City of Chicago

Pension discussion

March/April 2014

Draft

How the Municipal and Laborers pension funds work (1/2)

Key terms, definitions, and how they relate under current law

- During their working career, employees contribute into the funds a set % of each paycheck, known as the **employee contribution %**, into the pension fund (8.5% for Municipal and Laborers).

- The City then puts in an amount of money into the fund based on the employees contribution – this is the City's **multiplier contribution** (1.25 : 1 for Municipal, 1 : 1 for Laborers).

- Together, these two contributions "fund the fund" (put money into the funds' investment account).

- A common alternative to multiplier funding is "ARC" ("Actuarially Required Contribution") funding. ARC funding determines the a municipality or state's funding requirement through an actuarial calculation of the amount needed to reach a certain target by a certain time (e.g. 90% funding by 2054). No City of Chicago employee fund has ever been on ARC funding before.

- Once an employee retirees, they get an **annuity** (their pension checks) and a **COLA ("Cost-of-living adjustment)**. Currently, both funds have COLAs of 3% compounded -- meaning their annuity goes up 3% each year and then 3% of that new number the year after that. Because of current COLAs, employees who retire with maximum pensions will often make more in their yearly annuity than they did from yearly salary by their 8th year of COLA. Adding up all future employee benefits allows you to calculate a funds' **actuarial liability.**

How the Municipal and Laborers pension funds work (2/2)

Key terms, definitions, and how they relate under current law

- The % of money the fund has vs. what the fund will need for future benefits is called its **funded ratio** (Currently 38% for Municipal, 58% for Laborers).

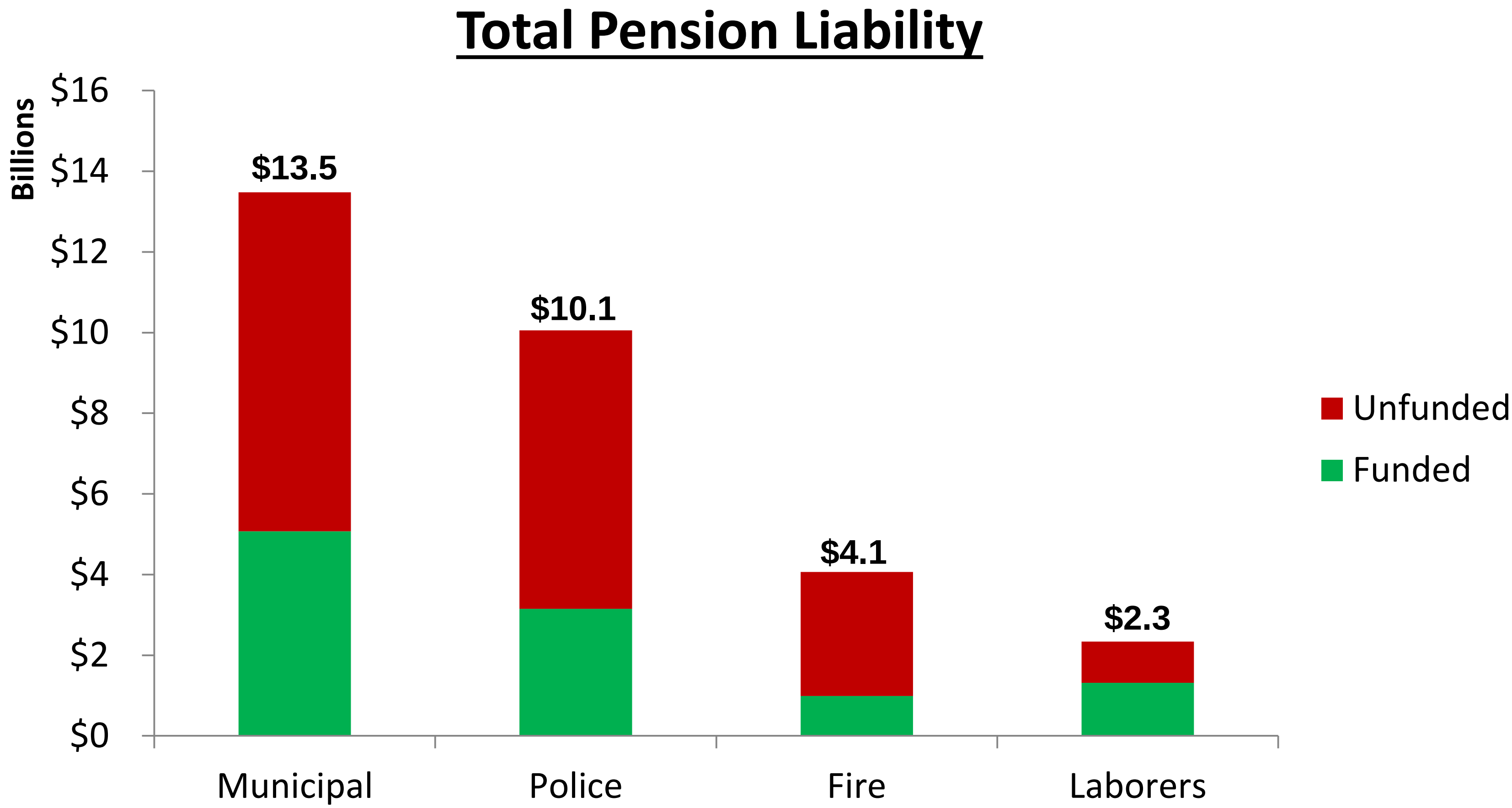
- The funds calculate how much money they'll need in the future using a **rate of return** they believe their investment accounts will bring in every year (7.5% for both funds, reduced from a previous 8.0%).

- Any amount of funding missing below a funded ratio of 100% is called the **unfunded liability** (Currently, Municipal has $8.4 billion in unfunded liability and Laborers has $1.0 billion).

- Because the unfunded liability is money that's not in the fund's investment account return 7.5% interest each year, **every year the fund has significant unfunded liabilities, the fund loses more money.**

- All changes to the pension fund are **governed by State law.**

Background on City employee pension funds

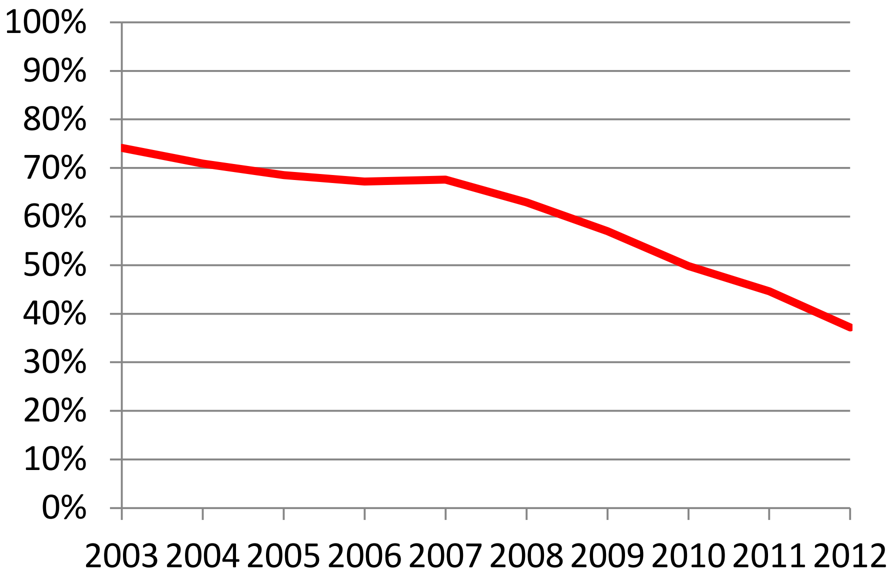


	Municipal	Police	Fire	Laborers
Actives	**31,326**	**12,026**	**4,740**	**2,865**
Retirees	**19,614**	**12,966**	**2,821**	**2,737**
Unfunded Liability ($B)	**$8.4**	**$6.9**	**$3.1**	**$1.0**

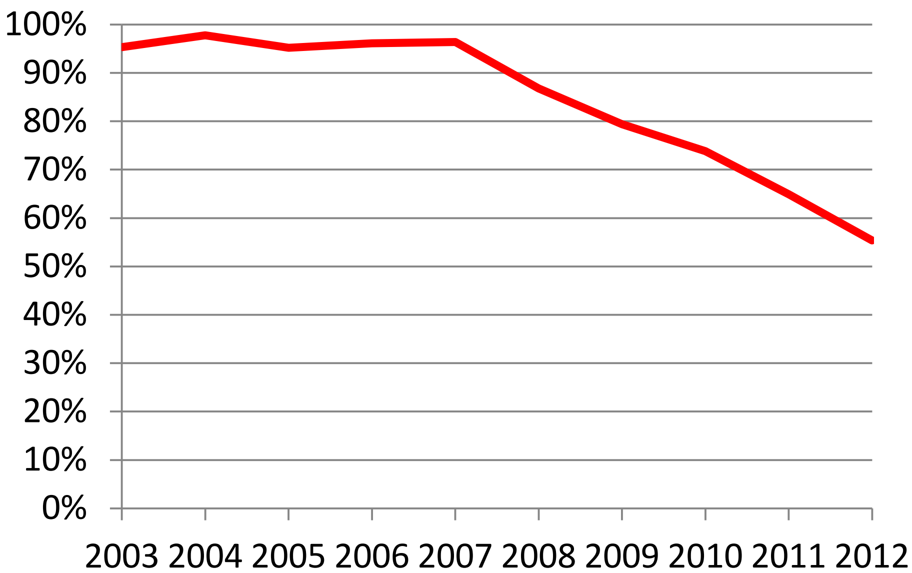
Note: All information current as of each pension fund's 2012 Annual reports using actuarial values for liability

The Municipal and Laborers' funds have fallen significantly over the last 10 years

Municipal fund



Laborers fund

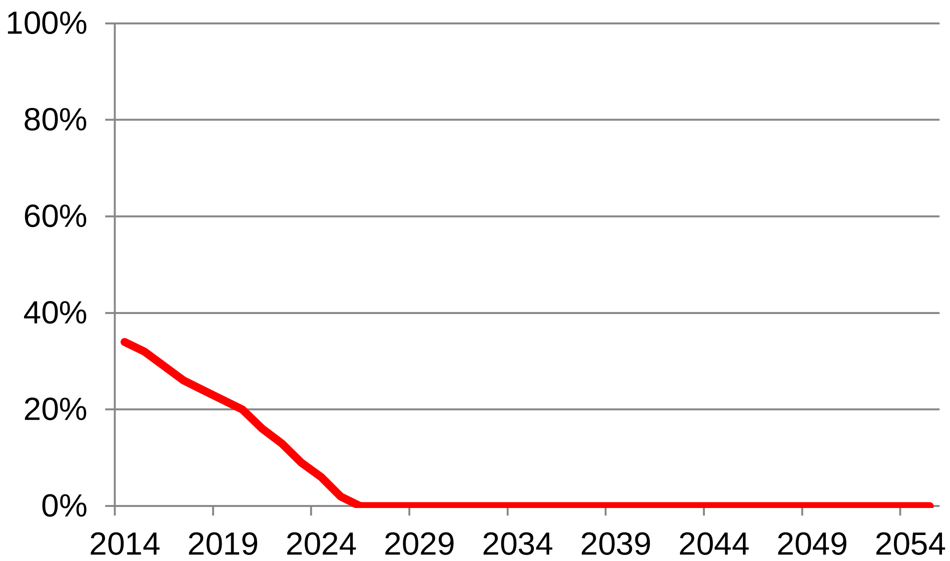


How did this happen?

- **Benefit and funding levels did not mathematically match up:** As more benefits were added, including adding a compounded COLA in the late 1990s to both funds, the funding and benefit levels didn't mathematically fit – exposing the funds to significant risk in tough times.
- **Market losses:** The Great Recession and dot-com crash significantly affected funds market returns.
- **No "ARC" funding plan:** Because both funds were on "multiplier" funding plans and not ARC funding plans, funding did not automatically adjust as market returns fell or benefits increased.
- **Not confronting the hard truth:** As both funds continued to go without reform and funding solutions, their funding ratios began to fall very rapidly

The Municipal & Laborers' funds will both be insolvent within 9-17 years without decisive action

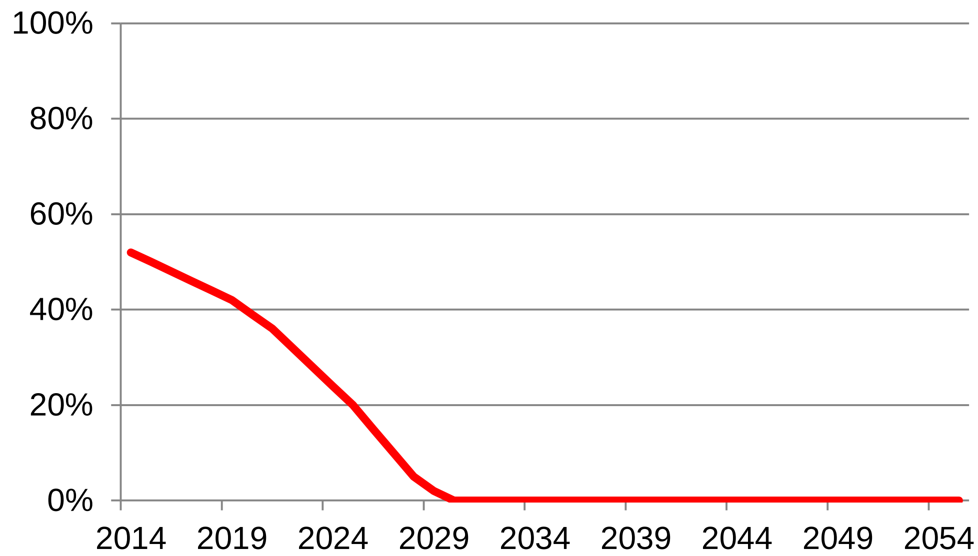
Municipal fund



- Current market value of assets: 38%
- Current # of active employees: 31,326
- Current # of retirees: 19,614

Potential total insolvency range:
2023 - 2027

Laborers fund



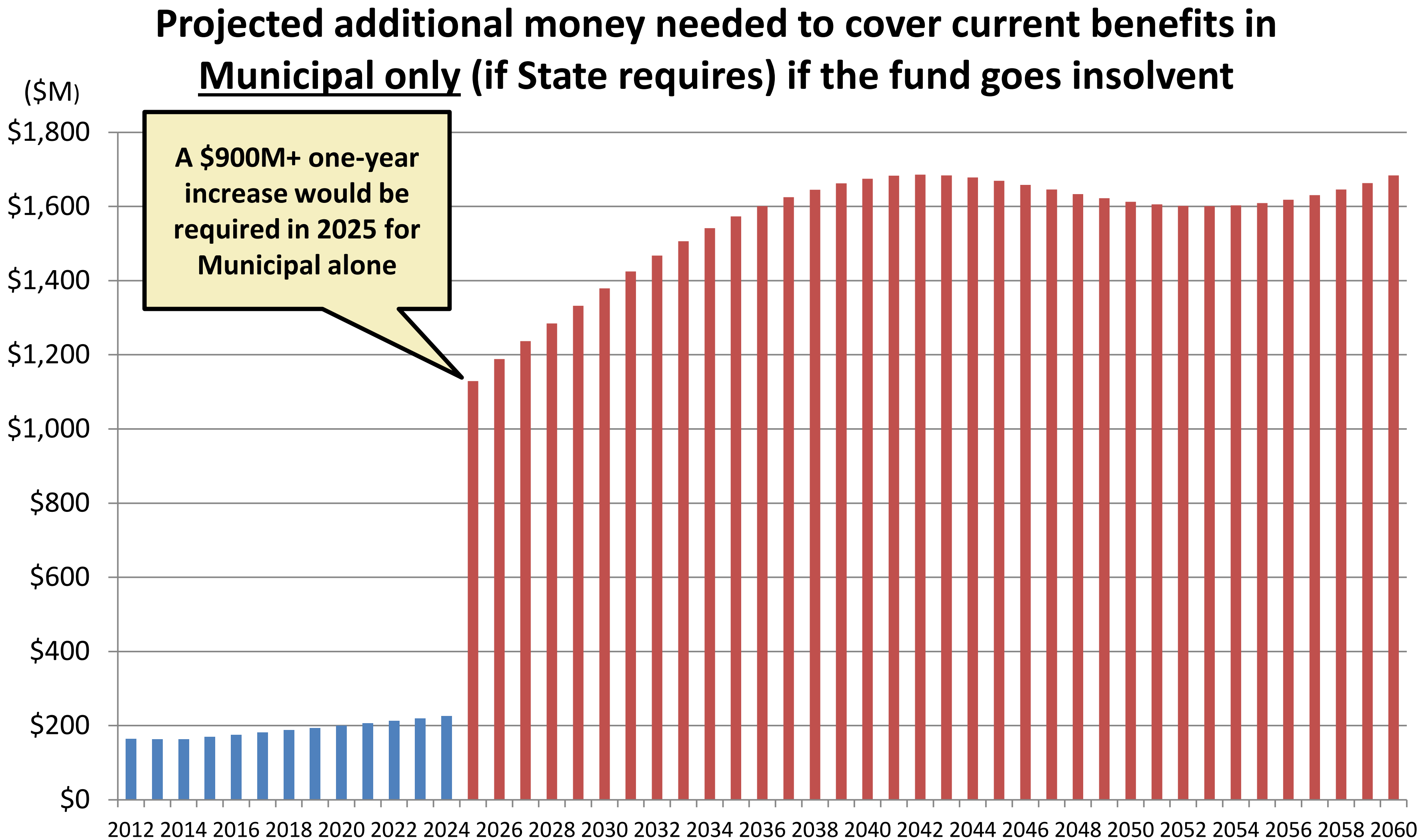
- Current market value of assets: 58%
- Current # of active employees: 2,865
- Current # of retirees: 2,737

Potential total insolvency range:
2024 - 2031

The funds will reach a point of no return several years before insolvency

Note: Insolvency ranges calculated by running scenarios with 2-8% yearly rates of return

If no action is taken, <u>the funds will go insolvent</u> and Municipal alone will require a $900M+ 1 year increase

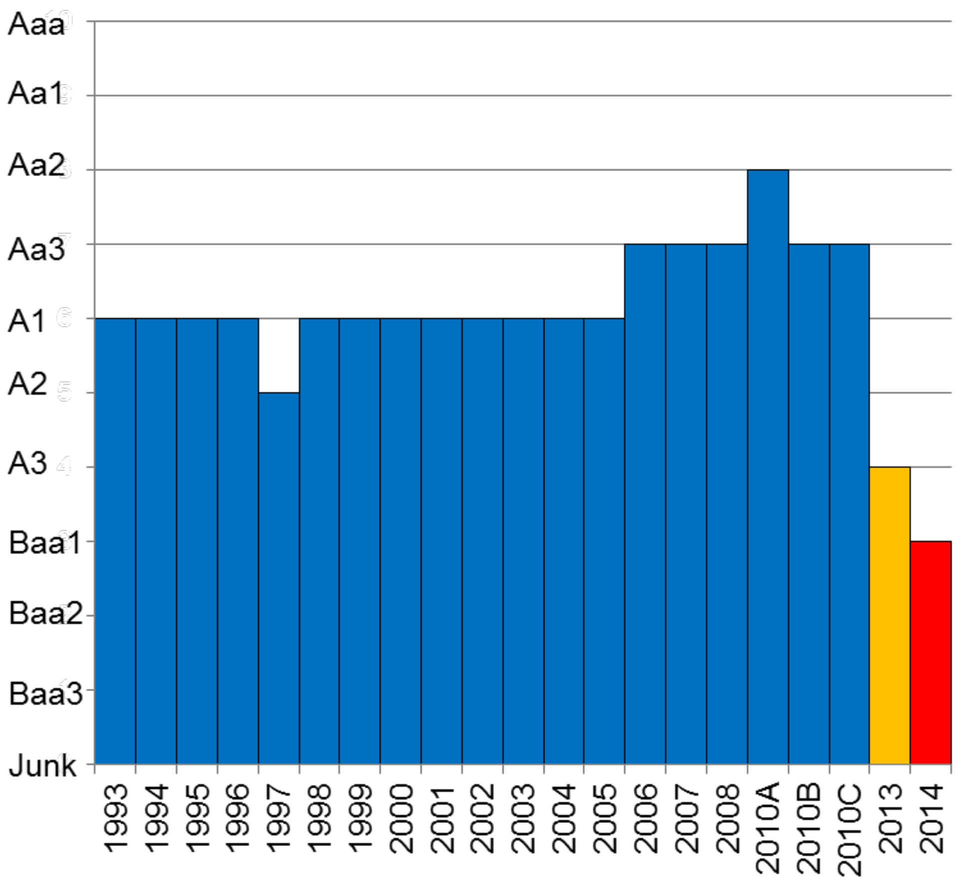


The longer we wait to act, the more difficult it will be to pay pensions

Note: The Laborers' fund has a very similar trajectory at a correspondingly smaller scale

These large legacy pension liabilities are battering the City's credit rating

Moody's City of Chicago rating history	Potential consequences of further ratings downgrade



- Increased interest rate will hit City budget immediately, as the City will have to pay more in each budget to service debt
- Ability to invest in needed maintenance and improvement to aging City infrastructure is significantly challenged, including neighborhood investment like paving and road repair, streetlight maintenance, and water/sewer projects

"The Baa1 rating on Chicago's GO debt reflects the city's massive and growing unfunded pension liabilities, which threaten the city's fiscal solvency"

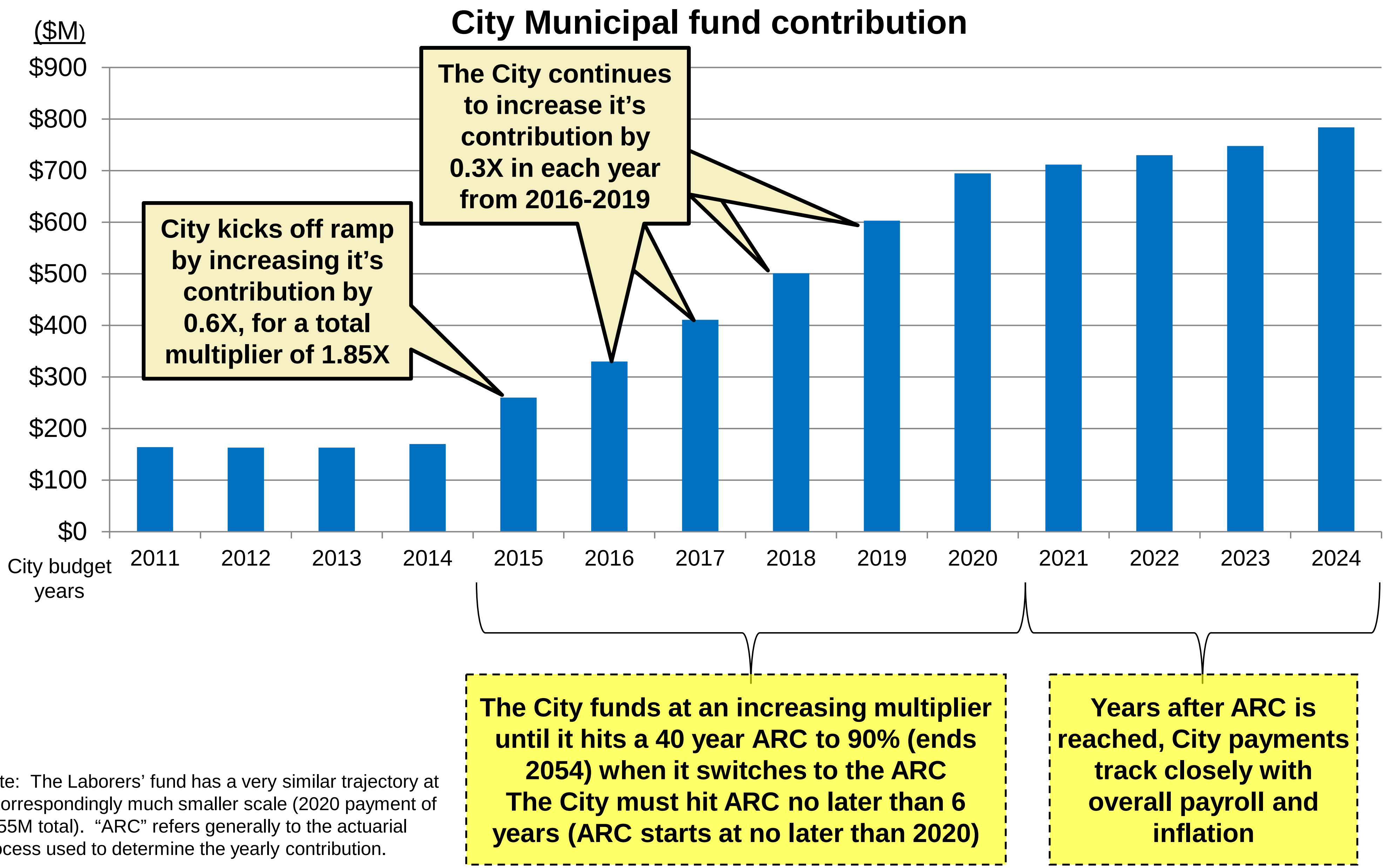
- Moody's

Proposed plan: Reforms to employee contributions and retiree benefits

Current		Proposed
COLA rate (Tier 1): 3%, compounded	→	**COLA rate (Tier 1):** 3% or 50% CPI (whichever is less), simple
COLA pause years: None	→	**COLA pause years:** 2017, 2019, and 2025
COLA delays: Varies for Tier 1 & Tier 2, delayed until Jan 1 at least	→	**COLA delays:** 1 additional year delay for both Tier 1 and Tier 2
Retirement age: 50-60 for Tier 1* dependent on years of service, 67 for Tier 2	→	**Retirement age:** No change for Tier 1, reduced to 65 for Tier 2
Employee contributions: 8.5% of payroll	→	**Employee contributions:** ½% increases in 2015-19 for total increase of a 2.5%, and total of 11%

*Current average retirement age is 62 for the Municipal fund and 60 for the Laborers' fund

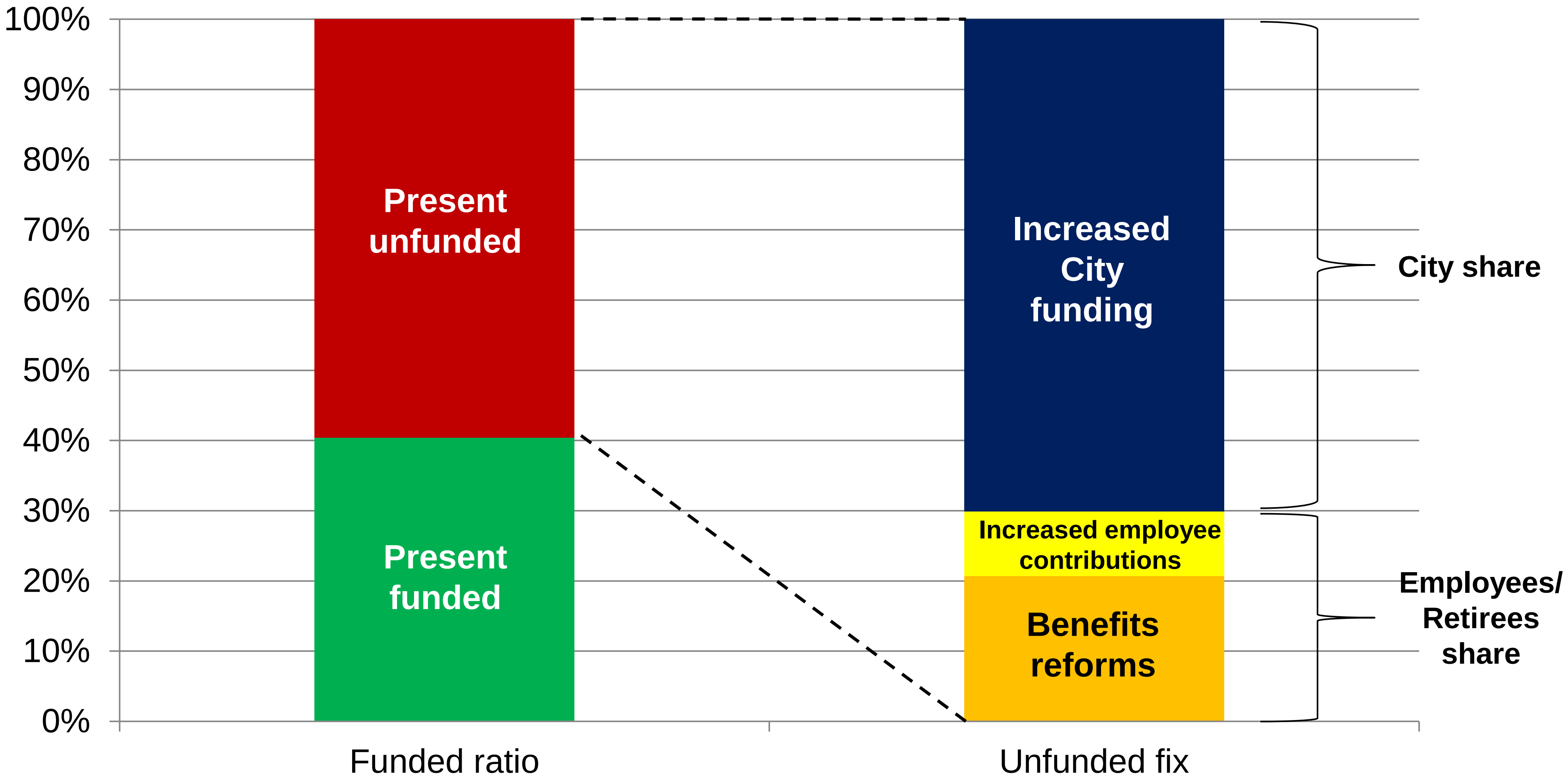
Proposed plan: Multiplier-based ramp to ARC to increase funding and protect taxpayers



Note: The Laborers' fund has a very similar trajectory at a correspondingly much smaller scale (2020 payment of ~$55M total). "ARC" refers generally to the actuarial process used to determine the yearly contribution.

Solution to address unfunded liability of Municipal and Laborers funds over 40 year stabilization plan

Employees, retirees, and the City will share the burden of a 40 year ARC to 90% funding

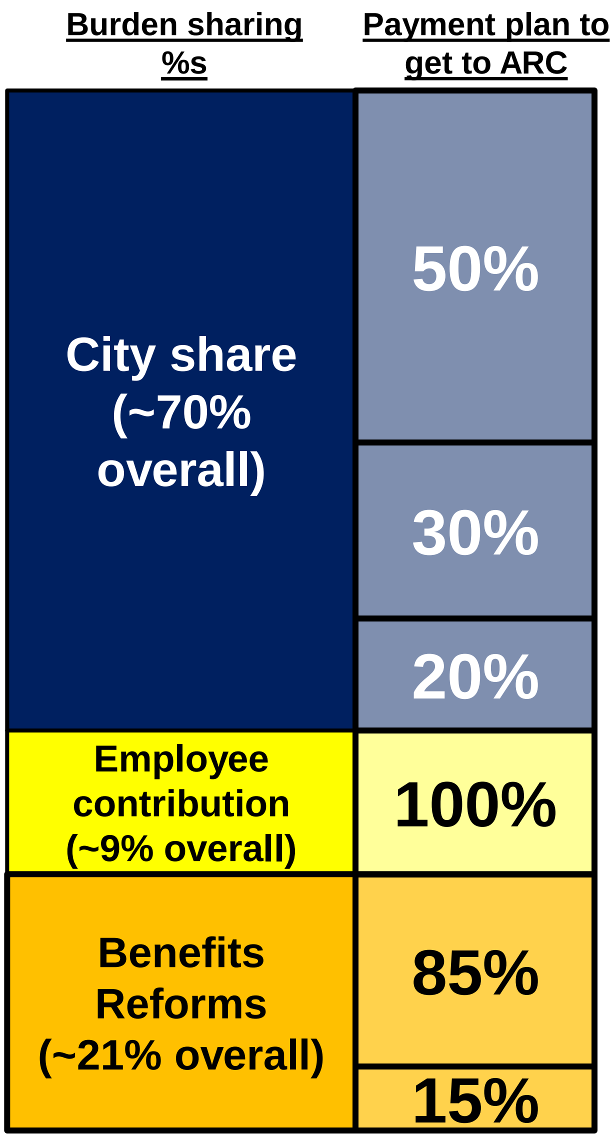


Note: Source of additional funding calculated in present discounted value using a 7.5% discount rate. A cash basis calculation leads to a very similar split (less than 1-2% differential). Sources of additional funding could change based on market returns

* "Increased total funding" refers to funding above and beyond the currently scheduled baseline (based on the current 1.25 and 1.00 multiplier)

Employees, retirees, & the City will share the burden of getting to ARC funding in the next 5-6 years

Planned sources of payment



- **Half of the yearly increase** from 2015-2020 will be provided through property tax increases starting in 2015 that would be approximately $50 for the average homeowner
- ~30% of the City's contribution will be paid by **appropriately allocating increased pension costs to enterprise funds** (Aviation & Water) based on their proportional share of employees
- ~20% will be paid for with **retiree health care savings**, budget savings, and other budget efficiencies
- The average employee in these two funds will pay **~$300 more a year in additional contributions** to the funds starting in 2015, and continuing in 2016 - 2019
- COLA change from **3% compounded to the lesser of 3% or 50% CPI simple**
- **COLA pause years in 2017, 2019, and 2025** and an additional 1 year COLA delay

Conclusion

Summary

After **months of discussions with its partners in labor, the City of Chicago is introducing legislation** (Senate Bill 1922) that will reform the Municipal and Laborers pension funds and ensure long-term sustainability for both funds.

- The plan strikes **the right balance of reform and revenue**, and serves as an honest framework in which everybody gives something, so that no one has to give everything
- It is a balanced solution resulting in a retirement system that is both affordable to taxpayers and that is solvent and secure for the City retirees of today and tomorrow, **providing certainty for everyone.**

The proposed legislation:

- **Provides a long-term solution to cut in half the City's pension crisis:** By reforming the City's largest pension fund (the Municipal Fund), which also has the largest unfunded liability, as well as the Laborers' Fund, the City has fixed 53% of its pension liabilities.
- **Ensures the solvency of the pension funds now and for the long-term:** This deal ensures an aggressive ramp to a 40-year Actuarially Required Contribution (ARC) that quickly stabilizes the funds off their current downward trajectory over a period of five years, and grows them to funding health on an actuarially guaranteed pace.
- **Provides retirement security for the workers:** Instead of facing a fund without money to pay pensions in the next decade, this deal guarantees retirement security for all City workers and retirees.
- **Provides certainty for taxpayers:** Instead of paying into a broken system that was headed toward insolvency, taxpayers will face modest tax increases over the next five years that will ensure the problem is fixed.
- **Includes reform <u>and</u> revenue:** As the Mayor has said repeatedly, the City would only consider additional revenue if real, substantial reform was put on the table. This proposal accomplishes that.