BUDGET BRIEF:
2018 PROPOSED BUDGET

MILWAUKEE PUBLIC SCHOOLS

PUBLIC POLICY FORUM

BUDGET BRIEF:

2018 Proposed Budget
Milwaukee Public Schools

MAY 2017

REPORT AUTHORS:

Doug Day, Researcher
Rob Henken, President

TABLE OF CONTENTS

We would like to thank the Greater Milwaukee Foundation and Northwestern Mutual Foundation for their generous support of our education research.

This analysis of MPS' 2018 proposed budget refers to the budget recently submitted to the Milwaukee Board of School Directors by the Milwaukee Public Schools Superintendent. The budget covers the school district's 2018 fiscal year, which takes effect on July 1, 2017, and runs through June 30, 2018. Also, it should be noted that while the School Board will adopt a tentative budget later this month and the fiscal year will begin in July, the budget will be revisited by the Superintendent and Board in the fall after the district receives final aid amounts from the State of Wisconsin.

INTRODUCTION

The overview to the 2018 proposed Milwaukee Public Schools (MPS) budget begins with the warning that "while every budget inherently has challenges and opportunities," developing this particular budget "posed a greater set of difficulties." Those who take the time to delve into the budget's details – and to ascertain the challenges involved with balancing the budget without sacrificing strategic initiatives established in 2017 – will find that warning appropriate.

Indeed, after two consecutive years in which the district was able to add positions and initiate new programs, the 2018 proposed budget reverts back to a more familiar budget paradigm – one in which MPS' leaders face fierce pressure to reduce positions and to shift resources from school operations to other needs.

The fundamental problem is a longstanding one: MPS' limited revenue growth is insufficient to meet its ongoing expenditure pressures. However, unlike 2016 and 2017, when health care savings and early debt payments allowed the district to overcome that problem and reallocate resources to new school-related programs, the 2018 budget must employ the opposite approach.

MPS entered its 2018 budget deliberations with a $46 million "hole," which was created by the use of one-time savings in 2017 to finance new positions and initiatives. District leaders were fully transparent about the move, acknowledging that the savings would need to be restored. They argued that this was a unique opportunity to invest in high-priority initiatives, however, and they expressed hope that additional revenues or new internal reallocation opportunities might materialize to painlessly plug the gap the following year.

Unfortunately, that has not turned out to be the case. Under the proposed State budget, MPS' State aids would increase only slightly. Meanwhile, not only do new reallocation opportunities not exist to help finance school operations, but the budget must find a way to *restore* $36.6 million to retirement and capital-related debt accounts, and to add $4.5 million for growing health care costs.

This reality necessitates the proposed elimination of 194 positions and an overall reduction of $31 million to school budgets. Yet, district officials argue the impacts are manageable, as position and funding increases implemented this year still exceed the reductions required in 2018. In fact, despite the sizable budget cutbacks, a few new program initiatives are proposed, including an Office of Black and Latino Male Achievement, principal coaches for each school, and six new deans of students at comprehensive middle schools.

In the pages that follow, we provide more detailed analysis of the major elements of the 2018 proposed budget, and the strategies the district is proposing to maintain funding for its strategic priorities despite its continued fiscal challenges. Our objective is to provide an independent assessment of the district's finances that will encourage informed deliberations by policymakers in Milwaukee and Madison.

BUDGET OVERVIEW

MPS' proposed 2018 budget represents a change of course for the district. Whereas in 2016 and 2017, MPS' leaders were able to secure resources for new positions and programs despite stagnant State revenues, this year's proposal could be characterized as a "retrenchment" budget that is more consistent with the district's longstanding revenue challenges.

Two major factors account for this change in course. First, the budget reallocates a considerable amount of revenues to boost payments to retirement liability and capital debt accounts, which were reduced on a one-time basis in 2017 because of the district's ability to pre-fund payments with surplus funds at the end of 2016. That factor – combined with cost increases in areas like employee health care – preclude MPS from reallocating funds for new positions and program expansion, as it has been able to do in previous years.

Second, little additional revenue is available to begin with, since an anticipated sizeable increase of $15.4 million in per pupil aid from the State is nearly offset by a $12.9 million decrease under revenue limits associated with the State's equalization aid program. Enrollment losses at MPS and other formulary adjustments associated with State revenue limits are mainly responsible for this funding decrease. (These funding amounts are anticipated per the Governor's 2017-19 recommended State budget – final State revenues will be determined in the fall.)

Below, we provide a synopsis of the major revenue and expenditure items that characterize MPS' 2018 proposed budget. Detailed analysis of key budget items is provided in later sections.

REVENUE

Total revenue in the 2018 proposed budget declines by $21 million (1.8%) from the 2017 budget. This revenue total is likely to change in the coming months, however, as it is anticipated that the final 2018 budget (to be considered by the MPS Board in October) will contain about $40 million more in loan proceeds for energy efficiency-related construction fund activity.[1] If that occurs, then the final 2018 budget would show an increase of around $20 million, or 1.6%.

As shown in **Table 1**, all five of MPS' major funds show slight growth in revenue, except for the construction fund. Increases range from $900,000 in the nutrition fund – which is mainly a depository for federal revenues from the subsidized lunch program – to $5.3 million in categorical aids.

[1] The MPS Board will adopt a preliminary 2018 budget in May, as MPS' fiscal year begins on July 1. However, a final budget will be adopted in the fall once MPS' State aid allocations are determined.

Table 1: MPS revenues by fund, 2017 vs. 2018 (in millions)

Fund	2017 Budgeted	2018 Proposed	2017 to 2018 % change
School operations	$928.3	$930.7	0.3%
Categorical	$161.1	$166.5	3.3%
Construction	$34.1	$2.7	-92.1%
Nutrition	$50.6	$51.5	1.8%
Extension	$23.0	$24.8	8.0%
Total	$1,197.1	$1,176.1	-1.8%

Source: MPS 2018 Proposed Budget

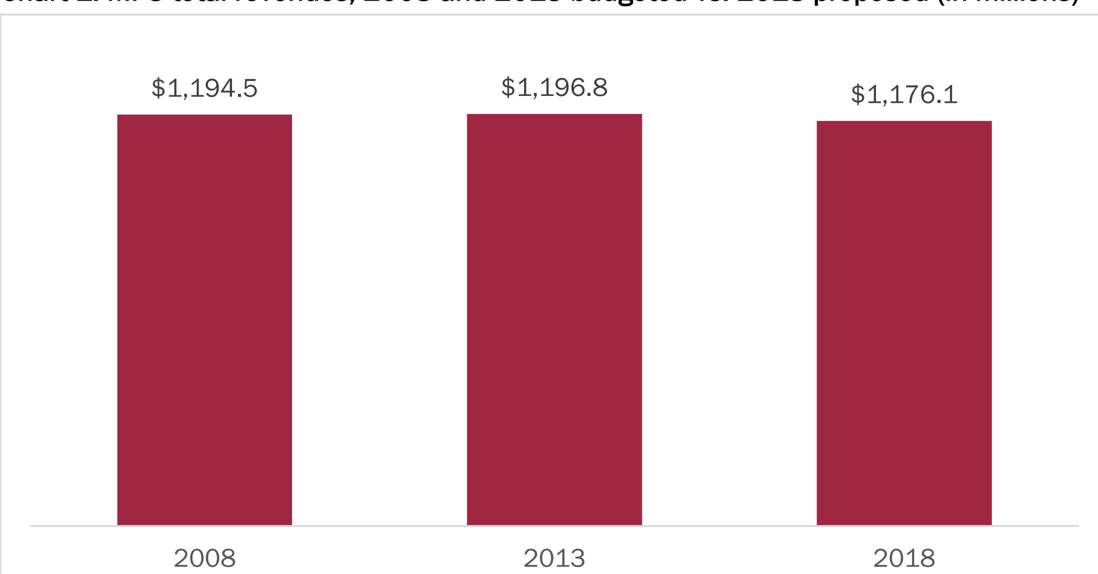
School operations – MPS' largest fund – is budgeted to increase by $2.4 million (0.3%). This small variation obscures some major swings in revenue, especially the aforementioned $15.4 million rise in State per pupil aid and the $12.9 million fall-off in combined equalization aid and property taxes.

The sizable plunge in construction fund revenues largely reflects the impact of a higher level of funding in 2017, when MPS borrowed $27 million to support energy efficiency improvements at three schools. As noted above, additional borrowing for energy efficiency projects in 2018 is being considered and may be added to the budget this fall. Also, a 2017 budget provision that transferred $9.5 million of property tax from the construction fund to school operations is continued in 2018.

The extension fund – which largely supports recreational and after-school programs – is budgeted to receive a $1.8 million increase in 2018, financed from surplus revenues. This follows a $2.9 million increase in property tax revenues in 2017 for new and expanded programming. The 2018 increase will support MPS C.A.R.E.S., a community outreach program serving children and young adults.

A major, ongoing budget story continues to be the stagnant nature of MPS' overall revenues. As shown in **Chart 1**, total district revenues have decreased by $18.4 million (1.5%) in the past decade.

Chart 1: MPS total revenues, 2008 and 2013 budgeted vs. 2018 proposed (in millions)



Source: MPS budget documents

The financial evaluation system of the International City/County Management Association (ICMA), a resource for several Forum fiscal analyses, uses a variety of indicators to assess the fiscal health of local governments. One is whether incoming revenue is rising at or near the rate of inflation. In this regard, MPS' fiscal condition clearly is problematic. Had MPS' total revenue grown at an inflationary rate during the past 10 years, then its total revenue budget would be $267 million higher in 2018.[2]

In recent years, MPS' revenue increases have come mainly from the State and, especially, its non-school aid allocations. As shown in **Table 2**, other State revenue grew by $10.4 million (7.2%) from 2015 to 2017. Federal funding increased slightly, while property taxes declined by 7% because of the impact of State revenue limits under the equalization aid formula.

The other local aid shown in **Table 2** comes from a variety of sources, including borrowing proceeds, student fees, applied surplus, private grants, rental charges, and other items. The decline from 2015 to 2017 mainly reflects a lower level of borrowing and a decline in refunds/insurance proceeds. **Table 2** does not include 2018 revenue since the State/local breakdown in equalization aid will not be known until the fall.

Table 2: MPS revenues by source, 2015 to 2017 (in millions)

State	2015 Actual	2016 Actual	2017 Budgeted	2015 to 2017 Difference	2015 to 2017 % Change
Equalization aids*	$505.3	$504.5	$512.2	$6.9	1.4%
Other State aids	$145.4	$147.7	$155.8	$10.4	7.2%
Total	$650.7	$652.2	$668.0	$17.3	2.7%
Federal	$196.1	$177.5	$199.0	$2.9	1.5%
Property tax	$302.3	$300.7	$281.2	($21.1)	-7.0%
Other local	$69.9	$38.1	$53.6	($16.3)	-23.3%

* After charter/choice deduction

Source: MPS 2017 Amended, Adopted Budget

Finally, it is worth noting that the Governor's proposed budget allocates $5.5 million in "performance-based funding" that would be available to all Milwaukee schools (including choice and charter) that achieve certain performance standards on State report cards. MPS' 2018 proposed budget does not include revenue from this new source because it is uncertain whether it will be included in the final State budget, and it is unclear how the funds would be distributed. If this program is initiated by the State and expanded in future years, then there could be far-reaching implications on MPS' finances. Conversely, the proposed budget does include funds from a $1.4 million summer school grant program proposed by the Governor that would specifically target MPS.

[2] U.S. Department of Labor, Bureau of Labor Statistics, *CPI Inflation Calculator.* Inflation calculated between 2007 and 2017 to correspond to the fiscal year 2008 and 2018 budgets.

EXPENDITURES

Reallocation of resources has been a budgetary staple for MPS over the past decade or more, as district leaders have relied upon sizeable transfers of resources annually across programs, schools, and expenditure objects to sustain strategic priorities and make ends meet. This trend continues in the proposed 2018 budget.

In the previous decade, a prolonged rise in pension and health care costs drove internal reallocation to those expenditure accounts, resulting in a contraction of resources available for educational programming. That situation changed in 2010, however, when fringe benefit expenditures were sent on a downward path because of a new four-year teachers contract that included restructuring of health care benefits. Passage of Wisconsin Act 10 in 2011 helped accommodate further savings, as a greater share of pension and health care costs were paid by employees, while the district also was able to make additional changes to benefits without being subjected to collective bargaining.

Changes to MPS' benefit structure also had the indirect effect of curtailing the district's salary and wage budget. The phase-out of certain benefits – such as eligibility for retirement at age 55 – precipitated a spike in retirements. As lower-salaried, less-experienced employees took the place of higher-paid, retiring teachers and staff, additional savings became available to reallocate to district priorities.

Other management strategies, such as holding open vacant positions and making one-time transfers from debt and capital funds, further expanded expenditure reallocation activity. As a result, despite little change in total revenues in recent years, MPS has had some wherewithal to add positions, provide modest salary increases, and restructure schools and programs.

The proposed budget for 2018 continues this now familiar story of internal reallocation, but opens a new chapter. As shown in **Table 3**, the proposed budget would reallocate funds from most expenditure categories largely to restore $36.6 million to the district's debt payments for other post-employment benefit (OPEB) liabilities for retirees and for other capital and pension-related debt.[3]

[3] This is reflected in the "Other" category in the table; the $36.6 million does not correspond to the $35.4 million in the table because there are additional items in the Other category.

Table 3: MPS school operations expenditures by category, 2017 vs. 2018 (in millions)

Expenditures	2017 Budgeted	2018 Proposed	2017 to 2018 Difference	2017 to 2018 % Change
Salaries/other wages	$420.5	$402.6	($17.9)	-4.3%
Benefits	$205.8	$209.3	$3.5	1.7%
Purchased services*	$256.0	$239.5	($16.5)	-6.4%
Supplies	$35.0	$26.4	($8.6)	-24.6%
Capital Purchases	5.2	$2.3	($2.9)	-55.8%
Debt Service	31.1	$32.8	$1.7	5.5%
Insurances	$10.1	$9.5	($0.6)	-5.9%
Other	($35.40)	$8.3	$43.7	-123.4%
Total	**$928.3**	**$930.7**	**$2.4**	**0.3%**

* The decline in purchased service expenditures shown in the table reflects, in part, the closing of two MPS charter schools and their transfer to traditional school status.

Source: MPS 2017 Amended, Adopted Budget and 2018 Proposed Budget

The need for "restoration" stems from the district's decision to pre-fund its 2017 obligations in those areas with surplus funds generated in 2016. The 2017 "savings" created from this strategy were used to pay for several new strategic initiatives in the 2017 budget. Because those funds need to be restored in 2018, the reallocation essentially must be reversed (i.e. they now must flow from programmatic areas back to debt-related obligations).

MPS will institute a variety of cost-cutting measures to restore retirement and capital debt spending, and to fund other cost increases. Perhaps the most significant action is the elimination of 194 positions, which will generate $11.1 million in savings. Overall, the reallocation falls hardest on MPS schools, wherein lie most district expenditures. In fact, school budgets would be reduced by about $31 million in 2018 (including the elimination of pay raises for school staff). Spending on other priorities also would be deferred, such as the expansion of charter schools, employee raises, and development of a virtual school.

The scope of MPS' internal cost reallocations for 2018 is substantial but should not impose radical changes on MPS operations. District officials argue that budget difficulties in the coming year will be moderated by the fact that schools enjoyed position and funding increases in 2017 that are larger than the reductions they will face in 2018. It is also worth noting that some program and staffing changes budgeted for 2017 have not been implemented given the impending fiscal situation.

Also, despite the sizable budget cutbacks, some new program initiatives and administrative changes are proposed. These include a new Office of Black and Latino Male Achievement, principal coaches for each school, and six new deans of students at comprehensive middle schools who will focus on improving school climate.

In addition, monies remain to expand the number of "high-performing, in-demand programs." The district's central services and regional service hubs also are being reorganized to better support and respond to school issues and buttress improvements in teaching and learning.

MPS continues to face the formidable challenge of raising the level of student achievement in schools with vast student poverty, while at the same time seeking to increase the number of schools that can compete successfully with private schools. Given its revenue challenges and expenditure pressures, it is easy to see why MPS has turned to one-time cost reallocation strategies as a means of financing new strategic initiatives, despite the potential to dig a deeper financial hole in subsequent budgets.

Nevertheless, the rate of change the district has undergone in recent years has created its own set of issues. Budget officials concede "there is no substitute for long-term stability, predictability, and continuity." Such goals will not be easily or quickly achieved.

KEYS TO UNDERSTANDING THE 2018 PROPOSED BUDGET

KEY #1: STATE PER PUPIL AID INCREASES

The Governor's 2017-19 recommended State budget includes a substantial increase in State per pupil funding. If adopted, this could provide MPS with an additional $15.4 million in 2018.

Why this is important

In 2011, the Wisconsin Legislature created the state per pupil aids program to compensate, in part, for funding reductions instituted under Act 10. Governor Walker's recommended State budget for 2017-19 increases this funding by $200 per pupil over the previous year. To receive this aid, however, a district's employees must pay at least 12% of their health care costs, which is the same share of employee costs recommended in fiscal changes associated with Act 10.[4]

MPS employees now pay roughly $3 million less than the Governor's recommended 12% requirement. Nevertheless, MPS' 2018 proposed budget includes the full amount of per pupil revenues included under the Governor's budget, despite the fact that it does not adjust employees' share of health care benefits. MPS officials do not believe the Legislature will sustain the Governor's 12% requirement, anticipating that it will be viewed as an intrusion into local control. If that provision is included, then the district does plan to require employees to contribute sufficiently to meet the 12% threshold, making it eligible for the $15.4 million increase in State funds.[5]

The amount of per pupil funding in the Governor's recommended budget for 2018 is $379 million, a number considerably lower than the $4.6 billion allocated for general school aids. Despite this lower level of funding, per pupil aid constitutes nearly 90% of all new State tax revenue for public instruction in the Governor's budget. This turn to per pupil aid – as opposed to equalization aids – is part of a recent funding trend. MPS' per pupil aid more than tripled from 2014 to 2017, growing from $6.2 million to $19.8 million. In contrast, State aid for all other MPS school operations, including equalization aid, grew by only 2.2% ($13.3 million).

How would a growing reliance on per pupil aid, if it were to continue, affect MPS and other Wisconsin school districts? While a complete analysis is beyond the scope of this budget brief, we note that per pupil aid is financed solely by the State, while equalization aid is funded through a combination of

---

[4] A total of $188 of the $200 additional per pupil payment pertains to the percentage of health benefits employees assume. A district also would be eligible for $12 per pupil aid in 2018 for compliance with other, more technical provisions related to health care financing. See Legislative Fiscal Bureau, Summary of Governor's Budget Recommendation, 2018-19 Biennial Budget: https://docs.legis.wisconsin.gov/misc/lfb/budget/2017_19_biennal_budget/102_summary_of_governor_s_budget_recommendations_by_agency/public_instruction.pdf

[5] In that case, MPS also would review internally reallocating $3 million to employee salaries to offset these additional employee benefit costs.

State funds and local property tax resources. As a result, the advent of per pupil aid has taken pressure off the property tax for many districts.

Milwaukee's case differs from that of many districts in that declining enrollments have led to reductions in equalization aid and property tax levy. Nevertheless, MPS enrollment losses have moderated in recent years, and MPS even projects a sizeable upturn in enrollment in the next five years. If such an eventuality occurs, then MPS undoubtedly will want to be able to turn to both the property tax and State aid to finance district growth.

KEY #2: EQUALIZATION AID DECLINES

The largest source of State aid for MPS and other Wisconsin districts is the equalization aid program. This program also is tied closely to districts' property tax levies, as State-imposed revenue limits are based on districts' combined amount of equalization aids and property taxes. MPS would see a decline of $12.9 million in the combination of equalization aids and property taxes under the Governor's recommended budget.

Why this is important

The Governor's budget holds the per pupil revenue limit constant for 2018, and no additional State funding is recommended for equalization aids. Nevertheless, MPS would experience a $12.9 million drop in funding in its combined equalization aids and property taxes, mainly because of a decline in student enrollments and enrollment-related adjustments applied under the equalization aid formula.

The combination of equalization aid and property tax levy provides 89% of all MPS school operations revenue, with State payments (including poverty aid) totaling $573 million and property tax payments $260 million in 2017. MPS' equalization aid decrease means that the district would receive a lower combined allocation of State and property tax revenue in 2018. However, the precise distribution of funding from each revenue source will not be known until October 2017, when the State certifies funding allocations.

Student enrollment has a strong impact on school district finances; in fact, several programs, in addition to equalization aids, have allocation formulas predicated on numbers of students served. MPS' enrollment has declined for nearly two decades, with the district's "membership" count nearly 20% lower than in 1999. Competition from private schools and non-MPS charter schools has been a primary contributor to the district's enrollment decline.

While the 2018 proposed budget anticipates a continued enrollment decline, the rate of decline has moderated from past years, and district analysts now predict that MPS' enrollment soon will turn upward. As shown in **Table 4**, the membership decline in 2018 is partially attributable to decreased use by Milwaukee students of the Chapter 220 integration program, which is being phased out; and the Open Enrollment program, which allows Milwaukee students to enroll in neighboring school districts if space is available.[6] The enrollment counts at MPS schools actually increase by 474 students after having increased by nearly 1,300 students the year before. Most of the enrollment change anticipated for MPS traditional and charter schools results from the closure of two independent charter schools in 2017 and the transfer of those schools to MPS control.

Table 4: MPS membership by school type, 2015 to 2118

School Type	2015 Actual	2016 Actual	2017 Actual	2018 Projected	2017 to 2018 % Change
MPS-traditional schools	68,835	66,920	66,186	67,530	2.0%
MPS-contracted schools*	1,657	1,524	1,687	1,800	6.7%
MPS independent charters	6,899	7,124	8,983	8,000	-10.9%
MPS sites total	**77,391**	**75,568**	**76,856**	**77,330**	**0.6%**
Chapter 220**	**1,476**	**1,313**	**1,040**	**856**	**-17.7%**
Open Enrollment	**5,578**	**6,434**	**5,865**	**5,326**	**-9.2%**
Total MPS membership	**84,445**	**83,315**	**83,761**	**83,512**	**-0.3%**

* Contracted category includes non-contract alternative schools
**Chapter 220 enrollment in suburban schools does not include intra-district MPS transfers
Source: MPS 2017 Amended, Adopted Budget and 2018 Proposed Budget

One outcome arising from MPS' modest enrollment decline is that MPS will receive $2.2 million less in State aid in 2018 under the declining enrollment exemption of State revenue limits. The exemption was established to moderate large revenue reductions for districts experiencing rapid enrollment declines. MPS is projected to continue to lose enrollment in 2018, but the enrollment loss will be less severe than in recent years, thus qualifying the district for a smaller declining enrollment exemption.

MPS has received this exemption for many years. Now, and perhaps for a number of years to come, MPS may find itself in the unenviable position of being negatively affected by a mechanism that was designed to give it fiscal relief.

KEY #3: MPS STARTS 2018 WITH A DE FACTO $46 MILLION BUDGET HOLE

MPS' 2017 budget had a structural "deficit" of $46 million because of the use of one-time retirement and capital-related debt savings and a transfer from the construction fund to school operations. In other words, actions undertaken in the 2017 budget created a revenue "hole" of $46 million going forward. This was part of a deliberate strategy to finance high-priority school operations initiatives in 2017, and it was expected that new revenues or internal reallocation would need to be used to restore the $46 million in 2018.

[6] While any decline in Open Enrollment affects the district's total membership count and the amount of per pupil aid MPS receives under State revenue limits, it is also the case that MPS payments to suburban school districts for the direct educational costs of each Open Enrollment student are reduced.

Why this is important

Two major decisions were made by MPS in 2017 that created a de facto, multi-million dollar budget hole for 2018. Under the first, the district transferred $9.5 million in ongoing property tax revenue out of the construction fund to help finance a series of new strategic initiatives in school operations. Under the second, the district used 2016 savings to pay 2017 retirement and construction-related debt payments at the end of 2016, thus “freeing up” $36.6 million in the 2017 budget that it similarly directed to school operations.

Per State law, all local units of government are required to adopt a balanced budget. While MPS’ budget is properly described as balanced in 2017, the use of one-time savings to replace funds dedicated to ongoing expenditure needs means that, in reality, the district enters 2018 in the red.

MPS officials undertook these funding transfers in order to expedite high-priority initiatives aimed at improving school effectiveness and increasing the district’s competitive position vis-à-vis private and independent charter schools. Strengthening competitiveness is part of MPS’ strategic plan and is critical to reversing the enrollment losses that, heretofore, have eroded MPS’ fiscal and program vitality.

The 2017 revenue transfers funded initiatives such as salary adjustments, 253 new positions, and implementation of Phase II of the Regional Development Plan that added capacity at high-demand language immersion, charter, and Montessori schools. The 2017 budget also funded new and expanded programs and services, such as for summer school, after-school programming, and free driver education.

The 2017 revenue transfers were proposed with full transparency as intentional, one-time strategies. The 2017 budget described the purpose and implications of this action:

> *Both of these are sound mechanisms for the one-year budget but will not be sustained for 2017–18. The district’s use….is part of an overall financial and program strategy that seeks to halt enrollment losses and the state equalization aid reductions associated with them. Also, the 2018 budget outlook will be shaped by unknown future factors and developments, such as the amount of new revenue provided by the next state budget. Nevertheless, the creation of this potential “hole” does set up a 2018 budget scenario that may be far more challenging than that experienced in the past two years.*
>
> *This means the MPS community, particularly administrative leadership, will need to prioritize its action plans and examine potential savings in areas such as transportation costs, building use, right-sizing enrollment and medical costs.*[7]

The 2018 proposed budget fully restores the $36.6 million in base funding for retirement and capital-related debt. However, it does not does not refund the $9.5 million transfer from the construction fund, as was originally intended.

---

[7] Milwaukee Public Schools, *2017 Amended Adopted Budget*, section 3, page 12.

KEY #4: MPS' CONSTRUCTION FUND REMAINS IN FLUX

The 2018 proposed budget essentially underfunds major and deferred maintenance, electing instead to re-direct $9.5 million in property tax revenues to school operations. The budget acknowledges this approach is not sustainable and describes the district's plans to increase future capital expenditures and refund the $9.5 million transfer.

Why this is important

As noted above, the transfer of $9.5 million of property tax revenues from the construction fund to school operations first occurred in 2017, and the 2018 proposed budget simply continues that policy. That move would leave only $1 million available for major maintenance/deferred maintenance projects in the coming year. In the previous four years, MPS' spending on major and deferred maintenance averaged $14 million annually.

MPS has a large backlog of deferred maintenance projects, and the condition of district schools and its other facilities is an educational and fiscal concern. In 2019, the district plans to increase deferred maintenance expenditures by using borrowing authority not yet fully drawn upon in Qualified School Construction Bonds. These bonds were part of the 2009 federal stimulus package and they carry a low interest rate.

With the availability of this borrowing authority and the repayment of the $9.5 million property tax transfer, MPS estimates that it can undertake approximately $18 million of major and deferred maintenance improvements annually from 2019 through 2022. The $18 million figure represents the capacity of existing staff to complete such projects. The proposed budget expresses confidence in the fiscal efficacy of this approach, noting that "with a cumulative surplus of over $30 million into the 2021–22 school year, the assumptions of the forecast result in solvent operations."

While MPS' plan is understandable given its other challenges – and while its strategy to restore its deferred maintenance program in 2019 is reasonable – this approach does raise some red flags. For example, while the budgeted surplus in MPS' construction account will be $47 million in 2018, that is nearly half of the district's total fund surplus of $97 million. A strong fund balance is one of the key indicators of a local government's fiscal health and is routinely reviewed by bond rating agencies.

In addition, we would note the following cautionary statement from the ICMA:

> *Local governments often delay capital plant expenditures because that is a relatively painless way to temporarily reduce expenditures and ease financial strain. Continued deferral can, however, create serious problems that are made even more serious by the size of the investment that capital facilities represent…If these assets are not property maintained or are allowed to become obsolete, the results are often (1) decreasing usefulness of the assets, 2) increasing cost of maintaining and replacing them, and 3) decreasing attractiveness… as a place to live or do business.*[8]

[8] International City/County Management Association, *Evaluating Financial Condition: A Handbook for Local Government*, 2003, page 98.

KEY #5: MPS' 2018 MEDICAL COSTS RISE

After several successive and remarkable years of decline, MPS' annual health care expenditures began to increase again in 2017. Another increase of $4.5 million is anticipated in 2018.

Why this is important

For MPS, as well as many other employers, controlling medical costs has been and continues to be a major budgetary challenge. MPS has undertaken commendable and highly successful efforts to *reduce* medical and other fringe benefit costs in recent years, which have generated savings that were used to bolster school operations. In 2017, medical costs again began to rise, however, and the 2018 proposed budget includes a $4.5 million increase (4.2%) for health care expenditures.

MPS has labeled fringe benefits the "dominant force" in its budget. Most of the district's budgets in recent years have restructured fringe benefits in some way, including both pension and health care cost-cutting measures. The greatest reduction in pension costs has come about through the closing of the district's supplemental teacher retirement plan to new employees, as well as cost sharing for required annual retirement system contributions between MPS and employees. Major health care cost reductions have resulted from several strategies, including:

- Redesigning medical, dental and pharmaceutical plans
- Creating low- and high-cost medical plans with differentiated premium costs
- Raising employee eligibility to receive health benefits from 20 to 30 hours per week
- Increasing the years of service and minimum age of retirement needed to qualify for retirement health care benefits
- Securing a new third-party administrator

As a result of these and other actions, MPS' annual fringe benefit expenditures in school operations have declined dramatically since 2011, as shown in **Table 5.** In addition, MPS' unfunded OPEB liability dropped from $2.4 billion to $997 million, which is still a considerable sum, but which represents an impressive improvement in a short period of time.

Table 5: MPS fringe benefit expenditures in school operations, 2011 vs. 2017-2018 (in millions)

Benefit	2011 Actual	2017 Budgeted	2018 Proposed	2017-2018 % Change	2011-2018 % Change
Employee medical insurance	$153.6	$105.4	$109.8	4.2%	-28.5%
Retiree health care	$76.7*	$49.5	$46.8	-5.5%	-39.0%
Pension	$101.8	$46.8	$46.6	-0.4%	-54.2%
Social Security	$40.6	$38.3	$37.8	-1.4%	-7.0%
Life Insurance & LT Disability	$1.8	$2.1	$4.0	91.9%	125.9%
Total fringe benefits	**$374.5**	**$242.1**	**$245.1**	**1.2%**	**-34.6%**

* Includes $16 million in OPEB payments made in advance with application of surplus funds

Source: MPS budget office

In 2017, fringe benefit costs again began to rise, as was inevitable. The overall fringe benefit rate increased from 43.2% of salary in 2016 to an anticipated 48.3% in 2017. A further increase to 50.2% is budgeted for 2018, which is mainly attributable to the $4.5 million increase in medical costs. MPS budget officials report that prescriptions are a strong cost driver, as they are anticipated to grow by 12% in 2018 and are now budgeted as a separate line item. Medical expenditures are expected to increase by 6% per year during the next five years, although actual expenditures may vary depending upon factors such as the number of enrollees in the district's health care plans.

MPS' increase in medical costs for the second consecutive year should not be surprising given the general direction of health care costs. If there is any silver lining to this returning fiscal cloud, it is that reductions in health care costs implemented in recent years have produced a smaller cost base. Consequently, annual increases are not as large or as difficult to manage as they otherwise might be. In fact, if the district's health care budget in 2017 had been the same as in 2011, then the increase in medical costs in the proposed budget would be $6.5 million, as opposed to $4.5 million.

KEY #6: MPS ELIMINATES 194 POSITIONS

To fund rising medical costs, restore debt payments, and address inflationary expenditure pressures, the proposed budget eliminates 194 positions, freeing up an estimated $11.1 million.

Why this is important

The number of positions eliminated is substantial, but the budget notes that few layoffs are anticipated and that the reductions mostly will be managed through staff turnover, retirements, and vacancies. **Table 6** breaks down these position changes by category. All but seven positions are school-related, with teaching positions reduced by 81 and educational assistants by 97.

Table 6: MPS positions by category, 2017 vs. 2018

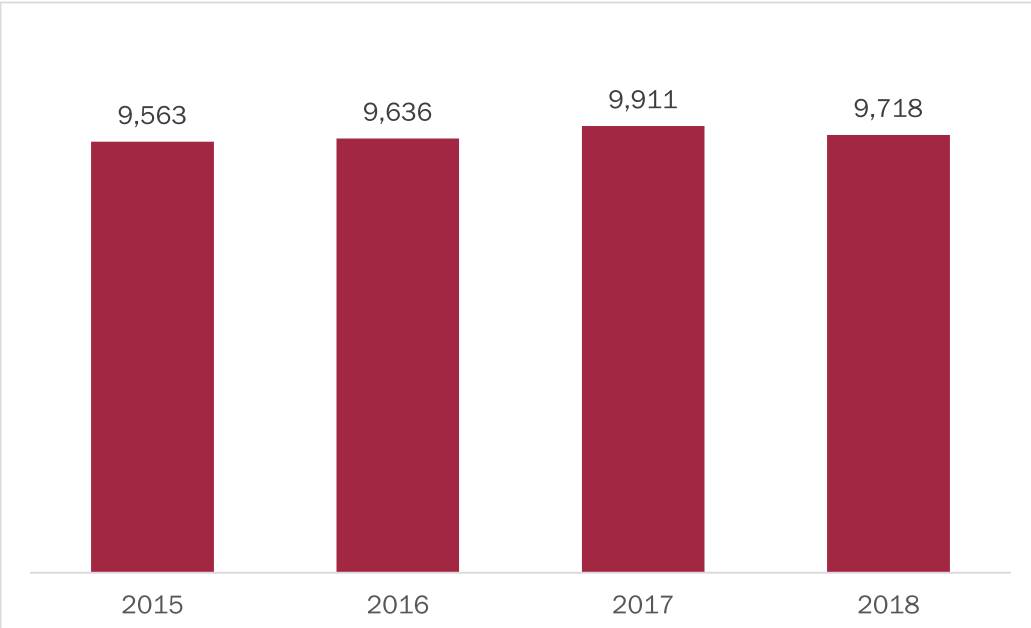
Type	2017 Budgeted	2018 Proposed	2017-2018 % Change
Certified school administrators	235	240	2.1%
Principals & assistant principals	263	258	-1.9%
Teachers	4952	4856	-1.9%
Licensed support professionals*	361	358	-0.8%
School nurses	64	64	0.0%
Educational assistants	1383	1286	-7.0%
Classified technical & administrative	387	404	4.4%
Trades & clerical	565	550	-2.7%
Safety aides	260	270	3.8%
Building services, engineers & boiler attendants	626	626	0.0%
Food service	466	466	0.0%
Other	350	342	-2.3%
Total	9,911	9,718	-2.0%

* Includes therapists, social workers, and psychologists

Source: MPS 2018 Proposed Budget

It also should be noted that the position decline in 2018 would be more than offset by the increase of 275 positions included in the 2017 budget. Looking at positions from a longer-term perspective, we see in **Chart 2** that the district's total position count in 2018 would be higher by 155 positions than the 2015 count. That is despite the fact that MPS' revenue has remained essentially flat during this time.

Chart 2: MPS positions, 2015 to 2018



Source: MPS budget documents

BUDGETARY IMPACTS IN MPS' TWO LARGEST FUNDS

In this section, we provide more detailed analysis of the two largest funds in MPS' budget: school operations and categorical aid. These funds not only are the most noteworthy in MPS' budget from a financial perspective, but they also have the greatest impact on school programming and academic achievement.

SCHOOL OPERATIONS

MPS's school and administrative expenses are financed through the school operations fund. This is the only general fund in the MPS budget; the other four funds support special purpose activities.

The school operations budget accounts for 79% of the district's total budget. Outside of changes in general school and per pupil aid (discussed above), revenue changes in this fund for 2018 mainly are associated with other designated State aids. In fact, the total funding increase for these aids in 2018 exceeds by $1 million the combined $2.5 million increase for per pupil and equalization aids, as shown in **Table 7** on the following page.

Because of MPS' large composition of disadvantaged and special needs students, it receives more State revenue from designated programming than most other districts.[9] In fact, while MPS ranked 100th among Wisconsin school districts in all equalization aid in 2016, it ranked 26th in overall State aid because of its larger share of non-equalization aid.

In recent years, MPS' revenue for designated aids has fluctuated. However, in 2018, handicapped aids are expected to increase by $1.7 million (from $47.6 million to $49.2 million), and transportation aids by $500,000. As noted above, the Governor also has proposed creating a new program, MPS summer school aids, with $1.4 million in funding for 2018.

[9] For example, students with disabilities constitute 20% of MPS' total enrollment, compared with 14% of statewide enrollment in 2017. Also, English Language Learners represent 9% of MPS students versus 5% of students statewide.

Table 7: MPS school operations revenue, 2017 vs. 2018 (in millions)

	2017 Budgeted	2018 Proposed	2017 to 2018 %Change
State			
General equalization aid	$572.6	**	
Integration aid	$37.7		
Poverty aid	$5.3		
Computer aid	$7.1		
Charter/Choice deduction	($60.4)		
*General School Aids**	*$822.4*	*$809.5*	*-1.6%*
Per Pupil Aid	$19.8	$35.2	77.8%
General School & Per Pupil Aids	*$842.2*	*$844.7*	*0.3%*
Handicapped	$47.6	$49.2	3.6%
Transportation	$2.0	$2.5	25.0%
Library	$5.0	$5.0	0.0%
Bilingual aid	$1.9	$1.9	0.0%
Summer school aid	NA	$1.4	NA
Tuition from state	$0.7	$0.7	0.0%
Other state aid	$0.1	$0.1	0.0%
State Total	**$899.5**	**NA**	**NA**
Federal			
Fed reimbursement	$3.5	$3.5	0.0%
Indirect cost aids	$5.4	$5.4	0.0%
Medicaid Reimbursements	$6.5	$5.0	-23.1%
Federal Total	**$15.4**	**$13.9**	**-9.7%**
Local			
Property tax	$260.1	***	NA
Non-property taxes			
Tuition	$8.4	$8.4	0.0%
Rental	$3.5	$1.3	-62.9%
Other	$1.5	$1.5	0.0%
Local Total	**$273.5**	***	**NA**
School Operations Grand Total*****	**$928.2**	**$930.7**	**0.3%**

* Includes funding from property tax levy

** The total and component pieces of the school aids budget are not known until fall; until then, MPS budgets school aids revenues as a single sum

*** Property tax levy for 2018 school aids budget is not set until fall 2017

**** Totals may not add due to rounding, excludes carry over funding

Source: MPS 2017 Amended, Adopted Budget and 2018 Proposed Budget

CATEGORICAL AID

MPS' second largest fund is for categorical aid, which consists largely of special purpose program grants. About 80% of MPS' categorical grants come from the federal government. As shown in **Table 8**, the 2018 proposed budget includes a $5 million (3%) increase in categorical aids, largely because of federal grant increases.

MPS budget officials are not optimistic about the district's ability to sustain current funding levels for the Title I program, however, which is the largest source of the district's categorical aids. They report that the federal formula for the distribution of Title I monies now requires that Milwaukee private schools receive a larger share of revenue. In fact, the district actually is anticipated to receive less Title I revenue in 2018 than it did in 2017. The $5.9 million Title I increase in the proposed budget results from the district's ability to carry over unused funding from previous years.

Final budget numbers will not be known until the fall, but the proposed budget anticipates that State and private categorical grant revenue will see little change in 2018. Revenues for the Achievement Gap Reduction program (formerly the Student Achievement Guarantee in Education program, or SAGE) are budgeted at $24.8 million. This program constitutes 87% of MPS' categorical aid from the State.

While not shown in the table, a five-year trend analysis indicates that categorical aid has changed little since 2014, inching up by $100,000, from $171.5 million to $171.6 million. In that period, federal categorical grants decreased by $2 million, while State categorical aids grew by $2.1 million.

Table 8: MPS categorical aid revenue, 2017 vs. 2018 (in millions)

Category	2017 Budgeted	2018 Proposed	2017 to 2018 % Change
Federal			
Title I	$72.4	$78.3	8.1%
Title II	$10.4	$10.7	2.9%
Title III	$1.6	$1.5	-6.3%
IDEA	$25.6	$28.1	9.8%
Head start	$7.9	$8.8	11.4%
Other	$16.7	$12.1	-27.5%
Federal Total	**$134.6**	**$139.6**	**3.7%**
State			
Student achievement guarantee (SAGE)	$24.8	$24.8	0.0%
Other	$3.5	$3.7	5.7%
State Total	**$28.4**	**$28.6**	**0.7%**
Local (private)			
GE Foundation	$3.2	$3.0	-6.3%
Other	$0.4	$0.4	0.0%
Local Total	**$3.6**	**$3.4**	**-5.6%**
Categorical Total*	$166.6	$171.6	3.0%

* Indirect aid not included of $5.4 million in 2017 and $5.1 million in 2018

Source: MPS 2018 Proposed Budget

FIVE-YEAR BUDGET AND ENROLLMENT FORECASTS

For the past several years, MPS's annual budget challenges have been accompanied by concern over its long-term fiscal health. Until recently, a primary source of that concern has been soaring pension and health care costs, which created a substantial structural deficit because they were rising at a rate that revenues could not match. Since 2011, MPS has taken action to reduce these costs and has brought its budget more in balance. Nevertheless, limited growth in State and federal funding – as well as the State's strict local revenue limits – suggest that the district's fiscal condition may remain problematic.

Table 9 – which summarizes MPS' five-year fiscal projections for its school operations budget – supports that concern. Budget forecasting represents a significant challenge for the district in light of the major fiscal forces that are beyond its control, such as State aid and medical costs. Still, these projections provide a useful tool for fiscal management and strategic planning. As shown in the table, a deficit of $74 million is anticipated in 2022 if the district's fiscal assumptions hold.

Table 9: MPS school operations five-year budget projection (in millions)

Category	2018 Proposed	2022 Projected	% Change
Revenues (without applied surplus)	**$930.7**	**$925.4**	**-0.6%**
Expenditures			
Salaries/other wages	$402.6	$418.9	*4.0%*
Benefits	$209.3	$245.0	*17.1%*
Purchased services	$239.5	$251.0	*4.8%*
Supplies	$26.4	$27.5	*4.2%*
Capital Purchases	$2.3	$2.4	*4.3%*
Debt Service	$32.8	$34.8	*6.1%*
Insurances	$9.5	$11.1	*16.8%*
Other	$8.3	$8.6	*3.6%*
Total expenditures	**$930.7**	**$999.3**	**7.4%**
Deficit		**($73.9)**	

On the expenditure side of this forecast, MPS estimates that fringe benefits will show the greatest increase, growing by $36 million (17%). Salaries are expected to rise by only 4%. The rise in purchased services largely reflects charter school expansion.

On the revenue side, MPS estimates that incoming funds will decline by $5.3 million, or less than 1%. This revenue projection assumes that MPS will receive little, if any, additional increases from State equalization aid and the property tax levy. This is a very conservative estimate since State revenues have grown in recent years, though it is worth noting that even a 3% increase would leave the district with a $40 million deficit in 2022. Also contributing to the revenue decline is the return of $9.5 million in property tax revenue to the construction fund.

The five-year budget forecast also assumes no change in MPS enrollment. In a separate enrollment projection, district analysts now predict *positive* enrollment growth starting in 2019. This forecast is quite different from those in recent years. For example, in the 2017 budget, district analysts predicted that "on-site" enrollment (i.e. the total from elementary through high schools, partnership schools, and non-instrumentality charter schools) would equal 71,589 students in 2020. In the 2018 proposed budget, the on-site enrollment projection for 2020 is 80,133.

The district's overall membership is projected to rise by a smaller amount than on-site enrollment. As shown in **Table 10**, from 2017 to 2022, the projected growth in on-site enrollment is 6,051 students (7.2%), while projected total membership growth is 2,768 students (3.3%). Projected declines in Chapter 220 and Open Enrollment are responsible for diminishing the membership total.

Table 10: MPS enrollment projection by school type, 2017 to 2022

School Type	2017 Actual	2018 Budgeted	2020 Projected	2022 Projected	2017-2022 % Change
MPS-traditional schools	66,186	67,530	68,762	71,116	7.4%
MPS-contracted schools*	1,687	1,800	1,800	1,800	6.7%
MPS Independent charters	8,983	8,000	9,571	9,991	11.2%
MPS sites total	**76,856**	**77,330**	**80,133**	**82,907**	**7.9%**
Chapter 220**	**1,040**	**856**	**482**	**192**	**-81.5%**
Open Enrollment	**5,865**	**5,326**	**4,337**	**3,430**	**-41.5%**
Total MPS Membership	**83,761**	**83,512**	**84,952**	**86,529**	**3.3%**

* Contracted category includes non-contract alternative schools
** Chapter 220 enrollment in suburban schools does not include intra-district MPS transfers
Source: MPS 2018 Proposed Budget

Interestingly, MPS officials do not expect that this long hoped-for change in student numbers will positively impact district revenues, at least in the near term. The main reason for their fiscal caution is that as enrollment swings upward, MPS would lose dollars previously credited to the district under the State's declining enrollment exemption, as explained above. In the 2018 proposed budget, MPS' declining enrollment exemption is $7.9 million.

CONCLUSION

The Milwaukee Public Schools is a large, complex, and multi-faceted school district. Not surprisingly, its annual budget shares those characteristics, with each year bringing fiscal changes and new developments.

This year, the main story in the Superintendent's proposed budget is a return to the paradigm that existed prior to her appointment in 2014. Lacking any significant growth in revenue – and needing to shift funds from school operations to restore retirement and capital debt payments that were pre-funded for 2017 – MPS must cut positions and forego major new initiatives (though infrastructure has been put in place to support new initiatives going forward).

These circumstances will affect many schools' plans to improve teaching and student learning. Furthermore, the benefits the district hoped to achieve through a large reallocation to school operations in 2017 will be more difficult to realize.

Yet, despite these setbacks, MPS should weather the upcoming year without serious or lasting damage to its fiscal prospects. Notwithstanding its need to "retrench" in this budget, the district will move forward with a reorganization of central services to better support and respond to needs of individual schools; and it will continue to build administrative structures in each school to guide and strengthen the reform efforts of principals and teachers.

Ultimately, the district's ability both to bring about the kind of systemic transformation that it seeks – and to set itself upon a more stable fiscal course – will rest on its ability to secure revenue increases that align with inflationary increases in costs. Use of one-time mechanisms, although perhaps necessary in the short run, is not a viable long-term strategy.

Two additional stories in this budget that cast a cloud over the district's future finances are the anticipated rise in medical costs and the flux in the construction fund. After several successive years of medical expenditure reductions prior to 2017, the district now estimates that those costs will grow by about 6% annually over the next five years. That is a concern given MPS' stagnant revenues and the fact that each 1% increase in medical expenditures costs about $1 million more per year. Of similar concern for the future is the need to restore $9.5 million in property tax levy to the construction fund, which will take those monies away from school operations.

Overall, MPS students, parents, teachers, and other stakeholders should take comfort in the fact that significant cuts to the teacher workforce and major changes in educational programming should be avoided in 2018, and that several of the strategic initiatives launched in the past two years should continue. A look ahead is far less comforting, however, and reveals that considerable heavy lifting will be required to avoid such undesirable consequences in future budgets.