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City of Chicago 2009 Budget Analysis

Executive Summary

The city of Chicago has presented a $5.97 billion total budget for fiscal year 2009, a 1.1% increase from 2008. The corporate fund portion of this appropriation totals $3.188 bil., a 1% decrease from 2008. In addition to the long-term structural increases in personnel costs, the slowing economy impacted a number of economically sensitive revenues, so Chicago's budgeters had to make up for a $161 mil. shortfall in the 2008 year-end budget, as well as a $420 mil. hole in the 2009 preliminary budget. Among the measures used to cover this shortfall were transactions to convert two major revenue-producing assets (Midway Airport and the city's parking meters) into one-time windfalls bringing more than $2.5 billion to the city. While the majority of the proceeds from these sales are already obligated or otherwise restricted in their use, more than $200 mil. from the transactions will be used to balance the 2008–2012 budgets.

An application of the Government Finance Officers Association Distinguished Budget Presentation Award criteria to the 2009 budget document finds the following issues:

- **Budget as Policy Document** The document operates under a definition of balance or accounting basis that allows revenues from different years to be recognized simultaneously.
- **Budget as Financial Plan** The budget does not describe in detail the methods used for revenue estimation. The impact of nonroutine capital expenditures on the operating budget is not disclosed (although that data may be in the separate Capital Improvement Program). It presents little detail on debt obligations, including the total amount allowed and the breakdown of principal vs. interest. Tax Increment Financing district revenues, expenditures, and fund balances are not accounted for.
- **Budget as Communication Device** The document has significant gaps between information presented in the narrative and the level of detail in the schedules with regard to one-time asset sales.

The proposed 99-year lease of Midway Airport to a private group has an uncertain impact on the budget going forward. It is unclear how the value of the airport's revenue stream was assessed, but the buyer might be receiving a premium of at least 10–30% in the transaction. The accounting of the lease may overstate revenues in 2008 and 2009 by as much as $40 million, and may overstate the impact on the operating budget. It's questionable if this transaction was in taxpayers' best long-term interest.

Introduction and Overview

The purpose of this paper is to evaluate the fiscal year 2009 budget for the City of Chicago, in order to a) determine how it fulfills the Distinguished Budget Presentation Award criteria set down by the Government Finance Officers Association (GFOA), and b) analyze in greater depth how the sale or long-term lease of major assets are presented in the budget, and how proceeds from such transactions are recognized.

The City of Chicago is a home-rule municipality, and derives its budgeting and appropriation authority from the Illinois Municipal Code (65 ILCS 5/8-2-1ff.). In accordance with paragraph 8-2-6 of this section, the city adopts a balanced budget annually. The City of Chicago budget document comprises four volumes: I. *Overview and Revenue Estimates* (the budget message and narrative explanation, along with detailed revenue estimates; cited in this paper as "Overview"); II. *Program and Budget Summary* ("Program"); III. *Draft Action Plan* ("Action Plan"; a management document outlining plans and progress on social programs, as required under certain federal grants and entitlements); and IV. *Mayor's Budget Recommendations* ("Recommendations"; the line-item budget).

The 2009 budget appropriates $5.97 billion in total resources (including the general revenues in the corporate fund, plus special revenues, enterprise funds, capital funds, and other reserved revenues) plus another $1.6 bil. in anticipated grant funds, a 1.1% increase from the 2008 budget. The 2009 corporate fund budget totals $3.188 bil., a 1% decrease from 2008.

The major budgetary issues facing Chicago in 2009 are 1) the nationwide economic downturn, which is causing large shortfalls in the economically sensitive revenues such as sales and real-estate transaction taxes that make up a significant portion of the revenue mix; 2) ongoing increases in personnel costs, including contractual wage increases and rising health and pension costs which the city is legally obligated to fund; and 3) increases in debt-service costs. In the 2009 preliminary budget released this past August, the city described a projected shortfall of $141 million in the 2008 year-end and a gap between expenditures and projected revenues of approximately $420 million in 2009. In the final recommendations for 2009, the measures applied to make up for these revenue shortfalls include the use of one-time proceeds from the proposed sale or lease of several large revenue-producing assets, including Midway

Airport and the city's parking meters; and increases in fees, fines, and penalties and stepped up code enforcement to bring in greater fine and penalty revenue.

Application of GFOA Criteria to Chicago's 2009 Budget

Chicago was awarded the Government Finance Officers Association Distinguished Budget Presentation Award in 2008, as it had been for a number of years previously. For the most part, Chicago's 2009 budget meets the criteria for the award, with a few notable exceptions. This section will touch on each of the major criteria areas in order, but only if the presentation falls short on a specific criterion will it be expounded in detail.

The Budget as a Policy Document For the first of the mandatory Policy Document criteria (PD1: inclusion of a coherent statement of entity-wide long-term financial policies), the document broadly meets the goal with a section specifically dedicated to explaining financial policies in fairly accessible language. (Overview, 102–107) However, on the subpoint of including a definition of balance, the document includes only a citation of the state statute requiring balance, and asserts that the budget presented is balanced by that definition. (Overview, 102) While the referenced statute is fairly easily obtained online, this fairly fundamental definition is not to be found summarized anywhere within the document itself. In addition, the budget seems to operate under a rather flexible definition of balance and accounting basis, which allows anticipated revenues from asset sales to be recognized in the year before the transaction actually takes place, while the assets to be sold are still appropriated at their full value for the coming year. The definition of balance is among the ideas examined in the second half of this paper.

For the most part, the Overview and the Program together satisfy the remaining criteria for this section. The document clearly states short- and long-term entity-wide policies, goals, and initiatives; includes a budget message that explains priorities and issues for the coming year; and includes quantifiable goals and objectives for major organizational units.

The Budget as a Financial Plan The document does not describe in any detail the methods used for revenue estimation as required to satisfy FP4, instead merely asserting that the city "estimates its annual revenues by objective and analytical processes." (Overview, 103) While specific revenues and year-over-year changes are discussed in detail in the revenue analysis and program budgets, the specific basis for the new revenue estimates is generally not disclosed.

FP7 is concerned with significant nonroutine capital expenditures, and describing the extent to which they will affect current and future operating budgets. Since Chicago prepares a separate Capital Improvement Program (CIP) with its own cycle, individual capital projects are not identified or discussed in any significant detail in the main budget document. As such, nonroutine capital projects' impact on the operating budget is not identified in this document, individually or in aggregate. However, the document does explain that certain types of capital projects (new branch libraries, for example) would tend to have a greater impact on the operating budgets than, say, infrastructure improvements or curb cuts. (Overview, 98)

FP8 suggests that along with data on current debt obligations, the document should outline the city's debt policy and limits (or the lack of such limits), the effects of debt levels on operations, and a breakout of principal and interest payments for the current year. Though the Chicago document does include the data on aggregate debt obligations (Overview, 97; Program, 271), it does not include any information on debt limits, nor what proportion of any limit current obligations represent, nor what the components of the obligations are. The document also seems to conflate principal and interest payments on a single line.

Finally, in a matter that's not clearly related to any of the criteria but which falls under the broad Financial Operations umbrella, the document makes only the barest mention of tax increment financing (TIF) funds, and makes no obvious attempt to account for them in the fund structure. The one mention of TIFs in the overview merely shows their total contribution to the capital program. Since TIFs represent a major revenue loss to the operating budget and a significant pool of funds, the document should treat the TIF pool like any other fund and, at the very least, a) show the amount of revenue diverted from the current year's budget by the increment, b) show accumulated fund balances, and c) show expenditures from the funds. Ideally, the document would include a section in the recommendations that breaks this down for individual TIF districts. As it stands, the TIFs essentially provide a large hidden fund with far less stringent reporting rules than other funds in the budget.

The Budget as an Operations Guide The document satisfies all the requirements of this section between the Overview and the Program. For OG2 (objective and meaningful measures of progress toward accomplishing government's mission), many of the performance measures seem only marginally related to the mission of the organizational units. For example, as performance measures for the Dept. of Aviation, striving for an increase in positive responses to customer satisfaction surveys about bathroom cleanliness and shopping variety. Meanwhile, airport security incidents are framed as merely something to be avoided altogether, and so are only counted, with no actual performance targets attached. A raw number of incidents is a practically meaningless measure. This example suggests that the budget's effectiveness as an management tool is limited by the strength of these individual performance measures.

The Budget as a Communications Device Again, broadly speaking, the document satisfies all the requirements of this section. And again, key pieces of information are left out of the picture presented by the document, for instance, any detail on TIFs and their relationship to the budgeting process (to satisfy CD2). A second major gap is between the budget narrative in the Overview volume and the Program and Recommendations on how the major asset sales/leases fit into the budget. Two pending major asset transactions—the 99-year lease of Midway Airport to a private entity, and the sale of rights to the city's parking meter collections—play a large role in balancing the 2008 and 2009 budgets, and the budget narrative touts the city's innovation in using such instruments to make up for revenue shortfalls elsewhere. However, actual detail on the transactions is very limited, and even at the Program level key pieces of information about the transactions are left out; these must be found elsewhere for a reader to even begin to make budgetary sense of the deal. Because of these omissions, it is impossible to get the full picture of the budget from the budget document itself. This is more than a question of the level of detail and it being impossible to express everything about the budget in a finite amount of space. The paper explores these issues at greater length in the next section.

Summary and Conclusions The most serious of the problems with the budget presentation seem to revolve around issues of transparency. A rather flexible definition of balance allows anticipated revenues from future transactions to be recognized at the same time that the revenue stream to be sold in the transaction is also recognized. The presentation's narrative explanation about these transactions is not adequate in itself for an interested observer to understand the transactions' true budget impact. Similarly, a major area of revenue expenditure is left almost wholly unaccounted-for in the document. Taken together, these omissions of information about major budgetary issues raise questions about whether the budget contains more systematic fudging and accounting tricks that would become obvious only on prolonged examination. In any case, they add up to a picture of an entity that is not striving for full accountability, which calls the reliability of the entire budget and revenue estimates into question.

Most of the remaining problems are technical ones, more likely related to the size and complexity of the Chicago budget (as compared to the much smaller entities that the GFOA criteria are also designed to measure). They are not as alarming as apparent effort to shed accountability noted above.

Accounting for the Midway Airport Lease

On October 8, 2008, the City Council voted to enter into a 99-year lease agreement for Midway International Airport, the first privatization of a major American airport. According to the Dept. of Aviation program narrative (Program, 251), the investment consortium Midway Investment and Development Corp. (MIDCo) will pay the city $2.521 bil. for the right to collect the operations fees that currently flow to the Midway Airport Fund. Though the transaction is still awaiting FAA approval, the Budget Message describes the establishment of $100 mil. "short term fund" with the proceeds, which will be used in operating budgets over the next five years. This will replace another $100 mil., five-year fund flowing from the Chicago Skyway lease transaction, which is expiring in 2008. (Overview, 2–3) This section will try to trace how the Midway transaction is reflected in the 2009 budget. It will also attempt a limited analysis of the value of the revenue stream, and whether the proceeds received from the lease represent a disposal of public assets that is worthwhile for the city.

The Chicago Midway Airport Fund has total appropriable revenue of $199.2 mil. in 2009. The Dept. of Aviation program summary states that a full year's worth of operations was appropriated for the Midway fund, even though the lease transaction is expected to be finalized in 2008, and that

> the City plans to transfer operations of the airport to MIDCo in the first quarter of 2009. It will not remain part of the City's budget appropriation going forward (it will remain self-supporting under the private operator's management control), but Midway will remain a City asset and continue to operate and serve customers as it does today. The lease agreement and operating standards provide for the continued operation of Midway as part of Chicago's Airport System. (Program, 251)

A press release from the Mayor's Office provides some additional detail:

- the entire $2.521 bil. of rent is due at closing
- net proceeds total more than $1 bil.
- “state law requires that 90% of the net proceeds be used for infrastructure improvements”; also, “up to half of the net can be used for the pension funds” [it is unclear how these two seemingly contradictory statements are to be reconciled, but regardless, the funds are unavailable for funding operations]
- use of the remaining 10% (approximately $100 mil.) of net proceeds is unrestricted
- terms of the lease include detailed operating standards governing all aspects of airport operations. City and airlines can both take action for failure of the operator to meet standards
- city will continue to provide all police and fire services at the airport, and TSA will continue to perform all of its current function in passenger screening and other areas (Mayor’s Press Office, 9/30/2008)
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As mentioned in the previous section, the fact that these details, which are crucial to understanding the lease’s budget impact, were not included in the budget document itself constitute a failure of the document’s communications role.

First, we will try to determine where the savings come from in this transaction by looking at expenditures from the Midway Airport fund (Recommendations, 502–522). The fund is balanced, with expenditures matching revenues of $199,221,000, and it pays for 346 positions, of which 152 are within the Department of Aviation. This, and some two dozen other administrative and oversight positions in assorted city departments, seem to be where the bulk of the savings will come. These total $102.3 mil., and 163 positions.

Since police and fire services will continue to be provided by the city, the 130 sworn personnel currently paid out of the fund (57 Police and 73 in the Fire Dept.), with operations totaling more than $11 mil., will not be part of the savings. Nor, presumably, will 37 positions and $2 mil. for the Office of Emergency Management and Communications or 16 positions and $3 mil. for Fleet Management (which I am assuming go almost entirely to support the public safety operations at the airport). If my assumptions are correct, these ongoing costs total at least $16.2 mil. and 183 positions in 2009, all of which was formerly funded with the revenue stream that the city has now leased the rights to for a century.

Another important assumption here is that some $81 mil. in annual debt service within the fund will be fully taken off the books as the debt is retired with the lease proceeds. Since the fund is fully appropriated as if it was a normal year, this is unclear from anything in the budget document.

Putting a value on the revenue stream from the airport is difficult, but for simplicity's sake, let us first assume that the level of revenue remains at this year's level ($199.2 mil.) over the life of the lease; using a discount rate of 7%, the net present value of this 99-year revenue stream is $2.84 bil.—the city is receiving about 89% of that amount. More realistically, assuming that the revenue stream does grow, but at no more than the constrained rate outlined in the lease (no growth for first six years, limited to core CPI thereafter, and moreover assuming a 2.5% core CPI and that fees are never raised beyond that even though they are permitted to), the net present value is $3.62 bil. The city recovers less than 70% of this amount. These conservative calculations suggest that MIDCo is receiving a risk premium on the order of 10–30% for taking over an established, self-sufficient municipal enterprise. Since MIDCo can opt to raise revenues beyond core CPI after 25 years, the value is potentially much greater. Is this a worthwhile transaction for the city? If the city were shedding a significant number of personnel in the transaction, it might seem to be favorable, but as the deal is structured the city retains the most expensive aspects of the operations (public safety operations and a significant number of sworn personnel, along with their associated benefit obligations). The deal does shore up pension and capital funds, but if the city had held out for a larger portion of the net present value of the revenue stream, this would have had a much greater impact on those obligations, as well as freeing up significantly more for general revenues.

Meanwhile, the impact on the operating budget is negligible. If the $100 mil. available to the corporate fund is spread out over five years as planned, this actually amounts to less than $4 mil. per year in new revenues once ongoing operations at Midway are accounted for. This will make up for less than half of the expiring short-term revenues from the Skyway sale.

Perhaps most problematically, the city is already counting the proceeds, even while appropriating for a full year's operations in 2009. The Overview states that the unreserved portions of the new revenues will be "used over a period of 5 years, starting in 2008," (3) and that the city's $161 million shortfall at year-end 2008 is partly filled with these revenues (8). This is more fully borne out in the revenue estimates (Overview, 65), which show that the one-time money is being classified under Proceeds and Transfers-in to balance both the 2008 year-end shortfall and the 2009 budget. Neither of these transfers is matched by any expenditure in the Midway Airport fund. This means that for two years, the budget is simultaneously dedicating the new Midway lease proceeds while still appropriating the Midway Airport fees at their full value: in short, revenues are overstated by $20 mil. in both years. Since Proceeds and Transfers-in is an unitemized entry in the Recommendations, it is only through a close reading of the revenue estimates that this is obvious. Clearly, this budget is working under a definition of “balance” that could not last in the long run.

A possible remedy to the problems with this transaction might lie in a set of policies for negotiating and accounting for major asset sales and leaseholds, especially since the city seems to be increasingly attracted to such deals. First, a consistent policy for setting the price of an asset should be adopted; at a minimum this would outline relevant variables to be used in the calculation, such as discount rate, acceptable risk premium, and how to calculate the future value of the associated revenue stream. Most likely this would produce a range of acceptable prices that could be weighed against relevant long-term trends like congestion, fuel prices, insurance premiums, etc. Any asset sale should have to satisfy a minimum return of value to the taxpayer. Since the city is most likely to enter into these transactions in times of financial distress, this would hopefully mitigate the temptation to take the first juicy-sounding offer without weighing all important considerations. Second, the budget policy should be explicit about how and when the revenue from these transactions can be recognized, and should require alternative schedules to be attached to the relevant funds to show how their revenues and expenditures will be affected if the transaction goes through as expected. It is reasonable and even prudent to make projections based on the assumption of a different revenue mix by year’s end, but these assumptions should be fully explained in the budget document and shown in the schedules.

Conclusions and Recommendations

In 2009, Chicago scrambled to make up a $420 mil. revenue hole, as well as a $161 mil. shortfall in its year-end 2008 budget, largely due to major decreases in economically sensitive revenues. The means used to make up for these shortfalls include expenditure cuts and increases in some fees, penalties, and other nontax revenues, but also the conversion of two important revenue streams into one-time windfalls. The budget holes have also been partly plugged by way of accounting tricks that may overstate revenue by tens of millions of dollars. Even if these accounting maneuvers are technically legal and acceptable, the transactions suggest that the city's structural imbalance is worsening, since the city appears increasingly willing to turn to one-time asset sales to produce a few years of operating revenues. While these creative transactions seem to solve individual years' budget crises relatively painlessly, they do nothing to address the underlying structural problems in the budget. Moreover, they remove important safety nets for the budget, since eventually all the valuable assets will be sold.

Perhaps we are facing a once-in-a-lifetime revenue crisis that will be resolved before the city has to sell off any more major assets or raise the property tax levy. But between these sales and the off-the-books budgets in the TIF funds, the city's budgeters seem to have a predilection for the choices with less short-term pain, even if they worsen long-term problems.