The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2012 BUDGET ROADMAP:

An Analysis of Governor Pat Quinn's Preliminary Budget Plans and Actionable Recommendations for the Governor and the Illinois General Assembly

February 15, 2011

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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.

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EXECUTIVE SUMMARY

Prior to the release of the Governor's annual budget recommendation the Institute for Illinois' Fiscal Sustainability at the Civic Federation releases an analysis of the State of Illinois' fiscal condition and actionable recommendations for the Governor and General Assembly for the coming fiscal year. This year the State of Illinois Budget Roadmap also includes an analysis and recommendations based on Governor Pat Quinn's preliminary budget plans for FY2011 and three-year budget plan published on January 20, 2011. Below is a summary of the findings of this analysis and recommendations included in this report.

Civic Federation Findings

- The **revised budget enacted for FY2011**, including new revenue from the increase in income taxes and borrowing to make the State's annual pension contributions, now results in an **operating surplus after borrowing for operations of $2.5 billion, as opposed to the originally enacted budget, which showed an operating shortfall of $3.7 billion after borrowing**;

- The Governor plans to seek approval for **additional appropriations totaling $783 million in FY2011 and increase borrowing for operations totaling $8.75 billion** in new General Obligation (GO) Restructuring Bonds;

- Proceeds from the GO Restructuring Bonds would **increase FY2011 borrowing for operations from $5.7 billion already enacted to $10.2 billion** and be used in part to pay down the State's $6.4 billion backlog of accounts payable;

- The State paid a total of $62.3 million in prompt payment interest penalty in FY2010 on $6.4 billion backlog of bills at the end of the year, which amounted to an **annual prompt payment interest penalty totaling 0.97%;**

- The **GO Restructuring Bonds will cost more than $3.4 billion in total additional interest costs** to the State over the next 15 years and **increase the total debt burden of the State from $24.4 billion in FY2010 to nearly $50 billion in FY2012**;

- The Governor's **three-year plan shows an increase of 9.0% in base appropriations in FY2012 or $2.2 billion more** than the appropriations in the enacted FY2011 budget;

- Proposed operating expenditures do not exceed spending limitations established in January 2011 legislation of $36.8 billion in FY2012, $37.6 billion in FY2013 and $38.3 billion in FY2014, but **state revenues are projected to be well beneath spending limits revenues totaling $35.2 billion in FY2012, $36.1 billion in FY2013 and $37.2 billion in FY2014**; and

- Under the Governor's three-year budget plan, **the State will continue to run operating shortfalls through FY2014 due to increases in appropriations, debt service and pension payments**, which are funded through additional borrowing for operations.

Civic Federation Recommendations

1. **The Civic Federation opposes the proposed long-term GO Restructuring Bonds** to pay for current operating expenses of government because they build deficits into future budgets, increase the cost of government and push the cost of current government operations onto future taxpayers;

2. The Civic Federation opposes the Governor's plan to increase FY2011 spending and **recommends that the State restrict annual appropriations increases to 2% or less through FY2014**. We further urge the State to use operating surpluses to pay down its backlog of accounts payable rather than proceeds from expensive long-term bonds;

3. The Civic Federation opposes long-term borrowing to pay down the State's backlog of accounts payable and recommends that **if the State borrows to pay down current liabilities that the loans be short-term notes repaid within the years of the temporary tax increase** and that the cost of borrowing not exceed the reasonably estimated revenues in those years;

4. **If the State must pay down additional liabilities outside the General Funds** as part of its operating budget it must **limit base appropriations to enacted FY2011 budget levels through FY2014** or until all additional liabilities are funded;

5. Illinois took an important first step toward pension reform by enacting reduced benefits for new employees. However, the State will continue to struggle to make its annual pension payments. In the past, it has skipped payments and has borrowed to make the payments. It appears that the State's pension burden is unaffordable. **The Civic Federation believes that for current employees the State must reduce non-vested benefits, increase employee contributions or both;**

6. The **Civic Federation recommends that the State relocate Medicaid recipients from institutions and into community settings, in order to both improve the quality of care and reduce costs**. The legislation enacted in January 2011 moves in the right direction but does not establish specific goals for reducing reliance on institutional care;

7. The **Civic Federation recommends that the State not continue to pay the entire health care premium for retirees**. This is a generous benefit that the State cannot afford. The Federation has supported the Governor's efforts to have retirees share the cost of their health insurance premiums; and

8. The **Civic Federation recommends that the State continue the process of developing and utilizing performance measures that are linked to specific program goals and objectives**. The measures adopted should be valid, reliable and verifiable.

INTRODUCTION

The State of Illinois faced the Great Recession in worse condition than many other states. Illinois underfunded its retirement systems for decades, skimped on budgetary reserves and ran recurring budget deficits. Instead of fixing the problems, the State put off paying bills and used one-time revenue sources such as borrowing to mask the shortfall.

The State's finances, like those of other states, deteriorated further because of the recession. Personal income taxes—the largest revenue source for the State's general operations—fell by 19.0% from the end of FY2008 to the end of FY2010. Total state-source general operating revenues declined by 16.3% during the same period.

Entering FY2011, Illinois confronted a budget deficit of nearly $13 billion. The budget that was enacted for FY2011 did little to close the gap and relied heavily on borrowing and delayed payments to vendors and local governments.

In January 2011, shortly before the inauguration of the 97th General Assembly, the State enacted a major income tax increase that is scheduled to be rolled back beginning in 2015. On the heels of the tax legislation, Governor Pat Quinn announced new proposals for borrowing and spending.

This report provides an overview and critique of the Governor's proposed budget changes for FY2011 and longer range budget plans. The report also offers the Civic Federation's alternative budget proposals and recommendations for other budgetary reforms. The report is issued in advance of the Governor's FY2012 budget recommendation on February 16, 2011 in order to assist citizens and policymakers in evaluating the State's financial options.

FY2011 BUDGET AND GOVERNOR'S THREE-YEAR PLAN

In January 2011, the General Assembly passed and Governor Pat Quinn signed legislation that had a significant impact on the FY2011 General Funds budget.[1] Also in January 2011, the Governor proposed further changes in the FY2011 budget and issued a three-year budget plan for FY2012 to FY2014.[2] The following section provides an overview of the changes in the budget for FY2011 and reviews the three-year plan.

Revised FY2011 Budget

The FY2011 General Funds budget, enacted on the first day of the fiscal year on July 1, 2010, included an initial deficit of $12.3 billion.[3] The initial deficit consisted of an operating shortfall

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[1] General Funds, the largest component of the State's operating budget, support the regular operating and administrative expenses of most state agencies. The state budget also includes Other State Funds and Federal Funds. Other State Funds consist of bond-financed funds, debt service funds, state trust funds and Special State Funds, which are other funds restricted to revenues and expenditures of a specific source. Federal Funds are revenues from the federal government, other than those designated for General Funds, which support a variety of state programs.

[2] The three-year budget plan is required by Public Act 96-1354, enacted on July 28, 2010.

[3] See The Civic Federation, *State of Illinois Enacted Budget FY2011: A Review of the Operating Budget Enacted for the Current Fiscal Year*, November 18, 2010, http://www.civicfed.org/iifs/publications/state-illinois-enacted-budget-fy2011-review-operating-budget-enacted-current-fisca (last visited on February 4, 2011).

of $5.8 billion and an accumulated deficit from prior years of $6.5 billion. To reduce the operating shortfall, the enacted budget included $2.2 billion of borrowing: $1.2 billion from the sale of bonds backed by tobacco litigation settlement proceeds and $964 million in borrowing for up to 18 months from Special Funds. A proposal by Governor Quinn to finance the State's roughly $4 billion contribution to its five retirement systems was passed by the House of Representatives but did not clear the Senate. The total budgeted year-end deficit stood at $10.2 billion. Because of the remaining deficit, payments to the retirement systems, vendors and local governments were delayed.

Six months after the FY2011 budget was enacted, the State took steps to strengthen its finances. In the last days of the 96th General Assembly, the legislature passed a bill to temporarily increase personal income tax rates from 3% to 5% and corporate income tax rates from 4.8% to 7%.The Governor signed the legislation on January 13, 2011, a day after the inauguration of the 97th General Assembly.[4] The tax increases were retroactive to January 1, 2011 and are scheduled to remain in place until January 1, 2015. Under the new law, the personal income tax will be reduced to 3.75% until 2025 and then drop to 3.25%; the corporate income tax will be reduced to 5.25% until 2025 and then return to 4.8%.

Illinois corporations also pay a Personal Property Replacement Tax (PPRT) of 2.5%. The PPRT is a corporate income tax established when the General Assembly abolished all ad valorem personal property taxes on corporations in 1979 pursuant to the 1970 Illinois Constitution.[5] The State distributes PPRT revenues to local taxing districts according to a formula based partly on each district's share of personal property tax collection in 1976 or 1977. With the newly enacted tax increase, the combined PPRT and corporate income tax rate rose to 9.5% on January 1, 2011.

The tax increase legislation established spending limitations for FY2012 through FY2015. The spending caps cover all expenditures from the State's General Funds, including appropriations, pension contributions, debt service payments and statutorily required transfers.[6] The Illinois Auditor General is required under the tax increase legislation to report on any spending in excess of the specified limits. If the overspending is not corrected by the Governor or the General Assembly, then tax rates for the year will be rolled back to their original levels.

The new legislation also raised state revenues by suspending through FY2014 the net operating loss (NOL) carryover deduction for corporations (but not for Subchapter S corporations). The NOL allows businesses to reduce their current tax liability by deducting losses suffered in prior years. The General Assembly also reinstated the state inheritance tax on estates of $2 million or more. The Illinois estate tax had lapsed in 2010 along with the federal estate tax.

Another major bill passed by the General Assembly and signed by Governor Quinn in January 2011 authorized borrowing of up to $4.1 billion to make the State's annual pension

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[4] Public Act 96-1496.
[5] An ad valorem tax is computed from the value of the tax base.
[6] For each fiscal year, the General Assembly passes and the Governor signs a budget that provides spending authority through appropriations for state activities such as education, healthcare and human services. Existing statutes require additional expenditures from General Funds for pension contributions, interest and principal payments on outstanding bonds, payments to local governments and other revenue diversions.

contributions.[7] The pension borrowing for FY2011 follows the issuance of $3.5 billion in Pension Obligation Bonds (POBs) to pay the State's contributions to the retirement systems in FY2010.[8] The new bonds are expected to be back-loaded over eight years, meaning that significant principal repayment does not begin until FY2015.[9] That structure allows the State to pay off the $3.5 billion of pension bonds issued in FY2010 before beginning to make major principal payments on the FY2011 debt. Delaying the repayment of principal on the FY2011 bonds leads to a higher total interest cost than if principal is repaid in level amounts, similar to the structure of the FY2010 POBs.

The actions in January 2011 increased state-source revenues by $2.9 billion and borrowing by roughly $4 billion. State officials also revised the accumulated deficit from prior years from $6.5 billion to $6.1 billion.[10] The change was largely due to the fact that $276 million in internal borrowings from the Budget Stabilization Fund remained unpaid as of the end of the FY2010 fiscal year on June 30, reducing the FY2010 operating shortfall after borrowing.[11]

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[7] Public Act 96-1497.
[8] The POBs were sold on January 7, 2010.
[9] See the Civic Federation's Institute for Illinois' Fiscal Sustainability blog at http://civicfed.org/iifs/blog/new-pension-borrowing-could-stress-state-budget-through-2019 for more information on the FY2011 pension borrowing.
[10] State of Illinois $3.7 Million General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.
[11] The Budget Stabilization Fund is a Special State Fund used to meet cash flow deficits in the General Funds resulting from timing variations between disbursements and the receipt of funds within a fiscal year.

As shown in the table below, the FY2011 revised budget has an initial operating shortfall of $3.2 billion. This operating shortfall is more than offset by $5.8 billion of new borrowing, including $4.1 billion of pension borrowing. The operating surplus after borrowing stands at $2.5 billion. The total deficit, including the accumulated deficit from prior years of $6.1 billion, is reduced to $3.6 billion from $10.2 billion in the originally enacted budget.

State of Illinois FY2011 Enacted and Revised General Funds Budget (in $ millions)		
	FY2011 Enacted	**FY2011 Revised**
Resources		
State Source Revenues	**$ 19,712**	**$ 19,685**
Personal Income Tax Increase	$ -	$ 2,632
Corporate Income Tax Increase	$ -	$ 150
Change in Net Operating Loss Deduction	$ -	$ 100
Federal Source Revenues	**$ 6,227**	**$ 5,976**
Subtotal Revenues	**$ 25,939**	**$ 28,543**
Statutory Transfers In	$ 1,716	$ 1,622
Total Resources	**$ 27,655**	**$ 30,165**
Expenditures		
Appropriations	$ 25,831	$ 25,831
Less Unspent Appropriations	$ (891)	$ (891)
Subtotal Net Appropriations Before Pension Contribution and Transfers	**$ 24,940**	**$ 24,940**
Pension Contributions	**$ 4,157**	**$ 4,157**
Pension Bond 2003 Debt Service	$ 516	$ 516
Pension Bond 2010/2011 Debt Service	$ 1,238	$ 1,209
Medicaid Borrowing Debt Service	$ 183	$ 189
Capital Debt Service	$ 645	$ 570
Statutory Transfers	$ 1,823	$ 1,823
Total Transfers	**$ 4,406**	**$ 4,307**
Total Expenditures	**$ 33,503**	**$ 33,404**
Operating Shortfall	**$ (5,848)**	**$ (3,239)**
Borrowing for Operations		
Tobacco Settlement Securitization	$ 1,200	$ 1,250
Interfund Borrowing	$ 964	$ 500
Pension Obligation Notes	$ -	$ 4,050
Short-Term Borrowing	$ 1,300	$ 1,300
Short Term Borrowing Repayment	$ (1,317)	$ (1,317)
Total Borrowing for Operations	**$ 2,147**	**$ 5,784**
Operating Surplus (Deficit) After Borrowing	**$ (3,701)**	**$ 2,545**
Accumulated Deficit From FY2010	**$ (6,475)**	**$ (6,131)**
Total Deficit	**$(10,176)**	**$ (3,586)**

Source: Civic Federation calculations based on State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement* , January 21, 2011, p. 27.

Governor's New Plan for FY2011

After the revisions enacted in January, Governor Quinn proposed further changes in the FY2011 budget. The new plan for FY2011 includes an increase in the State's cigarette tax, an increase in FY2011 appropriations and the sale of $8.75 billion in General Obligation (GO) Restructuring Bonds. The FY2011 plan is described in preliminary information provided by state officials in connection with the previously approved FY2011 sale of pension bonds.[12] The new plan for FY2011 is also described in the Governor's budget plan for FY2012 to FY2014, discussed in more detail below.[13]

A bill introduced in the 97th General Assembly would raise the cigarette tax by $1.01 per pack, from 98 cents to $1.99.[14] The Senate passed similar legislation in April 2009 but it was not approved by the House. The increase would be phased in over two fiscal years: 76 cents per pack on March 1, 2011 and 25 cents per pack on March 1, 2012. According to the Illinois Department of Revenue, the measure would generate roughly $88 million in additional taxes in FY2011, $330 million in FY2012 and $359 million in FY2013.[15] Nearly all of the additional revenues would be used to fund new education programs.

The changes proposed by Governor Quinn for the FY2011 budget also include an appropriation increase of $783 million, or 3.1%, from $24.9 billion to $25.7 billion. These figures refer to net appropriations, after unspent appropriations are subtracted out. Available documents do not explain the increase in appropriations, but the Governor's aides have stated that it reflects a supplemental appropriation needed to address healthcare expenses and certain additional unspecified shortfalls.[16] The State wants to pay Medicaid bills during FY2011, while Illinois and other states continue to receive enhanced federal funding for the joint federal-state program under the American Recovery and Reinvestment Act of 2009 (ARRA). The enhanced funding is scheduled to end on June 30, 2011.

Total expenditures would increase by $903 million, or 2.7%, from $33.4 billion to $34.3 billion, reflecting the supplemental appropriations and required debt service payments on the proposed GO Restructuring Bonds. As a result, the operating shortfall would increase from $3.2 billion to $4.1 billion.

The GO Restructuring Bonds represent the largest component of Governor Quinn's new plan for FY2011. A bill introduced in the 97th General Assembly would authorize the sale of up to $8.75 billion of 15-year GO bonds that could be used to pay bills that are more than 60 days past due, corporate income tax refunds, state employee medical expenses and other operating expenses of

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[12] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011.
[13] Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-14*, January 20, 2011, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on February 4, 2011).
[14] Illinois 97th General Assembly, Senate Bill 6.
[15] Fiscal Note, House Floor Amendment No. 8 (Department of Revenue), Illinois 96th General Assembly, Senate Bill 44.
[16] Email communication between the Civic Federation and the Governor's Office of Management and Budget, January 25, 2011. A supplemental appropriation represents additional spending authority granted by the General Assembly following passage of the initial budget.

the State.[17] Preliminary information provided by the State in connection with the pension bond sale indicates that the proposed borrowing might be split into two pieces, with approximately $5.75 billion sold in FY2011 and the remainder sold in FY2012.[18]

As shown in the next table, the Governor proposes to use $4.38 billion from the sale of GO Restructuring Bonds in FY2011. Total borrowing for operations would increase to $10.2 billion in FY2011. Use of the bond proceeds would eliminate the operating shortfall and create an operating surplus of $6.1 billion. The total deficit, after accounting for the accumulated deficit from prior years, would shrink to $21 million.

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[17] Illinois 97th General Assembly, Senate Bill 3.

[18] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

State of Illinois FY2011 Revised and New Plan for General Funds Budget (in $ millions)	FY2011 Revised	FY2011 New Plan
Resources		
State Source Revenues	**$ 19,685**	**$ 19,685**
Personal Income Tax Increase	$ 2,632	$ 2,632
Corporate Income Tax Increase	$ 150	$ 150
Change in Net Operating Loss Deduction	$ 100	$ 100
Cigarette Tax Increase	$ -	$ 88
Federal Source Revenues	**$ 5,976**	**$ 5,976**
Subtotal Revenues	**$ 28,543**	**$ 28,631**
Statutory Transfers In	$ 1,622	$ 1,622
Total Resources	**$ 30,165**	**$ 30,253**
Expenditures		
Appropriations	$ 25,831	$ 26,614
Less Unspent Appropriations	$ (891)	$ (891)
Subtotal Net Appropriations Before Pension Contribution and Transfers	**$ 24,940**	**$ 25,723**
Pension Contributions	**$ 4,157**	**$ 4,157**
Pension Bond 2003 Debt Service	$ 516	$ 516
Pension Bond 2010/2011 Debt Service	$ 1,209	$ 1,209
GO Restructuring Bond Debt Service	$ -	$ 120
Medicaid Borrowing Debt Service	$ 189	$ 189
Capital Debt Service	$ 570	$ 570
Statutory Transfers	$ 1,823	$ 1,823
Total Transfers	**$ 4,307**	**$ 4,427**
Total Expenditures	**$ 33,404**	**$ 34,307**
Operating Shortfall	**$ (3,239)**	**$ (4,054)**
Borrowing for Operations		
Tobacco Settlement Securitization	$ 1,250	$ 1,250
Interfund Borrowing	$ 500	$ 500
Pension Obligation Notes	$ 4,050	$ 4,050
Short-Term Borrowing	$ 1,300	$ 1,300
Proceeds of GO Restructuring Bonds	$ -	$ 4,380
Short Term Borrowing Repayment	$ (1,317)	$ (1,317)
Total Borrowing for Operations	**$ 5,784**	**$ 10,164**
Operating Surplus (Deficit) After Borrowing	**$ 2,545**	**$ 6,110**
Accumulated Deficit From FY2010	**$ (6,131)**	**$ (6,131)**
Total Surplus (Deficit)	**$ (3,586)**	**$ (21)**

Source: Civic Federation calculations based on State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27; Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011.

Under Governor Quinn's new plan for FY2011, the State would have a $6.1 billion operating surplus after borrowing. The Governor would use part—but not all—of this operating surplus to reduce the State's backlog of unpaid bills. Of the $6.1 billion, $4.6 billion would be used to reduce the backlog of bills. The Governor's new plan describes the source of the $4.6 billion as follows: $4.38 billion from bond proceeds and $230 million from operating surplus. Because the

Governor's plan does not use all of the operating surplus to pay down bills, the State is left with both unpaid bills and an increase in its year-end cash balance.

The following table compares the backlog of unpaid bills, or accounts payable, at the end of FY2011 under the revised and proposed budgets. The FY2011 Revised column in the table represents Civic Federation projections based on the revised enacted budget. The FY2010 year-end backlog of bills amounted to $6.4 billion.[19] If the total operating surplus after borrowing were applied to the unpaid bills, then the backlog would be reduced to $3.9 billion by the end of FY2011.

In contrast, the Governor's proposal reduces the bill backlog to $1.8 billion, which the Governor's Office of Management and Budget (GOMB) describes as the normal payment cycle.[20] The balance of unpaid bills at the end of the fiscal year must be paid during the lapse period, which usually lasts 60 days. During this period, the State may use revenues from the current fiscal year to pay bills from the prior fiscal year.[21] The lapse period was extended to six months in FY2010 to give the State more time to deal with its mountain of unpaid bills. Under the Governor's proposal, $1.5 billion of the surplus would remain at the end of FY2011 to add to the State's cash balance. The cash balance totaled $280 million at end of FY2010.

State of Illinois FY2011 Accounts Payable and Cash Balance (in $ millions)

	FY2011 Revised*	FY2011 New Plan
Accounts Payable Begining of Year	**$ (6,410)**	**$ (6,410)**
Operating Surplus Applied To Accounts Payable	$ 2,545	$ 230
GO Restructuring Bond Proceeds Applied to Accounts Payable	$ -	$ 4,380
Total Resources Applied to Accounts Payable	**$ 2,545**	**$ 4,610**
Accounts Payable End of Year	**$ (3,865)**	**$ (1,800)**
Operating Surplus (Deficit) After Borrowing	**$ 2,545**	**$ 6,110**
Surplus Applied To Accounts Payable	$ (2,545)	$ (4,610)
Increase in Cash Balance for Fiscal Year	**$ -**	**$ 1,500**

*Civic Federation projections.

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY2012-FY2014* , January 20, 2011.

[19] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

[20] Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-14*, January 20, 2011, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on February 4, 2011).

[21] State Finance Act, ILCS 105/25. See the Civic Federation's Institute for Illinois' Fiscal Sustainability blog at http://civicfed.org/iifs/blog/what-lapse-period-and-why-should-we-care for more information on the lapse period.

Governor's Three-Year General Funds Budget Plan

Governor Quinn's budget plan for FY2012 to FY2014 was made available to the public on January 20, 2011.[22] Public Act 96-1354, signed on July 28, 2010, requires GOMB to post on its website by January 1 of each year its fiscal policy intentions for the upcoming fiscal year and the next two fiscal years. The Governor is scheduled to announce details of his FY2012 recommended budget on February 16, 2011.

The Governor's three-year plan assumes that base General Funds revenues will increase at an average compound annual rate of 2.8% from FY2011 to FY2014. Base revenues consist of state revenues before new revenues from recent tax changes; federal-source revenues designated for the General Funds; and statutorily required transfers into General Funds from sources such as the Illinois Lottery and riverboat gaming taxes.

In FY2012, state revenues are projected to increase by $7.6 billion due to tax changes enacted in January 2011. These increases are offset by revenue reductions totaling $340 million relating to the sale of tobacco settlement bonds and to reforms in the State's Medicaid program. In the case of the tobacco settlement bonds, which were sold in December 2010, $140 million of revenues that previously went to the General Funds will be needed to make debt service payments on the bonds.

Medicaid reform legislation was signed by the Governor on January 25, 2011.[23] A press release issued on that day stated that the reforms contained in the legislation were expected to save $624 million to $774 over five years.[24] Under the Medicaid program, the State pays claims for healthcare expenses and is reimbursed by the federal government for a share of its expenditures at a rate known as the Federal Medical Assistance Percentage (FMAP). The Governor's plan for FY2012 includes a $200 million loss of federal Medicaid revenue. At an FMAP of roughly 50% in FY2012, the State would have to save $400 million to generate a loss of federal revenues of $200 million.[25] From FY2012 to FY2014, the Governor's plan shows that a total of $900 million in federal Medicaid revenue would be lost due to reforms. This implies a drop in state spending of $1.8 billion over the three years.

Under the Governor's three-year plan, appropriations rise by $1.5 billion, or 5.7%, to $27.2 billion in FY2012 from $25.7 billion in FY2011. Total expenditures increase by $2.2 billion, or 6.4%, to $36.5 billion, reflecting increased pension contributions and debt service payments as

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[22] Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-14*, January 20, 2011, http://www2.illinois.gov/budget/Pages/default.aspx (last visited on February 4, 2011).
[23] Public Act 96-1501.
[24] Illinois Governor Pat Quinn, "Governor Quinn Signs Landmark Medicaid Reform Legislation, Hails Bi-Partisan Effort to Preserve Health Care for Vulnerable Illinoisans and Will Save More Than $624 Million Over Five Years," *news release*, January 25, 2011, http://www.illinois.gov/PressReleases/ShowPressRelease.cfm?SubjectID=2&RecNum=9183 (last visited on February 5, 2011).
[25] Illinois and other states have been receiving higher FMAPs because of the American Recovery and Reinvestment Act of 2009. Illinois' FMAP was 50.32% before the federal stimulus program began on October 1, 2008; rose to 61.88% during the program; and is expected to be at 57.16% when the program ends on June 30, 2011. Illinois' FMAP without ARRA would have been 50.2% in 2011 and is expected to be set at approximately that rate when the program ends.

well as the increased appropriations. Debt service on the proposed GO Restructuring Bonds is $425 million.

The chart below shows that the FY2012 operating deficit before borrowing would amount to $1.35 billion. This would be more than offset by using $1.45 billion of proceeds from the sale of the GO Restructuring Bonds as part of General Funds resources, leaving an operating surplus after borrowing of $100 million.

State of Illinois Governor's Three-Year Budget Plan: FY2012-FY2014 (in $ millions)			
	FY2012	**FY2013**	**FY2014**
Base General Funds Revenue	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue			
Personal Income Tax Increase	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 770	$ 804	$ 839
Net Operating Loss Suspension	$ 250	$ 250	$ 250
Estate Tax Reinstatement	$ 182	$ 243	$ 243
Cigarette Tax Increase	$ 330	$ 359	$ 356
Loss of federal Medicaid reimbursements due to state Medicaid reforms	$ (200)	$ (300)	$ (400)
Loss of Tobacco Settlement Revenue	$ (140)	$ (140)	$ (140)
Total Revenue	**$ 35,162**	**$ 36,071**	**$ 37,192**
Expenditures			
Base Appropriations	**$ 27,177**	**$ 27,093**	**$ 26,660**
Existing Debt Service	$ 2,548	$ 1,997	$ 2,530
GO Restructuring Bond Debt Service	$ 425	$ 523	$ 587
Statutory Transfers	$ 1,870	$ 1,917	$ 1,966
Pension Contributions	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 36,512**	**$ 36,393**	**$ 36,981**
Operating Surplus (Deficit) Before Borrowing	**$ (1,350)**	**$ (322)**	**$ 211**
Borrowing For Operations			
Proposed Interfund Borrowing	$ -	$ 400	$ -
Proposed GO Restructuring Bonds	$ 1,450	$ -	$ -
Total Borrowing For Operations	**$ 1,450**	**$ 400**	**$ -**
Operating Surplus (Deficit) After Borrowing	**$ 100**	**$ 78**	**$ 211**

Source: Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011.

Including the $1.45 billion in FY2012, the Governor has specified uses for $5.75 billion of the proposed $8.75 billion in GO Restructuring Bond proceeds. Uses for the remaining $2.95 billion have not been specified. Other authorized uses of the proceeds include paying down the State's backlogs of corporate tax refunds and its bills relating to employee health insurance plans, both of which are not reflected in the General Funds budget. The backlog of corporate tax refunds is

expected to total $1.4 billion at the end of FY2011.[26] The backlog of employee health insurance bills is expected to total $1.1 billion at the end of FY2011.[27]
Under the three-year plan, appropriations decline by 1.9% from $27.2 billion in FY2012 to $26.7 billion in FY2014. However, total expenditures increase by 1.3% from $36.5 billion in FY2012 to $37.0 billion in FY2014 due to rising debt service and pension payments. Spending levels in the plan do not exceed the expenditure limits established in the legislation passed in January 2011.

The following chart compares the spending limits established in January 2011 with projected spending and revenues in the Governor's three-year plan. Projected revenues for each of the years are below the spending limits. Projected revenues for FY2012 and FY2013 are also below projected spending for those years.

State of Illinois Spending Limits and Projections: FY2012-FY2014 (in $ millions)*

	FY2012	FY2013	FY2014
Spending Limit	$ 36.8	$ 37.6	$ 38.3
Projected Spending	$ 36.5	$ 36.4	$ 37.0
Projected Revenues	$ 35.2	$ 36.1	$ 37.2

*Spending Limits based on Public Act 96-1496, which also caps FY2015 spending at $39.1 million.
Source: Illinois General Assembly, Public Act 96-1496; Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-14,* January 20, 2011.

[26] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30. See the Civic Federation's Institute for Fiscal Sustainability blog at http://civicfed.org/iifs/blog/state-illinois-owes-730-million-corporate-tax-refunds for more information on corporate income tax refunds.
[27] Email communication between the Civic Federation and officials at the Illinois Department of Healthcare and Family Services, February 10, 2011.

CIVIC FEDERATION CONCERNS ABOUT THE GOVERNOR'S PLANS

Governor Pat Quinn's Plan for changes to the FY2011 budget and three-year plan increase appropriations and borrowing for operations while continuing to spend more than is reasonably expected in revenues. These plans heavily rely on borrowing to fund operations. If the State of Illinois proceeds with additional borrowing to support increased spending it will ensure future budget deficits and face ongoing financial stress.

The Governor's plans could stabilize the State's finances in the short-term by reducing the State's backlog of unpaid bills and providing additional funding for its annual expenditures. However, the proposed reliance on one-time borrowing proceeds to prop up additional spending is unsustainable and will ensure deficits in future years. Further complicating the State's financial outlook is the rollback of the income tax in FY2015 and FY2016, as required under the tax increase legislation.

The following section discusses the Civic Federation's concerns with the Governor's three-year budget plan including; the cost and debt burden associated with the proposed GO Restructuring Bonds; the imbalance in expenditures compared to the State's expected resources; and the anticipated loss of revenue due to the income tax rollback in FY2015 and FY2016.

Cost and Size of General Obligation Restructuring Bonds

As discussed in the previous section, Governor Pat Quinn is supporting the sale of $8.75 billion in new GO Restructuring Bonds to pay down a portion of the State's $6.4 billion accounts payable at the end of FY2011 and to support $1.5 billion in General Funds operations in FY2012. Under the borrowing legislation proposed in the 97th General Assembly as Senate Bill 3, the remaining $2.9 billion in proceeds are available for a wide range of purposes including to pay vouchers that are more than 60 days past due, medical expenses for employee health plans, corporate income tax refunds and other operating expenses of the State.[28]

Also included in the bill are the dates that the principal amounts borrowed will be repaid. To accommodate the increased debt service costs associated with pension borrowing already approved in FY2010 and FY2011, the legislation proposes that repayment of principal be back-loaded into future years so that the State can afford the increased debt service cost of the proposed GO Restructuring Bonds. When debt is back-loaded, the State owes more principal for longer periods, which in turn increases the total debt service owed on the loan. Although this helps avoid annual debt service increases in the early years, it causes large increases in future years. The following chart shows that if the bonds were sold under recent market conditions, the State's projected interest cost for the bonds would total $3.4 billion over the next 15 years.

[28] Illinois 97th General Assembly, Senate Bill 3, introduced January 13, 2011.

State of Illinois: Proposed $8.75 Billion General Obigation Restructuring Bonds (SB03) Estimated Total Debt Service Based on Current Market Rates (in $ thousands)							
Year	AAA Rate	IL Spread	IL Rate	Maturity	Principal	Interest	Debt Service
1	0.37	70	1.07	01/01/12	$ 100,000.0	$ 347,657.8	**$ 447,657.8**
2	0.73	81	1.54	01/01/13	$ 100,000.0	$ 346,587.8	**$ 446,587.8**
3	1.11	88	1.99	01/01/14	$ 200,000.0	$ 345,047.8	**$ 545,047.8**
4	1.57	85	2.42	01/01/15	$ 450,000.0	$ 341,067.8	**$ 791,067.8**
5	1.86	96	2.82	01/01/16	$ 765,000.0	$ 330,177.8	**$ 1,095,177.8**
6	2.17	101	3.18	01/01/17	$ 765,000.0	$ 308,604.8	**$ 1,073,604.8**
7	2.52	101	3.53	01/01/18	$ 765,000.0	$ 284,316.0	**$ 1,049,316.0**
8	2.84	99	3.83	01/01/19	$ 765,000.0	$ 257,311.5	**$ 1,022,311.5**
9	3.12	101	4.13	01/01/20	$ 765,000.0	$ 228,012.0	**$ 993,012.0**
10	3.37	102	4.39	01/01/21	$ 765,000.0	$ 196,417.5	**$ 961,417.5**
11	3.58	103	4.61	01/01/22	$ 765,000.0	$ 162,834.0	**$ 927,834.0**
12	3.74	108	4.82	01/01/23	$ 765,000.0	$ 127,605.8	**$ 892,605.8**
13	3.89	110	4.99	01/01/24	$ 765,000.0	$ 90,732.8	**$ 855,732.8**
14	4.04	111	5.15	01/01/25	$ 765,000.0	$ 52,597.5	**$ 817,597.5**
15	4.18	110	5.28	01/01/26	$ 250,000.0	$ 13,200.0	**$ 263,200.0**
				Total	**$ 8,750,000.0**	**$ 3,432,170.5**	**$ 12,182,170.5**

Source: Principal maturities and term based on Illinois 97thGeneral Assembly Senate Bill 3; Civic Federation estimates based on MMD AAA Rates and IL Spreads from Bloomberg and Thomson MMD, January 25, 2011.

The estimates in the chart above are probably conservative for two reasons. First, the rates are based on market conditions as of January 25, 2011. If interest rates for municipal bonds continue to rise from now until the time that the bonds are issued, the total interest cost would also increase. The estimates also assume that the bonds will be sold as traditional tax-exempt municipal bonds. Tax-exempt bonds typically have much lower rates than taxable bonds because investors do not have to pay federal income taxes on the earnings from the bonds. The Internal Revenue Service enforces federal rules for issuance of tax-exempt bonds that limit the total amount of tax-exempt bonds a government may sell for operating funding. If the IRS found that some of the proposed bonds exceeded the State's limit, they would not qualify as tax exempt and the total debt service cost would increase.

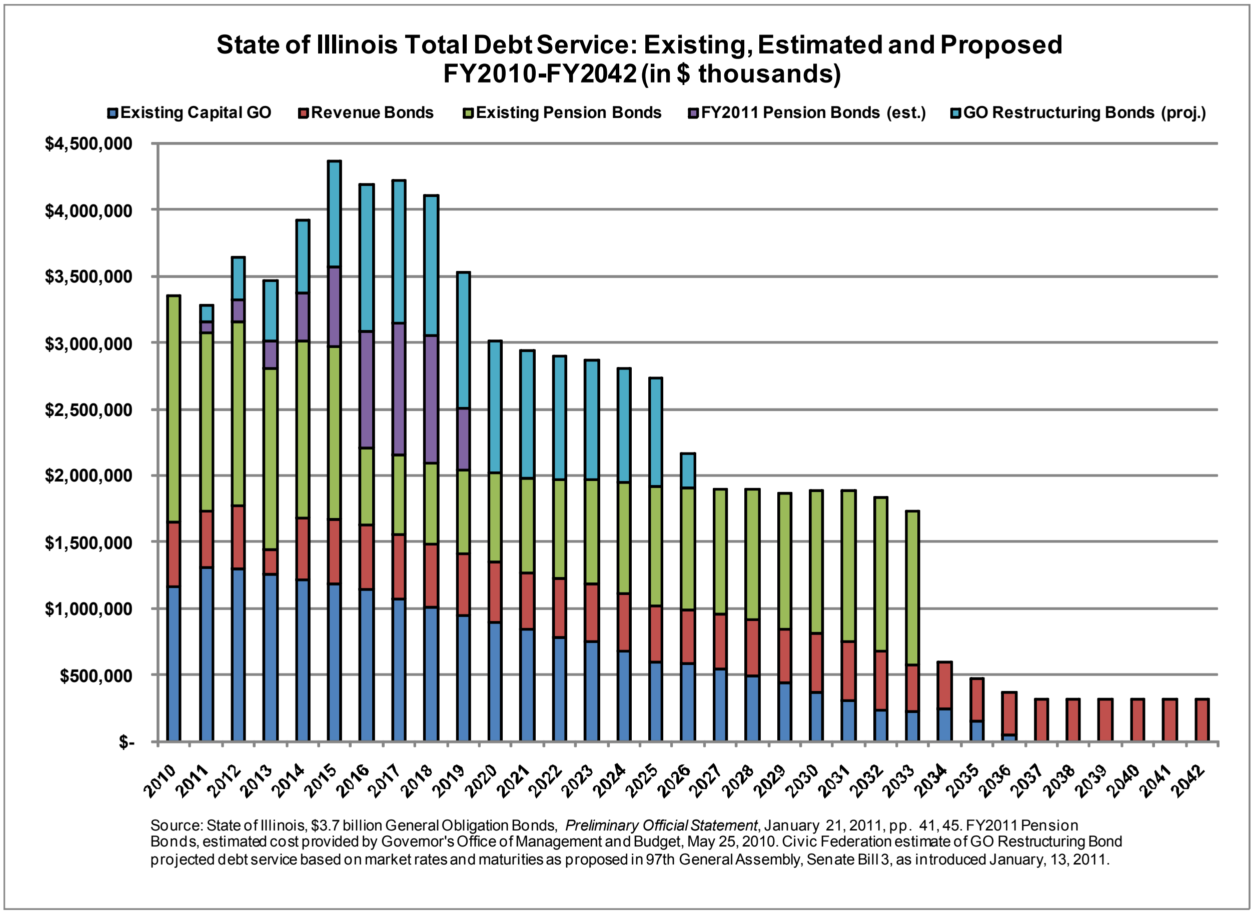
Total Debt Service Increase

If the GO Restructuring Bonds are authorized by the General Assembly, the State's total annual debt service due on all existing debt, including the FY2011 pension bonds, will climb to $4.4 billion by FY2015.[29] The State has seen a significant rise in its outstanding debt over the past two years, initially from the issuance of $3.5 billion to make its FY2010 pension payment. Since then the State has also begun selling additional capital bonds to support its ongoing *Illinois Jobs Now!* capital program.

According to the Governor's FY2010 budget, before the issuance of the FY2010 pension bonds the State's total debt service for that year would have totaled just under $2.0 billion, or less than half the peak level in FY2015.[30] Under the Governor's proposed borrowing plan, the State's total annual debt service would not return to FY2010 levels until after the last of the new bonds are

[29] See Appendix A for Total Debt Service Data and Sources.
[30] Illinois FY2010 State Budget, p. 12-11.

retired in FY2026. The following chart shows total debt service owed by the State for all outstanding debt combined with estimated debt service from the pending pension bond sale for FY2011 and the estimated cost of the proposed GO Restructuring Bonds.



As shown by the estimates above, the years of the highest debt service for the GO Restructuring Bonds coincide with the same years the income tax increases are scheduled to be rolled back. As enacted the income tax increases are temporary and under the legislation roll back halfway through FY2015 from 5.0% to 3.75% for the personal income tax and 7.0% to 5.25% for the corporate income tax. The increased spending pressures associated with the debt service levels shown above combined with the loss of revenues associated with the tax rate rollback are poised to cause significant financial difficulties for the State at the end of the Governor's three-year plan.

The chart above includes all tax supported debt service for the State. Some of the amounts included are paid from outside the General Funds. The Revenue bonds are paid for with an increment of the sales tax and other fees. A portion of the existing capital is paid for through the Road Fund and revenues passed to support the FY2010 capital spending program. All of the pension bond debt service is paid for out of the General Funds.

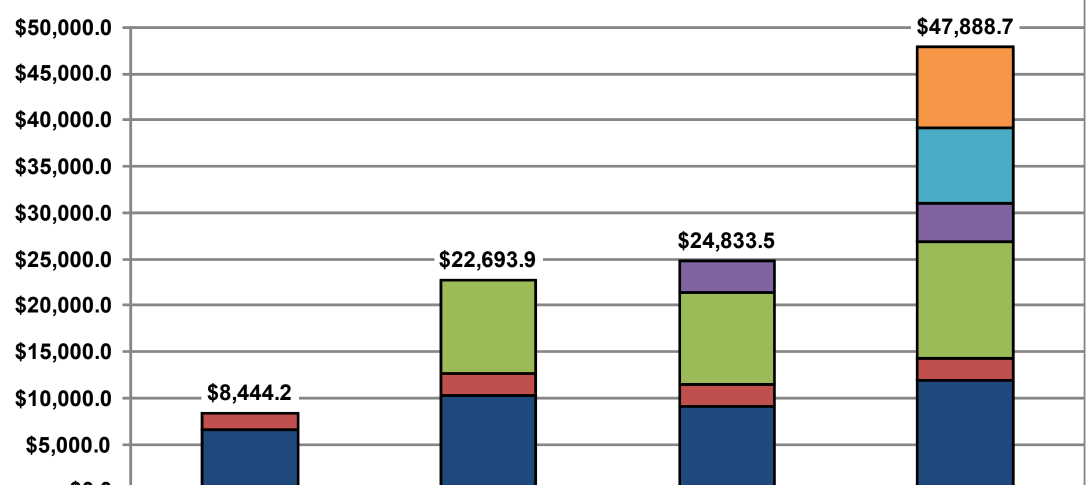
The estimates above do not account for any additional bonds authorized but yet to be issued as part of the State's ongoing capital program. The General Assembly approved $4.2 billion in additional GO Bonds for capital purposes on January 13, 2011, bringing the total outstanding but unissued capital bonds to $8.1 billion.[31] The State has yet to announce the schedule for issuance of these additional bonds.

Total Debt Burden Increase

The State's total debt burden would increase dramatically if the borrowing for operations included in the Governor's plan were approved. The State has increased borrowing for pensions by more than $7 billion to make its FY2010 and FY2011 pension payments. The State has authorized $8.1 billion in capital GO Bonds not yet issued to support capital projects as part of the $31 billion capital spending program approved in the FY2010 budget.

If all of the new debt already authorized by the State is sold and the GO Restructuring Bonds are approved, the State's total debt outstanding will increase to $47.9 billion. This is an increase of $39.4 billion, or 467.1%, since FY2001. The following chart shows the State's total existing debt in FY2011, authorized but unissued bonds and the proposed additional borrowing, compared with total debt levels in FY2001, FY2006 and FY2010.

State of Illinois Total Bonded Indebtedness: Existing, Approved and Proposed FY2001 FY2006, FY2010, FY2011 (in $ millions)



	FY2001	FY2006	FY2010	FY2011/FY2012
Total Bonded Indebtedness	$8,444.2	$22,693.9	$24,833.5	$47,888.7
GO Restructuring Bonds	$0.0	$0.0	$0.0	$8,750.0
New Capital Bonds	$0.0	$0.0	$0.0	$8,138.4
New Pension Bonds	$0.0	$0.0	$3,466.0	$4,096.0
Outstanding Pension Bonds	$0.0	$10,000.0	$9,950.0	$12,662.0
Build Illinois Bonds	$1,844.2	$2,442.5	$2,309.0	$2,336.0
Outstanding GO Capital	$6,600.0	$10,251.4	$9,108.5	$11,906.3

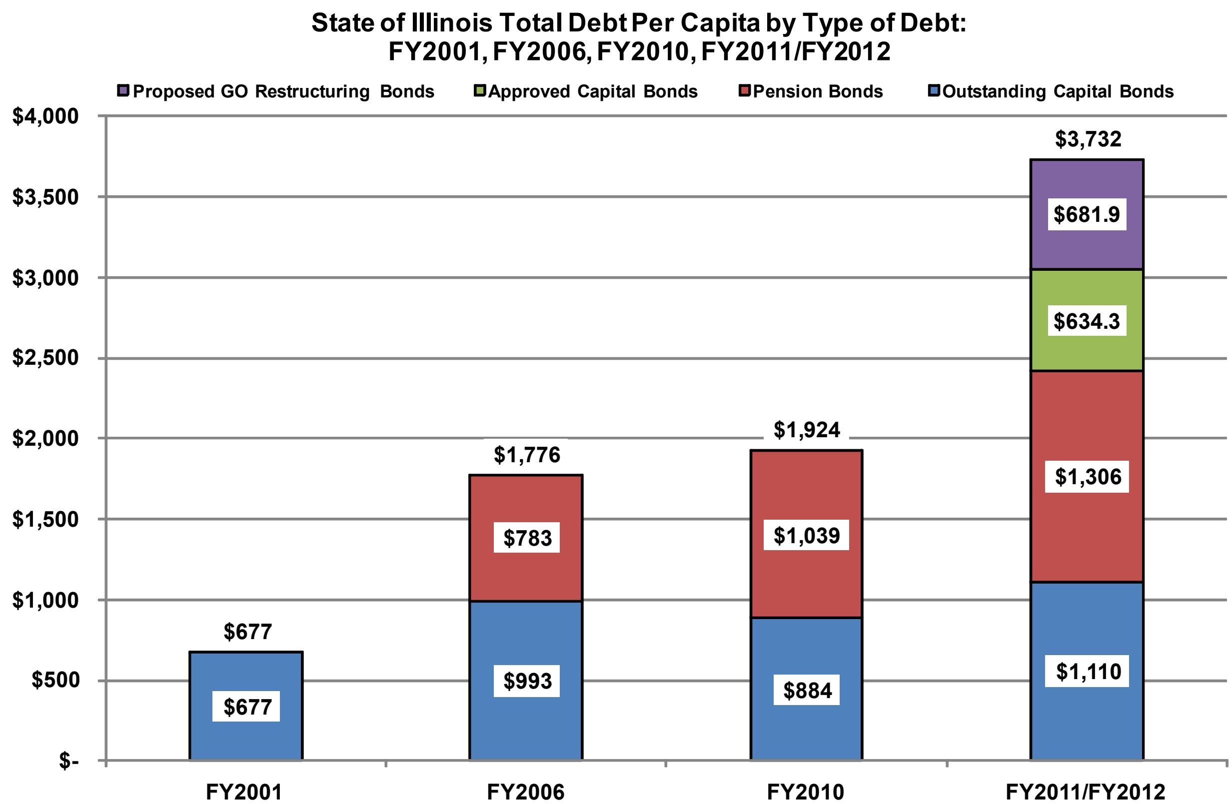
Source: State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, pp. 35, 41, 45. State of Illinois, General Obligation Bonds, *Official Statement,* May 14, 2009, pp. 32, 36. Illinois State Budgets FY2001, FY2006.

[31] State of Illinois, $3.7 billion General Obligation Bonds, *Official Statement,* January 21, 2011, p. 35.

Total Debt Per Capita

One of the most common measures used to analyze a state's debt burden is the ratio of total outstanding debt to the state's estimated population. If the GO Restructuring Bonds are authorized and all GO capital bonds are issued, the total debt per capita will reach an estimated $3,732 in FY2011. This would be an increase of $1,809, or 94%, over FY2010 and a $3,055 per capita increase since FY2001, or 451%.

The following chart shows debt per capita levels in FY2001, FY2006 and FY2010 compared to proposed and authorized increases for FY2011/FY2012 by type of debt.



Source: State of Illinois, Official Statement, $3.7 billion General Obligation Bonds, *Preliminary Official Statement,* January 21, 2011, pp. 41, 45; FY2011 Pension Bonds, estimated cost provided by Governor's Office of Management and Budget, May 25, 2010; Illinois State Budgets, FY2007, FY2002.

Spending Exceeds Revenues In Governor's Three-year Plan and FY2011 Plan

The Civic Federation is concerned that the Governor's plan to increase spending in FY2011 and over the next three years exceeds expected revenues, causing future deficits and continued fiscal stress.

General Funds appropriations excluding pension payments and other statutory transfers declined from FY2009 to the enacted FY2011 budget. However, the Governor now seeks to increase FY2011 appropriations before the end of the fiscal year and substantially increase appropriations in FY2012. Although the State expects new revenues from the enacted increase in the State's income tax rates to be added to the FY2011 resources, the enacted budget still maintains an operating shortfall in FY2011 before borrowing for operations.

The FY2011 budget as enacted on July 1, 2010 included General Funds appropriations of $24.9 billion.[32] This amounted to a reduction in appropriations of $2.4 billion or 8.7% from FY2009. However, as originally enacted, increases in the State's required pension payment, debt service and other required transfers would have resulted in total General Funds expenditures increasing by $526 million or 1.6%, from $33.0 billion in FY2009 to $33.5 billion in FY2011 despite the reductions in appropriations.

The Governor's new plan seeks to increase FY2011 net appropriations by $783 million, or 3.1%, to $25.7 billion. This would represent a decline of 4.3% from FY2009. A supplemental appropriation still must be passed by the General Assembly to increase the appropriations from the FY2011 enacted budget. The Governor's plan to increase FY2011 appropriations would be slightly higher than FY2010 appropriations of $25.4 billion.

[32] State of Illinois, $3.7 billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

The following chart compares General Funds appropriations and expenditures over the past three fiscal years compared to the enacted FY2011 budget and the Governor's new plan for FY2011.

State of Illinois General Funds Expenditures: FY2009-FY2011 (in $ millions)						
	FY2009 Actual	FY2010 Estimated	FY2011 Enacted	FY2011 New Plan	$ Change FY2009-FY2011	% Change FY2009-FY2011
Appropriations	$ 27,796	$ 26,354	$ 25,831	$ 26,614	$ (1,182)	-4.3%
Less Unspent Appropriations	$ (507)	$ (913)	$ (891)	$ (891)	$ (384)	75.7%
Net Appropriations before Pension Contributions	**$ 27,289**	**$ 25,441**	**$ 24,940**	**$ 25,723**	**$ (1,566)**	**-5.7%**
Pension Contributions*	$ 2,486	$ -	$ 4,157	$ 4,157	$ 1,671	67.2%
Net Appropriations After Pension Contributions	**$ 29,775**	**$ 25,441**	**$ 29,097**	**$ 29,880**	**$ 105**	**0.4%**
Statutory Transfers	$ 2,082	$ 2,242	$ 1,823	$ 1,823	$ (259)	-12.4%
Capital Debt Service	$ 636	$ 670	$ 645	$ 570	$ (66)	-10.4%
Medicaid Borrowing Borrowing Debt Service	$ -	$ 63	$ 183	$ 189	$ 189	NA
Total Pension Bond Debt Service	$ 466	$ 564	$ 1,754	$ 1,725	$ 1,259	270.2%
GO Restructuring Bonds Debt Service**	$ -	$ -	$ -	$ 120	NA	NA
Total Transfers Out	**$ 3,184**	**$ 3,539**	**$ 4,406**	**$ 4,427**	**$ 1,243**	**39.0%**
Total General Funds Expenditures	**$32,959**	**$28,980**	**$33,503**	**$ 34,307**	**$ 1,348**	**4.1%**

*In FY2010, pension contributions were paid from proceeds of sale of $3.5 billion in Pension Obligation Bonds.

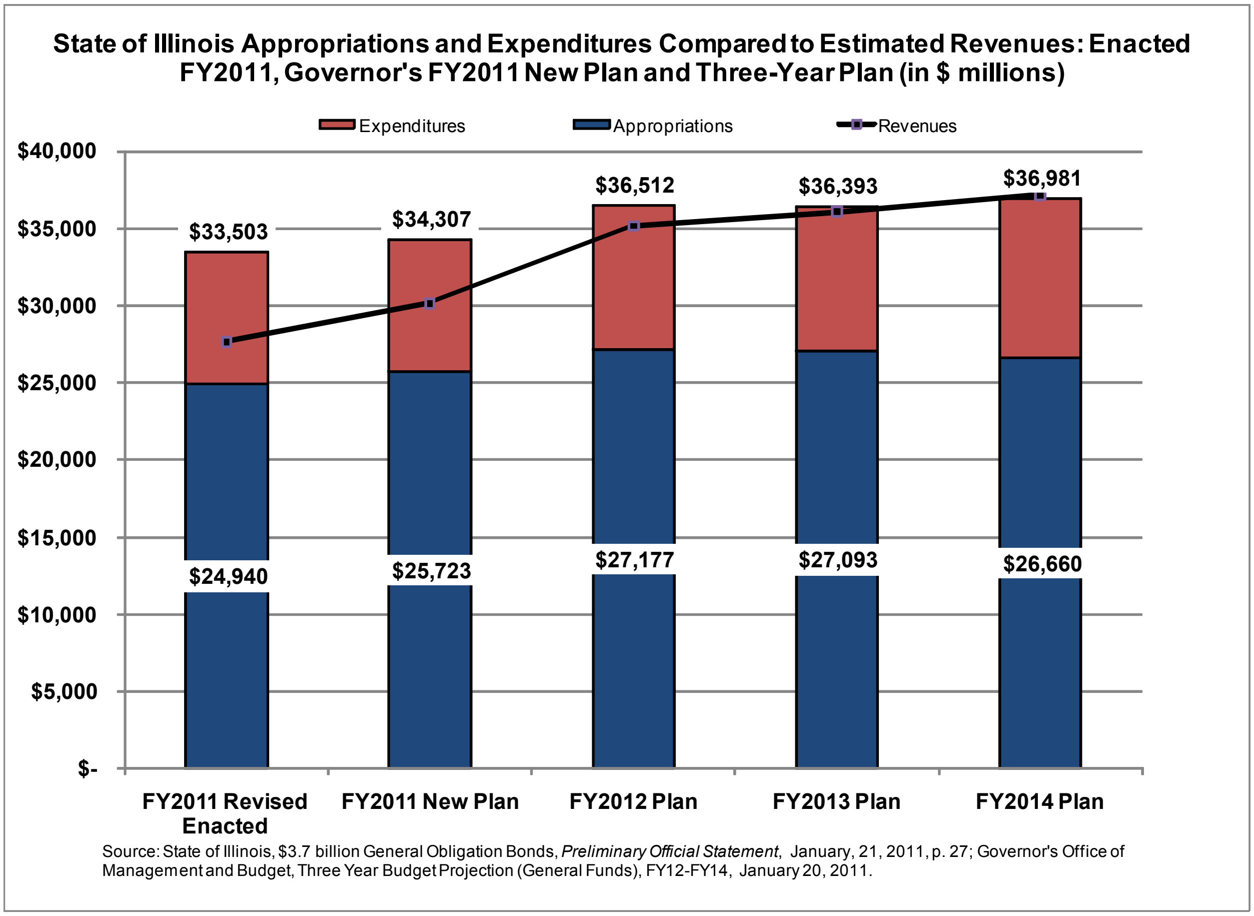
**Proposed FY2011 General Obligation Restructuring Bonds proposed in Illinois 97th General Assembly Senate Bills 3.

Source: State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

According to the Governor's new plan, total expenditures would increase by 4.1% from $33.0 billion in FY2009 to $34.3 billion in FY2011. The major spending increases during the period involve higher statutorily required contributions to the State's underfunded retirement systems and debt service on Pension Obligation Bonds (POBs) issued to make pension payments for FY2010. The increase in annual debt service for pension bonds from FY2009 to FY2011 totals $1.3 billion or 270%, while the annual pension payment has increased by $1.7 billion or 67.2%. To pay the roughly $4 billion in pension contributions for FY2011, Governor Pat Quinn on January 14, 2011 signed Public Act 96-1497 authorizing the sale of additional POBs in FY2011.

The Governor's three-year plan calls for an additional increase in appropriations in FY2012 to $27.2 billion. This would be a $2.2 billion, or 9.0%, increase over the appropriations originally enacted for FY2011. If the supplemental appropriations were approved for FY2011, it would amount to a $1.5 billion year-to-year increase in appropriations, or 5.7%. This increase would effectively eliminate nearly all appropriations reductions made over the last two fiscal years and return appropriations to just below the FY2009 levels of $27.3 billion. Total General Funds expenditures in the Governor's plan increase by $3.0 billion, or 9.1%, from $33.5 billion as originally enacted in FY2011 to $36.5 billion in the planned FY2012 expenditures. This amounts to a 6.4% increase over the expenditures of $34.3 billion proposed in the Governor's plan to increase FY2011 spending prior to the end of the year. In FY2013 and FY2014, expenditures are held relatively flat. However, because of increases in FY2011 and FY2012, expenditures far outpace revenues, causing continued operating shortfalls until FY2014.

The following chart compares the FY2011 enacted appropriations and expenditures to the Governor's plan for FY2011 and three-year plan.



The Governor's plan for FY2011 and three-year plan fill the operating shortfalls illustrated above with borrowing. The General Assembly has already approved $5.8 billion in borrowing to fund FY2011 operations in the form of interfund borrowing, securitizing a portion of the proceeds from the State's tobacco liability settlement and borrowing to make the FY2011 pension payment. If the GO Restructuring Bonds are approved, borrowing for operations would increase by an additional $4.4 billion in FY2011 and an additional $1.4 billion in FY2012. The Governor's three-year plan also calls for additional interfund borrowing in FY2013 to fill an anticipated operating shortfall of $322 million.

The following table shows the Governor's plan for expenditures compared to estimated revenues, operating shortfalls before borrowing and proposed borrowing for operations in the Governor's FY2011 plan and the three-year plan.

State of Illinois Governor's FY2011 New Plan and Three-Year Plan: Revenues and Expenditures FY2011-FY2014 (in $ millions)				
	FY2011	**FY2012**	**FY2013**	**FY2014**
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Cigarette Tax Increase	$ 88	$ 330	$ 359	$ 356
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,253**	**$ 35,162**	**$ 36,071**	**$ 37,192**
Expenditures				
Base Appropriations	**$ 25,723**	**$ 27,177**	**$ 27,093**	**$ 26,660**
Existing Debt Service	$ 2,484	$ 2,548	$ 1,997	$ 2,530
GO Restructuring Bonds Debt Service	$ 120	$ 425	$ 523	$ 587
Legislative Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contributions	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 34,307**	**$ 36,512**	**$ 36,393**	**$ 36,981**
Operating Surplus (Shortfall) Before Borrowing	**$ (4,054)**	**$ (1,350)**	**$ (322)**	**$ 211**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Proposed Interfund Borrowing	$ -	$ -	$ 400	$ -
Proposed GO Restructuring Bonds	$ 4,380	$ 1,450	$ -	$ -
Total Borrowing For Operations	**$ 10,164**	**$ 1,450**	**$ 400**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 6,110**	**$ 100**	**$ 78**	**$ 211**

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011.

As shown in the table above if the Governor's plans were enacted it would lead to continued operating shortfalls until FY2014 despite new revenues from the income tax increase, suspension of the net operating loss deduction and the proposed increase in the cigarette tax.[33] By continuing to run operating deficits throughout the three-year plan and using borrowing to support increased expenditures the State will not effectively stabilize its finances and as discussed in the previous section, will stress its annual budgets with annual increases in the debt service from the GO Restructuring Bonds. At the same time that the increases in debt service are scheduled to climb dramatically the annual pension contribution also continues to increase. From FY2011 through FY2014 the total required contribution increases by $1.1 billion.

Loss of Revenue from Income Tax Rollback in FY2015 and FY2016

Increases in spending in the Governor's three-year plan will further complicate the loss of revenue from the enacted roll back of the income tax rates that takes effect half way through FY2015 and for all of FY2016.[34] Increases from appropriations, pension contributions and debt service from additional borrowing result in an increase of $3.5 billion in expenditures by FY2014 over the FY2011 enacted budget under the three-year plan. The increased spending level

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[33] Illinois 97th General Assembly, Senate Bill 3.

[34] Illinois 96th General Assembly, Public Act 96-1496.

and known increases in expenditures in FY2015 and FY2016 will make it even more difficult for the State to absorb the loss of revenues from the roll back of the income tax rates.

As enacted, the temporary the personal income tax rate is reduced from 5.0% to 3.75% on January 1, 2015 and the corporate income tax rate is reduced from 7.0% to 5.25%. At the same time the suspension of the net operating loss deduction expires, which will decrease state revenues by an estimated additional $125 million for half of FY2015 and $250 million in the next year. The following year, FY2016, will be the first full fiscal year at the reduced income tax rate, which will lead to even lower revenues than FY2015. The following table estimates the anticipated budget gap from known revenue losses in FY2015 and FY2016 combined with changes in debt service and pension payments.

Anticipated Budget Gap FY2015-FY2016 (in $ millions)		
Revenue Losses	**FY2015**	**FY2016**
Personal Income Tax (5% to 3.75%)	$ (1,875)	$ (3,860)
Corporate Income Tax (7% to 5.25%)	$ (251)	$ (512)
Net Operating Loss Deduction	$ (125)	$ (250)
Revenue Change	**$ (2,251)**	**$ (4,622)**
Expenditure Changes		
Pension Payment Increase	$ 440	$ 690
POB Debt Service Change	$ 210	$ (238)
GO Restructuring Bond Increase	$ 246	$ 550
Total Expenditure Change	**$ 896**	**$ 1,002**
Anticipated Budget Gap	**$ (3,147)**	**$ (5,624)**

Source: Civic Federation revenue change estimates based on Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-14*; POB Debt Service change and pension payment change based on State of Illinois, $3.7 billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, pp. 41, 68.

This table only includes known reductions in revenues and estimated increases in expenditures. It does not account for other expenditures such as the new statutorily required transfer for education and human services out of the personal and corporate income tax receipts enacted as part of the tax increase legislation.[35]

The anticipated budget gaps do not account for any revenue growth beyond FY2014 that may offset some of the anticipated budget gap. The Governor's three-year plan assumes an average growth rate in base revenues of 2.8% between FY2011 and FY2014. However, in order to cover the entire shortfall in FY2015, total FY2014 base revenues of $29.7 billion would need to grow by 10.6%. Revenues would have to grow by an additional 8.4% from FY2015 to FY2016 to cover the additional revenue losses and expenditure increases shown above. In order to reduce appropriations to compensate for the losses, the State would need to cut 11.8% from FY2014 appropriations of $26.6 billion in FY2015 and reduce FY2016 appropriations by an additional 9.3% in FY2016.

[35] Public Act 96-1946 established the Fund for the Advancement of Education and the Human Services Fund. The State is required to deposit 3.3% of the personal and corporate income tax receipts into each fund beginning on January 15, 2015.

CIVIC FEDERATION RECOMMENDATIONS

This section discusses the Civic Federation's recommendations for the State of Illinois FY2012 budget and three-year budget plan. Based on our analysis of the State's fiscal condition and projected resources, we present the following alternatives to the Governor's recent plans and additional recommendations for improving the State's financial stability.

Issue 1: Borrowing for Operations

The Governor's proposal to sell GO Restructuring Bonds totaling $8.75 billion to increase spending and pay down a portion of the State's unpaid bills is not a sustainable plan for funding government operations. This long-term borrowing will increase the cost of government operations by more than $3.4 billion in new interest costs over the next 15 years and not effectively stabilize the State's long-term finances. The 15-year term of the borrowing and back loaded principal payments keep debt service payments low for the first few years but then dramatically increase just as the recent income tax increase is scheduled to roll back in FY2015 and FY2016. Such a large increase in debt service will make the planned rollback of the income tax increase very difficult.

The total increase in State debt burden would also limits the State's ability to access the credit markets through FY2026. If issued, the GO Restructuring Bonds will increase the State's debt burden to nearly $50 billion and nearly double the debt per capita debt burden from FY2010 levels.

Civic Federation GO Restructuring Bond Recommendation

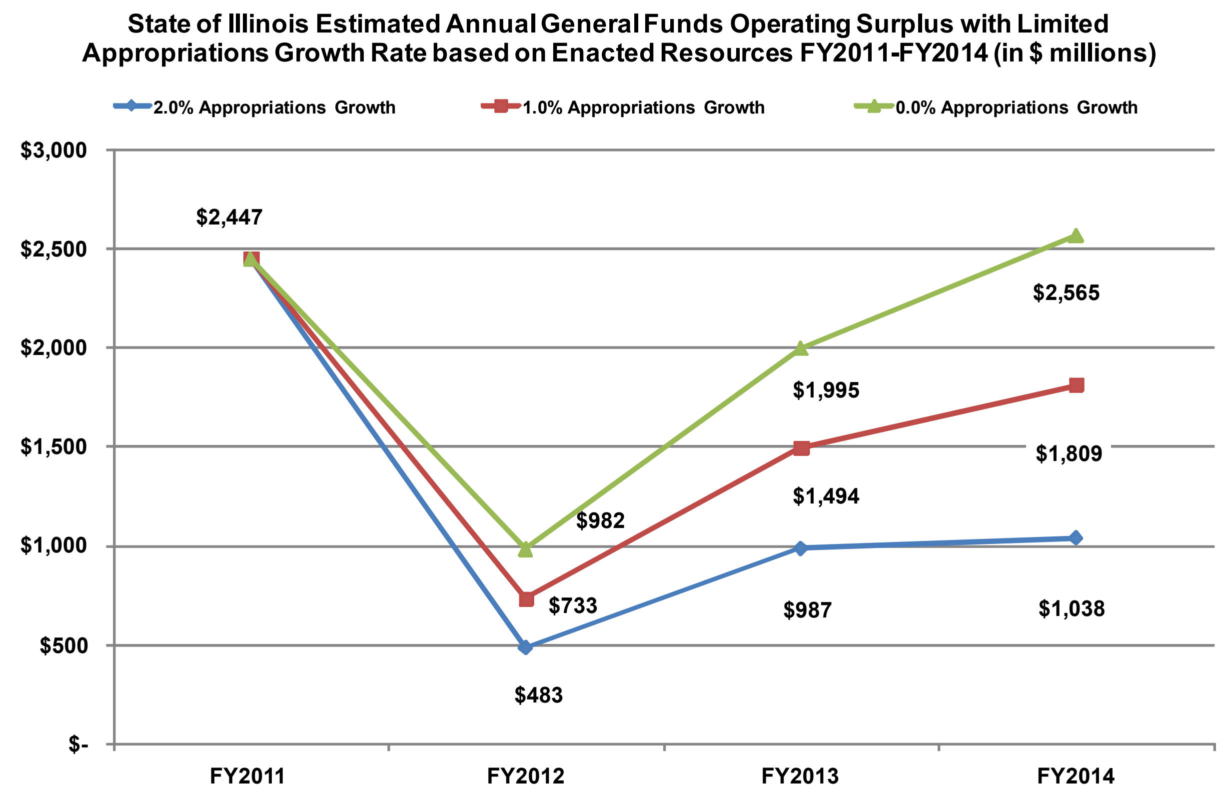
The Civic Federation opposes the proposed long-term GO Restructuring Bonds to pay for current operating expenses because it builds deficits into future budgets, increases the cost of government and pushes the cost of current government operations onto future taxpayers.

Issue 2: Spending Plan and Unpaid Bills

The Governor's plan for FY2011 and three-year plan, as detailed earlier in this report, include dramatic increases in spending in FY2011 and FY2012. These increases are supported by additional borrowing for operations, which will increase debt service owed by the State through FY2026. If the State instead maintains the appropriations levels originally enacted for FY2011 and controls spending increases throughout the three-year budget plan, the resources already enacted will lead to operating surpluses each year from FY2011 through FY2014.

If base appropriations are not increased for FY2011, the State will end the year with an estimated operating surplus of $2.4 billion after paying for all of its current year General Fund expenditures. This surplus is created through the new revenues expected from the increase in the income tax and the borrowing for operations already authorized by the Governor and General Assembly. If base appropriations growth is restricted to 2.0% or less from FY2011 to FY2014, the State will be able to afford all of its General Funds expenditures, including its pension contributions, from already enacted General Funds resources.

The following chart shows the operating surpluses in FY2011 and throughout the next three years if the State's base appropriations are restricted to 2.0%, 1.0% or 0.0% growth.[36]



Source: Civic Federation estimates based on Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011.

The following table shows the calculation of the State's year-end General Funds operating surplus if appropriations are held at the enacted FY2011 level and appropriations are only allowed to increase by 2% annually from FY2012 to FY2014.

[36] Civic Federation estimated surpluses based on revenues and expenditures in Governor's Office of Management and Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011. See Appendix B, C and D for calculation of surpluses.

State of Illinois Enacted and Projected Budget: FY2011-FY2014 Base Appropriations Growth 2.0% (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,165**	**$ 34,832**	**$ 35,712**	**$ 36,836**
Expenditures				
Base Appropriations (2.0% annual growth)	**$ 24,940**	**$ 25,439**	**$ 25,948**	**$ 26,467**
Existing Debt Service	$ 2,582	$ 2,548	$ 1,997	$ 2,126
Statutory Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contribution	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 33,502**	**$ 34,349**	**$ 34,725**	**$ 35,798**
Operating Surplus (Shortfall) Before Borrowing	**$ (3,337)**	**$ 483**	**$ 987**	**$ 1,038**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Total Borrowing For Operations	**$ 5,784**	**$ -**	**$ -**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 2,447**	**$ 483**	**$ 987**	**$ 1,038**

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011; $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

The State also has a backlog of accounts payable that are expected to total $6.4 billion at the end of FY2011. This backlog has increased over the last three fiscal years and has caused financial stress among the vendors and agencies that suffer from delayed payments from the State.

The State pays a prompt-payment interest penalty of 1% per month for any bills that are more than 60 days past due.[37] This penalty should not be misunderstood as an annual cost of 12.0% on the total backlog of accounts payable held by the State.[38] Many of the payments owed by the State that are included in the accounts payable backlog do not qualify for the penalty. Some of the payments included in the State's backlog of accounts payable that are exempt from the prompt payment penalty include interagency payments, pension payments, payments to local governments and nearly all State grants.[39] Of the $6.4 billion in unpaid bills as of December 31, 2010, roughly $1.3 billion represented the type of bills that could have qualified for interest penalties, according to information provided by the Illinois Comptroller's Office.[40] According to electronic records available on the Comptroller's website, prompt payment interest expenditures by the State in FY2010 totaled $62.3 million, which comes to only 0.97% of the total $6.4 billion in accounts payable at the end FY2010.

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[37] 30 ILCS 540 State Prompt Payment Act.

[38] The interest owed by the State is actually calculated on a daily rate of 0.03% per day until it is repaid, which prevents the cost from reaching even 1% if it is repaid before 30 days from the time a past due bill qualifies for the prompt payment penalty.

[39] State of Illinois, Office of the Comptroller, State Accounting Management System, Procedure 17.20.45, pp. 5, 6.

[40] Based on communication between Civic Federation staff and Illinois Comptroller's Office, February 10, 2010.

Despite the low cost of the prompt payment compared to the total backlog of accounts payable, it is important for the State to pay down its backlog of accounts payable to a reasonable payment cycle. The Governor's three-year plan shows $1.8 billion as the "normal payment" cycle and applies $4.3 billion of the proposed GO Restructuring Bonds to reach this level. If the State did not increase appropriations and applied the $2.5 billion to the accounts payable at the end of FY2011 it would reduce the backlog of accounts payable by 38.2% to $4.0 billion. The State could pay down the accounts payable to the normal payment cycle of $1.8 billion in FY2014 without additional borrowing by applying the operating surpluses shown in the previous table to the accounts payable at the end of every year.

The following table shows the reduction of accounts payable between FY2011 to FY2014 and increase in cash surplus in FY2014 based on using only previously enacted General Funds resources and restricting annual appropriations increases to 2.0%.

Accounts Payable and Cash Reserves FY2011-FY2014 Base Appropraitions 2.0% Annual Growth (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Accounts Payable Begining of Year	**$ (6,410)**	**$ (3,963)**	**$ (3,480)**	**$ (2,492)**
Operating Surplus Applied to Accounts Payable	**$ 2,447**	**$ 483**	**987**	**692**
Accounts Payable End of the Year	**$ (3,963)**	**$ (3,480)**	**$ (2,492)**	**$ (1,800)**
Operating Surplus (Deficit) After Borrowing*	**$ 2,447**	**$ 483**	**$ 987**	**$ 1,038**
Surplus Applied To Accounts Payable	$ (2,447)	$ (483)	(987)	(692)
Cash Surplus (Deficit) for the Year	**$ -**	**$ -**	**$ -**	**$ 346**
Existing Reserves	**$ 556**	**$ 556**	**$ 556**	**$ 556**
Total Reserves	**$ 556**	**$ 556**	**$ 556**	**$ 902**

*Estimates based on base appropriations annual growth limited to 2.0% from enacted FY2011 level.

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011; State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

Civic Federation's Spending Recommendation

The Civic Federation opposes the Governor's plan to increase FY2011 spending and recommends that the State restrict annual appropriations increases to 2% or less through FY2014. We further urge the State to use operating surpluses to pay down its backlog of accounts payable rather than use proceeds from expensive long-term bonds.

Issue 3: Borrowing to Pay Down Overdue Bills

Issuing long-term debt to pay for the State's backlog of accounts payable and to fund operations is very expensive and creates future deficits from using one-time resources to fund ongoing costs. If paying down the backlog of accounts payable by the end of FY2011 is a priority, the State should only consider using short-term debt such as a Tax Anticipation Note (TAN). A TAN is a short-term loan based on expected revenues from future tax receipts. Because the loan would be for a much smaller amount than the $8.75 billion GO Restructuring Bonds and paid back sooner, the borrowing costs would be well below the estimated $3.4 billion interest cost for the 15-year GO Restructuring Bonds.

Based on the Civic Federation's recommended spending plan that limits base appropriations to 2.0% annual increases, the State would only need to borrow $2.2 billion to pay down the remaining accounts payable in excess of the normal payment cycle of $1.8 billion by the end of FY2011. If the State issued a TAN for this amount, at the prescribed spending level it could afford the annual debt service within its currently enacted General Funds resources. The Civic Federation estimates that the total borrowing cost to issue a TAN totaling $2.2 billion to be repaid over three years would be between $156.5 million to $175.7 million.

The following chart shows the $156.5 million estimated cost of borrowing if a TAN were issued to pay down the accounts payable in FY2011 based on the surpluses that would be available if enacted FY2011 spending levels were maintained and appropriations were restricted to 2% or less in annual growth through FY2014.

Anticipated Debt Service Cost for Short-Term Borrowing Plan for Accoutns Payable
Lower Cost from Increased Upfront Principal (in $ millions)

Muni Bond Rates 1/25/2011			
Year	AAA Rate	IL Spread	IL Rate
1	0.37	150	1.87
2	0.73	175	2.48
3	1.11	200	3.11

	FY2012	FY2013	FY2014	Total
Principal	$ 401.0	$ 938.1	$ 823.9	**$ 2,163.0**
Interest	$ 82.0	$ 48.9	$ 25.6	**$ 156.5**
Total Debt Service	**$ 483.0**	**$ 987.0**	**$ 849.5**	**$ 2,319.5**
Operating Surplus	$ 483.0	$ 987.0	$ 1,038.0	**$ 2,508.0**
Remaining Surplus	**$ -**	**$ -**	**$ 188.5**	**$ 188.5**

Source: Civic Federation estimates based on best available information on secondary market rates and spreads to high grade municipal bonds for maturities listed above from Bloomberg and Thompson MMD.

The chart above assumes the maximum amount of principal affordable using the available surpluses is repaid in the early years of the loan using the entire annual operating surplus to repay the short-term borrowing. If the principal amounts of the TAN were back loaded, the total interest cost would increase and a smaller surplus would be available in the first year of the borrowing rather than FY2014. The following table shows the increase in interest cost by back loading three-year TANs.

Anticipated Debt Service Cost for Short-Term Borrowing Plan for Accounts Payable
Higher Cost from Back Loaded Principal (in $ millions)

Muni Bond Rates 1/25/2011			
Year	AAA Rate	IL Spread	IL Rate
1	0.37	150	1.87
2	0.73	175	2.48
3	1.11	200	3.11

	FY2012	FY2013	FY2014	Total
Principal	$ 223.7	$ 932.6	$ 1,006.7	**$ 2,163.0**
Interest	$ 89.9	$ 54.4	$ 31.3	**$ 175.7**
Total Debt Service	**$ 313.7**	**$ 987.0**	**$ 1,038.0**	**$ 2,338.7**
Operating Surplus	$ 483.0	$ 987.0	$ 1,038.0	**$ 2,508.0**
Remaining Surplus	**$ 169.3**	**$ -**	**$ -**	**$ 169.3**

Source: Civic Federation estimates based on best available information on secondary market rates and spreads to high grade municipal bonds for maturities listed above from Bloomberg and Thompson MMD.

Civic Federation Recommendation on Borrowing to Pay Overdue Bills

The Civic Federation opposes long-term borrowing to pay down the State's backlog of accounts payable. We recommend that if the State borrows to pay down current liabilities that the loans be short-term notes repaid within the years of the temporary tax increase and that the cost of borrowing not exceed the reasonably estimated revenues in those years.

Issue 4: Paying Down Additional Liabilities

In addition to the $6.4 billion backlog of accounts payable, the State has also accrued a backlog of several liabilities that are not part of the General Funds budget. The State expects a backlog of corporate income tax refunds to total $1.4 billion at the end of FY2011.[41] The State has also fallen behind on its payment of employee health care expenses, which is expected to total $1.1 billion in overdue bills at the end of FY2011.[42] Although the amount that would be used to pay down these liabilities is not specified in the Governor's three-year plan, the GO Restructuring Bonds could be used to pay down these liabilities and they are specifically mentioned as possible uses of the funds in the proposed borrowing legislation.[43]

If the State must use only General Funds resources are available to pay down all of these liabilities then the State's backlog would increase to a total of $8.8 billion at the end of FY2011. It would be possible for the State to fund all of these liabilities by the end of FY2014 using enacted resources and without further borrowing for operations. However, the State would no longer be able to increase annual base appropriations by 2.0% but instead would have to hold base appropriations flat at FY2011 levels for the next three fiscal years.

The following chart shows the operating surpluses generated by keeping base appropriations flat through FY2014 and paying for all other General Funds expenditures from resources already enacted.

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[41] State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 30.
[42] Email communication between the Civic Federation and officials at the Illinois Department of Healthcare and Family Services, February 10, 2011.
[43] Illinois 97th General Assembly, Senate Bill 3.

State of Illinois Enacted and Projected Budget: FY2011-FY2014 Base Appropriations 0.0% Growth (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Cigarette Tax Increase	$ -	$ -	$ -	$ -
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,165**	**$ 34,832**	**$ 35,712**	**$ 36,836**
Expenditures				
Base Appropriations (0.0% annual growth)	**$ 24,940**	**$ 24,940**	**$ 24,940**	**$ 24,940**
Existing Debt Service	$ 2,582	$ 2,548	$ 1,997	$ 2,126
Statutory Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contributions	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 33,502**	**$ 33,850**	**$ 33,717**	**$ 34,271**
Operating Surplus (Shortfall) Before Borrowing	**$ (3,337)**	**$ 982**	**$ 1,995**	**$ 2,565**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Total Borrowing For Operations	**$ 5,784**	**$ -**	**$ -**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 2,447**	**$ 982**	**$ 1,995**	**$ 2,565**

Source: Governor's Office of Management & Budget, Three Year Budget Projection (General Funds), FY12-FY14, January 20, 2011; State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

Operating surpluses would total $8.0 billion between FY2011 and FY2014 if base appropriations were held flat at levels currently enacted in the FY2011 budget as shown above. The following chart shows the reduction of the State's accounts payable to the normal payment cycle and completely paying off the other liabilities for corporate tax refunds and employee health care costs if the operating surpluses generated by the spending plan above were applied to the backlogs at the end of each fiscal year.

Payment of Accounts Payable and Additional Liabilities FY2011-FY2014 Base Appropriations 0.0% Annual Growth (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Accounts Payable Beginning of Year	**$ (6,410)**	**$ (6,433)**	**$ (5,451)**	**$ (3,456)**
Corporate Tax Refund Backlog	**$ (1,370)**	**$ -**	**$ -**	**$ -**
Employee Health Care Backlog	**$ (1,100)**	**$ -**	**$ -**	**$ -**
Operating Surplus Applied to Accounts Payable	**$ 2,447**	**$ 982**	**$ 1,995**	**$ 1,656**
Accounts Payable End of the Year	**$ (6,433)**	**$ (5,451)**	**$ (3,456)**	**$ (1,800)**
Operating Surplus (Deficit) After Borrowing*	**$ 2,447**	**$ 982**	**$ 1,995**	**$ 2,565**
Surplus Applied To Accounts Payable	$ (2,447)	$ (982)	$ (1,995)	$ (1,656)
Cash Surplus (Deficit) for the Year	**$ -**	**$ -**	**$ -**	**$ 909**
Existing Reserves	**$ 556**	**$ 556**	**$ 556**	**$ 556**
Total Reserves	**$ 556**	**$ 556**	**$ 556**	**$ 1,465**

*Shows operating surpluses based on appropriations at annual growth of 0.0% from originally enacted FY2011 appropriations.

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011; State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

Similar to the Civic Federation's recommendation regarding using operating surpluses to pay down the State's backlog of accounts payable, the surpluses generated to pay down the additional liabilities could also be used to support the issuance of short-term debt. This would reduce the financial stress on those whom the State is late in paying.

In order to pay all of the additional liabilities listed above and still reduce the accounts payable to the estimated normal payment cycle of $1.8 billion, the State would need to issue a TAN totaling $4.6 billion. Even at this increased amount issuing short-term debt would be significantly less expensive than the estimated cost of more than $3.4 billion of the proposed 15-year GO Restructuring Bonds. Based on current market conditions this larger TAN would cost an estimate of between $214.7 million and $261.4 million in total interest over the next three fiscal years. Although this larger borrowing is more expensive than the TAN that would pay down only the accounts payable, it is still only a fraction of the estimated $3.4 billion cost of the proposed GO Restructuring Bonds.

The following chart shows the total cost of a three-year TAN using all of the surpluses to pay debt service in FY2011 and FY2012 and committing all but $694.3 million of the FY2014 surplus to debt service.

Anticipated Debt Service Cost for Short-Term Borrowing Including Additional Liabilities
Lower Cost from Increased Upfront Principal (in $ millions)

Muni Bond Rates 1/25/2011					FY2012	FY2013	FY2014	Total
Year	AAA Rate	IL Spread	IL Rate	Principal	$ 870.0	$ 1,928.8	$ 1,834.2	**$ 4,633.0**
1	0.37	150	1.87	Interest	$ 112.0	$ 66.2	$ 36.5	**$ 214.7**
2	0.73	175	2.48	**Total Debt Service**	**$ 982.0**	**$ 1,995.0**	**$ 1,870.7**	**$ 4,847.7**
3	1.11	200	3.11	Operating Surplus	$ 982.0	$ 1,995.0	$ 2,565.0	**$ 5,542.0**
				Remaining Surplus	**$ -**	**$ -**	**$ 694.3**	**$ 694.3**

Source: Civic Federation estimates based on best available information on secondary market rates and spreads to high grade municipal bonds for maturities listed above from Bloomberg and Thompson MMD.

If the principal repayments of the bonds were back loaded it would increase the total debt service for the three-year TAN and only leave $647.6 million in the total operating surpluses in FY2012. The following table shows the TAN if the maximum principal amount that the State could afford was back loaded using the FY2014 surplus.

Anticipated Debt Service Cost for Short-Term Borrowing Including Additional Liabilities
Higher Cost from Back Loaded Principal (in $ millions)

Muni Bond Rates 1/25/2011					FY2012	FY2013	FY2014	Total
Year	AAA Rate	IL Spread	IL Rate	Principal	$ 202.6	$ 1,915.5	$ 2,515.0	**$ 4,633.0**
1	0.37	150	1.87	Interest	$ 131.8	$ 79.5	$ 50.0	**$ 261.4**
2	0.73	175	2.48	**Total Debt Service**	**$ 334.4**	**$ 1,995.0**	**$ 2,565.0**	**$ 4,894.4**
3	1.11	200	3.11	Operating Surplus	$ 982.0	$ 1,995.0	$ 2,565.0	**$ 5,542.0**
				Remaining Surplus	**$ 647.6**	**$ -**	**$ -**	**$ 647.6**

Source: Civic Federation estimates based on best available information on secondary market rates and spreads to high grade municipal bonds for maturities listed above from Bloomberg and Thompson MMD.

Civic Federation Recommendation on Paying Down Other Liabilities

If the State must pay down additional liabilities outside the General Funds as part of its operating budget then it must limit base appropriations to enacted FY2011 budget levels through FY2014 and apply the annual budget surplus to the backlog of accounts payable, employee health care liabilities and backlog of corporate tax refunds. We further recommend that if the State borrows to pay down current liabilities that the loans be short-term notes, repaid within the years of the temporary tax increase and that the cost of borrowing not exceed the reasonably estimated revenues in those years.

Issue 5: Pension Reform

The State's historic underfunding of its five retirement systems is a growing source of pressure on the budget. Illinois has recently relieved strain on General Funds by borrowing to make its statutorily required annual pension contributions. However, as discussed earlier in this section, the pension borrowing of $3.5 billion for FY2010 and planned borrowing of $3.7 billion for FY2011 will increase debt service costs by more than $1 billion a year until after FY2019. In addition, the State will continue to make payments until 2033 on a 30-year, $10 billion pension borrowing in FY2003.

Illinois pensions are funded under a 50-year plan that took effect in July 1995.[44] After a phase-in period of 15 years, the law required State contributions at a level percentage of payroll beginning in FY2011 sufficient to achieve a 90% funded ratio by the end of FY2045.[45]

The five retirement systems—the Teachers' Retirement System, the State Universities Retirement System, the State Employees' Retirement System, the Judges' Retirement System and the General Assembly Retirement System—calculate and certify the amounts needed each year to meet the requirements of this funding schedule. The funding schedule does not require the State to make adequate contributions to keep unfunded liabilities from growing until approximately 2034.

In April 2010, legislation was enacted that created a two-tier benefits system with lower benefits for state and many local government employees hired on or after January 1, 2011.[46] The new tier of benefits includes higher retirement ages, a cap on the maximum pensionable salary and lower cost of living adjustments. Because they apply only to new employees, the reduced benefits will not have a significant impact on required state contributions in the short run.

Three of the five retirement systems decided to lower their projected rate of return on investment as of June 30, 2010 to bring it more in line with recent market performance. The expected rate of return is used to determine the present value of benefits owed to members. For FY2009, each

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[44] Public Act 88-593.

[45] A funded ratio shows the percentage of liabilities that are covered by assets held by the systems' investment funds. Estimated pension liabilities are the present value of total benefits earned by employees. The present value of benefits is the amount that must be invested at a specified rate of return to provide benefit payments as they come due. Unfunded liabilities are liabilities that are not covered by assets.

[46] Public Act 96-889.

retirement system assumed an investment rate of return of 8.00% or 8.50%. For FY2010, the universities' and state employees' systems lowered their assumed rate of return to 7.75% and the judges' system reduced its rate of return to 7.00%. The action will have the effect of increasing unfunded liabilities and increasing the statutorily required contributions.

The chart below shows projected statutorily required state contributions to the five retirement systems before and after the two-tier structure was enacted. Contributions before the new structure are based on the old (higher) expected rates of return for the three systems; contributions after the new structure are based on the reduced rates of return. The impact of the new structure is partially offset by the lower rates of return for the three systems.[47]

State of Illinois Projected Required Annual Statutory Contributions to Retirement Systems: FY2011-FY2045 (in $ millions)[1]

	Before Two-Tier Structure	After Two-Tier Structure	$ Change	% Change
FY2011[2]	$ 4,541	$ 4,541	$ -	0
FY2012	$ 4,949	$ 4,866	$ (83)	-1.7%
FY2013	$ 5,412	$ 5,291	$ (121)	-2.2%
FY2014	$ 5,880	$ 5,719	$ (161)	-2.7%
FY2015	$ 6,356	$ 6,159	$ (197)	-3.1%
FY2016	$ 6,649	$ 6,409	$ (240)	-3.6%
FY2020	$ 7,871	$ 7,257	$ (614)	-7.8%
FY2025	$ 9,709	$ 9,187	$ (522)	-5.4%
FY2030	$ 12,043	$ 11,140	$ (903)	-7.5%
FY2035	$ 16,127	$ 14,225	$ (1,902)	-11.8%
FY2040	$ 20,064	$ 16,389	$ (3,675)	-18.3%
FY2045	$ 25,139	$ 18,986	$ (6,153)	-24.5%

[1]Total state contributions, including Other State Funds as well as General Funds.

[2]Recertification of the FY2011 contribution amount to reflect enactment of the two-tier structure is scheduled to take place on April 1, 2011.

Source: State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement,* January 21, 2011, p. 68.

In July 2009, legislation was enacted that required the retirement systems to account for unexpected investment gains or losses over a five-year period rather than recognizing them all at once.[48] Use of this method, known as asset smoothing, minimized investment losses suffered by the retirement systems in the 2008-2009 market downturn.[49] Prior to FY2009, the State valued assets at fair market value, accounting for investment gains and losses as they occurred.

The chart below shows that under the fair market value approach the combined funded ratio slipped from 38.5% at the end of FY2009 to 38.3% at the end of FY2010 and unfunded liabilities grew from $77.8 billion to $85.7 billion.[50] Using the asset smoothing approach, the combined funded ratio of the five pension funds declined from 50.6% at the end of FY2009 to at 45.4% at

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[47] State of Illinois $3.7 Million General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 68.
[48] Public Act 96-43.
[49] State of Illinois $3.7 Million General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 53.
[50] State of Illinois $3.7 Million General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 65.

the end of FY2010, while unfunded liabilities increased from $62.4 billion to $75.7 billion. These changes reflect both reductions in the assumed rate of return by three retirement systems and state contributions under the statutory funding plan that are insufficient to prevent the growth of unfunded liabilities.[51]

State of Illinois Retirement Systems Unfunded Liabilities and Funded Ratios: FY2004-FY2010 (in $ millions)				
	Fair Market Value		Asset Smoothing*	
	Unfunded Liabilities	Funded Ratio	Unfunded Liabilities	Funded Ratio
FY2004	$ 35,093	60.9%	na	na
FY2005	$ 38,601	60.3%	na	na
FY2006	$ 40,732	60.5%	na	na
FY2007	$ 42,177	62.6%	na	na
FY2008	$ 54,384	54.3%	na	na
FY2009	$ 77,772	38.5%	$ 62,439	50.6%
FY2010	$ 85,569	38.3%	$ 75,741	45.4%

*Asset smoothing method of asset valuation was adopted in FY2009.
Source: State of Illinois $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 65.

<u>Civic Federation Recommendations for State Pension Reform</u>

Illinois took an important first step toward pension reform by enacting reduced benefits for new employees. However, the State will continue to struggle to make its annual pension payments. In the past, it has skipped payments and has borrowed to make the payments. It appears that the State's pension burden is unaffordable. The Civic Federation believes that for current employees the State must reduce non-vested benefits, increase employee contributions or both.

The Illinois Constitution provides that membership in any pension system in the state is an enforceable contractual relationship and that members' benefits "shall not be diminished or impaired."[52] Legal opinions have varied on whether this prohibition applies to non-vested benefits of current employees.[53] Despite the legal controversy, this change must be pursued in the interests of the State's financial health. Any pension proposal considered by the State should be thoroughly reviewed by actuaries to determine savings both in the short run and over the long term.

Issue 6: Medicaid Reform

Illinois and other states are trying to rein in their Medicaid programs, which cost more than $327 billion, or 21.1% of total state spending in FY2009, according to the National Association of

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[51] Ibid., pp. 55 and 59.
[52] Illinois Constitution, Article XIII, Section 5.
[53] Eric Zorn, "Counterpoint: Can Illinois reduce pension benefits going forward?" *Chicago Tribune,* Change of Subject blog, April 13, 2010.

State Budget Officers.[54] Medicaid savings are often difficult to achieve because of general healthcare inflation and the complex way in which the program is financed.

Medicaid is a joint state-federal program that finances healthcare for certain categories of low-income people, including children, pregnant women, parents, the elderly and the disabled. Recipients must be citizens or permanent legal residents. Beginning in 2014 under federal healthcare reform the program will also cover needy adults without children. The federal healthcare reform act requires that states not tighten current eligibility requirements, although there is a limited exception from January 1, 2011 through December 31, 2013 for a state that certifies it has a budget deficit on or after December 31, 2010.

Under Medicaid, states pay for medical expenses and are reimbursed by the federal government for a portion of their costs. Illinois' reimbursement rate rose to nearly 62% under the federal stimulus program but is expected to fall to approximately 50% after the stimulus funding ends on June 30, 2011. In FY2009 Illinois spent $14.3 billion on Medicaid, but the state-source General Funds portion of the total was $4.3 billion.[55]

The State enacted legislation in January 2011 that could significantly improve the effectiveness and efficiency of Illinois' Medicaid program.[56] The legislation addressed two of the program's most significant problems: overuse of institutional care for the elderly and disabled and inadequate use of managed care.[57]

The legislation supported the idea of shifting more long-term care to community settings and required that the Governor create a unified budget report for long-term care services provided by different state agencies. It also required that half of all Medicaid recipients be enrolled in coordinated care programs by January 1, 2015.

Civic Federation Recommendations for Medicaid Reform

The State should act aggressively to encourage the relocation of Medicaid recipients from institutions into community settings, in order to both improve the quality of care and reduce costs. The legislation enacted in January 2011 moves in the right direction but does not establish specific goals for reducing reliance on institutional care. It is particularly troubling that under agreements with Council 31 of the American Federation of State, County and Municipal Employees, the State is prohibited from closing state facilities through June 30, 2012.

The Governor and General Assembly should support the Illinois Department of Healthcare and Family Services (HFS) in implementing effective managed care for Medicaid recipients. Although the language in the January 2011 legislation is promising, it does not guarantee that HFS will receive necessary support for programs that may result in politically unpopular

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[54] National Association of State Budget Officers, *2009 State Expenditure Report*, Fall 2010, pp. 48-49.
[55] Ibid., p. 48.
[56] Public Act 96-1501.
[57] See the Civic Federation, *Illinois Medicaid Program: An Issue Brief*, May 22, 2009, http://www.civicfed.org/iifs/publications/illinois-medicaid-program-issue-brief for more information about the State's Medicaid program.

outcomes, such as fewer hospitalizations. Managed or coordinated care is particularly important for the disabled and elderly, who incur the highest Medicaid expenses. The State's first experiment with mandatory Health Maintenance Organization enrollment—a pilot program for approximately 40,000 elderly and disabled Medicaid recipients in the Chicago suburbs—was scheduled to start in July 2010 but the date has been postponed to late spring of 2011.

As discussed earlier in this report, the Governor's projections for short-term savings due to the January 2011 legislation are well above the estimates provided by HFS.[58] HFS estimated savings of $624 million to $774 over five years, while the Governor's plan suggests savings of $1.8 billion over three years. The legislation calls for fundamental changes in the way healthcare is delivered to Medicaid recipients and is unlikely to generate substantial savings in a few years.

Short-term savings on Medicaid should come from programs that are not eligible for federal reimbursement. The most costly such services at $124 million in FY2009 were provided under Illinois Cares Rx, a prescription drug program that supplements coverage for seniors in Medicare Part D. Seniors in the program do not qualify for Medicaid because their income levels exceed federal limits. Governor Quinn's FY2011 budget proposed cutting the cost of the program in half by requiring seniors to pay a larger share, but the plan did not attract a legislative sponsor.

Issue 7: State Retiree Health Insurance

The State of Illinois currently pays the entire bill for health insurance premiums for approximately 90% of retired state workers in the State Employees Group Insurance Program.[59] Under Illinois law, retirees with at least 20 years of government service and their survivors do not have to pay any portion of their health insurance premiums. The State Employees Group Insurance Program provides coverage to employees, retirees and dependents of the state government, state universities, the General Assembly and the judiciary.

In his FY2011 budget, Governor Quinn proposed that the State limit its share of retiree health insurance premiums to $300 per month.[60] The change meant that Medicare-eligible retirees, for whom the state plan serves as supplemental coverage, would pay between $4 per month and $50 per month, depending on which insurance plan they chose. For retirees not on Medicare, the cost would have been between $290 per month and $500 per month. The proposal attracted opposition from labor unions and legislators and failed to advance in the General Assembly. The State is currently considering a proposal that would base retirees' contributions to health insurance premiums on their income.[61]

State law would have to be changed to require all retirees to contribute to their healthcare premiums, and unions would also be likely to challenge the action in court. In October 2009, the

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[58] See p. 12 of this report.
[59] Illinois Department of Healthcare and Family Services, *FY2011 Budget Outlook*, March 10, 2010, p. 10.
[60] See The Civic Federation's Institute for Illinois' Fiscal Sustainability blog at http://civicfed.org/iifs/blog/governor-proposes-increased-state-retiree-contributions-health-insurance and http://civicfed.org/iifs/blog/quinn-administration-retools-proposal-increase-state-retirees%E2%80%99-health-premiums for more information on the Governor's FY2011 proposal.
[61] Andrew Thomason, "State could ask retirees to pay more for health care," *Illinois Statehouse News*, February 9, 2011.

State began charging retirees a monthly premium for dental insurance. This action did not require a change in state law, because dental insurance is not part of basic health coverage. Council 31 of the American Federation of State, County and Municipal Employees filed a grievance against the State, arguing that it had historically bargained with the union over the terms of retiree healthcare and that the State could not unilaterally make a change in retiree dental coverage. An arbitrator ruled against the union, and in March of 2010 the union filed a lawsuit against the State in Cook County Court over the issue.

In October 2010, the State of Illinois was accepted into a federal program that covers certain medical expenses for early retirees 55 and older who are not yet eligible for Medicare.[62] The Early Retiree Reinsurance Program, which ends on January 1, 2014, was designed to provide assistance with health insurance before most of the provisions of federal healthcare reform take effect. Nearly 3,600 employers and unions have been approved to participate in the $5 billion program and it is not clear how long the money will last.

Civic Federation Recommendations on State Retiree Health Insurance

The Civic Federation believes that the State should not pay the entire premium bill for retirees. This is a generous benefit that the State cannot afford. The Federation has supported the Governor's efforts to have retirees share the cost of their health insurance premiums.

[62] Dean Olsen, "Illinois to Benefit from federal health-care aid for some retired workers," *The State Journal-Register,* October 31, 2010.

Issue 8: Performance Measurement

The Emergency Budget Act of FY2011 was amended to require all State agencies to undertake performance management and prioritization steps in FY2011, also referred to as budgeting for results, to prepare for the FY2012 budget.[63] Under the provisions, the Governor and all constitutional officers are required to undertake the process of prioritizing outcomes and goals and developing assessments to gauge the performance in achieving these predetermined benchmarks prior to the publication of the Governor's FY2012 budget recommendation. The statute includes a requirement that quarterly revenue and expenditure reports be released throughout the year. However, the legislation does not include originally proposed power for appropriations to be changed during the next fiscal year to fund priorities first if revenues begin to decline. The requirement that all departments provide comprehensive performance measurement only applies to the FY2011 budget year and the results of these reports will ideally be used to budget for results in the FY2012 appropriations process.

Legislation expanding the performance measures requirements and extending the policy to future fiscal years was passed by the General Assembly on January 13, 2011, but has not been signed into law by the Governor.[64] The bill also requires additional scrutiny of annual grants awarded by the General Assembly by suspending all grants at the end of FY2011 and requires reports on performance measures and outcomes from grant recipients. Although transparency requirements and performance criteria are required under the legislation, the specific measures for determining if an agency has succeeded in meeting its priorities are not included.

Performance measures are quantitative or qualitative indicators of program or service outputs and outcomes. They are effective means of monitoring, measuring and evaluating departmental and program performance over time. They help track progress toward meeting intended programmatic goals and help assess whether programs are making an efficient use of resources. Evaluating and reporting on program results helps keep policymakers and taxpayers alike informed about actual results compared to expectations.[65]

There are four types of performance measures:

- **Workload measures**, which provide counts of a service performed or a good delivered.
- **Efficiency measures**, which provide information on how many resources, are consumed in delivering a good or service, such as the cost per unit or output per employee.
- **Effectiveness measures**, which assess how well a program has met its goals by showing planned output versus actual output.
- **Quality measures**, which assess customer or constituent satisfaction with service delivery.

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[63] Public Act 96-0958.
[64] Illinois 96th General Assembly, House Bill 5424.
[65] National Advisory Council on State and Local Budgeting Recommended Practice 6.4: Develop Performance Measures; GFOA Recommended Practice: Performance Management: Using Performance Measurement for Decision Making -2002 and- Updated Performance Measures -1994.

Producing reams of performance measures that are not linked to goals or objectives, not utilized to inform management decisions, or developed without the buy-in of management and staff can be costly and have limited efficacy. However, using a few well-chosen measures, particularly those measuring efficiency and effectiveness that are produced consistently and developed with the buy-in of staff, can be extremely useful in assisting governments to improve their management and operations.

Civic Federation Recommendation on Performance Measurement

The Civic Federation recommends that the State develop and utilize performance measures that are linked to specific program goals and objectives. The measures adopted should be valid, reliable and verifiable. A high performing performance measurement system includes measures that provide for comparisons of outputs and outcomes over time, are used for managerial decision-making, are limited in number and are designed to help motivate staff to contribute in a meaningful way to organizational efficiency. We further urge that all performance measures should be included in budget documents and/or related financial management documents so that elected officials, citizens and other stakeholders can assess progress toward meeting program goals.

APPENDIX A

State of Illinois Total Debt Service: Existing, Authorized and Proposed (in $ thousands)						
Fiscal Year	Existing Capital GO	Revenue Bonds	Existing Pension Bonds	FY2011 Pension Bonds (est.)	GO Restructuring Bonds (proj.)	Total Debt Service
2010	$ 1,159,673	$ 490,088	$ 1,703,223	$ -	$ -	**$ 3,352,984**
2011	$ 1,307,369	$ 425,478	$ 1,344,377	$ 81,400	$ 120,000	**$ 3,278,624**
2012	$ 1,300,618	$ 469,706	$ 1,384,386	$ 162,800	$ 327,658	**$ 3,645,168**
2013	$ 1,262,163	$ 180,115	$ 1,361,462	$ 212,800	$ 446,587	**$ 3,463,127**
2014	$ 1,213,846	$ 464,521	$ 1,334,591	$ 360,600	$ 545,047	**$ 3,918,605**
2015	$ 1,181,731	$ 486,684	$ 1,302,421	$ 601,800	$ 791,067	**$ 4,363,703**
2016	$ 1,140,329	$ 491,594	$ 574,525	$ 882,000	$ 1,095,177	**$ 4,183,625**
2017	$ 1,075,502	$ 480,728	$ 595,175	$ 999,000	$ 1,073,604	**$ 4,224,009**
2018	$ 1,011,419	$ 471,460	$ 614,737	$ 959,400	$ 1,049,316	**$ 4,106,332**
2019	$ 945,696	$ 461,273	$ 633,212	$ 469,800	$ 1,022,311	**$ 3,532,292**
2020	$ 895,193	$ 453,025	$ 674,550		$ 993,012	**$ 3,015,780**
2021	$ 844,942	$ 423,158	$ 713,412		$ 961,417	**$ 2,942,929**
2022	$ 783,085	$ 439,588	$ 749,800		$ 927,834	**$ 2,900,307**
2023	$ 752,494	$ 436,138	$ 783,712		$ 892,605	**$ 2,864,949**
2024	$ 683,594	$ 427,947	$ 840,150		$ 855,732	**$ 2,807,423**
2025	$ 594,400	$ 426,405	$ 892,200		$ 817,597	**$ 2,730,602**
2026	$ 581,455	$ 407,229	$ 915,425		$ 263,200	**$ 2,167,309**
2027	$ 548,545	$ 410,439	$ 936,100			**$ 1,895,084**
2028	$ 492,555	$ 425,877	$ 979,225			**$ 1,897,657**
2029	$ 440,198	$ 406,230	$ 1,018,525			**$ 1,864,953**
2030	$ 368,191	$ 440,242	$ 1,079,000			**$ 1,887,433**
2031	$ 309,654	$ 438,797	$ 1,134,375			**$ 1,882,826**
2032	$ 239,105	$ 436,542	$ 1,159,650			**$ 1,835,297**
2033	$ 228,607	$ 346,906	$ 1,156,100			**$ 1,731,613**
2034	$ 250,325	$ 345,779				**$ 596,104**
2035	$ 153,691	$ 322,572				**$ 476,263**
2036	$ 49,136	$ 322,572				**$ 371,708**
2037		$ 322,572				**$ 322,572**
2038		$ 322,572				**$ 322,572**
2039		$ 322,572				**$ 322,572**
2040		$ 322,572				**$ 322,572**
2041		$ 322,572				**$ 322,572**
2042		$ 322,576				**$ 322,576**
Total	**$ 19,813,516**	**$13,266,529**	**$ 23,880,333**	**$ 4,729,600**	**$ 12,182,164**	**$ 73,872,142**

Source: State of Illinois, $3.7 billion General Obligation Bonds, *Preliminary Official Statement* , pp. 41, 45; FY2011 POB estimates provided by Governor's Offie of Management and Budget, May 25, 2010; Civic Federation estimates of GO Restructuring Bonds based on maturities indicated in Senate Bill 3 and using rates and yields based on market conditions as of January 25, 2011 reported by Thompson MMD and Bloomberg.

APPENDIX B

The following table shows surplus calculated starting at enacted FY2011 base appropriations limited to 2.0% growth.

State of Illinois Enacted and Projected Budget: FY2011-FY2014 Base Appropriations Growth 2.0% (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,165**	**$ 34,832**	**$ 35,712**	**$ 36,836**
Expenditures				
Base Appropriations (2.0% annual growth)	**$ 24,940**	**$ 25,439**	**$ 25,948**	**$ 26,467**
Existing Debt Service	$ 2,582	$ 2,548	$ 1,997	$ 2,126
Statutory Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contribution	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 33,502**	**$ 34,349**	**$ 34,725**	**$ 35,798**
Operating Surplus (Shortfall) Before Borrowing	**$ (3,337)**	**$ 483**	**$ 987**	**$ 1,038**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Total Borrowing For Operations	**$ 5,784**	**$ -**	**$ -**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 2,447**	**$ 483**	**$ 987**	**$ 1,038**

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011; $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

APPENDIX C

The following table shows surplus calculated starting at enacted FY2011 base appropriations limited to 1.0% growth.

State of Illinois Enacted and Projected Budget: FY2011-FY2014 Base Appropriations Growth 1.0% (in $ millions)				
	FY2011	**FY2012**	**FY2013**	**FY2014**
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Cigarette Tax Increase	$ -	$ -	$ -	$ -
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,165**	**$ 34,832**	**$ 35,712**	**$ 36,836**
Expenditures				
Base Appropriations (1.0% annual growth)	**$ 24,940**	**$ 25,189**	**$ 25,441**	**$ 25,696**
Existing Debt Service	$ 2,582	$ 2,548	$ 1,997	$ 2,126
Statutory Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contributions	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 33,502**	**$ 34,099**	**$ 34,218**	**$ 35,027**
Operating Surplus (Shortfall) Before Borrowing	**$ (3,337)**	**$ 733**	**$ 1,494**	**$ 1,809**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Total Borrowing For Operations	**$ 5,784**	**$ -**	**$ -**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 2,447**	**$ 733**	**$ 1,494**	**$ 1,809**

Source: Governor's Office of Management & Budget, *Three Year Budget Projection (General Funds), FY12-FY14*, January 20, 2011; $3.7 Billion General Obligation Bonds, *Preliminary Official Statement*, January 21, 2011, p. 27.

APPENDIX D

The following table shows surplus calculated starting at enacted FY2011 base appropriations limited to 0.0% growth.

State of Illinois Enacted and Projected Budget: FY2011-FY2014 Base Appropriations 0.0% Growth (in $ millions)				
	FY2011	FY2012	FY2013	FY2014
Base General Funds Revenue	**$ 27,283**	**$ 27,920**	**$ 28,636**	**$ 29,650**
New Revenue				
Personal Income Tax Increase	$ 2,632	$ 6,050	$ 6,219	$ 6,394
Corporate Income Tax Increase	$ 150	$ 770	$ 804	$ 839
Net Operating Loss Reduction (FY2011-FY2014)	$ 100	$ 250	$ 250	$ 250
Estate Tax Change	$ -	$ 182	$ 243	$ 243
Cigarette Tax Increase	$ -	$ -	$ -	$ -
Loss of Medicaid/Tobacco Settlement Revenue	$ -	$ (340)	$ (440)	$ (540)
Total Revenue	**$ 30,165**	**$ 34,832**	**$ 35,712**	**$ 36,836**
Expenditures				
Base Appropriations (0.0% annual growth)	**$ 24,940**	**$ 24,940**	**$ 24,940**	**$ 24,940**
Existing Debt Service	$ 2,582	$ 2,548	$ 1,997	$ 2,126
Statutory Transfers	$ 1,823	$ 1,870	$ 1,917	$ 1,966
Pension Contributions	$ 4,157	$ 4,492	$ 4,863	$ 5,239
Total Expenditures	**$ 33,502**	**$ 33,850**	**$ 33,717**	**$ 34,271**
Operating Surplus (Shortfall) Before Borrowing	**$ (3,337)**	**$ 982**	**$ 1,995**	**$ 2,565**
Borrowing For Operations				
Enacted Borrowing	$ 5,784	$ -	$ -	$ -
Total Borrowing For Operations	**$ 5,784**	**$ -**	**$ -**	**$ -**
Operating Surplus (Shortfall) After Borrowing	**$ 2,447**	**$ 982**	**$ 1,995**	**$ 2,565**

Source: Governor's Office of Management & Budget, Three Year Budget Projection (General Funds), FY12-FY14, January 20, 2011; State of Illinois, $3.7 Billion General Obligation Bonds, *Preliminary Official Statement* , January 21, 2011, p. 27.