

Pensions case study: North Riverside



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The problem

Illinois' municipal pension shortfall, excluding Chicago, has spiked to more than \$12 billion from \$1 billion just a decade ago. Municipalities are suffering the consequences. They're cutting core services, raising taxes and adding new fees to pay for their increasing government-worker pension costs.¹

Springfield, for example, closed three library branches, shrunk its police department by nearly 15 percent since 2007 and tripled its general-fund taxpayer contributions to pensions since 1999.² Peoria, in addition to major cuts to its public works staff, added new utility and gas taxes and doubled trash collection fees. Rockford's mayor Larry Morrissey is even calling for bankruptcy to bring the city's pension costs under control.³

Cities struggle while the state legislature, which sets municipal pension laws, continues to avoid any type of reform.

But one municipality, North Riverside has run out of options and it can't afford to wait for the state to reform local pension systems. North Riverside faces a \$1.9 million budget shortfall and \$1.8 million of it is due to increasing pension funding.⁴ The village has little ability to raise revenues and it doesn't want to slash public services.

To help avoid the nearing budget crisis, North Riverside developed an innovative plan to reform its current pension system without the approval of the Illinois General Assembly. North Riverside plans to move its entire fire department to a private provider of fire services – a private provider with a 401(k)-style retirement plan. The village wants to transfer its 12 firefighters and four lieutenants – and their full salaries – to the same private company that's been providing the village's ambulance service for nearly thirty years.⁵

The move to a private provider of fire protection services would reduce the village's \$1.9 million budget deficit by nearly 40 percent and begin to put an end to the village's perpetual pension problem.⁶ The savings would largely come from the private provider switching the firefighters from the traditional defined-benefit pension plans to 401k-style retirement plans going forward.

North Riverside's reform plan would finally bring more stability to the Village's decade long budget battle. Since the late 1990s, village leadership decided between making its yearly pension contributions or making a combination of service cuts and tax or fee hikes. The village made virtually no payments to its fire and police pensions in the years 2005-2006 and 2009-2011. The village blames operating deficits and volatile sales tax revenues – more than 70 percent of village revenues come from commerce fees and sales taxes – for forcing it to short its pension funds.

According to the village, if North Riverside had not reduced its pension contributions, it would have ended 12 of the last 15 budget years with a deficit, some of them quite large.

One major driver of the village's crisis has been the fact that the state repeatedly failed to reform how Illinois municipalities dole out government worker pensions. The state legislature sets the benefits that municipalities must pay with no regard to whether the city budget and taxpayers can afford them.

Time is running out for North Riverside. A new law taking effect in 2016 allows the state to redirect a municipality's funds if it fails to pay its required pension contributions. If the state takes nearly \$2 million from the village's \$12 million general fund budget in 2016 to pay the required pension contribution, the village may be forced to slash its public safety staff and services.

North Riverside would have ended 12 of the last 15 budget years with a deficit if full pension payment was made

General fund budget surplus (deficit)

Fiscal year	Budget surplus (deficit): under actual pension funding	Budget surplus (deficit): if full pension payment had been made
1999	48,698	(33,936)
2000	40,630	(149,239)
2001	22,148	(18,212)
2002	(784,266)	(879,725)
2003	(1,249,730)	(1,407,125)
2004	44,184	(378,669)
2005	(321,477)	(982,792)
2006	7,058	(761,205)
2007	9,884	405,639
2008	1,009,283	948,740
2009	(58,379)	(1,104,394)
2010**	1,474,239	386,341
2011	214,545	(1,226,329)
2012	698,038	(523,132)
2013	287,743	(799,910)

**** 2010 NOTE:** The General Fund posted a surplus of \$1,474,239 at year end only because of a \$2 million operating loan received and the debt proceeds were recorded as revenue. Without the operating loan proceeds, the Village would have posted a deficit of \$525,761 (no pension payments) and \$1,613,659 (with 100% pension payments)

The rating agencies have taken notice, with Moody's Investors Service recently downgrading North Riverside bonds three levels to Baa2. The village's rating now sits just two notches above junk bond status.⁷

North Riverside's budget crisis has been a long time in the making. Here's the story of how the village got to where it is today and how it plans to dig its way out.

■ North Riverside – the village

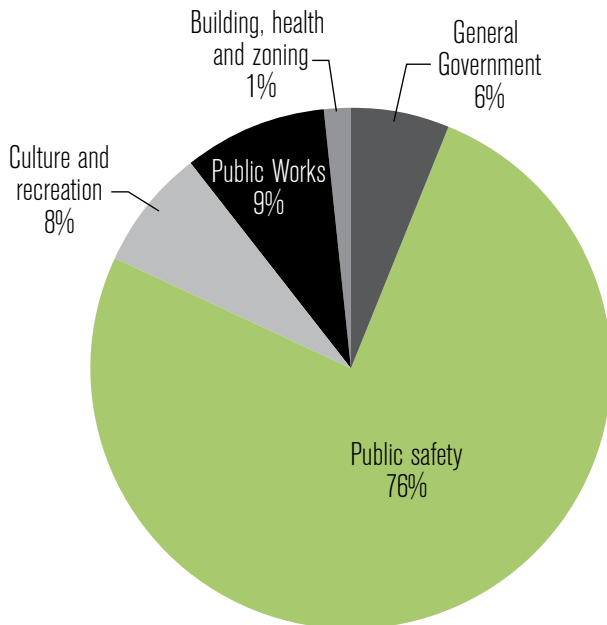
North Riverside is a small, non-home-rule village of 6,700 where male, full-time workers have a median income of \$45,528 and female, full-time workers earn \$42,073.⁸ The village relies heavily on commerce and entrepreneurs to fund the core services for the village's 1,800 families.⁹ Nearly 70 percent of the village's funding comes from sales taxes and commerce fees – the benefits of operating a large mall, a Costco and multiple other retailers and restaurants. North Riverside maintains occupancy levels of over 90 percent at its mall and other retail outlets.

The village supports a public safety force that consumes 75 percent of the city's general fund operating revenue – more than \$9 million of the village's \$12 million in general fund revenues goes toward its police, fire and ambulance services.¹⁰

■ Village in a budget bind

A quick look at the village's cost structure will show why the village is struggling to make its pension payments. Spending on public safety already consumes more than \$9 million dollars of the village general fund budget – or about 75 cents for every general fund dollar the village spends.¹²

Public safety consumes 75 percent of North Riverside's 2013 operating budget



Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013

That delicate balance between maintaining healthy revenues and providing public safety to preserve them is at the heart of the village's efforts to manage its costs and its labor force.

Village finances are in a precarious position. North Riverside's heavy dependence on large businesses and retailers exposes the village to lost income when a retailer leaves. The village lost one of its largest providers of tax revenue in 2012 when Edward Don, a restaurant supply company, left North Riverside after 41 years.¹¹

With labor costs making up the overwhelming share of the city's budget, it's unavoidable for village leaders to look at reforming overall compensation costs. And with pension costs making up nearly 95 percent of the village's \$1.9 million budget shortfall this year, pension benefits deserve the bulk of the attention.

Cutting current services to make room in the budget for increased pension payments could result in significant cuts to public safety. That's not something village officials want to do – it would put the city's commercial activity at risk – nor is it something taxpayers would likely support. When taxpayers and businesses are forced to pay more in local taxes to receive fewer and fewer services, they leave.

Raising revenues is also not an easy or sustainable proposition in North Riverside.

The village is not a home-rule community. That means a property tax hike large enough to cover pension costs would first need to be approved by voters via referendum. To cover the \$1.8 million increase in pension costs, voters would need quadruple their property taxes – which currently raise about \$490,000 in revenue each year.¹³

North Riverside has also maxed out its ability to increase its sales tax rate. The village sales tax rate is set at 1 percentage point above the rate levied by the state – the maximum allowed by law.

North Riverside's budget is already heavily reliant upon sales tax revenue. 70 percent of the village's budget comes from sales taxes and commerce fees. And the village's tax base is highly concentrated, with 10 taxpayers making up 45 percent of its equalized assessed value.¹⁴

10 taxpayers make up 45 percent of North Riverside's equalized assed value

Taxpayer	2013			2004		
	Taxable assessed value	Rank	Percentage of total village taxable assessed value	Taxable assessed value	Rank	Percentage of total village taxable assessed value
North Riverside Park Association	\$55,525,020	1	20.39%	\$25,402,822	1	9.70%
Tower Real estate	\$20,004,511	2	7.35%	\$8,360,000	2	3.19%
IG Riverside LLC	\$8,872,003	3	3.26%			
Sears	\$8,434,769	4	3.10%	\$5,345,748	5	2.04%
JC Penney Company	\$6,721,586	5	2.47%	\$6,755,965	3	2.58%
Edward Don & Company	\$5,569,866	6	2.05%	\$2,576,558	8	0.98%
Carson Pirie Scott	\$4,827,074	7	1.77%	\$5,317,197	4	2.03%
Sports Authority	\$4,278,026	8	1.57%			
7222 Cermak LLC	\$3,696,725	9	1.36%			
Riverside Golf Club	\$3,111,466	10	1.14%			
Riverside Association East				\$4,775,836	6	1.82%
MB Financial Bank				\$3,013,928	7	1.15%
Joe Rizza Ford				\$1,827,122	9	0.70%
S.M. Property Management				\$1,595,811	10	0.61%
Total	\$121,041,046		44.46%	\$64,970,987		24.80%

Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013

North Riverside Park Mall currently maintains a 98 percent occupancy rate and is a significant driver of revenue for the village. It's important for village officials to balance healthy revenues for the village with a low, competitive tax environment for its business community. A large company leaving North Riverside would have a significant impact on the village budget.

North Riverside has already seen it happen. Edward Don, a restaurant supply company, had been located in North Riverside for 41 years and was one of the village's largest

revenue generators. But in 2012, the company left North Riverside for the nearby village of Woodridge, Illinois – less than 20 miles outside of North Riverside.

A local tax increase would put North Riverside at risk of losing other major revenue generator.

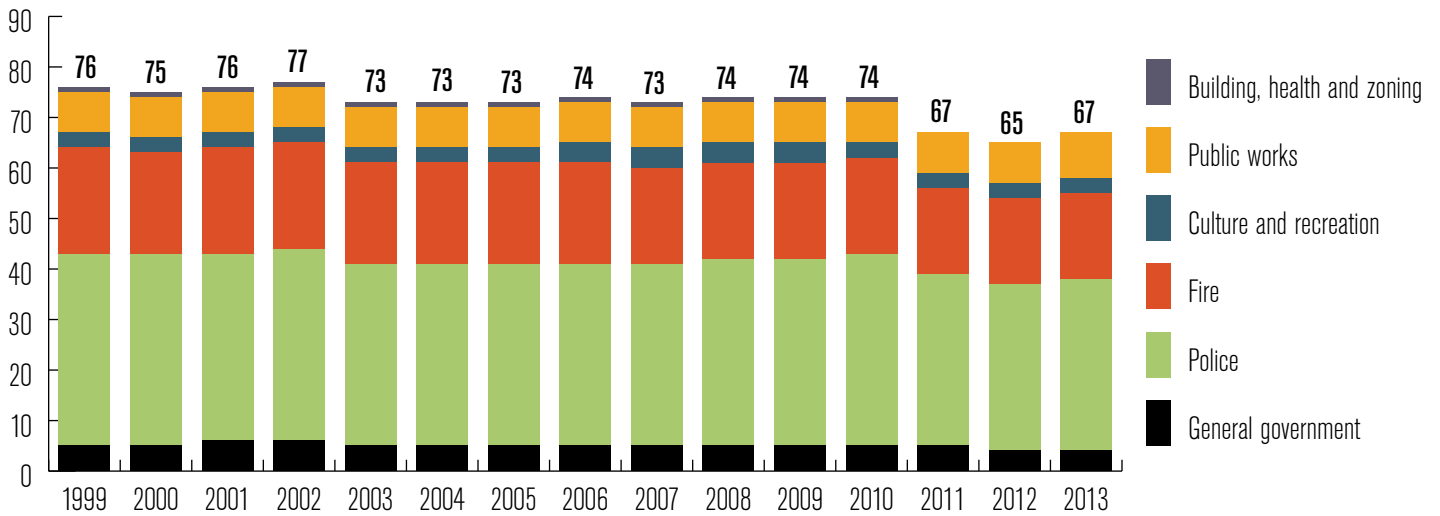
North Riverside has little choice but to focus on reining in its increasing pension costs.

■ Staff reductions and tax hikes

North Riverside has gradually reduced staff over the years to cut costs. The total number of village employees dropped to 67 in 2013 from its peak of 77 in 2002. Some of the reductions came from police and fire while other positions were eliminated or contracted out to a private company.

The village also passed a one percent “places for eating” tax which started in August 2010 and generated nearly \$340,000 in 2013.

North Riverside reduces village head count by 12 percent



Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013

■ North Riverside's pension crisis

North Riverside's pension crisis has worsened significantly during the last decade – its funding ratios have dropped, the amount the village should be paying into the pension systems has quadrupled and the pension system is close to having more retirees than active workers.

To put North Riverside's pension crisis into context, the village would have to completely shut down government for nearly two years and send every general fund dollar into the pension systems to get the funding level to where it should be today.

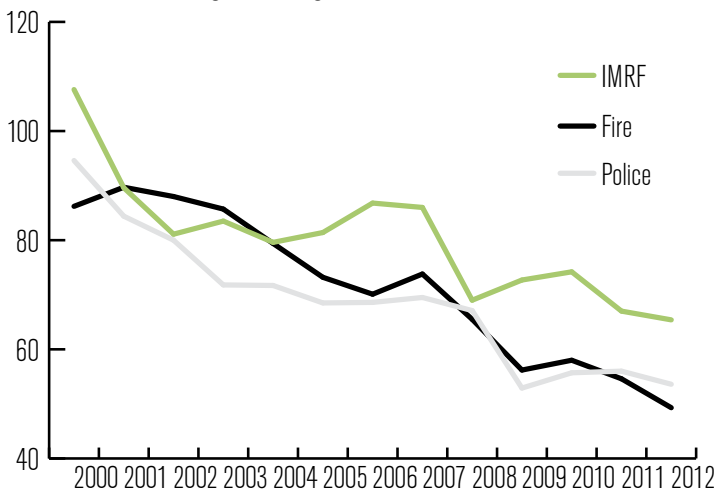
Additionally, a state law requires North Riverside to increase funding for its police and fire pensions. Starting in 2016, if the village fails to make the Annual Required Contribution, or ARC, the state comptroller can redirect state money away from North Riverside and use the funds to cover the pension shortfall. That means if the village does nothing, the state will force service cuts or higher taxes.

The city's three pension systems – covering police, firefighter and municipal workers (IMRF) – were relatively well funded in 2000. They had nearly 90 percent or more of the funding necessary to meet their future obligations.¹⁵

But by 2012, those percentages had collapsed. The police, fire and municipal worker pension systems had just 54, 49 and 65 percent of their required funds, respectively. The risk of one of those pension funds becoming insolvent has increased dramatically.

Funding levels of North Riverside pension funds collapse

Village funding ratios 2000 - 2012

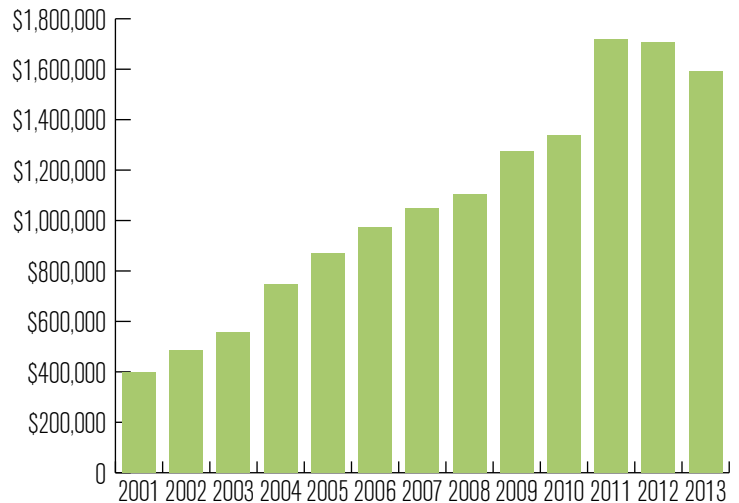


Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013

Several factors have contributed to the collapse, with the major driver being the rapid increase in the city's actuarially required contribution, or ARC. ARCs for cities across the state have jumped for the same reasons: stock market volatility, overly optimistic investment return expectations, changing actuarial assumptions and generous retirement benefits for government workers. In North Riverside, the village's required payments have quadrupled since 2001.

North Riverside's actuarially required pension contributions (ARC) quadrupled since 2001

ARC for police, fire and municipal worker pensions



Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013 and Freedom of Information Act request

Those increases have outstripped the city's ability to consistently make its required contributions. In several years, the city skipped its pension contributions entirely, while in others it only made partial payments. This has been the case for both the fire and police pension funds. In contrast, the municipal workers fund, IMRF, has been paid fully due to the funding process that ensures those pensions receive a priority.

Between 2009 and 2012, North Riverside paid just \$100,000 of the approximately \$2 million it was required to pay into its fire pension fund. In addition, the village paid just \$150,000 of the \$3 million it was required to contribute to its police pension fund during that same time period.¹⁶

North Riverside fails to make required pension contributions

City contributions vs. actuarially required contributions (ARC)

Year	Village pension contributions			Actuarially required funding			Funding surplus (shortfall)	Percent of required contribution paid
	IMRF	Police	Fire	IMRF	Police	Fire		
2000	\$100,896	\$0	\$0	\$100,896	\$103,338	\$119,390	(\$222,728)	31.2%
2001	\$93,548	\$103,338	\$119,390	\$93,548	\$144,143	\$159,750	(\$81,165)	79.6%
2002	\$85,267	\$144,268	\$159,750	\$85,267	\$239,780	\$159,697	(\$95,459)	80.3%
2003	\$94,966	\$144,143	\$159,697	\$94,996	\$285,442	\$175,793	(\$157,425)	71.7%
2004	\$164,476	\$99,905	\$61,528	\$164,476	\$379,791	\$204,495	(\$422,853)	43.5%
2005	\$209,278	\$0	\$0	\$209,278	\$406,110	\$255,205	(\$661,315)	24.0%
2006	\$203,375	\$0	\$0	\$203,375	\$474,683	\$293,580	(\$768,263)	20.9%
2007	\$216,570	\$756,705	\$472,163	\$216,570	\$500,252	\$332,861	\$395,755	137.7%
2008	\$238,227	\$473,266	\$332,861	\$238,227	\$539,281	\$327,389	(\$60,543)	94.5%
2009	\$226,844	\$0	\$0	\$226,844	\$617,755	\$428,260	(\$1,046,015)	17.8%
2010	\$239,098	\$0	\$0	\$249,628	\$643,353	\$444,545	(\$1,098,428)	17.9%
2011	\$253,577	\$0	\$0	\$276,741	\$896,875	\$543,999	(\$1,464,038)	14.8%
2012	\$228,901	\$150,000	\$100,000	\$233,913	\$921,789	\$549,381	(\$1,226,182)	28.1%
2013	\$255,118	\$150,000	\$100,000	\$255,118	\$823,076	\$514,577	(\$1,087,653)	31.7%

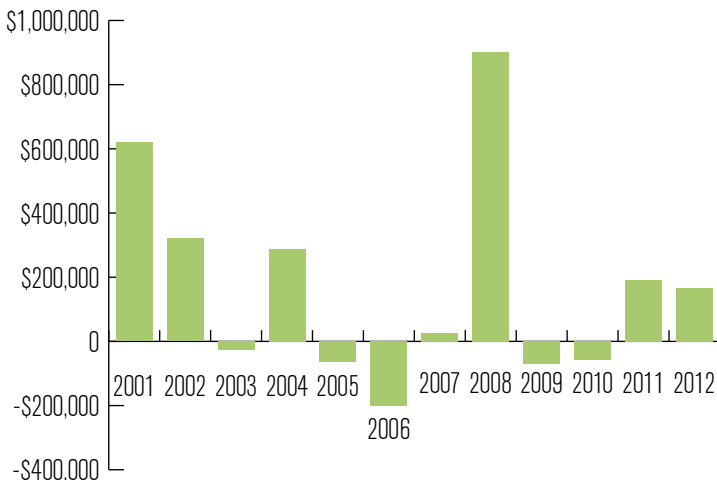
Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013 and Freedom of Information Act request

Those underpayments have contributed to the village's increasing pension shortfall. But there's more to the story than underfunding. Consider the case of IMRF, where the village has consistently made its full yearly pension contributions, the village's unfunded liability has nearly tripled to \$1.8 million since 2004. The yearly change in that unfunded amount is volatile and dependent on a host of other factors, as mentioned above.

Another factor impacting the health of North Riverside's pension funds is the increase in the number of North Riverside government retirees relative to the number of active employees.

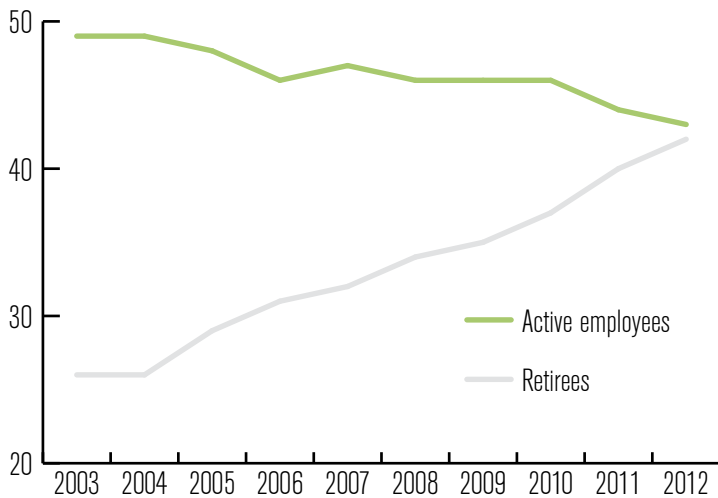
In North Riverside, the ratio of active police and fire employees who contribute into the pension systems vs. retirees who draw benefits from them has collapsed. In 2003, the village had nearly two active police and fire employees for every retiree drawing a pension check. Today, that village has just one active employee for every retiree, meaning that without real pension reform, more pressure to fund the pension shortfall will fall on active employees and taxpayers.

Yearly changes in North Riverside's IMRF unfunded liability



Source: Source: Village of North Riverside, Comprehensive Annual Financial Report for the year ending April 30, 2013

Number of North Riverside retirees jumps: puts more pressure to fund pensions on actives and taxpayers



Source: Illinois Department of Insurance

If this trend continues, the pension plans will be nothing more than Ponzi scheme, with no one left to put in more money.

Another stark reality is that government-employee benefits have grown to levels that are no longer sustainable and affordable for most cities and their taxpayers.

North Riverside's 12 firefighters make an average salary of more than \$80,000 a year – overtime pushes them over \$100,000. Their four lieutenants make \$100,000 on average and overtime pushes their total salary to nearly \$118,000.¹⁷

And since firefighters can retire in their 50s with 75 percent of their final pay, these government workers are able to take home multimillion dollar retirement packages during their retirement lifetime.

It's important to note that the village's firefighters have done nothing wrong. They've simply benefited from lucrative contract negotiations that offer overly generous retirements. But North Riverside taxpayers can no longer afford them. It's unfair to ask North Riverside residents, where male full-time workers had a median income of \$45,528 and females just \$42,073, to pay higher taxes for generous government retirements.¹⁸

It's also difficult for a village to budget, knowing that companies and people can leave if taxes rise too high or services are cut to pay for government-worker retirement costs.

The solution

North Riverside proposed an innovative way to implement 401(k)-style pension reform without the approval of the General Assembly. North Riverside plans to move its entire fire department to a private provider of fire services – a private provider with a 401(k)-style retirement plan. This move would save the village more than \$700,000 a year.

Under the proposal, North Riverside's current firefighters would:

- Keep their current job under the new employer
- Receive the same salary they're receiving today
- Retain their already-earned pension benefits
- Be given ownership and control of their own retirement plans going forward

The driver of the savings from contracting fire protection services with a private provider would come from taking politicians out of the retirement business and giving firefighters control and ownership over their own retirement future.

Instead of participating in the current defined-benefit system – which is nearing insolvency – firefighters would participate in a self-managed 401(k)-style retirement plan through their new employer. This would eliminate North Riverside's requirement to pay for ballooning pension costs going forward and give firefighters a retirement they can control and count on. Additional savings would also be had through reducing costs associated with overtime and workers' compensation.

But contracting services with a private provider isn't a new concept in North Riverside or other communities in Illinois. Nearly 30 years ago, the village signed a contract with a private provider for the village's ambulance services.

The villages of Lincolnwood and Barrington, Illinois, each have contracts with private-sector providers of fire protection services.

Lincolnwood switched to a private provider of fire protection services in 1990. The village purchased all the fire equipment and trucks for the private provider, and the private provider operated out of the same village facilities the public fire department had used until a new fire station was complete a year later.

At the time of the switch, Lincolnwood's new fire chief, Earl Field, said the fire department's 27 members would all be certified as firefighters and paramedics, with at least two to three years of experience.¹⁹ According to Field, Lincolnwood's fire department follows safety procedures recommended by the National Fire Protection Association and meets the state fire marshal's minimum requirements – including training at a state-certified fire academy and meeting standards for equipment, buildings and firefighting procedures.

Contracting fire protection services with a private provider is a good start toward a more stable future for North Riverside, its taxpayers and its government workers. But the village should

also continue to evaluate the city's current services.

For instance, North Riverside currently shares its fire services with neighboring communities. North Riverside firefighters responded to about 1,100 fire calls in North Riverside during the last four years – seven of those calls were actual fires. Outside of the village, North Riverside firefighters responded to about 1,900 fire calls during the last four years – 139 of which were actual fires.²⁰

North Riverside should examine whether or not it needs to maintain the current level of fire services it provides and determine the best fit for the village and its residents.

Contracting fire services to a private company is a good first step in reducing costs for North Riverside. But the costs of career firefighters will still be a significant expense for the village going forward.

Village officials should evaluate North Riverside's need to have a fire department of career firefighters. Most fire departments

in Illinois are either all volunteer or have a combination of career and volunteer firefighters. The training is similar but volunteer firefighters often only act on an on-call basis and some are paid based on their time spent on the scene working rather than the salaries that career fire fighters are paid.

Of Illinois' 1,081 fire departments:²¹

- 66.8 percent are all volunteer
- 14.6 percent are mostly volunteer
- 6.7 percent are mostly career
- 11.8 percent are all career

The long-term goal should be to maintain a level of safety that best fits the village of North Riverside and its residents. Depending on the village dynamics, it may be in the village's best interest to incorporate volunteer firefighters into the department going forward.

■ Why it works

Increasing pension costs are the single largest driver of North Riverside's budget crisis. Village officials are limited in their ability to reform the current pension system. Draining reserves and cutting services will only go so far. And taxes are already pushed to the limit.

Contracting fire protection services with a private provider is one of the few sustainable solutions that village officials can act on immediately – without waiting for the state to reform pensions.

This reform would mean the current level of safety would be maintained. North Riverside firefighters will be able to keep

their current jobs, their salaries will be maintained and going forward, they'll be given ownership and control over their own retirement accounts with 401(k)-style contracts through the private provider.

The reform will protect taxpayers from higher taxes and cuts in services to fund ever-increasing pension costs. And contracting fire protection services with a private provider will help end the cycle of credit downgrades and set the foundation for a positive outlook and a North Riverside turnaround.

Endnotes

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