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S&P: Court Rejects Chicago's Pension Reform; City Needs New Plan to Address Its Ongoing Structural Imbalance.

CHICAGO (Standard & Poor's) July 24, 2015—A Cook County circuit court judge today ruled against Chicago's statutory pension reform for its municipal and laborers plans, determining it is not allowable under the state's constitution. The case was brought by unions and retirees that challenged Chicago's pension reform. Standard & Poor's Ratings Services expects the city to appeal the decision to the Illinois Supreme Court.

In the short term, the amount of the city's contributions would decrease, likely reverting to the previous statutory formula. Despite a temporary budgetary reprieve, the increase in the city's pension liability is a significant credit risk, and the limitations placed on the city to fund those liabilities increases the liability's growth. The long-term impact of drawing down pension assets is not quantified at this time, and the magnitude of the financial and legal implications for the city if the municipal and laborers pension plans become insolvent are uncertain. Ultimately, the loss of this case means more hurdles for the city in its attempt to address its growing pension liabilities. We will likely lower our GO rating within the next six months if the city fails to incorporate pension contributions in a structurally balanced manner.

Pension reform has been one of the city's ongoing challenges. In our most recent outlook on the city's general obligation rating, we noted that, during the following six months, Chicago would need to address both its current structural imbalance, as well as the looming pension pressures to maintain its rating. For more information, please see the analysis published July 8, 2015 on RatingsDirect. Despite a likely appeal, which would delay a final decision, the loss at the circuit court level should spur the city to consider alternatives. In our view, the ruling forces the city to identify a solution that does not rely on pension reform to manage the budget demands of its pension liabilities in the long-run — a particular challenge given Illinois' state statutes governing pensions.

We expect that the next six months will show how serious the city is about implementing both immediate and far-reaching plans to address the structural cracks in its budget, including creating its own pension solution. Given the uncertainties surrounding an appeal, however, we expect city management to consider contingency plans for addressing its liability regardless of the ultimate outcome. Without long-term structural fixes, the rating on the city's debt will continue to be pressured.

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