Chicago Executive Summary

"A revitalized management team has reduced staff and implemented operational efficiencies to position the city to eventually reduce its reliance on non-recurring revenues to fund ongoing operations."
- Moody's Investor Services.

Chicago experienced significant fiscal decline in the years after former Mayor Daley completed his service—leaving the incoming administration of Mayor Rahm Emanuel to take office with an inherited operating deficit and a declining population—especially of key, economic age groups, and a significant loss of jobs. The Windy City inherited privatization schemes gone awry, high crime rates, significant public education challenges, and uncertainty about its own identity. The new administration not only inherited a significant pension problem, which it is dependent upon state action to address.

Now the city confronts an exceptional challenge in trying to define its future. Under its new administration, the operating deficit has been eliminated, revenues are coming back, and the Mayor has been a driving force in infrastructure investment to enhance the economic competitiveness of the city for major, international corporations. The leadership at the top and in the city's administration has been widely praised.

Chicago is also blessed with an exceptional talent bank of individuals and organizations that care deeply about the city and its future, from the Chicago Civic Federation to experienced experts who have been generous with their time, experience, and expertise. Chicago has demonstrated recovery from the first decade of the new century, and there appears to be a strong consensus that Mayor Emanuel understands the shape of the fiscal challenge – and that he has assembled an exceptionally competent team to face forward.

Whether Chicago continues to recover from the first decade of the century or not, its progress yields several important lessons for other leaders facing fiscal crisis:

- **Know your state.** State inaction and inability to address critical pension issues have been a big part of the problem in Chicago—along with the legacy from the previous decade.

- **Identify the problem.** The recognition and identification of the most critical issues and the city's economic strengths and opportunities have been an important step forward.

- **Pick your battles.** Trying to address public safety, schools, and legacy problems is picking a lot of battles.

- **Have a way out.** Having a strong, committed leader and leadership team is critical for the future.

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Introduction

The City of Chicago, after a significant—and initially successful—effort to remake itself into a global city today confronts unprecedented challenges, or as Aaron Renn noted: "[It's becoming evident that the city took a serious turn for the worse during the first decade of the new century. The gleaming towers, swank restaurants, and smart shops remain, but Chicago is experiencing a steep decline quite different from that of many other large cities. It is a deeply troubled place, one increasingly falling behind its large urban brethren and presenting a host of challenges for new mayor Rahm Emanuel."[1]

Mayor Emanuel inherited what some have termed a 'time bomb.' He took office to find a $635 million operating deficit—which he will have eliminated by the end of his term. The demographics are recovering from the previous decade which saw an exodus of 200,000—making Chicago the only one of the nation's 15 largest cities to lose population.[2] In the decade, the city lost 7.1% of its jobs.[3] Now, revenues are coming back, but the city faces an exceptional challenge in trying to shape its future. Indeed with a current debt level of about $63,525 per capita, one expert noted that if one included the debt per capita with the unfunded liability per capita, the city would be a prime "candidate for fiscal distress." Nevertheless, unemployment is coming down[4] (11.3% unemployment, seasonally adjusted) and census data demonstrated the city is returning as a destination for the key demographic group, the 25-29 age group, which grew from 227,000 in 2006 to 274,000 by end of 2011.[5]

Compounding the city's challenge is what one expert called the "Tooth Fairy" problem the city inherited: privatization, referring to both the Illinois Skyway (Jan. 2005), for which the city received $1.83 billion, on a 99-year lease; and the December 2008 75-year lease of parking meters (35,000) for $1.15 billion. Of these funds, which should have gone into long term investment and to help pay down debt, only $400 million remains[6]—and has imposed critical issues because of the structure of the sales, especially on the parking meters, which had required the city to pay for uncollected meter fees.[7]

Another expert noted that there are serious issues that threaten credit quality, including a lot going on between unions and mayor, which may be expected to build (especially after police sergeant agreement rejection[8]). The rejection, by itself is not a crisis, but it is a setback. The rejection means that a disproportionate percent of the city's budget must be devoted to long-term unfunded pension obligations instead of critical investments in the future. As one expert warned, the credit numbers are just so steep and are for so long that they could really hit property taxes….and hit businesses or companies that would be willing to come to Chicago. The more of its budget the city must divert to meet unsustainable pension obligations, the less it has to address its goal of investments in the city's infrastructure, schools and public safety—on which there is a consensus that such investments are fundamental to the city's economic future.

The most critical challenges confronting the City's fiscal future are:

- Schools, which one commentator cited as "almost insoluble;"
- Police—crime—bad gangs (also "almost insoluble");
- Infrastructure (on which the Mayor has earned very high marks);
- Pensions; —which are inextricably linked to the state;
- The July triple downgrade of the City's GO debt; and
- Bringing jobs back to Chicago.

Not only are these challenges daunting, but they come as the federal government and State of Illinois are in the process of reducing state and federal aid.[9]

Moody's Investors Service, in April 2012, lowered its outlook on Chicago's main credit rating to negative from stable, citing the lack of any progress so far on pension reform. Moody's maintained Chicago's solid investment-grade credit rating of Aa3, but warned that "should pension pressures continue to escalate absent a specific plan of reform, the city's credit quality will likely weaken."[10] Another Wall Street credit rater, Standard & Poor's Rating Services, maintained its stable outlook on Chicago's finances and affirmed its A+ credit rating on the city's general obligation debt, as did Fitch Ratings. S&P reported that "In our opinion, the city's rating could improve if it is able to show a track record of structurally balanced financial operations and substantially improve its pension systems' funded levels," albeit warning: "We could lower the rating if the city's financial position suffers due to a widening budget gap or if the funding level of its pension systems deteriorates further."[11]

Importantly, both credit-rating agencies applauded the city's financial improvements under Mayor Rahm Emanuel and Chief Financial Officer Lois Scott: "A revitalized management team has reduced staff and implemented operational efficiencies to position the city to eventually eliminate its reliance on non-recurring revenues to fund ongoing operations."[12] Moody's said in its report; but Moody's also said: "Chicago's administration has yet to unveil a detailed strategy for improving pension funding levels and is not currently contributing the full annual required contributions (ARCs). Should pension pressures continue to escalate absent a specific plan of reform, the city's credit quality will likely weaken."[13]

In a statement, Ms. Scott said: "We are proud to receive high marks from all three ratings agencies for tackling the city's many challenges head on, including the rebuilding our infrastructure and reducing our reliance on rainy day reserves and one-time revenue sources. We couldn't agree more with the agencies' concerns over the pension crisis. The cost of continued inaction will lead to further burden on taxpayers who have done nothing wrong and have been asked to sacrifice so much already. Leaders in Springfield must work together and fix this funding problem, and they must do it now."[14]

That is, there are some serious issues that threaten Chicago's credit quality. There are seemingly intractable labor issues going on between unions and mayor, and they will build (especially after police sergeant agreement rejection). The longer differences are irreconcilable, the more difficult economic recovery could prove. The inability to reach an agreement is not an immediate crisis, but the credit numbers are just so steep and the long-term obligations are for so long that they have implications for property taxes. As the city is laser focused on drawing in new businesses, any perception that assessed property taxes might have to increase—or that schools and crime rates will not improve—would adversely affect businesses' or companies' willingness to come to Chicago. You might also mention that Illinois' probable need for tax increases and high level of policy uncertainty also affects Chicago's competitiveness.

An issue on which there appears to be strong consensus is that Mayor Emanuel understands the challenge and is the first to note that the city's liquidity position is a precursor, a better guide than its fund balance. Indeed, an important issue has been the city's very weak cash position. A key Emanuel focus is on the number of days' over 30 with fund payment periods higher than average. That is, there is a laser focus on how the city's cash position has to be managed, as is a tight rein on growth in general expenditures. Perhaps, in this regard, the greatest challenge for the city is its limited ability to rein in its budget for police and schools, because investment in their improvements is integral to the city's economic competitiveness.

Leadership. Cities are immense corporations subject to events beyond their control from weather to state legislatures to the federal government. Chicago, whose population makes up 33.9 percent of the metropolitan region, has a poverty rate of 21.4 percent, compared to a statewide level of 13.1 percent. So the city's leaders face a heavier lift. That makes the issue of leadership ever so important. This intangible matters, and there appears to be a recognition of some exceptional talent and creative energies, especially in the finance area at City Hall. As one expert put it: "[They are] doing the best they can and getting a handle on the issues…but the city is very vulnerable." That indefinable quality is critical to ensure that businesses are still moving in, property sales holding up, and the city retains its international reputation as a cultural, transportation hub. Significantly, 2015 was identified as a critical year—"really important for economic growth." Right now, employment is not bailing the city out, and crime is imposing a high cost structure.   At least one leader identified a second term for Mayor Emanuel as the *true test* of the city's fiscal future.

Chicago has consciously created enterprise funds so that a greater and greater portion of city services are not financed through property taxes[15] and the operating budget. This means that some 83 percent of the city's budget is now concentrated on schools and public safety.[16] This creates the ability to reduce pressure on the property tax base and to focus on critical priorities. To be a global city, there is an urgent need to demonstrate world class public infrastructure, public safety, and a competitive education environment.

Schools. As Chicago began the process this year of closing 54 schools in an attempt to rescue an academically and financially failing educational system, one of its greatest challenges will be safely maneuvering thousands of students to and from class through the patchwork of rival gang territories that cover large parts of the nation's third-largest city.[17] Eleven other schools are to share space with other schools. The closures are the greatest number to be shut down at one time by a city in recent memory—maybe ever. Barbara Byrd-Bennett, chief executive of the Chicago Public School system stated: "For too long children in certain parts of Chicago have been cheated out of the resources they need to succeed because they are in underutilized, under-resourced schools."[18] For the City of Chicago, if one looks only at total budget numbers, the peak year was FY2007 and the trough year was FY2008. Chicago has a calendar year fiscal year. However, Chicago was manipulating features of its budget in order to maintain budget levels, particularly blowing through the proceeds of the 2009 75-year parking meter lease. So the low point for revenues for all local funds in Chicago was FY2009, but an increase in transfers from the proceeds of the parking meters allowed the entire budget to increase in FY2009 over FY2008.[19]

The closures were projected to save a projected $560 million over 10 years by reducing investment in the closed buildings and cut annual operating costs by $43 million. The closings represent about 8% of the city's 681 public schools, the third-largest school district in the country. More than 400,000 students are enrolled in public schools, a large majority black or Hispanic and from low-income families. CEO Byrd-Bennett has said that the district needs to reduce a $1 billion deficit. "By consolidating these schools, we can focus on safely getting every child into a better performing school close to their home." The Rev. Robin Hood stands in front of an elementary school in what's known as "The Holy City" – the Chicago neighborhood where the notorious Vice Lords street gang got its start decades ago and still one of the city's most dangerous areas.

Mayor Emanuel and his schools chief, Barbara Byrd-Bennett, have acknowledged the danger of mixing young people from different neighborhoods. Ms. Byrd-Bennett agreed in January not to close any high schools. A key criteria in the consolidation involved close consideration of maps of gang lines when choosing where to send elementary students whose schools were closing—the consideration was to protect younger students who might otherwise get caught in the crossfire of gang conflicts or be victimized in other ways. According to school leaders, it is not unheard of for kids as young as 10 years old to be involved in gangs.[20]

Crime. Addressing crime has been a critical fiscal priority for the city, as a perception of safety is fundamental to the city's aspirations to be an international convention city—not to mention the perception and relationship of public safety to healthy assessed property values. The increased attention and focus on crime appears to be paying off. Chicago crime statistics report an overall downward trend in crime based on data from 12 years with violent crime decreasing and property crime decreasing. Based on this trend, the crime rate in Chicago for this year is expected to be lower than in 2010. The city violent crime rate for Chicago in 2010 was higher than the national violent crime rate average by 148.31%. The city property crime rate in Chicago was higher than the national property crime rate average by 44%.

In 2010 the city violent crime rate in Chicago was higher than the Illinois state rate by 130.33% and the city property crime rate in Chicago was higher than the state property crime rate by 58.02%.[21] The tighter fiscal focus on continuing to invest in reducing crime is critical to both the city's economic competitiveness and to protecting its property tax base. Central to any successful effort to bring jobs and economic opportunity back to Chicago are these twin efforts to focus on crime and school.

Fiscal Fitness

Last February, Mayor Emanuel released the City of Chicago's first quarterly budget[22] in order "to ensure more transparency and honesty in the City's budgeting process."[23] The report tracks the City's revenues and expenditures as they align with the budget, but does not include information on grant funds, pension payments, debt service funds or capital expenditures. The report provides information on major initiatives implemented through the budget process. Separately, the City released its Quarterly Budget Report for the 4th Quarter, which focuses on local fund operating revenues and expenditures, as these represent the funds used to provide essential City services. The report is not an audited financial statement and as such the numbers are subject to change until the City releases its Comprehensive Annual Financial Report later this year.

Chicago's general operating fund, or corporate fund revenues,[24] which are projected estimated to reach $2.9 billion by fiscal year-end, up $69.0 million or 2.4% from the approved FY2012 budget. The increase is largely due to better than expected returns on economically sensitive revenues including transaction taxes, sales and use taxes, income and personal property replacement taxes, a sign of the local economy's ongoing recovery from the recession. This is demonstrated by both a strong commercial real estate market and rising assessed residential values from increasing home sales. In addition, the reports indicate increased income tax collections as a result of increased employment and higher corporate profits, as well as the City's expectation of receipt of 13 monthly income tax distributions from Illinois for the year – all of 2012's payments plus a delayed 2011 payment received in early 2012.

In contrast, non-tax revenues in the Corporate Fund were below budget estimates, including revenues received from licenses and permits and fines, forfeitures, and penalties. The report also found reduced revenue estimates for a category that includes expected Tax Increment Financing surplus, intergovernmental reimbursements, and reimbursements from the City's enterprise and special revenue funds. Although revenue from fines, forfeitures, and penalties were below expectations or expected budget estimates, they were up 8.0% from FY2011 due to increased debt collection efforts.

Corporate Fund expenditures were $40.6 million, or 1.3%, below budget estimates. The total budget of nearly $3.1 billion is comprised mostly of $2.2 billion in salaries and wages, which is estimated to be $31.2 million, or 1.4%, over budget by year-end. The increase over projections, according to the City, was on account of an increase in police hours throughout 2012. The City, however, reported significant savings on healthcare benefits, some $46.5 million, or 11.9%, below budget estimates—savings which the City claimed were the result of aggressive negotiations with providers and pursuing one-time reimbursements owed to the City. The City's hotel tax revenues were above budget estimates. This was a reaffirmation of the city's focus on public safety, as the report found a six percent increase in the hotel operator occupation tax revenue, notwithstanding a one percent increase in the home rule hotel tax rate.[25] The City reported reduced reimbursement revenue due to non-collection of budgeted reimbursement from the Chicago Public Schools for non-teacher pension contributions.[26]

How the City budgets its Corporate Fund is a concern, especially with regard to distinguishing between operating and long-term expenditures. According to media reports, Chicago has already spent its entire FY2013 Corporate Fund budget of $26.2 million for claims and judgments against the City and plans to use bond proceeds to cover future settlements.[27] Large settlements in FY2013 include a $22.5 million settlement arising from police misconduct.[28] According to the quarterly report, the City spent the entire Corporate Fund budget for claims and judgments prior to the end of the year and noted that each year the City uses both Corporate Fund resources and bond proceeds to pay for these kinds of expenses. Of greater concern, the Civic Federation's analysis of the FY2013 budget[29] expressed concern with the City's use of some of the proceeds of $308.0 million in taxable bonds it sold in May 2012 to pay for a $78.4 million tort settlement related to the City's hiring of firefighters. The risk is that the City "is borrowing to pay for what is essentially an operating cost,"[30] instead of reasonably "budgeting for known tort claims from ongoing lawsuits and making these payments from a budgetary reserve or from recurring revenues."[31]

Long Term and Capital Debt

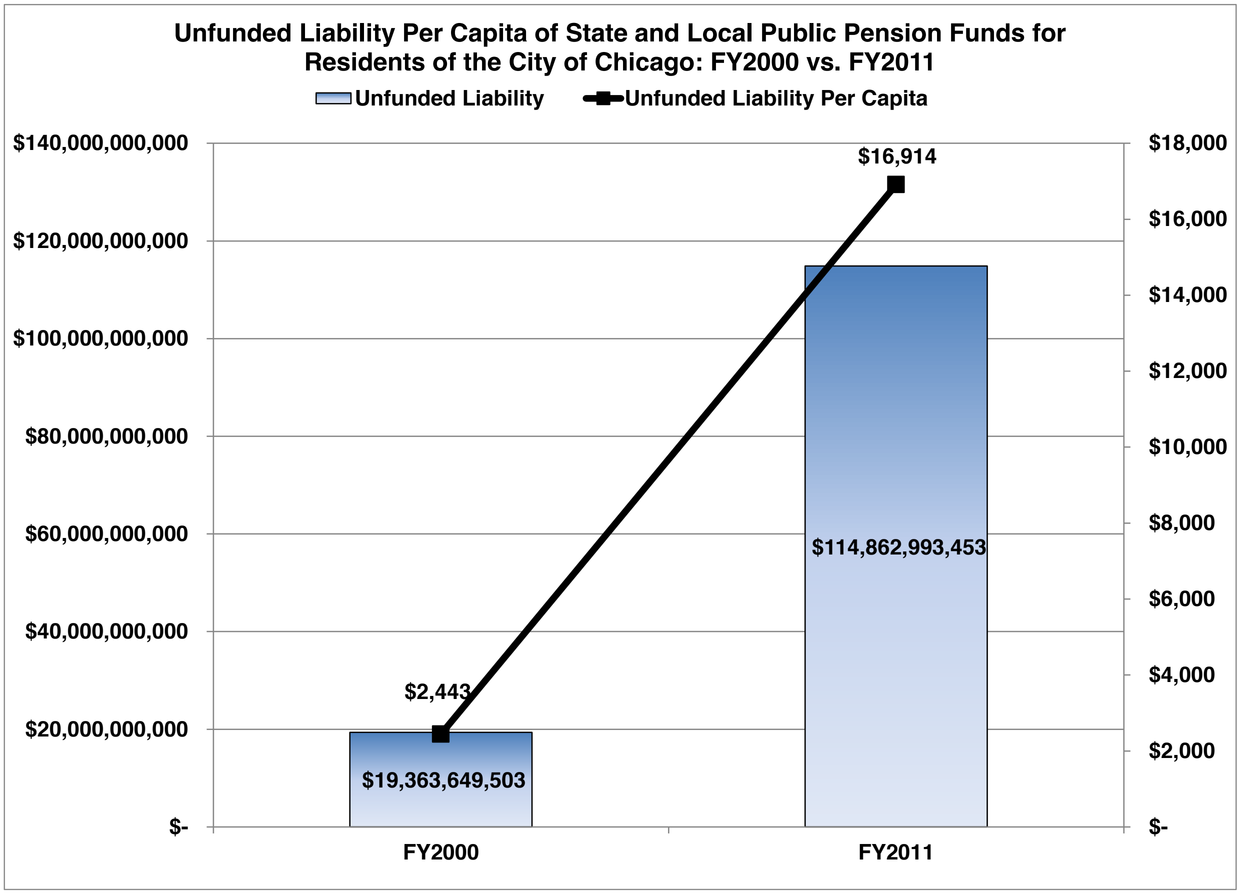
Between FY2002 and FY2011, long-term debt and pension obligations per capita grew from $6,157 to $17,569—an 185.3% increase, of which two-thirds is attributable to increases in pension obligations.[32] This encompasses two,[33] distinct kinds of debt: long-term revenue or general obligation debt issued by Chicago backed by the City's full faith and credit or revenue bonds backed by a dedicated revenue source; and pension debt.[34]

The debt issuances demonstrate one of the most conflicting challenges to the city's fiscal future.[35] The capital debt is a long-term investment and commitment to the city's future: it focuses on the city's infrastructure, both physical and human, critical to continued economic growth. The unsustainable pension debt, however, erodes the city's ability to make commitments of future tax dollars. In a sense, the capital debt is an investment in the city's future, while the pension debt undercuts the city's ability to issue new long term investment debt. As the Civic Federation carefully explains below, the pension debt is increasing at not just an unsustainable rate, but at a pace which increasingly consumes the operating budget.[36]

Figure 1 on the following page illustrates the growth in unfunded liabilities per capita for Chicago residents from 2000 to 2011. It includes four Chicago funds— Chicago Teachers Pension Funds and Chicago Park District—as well as Chicago's Chicagoans' portion of County, MWRD and State unfunded pension liabilities. At $20.3 billion, the City's net direct debt and overlapping net direct debt make up 42.6% of the $17,569 of long-term debt and pension obligations per capita. At $27.3 billion, unfunded pension obligations for the City's four funds and the City's portion of the pension funds of overlapping governments make up 57.4%. The largest components of the indicator are the City's net direct debt, at $7.6 billion, or 16.0% of the long-term obligations, followed by the Chicago Public Schools' Teachers' Pension Fund (at $6.8 billion, or 14.3%) and the Municipal Pension Fund (at $6.7 billion, or 14.2%). It is important to note that most bonded debt for the local governments below are amortized over thirty years from the issuance of the bond. This means that the governments have scheduled to pay the entirety of the costs of the bond over its thirty-year life. In contrast, the pension obligations of the government are never expected to be fully paid off because the government is expected to exist in perpetuity, and instead will continue as long as the government has living retirees collecting pension payments.

Between FY2002 and FY2011, long-term debt and pension obligations per capita grew from $6,157 to $17,569. This represents a 185.3% increase, of which two-thirds is attributable to increases in pension obligations. A breakdown of the indicator reveals that the City's long-term debt obligations per capita grew from $3,784 to $7,489, a 97.9% increase over the ten-year period. Meanwhile, long-term pension obligations per capita grew from $2,374 to $10,080, an increase of 324.7%. The sum of net direct debt, overlapping net direct debt, the City's portion of CTA's bonded debt and unfunded pension liabilities increased by 168.1% over the ten-year period. This represents a $29.8 billion increase in long-term obligations, from $17.7 billion in FY2002 to $47.6 billion in FY2011. A closer look at the sum of long-term obligations reveals that over the past ten years, bonded debt obligations grew by 86.0%, or $9.4 billion, while unfunded pension obligations grew by 299.0%, or $20.5 billion.

Figure 1. Per Capita Illinois & Chicago Pension Debt



Pension Challenges

On July 17, 2013, Moody's issued a triple downgrade of Chicago almost exclusively due to pension obligations. Lead Chicago analyst Rachel Cortez cited the updated information in the city's comprehensive annual financial statements for 2012 that showed the pension funds' worsening health as a central factor in the agency's action. Though the new actuarial figures were recently released, the city publicly warned late last year that it expected its unfunded obligation to grow to as much as $20 billion by year's end. Analysts said the city offered up no new plan of attack at the conference outside of elusive state legislative action on reforms that curtail benefits. Political resistance to higher taxes or fees adds to investor and analyst concerns. Demand for city services, especially spending on public safety considered crucial to maintaining the city's healthy tax base and tourist appeal, further feeds their concerns.[37]

While it is clear the Mayor's office recognizes that addressing the pension challenge is critical to the long term health of the city's economy, the effort to take it on is beset by state-local issues, political, and labor challenges. As one expert noted: "Chicago's pensions can only be directly addressed after the state acts."[38] Moreover, the pension funding increase for the City of Chicago precipitated by the new State law is set for 2015. The Chicago Public Schools, a legally distinct government entity, will face its own pension funding increase due to the end of a state-granted partial pension holiday in its FY2014, starting July 1, 2013.

In February, Mayor Emanuel announced a landmark agreement under which Chicago police sergeants would get a 9 percent pay raise over four years, while future retirees would be required to use 2 percent of their pensions to help cover health-care benefits. Mayor Emanuel noted: "This is the first agreement that has a sensible contract, realistic pension reform and changes how we fund retiree health care going forward."[39] He was joined by union leaders. The City has warned that ballooning pension costs may force the city to make deep cuts in government services—that is, an inability to curb pension obligations could force reductions in operating budget capacity to meet urgent public safety and public school priorities. The city noted that its retirement plans will consume 22 percent of the budget, about $1.2 billion, within four years, unless the state Legislature restructures them, including adjusting benefits and contribution rates, the mayor has said. Describing this potential landmark agreement, Mayor Emanuel stated: "We have a framework that addresses the financial pressure on taxpayers," calling it "a critical first step and baseline framework for fixing the city's pension crisis."[40]

The agreement was announced several days after the city's larger Fraternal Order of Police union pushed for a 12 percent increase over two years and $3,000 annual "cost of living in Chicago" stipends, leading Mayor Emanuel to describe the agreement as "a framework and blueprint for all to take note."[41] Less than a month later, however, members of Chicago Police Sergeants' Association overwhelmingly voted down the landmark pension reform proposal—an agreement the Mayor had hoped would serve as a blueprint for a collaborative pension reform, voting 1,100 to 134. What might have served as a critical template was crushed. Despite the vote, Mayor Emanuel said he would continue to push for pension reform in Springfield.

The city has announced it will phase out its post-retirement health-care benefits for 30,000 retirees by 2017, but continue coverage for the oldest retirees,[42] an action projected to reduce the annual operating budget by $108.7 million a year burden.[43] Some thirty thousand retired city employees will be forced to switch to Obamacare. City Comptroller Amer Ahmad noted: "With an increasing retiree population, earlier retirement ages and longer life spans, the ability of the city to continue to provide these benefits is totally untenable…. "It's far too expensive and could have an adverse impact on our credit worthiness and add a significant long-term liability to the city's financials….This is just a number that continues to grow over the years. We have to be financially responsible."

State-Local Issues

The sergeants' police union vote in March denotes the complexity of the city's relationships in and to the state. Local government taxing jurisdictions weave a complex web in Illinois. According to the 2007 *Census of Governments*, Illinois has more units of government than any other state — nearly 7,000. This includes 102 counties, 1,400 townships, 1,300 municipalities, 868 school districts, and about 4,000 special taxing districts such as library, fire protection, forest preserve, and park districts.[44] Consequently, local governments compete against each other—and they are part of the state:

- In Illinois, the fiscal condition of thousands of local governments is intertwined with that of the state. At present, neither is in a position to help the other. The state's fiscal stresses have led to cutbacks in transfers of state revenues to local governments, exactly at the time that local governments are most in need of assistance. As the state's bond rating has been downgraded, bonds issued by local governments are affected. On the local side, a number of school districts' and municipalities' bond ratings (including the City of Chicago and

Springfield, the state capitol) have recently been downgraded by Moody's Investors' Service, which certainly does not help Illinois.

- Other state actions also threaten to significantly impact municipalities. In spring of 2012, Governor Quinn proposed that funding the pensions of teachers (and state university employees) would become the responsibility of local school districts (and state universities) rather than the State of Illinois. This proposal would be a massive shift of responsibility and fiscal pressure from the state to the local level, and has been widely criticized on the grounds that it would require significant property tax increases. Local governments in Illinois rely heavily on revenue transfers from the state: shares of the personal income tax revenues, personal property tax replacement revenues, and sales tax.[45]

For, as deep as Chicago's fiscal challenges are, those of Illinois are in even worse shape, primarily because of pensions and post-retirement underfunded health care obligations. The state has the worst credit rating of any state. One writer described Illinois as "de facto bankrupt."[46]

In a sense, it is not just that Chicago confronts exceptional fiscal challenges itself, but also that, as the Volcker report on Illinois notes, "Other state actions also threaten to significantly impact municipalities."[47]

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Looking Ahead

In its report on Illinois, the State Budget Crisis Task Force recommended that Illinois should establish procedures for monitoring the fiscal condition of its local governments and taking early action to help local governments resolve their fiscal problems. Given the state's own exceptional fiscal challenges, it is difficult to imagine its capacity or skill to take on additional fiscal oversight.

By the same token, the exceptional number of local governments in Illinois cannot but mean that greater efficiencies could be wrung from the system. Moreover, while there may be the local fiscal capacity and capability in many of the state's municipalities, increasing disparities make it more difficult to attract and compensate competent and experienced staff. With Illinois' municipalities facing more federal and state cuts, the fiscal challenges of so many municipalities seem daunting and likely unsustainable.

There is a legal question in Illinois of who steps in when local government leaders do not have the skills necessary find a way forward for their municipalities. Several southern suburbs of Chicago are severely fiscally challenged: they have lost businesses and population, and, consequently their property tax bases. Additionally and crucially, as one expert told me, their municipal leaders are not up to the task of implementing the major restructuring these governments need. An extreme example, Ford Heights, could not afford to maintain its police department and dissolved it. The Cook County Sheriff provides policing in Ford Heights, at a cost to all Cook County taxpayers. This is not a solution, but it allows Ford Heights to limp along in a state of partial disincorporation with no solution in sight, to serve as a base for crime to export on other municipalities, but drains resources not just needed in Cook County, but in the Chicago metropolitan area. It risks being a cancer that could fiscally infect the region.

Chicago is fortunate. It has demonstrated recovery from the first decade of the new century. There appears to be a strong consensus that Mayor Emanuel understands the shape of the fiscal challenge and that he has assembled and leads an exceptionally competent team. It is clear that the city, not just with the Civic Federation, but with other fiscal experts, benefits from wide and deep support in the business community. It has a strong hand at the helm, although with apprehensions as to the duration of commitment. Now the city awaits more recent budget and fiscal reports—or, as one friend of the city noted: “the liquidity position will be a precursor, a better guide than the fund balance…”

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State and Local Public Pension Funds Unfunded Liabilities Per Capita FY2011 Total Unfunded Liability Per Capita in the City of Chicago				
Fund	**FY2011 Unfunded Actuarial Accrued Liability**	**2011 population**	**Unfunded liability per capita**	**Funded Ratio (Actuarial Value of Assets)**
Chicago Fire[1]	$ 2,797,157,362	2,707,120	$ 1,033	28.3%
Chicago Police[1]	$ 6,243,659,543	2,707,120	$ 2,306	35.6%
Chicago Municipal[1]	$ 6,903,880,605	2,707,120	$ 2,550	44.6%
Chicago Laborers[1]	$ 768,767,413	2,707,120	$ 284	64.9%
Subtotal Four City Funds	**$ 16,713,464,923**		**$ 6,174**	
MWRD[1]	$ 1,003,921,892	5,217,080	$ 192	52.2%
Cook County[1]	$ 5,826,910,283	5,217,080	$ 1,117	57.5%
Forest Preserve[1]	$ 111,195,011	5,217,080	$ 21	61.6%
CTA[2]	$ 1,145,987,972	3,530,000	$ 325	59.2%
Chicago Teachers[1]	$ 6,799,986,951	2,707,120	$ 2,512	59.9%
Chicago Park District[1]	$ 354,572,735	2,707,120	$ 131	58.0%
Subtotal Ten Local Funds	**$ 31,956,039,767**		**$ 10,472**	
Downstate Teachers (TRS)[3]	$ 43,529,992,000	12,869,257	$ 3,382	46.5%
State University Employees (SURS)[3]	$ 17,568,600,000	12,869,257	$ 1,365	44.3%
State Employees (SERS)[3]	$ 20,235,171,165	12,869,257	$ 1,572	35.6%
Judges[3]	$ 1,337,943,197	12,869,257	$ 104	31.5%
General Assembly[3]	$ 235,247,324	12,869,257	$ 18	21.2%
Subtotal Five State Funds	**$ 82,906,953,686**		**$ 6,442**	
Total All Local and State Funds	**$ 114,862,993,453**		**$ 16,914**	

Note: Includes all major public pension funds for which Chicago residents pay taxes.

[1] Supported by local property taxes (indirectly for Chicago Teachers' Fund)

[2] Supported by local sales taxes, real estate transfer tax, and fares

[3] Supported by state sales taxes, income taxes, and other general revenues

Source: FY2011 financial statements of the pension funds.

Source for population: U.S. Census Bureau estimates, except CTA is budget book estimate.

Figure 2 Chicago Police & Fire Unfunded Liabilities

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1 Aaron M. Renn, "The Second-Rate City?" *City Journal*, Vol. 22, No. 2, Spring 2012.

2 Ibid.

3 Ibid.

4 Bureau of Labor Statistics, January, 2013.

5 U.S. Census Bureau: State and County QuickFacts.

6 $500 million of the Skyway deal is in a reserve account that cannot be touched. The rest has been spent. There is a little over $100 million remaining from the Parking Meter fund, though the Emanuel administration is working to increase funding in what was supposed to be another long-term reserve in the style of the Skyway reserve. See this page for the most recent numbers on the funding status of each of Chicago's asset lease deals. http://www.cityofchicago.org/city/en/depts/fin/supp_info/public_private_partnerships/asset_lease_agreements.html. Chicago's 2012 Annual Financial Analysis additionally has a good section on the remaining proceeds from the leases. http://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/Budget%20Documents/2012AnnualFinancialAnalysis.pdf

7 The City Council just signed off on an agreement brokered by the Emanuel Administration that is intended to lower—though not eliminate—these payments going forward.

8 Members of Chicago Police Sergeants' Association in March overwhelmingly voted down a landmark pension reform proposal—a deal Mayor Rahm Emanuel had hoped would serve as a blueprint for a collaborative pension reform. Only 134 of the 1,100 who voted supported the four-year deal. The proposed agreement would have raised the retirement age for sergeants, increased City pension contributions, raised health care contributions and lowered cost of living increases. The

contract proposal also called for sergeants to pay an additional 3 percentage points more toward their retirement and would have raised the retirement age by three years, to 53. They now pay 9% of their salaries toward pensions and do not receive Social Security. Annual [we like to say "annual automatic increase" because this is not tied to the cost of living] automatic increases to annuities for current retirees would have dropped from 3 to 2.5% and been frozen every other year until 2019. [The plan for future retirees was more complicated and tied to the funded level of the plan.] For the first time, union members would be required to pay some of their retirement health care costs, at 2%[technically, they would be paying 2% of their retirement annuity, not a percentage of the cost of their retiree health care.]; but the union says they want a fair collective bargaining agreement that is not tied to any type of pension reform. Despite the vote, Mayor Emanuel says he will continue to push for pension reform in Springfield. [You should probably also mention that the deal included a 9% pay increase over 4 years.]

[9] Although units of local government have the authority to levy property taxes, sales taxes, utility taxes, and fees to sustain their operations, they also rely on federal and state aid. According to the Census, in 2008 in Illinois, 66 percent of local governments' revenues came from their own sources (taxes, fees, and miscellaneous charges); 34 percent came from state and federal aid. Roughly 30 percent of local governments' revenues come from the State of Illinois. Local governments' tax revenues come from the property tax (82 percent) and sales taxes (15 percent). "Local Government Fiscal Stress Poses Challenges for Illinois and Vice Versa," Report of the State Budget Crisis Task Force, October, 2012.

[10] Paul Merrion, "Moody's lowers outlook on city's main credit rating," *Crain's*, April 26, 2012.

[11] Ibid.

[12] Ibid.

[13] Ibid.

[14] Ibid.

[15] Right now, no property taxes flow to the Corporate Fund. All go to pay debt service and pension obligations and the Chicago Public Library.

[16] The Chicago Public Schools budget is separate from the City of Chicago budget. CPS has its own taxing and bonding authority.

[17] Sara Burnett, "Chicago School Closings: Gang Boundaries Consulted By District Amid Student Safety Concerns," *Associated Press,* April 15, 2013.

[18] Ibid.

[19] It is important to note the City budget is separate from the Chicago Public Schools; so there is a part of this debt/budget outside the city's direct control—although the city clearly has an overall concern with the fiscal health of the public school system. The Chicago Civic Federation has annual budget analyses for CPS on its very fine website. CPS has its own financial difficulties—particularly pensions.

[20] The district has dedicated about $16.1 million to expand a program known as Safe Passage aimed at assuring that children arrive safely at their new places of study. The program stations adults to stand watch along key routes and alert police of any problems.

[21] Chicago Crime Rating Report, *CityRating.com*

[22] City of Chicago Quarterly Budget Report.

[23] The city's Annual Financial Analysis (linked above) which is also very useful.

[24] These figures do not include proceeds and transfers in or prior year fund balance.

[25] Quarterly Report, op. cit., p. 4.

[26] The City currently makes pension contribution payments to the Municipal pension fund for non-teachers who work for CPS. In FY2011 approximately 52.3% of active Municipal Fund members were CPS employees. The City's approved FY2012 budget included $32.5 million in additional revenues from the pension reimbursement from CPS.

[27] "City Exceeds Yearly Funds Allocated for Police Misconduct Cases," NBC Chicago, March 14, 2013.

[28] Settlement agreement regarding case of Kathleen Paine, as Guardian of Estate of Christina Rose Eilman, a Disabled Person, Plaintiff, vs Sergeant David Berglind, Detention Aide Sharon Stokes, Officer Teresa Williams, Detention Aide Cynthia Hudson, Detention Aide Catonia Quinn, Officer Pamela Smith, and City of Chicago, a Municipal corporation, Defendants, cited as 06 C 3173.

[29] City of Chicago FY2013 Proposed Budget, Chicago Civic Federation, October 31, 2012.

[30] Ibid.

[31] Ibid.

[32] "Chicagoans' Long-Term Debt and Pension Obligations Per Capita Rose 185% Since 2002," Chicago Civic Federation, February 27, 2013.

[33] The Civic Federation Foundation comprehensively describes the components of the long-term debt and pension obligations per capita indicator as follows: the City of Chicago's net direct debt and the City's portion of the local governments' overlapping net direct debt, the City's portion of the Chicago Transit Authority's (CTA) bonded debt and the City's portion of the respective pension funds' unfunded actuarial accrued liabilities (UAAL). UAAL are the amount by which a pension fund's actuarial accrued liability (AAL) exceeds its assets, where the AAL is an estimate of the value of benefits already earned. It is important to note

that the calculations do include other post employment benefits (retiree healthcare) or state and federal long-term obligations. The long-term debt and pension obligations per capita indicator trends are presented for local governments in the Chicago area from FY2002 to FY2011, the ten most recent years for which audited financial data is available. The City's portion of overlapping net direct debt is reported by the City in its financial statements for other major Cook County governments with boundaries coterminous with the City of Chicago or located partially within its boundaries. These governments are: the Chicago Public Schools, Cook County, the Forest Preserve District of Cook County, the Metropolitan Water Reclamation District, the Chicago Park District, City Colleges of Chicago, the former School Finance Authority and the Chicago School Building Improvement Fund[3]. To calculate the long-term debt and pension obligations per capita indicator, the Civic Federation includes the City's portion of unfunded pension liabilities for all these governments, plus the CTA.

[34] Article XIII, §5 of the Illinois Constitution provides that membership in any pension system in the State is an enforceable contractual relationship and that member benefits "shall not be diminished or impaired." It does not require that governments provide a specific level of funding to the pension systems.

[35] There really are two separate kinds of policy problems. For discussion of the two problems separately, see our analysis of the FY2013 City of Chicago budget: http://civicfed.org/CityofChicago_FY13BudgetAnalysis

[36] "Chicagoans Long Term Debt," op. cit.

[37] Yvette Shields, "Moody's Hits Chicago With Multi-Notch Downgrade," *Bond Buyer*, July 18, 2013.

[38] Conversation in Chicago, April 30, 2013,

[39] Oliver Renick, "Emanuel Reaches Deal With Police Union to Fix Pensions," *Bloomberg*, Feb 12, 2013. Under the agreement, sergeants would have paid 1 percentage point more of their salaries into the pension fund annually for three years, pushing their contribution rate to 12 percent from 9 percent now, according to a statement from City Hall. The rate would have declined to 10 percent once the retirement system had 80 percent of the assets needed to cover projected obligations.

[40] Ibid.

[41] Ibid.

[42] Fran Spielman, *Chicago Sun Times*, May 14, 2013.

[43] This number was scheduled to rise to $540 million by 2023, according to the Retiree Healthcare Benefits Commission, http://www.cityofchicago.org/content/dam/city/depts/fin/supp_info/Benefits/RHBC/ReportToMayor/RHBC_Report_to_the_Mayor.pdf.

[44] "Local Government Fiscal Stress Poses Challenge for Illinois and Vice Versa," Report of the State Budget Crisis Task Force, October, 2012.

[45] Ibid., p. 50.

[46] Renn, op. cit.

[47] Report of the State Budget Crisis task Force – Illinois Report. http://www.statebudgetcrisis.org/wpcms/wp-content/images/2012-10-12-Illinois-Report-Final-2.pdf