CITY OF CHICAGO
FY2004 PROPOSED BUDGET
Analysis and Recommendations

Prepared By
The Civic Federation
November 5, 2003

EXECUTIVE SUMMARY

The City of Chicago proposes a FY2004 budget of $4.8 billion. The City faced a $155.5 million all funds deficit, which will be addressed through management efficiencies and minor revenue enhancements.

The Civic Federation **supports** the City's FY2004 budget. Our support is based on the following points:

- The City has made continued efforts to control personal services costs by reducing personnel over time. Over 2,600 positions have been eliminated since FY2000, including 1,400 positions in FY2004 alone.
- The City's net appropriation has increased an average of 2.6% per year over the last five years, on par with inflation.
- The City did not increase its property tax levy. A property tax increase in this negative economic climate would be counterproductive to the goal of attracting and maintaining business in Chicago.
- The 0.25% proposed restaurant tax increase is a small component of the budget, targets discretionary income, and should not significantly impact local businesses.

The Civic Federation offers the following **key findings** on the City of Chicago FY2004 budget:

- Eighty-five percent of the City's property tax levy is needed to fund pensions and service debts.
- Long-term debt per capita doubled from 1998-2002.
- The negative economic climate has had a severe effect on the funded ratios of the City's four pension funds, and on its investment rates of return.
- Appropriations for Public Safety have increased $231 million, or 17%, over the last five years.

The Civic Federation offers the following specific **recommendations** on ways to improve the City of Chicago's revenue stream and financial management:

- The Civic Federation is concerned that the City's FY2004 budget projects a fund balance of less than 1% of appropriations. The Government Finance Officers Association recommends an unreserved fund balance of 5 to 15% in order to provide for contingencies. The City should establish a formal budget reserve policy to address the continued low fund balance situation.
- The City should improve its budget format by providing financial and structural information in a single summary format. Currently, information is distributed in several volumes, making it difficult for citizens to quickly gain an overview understanding of the City's financial condition and structure.
- The City should adopt a performance measurement system to facilitate its future management efficiencies and track departmental activities over time.
- The City should implement a long-term financial planning process to be reviewed not just internally, but also by key external policymakers and stakeholders.
- The City should further examine the proposal to eliminate the nonprofit water fee exemption. While more detailed information is necessary, we accept as a basic tenet that nonprofits should be expected to pay City user fees that are designed to recover the cost of City services.
- The City should pursue privatization or sale-leaseback of the Chicago Skyway and use the revenue to reducing long-term debt or boosting the unreserved fund balance.

STATEMENT MADE AT THE PUBLIC HEARING ON THE PROPOSED FY2004 CITY OF CHICAGO BUDGET, NOVEMBER 5, 2003

The Civic Federation would like to thank Mayor Daley, Budget and Government Operations Committee Chairman Beavers and the members of the City Council for this opportunity to comment on the proposed FY2004 budget. We would also like to commend William Abolt, the Director of the Office of Budget and Management and his staff for their hard work and effort in preparing this budget.

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

OVERVIEW OF TESTIMONY

The Civic Federation is pleased to announce our **support** for the City of Chicago's $4.8 billion FY2004 budget. Based on our independent analysis, we believe that the proposed budget is balanced in its approach of using management efficiencies and targeted user fees and modest tax increases. We are particularly pleased that the budget avoids any increase in the property tax levy. A property tax increase in this negative economic climate would be counterproductive to the goal of attracting and maintaining business in Chicago. The Federation is particularly pleased to note that the City's share of the average Chicago property tax bill has declined from 29% to 21% since 1988 as a result of the City maintaining a conservative approach to property tax increases.

We especially **commend** the Mayor for his administration's continuing focus on implementing important cost-cutting management reforms. The City's $155.5 million all funds deficit has been eliminated through a reduction of over 1,400 positions, $25 million in savings from management efficiencies, $9.5 million in savings for renegotiation of contracts for computer and professional services and $54 million in user fees and other revenue enhancements. The modest increase in the restaurant tax is justified in that it targets discretionary income and should not significantly impact local businesses. These efforts continue in the direction set last year, when 200 positions and 1000 vacancies were eliminated, the Departments of Water and Sewers were consolidated and the financial and administrative functions of several departments were combined.

The Civic Federation applauds the continued efforts to reduce the workforce. Since FY2000, over 2,600 positions have been targeted for elimination according to the City's Program and Budget Summaries. Because over 80% of Corporate Fund expenditures are for personal services, the City must reduce headcount over time if it is to slow the aggregate rate of expenditure growth. The City must tighten its belt in the same manner as the private sector. We realize that this strategy is not an easy one, but it is a necessary one. To this end, we strongly support the City's strategy of reducing over 1,400 positions in FY2004 through a combination of early retirement position eliminations, vacancy eliminations and/or layoffs as a last resort. We endorse the City's Early Retirement Initiative and will support legislation in Springfield during the November veto session to implement that initiative.

The Civic Federation has long advocated that the City pursue privatization of the Chicago Skyway as a way to enhance revenues and significantly reduce long-term operating and maintenance obligations. We are very pleased that the City has announced it will continue to explore privatization of the Chicago Skyway in this coming fiscal year. We urge that the proceeds from any such action be applied to the City's shrinking fund balance or to pay off long-term debt.

Just as we did last year, the Civic Federation continues to have concerns about two financial issues that could have a negative impact on the City's financial condition in the near future: the low Corporate Fund balance and declining income from pension fund investments.

The City is projecting a Corporate Fund balance of only $21.2 million for FY2004. This represents just 0.8% of projected Corporate Fund appropriations of $2.6 billion. While we are pleased that some of the proceeds from the privatization or sale-leaseback of the Chicago Skyway will be used to increase the size of the fund balance, the continued low levels of reserves mean that it will be difficult for the City to meet unanticipated emergencies or contingencies. The City should give serious consideration to adoption of a formal budget stabilization policy.

The effects of the ongoing recession continue to have a negative impact upon the performance of the City's four pension funds. The average investment rate of return fell to –9.6% in FY2002, down from -3.5% in the previous fiscal year. The amount of unfunded liabilities rose by $1.4 billion, from $2.6 billion to $4.1 billion. The funded ratios of the Police Fund declined by nearly 6% to a 64.6% funded ratio, its lowest ratio in four years, while the Fire Fund dropped from 60.2% to 57.9%. If these negative trends continue, the City could be forced to raise taxes to maintain the health of the funds. We think it prudent at this time to caution the City against any further increases in employee benefit levels that could further exacerbate the situation.

The Civic Federation offers two additional recommendations. The first is related to the current exemption received by nonprofit organizations such as universities, hospitals and churches from paying for water provided by the City. We support further examination of the proposal to eliminate the nonprofit exemption for water fees. While more detailed information is necessary, we accept as a basic tenet that nonprofits should be expected to pay City user fees that are designed to recover the cost of City services.

The second recommendation is related to the City's budget format. Based on a review of other local government budgets and best practices from cities around the nation, we believe that the City should publish an Executive Summary that provides citizens with financial trend information and descriptions of organization and function. Consolidating the information in one place rather than having it published in different volumes would increase the user-friendly quality of the budget and help citizens quickly obtain a good overview and understanding of the City's financial condition and its underlying structure and functions.

FY2004 BUDGET HIGHLIGHTS

In August 2003, the Office of Budget and Management projected that the City would face a $115.5 Corporate Fund million deficit in FY2004. The total all funds deficit is reported by the budget office to be $155 million. The following exhibit shows how the City proposes to address the gap.

	Corporate Fund	All Funds
Chicago FY2004 Projected Deficit	**$ 115,000,000**	**$ 155,500,000**
Gap-Closing Measures		
Personnel Actions (Elimination of 1,414 non-sworn positions		
ERI/Reorganization/Layoffs	$ 30,000,000	$ 30,000,000
Hiring Freeze	$ 2,000,000	$ 4,000,000
75% Vacancy Reduction	$ 10,000,000	$ 19,500,000
Subtotal Personnel Actions	$ 42,000,000	$ 53,500,000
Utility Savings	$ 6,000,000	$ 7,000,000
Banking Fee Savings	$ 1,500,000	$ 1,500,000
Shift to Grants	$ 13,300,000	$ 16,500,000
Contract Reductions (Computers/Professional Services)	$ 9,500,000	$ 9,500,000
Subtotal All Expenditure Reductions	**$ 72,300,000**	**$ 88,000,000**
Revenue Enhancements (Fees and Taxes)	**$ 30,650,000**	**$ 54,350,000**
SPE & Other Financing Projects	**$ 12,050,000**	**$ 13,150,000**
Grand Total	**$ 115,000,000**	**$ 155,500,000**

Expenditure Reductions

The City is proposing to saving as much as $88 million in spending cuts. These reductions include $30 million in savings from the early retirement program as well as possible layoffs, $4 million from the continued hiring freeze and a 75% reduction in vacant positions. Other spending cuts include $9.5 million in savings for renegotiation of contracts for computer and professional services and $25 million in savings from a variety of management efficiencies, including utility savings, banking fee savings and shifts to grants to pay for the cost of services.

Revenue Enhancements

The FY2004 budget proposes a number of revenue enhancements. A total of 69 individual fees are slated for increase. The major revenue enhancements include:

- A new restaurant tax of 0.25%. This will increase the total restaurant tax in parts of the City to 10%. This tax is projected to generate $8.5 million per year.
- A 3% increase in water and sewer fees, which is expected to raise over $20 million. Proceeds will be used to fund the City's water and sewer infrastructure program.
- Requiring sponsors or promoters of major venues to assume traffic control costs.
- Increases in vehicle sticker fees for heavy vehicles.
- Standardize and simplify the ground transportation tax on cabs.
- 10% increase for licenses requiring inspections.
- Maintaining parking meters on Sundays and evenings in certain neighborhoods.

The City is also conducting research regarding the lease, sale of privatization of the Chicago Skyway. Proceeds from the Skyway will be used to increase the City's shrinking fund balance, pay off long-term debt and to build up a long-term revenue source.

Comparison of Chicago's Gap-Closing Measures with Other Cities

The exhibit below provides a snapshot of how several major cities eliminated the deficits in their FY2004 budgets. The focus in most of these cities has been on expenditure reductions, primarily through cuts in staffing and/or operating reductions across most departments.[1] Chicago's primary focus on expenditure reductions in FY2004 mirrors the pattern in other large cities.

GAP CLOSING MEASURES IN SELECTED MAJOR CITIES: FY04 BUDGETS

CITY	BUDGET	DEFICIT	REVENUE ENHANCEMENTS	SPENDING CUTS
Boston	$1.75 billion	$72.6 million	$4.3 million fee/fine hikes	$68.3 million (in all departments)
Houston	$2.6 billion	$20 million	Increased parking meter rates	Cut 180 positions Refinanced Debt
Los Angeles	$5.1 billion	$163.3 million	Transferred $102 million in Reserve Funds	Deleted vacancies Reduced Overtime Position Attrition Contracted out tree trimming
New York	$44.5 billion	$3.8 billion		Reduced FTEs by 4,800 Streamlined social services Reduced transit expenses Increased state assistance
Phoenix	$2.4 billion	$72.3 million	Transferred $11.6 milion from Reserve Fund	10% across the board cuts except public safety Postpone non-essential capital projects
San Diego	$2.3 billion	$30 million		Departmental reductions including Public Safety
Seattle	$2.6 billion	$60 million		Cut admin. Departments 13% Cut Police/Fire 3%

[1] It is important to point out, however, that New York City implemented an 18.5% property tax increase in December 2002 as part of its FY2003 gap-closing plan

FINANCIAL ISSUES AND TRENDS

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

All Fund Appropriations: $101 Million Increase from FY2003

The FY2004 budget proposes a net appropriation of $4.8 billion. This is an increase of 2.1% or approximately $101 million from the previous fiscal year. Personal service appropriatoins are projected to rise by 1.4% even as the number of positions is being reduced due to increases in salaries and benefits.

CITY OF CHICAGO APPROPRIATIONS BY OBJECT: FY2003 & FY2004				
Object	**FY2003**	**FY2004**	**% CHG**	**$ CHG**
Personal Services	$ 2,673,822,792	$ 2,711,604,025	1.4%	$ 37,781,233
Contractual Services	$ 579,169,640	$ 594,760,771	2.7%	$ 15,591,131
Travel	$ 3,494,775	$ 3,135,383	-10.3%	$ (359,392)
Commodities	$ 101,958,492	$ 95,673,380	-6.2%	$ (6,285,112)
Equipment	$ 8,712,114	$ 6,556,840	-24.7%	$ (2,155,274)
Permanent Improvements	$ 6,000,930	$ 3,000,000	-50.0%	$ (3,000,930)
Specific Items/Contingencies	$ 1,731,536,738	$ 1,736,625,601	0.3%	$ 5,088,863
Subtotal	**$ 5,104,695,481**	**$ 5,151,356,000**	**0.9%**	**$ 46,660,519**
Less Internal Transfers	$ 250,600,000	$ 236,172,000	-5.8%	$ (14,428,000)
Less Proceeds of Debt	$ 135,442,000	$ 96,292,000	-28.9%	$ (39,150,000)
Grand Total	**$ 4,718,653,481**	**$ 4,818,892,000**	**2.1%**	**$ 100,238,519**

Net appropriations are projected to rise by approximately 13% in the 5-year period since FY2000. The largest increase, or 14%, is projected to be in spending for the City's Enterprise Funds. Corporate Fund expenditues are expected to rise the least, by about 9%, from $2.4 billion to $2.6 billion.

CITY OF CHICAGO APPROPRIATIONS: FY00 & FY04 (In Millions of Dollars)			
	FY2000	**FY2004 Rec**	**% Change**
CORPORATE FUND	$ 2,394.0	$ 2,605.1	9%
SPECIAL REVENUE FUNDS	$ 381.6	$ 395.1	4%
PENSION FUNDS	$ 351.4	$ 382.9	9%
DEBT SERVICE FUNDS	$ 436.5	$ 485.7	11%
ENTERPRISE FUNDS	$ 1,123.3	$ 1,282.6	14%
TOTAL RESOURCES	**$ 4,686.8**	**$ 5,151.4**	**10%**
LESS PROCEEDS OF DEBT	$ 178.9	$ 381.6	**113%**
LESS INTERNAL TRANSFER	$ 231.5	$ 351.4	52%
NET APPROPRIATION	**$ 4,276.4**	**$ 4,819.9**	**13%**

Source: City of Chicago Revenue Estimates: FY00 & FY04

Appropriations by major program area between FY2000 and FY2004 are presented in the next exhibit. The largest single increase was in the Transportation category, which experienced an 88% increase in appropriations, from $249 million to $469 million. Decreases are projected the Regulatory and Community Services program areas of 16% and 14% respectively. Public Safety, which includes expenditures for police, for and emergency medical services, reported the largest dollar amount increase or $231 million in increased spending.

CITY OF CHICAGO APPROPRIATIONS BY PROGRAM AREA: FY00 & FY04				
	2000 Approp.	2004 Rec	% CHG	$ CHG
FINANCE AND ADMINISTRATION	$ 372,628,018	$ 393,818,563	6%	$ 21,190,545
LEGISLATIVE AND ELECTIONS	$ 31,840,461	$ 31,795,938	0%	$ (44,523)
CITY DEVELOPMENT	$ 296,668,403	$ 256,169,692	-14%	$ (40,498,711)
COMMUNITY SERVICES	$ 490,068,380	$ 556,513,152	14%	$ 66,444,772
PUBLIC SAFETY	$ 1,375,145,529	$ 1,606,245,445	17%	$ 231,099,916
REGULATORY	$ 96,982,253	$ 81,856,183	-16%	$ (15,126,070)
STREETS AND SANITATION	$ 342,411,693	$ 357,998,990	5%	$ 15,587,297
TRANSPORTATION	$ 414,227,845	$ 489,098,035	18%	$ 74,870,190
PUBLIC SERVICES ENTERPRISES	$ 539,624,945	$ 602,475,993	12%	$ 62,851,048
GENERAL FINANCING REQ.	$ 1,855,811,968	$ 2,032,578,199	10%	$ 176,766,231
SUBTOTAL	**$ 5,815,409,495**	**$ 6,408,550,190**	**10%**	**$ 593,140,695**
DEDUCT:				$ -
PROCEEDS AND REIMBURS.	$ 410,402,000	$ 332,464,000	-19%	$ (77,938,000)
GRANT FUNDS	$ 1,072,081,785	$ 1,257,194,190	17%	$ 185,112,405
GRAND TOTAL	**$ 4,332,925,710**	**$ 4,818,892,000**	**11%**	**$ 485,966,290**

Source: City of Chicago FY00 and FY04 Program & Budget Summaries

Personnel: Personal Service Appropriations and the Number of Budgeted Positions

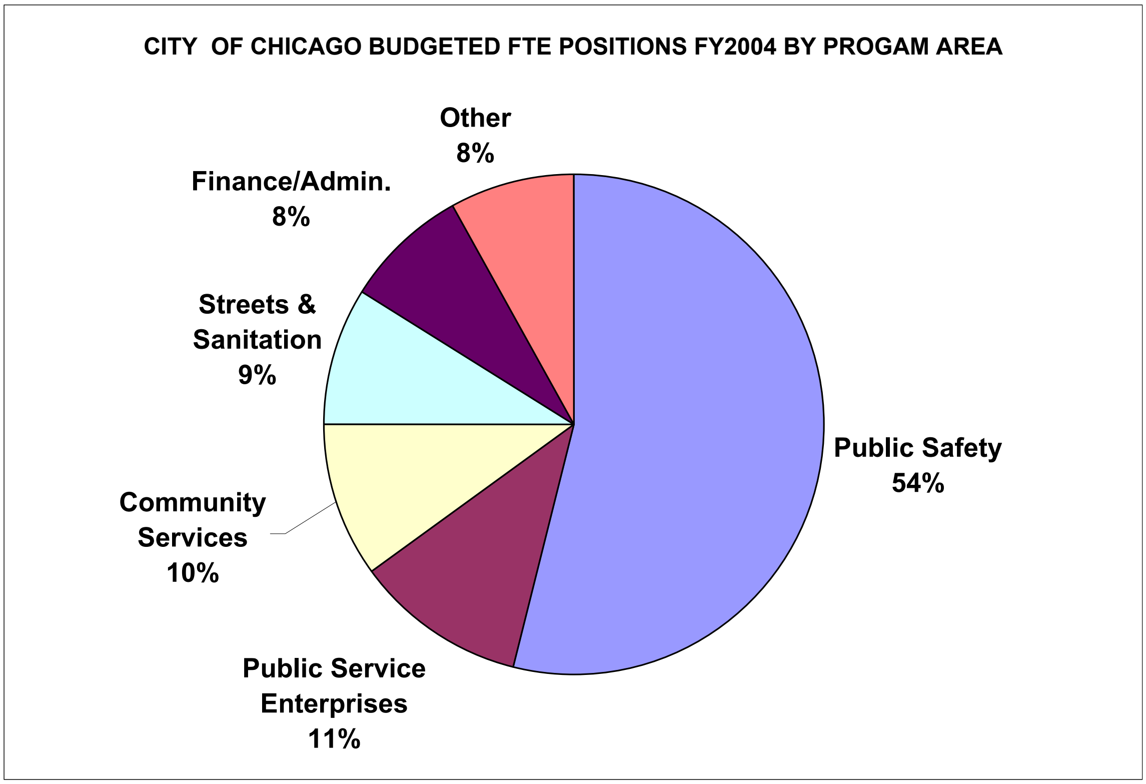
Corporate Fund personal service appropriations are projected to rise by 3% in FY2004 from FY2003. This is a $55.6 million increase. Personal service appropriations will consume 83.5% of the entire Corporate Fund budget. Since FY2000, personal service appropriations in the Corporate Fund rose by 13%, from $1.9 billion to $2.1 billion. The percentage of Corporate Fund appropriations earmarked for personal services increased from 79.5% to 83.5% during that period.

The City proposes the potential elimination of as many as 1,414 positions in FY2004 through a combination of early retirement position eliminations, vacancy eliminations and/or layoffs. 967 of these positions are expected to be eliminated in the Corporate Fund.[2] The Early Retirement Initiative (ERI) will require approval by the General Assembly and the City plans to seek approval in the legislature's November veto session. Employees who are 50, with 20 years of service or 55, with at least 15 years of service who could buy up to 5 years of service would be eligible for the ERI. The purchase price of each year is equal to half of the employee's normal contribution and deferred compensation may be used to purchase years. The City's assumption is that 40% to 50% of the 2,000 eligible employees would opt to take the early retirement offer. The Office of Management and Budget estimates that as much as $15 million in net savings can

[2] *City of Chicago FY2004 Budget Ove*rview.

be realized with this initiative with a job permanent reduction of 250 positions. These figures assume a position backfill rate of about 70%.[3]

Approximately 54% of all budgeted positions in the proposed FY2004 budget are in the Public Safety area, followed by 11% in the Public Service Enterprises, which include the new Department of Water Management and the city's airports.[4] 10% of positions are in the Community Services area, which includes the Department of Public Health and the Chicago Public Library.



The exhibit below shows the number of full time equivalents (FTE) positions budgeted in FY2000 and FY2004 by program area. The number of budgeted positions has fallen over this five-year time period by 6.1% or 2,669 FTEs.

[3] Meeting with Office of Budget and Management, October 16, 2003.
[4] These figures are derived from the City's *Program and Budget Summary* documents.

CITY OF CHICAGO POSITIONS BUDGETED (FTEs): FY00 & FY04	FY2000 Budgeted	FY2004 Projected	% Change	Chg in Positions
FINANCE AND ADMINISTRATION	3,585	3,350	-6.6%	(235)
LEGISLATIVE AND ELECTIONS	394	379	-3.8%	(15)
CITY DEVELOPMENT	838	652	-22.2%	(186)
COMMUNITY SERVICES	4,177	4,001	-4.2%	(176)
PUBLIC SAFETY	23,173	22,487	-3.0%	(686)
REGULATORY	984	900	-8.5%	(84)
STREETS AND SANITATION	4,084	3,746	-8.3%	(338)
TRANSPORTATION	1,427	1,034	-27.5%	(393)
PUBLIC SERVICES ENTERPRISES	5,305	4,749	-10.5%	(556)
GRAND TOTAL	43,967	41,298	-6.1%	(2,669)

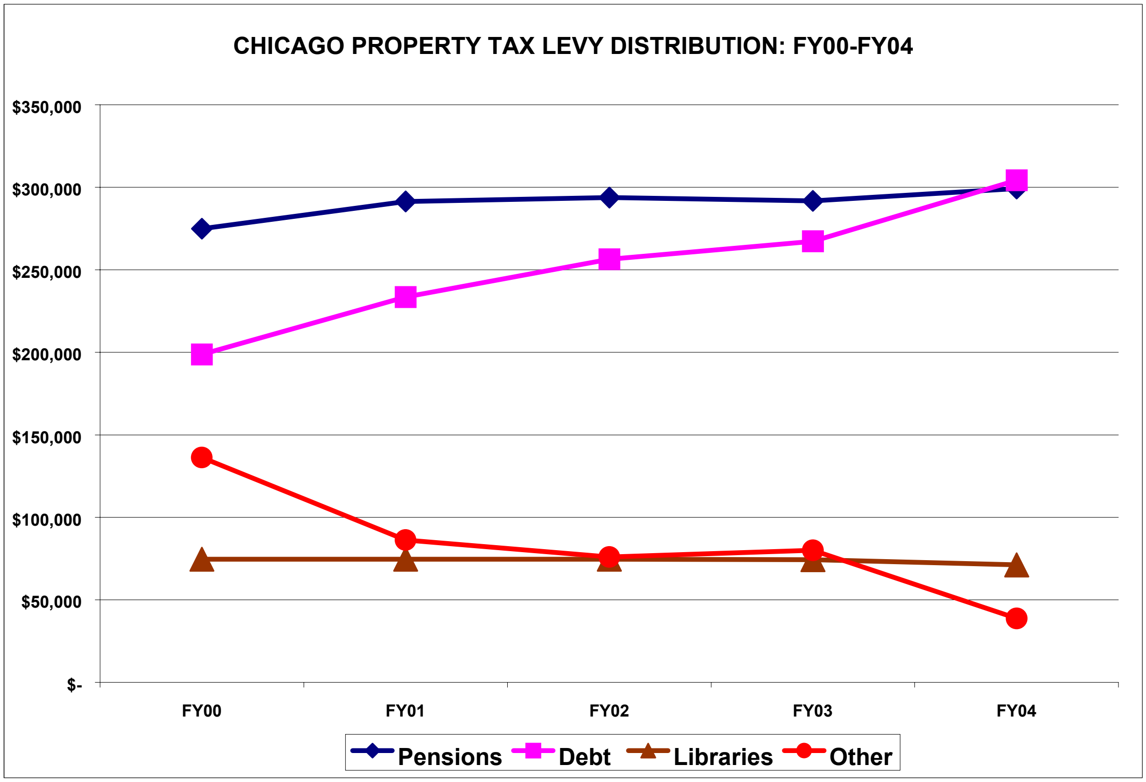
Source: Chicago Program and Budget Summaries: FY00 and FY04

Property Tax Levy: No Increase from FY2003

The City's property tax levy will be frozen in tax year 2004 at the previous year's level of $713.5 million. Since tax year 1999, the levy has risen by 4.3%.

Property tax revenues are distributed primarily to three major programs: pensions, debt service and libraries. In tax year 2004, 85% of the levy will be reserved for debt service and pensions. $304.3 million will be earmarked for debt service and $299.3 million will be set aside to pay for employee pension costs. Libraries will receive 10% of levy resources, or $71.2 million. The Library levy has remained fairly constant since FY2000, declining by about 5%, from $74.6 million to $71.2 million. The remaining 5% is reserved for other programs, including City Relief and the Corporate Fund.

During the 5-year period between tax year 2000 and 2004, the percentage of the levy earmarked for debt service has risen from 29% to 43%. This reflects increases in the City's long-term debt burden. During the same period, the amount reserved for pensions has increased slightly, from 40% to 42%. The "Other" category includes funding for the Corporate Fund and City Relief. This category consumes a shrinking portion of the levy. City Relief, which is used to reimburse the State of Illinois for certain public aid programs, will be phased out by 2007 as a result of General Assembly action.



Corporate Fund Revenues: 1% Increase Projected for FY2004

The Corporate Fund is the City's general fund, supporting a wide variety of services including public safety, public health, sanitation, and transportation. In FY2004, the City projects a 1%, $25 million increase in Corporate Fund revenues.

Revenue estimates for taxes remain conservative, reflecting continued concern over the effects of the ongoing recession. Overall, the City is projecting just a 1.3% increase in own source (local) and intergovernmental tax revenues. This translates into a $20.6 million increase. Revenues from non-tax revenue sources are expected to rise by only 0.5% in FY03.

CHICAGO CORPORATE FUND REVENUES: 2002 and 2003 (In Millions of Dollars)				
Tax Revenue	**2003 Est**	**FY2004 Prop**	**% CHG**	**$ CHG**
Utility Tax & Franchise Fees	$ 457.1	$ 464.7	1.7%	$ 7.6
Sales Taxes	$ 385.3	$ 400.8	4.0%	$ 15.5
Income Taxes	$ 217.9	$ 219.9	0.9%	$ 2.0
Transaction Taxes	$ 243.9	$ 235.9	-3.3%	$ (8.0)
Tranportation Taxes	$ 134.7	$ 138.2	2.6%	$ 3.5
Recreation Taxes	$ 86.5	$ 85.5	-1.2%	$ (1.0)
Business Taxes	$ 66.5	$ 67.5	1.5%	$ 1.0
Total Tax Revenue	**$ 1,591.9**	**$ 1,612.5**	1.3%	$ 20.6
Non-Tax Revenue				
Proceeds & Transfers In	$ 251.3	$ 195.5	-22.2%	$ (55.8)
Internal Service Earnings	$ 290.4	$ 288.1	-0.8%	$ (2.3)
Fines & Forfeitures	$ 176.4	$ 195.3	10.7%	$ 18.9
Licenses & Permits	$ 92.3	$ 94.9	2.8%	$ 2.6
Current Service Charges	$ 71.1	$ 90.2	26.9%	$ 19.1
Municipal Utilities	$ 23.5	$ 26.8	14.0%	$ 3.3
Leases,Rentals & Sales	$ 36.1	$ 36.3	0.6%	$ 0.2
Reimbursement,Interest,Other	$ 25.8	$ 44.3	71.7%	$ 18.5
Total Non-Tax Revenue	**$ 966.9**	**$ 971.4**	0.5%	$ 4.5
TOTAL CORPORATE REVENUE	**$ 2,558.8**	**$ 2,583.9**	**1.0%**	**$ 25.1**

Corporate Fund Balance in FY2004 Projected to be less than 1% of Appropriations

According to the City's audited financial statements, unreserved, undesignated Corporate Fund balances declined by 93% between FY1998 and FY2002, from $177 million to just $13 million.[5] This is a decline of $20 million from FY2001. In those same years, the unreserved fund balance in the Corporate Fund as a percentage of Corporate Fund revenues fell from 8.2% to 0.5%.

According to the FY2004 budget, the City anticipates carrying over $21.2 million in Corporate Fund reserves from the FY2003 budget. This represents just 0.8% of projected Corporate Fund appropriations of $2.6 billion. This level of fund balance is still far below the amount recommended by the Government Finance Officers Association (GFOA). GFOA recommends that general purpose governments' establish a general fund balance of 5 to 15 percent of regular general fund operating revenues.[6] A Corporate Fund reserve of 5% of Corporate Fund revenues would require approximately $129 million, over $100 million more than what the City has proposed.

---

[5] See City of Chicago *Comprehensive Annual Financial Reports*, FY1998-FY2002.

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

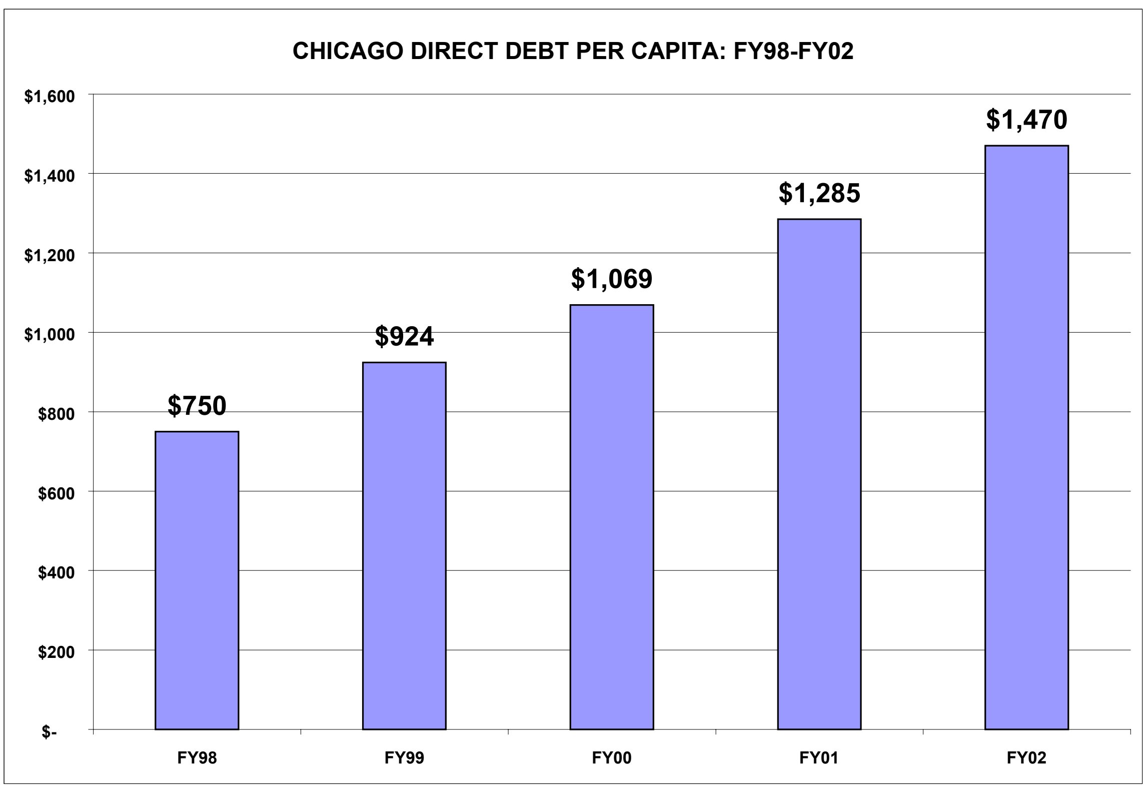
The City's continuing low level of Corporate Fund reserves is a cause of concern. The City has indicated that proceeds from the privatization or sale-leaseback of the Chicago Skyway in FY2004 will be used to increase the size of the fund balance. This would be a positive step.

CHICAGO CORPORATE FUND BALANCE			
Fiscal Year	Fund Balance	Expenditures	Ratio
FY1998	$ 177,254,000	$ 2,167,894,000	8.2%
FY1999	$ 108,107,000	$ 2,288,518,000	4.7%
FY2000	$ 80,653,000	$ 2,380,310,000	3.4%
FY2001	$ 33,241,000	$ 2,440,426,000	1.4%
FY2002	$ 13,014,000	$ 2,527,642,000	0.5%

Long-Term Direct Debt Per Capita

Long-term direct debt per capita is a measure of a government's ability to maintain its current financial policies. Direct debt is a government's tax-supported debt. Any increases bear watching as a potential sign of increasing financial risk.

Long-term debt per capita rose substantially by 96% between FY1998 and FY2002. This represents an increase of $2.1 billion in that time period, from $2 billion in FY1998 to $4.2 billion five years later. The large increases in direct debt continue to bear watching as a potential cause of concern. The Civic Federation believes that the City must carefully consider any future increases in its long-term debt burden in these uncertain economic times.



Pension Trends

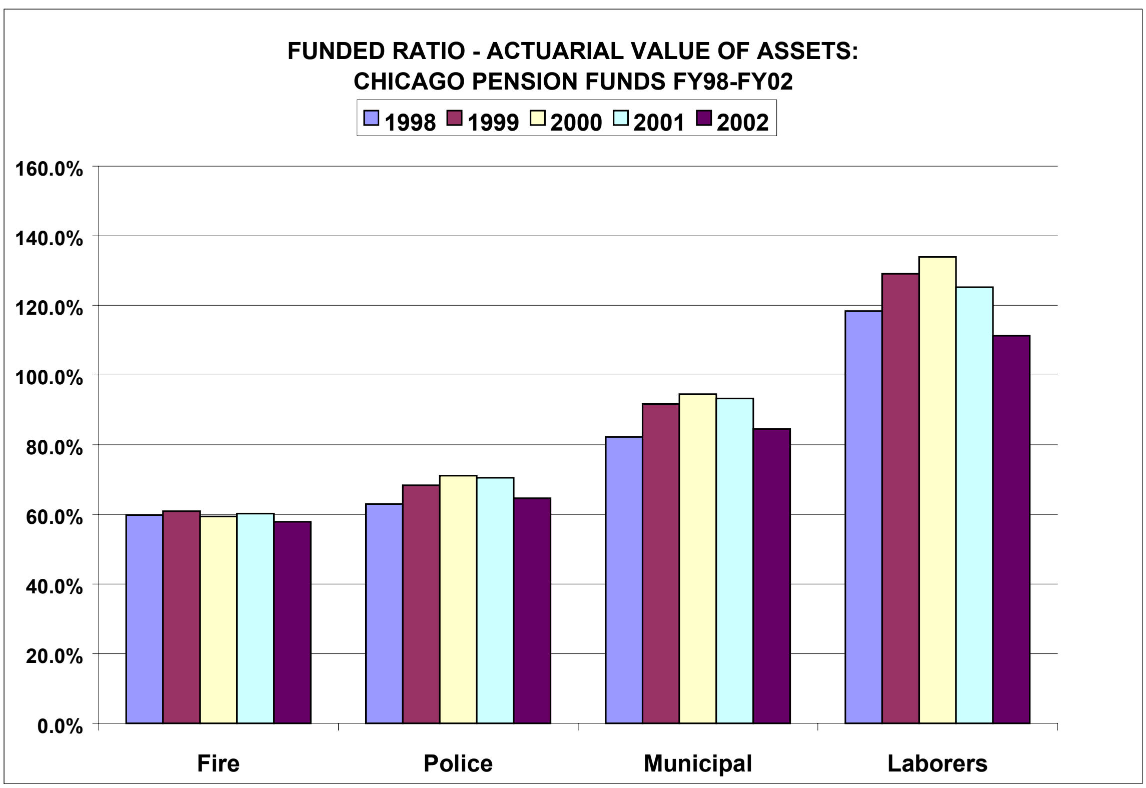
The City of Chicago maintains four employee pension funds: the Fire, Police, Municipal and Laborer's Funds. The Civic Federation used three measures to present a multi-year evaluation of the funds' fiscal health: funded ratios, the value of unfunded liabilities, and the investment rate of return.

Funded Ratios – Actuarial Value of Assets

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

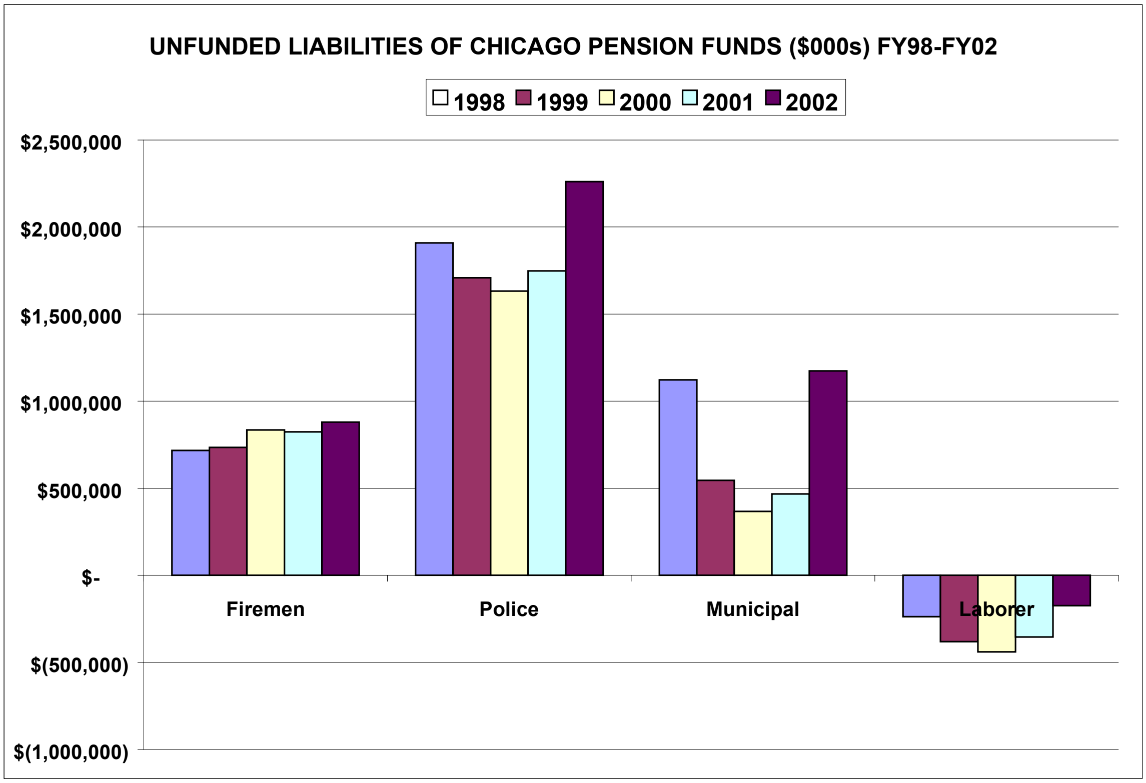
The funded ratios of all four City pension funds dropped between FY2001 and FY2002. The Police Fund declined by nearly 6% to a 64.6% funded ratio, its lowest ratio in four years. The Fire Fund dropped from 60.2% to 57.9%. The declines in the funded ratios of these funds bears watching.

Both the Municipal and Laborers Funds also reported declines for the second straight year. However, these funds remain healthy, with the Laborers Fund reporting a funded ratio of 111.3% and the Municipal Fund at 84.5%.



Unfunded Liabilities: 54% Increase Due to Declining Rates of Investment Returns

Unfunded liabilities are the dollar value of liabilities not covered by assets. Unfunded liabilities for all four City pension funds totaled approximately $4.1 billion in FY2002. This is a 54% increase in total unfunded liabilities from the previous fiscal year and an 18% increase since FY1998. However, it is important to point out that unfunded liabilities decreased by over $900 million between FY1998 and FY1999 before beginning to increase again. The dollar amount of unfunded liabilities in the Municipal Fund rose by $705 million and $511 million in the Police Fund in FY2002. In large part, the increase in unfunded liabilities is being driven by declining rates of return for the pension funds' investments.

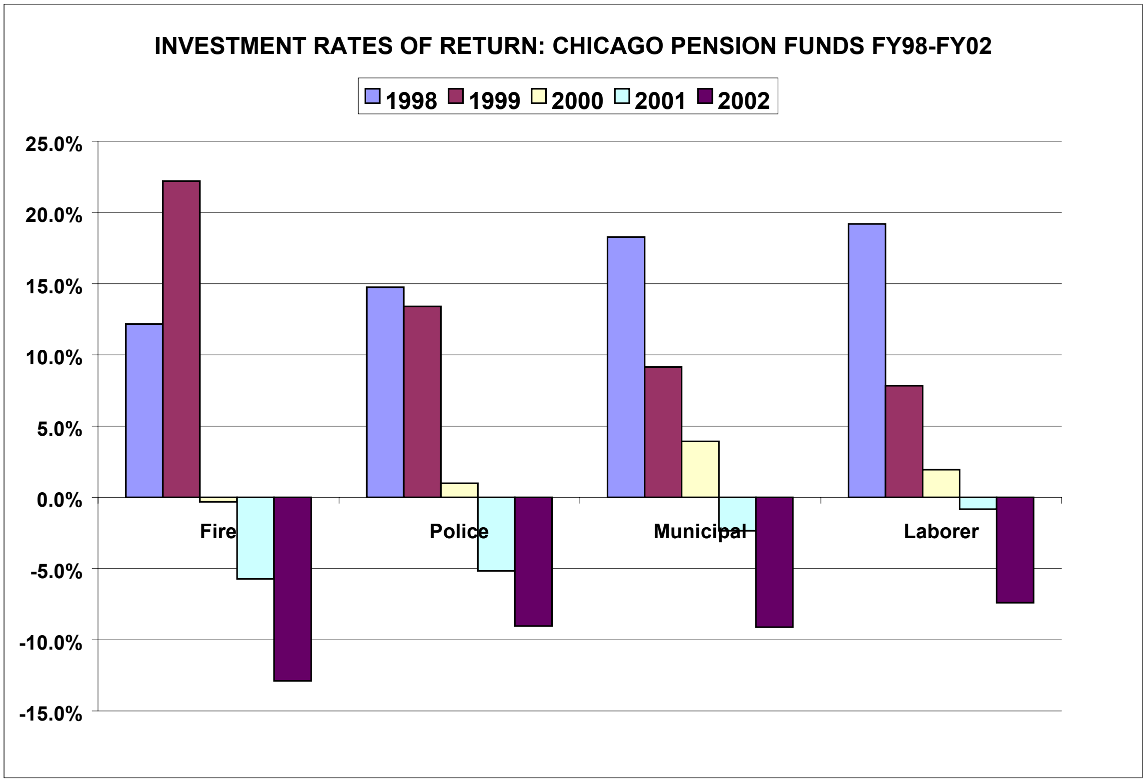


Investment Rates of Return

The declines in investment returns for all four City pension funds that began in FY2001 accelerated in FY2002, reflecting the continuing negative effects of the weak equities market. As in FY2001, all of the funds realized lower than the actuarially assumed rates of return.

The average rate of return for all City of Chicago pension funds fell to –9.6% in FY2002, down from -3.5% in the previous fiscal year. Each of the four funds continued to lose money in FY2002. The sharpest decline was in Fire Fund investments, where the rate of return was –12.9%. The Police and Municipal Funds reported –9% rates of return while the Laborers Fund registered –7.4%.

Because all four of the City's pension funds continued to lose money in FY2002, the outlook remains negative. If investment losses continue, the amount of unfunded pension fund liabilities will rise even higher and could, at some point in the near future, potentially force a tax increase to maintain a healthy asset to liability ratio.



CIVIC FEDERATION RECOMMENDATIONS

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

Carefully Examine the Proposal to Eliminate Nonprofit Exemption from Water Fees

Currently, nonprofit organizations such as universities, hospitals and churches are exempt from paying for water provided by the City. We support further examination of the proposal to eliminate the nonprofit exemption for water fees. While more detailed information is necessary, we accept as a basic tenet that nonprofits should be expected to pay City user fees that are designed to recover the cost of City services.

Establish a More Formal Budget Reserve Policy to Provide for Contingencies

The Civic Federation remains concerned this year, just as it did last year, that the relatively small amount of Corporate Fund balance proposed for FY2004 leaves the City with very little flexibility to deal with contingencies. The City's proposed Corporate Fund balance of $21.2 million for FY2004 represents an 88%, $156 million decline from FY1998. The Government

Finance Officers Association recommends that general-purpose governments maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues.[7] Maintaining a fund balance of at least 5% of Corporate Fund revenues would require approximately $129 million, over $100 million more than what the City has proposed.

The Civic Federation recognizes that the administration is considering ways to address the continued low fund balance situation, including the use of some funds from the privatization or sale-leaseback of the Chicago Skyway to increase the size of the City's reserves. We applaud any movement in this direction and hope that the City will not only increase the size of its reserves, but also move to establish a more formal budget reserve policy to ensure that funds are available to address emergency situations.

Improve Budget Format by Providing Financial and Structural Information in a Single Summary Format

The City budget is produced in several volumes, including a brief Overview, Budget Recommendations, a Program and Budget Summary, Revenue Estimates and a Draft Action Plan. Information about appropriations, expenditures, revenues and personnel can be found throughout these five documents. However, it is difficult to quickly gain a good overview and understanding of the City's financial condition and its underlying structure because the information is distributed among the different volumes.

The Cook County budget, which has won the GFOA's Distinguished Budget Presentation Award for several years, is a good example of a user-friendly budget document that provides citizens with useful summary information at the beginning of the budget document. The information includes:

- An organizational chart
- A description of budget procedures and structure
- A budget calendar
- A brief departmental directory describing functions of each agency
- A glossary of terms
- Five years of summary information:
    - Appropriations and Expenditures by Fund and Program
    - Appropriations and Expenditures by Control Officer
    - Appropriations and Expenditures by Object Classification and Fund
    - Positions by Fund and by Control Officer

In reviewing the narrative and financial information contained in the beginning pages of the Cook County budget, it is easy to quickly gain a good understanding of the County's structure, operations and how its financial position has changed over a 5-year period. Many other large governments around the country produce similar documents, including a user-friendly Executive Summary at the beginning of the budget document or under separate cover.

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

The Civic Federation recommends that the City of Chicago revise its budget format like other best practice governments around the U.S. to provide citizens with financial trend information and descriptions of organization and function in a brief summary section in the current Budget Recommendation volume or in a more detailed Executive Summary under separate cover.

Implement a Performance Measurement System

The FY2004 Program and Budget Summary volume includes discussions of each department's central purpose, some key facts about the department and a list of departmental objectives. Some performance statistics, primarily in the form of workload measures, are also included. Thus, there is discussion of the activities, services and functions carried out by organizational units. However, the budget des not include performance measures.

Given the City's focus on improving management efficiency, the Civic Federation believes that instituting a performance measurement program would be a useful tool in helping to monitor, measure and evaluate departmental and program performance over time.

The Civic Federation agrees with the International City Management Association (ICMA), the Government Finance Officers Association and the National Advisory Council on State and Local Budgeting that all governments should evaluate the performance of programs and services they provide. This is the best means extant to determine if they are accomplishing intended program goals and making efficient use of resources. Evaluating and reporting on program results helps keep policymakers and taxpayers alike informed about actual results compared to expectations.[8]

The Civic Federation is keenly aware that producing reams of measures (particularly workload measures) that are not linked to goals or objectives, utilized to inform management decisions, or developed without the buy-in of management and staff can be costly and have limited efficacy. However, using a few well-chosen measures, particularly those measuring efficiency and effectiveness that are produced consistently and developed with the buy-in of staff can be a valuable tool in assisting the City to improve its management and operations.

Implementing a Long-Term Financial Planning Process

The National Advisory Council on State and Local Budgeting (NACSLB) and the Government Finance Officers Association (GFOA) both recommend that all governments formally adopt a long-term financial plan as a key component of a sound budget process.[9] The City of Chicago currently employs many of the techniques of a long-term financial planning process internally, including the projection of multi-year revenue trends and modeling of various revenue and expenditure options. However, the City does not develop a formal plan that is shared with and/or reviewed by key policymakers and stakeholders. The Civic Federation recommends that the City of Chicago develop and implement a formal long-term financial plan.

---

[8] See Recommended Practice 11.1 "Monitor, Measure, and Evaluate Program Performance," in National Advisory Council on State and Local Budgeting. *Recommended Budget Practices: A Framework for Improved State and Local Budgeting* (Chicago: GFOA, 1998).

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

Adopt Formal Financial Policies

Formal or written financial policies are plans that guide and determine a government's present and future financial operations decisionmaking. Both the NACSLB and the GFOA recommend that all jurisdictions adopt formal written financial policies.[10] The Civic Federation recommends that the City of Chicago adopt written financial policies to guide the development of its annual budget. Priority should be given to adoption of a budget stabilization policy.

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