



The Civic Federation

Research * Information * Action * Est. 1894

LOCAL GOVERNMENT PROTECTION AUTHORITY:

*A Proposal Prepared by
the Civic Federation Pension Committee*

March 2015

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The Civic Federation is an independent, non-partisan government research organization working to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois.

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EXECUTIVE SUMMARY

The Local Government Protection Authority (LGPA) is a proposed quasi-judicial structure that provides financially distressed local governments and their employees with a venue, encouragement and supervision to aid in finding creative, voluntary solutions to financial challenges. LGPA will make recommendations and findings on what costs are affordable and sustainable and do not interfere with providing essential governmental services to residents.

LGPA's mission is to provide a supervised forum to assist financially distressed local governments with the determination of the following issues resulting from underfunded essential government services:

- What essential government services and post-employment benefits are affordable and sustainable;
- What cost-cutting measures are necessary to achieve affordable services and benefits;
- What recommendation, if any, for a tax increase is necessary to provide additional funding;
- What contribution increases are necessary by both taxpayers and employees;
- What intercept of State revenues is necessary so that essential governmental services can be provided and the local government can maintain access to the municipal debt market at relatively low cost;
- Whether arbitration (voluntary or mandatory) should be engaged in for contractual or labor disputes;
- Whether services or costs of the local government should be transferred to other governmental bodies;
- Whether certain services should be consolidated with other governmental bodies or transferred to a regional authority;
- Whether certain assets or provision of services should be sold, leased or privatized;
- Whether the local government should be authorized to file for Chapter 9 proceedings under the Federal Bankruptcy Code; and
- Whether, given the findings of LGPA, the local government's plan of a debt adjustment can be prepackaged or prenegotiated.

Under Chapter 9 of the Federal Bankruptcy Code, a State may authorize local governments to use federal bankruptcy procedures to adjust their debts, burdensome contractual obligations, unaffordable judgments or liabilities including labor contracts and post-employment obligations. By creating LGPA, the State is able to offer an alternative to bankruptcy which will allow local governments an opportunity to solve their critical problems related to providing essential government services without subjecting all of their operations to the jeopardy of a bankruptcy proceeding. Such problems could include unaffordable costs or liabilities that imperil

governmental services including unbearable obligations and liabilities, judgments, labor and post-retirement benefits.

Implicit in its mission is that LGPA will develop criteria for measuring the financial health of local governments and publicly comment on whether costs of operation including services, labor and pension and Other Post Employment Benefits (OPEB) obligations can be paid from reasonably available sources without impairing a local government's primary mission of providing essential services. The goal of LGPA is for all participating local governments to fund essential government services fully and make sustainable contributions to pensions and OPEB by a specified date in order to maintain the credibility of Illinois local governments in capital markets.

UNDERLYING ASSUMPTIONS

The Local Government Protection Authority (LGPA) will provide a forum in which taxpayers, elected officials, public employers and employees can address issues relating to essential government services, financial difficulties relating to costs, judgments, liabilities and post-employment benefit rates and payment structures and provide transparency to the public as to the affordability and sustainability of these services and benefits. The need for this Authority is evidenced by reductions in some government services and growing financial distress of local governments. Reductions have in many cases been spurred by the escalating costs of promised services, salaries, retirement annuities and health care benefits. Furthermore, certain goods, services, pension and retiree health care costs are expected to grow at a faster rate than inflation in the coming years.

In order to provide essential government services and reduce a local government's unfunded liabilities for the promised services, labor costs and post-employment benefits, either taxes and/or contributions must be increased, services and benefit costs must be reduced, or some combination of the alternatives must be achieved. When assessing these alternatives, it should be noted that Illinois taxpayers have supported tax caps in the past, compelling local government to manage within existing tax and revenue limitations.

To the extent that sufficient amounts of money are not raised to pay for services and costs or in the case of pensions irrevocably set aside and prudently invested, local governments' unfunded liabilities including pension and Other Post Employment Benefit (OPEB) obligations will continue to grow at a staggering rate. The ultimate fear is that these governmental services and future obligations to retirees that have not been funded today will impair the ability of local governments to provide essential governmental services.

As a matter of law, demands from retirees for both pension and OPEB payments may have the same priority for payment as those of ordinary suppliers of goods and services, employees necessary for normal operations and perhaps many bondholders. This may result in a situation where the current claims of all creditors for a local government will exceed the available revenues. When a local government is unable to pay both creditors and employees it may be forced to decide whether to pay salaries to police, firefighters and other government workers or pension benefits to retired police, firefighters and other government workers. No local

government official wants to be put into a position to pick and choose between constituent creditor bodies. However, inaction now may require such unwanted decisions in the future.

By creating LGPA, the State is able to offer an alternative to bankruptcy which will allow local governments and their elected officials, taxpayers and workers an opportunity to solve their problems related to providing services and pay the costs including retirement benefits without subjecting all of their operations to the jeopardy of a bankruptcy proceeding. There are financial relationships that are beneficial to the local government that should not be disturbed for the benefit of all which would automatically be affected by filing a Chapter 9 proceeding. Generally there are only a few creditor relationships that may need attention and resolution. As a last resort LGPA can recommend that the State provide the most desperate cases with specific authorization to file Chapter 9. Further, LGPA can make a determination based on the presentations of interested parties as to what cost and services are affordable and at what level.

Since local governments are creations of a State as means of providing essential government services on behalf of the State, ultimately it is the State that has the responsibility to find a solution for problems facing local governments. The best resolution is a cooperative effort between the State and the financially challenged local government where local elected officials and local governmental bodies along with taxpayers, workers and business entities develop a plan of financial recovery that is a permanent fix. LGPA is dedicated to voluntary resolution and finding of what is affordable so that basic governmental services can be provided on a long-term basis.

LOCAL GOVERNMENT PROTECTION AUTHORITY

The Local Government Protection Authority (LGPA) is a proposed quasi-judicial structure that provides local governments, their employees and the public with a venue, encouragement and supervision to aid in finding creative, voluntary solutions to underfunding situations.

LGPA's mission is to provide a supervised forum to assist with the determination of the following issues resulting from underfunded government services and unaffordable costs and liabilities for local governments:

- What essential government services and post-employment benefits are affordable and sustainable;
- What cost-cutting measures are necessary to achieve affordable services and benefits;
- What recommendation, if any, for a tax increase is necessary to provide additional funding;
- What contribution increases are necessary by both taxpayers and employees;
- What intercept of State revenues is necessary so that essential governmental services can be provided and the local government can maintain access to the municipal debt market at relatively low cost;
- Whether arbitration (voluntary or mandatory) should be engaged in for contractual or labor disputes;

- Whether services or costs of the local government should be transferred to other governmental bodies;
- Whether certain services should be consolidated with other governmental bodies or transferred to a regional authority;
- Whether certain assets or provision of services should be sold, leased or privatized;
- Whether the local government should be authorized to file for Chapter 9 proceedings under the Federal Bankruptcy Code; and
- Whether, given the findings of LGPA, the local government's plan of a debt adjustment can be prepackaged or prenegotiated.

Implicit in its mission is that LGPA will publicly comment on whether contractual obligations, debts, pension or OPEB obligations can be paid from reasonably available sources without impairing a local government's primary mission of providing essential services. The goal of LGPA is to have all participating local governments restore fiscal stability by restructuring obligations and providing a balance between what is owed and what is reasonably affordable. In cases where employee retirement obligations are the primary cause of the current or future expected fiscal imbalance, LGPA will act to ensure pension funds and other post employment benefits are funded in an actuarially sound and sustainable manner by a certain date.

Popular solutions from the corporate world to solve post-employment benefit funding problems may have some applicability to situations facing local governments. These solutions include:

- Changing retirement promises for new hires from defined benefit plans to reduced defined benefit plans, cash balance plans or defined contribution plans and variations thereto whereby the public employer's contribution is fixed and the employee's contribution can vary based on the benefit desired by the employee subject to State and federal law;
- Transferring OPEB obligations from employers to trusts administered by employees, funded with a one-time employer contribution and ongoing employee contributions or transfer retirees to an exchange created under the Affordable Care Act; and
- Negotiations to reduce costs of existing plans between representatives of employees and employers.

LGPA provides an opportunity for public employers and employees to explore these and other options.

Other costs that are unaffordable or unsustainable could be solved by consolidation with other governmental bodies, by public-private partnerships or by leasing, sale of assets or granting the rights to provide such services within defined parameters of costs and services.

Many of these changes are complex and will take time to implement. They may result in tax increases and/or reduced expenditures for current operations. They may also result in initial increased costs for the local government as service provider or employer.

Given existing constraints, it would be helpful if solutions to government services and burdensome costs such as unaffordable contract obligations, judgments, labor and post-employment benefits were individually tailored rather than imposed uniformly on all local governments. Whether each aforementioned solution can realistically be adopted by local governments and their taxpayers will require a case-by-case analysis. The Local Government Protection Authority provides a mechanism by which individually tailored solutions can be reached for participating local governments as they attempt to resolve the complex issues associated with growing pension and other costs.

Membership and Funding

LGPA will consist of nine members: Four appointed by the Illinois Municipal League and one appointed each by the Governor, and the Speaker of the Illinois House of Representatives, President of the Illinois Senate, Minority Leader of the Illinois House of Representatives and Minority Leader of the Illinois Senate. The members shall serve staggered six-year terms.

LGPA will be funded by the State of Illinois as part of its annual budget. LGPA shall consider whether it should establish a fee schedule for those who participate. The State Comptroller's Office shall collect local government reports required by LGPA and provide administrative and operational support for LGPA and its functions.

Jurisdiction

Participating local governments are all local governmental entities with funding responsibilities for operating costs such as contract costs for goods and services, labor and pensions and other benefits for their employees. LGPA would address those costs that have been identified as unaffordable or unsustainable.

The following parties may petition LGPA: (1) the Illinois Comptroller, (2) a local government, (3) a creditor that has not been paid on a liquidated debt obligation (unpaid for 6 months) of \$5,000,000 or 10% of the annual revenues of the local government, whichever is greater ("Significant Past Due Creditor") or (4) a pension fund (individually, a "Party in Interest") and may request that LGPA make a determination of what under the specific circumstances would be an appropriate resolution of the (specified) financial distress that a local government was suffering.

Denial of a petition to participate in LGPA is not an appealable decision. LGPA may seek declaratory and injunctive relief regarding the exercise of its powers and implementation of its findings and recommendations.

Trigger Criteria

LGPA will determine if a local government should participate by granting a petition filed by a local government or Party in Interest. Determinations may be based on the following guideline criteria for the local government or its individual pension plan (“Trigger Criteria”):

- 1) Past due debt obligations or judgments of more than a specified percentage of the annual revenues of the local government that have been unpaid for more than 6 months without an agreement by the creditors to forbear or standstill as to prosecution of the claims;
- 2) Failure to make statutory or Annual Required Contributions (or a suitable similar substitute concept) to pension funds from existing operating revenues for two consecutive years;
- 3) Funded ratio for an individual pension plan falls below a threshold set by LGPA;
- 4) Failure to pass a budget by a timeframe established by LGPA after the start of the fiscal year;
- 5) Bills of a specified percentage of annual current revenues are left unpaid for a period greater than 180 days as defined by a payment period;
- 6) Failure to achieve at least 30 days cash on hand in the General Fund at end of the fiscal year for two consecutive years;
- 7) Debts or judgments that are past due for more than six months or pension liabilities that exceed a given percent (e.g., 2%) of the fair market value of taxable real property in the taxing district;
- 8) Financial statements are not published within six months of the close of the fiscal year;
- 9) Local government has defaulted on debt securities;
- 10) The sum of the ARC plus the annual debt service on any outstanding pension obligation bonds has exceeded a threshold set by LGPA for the last three consecutive years; and
- 11) Any other criteria that LGPA determines is necessary to accomplish its mission.

LGPA will develop standards for interpreting these criteria and how it will grant participation to a local government.

LGPA’s Powers

LGPA will have the following powers:

- 1) Recommend a tax increase by means of requiring a vote by the local government on the tax increase. Home rule local governments will have their representative body (council, board, etc.) vote on the recommended tax increase. In the case of non-home rule local governments, LGPA can require a referendum on the tax increase. This process is necessary in order to determine whether there is an unwillingness to pay or an inability to pay for current post-retirement benefits. If both the local government and the referendum fail to increase taxes, this indicates an inability to pay;

- 2) Recommend a diversion of State revenues in order to fund specified costs of operation, labor and post-retirement benefits; and
- 3) Recommend voluntary mediation.

LGPA will act in a quasi-judicial capacity to provide appropriate relief consistent with the purposes of funding and enforcing reasonable and affordable government services and costs of operation, labor and post-employment benefits for employees of a local government.

LGPA will have the authority to obtain information from all participating local governments. All participating local governments must require their respective financial officer or equivalent to provide information regarding its budget, revenue sources and liabilities, including pension funds. Participating governments must also annually file information with LGPA demonstrating their budgets, revenues, costs, liabilities and funding level for their actuarially determined pension and OPEB liabilities. LGPA shall have access to the records of the pension funds for each participating local government for the purpose of confirming this information.

LGPA will be authorized to set acceptable levels of essential governmental services and increasing percentage targets for appropriate levels of annual funding for pension funds so that by a specified date full or appropriate funding is realized by the participating funds. For local governments that fail to meet LGPA's annual funding targets, LGPA will also be given the authority to encourage cost reduction negotiations between public employers and their employees. LGPA shall provide assistance with these cost reduction efforts including employer-employee benefit adjustment discussions. LGPA will mediate discussions regarding appropriate levels of governmental services, costs, taxes and pension funding and benefits to ensure that they are within an acceptable range of the funding target. LGPA may make findings as to affordable levels of services and costs, including labor costs and employee benefits, which allow adequate funding for essential governmental services. LGPA may also approve settlements. Voluntary mediation will be offered and supervised by LGPA.

LGPA may also require annual work plans, along with quarterly progress reports, from local governments that have not met the cost reduction or pension funding targets. Additionally, LGPA may require participating local governments that have individual budgets that are not affordable or specific pension plans with funded ratios below a level determined by LGPA and have not met the funding target for two consecutive years to submit an explanation to their electors. The affordability of the budget and acceptable levels for essential governmental services will be determined by standards established by the Illinois General Assembly based on recommendations by LGPA. The funding ratio for pension plans will be determined based on uniform actuarial methodology including assumptions based on comparable returns on investment, i.e. discount rate, from information annually required to be provided to LGPA ("Uniform Calculation Method" or "UCM"). The required explanation to the electors would include a statement of the impact of the underfunding of obligations and pensions on providing essential governmental services which is to be published in a newspaper of general circulation. LGPA shall establish rules and guidelines for such reporting and publication by local governments.