June , 2005

Dear Leadership Members (Sen. Dale Schultz; Sen. Judith Robson; Rep. John Gard; Rep James Krueser):

We are writing to express our concerns on the impact of the Joint Finance Committee's action to freeze property taxes for 2006, 2007 and 2008, particularly as it relates to debt service. The approach toward treatment of debt service would be extremely harmful to the City of Milwaukee's capital infrastructure program and to our economic development efforts. This approach is almost certain to result in higher future property taxes, and less new development and redevelopment, than if current law were maintained. The proposal will negatively impact the city financially and can only serve to harm the city's bond rating.

The provisions of this levy limit will impair the city's cash-flow borrowing. Since most of the city's state aid is received at the end of the year, the city borrows in anticipation of this aid to fund expenditures that occur throughout the year. It is not clear what policy objective is achieved by requiring a referendum for cash-flow borrowing, but the likely impact is that the city will not be able to pay its bills until state aids are received. Not being able to pay these bills promptly will trigger statutory penalties that further add to the city's costs. This issue could be resolved if the state cash-flow borrowed to make payments to municipalities at the beginning of the year, thereby relieving municipalities of the interest costs associated with cash-flow borrowing.

While the levy limit does exclude increases in debt service related to debt authorized prior to July 1, 2005, this provision is meaningless because it fails to distinguish between debt service and tax levy debt service. The city's total debt service is not increasing, but due to declining non-property tax funding sources, the city's tax levy for debt service is increasing. As a result, the city will not be able to exclude this debt service from the levy limit, despite the fact that its tax levy supported debt service is increasing as a result of debt issued prior to July 1, 2005. In order to make payments to bondholders, the city will have to make additional cuts to its operating levy.

Additionally, tax increment levies are excluded from the levy limit, but not tax increment related debt. The city borrows for tax increment district improvements and uses the resulting tax increments to support the debt. Since the increments are not likely to fully support the debt service in the initial years of a project, there is a short term debt service tax levy impact, even though over the life of the project the debt service is fully supported. As a result, it will be much more difficult to initiate new tax incremental districts given their immediate tax levy impact.

It should be noted that the city's debt receives high bond ratings, rated as Aa2 (Moody's) and AA (S&P). The city receives these high ratings despite state laws that limit the diversification of our tax base and low per capita personal income. These ratings reflect the rating agencies' positive assessments of the city's financial management, in general, debt management, in particular, and its responsible use of reserves.

This levy freeze can only have a negative impact on the city's bond rating. As described in the attached bonding report, rating agencies look at the city's financial flexibility in assessing its ability to repay debt obligations. A tax levy freeze places a significant constraint on the city's financial flexibility. In addition, the referendum requirement places a significant impediment on the city's ability to borrow for ongoing capital maintenance needs and will result in deferred maintenance of the city's infrastructure. It is likely that the rating agencies will reflect this greater risk and growing deferred maintenance in the city's credit rating, increasing the city's borrowing costs, thereby reducing the city's ability to fund its infrastructure.

A referendum requirement is not practical when considering the ongoing maintenance of existing infrastructure. For example, the city has approximately 1,100 miles of streets. These streets wear out and a certain portion must be replaced every year to maintain the city's infrastructure. With or without a levy limit these streets will continue to wear out. Assuming streets last 50 years, 22 miles need to be replaced annually. But, absent going to referendum, the number of miles the city can replace will diminish each year. Most of these deferrals will be funded after 2008, when construction costs are higher and the city's ability to "catch-up" is diminished.

In addition, the referendum requirement may jeopardize multi-year capital projects that have been initiated, but are contingent upon future capital funding. For instance, the city recently initiated a contract for a four-year project to stabilize and restore the exterior of the historic city hall structure. Since most of the funding for the project is scheduled for 2006, 2007 and 2008, this project may be in jeopardy despite the city's contractual obligation.

The policy objective of this provision is to control local property taxes. It should be noted, however, that the city spends less per capita than its peer cities for all city services including debt service (City of Milwaukee Comptroller's *Comparative Expenditure Report 2004* ). Given this fact, the clear solution would be the restoration of state aid increases to help offset runaway healthcare and utility costs. Instead, this provision negatively impacts the city's bond rating, increases the city's cost of borrowing, and defers the maintenance of the city's infrastructure. Further, it takes control away from local officials, who are the closest to the electorate and who are in the best position to determine local expenditure and revenue priorities.

This provision has far-reaching consequences on local governments, yet those most affected were not involved in the dialogue leading to its development. At a minimum, excluding debt service will help Milwaukee and other local governments deliver the infrastructure that our residents need, and will allow us to continue using responsible borrowing to support private sector development initiatives.

Please feel free to contact us if you wish to discuss this issue further.

Sincerely,
MTB
WMM
WH
MM

Cc: Governor; Milwaukee delegation