

THE UGLY TRUTH ABOUT ILLINOIS' LOCAL GOVERNMENT PENSIONS

The State of Illinois apparently believes that ignoring its massive unfunded pension crisis will make it go away. But it gets worse by the week, and soon it may be impossible to dig out. Every Illinois citizen will be impacted. The amount of Illinois' **unfunded** pension obligations nears \$200 billion. Not only is Illinois in the deepest pension hole of any state; but Illinois' state and local unfunded pension debt is 15% of the entire country's unfunded debt. The implications are difficult to comprehend.

One-fourth of Illinois' unfunded pension debt is local. This \$50 **billion** share could explode Illinois' property taxes. Cities like Streator can no longer wait on the State to do something. So Streator has decided to start its own reform movement. We're just a small town in central Illinois; but we've decided it's time to stop complaining, and start doing something. This detailed position paper lists reform strategies, not just for Streator, but for municipalities across Illinois, and for the State itself.

Illinois' property taxes are among the highest in the nation. Most cities want to limit property tax increases, but City Council's everywhere are losing control of their tax levies to pensions. Pensions comprise 55% of Streator's annual tax levy—mostly police and fire pensions. Some Illinois cities spend their entire property tax levy on pensions. Mandated pension contributions are not set by cities—so limiting property tax increases gets harder and harder. Local fire and police pension benefits are set by the State, though Illinois contributes nothing toward local pension costs. The Illinois General Assembly is happy to mandate higher police and fire pension benefits, because they do not pay for **ANY** of them.

Attempts by Streator to make modest pension reforms are fiercely resisted. Local police and fire unions have cut off collective bargaining, refuse to make new proposals, and demand arbitration. The impasse has less to do with wages, and more to do with opposing even small pension reforms—changes intended to **strengthen** the long-term health of pension funds. Everyone knows the system is broken. But locally we hear: “Yea, we realize there is a problem, but don't touch ours.”

How did the costs of servicing local public safety pensions become so large?

1. Permanently low interest rates cause local pension fund deficits because with marginal returns it costs more to honor future pension promises. Actuaries are allowed to optimistically calculate returns from pension assets at rates bearing no relation to actual market returns. Altering calculation methods drives up local property taxes, so no reforms of this type have been made.
2. Through collective bargaining, public safety unions have successfully “hiked” or “spiked” pension benefits by adding other forms of compensation to the pensionable base (like longevity pay, higher education stipends, etc.). These payroll enhancements distort the principles of actuarial analyses.
3. For decades employee special interest groups have lobbied the State for benefit increases (e.g., full retirement pensions at age 50, larger spousal benefits,

automatic 3% per year increases regardless of inflation, etc.). So what constitutes full-funding keeps increasing. As a result, public pension benefits in Illinois greatly exceed those provided in the private sector.

4. Fire and Police pension funds are managed inefficiently. There are 653 fire and police pension funds in Illinois (two in Streator). By contrast, all non-public safety employee pensions for all cities and counties outside Chicago are administered only by IMRF. Prudent management has made the Illinois Municipal Retirement Fund (IMRF) one of the ten best-funded public employee retirement systems in the country. Illinois' 653 fire and police pension funds do not benefit from such efficiency. Their inefficiency adds to the costs of pension administration and limits investment returns because assets cannot be 'bundled,' which indirectly increases the local property tax burden.

So what is the solution? How can local pensions be reformed while still providing reasonable benefits for all who earned them? There is no simple fix; solutions require structural reforms that vested, entrenched special interest groups resist:

1. Reform by the State: a) slowly transition public pensions from defined benefit to defined contribution plans over a period of several decades—a transition largely completed in the private sector; and b) gradually align pensions to match benefit levels in other states, and then shift oversight authority away from the Illinois General Assembly.

2. Encourage governments to make pension reforms: a) promoting staffing innovations like use of part-timers and outsourced public safety employees (where no existing public safety personnel are laid-off) to reduce the employees for whom pension obligations are created; and b) permitting governments to exclude compensation that is outside base pay from being included in pension calculations.

3. Give local governments greater access to new revenue streams to augment pension contributions: a) allowing public pension funds to purchase the bonds and assets of the revenue-producing infrastructure Illinois so desperately needs (railways, airports, toll roads, utilities and Smart technology systems, etc.). These more reliable investments provide a better rate of return on pensioners' contributions; and b) allow local governments more authority to operate non-traditional assets, utilities and infrastructure if net revenues go to pensions and infrastructure.

4. Combine the administration of Illinois' 653 local police and fire pension funds into a new Illinois police and fire pension agency, or into IMRF, to save costs and obtain higher returns on members' assets. Actuarial liabilities would still be calculated separately for each local government.

The current system is unsustainable. It will irreparably damage Illinois' economy, drive up local property taxes, damage the long-term viability of pension accounts, and push more people into leaving Illinois. We look forward to discussing our proposed solutions with our citizens, and with other cities.

-- Scot Wrighton