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CIVIC FEDERATION SALUTES MWRD LEADERSHIP ON OPEB LIABILITES

District One of Few Governments in Illinois to Address OPEB Funding Issue

(CHICAGO) The Civic Federation announced its **support** of the $968.7 million FY2007 Metropolitan Water Reclamation District tentative budget today because it minimizes the burden on taxpayers and incorporates sound financial planning techniques.

In stark contrast to many local governments in northeastern Illinois, the District makes a strong effort to follow sound, rational principles of strategic and long-term planning in its budgeting process. These steps include publishing a five-year financial forecast, a Capital Improvement Plan, and performance measures in the budget book. The District has shown fiscal restraint by not increasing the property tax levy to the maximum amount allowable under the tax cap law. The levy for tax capped funds will increase by 2.8% or $7.3 million, and the gross property tax levy, including non-tax capped funds, will increase by only 0.1%. Finally, the MWRD has developed a plan that proposes targeted future personnel reductions and will increase employee contributions to health insurance.

The most remarkable plan the District has made, however, is for the creation of a trust fund to begin saving for the payment of Other Post Employment Benefits (OPEB) or the health insurance, life insurance, and long-term care coverage an employer will pay to its retirees. While reporting OPEB liabilities is a new requirement for governments, Government Accounting Standards Board (GASB) does not require the additional step of funding future non-pension benefits; the MWRD has taken that leadership position of its own volition. "The MWRD has moved beyond the question of how to report OPEB liabilities currently occupying most other local governments and has moved toward a concrete plan to pay for them," said Msall. "The Civic Federation is impressed by the prescience and responsibility of this move."

The main **concern** the Federation had with the District's long-term finances was the downward trend in the MWRD Retirement Fund's funded ratio. Between FY2001 and FY2005, the most recent year for which data are available, the funded ratio dropped from 85.9% to 70.8%. The funded ratio is a measure of how well a government is prepared to meet its future pension obligations. While the MWRD Retirement Fund is not yet in crisis, the continued decline in funded ratio is a cause for concern. The Federation provided a number of recommendations in its analysis to improve the long-term financial health of its pension fund, most of which would require General Assembly authorization. They include containing future liabilities by establishing a two-tiered system with more modest benefits for new employees and requiring benefit enhancements to be tied to contribution increases.

The report is available on our website www.civicfed.org.

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.

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METROPOLITAN WATER RECLAMATION DISTRICT OF GREATER CHICAGO FY2007 TENTATIVE BUDGET

Analysis and Recommendations

Prepared By
The Civic Federation
December 13, 2006

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EXECUTIVE SUMMARY

The Civic Federation **supports** the Metropolitan Water Reclamation District's FY2007 Tentative budget of $968.7 million. This proposed budget is a fiscally responsible plan. It minimizes the burden on property taxpayers and makes a strong effort to follow sound, rational principles of strategic and long-term planning.

The Civic Federation **supports** the MWRD's Tentative FY2006 budget for the following reasons:

- The MWRD has chosen to exercise **fiscal restraint** by not increasing its property tax levy to the maximum amount allowable under the tax cap law. In FY2007 the MWRD will increase the levy for its tax capped funds by 2.8% or $7.3 million. This represents an increase from $262.3 million to $269.6 million
- The MWRD's budget process and budget documents incorporate a comprehensive, long-range planning perspective. Elements of the District's long-range planning process include:
    - The preparation and publication in the budget of **five-year financial forecasts** for revenues, expenditures, and personnel.[1]
    - A detailed **Capital Improvement Plan** that is published in the annual Budget Book.
    - The publication of **performance measures** for the District's departmental programs that follow Service Efforts and Accomplishments guidelines suggested by the Governmental Accounting Standards Board (GASB).
    - A long-term **personnel expense cost control plan** that proposes targeted future personnel reductions and that will increase employee contributions to health insurance premiums from 7% in 2005 to 11% in July 2007.
- In preparation for the implementation of GASB Statement Number 45 (which applies to governments providing other post employment or non-pension benefits), the District's Board of Commissioners adopted a policy establishing an irrevocable trust for **funding future OPEB liabilities.** The District is one of the few governments in Illinois that has moved beyond the question of how to report OPEB liabilities and moved toward a concrete plan to pay for them. The Civic Federation salutes the MWRD Board and staff for taking a leadership position in addressing the issue of OPEB funding.

The Civic Federation offers the following **key findings** on the MWRD's finances based on our analysis of its FY2007 budget and FY2005 audited financial statements:

- The total FY2007 Tentative Budget will decrease 6.7% from the FY2006 Adjusted Budget of $1.0 billion. This is a $70.0 million decrease.
- Corporate Fund appropriations will increase by 9.8% or $31.0 million, from $316.8 million to $347.8 million. The increase is due to the $10 million being earmarked for an OPEB Trust Fund, the higher energy costs associated with utility deregulation, and costs following from the opening of an alternative biosolids processing facility.
- The gross property tax levy will be increased by 0.1 % from the FY2006 Adjusted Budget levy. This is a $370,910 increase from $415.8 million to $416.2 million. The levy increase for tax capped funds will be 2.8%, from $262.3 million to $269.6 million. The increase for

[1] MWRD FY2007 General Superintendent's Recommendation, pp. 53-64.

tax capped funds remains below the estimated 3.4% rate of inflation limit that the tax cap law imposes on this levy.
- Thirty-two full-time equivalent positions will be eliminated in FY2007, reducing the total number of positions from 2,107 to 2,095.
- Corporate Fund net assets appropriable will be $94.4 million, or 27.2% of Corporate Fund appropriations. Approximately $56.98 million of that amount will not be appropriated, but will be set aside in a nonappropriated contingency fund. These funds are being reserved in anticipation of: the increased prices for electricity and natural gas associated with utility deregulation; costs associated with opening the Stickney pelletizer facility; the need to set aside funding for other post employment benefit liabilities; and the strong likelihood that real estate tax payments to governments will be delayed in FY2007 because a high volume of appeals traditionally follows the City of Chicago's property reassessments. The MWRD's Corporate Fund reserve will likely be depleted this year and as a result, will be much reduced in FY2008.

The Civic Federation has the following **concern** about the MWRD's long tern financial health:
- In FY2005, the last year for which complete data are available, the audited financial statements of the MWRD Retirement Fund showed that its funded ratio dropped from 85.9% in FY2001 to 70.8% in FY2005. During this period, unfunded liabilities have risen by 153.3% or $291.9 million, from $190.3 million to $482.3 million. While the pension fund is not yet in crisis, this downward trend is troubling.

The Civic Federation offers the following **recommendations** to improve the fiscal health and transparency of MWRD budget documents:
- The MWRD should seek legislation in Springfield authorizing the District to implement measures to control pension costs. These measures should include: reducing benefits for new employees; fixing annual annuity increases for new hires at the projected Consumer Price Index or 3%, whichever is less; requiring contribution increases for any new benefit increases; and requiring that employer contributions be related to funding levels rather than set by arbitrary multipliers.
- The MWRD Budget Book is a transparent, user-friendly document. We are impressed by its high quality and comprehensive nature. The inclusion of a summary table detailing revenues for All Funds, however, would improve the Budget Book by making this important part of the MWRD's overall financial picture more accessible to the budget's readers. A table showing by category the aggregated personnel expenditures for All Funds would also be a significant addition, and would improve readers' understanding of the District's efforts to control personnel costs.

OVERVIEW

The Civic Federation **supports** the Metropolitan Water Reclamation District's FY2007 Tentative budget of $968.7 million. This budget is a fiscally responsible financial plan that minimizes the burden on property taxpayers and makes a strong effort to incorporate and implement sound, rational principles of strategic and long-term planning.

Reasons for Civic Federation Support

The reasons for the Civic Federation's support of the MWRD's FY2007 budget are explained in detail below.

Restraint in Property Tax Levy Increase

In FY2007, the MWRD will increase the property tax levy for its tax capped funds by 2.8% or $7.3 million, from $262.3 million to $269.6 million.[2] The increase is below the rate of inflation – estimated here at 3.4% – which is the limit imposed by the tax cap law on this levy.

Overall, the gross property tax levy, which includes amounts levied for the non-tax capped funds, will increase by just 0.1%, rising from $415.8 million to $416.2 million. The small increase is due to a steep, $11.5 million drop in the amount levied for stormwater management purposes. The Stormwater Management Fund's levy will decrease from $15.5 million in FY2006 to $3.9 million in FY2007.

One of the MWRD's stated objectives is to "make every effort to minimize the tax levy through the use of sound management and cost-effective operations."[3] Clearly, the District's effort this year meets that objective.

The Civic Federation **commends** the MWRD for exercising restraint in increasing its property tax levy by declining to levy the maximum amount permitted under the tax cap law.

Strong Emphasis on Long Range Planning

The Civic Federation supports this budget in large part because the MWRD's budget process and its budget documents both incorporate a comprehensive, long-range planning perspective. Long-range plans are a key component of a high-quality budget process. They provide governments with the information and insights necessary for establishing sound financial and operations policies and for making decisions that maintain good fiscal health over time. More specifically, long-range planning helps governments determine if:

- Revenues are adequate to maintain services at current levels;
- Financial resources are sufficient to address future operating and capital needs;
- Expanding existing programs or initiating new ones is feasible; or
- Issuing new debt to fund new capital projects is prudent.

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[2] The tax cap law or the Property Tax Extension Limitation Law, limits a taxing body's annual property tax extension increase to 5% or the rate of inflation, whichever is less (35 ILCS 200/18-185 through 35 ILCS 200/18-245). However, the value of new properties is exempted from the tax cap calculation, thus allowing for a greater total extension. For details see http://www.revenue.state.il.us/LocalGovernment/PropertyTax/ptell.htm.The tax cap law limits increases in the property tax levy for certain governmental funds to 5% or the rate of inflation, whichever is less. The MWRD's funds subject to the limitation of the tax cap law are the Corporate, Construction, Pension and Reserve Claim Funds. The Bond and Interest and Stormwater Funds are not capped.

[3] MWRD FY2007 General Superintendent's Recommendation, p. 25.

By effectively linking policy and program priorities to the available financial resources, the long-term financial planning process also helps governments prepare for future contingencies before they become crises.

The MWRD is exemplary in its development and utilization of long-range planning tools and techniques. These include:

- The preparation and publication in the budget of **five-year financial forecasts** for revenues, expenditures, and personnel.[4]
- A detailed **Capital Improvement Plan** that is published in the annual Budget Book. The CIP includes narrative descriptions of capital projects, justifications for projects and descriptions of their impact, project costs, maps that show project locations, line item analyses of appropriations and expenditures, and an analysis of projects' personnel requirements.
- The publication of **performance measures** for the District's departmental programs. The MWRD's performance measures follow Service Efforts and Accomplishments guidelines suggested by the Governmental Accounting Standards Board (GASB) and include outcome measures, a series of metrics that many governments decline to use and/or publish.
- A long-term **personnel expense cost control plan** that proposes targeted future personnel reductions and will increase employee contributions to health insurance premiums from 7% in 2005 to 11% by July 2007.[5] The total number of full-time equivalent (FTE) positions is expected to be reduced to 2,052 FTEs within four years.[6] This year, the budget proposes reducing the number of FTES by 32 positions or 1.7%, from 2,107 to 2,095 FTEs. Since FY1998, the District has cut its workforce by 6.1% or 137 positions.
- The creation of a **Trust Fund** in order to begin saving for the future payment of other post employment benefits (OPEB) liabilities.

Creation of Other Post Employment Benefits (OPEB) Trust Fund

Non-pension benefits provided to employees after employment ends are referred to as Other Post Employment Benefits or OPEB. OPEB includes health insurance coverage for retirees and their families, dental insurance, life insurance, and long-term care coverage. It does not include termination benefits such as accrued sick leave and vacation. Most governments currently fund OPEB on a pay-as-you-go basis, paying an amount annually equal to the benefits distributed or claimed that year. They do not pre-fund obligations as is the case with pension obligations.

Detailed financial information about public employee non-pension benefits is not currently required in governmental audited financial statements. To address this problem, GASB issued two statements in June 2004 that provided reporting guidelines for these types of benefits, GASB Statements 43 and 45. These requirements will be phased in between 2005 and 2008 depending on the size of individual governments. The GASB statements do not require the funding of future non-pension benefits, just the reporting of assets and liabilities.

[4] MWRD FY2007 General Superintendent's Recommendation, pp. 53-64.
[5] MWRD FY2007 General Superintendent's Recommendation, p. 23.
[6] Information provided by Administrative Services Manager John Farris and Management Analyst Paul Piszkiewicz on December 3, 2004.

The MWRD provides subsidized health insurance benefits for retirees of the District. In preparation for implementation of GASB 45 (which applies to governments providing OPEB benefits), the District's Board of Commissioners adopted a policy on June 29, 2006 establishing an irrevocable trust for funding future OPEB liabilities. The parameters of the trust are:

- A 50% funded target level.
- A 50-year plan to reach the funding target.
- $10 million in funding to be provided for the Trust for each of the first five years beginning in FY2007. These funds are to be provided from the Corporate Fund.
- An initial investment mixture of 50% equities and 50% bonds with a maximum limit of 65% equities to permit investment growth.

The MWRD's accumulated unfunded OPEB liability is estimated to be $580 million. This amount will be reported in the District's FY2006 Comprehensive Annual Financial Report. The District has also provided $5 million in additional funding to the proposed OPEB Trust from its FY2006 fund surplus.[7]

MWRD financial staff has said that legislative approval may be required in order to authorize the District to create an OPEB Trust.[8]

The District is one of the few governments in Illinois that has moved beyond the question of how to report OPEB liabilities and moved toward a concrete plan to pay for them. The Civic Federation salutes the MWRD Board and staff for taking a leadership position in addressing the issue of OPEB funding.

CIVIC FEDERATION CONCERN: FINANCIAL STATUS OF PENSION FUND

The Civic Federation is concerned about the gradual decline in the fiscal health of the MWRD Pension Fund over the last five years. In FY2005, the last year for which complete data are available, the audited financial statements of the MWRD Retirement Fund showed that its funded ratio has dropped from 85.9% in FY2001 to 70.8% in FY2005. During this period, unfunded liabilities have risen by 153.3% or $291.9 million, from $190.3 million to $482.3 million. While the pension fund is not yet in crisis, this sharp downward trend is troubling.

CIVIC FEDERATION RECOMMENDATIONS

The Civic Federation offers several recommendations on ways to improve the District's financial management and the transparency of its operations.

Provide a Summary Table in Budget Book for All Fund Revenues

The MWRD Budget Book is a transparent, user-friendly document. We are impressed by its high quality and comprehensiveness. The inclusion of a summary table detailing revenues for

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[7] MWRD FY2007 General Superintendent's Recommendation, pp. 5-6.
[8] Meeting with MWRD Budget Staff, November 30, 2006

All Funds, however, would improve the Budget Book by making this important part of the MWRD's overall financial picture more accessible to the budget's readers. The table should present data using a consistent reporting method so that there are no discrepancies with data presented in other parts of the budget based on different accounting methods. (For example, there is inconsistent reporting of PPRT revenues on pages 71 and 78 of the General Superintendent's Budget Recommendations.) Alternatively, the differences in reporting could be explained in prose in order to avoid confusion. A table showing by category the aggregated personnel expenditures for All Funds would also be a significant addition, and would improve readers' understanding of the District's efforts to control personnel costs.

Implement Pension Funding Reform

The Civic Federation offers the following recommendations on ways in which the MWRD could improve the long-term financial health of its Pension Fund. These measures would require General Assembly authorization. We strongly urge the District to seek such approval as soon as possible.

Establish a Two-Tiered System

Although the pension benefits for current public employees and retirees are guaranteed by the Illinois Constitution, benefit levels can be reduced for new employees. Reducing benefits for new employees would mean the creation of a two-tiered benefit system in which existing and new employees receive different retirement benefits. Given the rising cost of pension benefits, this is a reasonable approach that the District should undertake.

Annuity Increases for New Hires should be Fixed at the Lesser of 3% or CPI

Currently, MWRD pension fund beneficiaries receive 3% annual cost of living increases. However, this rate can and often does exceed the rate of inflation. To control costs, annual annuity increases for new hires should be fixed at the projected Consumer Price Index or 3%, whichever is less.

Any Benefit Increases Should Require Contribution Increases

Many benefit enhancements for the MWRD and other local governments are added to public pensions by the Illinois General Assembly without any provision for accompanying contribution increases. The Civic Federation urges the MWRD to closely monitor the General Assembly's proposed pension legislation and to insist that any new benefit increase must identify additional funding to pay for the resulting annual accrued cost. This is a reasonable measure for controlling future benefit costs and for avoiding unnecessary local property tax increases.

Require that Employer Contributions Relate to Funding Levels

The MWRD employer contributions are determined by a multiplier that is not tied to the fund's funded ratio. The MWRD's multiplier is set by state statute at 2.19 times the total employee contribution made two years prior, except for employee contributions to optional additional benefits made after January 1, 2003, which are multiplied by 1.00. Unfortunately, meeting this statutory funding requirement does not ensure that the MWRD will provide sufficient resources to keep its pension fund financially healthy. The Civic Federation believes that, at a minimum, employer contributions should be tied to funded ratios so that additional contributions are required whenever the ratio drops below a given level. Linking pension contributions to actuarially required contribution (ARC) levels would be an even more effective way of guaranteeing the Pension Fund's financial health.

MWRD Retirement Fund Governance Reform

The MWRD Retirement Fund is governed by a five-member Board of Trustees that includes three active employees and two representatives from management.[9] The proper role of a pension board is to safeguard the fund's assets and to balance the interests of the employees and retirees who receive benefits and the taxpayers who pay for pension benefits. The employer, employees, retirees, and taxpayers all have an interest in the management of the fund. However, the tilt toward employees and retirees on the MWRD Retirement Fund Board raises questions about how objective the Board can be in its work. In our view, a pension board should:

- Balance employee and management representation;
- Have a tripartite structure that includes citizen representation on pension boards,
- Include financial experts, and
- Require financial training for non-experts.

We urge the MWRD to seek reform of the MWRD Retirement Fund Board governing structure to ensure a greater balance of interests.

ACKNOWLEDGMENTS

The Civic Federation would like to commend Budget Officer Paul Piszkiewicz, Management Analyst Eileen McElligott and their staffs for their hard work in preparing this budget. We very much appreciate their willingness to meet with us and provide additional information.

APPROPRIATIONS

The MWRD proposes to appropriate $968.8 million in its 2007 Tentative Budget. This is a 6.7%, $70.1 million decrease from the FY2006 Adjusted Budget of $1.04 billion.

It is important to recognize that the MWRD's budget process differs from the budget processes of other northeastern Illinois governments in two respects. First, the MWRD's appropriations often vary significantly from budget year to budget year, depending on the number and scale of capital projects that the District will undertake and also on the timing with which funding is required to complete different phases of multi-year projects. Second, the adjusted budget produced at the end of the fiscal year may differ significantly from the budget adopted by the

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[9] Civic Federation, *Recommendations to Reform Public Pension Boards of Trustees in Illinois* (February 13, 2006), www.civicfed.org.

MWRD because revenues for capital projects often become available only after the budget's adoption. For these reasons, the Civic Federation compares the MWRD's proposed or Tentative Budget to the adjusted budgets from previous years.

The following exhibit shows MWRD budget appropriations from FY2002 to FY2007. It compares the Tentative Budget appropriation proposed in each of those years with the final Adjusted Budget as reported in the succeeding year's budget book. Among other changes, adjusted appropriations include capital project awards made after the initial release of the budget. While FY2002 through FY2004 show relatively large differences between proposed and adjusted appropriations, FY2005 and FY2006 show smaller differences. The FY2006 variance reflects a July 2006 General Obligation bond sale that was completed in order to take advantage of favorable market conditions.[10]

MWRD APPROPRIATIONS: FY2002 - FY2007

	Tentative	Adjusted	Variance
FY2002	$ 793,431,326	$ 1,007,358,326	$ 213,927,000
FY2003	$ 758,497,339	$ 919,493,798	$ 160,996,459
FY2004	$ 768,177,049	$ 882,356,649	$ 114,179,600
FY2005	$ 945,848,564	$ 955,933,864	$ 10,085,300
FY2006	$ 1,000,557,313	$ 1,038,840,599	$ 38,283,286
FY2007	$ 968,775,832	N/A	N/A

Source: MWRD Tentative Budgets FY2002 - FY2007

In FY2007 Corporate Fund appropriations are projected to increase by 9.8% or $31.0 million. Approximately one third of this increase, $10.0 million, will be earmarked for an OPEB Trust Fund that the District will create in order to anticipate the long-term costs of retiree health benefits. Commencing operation of an alternative biosolids processing facility and significantly higher energy costs are the other driving factors behind the $31.0 million increase.[11] Due to the expiration of a contract with Commonwealth Edison that had allowed the MWRD to purchase electricity at the same rate for 50 years, Corporate Fund appropriations for electricity will jump from $27.7 million in FY2006 to $37.4 million in FY2007.

The Construction Fund serves as a pay-as-you-go funding source for capital projects that rehabilitate aged or less effective infrastructure. Capital projects paid for through this fund have a useful life of less than 20 years or a value of less than $1 million, and are financed by a tax levy sufficient to pay for project costs as they are constructed. In FY2007 the Construction Fund will be reduced by $9.1 million or 18.6%.

The Capital Improvements Bond Fund is for major infrastructural improvements whose useful life is longer than 20 years. The 20.6%, $80.3 million decrease in Capital Improvements Bond Fund appropriations for FY2007 reflects the timing of the award of major projects.[12]

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[10] Information provided by MWRD Budget Office, November 30, 2006.
[11] MWRD FY2007 General Superintendent's Recommendation, p. 79.
[12] Narrative descriptions of decreased appropriations for the Construction Fund and the Capital Improvement Bond Fund are provided in the MWRD FY2007 General Superintendent's Recommendation, pp. 17-18.

MWRD Major Fund Appropriations: FY2006 & FY2007				
	2006 Adj.	2007 Budg.	$ Change	% Change
Corporate Fund	$ 316,828,900	$ 347,858,400	$ 31,029,500	9.8%
Construction Fund	$ 49,034,600	$ 39,900,500	$ (9,134,100)	-18.6%
Capital Improvements Bond Fund	$ 389,058,800	$ 308,737,300	$ (80,321,500)	-20.6%
Stormwater Fund	$ 24,497,500	$ 24,499,600	$ 2,100	0.0%
Retirement Fund	$ 26,032,732	$ 30,889,770	$ 4,857,038	18.7%
Reserve Claim Fund	$ 41,700,000	$ 56,705,500	$ 15,005,500	36.0%
Bond Redemption & Interest Fund	$ 191,688,067	$ 160,184,762	$ (31,503,305)	-16.4%
Total Appropriations	**$ 1,038,840,599**	**$ 968,775,832**	**$ (70,064,767)**	**-6.7%**

Source: MWRD 2007 Tentative Budget, p. 10.

REVENUES

This portion of the analysis presents trend information about FY2007 MWRD Corporate Fund and All Fund revenues.

Corporate Fund Resources

FY2007 Corporate Fund resources will increase by 19.2% over FY2006 budgeted levels, rising from $339.6 million to $404.8 million. Because the MWRD built up its Corporate Fund balance in FY2006 and will do so again in FY2007 by setting aside a significant portion of the Fund's total resources, the Corporate Fund resources actually available to the MWRD were $316.4 million in FY2006, and will increase to $347.9 million in FY2007, a $31.4 million or 9.9% increase. The District will add $57.0 million to its fund balance for contingencies in FY2007. Some key resource changes include:

- The net Corporate Fund property tax levy, which constitutes 64.7% of available Corporate Fund revenues, will rise by 9.2%, from $206.0 million to $224.9 million.

- The Personal Property Replacement Tax (PPRT), which is a corporate income tax, is expected to constitute 6.7% of available resources and will decrease by nearly 2.4% from PPRT revenues in FY2006. PPRT revenues are first used to fully fund the Retirement Fund. Any remainder is distributed to the non-debt funds in proportion to their property tax levies.

- User charges will represent 13.7% of available Corporate Fund resources in FY2007. Revenues from user fees will increase by 2.1% in FY2007, rising from $46.6 million to $47.6 million.

- Property and Service Charges, which includes land rentals and other revenues, will increase by 39.6% or $4.9 million in FY2007 and will constitute 4.9% of the Corporate Fund's available resources.

- The Corporate Fund's appropriable net assets (that is, its fund balance) will be $94.5 million in FY2007. Approximately $57.0 million of that fund balance will not be appropriated, but will be saved as a contingency fund instead. Until FY2004, all net assets appropriable were reappropriated as revenue for the forthcoming year. Since then, a portion of those assets has not been reappropriated in order to provide for a Corporate Fund balance.

MWRD CORPORATE FUND REVENUES: FY2006 & FY2007				
	FY2006 Budg.	FY2007 Budg.	$ Change	% Change
Property Taxes (net)	$ 206,027,500	$ 224,907,700	$ 18,880,200	9.2%
PPRT	$ 24,000,000	$ 23,421,000	$ (579,000)	-2.4%
Property & Service Charges	$ 12,331,000	$ 17,209,000	$ 4,878,000	39.6%
User Charges	$ 46,600,000	$ 47,600,000	$ 1,000,000	2.1%
Other	$ 2,249,000	$ 1,849,000	$ (400,000)	-17.8%
Net Assets Apopropriable	$ 52,803,600	$ 94,460,100	$ 41,656,500	78.9%
Working Cash Borrowings Adjustment	$ (4,427,500)	$ (4,628,700)	$ (201,200)	4.5%
Total	**$ 339,583,600**	**$ 404,818,100**	**$ 65,234,500**	**19.2%**
Non-Appropriated Fund Balance	$ (23,156,000)	$ (56,959,700)	$ (33,803,700)	146.0%
Total Resources Available	**$ 316,427,600**	**$ 347,858,400**	**$ 31,430,800**	**9.9%**

Sources: FY2006 Revised Tenative Budget, p. 11, and FY2007 Tentative Budget, p. 13.

Major Revenues for All Funds

The following exhibit shows projected changes in selected major revenues for all funds between FY2006 and FY2007. The gross property tax levy will increase by approximately $0.4 million or 0.1% from the FY2006 adjusted budget. User charges are expected to decrease by 0.4%, from $48.1 million to $47.9 million. The largest increase will come in Investment Interest Income, which will rise by 34.8% or $11.2 million.

In the chart below, PPRT revenues appear to be diminishing in FY2007, falling from $26.5 million to $24.4 million. In fact, the District's PPRT revenues will increase from $40.0 million in FY2006 to $41.5 million in FY2007. The discrepancy between the numbers presented in the table below and the actual figures is due to the District's use of two different accounting methods to present the data.

MWRD All Funds Selected Major Revenues: FY2006 & FY2007				
	FY2006 Est.	FY2007 Budg.	$ Change	% Change
Property Tax (Gross Levy)	$ 415,839,079	$ 416,209,989	$ 370,910	0.1%
User Charges	$ 48,100,000	$ 47,900,000	$ (200,000)	-0.4%
PPRT	$ 26,535,000	$ 24,421,000	$ (2,114,000)	-8.0%
Investment Interest Income	$ 32,035,000	$ 43,199,000	$ 11,164,000	34.8%
Lease Revenue	$ 6,500,000	$ 6,750,000	$ 250,000	3.8%

Source: Provided by MWRD Budget Office, December 5, 2006.

Property Tax Levy

In FY2007 the MWRD's gross property tax levy will increase by just 0.1% to $416.2 million. Of this $416.2 million, 64.7% will be levied for funds that are subject to the tax cap law, which limits annual increases to 5% or the rate of inflation, whichever is less. The remaining 35.3%, or $142.6 million, is levied for the Bond and Interest Fund and the Stormwater Management Fund, which are not subject to tax caps.[13] The FY2007 Stormwater Management levy will decrease by 74.6%, from $15.5 million to $3.9 million. The Bond and Interest levy, reserved for debt

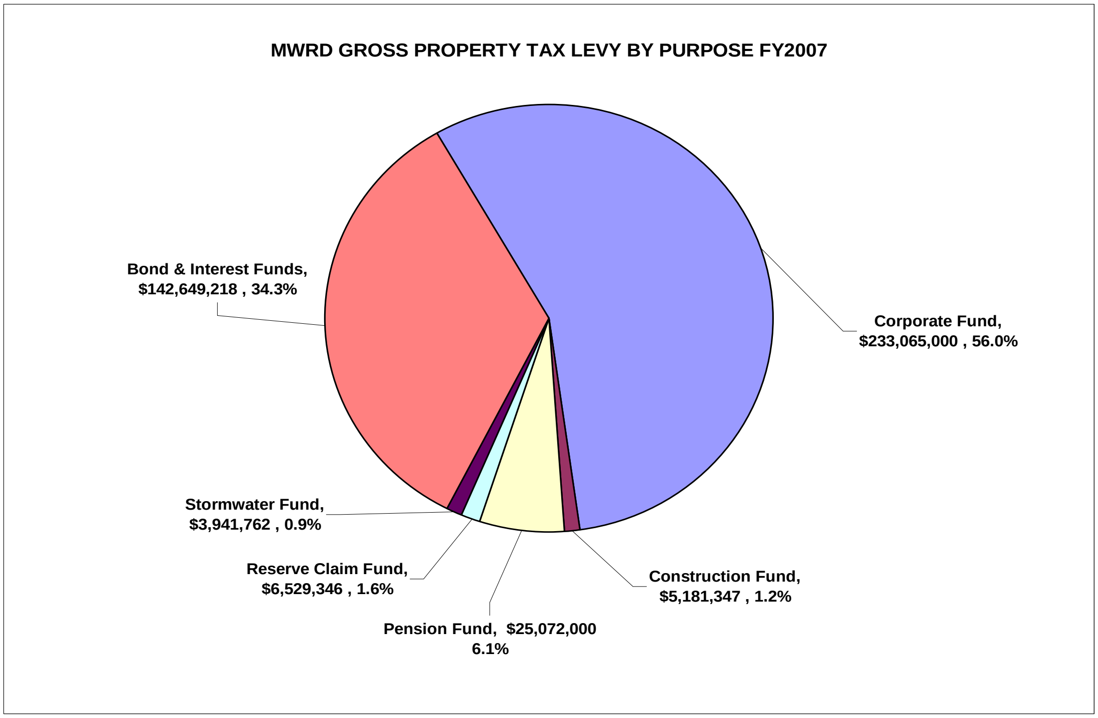
[13] The November 2004 passage of Public Act 93-1049 authorizes the MWRD to levy an additional $50 million in non-capped funds for stormwater management in Cook County.

service, will increase by 3.3% or approximately $4.6 million. The Construction Fund will also fall by 70.8% or $12.6 million. The Corporate Fund levy will increase by 9.2% or $19.6 million.

MWRD Gross Property Tax Levy: FY2006 & FY2007				
	FY2006 Adj	FY2007 Budg.	$ Change	% Change
Corporate Fund	$ 213,500,000	$ 233,065,000	$ 19,565,000	9.2%
Construction Fund	$ 17,766,010	$ 5,181,347	$ (12,584,663)	-70.8%
Pension Fund	$ 25,072,000	$ 24,843,316	$ (228,684)	-0.9%
Reserve Claim Fund	$ 5,956,730	$ 6,529,346	$ 572,616	9.6%
Stormwater Fund	$ 15,507,944	$ 3,941,762	$ (11,566,182)	-74.6%
Bond & Interest Funds	$ 138,036,395	$ 142,649,218	$ 4,612,823	3.3%
TOTAL	**$ 415,839,079**	**$ 416,209,989**	**$ 370,910**	**0.1%**

Source: MWRD FY2007 Tentative Budget, p. 10.

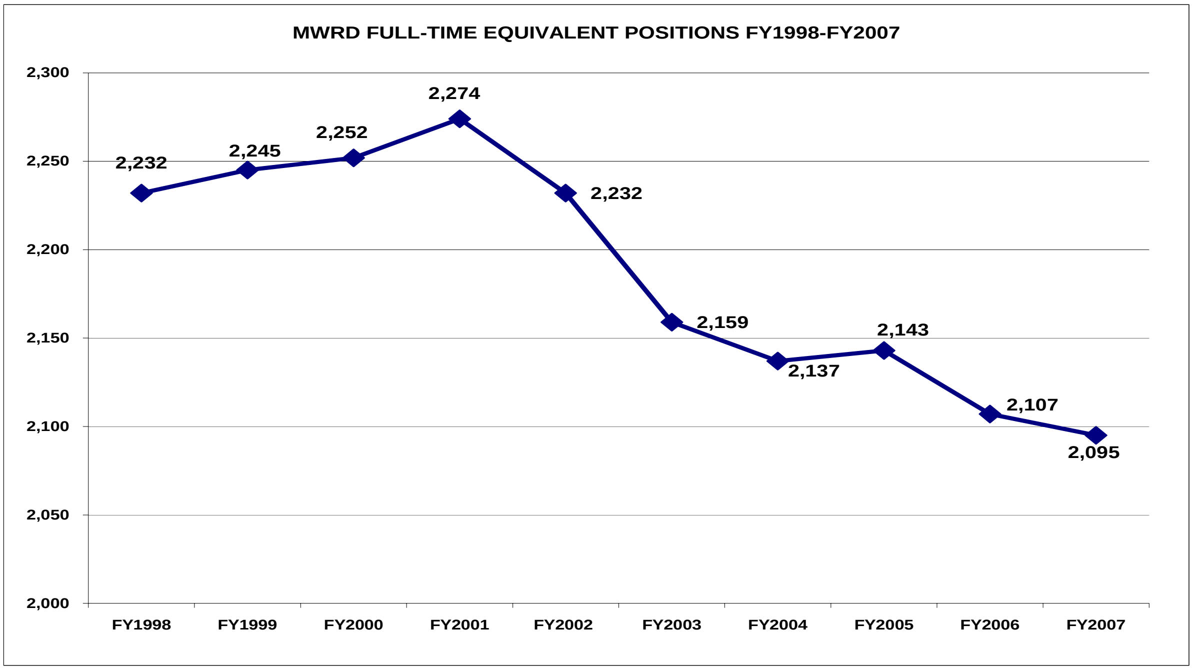
The next exhibit shows the distribution of property tax dollars among the MWRD's various funds in FY2007. The Corporate Fund and Bond and Interest Funds together will consume 90.3% of the District's total levy.



PERSONNEL

The number of full-time equivalent (FTE) positions is projected to decline by 32 positions or 1.7% in FY2007, a decrease from 2,107 to 2,095 FTEs. Since FY1998, the District has cut its workforce by 6.1% or 137 positions. The MWRD intends to reduce the total number of FTEs to 2,052 positions in the next four years.[14] This reduction is being accomplished by attrition.

[14] *MWRD FY2007 General Superintendent's Budget*, p. 59.



Almost 90% of District employees are funded with Corporate Fund dollars. Between FY2006 and FY2007, the number of Corporate Fund FTEs will decline by 1.7% or 32 positions. Twenty-five of the positions reduced are in Maintenance and Operations.

MWRD CORPORATE FUND FTES: FY2006 & FY2007				
	FY06	FY07	CHG	% CHG
Maintenance & Operations	1,071	1,046	-25	-2.3%
Research & Development	317	311	-6	-1.9%
General Administration	145	144	-1	-0.7%
Purchasing	70	70	0	0.0%
Information Technology	63	66	3	4.8%
Personnel	53	52	-1	-1.9%
Law	41	40	-1	-2.4%
Board of Commissioners	38	38	0	0.0%
Finance	35	34	-1	-2.9%
Engineering (Corporate Fund)	33	33	0	0.0%
Treasury	7	7	0	0.0%
TOTAL	**1,873**	**1,841**	**-32**	**-1.7%**

Personal Service Appropriations

This exhibit below shows personal service appropriations in FY2006 and FY2007. Some of the highlights include:

- The appropriation for regular employee salaries, which constitutes 48.4% of all personal service appropriations, will increase by 4.8%, reflecting cost of living increases. This represents an increase of $7.3 million from $152.7 million to $160.0 million.

- Appropriations for health and life insurance premium costs will rise by 19.4%, from $37.6 million to $44.9 million. This increase includes $10.0 million that will placed in a Trust Fund for future OPEB obligations. If this money were not being set aside, health and life insurance premium costs would decrease in FY2007. The District has worked to contain rising healthcare costs by providing for staggered increases in employee contributions over time. They rose from 7% to 9% in October 2005 and to 10% in July 2006. In July 2007 they will reach 11%. Deductibles and co-payments have also increased over time.[15]

- Contractual services will represent 31.0% of personal services appropriation in FY2007. The District will appropriate $102.6 million for contractual services, a 3.3% or $3.5 million decrease from FY2006 adjusted appropriations of $106.0 million. The FY2007 budgeted appropriations for contractual services represents an increase of $25.3 million or 32.7% over the appropriations for contractual services originally approved in the FY2006 budget. The discrepancy between the FY2006 budgeted and adjusted appropriations is due to construction related consulting work for which funding became available during the year. The MWRD says that Contractual Services appropriations will likely continue to be high for several years as contracts for major plant renovations are being prepared.[16]

Personal Service Appropriations: All Funds FY2006 & FY2007				
	FY2006 Adj.	FY2007 Budg.	$ CHG	% CHG
Salaries of Regular Employees*	$ 152,717,400	$ 160,041,800	$ 7,324,400	4.8%
Contractual Services	$ 106,037,321	$ 102,575,200	$ (3,462,121)	-3.3%
Health & Life Insurance Premiums**	$ 37,602,200	$ 44,881,500	$ 7,279,300	19.4%
Employee Claims	$ 10,110,000	$ 10,110,000	$ -	0.0%
Compensation Plan Adjustments	$ 8,736,700	$ 7,798,800	$ (937,900)	-10.7%
Other Employee Personal Services***	$ 3,332,900	$ 3,234,200	$ (98,700)	-3.0%
Social Security & Medicare Contributions	$ 1,764,000	$ 1,852,200	$ 88,200	5.0%
TOTAL	**$ 320,300,521**	**$ 330,493,700**	**$ 10,193,179**	**3.2%**

Source: Provided by MWRD Budget Office, December 5, 2006
* Includes FY2006 Salary Adjustments
** Includes OPEB distribution
*** Includes Tuition, Training, Nonbudgeted Salaries

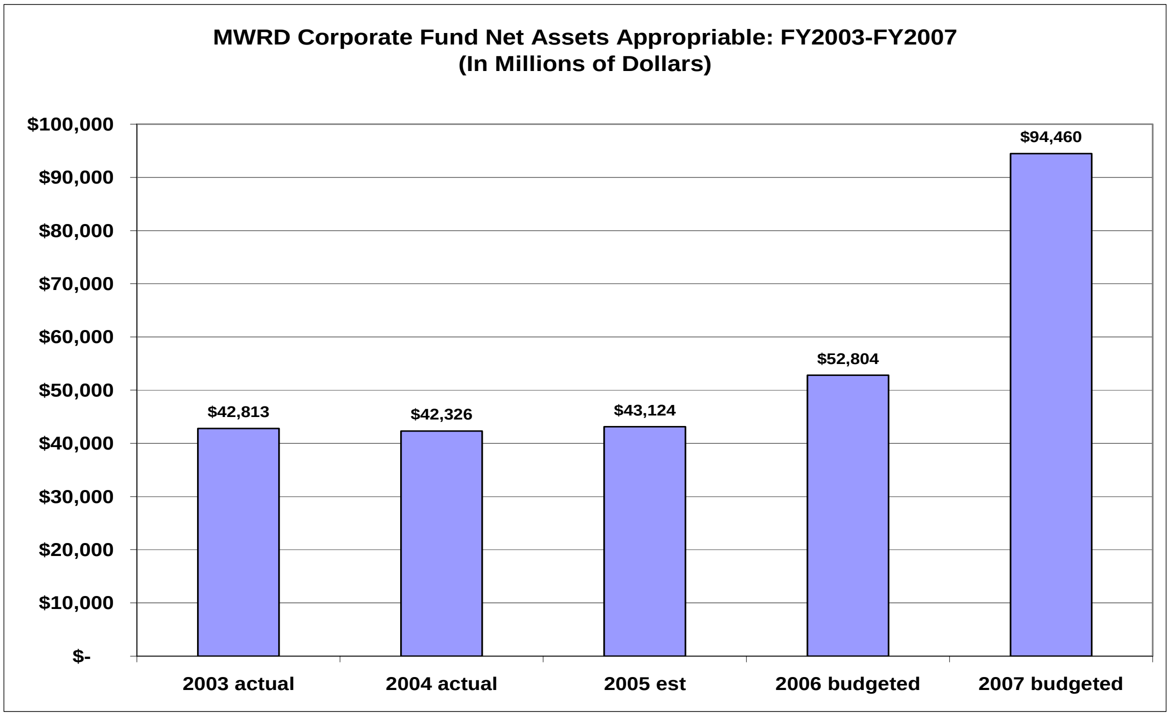
FUND BALANCE

One of the stated goals guiding MWRD budget development is to maintain a long-term Corporate Fund balance of $40 to $45 million, or 10% to 15% of Corporate Fund appropriations.[17] The Government Finance Officer's Association recommends a budgetary operating fund balance of 5-15%.[18]

The MWRD Corporate Fund balance, or net assets appropriable, is budgeted at $94.4 million in FY2007 or 27.2% of proposed Corporate Fund appropriations. This is a significant increase from FY2006, when net assets appropriable were $52.8 million or 16.7% of Corporate Fund appropriations. These increased, non-appropriated assets have been set aside for contingent

[15] MWRD FY2006 Tentative Budget Supplement, p. 6.
[16] Eileen McElligott (Management Analyst, MWRD), in an e-mail to the Civic Federation, December 5, 2006.
[17] MWRD FY2006 Tentative Budget, p. 15.
[18] Government Finance Officers Association Recommended Practice. "Appropriate Level of Unreserved Fund Balance in the General Fund" (Adopted 2002).

situations. The MWRD's policy regarding its non-appropriated fund balance is discussed further in the following section.



Non-Appropriated Corporate Fund Balance

Beginning in FY2005, the District began to designate a portion of the net assets appropriable as a non-appropriated or unreserved fund balance that would be available for contingencies. In FY2004, $4.6 million or 1.4% of the Corporate Fund appropriation was provided for contingencies. In FY2006, $23.1 million or 7.3% of projected appropriations was set aside. This fiscal year, 16.4% or $56.9 million will be designated as non-appropriated Corporate Fund balance.

This year's non-appropriated Corporate Fund balance is being increased substantially because of a unique convergence of events that create considerable uncertainty for the District's FY2007 financial plans: 1) prices for electricity and natural gas due to utility deregulation will increase; 2) the District will incur costs associated with the opening of the Stickney pelletizer facility; 3) the District plans to set aside funding for OPEB liabilities; and 4) there is a strong likelihood that governments' real estate tax payments will be delayed, since there is traditionally a high volume of appeals following the City of Chicago's property reassessment.[19] The District's reserve will likely be depleted this year and, as a result, will be much reduced in FY2008.

[19] *MWRD FY2007 Tentative Budget*, pp. 6-7.

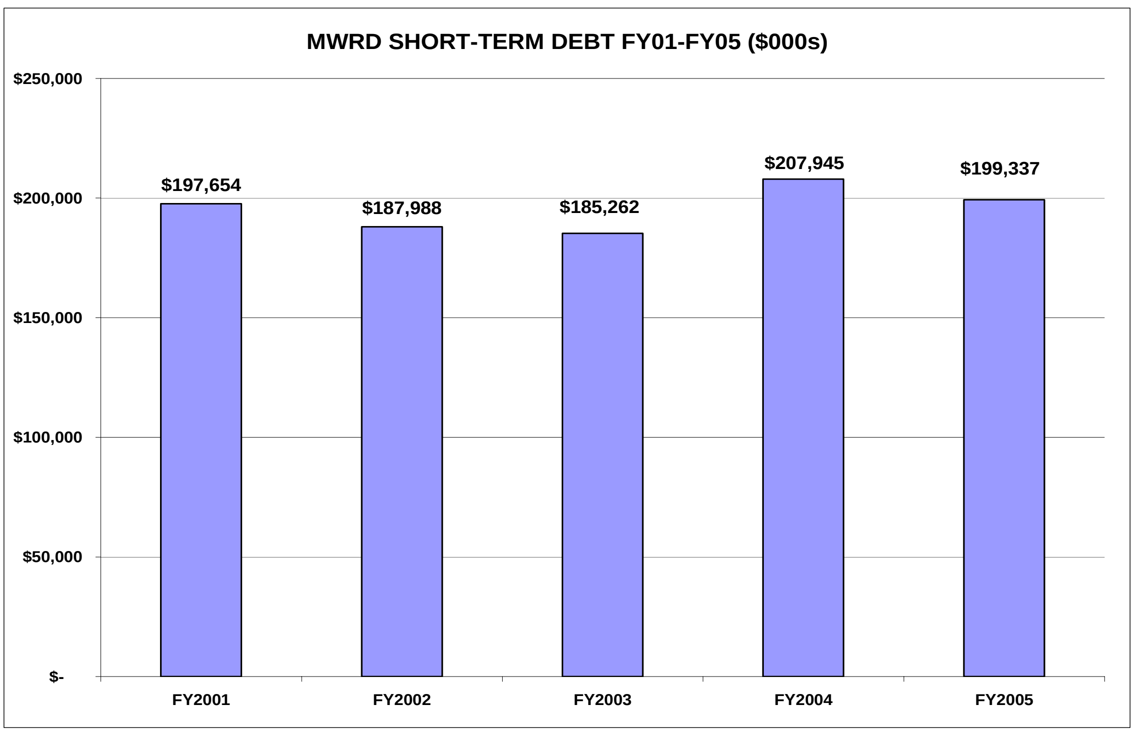
DEBT TRENDS

The Civic Federation has employed two measures of debt for the 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 for MWRD general governmental activities 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 that are reported in the General Corporate Fund.

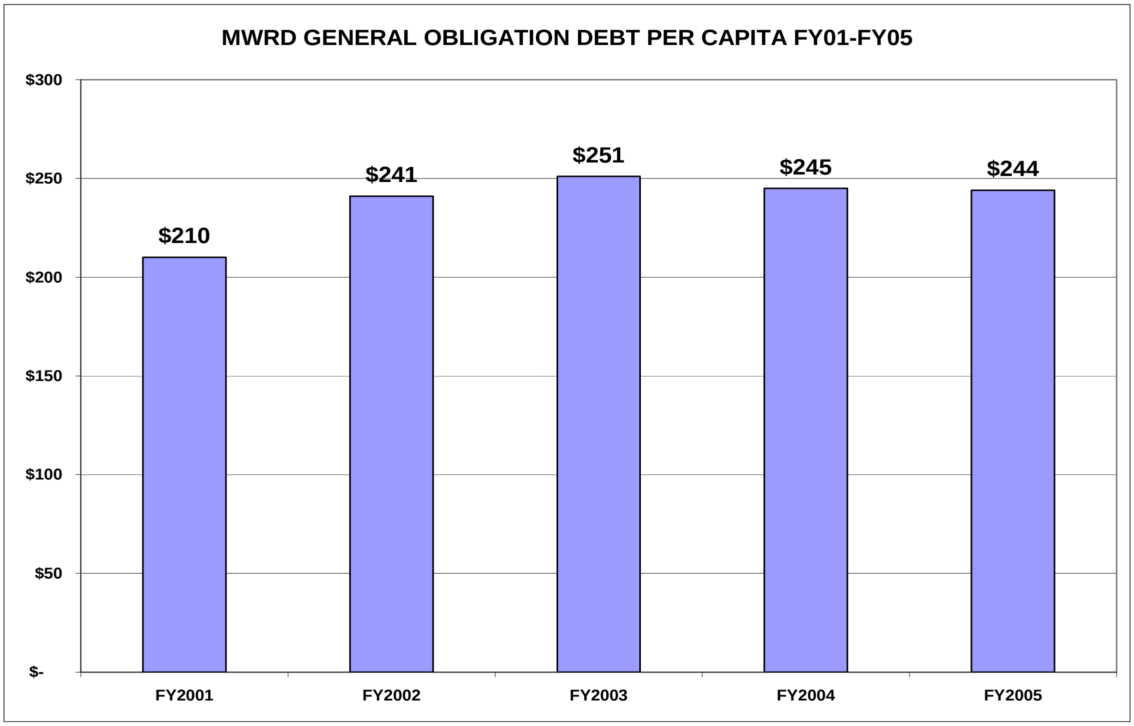
Between FY2001 and FY2005, MWRD short-term debt obligations rose by 0.9%, from $197.6 million to $199.3 million. After rising between FY2003 and FY2004 by 12.2%, short-term debt fell by $8.6 million or 4.1% the following year. The drop is a positive sign.



Long-Term Debt Per Capita

The MWRD's long-term debt is primarily General Obligation debt. The Civic Federation measures G.O. debt per capita is a measure of a government's ability to maintain its current financial policies. Increases over time bear watching as a potential sign of increasing financial risk.

The total amount of MWRD General Obligation debt in FY2005 was $1.3 billion. In that year G.O. debt per capita declined slightly by 0.5% from the previous fiscal year. This represented a total decline of $6.2 million. Between FY2001 and FY2005, the total dollar increase was $188.2 million. During the same five-year period, the MWRD's G.O. debt per capita increased by 16.2%, rising from $210 to $244.

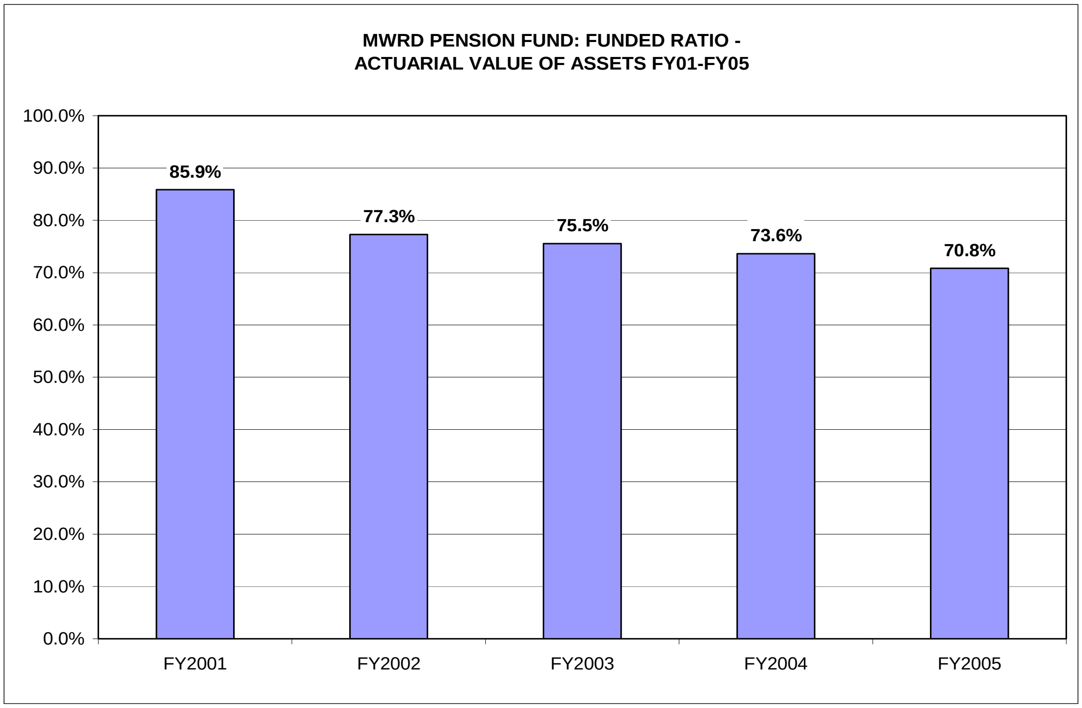


PENSION FUND TRENDS

The Civic Federation used three measures to present a multi-year evaluation of the fiscal health of the MWRD's pension fund: funded ratios, the value of unfunded liabilities, and the investment rate of return. A comparison of ten local government pension funds, including the MWRD, can be found in the Civic Federation's annual Status of Local Pensions reports.

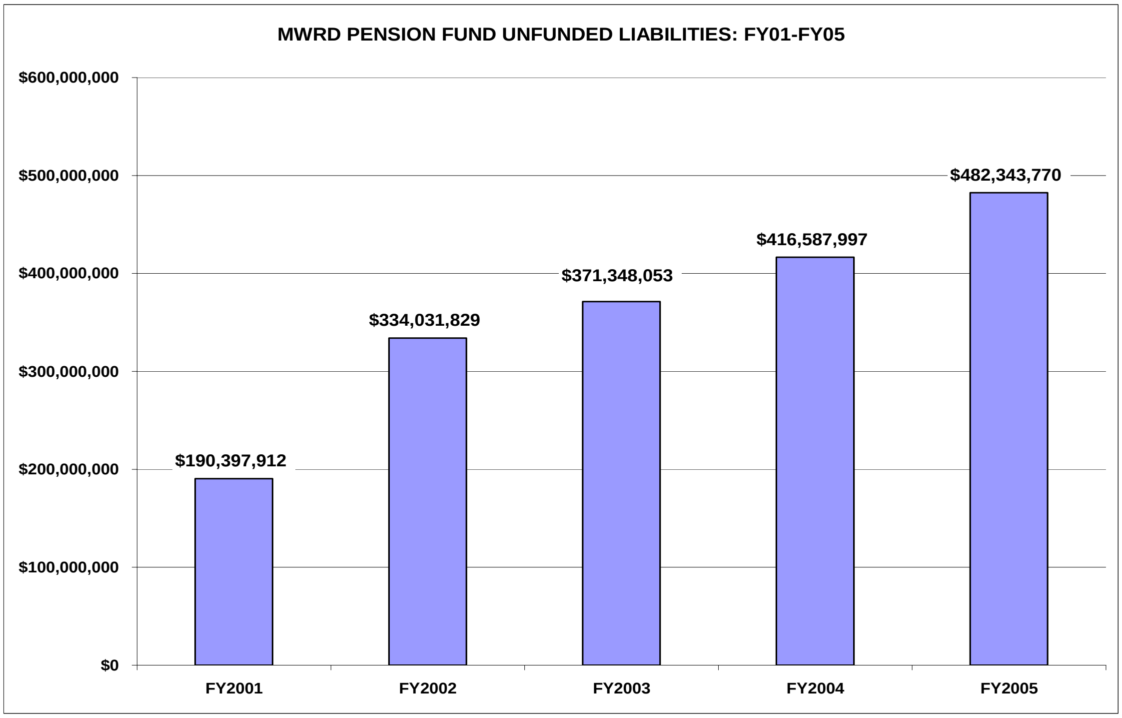
Funded Ratio – Actuarial Value of Assets

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 MWRD's funded ratio declined again in FY2005, from 73.6% to 70.8%. Since FY2001, it has declined steadily from the relatively healthy level 85.9%. This continued decline is a cause for concern.



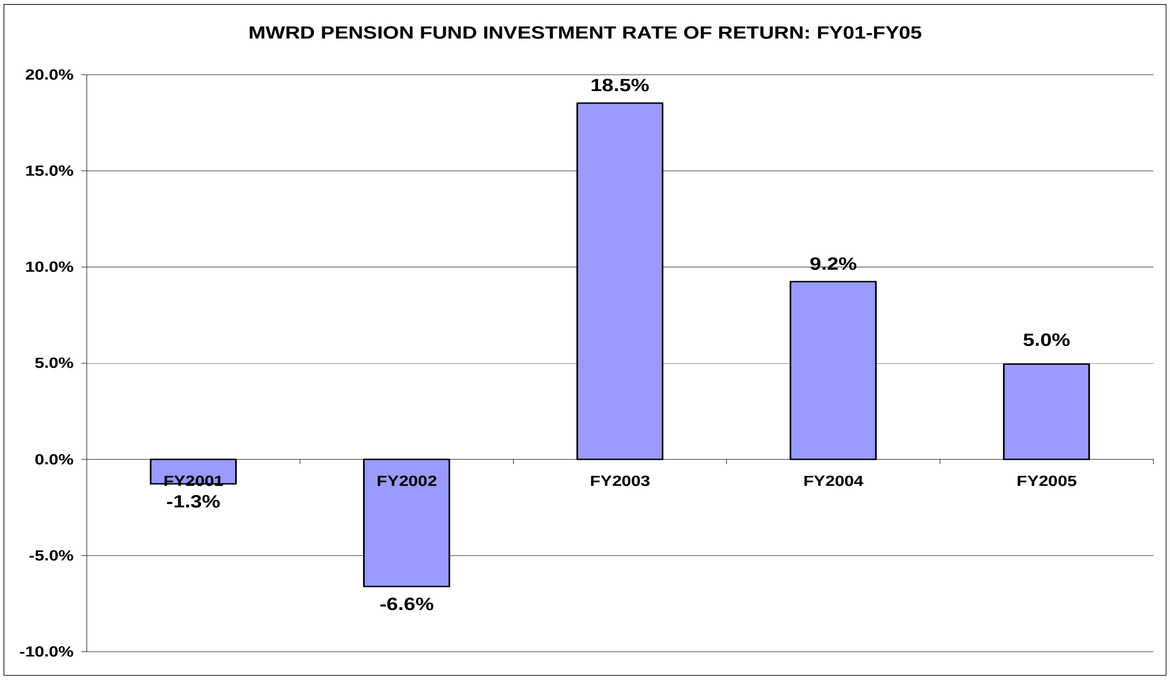
Unfunded Liabilities

Unfunded liabilities are the dollar value of pension liabilities not covered by assets. The exhibit below shows that unfunded liabilities for the MWRD's pension fund totaled approximately $482.3 million in FY2005, up from $416.6 million the previous fiscal year. Between FY2001 and FY2005, unfunded liabilities rose by 153.3% or $291.9 million. Shortfalls in employer contributions have significantly contributed to this increase. State statute requires the MWRD to levy a property tax equivalent to a multiple of the employee contributions made two years prior. This amount is unrelated to the actuarially required contribution (ARC) for funding normal cost plus the amortization of the unfunded liability. The ARC payment would have been $51.3 million in FY2005, $25.2 million more than the District's actual $26.2 million contribution. The lingering effects of the market downturn in 2001-2002 also increased the unfunded liability.



Investment Rates of Return

Investment income typically provides a significant portion (over 50%) of the funding for pension funds. Thus, declines over time negatively impact pension assets. From FY2001 to FY2005, MWRD investment rates of return ranged from a low of -6.6% in FY2002 to a high of 18.5% in FY2003. In FY2005, the rate of return fell to 5.0% from 9.2% the previous fiscal year.



CIVIC FEDERATION RECOMMENDATIONS

The Civic Federation offers several recommendations on ways to improve the MWRD's financial management and the transparency of its operations.

Implement Comprehensive Pension Benefit Reform

The Civic Federation offers the following recommendations on ways in which the MWRD could improve the long-term financial health of its Pension Fund. These measures would require General Assembly authorization. We strongly urge the District to seek such approval as soon as possible.

Establish a Two-Tiered System

Although the pension benefits for current public employees and retirees are guaranteed by the Illinois Constitution, benefit levels can be reduced for new employees. Reducing benefits for new employees would mean the creation of a two-tiered benefit system in which existing and new employees receive different retirement benefits. Given the rising cost of pension benefits, this is a reasonable approach that the District should undertake.

Annuity Increases for New Hires Should be Fixed at the Lesser of 3% or CPI

Currently, MWRD pension fund beneficiaries receive 3% annual cost of living increases. However, this rate can and often does exceed the rate of inflation. To control costs, annual annuity increases for new hires should be fixed at the projected Consumer Price Index or 3%, whichever is less.

Any Benefit Increases Should Require Contribution Increases

Many benefit enhancements for the MWRD and other local governments are added to public pensions by the Illinois General Assembly without any provision for accompanying contribution increases. The Civic Federation urges the MWRD to closely monitor the General Assembly's proposed pension legislation and to insist that any new benefit increase must identify additional funding to pay for the resulting annual accrued cost. This is a reasonable measure for controlling future benefit costs and for avoiding unnecessary local property tax increases.

Require that Employer Contributions Relate to Funding Levels

The MWRD employer contributions are determined by a multiplier that is not tied to the fund's funded ratio. The MWRD's multiplier is set by state statute at 2.19 times the total employee contribution made two years prior, except for employee contributions to optional additional benefits made after January 1, 2003, which are multiplied by 1.00. Unfortunately, meeting this statutory funding requirement does not ensure that the MWRD will provide sufficient resources to keep its Pension Fund financially healthy. The Civic Federation believes that, at a minimum, employer contributions should be tied to funded ratios so that additional contributions are required whenever the ratio drops below a given level. Linking pension contributions to actuarially required contribution (ARC) levels would be an even more effective way of guaranteeing the Pension Fund's financial health.

MWRD Retirement Fund Governance Reform

The MWRD Retirement Fund is governed by a five-member Board of Trustees that includes three active employees and two representatives from management.[20] The proper role of a pension board is to safeguard the fund's assets and to balance the interests of the employees and retirees who receive benefits and the taxpayers who pay for pension benefits. The employer, employees, retirees, and taxpayers all have an interest in the management of the fund. However, the tilt toward employees and retirees on the MWRD Retirement Fund Board raises questions about how objective the Board can be in its work. In our view, a pension board should:

- Balance employee and management representation;
- Have a tripartite structure that includes citizen representation on pension boards,
- Include financial experts, and
- Require financial training for non-experts.

We urge the MWRD to seek reform of the MWRD Retirement Fund Board governing structure to ensure a greater balance of interests.

Provide a Summary Table in Budget Book for All Fund Revenues

The MWRD Budget Book is a transparent, user-friendly document. We are impressed by its high quality and comprehensive nature. The inclusion of a summary table detailing revenues for All Funds, however, would improve the Budget Book by making this important part of the MWRD's overall financial picture more accessible to the budget's readers. A table showing by category the aggregated personnel expenditures for All Funds would also be a significant addition, and would improve readers' understanding of the District's efforts to control personnel costs.

[20] Civic Federation, *Recommendations to Reform Public Pension Boards of Trustees in Illinois* (February 13, 2006), www.civicfed.org.