GOOD JOBS FIRST

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PUTTING MUNICIPAL PENSION COSTS IN CONTEXT:

Chicago

Public pensions have gained public attention in Chicago recently, especially because of dramatic claims by Chicago Mayor Rahm Emanuel. "If we make no reforms at all across our pension funds, we would have to raise City property taxes by 150%... Businesses and families would flee, not just from our city but from our state." [1] Unfortunately, the Mayor's hyperbole leaves out a more complete picture of the city's fiscal condition.

The Mayor's reference to property taxes ignores decades of history that are vital to understanding public finance in Chicago. Nearly one out of every ten property tax dollars collected in Chicago doesn't end up in the city's general fund or with other taxing jurisdictions that provide public services. Instead, those revenues are siphoned off into what were once secret accounts controlled almost exclusively by the Mayor. Since 1986, nearly ***$5.5 billion*** has been diverted into these accounts. [2]

How is that possible? Chicago has made extensive use of a special economic development mechanism called Tax Increment Financing (TIF). TIF has rightfully been dubbed "Chicago's Shadow Budget." [3] At a moment when politicians are talking about cutting retirement benefits for civil servants like Teachers, Firefighters, and Policemen, we think it is useful to remind the public about Chicago's Shadow Budget. While this report does not specifically call for the abolition of TIF in Chicago or for TIF to be used to pay for the city's pension liabilities (that would not be legal), we believe that as a matter of honest accounting and fair budgeting, TIF requires careful consideration.

TIF costs have grown significantly in recent years and have for years exceeded the City's annual pension liability. Our analysis shows that property tax diversions into TIF have exceeded pension costs in every year since 2007 (pension data limitations prevent us from making the same comparison before 2007). For example, the city's pension costs were $385.8 million in 2012, while TIF diverted $457 million in property tax revenues.

In Illinois, as in other states, TIF is a state-enabled economic development tool that allows local governments to divert property tax revenues into funds for special projects. When a TIF district is designated, future property tax revenues are split into two streams. The first stream, tied to the pre-TIF assessed values, continues to fund public services. But all of the increase resulting from higher assessments (which occur both normally due to inflation and market appreciation and also due to redevelopment) – known as the "tax increment" – is diverted into the second stream, the TIF. This diversion occurs for 23 years and may be extended 12 more years. Chicago now has over 150 such TIF districts. Frequently, Chicago's TIF districts look remarkably similar to Gerrymandered congressional districts with lines drawn to include or exclude a special project or a particularly valuable piece of property. While those tax dollars normally would have gone to fund schools, police, fire, sanitation and other city services, instead they are diverted to TIF accounts.

Sometimes that TIF money just sits unused in an account, despite the rest of the city's financial situation. For example, in 2009, Chicago had $985 million in unallocated TIF funds sitting in accounts.[4] The City could have declared that amount as "surplus" and allocated it to the Chicago School Board and other taxing jurisdictions. The *Chicago Sun-Times* editorial board called upon the city to "hand over TIF surplus cash to Chicago schools."[5] Only recently has the city done this after the Mayor signed an executive order requiring a quarter of unused TIF revenues be returned. [6] In January of 2014, the School Board (which since 1995 has been controlled by the Mayor of Chicago) made an important first step by hiring new teachers with TIF funds declared as surplus. [7]

But the TIF surplus policy hardly solves the fundamental flaw of TIF: excessive spending on projects of questionable importance, secretive and concentrated budgetary power, and the long-term erosion of tax revenues for the rest of the city's budget. By diverting so much revenue, TIF is denying vital revenue to education, infrastructure and other public goods that benefit all employers and are vital to the city's economic development.

Worse, when a TIF expires, those incremental property taxes are supposed to revert to the correct taxing jurisdiction. But when a major TIF expired in 2008, it failed to catch up and collect that revenue. [8]

While TIF can be a tool for public good, the problems that have emerged over the years make us question its continued use in Chicago. Numerous criticisms of TIF have come to light:

- Lack of Transparency [9]
- Alleged use of TIF as a political patronage tool [10]
- High costs without adequately documented benefits
- Enormous opportunity costs relative to the rest of the city's budget [11]
- Unclear accountability for taxpayers
- Failure to target urban blight
- Because TIF involves borrowing, additional costs associated with interest on debt
- Subsidizing economic activity that did not need taxpayer funding

Much of the city's TIF revenue was spent on subsidizing corporations, non-profits, and developers. Over a decade between 2002 and 2012, more than $1 billion were awarded through Redevelopment Agreements. Some of the corporate subsidies were staggeringly large:

- $39.7 million for S & C Electric Company
- $27 million for LaSalle Street Capital (a subsidiary of Bank of America)
- $24.4 million for United Airlines
- $15 million for the Chicago Mercantile Exchange (it should be noted that some of these companies later rejected the subsidy deals, but only after bad publicity) [12]

When newly elected Mayor Rahm Emanuel took office in 2011, he convened a TIF review process in order to fix this so-called Shadow Budget.[13] And although the City made TIF far more transparent as a result, the review did not make TIF any less corrosive towards Chicago's budget. Recent new rounds of proposed subsidies for things like basketball stadiums and hotels raised serious doubts about whether TIF reform has actually materialized. [14]

Other TIF spending items also raise questions in comparison to the complete picture of the city's budget. For example, TIF dollars are going to new elite, selective enrollment schools even as the city shuts down other schools. [15] Some have even gone so far as to question the legality of using at least $200 million in TIF funds for school construction costs. [16]

In September of 2013, aides to Mayor Emanuel acknowledged that about $1.7 billion sits in TIF accounts, though $1.5 billion of it is obligated to various projects through 2017. [17] But if the city is willing to consider breaking pension commitments, why should TIF spending not receive similar scrutiny?

In California, Governor Jerry Brown thought so. In a strikingly similar situation, Governor Brown faced a statewide TIF budgeting problem. Much like the City of Chicago, TIF in California was siphoning off an enormous amount of property tax revenue: 12 percent overall. [18] In some California municipalities, TIF had become a major budgetary item: as much as 25 percent of property taxes were going into TIF accounts! [19]

When efforts to reform California TIFs failed, the state dissolved the authority of localities to have TIF districts and began the process of unwinding the existing debt obligations of TIF districts. While in the short term those debts will prevent a large immediate savings in California, the reforms will prove worthwhile in the long run. According to the Legislative Analyst's Office, "Within about 20 years… property tax revenues for [school] districts, counties, cities, and special districts will be about 10 percent to 15 percent higher than they otherwise would have been. These property tax revenues may be used for any local program or local priority." [20]

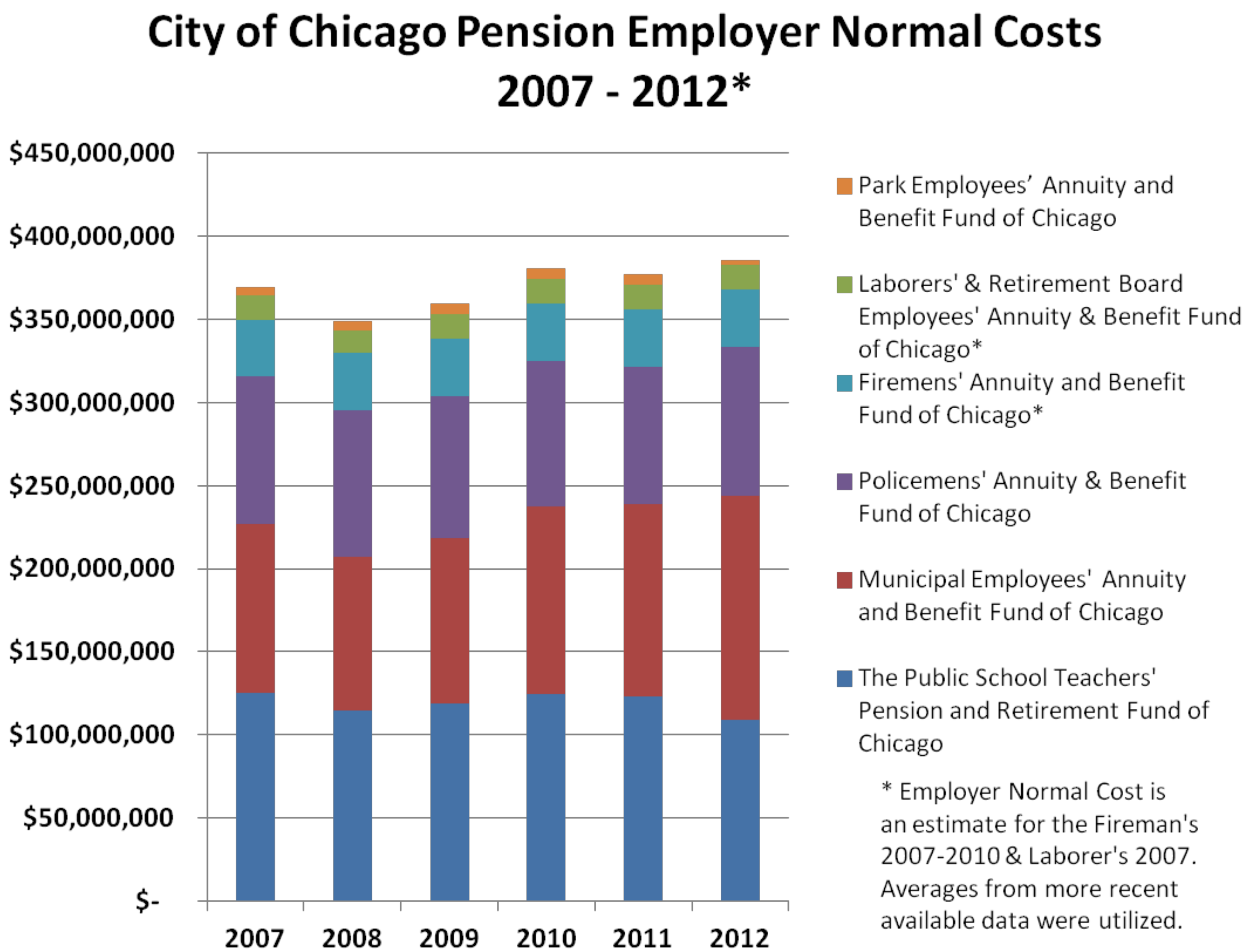
California's significant cost savings through abolition of TIF serves as a useful example to policy-makers in Chicago. While we are not necessarily suggesting that Illinois or Chicago end TIF altogether, we do believe that spending less on TIF would free up property tax revenues for other fiscal priorities.

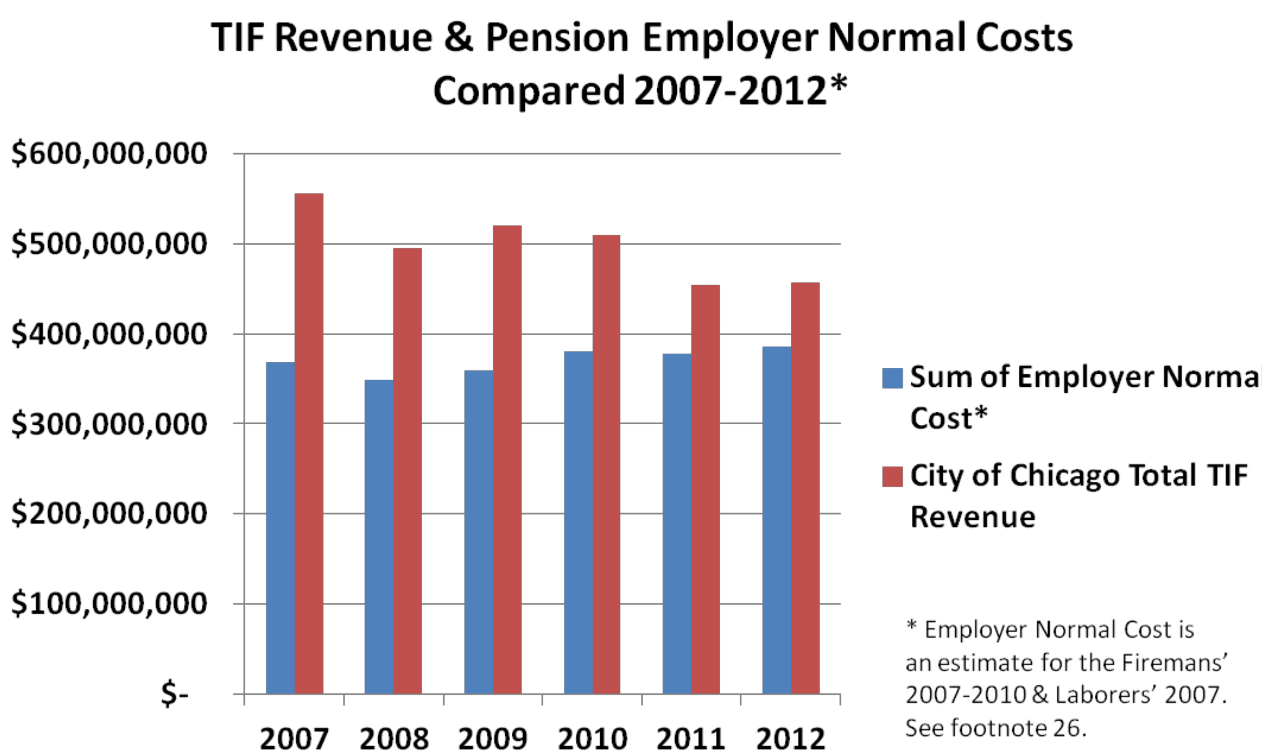
One way to look at both TIF and pensions is to compare the current revenue diverted for TIF in Chicago with the revenue needed to pay for the current year's pension costs, known as "employer normal cost." Such costs can be found in the annual financial reports that each public pension plan must issue.

We do not utilize here the Annual Required Contribution (ARC), which is the sum of the employer normal cost for the current year as well as payments due on any unfunded liability from previous years. [21] In order to make an apples-to-apples comparison with TIF, we must look at both programs' current annual costs.

In the City of Chicago there are six main plans primarily backed by city property tax revenues:

- The Public School Teachers' Pension and Retirement Fund of Chicago,
- Municipal Employees' Annuity and Benefit Fund of Chicago,
- Laborers' & Retirement Board Employees' Annuity & Benefit Fund of Chicago,
- Policemens' Annuity & Benefit Fund of Chicago,
- Firemens' Annuity and Benefit Fund of Chicago, and
- Park Employees' Annuity and Benefit Fund of Chicago.


City of Chicago Pension Employer Normal Costs
2007 - 2012*
$450,000,000
$400,000,000
$350,000,000
$300,000,000
$250,000,000
$200,000,000
$150,000,000
$100,000,000
$50,000,000
$-
2007
2008
2009
2010
2011
2012
Park Employees' Annuity and Benefit Fund of Chicago
Laborers' & Retirement Board Employees' Annuity & Benefit Fund of Chicago*
Firemens' Annuity and Benefit Fund of Chicago*
Policemens' Annuity & Benefit Fund of Chicago
Municipal Employees' Annuity and Benefit Fund of Chicago
The Public School Teachers' Pension and Retirement Fund of Chicago
* Employer Normal Cost is an estimate for the Fireman's 2007-2010 & Laborer's 2007. Averages from more recent available data were utilized.


TIF Revenue & Pension Employer Normal Costs
Compared 2007-2012*
$600,000,000
$500,000,000
$400,000,000
$300,000,000
$200,000,000
$100,000,000
$-
2007
2008
2009
2010
2011
2012
Sum of Employer Normal Cost*
City of Chicago Total TIF Revenue
* Employer Normal Cost is an estimate for the Firemans' 2007-2010 & Laborers' 2007. See footnote 26.

Recent financial reports for 2012 indicate annual employer normal costs of: [22]

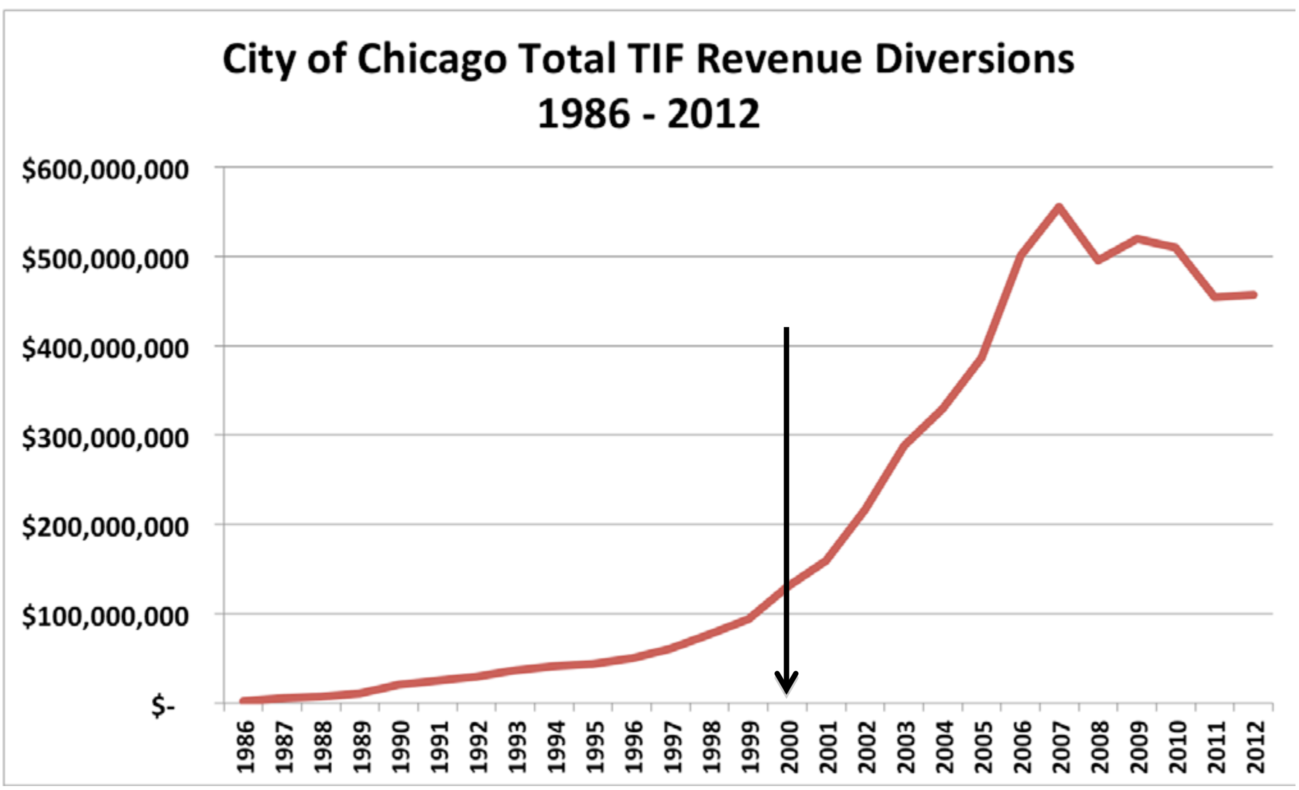
- $108.8 million for the Teachers' Pension fund;
- $135.2 million for the Municipal Employee's fund;
- $14.5 million for the Laborers' fund;
- $89.8 million for the Policemens' fund;
- $34.3 million for the Firemans' fund;
- $3.3 million for Park Employees' fund.

In total, that adds up to about $386 million.

It should be noted that of those six pension funds, both the Teachers' Pension and the Park Employees' fund are not part of the City's budget, but rather the Chicago Public Schools and the Chicago Park District. Both of those agencies levy their own property taxes, which are their primary revenue source. About half of all property taxes levied in Chicago fund the Chicago Public Schools. [23] Therefore, any TIF diversion of property tax revenues impacts the budgets for those agencies.

Year	TIF Revenue Diversion	Total Pension Employer Normal Cost[24]	Employer Normal Costs as a Percent of TIF Revenues
2007	$555,310,568	$369,150,718	66%
2008	$495,590,381	$348,771,255	70%
2009	$519,715,715	$359,278,364	69%
2010	$509,971,274	$380,525,278	75%
2011	$453,671,990	$377,300,681	83%
2012	$457,007,111	$385,877,181	84%

Compare the $386 million annual cost with revenue for Tax Increment Financing. In 2012, TIFs collected some $457 million in property



taxes across the city of Chicago. [25] In fact, TIF revenues far exceed the city's employer normal costs on pensions backed by property taxes for every year for which we can get consistent pension data (since 2007). [26]

TIF may have even played a significant role in undermining the city's pension system. According to a 2010 report issued under the previous Mayor of Chicago that looked at the four main pensions backed directly by the City of Chicago (Police, Firefighters, Municipal, and Laborers), as of 2000, those pension funds weren't in financial trouble;[27] that is, their problems emerged after 2000. While the report does cite the impact of early retirements (something employee contracts allow for), it clearly states that "inadequate contributions" from the city of Chicago played a major role. Two major recessions, one caused by Wall Street's risky financial speculation on a real estate bubble, didn't help either.

The City's pension problems emerged during a time when TIF revenue diversions soared. Although TIF has been an economic development tool in Chicago since the early 1980's , its use – and cost -- saw a meteoric rise during the same period that Chicago pension funds started suffering inadequate contributions.

As the chart on the previous page documents, Chicago property tax revenues lost to TIF more than doubled between 2000 and 2003 and quadrupled by 2007 to exceed half a billion dollars a year.

Various observers have noted that the City had a revenue problem, but rarely have they noted the corrosive nature of TIF spending. In 2002, the culprit, according to the Chicago Tribune, was "declining tax revenues." [28] In 2004 Chicago solved a budget gap by raising numerous regressive sales taxes. Property taxes were not raised, with then-Mayor Daley painting them as "politically toxic." [29] The regressive revenues were needed, the Mayor claimed, to "shore up our city's structural revenues."

It wasn't until 2008 that journalists and officials finally caught wind of TIF's pernicious effect on the city's budget. According to one Alderman quoted in a 2008 story: "We need to go to Springfield and change the state law so we can reclaim our TIF dollars that are being held hostage and put that money back in the general fund… We're at least partly in the trouble we're in because of the TIFs." [30]

It's hard to ignore the evidence that TIF impacted pensions: TIF costs grew, general fund revenues declined, and the city addressed its budget gap in part by making inadequate contributions to public pensions.

Conclusion

Chicago's Shadow Budget, also known as Tax Increment Financing (TIF), has grown exponentially since 2000: the same time period over which the City has made inadequate contributions to its employees' pensions.

Any fair budgeting discussion of pensions must include the enormous revenues diverted by TIF. When TIF reform efforts fell short in California, Gov. Jerry Brown and the state's legislature ended the state's TIF program altogether. In the long run, local jurisdictions there will see a 10 to 15 percent increase in property tax revenues over what they would have had with TIF still in effect.

For every year since 2007, the revenues diverted by Chicago's TIF program far exceed the annual cost of funding the main city administered public pension systems. This report is intended to put the two forms of spending into perspective.

TIF has played a role in the underfunding of pensions in Chicago, and curbing the use of TIF can also play a role in shoring up the city's financial situation. We leave open the broader question of TIF's abolition. But in summarizing

California’s experience, we remind policymakers that TIF costs can restore long lost property tax revenues.

Finally, pensions are not the only opportunity cost of TIF. Adequately funded investments in education and infrastructure are well-documented inducements for job creation and personal income growth. Economic development works best when if benefits all employers, not only the developers able to win inclusion in a TIF district.

Endnotes

[1] http://www.chicagobusiness.com/assets/interactive/otherFiles/PensionReform.pdf
[2] http://www.cookcountyclerk.com/tsd/DocumentLibrary/2012%20TIF%20Revenue%20Report.pdf
[3] http://www.chicagoreader.com/chicago/shadow-budget-tif/Content?oid=1251320
[4] http://planning.unc.edu/people/faculty/williamlester/LesterTIFinChicagoforthcoming.pdf
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[20] http://www.lao.ca.gov/analysis/2012/general_govt/unwinding-redevelopment-021712.aspx
[21] http://assets.aarp.org/www.aarp.org_/articles/work/contribution-requirements.pdf
[22] Pension figures were derived for each fund from recent Comprehensive Annual Financial Reports (CAFRs) available online at the following websites:
http://www.ctpf.org/general_info/financial_lists.htm
https://www.meabf.org/publications.php
http://www.labfchicago.org/investments/cafr-3-column/
http://www.chipabf.org/ChicagoPolicePension/Financials.html
http://www.fabf.org/Financial/FinancialReports.html
http://www.chicagoparkpension.org/CAFR.html

[23] http://www.illinoispirg.org/sites/pirg/files/reports/Cleaning%20up%20Tax%20Increment%20Financing%20FINAL_0.pdf

[24] Employer Normal Costs were not available for the Firefighters' fund from 2007 through 2010 and the Laborers' fund for 2007. We estimated these costs by utilizing averages from more recent available data.

[25] http://www.cookcountyclerk.com/newsroom/newsfromclerk/Pages/2012TIFreport.aspx

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