COUNTY OF MILWAUKEE

Interoffice Memorandum

DATE: January 2002

TO: Supervisor Lynne DeBruin, Chairperson, Committee on Finance and Audit

FROM: Terry D. Kocourek, Fiscal and Budget Administrator
Jerome J. Heer, Director of Audits
Rob Henken, County Board Director of Research

SUBJECT: Report on Tax Stabilization Fund (File No. 01-635)

ISSUE

On November 1, 2001, the Milwaukee County Board of Supervisors adopted Resolution File No. 01-635, which directed the Departments of Administration and Audit and County Board staff to investigate the potential benefits and/or negative aspects of the creation of a tax stabilization fund for Milwaukee County, and to report their findings to the Committee on Finance and Audit by February 2002. This directive came shortly after the State Legislature adopted a provision as part of the 2001-2003 State Budget granting authority to Milwaukee County to establish such a fund.

BACKGROUND

In 1963, the Wisconsin Legislature enacted legislation permitting the City of Milwaukee to establish a tax stabilization fund. The City established such a fund in 1965. As defined by Section 2-59 of the City of Milwaukee Code of Ordinances, the tax stabilization fund is to be comprised of year-end surplus monies and/or tax levy appropriations that can be utilized for the purpose of stabilizing the tax rate "within reasonable limits from year to year."

Efforts to establish a tax stabilization fund for Milwaukee County date back to 1972, when the County Board adopted a resolution requesting State legislation to allow counties to establish such a fund "if it is determined such a fund would be to the county's benefit." In 1985 and again in 1992, the County Board adopted resolutions directing the Division on Intergovernmental Relations to seek introduction and passage by the State Legislature of enabling legislation to give the County authority to establish a tax stabilization fund.

As part of the 2001-2003 State Budget, the Wisconsin Legislature adopted an amendment sponsored by Senator Brian Burke that creates Section 59.60(13) of the Wisconsin Statutes. This section authorizes county boards in counties with a population over 500,000 to create a tax stabilization fund. The statutory provisions in Section 59.60(13) essentially extend provisions adopted by the City governing the operation of its tax stabilization fund to Milwaukee County. This language is attached to this document as **Attachment 1**.

If Milwaukee County elected to create a tax stabilization fund, Section 59.60(13) would require the County to deposit into the fund its entire year-end surplus from the preceding year, as determined by the Controller by April 15 of each year. In addition, the County could choose to designate tax levy funds for deposit into the tax stabilization fund as part of its annual budget.

Withdrawals from the tax stabilization fund largely would be limited to the annual budget adoption process for use in stabilizing the property tax rate in a given year. Use of these funds as part of the budget would require a three-quarters vote of the members-elect, or a majority vote of the members-elect if the County's total levy rate is projected to increase by more than 3% in the current fiscal year and the withdrawn funds would prevent an increase of more than 3%. A review of the County's annual property tax levy rate since 1991 indicates that only once in the past ten years – in 1996 – did the levy rate increase by more than 3% (the rate increase was 4.27% in that year).

In addition, the County would be required to apply any uncommitted balance in the fund that is in excess of 5% of the current year's budget to reduce the next property tax levy. A flow chart illustrating the nature of fund deposits and withdrawals is attached to this report as **Attachment 2**.

The County would be prohibited from using the fund to offset deficits that may occur in the course of a given year. However, it is assumed that monies from the tax stabilization fund could be utilized during the year to meet a public emergency as defined by Section 59.60(9) of the Statutes. That section grants counties authority to use unappropriated surplus funds from the preceding fiscal year to meet a public emergency "affecting life, health, property or the public welfare."

COMPARISON OF TAX STABILIZATION FUND AND EXISTING RESERVE MECHANISMS

A discussion of the pros and cons of a tax stabilization fund for Milwaukee County would logically begin with a discussion of how such a fund would differ from the County's two existing reserve mechanisms: the Appropriation for Contingencies and the Debt Service Reserve.

Appropriation for Contingencies

Per the authority granted by Section 59.60(5)(e) of the Wisconsin Statutes, Milwaukee County has utilized the Appropriation for Contingencies (i.e. Contingency Fund) as a means of placing in reserve a sum in each annual budget that can be utilized to pay for unanticipated needs that arise during the year. A 10-year history of Contingency Fund activity is provided in the table below.

CONTINGENCY FUND BUDGETED AMOUNTS VS. TRANSFERS OUT

Year	Adopted Budget	Transfers Out
1991	$4,500,000	$4,789,182
1992	$3,000,000	$2,048,829
1993	$2,762,252	$2,616,635
1994	$4,000,000	$1,115,141
1995	$5,500,000	$4,553,967
1996	$2,897,880	$891,795
1997	$4,000,000	$289,201
1998	$4,250,000	$2,500,000
1999	$4,000,000	$3,914,027
2000	$4,576,194	$3,893,919
2001	$5,500,000	$802,444*
2002	$5,417,022	

* Reflects transfers out through December 20, 2001. DOA placed a "freeze" on Contingency Fund transfers in June 2001 as a means of addressing the County's projected 2001 budget deficit.

Major differences between the County's Contingency Fund and a tax stabilization fund created per State statutes include the following:

- Unlike a tax stabilization fund, unexpended funds in the Contingency Fund cannot be rolled over from one year to the next. Instead, any unexpended funds simply drop to the County's bottom line and become part of the overall surplus/deficit calculation.
- The primary use of funds set aside in the Contingency Fund is to address unanticipated spending needs that arise after budget adoption, while the primary use of funds from a tax stabilization fund would be to prevent significant fluctuations in the annual property tax rate during budget adoption.
- Withdrawals from the Contingency Fund require a two-thirds vote of the County Board, while withdrawals from a tax stabilization fund typically would require a three-fourths vote.
- The decision on whether and how much money to place in the Contingency Fund in a given year is made purely at the discretion of the County Executive and County Board. Conversely, should a tax stabilization fund be created, deposit of the year-end surplus into the fund would be mandatory (though discretionary appropriations also could occur).

Debt Service Reserve

The County's Debt Service Reserve (DSR) was created in 1995 (Resolution File No. 95-390) primarily as a means of placing surplus capital improvements appropriations in reserve for the payment of future debt service costs. Such surplus appropriations can occur as a result of lapsed projects or projects that are completed with fewer dollars than had been appropriated. The DSR also has been utilized as a means of putting away a portion of unexpectedly high year-end surplus dollars for future debt service costs. Most recently, it also was used as a means of placing in reserve a portion of significant savings from the refunding of prior year bond issues. The table below summarizes activity in the DSR since its inception.

DEBT SERVICE RESERVE DEPOSITS AND WITHDRAWALS

Year	Beg. Balance	Deposits	Withdrawals	End Balance
1994		5,283,000		5,283,000
1995	5,283,000	3,100,000	(5,200,000)	3,183,000
1996	3,183,000		(2,900,836)	282,164
1997	282,164	6,000,000	(282,164)	6,000,000
1998	6,000,000	972,736	(109,292)	6,863,444
1999	6,863,444	7,751,207	(3,445,852)	11,168,799
2000	11,168,799	1,527,948	(5,045,299)	7,651,448
2001*	7,651,448	1,000,000	(5,567,101)	3,084,347

* Projected based on annual budget

The DSR legally can be used only for expenditure on debt service costs or to meet a public emergency as defined under State statutes. However, policymakers established it with the knowledge and expectation that it also could be utilized to produce indirect property tax levy savings in future years. Such savings can occur because use of DSR funds to offset debt service costs in a particular budget can reduce or eliminate the amount of property tax levy that otherwise would have to be utilized to help pay those costs.

Such a scenario would occur, for example, if the amount of sales tax revenue in a given year is projected to be $3 million less than the amount required to service the County's debt. If a balance of $3 million or more existed in the DSR, then $3 million from the DSR could be utilized as an alternative to the use of $3 million in property tax levy to meet the County's debt service needs.

The amount of DSR monies that can be utilized to reduce property tax levy in a given budget generally is limited to the difference between sales tax revenue and debt service needs. For example, while policymakers hypothetically could allocate $5 million from the DSR to the debt service account in a year in which the projected gap between debt service needs and projected sales tax revenue totaled $3 million, such an action would not necessarily result in a $5 million tax levy reduction, as the extra $2 million could create a sales tax revenue surplus of that amount. If that were the case, the additional $2 million from the DSR would have to be utilized to increase cash financing in the capital improvements budget per Chapter 22 of the Milwaukee County Code of General Ordinances and could not be utilized for additional tax levy savings.

It would be possible, however, to utilize an excess DSR contribution to displace other forms of revenue in the debt service account in order to generate an indirect property tax reduction. The County has utilized such an approach in each of the last two budgets by establishing an Excess Power Plant Revenue account in the operating budget, which has housed power plant revenue transferred from the debt service account that is not needed due to an excess DSR contribution.

A major difference, then, between the DSR and a tax stabilization fund is that use of the DSR is limited to paying debt service costs, which *could* result in indirect property tax reduction. Use of a tax stabilization fund, meanwhile, is limited to directly reducing the amount of property tax levy needed in an annual budget. The other primary difference involves the mechanisms for deposit and withdrawal. Deposit of funds into the DSR requires a two-thirds vote of the County Board, while deposit of funds into a tax stabilization fund would require only a majority vote. Conversely, withdrawals from the DSR require only a majority vote, while withdrawals from a tax stabilization fund in most cases would require a three-fourths vote.

It is worth noting that both the DSR and the Appropriation for Contingencies could be continued should the County elect to establish a tax stabilization fund.

PROS AND CONS ASSOCIATED WITH CREATION OF A TAX STABILIZATION FUND

Pros

- A tax stabilization fund would provide the County with a true "rainy day fund" that could be built up when economic conditions are strong and utilized when they are weak to stabilize the property tax rate. Currently, the County lacks an effective mechanism to set aside unanticipated surplus funds for future property tax stabilization, as the entire year-end surplus from a preceding year must be used in the next year's budget. If the surplus is much higher than expected and policymakers do not wish to use the entire amount in the subsequent year's budget, then their only option is to place some of the surplus funds in the debt service reserve, the use of which is restricted to debt service payments and which therefore can require significant machinations for use in property tax levy reduction. With creation of a tax stabilization fund, the entire surplus would have to be placed in the fund, and policymakers could then determine how much – if any – they wish to use in the following year's budget. Those funds that are not used would stay in the fund and be available for tax levy reduction in a difficult budget year.

- While the County has obtained improved bond ratings in recent years, a lingering concern cited by the bond rating agencies has been the County's relatively low level of reserves. Creation of a tax stabilization fund undoubtedly would be viewed favorably by the bond rating agencies, though it would be important for the County to develop a means to adequately fund the reserve.

Cons

- The ability to tap the tax stabilization fund only during budget formulation and adoption (except for use to meet a public emergency) may provide the County with less flexibility than it had anticipated when lobbying for such a fund. It is possible that some policymakers had seen such a fund as serving both a tax stabilization function and the function currently served by the County's Contingency Fund (i.e. withdrawals could occur during the course of the year to meet unanticipated needs). If the County were to create a tax stabilization fund, in all likelihood it also would have to maintain a Contingency Fund, though policymakers could determine that smaller annual appropriations are appropriate.

- Section 59.60(13) was essentially reproduced from the provisions that govern the City of Milwaukee's tax stabilization fund, which would create some difficulties for the County. For example, the requirement that the Controller determine the amount of the year-end surplus by April 15 of the following year is inconsistent with Section 32.91 of the Milwaukee County Code of General Ordinances, which requires reporting of the year-end surplus by June 1 of each year. In addition, there is some ambiguity as to whether the emergency spending provisions in Section 59.60(9) of the Statutes would take precedence over the new Section 59.60(13) (thereby enabling the County to remove monies from the tax stabilization fund for use in meeting a public emergency).

- As noted above, while creation of a tax stabilization fund would be viewed favorably by the bond rating agencies, the County could come under criticism in future years if it fails to maintain a fund balance that the agencies deem to be appropriate. Given the difficult economic times that the County currently is experiencing, building the fund could be a challenging task.

RECOMMENDATION

<u>It is recommended that the County Board adopt the attached Resolution/Ordinance that would provide for the establishment of a tax stabilization fund for Milwaukee County.</u> This recommendation is based on the belief that a tax stabilization fund would provide the County with an improved means of building reserves and protecting taxpayers from sharp fluctuations in the annual property tax rate. It is also believed that sufficient flexibility exists to enable Milwaukee County to utilize monies that are deposited in a tax stabilization fund to meet any spending emergencies that may arise (though it would be prudent for the County to also maintain an Appropriation for Contingencies).

Furthermore, staff believes that the favorable reaction of the financial community to the County's creation of a tax stabilization fund would far outweigh any negative ramifications from an inability to rapidly build up the fund. Analysts at the bond rating agencies are well aware of the fiscal challenges facing all levels of government in light of the economic recession. The mere creation of a tax stabilization fund at such a difficult time would signal a firm and impressive commitment by the County to increase its reserves. Failure to accomplish a sizable build-up in the near term should not detract from the positive signals sent by the fund's creation.

In conjunction with adoption of the attached Resolution/Ordinance, it is also recommended that the Finance and Audit Committee direct the Department of Administration, Department of Audit and County Board staff to form a work group to examine and recommend proposed changes to Section 59.60 of the Wisconsin Statutes. These should include both modifications to Section 59.60(13) that will make the process for declaring the year-end surplus/deficit consistent with existing County policies as well as additional changes to 59.60 that would enhance the efficiency of County fiscal operations. Unless or until Section 59.60(13) is modified, it is assumed that the Controller would be required to report the amount of the year-end surplus/deficit for purposes of placing monies in the tax stabilization fund by April 15 of each year, with the understanding that the numbers may be modified when the final report is submitted to the County Board by June 1.

FISCAL NOTE

If the attached Resolution/Ordinance is adopted, the provisions governing the tax stabilization fund would become effective immediately. As a result, any 2001 year-end surplus would be deposited into the fund and would not automatically be available for use in the 2003 Budget. Policymakers could, however, elect to utilize some or all of these funds in the 2003 Budget with a three-fourths vote (or a majority vote if the County's total levy rate is projected to increase by more than 3% in the current fiscal year and the withdrawn funds would prevent an increase of more than 3%).

Terry Kocourek
Fiscal and Budget Administrator

Jerome J. Heer
Director of Audits

Rob Henken
County Board Director of Research

c.c. County Executive F. Thomas Ament
County Board Chairman Karen M. Ordinans
Earl R. Hawkins, Jr., Director, Department of Administration
Terrence Cooley, Assistant Fiscal and Budget Administrator
Scott Manske, Controller
Thomas Kuzma, Department of Administration
Lauri Henning, Chief Committee Clerk

ATTACHMENT II – Tax Stabilization Fund Flow Chart