DATE: March 17, 2025

TO: Sean Harden, President
Chicago Board of Education

FROM: Brock Bowsher, Principal, Baker Tilly Advisory Group

SUBJECT: Obligations Funding Options Summary

The Chicago Board of Education (hereafter 'Board' or the 'District') engaged Baker Tilly Advisory Group (Baker Tilly) to provide independent observations of possible options to the Board's obligations for the following: (1) collective bargaining agreement with the Chicago Teachers Union (CTU), (2) collective bargaining agreement with the Chicago Principals and Administrators Association and (3) an intergovernmental agreement (IGA) with the City of Chicago (the "City") for the reimbursement of a portion of the on-behalf-of cost for expenses related to the Municipal Employees Annuity and Benefit Fund (MEABF) (collectively "the obligations").

Baker Tilly was engaged by the Board in February 2025 and asked to provide options as quickly as possible. The work described herein is taken from the perspective of this limited time and scope. Baker Tilly relied on data, information and corresponding context provided by the Board in determining possible options. Given the limited scope and timing, Baker Tilly makes no representation and did not independently verify all data provided and relied upon the Board and corresponding conversations to provide accurate data, information and context in good faith.

Baker Tilly was asked to identify possible options for funding the Board's obligations, not to provide any assurance on the validity of amount of the obligations, payments or terms. In addition, while Baker Tilly provides the Board an option of restructuring debt for consideration, Baker Tilly was not hired to serve as the Board's advisor on any debt restructuring (referred to specifically as a municipal advisor or MA). While Baker Tilly does serve in this capacity for other school districts and local governments, municipal advisory is a specific service, which was not part of this project scope, and is regulated by the US Securities and Exchange Commission (SEC) through the Municipal Securities Rulemaking Board (MSRB).

Meetings

Baker Tilly had multiple conversations with the following (at Board request/with the Board's permission) as part of this engagement.

- Sean Harden, President, Chicago Board of Education
- Ruchi Verma, General Counsel, Chicago Public Schools
- Miroslava Krug, Chief Financial Officer, Chicago Public Schools
- Walter Stock, Deputy Chief Financial Officer, Chicago Public Schools
- Mike Sitkowski, Chief Budget Officer, Chicago Public Schools
- Jill Jaworski, Chief Financial Officer, City of Chicago
- Noor Shaikh, Deputy Chief Financial Officer, City of Chicago
- Lewis Greenbaum, Partner, Katten Muchin Rosenman LLP (the Board's Bond Counsel)

These conversations were key in providing further context of the issue at hand, understanding of the information provided/reviewed and were contemplated in developing the options possible given the expedited and difficult situation.

Data Provided

Baker Tilly was provided the following items by the Board:

- Presentations to the Board concerning the budget
- Draft Monthly Cash Flows

- Report on Analysis of District Finances and Entanglements Between the City of Chicago and the Board
- FY2025 Q1 Report to CEO per Board Rule 5-4
- Board/CTU Factfinding Report
- Internal Memos regarding Budget /Finance
- Intergovernmental Agreements
- Detailed Reports related to Budget, Purchase Orders, and Position Vacancies
- Official Statement for 2023A Bond Issuance
- Credit Rating Reports
- Civic Federation Reports

The City of Chicago also provided additional information related to historical Tax Increment Finance (TIF) surpluses.

Additional information Baker Tilly reviewed from publicly available sources include:

- Board Annual Comprehensive Financial Reports (ACFR) as available on its website
- Budget Documents, also as available on its website
- Budget Appropriation Resolutions
- City of Chicago TIF information:
  - 10-Year TIF Projection End-of-Year Report 2024-33.
  - District Annual Reports
- Illinois State Board of Education (ISBE) budget, finance and related information from its website
- Illinois Compiled Statutes as available on the web

Options

The Board has options to consider for making resources available for its obligations. However, with just over three months left in the fiscal year, the number, timing, and feasibility of these options are limited. None of the options presented below will address the Board's long-term structural budget imbalance. With planning for the FY2026 budget already underway, these options will likely require additional budget balancing and savings measures for FY2026 and beyond. Additionally, each option carries certain risks, such as Board approval, timing, and market conditions, which are highlighted in the narrative for each option.

Current Year Budget Reductions
One of the first areas considered is whether the Board could identify additional funds within the current fiscal year (FY2025) budget to meet its obligations. Baker Tilly discussed and reviewed information related to both non-personnel expenditures and staffing to evaluate the feasibility of identifying available cash on hand through expenditure reductions to determine if sufficient savings could be achieved to meet its obligations.

For context, the FY2025 operating budget for the Board totals $8.4 billion, with approximately $5.8 billion for salaries and benefits, approximately 70%. The remaining portion of the FY2025 budget is for non-personnel items, including contracts, commodities, equipment and contingencies, totaling approximately $2.6 billion.

Making significant budget reductions to cover the Board's obligation could be highly challenging, at best. The additional budget shortfalls outlined below makes this potential option even more challenging. Implementing the necessary budget reductions could be a significant undertaking with far reaching impacts across the District, which could damage the Board's reputation among stakeholders. Finally, any staff layoffs or other significant budget reductions could affect the in-process labor negotiations between the Board and its largest collective bargaining unit.

Compounding the difficulty in identifying availability of funds on hand for the Board's obligations is that the Board's financial team has identified budget shortfalls because of unanticipated events after the adoption of the FY2025 budget in July 2024. According to the Board's finance team, these events include, but are not limited to, a shortfall of personal property replacement tax (PPRT) revenue of approximately $93 million and cost overruns of over $100 million in special education, transportation and other building related costs. These unanticipated events collectively have resulted in a need to find approximately $200 million in reductions/savings to stay within the budget adopted for FY2025 even before addressing the additional Board obligations outlined above. According to Board officials, the Board is making efforts to address the $200 million budget deficit; however, with the remaining time left in FY2025, this will be challenging.

Given these additional budgetary challenges, finding necessary savings in the amount needed for the Board obligations could be difficult without significant disruption to students. This is mainly due to the timing as nearly three-quarters of the fiscal/school year has already passed.

Implementing staff reductions this late in the school year and fiscal year could present challenges, particularly without impacting student learning and services. The savings of any staff identified for reduction could only be realized, at best, for a quarter of the salaries and benefits associated with the reduced staff – given only about three and a half months remain in the fiscal year. Any reductions would need to be done quickly to realize as much savings as possible, which could run the risk of reductions not being as thoroughly discussed and assessed to minimize future academic and operational impacts. Additionally, there is also the risk that the Board may have to cut a larger number of staff in order to realize the need for more immediate savings, affecting service continuity. Further compounding considerations related to the ability to quickly implement staff reductions is the need for notice of termination, any severance, contractual limitations, etc. – which Baker Tilly was not asked to review as part of the scope of work. However, if the Board were able to implement staff reductions quickly and in a strategic manner, this option will benefit needed efforts to remedy the long-term structural imbalance in the Board's budget.

Other potential staff related savings would impact the Board's ability to provide services to students, particularly through a districtwide furlough. According to discussions with the Board, as many as 10 to 11 district-wide furlough days would be required to cover the pension portion of the Board's obligations alone. Such an extensive furlough would adversely impact students, and have broader implications with the Board stakeholders, including the number of student attendance days.

Reduction of non-personnel spending would also be challenging to realize sufficient savings – due to both the timing and that non-personnel is a significantly smaller portion of the overall annual operating budget. Reduction in use of vendors could be an option to generate savings, but this is less than ideal, likely impacting service levels and also the Board's reputation with its vendors. Based on Baker Tilly's observations and discussions with the Board, even a combination of personnel and non-personnel savings would be difficult to generate sufficient savings to cover both the current budget shortfall and other Board obligations.

Additional TIF Surplus from the City

The City of Chicago has nearly 130 Tax Increment Finance (TIF) districts across the City (and by co-location, the District) designed to capture incremental property tax revenue from development within the TIF district boundaries that occurred post creation of the TIF district and corresponding development agreements to encourage redevelopment. As background, any revenue from assessed value increases from development occurring after establishment of the TIF district is held for expenditures or commitments related to the specific TIF district. This incremental property tax revenue is not passed through to other jurisdictions, including the Board, the City, Cook County (the "County"), etc. for general purpose uses. Also of note, TIF districts exist for a limited time; once they 'expire', the incremental tax revenue is then distributed proportionately to the overlapping taxing units.

TIF districts that generate more revenue than expenses can accumulate reserves or balances. These reserves may offset future commitments made through redevelopment agreements or other commitments for future needs/projects. Funds beyond these agreements/commitments can be declared as surplus by the City and then returned to the County for redistribution. This redistribution is done proportionately based on the tax extension or levy that each jurisdiction, including the Board, receives.

Per our discussions with the City, City officials examine TIF districts annually for potential surpluses. For FY2025, the Board expects to receive $298 million from the TIF surplus declared by the City. TIF surplus is generally made in 2 payments, typically in March and August. The City has started its process to estimate the next annual TIF surplus, which would be paid to the Board in FY2026. TIF surpluses are approved by the City Council as a part of the City's annual budget.

For informational purposes, Baker Tilly received data from the City on the total amount of TIF surplus over the last decade. The amount has increased substantially, from approximately $65 million in 2014 to $570 million for 2025. Note, that based on tax extensions/levies, the Board proportional share of this surplus distribution is approximately half of the total surplus for the year.

If the Board were to request additional TIF surplus for its FY2025, timing presents challenges. As noted above, the City is already well into the process for identifying any surplus that would be distributed to the Board in its FY2026. In addition, any receipt of ‘additional’ surplus could impact future amounts of TIF surplus received by the Board, which the Board relies on for specific needs within its budget.

Restructuring of Current Debt Obligations
According to Board officials, the Board issues bonds (debt) nearly every year to fund capital improvement projects. As of the end of FY2024, the Board has approximately $9.3 billion in direct debt, as reported in the Annual Comprehensive Financial Report (ACFR). Local governments, including school districts like the Board, regularly refinance or refund outstanding bonds to capitalize on savings opportunities. In addition, local governments may also refinance their debt obligations for other purposes, as long as Federal and state laws permit and key requirements of the Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) requirements are met.

The Board must adhere to its local Debt Management policy (Debt Management | Chicago Public Schools) which governs the Board’s debt issuance and management. The Board’s Debt Management policy aims to manage debt responsibly by ensuring access to capital markets, maintaining strong credit rating and minimizing interest costs. The Debt Management policy includes guidelines for issuing both variable and fixed-rate debt to fund capital improvements, refund existing debt and meet cash flow needs. The policy emphasizes compliance with regulatory requirements and employs tools like debt refunding to manage risks and generate cost savings.

To further note and reiterate, refinancing and refunding current outstanding debt obligations requires a more in-depth analysis performed by the Board’s Municipal Advisor (MA). Baker Tilly does not, nor has been asked to, serve as the Board’s MA. Baker Tilly Advisory Group is not a municipal advisor as defined in Section 975 of the Dodd Frank Wall Street Reform and Consumer Protection Act. Baker Tilly Advisory Group is not recommending an action to the Board; is not acting as an advisor to the Board and does not owe a fiduciary duty pursuant to Section 15B of the Securities and Exchange Act to the Board with respect to the information and material contained in the deliverables issued under this engagement. The Board should discuss any information and material contained in the deliverables with any and all internal and external advisors and experts that the Board deems appropriate before acting on this information or material. Baker Tilly Advisory Group will rely on the management of the Board to provide key data related to the issuance of municipal securities.

Baker Tilly Municipal Advisors (BTMA) is registered as a "municipal advisor" pursuant to Section 15B of the Securities Exchange Act and rules and regulations adopted by the SEC and the Municipal Securities Rulemaking Board (MSRB).

Based on the aforementioned, the Board may be able to generate funding and/or FY2025 cost savings from refinancing/refunding outstanding debt in one or a combination of the following debt refinancing methods:

Refunding current outstanding issuances could decrease 2025 debt payments ‘freeing up’ restricted funds to be released as unrestricted funds back to the Board to meet its obligations. The refunding analysis needs to be performed by the Board’s municipal advisor as soon as possible. The potential savings are contingent upon market interest rates, outstanding principal, financial structuring, length of bond maturities and investor demand for the Board’s debt. The Board’s bond counsel would need to provide legal advice on timing and bond tax status. This option may result in additional interest costs and increased future debt service payments, and thus potential future budget shortfalls.

The Board could consider issuing Taxable Alternate Revenue Bonds as a debt refinancing or restructuring through a combination of tax-exempt and/or taxable bonds. This approach is similar to past issuances done by the Board in 2015 and 2016. This option requires a highly complex structure with uncertainties related to credit ratings, interest costs and marketing volatility. Further analysis and discussions are needed with the Board’s municipal advisor and bond counsel.

The Board could consider issuing taxable Alternate Revenue General Obligation (GO) Bonds to reimburse capital expenses that were previously paid from operational funds. The proceeds from these bonds would replenish the fund that originally covered the capital expenses. A deeper analysis is needed, involving the Board’s finance team to compile a list of such capital expenses and bond counsel to determine if these expenses are eligible for reimbursement; however, with the Board being nearly an annual issuer of bonds to fund capital projects a potential amount eligible for reimburse may be de minimis. Important to note, taxable GO Bonds historically carry higher interest rates than tax-exempt bonds. Additionally, the time required to identify potential capital expense items could pose risks to the feasibility of issuing and closing taxable Alternate Revenue GO Bonds within FY2025.

In addition to exploring debt instrument options, the Board should continue to examine the Debt Service Reserve and Debt Stabilization Funds to determine if any of the funds currently held in reserve could be released. Further discussions with the Board's finance team are necessary, as these funds have been leveraged to support short-term cash flow needs. A deeper analysis is required to avoid reducing the Board's cash balances, which could increase short-term cash flow borrowing needs in FY2026 and beyond.

There are trade-offs the Board should consider if debt is part of the strategy to fund its obligations. Bond issuances can generate immediate cash flow or savings; however, this may result in additional interest costs and also increased future debt service payments, and thus potential future budget shortfalls. In addition, general risks related to bond issuances include any needed Board approvals and financial market risks related to timing and volatility.

Long Term Needs

As acknowledged by the Board, all of the above options are short-term solutions. As also acknowledged by the Board, significant budgetary adjustments will be necessary in FY2026 and beyond to help alleviate longer term structural issues in the Board's budget.

A long-term plan needs to be developed by the Board to begin the work necessary to fix its structural deficit to alleviate the need for last minute, temporary solutions. The following is a high level, preliminary list of items the Board will need to address going forward:

1. Increase efforts for fairness in funding, particularly related to current structure of how the state-wide teachers pension plan versus the Chicago Teachers Pension Fund are funded.
2. Assessment of programs and other Board initiatives, including effectiveness, cost, and student population served.
3. Develop a process to best align recurring Board expenditures with recurring Board revenues.
4. Create a long-range forecast that is robust enough to develop multiple scenarios for how revenue, staffing levels, budget reductions, and other significant changes may impact the Board's finances and operational resiliency.
5. Consider a finance/budget oriented sub-committee focused on developing additional solutions to the Board's structural imbalance. This sub-committee could be structured to include/incorporate broader stakeholder input as well.