THE CIVIC FEDERATION
2008 Legislative Priorities

The Civic Federation is an independent, non-partisan government research organization founded in 1894. The Federation's membership includes business and professional leaders from a wide range of Chicago-area corporations, professional service firms and institutions.

1. PUBLIC EMPLOYEE PENSION REFORM

The Civic Federation strongly supported the Chicago Transit Authority pension and retiree healthcare reforms contained in Public Act 95-0708, signed on January 18, 2008. This landmark legislation was made possible by cooperation between CTA labor and management, who proposed a balanced solution to a dire pension crisis, and the unflagging legislative leadership of Representative Julie Hamos (D-Evanston).

We are encouraged by the passage of this reform legislation and we urge local governments and the General Assembly to pursue further reforms to improve the health of our state and local government pension plans. The five State of Illinois retirement systems have suffered from decades of underfunding and have some of the lowest funded ratios among the fifty states. Many of the local government pension funds in northeastern Illinois have similarly dismal outlooks and rapidly escalating unfunded liabilities. Unfunded liabilities for the ten major local government pension funds in Cook County has reached $18.7 billion, and the unfunded liabilities for the four City of Chicago pension funds alone has surpassed $9.3 billion.

There is no indication that these trends will reverse, or even slow, unless substantial changes are made to the pension plans both in terms of benefits provided and contributions made.
Local governments must take action now to control the downward spiral of pension underfunding. The problems caused by benefit enhancements and employer contribution shortfalls are real, and reliance on investment returns to compensate for actions that increase liabilities or reduce assets is shortsighted. The CTA pension fund experienced a precipitous descent toward insolvency, plunging from 80% funded in 1999 to only 25% funded in 2006. This decline was largely the result of years of underfunding combined with investment losses. Other governments are also experiencing fiscal crises brought on by pension pressures. The City of Springfield expects that it will "face a full-blown crisis in coming years because of police and fire obligations" and may need to cut city services or raise property taxes in order to make its pension contributions.[1] The City of Evanston has proposed a 15% property tax increase for fiscal year 2008-2009 primarily to address police and fire pension unfunded liabilities.[2] The Civic Federation applauds the CTA management and labor unions for taking action on their pension crisis and negotiating a landmark pension reform package. ***We urge other local governments and pension plans to be proactive in seeking similar changes through collective bargaining and/or state legislation***.

We offer the following specific recommendations designed to improve the long-term financial health of the local funds and address the major causes of funding decline that are within the control of the governments:

<u>Prohibit Benefit Enhancements Unless Plan is Over 90% Funded</u>

Benefit enhancements are a major source of increased liabilities for pension funds. In the case of collective bargaining, these enhancements are often granted in exchange for short-term employee concessions on salaries or health insurance. Offering benefit enhancements can seem like an attractive option to employers, since achieving short-term savings on other employee costs usually feels like a more pressing need than controlling long-term liabilities.

However, some local governments have offered benefit enhancements that they simply cannot afford in the long-term. Often these enhancements are written into statute by the General Assembly and Governor despite significant existing unfunded liabilities. The Civic Federation

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recommends that the **General Assembly stop granting any new retirement benefit enhancements for local governments unless their pension funds are over 90% funded**. The Federation believes that 90% is a healthy level of funding for a public pension fund.[3] Pension funds that are struggling with unfunded liabilities on current benefits should not be permitted to exacerbate the situation by granting greater benefits. The Pension Protection Act of 2006 changed the federal laws that govern private sector pension funds, requiring private plans to meet a 100% funding target, up from 90% previously under the Employee Retirement Income Security Act (ERISA). Plans that are less than 100% funded must make payments amortizing their unfunded liability over seven years. Plans that are less than 80% funded are considered "at-risk," and must make additional contributions to boost their funded ratio.[4]

Link Benefit Enhancements for Healthy Funds to Full Funding of Enhancements

The Civic Federation believes that **healthy local pension funds (over 90% funded) should be permitted to grant benefit enhancements only if employer and/or employee contributions are increased sufficiently to fully fund the benefit enhancements**. Under this pay-as-you-go system, the enhancements would not be permitted to erode the overall health of the fund.

Public Act 94-0004, Illinois' 2005 pension reform law, requires that every new benefit increase made to one of the five state retirement systems must identify and provide for additional funding to fund the resulting annual accrued cost of the increase. The Act also requires that any benefit increase **expire after five years**, subject to renewal. The Civic Federation supports extending this reasonable control on benefit enhancements to the local public pension funds through a change in the state statutes governing these funds.

Reduce Benefits for New Employees

Once granted, benefit enhancements cannot be diminished, according to the Constitution of the State of Illinois.[5] The only way for an employer to reduce liabilities by reducing retirement benefits is to reduce those benefits for new employees. This is commonly called a "two-tiered" system, where new and existing employees are promised different retirement benefits. The New York State and Local Retirement System has four different tiers depending on an employee's hiring date and occupation.[6]

By scaling back on retirement benefits for new hires, governments can undo some of the damage done by excessive benefit enhancements granted in the past. For example, an arbitration award reduced benefits for CTA employees hired after September 5, 2001 by setting an age minimum for the early retirement option and by eliminating a hospitalization supplement for retirees.[7] The pension reform package contained in Public Act 95-0708 also reduces certain benefits for new hires. The Civic Federation urges other local governments to consider similar ways to **reduce benefits for new hires**, thus reducing liabilities on pension plans that have become unaffordable. Reducing benefits for new hires is particularly imperative for pension funds with funded ratios well below 90%. Examples of benefit reductions include: **raising retirement age**, **increasing years of service required for full benefits**, **reducing the maximum annuity**, and **reducing the benefit formula**.[8]

Limit Annuity Increases for New Hires at the Lesser of 3% or CPI

One reasonable way to curb retirement costs would be to limit annuitants' annual automatic cost of living increases to the lesser of 3% or the annual increase in the Consumer Price Index. For example, Cook County pension fund beneficiaries receive 3% annual cost of living increases.[9] However, this rate has often exceeded the rate of inflation. To control costs, **annual annuity increases for new hires should be fixed at the equivalent of the projected Consumer Price Index or 3%, whichever is less**.

<u>Require Employer Contributions to Relate to Funding Levels</u>

The basic employer contributions for eight of the ten local funds analyzed here are simply a multiple of past employee contributions, with no relationship to the funding status of the plan. Only the Teachers' fund has a trigger that requires additional contributions when the funded ratio drops below 90%; this is a good provision to ensure that contributions do not fall hopelessly behind when funded ratios begin declining. **The Civic Federation recommends that employer contributions for all funds be tied to funded ratios, such that additional contributions are required when the ratio drops below 90%.** For those funds that are already well below 90%, a plan should be developed to gradually increase contributions until the 90% level is reached. This would entail devoting a greater portion of the property tax levy to pensions for those plans that are supported by a property tax, or seeking legislative authority for the use of general revenues or an alternative revenue source.

In addition, **all local pension funds should consider adopting the funding model of the Illinois Municipal Retirement Fund, which requires employer contributions to be funded at levels consistent with the actuarially required contribution (ARC)**, rather than a multiple of employee contributions made two years prior. **At a minimum, the multiple should be adjusted at regular intervals of three to five years to reflect the actuarially determined funding needs of the plan.**

<u>Reform Pension Boards of Trustees to Balance Stakeholder Interests, Safeguard Assets</u>

Achieving serious reforms that can have a real impact on the health of local pension funds will require a strong and unwavering commitment on the part of local governments. It will also require that their efforts not be thwarted by the trustees of the pension funds. The mission of a public pension fund board of trustees should be to safeguard the fund's assets through prudent investments and effective management. Unfortunately, some local pension boards also act as advocates on behalf of fund members, lobbying for benefit enhancements that ultimately increase the funds' liabilities. For example, the Chicago Teachers' Pension Fund FY2006 Annual Report lists the Fund's legislative agenda, including benefit enhancements, and states that "The Trustees and Fund administrators will continue to work diligently to represent the interests of the members through further accomplishment of the Trustees' legislative agenda. The Board, in conjunction with the Fund's consultants, continues to work in Springfield toward maintaining the financial stability of the Fund and improving benefits for the members."[10]

As outlined in the Civic Federation's *Recommendations to Reform Pension Boards of Trustees Composition in Illinois,* the Federation believes that a pension board should not function as an advocate for the interests of one stakeholder, especially when advocating those interests creates increased liabilities for the fund.[11] Rather, the trustees should focus on conserving and increasing the fund's assets to ensure that sufficient amounts are available to pay promised benefits when they come due. Although not all pension boards produce results favoring one stakeholder over another, board composition is an indicator of whose interests are most likely to be represented by the board's actions. Unfortunately, the membership of most Illinois public pension boards does not reflect a balance of interests. On the boards of the ten local funds surveyed here, either half or a majority of trustees are active employees or retirees.

In our view, a pension board of trustees should:

- Balance employee and management representation so that employees and retirees do not hold the majority of seats;
- Develop a tripartite structure that includes independent citizen representation on pension boards; and
- Include financial experts on pension boards and require financial training for non-experts.

We commend Representative Elaine Nekritz (D-Des Plaines)for introducing these reforms in House Bill 3400 in February 2007, and we ask the General Assembly to consider them. **We urge all local governments to seek legislative reform of their pension boards' governance structure in order to ensure greater balance of interests and ensure that trustees focus on their mission of safeguarding assets, not increasing liabilities.**

Require CTA Pension Fund to Report to the Illinois Department of Financial and Professional Regulation

Illinois statute requires that local government pension funds provide annual financial statements to the Illinois Department of Financial and Professional Regulation's Division of Insurance. These statements must include actuarial statements and must be filed no later than nine months after the close of the pension fund's fiscal year. The CTA, however, is exempt from these requirements.

Public Act 95-0708 takes the important step of requiring additional oversight of the CTA pension fund by the Auditor General. However, it would facilitate comparison with other state and local pension funds if the CTA fund were included in the biennial report produced by the Division of Insurance. Therefore, the Civic Federation believes that the **General Assembly should remove the exemption for the CTA pension fund and require it to report to the Division of Insurance as do other local pension funds.** Information on the CTA pension fund would then be included in the Division's biennial report alongside that of other state and local pension funds.

2. TAX INCREMENT FINANCING REPORTING REFORM

The Civic Federation **supports** the use of **tax increment financing (TIF)** as a municipal economic development tool. It is an important tool that has generated significant economic development benefits for Illinois municipalities and citizens over time. However, we believe that there is insufficient **transparency** in the availability and quality of TIF information provided to the public. We strongly support enhanced state and local reporting requirements to improve the provision of TIF information available to citizens and policymakers. We urge lawmakers to consider the following TIF reporting reforms:

1. Full financial information about TIF districts, including expenses, revenues, fund balance and debt, should be included in annual county municipal budgets.

2. Each TIF district should be required to undertake a status report ten years after its inception. The report would be presented and discussed at a public hearing and made publicly available. It would include information on the status of redevelopment projects within the TIF, a review of redevelopment plan goals and objectives, an accounting of TIF revenues and expenditures to date, and relevant evaluation or performance data such as return on investment reports for projects.

3. The State of Illinois should require information about TIF districts and TIF projects be made readily available electronically online. The information should be provided in the same electronic format that is required for local governments under the State of Illinois Fiscal Responsibility Report Card Act. (Currently, reports required by the Office of the State Comptroller are only available in printed form

4. Counties and municipalities with TIF districts should make complete information about TIF districts and TIF projects readily available electronically on the internet in a consistent and easily accessed format. This would include annual financial reports and redevelopment agreements.

3. CREATION OF A SEPARATE BOARD OF COMMISSIONERS FOR THE COOK COUNTY FOREST PRESERVE DISTRICT

The Civic Federation supports the creation of a separate elected Board of Commissioners to govern the Forest Preserve District of Cook County. Due to an inherent **conflict of interest** and an organizational structure that does not permit for **proper oversight**, the District is suffering from many problems that could be prevented by creating a separate governing body.

The County's interest in promoting economic development conflicts with the District's mission to preserve natural land, regardless of the economic benefits that could result from its sale. Actions of the Commissioners have illustrated the fact that Commissioners are placed in an irreconcilable position, and sometimes decide to give preference to County needs over forest preserve needs.

The current Cook County Board of Commissioners spends much more time on pressing County issues than on the needs of the Forest Preserve District. The Civic Federation believes that a separate Board for the Forest Preserve District would dedicate more time forest preserve issues, exercise greater financial oversight may have been exercised, pay more attention to the maintenance and acquisition of land, and prevent private encroachments on forest preserve land.

The Civic Federation urges the General Assembly to pass legislation creating a separate elected Board of Commissioners for the Forest Preserve District of Cook County to better serve the needs of the forest preserves and the residents of Cook County. The new board should be **non-partisan** and **elected by districts**. Board members should not be paid for their services, and given the entirely separate management structure already in place within the District, new staff will not be necessary. The board **president should be elected among and by the members of the forest preserve board**.

4. SCHOOL FINANCIAL MANAGEMENT ACCOUNTABILITY REFORMS

In March 2007, The Civic Federation reviewed Illinois school district financial management and accountability oversight structures and procedures for the Accountable Schools Task Force of the Metropolitan Mayors Caucus. The Federation's report also identified best practices and recommended practices in financial management and accountability from national organizations and governments across the nation. In addition, the Civic Federation offered several policy recommendations regarding steps Illinois should take to ensure greater financial accountability from its school districts by adopting features of the best practices and recommended practices that are most applicable to the financial management of school districts.

Many of these recommendations were included in House Bill 4194 introduced by Rep. Lou Lang (D-Skokie) in December 2007. The Civic Federation has not taken a position on the casino expansion proposed in HB 4194. However, we strongly support the following school financial management accountability reforms:

Budgeting

a) Budget Format

Executive Summary: Require a "plain English" executive summary of the budget that includes:

1. School district major goals and objectives
2. A discussion of major financial factors and tends affecting the budget such as changes in revenues, enrollment, debt

3. A description of the budget process
4. An overview of revenues and expenditures for all funds
5. An explanation of significant financial and demographic trends
6. Budget forecast for 3-5 years in the future
7. Student enrollment trends, including a future forecast
8. The number of personnel by type as well as a discussion of personnel changes
9. Changes in debt burden
10. Relevant performance statistics

Full Budget

1. An organizational chart
2. Formal Financial Policies
3. Long Term Financial Plan or a summary of the LTFP
4. Capital Improvement Plan or a summary of the CIP

b) Evaluation

1. Require performance measures for support service functions and programs such as facilities management, food service, administration, etc)

c) Disclosure

1. The Executive Summary should be made publicly available on the Web
2. At least ten working days should be allowed for public review of the budget prior to the public hearing
3. The Board should be provided with monthly financial reports that summarize financial operations and financial condition in an easy to understand format

Internal Controls

1. Create a Strong Internal Auditor Function
2. Implement more rigorous External Audit Requirements
3. Require School District Audit Committees
4. ISBE should develop a comprehensive set of internal procedures for adoption by school districts
5. School Districts should submit formal, written internal control policies to ISBE.

Planning Formal Financial Policies, Long Term Financial Planning, Capital Improvement Plan

a) Formal Financial Policies.

1. School district should be required to adopt formal financial policies in the following policy areas:
   - Debt Capacity, Issuance, and Management
   - Capital Asset Management
   - Reserve or Stabilization Funds
   - Requiring Periodic Budget to Actual Comparison Reports
   - Fees and Charges
   - The Use of One-Time Revenues
   - Risk Management
   - Purchasing
   - Vehicle Acquisition and Maintenance
2. Require Formal Approval of the Financial Policies by School District Board of Trustees
3. Make the Formal Financial Policies Publicly Available in Budgets and Other Documents

b) Long Term Financial Planning.

1. Develop a formal long term financial plan that is updated annually.
2. Include multi-year forecasts of revenues, expenditures and debt in the LTFP. The forecasts should extend over at least a three year period.
3. Make the long term financial plan publicly available by publishing it in the budget or as a separate document and on the government's Web site. The forecasts that are the foundation of the plan should be available to participants in the budget process before budgetary decisions are made.
4. Provide opportunities for stakeholder input into long term financial planning process.
5. Require annual formal approval of the LTFP by School District Board of Trustees.

c) **Capital Improvement Plan (CIP).**

1. Develop a Formal Five Year Capital Improvement Plan that is updated annually.
2. Require that Capital Improvement Plans include:
   - A five year summary list of projects and expenditures per project as well as funding sources per project
   - Information about the impact of capital spending on the annual operating budget for each project.
   - Brief narrative descriptions of individual projects, including the purpose, need, history, and current status of each project.
   - The time frame for fulfilling capital projects and priorities.
3. Require that Capital Improvement Plans be made available on the school district's Web site at least ten working days prior to a public hearing.
4. Each School District should hold a public hearing on the Capital Improvement Plan with opportunities for citizens to present commentary.
5. School district Capital Improvement Plans should be formally adopted by School Boards of Trustees.

Financial Management Training for School Board Members (This has been amended to eliminate mandatory training)

1. The State of Illinois should require all school board members complete at least six hours of training on their financial oversight, accountability, and fiduciary responsibilities.
2. The training must be completed within a year of their election and could be provided by a Illinois State Board of Education approved trainer.

Financial Management Accountability Oversight

1. An Office of State School District Financial Management Accountability within the Illinois State Board of Education should be created to monitor progress made by school districts in meeting the statutory requirements of approved reforms.
2. School districts failing to meet approved financial management reform standards within a reasonable, specified timetable would be placed under the direct oversight of the Office of State School District Financial Management Accountability.
3. School districts placed under state supervision would be required to develop a 3-year improvement plan to meet the reform standards.
4. ISBE would withhold funds from school districts failing to fulfill State financial management accountability requirements and would be empowered to remove and replace non-complying financial management administrators.

5. PROPERTY TAX ASSESSMENT APPEALS

The Civic Federation continues to support changes to the process of property tax assessment appeals. The process must balance the financial stability of Cook County taxing agencies with the rights of taxpayers to seek redress from inaccurate property tax assessments. To achieve that necessary balance, and to improve the functioning of the Property Tax Appeal Board (PTAB) as an administrative review agency, the Civic Federation recommends a number of procedural changes at the PTAB to streamline the agency and relieve the backlog of cases. A bifurcated system should be created in which larger cases are subject to different requirements including formal case management and discovery procedures. The Civic Federation does not support giving all taxing districts affected by an appeal the unconditional right to intervention and the same status as the named defendant, since this would undermine the role of the Cook County State's Attorney in defending the County's assessments. In addition, taxing agencies should be authorized to file a supplemental levy to recoup funds withheld from their current year property tax extensions to pay for previous year's refund orders. Under current practice, certain taxing agencies are forced to forego legally extended property tax revenue even though they are not responsible for incorrect assessments. While certain other agencies (such as home rule bodies) may be unaffected by this as a practical matter, the capacity to realize lawful extensions after correction of erroneous assessments should be secured as consistently and predictably as possible throughout the entire tax system.

6. REQUIRE LARGE COUNTIES TO PRODUCE TIMELY ANNUAL AUDITS

State law requires counties with a population over 10,000 but under 500,000 to produce a audited financial statements within six months of the close of the fiscal year and submit a financial report to the State Comptroller (55 ILCS 5/6-31003). The state's four largest counties, Cook, DuPage, Lake, and Will, are effectively exempted from these audit requirements. ***The Civic Federation urges the General Assembly to amend 55 ILCS 5/6-31003 so as to eliminate this exemption.*** There is no sound public policy reason for exempting large counties from producing timely annual audits and submitting financial reports to the State Comptroller.

7. AUTHORIZE STATE AND LOCAL GOVERNMENT ENTITIES TO ESTABLISH TRUST FUNDS FOR THE ADVANCE FUNDING OF RETIREE HEALTH CARE

The Governmental Accounting Standards Board Statement 45 will require large state and local governments to report liabilities for Other Post Employment Benefits (OPEB), namely retiree health insurance, beginning with their fiscal year 2008 financial statements. Although most governments and pension plans currently fund OPEB on a pay-as-you-go basis, the substantial size of the liabilities reported may lead some to establish trust funds in order to pre-fund their obligations.

The Civic Federation was pleased to support the Metropolitan Water Reclamation District's proposal to establish a trust fund for retiree health care. Public Act 95-0394, signed by the Governor in August 2007, created such a fund for the District. The Civic Federation urges the General Assembly to pass legislation ***enabling other entities to create irrevocable trusts for the prudent pre-funding of retiree health insurance obligations***.

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[1] Chris Wetterich, "Davlin forecasts full-blown fiscal crisis: Tax hikes possible in coming years because of pensions," *State Journal-Register,* December 4, 2007.
[2] Bob Seidenberg, "Budget proposes 15% tax hike," *Evanston Review*, January 3, 2008.
[3] The federal target for private sector pension funds under the Employee Retirement Income Security Act was 90% until the Pension Protection Act of 2006 raised the target to 100%.
[4] House Committee on Education & the Workforce, "Bill Summary – Pension Protection Act (H.R. 2830): Strengthening Retirement Security, Protecting Taxpayers by Fixing Outdated Worker Pension Laws" (March 8, 2006) http://www.house.gov/ed_workforce/issues/109th/workforce/pension/ppasummarylong.htm . See also

Deloitte, "Securing Retirement: An Overview of the Pension Protection Act of 2006," (August 3, 2006) http://www.deloitte.com/dtt/cda/doc/content/us_gre_securingretirement_310806.pdf .

[5] In Illinois, as in many states, pension benefits granted to public employees are guaranteed by the State Constitution. *Constitution of the State of Illinois, Article XIII Section 5.*

[6] See http://osc.state.ny.us/retire/members/find_your_tier.htm.

[7] For employees hired before September 5, 2001, early retirement is available after 25 years of service; for employees hired after September 5, 2001, early retirement is available after 25 years of service and attainment of age 55. Similarly, employees hired after September 5, 2001 do not receive the hospitalization supplement paid for by the Plan upon retirement. See the plan text, available at http://www.ctapension.com/about/PlanDocument.asp.

[8] A typical benefit formula is *years of service* X *a percentage of final average salary* = *annuity*.

[9] Cook County Employees' Annuity and Benefit Fund *Actuarial Valuation as of December 31, 2006*, p. 25. The CTA retirement fund does not have an automatic annual increase, but periodically grants ad hoc dollar amount annuity increases through collective bargaining.

[10] The Chicago Teachers' Pension Fund 2006 *111th Comprehensive Annual Financial Report*. p. 12.

[11] The Civic Federation, *Recommendations to Reform Pension Boards of Trustees Composition in Illinois,* (Chicago, IL) February 2006.