STATEMENT ON THE TENTATIVE FY2003 BUDGET OF THE METROPOLITAN WATER RECLAMATION DISTRICT OF GREATER CHICAGO, DECEMBER 11, 2002

The Civic Federation would like to thank the President, the Board of Commissioners and the General Superintendent for this opportunity to comment on the tentative FY2003 budget of the Metropolitan Water Reclamation District (MWRD) of Greater Chicago. We would also like to commend the MWRD's Budget and Finance staffs for their hard work and effort in preparing this budget. We would also like to commend the District's Budget Office for its willingness to provide additional information related to 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.

OVERVIEW OF TESTIMONY

The Civic Federation recently concluded an analysis of financial issues related to the MWRD's proposed FY2003 budget. Based upon that review, 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 and Civic Federation Recommendations.

The Civic Federation commends the Metropolitan Water Reclamation District for producing a proposed $758 million FY2003 budget that is $39 million smaller than the budget originally proposed five years ago. We are also pleased to see that the District is eliminating 62 positions and has developed a long-term strategy that will strategically shrink the size of the District's workforce through attrition.

However, while we commend the District for taking actions to reduce its headcount and rein in spending increases, the Civic Federation **opposes** the $7.3 million property tax increase proposed by the District for FY2003. Rather, the Federation believes that the MWRD should have followed the lead of other local governments, like Cook County and the Chicago Park District, and frozen its property tax levy at last year's level. In our view, raising taxes in a recession only exacerbates an already bad economic situation. Instead of raising property taxes, the MWRD should have cut spending or drawn down its substantial reserve funds[1], which totaled $88.7 million in FY2001.

The Civic Federation also remains concerned that the MWRD traditionally does not spend all the funds it appropriates it each year. Between FY1998 and FY2002, the District only spent an average of only 63% of what it appropriated.[2] The "over-appropriations" are due in part to the District's practice of re-appropriating unspent capital project revenues. However, the size of the unspent appropriations raises questions about the need of the District to ask property owners for additional tax revenues this year.

[1] General and Special Revenue Funds
[2] MWRD Comprehensive Annual Financial Reports, FY1998-FY2002.

The Civic Federation once again compliments the District and its budget staff for producing an excellent, user-friendly budget document. We strongly applaud the District for utilizing best practice financial management techniques, such as financial policies and long-term financial planning. We believe that other governments in the region would benefit by adopting some of the features of the MWRD's budget format.

Because of the likelihood that this region will endure more bad fiscal news during FY2003, the Civic Federation urges the District to implement measures that can generate additional budgetary savings and improve its financial management capabilities. The cost of health care is rising rapidly once again. Indeed, the MWRD's tentative FY2003 budget forecasts a 15% to 20% increase in health care costs for the District in the near term.[3] To contain these skyrocketing costs, The Civic Federation urges the MWRD to consider joining with other local governments to pursue the joint purchasing of health care insurance.

Civic Federation staff currently is working with the City of Chicago, Cook County and five other local governments to finalize an agreement providing for the joint purchasing of employee prescription drugs, a measure that will save millions of dollars. The next step will be to forge an agreement among these governments to jointly purchase employee health insurance. A recent study conducted for The Civic Federation found that forming a joint insurance pool consisting of the employees of the City of Chicago, Cook County (excluding the Forest Preserve District), Chicago Park District, Chicago Transit Authority, the City Colleges of Chicago, the Chicago Public Schools and the Chicago Housing Authority could yield projected savings of $40.1 million in the first year or $222 million over a 5-year period.[4] The MWRD could achieve similar benefits and savings by participating in this project.

Between FY1998 and FY2002, the MWRD spent an average of only 63% of what it appropriated. This raises questions regarding whether the District is over appropriating far in excess of actual expenditures, thus maintaining excessive reserves. The Civic Federation urges the MWRD to consider adjusting its appropriations to more closely match actual expenditures.

Finally, the Civic Federation would like to caution the MWRD that in coming months there may well be pressure to increase public employee pension benefits by adjusting state regulated contribution formulas. The Civic Federation urges the District to carefully monitor any such moves in the General Assembly that have the potential to dramatically increase costs to taxpayers of maintaining the District's pension fund.

FY2003 BUDGET HIGHLIGHTS

The MWRD's $758 million tentative proposed budget is 25% less than the previous fiscal year's appropriation of $1 billion. It includes the following highlights:

- A 1.9% increase in the property tax levy. This represents a $7.3 million rise from $387.4 million to $394.8 million.

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[3] See Metropolitan Water Reclamation District Tentative FY2003 Budget, p. 4.
[4] The Civic Federation. *Feasibility Study of Consolidated Purchasing: Chicago Public Employers*. A Study Conducted by the Segal Company. February 23, 2001.

- The elimination of 62 vacant positions from FY2002. This will reduce headcount from 2249 to 2187.
- A $4.9 million, or 1.6%, decrease in Corporate Fund appropriations.
- A $181 million reduction in the Capital Improvements Bond Fund reflecting the fact that no major Tunnel and Reservoir Projects are scheduled for FY2003.

FINANCIAL ISSUES AND TRENDS

This section provides summaries of key issues likely to have an impact on the District's financial situation in the forthcoming fiscal year as well as expenditure, appropriation and revenue trends.

Appropriations: FY2003 Appropriations Reduced by 25%

The District proposes to appropriate $758. 5 million in FY2003, a 25% or $249 million reduction from the previous fiscal year's appropriation of $1 billion.

Much of the reduction in the FY2003 appropriation, or approximately $181 million, comes in the Capital Improvements Bond Fund. The decrease reflects the pattern in the awarding of major capital projects. In FY2002, the District's budget reflected the Little Calumet TARP project award. This year, there will be no major TARP project awards, thus appropriations will be correspondingly less.[5] In addition, there is a reduction in the Construction Fund of $30 million due to scheduling of projects and shifts in funding for some projects from the Limited Bond Fund rather than the Construction Fund. The Corporate Fund is projected to decline by $27 million because there were certain one-time appropriations in FY2002, including a transfer to Reserve Claim and a provision for early retirement contributions.

The exhibit below shows MWRD budget appropriations from FY1999 to FY2003. It compares the tentative budget appropriation proposed in each of those years with the final adjusted budget approved by the Board of Commissioners. Adjusted appropriations, to a certain extent, reflect the inclusion of capital project awards after initial presentation of the budget. Between FY1999 and FY2002, adjusted appropriations rose by 26%, from $797 million in FY1999 to $1 billion in FY2002. Appropriations will have decreased by 5% between FY1999 and FY2003, if there is no adjusted appropriation at a later date.

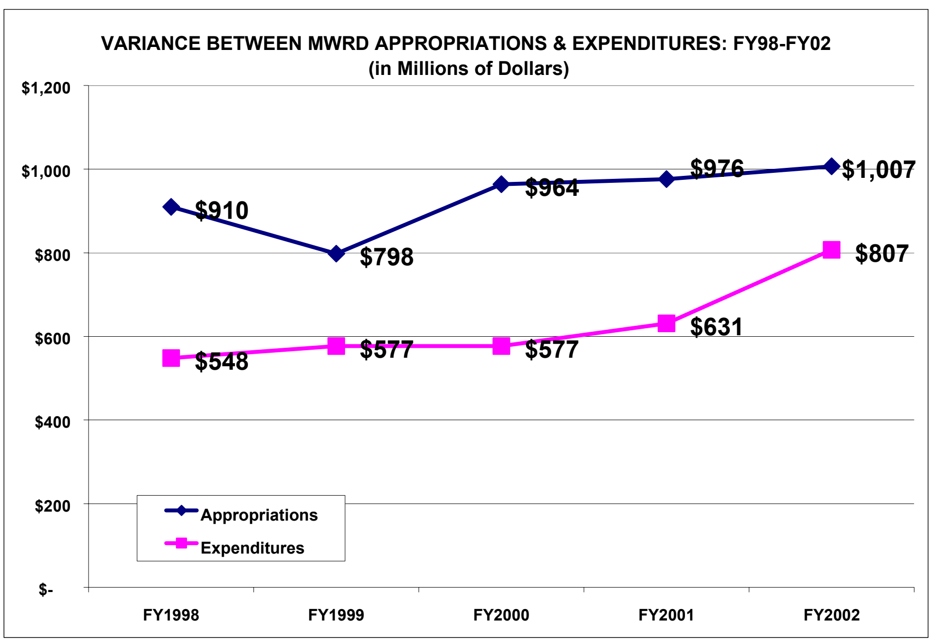
MWRD APPROPRIATIONS: FY99-FY03			
	As Originally Proposed	As Adjusted	Variance
FY1999	$ 797,983,170	$ 797,983,170	$ -
FY2000	$ 963,863,493	$ 964,090,014	$ (226,521)
FY2001	$ 924,196,538	$ 975,661,391	$ (51,464,853)
FY2002	$ 793,431,326	$ 1,007,358,326	$ (213,927,000)
FY2003	$ 758,497,339	N/A	N/A

[5] Prior year obligations for the Capital Improvement Bond Fund are included each year in the final budget as appropriations for liabilities.

The large variance between original and adjusted appropriations in recent fiscal years is due in large part to changes in award schedule or the design and development readiness of capital projects. The MWRD's future capital projects are included on its project lists published in the budget. These lists include projects planned for award in the budget year and projects that are planned for award in future years. Projects can also be under development and consolidated or split of from projects in the list. The readiness of projects for advertising and possible award in the next budget year is really not known with great accuracy until about late November of the prior year. Projects added for appropriation at the adopted or amended stage in December are in most cases included on the project lists for future award in earlier versions of the Budget. The possibility of federal or state financial participation, aside from the State Revolving Fund program, is also not known very early in the prior year. Thus, the decision to appropriate for a project will often not be made until that financing is certain.[6]

Historic Wide Variance Between Expenditures and Appropriations Continues

The MWRD has for many years appropriated far more than it spends. The variance between expenditures and appropriations averaged $334 million between FY1998 and FY2002. Thus, during those years, the MWRD spent an average of only 63% of what it appropriated. This raises questions regarding whether the District is over appropriating far in excess of actual expenditures, thus maintaining excessive reserves.



MWRD Fund Balance Ratio Dropped Significantly in FY01, from 59% to 30%

The MWRD historically maintained high fund balances, according to a review of its audited financial statements. In order to assess the size of fund balances, the Civic Federation has

[6] These comments are drawn from a communication from John Farris, MWRD Budget Officer, December 4, 2002.

devised a current fund balance ratio which divides the dollar amount of General and Special Revenue Fund balances by combined General and Special Revenue Fund expenditures.

Between FY97 and FY01 MWRD General and Special Revenue fund balances averaged $121 million. During that same period, the District's current fund balance ratio averaged 46%, giving it a "Substantial" " cash solvency rating. In FY01, the fund balance was reduced substantially, falling by 47% or $78 million.

MWRD CURRENT FUND BALANCE RATIO				
FY	GF & SRF Fund Balance	GF & SRF Operating Exp.	Ratio	Rating
1997	$ 133,268,000	$ 242,791,000	55%	High
1998	$ 152,015,000	$ 252,318,000	60%	High
1999	$ 157,451,000	$ 273,000,000	58%	High
2000	$ 167,109,000	$ 281,824,000	59%	High
2001	$ 88,771,000	$ 296,489,000	30%	Substantial
Average	**$ 121,968,600**	**$ 209,986,600**	**46%**	**Substantial**

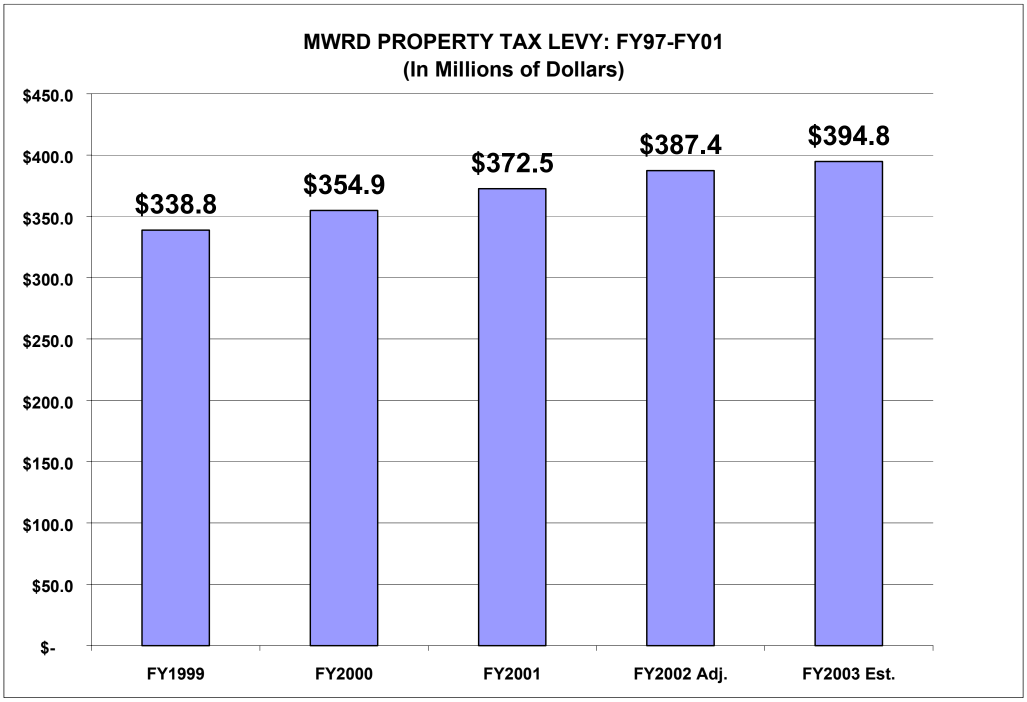
Major Revenues Up 1% in FY2003

The exhibit below shows projected changes in major District revenues between FY2002 and FY2003. Overall, these revenues are expected to increase by just 1%, from $474 million to $480 million. Reflecting the effects of the recession, Personal Property Replacement Tax (PPRT) revenues are expected to decline by 10.3%, while investment interest income will be down by 20%. Increases are projected for lease revenues and user charges.

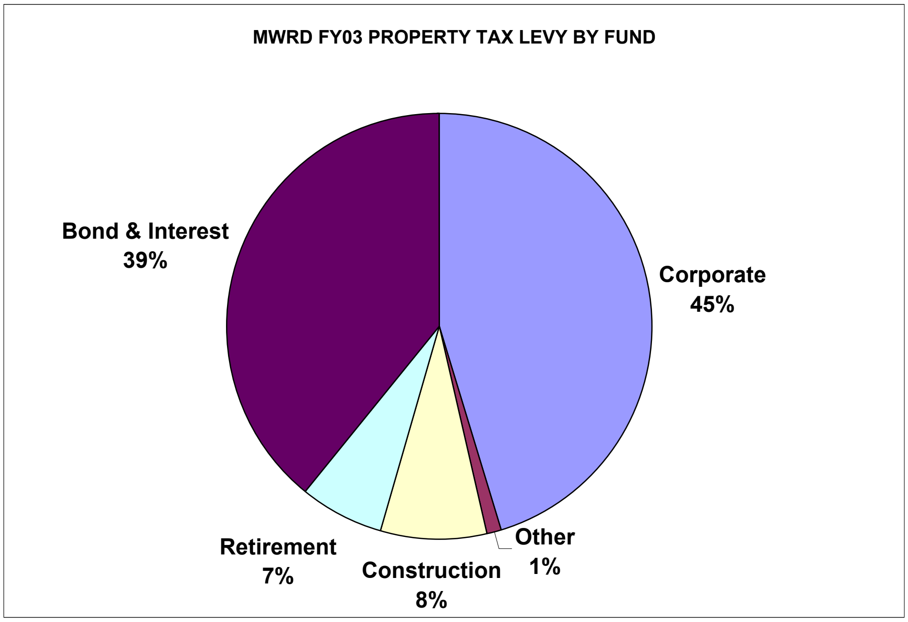
MWRD MAJOR REVENUES: FY02-FY03			
	FY2002	**FY2003**	**% Change**
Property Taxes	$ 387,400,000	$ 394,800,000	1.9%
User Charges	$ 44,600,000	$ 48,000,000	7.6%
PPRT	$ 22,400,000	$ 20,100,000	-10.3%
Investment Interest Income	$ 15,000,000	$ 12,000,000	-20.0%
Lease Revenue	$ 4,600,000	$ 5,500,000	19.6%
Total	**$ 474,000,000**	**$ 480,400,000**	**1.4%**

Property Tax Levy: 1.9% Increase to $395 Million

The MWRD proposes to increase its property tax levy by 1.9% in FY2003, from $387.4 million to $394.8 million. The total levy has increased by 17%, or $56 million since FY1999.

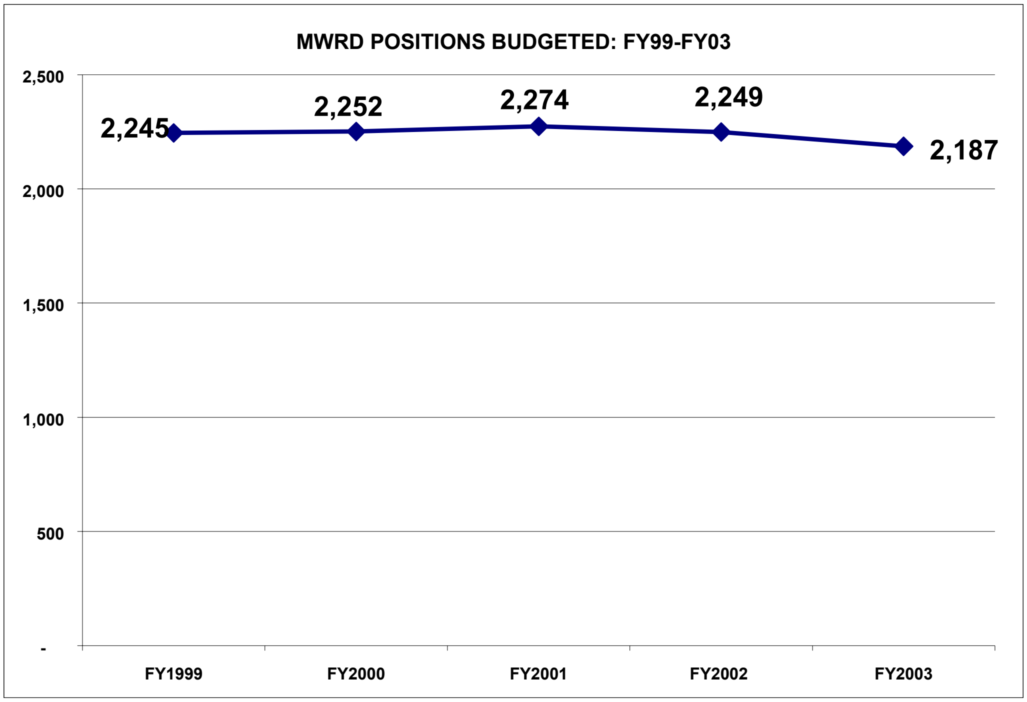


The exhibit below shows the distribution of the MWRD property tax levy proposed for the FY2003 budget. The Corporate Fund will receive 45% of all property tax funds, the single largest distribution. This will represent $178.6 million. The next largest recipient of property tax receipts will be the Bond and Interest Fund, with 39% of the total. The "other" category includes the corporate working cash and reserve claim funds.



Personnel: 62 Positions Eliminated in FY2003 Budget

The MWRD proposes to reduce the number of positions budgeted in FY2003 by 62, resulting in a 3% cut from 2249 in FY2002 to 2187. The positions eliminated are all vacancies. It is the District's policy to reduce headcount only by attrition. Over the 5 years of this analysis, between FY1999 and FY2003, the number of positions will have been reduced by a total of 58.



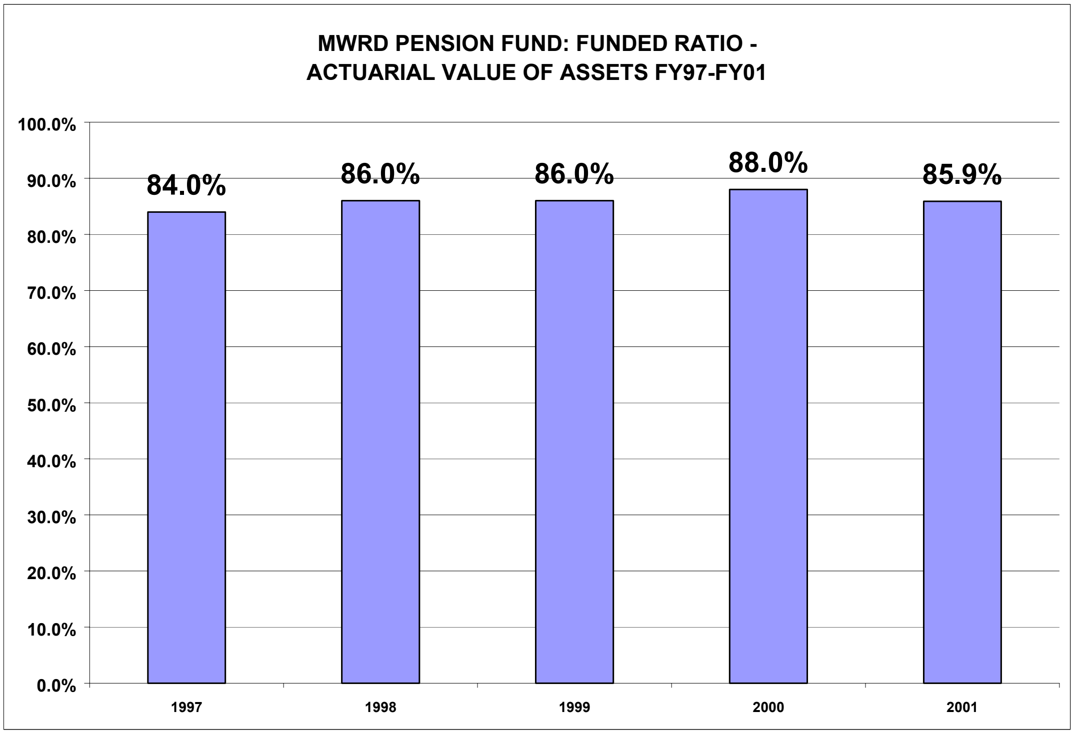
Pension Trends

The Civic Federation used three measures to present a multi-year evaluation of the fiscal health of the MWRD's pension fund: funded ratio, the investment rate of return and the value of unfunded liabilities.[7]

Funded Ratio – Actuarial Value of Assets: Remains Substantial at 86% in FY01

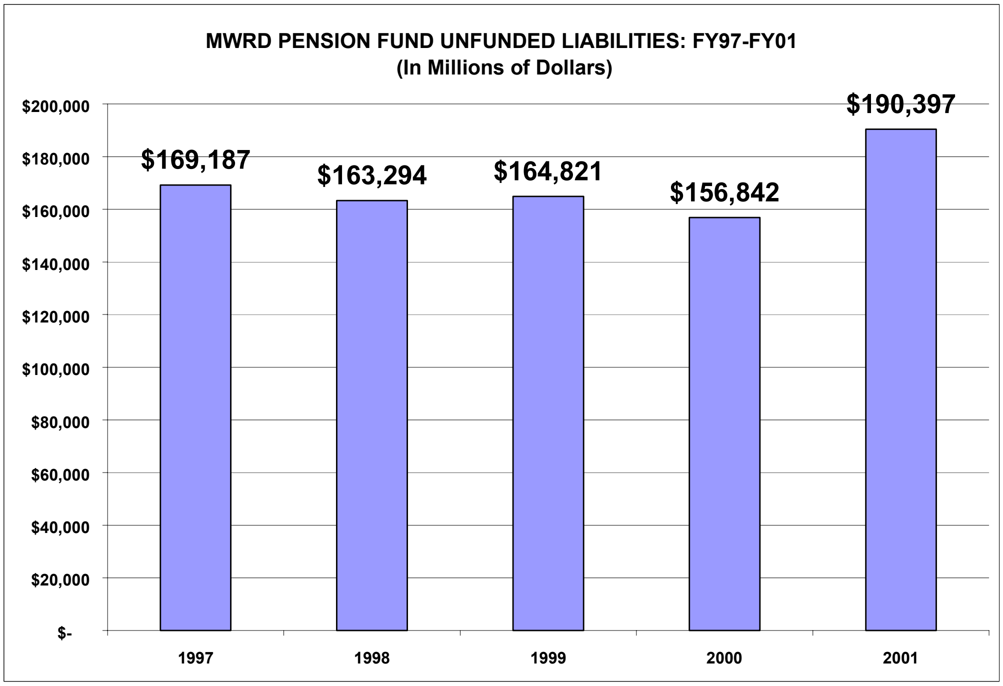
The following exhibit shows the funded ratio for the MWRD's pension fund. This ratio shows the percentage of pension liabilities covered by assets. The lower the percentage the more difficulty a government may have in meeting future obligations. The funded ratio for the MWRD's pension fund averaged 86% from FY1997 to FY2001. Thus, during this period, the MWRD had more than sufficient assets to cover pension liabilities in the long term.

[7] The discussion of MWRD's pension fund trends is drawn from Scott Metcalf. *Status of Local Pension Funding* (Chicago: Civic Federation, 2002).



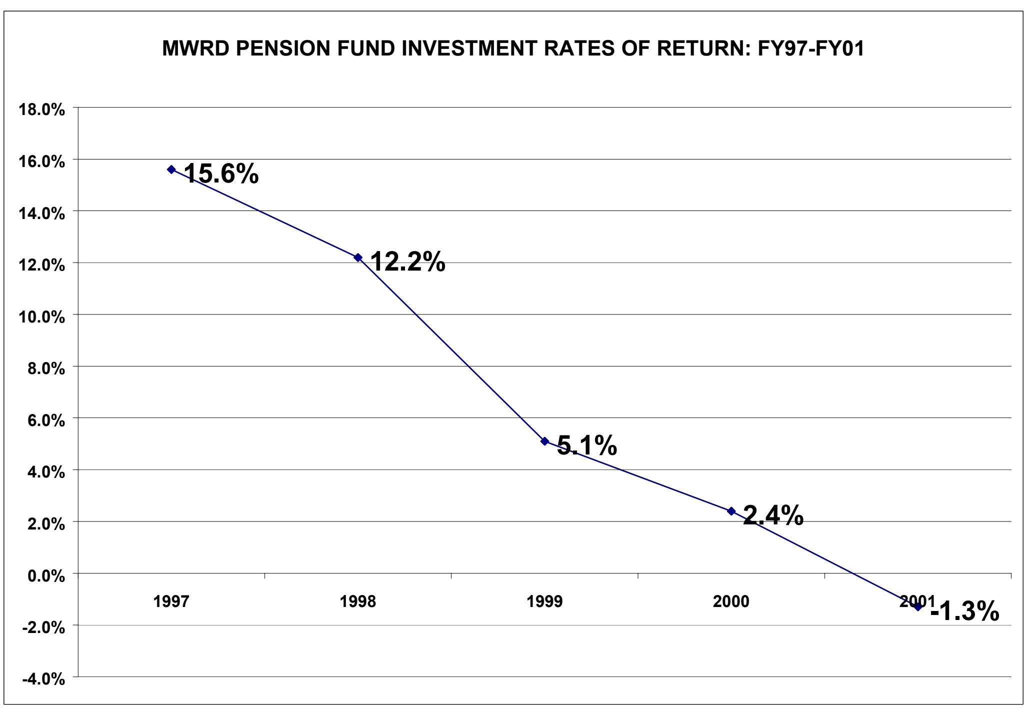
Unfunded Liabilities: Up by 21% in FY2001

Unfunded liabilities are the dollar value of pension liabilities not covered by assets. As the exhibit below shows, unfunded liabilities for the MWRD's pension fund totaled approximately $190 million in FY2001. Between FY2000 and FY2001, unfunded liabilities increased steeply by 21%, or $33.5 million. Much of the increase was due to losses in the pension fund's investments. Since FY1997, the pension fund has had a 13% increase in unfunded liabilities.



Investment Rates of Return: Returns Negative in FY2001

Investment income typically provides a significant portion (over 50%) of the funding for pension funds. Thus, declines over a period of time can have a negative impact on pension assets. Since FY1997, MWRD investment rates of return have dropped from 19.2% to –1.3%. Between FY2000 and FY2001, the rate of return fell from 2.4 %. Because the pension fund remains well funded, this is not yet a cause for concern.



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.

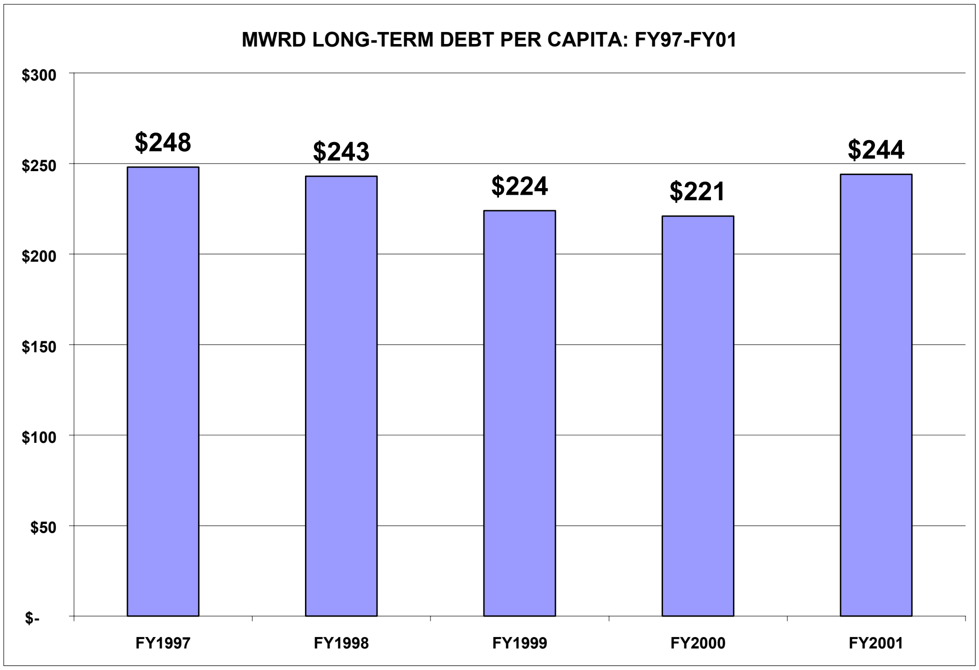
The MWRD's short-term debt obligations rose by 22% over the 5 years of this analysis. This was an increase from $185 million to $225 million, a $40 million jump. In FY2001, however, short term debt was reduced by $35 million or 14%. This is a positive sign.

MWRD SHORT-TERM DEBT ($000s)	
FY1996	$ 185,041
FY1997	$ 203,417
FY1998	$ 214,994
FY1999	$ 227,750
FY2000	$ 260,578
FY2001	$ 225,297

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. The MWRD's long-term debt includes general obligation bonds payable, capital leases payable, compensated absences, claims and judgments payable, and worker's compensation. Increases in this indicator bear watching as a potential sign of increasing financial risk.

MWRD long-term debt per capita decreased by 2% between FY1997 and FY2001, falling from $248 to $244. Between FY2000 and FY2001, long-term debt per capita rose by 10%, from $221 to $244. Total long-term debt decreased by $2.4 million over the 5 years of this analysis.



CIVIC FEDERATION RECOMMENDATIONS

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

Monitor Any Moves to Increase MWRD Employee Pension Benefits in Springfield

The MWRD's pension fund currently is well funded, with a 85.9% funded ratio. However, there may well be pressure in coming months to increase public employee pension benefits by adjusting state regulated contribution formulas. The Civic Federation urges the MWRD to carefully monitor any such moves in the General Assembly that have the potential to dramatically increase costs to taxpayers of maintaining the District's pension fund.

Join with Other Chicago Area Governments to Pursue Joint Purchasing of Health Insurance

The cost of health care is rising rapidly once again. Indeed, the MWRD's tentative FY2003 budget forecasts a 15% to 20% increase in health care costs for the District in the near term.[8]

To contain skyrocketing health care costs, The Civic Federation urges the MWRD to pursue the joint purchasing of health care insurance with other governments in the Chicago area. A recent

[8] See Metropolitan Water Reclamation District Tentative FY2003 Budget, p. 4.

study conducted for The Civic Federation on the feasibility of consolidated health insurance purchasing found that forming a joint insurance pool consisting of the employees of the City of Chicago, Cook County (excluding the Forest Preserve District), Chicago Park District, Chicago Transit Authority, the City Colleges of Chicago, the Chicago Public Schools and the Chicago Housing Authority could yield projected savings of $40.1 million in the first year or $222 million over a 5-year period.[9] The MWRD could achieve similar benefits and savings by participating in this project.

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