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

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The Civic Federation is an independent, non-partisan government research organization working to maximize the quality and cost-effectiveness of government services in the Chicago region and State of Illinois.

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.

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EXECUTIVE SUMMARY

The State of Illinois entered uncharted waters on February 17, 2016, when Governor Bruce Rauner proposed a budget for the upcoming fiscal year without a budget in place for the current fiscal year. The Governor's recommended budget covers FY2017, which begins on July 1, 2016. However, there is still no budget for FY2016, which ends on June 30.

Although Illinois' financial condition has been precarious for years, the current situation represents a new low in fiscal management by the General Assembly and the Governor. The failure to pass an FY2016 budget has led to deteriorating credit ratings and skyrocketing interest penalties on overdue bills. It has created hardship for low income college students and elderly and disabled residents and may have irreparably damaged the State's capability to provide social services in the future.

The Civic Federation **opposes** Governor Rauner's recommended FY2017 budget because it has an operating deficit of $3.5 billion and presents an insufficiently detailed plan for closing the gap. The $3.5 billion figure appears to be understated because it does not fully account for the actual cost of essential State services and is based on projected savings that are unlikely to be realized.

The Federation **cannot support** a financial plan that allows the State's backlog of unpaid bills to stand at $9.3 billion at the end of FY2017 if the operating deficit is eliminated and rise to $12.8 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.

Governor Rauner faced major challenges in developing the FY2017 budget. Largely because of the partial rollback of temporary income tax rates, the State's General Funds revenues are projected to be $4.4 billion lower in FY2017 than in FY2014, the last full fiscal year before the rates were reduced. The rate increases helped to cover the overwhelming cost of Illinois' pension contributions without borrowing.

However, the Federation **opposes** the Governor's plan to reduce General Funds pension contributions by $748 million in FY2017 largely by deferring payments to later years. Given the State's history of inadequate pension contributions and the current funded ratio of only 41.9%, it is not prudent to increase future costs by further delaying payments. The administration has not made available to the public a detailed breakdown of the savings or any actuarial reviews of the proposal.

The Federation is in favor of reductions in State employee health insurance costs but **cannot support** the projected reduction of $445 million, or nearly one-fourth, in group insurance payments. The savings depend on the outcome of labor negotiations or the removal of health insurance from collective bargaining. The projection follows a long history of underfunding health insurance contributions, which has fueled growth in the backlog of claims.

The Federation is **concerned** about the plan to save nearly $198 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 less than half as much—for seniors who do not qualify for Medicaid. Details of the plan have not been made public, and it remains to be seen whether the new services would be adequate to avoid emergency room visits or nursing home placements.

The proposed budget relies on the use of $475 million in one-time revenues, including the entire balance of the Budget Stabilization Fund and the proceeds of the sale of the James R. Thompson

Center in Chicago. The Federation **opposes** the depletion of the State's only rainy day fund and **cannot support** the use of proceeds from an asset sale for operating expenses.

The Federation calls on the Governor and General Assembly to recognize the urgent need to work together to help fix the FY2016 budget and develop a sustainable financial plan for FY2017. The Federation continues to **recommend** a comprehensive plan including increased revenues and spending restraints. Spending controls are at the center of the Federation's plan, but more revenue is also needed to help reduce the operating deficit in FY2016, close the gap in FY2017 and pay down the backlog of unpaid bills. Once the backlog is eliminated, Illinois could finally start building reserves to prepare for the next economic downturn.

The Federation further **recommends** that the legislature and Governor not pass or sign any appropriation bills that are not part of a complete balanced budget for FY2017. Last year Governor Rauner vetoed all of the General Assembly's unbalanced budget for FY2016 except for early childhood, elementary and secondary education. The Governor has proposed moving forward with increased P-12 appropriations for FY2017 before any other budget bills are considered. By allowing schools to open on time, singling out education funding shields much of the public from the impact of the budget impasse and has been shown to reduce pressure on State officials to find a comprehensive solution to the crisis.

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

- The proposed General Funds budget has an operating deficit of at least $3.5 billion and provides an insufficiently detailed plan for closing the gap;
- The backlog of unpaid bills[1] declined from $8.1 billion in FY2012 to $5.2 billion at the end of FY2015 and is expected to rise to $9.3 billion in FY2016 if additional appropriations are enacted with no additional revenue;
- The backlog is projected to remain at $9.3 billion at the end of FY2017 if the operating deficit is closed, or 27.2% of projected General Funds revenues in FY2018;
- If the operating deficit is not closed, the year-end FY2017 backlog could grow to $12.8 billion, or 37.5% of projected FY2018 revenues;
- The State paid $1.0 billion in interest penalties on overdue bills from FY2006 through FY2015, with more than 90% of that amount spent in the last six years;
- The State would have owed as much as $328 million in interest penalties if late group health insurance claims were paid at the end of February 2016, but the unpaid claims are increasing by $200 million per month and are not likely to be paid down in the near future;
- Due to the partial rollback of temporary income tax increases, total General Funds revenues decline by $5.1 billion in FY2016 compared to the peak in FY2014. In FY2017 General Funds revenues are $4.4 billion below the FY2014 level;
- The FY2017 maintenance budget[2] has an operating deficit of $6.6 billion, which is reduced to $3.5 billion in the proposed budget by the use of $475 million in one-time revenues and $2.6 billion in spending reductions;
- Proposed one-time revenues consist of $276 million from the depletion of the State's only rainy day fund and $200 million from the sale of the James R. Thompson Center;
- Proposed spending reductions include the following:
    - <u>Pensions</u>: Contributions to the State's five retirement systems would total $6.2

[1] For budgetary purposes, the backlog of unpaid bills represents this year's General Funds obligations that must be paid from next year's revenues.
[2] The maintenance budget is the amount needed to fund agencies' core missions and programs, after adjusting for price changes and one-time costs.

billion, which is $748 million below the amount currently required by State law. The savings would come from recalculating pension liabilities to lower current expenses and by shifting pension costs to local school districts and universities;
  - Group Health Insurance: Payments would be reduced by $445 million, or 24.6%, by giving employees a choice between significantly higher health insurance premiums or less generous coverage. The changes depend on the successful resolution of labor negotiations or the removal of health insurance benefits from collective bargaining;
  - Community Care Program: Spending on this program, which aims to keep seniors out of nursing homes, is cut by $197.6 million, or 19.1%. The administration plans to use less costly services for individuals who are not eligible for Medicaid;
  Education: Funding for higher education is reduced by $200 million, but spending on elementary and secondary education and early childhood education is increased by a total of $103 million; and
  - Interfund Borrowing: Only $15 million of the $454 million borrowed from other State funds at the end of FY2015 would be repaid.
- The FY2016 operating deficit is estimated at $4.4 billion if additional appropriations are enacted to fund agency operations and programs;
- Due to the budget standoff, hundreds of vendors provided services to the State under FY2016 contracts but have not been paid. The Illinois Department of Human Services has $357 million of such contracts with approximately 800 social services organizations;[3]
- If the State experiences multiple downgrades from the three major bond rating agencies, it could face potential swaps liabilities currently estimated to cost $138 million;
- The revenue sources enacted to fund the capital budget continue to fall short of expectations, leading to an accumulated deficit in FY2016 of about $800 million.

The Civic Federation is concerned about the following aspects of the Governor recommended FY2017 budget:

- The General Funds budget has an operating deficit of at least $3.5 billion and an insufficiently detailed plan to close the gap between revenues and expenditures;
- After declining for the past three years, the State's backlog of unpaid bills is expected to be significantly higher in FY2016 and FY2017 due largely to the phaseout of temporary income tax rate increases in the middle of FY2015;
- The State's pension contributions are reduced by $748 million partly by deferring costs to future years;
- The proposal budgets a reduction of nearly one-fourth in group health insurance costs, with savings that depend on either a successful resolution to labor negotiations or the removal of health insurance from collective bargaining; and
- The Budget Stabilization Fund, the State's only rainy day fund, is depleted to help balance the budget.
- The proposal to save nearly $198 million by moving seniors who are not eligible for Medicaid from the Community Care Program to a much less costly program could lead to increased institutionalization of elderly residents; and
- The use of one-time resources to pay for ongoing operating costs guarantees future deficits and continues the ongoing budget imbalance. These include fully depleting the Budget Stabilization Fund and the sale of the James R. Thompson Center and savings from not repaying FY2015 interfund borrowing.

[3] Illinois Department of Human Services, data provided to Senate Appropriations I Committee, March 16, 2016.

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

- The Governor and the General Assembly must enact a comprehensive budget plan for FY2017 that includes appropriations that covers the cost of all areas of State government and the necessary resources to balance those expenditures. The State should not approve separate appropriations for any individual areas of spending or programs for FY2017 in the absence of a comprehensive balanced budget;
- The State should pursue a balanced budget through the recommendations included in the Civic Federation's FY2017 State budget roadmap report including:
  - Limiting spending within its resources to reduce the growth in the backlog of unpaid bills and create surpluses in future years to completely pay down these accumulated liabilities;
  - Reinstating the higher income tax rates of 5.0% for individuals and 7.0% for corporations in FY2017 to address the revenue losses caused by the 25% rate reduction that went into effect January 1, 2015;
  - Broadening its income tax base by eliminating the tax exemption for retirement income, excluding Social Security income and all retirement income from individuals with taxable income of less than $50,000;
  - Expanding the sales tax base to include a new general consumer services tax while strictly excluding all business-to-business services and excluding medical, financial and legal services;
  - Temporarily suspending the sales tax exemption for food and nonprescription drugs to generate additional revenue immediately needed to balance the State's budget and keep its backlog of bills from growing; and
  - Pursuing other recommendations from the Roadmap such as capping the retailer's discount at $200 per month, increasing revenue sharing with local governments and considering long-term tax and budgetary reforms.
- To stabilize Illinois' massively underfunded pension funds, the Federation recommends:
  - A constitutional amendment limiting the State's pension protection clause to accrued benefits;
  - Supplemental payments to the State's five retirement systems corresponding to the reduced debt service obligations related to retiring Pension Obligation bonds beginning in FY2019; and
  - The consolidation of the Chicago Teachers' Pension Fund (CTPF) with the Teachers' Retirement System, giving the State responsibility for the unfunded liability of CTPF.

CIVIC FEDERATION POSITION AND RECOMMENDATIONS

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The Civic Federation is **encouraged** that the administration is working to modernize the State's information technology system and reform the criminal justice system by promoting alternatives to incarceration. These long-term efforts could improve the delivery of State services and help to create future budgetary savings.

However, the Federation **opposes** the Governor's plan to reduce General Funds pension contributions by $748 million in FY2017 largely by deferring payments to later years. Given the State's history of inadequate pension contributions and the current funded ratio of only 41.9%, it is not prudent to increase future costs by further delaying payments. The administration has not made available to the public a detailed breakdown of the savings or any actuarial reviews of the proposal.

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Civic Federation Concerns

The Civic Federation is concerned about the following aspects of the Governor's recommended FY2016 budget.

Unbalanced Budget Proposal

Governor Rauner's proposed FY2017 General Funds budget has a stated operating deficit of $3.5 billion. The Governor presented the legislature with two choices for closing the gap between revenues and expenditures:

> 1) Agreeing to key portions of his Turnaround Agenda, which is intended to boost economic growth by making Illinois more appealing to businesses.[4] In that case, the Governor would support unidentified additional revenues that could reach $36.3 billion; or
> 2) Granting the Governor broad authority to close the gap on his own by making spending cuts to or transferring resources from any area of government, with limited exceptions.[5] In that case, spending could be as low as $32.8 billion.

[4] The Governor's Turnaround Agenda includes constitutional amendments on term limits and redrawing legislative districts, changes in workers' compensation, limits on damages in civil lawsuits and a freeze on local property taxes that would be combined with measures to cut costs for local governments by limiting the scope of collective bargaining and eliminating prevailing wage requirements.

The FY2017 budget document includes a line worth $3.5 billion labeled "Working Together or Executive Management," representing the two proposed options for bringing the operating deficit to zero. The administration believes that the proposal satisfies the Illinois Constitution's requirement that the Governor present a balanced budget.[6]

However, these choices are not a detailed plan for eliminating the operating deficit. According to the FY2017 budget document, the State's backlog of unpaid bills could grow to $12.8 billion at the end of that year if the gap is not closed.

The administration arrives at the $3.5 billion operating deficit for FY2017 by beginning with a maintenance budget that has a $6.6 billion shortfall.[7] The Governor's recommended FY2017 budget reduces the operating deficit to $3.5 billion through projected spending cuts of $2.6 billion and the use of $476 million in one-time revenues.[8]

The $3.5 billion figure appears to significantly understate the shortfall because it does not fully account for the actual cost of essential State services and is based on projected savings that are unlikely to be realized. The administration has not released details about its proposed cuts to the Community Care Program, which seeks to keep elderly residents out of nursing homes, or any actuarial reviews of its proposal to save money on pension contributions. The recommended savings on overtime pay and group health insurance depend on changes that have so far been rejected by the State's largest labor union.

The administration is also seeking to transform other areas of government, including streamlining the procurement process and modernizing the information technology system, according to the FY2017 budget document and the Governor's State of the State speech in January 2016.

The Civic Federation supports efforts to increase the efficiency and effectiveness of government through major reforms. However, it is imprudent to base so many deficit-reduction measures on untested initiatives. Given the State's dire financial plight and long history of fiscal mismanagement, the State cannot afford to ignore the discipline of budgetary balance.

Backlog of Unpaid Bills

After declining for the past three years, the State's backlog of unpaid bills is expected to be significantly higher in FY2016 and FY2017 due largely to the phaseout 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.[9] Because of the backlog, the State begins each fiscal year in

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[5] 99th Illinois General Assembly, Senate Bill 2789, introduced on February 17, 2016.
[6] Illinois Constitution, Article VIII, Section 2(a). The constitutional provision technically covers all State accounts but has typically been interpreted to apply to General Funds.
[7] Maintenance spending in FY2017 is defined as the amount needed to fund agencies' core missions and programs, after adjusting for price changes and one-time costs.
[8] Projected FY2017 resources include $200 million from the sale of the James R. Thompson Center and $276 million from depleting the Budget Stabilization Fund.
[9] For more information on the State's backlog of unpaid bills, see p. 66 of this report.

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. If additional appropriations are enacted with no additional revenues, the backlog is expected to reach $9.3 billion at the end of FY2016. It will remain at that level in FY2017 if the operating deficit in the proposed budget is closed. If the gap is not eliminated, the backlog could grow to $12.8 billion, or 37.5% of projected FY2018 revenues.[10]

As the State pushes bills from one year to the next, it transfers its financial distress by delaying payments to vendors, social service agencies and local governments across the State. It also incurs interest penalties on overdue bills, which totaled $1.0 billion between FY2006 and FY2015.[11] The full cost of this practice to the State's budget—in higher bids for State work and a smaller pool of bidders willing to do business with the State—is not easy to quantify but is undoubtedly much higher.

Credit rating agencies have repeatedly cited the large backlog of unpaid bills, or accumulated liabilities, as a major reason for giving Illinois lower credit ratings than any other state. "Illinois' inability to balance its operations, eliminate accumulated liabilities and grow reserves during a period of economic growth leaves it far more vulnerable to the next economic downturn," Fitch Ratings said in October 2015 when it downgraded Illinois to BBB+ from A-.[12]

Proposed Changes in State Pension Contributions

The FY2017 budget proposes a reduction of $748 million, or 10.8%, in General Funds pension contributions to $6.2 billion from $6.9 billion in the FY2017 maintenance budget.[13] State savings are projected to come from the following proposed changes:[14]

- 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 the Governor's salary of $180,000.
- 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.
- Actuarial assumptions: Changes in required State contributions related to revisions in actuarial assumptions would be phased in over five years. The change would allow the State

[10] Illinois Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY17-FY19*, January 6, 2016.
[11] For more information, see the Civic Federation's Institute on Illinois' Fiscal Sustainability blog, https://www.civicfed.org/iifs/blog/penalties-overdue-bills-add-state-illinois (last visited on April 10, 2016).
[12] Fitch Ratings, "Fitch Downgrades Illinois' GO Rating to 'BBB+'; Outlook Revised to Stable," *news release*, October 19, 2015.
[13] The $6.9 billion maintenance level is based on existing statutory requirements, as certified in January 2016 by the five State retirement systems.
[14] Illinois State FY2017 Budget, pp. 46-47.

to defer additional contributions due to lower assumed investment rates of return or lower mortality rates.

- Pension pickup: State agencies and offices would be banned from paying employees' share of pension contributions. This change applies mainly to employees not under the Governor's control.

The Governor's Office has not made available the breakdown of savings attributed to each of the pension changes or any actuarial reviews of the proposals. Legislation related to the changes has not been introduced.

Illinois' five retirement systems had a total unfunded liability of $111.0 billion as of June 30, 2015, based on the market value of assets, and a combined funded ratio of 41.9%.[15] Since FY1996, when the current pension funding plan began, the unfunded liability has risen by $94.2 billion.[16] The largest factor was inadequate State contributions, which accounted for $41.9 billion of the increase.

The Civic Federation cannot support changes that defer payments to later years, which appear to account for most of the savings. Given the State's history of inadequate pension contributions and the systems' current underfunding, it is not prudent to increase future costs by further delaying payments.

Proposed Appropriation for Group Health Insurance

Although the Civic Federation supports efforts to reduce the State's group insurance expenses, it is unrealistic to budget savings of $445 million in FY2017 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 FY2017 budget includes General Funds group insurance appropriations of $1.3 billion, a decrease of 24.6% from the FY2017 maintenance level of $1.8 billion. Governor Rauner also assumed large spending reductions in FY2016, when the proposed group insurance appropriation was $1.2 billion.[18] The full funding amount for the current year is now estimated at $1.7 billion.

The administration planned to achieve savings in FY2016 mainly by negotiating new health insurance benefits with its largest union, Council 31 of the American Federation of State, County and Municipal Employees (AFSCME).[19] However, the State and AFSCME have not been able to come to terms on a new contract to replace an agreement that expired on June 30, 2015, and that agreement has remained in effect.

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[15] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2015*, March 2016, p. 25. The unfunded liability was $112.9 billion based on the smoothed value of assets and the funded ratio was 40.9%.

[16] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2015*, March 2016, p. 28. The other factors were changes in assumptions, $21.3 billion; other factors, $14.2 billion; investment returns, $14.0 billion; and benefit increases, $5.8 billion. Lower than expected salary increases reduced the unfunded liability by $3.1 billion.

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

[18] Illinois State FY2016 Budget, p. 3-21.

[19] Illinois State FY2016 Budget, p. 2-18. In addition, State officials have cited other savings, such as a reduction in negotiated HMO rates, since the budget was issued in February 2015.

The Governor is currently seeking a determination from the Illinois Labor Relations Board on whether the negotiations have reached an impasse.[20] A ruling in favor of the administration would allow the State to impose its terms on the union; the union could either accept the terms or strike. If the Board rules in favor of the union, negotiations would resume. The Governor has also proposed removing group health insurance from collective bargaining, which would require a change in State law.[21]

Most of the projected savings in FY2017 would be achieved by giving employees a choice between significantly higher health insurance premiums or less generous coverage, meaning higher deductibles, co-pays and co-insurance.[22] Premiums would double for employees who stay with their current plans.[23]

In the past, appropriating insufficient amounts to cover group health insurance costs caused the backlog of unpaid claims to grow to $1.4 billion at the end of FY2015. The State paid $522.1 million in interest penalties on overdue health insurance claims from FY2008 through FY2015, according to the Comptroller's Office.[24]

Unlike most other State bills, health insurance claims from one fiscal year may be paid out of future years' appropriations.[25] Underfunding the program has allowed the State to ease financial strains and mask deficits by deferring costs to the next year's budget.

Because of the FY2016 budget impasse, the backlog of unpaid claims had grown to $2.9 billion by the end of February 2016 and was expected to increase by $200 million per month.[26] Group health insurance is one of the main areas of government that has not received funding during the budget standoff. However, the costs of the program must be paid eventually due to State law and union contracts, and interest penalties will be paid at the same time.

Eliminating the Budget Stabilization Fund

The Civic Federation opposes the Governor's recommendation to spend down the entire balance of the State's Budget Stabilization Fund to pay for ongoing operating expenses in FY2017.
By depleting the entire $276 million balance of the Budget Stabilization Fund, the State would be eliminating its only rainy day fund.

Illinois has not maintained a functional rainy day fund, although a law was enacted in 2004 to build such a fund. [27] The law established a goal of maintaining 5.0% of General Funds revenues in the Budget Stabilization Fund. Instead of being used to withstand fiscal emergencies, the fund is used

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[20] Doug Finke, "Rauner, AFSCME go to labor board over new contract," *The State Journal-Register*, April 25, 2016.
[21] Joseph S. Pete, "Rauner calls for limits to collective bargaining," *Times of Northwest Indiana*, October 7, 2015.
[22] Illinois State FY2017 Budget, pp. 52-54.
[23] State of Illinois, Office of the Governor, Memorandum from Governor Bruce Rauner to State employees, January 15, 2016.
[24] For more information on interest penalties on health insurance claims, see p. 45 of this report.
[25] Group health insurance bills can be paid out of future year appropriations under an exception to Section 25 of the State Finance Act, 30 ILCS 105/25 (b-4).
[26] Commission on Government Forecasting and Accountability, *FY2017 Liabilities of the State Employees' Group Health Insurance Program*, March 2016, p. 11.
[27] Public Act 93-660, enacted on February 2, 2004.

for cash flow problems resulting from timing variations between receipt and disbursement of funds in a given fiscal year.[28]

The Civic Federation has recommended that the State establish greater long-term reserves in an adequate rainy day fund. Eliminating the Budget Stabilization Fund would be a step in the wrong direction and would also further reduce the State's access to cash-flow borrowing from the fund in future fiscal years.

Building a financial cushion to deal with future economic downturns is a key element in restoring the State to fiscal stability. Although Illinois has not fully recovered from the Great Recession, the risk of the next economic decline is already being factored into State revenue projections.[29]

According to public finance experts, all governments should place a portion of their general operating revenues in a general fund reserve or "rainy day" fund.[30] Rainy day funds are savings accounts that governments can use to address revenue shortfalls or unanticipated expenditures and to help stabilize tax rates. Governments that maintain adequate reserves are better positioned to deal with funding issues in bad times. Putting money into reserves is a more fiscally prudent action than spending surplus funds on new or expanded programs.

The adequacy of reserves is one of the factors considered by credit rating agencies in assessing a state's financial condition. In downgrading Illinois' bond rating in October 2015, Fitch Ratings cited the State's inability to grow reserves during an economic expansion as one reason for its vulnerability to the next economic downturn.[31]

In 2014 the Commission on Government Forecasting and Accountability (COGFA) concluded that raising the funding goal to 10.0% of General Funds revenues from 5.0% made sense in light of recent revenue volatility.[32] COGFA examined two funding strategies—making deposits into the fund only when revenues are growing rapidly or making regular deposits regardless of revenue growth—and determined that each presented challenges. While funding mechanisms that depend on excess revenues can have wide variations in annual funding, regular funding puts annual pressure on the budget.[33]

The Civic Federation supports COGFA's suggestion to establish a funding goal for a rainy day fund of 10% of General Funds revenues. This target should be part of a long-term budget plan to stabilize the State's current finances, pay down the backlog of unpaid bills and establish reserves to prevent similar crisis during times of economic difficulty.

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[28] Commission on Government Forecasting and Accountability, *Revenue Volatility Study, Public Act 98-0682*, December 31, 2014, p. 88.
[29] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, pp. 5-6.
[30] Government Finance Officers Association, *Best Practice: Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund*, October 2009.
[31] Fitch Ratings, "Fitch Downgrades Illinois' GO Rating to 'BBB+'; Outlook Revised to Stable," *news release*, October 19, 2015.
[32] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study Public Act 98-0682*, December 31, 2014, p. 99.
[33] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study Public Act 98-0682*, December 31, 2014, p. 103.

Proposed Changes to the Community Care Program

The recommended FY2017 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. The FY2017 budget recommends that the cost of the program be reduced by $197.6 million, or 19.1%, from a projected $1.0 billion.

Under the proposal, the Community Care program would cover 45,800 seniors who are eligible for Medicaid and cost a total of $608.7 million. Average monthly care costs, not including administrative costs, are estimated at $873 per person.[34] The new Community Reinvestment Program would enroll 43,700 seniors who are not eligible for Medicaid at a total cost of $228.4 million. Services for those individuals are projected to cost an average of $400 per month, less than half of the rate for participants in the Community Care Program.

Many advocates for the elderly have opposed the plan, saying it would result in expensive emergency room visits and increased admissions to nursing homes at higher cost to the State.[35] Details on the kinds of services that would be available at such significantly reduced costs have not been made available to the public.

The administration also proposed cutting the cost of the program in the recommended FY2016 budget. That plan, which would have raised the standard for elderly individuals to qualify, was dropped after protests from advocates.[36]

Although the State should pursue efficiencies in this growing program, changes should be undertaken in a deliberate and transparent way. It remains to be seen whether the current proposal is consistent with the administration's announced goal of shifting State resources from institutional to community care.[37]

One-time Resources

The Civic Federation is concerned that the Governor's recommended FY2017 budget depends on several one-time resources to pay 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 making investments in critical capital improvements.

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[34] Illinois State FY2017 Budget, p. 258.
[35] House Human Services Appropriations Committee, hearing on April 27, 2016, http://livestream.com/blueroomstream/events/5274073 2, 2016).
[36] Kim Geiger, "Rauner reverses course on cuts to child care, disability services," *Chicago Tribune*, November 9, 2015.
[37] Illinois State FY2017 Budget, p. 56.

A total of $915 million in one-time resources are included in the FY2017 measures used to reduce the $6.6 billion starting operating shortfall to the $3.5 billion operating shortfall included in the Governor's recommended budget.

Two sources of revenue, $200 million from the sale of the James R. Thompson Center and $276 million from spending down the entire balance of the Budget Stabilization Fund, are included in the Governor's revenue estimates for FY2017. As stated above, the Civic Federation opposes spending the entire balance of the Budget Stabilization Fund, which serves as the State's reserve fund and has been available for cash-flow borrowing in previous years.

It is uncertain if the revenue from the future sale of the Thompson Center would be available in FY2017 or how much the State would receive for the property. In the event that the sale is completed and the revenue becomes available, these funds should be used to pay down the backlog of bills or invest in capital improvements, not to prop up the operating budget.

The Governor's recommended FY2017 budget also reduces estimated expenditures by proposing the elimination of the requirement that the State fully repay $454 million of interfund borrowing that was authorized in FY2015.[38] By reducing nearly all of the interfund borrowing repayment, the Governor's proposed budget increases available resources by $439 million in FY2017, essentially treating the funds used in FY2015 as sweeps.

In the past the Civic Federation has recommended that the State use fund sweeps to help consolidate and eliminate any of the State's 550 Special Funds that do not serve a critical purpose. The Federation supports the use of these resources to stop the growth in unpaid bills or to pay down other liabilities. However, the Federation is concerned that in the absence of other sustainable revenue sources, using these funds to reduce the budgetary shortfall in FY2017 will lead to ongoing deficits in future fiscal years.

Civic Federation Recommendations

The Civic Federation recommends the following measures for the State of Illinois' FY2017 budget to address the State's current fiscal crisis and to provide for its sustainable long-term financial health. These recommendations were proposed in the Federation's FY2017 State budget roadmap report, which was issued on February 11, 2016.[39]

Comprehensive Balanced Budget

The Civic Federation recommends that the Governor and the General Assembly enact a comprehensive budget plan for FY2017 that includes appropriations to cover the cost of all areas of State government and the necessary resources to balance those expenditures. The State should not approve separate appropriations for any individual areas of spending or programs for FY2017 in the absence of a comprehensive balanced budget.

The Governor and General Assembly must not repeat the action taken in FY2016 to approve funding for early childhood, elementary and secondary education only. Although the Governor has

[38] For more details about interfund borrowing, see p. 32 of this report.
[39] The Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2017 Budget Roadmap: State of Illinois Budget Overview, Projections and Recommendations for the Governor and General Assembly*, February 11, 2016, https://www.civicfed.org/sites/default/files/ReportRoadmapFY2017.pdf (last visited on May 2, 2016).

requested that a budget for P-12 education be approved immediately as a priority area of spending for FY2017, the Civic Federation disagrees with this proposal.

As shown in this report, the lack of a balanced annual budget with sustainable long-term resources has put the State in the unprecedented situation of developing a financial plan for the new budget year without having enacted a budget for the previous year. By approving P-12 education spending for FY2016 without a full budget, much of the public pressure to address the State's full budgetary needs within a reasonable timeframe was relieved.

Without a full budget, State vendors do not know when or if they will be paid, residents cannot be sure that State services will continue to be delivered and taxpayers do not know how much they will eventually need to pay to fund State government. Those most affected have included low income college students who depend on State scholarships, social services providers who have not been paid since July 1, 2015 and residents who no longer have access to State-funded services such as day care for the elderly and community programs to keep non-violent offenders out of prison.[40]

The loss of revenues associated with the temporary income tax expiration halfway through FY2015 is at the center of the budget crisis. From the peak year FY2014, the last full year of the increased income tax rates, to FY2016, the first full year of the lower rates, the State's operating revenues declined by an estimated $5.1 billion, a 13.8% loss.

Despite having four years to prepare for the rollback of the income tax rates enacted in 2011, the State did not take action to reduce spending levels to the amount that would be lost from the income tax rate reduction, balance the budget by raising additional tax revenue or a combination of both.

During the years that the higher income tax rates were in place, the State was limited in its ability to reduce its total operating costs due to a massive increase in its annual pension costs. Under current law, Illinois' General Funds contributions to the State's five retirement systems are expected to total $6.9 billion in FY2017. This represents 24.7% of projected State-source revenues of $28.1 billion.[41]

Although Governor Rauner and the General Assembly were able to balance the FY2015 budget during that fiscal year through a series of one-time measures, no action has been taken to address the revenue loss in FY2016 even as the State enters the eleventh month of the fiscal year. Due to this inaction, the budget proposed by the Governor for FY2017 is also unbalanced.

The State currently anticipates an increase in the backlog of unpaid bills to more than $9.0 billion at the end of FY2016. Combined with the budget shortfall of more than $3.5 billion in FY2017, the State faces the continued financial collapse of government infrastructure and the loss of essential public services.

The State can no longer wait to take action to balance its operating budget. The Civic Federation continues to recommend the following measures as part of a comprehensive budget plan to balance the State's annual operating budget and begin to significantly pay down its multi-billion dollar backlog of bills within the next several budget years.

[40] For more details on impact of the budget impasse, see p. 41 of this report.

[41] Total General Funds pension costs in FY2017—including debt service payments of $1.6 billion on previously issued pension bonds—are $8.5 billion, or 30.4% of State-source revenues.

Revenue Losses from Income Tax Reduction

The Civic Federation recommends the State of Illinois reinstate the higher income tax rates of 5.0% for individuals and 7.0% for corporations in FY2017 to address the revenue losses caused by the 25% rate reduction that went into effect January 1, 2015.

Although in the State of Illinois FY2017 Budget Roadmap, issued in February 2016, the Federation recommended retroactively increasing the income tax rates to address the current year's budget shortfall, it is no longer feasible to administer such a change. As of the date of this report, the State will have entered into the seventeenth month of income tax collections at the lower rates of 3.75% for individuals and 5.25% for corporations and the fifth month of the current calendar year.

Raising the rates retroactively to the beginning of the 2016 calendar year would now be overly burdensome to taxpayers. More than 80% of individuals rely on withholding taxes remitted to the State by employers and a retroactive tax increase would now necessitate a sharp increase in the amount set aside from paychecks to compensate for the months already collected at the lower rates. The Illinois Department of Revenue also reports that administering a retroactive income tax is likely not feasible after six months of collections take place at a lower rate.[42]

By reinstating the higher income tax rates to 5.0% for individuals and 7.0% for corporations on January 1, 2017, the State can offset a large portion of the deficit in the coming year but cannot balance it entirely. The total revenue produced from the higher rates would only take effect for the second half of FY2017, greatly reducing the additional revenues. Based on the revenue projections in the FY2017 budget, increasing the rates halfway through the fiscal year could bring in approximately $3.0 billion, of which $2.6 billion would come from the individual income tax and $432 million from the corporate income tax. These amounts would double in the year following and increase due to underlying economic activity, allowing for a reduction in the unpaid bills in FY2018.

In light of the worsening financial crisis, the State is no longer in a position to continue the reduced tax rates. In addition, due to recent rulings by the Illinois Supreme Court the State can no longer expect to dramatically reduce its growing pension liability. The State's current statutory funding plan necessitates additional resources be available to make larger pension contributions each year to achieve 90% funding by FY2045.[43] In order to cope with growth in pension costs without crowding out other budget priorities, the State cannot afford to enact temporary rates and should anticipate the need for growing resources for the foreseeable future.

Retirement Income Exemption

The Civic Federation recommends that the State of Illinois broaden its income tax base by eliminating the tax exemption for retirement income, excluding Social Security income and all retirement income from individuals with taxable income of less than $50,000. This will enhance the State's fiscal stability by providing access to a faster growing portion of the State's income tax base to balance the operating budget and pay down its backlog of bills.

Unlike the federal government, which taxes certain levels of Social Security benefits and other retirement income, Illinois exempts all retirement income from the State's income tax base.[44] Out of

[42] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.
[43] See Appendix B on p. 85 for more details on the State's statutory pension funding plan.
[44] 35 ILCS 5/203.

the 41 states that impose an income tax, Illinois is one of only three that exempt all pension income and one of 27 that exclude all federally taxable Social Security income.[45] The Illinois Comptroller reports that this exemption of federally taxable retirement income reduced individual income tax revenues by $2.3 billion in FY2015.[46] The cost of this exemption will increase over time due to a population shift in Illinois, with the number of senior citizens expected to grow from 1.7 million in 2010 to 2.7 million by 2030.[47]

Excluding Social Security income, all other federally taxable retirement income exempted by Illinois as of 2012 totaled $39.7 billion.[48] **If income from individuals with a total adjusted gross income of less than $50,000 were also excluded from this tax base**, the total untaxed income in Illinois totaled an estimated $30.8 billion in FY2012. Historically, the retirement tax base grows at a much higher annual rate than regular income. Retirement income in Illinois has grown at an average annual rate of 6.0%, while revenue from the individual income tax has averaged only 2.7% growth over the last 15 years.[49] Including the high growth portion of the income tax base from retirement income would provide for a more sustainable revenue source for the State ranging **between $1.5 billion and $2.0 billion annually**.

Similar to the income tax increase discussed above, this change in tax policy could only take effect after January 1, 2017, to align with federal income tax collections. The delay in action would reduce the available revenues by half of the estimated totals.

Expanding the Sales Tax Base

The Civic Federation recommends that the State of Illinois expand the sales tax base to include a new general consumer services tax while strictly excluding all business-to-business services and excluding medical, financial and legal services. The State should also temporarily suspend the sales tax exemption for food and nonprescription drugs to generate additional revenue immediately needed to balance the State's budget and keep its backlog of bills from growing. Once the sales tax on services is implemented and the State's backlog of bills is eliminated, the sales tax exemption for food and nonprescription drugs could be reinstated.

The scope of Illinois' fiscal crisis is so large that raising income taxes and broadening the income tax base alone would not be enough to stabilize the State's finances. The second largest State revenue source is the sales tax, but sales tax rates across the Illinois are already too high to allow for an increase in the State rate. For example, the combined sales tax rate in the City of Chicago is highest of any major municipality in the United States at 10.25%. The State charges 6.25 percentage points,[50] and the remaining 4.0 percentage points are charged by local taxing authorities. The State keeps 5 percentage points of the tax and passes through the remaining 1.25 percentage points to county and municipal governments

[45] Chicago Metropolitan Agency for Planning, *Charting Progress Toward a More Efficient Regional and State Tax System via Indicators*, July 18, 2013. http://www.cmap.illinois.gov/about/updates/-/asset_publisher/UIMfSLnFfMB6/content/charting-progress-toward-a-more-efficient-regional-and-state-tax-system-via-indicators (last visited February 5, 2015)
[46] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2015*, April 2016, p. 6.
[47] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2013*, April 2014, p. 7.
[48] Internal Revenue Service, SOI Tax Stats – Historic Tables, Illinois 1999-2012. http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2 (last visited on February 7, 2015)
[49] Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study, Public Act 98-0682*, December 31, 2014, p. 23.
[50] The State retains 5.0 percentage points to fund its operations while passing along the remaining portions to county and local governments.

While a sales tax rate increase is not prudent, the State could examine broadening the sales tax base to generate additional revenue. According to a revenue study issued by the Commission on Government Forecasting and Accountability, Illinois' sales tax base is much narrower than other states leading to greater volatility and higher rates.[51]

The State currently provides sales tax exemptions and refunds totaling $3.7 billion that would otherwise be available to fund its operations.[52] The largest exemption from the sales tax is the exclusion of food and drug purchases from the full State rate of 6.25%. This exemption reduced the State's sales tax revenues by $1.9 billion annually as of FY2015.[53]

Illinois also excludes services from its sales tax base, with the exception of several public utility taxes. In recent years, a variety of revenue estimates have been produced to illustrate the range of revenue the State could receive if it were to broadly apply the sales tax to all service transactions or more narrowly tailor a list of specific services to be taxed.

Any taxation of services is expected to be controversial and draw intense opposition and legal challenges from a variety of special interest groups. In the past, attempts to add individual services to the current sales tax laws, which are made up of the Retailers' Occupation Tax, Service Occupation Tax, Service Use Tax and Use Tax, have been challenged in court. According to information provided by the Illinois Department of Revenue (IDOR), the Illinois Supreme Court's ruling in at least one case could prevent individual services from being added to the current sales tax laws incrementally due to the Illinois Constitution's uniformity clause.[54]

The Civic Federation therefore recommends creating a new consumer services sales tax so that the State could more efficiently broaden its tax base while avoiding business-to-business services taxation, which could lead to tax pyramiding.

The most recent estimates show that the broadest taxation of all service purchases, including personal and business-to-business transactions, could produce revenues totaling $9.3 billion, or $4.1 billion if business-to-business transactions are excluded.[55] However, medical services, professional services and legal services typically are not subject to sales taxes in most states. **A narrower application of the sales tax on services that excludes all business-to-business transactions, medical services and professional services, directed at taxing only general consumer services would increase annual General Funds revenue by an estimated $956 million once fully implemented**.[56]

If enacted, it should be expected that the new State revenues from the additional categories would be delayed for at least two years to allow for implementation.[57]

Unlike the new tax on consumer services, taxing food and drug purchases could immediately bring in additional revenue to the State. Food and drug purchases in Illinois are taxed statewide at a rate of 1.0% but are exempt from the 5.0% rate collected for the State and additional 0.25% rate

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[51] Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study, Public Act 98-0682*, December 31, 2014, p. 66 (See Appendix E on p. 91 for a regional comparison to other states).
[52] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2015*, April 2016, p. B-1.
[53] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2015*, April 2016, p. B-1.
[54] Fiorito v. Jones, 39 Ill.2d 531, 236, N.E. 2d 698 (Ill. 1968).
[55] Communication between the Civic Federation and Illinois Department of Revenue, January 19, 2016.
[56] Communication between the Civic Federation and Illinois Department of Revenue, January 19, 2016.
[57] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.

collected by the State but passed through to local governments.[58] The exemption for food purchases makes up approximately $1.0 billion of the State's tax expenditure. Drugs and medical devices make up the remaining $700 million with non-prescription drugs making up roughly 7.5% of that total.

Although very few States apply their full sales tax rate to food purchases and prescription drugs, most do not exempt nonprescription drugs.[59] While it is a commendable intention to reduce the cost of food and drugs to low income residents of Illinois by exempting those items from sales taxes, such relief is not targeted to low income residents and is provided for all food and drug purchases. As the State faces huge deficits and a backlog of unpaid bills, it cannot currently afford this generous tax expenditure. By eliminating the exemption for food and over-the-counter drugs and applying the full 6.25% sales tax rate to those purchases, the State could bring in much-needed revenue immediately from its 5% portion of the rate and provide some additional resources to local governments by expanding their portion of the sales tax by 0.25% from their current 1.0% distribution.

It is important to note that low income residents who qualify for federal food and nutrition assistance, such as the Supplemental Nutrition Assistance Program and the Women, Infants, and Children program, do not pay sales taxes on food purchased through these programs. The State can also consider increases in programs directly focused on assisting low income residents such as the Earned Income Tax Credit to help mitigate the additional cost from the elimination of the exemption.

Control Spending and Pay Down Bills

The Civic Federation recommends that the State of Illinois limit spending within its resources to reduce the growth in the backlog of unpaid bills and create surpluses in future years to completely pay down these accumulated liabilities.

Due to the delay in action to balance the FY2016 budget or enact resources in time for a full year of income tax collections in FY2017, it is likely the State's backlog of bills will grow in both years. It is essential that the State limit spending increases to reduce this growth and allow for a significant payment of bills in FY2018 once a full year of tax collections at the higher rate is possible.

According to the Governor's recommended budget, the State's backlog of unpaid bills is projected to grow from $5.2 billion at the end of FY2015 to $9.3 billion at the end of FY2016 and remain at that level in FY2017 if the $3.5 billion operating deficit is eliminated. The FY2017 backlog could reach $12.8 billion if the gap is not closed and $15.9 billion at current spending levels.

Even if the Governor and General Assembly authorize the difficult revenue increases recommended by the Civic Federation, the projected bill growth through the end of FY2017 would only be reduced by approximately $4 billion to $5 billion. This would still leave the State in a financially precarious condition. In order to ensure financial stability, the State must limit spending increases to allow for a significant reduction in the backlog of bills in FY2018.

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[58] The 1.0% sales tax on food and drugs benefits municipalities. The Regional Transportation Authority collects 1.25% on food, drugs and medical devices in Cook County and 0.75% in the collar counties of DuPage, Lake, McHenry and Will.

[59] Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study, Public Act 98-0682*, December 31, 2014, p. 23.

Pension Recommendations

The State of Illinois has a total unfunded public employee pension liability of $111.0 billion[60] 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.

In May 2015 the Illinois Supreme Court struck down a pension law that reduced State retirement benefits for retirees and existing workers, ruling that the measure violated the Illinois Constitution's stringent pension protection clause.[61] The high court reaffirmed that opinion in March 2016 when it rejected a law intended to stabilize two Chicago pension funds by reducing benefits while increasing funding.[62]

In light of the recent rulings, the Civic Federation recommends the following actions with respect to State and local pensions.

<u>Constitutional Amendment Limiting the Pension Protection Clause</u>

In the interest of protecting the future solvency of Illinois' pension funds and stabilizing the State's finances, the Civic Federation recommends that the General Assembly approve an amendment to the Illinois Constitution. The proposed amendment should specify that the pension protection clause applies only to accrued benefits, giving lawmakers the discretion to make adjustments to non-accrued benefits.

The pension protection clause states that "membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."[63] According to the high court, the constitutional protection begins when a worker is hired, and any subsequent changes to pension law that diminish benefits may not be applied to that employee.

This has left the State unable to reduce benefits that were in place when current employees were hired – even though the State has been hard pressed to afford that level of benefits, jeopardizing essential government services and the solvency of the pension funds. Under current law, Illinois' General Funds contributions to the State's five retirement systems are expected to total $6.9 billion in FY2017. This represents 24.7% of projected State-source revenues of $28.1 billion.[64]

In the early 1900s, state courts considered pensions to be gratuities from the government that could be changed or repealed at any time. This legal approach changed over time in most states to provide more protection to employees. Most pension benefits are now covered by contract or property rights theories that generally protect previously accrued benefits. The protection of benefits that are not yet accrued varies significantly by state. In general, this means that legal protections are strongest

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[60] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2015*, March 2016, p. 25. This figure is based on the market value of assets. The total is $112.9 billion based on the smoothed value of assets.
[61] In re Pension Reform Litigation, 2015 IL 118585, May 8, 2015.
[62] Mary J. Jones et al. v. Municipal Employees' Annuity and Benefit Fund of Chicago et al., 2016 IL 119618, March 24, 2016.
[63] Illinois Constitution, Article XIII, Section 5.
[64] Total General Funds pension costs in FY2017—including debt service payments of $1.6 billion on previously issued pension bonds—are $8.5 billion, or 30.4% of State-source revenues.

for current retirees. Even for current retirees, however, some courts have provided lesser levels of protection for cost of living adjustments.

Illinois is considered to have among the most stringent pension protections. It is one of a handful of states, including New York and Arizona, with specific constitutional provisions barring benefit reductions.

Amending the Illinois Constitution requires a three-fifths vote of each chamber of the legislature. An approved proposal may be put on the ballot at the next general election that occurs six months after the General Assembly vote and requires the approval of three-fifths of those voting on the issue.[65]

Given the early May deadline for approval, the General Assembly has most likely missed the chance to put the amendment on the ballot at the November 8, 2016 general election. The next opportunity is the general election scheduled for November 2018.

Supplemental Pension Payments

The Civic Federation recommends that the State mitigate the impact of its inadequate statutory funding plan by making supplemental payments corresponding to the reduced debt service obligations related to retiring Pension Obligation bonds beginning in FY2019. The supplemental payments would continue until all five retirement systems are 100% funded.

In recent years, Illinois has consistently ranked as the state with the worst funded retirement systems.[66] The growth in the unfunded liability is largely attributable to inadequate State contributions under the current 50-year funding plan, which began in FY1996. The plan and subsequently enacted changes deferred a large portion of required State contributions to later years. Under existing law, the unfunded liability does not peak until FY2029, after which it begins a steady decline.[67]

Under the pension reform law that was rejected by the Illinois Supreme Court in May 2015, the State would have moved to an actuarially based 30-year funding plan and made supplemental contributions to achieve 100% funding even sooner.[68] Due to the current fiscal crisis, it is impossible for the State to generate the funding necessary to increase pension funding until its operating budget is stabilized. However, a portion of the supplemental payment plan included in the pension reform law could still be affordable and would put the State on track to reach 100% funding within the next 30 years.

The State sold Pension Obligation bonds in FY2010 and FY2011 totaling $7.2 billion to make its annual contributions to the retirement systems. The annual debt service for these bonds totals more than $1.0 billion until the final payment of $365 million is made in FY2019. The State could make supplemental payments based on these debt service savings totaling $364 million in FY2019 and $1.0 billion annually thereafter until FY2045 or when the systems are all 100% funded.

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[65] Illinois Constitution, Article XIV, Section 2(a).
[66] Bloomberg, "State pension funding levels rise across U.S.—except you-know-where," *Crain's Chicago Business*, October 13, 2015.
[67] Commission on Government Forecasting and Accountability, Illinois State Retirement Systems Financial Condition as of June 30, 2015, March 2016, pp. 99-138.
[68] Public Act 98-0599, enacted on December 5, 2013.

Based on current actuarial estimates, if the State made similar supplemental payments starting in FY2019 the State's retirement systems would experience a decline in unfunded liabilities beginning in FY2025 and would be 100% funded by FY2043.[69]

Chicago and State Teachers' Pension Funding Reform

The Civic Federation recommends that the Chicago Teachers' Pension Fund (CTPF) be consolidated with the Teachers' Retirement System (TRS) and that the State assume responsibility for the unfunded liability of CTPF. The Federation also recommends that the Chicago Public Schools continue to pay for the normal cost of Chicago teachers' pensions and that responsibility for the normal cost of pensions for teachers outside of Chicago be shifted from the State to local school districts over three years.

Consolidating CTPF and TRS would eliminate the current inequitable funding structure under which Chicago taxpayers pay for both nearly the entire cost of Chicago teachers' pensions as well as downstate and suburban teachers' pension costs. It would achieve some cost efficiencies as duplicative functions were eliminated.

Under a consolidation plan, the CTPF and TRS systems would be managed by a single pension board with representation for all teachers' pension funds. However, the current separate member plans would be maintained. The State of Illinois would assume responsibility for the unfunded liability of CTPF, while CPS would continue to fund the pension fund's normal cost (the annual cost of the pension plan's benefits).

Adjusted for the fact that CPS makes its contribution at the end of the fiscal year, the employer normal cost for FY2015 was $145.7 million. State assumption of the CTPF unfunded liability would have reduced CPS' FY2015 required contribution by approximately $488 million, which would help to stabilize the district's finances.

The current situation in which local school districts have the power to incur expenses while the State of Illinois must pay those expenses is unsustainable and fiscally reckless. State taxpayers should not be required to pay the operating cost of local governments. Instead, all school districts in Illinois should assume funding the full normal cost of their employee pensions. The responsibility for contributing to a worker's pension should rest with the employer who determines the worker's salary. The shift would help inject greater fiscal accountability into school district operations and budgeting and would eventually offset the additional cost of the State taking on the unfunded liability of Chicago teachers' pensions.

The State currently pays approximately $800 million of the annual normal cost of TRS pensions, with school districts covering about $85 million.[70] The shift could be achieved gradually, over a period of three years, to allow school districts sufficient time to adjust to the change. To help pay for the normal cost of teachers' pensions, school districts could end the practice of paying or "picking up" all or a share of the annual 9.4% employee pension contribution.

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[69] See Appendix A for estimates of the impact of supplemental payments on the total unfunded liability and combined funded ratio.

[70] Teachers' Retirement System of the State of Illinois, *Actuarial Valuation Report, June 30, 2015 Actuarial Valuation of Pension Benefits*, January 7, 2016, pp. 28-29 and 70-71. The school district share includes administrative expenses of approximately $24 million.

It is reasonable for the State of Illinois to continue to assume financial responsibility for the unfunded liability of all school districts because:

- The State created the current expensive and unsustainable situation that has led to $62.7 billion in unfunded liability and a funded ratio of 42.0% for TRS as of June 30, 2015[71] and $9.6 billion in unfunded liability and a funded ratio of 52.0% for CTPF;[72] and
- Paying these enormous costs is beyond the capability of local school districts to readily absorb. This is particularly the case because they rely heavily on property taxes to fund their operations and many are under the property tax extension limitation law (PTELL), which limits levy increases to 5% or the rate of inflation, whichever is less.

Increase the Earned Income Tax Credit

The Civic Federation recommends mitigating some of the impact on lower income residents of the tax measures included in its comprehensive plan through an immediate 50% increase to the amount of the federal earned income tax credit (EITC) matched by the State of Illinois.

The federal EITC is a benefit provided to working individuals with low and moderate incomes. The credit reduces tax liabilities based on income level and household size and can be claimed as a refund if the credit exceeds tax liabilities.

As of 2015, single individuals claiming no dependents and income less than $14,820 could claim a maximum federal credit of $503 and married individuals without children could claim the same credit if their annual income was below $20,330. For a married couple with three or more children and an income of $53,267 or less, the maximum credit that could be claimed was $6,242. Single individuals with three or more children may also claim the highest credit level of $6,242 with an income of $47,747 or less.

Illinois currently matches 10% of the federal credit, which cost the State an estimated $234.0 million in FY2015.[73] If the credit was increased by 50%, payments would increase by $624 for the highest level of benefits available to married individuals with three or more dependents.

Local Government Revenue Sharing

In light of the financial pressures facing Illinois municipalities, the Civic Federation recommends the State provide the full 10% share of the income taxes to local governments and allow local governments to access the additional tax base expansions proposed for sales taxes.

The City of Chicago and many other local governments in Illinois are facing financial pressure due to severely underfunded pensions. Local governments did not share in the additional revenues collected by the State due to the 2011 temporary income tax rate increases. In enacting the tax increases, the State limited the previous 10% share of net income taxes distributed to local

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[71] These figures are based on asset smoothing. The unfunded liability was $61.7 billion and the funded ratio was 42.9% based on the market value of assets. For more information, see Teachers' Retirement System of the State of Illinois, *Actuarial Valuation Report, June 30, 2015 Actuarial Valuation of Pension Benefits*, January 7, 2016, p. 28.
[72] These figures are based on asset smoothing. The unfunded liability was $9.2 billion and the funded ratio was 53.7% based on the market value of assets. For more information, see Public School Teachers' Pension and Retirement Fund of Chicago, *Actuarial Valuation and Review as of June 30, 2015*, December 9, 2015, p. iv.
[73]Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2015*, April 2016, p. B-1.

governments to only the original 3.0% individual income tax rate and 4.8% corporate income tax rate.[74] This change maximized the revenues available to the State as it attempted to recover from the Great Recession.

Going forward, the State should try to share additional revenues with local governments in light of their financial distress. The Federation's recommended comprehensive budget offers the following benefits for local governments:

- Tax on retirement income: Local governments should receive revenues generated by the proposed elimination of the State's exemption for retirement income;

- Expansion of sales tax to services: The State's general sales tax rate of 6.25% would be applied to certain services. The State keeps 5% of the purchase price and the remaining 1.25% is paid to local governments. In addition, the Civic Federation's recommends that local governments be permitted to levy a municipal sales tax on services; and

- Tax on food and non-prescription drugs: The State's general sales tax rate of 6.25% does not apply to food and drugs; instead, the State taxes these items at 1.0% and distributes the proceeds to municipalities. The Civic Federation's recommendation would tax food and non-prescription drugs at the general sales tax rate until FY2020. As a result, municipalities would receive a 1.25% share, rather than 1.0%.[75] In addition, local governments should be permitted to expand the municipal sales tax to food and non-prescription drugs.[76]

Retailer's Discount

The Civic Federation recommends that the State of Illinois cap the retailer's discount at $200 per month for each retailer to recoup revenue that the State cannot afford to give up in light of its financial condition.

Illinois is one of 28 states that offer a retailer's discount, also known as a vendor discount or vendor collection allowance.[77] The retailer's discount is the percentage of sales tax due on a transaction that retailers are allowed to retain as reimbursement for collecting sales taxes and remitting them to the state.[78]

Illinois' retailer's discount of 1.75%, with no monthly limit, has been the third highest in the U.S., behind Colorado at 3.3% and Missouri at 2.0%.[79]

Among other neighboring states, Indiana and Kentucky have bracket systems with the highest rate applying to the smallest collection amounts.[80] Indiana's rates range from 0.26% to 0.73%, and

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[74] Income tax revenues are distributed to local governments through a transfer out of General Funds to the Local Government Distributive Fund. See 35 ILCS 5/901(b).

[75] For the City of Chicago, this could result in an increase in revenue of approximately $7.6 million a year based on current tax collections on food and drugs by the Regional Transportation Authority. The RTA collects a 1.25% tax on food and drugs in Cook County.

[76] At Chicago's local sales tax rate of 1.25%, this could generate approximately $37.9 million per year for the City.

[77] Federation of Tax Administrators, State Sales Tax Rates and Vendor Discounts, January 1, 2016, http://www.taxadmin.org/assets/docs/Research/Rates/vendors.pdf (last visited on February 5, 2016).

[78] For example, for a purchase of $100 with a state sales tax rate of 6.25%, sales taxes are $6.25 and the retailer is allowed to keep 11 cents ($6.25 x 1.75%).

[79] Illinois General Assembly, Tax Policy Subcommittees, Joint Revenue & Finance and State Government Administration Committees, *Report on Findings*, May 28, 2014, p. 13.

Kentucky's range from 1.5% to 1.75% with a maximum of $50 per month. Wisconsin has a rate of 0.5% with a $1,000 monthly maximum and Iowa does not offer a retailer's discount.

The retailer's discount in Illinois is expected to cost the State approximately $125 million in lost revenue in FY2016, according to the Illinois Department of Revenue.[81] If the amount of sales tax kept by each retailer were capped at $200 per month, the State would save about $85 million over 12 months. The Department of Revenue estimates that this action would only affect the largest five percent of retailers.

At a time when Illinois' financial condition has required cutbacks to essential services, the State cannot afford to provide this generous reimbursement to retailers. Illinois' retailer's discount is high compared with other states. Capping the amount of reimbursement would be preferable to lowering the rate because it would minimize the impact on small retailers.

Tax and Budget Reforms

Once the State has enacted a comprehensive budget and begins to emerge from its financial crisis, the Civic Federation recommends the General Assembly and Governor should study and reach agreement on fundamental tax and budget reforms to ensure that State government operates efficiently and responsibly. Specifically, the Federation recommends that the following reforms be considered:

- Graduated individual income tax: The permanent income tax rate of 5.0% recommended in the Federation's comprehensive plan 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 without affecting revenues should be considered.[82] Moving from a flat tax rate to a graduated rate structure would require an amendment to the Illinois Constitution;[83]
- Reinstate the food and drug exemption: The Federation's FY2017 roadmap plan included the proposal to apply the State's full sales rate of 6.25% to food and nonprescription drugs, instead of the existing 1.0% tax, which is distributed to local governments. Although this change is needed to help solve the State's financial problems, it moves Illinois out of line with most of its neighbors and could place a disproportionate burden on low income residents;
- Reduce the sales tax rate: Due to combined State and local rates, the City of Chicago has the highest sales tax of any major municipality in the country at 10.25%. Given the broader base that would include general consumer services, the State could consider lowering its rate, thereby providing Statewide tax relief;
- Lapse Period Spending: The lapse period is the period of time after the end of the fiscal year during which the next year's revenues can be used to pay for the current year's bills. Because of the large amount of payables outstanding at the end of the fiscal year, this

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[80] Federation of Tax Administrators, State Sales Tax Rates and Vendor Discounts, January 1, 2016, http://www.taxadmin.org/assets/docs/Research/Rates/vendors.pdf (last visited on February 5, 2016).
[81] Communication between the Civic Federation and the Illinois Department of Revenue, February 3, 2016.
[82] For regional comparison of rates and tax structures to other states, see Appendix E on p. 91.
[83] Illinois Constitution, Article IX, Section 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, 2016*, February 2016, http://www.taxadmin.org/assets/docs/Research/Rates/ind_inc.pdf (last visited on February 9, 2016).

period was extended to December 31 from August 31 beginning in FY2013.[84] The ability to roll bills over into the next year gives the State flexibility during times of financial crisis, but it also undermines responsible budgeting. Once the State pays off its bill backlog, the lapse period should be returned to two months, a reasonable period of time to process and pay late bills; and

- Section 25 Liabilities: The State should phase out the use of Section 25 liabilities and other practices that allow prior year's costs to be paid from the current year's appropriations.[85] An annual budget should reflect that year's costs. The practice of moving costs from one year to the next has allowed the State to disguise budget deficits and avoid development of a structurally balanced budget.

[84] 30 ILCS 105/25(m).
[85] For more information on Section 25 liabilities, see p. 68 of this report.

BUDGET OVERVIEW

The Governor's recommended budget covers FY2017, which begins on July 1, 2016. However, the State still does not have a budget for FY2016, which ends on June 30. As of the publication date of this report, there is no clear end in sight to the FY2016 budget standoff. The prolonged budget impasse 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.

The budget delay has diverted attention from the State's major underlying problem: the continuing mismatch between expenditures and revenues due to required contributions to its dramatically underfunded pension funds and the rollback of income tax rates midway through FY2015. As a result, Illinois' multi-billion dollar backlog of unpaid bills is expected to expand significantly in FY2016.

The proposed budget for FY2017 does not close a projected $3.5 billion operating deficit. Instead, the Governor presented the legislature with two choices for eliminating the gap:

1) Agreeing to key portions of his Turnaround Agenda, which is intended to boost economic growth by making Illinois more appealing to businesses. In that case, the Governor would support unidentified additional revenues that could reach $36.3 billion; or
2) Granting the Governor broad authority to close the gap on his own by making spending cuts to any area of government, with limited exceptions. In that case, spending could be as low as $32.8 billion.

It remains to be seen whether the legislature will take action on either choice.

Meanwhile, the effects of operating without an FY2016 budget are being felt across Illinois by individuals and organizations that have not received any State funding during the impasse. Those most affected have included low income college students who depend on State scholarships, agencies that have been providing social services under State contracts but have not been paid since July 1, 2015 and residents who no longer have access to State-funded services such as day care for the elderly and community programs to keep non-violent offenders out of prison.

This section provides an overview of events leading to the budget impasse, a summary of the Governor's FY2017 budget recommendation and subsequent developments and an examination of the financial and social costs of the standoff.

Path to Budget Impasse

Illinois' overriding fiscal issue in FY2015 was how to deal with reduced revenues caused by the phaseout of temporary income tax rate increases. Income tax rates were raised in January 2011 to offset a steep decline in economically sensitive State revenues related to the Great Recession.[86] Income taxes are the State's main source of General Funds revenue, followed by sales taxes. Individual income tax rates were increased to 5.0% from 3.0% and corporate tax rates were raised to 7.0% from 4.8%.[87] The rate increases were scheduled to roll back to 3.75% for individuals and

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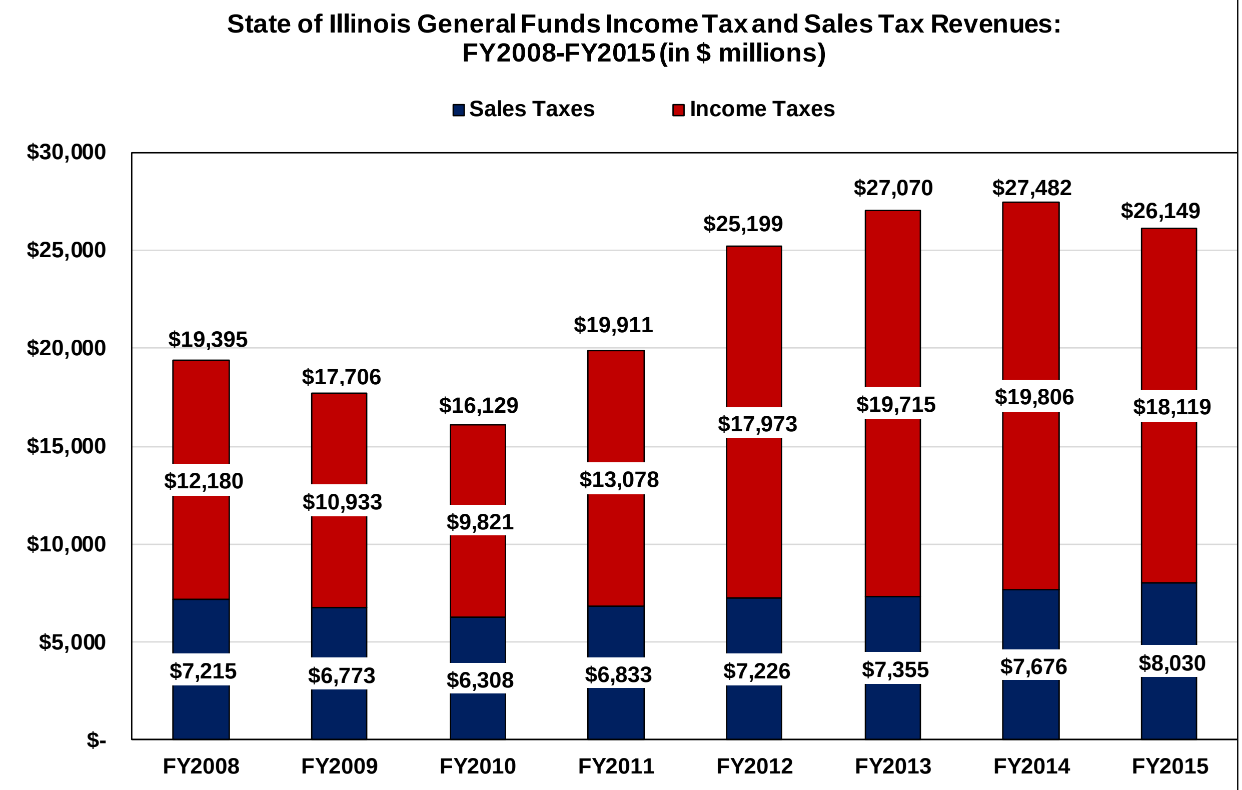
[86] The recession began in December 2007 and ended in June 2009, according to the National Bureau of Economic Research.
[87] Public Act 96-1496, signed on January 13, 2011. In addition to these rates, corporations pay a Personal Property Replacement Tax (PPRT) of 2.5%, which was not affected by the 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.

5.25% for corporations on January 1, 2015 and to 3.25% for individuals and 4.8% for corporations on January 1, 2025.

After the rate increases, income tax revenues more than doubled to $19.8 billion in FY2014 from $9.8 billion in FY2010.[88] Largely as a result of the rate decreases in January 2015, income tax revenues declined by $1.7 billion to $18.1 billion in FY2015. Beginning on February 1, 2015, the law that raised income tax rates also required that a specific share of income tax revenues be diverted from General Funds to provide additional funding for human services and elementary and secondary education.[89]

The following chart shows General Funds income tax and sales tax revenues from FY2008 through FY2015. The chart uses FY2008 as a starting point because it was the first full fiscal year before revenues declined due to the economic downturn.



Source: Illinois General Assembly, Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2016*, August 2015, Updated September 9, 2015, p. 40.

While State tax collections were shrinking due to the recession, statutorily required State pension contributions were accelerating. Since FY1996, State contributions to Illinois' five pension funds

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[88] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary FY2016*, August 2015, updated September 9, 2015, p. 40. The law that temporarily increased tax rates also eliminated the ability of businesses filing as C corporations to deduct net operating losses from their taxable State income, but was amended on December 12, 2011 to allow for up to $100,000 of losses to be deducted.

[89] 35 ILCS 5/901 (f) and (g). The Commitment to Human Services Fund and Fund for the Advancement of Education each receive 1/30 of net income tax revenues from individuals, trusts and estates annually through FY2024; in February 2025 the share increases to 1/26. This requirement diverted $484 million from General Funds in FY2015.

have been based on a 50-year funding plan.[90] After a 15-year phase-in period, the law requires the State to contribute a level percentage of payroll sufficient to bring the retirement systems' funded ratios to 90% by FY2045.[91]

When the funding plan began, the total unfunded liability of the five systems stood at approximately $19.5 billion.[92] By the end of FY2015, the unfunded liability had grown to $111.0 billion, based on the market value of assets, and the combined funded ratio stood at 41.9%.[93] In recent years, Illinois has consistently ranked as the state with the worst funded retirement systems[94] and the largest pension burden relative to revenues.[95]

The growth in the unfunded liability is largely attributable to inadequate State contributions. The funding plan and subsequently enacted changes deferred a large portion of required State contributions to later years. Under existing law, the unfunded liability does not peak until FY2029, after which it begins a steady decline.[96]

These problems were exacerbated in FY2006 and FY2007, when the funding law was modified in order to pay less than the statutorily required amounts. As a result, higher contributions were needed in the following three years to complete the 15-year phase-in ramp.[97]

The State issued a total of $7.2 billion in Pension Obligation Bonds to make its General Funds pension contributions in FY2010 and FY2011. Illinois had previously sold $10 billion in pension bonds in 2003 to reduce the unfunded liability and cover the full required contributions in FY2003 and a portion of the required contributions in FY2004.[98]

To reduce pension costs, the State in April 2010 created a two-tier benefits system with a lower Tier 2 level of benefits for workers hired on or after January 1, 2011.[99] These benefit reductions will

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[90] Public Act 88-0593, signed on August 22, 1994. The five retirement systems are the Teachers' Retirement System, the State Employees' Retirement System, the Universities Retirement System, the Judges' Retirement System and the General Assembly Retirement System.

[91] 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.

[92] Commission on Government Forecasting and Accountability, *Report on the 90% Funding Target of Public Act 88-0593*, January 2006, p. i. This figure is based on the purchase price (or book value) of assets. 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.

[93] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Condition as of June 30, 2015*, March 2016, p. 25.

[94] Bloomberg, "State pension funding levels rise across U.S.—except you-know-where," *Crain's Chicago Business*, October 13, 2015.

[95] Matt Dietrich, "Fitch Issues Credit Downgrade; Moody's May Follow; Budget Deadlock, Illinois Pension Debt Cited," *rebootillinois.com*, October 19, 2015.

[96] Commission on Government Forecasting and Accountability, Illinois State Retirement Systems Financial Condition as of June 30, 2015, March 2016, pp. 99-138. The contribution amount that is adequate to keep the unfunded liability from growing consists of the normal cost (the amount needed to cover the present value of benefits earned by system members in each fiscal year) plus interest on the unfunded liability. This contribution, while adequate to prevent growth in the unfunded liability, is not enough to pay down the unfunded liability. See Appendix B of this report for data on projected statutorily required State contributions and unfunded liability from FY2017 to FY2045.

[97] Public Act 94-0004, signed on June 1, 2005. For more information, see State of Illinois, Office of the Auditor General, *Supplemental Digest of Retirement Systems' Audits for the years ending June 30, 2014 and June 30, 2015*, January 12, 2016.

[98] State of Illinois, General Obligation Bonds, Series of January 2016, *Official Statement*, January 15, 2016, p. E-15.

[99] Public Act 96-0889, signed on April 14, 2010.

increasingly reduce the State's required pension contributions in future years, but they did not have a significant impact in the short term because they did not apply to retirees or current employees.

In December 2013 the State enacted a new pension law that significantly lowered its pension obligations by reducing annual benefit increases to retirees and Tier 1 employees upon retirement.[100] The law was scheduled to take effect on June 1, 2014 but was not implemented pending legal challenges by labor unions.

The Illinois Supreme Court struck down the law on May 8, 2015, ruling that it violated the Illinois Constitution's sweeping pension protection clause.[101] That provision establishes membership in a State retirement system as "an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."[102] According to the opinion, the constitutional protection begins when a worker is hired, and any subsequent changes to pension law that diminish benefits may not be applied to that employee.

Under existing law, statutorily required contributions grew to $6.0 billion in FY2015 from $1.56 billion in FY2008. Debt service on previously issued bonds increased to $1.5 billion from $467 million during the same period, bringing total pension-related payments to $7.5 billion from $2.0 billion.

Due to the income tax rate increases, the State has made its pension contributions without borrowing since FY2011. However, other General Funds expenditures not related to pensions have remained approximately flat overall.

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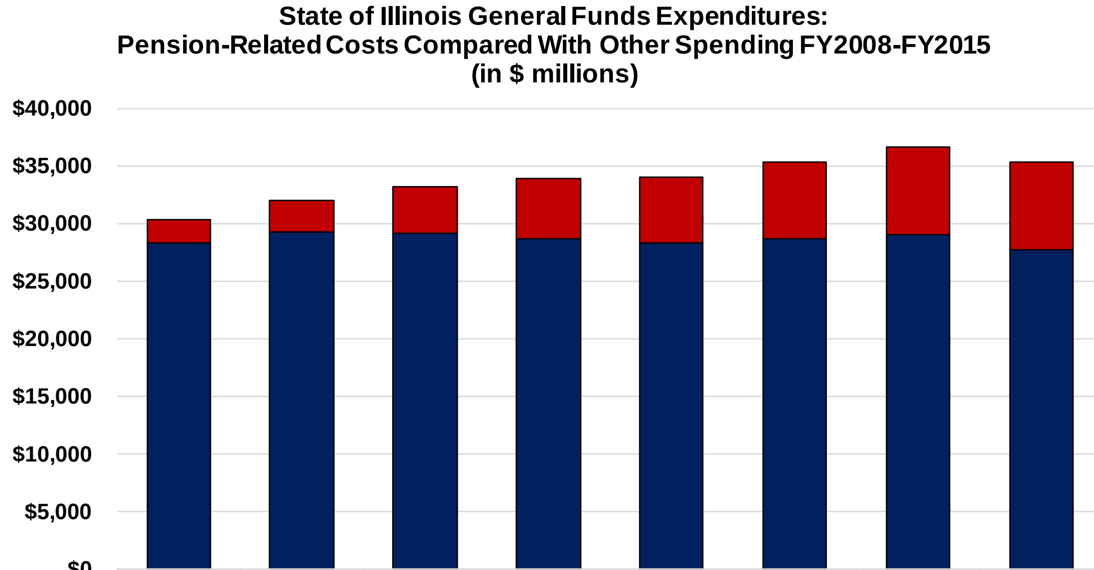
[100] Public Act 98-0599, signed on December 5, 2013. Retirees and Tier 1 employees upon retirement currently receive annual compounded benefit increases of 3%, while Tier 2 employees receive the lesser of 3% or one-half of the increase in the Consumer Price Index on a simple-interest basis. The law also raised retirement ages for younger workers and capped the salary on which pension benefits are based.
[101] In re Pension Reform Litigation, 2015 IL 118585, May 8, 2015.
[102] Illinois Constitution, Article XIII, Section 5.

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. Spending not related to pensions was $27.8 billion in FY2015, a decrease of $560 million, or 2.0%, from $28.3 billion in FY2008.[103]



	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
Total Expenditures	$30,355	$32,059	$33,254	$34,003	$34,097	$35,367	$36,701	$35,346
Pension Costs*	$2,026	$2,757	$4,030	$5,347	$5,742	$6,659	$7,643	$7,577
Other Spending	$28,329	$29,302	$29,224	$28,656	$28,355	$28,708	$29,058	$27,769

* Includes State contributions under existing law and debt service on Pension Obligation Bonds. Pension contributions in FY2010 and FY2011 were made through issuance of bonds and included for purposes of comparabiity.
Source:State of Illinois, General Obligation Bonds, *Official Statements*, January 16, 2016 July 18, 2014, April 10, 2014, February 23, 2011, and January 7, 2010; Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems: Financial Condition as of June 30, 2014*, February 2015, pp. 117-121; Illinois State FY2017 Budget, p. 75.

However, it should be noted that 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 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.[104] In addition, the revenue diversions discussed above resulted in total appropriations of $400 million for education and human services from two other State funds.[105]

[103] Increased spending in FY2009 and FY2010 was supported by federal stimulus funds from the American Recovery and Reinvestment Act of 2009.This analysis does not account for growth in Medicaid spending outside of General funds, primarily resulting from expansion of eligibility under the Affordable Care Act beginning on January 1, 2014. These costs are entirely funded by the federal government through calendar year 2016. Federal reimbursement declines to 95% in calendar year 2017, 94% in 2018, 93% in 2019 and 90% in 2020 and thereafter.
[104] Public Act 98-0642, signed on June 9, 2014.
[105] Public Acts 98-0677 and 98-0680, signed on June 30, 2014.

After adjusting for the advance funding of Medicaid and the spending shift to other funds, General Funds spending not related to pensions increased by $440 million, or 1.6%, from FY2008 to FY2015. The Consumer Price Index rose 9.1% during the same period.[106]

Despite the Medicaid funding shift, the FY2015 General Funds budget was still significantly out of balance when the new administration took over in January 2016. In his recommended budget for FY2015, Governor Pat Quinn, Governor Rauner's predecessor, had proposed that the higher income tax rates not be rolled back.[107] Rather than retaining the higher tax rates or cutting spending, the FY2015 budget passed by the General Assembly underfunded hundreds of millions of dollars in known expenses. It also authorized $650 million in interfund borrowing from accounts outside of General Funds, which had to be repaid in 18 months.[108]

Governor Rauner's proposed budget for FY2016, issued on February 18, 2015, showed that the FY2015 budget was unbalanced by $1.6 billion.[109] The operating deficit was partly due to the new administration's decision not to proceed with interfund borrowing that had been previously authorized.[110] It also reflected a shortfall in projected revenues and the need for supplemental appropriations to cover known costs that were not appropriated in the enacted FY2015 budget.

To close the FY2015 budget gap, the Governor and General Assembly agreed to approximately $1.3 billion in transfers from other State funds.[111] These transfers, known as fund sweeps, are different from interfund borrowing because they do not have to be repaid unless the affected accounts run out of needed resources. Balances in these funds accumulate over time, so the amount of surplus resources available in the near future is considerably reduced by fund sweeps. In addition, the General Funds appropriations of most agencies were cut by 2.25%.[112]

Largely because of the fund sweeps, the General Funds budget had an operating surplus of $1.0 billion at the end of FY2015.[113] The positive results also reflected the decision to do $454 million of interfund borrowing at the end of the fiscal year. As FY2015 ended without a complete budget in place for the next fiscal year, the administration borrowed from other State funds to increase cash reserves despite initial opposition to the practice.[114]

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[106] U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Price Index Detailed Report: Data for December 2015*, p. 73.
[107] 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 January 24, 2016). For FY2015 Governor Quinn proposed both a recommended budget, retaining the higher income tax rates, and a not recommended budget, which allowed the rates to be reduced.
[108] For more information on the enacted FY2015 budget, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois Enacted FY2015 Budget: A Review of the Operating and Capital Budgets for the Current Fiscal Year*, October 9, 2014, https://www.civicfed.org/sites/default/files/REPORT_StateofIllinoisEnactedBudgetFY2015.pdf (last visited on January 24, 2016).
[109] Illinois State FY2016 Budget, p. 3-6. For more information on Governor Rauner's FY2016 budget proposal, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois Recommended Operating and Capital Budgets: Analysis and Recommendations*, May 7, 2015, https://www.civicfed.org/sites/default/files/REPORT-FY2016RecommendedBudget.pdf (last visited on January 24, 2016).
[110] Illinois State FY2016 Budget, pp. 2-2 and 3-3.
[111] Public Act 99-0002, signed on March 26, 2015.
[112] Public Act 99-0001, signed on March 26, 2015.
[113] Illinois State FY2017 Budget, p. 75.
[114] State of Illinois, General Obligation Bonds, Series of January 2016, *Official Statement*, January 15, 2016, p. 21.

The FY2016 budget was even more challenging than FY2015's because it covered the first complete fiscal year with lower income tax rates. Income tax deposits into General Funds are expected to decline by $5.2 billion, or 26.2%, to $14.6 billion in FY2016 from $19.8 billion in FY2014.[115] The decrease also reflects the first full fiscal year of revenue diversions to two other State funds for education and human services, which are expected to total approximately $887 million.[116]

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.[117] Since the FY2012 budget, State law has also required that the Governor's budget proposal be based only on existing revenue sources.[118]

Governor Rauner's FY2016 budget proposal identified spending needs of $38.2 billion based on existing programs and services, compared with available revenue of $32.0 billion.[119] The Governor proposed closing the projected $6.2 billion gap through pension changes and steep spending cuts to most areas of government. The $31.5 billion budget also allocated $500 million to pay down the State's accumulated backlog of unpaid bills.

To achieve the projected savings, the FY2016 budget recommendation relied on a new pension proposal intended to cut the State's required FY2016 General Funds contribution by $2.2 billion.[120] The proposal would not have affected retirees but would have frozen Tier 1 benefits as of June 30, 2015, with benefits thereafter based on the less generous Tier 2 plan. The new proposal was not introduced as legislation and appeared to face very significant legal obstacles after the May 2015 ruling by the Illinois Supreme Court, striking down a previous 2013 reform law.[121]

In addition to pension savings, the Governor's FY2016 budget proposal assumed a reduction of $655 million, or more than a third, in the cost of State group health insurance through collective bargaining. Other budgeted savings depended on changes in State law, required federal approval or were likely to face federal court scrutiny.[122]

Although the budget proposal did not include new revenue, Governor Rauner has said repeatedly that he would consider tax increases if the legislature approved key elements of his Turnaround Agenda for the State.[123] The agenda includes changes in workers' compensation; limits on damages

[115] Illinois State FY2017 Budget, p. 130.
[116] Illinois State FY2017 Budget, pp. 160-161.
[117] Illinois Constitution, Article VIII, Section 2(a). The constitutional requirement does not prohibit carrying over a deficit from one year to the next.
[118] 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.
[119] Illinois State FY2016 Budget, p. 3-6.
[120] Illinois State FY2016 Budget, p. 2-15.
[121] Associated Press, "Illinois Gov. Bruce Rauner says no 'clear roadmap' on pension reform," *Northwest Herald*, May 14, 2015.
[122] For more information on Governor Rauner's FY2016 budget proposal, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois Recommended Operating and Capital Budgets: Analysis and Recommendations*, May 7, 2015, https://www.civicfed.org/sites/default/files/REPORT-FY2016RecommendedBudget.pdf (last visited on January 24, 2016).

[123] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 8.

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.[124] The General Assembly has not considered the Governor's legislation, although it acted on bills involving some of the same issues.[125]

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.[126] 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.[127]

At the end of May 2015, during the final days of the regular spring session, the General Assembly approved a $36.3 billion spending plan for FY2016 with an acknowledged operating deficit of at least $3 billion.[128] The actual gap was closer to $4 billion because Medicaid costs were underfunded by $600 million and the legislative budget relied on the same low number for group health insurance that was in the Governor's budget proposal.[129] Democratic leaders said they were willing to work with the Governor to pass additional revenues.[130]

On June 25, Governor Rauner vetoed virtually all of the General Assembly's spending plan, citing a duty to "protect taxpayers from an unbalanced and therefore unconstitutional budget."[131] A day earlier he had signed the appropriation bill for elementary and secondary education, which ensured that public schools could open on time despite the budget impasse.[132]

The legislature continued to meet after the regular session ended, but there was virtually no progress on the General Funds budget. The Senate voted to override a handful of the Governor's appropriation vetoes, but no action was taken by the House.[133]

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[124] Doug Finke, "Rauner agenda surfaces at Capitol," *The State Journal-Register*, May 22, 2015.
[125] Tina Sfondeles, "House Democrats approve workers' comp changes; Rauner cries politics," *Chicago Sun-Times*, June 4, 2015.
[126] Illinois Constitution, Article VIII, Section 2(b).
[127] Illinois Constitution, Articles IV, Section 10.
[128] Monique Garcia and Kim Geiger, "Illinois Democrats push ahead with budget that's $3 billion short," *Chicago Tribune*, May 26, 2015. The General Assembly projected total General Funds revenues at $33 billion, rather than at $32 billion as in the Governor's recommended budget, because of assumptions about federal revenues related to Medicaid spending. In both the Governor's proposal and the General Assembly's spending plan, total General Funds revenues included revenues required to be diverted for education and human services.
[129] For a summary of the General Assembly's spending plan, see Illinois Senator Heather A. Steans, "I'm disappointed, but there's a better plan," *e-newsletters*, June 2, 2015, http://www.senatorsteans.com/index.php/news/e-newsletters/149-budget-update-im-disappointed-but-theres-a-better-path (last visited on January 31, 2016).
[130] Doug Finke, "Madigan: Democrats will pass their own budget; needs $3 billion in more revenue," *The State Journal-Register*, May 25, 2015.
[131] The spending plan consisted of approximately 20 appropriation bills and related budget implementation legislation. A representative veto message can be found on the General Assembly's website at http://www.ilga.gov/legislation/fulltext.asp?DocName=09900HB4165gms&GA=99&SessionId=88&DocTypeId=HB&LegID=90394&DocNum=4165&GAID=13&Session= (last visited on January 31, 2016).
[132] Public Act 99-0005, signed on June 24, 2015.
[133] Three-fifths of the members in each chamber are required to override a veto. Democrats have a super majority in both chambers, but the margin is wider in the Senate, which has 39 Democrats and 20 Republicans, compared with 71 Democrats and 47 Republicans in the House. The Senate voted to override five of the Governor's vetoes of appropriation bills, but the House did not take action on any of the vetoed appropriation bills.

In August 2015 the legislature passed, and the Governor signed, a bill that allowed the State to spend about $5.2 billion in federal funds for a wide variety of programs.[134] Legislation signed in December authorized the spending of about $3.1 billion in State funds outside of General Funds, including lottery ticket sale proceeds owed to lottery winners and motor fuel taxes due to local governments.[135] Illinois attracted international attention for its decision not to pay lottery participants who won more than $600 until after the State passed a budget.[136]

With no budget in place, the Governor's Office announced a series of administrative actions to control costs.[137] The steps included suspending funding for certain violence prevention and job training programs and delaying the purchase of new forensic equipment by the State Police. The administration also tightened income limits for the State's subsidized child care program for working parents and requested federal permission to raise eligibility requirements for Medicaid-funded community care for the elderly and disabled. However, these actions were subsequently modified or halted after protests from advocates.[138]

Meanwhile, the vast majority of expected FY2016 spending from General Funds has continued, even in the absence of a full budget. The State is authorized or compelled to pay about $31.5 billion from General Funds during the fiscal year, according to documents issued in connection with the State's bond sale in January 2016.[139] That represented approximately 86% of the $36.6 billion that was expected to be spent to complete the year, according to the Governor's Office.[140]

The State is paying for early childhood, elementary and secondary education due to the $6.5 billion appropriation bill signed by the Governor.[141] That bill also includes authority to pay the $3.7 billion statutorily required FY2016 contribution to the Teachers' Retirement System, the pension fund for public school teachers outside of Chicago.

Pension contributions to the other four retirement systems are being made because the State's statutorily required payments to all of its retirement systems are covered by continuing appropriation, the standing authority to make payments in the absence of appropriations by the legislature. Debt service payments and operations of the legislative and judicial branches have also been funded pursuant to continuing appropriations. Certain statutory transfers from General Funds, such as the distribution of income tax revenues to local governments, must be made due to existing statutes.

The State is making 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

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[134] Public Act 99-0409, signed on August 20, 2015. The law also included $166.5 million in State funds outside of General Funds to help the Metropolitan Pier and Exposition Authority make a bond payment.
[135] Public Act 99-0491, signed on December 7, 2015. The legislation also included General Funds appropriations totaling $28 million for domestic violence shelters and operations of the Illinois Secretary of State.
[136] Harriet Alexander, "Illinois hands IOUs to lottery winners instead of cash," *The Telegraph*, October 16, 2015.
[137] Illinois Office of the Governor, "Administration Initiates Management Steps to Prepare for Madigan-Cullerton Budget, *news release*, June 2, 2015; Illinois Office of the Governor, "Administration Initiates Additional Management Steps to Prepare for Madigan-Cullerton Budget," *news release*, June 12, 2015.
[138] Kim Geiger, "Rauner reverses course on cuts to child care, disability services," *Chicago Tribune*, November 9, 2015.
[139] State of Illinois, General Obligation Bonds, Series of January 2016, *Official Statement*, January 15, 2016, p. 24.
[140] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 3.
[141] Public Act 99-0005, signed on June 24, 2015.

Departments of Children and Family Services and Juvenile Justice and certain human services programs.

State workers are receiving paychecks based on a ruling in July 2015 by a judge in St. Clair County Circuit Court, which was subsequently upheld by an appellate court.[142] 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.[143]

The main areas of State government not being paid are universities, community colleges, scholarships 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. In the case of group health insurance, the State is obligated to make the payments eventually due to State law and union contracts.

On January 28, 2016, the General Assembly passed an appropriations bill authorizing $721 million in General Funds spending for college scholarships under the Monetary Awards Program (MAP) and community college operations.[144] The Governor vetoed the bill on February 19; the Senate voted to override the veto, but a similar motion in the House failed by two votes.

Although State spending has dropped off in the absence of a budget, the backlog of unpaid bills has increased due to the decline in revenues.[145] In October the Comptroller's Office announced that November pension contributions of $560 million would be delayed because the State would not have enough cash on hand to make all payments required by State law and court orders.[146] Pension contributions are expected to be paid in full by the end of FY2016.

Governor's FY2017 Budget Proposal and Subsequent Developments

Governor Rauner's FY2017 recommended budget begins with a maintenance budget of $38.97 billion.[147] This General Funds spending plan is defined in the budget document as the amount needed to fund agencies' core missions and programs, after adjusting for price changes and one-time costs.[148] Given projected General Funds revenues of $32.34 billion, the maintenance budget results in an operating deficit of $6.63 billion.

The recommended FY2017 budget reduces the gap to $3.5 billion through certain one-time revenue increases and significant spending reductions. Revenues are increased by $475 million to $32.8 billion, and expenditures are cut by $2.6 billion to $36.3 billion.

The major changes in the proposed budget from the maintenance budget include the following:

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142 John O'Connor, Associated Press, "Illinois appellate court upholds order to pay state employees," *The State Journal-Register*, July 24, 2015.
143 Kim Geiger, "High court denies Lisa Madigan bid for ruling on state worker paychecks," *Chicago Tribune*, July 17, 2015.
144 99th Illinois General Assembly, Senate Bill 2043, House Amendment 2, passed by House and Senate on January 28, 2016.
145 Illinois Office of the Comptroller, "Expenditures, Revenues Down as Backlog Grows," *Comptroller's Quarterly*, January 2016. The backlog was reduced at the end of FY2015 due to fund sweeps and interfund borrowing.
146 Illinois Comptroller Leslie Geissler Munger, "Munger: Cash Shortage Requires State to Delay Pension Payment," *news release*, October 14, 2015.
147 Illinois State FY2017 Budget, p. 75.
148 Illinois State FY2017 Budget, p. 18.

- One-Time Revenues: The entire $276 million balance in the Budget Stabilization Fund, the State's only rainy day fund, would be spent. An estimated $200 million from the proposed sale of the James R. Thompson Center is also included in FY2017 resources.
- Pensions: Contributions to the State's five retirement systems would total $6.2 billion, which is $748 million below the amount currently required by State law. The savings would mainly come from shifting pension costs to local school districts and universities and by recalculating pension liabilities to lower current expenses.
- Group Insurance: Payments would be reduced by $445 million, or 24.6%, by giving employees a choice between significantly higher premiums or less generous coverage. The proposed changes have so far been rejected in negotiations over a new contract to replace an agreement that expired on June 30, 2015; the Rauner administration is currently seeking a determination from the Illinois Labor Relations Board on whether the talks have reached an impasse.[149] The Governor has proposed that health insurance benefits be removed from collective bargaining.
- Education: Funding for higher education is reduced by $200 million, but spending on elementary and secondary education and early childhood education is increased by a total of $103 million.
- Community Care Program: Spending on this program, which aims to keep seniors out of nursing homes, is cut by $197.6 million, or 19.1%. The administration plans to use less costly services for individuals who are not eligible for Medicaid.
- Interfund Borrowing: The Governor recommends repaying only $15 million of the $454 million borrowed from other State funds at the end of FY2015. Repayment had been due within 18 months, before the end of FY2017.
- Retiree Health Insurance: State contributions for retiree health insurance for public school teachers and community college employees outside of Chicago would be eliminated. Required state contributions to these programs, which are currently covered by continuing appropriations, total $114.0 million in FY2017.[150] The State's statutory contribution to the Chicago teachers' pension fund, which was expected to be $12.1 million in FY2016, is also not included in the FY2017 budget.
- Other: Additional savings would come from revising overtime pay and by centralizing and streamlining the procurement process.

Even after these changes, the proposed FY2017 budget would still be out of balance by $3.5 billion. The Governor asked the General Assembly to pass a "clean" appropriation bill—with no unrelated provisions—for early childhood, elementary and secondary education before working on a comprehensive budget plan.[151] However, Senate Democrats are pushing for school funding reform that would eventually bring more money to the cash-strapped Chicago Public Schools.[152]

The recommended FY2017 budget does not address the continuing budget impasse in FY2016, although an operating deficit of $4.4 billion in FY2016 is shown in the budget document. The

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149 Kim Geiger, Monique Garcia and Celeste Bott, "Rauner asks his labor board to determine if union contract talks at impasse," *Chicago Tribune*, January 15, 2016.
150 Communication between the Civic Federation and the Governor's Office of Management and Budget, April 8, 2016.
151 Illinois Government News Network, Office of the Governor, "Governor Rauner's Budget Address," *news release*, February 17, 2016. The Governor's appropriation bill for education was introduced on February 19, 2016 (99th Illinois General Assembly, Senate Bill 3234).
152 99th Illinois General Assembly, Senate Bill 231, Senate Amendment 1, introduced on April 6, 2016.

estimated results in FY2016 would require additional appropriations for areas of government that are not currently being funded, including higher education, certain human services programs and group health insurance.

The following table summarizes the proposed General Funds budget for FY2017. It also shows preliminary results for FY2015; estimated results for FY2016; and the FY2017 maintenance budget.

State of Illinois General Funds Budget Results and Plans: FY2015-FY2017 (in $ millions)				
	FY2015	**FY2016 Est.***	**FY2017 Maint.**	**FY2017 Rec.**
Operating Revenues				
State Source Revenues	$ 32,592	$ 27,551	$ 28,076	$ 28,551
Federal Revenues	$ 3,331	$ 4,161	$ 4,267	$ 4,267
Total Operating Revenues	**$ 35,923**	**$ 31,712**	**$ 32,343**	**$ 32,818**
Operating Expenditures				
Agency Appropriations Spent	$ 23,152	$ 23,187	$ 24,929	$ 23,937
Pension Contributions	$ 6,046	$ 6,632	$ 6,932	$ 6,184
Group Insurance	$ 1,565	$ 1,650	$ 1,810	$ 1,365
Total Appropriations Spent	**$ 30,763**	**$ 31,469**	**$ 33,672**	**$ 31,486**
Statutory Transfers Out				
Legislatively Required Transfers	$ 2,489	$ 2,486	$ 2,473	$ 2,473
Debt Service on Pension Bonds	$ 1,531	$ 1,419	$ 1,604	$ 1,604
Debt Service on Capital Bonds	$ 563	$ 710	$ 766	$ 766
Repayment of Interfund Borrowing	$ -	$ -	$ 454	$ 15
Total Statutory Transfers Out	**$ 4,583**	**$ 4,615**	**$ 5,298**	**$ 4,858**
Total Operating Expenditures**	**$ 35,346**	**$ 36,084**	**$ 38,969**	**$ 36,344**
Operating Surplus (Deficit)	**$ 577**	**$ (4,372)**	**$ (6,626)**	**$ (3,526)**
Borrowing for Operations	$ 454	$ -	$ -	$ -
Operating Surplus (Deficit) After Borrowing for Operations	**$ 1,031**	**$ (4,372)**	**$ (6,626)**	**$ (3,526)**

*Total FY2016 appropriations have not been enacted. Spending shown in the table would require the enactment of additional appropriations.

**Totals may not sum due to rounding.

Source: Illinois State FY2017 Budget, pp. 63, 75 and 76.

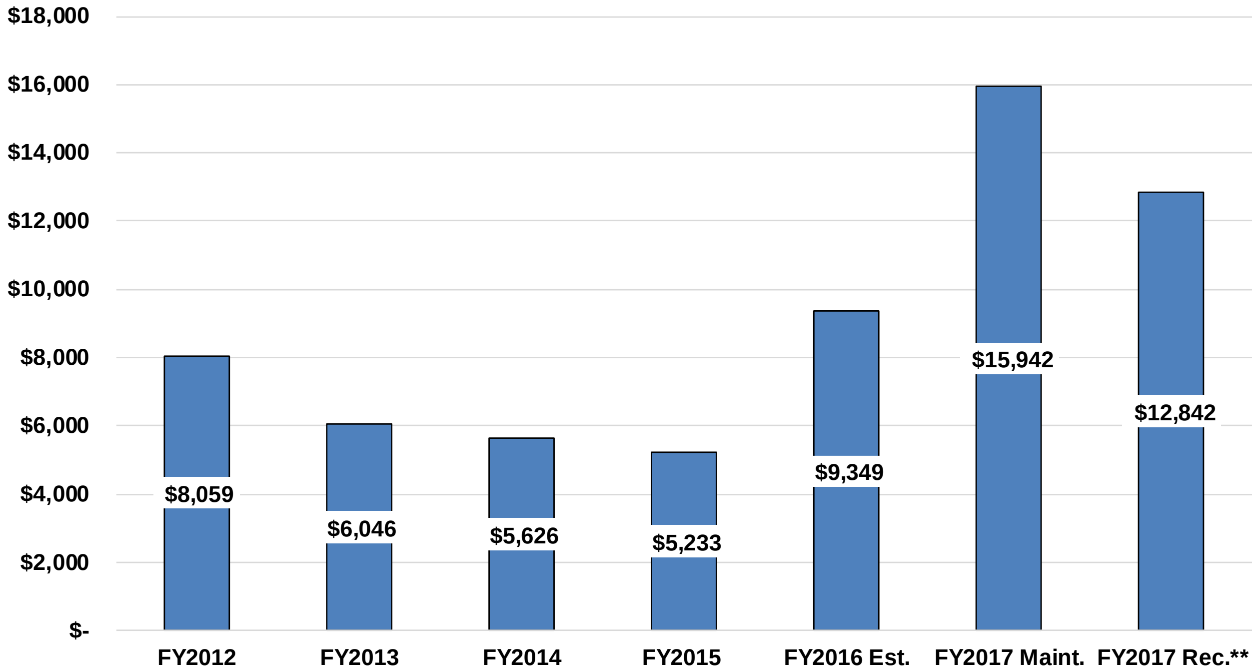
If additional appropriations are enacted with no additional revenues, the State's General Funds backlog of unpaid bills is expected to reach $9.3 billion at the end of FY2016. At maintenance spending levels, unpaid bills could grow to $15.9 billion at the end of FY2017. Under the Governor's proposed budget, the backlog could be $12.8 billion at the end of FY2017 if the operating deficit of $3.5 billion is not closed and $9.3 billion if the deficit is closed.

The following chart shows the General Funds backlog of unpaid bills from FY2012 to FY2017.[153] The backlog shown in the chart represents bills and other payables in the given fiscal year that must be paid from the next fiscal year's revenues. Fiscal year 2012 is used as the starting point because

[153] For more information on unpaid bills, see p. 66 of this report.

data on year-end backlogs before FY2012 are not available in annual budget documents.[154] Prior to the current fiscal situation the year-end backlog peaked in FY2012 due to of an accumulation of unpaid Medicaid bills. The backlog declined from $8.1 billion at the end of FY2012 to $5.2 billion at the end of FY2015, according to budget documents.

State of Illinois Unpaid General Funds Bills: FY2012-FY2017 (in $ millions)*



*General Funds bills and other payables that must be paid from the next fiscal year's revenues.
**Assumes that the $3.5 billion operating deficit in the FY2017 recommended budget is not closed. If the deficit were closed, the backlog would be $9.3 billion.
Source: Illinois State FY2015 Budget, p. 2-23; Illinois State FY2016 Budget, p. 3-7; Illinois State FY2017 Budget, p. 76.

After Governor Rauner presented his FY2017 budget proposal, the Senate began holding agency appropriation hearings in March and the House followed in April. However, attention largely remained focused on the still unresolved FY2016 budget.

In April the House and Senate passed an FY2016 appropriation bill authorizing General Funds payments of approximately $3.1 billion for MAP grants, public universities and community colleges and human services programs.[155] The bill also included about $63 million for raises owed to union workers since 2011. The administration indicated that the Governor was likely to veto the bill because it did not provide revenues to support the appropriations.[156]

Republican legislative leaders also introduced an FY2016 appropriation bill for social services programs in April, covering approximately $433 million in General Funds spending and tied to

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[154] Public Act 98-0460, signed on August 16, 2013.
[155] 99th Illinois General Assembly, Senate Bill 2046, House Amendment 1, passed on April 12, 2016 by the House and on April 13, 2016 by the Senate.
[156] Doug Finke, "Senate approves bill for human services, higher-education spending," *The State Journal Register*, April 13, 2016.

pension changes proposed in the Governor's FY2017 budget.[157] Other legislation supported by the Governor ties FY2016 appropriations for higher education to projected savings on procurement reforms.[158] These bills have not advanced in the legislature. Proposed legislation to freeze property taxes for non-home rule governments was approved by the House but criticized by the Rauner administration for not including limits on collective bargaining.[159]

Illinois Comptroller Leslie Geissler Munger attempted to apply pressure on lawmakers to resolve the budget standoff by announcing on April 17 that she planned to delay paychecks for General Assembly members and State constitutional officers.[160] Munger said the State did not have enough money to pay all its bills and that other needs should have higher priority.

On April 22, the House and Senate passed a $600.0 million stopgap funding measure for higher education that is expected to allow public universities to keep their doors open through the summer.[161] The Governor signed the bill three days later.[162] Unlike previous higher education appropriation bills approved by the General Assembly, the legislation was supported by funding: deposits into the Education Assistance Fund, one of the four General Funds, which may only be spent on education. The Education Assistance Fund recently had a balance of $347.6 million and is expected to have adequate resources to fund the total $600 million by the end of FY2016.[163]

The measure provides $350.1 million for public universities, or an average of 29.2% of their State funding in FY2015. An exception is Chicago State University, which was allocated $20.1 million, or 55.7% of its FY2015 State funding. Chicago State had declared a financial crisis and pushed up the end of the spring semester to April 28, saying it could not meet payroll after that date and would have to lay off hundreds of employees.[164] The Illinois Student Assistance Commission, which administers MAP grants, received $169.8 million, or 45.3% of its FY2015 State funding. The Illinois Community College Board received $74.1 million for distribution of major grants, or 28.4% of its FY2015 amount.

Lawmakers are considering proposals to provide partial funding for human services programs that have not been paid in FY2016 from the Commitment to Human Services Fund. That fund is an account outside of General Funds that was created to divert income tax revenues from General Funds to be used for human services beginning in February 2015. The Senate passed a bill on April 22 that would appropriate approximately $440 million from the fund for a variety of programs.[165] The Commitment to Human Services Fund is expected to receive about $444 million in income tax revenues in FY2016.[166]

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[157] 99th Illinois General Assembly, Senate Bill 3418, introduced on April 7, 2016.
[158] 99th Illinois General Assembly, Senate Bills 2400 and 2408, introduced on February 3, 2016.
[159] 99th Illinois General Assembly, House Bill 696, passed by the House on April 21, 2016; Associated Press, "Property tax-freeze proponent Rauner says plan approved in House not enough," *The State Journal-Register*, April 21, 2016.
[160] Illinois Comptroller Leslie Geissler Munger, "Munger: We Are All In This Together, We All Will Wait In Line," *news release*, April 17, 2016.
[161] Monique Garcia and Celeste Bott, "Lawmakers approve funding to keep universities afloat through summer," *Chicago Tribune*, April 22, 2016.
[162] Public Act 99-0502, enacted on April 25, 2016.
[163] Illinois Office of the Comptroller, http://ledger.illinoiscomptroller.gov/Ledger/?LinkServID=90D17A44-CB6B-77A6-D4DC314B32575620#fldFund (last visited on April 26, 2016).
[164] Paris Schutz, "Chicago State University Faces Closures Over Budget Impasse," *Chicago Tonight*, March 30, 2016, http://chicagotonight.wttw.com/2016/03/30/chicago-state-university-faces-closure-over-budget-impasse (last visited on April 10, 2016).
[165] 99th Illinois General Assembly, Senate Bill 2047, Senate Amendment 1, passed by the Senate on April 22, 2016.
[166] Illinois State FY2017 Budget, pp. 160-161.

Two rulings by the Illinois Supreme Court on March 24 also have implications for the budget debate. The high court reaffirmed its May 2015 opinion on State pension changes by rejecting a law intended to stabilize two Chicago pension funds by reducing benefits and increasing funding.[167] Governor Rauner said the ruling opened the door for an approach that would offer employees a choice between less expensive retirement options.[168]

In the other ruling, the Supreme Court determined that the raises owed to unionized State workers since 2011 as a result of collective bargaining could not be paid without appropriations from the General Assembly.[169] The opinion led to reports that the Illinois Attorney General's Office might seek a ruling from the high court to stop the ongoing payment of workers' salaries in FY2016 in the absence of appropriations.[170]

Cost of the Budget Impasse

A budget is a plan that indicates objectives and shows how to obtain and use resources to achieve those objectives.[171] Faced with sharply reduced revenues and rising pension costs, the State has not been able to create a financial plan for FY2016 to align resources and expenditures. The result has been cash flow problems, growth in the backlog of unpaid bills and accrued interest penalties and lower credit ratings.

Although most State functions have continued without a budget, several areas of government that have historically been funded are not being paid and have relied on reserves and lines of credit to stay afloat. In the past few months, with no sign of a resolution to the budget impasse, more of these traditional recipients of State funds have taken steps to cut staff, reduce services or discontinue operations entirely.

This section examines the financial and social costs of the budget standoff. While some effects can be quantified, others are difficult to measure and may only be known in the long run. For example, university officials have said the budget problems might make it difficult to recruit faculty and students due to concerns about the State's fiscal stability.[172] Advocates for the poor and disabled maintain that services eliminated due to the budget impasse will not be easy to replace.[173]

Debt Costs

Two of the three major rating agencies reduced the State of Illinois' bond ratings in October 2015, directly citing the State's budget impasse for the ratings actions. These downgrades made Illinois the only state credit currently rated below the 'A' category and signal a weakened capacity for the government to meet its financial obligations.

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[167] Mary J. Jones et al. v. Municipal Employees' Annuity and Benefit Fund of Chicago et al., 2016 IL 119618, March 24, 2016.

[168] John O'Connor, Associated Press, "Illinois Supreme Court strikes down Chicago pensions plan," *Daily Chronicle*, March 24, 2016.

[169] 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.

[170] Drew Zimmerman, "Rauner accuses attorney general of wanting to stop employee pay, shut down government," *The State Journal-Register*, April 12, 2016.

[171] Steven A. Finkler et al., *Financial Management for Public, Health, and Not-for-Profit Organizations*, 4th ed. Upper Saddle River, NJ: Pearson Education Inc., 2013, p. 29.

[172] Lolly Bowean, "State budget impasse leads to cost cutting at U of I," *Chicago Tribune*, October 19, 2015.

[173] Kim Geiger, "Social service groups sound alarm on Illinois budget impasse," *Chicago Tribune*, September 15, 2015.

The lower ratings also led to higher borrowing costs for the State when it entered the bond market in January 2016 than if it had received interest rates in line with municipal bonds in the ‘A’ categories.

The downgrades took place shortly after Illinois Comptroller Munger’s announcement that contributions to the State’s pension funds in would be delayed in November.[174]

Fitch Ratings was the first agency to take action, downgrading Illinois to BBB+ from A- on October 19, 2015.[175] This marked the seventh downgrade of Illinois’ General Obligation bond rating by Fitch in the last five years. The press release accompanying the downgrade from Fitch attributed the action directly to the State’s budget impasse and liquidity issues despite a growing economy in the State.

Moody’s Investors Service also lowered its rating on Illinois’ General Obligation bonds to Baa1 from A3 on October 22, 2015.[176] Using a rationale similar to Fitch’s, Moody’s attributed the ratings action to the State’s lack of a budget and deteriorating finances. This was the sixth downgrade of Illinois by Moody’s over the last five years. Illinois’ outlook from Moody’s remains negative, indicating the possibility of further downgrades if nothing is done to address the budget crisis.

Although the rating is now below the ‘A’ level, Illinois’ General Obligation bonds are still considered investment grade and three levels above speculative, or junk status. The outlook on Illinois’ credit from Fitch is listed as stable, indicating that another downgrade is not likely in the near term.

At the time of the downgrades, Illinois had $26.8 billion in outstanding General Obligation bonds with related interest payments totaling $13.9 billion in interest due on the debt as it is repaid through 2039.[177]

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[174] Illinois Comptroller Leslie Geissler Munger, “Munger: Cash Shortage Requires State to Delay Pension Payment,” n*ews release*, October 14, 2015.
[175] Fitch Ratings, “Fitch Downgrades Illinois' GO Rating to 'BBB+'; Outlook Revised to Stable,” *news release*, October 19, 2015.
[176] Moody’s Investors Service, “Moody's downgrades Illinois' outstanding $27B of GO bonds to Baa1; outlook negative,” *news release*, October 22, 2015.
[177] Moody’s Investors Service, “Moody's downgrades Illinois' outstanding $27B of GO bonds to Baa1; outlook negative,” *news release*, October 22, 2015.

The following table shows the State of Illinois' General Obligation debt rating at the end of each fiscal year from FY2008 through the current ratings in FY2016.

State of Illinois General Obligation Bond Ratings FY2008-FY2016			
	Moody's Investors Service	**Standard & Poor's**	**Fitch Ratings**
FY2008	Aa3	AA	AA
FY2009	A1	AA-	A
FY2010	Aa3*	A+	A+*
FY2011	A1	A+	A
FY2012	A2	A+	A
FY2013	A2	A	A
FY2014	A3	A-	A-
FY2015	A3	A-	A-
FY2016	Baa1	A-	BBB+

*Moody's and Fitch increased Illinois' bond ratings in March 2010 due to recalibrations of their entire rating scales but this was not considered an upgrade.

Source: Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2016* , August 2013, pp. 184; Moody's Investors Service, "Moody's downgrades Illinois' outstanding $27B of GO bonds to Baa1; outlook negative," *news release,* October 22, 2015; Fitch Ratings, "Fitch Downgrades Illinois' GO Rating to 'BBB+'; Outlook Revised to Stable," *news release,* October 19, 2015.

Both of the downgrades from Moody's and Fitch also affect several other types of bonds issued by the State.

Moody's lowered its ratings to Baa1 from A3 on the State's Build Illinois bonds, which are backed by a portion of sales tax receipts. It also cut the State's ratings to Baa2 from Baa1for debt associated with the Metropolitan Pier and Exposition Authority and the Civic Center program, which are subject to appropriation each fiscal year. The outlook for all of these credits was held at negative.

Fitch downgraded the Illinois Sports Facilities Authority and Metropolitan Pier and Exposition Authority McCormick Place to BBB from BBB+, also due to the need for State appropriations to pay for debt service, but gave the rating a stable outlook. It also downgraded the City of Chicago's motor fuel tax bonds to BBB from BBB+. Earlier this fall, the Metropolitan Pier and Exposition Authority received a quadruple downgrade from Fitch from AA- to BBB+ when the State failed to appropriate the funds needed to make its debt service payments.[178]

The third prominent ratings agency, Standard and Poor's, continues to rate Illinois A- with a negative outlook.

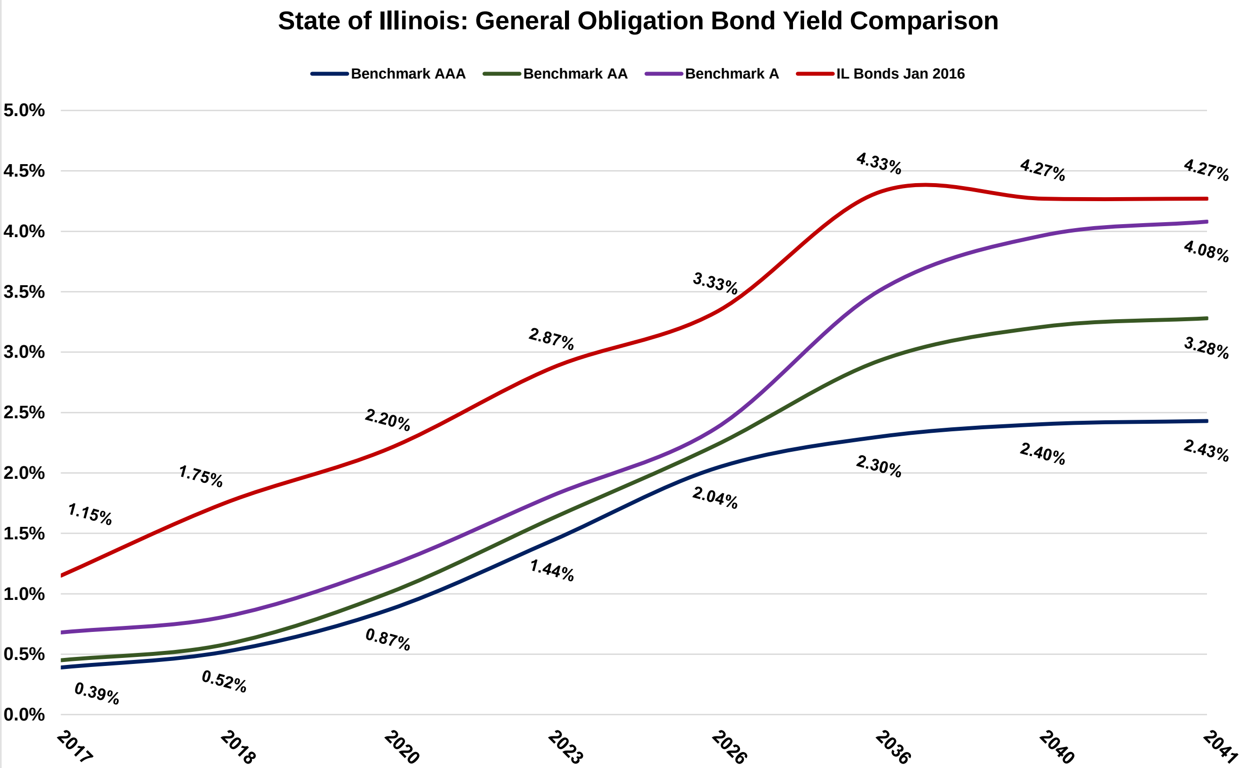
Lower bond ratings increase the State's cost of borrowing above other better-rated governments. Illinois had not issued General Obligation bonds since April 2014. Although the Governor's proposed FY2016 budget projected a sale of $250 million of capital purpose bonds in FY2015 and proposed the sale of an additional $1.1 billion in bonds in FY2016, the State remained out of the municipal securities market until early in 2016.[179]

[178] Fitch Ratings, "Fitch Rates $223MM Metropolitan Pier and Exposition Auth., IL Bonds 'BBB+'; Outlook Negative," *news release*, September 11, 2015.
[179] Illinois State FY2016 Budget, p. 7-9.

Prior to the downgrades, Illinois stood alone with New Jersey as the only single 'A' rated state credits. More than half of the remaining states are rated 'Aa' and 15 states have the highest level of 'Aaa' rating from Moody's.[180]

On January 16, 2016 the State sold $480 million of General Obligation bonds to fund ongoing capital projects.

The following chart compares the yields received by the State to the benchmark yields for better-rated municipal credits reported for the month of January.[181] 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: Yahoo Finance, Composite Bond Rates for January 2016, http://finance.yahoo.com/bonds/composite_bond_rates (last visited February 2, 2016). State of Illinois, General Obligation Bonds, Series January 2016, *Official Statement*, January 16, 2016.

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 and other portfolio standards can affect the outcome of a bond sale.

However, based on the available data, Illinois paid much more than a better rated government would have been charged for the $480 million of bonds issued in January, which will cost a total of $238.3 million in interest through FY2041.

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[180] Moody's Investors Service, *Annual State Debt Medians 2015*, June 24, 2015.
[181] For more details on the calculations and yield comparisons, including background data, see Appendix C on p. 87.

For the same bond issuance, a government with an 'A' bond rating receiving the composite yields in the chart above would have paid 18.0% less than Illinois, leading to a total of $43 million in interest savings.

Using the same methodology, a government rated 'AA' would have paid $72.8 million less, or 30.5%, and a government rated 'AAA' would have paid $105.0 million less, or 44.1%, for the same bond issuance.[182]

Although these additional interest charges are paid over 25 years, the higher yields lead to a significantly greater cost to provide essential infrastructure investments for the State of Illinois due to its low credit ratings and ongoing budget crisis.

Interest Penalties

The State is required to pay interest penalties on certain overdue bills. As the budget impasse continues, the backlog of unpaid bills is expected to grow, payment delays will increase and penalties owed to vendors will climb.

However, interest penalties are not paid until the State pays the underlying bills, which means that the amount of interest penalties paid in FY2016 will depend on the timing of bill payments. Some vendors with State contracts may not be paid at all unless appropriation bills are enacted. It should also be noted that many types of payments owed by the State, including grants and transfers to local governments, are not eligible for interest when payment is delayed.

The total backlog of unpaid bills stood at $6.6 billion at the end of February 2016, according to the Governor's Office of Management and Budget.[183] Group health insurance claims represented the largest category of unpaid bills at $2.9 billion.

The group health insurance program is one of the major areas of State government for which there appears to be no legal authority to pay bills during the budget impasse.[184] Nevertheless, the program's costs must be paid eventually because of State law and union contracts. Unlike most other State bills, group health insurance claims may be paid from future years' appropriations under an exception to Section 25 of the State Finance Act.[185]

Under the State Prompt Payment Act, which applies to managed care companies, interest accrues at 1% a month on complete claims that are not paid within 90 days.[186] Claims from healthcare providers accrue interest at 9% a year after 30 days under the Illinois Insurance Code.[187]

A recent report by the legislature's Commission on Government Forecasting and Accountability (COGFA) estimated that penalty payments on group health insurance claims would reach $221.0

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[182] For data and comparison calculations see Appendix C on p. 87.
[183] Illinois Governor's Office of Management and Budget, *Bills Outstanding – Summary*, March 15, 2016, http://www.illinois.gov/gov/budget/Documents/Bill_Backlog_Presentation_3.15.16.pdf (last visited on April 10, 2016).
[184] Illinois Department of Central Management Services, *Group Insurance Budget Impasse FAQs*, September 25, 2015, http://www.illinois.gov/cms/Employees/benefits/StateEmployee/Documents/Budget_Impasse_FAQs_092415.pdf (last visited on April 10, 2016).
[185] 30 ILCS 105/25(b-4).
[186] 30 ILCS 540.
[187] 215 ILCS 5.

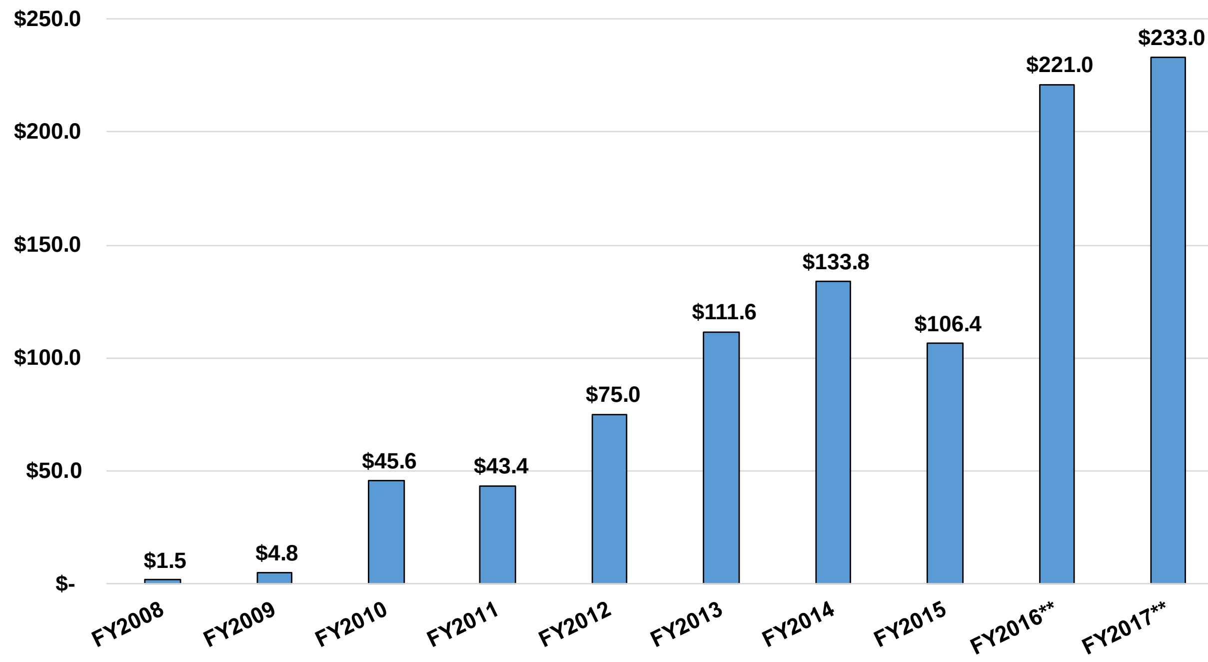
million in fiscal year 2016 and $233.0 million in fiscal year 2017.[188] The estimates are based on assumptions about when the current backlog of claims will be paid. If the overdue bills had been paid at the end of February 2016, the amount of interest penalties owed would have been $328.0 million.[189]

However, the backlog is increasing by about $200 million per month due to the budget impasse, meaning that interest penalties are continuing to grow.

The COGFA report describes the mounting cost of interest penalties as a "matter of concern for policymakers and budgeters" because the payments represent "lost money" that could be spent elsewhere in the group health insurance program or on other State services. The report contrasts the rates paid on overdue bills to the current prime commercial lending rate of 3.5%.

The following chart shows interest penalties related to the State group health insurance program from FY2008 through FY2015. The State has paid $522.1 million in such penalties during that period, according to the Comptroller's Office. The estimated payments of $221.0 million in FY2016 and $233.0 million in FY2017 would bring the total to $976.1 million over the ten-year period.

State of Illinois Interest Penalties on Overdue Health Insurance Bills: FY2008-FY2017 (in $ millions)*



*Includes penalties paid under the State Prompt Payment Act and the Illinois Insurance Code for claims to the State Employees Group Insurance Program..
**Estimated.
Source: Illinois Office of the Comptroller; Commission on Government Forecasting and Accountability, *FY2017 Liabilities of the State Employees' Group Health Insurance Program*, March 2016, pp. 15-16.

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[188] Commission on Government Forecasting and Accountability, *FY2017 Liabilities of the State Employees' Group Health Insurance Program*, March 2016, pp. 15-16.
[189] Commission on Government Forecasting and Accountability, *FY2017 Liabilities of the State Employees' Group Health Insurance Program*, March 2016, p. 11.

According to the COGFA report, managed care companies were waiting 479 days to be paid as of the end of February 2016. Providers in the largest self-insured plan were waiting between 446 days and 523 days.

The State paid total interest penalties—on health insurance claims as well as on other bills—of $1.0 billion between FY2006 and FY2015.[190] Of the total, 91.8% was paid in the last six year.

Loss of Services

The lack of an FY2016 budget has had the most impact on areas of State government that traditionally have been funded but are not currently being paid. The largest is higher education, which covers nine public universities, 48 community colleges and MAP, the college scholarship program for about 128,000 low income students. Higher education received $2.0 billion in General Funds in FY2015.[191]

Without State funding, public universities initially dipped into reserves, laid off administrators and credited students' tuition bills for their MAP grants, expecting to be reimbursed when a budget was enacted. More recently financially weaker institutions said they were running out of cash and were having trouble paying bills. University administrators are concerned that funding uncertainties might prompt students to consider private colleges or schools outside of Illinois.[192]

Chicago State University, which depends more heavily on State funding than any other public university, declared a financial crisis on February 4 and ended the spring session on April 28, saying that it could not make payroll after that date and that hundreds of layoffs would follow.[193] Chicago State received 31.6% of its revenue from State appropriations in FY2015, compared with an average of 17.5% for all public universities and 14.9% for the University of Illinois, the State's flagship university.[194] The U of I also made cutbacks, postponing upgrades to its information technology operating system, delaying building improvements and reportedly planning layoffs of civil service employees, such as child care and clerical workers.[195]

Many schools stopped covering MAP scholarships. A survey in December 2015 by the Illinois Student Assistance Program, which runs the grant program, found that 58% of institutions that responded credited students for MAP grants in the fall of 2015.[196] Overall only 37% were planning to continue to do so during the spring semester, but all of the public universities that responded said

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[190] Commication between the Civic Federation and the Illinois Office of the Comptroller, February 11, 2016. For more information, see the Civic Federation's Institute on Illinois' Fiscal Sustainability blog, https://www.civicfed.org/iifs/blog/penalties-overdue-bills-add-state-illinois (last visited on April 10, 2016).
[191] Illinois State FY2017 Budget, p. 63. This figure does not include General Funds pension contributions of $1.3 billion to the State Universities Retirement System.
[192] Dawn Rhodes, "High schoolers, parents are wary of Illinois colleges as budget crisis hits," *Chicago Tribune*, March 31, 2016.
[193] Paris Schutz, "Chicago State University Faces Closures Over Budget Impasse," *Chicago Tonight*, March 30, 2016, http://chicagotonight.wttw.com/2016/03/30/chicago-state-university-faces-closure-over-budget-impasse (last visited on April 10, 2016).
[194] Illinois Board of Higher Education, *Annual Report on Public University Revenues and Expenditures: Fiscal Year 2015*, October 2015, Appendix A.
[195] Lolly Bowean, "State budget impasses leads to cost cutting at U of I," *Chicago Tribune*, October 19, 2015; Associated Press, "University of Illinois planning layoffs," *Crain's Chicago Business*, April 20, 2016.
[196] Katherine Davis, "The latest victims of no state budget: IIT students," *Crain's Chicago Business*, March 24, 2016.

they planned to keep crediting the grants for the second term.[197] Students at the private Illinois Institute of Technology were recently informed that they would have to repay MAP grants credited in the fall semester.[198] More than 1,000 low income college students reportedly failed to return for the spring semester because their MAP grants were not funded.[199]

The $600.0 million stopgap funding measure for higher education signed by the Governor on April 25 provided enough funding to cover MAP grants for the 2015 fall semester but not the 2016 spring term, according to officials.[200] The legislation is expected to allow public universities to keep their doors open through the summer.[201] Despite the additional funding, Chicago State announced on April 29 that it was laying off 300 non-faculty workers, or about one-third of its staff, on April 29.[202]

Although most healthcare and social services programs are being funded due to federal consent decrees and court orders, there are notable exceptions. Many social services programs that Governor Rauner proposed to eliminate in his FY2016 budget have no expectation of funding in the current fiscal year. These include mental health services not covered by Medicaid, funeral and burial assistance for low-income families, after school programs for teens and programs that serve immigrants and individuals with autism and epilepsy.

In addition, approximately 800 social services agencies are still waiting to be paid on contracts worth $357 million that are not backed by appropriations.[203] These contracts specifically state that payments are subject to appropriations, but officials have provided assurances that the payments will be made eventually.[204]

Lutheran Social Services, one of the State's largest social service agencies, laid off 750 employees, or about 43% of its staff, and cut its annual budget by 21.9% from $96 million to $75 million.[205] More than 90% of the program cuts were a result of not being paid by the State, which owed the organization more than $6 million as of the end of January.

Lutheran Social Services said it was ending more than 30 programs for about 4,700 people. Many of the eliminated programs, such as in-home care and adult daycare for seniors, are part of 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 being paid by the State.

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[197] Illinois Student Assistance Commission, *FY16 MAP Grant Survey: How are colleges and universities handling MAP during the budget delay*, December 2015, https://www.isac.org/dotAsset/a1cb9678-6658-470d-97e1-8f6242ed8b8d.pdf (last visited on April 10, 2016).
[198] Katherine Davis, "The latest victims of no state budget: IIT students," *Crain's Chicago Business*, March 24, 2016.
[199] Douglas Belkin, "Illinois Budget Deadlock Hits College Enrollments," *The Wall Street Journal*, January 18, 2016.
[200] Monique Garcia and Celeste Bott, "Lawmakers approve funding to keep universities afloat through summer," *Chicago Tribune*, April 22, 2016.
[201] Public Act 99-0502, enacted on April 25, 2016. For more information on the legislation, see p. 40 of this report.
[202] Jodi S. Cohen, "Chicago State lays off a third of its staff; Rev. Jackson blasts Rauner," *Chicago Tribune*, April 30, 2016.
[203] Illinois Department of Human Services, data provided to Senate Appropriations I Committee, March 16, 2016.
[204] Statement of Illinois House Minority Leader Jim Durkin at press conference on April 7, 2016, http://livestream.com/blueroomstream/events/5144338 (last visited on April 10, 2016).
[205] Shia Kapos, "Big Lutheran social agency cuts 750 jobs amid budget impasse," *Crain's Chicago Business*, January 22, 2016.

Chicago's Catholic Charities, which provides services ranging from adult day care to substance abuse treatment, was owed $25 million by the State at the end of March.[206] The situation has led to layoffs, a hiring freeze and use of cash reserves. In February the organization sent a letter urging parishioners to lobby elected officials in Springfield on behalf of vulnerable residents.[207]

A survey in January 2016 by the United Way of Illinois found that nearly half of the 444 human services agencies that responded had reduced services, programs or staff since July 2015 due to the budget standoff.[208]

The deadlock has also affected crime prevention programs such as Adult Redeploy Illinois, which is aimed at diverting non-violent offenders from prison into community programs and was singled out for praise in Governor Rauner's first State of the State address. Adult Redeploy has not been funded in FY2016, resulting in reduced staff, unfilled positions, a decrease in service and treatment availability and reduced or suspended enrollments.[209]

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[206] The Catholic Charities of the Archdiocese of Chicago, "State Budget Impasse Greatly Impacting Our Programs and Services," *news release*, March 24, 2016.
[207] Manya Brachear Pashman, *Chicago Tribune*, "Catholic Charities appeals to pews to help get Illinois budget passed," February 19, 2016.
[208] United Way of Illinois, "Seven Months into State Budget Impasse, United Way of Illinois Survey Shows Extensive Cuts to Human Service Programs and Harm to Sector," *news release*, January 26, 2016.
[209] Adult Redeploy Illinois Oversight Board, Minutes of the Meeting on November 2. 2015, p. 4.

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 FY2017 budget projects total revenues of $63.2 billion, of which $32.8 billion are available for General Funds spending.[210] 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.[211]

Income Taxes

Income taxes are the largest source of State revenues, making up more than half of State-source General Funds revenues. The Governor's recommended FY2017 budget projects a slight increase in income tax revenues from FY2016, which was the lowest year income taxes since FY2011 because of the impact of the first full year of the partial rollback of the temporary income tax increase.

On January 1, 2015, 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%. 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%.

The reduction in income tax rates was enacted in January 2011 as part of legislation that temporarily increased the individual income tax from 3.0% to 5.0% and the corporate income tax to 7.0% from 4.8%.

Due to the half year of lower income tax rates, net income tax revenues declined by $1.7 billion to $18.1 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 $5.2 billion decline in net income tax revenues from the peak year of FY2014, or 26.2%.

Net General Funds income tax revenues are projected to increase by $321 million to $15.0 billion in FY2017 compared to the estimated total of $14.6 billion in FY2016. However, even after accounting for growth in FY2017, net income tax revenues are still $4.8 billion below the peak total in FY2014.

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210 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.

211 Beginning in February 2015 the Illinois Income Tax Act required that 1/15th of the individual income taxes collect 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. These special diversions are shown in the table below.

The following table shows income taxes collected by the State of Illinois from FY2013 through the recommended FY2017 budget projections. The table separates the amount collected under the original 3.0% and 4.8% individual income and corporate income tax rates from the increased increments for each year. It also shows that net income tax revenues are the revenues remaining after the amounts diverted to other funds for designated spending and to pay for tax refunds.

State of Illinois Income Total Tax Revenues FY2013-FY2017 (in $ millions)							
Income Tax Increment	**FY2013**	**FY2014**	**FY2015**	**FY2016 (Proj.)**	**FY2017 (Rec)**	**5-Year $ Change**	**5-Year % Change**
Individual Income Tax							
Individual Base (3.0%)	$ 10,944	$ 11,033	$ 12,125	$ 11,715	$ 12,018	$ 1,074	9.8%
*Individual Increase	$ 7,330	$ 7,355	$ 5,557	$ 2,929	$ 3,004	$ (4,326)	-59.0%
Gross Individual Income Tax	**$ 18,274**	**$ 18,388**	**$17,682**	**$14,644**	**$15,022**	**$ (3,252)**	**-17.8%**
Refund Fund Transfer	$ (1,785)	$ (1,746)	$ (1,768)	$ (1,428)	$ (1,502)	$ 283	-15.9%
Special Funds Diversions	$ -	$ -	$ (481)	$ (881)	$ (901)	$ (901)	na
Net Individual Income Tax	**$ 16,539**	**$ 16,642**	**$ 15,433**	**$ 12,335**	**$ 12,618**	**$ (3,921)**	**-23.7%**
Corporate Income Tax							
Corporate Base (4.8%)	$ 2,523	$ 2,496	$ 2,321	$ 2,460	$ 2,540	$ 17	0.7%
*Corporate Increase	$ 1,156	$ 1,144	$ 808	$ 230	$ 240	$ (916)	-79.2%
Gross Corporate Income Tax	**$ 3,679**	**$ 3,640**	**$ 3,129**	**$ 2,690**	**$ 2,780**	**$ (899)**	**-24.4%**
Refund Fund Transfer	$ (502)	$ (476)	$ (438)	$ (409)	$ (431)	$ 71	-14.1%
Special Diversions	$ -	$ -	$ (5)	$ (6)	$ (6)	$ (6)	na
Net Corporate Income Tax	**$ 3,177**	**$ 3,164**	**$ 2,686**	**$ 2,275**	**$ 2,343**	**$ (834)**	**-26.3%**
Total Income Taxes (net)	**$ 19,716**	**$ 19,806**	**$ 18,119**	**$ 14,610**	**$ 14,961**	**$ (4,755)**	**-24.1%**

*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.

Source: Illinois State FY2017 Budget, pp. 160-161.

As shown in the table above, net individual income taxes not only declined due to the rate changes in FY2015 but were also reduced by a new statutory diversion that began in February 2015. The legislation passed in 2011 authorizing the temporary income tax increase also required two new diversions, each totaling 1/30 of the gross receipts from the individual income tax, after the rates partially rolled back in 2015. The diversions are made after amounts set aside to pay tax refunds are removed but before the amount shared with local governments is calculated. The law designates that the diverted funds be deposited into two newly created accounts to pay for additional spending on human service programs and education.[212]

The new diversions reduced the net individual income tax revenue by a total of $481.0 million in FY2015, $881.0 million in FY2016 and are expected to total $901.0 million in FY2017.

After accounting for these diversions and the amount set aside to pay tax refunds, net individual income taxes increase by $283 million to $12.6 billion in FY2017 compared to $12.3 billion in FY2016. The net individual income taxes available for General Funds spending are $4.0 billion less than the peak total of $16.6 billion in FY2014. Gross individual income tax receipts in FY2017 are $3.3 billion less than FY2014.

Net corporate income tax revenues are projected to increase by $68 million to $2.34 billion in FY2017 compared to $2.28 billion in FY2016. The diversions for human service spending and education outside of the General Funds only applied to a small portion of the corporate income tax base attributable to estates and trusts, resulting in a $5.0 million reduction in General Funds resources in FY2015 and a diversion of $6.0 million in FY2016 and FY2017.

[212] 35 ILCS 5/901(f) and (g).

In FY2015 the corporate income tax rate declined in the second half of the year resulting in net revenues that were $478.0 million less than the previous year, totaling $2.7 billion, down from $3.2 billion in FY2014. The General Funds revenue from corporate income tax in FY2016, the first full year of the lower rate, is estimated to total $2.3 billion, which is $889.0 million less than peak year of FY2014.

Other than the rate reduction, corporate income tax receipts have been negatively affected by the January 1, 2015 expiration of a cap on the net operating loss deduction. The income tax increase passed in 2011 included a provision that completely suspended the net operating loss deduction for corporations. This was intended to maximize the amount the State received from the higher rates but was amended on December 12, 2011 to allow for up to $100,000 of losses to be deducted. No net operating loss deduction was allowed in calendar years 2010 and 2011, and in 2012 through 2014 only up to $100,000 was permitted.

When the changes were passed, it was estimated that the complete elimination of the net operating loss deduction would increase State tax revenues by $250 million annually and that the capped deduction would garner an additional $100 million annually for the years that it was in effect.

After the expiration of the limitation on net operating loss deductions halfway through FY2015, corporate taxpayers were able to begin reducing their taxable income by applying current and past losses dating back up to 12 years from their current liabilities. The full effect of the operating loss reinstatement will not be known until after final payments are made by businesses in the coming years.

The amount of income tax revenue set aside by the State to pay for annual refunds owed to taxpayers is also shown in the table above. The individual income taxes were set aside at a rate of 10.0% in FY2015, 9.5% in FY2014 and 9.75% in FY2013. Corporate income tax was set aside at a rate of 14.0% in FY2015, 13.4% in FY2014 and 14.0% in FY2013. The refund diversion rates in these years were set into statute by the General Assembly and led to surpluses in the fund that were transferred to the General Funds in FY2014 and FY2015.

Without a budget in place, the diversion rates were determined by statutory formula in FY2016. The current diversion rates are too low to cover estimated refunds for FY2016, according to the Governor's Office.[213]

The statutory formula set the rates at 9.75% for individual income taxes and 15.2% for corporate income taxes. The recommended rates in the Governors proposed FY2016 budget were 10.0% for the individual income tax and 16.5% for the corporate income tax.[214] The higher rates were proposed in order to adjust for the change in tax rates and the delay in withholding and payment changes that would lead to a higher demand for refunds in FY2016. Due to the lower statutory rates, it is expected that a backlog of tax refunds will occur in FY2016.

According to the Illinois Department of Revenue, the rates needed to pay expected tax refunds in FY2016 should have been 10.2% for individual taxes and above 17.3% for corporate taxes.[215] The revenue projections in the Governor's recommended FY2017 budget assume a 10.0% refund fund

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[213] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 6.
[214] Illinois State FY2016 Budget, pp. 4-9, 4-10.
[215] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 6.

rate for the individual income tax and 15.5% for the corporate income tax. The budget estimates that the backlog of refunds at the end of FY2016 due to the lower diversion rates will total $70 million.[216] The Illinois Department of Revenue currently expects the backlog in FY2016 to be much higher at $180 million.[217]

In order to pay for the backlog of tax refunds that will occur due to the FY2016 rates, the FY2017 diversion rates will likely need to be higher than those included in the budget. However, if the diversions are increased to pay for the previous year's tax refunds, income tax revenues available for General Funds spending in FY2017 will also decline.

General Funds Revenue

The Governor's FY2017 recommended budget includes total General Funds revenues of $32.8 billion, which is an increase of $1.1 billion from the estimated FY2016 total of $31.7 billion.[218]

State-source General Funds revenue increases by $1.0 billion in FY2017 to $28.6 billion from $27.6 billion in FY2016. As discussed in the previous section, the increase in income tax revenues contributes the largest portion of the growth in State-source revenue totaling $351 million. Sales taxes also grow by $170 million in FY2017, totaling $8.3 billion compared to $8.1 billion in FY2016.

The Governor's recommended FY2017 budget also includes two one-time revenue proposals to increase resources. The recommended budget includes spending down the entire balance of the State's Budget Stabilization Fund totaling $276 million in FY2017 and counts on funds from the sale of the James R. Thompson Center totaling $200 million to be available to support operating expenses. These one-time revenues would not be part of the State's ongoing tax base and only available for spending in FY2017. The revenue increase from the sale of the Thompson Center is included in the State's other sources of revenues, which increases by $185 million to $735 million in FY2017 from $550 million in FY2016. The use of the Budget Stabilization Fund is reported in the budget as other transfers, which increase by $298 million to $991 million in FY2017 compared to $693 million in FY2016.

Federal revenues included in the General Funds budget are primarily based on reimbursements for State Medicaid spending. Due to slightly higher expenditures for Medicaid in FY2017, federal revenues increase by $106.0 million to $4.3 billion compared to $4.2 billion in FY2016.

[216] Illinois State FY2017 Budget, p. 76.
[217] Communication between the Civic Federation and Illinois Department of Revenue, April 18, 2016.
[218] Illinois State FY2017 Budget, p. 130.

The following table compares amounts included in the Governor's recommended FY2017 budget to current estimates of FY2016 General Funds revenues.

State of Illinois General Funds Revenues: Estimated FY2016 and Governor's Recommended FY2017 (in $ millions)				
	FY2016 Est.	**FY2017 Rec.**	**$ Change**	**% Change**
State Taxes				
Income Taxes (net)	$14,610	$14,961	$ 351	2.4%
Individual (net)	$12,335	$12,618	$ 283	2.3%
Corporate (net)	$ 2,275	$ 2,343	$ 68	3.0%
Sales Taxes	$ 8,140	$ 8,310	$ 170	2.1%
Public Utility Taxes	$ 977	$ 958	$ (19)	-1.9%
Cigarette Tax	$ 355	$ 355	$ -	0.0%
Liquor Gallonage Taxes	$ 168	$ 169	$ 1	0.6%
Estate Tax	$ 275	$ 275	$ -	0.0%
Insurance Taxes & Fees	$ 355	$ 355	$ -	0.0%
Corporate Franchise Tax & Fees	$ 202	$ 201	$ (1)	-0.5%
Interest on State Funds & Investments	$ 19	$ 19	$ -	0.0%
Cook County Intergovernmental Transfer	$ 244	$ 244	$ -	0.0%
Other Sources	$ 550	$ 735	$ 185	33.6%
Total State Taxes	**$25,895**	**$26,582**	**$ 687**	**2.7%**
Transfers			$ -	
Lottery	$ 692	$ 705	$ 13	1.9%
Riverboat Transfers & Receipts	$ 271	$ 273	$ 2	0.7%
Other	$ 693	$ 991	$ 298	43.0%
Total Transfers	**$ 1,656**	**$ 1,969**	**$ 313**	**18.9%**
State Revenues	**$27,551**	**$28,551**	**$ 1,000**	**3.6%**
Federal Sources	**$ 4,161**	**$ 4,267**	**$ 106**	**2.5%**
Total Revenue	**$31,712**	**$32,818**	**$ 1,106**	**3.5%**

Source: Illinois State FY2017 Budget, p. 130.

Despite the FY2016 General Funds revenues decline of $5.1 billion from the peak year of FY2014, total operating resources have increased by $3.1 billion over the last ten fiscal years. This represents an increase of 10.6% from $29.7 billion in FY2008. The revenue growth is attributable to income taxes, which increase by $2.7 billion to $15.0 billion in FY2017 compared to $12.2 billion in FY2008. However, not all of the change in income tax revenue is from underlying economic activity. The income tax rates are slightly higher in FY2017 than in FY2008 and include the additional diversions to special funds for human services and education spending.[219] These changes should be taken into account when comparing the change in General Funds revenues over the last ten years.

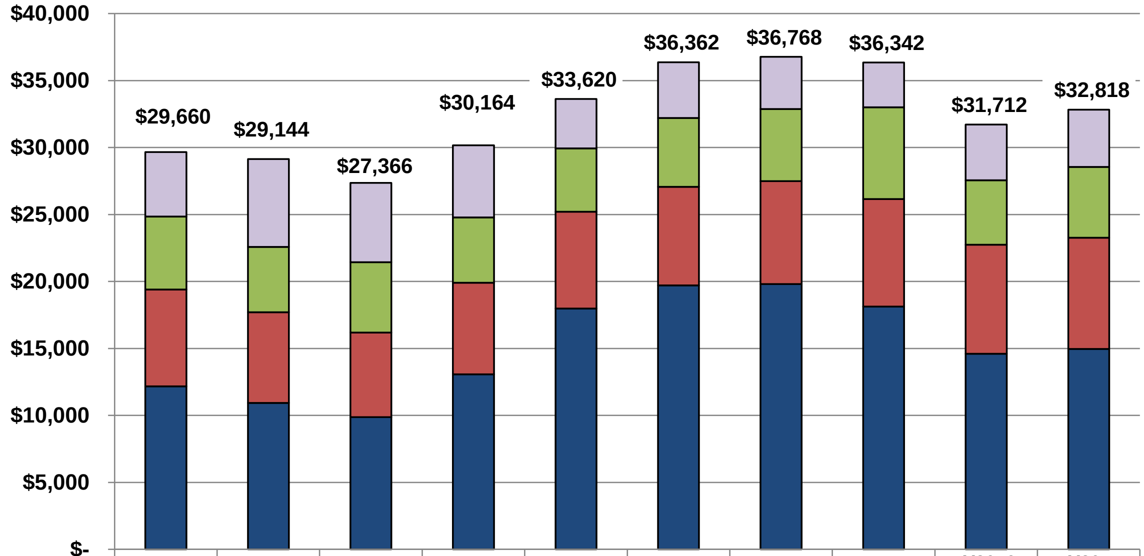
Sales taxes have been collected at the same rate over the last ten years and increase by $1.1 billion to $8.3 billion in FY2017 compared to $7.2 billion in FY2008. The State collects sales taxes at a rate of 6.25% and retains 5.0 percentage points to fund its operations while passing along the remaining portions to county and local governments.

The gains in sales taxes and income taxes over the last ten years are partially offset by losses in federal revenues and other sources. Federal revenues decline by $548 million to $4.3 billion in FY2017 compared to $4.8 billion in FY2008. Other sources of State operating revenue decline by $170 million to $5.3 billion in FY2017 compared to $5.5 billion in FY2008.

[219] See p. 50 for more information about income tax rates and new special fund diversions.

The following chart shows the ten-year trend in General Funds revenue by major source from FY2008 through the projections for FY2017.

State of Illinois General Funds Revenues FY2008-FY2017
(in $ millions)



	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016 (Est.)	FY2017 (Rec.)
Total	$29,660	$29,144	$27,366	$30,164	$33,620	$36,362	$36,768	$36,342	$31,712	$32,818
Federal	$4,815	$6,567	$5,920	$5,386	$3,681	$4,154	$3,903	$3,331	$4,161	$4,267
Other Resources*	$5,450	$4,871	$5,267	$4,869	$4,740	$5,138	$5,383	$6,861	$4,801	$5,280
Sales Taxes	$7,215	$6,773	$6,308	$6,833	$7,226	$7,354	$7,676	$8,030	$8,140	$8,310
Income Taxes	$12,180	$10,933	$9,870	$13,076	$17,973	$19,716	$19,806	$18,119	$14,610	$14,961

*Includes interfund borrowing in FY2011 and FY2015 and fund sweeps in FY2015.
Source: Illinois State Budgets FY2010-FY2017.

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.[220] Total State-source General Funds revenues declined by $3.4 billion from $24.8 billion in FY2008 to $21.5 billion in FY2010.[221] 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. Although revenues began to stabilize and show marginal growth in FY2011, overall revenue projections remained weak when the State enacted its FY2011 budget.

On January 13, 2011, halfway through the FY2011 fiscal year, the State approved temporary increases for both the personal and corporate income tax rates.[222]

Higher income tax rates created a greater disparity among revenue sources that support General Funds operations. In FY2008 income taxes made up 41.1% of the State's General Funds resources, while sales taxes accounted for 24.3%, federal revenues 16.2% and other sources 18.4%. At the peak year of the increased income tax rates in FY2014 income taxes made up 53.9% of General Funds revenue, with sales taxes totaling 20.9%, federal revenues 10.6% and other sources 14.6%. Since the partial rollback of the rates in FY2015, the proportionality has tightened.

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220 National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
221 Illinois State Budgets: FY2009-FY2012.
222 Public Act 96-1496, enacted on January 13, 2011.

In FY2017 income taxes are projected to make up 45.6% of General Funds revenue, sales taxes provide 25.3%, federal revenues are 13.0% and other sources make up 16.1%.

The heavier reliance on a single revenue source makes the State much more susceptible to changes in the economy, especially due to the economic sensitivity of income taxes in a downward business cycle.[223] The economic projections provided to the State by its economic forecasting consultants includes a pessimistic outlook that predicts a 20% chance that a national recession may occur in the first two quarters of FY2017.[224]

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[223] Government Finance Officers Association, *Best Practices in Public Budgeting*, Practice 4.6: Develop Policy on Revenue Diversification, 2000.
[224] Illinois State FY2017 Budget, p. 151.

APPROPRIATIONS AND EXPENDITURES

The recommended FY2017 budget proposes total appropriations of $68.2 billion, including $31.7 billion in General Funds appropriations. The budget proposal also includes $28.1 billion in Other State Funds and $8.4 billion in Federal Funds.

Proposed FY2017 General Funds expenditures total $36.3 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.[225] 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.

Appropriations by Fund Type

The following table shows appropriations by type of fund from FY2013 through FY2017. Total appropriations increase by $679 million, or 1.0%, from an estimated $67.5 billion in FY2016 to a recommended $68.2 billion in FY2017 and increase by $6.5 billion, or 10.6%, from $61.6 billion in FY2013. General Funds appropriations increase by $59 million, or 0.2%, from an estimated $31.68 billion in FY2016 to a recommended $31.74 billion in FY2017 and by $893 million, or 2.9%, from $30.8 billion in FY2013.

State of Illinois Appropriations by Fund: FY2013-FY2017 (in $ millions)

	FY2013	FY2014	FY2015	FY2016 Est. Maint.*	FY2017 Rec.**	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
General Funds	$ 30,848	$ 32,147	$ 31,787	$ 31,682	$ 31,741	$ 59	0.2%	$ 893	2.9%
Other State Funds	$ 22,883	$ 25,250	$ 27,074	$ 27,719	$ 28,078	$ 359	1.3%	$ 5,195	22.7%
Federal Funds	$ 7,912	$ 8,064	$ 8,186	$ 8,096	$ 8,357	$ 261	3.2%	$ 445	5.6%
Total* **	**$ 61,643**	**$ 65,461**	**$ 67,047**	**$ 67,497**	**$ 68,176**	**$ 679**	**1.0%**	**$ 6,533**	**10.6%**

*Total FY2016 appropriations have not been enacted. Estimated maintenance appropriations are amounts needed to fund agency operations and programs under current conditions.
**FY2017 recommended General Funds appropriations are reduced by $319 million of proposed procurement and unassigned transformation savings.
***Totals may not sum due to rounding.
Source:Illinois State FY2015 Budget, p. 2-41; Illinois State FY2016 Budget, p. 3-27; Illinois State FY2017 Budget, p.97.

Several caveats are in order. Because the State does not have a complete budget for FY2016, appropriations 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. The amount of General Funds appropriations actually enacted in FY2016 total $13.8 billion, rather than the $31.7 billion shown in the table.[226] The only major General Funds appropriations bill signed by the Governor was for early childhood, elementary and secondary education and State contributions to the Teachers’ Retirement System,

[225] General Funds consist of four funds: the General Revenue Fund, Education Assistance Fund, Common School Fund and General Revenue-Common School Special Account Fund.
[226] Illinois State FY2017 Budget, p. 97.

which covers public school teachers outside of Chicago.[227] Without a budget, other spending is being made from General Funds due to consent decrees, court orders and statutory requirements.

In evaluating FY2017 proposed appropriations it should also be noted that the Governor's proposed General Funds budget for FY2017 has an operating deficit of $3.5 billion. Balancing the budget would require a combination of revenue increases and reductions in appropriations or transfers out.

In addition, it is important to understand 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 FY2013, for example, actual spending from Other State Funds was $18.1 billion, compared with appropriations of $22.9 billion; actual spending from Federal Funds was $5.3 billion, compared with appropriations of $7.9 billion.[228]

General Funds Appropriations by Category and Area

To understand State spending pressures, it is helpful to distinguish agency appropriations from pension contributions and group insurance payments. The legislature generally has more discretion over agency appropriations than the other two spending categories.[229] 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 appropriations for these components of State spending from FY2013 through FY2017. Agency appropriations increase by $792 million, or 3.4%, from the estimated maintenance level of $23.4 billion in FY2016 to the Governor's recommended level of $24.2 billion in FY2017. Over the five-year period, agency appropriations decline by $99 million, or 0.4%, from $24.3 billion.

State of Illinois General Funds Appropriations by Category: FY2013-FY2017 (in $ millions)

	FY2013	FY2014	FY2015	FY2016 Est. Maint*	FY2017 Rec.**	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
Agency Appropriations	$ 24,291	$ 24,712	$ 24,176	$ 23,437	$ 24,192	$ 755	3.2%	$ (99)	-0.4%
Pension Contributions	$ 5,107	$ 5,989	$ 6,046	$ 6,632	$ 6,184	$ (448)	-6.8%	$ 1,077	21.1%
Group Insurance	$ 1,450	$ 1,446	$ 1,565	$ 1,650	$ 1,365	$ (285)	-17.3%	$ (85)	-5.9%
Total	**$ 30,848**	**$ 32,147**	**$ 31,787**	**$ 31,719**	**$ 31,741**	**$ 22**	**0.1%**	**$ 893**	**2.9%**

*Total FY2016 appropriations have not been enacted. Estimated maintenance appropriations are amounts needed to fund agency operations and programs under current conditions.

**FY2017 agency appropriations are reduced by $319 million of recommended procement and unassigned transformation savings.

Source: Illinois State FY2015 Budget, pp.2-22, 2-35 and 2-41; Illinois State FY2016 Budget, pp. 3-6, 3-21 and 3-27; Illinois State FY2017 Budget, pp. 75, 91 and 97.

Previously discussed caveats continue to apply. The FY2016 agency appropriations are based partly on supplemental appropriations that have not been enacted. The FY2017 budget proposal has a $3.5 billion operating deficit; balancing the budget will require a combination of additional revenues or reduced appropriations and transfers out.

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[227] Public Act 99-0005, signed on June 24, 2015. [227] Public Act 99-0491, signed on December 7, 2015, also included General Funds appropriations totaling $28 million for domestic violence shelters and operations of the Illinois Secretary of State.
[228] Illinois State FY2015 Budget, p. 2-41.
[229] Most spending changes in the Medicaid program require changes in State law, administrative rules and/or approval from the federal government.

The next table compares the recommended appropriations by area for FY2017 with maintenance appropriations in FY2017, estimated appropriations in FY2016 and enacted appropriations in FY2015. Maintenance appropriations in FY2017 represent the amount needed to fund agencies' core missions and programs, after adjusting for price changes and one-time costs.[230]

State of Illinois General Funds Agency Appropriations by Area: FY2015-FY2017 (in $ millions)						
	FY2015	FY2016 Est.*	FY2017 Maint.	FY2017 Rec.	FY2017 Rec. - Maint. $ Change	FY2017 Rec. - Maint. % Change
K-12 Education**	$ 6,555	$ 6,572	$ 6,572	$ 6,675	$ 103	1.6%
Higher Education	$ 1,950	$ 1,572	$ 1,950	$ 1,750	$ (200)	-10.3%
Economic Development	$ 104	$ 48	$ 59	$ 58	$ (1)	-1.7%
Public Safety	$ 1,619	$ 1,617	$ 1,718	$ 1,710	$ (8)	-0.5%
Human Services**	$ 5,407	$ 4,871	$ 5,435	$ 5,145	$ (290)	-5.3%
Healthcare	$ 7,178	$ 7,496	$ 8,173	$ 8,173	$ -	0.0%
Environment and Culture	$ 67	$ 54	$ 63	$ 54	$ (9)	-14.3%
Government Services	$ 1,308	$ 1,207	$ 1,210	$ 944	$ (266)	-22.0%
Total* **	**$ 24,188**	**$ 23,437**	**$ 25,180**	**$ 24,511**	**$ (669)**	**-2.7%**

*Total FY2016 appropriations have not been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions.

**Assumes continuing revenue diversion to Fund for Advancement of Education and Commitment to Human Services Fund and corresponding appropriations.

***Totals may not sum due to rounding. FY2015 does not include Comptroller's accounting reduction of $12 milliion. FY2017 does not include $319 million of procurement and unassigned transformation savings that are not allocated by area.

Source: Illinois State FY2017 Budget, p. 63.

General Funds appropriations for elementary and secondary education increase by $103 million, or 1.6%, to $6.7 billion in the recommended FY2017 budget from $6.6 billion in FY2016. As previously discussed, the appropriation bill for early childhood, elementary and secondary education was one of the only FY2016 General Funds budget bills signed by Governor Rauner.[231] Proposed FY2017 appropriations for early childhood education increase by $75 million, or 23.5%, to $394 million from $319 million in FY2016.[232] General State Aid (GSA), the State's main spending program for elementary and secondary education, increases by $55.3 million, or 1.2%, to $4.77 billion in the recommended FY2017 budget from $4.72 billion in FY2016.[233]

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.[234] 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 has been inadequate to fully pay

[230] Illinois State FY2017 Budget, p. 18.
[231] Public Act 99-0005, signed on June 24, 2015. Public Act 99-0491, signed on December 7, 2015, also included General Funds appropriations totaling $28 million for domestic violence shelters and operations of the Illinois Secretary of State.
[232] Illinois State FY2017 Budget, p. 49.
[233] Illinois State Board of Education, *FY2017 Budget Request Comparison to FY2017 Governor's Recommendation*, February 17, 2016, http://www.isbe.net/budget/fy17/FY17-budget-compare-gov.pdf (last visited on April 13, 2016).
[234] 105 ILCS 5/18-8.05(B).

for the Foundation Level.[235] The percentage of Foundation Level funding (known as proration) ranged from 87.1% in FY2015 to 99.9% in FY2011 and stood at 92.1% in FY2016. Despite the modest increase in GSA in the proposed FY2017 budget, the amount would be sufficient to fully fund the Foundation Level for the first time in seven years.[236]

General Funds appropriations for higher education decline by $200 million, or 10.3%, from $1.95 billion in the FY2017 maintenance budget to $1.75 billion in the recommended FY2017 budget. Higher education includes nine public universities, the Illinois Board of Higher Education, the Illinois Community College Board, the Illinois Student Assistance Commission, the Illinois Mathematics and Science Academy and the State Universities Civil Service System.

Proposed FY2017 appropriations for universities decline by $236.3 million, or 19.7%, to $961.4 million from $1.2 billion in FY2015.[237] The decrease is partly offset by $50 million in performance-based funding to be distributed by the Board of Higher Education. The Monetary Award Program, which provides financial assistance to low-income college students, is funded at the FY2015 level of $364.9 million in FY2017. Recommended appropriations for the Illinois Community College Board are virtually unchanged from FY2015 at $338.4 million.

Human services appropriations decline by $290 million, or 5.3%, to $5.1 billion in the FY2017 recommended budget from $5.4 billion in the FY2017 maintenance budget. The largest decrease involves the Community Care Program at the Department on Aging, which is designed to keep seniors out of nursing homes by providing home and community services. The Governor's proposal would reduce the program's costs by $197.6 million, or 19.1%, by providing less expensive services to individuals who are not eligible for Medicaid. The proposal would move 43,700 seniors, or 48.8% of the 89,500 expected to be enrolled in FY2017, into a new Community Reinvestment Program.[238] Services for those individuals are projected to cost an average of $400 per month, less than half of the $873 for participants in the Community Care Program.[239]

Many social services programs that Governor Rauner proposed to eliminate in his FY2016 budget are not being funded in the current year and are not included in the FY2017 maintenance or recommended budgets. These include mental health services not covered by Medicaid, funeral and burial assistance programs for low income families, after school programs for teens and programs for immigrants and individuals with autism and epilepsy.

Proposed FY2017 appropriations for healthcare of $8.2 billion are flat with the FY2017 maintenance level but up by $677 million, or 9.0%, from estimated FY2016 spending. Healthcare consists mainly of the Medicaid program at the Department of Healthcare and Family Services (HFS). The spending increase from FY2016 is largely attributed to a shift in managed care costs

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[235] Illinois State Board of Education, Division of Funding and Disbursement Services, *General State Aid (105 ILCS 5/18-18.05)*, September 21, 2015, http://www.isbe.net/budget/fy17/FY17-budget-request.pdf (last visited on April 13, 2016).
[236] Illinois State FY2017 Budget, p. 29. For more information on the amount of GSA needed to fund the Foundation Level, see Illinois State Board of Education, *Reviewing the March Forecast of FY17 General State Aid*, April 12, 2016, http://www.isbe.net/funding/pdf/fy17-gsa-funding-forecast-notes.pdf (last visited on April 13, 2016).
[237] Illinois Board of Higher Education, *FY2017 Governor's Budget Attachments*, http://www.ibhe.org/Fiscal%20Affairs/PDF/FY2017Attachments.pdf (last visited on April 13, 2016).
[238] Illinois State FY2017 Budget, p. 258.
[239] Illinois State FY2017 Budget, p. 258.

from other agencies and new requirements, including a State law that extends Medicaid coverage to heroin addiction treatment.[240]

It is important to understand that most Medicaid spending in Illinois is currently reimbursed by the federal government at a rate of 50.89%; for every $1 in appropriations, net State spending is 49.11 cents.[241] Since January 2014, the federal government has paid the entire bill for Medicaid recipients who became eligible for coverage under the Affordable Care Act. Federal reimbursement for this population declines to 95% beginning in January 2017, which is projected to add $57.6 million to net State costs in FY2017.[242]

Government services appropriations decline by $266 million, or 22.0%, from $1.2 billion in the FY2017 maintenance budget to $944 million in the FY2017 recommended budget. The decrease reflects reductions of approximately 10% to the General Funds budgets of the General Assembly, judicial and constitutional offices.[243] In addition, the recommended FY2017 budget does not include funding for the Teachers' Retirement Insurance Program (TRIP) or the College Insurance Program (CIP), which provide health insurance for retired public school teachers and community college employees outside of Chicago, or any contributions to the Chicago teachers' pension fund. The State's statutorily required contributions to TRIP and CIP are $109.7 million and $4.3 million, respectively, in FY2017 and are covered by continuing appropriation.[244] The State's contribution to the Chicago teachers' pension fund totaled $12.1 million in FY2016, as required by statute.[245]

The proposed FY2017 budget also includes $319 million in projected savings due to procurement reforms, compensation changes and other "transformation proposals" that are designed to generate short- and long-term savings.[246] Procurement savings are expected to come from centralization of agency purchasing and cooperative purchasing, which would allow Illinois to join competitively bid contracts with other states and consortiums.[247] Compensation changes include imposing a four-year freeze on general and experience-based wage increases for union workers, combined with a new merit-pay program, and basing overtime pay on a 40-hour work week rather than the current 37.5-hour work week.[248] The compensation changes have so far been rejected by the American Federation of State, County and Municipal Employees (AFSCME), the State's largest union, in negotiations over a new contract to replace an agreement that expired on June 30, 2015. The Rauner administration is currently seeking a determination from the Illinois Labor Relations Board on whether the talks have reached an impasse.[249]

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[240] Illinois Department of Healthcare and Family Services, *FY2017 Budget*, February 17, 2016, pp. 32-33. The heroin addiction treatment law is Public Act 99-0480, enacted on September 11, 2015.
[241] The reimbursement rate increases to 51.3% in federal fiscal year 2017, which begins in October 2016.
[242] Illinois Department of Healthcare and Family Services, *FY2017 Budget*, February 17, 2016, p. 28.
[243] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 15, 2016.
[244] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 8, 2016.
[245] Illinois State FY2017 Budget, p. 467; 40 ILCS 17/127.
[246] Illinois State FY2017 Budget, p. 43.
[247] Illinois State FY2017 Budget, p. 50.
[248] Illinois State FY2017 Budget, p. 55.
[249] Kim Geiger, Monique Garcia and Celeste Bott, "Rauner asks his labor board to determine if union contract talks at impasse," *Chicago Tribune*, January 15, 2016.

General Funds pension contributions in the recommended FY2017 budget of $6.2 billion are reduced by $748 million, or 10.8%, from $6.9 billion in the FY2017 maintenance budget.[250] State savings are projected to come from the following proposed changes:[251]

- 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 the Governor's salary of $180,000;
- 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.
- 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.
- Pension pickup: State agencies and offices would be banned from paying employees' share of pension contributions. This change applies mainly to employees not under the Governor's control.

The Governor's Office has not made available to the public the breakdown of savings attributed to each of the pension changes or any actuarial reviews of the proposals. Legislation related to the changes has not been introduced.

The proposed FY2017 budget includes group insurance contributions of $1.3 billion, a decrease of $445 million, or 24.6%, from the FY2017 maintenance level of $1.8 billion. Most of the savings would be achieved by giving employees a choice between significantly higher health insurance premiums or less generous coverage.[252] The recommended changes have so far been rejected in contract negotiations with AFSCME, but the Governor has also proposed that health insurance benefits be removed from collective bargaining.[253]

General Funds Expenditures

Expenditures from General Funds consist of net appropriations spent (appropriations minus unspent appropriations) and statutory transfers out. The next table shows total General Funds expenditures, including net appropriations spent and statutory transfers out, from FY2013 to FY2017. Total recommended FY2017 expenditures decline by $2.6 billion, or 6.7%, to $36.3 billion from the FY2017 maintenance level of $39.0 billion but increase by $260 million, or less than 1%, from an estimated $36.1 billion in FY2016.

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[250] The $6.9 billion maintenance level is based on existing statutory requirements, as certified in January 2016 by the five State retirement systems.
[251] Illinois State FY2017 Budget, pp. 46-47.
[252] Illinois State FY2017 Budget, pp. 52-54.
[253] Joseph S. Pete, "Rauner calls for limits to collective bargaining," *Times of Northwest Indiana*, October 7, 2015.

State of Illinois General Funds Expenditures: FY2013-FY2017 (in $ millions)	FY2013	FY2014	FY2015 Prelim.	FY2016 Est.*	FY2017 Maint.	FY2017 Rec.	FY2017 Rec. - Maint. $ Change	FY2017 Rec. - Maint. % Change
Agency Appropriations	$ 24,291	$ 24,712	$ 24,188	$ 23,438	$ 25,181	$ 24,511	$ (670)	-2.7%
(Unspent Appropriations)**	$ (556)	$ (667)	$ (1,036)	$ (251)	$ (251)	$ (255)	$ (4)	1.6%
(Procurement and Unassigned Savings)	$ -	$ -	$ -	$ -	$ -	$ (319)	$ (319)	na
Net Agency Appropriations Spent	$ 23,735	$ 24,045	$ 23,152	$ 23,187	$ 24,930	$ 23,937	$ (993)	-4.0%
Pension Contributions	$ 5,107	$ 5,988	$ 6,046	$ 6,632	$ 6,932	$ 6,184	$ (748)	-10.8%
State Group Insurance	$ 1,450	$ 1,446	$ 1,565	$ 1,650	$ 1,810	$ 1,365	$ (445)	-24.6%
Net Appropriations Spent	**$ 30,292**	**$ 31,479**	**$ 30,763**	**$ 31,469**	**$ 33,672**	**$ 31,486**	**$ (2,186)**	**-6.5%**
Statutory Transfers Out								
Legislatively Required Transfers	$ 2,840	$ 2,963	$ 2,489	$ 2,486	$ 2,473	$ 2,473	$ -	0.0%
Debt Service on Pension Bonds	$ 1,552	$ 1,655	$ 1,531	$ 1,419	$ 1,604	$ 1,604	$ -	0.0%
Debt Service on Capital Bonds	$ 551	$ 603	$ 563	$ 710	$ 766	$ 766	$ -	0.0%
Repayment of Interfund Borrowing	$ 132	$ -	$ -	$ -	$ 454	$ 15	$ (439)	-96.7%
Total Transfers Out* **	**$ 5,075**	**$ 5,222**	**$ 4,583**	**$ 4,615**	**$ 5,297**	**$ 4,858**	**$ (439)**	**-8.3%**
Total Expenditures	**$ 35,367**	**$ 36,701**	**$ 35,346**	**$ 36,084**	**$ 38,969**	**$ 36,344**	**$ (2,625)**	**-6.7%**

*Total FY2016 appropriations have not been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions.

**Unspent appropriations include Comptroller prior year adjustments of $60 million in FY2014 and $12 million in FY2015.

***Totals may not sum due to rounding.

Source: Illinois State FY2017 Budget, pp. 63 and 75; Illinois State FY2016 Budget, p. 3-21; Illinois State FY2015 Budget, pp. 2-22 and 2-35.

As previously discussed, expenditures in FY2015 are understated because FY2014 revenues were used to pay for some FY2015 Medicaid expenses.[254] 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.[255]

In addition, beginning on February 1, 2015, State law required that a specific share of income tax revenues be diverted from General Funds to provide additional funding for human services and elementary and secondary education.[256] The diversions resulted in total appropriations of $400 million for education and human services from two other State funds.[257] The additional appropriations should be taken into account when comparing expenditures before FY2015 with expenditures in subsequent years.

Transfers out include debt service payments and a wide variety of legislatively required transfers. The FY2017 recommended budget proposes that only $15 million of the $454 million borrowed from other State funds in FY2015 be repaid. Debt service transfers for pension bond payments decline by $112 million in FY2016 due to the full retirement of bonds sold in 2010.[258] A $185 million increase in debt service transfers out for pension bond payments in FY2017 reflects an increase in principal payments due on bonds issued in 2011.

[254] For more information on FY2015 expenditures, see p. 63 of this report.
[255] Public Act 98-0642, signed on June 9, 2014.
[256] 35 ILCS 5/901 (f) and (g). The Commitment to Human Services Fund and Fund for the Advancement of Education each receive 1/30 of net income tax revenues from individuals, trusts and estates annually through FY2024; in February 2025 the share increases to 1/26. This requirement diverted $484 million from General Funds in FY2015.
[257] Public Acts 98-0677 and 98-0680, signed on June 30, 2014.
[258] Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2015*, March 2016, p. 114.

Legislatively required transfers are projected to decline by $12.2 million, or 0.5%, to $2.47 billion in FY2017 from $2.49 billion in FY2016. The next table shows legislatively required transfers from FY2013 to FY2017.

State of Illinois Legislatively Required General Funds Transfers Out by Fund: FY2013-FY2017 (in $ millions)									
Fund	FY2013	FY2014	FY2015	FY2016 Est.	FY2017 Projected.	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
Local Government Distributive	$ 1,203.6	$ 1,223.2	$ 1,095.3	$ 1,293.9	$ 1,318.9	$ 25.0	1.9%	$ 115.3	9.6%
Public Transportation	$ 482.8	$ 474.5	$ 498.8	$ 511.4	$ 518.0	$ 6.6	1.3%	$ 35.2	7.3%
Downstate Public Transportation	$ 208.7	$ 216.4	$ 211.9	$ 205.3	$ 209.4	$ 4.1	2.0%	$ 0.7	0.3%
Workers' Compensation Revolving	$ 101.3	$ 81.3	$ 96.0	$ 104.1	$ 104.3	$ 0.2	0.2%	$ 3.0	3.0%
School Infrastructure	$ 84.2	$ 79.6	$ 91.1	$ 89.1	$ 92.8	$ 3.7	4.2%	$ 8.6	10.2%
University of Illinois Hospital Services	$ 45.0	$ 45.0	$ 45.0	$ 45.0	$ 45.0	$ -	0.0%	$ -	0.0%
Metropolitan Exposition, Auditorium and Office Building	$ 37.9	$ 37.9	$ 37.9	$ 37.9	$ 27.9	$ (10.0)	-26.4%	$ (10.0)	-26.4%
Agricultural Premium	$ 23.8	$ 23.8	$ 23.8	$ 23.8	$ 21.6	$ (2.2)	-9.2%	$ (2.2)	-9.2%
Live and Learn	$ 20.9	$ 20.9	$ 20.9	$ 20.9	$ 20.9	$ -	0.0%	$ -	0.0%
Audit Expense	$ 16.6	$ 19.4	$ 17.6	$ 19.0	$ 19.1	$ 0.1	0.5%	$ 2.5	15.1%
Professional Services	$ 14.0	$ 9.0	$ 4.3	$ 9.9	$ 17.8	$ 7.9	79.8%	$ 3.8	27.1%
Partners for Conservation	$ 15.0	$ 14.0	$ 14.0	$ 14.0	$ 14.0	$ -	0.0%	$ (1.0)	-6.7%
Metropolitan Pier and Exposition Authority Incentive	$ 15.0	$ 11.7	$ 14.7	$ 15.0	$ 11.5	$ (3.5)	-23.3%	$ (3.5)	-23.3%
Tourism Promotion	$ 42.3	$ 48.1	$ 52.2	$ 53.4	$ 11.5	$ (41.9)	-78.5%	$ (30.8)	-72.8%
Presidential Library and Museum	$ -	$ 9.8	$ 10.0	$ 10.0	$ 10.0	$ -	0.0%	$ 10.0	na
All Others	$ 528.8	$ 648.7	$ 256.0	$ 32.9	$ 30.7	$ (2.2)	-6.7%	$ (498.1)	-194.6%
Total	$ 2,839.9	$ 2,963.3	**$ 2,489.5**	**$ 2,485.6**	**$ 2,473.4**	**$ (12.2)**	**-0.5%**	**$ (366.5)**	**-14.7%**

Source: Illinois State 2016 Budget, pp. 3-52 to 3-53; Illinois State FY2017 Budget, pp. 127-128.

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 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.[259] The transfer is expected to increase by $25 million, or 1.9%, to $1.32 billion in FY2017 from $1.29 billion in FY2016.

Despite the lack of an FY2016 budget, only about three of the transfers would require legislation; the remainder are authorized by statute.[260] However, the Comptroller still needs authorization to write checks from the accounts receiving the transfers.

For example, income tax transfers from General Funds to the LGDF are required by statute[261] and income tax distributions from the LGDF are covered by continuing appropriation.[262] But sales taxes deposited into the LGDF from the State and Local Sales Tax Reform Fund could only be distributed to local governments after the Governor signed a bill that included those appropriations.[263]

Similarly, transfers out of General Funds to the Metropolitan Pier and Exposition Authority Incentive Fund are required by statute.[264] But the agency that runs McCormick Place has not received the money, which is used to offer discounted rent to major trade shows and conferences, because the funds have not been appropriated.[265]

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[259] 35 ILCS 5/901(b).
[260] Communication between the Civic Federation and the Governor's Office of Management and Budget, April 19, 2016.
[261] 35 ILCS 5/901(b).
[262] 30 ILCS 115.1.
[263] Public Act 99-0491, signed on December 7, 2015.
[264] 70 ILCS 210/5.
[265] Danny Ecker, "State holding back McPier's trade show money," *Crain's Chicago Business*, April 19, 2016.

BUDGET DEFICIT AND UNPAID BILLS

The maintenance budget for FY2017 has a $6.6 billion gap between General Funds revenues and expenditures.[266] The Governor's recommended FY2017 budget reduces the operating deficit to $3.5 billion through projected spending cuts of $2.6 billion and the use of $476 million in one-time revenues.[267]

Because the State does not currently have a budget for FY2016, 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 FY2016 is estimated at $4.4 billion.

The following table provides a summary of the General Funds budget for FY2013 to FY2017. In the table, the total deficit is the sum of the operating deficit and the accumulated deficit from prior years. If the $3.5 billion gap between revenues and expenditures is not closed in FY2017, the total deficit would be $10.8 billion at the end of the fiscal year.

State of Illinois General Funds Budget Results and Plans: FY2013-FY2017
(in $ millions)

	FY2013	FY2014	FY2015	FY2016 Est.*	FY2017 Maint.	FY2017 Rec.
Operating Revenues						
State Source Revenues	$ 32,208	$ 32,855	$ 31,308	$ 27,551	$ 28,076	$ 28,551
Federal Revenues	$ 4,155	$ 3,903	$ 3,331	$ 4,161	$ 4,267	$ 4,267
Fund Sweeps to Fix FY2015 Budget	$ -	$ -	$ 1,284	$ -	$ -	$ -
Total Operating Revenues	**$ 36,363**	**$ 36,758**	**$ 35,923**	**$ 31,712**	**$ 32,343**	**$ 32,818**
Operating Expenditures						
Net Agency Appropriations Spent**	$ 23,735	$ 24,045	$ 23,152	$ 23,187	$ 24,930	$ 23,937
Pension Contributions[2]	$ 5,107	$ 5,988	$ 6,046	$ 6,632	$ 6,932	$ 6,184
State Group Insurance	$ 1,450	$ 1,446	$ 1,565	$ 1,650	$ 1,810	$ 1,365
Total Appropriations Spent	$ 30,292	$ 31,479	$ 30,763	$ 31,469	$ 33,672	$ 31,486
Statutory Transfers Out						
Legislatively Required Transfers	$ 2,840	$ 2,963	$ 2,489	$ 2,486	$ 2,473	$ 2,473
Debt Service on Pension Bonds	$ 1,552	$ 1,655	$ 1,531	$ 1,419	$ 1,604	$ 1,604
Debt Service on Capital Bonds	$ 551	$ 603	$ 563	$ 710	$ 766	$ 766
Repayment of Interfund Borrowing	$ 132	$ -	$ -	$ -	$ 454	$ 15
Total Statutory Transfers Out***	$ 5,075	$ 5,221	$ 4,583	$ 4,615	$ 5,298	$ 4,858
Total Operating Expenditures* **	**$ 35,367**	**$ 36,701**	**$ 35,346**	**$ 36,084**	**$ 38,969**	**$ 36,344**
Operating Surplus (Deficit)	**$ 996**	**$ 57**	**$ 577**	**$ (4,372)**	**$ (6,626)**	**$ (3,526)**
Borrowing for Operations	$ -	$ -	$ 454	$ -	$ -	$ -
Operating Surplus (Deficit) After Borrowing	$ 996	$ 57	$ 1,031	$ (4,372)	$ (6,626)	$ (3,526)
Accumulated Deficit from Prior Years	$ (4,984)	$ (3,988)	$ (3,931)	$ (2,900)	$ (7,272)	$ (7,272)
Total Deficit	**$ (3,988)**	**$ (3,931)**	**$ (2,900)**	**$ (7,272)**	**$ (13,898)**	**$ (10,798)**

*Total FY2016 appropriations have not been enacted. Estimated appropriations are amounts needed to fund agency operations and programs under current conditions.

**Agency appropriations minus unspent appropriations. Recommended FY2017 net agency appropirations spent are also net of $319 million in projected savings from procurement reforms and other changes.

***Totals may not sum due to rounding.

Source: Illinois State FY2015 Budget, p. 2-35; Illinois State FY2016 Budget, pp. 3-6 and 3-21; Illinois State FY2017 Budget, pp. 75 and 91.

266 Maintenance spending in FY2017 is defined as the amount needed to fund agencies' core missions and programs, after adjusting for price changes and one-time costs.

267 Projected FY2017 resources include $200 million from the sale of the James R. Thompson Center and $276 million from depleting the Budget Stabilization Fund.

Rather than providing a detailed plan to close the $3.5 billion gap, the proposed FY2017 budget offers the General Assembly a choice between two options:

1. Agreeing to key portions of Governor Rauner's Turnaround Agenda, which is intended to boost economic growth by making Illinois more appealing to businesses. In that case, the Governor would support unidentified additional revenues and spending that could reach $36.3 billion; or
2. Granting the Governor broad authority to close the $3.5 billion gap on his own by making cuts to any area of government, with limited exceptions. In that case, spending could be as low as $32.8 billion.

The broad authority described in the second option is contained in proposed legislation known as the Unbalanced Budget Response Act.[268] To balance the budget in FY2016 and FY2017, the Governor would be allowed to set aside contingency reserves from any appropriations except debt 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. For budgetary purposes, the backlog of unpaid bills represents General Funds obligations that must be paid from the next year's revenues. 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 FY2017. Fiscal year 2012 is used as the starting point because data on year-end backlogs before FY2012 are not available in annual budget documents.[269] Prior to the current fiscal situation the year-end backlog peaked in FY2012 due to of an accumulation of unpaid Medicaid bills.

State of Illinois Unpaid Bill Backlog at Fiscal Year End: FY2012-FY2017 (in $ millions)

	FY2012	FY2013	FY2014	FY2015	FY2016 Est.	FY2017 Maint.	FY2017 Rec.*
General Funds Payables	**$ (5,024)**	**$ (4,142)**	**$ (4,005)**	**$ (3,521)**	**$ (7,400)**	**$ (14,026)**	**$ (10,926)**
Section 25 Liabilities							
Healthcare and Family Services	$ (1,422)	$ (495)	$ (244)	$ (295)	$ (426)	$ (395)	$ (395)
Human Services	$ (19)	$ (19)	$ (14)	$ (16)	$ -	$ (21)	$ (21)
Group Health Insurance	$ (1,351)	$ (1,351)	$ (1,364)	$ (1,401)	$ (1,453)	$ (1,500)	$ (1,500)
Total Section 25 Liabilities	**$ (2,792)**	**$ (1,865)**	**$ (1,622)**	**$ (1,712)**	**$ (1,879)**	**$ (1,916)**	**$ (1,916)**
Aging	**$ (173)**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Income Tax Refunds Payable	**$ (70)**	**$ (40)**	**$ 1**	**$ -**	**$ (70)**	**$ -**	**$ -**
Total**	**$ (8,059)**	**$ (6,046)**	**$ (5,626)**	**$ (5,233)**	**$ (9,349)**	**$ (15,942)**	**$ (12,842)**

*Based on the $3.5 billion operating deficit in the Governor's recommended FY2017 budget.

**Totals may not sum due to rounding.

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

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268 99th Illinois General Assembly, Senate Bill 2789, introduced on February 17, 2016.

269 The data were required by Public Act 98-0460, signed on August 16, 2013.

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 $9.3 billion at the end of FY2016. At maintenance spending levels, unpaid bills could grow to $15.9 billion at the end of FY2017.

Under the Governor's proposed budget, the backlog could be $9.3 billion at the end of FY2017 if the operating deficit is closed, or 27.2% of projected FY2018 General Funds revenues of $34.3 billion.[270] If the gap is not eliminated, the backlog could grow to $12.8 billion, or 37.5% of projected FY2018 revenues.

In the table, General Funds payables are bills paid and transfers made during the lapse period. The lapse period is the time during which this year's bills may be paid with next year's revenues. Most bills are due to the Comptroller by two months after the end of the fiscal year on June 30, but the Comptroller has until December 31 to pay them.[271]

Under State law, most bills must be paid based on the current year's spending authority. However, exceptions to Section 25 of the State Finance Act permit the payment of certain bills based on future years' appropriations.[272] These bills are known as Section 25 liabilities. The authority to defer Medicaid bills at the Department of Healthcare and Family Services was sharply restricted beginning in FY2013; group health insurance bills currently represent the major Section 25 liability.

Another General Funds liability that is not part of General Funds payables involves the Community Care Program at the Illinois Department on Aging, which is designed to allow seniors to stay out of nursing homes. Community Care has not usually been covered by a Section 25 exception, but annual appropriation bills in have often allowed the program's prior year costs to be paid from the current year's budget.

In recent years the State has also accumulated unpaid income tax refunds, an additional General Funds liability that is not a General Funds payable. Unpaid tax refunds, primarily owed to businesses, peaked at $735 million at the end of FY2010.[273] The table shows $70 million in unpaid income tax refunds at the end of FY2016, but that backlog is likely to grow to totaling $180 million, according to the Illinois Department of Revenue.[274] The current diversion rates—the percentage of individual and corporate income taxes diverted from General Funds to pay income tax refunds—are too low to cover estimated refunds for FY2016.[275] Without an FY2016 budget in place, the diversion rates were determined by statutory formula.

[270] Illinois Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY17-FY19*, January 6, 2016.
[271] 30 ILCS 105/25(m). For more information, see Illinois Office of the Comptroller, *What is Lapse Period*, November 3, 2015, http://ledger.illinoiscomptroller.gov/fiscal-focus/what-is-lapse-period/ (last visited on April 8, 2016).
[272] 30 ILCS 105/25.
[273] Communication between the Civic Federation and the Illinois Department of Revenue, August 16, 2012.
[274] Communication between the Civic Federation and Illinois Department of Revenue, April 18, 2016.
[275] Illinois Governor's Office of Management and Budget, *Illinois Economic and Fiscal Policy Report*, January 6, 2016, p. 6.

DEBT BURDEN AND RATINGS

In FY2017 the State of Illinois will pay debt service totaling $3.3 billion due on $28.2 billion of principal owed for all outstanding General Obligation Bonds and Build Illinois Bonds.[276] The State currently owes $13.9 billion in interest on these bonds through FY2041 for a total outstanding debt service cost of $42.2 billion.

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. The remaining amounts are paid through transfers from Other State Funds that are funded through separate designated revenue sources. 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 FY2017 totals $2.4 billion, or 7.4% of State-source General Funds resources.

Total Debt

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.[277] 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. General Obligation (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 did not issue GO bonds in FY2015 and sold a total of $480 million in FY2016.[278] The State authorized issuing an additional $600 million in GO bonds for capital purposes and $1.1 billion in GO bonds for transportation projects in 2015, of which only a small portion has been issued.[279] A total of $3.7 billion in capital GO bonds were issued during FY2014.[280]

As a result of the State issuing only a small amount of bonds, combined with the level principal repayment requirements for Illinois' debt issuance, total outstanding capital purpose GO bonds decreased by $450.1 million to $13.6 billion in FY2017 from $14.1 billion in FY2016.[281] The interest owed on the State's outstanding capital-purpose GO bonds decreased by $484.0 million to $7.1 billion in FY2017 from $7.6 billion in FY2016. The combined total debt service owed on all outstanding capital GO bonds totals $20.8 billion in FY2017 compared to $21.7 billion in FY2016.

The State anticipates selling an additional $1.0 billion in capital purpose GO bonds before the end of FY2016 and $800 million in FY2017 to continue funding its capital budget.[282] If these issuances are completed as scheduled, total outstanding GO bond principal will increase by $878 million by

[276] Illinois State FY2017 Budget, pp. 527, 528.
[277] 30 ILCS 330/1.
[278] Illinois State FY2017 Budget, p. 525.
[279] Public Act 98-0781, enacted on July 22, 2014.
[280] Commission on Government Forecasting and Accountability, *State of Illinois Capital Plan Analysis FY2016*, April 2016, p. 22.
[281] Illinois State FY2017 Budget, p. 527; Illinois State FY2016 Budget p. 7-10.
[282] Illinois State FY2017 Budget, p. 526.

the end of FY2017 after accounting for the $921.1 million in principal repayment that will also be made in the coming year.

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 to make the annual contributions that otherwise would have come from the State's General Funds. The FY2010 POBs are repaid through FY2015. In FY2011 the State again issued POBs to make its annual contribution to its retirement systems, this time totaling $3.7 billion to be repaid over eight years. The FY2011 POBs will be completely retired in FY2019.

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.[283] 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 structure of the FY2011 bonds, which backloaded 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 backloaded. The State paid interest only on the loan 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 loan. 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.

Total principal owed on all outstanding POBs in FY2017 totals $12.0 billion, a decrease of $700 million from the total of $12.1 billion in FY2016.[284] The outstanding interest owed on the pension debt declined by $657.2 million to $5.9 billion in FY2017 from $6.5 billion in FY2016. The remaining debt service, including principal and interest, on the State's pension bonds totals $17.9 billion in FY2017 compared to $19.2 billion in FY2016. The State has not issued new POBs since 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. The largest ongoing revenue bond program are the Build Illinois Bond issuances, which began in 1985. Build Illinois Bonds are backed by a pledge of the State's portion of sales tax receipts.[285] The total bond authorization has been increased by the General Assembly on several occasions since the late 1980s. The State has not issued Build Illinois Bonds since it sold $402 million in FY2014.[286]

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[283] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2015*, August, 1 2014, p 194.
[284] Illinois State FY2017 Budget, p. 527.
[285] Build Illinois Bond Act, 30 ILCS 425.
[286] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2014*, August 2013, p 191.

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.[287] 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 FY2017 the outstanding Build Illinois Bonds principal totals $2.5 billion compared to $2.7 billion in FY2016. The interest owed on the loans through FY2038 totals $964.4 million as of FY2017, which is a decrease of $119.9 million from a total of $1.1 billion in FY2016. Total debt service on all outstanding Build Illinois Bonds decreased by $355.2 million to $3.5 billion in FY2017 from $3.8 billion in FY2016.

The following chart shows the total principal, interest and debt service in FY2016 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)*

	FY2016	FY2017	$ Change	% Change
Principal				
GO Capital	$14,144.9	$13,694.8	$ (450.1)	-3.18%
GO Pension	$12,700.0	$12,000.0	$ (700.0)	-5.51%
Build Illinois	$ 2,748.9	$ 2,513.6	$ (235.4)	-8.56%
Total Principal	**$29,593.8**	**$28,208.4**	**$ (1,385.5)**	**-4.68%**
Interest				
GO Capital	$ 7,599.7	$ 7,115.7	$ (484.0)	-6.37%
GO Pension	$ 6,540.7	$ 5,883.5	$ (657.2)	-10.05%
Build Illinois	$ 1,084.3	$ 964.4	$ (119.9)	-11.06%
Total Interest	**$15,224.7**	**$13,963.6**	**$ (1,261.1)**	**-8.28%**
Debt Service				
GO Capital	**$21,744.6**	**$20,810.5**	**$ (934.1)**	**-4.30%**
GO Pension	**$19,240.7**	**$17,883.5**	**$ (1,357.2)**	**-7.05%**
Build Illinois	**$ 3,833.2**	**$ 3,478.0**	**$ (355.2)**	**-9.27%**
Total	**$44,818.6**	**$42,172.0**	**$ (2,646.6)**	**-5.91%**

Source: Illinois State FY2017 Budget, pp. 527, 528; Illinois State FY2016 Budget, p. 7-10.

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 $2.2 billion in outstanding principal in FY2017 compared to the FY2013 total of $30.4 billion. However, the ongoing capital program has led to an increase of capital purpose principal debt of more than $1.6 billion in additional GO bonded debt. This increase is offset by a decline in principal Build Illinois Bond debt of $383 million compared to FY2013 and a decline of $3.5 billion in POB principal outstanding.

Total interest owed on the State's outstanding debt has declined by $2.1 billion over the last five years, primarily due to the increased interest payments on the State's outstanding POBs. Interest owed on POBs is $2.9 billion less in FY2017, totaling $5.9 billion, compared to $8.8 billion in FY2013. This represents the total interest owed on POBs through FY2033.

[287] For more information on the State capital budget see page 79 of this report.

Interest on capital purpose GO bonds has increased by $1.1 billion due to the the issuance of additional principal over the last five years. The State owes $7.1 billion in interest on capital GO bonds for debt repaid through FY2041 compared to $6.0 billion in FY2013.

The interest owed on all outstanding Build Illinois Bond debt through FY2038 declined by $364.3 million in FY2017, totaling $964.4 million compared to $1.3 billion in FY2013.

The following chart compares the outstanding principal, interest and total debt service on all Build Illinois Bonds, GO capital bonds and POBs from FY2013 to FY2017.

State of Illinois Total Outstanding Debt Service: General Obligation and Build Illinois Bonds Five-Year Comparison FY2013 to FY2017 (in $ millions)*

	FY2013	FY2014	FY2015	FY2016	FY2017	5-year $ Change	5-year % Change
Principal							
GO Capital	$12,071.4	$13,487.5	$14,337.3	$ 14,144.9	$13,694.8	$ 1,623.4	13.4%
GO Pension	$15,479.0	$14,686.4	$13,975.2	$ 12,700.0	$12,000.0	$ (3,479.0)	-22.5%
Build Illinois	$ 2,896.3	$ 2,798.9	$ 2,982.3	$ 2,748.9	$ 2,513.6	$ (382.7)	-13.2%
Total Principal	**$30,446.7**	**$30,972.9**	**$31,294.8**	**$ 29,593.8**	**$28,208.4**	**$ (2,238.3)**	**-7.4%**
Interest							
GO Capital	$ 6,009.1	$ 7,576.5	$ 7,923.8	$ 7,599.7	$ 7,115.7	$ 1,106.6	18.4%
GO Pension	$ 8,754.1	$ 7,986.3	$ 7,245.4	$ 6,540.7	$ 5,883.5	$ (2,870.5)	-32.8%
Build Illinois	$ 1,328.7	$ 1,133.6	$ 1,220.9	$ 1,084.3	$ 964.4	$ (364.3)	-27.4%
Total Interest	**$16,091.9**	**$16,696.4**	**$16,390.0**	**$ 15,224.7**	**$13,963.6**	**$ (2,128.3)**	**-13.2%**
Debt Service							
GO Capital	**$18,080.5**	**$21,064.1**	**$22,261.1**	**$ 21,744.6**	**$20,810.5**	**$ 2,730.0**	**15.1%**
GO Pension	**$24,233.1**	**$22,672.7**	**$21,220.6**	**$ 19,240.7**	**$17,883.5**	**$ (6,349.5)**	**-26.2%**
Build Illinois	**$ 4,225.0**	**$ 3,932.5**	**$ 4,203.2**	**$ 3,833.2**	**$ 3,478.0**	**$ (747.0)**	**-17.7%**
Total	**$46,538.6**	**$47,669.2**	**$47,684.9**	**$ 44,818.6**	**$42,172.0**	**$ (4,366.6)**	**-9.4%**

*As of the beginning of the fiscal year.

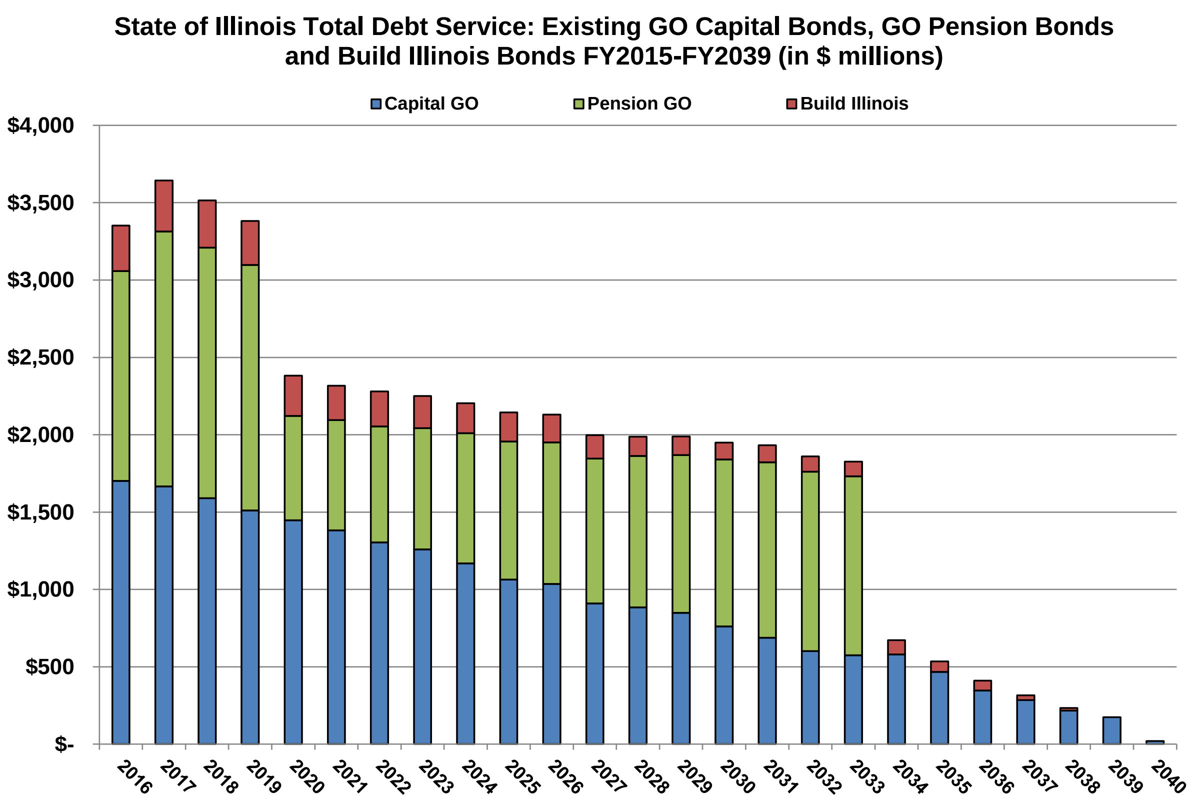
Source: Illinois State FY2017 Budget, pp. 527, 528; Illinois State FY2016 Budget, pp. 7-10, 7-11; State of Illinois, General Obligation Bonds, Series May 2014, *Official Statement* , April 25, 2014, p.53; State of Illinois, Build Illinois Bonds, Series of March 2014, *Official Statement* , March 11, 2014, p. 20; State of Illinois, General Obligation Bonds, Series of June 2013, *Official Statement* , June 26, 2013, p. 50; State of Illinois, General Obligation Bonds, Series of May 2009, *Official Statement* , May, 21, 2009, p. 36; State of Illinois, Build Illinois Bonds, Junior Obligation Series of June 2013, *Official Statement* , June 15, 2013, p. 18; Illinois State FY2010 Budget, p. 12-11; State of Illinois, General Obligation Bonds, Taxable Build America Bonds Series 2010-5, *Official Statement* , July 14, 2010, p. 38.

Debt Service

The State's debt service schedule sets forth the principal and interest amounts due to investors for its outstanding bonds on an annual basis. In FY2017 the State is required to pay a total of $3.6 billion for all outstanding GO Bonds, POBs and Build Illinois Bonds.[288] The largest portion of this payment is due on capital purpose GO Bonds totaling $1.7 billion. Debt service in FY2017 totals $1.6 billion for POBs and $329.7 million for Build Illinois Bonds.

Based on the State's current bonded indebtedness, debt service payments will peak in FY2017 and decline marginally through FY2019 to $3.3 billion. Once the State has paid off the FY2011 POBs, debt service declines by $1.0 billion to $2.3 billion in FY2020.

The following chart shows total debt service for existing Pension Obligation bonds, GO capital bonds and other capital bonds through FY2041.[289]



Source: Illinois State FY2017 Budget, pp. 527, 528.

288 Illinois State FY2017 Budget, pp. 527, 528.
289 For more details on total debt service, see Appendix D on page 91 of this report.

As noted above, the State does not pay for all debt service out of General Funds. Revenue bonds have specific dedicated sources outside the General Funds. 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.

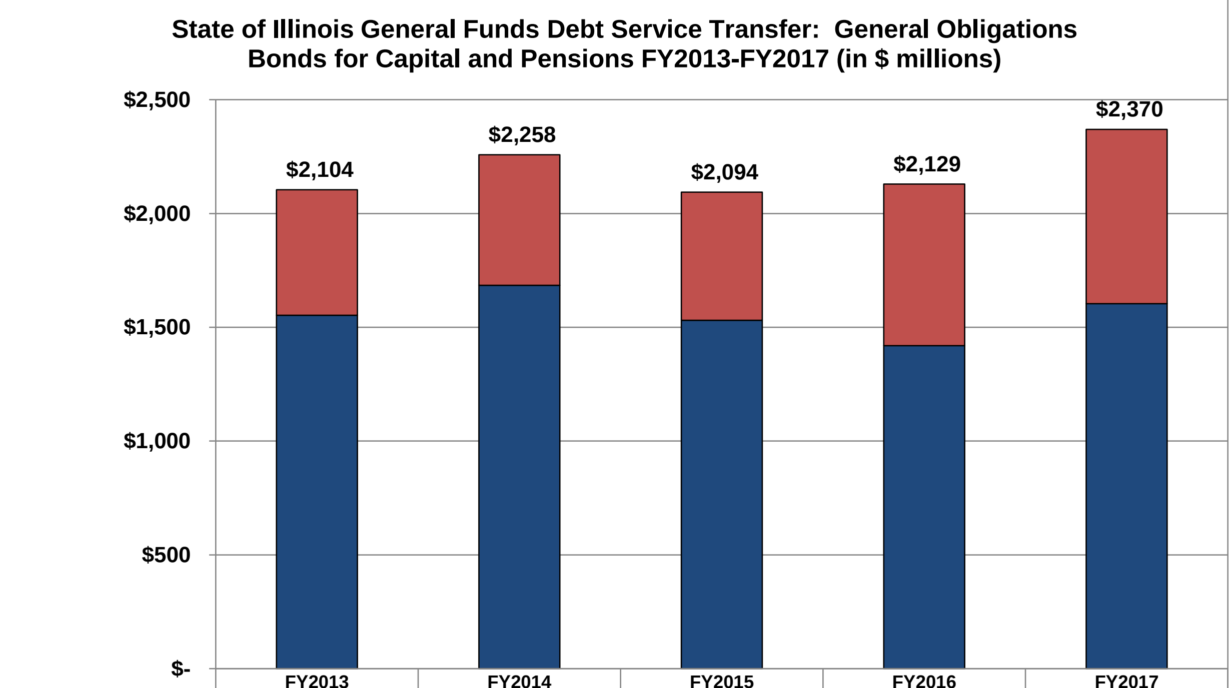
The enacted FY2017 budget includes debt service transfers from General Funds totaling $2.4 billion, an increase of $241 million from FY2016.[290]

The debt service transfer associated with capital GO bonds in FY2017 increases by $56 million, totaling $766 million compared to $710 million in FY2016. Over the last five years the General Funds debt service cost for capital bonds has increased $215 million from a total of $551 million in FY2013. The operating budget incurs higher costs for capital purpose debt service due to the shortfall in revenues in the Capital Projects Fund.[291] 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.

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.

[290]Illinois State FY2017 Budget, p. 512.
[291] For more information on the Capital Projects Fund see page 79or this report.

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 FY2013 through FY2017.



	FY2013	FY2014	FY2015	FY2016	FY2017
Debt Service Transfer	$2,104	$2,258	$2,094	$2,129	$2,370
Capital	$551	$573	$563	$710	$766
Pensions	$1,553	$1,685	$1,531	$1,419	$1,604

Source: 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.

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' 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.

Illinois' bond rating is the lowest of all 50 states, leading to dramatically higher borrowing costs than better-rated governments. Two of the three major rating agencies have cut the State of Illinois' bond ratings due to its ongoing budget crisis and worsening financial condition. These downgrades make Illinois the only state credit currently rated below the 'A' category and signal a weakened capacity for the government to meet its financial obligations.

The following table shows the current bond ratings for Illinois' General Obligation Bonds and Build Illinois Bonds including the outlook from each of the three major ratings agencies.

State of Illinois: Current Bond Ratings				
	GO Bonds		Build Illinos Bonds	
Agency	**Rating**	**Outlook**	**Rating**	**Outlook**
Moody's Investors Service	Baa1	Negative	Baa1	Negative
Standard & Poor's	A-	Negative	AAA	Stable
Fitch Ratings	BBB+	Stable	AA+	Stable

Source: Illinois State FY2017 Budget, p. 522.

The most recent downgrades came shortly after an announcement by the State Comptroller that due to year-end spending pressures and lower revenues, Illinois would delay it contributions to the State's pension funds in November, and possibly in December.[292]

Fitch Ratings took action to downgrade Illinois to BBB+ from A- on October 19, 2015. This marked the seventh downgrade of Illinois' General Obligation Bond rating by Fitch in the last five years. The press release accompanying the downgrade from Fitch attributed the action directly to the State's budget impasse and liquidity issues despite a growing economy in the State.

Although the rating is now below the 'A' level, the credit is still considered investment grade and three levels above speculative, or junk status. The outlook on Illinois' credit from Fitch is listed as stable, indicating that another downgrade is not likely in the near term.

Moody's Investors Service also lowered its rating on Illinois' General Obligation Bonds to Baa1 from A3 on October 22, 2015. Using a similar rationale, Moody's cited the State's lack of a budget and deteriorating finances for taking the ratings action. This was the sixth downgrade of Illinois by Moody's over the last five years. Illinois' outlook from Moody's remains negative, indicating the possibility of further downgrades if nothing is done to address the budget crisis.

Prior to the downgrade, Illinois stood alone with New Jersey as the only single 'A' rated state credits. More than half of the remaining states are rated 'Aa' and 15 states have the highest level of 'Aaa' rating from Moody's. Moody's also lowered the ratings for the State's Build Illinois Bonds to Baa1 from A3, which are backed by a portion of the State's sales tax receipts.

The third prominent ratings agency, Standard and Poor's, continues to rate Illinois A- with a negative outlook. In FY2008, prior to the economic downturn, the State of Illinois was AA rated by Fitch, AA rated by S&P and AA3 rated by Moody's.[293]

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[292] Illinois Comptroller Leslie Geissler Munger, "Munger: Cash Shortage Requires State to Delay Pension Payment," *news release*, October 14, 2015, (https://illinoiscomptroller.gov/news-portal/munger-cash-shortage-requires-state-to-delay-pension-payment/#.VxkY7_krKUk (last visited on April 21, 2016).
[293] Illinois State FY2009 Budget, p. 12-3.

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.[294] 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. If the ratings for the State's GO bonds falls below Baa2 with Moody's or BBB for Fitch and S&P, then the State would owe whatever the current calculated market values of the swaps were at that time.

As of December 31, 2015 the State's swaps portfolio has a negative value of $138.0 million, which is an increase in its liability exposure from the negative value of $123.7 million reported as of June 30, 2014.[295] The State's credit rating would trigger its swaps termination clauses if either Moody's or Fitch reduced its credit rating two levels or if S&P reduced its rating by three levels.

In order to maintain its variable rate debt, the State also has letters of credit totaling $600 million. The State's current letters of credit cost 2.6% annually, or $15.6 million, and must be renewed or replaced each year. These loans are necessary because variable debt allows investors to resell the debt on a weekly basis when the interest rate also resets. If investors cannot find buyers in the market, the State must buy the notes. The letters of credit are used to cover these costs. Any amounts of the credit used must be repaid over a three-year period according to the terms of the current deals, which expire on November 26, 2016.

The State also pays a synthetically fixed interest rate of 3.89% on the $600 million principal amount of variable rate debt to the counterparties to its swaps. Combined with the letters of credit this makes for an effective interest cost of 6.46% for the $600 million variable rate bonds.

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[294] Illinois State FY2017 Budget, p. 515.

[295] Illinois State FY2017 Budget, p. 515; Illinois State FY2016 Budget, 7-5.

CAPITAL BUDGET

The Governor's recommended FY2017 capital budget includes a total of approximately $18.6 billion in new and reauthorized projects and marks the seventh year of the *Illinois Jobs Now!* capital spending program.[296]

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 FY2017 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 annual General Funds expenditures.

The enacted FY2016 capital budget included $15.1 billion of which $2.8 billion were new appropriations and $12.3 billion were reauthorized projects.[297] The $18.6 billion recommended for FY2017 includes $4.4 billion of new appropriations and $14.2 billion of previously approved spending authority proposed for reauthorization.

Funding for statewide road and bridge construction remains the largest portion of the State's capital expenditures. The proposed FY2017 capital budget included $11.5 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).[298] Of the total allocated to IDOT, $8.9 billion represents amounts proposed for reauthorization from previous years and $2.9 billion is new funding.[299]

As part of the recommended FY2017 capital budget, the Governor recommends new funding totaling $300 million for areas of critical deferred maintenance needs at State facilities and $100 million for improvements at correctional facilities.[300] Even as the State has undertaken its capital spending program since FY2010, the Capital Development Board has reported average annual growth of $500 million in deferred maintenance at state-owned facilities. State facilities currently have a backlog of more than $6.0 billion in deferred maintenance including office buildings, hospitals, laboratories, residential care facilities, prisons, parks, historic sites, fairgrounds and other storage facilities.[301] The State has only invested $436 million in maintaining these properties since *Illinois Jobs Now!* began in FY2010.

The proposed FY2017 capital budget also includes $400 million in new funding for technology upgrades. The Governor's capital budget proposes spending $250 million on a centralized financial management and planning system. An additional $150 million would be spent on other information technology projects.[302]

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[296] Illinois State FY2017 Capital Budget, p. 31.
[297] Illinois State FY2017 Capital Projects List, http://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/FY2017IllinoisCapitalProjectsList.xls (last visited on April 26, 2016).
[298] Illinois State FY2017 Capital Budget, p. 30.
[299] Illinois State FY2017 Capital Budget, p. 88, 89.
[300] Illinois State FY2017 Capital Budget, p. 21.
[301] Illinois State FY2017 Capital Budget, p. 21.
[302] Illinois State FY2017 Capital Budget, p. 23.

The following table compares the capital budget proposed by the Governor for FY2017 to the enacted capital budget for FY2016.

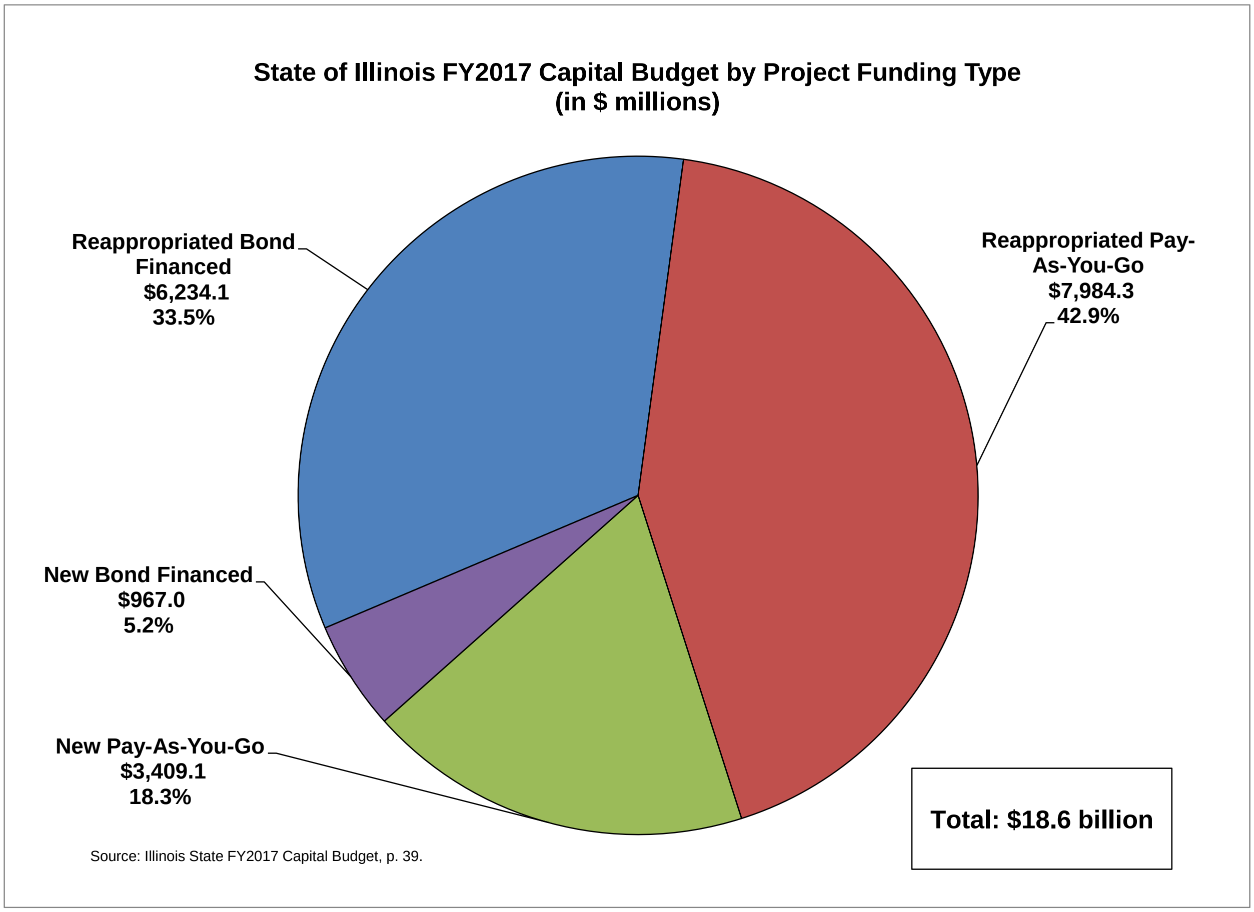
State of Illinois Capital Budget: FY2016 Enacted Compared to Governor's Recommended FY2017 (in $ billions)				
	FY2016 Enacted	FY2017 Rec.	$ Change	% Change
Reappropriation	$ 12.3	$ 14.2	$ 1.9	15.9%
New	$ 2.8	$ 4.4	$ 1.5	54.2%
Total	**$ 15.1**	**$ 18.5**	**$ 3.4**	**22.4%**

Source: Illinois State FY2017 Capital Projects List, http://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/FY2017IllinoisCapitalProjectsList.xls (last visited April 26, 2016).

Projects funded using bond proceeds make up $7.2 billion of the total proposed spending in FY2017, while $11.4 billion are pay-as-you-go projects financed with currently available resources.

The largest source of pay-as-you-go funding comes from the federal government. Federal funds support $1.3 billion of new projects and $4.1 billion of reappropriations, for a total of $5.4 billion in capital funds. The second largest source of pay-as-you-go funding is through user taxes and fees including motor fuel taxes, vehicle fees, licensing and other related charges. The FY2017 capital budget includes $953.9 million in new projects funded by user fees and taxes. Reappropriated projects funded by user fees and taxes total $1.7 billion.

The following chart shows the total FY2017 capital budget by the type of project funding.



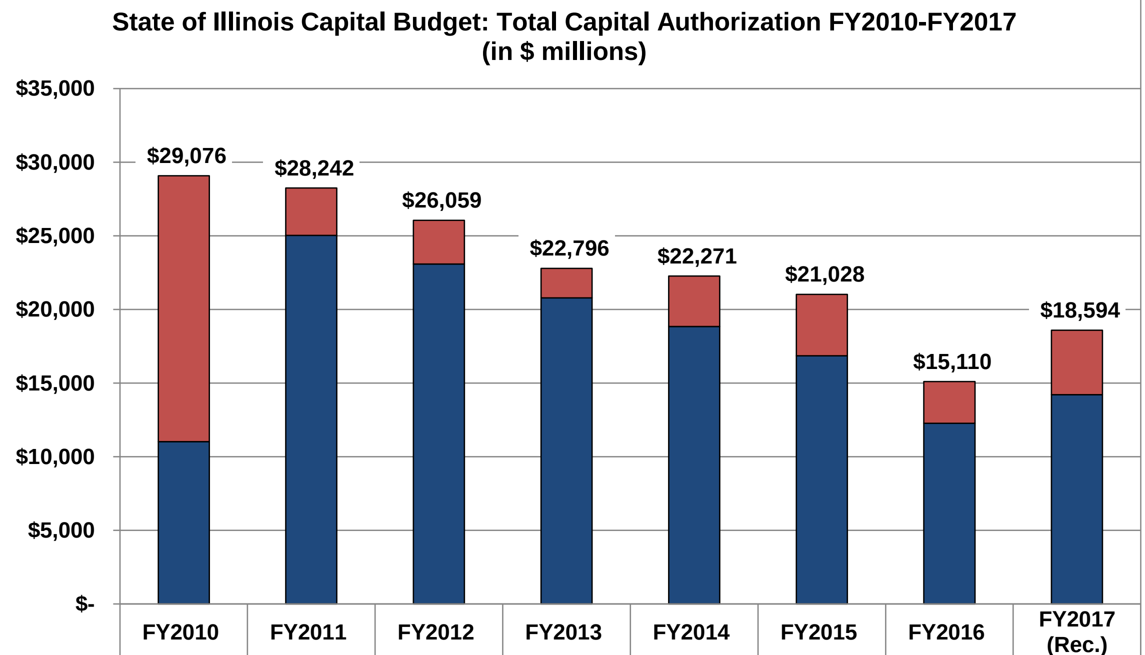
Total appropriations in the State's capital budget have declined to approximately $12.7 billion in the enacted FY2016 capital budget from $29.1 billion in FY2010. Reappapropriations would grow under the Governor's FY2017 recommended budget to $14.2 billion. Due to the addition of new projects and the 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 FY2010 capital budget included $18.0 billion in new projects added to $11.0 billion of reappropriations from previous years. The *Illinois Jobs Now!* program is commonly referred to as a $31.0 billion spending plan due to an additional $3.0 billion of new capital spending approved prior to the FY2010 capital budget in the summer of 2009.

Since the initial *Illinois Jobs Now!* spending was approved, the State has authorized new projects annually that add up to a total of $23.0 billion from FY2011 through the proposed FY2017 budget. The largest amount of new projects since FY2010 were approved in FY2015 totaling $4.2 billion. The Governor's proposed FY2017 appropriation for new capital projects is slightly larger totaling $4.4 billion.

Reappropriations increased to $25.0 billion in FY2011 and then declined over the next five years to a total of $12.3 billion in FY2016. Reappropriations in the FY2017 capital budget increase for the first time since FY2011.

The following chart shows the total new and reappropriated amounts in the capital budget approved by the State of Illinois from FY2010 through FY2017.



	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017 (Rec.)
Total	$29,076	$28,242	$26,059	$22,796	$22,271	$21,028	$15,110	$18,594
New	$18,042	$3,205	$2,978	$2,004	$3,434	$4,174	$2,837	$4,376
Reappropriation	$11,034	$25,037	$23,081	$20,792	$18,837	$16,854	$12,272	$14,218

Source: Illinois State FY2016 Budget, p. 28; Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2016*, April 2015, p. 8Illinois State FY2017 Capital Projects List, http://www.illinois.gov/gov/budget/Documents/Budget%20Book/FY%202017%20Budget%20Book/FY2017IllinoisCapitalProjectsList.xls (last visited April 26, 2016).

The State relies heavily on the sale of bonds to fund the capital budget. The original *Illinois Jobs Now!* capital program included approximately $16.2 billion of bond-funded expenditures.[303]

The State has issued $11.9 billion in bonds to pay for capital projects since the spending program began in FY2010.[304] A package of dedicated revenue sources was authorized to pay for the additional debt service related to spending on *Illinois Jobs Now!* 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.

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. This is intended to limit the General Funds impact of the additional debt sold to pay for the new capital budget.

303 Illinois State FY2017 Budget, p. 525.
304 For more details on the State's total debt burden and annual debt service costs, see p. 69 of this report.

However, the taxes and fees have yet to produce the funding projected when *Illinois Jobs Now!* was originally approved. In FY2017 Capital Projects Fund revenues are projected to total $754.4 million compared to the total of $731.4 million in FY2016. However, the legislative projections provided when the spending was approved in FY2010 anticipated $943 million to $1.2 billion annually.

The following table shows the revenues deposited into the Capital Projects Fund from FY2010 through the estimated FY2016 and projections for FY2017. 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 (Est.)	FY2017 (Proj.)
Video Poker Tax*	$288 - $534	$ -	$ -	$ -	$ 24.5	$ 114.4	$ 195.7	$ 240.0	$ 258.0
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	$ 56.0	$ 56.0
Liquor Tax	$ 108	$ 78	$ 105.2	$ 114.8	$ 115.1	$ 115.0	$ 116.4	$ 121.0	$ 123.0
Vehicle Related	$ 332	$ 117	$ 294.6	$ 299.7	$ 298.4	$ 304.0	$ 310.6	$ 314.0	$ 317.0
Other	$ -	$ -	$ (0.1)	$ 0.1	$ 0.3	$ 0.4	$ 0.4	$ 0.4	$ 0.4
Total	**$943 - $1,189**		**$ 505.8**	**$ 532.5**	**$ 627.3**	**$ 733.8**	**$ 687.0**	**$ 731.4**	**$ 754.4**

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

Source: Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2017* , April 2017, p.9.

The largest shortfalls in revenues are 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.

Due to administrative delays, the first video poker machines were not put into service until October 2012. Fiscal year 2013 was the first year that the capital budget received revenue from the 30% tax on video gaming. 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.[305]

The estimated FY2017 video gaming revenue totaling $258.0 million is still below the projection of $288 million to $534 million annually. This is largely due to the ability of local governments to opt out of video gaming or to continue existing local bans on the machines. According to a report from the Commission on Government Forecasting and Accountability, 46.5% of the Illinois population lives in communities where video gaming is illegal. Chicago, where video gaming remains prohibited, represents 21.0% of the State's population.[306]

The lease to manage the State's lottery is no longer expected to bring in any funding for the capital budget in FY2016 and FY2017 after revenues dropped to only $8 million in FY2015. 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.

Although gaming related revenues account 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.

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[305] Public Act 96-0034, enacted July 13, 2009.
[306] Commission on Government Forecasting and Accountability, *FY2017 Capital Plan Analysis,* April 2016, p. 11.

In addition to paying for the debt service on the *Illinois Jobs Now!* bonds, the Capital Projects Fund is statutorily required to make an annual payment of $245.2 million to General Funds. If the revenues generated for the Capital Projects Fund are not adequate to pay for all of these costs, the General Funds and Road Fund are used to cover the shortfall. The Capital Projects Fund must then repay the shortfall in the next fiscal year. This cycle of borrowing and repayment, combined with the inadequate resources in the Capital Projects Fund has led to the growth of an accumulated shortfall passed from one year to the next in the Capital Projects Fund.

The Capital Projects Fund will have an accumulated shortfall of $800.7 million in FY2016, which is an increase of $309.6 million from the FY2015 total of $491.1 million.[307] The accumulated shortfall in FY2016 exceeds the total expected revenues of $754.4 million in the Capital Projects Fund for FY2017.

A projection of the FY2017 Capital Projects Fund shortfall is not currently available. However, without additional resources it can be expected to grow until the debt service on the new bonds is significantly paid down.

The following table shows the revenues and expenses leading to the shortfalls in the Capital Projects Fund in FY2015 and FY2016.

State of Illinois Capital Projects Fund Accumulated Shortfall		
	FY2015	**FY2016**
Revenue	**$ 686.7**	**$ 731.0**
Expenditures		
Debt Service	$ 787.2	$ 791.1
General Funds Transfer	$ 245.2	$ 245.2
Shortfall Repayment	$ 145.3	$ 495.4
Total Expenditures	**$ 1,177.7**	**$ 1,531.7**
Surplus/(Deficit)	**$ (491.1)**	**$ (800.7)**

Source: Commission on Government Forecasting and Accountability, *FY2017 Capital Plan Analysis* , April 2016, p. 11.

[307] Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2017,* April 2016, p. 10.

APPENDIX A: SUPPLEMENTAL PENSION CONTRIBUTIONS

The following table shows the application of the supplemental payments related to the reduced debt service obligations associated with retiring Pension Obligation bonds beginning in FY2019. The payments total $364 million in FY2019 and $1.0 billion each year after until the systems are 100% funded, based on the most recent actuarial reports on the pension systems.[308]

State of Illinois Pension Funding Projections: Supplemental Annual Contribution FY2019 to FY2045 (in $ million)								
Fiscal Year	Supp. Contribution Value*	Accrued Liabilities	Actuarial Value of Assets	Unfunded Liabilities	Funded Ratio	Total Asssets with Supp. Value	Reduced Unfunded Liabilities	Increased Funded Ratio
2019	$ 364	$ 218,600	$ 98,920	$ (119,680)	45%	$ 99,284	$ (119,316)	45%
2020	$ 1,391	$ 225,424	$ 103,670	$ (121,754)	46%	$ 105,061	$ (120,363)	47%
2021	$ 2,496	$ 232,194	$ 108,511	$ (123,683)	47%	$ 111,007	$ (121,187)	48%
2022	$ 3,683	$ 238,894	$ 113,414	$ (125,480)	47%	$ 117,097	$ (121,797)	49%
2023	$ 4,959	$ 248,515	$ 118,398	$ (130,117)	48%	$ 123,357	$ (125,158)	50%
2024	$ 6,331	$ 252,034	$ 123,448	$ (128,586)	49%	$ 129,779	$ (122,255)	51%
2025	$ 7,806	$ 258,441	$ 128,582	$ (129,859)	50%	$ 136,388	$ (122,053)	53%
2026	$ 9,391	$ 264,717	$ 133,835	$ (130,882)	51%	$ 143,226	$ (121,491)	54%
2027	$ 11,096	$ 270,835	$ 139,218	$ (131,617)	51%	$ 150,314	$ (120,521)	56%
2028	$ 12,928	$ 276,771	$ 144,711	$ (132,060)	52%	$ 157,639	$ (119,132)	57%
2029	$ 14,897	$ 282,508	$ 150,344	$ (132,164)	53%	$ 165,241	$ (117,267)	58%
2030	$ 17,015	$ 288,032	$ 156,118	$ (131,914)	54%	$ 173,133	$ (114,899)	60%
2031	$ 19,291	$ 293,387	$ 162,136	$ (131,251)	55%	$ 181,427	$ (111,960)	62%
2032	$ 21,737	$ 298,497	$ 168,397	$ (130,100)	56%	$ 190,134	$ (108,363)	64%
2033	$ 24,368	$ 303,342	$ 174,953	$ (128,389)	58%	$ 199,321	$ (104,021)	66%
2034	$ 27,195	$ 307,909	$ 182,578	$ (125,331)	59%	$ 209,773	$ (98,136)	68%
2035	$ 30,235	$ 312,178	$ 190,601	$ (121,577)	61%	$ 220,836	$ (91,342)	71%
2036	$ 33,503	$ 316,131	$ 199,056	$ (117,075)	63%	$ 232,559	$ (83,572)	74%
2037	$ 37,015	$ 319,764	$ 207,999	$ (111,765)	65%	$ 245,014	$ (74,750)	77%
2038	$ 40,792	$ 323,066	$ 217,472	$ (105,594)	67%	$ 258,264	$ (64,802)	80%
2039	$ 44,851	$ 326,040	$ 227,522	$ (98,518)	70%	$ 272,373	$ (53,667)	84%
2040	$ 49,215	$ 328,681	$ 238,204	$ (90,477)	72%	$ 287,419	$ (41,262)	87%
2041	$ 53,906	$ 331,013	$ 249,590	$ (81,423)	75%	$ 303,496	$ (27,517)	92%
2042	$ 58,949	$ 333,078	$ 261,779	$ (71,299)	79%	$ 320,728	$ (12,350)	96%
2043	$ 64,370	$ 334,937	$ 274,897	$ (60,040)	82%	$ 339,267	$ 4,330	101%
2044	$ 69,198	$ 336,675	$ 289,093	$ (47,582)	86%	$ 358,291	$ 21,616	106%
2045	$ 74,387	$ 338,367	$ 304,530	$ (33,837)	90%	$ 378,917	$ 40,550	112%

*Assumes $364 million payment in FY2019 and $1.0 billion annually from FY2020 until 100% funded in FY2043 with 7.5% long-term rate of return.
Source: Commission on Government Forecasting and Accountibility, *November 2015 Special Pension Briefing* , November 2015, p. 9.

308 Commission on Government Forecasting and Accountability, *November 2015 Special Pension Briefing*, November 2015, p. 9.

APPENDIX B: PROJECTED STATE PENSION FUNDING

The following table and chart show the State of Illinois' projected statutorily required contributions to its five retirement systems from FY2017 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.[309]

The contributions below are total statutorily required pension contributions, from both General Funds and other State funds. Approximately 89% of total contributions come from General Funds.[310] Total projected contributions rise to $17.3 billion in FY2045. The total unfunded liability is projected to peak at $132.2 billion in FY2029.

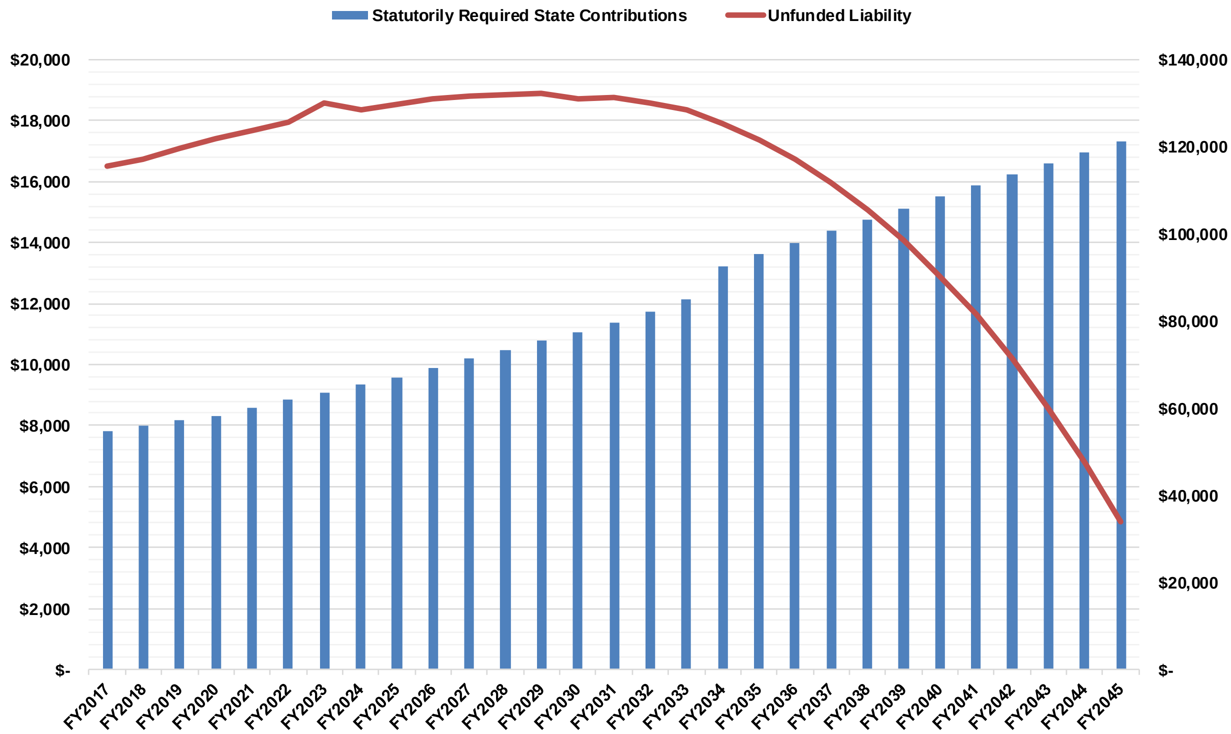
State of Illinois Projected Pension Contributions and Unfunded Liability: FY2017-FY2045 (in $ millions)*

Year	State Contributions	Unfunded Liability	Year	State Contributions	Unfunded Liability
FY2017	$ 7,826	$ 115,620	FY2032	$ 11,745	$ 130,100
FY2018	$ 8,014	$ 117,009	FY2033	$ 12,134	$ 128,389
FY2019	$ 8,155	$ 119,681	FY2034	$ 13,232	$ 125,331
FY2020	$ 8,326	$ 121,753	FY2035	$ 13,612	$ 121,577
FY2021	$ 8,592	$ 123,683	FY2036	$ 13,994	$ 117,075
FY2022	$ 8,832	$ 125,480	FY2037	$ 14,374	$ 111,765
FY2023	$ 9,084	$ 130,116	FY2038	$ 14,752	$ 105,594
FY2024	$ 9,330	$ 128,586	FY2039	$ 15,125	$ 98,517
FY2025	$ 9,585	$ 129,859	FY2040	$ 15,494	$ 90,477
FY2026	$ 9,875	$ 130,882	FY2041	$ 15,860	$ 81,423
FY2027	$ 10,178	$ 131,616	FY2042	$ 16,226	$ 71,299
FY2028	$ 10,472	$ 132,060	FY2043	$ 16,594	$ 60,040
FY2029	$ 10,780	$ 132,164	FY2044	$ 16,962	$ 47,582
FY2030	$ 11,077	$ 131,013	FY2045	$ 17,334	$ 33,837
FY2031	$ 11,392	$ 131,251			

*Does not include debt service payments on 2003 pension bonds for the State Employees' Retirement System.
Source: Commission on Government Forecasting and Responsibility, *Illinois State Retirement Systems Financial Condition as of June 30, 2015* , March 2016, pp. 99-138.

[309] 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.
[310] State of Illinois, General Obligation Bonds. Series of January 2016, *Official Statement*, January 15, 2016, p. H-2.

State of Illinois Projected Pension Contributions and Unfunded Liability: FY2017-FY2045 (in $ millions)*



*Contributions do not include debt service payments on 2003 pension bonds for the State Employees' Retirement System.
Source: Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems Financial Condition as of June 30, 2015*, March 2016, pp. 99-138.

APPENDIX C: DEBT COMPARISION

The following tables show the calculations used for the debt cost comparisons used in this report. For the chart on page 41 showing the comparative yield between various 'A' level debt and the yields charged to the State for the Series January 2016 bonds, the trend lines are smoothed for easier comparison.

Benchmark yields for each category of debt are provided for 2018, 2021 and 2036. The remaining benchmark yields are extrapolated using the average rate for growth between the actual data points.

State of Illinois Bond Cost Comparision									
Benchmark AAA Rated Bonds					Illinois, GO Bonds, Series January 2016				
Maturity	Yield	Principal	Interest	Debt Service	Yield	Principal	Interest	Debt Service	Increase Cost
2017	0.39	$ 19.2	$ 8.7	$ 27.9	1.15	$ 19.2	$ 16.2	$ 35.4	$ 7.4
2018	0.52	$ 19.2	$ 8.6	$ 27.8	1.75	$ 19.2	$ 15.9	$ 35.1	$ 7.3
2019	0.69	$ 19.2	$ 8.5	$ 27.7	2.00	$ 19.2	$ 15.6	$ 34.8	$ 7.1
2020	0.87	$ 19.2	$ 8.4	$ 27.6	2.20	$ 19.2	$ 15.2	$ 34.4	$ 6.8
2021	1.04	$ 19.2	$ 8.2	$ 27.4	2.40	$ 19.2	$ 14.8	$ 34.0	$ 6.6
2022	1.24	$ 19.2	$ 8.0	$ 27.2	2.60	$ 19.2	$ 14.3	$ 33.5	$ 6.3
2023	1.44	$ 19.2	$ 7.8	$ 27.0	2.87	$ 19.2	$ 13.8	$ 33.0	$ 6.0
2024	1.64	$ 19.2	$ 7.5	$ 26.7	3.08	$ 19.2	$ 13.3	$ 32.5	$ 5.8
2025	1.84	$ 19.2	$ 7.2	$ 26.4	3.22	$ 19.2	$ 12.7	$ 31.9	$ 5.5
2026	2.04	$ 19.2	$ 6.9	$ 26.1	3.33	$ 19.2	$ 12.1	$ 31.3	$ 5.2
2027	2.07	$ 19.2	$ 6.5	$ 25.7	3.49	$ 19.2	$ 11.4	$ 30.6	$ 5.0
2028	2.09	$ 19.2	$ 6.1	$ 25.3	3.57	$ 19.2	$ 10.8	$ 30.0	$ 4.7
2029	2.12	$ 19.2	$ 5.7	$ 24.9	3.66	$ 19.2	$ 10.1	$ 29.3	$ 4.4
2030	2.14	$ 19.2	$ 5.3	$ 24.5	3.74	$ 19.2	$ 9.4	$ 28.6	$ 4.1
2031	2.17	$ 19.2	$ 4.9	$ 24.1	4.10	$ 19.2	$ 8.7	$ 27.9	$ 3.8
2032	2.20	$ 19.2	$ 4.4	$ 23.6	3.93	$ 19.2	$ 7.9	$ 27.1	$ 3.4
2033	2.22	$ 19.2	$ 4.0	$ 23.2	3.98	$ 19.2	$ 7.1	$ 26.3	$ 3.1
2034	2.25	$ 19.2	$ 3.6	$ 22.8	3.91	$ 19.2	$ 6.4	$ 25.6	$ 2.8
2035	2.27	$ 19.2	$ 3.2	$ 22.4	4.08	$ 19.2	$ 5.6	$ 24.8	$ 2.5
2036	2.30	$ 19.2	$ 2.7	$ 21.9	4.33	$ 19.2	$ 4.8	$ 24.0	$ 2.1
2037	2.33	$ 19.2	$ 2.3	$ 21.5	4.05	$ 19.2	$ 4.0	$ 23.2	$ 1.7
2038	2.35	$ 19.2	$ 1.8	$ 21.0	4.10	$ 19.2	$ 3.2	$ 22.4	$ 1.4
2039	2.38	$ 19.2	$ 1.4	$ 20.6	4.13	$ 19.2	$ 2.4	$ 21.6	$ 1.0
2040	2.40	$ 19.2	$ 0.9	$ 20.1	4.27	$ 19.2	$ 1.6	$ 20.8	$ 0.7
2041	2.43	$ 19.2	$ 0.5	$ 19.7	4.27	$ 19.2	$ 0.8	$ 20.0	$ 0.4
Total		**$ 480.0**	**$ 133.3**	**$ 613.3**		**$ 480.0**	**$ 238.3**	**$ 718.3**	**$ 105.0**

Note: Benchmark AAA yields used in 2018, 2026 and 2036, the remaining benchmark yields are extrapolated using the average growth between data points.
Source: Yahoo Finance, Composite Bond Rates, http://finance.yahoo.com/bonds/composite_bond_rates (last visited February 2, 2016). State of Illinois, General Obnligation Bonds, Series January 2016, *Official Statement* , January 15, 2016.

State of Illinois Bond Cost Comparision									
Benchmark AA Rated Bonds					Illinois, GO Bonds, Series January 2016				
Maturity	Yield	Principal	Interest	Debt Service	Yield	Principal	Interest	Debt Service	Increase Cost
2017	0.45	$ 19.2	$ 10.6	$ 29.8	1.15	$ 19.2	$ 16.2	$ 35.4	$ 5.6
2018	0.58	$ 19.2	$ 10.5	$ 29.7	1.75	$ 19.2	$ 15.9	$ 35.1	$ 5.5
2019	0.79	$ 19.2	$ 10.4	$ 29.6	2.00	$ 19.2	$ 15.6	$ 34.8	$ 5.2
2020	1.01	$ 19.2	$ 10.2	$ 29.4	2.20	$ 19.2	$ 15.2	$ 34.4	$ 5.0
2021	1.22	$ 19.2	$ 10.0	$ 29.2	2.40	$ 19.2	$ 14.8	$ 34.0	$ 4.8
2022	1.42	$ 19.2	$ 9.8	$ 29.0	2.60	$ 19.2	$ 14.3	$ 33.5	$ 4.6
2023	1.62	$ 19.2	$ 9.5	$ 28.7	2.87	$ 19.2	$ 13.8	$ 33.0	$ 4.3
2024	1.83	$ 19.2	$ 9.2	$ 28.4	3.08	$ 19.2	$ 13.3	$ 32.5	$ 4.1
2025	2.03	$ 19.2	$ 8.9	$ 28.1	3.22	$ 19.2	$ 12.7	$ 31.9	$ 3.8
2026	2.23	$ 19.2	$ 8.5	$ 27.7	3.33	$ 19.2	$ 12.1	$ 31.3	$ 3.6
2027	2.30	$ 19.2	$ 8.0	$ 27.2	3.49	$ 19.2	$ 11.4	$ 30.6	$ 3.4
2028	2.37	$ 19.2	$ 7.6	$ 26.8	3.57	$ 19.2	$ 10.8	$ 30.0	$ 3.2
2029	2.44	$ 19.2	$ 7.1	$ 26.3	3.66	$ 19.2	$ 10.1	$ 29.3	$ 2.9
2030	2.51	$ 19.2	$ 6.7	$ 25.9	3.74	$ 19.2	$ 9.4	$ 28.6	$ 2.7
2031	2.58	$ 19.2	$ 6.2	$ 25.4	4.10	$ 19.2	$ 8.7	$ 27.9	$ 2.5
2032	2.65	$ 19.2	$ 5.7	$ 24.9	3.93	$ 19.2	$ 7.9	$ 27.1	$ 2.2
2033	2.72	$ 19.2	$ 5.2	$ 24.4	3.98	$ 19.2	$ 7.1	$ 26.3	$ 1.9
2034	2.79	$ 19.2	$ 4.7	$ 23.9	3.91	$ 19.2	$ 6.4	$ 25.6	$ 1.7
2035	2.86	$ 19.2	$ 4.1	$ 23.3	4.08	$ 19.2	$ 5.6	$ 24.8	$ 1.5
2036	2.93	$ 19.2	$ 3.6	$ 22.8	4.33	$ 19.2	$ 4.8	$ 24.0	$ 1.3
2037	3.00	$ 19.2	$ 3.0	$ 22.2	4.05	$ 19.2	$ 4.0	$ 23.2	$ 1.0
2038	3.07	$ 19.2	$ 2.4	$ 21.6	4.10	$ 19.2	$ 3.2	$ 22.4	$ 0.8
2039	3.14	$ 19.2	$ 1.8	$ 21.0	4.13	$ 19.2	$ 2.4	$ 21.6	$ 0.6
2040	3.21	$ 19.2	$ 1.2	$ 20.4	4.27	$ 19.2	$ 1.6	$ 20.8	$ 0.4
2041	3.28	$ 19.2	$ 0.6	$ 19.8	4.27	$ 19.2	$ 0.8	$ 20.0	$ 0.2
Total		**$ 480.0**	**$ 165.5**	**$ 645.5**		**$ 480.0**	**$ 238.3**	**$ 718.3**	**$ 72.8**

Note: Benchmark AA yields used in 2018, 2026 and 2036, the remaining benchmark yields are extrapolated using the average growth between data points.
Source: Yahoo Finance, Composite Bond Rates, http://finance.yahoo.com/bonds/composite_bond_rates (last visited February 2, 2016). State of Illinois, General Obnligation Bonds, Series January 2016, *Official Statement* , January 15, 2016.

State of Illinois Bond Cost Comparision									
Benchmark A Rated Bonds					Illinois, GO Bonds, Series January 2016				
Maturity	Yield	Principal	Interest	Debt Service	Yield	Principal	Interest	Debt Service	Increase Cost
2017	0.68	$ 19.2	$ 12.4	$ 31.6	1.15	$ 19.2	$ 16.2	$ 35.4	$ 3.8
2018	0.81	$ 19.2	$ 12.2	$ 31.4	1.75	$ 19.2	$ 15.9	$ 35.1	$ 3.7
2019	1.02	$ 19.2	$ 12.1	$ 31.3	2.00	$ 19.2	$ 15.6	$ 34.8	$ 3.5
2020	1.23	$ 19.2	$ 11.9	$ 31.1	2.20	$ 19.2	$ 15.2	$ 34.4	$ 3.3
2021	1.44	$ 19.2	$ 11.6	$ 30.8	2.40	$ 19.2	$ 14.8	$ 34.0	$ 3.2
2022	1.63	$ 19.2	$ 11.4	$ 30.6	2.60	$ 19.2	$ 14.3	$ 33.5	$ 3.0
2023	1.81	$ 19.2	$ 11.1	$ 30.3	2.87	$ 19.2	$ 13.8	$ 33.0	$ 2.8
2024	2.00	$ 19.2	$ 10.7	$ 29.9	3.08	$ 19.2	$ 13.3	$ 32.5	$ 2.6
2025	2.18	$ 19.2	$ 10.3	$ 29.5	3.22	$ 19.2	$ 12.7	$ 31.9	$ 2.4
2026	2.37	$ 19.2	$ 9.9	$ 29.1	3.33	$ 19.2	$ 12.1	$ 31.3	$ 2.2
2027	2.48	$ 19.2	$ 9.5	$ 28.7	3.49	$ 19.2	$ 11.4	$ 30.6	$ 2.0
2028	2.60	$ 19.2	$ 9.0	$ 28.2	3.57	$ 19.2	$ 10.8	$ 30.0	$ 1.8
2029	2.71	$ 19.2	$ 8.5	$ 27.7	3.66	$ 19.2	$ 10.1	$ 29.3	$ 1.6
2030	2.83	$ 19.2	$ 8.0	$ 27.2	3.74	$ 19.2	$ 9.4	$ 28.6	$ 1.4
2031	2.94	$ 19.2	$ 7.4	$ 26.6	4.10	$ 19.2	$ 8.7	$ 27.9	$ 1.3
2032	3.05	$ 19.2	$ 6.8	$ 26.0	3.93	$ 19.2	$ 7.9	$ 27.1	$ 1.0
2033	3.17	$ 19.2	$ 6.3	$ 25.5	3.98	$ 19.2	$ 7.1	$ 26.3	$ 0.9
2034	3.28	$ 19.2	$ 5.7	$ 24.9	3.91	$ 19.2	$ 6.4	$ 25.6	$ 0.7
2035	3.40	$ 19.2	$ 5.0	$ 24.2	4.08	$ 19.2	$ 5.6	$ 24.8	$ 0.6
2036	3.51	$ 19.2	$ 4.4	$ 23.6	4.33	$ 19.2	$ 4.8	$ 24.0	$ 0.5
2037	3.62	$ 19.2	$ 3.7	$ 22.9	4.05	$ 19.2	$ 4.0	$ 23.2	$ 0.3
2038	3.74	$ 19.2	$ 3.0	$ 22.2	4.10	$ 19.2	$ 3.2	$ 22.4	$ 0.2
2039	3.85	$ 19.2	$ 2.3	$ 21.5	4.13	$ 19.2	$ 2.4	$ 21.6	$ 0.1
2040	3.97	$ 19.2	$ 1.5	$ 20.7	4.27	$ 19.2	$ 1.6	$ 20.8	$ 0.1
2041	4.08	$ 19.2	$ 0.8	$ 20.0	4.27	$ 19.2	$ 0.8	$ 20.0	$ 0.0
Total		**$ 480.0**	**$ 195.3**	**$ 675.3**		**$ 480.0**	**$ 238.3**	**$ 718.3**	**$ 43.0**

Note: Benchmark A yields used in 2018, 2026 and 2036. The remaining benchmark yields are extrapolated using the average growth between data points.

Source: Yahoo Finance, Composite Bond Rates, http://finance.yahoo.com/bonds/composite_bond_rates (last visited February 2, 2016). State of Illinois, General Obligation Bonds, Series January 2016, *Official Statement,* January 15, 2016.

APPENDIX D: TOTAL DEBT SERVICE

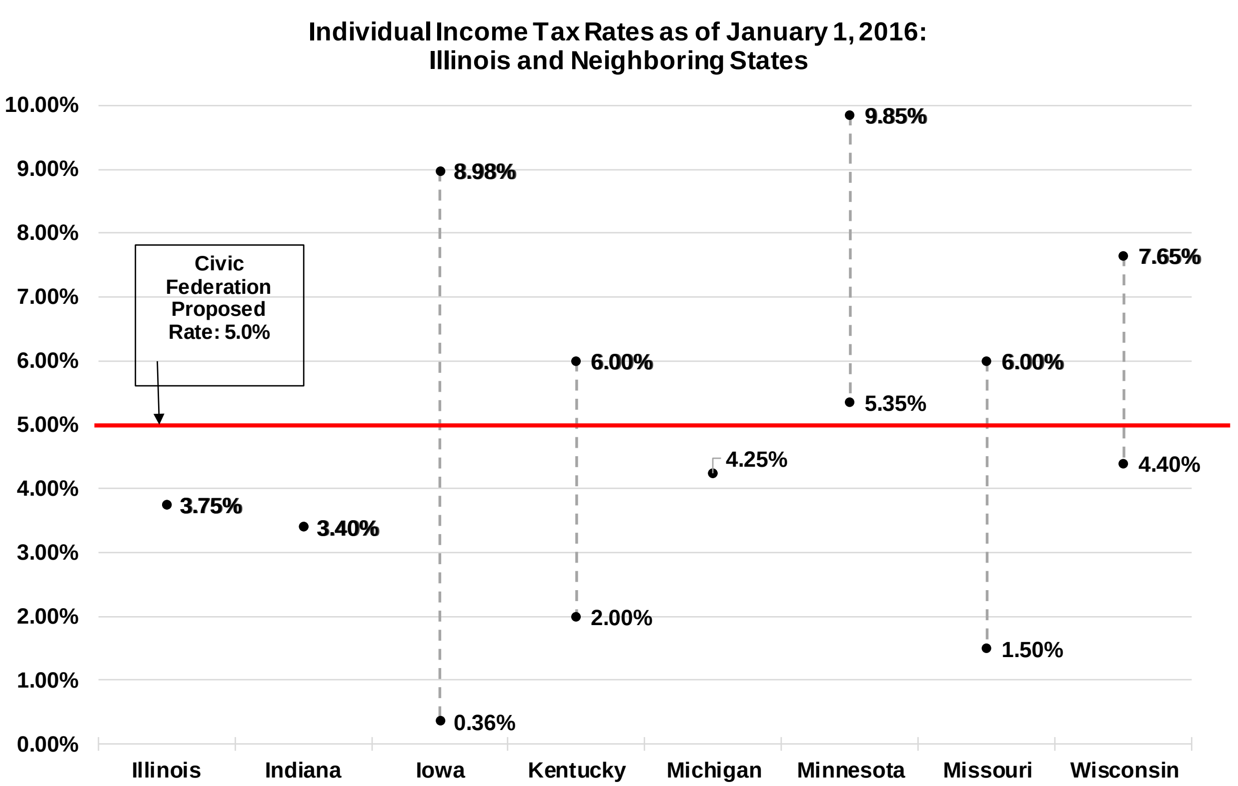
The following chart shows all outstanding General Obligation and Build Illinois Bond debt service owed by the State of Illinois.

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	Total Debt Service
2016	$ 1,701.4	$ 1,356.5	$ 294.0	**$ 3,351.9**
2017	$ 1,666.0	$ 1,647.3	$ 329.7	**$ 3,643.0**
2018	$ 1,590.4	$ 1,618.6	$ 305.2	**$ 3,514.2**
2019	$ 1,511.3	$ 1,586.1	$ 284.3	**$ 3,381.7**
2020	$ 1,446.7	$ 674.6	$ 260.4	**$ 2,381.6**
2021	$ 1,381.6	$ 713.4	$ 221.6	**$ 2,316.6**
2022	$ 1,304.7	$ 749.8	$ 226.0	**$ 2,280.5**
2023	$ 1,258.7	$ 783.7	$ 208.0	**$ 2,250.5**
2024	$ 1,169.3	$ 840.2	$ 194.6	**$ 2,204.0**
2025	$ 1,064.5	$ 892.2	$ 187.2	**$ 2,143.9**
2026	$ 1,035.9	$ 915.4	$ 179.2	**$ 2,130.5**
2027	$ 909.5	$ 936.1	$ 151.6	**$ 1,997.2**
2028	$ 883.8	$ 979.2	$ 124.9	**$ 1,987.9**
2029	$ 849.8	$ 1,018.5	$ 120.7	**$ 1,989.1**
2030	$ 761.9	$ 1,079.0	$ 108.5	**$ 1,949.4**
2031	$ 687.6	$ 1,134.4	$ 109.8	**$ 1,931.8**
2032	$ 601.2	$ 1,159.7	$ 99.8	**$ 1,860.6**
2033	$ 574.8	$ 1,156.1	$ 96.1	**$ 1,826.9**
2034	$ 580.4	$ -	$ 92.3	**$ 672.7**
2035	$ 467.9	$ -	$ 66.6	**$ 534.5**
2036	$ 347.3	$ -	$ 64.0	**$ 411.4**
2037	$ 284.7	$ -	$ 31.3	**$ 316.0**
2038	$ 216.9	$ -	$ 17.5	**$ 234.4**
2039	$ 174.7	$ -		**$ 174.7**
2040	$ 21.1	$ -		**$ 21.1**
2041	$ 20.2	$ -		**$ 20.2**
Total	**$ 22,512.3**	**$ 19,240.7**	**$ 3,773.3**	**$ 45,506.1**

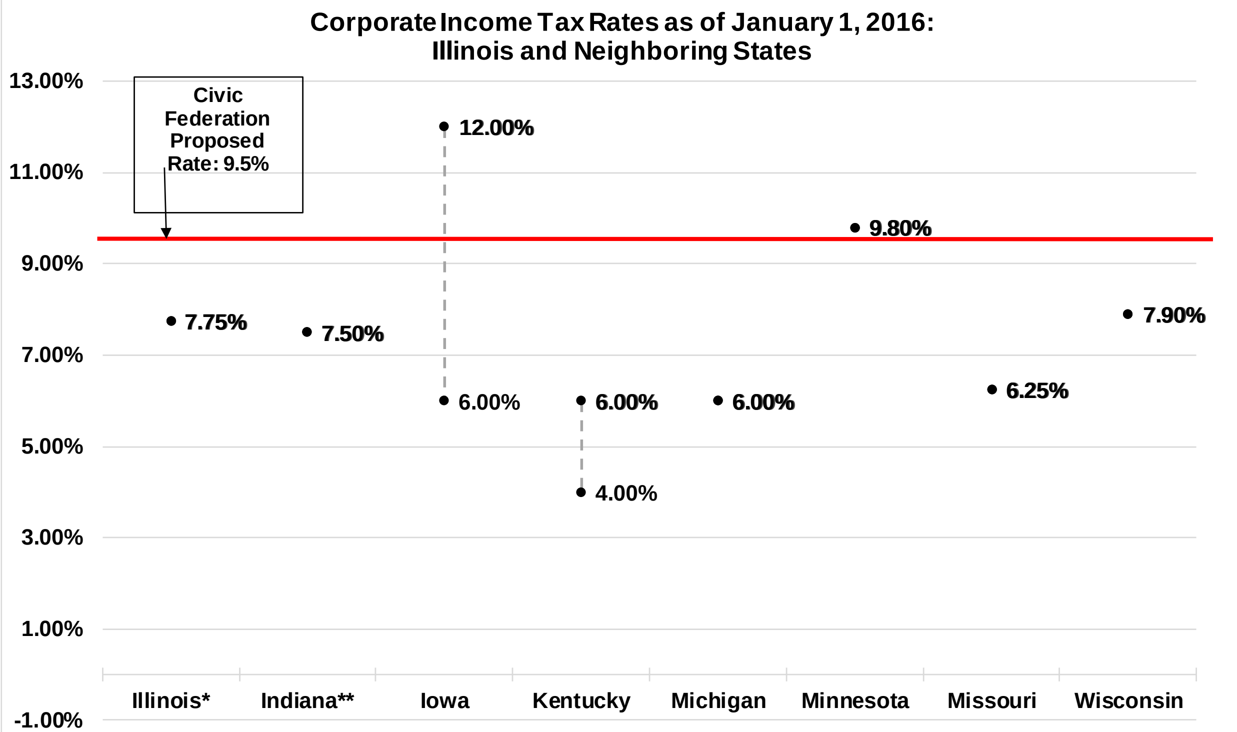
Source: Illinois State FY2017 Budget, pp. 527, 528,

APPENDIX E: INCOME TAX RATES IN ILLINOIS AND NEIGHBORING STATES

The following charts compare Illinois' current and proposed individual and corporate rates to those 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 2016 as of January 1, 2016)*, February 2016.



* 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 6.25% on July 1, 2016.
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 2016 as of January 1, 2016)*, February 2016.