



EXECUTIVE SUMMARY
ON THE MONEY?

THE CITY OF MILWAUKEE'S UNCOMMON REVENUE
STRUCTURE AND HOW IT COMPARES TO PEER CITIES



PUBLIC POLICY FORUM

Making Ends Meet,¹ the Public Policy Forum's September 2016 analysis of the City of Milwaukee's fiscal condition, revealed a "broken" revenue structure that was unable to generate sufficient growth to keep pace with the City's retirement obligations, aging infrastructure, and "fierce public safety expenditure pressures." This inability was linked to excessive reliance on aids from the State of Wisconsin, which had been stagnant for the past two decades; and a lack of local revenue options, which has required the City to lean increasingly on property owners, despite the tens of thousands of suburban commuters and visitors who use City services each day, but who are not asked to share in the cost.

While *Making Ends Meet* identified the problem, this report is dedicated to exploring potential solutions. It does so by considering how similar-sized cities across the country generate the revenues required to sustain core services, and then by applying a handful of those revenue models to Milwaukee. Specifically, the report seeks to initiate discussion on possible alternative revenue structures that might tap into Milwaukee's economic strengths while reducing the City's reliance on shared revenue from the State and property taxes and fees from its residents.

Changing a local tax structure is difficult, as it should be. Yet, at the same time, living with a tax structure that has outlived its effectiveness makes little sense. We hope to stimulate an informed, community-wide conversation about the condition of Milwaukee's finances, and about the steps that need to be taken to ensure that City government is able to deliver the core public services demanded by residents, businesses, and visitors.

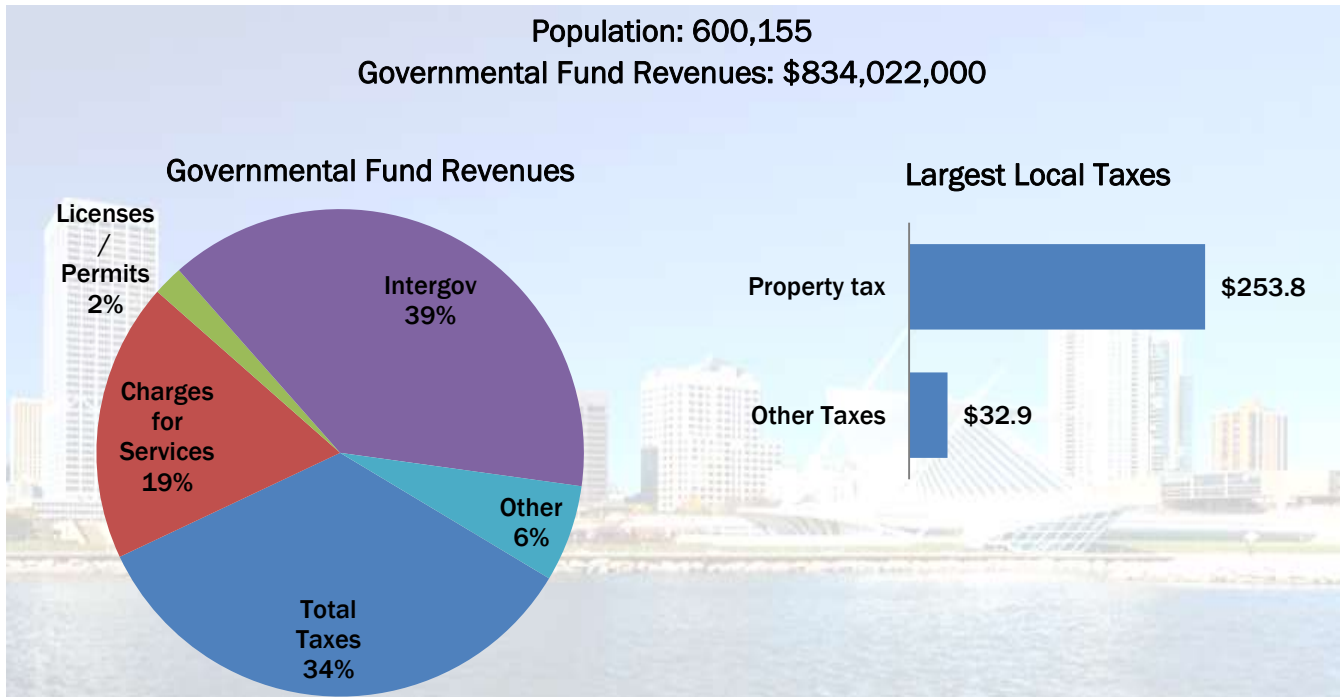
BACKGROUND: MILWAUKEE'S REVENUE STRUCTURE

The figure on the following page summarizes Milwaukee's major revenues for governmental activities per its 2015 audited financial statements. Milwaukee's three predominant funding sources are intergovernmental revenues (\$323 million or 39%), local taxes (\$286 million or 34%), and charges for services (\$154 million or 19%). We briefly summarize those sources below:

- *Intergovernmental revenue* consists largely of general state aid, which comprises \$263 million (81%) of the total. State aid historically has been Milwaukee's largest revenue source. Most general state aid comes from the shared revenue program (\$219 million in 2015).
- *Local taxes* consist primarily of property tax revenues (\$254 million, or 89% of local taxes). The remaining \$33 million of "other taxes" is comprised mostly of revenues from Tax Incremental Districts. Property tax revenues historically have been Milwaukee's second largest revenue source.
- *Charges for services* represent funds received for the delivery of certain services for which fees can be assessed under Wisconsin's statutes. Milwaukee's major charges include solid waste and snow and ice fees. Service charges produced \$154 million in revenue for the City in 2015.

¹ This report can be accessed at <http://publicpolicyforum.org/research/city-milwaukee%E2%80%99s-fiscal-condition-making-ends-meet>.





This revenue structure dates back to 1911, when State of Wisconsin leaders decided to share a portion of the new state income tax with local governments. The decision to share income tax revenues with local governments has been accompanied by a policy of strictly limiting the ability of those governments to establish their own forms of taxation outside of the property tax.

In theory, that notion would appear reasonable. Yet, in practice, it has proved highly problematic for Milwaukee. Since 2004, except for one year, the State's annual funding for shared revenue either has remained essentially the same, or has been reduced. Milwaukee's shared revenue allocation is budgeted at \$219 million this year, which is \$15 million lower than its actual shared revenue payment in 1997. Had that revenue source simply kept up with inflation, then the City's shared revenue allocation would be \$138 million higher than it is today.

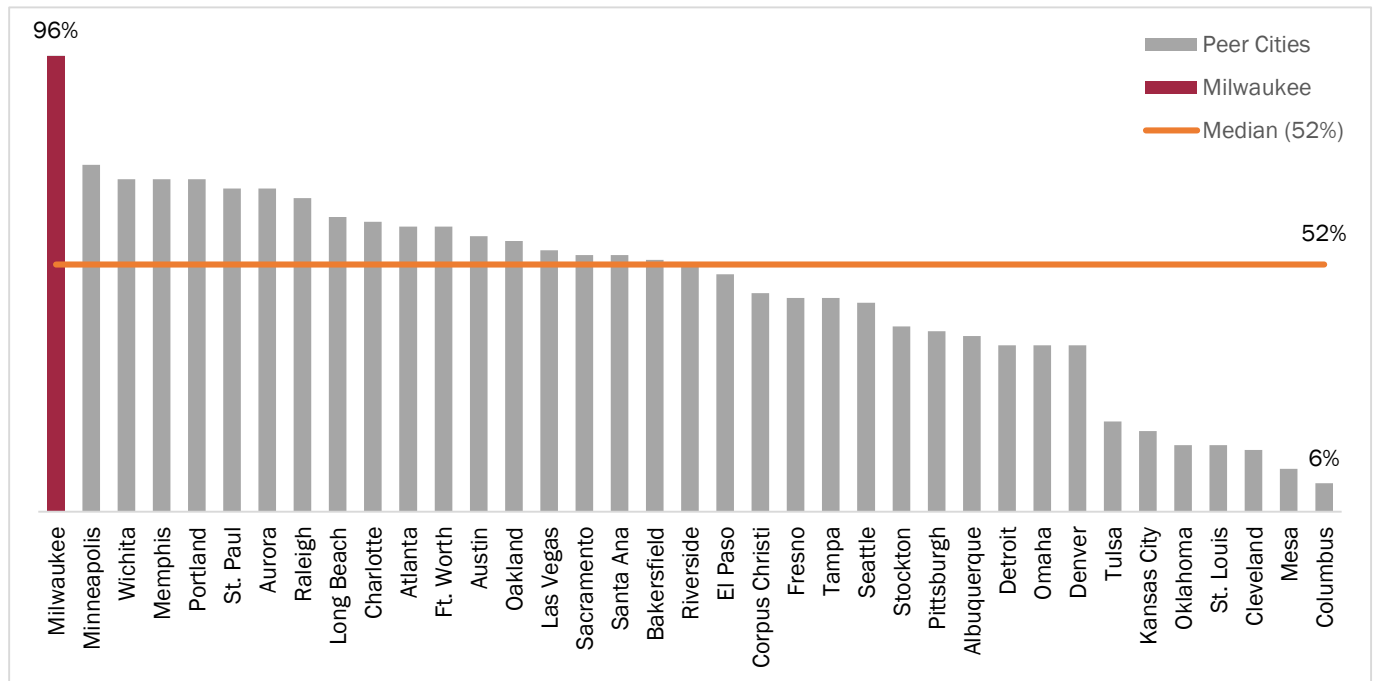
REVENUE STRUCTURES OF PEER CITIES

Our analysis of a peer group of 39 peer cities (including Milwaukee) with populations between 300,000 and one million indicates that Milwaukee's revenue structure is highly unique. In 2012, property taxes comprised 96% of Milwaukee's local tax revenues.² No other city in the peer group approached this level of property tax reliance as a percentage of local tax funds, as shown in **Chart 1**. Minneapolis, the city with the next highest level, received 73% of total local tax revenues from property taxes.

² This percentage is based on reporting to the U.S. Census Bureau, which differs from the methodology used in the City's annual financial statements. In this case, the remaining 4% consists primarily of revenues generated from licenses and permits.



Chart 1: Peer cities where property taxes comprise the largest share of local tax revenues, 2012



Source: Lincoln Institute of Land Policy

Thirty of the 39 peer group members have a general sales tax, while nine (including Milwaukee) do not. Most of those nine raise substantial revenues through selective sales taxes (e.g. sales taxes on specific items like food/beverages, parking, or entertainment). Unlike each of the other peer cities, Milwaukee does not have authority from the State to levy either general or selective sales taxes.

Our analysis finds that as a general rule, cities with larger populations tend to draw more heavily on the sales tax and less upon the property tax, as shown in **Table 1**. That may reflect the fact that as cities increase in size, they become more cosmopolitan (i.e. less local) and host greater numbers of non-residents who are engaged in business, employment, tourism, entertainment, etc. The sales tax enables local governments to recoup the costs of services provided to all users irrespective of their purpose for being in the city.

Table 1: Relationship of property to sales taxes as % of total local taxes for cities, 2012³

Tiers	Property	Sales	Total
Tier 1-- (1 million +)	43%	42%	85%
Tier 2-- (300,000 to 1 million)	44%	41%	85%
Tier 3-- (circa 150,000+)	54%	28%	82%

Source: Lincoln Institute of Land Policy

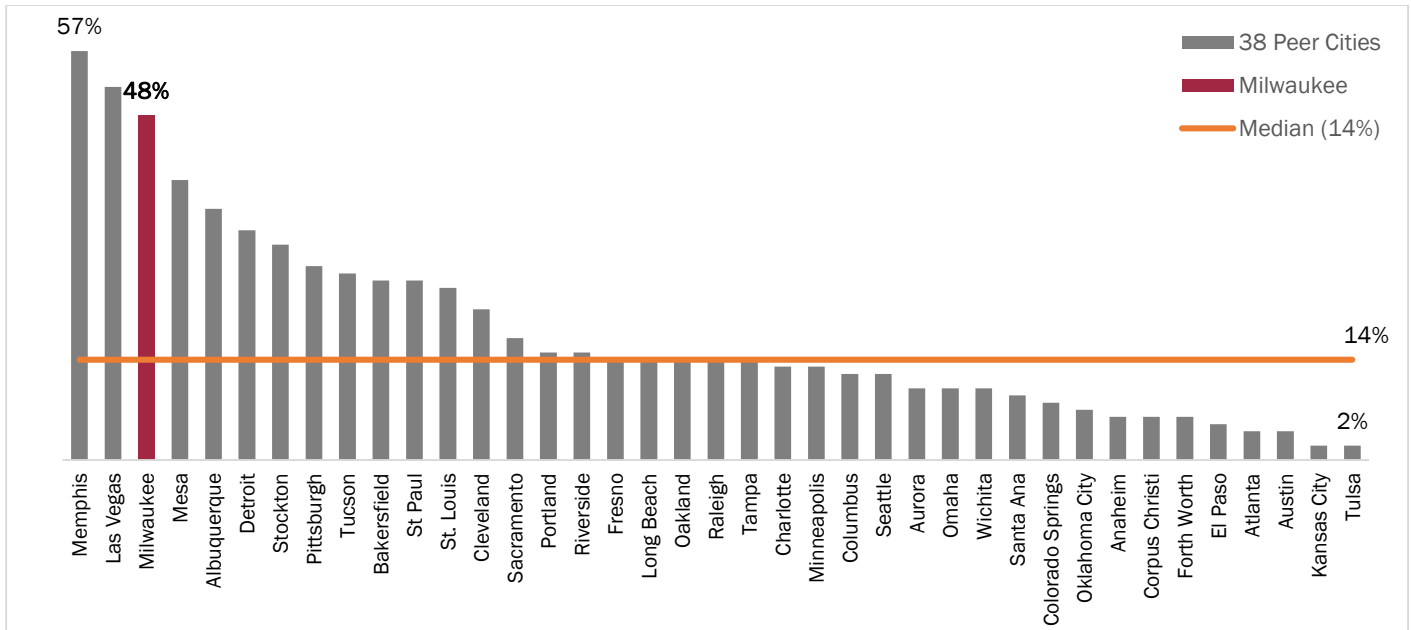
State aid is a relatively minor source of revenue for most of the peer cities, providing supplemental financial assistance, but not serving as a principal source of support compared with property or sales

³ Tier 2 does not include cities with financial and/or operational responsibilities that typically are a part of other local governments, nor city/county consolidated governments.



taxes. Indeed, our analysis found that state funding represented 14% or less of total intergovernmental and local tax revenue for half of the peers. In contrast, state funding equaled 48% of Milwaukee’s total and, historically, has been its largest revenue resource. Only two other cities in the peer group had a greater proportion of state funding, as shown in **Chart 2**.

Chart 2: Peer cities where state funding comprises the largest share of total intergovernmental and local tax revenues, 2012



Source: Lincoln Institute of Land Policy

Only six members of the peer group have a local income tax: Columbus, Cleveland, Pittsburgh, Detroit, St Louis, and Kansas City. These cities are located in four states that authorize local income taxes either for all municipalities, or for specified cities within their borders.

CLOSER LOOK AT FOUR PEER CITIES

We decided to take a more detailed look at the revenue structures of four Midwestern peer cities that were included in the 39-city peer group: Pittsburgh, Cleveland, Minneapolis, and Kansas City. Our intention is to provide greater insight into the distinct features of revenue structures used by cities that are comparable to Milwaukee, assess the general pros and cons of such features, and examine their potential relevance to possible modifications to Milwaukee's revenue structure.

In our analysis of the revenue characteristics of the four peer cities, we take into account four qualities that many government finance experts agree are important in defining a high-quality revenue system:

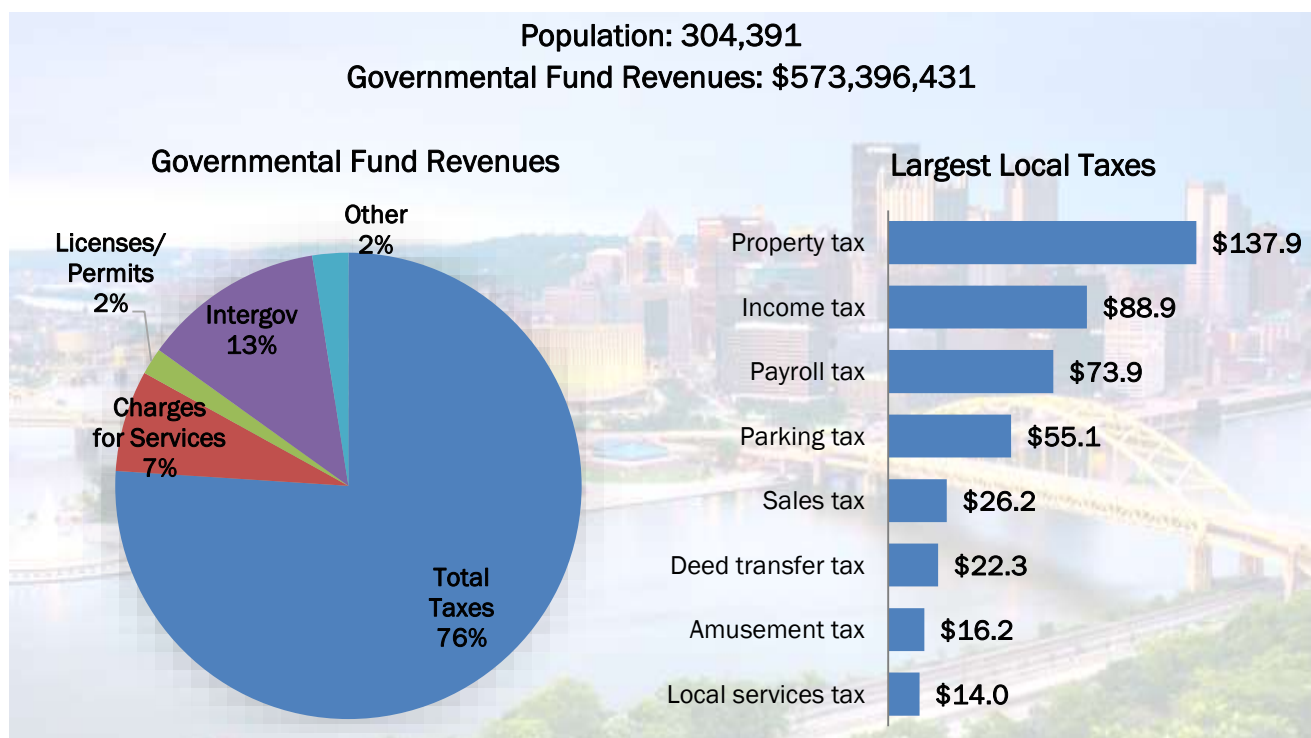
- A **reliable** revenue system is likely to generate the same amount or additional revenues from one year to the next with a relatively high degree of certainty and generally is expected to grow at a pace that mirrors the pace of local economic growth.



- A **balanced** system relies on a variety of revenue sources that are generated by different types of activities and by different types of taxpayers (e.g. property owners versus consumers of goods and services).
- A system that is **straightforward** does not require an inordinate amount of staff resources to collect revenues; does not place a significant burden on individuals or employers in terms of compliance; and is uncomplicated and easy for citizens to understand.
- An **equitable** system imposes similar tax burdens on people in similar circumstances.⁴

PITTSBURGH

As shown in the figure below, Pittsburgh's revenue structure is characterized by reliance on several types of local taxes that spread taxation across residents, employers, commuters, and visitors.



The following provides a brief summary of Pittsburgh's non-property tax forms of local taxation.

- **Earned income tax** – a 1% tax on the wages or net profits earned by city residents.
- **Payroll preparation tax** – a 0.55% tax on the gross payroll of for-profit employers.
- **Parking tax** – a 37.5% tax on parking transactions at nonresidential parking places.
- **Sales tax** – a percentage of a 1% sales tax levied by Allegheny County. One quarter of the proceeds is distributed by formula to municipalities.

⁴ "Principles of a High-Quality State Revenue System," National Conference of State Legislatures.



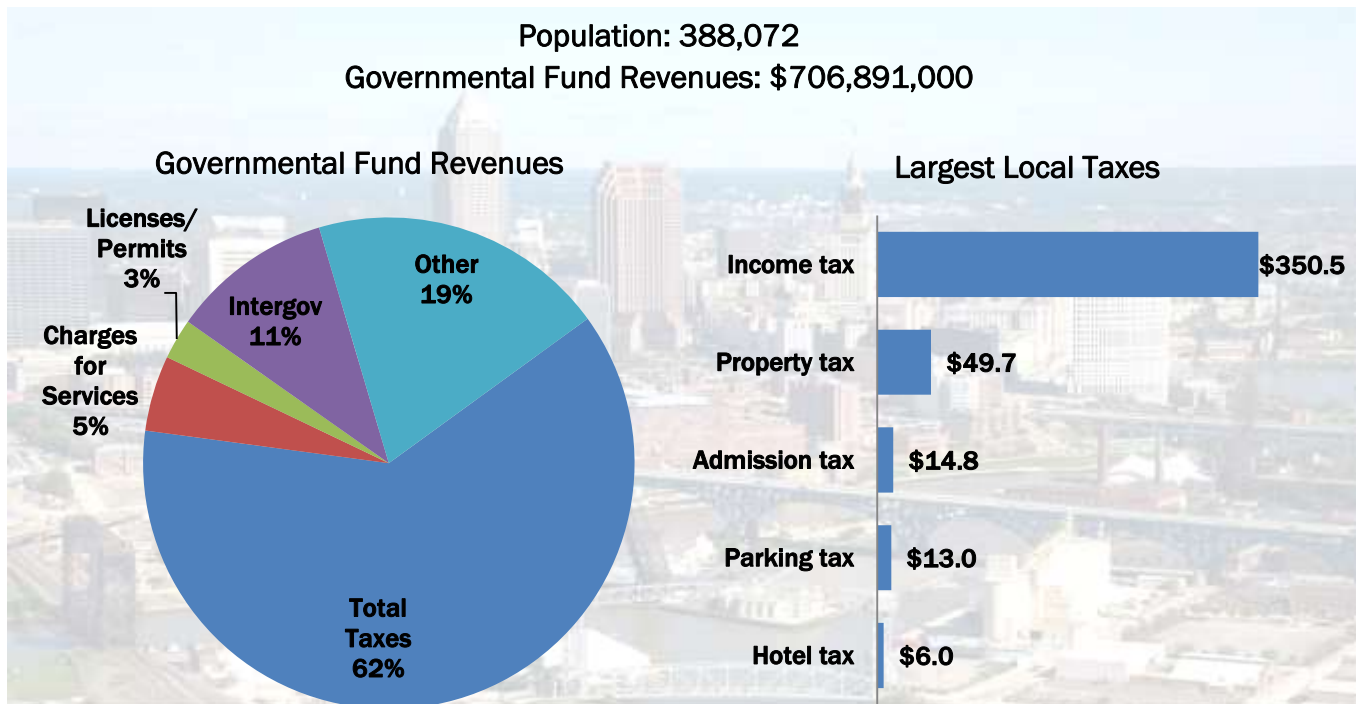
- **Deed transfer tax** – a 2% tax levied upon the transfer of an interest in real property.
- **Amusement tax** – a 5% tax on the admission price paid by patrons of any entertainment event (non-profit performing arts groups are exempted).
- **Local services tax** – a tax of \$1 per week (\$52 per year) on every employee working within the city (both residents and non-residents).

Pittsburgh's approach to generating revenues offers food for thought for Milwaukee. State and City leaders recognized a need to spread an increased share of the local tax burden to non-residents – both to ensure equity and to tap into Pittsburgh's growing advantages as a place where businesses wish to locate and where citizens from across the region and state wish to visit. Milwaukee has similar advantages that are rapidly expanding, which could lead to a similar conclusion.

City and state leaders also saw reform of their tax structure as an opportunity to make Pittsburgh more attractive to new businesses and to better position existing businesses to compete in the global economy. Similarly, the opportunity to engage Milwaukee business leaders in discussion on the potential benefits of substituting different forms of sales or payroll taxes for property taxes and user fees might be warranted and might be welcomed by those leaders.

CLEVELAND

As shown in the figure below, Cleveland's revenue structure is characterized by a heavy reliance on local taxes, with particular reliance on a local income tax.



The following provides a brief summary of Cleveland's non-property tax forms of local taxation.

- **Income tax** – a 2.5% tax on corporate income and wages earned in the city, whether by residents or non-residents. In November 2016, voters in Cleveland approved a 0.5% rate increase to 2.5%.
- **Admission tax** – an 8% tax on ticket sales for events held within the city. Religious and charitable organizations are exempted, as well as entertainment venues with capacity of fewer than 150 people.
- **Parking tax** – an 8% tax on commercial, non-residential parking facilities offering three or more parking spaces.
- **Hotel tax** – a 3% tax on hotels, motels, and other establishments that sell lodging to transient guests. The City of Milwaukee has a 7% hotel/motel tax, but the proceeds go to the Wisconsin Center District.

While Cleveland's revenue structure is similar to that of Milwaukee in its strong reliance on a single source of local taxation, the similarities end there. Cleveland's income tax reflects a far different philosophy for generating revenue in that it leans on non-residents who inhabit the city during the workday. The same is true – with visitors added to the mix – with regard to Cleveland's use of admission, parking, and hotel taxes. In stark contrast, Milwaukee's approach relies heavily on residents through property taxes and fees (though businesses pay these as well), and Milwaukee reaps no direct financial benefit from the entertainment, parking, food/beverage, retail, and hotel/motel purchases made by commuters and visitors.

Using a city income tax similar to Cleveland's likely would be a difficult pill for Milwaukee to swallow given the State's already high income tax rates. Nevertheless, Cleveland's use of a revenue structure that spreads the burden of paying for City services across the wide range of users – and that allows residents to determine when that burden can be increased without unduly impacting the city's attractiveness and competitiveness – would appear to merit consideration by those contemplating a different revenue structure for Milwaukee.

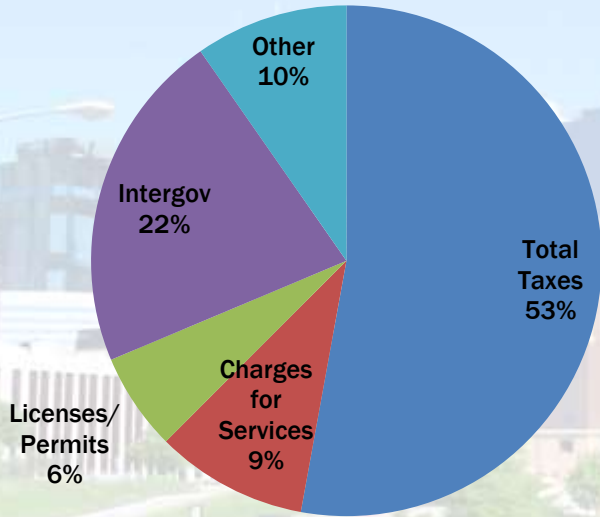
MINNEAPOLIS

As shown in the figure on the following page, Minneapolis' revenue structure, like Milwaukee's, is highly dependent on one single source: the property tax. Minneapolis supplements the property tax with a variety of general and selected sales taxes, however, and it also levies a franchise fee on local businesses.

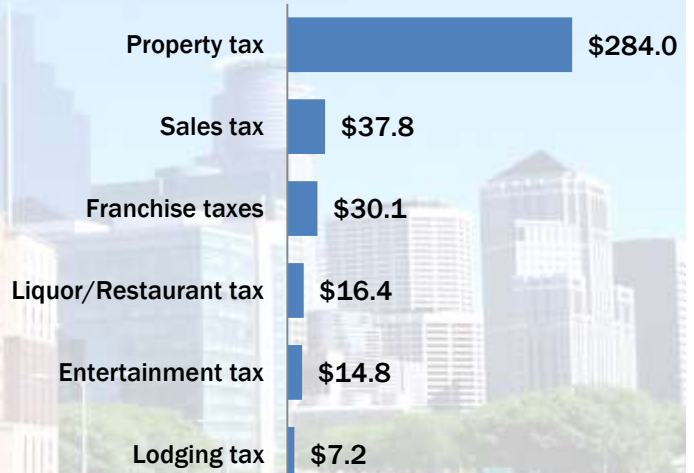


Population: 410,939
 Governmental Fund Revenues: \$743,458,000

Governmental Fund Revenues



Largest Local Taxes



The following provides a brief summary of the different types of non-property tax forms of local taxation employed by the City of Minneapolis.

- **Sales tax** – a 0.5% sales and use tax. Sales tax proceeds are directed first to payment of debt service and operational support for the city's convention center.
- **Franchise tax** – taxes on electric and natural gas utilities and cable television companies that serve the city. The City of Milwaukee does not have statutory authority to levy such taxes for energy utilities, but does for cable television companies.
- **Liquor/Restaurant tax** – a 3% tax on liquor, food, and beverages sold at bars, hotels, restaurants, and clubs in a downtown taxing district.
- **Entertainment tax** – a 3% city-wide entertainment tax on admission fees; use of amusement devices and games; food, drink, and merchandise sold in public places during live performances; and short-term lodging.
- **Lodging tax** – a 2.625% tax on lodging at hotels and motels with more than 50 rooms.

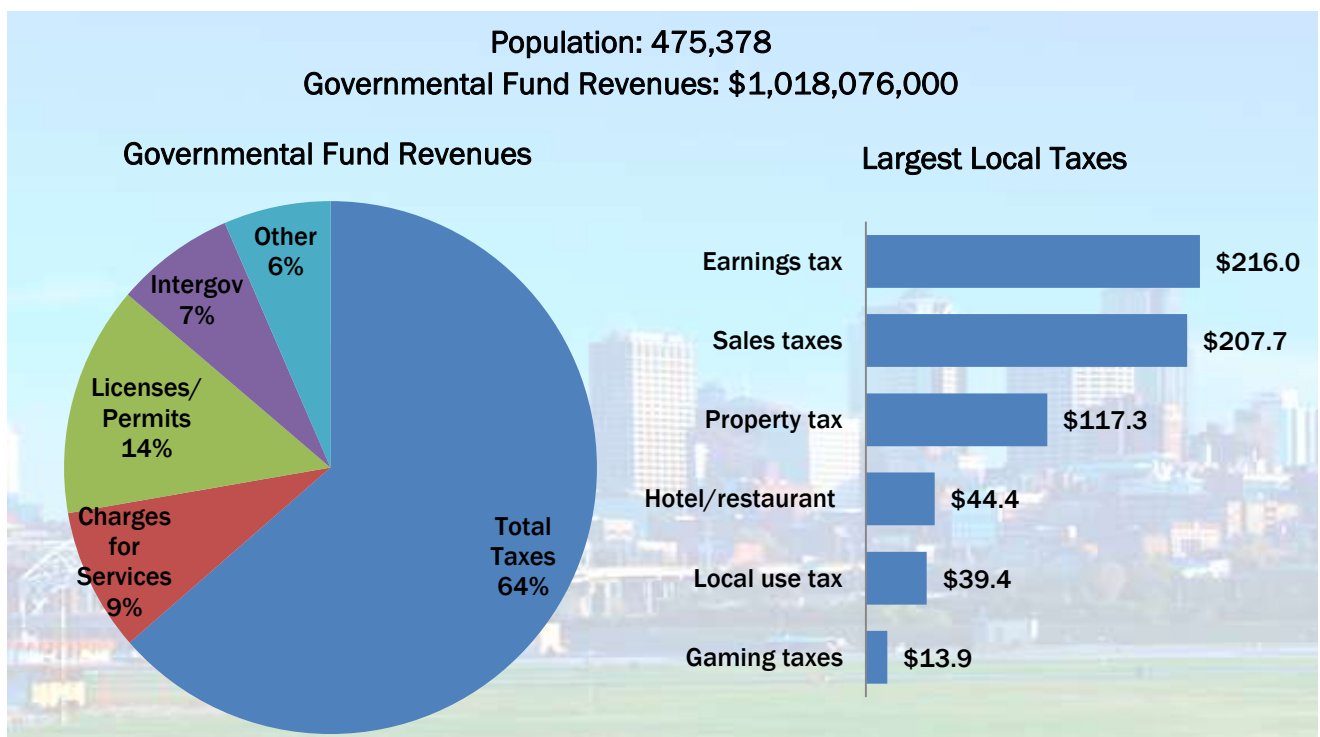
Of all of the cities analyzed in this report, Minneapolis has the revenue structure that is most similar to Milwaukee's. Minneapolis' heavy reliance on state aids and the property tax – while not quite as pronounced as Milwaukee's – gives its budget a similar flavor, particularly given that both cities have suffered from shared revenue reductions. Common characteristics include an increasing need to lean on user-based fees, and high property tax rates that are unpopular with constituents and that make policymakers wary of increasing them.



Where the two cities diverge is in Minneapolis' collection of general and selective sales tax revenues, which give it greater revenue diversity and elasticity than Milwaukee. Despite the fact that the first use of those taxes is to help pay for convention center debt service and operations, growth in those revenue sources also has been used to help the City withstand reductions in state aids. In addition, Minneapolis' use of an entertainment tax and downtown liquor and restaurant taxes show how selective sales taxes can target the unique attributes of a first class city to ensure that its throngs of entertainment-seeking visitors chip in for the cost of the basic city services they use.

KANSAS CITY (MISSOURI)

Like the other three peer cities, Kansas City's revenue structure is characterized by a heavy reliance on local taxes. Where Kansas City is distinct, however, is in its heavy usage of *each* of the three major forms of local taxation (income, sales, and property taxes), as shown in the figure below.



The following provides a brief summary of the different types of non-property tax forms of local taxation employed by Kansas City.

- **Earnings tax** – a 1% tax on the city earnings of all residents and non-residents, as well as business net profits. Both the earnings and profits taxes must be renewed by Kansas City voters every five years; the most recent renewal occurred in April 2016, with 77% of the vote.
- **Sales tax** – a 3% general sales tax, with the revenues specifically earmarked for distinct city functions.



- **Hotel/Restaurant tax** – a 2% tax on the sale of food, beverages, and liquor at restaurants and a 7.5% tax on lodging at hotels and motels. The two taxes are segregated in a special fund and only can be used to support convention and tourism activities.
- **Local option use tax** – levied at the same rates as the City's sales tax, but revenues primarily flow into the general fund. The tax is imposed on the out-of-state purchase of tangible personal property that is stored, used, or consumed in the city.
- **Gaming tax** – 10% of the proceeds of a state tax on the earnings of the city's two casinos.

Milwaukee leaders likely would envy Kansas City's mix of income, sales, and property taxes, which combine to provide a high likelihood of inflationary growth and to effectively spread local taxation among residents, commuters, businesses, and visitors. Yet, at the same time, there are strings attached to Kansas City's major revenue sources that detract from the reliability of its revenue structure. As recently noted by the Fitch ratings agency, Kansas City "has essentially no independent legal ability to increase revenues, with voter approval required for all new and increased taxes." Consequently, its capacity for revenue growth is dependent on "economic development trends."⁵

The need for voter approval can be a positive attribute of a revenue structure, and it certainly could be considered as a condition for altering Milwaukee's local tax structure. Dedicating specific local taxes to specific purposes also is a strategy that may have merit, as it provides taxpayers with assurance that any extra tax burden they accept will be linked to addressing a specific high-priority need (e.g. public safety) or resolving a specific high-priority problem (e.g. infrastructure repair backlogs). That being said, a structure with time-limited revenue streams and restrictions on uses of particular revenues can be confusing for taxpayers and disconcerting for fiscal officials.

MODELING ALTERNATIVE REVENUE STRUCTURES FOR MILWAUKEE

Next, we consider what the City's revenue picture might look like if revenue models from peer cities were applied to Milwaukee. Using insights gleaned both from our broad review of 38 peers and from our deeper analysis of four Midwestern cities, we developed four models.

A critical methodological decision was to **keep the total amount of revenue generated under each model identical to the amount of governmental fund revenue generated by the City of Milwaukee in 2015** (\$834 million). Consequently, the additional revenues generated by new forms of taxation in each model are used exclusively to reduce the property tax and state aids, as opposed to increasing the total amount of revenue available to the City.

This decision does not reflect a belief that consideration should not be given to *adding* revenue to the City budget or to redistributing the new resources in other ways. Our intent simply is to demonstrate how new revenue sources would alter the City's existing revenue portfolio and to discuss those in the context of the strengths and weaknesses of each form of taxation.

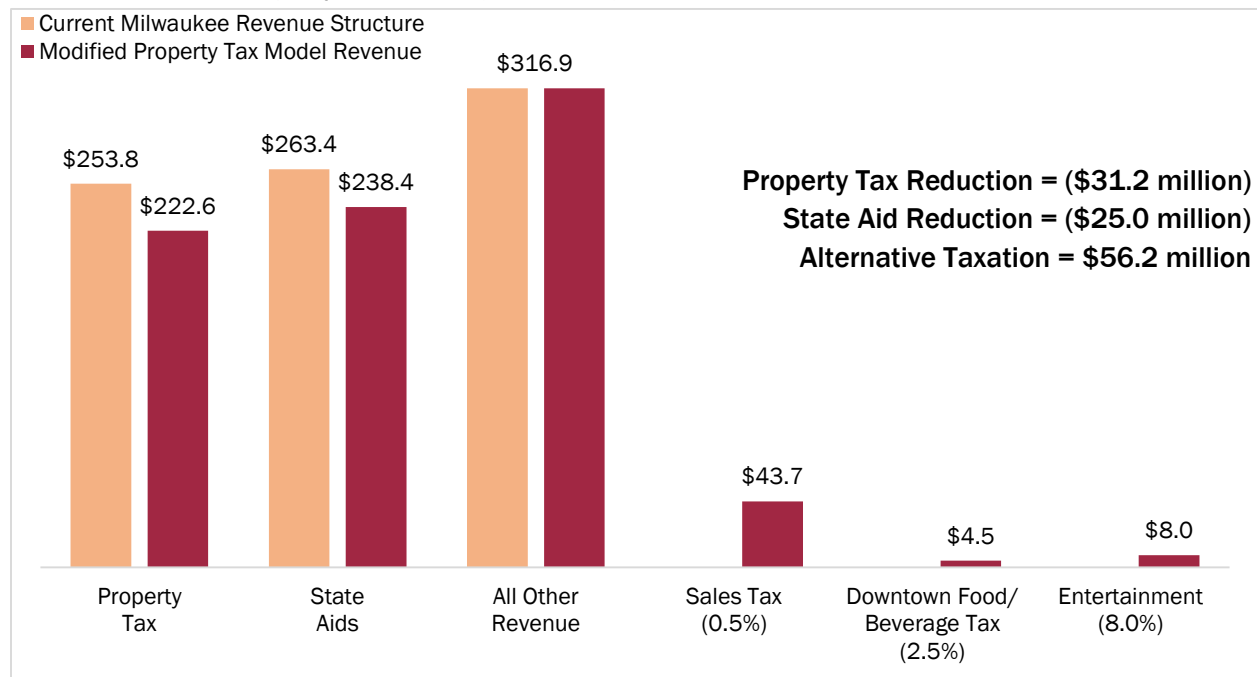
⁵ Fitch Ratings, "Fitch Downgrades Kansas City, MO GO to AA- on Criteria Change," February 2017.



MODEL I: MODIFIED PROPERTY TAX MODEL

We start with a model that most closely parallels the current tax structure in Milwaukee. This model is loosely based on Minneapolis' structure. It continues Milwaukee's heavy reliance on the property tax, but lessens it somewhat by adding a 0.5% general city sales tax; and selective sales taxes on entertainment (8%) and food/beverages (2.5%). We apply the entertainment tax to the entire city to ensure that Miller Park is included, but limit the food/beverage tax to the City's downtown per the example set by Minneapolis. **Chart 3** outlines the City of Milwaukee's revenue structure under the Modified Property Tax Model.

Chart 3: Modified Property Tax Model (in millions)

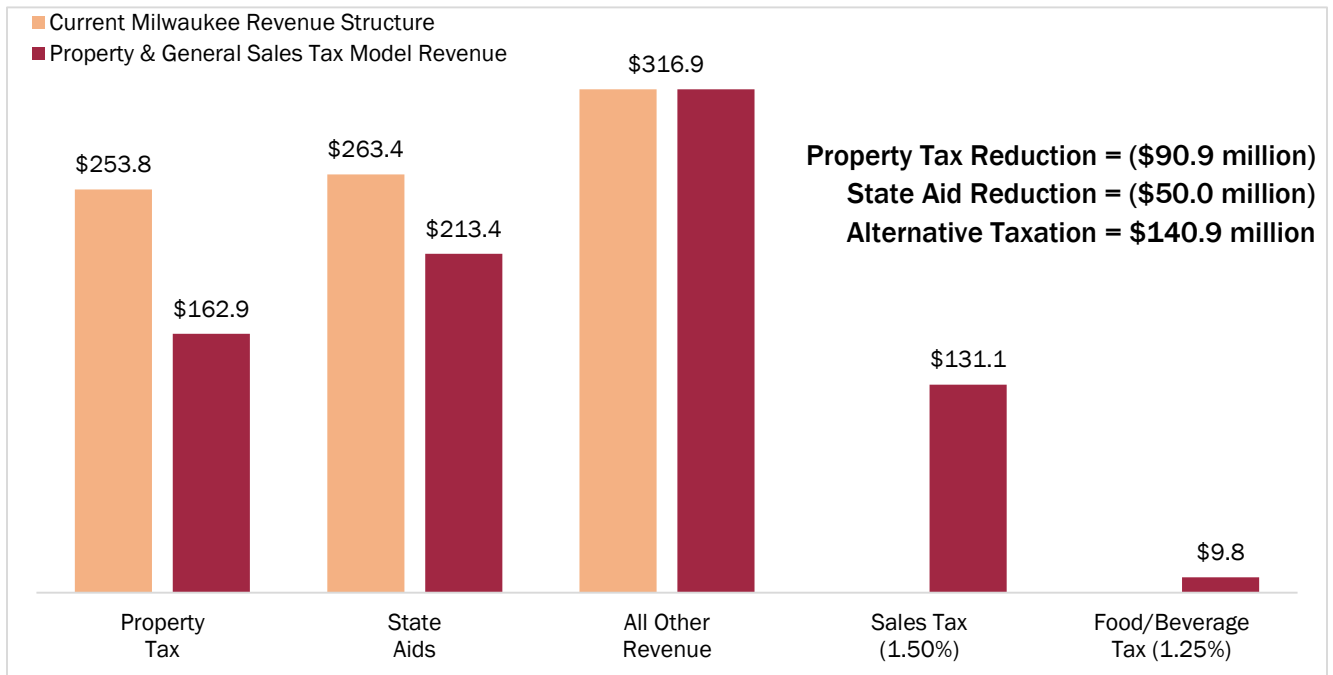


MODEL II: PROPERTY AND GENERAL SALES TAX MODEL

This model, which is loosely based on Kansas City's, adds a 1.5% general sales tax to Milwaukee's revenue portfolio, making that roughly equivalent to the property tax. Kansas City also has substantial reliance on the income tax, but we do not include income tax revenue in this model, as we felt it appropriate to include an income tax in only one of our four models (Model III). We do include a food and beverage tax in this model, as is the case in Kansas City. **Chart 4** outlines the City of Milwaukee's revenue structure under the Property and General Sales Tax Model.



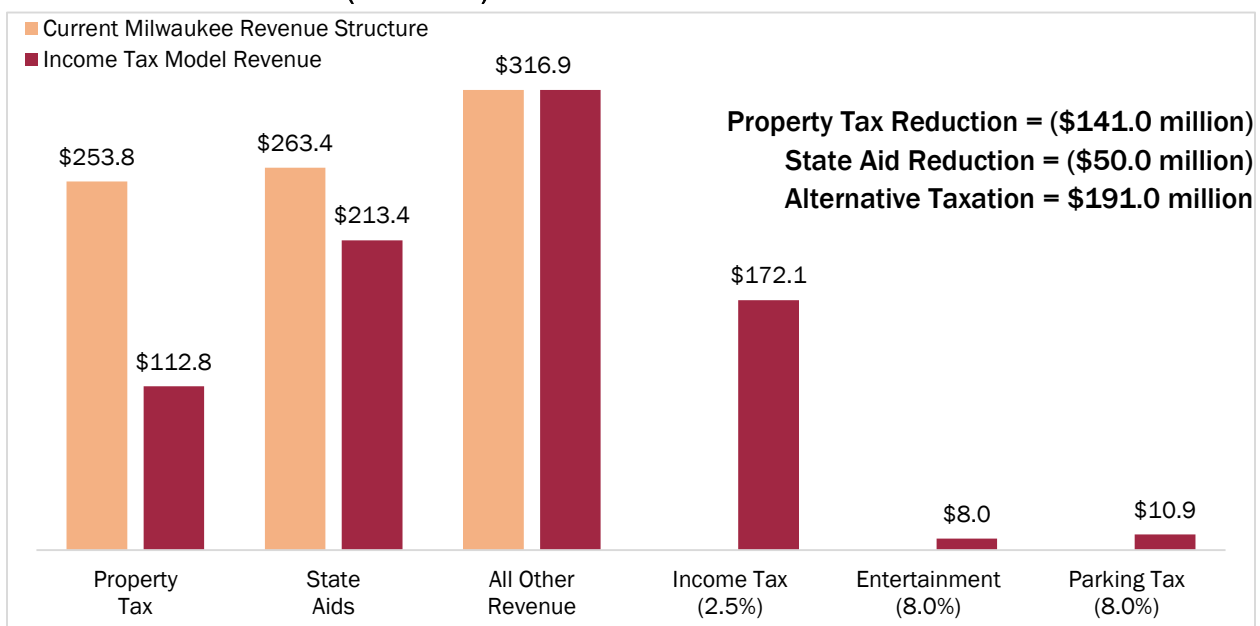
Chart 4: Property and General Sales Tax Model (in millions)



MODEL III: INCOME TAX MODEL

Our third model is based on Cleveland's revenue structure, which relies heavily on a 2.5% income tax on residents, non-residents who work in the city, and corporate income. Mirroring Cleveland, our Income Tax Model applies a 2.5% tax to individual and corporate income earned within the city as the primary source of local taxation, as well as an 8% selective sales tax on entertainment and parking. **Chart 5** outlines the City of Milwaukee's revenue structure under the Income Tax Model.

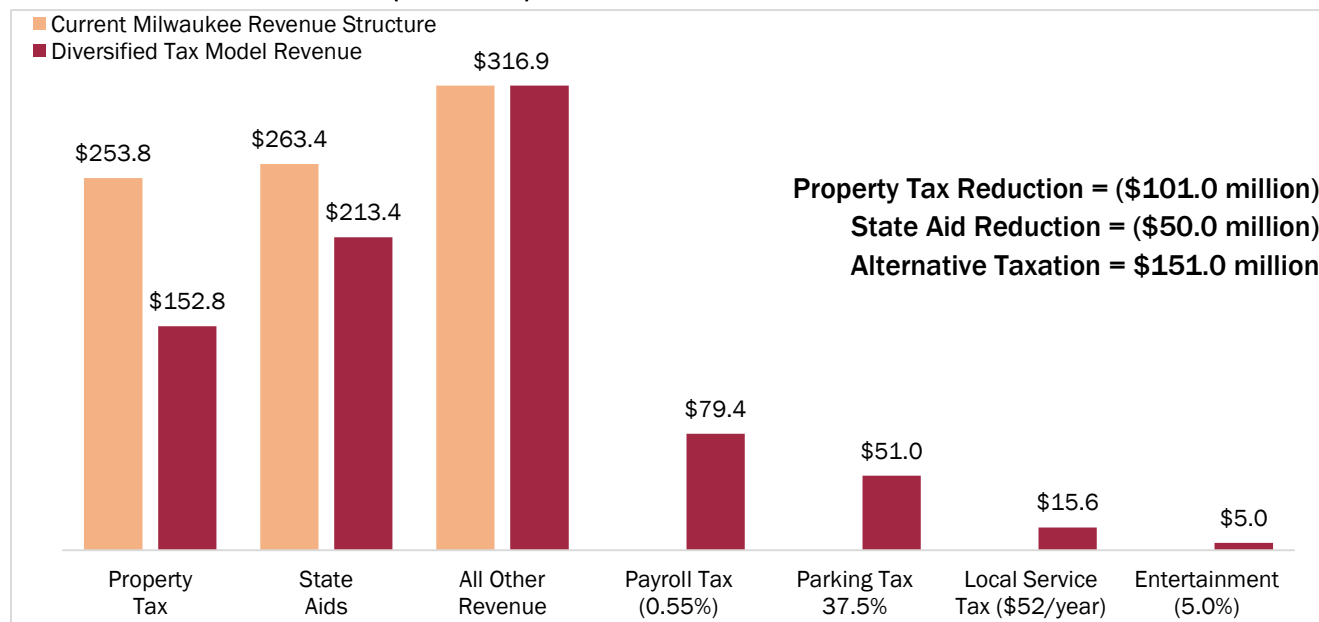
Chart 5: Income Tax Model (in millions)



MODEL IV: DIVERSIFIED TAX MODEL

Our final model, based on Pittsburgh’s revenue structure, institutes an array of local taxes that establish a highly diverse revenue portfolio. Specifically, our Diversified Tax Model mirrors Pittsburgh's by using a 0.55% payroll tax, 37.5% parking tax, 5% entertainment tax, and \$1 per week local services tax. **Chart 6** lays out the City of Milwaukee's revenue structure under this model.

Chart 6: Diversified Tax Model (in millions)



Our modeling exercise shows that the application of local taxes used by the Midwestern peer cities at their respective approximate levels of taxation would ameliorate several of the weaknesses inherent in Milwaukee's current revenue structure. In particular, each of the models would help Milwaukee address its two most visible defects: its over-reliance on the property tax and state aids.

Our modeling also suggests that when considered in the context of ideal revenue characteristics, each of the models would produce greater reliability, balance, and equity than Milwaukee's current structure. While each would add complexity by imposing new taxes, most of the new taxes we model already are being collected by a different governmental entity in Milwaukee.

OBSERVATIONS AND CONCLUSION

This report is intended to shed new light on the characteristics of the revenue structure that is supporting the City of Milwaukee. We began by analyzing the historical and statutory underpinnings of Milwaukee's revenue structure and how it compares to similar-sized cities across the United States. That analysis produced the following key observations:

- **No other state in the Midwest has a local tax structure like Wisconsin's.** Wisconsin is the only Midwestern state that limits municipalities to the property tax as the sole major form of local taxation, and one of the only whose largest city has the same tax structure as its other municipalities.



- **Milwaukee is particularly unique in its absence of general and selective sales taxes.** With the exception of Milwaukee, each of our 39 peer cities has multiple taxes and most have general or selective sales taxes. In fact, 30 have a general sales tax and each of the remaining eight generates substantial revenue from selective sales taxes and/or other forms of taxation besides the property tax.
- **As a general rule, cities with larger populations tend to draw more heavily on the sales tax and less upon the property tax.** Our analysis shows that sales taxes comprise more than 40% of the local tax revenues collected by cities with populations over 300,000, but just 28% for those with populations between 150,000 and 300,000.
- **State aid is a relatively minor source of revenue for most peer cities.** We find that among our 38 peer cities, state aids typically are a form of supplemental financial assistance, but they do not serve as a principal source of support compared with property or sales taxes.

Our deeper analysis of four Midwestern peers shows how distinct approaches to local taxation work in practice. We find there is no single or ideal model for Milwaukee to follow in local taxation. Nevertheless, we see that in their ability to draw on multiple sources of local taxation – and to have greater latitude to establish a structure that reflects their unique economic strengths – some peer cities appear to have substantial advantages.

Furthermore, in viewing peer cities in the context of revenue structure best practices, we see more clearly where Milwaukee's current structure falls short:

- **It is poorly balanced with low reliability.** Lacking diverse revenue streams, Milwaukee lacks the ability to offset the effects of economic swings with revenue sources that vary in response to economic factors.
- **It is inequitable in its reliance only on property-based taxes and fees.** Milwaukee's property owners and residents bear the bulk of the financial burden for Wisconsin's flagship city. Their property-related taxes and fees are the sole source of locally-generated support for municipal infrastructure and services that are critical to employment and entertainment for nonresidents, who pay no local taxes to the City.
- **It is far too reliant on state aid.** State aid has clear benefit to cities in that it redistributes statewide wealth to jurisdictions with high levels of poverty. Yet, because Milwaukee's state aids have not grown over time, the City has been severely challenged in securing total annual revenue growth that matches inflation and meets its expenditure needs.

Overall, our analysis reinforces the need for an objective and informed discussion among policymakers, civic leaders, and citizens about the efficacy of Milwaukee's current revenue structure. Initially, this discussion should put aside the question of whether the City requires *more* revenue. Instead, it should focus on whether a structure that was imposed on the City more than a century ago still is effective and relevant, and on what types of changes might be pursued to ensure that principles of tax equity, revenue reliability, and administrative simplicity can be achieved.





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