STATEMENT MADE AT THE PUBLIC HEARING ON THE PROPOSED FY2003 CITY OF CHICAGO BUDGET, NOVEMBER 6, 2002

The Civic Federation would like to thank Mayor Daley and members of the City Council for this opportunity to comment on the proposed FY2003 budget. We would also like to commend the City's Budget and Finance staffs for their hard work and effort in preparing this budget.

As a government tax and fiscal research organization, the Civic Federation has closely monitored and commented on the fiscal health of local area governments since 1894 and greatly appreciate the cooperation we have received from both the Mayor's and Council staff.

OVERVIEW OF TESTIMONY

The Civic Federation recently concluded an analysis of financial issues related to the City of Chicago's proposed FY2003 budget. Based upon that review and a consideration of some key issues that we believe will have an impact in the future upon the City's long-term financial condition, we would like to offer the following comments. The full text of our analysis follows this summary and is also available on our Web site at www.civicfederation.org. The analysis includes sections on FY2003 Budget Highlights, Financial Issues and Trends, Budget Management and Process Improvements and Civic Federation Concerns and Recommendations.

The Civic Federation commends Mayor Daley and the City of Chicago for avoiding any broad based tax increases in its $4.7 billion FY2003 budget. It is our contention that any major tax increases could exacerbate an already fragile economic situation and negatively impact on the City's business climate. In our view, City budget officials have taken a fair and balanced approach in addressing the current $116 million budget deficit. As a result, the Federation supports the proposed use of $10 million in fee and fine increases, $30 million in increased revenue collections, the elimination of 200 positions and 1000 vacancies, the consolidation of the Departments of Water and Sewers, and other measures. We think it especially important to recognize Mayor Daley's leadership and willingness to make the painful personnel reductions that are necessary to ensure the continued fiscal health and stability of the City.

While we endorse the actions taken in the FY2003 budget, The Civic Federation does have several concerns regarding the City's financial position. Based on our analysis of the budget, audited financial reports and a review of best practices in budgeting, The Civic Federation offers the following policy recommendations and notes several issues that could impact City finances in the long-term.

Because of the likelihood that Chicago will endure more bad fiscal news during FY2003, it is imperative that the City be prepared to implement measures that can generate additional budgetary savings and improve its financial management capabilities. Along these lines, we are pleased that the City's financial management team is actively working with Civic Federation staff and other local governments in pursuit of joint purchasing of employee prescription drugs. Hopefully, in the near future, the group will finalize an agreement for the joint purchasing of health insurance. A recent Civic Federation study found that forming such an agreement consisting of the employees of the City of Chicago, Cook County, Chicago Park District, Chicago Transit Authority, the City Colleges of Chicago, the Chicago Public Schools and the Chicago Housing Authority could yield projected taxpayer savings of $40.1 million.[1]

Looking to the future, The Civic Federation remains very supportive of the proposal to privatize interested the Chicago Skyway. The City of Chicago has long been a national leader in the implementation of innovative and cost effective privatization strategies and we urge serious consideration of such a proposal that should provide both an immediate revenue enhancement and significantly reduce long-term operating and maintenance obligations.

At this time, the Civic Federation would also like to comment upon three issues that could have a negative impact on the City's financial condition in the near future: a low Corporate Fund balance, declining income from pension fund investments; and the continued large increases in long-term debt burden in recent years.

First, The Civic Federation is concerned that the $27.4 million Corporate Fund balance proposed for FY03 may not be sufficient for unbudgeted and unexpected contingencies. Although we recognize the severe pressure on City revenues, we caution that the $27.4 million fund balance is 15% smaller than FY2002 and 75% less than 1998. The rapid decline in the Corporate fund balance from $177 million in 1998 buttresses the need for the City to establish a more formal budget reserve policy to ensure that funds are available to address emergency situations.

Another area of potential financial concern is the continuing decline in City pension funds. Although mainly the result of the stock market's meteoric fall, the City's pension liabilities are also mounting as a result of increased benefits mandated by recent state statutory changes. While strong stock markets allowed the City to limit its contributions to the pension funds for many years, the average rate of return for all City pension funds has fallen from 19.1% in 1997 to -3.5% in FY01. With each of the City's four funds losing money between FY00 and FY01, continued investment losses and new benefit requirements will exacerbate unfunded pension fund liabilities and potentially force a tax increase to maintain a healthy asset to liability ratio.

Finally, long-term debt per capita rose substantially by 65% between FY97 and FY01. This large increase in long-term debt bears watching as a potential cause of concern. While we are confident the City can meet its current obligations, the City must carefully consider any future increases in its long-term debt burden given the current recessionary environment.

[1] The Civic Federation. *Feasibility Study of Consolidated Purchasing: Chicago Public Employers*. A Study Conducted by the Segal Company. February 23, 2001.

FY2003 BUDGET HIGHLIGHTS

The City of Chicago's $4.7 billion FY2003 budget is balanced through a combination of revenue enhancements, expenditure reductions and reengineering techniques.

Measures proposed to close the projected $116 million budget gap include:

- The layoff of 200 employees and elimination of approximately 1000 vacancies. This effort should yield $15 million in savings. At least half of the layoffs will be of managers making over $75,000 per year.
- The current hiring freeze and cutbacks in overtime will be sustained. The overtime reductions should save $15 million, while the hiring freeze will save an additional $15 million.
- $21 million in non-personnel actions
- $15 million from the City's Street Furniture Contract financing
- $11 million saved from the City's Sales Tax Bond Refinancing
- $9 million saved in a Leaseback arrangement involving the Orange Line
- $5 million saved from a Waste Disposal Charge reduction
- $4 million in Parking Ticket Boot revisions

The City is also proposing several additional expenditure reductions and revenue enhancements:

- Increased fine collections of approximately $30 million (from $146.9 million to $173.4 million).
- $10 million in fee and fine increases for selected activities including valet parking, billboard and sign permits, parking meters in the Central Business District, commercial driveway permits, environmental fines and permits, rabies observation fees, Maxwell Street market permits, false alarm fees, a convenience fee for Internet bill payments, etc.
- Merging the Departments of Water and Sewers, a reorganization effort that should net the City $7 million per year
- Combining the financial and administrative functions of several departments.

FINANCIAL ISSUES AND TRENDS

This section provides summaries of key expenditure and revenue issues and trends likely to impact the City's financial situation in the forthcoming fiscal year.

All Fund Appropriations: 2.5% Increase Between FY02 and FY03

The FY2003 budget proposes a net appropriation of $4.7 billion. This is an increase of 2.5% or approximately $115 million from FY2002. Between FY99 and FY2003, net appropriations could increase by 17%. The two largest increases came in the Special Revenue and Debt Service Funds, each projected to increased by 24% over the 5-year period.

CITY OF CHICAGO APPROPRIATIONS ALL FUNDS: FY99 & FY03 (In Millions of Dollars)			
	1999 Approp.	2003Rec	% Change
CORPORATE FUND	$ 2,294.1	$ 2,549.8	11%
SPECIAL REVENUE FUNDS	$ 336.6	$ 416.2	24%
PENSION FUNDS	$ 322.1	$ 351.0	9%
DEBT SERVICE FUNDS	$ 423.0	$ 523.7	24%
ENTERPRISE FUNDS	$ 1,068.1	$ 1,264.0	18%
TOTAL RESOURCES	**$ 4,443.9**	**$ 5,104.7**	**15%**
LESS PROCEEDS OF DEBT	$ 196.9	$ 135.4	
LESS INTERNAL TRANSFER	$ 206.9	$ 250.6	21%
NET APPROPRIATION	**$ 4,040.1**	**$ 4,718.7**	**17%**

Source: City of Chicago Revenue Estimates: FY00 & FY93

The next exhibit provides a 5-year summary of appropriations by program area for FY1999 and the proposed FY2003 budget. The largest single increase was in the Transportation category, which experienced an 88% increase in appropriations, from $249 million to $469 million. Much of this increase occurred because of grant-funded costs for major infrastructure improvements, such as the Wacker Drive reconstruction and Illinois First capital programs within the City.

CITY OF CHICAGO APPROPRIATIONS BY PROGRAM AREA: FY99 & FY03			
	1999 Approp.	2003Rec	% Change
FINANCE AND ADMINISTRATION	$ 365,936,341	$ 393,824,817	8%
LEGISLATIVE AND ELECTIONS	$ 34,842,400	$ 37,266,228	7%
CITY DEVELOPMENT	$ 251,712,571	$ 261,462,447	4%
COMMUNITY SERVICES	$ 464,459,530	$ 558,682,867	20%
PUBLIC SAFETY	$ 1,357,376,420	$ 1,554,331,993	15%
REGULATORY	$ 63,024,709	$ 100,631,490	60%
STREETS AND SANITATION	$ 323,876,497	$ 361,380,084	12%
TRANSPORTATION	$ 249,274,960	$ 469,859,721	88%
PUBLIC SERVICES ENTERPRISES	$ 537,157,781	$ 617,539,855	15%
GENERAL FINANCING REQUIREMENTS	$ 1,713,651,995	$ 1,963,305,756	15%
GRAND TOTAL	**$ 5,361,313,204**	**$ 6,318,285,258**	**18%**
DEDUCT:			
PROCEEDS AND REIMBURSEMENTS	$ 403,914,000	$ 386,042,000	-4%
GRANT FUNDS	$ 833,053,264	$ 1,213,589,577	46%
GRAND TOTAL	**$ 4,124,345,940**	**$ 4,718,653,481**	**14%**

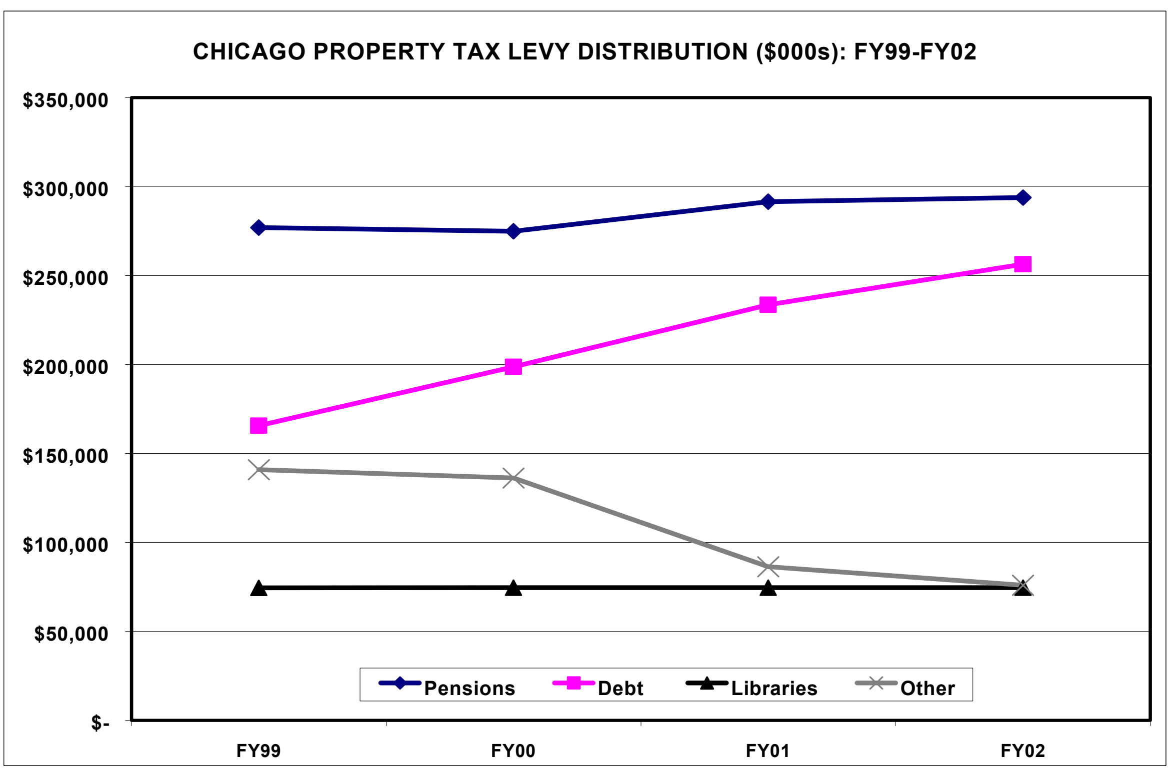
Source: City of Chicago FY99 and FY03 Program & Budget Summaries

Property Tax Levy: 2% Increase to $713.5 Million from FY02

The City's property tax levy is expected to rise by 2% between FY02 and FY03, from $700.6 million to $713.5 million. This rate of increase is well within the rate of inflation and the City's self-imposed tax extension limitation. Since FY99, the levy has risen by 8%.

Property tax revenues are distributed primarily to four major programs: pensions, debt service, libraries and the corporate fund. In FY03, $291.8 million, or 41% of the total levy, will be used for pensions. 37% of the levy, or $267.3 million will be earmarked for debt service. Finally, $74.4 million will be used to fund the City's libraries and $67.7 million returned to the Corporate Fund for general governmental purposes. Pensions and libraries will experience slight decreases in the amount of property tax revenues they receive while debt service will receive a 4% increase in funding. The amount of property tax revenues earmarked for the Corporate Fund is projected to increase substantially, by $14.4 million, or 27%.

Change in the distribution of property tax revenues between FY99 and FY03 is shown below. The percentage of property tax revenues used to pay debt service rose by 61% between FY99 and FY03, reflecting increases in the City's growing long-term debt burden. The share of the levy earmarked for debt service is expected to increase from 25% of the total in FY99 to almost 38% of the total five years later. The portion of the levy used to pay for City pensions, remained relatively constant at 42% of the total. The "Other" category includes funding for the Corporate Fund and City Relief. City Relief, which is used to reimburse the State of Illinois for certain public aid programs, will be phased out by 2007 as a result of General Assembly action.



Corporate Fund Revenues: $97 Million, 4% Increase Projected for FY2003

The Corporate Fund is the City's general fund, supporting a wide variety of services including public safety, public health and sanitation, and transportation. In FY03, the City projects a 4% $97 million increase in Corporate Fund revenues.

Revenue estimates for taxes are appropriately conservative, reflecting the continued economic downturn. Overall, the City is projecting just a 1% increase in own source (local) and intergovernmental tax revenues.

Revenues from non-tax revenue sources are expected to rise by 9% in FY03. This reflects in part the City's increase in certain fees and more aggressive efforts to enforce the collection of fees and fines.

CHICAGO CORPORATE FUND REVENUES: 2002 and 2003
(In Millions of Dollars)

Tax Revenue	2002 Yr End Est	2003 Proj	% Change
Utility Tax & Franchise Fees	$ 435.6	$ 451.9	4%
Sales Taxes	$ 406.2	$ 402.9	-1%
Income Taxes	$ 183.5	$ 180.3	-2%
Transaction Taxes	$ 212.7	$ 210.3	-1%
Tranportation Taxes	$ 131.2	$ 134.0	2%
Recreation Taxes	$ 86.2	$ 87.2	1%
Business Taxes	$ 60.7	$ 61.1	1%
Total Tax Revenue	**$ 1,516.1**	**$ 1,527.7**	1%
Non-Tax Revenue			
Proceeds & Transfers In	$ 183.2	$ 218.8	19%
Internal Service Earnings	$ 303.6	$ 290.3	-4%
Fines & Forfeitures	$ 167.7	$ 175.1	4%
Licenses & Permits	$ 85.0	$ 91.2	7%
Current Service Charges	$ 67.1	$ 71.6	7%
Municipal Utilities	$ 20.5	$ 25.1	22%
Leases,Rentals & Sales	$ 17.5	$ 35.5	103%
Reimbursement,Interest,Other	$ 64.6	$ 87.2	35%
Total Non-Tax Revenue	**$ 909.2**	**$ 994.8**	9%
TOTAL CORPORATE REVENUE	**$ 2,425.3**	**$ 2,522.5**	**4%**

Source: City of Chicago 2003 Revenue Estimates

Corporate Fund Balance Projected to be 1% of Corporate Fund Revenues

The City is projecting a Corporate Fund balance of $27.4 million for FY03. This represents just 1% of projected Corporate Fund revenues of $2.5 billion.

Unreserved Corporate Fund balances are projected to decline by 83% between FY97 and FY03, from $164 million to $27.4 million.[2] This is a decline of $4.9 million from FY02. In those same years, the unreserved fund balance in the Corporate Fund as a percentage of Corporate Fund revenues fell from 8% to 1%.

CHICAGO CORPORATE FUND BALANCE			
Fiscal Year	**Fund Balance**	**Expenditures**	**Ratio**
FY1997	$ 164,440,000	$ 2,078,539,000	8%
FY1998	$ 177,254,000	$ 2,167,894,000	8%
FY1999	$ 108,107,000	$ 2,288,518,000	5%
FY2000	$ 80,653,000	$ 2,380,310,000	3%
FY2001	$ 33,241,000	$ 2,440,426,000	1%
FY2002 Proj.	$ 32,396,000	$ 2,527,642,000	1%
FY2003 Proj.	$ 27,439,000	$ 2,522,500,000	1%

Personnel: Personal Service Appropriations and the Number of Budgeted Positions

Corporate Fund personal service appropriations are projected to rise by 3% in FY03 from the previous year. This is an increase from $2 billion to approximately $2.1 billion. Personal service appropriations will consume 83.1% of the entire Corporate Fund budget. Since FY99, personal service appropriations in the Corporate Fund rose by 11%, from $1.9 billion to $2.1 billion. The percentage of Corporate Fund appropriations earmarked for personal services increased from 79.5% to 83.1% during that period.

The exhibit below shows the number of positions budgeted in FY99 and FY03 by program area. The number of budgeted positions has fallen over this five-year time period by 3%. This represents a decrease of 1,284 positions. Approximately 54% of all budgeted positions in the proposed FY03 budget are in the Public Safety area, followed by 11% in the Public Service Enterprises, which include the new Department of Water Management and the city's airports.

[2] See City of Chicago *Comprehensive Annual Financial Reports*, FY97-FY01.

CITY OF CHICAGO POSITIONS BUDGETED (FTEs): FY99 & FY03			
PROGRAM AREA	**1998**	**2002**	**% CHANGE**
FINANCE AND ADMINISTRATION	3,382	3,247	-4%
LEGISLATIVE AND ELECTIONS	395	382	-3%
CITY DEVELOPMENT	803	688	-14%
COMMUNITY SERVICES	4,133	4,106	-1%
PUBLIC SAFETY	23,230	22,814	-2%
REGULATORY	930	987	6%
STREETS AND SANITATION	3,966	3,890	-2%
TRANSPORTATION	1,344	1,212	-10%
PUBLIC SERVICE ENTERPRISES	5,274	4,847	-8%
GRAND TOTAL	**43,457**	**42,173**	**-3%**

Source: Chicago Program and Budget Summaries: FY99 and FY03

Debt Trends

The Civic Federation has employed two measures of debt for purposes of this analysis: short-term debt trends and long-term debt per capita trends.

Short-Term Debt Trends

Short-term debt is a financial obligation that must be satisfied within one year. An increasing trend in short-term debt may be a warning sign of future financial difficulties. It is a measure of budgetary solvency, that is, a government's ability to generate enough revenue over the course of a normal budgetary period to meet its expenditures and prevent deficits

Short-term debt in the General and Special Revenue Funds includes obligations such as accounts payable, contracts payable, deposits, interest payable, interest, due to other funds, and liabilities from restricted assets. In sum, it includes all liabilities except accrued salaries and wages, accrued payroll, compensated absences and long-term debt.

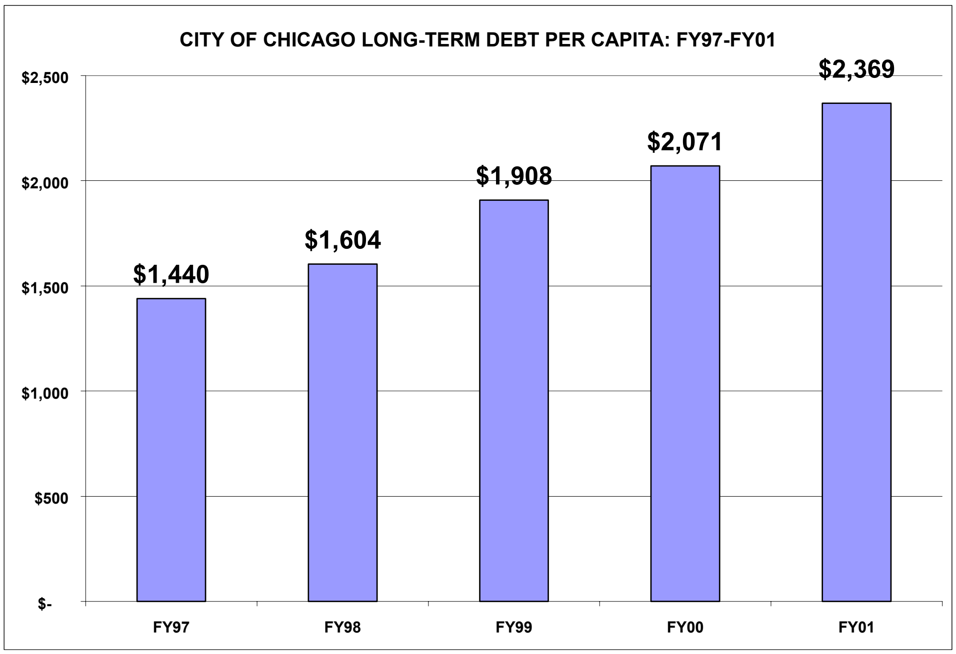
Since FY97, short-term debt rose by 45%, from \$1.1 billion to \$1.6 billion. The largest single increase came in FY00, when short-term debt rose by 21%. However, in FY01, the rate of growth fell dramatically, to 3.6%. This leveling-off in the rate of increase is an encouraging sign.

Fiscal Year	Total Short-Term Debt		% Annual Increase
1997	$	1,147,439,000	…….
1998	$	1,184,048,000	3.2%
1999	$	1,323,950,000	11.8%
2000	$	1,605,041,000	21.2%
2001	$	1,662,295,000	3.6%

Long-Term Debt Per Capita

Long-term debt per capita is a measure of a government's ability to maintain its current financial policies. This long-term debt analysis takes the total liabilities in the General Long-Term Obligations Account Group and divides them by population. Chicago's long-term debt includes capital leases, general obligation bonds payable, employee vacation leave, and claims payable. Any increases bear watching as a potential sign of increasing financial risk.

Long-term debt per capita rose substantially by 65% between FY97 and FY01. This represents an increase of $2.8 billion in that time period, or from $4 billion to $6.8 billion. The large increases in long-term debt bear watching as a potential cause of concern. Given the current economic uncertainty and the revenue constraints that it brings, the City must carefully consider any future increases in its long-term debt burden.



Pension Trends

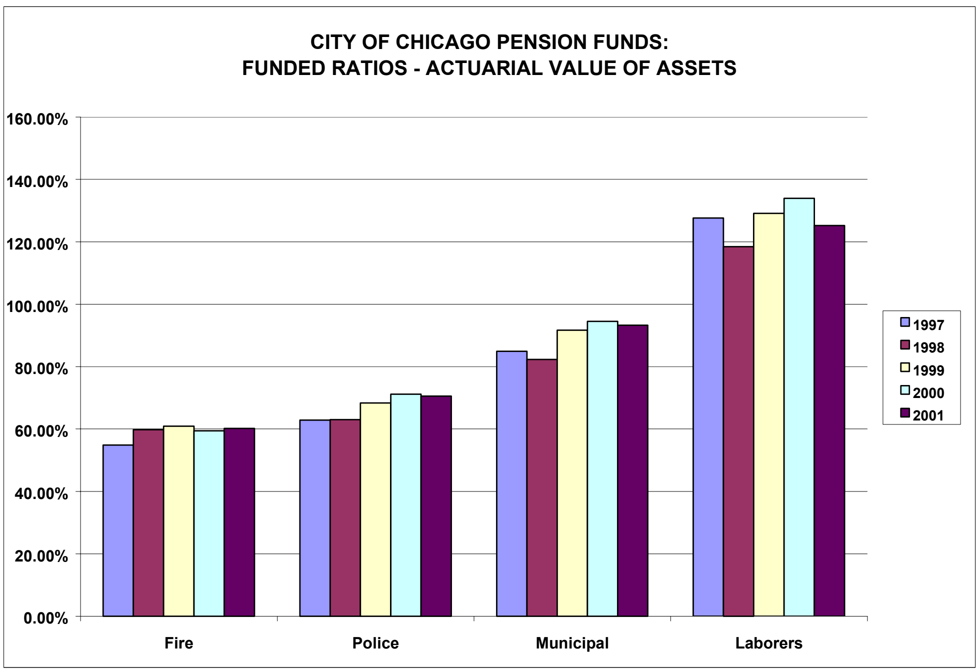
The City of Chicago maintains four employee pension funds: the Fire, Police, Municipal and Laborer's Funds. The Civic Federation used three measures to present a multi-year evaluation of the funds' fiscal health: funded ratios, the value of unfunded liabilities, and the investment rate of return.[3]

[3] The discussion of City of Chicago pension trends is drawn from Scott Metcalf. *Status of Local Pension Funding* (Chicago: Civic Federation, 2002).

Funded Ratios – Actuarial Value of Assets

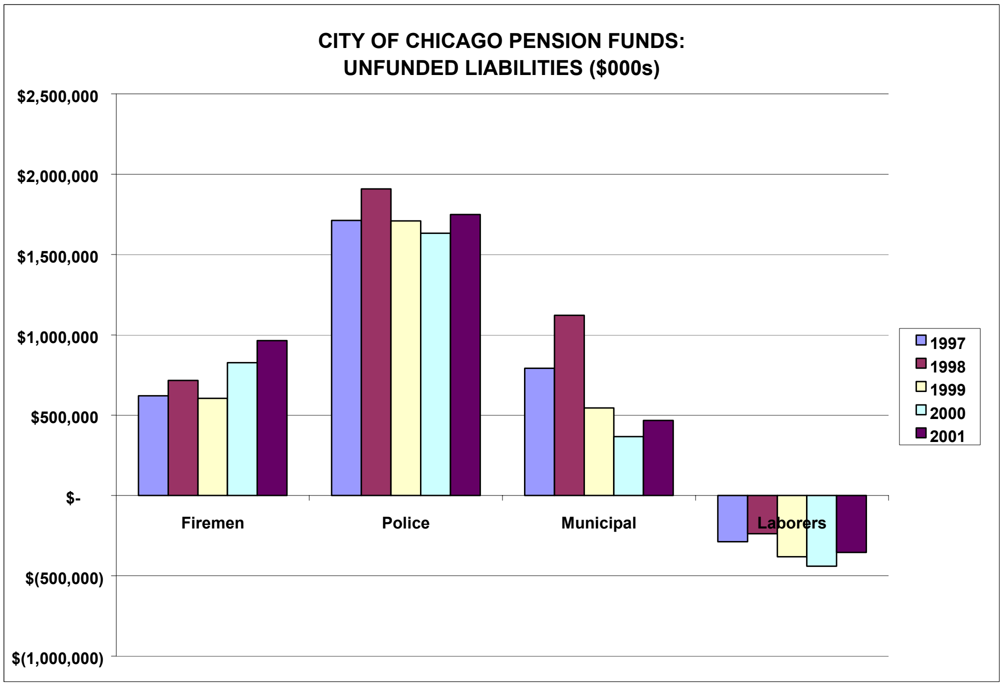
The following exhibit shows funded ratios for each of the four pension funds. This ratio shows the percentage of pension liabilities covered by assets. The lower the percentage the more difficulty a government may have in meeting future obligations.

The funded ratios of three of the four City pension funds dropped between FY00 and FY01. The Police Fund's funded ratio fell slightly, from 71.1% to 70.5%. The Municipal and Laborers Funds also reported declines. However, both funds are relatively healthy, with the Laborers Fund reporting a funded ratio of 125% and the Municipal Fund at 94%. In a positive sign, the Fire Fund's funded ratio rose by 0.8% in FY01, a reversal of the decline in between FY99 and FY00.



Unfunded Liabilities

Unfunded liabilities are the dollar value of liabilities not covered by assets. Unfunded liabilities for all four City pension funds totaled approximately $2.8 billion in 2000. This was a 5-year decline of 0.4% since 1997. However, unfunded liabilities increased by $439 million or 18% from 2000, a reversal of the substantial decline since 1998 when unfunded liabilities totaled approximately $3.5 billion. The largest unfunded liability continues to be in the Police Fund, totaling over $1.7 billion.



Investment Rates of Return

Investment returns for all four City pension funds continued to tumble in FY01 reflecting persistent upheaval in the stock market. All of the funds realized lower than the actuarially assumed rates of return.

The average rate of return for all City of Chicago pension funds fell from 19.1% in 1997 to -3.5% in FY01. Each of the four funds lost money between FY00 and FY01. The sharpest declines came in the Fire and Police Funds, which reported growth rates of –5.7% and –5.2%.

While strong stock markets allowed the City to limit its contributions to the pension funds for many years, the average rate of return for all City pension funds has fallen from 19.1% in 1997 to -3.5% in FY01. With each of the City's four funds losing money between FY00 and FY01, continued investment losses and new benefit requirements will exacerbate unfunded pension fund liabilities and potentially force a tax increase to maintain a healthy asset to liability ratio.

CIVIC FEDERATION RECOMMENDATIONS

The Civic Federation has several recommendations regarding ways to improve the City of Chicago's financial management.

Establish a More Formal Budget Reserve Policy to Provide for Contingencies

The Government Finance Officers Association recommends that general-purpose governments maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues.[4] The fund balance in the City's Corporate Fund has shrunk dramatically from $177 million in FY98 to a projected $27.4 million for FY03. Maintaining a fund balance of at least 5% of Corporate Fund revenues would require approximately $126 million, far more than what the City is proposing.

The Civic Federation is concerned that the amount of Corporate Fund balance proposed for FY03 would leave the City with little or no flexibility to deal with contingencies. Although we recognize the current severe pressure on City revenues, we caution that the $27.4 million fund balance is 15% smaller than FY2002 and 75% less than 1998. The rapid decline in the Corporate fund balance from $177 million in 1998 buttresses the need for the City to establish a more formal budget reserve policy to ensure that funds are available to address emergency situations.

Implement Joint Purchasing of Prescription Drugs and Employee Health Insurance

The City of Chicago may well endure more bad fiscal news during FY2003. Thus, it is important that the City implement measures that can generate additional budgetary savings. To that point, we are pleased that the City's financial management team is actively working with Civic Federation staff and other local governments in pursuit of joint purchasing of employee prescription drugs. Hopefully, in the near future, the group will finalize an agreement for the joint purchasing of health insurance. A recent Civic Federation study found that forming such an agreement consisting of the employees of seven major local governments including the City of Chicago could yield projected savings of $40.1 million for all the governments in the first year or $222 million over a 5-year period.[5]

Consider Privatization of the Chicago Skyway

The Civic Federation remains very supportive of the proposal to privatize interested the Chicago Skyway. The City of Chicago has long been a national leader in the implementation of innovative and cost effective privatization strategies and we urge serious consideration of such a proposal that should provide both an immediate revenue enhancement and significantly reduce long-term operating and maintenance obligations.

Implementing a Long-Term Financial Planning Process

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association GFOA) both recommend that all governments formally adopt a long-term financial plan as a key component of a sound budget process.[6] The City of Chicago currently employs many of the techniques of a long-term financial planning process internally, including the projection of multi-year revenue trends and modeling of various revenue and expenditure options. However, the City does not develop a formal plan that is shared with and/or

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[4] Government Finance Officers Association Recommended Practice: "Appropriate Level of Unreserved Fund Balance in the General Fund" (Adopted 2002).

[5] The Civic Federation. *Feasibility Study of Consolidated Purchasing: Chicago Public Employers*. A Study Conducted by the Segal Company. February 23, 2001.

[6] See National Advisory Council on State and Local Budgeting and Government Finance Officers Association

reviewed by key policymakers and stakeholders. The Civic Federation recommends that the City of Chicago develop and implement a formal long-term financial plan.

Adopt Formal Financial Policies

Formal or written financial policies are plans that guide and determine a government's present and future financial operations decisionmaking. Both the NACSLB and the GFOA recommend that all jurisdictions adopt formal written financial policies.[7] The Civic Federation recommends that the City of Chicago adopt written financial policies to guide the development of its annual budget. Priority should be given to adoption of a budget stabilization policy.

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[7] See Recommended Practices 4.1 – 4.7 in National Advisory Council on State and Local Budgeting. *Recommended Budget Practices: A Framework for Improved State and Local Budgeting* (Chicago: GFOA, 1998) and "Adopting Financial Policies," Recommended Practice, Committee on Governmental Budgeting and Management (2001).