PENSION NEWSLETTER – JULY 2019

You may have received an email from Local 2 President Jim Tracy stating my last pension newsletter was defamatory towards pension fund trustee Tony Martin; I disagree. Tony Martin refused to follow the pension Board's specific direction to describe the Illinois Appellate Court's Harvey case in the Secretary's letter. This case is vitally important to the membership and integrity of our pension fund, so I will mention it here rather than waiting on Tony Martin.

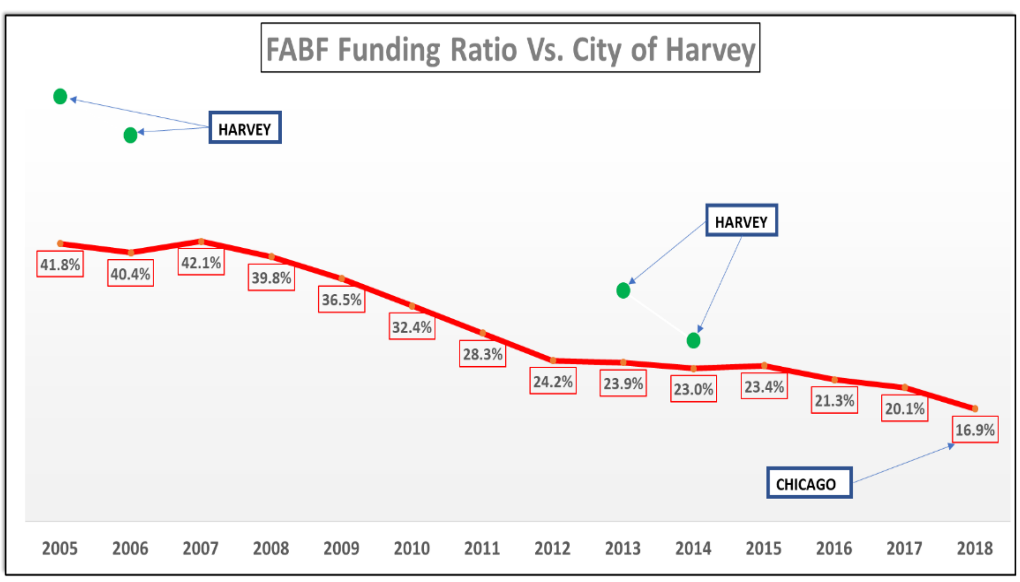
The Court's decision is important because it identifies the threshold of when a pension fund is considered bankrupt or 'on the verge of default'; the threshold allowing stakeholders to sue the plan sponsor for adequate funding. The Appellate Court doesn't identify a specific figure that sets the standard for "on the verge of default". Instead the Court looks at factors which aren't quantifiable, but are more qualifiers.

The Court looked at three qualifying factors when determining if a pension fund is on the verge of default; these factors include the financial history, the financial condition and finally the plan sponsor's intention to correct the deficit in the future. So in essence the Court is taking a look back, looking at what is in front of them and finally taking a look forward; a very reasonable approach in my opinion. A critical unbiased eye, applying the Court's criteria, could reasonably, without much difficulty, conclude that our fund has approached the threshold of being on the verge of default and therefore a lawsuit compelling the City to adequately fund our pension fund would prevail. Let's review the three qualifying factors the Illinois Appellate Court looked at when defining "on the verge of default":

1) Financial History The Court, when qualifying this factor, emphasized the gap between what the City of Harvey levies and actually puts into the pension fund, but also the gap between what is put into the fund and what is disbursed in benefits. The Court appears to place significant importance on the percentage gap between what is actuarially required (ARC) and the actual contribution, even presenting two tables of data in the opinion. The Court's decision compares Harvey's "actuarial gap" with Riverdale's, a city which the Court does not consider near the verge of default. During the eight years illustrated in the report Riverdale contributed, on average, 64.7% of the ARC and Harvey contributed 15.3%. Chicago during its most recent eight year period, ending in 2014, contributed 36.4%. The question then becomes where would Chicago come in under this initial factor that the Court identified as relevant. If Riverdale's 64.7% is the top of the threshold, then Chicago's 36.4% average ARC contribution would support the argument Chicago is considered at the verge of imminent default. If Harvey's 15.3% average ARC contribution is the top of the threshold, then Chicago would not be considered at the verge of imminent default, at least not as it relates to the Court identified factor of financial history. It is important to note the passage of SB777; starting in 2016 the City did start contributing additional money into the pension fund, known as the "ramp to the ARC", so it reasonable to expect that the 36.4% figure would be slightly better if the years 2016-2018 were included.

	HARVEY			CHICAGO			RIVERDALE		
	Required Contribution	Actual Contribution	% of ARC Contr.	Required Contribution	Actual Contribution	% of ARC Contr.	Required Contribution	Actual Contribution	% of ARC Contr.
2003							432,261	420,000	97.2%
2004							473,860	262,940	55.5%
2005	876,692	9,885	1.1%				486,673	262,940	54.0%
2006	980,024	38,304	3.9%				603,772	280,000	46.4%
2007	1,060,727	480,632	45.3%	188,201,379	72,022,810	38.3%	651,990	440,000	67.5%
2008	1,077,837	771,471	71.6%	189,940,561	81,257,754	42.8%	754,607	440,000	58.3%
2009	1,294,791	18,181	1.4%	203,866,919	89,211,671	43.8%	849,300	440,000	51.8%
2010	1,574,792	5,143	0.3%	218,388,037	80,947,311	37.1%	1,018,396	866,168	85.1%
2011	1,611,369	-	0.0%	250,056,273	82,869,839	33.1%			
2012	N/A	N/A		271,505,718	81,521,883	30.0%			
2013	2,036,497	-	0.0%	294,877,895	103,669,015	35.2%			
2014	2,070,500	600,000	29.0%	304,265,411	107,334,399	35.3%			
Total	12,583,229	1,923,616	15.3%	1,921,102,193	698,834,682	36.4%	5,270,859	3,412,048	64.7%

1) The Riverdale and Harvey figures Taken from the Apellate Court case
2) The Chicago figures were taken from the Firemen's Annuity and Benefit Fund of Chicago Acturial Valuation Report as of December 31, 2014, which is the most recent audited report that contains the GASB #27 figures



Another metric that the Court mentions when discussing the financial history qualifier is the funding ratio. The Court's written decision mentions the concern, in expert testimony, of the funding ratio. During the historical period looked at by the Court, the Chicago fire pension fund is worse than the Harvey fire pension fund in every year mentioned. Chicago's Firemen's Annuity and Benefit Fund, our pension fund, currently stands at a 16.9% funding ratio.

So given the Appellate Court's qualifications for the 'financial history' factor, I believe the Chicago fire pension fund qualifies as being impaired and near imminent default. Although Chicago's actuarial gap, 36.4%, is between what the Court identified as not qualifying, 64.7% (Riverside) and qualifying, 15.3% (Harvey), the historical funding ratio is consistently worse than Harvey's.

2) <u>Financial Condition</u> The second factor the Appellate Court qualified when determining if a pension fund was on the verge of default was the plan sponsor's financial condition. In doing so, the Court, in their written decision, focused on Harvey's financial disarray, including – lack of audits, unwillingness to put money into the pension fund that was appropriated, the comptroller invoking his fifth amendment right rather than testify on Harvey's financial condition, fraudulent bond offerings, alderman having unmonitored expense accounts, paying an alderman's son for non-compete work at an inflated rate, and improperly diverting funds. Again, the difficulty here lies in that the factor, as identified by the Court, is not an easily quantifiable objective number. Nevertheless, applying the standard the Court identified to the City of Chicago's financial condition, you can't help but notice the <u>glaring similarities</u> to the City of Harvey's. The financial conditions in Chicago that I believe mirrors Harvey's are as follows:

1. Continuing to divert property tax receipts meant for pension funds to TIF accounts to subsidize private development. Although this diversion may be legal, per se, it is still nevertheless a diversion.
2. The longest serving alderman and chairman of the most powerful committee on the City Council, Finance Chairman Edward Burke, is under federal indictment. Furthermore, Alderman Burke oversaw a fund with approximately $100M in annual expenditures with little, if any, oversight. Additionally, the alderman allegedly used his influence to secure a job for his son with the county board and secure TIF funds for political donors.
3. Chicago's former Comptroller, and fire pension fund trustee, was extricated back to the United States after fleeing the country to avoid a 15 year sentence for a kick-back scheme while serving the public trust. In 2006, Chicago's City Clerk, another fire pension fund trustee, plead guilty to federal charges of bribery for steering City business to political contributors.
4. Pension fund Secretary Tony Martin failed to maintain a record of testimony by two expert financial consultants to the retirement board that if ARC funding continues to be postponed that the fund will soon be entering a "death spiral" it could not pull out from and that they would no longer advise investing in riskier assets.
5. The City has lost access to one of its largest revenue sources; in the 2018 Budget the City's share of sales tax is nearly 90% less, $445M, than the previous year. The reason for this is that in order to take advantage of lower interest rates that better managed municipalities receive from the bond market, Chicago had to securitize their sales tax receipts by selling them to the Sales Tax Securitization Corporation. The bond market does not trust the City to properly handle these tax receipts and instead demands they go directly to a third party for disbursement to bondholders before they would lend money to the City. The bond market, made up of thousands of investors and financial analysts, collectively penalize the City for mismanaging their finances.
6. The City has, out of desperation, sold off or leased assets, including parking lots, toll roads and long term parking meter income to plug a structural deficit that, year after year, the City administration refuses to correct. A recent analysis by the incoming Lightfoot administration states, as reported in the Chicago Tribune, that the investors in the parking meter lease have already recouped their initial $1.16 billion investment – and still have 65 years to go on the 75-year lease; a fact that highlights the mismanagement of the City's resources.
7. The City Council refuses to allow an Inspector General any real authority over the City Council; the City Council, as a legislative body, is clearly incapable of self-regulating itself or properly funding the fire pension fund.

3) <u>City's Intention</u> The third and final qualifying factor the Appellate Court identified was the plan sponsor's intent to properly fund the pensions. Specifically the Court asked if the plan sponsor "*intends to correct the pension deficit in the future. Harvey has provided no plan to correct its handling of this pension crisis. Harvey has a complete lack of accountability now and in the past,…*". The City of Chicago presents itself in a similar light having no plan to correct the massive shortfall facing the fire pension fund. Former Mayor Emanuel's plan to borrow up to $10B in pension obligation bonds never materialized and was not accepted as a credible solution by the financial community. The City Council is unwilling to raise property taxes to a level that will change the trajectory of the funding ratio. In fact, the City Council, with no fiscal awareness whatsoever, continues to divert property tax revenue away from the pension funds and into a TIF scheme that benefits the risk profile of private developers.

The long awaited Chicago casino, which currently is statutorily required to fund both the police and fire pension funds, has finally been conceived with legislation signed by Governor Pritzker this past month. But even the adequacy of that legislation is being called into question. If you read the changes to the 800+ page casino legislation, the Legislature appeared to just cut and paste a paragraph providing the City with an additional 33% of the adjusted gross receipts from the eventual casino operator. Under the current legislation the new operator will be required to pay $120M just for the licensee fee and then have to build and operate a casino at an 80% tax rate. If, and that is a big 'if', an operator accepts these terms, it is unlikely the gambling revenue will keep pace with the benefit payment growth. The pension fund trustees need to ask themselves if in the long term, gambling revenue that is inconsistent and subject to economic cycles, will be adequate to cover the consistent and growing fund liabilities.

Given this analysis I think the pension Board will need to revisit its position on pursuing a lawsuit against the City for adequate funding in order to secure the pension fund member's benefits. If there is a vote to pursue a lawsuit, I hope this time around, Trustee Tony Martin could side with the firefighters and paramedics rather than posture for favors from City officials. If any member has questions on this analysis please feel free to reach out.

Tim McPhillips - Active pension fund trustee

Timothy J McPhillips