www.chicagotribune.com/news/local/ct-met-pensions-deals-20101116,0,4059864.story

chicagotribune.com

Politicians helped bring Chicago's public pension funds to the brink of insolvency

Inadequate contributions, underperforming investments have also jeopardized the retirement of tens of thousands of city workers and put taxpayers on the hook for billions of dollars

By Jason Grotto, Tribune reporter

8:33 PM CST, November 16, 2010

advertisement

Chicago's public pension funds are teetering on the brink of insolvency in large part because city officials and union leaders repeatedly exploited the system, draining away billions of dollars in the last decade to serve short-term political needs, a Tribune investigation has found.

Time and again, the funds have been used as a bargaining chip or a piggy bank. Politicians trimmed budgets by offering early retirement incentives and greased union contract deals with increases in benefits. "Pension holidays" allowed the city to avoid paying into workers' retirement funds.

As a result, the funds soon may not be able to keep promises that are codified in the state constitution, threatening the retirements of tens of thousands of rank-and-file union members and leaving taxpayers on the hook for billions of dollars owed to teachers, police officers, firefighters and others.

A Tribune review of legislative changes pushed by city officials and union leaders during the last 15 years found that laws governing city pension funds' contributions and benefits have been changed nearly 40 times, often with little discussion of the financial consequences.

In most cases, pension fund managers had no idea how much the changes ended up hurting them. But in 10 that the Tribune was able to track, the long-term impact on pension funds was more than $3.6 billion.

Those losses, together with Illinois' fundamentally flawed pension funding process and poorly performing investments, have driven the unfunded liabilities of the eight pensions funded with city tax dollars from about $3.3 billion in 2000 to at least $20 billion — a staggering 500 percent increase.

Even if all retirement benefits were cut off today, every man, woman and child in Chicago would owe more than $7,000 to cover obligations already incurred — an amount that doesn't include state pension debt of about $60 billion.

"What's happened in Chicago is a reckless disregard for the next generation of taxpayers and workers," said Jeremy Gold, a national pension expert who advises public and private pension funds. "Their birthright has been sold out from under them because they'll be paying for services and benefits that were rendered before they grew up while theirs are cut to save money."

Chicago's pension crisis threatens to stain the legacy of Mayor Richard Daley, who has been at the helm of city government for the past two decades and appoints some of the trustees to the city's pension boards.The city's chief financial officer, Gene Saffold, said that the problems facing the city's public pension funds are not unique to Chicago and have been driven in large part by the worst economic climate in more than 70 years. He said the possibility of the funds running out of money "is purely hypothetical and speculative."

"It's the city's goal to ensure the funds remain solvent without additional burden to the taxpayers," he said in a written response.

The options for addressing these shortfalls are not pretty. Which would you try first? Vote and share your ideas on Trib Nation.

It hasn't always been this way. The pensions were run successfully for decades and, just 10 years ago, were relatively well-funded. The teachers pension was close to 100 percent funded in 2000. Municipal workers had funding levels above 90 percent. City laborers had enough assets to cover 133 percent of their liabilities. The city's police pension, traditionally underfunded, hovered around 70 percent.

By the end of this year, however, not one of the pensions' funding levels will be above 70 percent. The police and fire funds are already below 40, and the municipal fund is below 50. Pension experts say funding levels below 80 percent place the long-term viability of pensions in jeopardy and are nearly impossible to overcome without massive borrowing, painful tax increases, cuts to benefits and increased contributions.

Decisions made a flawed system worse

While Illinois' broken pension system has captured headlines across the country, comparatively little attention has been paid to the looming crisis in Chicago.

The city's pension funds were set up to provide retirement security for tens of thousands of city laborers, engineers, administrators, teachers, bus drivers, police officers and firefighters. Most don't participate in the federal Social Security program, and the vast majority receives modest benefits averaging about $40,000 a year, the Tribune found.

Most also don't realize their futures are at risk.

"The average cop, right now, doesn't know what's going on with the pension," said Damon Stewart, 34, a police instructor who trains recruits for the Chicago Police Department after spending six years on the beat in Roseland and earning a law degree.

Stewart puts money into the pension fund with each paycheck but says he has no illusions about receiving a pension after he retires. Growing up in Detroit, he saw firsthand how pension funds could go bankrupt.

"Where I come from, a lot of people lost their pensions," Stewart said. "And the way the police pension is going, I've decided not to put all of my eggs in that basket."

From the start, structural flaws buried deep in state law weakened the pension fund system, the Tribune found. It then crumbled under the pressure of questionable accounting practices, a series of politically expedient decisions, Chicago's budget woes, and a recession that wiped out billions of dollars from pension fund investments.

With corporate pensions, which are regulated by the federal government, actuaries determine how much money will be required to keep up with retirement promises made to workers. Then contributions from employers and employees are adjusted to meet that bar.

But under Illinois law, city contributions are based not on actuarial projections but, in most cases, on a formula based on employee contributions. The figures used to calculate the city's payment, called multiples, have not changed to keep pace with promises made to public employees.

In the name of labor peace, city officials and union leaders signed collective bargaining agreements that resulted in average salary increases of about 4 percent annually from 2000 to 2009, even though increases in Chicago's cost of living averaged just 2.2 percent during that time.

Because pensions are based in large part on salaries, any increase in pay means an increase in pension obligations to cover higher benefits. City and union officials also provided more generous benefits for retirees during the late 1990s.

Yet pension contributions did not rise accordingly. In essence, the city has been cutting deals that cost billions of dollars without actually paying for them.

"The political economy of all this is really the bottom line," said Olivia Mitchell, executive director of the Wharton School's Pension Research Council. "Nobody was acting like a grown-up and looking at the long-term consequences of the promises that were being made."

Widening the gap even more was a hiring binge from 2000 to 2003 that added nearly 5,000 employees to the city's payroll.

By 2004, the city was struggling to balance its budget and sought to shed some of its work force. But union contracts made it difficult to lay off public employees.

A piece of legislation in Springfield would provide the answer to the city's problem — but it also would threaten workers' retirement security.

House Bill 400, which House Speaker Michael Madigan introduced in 2003, started as a "technical" or "shell" bill that changed a single word in existing state pension laws. But a year later, former Senate President Emil Jones filed a 90-page amendment that rewrote large swaths of the state's pension code and provided early retirement incentives and benefit increases for city police, fire, labor, municipal and parks employees.

"The city's pensions are well-funded pension funds," Jones told his colleagues, according to legislative transcripts. "The employees pay their share. The city pays its share. This is something that does not impact the state of Illinois."

In fact, the bill had a huge impact because luring employees off of government payrolls through retirement incentives puts a double whammy on pension funds. Not only are more retirees collecting larger annuities for longer periods of time, but fewer employees are paying into the funds. In all, the legislation put pension

funds on the hook for an additional $456 million in early retirement money.

It also gave the city a pass on more than $56 million in pension contributions over 10 years.

Saffold said that funds directly linked to the city's budget—police, fire, municipal and labor pensions—have only used early retirement incentives once to trim the work force. He said the city's efforts to cut jobs "have saved the city hundreds of millions of dollars over the the years, and ultimately have reduced the number of potential retirees that will receive benefits through the funds."

In recent months, Daley has called for reforms in the police and firefighters pension funds similar to those enacted last year in Springfield. But, like those changes, the new rules would do virtually nothing to solve the underlying funding crisis. Nor would they help fill the huge financial hole in which the pension funds currently find themselves, because saving from those reforms wouldn't be felt for the next 20 or 30 years.

Union representatives say the problems with the pension funds don't have to do with benefit levels but, rather, inadequate contributions from the city. "It was a series of bad decisions and financial mismanagement, not unlike the parking meters," said Jackson Potter, a staff coordinator for the Chicago Teachers' Union.

The total unfunded liabilities for pensions funded by city taxpayers, meanwhile, now hover around $20 billion.

But some experts peg the number closer to $40 billion. That's because current accounting rules allow pension funds to subtract assumed investment earnings from liabilities. Under the rules, most funds assume annual returns of about 8 percent. The actual returns during the past decade have been closer to 4 percent, yet the funds still are able to subtract 8 percent from their unfunded liabilities.

The crushing pension debts have contributed to the downgrading of the city's bond rating by two rating agencies this year, meaning it will cost more to borrow money for big infrastructure projects that help create jobs in a state where unemployment hovers around 10 percent.

Pension holidays now, judgment day to come

The political horse-trading that has diminished all of the city's pension funds can be viewed most dramatically through the recent history of the Chicago Teachers' Pension Fund.

For decades, the pension was robust, with funding levels sometimes exceeding 100 percent. But by next year the funding level is expected to drop below 60 percent, placing the retirement security of nearly 60,000 active and retired teachers in jeopardy while imperiling the public school budget.

This predicament can be traced to decisions made in the wake of Mayor Richard Daley's takeover of the public school system in 1995.

With help from allies in Springfield, the Daley administration pushed to have the pension code rewritten so property tax money that normally went to pensions would go to Chicago Public Schools coffers. Under the old law, the district's pension bill was slated to be $93 million in 1995. Instead, it paid just $10 million.

CPS officials went back to Springfield the following year and had the law changed again. This time, the district would have to put money into the pension only if the fund's level fell below 90 percent.

For the next decade, the district's contribution to the retirement of tens of thousands of public school teachers was zero. In all, the pension holiday cost the teachers fund more than $1.5 billion from 1995 to 2009,

according to fund documents. The state was supposed to help soften the blow by contributing to the fund, but that never happened.

At first, the pension fund was able to make up the difference with investment income, thanks in no small part to an overheated stock market fueled by the tech bubble. When that burst in 2000, however, the returns fell. Together with the massive pension holiday and a string of benefits increases averaging about 6.4 percent a year, the pension's funding level started slipping, fund documents show.

In 2004, it dipped below 90 percent for the first time, but because funding is based on results from two years earlier, that milestone didn't affect the district until 2006. That year the school system had to contribute $36 million to the pension fund. The bill nearly tripled to $90 million in 2007, and by this year it was $340 million — an 844 percent increase in just four years.

At the beginning of the 2009 school year, the district's CEO — longtime Daley lieutenant Ron Huberman — began working the halls in Springfield, seeking more pension relief. Despite paying nothing toward its workers' retirements for a decade, the schools still faced a huge budget deficit.

"The Board of Education crying poor is akin to someone buying a house and being told that they wouldn't have to pay a thing for 10 years. So for 10 years, the person parties like there's no tomorrow, and when the time comes to pay, (they say) it's too much," said Jay Rehak, who was recently elected to the pension board to represent teachers.

Eventually Huberman found the perfect vehicle for the district's third round of pension relief: the largest rewrite of the state's pension code in decades.

Passed at the 11th hour of the legislative session in April, under the banner of pension reform, the law created a two-tier pension system by capping benefits and increasing the retirement age — but only for new hires. The state constitution forbids diminishing retirement benefits for unionized public employees.

Among the "reforms" inserted into Illinois' 1,400-page pension code was a three-paragraph clause that reduced CPS contributions, giving it a pass on more than $1.2 billion during the next three years.

The move will save the school district money in the short term, but once the holiday is over, reality will set in again.

"It simply delays the inevitable, which is CPS making its required contributions," said Kevin Huber, the fund's executive director.

Diana Ferguson, the school district's chief financial officer, defended the pension maneuvers, saying the money saved by not paying into the pensions still went to teachers through salary increases and other benefits. "It's not as if we are keeping the money from them," she said.

She said the district has not backed away from its responsibility. "The board," she said, "is committed to paying contributions to the pension fund."

According to documents from the pension fund's actuary, when the holiday ends in 2014, the district will owe the teachers pension fund $599 million. By 2033, pension contributions will cost more than $1 billion a year. To reach 90 percent funding by 2059 — as currently required under state law — CPS will need to pay more than $2 billion a year by 2055.

The pension fund is unlikely to last that long, however. Next year, its funding level is poised to drop below

60 percent, a shortfall that most experts agree is impossible to overcome without massive borrowing and increased contributions from both current teachers and the district.

"The CPS pension holiday was basically billed as budget relief, but it was completely irresponsible," said Laurence Msall, president of the Civic Federation, a nonprofit public-policy think tank that has been raising the alarm on public pension for years. "In 1995, the (teachers) pension was nearly 100 percent funded. Now look at it."

jgrotto@tribune.com

Copyright © 2010, Chicago Tribune