THE CIVIC FEDERATION
2009 Legislative Priorities
February 11, 2009

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.

I. ENACT PUBLIC EMPLOYEE PENSION REFORMS

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

The recent crisis in financial markets has led to investment losses of 20-40% for many other public pension plans and there is a very real possibility that some funds have now entered a downward spiral from which they cannot recover without major benefit reductions or contribution increases. While the investment losses have accelerated this process, many of our state and local pension funds have been routinely underfunded for years as benefit enhancements were granted without regard for their long-term cost to taxpayers.

The status quo for Illinois' state and local pension funds is not a responsible option. The Civic Federation urges the General Assembly to take action immediately on four critical areas of pension reform: benefits, contributions, governance, and financial reporting.

Benefit Reforms

Pension benefits have reached unaffordable levels in the State of Illinois and funding these benefits now threatens to crowd out spending on critical public services. The pension problem cannot be solved without reducing benefits to levels that are tolerable to taxpayers and do not shift the cost of today's government to tomorrow's citizens.

1) Reduce Pension Benefits

The Civic Federation recommends **five ways to reduce public pension benefits**:

- Increase minimum retirement age for unreduced benefits to match Social Security (currently age 67)
- Increase minimum years of service for unreduced benefits (e.g., from 25 to 30)
- Reduce the annuity cost of living increase (e.g., from 3% to 2%)
- Reduce the final average salary used for pension benefits (e.g., from average of last four years to average of last eight years)
- Reduce benefit formula multiplier (e.g., from 2.3% to 1.8%)

Benefit reductions should be considered for every state and local public pension plan, and where reductions cannot be negotiated for current and future employees, they should be implemented for new hires. Such changes might also include transition to a cash balance or defined contribution plan.

2) *Prohibit Benefit Enhancements Unless They Are Fully Funded, Will Expire in Five Years, and the Plan is Over 90% Funded*

Benefit enhancements are a major source of increased liabilities for pension funds. Employee groups often advocate for benefit enhancements with the expectation that investment returns or tax increases will finance the enhancements. But years of enhancements have led to pension benefits that are now unaffordable for many governments and threaten to crowd out spending on public services.

The Civic Federation urges the General Assembly to **prohibit retirement benefit enhancements for any state or local government pension plan that is less than 90% funded**.

Any enhancements granted for healthy fund (over 90% funded) **should only be permitted on a pay-as-you-go basis whereby employer and/or employee contributions are increased sufficiently to fully fund the enhancements**.

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

3) *Consider Elimination of Early Retirement Programs and Reject Adding DROP Benefits*

Early retirement programs are designed to reduce current payroll expenses by encouraging senior employees to retire early, but they often create substantial additional pension costs.

The Civic Federation recommends that the State and local governments be **required to conduct and publish comprehensive cost-benefit analyses before being permitted to implement early retirement programs** because these programs increase pension costs and effectively shift the price of government services from current taxpayers to future taxpayers.

The Civic Federation also urges the General Assembly to **reject any proposals to offer Deferred Retirement Option Plans (DROP)** to state or local government employees as a means of retaining employees who have reached retirement age. These plans allow employees to accrue annuity payments while continuing to work for the employer. They constitute a pension benefit enhancement and create significant additional pension liabilities.

Contribution Reforms

Resolving the funding crisis facing state and local pension funds will require contribution reforms as well as benefit reforms.

1) Require Employer Contributions to Relate to Funding Levels

The employer contributions for eight major local government pension funds in the Chicago area are simply a multiple of past employee contributions, with no relationship to the funding status of the plan.

The Civic Federation recommends that **employer contributions for all funds be tied to funded ratios, such that additional contributions are required when the ratio drops below 90%**. For those funds that are already well below 90%, a plan should be developed to gradually increase contributions until the 90% level is reached, similar to the statutes governing Chicago Public Schools and Chicago Transit Authority.

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

2) Tie Pension Obligation Bond Issuance to Pension Reforms

The Civic Federation recommends that **no state or local government be permitted to issue pension obligation bonds without first enacting pension benefit reforms**. We supported the issuance of $1.1 billion in pension obligation bonds for the Chicago Transit Authority because Public Act 95-0708 also required major benefit and contribution reforms. The Civic Federation does not support putting more money into pension funds without fixing some of the underlying problems causing chronic underfunding.

3) Increase employee contributions

The Civic Federation believes that employees need to share in the increased costs of public pension plans and recommends that all public employee contributions be increased at least 1 percentage point.

<u>Governance Reform</u>

The number and composition of pension boards of trustees should be changed in order to achieve economies of scale and to ensure that the trustees are well prepared for their role as fiduciaries of millions of dollars in invested assets.

1) Consolidate Investment Functions of Five State-Funded Pension Plans

The Civic Federation supports Illinois Treasurer Alexi Giannoulias' proposal to **merge the investment functions of all five state-funded pension systems** into a single fund managed by a new Illinois Public Employees' Retirement System (ILPERS). The benefits of consolidating the investment aspects of the five pension systems include reduced costs due to economies of scale and savings in administrative expenses related to operating separate pension investment bodies. The Treasurer's proposal would also require ILPERS to make investment information more accessible and transparent by making monthly investment updates available online.

2) Consolidate Local Pension Funds

The Civic Federation also recommends that the General Assembly consolidate local pension funds. There are over 600 local pension funds in the state, each with its own governing board, most of which are police and fire funds for individual municipalities. While these funds may enjoy local control over investing and disability decisions, we believe that **overall investment performance and administrative efficiency generated by economies of scale would greatly improve if funds were consolidated into a multi-employer fund like the Illinois Municipal Retirement Fund**.

3) Reform Pension Boards of Trustees to Balance Stakeholder Interests, Safeguard Assets

The mission of a public pension fund board of trustees should be to safeguard the fund's assets through prudent investments and effective benefit administration. Unfortunately, many pension boards also act as advocates on behalf of fund members, lobbying for benefit enhancements that ultimately increase the funds' liabilities.

As outlined in the Civic Federation's *Recommendations to Reform Pension Boards of Trustees Composition in Illinois,* the membership of most Illinois public pension boards does not reflect a balance of interests. The employer, employees, retirees, and taxpayers all have stake in the management of the fund. Furthermore, we are concerned that not all pension board members have adequate financial knowledge or training for their role in setting policies and overseeing millions of dollars of investments. We urge the General Assembly to undertake state and local pension governance reform that will:

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

We commend Representative Elaine Nekritz (D-Des Plaines) for introducing these reforms in House Bill 3400 in February 2007, and we ask the 96^{th} General Assembly to consider them again.

Financial Reporting and Disclosure Recommendations

The minimal reporting currently required of pension funds by Illinois state statutes does not give citizens or other interested observers a clear or complete picture of what the public pension situation means for future taxpayers and future budgets.

1) Require Reporting of Basic Projections

The Civic Federation believes that the state pension code should be amended to **require state and local pension funds to report four basic measures of fiscal health**. These are measures that can easily be calculated by the funds' actuaries and included in their actuarial reports.

They should also be published for public access on the state Department of Financial Regulation's Division of Insurance web site:

1) Projected funded ratios for the next 30 years
2) Projected unfunded liabilities for the next 30 years
3) Projected required employer contributions for the next 30 years
4) Projected date of insolvency (the year when the pension fund is projected to run out of money to pay retiree benefits)

These measures should be calculated and reported two ways: first according to current state laws governing employer contributions to the funds (i.e., under the current state funding policy), and second under a state funding policy equal to normal cost plus a closed 30-year amortization of the unfunded liability (i.e., what it would take to reach 100% funded in 30 years). We realize that actuarial assumptions for such factors as wage increases, turnover, and investment return will differ among the funds, so the measurements should also include a disclosure of all underlying actuarial assumptions and methods

2) Require Benefit Enhancement Reporting

The Civic Federation recommends that all pension funds be **required to describe any benefit enhancements granted in a given year in their annual financial report and to calculate the effects of those enhancements on the fund's total liabilities**. Taxpayers deserve to know the costs of benefit enhancements.

II. DISSOLVE THE ILLINOIS INTERNATIONAL PORT DISTRICT

A Civic Federation report published on June 30, 2008 found that the Illinois International Port District has shifted its primary focus from port operations to the management of a golf course.[i] The golf course brings in over half of the District's annual revenue, but there is no evidence that those revenues have been reinvested to improve port facilities or promote commerce. **Because the District is failing to fulfill its principal mission, the Civic Federation calls upon the Illinois General Assembly and Governor to dissolve it. The District's port operations should be transferred to the City of Chicago and its assets to governments more suited to operate them.**

The Civic Federation analyzed the Illinois International Port District's finances and activities and contrasted them with five comparable ports along the Great Lakes – St. Lawrence Seaway. As a result of this investigation, the Federation is concerned that the District appears to be focused on golf rather than shipping and port operations. Harborside International Golf Center is the Port District's only major construction project since 1981. In contrast, the Federation found that none of the five other ports in the study focus their operations predominantly on recreational activities or entertainment facilities. Port authorities in the other cities derive most of their revenues from activities associated with the normal operations of a port, such as leases, rentals, contracts, and grants.

Of additional concern to the Civic Federation is the fact that the District seriously lacks transparency and openness to the public when compared to other ports and governments. The Civic Federation found that the District did not make information about its finances, Board members, or Board meetings publicly available on its website.

Due to these serious concerns, the Civic Federation calls for the dissolution of the Illinois International Port District. The Federation's report recommends that the City of Chicago assume control of port operations because the City has a clear stake in turning the Port of Chicago into a more vibrant center of maritime commerce and regional economic and industrial development. By reassuming the control of port lands it gave up over fifty years ago, the City of Chicago could provide access to greater financial resources and professional staff that would benefit the port and its mission. After the District has been dissolved, the Civic Federation believes that open lands on District property would be better managed by the Forest Preserve District of Cook County and that the District's golf course should be managed by the Chicago Park District.

III. CREATE A NEW GOVERNING BOARD FOR THE COOK COUNTY FOREST PRESERVE DISTRICT

On March 17, 2008, The Civic Federation and Friends of the Forest Preserves published a report calling for the removal of the beleaguered Cook County Forest Preserves from the control of the Cook County Board of Commissioners.[ii] The report found that the County's dual board structure whereby the Cook County Board of Commissioners also serve as Forest Preserve District Commissioners creates an inherent conflict of interest and inhibits proper oversight of the Forest Preserves of Cook County.

The Federation and Friends of the Forest Preserves are calling for a new, separate forest preserve board with members that are **elected County-wide** via a **non-partisan election** with a **board president elected among and by the members** of the forest preserve board. A separate board will allow voters to elect Commissioners on the basis of candidates' positions, credentials, experience and interest in the forest preserves.

Currently the Forest Preserve District of Cook County is organized as a separate local government with independent property tax authority, but it shares a board of commissioners with Cook County government. This structure has created an **inherent conflict of interest** for the Commissioners, who have not effectively separated the interests of Cook County and the Forest Preserve District. Many of the current Commissioners have shown a keen interest in promoting economic development and other uses of District property that conflict with the District's core mission to preserve natural land. The Commissioners have frequently placed themselves in the irreconcilable position of choosing Cook County's mission over the forest preserves' needs. The Civic Federation and Friends of the Forest Preserves' report documents many such instances where the County's needs trumped the interests of the forest preserves. The most recent and egregious example was the transfer of $13.3 million in District capital funds to the County in 2007 to help alleviate the County's budget deficit.

The report found that the County and District's "double-duty" Commissioners spend the vast majority of their time dealing with County issues. These weighty concerns leave little time for the Commissioners to focus on the forest preserves. Commissioners meet far less frequently to discuss Forest Preserve District matters than they do to discuss County matters and provide **less comprehensive oversight**. A separate board of commissioners would be able to focus their attention fully on the forest preserves. At the same time, the County would benefit from having the undivided attention of its Commissioners on pressing financial, health and public safety issues.

The report's findings have led the Civic Federation and the Friends of the Forest Preserves to the unanimous conclusion that **the District has suffered from financial and land management problems because of the conflicts of interest and lack of oversight created by the dual board structure**.

We commend Senator Don Harmon (D-Oak Park) for introducing these reforms in Senate Bill 176 in January 2009, and we ask the 96th General Assembly to consider them.

IV. REQUIRE ALL COUNTIES TO HOLD BUDGET HEARINGS

The Civic Federation urges the General Assembly to **require that all counties hold at least one public hearing prior to approving the annual budget**. Currently, state statutes require Cook County, municipalities with over 500,000 residents, and school districts residing in these cities to hold public hearings prior to passage of the budget (see Cook County Appropriations, 55 ILCS 5/6-24; Municipal Code – Budget hearing, 65 ILCS 5/8-2-6; School Code, 105 ILCS 5/34-46). We believe that all counties should hold public budget hearings as a matter of transparent and open governance.

V. REQUIRE LARGE COUNTIES TO PRODUCE TIMELY ANNUAL AUDITS

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

VI. ENACT TAX INCREMENT FINANCING REPORTING REFORM

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

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

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

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

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

VII. REQUIRE SCHOOL FINANCIAL MANAGEMENT ACCOUNTABILITY REFORMS

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

We commend Representative Lou Lang (D-Skokie) for introducing these reforms in House Bill 4194 in December 2007 and we ask the 96th General Assembly to consider the following school financial management accountability reforms:

Budgeting

a) Budget Format

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

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

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

Full Budget

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

b) Evaluation

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

c) Disclosure

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

<u>Internal Controls</u>

1. Create a strong internal auditor function.
2. Implement more rigorous external audit requirements.
3. Require school district audit committees.
4. ISBE should develop a comprehensive set of internal procedures for adoption by school districts.
5. School districts should submit formal, written internal control policies to ISBE.

<u>Planning Formal Financial Policies, Long Term Financial Planning, Capital Improvement Plan</u>

a) Formal Financial Policies

1. School districts should be required to adopt formal financial policies in the following policy areas:
    - Debt Capacity, Issuance, and Management
    - Capital Asset Management
    - Reserve or Stabilization Funds
    - Requiring Periodic Budget to Actual Comparison Reports
    - Fees and Charges
    - The Use of One-Time Revenues

- o Risk Management
- o Purchasing
- o Vehicle Acquisition and Maintenance

2. Require formal approval of the financial policies by school district board of trustees.
3. Make the formal financial policies publicly available in budgets and other documents.

b) Long Term Financial Planning

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

c) Capital Improvement Plan (CIP)

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

<u>Financial Management Training for School Board Members</u>

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

<u>Financial Management Accountability Oversight</u>

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

ISBE would withhold funds from school districts failing to fulfill State financial management accountability requirements and would be empowered to remove and replace non-complying financial management administrators.

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

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

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

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[i] The Civic Federation, "A Call for the Dissolution and Restructuring of the Illinois International Port District," Chicago: June 30, 2008. http://www.civicfed.org/articles/civicfed_273.pdf

[ii] The Civic Federation and Friends of the Forest Preserves, "Forest Preserve District of Cook County: A Call for a Separate Board of Commissioners," Chicago: March 17, 2008. http://www.civicfed.org/articles/civicfed_269.pdf