



Wirepoints Special Report

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Why Chicago's Lightfoot should push for a pension amendment, not tax hikes

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— *Connecting the dots between our economy, government and people* —

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Introduction

Chicago Mayor Lori Lightfoot has yet to articulate a plan for how to fix Chicago's collapsing finances, but she's reportedly about to "lower the boom" on taxpayers, according to the Chicago Sun-Times. The mayor is set to give a state-of-the-city speech this week to address a city budget that's as much as \$1 billion in the red.

If reports of Lightfoot's plans are true – that she wants to increase taxes and push debts off further into the future – then it's clear she doesn't intend to fix Chicago's problems. If she did, she would instead push for an amendment to the Illinois Constitution's pension protection clause and take a hard line on contract negotiations. The city's crisis isn't about a one-year budget deficit. It's about the structural issues that are doing long-term damage to Chicago and driving its residents out.

Here's why a pension amendment and structural reforms – and not tax hikes – are Lightfoot's only real options:

- **Chicagoans are on the hook for more debts than they can ever repay.** Every Chicago household is already on the hook for \$145,000 in overlapping retirement debts.
- **Chicago is an extreme outlier fiscally.** The city has the nation's worst finances under almost every measure.
- **Government-worker benefits are out of line with what Chicagoans can afford.** Compensation has grown beyond what residents can pay for.
- **Chicago is already shrinking.** The city's population loss has created negative consequences for the residents who remain, from growing tax burdens to falling property values.

Lightfoot should realize the debt burden on Chicagoans has already reached absurd levels. A Wirepoints analysis based on Moody's pension calculations shows Chicago households are each on the hook for \$145,000 in combined local and state retirement debts. And that's the rosy scenario. Exclude the Chicagoans that don't have the means to help pay down those debts and that per household amount jumps to an impossible \$400,000 each.

Even though half of Chicagoans' retirement debt comes from Cook County and the state, the full burden is still Lightfoot's problem. If city residents leave because their combined tax bills are too big, Chicago loses.

The trouble for the mayor is that she's repeatedly promised the unions she won't reform their pensions. Lightfoot doesn't support changing the pension protection clause, even for benefits that have yet to be earned. And that puts her at odds with the painful reality Chicagoans face every day.

The mayor is taking a big risk if she embraces yet another round of tax hikes and can-kicks. The city's vicious cycle of higher taxes and more flight will worsen. That's all the more dangerous considering the inevitability of a recession in the next few years.

The truth is Chicago is simply too indebted and Chicagoans too overtaxed for Lightfoot to demand anything less than a pension amendment from Springfield and structural reforms from city hall.

1. Chicagoans are on the hook for more debts than they can ever repay


Chicagoans are on the hook for over \$70 billion in city and Chicago Public Schools retirement debts. But that's only a fraction of the total burden they face. Chicago residents are also responsible for their share of Cook County and state retirement debts, too.

When you add it all up, Chicagoans owe \$150 billion in total retirement debts, based on Moody's most recent pension data. Split that evenly across the city's one million-plus households and that comes to nearly \$145,000 per household.

Chicago households are burdened with nearly \$145,000 in overlapping retirement debts
Chicagoans' overlapping unfunded retirement debts. Official vs. Moody's Investors Service adjusted net pension liabilities (ANPL), 2017

Pension fund	Chicagoans' official unfunded retirement liabilities (in billions)	Chicagoans' unfunded liabilities based on Moody's ANPL (in billions)
Chicago's four city-run funds	\$27.6	\$42.1
Chicago Teachers Pension Fund	\$10.8	\$24.7
Park District	\$0.5	\$1.1
Chicago retiree health	\$2.5	\$2.5
Cook County (Chicago's share)	\$3.9	\$8.7
Cook retiree health (Chicago's share)	\$1.1	\$1.1
MWRD (Chicago's share)	\$0.6	\$1.2
Forest Preserve (Chicago's share)	\$0.1	\$0.2
State pension funds (Chicago's share)	\$29.0	\$50.7
State retiree health (Chicago's share)	\$15.7	\$15.7
State POBs (Chicago's share)	\$2.4	\$2.4
Total unfunded retirement debt	\$94.1 billion	\$150.3 billion
Chicago households	1,046,789	
Total debt per household	\$89,960	\$143,623

Source: 2017 Actuarial Reports of: City of Chicago funds, CTPF, Chicago Park District, Cook County, Cook County Forest Preserve, MWRD; Moody's Investors Service; U.S. Census Bureau; Commission on Government Forecasting and Accountability
Note: State, Cook and other sister government funds pro-rated by population.
Updated to include additional retiree health and pension bond debt.



That's already a massive amount, but if Lightfoot and other politicians want to try a more "progressive" solution to paying off that debt, the per household debt numbers jump even higher.

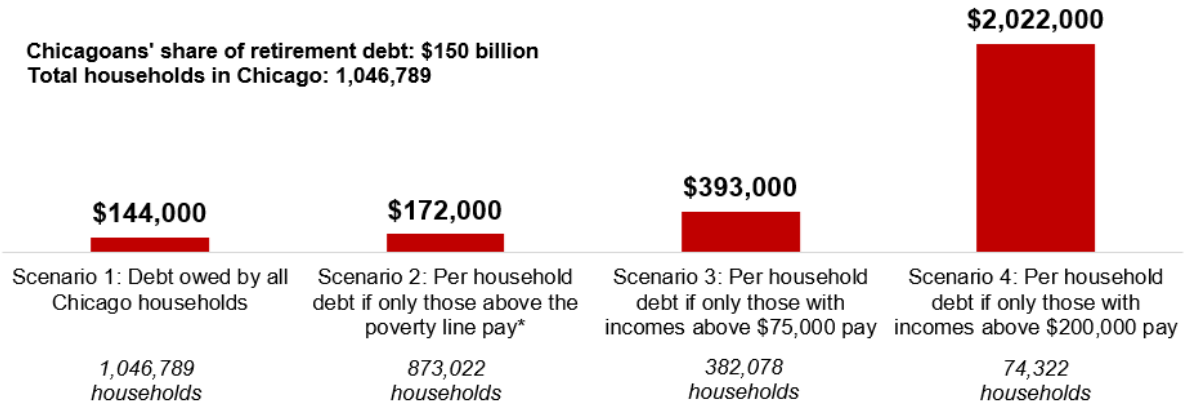
For example, if politicians demand that only households with incomes of \$75,000 or more pay down the debts, the burden on those households would total an impossible \$393,000 each.

And if politicians tried a progressive scheme that targeted only those households earning \$200,000 or more? The burden per household would come to an impossible \$2 million each.

Chicago households on the hook for up to \$2 million in debts each under progressive approach to retirement crisis

Chicago households' share of \$150 billion in Chicago, Cook County and state retirement debts, based on Moody's Investors Service adjusted pension liabilities (ANPL)

Chicagoans' share of retirement debt: \$150 billion
Total households in Chicago: 1,046,789



Source: Moody's Investors Service; Commission on Government Forecasting and Accountability; U.S. Census Bureau: ACS data 2017; Pension fund actuarial reports, 2017, 2018
*Assumes household poverty rate is same as total city family poverty rate (16.6%)

Some wealthy residents would flee, making the burden more unbearable for those who remain.

2. Chicago is an extreme outlier fiscally

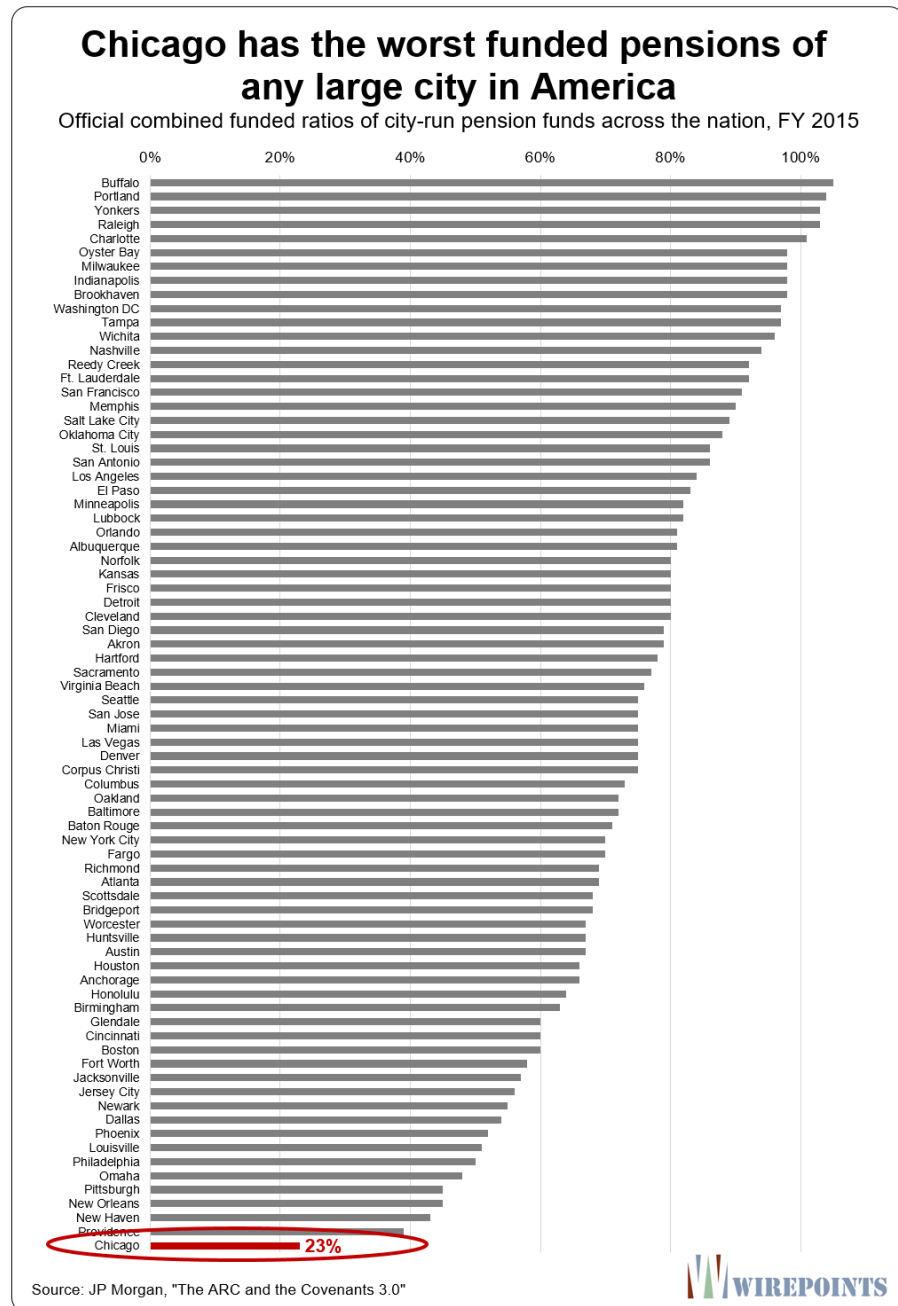
Cities across the nation are dealing with deep pension problems, but Chicago is in a class of its own. The Windy City has the nation's worst pension crisis under almost every measure.

J.P. Morgan compiled funding ratios for the country's major cities and found Chicago pensions, at just 23 percent, were the nation's worst-funded. They're effectively insolvent.

An even more pertinent city-to-city comparison is the total debt burden residents are on the hook for – not just from their own cities, but from other overlapping local governments and their state, too.

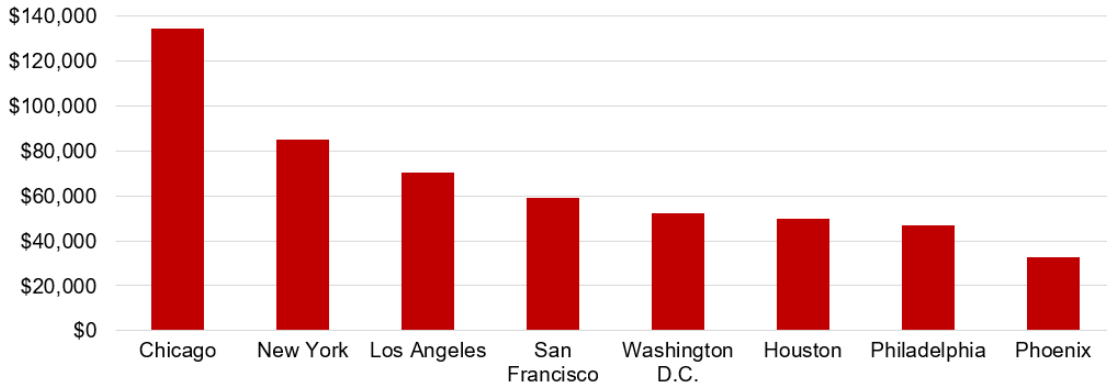
Moody's published those numbers last year and found Chicagoans are in real trouble.

Every single Chicago household is on the hook for nearly than \$140,000 in city, state and other local debts, compared to just over \$85,000 in New York and \$70,000 in L.A. Meanwhile, households in Houston, Philadelphia and Phoenix all face burdens lower than \$50,000 each.



Chicago households are on the hook for far more debt than households in other cities

Total general debt and adjusted net pension liability (ANPL) burden imposed by overlapping governments per city household, 2017



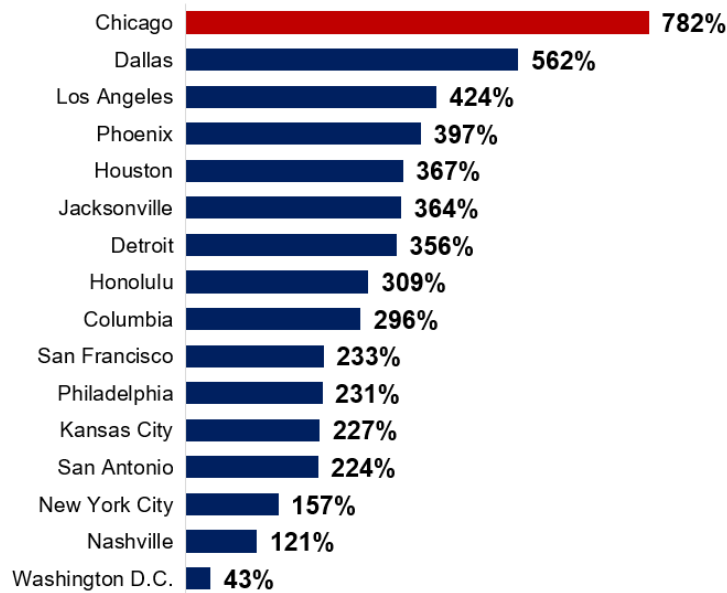
Source: Moody's Investors Service



Chicago is also an outlier when it comes to the city's capacity to pay for the debts it has accumulated. According to Moody's assumptions, Chicago's pension debts are nearly eight times the size of its annual revenues.

Chicago has largest pension debt to revenue burden among some of the biggest U.S. cities

Moody's adjusted unfunded city pension debt (ANPL) as a percentage of city revenues, 2017



Source: Moody's Investors Service, "Adjusted net pension liabilities rise for most of the 50 largest local governments in 2017"



That's much larger than any other major city Moody's analyzed. Dallas is also considered to have one of the worst pension crises in the nation, and yet its revenue burden is 40 percent smaller than Chicago's.


Chicago's outlier status among U.S. cities is perhaps best summed up in one statistic: its credit rating. Chicago is the only major city in the nation besides Detroit to be rated "junk" by Moody's (S&P and Fitch rate Chicago one notch above junk). Chicago Public Schools' rating is even worse off. At five notches into junk territory, it's lower than Detroit's.

Chicago's junk credit rating far lower than other big U.S. cities

Credit ratings of the 20 largest U.S. cities by Moody's Investors Service, as of 8/28/2019

Investment grade		
Highest quality, lowest credit risk	Aaa	Austin, Charlotte, Columbus, Denver, Indianapolis, San Antonio, San Francisco, Seattle, Washington D.C.
High quality, very low credit risk	Aa1	New York City, Phoenix, San Jose
	Aa2	Los Angeles, San Diego
	Aa3	Houston, Fort Worth
Upper-medium grade, low credit risk	A1	Dallas
	A2	Jacksonville, Philadelphia
	A3	
Medium grade, some speculative elements and moderate risk	Baa1	
	Baa2	
	Baa3	
Speculative grade "Junk"		
Judged to have speculative elements, significant credit risk	Ba1	City of Chicago
	Ba2	
	Ba3	Detroit
Speculative, high credit risk	B1	
	B2	Chicago Public Schools
	B3	
...(4 additional ratings)...		
Lowest rated, in default	C	

Source: Moody's Investors Service
 Note: S&P and Fitch rate Chicago one notch above junk



3. Government-worker benefits are out of line with what Chicagoans can afford

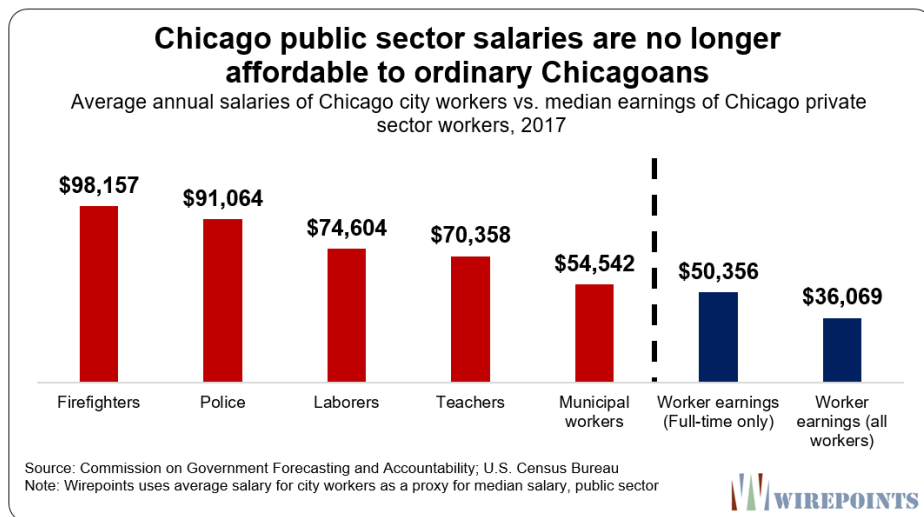
The city’s public sector unions have leveraged their power over the years to create a benefit structure that is no longer affordable for the ordinary Chicagoan.

City workers have multi-year government contracts with guaranteed raises. They have pay scales based on years of service, not merit. Salaries are often spiked. Many workers retire in their late 50s, usually with full benefits. Lifetime pensions for career workers now exceed \$2 million, far more than the ordinary Chicagoan will ever have when he retires. Teachers even have most of their required pension contributions “picked-up” by taxpayers. That, alone, costs Chicagoans over \$100 million a year.

All those benefits have made government worker compensation unaffordable to the residents who pay for them. That’s particularly problematic since a fifth of Chicagoans are in poverty and nearly half of all households earn less than \$50,000 annually. Private sector median earnings in Chicago were just \$36,000 in 2017, while full-time workers earned \$50,000.

There may be a debate about how much public sector workers should earn, but the fact remains that salaries set the base for pensions – the most unaffordable part of city worker compensation. When salaries are high, pensions become unaffordable more quickly.

That’s particularly true because Chicago’s Tier 1 pension rules allow long-time city workers to retire in their 50s with a maximum of 75 to 80 percent of their final average salary. Chicago municipal workers, laborers and teachers also receive compounded 3 percent cost-of-living adjustments that double their annual pension benefits after 25 years in retirement.



Career workers are now retiring, on average, with \$2 to \$2.5 million in lifetime pension benefits. (Tier 2 has changed the rules, but it will take years before its full impact is felt.) A private sector worker would need at least \$1.5 to \$1.8 million saved *at retirement* to lock in the same amount of benefits. Most Chicagoans will never save that amount of money.

Career Chicago workers on average receive \$2 million or more in pension benefits during their retirement

Average pension benefits of recently retired career city workers*

Chicago pensioners	Annual pension benefit	Approximate age at retirement	Total benefits over course of retirement
Firefighters	\$81,000	59	\$2.5 million
Police	\$73,000	60	\$2.1 million
Teachers	\$71,000	61	\$2.4 million
Laborers	\$59,000	58	\$2.3 million
Municipal	\$50,000	59	\$2.0 million

Source: Data based on 2014 FOIA request to the Chicago pension systems; Wirepoints calculations
 *30+ years of service, retired in the last three years.



The driver behind the escalation in compensation is multi-year contracts that include guaranteed raises. Chicago’s police, fire, municipal and other unions recently came to the end of 10-year contracts that locked-in raises between 21 and 26 percent over the period. That’s pushed up pension debts even higher.

And expect the pension situation to get worse if the Chicago Teachers Union accepts Lightfoot’s proposed contract terms. Lightfoot has already capitulated and offered a five-year contract and a 16% salary increase. That will cost Chicago

residents \$351 million, according to WTTW.

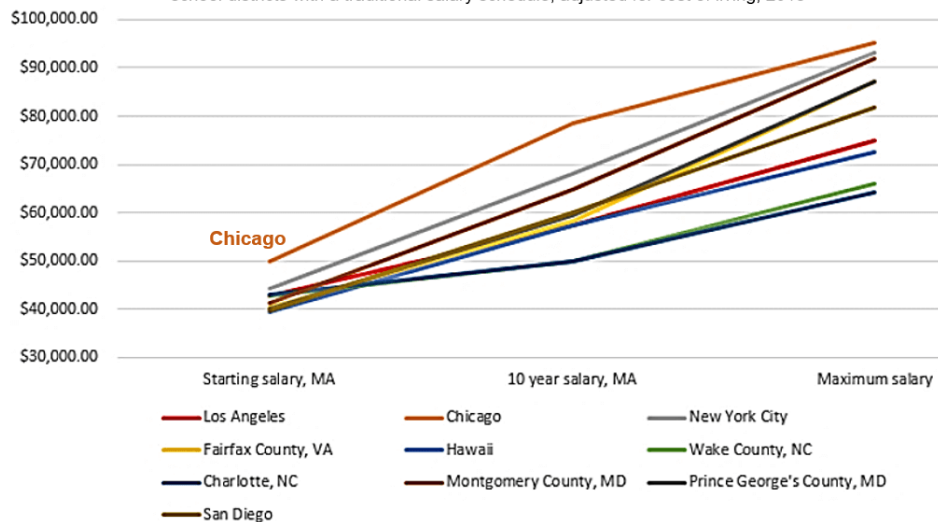
Between that raise and regular increases based on years of service, the average teacher would see their salary grow 24% over the life of the five-year deal.

Raises like that have helped catapult Chicago teachers to some of the nation’s highest paid educators when compared to the largest school districts with traditional salary schedules (adjusted for cost-of-living). That’s according to data from the National Center on Teacher Quality.

For example, a Chicago teacher with a master’s degree receives \$80,000 a year after ten years of work. In contrast, an equivalent teacher in New York City makes \$70,000 and a Los Angeles teacher makes \$60,000.

Chicago teachers receive the highest salaries vs. similar school districts across the nation

Salaries of a career teacher with a Masters degree, in ten largest school districts with a traditional salary schedule, adjusted for cost of living, 2018



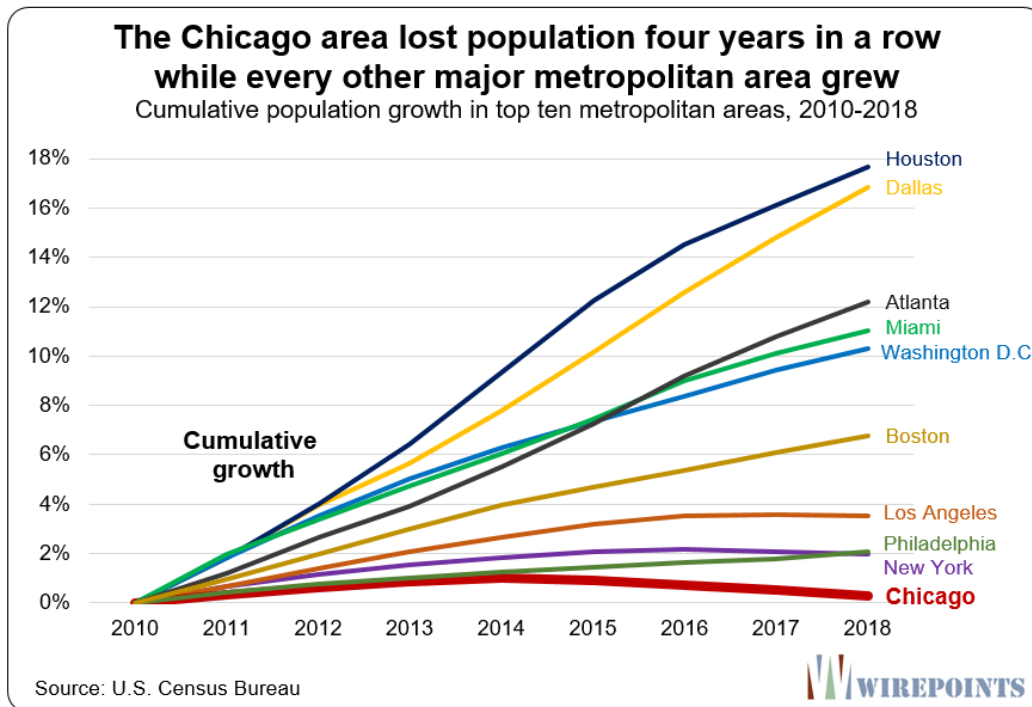
Source: National Center on Teacher Quality



4. Chicago is already shrinking

Chicago is experiencing a drain of people not felt by the other major cities across the nation. Its population has fallen four years in a row, the only top-ten city to shrink like that.

The Chicago MSA lost 66,000 people between 2014 and 2018. Those recent losses are part of a broader trend. Chicago saw its population drop by over 200,000 people from 2000 to 2010.



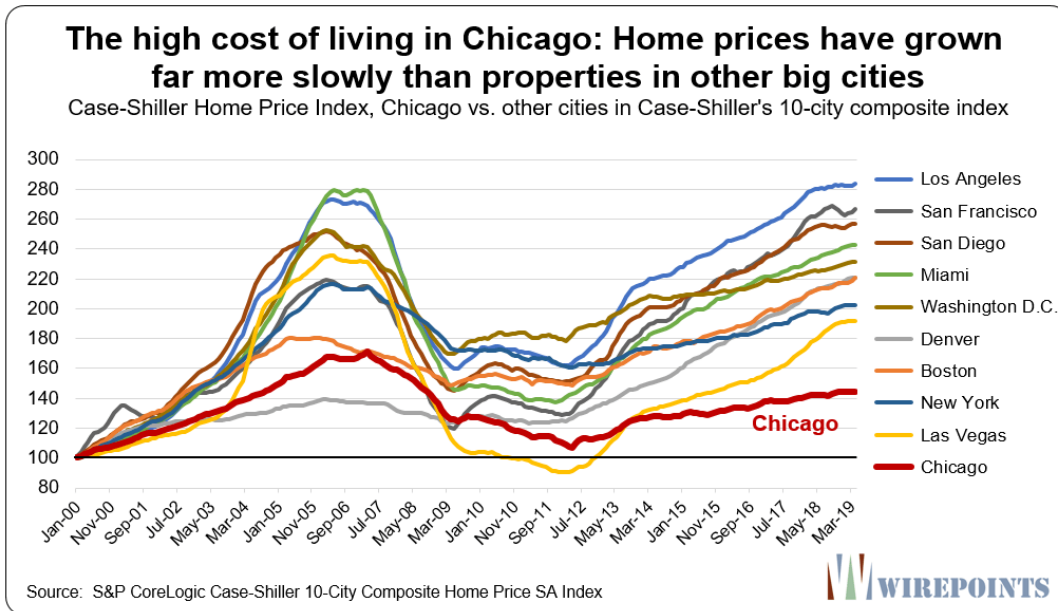
A shrinking population means the city's massive debts are constantly falling on a smaller number of taxpayers. And so are the city's taxes.

Chicagoans were hit with over \$860 million in tax hikes over Mayor Rahm Emanuel's tenure, including:

- A \$543 million property-tax hike in 2015, the single largest in the city's history.
- A separate \$250 million property-tax hike by CPS to pay for pensions in 2016.
- Numerous fee hikes on garbage collection, utilities, permits and more.
- New taxes on ride sharing, online entertainment, e-cigarettes and more.

The slew of new taxes and declining population has undoubtedly had a negative effect on the city's property values. Chicago home prices have fallen in real terms since 2000, leaving the city in last place when compared to other big cities that make up the Case-Shiller 10-City Composite Home Price Index. Home prices in the Chicago have grown just 44 percent since 2000. By comparison, inflation was up 46 percent over the same time period.

Meanwhile, home prices in Los Angeles grew four times that of Chicago's, or 181 percent. And prices in Miami, up 143 percent, and Washington D.C., up 130 percent, have grown three times more than those in Chicago.



That's a double punch to every homeowner in the city. The value of residents' own retirement nest-eggs are stagnating at the same time the public sector retirement debt they're on the hook for has grown to an all-time high.

What Mayor Lightfoot should do

Lightfoot has inherited a financial mess as deep as any in the nation. She can be the agent of change, no matter how politically difficult that may be, or she can follow her predecessors in hiking taxes and passing can-kicks. The direction she takes is up to her.

The facts, however, are indisputable. There is no fixing Chicago without a significant reduction in its structural debts. And that means a pension amendment and subsequent pension reforms, along with holding the line on contracts.

It's true Lightfoot is dependent on Springfield to get anything with pensions done. But if she wants to fix Chicago, she's going to need to be the champion for an amendment.