

THE BIG SQUEEZE:

Retirement Costs and School District Budgets

Milwaukee: Saved by Act 10... For Now

by Robert Costrell
and Larry Maloney



TAXES



RETIREMENT COSTS



EDUCATION BUDGETS



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Milwaukee: Saved by Act 10... For Now

SUMMARY

As of 2011, the Milwaukee Public Schools (MPS) were spending \$1,860 per pupil on retirement costs. Under the policies in place at that time, this figure was slated to rise to \$3,512 by 2020 (all dollar figures, here and that follow, are adjusted for inflation).

That projected increase was driven primarily by an explosion in the district's costs for retiree health insurance, a program that was covered by collective bargaining agreements between the district and its unions. Retiree health costs in MPS were dominated by expenditures on early retirees, heavily subsidized by the district, prior to Medicare eligibility at age 65.¹ Retiree health costs rose from \$268 per pupil as recently as 2004 to \$831 per pupil in 2011, and they were projected to rise to \$2,135 by 2020, based on MPS's actuarial valuation at the time. Moreover, as daunting as these projections were, they were predicated on the fiscally short-sighted practice of funding retiree health care almost entirely on a pay-as-you-go basis (also called "pay-go"), instead of actuarial pre-funding.² If Milwaukee started pre-funding future health-care retirement costs in full, these numbers would have been far worse. MPS's actuarial valuation report showed that the "annual required contribution" (ARC) was close to \$2,500 per pupil in FY11 and projected to rise to more than \$4,900 by FY20.

The good news is that Wisconsin passed Act 10, also known as the Budget Repair Bill, in March 2011 (effective that June). By removing benefits from collective bargaining, Act 10 gave MPS the authority to modify its retiree health program, and MPS has acted upon that authority. In November 2011, the Milwaukee Board of School Directors approved a number of important changes, including reduction of the retiree health subsidy (and other measures discussed in this report) that will reduce current pay-go expenditures and slow future growth. Instead of rising from \$831 per pupil in FY11 to \$2,135 by FY20 (an increase of \$1,304 per pupil), we project a more modest rise of \$248 per pupil to \$1,079.³ This is a savings of \$1,056 per pupil under Act 10. As welcome as this relief is, however, this assumes Milwaukee continues on its pay-go path. If so, the actuarial cost by FY20 would rise to \$1,992 per pupil. This is less than half the actuarial cost that was projected prior to Act 10, but is still nearly double the current projection for pay-go expenditures in FY20. Future difficulties, while much reduced, are still being deferred.

The numbers above are for retiree health insurance alone—they do not include pension costs. Adding in pension costs raises the figure. MPS employees participate in four pension plans, run by the state, the

city, and the school district. MPS contributions to all four plans cost \$734 per pupil in FY02 and rose to \$1,029 as of FY11. Fortunately, Act 10 offers MPS good news here, too. Act 10 made two changes relevant to pension costs. First, it required employees to actually pay the employee portion of the state retirement plan (to which MPS teachers belong) and Milwaukee’s city retirement plan (to which MPS “classified” employees belong, generally meaning non-teachers). Previously, these “employee” contributions were paid by MPS. Second, by removing benefits from local collective bargaining, Act 10 allows districts to modify district-specific retiree benefits. MPS used that authority to close and freeze its supplemental pension plan for teachers, starting in FY14. As a result of these combined changes, MPS pension costs are now projected to drop \$184, from \$1,029 in FY11 back to \$845 by FY20. If Act 10 had not been passed (or if its effects were to be repealed), the pension costs would rise to \$1,378 by FY20. Thus, Act 10 is projected to save MPS \$533 per pupil in pension costs by FY20.

Taking pension costs and retiree health together, we calculate that Act 10 will save MPS \$1,588 per pupil by FY20. Instead of retiree costs rising by \$1,652 per pupil (to a total of \$3,512), we now project a rise of only \$64 per pupil (to \$1,924). To be sure, MPS is not out of the woods yet. Its pay-go policy on retiree health means that the cost of obligations incurred to current employees is being postponed. The cuts MPS has enacted to district costs for retiree health have bought the system time, but further action may still be required. Indeed, the Milwaukee school board’s finance committee voted in December to close the retiree health plan entirely to new employees. The full board did not accept this recommendation, but directed the administration to notify all prospective new employees that the current plan would not be available, while it considered such measures as requiring active employee contributions.⁴ Fortunately, Act 10 provides MPS with the authority to act as needed. Even without future action, Act 10 has allowed MPS to avoid considerable adverse impact. Without the authority to make the changes, Milwaukee would likely have faced intractable choices between raising taxes or cutting the rest of the K-12 budget.

The lesson from Milwaukee—and Wisconsin more generally—is that the difficult problem of rising retirement costs faced by school districts is not entirely beyond the system’s control. Act 10 gave MPS the authority to act without the constraint of collective bargaining. MPS used that authority quickly and responsibly, approving changes that will dramatically shift costs from the district to the member for health benefits of future early retirees, i.e., those who retire before Medicare kicks in at age 65. Together with Act 10’s requirement that employees actually pay the employee contribution to pension plans, these actions mean that MPS faces a more manageable future.

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This technical report is one of three on retirement costs and their impact on school-district budgets. The first, [Paying the Pension Price in Philadelphia](#), was released in June 2013; the third, [Ohio Pension Reform in Cleveland: New Teachers Beware](#), is due for release in early Fall 2013. A summary report of all three can be found at <http://www.edexcellence.net/publications/the-big-squeeze.html>

INTRODUCTION: RETIREMENT COSTS IN MILWAUKEE

Retirement benefits in Milwaukee—the largest district in Wisconsin, with about 75,000 students and 5,400 teachers—combine membership in the state pension plan with locally-sponsored pensions and the district's retiree health plan. In FY11, MPS spent about 43.3 percent of its \$1.27 billion budget on the salaries of current employees and 11.5 percent on retirement benefits. Retirement costs were therefore 26.5 percent of salaries on average, far higher than the comparable standard of 5 percent in the private sector.⁵ In per-pupil terms, MPS spent about \$16,200 in FY11, of which \$1,860 went to retirement costs.

As of 2011, Milwaukee's cost of retirement benefits was slated to rise rapidly over the rest of the decade. While MPS's contributions to the state, city, and district pension funds were set to rise modestly, it was the district's retiree health insurance (RHI) program that most threatened fiscal disaster.

Part of the problem is that the district's RHI program has been funded almost entirely on a pay-as-you-go basis. This means that MPS is using current-year tax revenues to pay current-year retiree health benefits—rather than pre-funding the obligation during the work-life of those who will later become the beneficiaries. Such a policy might have seemed to make sense in an era of growing enrollments, payroll, and revenues, as modest contributions from a large current payroll could support the much smaller number of retirees from previous cohorts. But in districts with declining enrollments (such as MPS), the current available payroll

Act 10 Provisions Related to Retirement Costs for MPS

Act 10 has two provisions that pertain to the various components of MPS retirement costs:

The first provision replaces some employer contributions with employee contributions to certain retirement programs. Under previous law, the Wisconsin Retirement System (WRS) specified both employee and employer contributions, but authorized WRS employers to pay all or part of the employee contribution. MPS teachers are WRS members, and this benefit—employers paying the employee share—was negotiated under collective bargaining with MPS (as in most other districts). Act 10 repeals this benefit, once the current contract expires, thereby reducing MPS's total contributions. This provision also applies to the City of Milwaukee's Employee Retirement System, to which MPS classified employees belong.⁶

The second provision removes locally negotiated retirement benefits from collective bargaining (again, once the current contract expires), which allows the employer to then modify (or eliminate) those benefits.⁷ The locally bargained retirement programs for MPS include the Early Retirement Supplement and Benefit Improvement Plan, for administrators and other professional employees (originally negotiated with the Administrators' and Supervisors' Council, but closed to new hires since 2003),⁸ and the Supplemental Early Retirement Plan for Teachers (which was frozen by MPS last year for current teachers and closed to new hires beginning July 1, 2013, under authority of Act 10).⁹ This provision of Act 10 also pertains to MPS's Retiree Healthcare and Life Insurance Programs, as well as the active employees' health benefits, upon which the retiree program is based. That authority was exercised in November 2011 when the MPS school board approved various benefit reductions, effective upon expiration of current contracts, as discussed in the text; MPS is considering exercising that authority again, as resolved at the December 2012 board meeting.

to support those expenses under a pay-go policy is shrinking—and, at the same time, baby boomers are retiring.¹⁰ Coupled with rising health costs in general, this was a recipe for a rapidly rising fiscal burden from retiree health insurance expenditures—until MPS was able to take action.

Both retiree health insurance and pension costs are now more manageable thanks to Wisconsin's controversial 2011 Act 10 (see *Act 10 Overview and Legal Status*). Under that legislation, school employees will contribute more of their salaries to the state and city pension funds, and, using the authority granted by that legislation, MPS will close and freeze a district-specific supplemental pension plan for teachers. Most important of all for Milwaukee, Act 10 provided MPS with the tools to bring the retiree health program under control, and MPS has made a good start on using those tools (see *Act 10 Provisions Related to Retirement Costs for MPS*).¹¹ Specifically, by removing benefits from collective bargaining upon expiration of current contracts, Act 10 empowered MPS to pare back the costs of retiree health benefits (as well as active employee health benefits). This enabled MPS to start making the hard choices necessary to avert more acute fiscal distress in the near future.

Without the changes MPS made under Act 10, the district's retiree health costs of \$831 per pupil in FY11 were slated to jump to \$2,135 per pupil by 2020 (all figures, here and that follow, are inflation-adjusted to 2011 dollars). Under the authority of Act 10, MPS took steps to bring these skyrocketing expenditures back to earth. Instead of rising from \$831 per pupil in FY11 to \$2,135 in FY20, the pay-go projections rise only to \$1,079 by FY20.^{12, 13}

However, the small increases under pay-go mask the fact that the policy still pushes the costs of the current generation on to future taxpayers. Prior to the changes under Act 10, the deferral of future obligations was truly stunning. According to data from the MPS actuarial valuation in effect at that time (dated June 25, 2010) the "annual required contribution" (ARC) to pre-fund retiree health benefits and pay off that program's unfunded liabilities would have amounted to \$2,485 per pupil in FY11, instead of the \$831 contributed under pay-go. Moreover, the longer pre-funding is delayed, the more painful the adjustment in the future. Assuming MPS continues on its pay-go path, without Act 10 the ARC was slated to reach \$4,903 per pupil by FY20. With the changes that MPS enacted under Act 10, the ARC is projected to rise to \$1,992 per pupil—a far cry from \$4,903, but still nearly double the projected pay-go expenditure for that year. It is for that reason that MPS is considering further changes to the retiree health plan, or even closing it down altogether for new hires, steps that could not readily be taken without Act 10.

All of these figures are for retiree health alone, before adding in the cost of pension benefits. With regard to the district's pension costs, Wisconsin's Act 10 helped ease the burden directly by shifting some pension contributions from MPS to the employee for those plans provided by the state and city. Act 10 also helped indirectly by allowing MPS to address its district-based supplemental pension plan for teachers, without going through collective bargaining.

To understand the impact of MPS's retirement obligations, we first present our analysis of the total financial burden of growing retiree costs under both the pre-Act 10 and post-Act 10 scenarios. We rely heavily on the projections prepared for MPS in its actuarial valuations of retiree health care, as well as the actuarial reports for the various pension plans covering MPS employees. The comparison between the two scenarios will show the extent of the fiscal fiasco that Act 10 allowed Milwaukee to dodge, at least for now.

For the retiree health program, we assume that MPS continues to operate on a pay-go basis. However, we also show what the costs would be under the actuarially-determined “annual required contribution,” to pre-fund benefits and pay down past liabilities. These estimates are also drawn from the MPS valuation reports. Comparing these scenarios helps illustrate the continuing challenges that MPS faces.

In the final part of this analysis, we examine the potential impact of the projected rise in retiree health and pension costs on staffing, salaries, and other instructional supports in MPS. It is an instructive tale about the strong measures required to avert fiscal collapse, empowered by Wisconsin’s Act 10.

Act 10 Overview and Legal Status

By Dara Zeehandelaar, Thomas B. Fordham Institute

In March 2011, Wisconsin enacted Act 10, a bill requested by Governor Scott Walker to reduce Wisconsin’s budget deficit. The law requires public employees to provide half of the pension contributions to the Wisconsin Retirement System (the state’s largest pension fund, covering all Wisconsin public school teachers) and the Milwaukee County Employees’ Retirement System. It also requires workers in the City of Milwaukee Employees’ Retirement System to pay the entire expected employee contribution. These systems had previously allowed workers to contribute little or nothing to their pensions, with employers paying large shares of their expected contributions.¹⁴ Act 10 also imposes limits on collective bargaining by narrowing the scope of bargaining to wages only, restricting wage increases to a cap determined by the consumer price index (barring a referendum saying otherwise), and limiting contracts to one-year terms. Moreover, the law prohibits unions from collecting dues through automatic deductions from its members’ wages and requires each union to be recertified annually by a majority of eligible employees. Public-safety unions, such as those representing police and firefighters, are exempt from the collective bargaining provisions of the Act.¹⁵

Organized labor reacted strongly against the law, filing suits in federal and state courts. In June 2011, the Wisconsin Education Association Council (WEAC) and six other public sector unions filed a federal suit, arguing that the limitations on collective bargaining violated workers’ free-speech and (due to the public-safety exemption) equal-protection rights.¹⁶ The district court initially sided, in part, with the pro-union plaintiffs and overturned portions of the law in March 2012.¹⁷ But in January 2013, the U.S. Court of Appeals for the Seventh Circuit reversed the lower court’s decision and upheld Act 10 in its entirety.¹⁸

Meanwhile, Madison Teachers Inc. and Milwaukee’s Public Employees Local 61 filed suit in a Dane County district court in August 2011, challenging all the collective bargaining limitations and the increased pension contributions for Milwaukee employees. In September 2012, the court ruled in the pro-union plaintiffs’ favor, overturning the collective bargaining limitations because they violated the union’s right to free speech, free association, and equal protection under the law. The court also struck down the requirement that City of Milwaukee employees pay their full share of pension contributions because Milwaukee has constitutionally guaranteed home-rule authority over its pensions.¹⁹

Unsurprisingly, the state appealed. In response, in March 2013 the Wisconsin Court of Appeals denied the state’s request but clarified that the Dane County court’s ruling applied to that county only.²⁰ (Dane County includes Madison, but not Milwaukee.) The state court’s decision, coupled with the federal ruling that declared all provisions of Act 10 constitutional, means that Act 10 is presently in full effect in seventy of Wisconsin’s seventy-one counties. However, the Court of Appeals has yet to make its final ruling, which will be binding in all of the state’s counties (and will likely be appealed to the state supreme court regardless of what it decides).²¹

SUMMARY OF MILWAUKEE'S RETIREMENT BENEFIT PROGRAMS

Milwaukee Public Schools has five retirement benefit programs for its employees: two regular pension plans, two supplemental pension plans, and a retiree health insurance (RHI) plan (see below). The plans vary by which group of employees is covered (teachers, administrators, and other non-teaching staff), which public entity administers the plan (state, city, district), and how it is funded (contributions by district and/or employee).²² In brief, these are the five plans and their major characteristics:

Retiree Health Insurance (RHI). This benefit is a district program that covers virtually all employees of MPS (both teaching and non-teaching). The program was previously locally bargained, but under Act 10 it is now under the sole control of the MPS Board of School Directors. MPS recently enacted important changes that have gone, or will soon go, into effect for new and current retirees. The benefit is funded primarily by MPS contributions, together with generally small premiums for the retirees, but this will gradually shift in the coming years.

Regular Pension, Certificated Employees. The regular pension for MPS teachers and other “certificated” staff (such as principals and assistant principals) is provided by the Wisconsin Retirement System (WRS), a state program that covers all teachers in the state, as well as state employees. For MPS (and many other districts), it has been funded by district contributions alone, including the contribution designated for members, but under Act 10 half the total contribution will shift to employees.

Regular Pension, Classified Employees. The regular pension for classified school staff, such as clerical employees and service workers, is provided by the city through the Milwaukee Employee Retirement System (ERS). As with MPS members of WRS, the pension for MPS members of ERS has been funded by district contributions alone, including the 5.5 percent contribution designated for members, but under Act 10 member contributions will shift to employees.

Administrators' Supplemental Pension. This benefit, covering school administrators, is a district program. It provides supplemental benefits to principals, assistant principals, and other administrators who retire early. It is funded by MPS contributions. The program has been closed to new hires since 2003.

Teachers' Supplemental Pension. This benefit is a district-sponsored pension for teachers. Prior to Act 10, it was locally bargained. Modeled after the Administrators' Supplemental Pension, it provides supplemental benefits for early retirement. It is funded by MPS contributions. Using authority granted to it under Act 10, MPS closed the program to new hires and froze it for current employees, effective July 1, 2013.

We explore the budgetary implications for all five programs in this analysis, beginning with RHI—which was previously projected to do the most damage to the district's bottom line, prior to recently enacted changes.

THE DISTRICT'S BILL, PART 1: RETIREE HEALTH INSURANCE

Retiree health insurance is a benefit rarely offered by private employers, primarily because the standard retirement age is 65, at which point individuals are covered immediately by Medicare. Teachers, however, often retire in their 50s, due to the provisions for early retirement embedded in their pension plans and the eligibility conditions for "normal retirement" that are often satisfied well before age 65. In MPS's program, retirees have been generally eligible for health coverage at age 55 with 15 years of service to the district. The program's main expense is for those retirees younger than 65, who continue on the same health plan they had when they were employed. Upon reaching age 65, the costs mostly shift to Medicare.²³

The MPS health plans (covering both non-Medicare retirees and actives) have been very expensive, due to design features such as low (or zero) deductibles and low co-insurance.²⁴ For retirees, MPS has covered the same amount of the premium as it did upon the date of the individual's retirement.²⁵ Prior to August 2011, MPS paid the entire premium for most employees, and so, as a result, most current retirees pay only the increase in premiums after they have retired.²⁶

The retiree health benefits were previously established by local collective bargaining, as were the health benefits for active employees, upon which the pre-Medicare retiree benefit plan is based. However, Act 10 removed health benefits from collective bargaining. In November 2011, acting under authority of Act 10, the MPS Board of School Directors approved benefit changes, effective upon expiration of current contracts (July 1, 2013 for teachers and July 1, 2012 for classified employees).²⁷ There are several important aspects to the changes.

First, the deductibles, co-insurance, and co-pays on health plans for active employees and non-Medicare retirees will be increased dramatically.²⁸ For the Preferred Provider Organization (PPO) plan, the deductibles will rise by a factor of 10, from \$75 per person and \$225 per family to \$750 and \$2,250. The co-insurance rate paid by the member will rise from 10 percent to 20 percent, and the annual limit on co-insurance payments will go up by a factor of 12.5, from \$200 per person and \$600 per family to \$2,500 and \$7,500. Deductibles, co-insurance, and co-pays on the more restrictive plan, offered by the Exclusive Provider Organization (EPO), will also increase substantially.^{29, 30}

Second, employee premiums for these plans will rise. Upon expiration of the current contract, employees will pay between 11 and 14 percent of the PPO premium (depending on salary) and between 5 and 12 percent of the EPO premium. Specifically, the premium for the average MPS teacher with family coverage will rise from about 6 percent of the total premium to 10 percent for the EPO and 13 percent for the PPO.³¹ This will reduce the MPS share of the premium, which establishes the retiree's subsidy, upon retirement. Moreover, the formula for the retiree subsidy will change. Instead of the MPS share of the PPO premium, the subsidy for new retirees will equal the average of the MPS share of the PPO and EPO premiums, upon retirement. In addition, the eligibility condition for new retirees to receive this premium subsidy will rise from the accrual of 70 percent of maximum sick leave to 90 percent.

Third, the district will end the currently available indirect subsidy for those pre-Medicare retirees who lack sufficient sick leave to qualify for the premium subsidy. The indirect subsidy was the privilege of buying MPS insurance as part of a blended pool with active employees, who are, on average, younger and healthier. Henceforth, self-paid premiums will be rated separately for new pre-Medicare retirees.

Fourth, the age-and-service eligibility requirement will rise. For retirements prior to July 1, 2013, the retiree must be age fifty-five with fifteen years of service. Thereafter, the requirement will be age sixty and twenty years of service.³² This is a particularly important measure, since it reduces the high-cost pre-Medicare period of coverage.

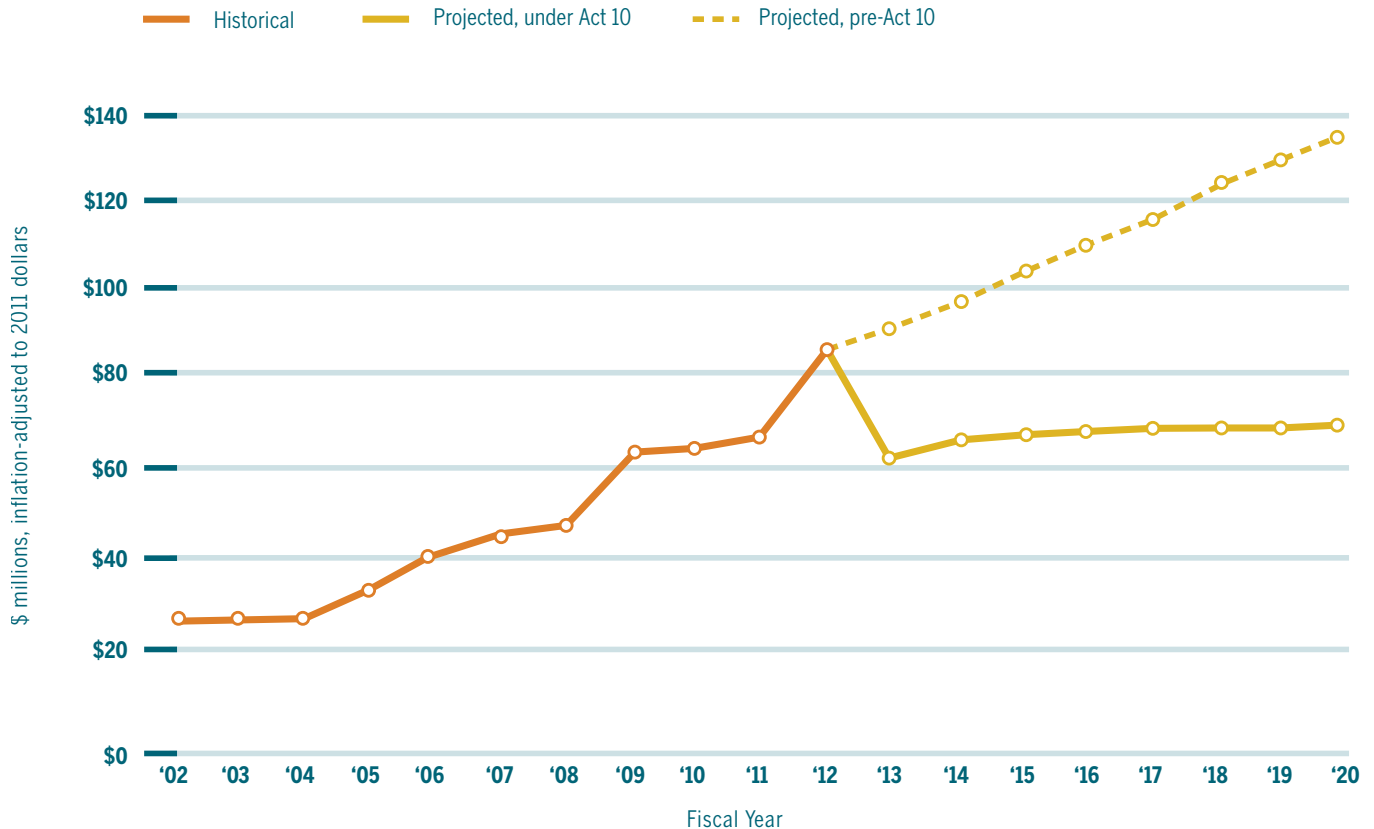
Taken together, MPS projects that these changes will have a significant impact on district costs in both the short run and the long run, as we will show.³³

But first, a word about funding policy. Like many other public retiree health insurance programs, MPS's program is effectively operated on a pay-as-you-go basis. In other words, annual contributions to the plan pay for current-year retiree health benefits instead of pre-funding the future obligation for those who will later become the beneficiaries.³⁴ This creates a huge problem when the number of retirees grows faster than the number of active employees, and especially when the number of active employees declines, as has occurred in MPS. The district had one retiree receiving health benefits for every 1.99 current employees as of 2007 (according to the actuarial valuation for that year), but that ratio is now projected by MPS to reach 1.25 retirees for every active employee by 2014.³⁵ As a result, the district's retiree health care costs, as a percentage of payroll, were projected to nearly double, from 12.0 percent in FY10 to 23.0 percent in FY19, in the valuation prior to Act 10.³⁶

In dollar terms, MPS contributions to retiree health costs grew from \$25.4 million in FY02 (inflated to 2011 dollars) to \$65.3 million in FY11.³⁷ These contributions are projected forward for a ten-year horizon in each actuarial valuation of the MPS retiree health plan, conducted by Gabriel Roeder Smith & Company (GRS).³⁸ These valuations are prepared biennially. Two separate projections are presented, drawn from the last two such reports, released in 2010 (based on 2009 data) and in 2012 (including actual data for FY12).³⁹ The projections from these two reports differ primarily because of the changes in the retiree health plans that were enacted by MPS in the interim, as empowered by Act 10.

As shown by the solid yellow line in Figure 1, contributions are projected by MPS, in the most recent valuation, to rise from \$65.3 million in 2011 to \$68.7 million (adjusted for inflation) by 2020. The bump depicted for 2012 reflects a one-time extra contribution of \$31.6 million for pre-funding, well in excess of the \$3.2 million required under MPS's policy of pre-funding an amount equal to 5 percent of claims.⁴⁰ Thus, aside from that bump, the valuation report projects essentially flat pay-go expenditures. These projections reflect the board-approved future changes, under Act 10. The anticipated costs without the plan changes are also depicted in Figure 1, with the dashed line. This projection is drawn from the prior valuation (with a one-year extrapolation from that report's 2019 horizon to 2020). The difference between the two trajectories, pre- and post-Act 10, is quite substantial.

To understand the true impact of the district's retiree health cost, it is most useful to present these figures on a per-pupil basis. Figure 2 provides the historical and projected figures, using enrollment counts discussed in Appendix A. The MPS contribution to retiree health insurance rose from \$261 per pupil in FY02

Figure 1 MPS Retiree Health Contributions

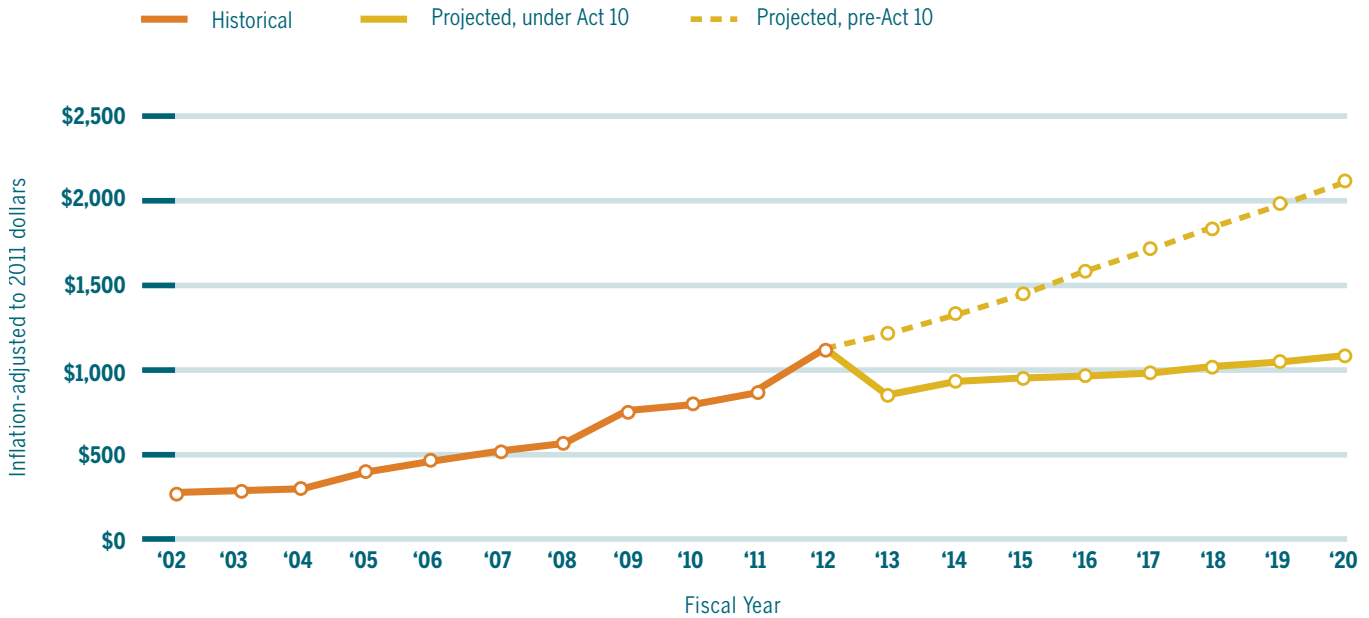
Sources: MPS CAFRs FY02-FY11; MPS OPEB Valuations FY09, FY11

to \$831 in FY11 and is projected to rise modestly, but significantly, to \$1,079 by FY20 (again, all figures in 2011 dollars), a rise of \$248 per pupil. As a percent of salaries, this is essentially flat, ranging from 13.0 percent in FY11 to 13.4 percent by FY20.

By contrast, without the changes enacted under Act 10, we project that FY20 costs would have reached \$2,135 per pupil, or 26.4 percent of payroll. Thus, we project the changes to RHI under Act 10 will save over \$1,000 per pupil. Instead of rising by \$248 per pupil, the costs would have risen by \$1,304.

Both of these scenarios assume that MPS continues on its current policy of “mainly pay-as-you-go funding” (to use the term from the valuation reports). Prior to FY11, the system was purely pay-go: liabilities were not only *underfunded* but literally *unfunded*—the district put aside no assets whatsoever to cover its future costs. Starting July 1, 2010, MPS established a policy to add an employer contribution equal to 5 percent of current claims and deposit this sum in a trust, to provide some minimal pre-funding for future benefits. For the first two years of this policy, MPS has actually exceeded this requirement, including the FY12 bump discussed above, which represented almost ten times the 5 percent policy. As a result, assets accumulated to fund future benefits rose from 0 percent to 2.9 percent of accrued liabilities. However, MPS’s actuarial projections assume the district will not exceed the requirement again, so assets will rise slowly, reaching only 4.9 percent of liabilities by FY20.⁴¹ In other words, the RHI program will still be unfunded for all practical purposes.

Figure 2 MPS Retiree Health Contributions Per Pupil



Sources: MPS CAFRs FY02-FY11; MPS OPEB Valuations FY09, FY11

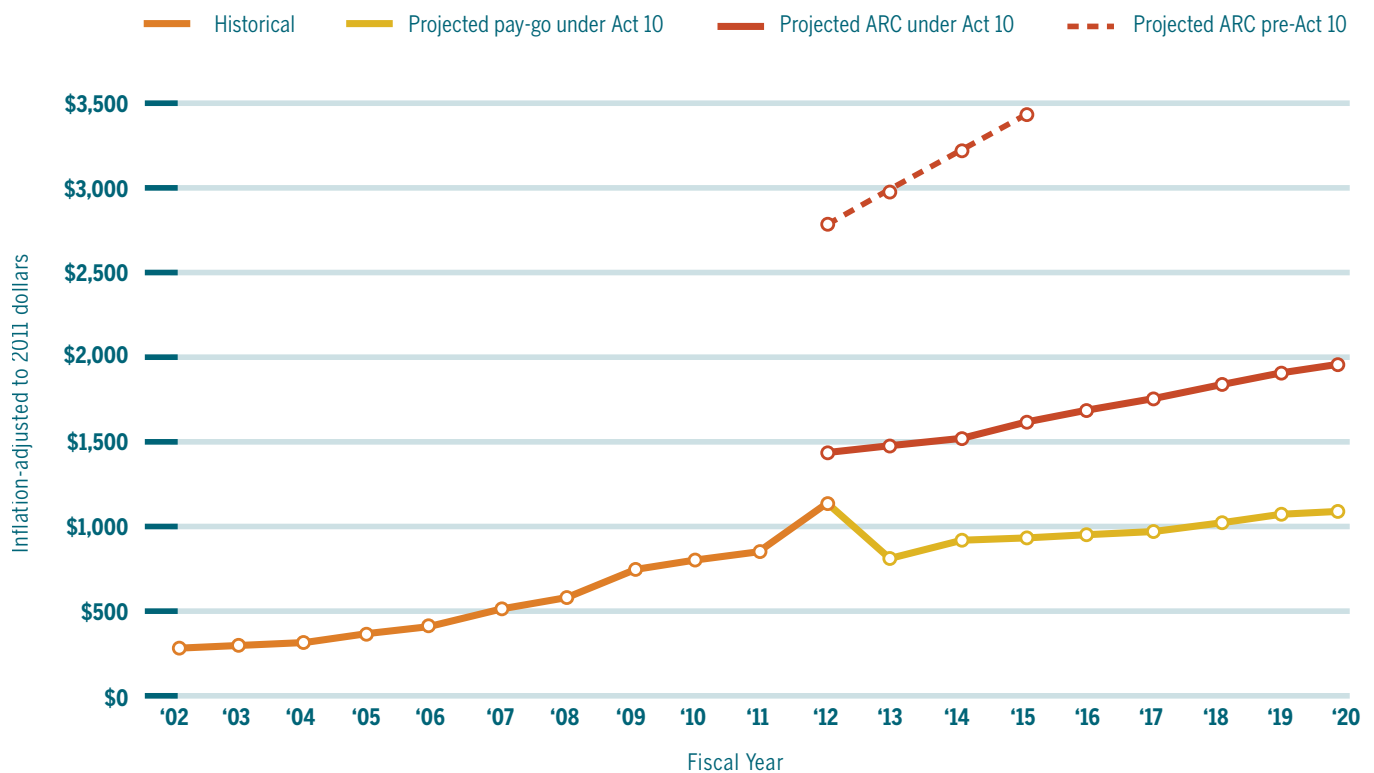
In dollar terms, the unfunded accrued liability stood at \$1.4 billion as of July 1, 2011 and is projected to rise to \$1.6 billion (inflation-adjusted) by July 1, 2020, according to the current valuation report’s projection of the pay-go policy. This sum (representing 95.1 percent of accrued liabilities) must be paid eventually of course, so this “pay-as-you-go” strategy is also a “pay-more-later” strategy, and this must be factored into the picture.

MPS’s actuarial report provides a measure of this looming burden—the annual required contribution (ARC)—for comparison with actual payments. The ARC includes two amounts: the cost of pre-funding future retiree health benefits earned in the current year and the annual cost of gradually paying down the unfunded liability that had been accumulated in previous years.⁴² MPS is required to disclose this calculation by current accounting rules, but is not required to actually pay it. As Figure 3 shows, the FY12 ARC was \$1,428 per pupil (the solid red line), and is projected to reach \$1,992 (adjusted for inflation) by FY20—almost double the pay-go contribution. The widening gap between the solid red and yellow curves illustrates the cost of delaying the switch from pay-go funding to actuarial funding.⁴³

As daunting as these prospects are, the situation would be far worse without the changes to future benefits enacted by MPS under Act 10. This is illustrated in Figure 3 by the difference between the solid red line (projected ARC under Act 10) and the dashed red line (projected ARC prior to the changes in retiree health benefits MPS made under the authority of Act 10). Those changes slashed the annual cost of currently accruing liabilities (“normal cost”) by 90 percent, from a previously projected figure of \$96.9 million for FY12 to \$9.3 million for the same year.

In addition, the changes to the RHI program dramatically cut previously accrued benefits of active employees. This is noteworthy, since it is usually legally impossible to cut previously accrued pension benefits. Retiree health benefits, however, are governed by a different legal standard. The accrued liability was previously projected to reach \$2.763 billion by July 1, 2011. The new valuation calculates the accrued liability at barely half that level, \$1.393 billion. The \$1.370 billion drop in accrued liability is due to the changes in eligibility requirements (\$1.089 billion) and plan design changes (\$0.458 billion).⁴⁴ Other things equal, this drop in the accrued liability would reduce the amortization component of the ARC by about the same proportion. However, the actuaries chose to accelerate the amortization schedule, so this component of the ARC only fell from \$113 million to \$100 million for FY12.

Figure 3 MPS Retiree Health Required Contributions Per Pupil



Sources: MPS CAFRs FY02-FY11; MPS OPEB Valuations FY09, FY11

Taking the normal cost and amortization together, the cuts in currently accruing liabilities and payments on previously accrued liabilities reduce the ARC for FY12 from \$2,748 per pupil to \$1,428 (in 2011 dollars). The gap between the top two curves in Figure 3 represents the cut in the per-pupil ARC from the changes enacted under Act 10. As Figure 3 indicates, without Act 10 the future ARC would have been quite off the chart—reaching a staggering \$4,903 per pupil (adjusted for inflation) by FY20. The difference between this figure and the \$1,992 ARC projected under the new plan illustrates the magnitude of the actuarial savings achieved under the authority of Act 10.

In the remainder of this analysis, we shall confine our estimates of the impact of rising retirement costs to the pay-go scenario. Specifically, we shall examine the impact of the rise in retiree health costs by \$248 per pupil from FY11 to FY20 (\$1,304 without Act 10), under the pay-go policy, as depicted in Figure 2. It is important to bear in mind that potentially worse impacts lie in the future as the accrued liabilities will come due beyond the projection period shown here. The changes enacted under Act 10 have substantially mitigated the future benefit payments, but the continuing deferral of paying for those future benefits still means harder times ahead. As the MPS actuary put it, “Despite the plan design changes made, we recommend monitoring and evaluating the future growth in the [retiree health] actuarial liability and balance sheet liability to determine next steps.”⁴⁵

With those caveats in mind, we now consider the four pension programs, which add to the total tab owed by MPS. Act 10 has resulted in changes in these programs, too, averting further difficulties, on top of the fiscal fiasco threatened by the RHI program.

THE DISTRICT'S BILL, PART 2: REGULAR AND SUPPLEMENTAL PENSION PLANS

The regular (or primary) pension plans for teachers and other school employees are provided by the state or the city, depending on the category of employee.⁴⁶ For certificated employees (mainly teachers, principals and assistant principals), this pension is provided by the state plan, the Wisconsin Retirement System (WRS). Classified employees (such as clerical and service staff) participate in the City of Milwaukee's Employees' Retirement System (ERS). Of these two plans, the state plan is more important for MPS budgets, as MPS contributions to WRS far exceed those to ERS.

Act 10 will have a significant impact on MPS's contributions to these two plans. Under Act 10, employees will start contributing to the funding of their pensions. Previously, although WRS and ERS designated "employee contributions" and "employer contributions," MPS paid both portions, under local collective bargaining agreements. Act 10 ends this practice, so that employees will in fact pay the "employee contribution." Specifically, this means employees covered by WRS will pick up half the required contribution (6.65 percent of the 13.3 percent total in calendar 2013, a rate that varies annually).⁴⁷ Employees covered by ERS now contribute a fixed 5.5 percent, previously paid by the district. These shifts take place once the relevant collective bargaining contracts expire, in FY14 for teachers (members of WRS) and in FY13 for classified employees (members of ERS).

In addition to the primary pension plans, provided by the state and city, MPS provides supplemental pension benefits to administrators and teachers who take early retirement. These two plans mitigate the penalty for early retirement under the primary plans. They were established under collective bargaining agreements dating to 1978 and 1982 and are funded by employer contributions only. The administrators' plan was closed to new hires in 2003. The teachers' plan, which is considerably larger than the administrators' plan, was closed by the MPS Board in March 2012, under authority newly granted by Act 10. In addition to closing the plan to new hires, the Board also froze the future accrual of benefits for current members. In explaining these actions, the Board cited the "alarming rate" at which the district's pension obligations were growing.⁴⁸ Previously, the Board could not change the plan without going through collective bargaining. Act 10, however, removed benefits from bargaining, so the Board could choose to close and freeze the program, effective once the contract expires in FY14.

Act 10, therefore, reduces MPS contributions to three pension plans—the primary plan run by the state (WRS), the primary plan run by the city (ERS), and the supplemental plan for teachers run by the district. Taken together, these will save MPS about \$35 million per year, starting in FY14.⁴⁹ **On a per-pupil basis, Act 10 will reduce MPS pension costs by \$533 below what they would otherwise have been by FY20.**

Most of these savings will be offset, however, by underlying funding problems that continue to place upward pressure on pension costs. Total contribution rates (employer plus employee) to WRS and ERS were expected to rise to make good on investment shortfalls since the crash of 2008, along with poor market performance in 2011, according to the most recent actuarial reports for the two funds.⁵⁰ As the WRS valuation states, "The statutory asset valuation method will recognize all of the differences between actuarial value and market value (\$5.3 billion) over four future years. The result will be upward pressure on

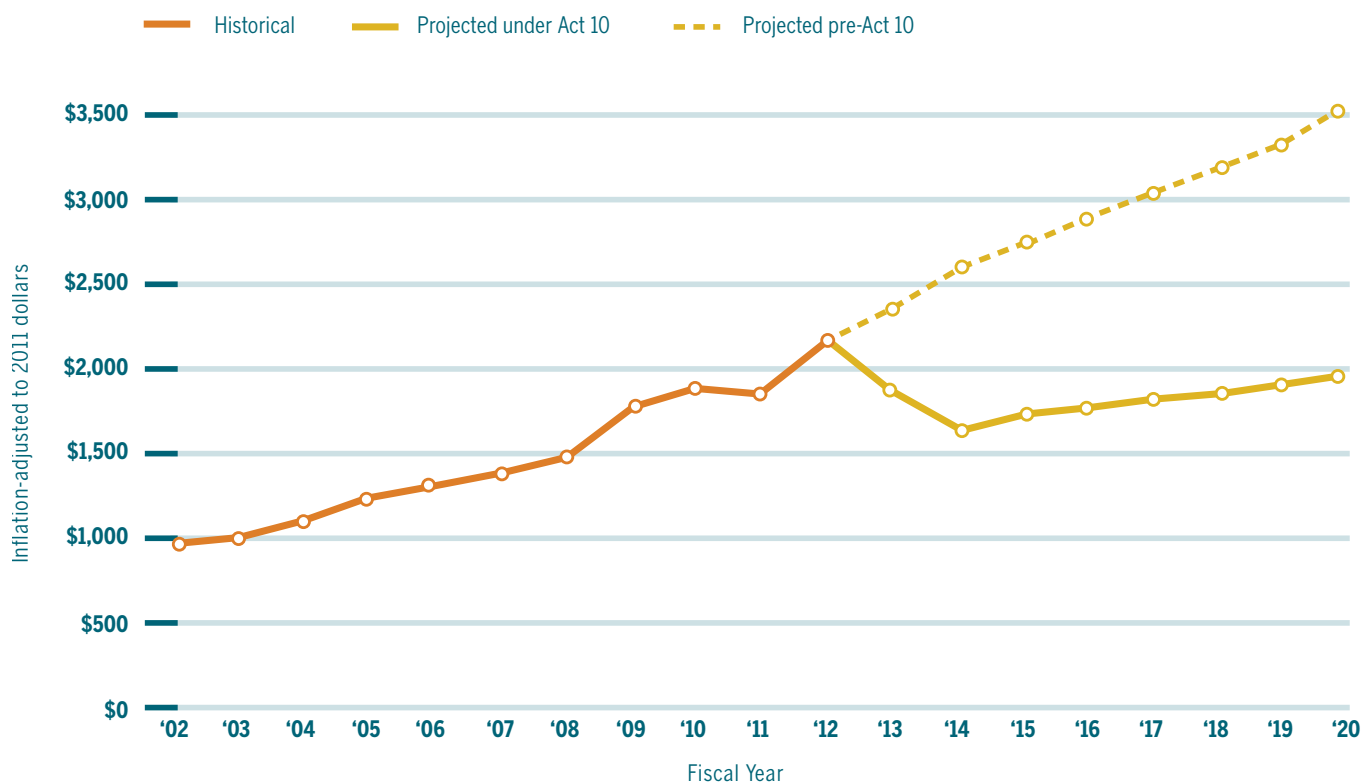
contribution rates next year.”⁵¹ Neither system’s valuation report quantifies these projections, but using the data in the reports, we were able to estimate what the rise will be, albeit with the caveat that these valuation reports do not reflect the market gains in calendar year 2012.⁵²

Taken all together, we estimate that the **four pension plans cost MPS \$734 per pupil in FY02, rising to \$1,029 in FY11, and will drop back to \$845 by FY20.** The drop of \$184 represents the difference between a \$349 projected rise due to funding shortfalls and the \$533 savings from Act 10.

THE BOTTOM LINE: TOTAL GROWTH IN MPS RETIREMENT COSTS AND IMPACT ON MPS BUDGETS

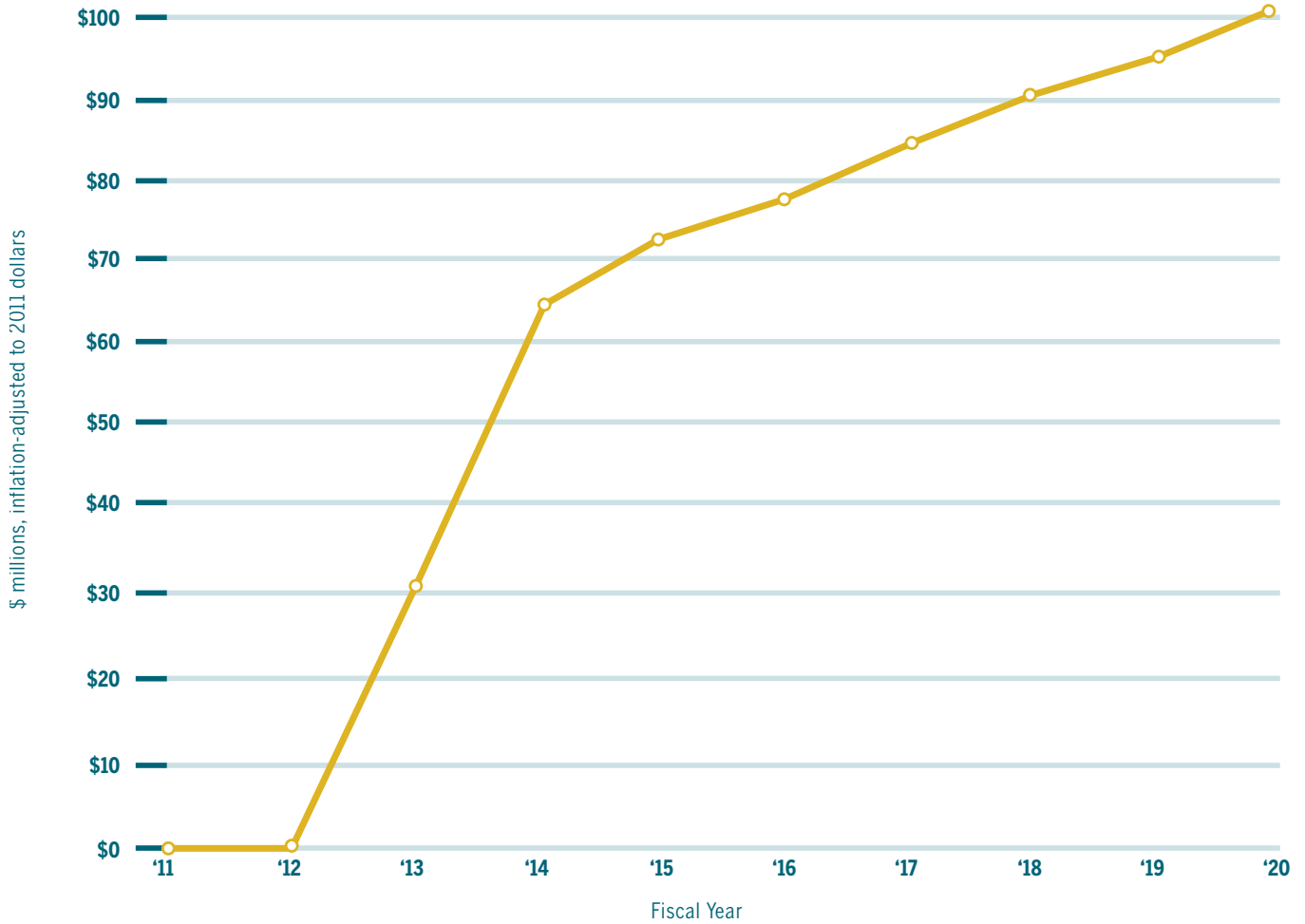
Adding the four pension plans to the retiree health benefit, we calculate the total retirement cost for MPS. These costs totaled \$995 per pupil in FY02 and rose to \$1,860 by FY11 (\$831 for retiree health and \$1,029 for all pensions). As Figure 4 shows, there was a bump up in FY12, as MPS made an extra contribution to the retiree health fund, followed by a projected dip in FY13 and on into FY14 as the savings from Act 10 kick in during these two years. Thereafter, we project a modest drift upward, to \$1,924 per pupil in FY20 (\$1,079 for retiree health and \$845 for all pensions). **In all, we project per-pupil retirement costs will be essentially unchanged from FY11 to FY20, as the \$248 rise for retiree health is mostly offset by a \$184 drop in pension costs for a net rise of \$64.** Thus, unlike the previous report in this series on Philadelphia, we find no impact of rising retirement costs on MPS budgets, employment, salaries, and so forth.

Figure 4 MPS Total Retirement Costs Per Pupil



This relatively good news is almost entirely due to Wisconsin's Act 10.⁵³ The top curve in Figure 4, based on the cost projections prior to Act 10, shows that without it, per-pupil retirement costs would have risen from \$1,860 in FY11 to \$3,512 by FY20. This rise of \$1,652 (\$1,304 from retiree health and \$349 from pensions) would have had profound effects on MPS budgets. The district would have had to either generate significant additional revenue or reduce expenditures elsewhere in its budget.

Figure 5 Projected Savings on Retirement Costs From Act 10



To calculate the total impact on MPS budgets of rising retirement costs, we multiply the per-pupil rise, depicted in Figure 4 under both contingencies, by the projected number of pupils.⁵⁴ Since the impact under current policy is minimal, we will not pursue this in detail in the next section (unlike our analyses of Cleveland and Philadelphia). Instead, we consider the impact of the difference between the two curves in Figure 4—the impact of Act 10. **By FY20, we estimate that Act 10 will save \$1,588 per pupil on retirement costs.**⁵⁵ Multiplying this by 63,695 students yields a total savings of \$101.1 million, as depicted in Figure 5, along with the savings between now and FY20. For FY20, this represents a savings of 10.6 percent of projected revenues. In the next section, we calculate the dimensions of this dodged bullet, in terms of the resources that would not have been available for the classroom.

THE (AVERTED) IMPACT: HOW MIGHT THE RETIREMENT-FUNDING SHORTFALL HAVE IMPACTED MPS CLASSROOMS?

Our early examination of MPS financial data post-Act 10 indicates that the law will help avert a catastrophe in Milwaukee's classrooms through \$101.1 million annual savings in retirement costs by 2020 (in 2011 dollars). Now, let's examine what Milwaukee's expenditures would look like if Act 10 did not exist.

For this exercise, we first project future enrollment, staffing, and revenues in MPS. We need these projections to estimate the size of MPS's future annual budgets, so we can see the impact of the retirement shortfall in outlying years, absent Act 10. For simplicity's sake—and for those who prefer the “bottom line”—we've moved those background projections to the end of this discussion (see Appendix A).

Impact on the overall budget

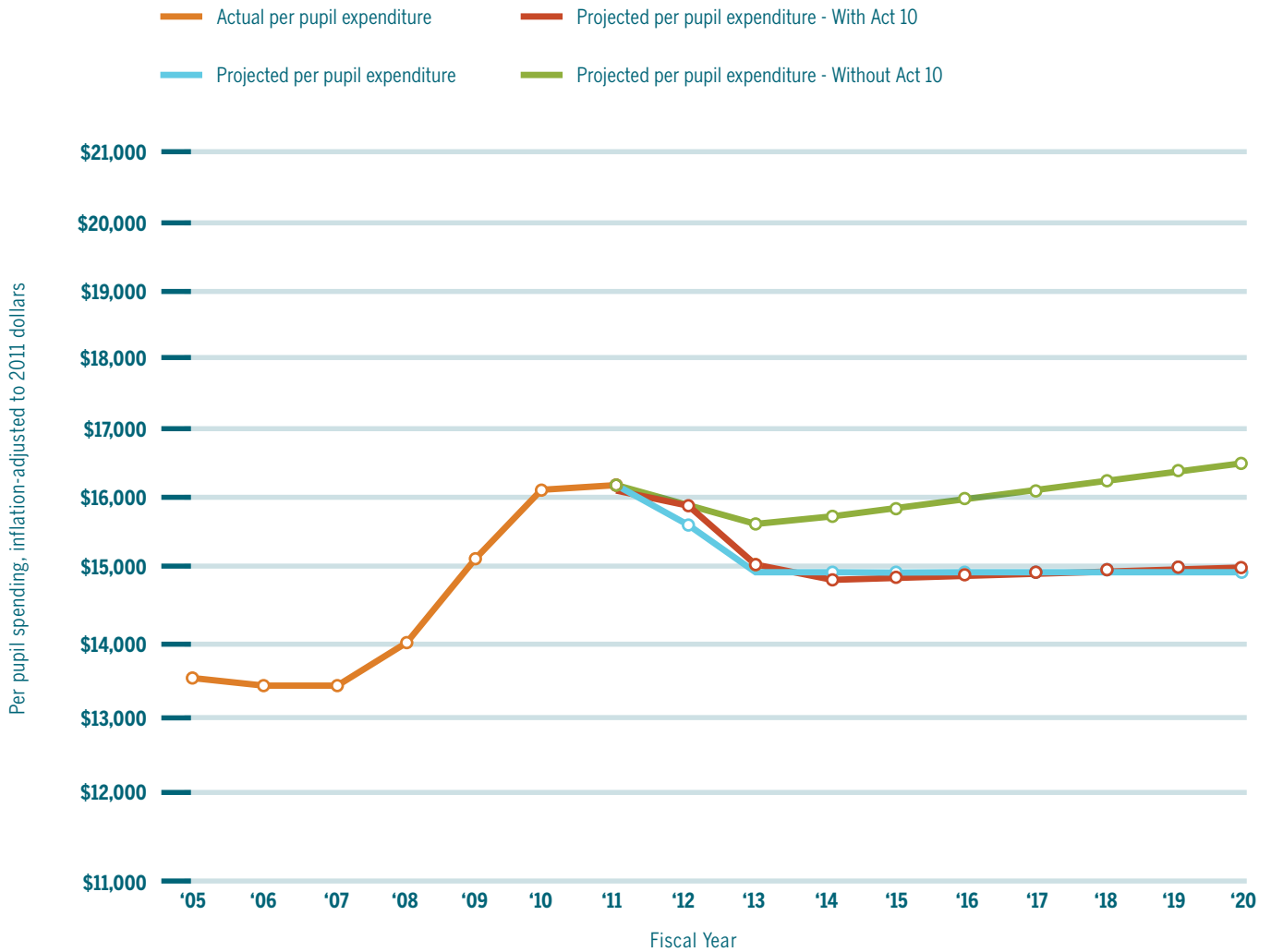
Figure 6 shows the impact of the growth in per-pupil retirement costs on the overall MPS budget in outlying years if Act 10 did not exist. The blue line depicts the projected baseline per-pupil expenditures (inflation-adjusted, drawn from Appendix A), and the additional amounts necessary to support growth in per-pupil retirement costs with and without Act 10 are shown by the red and green lines, respectively. The difference between these latter two curves is the per-pupil impact of Act 10, reported above as \$1,588 by FY20. **In effect, Act 10 now makes it possible for MPS to live within its means—to provide instructional services based on revenue projections without incurring significant deficits.** Put differently, by 2020, without Act 10, retirement obligations would double from 11.5 percent of MPS expenditures to 23.5 percent. With the changes enacted under Act 10, we project this would only grow to 12.9 percent. This is a savings of 10.6 percent of the FY20 budget.

Impact on staffing and instruction

Given that salaries and benefits comprise nearly three-quarters of public education costs in Milwaukee, the magnitude of such a pension and retiree health funding gap would very likely lead to staff reductions. Assuming the cost of the retirement shortfall were distributed based on the district's historic spending pattern, 55 percent of any impact would fall on instructional costs and just 18 percent on non-classroom instructional support (Table 1, p. 20). Operations account for an additional 20 percent of the district's operational spending, while 5 percent is absorbed by central and school leadership functions.

Figure 7 (p. 21) shows this distributed impact of Act 10 on a per-pupil basis. Based on the distribution of expenditures, the pension/health care shortfall would result in a reduction of instructional spending of \$873 per pupil by FY20 (orange curve) and a reduction of \$286 in instructional support (yellow), if not for the measures applied under Act 10. Of course, instructional costs would not be the only area affected, if we assume the pain of such costs is distributed proportionally across the MPS budget. In FY20, operations costs could be reduced by \$318 per pupil (red curve) if Act 10 were not in place.

Figure 6 Retiree Health and Pension Obligation Impact with Act 10 on Per Pupil Spending



| | '05 | '06 | '07 | '08 | '09 | '10 | '11 | '12 | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Actual Per Pupil Expenditure | 13,569 | 13,451 | 13,478 | 14,084 | 15,194 | 16,178 | 16,214 | | | | | | | | | |
| Projected Per Pupil Expenditure | | | | | | | | 15,456 | 14,935 | 14,935 | 14,935 | 14,935 | 14,935 | 14,935 | 14,935 | 14,935 |
| Projected Per Pupil Expenditure - With Act 10 | | | | | | | | 15,781 | 14,965 | 14,766 | 14,815 | 14,846 | 14,887 | 14,928 | 14,960 | 14,999 |
| Projected Per Pupil Expenditure - Without Act 10 | | | | | | | | 15,781 | 15,483 | 15,682 | 15,834 | 15,977 | 16,132 | 16,292 | 16,435 | 16,587 |

Table 1 Budget Impact of Rise in Per Pupil Retirement Costs, FY20

| | SHARE OF DISTRICT EXPENDITURES* | COST TO MPS, FY20 (IN MILLIONS) | | |
|-------------------------------------|---------------------------------|---------------------------------|--------------|----------------------|
| | | WITHOUT ACT 10 | WITH ACT 10 | SAVINGS UNDER ACT 10 |
| Classroom instruction | 55% | \$57.9 | \$2.3 | \$55.6 |
| Non-classroom instructional support | 18% | \$18.9 | \$0.7 | \$18.2 |
| Operations | 20% | \$21.0 | \$0.8 | \$20.2 |
| Leadership | 5% | \$5.3 | \$0.2 | \$5.1 |
| Other | 2% | \$2.1 | \$0.1 | \$2.0 |
| TOTAL | 100% | \$105.2 | \$4.1 | \$101.1 |

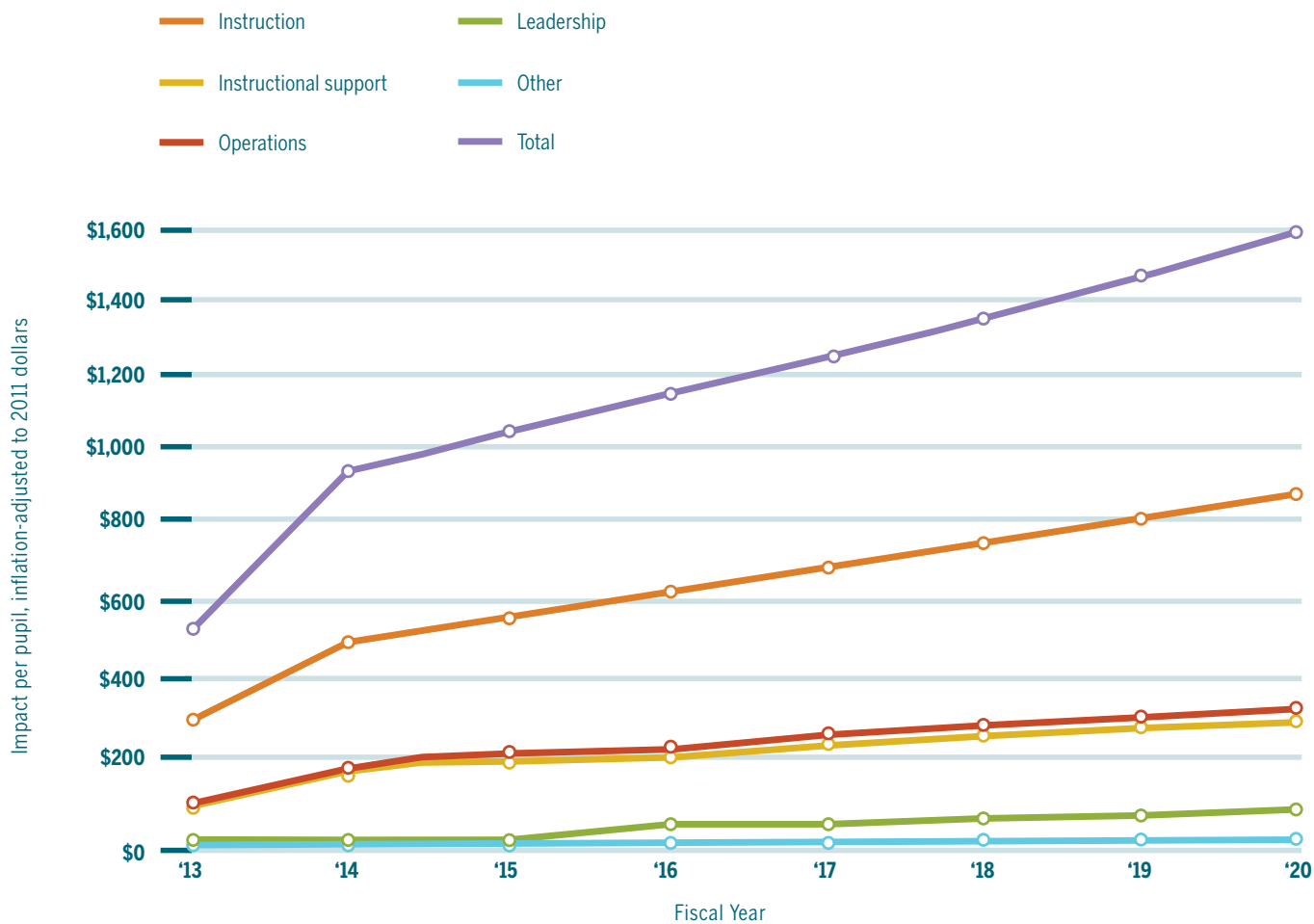
Note: The model includes five main functions of education: Instruction includes all salaries, benefits, materials, and technology used for classroom instruction; instructional support includes all student, teacher, and program support functions occurring outside of classroom instruction; operations covers all non-instructional support services such as food service, building operations, and business operations; and finally, leadership includes the costs of the superintendent, deputies, school board, legal, principals, and school office costs.

* We use the percentages expended for all of MPS's operating expenditures in FY11 (most recent year available) to distribute any pension obligation impact, starting with the FY12 school year.

What might the impact be on staffing if Act 10 were not reining in pension and retiree health care obligations? By FY20, if the district chose to reduce its costs from the pension shortfall solely through teacher layoffs, the budget shortfall would claim 1,014 teaching positions out of 4,192 (Figure 8, p. 22).⁵⁶ (For an explanation of the district's future staffing needs, see Appendix A.)

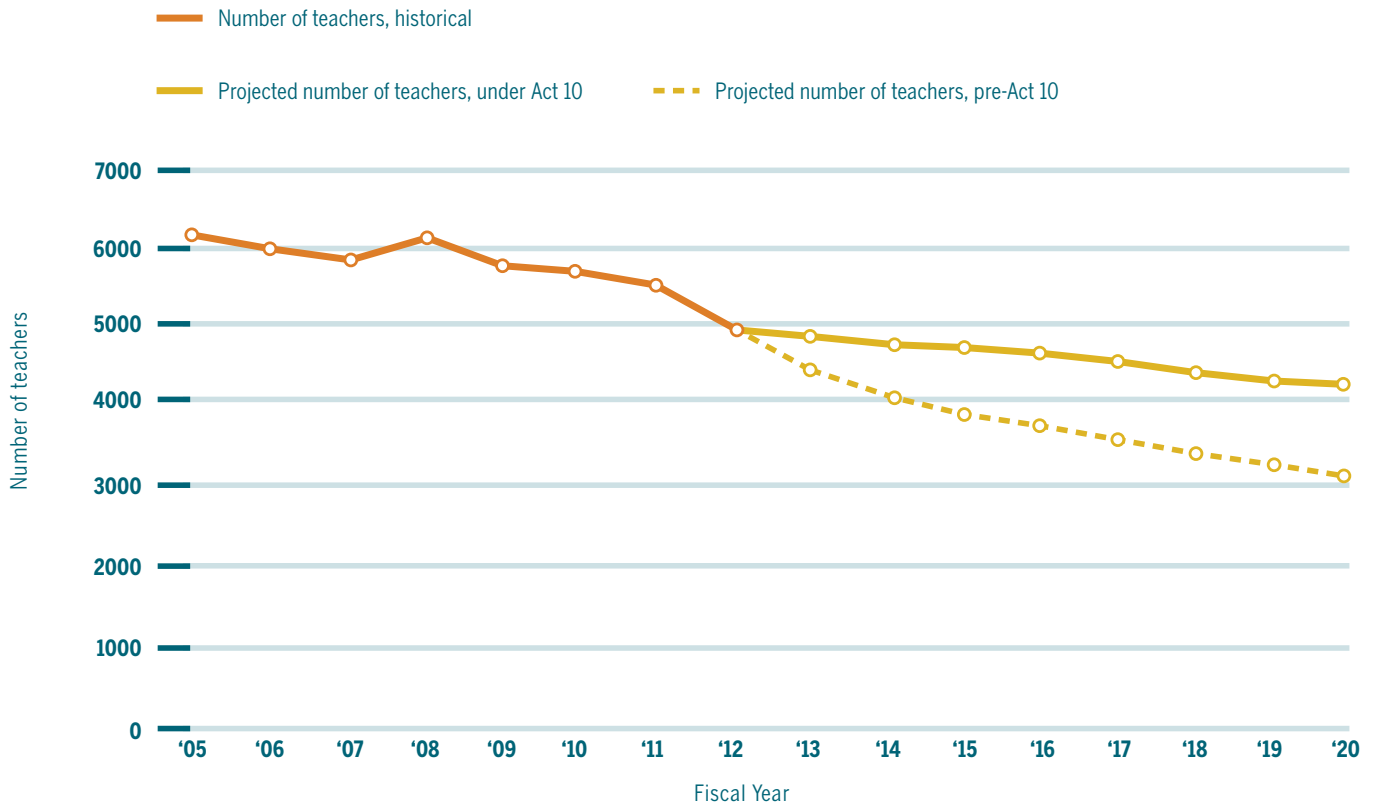
Impact on salaries

Act 10 diminishes the likelihood that MPS might target teacher salaries as a way to close a pension-induced budget gap. As noted above, Act 10, at a minimum, spared \$55.6 million in cuts to instruction by FY20. If we assume that the \$55.6 million reduction would have occurred in instruction salaries alone, 557 teachers would have faced layoffs. Even these drastic cuts would still leave a pension-induced shortfall of \$45.5 million to cut in other non-instruction areas of the school system. If however, MPS determined the funding gap should be closed by lowering teacher salaries instead of layoffs, then salary and benefits for teachers would have been lowered by \$24,127 per teacher in FY20 from an average total compensation of \$99,762 (in FY11 dollars).

Figure 7 MPS Retirement Act 10 Impact Per Pupil, by School Function

| | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|-----------------------|--------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Instruction | \$285 | \$504 | \$560 | \$622 | \$685 | \$750 | \$811 | \$873 |
| Instructional support | \$93 | \$165 | \$183 | \$204 | \$224 | \$246 | \$266 | \$286 |
| Operations | \$104 | \$183 | \$204 | \$226 | \$249 | \$273 | \$295 | \$318 |
| Leadership | \$26 | \$46 | \$51 | \$57 | \$62 | \$68 | \$74 | \$79 |
| Other | \$10 | \$18 | \$20 | \$23 | \$25 | \$27 | \$30 | \$32 |
| Total | \$518 | \$916 | \$1,019 | \$1,131 | \$1,245 | \$1,364 | \$1,475 | \$1,588 |

Figure 8 Milwaukee Public Schools Number of Teachers 2005-2020



| | '05 | '06 | '07 | '08 | '09 | '10 | '11 | '12 | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Number of teachers, historical | 6,190 | 6,041 | 5,836 | 6,131 | 5,827 | 5,716 | 5,427 | 4,931 | | | | | | | | |
| Projected number of teachers, under Act 10 | | | | | | | | | 4,829 | 4,733 | 4,638 | 4,545 | 4,454 | 4,365 | 4,278 | 4,192 |
| Projected number of teachers, pre-Act 10 | | | | | | | | | 4,425 | 4,033 | 3,882 | 3,731 | 3,585 | 3,441 | 3,308 | 3,178 |

CONCLUSION

Prior to Act 10, MPS faced a daunting fiscal future, exacerbated by a rise in retirement costs to \$3,512 per pupil by FY20. Act 10 allowed Milwaukee to cut that by almost half, averting a major impact on instructional resources. To be sure, MPS is not out of the woods yet. Its pay-go policy on retiree health means that the cost of obligations incurred to current employees is being postponed. The cuts MPS has enacted to district costs for retiree health have bought the system time, but further action may still be required. Indeed, the Milwaukee school board's finance committee voted in December to close the retiree health plan entirely to new employees. The full board did not accept this recommendation, but directed the administration to notify all prospective new employees that the current plan would not be available, as it considered such measures as requiring active employee contributions.⁵⁷ Fortunately, Act 10 provides MPS with the authority to act as needed. Without the authority to make such changes, Milwaukee would likely have faced intractable choices between raising taxes or cutting the rest of the K-12 budget.

The lesson from Milwaukee—and Wisconsin more generally—is that the difficult problem of rising retirement costs faced by school districts is not entirely beyond the system's control. Act 10 gave MPS the authority to act without the constraint of collective bargaining. MPS used that authority quickly and responsibly, approving changes that will dramatically shift costs from the district to the member for health benefits of current and future early retirees (i.e., those who retire before Medicare kicks in at age 65). Together with Act 10's requirement that employees actually pay the employee contribution to pension plans, these actions mean that MPS faces a more manageable future.

Acknowledgments

Sincere thanks to Robert Costrell and Larry Maloney, who conducted this illuminating analysis. Dr. Costrell is a professor of education reform and economics, holds the endowed chair in education accountability at the University of Arkansas, and is a fellow in education reform at the George W. Bush Institute. Larry Maloney is president of Aspire Consulting, LLC.

Thanks also to the Joyce Foundation for their financial support, and their patience in seeing this report to the finish line, as well as to our sister organization, the Thomas B. Fordham Foundation.

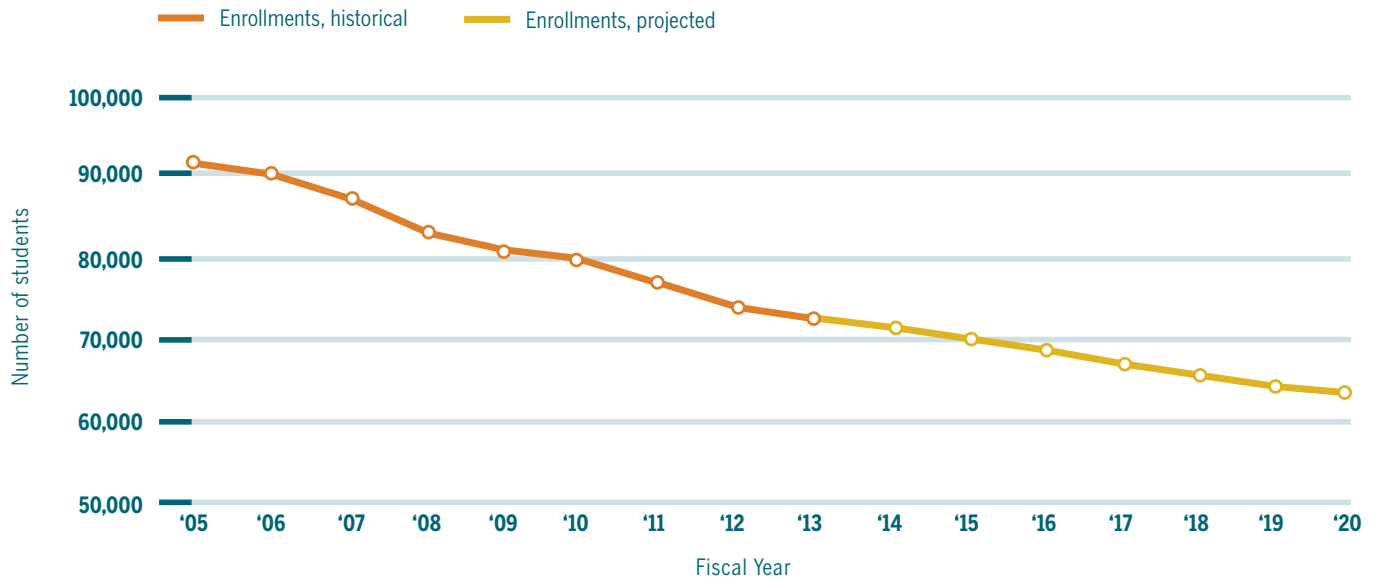
APPENDIX A: ESTIMATING ENROLLMENT, STAFFING, AND REVENUE

Here we present projections for the number of MPS students and staff, as well as funding levels, for 2011 through 2020. These projections drive many of the calculations presented in this chapter.

Figure A-1 shows actual and projected enrollment for MPS.⁵⁸ Given the 19 percent decline in enrollment from 2005 to 2013, we assume that future enrollment will continue to decline at a conservative 2 percent annual rate.⁵⁹ Under this scenario, by 2020 the district will have lost 30 percent of its total enrollment from 2005.

Like most states, Wisconsin allocates state funds to districts primarily on a per-pupil basis. Therefore, these enrollment projections are key determinants of any projected MPS budgets. And continued enrollment declines will inevitably affect the number of personnel the district can afford—and would need—to hire.

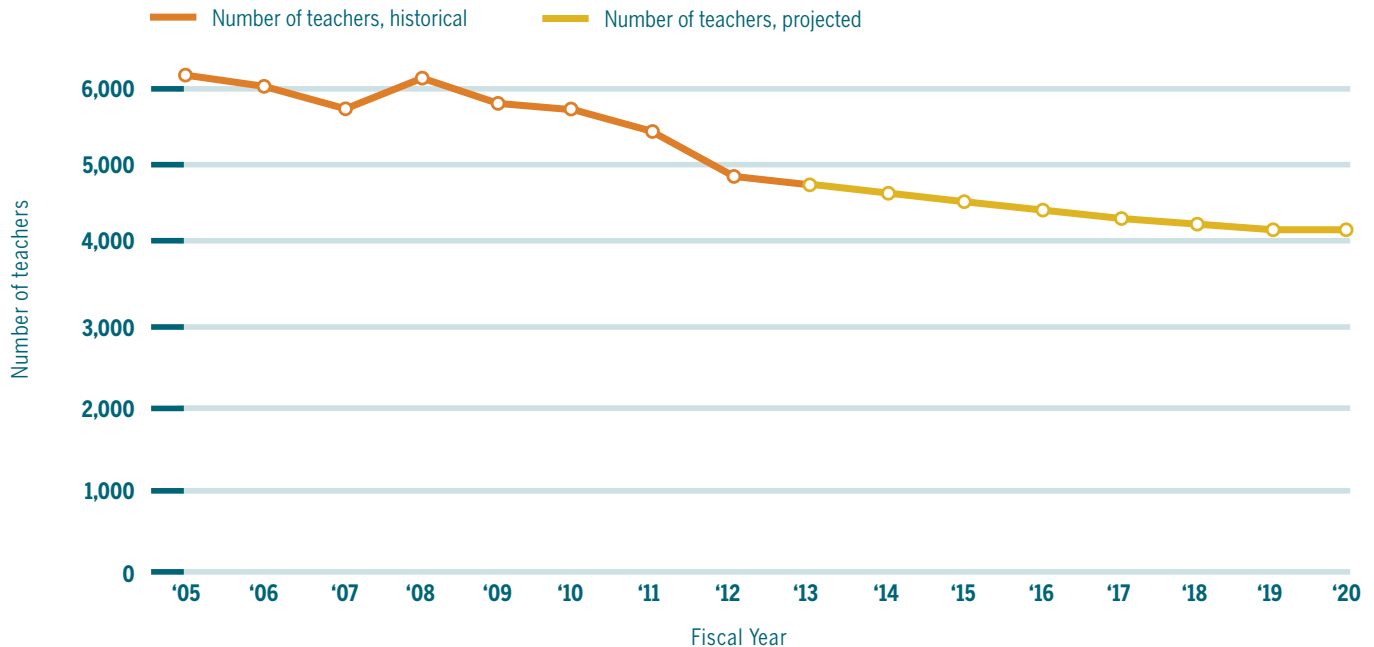
Figure A-1 Milwaukee Public Schools Enrollment 2005-2020



| | '05 | '06 | '07 | '08 | '09 | '10 | '11 | '12 | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Historical | 91,011 | 89,260 | 86,977 | 83,496 | 81,348 | 79,916 | 78,480 | 74,918 | 73,371 | | | | | | | |
| Projected | | | | | | | | | | 71,904 | 70,466 | 69,056 | 67,675 | 66,322 | 64,995 | 63,695 |

Figure A-2 includes historic and projected data for the number of teacher positions at MPS. In FY05, MPS employed 6,190 teachers, and by FY12 teacher ranks had declined to 4,931, a 20.32 percent drop in seven years. In projecting the number of teachers in future years, we have increased slightly the student-to-teacher ratio based on MPS reports released October 2012 to 15.2:1 ratio.⁶⁰ As a result, and given declining enrollment, by 2020 the number of teachers employed by MPS will be 32.3 percent less than in 2005.

Figure A-2 Milwaukee Public School Teachers 2005-2020



| | '05 | '06 | '07 | '08 | '09 | '10 | '11 | '12 | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Historical | 6,190 | 6,041 | 5,836 | 6,131 | 5,827 | 5,716 | 5,427 | 4,931 | | | | | | | | |
| Projected | | | | | | | | | 4,829 | 4,733 | 4,638 | 4,545 | 4,454 | 4,365 | 4,278 | 4,192 |

Projecting future revenues and expenditures in the current, uncertain economic climate presents a bit of hazard. State and local governments continue to face revenue shortfalls, a landscape that is unlikely to change in the near term. Given this uncertainty, we use the simplest and most reliable indicators to project future MPS revenues. For 2014-2020, we use the projected Consumer Price Index (CPI, from the Congressional Budget Office) to determine the annual growth in per-pupil funding for MPS. This represents per-pupil revenue growth in the range of 1.8-2.3 percent, after falling the last two years.⁶¹ These projections are built off base-year revenue data drawn from MPS CAFRs and budget documents for FY12 and FY13.

Table A-1 shows funding in future years using as a base the FY13 estimate of \$15,456 (down from \$16,214 in FY11).⁶² For example, FY13 per-pupil funding, increased by the CPI projection, results in per-pupil funding of \$15,851 in FY14. We multiply that figure by the projected number of pupils in MPS in FY14 to arrive at total funding. By FY20, per-pupil funding is estimated to reach \$16,523; in constant 2011 dollars (adjusted for inflation), it is projected to be unchanged from FY13 to FY20 at \$14,935.

Again, projected total revenues is based only on the number of pupils enrolled in the district and does not include any supplemental funding to compensate for a shortfall in the pension or retiree health insurance plans.

Table A-1 Funding (in billions)

| | '10 | '11 | '12 | '13 | '14 | '15 | '16 | '17 | '18 | '19 | '20 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Total funding less non-instrumentality charters | \$1.253 | \$1.272 | \$1.182 | \$1.134 | \$1.132 | \$1.131 | \$1.133 | \$1.136 | \$1.139 | \$1.142 | \$1.145 |
| Non-instrumentality charter school funding* | \$0.014 | \$0.018 | \$0.034 | \$0.035 | \$0.036 | \$0.037 | \$0.037 | \$0.038 | \$0.039 | \$0.040 | \$0.041 |
| Total | \$1.267 | \$1.291 | \$1.216 | \$1.170 | \$1.168 | \$1.168 | \$1.171 | \$1.174 | \$1.178 | \$1.182 | \$1.186 |

*Non-instrumentality charters are funded through the district but are essentially independent. Their staff are not employees of the school district and the school does not receive free facilities.

ENDNOTES

1. Our analyses of this program are based primarily on MPS's biennial actuarial valuations, conducted by Gabriel Roeder Smith & Company (GRS), "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2009](#)" (dated June 25, 2010), and "[... as of July 1, 2011](#)" (dated August 30, 2012). The 2009 valuation includes projections formed prior to enactment of Act 10 and the 2011 valuation's projections reflect actions taken by MPS subsequent to Act 10.
2. Instead of setting aside funds to cover the current cohort's future benefits, under pay-as-you-go systems the annual contributions are used to pay for previous cohorts' benefits. Most retiree health systems are pay-as-you-go, or "pay-go." One of the problems with pay-go is that if enrollments decline (as they have in MPS), this will increase per-pupil retiree health costs. This occurs without a corresponding rise in per-pupil revenues, since revenues in Wisconsin (as elsewhere) are closely tied to enrollments. This problem is sometimes wrongly attributed to the declining enrollment itself, rather than the pay-go funding system (it is not a problem in pre-funded systems). Another manifestation of the pay-go problem is that almost one-quarter of the current fringe benefit rate for MPS is for the cost of retiree benefits, rather than the benefits of current employees (Attachment to Item 2 of January 3, 2013 Agenda of the Milwaukee Board of School Directors, 1-5). In 2011, MPS instituted a policy of pre-funding a small amount of the accruing benefits, as explained in this report. MPS's valuation reports refer to the current system as "mainly pay-as-you-go funding."
3. MPS estimates of "Retiree Health Care Per Student" are about \$300 higher, as reported in [Attachment 1 to Item 12](#) of the December 18, 2012 Agenda of the Board's Committee on Accountability, Finance, and Personnel (attached also to the full Board's Agenda for December 20, 2012). These MPS estimates are from a different source (Milliman) than the GRS actuarial report on which we rely. One of the substantive reasons for the difference appears to include member contributions, which are excluded from our estimates of district costs.
4. Milwaukee Board of School Directors, [Minutes Library, December 20, 2012](#), 465-467.
5. For the 5 percent figure, see Robert M. Costrell and Michael Podgursky, "[Teacher Retirement Benefits](#)," *Education Next*, Spring 2009, Figure 2. This figure does not include retiree health benefits, but that is rarely offered in the private sector. The MPS figures of 26.5 percent and 11.5 percent do not include contributions to Social Security and Medicare. Including them would raise the figures to about 34 percent and 15 percent respectively. For the remainder of this analysis, we shall not consider Social Security and Medicare.
6. Wisconsin State Legislature, Legislative Fiscal Bureau, "[Summary of Provisions of 2011 Act 10](#)," 887-88.
7. Wisconsin State Legislature, Legislative Fiscal Bureau, "[Summary of Provisions of 2011 Act 10](#)," 896.
8. MPS, [2012 Comprehensive Annual Financial Report](#), 63
9. Milwaukee Board of School Directors, [Minutes Library, March 29, 2012](#), 917-922.
10. From 2005 to 2013, MPS lost about 19 percent of its students, about half of whom enrolled in Milwaukee's voucher schools.
11. For the legislation, see "[2011 Wisconsin Act 10](#)." See also "[Questions about the Wisconsin Retirement System](#)" for information about Act 10 provided by the Wisconsin Department of Employee Trust Funds, and the Wisconsin State Legislature Legislative Fiscal Bureau, "[Summary of Provisions of 2011 Act 10](#)" (Madison, WI: 2011), 886-888.

12. These projections are based on MPS's most recent biennial actuarial valuation, conducted by Gabriel Roeder Smith & Company (GRS), "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2011](#)" (dated August 30, 2012). The pre-Act 10 projections were based on the previous valuation, "[... as of July 1, 2009](#)" (dated June 25, 2010).
13. The "pay-go" figures cited here include a small portion of pre-funding. Beginning in FY11, the funding policy called for pre-funding amounts of 5 percent of total claims. As discussed below, this is a very modest step, and the valuation report refers to this policy as "mainly pay-as-you-go funding." In FY11 and FY12, MPS contributions exceeded the 5 percent policy, as detailed in the report.
14. Wisconsin State Legislature, Legislative Fiscal Bureau, "[Summary of Provisions of 2011 Act 10](#)," 888; Chris Abele (Milwaukee County Executive), *2013 Recommended Operating Budget – Employee Fringe Benefits*, 5; Barry B. Burr, "[Wisconsin Assembly OKs hiking state employee contributions](#)," *Pensions & Investments Online*, February 25, 2011.
15. *Wisconsin Education Association Council et al. v. Walker et al.*, Opinion and Order, 11-cv-428-wmc (W.D. Wis. 2012).
16. *Wisconsin Education Association v. Walker*, Case No. 11-cv-428-wmc, Complaint for Declaratory and Injunctive Relief, June 15, 2011.
17. *Wisconsin Education Association v. Walker*, Case No. 11-cv-428-wmc, Opinion and Order, March 30, 2012.
18. *Wisconsin Education Association Council v. Walker*, Case no. 12-854, Opinion. January 18, 2013.
19. *Madison Teachers, Inc. v. Walker*, Case No. 11CV3774, Decision and Order, September 14, 2012.
20. *Madison Teachers, Inc. v. Walker*, L.C. #2011CV3774, Doc. No. 2012AP2067 (March 12, 2013, WI Ct. App. Dist. IV) (Order denying motion for relief pending appeal)
21. "[The Status of Act 10 – Finally Some Guidance](#)," Gonzalez Saggio & Harlan LLP, March 14, 2013.
22. A good overview of these programs (prior to the changes under Act 10) is found in the "[Superintendent's Fiscal Year 2011 Proposed Budget](#)," 201-203. Another good source is the MPS "[Comprehensive Annual Financial Report \(CAFR\) for the fiscal year ended June 30, 2012](#)," 59-73, as well as earlier CAFRs. Actuarial valuations used in the projections in this report, and cited accordingly, are also good sources of information on these programs.
23. At age 65, retirees are required to enroll in Medicare Part A (hospital insurance), and MPS covers the Medicare Part B premiums (for doctor services), unless those premiums exceed the pre-65 subsidy (which is rarely the case).
24. MPS's looming crisis in RHI has been evident for some time. For an in-depth report on this program, see Don Bezruki, "[A Critical Element of Reform of Milwaukee Public Schools: The Escalating Cost of Retiree Health Insurance](#)," Wisconsin Policy Research Institute, December 2009. WPRI issued a more recent report, reflecting MPS's changes in the program, but this report was issued prior to the MPS actuarial valuation of those changes, so it relied on the November 2011 preliminary estimates presented to the MPS Board, which differed substantially from those in the subsequent valuation report. See Mike Ford, "[MPS' looming fiscal crack-up](#)," *Wisconsin Interest*, Volume 21, No. 2, June 2012.

25. To be eligible for this subsidy, in addition to the age and service requirement, the retiree must have 70 percent of her maximum accumulated sick leave. If not, she can still buy the same health insurance plan, which carries an implicit subsidy by virtue of being pooled with the active employees, who are generally younger and healthier.
26. For FY12, retiree contributions covered about 15 percent of the benefit payments.
27. Some changes in plan design and vendor were implemented in April 2011, while still under collective bargaining, but these changes were quite modest compared to those enacted under Act 10. Also, employee premiums were introduced in August 2011, under the existing contract, and then raised under Act 10.
28. These plan design changes apply to those already retired, not just new retirees.
29. Plan information is drawn from "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2011](#)" and MPS Employee Presentation, "[Changes for Health Plan Benefits & Retiree Health Eligibility & Pension Contributions](#)," February 13, 2012.
30. The current valuation report projects per capita claims for retirees on the assumption that 30 percent of future retirees will enroll in the PPO and 70 percent in the EPO. The prior valuation report, for FY09 (before the recent plan changes), assumed that 80 percent would be in the PPO and 20 percent in the EPO.
31. When employee premiums were introduced in August 2011, they were set as a percent of salary: 1 percent for single coverage and 2 percent for family coverage. For fiscal year 2013, the last year of the teachers' contract, the average salary was \$62,800 (according to the superintendent's fiscal year 2014 budget proposal), which implies a contribution of \$105 per month for family coverage. The total monthly premium for family coverage under the PPO was \$1,737 and \$1,607 for the EPO. Thus, the share paid by the average teacher worked out to 6 or 6.5 percent. For fiscal year 2014, the contribution will shift to a percentage of the total premium. For salaries in the range of \$50,001 - \$75,000, that percentage is 13 percent for the PPO and 10 percent for the EPO. The rise in percent of premium is greater than the rise in the employee's dollar premium, because the changes in plan design (rise in deductibles, etc.) reduces the total premium to \$1,544 for the PPO and \$1,563 for the EPO.
32. There will be a two-year transition period, under which fifty-five-year-olds can claim the benefit, if they have thirty years of service.
33. The initial estimates, presented to MPS in November 2011, projected little or no impact on MPS costs for the five-year planning horizon, through FY17, but much reduced accrued liability for future costs. (See Dr. Gregory E. Thornton, "[Proposed Plan Changes to Manage MPS OPEB Liability](#).") By contrast, the FY11 actuarial valuation, dated August 30, 2012, projects very substantial short-term impacts, and that is the basis for the data presented in the text.
34. The Pew Center on the States reports that among state retiree health plans, the total liability in 2010 was \$660 billion, but only \$33.1 billion was held in assets, a funding ratio of 5 percent ("[The Widening Gap Update](#)"). In many states such plans are provided, if at all, at the district level (as with MPS), rather than the state level. Plans also vary widely in the degree to which they are employer-subsidized (see Robert L. Clark, "[Retiree Health Plans for Public School Teachers after GASB 43 and 45](#)," *Education Finance and Policy*, Fall 2010)
35. The projection calls for a slight rise to 1.32 by FY20, but this is a consequence of the actuarial convention of assuming constant active employee counts; if MPS employment continues to decline, the ratio of actives to retirees will likely continue to fall.

36. The projected rise was likely understated, due to the actuarial convention mentioned in the previous note. With constant assumed employment and salary growth of 3.0 percent, payroll was projected to rise 3.0 percent annually. With payroll actually falling, retiree health expenditures, as a percentage of payroll, would rise more rapidly than projected.
37. These historical data are drawn from [MPS Comprehensive Annual Financial Reports](#), or CAFRs, 2002-2011. The \$65.3 million contribution by MPS in FY11 includes, for the first time, a contribution to the trust fund for pre-funding. The amount that year was \$9.3 million (see "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2011](#)," 6).
38. MPS also commissions five-year projections from Milliman, for budgeting purposes.
39. MPS, "[Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2009](#)" and "... as of July 1, 2011." Until recently, public accounting standards did not require employers to provide such valuations. MPS provided one earlier valuation, as of July 1, 2007.
40. The \$31.6 million FY12 pre-funding bump is identified on page 6 of "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2011](#)." The projection on page 12 of the valuation assumes that pre-funding will drop in FY13 to the required level, \$3.1 million.
41. This is the "funded ratio," the ratio of the amount saved to the discounted present value of accrued liabilities for future benefits. See glossary (in the [Summary Report](#), p. 20) for full list of terms.
42. These are the "normal costs" and the "amortization payments," both of which are defined in the [glossary](#).
43. The actuarial report also provides a "full funding" scenario, which lies between the solid red and yellow curves depicted in Figure 3. The "full-funding" figures are calculated the same way as the ARC—normal cost plus amortization—but use a higher discount rate for valuing its liabilities. Under current accounting rules, a system that is committed to a pre-funding policy is allowed to use a higher discount rate for valuing its liabilities than a system operating under pay-go. MPS's valuation uses a 7.50 percent discount rate for the "full-funding" scenario and a 4.55 percent discount rate for the ARC under the pay-go scenario. Even under the "full-funding" scenario, however, the funded ratio would only reach 28.3 percent by July 1, 2020.
44. The other two factors were changes in demographic assumptions (\$0.088 billion) and an offsetting change from accelerated retirements by those seeking to avoid the cuts in benefits (\$0.266 billion, increasing the liability). See "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs, Actuarial Valuation as of July 1, 2011](#)," 2.
45. Alex Rivera, "[Milwaukee Public Schools Retiree Healthcare and Life Insurance Programs](#)," presentation to MPS Board, September 18, 2012.
46. The main sources for this section are the Wisconsin Retirement System "[Thirty-first Annual Actuarial Valuation, December 31, 2011](#)" (dated September 10, 2012), the Employees' Retirement System of the City of Milwaukee "[Actuarial Valuation Report as of January 1, 2012](#)" (dated June 19, 2012), the GRS valuation for "[Closing and Freezing of Supplemental Teachers Plan](#)" (February 28, 2012), and the [MPS CAFRs](#) for various years.
47. In addition to MPS's contributions to WRS, which cover the normal cost of currently accruing pension benefits, MPS also pays an additional 2 percent of payroll to cover unfunded liabilities. These liabilities were converted to bonded debt in 2003, taking MPS's share of the unfunded liability off the books of WRS. Thus, MPS's amortization payments take the form of debt service, but they are recognized as pension costs, and are included in our calculations.

48. Milwaukee Board of School Directors, [Minutes Library, March 29, 2012](#), 917.
49. In addition to the direct savings from the supplemental teachers' pension, which account for \$5 million of the \$35 million total, closing that plan will discourage early retirement, thereby saving additional funds on the retiree health plan. This very important connection was made by Bezruki, cited above, and appears to have been incorporated into the MPS valuation for RHI.
50. For both funds, the asset smoothing period is five years. (See [glossary](#) for "Actuarial Value of Assets.") For ERS, there is an additional feature, known as the "full funding limit," which artificially reduced the employer contribution to zero in 2011 and 2012; this feature deferred contributions, adding to future growth.
51. Wisconsin Retirement System, "[Thirty-first Annual Actuarial Valuation, December 31, 2011](#)," September 10, 2012, I-4.
52. Last year, WRS issued a legislatively mandated study, which included projected contributions through 2061. The projections are depicted in graphical form, but not presented numerically. However, the projected rise over the next several years is consistent with our projections. (See "[Study of the Wisconsin Retirement System](#)," June 30, 2012, 39.) Since this report was issued, WRS released "[Three-Year Experience Study, January 1, 2009 - December 31, 2011](#)" (November 20, 2012), adding 0.2 percent to future contribution rates, which we have also factored in.
53. As notes 27 and 31 explain, MPS negotiated some relatively minor changes before benefits were removed from collective bargaining (albeit while Act 10 was being enacted). The data were unavailable to separate the cost impact of these changes from those clearly made under Act 10.
54. To estimate the potential impact of rising retirement costs, we assume no further cuts in available revenues per pupil beyond what has already occurred. In other words, we estimate that revenues will rise with inflation only and drop with enrollments.
55. As we have seen, Act 10 also allowed MPS to save on health costs for *current* employees. Thus, the figures presented here significantly understate the total savings from Act 10. For an analysis of savings to Wisconsin school districts on current employee health costs, see Costrell and Dean, "[The Rising Cost of Teachers' Health Care](#)," *Education Next*, Spring 2013, and for total savings from Act 10, see the [unabridged version](#).
56. Reduction in teacher workforce based on the average of total salary and benefits paid to all teachers in FY11 with increases based on Milwaukee projected revenue increases for MPS and CBO Consumer Price Index calculations through 2020. Using average teacher compensation assumes that teachers are dismissed irrespective of seniority. In reality, Milwaukee Public Schools (and most other districts) target the least experienced teachers as the first to be fired when budgets are tight. Because these newer teachers are also less expensive, studies have found that this practice requires districts to lay off a greater number of teachers to accomplish the same fiscal savings. See, for instance, Marguerite Roza, "[Seniority-Based Layoffs will Exacerbate Job Loss in Public Education](#)," *Center for Reinventing Public Education*, February 2009.
57. Milwaukee Board of School Directors, [Minutes Library, December 20, 2012](#), 465-467.
58. These figures exclude "non-instrumentality charter" enrollment. Only "instrumentality" charter employees are covered under the retirement provisions. Instrumentality charters receive free use of MPS school facilities and hire their employees through the district's HR function, while non-instrumentality charters must secure their own facilities (or rent them from the district) and hire their own employees.
59. MPS does not publish enrollment projections.

60. MPS human resources department provided information on historic teacher counts.
61. Congressional Budget Office, “[An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022](#),” 2012, 56. Under Wisconsin law, the funds available from the state’s general aid formula and local property tax are determined by the state-legislated “revenue limit.” From FY04 to FY09, MPS’s revenue limit rose about 3.0 percent per year on a per-pupil basis. For the FY10-FY11 budget cycle, the per-pupil revenue limit was set to rise statewide at a flat rate of \$200 per pupil, which was about 2 percent for MPS. For FY12, the per-pupil revenue limit was cut 5.5 percent and for FY13 it was \$50. (See Wisconsin Legislative Fiscal Bureau, “[Local Government Expenditure and Revenue Limits](#),” Informational Paper 12, January 2013, 2.) Our data indicate that the impact of the sharp cut in FY12 was spread over two years, into FY13. Other components of MPS’s revenue stream include federal funds and state categorical funding.
62. Typically, most districts will show a slight difference between the per-pupil revenue and per-pupil expenditure figures.