The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2018 RECOMMENDED OPERATING AND CAPITAL BUDGETS:

Analysis and Recommendations

May 9, 2017

The Civic Federation ● 10 N. Dearborn Street ● Chicago, IL 60602 ● civicfed.org

The Civic Federation
would like to express its gratitude
to the John D. and Catherine T. MacArthur Foundation,
whose generous grant to fund
the Institute for Illinois' Fiscal Sustainability at the Civic Federation
made the research and writing of this report possible.

ACKNOWLEDGMENTS

The Institute for Illinois' Fiscal Sustainability at the Civic Federation would like to express its appreciation to the Governor's Office of Management and Budget, the Illinois Department of Revenue and the Illinois Office of the Comptroller for their assistance with this report.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The State of Illinois has endured almost two years without a complete budget. This unprecedented lapse represents a stunning failure of leadership by the Governor and all of the members of the Illinois General Assembly.

Without a budget, Illinois' credit rating has fallen to near-junk status and its ability to defer payments—as evidenced by a mountain of unpaid bills—may be coming to an end. Vendors, healthcare providers and school districts are straining to cope with the payment delays. Public universities and social service agencies, offered only limited State funding for more than 22 months, are cutting programs and laying off staff.

The Federation calls on the Governor and General Assembly to end the unacceptable budget impasse and work together to develop a sustainable financial plan for FY2018. The Federation **opposes** any effort to enact appropriations for FY2018 that are not part of a comprehensive and balanced budget, including partial-year stopgaps and K-12-only appropriations.

Enacted appropriations for elementary and secondary education in FY2016 and FY2017 have allowed public schools to stay open, despite the lack of a full budget. Singling out K-12 education shields much of the public from the impact of the budget standoff and reduces pressure on State officials to find a comprehensive solution to the crisis. However, even with full funding, school districts are still hurting because of delayed payments for areas such as transportation and special education.

Unfortunately, Governor Bruce Rauner's recommended budget for FY2018 does not offer a sufficiently detailed plan to fully address the State's immense financial problems. The Civic Federation **opposes** the proposed budget because it has an operating deficit of at least $4.6 billion. To close the gap, it relies on a bipartisan agreement in the Illinois Senate, the provisions of which are in flux and likelihood of passage unclear.

The Federation **cannot support** a budget that could allow the backlog of unpaid bills to increase to $15.2 billion—even if the operating deficit is somehow eliminated—and rise to $19.7 billion if the gap is not closed. Because of the backlog, the State begins each fiscal year in a hole, using revenues from the current year to pay off the previous year's obligations.

Illinois has massive pension costs that are difficult to reduce due to recent Illinois Supreme Court rulings on State constitutional protections. However, the Federation **cannot support** the Governor's plan to cut General Funds contributions by $1.25 billion, or 15.8%, in FY2018, partly by deferring payments to later years and taking upfront savings on future liability reductions. Given the State's history of inadequate pension contributions and its current funded ratio of only 37.6%, it is not prudent to use accounting gimmicks to reduce pension costs. The administration has not made available any actuarial reviews of the pension changes that might allay those concerns.

The Federation is in favor of reductions in State employee health insurance costs but **cannot support** the projected decrease of $435 million, or nearly one-quarter, in group insurance payments in the proposed FY2018 budget. The savings depend on a new contract with the State's largest union that is currently tied up in a legal dispute, and it is uncertain when or if the administration's terms will be implemented. The projection follows years of underfunding health insurance contributions, which has fueled growth in the backlog of claims. The Federation is similarly

concerned about the project $336 million in reduced compensation costs from changes in the new contract.

The Federation is **concerned** about the plan to save $120 million on the Community Care Program, which is aimed at keeping elderly residents out of nursing homes. The savings would come from the creation of a new program—offering services costing on average 60% as much—for seniors who do not qualify for Medicaid. It remains to be seen whether the new services would be adequate to avoid more expensive nursing home placements.

The proposed budget relies on the use of $240 million in projected net proceeds from the sale of the James R. Thompson Center in Chicago. The Federation **opposes** the use of proceeds from an asset sale for operating expenses and questions whether the sale would be completed in time to help balance the FY2018 budget.

The Federation continues to **recommend** a comprehensive plan including spending restraints and increased revenues. Spending controls are at the center of the Federation's plan, but more revenue is also needed to help reduce the operating deficit in FY2017 and close the gap in FY2018 without drastically changing the scope of State government. The plan also proposes borrowing to pay off the backlog of bills, but only in the context of a balanced FY2018 budget, a credible plan to maintain fiscal sustainability, restriction of the bond proceeds to eliminating the bill backlog and the payment of debt service with revenues not otherwise needed to balance the budget.

The Civic Federation offers the following key **findings** on the Governor's recommended budget:

- The proposed General Funds[1] budget has an operating deficit of at least $4.6 billion and relies exclusively on a group of still changing proposals under consideration by Illinois Senate leaders to close the gap;
- The backlog of unpaid bills[2] declined from $8.1 billion at the end of FY2012 to $5.2 billion at the end of FY2015 before rising to $9.1 billion in FY2016 and could climb to $14.7 billion in FY2017 if additional appropriations are enacted without additional revenue;
- If the FY2018 operating deficit is closed, the backlog shown by the Governor could be $15.2 billion at the end of the year, requiring 44.6% of projected FY2019 revenues to pay off the bills;
- If the FY2018 operating deficit is not eliminated, the backlog could grow to $19.7 billion, which would need to be paid off with 58.1% of projected FY2019 revenues;
- The FY2018 maintenance budget[3] has an operating deficit of $7.2 billion, which is reduced to $4.6 billion through $2.4 billion in spending reductions and about $240 million in one-time net revenues related to the proposed sale of the James R. Thompson Center;
- Proposed spending reductions from the maintenance level include the following:
    - Pensions: General Funds contributions to the State's five retirement systems total $6.6 billion, which is $1.25 billion below the amount currently required by State

[1] General Funds consist of the General Revenue Fund, the Education Assistance Fund, the Common School Fund and the General Revenue-Common School Special Account Fund. The Governor's proposed FY2018 budget proposes that three additional funds—the Fund for the Advancement of Education, the Commitment to Human Services Fund and the Budget Stabilization Fund—be included in General Funds. This report includes the three funds in General Funds.
[2] For budgetary purposes, the backlog of unpaid bills represents this year's General Funds obligations that must be paid from subsequent years' revenue.
[3] Maintenance budget is defined as the amount sufficient to fully fund agencies' core missions and programs for a given fiscal year.

law. The savings come from recalculating pension liabilities to lower current expenses and by shifting pension costs to local school districts and universities.
    - Group Insurance: State payments are reduced by $435 million, or 23.5%, by requiring workers to pay sharply higher health insurance premiums or accept less generous coverage, but these changes are awaiting the outcome of a legal dispute over a new labor contract.
    - Employee compensation: Costs are estimated to be $336 million less than they would have been under the expired labor contract through a four-year freeze on wages under the new contract, which has yet to be implemented.
    - Higher education funding: Total proposed funding declines by $125 million.
    - Human Services: At-home senior care is reduced by $120 million and about a dozen programs with a total cost of $69 million are eliminated, including funeral and burial expenses for the poor, after-school programs for teens and youth employment services.
    - Others: The budget includes savings of $174 million from procurement changes and $130 million from eliminating State contributions for retiree health insurance for teachers and community college employees outside Chicago and to the Chicago teachers' pension fund;
- Proposed spending increases from the maintenance level include $250 million for elementary and secondary education and $10.5 million for 170 additional State troopers;
- The FY2017 operating deficit is estimated at $5.7 billion if additional appropriations to fund current programs and services are enacted without revenue increases;
- Average annual funding for higher education over the past two years has been 41.8% of the FY2015 level, and an additional $2.3 billion would be needed to match FY2015's annual funding;
- Human service programs not covered by court orders or consent decrees have a two-year funding shortfall of $952 million, compared with the FY2015 level;
- If the State receives three-notch downgrades from either Standard & Poor's or Moody's it faces potential swap termination payments currently valued at $107.9 million. A lesser amount would be triggered by two-notch downgrades from either rating company; and
- Despite some improvement, the revenue sources enacted to fund the capital budget have continue to fall short of expectations since FY2010.

The Civic Federation is **concerned** about the following aspects of the Governor's recommended FY2018 budget:

- The General Funds budget has an operating deficit of at least $4.6 billion and no detailed plan to close the gap between revenues and expenditures;
- The State's backlog of unpaid bills could grow to $15.2 billion, even if the operating deficit is closed, and the budget contains no detailed plan to deal with the backlog;
- General Funds **pension contributions are reduced by $1.25 billion**, partly by deferring contributions to later years and taking upfront saving on future liability reductions, and **no actuarial reviews of the changes** have been provided;
- Group insurance payments are reduced by nearly one-quarter and employee compensation is estimated at $336 million lower than the old labor contract, even though contractual changes required to achieve the savings have not been implemented;
- A new at-home care program for seniors not eligible for Medicaid would reduce costs by $120 million but might result in more nursing home placements; and

- One-time resources from the sale of the James R. Thompson Center may not materialize in FY2018 and should not be used to help balance the budget.

The Civic Federation has the following **recommendations** intended to address Illinois' current fiscal crisis and provide for long-term improvement to the State's financial health:

- The Governor and General Assembly must enact a comprehensive budget for the full year of FY2018 that covers the cost of all areas of State government and the necessary resources to balance those expenditures.
    - The State should not approve any temporary, stop-gap or partial budgets that cover only some areas of expenditure for FY2018.
    - Nor should it expand the use of continuing appropriations to cover expenditures normally appropriated during the annual budget process;
- The State should pursue a balanced budget and a multi-year plan to restore fiscal sustainability by following the recommendations in the Civic Federation's FY2018 Budget Roadmap report, including:
    - **Limiting expenditure growth to no more than 1.7%** until the State's financial condition can be substantially improved.
    - Increasing the **individual income tax to 5.25%** from 3.75% until January 1, 2022, when it can be lowered to 5.00%.
    - Expanding the Earned Income Tax Credit by 50% to alleviate the impact of the tax increases on low-income taxpayers.
    - Increasing the **corporate income tax to 7.00% from 5.25%**.
    - Broadening the income tax base by **eliminating the exemption of federally-taxed retirement income**.
    - Expanding the sales tax base to include services and **lowering the State portion** of the rate to **4.25% from 5.00%**.
    - Limiting or eliminating business tax expenditures.
    - Merging the Chicago teachers' pension fund (CTPF) with the Teachers' Retirement System (TRS), assuming the unfunded liability of the CTPF, and shifting the normal cost of employees under TRS to local school districts over three years.
    - Borrowing to clear the unpaid bill backlog, only in the context of a balanced budget and credible plan to restore fiscal sustainability.
    - Making supplemental pension payments of $1 billion per year following the repayment of all **backlog bond debt**, until all State funds are 100% funded.
    - Building a rainy day fund equal to 10.0% of General Funds revenues;
- The State should **facilitate the consolidation of local government** units to promote greater **efficiency and accountability**, including:
    - Merging CTPF and TRS.
    - Consolidating local pension funds.
    - Merging the offices of the Illinois Comptroller and Treasurer.
    - Authorizing townships to be dissolved by referendum.
    - Further consolidating property tax administration roles in Cook County.
    - Dissolving the Illinois International Port District;
- The State should immediately implement the following best practices for financial reporting and management:
    - Pension reforms proposed as part of the Governor's budget should include an actuarial review to assess the effects of the proposed changes.

- The State should report monthly on bills outstanding at all agencies, their age and any penalty interest accrued under state law;
- Once the State pays off its unpaid bill backlog and begins to make progress toward building a rainy day fund, it should consider the following measures that would give the State's finances more long-term sustainability:
  - A reduction in the interest the State pays on overdue bills.
  - A return of the lapse period to two months from six.
  - A phase-out of Section 25 liabilities and other practices that allow current years' costs to be paid from future years' appropriations;
- The Civic Federation recommends consideration of two changes to the Illinois Constitution to improve long-term fiscal sustainability and ensure that sufficient revenues can be raised equitably:
  - An amendment specifying that the pension protection clause applies only to accrued benefits.
  - An amendment to allow a graduated individual income tax.

CIVIC FEDERATION POSITION AND RECOMMENDATIONS

The State of Illinois has endured almost two years without a complete budget. This unprecedented lapse represents a stunning failure of leadership by the Governor and all of the members of the General Assembly.

Without a budget, Illinois' credit rating has fallen to near-junk status and its ability to defer payments—as evidenced by a mountain of unpaid bills—may be coming to an end. Vendors, healthcare providers and school districts are straining to cope with the payment delays. Public universities and social service agencies, offered only limited State funding for more than 22 months, are cutting programs and laying off staff.

The Federation calls on the Governor and General Assembly to end the unacceptable budget impasse and work together to develop a sustainable financial plan for FY2018. The Federation **opposes** any effort to enact appropriation bills for FY2018 that are not part of a comprehensive and balanced budget.

Enacted appropriations for elementary and secondary education in FY2016 and FY2017 have allowed public schools to stay open, despite the lack of a full budget. Singling out K-12 education funding shields much of the public from the impact of the budget standoff and reduces pressure on State officials to find a comprehensive solution to the crisis. Even with full funding, school districts are still hurting because of delayed payments for areas such as transportation and special education.

Unfortunately, Governor Bruce Rauner's recommended budget for FY2018 does not offer a sufficiently detailed plan to fully address the State's immense financial problems. The Civic Federation **opposes** the proposed budget because it has an operating deficit of at least $4.6 billion. To close the gap, it relies on the hope of a bipartisan agreement in the Illinois Senate, the provisions of which are in flux and likelihood of passage remains unclear.

The Federation **cannot support** a budget that could allow the backlog of unpaid bills to increase to $15.2 billion even if the operating deficit is somehow eliminated and rise to $19.7 billion if the gap is not closed. Because of the backlog, the State begins each fiscal year in a hole, using revenues from the current year to pay off the previous year's obligations.

Illinois has massive pension costs that are difficult to reduce due to recent Illinois Supreme Court rulings on State constitutional protections. However, the Federation **cannot support** the Governor's plan to cut General Funds contributions by $1.25 billion, or 15.8%, in FY2018, partly by deferring payments to later years and taking upfront savings on future liability reductions. Given the State's history of inadequate pension contributions and its current funded ratio of only 37.6%, it is not prudent to use accounting gimmicks to reduce pension costs. The administration has not made available any actuarial reviews of the pension changes that might allay those concerns.

The Federation is in favor of reductions in State employee health insurance costs but **cannot support** the projected decrease of $435 million, or nearly one-quarter, in group insurance payments in the proposed FY2018 budget. The savings depend on a new contract with the State's largest union that is currently tied up in a legal dispute, and it is uncertain when or if the administration's terms will be implemented. The projection follows years of underfunding health insurance contributions, which has fueled growth in the backlog of claims. The Federation is similarly

concerned about $336 million in lower compensation levels based on proposed changes in the new contract.

The Federation is **concerned** about the plan to save $120 million on the Community Care Program, which is aimed at keeping elderly residents out of nursing homes. The savings would come from the creation of a new program—offering services costing on average 60% as much—for seniors who do not qualify for Medicaid. It remains to be seen whether the new services would be adequate to avoid more expensive nursing home placements.

The proposed budget relies on the use of $240 million in projected net proceeds from the sale of the James R. Thompson Center in Chicago. The Federation **opposes** the use of proceeds from an asset sale for operating expenses and questions whether the sale would be completed in time to help balance the FY2018 budget.

The Federation continues to **recommend** a comprehensive plan including spending restraints and increased revenues. Spending controls are at the center of the Federation's plan, but more revenue is also needed to help reduce the operating deficit in FY2017 and close the gap in FY2017 without drastically changing the scope of State government. The plan also proposes borrowing to pay off the backlog of bills, but only in the context of a balanced FY2018 budget, a credible plan to maintain fiscal sustainability, restriction of the bond proceeds to eliminating the bill backlog and the payment of debt service with revenues not otherwise needed to balance the budget.

Civic Federation Concerns

The Civic Federation is concerned about the following aspects of the Governor's recommended FY2018 budget.

Unbalanced Budget Proposal

Governor Rauner's proposed FY2018 budget has an operating deficit of at least $4.6 billion. Instead of a detailed plan for closing the gap between revenues and expenditures, the Governor presented the legislature with two choices:

1. Reaching a "grand bargain" on taxes, spending and reforms, along the lines of a bipartisan effort that has been underway in the Senate for several months with as yet no conclusion; or
2. Granting the Governor broad authority to close the $4.6 billion gap on his own by making cuts to any area of government, with limited exceptions.

The administration arrives at a $4.6 billion operating deficit by beginning with a maintenance budget that has a $7.2 billion shortfall. The budget proposal reduces the gap through projected spending cuts of $2.4 billion and the use of about $240 million in net proceeds from the sale of the James R. Thompson Center in Chicago.

The $4.6 billion figure appears to understate the actual shortfall by as much as $1 billion. The budget proposal assumes a total of $771 million in savings on group health insurance and employee compensation that depend on the implementation of a new contract with the State's largest union. However, the American Federation of State, County and Municipal Employees (AFSCME) has not agreed to the administration's terms and has filed suit to prevent them from taking effect.[4] As a result, it remains to be seen when or if the projected savings might be realized.

In addition, there are several potential impediments to the sale of the Thompson Center. The sale would require authorization by the General Assembly and potentially re-zoning by the City of Chicago.[5] Mayor Rahm Emanuel has also made it clear that he expects the State to pay the costs of replacing the CTA station in the building, which he estimates at $80 to $120 million.

The Illinois Constitution requires the Governor to present a budget in which proposed expenditures do not exceed funds estimated to be available for the fiscal year.[6] Although the Governor's Office has said the recommended FY2018 budget fulfills this requirement,[7] the proposal does not provide a detailed financial plan to eliminate the gap.

Backlog of Unpaid Bills

After declining for the previous three years, the State's backlog of unpaid bills increased significantly in FY2016 and could be even higher in FY2017 and FY2018 due largely to the phase-out of temporary income tax rate increases in the middle of FY2015. Until the State eliminates the backlog, it will not have completed its recovery from the economic downturn that officially ended nearly seven years ago.

For budgetary purposes, the backlog of unpaid bills represents General Funds obligations that must be paid from the next year's revenues.[8] Because of the backlog, the State begins each fiscal year in a hole, using revenues from the current year to pay off the previous year's bills and limiting revenues available for current spending.

The backlog of unpaid bills declined from $8.1 billion at the end of FY2012 to $5.2 billion at the end of FY2015 before rising to $9.1 billion at the end of FY2016. If additional appropriations are enacted with no additional revenues, the backlog could reach $14.7 billion at the end of FY2017. Under the Governor's proposed budget, the backlog could be $15.2 billion at the end of FY2018 if the operating deficit is closed, or 44.6% of projected FY2019 General Funds revenues of $34.0 billion.[9] If the gap is not eliminated, the backlog could grow to $19.7 billion, or 58.1% of projected FY2019 revenues.

As the State pushes bills from one year to the next, it continues to delay payments to vendors and other service providers, transferring its financial distress to businesses, social service agencies and local governments across the State. Fewer companies are bidding for State work and bids are

---

[4] Doug Finke, "Illinois Supreme Court won't immediately hear AFSCME case," *The State Journal-Register*, April 4, 2017.
[5] Lauren Chooljian, "Emanuel Adds More Complications to Thompson Center Sale," WBEZ, May 2, 2017, https://www.wbez.org/shows/wbez-news/emanuel-adds-more-complications-to-thompson-center-sale/258dc2ba-06fa-490c-96f4-dfeb3f69506e (Last accessed May 3, 2017).
[6] Ill. Const. art. VIII, sec. 2(a). The constitutional requirement does not prohibit carrying over a deficit from one year to the next.
[7] Monique Garcia, Kim Geiger and Haley BeMiller, "Rauner talks tax hikes, need for compromise, drawing Democratic laughter," *Chicago Tribune*, February 15, 2017.
[8] For more information on the State's backlog of unpaid bills, see p. 36 of this report.
[9] State of Illinois Governor's Office of Management and Budget, *General Funds/Fund for the Advancement of Education/Commitment to Human Services Fund Financial Walkdown*, November 15, 2016.

coming in higher because vendors cannot be sure when they will be paid.[10] The State also pays steep interest penalties on many overdue bills, which totaled more than $1.0 billion between FY2007 and FY2016[11] and could amount to an additional $700 million in FY2017 if all late bills were paid.[12]

Proposed Changes in State Pension Contributions

The Governor's recommended FY2018 budget includes $750 million in savings from the following proposed pension changes that were also included in the recommended FY2017 budget but not taken up by the General Assembly:

- Actuarial assumptions: Changes in required State contributions related to revised actuarial assumptions would be phased in over five years. The change would allow the State to defer additional contributions due to lower assumed investment rates of return or lower mortality rates.
- Funding formula based on payroll: The retirement systems would use total payroll in determining the State's required contributions, even though pensionable salaries are capped for the less generous Tier 2 pension plan that applies to workers hired on or after January 1, 2011. Because required State contributions are based on a level percentage of payroll through FY2045, the change would reduce near-term contributions.
- Salary spiking: School districts and universities would pay pension costs for end-of-career raises that exceed the average growth rate in wages. The State currently pays pension costs due to salary increases up to 6%.
- High salary employees: School districts and universities, rather than the State, would pay pension costs for teachers' and university employees' salaries above $180,000.

In addition, the FY2018 budget includes $500 million in pension savings from a proposal to require universities and school districts outside Chicago to cover all pension costs for new employees. New workers would have a choice between the Tier 2 plan or a new Tier 3 offering that would have both defined benefit and defined contribution components.[13] The cost shift to school districts and universities would occur gradually, as new workers are hired over time. The State would see considerable savings immediately because the significant reduction in future pension liabilities would lead to a sharp decline in current contribution requirements, according to the Governor's Office.[14] Under the State's pension funding plan, contributions are based on benefits expected to be provided to employees hired far into the future, as well as to existing workers.

Illinois' five retirement systems had a total unfunded liability of $129.8 billion as of June 30, 2016, based on the market value of assets, and a combined funded ratio of 37.6%.[15] Since FY1996, when the current pension funding plan began, the unfunded liability has risen by $107.8 billion.[16] The largest factor was inadequate State contributions, which accounted for $44.7 billion of the increase.

---

[10] Testimony of Matthew von Behren, Executive Director of the Illinois Procurement Policy Board, to the Senate Appropriations I Committee, March 15, 2017.
[11] For more information on interest penalties on overdue bills, see p. 35of this report.
[12] Communication between the Civic Federation and the Illinois Office of the Comptroller, February 2, 2017.
[13] Illinois State FY2018 Budget, pp. 176-177.
[14] Communication between the Civic Federation and the Governor's Office of Management and Budget, February 16, 2017. No actuarial reports evaluating the proposed changes have been provided.
[15] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2016*, March 2017, p. 25.
[16] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2016*, March 2017, p. 28. The other factors were changes in assumptions,

Given the State's history of inadequate pension contributions and the systems' current underfunding, it is not prudent to defer payments to later years or take upfront savings on contributions based on future decreases in liabilities. The Governor's Office has not made available any actuarial reviews of the pension changes that could allay these concerns.

Proposed Appropriation for Group Health Insurance and Employee Compensation

Although the Civic Federation supports efforts to reduce the State's group insurance expenses, it is unrealistic to budget savings of $435 million in FY2018 due to uncertainties surrounding the State's labor negotiations.[17] In recent years, inadequate funding of the group health insurance program has resulted in a large backlog of unpaid claims and steep interest penalties for late payments to healthcare providers and managed care organizations.

The proposed FY2018 budget includes General Funds group insurance appropriations of $1.4 billion, a decrease of 23.5% from the FY2018 maintenance level of $1.9 billion. The savings are based on the administration's ability to execute a new contract with the State's largest union that includes sharply higher employee health insurance premiums or less generous coverage.[18]

The last contract with the American Federation of State, County and Municipal Employees (AFSCME) expired at the end of June 2015, and the dispute has now shifted to court. The Illinois Labor Relations Board ruled in the fall of 2016 that negotiations over a new contract had reached an impasse.[19] The ruling appeared to pave the way for the administration to impose its contract terms on the union, but AFSCME went to court to prevent that from happening. The Illinois Supreme Court on April 4, 2017 denied a request by the Rauner administration to take up the protracted contract dispute, which means that the case will be heard in the Fourth District Appellate Court.[20]

Despite the difficulty in reaching agreement with AFSCME, each of the Governor's budgets has incorporated projected health insurance savings based on a new contract. The FY2016 budget proposed group insurance appropriations of $1.2 billion, or savings of $655 million,[21] and the FY2017 budget recommended appropriations of $1.4 billion, or savings of $445 million.[22]

The Civic Federation has similar concerns about FY2018 employee compensation, budgeted at $336 million less than it would have been under the expired labor contract. These projected compensation levels are based on the administration's proposed contract terms, which include a four-year wage freeze. Because of the ongoing legal dispute, it remains to be seen when or if the savings will be realized.

$31.0 billion; other factors, $15.7 billion; investment returns below expectations, $14.8 billion; and benefit increases, $5.8 billion. Lower than expected salary increases reduced the unfunded liability by $4.1 billion.

[17] Group insurance mainly covers health insurance but also includes life insurance.

[18] Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2018 Liabilities of the State Employees' Group Health Insurance Program*, March 2017, pp. 4-5.

[19] Kim Geiger, "Rauner scores big win over union on contract talks," *Chicago Tribune*, November 16, 2016.

[20] Doug Finke, "Illinois Supreme Court won't immediately hear AFSCME case," *The State Journal-Register*, April 4, 2017.

[21] Illinois State FY2016 Budget, p. 6-74 to 6-76.

[22] Illinois State FY2017 Budget, p. 63.

Proposed Changes to the Community Care Program

The recommended FY2018 budget proposes moving seniors who are not eligible for Medicaid from the Community Care Program to a new, lower-cost program. The Civic Federation is concerned that service reductions could lead to increased institutionalization of elderly residents.

The Community Care Program at the Department on Aging is intended to keep seniors out of nursing homes by providing in-home services such as cleaning and meal preparation and community-based adult day care. In a modified version of a plan proposed in the previous year's budget, the Governor's Office would move 36,000 seniors, or about 47% of the 77,357 expected to be enrolled in FY2018, into a new Community Reinvestment Program.[23]

Services for those individuals are projected to cost an average of $530 per month, or about 60% of the $883 per month for participants in the Community Care Program.[24] Total savings from the change are projected at $120 million in FY2018, rising to $161 million in FY2021.[25]

Advocates for the elderly have opposed the plan, saying it would result in increased admissions to nursing homes at a higher cost to the State.[26]

Although the State should pursue efficiencies in this growing program, changes should be undertaken in a deliberate way. It remains to be seen whether the current proposal is consistent with the administration's stated goal of shifting State resources from institutional to community care.[27]

One-Time Resources from Sale of the Thompson Center

The Civic Federation is concerned that the recommended FY2018 budget uses $240 million in one-time net proceeds from the sale of the James R. Thompson Center in Chicago for ongoing operating costs.

By accessing resources to pay for current year operations that will not be available in future years, the State guarantees future year deficits and continues the budget imbalance. Ongoing operations should be funded by sustainable resources that are adequate to avoid future budgetary shortfalls. The Civic Federation supports using one-time revenues only for establishing reserves, paying down accrued liabilities such as the State's backlog of unpaid bills or for making investments in critical capital improvements.

In addition, it is uncertain how much the State would receive for the property or if the revenue from the sale would be available in FY2018. The estimated net revenue has been revised upwards by $40 million since the sale was proposed in the FY2017 budget.[28] The sale would require authorization

---

[23] Illinois State FY2018 Budget, p. 250.
[24] Illinois State FY2017 Budget, pp. 249-251.
[25] Illinois State FY2018 Budget, p. 46.
[26] AARP Illinois, "AARP IL Urges Dept. on Aging to Halt Proposed Senior Care Rule Changes," *news release*, March 9, 2017.
[27] Illinois State FY2018 Budget, p. 58.
[28] Mike Hoffman, Acting Director of Central Management Services, Testimony before Senate Appropriations I Committee, March 15, 2017.

by the General Assembly, and potentially re-zoning by the City of Chicago.[29] Mayor Emanuel has also made it clear that he expects the State to pay the costs of replacing the CTA station in the building, which he estimates at $80 to $120 million.

[29] Lauren Chooljian, "Emanuel Adds More Complications to Thompson Center Sale," WBEZ, May 2, 2017, https://www.wbez.org/shows/wbez-news/emanuel-adds-more-complications-to-thompson-center-sale/258dc2ba-06fa-490c-96f4-dfeb3f69506e (Last accessed May 3, 2017).

Civic Federation Recommendations

The Civic Federation presents the following comprehensive plan and recommendations to stabilize the State's operating budget and establish a balanced financial path out of its ongoing fiscal crisis.

Do Not Pass Partial Budgets or Stopgap Appropriations in FY2018

The Civic Federation opposes partial budgets and stopgap measures that would continue spending in FY2018 without the discipline of a comprehensive, balanced budget. The Illinois Constitution requires the Governor to propose and the General Assembly to adopt balanced budgets.[30] The Civic Federation believes that partial measures enacted since FY2015 have allowed the Governor and General Assembly to avoid these responsibilities.

Such measures include the adoption of full-year funding for primary and secondary education in both FY2016 and FY2017.[31] The Governor has indicated a willingness to sign a similar bill for FY2018.[32] Another example is pending legislation that expands continuing appropriations, which statutorily authorize spending without any specific action taken by the General Assembly. Pending legislation would make employee pay subject to continuing appropriation—either permanently[33] or for the remainder of FY2017.[34] Governor Rauner has said he supports permanent continuing appropriations for workers' salaries.[35] Another bill[36] would provide continuing appropriations for public education and human services, prioritizing those areas of spending in the event of a cash shortage.

The Civic Federation is also opposed to the payment of State workers' salaries without appropriations, which has gone on since July 2015 due to a court order in St. Clair County. Any legal justification for this practice appeared to end in March 2016, after the Illinois Supreme Court ruled in another case that raises owed to State workers as a result of collective bargaining could not be paid without appropriations from the General Assembly.[37] However, the high court recently denied a request by the Illinois Attorney General to consider the issue immediately.[38]

The Civic Federation believes that **State employees should be paid for their work**, that **K-12 education should be funded** and that the **leadership of the State should work to avoid a government shutdown**. Moreover, the Federation **does not oppose spending revenues already being collected** in special funds for FY2017 that need only legislative authorization to be disbursed to their intended uses.[39] However, the **reliance on partial budgets and stopgap measures** during

---

[30] Ill. Const. art. VIII, sec. 2.
[31] Public Act 99-0005, signed on June 24, 2015; Public Act 99-0524, signed on June 30, 2016.
[32] Jeff Daly, "Manar says no budget could mean some schools may not open," *WSOY*, May 1, 2017.
[33] 100th Illinois General Assembly, House Bill 1787, filed on February 1, 2017.
[34] 100th Illinois General Assembly, House Bill 1798, filed on February 1, 2017.
[35] Doug Finke, "Rauner says he will veto Dems' bill to guarantee state worker pay," The State Journal-Register, February 9, 2017.
[36] 100th Illinois General Assembly, House Bill 3871, filed on February 10, 2017.
[37] *The State of Illinois (The Department of Central Management Services) v. American Federation of State, County and Municipal Employees, Council 31*, 2016 IL 118422, March 24, 2016.
[38] Doug, Finke, "Illinois Supreme Court won't take up state employee pay case," *The State Journal-Register*, March 20, 2017.
[39] For example, the "lifeline" plan in House Bill 109 would authorize spending funds collected by the Education Assistance Fund and the Commitment to Human Services fund on higher education and human services. For more information, see Institute for Illinois' Fiscal Sustainability at the Civic Federation blog,

the past two fiscal years has **insulated the majority of Illinoisans from direct impacts of the budget impasse**. A recent poll found that only 33% believed their families had been affected by the budget impasse.[40] Without the risk of a government shutdown or schools failing to open on time, both State leaders and too many rank-and-file members of the General Assembly may be content to prolong the impasse, which has done immense and lasting damage to the State's finances, its reputation and its most vulnerable residents.

Enact a Comprehensive Balanced Budget for FY2018 and a Multi-Year Plan for Financial Recovery

In order to achieve stability in the State's long-term finances, the Civic Federation has proposed a comprehensive financial plan[41] designed to meet the following goals:

- Ensure future annual operating budgets are balanced;
- Eliminate the backlog of unpaid bills;
- Provide achievable spending limits;
- Avoid drastic revenue cliffs;
- Broaden the tax base to provide sustainable revenue sources;
- Include additional assistance for local governments; and
- Set aside reserves for an adequate rainy day fund.

It is important to recognize that the State is in an exceedingly difficult position due to the 22-month budget impasse and the lack of action taken to contain spending and/or increase revenues to address the revenue cliff from the rollback of income tax rates as of January 1, 2015. With less than two months remaining in the current fiscal year, there are no practical measures that would completely balance the FY2017 budget and prevent an increase in the backlog of unpaid bills by the end of FY2017. Only difficult choices remain for the State.

Given the projected FY2018 operating shortfall of at least $4.6 billion, fixing the State's finances will require stricter spending restraints and more painful revenue increases to balance the budget and pay down the backlog of bills than the Civic Federation has previously proposed. The Federation's plan is based on limiting agency spending so that the State can use additional revenues to pay for new borrowing costs, as discussed below, and to build financial reserves.

Illinois must also pursue tax policy changes that will reduce the FY2017 operating deficit, balance the FY2018 budget and generate surpluses. Many of these tax changes are politically unappealing and painful for both individuals and businesses in the State, but they are of the magnitude necessary to solve the State's financial crisis. Income tax rate increases in the plan are accompanied by a proposed decrease in the State's sales tax rate for goods.

---

https://www.civicfed.org/iifs/blog/lifeline-plan-would-partially-fund-higher-education-human-services (last visited on May 3, 2017).

[40] Southern Illinois University, Paul Simon Public Policy Institute, "Half of Illinoisans Want to Keep Obamacare," *news release*, March 24, 2017, p. 9, http://paulsimoninstitute.siu.edu/_common/documents/opinion-polling/simon-institute-poll/2017/march-24-psppi-simon-poll-healthcare-poverty.pdf (last visited May 3, 2017).

[41] Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2018 Budget Roadmap*, February 10, 2017, https://www.civicfed.org/iifs/FY2018IllinoisRoadmap.

The Civic Federation's comprehensive plan proposes the following tax policy changes to address the State's fiscal crisis:

Spending Controls

In a five year projection released in November 2016, the Governor's Office of Management and Budget shows growth in net agency expenditures of only 1.7% per year.[42] This is lower than the Federal Reserve's longstanding inflation target of 2.0%.[43] The Civic Federation endorses this constrained level of spending growth until the State's fiscal condition can be substantially improved.

Increasing Income Tax Rates

The State should increase the individual income tax to 5.25% from 3.75% and to 7.0% from 5.25% for corporations. The State should be in a position to lower the individual tax rate to 5% on January 1, 2022. The burden of the increase on low-income residents should be alleviated by expanding the earned income tax credit by 50%.

Retirement Income Exclusion

The State should broaden its income tax base by eliminating the tax exemption for retirement income, excluding only federally tax-exempt Social Security income. The State can no longer afford to provide this generous exemption, which is out of line with most other states.

Expanding the Sales Tax Base and Lowering the Rate

In order to avoid tax pyramiding while accessing a larger and growing sales tax base, the State should enact a new service tax including a broad-based definition of consumer services, a firm business-to-business transaction exemption and also exclude medical services. In conjunction with this change, the State should lower the general sales tax rate for goods and services from 6.25% to 5.5%. This should be accomplished by lowering the state portion from 5% to 4.25%, without lowering the 1.25% share for local governments.

Business Tax Changes

The State should limit business tax expenditures that it can no longer afford and that do not provide sufficient public value to justify their cost. The State should cap the retailer's discount for sales taxes at $200 per month per retailer, eliminate the E-10 ethanol incentive, decouple from the federal domestic production activities deduction from corporate income tax and eliminate the continental shelf exemption from taxable income.

Merging the Chicago and State Teachers' Pension Funds

The Chicago Teachers' Pension Fund (CTPF) should be consolidated with the downstate and suburban Teachers' Retirement System (TRS). There is no good public policy reason for Illinois to maintain two separate funds for public school teachers' pensions. Chicago Public Schools (CPS) should continue to be responsible for paying the normal cost of its plan, while responsibility for paying all of the normal cost of the TRS system should be shifted over three years to school

---

[42] State of Illinois Governor's Office of Management and Budget, *General Funds/Fund for the Advancement of Education/Commitment to Human Services Fund Financial Walk Down*, November 15, 2016

[43] Federal Open Market Committee of the Board of Governors of the Federal Reserve Bank, *news release*, February 1, 2017.

districts outside of Chicago. Consolidation would provide more equitable pension funding for all teachers and help stabilize CPS finances.

Borrowing to Clear the Unpaid Bill Backlog

In order to eliminate the backlog of unpaid bills, save on interest penalties and restore confidence in the State's finances, the Civic Federation recommends borrowing to pay off the accumulated bill backlog during FY2018. If the other recommendations in the Federation's Roadmap are adopted, the Civic Federation estimates that approximately $9.0 billion in proceeds will be necessary to bring the backlog to zero by the end of FY2018. The bonds should amortize as quickly as possible, ideally within five years. This recommendation is contingent upon a balanced budget, a credible plan to maintain fiscal sustainability, restriction of the bond proceeds to eliminating the bill backlog and the payment of debt service with revenues not otherwise needed to balance the budget.

Supplemental Pension Payments

The State should make supplemental payments to the pension funds corresponding to the debt service savings associated with retiring pension obligation bonds. The payments should begin after backlog bond debt service ends in FY2024 and continue through FY2034. The Civic Federation estimates that returns on these additional contributions will be sufficient to bring all five State retirement systems to 100% funded status by FY2045. It is important to note that there is no actuarial standard other than 100% funding.

Rainy Day Fund

The State should work toward building a rainy day fund equal to 10.0% of General Funds revenues to cushion the budget from the next economic downturn. Legislation must explicitly indicate when deposits will be made and in what amount and the circumstances under which withdrawals will be allowed.

The following table presents the Civic Federation's comprehensive plan for the State of Illinois.

State of Illinois: Adjusted Governor's Five-Year Budget Projection and Civic Federation Comprehensive Plan FY2017-FY2022 (in $ millions) with Backlog Bonds General Funds, Fund for the Advancement of Education and Commitment to Human Services Fund (combined)	**Governor's FY2017**	**Estimated FY 2017**	**Projected FY 2018**	**Projected FY 2019**	**Projected FY 2020**	**Projected FY 2021**	**Projected FY 2022**
Revenues							
State Source Revenues	$ 29,048	$ 29,048	$ 29,543	$ 30,086	$ 30,970	$ 31,838	$ 32,715
Federal Revenues	$ 3,809	$ 3,809	$ 3,847	$ 3,886	$ 3,924	$ 3,964	$ 4,003
Other Resources	$ 856	$ 856	$ 70	$ -	$ -	$ -	$ -
Civic Federation Tax Changes							
Increase Individual Income Tax (5.25% through 12/31/2021, then 5%)	$ -	$ 2,782	$ 5,776	$ 5,905	$ 6,137	$ 6,387	$ 6,091
Increase Corporate Income Tax (7.0%)	$ -	$ 325	$ 642	$ 657	$ 703	$ 729	$ 747
Increase Local Share of Income Tax to 10%					$ (1,009)	$ (1,050)	$ (1,035)
Retirement Income[1]	$ -	$ 1,319	$ 2,745	$ 2,890	$ 3,043	$ 3,203	$ 3,292
Local Government Share of Retirement Income Tax[2]	$ -	$ (75)	$ (157)	$ (289)	$ (304)	$ (320)	$ (329)
Business Tax Changes	$ -	$ -	$ 265	$ 265	$ 265	$ 265	$ 265
Sales Tax on Services at 5.5%[3]	$ -	$ -	$ -	$ 705	$ 1,438	$ 1,467	$ 1,497
Reduce State General Sales Tax to 5.5%[4]	$ -	$ -	$ -	$ (641)	$ (1,305)	$ (1,330)	$ (1,355)
Net New Revenues	**$ -**	**$ 4,351**	**$ 9,271**	**$ 9,492**	**$ 8,969**	**$ 9,352**	**$ 9,173**
Total Revenues	**$ 33,713**	**$ 38,064**	**$ 42,731**	**$ 43,464**	**$ 43,863**	**$ 45,154**	**$ 45,891**
Expenditures							
Net Agency Expenditure	$ 25,336	$ 25,336	$ 25,800	$ 26,273	$ 26,724	$ 27,185	$ 27,653
Pension Contributions	$ 6,971	$ 6,971	$ 7,889	$ 8,088	$ 8,330	$ 8,659	$ 8,949
Group Insurance Payments	$ 1,810	$ 1,810	$ 1,873	$ 1,939	$ 2,007	$ 2,077	$ 2,150
Statutory Transfers[5]	$ 2,547	$ 2,547	$ 2,575	$ 2,634	$ 2,707	$ 2,786	$ 2,867
Debt Service	$ 2,350	$ 2,350	$ 2,418	$ 2,091	$ 1,536	$ 1,585	$ 1,628
Civic Federation Expenditure Changes							
CTPF Unfunded Liability	$ -	$ 487	$ 477	$ 531	$ 571	$ 596	$ 621
TRS Normal Cost Shift	$ -	$ -	$ (322)	$ (631)	$ (924)	$ (899)	$ (876)
EITC Increase 10%-15%	$ -	$ -	$ 131	$ 134	$ 139	$ 145	$ 151
Supplemental Pension Payment (Postponed to Pay Debt Service on Backlog Bonds)							
Debt Service on Backlog Bonds	$ -	$ -	$ 226	$ 2,070	$ 2,064	$ 2,058	$ 2,053
Total Civic Federation Expenditure Changes	**$ -**	**$ 487**	**$ 511**	**$ 2,104**	**$ 1,850**	**$ 1,900**	**$ 1,949**
Total Expenditures[6]	**$ 39,014**	**$ 39,501**	**$ 41,067**	**$ 43,129**	**$ 43,154**	**$ 44,192**	**$ 45,196**
Operating Surplus (Deficit)[7]	**$ (5,301)**	**$ (1,437)**	**$ 1,662**	**$ 335**	**$ 709**	**$ 963**	**$ 696**
Proceeds from Backlog Bonds	**$ -**	**$ -**	**$ 8,963**	**$ -**	**$ -**	**$ -**	**$ -**
Bill Backlog	**$ (14,489)**	**$ (10,625)**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Reserves	**$ -**	**$ -**	**$ -**	**$ 335**	**$ 1,043**	**$ 2,006**	**$ 2,702**

[1] Revenue estimates for taxing of retirement income include all income taxable at the federal level.

[2] Local governments begin to get full 10% share of retirement income tax in FY2019.

[3] Excludes business-to-business transactions and medical services, but includes financial and legal services. The 5.5% rate reflects a 4.25% State rate and 1.25% rate for local governments. Implemented in January, 2019.

[4] The 5.5% sales tax rate reflects a 4.25% State rate and 1.25% rate for local governments. The State rate is reduced from the existing 5.0% and the total rate is reduced from 6.25%. Implemented in January, 2019.

[5] Includes repayment of $15 million of interfund borrowing in FY2017.

[6] Includes approximately $3.9 billion of as-yet-unauthorized expenditures in FY2017 to maintain services at existing levels.

[7] The Civic Federation has made adjustments to the starting backlog for FY2017 of $131 million, reflecting actual FY2016 results in the Traditional Budgetary Financial Report. Additionally, $815 million in accumulated FY16 higher education bills that GOMB excluded from its analysis are included here.

Source: State of Illinois, Governor's Office of Management and Budget, *Five Year Forecast*, *FY18-FY22*, November 15, 2016; Civic Federation calculations.

A few caveats are in order about the financial projections underlying these recommendations. First, since the Civic Federation does not endorse the Governor's proposed FY2018 Budget, the base revenues and expenditures come from the Five Year Forecast published last November.

Second, the projections should be regarded as rough estimates due to data limitations and significant uncertainty about major factors that will affect the State's budget. For example, since no new appropriations have been passed since the expiration of the stopgap spending on December 31, 2016, total FY2017 expenditures are difficult to predict.

After two years, the outcome of labor negotiations with the State's largest union is still uncertain. The last contract with the American Federation of State, County and Municipal Employees (AFSCME) expired at the end of June 2015, and the dispute has now shifted to court.[44]

A final example is the transportation lockbox amendment[45] approved by Illinois voters at the November 2016 general election. The amendment restricts some transportation-related revenues, such as vehicle licensing fees, to various transportation-related expenses. Although proponents of the amendment claimed that its purpose was primarily to prevent sweeps from transportation funds,[46] the full effect of this amendment on the General Funds is still unknown.

Despite these caveats, the recommendations proposed in this report by the Civic Federation show the required magnitude of any set of solutions the State must use to overcome the budget impasse and achieve fiscal sustainability. To the extent that the Governor and General Assembly agree to alternative changes to expenditures or revenues, they must provide at least as much relief to the budgetary pressures facing Illinois.

Funding for and Reform of Local Government

The Governor and many members of the General Assembly have indicated that the State should reduce local tax burdens through a property tax freeze.[47] However, many local governments, including school districts, townships and special service districts, are dependent on property taxes to fund pensions and provide essential services. Unless and until significant consolidations are enacted to reduce the number of local governments—entities created by the State—Illinois must provide assistance in the form of alternate revenues if it wishes to limit property taxes.

In addition to the assistance provided to the Chicago Public Schools through the proposed pension consolidation, the Federation's plan provides new revenues for local governments through the proposed tax changes. The plan also increases costs for school districts outside of Chicago because of the proposed shift in normal pension costs from the State to local districts.

The main source of new funds for local governments is an increased share of income tax revenue at the higher proposed rates. Before tax rates were increased in 2011, local governments received 10% of total net income tax collections (after amounts were deducted to pay for tax refunds). The rate increases brought in more revenue for the State, but the share paid to local governments was still based on the revenues collected at the old rates. The Civic Federation's plan restores the local share to 10% of total net collections in FY2020, which generates more than $1 billion. Although the State needs all of the new revenues from taxation of retirement income to balance its FY2018 budget, local governments begin to receive the full 10% share beginning in FY2019.

Once fully implemented, the sales tax on services provides an estimated $412 million to local governments in FY2022. This represents the 1.25% distributed to local governments based on their

---

44 Doug Finke, "Illinois Supreme Court won't immediately hear AFSCME case," *The State Journal-Register,* April 4, 2017.
45 Ill. Const. art. IX, sec. 11.
46 *See* Institute for Illinois' Fiscal Sustainability at the Civic Federation, "State of Illinois Diversions of Transportation Funds," blog post, October 7, 2016, http://civicfed.org/iifs/blog/state-illinois-diversions-transportation-funds, (last visited on February 9, 2017).
47 Kiannah Sepeda-Miller, "Suburban mayors band together against property tax freeze," *Daily Herald,* April 27, 2017.

share of the State sales tax rate. The tax on services could bring in significantly more if municipal sales tax rates are applied to the new tax base.

As shown in the next table, the net effect on local governments of the recommendations would be an additional $562 million if they could be fully implemented in FY2017. The net additional assistance increases to $1.5 billion in FY2022.

Civic Federation Comprehensive Plan FY2017-FY2022 (in $ millions) Net Effect on Local Governments*						
	Estimated FY 2017	Projected FY 2018	Projected FY 2019	Projected FY 2020	Projected FY 2021	Projected FY 2022
Increase Local Share of (Increased) Income Tax to 10%	$ -	$ -	$ -	$ 1,009	$ 1,050	$ 1,035
Local Government Share of Retirement Income Tax	$ 75	$ 157	$ 289	$ 304	$ 320	$ 329
Local Share of Service Sales Tax	$ -	$ -	$ 194	$ 396	$ 404	$ 412
CTPF Unfunded Liability	$ 487	$ 477	$ 531	$ 571	$ 596	$ 621
TRS Normal Cost Shift	$ -	$ (322)	$ (631)	$ (924)	$ (899)	$ (876)
Total Assistance to Local Government	**$ 562**	**$ 312**	**$ 383**	**$ 1,356**	**$ 1,470**	**$ 1,522**

*Does not include local benefit from proposed reduction of retailer's discount.

Source: Civic Federation calculations based on data sources in table on p. 19.

However, increased funding alone is insufficient to remedy the fiscal pressures faced by local governments throughout the State. Illinois has by far the highest number of local governments in any state, at 6,963, according to the United States Census Bureau.[48] The multiplicity of local units of government, many of which are funded predominantly by property taxes, is often cited as a reason for high property tax rates in Illinois.[49] The Civic Federation supports the following:

- Merging of the Chicago and State Teachers' Pension Funds;
- Consolidating local pension funds;
- Merging the offices of the Illinois Comptroller and Treasurer;
- Authorizing townships to be dissolved by referendum;
- Consolidating property tax administration roles in Cook County; and
- Dissolving the Illinois International Port District.

Financial Best Practices

The Civic Federation recommends that the State immediately implement two practices that will increase transparency and improve the budgetary process.

Actuarial Review of Proposed Pension Reforms

Pension reforms proposed as part of the Governor's annual budget proposal should provide an actuarial analysis to show that they will have the intended budgetary effects and the long-term

---

[48] United States Census Bureau 2012 Census of Governments, *Government Organization Summary Report: 2012*, September 26, 2013, p. 1, http://www2.census.gov/govs/cog/g12_org.pdf (last visited on February 9, 2017).

[49] Illinois ranked seventh among the states in per capita property taxes collected in 2013 and was the highest ranking states in the Midwest. For more information, see Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois' National Rankings – 2016 Update*, November 2016, p. 30.

effects on the pension funds. This will allow the General Assembly to make more informed decisions regarding these proposals.

Reporting of Accrued Penalty Interest for Past-Due Bills

The State should, on a monthly basis, report on the amount of bills pending within each agency and at the Comptroller's office, along with their age and the amount of interest penalties that have accrued through the Prompt Payment Act and the Illinois Insurance Code.

Once the State pays off its unpaid bill backlog and begins to make progress toward building a rainy day fund, it should consider the following measures that would give the State's finances more long-term sustainability:

- A reduction in the interest the State pays on overdue bills;
- A return of the lapse period to two months from six; and
- A phase-out of Section 25 liabilities and other practices that allow current years' costs to be paid from future years' appropriations.

Constitutional Changes

The Civic Federation recommends consideration of two changes to the Illinois Constitution to improve long-term fiscal sustainability and ensure that sufficient revenues can be raised equitably.

Constitutional Amendment Limiting the Pension Protection Clause

The State of Illinois has unfunded public employee pension liabilities of $129.8 billion[50] and many local governments are either straining under the cost of employee pensions or facing the possibility that the funds will run out of money to pay retirees. The Supreme Court rulings striking down recent pension reform efforts[51] make it difficult to see how Illinois governments can reduce benefits in place when workers were hired – even if the obligations are unaffordable and jeopardize the solvency of the pension funds. The General Assembly should approve an amendment to the Illinois Constitution for the November 2018 statewide ballot that would specify that the pension protection clause applies only to accrued benefits, giving the State legislature the discretion to make adjustments to non-accrued future benefits for existing employees.

Graduated Individual Income Tax

The Civic Federation's comprehensive plan calls for increasing the individual income tax rate to 5.25% from 3.75% retroactive to January 1, 2017 and then reducing it to 5.0% on January 1, 2022. A permanent income tax rate of 5.0% is burdensome for low income taxpayers, despite the proposed increase in the earned income tax credit. A modestly graduated rate structure that could lower rates for many taxpayers should be considered.[52] Moving from a flat tax rate to a graduated rate structure would require an amendment to the Illinois Constitution.[53]

---

[50] Illinois Commission on Government Forecasting and Accountability, *Special Pension Briefing*, November 2016, p. 2. This figure is based on the market value of assets as of June 30, 2016. The total is $126.5 billion based on the smoothed value of assets.

[51] In re Pension Reform Litigation, 2015 IL 118585, May 8, 2015; Jones v. Municipal Employees' Annuity & Benefit Fund, 2016 IL 119618, March 24, 2016.

[52] For regional comparison of income tax rates and structures to other states, see Appendix D on p. 83.

[53] Ill. Const. art. IX, sec. 3(a). Among nearby states, Indiana and Michigan have flat individual income tax rates; Iowa, Kentucky, Minnesota, Missouri and Wisconsin have graduated rate structures. For more information, see Federal Tax Administrators, *State Income Taxes Updated January 1, 2017*, March 2017. http://www.taxadmin.org/assets/docs/Research/Rates/ind_inc.pdf (last visited on February 9, 2017).

ILLINOIS' BUDGET IMPASSE

The State of Illinois has endured more than 22 months without a complete budget and is facing a backlog of unpaid bills of as much as $14.7 billion at the end of the current fiscal year.[54] Despite the financial toll on the State and the hardships imposed on many residents and businesses, there is still no clear end in sight to the budget impasse.

The prolonged standoff is the result of a political struggle between Democratic legislators who control the General Assembly and a Republican Governor who took office in January 2015. Governor Bruce Rauner has said he would consider higher taxes to balance the budget, but only in exchange for economic and regulatory initiatives that have not been agreed to by the legislature.[55]

Path to Financial Crisis

Illinois' current financial predicament stems partly from a failure to plan for and deal with the revenue losses caused by the partial rollback of income tax rates in 2015. Income tax rates were temporarily increased in 2011 to offset a steep decline in economically sensitive State revenues due to the Great Recession.[56] Income taxes are the State's main source of General Funds revenue, followed by sales taxes.[57]

On January 1, 2011, individual income tax rates were increased to 5.0% from 3.0% and corporate tax rates were raised to 7.0% from 4.8%.[58] Rates rolled back to 3.75% for individuals and 5.25% for corporations halfway through the fiscal year on January 1, 2015 and are scheduled to decrease to 3.25% for individuals and 4.8% for corporations on January 1, 2025. The State has enacted no plan or preparations for reducing expenditures or finding alternate revenue sources to accommodate the reduction in rates.

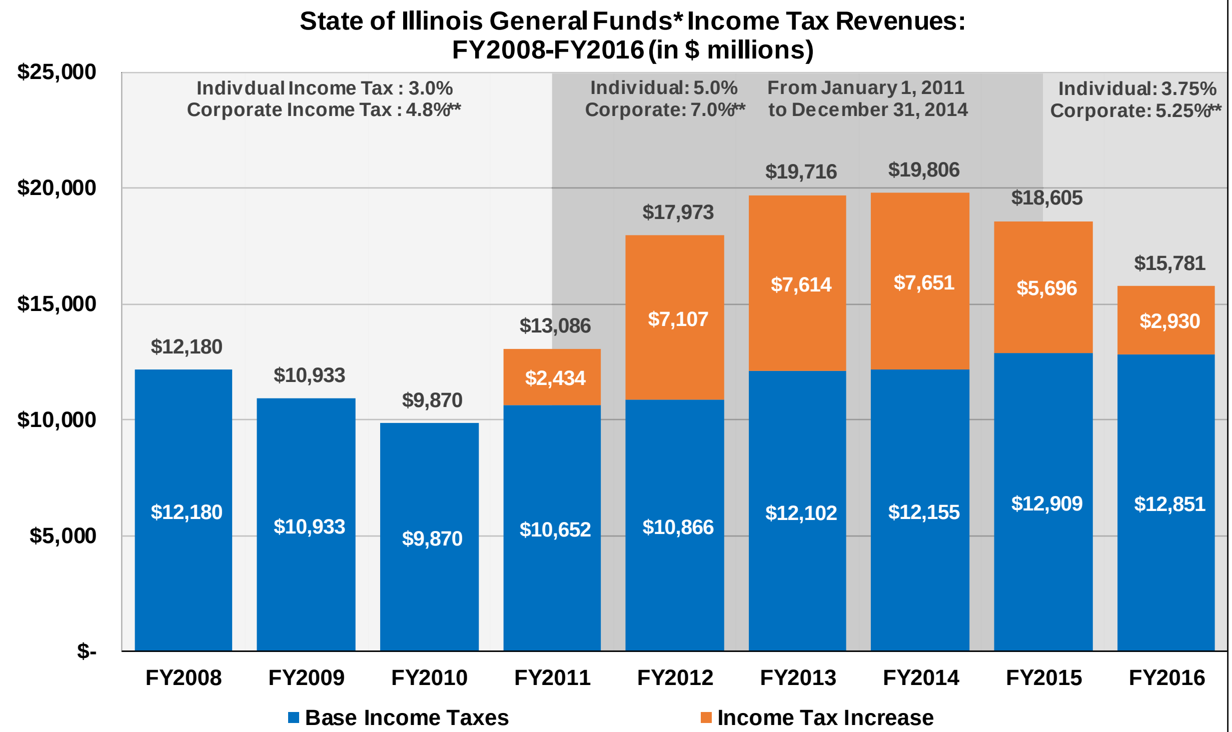
After the rate increases, income tax revenues doubled to $19.8 billion in FY2014 from $9.9 billion in FY2010.[59] In FY2016, the first full fiscal year of lower rates, income tax revenues were $15.8 billion, a decrease of $4.0 billion, or 20.3%, from FY2014.[60]

The following chart, based on analysis by the Illinois Department of Revenue, shows the estimated impact of the tax rate increases on General Funds income tax revenues. The chart uses FY2008 as a

---

[54] Illinois State FY2018 Budget, pp. 78-79. Fiscal year FY2017 ends on June 30, 2017.
[55] Illinois Government News Network, *2017 Budget Address as Prepared for Delivery*, February 15, 2017, http://www4.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=1&RecNum=14040 (last visited on April 14, 2017).
[56] The recession began in December 2007 and ended in June 2009, according to the National Bureau of Economic Research.
[57] General Funds support the regular operating and administrative expenses of most agencies and are the funds over which the State has the most control. The General Funds consist of the General Revenue Fund, the Education Assistance Fund, the Common School Fund and the General Revenue-Common School Special Account Fund. The Governor's proposed FY2018 budget proposes that three additional funds—the Fund for the Advancement of Education, the Commitment to Human Services Fund and the Budget Stabilization Fund—be included in General Funds. This report includes the three funds in General Funds.
[58] Public Act 96-1496, signed on January 13, 2011. In addition to these rates, corporations pay a Personal Property Replacement Tax (PPRT) of 2.5%, which was not affected by the income tax rate changes. The PPRT, which was created by the Illinois General Assembly in 1970 to replace a tax on the personal property of businesses that was abolished pursuant to the 1970 Illinois Constitution, is mainly a revenue source for local governments.
[59] Civic Federation calculations based on Illinois State FY2016 Budget, pp. 4-9 to 4-17, and Illinois State FY2014 Budget, pp. 3-11 to 3-20.
[60] Civic Federation calculations based on Illinois State FY2018 Budget, pp. 160-169.

starting point because it was the first full fiscal year before revenues declined due to the economic downturn. Additional revenues attributed to the rate increases peaked at $7.7 billion in FY2014 and declined to $2.9 billion in FY2016.



* Includes revenues allocated to the General Funds, Fund for the Advancement of Education, Committment to Human Services Fund and Budget Stabilization Fund. Income tax amounts are net of diversions to the Refund Fund.
** Corporations also pay a Personal Property Replacement Tax of 2.5%.
Source: Illinois State FY2018 Budget, pp. 160-169; Illinois State FY2017 Budget, pp. 160-168; Illinois State FY2016 Budget, pp. 4-9 to 4-17; Illinois State FY2015 Budget, pp. 3-12 to 3-19; Illinois State FY2014 Budget, pp. 3-11 to 3-20; Illinois State FY2013 Budget, pp. 3-10 to 3-19; Illinois State FY2012 Budget, pp. 5-12 to 5-23.

While State tax collections shrank as a result of the recession, statutorily required pension payments continued to climb. General Funds pension contributions grew to $6.0 billion in FY2015 from $1.6 billion in FY2008.

Illinois' 50-year funding plan, which began in FY1996, requires the five retirement systems to reach 90% funding by FY2045. Largely because the plan defers adequate State contributions to later years, Illinois has consistently ranked among the states with the worst funded pensions.[61] By the end of FY2016, total unfunded liability had grown to $129.8 billion, based on the market value of assets, and the combined funded ratio stood at 37.6%.[62]

To make its pension contributions in FY2010 and FY2011, the State issued a total of $7.2 billion worth of pension bonds. As a result, debt service on pension bonds increased to $1.5 billion in

[61] The Pew Charitable Trusts, *The State Pension Funding Gap: 2015*, April 20, 2017.
[62] State of Illinois, Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2016*, March 2017, p. 25. Unfunded liability is the actuarial value of accrued pension benefits that are not covered by pension assets. A pension fund is considered 100% funded when its asset level equals the actuarial accrued liability.

FY2015 from $467 million in FY20008.[63] Total pension-related payments—including both contributions and debt service—rose to $7.5 billion from $2.1 billion.[64]

Since FY2011 the State has made its pension contributions without borrowing. However, other General Funds expenditures not related to pensions remained approximately flat overall through FY2015—Illinois' last fiscal year with a complete budget.

Spending not related to pensions was $28.2 billion in FY2015, compared with $28.3 billion in FY2008. However, FY2015 expenditures were artificially low. To manage the budget in light of the January 2015 income tax rate reductions, FY2014 revenues were used to pay for $600 million of FY2015 Medicaid expenses.[65] After adjusting for the advance funding of Medicaid, spending not related to pensions increased by $424 million, or 1.5%, from FY2008 to FY2015. The Consumer Price Index rose 9.1% during the same period.[66]

The next chart shows General Funds spending from FY2008 through FY2015 in two categories: spending related to pensions, including contributions and debt service, and spending not related to pensions. Non-pension spending increased in FY2009 and FY2010 due to federal stimulus funds from the American Recovery and Reinvestment Act of 2009.[67]

---

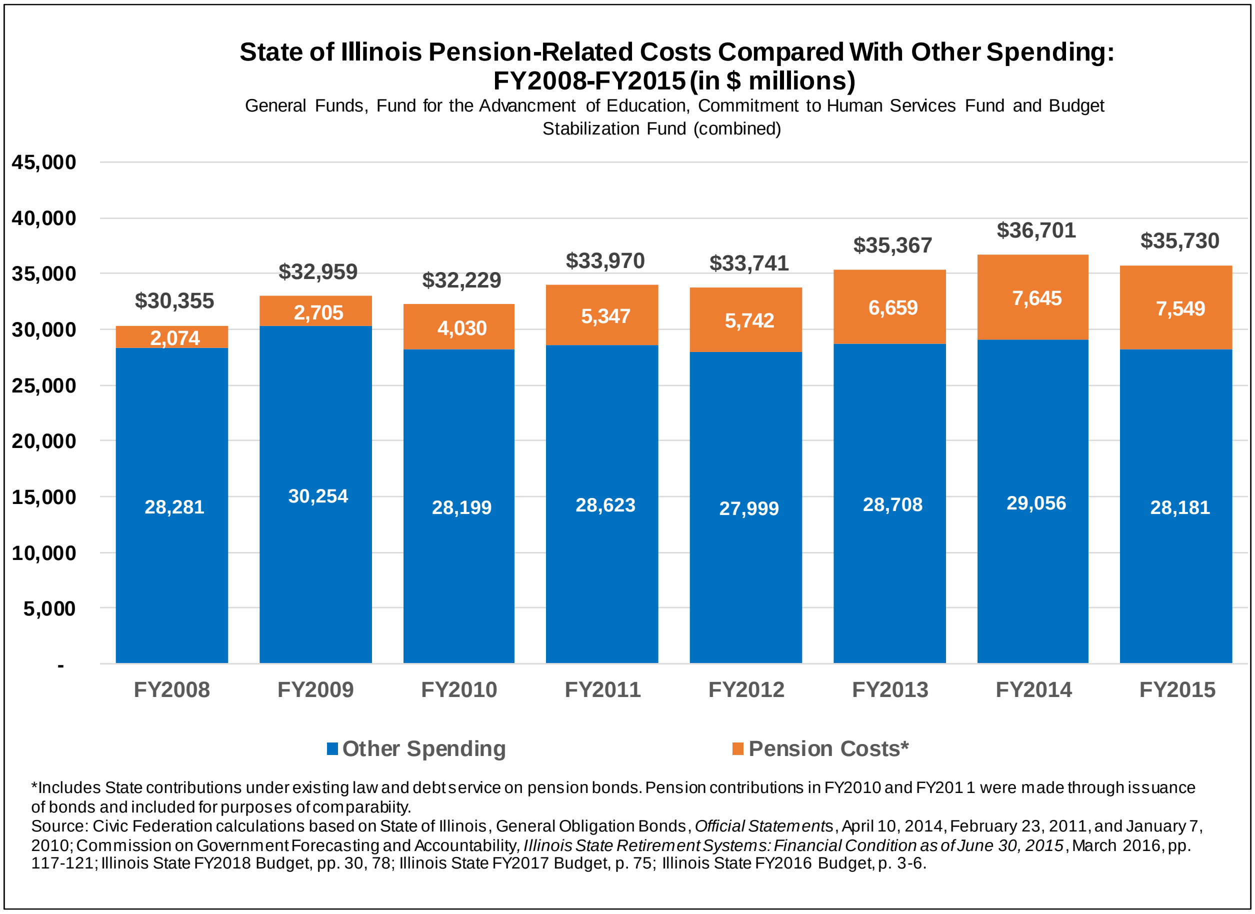
[63] The State also sold $10 billion of pension bonds in 2003, of which $7.3 billion was used to reduce unfunded liability and $2.2 billion for required contributions in FY2003 and FY2004.

[64] Prior to FY2011, the State sold $10 billion of pension bonds in 2003.

[65] State of Illinois, General Obligation Bonds, Series of November 2016, *Official Statement*, November 8, 2016, p. 17.

[66] U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Price Index Detailed Report: Data for December 2016*, p. 73.

[67] This analysis does not account for growth in Medicaid spending outside of General Funds, primarily due to expansion of eligibility under the Affordable Care Act beginning on January 1, 2014. These costs were entirely funded by the federal government through calendar year 2016. Federal reimbursement declined to 95% in calendar year 2017 and are scheduled to be further reduced to 94% in 2018, 93% in 2019 and 90% in 2020 and thereafter.



Despite the Medicaid funding shift described above, the FY2015 General Funds budget was still significantly out of balance when the new administration took office in January 2015. In his recommended budget for FY2015, Governor Pat Quinn, Governor Rauner's immediate predecessor, had proposed that the higher income tax rates be kept in place.[68] Then-candidate Rauner supported the scheduled rate rollback.[69]

However, rather than retaining the higher tax rates or cutting spending, the FY2015 budget passed by the General Assembly and signed by Governor Quinn in June 2014 underfunded hundreds of millions of dollars in known expenses. To close the FY2015 budget gap, the State transferred about $1.3 billion in excess balances from other State funds to General Funds (a practice known as fund sweeps) and reduced most agencies' spending by 2.25%. As FY2015 ended without a complete budget in place for the next fiscal year, the Rauner administration borrowed a net $377 million from other State funds to increase cash reserves.[70]

---

[68] For more information on Governor Quinn's FY2015 budget proposal, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2015 Recommended Operating Budget: Analysis and Recommendations*, May 13, 2014, https://www.civicfed.org/sites/default/files/Illinois%20Recommended%20FY2015%20Budget.pdf (last visited on April 19, 2017).

[69] Rick Pearson, Ray Long and Monique Garcia, "Keep tax hike or face stark cuts, Quinn says; Governor calls budget responsible; Rauner, GOP call it money grab," *Chicago Tribune*, March 27, 2014.

[70] Illinois State FY2018 Budget, p. 69; State of Illinois, General Obligation Bonds, Series of November 2016, *Official Statement*, November 8, 2016, p. 17.

Operating Without a Budget

The FY2016 budget was even more challenging than FY2015's because it covered the first complete fiscal year with lower income tax rates. **The Illinois Constitution requires the Governor to present a budget in which proposed expenditures do not exceed funds estimated to be available for the fiscal year.**[71] Since the FY2012 budget, State law has also required that the Governor's budget proposal be based only on existing revenue sources.[72]

Governor Rauner's FY2016 budget identified a $6.2 billion gap between revenues and expenditures and proposed to fill it through reductions in pension benefits and other steep spending cuts.[73] However, many of the proposed savings proved to be elusive. The pension proposal, for example, would have shaved $2.2 billion, or about one-third, off the State's required pension contributions. But the plan was dropped after the Illinois Supreme Court ruled in May 2015 that a previously enacted pension reform law violated the Illinois Constitution's strict pension protection clause.[74] Similarly, a proposed reduction of $655 million, or more than 35%, in State payments for group health insurance depended on a new union contract that was not in place by the end of FY2016.

Although the budget proposal did not include new revenue, Governor Rauner said he would consider tax increases if the legislature approved key elements of his Turnaround Agenda for the State.[75] The agenda included changes in workers' compensation; limits on damages in civil lawsuits; constitutional amendments on term limits and redrawing legislative districts; and a freeze on local property taxes, combined with measures to cut costs for local governments by limiting the scope of collective bargaining and eliminating prevailing wage requirements. The General Assembly did not consider the Governor's legislation, although it acted on bills involving some of the same issues.

The Illinois Constitution requires that the legislature make appropriations for all expenditures of public funds by the State and that appropriations for a fiscal year not exceed funds estimated by the General Assembly to be available during that year.[76] After the end of May of one calendar year, a three-fifths vote of each chamber, rather than a simple majority, is required for legislation to be effective before June 1 of the next calendar year.[77]

During the final days of the regular spring session, the General Assembly approved a spending plan for FY2016 with an acknowledged operating deficit of at least $3 billion. Governor Rauner vetoed virtually all of the spending plan but signed the appropriation bill for elementary and secondary education, which ensured that public schools could open on time despite the budget impasse.

[71] Ill. Const. art. VIII, sec. 2(a). The constitutional requirement does not prohibit carrying over a deficit from one year to the next.
[72] 15 ILCS 20/50-5(a). Governor Quinn's budget proposal for FY2015, presented in March 2014, included a recommended budget, with income tax rates at existing levels, and a not recommended budget, with income tax rates reduced in January 2015 as required by law.
[73] For more information on Governor Rauner's FY2016 budget proposal, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2016 Recommended Operating Budget: Analysis and Recommendations*, May 7, 2015, https://www.civicfed.org/file/6792/download?token=3ekrTY71 (last visited on April 19, 2017).
[74] *In re Pension Reform Litigation*, 2015 IL 118585, May 8, 2015.
[75] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 8.
[76] Ill. Const. art. VIII, sec. 2(b).
[77] Ill. Const. art. IV, sec. 10.

The vast majority of other State spending also continued, even in the absence of a full budget.[78] The State spent $31.7 billion in FY2016 from General Funds, or about 89% of the $35.7 billion in FY2015 expenditures.[79] Government continued to function mainly because of federal consent decrees, court orders and existing statutory spending requirements.

The appropriation bill for elementary and secondary education included contributions to the State's largest pension fund, the Teachers' Retirement System, which covers public school teachers outside Chicago. Contributions to the State's four other retirement systems were made pursuant to continuing appropriations, the statutory authority to make payments without annual appropriations by the legislature.

Debt service payments and operations of the legislative and judicial branches were also funded due to continuing appropriations. Certain statutory transfers from General Funds, such as the distribution of income tax revenues to local governments, were made based on existing statutes.

The State made payments pursuant to court orders related to about a dozen prior federal consent decrees. These court orders cover payments to Medicaid providers, the operations of the Departments of Children and Family Services and Juvenile Justice and certain human services programs.

State workers received paychecks based on a ruling in July 2015 by a judge in St. Clair County Circuit Court.[80] The Rauner administration had pushed for full payment of all employees, but the Illinois Attorney General's Office argued that such payment without a budget violated the Illinois Constitution. The Illinois Supreme Court declined the Attorney General's request to consider the issue immediately.[81]

The main areas of State government not being fully paid were universities, community colleges, Monetary Award Program (MAP) tuition grants for low income college students, group health insurance for employees and retirees, social service programs not covered by Medicaid and operational costs of certain agencies.[82] In the case of group health insurance, the State is obligated to make the payments eventually due to State law and union contracts.

Partial higher education funding of $600 million was authorized in April 2016 from a General Funds account specifically designated for education, where money was accumulating but not being spent.[83] The amount represented less than one-third of FY2015 spending of $1.9 billion.

---

[78] The General Assembly passed and the Governor signed legislation authorizing spending of federal funds and certain other State funds.
[79] Illinois State FY2018 Budget, pp. 70 and 72. The $31.7 billion expenditure figure for FY2016 does not include $12 million in prior year adjustments.
[80] Kim Geiger, "Illinois state workers' paychecks to go out as court fight continues," *Chicago Tribune*, July 14, 2015.
[81] Kim Geiger, "High court denies Lisa Madigan bid for ruling on state worker paychecks," *Chicago Tribune*, July 17, 2015.
[82] Public Act 99-0491, signed on December 7, 2015, authorized a total of $28 million in General Funds spending for domestic violence shelters and operations of the Illinois Secretary of State.
[83] Public Act 99-0502, signed on April 25, 2016.

There was no further progress on an FY2016 budget—or any progress on an FY2017 budget—until the last day of the fiscal year. Governor Rauner proposed his FY2017 budget in February 2016 without a budget in place for the current fiscal year.[84]

The Governor's FY2017 budget had a General Funds operating deficit of at least $3.5 billion. To deal with the gap, the budget document showed a line worth $3.5 billion labeled "Working Together or Executive Management," representing two proposed options for lawmakers. They could either agree to elements of the Turnaround Agenda, in which case the Governor would support unspecified additional revenues, or grant him broad authority to make spending cuts. The General Assembly did not authorize either option.

During the spring of 2016, lawmakers participated in bipartisan budgetary working groups created by the Governor. But House Speaker Michael Madigan eventually gave up on talks about the Turnaround Agenda, and the House passed an FY2017 spending plan without any new revenues that the Rauner administration deemed to be $7 billion out of balance.[85] The House plan was later rejected by the Senate.

On June 30, 2016—the last day of the fiscal year—a stopgap funding bill and related legislation were rushed through the legislature and signed by the Governor.[86] The spending plan included another full year of funding for elementary and secondary education, as well as appropriations from federal and other State funds.[87] The stopgap bill also included partial funding for areas not previously required by statute or court order (except group health insurance). That spending authority could be used for costs incurred through December 31, 2016.

To help pay for the stopgap spending, the State forgave all but $15 million of the net $377 million interfund borrowing from FY2015; used up the entire $275 million balance in the Budget Stabilization Fund, the State's only rainy day fund; and negotiated a new assessment on hospitals that provided $150 million to the State in exchange for increased federal Medicaid funding. The State also refinanced some of its outstanding bonds to save money on interest payments.

For the areas of government not covered by court orders or statutory requirements, **the stopgap measure left funding shortfalls of $2.9 billion in FY2016 and more than $3.0 billion in FY2017 compared with historical levels, according to the FY2018 budget book.[88] However, this tally does not include more than $1 billion needed to bring higher education funding over the two years to FY2015 levels.** Since the stopgap budget expired on December 31, nothing has replaced it.

[84] For more information on the Governor's FY2017 budget proposal, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2017 Recommended Operating and Capital Budgets: Analysis and Recommendations*, May 3, 2016, https://www.civicfed.org/file/7129/download?token=W6MpQNXM (last visited on April 20, 2017).
[85] Monique Garcia and Kim Geiger, "Budget battle deepens; Madigan concocts plan; Speaker touts $700M for schools; Rauner ally calls proposal $7B short," *Chicago Tribune*, May 26, 2016.
[86] Public Act 99-0524, signed on June 30, 2016.
[87] For more information about the stopgap legislative package, see Illinois State FY2018 Budget, pp. 74-75. The legislative package also included Senate Bill 2822, which provided $215 million for normal pension costs of the Chicago Teachers' Pension Fund. The bill was vetoed by the Governor on December 1, 2016.
[88] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 19, 2017; Illinois State FY2018 Budget, pp. 30 and 128. The partial total for FY2017 includes $1.8 billion for group insurance, $832 million for higher education and $381 million for human services. For other areas, additional appropriations required for operational expenses not covered by court orders or consent decrees could not be determined from the budget book.

On February 1, 2017, Fitch Ratings cut the State's lowest-in-the-nation credit rating by another notch, citing the financial damage caused by Illinois' "unprecedented failure" to pass a budget for two consecutive years.[89]

Governor's FY2018 Budget Proposal and Other Developments

Governor Rauner issued his budget proposal for FY2018 on February 15, 2017.[90] The recommended FY2018 budget follows the format of the previous year's proposal. In FY2018 the budget shows an operating gap of $4.6 billion, which the administration proposes to fill by "working together on a 'grand bargain.'"[91] If no bargain is enacted, the Governor said he would seek broad authority to make cuts on his own to balance the budget.

The grand bargain refers to a bipartisan effort by Senate President John Cullerton and Minority Leader Christine Radogno to break the budget deadlock. A package of about a dozen bills related to this attempt were the first to be filed after the swearing in of the 100th General Assembly on January 11, 2017.[92] The package of bills is fluid but has included spending cuts, tax increases and policy changes, as well as the sale of bonds to pay down the bill backlog.[93]

In his budget address, Governor Rauner said he could support the Senate plan under certain conditions: no State tax on retirement income; no permanent increase in income tax rates without a permanent freeze on property taxes; no increased sales tax rates for food and drugs (but he was open to taxing services); and a firm limit on spending. The Governor continued to press for term limits for lawmakers and reforms to the workers' compensation system but said no single demand was essential.

The fate of the bargain remains uncertain. Governor Rauner said recently that he expects a budget deal to come soon.[94] However, prospects appeared to dim in March, after only a handful of Republicans voted in favor of several of the grand bargain bills and the Senate President refused to call other components of the package for a vote without bipartisan support.[95]

The Governor recently praised another package of bills, proposed by Republican Senator Bill Brady.[96] Those bills are intended to work in tandem with the grand bargain but are designed to match any revenue increases with spending reductions.[97] The Brady bills have not been considered by the Senate.

---

[89] Fitch Ratings, "Fitch Downgrades Illinois Ratings to 'BBB'; Negative Rating Watch Maintained," *news release*, February 1, 2017.

[90] The FY2018 recommended budget is available at https://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY2018%20Budget%20Book/FY2018OperatingBudgetBook.pdf (last visited on April 21, 2017).

[91] Illinois State FY2018 Budget, p. 78.

[92] Evan Garcia, "Cullerton, Radogno Discuss Budget 'Grand Bargain,'" *Chicago Tonight*, January 19, 2017.

[93] 100th Illinois General Assembly, Senate Bills 1, 3, 4, 5, 6, 7, 8, 9, 10, 12, 13 and 16, filed on January 11, 2017.

[94] Kerry Lester, "Illinois 'very close' to budget deal. Senate leaders less hopeful," *Daily Herald*, April 20, 2017.

[95] Doug Finke, "Illinois Senate cancels budget votes; leader blames Rauner," *The State Journal-Register*, March 1, 2017.

[96] Monique Garcia and Haley BeMiller, "Democrats counter Rauner with 'Illinois Comeback Agenda,'" *Chicago Tribune*, March 29, 2017.

[97] 100th Illinois General Assembly, Senate Bills 2176, 2177, 2178, 2179, 2180, 2181 and 2182, filed on March 28, 2017.

Governor Rauner has pledged to veto a House measure that would provide another round of stopgap funding for higher education and human services. The bill, which was passed by the House with no Republican votes on April 6, would appropriate $559 million for MAP grants, public universities and community colleges and $258 million for social services programs.[98] The $817 million would come from money accumulating in funds specifically designated for those purposes that cannot be used without legislative authorization. The Governor said he would not accept another stopgap budget without a permanent property tax freeze. [99]

Meanwhile, recent actions by the Illinois Supreme Court are likely to affect the budget debate. On March 20, the high court said it would not immediately decide whether State employees can continue to be paid without a budget, meaning that the matter would first be considered by the Fifth District Appellate Court.[100]

The Attorney General's Office had asked the Supreme Court to overturn the 2015 ruling in St. Clair County that allowed the salaries to be paid. That request came after a 2016 high court decision in a separate case in which **the Supreme Court said raises owed to State workers as a result of collective bargaining could not be paid without appropriations from the General Assembly.**[101]

The Attorney General's Office argued that the 2016 opinion upended the only legal basis for the St. Clair County ruling. By removing the threat of a government shutdown, the ruling eliminated the sense of urgency needed to force elected officials to reach a budget agreement, according to Attorney General Lisa Madigan.[102] The Rauner administration and the State's largest union, the American Federation of State, County and Municipal Employees (AFSCME), have opposed the Attorney General's move.

In another recent action, the Illinois Supreme Court on April 4 denied a request by the Rauner administration to take up the protracted contract dispute between the State and AFSCME.[103] As a result, the case will be heard in the Fourth District Appellate Court.

The Illinois Labor Relations Board ruled in the fall of 2016 that negotiations over a new contract to replace the agreement that expired at the end of FY2015 had reached an impasse.[104] The ruling appeared to pave the way for the administration to impose its contract terms on the union, but AFSCME went to court to prevent that from happening. The Governor's recommended FY2018 budget includes $771 million in General Funds savings from health insurance and wage changes under the proposed contract terms, but when or if those terms will be implemented is yet to be determined.

---

[98] 100th Illinois General Assembly, House Bill 109, House Amendment 1, filed on April 5, 2017.

[99] Tina Sfondeles, "Rauner says Dems' 'lifeline bill' would sink state in debt, taxes," *Chicago Sun-Times*, April 6, 2017.

[100] Doug, Finke, "Illinois Supreme Court won't take up state employee pay case," *The State Journal-Register*, March 20, 2017.

[101] *The State of Illinois (The Department of Central Management Services) v. American Federation of State, County and Municipal Employees, Council 31*, 2016 IL 118422, March 24, 2016.

[102] Lisa Madigan, "Lisa Madigan: Consequences of budget inaction have already been catastrophic," *The State Journal-Register*, February 5, 2017.

[103] Doug Finke, "Illinois Supreme Court won't immediately hear AFSCME case," *The State Journal-Register*, April 4, 2017.

[104] Kim Geiger, "Rauner scores big win over union on contract talks," *Chicago Tribune*, November 16, 2016.

The prolonged budget standoff has prompted efforts to expand statutory spending authorization that does not require action by the General Assembly. Pending legislation would make employee pay subject to continuing appropriation—either permanently[105] or for the remainder of FY2017.[106] Governor Rauner has said he supports permanent continuing appropriations for workers' salaries.[107]

Another bill[108] would provide continuing appropriations for public education and human services. The legislation would also require the Comptroller's Office to pay those areas before financial services in the event of a cash shortage.

---

[105] 100th Illinois General Assembly, House Bill 1787, filed on February 1, 2017.
[106] 100th Illinois General Assembly, House Bill 1798, filed on February 1, 2017.
[107] Doug Finke, "Ranuer says he will veto Dems' bill to guarantee state worker pay," The State Journal-Register, February 9, 2017.
[108] 100th Illinois General Assembly, House Bill 3871, filed on February 10, 2017.

COST OF THE BUDGET IMPASSE

The State of Illinois' failure to enact a budget for nearly two years has not changed the day-to-day experiences of most of its residents. Public schools have remained open. State workers are still being paid. With government continuing to function normally in many respects, it could be easy to overlook the lasting damage caused by Illinois' financial disarray.

But the toll, while often difficult to quantify, is mounting. The State's credit rating has been lowered to just above junk status, burdening taxpayers with higher borrowing costs. Ratings companies also have a bleak outlook on the State's public universities due to the lack of support for higher education during the budget standoff. As the multi-billion dollar backlog of bills has continued to grow, so have the steep interest penalties owed on many overdue payments. Fewer companies are bidding for State work and bids are coming in higher because vendors cannot be sure when they will be paid.[109]

Other costs may only be fully known in the long run. University officials have said the budget problems have made it difficult to recruit and retain faculty due to concerns about the State's fiscal stability. Advocates maintain that social services eliminated due to the budget impasse might take years to replace. For residents who could not get treatment for mental health problems, were turned away from domestic violence shelters or did not receive State-funded college scholarships, the costs are life-changing.

Debt Costs

During the second year of the budget impasse, all three ratings companies further downgraded Illinois' general obligation rating. In June 2016, Moody's Investors Service lowered its rating from Baa1 to Baa2, and Standard & Poor's lowered its rating from A- to BBB+.

In its report, Moody's noted that continuing gridlock has prevented the State from dealing with a structural imbalance caused by the expiration of the temporary tax increases.[110] Moody's also cited the growing unfunded pension liability. This downgrade was the second by the company in eight months. The new rating was the lowest ever assigned to a state by Moody's, tied only with Massachusetts from 1990 to 1992.[111]

S&P said that its downgrade was due to the State's delay in addressing fiscal strain, resulting in structural imbalance and a large backlog.[112] The company stated that the rating could improve if State leaders were able to negotiate a compromise that restored fiscal balance.

Four months later, on September 30, S&P downgraded Illinois another notch, to BBB, in advance of the State's October 2016 refunding transaction.[113] The report cited weak financial management and rising short- and long-term pressures as a result of the impasse. The downgrade came with a warning of further downgrades if the State was not willing or able to address these issues.

---

[109] Testimony of Matthew von Behren, Executive Director of the Illinois Procurement Policy Board, to the Senate Appropriations I Committee, March 15, 2017.
[110] Moody's Investors Service, "Moody's downgrades Illinois GOs to Baa2 from Baa1; related ratings also downgraded," *news release*, June 8, 2016.
[111] Yvette Shields, "Illinois Ratings Punished For Impasse," *The Bond Buyer*, Jun 9, 2016.
[112] Yvette Shields, "Illinois Ratings Punished For Impasse, "*The Bond Buyer*, Jun 9, 2016.
[113] "S&P cuts Illinois' credit rating on state's 'weak' management," *Reuters*, September 30, 2016.

Fitch Ratings downgraded the State to BBB on February 1, 2017, citing the "unprecedented failure" to pass a budget for two consecutive years, which had "fundamentally weakened" the State's finances even if the impasse is resolved.[114] The report maintained a negative watch on the credit.

Illinois currently has the lowest rating of any state by all three ratings agencies. At the time of this report, all three ratings companies place the State's general obligation credit at the BBB/Baa2 level, two notches above junk, with a negative outlook.

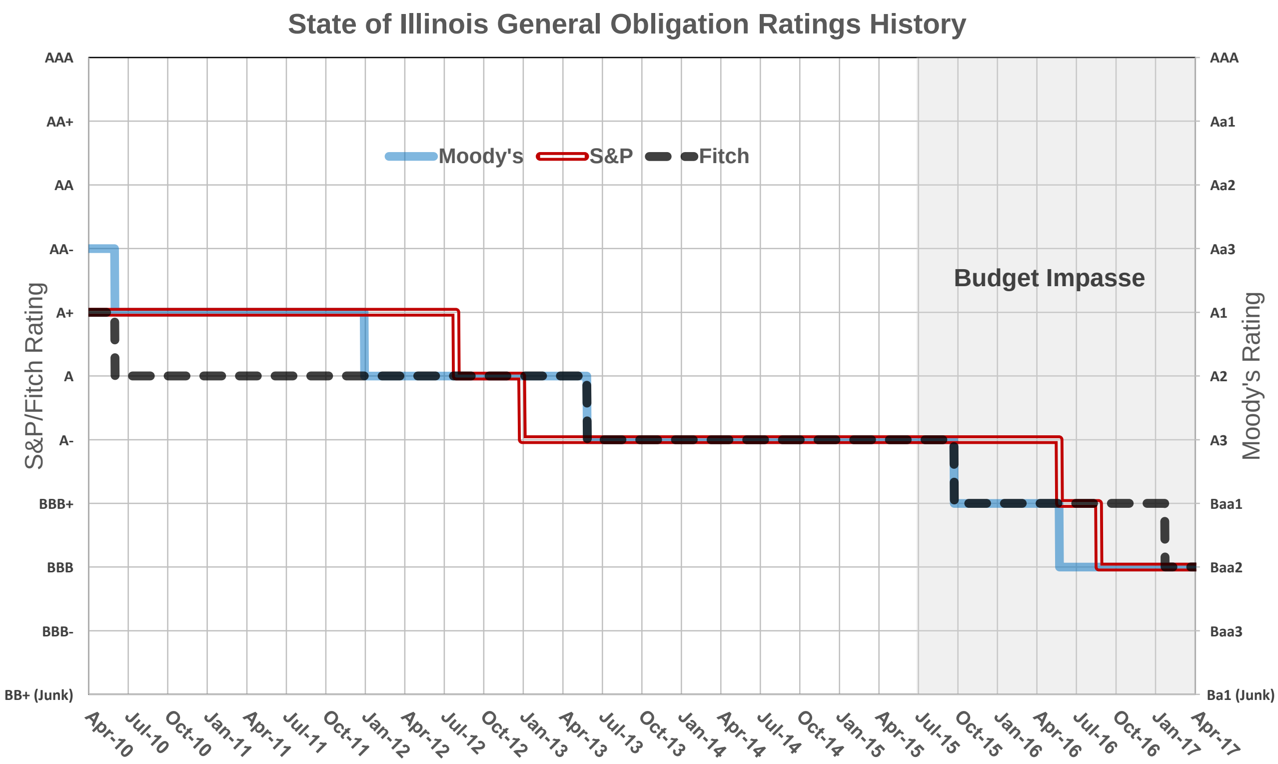
Moreover, the State has been warned that further downgrades could be forthcoming as soon as the end of May 2017 if the budget impasse is not resolved soon. In a report issued in March, Moody's warned that "failure to reach a consensus before the current legislative session adjourns on May 31 would signal deepening political paralysis, heightening the risk of creditor-adverse actions."[115]

On April 20, S&P downgraded the City Colleges of Chicago and six State universities, and issued a negative credit watch for a seventh.[116] The ratings actions pointed to the state budget impasse, stating that the downgrades, "reflect our belief that the state may fail to pass a fiscal year 2017 budget by the end of May, which would likely result in zero operating appropriations distributed to the [universities] for the entirety of fiscal 2017."[117]

---

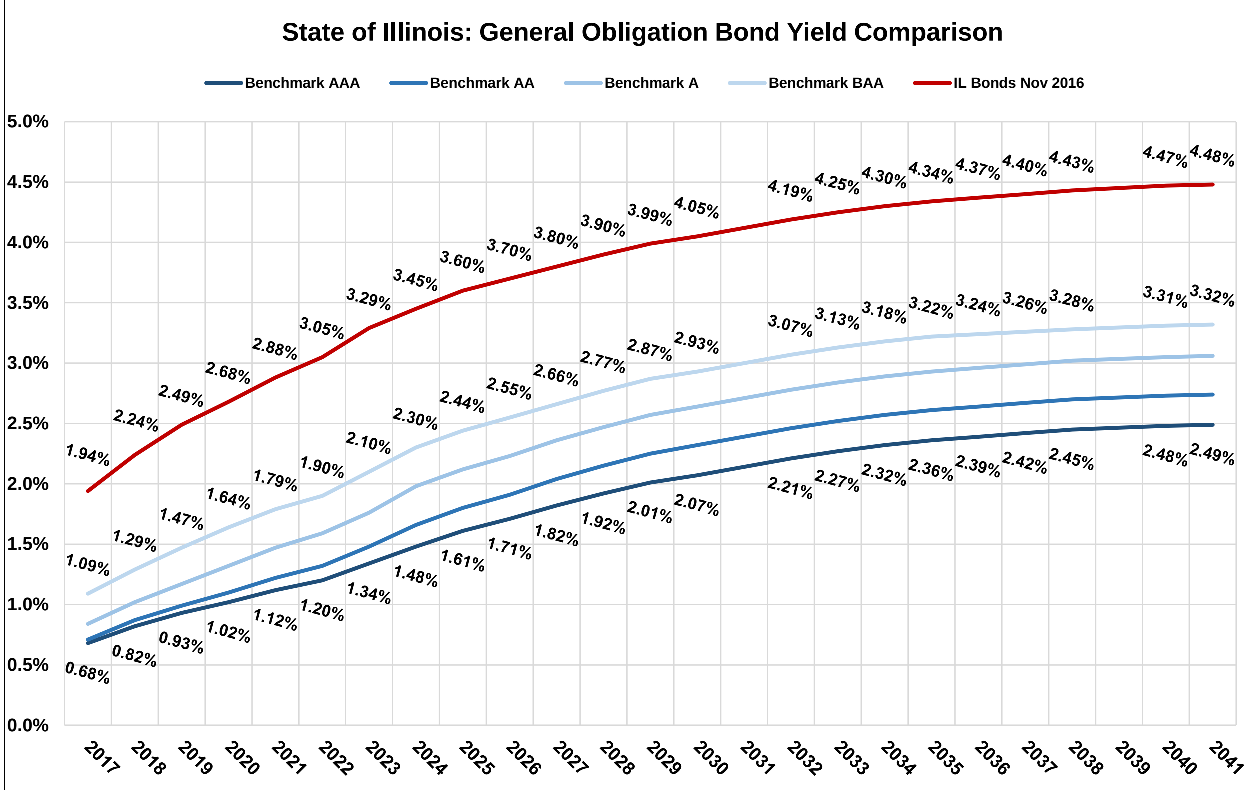
[114] Fitch Ratings, "Fitch Downgrades Illinois Ratings to 'BBB'; Negative Rating Watch Maintained," *news release*, February 1, 2017.
[115] Moody's Investors Service, "Record Backlog of Unpaid Bills Signals Critical Juncture for State Leaders," *Issuer In-Depth, State of Illinois*, March 30, 2017, p. 1.
[116] *E.g.* S&P Global Ratings, "University of Illinois Debt Ratings Lowered to 'A' Based on Criteria; On Watch Neg," *news release*, April 20, 2017.
[117] *E.g.* S&P Global Ratings, "University of Illinois Debt Ratings Lowered to 'A' Based on Criteria; On Watch Neg," *news release*, April 20, 2017.

The following chart shows the history of the State of Illinois' general obligation debt rating from 2010 through the present day.



Source: Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2017*, August 2016, pp. 208; Reuters, "S&P cuts Illinois' credit rating on state's 'weak' management," *news release,* September 30, 2016; Fitch Ratings, "Fitch Downgrades Illinois Ratings to 'BBB'; Negative Rating Watch Maintained," *news release,* February 1, 2017.

The downgrades have increased the cost of Illinois' borrowing. On November 8, 2016 he State issued $480 million in general obligation bonds for capital improvements.[118] The following chart compares the yields received by the State to the benchmark yields for better rated municipal credits reported for the date of the sale.[119] Yields represent the interest rates on bonds after accounting for any premiums or discounts paid or received by investors at the time of a bond sale.



Source: Thompson Reuters Muncipal Market Data benchmark rates as of November 8, 2016; State of Illinois, General Obligation Bonds, Series November 2016, *Official Statement*, November 8, 2016. The years 2031 and 2039 are omitted because those maturities were offered at a coupon rate other than 5.0%.

Various market factors may affect the yields that investors are willing to pay for new bond issuances at any given time, including but not limited to the bond ratings attributed to the issuer. Internal analysis by investors, market supply, demand for various yields at specific maturities, other portfolio standards and current events can affect the outcome of a bond sale.

However, not only did Illinois pay yields averaging 1.88 percentage points higher than the AAA-rated benchmark, it also paid an average of 1.11 percentage points over the BAA-rated benchmark, the level of ratings that Illinois possesses. This suggests that, for a number of reasons, investors may have demanded an additional penalty due to factors specific to Illinois.

As a result of the high yield penalties, Illinois will pay substantially more in debt service than it would have otherwise. The total cost of the November 2016 bonds will be $786 million over the 25-

[118] State of Illinois, General Obligation Bonds, Series of November 2016, *Official Statement*, November 8, 2016.
[119] Thompson Reuters, *Municipal Market Data Index*, November 8, 2016. Both the daily index and the sale were completed before the result of the U.S. Presidential election was known and do not reflect the resulting instability in markets.

year life of the series. This is $61 million higher than the State would have paid if it had issued bonds producing the same total proceeds at the BAA-rated benchmark levels, and $103 million higher than it would have paid at the AAA-rated levels.[120]

Not only does Illinois' higher cost of borrowing impose a burden on Illinois taxpayers, but the State's low ratings also affect the borrowing costs of local governments. Despite recent outlook changes from negative to stable in two of the City of Chicago's ratings, the market demanded steep yield penalties on a January 2017 General Obligation issuance, in part due to the continued instability of State finances.[121]

Interest Penalties

The State is required to pay interest penalties at relatively high rates on certain overdue bills. As the budget impasse has continued, the backlog of unpaid bills has grown, payment delays have increased and penalties owed to vendors have climbed.

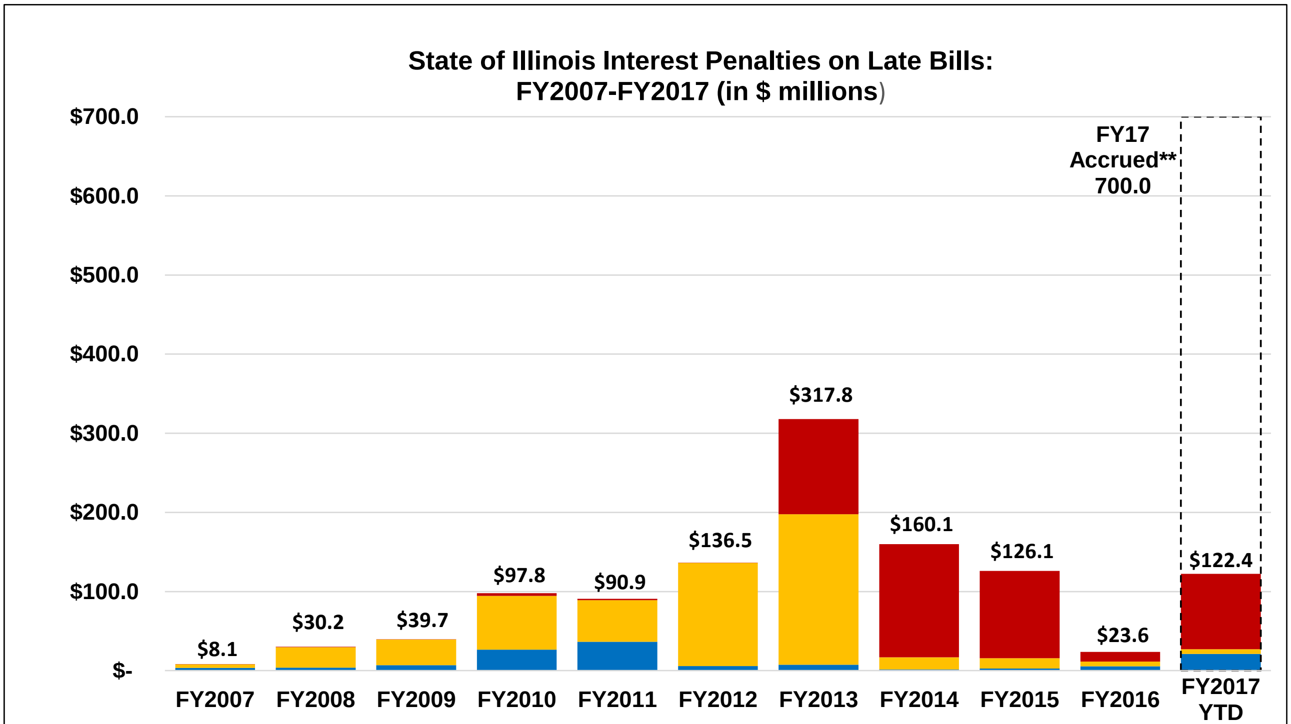
In the past ten years, delayed payment of bills cost the State more than $1.0 billion in interest penalties.[122] In February 2017, the Illinois Comptroller's Office estimated that the State would have to spend another $700 million if overdue bills on hand were paid at the end of FY2017.[123]

Interest penalties are not paid until the State pays the underlying bills, which means that the amount of interest penalties paid depends on the timing of bill payments. **Under the State Prompt Payment Act, interest accrues on some bills at 1% a month, or more than 12% annually, on proper bills that are not paid within 90 days.[124] Other claims, including those from healthcare providers, accrue interest at 9% a year after 30 days under the Illinois Insurance Code.**[125] Many types of State payables, including grants and transfers to local governments and State agencies, are not eligible for interest penalties when payment is delayed.

As indicated in the following chart, interest penalties from FY2007 through March FY2017 totaled $1.2 billion. The vast majority of penalties in the past ten years have been paid by the Departments of Healthcare and Family Services (HFS) and Central Management Services (CMS). HFS administers the Medicaid program and was in charge of employee and retiree group health insurance before FY2013, when the responsibility was shifted to CMS.

---

[120] For data and comparison calculations, see Appendix A on p.79.
[121] Yvette Shields, "Chicago Yield Penalties Steepen," *The Bond Buyer*, January 19, 2017.
[122] Civic Federation calculations based on data from the Illinois Office of the Comptroller.
[123] Communication between the Civic Federation and the Illinois Office of the Comptroller, February 2, 2017.
[124] 30 ILCS 540. Proper bills are defined as those that include the information needed to process the payment.
[125] 215 ILCS 5/368(a).



	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017 YTD
CMS	$0.1	$0.5	$0.4	$3.3	$1.8	$0.2	$120.3	$143.2	$110.4	$12.0	$95.2
HFS	$4.5	$25.9	$32.4	$68.1	$52.6	$130.6	$190.2	$15.3	$13.0	$6.2	$5.9
Other	$3.5	$3.8	$6.8	$26.4	$36.5	$5.7	$7.4	$1.5	$2.7	$5.4	$21.2
Total*	$8.1	$30.2	$39.7	$97.8	$90.9	$136.5	$317.8	$160.1	$126.1	$23.6	$122.4

*Totals may not sum due to rounding.
**Projected by the Illinois Office of the Comptroller to have accumulated by the end of FY2017.
Source: Civic Federation calculations based on data from State of Illinois Comptroller.

State spending on interest penalties began to climb in FY2008, as unpaid bills accumulated during the Great Recession. Interest penalties rose to $317.8 million in FY2013, largely due to a pay down of Medicaid bills.

In the last few years, late payment of group health insurance bills has accounted for most of the interest penalties paid by the State. **Health insurance bills can be held indefinitely because, unlike most other State bills, they may be paid from future years' appropriations.** As of the end of March 2017, State group health insurance claims totaled about $4.4 billion and were expected to remain unpaid in some cases for as long as two years.[126]

Despite mounting bills, interest payments were relatively low at $23.6 billion in FY2016 due to the lack of health insurance appropriations to pay down the claims. As of the end of March 2017, the State had paid $122.4 million in interest penalties in FY2017, of which $91.8 million were related to State group health insurance.[127] Although there have been no General Funds appropriations for group health insurance since FY2015, the stopgap spending bill enacted in June 2016 authorized the use of other funding sources, such as employee premiums, to pay bills.

[126] State of Illinois, Commission on Government Forecasting and Accountability, *Monthly Briefing for the Month Ended: March 2017*, p. 10.
[127] This amount is the portion of the penalties paid by CMS out of the Health Insurance Reserve Fund, the account that funds payments for State group health insurance.

According to the Comptroller's estimate, the State could pay $700 million in interest penalties if all of the unpaid bills were paid off by the end of FY2017.[128] The total consists of about $600 million in health insurance-related interest penalties and $100 million in penalties related to other kinds of bills.

A portion of the accrued penalties are not owed to vendors but to third parties who participate in the State's Vendor Support Initiative.[129] This program allows vendors to assign bills to authorized third party collectors, who pay the vendors 90% of the bills up front and the remaining 10% when the bills are paid by the State. In return, the collectors get to keep any interest penalties. As of September 15, 2016, **private financing companies had purchased about $970 million in group health insurance bills through the program.**[130]

Loss of Services

The lack of a complete State budget has had the most impact on areas that were funded partially or not at all over the last two years, including higher education, human services not covered by consent decrees and State group health insurance. But prolonged payment delays due to deteriorating cash flows are causing increasing financial strains for all activities supported by the State.

Perhaps the hardest hit area has been higher education, which includes **nine public universities**; the Illinois Community College Board, which distributes funds to **48 community colleges**; and the **Monetary Award Program**, which provides college tuition grants for low income students.[131]

In FY2015, the last year with a complete budget, higher education received $1.9 billion in General Funds. The area received $623 million in FY2016[132] and an allocation of $997 million in the stopgap budget passed in June 2016, which expired on December 31, 2016 and could be used to cover FY2016 costs. In total, higher education received $1.6 billion over the past two years—a cumulative shortfall of about $2.2 billion compared with the FY2015 level.

As a result, public colleges and universities have spent down their reserves, eliminated administrative and clerical jobs, instituted furlough days and cut programs. Chicago State University, which was troubled before the budget impasse, declared a financial crisis in 2016, laid off hundreds of workers, reduced library hours and cut spending on travel and supplies.[133] Northeastern Illinois University closed its campus for several days and furloughed employees, while Southern Illinois University plans to cut $30 million in costs, which is likely to result in

---

[128] Communication between the Civic Federation and the Illinois Office of the Comptroller, February 2, 2017.
[129] Illinois Department of Central Management Services, Vendor Support Initiative, https://www.illinois.gov/cms/business/VendorPayment/Pages/VSI.aspx (last visited on January 29, 2017).
[130] State of Illinois, Commission on Government Forecasting and Accountability, *Monthly Briefing for the Month Ended: January 2017*, p. 15.
[131] Higher education also includes the Board of Higher Education, Math and Science Academy and State Universities Civil Service System. Higher education budget numbers presented here do not include State contributions to the State Universities Retirement System.
[132] The $623 million in FY2016 includes both General Funds appropriations and personnel costs paid under court order.
[133] Peter Matuszak and Dawn Rhodes, "Chicago State University faces year-end deficit, needs to slash expenses," *Chicago Tribune*, December 27, 2016.

layoffs.[134] SIU is also considering a plan to allow its main campus to borrow money from another campus.[135] Western Illinois University took $20 million in budget cuts, as well as layoffs and furloughs.[136] Governors State University is eliminating more than one-third of its degree programs and increasing tuition by 15% in the fall.[137]

The flagship University of Illinois, which relies less on State funding than other public universities in Illinois, has asked departments to cut an average of about 2 percent from their budgets during the impasse.[138] U of I officials have said the school is losing top faculty who can bring in grants to other universities that can offer higher salaries.[139]

Overall undergraduate enrollment at Illinois' public universities dropped by 2% in the fall of 2016 from a year earlier, with only the University of Illinois and Illinois State University reporting increases, according to the State's Board of Higher Education.[140] School leaders could not say for sure that the declines were caused by the budget uncertainty, but some officials pointed to decreases in the size of the freshmen class as evidence of a connection.[141] At Chicago State, only 86 first-time, full-time freshmen enrolled last fall, down from 200 the prior year.[142]

During the budget standoff, many schools credited students' tuition bills for their MAP grants. The stopgap spending plan included MAP grant funding for the 2015-2016 school year but no remaining funds for the current academic year.[143]

A survey by the Illinois Student Assistance Commission found that nearly all public universities covered MAP grants in the fall of 2016, but only two-thirds were committed to covering them in the spring.[144] Among community colleges surveyed, 39% said they planned to credit student accounts for the grants in the spring, compared with 65% at private institutions.

Although many healthcare and social services programs have been paid due to federal consent decrees, there are notable exceptions. Lutheran Social Services, one of the State's largest social service agencies, said in January 2016 that it was laying off 750 employees, cutting its annual budget by 21.9% and ending more than 30 programs for about 4,700 people because it was owed

---

[134] Dawn Rhodes, "Standard & Poor's downgrades NEIU, SIU and University of Illinois," *Chicago Tribune*, April 20, 2017.
[135] Marnie Leonard, "University officials address financial situation with faculty," *Daily Egyptian*, April 13, 2017.
[136] Lainie Steelman, "House stopgap 'not enough,' say Western's budget director and state Rep. Hammond," *The McDonough County Voice*, April 10, 2017.
[137] Dawn Rhodes, "State budget gridlock forces another Northeastern campus shutdown, *Chicago Tribune*, April 11, 2017.
[138] Associated Press, "U of Illinois asks departments to cut budgets by 2 percent," *The Pantagraph*, March 3, 2017.
[139] Greg Hinz, "U of I credit now at risk in state budget war," *Crain's Chicago Business*, April 18, 2017.
[140] Illinois State Board of Higher Education, *Fall 2016 Enrollment Snapshot for Public Universities*, http://www.ibhe.org/DataPoints/Fall2016Enrollment.pdf (last visited on February 2, 2017).
[141] Dawn Rhodes and Kate Thayer, "Illinois public universities have fluctuating enrollment after difficult year," *Chicago Tribune*, September 8, 2016.
[142] Dawn Rhodes, "New leaders start at Chicago State University," *Chicago Tribune*, April 24, 2017.
[143] Illinois Student Assistance Commission, *Student and Parent FAQs: Impact of State Budget Delay on ISAC Gift Assistance Programs*, https://www.isac.org/students/during-college/budget-faqs.html (last visited on February 2, 2017).
[144] Illinois Student Assistance Commission, *FY17 ISAC Grant Survey: How are colleges and universities handling MAP during the budget delay?,"* December 2016.

more than $6 million by the State.[145] The agency participated in the State's Community Care Program, which is designed to keep seniors out of nursing homes. A large portion of the Community Care Program does not fall under Medicaid and is not covered by a consent decree.

A survey in March 2017 by the United Way of Illinois found that 46% of the 463 human services agencies that responded had reduced the number of clients served and one-quarter had closed programs due to the budget impasse.[146] To keep operating, agencies said they had used reserves and lines of credit, laid off staff, left positions vacant, reduced staff hours and benefits and increased waiting lists for services.

At a hearing of the Illinois House of Representatives in Chicago on April 20, the head of a domestic violence shelter said the number of clients turned away due to lack of funding to pay staff had quadrupled to 100 per month.[147] A representative of La Casa Norte, which provides shelter for homeless youth and families, said the organization had eliminated treatment for substance abuse, cut access to psychiatrists and increased caseloads by 80%.[148]

Continued funding shortages are also affecting State workers and their families who need medical care. Because of record delays in payments of State health insurance claims, some doctors and hospitals are demanding payment up front or are declining to accept new State-insured patients.[149] In one instance, a medical equipment maker tried to reclaim the oxygen machine used by the young son of a State employee.[150] The company said it had stopped taking orders from Illinois in October 2016 and was waiting 20 months to be paid by the State.

During the budget impasse, State agencies have received only partial funding for their operations, including maintenance costs and day-to-day expenses such as utilities. The Department of Natural Resources said earlier this month that it was unable to dredge a lake near Rockford that has been closed due to poor water quality.[151] The dredging machine is broken and the agency does not have the $450,000 in repair costs.

Even elementary and secondary education, which was singled out for two full years of funding, has not been protected from the fiscal crisis. Because of Illinois' cash shortage, it took six months for public schools to get their last quarterly installment for 2015-2016 of State "categorical" payments, which cover transportation, special education and free and reduced-price lunches.[152] This year's first quarterly payments, which typically would have been received months ago, reportedly were scheduled to be sent out at the end of April.[153]

---

145 Shia Kapos, "Big Lutheran social agency cuts 750 jobs amid budget impasse," *Crain's Chicago Business*, January 22, 2016.
146 United Way of Illinois, *United Way of Illinois Post-Stop Gap Funding Survey: High Level Findings*, April 6, 2017.
147 Testimony of Kate Johnson, Chairperson of A Safe Place, to House Human Services Appropriations Committee, April 20, 2017.
148 Testimony of Rachel Bhagwat, Community Engagement Coordinator at La Casa Norte, to House Human Services Appropriations Committee, April 20, 2017.
149 Dean Olsen, "Orthopedic Center requiring up-front payments from state workers," *The State-Journal Register*, January 17, 2017; Jordan Abudayyeh, "The 'State' of Illinois: Comptroller Mendoza Discusses the Costs of the Gridlock," *WICS News Channel 20*, February 1, 2017.
150 Lauren Trager, "News 4 Investigates: Fighting for air," KMOV, February 9, 2017.
151 Associated Press, "Illinois budget problems, bill backlog affecting state parks," *Daily Herald*, April 19, 2017.
152 Suzanne Baker, "State funding for buses, lunches and special ed arrives late," *Naperville Sun*, January 5, 2017.
153 Sarah Freishtat, "Aurora-area school districts among hundreds calling for state budget," *Aurora Beacon-News*, April 24, 2017.

In response, hundreds of school districts across the State have joined a campaign for a complete State budget. The CEO of School District U-46 has said his district may not be able to open in the fall without a full budget in place.[154] The northwest suburban district, the State's second largest, is owed $25 million by the State and has stopped all discretionary spending, such as travel and technology upgrades.

Late payments from the State have already caused some public transit agencies outside of the Chicago area to reduce services. The West Central Mass Transit District, which serves six counties in Western Illinois, suspended all service in October 2016 before resuming limited operations after receiving partial payment two months later.[155] The River Valley Metro Mass Transit District suspended bus service around Kankakee on Sundays and holidays and sued the State to collect unpaid funds.[156]

The money owed to downstate transit districts comes from local sales taxes collected by the State. The agencies have to wait in line to be paid because the taxes are deposited into a general operating account before being transferred to the Downstate Public Transportation Fund. Legislation recently passed by the Illinois House would require that the taxes be deposited directly into the transportation fund.[157]

---

154 Rafael Guerrero, "U46: CEO: State budget imapsse could shut down school year," *Elgin Courier News*, April 24, 2017.

155 John Reynolds, "West Central Mass Transit District to resume limited service," The State Register-Journal, December 11, 2016.

156 Tony Arnold, "Downstate Transit Agency Sues for Money Tied up In Budget Impasse," *WGLT*, April 3, 2017.

157 100th Illinois General Assembly, House Bill 2453, passed by the House on April 27, 2017.

REVENUES

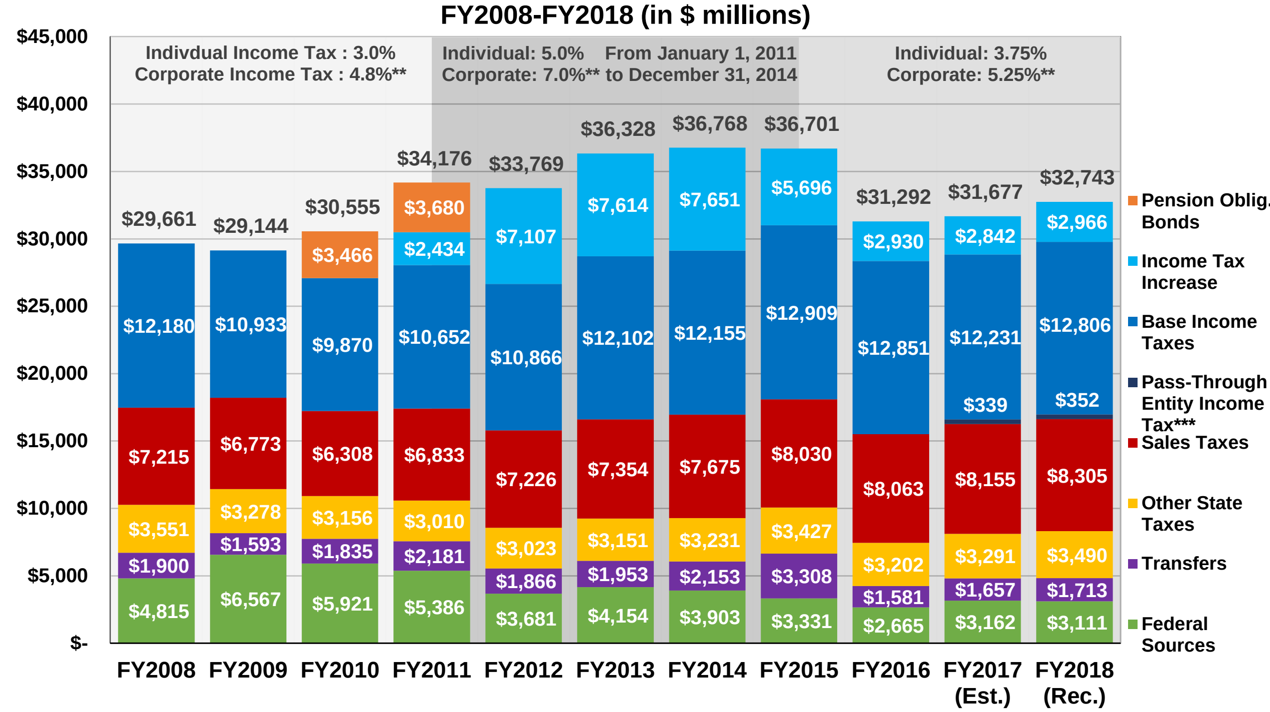
The State of Illinois generates annual operating resources by collecting taxes and fees levied by the State, as well as grants and reimbursements provided by the federal government. The Governor's recommended FY2018 budget projects total revenues of $63.7 billion, of which $32.7 billion are available for General Funds spending.[158] The remaining revenues that are not included in the General Funds are restricted for specific purposes, shared through revolving funds between government agencies, held in trusts or generally not available for discretionary spending by the General Assembly.[159]

[158] General Funds support the regular operating and administrative expenses of most State agencies and are the funds over which the State has the most control. The operating budget also includes Other State Funds, which are accounts for activities funded by specific revenue sources that may only be used for specific purposes, and Federal Funds (other than those designated for General Funds), which support a variety of State programs with federal revenues.

[159] Beginning in February 2015 the Illinois Income Tax Act required that 1/15th of the individual income taxes collected by the State be diverted to two special funds to support human service programs and education spending. This shifted a significant portion of revenue previously available for discretionary General Funds spending into restricted Special Funds. However, since the restricted uses of these funds have historically been considered "general purpose," both the Governor's Office and the Civic Federation have chosen to analyze these funds together with the General Funds.

The following chart shows the 11-year trend in General Funds revenue by major source from FY2008, the last full budget year before the impact of the Great Recession was felt by State revenue sources.[160]

State of Illinois General Funds* Revenues: FY2008-FY2018 (in $ millions)



* Includes revenues allocated to the General Funds, Fund for the Advancement of Education, Committment to Human Services Fund and Budget Stabilization Fund. Income tax amounts are net of diversions to the Income Tax Refund Fund.
** Corporations also pay a Personal Property Replacement Tax of 2.5%.
*** The FY2018 Budget began reporting tax revenue from pass-through business entities, such as partnerships and S-corporations, separately from other individual income tax
Source: Illinois State FY2018 Budget, pp. 160-169; Illinois State FY2017 Budget, pp. 160-168; Illinois State FY2016 Budget, pp. 4-9 to 4-17; Illinois State FY2015 Budget, pp. 3-12 to 3-19; Illinois State FY2014 Budget, pp. 3-11 to 3-20; Illinois State FY2013 Budget, pp. 3-10 to 3-19; Illinois State FY2012 Budget, pp. 5-12 to 5-23.

As shown in the chart above, both income taxes and sales taxes declined dramatically during the recession that began in December 2007 and lasted until June 2009.[161] Total income tax revenues declined by $2.3 billion to $9.9 billion in FY2010 from $12.2 billion in FY2008. Sales taxes declined by $907 million to $6.3 billion in FY2010 from $7.2 billion in FY2008.

The State weathered these years with the assistance of temporary federal stimulus spending,[162] causing total federal funds to peak at $6.6 billion in FY2009. The State also issued pension obligation bonds that brought in $3.5 billion and $3.7 billion for pension payments in FY2010 and FY2011, respectively. Although state-source revenues began to stabilize and show marginal growth in FY2011, overall revenue projections remained weak when the State enacted its FY2011 budget. Halfway through the FY2011 fiscal year, the State approved temporary increases for both the personal and corporate income tax rates.[163]

---

[160] *See* Illinois General Assembly, Commission on Government Forecasting and Accountability, *Economic and Revenue Update, FY2009*, November 19, 2008, p. 27.
[161] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[162] The American Recovery and Reinvestment Act, Pub.L. 111-5.
[163] Public Act 96-1496.

On January 1, 2015, after four years at temporarily increased rates, the individual income tax rate declined to 3.75% from 5.0% and the corporate income tax rate declined to 5.25% from 7.0%. Due to the half year of lower income tax rates, net income tax revenues declined by $1.2 billion to $18.6 billion in FY2015 from $19.8 billion in FY2014. Fiscal year 2016 was the first full year of the lower rates, which resulted in a $4.0 billion decline in net income tax revenues from the peak year of FY2014, or a 20.3% drop.

Although base income and sales taxes have recovered since the downturn, other State taxes and transfers have remained flat, and federal funds and total income taxes have declined. Overall, the Governor's Office projects FY2017 General Funds revenues that are $2.0 billion higher than FY2008, a 6.8% increase over nine years. For comparison, inflation over the same period was 14.2%.[164]

With few proposed revenue policy changes, the Governor's Office projects an increase of $1.0 billion in total General Funds revenue from FY2017 to FY2018, an increase of 3.4%.

Income Taxes

Income taxes are the largest source of State revenues, making up approximately half of State-source General Funds revenues. The Governor's recommended FY2018 budget projects a 4.6% increase in income tax revenues from FY2017, which is projected to have the lowest income tax revenue since the partial rollback of the temporary income tax increase in FY2015.

FY2017 and FY2018 are not expected to be dramatically different from FY2016, with a $368 million decrease in FY2017 followed by a $713 million increase in FY2018. Even after accounting for growth during the three year period, net income tax revenues projected for FY2018 are still $3.7 billion below the peak total in FY2014.

---

[164] Federal Reserve Bank of St. Louis, FRED Economic Data, Consumer Price Index for All Urban Consumers: All Items (CPIAUCSL), from March 2008 to March 2017, https://fred.stlouisfed.org/series/CPIAUCSL (last visited on April 20, 2017).

The following table shows income taxes collected by the State of Illinois from FY2014 through the recommended FY2018 budget projections. The table separates the amount collected under the original 3.0% individual income and 4.8% corporate income tax rates from the increased increments for each year. It also includes the amounts diverted to pay for tax refunds.

State of Illinois Income Total Tax Revenues FY2014-FY2018 (in $ millions) Includes Fund for the Advancement of Education and Commitment to Human Services Fund							
Income Tax Increment	**FY2014**	**FY2015**	**FY2016**	**FY2017 Est.**	**FY2018 Rec.**	**5-Year $ Change**	**5-Year % Change**
Individual Income Tax							
Individual Base (3.0%)	$ 11,033	$ 12,125	$ 12,241	$ 12,227	$ 12,561	$ 1,528	13.9%
Individual Increase*	$ 7,355	$ 5,557	$ 3,060	$ 3,056	$ 3,140	$ (4,215)	-57.5%
Pass-Through Entities**	n/a	n/a	n/a	$ 382	$ 391	n/a	n/a
Gross Individual Income Tax	**$ 18,388**	**$ 17,682**	**$ 15,301**	**$ 15,665**	**$ 16,093**	**$ (2,295)**	**-12.5%**
Refund Fund Transfer	$ (1,746)	$ (1,768)	$ (1,494)	$ (1,754)	$ (1,609)	$ 137	-7.7%
Net Individual Income Tax	**$ 16,642**	**$ 15,913**	**$ 13,806**	**$ 13,911**	**$ 14,484**	**$ (2,158)**	**-13.0%**
Corporate Income Tax							
Corporate Base (4.8%)	$ 2,496	$ 2,321	$ 2,136	$ 1,659	$ 1,819	$ (677)	-26.8%
Corporate Increase*	$ 1,144	$ 808	$ 200	$ 155	$ 170	$ (974)	-84.3%
Gross Corporate Income Tax	**$ 3,640**	**$ 3,129**	**$ 2,336**	**$ 1,814**	**$ 1,989**	**$ (1,651)**	**-44.9%**
Refund Fund Transfer	$ (476)	$ (438)	$ (362)	$ (313)	$ (348)	$ 128	-25.5%
Net Corporate Income Tax	**$ 3,164**	**$ 2,691**	**$ 1,974**	**$ 1,501**	**$ 1,641**	**$ (1,523)**	**-47.9%**
Total Income Taxes (net)	**$ 19,806**	**$ 18,604**	**$ 15,780**	**$ 15,412**	**$ 16,125**	**$ (3,681)**	**-18.7%**

*The individual income tax rate increase totaled 2.0 percentage points from January 1, 2011 through January 1, 2015, when the increase amount declined to 0.75 percentage points. The corporate income tax increase totaled 2.2 percentage points from January 1, 2011 through January 1, 2015 when the increase declined to 0.45 percentage points.

** The FY2018 Budget began reporting income from pass-through business entities, such as partnerships and S-corporations, separately from other individual income.

Source: Illinois State FY2018 Budget, pp. 160-161.

After accounting for the amount set aside to pay tax refunds, net individual income taxes available for General Funds spending increase by $573 million to $14.5 billion in FY2018 compared to $13.9 billion in FY2017. Net individual income taxes are $2.2 billion less than the peak total of $16.6 billion in FY2014.

Net corporate income tax revenues are projected to increase by $140 million to $1.64 billion in FY2018 compared to $1.50 billion in FY2017. Net corporate income taxes are $1.1 billion less than the peak total of $3.7 billion in FY2013.[165] It should be noted that the State also collects the Personal Property Replacement Tax on behalf of local governments at a rate of 2.5% on corporate income, making the current effective corporate income tax rate in Illinois 7.75%.

Other than the rate reduction, corporate income tax receipts have been negatively affected by the January 1, 2015 expiration of a $100,000 cap on the net operating loss deduction. The effect of this change, however, has not yet been quantified.

Additionally, corporate income taxes are affected by the reclassification of $391 million in tax revenue from pass-through business entities, such as partnerships, LLCs and S-Corporations, into the individual income tax category, as required by statute.[166]

[165] Illinois State FY2017 Budget, p. 161.
[166] Public Act 98-0478, signed on August 16, 2013.

Other General Funds Revenue

The following table compares amounts included in the Governor's recommended FY2018 budget to current estimates of FY2017 General Funds revenues.

State of Illinois General Funds Revenues: Estimated FY2017 and Governor's Recommended FY2018 (in $ millions)	FY2017 Est.	FY2018 Rec.	$ Change	% Change
State Taxes				
Income Taxes (net)	$15,412	$16,125	$ 713	4.6%
Individual (net)	$13,911	$14,484	$ 573	4.1%
Corporate (net)	$ 1,501	$ 1,641	$ 140	9.3%
Sales Taxes	$ 8,155	$ 8,305	$ 150	1.8%
Public Utility Taxes	$ 899	$ 917	$ 18	2.0%
Cigarette Tax	$ 353	$ 353	$ -	0.0%
Liquor Gallonage Taxes	$ 171	$ 172	$ 1	0.6%
Estate Tax	$ 275	$ 275	$ -	0.0%
Insurance Taxes & Fees	$ 395	$ 395	$ -	0.0%
Corporate Franchise Tax & Fees	$ 205	$ 203	$ (2)	-1.0%
Interest on State Funds & Investments	$ 26	$ 24	$ (2)	-7.7%
Cook County Intergovernmental Transfer	$ 244	$ 244	$ -	0.0%
Other Sources	$ 723	$ 907	$ 184	25.4%
Total State Taxes	**$26,858**	**$27,920**	**$ 1,062**	**4.0%**
Transfers				
Lottery	$ 720	$ 719	$ (1)	-0.1%
Riverboat Transfers & Receipts	$ 270	$ 274	$ 4	1.5%
Other	$ 667	$ 720	$ 53	7.9%
Total Transfers	**$ 1,657**	**$ 1,713**	**$ 56**	**3.4%**
Total State Revenues	**$28,515**	**$29,633**	**$ 1,118**	**3.9%**
Federal Sources	**$ 3,162**	**$ 3,111**	**$ (51)**	**-1.6%**
Total Revenue	**$31,677**	**$32,744**	**$ 1,067**	**3.4%**

Source: Illinois State FY2018 Budget, p. 131.

Sales taxes have been collected at the same rate over the last decade and increase by $150 million to $8.3 billion in FY2018. The State collects sales taxes at a rate of 6.25% and retains 5.0 percentage points to fund its operations while passing along the remaining portions to county and local governments. Other taxes are forecast to be nearly unchanged in FY2018, only increasing by $17 million from FY2017. Earnings on State investments are expected to decline by $2 million.

The FY2018 budget includes a single revenue proposal to increase resources: the sale of the James R. Thompson Center totaling $300 million to be available to support operating expenses.[167] Net of associated costs, the Governor's Budget expects the sale to bring $240 million in revenue for the State. This one-time revenue source would not be part of the State's ongoing tax base and would only be available for spending in FY2018. The estimated net revenue has been revised upwards by

[167] Illinois State FY2018 Budget, p. 44.

$40 million since the sale was proposed in the FY2017 Budget.[168] The revenue increase from the sale of the Thompson Center is included in the State's Other Sources of revenues, which has a net increase of $184 million to $907 million in FY2018 from $723 million in FY2017.

However, there are several potential impediments to realizing these revenues during FY2018. The sale of the Thompson Center would require authorization by the General Assembly, and potentially re-zoning by the City of Chicago.[169] Mayor Rahm Emanuel has also made it clear that he expects the State to pay the costs of replacing the CTA station in the building, which he estimates at $80 to $120 million.

Potential Revenue Underperformance

The Governor's revenue forecast is based on conservative assumptions of economic growth, blending a baseline scenario with a pessimistic scenario that includes a 20% chance of recession within the last two quarters of FY2018.[170]

However, a report issued in March by the Commission on Government Forecasting and Accountability (COGFA) estimated even lower revenues in both FY2017 and FY2018. Total FY2017 revenue is forecast to be $562 million less than GOMB's estimate.[171] Total FY2018 revenue is forecast to be $355 million less than GOMB's estimate.[172]

COGFA takes a more conservative view of revenue growth based on weak year-to-date tax receipts and a report prepared for the agency by Moody's Analytics that predicts that Illinois job growth will lag the national average, especially outside of the Chicago metropolitan area.[173] The COGFA report is careful to note that accounting changes by the Illinois Department of Revenue (IDOR) have made it difficult to distinguish between true revenue underperformance and intra-year delays in receipts. However, COGFA concluded that the magnitude of the underperformance warranted a downward revision in the projection.

However, IDOR has argued that individual taxpayers under-withheld taxes in 2016, after having the experience of over-withholding in 2015 following the rate rollback.[174] As a result, IDOR predicted that revenue receipts would accelerate once all tax returns were filed, and that its revenue estimates were accurate. Data from filing returns is not yet available, so which agency's prediction is more accurate remains to be seen.

---

[168] Mike Hoffman, Acting Director of Central Management Services, Testimony before Senate Appropriations I Committee, March 15, 2017.

[169] Lauren Chooljian, "Emanuel Adds More Complications to Thompson Center Sale," WBEZ, May 2, 2017, https://www.wbez.org/shows/wbez-news/emanuel-adds-more-complications-to-thompson-center-sale/258dc2ba-06fa-490c-96f4-dfeb3f69506e?mc_cid=bd40945ea3&mc_eid=94f512f58b (Last accessed May 3, 2017).

[170] Illinois State FY2018 Budget, p. 152.

[171] Net of transfers to the Income Tax Refund Fund. Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2018 Economic Forecast and Revenue Estimate and FY 2017 Update*, March 7, 2017, p. 23.

[172] COGFA does not analyze the Thompson Center sale proceeds, so they are excluded from this comparison. Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2018 Economic Forecast and Revenue Estimate and FY 2017 Update*, March 7, 2017, p. 28.

[173] Moody's Analytics, *State of Illinois Economic Forecast*, prepared for Illinois General Assembly, Commission on Government Forecasting and Accountability, January 2017.

[174] Hans Zigmund, director of IDOR, Testimony before the House Revenue Committee on March 21, 2017.

APPROPRIATIONS AND EXPENDITURES

The recommended FY2018 budget proposes total appropriations of $69.8 billion, including $33.6 billion in General Funds appropriations. The budget proposal also includes $27.6 billion in Other State Funds and $8.5 billion in Federal Funds.[175]

Proposed FY2018 General Funds expenditures total $37.3 billion. General Funds expenditures include both spending from appropriations and transfers out of General Funds to make interest and principal payments on previously issued bonds and provide funding for local governments and for other purposes.

General Funds support the regular operating and administrative expenses of most agencies and are the funds over which the State has the most control.[176] Other State Funds are accounts for activities funded by specific revenue sources that may only be used for specific purposes. Federal Funds (other than those designated for General Funds) use federal revenues to support a variety of State programs.

Since FY2015 was the last fiscal year in which Illinois had a complete General Funds budget, this report uses FY2015 as the baseline for comparison with the recommended FY2018 budget. It is difficult to determine annual costs in FY2016 and FY2017 because of limited appropriations in those years and agencies' ability to use FY2017 appropriations to cover FY2016 bills under the stopgap spending plan passed in June 2016.

Total Budget by Fund Type

The following table shows appropriations by type of fund from FY2015 through FY2018. Total appropriations increase by $2.3 billion, or 3.5%, from $67.4 billion in FY2015 to a recommended $69.8 billion in FY2018. General Funds appropriations increase by $1.4 billion, or 4.4%, from $32.2 billion in FY2015 to $33.6 billion in FY2018.

State of Illinois Appropriations by Fund: FY2015-FY2018 (in $ millions)

	FY2015 Enacted	FY2016 Enacted*	FY2017 Enacted*	FY2018 Rec.	FY2015-FY2018 $ Change	FY2015-FY2018 % Change
General Funds**	$ 32,182	$ 14,817	$ 17,390	$ 33,610	$ 1,428	4.4%
Other State Funds	$ 27,074	$ 26,651	$ 27,768	$ 27,631	$ 557	2.1%
Federal Funds	$ 8,186	$ 8,137	$ 8,430	$ 8,541	$ 355	4.3%
Total	**$ 67,442**	**$ 49,605**	**$ 53,588**	**$ 69,782**	**$ 2,340**	**3.5%**

*FY2016 and FY2017 enacted appropriations include appropriations under statutory continuing appropriation authority.

**General Funds include Commitment to Human Services Fund, Fund for the Advancement of Education and Budget Stabilization Fund.

Source: Illinois State FY2017 Budget, pp. 97, 261, 325 and 465; Illinois State FY2018 Budget, pp. 98-99.

In FY2016, the only major enacted General Funds appropriations were for elementary and secondary education, teachers' pensions outside Chicago and partial funding for higher

[175] The total does not sum to $69.8 billion due to rounding.

[176] General Funds consist of four funds: the General Revenue Fund, Education Assistance Fund, Common School Fund and General Revenue-Common School Special Account Fund. The FY2018 budget proposes that three other funds—the Fund for the Advancement of Education, the Commitment to Human Services Fund and the Budget Stabilization Fund—be included in General Funds. This report includes the three additional funds in General Funds.

education.[177] Enacted General Funds appropriations of $14.8 billion represented only 54.4% of reported appropriated spending; the remaining spending was authorized pursuant to court order or consent decree.[178] The 54.4% includes continuing appropriations. Reported FY2016 spending does not account for costs that remained unpaid at the end of the fiscal year, which the Governor's Office estimates at $2.9 billion.[179]

Enacted General Funds appropriations so far in FY2017 under the stopgap plan provided a full year of funding for elementary and secondary education and partial funding for higher education, human services not covered by consent decrees and agency operations.[180] These appropriations represent 50.6% of appropriated spending estimated by the Governor's Office, which includes appropriations that have not as yet been enacted but would be needed to maintain existing programs and services. The 50.6% includes continuing appropriations.

It is important to recognize that total appropriations do not accurately reflect State spending because spending from Other State Funds and Federal Funds is often significantly below appropriated amounts. In FY2015, for example, actual spending from Other State Funds was $22.5 billion, compared with appropriations of $27.1 billion; actual spending from Federal Funds was $5.1 billion, compared with appropriations of $8.2 billion.[181]

General Funds spending is typically somewhat below appropriated amounts due to unspent agency appropriations and other below-the-line adjustments. The recommended FY2018 budget has $1.1 billion in such adjustments, including $809 million in unspent appropriations, $230 million in reforms to the procurement process and other savings and $70 million from use of another fund to support higher education.[182]

It should also be noted that the proposed FY2018 General Funds budget has an operating deficit of $4.6 billion. Balancing the budget could require revenue increases, spending reductions or a combination of the two.[183]

General Funds Appropriated Spending by Category

To understand State spending pressures, it is helpful to distinguish appropriated agency spending from pension contributions and group insurance payments. The legislature generally has more discretion over agency appropriations than the other two spending categories.[184] State pension contributions are based on State law, determined by Illinois' five retirement systems and covered by continuing appropriation. Group insurance consists mainly of health insurance for employees and retirees, which is governed by State law and union contracts.

The following table shows appropriated spending for these categories from FY2015 through FY2018. In addition to recommended FY2018 spending, the table shows estimated FY2018

[177] In addition, $28 million in General Funds appropriations were enacted to cover domestic violence shelters and the Illinois Secretary of State's Office.
[178] Illinois State FY2018 Budget, p. 99.
[179] Illinois State FY2018 Budget, pp. 127-128.
[180] Illinois State FY2018 Budget, p. 99.
[181] Illinois State FY2017 Budget, p. 97.
[182] Illinois State FY2018 Budget, p. 30.
[183] Illinois State FY2018 Budget, p. 76.
[184] Medicaid is considered as discretionary in this analysis, even though most spending changes in the Medicaid program require changes in State law, administrative rules and/or approval from the federal government.

maintenance spending, with no changes to programs or services. Agency spending from appropriations (net of below-the-line adjustments) increases by $983 million, or 4.2%, from $23.5 billion in FY2015 to the Governor's recommended level of $24.5 billion in FY2018. The recommended FY2018 amount represents a decrease of $614 million, or 2.4%, from the FY2018 maintenance level of $25.1 billion.

State of Illinois General Funds Appropriated Expenditures by Category: FY2015-FY2018 (in $ millions)[1]

	FY2015	FY2016	FY2017 Est.[2]	FY2018 Maint.[3]	FY2018 Rec.[4]	FY2015-FY2018 $ Change	FY2015-FY2018 % Change	FY2018 Rec.- Maint. $ Change	FY2018 Rec.- Maint. % Change
Agency Appropriations Spent	$ 23,534	$ 20,576	$ 24,696	$ 25,131	$ 24,517	$ 983	4.2%	$ (614)	-2.4%
Pension Contributions	$ 6,047	$ 6,632	$ 6,931	$ 7,889	$ 6,639	$ 592	9.8%	$ (1,250)	-15.8%
Group Insurance	$ 1,565	$ -	$ 1,810	$ 1,850	$ 1,415	$ (150)	-9.6%	$ (435)	-23.5%
Total	**$ 31,146**	**$ 27,208**	**$ 33,437**	**$ 34,870**	**$ 32,571**	**$ 1,425**	**4.6%**	**$ (2,299)**	**-6.6%**

[1]General Funds include include Commitment to Human Services Fund, Fund for the Advancement of Education and Budget Stabilization Fund.

[2]Total FY2017 appropriations have not been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions. FY2017 agency appropriations are reduced for $858 million of below the line adjustments, including $761 million in unspent appropriations and $97 million use of Personal Property Replacement Tax

[3]FY2018 maintenance agency appropriations are reduced by $882 million in below the line adjustments, including $812 million in unspent appropriations and $70 million use of Personal Property Replacement Tax Fund for higher education.

[4]FY2018 recommended agency appropriations are reduced by $1.1 billion of below the line adjustments, including $809 million in unspent appropriations, $230 million in procurement and unassigned transformation savings, and $70 million use of Personal Property Replacement Tax Fund for higher education.

Source: Illinois State FY2017 Budget, p. 91; Illinois State FY2018 Budget, pp. 30 and 78.

General Funds pension contributions in the recommended FY2018 budget are $6.6 billion, an increase of $592 million from $6.0 billion in FY2015 but a reduction of $1.25 billion from the FY2018 maintenance amount of $7.9 billion.

As previously discussed, the State's pension contributions are based on a 50-year funding plan designed to reach 90% funding by FY2045.[185] Statutorily required FY2018 General Funds contributions climbed by $958 million from $6.9 billion in FY2017 to $7.9 billion in FY2018. The significant increase stemmed largely from changes in actuarial assumptions, including reductions in assumed rates of investment return by four of the five retirement systems.[186]

The Governor's recommended FY2018 budget includes $750 million in savings from the following proposed pension changes that were also included in the recommended FY2017 budget but not taken up by the General Assembly:

- Actuarial assumptions: Changes in required State contributions related to revised actuarial assumptions would be phased in over five years. The change would allow the State to defer additional contributions due to lower assumed investment rates of return or lower mortality rates;
- Funding formula based on payroll: The retirement systems would use total payroll in determining the State's required contributions, even though pensionable salaries are capped for the less generous Tier 2 pension plan that applies to workers hired on or after January 1, 2011. Because required State contributions are based on a level percentage of payroll through FY2045, the change would reduce near-term contributions;
- Salary spiking: School districts and universities would pay pension costs for end-of-career raises that exceed the average growth rate in wages. The State currently pays pension costs due to salary increases up to 6%; and

[185] 40 ILCS 5.

[186] For more information, see Institute for Illinois' Fiscal Sustainability at the Civic Federation blog, https://www.civicfed.org/iifs/blog/state-illinois-pension-contributions-increase-significantly-fy2018 (last visited on April 26, 2017).

- High salary employees: School districts and universities, rather than the State, would pay pension costs for teachers' and university employees' salaries above $180,000.

In addition, the FY2018 budget includes $500 million in pension savings from a proposal to require universities and school districts outside Chicago to cover all pension costs for new employees. New workers would have a choice between the Tier 2 plan or a new Tier 3 offering that would have both defined benefit and defined contribution components.[187] The cost shift to school districts and universities would occur gradually, as new workers are hired over time. The State would see considerable savings immediately because the significant reduction in future pension liabilities would lead to a sharp decline in current contribution requirements, according to the Governor's Office.[188] Under the State's pension funding plan, contributions are based on benefits expected to be provided to employees hired far into the future, as well as to existing workers.

General Funds group insurance payments decline by $150 million, or 9.6%, from $1.45 billion in FY2015 to $1.42 billion in the recommended FY2018 budget. The proposed FY2018 level is $435 million, or 23.5%, below the FY2018 maintenance level of $1.85 billion. The savings are based on the administration's ability to execute a new contract with the State's largest union that includes sharply higher employee health insurance premiums or less generous coverage.[189]

The last contract with the American Federation of State, County and Municipal Employees (AFSCME) expired at the end of June 2015, and the dispute has now shifted to court. The Illinois Labor Relations Board ruled in the fall of 2016 that negotiations over a new contract had reached an impasse.[190] The ruling appeared to pave the way for the administration to impose its contract terms on the union, but AFSCME went to court to prevent that from happening. The Illinois Supreme Court on April 4 denied a request by the Rauner administration to take up the protracted contract dispute, which means that the case will be heard in the Fourth District Appellate Court.[191]

Despite the difficulty in reaching agreement with AFSCME, each of the Governor's budgets has incorporated projected health insurance savings based on a new contract. The FY2016 budget proposed group insurance appropriations of $1.2 billion, or savings of $655 million,[192] and the FY2017 budget recommended appropriations of $1.4 billion, or savings of $445 million.[193]

---

[187] Illinois State FY2018 Budget, pp. 176-177.
[188] Communication between the Civic Federation and the Governor's Office of Management and Budget, February 16, 2017.
[189] Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2018 Liabilities of the State Employees' Group Health Insurance Program*, March 2017, pp. 4-5.
[190] Kim Geiger, "Rauner scores big win over union on contract talks," *Chicago Tribune*, November 16, 2016.
[191] Doug Finke, "Illinois Supreme Court won't immediately hear AFSCME case," *The State Journal-Register*, April 4, 2017.
[192] Illinois State FY2016 Budget, p. 6-74 to 6-76.
[193] Illinois State FY2017 Budget, p. 63.

General Funds Agency Spending and Appropriations by Area

The next table shows spending and appropriations by area of government. Actual spending by area is shown for FY2015 through FY2016, while estimated expenditures are shown for FY2017 and maintenance and recommended appropriations are shown for FY2018. The amounts for FY2018 are overstated because they do not incorporate reductions due to unspent appropriations and other items. Because these deductions are given as lump sums in the budget book, it is not possible to distribute them across the various areas. The FY2017 figures include appropriations that have not yet been enacted.

State of Illinois General Funds Agency Spending and Appropriations by Area: FY2015-FY2018 (in millions)*

	FY2015 Exps.	FY2016 Exps.	FY2017 Est. Exps.**	FY2018 Maint. Approps.***	FY2018 Rec. Approps.***	FY2015-FY2018 $ Change	FY2015-FY2018 % Change	FY2018 Rec.-Maint. $ Change	FY2018 Rec.-Maint. % Change
K-12 Education	$ 6,745	$ 7,001	$ 7,474	$ 7,474	$ 7,724	$ 979	14.5%	$ 250	3.3%
Higher Education	$ 1,940	$ 623	$ 1,830	$ 1,950	$ 1,825	$ (115)	-5.9%	$ (125)	-6.4%
Economic Development	$ 77	$ 29	$ 54	$ 62	$ 52	$ (25)	-32.5%	$ (10)	-16.1%
Public Safety	$ 1,597	$ 1,129	$ 1,714	$ 1,831	$ 1,823	$ 226	14.2%	$ (8)	-0.4%
Human Services	$ 5,434	$ 4,680	$ 5,973	$ 6,174	$ 5,947	$ 513	9.4%	$ (227)	-3.7%
Healthcare	$ 6,524	$ 6,090	$ 7,221	$ 7,134	$ 7,134	$ 610	9.4%	$ -	0.0%
Environment and Culture	$ 54	$ 39	$ 64	$ 68	$ 60	$ 6	11.1%	$ (8)	-11.8%
Government Services	$ 1,197	$ 990	$ 1,223	$ 1,322	$ 1,060	$ (137)	-11.4%	$ (262)	-19.8%

*General Funds include Commitment to Human Services Fund, Fund for the Advancement of Education and Budget Stabilization Fund.
**FY2017 estimated expenditures include appropriations that have not yet been enacted and are not reduced for $858 million of below the line adjustments.
***FY2018 maintenance and recommended appropriations are not reduced by $882 million and $1.1 billion, respectively, in below the line adjustments.
Source: Civic Federation calculations based on Illinois State Operating Budget Detail, FY2017-FY2018, https://www.illinois.gov/gov/budget/pages/default.aspx.

General Funds funding for elementary and secondary education increases by $979 million, or 14.5%, to $7.7 billion in the recommended FY2018 budget from $6.7 billion in FY2015. As previously discussed, public schools have received full-year funding throughout the budget impasse and there have been significant yearly increases. Proposed FY2018 appropriations are $250 million above maintenance funding of $7.5 billion, with the largest increases to transportation, early childhood education and bilingual education.[194]

General State Aid (GSA), the State's main spending program for elementary and secondary education, increases by $30 million to $5.11 billion in the proposed FY2018 budget from $5.08 billion in FY2017.[195] GSA payments are based on a Foundation Level of funding, which is established by statute and represents the minimum per child amount of financial support that should be available to provide for the basic education of each student.[196] GSA is designed to help fill the gap between the Foundation Level and the amount a school district can provide from local property tax revenues and other local resources. The Foundation Level has been unchanged since FY2010 at a per pupil amount of $6,119, but the amount of GSA funding since that time was inadequate to fully pay for the Foundation Level until FY2017.[197] The amount proposed for FY2018 would also be sufficient to fully fund the Foundation Level.[198]

---

[194] Illinois State FY2018 Budget, p. 48.
[195] Illinois State FY2018 Budget, p. 100.
[196] 105 ILCS 5/18-8.05(B).
[197] Illinois State Board of Education, *General State Aid Overview – February 2017*, http://www.isbe.net/budget/fy17/FY17-budget-request.pdf (last visited on April 27, 2017).
[198] Illinois State Board of Education, *FY2018 Budget Request Comparison to FY2018 Governor's Recommendation 2/15/17*, https://www.isbe.net/Documents/Comparison-to-Gov-Budget-request.pdf (last visited on April 27, 2017).

Funding for public safety at $1.8 billion in the FY2018 recommended budget is virtually flat with the maintenance funding level. The budget proposal includes 170 new State troopers at the Illinois State Police at an additional cost of $10.5 million in FY2018.[199]

Proposed FY2018 appropriations for healthcare of $7.1 billion are flat with the FY2018 maintenance level but up by $610 million, or 9.4%, from FY2015 spending. Expenditures in FY2015 are understated because FY2014 revenues were used to pay for some FY2015 Medicaid expenses. Instead of using $600 million of General Funds in FY2015 to pay for those costs, the State appropriated the money from General Funds in FY2014 and deposited it in another account to spend in FY2015.[200]

Most Medicaid spending in Illinois is currently reimbursed by the federal government at a rate of 51.3%; for every $1 in appropriations, net State spending is 48.7 cents.[201] From January 2014 through the end of calendar year 2016, the federal government paid the entire bill for Medicaid recipients who became eligible for coverage under the Affordable Care Act (ACA). There are about 650,000 ACA enrollees, or approximately 21% of the total 3.1 million Medicaid recipients.[202] Federal reimbursement for this population declined to 95% beginning in January 2017 and further decreases to 94% in January 2018. These reductions in federal reimbursement are expected to add $61.8 million to net State cost in FY2017 and $138.6 million in FY2018.[203]

For other areas of government, the FY2018 budget proposes decreases from the FY2018 maintenance level. Recommended human services appropriations of $5.9 billion represent a reduction of $227 million, or 9.4%, from the maintenance level of $6.2 billion. Since FY2015, most of the funding for human services has resulted from court orders, rather than appropriations, According to the Governor's Office, the area had a funding shortfall of $571 million in FY2016[204] and would require an additional $381 million in FY2017, in addition to court-ordered funding.[205]

The largest human services decrease in proposed FY2018 involves the Community Care Program at the Department on Aging, which is designed to keep seniors out of nursing homes. In a modified version of a plan proposed in the FY2017 budget, the program's costs would be reduced by about $120 million, or 15%, by providing less expensive services to seniors who are not eligible for Medicaid.[206] The proposal would move 36,000 seniors, or about 47% of the 77,357 expected to be enrolled in FY2018, into a new Community Reinvestment Program.[207] Services for those individuals are projected to cost an average of $530 per month, or about 60% of the $883 for participants in the Community Care Program.[208]

Many of the programs at the Department of Human Services (DHS) that Governor Rauner proposed to eliminate in his FY2016 and FY2017 budgets are not funded in the FY2018 recommended budgets. These include funeral and burial expenses, after school programs for teens, youth

---

199 Illinois State FY2018 Budget, p. 55.
200 Public Act 98-0642, signed on June 9, 2014.
201 The reimbursement rate declines to 50.74% in federal fiscal year 2018, which begins in October 2017.
202 Illinois Department of Healthcare and Family Services, *FY2018 Budget*, February 15, 2017, p. 10.
203 Illinois Department of Healthcare and Family Services, *FY2018 Budget*, February 15, 2017, p.11.
204 Illinois State FY2018 Budget, pp. 127-128.
205 Communication between the Civic Federation and the Governor's Office of Management and Budget, April 19, 2017.
206 Illinois State FY2018 Budget, p. 44.
207 Illinois State FY2018 Budget, p. 250.
208 Illinois State FY2017 Budget, pp. 249-251.

employment services and programs for immigrants and individuals with autism and epilepsy. DHS expects to save about $69 million in FY2018 by eliminating programs.[209]

General Funds appropriations for DHS' Child Care Assistance Program, which helps low income families pay for day care so parents can go to work, increase by $148 million to $548 million in the proposed FY2018 budget from estimated FY2017 spending of $400 million.[210] Roughly half of the increase stems from a restoration of the eligibility ceiling to 185% of the federal poverty level, while the remainder relates to program changes required by the federal government.[211]

Government services appropriations decline by $262 million, or 19.8%, to $1.1 billion from the FY2018 maintenance level of $1.32 billion. The decrease reflects reductions of approximately 10% to the General Funds budgets requested by the General Assembly, judicial and constitutional offices. In addition, the recommended FY2018 budget includes savings of about $130 million by eliminating funding for the Teachers' Retirement Insurance Program (TRIP) and the College Insurance Program (CIP), which provide health insurance for retired public school teachers and community college employees outside of Chicago, and contributions to the Chicago teachers' pension fund.[212]

Compensation costs for FY2018 are expected $336 million than they would have been if previous cost of living and step increases had continued after the expiration of the AFSCME contract in June 2015.[213] The Governor has included a four-year wage freeze in the administration's proposed terms for a new contract with AFSCME.[214] As previously discussed, the State and its largest union are currently in a legal battle over implementation of the contract terms, and it remains unclear when or if they will take effect, or whether they will include any retroactive increases for the period since the last contract.

Funding for higher education has dropped sharply during the budget impasse. Higher education includes nine public universities; the Illinois Community College Board, which distributes funds to 48 community colleges; and the Monetary Award Program, which provides tuition grants to low income college students.[215]

---

[209] Testimony of James Dimas, Secretary of the Illinois Department of Human Services, to the House Human Services Appropriations Committee, April 6, 2017.
[210] Illinois State FY2018 Budget, p. 314.
[211] Communication between the Civic Federation and the Governor's Office of Management and Budget, May 3, 2017. The Rauner administration lowered the eligibility level to 50% of the federal poverty level from 185% in July 2015 before raising it to 162% in November 2015.
[212] Illinois State FY2018 Budget, p. 39. The State's statutorily required contributions to TRIP and CIP in FY2018 are $114.2 million and $4.1 million, respectively, and are covered by continuing appropriations. The State is expected to contribute $12.2 million to the Chicago teachers' pension fund in FY2017.
[213] Communication with Marc Staley, Human Services Manager, Governor's Office of Budget and Management, May 5, 2017.
[214] Illinois State FY2018 Budget, p. 41.
[215] Higher education also includes the Board of Higher Education, Math and Science Academy and State Universities Civil Service System. Higher education budget numbers presented here do not include State contributions to the State Universities Retirement System.

The next table compares higher education funding levels in FY2016 and FY2017 with FY2015 spending. Spending for higher education was $1.9 billion in FY2015, compared with a total of $1.6 billion over the last two years. In other words, average annual funding for the last two years has been 41.8% of the FY2015 level. An additional $2.3 billion would be needed to match FY2015's annual funding.

State of Illinois General Funds Funding for Higher Education: FY2015-FY2017 (in $ thousands)[1]

	FY2015 Exps.	FY2016 Exps.	FY2017 Stopgap Approps.[2]	Total FY2016& FY2017	Average Annual Funding FY2016&FY2017[3]
Chicago State	$ 36,102	$ 20,107	$ 15,610	$ 35,717	49.5%
Eastern Illinois	$ 42,903	$ 12,457	$ 31,804	$ 44,261	51.6%
Governors State	$ 23,858	$ 6,974	$ 12,757	$ 19,731	41.4%
Northeastern Illinois	$ 36,899	$ 10,695	$ 19,562	$ 30,257	41.0%
Western Illinois	$ 51,445	$ 14,911	$ 39,787	$ 54,698	53.2%
Illinois State	$ 72,227	$ 20,935	$ 38,291	$ 59,226	41.0%
Northern Illinois	$ 90,985	$ 26,403	$ 48,293	$ 74,696	41.0%
Southern Illinois	$ 199,559	$ 57,482	$ 106,156	$ 163,638	41.0%
University of Illinois	$ 643,719	$ 180,094	$ 350,599	$ 530,693	41.2%
Total Universities	**$ 1,197,697**	**$ 350,059**	**$ 662,859**	**$1,012,918**	**42.3%**
Board of Higher Education	$ 10,002	$ 2,070	$ 5,165	$ 7,235	36.2%
Community College Board	$ 338,319	$ 75,918	$ 169,834	$ 245,752	36.3%
ISAC[4]	$ 10,690	$ 6,023	$ 3,762	$ 9,785	45.8%
ISAC/MAP[4]	$ 364,050	$ 169,793	$ 151,000	$ 320,793	44.1%
Math and Science Academy	$ 17,859	$ 17,956	$ 5,075	$ 23,031	64.5%
State Universities Civil Service	$ 1,158	$ 712	$ 230	$ 942	40.7%
Total	**$ 1,939,775**	**$ 622,531**	**$ 997,925**	**$1,620,456**	**41.8%**

[1]General Funds include the Fund for Advancement of Education and Budget Stabilization Fund. Stopgap appropriations were also made from the Personal Property Replacement Tax Fund.
[2]Public Act 99-0524.
[3]Based on FY2015 spending level.
[4]The Illinois Student Assistance Commission (ISAC) administers the Monetary Award Program (MAP).
Source: Civic Federation calculations based on Illinois State FY2017 and FY2018 Operating Budget Details, https://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY2018%20Budget%20Book/FY18BudgetbyLineItemDetail.xls.

The FY2018 budget recommends higher education appropriations of $1.83 billion, a decrease of $115 million, or 5.9%, from $1.94 billion in FY2015 and $125 million, or 6.4% from $1.95 billion in the FY2018 maintenance budget. The budget book shows unpaid commitments of $202.5 million in FY2016, mainly for MAP grants, and additional FY2017 appropriations of $832.5 million required to maintain current programs.

The following table compares General Funds spending on higher education in FY2015 with recommended appropriations in FY2018.

State of Illinois General Funds Funding for Higher Education: FY2015-FY2018 (in $ thousands)*				
	FY2015 Exps.	FY2018 Rec. Approps.	$ Change	% Change
Chicago State	$ 36,102	$ 30,881	$ (5,221)	-7.2%
Eastern Illinois	$ 42,903	$ 36,529	$ (6,374)	-7.4%
Governors State	$ 23,858	$ 20,453	$ (3,405)	-7.1%
Northeastern Illinois	$ 36,899	$ 31,364	$ (5,535)	-7.5%
Western Illinois	$ 51,445	$ 43,728	$ (7,717)	-7.5%
Illinois State	$ 72,227	$ 61,393	$ (10,834)	-7.5%
Northern Illinois	$ 90,985	$ 77,429	$ (13,556)	-7.4%
Southern Illinois	$ 199,559	$ 169,625	$ (29,934)	-7.5%
University of Illinois	$ 643,719	$ 550,108	$ (93,611)	-7.3%
Total Universities	**$ 1,197,697**	**$ 1,021,510**	**$ (176,187)**	**-7.4%**
Board of Higher Education	$ 10,002	$ 65,694	$ 55,692	278.4%
Community College Board**	$ 338,319	$ 306,179	$ (32,140)	-4.7%
Illinois Student Assistance Commission	$ 10,690	$ 11,431	$ 741	3.5%
Illinois Student Assistance Commission/MAP***	$ 364,050	$ 401,342	$ 37,292	5.1%
Math and Science Academy	$ 17,859	$ 18,031	$ 172	0.5%
State Universities Civil Service	$ 1,158	$ 1,233	$ 75	3.2%
Total	**$ 1,939,775**	**$ 1,825,420**	**$ (114,355)**	**-2.9%**

*General Funds include the Fund for Advancement of Education and Budget Stabilization Fund.
**FY2018 appropriations for Community College Board include $70 million from the Personal Property Replacement Tax Fund.
***The Illinois Student Assistance Commission administers the Monetary Award Program (MAP).
Source: Illinois State FY2017 Budget, pp. 95-96; Illinois State FY2018 Budget, pp. 97-98.

Proposed FY2018 appropriations for universities decline by $176.2 million, or 7.4%, to $1.02 million from FY2015 spending of $1.2 billion. The decrease is partly offset by $60.1 million in performance-based funding to be distributed by the Board of Higher Education.[216] MAP funding increases by $37.3 million, or 5.1%, to $401.3 million from the FY2015 level of $364.1 million. Recommended appropriations for the Illinois Community College Board, including $70 million from the Personal Property Replacement Tax Fund, are down by $32.1 million, or 4.7%.

Governor Rauner has proposed funding decreases for higher education in each of his budgets. The Governor recommended total higher education appropriations of $1.59 billion in FY2016[217] and $1.75 billion in FY2017.[218]

[216] Illinois State FY2018 Budget, p. 483.
[217] Illinois State FY2016 Budget, p. 2-23.
[218] Illinois State FY2017 Budget, p. 63.

General Funds Expenditures

Expenditures from General Funds consist of net appropriations spent (appropriations minus unspent appropriations and other adjustments) and statutory transfers out. The next table shows total General Funds expenditures, including net appropriations spent and statutory transfers out, from FY2015 to FY2018. Total recommended FY2018 expenditures decline by $2.4 billion, or 6.1%, to $37.3 billion from the FY2018 maintenance level of $39.7 billion but increase by $1.6 billion, or 4.4%, from an estimated $35.7 billion in FY2015. As previously discussed, expenditures in FY2015 were understated because FY2014 revenues were used to pay for some FY2015 Medicaid expenses.

State of Illinois General Funds Expenditures: FY2015-FY2018 (in $ millions)[1]

	FY2015	FY2016 Prelim.	FY2017 Est.[2]	FY2018 Maint.	FY2018 Rec.	FY2015-FY2018 $ Change	FY2015-FY2018 % Change	FY2018 Rec. - Maint. $ Change	FY2018 Rec. - Maint. % Change
Agency Appropriations	$ 24,583	$ 22,351	$25,554	$26,013	$25,626	$ 1,043	4.2%	$ (387)	-1.5%
(Unspent Appropriations)[3]	$ (1,049)	$ (1,787)	$ (761)	$ (812)	$ (809)	$ 240	-22.9%	$ 3	-0.4%
(Use of PPRT for Higher Education)[4]			$ (97)	$ (70)	$ (70)	$ (70)	na	$ -	0.0%
(Procurement and Unassigned Savings)	$ -	$ -	$ -		$ (230)	$ (230)	na	$ (230)	na
Net Agency Appropriations Spent	$ 23,534	$ 20,564	$24,696	$25,131	$24,517	$ 983	4.2%	$ (614)	-2.4%
Pension Contributions	$ 6,047	$ 6,632	$ 6,931	$ 7,889	$ 6,639	$ 592	9.8%	$ (1,250)	-15.8%
State Group Insurance	$ 1,565	$ -	$ 1,810	$ 1,850	$ 1,415	$ (150)	-9.6%	$ (435)	-23.5%
Net Appropriations Spent	**$ 31,146**	**$ 27,196**	**$33,437**	**$34,870**	**$32,571**	$ 1,425	4.6%	$ (2,299)	-6.6%
Statutory Transfers Out									
Legislatively Required Transfers	$ 2,489	$ 2,472	$ 2,424	$ 2,517	$ 2,395	$ (94)	-3.8%	$ (122)	-4.8%
Debt Service on Pension Bonds	$ 1,502	$ 1,423	$ 1,609	$ 1,577	$ 1,577	$ 75	5.0%	$ -	0.0%
Debt Service on Capital Bonds	$ 592	$ 556	$ 638	$ 773	$ 773	$ 181	30.6%	$ -	0.0%
Repayment of Interfund Borrowing	$ -	$ -	$ 15	$ -	$ -	$ -	na	$ -	na
Total Transfers Out	**$ 4,583**	**$ 4,451**	**$ 4,686**	**$ 4,867**	**$ 4,745**	$ 162	3.5%	$ (122)	-2.5%
Total Expenditures[5]	**$ 35,729**	**$ 31,647**	**$38,123**	**$39,738**	**$37,316**	**$ 1,587**	**4.4%**	**$ (2,422)**	**-6.1%**

[1]General Funds include Commitment to Human Services Fund, Fund for the Advancement of Education and Budget Stabiization Fund.

[2]Total FY2017 appropriations have not been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions.

[3]Unspent appropriations include Comptroller prior year adjustments of $12 million in FY2015 and $12 million in FY2016.

[4]Personal Property Replacement Tax Fund.

[5]Totals may not sum due to rounding.

Source: Illinois State FY2017 Budget, p. 91; Illinois State FY2018 Budget, pp. 30, 79 and 93.

Transfers out include debt service payments and a wide variety of legislatively required transfers. Debt service is discussed later in this report.[219] Legislatively required transfers are projected to decline by $94 million, or 3.8%, to $2.40 million in the recommended FY2018 budget from $2.49 billion in FY2015 and by $122 million, or 4.8%, from $2.5 million in the FY2018 maintenance budget.

The next table shows legislatively required transfers from FY2015 to FY2018. The comparison shown is from estimated FY2017 to projected FY2018. Because most transfers are required by statute, they generally were not affected by the budget impasse.

---

[219] For more information on debt service, see p. 62 of this report.

Fund	FY2015	FY2016	FY2017 Est.	FY2018 Projected	2-Year $ Change	2-Year % Change
State of Illinois Legislatively Required General Funds Transfers Out by Fund: FY2015-FY2018 (in $ millions)						
Local Government Distributive	$ 1,316	$ 1,301	$ 1,250	$ 1,309	$ 59	4.7%
Public Transportation	$ 499	$ 512	$ 518	$ 521	$ 3	0.6%
Downstate Public Transportation	$ 212	$ 205	$ 209	$ 206	$ (3)	-1.7%
School Infrastructure	$ 91	$ 89	$ 92	$ 103	$ 11	12.3%
Workers' Compensation Revolving	$ 96	$ 104	$ 75	$ 84	$ 9	8.6%
Metropolitan Exposition, Auditorium and Office Building	$ 38	$ 38	$ 38	$ 28	$ (10)	-26.4%
Live and Learn	$ 21	$ 21	$ 21	$ 21	$ 0	0.5%
University of Illinois Hospital Services	$ 45	$ 45	$ 45	$ 20	$ (25)	-55.6%
Audit Expense	$ 18	$ 19	$ 19	$ 19	$ (0)	-0.5%
Professional Services	$ 4	$ 9	$ 18	$ 17	$ (1)	-8.9%
Metropolitan Pier and Exposition Authority Incentive	$ 15	$ 15	$ 12	$ 15	$ 4	23.3%
Tourism Promotion	$ 52	$ 54	$ 57	$ 12	$ (45)	-83.3%
All Others	$ 83	$ 60	$ 70	$ 29	$ (41)	-68.3%
Total	**$ 2,489**	**$ 2,472**	**$ 2,424**	**$ 2,384**	**$ (40)**	**-1.6%**

Source: Illinois State 2018 Budget, p. 129.

By far the largest legislatively required transfer is to the Local Government Distributive Fund (LGDF), which receives the share of State income taxes that is distributed to local governments. The share had been 10% but was lowered in January 2011 after income tax rates were temporarily increased, so that the State could get the full benefit of the higher rates. Local governments currently receive 8.0% of individual income tax revenues and 9.14% of corporate tax revenues.[220] The transfer is expected to increase by $59 million, or 4.7%, to $1.31 billion in FY2018 from $1.25 billion in FY2017.

Transfers to the Tourism Promotion Fund decline by $45 million in FY2018. Hotel tax receipts will be deposited directly into that fund instead of being transferred out of General Funds.[221]

The FY2018 budget proposes the elimination of transfers to a handful of funds that were expected to receive General Funds deposits in FY2017. These include the Illinois Standardbred Breeders Fund, which was expected to collect $1.7 million in FY2017, and the Illinois Thoroughbred Breeders Fund, which was to get $2.4 million.

[220] 35 ILCS 5/901(b).
[221] Illinois State FY2018 Budget, p. 167.

BUDGET DEFICIT AND UNPAID BILLS

The maintenance budget for FY2018 has a $7.2 billion gap between General Funds revenues and expenditures.[222] The Governor's recommended FY2018 budget reduces the operating deficit to $4.6 billion through projected spending cuts of $2.4 billion and the use of about $240 million in one-time net revenues.

If the Governor's budget were enacted, the actual operating deficit could be about as much as $1 billion higher. Budgeted savings include about $771 million related to a new contract with the State's largest union, the American Federation of State, County and Municipal Employees, but the agreement is currently tied up in a legal dispute. The projected $240 million in net revenues from a potential sale of the James R. Thompson Center in Chicago might not be realized in FY2018.[223]

Because the State does not currently have a complete budget for FY2017, results for that year are based on the administration's estimate of amounts needed to fund agency operations and programs under current conditions. Supplemental appropriations would be required to reach these levels of spending authority. If additional amounts were appropriated but revenues were not increased, the operating deficit in FY2017 is estimated at $5.7 billion.

---

[222] General Funds consist of four funds: the General Revenue Fund, Education Assistance Fund, Common School Fund and General Revenue-Common School Special Account Fund. The FY2018 budget proposes that three other funds—the Fund for the Advancement of Education, the Commitment to Human Services Fund and the Budget Stabilization Fund—be included in General Funds. This report includes the three additional funds in General Funds.
A maintenance spending is defined in the budget book as the amount needed to fund agencies' core missions and programs for a given year.

[223] For more information on the proposed sale of the Thompson Center, see p. 45 of this report.

The following table provides a summary of the General Funds budget for FY2015 to FY2018. In the table, the total deficit is the sum of the operating deficit and the accumulated deficit from prior years. If the $4.6 billion gap between revenues and expenditures is not closed in FY2018, the total deficit would be $13.8 billion at the end of the fiscal year. The total deficit in FY2018 will also depend on the outcome of FY2017.

State of Illinois General Funds Budget Results and Plans: FY2015-FY2018 (in $ millions)[1]	FY2015	FY2016 Prelim.	FY2017 Est.[2]	FY2018 Maint.	FY2018 Rec.
Operating Revenues					
State Source Revenues[3]	$ 33,404	$ 28,377	$ 29,274	$ 29,381	$ 29,633
Federal Revenues	$ 3,331	$ 2,665	$ 3,162	$ 3,111	$ 3,111
Total Operating Revenues	**$ 36,735**	**$ 31,042**	**$ 32,436**	**$ 32,492**	**$ 32,744**
Operating Expenditures					
Net Agency Appropriations Spent[4]	$ 23,534	$ 20,564	$ 24,696	$ 25,131	$ 24,517
Pension Contributions	$ 6,047	$ 6,632	$ 6,931	$ 7,889	$ 6,639
State Group Insurance	$ 1,565	$ -	$ 1,810	$ 1,850	$ 1,415
Total Appropriations Spent	$ 31,146	$ 27,196	$ 33,437	$ 34,870	$ 32,571
Statutory Transfers Out					
Legislatively Required Transfers	$ 2,489	$ 2,472	$ 2,424	$ 2,517	$ 2,395
Debt Service[5]	$ 2,094	$ 1,979	$ 2,262	$ 2,350	$ 2,350
Total Statutory Transfers Out	$ 4,583	$ 4,451	$ 4,686	$ 4,867	$ 4,745
Total Operating Expenditures[6]	**$ 35,729**	**$ 31,647**	**$ 38,123**	**$ 39,738**	**$ 37,316**
Operating Surplus (Deficit)[7]	**$ 1,006**	**$ (605)**	**$ (5,687)**	**$ (7,246)**	**$ (4,572)**
Accumulated Deficit from Prior Years	$ (3,931)	$ (2,925)	$ (3,530)	$ (9,217)	$ (9,217)
Total Deficit	**$ (2,925)**	**$ (3,530)**	**$ (9,217)**	**$ (16,463)**	**$ (13,789)**

[1]General Funds include the Commitment to Human Services Fund and the Fund for the Advancement of Education.
[2]Total FY2017 appropriations have not yet been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions.
[3]Includes fund sweeps of $1.284 billion and interfund borrowing of $377 million in FY2015 and use of $759 million in balances in the Commitment to Human Services Fund and the Budget Stabilization Fund in FY2017.
[4]Agency appropriations minus unspent appropriations and other adjustments.
[5]Includes repayment of $15 million in interfund borrowing in FY2017.
[6]Totals may not sum due to rounding.
[7]The FY2018 budget has a line item of $4.572 billion titled "Working together on a grand bargain" that reduces the operating deficit to zero.
Source: Illinois State FY2017 Budget, p. 90; Illinois State FY2018 Budget, pp. 30, 78, 79 and 93.

Rather than providing a specific plan to close the $4.6 billion gap in FY2018, the proposed FY2017 budget offers the General Assembly a choice between two options:[224]

1. Reaching a “grand bargain” on taxes, spending and reforms, along the lines of a bipartisan effort that has been underway in the Senate for several months with as yet no conclusion;[225] or
2. Granting the Governor broad authority to close the $4.6 billion gap on his own by making cuts to any area of government, with limited exceptions.

The broad authority described in the second option is contained in proposed legislation known as the Unbalanced Budget Response Act.[226] To balance the budget in FY2017 and FY2018, the Governor would be allowed to set aside contingency reserves from any appropriations except debt

[224] Illinois State Budget, pp. 28 and 76.
[225] For more information on the grand bargain, see p. 28 of this report.
[226] 100th Illinois General Assembly, Senate Bill 2063, filed on February 10, 2017.

service payments, General State Aid for elementary and secondary education and funding for early childhood education. The enhanced authority would extend to spending covered by continuing appropriation, including State pension contributions. The Governor would also be permitted to transfer money to General Funds from most other State funds and to reduce reimbursement rates for healthcare and human services providers.

Illinois has dealt with budget deficits by delaying payments to vendors, school districts, local governments and other State funds, resulting in billions of dollars in unpaid bills at the end of the fiscal year. Because of the backlog, the State begins each fiscal year in a hole, using revenues from the current year to pay off the previous year's bills and limiting revenues available for current spending.

The next table shows the State's backlog of unpaid bills from FY2012 to projected FY2018. Data on year-end backlogs before FY2012 are not available in annual budget documents.[227]

State of Illinois General Funds Unpaid Bill Backlog at Fiscal Year End: FY2012-FY2018 (in $ millions)*

	FY2012	FY2013	FY2014	FY2015	FY2016 Prelim.	FY2017 Est.**	FY2018 Maint.	FY2018 Rec.***
General Funds Payables	**$ (5,024)**	**$ (4,142)**	**$ (4,005)**	**$ (3,591)**	**$ (3,789)**	**$ (9,350)**	**$ (16,596)**	**$ (13,922)**
Estimated Unpaid FY2016 Operational Liabilities	**$ -**	**$ -**	**$ -**	**$ -**	**$ (1,321)**	**$ (1,321)**	**$ (1,321)**	**$ (1,321)**
Section 25 Liabilities								
Healthcare and Family Services	$ (1,422)	$ (495)	$ (244)	$ (210)	$ (295)	$ (245)	$ (325)	$ (325)
Human Services	$ (19)	$ (19)	$ (14)	$ (16)	$ (19)	$ (17)	$ (17)	$ (17)
Group Health Insurance	$ (1,351)	$ (1,351)	$ (1,364)	$ (1,372)	$ (3,441)	$ (3,605)	$ (4,144)	$ (4,144)
Total Section 25 Liabilities	**$ (2,792)**	**$ (1,865)**	**$ (1,622)**	**$ (1,598)**	**$ (3,755)**	**$ (3,867)**	**$ (4,486)**	**$ (4,486)**
Aging	**$ (173)**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Income Tax Refunds Payable	**$ (70)**	**$ (40)**	**$ (1)**	**$ -**	**$ (278)**	**$ (140)**	**$ -**	**$ -**
Total	**$ (8,059)**	**$ (6,046)**	**$ (5,628)**	**$ (5,189)**	**$ (9,143)**	**$ (14,678)**	**$ (22,403)**	**$ (19,729)**

*General Funds include the Commitment to Human Services Fund, Fund for the Advancement of Education and Budget Stabilization Fund.

**Results for estimated FY2017 and based on appropriations that have not yet been enacted.

***Based on the $4.6 billion operating deficit in the Governor's recommended FY2017 budget.

Source: Illinois State FY2015 Budget, p. 2-23; Illinois State FY2016 Budget, p. 3-7; Illinois State FY2017 Budget, p. 76; Illinois State FY2018 Budget, p. 79.

The backlog estimates presented above are on a budgetary basis and are intended to show accounts payable and other liabilities at the end of a fiscal year that will have to be paid from a subsequent year's revenues. This is somewhat different from the backlog reported by the Comptroller's Office, which represents outstanding bills at a point in time.[228]

The budgetary basis numbers include fiscal year-end General Funds payables—bills owed to vendors and payments and transfers owed to State agencies and local governments—that will be paid during the lapse period, as well as estimated Section 25 liabilities, which may be paid from subsequent years' appropriations.[229] The largest Section 25 liability is group health insurance, which has received no General Funds appropriations since the end of FY2015.

The backlog totals beginning in FY2016 also include an estimate of other commitments that remain unpaid due to the budget impasse. This carryover amount of $1.3 billion is not part of estimated

[227] The data were required by Public Act 98-0460, signed on August 16, 2013.
[228] Illinois Office of the Comptroller, http://ledger.illinoiscomptroller.gov/fiscal-condition/ (last visited on April 29, 2017).
[229] Because of the large amount of outstanding payables, the lapse period—the period during which this year's bills may be paid from next year's revenues—has been extended to December 31, six months after the end of the fiscal year.

FY2017 expenditures, and it remains unclear when or if it might be paid. The $1.3 billion includes $571 million for human services, $400 million for the Illinois Department of Corrections and $202 million for higher education.[230]

The backlog of unpaid bills declined from $8.1 billion at the end of FY2012 to $5.2 billion at the end of FY2015, according to budget documents. If additional appropriations are enacted with no additional revenues, the backlog is expected to reach $14.7 billion at the end of FY2017. At maintenance spending levels, unpaid bills could grow to $22.4 billion at the end of FY2018.

Under the Governor's proposed budget, the backlog could be $15.2 billion at the end of FY2018 if the operating deficit is closed, or 44.6% of projected FY2019 General Funds revenues of $34.0 billion.[231] If the gap is not eliminated, the backlog could grow to $19.7 billion, or 58.1% of projected FY2019 revenues.

The ultimate amount of the backlog depends on both the outcome of FY2017 and a plan to address the backlog itself, neither of which is addressed in the FY2018 budget book. As indicated above, the Governor's Office estimates that if FY2017 expenditures occur at maintenance levels, the year will end with a $5.7 billion deficit, which would be added to the backlog. Since the second half of FY2017 expenditures have yet to be appropriated, it is within the State's power to make meaningful cuts. Moreover, some new revenue measures to address the FY2018 deficit, if implemented immediately, would provide additional revenues in FY2017 as well.

However, even in the unlikely scenario that FY2017 ends with no deficit, the backlog left over from FY2016 would continue to grow due to interest costs. A significant portion of the backlog earns interest at either 9% or just over 12% annually.[232] The Governor's recommended budget proposal as written assumes a balanced budget in FY2018, but shows that the backlog would increase by an estimated $479 million, from the end of FY2017 to the end of FY2018, based on interest costs alone.

---

[230] Illinois State FY2018 Budget, pp. 127-128.

[231] State of Illinois Governor's Office of Management and Budget, *General Funds/Fund for the Advancement of Education/Commitment to Human Services Fund Financial Walkdown*, November 15, 2016.

[232] For more information on interest penalties on overdue bills, see p. 35 of this report.

DEBT BURDEN AND RATINGS

The State of Illinois currently pays debt service on three major types of bonds: General Obligation (GO) bonds for capital projects, GO bonds for pension obligations, and Build Illinois bonds.

Both types of GO bonds are guaranteed by a pledge of the full faith and credit of the State, which is a legally binding pledge to pay both principal and interest on these loans as required by the bond agreements prior to any other use of State funds. The State is authorized under the General Obligation Bond Act to issue bonds to fund a variety of capital investments including roads, schools, mass transit, environmental projects and other facilities.[233] In 2003 the State amended the Act to include the authorization to issue Pension Obligation bonds (POBs), used to increase the assets in its pension funds and make the required annual contributions to the State's five retirement systems. The State issued additional POBs in FY2010 and FY2011.

Illinois also depends on several types of revenue bonds to fund capital projects. Unlike GO bonds, revenue bonds are not guaranteed by the full faith and credit of the State but rather pledge a portion of specific state revenues. By far the largest ongoing revenue bond issuances are the Build Illinois bonds, which began in 1985. Build Illinois bonds are backed by a pledge of the State's portion of sales tax receipts.[234] The total bond authorization under the Build Illinois bonds Act has been increased by the General Assembly on several occasions since the late 1980s.[235] The State most recently issued $210 million of capital bonds and $339 million of refunding bonds under the Build Illinois credit in September 2016.[236]

Debt Service

In FY2018 the State of Illinois is scheduled to pay debt service totaling $3.6 billion due on $27.2 billion of principal owed for all outstanding GO and revenue bonds.[237] The State currently owes $13.1 billion in interest on these bonds through FY2042 for a total outstanding debt service cost of $40.3 billion.

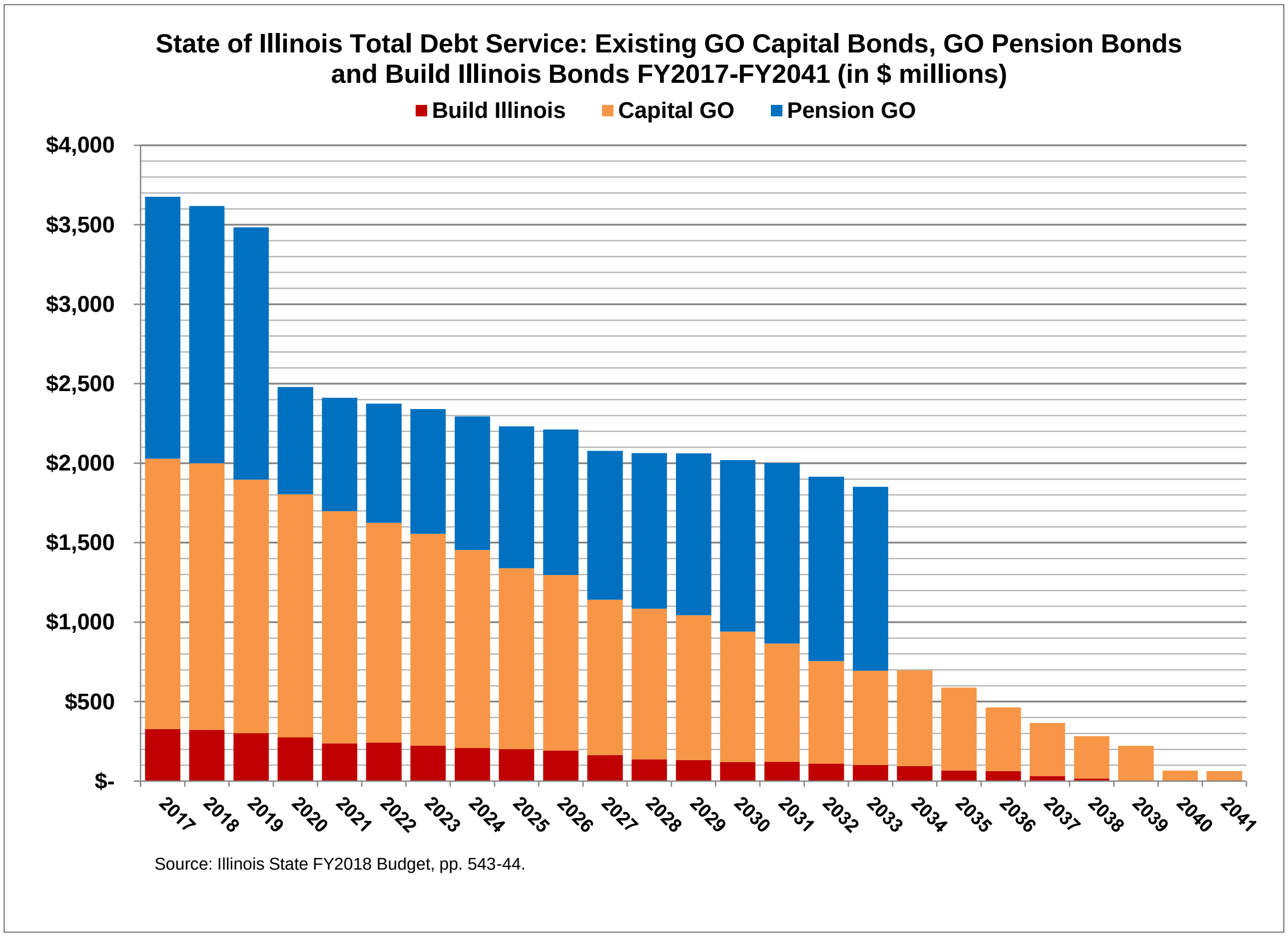
The largest portion of the $3.6 billion FY2018 debt service payment is due on capital purpose GO Bonds totaling $1.7 billion. Debt service in FY2018 totals $1.6 billion for POBs and $323 million for Build Illinois bonds.

Based on the State's current bonded indebtedness, debt service payments peaked in FY2017 and will decline marginally through FY2019 to $3.5 billion. Once the State has paid off the FY2011 POBs, debt service declines by $1.0 billion to $2.5 billion in FY2020.

---

[233] General Obligation Bond Act, 30 ILCS 330/1.
[234] Build Illinois Bond Act, 30 ILCS 425.
[235] Build Illinois Bond Act, 30 ILCS 425.
[236] State of Illinois, Build Illinois bonds, Junior Obligation Series of September 2016, *Official Statement*, August 25, 2016.
[237] Illinois State FY2018 Budget, pp. 543, 544.

The following chart shows total debt service for existing Pension Obligation bonds, GO capital bonds and other capital bonds through FY2042.[238]



In general, the State is required under the General Obligation Bonds Act and the Build Illinois Bonds Act to issue bonds with level principal payments for the life of each bond series.[239] Moreover, refunding bonds are generally prohibited from extending the principal maturities of the bonds they refund.[240] Because interest accrues on only the outstanding portion of each bond series, these rules result in a downward sloping debt service schedule for both types of capital bonds.

The State made exceptions to the level principal rule for the Pension Obligation bonds. Under the 2003 pension bond authorization, the State issued $10 billion in POBs that are repaid through FY2033, of which $7.2 billion was used to increase the assets of the State's retirement systems. The remainder was used to make the part of the State's statutorily required contributions that would have otherwise been made from General Funds resources in FY2003 and the entire FY2004 contribution. The pension bond authorization was increased in FY2010 by $3.5 billion and again in FY2011 by $3.7 billion to make the annual contributions that otherwise would have come from the State's General Funds. The FY2010 POBs were repaid through FY2015 and the FY2011 POBs will be completely retired in FY2019.

[238] For more details on total debt service, see Appendix B on p. 80 of this report.
[239] General Obligation Bond Act, 30 ILCS 330/9; Build Illinois Bond Act, 30 ILCS 425/6.
[240] General Obligation Bond Act, 30 ILCS 330/16.

The FY2011 POBs back loaded the principal repayment into the later years of the bonds and paid mostly interest only until the FY2010 bonds were completely paid off in FY2015. The FY2003 POBs are also back loaded. The State paid interest only on that series through FY2007, then annual principal amounts increased to $50 million per year from FY2008 through FY2011 and to $100 million per year from FY2012 through FY2016. Beginning in FY2017, principal repayment increases annually by increments of $25 million, $50 million or $100 million through FY2033, when $1.1 billion is due in the final year of the series. More than 75% of the principal borrowed will be repaid in the final 10 years of the debt service schedule, leading to interest costs of $11.9 billion over 30 years due on the original $10 billion of borrowed funds.

Interest on the $3.5 billion of POBs sold in FY2010 totaled $382 million over five years. The FY2011 bonds, which totaled $3.7 billion, cost the State a total of $1.3 billion of interest over eight years.[241] The FY2011 pension debt included $234 million more principal than the FY2010 POBs, or 6.8%, but the interest owed on the bonds was $897.5 million greater, or 234.8%. The significant increase in the borrowing costs is due to the back loaded structure of the FY2011 bonds.

Debt Service Transfers

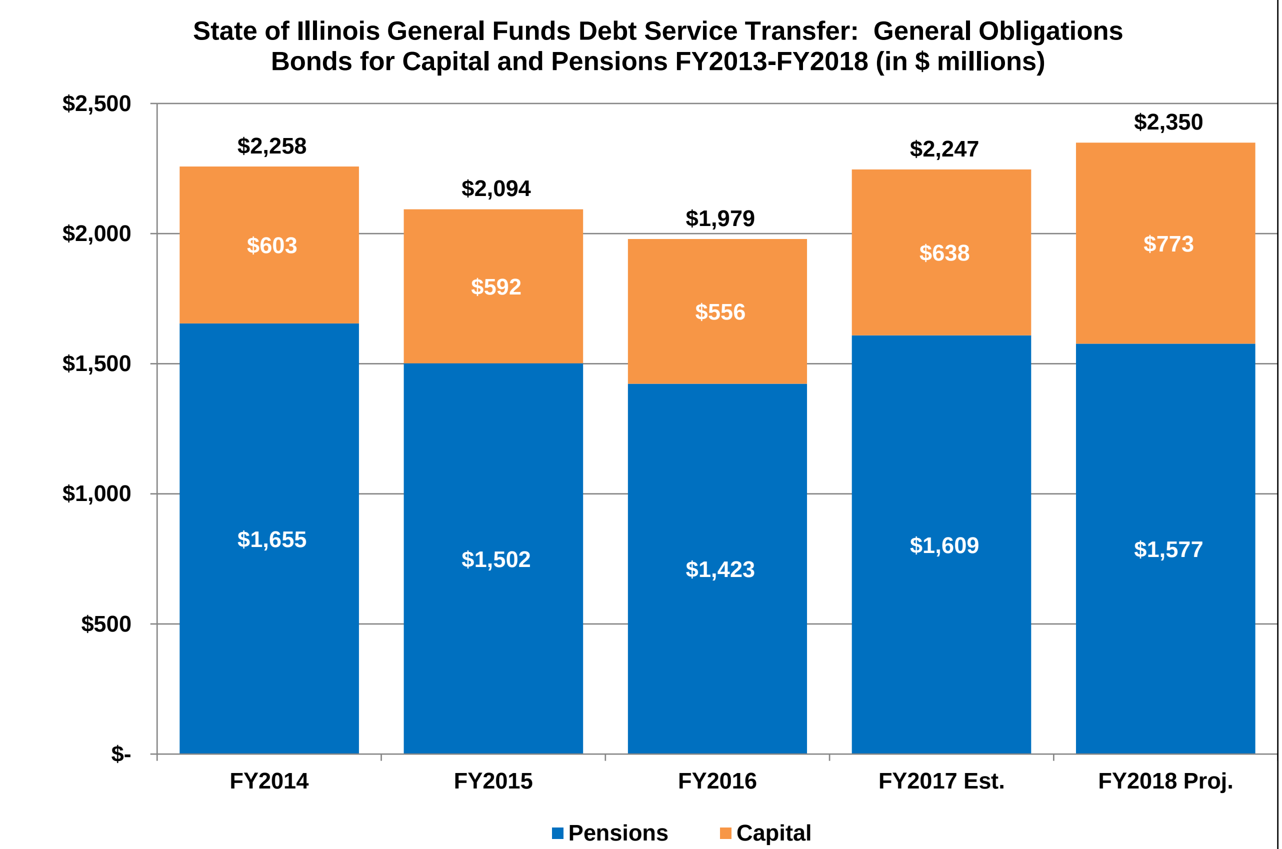
Although the total debt service represents the entire annual payment due to bond holders during the fiscal year, only a portion of the repayment is made through a transfer from the General Funds. Build Illinois bonds are paid through sales taxes diverted outside the General Funds and through the Capital Projects Fund. The General Funds debt service transfer for FY2018 totals $2.4 billion, or 7.8% of projected state-source General Funds resources.[242] GO capital bonds are funded through transfers from the Road Fund, Capital Projects Fund, School Infrastructure and State Construction Fund, in addition to the General Funds.

The enacted FY2018 budget includes debt service transfers from General Funds totaling $2.35 billion, an increase of $103 million from FY2017.[243]

---

[241] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2015*, August, 1 2014, p 194.
[242] Illinois State FY2018 Budget, p. 30.
[243]Illinois State FY2018 Budget, p. 525.

The following chart shows the General Funds cost of debt service paid on the State's General Obligation bonds, both capital and pension related, for FY2014 through FY2018.



Source: Illinois State FY2018 Budget, p. 525.

The debt service transfer associated with capital GO bonds in FY2018 increases by $135 million, totaling $773 million compared to $638 million in FY2017. Over the last five years the General Funds debt service cost for capital bonds has increased $17 million from a total of $603 million in FY2014. The operating budget incurs higher costs for capital purpose debt service due to the shortfall in revenues in the Capital Projects Fund.[244] Despite an enacted package of revenues to fund the new borrowing associated with the *Illinois Jobs Now!* capital program, the State has incurred additional General Funds cost. However, improvement in the condition of the Capital Projects Fund and slower than expected issuance have lowered the expected FY2016 and FY2017 operating fund contributions from projections in last year's Budget, when they were $710 million and $766 million, respectively.[245]

The structure of the debt service on the State's POBs was designed to remain relatively flat as the FY2010 and FY2011 bonds were repaid. The transfer for POB debt service totaled $1.6 billion in FY2013 and only declined slightly in FY2014 and FY2015 as the first issuance matured and principal payments began on the FY2011 bonds.

[244] For more information on the Capital Projects Fund see page 77 of this report.
[245] Communication with Kelly Hutchinson, Director of Capital Markets, Governor's Office of Budget and Management, May 2, 2017; Illinois State FY2017 Budget, p. 512.

Funding to pay for the Build Illinois bonds debt service is diverted from the State's portion of sales tax receipts prior to being deposited into the General Funds. Although these bonds are not paid for through a General Funds transfer, the cost of the Build Illinois bonds reduces the amount of sales tax revenues that would otherwise be available to fund the annual operating budget.

Outstanding Debt

The State sold a total of $1.03 billion GO bonds for capital projects in FY2016.[246] In FY2017 the State has thus far issued $480 million in bonds for capital projects and $1.3 billion of refunding bonds.[247] The FY17 Stopgap Budget Implementation Act created an exception to the usual requirement that refunding bonds not extend the principal maturities of the refunded bonds.[248] The State was able to take advantage of low prevailing interest rates to achieve net present value savings of $106 million through the October 2016 refunding transaction.[249]

The following chart shows the total principal, interest and debt service in FY2018 compared to FY2017 for all GO bonds and Build Illinois bonds currently outstanding.

State of Illinois Total Outstanding General Obligation and Build Illinois Bonds FY2016 and FY2017 (in $ millions)*

	FY2017	FY2018	$ Change	% Change
Principal				
GO Capital	$15,244.8	$13,711.0	$ (1,533.8)	-10.06%
GO Pension	$12,000.0	$10,975.0	$ (1,025.0)	-8.54%
Build Illinois	$ 2,514.6	$ 2,489.0	$ (25.6)	-1.02%
Total Principal	**$29,759.4**	**$27,175.0**	**$ (2,584.4)**	**-8.68%**
Interest				
GO Capital	$ 7,411.2	$ 6,892.0	$ (519.2)	-7.01%
GO Pension	$ 5,884.3	$ 5,262.0	$ (622.3)	-10.58%
Build Illinois	$ 965.1	$ 878.0	$ (87.1)	-9.02%
Total Interest	**$14,260.6**	**$13,032.0**	**$ (1,228.6)**	**-8.62%**
Debt Service				
GO Capital	**$22,656.0**	**$20,603.0**	**$ (2,053.0)**	**-9.06%**
GO Pension	**$17,884.3**	**$16,237.0**	**$ (1,647.3)**	**-9.21%**
Build Illinois	**$ 3,479.7**	**$ 3,367.0**	**$ (112.7)**	**-3.24%**
Total	**$44,020.0**	**$40,207.0**	**$ (3,813.0)**	**-8.66%**

Illinois State FY2018 Budget, pp. 543, 544; State of Illinois, General Obligation Bonds, Series of June 2016, Official Statement, June 23, 2016, p. 28; State of Illinois, Build Illinois Bonds, Series of March 2014, Official Statement, March 11, 2014, p. 20.

Total outstanding capital purpose GO bonds decreased by $1.5 billion from $15.2 billion at the beginning of FY2017 to $13.7 billion at the beginning of FY2018.[250] However, the Budget anticipates that an additional $200 million for capital projects will be issued by the end of FY2017

---

[246] Illinois State FY2017 Budget, p. 525.
[247] State of Illinois, General Obligation Bonds, Series of November 2016, *Official Statement*, November 8, 2016, p. 29.
[248] Public Act 99-0523, signed on June 30, 2016.
[249] State of Illinois, General Obligation Refunding Bonds, Annual Debt Service Savings Disclosure, https://www.illinois.gov/gov/budget/capitalmarkets/Documents/Bond%20Sale%20Disclosures/2016/October%202016%20GO%20Annual%20Debt%20Service%20Savings%20Disclosure.pdf (last visited on April 24, 2017).
[250] Illinois State FY2018 Budget, pp. 543, 544; State of Illinois, General Obligation Bonds, Series of June 2016, *Official Statement*, June 23, 2016, p. 28.

and $850 million during FY2018.[251] If these issuances are completed as scheduled, total outstanding capital GO bond principal will increase by $85.8 million by the end of FY2018 after accounting for the $939.2 million in principal repayment that will also be made in the coming year. Not including these anticipated issuances, the combined total debt service owed on all outstanding capital GO bonds totals $20.6 billion at the beginning of FY2018 compared to $22.7 billion in FY2017.The interest owed these bonds decreased by $519.2 million from $7.4 billion in FY2017 to $6.9 billion in FY2018.

Total principal owed on all outstanding POBs in FY2018 totals $10.98 billion, a decrease of $3.7 billion from the total of $12.0 billion in FY2017.[252] The outstanding interest owed on the pension debt declined by $2.7 billion to $5.3 billion during FY2017 from $5.9 billion at the beginning of that fiscal year. The remaining debt service, including principal and interest, on the State's pension bonds totals $16.2 billion in FY2018 compared to $17.9 billion in FY2017. The State has not issued new POBs since FY2011.

Beginning in FY2010, the new Build Illinois bonds sold to support the *IllinoisJobsNow!* capital spending program also receive a transfer from the Capital Projects Fund to pay for the increase in debt service. Although the new Build Illinois bonds are structured to receive additional funding from the revenue package of taxes and fees approved in 2009 to fund the increased capital appropriations, the bonds are still backed by the State's sales tax revenues.[253] The State is required to transfer the larger of 3.8% of its share of the sales taxes collected each year or the certified annual debt service owed on all outstanding Build Illinois bonds.

In FY2018 the outstanding Build Illinois bonds principal totals $2.49 billion compared to $2.51 billion in FY2017. The interest owed on the loans through FY2038 totals $878.0 million as of FY2018, which is a decrease of $87.1 million from a total of $965.1 million in FY2017. Total debt service on all outstanding Build Illinois bonds decreased by $112.7 million to $3.37 billion during FY2017 from $3.5 billion at the beginning of the fiscal year.

---

[251] Illinois State FY2018 Budget, p. 526.
[252] Illinois State FY2018 Budget, p. 543.
[253] For more information on the State capital budget, see page 72 of this report.

The following chart compares the outstanding principal, interest and total debt service on all Build Illinois bonds, GO capital bonds and POBs from FY2014 to FY2018.

State of Illinois Total Outstanding Debt Service: General Obligation and Build Illinois Bonds Five-Year Comparison FY2014 to FY2018 (in $ millions)*							
	FY2014	**FY2015**	**FY2016**	**FY2017**	**FY2018****	**5-year $ Change**	**5-year % Change**
Principal							
GO Capital	$13,487.5	$14,337.3	$ 14,144.9	$15,244.8	$13,710.7	$ 223.2	1.7%
GO Pension	$14,686.4	$13,975.2	$ 12,700.0	$12,000.0	$10,975.0	$ (3,711.4)	-25.3%
Build Illinois	$ 2,798.9	$ 2,982.3	$ 2,748.9	$ 2,514.6	$ 2,489.1	$ (309.8)	-11.1%
Total Principal	**$30,972.9**	**$31,294.8**	**$ 29,593.8**	**$29,759.4**	**$27,174.8**	**$ (3,798.1)**	**-12.3%**
Interest							
GO Capital	$ 7,576.5	$ 7,923.8	$ 7,599.7	$ 7,411.2	$ 6,892.4	$ (684.1)	-9.0%
GO Pension	$ 7,986.3	$ 7,245.4	$ 6,540.7	$ 5,884.3	$ 5,261.9	$ (2,724.4)	-34.1%
Build Illinois	$ 1,133.6	$ 1,220.9	$ 1,084.3	$ 965.1	$ 878.3	$ (255.3)	-22.5%
Total Interest	**$16,696.4**	**$16,390.0**	**$ 15,224.7**	**$14,260.6**	**$13,032.6**	**$ (3,663.8)**	**-21.9%**
Debt Service							
GO Capital	**$21,064.1**	**$22,261.1**	**$ 21,744.6**	**$22,656.0**	**$20,603.1**	**$ (461.0)**	**-2.2%**
GO Pension	**$22,672.7**	**$21,220.6**	**$ 19,240.7**	**$17,884.3**	**$16,236.9**	**$ (6,435.8)**	**-28.4%**
Build Illinois	**$ 3,932.5**	**$ 4,203.2**	**$ 3,833.2**	**$ 3,479.7**	**$ 3,367.4**	**$ (565.1)**	**-14.4%**
Total	**$47,669.2**	**$47,684.9**	**$ 44,818.5**	**$44,020.0**	**$40,207.4**	**$ (7,461.8)**	**-15.7%**

* As of the beginning of the fiscal year.

** For all debt outstanding as of April 23, 2017.

Source: Illinois State FY2018 Budget, pp. 543, 544; State of Illinois, General Obligation Bonds, Series of June 2016, Official Statement, June 23, 2016, p. 28; Illinois State FY2017 Budget, pp. 527, 528; Illinois State FY2016 Budget, pp. 7-10, 7-11; State of Illinois, General Obligation Bonds, Series May 2014, *Official Statement* , April 25, 2014, p.53; State of Illinois, Build Illinois Bonds, Series of March 2014, *Official Statement* , March 11, 2014, p. 20; State of Illinois, General Obligation Bonds, Series of June 2013, *Official Statement* , June 26, 2013, p. 50; State of Illinois, Build Illinois Bonds, Junior Obligation Series of June 2013, *Official Statement* , June 15, 2013, p. 18.

The State of Illinois has paid off more principal debt than it has issued over the last five fiscal years, leading to a decline of $3.8 billion in outstanding principal in FY2018 compared to the FY2014 starting total of $31.0 billion. However, the ongoing capital program has led to an increase of capital purpose principal debt of 223.5 million in additional GO bonded debt. This increase is offset by a decline in principal Build Illinois Bond debt of $309.9 million compared to FY2014 and a decline of $3.7 billion in POB principal outstanding.

Total interest owed on the State's outstanding debt has declined by $3.7 billion over the last five years, primarily due to the increased interest payments on the State's outstanding POBs. Interest owed on POBs is $2.7 billion less in April 2017, totaling $5.3 billion, compared to $8.0 billion in FY2014. This represents the total interest owed on POBs through FY2033.

Outstanding interest on capital purpose GO bonds has decreased by $684.5 million over five years despite a net increase in principal, due to a slightly faster amortization schedule[254] and low prevailing interest rates throughout the period.[255] New issuances generally carried lower rates than maturing bonds, and the State was able to issue refunding transactions for interest savings. The

[254] Illinois State FY2018 Budget, p. 543; State of Illinois, General Obligation Bonds, Series of June 2013, *Official Statement*, June 26, 2013, p. 50.
[255] Bloomberg Markets, BVAL Muni Benchmark 30Y, https://www.bloomberg.com/quote/BVMB30Y:IND (Last visited on May 8, 2017).

State owes $6.9 billion in interest on capital GO bonds for debt repaid through FY2042 compared to $7.6 billion in FY2014.

The interest owed on all outstanding Build Illinois Bond debt through FY2038 declined by $255.6 million over five years, compared to $1.1 billion in FY2014.

Bond Ratings

Bond ratings are one of the factors that weigh heavily in determining the interest rates the State must pay to issue debt. The State of Illinois' GO ratings have been lowered by all three rating agencies multiple times over the last several years, which has led to an overall increase in debt service costs above better rated governments.

The following chart shows the current ratings for Illinois' General Obligation Bonds and Build Illinois bonds.

State of Illinois: Current Ratings				
	GO Bonds		Build Illinois Bonds	
Company	Rating	Outlook	Rating	Outlook
Fitch Ratings	BBB	Negative	AA+	Stable
Moody's Investors Service	Baa2	Negative	Baa2	Negative
Standard & Poor's	BBB	Negative	AAA	Negative

Source: Illinois State FY2018 Budget, p. 538

Illinois currently has the lowest GO rating of any state by all three ratings agencies. At the time of this report, all three ratings companies place the State's general obligation credit at the BBB/Baa2 level, two notches above junk, with a negative outlook.

Moreover, the State has been warned that further downgrades could be forthcoming as soon as the end of May 2017 if the budget impasse is not resolved soon. In a report issued in March, Moody's warned that "failure to reach a consensus before the current legislative session adjourns on May 31 would signal deepening political paralysis, heightening the risk of creditor-adverse actions."[256]

On April 20, S&P downgraded the City Colleges of Chicago and six state universities, and issued a negative credit watch for a seventh.[257] The ratings actions pointed to the state budget impasse, stating that the downgrades, "reflect our belief that the state may fail to pass a fiscal year 2017 budget by the end of May, which would likely result in zero operating appropriations distributed to the [universities] for the entirety of fiscal 2017."[258]

[256] Moody's Investors Service, "Record Backlog of Unpaid Bills Signals Critical Juncture for State Leaders," *Issuer In-Depth, State of Illinois*, March 30, 2017, p. 1.
[257] *E.g.* S&P Global Ratings, "University of Illinois Debt Ratings Lowered to 'A' Based on Criteria; On Watch Neg" *news release*, April 20, 2017.
[258] *E.g.* S&P Global Ratings, "University of Illinois Debt Ratings Lowered to 'A' Based on Criteria; On Watch Neg" *news release*, April 20, 2017.

Variable Rate Debt and Swaps

Due to its recent downgrades, the State is closer to a possible exposure to liabilities associated with its swaps portfolio.

Illinois' debt portfolio includes five derivative instruments, also known as swaps, associated with variable rate bonds with a notional value of $600 million that were sold in 2003.[259] These swap contracts convert the State's variable rate debt to synthetically fixed rate payments through agreements with counterparties that are intended to offset interest rate risk.

Under the terms of the contract, if the State's credit rating falls below a certain threshold the deal is terminated and the State must pay the market value of the deals at the time of the termination. The State also then would continue to pay the variable rate interest on the loans as set forth in the original bond sale.

Due to the State's deteriorating credit quality, the State entered negotiations with all four counterparties during 2016. Two of the swaps were transferred to a new counterparty, and all of the swaps now have lower ratings termination thresholds.

The following table summarizes the results of the swap renegotiations, as well as the market value of the termination during the last year.

State of Illinois Interest Rate Swap Agreements
Present Value and 2016 Renegotiation Results (in $ thousands)*

Prior Counterparty	New Counterparty	Notional Value	Prior Ratings Termination Threshold	New Ratings Termination Threshold	Present Value 12/31/2015	Present Value 9/15/2016	Present Value 12/31/2016	1-year $ Change	1-year % Change
AIG Financial Products	Barclays	$ 54,000	S&P - below BBB Moody's - below Baa2	S&P - below BBB- Moody's - below Baa3	$ (11,999)	$ (13,356)	$ (9,490)	$ 2,509	20.9%
Merrill Lynch Capital Markets	Barclays	$ 54,000	S&P - below BBB Moody's - below Baa2	S&P - below BBB- Moody's - below Baa3	$ (12,091)	$ (13,484)	$ (9,677)	$ 2,414	20.0%
Bank of America	Bank of America	$ 54,000	S&P - below BBB Moody's - below Baa2	S&P - below BBB- Moody's - below Baa3	$ (12,091)	$ (13,875)	$ (10,109)	$ 1,982	16.4%
JP Morgan Chase	JP Morgan Chase	$ 54,000	S&P - below BBB Moody's - below Baa2	S&P - below BBB- Moody's - below Baa3	$ (12,586)	$ (13,875)	$ (10,388)	$ 2,198	17.5%
Loop Capital/ Deutsche Bank	Deustche Bank	$384,000	S&P - below BBB Moody's - below Baa2	S&P - below BB+ Moody's - below Ba1	$ (89,274)	$ (98,666)	$ (74,519)	$14,755	16.5%
Total	**Total**	**$600,000**			**$(138,040)**	**$(153,256)**	**$(114,184)**	**$23,856**	**17.3%**

Source: Illinois State FY2018 Budget, pp. 529, 530; State of Illinois, General Obligation Bonds, Series of November 2016, Official Statement, November 8, 2016, p. 31; Illinois State FY2017 Budget, p. 515.

As of December 31, 2015 the State's swaps portfolio had a negative value of $138.0 million.[260] While the value worsened to negative $153.3 million[261] during the low interest rate environment of 2016, rising interest rates since that period improved the present value to negative $114.2 million as of December 31, 2016,[262] and negative $107.9 million as of March 31, 2017.[263]

As a result of the renegotiations and the State's current credit ratings, a two-notch downgrade by either Moody's or S&P would trigger termination of all but the Deutsche Bank Swap (which has the

---

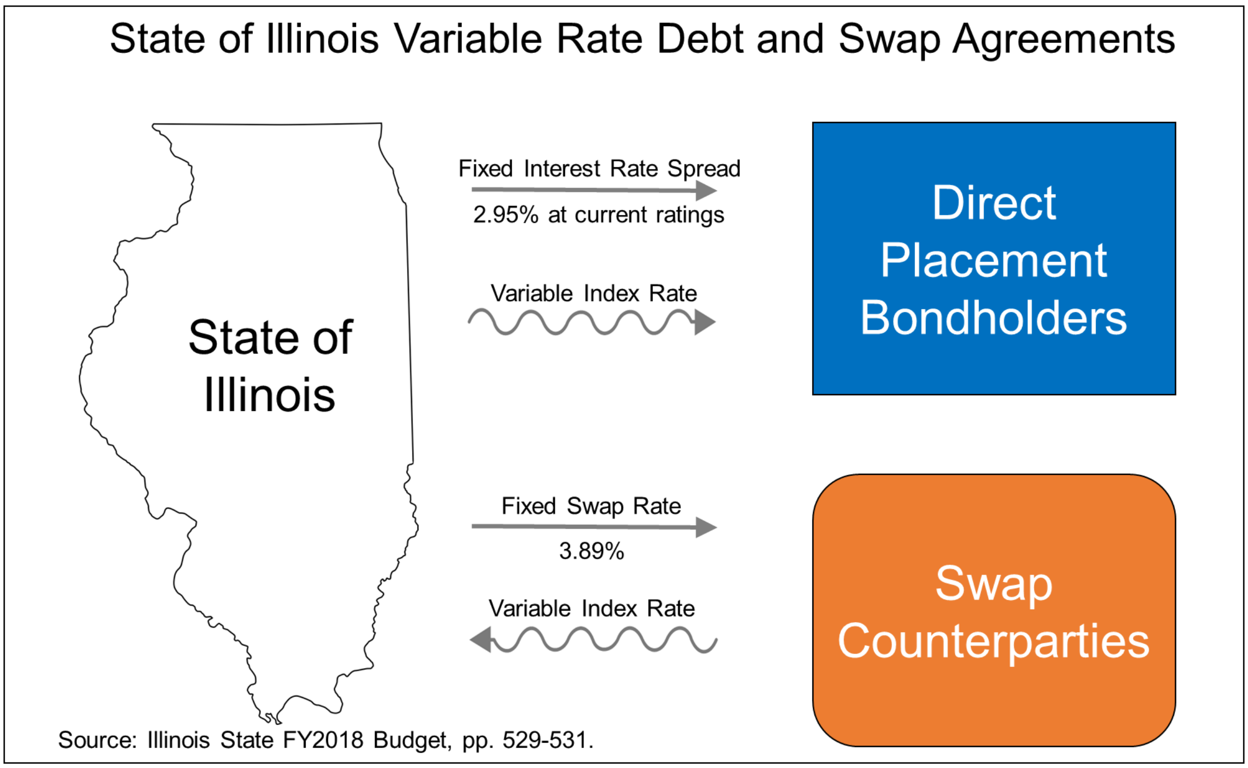
[259] Series 2003B, the State's only variable-rate series. Illinois State FY2018 Budget, p. 529.
[260] Illinois State FY2017 Budget, p. 515.
[261] State of Illinois, General Obligation Bonds, Series of November 2016, Official Statement, November 8, 2016, p. 31.
[262] Illinois State FY2018 Budget, p. 529.
[263] Communication with Kelly Hutchinson, Director of Capital Markets, Governor's Office of Budget and Management, May 2, 2017.

largest termination value). A three-notch downgrade by either company would terminate all five swaps.

In order to maintain its variable rate debt, the State also maintained letters of credit totaling $600 million. When the six letter of credit agreements expired in November 2016, the State replaced them with direct placement agreements in which four banks purchased all of the outstanding variable rate bonds.[264]

Under the direct placement agreements, the State pays the bondholder banks an interest rate spread plus a floating index interest rate.[265] The current spread is 2.95%, but will rise if the state is downgraded. The State also pays a synthetically fixed interested rate of 3.89% on the $600 million principal amount of variable rate debt to the counterparties to its swaps. Finally, it receives a floating interest rate payment from the counterparties. Combined with the private placement agreements, this makes for a current effective interest cost of 6.84%, plus the floating index rate for the variable rate bonds, minus the floating index rate paid by the swap counterparties.

The following illustration shows the relationships between the various parties to the synthetic fixed variable rate transactions.



264 Illinois State FY2018 Budget, p. 530.
265 Either SIFMA or 70% of one month LIBOR. Illinois State FY2018 Budget, p. 530.

CAPITAL BUDGET

The Governor's recommended FY2018 capital budget includes a total of approximately $17.7 billion in new and reauthorized projects and marks the eighth year since the initiation of the *Illinois Jobs Now!* capital spending program.[266]

Unlike the State's General Funds budget, which is intended to cover only the cost of the State's operations for the current fiscal year, capital appropriations are reauthorized over multiple years as planning, engineering and construction of capital investments commences. The total spending proposed in the FY2018 capital budget includes funding from the State, grants from the federal government and local matching funds. Since 2005 the capital budget has been proposed in a separate document from the State's operating budget and is not part of the annual General Funds expenditures.

The enacted FY2017 capital budget included $15.2 billion of which $4.4 billion were new appropriations and $10.8 billion were reauthorized projects.[267] The $17.7 billion recommended for FY2018 includes $4.8 billion of new appropriations and $12.8 billion of previously approved spending authority proposed for reauthorization.

The following table compares the capital budget proposed by the Governor for FY2018 to the enacted capital budget for FY2017.

State of Illinois Capital Budget: FY2017 Enacted Compared to Governor's Recommended FY2018 (in $ billions)

	FY2017 Enacted	FY2018 Rec.	$ Change	% Change
Reappropriation	$ 10.8	$ 12.8	$ 2.0	18.4%
New	$ 4.4	$ 4.8	$ 0.5	10.5%
Total	**$ 15.2**	**$ 17.7**	**$ 2.5**	**16.1%**

Source: Illinois State FY2018 Capital Projects List, http://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/FY2017IllinoisCapitalProjectsList.xls (last visited April 26, 2016).

Funding for statewide road and bridge construction remains the largest portion of the State's capital expenditures. The proposed FY2018 capital budget includes $10.2 billion in total spending for the Illinois Department of Transportation including the annual road program for ongoing surface transportation improvements (roads, bridges and mass transit).[268] Of the total allocated to IDOT, $7.5 billion represents amounts proposed for reauthorization from previous years and $2.6 billion is new funding.[269]

As part of the recommended FY2018 capital budget, the Governor recommends new funding totaling $787 million for areas of critical deferred maintenance needs at State facilities.[270] The Capital Development Board has reported average annual growth of $550 million in deferred

---

[266] Illinois State FY2018 Capital Budget, p. 33.
[267] Illinois State FY2018 Capital Projects List, https://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/FY2017IllinoisCapitalProjectsList.xls (last visited April 26, 2017).
[268] Illinois State FY2018 Capital Budget, p. 28.
[269] Illinois State FY2018 Capital Budget, p. 28.
[270] Illinois State FY2018 Capital Budget, p. 21.

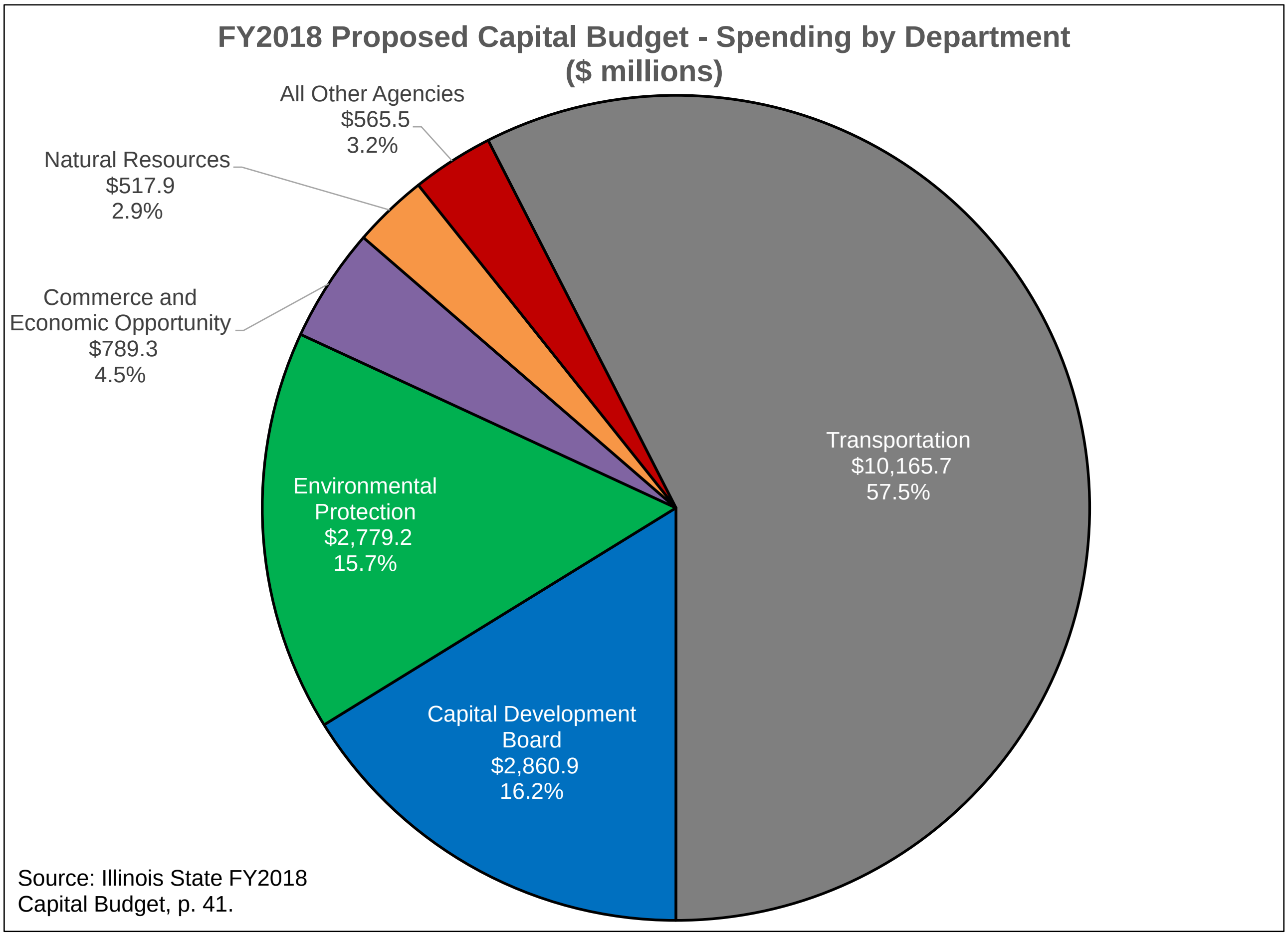
maintenance at state-owned facilities since FY2011.[271] **State facilities currently have a backlog of $7.0 billion in deferred maintenance** including office buildings, hospitals, laboratories, residential care facilities, prisons, parks, historic sites, fairgrounds and other storage facilities.[272] The State has only invested $436 million in maintaining these properties since *Illinois Jobs Now!* began in FY2010.[273]

The proposed FY2018 capital budget also includes $400 million in new funding for technology upgrades. The Governor's capital budget proposes spending $250 million on an Enterprise Resource Planning (ERP) system that would centralize financial and project management data. An additional $150 million would be spent on other information technology projects.[274]

The FY2018 proposal includes $80 million in spending for statewide lead abatement.[275] $50 million would be given as grants to school districts to abate lead hazards in schools. The remaining $30 million would expand the existing CLEAR-Win program, which helps homeowners remove residential lead.[276]

[271] Illinois State FY2018 Capital Budget, p. 26.
[272] Illinois State FY2018 Capital Budget, p. 26.
[273] Illinois State FY2018 Capital Budget, p. 26.
[274] Illinois State FY2018 Capital Budget, p. 23.
[275] Illinois State FY2018 Capital Budget, p. 21.
[276] Illinois State FY2018 Capital Budget, p. 22.

The following chart shows the total FY2018 capital budget by department.

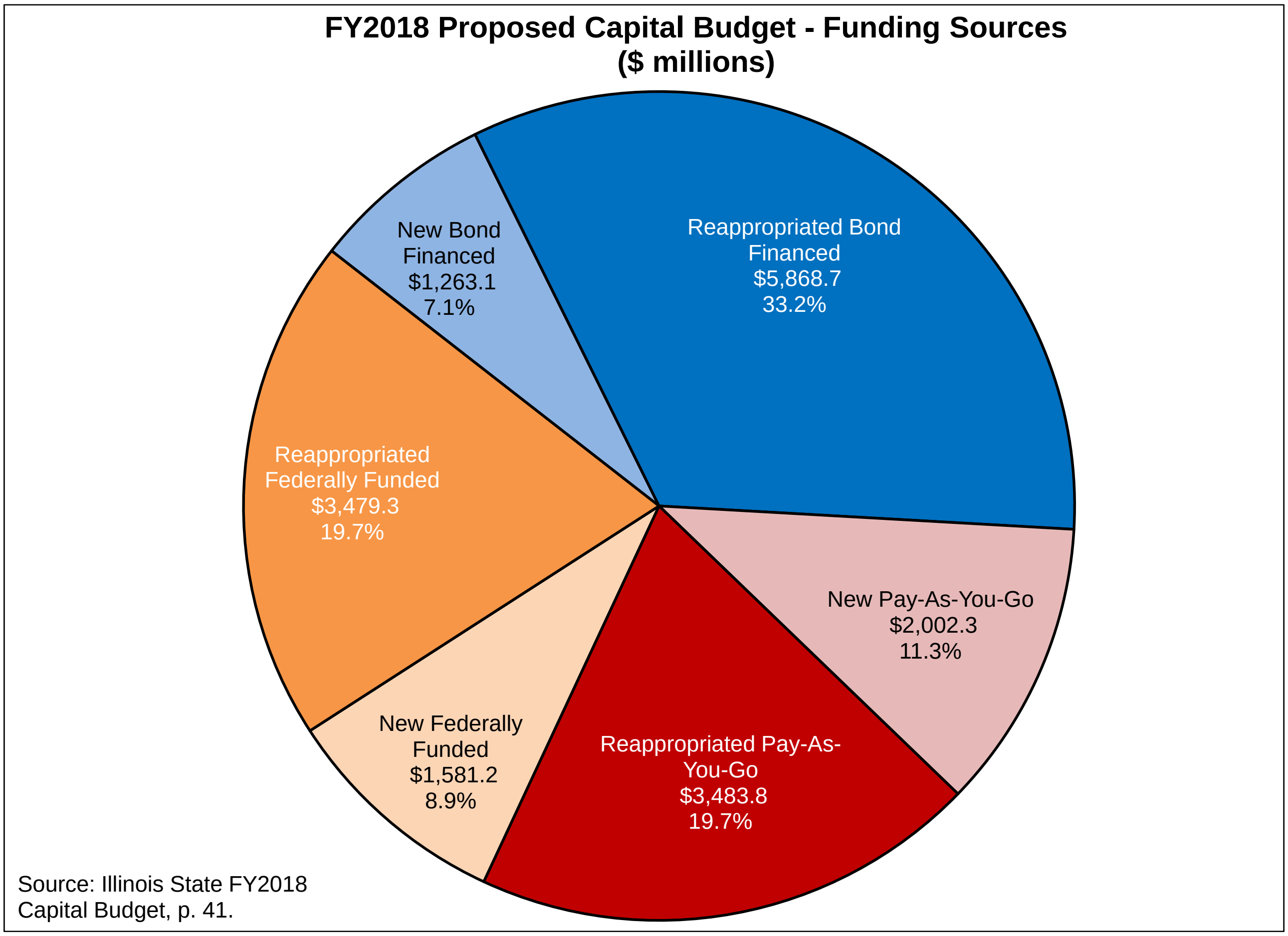


Projects funded using bond proceeds make up $7.1 billion of the total proposed spending in FY2018, while $10.5 billion are pay-as-you-go projects financed with currently available state and federal resources.[277]

The largest single source of pay-as-you-go funding comes from the federal government. Federal funds support $1.6 billion of new projects and $3.5 billion of the reappropriations, for a total of $5.1 billion in capital funds.[278] The State collects the remaining pay-as-you-go funding through user taxes and fees including motor fuel taxes, vehicle fees, licensing and other related charges. The FY2018 capital budget includes $2.0 billion in new projects and $3.5 billion in reappropriations funded by State sources.[279]

[277] Illinois State FY2018 Capital Budget, p. 41.
[278] Illinois State FY2018 Capital Budget, p. 41.
[279] Illinois State FY2018 Capital Budget, p. 41.

The following chart shows the total FY2018 capital budget by the type of project funding.



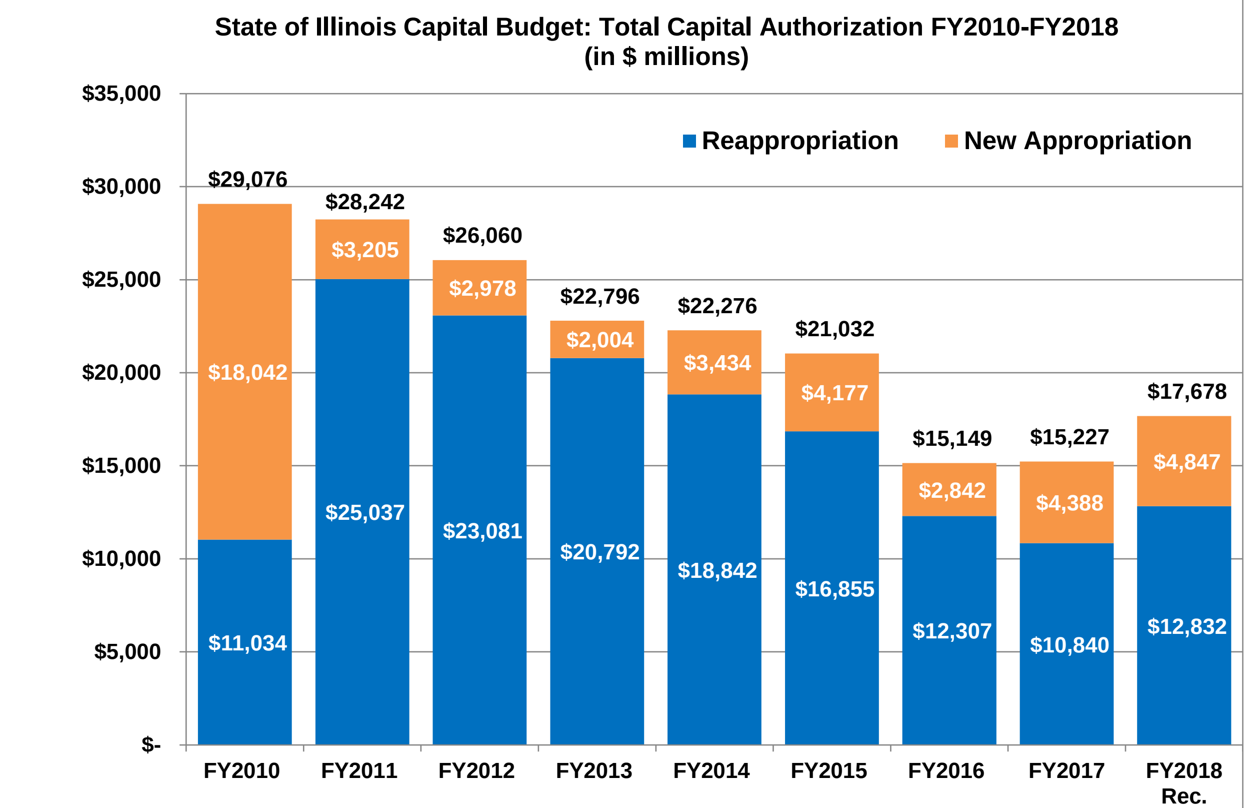
Total appropriations in the State's capital budget have declined to approximately $15.2 billion in the enacted FY2017 capital budget from $29.1 billion in FY2010. Reappropriations would grow under the Governor's FY2018 recommended budget to $12.8 billion. Due to the addition of new projects and the lack of a comprehensive capital improvement plan to explain the annual prioritization and completion of projects, it is unclear which of the original projects have been completed and how much of the current budget represents additional authorizations passed in the intervening years.

The *Illinois Jobs Now!* FY2010 capital budget included $18.0 billion in new projects added to $11.0 billion of reappropriations from previous years.[280] Since the initial *Illinois Jobs Now!* spending was approved, the State has authorized new projects annually that add up to a total of $27.9 billion from FY2011 through the proposed FY2018 budget. The largest amount of new projects since FY2010 were approved in FY2015 totaling $4.2 billion. The Governor's proposed FY2018 appropriation for new capital projects is slightly higher at $4.8 billion.

Reappropriations increased to $25.0 billion in FY2011 and then declined over the next six years to a low of $10.8 billion in FY2017. Reappropriations proposed in the FY2018 capital budget, if adopted, would increase for the first time since FY2011.

280 Source: Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p.7.

The following chart shows the total new and reappropriated amounts in the capital budget approved by the State of Illinois from FY2010 through FY2018.



Source: Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 7; Illinois State FY2018 Capital Projects List, https://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY2018%20Budget%20Book/FY2018_Illinois_Capital_Projects_List.xls (last visited April 26, 2017).

The State relies heavily on the sale of bonds to fund the capital budget. The State has issued $13.2 billion in General Obligation and Build Illinois bonds to pay for capital projects since the *Illinois Jobs Now!* spending program began in FY2010.[281] A package of dedicated revenue sources was authorized to pay for the additional debt service related to spending on *Illinois Jobs Now!*[282] The new taxes and fees consist of the following:

- Statewide legalization and taxation of video poker;
- Expanded sales tax on candy, sweetened beverages and some hygiene products;
- Leasing a portion of state lottery operations;
- Increased per-gallon tax on beer, wine and liquor; and
- Increased license and vehicle fees.

[281] Illinois State FY2018 Budget, p. 541; Illinois State FY2017 Budget, p. 525. For more details on the State's total debt burden and annual debt service costs see page 62 of this report.
[282] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2011, pp. 9-10.

The proceeds from these sources are deposited in the Capital Projects Fund and used to pay for debt service on new capital bonds and some ongoing capital expenses.[283] This is intended to limit the General Funds impact of the additional debt sold to pay for the new capital budget.

However, the taxes and fees have yet to produce the funding levels projected when *Illinois Jobs Now!* was originally approved.[284] In FY2018 Capital Projects Fund revenues are projected to total $805.2 million compared to an estimated $777.2 million in FY2017. However, the legislative projections provided when the spending was approved in FY2010 anticipated to be $943 million to $1.2 billion annually.[285]

The following table shows the revenues deposited into the Capital Projects Fund from FY2010 through the estimated FY2017 and projections for FY2018. The original legislative projections are also included in the table for comparison.

Capital Projects Fund: Revenues by Source
(in $ millions)

Source	Original Projections	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017 Est.	FY2018 Est.
Video Poker Tax*	$288 - $534	$ -	$ -	$ -	$ 24.5	$114.4	$195.7	$251.6	$285.0	$308.0
Lottery Fund	$ 150	$ 33	$ 54.1	$ 65.2	$135.0	$145.0	$ 8.0	$ -	$ -	$ -
Sales Tax	$ 65	$ 39	$ 52.0	$ 52.7	$ 54.0	$ 55.0	$ 55.9	$ 56.9	$ 57.0	$ 58.0
Liquor Tax	$ 108	$ 78	$105.2	$114.8	$115.1	$115.0	$116.4	$118.4	$124.0	$125.0
Vehicle Related	$ 332	$ 117	$294.6	$299.7	$298.4	$304.0	$310.6	$308.1	$311.0	$314.0
Other	$ -	$ -	$ (0.1)	$ 0.1	$ 0.3	$ 0.4	$ 0.4	$ 0.1	$ 0.2	$ 0.2
Total	**$943 - $1,189**		**$505.8**	**$532.5**	**$627.3**	**$733.8**	**$687.0**	**$735.1**	**$777.2**	**$805.2**

*FY2013 does not include one-time video poker operator fees totaling $33.5 million.

Source: Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2018* , April 2017, p. 9; Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2011, pp. 9-10.

Historically, only the liquor tax has regularly produced revenues in excess of the original projections. The largest historical shortfalls in revenues were related to the gaming sources from leasing the management of the lottery out to a private company and the legalization of video poker in Illinois.[286]

The lease to manage the State's lottery is no longer expected to bring in any funding for the capital budget in FY2017 and FY2018 after revenues dropped to only $8 million in FY2015 and to $0 in FY2016. It was assumed that the contract would earn the State $150 million annually when *Illinois Jobs Now!* was enacted. After several years of delays in the management bidding process and then disputes over performance requirements, the State has requested the termination of the agreement with its vendor. It is unclear how long it will take the State to exit its existing agreement and choose a new vendor.[287]

The estimated FY2018 video gaming revenue totaling $308.0 million is for the first time within the original projected range of $288 million to $534 million annually. Due to administrative delays, the

---

283 Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 9.
284 Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 9.
285 Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2011, pp. 9-10.
286 Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 9.
287 Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 12.

first video poker machines were not put into service until September 2012,[288] and thus FY2013 was the first year that the capital budget received revenue from the 30% tax on video gaming.

Since then, video gaming under performance has largely been due to the ability of local governments to opt out of video gaming or to continue existing local bans on the machines. Under the law establishing legalized video poker, five-sixths of the tax revenues generated are used for capital project funding and the remainder is shared with local governments where the machines are in service.[289] According to a report from the Commission on Government Forecasting and Accountability, 38.1% of the Illinois population lives in communities where video gaming is illegal.[290] However, this represents a significant expansion in video gaming over last year, when the percentage was 46.5%.[291] Chicago, where video gaming remains prohibited, represents 21.0% of the State's population.[292]

Although gaming-related revenues have accounted for the largest shortfall in capital funding, as shown in the table above, all other sources of capital projects revenue except liquor taxes continue to fall short.

The Capital Projects Fund is statutorily required to make an annual payment of $245.2 million to General Funds.[293] However, the payment is often offset by additional General Funds resources used to cover debt service costs not accounted for by the Capital Projects Fund. When the Capital Projects Fund does not have adequate revenue to cover the debt service and other statutory expenses, the State uses resources from the Road Fund or the General Funds to make up the difference. [294] These additional debt service costs are repaid in the subsequent year when shortfalls are covered by either fund.

Because current-year revenues have been insufficient to support all required transfers out of the Capital Projects Fund, the Comptroller is behind on transfers out in the amounts of $620.0 million for FY2016 and $516.0 as of April 2017 for FY2017.[295]

---

[288] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 11.
[289] Public Act 96-0034, enacted July 13, 2009.
[290] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 11.
[291] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2017, April 2016, p. 11.
[292] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 9.
[293] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 9.
[294] Public Act 96-0034, enacted on July 19, 2009.
[295] Commission on Government Forecasting and Accountability, Capital Plan Analysis FY2018, April 2017, p. 10.

APPENDICES

APPENDIX A: Borrowing Costs

The following table compares the debt service schedule for the November 2016 bonds with the debt service schedules that would have resulted if the State of Illinois had been able to borrow at the Thompson Reuters MMD Scale yields for AAA and BAA-rated credits. In all scenarios, the sale proceeds, purchaser's discount and costs of issuance are held constant.

State of Illinois Bond Cost Comparision ($ millions)

Illinois, GO Bonds, Series November 2016					Benchmark AAA Rated Bonds					Benchmark BAA Rated Bonds				
Maturity	Yield	Principal	Interest	Debt Service	Yield	Principal	Interest	Debt Service	Increased Cost	Yield	Principal	Interest	Debt Service	Increased Cost
2017	1.94	$ 19.2	$ 22.7	$ 41.9	0.68	$ 16.7	$ 19.7	$ 36.4	$ 5.5	1.09	$ 17.7	$ 20.9	$ 38.6	$ 3.3
2018	2.24	$ 19.2	$ 22.8	$ 42.0	0.82	$ 16.7	$ 19.8	$ 36.5	$ 5.5	1.29	$ 17.7	$ 21.0	$ 38.7	$ 3.3
2019	2.49	$ 19.2	$ 21.8	$ 41.0	0.93	$ 16.7	$ 19.0	$ 35.6	$ 5.4	1.47	$ 17.7	$ 20.1	$ 37.8	$ 3.2
2020	2.68	$ 19.2	$ 20.9	$ 40.1	1.02	$ 16.7	$ 18.1	$ 34.8	$ 5.3	1.64	$ 17.7	$ 19.2	$ 36.9	$ 3.1
2021	2.88	$ 19.2	$ 19.9	$ 39.1	1.12	$ 16.7	$ 17.3	$ 34.0	$ 5.1	1.79	$ 17.7	$ 18.3	$ 36.0	$ 3.0
2022	3.05	$ 19.2	$ 18.9	$ 38.1	1.20	$ 16.7	$ 16.5	$ 33.1	$ 5.0	1.90	$ 17.7	$ 17.5	$ 35.2	$ 3.0
2023	3.29	$ 19.2	$ 18.0	$ 37.2	1.34	$ 16.7	$ 15.6	$ 32.3	$ 4.9	2.10	$ 17.7	$ 16.6	$ 34.3	$ 2.9
2024	3.45	$ 19.2	$ 17.0	$ 36.2	1.48	$ 16.7	$ 14.8	$ 31.5	$ 4.7	2.30	$ 17.7	$ 15.7	$ 33.4	$ 2.8
2025	3.60	$ 19.2	$ 16.1	$ 35.3	1.61	$ 16.7	$ 14.0	$ 30.6	$ 4.6	2.44	$ 17.7	$ 14.8	$ 32.5	$ 2.7
2026	3.70	$ 19.2	$ 15.1	$ 34.3	1.71	$ 16.7	$ 13.1	$ 29.8	$ 4.5	2.55	$ 17.7	$ 13.9	$ 31.6	$ 2.7
2027	3.80	$ 19.2	$ 14.1	$ 33.3	1.82	$ 16.7	$ 12.3	$ 29.0	$ 4.4	2.66	$ 17.7	$ 13.0	$ 30.7	$ 2.6
2028	3.90	$ 19.2	$ 13.2	$ 32.4	1.92	$ 16.7	$ 11.4	$ 28.1	$ 4.2	2.77	$ 17.7	$ 12.1	$ 29.9	$ 2.5
2029	3.99	$ 19.2	$ 12.2	$ 31.4	2.01	$ 16.7	$ 10.6	$ 27.3	$ 4.1	2.87	$ 17.7	$ 11.3	$ 29.0	$ 2.4
2030	4.05	$ 19.2	$ 11.3	$ 30.5	2.07	$ 16.7	$ 9.8	$ 26.5	$ 4.0	2.93	$ 17.7	$ 10.4	$ 28.1	$ 2.4
2031	4.25	$ 19.2	$ 10.3	$ 29.5	2.14	$ 16.7	$ 8.9	$ 25.6	$ 3.9	3.00	$ 17.7	$ 9.5	$ 27.2	$ 2.3
2032	4.19	$ 19.2	$ 9.5	$ 28.7	2.21	$ 16.7	$ 8.3	$ 24.9	$ 3.8	3.07	$ 17.7	$ 8.8	$ 26.5	$ 2.2
2033	4.25	$ 19.2	$ 8.5	$ 27.7	2.27	$ 16.7	$ 7.4	$ 24.1	$ 3.6	3.13	$ 17.7	$ 7.9	$ 25.6	$ 2.2
2034	4.30	$ 19.2	$ 7.6	$ 26.8	2.32	$ 16.7	$ 6.6	$ 23.3	$ 3.5	3.18	$ 17.7	$ 7.0	$ 24.7	$ 2.1
2035	4.34	$ 19.2	$ 6.6	$ 25.8	2.36	$ 16.7	$ 5.8	$ 22.4	$ 3.4	3.22	$ 17.7	$ 6.1	$ 23.8	$ 2.0
2036	4.37	$ 19.2	$ 5.7	$ 24.9	2.39	$ 16.7	$ 4.9	$ 21.6	$ 3.3	3.24	$ 17.7	$ 5.2	$ 22.9	$ 1.9
2037	4.40	$ 19.2	$ 4.7	$ 23.9	2.42	$ 16.7	$ 4.1	$ 20.8	$ 3.1	3.26	$ 17.7	$ 4.3	$ 22.0	$ 1.9
2038	4.43	$ 19.2	$ 3.7	$ 22.9	2.45	$ 16.7	$ 3.3	$ 19.9	$ 3.0	3.28	$ 17.7	$ 3.5	$ 21.2	$ 1.8
2039	4.61	$ 19.2	$ 2.8	$ 22.0	2.47	$ 16.7	$ 2.4	$ 19.1	$ 2.9	3.30	$ 17.7	$ 2.6	$ 20.3	$ 1.7
2040	4.47	$ 19.2	$ 1.9	$ 21.1	2.48	$ 16.7	$ 1.7	$ 18.4	$ 2.8	3.31	$ 17.7	$ 1.8	$ 19.5	$ 1.6
2041	4.48	$ 19.2	$ 1.0	$ 20.2	2.49	$ 16.7	$ 0.8	$ 17.5	$ 2.6	3.32	$ 17.7	$ 0.9	$ 18.6	$ 1.6
Total		**$ 480.0**	**$ 306.2**	**$ 786.2**		**$ 417.0**	**$ 266.1**	**$ 683.1**	**$ 103.1**		**$ 442.6**	**$ 282.4**	**$ 725.0**	**$ 61.3**

Note: Principal amounts on benchmark bonds are calculated to achieve the same proceeds as the actual sale using the actual coupon rates and the benchmark yields as of November 8, 2016.

Source: Thompson Reuters Muncipal Market Data benchmark rates as of November 8, 2016;. State of Illinois, General Obligation Bonds, Series November 2016, Official Statement, November 8, 2016.

APPENDIX B: Total Debt Service

The following table shows all outstanding General Obligation, Build Illinois, and other revenue bond debt service owed by the State of Illinois.

State of Illinois Total Debt Service: GO Bonds and Build Illinois Bonds Bonds Principal and Interest (in $ millions)					
Fiscal Year	**Capital GO**	**Pension GO**	**Build Illinois**	**Other Revenue Bonds**	**Total Debt Service**
2017	$ 1,699.4	$ 1,647.3	$ 328.7	$ 17.6	**$ 3,693.1**
2018	$ 1,676.9	$ 1,618.6	$ 322.8	$ 17.7	**$ 3,636.0**
2019	$ 1,595.8	$ 1,586.1	$ 300.8	$ 14.4	**$ 3,497.2**
2020	$ 1,528.9	$ 674.6	$ 276.0	$ 14.4	**$ 2,493.9**
2021	$ 1,461.2	$ 713.4	$ 237.3	$ 5.6	**$ 2,417.4**
2022	$ 1,383.2	$ 749.8	$ 241.4	$ -	**$ 2,374.4**
2023	$ 1,333.5	$ 783.7	$ 222.8	$ -	**$ 2,340.1**
2024	$ 1,244.9	$ 840.2	$ 208.9	$ -	**$ 2,294.0**
2025	$ 1,138.5	$ 892.2	$ 201.0	$ -	**$ 2,231.7**
2026	$ 1,103.9	$ 915.4	$ 192.5	$ -	**$ 2,211.8**
2027	$ 976.9	$ 936.1	$ 164.4	$ -	**$ 2,077.3**
2028	$ 947.5	$ 979.2	$ 137.4	$ -	**$ 2,064.1**
2029	$ 910.8	$ 1,018.5	$ 133.0	$ -	**$ 2,062.3**
2030	$ 820.7	$ 1,079.0	$ 120.4	$ -	**$ 2,020.1**
2031	$ 744.7	$ 1,134.4	$ 121.6	$ -	**$ 2,000.6**
2032	$ 644.9	$ 1,159.7	$ 110.9	$ -	**$ 1,915.5**
2033	$ 593.3	$ 1,156.1	$ 101.3	$ -	**$ 1,850.7**
2034	$ 602.2	$ -	$ 95.4	$ -	**$ 697.6**
2035	$ 522.4	$ -	$ 66.6	$ -	**$ 589.0**
2036	$ 400.0	$ -	$ 64.0	$ -	**$ 464.0**
2037	$ 335.5	$ -	$ 31.3	$ -	**$ 366.8**
2038	$ 265.8	$ -	$ 17.5	$ -	**$ 283.3**
2039	$ 221.8	$ -	$ -	$ -	**$ 221.8**
2040	$ 66.4	$ -	$ -	$ -	**$ 66.4**
2041	$ 63.7	$ -	$ -	$ -	**$ 63.7**
2042	$ 19.7	$ -	$ -	$ -	**$ 19.7**
Total	**$ 22,302.5**	**$ 17,884.3**	**$ 3,696.1**	**$ 69.7**	**$ 43,952.7**

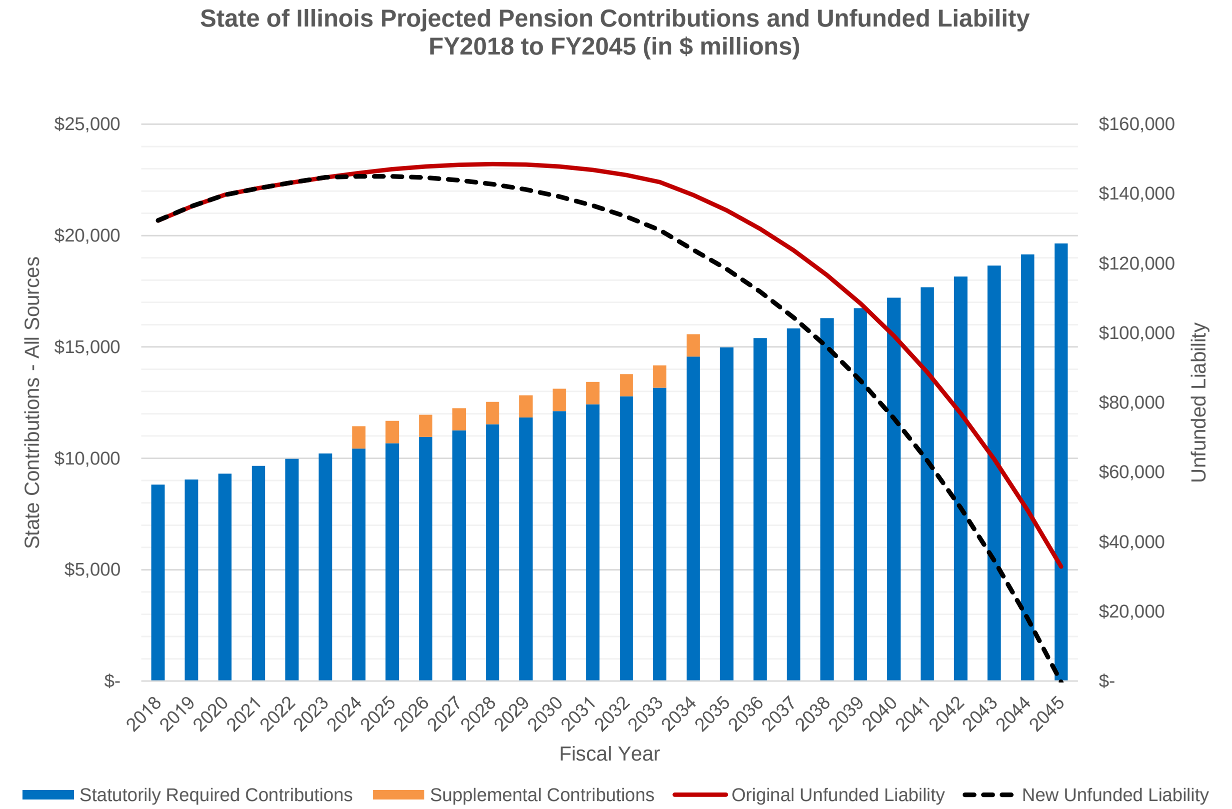
Source: Illinois State FY2018 Budget, pp. 543-44.

APPENDIX C: Projected State Pension Funding and Supplemental Pension Payments

The following chart and table show the State of Illinois' projected statutorily required contributions to its five retirement systems from FY2018 to FY2045 and the Systems' projected unfunded liability for the same period. Existing law requires the State to contribute a level percentage of payroll sufficient to bring the retirement systems' funded ratios to 90% by FY2045.[296]

The contributions below are statutorily required pension contributions, from both General Funds and other State funds. Approximately 89% of total contributions come from General Funds.[297] Total projected contributions rise to $19.6 billion in FY2045. The total unfunded liability is projected to peak at $148.5 billion in FY2029.

The chart and table also show the Civic Federations proposed supplemental contributions that would allow the funds to achieve 100% funded status by FY2045.



Source: Illinois General Assembly, Commission on Government Forecasting and Accountibility, "Illinois State Retirement Systems, Financial Condition as of June 30, 2016," March 2017, pp. 30 and 99; Civic Federation calculations.

[296] A funded ratio shows the percentage of accrued pension liability covered by pension assets and is a commonly used measure of the financial health of a retirement system.

[297] State of Illinois, General Obligation Bonds Series of November 2016, *Official Statement*, November 8, 2016, p. G-2.

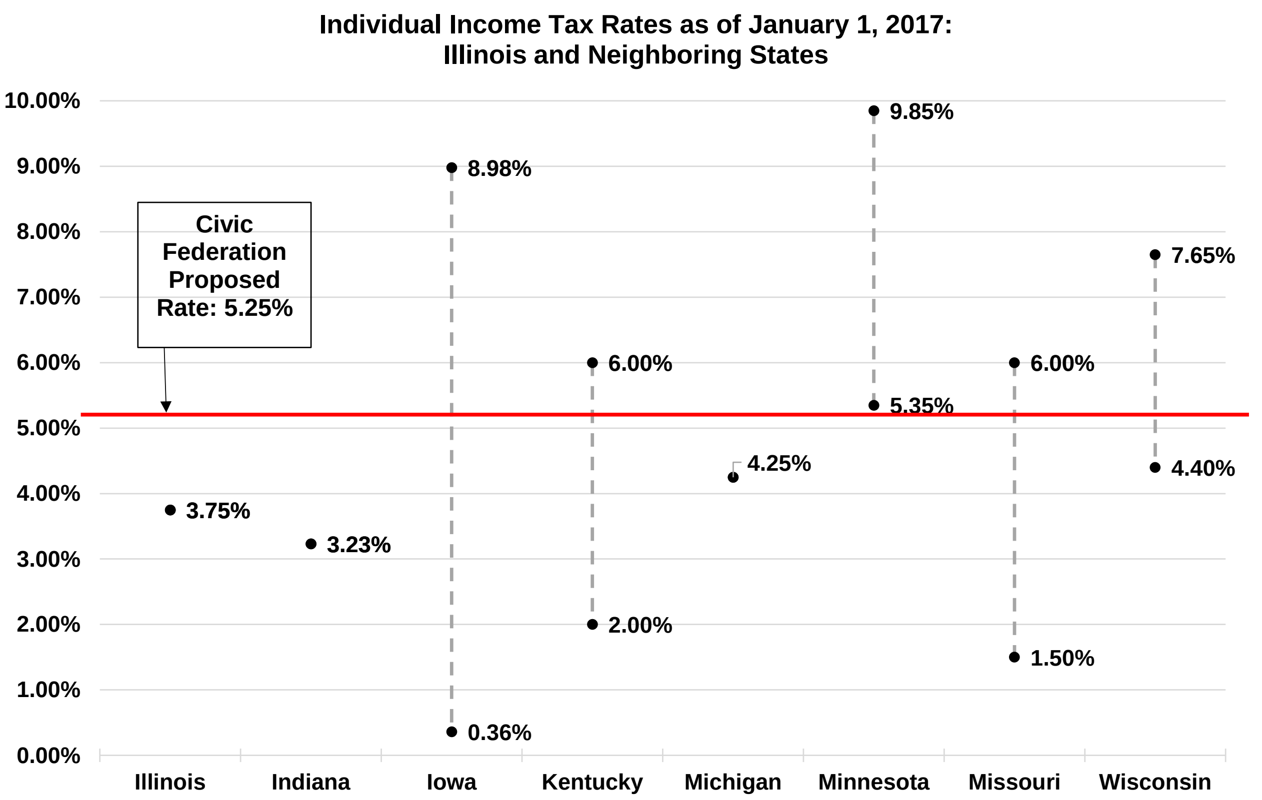
State of Illinois Pension Funding Projections: Supplemental Annual Contribution FY2019 to FY2045 (in $ million)									
Fiscal Year	**Accrued Liabilities**	**Actuarial Value of Assets**	**Unfunded Liabilities**	**Funded Ratio**	**Supplemental Contributions**	**Supplemental Contribution Value***	**Total Asssets with Supp. Value**	**Reduced Unfunded Liabilities**	**Increased Funded Ratio**
2018	$ 221,685	$ 89,349	$ (132,337)	40%		$ -	$ 89,349	$ (132,337)	40%
2019	$ 228,454	$ 92,078	$ (136,376)	40%		$ -	$ 92,078	$ (136,376)	40%
2020	$ 235,141	$ 95,422	$ (139,719)	41%		$ -	$ 95,422	$ (139,719)	41%
2021	$ 241,722	$ 100,128	$ (141,593)	41%		$ -	$ 100,128	$ (141,593)	41%
2022	$ 248,183	$ 104,951	$ (143,232)	42%		$ -	$ 104,951	$ (143,232)	42%
2023	$ 254,504	$ 109,810	$ (144,694)	43%		$ -	$ 109,810	$ (144,694)	43%
2024	$ 260,667	$ 114,690	$ (145,977)	44%	$ 1,000	$ 1,000	$ 115,690	$ (144,977)	44%
2025	$ 266,645	$ 119,596	$ (147,049)	45%	$ 1,000	$ 2,070	$ 121,666	$ (144,979)	46%
2026	$ 272,416	$ 124,563	$ (147,853)	46%	$ 1,000	$ 3,215	$ 127,777	$ (144,639)	47%
2027	$ 277,964	$ 129,612	$ (148,352)	47%	$ 1,000	$ 4,440	$ 134,052	$ (143,912)	48%
2028	$ 283,273	$ 134,733	$ (148,540)	48%	$ 1,000	$ 5,751	$ 140,484	$ (142,789)	50%
2029	$ 288,328	$ 139,955	$ (148,373)	49%	$ 1,000	$ 7,153	$ 147,108	$ (141,220)	51%
2030	$ 293,111	$ 145,278	$ (147,833)	50%	$ 1,000	$ 8,654	$ 153,932	$ (139,179)	53%
2031	$ 297,597	$ 150,726	$ (146,871)	51%	$ 1,000	$ 10,260	$ 160,985	$ (136,612)	54%
2032	$ 301,827	$ 156,414	$ (145,413)	52%	$ 1,000	$ 11,978	$ 168,392	$ (133,435)	56%
2033	$ 305,735	$ 162,355	$ (143,380)	53%	$ 1,000	$ 13,816	$ 176,171	$ (129,563)	58%
2034	$ 309,318	$ 169,641	$ (139,677)	55%	$ 1,000	$ 15,784	$ 185,424	$ (123,893)	60%
2035	$ 312,560	$ 177,341	$ (135,219)	57%		$ 16,888	$ 194,229	$ (118,331)	62%
2036	$ 315,462	$ 185,519	$ (129,944)	59%		$ 18,071	$ 203,589	$ (111,873)	65%
2037	$ 318,041	$ 194,263	$ (123,778)	61%		$ 19,336	$ 213,598	$ (104,443)	67%
2038	$ 320,271	$ 203,624	$ (116,647)	64%		$ 20,689	$ 224,313	$ (95,958)	70%
2039	$ 322,170	$ 213,696	$ (108,474)	66%		$ 22,137	$ 235,834	$ (86,337)	73%
2040	$ 323,752	$ 224,581	$ (99,171)	69%		$ 23,687	$ 248,267	$ (75,484)	77%
2041	$ 325,056	$ 236,390	$ (88,666)	73%		$ 25,345	$ 261,735	$ (63,321)	81%
2042	$ 326,128	$ 249,256	$ (76,872)	76%		$ 27,119	$ 276,375	$ (49,753)	85%
2043	$ 327,037	$ 263,334	$ (63,703)	81%		$ 29,018	$ 292,352	$ (34,685)	89%
2044	$ 327,866	$ 278,804	$ (49,062)	85%		$ 31,049	$ 309,852	$ (18,013)	95%
2045	$ 328,678	$ 295,811	$ (32,867)	90%		$ 33,222	$ 329,033	$ 355	100%

*Assumes $1.0 billion annually from FY2024 through FY2034. Earnings on these contributions, with a 7.0% long-term rate of return, will be sufficient to lower the unfunded liabilities of the funds to zero by FY2045.

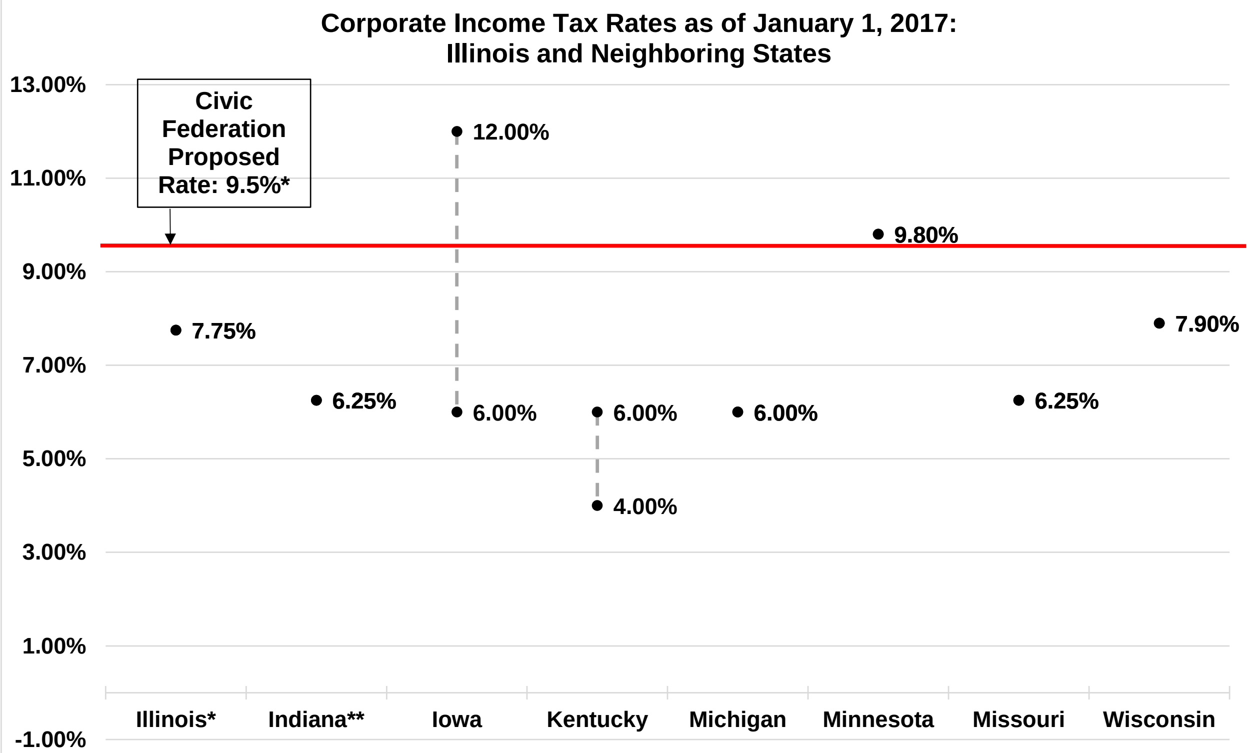
Source: Illinois General Assembly, Commission on Government Forecasting and Accountibility, *Illinois State Retirement Systems Financial Condition as of June 30, 2016,* March 2017, pp. 30 and 99; Civic Federation calculations.

APPENDIX D: State Income Tax Comparison

The following charts compare individual and corporate income tax rates in neighboring states.



Note: Each state has different exemption levels and states with multiple tax rates have different numbers of tax brackets.
Source: Federation of Tax Administrators, *State Individual Income Taxes (Tax rates for tax year 2017 as of January 1, 2017*), March 2017.



***** Current and proposed Illinois corporate income tax rates include 2.5% personal property replacement tax.
**Indiana's corporate tax rate is scheduled to decrease to 6.0% on July 1, 2017.
Note: Each state has different exemptions and states with multiple tax rates have different numbers of tax brackets.
Source: Federation of Tax Administrators, *Range of State Corporate Income Tax Rates (For tax year 2017 as of January 1, 2017)*, March 2017.

APPENDIX E: State Sales Tax Comparison

The following table compares sales tax rates and exemptions in neighboring states.

Sales Tax Rates: Illinois and Neighboring States				
	Tax Rate	**Food**	**Prescription Drugs**	**Non-Prescription Drugs**
Illinois				
Current	6.25%	Yes - 1.0%	Yes - 1.0%	Yes - 1.0%
Proposed	5.50%	Yes - 1.0%	Yes - 1.0%	Yes - 1.0%
Indiana	7.00%	No	No	Yes - 7.0%
Iowa	6.00%	No	No	Yes - 6.0%
Kentucky	6.00%	No	No	Yes - 6.0%
Michigan	6.00%	No	No	Yes - 6.0%
Minnesota	6.875%	No	No	No
Missouri	4.225%	Yes - 1.225%	No	Yes - 4.225%
Wisconsin	5.00%	No	No	Yes - 5.0%

Source: Federation of Tax Administrators, *State Sales Tax Rates and Food & Drug Exemptions (As of January 1, 2017)*, January 2017.