THE BOND BUYER

Chicago Water Reclamation District Gets State POB Authority

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Illinois Gov. J.B. Pritzker signed legislation that gives the Metropolitan Water Reclamation District of Greater Chicago $600 million in pension obligation bonding authority at it looks to reach a funded goal of 65% by the end of 2026.

The special-purpose district responsible for treating wastewater and providing stormwater management for Chicago and 128 suburbs closed out 2021 with its pensions at a 58.7% funded ratio. While weak when held up against national standards, it’s among the better in the Chicago area after the district took action nearly a decade ago to raise contribution levels.

"The district will be reviewing the possibility of issuing bonds this year with its financial and legal advisors," district Treasurer Mary Ann Boyle said in an email. "Interest rates were at historic lows at the end of 2021. The large difference in market interest rates and the 7.25% pension liability discount rate is the source of savings we hope to achieve in this transaction. Market conditions will be monitored, and a decision will be made when it may be best to access the market."

The Metropolitan Water Reclamation District of Greater Chicago's Stickney Water Reclamation Plant. **Bloomberg News**

The district would tap the POB authority incrementally. It faces a rising interest rate environment and the expectation of further Federal Reserve rate hikes to combat inflation.

The Government Finance Officers Association recommends against the use of POBs because of the "considerable investment risk" inherent in the arbitrage gamble that earnings on investments purchased with bond proceeds will exceed the interest payments on the bonds.

Rating agencies weigh POBs on a credit-by-credit basis, but MWRD sees the potential issuance as an option that can help make further progress on funding levels.

“The district is actively addressing its pension liability by providing increased funding to the plan,” Boyle said. “This legislation is another tool to assist the district in meeting its obligation to fully fund the pension liability.”

The legislation also formally puts in statute a track to reach a 100% funded ratio by 2050 — up from 90%. The district adopted the 90% target in 2014. The formal move will draw positive reviews.

Most other local and state plans in Illinois are making pension contributions — some at actuarially based levels — to reach 90% funded ratios in the coming decades under payment plans governed by state statutes, but actuaries recommend a 100% target.

The district last year put a 65% funded ratio goal in its five-year strategic plan to reach by the end of 2026.

With airtight constitutional protections against benefit cuts, MWRD took early steps ahead of most Illinois peers a decade ago to begin addressing the pension and other post-employment retiree healthcare strains with increased funding contributions and setting up an OPEB trust. The district's payments since 2014 have exceeded an annual determined contribution, or ADC.

The previous legislative package raised employee and employer contributions but did not cut benefits. The district did not face a legal challenge.

Pension overhauls by Chicago and the state government were overturned by the Illinois Supreme Court, but they cut benefits which the courts have said violates the state constitution's pension clause banning the impairment or diminishment of benefits.

Statutes allow the district to levy an amount up to 4.19 times employee contributions. The district made a combined contribution of $88.8 million for fiscal 2021, over an ADC level of $76.8 million. In 2021, legislation allowed the district to also transfer excess revenues from lawfully available sources to the pension plan. As a result of that legislation, an additional $30 million was contributed to the pension plan in March as part of the 2022 budget.

"The three tools we have in place to increase funding for the plan are to contribute an amount in excess of the ADC each year, contribute excess revenues as available, and issue bonds to supplement funding when the market interest cost is lower than historical rates," Boyle said.

The new bill received final passage March 31 and Pritzker signed it Friday.

It allows the district to use tax revenues collected for the benefit of the pension fund to pay principal and interest on bonds sold for the sole purpose of making contributions. It authorizes up to $600 million of borrowing without submitting the question to voters if intended to decrease the unfunded liability of the pension fund and not to decrease the amount of employer pension contributions.

The district carried an unfunded tab of $1.13 billion based on its last actuarial report for 2020 and 57.3%.

The district's $1 billion of unfunded liabilities make up a small piece of the $47 billion tab in 2019 for all eight funds that rely on Chicago's tax base. The reclamation district's tax base is also more expansive than the others: Chicago's four city pension funds, the Chicago Park District, Chicago Board of Education, and Chicago Transit Authority.

The collective funded ratio of the eight was just 34% and MWRD has the strongest funded ratio among the eight. MWRD's funded ratios has risen since 2012 when it was at 50%. It's hovered between 54% and 58% since, according to the legislature's Commission on Government Forecasting and Accountability's 2021 review.

The district was early among local governments to pre-fund its non-pension retiree healthcare liability. Its other post-employment benefit plan is 92% funded. The OPEB trust fund is expected to be fully funded by 2026.

The district's actions haven't prevented rating downgrades although they might have prevented deeper deterioration. One past downgrade was blamed primarily on the risks associated with a tax base shared with so many governments weighed down by burdensome pension liabilities.

S&P Global Ratings in 2016 knocked the district down one notch to AA-plus from AAA saying it "reflects our view of the potential impacts of the combined pension liabilities and debt of the overlapping governmental entities on the district's tax base."

S&P acted again in October 2020 cutting the rating one notch to its current level of AA citing the district's "poorly funded pension plan with a sizeable liability of over $1.2 billion which we believe weakens its overall credit worthiness and represents a governance risk that in our view is above the sector standard despite management's efforts to improve the funded status during the past seven years."

The district has held on to its AAA rating and stable outlook from Fitch Ratings.

Moody's Investors Service rates the district Aa2 with a stable outlook, but has not been asked to rate deals since 2011.

"The district benefits from a very large tax base and diverse economic composition that serves as the largest regional economic center in the Midwest. The district's challenges include elevated debt and pension burdens of the district and overlapping local governments," Moody's said in a January report.

In addition to borrowing on its own, the district taps low interest loans through the Illinois Environmental Protection Agency. No bonds with the exception of POBs are planned until 2025 unless a refunding opportunity arises, Boyle said.

A $500 million borrowing late last year supported a five-year, $787 million capital program that relies on a total of $633 million of direct and state revolving fund borrowing with other funding coming from the Army Corps of Engineers and storm-water management fund tax levy collections.

Projects include the deep tunnel known as the Tunnel and Reservoir Plan that's designed to capture storm water and prevent flooding; bio-solids management; facility upgrades; and intercepting sewers.

The district operates on a roughly $375 million budget with property taxes its largest revenue source. Reserves and liquidity remain in healthy shape and the COVID-19 pandemic had little impact on the district's balance sheet.

The market saw an uptick of local Illinois government POB issuance last year and early this year as they grapple with rising statutorily required contributions for their public safety funds that are straining budgets. Several are still considering POBs even as interest rates rise.

The unfunded tab for the 295 firefighter funds and 352 police funds outside of Chicago grew to $13 billion in fiscal 2019 from $12.3 billion in 2018 and $11.5 billion in 2017. Police accounted for $7.5 billion of the total and firefighters for $5.5 billion, according to a report published by the Illinois Commission on Government Forecasting and Accountability.