Fund Stabilization Bonds Ordinance and Financing Plan Overview

A Viable Solution to Strengthening Chicago's Pensions

After decades of uncertainty, today, each of the City's four pension funds are on a path to stability with statutorily mandated funding plans. In addition, the City has identified dedicated revenue for each fund. In fact, since 2014, City Council has dedicated over $800 million of new revenues to the pensions funds, including a $543 million property tax increase levied solely for PABF and FABF.

Despite the extensive actions already taken, there are still challenges ahead. Required contributions to all four funds are projected to increase significantly between 2020 and 2022. This is true because the basis for establishing the required contribution for each fund moves to an actuarially determined methodology.

Two factors are considered by actuaries when calculating employer contribution, cost of the current benefit and the unfunded liability. The cost of the current benefit represents the portion of the cost of projected benefits allocated to the current year. The unfunded liability represents the value of the benefits earned to date that are not covered by current plan assets. The Fund Stabilization Bonds finance plan would reduce the cost of the unfunded liability enabling the City to also reduce the amount of new revenue required to meet increased contributions.

Fund Stabilization Bonds Finance Plan

The City of Chicago currently has approximately $38 billion of general purpose long-term debt outstanding. Pension debt accounts for $28 billion, or 73 percent, and bonded debt accounts for $10 billion, or 27 percent, of the City's overall general long-term debt. The Illinois Supreme Court, Illinois General Assembly, rating agencies and bond investors have all been clear that the City's pension debt is a hard liability. The cost of pension debt is between 7 percent and 7.5 percent. The current cost of the City's bonded debt is between 2.5 percent and 6.25 percent. Through the Fund Stabilization Bonds the City can refinance a portion of its existing high cost pension debt with lower cost bonded debt.

- Issue approximately $10 billion of Fund Stabilization Bonds and deposit the proceeds into the pension funds.
- Deposits to the pension funds would immediately increase the funded ratio of the funds and reduce the unfunded liability.
- Improved funded ratios would lower future contributions necessary to reach 90% funded.

While improving the overall health of the pension funds, the Fund Stabilization Bonds finance plan does not eliminate or defer the City's statutorily required contributions and does not allow for the use of proceeds for any purpose except for the benefit of the pension funds. The plan also does not introduce additional reinvestment risk.

Financing Plan

The financing plan has been specifically designed to have favorable implications for the City's Corporate Fund and the City's overall credit profile.

Public Act 100-0023 authorizes home rule municipalities to sell their interest in revenues or taxes received from the State to special purpose entities; the City utilized this authority in the creation of the Sales Tax Securitization Corporation ("STSC"). The City intends to use this authority to establish the Dedicated Tax Securitization Corporation ("DTSC") and sell and assign to the DTSC all Income Tax and Personal Property Replacement Tax ("PPRT"). The City also intends to use its home rule powers to sell and assign to the DTSC the City's Residual Sales Tax Revenues after payment of obligations to STSC.

Income Tax, PPRT and Residual Sales Tax Revenues are currently budgeted in the Corporate Fund for annual operating expenses. The City's four pension funds are funded through a variety of revenue sources, including property taxes.

The financing plan contemplates selling Income Tax, PPRT and Residual Sales Tax Revenues to the DTSC. The DTSC will issue bonds secured by these revenue sources. Residual revenues not required to pay debt service will flow back to the City to fund a portion of the pension funds annual required contribution. The DTSC securitized revenue, currently utilized in the Corporate Fund, would be replaced with property taxes that are currently used to fund a portion of the City's pension contribution.

The amount of revenues previously used for Corporate Fund purposes is expected to equal debt service on the DTSC bonds. The City will repurpose existing property tax revenues previously dedicated to pensions for the Corporate Fund equivalent to the annual debt service on DTSC bonds. All of the securitized Corporate Fund revenues will be replaced with existing property tax revenues. The Corporate Fund will be reimbursed for 100% of these revenues from the City's existing property tax levies for pensions.

The Chicago Water and Sewer Tax Ordinance was passed by City Council on September 14, 2016. Proceeds are required to be used to meet the City's MEABF funding obligations . The Water and Sewer Tax is not legally available for the Corporate Fund. The proposed financing contemplates the City issue bonds secured by the Water and Sewer Tax revenue to generate proceeds to deposit to MEABF.

The Fund Stabilization Bonds Ordinance does not contemplate any new revenues or increases in existing revenues.

Fund Stabilization Bonds Ordinance

The Fund Stabilization Bonds Ordinance introduced today:

- Creates the Dedicated Tax Securitization Corporation ("DTSC").
    - Similar to the Sales Tax Securitization Corporation, the DTSC is a special purpose entity authorized to purchase certain revenues of the City.
    - The DTSC would "securitize" those revenues and issue debt and deposit the proceeds of that debt into the pension funds.
- Provides the framework for a future ordinance to approve the sale of up to $10 billion of DTSC Securitization Revenue Bonds and Water and Sewer Excise Tax Receipt Revenue Bonds. The Fund Stabilization Bonds Ordinance introduced does not authorize the sale of bonds. The adoption by City Council of a subsequent ordinance authorizing the sale of bonds is required prior to the issuance of any fund stabilization bonds.
    - Up to $ 7.7 billion in bonds to be issued by the DTSC would securitize the City's Income Tax, PPRT and Residual Sales Tax Revenues
    - Up to $2.3 billion in bonds issued by the City, secured by the City Water and Sewer Tax, leveraging revenues already pledged to MEABF
    - The bonds would be structured to have a stronger rating than the City's General Obligation credit, expected ratings in the 'A' range
- Mandates that all proceeds from a future issuance must be "lock-boxed" with a third-party trustee; and
- Establishes that these proceeds will be used to make large one-time deposits into the City's pension funds; to establish stabilization accounts for the benefit of the pension funds; and to pay certain costs of issuance.

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