

Case Study Overview: Chicago

Chicago, after a significant effort to remake itself into a global city today confronts unprecedented challenges. 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 decline different from other large cities. It is a troubled place, one falling behind its large urban brethren and presenting a host of challenges for Mayor Rahm Emanuel. Challenges confronting the city's fiscal future are: schools, which one commentator cited as "almost insoluble;" police—crime—gangs (also "almost insoluble"); infrastructure (on which the mayor has earned very high marks); pensions, where Chicagoans' long-term debt and pension obligations per capita rose 185% since 2002—which are inextricably linked to the state; and bringing jobs back to Chicago. These challenges come as state and federal aid are reduced.

City Snapshot. Chicago is the third most populous city in the U.S. with 2.7 million residents. Mayor Emanuel inherited what some have termed a 'time bomb.' He took office to find a \$635 million operating deficit—which he expects to have eliminated by the end of his term. The demographics are recovering from the previous decade which saw an exodus of 200,000. In the decade, the city lost 7.1% of its jobs. Now, revenues are coming back, but the city faces an exceptional challenge in trying to shape its future. With a current debt level of \$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 (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. On the long-term side, the city confronts significant challenges. Moody's has downgraded Chicago's \$8.2 billion of general obligation and sales tax backed bonds with a three-level downgrade—and warned the city could face further actions absent progress in confronting growing unfunded pension liabilities and a dramatic spike in payments due in 2015. Moody's noted the city's \$36 billion retirement-fund deficit and "unrelenting public safety demands" on the budget: "Absent significant growth in the city's operating revenues, escalating pension funding requirements will increasingly strain the city's operating budget, as pension outlays compete with other spending priorities, including debt service and public safety."

Fiscal Structure. Chicago has one of the largest city councils in the U.S., and yet it lacks the ability to evaluate independently the city's budgetary and long-term fiscal conditions. Last year, Chicago's budget was more than 500 pages, encompassing 35 departments. Aldermen are heavily dependent on the mayor and the mayor's staff for budgetary information.

Fiscal Circumstances. Chicago faced a budget deficit of \$298 million before the approval in November of the 2013 spending plan, which would eliminate the projected gap without raising fees or taxes. 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."¹ 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."² 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 yr. lease; and the December 2008 sale of parking meters (35,000) for \$1.6 billion. Of these funds,

which should have gone into long term investment and to help pay down debt, only \$400 million remains—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. Other issues threaten credit quality especially the city’s ability to negotiate with unions and address pension funding challenges. 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.

Role of the State. Moody’s noted that the Illinois legislature creates political obstacles to retirement system reform at the state level—a position Mayor Emanuel concurred with: noting, “Without comprehensive pension relief from Springfield, municipalities such as Chicago will continue to receive negative reviews from rating agencies.” The Mayor’s office warns that retirement contributions will cost about \$1.2 billion within four years if the state legislature is unable to enact reforms, up from \$476 million last year. Illinois’ Financially Distressed City Law provides that a financially distressed city may receive assistance from the Illinois Finance Authority, so that the city can provide municipal services and maintain obligations to creditors and bondholders, but no city is authorized to file for federal municipal bankruptcy protection without further legislative authorization. The state comptroller’s office Local Government Division was created to fulfill two broad areas of responsibility on behalf of the Illinois Comptroller: to serve as the state’s watchdog on financial status of local governments and to provide assistance to local government in fulfilling mandated fiscal responsibilities to taxpayers.

Analysis. Issues that threaten Chicago’s credit quality include seemingly intractable labor issues, on which, 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 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 companies willingness to come to Chicago. These experiences yield lessons about confronting fiscal challenges:

- **Focus on credit quality threats:** Do not permit a disproportionate percent of the budget to be devoted to long-term pension borrowing obligations instead of critical future investments. 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—investments fundamental to the city’s economic future.
- **Leadership.** Most agree that Mayor Emanuel understands the city’s challenges and has a vision of what Chicago needs to be. Credit-rating agencies have applauded the city’s financial improvements under Mayor 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.”³
- **Investing in the Future.** Chicago has created enterprise funds so that a greater portion of city services are not financed through property taxes and the operating budget. Some 83 percent of its budget is concentrated on schools and public safety. Chicago needs to demonstrate world class public infrastructure, public safety, and a competitive education environment.

¹ Moody’s Affirms Aa3 rating on City of Chicago, April 26, 2012.

² Ibid.

³ Ibid.