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Fitch: Chicago's Plan Slow to Improve Pensions.

Fitch Ratings-New York-09 April 2014: The Chicago pension reform plan, approved by the Illinois State Legislature Tuesday, would eliminate the threat of pension insolvency facing two of the city's four plans. However, long-term pension fund sustainability is many years away, according to Fitch Ratings. Illinois affords particularly strong legal protection to pension benefits and Fitch expects these changes will face protracted litigation.

Chicago's ('A-'/Outlook Negative) combined unfunded liability for all four plans totals $19 billion, yielding a funded ratio of 35%. Fitch considers pension funding levels below 70% to be weak. The proposal seeks to improve two pension systems by trimming future growth of the liability with changes to the cost of living adjustments (COLA), while providing increased contributions from both employer and employees. The plan redefines the city's annual required contribution (ARC) to an amount that would be sufficient to produce 90% funding in 40 years, similar to the weak funding standard used by the state's plans prior to its recent pension reform.

The closed amortization period is a positive, but given the four- to six-year ramp up before reaching the weaker ARC level, combined with the long amortization period, Fitch believes it will be many years before meaningful reduction in the unfunded liability is evident.

Officials expect a property tax increase will cover half of the increased costs with budget savings, such as the elimination of most retiree healthcare benefits to make up the balance.

Increasing pension costs are a recurring theme among Chicago area governments and funding these increases will likely place a considerable stacked burden on the area's resource base. The city plans to gradually increase its property tax levy by $50 million (approximately 6%) annually for five years before reaching the target increment of $250 million in the fifth year.

These increases will occur in the context of other steeply rising costs, including a statutorily required $600 million increase in contributions for the city's other two pension systems (police and fire) in 2016. The city has not said how the $600 million increase for police and fire will be accommodated, but media reports indicate that future legislation may allow for a ramping up of the funding obligation.

Contact:

Arlene Bohner
Senior Director
U.S. Public Finance
+1 212-908-0554
33 Whitehall Street
New York, NY

Rob Rowan
Senior Director

Fitch Wire
+1 212 908-9159
1 State Street Plaza
New York, NY

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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