Illinois State Board of Education

Dr. Tony Sanders, State Superintendent of Education
Dr. Steven Isoye, Chair of the Board

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MEMORANDUM

TO: The Honorable JB Pritzker, Governor
The Honorable Tony McCombie, House Minority Leader
The Honorable Don Harmon, Senate President
The Honorable John Curran, Senate Minority Leader
The Honorable Emanuel "Chris" Welch, Speaker of the House

FROM: Dr. Tony Sanders
State Superintendent of Education

DATE: June 23, 2023

SUBJECT: CPS Entanglement Report

Pursuant to 105 ILCS 5/34-18.70, the enclosed report provides a review on the Chicago Board of Education's ability to operate with the financial resources available to it as an independent unit of local government.

This report is transmitted on behalf of the State Superintendent of Education. For more information, please contact Jennifer Saba, interim Executive Director, Legislative Affairs at (217) 782-6510 or jsaba@isbe.net.

cc: Secretary of the Senate
Clerk of the House
Legislative Research Unit
State Government Report Center

Report and Recommendations

Review of the Chicago Board of Education's ability to operate with the financial resources available to it as an independent unit of local government

JUNE 2023

Illinois State Board of Education

Introduction

The Board of Education of the City of Chicago was established under Article 34 of the Illinois School Code (105 ILCS 5/34). Since 1999, the Board has consisted of seven members appointed by the mayor of Chicago, without the advice, consent, or approval of the City Council. Members of the Board serve four-year terms. The mayor also appoints a full-time, compensated chief executive officer.

Public Act 102-0177, effective June 1, 2022, created a process to transition the Board from a seven-member appointed Board to a 21-member elected Board. Beginning with the November 5, 2024, election, members of the Chicago Board of Education will be elected on a nonpartisan basis. The legislation specifies that the terms of all seven members of the Board will end and a new Board consisting of 21 members will take office. The mayor of Chicago will appoint 10 members to the new Board, with the advice and consent of the City Council, to serve two-year terms. Ten members will be elected in the November 5 general election to serve four-year terms. The remaining member will be appointed by the mayor, with the advice and consent of the City Council, to be the president of the Board and will serve a two-year term.

Ten additional members will be voted to the Board in the 2026 general election. A board president also will be elected at large at that time. As of January 15, 2027, all 21 members on the Board will have been elected.

Public Act 102-691 updates language contained in Public Act 102-0177 by changing dates of a required independent financial review and review of this independent financial review by the Illinois State Board of Education (ISBE). Specifically, Section 34-18.70 of the School Code reads as follows:

> Sec. 34-18.70. Independent financial review. The Chicago Board of Education shall commission an independent review and report of the district's finances and entanglements with the City of Chicago. No later than October 31, 2022, the report shall be provided to the Governor, the State Board of Education, the General Assembly, the Mayor of the City of Chicago, and the Chicago Board of Education. No later than July 1, 2023, the State Board of Education shall review the independent review and report and make recommendations to the legislature on the Chicago Board of Education's ability to operate with the financial resources available to it as an independent unit of local government.

Chicago Public Schools (CPS) submitted a report titled *Analysis of District Finances and Entanglements Between the City of Chicago and the Chicago Public Schools* (the Analysis) to the ISBE via email on October 31, 2022. CPS completed the report with the assistance of an independent municipal financial adviser, Columbia Capital Management LLC, to satisfy the requirement of an independent review and report of the district's finances and entanglements with the City of Chicago.

The statute requires that the State Board of Education review the independent report and make recommendations to the legislature on the Chicago Board of Education's ability to operate with the financial resources available to it as an independent unit of local government.

In preparing this report to meet that statutory requirement, ISBE relied on the accuracy of information and projections provided in the Analysis, along with publicly available data relating to the finances of the Chicago Board of Education.

Summary of Reported Entanglements

As with most school districts, CPS has a variety of entanglements with other units of local government. The Analysis defines entanglement as "a financial, economic or operational connection between CPS and the City of Chicago or its sister agencies, whether formal or informal, that confers a direct or indirect benefit on CPS that is directly measurable or that the City does not confer on other governmental agencies in the city." The Analysis attempts to report key entanglements between CPS and the City of Chicago that may impact the ability of CPS to operate as an independent unit of local government.

The Analysis organizes entanglements into three main categories: direct benefit to CPS, indirect benefit to CPS, and other entanglements. Direct and indirect benefits to CPS are further divided into direct appropriation or reduced payments. Direct appropriations indicate an item supported by a direct budgetary obligation of the City of Chicago. Reduced payments are a benefit to CPS that do not appear on the City budget because the value of the benefit is from revenue not received by the City. Other entanglements include items in which money flows from CPS to the City of Chicago or another local government agency, or relationships that provide value to both the City and CPS.

The Analysis discusses three direct benefits with direct appropriation: bond debt service, Tax Increment Financing (TIF) surplus returns, and TIF school improvements. The total reported benefit to CPS for these entanglements was $306.5 million in fiscal year 2021. The Analysis reports one direct benefit due to reduced payments. This item, user fee waivers in the form of water and sewer usage fee waivers and city permitting fee waivers, provided an estimated $10 million in benefit to CPS in FY 2021.

The Analysis discusses four indirect benefits to CPS that have direct appropriation:

- Municipal Employees' Annuity and Benefit Fund (MEABF) pension contributions
- MEABF payments to the City of Chicago from CPS
- Modern school bonds
- Five grant programs

The total reported benefit to CPS for these entanglements was $141.1 million in FY 2021. The Analysis reports one indirect benefit due to reduced payments. The Chicago Transit Authority (CTA) provides reduced fares for CPS students. These fares are paid by students directly. CTA estimates the FY 2021 fare reduction that students pay to be $19 million.

The Analysis discusses five other entanglements, most of which are outflows from CPS to the City of Chicago or other units of local government. These include:

- Payments to the City of Chicago for a partnership for early childhood preschool programs
- School resource officers
- Crossing guards
- Lease arrangements with the City and other units of local government
- Fees paid to the Chicago Public Building Commission for project management services. The outflow from CPS for these entanglements was estimated at $96.1 million in FY 2021.

The total estimated net benefit to CPS from the entanglements in FY 2021 as listed in the summary in Table 6 of the Analysis is $380.5 million. If this total were all direct expenditures by CPS, it would have constituted a 5.2% increase in its FY 2021 expenditure budget. The Analysis does project some entanglement values through FY 2025; however, not all entanglements are projected. Those include current outflows from CPS to the City, such as payments for school resource officers and early childhood programs, and CPS payments for MEABF contributions.

As previously noted, the Analysis breaks down the entanglements into three categories, direct benefit to CPS, indirect benefit to CPS, and other. Table 6 of the Analysis, found on page 17 of the analysis, provides a summary of the potential financial impacts of the entanglements.

Category: Direct Benefit to CPS—Direct Appropriation							
($ in Millions)	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
IGA/Bond Debt Service	112.5	142.3	142.3	142.3	142.3	142.3	142.3
TIF Surplus	93.8	155.6	163.9	150.2	97.0	97.0	97.0
IGA/TIF School Improvements	32.8	14.3	0.3	TBD	TBD	TBD	TBD
Category: Direct Benefit to CPS—Reduced Payments							
User Fee Waivers	11.0	9.0	10.0	11.0	11.0	12.0	12.0
Category: Indirect Benefit to CPS—Direct Appropriation							
MEABF Pension Contributions	n/a	n/a	187.8	259.4	272.7	283.4	293.9
CPS MEABF Payments to City	-	-	(60.0)	(100.0)	(175.0)	TBD	TBD
Modern Schools Bonds	2.8	21.2	10.5	20.7	7.9	11.8	6.6
Grant Programs	3.3	3.1	2.8	TBD	TBD	TBD	TBD
Category: Indirect Benefit to CPS—Reduced Payments							
Student Transportation	35.0	11.0	19.0	23.0	27.0	31.0	35.0
Category: Other Relationships							
Early Childhood Preschools	(72.8)	(80.2)	(80.2)	(80.2)	(80.2)	TBD	TBD
School Resource Officers	-	(16.5)	(12.1)	(11.1)	(10.2)	TBD	TBD
Safe Passage Program	1.0	1.0	1.0	1.0	TBD	TBD	TBD
Leases	(2.9)	(2.9)	(2.9)	(2.9)	(2.9)	(2.9)	(2.9)
PBC Fees	(4.7)	(5.3)	(1.9)	n/a	n/a	n/a	n/a

Note: Positive values are costs paid by other parties to or on behalf of CPS; negative values are costs paid by CPS to or on behalf of other parties. MEABF's actuary did not calculate pension contributions on CPS' behalf for FY 2019 or FY 2020.

Recent District Financial Trends

CPS has seen a 30% increase in operating revenue from FY 2018 to FY 2022. As noted in Figure 1 below, total operating revenue has increased by over $1.6 billion during that time. The largest increases came in federal funds (106% increase) and local funds (30% increase), with trends shown in Figure 2. It is important to note that a large portion of the federal revenue increase, approximately $781 million according to the district's FY 2022 Annual Financial Report (AFR), is due to federal COVID-19 relief funding, which could impact CPS revenue through FY 2025.

Additionally, the increase in local revenue is largely due to an increase in Corporate Personal Property Replacement Tax (CPPRT) revenue during the past two completed fiscal years. CPS saw a 118% increase in CPPRT revenue from FY 2021 to FY 2022, compared to an average annual increase of 9.2% from FY 2018 to FY 2020.

Operating Revenue	Change FY18 to FY22	% Change
Local	953,701,020	30%
State	(53,653,382)	-3%
Federal	742,863,046	106%
Total	1,642,910,684	30%

Figure 1

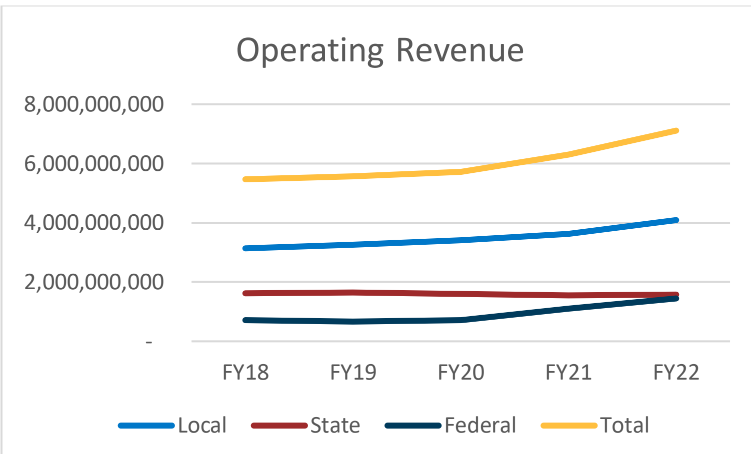

Figure 2

CPS has seen a 33% increase in operating expenditures from FY 2018 to FY 2022. (See Figure 3.) As noted in Figure 4, the percentage increase from FY 2021 to FY 2022 was more than double what has been typical over the prior three fiscal years.

Operating Expenditures	Change FY18 to FY22	% Change
Instruction	943,100,577	27%
Support Services	739,443,323	50%

Community Services	27,778,301	46%
Payments to Other Districts & Governmental Units	15,934,225	27%
Debt Service	(27,711,755)	-89%
Total	1,698,544,670	33%

Figure 3

Operating Expenditures	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**
Instruction	3,468,836,098	3,610,774,046	3,782,381,390	3,998,835,613	4,411,936,675
Support Services	1,491,749,367	1,671,765,510	1,747,209,170	1,850,913,670	2,231,192,690
Community Services	60,590,087	63,798,471	60,518,763	72,495,278	88,368,388
Payments to Other Districts & Governmental Units	58,563,003	69,201,295	73,472,765	70,569,284	74,497,228
Debt Service	30,974,292	6,659,083	7,363,552	2,682,146	3,262,537
Total	5,110,712,847	5,422,198,405	5,670,945,640	5,995,495,991	6,809,257,517
% Increase from Prior Year		*6.1%*	*4.6%*	*5.7%*	*13.6%*

Figure 4

The total fund balance for CPS has remained steady over the past five fiscal years, with a decrease in FY 2020 but a recovery in total fund balance by the end of FY 2022. (See Figure 5.) As shown in Figure 6, the total fund balance has increased by 3% from FY 2018 to FY 2022. During that time, the capital projects and tort fund balances have decreased by a combined $830 million. Notably, the educational fund balance has increased by $800 million during this time, an increase of 235%.

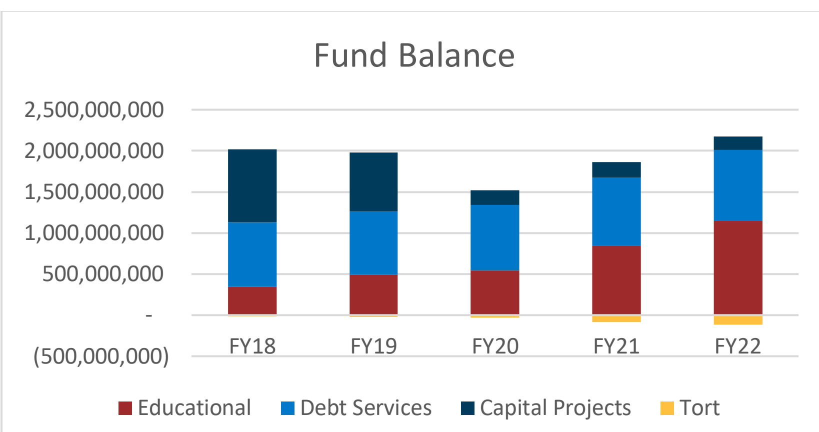

Figure 5

Fund Balance	Change FY18 to FY22	% Change
Educational	802,888,169	235%
Debt Services	83,521,073	11%
Capital Projects	(731,398,126)	-82%
Tort	(98,681,157)	-553%
Total	56,329,959	3%

Figure 6

As measured by the School District Financial Profile System, the CPS financial condition has improved over the past five years. CPS' financial profile score resulted in a "financial early warning" designation, only one level above the lowest rating of "financial watch" in fiscal years 2018, 2019, and 2020. That status improved to a "financial review" status, the second-highest rating of four possible ratings, in fiscal years 2021 and 2022.

Financial Comparisons

CPS is more reliant on state and federal revenue than districts generally are statewide. As seen in Figure 7 and Figure 8, 55.3% of revenue for CPS came from local sources in FY 2021, compared to an average of 64.6% statewide. This number is slightly deflated due to the increase in federal revenues for FY 2021, but the general trend holds over the past five years.

CPS Revenue %	2017	2018	2019	2020	2021
Local	56.7%	56.4%	58.1%	58.2%	55.3%
State	29.7%	31.9%	31.0%	30.3%	28.8%
Federal	13.6%	11.8%	11.0%	11.4%	16.1%

Figure 7

Statewide Revenue %	2017	2018	2019	2020	2021
Local	68.1%	66.0%	66.4%	65.9%	64.6%
State	24.4%	26.9%	26.6%	27.0%	26.0%
Federal	7.5%	7.1%	7.0%	7.1%	9.5%

Figure 8

Operating expense per pupil (OEPP) is the gross operating cost of a school district (excepting summer school, adult education, bond principal retired, and capital expenditures) divided by the nine-month Average Daily Attendance for the regular school term. As Figure 9 indicates, CPS typically spends more in OEPP than the average district in the state, as the district serves a comparably higher need student population. The district serves 64% more low-income students, twice as many students identified as homeless, and 57% more English learners compared to the state average. The difference between the CPS OEPP and the statewide average has increased from $2,075 to $4,437 between FY 2017 and FY 2021.

OEPP	**2017**	**2018**	**2019**	**2020**	**2021**
CPS	15,412	15,878	16,923	17,779	20,465
State Average	13,337	13,764	14,492	14,747	16,029

Figure 9

CPS receives Evidence-Based Funding (EBF), which is distributed annually through a formula that considers the adequacy target for each district according to defined cost factors, along with the district's local resources, to distribute state funds equitably. New EBF funds are distributed into four tiers, with Tier 1 receiving 50% of new resources. CPS was assigned to the Tier 1 group for each year that tier funding was distributed from fiscal years 2018-22, which put it in the group of districts that has the largest gap between the adequacy target and resources available. However, CPS was assigned to Tier 2 for FY 2023 EBF funding due in part to the large increase in CPPRT revenue. The increase in EBF funding CPS received in FY 2023 was approximately $29 million less in Tier 2 than if it had been assigned to Tier 1. As noted by CPS, the increased CPPRT may be temporary, so a move back to Tier 1 is possible.

CPS was at 74.6% of adequacy for the FY 2023 EBF calculation, with an adequacy funding gap of approximately $1.4 billion. The district is ranked in the bottom half of all school districts for adequacy of funding. The district is ranked as having the 480th highest percentage of adequacy compared to all school districts, which means that 479 districts have a higher percentage of adequacy and 371 districts have a lower percentage of adequacy than CPS, according to FY 2023 EBF calculations.

EBF	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Percent of Adequacy	63.1%	64.9%	66.4%	68.4%	67.8%	74.6%
Tier Designation	1	1	1	N/A	1	2
New Tier Funding	66,383,046	47,416,408	53,076,677	-	56,653,898	27,012,298

Figure 10

Outlook

Recent budget trends show operating fund surpluses over the past five years. (See Figure 11.) In the Analysis, CPS projects balanced budgets for fiscal years 2023, 2024, and 2025. CPS then projects deficit spending in FY 2026 and beyond. (See Figure 12.)

	FY18	FY19	FY20	FY21	FY22
Operating Results	357,341,460	149,339,161	43,456,045	296,945,167	301,707,474

Figure 11

($ in Millions)	FY23	FY24	FY25	FY26	FY27	FY28
Projected Surplus/(Deficit)	0	0	0	(628)	(733)	(650)

Figure 12 (data from CPS entanglement study)

CPS lists impacts to its long-term budget as growth in annual pension contributions, new expenditures for school resource officers and crossing guards, EBF revenue reductions in new funds, growth in employee wages and benefits, costs related to alternate revenue bond payments, the impact of inflation, and the potential expansion of Tax Increment Financing by the City of Chicago. While these revenue and expenditure challenges were listed, it is unclear from the analysis if the projected deficits account for any potential expenditure reductions by the district that might offset the listed factors driving its projected deficits.

It also must be noted that school districts across Illinois must work collaboratively with their local municipalities to address issues regarding the funding of school resource officers, crossing guards, and expansion of TIF districts with their local municipalities. The pension contribution is something that is different for CPS; however, this was addressed by the legislature in the passage of Evidence-Based Funding in that CPS is provided an adjustment related to its pension obligations, which factors into the district's percentage of adequacy.

EBF requires that an amount equal to the remaining CPS pension contribution be deducted from the Local Capacity Target of the district. Local Capacity Target is one of three components of district resources. The deduction reduces the district's resources, lowering its percentage of adequacy. Percentage of adequacy is the value used to compare districts and rank them in order of need for state assistance. The outstanding pension amount is certified annually by the Chicago Teachers Pension Fund.

Conclusions and Recommendations

The Analysis report identifies financial risk factors when CPS transitions to an independent unit of local government. These risks include:

- Risk Related to Pandemic Impacts
- Risk Related to Underfunded State Aid
- Risk Related to Local Pension Funding Demands
- Risk Related to Backlog in Capital Investment
- Risk Related to Statutory Constraints
- Risk Related to Other Entanglements
- Risk Related to CPS Unfunded Mandates Resulting from the Process of Disentangling

There are 852 school districts in the State of Illinois. Each district is unique in the circumstances that pertain to the financial operations within the school system. CPS is no different in that regard.

Similar to all public school districts in Illinois, CPS submits a property tax levy annually with various funds and maximum tax rates allowed. CPS is a district subject to the Property Tax Extension Limitation Law (PTELL). That law limits the district's annual growth in operating extensions to the lesser of the Consumer Price Index or 5%. The maximum total of all operating tax rates may not exceed what is known as the limiting rate. The sum of all operating rates for CPS in the report is 2.876, which is also the limiting rate. That means for operating purposes the district has currently maximized its operating extensions.

The tax rate allowable for the CPS contribution to the Public School Teachers' Pension and Retirement Fund of Chicago was increased to 0.567% beginning in tax year 2017 per Public Act 100-0465. Diversion of operating revenues for pension purposes are set to decline past FY 2023, according to the FY 2023 CPS Budget Book. The combination of state and local funding has promoted stability in the CTPF (Chicago Teachers' Pension Fund)[i].

As part of the current intergovernmental agreement with the City of Chicago, CPS pays approximately 66% of the estimated contribution requirement for non-teaching CPS employees in the Municipal Employees' Annuity and Benefit Fund. CPS currently has no mechanism to levy taxes for this cost nor does the district have any governance representation for the management of this fund.

The General Assembly passed the Evidence-Based Funding for Student Success Act in 2018 to create a system to recognize each district's unique characteristics and provide funding for each district based on several indicators. The Illinois General Assembly has increased the EBF appropriation for schools throughout Illinois every year but one since 2018.

The EBF distribution calculation has a mechanism built into the formula to lower the CPS percentage of adequacy based on the pension contribution, which facilitates additional tier funding to be provided to the district.

The substantial increase in Corporate Personal Property Replacement Tax in FY 2022 and FY 2023 resulted in the CPS tier assignment being changed from a Tier 1 district to a Tier 2 district under the EBF formula. This change resulted in less tier funding to be distributed to CPS. If CPS reverts to Tier 1, EBF tier funding will increase in future years. CPS' historical tier assignment is shown below.

	FY18	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
CPS Percentage of Adequacy	63.1%	64.9%	66.4%	68.4%	67.8%	74.6%
Tier Assignment	1	1	1	N/A	1	2
Tier 1 Target Ratio (Boundary Between Tiers 1 and 2)	64.6%	65.7%	67.7%	N/A	69.4%	73.2%

Evidence-Based Funding can be used to fund each area identified in the Analysis as an area of concern. Increasing the EBF appropriation annually would provide more sustained funding for CPS to address these potential funding shortfalls.

The recommendation(s) by the Illinois State Board of Education to the General Assembly are as follows:

- Continue to fund EBF at a high level, committing at least the minimum $350 million in additional tier funding annually to address potential funding shortfalls following the separation from the City of Chicago. Depending on CPS's tier assignment, new tier funding will be distributed to CPS annually through the EBF formula until the district's percentage of adequacy reaches 90%.
- Fund transportation, early childhood grants, and other grant lines at a high level to mitigate the financial risks of CPS and all other districts in the State of Illinois. Statute specifies that CPS receives a specific set-aside for many different grant programs.
- Re-establish a capital construction program for schools throughout Illinois to potentially benefit all school districts, including Chicago Public Schools.

- Districts subject to PTELL have the option of seeking an increase in operating rates that exceeds the limiting rate for up to four years. This process is discussed in the Illinois Department of Revenue PTELL Technical Manual.[ii] CPS should consult with its legal counsel to determine its eligibility.
- Provide a structure of governance for the MEABF that includes representation by CPS.
- Provide the newly elected Board of Education for CPS with the ability to call for a referendum for operating tax increases that may assist with operational costs, pending referendum approval.
- Advise CPS to continue to partner with the City of Chicago on matters that include, but are not limited to, student transportation and school resource officers using intergovernmental agreements. Continuing with these partnerships as intergovernmental agreements ensures continuity of services.

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[i] https://www.cps.edu/globalassets/cps-pages/about-cps/finance/budget/budget-2023/docs/fy23-budget-book.pdf

[ii] https://tax.illinois.gov/content/dam/soi/en/web/tax/research/publications/documents/localgovernment/ptax1080.pdf