
Chicago's Next Mayor Can't Dodge Tax Pain Needed for Pension Fix.

- **14 candidates, few willing to consider hiking property levy**
- **Investors say refusal could worsen city's financial reckoning**

The leading candidates in Chicago's mayoral election on Tuesday have clashed over everything from reducing violent crime to fighting public corruption. Most agree on one thing: Property taxes in the nation's third-largest city are too high and shouldn't be raised.

But taking the most reliable source of revenue off the table could worsen Chicago's financial plight, especially as it struggles to come up with an additional $1 billion needed by 2023 to cover mandatory pension payments, say municipal-finance investors and analysts.

Mayor Rahm Emanuel, who took office in 2011 and isn't seeking re-election, put all four retirement plans on a path to solvency, boosting contributions to the funds by raising taxes and utility fees. From 2007 to 2016, Chicago's effective residential tax rate rose by more than 35 percent, according to a Civic Federation report published last month. That limits the political options for whoever wins an expected runoff on April 2.

"Emanuel's achievements came with a price — namely, tax fatigue," John Humphrey, head of credit research at Gurtin Municipal Bond Management, a Pimco subsidiary, wrote in a January research note. Those taxes and other local pension demands "have left residents with sticker shock," he added, "and the next mayor will confront increased tax fatigue as he or she looks to find revenues to ease the city's financial strain."

Property taxes are far and away the largest source of revenue for the retirement plans: Emanuel's most recent proposed budget allocated $1.36 billion toward pension funds, and more than $905 million of that came from such taxes.

Susana Mendoza, Illinois's comptroller and a leading mayoral contender, said in an interview that Chicagoans "feel suffocated to death" by property taxes.

Bill Daley, the younger brother of former Mayor Richard M. Daley, echoed those sentiments when he told local media that "we've got to begin to solve our long-term fiscal problems, but we cannot do it on the backs of homeowners and property taxes." He has committed to not raising those taxes, at least in the first year.

The one well-known candidate willing to voice support for a property-tax hike is Paul Vallas, a former city budget director. On his campaign site, he proposes $250 million in additional property taxes over the next five years capped at 5 percent or the rate of inflation, whichever is lower.

Junk Grade

The hikes under Emanuel made headway toward arresting mounting financial strains that caused

Moody’s Investors Service in 2015 to downgrade Chicago’s bonds to junk grade. But his plan delayed a surge in payments until after he left office, and the city doesn’t have the money at current funding levels to make that jump.

That means whoever emerges from the field of 14 candidates will likely have to raise property taxes, said John Miller, co-head of fixed income at Chicago-based Nuveen who oversees about $155 billion municipal bonds under management.

“I think if phased in appropriately and combined with other efforts, Chicago can probably handle another property-tax increase,” Miller said.

The next mayor, who will take over in May, will see Chicago’s required annual contribution to the city’s four pension funds double from about $1 billion in 2018 to $2.1 billion in 2023, city documents show.

The pension bills will soar because the city will have to pay what actuaries say is needed into the public safety funds starting in the 2020 budget year and in 2023 for the municipal employees’ and laborers’ plans. That means not only covering what it owed for newly earned benefits, but making up for the shortfall that resulted from years of not paying the full amount.

Unless Chicago’s economy continues to expand at a robust rate to generate natural growth in other sources, such as sales taxes and fees, additional tax increases will be needed to fund the required pension contributions over the long term, Moody’s said in a report.

Sports Betting

Two potential sources of new money for Chicago would be its share from legalizing sports betting and marijuana — proposals included in Governor J.B. Pritzker’s budget announced last week. The state legislature is controlled by Pritzker’s fellow Democrats, but even if those measures passed they wouldn’t fill the pension hole.

“The issues that they’re talking about — ranging from a casino to marijuana — I don’t think that’ll be enough,” said RBC Capital Markets municipal-debt strategist Brian Olson. “It has to be comprehensive. It has to be taxes, it has to be cuts.”

In the months since Emanuel’s surprise announcement that he wasn’t going to run for a third term, he has advocated for the sale of $10 billion in pension obligation bonds — debt issued to infuse cash into the pension system on the bet that the returns generated will outpace the interest payments to investors. The proposal has had mixed reviews among candidates and the bond market alike.

Bill Daley, who served as chief of staff to President Barack Obama, said such a proposal “ought to be on the table” but he remains skeptical of the plan. “It’s all great as long as rates stay good,” he said. “There’s a risk-reward.” Daley has said the best way to solve the city’s pension problem would be to alter the state’s constitution to allow existing benefits for public employees to be reduced.

relates to Chicago’s Next Mayor Can’t Dodge Tax Pain Needed for Pension Fix
Susana Mendoza.Photographer: Seth Perlman/AP Photos
Mendoza has advocated for a bond deal, though not one as large as the $10 billion sale Emanuel floated. She called that amount “overly aggressive.” Instead, she said a lower-risk plan of $2 billion to $3 billion or medium-risk one of $5 billion to $6 billion should be presented to the voters. “It’s not an ideal option, but we don’t really have other sources of immediate cash flow,” she said.

Another prominent candidate, Gery Chico, said in an interview that he’d been hesitant to bond out the liabilities, but after speaking with bankers “they’ve made me more comfortable with it as a tool.”

Whatever temporary tool is used, Chicago’s pension burden will increase and current contributions will likely fail to meet the required amounts. So the next mayor likely will face an unpalatable decision, said Michael Belsky, executive director of the Center for Municipal Finance at the University of Chicago.

“The liability isn’t going to go away, and you’ll need additional revenue,” Belsky said. “The most reliable source of revenue is the property tax.”

Bloomberg Markets

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February 25, 2019

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