LOCAL DEBT ON THE RISE

Local government debt in Wisconsin hit record levels in 2020, driven upward by low interest rates, infrastructure needs, and a little-known incentive in state law. Even after adjusting for inflation and population growth, debt levels are the highest on record for cities and other municipalities in the state. While the growth in property values has made it easier for local governments to repay their debts, currently rising interest rates could create new challenges by increasing the costs of new debt and slowing the growth in property values.

The total debt owed by local governments in Wisconsin rose by 5.4% in 2020, reaching the highest level on record. On Dec. 31, 2020, cities, counties, and other local governments owed $11.04 billion, an increase of $566 million over the prior year and the most ever even after adjusting for inflation and the growth in population in the state over time.

Several forces have pushed up local borrowing in recent years, particularly for cities. They range from a need to replace aging infrastructure and update IT systems to previously low interest rates. As we will see, state law has also incentivized borrowing for local governments over paying for projects and capital purchases in cash.

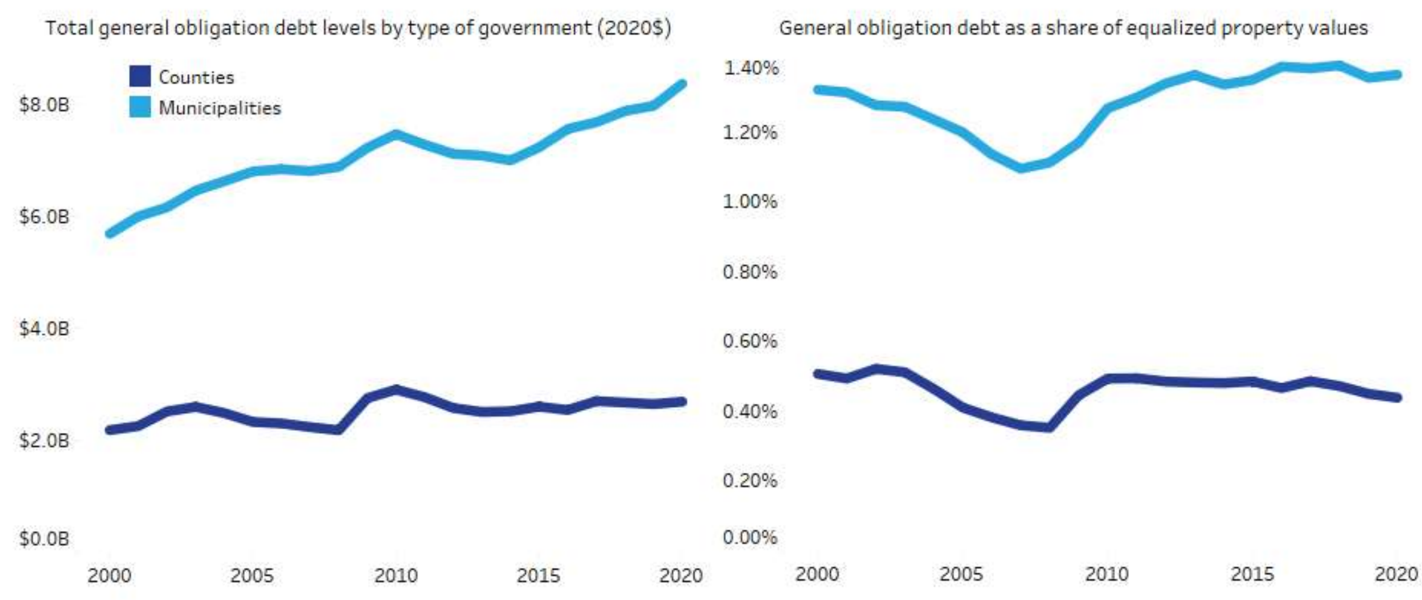
The picture is not all alarming. Counties, for example, have not borrowed so heavily over the past decade and all local governments have benefited greatly from rising property values that make it easier to pay off their debt.

Yet the increase in borrowing is widespread, affecting large cities such as Milwaukee, Madison, and Kenosha but also much smaller communities. Though most debt is owed by cities, the fastest growth in debt since 2015 has been in Wisconsin towns. Given the recent increase in borrowing and the fact that interest rates are now on the rise, a troubling question arises: could debt payments begin to crowd out spending on local services such as police, fire protection, parks, and libraries?

TRACKING THE GROWTH IN LOCAL DEBT

To delve into local debt in the state, we assembled data from the Wisconsin Department of Revenue going back to 2000 for all of the state's cities, villages, towns, and

Figure 1: Debt Rises to Record Levels for Wisconsin Municipalities but Remains a More Modest Share of Property Values



Sources: WI Department of Revenue and U.S. Bureau of Labor Statistics; debt amounts are as of Dec. 31 of each year and property values are as of Jan. 1 of that year.

counties – more than 1,920 local governments in all. The data come from financial statements filed by these governments each year with DOR with some limited corrections supplied by local officials, including those in the city of Beloit and village of Mount Pleasant.

The figures deal exclusively with general obligation (G.O.) debt, or debt that municipalities and counties have pledged their property tax levy and other local taxes to repay. These figures do not include debt secured by other specific sources of revenue, such as debt for a local water utility that is repaid with user fees.

On Dec. 31, 2000, cities, villages, towns, and counties in Wisconsin together owed $5.23 billion in general obligation debt, the equivalent of $7.86 billion in 2020 dollars. By the end of 2020, the total debt in raw dollars had more than doubled, and had risen by 40.5% after adjusting for inflation (see Figure 1 on page 1).

Most of that increase was due to an increase in debt owed by the state's 602 cities and villages, which rose from $3.5 billion at the end of 2000 ($5.26 billion in 2020 dollars) to $7.88 billion in 2020, an inflation-adjusted increase of 49.9%. The state's 72 counties, however, have borrowed less heavily over the past decade and their $2.69 billion in total debt at the close of 2020 was down somewhat from its inflation-adjusted peak of $2.9 billion at the end of 2010.

As Figure 2 shows, debt owed by cities and villages increased 125.4% between 2000 and 2020, more than doubling the rate of inflation, while county debt grew by 85.3% and town debt by 68.1%. However, since 2015, debt for the state's 1,248 towns has grown the most (39.5%), easily outpacing that of cities and villages (25.6%) and counties (12.9%) and raising concerns we highlighted in this recent Wisconsin Policy Forum brief about town finances.

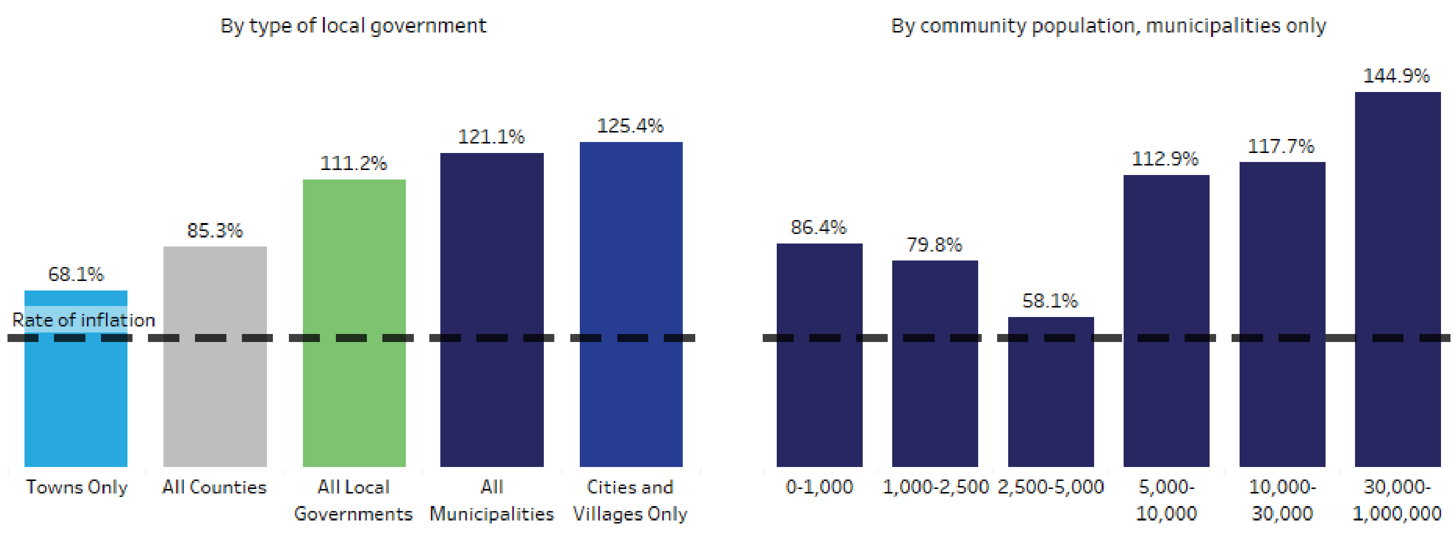
When looking at municipalities by their size, debt rose the most from 2000 to 2020 in cities with more than 30,000 residents (144.9%) and barely outpaced inflation in municipalities with 2,500 to 5,000 residents (58.1%). However, the very smallest communities with less than 1,000 residents have also seen somewhat greater growth in debt than mid-sized communities.

Most local governments saw debts spike as they encountered fiscal challenges during the Great Recession and lowered them somewhat in the following years, only to have them begin to rise again in roughly 2014. The reasons could include relatively low interest rates in the 2010s, the rising need for, and cost of, infrastructure and other capital projects such as new IT systems, and renewed efforts to attract economic development as the recession faded.

In addition, the state's limits on property tax levies may also lead to more borrowing. State law limits the amount that local governments can raise property taxes annually for their operations to the rate of new construction in a community. The law, however, also provides an exception equal to the added amount

Figure 2: Debt Has Grown Most Quickly in Large Cities and Villages

Percentage increase in general obligation debt from 2000 to 2020



Source: Wisconsin Department of Revenue

needed to make G.O. debt payments, giving towns and other local governments an incentive to borrow for expenses they previously might have paid for in cash. Some cities such as Milwaukee have been drawn into that cycle.

It's worth noting, however, that municipalities with rising G.O. debt payments can raise more property tax revenues even if they actually use other revenues such as water utility fees to make those payments. That may also incentivize communities to issue G.O. bonds when in the past they would have used revenue bonds. That might make the rise in G.O. debt seem somewhat worse than it actually is for municipalities.

RISING PROPERTY VALUES EASE PAIN

As local governments have amassed greater debts in recent years, they have benefited from one factor that has helped to lighten that load: rising property values. Since most local governments in Wisconsin rely heavily on the property tax, rising property values suggest local governments have greater ability to repay their debt.

The Wisconsin Constitution recognizes that fact by limiting municipal and county G.O. debt in most cases to 5% of a community's equalized property value.

Between 2010 and 2020, statewide property values outpaced local debt, leaving local governments in a better position to pay off their borrowing, at least on paper. As Figure 1 on page 1 shows, total municipal debt fell from 1.35% of statewide property values in 2012 to 1.28% in 2020 – well below the state debt limit. County debt levels were even lower. The strong growth in property values in 2021 should further reduce these ratios once new data become available.

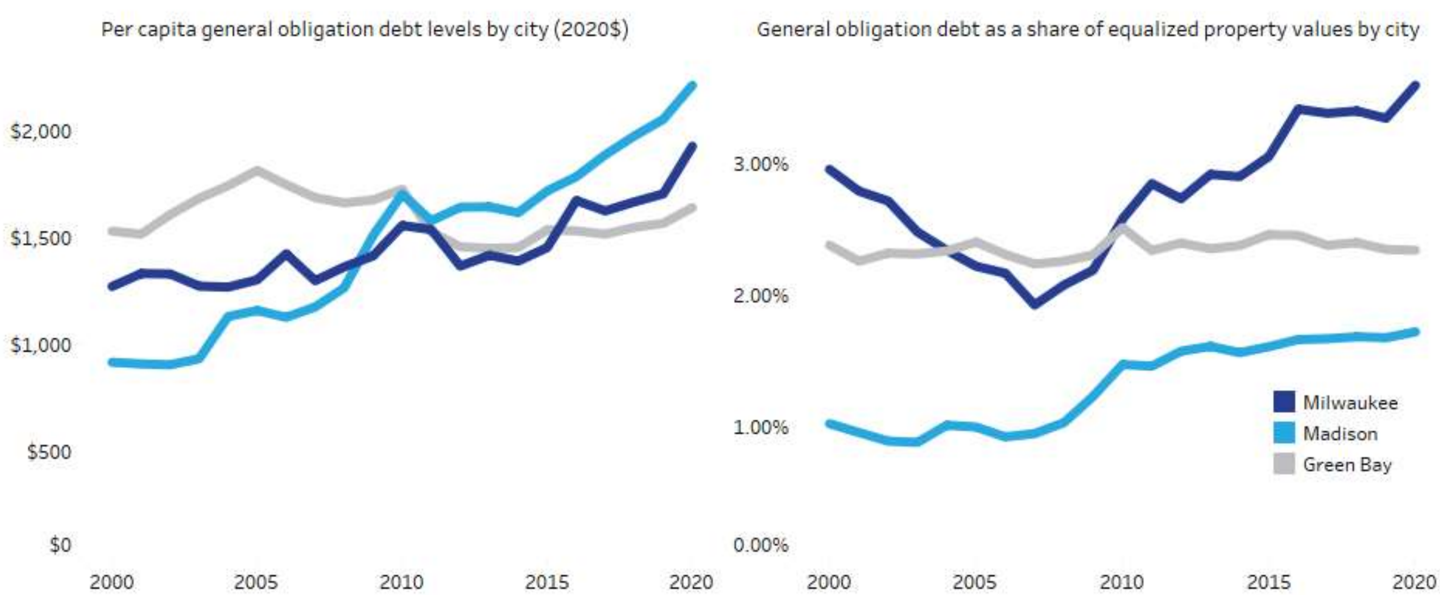
However, debt levels remained substantially higher than they were just prior to the Great Recession. In addition, if local officials raise property taxes too much to cover debt payments, they may be disinclined to raise them further for other local spending. Debt payments in 2020 made up a somewhat greater share of all city and village spending than they had on average over the past twenty years. Town debt payments made up a larger share of 2020 spending than in any year since 2002.

LARGE CITIES SEE DEBTS RISE

Of the debt owed by the state's 1,850 cities, villages, and towns, more than one-quarter of it, or $2.18 billion, is owed by the state's five largest cities (Milwaukee, Madison, Green Bay, Kenosha, and Racine) and more than one-eighth of it, or $1.13 billion, is owed by the city of Milwaukee alone. In both cases, that is only a slightly larger share than in 2000.

As Figure 3 shows, the per capita G.O. debt owed by the state's top three cities increased between 2000 and 2020, even after adjusting for inflation. Madison more than doubled its debt levels, from $919 per capita in

Figure 3: Debt Levels Grow for Most Large Cities in Wisconsin but Rising Property Values Lighten the Load



Sources: WI Department of Revenue and U.S. Bureau of Labor Statistics; debt amounts are as of Dec. 31 of each year and property values are as of Jan. 1 of that year.

2000 to $2,216, rising from the lowest rank among the three largest cities to the highest. Milwaukee also increased its per capita debt to the highest level on record ($1,930) in 2020 while Green Bay's increase was more modest. To see these figures for any city or county in Wisconsin, you can go to this interactive tool.

The picture looks different, however, when debt is shown as a share of property values. With its high property values, Madison has by far the lowest debt level of the three cities on this metric. With its much lower property values, Milwaukee has by far the highest debt as a share of its property tax base at 3.6%. Though that remains well below the 5% state debt limit, it's still almost double Madison's 1.7%.

The Forum warned about the rise in Milwaukee's debt levels in its recent fiscal analysis of the city, pointing out it comes at a time when the city's unfunded pension and retiree health care liabilities are also rising. Notably, the debt figures used here do not even include borrowing done by the city on behalf of the Milwaukee Public Schools. However, the rise in the city's debt does reflect a ten-year, more than $100 million note that was issued by the city in 2020 to lock in a low interest rate while ensuring the city had enough cash to carry out its basic operations.

The recent analysis of Milwaukee's finances found that a greater share of the city's property tax levy is going to make debt payments, from $68.7 million in 2012 to $98.5 million in the mayor's proposed 2023 budget. Under the proposal, debt would account for 31.7% of the overall levy next year, the most since 2008.

Madison's borrowing remains more manageable but has also grown over the past decade. Debt payments have also risen as a share of the city's general fund spending – a trend that the Forum has highlighted in its Madison budget briefs.

Nor is this trend limited to large cities. Debt for the state's 1,248 towns currently stands at $290 per resident, an all-time high even after adjusting for inflation. Meanwhile, overall town debt as a share of town property values is 0.22%, a relatively low figure but still the highest ratio since 2003.

CONCLUSION

Debt is an essential tool for local governments, and many may have benefited in recent years by using previously low interest rates to help address their infrastructure needs. Yet for several years, the Wisconsin Policy Forum has been warning that rising debt levels could start to crowd out other spending on key local services such as public safety. In some large cities such as Milwaukee, that fear is becoming a reality and even in some small towns and wealthier communities such as Madison it is becoming a more long-term concern.

Though recent increases in property values have helped keep debt loads manageable for most counties and municipalities in the state, rising interest rates, slowing growth in property values, and ongoing infrastructure and IT needs will add to the challenges moving forward. Policymakers may want to consider a range of options to slow the growth in local debt, from incentivizing local governments to team up on capital projects and purchases such as a new road or fire engine to giving local governments more flexibility in raising revenues.

Ultimately, the more local governments and taxpayers must spend to pay off past borrowing, the more difficult it will be for them to finance ongoing services and projects. Helping local officials to keep debts under control now ensures they will be able to meet their communities' needs in the future.