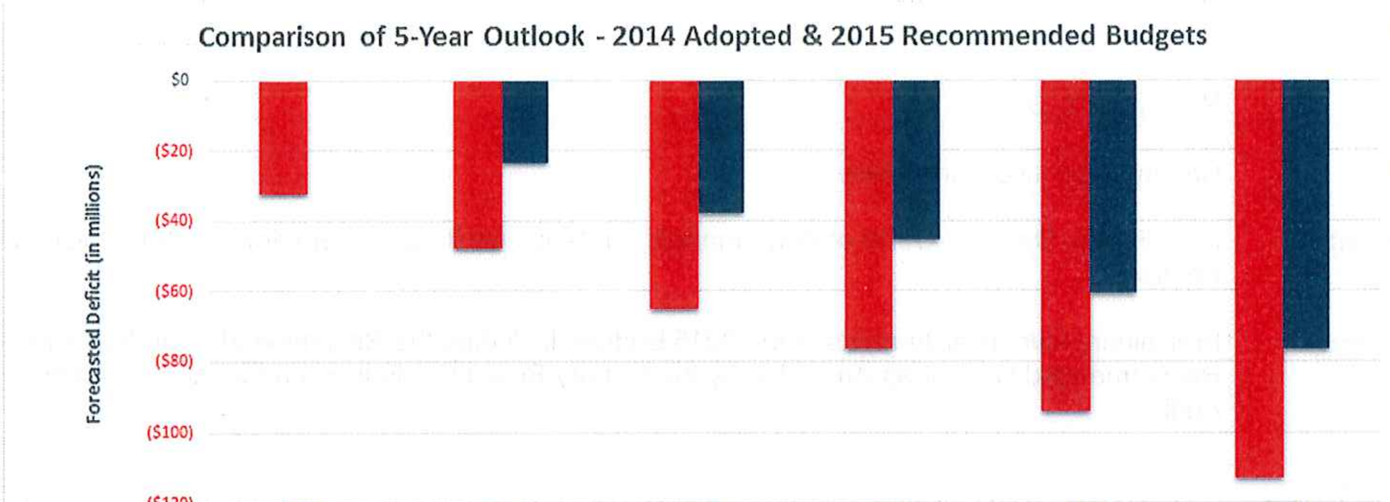
<u>County Executive's Recommended Budget</u>

Based on our analysis, the 2015 Recommended Budget would reduce the County's structural deficit by approximately one-third by the fifth year, 2020, from $113 million in the 2014 baseline to approximately $76 million. The sum of the reduced deficits over the 5-year period is $142 million.

The reduction in the five-year deficit is primarily due to reductions in health care costs related to a new prescription drug administration contract, implementing the Medicare Advantage plan for County retirees, and due to lower-than-anticipated health care cost inflation. Additional savings were created through an alignment of healthcare plan design to market benchmarks. The 2014 five-year forecast projected health care costs of $173.9 million in 2020; the projection for 2020 based on the recommended budget is $155.9 million; and salary and social security costs based mainly on reduced headcount. The 2014 five-year forecast projected salary and social security costs of $268.8 million in 2020; the projection for 2020 based on the recommended budget is $256.6 million.

Much of the reduction in projected salary and healthcare costs noted above is based on specific service delivery model changes and is partially offset by increased contracting costs, which are projected to grow more slowly each year. For instance, the five-year impact of utilizing municipalities for law enforcement services in the parks is approximately $0.5 million annually; the five-year impact of utilizing a private firm to provide security is $0.2 million annually. Other factors included slight increases in some revenues such as sales tax.

A comparison of the structural deficit from the 2014 Adopted and 2015 Recommended budgets is shown in the table on the next page:



	2015	2016	2017	2018	2019	2020
2014 Adopted	($32)	($48)	($65)	($76)	($94)	($113)
2015 Recommended	($0)	($23)	($38)	($46)	($61)	($76)

<u>Finance Committee Amended Budget</u>
Based on analysis of amendments passed by the Committee on Finance, Personnel & Audit (FPAC Committee), the five-year structural deficit would increase by approximately $3.8 million in 2016 and increase an incremental 6 percent or $200,000 per year over the five-year period, from $27 million in 2016 to $81 million in 2020.

The increase in the structural deficit over the 2015 Recommended Budget is primarily due to:

- Increased active health care costs of $3.21 million over what would have occurred in 2016, which rises to $4.8 million in additional costs by 2020 and totals $21.4 million over the five-year period.

- Reduced employee health care premiums of $2.55 million annually, which total $12.8 million in reduced revenue over the five-year period.

- Additional debt service principal and interest costs of $1 million annually due to the increase in general obligation bonding of $12.8 million proposed in 2015.

- Increased salary and social security costs of $4.6 million in 2016, which rise to $5.2 million in 2020 and total $24.3 million over the five-year period.

- $1.3 million of the increase is related to unfunded but filled command staff positions that were restored in the Office of the Sheriff. For the purposes of this analysis it is assumed that these positions continue to be deficit financed during the five-year period. The 2015 deficit is reflected in the chart below.

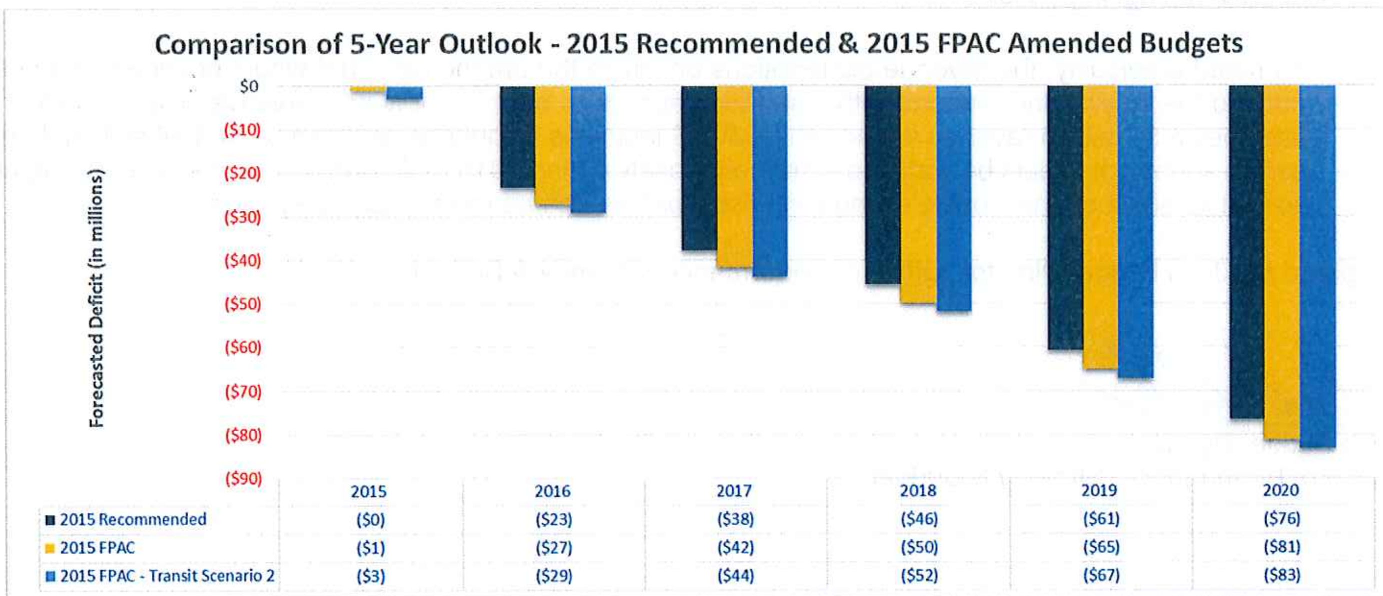
- The amendment to increase employee fringe benefits by restoring the FSA and reducing proposed employee health insurance premiums results in a $1.4 million deficit in 2016 which rises to $1.8 million by 2020 and totals $7.7 million over the five-year period.

  The primary reason this amendment results in a significant deficit is that it relies on one-time revenues in 2015 of $1.3 million. The amendment does include an increase in the contingency fund of $0.5 million in 2015 which could be eliminated in 2016, but that would still leave a deficit of $0.8 million related to health care costs.

- The amendment to provide free rides to persons with disabilities and the elderly, and to expand service, would result in an assumed tax levy increase of $1.58 million in 2015, which under the five-year forecast model would rise by seven-tenths of a percent annually to $1.64 million by 2020. However, associated expenditures and revenue losses would result in a net deficit of $81,000 by the fifth year.
  In addition, the revenue impacts of providing free rides to the elderly and persons with disabilities in this amendment are very uncertain. Milwaukee County Transit Services, Inc. provided information to the Department of Transportation that the associated revenue loss could be "on the order of $3 Million annually". If this estimate were to be shown correct, it could result in an increase in the structural deficit of as much as $2 million annually.

- Many of the increases in salary and active fringe benefit costs are offset by the elimination of proposed contracting costs related to privatization initiatives. The eliminated contracting costs total $2.6 million in 2016 and would have risen to $2.8 million by 2020 for the following specific initiatives: Park Patrol security, County Grounds law enforcement, Courthouse Security, and the Nature in the Parks program. The net impact of the rejection of these four initiatives, including contracting costs, employee costs and other associated items is an increase in costs by 2020 of $0.8 million, or a total of $3.1 million over the five-year period 2016-2020.

A chart showing the estimated structural deficit as a result of the 2015 Recommended and 2015 FPAC Amended budgets for the period 2015-2020 is shown below. The third item, "2015 FPAC – Transit Scenario 2" represents the five-year impact if the MCTS annual revenue impact of $3 million were proven to be accurate. In both the 2015 FPAC and 2015 FPAC – Transit Scenario 2 cases there is a $1 million deficit assumed due to the unfunded command staff positions that were restored in the Office of the Sheriff.



<u>In Summary</u>

We have identified increases in expenditures of approximately $11.2 million and revenues of approximately $9.9 million[1] that have been adopted by the FPAC Committee through today (the $1.3 million difference is related to the unfunded command staff positions in the Office of the Sheriff). Over the course of the five-year period 2016-2020, expenditures are forecast to increase by a total of $2.9 million while revenues would decrease by $0.7 million. The revenue decrease is mainly due to the one-time revenue of $1.3 million included in 2015 that would finance employee fringe benefits but would not be available in 2016. It is assumed that the tax levy increase of $3.2 million included in the amended budget increases by 0.7 percent annually.

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[1] These totals do not reflect all the changes made by the FPAC Committee to the County Executive's Budget, rather they are an estimate of the impacts to the Operating Budget that have an impact on the County's structural deficit.

This estimate is based on a preliminary analysis of the five-year impact of both the Recommended Budget and the budget as amended by the FPAC committee. The analysis related to the five-year forecast performed by the Office of the Comptroller is very complex, and we have utilized the model to the best of our abilities in the short time frame.

Areas of Concern for 2016

As noted above, we have identified the following significant issues that would have to be addressed in 2016 if the 2015 budget is adopted as amended:

- The use of $1.3 million in one-time revenues in 2015 would not be available in 2016 to support increased employee fringe benefits and contingency fund costs. If the $0.5 million increase in contingency funding were eliminated in 2016, there would still be a deficit of approximately $0.8 million in health care costs that would have to be addressed.

- The increase in general obligation bonding of $12.8 million in 2015 would result in increased debt service costs of $1 million in 2016 that would result in less sales tax available to cash-finance capital projects or support general operations.

- If the command staff positions in the Office of the Sheriff remain filled throughout 2015, it would be prudent to either eliminate the positions in 2016 or identify additional funding of approximately $1.4 million to prevent ongoing deficits.

- As noted previously, the revenue assumptions on which the amendment that would provide free transit rides to the elderly and persons with disabilities appear to be extremely conservative. The amendment assumes a $1 million revenue impact while MCTS indicates it could be between $2 and $4 million. If this item is adopted it should be watched extremely closely during 2015 to determine the true revenue impact so that its effect on the County's long-term fiscal picture can be more adequately gauged.

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