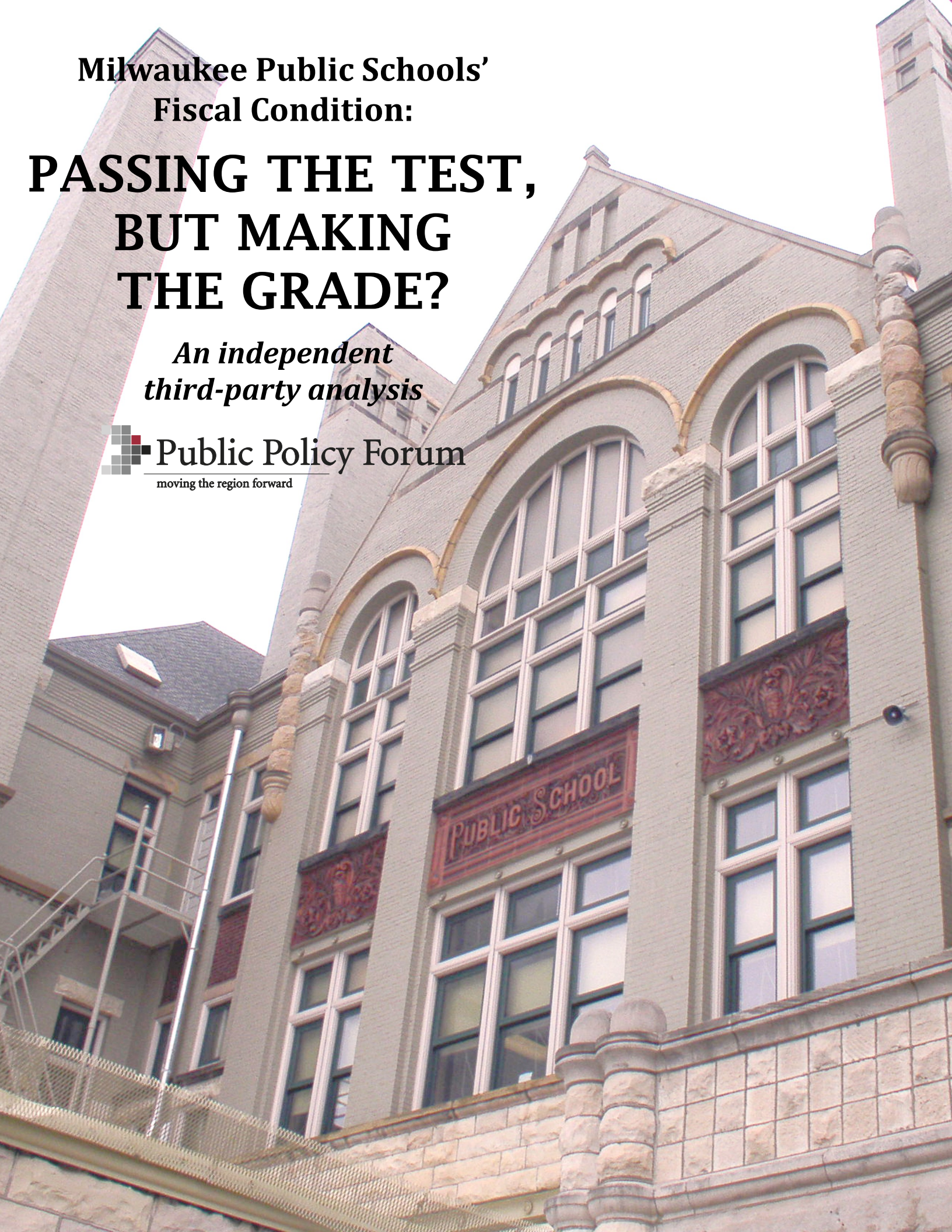
Milwaukee Public Schools' Fiscal Condition:

PASSING THE TEST, BUT MAKING THE GRADE?

An independent third-party analysis

Public Policy Forum
moving the region forward



ABOUT THE PUBLIC POLICY FORUM

Milwaukee-based Public Policy Forum – which was established in 1913 as a local government watchdog – is a nonpartisan, nonprofit organization dedicated to enhancing the effectiveness of government and the development of southeastern Wisconsin through objective research of regional public policy issues.

PREFACE AND ACKNOWLEDGMENTS

This report was undertaken to provide citizens, education officials and policymakers in Milwaukee and across the state with an independent, comprehensive and objective analysis of the fiscal condition of the Milwaukee Public Schools. We hope that elected officials and community leaders will use the report's findings to inform discussions during policy debates and budget deliberations at the school district, city and state level.

Report authors would like to thank the MPS Superintendent and staff of MPS for facilitating our efforts to produce this report. We were provided access to numerous reports and financial materials, and MPS administrative, financial and program staff spent several hours meeting with us to review many aspects of the district's finances and operations. We also would like to thank and acknowledge MPS for providing the photo of Golda Meir School that appears on the cover of this report.

Finally, we wish to thank the Northwestern Mutual Foundation for the grant funding that made this research possible.

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EXECUTIVE SUMMARY

In an interview with the Milwaukee Journal Sentinel just days after taking office in July 2010,[1] Milwaukee Public Schools (MPS) Superintendent Gregory Thornton was asked to comment on the impacts of recent teacher layoffs. His response: "You can trim back and trim back, and pretty soon you're going to start to hit the bone. Guess what? We're bumping up against the bone."

Just two-and-a-half years later, MPS' financial structure has changed in significant ways. Health care benefit revisions negotiated in the last teachers' union contract – combined with upcoming changes that will be imposed unilaterally by the district once that contract expires – are expected to save more than $80 million per year. In addition, a rash of retirements provides an opportunity to control spending on salaries to the extent that new hires are not needed to fill the gap. Countering those savings, however, is a revenue picture that has been hit hard by the latest state budget and a continued decline in enrollment, and that consequently has become even more reliant on local property taxes.

In light of these changes, an important question is whether the budgetary assessment offered by the Superintendent when he took office in July 2010 remains accurate today. Have MPS' meaningful efforts to control health care costs, "right-size" its operations, and improve operational efficiency improved its fiscal outlook? Or, conversely, have reduced state aids, declining enrollment, and enhanced competition from voucher and non-MPS charter schools made a desperate situation even worse?

In this report, the fifth in a series of comprehensive examinations of the finances of Milwaukee's major governmental bodies, we seek answers to those questions. Using the same respected fiscal monitoring system employed for recent reports on Milwaukee County, the City of Milwaukee, Milwaukee Area Technical College, and the Milwaukee Metropolitan Sewerage District, we analyze fiscal trends, compare MPS to other school districts statewide and nationally, and examine the school district's financial challenges and their consequences.

We find that MPS' recent fiscal trends are worrisome and that the future outlook – while improved – remains unsettled and uncertain. **A crux of the problem is the volatile and uncontrollable fiscal environment in which the district must operate.** For example, MPS is far more dependent upon the State of Wisconsin than any of Milwaukee's other governments – not only with regard to appropriations and revenue limits, but also with regard to regulatory changes to charter school or private school choice programs that can sharply affect MPS enrollment and revenue, and the state's ability to impose new instructional practices or standards that can impact expenses. MPS' financial condition also can be sharply impacted by the chartering decisions of outside entities, and by demographic trends impacting the city.

[1] http://www.jsonline.com/news/opinion/98142639.html.

The following are additional key findings from our analysis of the fiscal condition of the Milwaukee Public Schools:

- **Analysis of recent fiscal trends reveals red flags.** MPS experienced a decline in liquidity and general fund balance from 2007 to 2011. Meanwhile, annual budgets during that period accommodated severe cuts in state revenue streams only because of unsustainable increases in the property tax levy and one-time federal stimulus funds. Even with those measures, MPS was forced to reduce its full-time teaching staff by 11% (though that reduction was accommodated somewhat by a decline in enrollment).

- **The near-term future is looking better, but deep structural issues remain**. MPS plans to vigorously respond to its immediate revenue challenges with substantial additional reductions in fringe benefits spending made possible by Wisconsin Act 10. Changes in the 2013-14 school year are expected to save almost $35 million annually and reduce the district's long-term retiree health care liability by $1.4 billion. The longer-term future looks more uncertain, however, as the district's revenue streams are likely to be constrained well into the future and impacted by circumstances beyond its control, including growth of non-MPS charter and/or voucher schools. Meanwhile, its retiree health care liability – though substantially reduced – will remain daunting, and its ability to further reduce personnel costs will be limited by its need to attract and retain quality teachers and administrators.

- **MPS' high expenditure levels must be placed in context.** We find that while the district's prohibitive fringe benefit costs have been an issue, MPS' high levels of per-pupil spending are driven much more by its receipt of large amounts of state and federal categorical funds. Those funds are used mainly to support economically disadvantaged and special needs students, who comprise the vast majority of MPS' student population. When categorical funds are excluded, the district's per-pupil spending is only slightly above the state average.

- **MPS' greatest challenge is its lack of fiscal options.** After it has reaped the benefits of its initial rounds of health care and pension changes, MPS will have few alternatives left to counter the effects of flat state funding and declining enrollments. The district does not have program revenue, as do other local governments, and it is unlikely to be able to grow the property tax at the same rate as in the past. Meanwhile, enrollment competition exerts pressure on MPS to maintain its teacher compensation structure and capital footprint, and potential programmatic cutbacks run the risk of reducing program quality and engendering further enrollment and revenue loss.

Despite its significant challenges, we also find that MPS' financial plight does not seem so dire when compared to other local governments. The district's most recent five-year forecast reveals a potential deficit of $41 million in 2017 – a figure that actually is more optimistic than those contained in similar recent forecasts by Milwaukee County and the City of Milwaukee. Even this slightly more optimistic perspective must be tempered, however, by recognition that MPS is even more limited than those governments in its ability to reduce service levels because of its competitive environment and the threat to educational quality, and that it is even more susceptible to financial volatility from decisions made in Madison.

Overall, it is difficult to gauge whether successful implementation of the strategies recently initiated by MPS officials will be enough to solve the district's fiscal challenges. Our modeling shows that *if* the 2013-14 health care and pension changes are implemented, *if* the district can achieve even minimal growth in combined equalization aids and property tax levy under future state revenue limits and appropriations, and *if* MPS can achieve a limited reduction in salary expenditures, then balanced budgets are readily achievable in the next five years. Under another plausible scenario, however, in which the benefit changes made possible by Act 10 do not fully take effect, major revenue streams remain flat, and salary expenditures decrease by a lesser amount, a dire fiscal picture emerges.

Perhaps the most troublesome question raised by the fiscal assessment is whether any entity could be expected to effectively manage a fiscal predicament as challenging as that faced by MPS in an environment that is plagued with such uncertainty. That question leads us to conclude that it is time for local and state leaders to reach agreement – once and for all – on the role MPS will play in the city's education framework, and to define and secure the resources required to effectively fulfill that role.

INTRODUCTION

Perhaps no local government in southeastern Wisconsin generates as much attention as the Milwaukee Public Schools (MPS). In recent years, there have been major studies and proposals to restructure and reorganize MPS, as well as extensive research and commentary on its instructional methods and costs.

Public discussion and inquiry arises, no doubt, from MPS' low test scores and the sharp discrepancy between academic performance in Milwaukee and the rest of the state. Concern is raised not only for the future of MPS' students, but also for what these test results may suggest for the prospects of the state's largest city and regional economy.

While finances have played a part in community-wide conversations about MPS' problems and challenges, education reform strategies often have been the main focus. Ultimately, however, discussions about whether change is needed at MPS usually touch on the district's fiscal condition, and whether its financial challenges have reached the point where they are preventing progress on MPS' educational imperatives and its ability to meet the expectations of the larger community.

This report is an independent assessment of MPS' financial condition. To our knowledge, this is the first comprehensive study of MPS' fiscal structure and condition since a March 2007 report by the Wisconsin Taxpayers Alliance, entitled *Challenges Today and Tomorrow*. In addition, a 2009 report by McKinsey and Company, entitled *Towards a Stronger Milwaukee Public Schools*, examined the district's non-instructional costs and opportunities for greater operational efficiency.

This is the fifth report in a series of local government fiscal analyses conducted by the Forum. It follows assessments on Milwaukee County (March 2009), the City of Milwaukee (September 2009), Milwaukee Area Technical College (September 2010), and the Milwaukee Metropolitan Sewerage District (June 2011).

As in the previous analyses, this report employs the financial evaluation system of the International City/County Management Association (ICMA). Unlike many studies of local finance that rely solely upon a comparison of past trends and projected trajectories in revenues and expenditures, the ICMA system goes beyond budget balance. Instead, it provides a multi-dimensional look at underlying fiscal structures related to four types of solvency:

- **Cash solvency**, which refers to the ability to pay bills and meet payrolls.
- **Budgetary solvency**, defined as the ability to generate enough revenues over a normal budgetary period to meet expenditures and avoid deficits.
- **Long-run solvency**, which examines the future costs of current fiscal decisions.
- **Service solvency**, or the "ability to provide services at the level and quality that are required for the welfare of the community and that its citizens desire."

While MPS' focus is education, it also is a local unit of government, relying on the same taxpayer resources as the City of Milwaukee and Milwaukee County. Consequently, this report illuminates how MPS' financial condition and challenges might be compared to other Milwaukee-area local governments by using a set of solvency indicators typically used to assess the finances of municipalities and counties. It should be noted that for purposes of consistency with our other ICMA indicator reports, certain school district measures are reported on a per-capita basis, rather than a per-pupil basis, based on the population of the City of Milwaukee.

The ICMA system is designed to examine trend indicators pertaining to these solvencies. By showing the direction in which financial indicators are moving, the approach identifies areas of concern and acts as a financial early warning system. The indicators provide information on basic questions such as the capacity of revenues to pay for expenditures, the forces that are driving costs, and long-term financial sustainability. Taken together, the indicators and analysis of fiscal structure offer not only a "big picture" view of a local government's finances, but also an important perspective from which to examine current policy issues.

METHODOLOGY AND DATA

In order to provide a thorough and objective assessment of MPS' fiscal condition, this report relies on ICMA's Financial Trend Monitoring System, the purpose of which is to:

- *Examine local government financial condition—the forces that affect it and the obstacles to measuring it;*
- *Identify existing and emerging financial problems; and*
- *Provide insight into remedies for these problems*

ICMA offers the kind of evaluation that rarely is possible during time-sensitive budget deliberations. The analysis strives to take the temperature of a government's finances by examining its critical fiscal forces. The ICMA system helps a public body better understand the nature of its revenues and expenditures, and how they influence both service levels and budget solvency.

The heart of the ICMA system is the selection of a group of indicators critical to local circumstances and the collection of information relevant to those indicators. In this report, the analysis tracks selected indicators over a five-year period. ICMA does not provide a formula for interpreting the gathered information. Rather, the format organizes and presents data, and provides a context by which to reach considered opinion. As the ICMA handbook says:

> *Evaluating a jurisdiction's financial condition is a complex process…Not only are there large numbers of factors to evaluate, but many of them are also difficult to isolate and quantify. Relationships between the factors add to the complexity. Some are more important than others, but often this cannot be determined until all the factors have been assembled…No single indicator is conclusive.*

Per the ICMA model, this report draws on a broad range of material in order to assess MPS' fiscal health. Information is taken from different sources to address various aspects of MPS' finances. It is important to note that because MPS is one of the largest public school districts in the country, there are several sources of data on its finances. For this analysis, we turned most frequently to MPS' annual budget documents; the district's comprehensive annual financial report (CAFR); the Wisconsin Department of Public Instruction (DPI); and the National Center of Education Statistics (NCES).

Other major data sources include:

- Select MPS reports with relevant fiscal information, such as the 2011 Long-Range Facilities Master Plan, and the actuarial valuation of the retiree health care program.
- Unpublished financial information supplied by MPS fiscal staff.
- Wisconsin Legislative Fiscal Bureau and Wisconsin Legislative Audit Bureau reports on state elementary and secondary school programs, state funding formulae, and state and district revenues and expenditures for public education.
- Data platforms, peer tools, and databases assembled not only by DPI and NCES, but also by the U.S. Census Bureau.

- The 2012 report of the Council of Great City Schools, *Managing for Results in America's Great City Schools: A Report of the Measurement and Benchmarking Project.*
- In-depth reports on MPS performed by other third parties, including the 2009 McKinsey Report, *Toward a Stronger Milwaukee Public Schools*, and the Fiscal Efficiency Committee Report on *MPS' Implementation of McKinsey Opportunities*.
- Secondary sources from non-profit organizations, educational associations, and academic experts.

Unfortunately, we found during the course of our research that fiscal data for particular indicators for the same period of time often differed from source to source. In some cases, these discrepancies may have been caused by use of different definitions and reporting processes by different sources, but in others they may suggest inconsistencies in MPS' presentation and interpretation of financial data. **This problem suggests the district and DPI need to review financial data reporting processes to ensure consistency in published financial figures.** In this report, we present data from individual sources that we believe are most reliable for the specific fiscal indicators and trend analyses that are the subject of our discussion.

Finally, it is important to note that the fiscal year for MPS and other public school districts corresponds with the end of the academic year, or July 1 through June 30. Consequently, when we refer, for example, to an expenditure figure for 2011, we are referring to an expenditure that occurred during the fiscal year of July 1, 2010 through June 30, 2011.

BACKGROUND

The Milwaukee Public School district operates within the City of Milwaukee providing education to students through grade 12. Established in 1846, the district is a legal agent of the state operating under Chapter 119 of the Wisconsin Statutes. A nine-member board governs MPS, with one member elected from the district at large and the other eight from designated geographic areas.

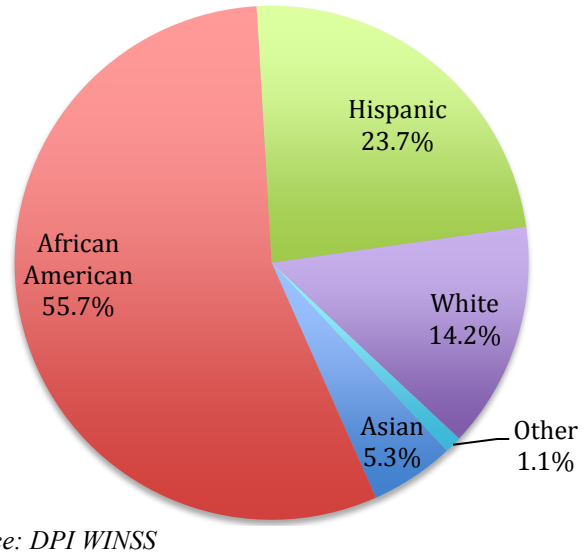
MPS has an enrollment of about 80,000 students, making it the 37th largest school district in the United States and by far the largest school system in Wisconsin. MPS enrolls approximately one of every 11 public elementary and secondary school students in the state. MPS also employs 12,000 individuals on a full-time or part-time basis, including 4,600 full-time teachers.

MPS manages facilities on 170 sites, which include 139 schools, as well as administrative buildings and recreational centers, all of which total 17.7 million square feet in space. The district also maintains about 150 playgrounds, as well as dozens of football, soccer, and baseball fields, running tracks, and swimming pools. The overall value of its assets equaled $1.1 billion in 2011 (or $638 million after deducting for accumulated depreciation and amortization).

MPS' $1.2 billion operating budget is the second-largest of any local government in Wisconsin, narrowly trailing Milwaukee County. The Milwaukee district receives more individual property tax, federal, and state revenue than any other local government in the state.

Milwaukee is the most racially and ethnically diverse community in Wisconsin yet, like most public school districts, MPS' student diversity is even greater than that of the city as a whole. **Chart 1** shows MPS' racial breakdown in the 2011-12 school year. MPS enrolls half of all African American students and 20% of all Hispanic students statewide.

Chart 1: MPS enrollment by race, 2011-12

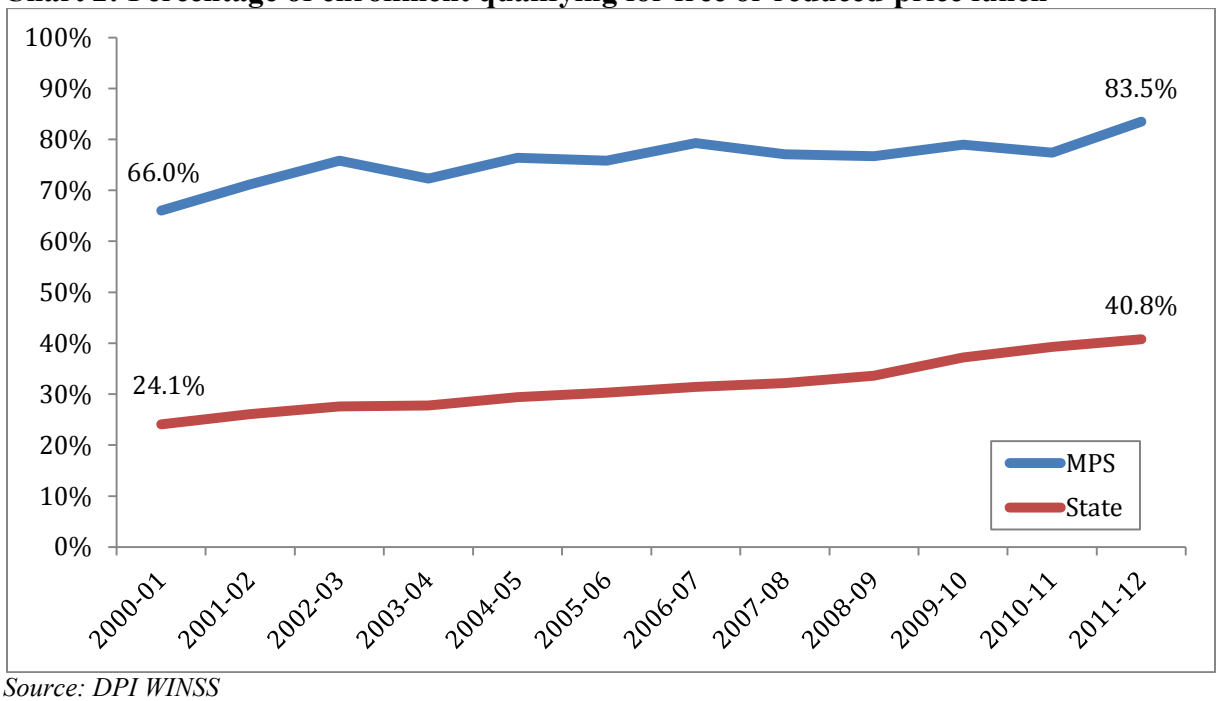


Source: DPI WINSS

MPS also enrolls a large number of students with special educational needs. In the last school year, about 15,600 students, or 20% of MPS' student enrollment, had educational, physical, or mental disabilities, compared with 14% of the state's total enrollment. This select student population exceeds the total enrollment of the Appleton school district, the state's sixth-largest district. Also, limited English proficiency students comprise 10% of MPS' enrollment, compared with 6% of students statewide.

In addition, many MPS students are living in poverty. According to DPI, 84% of the district's students are "economically disadvantaged," meaning they qualify for free or reduced-price lunch. As shown in **Chart 2**, that figure has increased substantially from the start of the last decade, when 66% of all MPS students were so classified. In contrast, 41% of all students statewide meet this low-income definition.

Chart 2: Percentage of enrollment qualifying for free or reduced-price lunch



Source: DPI WINSS

MPS BY THE NUMBERS

General information	
Year Founded	1846
Governance	9-member board
Total full-time and part-time position count (2012)	11,679
Full-time teachers (2012)	4,659
District and school administrators (2012)	301
Facilities	18 million sq. feet
Students (2011-12 academic year)	
Enrollment at MPS sites (per headcount)	80,098
Open enrollment (including Tuition Waivers)	5,991
Integration program (Milwaukee transfers)	2,025
Race/ethnicity	
African American	56%
Hispanic	24%
White	14%
Asian	5%
Native American	1%
Students with disabilities	20%
Limited English Proficiency	10%
Economically Disadvantaged	83%
Finances (2010-11 academic year)	
Operational expenditures (without debt service)	$1.3 billion
Operational revenues	$1.3 billion
Property tax levy (includes debt service and capital levy)	$293.5 million
General state school aids	$584 million

By most any standard, the academic performance of MPS students is far below the state average. For example, on the most recent state Wisconsin Knowledge and Concept Exam (WKCE), 64% of MPS' eighth grade students tested as having achieved proficient or above in reading. In contrast, eighth grade students in medium-sized cities such as Kenosha, Green Bay, and Janesville achieved proficiency rates in the 80% range. In mathematics, only 54% of MPS' eighth graders tested at the proficient or advanced level, also far below the test scores of most other districts in the state.

Test scores at the third, fourth, and tenth grade levels show similar differences between MPS and other districts in the state. In the past decade, MPS' students have shown some improvement on the state's mathematics test, but not much improvement in reading.

The instructional program of the district is broad and diverse. MPS students attend traditional neighborhood and citywide public schools, some of which have selective admission. They also attend schools with a particular learning focus or philosophy, such as Montessori schools, language immersion schools, and schools for the arts.

Students may attend charter schools that either are directly operated by MPS or operated by independent entities under contract with MPS in accordance with state laws and regulations. MPS also works with alternative education programs, such as a school-age parent program. In addition, MPS contracts with partner organizations to offer specific types of instructional services for select populations, such as at-risk students, students with behavioral difficulties, and students with severe emotional problems.

MPS is unique among Wisconsin's school districts in that a substantial percentage of school-age students who reside within its boundaries attend private schools, non-MPS charter schools, and suburban schools outside the district at no additional cost to their parents. This circumstance has far-reaching impacts on MPS' financial condition and is analyzed in detail throughout this report.

Finally, MPS offers extensive social welfare services of considerable size and scope. In an average day, about 40,500 students, or one half of MPS' total enrollment, eat lunch at school and 22,100 eat breakfast. Nurses treated more than 250,000 school children in the 2010-11 school year (this includes students who were treated on multiple occasions). The district also has a large community outreach program that sponsors recreational activities, youth and adult enrichment courses, before and after-school programs, cultural events, and community learning centers.

BUDGETARY SOLVENCY: REVENUES

Analyzing revenues with the ICMA system

Since local governmental entities typically rely upon multiple revenue sources, ICMA emphasizes that solvency may reflect decisions not just about whether or how much to increase taxes and fees, but also about the nature and relative proportion of revenue streams. Whether an institution relies mainly upon the property tax, tuition and fees, or external state support, can make a significant difference in its fiscal circumstances.

The ICMA system, therefore, encourages close examination of a government's revenue *characteristics* and highlights the importance of revenue flexibility and dependability. In the organization's professional judgment, a local government's fiscal condition is strongest when it has diverse revenue sources that are not overly dependent upon external factors, when a significant portion of its revenues vary with the rate of inflation, and when its revenues are flexible and free from spending limitations.

SUMMARY OF REVENUE FINDINGS

MPS has three major revenue sources: state aid, the property tax, and federal funds. State funding comprises nearly three-fifths of MPS' total revenue. State and federal funds combined total three quarters of general fund revenues. MPS receives a higher percentage of its funding from intergovernmental revenues than most local governments in Wisconsin.

MPS also receives comparatively greater state and federal funding than other Wisconsin districts on a per-pupil basis. Using that measure, MPS ranks 6th in federal revenue and 26th in state revenue among Wisconsin's 424 school districts. MPS' state rank reflects the categorical funding that it receives, mainly from special programs targeting disadvantaged students and students with special needs. The district ranks 152nd in per-pupil equalization aid, the state's largest general school aid program.

From 2007 to 2011, MPS' total revenue increased by 13.2%. However, most increased revenues went to categorical programs, as opposed to general education, and 60% of the increase was driven by an influx of temporary federal stimulus dollars. State funding, MPS' largest revenue source, decreased by 2%, including a $41.7 million decrease in equalization aid. The drop in equalization aid partially resulted from a fall-off in student enrollment, part of a decade-long trend. To help offset the loss in state funding, MPS increased the property tax by $63 million. As a result, property taxes represent an increasing share of MPS' total revenue picture.

Major revenue sources

MPS draws on three principal revenue sources: state aid, local property taxes, and federal funds. **Table 1** shows these revenues distributed across the district's major fund accounts. State aid

constitutes the largest revenue source, accounting for 58% of general operating funds in 2011.[2] Property tax revenue typically makes up the next largest share at 22% in 2011. Federal revenue, which comprised 18% of general operating revenue in 2011, has fluctuated considerably in recent years, in large part due to the inflow of federal stimulus funds from 2009 through 2011.

Table 1: MPS total revenue, 2011

Revenues	General	Debt Service/ Capital	Food Service	Community Service	Total
State Aid	$705,078,321	$0	$1,004,873	$3,654	**$706,086,847**
Federal Aid	$220,853,163	$0	$38,635,448	$8,453,697	**$267,942,308**
Property Tax	$274,474,136	$5,698,454	$0	$13,334,418	**$293,507,008**
Other Revenues	$21,763,486	$16,402,166	$3,233,077	$3,887,242	**$45,285,972**
Total Revenues	**$1,222,169,106**	**$22,100,620**	**$42,873,398**	**$25,679,011**	**$1,312,822,135**

Source: DPI School Finance Data Warehouse

Table 2 breaks down general operating revenue in 2011. Most of these funds came from two sources: state equalization aid and local property taxes. The "other state aids" line consists primarily of categorical funds provided to MPS to meet specific needs. Categorical funds are discussed in greater detail later in this report.

Table 2: MPS general operating revenue, 2011

	2011
School operations fund	$864,368,322
Property tax levy	$274,474,136
State-equalization aid	$544,914,729
Integration Aid	$39,158,028
Computer Aid	$5,821,429
Other state aids	$115,184,135
Federal aids	$220,853,163
Other Revenues	$21,763,486
Total general operating revenue	**$1,222,169,106**

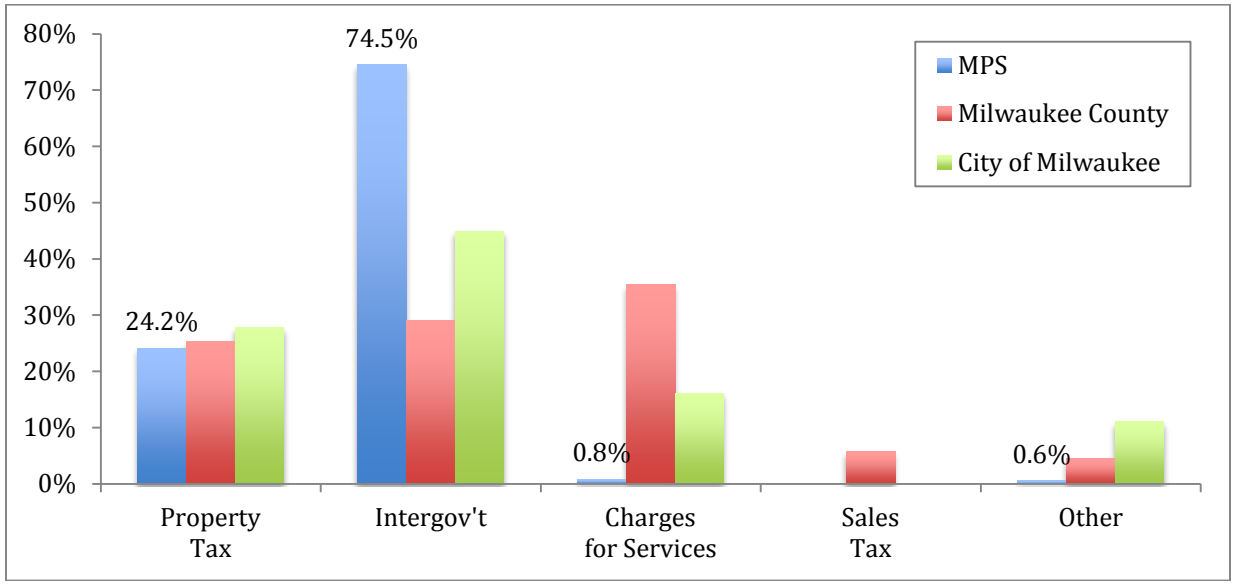
Source: DPI School Finance Data Warehouse

This information shows that MPS' reliance on federal and state revenue is one of the defining features of its finances. **Chart 3** further illustrates that reliance by comparing MPS' major revenues with those of Milwaukee County and the City of Milwaukee, the two other large Milwaukee-area governments. **The chart shows that MPS depends much more on "intergovernmental funds" than either the city or the county**. In this comparison, the focus is on combined state and federal funds because, in some cases, incoming state and federal monies are intermingled and the true source of government funding is difficult to identify.

Because Milwaukee County and the City of Milwaukee receive a smaller proportion of intergovernmental revenue than MPS, they have control over a much larger share of their budgetary revenues through the property tax and charges for services. Property tax and charges for services represented 61% of Milwaukee County's and 44% of the City of Milwaukee's general government revenues in 2010, according to recent accounting reports. In contrast, the property tax represented 24% of MPS' total governmental revenues in 2010, and the school district received less than 1% of its revenue from charges for services.

[2] General operating funds generally refer to funds used for instructional and administrative purposes.

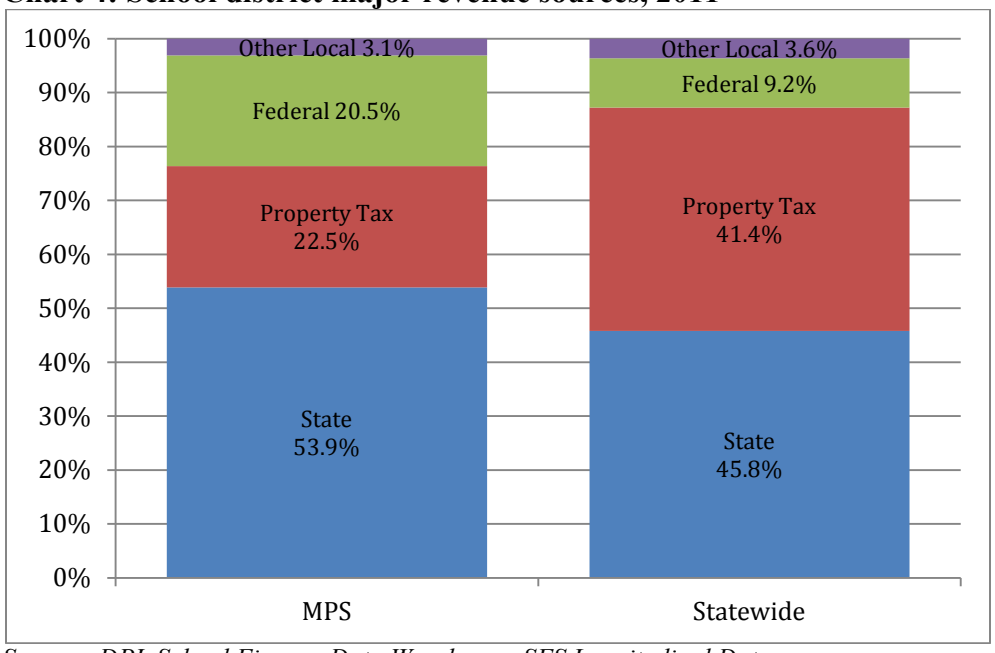
Chart 3: General government revenues – MPS, Milwaukee County and City of Milwaukee, 2010



Source: MPS, Milwaukee County, and City of Milwaukee 2010 CAFRs

Interestingly, the same pattern of reliance upon intergovernmental revenue reappears when MPS is compared with school districts throughout the state, as shown in **Charts 4** and **5**. Because MPS receives a large amount of equalization funding, other state funds, and federal aid, and because MPS has less property wealth to draw on than other districts, intergovernmental dollars represent a much larger proportion of its total revenue. In 2011, state and federal revenue represented about three quarters of total revenues at MPS and only a little over one half of total revenues for all districts statewide.

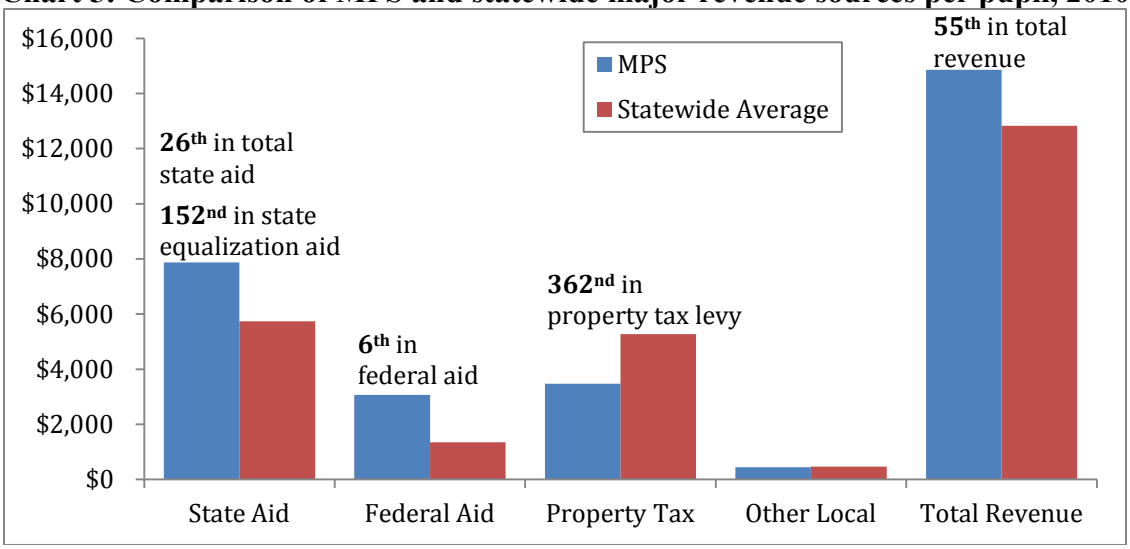
Chart 4: School district major revenue sources, 2011



Source: DPI, School Finance Data Warehouse, SFS Longitudinal Data

Chart 5 provides another statewide fiscal comparison, this time comparing the four major revenue sources at MPS with districts statewide on a per-pupil basis. MPS ranked 55th among all districts in total revenue per pupil in 2010 and received $2,040 more than the average state district. MPS' higher level of funding is caused, in part, by its greater draw on federal funds, which were $1,735 per pupil more than the statewide average in 2010. The distribution of state and property tax revenue offer a mirror image of one another, with MPS receiving $2,135 more in state aid per pupil than the average district, but generating $1,801 less in property tax revenue per pupil.

Chart 5: Comparison of MPS and statewide major revenue sources per pupil, 2010



Source: DPI, School Finance Data Warehouse, Standard Reports

State revenue

State funding is MPS' predominant revenue source. MPS ranked 26th out of 424 districts in state aid per pupil in 2010. Except for Beloit, with an enrollment of just over 7,000, those districts receiving more aid per pupil than Milwaukee were small districts with enrollments under 1,000, which lack a sufficient local property tax base. The various types of state aids that Milwaukee receives are summarized below.

Equalization aid

The State of Wisconsin's annual appropriation for school aids exceeds that of any other state program. Equalization aid constitutes the lion's share, or 85%, of Wisconsin's school aids funding. The emphasis placed upon equalization aid generally is seen as a reflection of the state's commitment to equivalent levels of public education for all citizens. This commitment is rooted in the state constitution that affirms the goal of extending access and opportunity regardless of socio-economic status or race.

The overall philosophy governing the allocation of equalization aids is that state funds should offset differences in local property wealth. Consequently, equalization aids are distributed in inverse proportion to property wealth.

Under the equalization aid formula, the amount of funding that an individual district receives each year is determined by four major aid components: number of full-time-equivalent students residing in the district, which DPI refers to as "membership"; property value equalized across Wisconsin by the Department of Revenue; eligible costs (often referred to as "shared costs"); and the total funding appropriated by the state legislature. The interaction of these components can be complex, as a positive change in one aspect of the formula will not necessarily lead to a net inflow of dollars. For example, the financial benefits derived from an overall increase in the state appropriation may be more than offset by a district's enrollment decline.

A full explanation of the workings of the equalization aid formula is beyond the scope of this paper. However, a few details are noteworthy for their relevance to MPS' fiscal condition.

First, costs that are considered "aidable" under the formula are for general educational costs and long-term debt service payments. Not included are costs funded by state and federal categorical aids and local non-property tax revenue, such as ticket sales and student fees. Those costs are excluded because they have their own designated revenue streams. As shown below, MPS has a higher proportion of categorical funding than other districts. As a result, equalization aid does not fiscally define MPS in quite the same way that it defines many other districts in Wisconsin.

Second, the definition of pupil residency has greater fiscal significance for MPS than for most other school districts because of the varied types of schools attended by Milwaukee schoolchildren. For equalization aid purposes, DPI counts the following students as part of MPS' membership enrollment:

1) All resident pupils enrolled at MPS elementary, middle and high schools.

2) Milwaukee students who attend institutions accountable to MPS, such as some charter schools, partnership schools, and schools that provide educational services under contract.

3) Resident students who attend suburban schools under the state's integration and open enrollment programs.

Table 3 shows the categorical distribution of MPS' enrollment for 2010-11.

Table 3: MPS enrollment, 2010-11

Schools	Enrollment
MPS schools	77,160
Elementary	19,041
K-8	30,648
Middle school	6,286
High school	20,754
Alternative schools	431
MPS-affiliated schools	4,212
Partnership schools	1,417
K-8 contracted schools	324
MPS charter schools*	2,471
Total MPS schools	**81,372**
Other Milwaukee resident students	8,042
Integration aid participants	2,261
Open enrollment participants	5,781
MPS membership total	**89,414**

** Non-instrumentality charters*
Source: MPS' 2012 proposed budget

MPS receives more equalization aid than any other Wisconsin school district. In fact, in 2010, MPS' equalization aid payment was about the same as the combined payments of the next five largest equalization aid districts: Kenosha, Green Bay, Racine, Appleton, and Sheboygan. On a per-pupil basis, MPS ranked 152nd in the state in equalization aid at $5,910 in 2010. That compares to a statewide average of $4,864. Many of the large urban districts in Wisconsin received similar per-pupil equalization aid as MPS. Green Bay, for example, received $5,832 and Racine $5,532. An exception was Madison, which received $1,563, ranking it 356th among Wisconsin's 424 school districts.

MPS' substantial allocation of equalization aid reflects the prominence of enrollment as a key element of the funding formula. No other district in the state approaches MPS' enrollment of more than 80,000 students. Indeed, only four other districts in the state enroll more than 20,000 students (Madison, Kenosha, Racine and Green Bay).

In addition, MPS' equalization aid allocation is driven by its property valuation, which is much lower than most other school districts. In 2010, MPS' average equalized property value per pupil was $361,691, which was only 62% of the state's average of $581,087.

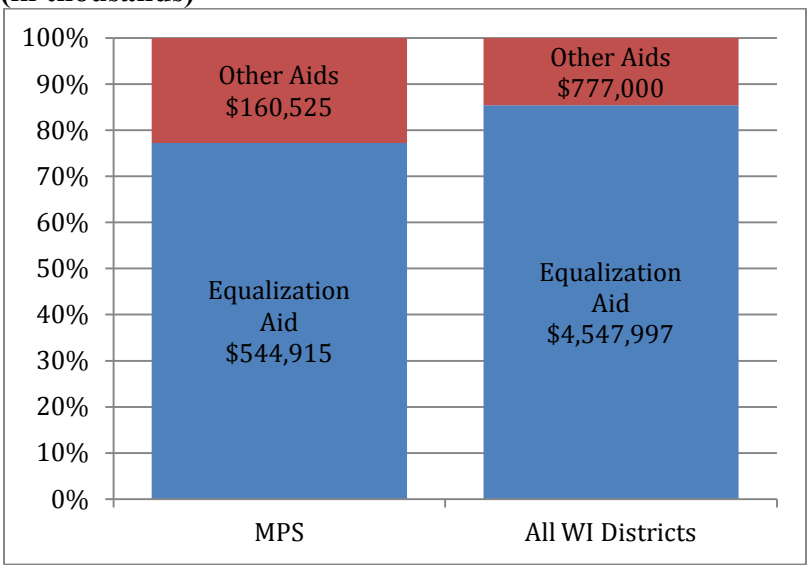
It is interesting to note that MPS' aidable costs under the equalization aid formula of $10,153 per pupil were only slightly above the state average of $10,107 per pupil.[3] As discussed above, Milwaukee receives more revenue per pupil than most other districts, but this total includes federal funds and categorical aid. **When the focus is on general educational costs alone, MPS closely resembles the average Wisconsin school district**.

[3] The costs are from comparative DPI data on revenue limit costs, very similar to shared costs. For instance, MPS' shared costs of $9,812 in 2010 were 99% of its revenue limit of $10,107.

Other state aid programs

Given that most state aid is distributed via the equalization aid formula, one might assume that MPS' high rank in state funding per pupil (26th of 424 districts) is attributed to the amount of equalization aid it receives. As shown above, however, that is not the case, as MPS ranked 152nd in per-pupil equalization aid among all districts in 2010. In reality, MPS' sizable allocations of other forms of state funding are responsible for its high rank. As **Chart 6** illustrates, non-equalization aid constituted nearly one quarter of MPS' state funding, but only 15% of all districts' state funding in 2011.

Chart 6: Allocation of state school aids, MPS and all Wisconsin districts, 2011 (in thousands)



Sources: Wisconsin Legislative Fiscal Bureau, State Aid to School Districts; MPS 2011 CAFR

MPS' largest sources of non-equalization state aid are summarized below. With the exception of SAGE grants, MPS budgets these revenue sources as part of school operations, where they are grouped together with property tax and state equalization aid.

- *Special education* – The state funds eligible education and transportation costs of students with disabilities between the ages of three and 21. There is also a large federal program that assists these students. In 2011, MPS received $50 million of the $369 million awarded by the state for special education.

- *Integration aids* – Also known as Chapter 220, integration aids encourage and support efforts to improve racial balance. Both sending and receiving districts receive payments on a per-student basis, as explained below. MPS received $39 million of the $79 million appropriated in 2011. Most of this aid ($36 million) is intended to be spent on transportation.

- *Student Achievement Guarantee in Education (SAGE)* – This school-based, incentive program awards five-year grants to districts that have at least one school where one half or more of the students are low-income. To qualify for funds, a school district must reduce

enrollment in SAGE schools to 18 students per teacher in grades K5-3. A total of 458 schools in Wisconsin were awarded SAGE grants in 2011. MPS received $29 million of the $109 million state appropriation.

- *Poverty aid* – Created in 2007, this program provides general aids for districts with high levels of poverty. MPS received $10 million of the $19 million in poverty aid appropriated in 2011 to 47 districts. State law requires MPS to use its poverty aid to offset levy increases implemented to fund the Milwaukee parental choice program (see discussion below).

Property tax revenue

The property tax is MPS' second largest source of revenue. In 2011, MPS' property tax revenue of $293 million constituted 23% of its total revenue. MPS budgeted $274 million of its property tax revenue for general school operations, with the remainder budgeted for maintenance repair and renovation ($14.7 million) and debt service ($5.7 million).[4]

MPS has few local sources of revenue besides the property tax. Other local revenue sources totaled $21 million in 2011 and consisted mainly of program-related revenue such as school meal sales, as well as one-time payments and rental payments. MPS reports no income revenue from student fees.

As discussed above, MPS receives lower levels of property tax revenue per pupil than most other districts in the state. In 2010, MPS' property tax revenues amounted to $3,471 per pupil, which ranked it 362nd in the state. The statewide district average was $5,272.

MPS' relatively low receipt of property tax revenue per pupil stems from the district's comparatively low property value. In 2011, property wealth in Wisconsin ranged from $12 million in equalized value per pupil in the North Lakeland district, to $215,000 in equalized value per pupil in Beloit. MPS ranked 364th, or close to the bottom, at $361,691 in equalized value per pupil.

Despite its low level of per-pupil property tax revenue, MPS' tax effort is above average. In 2011, MPS' mill rate was $10.30 per $1,000 of equalized value, placing it in the top quarter of all districts statewide. The median district had a mill rate of $9.10.

Property tax increases are governed by state revenue limits. In recent years, these limits have exerted a powerful influence on MPS although, as explained below, not always in the way intended. Revenue limits control the amount of annual increases that can be financed from the combined revenue of general school aids and property taxes, as calculated on a per-pupil basis. State and federal categorical funding are not governed by revenue limits.

Funds covered by revenue limits include, most prominently, equalization aid. Also included are integration aids and poverty aid. Under the state formula, MPS also qualifies for several revenue

[4] MPS' property tax levy reflects both the amount levied for MPS' own purposes and an additional amount levied in connection with the Milwaukee Parental Choice Program (MPCP). Additional details on MPCP financing are discussed later in this report.

limit adjustments. For example, MPS qualifies for a revenue allowance for declining enrollment districts, equal to $16 million in 2011. In addition, MPS receives a "transfer of service" adjustment for costs related to special education, which increased MPS' revenue limit by an average of $6 million per year from 2008 to 2011.

While the revenue limit formula does recognize some of the special costs and programs incurred by MPS, the district's revenue limit per pupil of $10,153 placed it 191st in the state, or just slightly above the district median of $10,038 in 2010. Revenue limits statewide ranged from $20,712 at North Lakeland to $9,193 at the Brillion district.

Federal revenue

MPS received $267.9 million in federal aid in 2011, an increase of 55% when compared to 2007. This rapid increase elevated the proportion of total revenues supported by federal aid from 15% in 2007 to 21% in 2011. American Reinvestment and Recovery Act (ARRA) funds drove this increase, infusing the district with $226 million from 2009 to 2011, as shown in **Table 4**.

Table 4: Direct federal ARRA funds

	2009	2010	2011
Federal ARRA funds	$75,840,846	$59,001,848	$91,224,335

Note: This does not include federal ARRA funding provided through the State Fiscal Stabilization Fund that helped the state maintain aid payments to districts in 2009 ($75.8 million) and 2010 ($28.8 million).
Source: Summary of ARRA funds provided by MPS

In terms of federal aid per pupil, MPS ranks 6th among all Wisconsin districts and receives more than double the state average. The majority of MPS' federal funding is categorical in nature, as shown in **Table 5**, which cites the district's largest federal categorical programs and compares the amounts received in 2011 to those received in 2007. In 2011, these programs comprised 93% of all federal categorical funds received by MPS and supported 1,821 positions.

Table 5: Largest federal categorical funding sources

Federal categorical program	2007 Funding Amount	2007 Positions funded	2011 Funding Amount	2011 Positions funded
Elementary & Secondary Education Act (ESEA), Title 1-A	$76,722,804	584	$161,407,815	858
Individuals with Disabilities Education Act (IDEA)	$27,295,608	228	$47,447,839	227
Principal & Teacher Quality Improvement (Title II)	$16,843,970	100	$14,490,289	102
Economic Opportunity Act - Head Start II	$5,619,437	83	$6,655,120	86
21st Century Community Learning Centers	$4,495,497	-	$4,438,240	-
U.S. Dept. of Agriculture (passed through DPI) - Meals Program	$30,114,964	480	$38,163,553	479
Total of above federal categorical programs	$161,092,280	1,476	$272,602,856	1,751
Above programs as a % of overall federal categorical	***88%***	***94%***	***93%***	***96%***
Total federal categorical	**$183,601,472**	**1,569**	**$294,214,903**	**1,821**

Source: MPS financial records; MPS budget documents

Several of MPS' federal programs grew as a result of the ARRA funds cited above. The following briefly describes each of the major federal funding sources received by MPS.

- *Title I, Part A: Improving basic programs operated by local educational agencies* – This program is the main component of the Elementary and Secondary Education Act (ESEA) and is the nation's largest federally-funded education program. The program's goal is to support basic educational programs in high-poverty areas in order to ensure that all children have access to a high-quality education. Title I funding more than doubled from 2007 to 2011, in large part because of the influx of ARRA funding. The funds are distributed based on the number of students that qualify for free or reduced-price lunch. To continue to receive funding, schools must make adequate yearly progress on the WKCE. Districts that are identified as in need of improvement, like MPS, must set aside a portion of this aid for staff development and supplemental education services for schools in need of improvement (SIGs).

- *Individuals with Disabilities Education Act (IDEA)* – This law guides education and related services for students with special needs. In 2011, IDEA funding supported roughly 16% of MPS' special education costs, a slightly higher rate than seen in the past. IDEA funding in 2011 included $23.6 million in ARRA funding. According to district financial records, with the expiration of ARRA funding in 2012, the proportion of special education costs supported by the IDEA grant drops to approximately12%.

- *Title II: Improving quality of principals and teachers* – Title II also falls under the ESEA umbrella and focuses on class size reduction and professional development to ensure students are provided with qualified and effective teachers. This also includes $2.2 million in Title II, Part D funding that supports efforts to enhance learning through the use of technology.

- *Economic Opportunity Act, Head Start II* – This funding advances school readiness through enhanced cognitive development of low-income children through health, educational, nutritional, social and other services based on family needs assessments. The program is family and community-oriented and serves many types of children, including those with special needs, and those who are bilingual, homeless or in foster care. The 2011 allocation included $529,000 in ARRA funds for Head Start expansion.

- *21st Century Community Learning Centers* – Funding under this program supports afterschool programs for students attending low-performing schools that are designed to expand academic learning opportunities. Programs provide tutoring and other activities to help students achieve established academic standards.

- *U.S. Department of Agriculture Meal Program* – The district's meal program provides breakfasts, lunches and snacks to interested students, most of whom are eligible for free or reduced-price meals. In 2011, the district received $38 million in federal aid to support the meal program, an increase of roughly $8 million from 2007. A portion of this increase is attributable to an expansion of the district's breakfast program.

Revenue trends

The ICMA evaluation system applies multi-year analysis to determine whether institutional finances are stable, improving, or deteriorating. A key feature of any fiscal assessment is whether overall revenues are increasing at a rate sufficient to sustain existing levels of services and program operations. The ICMA handbook states that "under ideal conditions, revenues would grow at a rate equal to or greater than the combined effects of inflation and expenditure."

Revenue trends for individual sources, meanwhile, can provide further insight into a government's challenges. While changes in a particular source may be more than offset by changes in another, substantial changes in even a single revenue stream can place severe pressure on institutional budgets, fiscal structure and long-term solvency.

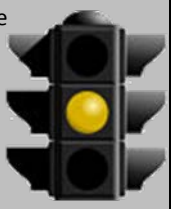
We use three ICMA indicators in this report to analyze MPS' revenue trends: total operating revenues per capita in constant dollars; local tax revenue in constant dollars; and intergovernmental revenue as a percentage of operating revenue. As in our other local government fiscal analyses, the last year included in the trend analysis is the year for which complete fiscal information is available. In this instance, MPS also saw major changes in its revenue streams in 2012 and, to a lesser extent, in 2013. **Therefore, the trends discussed in this section should be reviewed in conjunction with the fiscal information contained in a later section on the 2012 and 2013 budgets.**

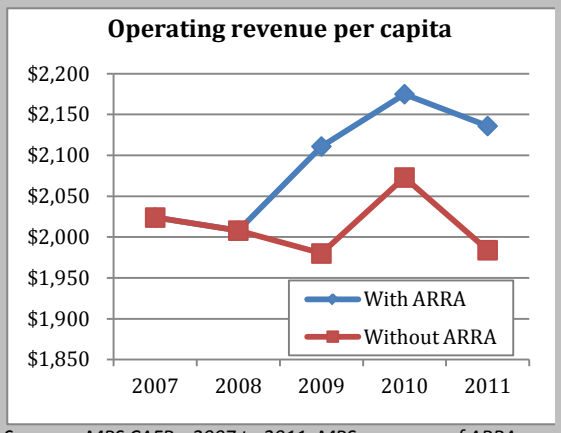
ICMA Fiscal Indicator 1 – Operating Revenues Per Capita

Why it is important – Steady levels of revenue are generally associated with stable operations and levels of service.

ICMA Warning Sign – Increases in net operating revenues per capita in constant dollars raise issues of program and service responsibility. Decreases raise issues of revenue adequacy.

MPS Finding – Operating revenues per capita increased 5.5% when adjusted for inflation. This figure is somewhat misleading, however, because much of the revenue increase occurred in categorical programs, not in general aid, and was funded with stimulus dollars. Factoring out the short-term ARRA funding, operating revenues per capita declined by 2% in constant dollars. Also, state funding, the district's largest funding source, declined during this period and only an exceptional rise in the property tax levy, as well as the federal revenue increase, enabled the district to have real growth in revenue. Given these particular circumstances, which call into question the district's long-term revenue capacity, we find this is an indicator that **requires monitoring**.





Sources: MPS CAFRs, 2007 to 2011; MPS summary of ARRA funds; U.S. Census

Trends in MPS' total operational revenue are shown in **ICMA Indicator 1** and **Chart 7**. Operating revenue grew by nearly $150 million (13.3%) from 2007 to 2011, or by 5.5% per capita after adjusting for inflation. Federal stimulus funding accounted for 60% of the total increase. Absent this temporary funding, MPS revenues grew by less than the rate of inflation.

Perhaps MPS' most distinctive fiscal features during this period were the different trajectories of its revenue streams. Property tax revenue grew by a remarkable $63 million, or 29%. State revenue, the district's key fiscal resource, declined by $16 million, or 2.2%. Federal revenue

rose sharply by $95 million, or 55.3%, which can be attributed almost entirely to stimulus dollars.

While the federal funding trend more than offsets the loss in state funding, it must be noted that **the decrease in state funds mainly occurred in the district's core general education program, while the federal increases were in categorical programs and were temporary in nature**. In the end, intergovernmental funding, as shown in **Indicator 2**, represented a declining percentage of MPS' operational revenue, the result primarily of a fall in state dollars and a large increase in property tax revenue.

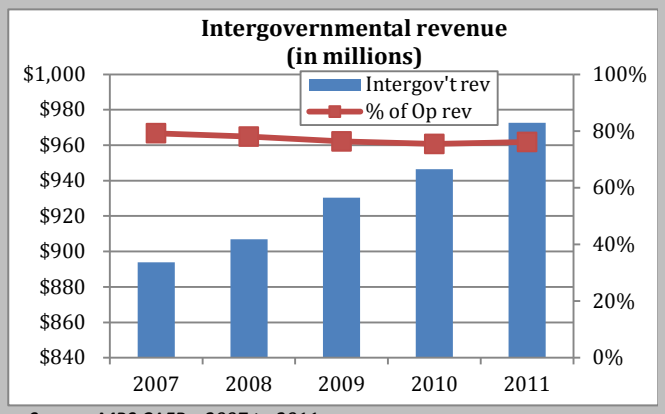
The overall decline in MPS' state support reflects the budgetary challenges facing state government, which were deeply impacted by the national recession. State funding for public education remained essentially flat during the period, increasing by just 0.6%, which is far less than the increase in inflation.

ICMA Fiscal Indicator 2 – Intergovernmental Revenue as a Percentage of Operating Revenue

Why it is Important – MPS intergovernmental funds consist of general state aid and categorical state and federal grants. More than most local governments in Wisconsin—including local municipalities and school districts—MPS relies on intergovernmental funds, which constitute about three quarters of its operating revenues.

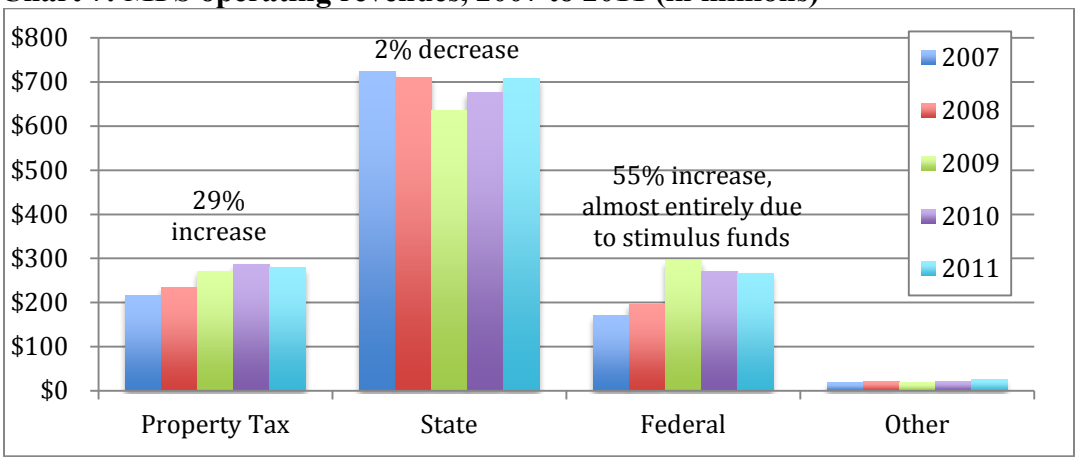
ICMA Warning Sign – A decreasing percentage of intergovernmental revenue as a proportion of operating revenues.

MPS Finding – The years under review show a decline in the percentage of operating revenue represented by intergovernmental funds. This change results from a strong increase in property tax revenue and a decline in state revenue. The trajectory of the trend was not affected by ARRA funding. Given the importance of intergovernmental funds for MPS and consistent with the ICMA methodology, we find this a **negative indicator** of fiscal solvency.



Source: MPS CAFRs, 2007 to 2011

Chart 7: MPS operating revenues, 2007 to 2011 (in millions)



Source: MPS CAFRs, 2007 to 2011

Over a longer period, however, state revenues have declined more significantly. Prior to the 2003-2005 state budget, the legislature was statutorily committed to funding two-thirds of state school district costs via general school aids. The general school aids funding level is now determined through the budget process similar to most other state appropriations. Based on the funding appropriated for 2012 and information on the 2011 gross property taxes levied for school districts, the state share of K-12 education in 2012 is estimated to be 61.7% of partial school revenues. This change in policy not only has resulted in less revenue for school districts, but also greater uncertainty. The lack of a clear state policy regarding education funding means greater fiscal instability for MPS and complicates long-range planning.

MPS' state aid varies by program, as shown in **Table 6**. According fiscal materials provided by MPS, general school aids fell by $48 million because of a $39 million decrease in equalization aid partially generated by the district's declining enrollment, as well as state budget cuts. Other revenues, mainly categorical funds, increased by $32 million. Without this funding boost, the fiscal impact of the loss in equalization aid would have been much more severe.

Table 6: MPS: Major state operating revenues, 2007 to 2011 (in thousands)

Year	Equalization Aid	Integration Aid	Choice Deduction	General School Aids	Other State Aids	Total State Revenue
2007	$638,074	$45,208	($49,723)	$631,845	$90,638	$722,483
2008	$619,595	$41,865	($54,131)	$605,240	$105,437	$710,677
2009	$605,628	$41,276	($57,985)	$587,025	$48,384	$635,409
2010	$599,896	$40,805	($54,108)	$584,580	$91,000	$675,580
2011	$598,928	$39,158	($50,216)	$584,073	$122,372	$706,445
5-yr change	**($39,146)**	**($6,050)**	**($493)**	**($47,772)**	**$31,734**	**($16,038)**
5-yr % change	**-6.10%**	**-13.40%**	**1.00%**	**-7.60%**	**35.00%**	**-2.20%**

Source: MPS CAFRs, 2007 to 2011; MPS financial records

Perhaps the most notable financial trend was the increase in property taxes levied by MPS. Total property tax revenues increased by $63 million (27%), as shown in **Indicator 3** on the following page, despite an 8% drop-off in equalized valuation from 2008 to 2011. To generate this additional revenue, MPS increased its mill rate from $7.48 in 2007 to $10.30 in 2011.

The increase in property taxes reflects MPS' determination to sustain expenditure levels in the face of decreasing general school aids. It is worth noting, however, that the revenue limit formula itself may have influenced the tax rate. The point of a revenue limit, of course, is to control local property tax increases. In the case of Wisconsin's revenue limit, however, there are strong financial incentives for school districts to reach the limit every year. Consequently, in the years under review, revenue limits for some school districts became a target which only could be met by raising property taxes, as opposed to a ceiling under which they had to operate.

This situation occurred because state aids could not keep up with annual increases afforded by the revenue limit formula. As a result, high-aid districts like MPS had to increase their property taxes considerably to make up for the state funding shortfall and raise overall revenues to permitted levels. Of course, MPS could have decided not to levy up to its revenue limit, as it did in 2008. The consequence of adopting that option, however, would have been to permanently lower MPS' revenue limit, as the revenue cap resets if a district fails to maximize revenues.

The increase in MPS' property tax levy and the decline in state aid resulted in a shift in the proportion of general education costs paid by city residents, as shown in **Chart 8**. In a relatively short period of time, property taxes as a percentage of state general school aids increased from about one-third in 2007 to nearly one-half in 2011.

It is important to note that this dramatic shift of costs to local property taxpayers has occurred during a time period of flat or declining shared revenue and exceptional increases in retiree benefit costs for the City of Milwaukee and Milwaukee County, putting additional pressure on the property tax at those two governments, as well. Because the three taxing bodies share most of their tax base, the long-term sustainability of this revenue trend is questionable.

ICMA Fiscal Indicator 3 – Local Tax Revenue

Why it is Important - Local tax revenue can take many forms, but for MPS it generally means property tax revenue, which we examine here. These funds are of fundamental importance to local governments in the resources they provide and the flexibility they afford.

ICMA Warning Sign – A trend of declining property tax revenues in constant dollars raises questions of budget solvency. A trend of increasing property tax revenues in constant dollars raises questions of revenue and service sustainability over a longer term.

MPS Finding – Property taxes for operating and capital funds increased by $63 million from 2007 to 2011, which represents an increase of 27%, or 17% when adjusted for inflation. These increases occurred even through equalized property valuation dropped by 8% during this time and MPS had to raise its mill rate from $7.48 in 2007 to $10.30 in 2011. In one sense, it is a positive sign for MPS finances that the district was willing and able to increase property taxes at a time of state funding difficulty. However, this type of increase in the property tax is not typical for local governments and it likely would be difficult for MPS to continue to balance its budget through similar increases. Consequently, we find this an indicator that **requires monitoring.**

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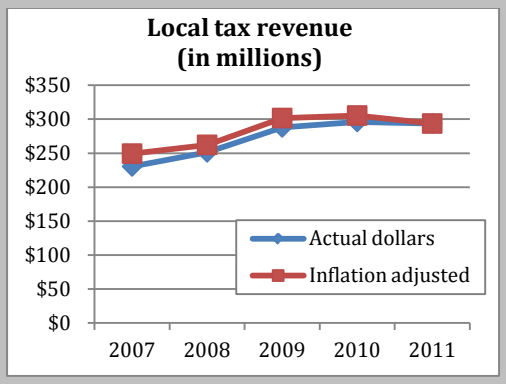
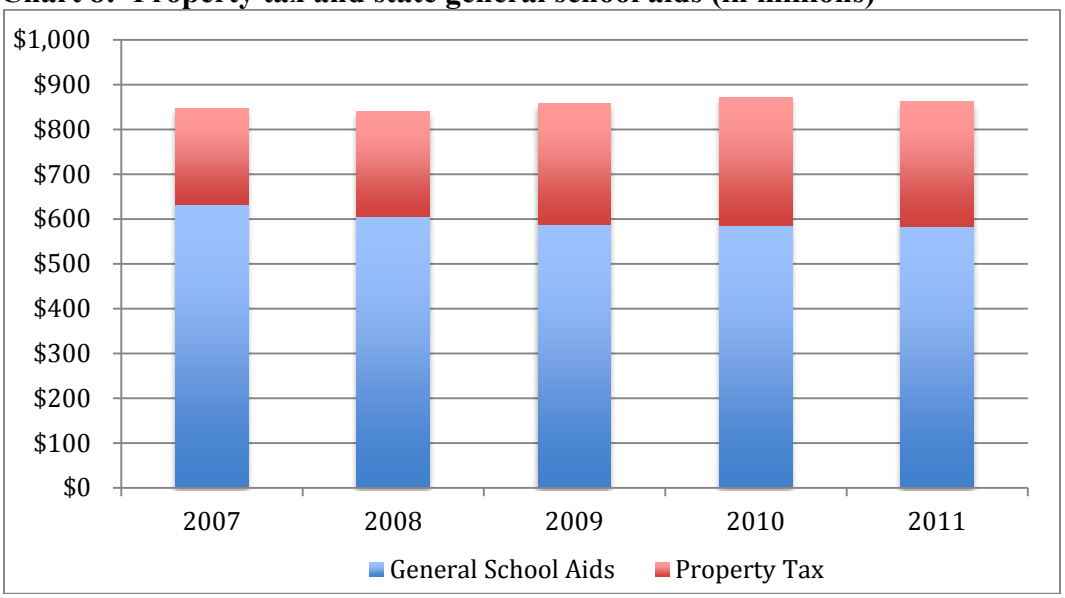


Source: MPS CAFRs, 2007 to 2011

Chart 8: Property tax and state general school aids (in millions)



Source: MPS financial records

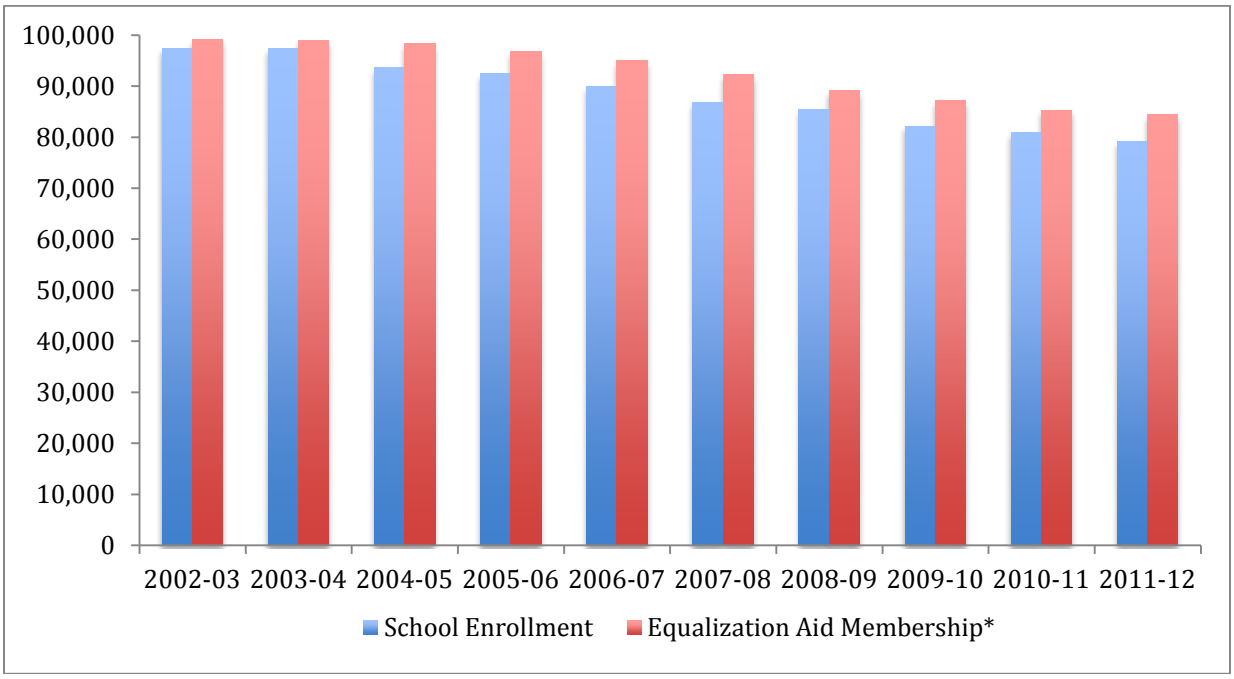
Revenue trends and declining enrollment

MPS' major state and federal revenues are governed by funding formulas that are highly sensitive to enrollment. For example, as discussed above, the equalization aids formula distributes funds on a per-pupil basis, using a three-year rolling enrollment average. Other state aids are cost-based, with funding determined either directly or indirectly by the total number of students a program serves.

Given the integral role of enrollment in state funding formulas, a downward trend in the number of students a district serves can have a significant financial impact if the state does not enact a "hold harmless" policy. Districts undergoing enrollment declines face a serious fiscal challenge as their operational costs must be brought into line with lower attending revenue.

MPS enrollments have declined for more than a decade, as shown in **Chart 9**. The blue bar shows the number of students enrolled at MPS schools, while the red bar includes Open Enrollment and Chapter 220 students and is used in the calculation of equalization aid. Enrollments have fallen because of both a decline in the number of children living in the city, and increasing numbers of Milwaukee children attending school elsewhere under a variety of public and private school choice programs.

Chart 9: MPS enrollment FY 2002-03 to 2011-12



** Full-time equivalent enrollment*
Source: DPI, School Financial Services Longitudinal Data

The state initiative with the greatest impact on MPS enrollment is the Milwaukee Parental Choice Program (MPCP), which provides lower-income Milwaukee students the opportunity to attend private schools. Participating schools receive voucher payments, amounting to $6,442 per student in 2011-12, and students are not assessed tuition. Created in the early 1990s, the program has steadily expanded throughout its existence, accelerating after a 1998 Wisconsin Supreme Court decision affirmed that students attending religious schools were eligible to receive voucher aid. Today, 90 of the 107 educational institutions participating in the program are religious schools.

A total of 23,198 students received MPCP vouchers in 2011-12, a figure that represents slightly less than 30% of Milwaukee's public school enrollment. This past year, the number of Milwaukee students using vouchers increased 10% because of a series of programmatic changes enacted in the 2011-13 state budget. Those changes included removal of an enrollment cap that had previously limited participation to 22,500 students, and an increase in the income limit from 220% to 300% of the federal poverty level, equal to $67,050 for a family of four. Consequently, the vast majority of Milwaukee public school students now qualify for the program, as evidenced by the fact that 84% of MPS students are eligible for the federal student lunch program, which has an eligibility limit of $41,000 for a family of four. There is no requirement that voucher users must have been previously enrolled in MPS, and the data indicate many new voucher users in 2012 were existing private school students.

MPCP students are not included in MPS' enrollment count and MPS does not receive any equalization aid for those students. To the contrary, as enrollment falls at MPS, the district's revenue limit and equalization aid are reduced.

By state statute, private school vouchers are the joint fiscal responsibility of the state and MPS, a funding obligation that has received criticism in Milwaukee. Under the program's funding formula, the state deducts 45% of the voucher cost for each MPCP participant from MPS' equalization aid payment (equal to $50 million in 2011), with the state making up the remaining 55%. Consequently, some argue that state taxpayers have lower tax bills because of the choice program, but Milwaukee taxpayers do not.

MPS is permitted to recoup choice costs by increasing its district levy, an option of which the district availed itself in recent years, with the exception of 2008. The MPS "choice levy" is reduced, however, by the amount of High Poverty Aid it receives ($9.7 million in 2011). The City of Milwaukee also receives an annual payment from the state for property tax relief to offset choice levy costs. When these state offsets are factored in, Milwaukee taxpayers actually funded closer to a third of total voucher costs in 2011.

Charter schools are another educational option open to Milwaukee students. In 1993, the Wisconsin legislature enacted a charter school law that established a framework for the creation of publicly-funded schools that could operate outside the traditional rules and regulations governing public education.

The state's charter school law contains provisions that specifically govern the formation and development of charter schools in Milwaukee. The City of Milwaukee and the University of Wisconsin-Milwaukee (UWM), in addition to MPS, are authorized to operate charter schools. MPS operates charter schools under its own auspices or contracts with an independent or "non-instrumentality" operator, whose employees are not employees of MPS.

The 4,300 students enrolled in MPS non-instrumentality charter schools in the 2011-12 school year are counted as MPS students under the equalization aid formula.[5] The amount of funding MPS awards non-instrumentality charter schools is set, according to school board policy, at the per-pupil amount the state pays charter schools run by UWM and the City of Milwaukee ($7,775 in 2011).

Open Enrollment and Integration Aids also are impacted directly by MPS enrollment. In 1998-99, the Wisconsin Legislature created the Open Enrollment program, which permits a pupil to attend a public school in another district, if space is available. Originally, districts losing students to Open Enrollment could limit that loss to 3% of their membership. That restriction, however, was gradually eased and eliminated entirely in 2006. During the past decade, students participating in Open Enrollment statewide grew more than threefold, from 9,602 in 2001-02 to 31,891 in 2009-10. Of the nearly 32,000 students participating in 2009-10, 5,029 were Milwaukee residents enrolled in neighboring districts, and 381 were residents of suburban districts enrolled in MPS.

Open Enrollment students are included in their home district's membership count, as opposed to the count of the enrolled district. Under state law, Open Enrollment costs are paid through a transfer of state aid from the sending district to the receiving district. The amount transferred per

[5] An estimated 6,900 other Milwaukee students were enrolled in non-MPS charter schools and are not included in MPS' student membership count, meaning MPS does not receive state aid for them.

pupil equals the statewide per-pupil average of four types of school costs: regular instruction, co-curricular activities, instructional support services, and pupil support services. In the 2010-11 school year, this amount equaled $6,665 per pupil, which is more than the district's equalization aid per pupil. In the same year, the net loss in enrollment at MPS due to Open Enrollment was 4,569 students. MPS is not allowed to increase property taxes to compensate for its lost state aid.

Finally, MPS finances are affected by participation in the Integration Aids, or Chapter 220 program, created by the state legislature in 1975 to encourage racial balance within and among school districts. Inter-district Chapter 220 transfers occur between MPS and contracted suburban districts in southeast Wisconsin. Unlike the other programs described above, the number of students participating in the inter-district Chapter 220 program has declined, from 4,033 transfers in 2002-03 to 2,260 transfers in 2010-11. Inter-district transfers out of Milwaukee are counted as three quarters of a full-time equivalent student (FTE) for equalization aid purposes. MPS received $3 million in inter-district transfer aid in 2011, which must be used as property tax relief. Therefore, to the extent inter-district transfers have declined over the years, the district's tax levy has been negatively impacted.

In 2011, MPS received $36.1 million in intra-district aid to support the costs of busing students throughout the city. While intra-district aid falls under the general aid program, because it is intended to offset transportation costs it operates as if it were categorical aid.

Conclusion

The revenue picture at MPS shows the following major characteristics and trends.

- **MPS is highly dependent on revenue sources outside its control.** State and federal aids are the largest source of revenue for the district, and have proven to be unpredictable in recent years.

- Changes in state general school aids, enrollment declines, and the state-imposed revenue cap have resulted in **higher local property tax rates**. The same taxpayers being asked to share more of the costs of city and county government also must bear a greater portion of school district costs. This is not a sustainable trend.

- **Declining enrollment hurts the bottom line**. The significant decline in enrollment not only has resulted in less equalization aid, but it also has made balancing the district's budget very difficult. Because enrollment losses cannot be matched with proportional expenditure cuts, declining enrollment paints a bleak picture for fiscal solvency. In the next section, the district's recent efforts to bring expenditures in line are detailed.

- **Revenue growth from 2007 to 2011 was driven by a $91 million increase in federal stimulus dollars** that accounted for 60% of the district's total revenue increase. Other funds, when taken as a whole, increased at a rate lower than inflation.

BUDGTARY SOLVENCY: EXPENDITURES

Analyzing expenditures with the ICMA system

An institution's fiscal stability is determined largely by whether its revenue-generating capacity meets its expenditure demands. The ICMA fiscal indicators discussed in this section are useful in analyzing the pace of expenditure growth. When analyzed in conjunction with the revenue trends laid out in the previous section, this information provides a basis for determining the institution's long-term fiscal trajectory. For example, trends that indicate continual spending beyond the amount of available revenue raise questions about long-term fiscal stability.

ICMA's method of analysis drills down from overall trends, giving a sharper focus on those items that drive expenditure growth. It is important to understand the dynamics of each major cost driver in order to determine whether or not it is a long-term fiscal threat. Expenditures that are one-time in nature and require temporary appropriations, for example, may be less threatening than those that compound in future years and continually need increased support.

SUMMARY OF EXPENDITURE FINDINGS

MPS' operating expenditures increased by 12% from 2007 to 2011. Much of the increase was tied to categorical expenditures initiated with the receipt of ARRA funds. Instructional costs – linked largely to teacher salaries and benefits – comprise about 59% of all operating costs. Non-instructional costs were the subject of considerably scrutiny in the 2009 McKinsey report, which prompted several steps to control those costs and enhance administrative efficiency.

Instructional budgets were severely challenged by increased health care costs during the period, which began to be curbed in 2011 with implementation of changes negotiated with the teachers' union. During the 2007-2011 timeframe, fringe benefit costs grew by 27% to $387 million, and benefit costs as a proportion of salaries increased from 58% in 2007 to 65% in 2011. The district had the highest fringe rate by far when compared to the next 10 largest Wisconsin school districts.

Expenditure challenges intensified in the 2012 and 2013 budgets because of severe cuts in state aids, stringent revenue limits, and the district's inability to implement planned health care changes until the expiration of the current teachers' union contract. The district cut more than 1,000 full-time positions in response to those challenges.

Operating expenditures

In 2011, MPS' total operating expenditures (not including debt service and capital outlay) totaled $1.25 billion, up $138.7 million, or 12.5%, from 2007. Approximately 66% of this growth can be attributed to receipt of federal ARRA funding. Without ARRA, expenditures grew by $47.5 million, or 4.3%. About 59% of expenditures support student instruction. As shown in **Table 7**, those expenditures grew by 10.8% during the five-year period. Pupil and staff services, on the other hand, grew by more than 30%, an increase that exceeded those of all other functional areas.

Operating expenditures on a per-capita basis grew at a slightly lower 11.5% due to a minor uptick in Milwaukee's population from 2007 to 2011. This growth marginally surpasses the 8.5% inflation rate seen over the same time period but remains within the district's revenue capacity. As seen in **Indicator 4**, when ARRA-supported expenditures are excluded, MPS expenditure increases fell short of inflation, declining by 4.7% in constant dollars.

According to MPS financial records, about 25%, or $270 million, of MPS' operating expenditures are supported by aid designated for a particular program or purpose, also known as categorical funds. Most of the district's expenditure growth from 2007 to 2011 is attributed to categorical funds, with ARRA funding providing for the bulk of that growth. As previously discussed, the temporary infusion of ARRA funding provided new expenditure capacity of $91.2 million in 2011. MPS has utilized ARRA funds largely to support non-recurring expenditures, such as start up-costs for new programs, greater professional development for teachers, enhanced curriculum, and capacity-building for technological learning. ARRA funding declined to $15.3 million in 2012.

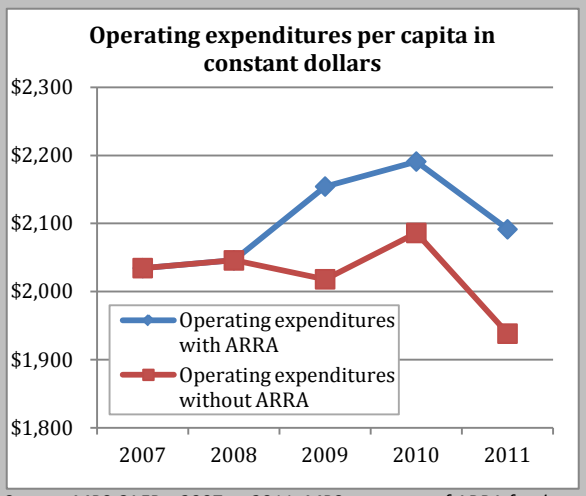
ICMA Fiscal Indicator 4 – Net Expenditures Per Capita

Why it is Important – In a state of fiscal health, a government's or institution's per capita expenditures in constant dollars should hold nearly level or increase slightly and should not exceed per capita operating revenues. A scenario in which expenditures increase too rapidly may cast doubt on long-term funding sustainability.

ICMA Warning Sign – Imbalance between expenditures and net operating revenues or a large increase in expenditures in constant dollars.

MPS Findings – MPS per capita net operating expenditures increased by 11.5% from 2007 to 2011, or 2.8% after adjusting for inflation. In constant dollars, per capita revenue growth of 5.5% was more than sufficient to sustain this level of expenditure growth. However, expenditure growth would be significantly different had the district not received ARRA funding. Without ARRA, district expenditures per capita trailed inflation, falling by 4.7% in constant dollars. Despite MPS' ability to hold expenditures in check in the five-year period, this area **requires monitoring** in light of the expiration of ARRA funds in 2012 and declining state aid generally.

The district already has taken steps during the past three years to bring down costs in response to stagnant revenue capacity, including significant reductions to health care benefits. While this will provide some breathing room, the district should closely monitor the impact of these changes on service solvency given projections of a significant number of retirements resulting from the benefit changes.



Source: MPS CAFRs, 2007 to 2011; MPS summary of ARRA funds; US Census

Table 7: Overview of MPS expenditures (in thousands)

Function	2007	2011	$ Change	% Change
General & school building administration	$109,868	$118,430	*$8,562*	*7.8%*
Business services*	$160,818	$170,710	*$9,892*	*6.2%*
Instruction	$660,326	$731,709	*$71,383*	*10.8%*
Pupil & staff services	$120,056	$158,034	*$37,978*	*31.6%*
Nutrition services	$35,782	$43,248	*$7,466*	*20.9%*
Community services	$20,022	$23,468	*$3,446*	*17.2%*
Total expenditures	**$1,106,872**	**$1,245,599**	***$138,727***	***12.5%***
Expenditures without ARRA	**$1,106,872**	**$1,154,375**	***$47,503***	***4.3%***

**Business services include costs related to student transportation, which amounted to roughly $60 million in both years.*

Source: MPS 2011 CAFR; MPS summary of ARRA funds

The remaining 75% is non-categorical district expenditures supported mostly by general state education aids and local property taxes which, as previously discussed, are influenced heavily by state-imposed revenue caps. MPS faces an annual challenge of balancing the available revenue from those sources with its staffing needs and retirement obligations, as salary and fringe benefit costs comprise 75% of all operating expenditures.

MPS obviously spends much more on an annual basis than other Wisconsin school districts because it is so much larger. In **Table 8**, we show MPS' 2007 and 2011 expenditures on a per-pupil basis, and how they compare to those of the next 10 largest school districts in the state. Analyzing MPS' expenditures on a per-pupil basis provides a better sense of its spending levels as compared to other state districts, though it should be noted that this approach also has its limitations in that some of MPS' costs – such as for transportation and recreation – serve all Milwaukee children, and not only those attending MPS.

Table 8: MPS total per-pupil costs compared to next 10 largest Wisconsin districts

	2007	2011	$ Change	% Change
Milwaukee	**$12,471**	**$15,327**	***$2,856***	***23%***
Madison Metropolitan	$13,280	$14,254	*$974*	*7%*
Kenosha	$10,913	$13,235	*$2,322*	*21%*
Sheboygan Area	$12,017	$12,984	*$966*	*8%*
Racine	$10,411	$12,728	*$2,317*	*22%*
Eau Claire Area	$11,694	$12,565	*$871*	*7%*
Green Bay Area	$11,712	$12,480	*$767*	*7%*
Janesville	$10,295	$12,244	*$1,949*	*19%*
Appleton Area	$11,030	$12,197	*$1,166*	*11%*
Waukesha	$10,851	$12,158	*$1,307*	*12%*
Oshkosh Area	$10,756	$11,888	*$1,132*	*11%*
Milwaukee rank among largest WI districts	**2**	**1**		

Source: DPI School Financial Services, Comparative Cost Per Member

Per the table, in 2011, MPS not only had the highest total expenditures among Wisconsin's school districts, but also the highest per-pupil costs among the state's largest school districts. ARRA funding played a big role in the district's per-pupil expenditure increase during the period. If ARRA funding had been excluded in 2011, MPS' per-pupil costs of $15,327 would have dropped to $14,246. Given that many other districts also received ARRA funding, however, MPS still would have maintained the highest per-pupil cost after filtering out temporary ARRA support. Again, the impact of categorical funding for MPS' substantial proportion of special needs and disadvantaged students needs to be taken into account in considering these expenditure amounts.

Between 2007 and 2011, MPS cut a net total of more than 1,000 full-time positions to help balance its budget. The district achieved a significant portion of those reductions through attrition. **Table 9** shows MPS' position counts in 2007 versus 2011 for both full-time and part-time positions, while **Indicator 5** (following page) shows the reduction in full-time positions on a per-capita basis. In 2011, MPS had a total of 7,785 full-time positions, which was a reduction of 1,049 positions (12%) from 2007. Full-time teaching positions declined by 631 (11%), while teacher aide positions declined by 142 (28%). These staffing changes also must be viewed in the context of the district's declining enrollment, which was discussed in the previous section.

Table 9: Snapshot of MPS position counts, 2007 vs. 2011

Position category	2007	2011	Change	% Change
Officials, administrators, managers	94	99	5	5%
Principals	139	127	(12)	-9%
Assistant principals	142	91	(51)	-36%
Teachers	5,694	5,063	*(631)*	*-11%*
Teacher aides	503	361	(142)	-28%
Guidance counselors	48	55	7	15%
Psychological	159	149	(10)	-6%
Other professional staff*	441	468	27	6%
Consultants/ supervisors	94	66	(28)	-30%
Librarian/ audiovisual	36	28	(8)	-22%
Technicians	70	57	(13)	-19%
Skilled trade workers and engineers	393	341	(52)	-13%
Unskilled laborers	77	64	(13)	-17%
Service Workers**	415	404	(11)	-3%
Clerical/Secretarial	529	412	(117)	-22%
Total full-time	**8,834**	**7,785**	**(1,049)**	**-12%**
Part-time professionals***	556	408	(148)	-27%
All other part-time	4,801	4,448	(353)	-7%
Total part-time	**5,357**	**4,856**	**(501)**	**-9%**
Grand total	**14,191**	**12,641**	**(1,550)**	**-11%**

** The types of positions included in other professional staff include social workers (30%), nurses (14%), physical and occupational therapists (14%), and more unique job classifications that are largely within human resources, finance, curriculum, information systems, and transportation (42%).*
***Service workers largely include full-time building maintenance (70%) and food service workers (26%).*
**** The part-time professionals category is largely made up of substitute teacher positions.*
Source: MPS' federal EEO5 staffing reports

Non-instructional costs

About 40% of MPS' operating expenditures are devoted to non-instructional costs, which include the district's administration, student transportation, student meals, and community service programs. Costs outside of the classroom received considerable scrutiny in 2009, in the aftermath of a study on MPS operations conducted by a national consulting firm – McKinsey and Company – at the behest of the governor, Milwaukee mayor, and civic leaders. The study concluded that "improvements to the district's non-instructional operations may have the greatest short-term impact in securing the district's financial future."

The McKinsey report proposed several non-instructional operational changes that it estimated could save the district between $58 and $103 million annually. **Table 10** summarizes the most significant of those proposed changes.

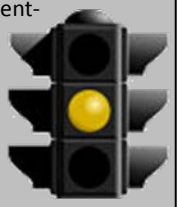
Since the report's release, the district has provided occasional updates on operational improvements related to the McKinsey recommendations. The following discussion provides an overview of non-instructional cost trends and touches on several options referenced by the McKinsey report and subsequent decisions by MPS to implement them.

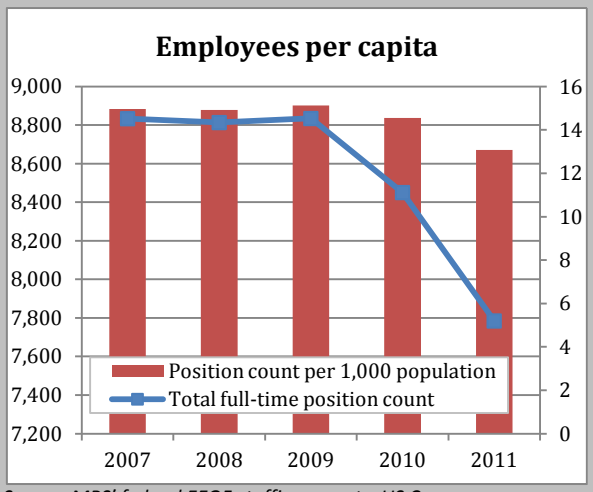
ICMA Fiscal Indicator 5 – Employees Per Capita

Why it is Important – Employees per capita has implications for budget solvency because of the significant impact of personnel costs on local government budgets. An increase in employees per capita may have long-term growth implications and may indicate that the institution is expanding operations, becoming more labor-intensive, or that productivity is declining.

ICMA Warning Sign – Increasing number of employees per capita.

MPS Finding – The total number of full-time positions employed by MPS declined by 12%, or 13% on a per capita basis, from 2007 to 2011. This includes an 11% reduction in teachers. Given relatively high average student-to-teacher ratios and an anticipated spike in retirements, the district's staff levels **require monitoring** to ensure that critical positions and service solvency are maintained.





Source: MPS' federal EEO5 staffing reports; US Census

Table 10: Summary of key McKinsey report cost-saving options

Administration

- Restructure salaries to reflect the pay levels seen in other comparable districts.
- Reduce school-level administrative staff that appear high on a per-pupil basis and correct inefficient processes that may be the genesis of these high staff counts.

Procurement

- Consolidate all subject area textbook purchasing into one order to reduce the undue expense related to fragmented purchasing practices.
- Compare pricing to establish a standard, low-cost array of supply options for use by all schools and ensure that those purchases are tracked electronically in a centralized system.

Maintenance & facilities

- Provide maintenance staff to each school according to building utilization rather than its square footage.
- Optimize facilities by consolidating programs located within underutilized buildings and selling facilities that go unused.

Food Service

- Expand the use of the pre-packaged meal service already seen in the breakfast program in order to cut staff costs that are inherent in full production kitchens.
- Monitor costs and changes to food items to balance low-cost meals, healthy options and student participation.

Transportation

- Change eligibility for MPS and Milwaukee County bus service (i.e. reduce distance to which school buses will travel and/or expand the number of students eligible to ride county buses to school).
- Work with bus service vendors to right-size buses to reflect route utilization and rid the district of costs associated with larger-than-needed vehicles.
- Negotiate with the Milwaukee County Transit System to work toward greater discounts on student bus tickets so that the level of subsidy resembles that provided by other large districts.

Health care

- Implement health care premiums and plan design changes in order to shift employees to the lower-cost health care plan.
- Adjust eligibility requirements for both employees and retirees in order to limit costs.

Source: McKinsey, Toward a Stronger Milwaukee Public Schools, April 2009

- ***Administration*** *(18.5% of all district operating costs)* – As shown earlier in **Table 7**, the district spent roughly $230 million in 2011 in the areas of general district, school and business operations, a 9% increase over 2007. This includes costs related to district administrators, fiscal and business operations, maintenance, and facilities.

  Roughly $100 million of district and school building administration supports utilities, maintenance, and structural alterations to facilities. The McKinsey report noted that one possible way to cut costs in this area would be to provide maintenance staff to each school according to building utilization rather than square footage, an initiative in which the district has expressed interest but has yet to implement.

- ***Transportation*** *(4.7% of all district operating costs)* – DPI data show that MPS transportation costs have fallen from $59.9 million in 2007 to $58.9 million in 2011, or about 2%. Several changes recently introduced in this area by MPS contributed to this drop. One was the district's decision to renegotiate its transportation contracts, which generated $2.2 million in savings. The district also has followed through with limiting the distance in which

MPS buses travel to pick up students. These changes began in 2009 and have saved the district $3.9 million since then.

More controversial changes include the district's attempt to negotiate higher discounts with the Milwaukee County Transit System (MCTS) for the tickets/passes provided to student riders. The McKinsey study pointed out that while MPS received a 6% discount, other large school districts, including Chicago's, typically received discounts in the vicinity of 25-50%. After negotiations failed in 2009, the school board directed that $3 million, or 50%, of its transportation contracts be transferred from MCTS to private bus contractors, which it deemed to be a cost-saving option given continual increases in MCTS bus fares. More recently, in May 2011, a proposal to charge a fee to all three-year-old and four-year-old kindergarten students for their bus transportation failed to pass the school board, in part because of legal concerns. The proposal was estimated to save $2 million in 2012.

- ***Food services*** *(3.5% of all district operating costs)* – MPS provides roughly 65,000 meals per day to district students, offering breakfast, lunch and dinner depending on student circumstances. Costs related to the district's meal program grew 21% from 2007 to 2011, to $43.2 million. A total of 480 FTEs were budgeted in this area for the 2011 school year. The majority of food services expenditures ($33 million) are linked to school lunches – a service provided to 47% of district students each day, on average. While the number of students purchasing or receiving school lunches has declined by 7% from 2007 to 2011, or 2,876 students, a 24% increase in average daily breakfast program participation has more than made up for that loss. A portion of the cost increase in the meal program is due to this expansion, which is predominantly supported by federal aid.

  The McKinsey report also cited opportunities for cost savings in this area, including expanding the use of a pre-packaged meal service, altering the menu to include attractive but lower-cost options, increasing fees for paying students, and privatizing the operation. The district has discussed several of those options in depth, including proposals by the superintendent related to outsourcing that have been rejected by the school board. For the 2013 school year, the district contemplated a centralized kitchen that would have provided pre-packaged meals to schools using district staff. That move was estimated to save $90 million over 15 years. That move was not approved, but an alternative approach in which pre-packaged meals will be phased in for elementary schools was adopted by the board. According to MPS officials, that approach is expected to achieve some level of savings over time.

  The high cost of MPS' fringe benefits is a primary topic of this report, but in few areas is it more acute than in food services. The fringe benefit rate (i.e. the ratio of benefits to salary) for the district's food services section has been reported to be over 100%, as most part-time workers work enough hours to be eligible for full-time benefits. A change adopted in 2012 to increase the number of hours necessary to be eligible for health care for new employees eventually will bring down the benefit rate in this area.

- ***Pupil and staff services*** *(12.7% of all district operating costs)* – From 2007 to 2011, pupil and staff services increased by 32%, or $38 million. This area was the major beneficiary of ARRA funding over the past few years.

The district recently has implemented several initiatives aimed at improving the efficiency of its operations. For example, the district has established a new office that is charged with generating operational improvements and enhanced efficiency within the entire scope of MPS operations, with a particular emphasis on utilizing the "Six Sigma" process improvement framework. An example of Six Sigma's use to address McKinsey report recommendations is the area of procurement, which has become a major Six Sigma initiative for the district.

Instructional costs

At $732 million, instructional costs – which essentially consist of those directly related to teaching in the classroom – increased by 10.8% during the 2007-2011 timeframe and comprised 59% of MPS' total operating expenditures in 2011. The district spent $8,678 on instructional costs on a per-pupil basis in 2011. As shown in **Table 11**, when compared to the next 10 largest Wisconsin school districts, MPS ranks first in per-pupil instructional spending. (Clearly, MPS' receipt of ARRA impacted the growth in instructional costs. Unfortunately, we are unable to quantify this impact.)

Table 11: MPS per-pupil instructional costs compared to next 10 largest Wisconsin districts

	2007	2011	$ Change	% Change
Milwaukee	**$7,042**	**$8,678**	***$1,636***	***23%***
Sheboygan Area	$7,459	$8,377	*$918*	*12%*
Racine	$6,572	$8,084	*$1,513*	*23%*
Madison Metropolitan	$7,296	$7,918	*$622*	*9%*
Kenosha	$6,472	$7,875	*$1,404*	*22%*
Green Bay Area	$6,700	$7,393	*$693*	*10%*
Waukesha	$6,436	$7,209	*$773*	*12%*
Oshkosh Area	$6,442	$7,180	*$737*	*11%*
Appleton Area	$6,503	$7,135	*$632*	*10%*
Janesville	$6,125	$7,038	*$913*	*15%*
Eau Claire Area	$6,321	$6,747	*$425*	*7%*
Milwaukee rank among largest WI districts	**3**	**1**		

Source: DPI School Financial Services, Comparative Cost Per Member

As shown earlier in **Table 9**, despite the growth in instructional expenditures during the five-year period, MPS' teaching staff was reduced by 11% to accommodate increased salary and benefit costs. This indicates that **while ARRA funding allowed for general growth in expenditures, those funds were directed primarily to temporary initiatives and did not prevent cuts to core staffing**. The reductions in teachers resulted in elevated class sizes, as the average student-to-teacher ratio increased from 17.6 in 2007 to 19.6 in 2011. MPS continues to have the highest

student-to-teacher ratio when compared to the next 10 largest Wisconsin districts, as shown in **Table 12**. While most of the other large districts have seen a slight increase in student-to-teacher ratios, none have reached the level that Milwaukee had in 2007, let alone its 2011 level.

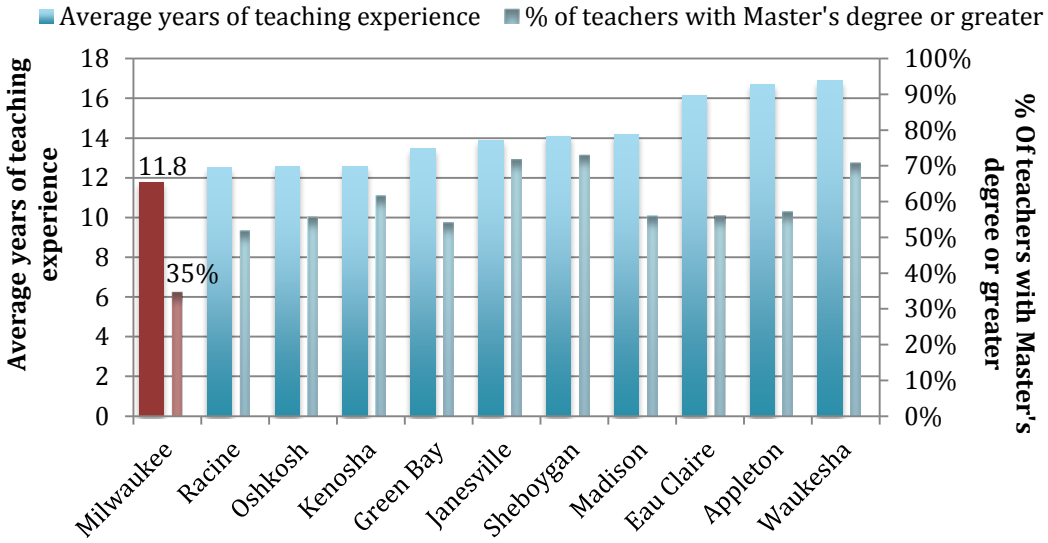
Table 12: Student-to-teacher ratios

	2007	2011
Milwaukee	**17.6**	**19.6**
Waukesha	16.5	16.8
Appleton	15.7	16.7
Eau Claire	15.1	16.0
Kenosha	16.5	15.2
Racine	16.3	15.1
Oshkosh	14.5	14.8
Green Bay	14	14.7
Sheboygan	14	14.7
Janesville	13.9	14.2
Madison	13.6	13.8
Milwaukee rank	**1**	**1**

Source: NCES, Common Core of Data

Increased class sizes pose a substantial problem for MPS as it seeks to improve upon its relatively low levels of student achievement. In addition, the MPS teachers who are instructing these large classes are relatively inexperienced, as MPS has the lowest average level of experience among its teachers (11.8 years) among the largest Wisconsin districts, as shown in **Chart 10**. This figure also shows that MPS teachers possess relatively low education levels, as only 35% hold Master's degrees or higher, again placing the district last when compared to other large Wisconsin districts.

Chart 10: Teacher experience and educational attainment



Source: DPI WINNS "What programs, staff, and money are available?"

Salaries and fringe benefits

According to district financial records, MPS salary and fringe benefit expenditures grew by 5% and 27% respectively during the 2007 to 2011 timeframe. Collectively, those costs made up about two-thirds of the district's overall expenditure growth during this period.

Health care and pension costs are the largest components of MPS' fringe benefits budget, encompassing $335.3 million, or 87%, of the district's fringe benefits spending in 2011. This amount includes a $15 million pre-payment for 2012 pension obligations and a $9 million contribution to the Other Post-Employment Benefit (OPEB) trust for future OPEB costs. These payments are removed for the purpose of trend analysis in the discussion below and the accompanying indicator box.

Table 13, which isolates health care and pension expenditures for the five-year period, shows that the percentage of the fringe benefits budget devoted solely to health care grew rapidly from 2007 to 2009, before declining in 2010 and 2011. The drop in 2011 reflects several health care benefit changes implemented that year. Fringe benefit expenditures as a whole rose dramatically as a percentage of salaries, as described in **Indicator 6**, growing from 57.7% in 2007 to 65.4% in 2011.[6] Health care changes already planned for subsequent years will reverse that trend, however.

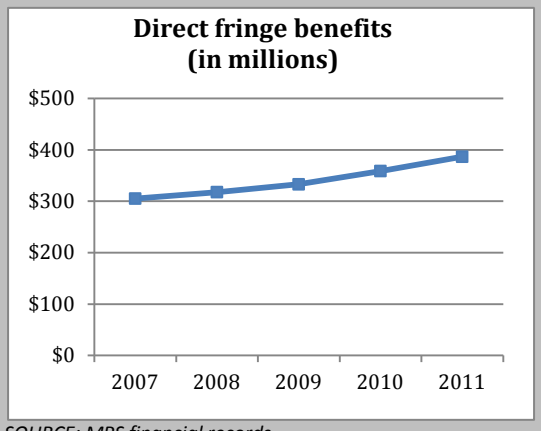
ICMA Fiscal Indicator 6 – Direct Fringe Benefits

Why it is Important – Direct fringe benefits typically include employee health, pension and life insurance benefits and represent one of the largest and fastest-growing items of expenditure in the public sector. In recent years, many local taxpayer-funded entities have seen increases in health care and pension costs far surpassing the rate of inflation. This expenditure increase has had a debilitating effect upon budgets and fiscal condition.

ICMA Warning Sign – Increasing fringe benefits as a percentage of salaries and wages and operating expenditures.

MPS finding – Total fringe benefit expenditures (including special pension and OPEB payments) grew by $81.4 million from 2007 to 2011 (27%), to a total of $386 million. When the payments are removed, fringe benefits for 2011 amounted to $362 million, an increase of $57.4 million (18.8%) over 2007. As a percentage of salary and wages, fringe benefit costs grew from 57.7% in 2007 to 65.4% in 2011.

While continued growth at this level would be difficult for the district to sustain, it is important to note that it is planning significant benefit changes after the expiration of labor union contracts that will produce a substantial initial cost reduction and that promise to curb annual growth in the future. Given the continued magnitude of MPS' employee health care budget, however, as well as the uncertain legal status of the state legislation that empowered the district to adopt these changes, this is an area that **requires monitoring**.



SOURCE: MPS financial records

[6] In keeping with our prior analyses, this fringe benefit rate calculation includes benefits for both active employees and retirees.

Table 13: Health care and pension costs as a % of overall fringe benefit expenditures

	Health care	Health care as % of fringe	Pension	Pension as % of fringe	Combined health care and pension as % of fringe	Overall fringe
2007	$182,488,508	59.9%	$72,520,042	23.8%	83.7%	304,621,536
2008	$192,006,942	60.3%	$74,934,256	23.5%	83.9%	318,250,774
2009	$215,452,735	64.0%	$68,216,538	20.3%	84.3%	336,422,562
2010	$230,184,228	62.6%	$85,200,968	23.2%	85.8%	367,702,722
2011	$223,261,716	61.7%	$87,434,147	24.2%	85.8%	361,986,013

Note: In order not to skew actual fringe benefit rates, these figures reflect fringe costs associated with each given year and do not reflect any special pension or OPEB payment amounts.
Source: MPS financial records; special payment detail provided by MPS fiscal staff

The extent to which MPS differed from other districts in terms of the ratio of average fringe benefit expenditures to salary expenditures is shown in **Table 14**, which compares average MPS teacher salary and fringe benefit costs and ratios to the next 10 largest Wisconsin districts. **MPS' fringe benefit rate of 63% was by far the highest among the group**.[7]

Table 14: MPS fringe benefit costs as a percentage of teacher salaries compared to next 10 largest Wisconsin districts

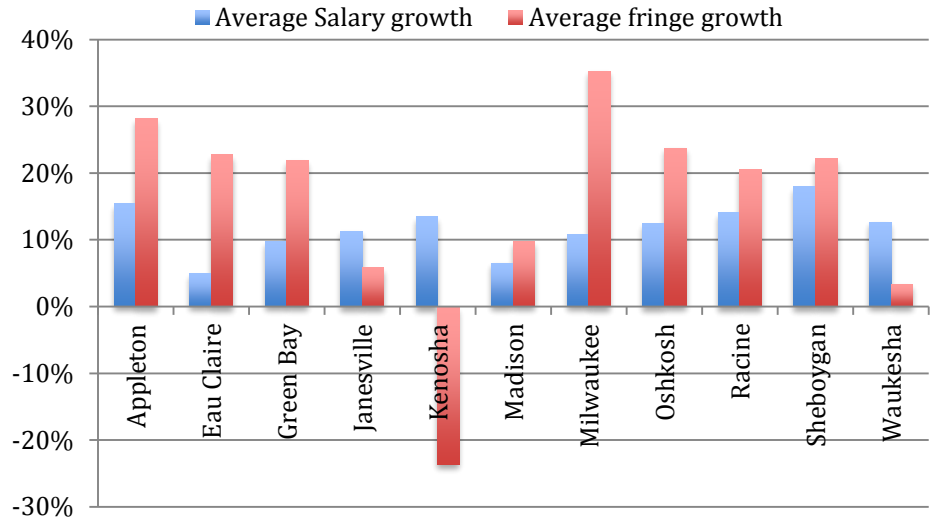
	2011 Average salary	2011 Average fringe	Fringe as % of salary	
			2007	2011
Milwaukee	**$57,602**	**$36,040**	**51%**	**63%**
Eau Claire	$52,442	$29,326	48%	56%
Kenosha	$57,475	$32,201	NA	56%
Green Bay	$53,109	$28,099	48%	53%
Appleton	$59,303	$30,542	46%	52%
Oshkosh	$51,900	$26,369	46%	51%
Racine	$55,405	$28,533	49%	51%
Waukesha	$63,887	$29,528	50%	46%
Janesville	$52,629	$23,614	47%	45%
Madison	$52,877	$23,299	43%	44%
Sheboygan	$63,440	$26,261	40%	41%
Milwaukee rank	**4**	**1**	**1**	**1**

Source: DPI WINNS "What programs, staff, and money are available?"

In 2011, MPS ranked fourth-highest in average teacher salary among the largest Wisconsin districts and first in average fringe benefits per teacher. As shown in **Chart 11**, while teacher salaries at MPS grew relatively slowly over the 2007-2011 period when compared to the other districts, fringe benefit expenditures grew at the fastest rate among the large districts.

[7] It is important to note that the average fringe benefit calculation is derived by dividing total fringe benefits costs (for both active and retired employees) by the number of teachers, and does not reflect the actual value of benefits received by MPS teachers. In other words, the 63% fringe rate does not mean that the average MPS teacher received a fringe benefits package in 2011 that was equivalent to 63% of his or her salary, as the fringe amount includes an amount for retiree health care. The same qualifier would apply to the other school districts in the table.

Chart 11: MPS five-year average salary and fringe benefit growth compared to next 10 largest Wisconsin districts, 2007-2011



** Appears to be a data reporting error in Kenosha's fringe benefit data*
Source: DPI WINNS "What programs, staff, and money are available?"

MPS employees can choose between two health care plans: an Exclusive Provider Organization (EPO) plan and a Preferred Provider Organization (PPO) plan, both of which are self-funded. Prior to 2011, MPS employees did not contribute toward the cost of their health insurance premiums, giving them little incentive to choose the lower-cost EPO plan. In fact, only 30% of active employees typically opted for the EPO, as compared to the 90% of City of Milwaukee employees who have chosen the EPO plan over that government's PPO. In 2010, the annual premium cost for the district's EPO family plan was $17,660, while the cost for a family PPO plan was $26,850. Regardless of the employee's selection, MPS absorbed the entire premium cost.

MPS initiated several rounds of health care benefit changes in 2010 in a new four-year teachers' union contract. The first set of changes included a shift to a new third-party administrator; plan design changes; new employee premium contributions; and elimination of benefits for substitute teachers. Those changes helped the district achieve an estimated $44.8 million savings annually, of which approximately $30 million was attributed to the change in third party administrator. The new employee premium contributions – which are effective through June 30, 2013 – require teachers to contribute 1% of base salary for a single plan and 2% for a family plan. Rates for most other employees are set at 2.5% of the premium cost for the EPO and 5% for the PPO. The new distinction between EPO and PPO rates is designed to help steer employees into the lower-cost EPO option. In fact, according to MPS staff, approximately 70% of district employees have shifted to the EPO plan as a result of these benefit changes.

MPS also provides health care benefits for thousands of retirees. In fact, its OPEB liability, the bulk of which is attributed to retiree health care benefits, currently stands at about $2.8 billion. MPS has been accounting for this liability largely on a "pay-as-you-go" basis, and its retiree

health care and life insurance costs amounted to approximately $65 million in 2011, which was about 30% of the district's total 2011 health care expenditure.[8]

A second round of health care changes was initiated in November 2011 that will have an even bigger impact than the 2010 changes on both retiree and active health care costs, as well as MPS' overall fiscal prognosis. Because the current four-year teachers' union contract does not expire until after the 2012-13 school year, those changes will not be fully implemented until the 2014 budget. The November 2011 benefit changes are discussed in detail in a subsequent section of this report.

The 2012 & 2013 budgets

The 2011-13 State Budget – adopted in the summer of 2011 – produced dramatic additional budgetary challenges for MPS. The state budget cut MPS' total state aids by $68 million and prevented districts statewide from offsetting state aid cuts through property tax levy increases by reducing the per-pupil revenue limit by $555. While many other districts were able to balance at least some of their revenue loss with unilateral changes to employee benefits made possible by Act 10, MPS could not because of its existing four-year teachers' union contract.

The first round of benefit concessions included in that contract, though beneficial to the district's bottom line, was insufficient to offset the revenue loss. MPS was able to increase property taxes by $10 million in 2012 (4%), but had to turn to position reductions to manage the rest of the loss. MPS' 2012 budget included a reduction of roughly 790 FTEs. The district originally sent out 350 teacher layoff notices, but several of those were reversed after health care savings turned out to be somewhat higher than expected.

The boost that ARRA gave the district in 2009-2011 also largely disappeared in 2012, reducing total federal funds by roughly $80 million. As previously mentioned, however, because the district directed most of its ARRA funding toward costs that were temporary in nature, the impact of that loss to core operations was not severe.

In the 2013 budget, revenue levels remain largely flat while fringe benefit and other cost pressures continue. This combination led the district to reduce staff by another 400 FTEs. Layoffs were avoided, however, because of the vacancies created through attrition.

The district also launched an effort to centralize administrative processes in 2012 that continues in 2013. Over these two years, management of certain functions has been transferred from schools to centralized offices. In addition, the district has stepped up its use of Six Sigma and other efficiency strategies. Consolidating textbook purchases is one example; monitoring student participation in the district's meal program as low-cost menu options are introduced is another.

[8] This includes a $9.3 million payment toward the district's OPEB liability. This practice began in 2011 when the district established a trust in which it has committed to set aside 5% of all retiree health care claims annually, a level the district was confident in achieving on an annual basis. Since implementation, the district has exceeded the 5% contribution level, contributing $9.3 million in 2011 and $31.6 million in 2012. The amount contributed largely depends on the district's overall year-end fiscal status.

When looking at the district's overall budget, the loss of ARRA funds along with declining state aid generated a substantial reduction in budgeted expenditures in both 2012 and 2013. **Table 15** compares total expenditures in the 2012 and 2013 adopted budgets with 2011 actual amounts.

Table 15: Total MPS expenditures, 2011 to 2013

	2011	2012 Adopted Budget	2013 Adopted Budget
Expenditures	**$1,291,225,504**	**$1,179,533,511**	**$1,167,280,150**

Note: These figures do not include capital expenditures.
Source: MPS' 2013 proposed budget document; 2013 adopted expenditure provided by MPS budget staff

While MPS' 2012 and 2013 budgets benefited substantially from health care changes set in motion through the most recent teachers' union contract, those savings will become even more impactful in the 2014 academic year, assuming that the legality of Act 10 stands and that the changes announced in November 2011 are effectuated.

PEER ANALYSIS

SUMMARY OF PEER ANALYSIS

To provide a national perspective, we examined MPS' major revenue and expenditure characteristics in relation to other large school districts in the U.S. The data show that MPS' total spending was 17th among the 100 largest school districts in 2009 and 5th in its 11-member peer group in 2010.

The distribution of MPS' revenues and expenditures generally is more similar to its national peers than to other school districts in Wisconsin. Like many of its peers, MPS has higher funding per pupil than the statewide average, greater federal revenue per pupil, and a lower percentage of property tax support.

In terms of expenditures, MPS had the second-lowest expenditures per pupil for salaries when compared to its peers, yet the second-highest expenditure per pupil for employee benefits. Benefits also comprised a larger share of MPS' total expenditures than any of the other districts. MPS ranked 6th among its peers in total employee compensation per pupil in 2010.

This section also includes a brief comparative analysis of MPS' business operations. The data is from the Council of Great City Schools' (CGCS) 2012 report, *Managing for Results,* which examines performance on 76 indicators for member districts. Business operations examined include procurement, cash and financial management, human resources, food services, and transportation. MPS' performance on these indicators varies but is generally close to the all-district median.

Until this point, this report has reviewed MPS' finances in their state context. Such a perspective is essential given that state financial policies, funding formulae, and programs greatly affect MPS' fiscal condition, and that state funding comprises more than one half of the district's revenues.

Yet, despite the state's central role in MPS finances, it would be inappropriate to leave the analysis so narrowly confined. There is no other district in Wisconsin that is like MPS in terms of size, student characteristics, program diversity, and financial complexity. Only outside Wisconsin does one find districts that resemble MPS. It is logical to ask, therefore, whether other large, urban school districts have financial features and challenges that resemble those of MPS, and whether reviewing MPS finances in relationship to its true peers might yield further understanding about the district's fiscal profile and condition.

Table 16 presents a general overview of MPS in comparison with the nation's largest school districts. The information in the table comes from the most recent National Center of Educational Statistics publication on the finances of the nation's 100 largest school districts and is for the 2008-09 school year and 2008 fiscal year (i.e. 2007-08). As shown, MPS ranked as the 37th largest school district in terms of enrollment, while the City of Milwaukee has the 28th largest population in the U.S. Between 2003 and 2009, MPS fell from the nation's 29th to its 37th largest school district due to declining enrollment.

As the table demonstrates, there was a tremendous range in per-pupil spending among the 100 largest school districts in 2008, ranging from $23,298 in Boston to $6,363 in Salt Lake City. MPS' per-pupil expenditures of $13,600 placed it 17th and $1,028 per pupil above the overall average for the group.

Table 16 also provides information about the distribution of instructional expenditures among the nation's largest school districts. It indicates that MPS spends slightly more on instruction as a proportion of total expenditures than the overall district average. In addition, MPS' instructional expenditures are distributed differently from most other large districts in that MPS spends less on teachers but more on instructional support personnel. It is important to note that these figures are from 2009 and that MPS' distribution of funding for teachers and instructional support staff has changed somewhat as a result of recent budget adjustments.

Table 16: **MPS and 100 largest school districts - General overview, 2008-09 school year**

	Students	Per Pupil Expenditure*	Instruction % of Total Exp.*	Teaching FTEs	Pupil/ Teacher Ratio*	FTE Staff - % Teachers	FTE Staff - % Inst. Support
MPS characteristics	*85,381*	*$13,600*	*53.2%*	*5,158*	*16.1*	*47.5%*	*18.5%*
rank	*37th*	*17th*	*32nd*	*40th*	*60th*	*76th*	*6th*
1st district	981,690	$23,298	65.0%	71,824	12.7	88.7%	21.4%
100th district	47,448	$6,363	30.8%	2,098	22.8	28.6%	0.0%
overall average	71,554***	$12,572	52.8%	7,101	15.4	52.3%	9.4%

* 2007-08

Source: NCES, Characteristics of the 100 Largest Public Elementary and Secondary School Districts in the United States, 2008-09

MPS has a greater percentage of special needs students and minority students than many other large school districts in the U.S. As shown in **Table 17**, MPS ranked 4th in the proportion of students with an Individualized Education Program, or IEP (mandated by the federal government for special education students). The district also ranked 11th in the percentage of students with Title I eligibility and 10th in the percentage of students who qualified for free or reduced-price lunch.

These student statistics have significant financial implications. In terms of resource demand and expenditures, they provide an indication of the district's substantial educational needs and justification of higher levels of spending. In terms of revenue, they show that MPS is likely to continue to be able to make a strong case to receive substantial state and federal funding from the large governmental programs serving disadvantaged and special needs students.

Table 17: **MPS and 100 largest school districts*– Student characteristics**

District	Title I eligible	Free lunch**	With IEPs	Minority***
MPS				
characteristics	*94.7%*	*76.7%*	*18.5%*	*84.9%*
rank	*11th*	*10th*	*4th*	*28th*
1st district	100.0%	91.4%	21.1%	99.9%
100th district	0.0%	7.5%	7.3%	12.4%
overall average	57.4%	55.9%	12.8%	71.1%

** 2008-09*
*** Includes reduced price lunch*
**** Total of combined Black, Hispanic, Asian, Native American and two or more race students*
Source: NCES, Characteristics of the 100 Largest Public Elementary and Secondary School Districts in the United States, 2008-09

For comparative financial analysis, we turn to the 10 school districts nationwide to which MPS compares itself, and for which 2009-10 data has just become available from the U.S. Census' Public Education Finances Report. MPS' peers are urban districts. They range in enrollment from Indianapolis's 33,372 students to Detroit's 90,499 students. Many of the districts are in the Midwest and Northeast. Most have a high level of minority and special need students.

Comparing individual districts of any size across state boundaries is difficult because of the different funding structures and levels of support for public education that exist in each state. What may appear to be a difference among individual districts may actually reflect the influence of state, as opposed to local, policies and practices. States vary greatly in their funding of public education. For example, in 2010, state funding per pupil in Vermont equaled $14,625, while in Florida it was $3,127. In focusing on the finances of the peer districts, therefore, we show how each peer compares not only with one another, but also with other districts in its state. This methodology is followed for total spending, as well as federal, state, and local revenue.

One of the distinctive fiscal features of MPS is its relatively high level of spending when compared to other Wisconsin districts. In 2010, MPS ranked 55th out of 424 districts in Wisconsin in per-pupil spending. As shown in **Table 18**, MPS' peers exhibited this same fiscal pattern. With the exception of Fort Worth, all districts exceeded their state average of spending per pupil, some by many thousands of dollars. MPS ranked fifth among the 11 districts in the difference between district and state average spending.

Table 18: National peers – Spending for districts and their states

District	Spending Per Pupil		
	District	State Average	Difference
Newark	$22,391	$16,841	$5,550
Indianapolis	$14,032	$9,611	$4,421
Boston	$17,784	$14,350	$3,434
Cleveland	$13,963	$11,030	$2,933
Milwaukee	***$14,038***	***$11,364***	***$2,674***
Detroit	$12,801	$10,644	$2,157
Cincinnati	$13,037	$11,030	$2,007
Denver	$9,930	$8,853	$1,077
Baltimore	$14,711	$13,738	$973
Oakland	$9,582	$9,375	$207
Fort Worth	$8,641	$8,746	($105)

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

MPS' higher level of expenditures in Wisconsin is caused, in part, by the large inflow of federal dollars to the district. MPS is similar to its national peers in this way. As shown in **Table 19**, all of MPS' peers had federal revenue per pupil in 2010 that exceeded the federal revenue per pupil average in their state. Across the U.S., federal monies constituted 12.5% of all school district revenue in 2010, a funding proportion that all MPS peers exceeded. Compared with its peers, MPS ranked fourth in federal revenue as a percentage of total revenue, at 20.5%. It also placed fourth in the per-pupil difference between its federal revenue and the average federal revenue received by all districts in the state.

Table 19: National peers – Federal revenue for districts and their states, 2010

District	Federal Revenue		Federal Revenue Per Pupil		
	Total	% of Total Revenue	District	State Average	Difference
Newark	$211,497,000	19.3%	$5,362	$1,743	$3,619
Indianapolis	$164,521,000	22.6%	$4,930	$1,440	$3,490
Cleveland	$163,912,000	18.3%	$3,387	$1,384	$2,003
Milwaukee	***$259,642,000***	***20.5%***	***$3,163***	***$1,290***	***$1,873***
Detroit	$287,377,000	24.3%	$3,175	$1,564	$1,611
Cincinnati	$97,408,000	14.4%	$2,912	$1,384	$1,528
Baltimore	$213,503,000	15.8%	$2,576	$1,184	$1,392
Boston	$124,894,000	10.9%	$2,256	$1,176	$1,080
Denver	$129,150,000	13.5%	$1,671	$865	$806
Fort Worth	$186,710,000	22.3%	$2,328	$1,689	$639
Oakland	$88,869,000	17.2%	$1,928	$1,582	$346

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

MPS' comparatively higher level of *state* funding is a revenue feature that is not characteristic of its peers. As shown in **Table 20**, only three other districts had a level of state funding that exceeded their state's average.

Table 20: National peers – State revenue, 2010

District	State Revenue % of Total Revenue	
	District %	State Average %
Newark	70.1%	35.1%
Baltimore	66.3%	41.6%
Cleveland	58.2%	44.2%
Milwaukee	***53.0%***	***44.8%***
Detroit	52.0%	52.7%
Oakland	49.3%	52.6%
Indianapolis	48.5%	53.5%
Cincinnati	34.8%	44.2%
Fort Worth	34.4%	37.5%
Denver	27.9%	43.7%
Boston	22.6%	41.6%

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

Table 21 shows that the reliance of many peers upon local revenue correlates with their community's economic position in their state. For example, Newark, whose median family income of $38,632 was $45,915 below the state's median, had the lowest proportion of local revenue at 10.6%. School districts in Baltimore, Cleveland, Milwaukee and Detroit, all of which have median family incomes much lower than their state average, followed Newark in being less reliant upon local revenue. Some districts, such as Cincinnati, Denver, and Boston, departed from this pattern.

Table 21: **National peers – Local revenue compared with gap between district and state family income, 2010**

District	Local Revenue % of Total Revenue	Family Median Income		
		District*	State	Difference
Newark	10.60%	$38,632	$84,547	$45,915
Baltimore	17.80%	$47,046	$84,452	$37,406
Cleveland	23.50%	$32,357	$58,566	$26,309
Milwaukee	***26.50%***	***$40,155***	***$63,858***	***$23,703***
Detroit	23.70%	$31,946	$58,376	$26,430
Oakland	33.50%	$57,722	$67,874	$9,962
Indianapolis	29.00%	$51,673	$57,617	$5,944
Fort Worth	43.20%	$56,459	$57,998	$1,539
Cincinnati	50.90%	$44,007	$58,566	$14,559
Denver	58.60%	$57,309	$69,515	$12,206
Boston	66.50%	$60,240	$80,734	$20,494

** Based on city income*

Sources: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012; U.S. Census, American Community Survey, 2007-10 average

Turning to expenditures, MPS ranked eighth among its peers on the key measure of the percentage of spending devoted to instruction, as shown in **Table 22 (**although the peer districts are closely bunched). **MPS had the lowest percentage of its expenditures devoted to salary** and is among a group of districts with salary expenditures per pupil in the $6,000 range, as

shown in **Table 23**. A number of peer districts have much higher salary expenditures per pupil. Because the most recently available data from the Census Bureau is 2009-10 data, these rankings reflect MPS' comparative position prior to the passage of Act 10 and the 2011-13 biennial budget.

Table 22: **National peers – Instruction and support service expenditures, per pupil 2010**

District	Instruction Expenditures Per Pupil	Instruction Expenditures % of Total	Support Services Expenditures Per Pupil	Support Services Expenditures % of Total
Cleveland	$8,043	61.6%	$5,406	33.1%
Baltimore	$8,750	59.5%	$5,472	37.2%
Newark	$11,637	59.1%	$10,046	37.7%
Boston	$9,840	58.6%	$7,184	36.9%
Cincinnati	$6,854	57.3%	$5,783	37.9%
Fort Worth	$4,944	56.2%	$3,309	37.6%
Detroit	$7,195	55.7%	$5,208	40.3%
Milwaukee	***$7,869***	***55.0%***	***$5,648***	***39.5%***
Oakland	$5,335	52.6%	$3,929	38.8%
Indianapolis	$7,469	52.6%	$5,993	42.2%
Denver	$5,202	50.6%	$4,371	42.5%

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

Table 23: National peers – Salary, benefits and total compensation, 2010

District	Salary Expenditures % of all Spending	Salary Expenditures $ per Pupil	Benefit Expenditures % of all Spending	Benefit Expenditures $ per Pupil	Total Compensation % of all Spending	Total Compensation $ per Pupil
Baltimore	56.2%	$8,273	21.7%	$3,188	77.9%	$11,461
Boston	58.1%	$11,301	15.7%	$3,048	73.8%	$14,349
Cincinnati	48.9%	$7,470	18.3%	$2,786	67.2%	$10,255
Cleveland	55.7%	$9,105	19.9%	$3,249	75.6%	$12,354
Denver	65.4%	$6,730	9.0%	$925	74.4%	$7,655
Detroit	53.3%	$6,884	24.6%	$3,180	77.9%	$10,064
Fort Worth	71.9%	$6,320	10.5%	$919	82.4%	$7,239
Indianapolis	58.1%	$8,255	24.1%	$3,425	82.2%	$11,680
Milwaukee	***47.2%***	***$6,754***	***30.0%***	***$4,287***	***77.1%***	***$11,041***
Newark	55.1%	$14,680	17.5%	$4,664	72.7%	$19,344
Oakland	54.2%	$5,492	21.9%	$2,220	76.1%	$7,712

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

The amount of money MPS spends on employee benefits has been an area of concern discussed in this report, as our research has shown that MPS' employee benefits are high when compared with other districts in Wisconsin. **Table 23** demonstrates that in 2010, MPS' benefit expenditures also were high when compared with national peers. **Indeed, on a percentage basis, MPS spent more on employee benefits (30%) than any other peer district**. Only four districts spent more than 20% of their total dollars on employee benefits. On a per-pupil basis, MPS' high spending on employee benefits also stands out, with the district's $4,287 per-pupil in 2010 ranking second to Newark and more than $800 per pupil higher than the next district, Indianapolis.

Taken together, MPS' high spending on benefits offsets its low spending on salaries so that the district ranked sixth among its peers in 2010 in total compensation expenditures per pupil. The district ranked fifth in the percentage of its spending allocated to compensation. Total compensation expenditures varied greatly among the group, from Newark's $19,344 per pupil to Denver's $7,655, and from 82.4% of total spending in Fort Worth to 67.2% of total spending in

Cincinnati. Whether MPS' place relative to its peers would differ if more recent data were available is uncertain; however, as shown in this report, the district has significantly changed the ratio of salary to benefits over the past two years.

When examined in its statewide context, MPS often seems somewhat unique – not only in its general characteristics, such as the size of student enrollment and the number of buildings and staff, but in its financial profile, such as in the distribution of revenues and expenditures. **The above analysis shows that with the exception of fringe benefits spending, when examined in a national context, MPS seems less distinctive**.

Indeed, from this perspective, it becomes more apparent that MPS' fiscal structure reflects, in part, the influx of higher levels of federal funding available nationally to support the education of disadvantaged and special need students in urban districts. Also, the peer analysis illustrates that MPS' low level of local funding is not unusual for large districts in cities with high concentrations of poverty, though its state revenue represents a greater proportion of its total funding than most of its national peers.

Business operations

This brief comparative analysis of MPS business operations is drawn from data gathered by the Council of Great City Schools (CGCS). The CGCS is an organization that is comprised of 67 of the country's largest urban school districts. It includes many of MPS' peers discussed above. The organization focuses on legislation, research, member services, and the dissemination of information pertinent to urban education.

CGCS has published data on business services and operations for the past 10 years under its performance measurement and benchmarking project, *Managing for Results in America's Great City Schools*. Developed in conjunction with the membership's business officers, this information system is intended to help urban school systems measure the effectiveness, efficiency, and service levels of non-instructional operations and departments.

The data below is from CGCS' 2012 report on *Managing for Results,* which cites school district performance with regard to 76 indicators. A total of 61 of CGCS member districts submitted information for this report, although not necessarily for each performance indicator. We focus here on a handful of select "Power Indicators," strategic and policy-level measures intended for review by superintendents and school boards to provide "an important view of the overall performance of the non-instructional operations of school districts."

The following results should be reviewed with caution. They present a single-year snapshot, and while some indicators do not change much from year to year, others can show a wide variation. In addition, results for indicators that have a higher level of respondents are more statistically sound than indicators for which only a few districts have reported results.

The performance metrics in **Table 24** provide information on how MPS compares to other school districts in terms of cost efficiency, productivity, and services in several key administrative areas.

Table 24: Administrative indicators

Indicator	Responses	MPS Rank*	Median
Purchasing department costs as % of dollars spent	48	7th (0.19%)	0.5%
Cost per purchase order	48	5th ($18.18)	$46.33
Reserves as a percentage of general fund revenues	41	23rd (11.29%)	12.57%
Debt service payments per $1,000 in general fund revenues	27	13th ($24.08)	$26.65
Staff turnover rate	43	25th (9.7%)	8.96%
Meals per labor hour	50	20th (21.9)	19.8
Transportation cost per mile operated	36	20th ($4.41)	$4.31

**In descending order, best to worst*
Source: Council of Great City Schools, Managing for Results in America's Great City Schools, A Report of the Performance Measurement and Benchmarking Project, 2012

The following briefly summarizes MPS' performance in these indicators:

- **Procurement** – MPS ranked near the top of the 48 districts that responded in purchasing department costs as a percentage of dollars spent and cost per purchase order.

- **Cash and Financial Management** – MPS reserves were at 11.29% of general fund revenues, which placed the district just below the all-district median of 12.57%. Meanwhile, MPS ranked just above the median on CGCS' measure of debt burden at $24.08, which represents the amount of debt service payments on long-term debt obligations per $1,000 in general fund revenues.

- **Human Resources** – MPS' turnover rate for full-time classroom teachers of 9.7% was slightly below the all-district median of 9%.

- **Food Service** – Meals per labor hour, according to CGCS, is a common productivity standard of the food industry. MPS ranked 20th out of 50 responding districts, with 21.9 meals per labor hour. The median among respondents was 19.8.

- **Transportation** – A key "summative measure" is cost per total mile operated. MPS ranked 20th among 36 respondents at $4.41, which was just above the median of $4.31.

Given the large number of indicators provided in the CGCS report, it is difficult to summarize MPS' performance. Generally, the district was around the peer median for most indicators, including most of those selected for presentation above.

CASH SOLVENCY

Analyzing cash solvency with the ICMA system

Cash solvency refers to the ability of a government to pay its bills. Two ICMA measures for cash solvency pertain to liquidity and general fund balance. Liquidity examines the flow of money in and out of the treasury. If revenues are on hand to cover expenditures, a government has positive liquidity or cash flow. A positive fund balance, meanwhile, provides an indication of a government's ability to maintain cash solvency, as well as to meet unanticipated emergencies.

Analysis

In the years under review, MPS' cash position deteriorated. Trends in liquidity and cash balance were negative, as shown in **Indicators 7** and **8**. Cash and short-term investments remained steady, but accounts payable and other current liabilities increased each year, which produced a deteriorating liquidity ratio. Throughout this period, annual accounts payable and other current liabilities always exceeded non-restricted cash and investments.

To meet cash flow demands, MPS borrows funds on a short-term basis. Such financing is common for school districts because state revenue is received after the start of the fiscal year, which requires many school districts to use short-term obligations to pay for current operating expenditures as they await state funds. For example, the City of Milwaukee issued $50 million of commercial paper for MPS for this purpose in September 2010 and $45 million in October 2010. The entire $95 million was paid back in June 2011 from the district's state equalization aid payment.

ICMA Fiscal Indicator 7 – Liquidity

Why it is Important – A key measure of short-term fiscal condition is liquidity. ICMA defines liquidity as the ratio of non-restricted cash and short-term investments to current liabilities. Assessing liquidity is complicated by the flow of payments in and out of an institution's coffers in the course of the year. For this reason, evaluation of liquidity should take place at the same point in time, as we do here.

ICMA Warning Sign –

- A decreasing amount of cash and short-term investment as a percentage of current liabilities.
- Three or more years of a ratio of greater than 1 to 1.

MPS Finding – MPS' liquidity ratio has deteriorated in the years under review as cash and short-term investments stayed in the $60 million range, but accounts payable and other current liabilities rose from $63 million in 2007 to $82 million in 2011. Accounts payable and other current liabilities exceeded cash and short-term investments in each year. These are **negative indicators** of fiscal health under ICMA criteria.

Liquidity ratio

Year	Ratio
2007	1 to 1.1
2008	1 to 1.1
2009	1 to 1.2
2010	1 to 1.2
2011	1 to 1.4

Source: MPS CAFRs, 2007 to 2011

MPS' general fund balance declined from 2007 to 2011. Reserves dropped from $110.6 million in 2007 to $98.2 million in 2008, and then fell by an additional $6.6 million in the next three years. The general fund balance now represents a smaller percentage of operating revenues, dropping from 9.8% in 2007 to 7.2% in 2011.

For additional perspective, we consulted the annual financial reports of peer school districts and local governments to determine the relationship between their general fund ending balance and general fund revenues. We found that the 2010 balance represented 32% of revenues in Cincinnati, 9% in Denver, and 6% in Baltimore. Cleveland's public school district had a negative balance of $21 million and general fund revenues of $624 million in 2010.

Among an expanded group, MPS' general fund ending balance was very close to the median ending balance of the 41 large urban school districts that reported this information to the Council of Great City Schools.

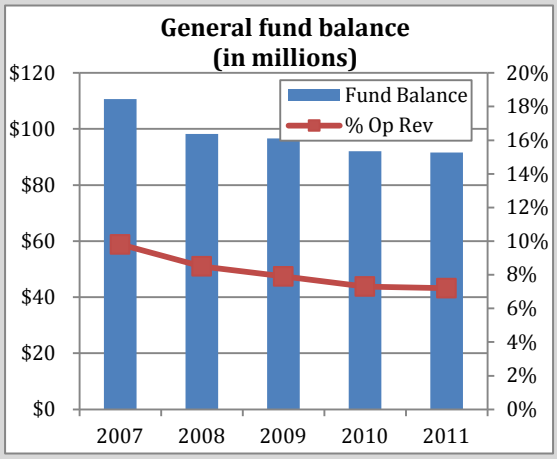
Finally, we note that in 2010, MPS' ending balance of 7.3% of general fund revenues was about midway between the City of Milwaukee's ending balance of 9.9% and Milwaukee County's at 4.3%.

ICMA Fiscal Indicator 8 – Fund Balance

Why it is Important – Fund balances are a form of financial reserve that affect a government's ability to meet unanticipated costs and emergencies.

ICMA Warning Sign – Declining general fund balance as a percentage of net operating revenues.

MPS Finding – From 2007 to 2011, MPS' general fund balance fell by 17%, from $110.6 million in 2007 to $91.6 million in 2011. As a result, the general fund balance represents a smaller proportion of operating revenues, dropping from 9.8% in 2007 to 7.2% in 2011. Under the ICMA methodology, this is a **negative indicator** of fiscal health.



Source: MPS CAFRs, 2007 to 2011

LONG-TERM BUDGETARY SOLVENCY

Analyzing long-term budgetary solvency with the ICMA system

The ICMA system is an excellent tool for examining long-term solvency, an inherently complex topic. Central to ICMA's methodology is the question of whether a government is "currently paying the full cost of operating, or is it postponing costs to a future period when revenues may not be available to pay these costs." To address this question, the ICMA format explores four areas that can have a major effect on future spending levels: OPEB, pensions, long-term borrowing, and capital assets. It also examines the cumulative impact of all fiscal pressures upon long-term budget solvency.

SUMMARY OF LONG-TERM SOLVENCY FINDINGS

MPS' five-year fiscal outlook is about to show substantial improvement with the expected implementation in the 2013-14 school year of major health care changes that will produce both immediate budgetary relief and a projected $1.4 billion reduction in the district's long-term OPEB liability. MPS also will save considerable sums on pension costs upon the expiration of existing labor agreements.

Meanwhile, a new facilities master plan holds some promise in reducing the district's ongoing repair and replacement needs, and MPS' long-term debt – while showing some downward movement in terms of debt indicators during the past five years – is well within acceptable standards for governmental entities.

MPS' current modeling shows a five-year structural deficit of about $41 million, which poses a considerable challenge, but which actually is less daunting than the comparable outlook for Milwaukee's city and county governments. Nevertheless, MPS faces unique circumstances not experienced by those governments – including a responsibility to meet state and federal standards pertaining to academic achievement – that continue to raise serious questions about its long-term fiscal prospects.

Health care costs and obligations

As discussed earlier in this report, MPS initiated a series of comprehensive health care changes in November 2011 that were designed to address both immediate budget challenges and the district's ominous $2.8 billion OPEB liability. To address the latter, the school board approved an increase in the age and years of service necessary to become eligible for retiree health benefits, as well as an increase in the level of sick leave balance needed at retirement to become eligible for a district-subsidized benefit. Changes also included dramatic adjustments to plan design for both retirees and active employees that were intended to produce both sizable short-term savings and a long-term reduction in the OPEB liability. While adopted late in 2011, most of these changes will not take effect until the 2014 budget, when existing union contracts will expire.

Tables 25, 26 and **27** outline the substantial changes to MPS' health care plan design and employee premium contributions that will take effect in the 2014 (assuming Act 10 is not reversed by the courts). The district anticipates these changes will save an average of $34.7 million annually in active and retiree health care costs and reduce the district's OPEB liability by half, to $1.4 billion.

Table 25: MPS EPO plan design changes
(Approved in November 2011 and effective following expiration of current labor contracts)

	Current		New (Approved November 2011)	
	Per person	Family (3+ individuals)	Per person	Family (3+ individuals)
Annual deductible	$50/person	$150/family	$350/person	$1,050/family
Co-insurance after deductible	90%	90%	80%	80%
Out-of-pocket maximum	$150/person	$450/family	$1,000/person	$3,000/family
Office visit co-pays	$10	$10	$20	$20
Emergency room	$50	$50	$125	$125
Preventive care	100%	100%	100%	100%

Source: "MPS health care benefits: Changes approved November 2011" brochure

Table 26: MPS PPO plan design changes
(Approved in November 2011 and effective following expiration of current labor contracts)

	Current				New (Approved November 2011)			
	Per person		Family (3+ individuals)		Per person		Family (3+ individuals)	
	In network	Out of network	In network	Out of network	In network	Out of network	In network	Out of network
Annual deductible	$75/ person	$326/ person	$225/ family	$500/ family	$750/ person	$1,500/ person	$2,250/ family	$4,500/ family
Co-insurance after deductible	90%	70%	90%	70%	80%	50%	80%	50%
Out-of-pocket maximum	$200/ person	$600/ person	$600/ family	$2,800/ family	$2,500/ person	$3,000/ person	$7,500/ family	$9,000/ family
Office visit co-pays	$10	70%	$10	70%	$20	50%	$20	50%
Emergency room	$50	$50	$50	$50	$150	50%	$150	50%
Preventive care	100%	70%	100%	70%	100%	50%	100%	50%

Source: "MPS health care benefits: Changes approved November 2011" brochure

Table 27: MPS annual health care premiums and employee contributions
(Approved in November 2011 and effective following expiration of current labor contracts)

	EPO		PPO	
	Single	Family	Single	Family
Premium cost	**$6,347**	**$16,658**	**$9,644**	**$21,318**
Income level				
$25,000 or below	5%		11%	
$25,001 - $50,000	8%		12%	
$50,001 - $75,000	10%		13%	
$75,001 and above	12%		14%	

Source: "MPS health care benefits: Changes approved November 2011" brochure

In June 2012, MPS made one additional change requiring part-time workers to work 30 hours per week to receive health care benefits, as opposed to the current 20. The district projects this initiative will save an additional $3.9 million annually. Collectively, MPS projects the health care changes made in 2010, 2011 and 2012 will save more than $80 million annually, surpassing those originally thought possible by the McKinsey study.

Table 28 provides additional perspective by comparing MPS' new health care benefit levels and contributions to those provided by the State of Wisconsin, Milwaukee County and the City of Milwaukee. The premium for MPS' EPO plan is one of the least costly shown. EPO deductibles also are relatively low, though the state's equivalent plan has no deductible. MPS' single PPO premium is one of the more costly single plans offered among the plans listed. MPS' family PPO plan, on the other hand, is less expensive than that of the city, county and state. This family plan also has the highest deductibles and out-of-pocket maximums when compared to all other family plans.

Table 28: Comparison of health care benefit premiums, employee contributions and plan design

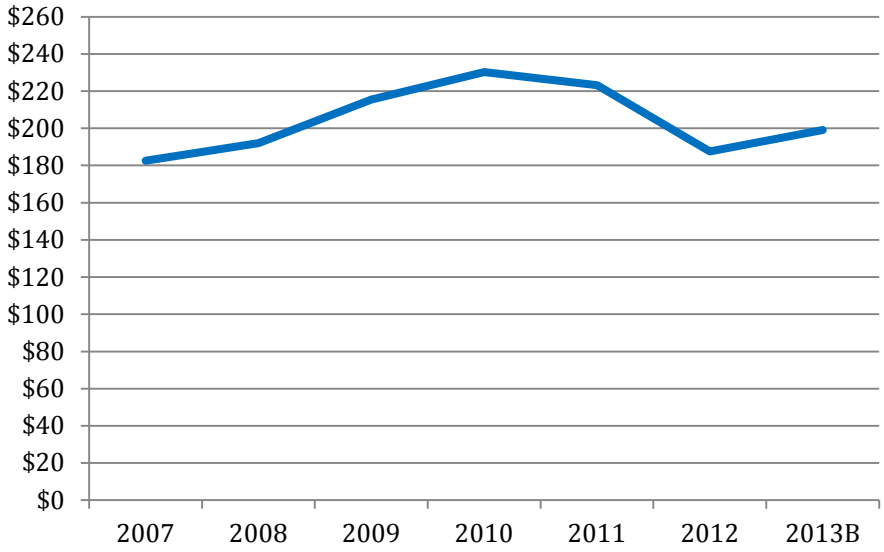
	State of Wisconsin HMO	State of Wisconsin PPO*	Milwaukee County PPO* **	City of Milwaukee EPO	City of Milwaukee PPO*	MPS EPO (Nov. 2011 changes)	MPS PPO* (Nov. 2011 changes)
Total monthly premium cost * **							
· Single	$724****	$866	$584	$537	$655	$529	$804
· Family	$1,806****	$2,161	$1,996	$1,610	$1,964	$1,388	$1,777
Employee premium contributions							
· Individual employee	$85	$230	$100	$54	$69	$26 - $63	$88 - $113
· Employee + children			$125	$87	$108		
+ spouse	$211	$575	$200	$109	$137	$69 - $167	$195 - $249
+ family			$225	$173	$216		
Elements of plan design							
· Single deductible	$0	$200	$800	$500	$750	$350	$750
· Family deductible	$0	$400	$1,850	$1,000	$1,500	$1,050	$2,250
· Co-insurance after deductible	90%	90%	80%	90%	90%	80%	80%
· Single out-of-pocket maximum	$500	$800	$2,500	$1,000	$1,500	$1,000	$2,500
· Family out-of-pocket maximum	$1,000	$1,600	$5,000	$2,000	$3,000	$3,000	$7,500
· Emergency room	$75	$75	$200	90%	90%	$125	$150

** PPO comparisons only provide elements of the in-network plan design.*
***Milwaukee County is the only entity listed that also provides an employer contribution to employees' flexible spending accounts (FSAs). In 2013, the county will make FSA contributions of $600 for employees with individual insurance plans and $1,800 for employees who are enrolled in family plans.*
**** The city and the county have four-tiered plan structures, which include different cost structures for individuals, employees plus dependents, employees plus spouse, and families. This table only provides total premium comparisons between the single and family plan components.*
***** The state offers multiple options for its Tier 1 HMO plan. For comparison purposes, we report the lowest cost Tier 1 plan offered in Milwaukee County. If we were to use the more expensive Tier 1 plan, the state's relative position as compared to the other government entities would be unchanged.*
Source: Wisconsin Department of Employee Trust Funds "It's Your Choice: 2013 Decision Guide"; Milwaukee County Employee Benefits Division staff; City of Milwaukee Department of Employee Relations, "2013 Rate Chart for Active Employees"; "MPS health care benefits: Changes approved November 2011" brochure

When the new plans take effect, a teacher making the district's 2011 average salary of roughly $57,000 will have a choice between paying $139 (a 10% employee premium contribution) per month for an EPO family plan or $231 (a 13% employee premium contribution) per month for a PPO family plan. This is a stark contrast from just a couple of years ago, when employees had access to both plans at no premium cost.

Chart 12 illustrates MPS' recent progress in curbing the sharp upward trajectory of its health care costs. The chart shows that even before MPS' major union contracts expire and the changes adopted in November 2011 are applied to all employees, the district has been able to reduce its costs in dramatic fashion.

Chart 12: MPS health care spending, 2007 through 2013 (budgeted)



Source: MPS financial records; annual special OPEB payments removed for purposes of this figure

These substantial changes to health care plan design and premium rates – plus changes to benefit eligibility – have made a substantial dent in the district's long-term liabilities as well, according to district projections. As noted previously, the OPEB liability now stands at $1.4 billion according to MPS' most recent actuarial report, dated August 2012. This represents a 50% reduction from the $2.8 billion liability that existed under the previous set of benefits.

For comparison purposes, **Table 29** compares MPS' previous and recently calculated OPEB liability with recent OPEB liability estimates for Milwaukee County and the City of Milwaukee. Prior to the recent changes, MPS' unfunded OPEB liability equaled those of the other two governments combined. Assuming that the 2013-14 changes take effect, however, MPS will be comparable to those other entities. It should be noted that the Milwaukee County estimate was calculated prior to adoption of significant health care benefit reductions in the last two budgets.

Table 29: Unfunded OPEB liability comparison between MPS, Milwaukee County and City of Milwaukee

	Payroll	Unfunded OPEB liability (UAAL)	UAAL as % of payroll
MPS (old actuarial projection)	*$538,200,000*	*$2,759,100,000*	512.65%
Impact of benefit changes		**-49.8%**	
MPS (new actuarial projection)	$489,000,000	$1,384,100,000	283.0%
Milwaukee County	$97,620,000	$1,465,159,000	1500.9%
City of Milwaukee	$384,158,100	$916,383,400	238.5%
MPS as % of combined totals	***50%***	***37%***	
MPS rank	***1***	***2***	**2**

Source: MPS' projected valuations are taken from OPEB actuarial reports dated June 2010 and August 2012; Milwaukee County's projected valuations are from its actuarial report dated April 2011 and its 2011 CAFR; City of Milwaukee's projected valuation is taken from its actuarial report dated July 2012. These are the most updated reports available for each entity.

This significant potential improvement to the district's long-term OPEB liability also will benefit it in the short-term. As shown in **Table 30**, the district's annual payments to support retiree health care costs – which comprise the bulk of its OPEB liability – will shrink substantially as a result of recent changes. It is important to note that MPS funds these costs largely on a "pay-as-you-go" basis, as opposed to doing so on an actuarially determined pre-funding basis similar to the manner in which pension liabilities are funded. Consequently, the retiree health care obligation is not as large in the near-term as it would be if it was entirely pre-funded, but it will instead extend over a much longer horizon.

Table 30: Annual MPS expected employer contributions for retiree health care and other OPEB liabilities (in millions)

	Fiscal year					5-year % Change
	2013	2014	2015	2016	2017	
Old actuarial projection	$89.4	$97.5	$106.1	$114.8	$124.0	39%
New actuarial projection	$59.6	$66.4	$68.7	$70.1	$71.8	20%
Difference	***($29.8)***	***($31.1)***	***($37.4)***	***($44.7)***	***($52.2)***	

Note: Projections do not include possible payments to the OPEB Trust.
Source: MPS' employer contributions are taken from OPEB actuarial reports dated June 2010 and August 2012

MPS' potential reduction in its long-term and annual retiree health care costs is substantial and bolsters its long-term fiscal outlook. Nevertheless, the annual employer contribution of more than $70 million by 2017 still is immense, and that contribution is expected to continue to grow over time. In addition, it is important to note that as MPS' workforce further declines, the OPEB liability will be spread across a smaller base of active employees, thus causing the impact to grow substantially when calculated as a percentage of employee salaries. The MPS board currently is considering further action to eliminate retiree health care for new employees, an action that Milwaukee County took several years ago but that the city has yet to take. A decision to do so would "cap" the liability and stop its continued growth after several decades.

Pension

MPS' total pension costs increased from $73 million in 2007 to $102.7 million in 2011, or 41%. The 2011 pension cost included a $62 million payment to the Wisconsin Retirement System (WRS), $6 million to the City of Milwaukee employee retirement system, $19 million to the district's early retiree supplemental pension funds, and a $15 million pre-payment for the 2012 contribution to those supplemental funds. Without that pre-payment, pension costs rose by roughly 20%, or an average of 5% annually.

While most district employees participate in the WRS, certain classified positions participate in the city's retirement system. For WRS, eligible district employees are immediately vested and employees who retire at or after age 65 are entitled to benefits. Early retirement is permitted at age 55 with a reduced benefit. Retiree benefits are based on a formula multiplier (1.765% for pre-2000 service and 1.6% for post-1999 service) that takes into account years of service and 70% of average earnings in the highest three years of pay.

Act 10 requires all employees who participate in the WRS to pay the employee share of pension contributions. For MPS, however, this provision cannot be fully applied until the expiration of existing union contracts. Consequently, the district continues to pay the employee share on behalf of teachers and psychologists. Through 2012, the district has saved $2.5 million on the WRS participants to whom the new requirement has been applied, and it expects to save an additional $36 million through 2014 once the requirement is fully applied to all employees.

In addition to these pension plans, the district has two single-employer, defined benefit supplemental pension plans for early retirees, one for school directors and the other for teachers. The plan for school directors, however, was closed in 2003, and under a change adopted as of March 2012, the teachers' plan also is now closed to future participants, thus capping a substantial liability for the district.

Despite these recent improvements in MPS' long-term pension liabilities, it also is important to recognize that the district, like other employers that participate in the WRS, must operate under the threat of higher pension contributions should WRS investments not achieve their actuarially projected growth. While the WRS is one of the healthiest public pension systems in the country, a few poor years of stock market performance could produce the need for increased employer contributions that could erode some or all of the savings realized under Act 10.

Capital assets

Capital facilities and costs are an integral part of long-term solvency since the development, operation, and financing of capital facilities require a sustained effort over many years. Governments must ensure that capital expenditures are aligned with current and developing program needs, and they must maintain assets in proper condition. Failure to provide adequate upkeep not only reduces the value and usefulness of the asset, but also can lead to higher long-term capital costs. Nevertheless, as ICMA has observed, many governments have not been willing to fully fund such costs and have discovered that underfunding capital assets is "a relatively painless way to temporarily reduce expenditures and ease financial strain."

MPS' capital assets currently are valued at $1.1 billion, or $638 million after deducting for accumulated depreciation and amortization. This sum reflects the total value of MPS' school buildings, as well as administrative, support, and recreational facilities. Many of these facilities are aging. About 45% were built before 1940, and 48% were built between 1940 and 1980. Their average age, weighted by the size of the buildings, is 66 years.

According to the 15th Annual School Construction Report from *School Planning and Management Magazine*, MPS' schools have fewer pupils than most U.S. schools, a characteristic with fiscal implications since lower utilization rates generally are associated with higher operating costs per pupil. The School Construction Report also indicates that MPS has considerably more space per student than the average U.S. school. **Table 31** shows MPS' average enrollment and square footage per student for its elementary, middle and high schools compared to national medians.

Table 31: Average enrollment and square footage by school type

	Average School Enrollment		Average School Square Footage Per Student	
	National Median	MPS	National Median	MPS
Elementary Schools	700	459	125	162
Middle Schools	900	564	142	252
High Schools	1,600	984	156	292

Source: 15th Annual School Construction Report from School Planning and Management Magazine

As part of the development of its Master Plan, MPS staff conducted an extensive analysis of the physical condition of its facilities. The analysis concluded that "the total capital improvement need over the next 10 years is $1.26 billion, while the overall estimated portfolio replacement value is estimated to be $4.34 billion. Given these figures, the district FCI [Facility Condition Index] is 29% and is considered, for the most part, to reflect district-wide facilities in below average condition for a large urban district."

The Master Plan estimated MPS' capital needs for major maintenance replacement at $411 million, and for mechanical, electrical, and plumbing system modernization at $663 million. Included in those costs are $313 million for deferred maintenance expenditures.

To place these facility needs in context, the Master Plan applied the Facility Condition Index to other comparable districts. It found that "comparable assessments have ranged from 19% at Houston Independent School District following a 10-year bond program and $1.5 billion in spending, to 21% FCI at Miami-Dade County Public Schools, to 39% at Portland Public Schools, to a high of 80% at the Cleveland Municipal School District, where 92 of their 120 schools met the state's threshold for complete replacement."

To "right-size" its capital assets, MPS has formulated a 10-year facilities plan that includes recommendations for closing, upgrading, and repairing existing schools, as well as restructuring and relocating academic programs. The recommendations work off the facility condition

analysis, future enrollment projections, and academic planning. The plan estimates that enrollments will continue to fall in the next five years by 6,000 students, or 7.5%, with declines more pronounced in the central and eastern sections of the city.

In response to these anticipated enrollment changes, the district's Master Plan calls for the closing of 12 elementary schools (as well as the opening of two new elementary schools) and the closing of six to nine secondary schools over a 10-year period. MPS has estimated that school closings would save $1.5 million to $2 million annually for each comprehensive high school, $500,000 for each comprehensive middle school, and $400,000 to $600,000 for each elementary school.

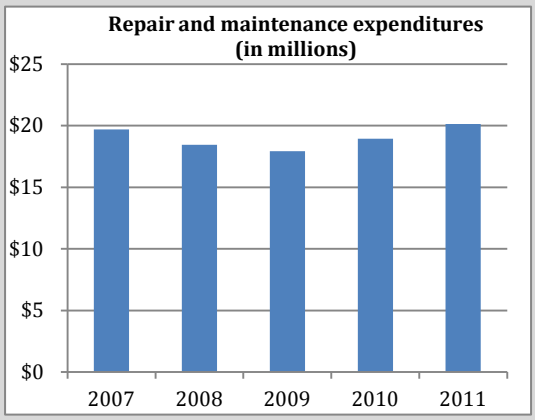
The Master Plan recommendations represent a departure from planning strategies pursued in the past decade that committed the district to maintaining a large capital footprint in the midst of enrollment declines. These efforts were undertaken for educational and financial reasons, and sought to increase the appeal of district facilities in the face of competition from voucher-funded private schools.

ICMA Fiscal Indicator 9 – Repair and Maintenance

Why it is important? – Repair and maintenance expenditures provide an indication of whether a government's capital assets are being addressed.

ICMA Warning Sign – A three-year or more decline in capital maintenance and repair expenditures.

MPS Finding – MPS repair and maintenance spending fluctuated from 2007 to 2011, at first declining and then increasing slightly. Over the five years, expenditures increased by only 2%, or less than the rate of inflation. Since inflation-adjusted expenditures declined, and given the age and condition of MPS facilities, this is an indicator that will **require monitoring** in the future.



Source: MPS financial records

The most important capital program at MPS in recent years was the Neighborhood Schools Initiative (NSI), initiated in 2000. The program was established by state legislation that permitted MPS to borrow state funds for expansion of its capital plant.

As described by MPS, the "goals of the Neighborhood Schools Plan were to improve parents' choices of neighborhood schools their children could attend and create desirable schools in every neighborhood." NSI resulted in three new buildings, 24 major facility renovations and additions, and six new science elementary education rooms. The initiative increased the district's enrollment capacity by 5,747 seats.

A different educational initiative, undertaken at about same time, also had implications for capital planning. In 2003, MPS released its *Blueprint for Milwaukee's New Vision High Schools* that called for the creation of 30 new high schools of fewer than 400 students each. The move to smaller high schools was part of a national effort by the Gates Foundation, which awarded MPS a $17 million grant to help implement the *Blueprint*. Nearly a decade later, MPS is no longer working to implement the *Blueprint*, but most of the district's high schools remain smaller than the national average.

As enrollments declined, MPS did close some schools throughout the district. Until recently, however, because of the influences described above, there was no overall capital strategy that recognized and responded to the reality that the district inevitably would need to substantially downsize its capital plant.

The district's annual expenditures on basic repairs and maintenance – which often are not included in estimates of capital improvement and major maintenance needs – are another barometer of its commitment to maintaining its capital assets. **Indicator 9** shows that MPS expenditure levels varied during the 2009-2011 timeframe but did not keep pace with inflation.

Long-term debt

MPS does not have capital financing authority. Rather, the City of Milwaukee issues debt for MPS, and the district reimburses the city for related debt service payments through the district's property tax levy. The total of these school bonds, notes, and capital lease obligations equaled $415 million through June 2011. About $57 million of that amount, however, represented bonds and notes that will be repaid by the city through its property tax. Actual MPS debt obligations were $358 million in 2011. **Indicator 10** portrays MPS' debt levels in a slightly different way, showing direct debt on a per capita basis.

ICMA Fiscal Indicator 10 – Long-term Debt

Why it is Important – Credit agencies routinely examine a local government's debt load in setting a bond rating. Increasing debt is one possible indication of a deteriorating fiscal condition. Conversely, low debt may indicate an underinvestment in capital facilities. Direct debt is bonded debt for which a local government has pledged its good faith and credit and which is supported by tax revenues. Overlapping debt includes MPS debt plus all bonded debt issued by other governmental units, such as Milwaukee County.

ICMA Warning Signs –

- Increasing direct debt or overlapping debt as a percentage of assessed valuation
- Overlapping direct debt exceeding 10% of assessed valuation

MPS Finding – In 2011, MPS' direct debt represented 0.09% of equalized valuation and $420 per capita. MPS borrowing increased in 2010 in order to refinance previous debt. Direct debt as a percentage of equalized value rose during this period because of these capital improvements and the drop in property value caused by the recession. Overlapping direct debt issued by all governmental units represented 6% of equalized value, substantially below the warning threshold. Despite some downward movement in long-term debt indicators during this period, MPS' debt profile is a **positive indicator** of fiscal health.

Year	Equalized Value*	Direct Debt*	% Equalized Value	Debt Per Capita
2007	$31,867,144	$190,596	0.06%	$316
2008	$32,238,573	$189,274	0.06%	$313
2009	$31,246,161	$192,857	0.06%	$319
2010	$29,500,535	$253,444	0.09%	$426
2011	$27,935,088	$250,846	0.09%	$420

** In thousands*
Source: MPS 2011 CAFR; City of Milwaukee Assessor's Office, 2011 Assessments and Taxes

MPS' greatest single long-term obligation is pension-related debt, which totaled $179 million in 2011, or about one half of MPS' long-term debt and 71% of its general obligation debt of $251 million. MPS converted its "soft" pension liabilities into "hard" debt service obligations in 2003 with the issuance (by the City) of $168 million in bonds to refund MPS' unfunded liabilities within the Wisconsin Retirement System. The State of Wisconsin and a number of local municipalities issued similar types of "pension obligation bonds" at that time.

MPS' other major capital debt is related to Neighborhood School Initiative bonds ($95 million outstanding in 2011) and school construction bonds ($49 million). The NSI debt is financed by revenue bonds issued by the Redevelopment Authority of the City of Milwaukee on behalf of MPS. A total of $112 million was issued for NSI in 2002 and 2003.

Because MPS does not issue debt, its financial condition is not evaluated by national credit rating agencies. Factors in the City of Milwaukee's credit evaluation are relevant to MPS, however, and the city's bond rating affects the district's borrowing costs. In addition, the ratings agencies consider the level of debt the city assumes on behalf of MPS in determining the city's bond rating.

In April 2012, Moody's downgraded the City of Milwaukee's credit rating from Aa1 to Aa2 but upped its financial outlook from "negative" to "stable." Moody's cited diminished revenue capacity as a prominent reason for the rating change, including "three years of consecutive declines in equalized valuation" and "reliance on state shared revenues, which declined in fiscal 2011 and 2012, [and represent] almost half of General Fund revenues." Moody's forecasted that the city was unlikely "to see any growth in state aid over the medium to long term, and these revenues will remain under pressure for the foreseeable future." Offsetting these negatives, according to Moody's, was the strong local economy and tax base, which make Milwaukee "the most populous urban center and economic hub of Wisconsin."

In regard to the city's internal finances, Moody's pointed out that Milwaukee's general fund reserve had dropped from its 2006 level. While noting that the city's debt burden is above "state and national medians," the rating agency concluded that its "debt burden will remain manageable given rapid principal amortization and support from the PDAF [Public Debt Amortization Fund] and other non-levy sources." The PDAF is a fiscal account against which the city can draw funds to avoid sizeable increases in the tax levy required to services its debt in a single year. At the end of 2010, the PDAF balance was at $63.1 million.

Table 32 shows the long-term debt of MPS' national peers. The table tracks all school-related debt, including the bond obligations incurred by the City of Milwaukee. Although MPS has the third-largest student enrollment among the 11-member group, it ranks seventh in long-term school debt. The range in debt is substantial, from Boston's $71.7 million to Detroit's $1.8 billion. Four districts have less than $200 million in debt and two have more than $1 billion.

Table 32: Long-term debt, MPS and national peers, 2010 (in millions)

District	Long-Term Debt
Detroit	$1,760.0
Denver	$1,027.4
Oakland	$733.9
Cincinnati	$732.8
Indianapolis	$709.2
Forth Worth	$690.8
MPS	***$416.7***
Cleveland	$179.4
Newark	$107.2
Baltimore	$96.1
Boston	$71.7

Source: U.S. Census Bureau, Governments Division Reports, Public Education Finances, 2010, Issued June 2012

Long-term budget prospects

There is little doubt that MPS will continue to be plagued by budgetary uncertainty for the foreseeable future. Because of the continued threat of declining enrollment and the volatility of the state budget, its revenue picture remains cloudy, at best. On the expenditure side, efforts to control health care costs should reap substantial benefits in the near term, but over the long term those costs are likely to rise again above the rate of inflation barring a dramatic reversal of nationwide health care trends.

Another major challenge for the district is unprecedented retirement levels expected to occur in 2013. The consequences of those departures must be monitored carefully, as a wealth of knowledge will leave the district, yet the desire and need for quality talent will remain. Similar to other local governments in Wisconsin, MPS will have to balance the flexibility and opportunities provided by Act 10 to control employee compensation costs on an ongoing basis with the need to maintain a quality workforce. Achieving the proper balance may be particularly difficult for MPS given the highly competitive environment in which it operates.

The state's 2013-15 biennial budget – to be debated early next year – obviously could have a dramatic impact on MPS' long-term solvency. In addition, several significant impacts could result from circumstances outside of the state budget process. The new health care paradigm established under the federal Affordable Care Act (ACA), for example, may bring new opportunities for governments to reduce health care costs during a time of limited resources. On the other hand, the judicial reversal of Act 10 certainly could have severe negative financial consequences for the district.

Given these and many other fiscal uncertainties, it will be important for MPS to carefully monitor its financial condition and continually update its long-term fiscal forecast. Unfortunately, we have some concern about the district's capacity to effectively do so. The retirements noted above will impact not only educational staff, but also administrative, budget and fiscal personnel. And, even without the impacts of those retirements, we have observed that MPS – to a far greater extent than the four other major Milwaukee governments whose finances we have assessed – has difficulty producing consistent financial data and explaining trends. It may be appropriate for MPS to consider new strategies for ensuring the consistency and transparency of financial data.

MPS' financial staff did produce a pair of recent five-year fiscal forecasts that provide some insight into its long-term outlook. In November 2011, as the MPS board contemplated substantial health care reforms, the administration presented a five-year forecast showing the impacts of a decision to do nothing to control health care costs. Those projections showed annual structural deficits that were estimated to reach $103 million by 2017. A more recent projection – shown in **Table 33** – was presented in August 2012 and highlights the structural improvement generated by the upcoming health care benefit changes.

Table 33: MPS projections

MPS PROJECTIONS		2013	2014	2015	2016	2017	*5-year change*
	Expenditures						
	Salaries	$405,151,127	$384,036,257	$380,209,644	$387,040,058	$394,110,543	*-2.7%*
	Fringe benefits	$273,214,004	$222,567,019	$235,666,416	$250,994,997	$268,341,194	*-1.8%*
	Purchased services	$194,198,771	$196,629,862	$205,062,962	$213,529,842	$222,825,363	*14.7%*
	Other expenditures	$30,982,525	$47,745,329	$48,256,759	$49,615,198	$50,255,885	*62.2%*
	Total expenditures	**$903,546,427**	**$850,978,467**	**$869,195,781**	**$901,180,095**	**$935,532,985**	***3.5%***
	Revenues						
	Property tax, equalization aid and integration aids *(Revenue limit)*	***$811,374,448****	***$812,395,058***	***$812,512,369***	***$813,095,136***	***$813,275,192***	***0.2%***
	Other state aids	$70,046,247	$65,843,601	$65,795,313	$65,747,431	$65,699,952	*-6.2%*
	Federal aids	$12,700,000	$11,200,000	$11,051,500	$10,907,010	$10,766,420	*-15.2%*
	Local revenue	$9,425,732	$5,170,162	$5,207,739	$5,245,315	$5,282,892	*-44.0%*
	Total revenue	**$903,546,427**	**$894,608,821**	**$894,566,921**	**$894,994,892**	**$895,024,456**	***-0.9%***
	SURPLUS (DEFICIT)	**$0**	**$43,630,354**	**$25,371,140**	**($6,185,203)**	**($40,508,529)**	

** This revenue limit estimate is based on the amount contained in MPS' 2013 proposed budget.*
Source: MPS fiscal staff and school board reports

These projections reflect school operations only and do not take into account categorical programs or nutrition services that are largely supported by grant funds. They also assume the following:

- The combination of property taxes, state equalization aid and integration aids will be relatively flat, growing 0.2% from 2013 to 2017, or roughly 0.06% each year.
- Federal revenues will drop by $1.5 million in 2014 and then gradually decline thereafter.
- Other state aids will decline about $4 million in 2014 and then remain flat.
- Salary expenditures will decline dramatically in 2014 – a product of significant staff retirements – and grow by 1.8% annually starting in 2016, resulting in an overall salary decline of 2.7% over the five-year period.
- After a $50 million drop in health care costs in 2014 following expiration of union contracts, fringe benefit costs will grow by an average of 6.3% each year.

Using this set of assumptions, MPS administrators projected the district would run a substantial budgetary surplus in two of the five years and would end up with a $40.5 million structural deficit in 2017. While cause for concern, this projection actually is rosier than similar projections issued by Milwaukee County and the City of Milwaukee during 2013 budget deliberations. The county projected a $92 million deficit by 2017, while the city, with a much smaller operating budget, projected a structural gap of $65 to $75 million by 2016. As with the MPS forecast, these projections provide only a broad snapshot and contain several educated but uncertain assumptions regarding key revenue streams and expenditure items.

In the two tables that follow, we provide additional context by modifying the assumptions used in **Table 33** based on some plausible changes to MPS' assumptions. **Table 34** provides a less favorable set of assumptions that holds funding allowed under the state revenue limit flat (we assume an increased property tax levy will offset declining state equalization aids and integration aids); assumes a smaller decline in salary expenditures of 1.4% over the five-year period; and assumes that the fringe benefit savings in 2014 are partially realized with benefits growing by an average of 6.2% annually following a decline in 2014, which results in an overall 14.1% increase in fringe benefits over the period. Under this set of assumptions, the district's structural deficit would more than double, growing to $91.1 million by 2017. This projection reinforces the positive fiscal impact of the projected 2013-14 benefit changes, thus signaling to MPS officials the importance of pursuing those (or similar) savings should Act 10 fail to pass legal muster.

Table 34: Financially unfavorable outlook

LESS **FAVORABLE** OUTLOOK							
		2013	2014	2015	2016	2017	*5-year change*
	Expenditures						
	Salaries	$405,151,127	$394,593,692	$396,172,067	$397,756,755	$399,347,782	*-1.4%*
	Fringe benefits	$273,214,004	$260,200,000	$274,700,000	$292,200,000	$311,800,000	*14.1%*
	Purchased services	$194,198,771	$196,629,862	$205,062,962	$213,529,842	$222,825,363	*14.7%*
	Other expenditures	$30,982,525	$47,745,329	$48,256,759	$49,615,198	$50,255,885	*62.2%*
	Total expenditures	**$903,546,427**	**$899,168,883**	**$924,191,788**	**$953,101,795**	**$984,229,030**	***8.9%***
	Revenues						
	Property tax levy	$275,325,515	$286,582,542	$297,603,172	$308,392,369	$318,954,993	*15.8%*
	Equalization aid and integration aids	$536,048,933	$524,791,906	$513,771,276	$502,982,079	$492,419,455	*-8.1%*
	Revenue limit	***$811,374,448***	***$811,374,448***	***$811,374,448***	***$811,374,448***	***$811,374,448***	***0.0%***
	Other state aids	$70,046,247	$65,843,601	$65,795,313	$65,747,431	$65,699,952	*-6.2%*
	Federal aids	$12,700,000	$11,200,000	$11,051,500	$10,907,010	$10,766,420	*-15.2%*
	Local revenue	$9,425,732	$5,170,162	$5,207,739	$5,245,315	$5,282,892	*-44.0%*
	Total revenue	**$903,546,427**	**$893,588,211**	**$893,429,000**	**$893,274,204**	**$893,123,712**	***-1.2%***
	SURPLUS (DEFICIT)	**$0**	**($5,580,672)**	**($30,762,788)**	**($59,827,591)**	**($91,105,318)**	

We provide a more favorable set of assumptions in **Table 35**. Benefit changes are implemented and grow at a slightly more tepid 5% annually; salary expenditures drop more sharply in 2014 than the original MPS projection and grow by 1% starting in 2016, producing an overall decline of 5.2% overall during the period; and equalization and integration aids remain flat, but the revenue limit allows property taxes to increase by 1.5% annually. This set of assumptions shows surpluses throughout most of the period and reduces the district's 2017 deficit to $5.2 million.

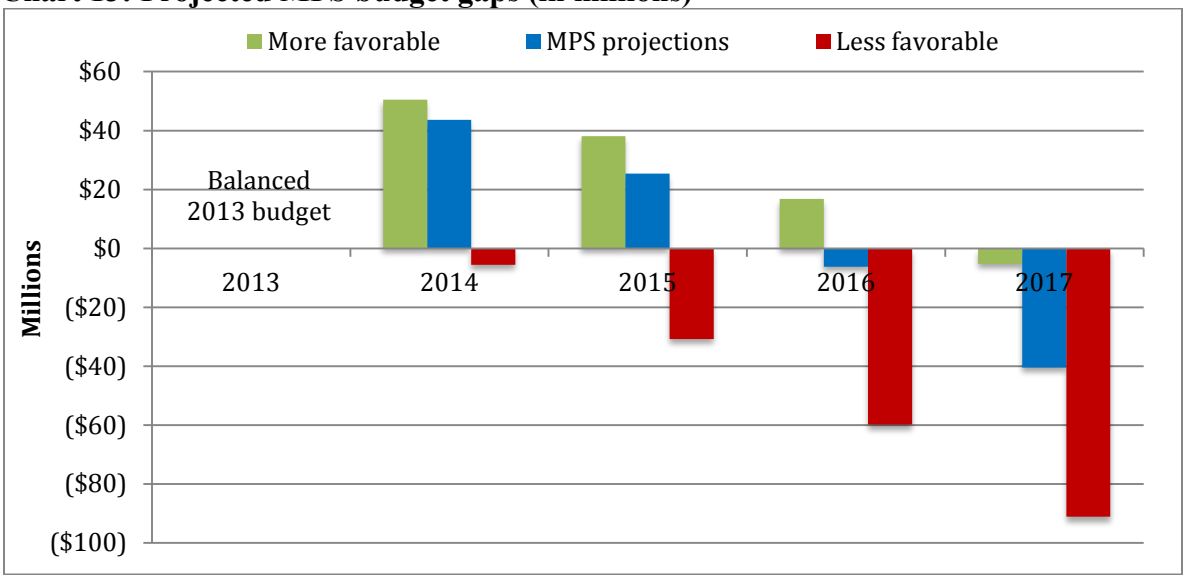
Table 35: Financially favorable outlook

MORE **FAVORABLE** OUTLOOK

	2013	2014	2015	2016	2017	*5-year change*
Expenditures						
Salaries	$405,151,127	$380,195,894	$376,407,548	$380,171,623	$383,973,339	*-5.2%*
Fringe benefits	$273,214,004	$222,567,019	$233,695,370	$245,380,138	$257,649,145	*-5.7%*
Purchased services	$194,198,771	$196,629,862	$205,062,962	$213,529,842	$222,825,363	*14.7%*
Other expenditures	$30,982,525	$47,745,329	$48,256,759	$49,615,198	$50,255,885	*62.2%*
Total expenditures	**$903,546,427**	**$847,138,104**	**$863,422,639**	**$888,696,801**	**$914,703,733**	***1.2%***
Revenues						
Property tax levy	$275,325,515	$279,382,387	$283,459,544	$287,557,086	$291,675,116	*5.9%*
Equalization aid and integration aids	$536,048,933	$536,048,933	$536,048,933	$536,048,933	$536,048,933	*0.0%*
Revenue limit	***$811,374,448***	***$815,431,320***	***$819,508,477***	***$823,606,019***	***$827,724,049***	***2.0%***
Other state aids	$70,046,247	$65,843,601	$65,795,313	$65,747,431	$65,699,952	*-6.2%*
Federal aids	$12,700,000	$11,200,000	$11,051,500	$10,907,010	$10,766,420	*-15.2%*
Local revenue	$9,425,732	$5,170,162	$5,207,739	$5,245,315	$5,282,892	*-44.0%*
Total revenue	**$903,546,427**	**$897,645,083**	**$901,563,029**	**$905,505,775**	**$909,473,313**	***0.7%***
SURPLUS (DEFICIT)	**$0**	**$50,506,979**	**$38,140,390**	**$16,808,974**	**($5,230,419)**	

In **Chart 13**, we show the projected surpluses/deficits for the three scenarios in a bar graph format to demonstrate how our plausible (and in most cases minor) adjustments to the district's previous assumptions could substantially alter its financial picture. **The divergence between the three scenarios again demonstrates the volatility of MPS' overall financial picture.**

Chart 13: Projected MPS budget gaps (in millions)



Overall, this exercise also demonstrates that MPS' five-year fiscal outlook – while far from upbeat – is not as apocalyptic as some have suggested. In fact, examining the raw numbers would yield the conclusion that MPS is not any worse off than Milwaukee's two other largest governmental bodies, the City of Milwaukee and Milwaukee County.

There are some important qualifiers, however, that are unique to MPS and that portray its long-term fiscal prospects in a much more alarming light:

1. On the revenue side, the only scenario in which MPS' five-year outlook appears manageable is one in which the district receives *some* growth in property taxes and/or state aids. The same might be said about the city and county, but in the case of MPS, this scenario not only is dependent upon decisions made in Madison, but also upon curbing the decline in enrollment that threatens its state funding regardless of those decisions.

2. On the expenditure side, MPS is far more limited than most other governmental entities in its ability to ramp down service levels in accordance with budgetary realities. Not only must the district strive to meet state and federal standards pertaining to academic achievement and meet the pressing social and emotional needs of the mostly low-income children it serves, but it also must compete with voucher schools, charter schools, suburban districts, and others for a sufficient share of Milwaukee's K-12 education market. Unlike garbage collection or parks, even minor reductions to service levels or quality at MPS could have repercussions that threaten its very survival.

The vast uncertainty regarding MPS' key revenue streams, state revenue limits, and enrollment makes it exceedingly difficult to discuss its fiscal prospects beyond the next five years. It is clear, however, that the district's OPEB liability – while much-improved – will continue to be a huge factor in determining its financial health, as annual health care increases for both retired and active workers are likely to be a substantial drain on any enhanced revenue capacity. Even in an optimistic scenario in which total fringe benefit increases are limited to 5% annual growth, MPS will need to identify more than $10 million annually in additional revenue or offsetting spending cuts to address that one budget need. Unless revenue limits are substantially relaxed, concerns about the city's high level of property taxation substantially abate, state aids grow at least in tune with inflation, and/or the size and compensation levels of MPS' workforce can be substantially reduced, it is difficult to see how the district's long-term fiscal picture will markedly improve after 2017.

In the next section, we review a set of related questions that add further context to an evaluation of MPS' financial future and its prospects for long-term solvency.

KEY STRATEGIC QUESTIONS

Several recurring strategic questions have swirled around MPS during the past several years as its administration, school board, and leaders of Milwaukee's business and civic communities have debated its future. In this section, we contemplate those questions in the context of our previous analysis.

Can MPS address its fiscal challenges simply by bringing its costs in line with other school districts?

Before determining the answer to that question, it first is necessary to consider whether MPS' costs are out of line in the first place. If that question is interpreted as pertaining to the amount of financial resources received and expended by MPS, then the data suggest the district's per-pupil costs are quite high. Indeed, MPS expenditures totaled $15,672 per pupil in 2011, ranking it 35th out of the state's 424 districts. We have shown that MPS' revenues and expenditures also are high when compared to other large urban districts throughout the country; for example, the district recently ranked 17th among the top 100 largest districts in per-pupil expenditures.

The extent to which these higher costs are driven by extraordinary factors must be considered before concluding that the district's costs truly are out of line, however. When MPS is compared with other districts on the basis of its revenue limit, which is calculated for each district based on a set of common cost drivers, its cost position changes substantially. Under this measure, in 2010, Milwaukee's revenue limit of $10,153 was just slightly above the state average of $10,107, and the district ranked 191st out of 424 Wisconsin school districts.

What explains the dramatic difference in these two measures of educational costs? As noted earlier in this report, the answer can be found in MPS' categorical programs, the largest of which assist students with disabilities and the economically disadvantaged, who make up significant portions of MPS' enrollment. MPS had $270 million in categorical fund expenditures in 2011, which amounted to about 20% of total expenditures. In federal funding alone – most of which is categorical in nature – MPS received $1,700 more per pupil in 2010 than the statewide average, and it also received more in federal funds than many of its national peers.

A logical follow-up question – particularly in light of the McKinsey findings – is how MPS' administrative operations compare in terms of cost efficiency with the average district in the state. Because of its size, economies of scale should be expected in MPS' operations, and there is evidence that some MPS operations do produce these results. For example, according to DPI data from 2011, MPS spends a greater proportion of its funds on instruction and pupil/instructional staff support than other districts statewide (69% for MPS compared with 65% statewide), and spends less on general administrative support, miscellaneous support and facility operations (21% for MPS compared with 27% statewide). At the national level, as shown in the peer analysis section, MPS compares favorably to other large urban school districts in cost efficiency and effectiveness in some areas of its business operations, and at or just below the peer median in others.

One area in which MPS' costs do appear out of line is fringe benefits. This report shows that MPS' benefits are, indeed, higher than those of other school districts in Wisconsin and most national peers and that, from a fiscal perspective, MPS has little choice but to substantially reduce its benefit costs. Recognizing that reality, the district has taken important steps to control health care spending and will implement substantial additional reductions to health insurance benefits when the current teachers' union contracts expire.

A critical question for future years, however, is whether use of the Wisconsin Act 10 "tools" can continue to be a primary annual budget-cutting strategy. Assuming that Act 10 eventually passes legal muster, MPS clearly will have the ability to limit annual salary increases for teachers, require them to pay more for fringe benefits, and adjust their work conditions, as the realities of its revenue situation dictates. MPS finds itself in a unique situation, however, in that the vast majority of its students can seek education outside the confines of the district at no additional educational cost. Consequently, more than perhaps any other public school district in Wisconsin, MPS must consider the impacts of teacher compensation on educational quality.

In sum, with the exception of fringe benefits, it seems hard to conclude that MPS' costs are out of line, if by that term one means that MPS spends more to educate students in the typical classroom setting. MPS' costs are higher because of the categorical funds it receives for its large number of students with disabilities and economic hardship. While there are certainly areas outside the classroom where the district can achieve further cost savings, it also is clear that achieving those efficiencies cannot, in and of itself, solve the district's long-term fiscal problems. Meanwhile, a fiscal strategy that relies on annual reductions to teacher compensation may ultimately run counter to the district's need to attract and retain quality teachers.

In light of declining enrollment, does MPS have an opportunity to address its fiscal challenges by "right-sizing?"

It could be argued that because of its revenue challenges, MPS already has engaged in "right-sizing" in the past couple of budgets to better align its staffing and building operations with enrollment. **Table 36** examines the changes in MPS full-time teaching and principal positions from 2008 to 2012. This five-year period was chosen because it includes 2012, a year in which significant budget cuts occurred.

Table 36: MPS full-time teaching and principal positions, 2008 and 2012

Position Type	2008	2012	Change #	Change %
Teachers	5,700	4,659	*-1041*	*-18%*
Teacher aides	474	338	*-136*	*-29%*
Principals	129	120	*-9*	*-7%*
Assistant Principals	144	92	*-52*	*-36%*

Source: MPS' federal EEO5 staffing reports

This information shows that MPS' student enrollment fell by 7,300, or 9%, during this period, which was significantly exceeded by reductions in its full-time teaching force (18%) and teacher aides (29%). Principals and assistant principals also fell by 7% and 36% respectively. These

reductions also caused the district's student-to-licensed staff ratio to deteriorate during this period. According to DPI, in fact, MPS' student-to-licensed staff ratio increased from 14.7 in 2008 to 16.1 in 2012. Most of the decrease in FTEs has occurred since 2010.

While the service-level impacts of this dramatic decrease in teaching personnel have yet to be determined, the district does have the opportunity to take a fresh look at the extent to which it needs to add staff in each grade level, in which buildings, and with what types of specialized expertise. It also has greater leeway in closing buildings and consolidating programs. There is risk, however, that these contractions will disrupt the learning environment and lead to inefficiencies. Given the degree of change in enrollments and budgets now occurring, MPS' ability to effectively manage its resources and operations in this dynamic environment constitutes, arguably, its greatest challenge.

Finally, because most of these staffing level decreases have occurred in the wake of Act 10, it is reasonable to assume that many of the staff who have departed are experienced teachers and administrators who elected to retire before major changes to fringe benefits were effectuated. That loss in expertise must be considered in MPS' competitive context.

To what extent do MPS' special education requirements and costs drive its financial challenges and restrict its ability to address them?

Thus far, this report has only briefly discussed special education in the context of categorical aids and their impact on MPS' comparative position with regard to revenues and expenditures. The district's special education requirements also play a prominent role, however, in assessing the severity of its ongoing fiscal challenges.

In 2011, MPS served 15,751 special needs students, or 19.5% of total enrollment. That percentage has increased substantially since 2007, when special needs students represented 17.1% of total enrollment. As seen in **Table 37**, the increased proportion of special needs students has less to do with an increase in the number of such students attending MPS schools than with a decline in MPS' general enrollment. In fact, MPS saw total enrollment decline by 10% over the period, while the special needs population grew by 2.7%.

Table 37 also shows that MPS appears to be alone in experiencing these trends. Statewide enrollment has remained steady, with 0.6% growth since 2007, but there has been a 3.5% decline in students with special needs across the state.

Table 37: Comparisons between general and special education enrollment

	Change in total Enrollment	Change in Special Ed Students	% Special Ed	
			2007	2011
Milwaukee	**-9.98%**	**2.70%**	**17.06%**	**19.46%**
Rest of WI	0.63%	-3.51%	13.65%	13.09%
Sheboygan	-1.11%	15.48%*	13.95%*	16.29%*
Kenosha	2.24%	1.67%	13.06%	12.99%
Appleton	-0.35%	0.24%	13.62%	13.70%
Racine	-2.75%	-1.07%	16.84%	17.13%
Oshkosh	-1.66%	-2.67%	15.32%	15.17%
Madison	0.21%	-3.44%	17.02%	16.40%
Janesville	-2.09%	-3.47%	13.91%	13.71%
Waukesha	1.61%	-5.47%	13.86%	12.90%
Eau Claire	0.48%	-6.63%	13.61%	12.65%
Green Bay	1.52%	-99.75%*	18.06%*	0.04%*

** Information for Sheboygan and Green Bay seem to have data reporting errors.*
Source: DPI WINNS "What is the enrollment by student group?"

The diverging trends between MPS' general and special needs populations have significant fiscal implications. As discussed previously, declining enrollment impacts both the district's revenue cap and its equalization aid payment. As shown in **Table 38**, despite this circumstance, MPS' special education expenditures grew 40% from 2007 to 2011, a far more rapid increase than the 13% growth in overall expenditures. In fact, the special education expenditure growth of $71 million comprises 40% of MPS' overall expenditure increase during the period. Fringe benefit costs are the predominant cost driver, making up 57% of the special education increase, with salaries making up most of the remainder. Student-teacher ratios over this five-year span have stayed relatively steady at 12 special needs students per teacher.

Table 38: Growth in special education expenditures versus general student expenditures

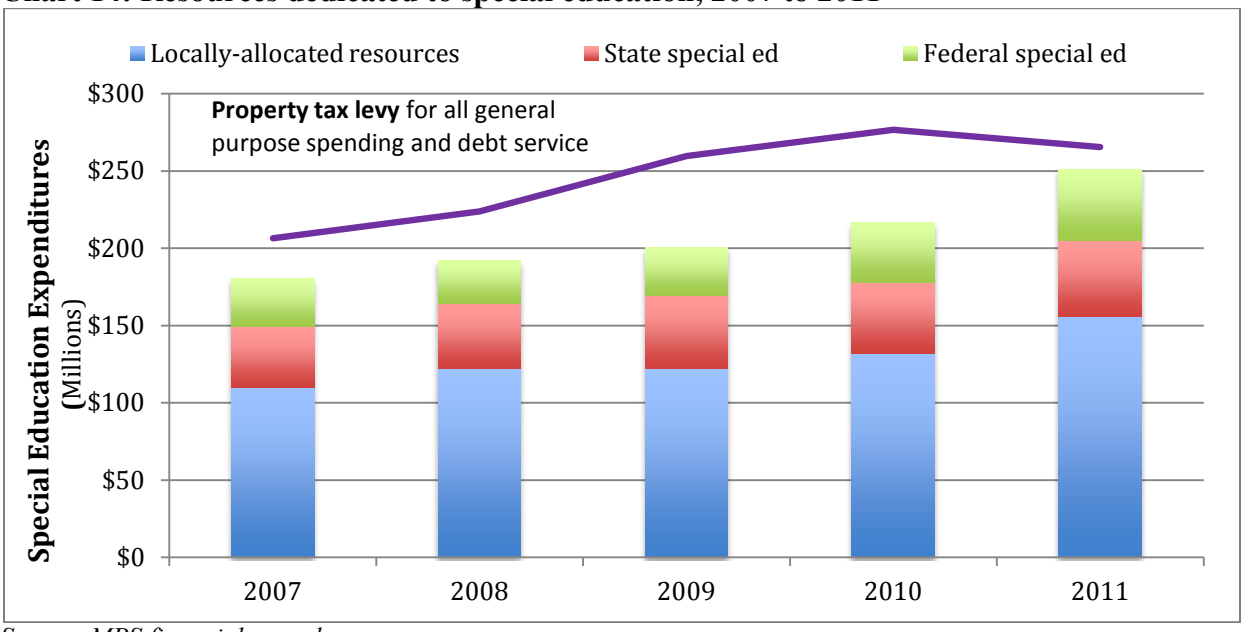
	2007	2011	*5-year Change*	
General students	$928,135,226	$996,312,695	*$68,177,469*	*7%*
Special ed. students	$180,447,342	$251,814,883	*$71,367,541*	*40%*
Total expenditures	**$1,108,582,568**	**$1,248,127,578**	***$139,545,010***	***13%***

Source: MPS fiscal staff

Chart 14 shows that increases in state reimbursements and federal categorical funds – plus temporary ARRA funding – have helped support roughly $25 million of this growth. However, locally allocated resources also have been tapped to a greater extent than in the past, as $46 million of the growth in special education costs came from locally allocated property tax levy and equalization aid, a 42% increase over 2007. This surge in special education costs has

required MPS to divert more than $28 million in property tax levy and equalization aid from general education.[9]

Chart 14: Resources dedicated to special education, 2007 to 2011



Source: MPS financial records

Even if it were inclined to do so, federal maintenance of effort (MOE) requirements would make it difficult for MPS to reduce special education expenditures going forward. A district can jeopardize federal funds by reducing local and state expenditure support for special education below levels seen in the previous year. Generally, an expenditure reduction for special education only can take place as a result of a reduction in the special needs population; the voluntary departure (or departure for just cause) of special education personnel; and the termination of large, long-term costs such as equipment purchases.

Absent from this list is a reduction in expenditures stemming from changes in employee compensation or layoffs. As previously discussed, once existing union contracts expire in 2013, the district is anticipating significant savings in health care and pension costs. Any savings generated by reduced benefits in the area of special education, however, must be reinvested within that program. In fact, DPI has advised districts on how to reinvest any savings that have resulted from utilizing Act 10 provisions into new or enhanced programs for special needs students. Some districts have advocated doing away with the federal MOE, but it enjoys strong support from special education advocates who fear that the quality of special education could suffer without it.

[9] From 2007 to 2011, equalization aid declined by $41.7 million, and property tax levy for general operations and debt service (not including levy for construction or community services) grew by $59 million, for a combined net increase of $17 million. This has only partially supported the $45.6 million growth in locally-supported special education costs, requiring the district to divert approximately $28 million away from regular education costs to special education.

As long as the proportion of students at MPS requiring special education continues to increase, therefore, the savings that accrue from teacher wage or benefit changes will be diminished by the need to maintain special education spending. The only way for the district to realize a cost savings in special education is through retirements of special education staff. According to MPS 2012 fiscal data, such retirements will indeed result in a $9.4 million savings from the 2011 level. To the extent that MPS needs to replace that staff to meet the needs of its special needs population, however, the net savings will be diminished and will have a proportionately small impact on the district's long-term solvency.

If MPS' cost-cutting options are limited, can it build its revenue base by expanding its market share instead?

The revenue side of the balance sheet is just as important to the district as the expenditure side, as shrinking the long-term structural deficit will require revenue stability. Because MPS is heavily reliant on state and federal aids, however, its ability to control revenues is quite limited. Even the size of the property tax levy is driven by state policy, as we have discussed earlier in this report.

Yet, because most state and federal aids are distributed on a per-pupil basis, MPS could have an opportunity to shore up its revenues if it could maintain or somehow increase its enrollment. An important question, obviously, is whether the district has the wherewithal to do so. With Milwaukee often referred to as the "ground zero" of school choice, MPS finds itself in a unique situation when compared to most other public school districts in that the vast majority of its resident schoolchildren can obtain publicly-funded education outside the confines of the district. Programs available to Milwaukee residents include taxpayer-funded vouchers to attend private schools in the county, independent tuition-free charter schools in the city, and public schooling options in neighboring districts and beyond.

Students have taken advantage of these educational opportunities in increasing numbers over the past two decades, causing fiscal stress for the district. When MPS loses students, several negative fiscal impacts occur. For example, each student that MPS loses produces a downward adjustment under the state equalization aid and revenue limit formulas. While the impact of these reductions can be offset by other factors, such as changes in property value or state policies that hold the district harmless, long-term enrollment decline does not portend well for MPS finances.

To some extent, enrollment growth is outside of the district's control, as enrollment consequences flow not only from decisions made by MPS, but also from the actions of private and public schools in the area, and from any legislative changes that affect choice or charter program subsidies, enrollment limits, and eligibility requirements. In addition, the city's school-age population has dwindled in recent years. When those variables are combined with the district's fiscal challenges, the difficulty faced by MPS even to *maintain* its existing enrollment becomes apparent.

Recently, however, MPS leaders have cited efforts to promote non-instrumentality charter school[10] enrollment as a strategy that has potential to preserve or expand market share. The 2012 budget, for example, identifies increasing "the number of charter schools to improve market share of students in MPS" as one of the district's main initiatives.

For each student who is retained within the district and who opts to attend an MPS charter school instead of a private school or a charter school affiliated with UWM or the City of Milwaukee, the district is able to avoid a loss in funding under state equalization aid and a lowering of revenue limits. In addition, non-instrumentality charter schools are funded differently from regular schools, employ non-district staff, are managed by outside entities, and make minimal use of the district's central administrative services.

MPS has had some success in the past few years in expanding its non-instrumentality charter schools. In 2010, 2,195 students attended these schools. By 2012, enrollment had grown to 4,326 students because of the opening of five new schools. In contrast, non-MPS charter schools increased enrollment from 6,165 students to 6,895 students. In 2012, MPS' non-instrumentality charter school enrollment represented 5% of its total enrollment, as compared to only 1% a decade before.

In the coming year, the administration will present to the school board four new contracts for charter schools that are scheduled to open in 2013-14. Those include an expansion of two existing schools to new educational sites. The district projects enrollment for non-instrumentality charters will increase by 53% in the next five years, from 4,326 in 2012 to 6,599 in 2017. Non-instrumentality charters are expected to rise to 9% of MPS' enrollment at that time.

The significance of this growth lies not just in the enrollment numbers and the associated revenue benefits, but also in the potential cost savings. Because these schools are operated and funded so differently from regular district schools, including the use of non-MPS teaching staff who do not receive MPS salaries and benefits, there may be long-term fiscal advantages associated with an increase in the number of non-instrumentality charter schools. In addition, to the extent that MPS-affiliated charter schools are able to preserve existing market share – or even gain market share from non-MPS charter schools, voucher schools or suburban schools – there is an added fiscal benefit to the district.

The growth in MPS charter schools also poses considerable risk for the district, however, for the following reasons:

- An association between a charter school and MPS is not permanent, as a school can end its affiliation with MPS after its contact has terminated. In fact, in recent years, a number of MPS schools have changed their affiliations. This is important because when an MPS charter school transfers to the auspices of UWM or the City of Milwaukee, substantial dollars flow out of the district.

[10] A key difference between a "non-instrumentality" charter school and an "instrumentality" charter school is that the non-instrumentality school's teachers are employed by the charter school, as opposed to being employed by the district. Students at either type of school are counted as members of the school district for state aid purposes.

- Charter school funding is not based on MPS' school costs, but upon a substantially higher per-student contractual amount. In 2012, for example, MPS allocated $4,732 per student to high schools and $4,520 per student to elementary schools, as compared to a $7,775 per-student payment to each charter. This discrepancy stems largely from the fact that centralized overhead costs for the district are not included in the allocation to the regular MPS schools, while they are part of the charter school calculations because those schools have their own costs for rent, utilities, textbooks, etc. The non-instrumentality charter schools still yield cost savings for MPS because the per-student state aid received by the district exceeds the $7,775 per-pupil payment. It is important to recognize, however, that the state aids do not fully offset the overhead costs that remain with the district. As a result, new charter schools place additional financial pressure on the district's ability to fund its centralized overhead costs, including those associated with its OPEB liability.

- Greater utilization of non-instrumentality charter schools may have implications for the district's educational mission. There is a tension, for example, between a comprehensive-school model and the specialized school model represented by most charter schools.

Perhaps the most important consideration for MPS with regard to charter schools, however, is the financial threat posed by the growth of non-MPS charter schools. Indeed, while MPS is attempting to enhance its market share by growing its own charter schools, several outside entities are attempting to do likewise with charters backed by the city, including two prominent national operators, Rocketship Education and American Quality Schools. Notwithstanding any potential educational benefits that could accrue from the growth of non-MPS charters, it is clear that the substantial expansion of Milwaukee charter schools that is envisioned by many elected and civic leaders could exacerbate MPS' revenue challenges and alter the nature of its long-term forecasts. It will be critical for both MPS and City of Milwaukee leaders to quantify and consider these impacts moving forward.

In conclusion, MPS would appear to be improving its financial position through the creation of charter schools. There is no way of knowing, of course, whether MPS' increase in charter school enrollment has prevented the district from losing enrollment or whether charter school growth represents an enrollment redistribution within the district from regular to charter schools[11]. Perhaps some of both have occurred. In any event, any improvement in the district's enrollment due to the strengthening of its own charter schools could come as a mixed blessing, and may be completely overshadowed by the growth of non-MPS charters.

[11] MPS is now making an effort to market charter schools in neighborhoods where many students attend schools outside the district.

CONCLUSION

With more than 80,000 students, MPS is Wisconsin's largest school district, representing half of all African-American students in the state, one-fifth of all Hispanic students, and 14% of all special education students. One-tenth of the district's student population has limited proficiency in English and 84% are economically disadvantaged. MPS employs 9% of all public school teachers in the state and has a $1.2 billion operating budget – the second largest of any local government in Wisconsin. Because of its outsized roles as an educational institution and social services provider to the state's most at-risk students, as well as its role as one of the region's largest employers, the importance of understanding its fiscal solvency cannot be understated.

Thus, the primary basis of analysis for this report is the ICMA financial evaluation system, which provides a framework for local governments to assess their fiscal condition in four categories of solvency. Our research and analysis of MPS fiscal trends for the 2007 to 2011 timeframe finds weaknesses in each of those categories:

- **Cash solvency** – MPS showed negative trends in both liquidity and cash balance, as accounts payable and other current liabilities increased each year, while the general fund balance decreased from 9.8% of operating revenues in 2007 to 7.2% in 2011. Despite this downward trend, MPS clearly is not in imminent financial danger. On the contrary, MPS still falls near the median in general fund balance when compared to other large urban school districts. Nevertheless, the negative trends in this area bear careful monitoring.

- **Budgetary solvency** – Key indicators of budgetary solvency during the five years in question reflect severe turmoil and raise concerns about service levels and long-term fiscal health. Annual budgets accommodated severe cuts in state revenue streams only because of unsustainable increases in the property tax levy and some limited assistance from one-time federal ARRA funds. Even with those measures, MPS was forced to reduce its full-time teaching staff by 11% between 2007 and 2011.

- **Long-term solvency** – Beginning in the 2013-14 school year, MPS has an opportunity to build on recent progress and vigorously counter its immediate revenue challenges with substantial reductions in fringe benefits spending made possible by Wisconsin Act 10. The longer-term future looks far more challenging, however, as the district's revenue streams are likely to be constrained well into the future; its retiree health care liability – though substantially reduced from recent benefit reductions – will remain daunting; and its ability to further reduce personnel costs will be limited by its need to attract and retain quality teachers and administrators.

- **Service solvency** – MPS faces substantial pressure to at least maintain existing service levels given its need to stem declining enrollment and successfully compete with choice, charter and suburban schools. To the extent that service quality is linked to maintaining competitive compensation packages for teachers and reducing class sizes, its ability to do so is questionable given its uncertain revenue picture and the weight of its OPEB liability.

The troublesome fiscal picture painted by the ICMA solvency indicators is abated somewhat by our finding that MPS' fiscal plight is not noticeably different from that of either Milwaukee County or the City of Milwaukee. Each of those governments faces five-year structural deficits of similar magnitude, and each suffers from similar revenue uncertainty and long-term liabilities.

Comparing MPS to other large urban school districts also provides a modicum of reassurance. We find that it is the composition of MPS' student body that accounts for its high levels of spending when compared to other Wisconsin school districts, as its predominance of low-income and special needs students allows it to draw down much higher levels of federal categorical funds. When compared to other large urban districts with similar student populations, it turns out that MPS' per-pupil spending is much more in line.

While MPS' comparability with the other major Milwaukee governments and its national peers does nothing to address its fiscal challenges, it does imply that the district's problems are not the byproduct of out-of-control spending. Also, this comparability suggests that MPS' challenges – while serious – are not hopeless, unless one considers the problems facing other local governments and large urban school districts to be similarly insoluble.

Even this slightly more optimistic perspective must be tempered, however, by recognition of MPS' unique obligations and playing field. While municipalities and counties may have the ability to reduce staff and service levels in areas of their operations that will produce consequences related only to aesthetics or convenience (e.g. trash pick-up or median mowing), MPS has few options to do so that will not pose a threat to educational quality or the social and emotional well-being of students. And, while other large urban school districts may need to reluctantly accept larger class sizes or less-experienced teachers, MPS does so at the peril of losing even more market share to its competitors.

MPS leaders are attempting to right their financial ship with a balanced approach that seeks both cost reductions and expanded revenue streams. On the expenditure side, assuming that Act 10 is upheld by the courts, MPS will use the legislation's "tools" to dramatically reduce employee and retiree health care benefits. In addition, it will continue to seek efficiencies in administrative operations with Six Sigma methods and pursuit of McKinsey-suggested strategies, and use a new facilities master plan to reduce the size of its infrastructure in accordance with its shrunken student population. On the revenue side, meanwhile, it will pursue a new strategy to expand the number of non-instrumentality charter schools, thus attempting to stem the flow of students to schools outside of the district and improve its position with regard to the state equalization aid formula.

Some of those actions have been merely controversial, such as changes in employee benefits or methods of providing nutritional services. Others, however, may require re-evaluation of the district's educational mission. More charter schools focusing on specialized curricula, for example, could conflict with a notion of providing a uniform, comprehensive education for all students.

Regardless of political and/or educational considerations, the key question posed by this report is whether successful implementation of the strategies cited above would be enough to right MPS' financial ship. Our modeling shows that *if* the health care and pension changes made possible by Act 10 are implemented, *if* the district can achieve marginal annual growth in combined equalization aids and property tax levy under future state revenue limits and appropriations, and *if* MPS can achieve a limited reduction in salary expenditures, then balanced budgets are readily achievable in the next five years. Under another plausible scenario, however, in which the benefit changes are not fully effectuated because Act 10 is ruled illegal, major revenue streams remain flat, and salary expenditures decrease by a lesser amount, a dire fiscal picture emerges.

In the end, it is MPS' untenable fiscal structure – more than recent trends – that poses the greatest concern regarding its long-term fiscal health. MPS is much more dependent upon a single outside entity than Milwaukee's other governments – a prominent ICMA red flag. State government not only lacks a clear policy for its funding of elementary/secondary education, but it also has the ability to control the amount of funds MPS can produce from its other major revenue source, the property tax. Furthermore, the state can adopt regulatory changes to either the charter school or private school choice programs, thus affecting MPS enrollment and revenue; and it can make changes in requirements for instructional practices or delivery of special education, thus impacting MPS' expenses.

MPS also faces volatility from the possible actions of entities closer to home. The expansion of non-MPS charter schools, for example, under the purview of the City of Milwaukee or UWM, poses an additional threat to MPS' revenue picture that could wipe out any potential financial advantages associated with efforts to grow its own charter schools.

In light of the enrollment declines and revenue changes it has experienced in recent years and can expect to see in the future, it could be argued that MPS, more than any other local government entity, needs a strong strategic and budget management capacity. Yet, it will be inherently difficult for the district to effectively manage in this dynamic environment when it has so little control of its own destiny. That factor – combined with our observations regarding MPS' financial data challenges – leads us to question whether MPS can manage its way out of its anticipated degree of change and accompanying fiscal challenges.

The intent of this report is to objectively assess the nature and severity of MPS' financial challenges, as well as the highly complex and difficult set of circumstances that have created them. It is our hope that policymakers in Milwaukee and Madison who read this report will use its findings not to cast blame, but to determine a path forward for Wisconsin's largest school district that is both realistic and appropriate for the students and taxpayers it serves.

Efforts to effectively educate 80,000 schoolchildren cannot and should not take place in a fiscal environment that is plagued with such vast uncertainty and challenged by a set of overriding variables that are so beyond the school district's control. It is incumbent upon local and state leaders to reach agreement – once and for all – on the role MPS will play in the city's education framework, and to define and secure the resources required to fulfill that role.