CITY OF CHICAGO

COUNCIL OFFICE ON FINANCIAL ANALYSIS (COFA)

February 10, 2020

The Honorable Alderman Pat Dowell
Chairman, Committee on Budget and Government Operations
121 N. LaSalle St., Ste 200
Chicago, IL 60602

Chairman Dowell:

This memo is in response to inquiries from Alderman Gilbert Villegas regarding the City's unfunded pension obligations.

1. *What was the Actuarially Determined Contribution the City would have needed to make in 2018 to keep the unfunded liability from growing? 2018 is the latest year for which a Comprehensive Annual Financial Report has been completed.*

- In 2018, the City contributed $1.24 billion to its pension funds, and its unfunded pension liability grew by $1.55 billion (from $20.23 billion to $21.78 billion).
- So, in order to keep the size of the unfunded liability from growing, the City would have had to contribute $2.79 billion ($1.24 billion plus $1.55 billion).
- Going into the year, the funds' actuaries had projected investment income between 6.75% and 7.25%. Had they met their target returns, the funds would have earned $237 million in investment income, but in fact their investments lost $476 million. 2018 was a bad year for most investors. There will be good years and bad, but it is assumed that the funds will meet their target returns over time. If the funds had met their target returns in 2018, the city could have kept their unfunded liabilities from growing by contributing $2.08 billion, which would have still been more than the $1.24 billion the City actually did contribute.

2. *Will the City's required pension contribution continue to rise after 2035?*

Yes, it will continue to rise at a modest pace, because the City must keep up with current costs, as well as raising the unfunded ratio from past years. If the City adheres to the contribution schedule mandated by current state law, all four pension funds will achieve 90% funding levels by 2057. Then, starting in 2058, the City's required contributions would drop significantly, because it would only have to pay for new obligations as they accrue, and no longer have to pay down past unfunded liabilities.

3. What are the minimum ages to collect pensions for Tier I and Tier II employees?

City retirees qualify for annuities based on their ages and years of service. The formulas are different for each of the four pension funds, and are summarized in the table below.

MEABF and LABF, Tier 1 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system prior to 1/1/2011)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 50 with at least 30 years of service credit	Annual Annuity = (Years of Service) x (2.4%) x (Final Average Salary) The maximum annuity is 80% of Final Average Salary	The highest average annual salary for any 4 consecutive years within the last 10 years of service
Age 50 with at least 30 years of service credit		
Age 55 with at least 25 years of service credit		
Age 55 with at least 20 years of service credit (benefit is reduced by ¼ of 1% for each month that the employee is under age 60)		

MEABF and LABF, Tier 2 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system on or after 1/1/2011 but prior to 7/6/2017)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 67 with at least 10 years of service credit	Annual Annuity = (Years of Service) x (2.4%) x (Final Average Salary) The maximum annuity is 80% of Final Average Salary	Final Average Salary is highest average annual salary for any 8 consecutive years within the last 10 years of service
Age 62 with at least 10 years of service (benefit is reduced by ½ of 1% percent each month that the employee is under age 67)		

MEABF and LABF, Tier 3 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system on or after 7/6/2017, or a former Tier 2 member who elected Tier 3 status)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 67 with at least 10 years of service credit	Annual Annuity = (Years of Service) x (2.4%) x (Final Average Salary) The maximum annuity is 80% of Final Average Salary	Final Average Salary is highest average annual salary for any 8 consecutive years within the last 10 years of service
Age 62 with at least 10 years of service (benefit is reduced by ½ of 1% percent each month that the employee is under age 67)		

Firemen's Annuity and Benefit Fund of Chicago, Tier 1 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system prior to 1/1/2011)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 50 with at least 20 years of service credit	Annual Annuity = 50% of Final Average Salary, plus 2.5% of Final Average Salary for each year or fraction thereof above 20 years of service The maximum annuity is 75% of Final Average Salary The minimum annuity for retirees over age 50 with at least 20 years of service will be 125% of the Federal Poverty Level	The highest 48 consecutive months of the last 10 years of service

Firemen's Annuity and Benefit Fund of Chicago, Tier 2 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system on or after 1/1/2011)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 55 with at least 10 years of service credit	Annual Annuity = (Years of Service) x (2.5%) x (Final Average Salary) The maximum annuity is 75% of Final Average Salary	"Final Average Salary" means the average monthly salary obtained by dividing the total salary of the participant during the 96 consecutive months of service within the last 120 months of service in which the total salary was the highest by the number of months of service in that period. For purposes of annuity calculation, the maximum Final Average Salary is $106,800.
Age 50 with at least 10 years of service (benefit is reduced by ½ of 1% percent each month that the employee is under age 55)		

Policemen's Annuity and Benefit Fund of Chicago, Tier 1 (First became a member of a Fund or another qualifying reciprocal pension fund or retirement system prior to 1/1/2011)

Minimum Age to Collect Annuity	Annuity Formula	Final Average Salary
Age 50 with at least 20 years of service	Annual Annuity = (Years of Service) x (2.5%) x (Final Average Salary) The maximum annuity is 75% of Final Average Salary	The highest average annual salary for any 4 consecutive years within the last 10 years of service
Age 50 with at least 10 but fewer than 20 years of s	Receives an annuity set by a formula based on the pension contributions made by the retiree over the course of their service, and a portion of the contributions made by the City on their behalf	

4. *What would be the effect of raising the retirement age for future retirees?*

Any change in the annuity formula could only affect employees hired after the date of the policy change, because promised pension benefits are guaranteed by the Illinois Constitution. Estimating the financial impact of such a change would depend on the details of the change, and would require an extensive study by the actuaries for the respective funds. However, COFA is able to make certain general statements:

- A major factor affecting the impact of changing the annuity formula for future hires would be how quickly the City's workforce turns over. The more quickly current employees leave the City's workforce, and the more quickly the City hires new employees, the larger the effect of changing pension terms for new hires would be. Current City policy discourages rapid hiring in order to reduce personnel costs by increasing vacancies.

- If the City changed the annuity formula for new hires, we can expect employees and retirees hired prior to the change to make up the bulk of active members for many years after the change. For example, an employee would have had to have been hired before January 1, 2011 to qualify for Tier 1 status. But, as of December 31, 2018, 18,372 of the MEABF's 31,285 active employees (59%) were Tier 1, as were all 21,393 of its living retirees.[1]

- Rather than adjusting annuity formulas, the City would likely have more success reducing the burden of future employer contributions by not offering an annuity to new hires at all, and instead switching to a defined contribution plan. Under a defined contribution plan (as opposed to a defined benefits plan), the City would make agreed upon contributions to the employee's retirement fund. Upon retirement, the employee would receive whatever had accumulated in their fund after contributions and investment. This would relieve the City of all risk (and opportunity) in the investment market, while exposing the employees to all risk (and opportunity) in the investment market. As with other changes, this could only be applied to employees hired after the date of the new policy.

Sincerely,

Jonathan Silverstein
Legislative Fiscal Analyst

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[1] *Actuarial Valuation and Review as of December 31, 2018*, Municipal Employees' Annuity and Benefit Fund of Chicago, p. 15