Estimation Unknown

Tasked with estimating city revenue and implementing a new municipal sales tax, the City of Milwaukee Comptroller's Office shares lessons learned and tips for success.

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Before 2024, the City of Milwaukee's primary revenue sources—transfer payments from the state, property taxes, and charges for service—were quite stable, but largely stagnant. Shared revenue payments from the state had been frozen for nearly two decades, and that, along with property tax levy limits and rising pension costs, left the city on the precipice of a fiscal cliff. The city's 2024 budget faced a $180 million budget deficit, and there were no viable options for closing the budget gap short of devastating cuts to public safety.

The state legislature passed sweeping legislation known as Act 12 in spring 2023 to stave off the city's impending financial disaster. The act also made other changes impacting municipalities across the state. It authorized a new two percent sales tax for the City of Milwaukee, with proceeds to be used for paying off unfunded actuarial accrued pension liability and increasing the number of public safety personnel. Before Act 12, there was a five percent state and 0.5 percent county sales tax in effect, but no dedicated City of Milwaukee sales tax. Act 12 also provided for a 0.4 percent increase to Milwaukee County's sales tax, which brought the effective sales tax rate in the City of Milwaukee to 7.9 percent.

The responsibilities of Milwaukee's elected comptroller include independently recognizing revenue in the city's budget. The Comptroller's Office became the lead city agency responsible for estimation and administration of the city's new two percent sales tax, also becoming, by default, the lead agency in charge of communicating information about the sales tax to elected city officials, other internal stakeholders, and the public at large.

Shortly before the legislation was adopted, the Wisconsin Department of Revenue (WIDOR) released its initial city revenue estimate: $193.6 million. The Comptroller's Office's review found this to be more of an "aim for the bullseye" estimate than a number to base the budget on, so it set a benchmark against which the city's estimate would be measured and compared. Would the expectation be that we would also "aim for the bullseye," or should we take a conservative approach to reduce the likelihood of overestimating?

The 2024 sales tax revenue estimate got a lot of attention because of the high-profile nature of Act 12 and the new two percent city sales tax. With only four months before the Comptroller's Office revenue estimate had to be submitted, the compressed timeline didn't provide enough time for rigorous consultant engagement. The office had a steep learning curve and a very bright spotlight on the outcome of its work.

Initial challenges

The first challenge the Comptroller's Office faced was the lack of reliable historical taxable sales tax data for just the city. The closest proxy available for historical city sales tax data was aggregated data for all of Milwaukee County. The City of Milwaukee is located almost entirely within Milwaukee County and makes up approximately 61 percent of the county's population. Retailers had not been required to identify which municipality within the county generated the taxable sales, so this data couldn't be used to parse out the city's sales tax base.

Key city revenues before 2024 were quite stable—property taxes, transfers from the state, and charges for service—so economic forecasts were not a significant factor in prior revenue estimates. But economic forecasts play a critical role in estimating sales tax revenue. In summer 2023, some economists were forecasting the possibility of a recession in 2024. In Milwaukee County, taxable sales had declined for the last four out of the past 25 years, which gave the office reason to be cautious. On top of that, the impact of inflation on consumer spending was uncertain when the estimate was being developed. Increasing prices could be positive for taxable sales, but would consumers buckle down and cut back on spending?

Finally, there was much to learn about the logistics of the sales tax. How often do retailers report taxable sales to the state? Does the state keep a portion of sales tax revenue as an administrative fee? What items are exempt from sales tax? Are deliveries (for example, online shopping) taxed at the effective rate of where the goods are delivered? These factors and others could impact the estimate, and the Comptroller's Office would be expected to inform local stakeholders about how residents and retailers would be affected.

GFOA's recommended practices

GFOA's Certified Public Finance Officer (CPFO) planning and budgeting test preparation materials on revenue forecasting helped staff in the Comptroller's Office develop their game plan. One quote from the CPFO materials applied to the situation: "No one method works best for a particular revenue source. Don't ask what method you should use for the sales tax. Ask what method you should use given the information available." Given the challenges posed by limited or imperfect data, it was comforting to know that GFOA guidance did not apply a "one size fits all" approach.

GFOA's information about revenue forecasting starts with the concept of building data. Know and understand the applicable laws, rules and regulations, and the history of effective rates, and connect with authorities who can provide guidance and answer questions. It's also important to keep both quantitative and qualitative factors in mind. Historical data can help build a baseline, but there's also tremendous value in comparing the story the data is telling you with other external factors that aren't based on hard data. Logic-test your assumptions—does this intuitively make sense? And finally, use moving averages to smooth out bubbles and tune out static. Don't let the most recent two to three years (or months) drive your forecast. Longer evaluation periods can bring the bigger picture into focus.

How challenges were addressed

With the eyes of elected officials, media, interest groups, and the public at large fixed on the Comptroller's Office, the sales tax estimation process began in May 2023. The first step, based on guidance available from GFOA, was connecting with other governments that have experience or authority in sales tax estimation and administration. Contacts at Milwaukee County provided useful information about the administration of the sales tax, including how and when revenue collected by the state gets distributed to municipalities. But Milwaukee County's sales tax had been in place for many years, and there was no recent experience with estimating revenue from a newly authorized sales tax. The city contracted with an economist for perspective on local economic forecasts as well as insight into the City of Milwaukee's share of the Milwaukee County sales tax base.

The Comptroller's Office most productive and beneficial partnership was with WIDOR. Part of the office's effort to build intelligence was fully understanding every possible factor affecting city sales tax revenue. WIDOR was incredibly helpful and responsive, walking the office through each detail of their revenue estimation model as the office's research uncovered more items to consider. The office's own research prompted questions that WIDOR was always able to answer quickly and thoroughly. For example, WIDOR's model didn't include private party vehicle sales or the use tax portion of the sales and use tax as part of the Milwaukee County sales tax base, removing $1.2 billion from the taxable sales base.

This led the Comptroller's Office to initially believe that WIDOR's estimate could be too low. When asked about this possibility, WIDOR said those items had been left out because their impact was largely offset by two other factors staff hadn't yet considered: the administrative fee WIDOR charged for collecting and administering the tax, and the retailer's discount, a small amount of sales tax revenue retailers kept as compensation for their efforts in collecting sales tax. WIDOR's methodology ultimately proved to be perfectly reasonable, as these items largely cancelled each other out—but this exchange provided excellent insight into factors the Comptroller's Office hadn't considered. It also led to the conclusion that the office's communication strategy for local stakeholders needed to explain all relevant factors up front to avoid any misperception that significant factors had been left out of the estimate.

WIDOR provided data and analysis of historical sales tax data, including Milwaukee County data from 2017 through 2022 and 2023 year-to-date. The Comptroller's Office also obtained data for Sheboygan County, Wisconsin, which had instituted a 0.5 percent sales tax in 2017. Analyzing the first year of a sales tax would provide perspective on whether implementation challenges or non-compliance by retailers could have a significant impact on revenue.

Our next step was to identify the key variables in the office's estimation model. It was clear from early on that the most significant variable was the City of Milwaukee's share of Milwaukee County taxable sales. Because sales tax data had been reported to the state only at the county level, the data from WIDOR didn't shed light on this figure. Other factors, both quantitative and qualitative, were used instead to inform this data point.

Census and American Community Survey data showed that the City of Milwaukee made up 61 percent of the population of Milwaukee County. But

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the city makes up approximately 48.5 percent of Milwaukee County's adjusted gross income, as reported on state income tax returns. Census data from 2017 found that the City of Milwaukee was responsible for 47 percent of the total weighted dollar amount of sales activity in Milwaukee County in that year. Major retail shopping centers that sell primarily taxable goods in Milwaukee County are largely located outside of the city's boundaries, which could skew taxable sales in favor of the rest of the county. But most deliveries, including online sales, are taxed at the effective rate where goods are delivered. The trend toward online shopping and away from brick-and-mortar retail has only accelerated since 2017, which might move the needle back in the city's favor.

The data and analysis the economist provided brought several data points into focus, but no single one was conclusive. These included comparisons of the city to the rest of the county in terms of consumer spending and household income, a measure of commercial property value as a proxy for the ability to generate taxable sales, and the daytime population, to take into account spending power of commuters. Anecdotal evidence and logic-testing did not support the 61 percent indicator of the city's daytime population, and this factor was removed from consideration. The remaining factors, along with the indicators provided by WIDOR, supported a city share of county taxable sales in a range from 47 percent to as high as 52 percent.

Downstream from the city share of county taxable sales was the projection of growth for both the remainder of 2023 and for 2024. Projected growth was the next most important variable in the office's model. In summer 2023, when the estimate was being developed, inflation was a significant consideration—rising prices could bode well for taxable sales. At a certain point, though, consumer spending may pull back in taxable categories to offset rising prices for nontaxable items like groceries. Some economists at the time discussed the possibility of a mild recession in 2024—but there was optimism that major events taking place in Milwaukee in 2024, such as the Republican National Convention, would limit the impact of a recession. The economist ultimately recommended using a growth assumption of 3.8 percent for year-over-year growth from 2022 to 2023, and two percent from 2023 to 2024.

The review of Sheboygan County's sales tax in 2017 indicated the possibility of delays in implementing new sales tax rates by retailers. A strong communications campaign to retailers could limit the impact of noncompliance, but this gave the office another reason to be conservative.

Ultimately, the staff used what it calls a "reasonably conservative" approach to develop its 2024 sales tax revenue estimate. For each variable in its model, the office used the lowest end of the range that was still supported by the data. For example, data for the key variable-city share of county taxable sales—supported a range from 47 percent to up to 52 percent. The office's final estimate used the lowest end of the range, 47 percent, to account for uncertainty and to protect against the risk of an overly optimistic estimate. The office didn't want its sales tax revenue estimate to have a 50 percent chance of being too low and a 50 percent chance

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of being too high. The consequences of overestimating were far more severe than the consequences of underestimating, as significant revenue shortfalls could force drastic expenditure and service reductions, or unplanned withdrawals from unrestricted fund balance or other reserve funds.

Outcome

The "reasonably conservative" approach resulted in the City of Milwaukee's 2024 sales tax revenue estimate coming in at $184 million. This was well below the $193.6 million estimate from WIDOR, but the office believed it was as conservative as possible while still being supported by the data.

The early results were not promising. The first two full months' distributions the city received, in March and April, were much less than anticipated. Disappointment set in among city stakeholders, and there was discussion about the possibility of curtailing spending to offset a potential sales tax revenue shortfall.

The Comptroller's Office knew that delays in implementation and non-compliance among retailers could be a factor in these early months, so it became critical to communicate patience to elected officials and other stakeholders, both to provide context and to avoid hasty decision making. The office informed stakeholders about the impact the initial implementation could have on the first few months' revenue and urged patience. The media published articles about some large online retailers incorrectly applying the new effective sales tax rates, but these issues were quickly identified and remedied.

Distributions the city received in May and June were significantly greater than expected, easing fears of a major revenue shortfall. This uptick was partially caused by corrections from previous months, when retailers were underreporting sales tax, but much of it was from better-than-forecasted sales. Over subsequent months, month-to-month revenue was more volatile than expected, and the Comptroller's Office urged stakeholders to focus on the "signal" rather than the "noise," and to focus more on rolling averages without drawing new conclusions from each month's results. The key message was that our conservative estimate would protect the city from downside risk over the full year.

Despite significant interest in the economic impact of Republican National Convention on City of Milwaukee sales tax revenue, the lack of historical city-only data made year-over-year comparisons unreliable. It turned out that some businesses did exceptionally well during the convention, and others fell short of revenue expectations. But it wasn't possible to draw broad conclusions about the impact of the event through sales tax data alone.

Final result

The "reasonably conservative" model used to develop the final 2024 estimate for City of Milwaukee sales tax revenue produced an estimate of $184 million. The city's actual sales tax revenue in 2024 came to $200.6 million, a favorable but significant variance of $16.6 million, or nine percent. While a more aggressive estimate would have allowed for a greater degree of flexibility in developing the 2024 budget, if the economy hadn't remained strong and the sales tax revenue estimate hadn't been met, the city would have been forced to make some very difficult choices. In the end, the Comptroller's Office's revenue estimate wasn't "aiming for the bullseye"; it was deliberately conservative to account for the lack of reliable historical data and the uncertainty inherent in the first year of a new revenue source.

Lessons learned and key takeaways

Connect with those who are "in the know." Build a cross-functional internal team. Connect with authorities on the matter, or other sources that have experience with the revenue. The Wisconsin Department of Revenue, Milwaukee County, and the economist all brought valuable insight to the table.

Leave no questions unanswered. Peel back every layer to make sure all the questions are answered, and try to anticipate the questions other stakeholders might have. Develop an understanding of all factors that ultimately affect revenue, no matter how minor, and make sure you can explain their significance or lack thereof.

Communicate! There is no such thing as "over-communicating." Even if things aren't clear yet, or reliable projections aren't available, share as much as possible about what is and isn't known with relevant stakeholders. Keep your message clear and consistent.

Don't "aim for the bullseye" with your first year revenue estimate. While there may be reasons for trying to be spot-on with your revenue estimate—whether there's pressure to maximize revenue, or for numerous other reasons—using a number that has a far greater chance of being too low is better than using one that's too high. You would much rather be sharing good news about greater-than-anticipated revenues than bad news about a revenue shortfall.

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