April 23, 2014

Alderman Brendan Reilly

Dear Alderman Reilly:

Thank you for your recent letter and your continued attention to this matter of utmost importance to the City's financial future. It is critical that we work together to develop a comprehensive, realistic, and fiscally responsible approach to solving the City's pension crisis.

First of all, the mayor does not take increasing taxes lightly by any means. That's why the City has balanced the last three budgets without increasing property, sales, or gas taxes. The pension funding proposal put forth earlier this month would increase property taxes by $50 million, or approximately $50 per year for the average homeowner, for the next five years. The total increase, reached in 2019, would be $250 million, not $750 million as stated in your letter. This phased-in increase provides an economically stable source of revenue to fund the City's pension payments, which guarantees that the pensions that nearly 60,000 employees and retirees have paid into will be there for them.

As we move forward with reform for all four of the City's pension funds, other sources of revenue will of course need to be on the table. These sources of revenue must be legally achievable, economically sustainable, and reliable. As you are aware, the ideas that you raise in your letter are ideas that have been discussed for some time and are ideas that we have looked into and investigated. We have vetted each internally and have significant concerns with each of the potential alternatives you have proposed.

A. Increase Local Government Distributive Share

You suggest requesting that the State pass legislation that would increase the portion of its income tax revenue that flows to local governments. Increasing the local government distributive share by .25% each year for five years would yield an estimated $11 million in the first year, increasing to $55 million in the fifth year. While this is a relatively small fraction of the City's pension funding needs over the next 5 years, we agree that any amount helps.

However, our larger concern is the nature of this revenue source. Income tax revenue is controlled entirely by the State, and any increase in the local government distributive share is a direct loss in revenue to the State. Given the State's own fiscal challenges, it is highly unlikely that lawmakers in Springfield could be convinced to pass legislation that would do this. In fact, the trend at the State level has been the <u>opposite</u>. In 2010 when the State increased the income tax rate, it reduced the share of these taxes going to local governments so that the full portion of the tax increase accrued to the State to meet their own fiscal needs. In addition, since 2007, the City has experienced a loss of almost $300 million in State revenues due to, among other actions, the diversion of personal property replacement tax (PPRT) revenue and the reduction of grant funding.

Seeking an increase in the local government distributive share of State income tax revenue is an idea that we have and will continue to advocate for; however, due to the difficulty of compelling a change in State law, it does not negate the need to explore other sources of funding.

B. Amend TIF Statute for More Flexibility

You suggest seeking an amendment to the State TIF Act that would enable the City to dedicate up to 50% of TIF revenue to pension payments, stating that TIFs divert funds from local taxing bodies. In fact, the opposite is true. TIF funds support significant neighborhood capital investment and economic development across Chicago. Over the past 10 years, over $2 billion in TIF capital funds have been spent on developing and improving the facilities used by the City, our sister agencies, and our communities. This is more than two-thirds of TIF expenditures over this time period. Over $1 billion has been invested in improving almost 60 schools across the city, $225 million in CTA tracks and stations, $300 million in parks and open spaces, $60 million in libraries, and millions more in other City facilities and infrastructure.

Diverting TIF capital funds to make City pension payments would have the effect of shutting other taxing districts – including CPS, CTA, and the Park District – out of their share of TIF revenue. Without these funds, these agencies would have to cut services, raise taxes, or simply stop making these important capital investments in Chicago's neighborhoods.

Not only would it deplete funds for current and future projects for these sister agencies, it would decrease and even eliminate the TIF surplus funds that these districts receive. The City currently strategically and aggressively surpluses and terminates TIFs, returning unspent TIF funds to taxing districts. Since 2009, the City has received approximately $90 million through TIF surplus, CPS $230 million, and the Park District $26 million.

C. Further Explore the "TIF Expiration Bond" Proposal

You were also interested in the idea proposed by a former City employee, John McCormick, and reported by a local newspaper, of issuing so-called "TIF Expiration Bonds." Mr. McCormick has said that borrowing against future TIF increment would allow the City to reduce its unfunded pension liabilities and thus reduce current year payments. However, there are several problems with this theory.

First, Mr. McCormick's estimates of the future TIF revenue stream appear to assume a continuous growth in property values for the next several decades. In order to generate the revenue necessary to meet debt service obligations on the proposed TIF Expiration Bonds, incremental TIF EAV would need to double prior to expiration. Recent experience has shown that this is an erroneous assumption; EAV across Chicago declined by 21% over the past two years. While the economy is steadily recovering, the timing of the County assessment cycle means that the recession will continue to impact TIF revenues in coming years, and there is no guarantee of growth in the future. Placing a $2 billion burden on taxpayers without revenue certainty is not a fiscally sound option.

Further, even if these very optimistic revenue projections materialized, the resulting $2 billion is such a small amount of the $19 billion liability that has been built up over the decades that it would barely reduce future payments. In the end, the City would not only need to make significantly increased annual payments to the pension funds but would also have to make payments on a substantial debt. The City would need to pay off this $2 billion in debt like any other debt, at a total cost of $4.6 billion or approximately $150 million per year over 30 years. If payments were delayed in years that the proposed TIF revenues are insufficient to meet annual debt service needs, as suggested by Mr. McCormick, the City's liability would increase by billions of dollars due to increased interest payments.

Finally, we question the idea that TIF Expiration Bonds are supplementing instead of replacing our pension payments. We are obligated to pay the unfunded liability and this proposal uses long-term borrowing for near-term annual payments.

Thank you again for your dedication to addressing the financial issues that face the City in the coming years. Mayor Emanuel remains committed to hearing from Aldermen on their ideas to fix, and ultimately fund, our very serious pension problem. Please do not hesitate to call me with any further questions, concerns, or ideas.

Sincerely,