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Fitch: Chicago Pension Litigation Threatens Progress.

Fitch Ratings-New York-19 December 2014: Tuesday's legal challenge to Chicago's recent pension reform plan was expected and underscores the difficulty the city faces in its efforts to put its pension plans on firmer footing. Illinois affords particularly strong legal protection to pension benefits.

If the litigation succeeds and changes to the cost of living adjustments (COLAs) and employee contributions are struck down (and no replacement legislation is passed), the city would likely revert back to the lower, statutorily based payments, as annual payments on an actuarially sound basis would rise dramatically. These increases would occur in the context of a statutorily required $538 million increase in contributions for the city's other two pension systems (police and fire) in 2016. The city has not yet said how the increased pension costs will be accommodated, but Fitch Ratings believes they threaten to crowd out other governmental priorities and remain a formidable challenge to the city's financial equilibrium.

The city benefits from a strong local economy and enjoys broad home rule authority to raise revenues. However, increasing pension costs are a common problem among Chicago-area governments and funding these increases will likely place a considerable stacked burden on the area's resource base.

All four of Chicago's (A-/Outlook Negative) pension plans are poorly funded, at a combined 35%, according to Fitch. Annual payments historically were calculated and made based upon a statutory formula, rather than on actuarial projections. The Illinois legislature passed changes to two of Chicago's four pension plans in April 2013, trimming future growth of the liability with changes to the COLA while providing increased contributions from employer and employees.

If the new plan is upheld, it would require significant payment increases from the city, approximately half of which are expected to be funded by increased property taxes and half by budgetary savings. The city plans to gradually increase its revenues for pension payments, which may include property taxes, by $50 million (approximately 6%) annually for five years before reaching the target increment of $250 million in the fifth year.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.