Overview of the Firemen's Annuity and Benefit Fund & the Policemen's Annuity and Benefit Fund of Chicago

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Unfunded Pensions

Funding city pensions is the single most pressing fiscal issue facing the City of Chicago and its taxpayers. In fact, Chicago has more total pension debt than 44 U.S. states.[i] Governor J.B. Pritzker signed a measure (HB2451) to boost the annual cost of living ensuring that all retired Chicago firefighters receive a 3% annual cost-of-living boost, regardless of whether they were born before or after January 1966.[ii] This appeared to escalate the pension problem, but Gov. Pritzker indicated the city will be able to pay its pension bill with the sale of the Thompson Center.

Chicago ranks second highest in debt per taxpayer behind New York City.[iii] The financial woe in Chicago comes in large part from out-of-control pension promises. Mayor Rahm Emmanuel passed the largest property tax hike and said it would put pension funds on a path to pension stability. The fiscal impact created by the pension shortfalls and further tightening of available funding because of the impact of the pandemic should highlight the need for necessary pension reforms

According to the fiscal watchdog, Truth in Accounting Chicago was given a grade “F” due to the high debt driven by unsustainable pension costs, the Financial State of the Cities report indicated the cost of debt translates to $43,100 for each taxpayer in the City of Chicago. Pension costs are having an adverse effect on public finance in Chicago. The pensions are only 34% funded overall therefore they have 34 cents saved for every $1 of future commitments. The pension problem has created a cyclical problem increasing taxpayer costs and decreasing service quality.

Taxpayers are asked to pay more for water, sewer use, rideshares, taxes, fines, and fees. Increasing spending amounts on pension debt translates into fewer dollars for residents’ programs and services. The state law requires that the city’s pensions must be funded at a 90% level by 2045 helped increase the city’s deficit. It means further tax and fee hikes; this is not good for a city already struggling with issues related to the pandemic, public safety issues and changing demographics.

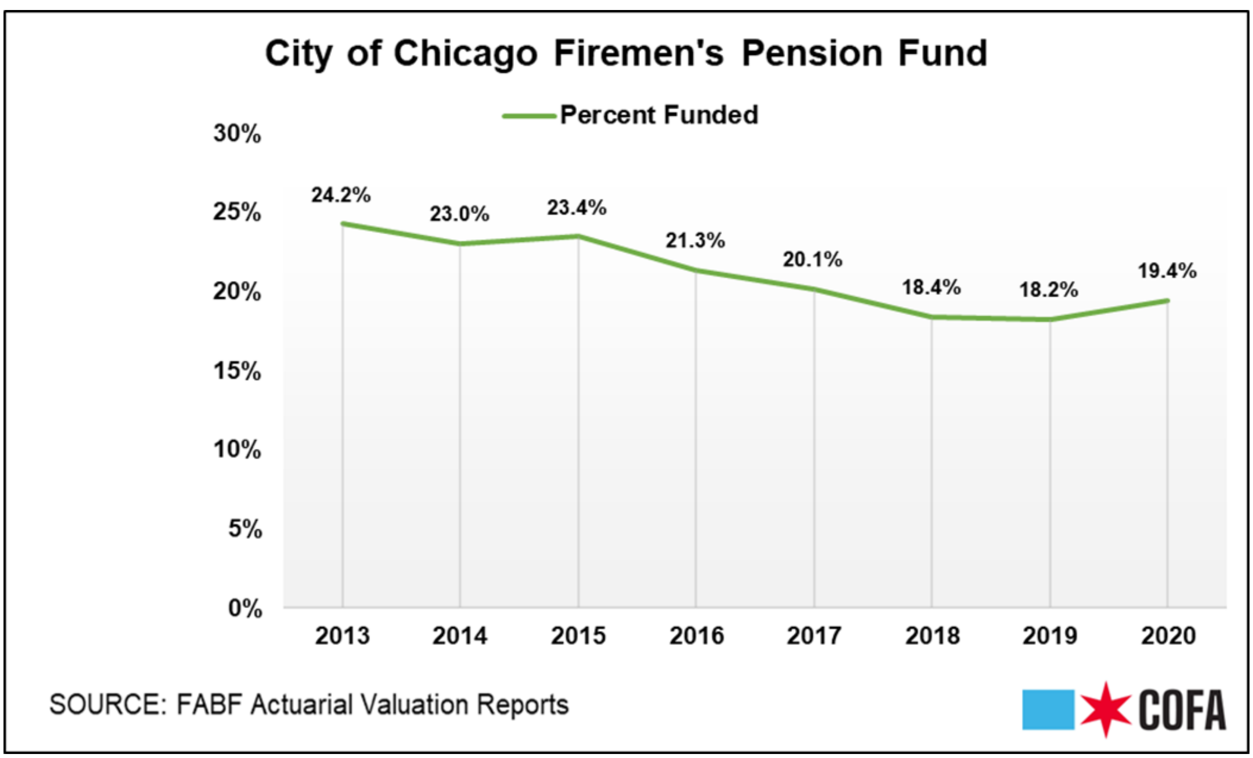
Beginning in tax levy year 2020, the city shall levy an annual tax that will increase the funding ratio to 90% by 2055. The city is currently pushing for a casino in Chicago with plans to dedicate tax revenue from gaming proceeds to police and fire pensions. The casino will certainly provide additional revenue for the underfunded pension funds. The casino coupled with the tax levy may position Chicago to have a fund rate of 90% for pensions by 2045. This will need to be tracked closely to ensure the pension is funded, if not the pension problem may require structural reform.

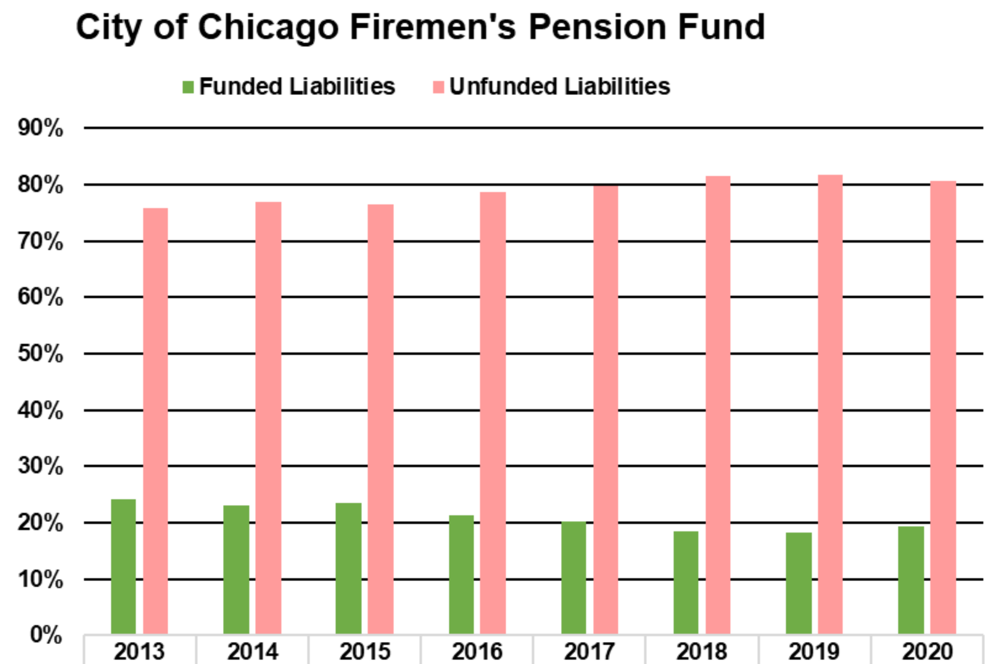
In 2013 Gov. Pat Quin signed into law Public Act 99-0599, this was an effort to address the pension problem by reforming future pension growth.[iv] This was blocked by the Illinois Supreme Court in 2015. The reforms in PA 99-0599 were not a panacea but would have provided a roadmap for addressing the pension unfunded problem. We should revisit amending the constitution to fix the pension issue.

The unsustainable nature of the city's pension obligations dictates a need for pension restructuring possibly a constitutional amendment. With the possibility of a casino and the tax levy there may not be a need for restructuring. If Chicago does get a casino the funds used for the pension must be restricted. We have a possible roadmap with restricted casino funding and tax levy funding, tracking and implementation is key to the city successfully reaching the 90% funding of pensions by 2055. it is important for our fiscal viability to restore Chicago's financial position.

The Firemen's Annuity and Benefit Fund of Chicago

The most recent data on the Firefighters' pension according to the annual Actuarial Valuation and Review as of December 31, 2020, has a fund rate of 19.4%.[v] According to the Firemen's Annuity & Benefit Fund (FABF) the pension is funded by employer and member contributions in accordance with the Illinois Pension Code (40 ILCS 5/4). The FABF is seriously underfunded. The funded ratio is 19.4% using the fair value of assets, and the unfunded actuarial accrued liability is $5.3 billion as of December 31, 2020. Therefore, the most recent data suggest the FABF has about 19 cents saved up to cover every $1 in existing promises. The chart below shows historically the funded rate for the Fire pension from fiscal years 2013 to 2020—graphically you can see how the fund rate dips each year, but slightly increased in fiscal year 2020. The second graph highlights the fund rate but more importantly the percentage that remains unfunded.

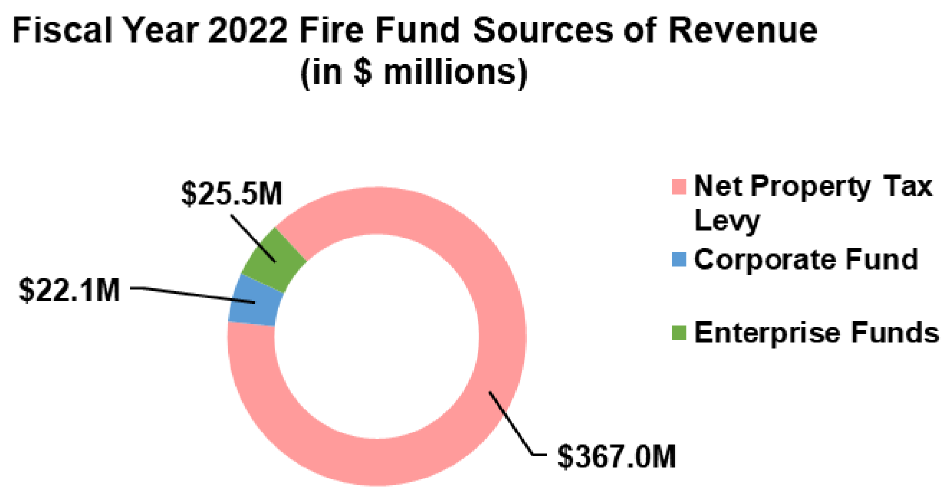




	2013	2014	2015	2016	2017	2018	2019	2020
Funded Liabilities	24.2%	23.0%	23.4%	21.3%	20.1%	18.4%	18.2%	19.4%
Unfunded Liabilities	75.8%	77.0%	76.6%	78.7%	79.9%	81.6%	81.8%	80.6%

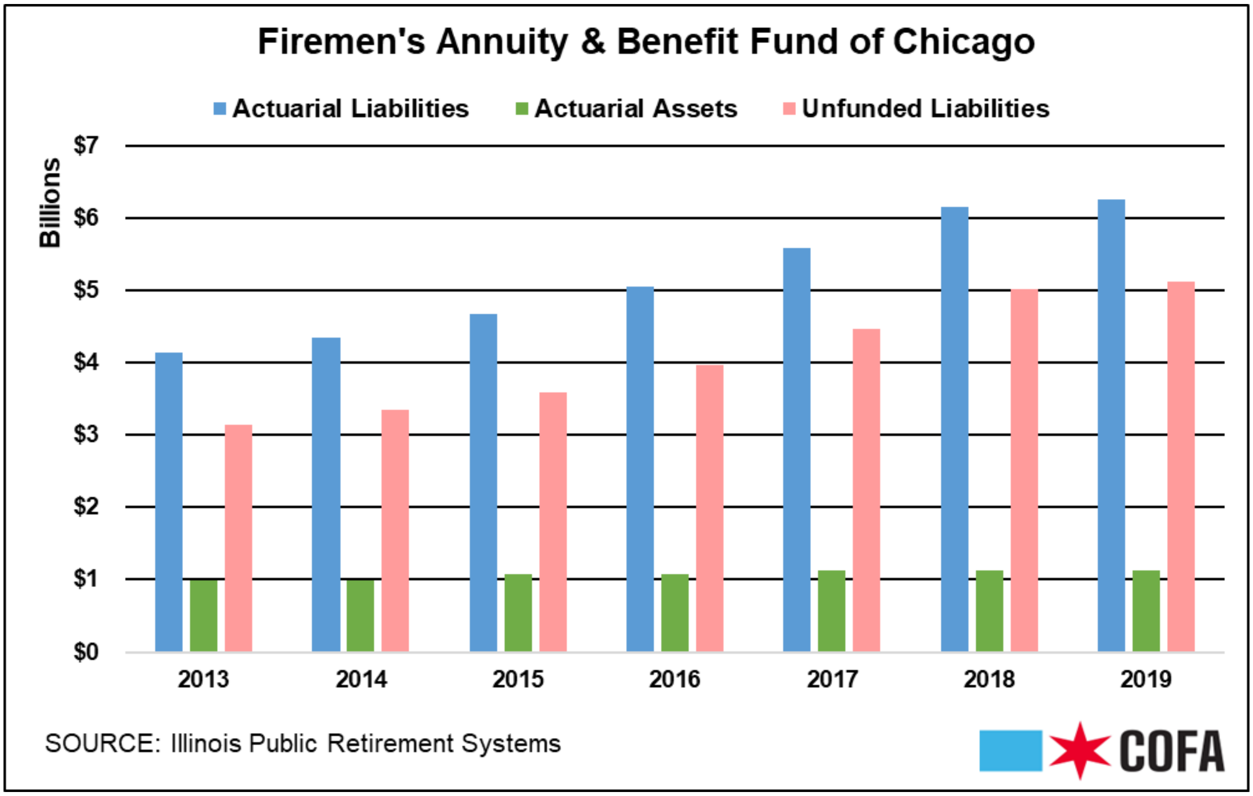
SOURCE: FABF Actuarial Valuation Reports

The City of Chicago uses several revenue sources for pension contributions; the chart shows a breakdown of sources used for the Fire fund. The property tax is the single largest source of revenue for pensions.



SOURCE: City of Chicago, 2022 Budget Ordinance, p. 28

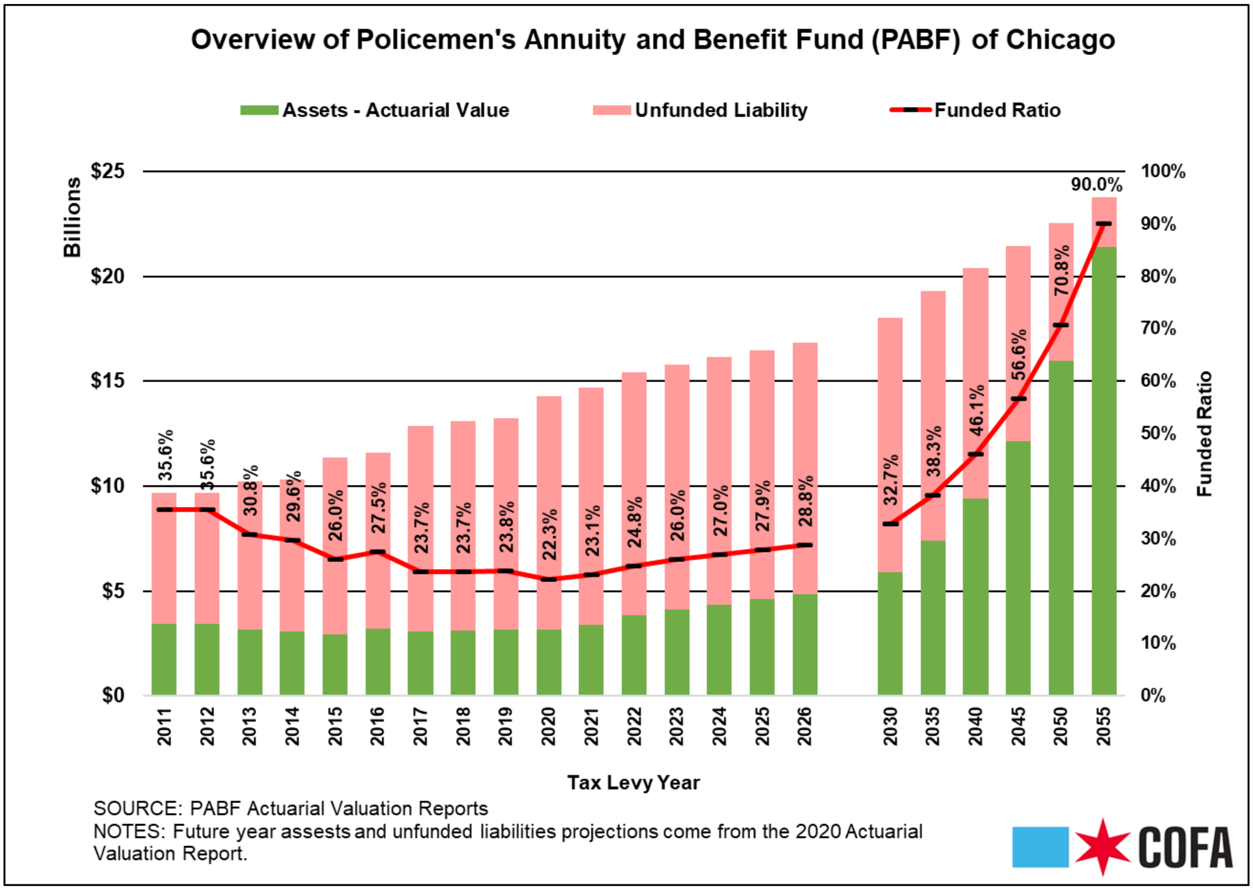
The graph below displays the actuarial liabilities, actuarial assets and unfunded liabilities from fiscal years 2013 to 2019.[vi]



The Policemen's Annuity and Benefit Fund of Chicago

As of December 31, 2020, there were 12,715 active Chicago Police Department (CPD) employees and 13,900 persons receiving benefits.[vii] The total amount of actuarial assets in the Policemen's Annuity and Benefit Fund (PABF) of Chicago at the end of 2020—the latest data available—was $3.400 billion, and the total amount of actuarial liabilities was $14.703 billion.[viii] As a result, the City's unfunded liability for the PABF totaled approximately $11.303 billion, or a funded ratio of 23.1%. This essentially means that the PABF has just 23 cents currently saved up to cover every $1 in benefit obligations. For comparison, at the end of fiscal year 2019, the City's unfunded liability for the PABF totaled $11.090 billion, or a funded ratio of 22.3%. A lower funded ratio places more stress on the PABF and increases the risk of insolvency for the retirement benefits of police.

While the funded ratio improved in 2020, the City is still far from the 90% funding level target by the end of 2055.[ix] The PABF's funded ratio is expected to grow to 32.7% in 2030—an increase of almost 10% from the 2020 funded ratio—under the Illinois statutory funding policy. From there the ratio is projected to rise to 46.1% in 2040 and 70.8% in 2050 before reaching the 2055 target of 90%. In order for the City to keep up with the funded ratio goals, and aside from external factors like the market performance of investments, the City will need to follow an annual statutory contribution amount that is determined as a percentage of the capped payroll. This annual statutory contribution as a percentage of pay was last calculated to be 63.4% by the Actuary for PABF. For the fiscal year 2022 tax levy, which is payable in the fiscal year 2023,[x] this contribution amount is estimated to be $799.4 million. By 2055, this statutory contribution amount is estimated to be $1,371.6 million.[xi]



Another ratio for the City to monitor is the number of active employees to inactive employees or beneficiaries currently receiving benefits. This ratio is significant because it highlights the number of employees paying into the PABF versus those who are retired and receiving annuity payments from the fund. A higher ratio, for example, greater than 1.00, indicates that there are more individuals contributing to the fund than receiving. On the contrary, a lower ratio indicates that more individuals are receiving from of the fund than are contributing. For the fiscal year ending 2020, the City's ratio of active CPD employees to PABF annuitants was 0.91. This ratio is especially important to consider when analyzing the Chicago Police Department's turnover and hiring rates. For example, while department vacancies can lead to lower expenditures, they may bring additional stress to the already underfunded PABF.

A recent solution to aid the City in meeting the statutory contribution amounts is the establishment of a casino in the City of Chicago. One of the major benefits of a casino operating in the City is that the tax revenues from the casino will bring a much-needed additional revenue stream to fund the City's fire and police pensions. The casino, which still needs approval from the City Council, is being touted as an alternative to increasing property taxes on everyday Chicagoans. If the revenues collected from the casino align with the City's initial projections, Chicago will reap approximately $200 million a year once the permanent casino reaches stabilization, which is expected to be in the fiscal year 2028.[xii]

Something to consider is that in order to meet the long-term statutory contribution amounts, the City still may have to increase property taxes, despite a steady flow of revenues from a casino. Furthermore, the projected revenues from the proposed Bally's Tribune casino assume that there will be no delays in the required license approvals and construction process. It also assumes that a casino will remain popular and frequented over time amongst Chicagoans and not just tourists. Lastly, the effects of a pandemic or any future health crisis may severely hinder a casino's reliability to help fund pension obligations.

Recommendation

COFA recommends that the City Council create a safeguard and internal control that will allocate all the casino proceeds into a special purpose fund that restricts pension payments to the Firemen's Annuity and Benefit Fund of Chicago, and Policemen's Annuity and Benefit Fund of Chicago solely.

This policy will ensure that the casino proceeds are used for its intended purposes and not redirected for other purposes which created the City's long-term liability and repeat the mistakes of the past.

Endnotes:

[i] Carlson, J. (2022, February 8). *Chicago's $43,100 debt per taxpayer driven by pension debt*. Illinois Policy Institute. www.illinoispolicy.org
[ii] Schuster, A., & Atterbury-Kiernan, A. (2022, March 9). *Bill to boost Chicago police pensions would cost taxpayers $3 billion*. Illinois Policy Institute. www.illinoispolicy.org
[iii] Carlson, J. (2022, February 8). *Chicago's $43,100 debt per taxpayer driven by pension debt*. Illinois Policy Institute. www.illinoispolicy.org
[iv] Schuster, A. (2018). *Tax hikes vs. reform: Why Illinois must amend its constitution to fix the pension crisis*. Illinois Policy Institute. www.illinoispolicy.org
[v] The Segal Group, Inc. (2021, June). *Firemen's Annuity and Benefit Fund of Chicago: Actuarial Valuation and Review as of December 31, 2020*. www.fabf.org

[vi] Commission on Government Forecasting & Accountability. (2021, May). *A Report on the Financial Condition of the Illinois Municipal, Chicago and Cook County Pension Funds of Illinois*. cgfa.ilga.gov
[vii] Department of Finance. (2021, June). *Annual Comprehensive Financial Report For The Year Ended December 31, 2020*. City of Chicago. www.chicago.gov
[viii] Gabriel, Roeder, Smith & Company. (2021, April). *Policemen's Annuity and Benefit Fund of Chicago: Actuarial Valuation Report for the Year Ending December 31, 2020*. www.chipabf.org
[ix] P.A. 99-0506 requires that beginning in payment year 2021—tax levy year 2020—the City's annual contributions to PABF, as well as Firemen's Annuity and Benefit Fund of Chicago (FABF), be an amount actuarially determined to be sufficient to produce a funding level of 90 percent for each such Plan by the end of 2055.
[x] The City's contributions to the PABF, and all other City pension funds, are budgeted in the same year as the applicable levy year for the property taxes funding the contributions. The City then remits the contributions to the PABF in the following year when the Cook County Treasurer collects and pays the levied property taxes to the City.
[xi] The latest *Actuarial Valuation Report* for the PABF estimates Capped Payroll for the period ending December 31, 2021 to be $1,260.4 million.
[xii] City of Chicago. (2022, May 5). *Casino in the City of Chicago: Evaluation Report*. www.chicago.gov