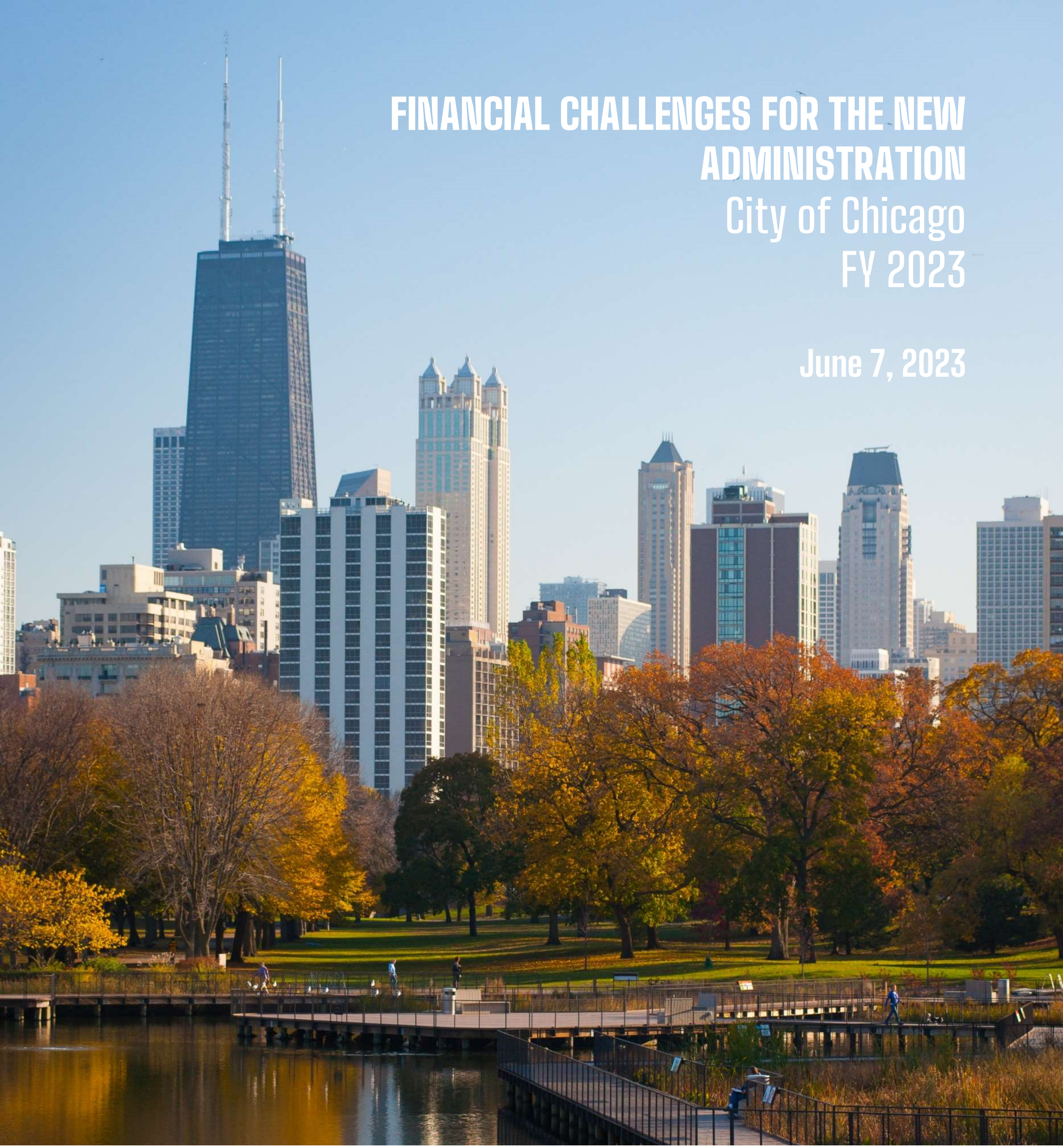


FINANCIAL CHALLENGES FOR THE NEW ADMINISTRATION

City of Chicago
FY 2023

June 7, 2023

City of Chicago
Council Office of Financial Analysis
Kenneth P. Williams, Sr., Chief Administrative Officer

2 N. LaSalle St, Ste M550
Chicago, IL 60602
cofa@cityofchicago.org

COFA
City Council Office
of Financial Analysis

Financial Challenges for the New Administration

FISCAL CHALLENGES FOR THE NEW ADMINISTRATION

On May 15, 2023, Brandon Johnson was sworn in as the 57th Mayor of the City of Chicago. In addition, the City Council swore in thirteen new Alderpersons. The City Council Office of Financial Analysis is releasing this report for City policymakers to highlight urgent fiscal needs and for consideration in the coming months or years. The report details fiscal challenges for the City of Chicago as well as options and recommendations to secure the City's financial position.

The three major fiscal challenges for the incoming leadership include:

1. Funding the City's massive pension shortfall
2. Debt Burden
3. Sustainable Balanced Budget

In addition to the three key fiscal issues identified above Chicago faces various social, economic, and financial problems. These include:

- Crime, criminal justice reform and violence
- Population loss - Out Migration
- Vacant Commercial properties
- Lack of affordable housing
- Vacant retail stores on the Gold Coast
- Education performance
- Infrastructure updates: Bridges, lead pipe replacement
- Transportation (safer, cleaner, and more reliable)
- Reinvestment in underserved neighborhoods
- Property Tax
- Systemic Racism (environmental)
- CPS School resources/funding (funding for music classes)
- Immigration
- Homelessness

The City Council of Financial Analysis has identified recommendations to identify and analyze financial issues. These include:

- Reassess fees.
- Release budget documents prior to hearings (30 days prior)
- Strengthen the City Council's Office of Financial Analysis

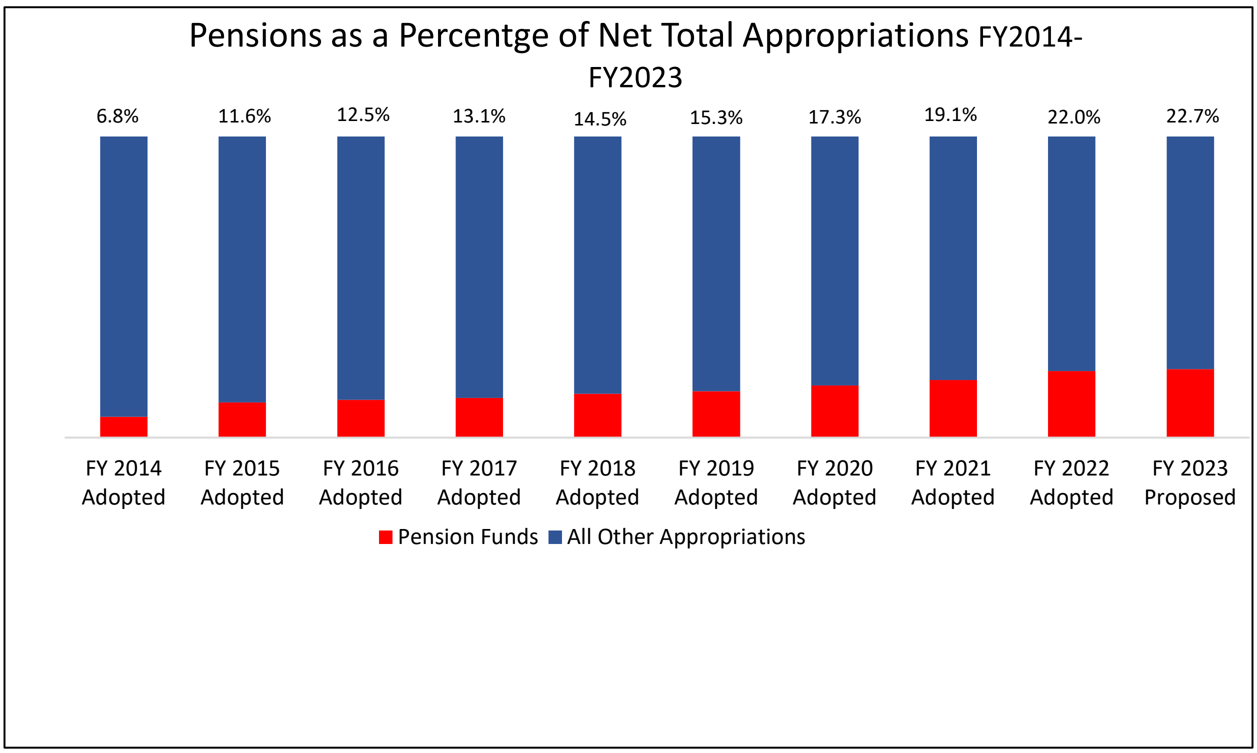
Major Fiscal Problems Facing the Next Mayor and City Council

This section will focus on the three major fiscal challenges facing the new administration. While the issues here are not new, they must be addressed to stabilize the City of Chicago finances. The new administration will not have the $1.9 billion received from the American Rescue Plan funding. The City Council Office of Financial Analysis is presenting this report to address financial, social, and economic issues that may potentially negatively impact our City. The options, concepts and recommendations presented are for informational purposes only.

The three major fiscal problems facing the next Chicago Mayor and City Council are 1) Pension shortfall 2) High debt burden and 3) structural budget deficit.

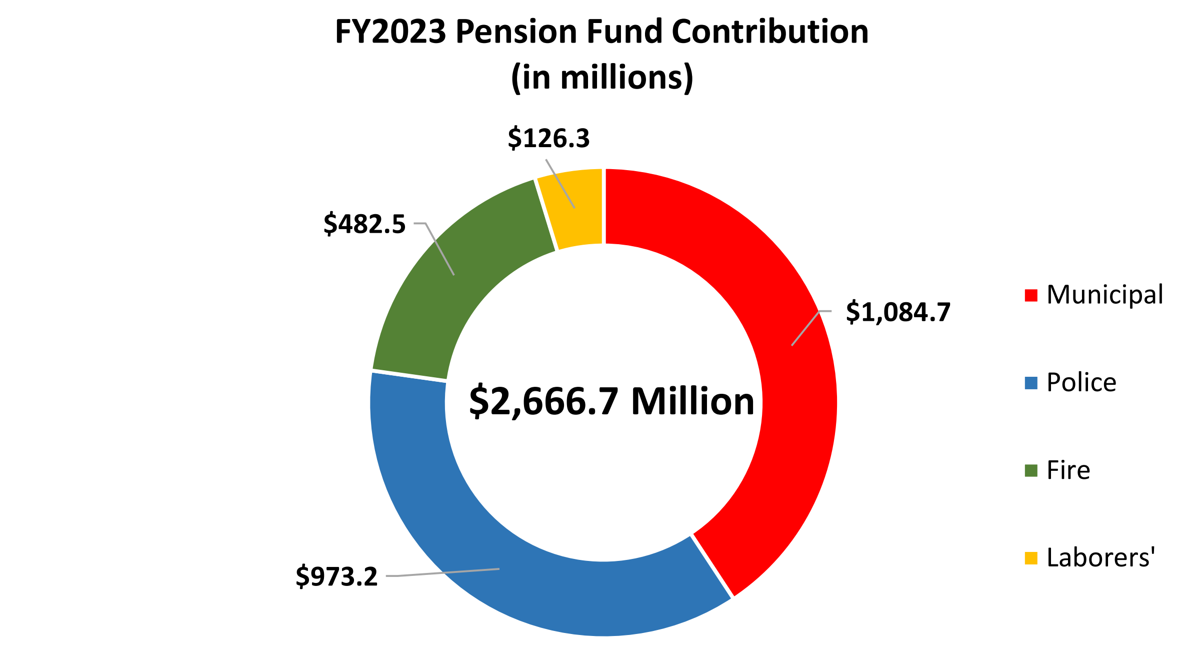
Issue #1: Pension Shortfall - Where will the money come from

The City of Chicago's four pensions are underfunded. Statutory underfunding, investment losses, benefit enhancements, and other long-term issues contributed to the current financial situation. Chicago pensions have enough assets to cover only about 25% of what they owe, these underfunded pensions are impacting the ability of the City to pay for much-needed services. The chart below highlights pensions as a percentage of net total appropriations.



Source: The Civic Federation
https://www.civicfed.org/sites/default.final_city_of_chicago_fy2023_budget_analysis.pdf

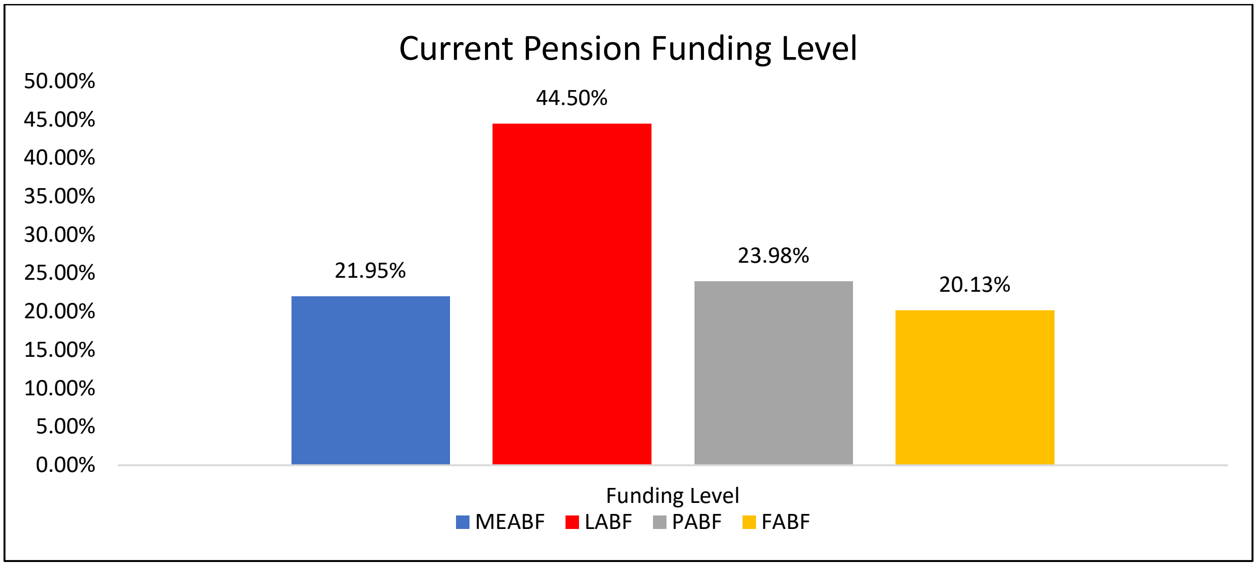
As displayed in the chart, the percentage of annual appropriations going to pensions has increased over the past ten years from 6.8% to 22.7%. This is particularly problematic with revenues falling short of expenditure along with market downturns and fluctuations. The proposed contribution to the City's four pensions is approximately $2.7 billion.[2] The Police and Municipal funds receive the largest portion at 77% of the pension pie.



Source: FY2023 City of Chicago Budget Overview, p.61.

Pensions remain a credit risk for Chicago and the unfunded amounts are the most significant long-term liability, according to Moody's Investors Service. The impact of the underfunded pensions overtaxes on the City's ability to pay for needed services. How bad is the pension problem? According to the federal General Accountability Office a healthy public pension system should have as fund radio of at least 80%. In other words, the dollar value of its assets should cover at least 80% of the benefit dollar. Chicago four pension systems is below that standard. The City of Chicago four pension funds have an unfunded liability of $33.7 billion, more than twice the size of its annual budget. [4] Chicago's pensions have assets to only cover about 25% of what they owe, compared to average funding ratios for US local and state pensions hovering around 70%, according to research at Boston College.[5] Currently for every $5 in the City's budget $1 goes toward pensions.[5]

A signal of distress is that the funds have more annuitants and beneficiaries than active employees with a ratio of actives to annuitants ranging from .67 in Laborers to .90 and .85 for the Fire and Police funds to 1.26 for the Municipal Fund.[6] The low ratio of active employees to annuitants indicates that there are fewer employees paying into the fund while more retirees are taking annuity payments out of the fund, this signals distress for an underfunded pension.[7]



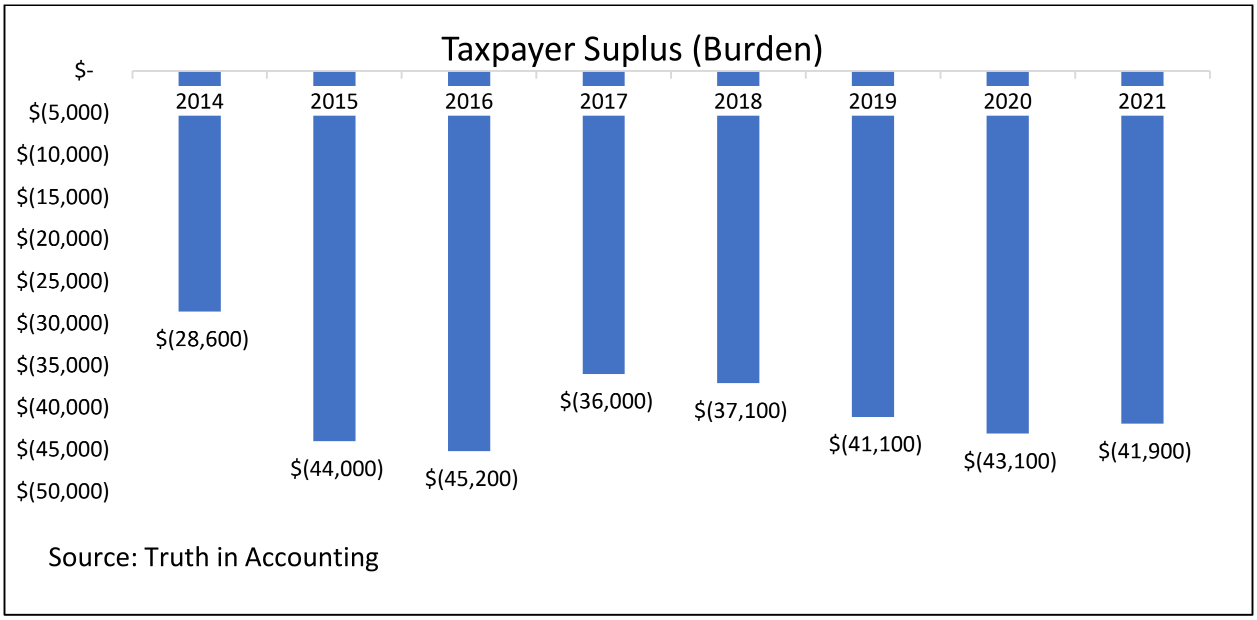
Source: Pension Funding History Series
https://amandakass.blog/2023/03/24/pension-funding-history-series-part-ii-the-city-of-chicagos-four-pension-funds/

Combined, Chicago four pensions are funded at 23.80%. Funding levels are the ratio of assets to liabilities. Funding levels below 100% are underfunded. The Chicago pension system is funded poorly. Chicago four pension funds unfunded liabilities exceed $33 billion, and the City of Chicago must pay off 90% of that debt by 2044 (for PABF and FABF) and 2058 (for MEABF and LABF).[9] Unfunded liabilities in this instance are not static but in constant flux and change as assets and liabilities change. With market fluctuations and investment losses (as happened recently) the assets decline, and unfunded liabilities increase. Therefore, the unfunded liabilities will change from year to year, but even with that the pension funds must be 90% funded by 2044 and 2058.[10.]

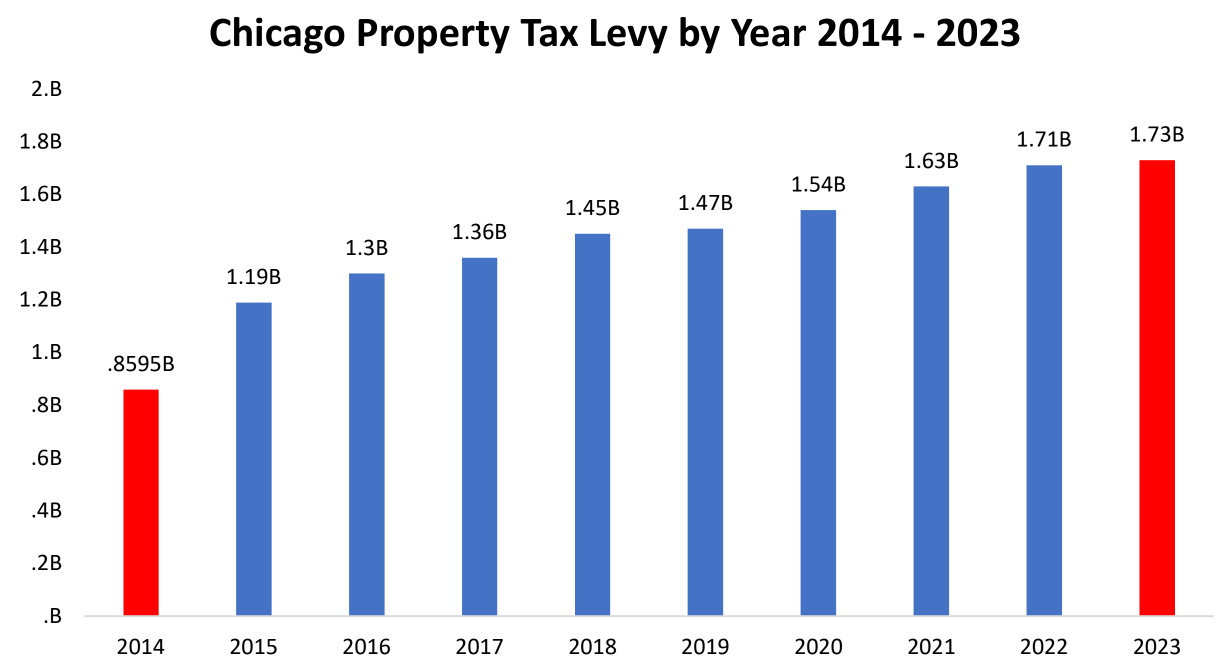
The City made a voluntary advance pension payment of $242 million for the 2023 budget to prevent unfunded liabilities increasing. In fiscal year 2022, for the first time in the City's history, all four pension funds were paid based on the actuarially determined contribution amounts. The past administration contributed the $242 million as an advanced pension payment as part of a new pension policy to ensure the City's financial recovery.[11]

Issue #2: Debt Burden – The City of Chicago owes more than it owns.

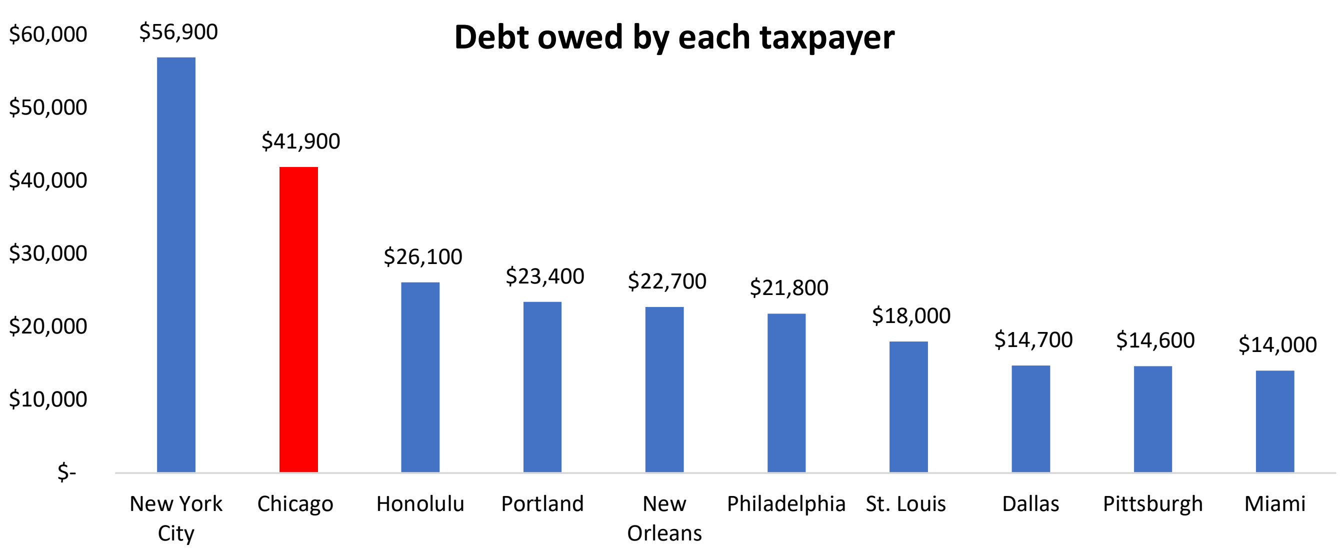
The City of Chicago has a high debt burden and owes more than it owns. The taxpayer burden for Chicagoans is -$41,900 and received a grade of "F" from the Truth in Accounting (TIA).[12] The Taxpayer Burden is the amount of money available (or in the case of a burden, the amount needed to pay bills divided by the number of taxpayers). From the graph below for the eight years represented the burden has fluctuated between 28,600 to a high of $44,000 in 2015. Chicago has the second highest debt of US cities. Chicago does not have enough money to pay bills, it is in a ($38.2 billion) dollar hole, to eradicate this shortfall each Chicago taxpayer would have to send ($41,900) to the city.[13] The high debt burden is a cause for concern, the high debt burden reduces the City's credit rating making future borrowing more expensive and may limit borrowing for needed priorities.



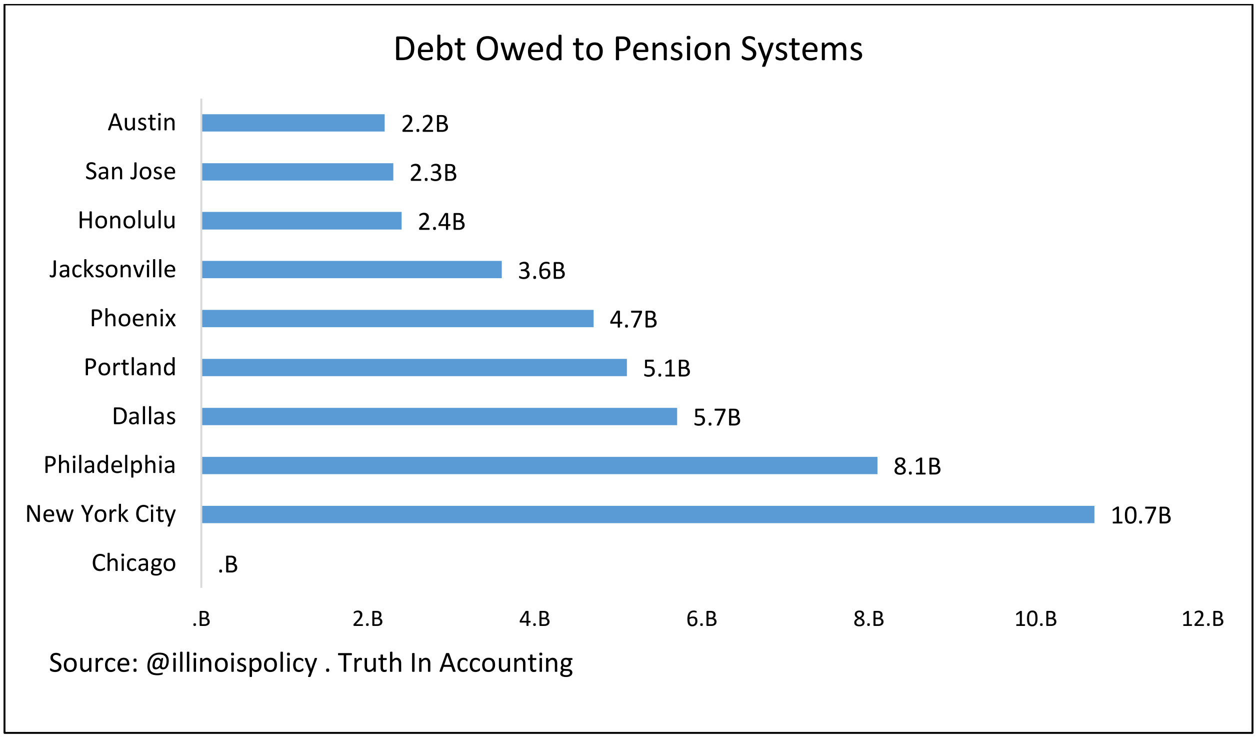
The increase in debt over time is problematic for the City of Chicago. It makes borrowing more expensive, may reduce the City's credit ratings and may shift spending to other critical priorities. The upward trend in debt will continue to put additional strain on the budget constraining City finances. Growth in Chicago's pension and debt services is using almost 43% of the city's budget after increases in recent years.[14] The city's property tax levy has more than doubled to keep up with these payments. (see chart below)



Source: Truth in Accounting. @illinoispolicy



Source: @illinoispolicy . Truth in Accounting


Debt Owed to Pension Systems
Austin
San Jose
Honolulu
Jacksonville
Phoenix
Portland
Dallas
Philadelphia
New York City
Chicago
2.2B
2.3B
2.4B
3.6B
4.7B
5.1B
5.7B
8.1B
10.7B
.B
.B
2.B
4.B
6.B
8.B
10.B
12.B
Source: @illinoispolicy . Truth In Accounting

Issue #3: Structural Budget Deficit – More than passing a balanced budget.

State and local governments are required to pass a balanced budget. However, a budget that aligns with the statutory definition of a balanced budget may not in all cases be financially sustainable. A financially sustainable budget is one that supports sustainability for future years. It is important for the City of Chicago to achieve a structurally balanced budget. A structurally balanced policy would entail recurring revenues equal to or exceeding recurring expenditures.[15]

Chicago continues to have a chronic structural budget deficit. The past Administration presented a mid-year budget forecast that has 2023 ending with a surplus of $142.8, 2024 – ($84.5M), 2025 – ($123.8M), and 2026 ($144.5M).[16] This is the lowest budget gap seen in 12 years.[17] The past administration has taken actions to have a financially sustainable budget by increasing pension funding, ending scoop and toss, paying down $399 million a year in debt, and announcing a Chicago Casino that is expected to add $2.7 billion of financial value to the City.[18]

Concerns remain regarding the sustainability of a balanced budget particularly after the American Rescue Plan Act funds are exhausted. Reliance on casino revenues to fund pension debt is also a concern, realizing that this revenue stream will only account for 9% of what the City needs.[19] Another concern within the budget is the cross-departmental Finance General category that fails to allow evaluation of the true cost of services by departments. The City must move towards a structurally balanced policy that includes recurring revenue streams equal to or greater than recurring expenditures.

Below is the Mid-Year Budget Forecast prepared by the past administration.

Income Statement

	2022 BUDGET AS AMENDED	2022 YEAR-END ESTIMATES	2023 BUDGET ORDINANCE	2023 YEAR-END ESTIMATES	2024 PROJECTED	2025 PROJECTED	2026 PROJECTED
Revenues							
Local Non-Tax Revenue	$ 1,495.9	$ 1,360.8	$ 1,575.8	$ 1,550.1	$ 1,590.6	$ 1,590.2	$1,597.4
Proceeds and Transfers in	$ 1,048.9	$ 962.0	$ 865.8	$ 759.6	$ 566.4	$ 578.9	$ 592.9
Intergovernmental Revenue	$ 536.2	$ 979.2	$ 649.6	$ 924.5	$ 876.3	$ 878.9	$ 882.8
Local Tax Revenue	$ 1,767.5	$ 2,116.1	$ 2,123.0	$ 2,122.7	$ 2,153.2	$ 2,183.4	$2,194.1
Prior Year Assigned Available	$ 51.4	$ -	$ 222.1	$ 222.1	$ 65.6	$ 66.0	$ 66.4
Total Revenue	**$ 4,899.9**	**$ 5,418.2**	**$ 5,436.3**	**$ 5,579.0**	**$ 5,252.1**	**$ 5,297.4**	**$5,333.6**
Expenditures							
Commodites and Materials	$ 82.9	$ 76.5	$ 96.4	$ 96.4	$ 101.2	$ 104.3	$ 107.4
Contingencies	$ 0.2	$ 0.1	$ 0.2	$ 0.2	$ 0.2	$ 0.2	$ 0.2
Contractual Services	$ 486.9	$ 440.5	$ 569.8	$ 569.8	$ 598.3	$ 616.2	$ 634.7
Equipment	$ 1.6	$ 1.1	$ 2.2	$ 2.2	$ 2.4	$ 2.5	$ 2.6
Financial Cost	$ 613.5	$ 630.7	$ 623.7	$ 623.7	$ 462.2	$ 489.0	$ 521.6
Pension Cost	$ 329.2	$ 329.2	$ 644.9	$ 644.9	$ 559.7	$ 552.0	$ 543.1
Permanent Improvements	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Personnel Services	$ 3,083.1	$ 3,017.1	$ 3,189.9	$ 3,189.9	$ 3,303.5	$ 3,347.8	$3,359.3
Specific Items and Projects	$ 258.2	$ 326.4	$ 301.2	$ 301.2	$ 301.2	$ 301.2	$ 301.2
Transfers and Reimbursements	$ 43.2	$ 40.8	$ 6.4	$ 6.4	$ 6.4	$ 6.4	$ 6.4
Travel	$ 1.2	$ 1.0	$ 1.5	$ 1.5	$ 1.5	$ 1.5	$ 1.5
Total Expenses	**$ 4,899.9**	**$ 4,863.4**	**$ 5,436.3**	**$ 5,436.3**	**$ 5,336.7**	**$ 5,421.1**	**$5,478.1**
SUBTOTAL		$ 554.8	$ 0.0	$ 142.8	$ (84.5)	$ (123.8)	$ (144.5)
Additional Expenditures and Transfers							
Pension Advance Payment					$ 241.0	$ 214.7	$ 185.8
Transfer to Rainy Day Fund					$ 5.0	$ 5.0	$ 5.0
Additional Reserves							
FY 2022=2023 Fund Balance Reserve					$ 246.0	$ 219.7	$ 190.8
SUBTOTAL					$ -	$ -	$ -
GAP (REVENUE LESS EXPENDITURES)					**$ (84.5)**	**$ (123.8)**	**$ (144.5)**

Source: City of Chicago Mid-Year Budget Forecast

Social, Economic, and Financial issues facing Chicago.

All big cities have a crime issue, but Chicago is different. Overall, Chicago' per capita murder rate exceeds New York and Los Angeles, but is lower than other Midwestern cities such as Detroit, Milwaukee, and St. Louis.[20] Chicago's North Side is as safe as it has been in a generation, crime slightly increased during the violent years of 2016 and 2020, then declined in 2021, even as the city as a whole experienced the bloodiest year since the mid-1990s, according to data from the Chicago Police Department.[21] The story is quite different on the West Side. The Garfield Park and Austin neighborhood during the 2000s was already plagued with poverty, drugs, and economic disinvestment. The per-capital murder rate in the Chicago Police 15th district in Austin climbed 274% between 2010 and 2020, compared to the North Side that saw a declining homicide rate barely ticking up during the violent years of 2016 and 2020.[22] It is really a tale of two-cities where the current crime surge made matters worse for areas already plagued by violence.

The increase in crime is directly correlated to population loss, vacant retail stores on the Gold Coast, and the decrease in transportation ridership. A reduction in violence is not a panacea for the impacted communities. If the shooting stopped, poverty would still exist, education performance would continue to lag, and the lingering effects of trauma that comes with living in communities where violence is normalized would continue. The lack of affordable housing, lack of reinvestment in underserved neighborhoods and systemic racism all contribute to the cycle. Crime is directly related to many of the social, economic, and financial problems that plague the City, reducing crime is critical.

Other areas of concern include infrastructure updates: updating the roads and bridges and looking for alternative revenue streams as electronic vehicles impact motor fuel revenue. Lead pipe replacement; as of December 2022, only 280 Chicago homeowners have had lead pipe replacement out of an estimated 390,000 lead service lines, the most lead water lines in any city in the United States.[23]

Property tax, CPS School resourcing, and Immigration funding are other problems Chicago must address. The issue with immigration funding was recently highlighted during the City Council meeting approval of $51 million in migrant crisis funding that would last through the end of June 2023. The meeting was contentious and racially charged, further deepening the City's divide. The pain caused by historic and generational disinvestment in Black communities was seen in the faces of the speakers opposing the funding. The funding was approved but the question remained, how will we continually fund immigration as a sanctuary city. The funding added salt to the wound of those communities impacted by systemic environmental racism, where HUD recently announced that an investigation found Chicago engaging in a pattern of civil rights violations through planning, zoning, and land use policies routinely relocating polluting businesses from white communities to African American and Latinx ones. [24] The country is looking to see how Chicago handles its immigration problem.

Looking through an economic lens Chicago has major strengths of being a major center for business distribution, transportation, and finance, having a strong talent pool and a budding high-tech center in River North. Conversely, Chicago has State and local budget pressures, weak population trends and a high crime rate, coupled with geopolitical tensions over Taiwan's independence, banks raising lending standards and issuing less credit while consumers and businesses worry about the possibility of a recession.

As the new administration grapples with the three major fiscal challenges (pension shortfall, debt burden, and sustained balanced budget), they also face various social, financial, and economic problems that can wreak havoc for the City's finances.

City Council of Financial Analysis (COFA) recommendations

The City Council of Financial Analysis has identified recommendations to better serve the City Council, these include:

- Reassess fees.
- Release budget documents prior to hearings (30 days prior)
- Strengthen the City Council's Office of Financial Analysis

One of the recommendations by the Office of the Inspector General was to staff the Office of Budget and Management (OBM) to analyze and manage the fees in Chicago, develop a fee policy, schedule reviews, and maintain a comprehensive list of the City's fees.[25] COFA supports that an analysis should be done to ensure fees are in line with other major U.S. cities to determine revenue opportunities.

Another recommendation is to release budget documents 30 days prior to hearings. In 2022 the budget was introduced on Monday and the first budget hearing followed on Thursday. More time and staff are needed to adequately review the budget.

Expanding the City Council Office of Financial Analysis would allow Alderman to scrutinize how the city spends money and be a reliable source for budget analysis that is council centered. The new and expanded COFA could compare the previous year's budget spending to actual to identify trends and estimate costs. The current office has a staff of three (3) compared to New York and San Diego that has a staff of 33 and 11 respectively.[26] A guaranteed minimum budget for COFA will allow for staffing levels needed to make COFA a significant asset to the City Council.

Endnotes

[1]The Civic Federation City of Chicago Proposed Budget. https://www.civicfed.org/sites/default/files/final_city_of_chicago_fy2023_budget_analysis.pdf
[2]The Civic Federation City of Chicago Proposed Budget. https://www.civicfed.org/sites/default/files/final_city_of_chicago_fy2023_budget_analysis.pdf
[3]Chicago's Shaky Pension Funds Face New Hit From Looming Downturn. https://www.bloomberg.com/news/articles/2022-12-27/chicago-s-shaky-pension-funds-face-new-hit-from-looming-downturn
[4]Chicago's Shaky Pension Funds Face New Hit From Looming Downturn. https://www.bloomberg.com/news/articles/2022-12-27/chicago-s-shaky-pension-funds-face-new-hit-from-looming-downturn
[5]Chicago's Shaky Pension Funds Face New Hit From Looming Downturn. https://www.bloomberg.com/news/articles/2022-12-27/chicago-s-shaky-pension-funds-face-new-hit-from-looming-downturn
[6]The Civic Federation City of Chicago Proposed Budget. https://www.civicfed.org/sites/default/files/final_city_of_chicago_fy2023_budget_analysis.pdf
[7]The Civic Federation City of Chicago Proposed Budget. https://www.civicfed.org/sites/default/files/final_city_of_chicago_fy2023_budget_analysis.pdf
[8]A.Kass. Pension Funding History Series. https://amandakass.blog/2023/03/24/pension-funding-history-series-part-ii-the-city-of-chicagos-four-pension-funds/
[9]A.Kass. Pension Funding History Series. https://amandakass.blog/2023/03/24/pension-funding-history-series-part-ii-the-city-of-chicagos-four-pension-funds/
[10]A.Kass. Pension Funding History Series. https://amandakass.blog/2023/03/24/pension-funding-history-series-part-ii-the-city-of-chicagos-four-pension-funds/
[11]https://www.chicago.gov/city/en/depts/mayor/press_room/press_releases/2023/january/VoluntaryAdvancePensionPayment.html#:~:text=%E2%80%9CIn%20FY2021%2C%20for%20the%20first,for%20all%20four%20pension%20funds.
[12] Truth in Accounting released 2/7/2023. https://www.data-z.org/state_data_and_comparisons/city/chicago.
[13] Truth in Accounting released 2/7/2023. https://www.data-z.org/state_data_and_comparisons/city/chicago
[14] Illinois Policy. Each Chicago Taxpayer on Hook for Nearly $42,000 of City Debt. https://www.illinoispolicy.org/each-chicago-taxpayer-on-hook-for-nearly-42000-of-city-debt/
[15]GFOA. Achieving a Structurally Balanced Budget. https://www.gfoa.org/materials/achieving-a-structurally-balanced-budget
[16]City of Chicago Mid-Year Budget Forecast. https://www.chicago.gov/content/dam/city/depts/obm/supp_info/2024Budget/MidYearBudgetForecast.pdf

[17]City of Chicago Mid-Year Budget Forecast. https://www.chicago.gov/content/dam/city/depts/obm/supp_info/2024Budget/MidYearBudgetForecast.pdf
[18]City of Chicago Mid-Year Budget Forecast. https://www.chicago.gov/content/dam/city/depts/obm/supp_info/2024Budget/MidYearBudgetForecast.pdf
[19]Illinois Policy. Chicago Casino Revenue Doesn't Address 91% of City Pension Debt. https://www.illinoispolicy.org/chicago-casino-revenue-doesnt-address-91-of-city-pension-debt/
[20]Crain's Chicago Business. The inequality of safety. https://www.chicagobusiness.com/crains-forum-safer-chicago/chicago-violence-problem-debate-safety-inequality
[21]Crain's Chicago Business. The inequality of safety. https://www.chicagobusiness.com/crains-forum-safer-chicago/chicago-violence-problem-debate-safety-inequality
[22]Crain's Chicago Business. The inequality of safety. https://www.chicagobusiness.com/crains-forum-safer-chicago/chicago-violence-problem-debate-safety-inequality
[23]Chicago Sun Times, Lightfoot's plan to replace Chicago's lead water pipes has switched out 280 of an estimated 390,000 service lines. https://chicago.suntimes.com/2022/12/2/23488902/lead-water-service-line-replacement-chicago
[24]NRDC. What is environmental racism. https://www.nrdc.org/stories/what-environmental-racism#:~:text=Then%20in%20July%202022%2C%20in%20response%20to%20the,white%20communities%20to%20African%20American%20and%20Latine%20ones.
[25]Office of Inspector General. (2018, June). *Audit of the City's Process for Evaluating and Setting User Fees*. City of Chicago. igchicago.org
[26]The making of Chicago's fiscal mess. Crain Chicago Business. https://www.chicagobusiness.com/government/chicago-budget-process-city-council-aldermen