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To:	MY GROUP; All Alders
Cc:	Dept Division Heads; Budget Contacts; Committee Staff List; FN GROUP
Subject:	Information Series on the Outlook for the 2025 City Budget -- Part 2 -- The Structural Deficit
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Attachments:	image001.png Outlook for 2025 Budget -- Part 2 -- Structural Deficit.pdf

Mayor and Alders:

Last week we kicked off an informational series on the outlook for the 2025 City budget. Today's edition is Part 2 of that series – The Structural Deficit.

A link to Part 2 of the information series – The Structural Deficit -- can be found here. A PDF of the slides is attached to this email.

Introduction

A number of Alders have reached out to me recently with questions regarding the upcoming 2025 budget process. In addition, there were a number of questions raised as part of the discussions around the 2024 budget. This four part series is an attempt to help answer those questions.

As you know, the City of Madison has faced a budget shortfall of some degree every year for the past 14 years due to state-imposed restrictions on City revenue and growing need for services. We have used a variety of measures to close these gaps over the years and balance the budget while maintaining services, even as the City continues to grow.

The City has been fortunate over the past 5 budget years to have sufficient funding from short-term federal pandemic relief and economic recovery funding, along with strong city reserves, to weather revenue losses and maintain service levels. As you know, the last of these short-term funding sources were used to balance the 2024 budget. As we look to the future, the City is facing significant challenges to maintain service levels for a growing population in the face of the State Legislature's limits on property taxes, state aid, and other revenue sources.

In order to help the Mayor and Council understand and address these challenges, the Finance Department has developed a four part series of recorded presentations on the outlook for the 2025 budget. This week's edition focuses on the City's structural budget deficit.

Part 1: Budget Foundations
- Understanding the City's fund structure & main components of the operating budget

Part 2: The Structural Budget Deficit
- Internal and external factors driving the deficit

Part 3: Budget Balancing Strategies – Expenditures
- Impact of personnel costs and debt service

Part 4: Budget Balancing Strategies – Revenues
- Options for raising local revenues, special charges and the property tax

A briefing on all four parts of the series is planned for the Council meeting on February 13th.

One goal of the series is to provide a general understanding of the overall City budget as a first step, followed by an explanation of what has been termed the "structural deficit". A "structural deficit" is a persistent annual gap between what the City is allowed to raise in revenue under state law and what it needs to spend to maintain current service levels to a growing population. The City has used a broad array of approaches to close this deficit in each years' budget. The economic effects of the pandemic made the deficit worse, but federal fiscal relief funding to state and local governments, along with City reserves, helped close the gap in the short term. With those short-term funding sources fully expended, the projected deficit for 2025 is $27 million and the options to close that gap and deficits in future years are limited.

Parts 3 and 4 of the informational series explore the options for addressing the deficit. Part 3 focuses on putting into perspective the impact of closing a $27 million budget gap solely through cutting expenditures and service reductions. Part 4 focuses on revenue options available to balance the budget and maintain current service levels.

This informational series is a first step toward deciding on an approach to balancing next year's budget. Additional discussion and analysis will be necessary to support the Mayor and Council in their efforts to make decisions on top priorities, service levels, and revenue approaches.

Part 2– The Structural Deficit

In the Structural Deficit presentation, the goal is to provide general background on the persistent gap between the City's cost to continue current services and the allowable growth the City's revenues, along with the limited array of revenue options, under state law. This gap has been in place for over a decade and was made worse by the economic effects of the recent pandemic. Federal fiscal relief funding and other City funding helped maintain City services over the past few years. But these were short-term measures – longer-term action is now necessary to address the deficit.

The Structural Deficit

As discussed in last week's communication on Part 1 of this series, a structural deficit is an on-going gap between the costs-to-continue current services to City residents and the growth in revenues that is allowed under Wisconsin law. Costs-to-continue current services include assumptions of employee wage adjustments and fringe benefit cost increases, additional positions to provide the same level of services as Madison's population continues to grow, annual principal and interest payments for bonds and notes issued to finance the City's capital projects ("debt service"), and the impact of inflation on supplies and purchased services. Examples of supplies costs include fuel and equipment; examples of purchased services costs include critical technology maintenance agreements and contracts with non-profit organizations to provide community services on behalf of the City. The estimated gap between costs-to-continue current services and allowable revenues for 2025 is $27 million. Without any action, that deficit will grow to over $60 million by 2029, depleting the City's reserves, undermining the City's finances, and threatening core city services.

The City's structural deficit has been an on-going issue in each budget since 2011. In that year, the State Legislature adopted very strict limits on the authority of cities (and other local governments) to increase property taxes. The Legislature also cut state aid to local governments ("shared revenue") in that year, further increasing the reliance of Wisconsin cities on the property tax. According to the Wisconsin Policy Forum, the reliance on the property tax to finance services provided by Wisconsin cities is the highest among Midwestern states. Wisconsin finances local government services through a combination of local property taxes and "sharing" of sales and income taxes collected by the state. Under this model, Wisconsin cities have very few local general revenue options and are under strict control by the State for the funding necessary to provide services to residents.

Madison has used many of the limited options allowed under state law to help maintain funding for current services in each year's budget starting since 2011. Some of the measures used to balance the budget include increases in certain charges and fees, such the ambulance fee, building permits, room taxes, vehicle registration fees, and special charges for city-wide services, such as forestry management. Costs have also been managed through higher employee contributions to benefits and modest across-the-board reductions to agency budgets.

Impact of the Pandemic on City Budget

The economic effects of the pandemic were swift and wide-reaching. For example, City room taxes fell by nearly two-thirds in 2020 compared to 2019. Similar declines in revenue occurred in the City's Parking Utility and the Monona Terrace Convention Center. While Dane County and the State of Wisconsin also experienced falling sales tax collections, those collections bounced back very quickly once the pandemic ended and actually exceeded the pre-pandemic trends by over 10%. In contrast, Madison's revenues remain nearly 10% ($33 million) below pre-pandemic trends because Madison's limited revenue options under state law do not allow it to benefit from the recent economic recovery to the same extent as the County and State.

Projected Deficit for 2025

Allowable property tax and other revenue growth under state law is expected to add $13 million in revenues to the City's budget in 2025. However, the City's on-going commitments, including replacing $18 million of one-time federal and local funding used to balance the 2024 budget, along with $22 million needed to fund the cost of maintaining current services to residents, total $40 million next year. As such, the gap between revenues and commitments is $27 million.

Options for addressing the deficit are made more complicated by a new state law that requires a "maintenance of effort" for local police, fire, and emergency medical services. These provisions require that funding for law enforcement officers, fire fighters and emergency medical services personnel, as well as the number of those staff employed and service levels must be maintained at least at the same level as, or greater than, the previous year. If these maintenance of effort requirements are not met, state "shared revenues" allocated to Madison will be cut by 15% (equal to $1.2 million).

Part 3 of this information series will show the impact on City staff and services to residents of closing the $27 million deficit through spending reductions.

Thank you.

David Schmiedicke

[Please share this email with members of Boards, Committees and Commissions, and others]

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Outlook for 2025 City Budget

Information Series on the General & Library Fund Budget

Part 2: The Structural Deficit

Series Overview

Part 1: Budget Foundations

- Understanding the City's Fund structure & main components of the Operating Budget

Part 2: The Structural Deficit

- Internal and external factors driving the deficit

Part 3: Budget Balancing Strategies – Expenditures

- Impact of Debt Service and Personnel Costs

Part 4: Budget Balancing Strategies – Revenues

- Local Revenues, Special Charges, Property Tax

Additional topics to be determined

Part 2: Components of the Structural Deficit

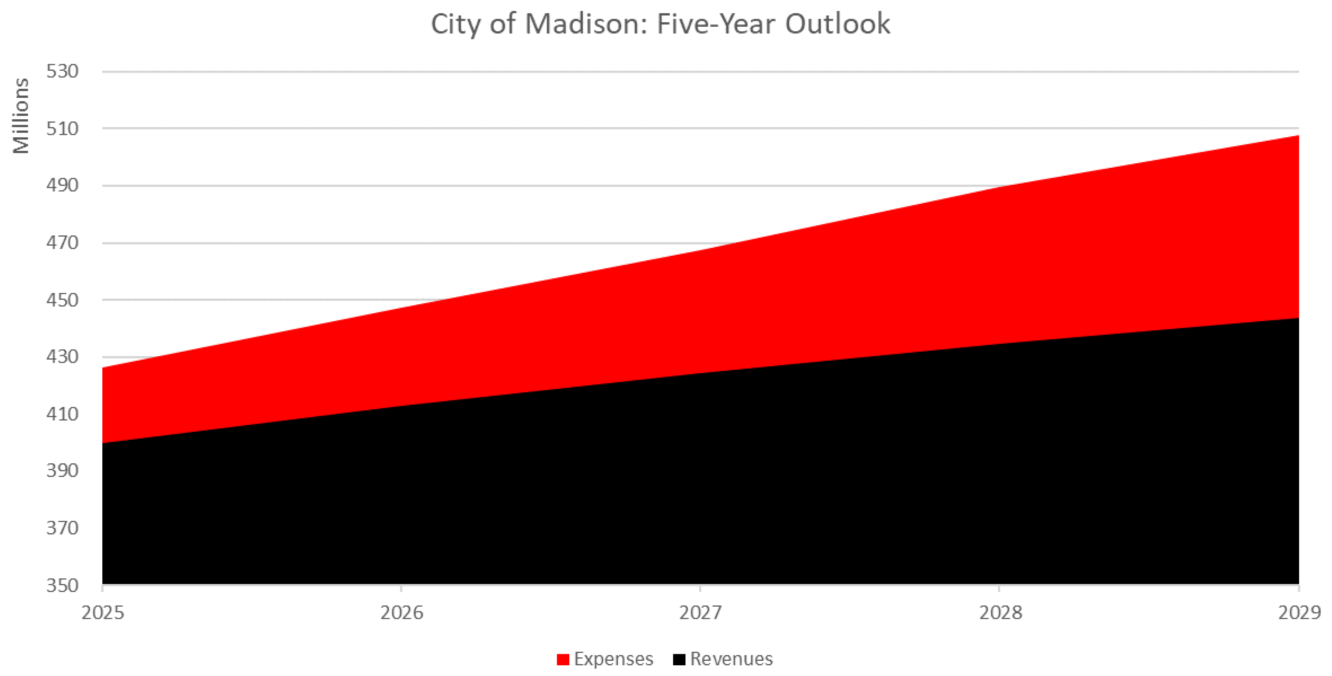
Takeaways:

- Revenues have not fully recovered from the COVID-19 pandemic
- The growth in expenses outpaces the growth in revenues
- Cost to Continue assumptions for personnel costs and recent State law requirements for Public Safety spending contribute to structural deficit

The City faces a persistent structural deficit

A **structural deficit** is when projected expenses are greater than projected revenues, despite external economic conditions.

- In other words, the **cost to continue** (provide the same level of service each year) is more than what we think we will bring in through taxes and other revenue.
- Recent budgets have relied heavily on one-time federal funding for pandemic relief and use of the City's rainy day fund to close the gap.
- The City forecasts an **annual deficit of $27 million in 2025; without any action, deficit is more than $60 million by 2029**.



Prior Budget Balancing Strategies

Allowable levy increases do not keep pace with cost growth

2012	2013	2014	2015	2016	2017
• Debt premium • Police and fire pension contributions • Premium stabilization surplus	• Room tax growth • Ambulance fee	• Room tax – shift from MT projects • Building Permit revenue • Urban forestry special charge	• Room tax • Building permits • Urban forestry special charge	• Room tax – Overture shift • Urban forestry special charge • Health Insurance Plan Design	• Room tax • Ambulance fee • Transit fund surplus • Snow and ice removal budget • Urban forestry special charge

2018	2019	2020	2021	2022	2023
• Increased Room Tax rate • Cost Allocation • Increased investment revenue	• TID 32 Closure • Increased interest revenue • Shift Library Collection to capital	• Vehicle Reg Fee • Shift Parking Enforcement to Parking Enterprise • Increased Forestry staff time to Urban Forestry • Debt premium	• $8 million from fund balance • $6 million in cuts / Workshare / service efficiencies / "furloughs" • $2 million in fee increases / TOM fire/EMS contract	• $13.1m in one-time ARPA funding • Anticipating $1.5m revenue from Sorting Special Charge • $1.4m in cuts	• $3m Sorting Special Charge • $5m-$10m remaining ARPA funds and TID 25 proceeds • Explore other revenue options

Prior to 2012, levy limits had a 3% floor for annual increases rather than 0%; 3% minimum was applied to prior year maximum allowable levy rather than actual levy.

2024 Budget Balancing Strategies

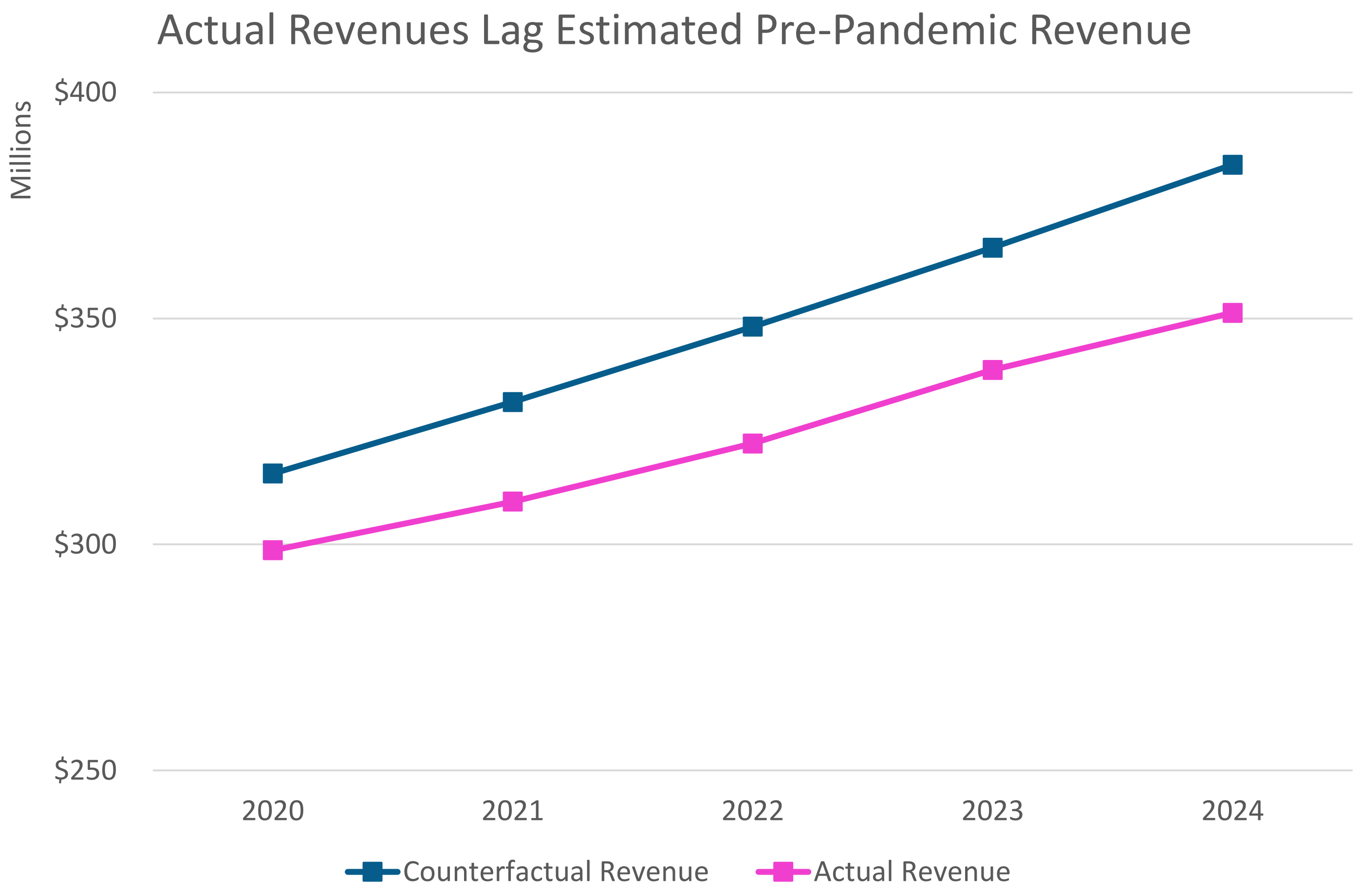
On-Going -- $6 million

- 1% Across the Board Reductions -- ***$3 million***
  - Over the past 5 years, agencies have underspent their authorized budgets by about 4% annually.
  - Agencies will address the reductions primarily by holding positions vacant
- Higher "Salary Savings" -- ***$2.4 million***
  - Turnover in positions due to departures and retirements generates savings
  - Sliding scale – very small agencies have no salary savings
  - Largest savings is 4% of salaries – based on multi-year analysis
- Room Tax for Zoo and Olbrich Gardens -- ***$0.6 million***

One-Time – $18 million

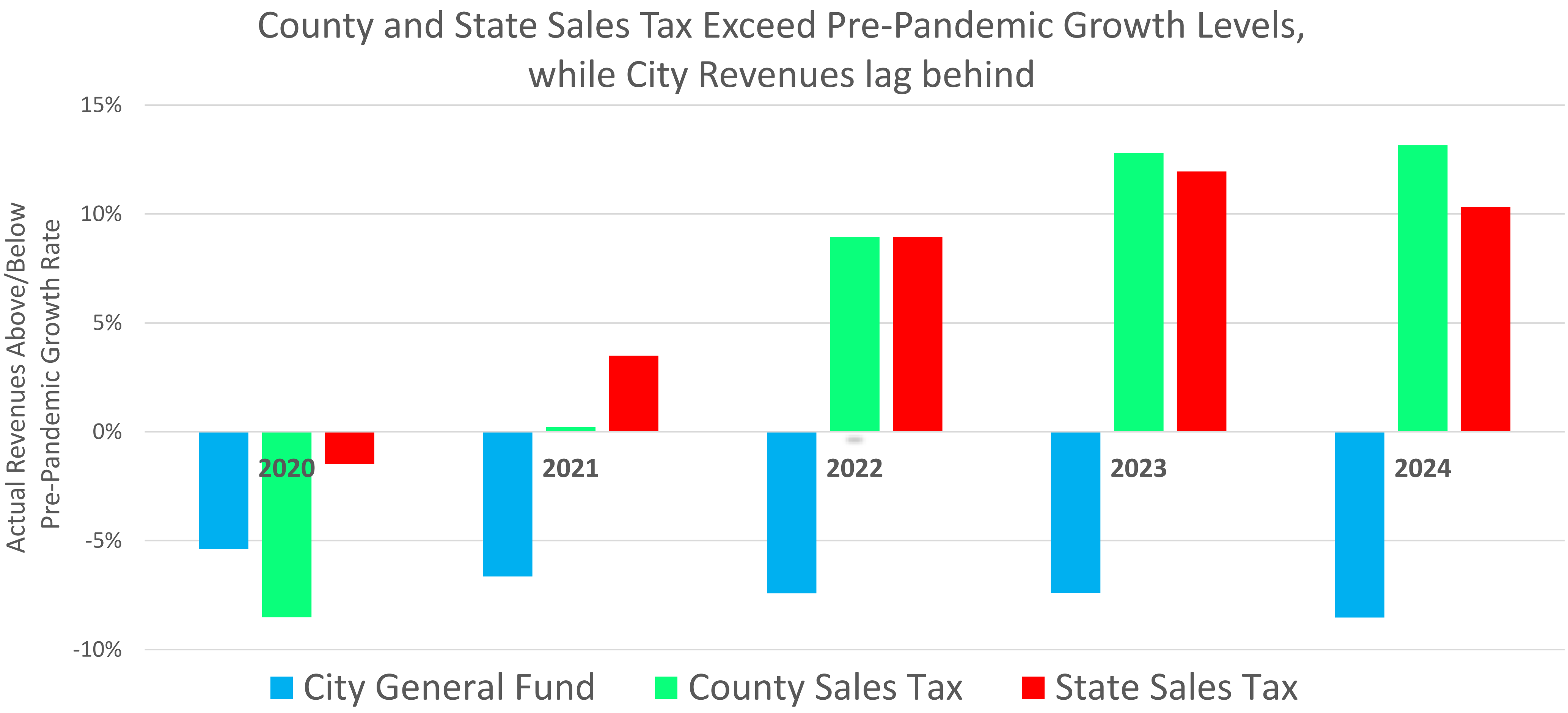
- American Rescue Plan Act –-- ***$5.6 million***
  - City received $47 million
  - $23m allocated to community needs
  - $24m allocated to maintaining services
  - 2021 to 2024
- City Share of Surpluses in Closed Tax Increment Districts --***$3.1 million***
  - Tax increment districts close periodically
  - Large surpluses are rare
- City Fund Balance ("Rainy Day Fund") -- ***$9.2 million***
  - Balance has increased due to one-time revenues and underspending.
  - City Reserve Target – 15% or more of expenditures

Lasting Impact of COVID-19 Pandemic on City Revenues

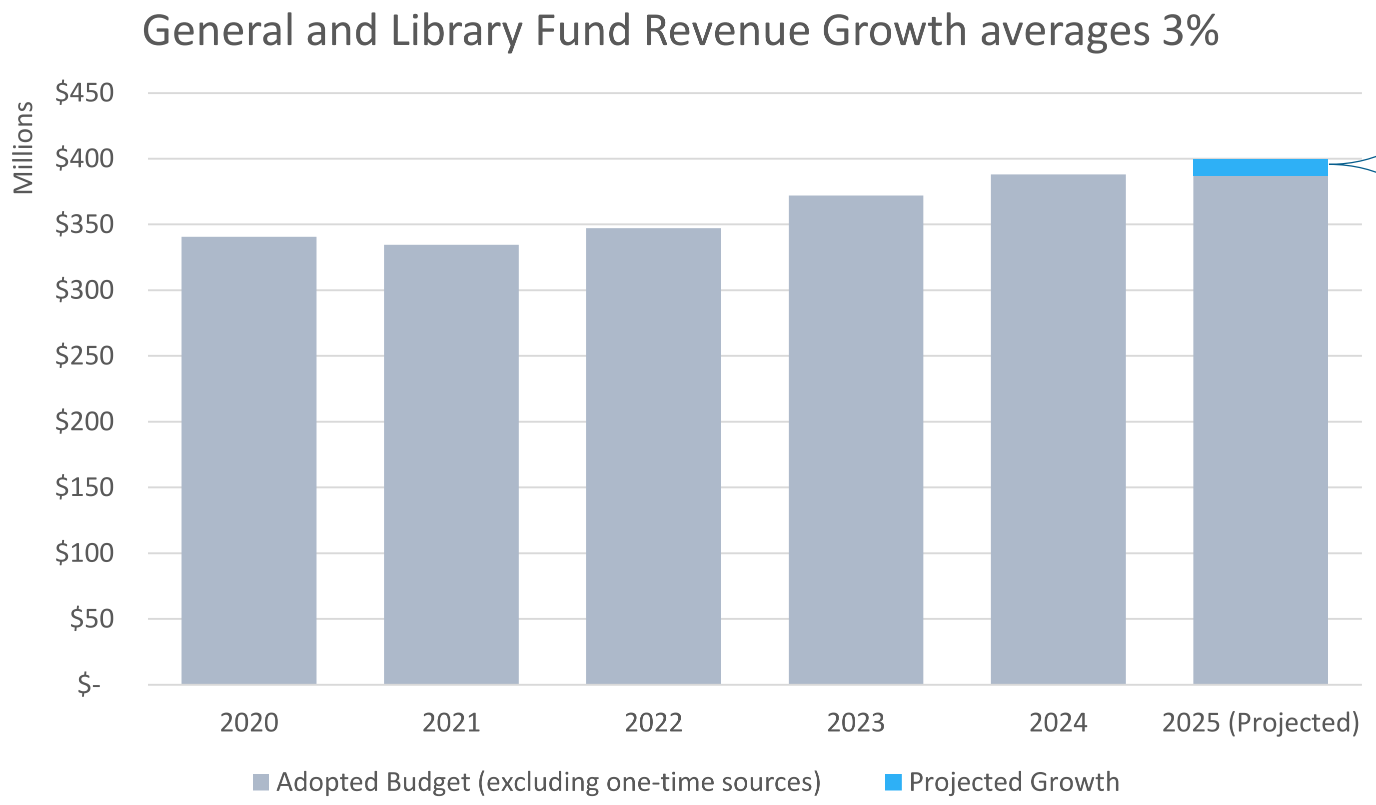


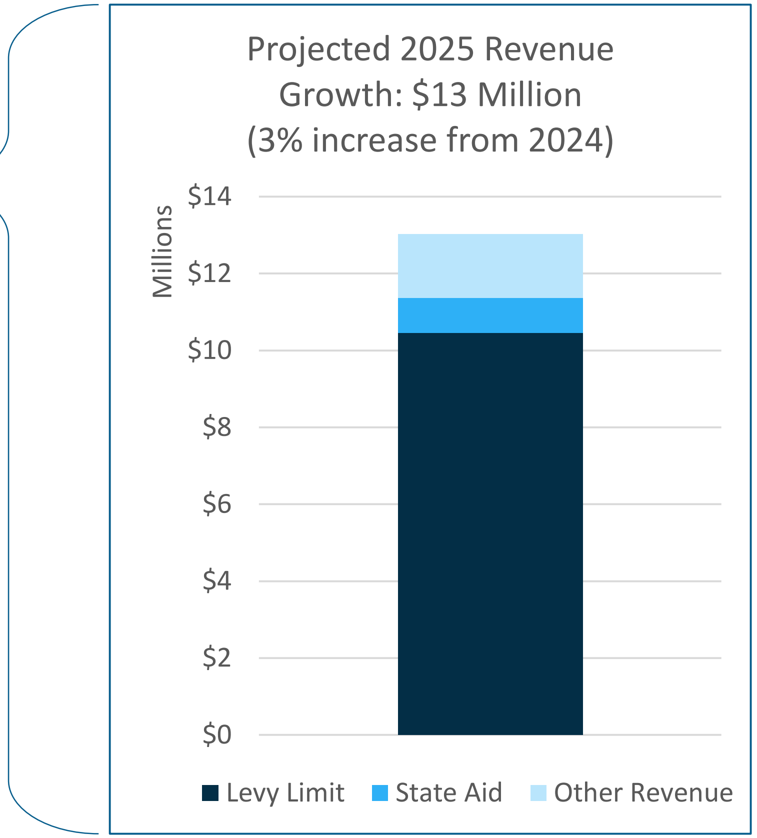
- Pre-Pandemic revenue is based on U.S. Treasury methodology for estimating revenues.
- 2024 Budgeted Revenues are $33 million (9%) less than pre-pandemic trends.
- Despite strong economic growth, state limits on property taxes are less connected to economic recovery than other revenue sources (e.g. sales tax)

Property taxes less connected to economic recovery than County and State Sales Tax



Local Revenues Projected to Increase by $13 million (3%) in 2025

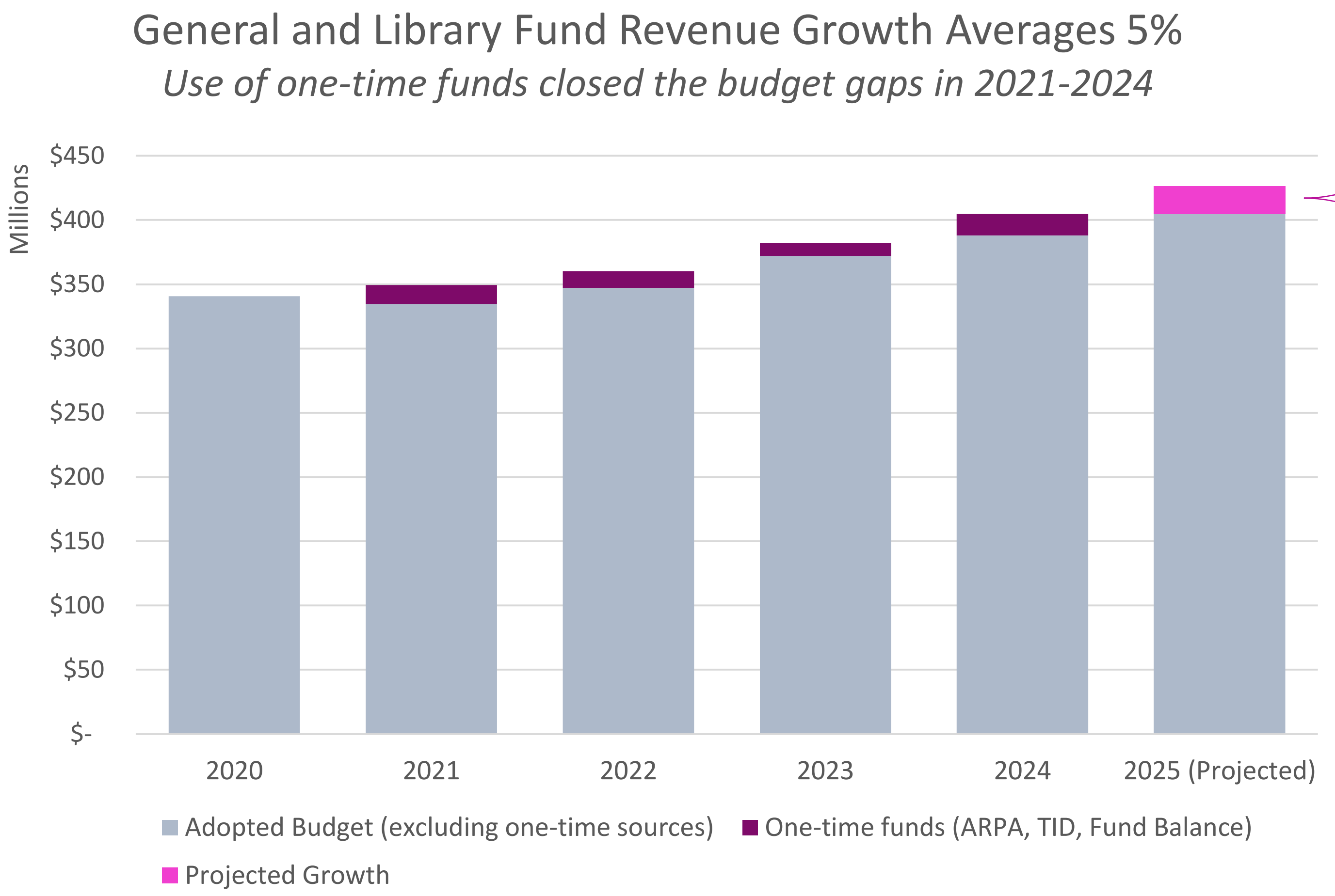


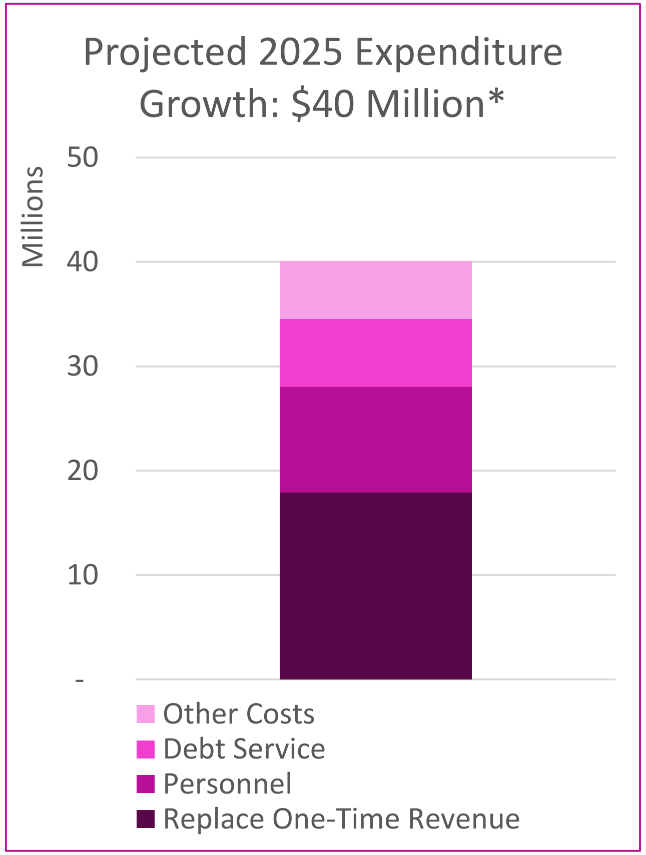


Factors Limiting Revenue Growth

- The State Legislature controls the growth of local property taxes through a “levy limit”. As a result, revenues do not keep pace with the cost of services to the public.
- Cities in Wisconsin need the approval of the State Legislature to raise revenues. For example, many cities around the country have a sales tax. Wisconsin law does not authorize a sales tax for cities, with the exception of Milwaukee.
- Restrictions on other sources make City revenues heavily reliant on property taxes, particularly residential property taxes.
- State Aid has not kept pace with costs. Madison received lowest per capita increase from 2023 State Shared Revenue Legislation.

Rising Expenditures and Replacing One-Time Revenues Projected to Cost Additional $40 million



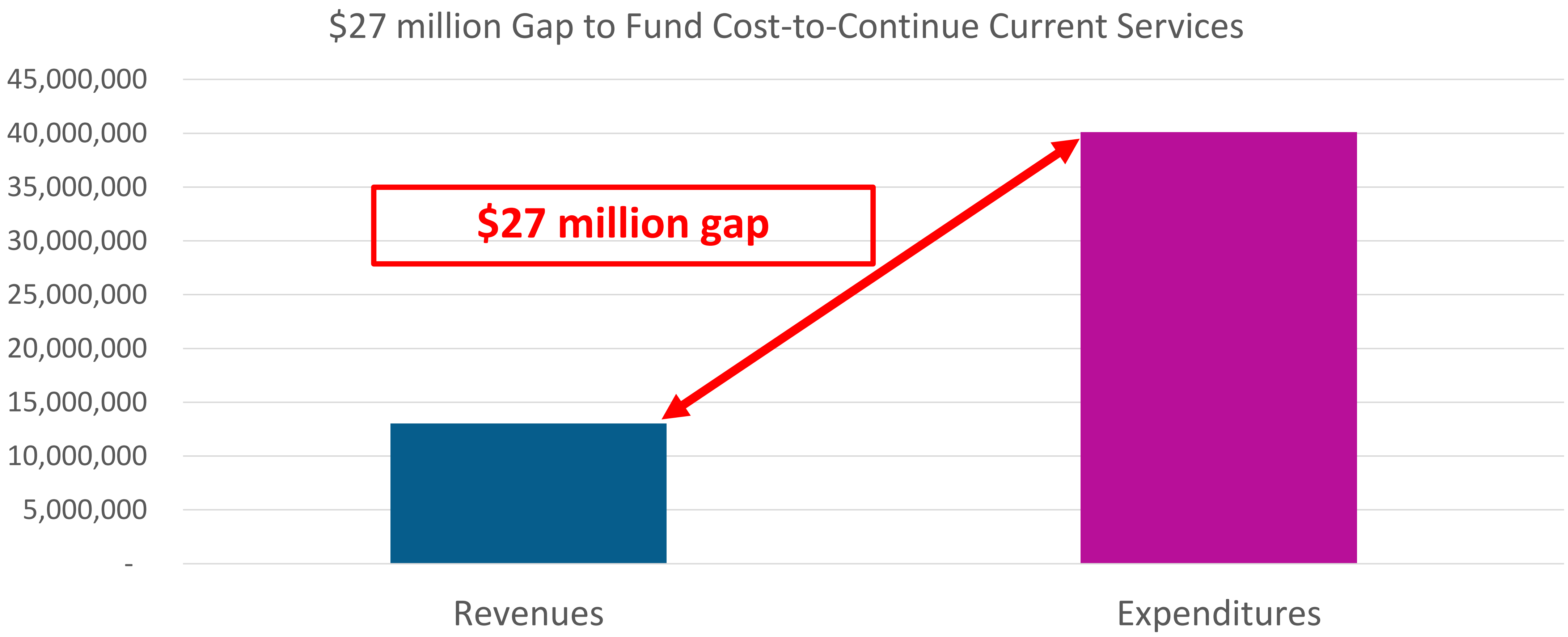


** $40 Million Increase =*
$22 Million cost to continue expenses
+ $18 Million to replace one-time revenues

Cost to Continue Expenditure Assumptions

- Pay Increase
  - All employees = 3% COLA (Police already bargained)
  - Fully fund July 2024 2% increase for general municipal employees
- Fringe Benefits
  - Health insurance rates up 6.5%
  - WRS rates – no change
- Staffing
  - 20 new positions to address population growth and service needs
  - Includes positions that were previously grant-funded and/or part of planned service expansions
- Metro and Public Health Subsidies
  - Grow at 4% to cover compensation and other increases
- Other Costs
  - Supplies and purchased services grow at 2.2% to cover inflation.
  - Debt service based on adopted 2024 Capital Improvement Plan and typical pace of debt issuance.

2025 Budget Deficit = $27 million



Recently Enacted State Law
Public Safety Maintenance of Effort (MoE)

New State Law requirement for Public Safety MoE adds pressure to cost to continue and limits options for reducing expenses in our largest agencies. Penalty for failure to comply is a 15% reduction in shared revenue (municipal aid) = $1.2 million

Police

At least one of the following remains the same or greater from previous year:

- Spending for employment costs of law enforcement officers
- Percentage of budget
- Number of FTE law enforcement officers employed

Fire and EMS

At least two of the following remains the same or greater from previous year:

- Spending for fire protective and emergency medical services
- Number of FTE firefighters and EMS employed
- Level of training and licensure
- Response times

Takeaways

- **Revenues have not fully recovered from the COVID-19 pandemic**
  - State property tax limits keep city from benefitting from recent economic recovery
  - County and State revenues have grown significantly, by comparison.
- **The growth in expenses outpaces the growth in revenues**
  - Maintaining current service levels requires meeting wage and cost inflation and population growth
  - Costs grow faster than revenues due to state limits on property taxes and other revenues
- **Cost to Continue assumptions for personnel costs and recent State law requirements for Public Safety spending contribute to structural deficit**
  - One-time pandemic relief funding ending.
  - Must maintain current police and fire staffing and service levels or risk losing state aid