The Civic Federation

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FINANCIAL CHALLENGES FOR THE NEW MAYOR OF CHICAGO

Analysis and Recommendations

February 14, 2011

The Civic Federation ● 177 N. State Street ● Chicago, IL 60601 ● civicfed.org

The Civic Federation is an independent, non-partisan government research organization working to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

The purpose of this report is to identify the most significant financial challenges facing the City of Chicago and to provide recommendations to the new mayor of Chicago for ways to improve the City's finances in the short- and long-term. On February 22, 2011 Chicagoans will vote for a new mayor of Chicago. A runoff election will be held on April 5, 2011 if no candidate receives a majority of the vote in February. The mayor will take office on May 16, 2011 and will lead the first new administration in over twenty years.

The City of Chicago has a structural deficit, a condition characterized by annual expenditure increases that consistently exceed recurring revenue increases during normal economic times. Over the past ten fiscal years, the City has had significant budget deficits. These deficits have grown dramatically because the City has failed to implement enough efficiencies, make deep enough spending cuts and/or utilize new or increased recurring revenues. Rather, it has closed annual deficits with temporary spending reductions and non-recurring revenues, including over $1 billion in proceeds from the long-term leases of the Skyway and parking meters. The City has depleted the small Corporate Fund reserves that it once had. Meanwhile, bonded debt levels and pension obligations have grown at a rapid rate.

The new mayor of Chicago will need to make difficult choices to close the immediate budget gap of at least $500 million and set the City on a path to long-term fiscal stability. The Civic Federation offers the following short- and long-term recommendations to the new mayor:

Short-Term Recommendations:

1. Develop and publish multi-year financial forecasts that allow the mayor and other stakeholders to project the effects that short-term actions will have on the City's long-term fiscal health.
2. Implement immediate expenditure reductions in order to close the budget gap and begin to address the structural deficit.
3. Adopt an asset lease reserves withdrawal policy that will protect the remaining reserves even when economically-sensitive revenues begin to recover.
4. Adopt a fund balance policy that will build up Corporate Fund reserves as revenues recover.
5. Pursue alternative service delivery opportunities that will reduce costs and ensure quality service provision.
6. Improve transparency in Tax Increment Financing reporting to better inform public debate over the proper use of TIF revenues.

Long-Term Recommendations:

1. Develop a long-term financial plan in the first year in order to engage all stakeholders in the difficult choices about taxation and service provision that are needed to regain fiscal balance and sustain critical services in the future.
2. Stabilize the City's critically underfunded pensions by implementing pension reforms, such as increased contributions and reduced benefits.
3. Pursue creation of a separate retiree health care trust fund as the current retiree health care agreement expires in 2013.

INTRODUCTION

The purpose of this report is to identify the most significant financial challenges facing the City of Chicago and to provide recommendations for ways to improve the City's finances in the short- and long-term. The Civic Federation will release a comprehensive report later this year that will provide more detailed recommendations on ways to strengthen the City's fiscal foundation.

The City of Chicago has a structural deficit, a condition characterized by annual expenditure increases that consistently exceed recurring revenue increases during normal economic times. Over the past ten fiscal years, the City has had significant budget deficits, which continue to grow because the City has failed to implement enough efficiencies, make deep enough spending cuts and/or utilize new or increased recurring revenues. Rather, it has closed annual deficits with temporary spending reductions and non-recurring revenues such as proceeds from the Skyway and parking meter long-term lease agreements.

The Civic Federation's *Financial Challenges for the New Mayor of Chicago* comes at a time when a unique opportunity exists to promote reforms. On February 22, 2011 Chicagoans will vote for a new mayor of Chicago.[1] The mayor will take office on May 16, 2011 and will lead the first new administration in over twenty years.

In this report, the Civic Federation proposes that the City move aggressively to adopt best practices and take actions that will allow the City to begin to address its structural deficit. The Civic Federation believes that it should be a high priority to implement a formal long-term financial planning process that is shared with and reviewed by key policymakers and stakeholders. Long-term planning is critical both during times of protracted fiscal distress, such as the current economic climate, and during times of recovery when it is important to prudently plan for the next downturn.

The report describes major fiscal problems facing the City of Chicago and identifies factors that have led to its structural deficit. It then offers the Civic Federation's ideas for addressing each of the issues with short- and long-term recommendations. The report builds on the Civic Federation's analysis of the City's FY2011 budget, which can be found at www.civicfed.org.[2]

[1] If no candidate receives the majority vote on February 22, a runoff election will be held on April 5, 2011.
[2] See the Civic Federation, "City of Chicago FY2011 Proposed Budget: Analysis and Recommendations," November 3, 2010. http://civicfed.org/civic-federation/publications/city-chicago-fy2011-proposed-budget-analysis-and-recommendations (last visited on February 9, 2011).

FINANCIAL CHALLENGES FACING THE CITY OF CHICAGO

The City of Chicago suffers from several fiscal problems: a persistent structural deficit, a lack of Corporate Fund reserves and growing long-term liabilities.[3]

Persistent Structural Deficit

The City of Chicago has a structural deficit, a condition characterized by annual expenditure increases that consistently exceed recurring revenue increases during normal economic times. Annual budget deficits have continued to grow because the City has failed to enact measures that make deep enough spending reductions and/or utilize new or increased recurring revenues. Rather, the City has attempted to address its structural imbalance with insufficient spending reductions and non-recurring revenues, including over $1 billion in proceeds from the long-term leases of the Skyway and parking meters.

Significant and Growing Annual Budget Deficits

The City of Chicago has had significant and growing budget deficits to close during the past ten fiscal years beginning with a $58.3 million budget gap in FY2002 that grew to a $220.4 million budget gap in FY2005. In FY2009 the budget deficit totaled $469.6 million and in FY2010 the deficit totaled $520.0 million. The FY2011 budget deficit of $654.8 million equaled 10.6% of the total budget for the City across all local funds and 20.1% of the Corporate Fund appropriation.[4] The City is likely to face a FY2012 budget deficit of at least $500 million given that revenues have been slow to recover and the majority of the prior year deficit was closed with non-recurring revenue. Even during times of economic stability and growth the City faced large budget deficits. The increase in the City's annual budget deficit over time is a leading indicator that its expenses are outpacing its revenues.

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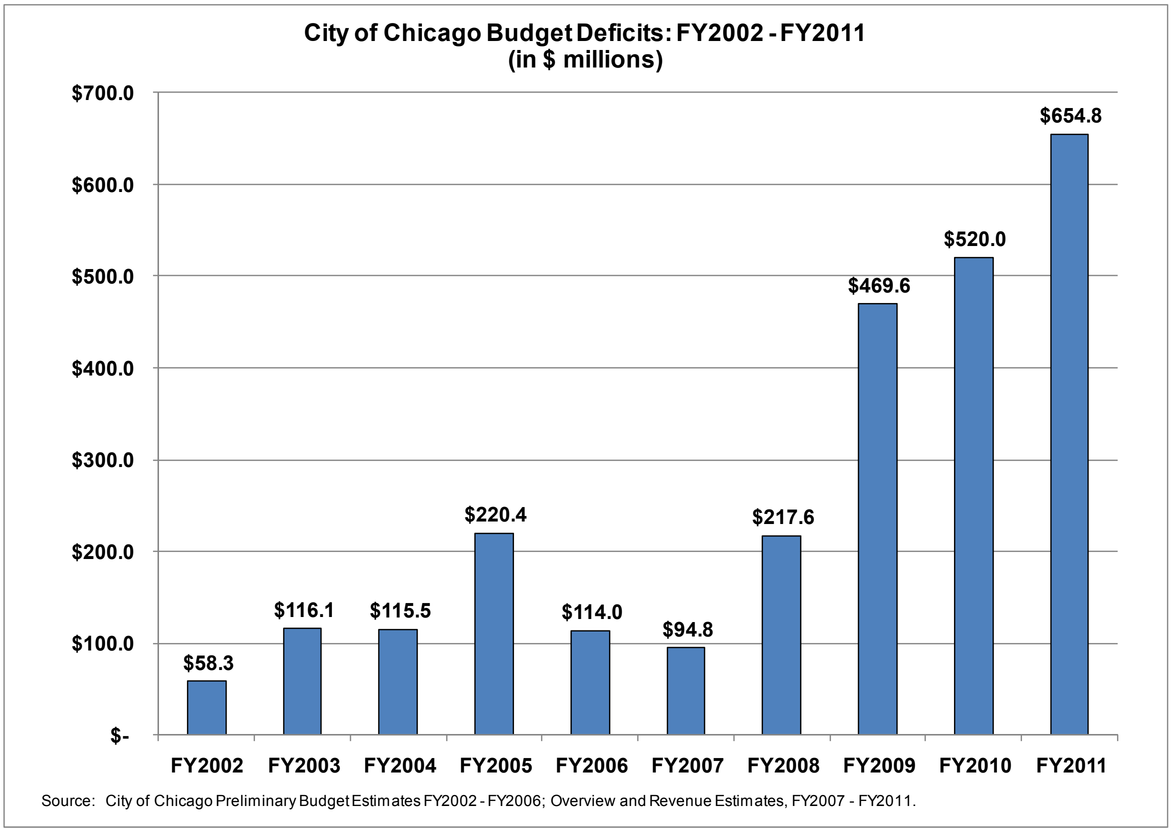
[3] These findings have been pointed out in numerous reports in the past, including the Civic Federation's analysis of the proposed FY2011 City of Chicago budget available at http://www.civicfed.org/civic-federation/publications/city-chicago-fy2011-proposed-budget-analysis-and-recommendations (last visited on February 9, 2011).

[4] The City's Corporate Fund is used for general operations such as police and fire protection, garbage collection and public health programs. "All local funds" is the Corporate Fund, special revenue funds, pension funds, debt service funds and enterprise funds. It excludes grant funds.



Expenditure Growth Outpacing Recurring Revenue Growth

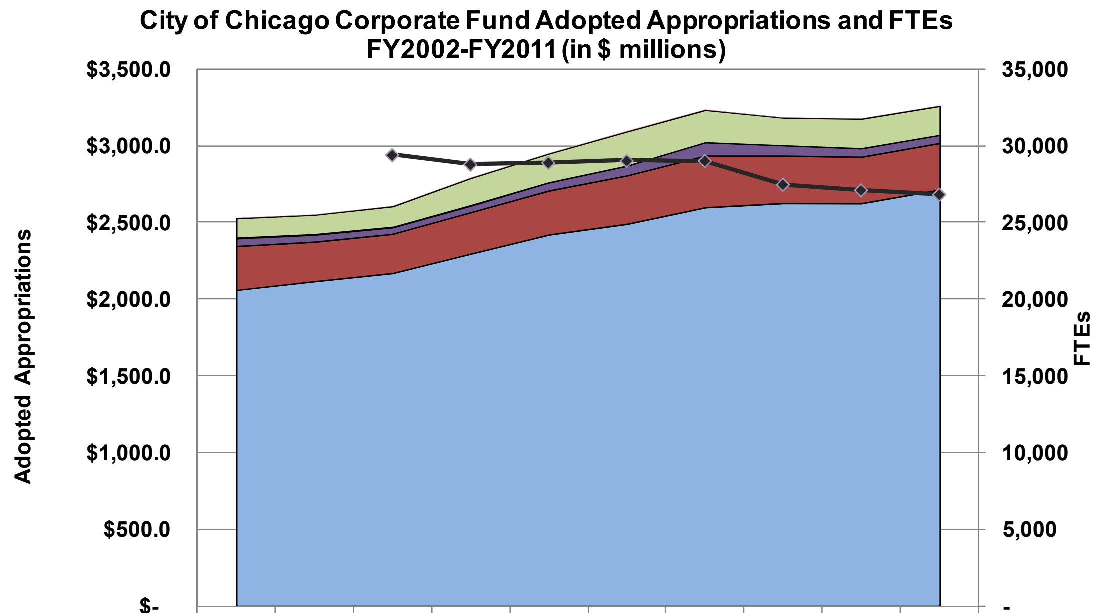
The City has experienced deep revenue declines in recent years due in part to the economic recession that officially ended in June 2009 and its lingering after effects.[5] The City reported in October 2010 that it expected to lose a cumulative total of $734.3 million in economically-sensitive revenues between the 2007 revenue peak and the end of 2010 and it projected an additional $297.2 million loss for 2011.[6] The decline in economically-sensitive revenues has added roughly $300 million in pressure on the City's annual budget in each of the last three years.

However, the City's deficit problem is not due solely to the recent recession. Spending has continued to rise. Between FY2007 and FY2011, net appropriations for all local funds will have increased by 8.6%, rising from $5.7 billion to $6.2 billion.[7] Corporate Fund appropriations will approach $3.3 billion in FY2011, an increase of 5.4% or $165.9 million from FY2007.[8]

Personnel services are the single biggest expenditure in the Corporate Fund budget, constituting 83.2% of the $3.3 billion FY2011 adopted appropriation.[9] Nearly two-thirds (64.5%) of the FY2011 personnel expenses are for fire, police and emergency management. Appropriations for personnel will have increased by 9.0% over five years, rising from $2.5 billion in FY2007 to

[5] The National Bureau of Economic Research announced on September 20, 2010 that the recession that began in December of 2007 ended in June 2009. National Bureau of Economic Research, http://www.nber.org/cycles/sept2010.html (last visited on October 25, 2010).
[6] City of Chicago, FY2011 Budget Overview and Revenue Estimates, p. 63.

$2.7 billion in FY2011.[10] Personnel costs have been rising despite a reduction in the Corporate Fund workforce of 2,201 full-time equivalent (FTE) positions, or 7.6%, over the same time period.[11] The graph below illustrates this trend.[12]

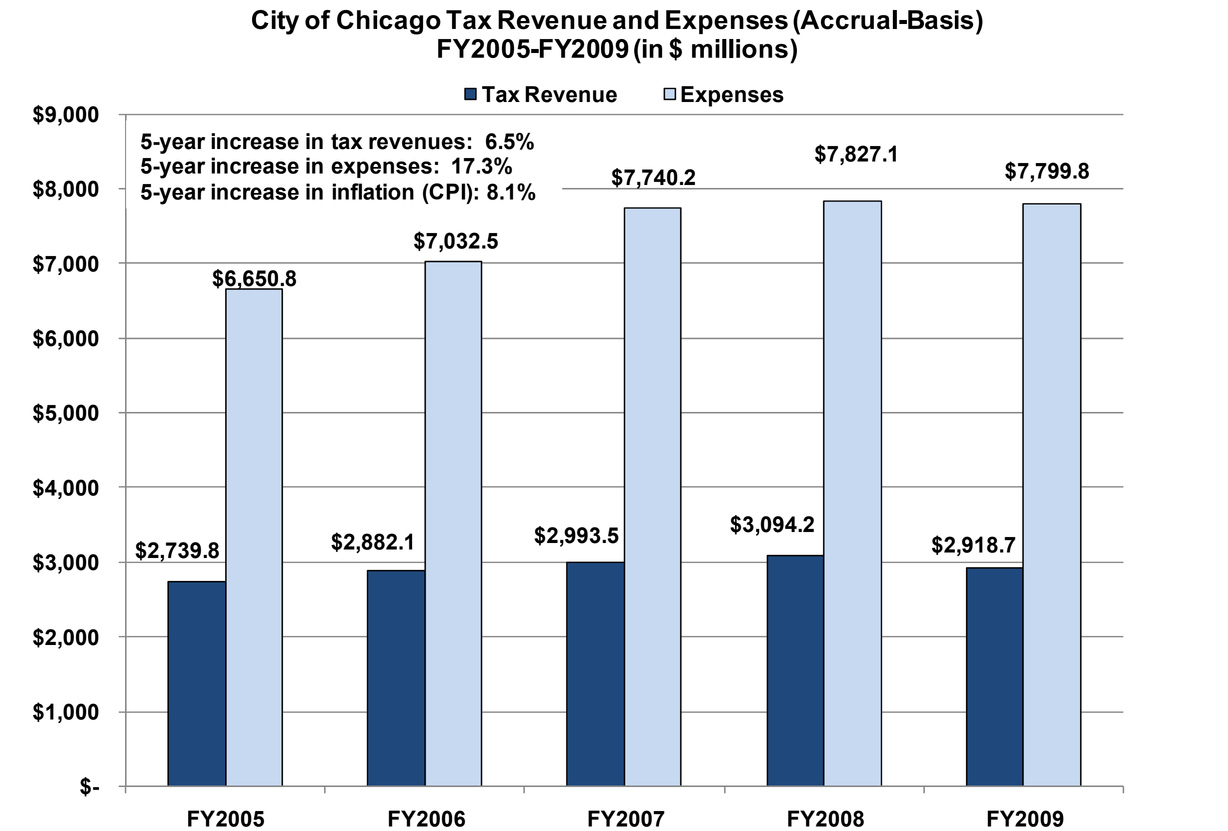


	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Other	$3.0	$2.7	$2.5	$2.4	$3.4	$3.6	$3.4	$2.5	$2.4	$2.2
Specific Items/Contingencies	$128.4	$127.4	$135.5	$178.8	$188.4	$224.7	$212.8	$181.3	$194.3	$190.5
Commodities	$49.5	$45.2	$41.4	$43.1	$52.6	$63.2	$87.6	$68.0	$55.6	$53.9
Contractual Services	$285.4	$256.5	$255.0	$269.1	$285.8	$315.0	$335.9	$308.3	$301.9	$302.6
Personnel Services	$2,061	$2,118	$2,171	$2,297	$2,421	$2,491	$2,598	$2,626	$2,625	$2,714
Total	$2,527	$2,549	$2,605	$2,790	$2,952	$3,097	$3,238	$3,186	$3,179	$3,263
FTE	-	-	29,386	28,771	28,890	29,020	29,015	27,471	27,097	26,819

Note: FTE numbers for 2002 and 2003 were unavailable. Figures are adopted budgets.
Source: City of Chicago Annual Appropriation Ordinance FY2002-FY2010, Budget Overview and Revenue Estimates FY2004-2011.

[7] City of Chicago, FY2007 Appropriations Ordinance, p. IX and FY2011 Appropriations Ordinance, p. 3.
[8] City of Chicago, FY2007 Appropriations Ordinance, p. V and FY2011 Appropriations Ordinance, p. 6.
[9] The City's definition of personnel services includes only salaries and wages. Employee benefits are included in the "Specific Items/Contingencies" category while pensions are accounted for in a separate fund.
[10] City of Chicago, FY2007 Appropriations Ordinance, p. V and FY2011 Appropriations Ordinance, p. 6.
[11] City of Chicago, FY2007 and FY2011 Appropriations Ordinances.
[12] The graph shows adopted appropriations rather than actual expenditures because they are not available by object in the budget documents. There has not been a signficant change in categories of appropriations during the past ten years.

Accrual-basis figures from the City's audited financial statements also show expenses outpacing tax revenues between FY2005 and FY2009 (the most recent audited figures available). Expenses grew from $6.7 billion in FY2005 to $7.8 billion in FY2009. This 17.3% growth in expenses was more than twice the 8.1% rate of inflation over the same period. Meanwhile the City's tax revenues grew by $178.9 million, from $2.7 billion in FY2005 to $2.9 billion in FY2009. The 6.5% growth in tax revenue over the five-year period is less than the rate of inflation over the same period, and 9.2 percentage points less than expenditure growth.



Source: City of Chicago Comprehensive Annual Financial Reports, Statement of Activities, FY2005-FY2009; Bureau of Labor Statistics All Urban Consumers Annual Consumer Price Index for Chicago-Gary-Kenosha MSA

Increasing Dependence on Non-Recurring Revenues to Close Budget Deficits

The City of Chicago has shown increasing dependence on non-recurring revenue sources to close its annual budget deficits even before the economic recession. An examination of Corporate Fund recurring and non-recurring revenues sources over time illustrates this trend.

The City's Corporate Fund resources can be described using the following five categories of generally recurring and generally non-recurring sources: [13]

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[13] This discussion focuses on the Corporate Fund because it is the general fund used for basic services such as police and fire protection, garbage collection and public health programs. "Revenues" refer here to dollars generated by the Corporate Fund for that fiscal year, while "resources" encompass revenues as well as other financing sources such as fund transfers and fund balance.

Generally Recurring Sources

1. Tax Revenue: Includes both local tax revenue and intergovernmental tax revenue the City receives from the State of Illinois. The biggest generators of tax revenue for the Corporate Fund are the sales and use tax, utility tax and franchise fees, and income taxes.
2. Non-Tax Revenue:[14] The City generates a variety of non-tax revenues including fines & forfeitures, interest income, licenses & permits, charges for services, leases, rentals and other sources.

Generally Non-Recurring Sources

3. Prior Year Fund Balance: These are resources that were earned in previous fiscal years and that are being drawn from the Corporate Fund balance. This can be thought of as the amount the City takes from its savings account.
4. Proceeds and Transfers-In: These are financial resources that have been transferred from other City funds to support the Corporate Fund. This category includes the transfer of interest and use of proceeds from the City's Skyway and parking meter asset lease transactions. It also reflects revenue generated through complex financial initiatives, Midway airport termination payments,[15] debt restructuring and property tax revenues prior to FY2005 (see explanation below).
5. Other Revenue: This category includes a wide variety of generally non-recurring revenues[16] including the distribution of surplus Tax Increment Financing (TIF) funds budgeted for FY2011.

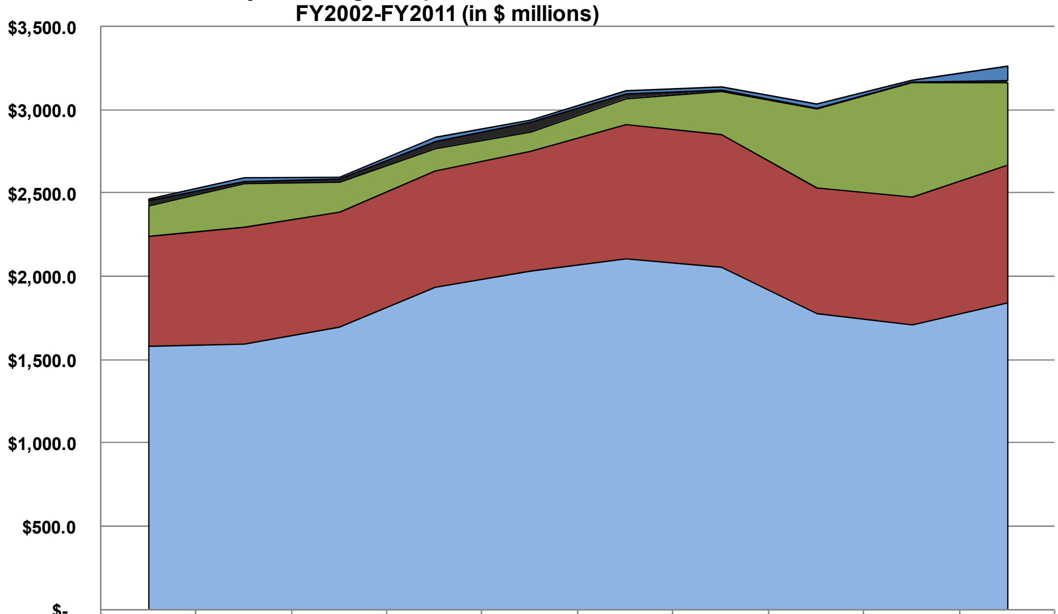
The tax revenue and non-tax revenue categories are ongoing revenues while the other categories are largely non-recurring financial resources. There was significant growth in both tax and non-tax revenue through FY2007, which was the peak year for both sources. Despite growing revenues, the City drew significant amounts from its fund balance in FY2005-FY2007 ($42.2 million, $57.6 million and $26.8 million, respectively). Since FY2007, overall revenues have dropped significantly. However, the City has drawn on more resources in FY2011 than FY2010 even though it has less ongoing revenue. It has done so largely through reserve funds and other generally non-recurring sources of funds.

The growing dependence on non-recurring resources can be seen in the huge expansion in the proceeds and transfers-in category. This trend has been driven by the use of funds from City's Skyway and parking meter asset lease transactions. Only a small percentage of the asset lease proceeds used for operating purposes can be considered a recurring revenue source: the approximately $15 to $25 million generated annually from interest on the Skyway long-term

[14] The City's Overview and Revenue Estimates includes "other" revenue in this category. The "other" category has been separated here to analyze the trends in this generally non-recurring source.
[15] Email communication between the Civic Federation and the Office of Budget and Management, October 21, 2010. The City retained a $126 million deposit from the canceled sale of Midway airport. See Bob Sechler and Amy Merrick, "Chicago Cancels $2.52 Billion Deal to Privatize Midway Airport," *Wall Street Journal*, April 21, 2009.
[16] City of Chicago, FY2011 Overview and Revenue Estimates, p. 61.

reserve fund.[17] The proceeds and transfers-in category is an even less reliable source of funds than it might appear to be in the chart. Prior to FY2005, this category included the balance of property taxes available to the Corporate Fund after paying debt service, pension and library obligations.[18] Starting with the FY2005 budget there were no extra proceeds from property taxes available for the Corporate Fund[19] at the property tax levy level chosen by the City.[20] Proceeds and transfers-in currently make up 15.2% of FY2011 budgeted Corporate Fund resources, but there will be little available from these sources for future budgets because the majority of the asset lease proceeds will have been spent. In addition, there is only a nominal amount of Corporate Fund balance remaining and the "other" category also is made up of nonrecurring sources.

City of Chicago Corporate Fund Resources: FY2002-FY2011 (in $ millions)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
"Other" Revenue	$9.6	$23.2	$10.8	$25.9	$12.6	$19.1	$19.1	$25.4	$11.0	$86.4
Prior Year Fund Balance	$33.2	$13.0	$19.5	$42.2	$57.6	$26.8	$4.6	$1.5	$-	$9.4
Proceeds & Transfers In	$183.1	$261.8	$180.1	$133.3	$115.1	$154.5	$259.2	$474.6	$687.2	$494.6
Non-Tax Revenue	$658.4	$700.5	$689.3	$698.5	$720.2	$807.0	$797.3	$754.1	$766.6	$826.4
Tax Revenue	$1,587.4	$1,600.2	$1,702.0	$1,939.5	$2,036.2	$2,109.4	$2,059.3	$1,782.2	$1,714.8	$1,846.8
Total	$2,471.7	$2,598.7	$2,601.7	$2,839.4	$2,941.7	$3,116.8	$3,139.5	$3,037.8	$3,179.6	$3,263.6

Note: FY 2002-FY2009 are actual expenditures, FY2010 and FY2011 are adopted budgets.
Source: FY2007-2011 Budget Overview and Revenue Estimates, FY2011 Annual Appropriation Ordinance, pp. 16-26.

The following table details the specific amount of resources that the Corporate Fund has received from asset lease proceeds.[21] Between FY2004 and FY2011 the Corporate Fund is projected to

[17] Prior to the FY2011 budget, interest from the parking meter long-term reserve fund appeared to be a recurring revenue source. However, the FY2011 budget utilizes the majority of these reserves and is projected to leave the fund with less than 7% of the principal at year-end.
[18] City of Chicago, FY2004 Overview and Revenue Estimates, p. 11.
[19] City of Chicago, FY2005 Overview and Revenue Estimates, p. 11.
[20] As a home rule unit of local government, the City can determine its property tax levy and is not subject to property tax caps. Therefore, there could be funds available to the Corporate Fund if the City chose to raise the property tax levy.

utilize $1.6 billion in revenues from those sources. The only recurring revenue source, the Skyway Long-Term Reserve Fund interest earnings, represents just 10.2% of the total funds received by the Corporate Fund from the asset lease proceeds.

Transfers & Disbursements to Corporate Fund from Long-Term Asset Lease Proceeds (in $ millions)

Year	Skyway Mid-Term Reserve Fund*	Skyway Long-Term Reserve Fund	Parking Meter Mid-Term Reserve Fund**	Parking Meter Long-Term Reserve Fund	Parking Meter Budget Stabilization Fund***	Total
2004	$ -	$ -	$ -	$ -	$ -	$ -
2005	$ 100.0	$ 18.2	$ -	$ -	$ -	$ 118.2
2006	$ 50.0	$ 27.4	$ -	$ -	$ -	$ 77.4
2007	$ 75.0	$ 26.5	$ -	$ -	$ -	$ 101.5
2008	$ 50.0	$ 28.9	$ -	$ -	$ -	$ 78.9
2009	$ 50.0	$ 25.1	$ 150.0	$ 20.0	$ 224.8	$ 469.8
2010 Estimated	$ 50.0	$ 25.0	$ 100.0	$ 210.0	$ 102.4	$ 487.4
2011 Adopted	$ 50.0	$ 15.0	$ 82.8	$ 140.0	$ -	$ 287.8
Total	**$ 425.0**	**$ 166.1**	**$ 332.8**	**$ 370.0**	**$ 327.2**	**$ 1,621.0**
Percent of Total	**26.2%**	**10.2%**	**20.5%**	**22.8%**	**20.2%**	**100.0%**

Source: City of Chicago, Asset Lease Agreements

http://w w w .cityofchicago.org/city/en/depts/fin/supp_info/public_private_partnerships/asset_lease_agreements.html

City of Chicago, 2011 Overview and Revenue Estimates, p. 62.

City of Chicago 2011 Appropriation Ordinance p.17.

Note: Historical data based on date of transfers, w hich may not match fiscal year accounting. Chart does not include Human Infrastructure Funds.

*2005 includes $50 million for 2004 per ordinance and 2007 includes $25 million in investment earnings.

**For FY2009, $100 million is not reflected in the budget under proceeds and transfers-in as this w as made as a direct disbursement to cover liabilities carried forw ard from FY2008.

***For FY2009, $7.1 million is not reflected in the budget under proceeds and transfers-in as this w as made as a direct disbursement for transaction costs.

As the lease proceeds that were allocated for mid-term reserves and budget stabilization are exhausted, the City has turned to the parking meter long-term reserves to balance its budget. In FY2009 the City utilized $20.0 million of the parking meter long-term reserves. It is expected to utilize $210.0 million in FY2010 and it has budgeted the use of $120.0 million in FY2011.[22] In total the parking meter long-term reserve fund will have declined by 86.5% or $346.0 million since it was established in 2009.[23] The City characterizes these withdrawals as borrowing from

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[21] Human Infrastructure Funds from the asset lease proceeds have funded a variety of activities primarily focused on human service, job training and housing programs. These funds were not included in the chart as they are not used for general operating expenses, but for specific programs that theoretically can be discontinued as funds are depleted. However, there will likely be pressure to continue these programs.

[22] The budget lists funds from the parking meter long-term reserve line in two categories, one titled "Reserve" and the other "annuity." They have been combined here because the funds are from the same source and have been transferred as budgeted regardless of actual interest earnings.

[23] The difference in the listing by year and total is due to additional funding being used to compensate for investment earnings as described in the succeeding paragraph.

the fund. Fitch Ratings' recent downgrade of City bonds cited "the accelerated use of reserves to balance operations" as one of the primary rating rationales.[24]

City of Chicago Asset Lease Proceeds (in $ millions)				
	Original Proceeds	FY2011 Projected Year End*	$ Change	% Change
Skyway Long-Term Reserve Fund	$ 500.0	$ 500.0	$ -	0.0%
Skyway - Other Balances	$ 1,330.0	$ -	$ (1,330.0)	-100.0%
Total Skyway	**$ 1,830.0**	**$ 500.0**	**$ (1,330.0)**	**-72.7%**
Parking Meter Long-Term Reserve Fund	$ 400.0	$ 54.0	$ (346.0)	-86.5%
Other Parking Meter Balances	$ 751.4	$ 22.0	$ (729.4)	-97.1%
Total Parking Meter	**$ 1,151.4**	**$ 76.0**	**$ (1,075.4)**	**-93.4%**
Total Long-Term Reserves	$ 900.0	$ 554.0	$ (346.0)	-38.4%
Total Other Proceed Balances	$ 2,081.4	$ 22.0	$ (2,059.4)	-98.9%
Grand Total Proceed Balances	**$ 2,981.4**	**$ 576.0**	**$ (2,405.4)**	**-80.7%**

Sources: City of Chicago, 2011 Overview and Revenue Estimates, p. 62 and City of Chicago, Asset Lease Agreements www.cityofchicago.org/city/en/depts/fin/supp_info/public_private_partnerships/asset_lease_agreements.html

*Does not include additional funds that may be needed if interest earning do not reach $20.0 million.

Note: In addition to the original proceeds, the funds have earned interest The projected year end is the net of earnings and expenditures.

All proceeds from investment earnings from the long-term reserves are to be transferred to the Corporate Fund. The parking meter long-term reserve fund was intended as a revenue replacement fund that would generate interest to offset lost parking meter revenue. There is a floor of $20 million on the amount of investment earnings that must be transferred to the Corporate Fund from the parking meter long-term reserve fund.[25] If the interest earnings do not reach $20 million[26] then the balance will come from the principal, further eroding the fund.

The City of Chicago's projected budget deficit for FY2011 totaled $654.8 million. Only $96.9 million or 14.8% of the gap was closed through proposed expenditure reductions.[27] The City closed the majority of the deficit using a variety of non-recurring revenue sources, some of which will create greater costs in the future and all of which will guarantee an enormous deficit again next year.

The Civic Federation estimates that at least 17.6% of the FY2011 estimated Corporate Fund revenues are from non-recurring sources. This is a significant increase from 5.6% in FY2007. The accelerating use of non-recurring revenues is a major concern as these sources are being exhausted. The FY2011 adopted budget included at least $272.7 million from asset lease

[24] Fitch Ratings, "Fitch Rates City of Chicago, IL GO Bonds and Tender Notes 'AA'; Downgrades Outstanding GOs," August 5, 2010.

[25] City of Chicago, Authorization for Execution of Concession and Lease Agreement and Amendment of Titles 2, 3 9 and 10 of Municipal Code of Chicago in Connection with Chicago Metered Parking System, Section 5 Use of Concession Proceeds.

[26] Interest earnings were $6.5 million in FY2009. As of 6/30/10, 2010 earnings had reached $7.2 million.

[27] City of Chicago, FY2011 Budget Overview and Revenue Estimates, p. 5.

reserves.[28] By the end of FY2011, the City projects that only $576.0 million[29] of the $2.98 billion generated from asset lease proceeds will remain. Nearly 80.7% of the proceeds will have been spent in just six years.

Estimate of City of Chicago Corporate Fund Non-Recurring Revenues (in $ millions)					
	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Ordinance	FY2011 Estimated
Proceeds and Transfers*	$ 129.5	$ 234.2	$ 449.6	$ 662.2	$ 479.6
Other Revenues	$ 19.1	$ 19.1	$ 25.4	$ 11.0	$ 86.4
Prior Year Unreserved Fund Balance	$ 26.8	$ 4.6	$ 1.5	$ -	$ 9.4
Estimated Non-recurring Revenue	**$ 175.4**	**$ 257.9**	**$ 476.5**	**$ 673.2**	**$ 575.4**
Total Corporate Fund Resources	$ 3,116.7	$ 3,139.6	$ 3,037.7	$ 3,179.7	$ 3,263.7
% of Total Resources	5.6%	8.2%	15.7%	21.2%	17.6%

*Less Skyway Long-Term Reserve interest, which is recurring as long as the principal remains intact.

Source: City of Chicago, FY2011 Overview and Revenue Estimates, pp. 108-109; FY2011 Appropriations Ordinance, pp. 1 and 26.

Especially troubling is the rapid rate at which the parking meter lease proceeds have been depleted. In just three years 93.4% of the funds will have been used, including $100.0 million of mid-term reserve funds that were supposed to be available in FY2012 and at least $350.0 million in funds intended to serve as long-term reserves.[30] The City has given up a valuable asset for 75 years and it has used the vast majority of the proceeds in just three years.[31] These actions also bring up issues of intergenerational equity as current taxpayers are benefiting at the expense of past and future taxpayers.

The City has repeatedly used non-recurring revenue sources to close its budget gaps in recent years, and those gaps have grown larger as a result. This approach is short-sighted. It fails to plan for the future. It also fails to acknowledge that a structural imbalance exists between the City's ongoing expenditures and recurring revenue sources. The result is that each budget is patched together with non-recurring revenues that leave budget gaps in subsequent years. The structural deficit will eventually have to be closed with even larger service cuts and tax or fee increases in the future. The depletion of the asset lease long-term reserves creates additional challenges such as finding funds to replenish principal on the proceeds restricted as long-term reserves, decreased revenue from interest earnings, addressing the future of programs funded through Human Infrastructure funds and possibly increased borrowing costs as the City's bond ratings are downgraded.

These structural challenges are not simply the result of current economic conditions. According to the City, 2007 was the peak year for economically sensitive revenues.[32] The City began using Skyway Mid-Term Reserve funds to balance its budget in 2005. Between FY2000 and the peak

[28] This includes $50.0 million from the Skyway Mid-Term Reserve Fund, $139.9 million from the Parking Meter Long-Term Reserve Fund (interest and principal) and $82.8 million from the Parking Meter Mid-Term Reserve Fund. Not included are the Skyway Long-Term Reserve interest as this is recurring as long as the principal is intact and the Human Infrastructure Fund as these are theoretically for specific programs that can be discontinued as funds are depleted.
[29] City of Chicago, FY2011 Overview and Revenue Estimates, p. 62.
[30] Exact amount is unknown because principal is utilized when interest earnings do not reach $20 million per year.
[31] The principal amounts that have been transferred from the Parking Meter Long-Term Reserve fund have been "borrowed" and are designated to be repaid to the fund in the future.
[32] City of Chicago, FY2011 Overview and Revenue Estimates, p. 63.

year of FY2007, the City drew down its Corporate Fund fund balance by $76.0 million or 94.3%. The fiscal years from 2004 to 2007 were a boom time: sales and use taxes were growing an average of 7.8% per year,[33] real estate transfer taxes reached record levels[34] and the City had a new revenue stream in the form of interest earnings from the Skyway Long-Term Reserve Fund. At a time when the City should have been preserving and adding to reserves it was already starting to deplete them.

Unfortunately the City has not always acknowledged the underlying condition of its finances, which has been a major deficiency of its budget process. For example, in the FY2007 budget proposal the City claimed it had a structurally balanced budget[35] even as it was exhausting its Corporate Fund balance and beginning to use significant amounts of non-recurring reserve funds.

There have been costly consequences to the City's repeated use of asset lease reserves. In August of 2010, Fitch downgraded $6.8 billion in outstanding City general obligation bonds from AA+ to AA and a negative outlook.[36] The downgrade reflected the City's weakening financial condition as a result of revenue declines and the accelerated use of asset lease reserves to balance the operating budget, as well as the City's large unfunded accrued actuarial pension liability.[37] On October 28, 2010 Fitch announced another downgrade of the City's outstanding General Obligation bonds from AA to AA-, again citing the City's accelerated use of asset lease reserves and other non-recurring revenues for operating purposes as a key factor in assigning the downgrade.[38]

Moody's downgraded the rating on the City's outstanding $6.8 million in long-term general obligation debt to Aa3 with a stable outlook from the previous rating of Aa2 in August 2010. The reasons given for the downgrade were that Chicago is overly dependent on asset lease reserves that are being rapidly depleted, the City's pension funds are severely underfunded and that the City maintains an above average debt burden characterized by a slow 32-year payout.[39]

Standard & Poor's is the latest agency to lower the City's rating. S&P reduced the City's rating one step from AA- to A+ in November 2010, also citing the City's reliance on cash reserves to

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[33] City of Chicago, FY2011 Overview and Revenue Estimates, p. 55.
[34] City of Chicago, FY2011 Overview and Revenue Estimates, p. 45.
[35] City of Chicago, FY2007 Overview and Revenue Estimates, p. 11.
[36] The City's GO debt had been raised to AA+ as part of Fitch Ratings' recalibration of almost all municipal issuers in April 2010. Moody's and Standard & Poor's also undertook recalibrations intended to rate public and corporate debt on the same scale. Dan Seymour, "Fitch Recalibrates 38,000-Plus Ratings," *The Bond Buyer*, April 6, 2010.
[37] Fitch Ratings, "Fitch Rates City of Chicago, IL GO Bonds and Tender Notes 'AA'; Downgrades Outstanding GOs," August 5, 2010.
[38] Fitch Ratings, "Fitch Rates City of Chicago, IL GO Bonds and Tender Notes 'AA'; Downgrades Outstanding GOs," August 5, 2010. Fitch Ratings, "Fitch Downgrades Chicago, IL's GO Bonds to 'AA-'; Outlook Revised to Stable," October 28, 2010.
[39] Moody's Investors Service, "City of Chicago High Profile New Issue," August 12, 2010. Moody's noted, however, that Chicago has a large and diverse tax base, it still maintains reserves from the Skyway long-term lease and management has taken steps to reduce expenditures.

balance the budget.[40] These downgrades will increase the cost of future debt obligations at a time when the City can least afford it.

Inadequate Corporate Fund Reserves

The City has been utilizing its Corporate Fund fund balance and other reserves at a rapid rate. Between FY2000 and FY2009, the Corporate Fund unreserved fund balance dropped from $80.7 million to just $2.7 million. The fund balance ratio fell from 3.39% to 0.09%. There was slight growth between FY2008 and FY2009 with the balance rising by $2.4 million. This increase is not the result of any structural improvement as there were $469.9 million in asset lease proceeds disbursed and transferred to the Corporate Fund in FY2009.

Fund balance is an important financial indicator for governments because it measures a jurisdiction's capacity to withstand financial emergencies.[41] The *unreserved* fund balance refers to resources that do not have any external legal restrictions or constraints. The Government Finance Officers Association (GFOA) recommends that "at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures."[42] Two months of operating expenditures is approximately 17%.

To meet the GFOA standard of two months of operating expenditures the City would need approximately $500 million. A smaller ratio may be appropriate for the largest governments.[43] For example, five percent of expenditures would amount to $150 million for the City of Chicago.

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[40] Jones, Tim, "Chicago's Credit Rating Is Lowered by S&P Amid Concern About Cash Reserves," Bloomberg, November 5, 2010, http://www.bloomberg.com/news/2010-11-05/chicago-s-credit-rating-is-lowered-by-s-p-amid-concern-about-cash-reserves.htm (last visited on November 9, 2010).
[41] Craig S. Maher and Karl Nollenberger, "Revisiting Kenneth Brown's 10-Point Test" *Government Finance Review*, October 2009.
[42] Previously the GFOA had recommended a general fund balance of 5% to 15%.
[43] Government Finance Officers Association, "Appropriate Level of Unrestricted Fund Balance in the General Fund" (Adopted October 2009).

Even during times of economic stability and growth when the City could have been replenishing its Corporate Fund fund balance, it was spending it down. The City ended its peak revenue year of FY2007 with just 0.15% expenditures or $4.6 million in fund balance. This left the City unprepared to deal with the financial challenges of the economic downturn. Fitch Ratings noted that while there was sound economic growth prior to 2008, there were still sizable fund balance draw downs in both FY2006 and FY2007.[44] The City's current nominal 0.09% of expenditures was an insufficient Corporate Fund balance.

City of Chicago Unreserved Corporate Fund Balance: FY2000-FY2009			
	Unreserved Corporate Fund Balance	Operating Expenditures	Ratio
FY2000	$ 80,653,000	$ 2,380,310,000	3.39%
FY2001	$ 33,241,000	$ 2,440,426,000	1.36%
FY2002	$ 13,014,000	$ 2,442,796,000	0.53%
FY2003	$ 19,458,000	$ 2,661,102,000	0.73%
FY2004	$ 42,246,000	$ 2,567,658,000	1.65%
FY2005	$ 57,648,000	$ 2,739,570,000	2.10%
FY2006	$ 26,834,000	$ 2,902,202,000	0.92%
FY2007	$ 4,634,000	$ 3,063,019,000	0.15%
FY2008	$ 226,000	$ 3,107,284,000	0.01%
FY2009	$ 2,658,000	$ 3,014,077,000	0.09%

Sources: City of Chicago Comprehensive Annual Financial Reports, FY2000-FY2009

The City's discussion of its financial policies in its budget document does not include an explicit Corporate Fund balance target. Its policy regarding financial reserves refers only to the $500.0 million long-term reserve[45] from the lease of the Chicago Skyway. The City set aside $500 million of the $1.83 billion Skyway lease proceeds and $400 million of the $1.15 billion parking meter lease proceeds for long-term reserves. The City considers its asset lease long-term reserves when measuring its adherence to the GFOA standard[46] and ratings agencies also consider these balances.

While the asset lease long-term reserves are important, they are only a supplement, not a substitute, for a Corporate Fund balance. The Skyway lease transaction requires the long-term reserve principal to be restricted[47] and the GFOA standard refers specifically to unrestricted balances. That restriction also means that the reserve cannot properly be used for the short-term revenue shortfalls and unanticipated expenditures that a general fund balance is intended to address. Furthermore, the interest from Skyway and parking meter long-term reserve funds was intended to provide an ongoing source of revenue for the general fund, which is not sustainable if the principal is eroded.

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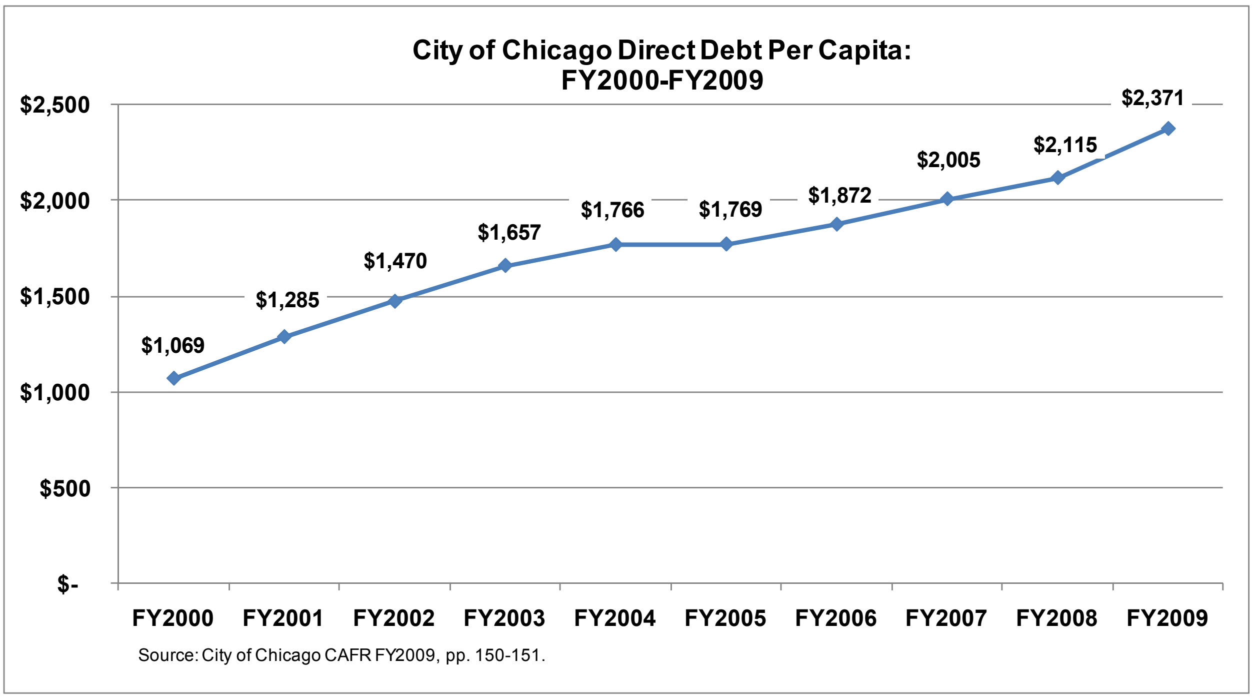
[44] Fitch Ratings, "Fitch Rates City of Chicago, IL GO Bonds and Tender Notes 'AA'; Downgrades Outstanding GOs," August 5, 2010. Fitch Ratings, "Fitch Downgrades Chicago, IL's GO Bonds to 'AA-'; Outlook Revised to Stable," October 28, 2010.
[45] City of Chicago, FY2011 Overview and Revenue Estimates, p. 104.
[46] City of Chicago, FY2011 Overview and Revenue Estimates, p. 62.
[47] City of Chicago, FY2009 Comprehensive Annual Financial Report, p. 51.

Growing Long-Term Liabilities

The City of Chicago has a relatively high and growing level of bonded debt. The unfunded liabilities of the City's pension funds have also increased rapidly in recent years and will require dramatic action in order to maintain solvency in the funds.

Bonded Debt

Direct debt is a government's tax-supported bonded debt. Between FY2000 and FY2009 the City of Chicago's net direct debt rose by 121.9% or $3.8 billion from $3.1 billion to $6.9 billion. Direct debt per capita is a common ratio used by rating agencies and other public finance analysts to evaluate long-term debt. Between FY2005 and FY2009, the City of Chicago's direct debt per capita rose by 34.0% from $1,769 to $2,371. An increasing trend over time may be cause for concern if it is not proportional in size and rate to growth in tax revenue used to support the debt.[48] The ten-year increase in the City's debt per capita of 121.9% is a $1,302 per capita increase. The following chart shows the trend in the City of Chicago's direct debt per capita over the last decade.[49]



This upward trend in debt per capita between FY2000 and FY2009 is cause for concern for the City of Chicago. It threatens to further reduce the City's credit rating, making borrowing more expensive, and could limit available capacity for additional borrowing.

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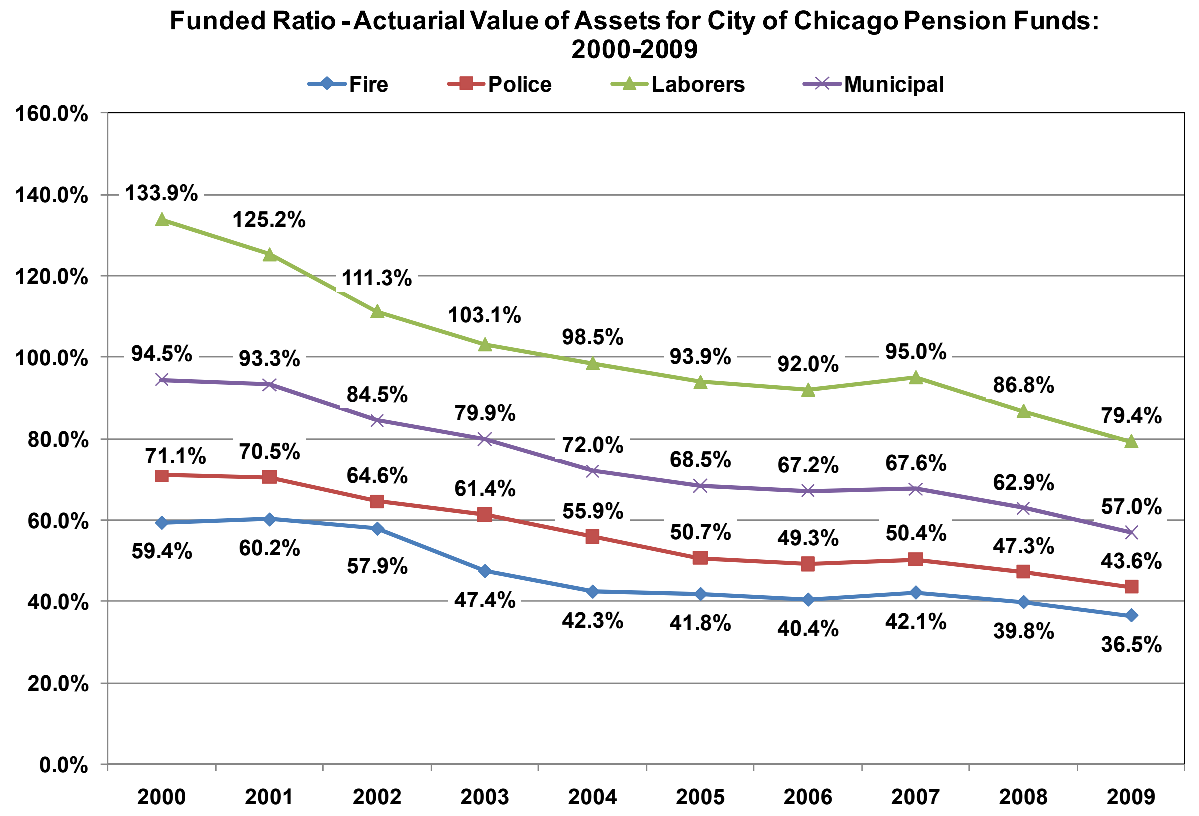
[48] Karl Nollenberger, et al., *Evaluating Financial Condition: A Handbook for Local Government,* (International City/County Management Association, 2003), p. 74.

[49] For a more detailed discussion of the City's debt burden see the Civic Federation, "City of Chicago FY2011 Proposed Budget: Analysis and Recommendations," November 3, 2010. http://civicfed.org/civic-federation/publications/city-chicago-fy2011-proposed-budget-analysis-and-recommendations (last visited on February 9, 2011).

Pension Obligations

The City of Chicago maintains four employee pension funds: the Fire, Police, Municipal and Laborer's Funds.[50] The City is facing a severe pension crisis. In April 2010 the City's Commission to Strengthen Chicago's Pension Funds reported that the Police and Fire pension funds were likely to run out of assets within ten years if nothing was done.[51] The Police and Fire pension funds were only 43.6% and 36.5% funded in FY2009 on an actuarial value basis; the funded ratio for the Municipal Fund was 57.0% and the Laborers Fund was 79.4%.[52] A funded ratio below 80% is a cause for concern as it raises questions about the ability of the government to adequately fund its retirement systems over time.



Note: Actuarial Value of Assets smoothes investment returns over five years.
Source: Fire, Police, Laborers & Municipal Employees Pension Fund Annual Financial Reports FY2000-FY2009.

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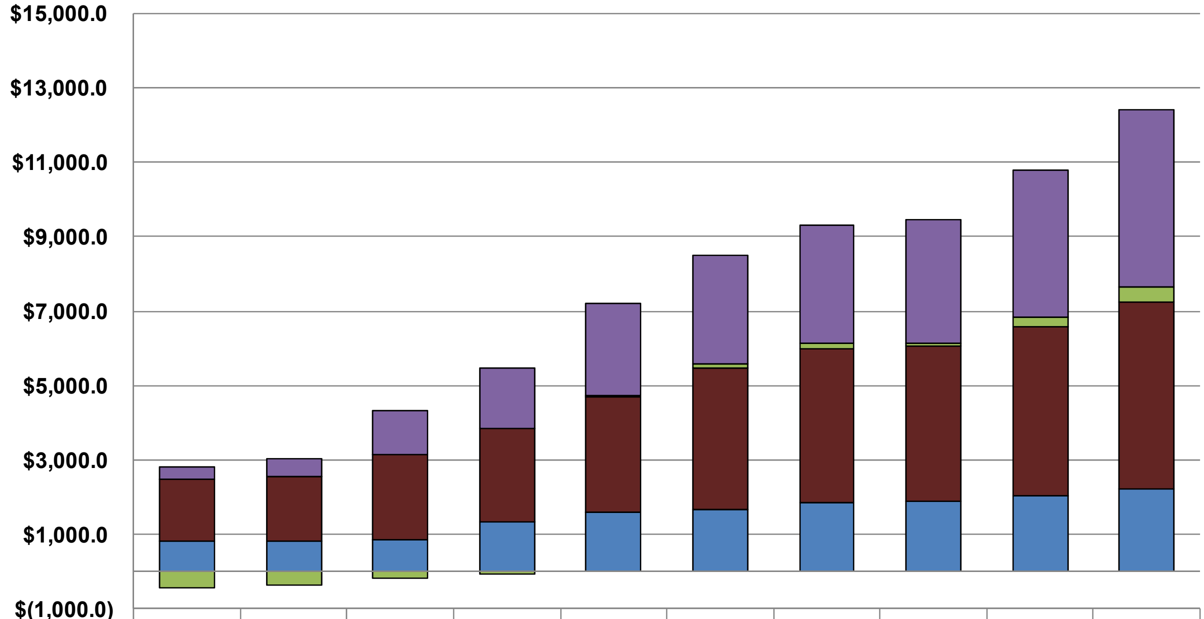
[50] Additional information and analysis of the City's pension funds can be found in the Civic Federation's City of Chicago budget analyses and Status of Local Pension Funding reports. See Civic Federation, "Status of Local Pension Funding Fiscal Year 2009," February 10, 2011, at http://www.civicfed.org/civic-federation/publications/status-local-pension-funding-fiscal-year-2009-evaluation-ten-local-gov.

[51] City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, p. 21. http://www.cityofchicago.org/city/en/depts/obm/provdrs/perf_mang/news/2010/apr/commission_to_strengthenchicagospensionfundsreleasesreportonfisc.html (last visited on January 31, 2011).

[52] These are funded ratios based on the actuarial value of assets. For a discussion of actuarial value see Civic Federation, "Status of Local Pension Funding Fiscal Year 2009," February 10, 2011, at http://www.civicfed.org/civic-federation/publications/status-local-pension-funding-fiscal-year-2009-evaluation-ten-local-gov.

Over the past ten years, the unfunded actuarial accrued liabilities of the four pension funds combined have grown by $10.0 billion or 418%, from $2.4 billion in FY2000 to $12.4 billion in FY2009. This amounts to an increase from $827 to $4,348 per resident of Chicago.

Unfunded Actuarial Accrued Liabilities for the City of Chicago Pension Funds: 2000-2009 (in $ millions)



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Municipal	$367.2	$467.4	$1,173.1	$1,604.5	$2,465.4	$2,917.8	$3,183.2	$3,296.2	$3,936.3	$4,758.5
Laborers	$(440.1)	$(353.9)	$(174.5)	$(51.2)	$24.7	$106.7	$145.2	$92.0	$259.0	$416.1
Police	$1,632.6	$1,748.7	$2,260.3	$2,541.7	$3,101.2	$3,808.3	$4,118.6	$4,167.7	$4,558.8	$5,015.9
Fire	$833.9	$823.6	$878.9	$1,323.3	$1,610.9	$1,679.3	$1,868.6	$1,888.0	$2,022.9	$2,207.5
TOTAL	$2,393.6	$2,685.7	$4,137.9	$5,418.3	$7,202.3	$8,512.1	$9,315.5	$9,443.9	$10,777.0	$12,398.1

Source: Fire, Police, Laborers & Municipal Employees Pension Fund Comprehensive Annual Financial Reports FY2000-FY2009.

The City's pension crisis has been caused largely by consecutive years of contributions that were insufficient for the level of benefits promised. The crisis was exacerbated by significant investment losses in FY2008.[53]

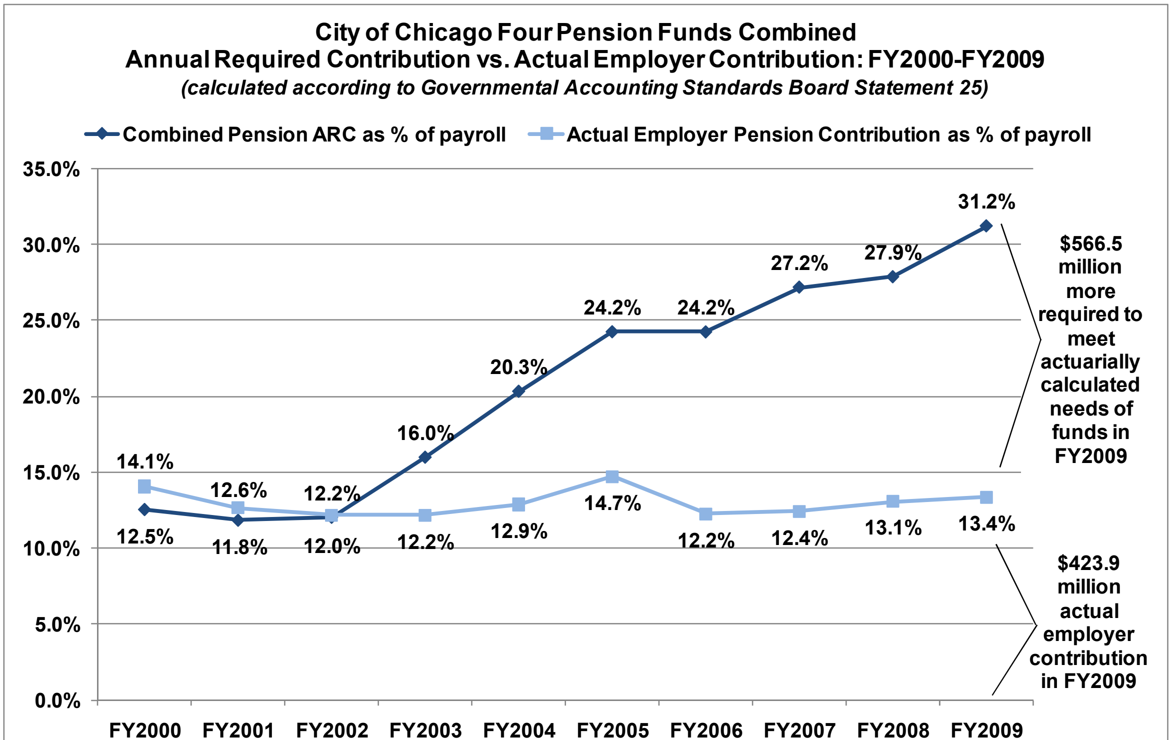
The financial reporting requirements for public pension funds and their associated governments are set by the Governmental Accounting Standards Board (GASB). GASB standards require disclosure of an Annual Required Contribution (ARC), which is an amount equal to the sum of (1) the employer's "normal cost" of retirement benefits earned by employees in the current year and (2) the amount needed to amortize any existing unfunded accrued liability over a period of not more than 30 years. Normal cost is that portion of the present value of pension plan benefits and administrative expenses which is allocated to a given valuation year and is calculated using one of six standard actuarial cost methods. Each of these methods provides a way to calculate the

[53] For more discussion of these causes, see City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, pp. 18-22. Employee and employer contributions are not related to the health of the fund. Employee contributions are a percentage of pay: 8.50% for Municipal and Laborers'; 9.0% for Police; and 9.125% for Fire. Employer contributions are multiples of the employee contributions made two years prior: 1.0 for Laborers'; 1.25 for Municipal; 2.0 for Police; and 2.26 for Fire.

present value of future benefit payments owed to active employees. The methods also specify procedures for systematically allocating the present value of benefits to time periods, usually in the form of the normal cost for the valuation year and the actuarial accrued liability (AAL). The actuarial accrued liability is that portion of the present value of benefits which is not covered by future normal costs.

ARC is a financial reporting requirement but not a funding requirement. The statutorily required City of Chicago contributions to its pension funds are set in the state pension code. However, because paying the normal cost and amortizing the unfunded liability over a period of 30 years does represent a reasonably sound funding policy, the ARC can be used as an indicator how well a public entity is actually funding its pension plan.

Expressing ARC as a percent of payroll provides a sense of scale and affordability. The following graph illustrates the growing gap between the combined pension ARC of the four funds as a percent of payroll and the actual employer contribution as a percent of payroll. The spread between the two amounts has grown from surplus of 1.5% of payroll, or $37.6 million, in FY2000 to a gap of 17.9% of payroll in FY2009. In other words, to fund the pension plans at a level that would both cover normal cost and amortize the unfunded liability over 30 years the City would have needed to contribute an additional 17.9% of payroll, or $566.5 million, in FY2009.[54]



Note: Beginning in FY2005, the ARC for the portion of OPEB paid for by the pension funds was calculated separately from the pension ARC. This graph shows only the pension ARC after FY2005. The OPEB ARC for the pension funds would add roughly 1-2% of payroll and the actual employer contribution was roughly 0-1% of payroll.
Sources: Actuarial Valuations for the Police, Fire, Municipal, and Laborers pension funds, FY2000-FY2009.

The City of Chicago has consistently contributed its statutorily required amounts of 2.26 times the employee contribution made two years prior for the Fire Fund, 2.0 for the Police Fund, 1.25 for the Municipal Fund and 1.00 for the Laborers Fund. However, these amounts have been less

[54] This $566.5 million FY2009 figure is calculated according to the reporting requirement of Governmental Accounting Standards Board Statement 25. The assumptions are different from those used by the Commission to Strengthen Chicago's Pension Funds to project the $710 million additional contribution needed in FY2012. The GASB ARC assumptions are described in the Civic Federation's Status of Local Pension Funding FY2009 report and represent the contribution needed to fund normal cost and a 30-year rolling amortization of the unfunded liabilities *after the employee contributions have been made*. The Commission's estimates were made assuming a schedule to reach 90% funded by December 31, 2061 and the $710 million figure is the total additional amount needed for that schedule without designating whether the employer or the employee makes the additional contribution. Page 55 of the Commission report shows that if the additional contribution were split such that the employer paid 60% and the employee paid 40%, the additional City contribution would be $427 million and the additional employee contribution would be 7.94% of pay.

than the ARC for most of the last ten years. The pension fund actuaries estimate that in order to contribute an amount sufficient to meet the ARC in FY2010, the City would have needed to contribute a multiple of 6.24 for the Fire Fund, 4.61 for the Police Fund, 3.76 for the Municipal Fund and 2.76 for the Laborers Fund.[55]

FY2010 Statutory Multiple for Employer Contribution vs. Annual Required Multiple			
	Unfunded Actuarial Accrued Liability Amortization Method	**Annually Required Multiple (Normal Cost + UAAL Amortization)**	**Statutory Multiple**
Fire	level dollar, open	**6.24**	2.26
Police*	level % of payroll, open	**4.61**	2.00
Municipal	level dollar, open	**3.76**	1.25
Laborers	level dollar, open	**2.76**	1.00

*Police Fund also computes that the FY2010 annual required multiple using a level dollar amortization would be 6.42. See Police Fund FY2009 actuarial valuation p. 19.

Source: Respective Pension Fund FY2009 Actuarial Valuations

The Commission to Strengthen Chicago's Pension Funds calculated that restoring the pensions to a 90% funded ratio in 50 years would require an additional $710 million contribution each year, growing with inflation, beginning in FY2012.[56] This amount exceeded the City's $654.8 million FY2011 preliminary budget deficit. The City's own Commission stated the urgency of the situation clearly:

> "The problem worsens with each passing year, as the deficit grows and becomes more expensive to fix. It is important to address this problem effectively and quickly. If we fail to act, the pension funds will begin to run out of assets in a decade or less."[57]

The Illinois General Assembly took action on Chicago's Municipal and Laborers' pension funds in April 2010 and on the Police and Fire pension funds in December 2010. Public Acts 96-0889 and 96-1495 created reduced benefit tiers for new members of the City's four pension funds hired on or after January 1, 2011. Over time these benefit changes for new hires will slowly reduce liabilities from what they would have been as new employees are hired and fewer members remain in the old benefit tier.

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[55] Chicago Policemen's Annuity and Benefit Fund Actuarial Valuation for the year ended December 31, 2009, p. 14; Chicago Firemen's Annuity and Benefit Fund Actuarial Valuation for the year ended December 31, 2009, p. 14; Laborers' Annuity and Benefit Fund of Chicago Actuarial Valuation for the year ended December 31, 2009, p. 84; and Municipal Employees' Annuity and Benefit Fund of Chicago Comprehensive Annual Financial Report For the year ended December 31, 2009, p. 87.

[56] The report noted that the new benefit tier created by P.A. 96-0889 may reduce this figure to roughly $660 million. The Commission's estimates were made assuming a schedule to reach 90% funded by December 31, 2061 and the original $710 million figure is the total additional amount needed for that schedule without designating whether the employer or the employee makes the additional contribution. Page 55 of the Commission report shows that if the additional contribution were split such that the employer paid 60% and the employee paid 40%, the additional City contribution would be $427 million and the additional employee contribution would be 7.94% of pay. City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, pp. 4, 55.

[57] City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, p. 4.

Public Act 96-0889 did not change the employer or employee contributions to the Municipal and Laborers' Funds. Both funds are still projected to run out of assets during the year 2030 despite the reduced benefits for new members.[58] Prior to the enactment of Public Act 96-1495, the Fire Fund was projected to run out of assets during 2021 and the Police Fund was projected to run out of assets during 2025.[59] In contrast to Public Act 96-0889, Public Act 96-1495 made a significant change to the City's employer contributions to the Police and Fire funds. In 2015 the City will be required to begin making contributions sufficient to bring the funded ratio of the Police Fund and the Fire Fund to 90% by the end of 2040.[60] City officials have estimated that contributions will increase by roughly $550 million, or 60%, in 2015 and rise thereafter.[61] If the City fails to make its required contributions, the Illinois Comptroller will withhold State fund transfers to the City.

In summary, the new mayor of Chicago faces two distinct pension challenges:

1) the Municipal and Laborers' funds are still on a path to deplete their assets within twenty years if nothing more is done; and
2) the Police and Fire funds are no longer on a path to insolvency but the mandated increase in statutory employer contribution will require an enormous additional expenditure beginning in 2015.

Retiree Health Care

The new mayor of Chicago will soon need to address a retiree health insurance challenge. The City of Chicago government directly subsidizes a portion of health insurance for City retirees and its four pension funds also subsidize a portion of retiree health insurance. This arrangement is pursuant to a written legal settlement agreement that requires the City to pay a percentage of the cost of health care for eligible retirees and dependents through June 30, 2013 when the agreement expires. State statues also authorize the four City of Chicago pension funds to subsidize the participant portion of retiree health insurance premiums for those annuitants participating in the City's retiree health insurance program until June 30, 2013. In FY2008 the City's contribution was roughly 55% of the premium cost, with the remainder to be paid by the annuitant. The Fire, Police, Municipal and Laborers' pension funds each contributed roughly 33% of the annuitant contribution, effectively subsidizing 12% of the total premium cost.[62] The pension funds provide $95 per month for non-Medicare eligible annuitants and $65 per month for Medicare eligible annuitants.[63]

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[58] Illinois Commission on Government Forecasting and Accountability, *Illinois Public Retirement Systems: A Report on the Financial Condition of the Chicago, Cook County and Illinois Municipal Retirement Fund Systems of Illinois*, November 2010, pp. 68, 88.
[59] Illinois Commission on Government Forecasting and Accountability, *Illinois Public Retirement Systems: A Report on the Financial Condition of the Chicago, Cook County and Illinois Municipal Retirement Fund Systems of Illinois*, November 2010, pp. 46, 108.
[60] The Act states that the required contributions will be calculated using a level percentage of payroll and projected unit credit actuarial valuation method.
[61] Letter of December 8, 2010 from the Chicago City Council to Governor Pat Quinn, http://www.wttw.com/res/pdf/quinn_letter.pdf (last visited on January 27, 2011).
[62] FY2009 figures are not yet available. Cost allocation estimates provided to the Civic Federation by Sulan Tong, City of Chicago Department of Finance, February 15, 2010.
[63] Municipal Employees' Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report as of December 31, 2009*, p. 63.

The City of Chicago's financial statements reported an FY2009 unfunded other post employment benefits (OPEB)[64] liability of $478.6 million for the portion subsidized by the pension funds and a FY2009 unfunded OPEB liability of $787.4 billion for the portion subsidized by the City.[65] The City does not pre-fund OPEB, so there are no assets to offset the actuarial accrued liability and the funded ratio is 0%. The total combined unfunded OPEB liability for the City portion and the pension fund portion is nearly $1.3 billion.

CIVIC FEDERATION RECOMMENDATIONS

The Civic Federation offers the following recommendations to improve the City of Chicago's finances in the short- and long-term. Many of these recommendations and best practices have been proposed by the Federation in previous reports[66] and will be expanded upon in a comprehensive report to be released later this year.

Short-Term Recommendations

In its first few months the new administration must take actions to stabilize city finances and produce a fiscally responsible budget. The Civic Federation recommends that instead of relying heavily on asset lease reserves to close its deficits, the City begin to address its structural deficit by publically releasing financial forecasts, significantly cutting expenditures and pursuing alternative service delivery opportunities. The longer these actions are delayed, the deeper cuts will have to be when the City runs out of asset lease proceeds and other non-recurring sources, or the City will have to raise taxes and fees substantially.

Publish Multi-Year Financial Forecasts

The critical first step in making responsible decisions for the City's fiscal future is to examine revenue and expenditure forecasts for 2012 and beyond. The City should publically release a five-year forecast of revenues and expenditures as part of the annual preliminary budget estimates. The forecast should be updated and released annually. This is the first step towards an informed discussion of the immediate actions that need to be taken by the new administration and of the FY2012 budget. The decisions made during each budget cycle can have repercussions for many years into the future that should be considered. The multi-year forecast will also help set the stage for the City to undertake a long-term financial planning process, something the Civic Federation has been urging for at least a decade.[67]

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[64] Other post employment benefits (OPEB) is the term used by the Governmental Accounting Standards Board to describe retirement benefits other than pensions.

[65] City of Chicago, FY2009 Comprehensive Annual Financial Report, pp. 84, 86. The FY2009 financial statements state that January 1, 2009 was the most recent actuarial valuation date for the portion of OPEB subsidized by the City. The City does not report a combined total liability for both the pension fund and the City OPEB subsidies, nor does it break out its liabilities by pension fund.

[66] See the Civic Federation, "City of Chicago FY2011 Proposed Budget: Analysis and Recommendations," November 3, 2010, http://civicfed.org/civic-federation/publications/city-chicago-fy2011-proposed-budget-analysis-and-recommendations (last visited on January 27, 2011).

[67] Civic Federation, *City of Chicago FY2001 Proposed Budget: Analysis and Recommendations 2001,* November 1, 2000, http://civicfed.org/sites/default/files/civicfed_76.pdf (last visited on January 28, 2011).

The GFOA recommends that all governments forecast major revenues and expenditures and that the forecast be made available to participants in the budget process.[68] It also recommends that the underlying assumptions and methodology be clearly outlined. The GFOA explains that the forecast accomplishes the following:

- Provides an understanding of available funding;
- Evaluates financial risk;
- Assesses the likelihood that services can be sustained;
- Assesses the level at which capital investment can be made;
- Identifies future commitments and resource demands; and
- Identifies the key variables that cause change in the level of revenue.

Stakeholders in the budget process cannot be expected to make difficult choices wisely if the ongoing nature of the challenges have not been transparently and clearly communicated. The City should begin sharing a forthright assessment of its financial challenges through publically disclosed multi-year forecasting. If such forecasts had been produced each year over the last decade, they would have shown the unsustainability of the City's use of asset lease proceeds for ongoing operating expenses.

Implement Expenditure Reductions

The City's budget gap is so large that the new mayor will need to immediately make expenditure reductions. The proposed FY2011 budget contained $96.9 million in expense reductions. This was in addition to the continuation of personnel cost reductions negotiated in 2009, which were expected to save $52 million.[69] Those reductions take the form of unpaid holidays, reduced work weeks and the use of compensatory time instead of payment. The FY2011 proposed payroll for all local funds is $3.3 billion for 32,922 positions.[70] The FY2011 budget proposed to lay off 42 employees and eliminate a total of 277 positions in the Corporate Fund, although 43 positions would be added in other funds, for a net all local funds reduction of 234 positions.[71] The City also expected $22 million in savings from health care cost reductions.[72] Non-personnel expense reductions totaling $12.2 million were proposed by reducing materials, supplies, property rent, fuel, natural gas and contractual expenses such as custodial services.[73]

The Civic Federation supports the City's efforts to reduce operating expenses and urges further reductions. Roughly 83% of the Corporate Fund budget is spent on personnel costs, which consistently rise faster than revenues due in large part to labor agreements.[74] Personnel

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[68] Government Finance Officers' Association, "GFOA Recommended Practice: Financial Forecasting in the Budget Preparation Process" (1999).
[69] City of Chicago, FY2011 Budget Overview and Revenue Estimates, p. 2.
[70] City of Chicago, FY2011 Budget Recommendations, p. 11 and FY2011 Budget Overview and Revenue Estimates, p. 6.
[71] "All local funds" is the Corporate Fund, special revenue funds, pension funds, debt service funds and enterprise funds. It excludes grant funds.
[72] City of Chicago, FY2011 Budget Overview and Revenue Estimates, p. 2.
[73] City of Chicago, FY2011 Budget Overview and Revenue Estimates, p. 2 and briefing to the Civic Federation, October 11, 2010, p. 8.
[74] Health care costs have also increased rapidly in recent years, but the City does not include health care costs in the personnel services category. The 83% of Corporate Fund spent on personnel cost includes only salaries and wages. See page 5 of this report.

reductions will continue to be a key factor in closing the City's ongoing structural deficit, which will require matching annual expenditures to recurring revenues.

An Inspector General's Office's report released in 2010 quantified potential savings and revenue increases from a variety of actions the City could take. Many of these were recommendations that the Civic Federation had made previously. Some of the options that the Civic Federation has long recommended, such as ending water subsidies for non-profits, would not necessarily be available for closing the Corporate Fund deficit.

The Civic Federation recommends that the new mayor study a number of options in the Inspector General's report, including reducing fire truck staffing from five persons to four persons, eliminating police supervisor quarterly pay, privatizing City garbage and recycling collection and eliminating additional pay for certain Water Department workers who work on weekends as part of their normal schedule. The City could also save by eliminating current inefficiencies in public services such as garbage collection. The Inspector General estimates that by switching from ward-based collection routes to grid-based routes as used for recycling collection, the number of daily routes could be reduced by 24.6% with a total estimated savings of $29.6 million in FY2011.[75] The Civic Federation urges the new mayor to begin work on these or similar actions early in order to reduce future budget deficits.

Adopt an Asset Lease Reserves Withdrawal Policy

The Civic Federation has repeatedly urged the City of Chicago to adopt a formal asset lease reserves withdrawal policy. This should be done as soon as possible in order to protect the remaining reserves even when economically-sensitive revenues begin to recover.

The City had originally set aside $900 million of the Skyway and parking meter long-term lease proceeds for long-term reserve accounts and approximately $1.3 billion which it planned to spend for operating purposes between FY2005 and FY2012. The $1.3 billion will be exhausted by the end of FY2011 and the City has already begun to deplete the long-term reserve funds.[76]

The Civic Federation believes that short-term operating appropriations are an improper use of asset lease proceeds. *Asset lease proceeds should not be used for operating expenses.* Instead, they should be dedicated to retiring debt, reducing unfunded pension liabilities, making long-term capital investments and creating substantial long-term reserve accounts. Only the interest earned on asset lease proceeds should be used for operating expenses as a replacement for the revenues that were originally generated by the assets before they were leased.

However, given the severity of the City's fiscal crisis, the Civic Federation recommended in 2009 that the City create a policy to determine the extraordinary circumstances under which it may use the principal of asset lease reserve funds for operating purposes. The Federation repeats

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[75] City of Chicago, Office of the Inspector General, "Budget Options for the City of Chicago," October 2010, http://www.chicagoinspectorgeneral.org/pdf/IGO%20Budget%20Options%20for%20the%20City%20of%20Chicago-%20October%202010.pdf (last visited on November 3, 2010).
[76] The balance of the asset lease proceeds was used to retire outstanding debt.

that recommendation here. The policy should articulate both the situations under which the principal may be drawn down and how much may be withdrawn from the reserve fund.

In the past the Civic Federation recommended that the City Council adopt and adhere to the following proposed policy on the use of asset lease reserve fund principal:

1) The City shall be authorized to use principal from asset lease reserve funds for operating expenses if the following three conditions exist:
    a. A combined decrease in sales, use, income, real estate transfer, hotel, amusement and personal property replacement tax revenues, designated for Corporate Fund use, that exceeds 5.0% between prior-year-end estimates and the City's annual preliminary budget revenue forecasts;[77]
    b. A budget deficit that exceeds 10.0% of the projected Corporate Fund appropriations in the City's annual preliminary budget estimates; and
    c. A declaration of a nationwide economic recession by the National Bureau of Economic Research within the previous nine months from July 31.
2) If the City Council approves by a simple majority vote a certification by the Mayor of Chicago that all three elements exist, then:
    a. The City may use asset lease proceeds and reserves to reduce only the amount of Corporate Fund revenue projected to decline between year-end estimates and proposed budget forecasts for the upcoming fiscal year.

The Federation still recommends that the City adopt this or a similar policy to guide its use of asset lease reserve funds. All three of the conditions were met in FY2010 and the policy would have permitted use of $93.1 million in Parking Meter Mid-Term reserves.[78] This was less than the $370 million[79] in reserve funds that the City had proposed to spend.

Only one of the above conditions is met in FY2011. In its FY2011 Preliminary Budget Estimate released on July 30, 2010, the City projected that FY2011 sales, use, income, real estate transfer, hotel, amusement and personal property replacement tax revenues in the Corporate Fund would increase by 1.0% over FY2010 year-end estimates, thus the first condition is not met.[80] In the FY2011 Preliminary Budget Estimates, the City predicted that its budget deficit would total 19.3% of its projected FY2011 Corporate Fund expenditures, thereby meeting the second

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[77] Income, personal property replacement, real estate transfer and sales taxes are economically sensitive or "elastic" revenues. Elastic revenues will rise as the economic base expands or inflation rises. Conversely, elastic revenues will contract when the economic base shrinks or inflation declines. The City of Chicago and other local governments that rely in part on elastic revenues such as sales and income taxes are currently experiencing serious reductions in these revenues because of the recent recession. See John L. Mikesell, *Fiscal Administration: Analysis and Administration for the Public Sector* (Belmont, CA: Thomson Wadsworth, 2003), p. 300. The City of Chicago includes hotel and amusement taxes as part of its definition of economically sensitive revenues.

[78] Civic Federation, "City of Chicago FY2010 Proposed Budget: Analysis and Recommendations," November 18, 2009, pp. 11-16.

[79] The $370 million included $270 million from the Parking Meter Revenue Replacement Fund, $50 million from the Skyway mid-term Reserve and $50 million from the parking meter mid-term reserve. See City of Chicago FY2010 Budget Overview and Revenue Estimates, p. 65.

[80] City of Chicago, FY2011 Preliminary Budget Estimates, p. 13.

condition. Finally, the National Bureau of Economic Research announced on September 20, 2010 that the recession that began in December of 2007 ended in June 2009.[81]

A review of these conditions also reveals that although economically sensitive revenues were projected to perform better in the FY2011 Preliminary Budget Estimate than in the FY2010 Preliminary Budget Estimate, the deficit still grew from 15.7% to 19.3% of projected Corporate Fund expenditures.

Adopt a Fund Balance Policy

The Civic Federation is deeply concerned that the City has not demonstrated the will or ability to build a Corporate Fund reserve through disciplined execution of a reserve policy that would require it to hold back spending on an annual basis until the target reserve level is reached. Between FY2000 and FY2009, the City of Chicago Corporate Fund unreserved fund balance dropped from $80.7 million to just $2.7 million. The fund balance ratio fell from 3.39% to 0.09% of Corporate Fund appropriations.

The Government Finance Officers Association (GFOA) recommends "at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures." Two months of operating expenditures is approximately 17%.[82] In FY2011 this amount would total approximately $500 million for the City of Chicago. The GFOA adds that each unit of government should adopt a formal policy that considers the unit's own specific circumstances and that a smaller fund balance ratio maybe appropriate for the largest governments.[83]

The City's discussion of its financial policies in its budget documents does not include an explicit Corporate Fund fund balance target. Its policy regarding financial reserves contained in the budget only states that the City has established a $500.0 million long-term reserve from the lease of the Chicago Skyway[84] and that operating reserves in its enterprise funds are established to pay for unforeseen emergencies or shortfall caused by revenue declines.[85] However, the Skyway lease transaction requires the long-term reserve principal to be restricted[86] and therefore cannot properly be used to address the short-term revenue shortfalls and unanticipated expenditures that a general fund balance is intended to address. While asset lease reserves have in the past been viewed favorably by bond rating agencies, they are a one-time windfall.

The Civic Federation recommends that the City develop a policy to build up its Corporate Fund reserves as revenues slowly begin to recover. These reserves must be built using the fiscal

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[81] National Bureau of Economic Research, http://www.nber.org/cycles/sept2010.html (last visited on October 25, 2010).
[82] Previously the GFOA had recommended a general fund balance of 5 to 15%.
[83] Government Finance Officers Association, "Appropriate Level of Unrestricted Fund Balance in the General Fund" (Adopted October 2009).
[84] The GFOA standard refers specifically to the unreserved General Fund balance. The Skyway and parking meter reserves are held in a separate fund as reserved and are legally restricted.
[85] City of Chicago, FY2011 Overview and Revenue Estimates, p. 104.
[86] City of Chicago, FY2009 Comprehensive Annual Financial Report, p. 51.

discipline of not spending all anticipated revenues. Other units of local government have Corporate Fund reserve policies that outline how much money the government should have on hand, including the Metropolitan Water Reclamation District, the Chicago Park District and the Forest Preserve District of Cook County.

Pursue Alternative Service Delivery to Reduce Costs

The Civic Federation has traditionally supported alternative service delivery or privatization efforts that contain certain safeguards.[87] If properly implemented and monitored, these efforts can be effective means of reducing costs and/or improving efficiency. Competition from private, nonprofit and even other public entities can help reduce the cost and operational inefficiencies that often develop in a system of monopoly service provision by a single government.

The Civic Federation urges the new mayor to seek out City operations that could be outsourced to private sector management. Potential functions suggested in the past by the Civic Federation include garbage removal, customer service centers, fleet management, 311 calls for non-emergency services, building management, payroll processing and accounting. The City has recently proposed or sought bids on the operation of City festivals, "Blue Cart" recycling and animal care in the Animal Care and Control department.[88] We urge the City to consider these and other possibilities when there is an opportunity to reduce costs to the City or provide better service.

Any alternative service delivery effort must include strong and sustained management oversight from the City to ensure that Chicagoans receive high quality public services.

Improve Transparency in City of Chicago Tax Increment Financing (TIF) Reporting

The City of Chicago receives and distributes the property tax revenue for Tax Increment Financing districts within its boundaries. This revenue is not appropriated as part of the City budget, but is spent by the City according to the Redevelopment Plan for each TIF. There are 165 active TIFs in Chicago according to the City's Department of Community Development web site.[89] For tax year 2009, Chicago TIFs generated $519.7 million, up from $386.5 million in 2005.[90] For FY2011 the City is declaring a surplus of $180 million in 25 Tax Increment Financing districts, thus allowing for the transfer of $38.5 million to the City's Corporate Fund. The balance of the surplus will be distributed to other local governments according to their proportional share of the composite property tax rate.

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[87] See the Civic Federation's "Alternative Service Delivery: A Civic Federation Issue Brief," December 2006. http://www.civicfed.org/civic-federation/publications/alternative-service-delivery-civic-federation-issue-brief, (last visited on January 27, 2011).

[88] City of Chicago, "Mayor Daley Says City Will Look Into Privatizing Management of Recycling Program, Lakefront Festivals, Other Functions," August 26, 2010. http://mayor.cityofchicago.org/mayor/en/press_room/press_releases/2010/august_2010/0826_management_initiatives.html, (last visited on January 27, 2011).

[89] City of Chicago Department of Community Development web site, TIF District FAQ's, navigate from www.cityofchicago.org, (last visited on February 9, 2011).

[90] Cook County Clerk TIF Reports. See http://www.cookcountyclerk.com/tsd/tifs/Pages/default.aspx (last visited on February 9, 2011).

There is considerable public debate about the proper use of TIF revenue. The number of TIFs, the size of TIF revenue and public confusion over how TIF revenues are actually expended all point to the need for greater TIF transparency.

In recent years the City of Chicago has taken steps to address the issue of TIF transparency by enhancing the Department of Community Development (DCD) website and the information it provides about TIF. The City Council's April 2009 TIF Sunshine Amendment delegated new responsibilities for online reporting of TIF information to DCD. The ordinance, which was introduced by Aldermen Scott Waguespack and Manny Flores, addressed a few goals that included consolidating information about TIFs already posted on several city departments' web pages and providing the public with better information about TIF in a more accessible manner.

The new TIF section of the DCD website organizes TIF information into sub-sections containing district overviews, annual reports, Community Development Commission reports, district redevelopment plans, maps, frequently asked questions and success stories. The DCD has added documents projecting the revenues, transfers out, current obligations, potential projects and fund balance for each TIF.[91] The new TIF Projection Reports webpage includes some overall totals for the amount of TIF revenue collected and spent by local governments and by the private sector.[92] These are good steps forward on TIF transparency.

The City has also begun to comply with TIF transparency requirements of Public Act 96-1335, enacted in July 2010. The Civic Federation had long advocated for these transparency reforms.[93] In compliance with P.A. 96-1335, the City included a summary of 2009 revenues and expenses for each TIF in the back of the budget recommendations book and created a separate TIF administration fund to account for personnel and non-personnel costs associated with the TIF program.[94]

A persistent problem with the TIF information presented by the City, however, is the lack of aggregate data. For example, the City did not provide totals collected and spent on TIF City-wide in the 2009 schedule of TIF revenues and expenditures included for the first time in the budget book. Although the new TIF Projection Reports webpage provides a few total numbers, much more could be done to show the types of revenue and spending by year across TIFs. In its display of TIF information, the City has historically treated each TIF as a separate entity while in reality a significant amount of money is transferred ("ported") between TIFs, and all taxpayers ultimately pay for TIF whether they reside in a TIF or not.[95] TIF is a City-wide economic

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[91] http://www.cityofchicago.org/content/dam/city/depts/dcd/general/ProjectedTIFFundBalances2010_2012.pdf (last visited on February 9, 2011).

[92] http://www.cityofchicago.org/city/en/depts/dcd/supp_info/tif_projection_reports.html (last visited on February 9, 2011).

[93] See Civic Federation, "Tax Increment Financing (TIF): A Civic Federation Position Statement," November 12, 2007, http://www.civicfed.org/civic-federation/publications/tax-increment-financing-tif-civic-federation-position-statement (last visited on February 9, 2011).

[94] City of Chicago, FY2011 Budget Recommendations, pp. 506-512, 535-538. http://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/2011_Budget_Recommendations.pdf (last visited on February 9, 2011).

[95] Civic Federation, "The Cook County Property Tax Extension Process: A Primer on Levies, Tax Caps and the Effect of Tax Increment Financing Districts," October 5, 2010. http://www.civicfed.org/civic-

development tool. The Civic Federation recommends that the City also display annual TIF information grouped by type of project in order to better inform the public about TIF activity across the City.

Furthermore, a large amount of TIF funds are used directly for capital projects of other local governments, particularly the Chicago Public Schools and the Chicago Park District. The Civic Federation recommends that the City publish annual TIF reports that list the TIF projects completed for or by other local governments in order to better inform the public about this substantial use of their tax dollars.

Long-Term Recommendations

Long-term treatments are intended to address the fundamental causes of fiscal distress. By reforming the budget plan to introduce a longer-term perspective, a government can define greater accountabilities for dollars spent and prioritize services to guide spending decisions.[96] In addition, the City's financial sustainability relies on addressing its long-term liabilities with comprehensive reform. The Civic Federation offers the following longer-term recommendations on issues to be addressed by the new mayor of Chicago.

Develop a Long-Term Financial Plan

The Civic Federation recommends that the development of a long-term financial plan be the City's top priority in 2011 and 2012. Upon taking office the new Mayor should immediately begin mobilizing resources to undertake a long-term financial planning process and should complete the City's first long-term financial plan by the end of his or her first full year in office. The City's budgetary challenge is of a magnitude so great that it will require a multi-year plan to address. All stakeholders must be actively engaged because the City must pursue opportunities for efficiency, address personnel expenses and make difficult choices about taxation and service levels. Long-term financial planning is no longer an option, but has become a necessity for the City to achieve the fiscal balance that it needs to be able to sustain its critical public services.

The Civic Federation is not alone in recognizing the importance of long-range financial planning. Other groups such as the Government Finance Officers Association (GFOA) and the National Association Advisory Council on State and Local Budgeting (NASCLB) consider long-term financial planning to be a pillar of proper financial management. Credit rating agencies have also recognized the importance of long-term financial planning. For example, Standard and Poor's Ratings Services states in its ratings criteria that "a government's financial management practices is an important factor in […] analysis of that government's creditworthiness" and one of the practices examined is long-term financial planning.[97] A recent GFOA white paper identified long-term financial planning as the central tool for local governments to become financially resilient, which is characterized by an ability to sustain external shocks such as an economic

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federation/publications/cook-county-property-tax-extension-process-primer-levies-tax-caps-and- (last visited on February 9, 2011).

[96] Government Finance Officers Association, "Recovery from Financial Distress and Fiscal First Aid," GFOA, http://www.gfoa.org/index.php?option=com_content&task=view&id=1135&Itemid=563 (last visited on February 8, 2011).

[97] Standard and Poor's, "U.S. Public Finance: Financial Management Assessment" June 27, 2006.

downturn.[98] The GFOA found that governments that utilized long-term financial planning did not have to suddenly and reflexively resort to the severe "retrenchment tactics" as many governments have.

Multi-year forecasting (discussed on page 23) is primarily a technical and politically neutral undertaking. In contrast, the long-term financial planning process should engage stakeholders in a discussion of budgetary and policy options. While a portion of the City's financial challenges can be addressed through increased efficiencies and operational improvements, the size of the deficit will likely require value-laden and political decisions regarding service levels, taxation and employee compensation. Long-term financial planning provides an opportunity to make those decisions in an orderly manner, which is difficult to do simply through the normal one-year planning cycle of the budget process.

The NASCLB defines the financial planning process as an assessment of the long-term financial implications of current and proposed policies, programs and assumptions with development of appropriate strategies to achieve the plan's goals.[99] The NASCLB and the GFOA have developed best practices in long-term financial planning. A summary of recommended elements of a long-term financial plan from those institutions are the following:[100]

1. An analysis of financial trends.
2. An assessment of problems and opportunities facing the jurisdiction including an analysis of the financial environment.
3. A description of financial policies, service level preferences and financial goals.
4. Possible strategies, actions and scenarios needed to address financial imbalances and other long-term issues.
5. A long-term forecast of revenues and expenditures that uses alternative economic, planning and policy assumptions.
6. Identification of key assumptions.
7. A discussion of debt position.

An essential element of the long-term financial planning process is that it be an open and public process. No matter how sophisticated a local government's internal planning process may be, unless it is shared with all stakeholders it is insufficient. The Mayor's management team is only one actor in the budget process. In order to successfully take on the difficult decisions all stakeholders need to be engaged in the planning process. The GFOA describes the long-term financial planning process as "not just a staff-driven process. It is consensus-driven and inclusive, involving elected officials, staff and the public."[101]

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[98] Shayne Kavanagh, "Building a Financially Resilient Government through Long-Term Financial Planning," Government Finance Officers Association, www.gfoa.org/downloads/financiallyresilientgovernment_whitepaper.pdf (last visited on January 10, 2011).

[99] National Advisory Council on State and Local Budgeting, *Recommended Budget Practices, (*Chicago: GFOA, 1998).

[100] See Shayne Kavanagh, *Financing the Future: Long-Term Financial Planning for Local Government* (Chicago: GFOA, 2007) and National Advisory Council on State and Local Budgeting, *Recommended Budget Practices,* (Chicago: GFOA, 1998).

[101] Government Finance Officers Association, "An Introduction to Financial Planning," (http://www.gfoa.org/downloads/LTFPbrochure.pdf (last visited on January 10, 2011).

The following are some benefits of involving all stakeholders in the long-term financial planning process:

- *Refinement of Forecast:* Involving stakeholders in financial planning can help make forecasting more realistic. Operating departments can improve the qualitative judgments while elected officials can review critical assumptions.[102]
- *Shared Sacrifice:* Stakeholders will be more likely to make sacrifices if there is open dialogue and clear communication of budgetary challenges. For example, Oakland County, Michigan regularly shares budgetary projections with all employees, which allowed them to reduce salaries by 2.5% in two successive years without great controversy in order to avoid layoffs.[103]
- *Institutionalizes Financial Planning:* The involvement of elected officials provides legitimacy to the process.[104] In addition, formal financial policies adopted by the legislative body can help preserve practices through changes in leadership. Citizen engagement can generate grassroots support for financial planning within the community so that it becomes a routine and expected government practice.[105]
- *Promotes Strategic Decisions:* A long-term financial plan helps promote strategic thinking as it makes "the long-term consequences of decisions apparent […]. Financial planning transforms discussions that occur among the management team and elected officials."[106] For example, governments studied by GFOA were able to build support for strategic investments such as technology enhancements through financial forecasting.
- *Prioritization of Services:* Input from the public and elected officials is critical in effective prioritization. The long-term planning process is an opportunity to communicate the cost of services and available resources. The long-term financial plan should consider the preferences and policy outcomes that the community desires.[107] As governments are increasingly faced with difficult decisions they should seek public input regarding appropriate service and taxation levels. In addition, using the long-term planning process can help provide guidance to departments who are implementing budget reductions.
- *Implementation of Plan:* The involvement of all stakeholders results in a long-term financial plan that better reflects the interests of various groups and will therefore garner more support for the plan's implementation.[108]

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[102] Shayne Kavanagh, "Building a Financially Resilient Government through Long-Term Financial Planning," Government Finance Officers Association, www.gfoa.org/downloads/financiallyresilientgovernment_whitepaper.pdf (last visited on January 10, 2011).

[103] Laurie Van Pelt, "Oakland County: emphasizes long-term planning over immediate fixes," *Government Finance Review*, April 2010.

[104] Shayne Kavanagh, *Financing the Future: Long-Term Financial Planning for Local Government* (Chicago: GFOA, 2007), p. 217.

[105] Shayne Kavanagh, "Building a Financially Resilient Government through Long-Term Financial Planning," Government Finance Officers Association, www.gfoa.org/downloads/financiallyresilientgovernment_whitepaper.pdf (last visited on January 10, 2011).

[106] Shayne Kavanagh, "Protect Your Community with Financial Planning," *Public Management*, June 2007.

[107] Shayne Kavanagh, *Financing the Future: Long-Term Financial Planning for Local Government* (Chicago: GFOA, 2007), p. 20.

[108] Shayne Kavanagh, *Financing the Future: Long-Term Financial Planning for Local Government* (Chicago: GFOA, 2007), p. 234.

Implement Pension Reform

The City of Chicago is facing a severe pension crisis. The new mayor of Chicago faces two distinct pension challenges:

1) the Municipal and Laborers' funds are still on a path to deplete their assets within twenty years if nothing more is done; and
2) the Police and Fire funds are no longer on a path to insolvency but the mandated increase in statutory employer contribution will require an enormous additional expenditure beginning in 2015.

The City's pension problem has become so severe that solving it is likely to require a combination of significant new revenues from City taxpayers and from employees, further benefit reductions, as well as the diversion of resources from other City spending. Although it may take some time to implement solutions, we urge the new mayor to begin working on the issue immediately because the longer action is delayed, the more severe the tax increases and/or service cuts will have to be for Chicago residents.

The Civic Federation makes the following five recommendations to the new mayor regarding the City's pension challenges.

1. Increase City Funding for Pensions

The City's pension contributions have been insufficient to meet the needs of the funds for most of the last ten years (see page 20 of this report). Both the Commission to Strengthen Chicago's Pension Funds and Public Act 96-1495 have affirmed a point the Civic Federation has been making for years: the City has not contributed enough money to its pension funds to match the promises it has made to employees and retirees.

The Civic Federation recommends that the new mayor immediately make room for greater pension contributions in the City budget. As discussed below, the magnitude of the additional contributions can be diminished in multiple ways but it is clear that more City revenues must be dedicated to pensions. Increased City contributions may come from cutting other areas of the budget or from higher taxes and fees.

2. Reduce Benefits for Current Employees if Adequate Funding for Pension Promises Is Not Secured

The City's pension liabilities have grown so large and the contributions needed to rescue the funds are so substantial that the City will have great difficulty funding the current pension promises it has made to its employees. To rescue only the Police and Fire Funds, the City will need to contribute at least $550 million additional dollars beginning in 2015. The City Council and Mayor Daley have already declared that sum unaffordable, stating that the "record-breaking tax increase could cause many more people to lose their homes."[109] Saving the Municipal and Laborers' funds from insolvency will require even more City revenues.

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[109] Letter of December 8, 2010 from the Chicago City Council to Governor Pat Quinn. http://www.wttw.com/res/pdf/quinn_letter.pdf (last visited on January 27, 2011).

It may not be possible to raise taxes high enough and cut services deeply enough to make the contributions needed save the City's four pension funds. Therefore, the Civic Federation recommends that the City also seriously consider reductions in non-vested pension benefits for current employees in future pension reform legislation as proposed by the Commercial Club of Chicago. Scenario "2-all" in the Commission to Strengthen Chicago's Pension Funds report modeled such a reduction for current employees.[110] The new mayor should seek additional actuarial calculations and legal opinions on the size and type of benefit reductions needed to make the pension plans affordable now and in the future. It is important to reiterate that the reduction in benefits would not affect existing retirees or benefits already earned by current employees, but would prospectively affect future benefits earned by current employees.

3. Require Both Employer and Employee Contributions to Relate to Funded Status of the Plans

The City's employer contributions to its four pension funds are a multiple of past employee contributions, with no relationship to the financial health of the plan. The employee contributions are a fixed percentage of pay.

The Civic Federation recommends that both employer and employee contributions be tied to actuarial liabilities and funded ratios, such that contributions are at levels consistent with the actuarially calculated annual required contribution (ARC). At a minimum, contributions to the Municipal and Laborers' funds should be put on a 30-year schedule to reach 90% funded, as the Police and Fire funds were pursuant to Public Act 96-1495.

The Civic Federation believes that employees need to share in the rising costs of public pension plans and recommends that employer and employee contributions be restructured such that employees pay a proportion of required contributions, similar to the new structure of the Chicago Transit Authority contributions. A proportional relationship should be set whereby, for example, the employer pays 50% and the employees pay 50% of the annual required contribution. Whether the proportion is 50%/50%, 60%/40%, or some other ratio, it is critical that both parties pay a share of required contributions, and that those contributions relate to the fiscal health of the fund. The Commission to Strengthen Chicago's Pension Funds modeled 60%/40% cost-sharing for additional contributions but noted that this ratio could be changed.[111]

4. Pursue Pension Fund Consolidation

It is difficult to understand how the maintenance of four separate pension funds is either beneficial to taxpayers or cost effective for the City of Chicago. The Civic Federation recommends that the City study ways to consolidate the funds by, for example, merging the four funds into a single fund, or by merging the Municipal and Laborers funds with the Illinois Municipal Retirement Fund and merging the Police and Fire funds into a single Chicago Public Safety fund.

[110] City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, pp. 55-60.
[111] City of Chicago, Commission to Strengthen Chicago's Pension Funds, April 30, 2010, p. 34*ff*.

5. Reform Pension Board Governance

If the four pension funds remain separate, the Civic Federation recommends that the composition of the pension boards of trustees be revised in three ways. The balance of employee and management representation on the boards should be changed so that employees do not hold the majority of seats. A tripartite structure should be created that includes independent taxpayer representation on the board. Finally, financial experts should be included on the pension boards and financial training for non-expert members should be required.[112]

Pursue Creation of a Separate Retiree Health Care Trust Fund

Chicago's new mayor will soon need to engage in negotiations regarding provision of retiree health insurance after the current agreement expires. As of FY2009, the City's unfunded OPEB liability was nearly $1.3 billion including the portion subsidized by the pension funds.

The Civic Federation recommends that the new mayor study and carefully consider pursuing the model adopted by the Chicago Transit Authority to shift retiree health insurance to an independent trust fund. Public Act 95-0708 created a separate Retiree Health Care Trust for the provision of CTA retiree health insurance. The CTA seeded the Trust with bond proceeds and neither the CTA nor the CTA pension fund has any further financial obligations regarding retiree health insurance.[113] Public Act 95-708 requires employees to contribute 3% of pay to the CTA Retiree Health Care Trust and that amount will increase to 6% in 2012.[114] Retiree, survivor and dependent contributions to their health care benefits cannot exceed 45% of the total benefit cost.[115] The fiscal health of the fund is monitored by the State Auditor General. If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors is found to exceed the actuarial present value of projected contributions, trust income and reserves, the Trust's Board of Trustees must submit to the Auditor General a plan to rectify the situation within ten years by increasing participant contributions, reducing benefits or making other plan changes.[116] The Civic Federation urges the mayor of Chicago to consider a similar solution for the City to divest itself of financial responsibility for retiree health insurance.

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[112] Government Finance Officers Association, "Best Practice: Governance of Public Employee Post-Retirement Benefits Systems (2010)." http://www.gfoa.org/downloads/GFOA_governanceretirementbenefitssystemsBP.pdf (last visited on February 9, 2011). See also Civic Federation, "Recommendations to Reform Public Pension Boards of Trustees in Illinois," February 16, 2006. http://www.civicfed.org/civic-federation/publications/recommendations-reform-public-pension-boards-trustees-illinois (last visited on February 9, 2011).

[113] See the Civic Federation's annual Status of Local Pension Funding reports for more information on the CTA pension reform and Retiree Health Care Trust legislation.

[114] Chicago Transit Authority, *Financial Statements and Supplementary Information December 31, 2009 and 2008,* p. 14 and Chicago Transit Authority Retiree Health Care Trust, *Funding Results as of January 1, 2010*, p. 13.

[115] Chicago Transit Authority, *Financial Statements and Supplementary Information December 31, 2009 and 2008,* p. 14 and 40 ILCS 5/22-101B.

[116] 40 ILCS 5/22-101B.