2020 BUDGET FORECAST
FINANCIAL ANALYSIS
REVIEW

2020 Financial Analysis Review

The Budget Forecast is a document produced annually that details the state of City's finances and provides future year budget projections based on multiple potential scenarios. The 2020 Budget Forecast shows the City has a structural budget deficit, commonly referred to as the "gap", which is any budget imbalance between existing revenues and anticipated expenses for that budget year. The City estimates a 2020 Corporate Fund gap of **$838.2 million**. The Corporate Fund, the city's operating fund, represents more than $3.8 billion or more than just over 34% of the city's total $10.6 billion budget in 2019. The forecast reveals that in 2020 the pension, personnel and healthcare costs that make up a significant part of the Corporate Fund expenses will comprise 70% of the budget gap, while debt and legal settlement costs make up an additional 22% of the structural deficit.

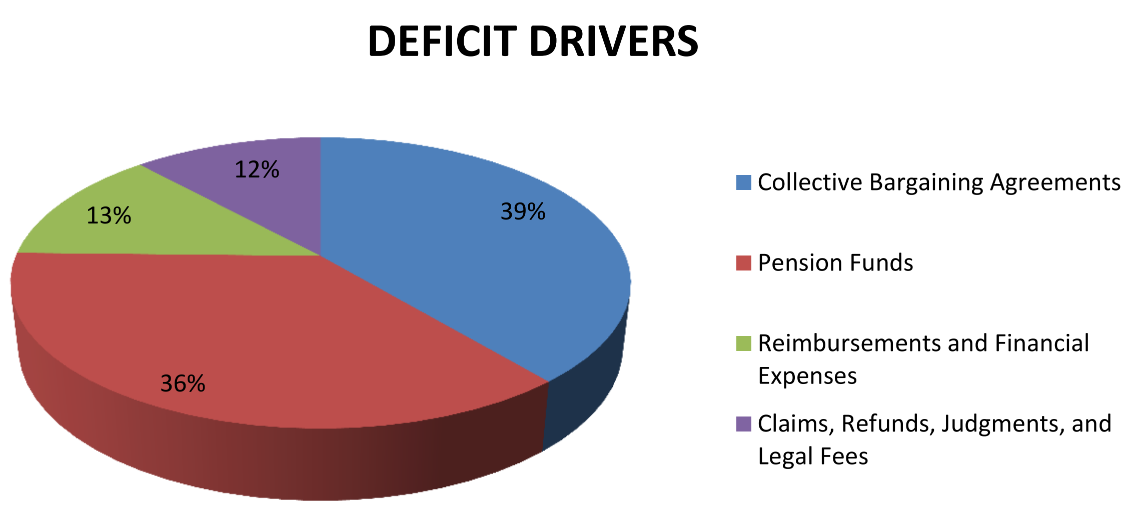
The forecasted 2020 Budget gap is larger than the previous year's primarily due to a change in methodology. Prior to 2019, the structural budget deficit methodology did not define long-term liabilities for future years as structural budget imbalances. Beginning with the 2020 structural budget deficit presented in the forecast, the methodology for projecting the budget deficit includes known long term liabilities, such as pensions and debt service. The 2020 Budget Forecast also does not take into account projected/potential/typical end-of-year savings, reforms, efficiencies, new investments and revenue enhancements. In addition, savings with the surplus in the city's Tax Increment Financing districts of $181 million. In her State of the City Address, the Mayor outlined the administration's efforts to identify more than $100 million in savings and efficiencies are not reflected in the complete overhaul of the $100-million workers' compensation program; the release of a new healthcare RFP to revisit competitive costs for the $471-million-a-year program; changes to refinance old debt at better rates; and the creation of the first citywide enterprise risk management system are also not incorporated in the 2020 Budget Forecast.

A concern with changing the methodology is that the large budget gap signals fiscal distress to rating agencies which could threaten the City's bond rating, which Moody's Investors Service already rates as junk. Critics question the rationale for changing the methodology, and placing the vast burden of long-term debt in the Corporate Budget in contrast to placing the debt under non-property tax supported funds.

Below is COFA's analysis of the four categories that drive the "gap": Collective Bargaining Agreements, Pension Funds, Reimbursements & Financial Expenses, and Claims, Refunds, Judgments, & Legal Fees. The charts and pie chart represents the four categories that's creates the gap.

2020 Budget Forecast	2019	2020	Variance
Revenues	$3,841.7M	$3,831.0M	$10M
Expenditures	$3,815.2M	$4,669.2M	($854M)
Surplus / (Deficit)	$26.5M	($838.2M)	($811.7M)

DEFICIT DRIVERS	Expenditures Increase	2019	2020
Collective Bargaining Agreements	$296.3M	$2,483.3M	$2,779.6M
Pension Funds	$277.4M	$136.8M	$414.2M
Reimbursements & Financial Expenses	$98.0M	$29.2M	$127.2M
Claims, Refunds, Judgments, & Legal Fees	$89.7M	$63.2M	$152.9M
TOTAL	**$761.4M**	**$2,743.0M**	**$3,568.2M**



The deficit drivers totaling $825 makes up 90.8% of the 2020 Budget Forecast Gap of $838.2 million. When combined with $63.8 million in "Transfers Out", the percentage grows to 98.2% of the budget forecast gap. Transfers Out is the movement of resources from local funds to reserves and other non-recurring revenue sources.

DEFICIT DRIVERS

Collective Bargaining Agreements ("CBAs")

The 2020 projection for these expenses assumes salary and wages will grow based on required contractual wage and prevailing rate increases for current collective bargaining agreements ("CBAs") as well as certain estimated salary and wage growth for CBAs under negotiation. Personnel expenditures are expected to grow by more than $296.3 million in 2020, totaling $2,779.6 million.

Pension Funds

The 2020 budget marks the first year the City contributes to the Policemen's Annuity and Benefit Fund (PABF) and Firemen's Annuity and Benefit Fund (FABF) as a result of based on the actuarially-calculated statutory requirement. In 2015, the City Council adopted a four-year property tax increase totaling $543 million to fund increasing contributions to the PABF and FABF between 2015 and 2018.

In 2020, it will be the City's third year of statutory contribution increases in the Municipal and Laborers Pension Fund. This contribution increase will result in a $277.4 million increase to the Corporate Fund liabilities, totaling $414.1 million.

A Chicago casino or transferring of City's assets theoretically could produce extra revenues to be used for future pension obligations. Another unpopular option for raising city revenues to meet pension obligations is to increase property taxes. A favorable method to accomplish this is to slowly implement the increases over time to address the pension deficit. Campaigning to amend the Illinois Constitution to reduce the 3 percent annual compound COLA is a viable possibility but a difficult challenge to rally support in Springfield based on previous year's conversations with legislators. Moreover, reducing pension liabilities through benefit reductions or dedicated revenue streams would positively change the outlook, but be challenging considering the Court's previous pension benefit protection decisions.

Reimbursements and Financial Expenses

Debt service is the cash required to pay back the principal and interest of outstanding debt for a particular period of time. Reimbursements and Financial Expenses are expected to increase by $98 million in 2020. That figure accounts for a $114 million increase in debt service, offset by short-term borrowing savings. "The increase in debt service is primarily due to lower savings realized from the Sales Tax Securitization Corporation in 2020 when compared to 2019," per the forecast. Other expenses on the rise account for the remainder.

The $838 million deficit sounds alarms to Wall Street rating agencies. Moody's Investors Services issued the City a junk-bond rating of Ba1 with a stable outlook. S&P Global rates the City BBB-plus and stable and Fitch Ratings rates it BBB-minus and stable. S&P and Fitch ratings are one level above junk-bond rating.

Claims, Refunds, Judgments, and Legal Fees

Claims, Refunds, Judgments, and Legal Fees projections continue to trend upwards, which is expected to increase by $89.7 million over the 2019 budget. Total Corporate Fund settlements and judgments are projected to be $145 million in the Budget Forecast. This aligns with historic expenditures related to settlements and judgments which estimate the city will spend nearly $153 million fighting legal battles next year. The settlement line item can be difficult to budget because at any given time, the city's lawyers are working on hundreds of cases. These cases range from small insurance claims to settlements in high-profile police misconduct lawsuits. It was a long term practice to pile these settlements on to the city's debt load until this practice was phased out several years ago.

Alderman Pat Dowell

Chairman

COMMITTEE ON THE BUDGET AND GOVERNMENT OPERATIONS

CITY COUNCIL'S OFFICE OF FINANCIAL ANALYSIS