CITY OF CHICAGO
FY2005 PROPOSED BUDGET

Analysis and Recommendations

Prepared By
The Civic Federation
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TABLE OF CONTENTS

EXECUTIVE SUMMARY 3

OVERVIEW OF ANALYSIS 4

- Issues The Civic Federation Supports 4
- Issues of Concern to the Civic Federation 5
- Civic Federation Recommendations 8

FY2005 BUDGET HIGHLIGHTS 10

- Expenditure Reductions 11
- Skyway Revenues 11
- Revenue Enhancements 11

BUDGET FORMAT ISSUES 16

REVENUES 17

- Corporate Fund Revenue Trends 18
- Property Tax Levy Trends 20

RESERVE FUNDS 23

APPROPRIATIONS 24

- Appropriations by Fund: FY2001 to FY2005 25
- Appropriations by Program Area: FY2001 to FY2005 25

PERSONNEL: APPROPRIATIONS AND BUDGETED POSITIONS 26

OPPORTUNITIES FOR ALTERNATIVE SERVICE DELIVERY 28

DEBT TRENDS 29

- Short-Term Debt Trends 30
- Long-Term Direct Debt Trends 30
- Long-Term Net Direct Debt Per Capita 31
- Overlapping Debt: Chicago vs. Other Governments 32
- Debt Service Appropriations 32
- Bond Ratings and Rating Agency Outlook: Negative Outlook from Moody's 33
- The Skyway Transaction 33

PENSION TRENDS 36

- Funded Ratios – Actuarial Value of Assets 36
- Unfunded Liabilities 37
- Investment Rates of Return 37

CIVIC FEDERATION RECOMMENDATIONS 39

- Use Skyway Transaction to Improve Long-term Financial Stability 39
- Expand Privatization Efforts to Obtain Cost Savings and Service Improvements 39
- Provide Additional Information in Budget Documents 39
- Consider Seeking Authorization to Expand Sales Tax to Food and Drugs 40
- Implement a Long-Term Financial Planning Process 40
- Continue to Improve Performance Measurement System 41
- Return to Presenting Changes in Pension Fund Plan Assets on a Disaggregated Basis 41

APPENDIX I 42

APPENDIX II 43

EXECUTIVE SUMMARY

The City of Chicago proposes a FY2005 budget of $5.08 billion. The City faced a $220.4 million Corporate Fund deficit, which will be addressed through personnel reductions, management efficiencies, revenue enhancements and the use of proceeds from the sale of the Skyway.

The Civic Federation offers the following **key findings** on the City of Chicago FY2005 budget:

- The budget will increase by 5.6% from the original FY2004 budget. This is a $269.5 million increase from $4.8 billion to $5.08 billion.
- The budget contains $50 million in expenditure reductions, including the elimination of 1,252 positions and savings from the privatization of janitorial services at O'Hare Airport and the customer service function of the Department of Water Management.
- $86.9 million in revenue enhancements are proposed, including a 0.25% increase in the City's home rule sales tax, a 25-cent increase in the parking tax, an increase in the natural gas use tax from $0.014 per therm to $0.052 per therm, an increase in the amusement tax, an increase from 3% to 3.5% in the hotel accommodations tax and various "sin" tax increases in cigarette and liquor taxes.
- $106 million in proceeds from the $1.83 billion sale of the Chicago Skyway will be used for operating purposes in the FY2005 budget.
- The property tax levy is frozen for the second year at $713.5 million. 90% of the property tax levy will be reserved to pay for pensions and debt service.

The Civic Federation **supports** many elements of the City's FY2005 proposed budget:

- The budget holds the property tax levy constant for the second year in a row.
- The budget takes prudent measures to control personnel expenditures through a reduction in the number of City employees by 1,252 positions, requiring two furlough days for managers and delaying nonunion personnel salary increases for at least 6 months.
- The City continues to increase efficiency of operation and manage costs by privatizing the janitorial services at O'Hare Airport and customer service operations in the Department of Water Management.
- The Civic Federation strongly applauds the City for its innovative privatization of the Skyway. While the proceeds must pay the costs of the transaction and retire the outstanding Skyway bonds, the balance of the proceeds provides a unique opportunity to enhance the City's long-term financial position.

The Civic Federation has **concerns** about several financial issues related to the budget:

- Personnel expenditures far outstrip revenue growth; between FY2000 and FY2004, Corporate Fund tax revenues fell by 1.8% while expenditures for salaries and benefits rose by 14.8%. This situation is not likely to improve.
- The Civic Federation is disappointed that the City is using $106 million of the $1.83 billion windfall from the Skyway for operating purposes, including new programs, rather than targeting use of the proceeds for reducing long-term obligations.
- Raising hotel taxes from 3% to 3.5% in 2005 could reduce the competitiveness of the region's important convention and tourism industry in what continues to be a relatively flat economy.
- The funded ratios of all four City pension funds dropped in FY2003. The Fire Fund experienced the sharpest decline, with its funded ratio dropping to a 47.4% funded ratio, its lowest ratio in five-years. The Police Fund's funded ratio dropped from 64.6% to 61.4%.

The Civic Federation several **recommendations** to improve the City's financial management, including:

- We strongly urge the Mayor to continue expanding the pool of services and programs to be privatized. A likely target for City privatization is solid waste collection and disposal, services for which there are viable and cost-effective private contractors.
- The City should use available proceeds, and interest on proceeds, from the Skyway transaction to focus on paying down long-term debt and pension obligations that are a burden on the property tax.
- The City should implement a long-term financial planning process to be reviewed not just internally, but to allow for input from key external policymakers and the media.

OVERVIEW OF ANALYSIS

The Civic Federation recently concluded an analysis of the City of Chicago's proposed FY2005 $5.08 billion budget.

While we support much of Mayor Daley's budget, we have some concerns, particularly regarding the use of Skyway proceeds, the increase in the hotel accommodations tax and the proposed levels of pension funding. (The full text of our analysis follows this summary and is also available on our web site at www.civicfed.org.)

Issues The Civic Federation Supports

The Civic Federation supports Mayor Daley's ongoing efforts to manage the City of Chicago's resources more efficiently and cost-effectively. We especially applaud his commitment to shrinking the workforce and outsourcing non-essential functions and programs.

No Property Tax Increase in FY2005

The Civic Federation is **pleased** that Mayor Daley's proposed FY2005 budget for the City of Chicago **contains no property tax increase** for the second year in a row. Property taxes are inherently regressive because there is no relationship between increased assessments and a property owner's actual income.

Thanks to Mayor Daley's conservative approach to property tax increases, the City's share of the average Chicago property tax bill has declined from 28.5% in 1998 to 21.5% in 2003. The City's actual property tax levy has increased only 4.3 % between tax years 1999 and 2005 (0.6% per year), far below the rate of inflation.

The Mayor's prudence in limiting property tax increases stands in sharp contrast to several other local governments, including the Chicago Public Schools and the City Colleges, which increased property taxes this year to the maximum amount allowed instead of balancing revenues by cutting spending and increasing efficiency.

Personnel Reductions are Essential and Reflect National Trends

We are **encouraged** by the City's proposal to **control personnel expenditures** by cutting 1,252 positions, requiring two furlough days for managers and delaying nonunion personnel salary increases for at least 6 months. This reduction in the City of Chicago's headcount follows the elimination of 2,600 positions between FY2000 and FY2004.

Improved employee work processes, technological advancements, and increased competition have already driven many private sector industries into significant workforce reductions while maintaining high quality delivery of services. From 2000 to 2003, insurance companies were able to reduce staff by more than 10% nationwide, the real estate industry eliminated 9% of their workforce, and the banking industry shed 14% of headcount.[1]

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[1] Data from the U.S. Department of Labor Bureau's of Labor Statistics. 2003 data is the most recent data available as of this writing.

The public sector must embrace the modernization and improved efficiencies adopted by the rest of the economy if it is to be fiscally responsible and operate within a rational tax environment.

Privatization Efforts

The Civic Federation salutes the Mayor for continuing to explore **targeted privatization efforts**, including janitorial services at O'Hare Airport and customer service operations in the Department of Water Management. The City has long been a regional leader in sensible privatization efforts that have helped to reduce operating costs and improve efficiency of service delivery.

We also **strongly applaud** the City for **privatizing the Skyway**, a move we have long supported. While the proceeds of this innovative transaction must pay the costs of the transaction and retire the outstanding Skyway bonds, the balance will provide a substantial windfall that offers a unique opportunity to enhance the City's long-term financial position.

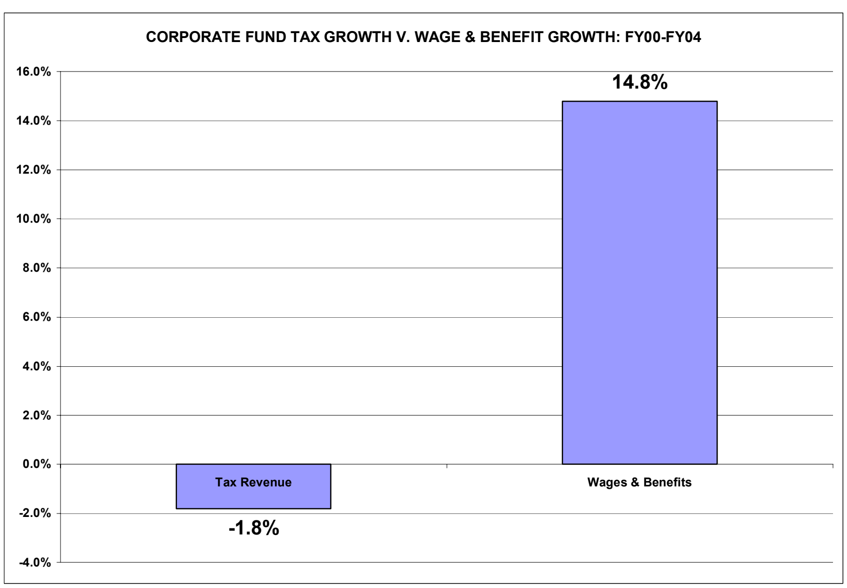
Issues of Concern to the Civic Federation

Despite the many positive elements in the proposed City budget, The Civic Federation is **concerned** about several budgetary issues and warns that failure to address these issues could be very detrimental to the City's financial and economic health.

Personnel Cost Increases Unsustainable

The City of Chicago faces a serious long-term structural problem caused by escalating personnel costs.

As shown by this chart from the FY2005 Budget Overview, Corporate Fund tax revenues declined by 1.8 % from FY2000 and FY2004, while expenditures for salaries and benefits rose by 14.8%, largely driven by double-digit increases in health care costs.



In recent years, the City has balanced its budget with a smorgasbord of new revenue enhancements and increases in existing revenues. While such measures have plugged single-year budget gaps, they fail to address the basic financial reality: Rising costs are outpacing current revenues. To balance its future budgets, the City must significantly reduce operating costs or secure a large new source of recurring revenues.

Unfortunately, the City's options for revenue enhancements are severely limited:

- If the City's proposed sales tax increase is approved, the composite rate will soar to 9.0% -- one of the highest in the nation -- making further increases unlikely (see p.13).

- The City of Chicago and other home rule municipalities could consider seeking legislative authorization **to levy additional sales taxes on food and drugs**. The current exemption, intended to give lower-income households tax relief on necessary purchases, is far too broad; federal law already exempts food purchased with food stamps from sales taxes. It would be a far better fiscal policy to apply sales tax on food and drug purchases and provide relief through tax refunds, credits or rebates to lower-income consumers. However, this would require a change in state law.

- New funds from the State of Illinois are doubtful, given the State's own financial challenges.

- Taxpayer unrest over mounting property tax bills (whose increases are driven by the over 520 local governments in Cook County) is reaching the boiling point, making a significant increase in the City's property tax levy politically unpalatable.

- Potential revenues from a city-owned casino have been estimated at $272 million to $392 million annually.[2] However, it is unclear whether the General Assembly or Governor Blagojevich will approve such a casino. In addition, casino revenues can fluctuate over time, which make them more appropriate for funding capital projects rather than recurring operating expenses.

Some additional small-scale tax and fee options are still available, but none of these is likely to yield the large, new, recurring infusions of revenues needed to meet the City's rising expenditures**.** Currently, nearly 84% of the City of Chicago's Corporate Fund expenditures are related to personnel costs, including salaries, benefits and pensions

All of this makes clear that the City must further reduce its workforce if it is to balance future budgets and continue on a fiscally responsible path.

<u>Use of Skyway Revenues for Operating Purposes</u>

The Civic Federation is **disappointed** that the City is *not* choosing to use the $1.83 billion windfall from the Skyway to more significantly improve its long-term financial position. The City plans to use a significant portion of Skyway proceeds to establish income-generating funds that will pay for current operating expenses and new programs instead of paying down long-term debt or meeting pension obligations. Although such income-generating funds may improve the

[2] Information provided by City of Chicago Office of Budget and Management, September 9, 2004.

City's reserves, they will support increased expenditures rather than eliminate long-term obligations.

The City plans to establish three funds: A $500 million Skyway Investment Fund (a reserve fund projected to generate roughly $25 million in annual revenues); a $325 million Skyway Annuity Fund that will produce payments over the next five-years beginning with $50 million in 2005; and a $100 million Skyway and Human Infrastructure Fund, which will fund a variety of new and existing programs over the next five-years.

In addition, some Skyway funds will be used appropriately to reduce the City's short and long-term obligations. $134 million will be used to pay down long-term debt. $258 million will be used to eliminate the City's outstanding short-term debt obligation. We applaud the City for taking these actions.

However, we understand at least $106 million in Skyway proceeds will go toward new operating expenses in the 2005 budget. We do not view this as prudent use of financial resources. We are particularly opposed to using this money for programs such as the Condo Rebate program and new human infrastructure programs that would not otherwise be funded. *As these are recurring programs, they should be funded from recurring revenues.*

We have long urged the City to establish an adequate reserve fund that is in line with industry standards.[3] Therefore, we **support** the Administration's decision to establish a $500 million reserve fund from Skyway proceeds. However, we are disappointed that the City has indicated it will apply the interest generated from that fund to pay operating expenses. We would prefer to see that interest used to continue reducing long-term liabilities.

Increase in the Hotel Accommodations Tax

The City's proposed hotel tax increase from 3% to 3.5% will push the composite hotel tax rate in Chicago from 14.89% to 15.39%, making it one of the highest in the nation. At this time, Cook County also is considering a new hotel tax to help meet its FY2005 budget deficit, a measure that would push the tax on hotel and motel stays even higher.

Any increase in hotel taxes in 2005 could threaten the competitiveness of the region's important convention and tourism industry, which is already lagging. The hotel occupancy rate in 2003 in downtown Chicago was 70.0%, significantly below the 74.7% occupancy rate in 2000. Those hotels report annual gross receipts of $1.17 billion for 2003 -- $159 million less than gross receipts in 2000.[4] These statistics indicate Chicago's hospitality industry has not yet recovered from the effects of the September 11, 2001 terrorist attacks and the economic recession.

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

[4] 2003 is the last year for which complete data are available. The figures presented are based on year-to-date calculations. Data provided by Chicago Convention and Tourism Bureau, October 29, 2004.

As the hotel accommodations tax increase will generate only $3 million in FY2005 for the City, and approximately $6 million annually thereafter, we believe judicious cuts elsewhere in the $5.08 billion budget could be readily substituted for these revenues.[5]

Pension Funding Ratios Decline

The funded ratios of all four City pension funds dropped in FY2003, according to the City's audited financial statements. The Fire Fund experienced the sharpest decline, with its funded ratio dropping to a 47.4, its lowest ratio in five-years. The Police Fund's funded ratio dropped from 64.6% to 61.4%.

Reflecting the drops in the funded ratios of the Police, Fire and Municipal Pension Funds, unfunded pension liabilities rose by $1.2 billion, or 30.9%, between FY2002 and FY2003.

All four City pension funds did report positive, double-digit rates of return on investments, well above the 8% actuarial assumption -- a sharp turnaround from the previous two years, when all four funds reported negative results. However, the continued declines in the funded ratios of the Fire and Police Pension Funds are serious cause for concern. If these negative trends continue, the City could be forced to raise taxes to maintain the health of the funds. At this time, the City cannot afford further increases in employee benefit levels that would further aggravate funding shortfalls.

Civic Federation Recommendations

The Civic Federation offers several **recommendations** on ways to improve the City's financial management and fulfill its financial obligations:

Use Skyway Transaction to Improve Long-Term Financial Stability

The Civic Federation **strongly recommends** that Skyway transaction proceeds – and interest on those proceeds – be used primarily for reduction in long-term obligations. This move is prudent as a financial strategy and would make more property tax revenues available to fund general operations or back new bond issues for necessary capital improvements.

Expand Privatization Efforts to Obtain Cost Savings and Service Improvements

In his proposed budget, Mayor Daley has taken important steps by privatizing O'Hare janitorial services and Water Department customer service operations. The Civic Federation strongly urges the Mayor to build upon these efforts in the coming year by conducting market and efficiency studies to select additional promising candidates for alternative service delivery, including managed competition and outsourcing.

Privatization is not a panacea for the City's financial problems. We caution that privatization can be beneficial only if there is a marketplace of competitive, qualified vendors and strong,

[5] The tax increase will take effect on July 1, 2005. Therefore, on an annualized basis, the tax increase will generate approximately $6 million per year.

sustained management oversight. But it is an important tool that can be used to reduce costs and improve efficiency.

One likely target for City privatization is garbage removal, given the number of viable, cost-effective private contractors available. Other potential candidates include customer service centers, fleet management, 311 calls (non-emergency services), building management, payroll processing and accounting.

Provide Additional Information in Budget Documents

The Civic Federation commends Office of Budget and Management staff for improving the quality of their budget information.

The *Budget Overview and Revenue Estimates* summary document is a marked improvement from previous budget books. However, the Civic Federation believes it could be strengthened further by including:

- A “walk-up” that describes the sources of the current fiscal year’s deficit or surplus;
- A “walk-down” that clearly identifies steps taken to eliminate any budget deficit;
- A breakdown of personal services expenditures, including the amounts budgeted or spent on wages and salaries, health insurance, worker’s compensation, etc.
- 5-year trends of appropriations, budgeted positions and grant revenues in forthcoming Budget Overview documents.

Consider Seeking Authorization to Expand Sales Tax to Food and Drugs

The City of Chicago and other home rule municipalities should consider seeking legislative authorization to levy additional sales taxes on food and drugs. The current exemption is far too broad, benefiting many more than the lower income households it was intended to benefit. Removing food and drugs from the sales tax base has also forced rates on general merchandise to levels that will soon rank among the highest in the nation. It would be a far better fiscal policy to target relief for food and drug purchases to those who need it through refunds or credits than to provide the benefit to everyone.

Implement a Formal Long-Term Financial Planning Process

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 planning process to be reviewed not just internally, but to allow for input from key external policymakers, the media and the City Council.

Continue to Improve Performance Measurement System

The performance data contained in the *FY2005 Program and Budget Summary* is dramatically improved from previous years. Instead of a simple presentation of workload statistics, this budget includes service delivery targets for certain programs in each department, alongside four years of performance data. This permits City managers and citizens alike to assess success in meeting department service delivery goals. We applaud the Office of Management and Budget for taking this important first step toward a performance-based management system.

Given the City's continued focus on improving management efficiency, the Civic Federation urges the City to continue enhancing the quality and effectiveness of the performance data collected, presented and utilized. Optimally, this would include the inclusion of specific efficiency, effectiveness and service quality measures.

Return to Presenting Changes in Pension Fund Plan Assets on a Disaggregated Basis

Prior to FY2003, the City of Chicago presented the statement of changes in plan assets in its Comprehensive Annual Financial Report for each of the City's four pension trust funds. However, in the FY2003 CAFR, this information was combined in a statement that aggregates the net changes in the pension funds assets into a single presentation.

The performance of each pension fund is critical to the overall fiscal health of the City. While disaggregated financial information is available from each individual fund's office, we believe each fund merits a separate presentation within the City's CAFR.

ACKNOWLEDGEMENTS

The Civic Federation would like to express appreciation to Office of Budget and Management (OBM) Director John Harris, Managing Deputy Budget Director Russ Carlson, Assistant Budget Director Craig Lesner and the OBM Department staff for their hard work in preparing this budget and their willingness to provide us with a briefing and answer many of our budget questions.

We would further like to **congratulate** Mayor Daley, Director Harris and the City of Chicago's financial management team for substantially improving the format of the City's budget this year to reflect many of the more user-friendly guidelines recommended by the Government Finance Officer's Association Distinguished Budget Awards Program.

The Federation has long advocated format improvements to enhance the transparency and usefulness of the City's budget documents. We were very pleased this year to observe the incorporation of many of our suggestions into the new *Budget Overview and Revenue Estimates* document.

FY2005 BUDGET HIGHLIGHTS

The City of Chicago has proposed a $5.08 billion budget for FY2005. This is an increase of 5.6% or approximately $269.5 million from the original FY2004 budget. Corporate (General) Fund expenditures are expected to rise by 10.7%, from approximately $2.5 billion to $2.7 billion. The Corporate Fund accounts for revenues and expenditures used for the general operations of the City.

$220.4 Million Corporate Fund Deficit for FY2005

In August 2004, the Office of Budget and Management estimated that the City of Chicago financial resources would decrease by 3.5% in FY2005 while spending would increase by 5.7%, leaving the City with a projected $220.4 Corporate Fund deficit.

City of Chicago Corporate Fund 2004 vs. 2005 (millions)				
	2004 Estimated	2005 Projected	% change	$ change
Revenue + Fund Balance	$ 2,613.9	$ 2,521.3	-3.5%	$ (92.6)
Expenditures	$ 2,594.2	$ 2,741.7	5.7%	$ 147.5
Ending Fund Balance	$ 19.7	$ (220.4)		

The budget deficit was closed this fiscal year with a combination of expenditure reductions, an infusion of resources from the sale of the Skyway and revenue enhancements from selected tax and fee increases or additions.

Expenditure Reductions

The City is proposing to save as much as $50 million through targeted spending cuts in FY2005. These cuts include:

- Eliminating 1,252 positions. These cuts will reduce the City's non-grant funded headcount to 35,919 from 37,171 in FY2004.
- Delaying nonunion personnel salary increases for at least 6 months.
- Requiring that managers who earn more than $55,000 per year take two furlough days.
- Imposing 3% across the board reductions in non-personnel costs.
- Privatizing janitorial services at Terminals 1 and 3 at O'Hare Airport. This effort will impact a total of 220 jobs.
- Outsourcing customer service functions in the Department of Water Management, including the call center & meter reading.
- Requiring the Chicago Public Schools to pay for garbage pickup; this service has been provided by the City free of charge.

Skyway Revenues

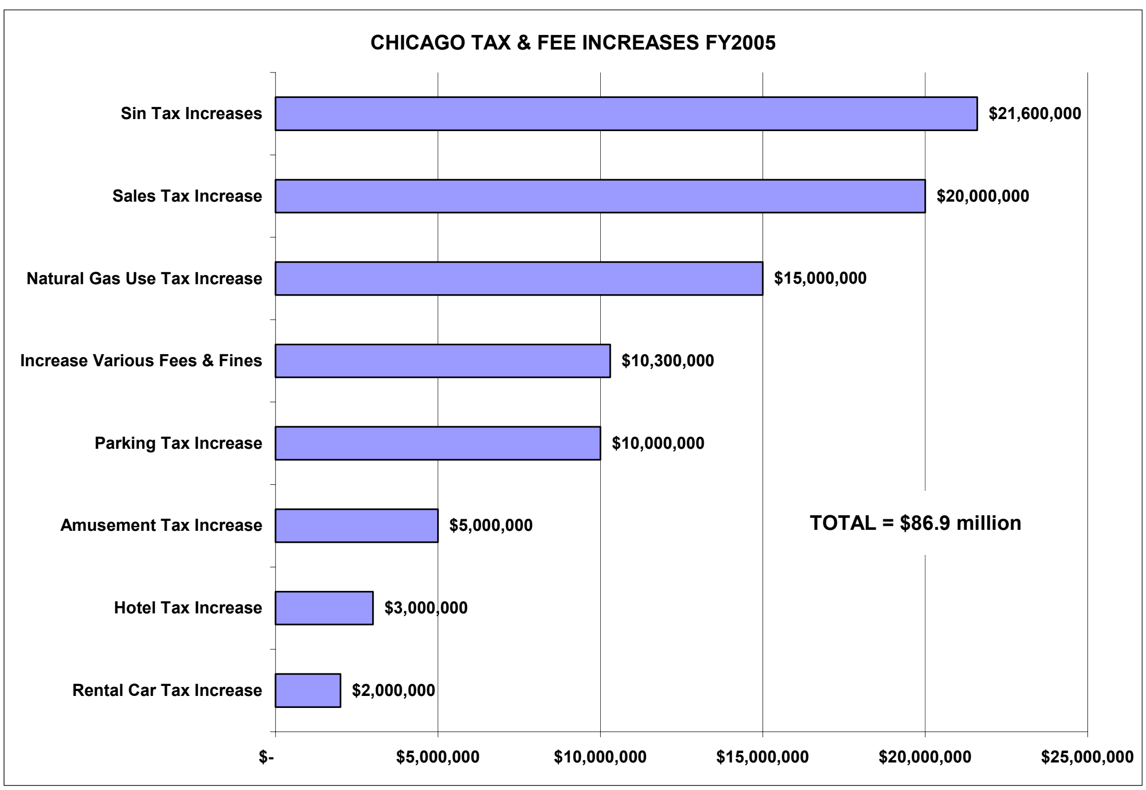
Fifty million dollars in proceeds from the sale of the Chicago Skyway will be used to close the Corporate Fund deficit in FY2005. These funds are a portion of the $325 million, 5-year annuity the City has established with Skyway sale proceeds.

Revenue Enhancements

The FY2005 budget proposes $86.9 million in revenue enhancements. $10.3 million of this amount is derived from new fees and fee increases. The remaining $76.6 million will be generated from tax increases.

The major revenue enhancements include:

- A 0.25% increase in the City home rule sales tax. Because the tax cannot be implemented until July 1, it will generate 6 months of revenue, or $20 million in FY2005.
- A 25 -cent parking tax increase will generate $10 million. The tax on parking spaces in lots and garages will rise from $2.00 to $2.25.
- A $1.00 increase in the car rental tax, from $2.75 to $3.75, will yield $2 million.
- An increase in the natural gas use tax from 1.4 cents per therm to an estimated 5.2 cents per therm. This will generate an estimated $15 million on will impact commercial users.
- An increase in the amusement tax from 3% to 4% for live performances and 7% to 8% for all other performances is projected to yield $5 million.
- An increase in the City's hotel accommodations tax from 3% to 3.5% is expected to yield $3 million. Because the tax cannot be implemented until July 1, it will generate only 6 months of revenue in FY2005. In FY2006, it will generate approximately $6 million annually.
- "Sin" tax increases that will provide approximately $21.6 million in new revenues. These include raising the City cigarette tax from 16 cents to 48 cents per pack and raising alcoholic beverage taxes by the following rates:
    - The tax on beer will increase from 16 cents to 19 cents per gallon
    - The tax on wine with <14% alcohol will rise from 20 cents to 24 cents per gallon
    - The tax on wine with >14% but <20% alcohol will rise from 50 cents to 60 cents per gallon
    - The tax on distilled spirits with >20% alcohol will rise from $1.50 to $1.80 per gallon
- Imposing a fee on bids for City contracts will yield $1 million.
- Charging a development fee will generate $2.3 million.
- Various fees, fines and charges are expected to generate $7 million.



Chicago Sales and Hotel Tax Rates Compared to Other Municipalities

The City proposes a 0.25% increase in the City's home rule sales tax on general merchandise. The sales tax rate increase will boost the composite sales tax rate in the City to 9.0%, making it one of the highest in the nation as well as the 6-county region.[6]

SALES TAX RATE COMPARISON: SELECTED U.S. CITIES	
City	**General Merchandise Rate**
Memphis, TN	9.250%
Chicago, IL (proposed)	**9.000%**
New Orleans, LA	9.000%
Seattle, WA	8.800%
New York City, NY	8.625%
Los Angeles, CA	8.250%
Atlanta, GA	7.000%
Philadelphia, PA	7.000%
Kansas City, KS	6.975%
Columbus, OH	6.750%
Des Moines, IA	6.000%
Detroit, MI	6.000%
Indianapolis, IN	5.000%
Boston, MA	5.000%
Honolulu, HI	4.000%

SALES TAX RATE COMPARISON: CHICAGO REGION		
Municipality	**General Merchandise Rate**	**Food/Drugs/Medical Appliances Rate**
CHICAGO (COOK proposed)	**9.00%**	**2.00%**
Evanston	8.75%	2.00%
Oak Park	8.75%	2.00%
Schaumburg (Cook)	8.75%	2.00%
Elgin (Cook)	8.50%	2.00%
Orland Park (Cook)	8.50%	2.00%
Oak Brook (Cook)	8.00%	2.00%
Joliet (Kendall)	8.00%	1.00%
Joliet (Will)	7.75%	1.25%
CHICAGO (DUPAGE proposed)	**7.75%**	**1.25%**
Schaumburg (DuPage)	7.50%	1.25%
Elgin (Kane)	7.25%	1.25%
Orland Park (Will)	7.25%	1.25%
Gurnee	7.00%	1.25%
Naperville (DuPage)	6.75%	1.25%
Naperville (Will)	6.75%	1.25%
Oak Brook (DuPage)	6.75%	1.25%
Midwest Retail Cities around the Chicagoland Region		
Highland (IN)	6.00%	0%
Michigan City (IN)	6.00%	0%
Milwaukee (WI)	5.60%	0.25%
Kenosha (WI)	5.50%	0%

[6] Current City of Chicago sales tax rates are as follows: 8.75% on general merchandise and 2.00% on food, drugs, and medical appliances in Chicago (Cook County), and 7.50% on general merchandise and 1.25% on food, drugs, and medical appliances in Chicago (DuPage County).

The increase in the City's hotel accommodations tax from 3% to 3.5% will yield a composite hotel to 15.39%. This is less than the rate in Seattle, Columbus or Houston, but higher than most other major cities.

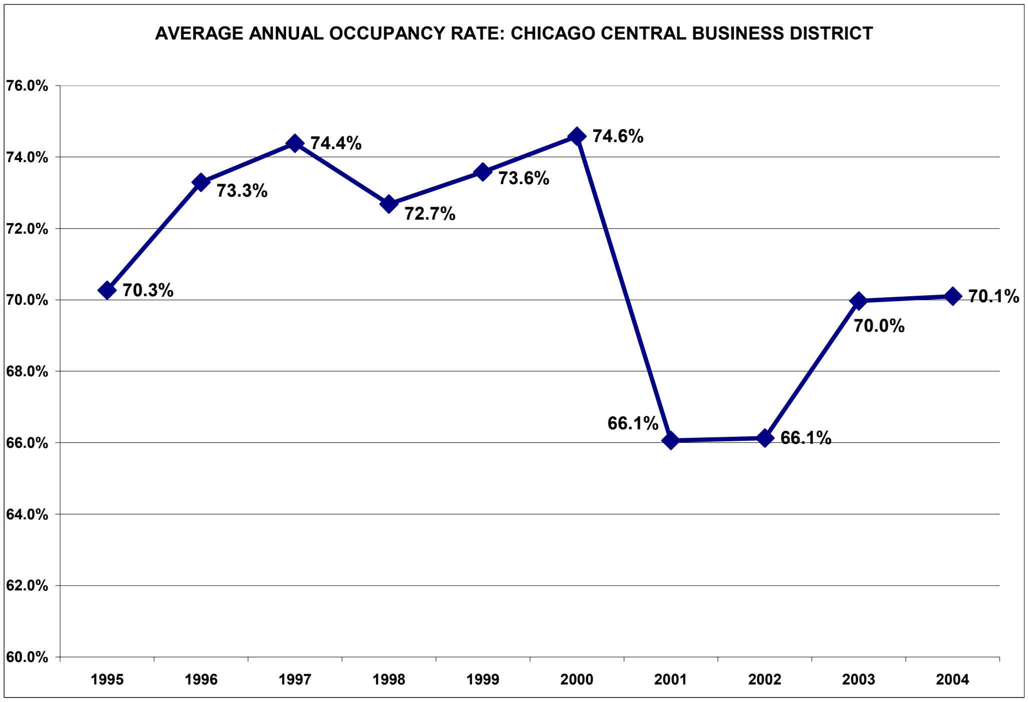
COMPOSITE HOTEL TAX RATE COMPARISON: Selected U.S. Cities	
Houston	17.00%
Columbus	15.75%
Seattle	15.60%
CHICAGO (proposed)	**15.39%**
Los Angeles	14.00%
San Francisco	14.00%
Philadelphia	14.00%
New York City	13.25%
Atlanta	13.00%
New Orleans	12.00%
Portland	11.50%

Chicago Hotel Occupancy Rates and Estimated Annual Gross Receipts

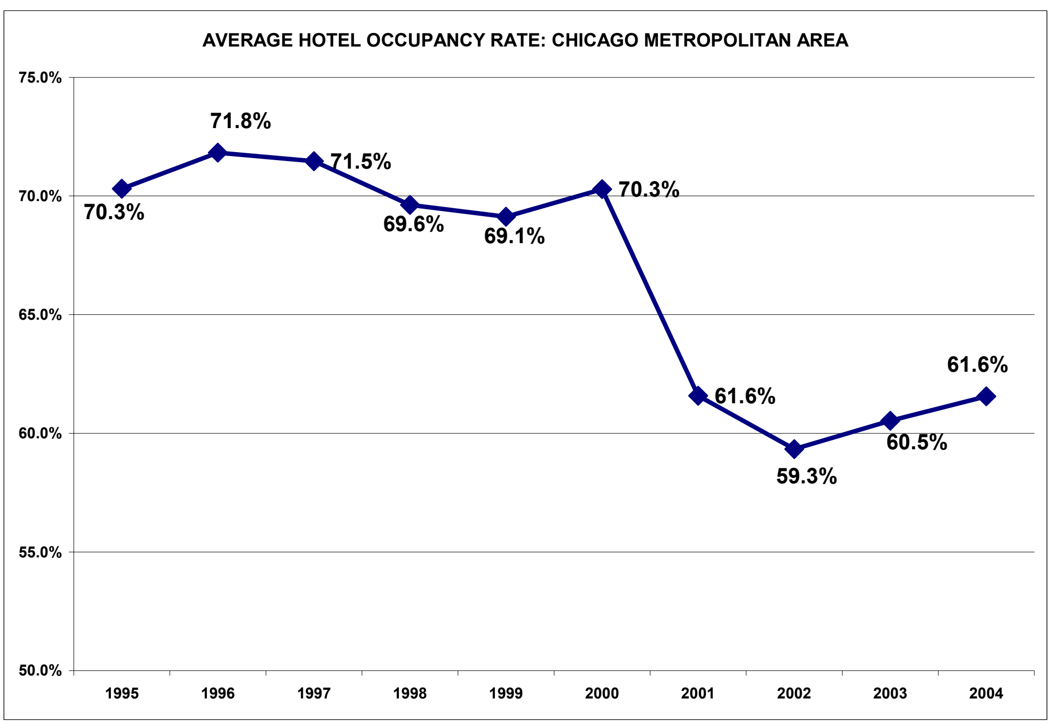
The Chicago hotel industry has not yet recovered from the twin negative effects of the economic recession and the September 11, 2001 attacks on the U.S. While statistics show that a recovery is clearly occurring, neither hotel occupancy rates or gross receipts have yet exceeded 2000 levels.

The following exhibits show average annual hotel occupancy rates for the Central Business District of Chicago (Loop area) and the entire Chicago Metropolitan area for the ten year period from 1995 to 2004. The information was provided by the Chicago Convention and Tourism Bureau.

In the Central Business District of Chicago, the highest average occupancy rate of approximately 75% was observed in the year 2000. In 2004, the estimated average occupancy rate will be 70.1%.



The metropolitan area of Chicago is comprised of the city and surrounding counties including the areas around O'Hare and Midway Airports. For this region, the average occupancy rate in 2000 was 70.3%. In 2004, the estimated average occupancy rate will be 61.6%.



Estimated annual gross receipts for hotels in the Central Business District of Chicago and the entire Chicago Metropolitan area for the ten-year period from 1995 to 2004 are shown next. Estimated annual gross receipts for hotels in the Central Business District of Chicago exhibited steady increases in the range of 6-13% throughout the 1990s, eventually reaching their highest level in 2000 at approximately $1.3 billion. Estimated annual gross receipts exhibited two consecutive years of declines in 2001 and 2002, with declines from the previous year of 12.1% and 7.8% respectively. In 2003, estimated annual gross receipts recovered to 2001 levels of roughly $1.16 billion. For 2004, gross receipts for hotels in the Central Business District of Chicago are estimated at $1.15 billion, down 1.4% from 2003 and $174.9 million or 13.2% lower than the peak observed in 2000.

ESTIMATED ANNUAL HOTEL GROSS RECEIPTS (In Millions of Dollars)						
YEAR	Chicago Central Business District	$ CHG (Prev Yr)	% CHG (Prev Yr)	Chicago Metro Area	$ CHG (Prev Yr)	% CHG (Prev Yr)
1995	$ 776.0			$ 1,475.4		
1996	$ 878.3	$ 102.29	13.2%	$ 1,709.2	$ 233.87	15.9%
1997	$ 993.3	$ 114.98	13.1%	$ 2,212.3	$ 503.08	29.4%
1998	$ 1,114.0	$ 120.78	12.2%	$ 2,384.1	$ 171.76	7.8%
1999	$ 1,183.2	$ 69.17	6.2%	$ 2,605.4	$ 221.35	9.3%
2000	$ 1,327.2	$ 143.98	12.2%	$ 2,902.0	$ 296.57	11.4%
2001	$ 1,167.2	$ (160.00)	-12.1%	$ 2,420.6	$ (481.39)	-16.6%
2002	$ 1,076.2	$ (91.01)	-7.8%	$ 2,228.6	$ (192.04)	-7.9%
2003	$ 1,168.2	$ 92.03	8.6%	$ 2,287.5	$ 58.89	2.6%
2004	$ 1,152.3	$ (15.90)	-1.4%	$ 2,312.5	$ 25.06	1.1%

Estimated Annual Hotel Gross Receipts calculated from annual averages for Daily Rates, Capacity & Occupancy reported by CCTB.
Source: Chicago Convention & Tourism Bureau (CCTB), 10/29/04

BUDGET FORMAT ISSUES

The Civic Federation <u>**commends**</u> the financial management team at the Office of Budget and Management for creating a new *Budget Overview and Revenue Estimates* document that reflects many of the guidelines of the Government Finance Officer's Association Distinguished Budget Awards Program as well as previous suggestions made by the Civic Federation. The new Overview contains many important user-friendly features, including:

- A table of contents;
- A description of budget procedures and structure;
- A budget calendar;
- Narrative descriptions of funds;
- A glossary of terms;
- Descriptions of District financial policies;
- 7 years of trend information for revenues as well as a useful guide on how to read and understand the revenue estimates;
- 3 years of trend data for appropriations by department and program area;
- 2 years of information on budgeted positions;
- A discussion of FY2005 grant revenues and appropriations

The Overview provides citizens with a concise and informative summary of trends, programs and budget processes. We **congratulate** the City of Chicago's financial management team for their outstanding efforts this year to improve budget transparency.

Budget Format Recommendations

The Civic Federation offers the following recommendations to further improve the format of the City of Chicago budget document:

- The budget should include an easily understood **"walk-up"** that describes the sources of the current fiscal year budget deficit or surplus in the introductory pages of the budget and a **"walk down"** that clearly identifies the steps taken to eliminate the budget deficit if there is one.
- More detailed information should be provided about personal services expenditures and appropriations, such as the amounts budgeted or spent on wages and salaries, health insurance, worker's compensation, etc.
- The budget should include a presentation of information about new initiatives for the current fiscal year that clearly outlines savings or costs for each of those initiatives.
- The budget should contain 5-year trends of appropriations, budgeted positions and grant revenues in future years.

REVENUES

City of Chicago revenues from all sources are expected to increase by 4.4% in FY2005, rising from $4.8 billion to $5.0 billion.[7]

- Aviation fees, the single largest revenue source are projected to rise by 8.1%, increasing by $60 million to $809.1 million.
- Utility taxes will rise by 5.1%, largely as a result of the proposed increase in the natural gas use tax for commercial users.
- Sewer and water fee collections will drop slightly, by 0.2%. Sales tax receipts should increase by 7.7% or $33.9 million, although at least $20 million of the increase can be attributed to the 0.25% increase in the City's home rule sales tax rate. Because that tax cannot be implemented until July 1, the City will only be able to assume 6 months of sales of sales tax revenues. A full year of sales tax revenues would generate as much as $40 million.
- Income tax collections, including receipts for the personal property replacement tax (PPRT), which is essentially a corporate income tax, are expected to increase by 7.8% I FY2005, rising from $288.5 million to $311.0 million
- "Other" taxes, which include business, recreation, transportation, and recreation and motor fuel taxes are projected to generate $792.9 million in FY2005, a $34.1 million increase from FY2004.
- Internal service earnings, which are reimbursements to the Corporate Fund for services that are paid with other City funds, will rise by 5.2%, from $262.3 million to $276.0 million
- "Other resources," which includes all other fees, charges, proceeds and reimbursements is projected to increase slightly, from $639.4 million to $663.3 million.

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[7] These total figures include deductions for transfers between funds and the proceeds of debt.

CHICAGO ALL FUND REVENUES: FY2004 and 2005 (In Millions of Dollars)				
	FY2004	FY2005	$ CHG	% CHG
Aviation	$ 748.3	$ 809.1	$ 60.8	8.1%
Property Taxes	$ 712.4	$ 712.4	$ (0.0)	0.0%
Utility Taxes	$ 500.2	$ 525.6	$ 25.4	5.1%
Sewer & Water	$ 527.3	$ 526.4	$ (0.9)	-0.2%
Sales Taxes	$ 437.8	$ 471.7	$ 33.9	7.7%
Income Taxes/PPRT	$ 288.5	$ 311.0	$ 22.5	7.8%
Internal Service Earnings	$ 262.3	$ 276.0	$ 13.7	5.2%
Other Taxes	$ 758.8	$ 792.9	$ 34.1	4.5%
Other Resources	$ 639.4	$ 663.3	$ 23.9	3.7%
Total	**$ 4,875.0**	**$ 5,088.4**	**$ 213.4**	**4.4%**

Source: City of Chicago FY2005 Budget Overview & Revenue Estimates

A five-year trend analysis of City of Chicago revenues from all sources reveals that revenues will have increased by 13.9% between FY2001 and FY2005, from $4.4 billion to $5.0 billion.

CHICAGO ALL FUND REVENUES: FY2001 and FY2005 (In Millions of Dollars)				
	FY2001	FY2005	$ CHG	% CHG
Aviation	$ 706.4	$ 809.1	$ 102.7	14.5%
Property Taxes	$ 685.9	$ 712.4	$ 26.5	3.9%
Utility Taxes	$ 482.0	$ 525.6	$ 43.6	9.0%
Sewer & Water	$ 494.5	$ 526.4	$ 31.9	6.5%
Sales Taxes	$ 428.5	$ 471.7	$ 43.2	10.1%
Income Taxes/PPRT	$ 314.6	$ 311.0	$ (3.6)	-1.1%
Internal Service Earnings	$ 262.3	$ 276.0	$ 13.7	5.2%
Other Taxes	$ 685.4	$ 792.9	$ 107.5	15.7%
Other Resources	$ 407.9	$ 663.3	$ 255.4	62.6%
Total	**$ 4,467.5**	**$ 5,088.4**	**$ 620.9**	**13.9%**

Source: City of Chicago FY2005 Budget Overview & Revenue Estimates

Corporate Fund Revenue Trends

The Corporate Fund is the City's general fund. It supports a wide variety of services including public safety, public health, sanitation, and transportation. In FY2005, the City projects a 4.8%, $125.8 million increase in Corporate Fund revenues.

City of Chicago tax revenues are projected to rise by 6.7%, from nearly $1.7 billion to $1.8 billion. Utility taxes and franchise, the largest source of tax revenue, is expected to increase by 4.9%. Sales and use taxes, which include the City's share of sales taxes collected by the State as well as its own home rule sales tax, will rise by 8.3%, or approximately $34 million. Much of the increase is due to the City's 0.25% increase in its home rule sale tax. Income tax receipts, which include the personal property replacement tax levied on corporations and utilities, is projected to rise by 8.1%.

Non-tax Corporate Fund revenues will increase by 4.6%, rising from $732 million to $765.8 million. Most of these revenues, or 76% of the total, derive from internal service earnings, fines and forfeitures and licenses and permits.

Proceeds and Transfers In will decline by 10.9% in FY2005, falling from $188.5 million to $167.9 million. This category includes a total of $101.4 million in revenue from investment on the Skyway Investment Fund and proceeds from the Skyway Annuity Fund and Skyway Neighborhood and Infrastructure Fund. [8]

CHICAGO CORPORATE FUND REVENUES: FY2004 and FY2005 (In Millions of Dollars)				
Tax Revenue	**FY2004**	**FY2005 Prop**	**% CHG**	**$ CHG**
Utility Tax & Franchise Fees	$ 477.2	$ 500.4	4.9%	$ 23.2
Sales & Use Taxes	$ 411.4	$ 445.4	8.3%	$ 34.0
Income Taxes (Incl. PPRT)	$ 234.9	$ 253.9	8.1%	$ 19.0
Transaction Taxes	$ 274.7	$ 269.5	-1.9%	$ (5.2)
Transportation Taxes	$ 140.6	$ 152.6	8.5%	$ 12.0
Recreation Taxes	$ 85.5	$ 110.5	29.2%	$ 25.0
Business Taxes	$ 63.8	$ 68.3	7.1%	$ 4.5
Municipal Auto Rental Tax	$ 3.3	$ 3.4	3.0%	$ 0.1
Total Tax Revenue	**$ 1,691.4**	**$ 1,804.0**	**6.7%**	**$ 112.6**
Non-Tax Revenue				
Internal Service Earnings	$ 287.0	$ 276.0	-3.8%	$ (11.0)
Fines & Forfeitures	$ 189.0	$ 195.0	3.2%	$ 6.0
Licenses & Permits	$ 103.7	$ 107.9	4.1%	$ 4.2
Current Service Charges	$ 81.5	$ 83.7	2.7%	$ 2.2
Municipal Utilities	$ 23.0	$ 25.2	9.6%	$ 2.2
Leases,Rentals & Sales	$ 30.8	$ 40.5	31.5%	$ 9.7
Reimbursement,Interest,Other	$ 17.0	$ 37.5	120.6%	$ 20.5
Total Non-Tax Revenue	**$ 732.0**	**$ 765.8**	4.6%	$ 33.8
Proceeds & Transfers In	**$ 188.5**	**$ 167.9**	**-10.9%**	**$ (20.6)**
TOTAL CORPORATE REVENUE	**$ 2,611.9**	**$ 2,737.7**	**4.8%**	**$ 125.8**

The next exhibit presents a 5-year trend for Corporate Fund revenues. Between FY2001 and FY2005, all Corporate Fund revenues increased by 12.1%. This represents a $296.2 million increase from $2.4 billion to $2.7 billion. During this period, tax revenues rose by 12.2%, non-tax revenues increased by 10.7% while Proceeds and Transfers In increased by 18.2%.

[8] See *Summary of 2205 Projected Corporate Fund Revenues* from Skyway proceeds in "Use of Skyway Proceeds."

CHICAGO CORPORATE FUND REVENUES: FY2001 and FY2005 (In Millions of Dollars)				
Tax Revenue	**FY2001**	**FY2005 Prop**	**% CHG**	**$ CHG**
Utility Tax & Franchise Fees	$ 455.8	$ 500.4	9.8%	$ 44.6
Sales Taxes	$ 431.3	$ 445.4	3.3%	$ 14.1
Income Taxes (Incl. PPRT)	$ 219.1	$ 253.9	15.9%	$ 34.8
Transaction Taxes	$ 198.2	$ 269.5	36.0%	$ 71.3
Transportation Taxes	$ 145.3	$ 152.6	5.0%	$ 7.3
Recreation Taxes	$ 85.8	$ 110.5	28.8%	$ 24.7
Business Taxes	$ 68.7	$ 68.3	-0.6%	$ (0.4)
Municipal Auto Rental Tax	$ 3.7	$ 3.4	-8.1%	$ (0.3)
Total Tax Revenue	**$ 1,607.9**	**$ 1,804.0**	**12.2%**	**$ 196.1**
Non-Tax Revenue				
Internal Service Earnings	$ 271.6	$ 276.0	1.6%	$ 4.4
Fines & Forfeitures	$ 145.0	$ 195.0	34.5%	$ 50.0
Licenses & Permits	$ 73.1	$ 107.9	47.6%	$ 34.8
Current Service Charges	$ 55.0	$ 83.7	52.2%	$ 28.7
Municipal Utilities	$ 23.4	$ 25.2	7.7%	$ 1.8
Leases, Rentals & Sales	$ 12.6	$ 40.5	221.4%	$ 27.9
Reimbursement,Interest,Other	$ 110.9	$ 37.5	-66.2%	$ (73.4)
Total Non-Tax Revenue	**$ 691.6**	**$ 765.8**	**10.7%**	**$ 74.2**
Proceeds & Transfers In	**$ 142.0**	**$ 167.9**	**18.2%**	**$ 25.9**
TOTAL CORPORATE REVENUE	**$ 2,441.5**	**$ 2,737.7**	**12.1%**	**$ 296.2**

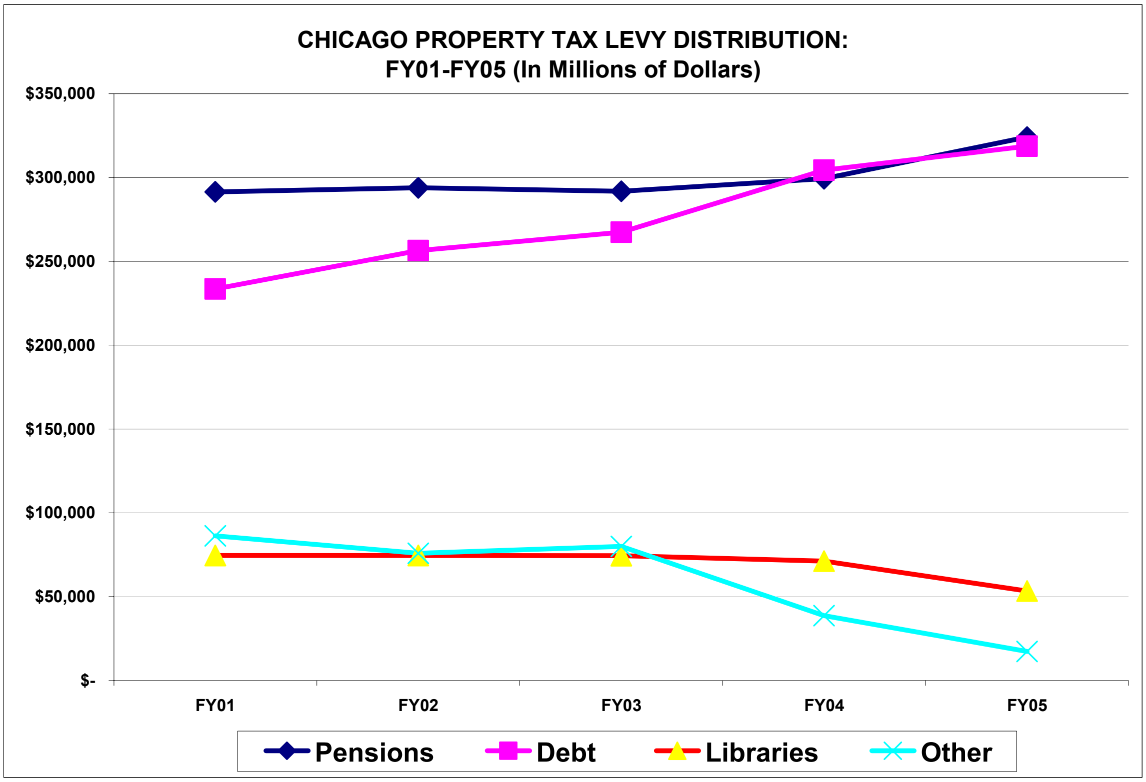
Source: City of Chicago FY2005 Budget Overview & Revenue Estimates

Property Tax Levy Trends

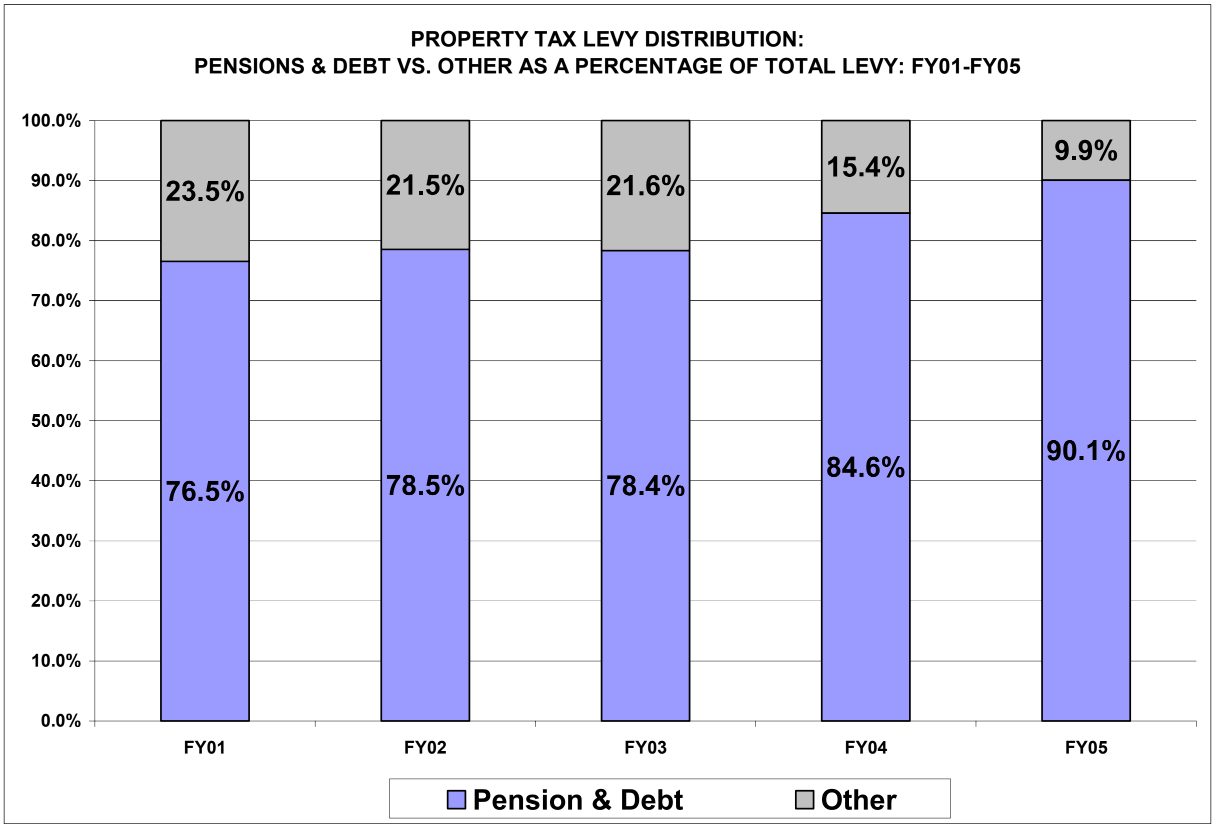
The City's property tax levy will be frozen in tax year 2005 at the previous year's level of $713.5 million. This is the second year that the levy will be frozen. Since tax year 1999, the levy has risen by 4.3%.

Property tax revenues are distributed primarily to three major programs: pensions, debt service and libraries. In tax year 2005, 90% of the levy will be reserved for pensions and debt service. The City's four employee retirement systems will receive the largest share of levy proceeds, or $324.1 million. Debt service will receive $318.7 million. The share of the levy earmarked for libraries will be reduced from $71.2 million in tax year 2004 to $54.5 million.[9] Correspondingly, the library system's total share of the levy will drop from 10% of the total levy to 7.6%. However, $24.2 million in Corporate Fund revenues also will be tapped to fund the libraries, bringing total library expenditures to $78.7 million. Approximately 2.3% of the tax year 2005 levy will be utilized for City Relief, which is used to reimburse the State of Illinois for certain public aid programs. City Relief will be phased out by 2007 as a result of General Assembly action. No property tax dollars will be used for Corporate Fund expenditures in FY2005 for the first time.

[9] This amount includes a $53.4 million library levy and $1.1 million to support debt service and equipment purchases.



During the 5-year period between tax year 2001 and 2005, the percentage of the levy earmarked for debt service has risen from 34% to nearly 45%. This reflects increases in the City's long-term debt burden. During the same period, the amount reserved for pensions has increased slightly, from 42% to approximately 45%. The exhibit below compares the portion of the levy reserved for both of these long-term obligations versus all other programs. By FY2005, over 90% of levy proceeds will be used for long-term obligations. This is a substantial increase from 76.5% just five-years ago.

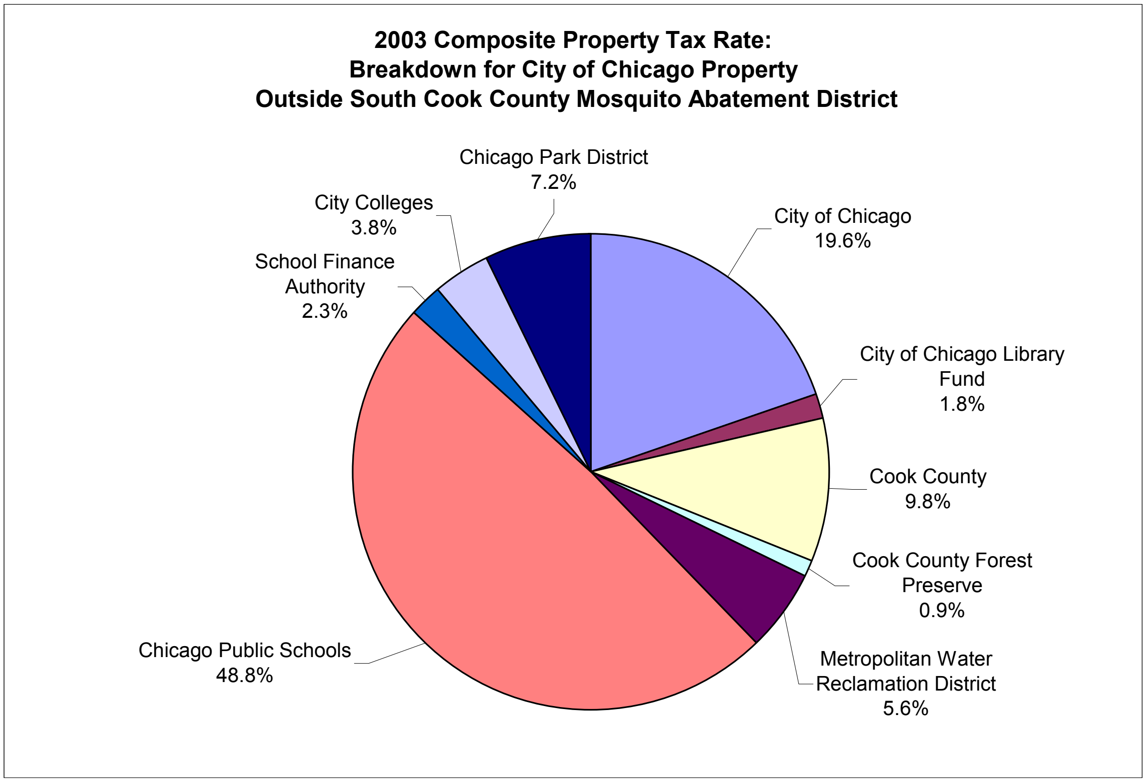


The City of Chicago's share of the average Chicago property tax bill has declined from 28.5% to 21.5% between 1988 and 2003 as a result of the City maintaining a conservative approach to property tax increases.

City of Chicago Tax Rate vs. Composite Rate: 1988-2003			
YEAR	**CITY TAX RATE**	**COMPOSITE TAX RATE**	**CITY AS % OF TOTAL**
1988	2.871	9.927	28.9%
1989	2.848	10.197	27.9%
1990	2.570	9.996	25.7%
1991	2.183	9.311	23.4%
1992	2.210	9.501	23.3%
1993	2.228	9.435	23.6%
1994	2.158	9.264	23.3%
1995	2.131	9.345	22.8%
1996	2.182	9.453	23.1%
1997	2.024	8.843	22.9%
1998	1.998	8.872	22.5%
1999	1.860	8.536	21.8%
2000	1.660	7.788	21.3%
2001	1.637	7.692	21.3%
2002	1.591	7.277	21.9%
2003	1.380	6.433	21.5%

Note: City Tax Rate is sum of City of Chicago and City of Chicago Library Fund.
Rate is for for property outside South Cook County Mosquito Abatement District.

The following exhibit illustrates the distribution of the composite property tax rate among levying agencies in the City of Chicago in tax year 2003, the last year for which information can be provided.[10] The Chicago Public Schools account for almost half of the average Chicago property tax bill, while the City of Chicago and Library Fund constitute roughly one-fifth of the total.



RESERVE FUNDS

Between FY1999 and FY2003, unreserved, undesignated Corporate Fund balances declined by 82%, from $108 million to only 19 million.[11] In those same years, the unreserved fund balance in the Corporate Fund as a percentage of Corporate Fund operating expenditures fell from 4.7% to 0.7%. In FY2005, the City anticipates designating a $51.7 million unreserved Corporate Fund balance. This is a $30.5 million increase from the $21.2 million originally budgeted in the reserve fund last year and represents 1.9% of all Corporate Fund appropriations. While the size of the Corporate Fund balance will increase substantially, it represents an amount that 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 or expenditures.[12] A Corporate Fund reserve of 5% of Corporate Fund expenditures would require approximately $139 million, over $98 million more than what the City has proposed.

[10] Property taxes are collected one year after the year they are levied. Property taxes levied in 2003 are paid in 2004.
[11] See City of Chicago *Comprehensive Annual Financial Reports*, FY1998-FY2002.
[12] Government Finance Officers Association Recommended Practice. "Appropriate Level of Unreserved Fund Balance in the General Fund" (Adopted 2002).

CITY OF CHICAGO UNRESERVED, UNDESIGNATED CORPORATE FUND BALANCE RATIO			
	Unreserved, Undesignated Corporate Fund Balance	Operating Expenditures	Ratio
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%
FY2003	$ 19,458,000	$ 2,661,102,000	0.7%

However, while unreserved, undesignated Corporate Fund balance remains below best practice standards, we must point out that the City has also designated $500 million from the sale of the Skyway as a reserve fund. Interest from that fund will be used this year and in future years for operating purposes. The earmarking of these new funds is a prudent move and we hope that the City will continue to maintain an adequate balance in that reserve fund in future years.

APPROPRIATIONS

The FY2005 budget proposes a net appropriation of nearly $5.1 billion. This is an increase of 5.6% or approximately $269.5 million from the previous fiscal year. Personal service appropriations are projected to rise by 4.0% even as the number of positions is being reduced due to increases in salaries and benefits.

CITY OF CHICAGO APPROPRIATIONS BY OBJECT: FY2004 & FY2005				
Object	**FY 2004**	**FY 2005**	**% CHG**	**$ CHG**
Personal Services	$ 2,711,604,025	$ 2,821,034,235	4.0%	$ 109,430,210
Contractual Services	$ 594,760,771	$ 649,315,515	9.2%	$ 54,554,744
Travel	$ 3,135,383	$ 3,059,216	-2.4%	$ (76,167)
Commodities	$ 95,673,380	$ 101,328,955	5.9%	$ 5,655,575
Equipment	$ 6,556,840	$ 9,417,748	43.6%	$ 2,860,908
Permanent Improvements	$ 3,000,000	$ 3,000,000	0.0%	$ -
Specific Items/Contingencies	$ 1,736,625,601	$ 1,829,766,331	5.4%	$ 93,140,730
Subtotal	**$ 5,151,356,000**	**$ 5,416,922,000**	**5.2%**	**$ 265,566,000**
Less Internal Transfers	$ 236,172,000	$ 262,500,000	11.1%	$ 26,328,000
Less Proceeds of Debt	$ 96,292,000	$ 66,013,000	-31.4%	$ (30,279,000)
Grand Total	**$ 4,818,892,000**	**$ 5,088,409,000**	**5.6%**	**$ 269,517,000**

Source: City of Chicago Budget Recommendations FY 2004 & FY 2005

Over the five-year period from FY2001 to FY2005, net appropriations have risen by 13.0%, or approximately $587 million. Personal Services appropriations have increased by roughly 12.0% over the five-year span from FY2001 to FY2005.

CITY OF CHICAGO APPROPRIATIONS BY OBJECT: FY2001 vs. FY2005				
Object	**FY 2001**	**FY 2005**	**% CHG**	**$ CHG**
Personal Services	$ 2,519,494,510	$ 2,821,034,235	12.0%	$ 301,539,725
Contractual Services	$ 609,867,212	$ 649,315,515	6.5%	$ 39,448,303
Travel	$ 3,556,513	$ 3,059,216	-14.0%	$ (497,297)
Commodities	$ 109,204,409	$ 101,328,955	-7.2%	$ (7,875,454)
Equipment	$ 15,709,157	$ 9,417,748	-40.0%	$ (6,291,409)
Permanent Improvements	$ 6,071,566	$ 3,000,000	-50.6%	$ (3,071,566)
Specific Items/Contingencies	$ 1,647,888,969	$ 1,829,766,331	11.0%	$ 181,877,362
Subtotal	**$ 4,911,792,336**	**$ 5,416,922,000**	**10.3%**	**$ 505,129,664**
Less Internal Transfers	$ 257,400,000	$ 262,500,000	2.0%	$ 5,100,000
Less Proceeds of Debt	$ 153,058,000	$ 66,013,000	-56.9%	$ (87,045,000)
Grand Total	**$ 4,501,334,336**	**$ 5,088,409,000**	**13.0%**	**$ 587,074,664**

Source: City of Chicago Budget Recommendations FY 2001 & FY 2005

Appropriations by Fund: FY2001 to FY2005

Net appropriations are projected to rise by approximately 13.9% in the 5-year period since FY2001. The largest increase, or 20.4%, is projected to be in spending for the City's Pension Funds. Corporate Fund expenditures are expected to rise by 10.7%, from approximately $2.5 billion to $2.7 billion. Expenditures for Special Revenue Funds are expected to increase the least, by 3.8%. Over the five-year period from FY2001 to FY2005 total debt proceeds exhibit a 56.8% decrease, and internal transfers exhibit a 1.9% increase over the five-year period.

CITY OF CHICAGO APPROPRIATIONS: FY01 & FY05 (In Millions of Dollars)			
	FY2001	**FY2005 Rec**	**% Change**
CORPORATE FUND	$ 2,519.4	$ 2,790.1	10.7%
SPECIAL REVENUE FUNDS	$ 391.1	$ 406.1	3.8%
PENSION FUNDS	$ 339.0	$ 408.2	20.4%
DEBT SERVICE FUNDS	$ 442.3	$ 477.6	8.0%
ENTERPRISE FUNDS	$ 1,186.3	$ 1,335.5	12.6%
TOTAL RESOURCES	**$ 4,878.1**	**$ 5,417.5**	**11.1%**
LESS PROCEEDS OF DEBT	$ 153.1	$ 66.1	-56.8%
LESS INTERNAL TRANSFER	$ 257.5	$ 262.5	1.9%
NET APPROPRIATION	**$ 4,467.5**	**$ 5,088.9**	**13.9%**

Source: City of Chicago Revenue Estimates: FY01 & FY05

Appropriations by Program Area: FY2001 to FY2005

Appropriations by major program area between FY2001 and FY2005 are presented in the next exhibit. The largest increases occurred in General Financing Requirements and in the area of Public Safety, with increases of 18.3% and 17.2% respectively. Over the five-year period, there has been a dramatic 53.0% decrease in appropriations in the area of Transportation, from $515,136,344 appropriated in FY2001 to the FY2005 recommendation of $242,159,313. Decreases are also projected in the Legislative and Elections category and in the area of City Development by 2% and 6.6% respectively.

CITY OF CHICAGO APPROPRIATIONS BY PROGRAM AREA: FY01 & FY05	2001 Approp.	2005 Rec	% CHG	$ CHG
FINANCE AND ADMINISTRATION	$ 405,822,664	$ 416,646,439	2.7%	$ 10,823,775
LEGISLATIVE AND ELECTIONS	$ 30,937,260	$ 30,321,374	-2.0%	$ (615,886)
CITY DEVELOPMENT	$ 264,932,760	$ 247,520,908	-6.6%	$ (17,411,852)
COMMUNITY SERVICES	$ 521,723,761	$ 570,361,633	9.3%	$ 48,637,872
PUBLIC SAFETY	$ 1,412,800,126	$ 1,655,165,150	17.2%	$ 242,365,024
REGULATORY	$ 99,036,955	$ 99,595,968	0.6%	$ 559,013
STREETS AND SANITATION	$ 347,414,046	$ 349,807,698	0.7%	$ 2,393,652
TRANSPORTATION	$ 515,136,344	$ 242,159,313	-53.0%	$ (272,977,031)
PUBLIC SERVICES ENTERPRISES	$ 567,238,127	$ 590,060,052	4.0%	$ 22,821,925
GENERAL FINANCING REQ.	$ 1,938,853,284	$ 2,294,593,749	18.3%	$ 355,740,465
SUBTOTAL	**$ 6,103,895,327**	**$ 6,496,232,284**	**6.4%**	**$ 392,336,957**
DEDUCT:				
PROCEEDS AND REIMBURS.	$ 410,458,000	$ 328,513,000	-20.0%	$ (81,945,000)
GRANT FUNDS	$ 1,190,250,991	$ 1,079,310,284	-9.3%	$ (110,940,707)
GRAND TOTAL	**$ 4,503,186,336**	**$ 5,088,409,000**	**13.0%**	**$ 585,222,664**

Source: City of Chicago FY02 and FY05 Program & Budget Summaries

PERSONNEL: APPROPRIATIONS AND BUDGETED POSITIONS

Corporate Fund personal service appropriations are projected to increase by 5.7% in FY2005 from FY2004. The increase amounts to roughly $129.9 million. Personal service appropriations will consume 82.4% of the entire Corporate Fund budget.

Allocation	Total (2004)	Total (2005)	$ Change (04 vs. 05)	% Change (04 vs. 05)
Personal Services	$ 2,174,137,784	$ 2,298,027,117	$ 129,889,333	5.7%
Non-Personal Services	$ 430,922,216	$ 491,410,883	$ 60,488,667	14.0%

Source: City of Chicago Budget Recommendations FY2001 & FY2005

Between FY2001 and FY2005, personal service appropriations in the Corporate Fund will rise by 14.8%, from approximately $2.0 billion to $2.3 billion. The percentage of Corporate Fund appropriations earmarked for personal services increased from 79.5% to 82.4% during the five-year period.

Allocation	FY 2001	FY 2005	Δ FY05 vs. FY01	% Change
Personal Services	$ 2,002,159,636	$ 2,298,027,117	$ 295,867,481	14.8%
Personal Services [as % of Corporate Fund]	79.5%	82.4%		

Source: City of Chicago Budget Recommendations FY2001 & FY2005

For FY2005, the City of Chicago recommends funding for 40,233 full time equivalent (FTE) positions. This represents a 3% reduction from the level of FTE positions budgeted in 2004, or an elimination of 1,246 FTE positions from the previous year. The greatest reduction in FTE positions occurred in the area of Public Service Enterprises, which saw a reduction of 564 FTE positions. The totals for full-time equivalents were obtained from the FY2005 Program & Budget Summary – these totals are larger than those reported in the Budget Overview because they include positions funded by grants.

In comparing the level of FTE positions recommended for FY2004 to those originally budgeted in FY2004, it appears that 124 positions were added. A comparison of FTE position recommendations for FY2005 to recommendations for FY2004 indicates an elimination of 1,122 positions from the previous fiscal year.

FULL-TIME EQUIVALENT POSITIONS BY AGENCY			
Agency	2004 Budgeted	2005 Recommended	CHG FY05 vs.FY04
FINANCE & ADMINISTRATION	3,380	3,151	(229)
LEGISLATIVE & ELECTIONS	379	369	(10)
CITY DEVELOPMENT	657	598	(59)
COMMUNITY SERVICES	4,010	3,949	(61)
PUBLIC SAFETY	22,487	22,471	(16)
REGULATORY	915	1,002	87
STREETS AND SANITATION	3,806	3,496	(310)
TRANSPORTATION	1,036	952	(84)
PUBLIC SERVICE ENTERPRISES	4,809	4,245	(564)
Total	**41,479**	**40,233**	**(1,246)**

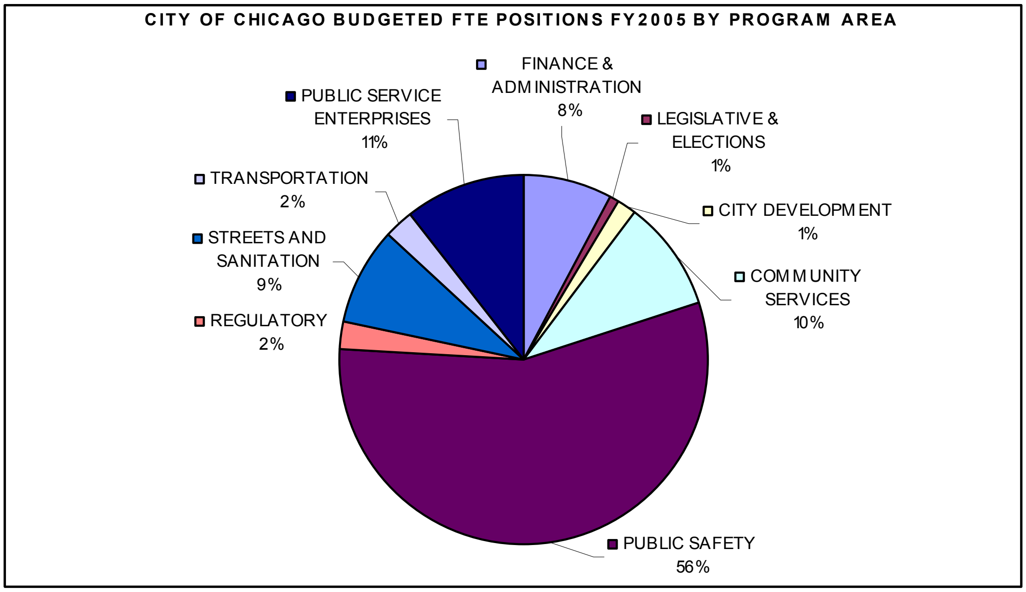
Source: City of Chicago FY05 Program & Budget Summary

From FY 2001 to FY2005, there has been a reduction of 9.3% in the level of total full-time equivalent positions. The five-year period has seen a reduction of 4,130 FTE positions from 44,363 FTE positions budgeted in FY2001 to 40,233 recommended for FY2005. There has been a trend of reduction in all nine agencies except for the Regulatory agency, which has seen an additional 10 FTE positions, or a 1% increase, over the five-year period. The greatest unit decreases occurred in the agencies of Public Safety and Public Service Enterprises, which experienced reductions of 1,042 FTE positions and 1,023 FTE positions respectively. The greatest percentage declines for the years between FY2001 and FY2005 were in the agencies of Transportation and City Development, with decreases of 30.8% and 27.3% respectively.

FULL-TIME EQUIVALENT POSITIONS BY AGENCY				
Agency	2001 Budgeted	2005 Recommended	CHG (FY05 vs. FY01)	% CHG (FY05 vs. FY01)
FINANCE & ADMINISTRATION	3,559	3,151	(408)	-11.5%
LEGISLATIVE & ELECTIONS	392	369	(23)	-5.9%
CITY DEVELOPMENT	823	598	(225)	-27.3%
COMMUNITY SERVICES	4,305	3,949	(356)	-8.3%
PUBLIC SAFETY	23,513	22,471	(1,042)	-4.4%
REGULATORY	992	1,002	10	1.0%
STREETS AND SANITATION	4,135	3,496	(639)	-15.5%
TRANSPORTATION	1,376	952	(424)	-30.8%
PUBLIC SERVICE ENTERPRISES	5,268	4,245	(1,023)	-19.4%
Total	**44,363**	**40,233**	**(4,130)**	**-9.3%**

Source: City of Chicago Program & Budget Summary - FY2002, FY2005

Approximately 56% of all budgeted FTE positions in the proposed FY2005 budget are in the area of Public Safety, followed by 11% in the area of Public Service Enterprises. 2% of the FTE positions are in the area of Transportation, which underwent a reorganization from being comprised of an Office of the Commissioner and 7 Bureaus to an Office of the Commissioner and 5 Divisions.



OPPORTUNITIES FOR ALTERNATIVE SERVICE DELIVERY

In the FY2005 Budget, the City of Chicago proposes privatizing janitorial services at O'Hare Terminals 1 and 3, and allowing City workers at Terminal 2 to compete against private contractors for the work in their terminal. The City also proposes privatizing the customer service functions of the Water Management Department, including meter readers. The Civic Federation supports these efforts to provide lower cost services and expects that the City will analyze the savings attributable to these efforts in order to better select additional candidates for managed competition or privatization.

Privatization of government assets and services refers to a variety of practices aimed at shifting public sector functions and responsibilities, in whole or in part, from the government to the private sector. It is also commonly referred to as alternative service delivery. Alternative service delivery practices can include managed competition, leasing agreements, service contracts, public/private partnerships and voucher systems.

The goal of privatization or alternative service delivery is to reduce costs and/or to improve service. The mechanism by which lower cost or higher quality services can be achieved is competition. Competition motivates the private sector to deliver quality efficiently because failure to do so can result in bankruptcy, but the public sector generally has a monopoly on the services it provides unless it chooses to open them to competition. Some governments, like the City of Indianapolis, have successfully introduced a system of managed competition into their service provision by accepting bids on service contracts and allowing the government employees to submit bids. In certain cases, public employees have successfully competed against private sector bids, so reaping the benefits of competition does not necessarily result in a transfer of management and operation functions to the private sector.

The City of Phoenix was one of the first U.S. municipalities to successfully implement managed competition. In 1978, Phoenix divided its solid waste collection service area into five districts and requested bids on each district. For the first several years, private companies won the contracts, but in 1984 the Public Works Department won back the largest district and by 1988 it had outbid the private sector on all five districts. The result was a 4.5% reduction in the city's solid waste collection costs.[13] Similarly, the City of Indianapolis bid out over 70 city services between 1992 and 1999, for a cumulative savings of approximately $120 million.[14]

Privatization can a useful tool for achieving the goals of lower cost or higher quality service, but it is not suitable for all services and can be counterproductive if improperly managed. However, it is not a panacea for the City's financial situation. We caution that privatization can be beneficial <u>only</u> if there is a marketplace of competitive, qualified vendors and if there is strong and sustained management oversight. But it is an important tool that can help reduce costs significantly and improve efficiency in many instances.

The cities of Indianapolis, Phoenix, Milwaukee, and Philadelphia have used alternative service delivery techniques to wring more efficiency out of a range of municipal services. The City of Chicago should follow their lead consider opening more city functions to competitive bidding. The City should particularly consider alternatives for solid waste collection and disposal, which have been outsourced in many municipalities. The Chicago Department of Streets and Sanitation's Bureau of Sanitation, which collects and disposes of the city's solid waste, is the largest city department after Police and Fire. The FY2005 Proposed Budget recommends a Bureau of Sanitation budget increase of 0.8% or $1.1 million, from $141.6 million to $142.7 million, and a reduction of 111 positions, from 1,656 to 1,545. The Bureau of Sanitation is entirely funded from the Corporate Fund, and represents 5.2% of that fund. The City should analyze the full cost of its solid waste collection and disposal services in order to determine how efficiently solid waste services are being delivered and whether managed competition could bring savings or service improvements.

Other potential candidates for privatization efforts include customer service centers in departments other than the Water Department, fleet management, 311 calls (non-emergency services), building management, payroll processing and accounting.

DEBT TRENDS

The Civic Federation employs several measures of debt for purposes of this analysis: short-term debt trends, long-term net direct debt and net direct per capita trends, debt service appropriation trends and bond ratings. Our review of key debt indicators shows that the City's short-term debt burden appears to have declined, which is a positive sign. However, Chicago's long-term debt burden is now at such a high level that unless revenues and the size of the unreserved fund balance are increased, the City will be hard pressed to embark on any new infrastructure development or rehabilitation programs and may even face a downgrading of its bond rating.

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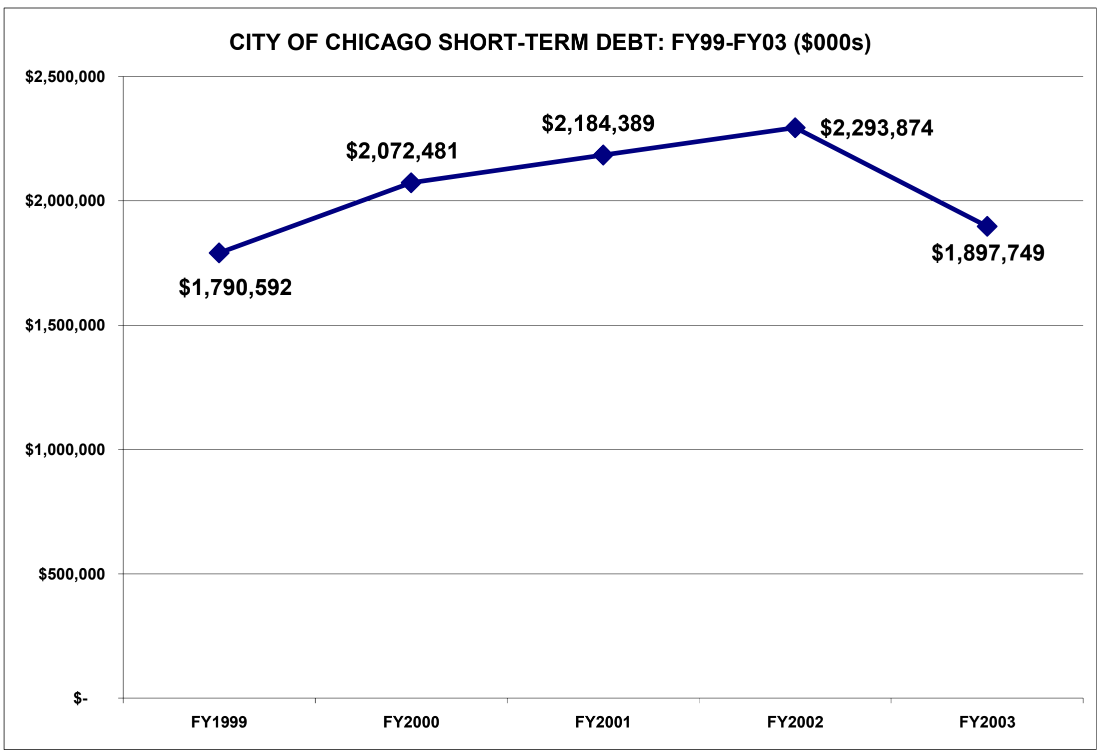
[13] David Osborne and Peter Hutchinson, *The Price of Government* (New York: Basic Books, 2004), 153.
[14] Ibid., 328.

Short-Term Debt Trends

Short-term debt is a financial obligation that must be satisfied within one year. An increasing trend in short-term debt may be a warning sign of future financial difficulties. It is a measure of budgetary solvency, that is, a government's ability to generate enough revenue over the course of a normal budgetary period to meet its expenditures and prevent deficits. City of Chicago short-term debt includes all current liabilities except accrued salaries and wages, accrued payroll, compensated absences, accrued interest and accrued and other liabilities. For purposes of consistency over time, short-term debt is calculated for Governmental Activities, or activities in the four Governmental Funds.

In FY2003, City short-term debt for Governmental Activities declined by 17%, falling from $2.2 billion to $1.8 billion. This was the first decline since FY1997. Since FY1999, short-term has increased by 6.0%., from $1.7 billion to $1.8 billion. The overall moderate rate of growth as well as the decrease in growth between FY2002 and FY2003 are positive signs.



Long-Term Direct Debt Trends

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. Increases bear watching as a potential sign of increasing financial risk.

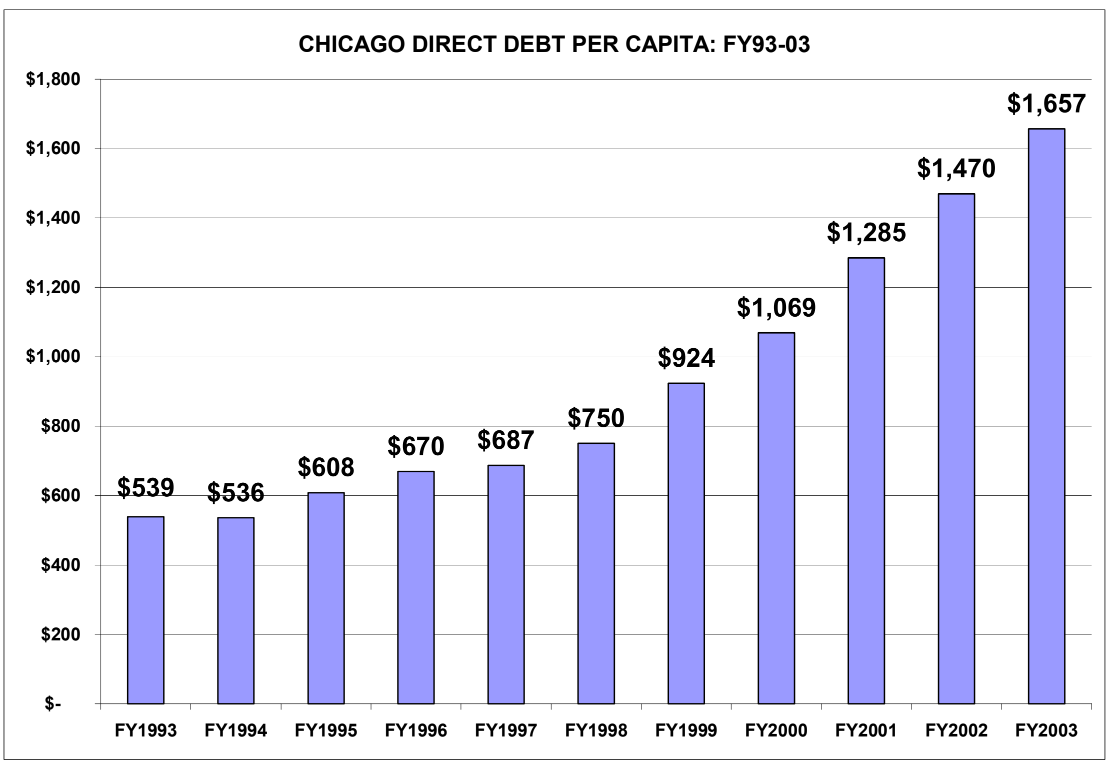
The exhibit below presents 10-year trend information for the total amount of City of Chicago net direct debt. During that time period, total net direct debt rose by 222% or $3.3 billion. This represents an increase from nearly $1.5 billion to almost $4.8 billion. Between FY2002 and FY2003, net direct debt increased by $541 million or 13%.

CITY OF CHICAGO DIRECT DEBT: FY1993-FY2003	
FY1994	$ 1,491,998,000
FY1995	$ 1,693,560,000
FY1996	$ 1,863,870,000
FY1997	$ 1,913,120,000
FY1998	$ 2,088,913,000
FY1999	$ 2,571,412,000
FY2000	$ 3,094,839,000
FY2001	$ 3,722,403,000
FY2002	$ 4,257,256,000
FY2003	$ 4,798,541,000

Source: FY2003 Chicago Comprehensive Annual Financial Report, pp. 128-129.

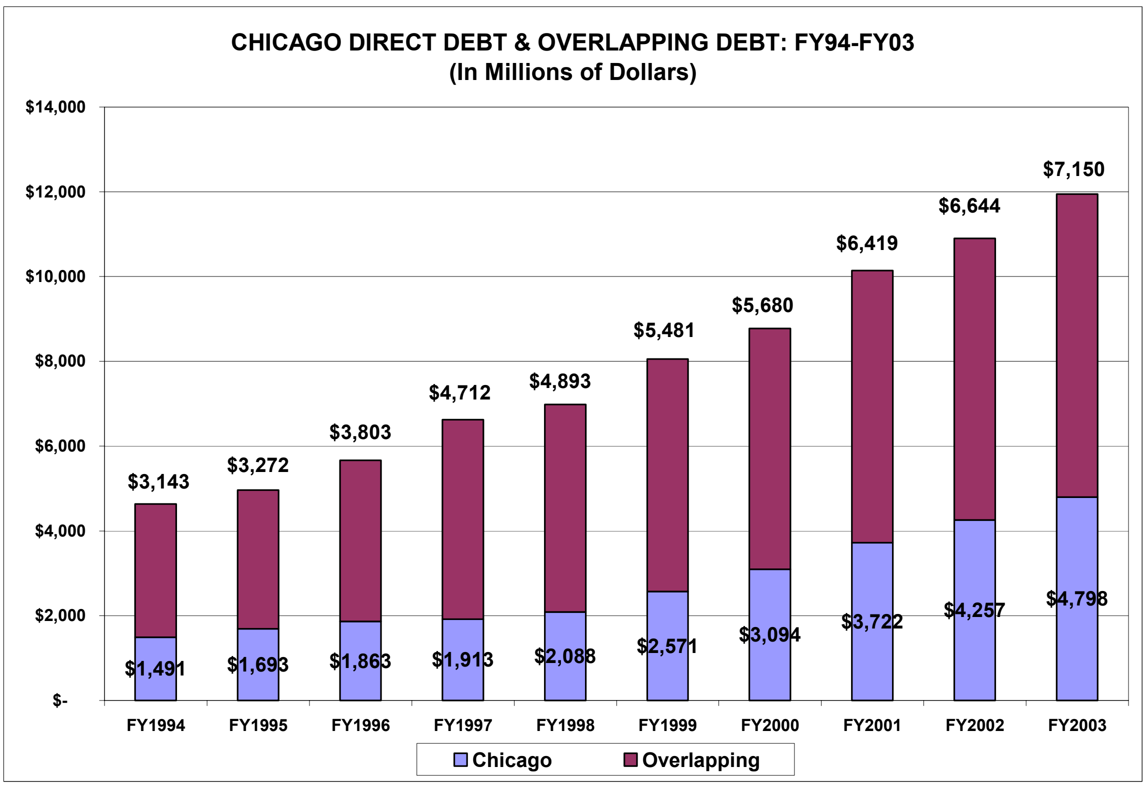
Long-Term Net Direct Debt Per Capita

A common ratio used by rating agencies and other public finance analysts to evaluate long-term debt trends is debt per capita. This ratio reflects the premise that the entire population of a jurisdiction benefits from infrastructure improvements. Between FY1994 and FY2003, net direct debt per capita rose by 209%, from $539 to $1,657. Over the 5-year period between FY1999 and FY2003, net direct debt per capita increased by 79%.



Overlapping Debt: Chicago vs. Other Governments

The next exhibit compares total City of Chicago net direct debt with overlapping net debt reported by seven other major Cook County governments with boundaries coterminous with the City of Chicago or located partially within its boundaries. These governments are: the Chicago Public Schools, Cook County, the Forest Preserve District of Cook County, the Metropolitan Water Reclamation District, the Chicago Park District, the City Colleges of Chicago and the School Finance Authority. Rating agencies and other financial analysts commonly monitor overlapping debt trends as an affordability indicator when governments consider debt issuance. Between FY1994 and FY2003, overlapping debt increased by 127% at the same time City of Chicago debt rose by 222%. Total debt from all eight major governments rose by 158%. Thus, the rate of increase in City of Chicago net direct debt far outstripped increases for the other governments in the region



Debt Service Appropriations

Debt service appropriations in FY2005 are projected to be 18% of total appropriations, or $895 million of $5 billion. This figure is relatively high, as the rating agencies consider a debt burden high if this ratio is between 15% and 20%. The debt service to total appropriation ratio has remained consistently at 18% since FY2001.

CITY OF CHICAGO DEBT SERVICE APPROPRIATIONS			
	Debt Service	Total Appropriation	Ratio
FY2001	$ 793,819,363	$ 4,501,334,336	18%
FY2002	$ 839,712,849	$ 4,602,025,000	18%
FY2003	$ 862,120,771	$ 4,718,653,481	18%
FY2004	$ 855,996,149	$ 4,818,892,000	18%
FY2005	$ 895,752,246	$ 5,088,409,000	18%

Bond Ratings and Rating Agency Outlook: Negative Outlook from Moody's

The City retains a high bond rating due to its broad-based economy. Moody's assigned the City an above average A1 rating for its general obligation bonds in November 2003. Fitch assigned the City's general obligation bonds an AA- rating in November 2003. However, there are problems on the horizon. In August 2004, Moody's changed its outlook on Chicago bonds from "neutral" to "negative." This means that there is a 50% likelihood that the rating will be reduced in the next 12 to 18 months. Moody's cited the City's low fund balance, use of debt for operations and the projected FY2005 deficit as reasons for the change.[15] A downgrade in bond rating would require the City to pay higher interest rates on future debt offerings. The rating agencies are anticipated to review the City's general obligation ratings in light of the Skyway transaction.

City of Chicago General Obligation Ratings					
Moody's		S&P		Fitch	
Rating	Outlook	Rating	Outlook	Rating	Outlook
A1	Negative	A+	Stable	AA-	Negative

The Skyway Transaction

On October 27, 2004, the Chicago City Council approved an ordinance authorizing a 99-year lease agreement with the Cintra-Macquarie Consortium for the operation of the Chicago Skyway. Under the agreement, the Consortium pays an upfront amount of approximately $1.83 billion to the City in return for the rights to operate the Skyway. This payment represents the present value of the anticipated cash flow from the Skyway operations as well as the value of the tax advantages of the transaction to the Cintra-Macquarie Consortium

> ***1) Present Value of Future Cash Flow.*** The payment to the City reflects the present value of anticipated cash flow from Skyway operations from toll and concession revenue net of operational and maintenance costs [16] which the City will forego. While presumably the Cintra-Macquarie Consortium expects to generate larger profits, the table below the Skyway's net income during the last three years:

[15] Greg Hinz. "City Debt Levels Worry Moody's," *Crain's Chicago Business*, August 16, 2004 and Mickey Ciokajlo. "Moody's is Skeptical on City Bond Outlook," *Chicago Tribune*, August 17, 2004.
[16] Present value represents the amount of money in today's dollars that a buyer would pay today for series of cash flows expected in the future.

	2000	2001	2002
Revenues	$39,214	$44,064	$43,232
Expenses	$7,896	$9,106	$10,050
Net Income	$31,318	$34,958	$33,182

2) Tax-Advantages of the Transaction. The agreement allows the consortium to access the tax benefits of depreciation, thereby increasing the value of the deal.[17]

Use of the Skyway Proceeds

The first use of the proceeds of the Skyway transaction is to retire the approximately $438 million in outstanding Skyway bonds. [18]

Redemption of Skyway Bonds Outstanding	
1996 Bonds	$179,765,000
2000 Bonds	$139,430,000
2001Bonds	$118,715,000
Total Par Value Outstanding	$437,910,000

However, it is important to note that it will cost the City more than $437.9 million to retire this debt. This is because not only will there be transaction costs, there will also be additional costs associated with retiring debt in advance of its maturity and optional redemption dates. [19]

While total amount of transaction and debt retirement costs are not yet available, the administration has disclosed its intent in the 2005 budget to apply the proceeds to pay the Skyway debt, retiring additional unspecified long-term debt, and establish reserves that will provide earnings to budgets going forward. To facilitate these expenditures, the City plans to establish three funds as follows:[20]

[17] The Bond Buyer. “Kudos for Skyway Plan.” Yvette Shields, 10/18/04
[18] City of Chicago CAFR, Table 14 A – Long-term Debt December 31, 2003.
[19] There are a variety of reasons why it will cost the City more to retire the Skyway bonds than the amount of bonds outstanding including: 1) Skyway Bonds are Call Protected. Chicago cannot simply prepay the debt at will as one might prepay a mortgage. Bond documents typically provide the investors “call protection.” This is a specific amount of time, generally 10 years, during which the Issuer is prevented from paying off (“redeeming” or “calling”) the bonds. 2) Bonds may be Defeased. Although Chicago may not simply call the bonds today, they may “defease” the bonds.” Basically, this means setting up a sort of escrow that will pay both the principal and the interest on the bonds until such time as they may be redeemed. The amount of money needed to cover principal and interest will depend upon the time, interest rate on the bonds, and the interest rate on the investments. When bonds have been defeased, they are no longer considered legally outstanding debt of the issuer. Defeased bonds are removed from the Statement of Net Assets. At the close of fiscal 2003, the City of Chicago had a total of $1.2 billion in defeased debt. 3) Call Price includes a Premium. After a period of time, generally ten years from the date of issuance, the bonds are said to have reached the “optional call date.” At this point in time, the issuer may redeem the bonds, generally at a premium of 102%.

[20] City of Chicago Budget Overview and Revenue Estimates, page 4.

Summary of Disclosed Uses of Skyway Proceeds	
Skyway Investment Fund	$500,000,000
Skyway Annuity Fund	$325,000,000
Skyway Neighborhood and Human Infrastructure Fund	$100,000,000

The Skyway Investment fund is a reserve for the City that will generate investment income for each budget year going forward. The Skyway Annuity Fund will provide a specified series of payments over the next several years. The Skyway Neighborhood and Human Infrastructure Fund will be used to dedicate $100 million to a variety of programs over the next five-years.

These funds are projected to generate a total of $101.4 million proceeds of in 2005, or 3.7% of the total $2.7 billion projected Corporate Fund revenues. [21]

The next exhibit shows the use of the entire $1.83 billion in Skyway proceeds.

USE OF SKYWAY PROCEEDS	
Establish Reserve Fund	$ 500,000,000
Retire Skyway Debt	$ 463,000,000
Establish 8-Year Annuity (2004-2011)	$ 375,000,000
Eliminate Short-Term Debt Obligation	$ 258,000,000
Pay Down Long-Term Debt	$ 134,000,000
Create Neighborhood/Human Investment Fund	$ 100,000,000
TOTAL	**$ 1,830,000,000**

Source: Chicago Office of Budget & Management

A total of $106 million in proceeds from the sale of the Chicago Skyway will be used for operating purposes in FY2005.

- $50 million of the total amount will be derived from a $325 million, 5-year annuity the City has established, and
- $25 million will be dedicated from interest earnings on a $500 million reserve fund that has been established.
- $31 million of the $100 million of proceeds in the fund dedicated to neighborhood and human infrastructure programs. [22]

The expenditures relating to the Neighborhood and Human Infrastructure program will begin in FY2005 and extend over several years. A breakdown of those expenditures in FY2005 is provided below.

Identified Uses as for Neighborhood and Human Infrastructure	
Condo Rebate	$15,000,000
Library Automation	$5,000,000
Phase III Plan to End Homelessness	$10,000,000
Build Additional Senior Satellite Centers	$9,300,000
Total Expenditures included in the 2005 Budget	$31,800,000

[21] City of Chicago Budget Overview and Revenue Estimates, page 49.

[22] Of this $31 million, $26.4 million is included in Proceeds and Transfers to the Corporate Fund. See *Summary of Projected Corporate Fund Revenues from Skyway Proceeds* in “Use of Skyway Proceeds” section.

PENSION TRENDS

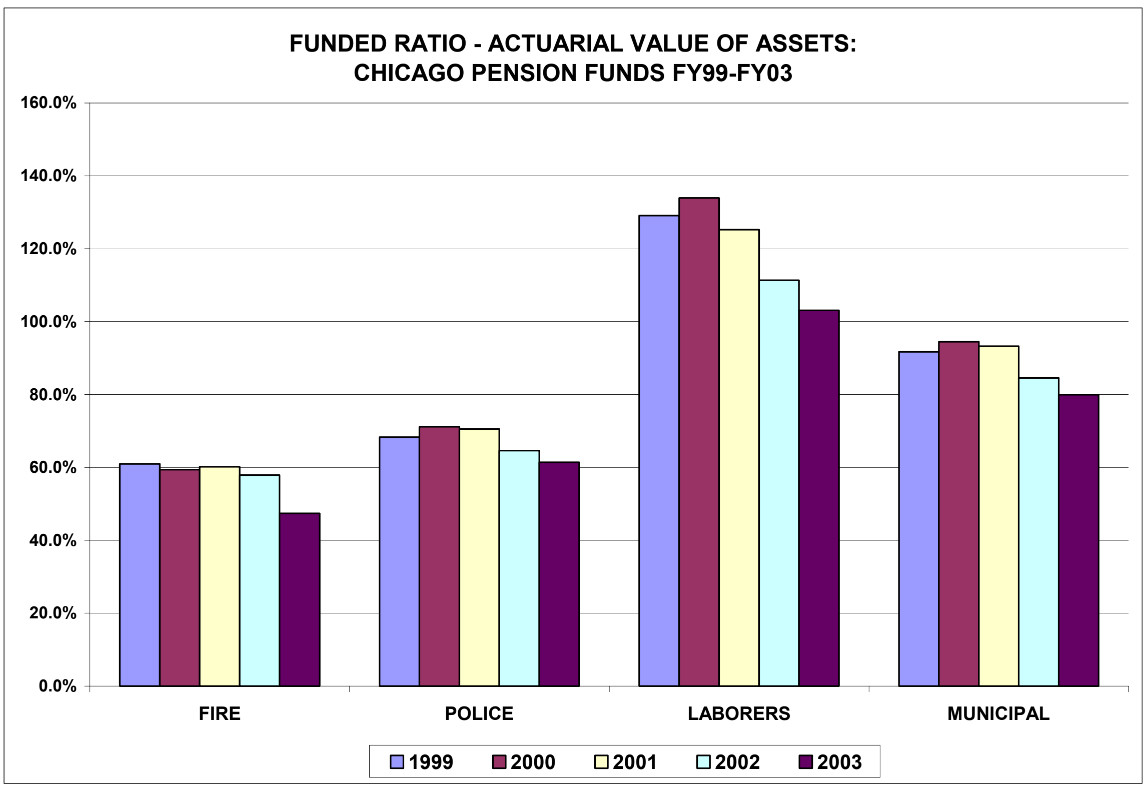
The City of Chicago maintains four employee pension funds: the Fire, Police, Municipal and Laborer's Funds. The Civic Federation used three measures to present a multi-year evaluation of the funds' fiscal health: funded ratios, the value of unfunded liabilities, and the investment rate of return.

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.

For the second year, the funded ratios of all four City pension funds dropped in FY2003. The Fire Fund experienced the sharpest decline, with its funded ratio dropping 18% to a 47.4% funded ratio, its lowest ratio in five-years. The Police Fund's funded ratio dropped from 64.6% to 61.4%. The continued declines in the funded ratios of the Fire and Police Pension Funds are a cause for concern and bears watching.

Both the Municipal and Laborers Funds also reported declines for another year. However, these funds continue to remain healthy, with the Laborers Fund reporting a funded ratio of 103.1% and the Municipal Fund at 79.9%.

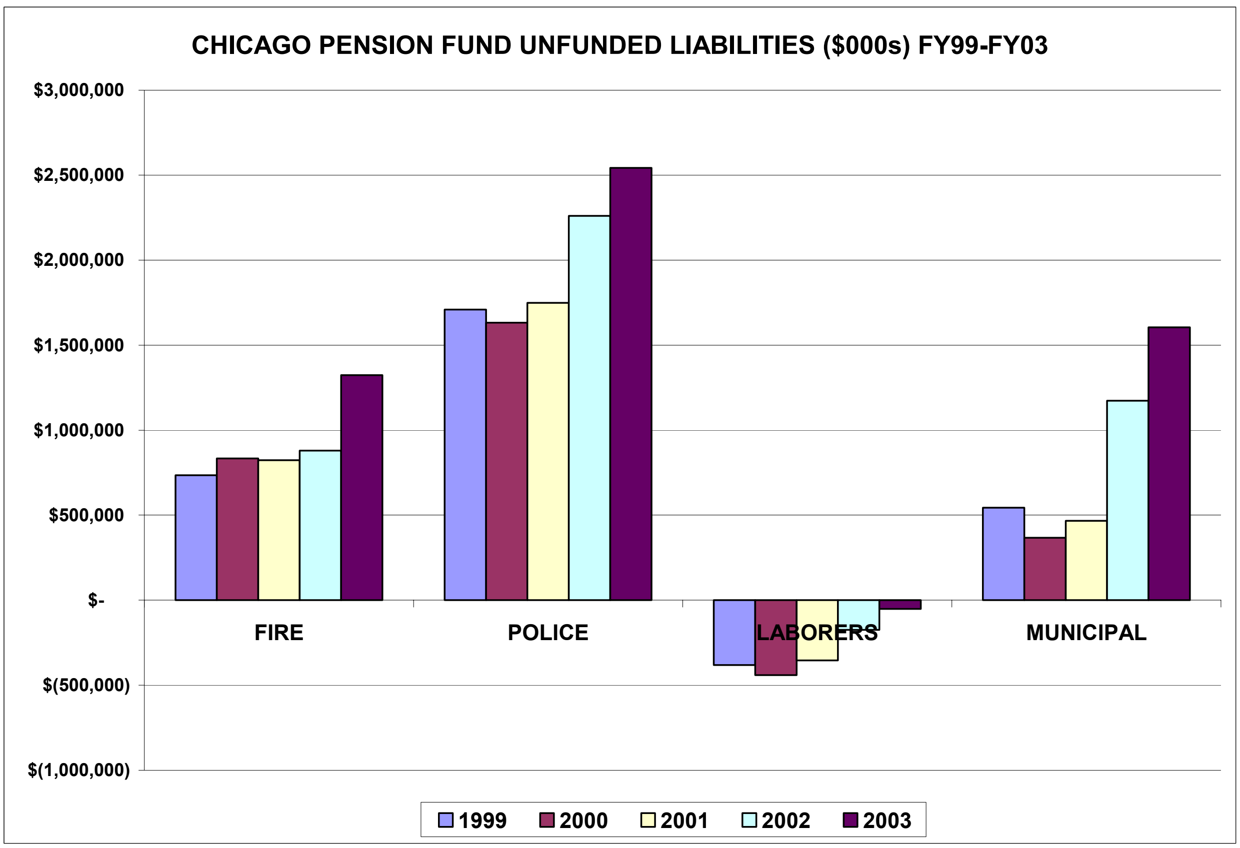


Unfunded Liabilities

Unfunded liabilities are the dollar value of liabilities not covered by assets. Between FY1999 and FY2003, unfunded liabilities for the City's pension funds increased by 108% or $2.8 billion, from $2.6 billion to $5.4 billion. These increases reflect the drops in the funded ratios of the Police, Fire and Municipal Pension Funds between FY2002 and FY2003. A summary of the 5-year changes in unfunded liabilities is shown below:

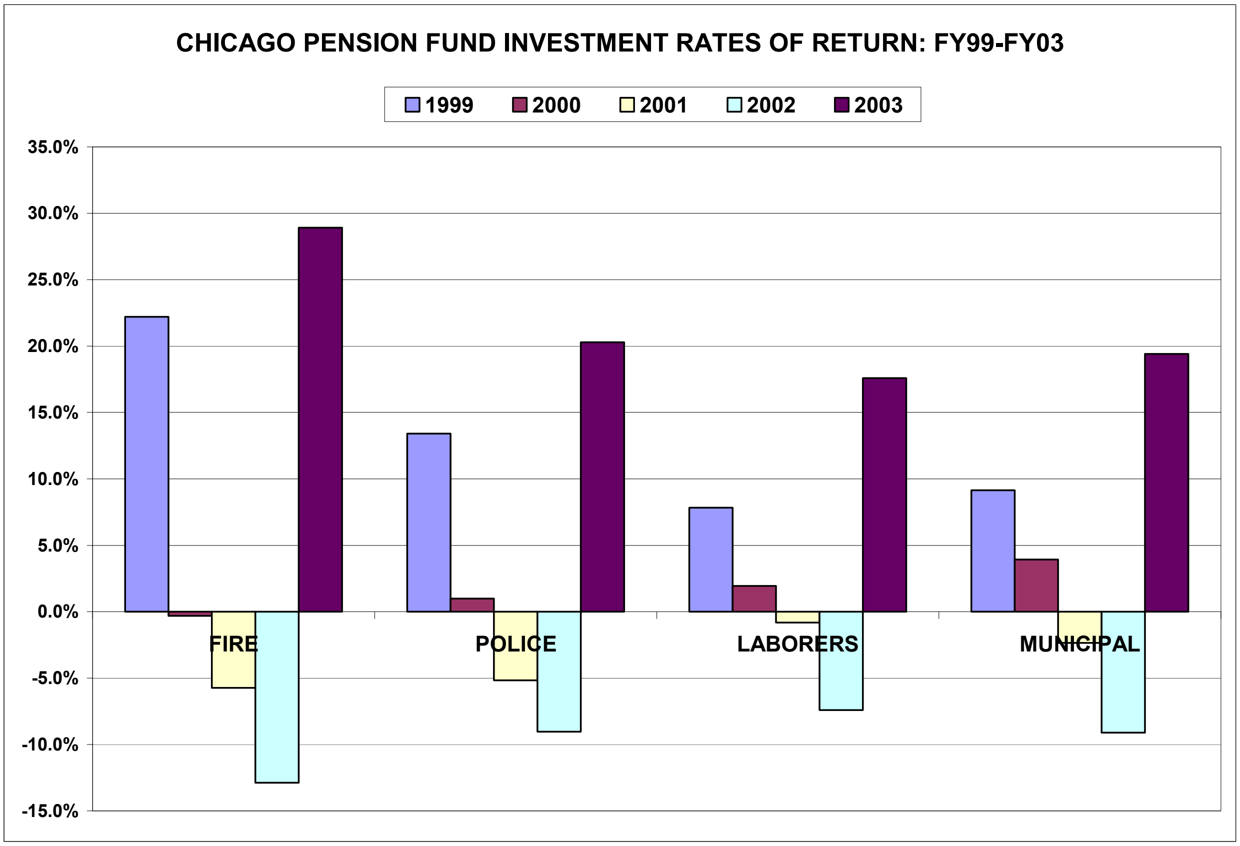
- Fire Pension Fund: 80% increase, from $734 million to $1.3 billion;
- Police Pension Fund : 49% increase, from $1.7 billion to $2.5 billion; and
- Municipal Pension Fund: 195% increase, from $544 million to $1.6 billion.

The Laborers Pension, which is traditionally funded at levels exceeding 100%, reported an 87% decrease in the amount that assets exceeded liabilities, from $370 million to $51 million.



Investment Rates of Return

In FY2003, all four City pension funds reported positive, double digit rates of return for investments. This is a sharp turnaround from the previous two fiscal years, when all four funds reported negative results far below the 8% actuarial assumption used in 2002 and 2003. The average market rate of return for all City of Chicago pension funds rose to 21.6% in FY2002, a substantial increase from the -9.6% return in FY2002. The Fire Fund reported the highest return of 28.9%, followed by 20.3% for the Police Fund.



It should be noted the volatility in the rates of return reflects fluctuations in the market value of the investments within the fund. Under GAAP, the fair value of an investment is the amount at which the asset could be bought or sold. The value of an investment may increase or decline depending upon market conditions. Just as the pension fund investments experienced losses during difficult markets in 2000 through 2002, the investments benefited from the improvements in the investment and economic environments in 2003. The table below illustrates the impact of changes in market value upon the balance of pension plan assets.

Combining Statement of Changes in Plan Net Assets: Selected Data [23]		
(000s)	2002	2003
Beginning of the Year Balance	$12,193,356	$10,468,138
End of the Year Balance	$10,648,138	$12,277,996
Net Appreciation (Depreciation) in Fair Value of Investments	($1,403,399)	$1,855,703
as a % of beginning year balance	(12%)	17%
Interest, Dividends and Other	$297,643	$248,390
as a % of beginning year balance	2%	2%

[23] Excerpted information from City of ChicagoCAFR, Exhibit 11: City of Chicago Illinois Fiduciary Funds – Pension Trust Funds Combining Statement of Changes in Plan Assets.

CIVIC FEDERATION RECOMMENDATIONS

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

Use Skyway Transaction to Improve Long-term Financial Stability

Clearly, such a lucrative transaction as the Skyway presents tremendous opportunities for the City of Chicago to improve its financial standing well beyond establishing adequate reserves. The Civic Federation understands that the proceeds from the transaction must first be applied to retire the outstanding skyway debt and pay for the defeasance, redemption premiums, transaction fees and other costs associated with retiring that debt.

The Civic Federation strongly recommends that available proceeds, and interest on proceeds, from the Skyway transaction be used to pay down long-term obligations that are a burden on the property tax such as long-term debt and pension obligations.

Expand Privatization Efforts to Obtain Cost Savings and Service Improvements

The Civic Federation supports the City's use of privatization and managed competition of janitorial services at O'Hare airport and customer service in the Water Department. We expect that the City will analyze the savings attributable to these efforts in order to better select additional candidates for managed competition or privatization. We urge the City to consider opening more city functions to competitive bidding. Customer service functions at a variety of departments in addition to the Water Department could be candidates for privatization or managed competition, as could accounting and data processing activities. The City should especially consider alternatives for solid waste collection and disposal, which have been outsourced in many other municipalities.

Privatization is not a panacea for the City's financial problems. We caution that privatization can be beneficial only if there is a marketplace of competitive, qualified vendors and strong, sustained management oversight. But it is an important tool that can be used to reduce costs and improve efficiency.

Provide Additional Information in Budget Documents

The *Budget Overview and Revenue Estimates* summary document is a marked improvement from previous budget books. However, the Civic Federation believes that it could be strengthened further by including:

- A "walk-up" that describes the sources of the current fiscal year budget deficit or surplus;
- A "walk-down" that clearly identifies the steps taken to eliminate the budget deficit if there is one;
- A breakdown of personal services expenditure including the amounts budgeted or spent on wages and salaries, health insurance, worker's compensation, etc.
- 5-year trends of appropriations, budgeted positions and grant revenues in forthcoming Budget Overview documents.

Consider Seeking Authorization to Expand Sales Tax to Food and Drugs

The City of Chicago and other home rule municipalities should consider seeking legislative authorization to levy additional sales taxes on food and drugs. The current exemption is far too broad, benefiting many more than the lower income households it was intended to benefit. Removing food and drugs from the sales tax base has also forced rates on general merchandise to levels that will soon rank among the highest in the nation. It would be a far better fiscal policy to target relief for food and drug purchases to those who need it through refunds or credits than to provide the benefit to everyone.

Counties and municipalities in Illinois, including the City of Chicago, currently receive the proceeds of a 1% sales tax on food, prescription drugs and medical appliances. The tax is collected by the State of Illinois and distributed to the various counties and municipalities; the State does not keep any of this revenue. Illinois statute currently prohibits home rule governments from imposing an additional sales tax on food and drugs.[24]

The exemption of food and drugs is intended to provide relief to lower income people by limiting sales taxes on purchases of essential items. However, this relief is not targeted. All citizens, rich or poor, benefit from the exemption. In addition, the exemption significantly narrows the base available for taxing sales by limiting it to general merchandise. The result is a very high sales tax rate on non-food items, which paradoxically has a disproportionate impact on lower income individuals.

The Civic Federation believes there are better ways to target relief to the poor than by exempting food and drugs from sales taxes. Federal law already exempts food purchased with food stamps from sales taxes, which covers a significant portion of the typical lower income household's grocery bills. Additional targeted relief can be offered by making lower income taxpayers eligible for refunds of sales tax payments and/or by authorizing state income tax credits for food purchases. Structuring targeted relief helps those who need assistance, rather than providing everyone with a broad benefit.

Implement a Long-Term Financial Planning Process

Although the Civic Federation recognizes that the potential windfall from the Skyway transaction comes at an opportune time in light of budget deficits and potential lay-offs, we believe that the City should not only implement measures for long-term financial stability, but also to use this opportunity to improve the fiscal policy and 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.[25] 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

[24] ILCS 65, Section 5/8-11.1. Home Rule Municipal Retailer's Occupation Tax Act.
[25] See National Advisory Council on State and Local Budgeting and Government Finance Officers Association

reviewed by key policymakers and stakeholders. The Civic Federation recommends that the City of Chicago develop and implement a formal long-term financial plan.

Continue to Improve Performance Measurement System

A sound financial planning process involves tracking and improving productivity among the City's departments. The performance data contained in the *FY2005 Program and Budget Summary* is dramatically improved from previous years by moving away from simple presentation of workload statistics. In this budget, service delivery targets are shown for certain programs in each department. Then, four years of data regarding the degree to which the targets have been met is presented. This permits City managers and citizens alike to assess success in meeting department service delivery goals. We applaud the Office of Management and Budget for moving in this direction. It is an important first step.

Given the City's continued focus on improving management efficiency, the Civic Federation urges the City to continue enhancing the quality and effectiveness of the performance data collected, presented and utilized. Optimally, this would include the inclusion of efficiency, effectiveness and service quality measures.

Return to Presenting Changes in Pension Fund Plan Assets on a Disaggregated Basis

Prior to FY2003, the City of Chicago presented the statement of changes in plan assets for each of the City's four pension trust funds: Municipal Employees, Laborers', Policemen's, Firemen's. However, in the FY2003 CAFR, this information was combined in a statement that aggregates the net changes in the pension funds assets in a single presentation. While the Civic Federation appreciates that separated financial information is available from each respective funds' office, we believe the performance of each of the pension funds investment is critical enough to the overall fiscal health of the City as to merit a separate presentation within the City's CAFR.

APPENDIX I

Revenue Enhancements for FY2005 City of Chicago Budget

REVENUE ENHANCEMENTS - FY2005 CITY OF CHICAGO BUDGET		
FEE & FINE INCREASES		**Revenue**
Development Fee	$	2,300,000
New Construction Permit	$	2,100,000
Bid & Certification Fee	$	1,000,000
Handicapped Parking Violation	$	1,000,000
Vehicle Impoundment Program	$	1,000,000
False Burglar Alarms	$	1,000,000
Building Re-inspection Fee	$	750,000
Tow Fee - Disabled Boat	$	425,000
Sidewalk Café Fee	$	265,000
4 A.M. Liquor License Fee	$	200,000
Certificate of Operations	$	150,000
Festival Fee	$	150,000
Environmental Inspection Fee	$	75,000
Lobbyist Registration Fee	$	65,000
Fee - Missing Permit Review Appointment	$	40,000
Inspection Fee	$	180,000
Fine - Inappropriate Use of Public Way		(increase from $500 to $2500)
Total	**$**	**10,700,000**
TAX INCREASES		**Revenue**
Sin (Alcohol & Cigarette) Tax	$	21,600,000
Sales Tax	$	20,000,000
Natural Gas Use Tax	$	15,000,000
Parking Tax	$	10,000,000
Amusement Tax	$	5,000,000
Hotel Tax	$	3,000,000
Car Rental Tax	$	2,000,000
Total	**$**	**76,600,000**
GRAND TOTAL	**$**	**87,300,000**

Source: City of Chicago - Office of Budget & Management

APPENDIX II
Comparison of Hotel/Motel Tax Rates and Cigarette Tax Rates by Municipality

	Hotel/Motel Tax	Cigarette Tax
Chicago (IL)	5.64% (state) 0.99% (Chicago Municipal) 3.5% (City) 1.96% (ISFA) 2.50% (MPEA) **Total = 14.59%**	20 pack cigarette $0.98 (state) $0.48 (city) $1.00 (county) $0.39 (federal) **Total = $2.85**
Cook County *Suburbs* (IL)	5.64% (state) ? (city) **Total > 6%**	20 pack cigarette $0.98 (state) $1.00 (county) $0.39 (federal) **Total = $2.37**
DuPage County (IL)	City Rates Range: **Total 7%-14%** (composite)	20 pack cigarette $0.98 (state) $0.39 (federal) **Total = $1.37**
Schaumburg (DuPage) (IL)	5.64% (state) 8% (city) **Total = 14%**	20 pack cigarette $0.98 (state) $0.39 (federal) **Total = $1.37**
Naperville (DuPage) (IL)	5.64% (state) 4.40% (city) **Total = 10.04%**	20 pack cigarette $0.98 (state) $0.39 (federal) **Total = $1.37**
Oakbrook (DuPage) (IL)	5.64% (state) 1% (city) **Total = 7%**	20 pack cigarette $0.98 (state) $0.39 (federal) **Total = $1.37**
Midwest Regional Cities		
Milwaukee (WI)	5% (state) 0.5% (county) 0.10% (Stadium) 2% (local exposition – county) 7% (local exposition – city) **Total = 14.6%**	20 pack cigarette $0.77 (state) $0.39 (federal) **Total = $1.16**
Kenosha (WI)	5% (state) 0.5% (county) **Total = 5.5%**	20 pack cigarette $0.77 (state) $0.39 (federal) **Total = $1.16**
Lake County (IN) --Hammond --Gary	5% (state) 1% (county) **Total = 6%**	20 pack cigarette $0.555 (state) 25 pack cigarette $0.69375 (state) [Other tobacco products 18% wholesale price] $0.39 (federal) **Total = $0.945**
LaPorte County (IN) --Michigan City --LaPorte	5% (state) **Total = 5%**	20 pack cigarette $0.555 (state) 25 pack cigarette $0.69375 (state) [Other tobacco products 18% wholesale price] $0.39 (federal) **Total = $0.945**
Oakbrook (DuPage) (IL)	5.64% (state) 1% (city) **Total = 7%**	20 pack cigarette $0.98 (state) $0.39 (federal) **Total = $1.37**