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Chicago Pension Ruling Seen as a Loss For Investors.

As Chicago awaits the ruling on whether Mayor Rahm Emanuel's plan to save its retirement funds from insolvency is dead or alive, investors are already marking the fight down as a loss that will strain city coffers and boost pension costs by billions.

Conning, which oversees \$11 billion of municipal bonds including Chicago debt, has encouraged investors to reduce their holdings for more than a year, and said the projected negative ruling affirms that view. Wells Fargo Asset Management, which holds \$475 million of Chicago general obligations, said the market is "emotionally prepared" for the loss, and hasn't materially changed position.

The Illinois Supreme Court is weighing whether to uphold or overturn a lower court's July ruling that deemed the restructuring of two non-public-safety retirement funds illegal. If the overhaul is not upheld, it's expected that the unfunded liabilities of the municipal pension fund would increase by \$2 billion, according to the Civic Federation, which cited actuarial reports. Moody's Investors Service said Nov. 10 that rejecting the pension fix could pressure Chicago's credit quality, but has factored such a decision into its speculative-grade rating on the city that has a \$20 billion pension shortfall.

"As an investor, you have to assume that the city is going to lose," according to Matt Fabian, a partner at Concord, Massachusetts-based Municipal Market Analytics, who said the city is still a good purchase for investors seeking tax-exempt income. "The city doesn't have many triggers left to pull."

After shortchanging its pensions by billions over the last decade, the city enacted a plan Jan. 1 to make the laborer and municipal workers' pensions 90 percent funded by the end of 2055. The move forces employees and the city to pay more while trimming cost-of-living increases.

Bond prices for the most-actively traded Chicago debt over the last three months have climbed since a circuit court judge struck down the pension changes in July. The city council passed a 2016 spending plan on Oct. 28 that includes a record property tax increase to fund police and fire pensions.

A portion of taxable Chicago debt that matures in January 2033 traded Nov. 20 for an average of 106 cents on the dollar to yield 6.8 percent, up from 102 cents to yield 7.2 percent on July 24, the day of the lower court's decision.

Unions that sued to block changes say benefits cuts make the plan unconstitutional, while the city argues this will keep the funds from running out of money in the next 10 to 13 years. The justices heard oral arguments on Nov. 17 in Springfield, the state capital. Stephen Patton, the city's lawyer, noted that most of the unions that represent the affected workers supported the changes. He sought to distinguish the fix from the state's act in May that was found unconstitutional.

Under Consideration

“The act avoids this looming disaster for the funds and their participants by massively increasing the city’s contributions and imposing a new obligation that the city must pay each year whatever amount the funds’ actuaries determine is necessary to ensure that the funds are fully funded and that all pensions will be paid,” Patton told the justices in his opening remarks.

The case is under consideration, and a decision will come whenever the justices are prepared to release one, said Bethany Krajelis, a spokeswoman for the court. There’s no deadline or timeline on a decision, she said.

Lawyers for unions that sued argued that the changes unquestionably cut benefits, making it illegal as Illinois’s constitution bans reducing worker retirement benefits.

Market analysts including Fabian, Paul Mansour of Conning and Dan Heckman of U.S. Bank Wealth Management don’t expect much of a market reaction, unless the justices reverse the lower court’s decision in a surprise move.

Longer View

“If the city wins, you could see some positive price action just because it’s been void of victories from a financial standpoint,” Gabe Diederich of Wells said. After the win on higher property taxes rallied Chicago bonds, a positive court ruling on the pension overhaul “just shows they’re taking steps, and they’re taking steps that are being either recognized, or upheld that can get put through.”

While a favorable ruling on the municipal and laborers pensions would certainly be a positive, it doesn’t change the “long-term view” that the city still has high pension obligations that they need to cover and meet, said Mansour, who oversees funds for insurance companies.

If the court doesn’t uphold the pension changes as constitutional, that will “severely limit” how the city can manage its mounting retirement debt, said Laurence Msall, president of the Civic Federation, which tracks the city’s finances.

“If the courts don’t allow it to negotiate benefit changes that protect the fund, then that’s going to put additional financial pressure on already a severely strained city government,” Msall said. “It will bode ill for Chicago public schools and all other local governments throughout the state of Illinois that are challenged to meet their pension obligations.”

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