The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2016 RECOMMENDED OPERATING AND CAPITAL BUDGETS:

Analysis and Recommendations

May 7, 2015

The Civic Federation ● 177 N. State Street ● Chicago, IL 60601 ● civicfed.org

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

ACKNOWLEDGMENTS

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

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The Civic Federation **opposes** Governor Bruce Rauner's recommended FY2016 budget for the State of Illinois because in order to close a $6.2 billion operating deficit it relies heavily on projected savings that do not appear to be achievable or are not prudent in light of the State's obligations and long-term policy objectives.

Governor Rauner faced significant challenges in developing the FY2016 budget. The upcoming fiscal year is the first full budget year since the partial phaseout of temporary income tax rate increases enacted in 2011. During the past four years, the tax rate increases helped cover escalating pension contributions without borrowing, but the State confronts a steep decline in revenues in FY2016.

However, the Civic Federation **opposes** the Governor's decision to include $2.2 billion in savings related to a new proposal to reform Illinois' critically underfunded retirement systems. These savings are assumed to be realized in the fiscal year that begins on July 1, 2015, even though the pension proposal has not yet been introduced as legislation in the Illinois General Assembly and is likely to face legal challenges. The Governor's additional proposal for an amendment to the Illinois Constitution to limit pension protections does not appear to be feasible before the fiscal year ends on June 30, 2016.

The Federation is **encouraged** that Governor Rauner's $31.5 billion General Funds spending plan was issued on time and does not propose borrowing to pay for the State's operating expenses. The Federation **supports** the Governor's recommendations to eliminate diversions from General Funds revenues, seek savings on State group health insurance and pay down the multibillion dollar backlog of unpaid bills.

Yet the Federation cannot support spending reductions that balance the budget on paper but could actually worsen the State's financial condition if not realized. In addition to pension savings, the proposed FY2016 budget assumes a reduction of $655 million, or more than one third, in the cost of State group health insurance through collective bargaining. Other budgeted savings, particularly in the Medicaid program, depend on changes in State law or require federal approval.

The Federation also cannot support spending reductions that are likely to harm the State's finances in the long run. The Federation **opposes** the recommendation to cut local governments' share of State income taxes because this reduction is inadvisable at a time when many municipalities are under severe strain. The State's fiscal position will suffer if the finances of the City of Chicago—the State's economic engine—are allowed to deteriorate further. The Civic Federation also opposes cuts to spending on community care for the elderly, disabled and those with mental illness, which saves money in the long-run by avoiding the costs of institutionalization.

The Federation continues to **recommend** a comprehensive plan for the State, which includes spending restraints and new revenues to address its $6 billion of unpaid bills and continued fiscal crisis. The Federation **recommends** tax changes that would **broaden the State's revenue base** and provide sustainable revenue sources for funding essential government services and ongoing costs over the long term.

The Civic Federation offers the following key findings on the Governor's recommended FY2016 budget:

- General Funds revenues are projected to total $32.0 billion in FY2016, or $2.1 billion less than the estimated FY2015 total of $34.1 billion;
- After accounting for the $1.3 billion in fund sweeps in FY2015, total General Funds resources in FY2016 are $3.4 billion less than the FY2015 total of $35.4 billion;
- The proposed FY2016 budget includes General Funds expenditures of $31.5 billion, a decrease of $3.9 billion from estimated FY2015 total of $35.4 billion. However, FY2015 expenditures are understated by $1 billion due to spending outside the General Funds;
- The Governor's recommended FY2016 budget proposes using a surplus of $505 million to reduce a portion of the State's backlog of unpaid bills, which is expected to total approximately $6.0 billion at the end of FY2015. However, due to unattainable savings, primarily from additional pension reforms, this reduction is not likely to occur and the unpaid bills could grow in FY2016 under the Governor's proposed spending plan;
- The Governor's budget also presents a $38.2 billion FY2016 maintenance or autopilot spending plan, which is intended to represent the spending level needed to fully fund government services provided in FY2015. This spending level would result in a $6.2 billion operating deficit based on revenues of $32.0 billion;
- General Funds contributions to the State's five retirement systems are shown in the recommended FY2016 budget at $4.47 billion, which is $2.2 billion less than the amount needed for General Funds contributions required under existing State law;
- The recommended FY2016 budget proposes reducing the share of State income taxes distributed to local governments by 50% or $634 million;
- General Funds appropriations for the State group health insurance are $1.195 billion in the proposed FY2016 budget, a reduction of $655 million, or 35.4%, from $1.850 billion in the FY2016 maintenance budget;
- Proposed FY2016 General Funds appropriations to the Medical Assistance Program at the Illinois Department of Healthcare and Family Services[1] decline by $1.46 billion from the FY2016 maintenance budget, but net savings are approximately half of that amount due to the loss of federal reimbursements;
- General State Aid, the State's main spending program for elementary and secondary education, increases by $387.8 million to $4.8 billion in the recommended FY2016 budget from $4.4 billion in the revised FY2015 budget;
- In FY2016 the State of Illinois will pay debt service totaling $3.4 billion due on $29.6 billion of principal owed for all outstanding General Obligation Bonds and Build Illinois Bonds. The State currently owes $15.2 billion in interest on these bonds through FY2039 for a total outstanding debt service cost of $44.8 billion;
- The Governor's recommended FY2016 capital budget includes a total of approximately $19.0 billion, of which only $3.3 billion are new projects and $250 million are new debt-funded appropriations; and
- Due to transfers to the General Funds, the Capital Projects Fund, which is intended to be a self-supporting account to pay for new costs of the *Illinois Jobs Now!* capital program, is projected to have a $553.2 million deficit in FY2016.

[1] The Medical Assistance Program is the best approximation in the budget to Medicaid, although it includes expenditures not covered by Medicaid and does not include expenditures at other agencies that are covered by Medicaid.

The Civic Federation **opposes** the Governor's recommended FY2016 budget and the following aspects of the proposed spending plan for the fiscal year:

- Accounting for $2.2 billion in savings from the State's statutorily required pension contributions because it is unlikely that the Governor's new reform proposal could be implemented in FY2016 and the State's fiscal condition would worsen if the savings were budgeted but not achieved;
- Budgeting a reduction of $655 million in the State's group health insurance costs through collective bargaining because the magnitude and timing of the savings make it unlikely that they will be realized in FY2016;
- Budgeting for other savings in FY2016 that appear to be unlikely to be achieved because they require changes in State law, approval from the federal government or scrutiny from federal courts overseeing consent decrees. These include changes to the eligibility threshold for the elderly and physically disabled to qualify for Medicaid-funded community services and elimination of services to former foster children age 18 to 21;
- Cutting the share of State income taxes distributed to local governments by 50%, totaling $634 million, because many local governments are facing severe financial pressures due to pension burdens and other liabilities; and
- Reducing funding for community services for the elderly, disabled and people with mental illnesses because community-based care is more efficient and effective in the long run than institutional treatment. Proposed reductions include:
    - $170 million for the Community Care Program, which serves approximately 76,000 clients a month and is designed to keep seniors out of nursing homes;
    - $110.2 million for the Home Services Program, which provides support such as personal assistants for approximately 30,000 people under 60 with severe physical disabilities.
    - $75 million for community mental health services, including psychiatric treatment and assistance in moving from institutions to community settings.

The Civic Federation **supports** the following aspects of the Governor's recommended FY2016 budget:

- Publishing the recommended FY2016 budget on the statutorily required date of February 18, 2015, little more than a month after Governor Rauner's inauguration, which allows legislators more time to evaluate the financial plan before the start of the new fiscal year on July 1;
- Eliminating the income tax revenue diversions from General Funds for education and human services that shifted $452 million outside the General Funds in FY2015 and would have more than doubled that amount in FY2016;
- Prioritizing the reduction of the State's backlog of unpaid bills, which is expected to total approximately $6.0 billion at the end of FY2015;
- Forgoing the FY2015 borrowing for operations through interfund borrowing, which originally totaled $650 million, and not including any borrowing for operations in FY2016; and
- Efforts to reduce group health insurance costs for employees and retirees through collective bargaining.

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

- Eliminate the $6.0 billion backlog of unpaid bills within the next five years by establishing spending controls that create annual operating surpluses to pay down the bill backlog;
- Increase income tax rates in FY2016 to help mitigate the additional $2.1 billion in revenue losses caused by the 25% rate reduction that went into effect January 1, 2015 including:
    - Raising the individual income tax rate to 4.25%, which declined to 3.75% from 5.0%; and
    - Raising the corporate income tax rate to 6.0%, which declined to 5.25% from 7.0%;
- Broaden the income tax base by eliminating the income tax exemption for retirement income, excluding Social Security income and all income from individuals with taxable income of less than $50,000, to create more equity among taxpayers while providing access to a faster growing portion of the State's income tax base;
- Expand the sales tax base to include 32 services recommended by Governor Rauner and possibly other consumer-based services;
- Temporarily eliminate the sales tax exemption for food and non-prescription drugs to broaden the State's sales tax base while sales taxes on services are implemented;
- Consolidate and eliminate nonessential Special State Funds as part of its annual budget process in order to provide increased transparency and scrutiny over all annual State spending;
- Continue to provide the full share of income taxes under current statute to local governments and allow local governments to access the additional tax base expansions proposed for sales taxes;
- Continue to pursue additional federal Medicaid funding through a Section 1115 waiver to develop community-based services for disabled individuals and those with mental health and substance abuse problems; and
- Continue the previous administration's plan to reduce Illinois' reliance on institutional care for the disabled by closing the State-operated Murray Developmental Center in Centralia.

CIVIC FEDERATION POSITION AND RECOMMENDATIONS

The Civic Federation **opposes** Governor Bruce Rauner's recommended FY2016 budget for the State of Illinois because in order to close a $6.2 billion operating deficit it relies heavily on projected savings that do not appear to be achievable or prudent in light of the State of Illinois' obligations and long-term policy objectives.

In particular, the Civic Federation **opposes** the Governor's decision to include in the budget $2.2 billion in savings related to a new proposal to reform Illinois' critically underfunded retirement systems. These savings are assumed to be realized in the fiscal year that begins on July 1, 2015, even though the pension proposal has not been introduced as legislation in the Illinois General Assembly and is likely to face legal challenges. The Governor's additional proposal for an amendment to the Illinois Constitution to limit pension protections does not appear to be feasible before the fiscal year ends on June 30, 2016.

While opposing Governor Rauner's $31.5 billion General Funds spending plan, the Federation is **encouraged** that the budget was issued on time and does not propose borrowing to pay for the State's operating expenses. The Federation **supports** the Governor's recommendations to eliminate diversions from General Funds revenues, seek savings on State group health insurance and pay down the multibillion dollar backlog of unpaid bills by $505 million.

Governor Rauner faced significant challenges in developing the FY2016 budget. The upcoming fiscal year is the first full budget year since the partial phaseout of temporary income tax rate increases enacted in 2011. During the past four years, the tax rate increases helped cover escalating pension contributions without borrowing, but the State confronts a steep decline in revenues in FY2016.

However, the Federation cannot support overly optimistic projected spending reductions that balance the budget on paper but could actually worsen the State's financial condition if not realized. In addition to pension savings, the proposed FY2016 budget assumes a reduction of $655 million, or more than one third, in the cost of State group health insurance through collective bargaining. Other budgeted savings, particularly in the Medicaid program, depend on changes in State law or require federal approval.

The Federation also cannot support spending reductions that are likely to harm the State's finances in the long run. The Federation **opposes** the recommendation to cut local governments' share of State income taxes by half to $634 million. This reduction is inadvisable at a time when many municipalities are under severe strain. The State's fiscal position will suffer if the finances of the City of Chicago—the State's economic engine—are allowed to deteriorate further. The Civic Federation also opposes cuts to spending on community care for the elderly and disabled, which is recommended by advocates and saves money in the long-run by avoiding the costs of institutionalization.

As described in our recent State budget roadmap for FY2016, the Federation **recommends** a combination of spending restraints and new revenues to solve Illinois' fiscal problems. The Federation continues to advise the Governor and General Assembly to **limit spending growth** in order to eliminate the backlog of unpaid bills over several years. It is estimated that the backlog will total $6 billion at the end of FY2015. The Federation also continues to support tax changes that would **broaden the State's revenue base** and provide sustainable revenue sources for funding essential State and local government services and ongoing costs over the long term.

Issues the Civic Federation Opposes

The Civic Federation opposes the following proposals in the Governor's recommended FY2016 budget.

Budgeting Savings in FY2016 from a New Pension Proposal

The Governor's new plan to reduce the State's massive pension costs is a key component of the recommended FY2016 budget, representing the largest projected savings at $2.2 billion. The Civic Federation opposes the budgeting of these savings because it is unlikely that the plan could be implemented in FY2016. The State's fiscal condition would worsen if the savings were budgeted but not achieved.

As outlined in the FY2016 budget, the plan would end the State's more generous Tier 1 pension benefits as of June 30, 2015.[2] Benefits after that date would be accrued at the less generous Tier 2 level that currently applies to State employees hired on or after January 1, 2011.

A major pension reform law enacted in December 2013 has yet to take effect due to legal challenges from labor unions, employees and retirees.[3] A State court ruled in November 2014 that the law violated the pension protection clause of the Illinois Constitution,[4] and the Illinois Supreme Court heard oral arguments in the case in March 2015.

The Governor's pension plan has not been introduced as legislation in the General Assembly and any actuarial assessments of the plan by the State's five retirement systems have not been made public. The plan must be approved by the legislature, which passed the 2013 law by a narrow margin. Even if the 2013 law is upheld by the Supreme Court, public employee unions would be likely to take legal action to block the new pension plan.

Governor Rauner has also proposed that the State's Constitution be amended to limit pension protections,[5] but the amendment process is neither quick nor easy.[6] Amending the Illinois Constitution requires a three-fifths vote of each chamber of the legislature. An approved proposal may be put on the ballot at the next general election that occurs six months after the General Assembly vote and requires the approval of three-fifths of those voting on the issue.[7] The next general election is scheduled for November 2016.

The Civic Federation has not taken a position on the Governor's pension proposal itself because it has not been formally presented. However, it should be noted that the less generous benefit plan that most workers would be covered by in the Governor's proposal—known as Tier 2—may not be sustainable over the long term. Many Tier 2 members are paying more than the full cost of their benefits, effectively subsidizing the State by helping to pay down its unfunded liability.[8] Most State

---

[2] Illinois State FY2016 Budget, p. 2-17.
[3] Public Act 98-0599, signed on December 5, 2013.
[4] Illinois Constitution, Article XIII, Section 5, states: "Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."
[5] Illinois State FY2016 Budget, p. 2-14.
[6] Paul Merrion, "Amending the Illinois Constitution a tough path for pension reform," *Crain's Chicago Business*, July 16, 2014.
[7] Illinois Constitution, Article XIV, Section 2(a).
[8] Teachers' Retirement System of the State of Illinois, *Actuarial Valuation Report: June 30, 2014*, January 22, 2015, p. 15.

employees are not currently covered by Social Security, but Tier 2 benefit caps might eventually be considered too low to meet minimum standards for exemption from Social Security coverage.[9]

Budgeting $655 Million in Group Health Insurance Savings

Although the Civic Federation supports efforts to reduce the State's group health insurance costs, we believe it is unrealistic to budget savings of $655 million in FY2016 through collective bargaining. Both the magnitude of the projected savings and the short timeframe for reaching agreement with the State's largest union suggest that the budgeted numbers are unlikely to be realized.

The FY2016 budget recommends General Funds appropriations of $1.195 billion for the group health insurance program.[10] That compares with appropriations of $1.565 billion in FY2015 and the $1.850 billion that is projected to be needed to maintain the current program in FY2016. The budgeted appropriation is 35.4% below the maintenance level.

The Rauner administration plans to achieve these spending reductions mainly through labor negotiations.[11] The State is currently in discussions with Council 31 of the American Federation of State, County and Municipal Employees (AFSCME) on a new contract to replace an agreement that expires on June 30, 2015.[12] In FY2016 the proposed State savings would be realized by more than doubling employees' average share of health insurance premiums to 40% from 17%.[13]

The current contract, which began on July 1, 2012, was not executed until May 2013. Health insurance savings did not begin to be realized until FY2014.

In the past, appropriating insufficient amounts to cover group health insurance costs has led to a backlog of State health insurance bills. Under State law, health insurance claims incurred in one fiscal year may be paid out of future years' appropriations.[14] State officials have said that the current backlog of approximately $1.5 billion will not be permitted to grow, regardless of the outcome of union negotiations.[15]

Budgeting for Other Unrealistic Savings

The Civic Federation opposes other savings budgeted for FY2016 that are unlikely to be achieved because they require changes in State law, approval from the federal government or scrutiny from federal courts overseeing consent decrees.

The largest single proposed reduction to the Medicaid program—$400 million—requires a change in State law. The proposal involves the State's hospital assessment program, which brings in federal Medicaid revenues for hospitals. Under the program, assessments paid by hospitals are used to draw federal matching funds; most of the hospitals' payments, along with the federal reimbursements, are returned to the hospitals. In the FY2016 budget, $400 million of revenues in the program that had

---

[9] Teachers' Retirement System of the State of Illinois, *Topics & Report*, Winter 2015, pp. 1-2.

[10] In addition to health insurance, the program also provides life insurance at a relative small cost to the State.

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

[12] The agreement with AFSCME has traditionally been used as a model for the State's other labor agreements.

[13] Testimony by officials of the Department of Central Management Services at a hearing of the Illinois General Assembly's Commission on Government Forecasting and Accountability, April 14, 2015.

[14] Group health insurance bills can be paid out of future year appropriations under an exception to Section 25 of the State Finance Act, 30 ILCS 105/25 (b-4).

[15] Testimony by officials of the Department of Central Management Services at a hearing of the Senate Appropriations I Committee, April 28, 2015.

been distributed among hospitals would instead be used by the State to offset General Funds costs. State law currently ends hospital assessments if State payments are reduced.[16]

Federal approval is required for a proposed increase in the eligibility threshold for elderly and disabled individuals to qualify for Medicaid-covered long-term care services. The federal government turned down a previous request from Illinois to increase the Determination of Need (DON) score, which is used to evaluate an individual's care needs and to identify available resources for meeting those needs.[17] The earlier request was part of the restructuring of the Medicaid program in FY2013 to close a $2.7 billion funding gap.[18] State officials recently testified that circumstances have changed because states are no longer bound by federal prohibitions on eligibility restrictions that were in place at that time.[19] Advocates argued that raising the DON score requires a clinical reason to change eligibility and a detailed transition plan for the care of individuals who would no longer be eligible for services.[20]

The recommended FY2016 budget proposes the elimination of State funding for retiree health insurance contributions for public school teachers and community college employees outside of Chicago.[21] The State's statutorily required contribution to these programs in FY2016 totals $112.9 million.[22] These State contributions are currently covered by continuing appropriation, which would have to be repealed to implement the proposal in the FY2016 budget.[23] Different considerations apply to State contributions to the Chicago teachers' pension fund, which are also not included in the proposed FY2016 budget.[24] The State's contribution to the Chicago teachers' fund totaled $62.1 million in FY2015, of which $12.1 million are covered by statute, but not continuing appropriation.[25] The Civic Federation opposes reducing State funding for Chicago Public Schools at a time of financial crisis for the school district.

A proposed funding reduction of $167.0 million to the Illinois Department of Children and Family Services would violate a long-standing federal consent decree, according to the American Civil Liberties Union. [26] The projected savings would come from eliminating services to young adults age 18 to 21 who were in the foster care system.[27] The consent decree, initially agreed to in 1991,

---

[16] 305 ILCS 5/5A-10 (d).
[17] Illinois Department of Healthcare and Family Services, *SMART Act Implementation Report for Fiscal Year 2013*, March 1, 2014, p. 3.
[18] Public Act 97-0689, signed on June 14, 2012.
[19] Testimony of officials of the Illinois Department of Healthcare and Family Services at a hearing of the House Human Services Appropriations Committee, April 15, 2015.
[20] Testimony of the Heartland Alliance at a hearing of the House Human Services Appropriations Committee, April 15, 2015
[21] Illinois State FY2016 Budget, pp. 2-16 to 2-17.
[22] The State is statutorily required to contribute $108.3 million for the Teachers' Retirement Insurance Program and $4.6 million for the College Insurance Program in FY2016, based on certifications by the Teachers' Retirement System and the State Universities Retirement System.
[23] 40 ILCS 15/1.3 and 40 ILCS 15/1.4. Continuing appropriation is statutory authority that allows funds to be spent in the event the legislature fails to appropriate necessary funds or appropriates an insufficient amount for a specified purpose.
[24] The full name of this fund is the Public School Teachers' Pension and Retirement Fund of Chicago.
[25] 40 ILCS 17/127.
[26] American Civil Liberties Union, "ACLU tells Senate Committee that proposed DCFS budget cuts violate long-standing consent decree," news release, March 17, 2015.
[27] Illinois State FY2016 Budget, p. 6-78.

requires the State to provide minimally adequate care to children in its custody.[28] The elimination of services would also require a change in State law.[29]

Reducing Local Governments' Share of State Income Taxes

The Civic Federation opposes the proposal to reduce by half the share of State income taxes distributed to local governments because many local governments are facing severe financial pressures due to pension burdens and other liabilities. The fiscal soundness of local governments—particularly its economic engine, the City of Chicago—is of critical importance to the State. Illinois must not fix its own fiscal crisis at the cost of other governments' fiscal stability.

The recommended FY2016 budget proposes $634 million in State income tax revenues be distributed to local governments.[30] That compares with an estimated $1.201 billion in FY2015 and a projected $1.268 billion in FY2016, if the current distribution formula remained in place.

Local governments in Illinois are not allowed to levy income taxes. Instead, they receive a share of State income tax proceeds from the Local Government Distributive Fund (LGDF). A certain percentage of individual and corporate income tax revenues (net of amounts required to be set aside to pay for income tax refunds) are deposited into the LGDF as a legislatively required transfer from the State's General Funds. The Illinois Comptroller then distributes the money to local governments based on population.

While the percentage of State income tax revenues given to local governments has varied in the last decade due to changes in the overall income tax rate, the resulting total level of funding has remained fairly consistent. The State has kept the local share equivalent to 10% of the first 3.0 percentage points of the individual income tax and the first 4.8 percentage points of the corporate income tax.

Prior to 2011, local governments received 10% of State income tax proceeds through the LGDF. After income tax rates were temporarily increased in 2011 from 3% to 5% for individuals and from 4.8% to 7% for corporations, the income tax revenue share distributed to local governments was reduced so the State could get the full benefit of the higher rates. From January 1, 2011 through December 31, 2014, local governments received 6% of individual income tax revenues and 6.86% of corporate income tax revenues.

The LGDF share was adjusted again on January 1, 2015 when individual income tax rates declined to 3.75% and corporate income tax rates declined to 5.25%. Local governments currently receive 8% of individual income tax revenues and 9.14% of corporate income tax revenues.[31] The FY2016 budget proposal cuts this distribution by half in FY2016 to 4% of net individual income taxes and 4.57% of corporate income taxes.

The LGDF is one of the largest sources of state funding for local governments in Illinois, but it is not the only source.[32] The City of Chicago receives approximately 21% of LGDF funding and

[28] *B.H. v. McEwen*, No. 88-5599 (N.D. Ill filed June 29, 1988).
[29] 20 ILCS 505.
[30] Illinois State FY2016 Budget, p. 3-52.
[31] 35 ILCS 5/901(b).
[32] Other funding transfers from the State to local governments include the Personal Property Replacement Tax levied on corporations by the State and distributed to local governments, the local share of the sales and use taxes and sales tax transfers for local transportation. The State also collects various taxes for local governments including taxes on automobile rentals, vehicle use, soft drinks and hotels.

estimates that it would have received more than $400 million in total additional revenues if local governments had not been excluded from sharing in the increased income tax revenues since 2011.[33]

Significant Reduction in Funding for Community Services for the Elderly, Disabled and Residents with Mental Illness

The Civic Federation opposes proposed reductions in funding for community services for the elderly, disabled and people with mental illness. The Federation has in the past supported the State transitioning more residents to these community programs, which are more effective and efficient in the long-run than relying on institutional treatment in State-owned facilities, private nursing homes, hospitals, jails and prisons.

The proposed FY2016 budget would make significant cuts to two major programs that provide community-based services to the elderly and disabled: the Department on Aging's Community Care Program and the Home Services Program at the Department of Human Services.

Community Care, which serves approximately 76,000 clients a month[34] and is designed to keep seniors out of nursing homes, is projected to be cut by about $170 million[35] and eliminate services for thousands of seniors.[36] The changes include an increase in the eligibility threshold for services (the Determination of Need or DON score discussed above), decreases in hours of service provided and a new income limit (in addition to a previous ceiling on assets). The program, which is partly covered by Medicaid, cost an average of $865 per person per month in FY2015,[37] while nursing home care costs three to four times that amount.[38] Although the same revised DON score would apply to Medicaid-funded admission to nursing homes, seniors who lose community services could see their health deteriorate, leading to increased emergency room visits and a greater likelihood of nursing home placement, according to advocates.[39]

The proposed budget would reduce spending on the Home Services Program by $110.2 million.[40] The Home Services Program, which is mainly covered by Medicaid, provides support such as personal assistants for approximately 30,000 people under 60 with severe physical disabilities.[41] The proposed reductions mainly involve the increase in the DON score, which would make it more difficult to qualify for program services.

In addition to proposed reductions to these community services, the recommended FY2016 budget includes a decrease of about $75 million to community mental health services.[42] These include psychiatric treatment, assistance in moving from institutions to community settings and supportive

---

[33] City of Chicago, Annual Financial Analysis 2013, p. 16. The City of Chicago estimates that it would have received additional revenue of more than $50 per resident per year beginning in 2011.

[34] Illinois Department on Aging, *FY16 Proposed Budget*, https://www.illinois.gov/aging/AboutUs/Documents/FY16ProposedBudget.pdf (last visited on May 3, 2015).

[35] Illinois State FY2016 Budget, p. 6-63.

[36] Testimony of Department on Aging officials at House Human Services Appropriations Committee hearing on March 12. 2015.

[37] Illinois State FY2016 Budget, p. 6-64.

[38] Testimony of Department on Aging officials at House Human Services Appropriations Committee hearing on March 12. 2015.

[39] Communication between the Civic Federation and the Illinois Council of Care Coordination Units, April 30, 2015.

[40] Illinois Department of Human Services, *Fiscal Year 2016 Budget Request: Agency Briefing*, February 18, 2015.

[41] Access Living, "Cuts will have devastating impact on community supports: Access Living Response to Governor Rauner Budget Address," news release, March 6, 2015.

[42] Illinois Department of Human Services, *Fiscal Year 2016 Budget Request: Agency Briefing*, February 18, 2015.

housing services. The proposed budget would also save $8.9 million by ending respite services for families of the developmentally disabled, which provide in-home care to relieve family caregivers.[43]

The Rauner administration has stated that providing community-based services was one of its priorities in developing the FY2016 budget and that services for the elderly and disabled "are most compassionately provided through community-based care, rather than institutionalized care."[44] The Civic Federation agrees with these statements, which are in line with the U.S. Supreme Court's 1999 opinion in the *Olmstead* case[45] and the State's settlement in the past several years of three federal lawsuits alleging excessive use of institutions in caring for the developmentally disabled, physically disabled and people with mental illness.[46] Continued investment in community care is necessary to support this priority.

Elimination of Fees for New Managed Care Entities

The Civic Federation is concerned that the proposal to eliminate fees for new Medicaid managed care entities and require them to accept fully capitated rates could disrupt the State's overdue transition to managed care.

States are increasingly turning to managed care in an effort to control Medicaid costs and improve patient care, but Illinois has historically lagged behind other states.[47] Managed care is designed to reward healthcare organizations for keeping patients healthy and avoiding unnecessary tests and procedures. This is in contrast to traditional fee-for-service payment, which is based on the volume of services provided. Health maintenance organizations (HMOs), for example, receive a fixed monthly fee, known as a capitation rate, for each Medicaid enrollee.

A State law enacted in 2011 required that half of Medicaid recipients be enrolled in managed care, which is also known as coordinated care, by January 1, 2015.[48] More than 60% of recipients are expected to be enrolled by the end of FY2015.[49]

Legislation enacted in 2013 allowed hospitals to form their own networks to compete with traditional HMOs.[50] The new hospital networks, known as Accountable Care Entities or ACEs, would have moved to fully capitated payments over three years, with the State paying care

[43] Illinois Department of Human Services, *GRF Walk to DHS FY16 Introduced Budget*, https://www.dhs.state.il.us/page.aspx?item=77073 (last visited on April 30, 2015).
[44] Illinois State FY2016 Budget, p. 2-24.
[45] *Olmstead v. L.C.*, (98-536) 527 U.S. 581 (1999). The court ruled that the federal Americans with Disabilities Act requires states to provide services in the most integrated setting appropriate to the needs of individuals, consistent with an individual's wishes and the resources available to the state.
[46] *Williams v. Quinn*, No. 05-4673 (N.D. Ill. filed August 15, 2005); *Colbert v. Quinn*, No. 07-4737 (N.D. Ill. filed August 22, 2007); *Ligas v. Hamos*, No. 05-4331 (N.D. Ill. filed July 28, 2005).
[47] For more information, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois Enacted FY2015 Budget: A Review of the Operating and Capital Budgets for the Current Fiscal Year*, October 9, 2014, p. 39, http://www.civicfed.org/sites/default/files/REPORT_StateofIllinoisEnactedBudgetFY2015.pdf (last visited on May 3, 2015).
[48] Public Act 96-1501, signed on January 25, 2011.
[49] Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget Overview*, February 18, 2015, p. 5.
[50] Public Act 98-0104, signed on July 22, 2013. The Illinois Department of Healthcare and Family Services also provided for the creation of Coordinated Care Entities (CCEs), collaborations of providers and community agencies, which service seniors and individuals with disabilities. CCEs receives a care coordination payment with a portion of the payment at risk for meeting quality outcome targets, while medical and other services are paid on a fee-for-service basis.

coordination fees in the first 18 months. The State also provided for the creation of more specialized Coordinated Care Entities (CCEs), which serve seniors and individuals with disabilities. CCEs receives a care coordination payment with a portion of the payment contingent on meeting quality outcome targets, while medical and other services are paid on a fee-for-service basis.

The FY2016 budget proposal eliminated fees to ACEs and CCEs, which was expected to reduce appropriations by $60 million.[51] The proposal would cause the newly formed managed care entities to disband, be folded into other organizations or agree to full capitation. Total enrollment in nine ACEs and eight CCEs stands at approximately 580,000.[52] The largest ACE, Advocate Accountable Care, with more than 95,000 enrollees, recently agreed to move to full capitation by the end of calendar year 2015.[53] The move is expected to reduce Medicaid spending by $5.1 million in FY2016.

The Civic Federation is encouraged by the State's progress in implementing managed care. This represents a tremendous change for Medicaid program. While it is desirable to move to full capitation as quickly as possible, the proposal in the FY2016 budget has the potential to disrupt medical care for approximately 485,000 recipients if their managed care entity does not agree to full capitation and must disband.

Issues the Civic Federation Supports

The Civic Federation supports the following aspects of the Governor's recommended FY2016 budget.

Presenting the Budget on Time

The Civic Federation supports Governor Rauner's presentation of the recommended FY2016 budget on February 18, 2015, little more than a month after his inauguration on January 12. The timely issuance of the Governor's budget gives the public and the General Assembly more time to evaluate the financial plan before the start of the new fiscal year on July 1.

The Governor's FY2016 budget was issued on the third Wednesday in February, as required by State law unless changed by the General Assembly.[54] During the previous six years, the budget was delayed five times. The recommended FY2010 budget was issued on March 18, 2009; the FY2011 budget on March 10, 2010; the FY2012 budget on February 16, 2011; the FY2013 budget on February 22, 2012; the FY2014 budget on March 6, 2013; and the FY2015 budget on March 26, 2014.

The General Assembly usually approves the annual budget in the final days of the spring session, which is scheduled to end on May 31, 2015. After the end of May of one calendar year, a three-fifths vote of each chamber, rather than a simple majority, is required for legislation to be effective before June 1 of the next calendar year.[55] House Speaker Michael Madigan has reportedly stated

[51] Communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, April 30, 2015.
[52] Illinois Department of Healthcare and Family Services, "HFS and Advocate Health Care announce plan to ensure Medicaid coverage for nearly 100,000: Model Accountable Care Entity agreement serves taxpayers and clients," news release, April 16, 2015.
[53] Illinois Department of Healthcare and Family Services, "HFS and Advocate Health Care announce plan to ensure Medicaid coverage for nearly 100,000: Model Accountable Care Entity agreement serves taxpayers and clients," news release, April 16, 2015.
[54] 15 ILCS 20/50-5(a).
[55] Illinois Constitution, Article IV, Section 10.

that the General Assembly is likely to have to work well beyond May 31 to pass a budget for FY2016.[56]

Eliminating Revenue Diversions from General Funds

The Civic Federation supports the proposed elimination of income tax revenue diversions from General Funds for education and human services. Ending the diversions will increase financial flexibility and promote budget transparency.

Beginning on February 1, 2015, State law required that a specific share of individual income tax revenues be diverted from General Funds to provide additional funding for education and human services.[57] This requirement, which is contained in a provision of the 2011 law that temporarily increased income tax rates, was designed to provide a guaranteed source of funding to these two areas of the budget after the income tax rate increases began to be phased out.[58]

Under the requirement, a portion of net revenues from individual income taxes is deposited into two new funds: the Fund for the Advancement of Education and the Commitment to Human Services Fund.[59] Each of the new funds receive 1/30 (about 3.33%) of net individual income tax revenues annually through FY2024; in February 2025 the share increases to 1/26 (about 3.85%).

A total of $452 million was expected to be diverted to the two funds in FY2015.[60] For FY2016, the diversion would be in effect for the full fiscal year, the total is projected to grow to $886 million.[61]

Although this revenue is still available to the State, it is essentially hidden from public view due to the intense focus on General Funds during the annual budget process. The diversion makes the budget process less transparent and hinders lawmakers' ability to direct resources each year to the areas of highest priority.

Allocating Resources to Pay Down the Backlog of Unpaid Bills

The Civic Federation supports the prioritization of reducing the State's backlog of unpaid bills, which is expected to total approximately $6.0 billion at the end of FY2015.[62] The budget proposal allocates $505 million to pay down the backlog.

Until the State eliminates the backlog entirely, it will not have completed its recovery from the economic downturn that officially ended nearly six years ago. Because of the backlog, the State begins each fiscal year in a hole, using revenue from the current year to pay off the previous year's bills and reducing resources available for current spending. Credit rating agencies have repeatedly cited the large backlog of unpaid bills as a major reason for giving Illinois lower ratings than any other state.[63]

---

[56] Rich Miller, "Mike Madigan says budget impasses will send Legislature into overtime," *Chicago Sun-Times*, February 24, 2015.
[57] The diversion also applies to net receipts from estates and trusts.
[58] Public Act 96-1496, enacted on January 13, 2011. The provision can be found at 35 ILCS 5/901 (f) and (g).
[59] Net revenues exclude the share of individual income tax revenues diverted to pay income tax refunds.
[60] Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2016 Economic Forecast and Revenue Estimate and FY2015 Revenue Update*, April 29, 2015, p. 23.
[61] Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2016 Economic Forecast and Revenue Estimate and FY2015 Revenue Update*, April 29, 2015, p. 23.
[62] For more information on unpaid bills, see page 60 of this report.
[63] For example, see Moody's Investors Service, *Illinois Tax-Rate Extension, Pension Reforms Would Reduce Fiscal Stress*, April 18, 2014.

As the State pushes these costs from one year to the next, it continues to delay payments to vendors and other service providers, transferring its financial distress to businesses, social service agencies and local government agencies across the State. The cost of this practice to the State's own budget—in higher bids for State work and a smaller pool of bidders willing to do business with the State—is not easily quantifiable but undoubtedly significant.

Eliminating Borrowing for Operations

The Civic Federation supports Governor Rauner's decision to forgo the borrowing for operations approved in the FY2015 budget and excluding any further borrowing for operations in FY2016.

The State of Illinois FY2015 budget included authorization to borrow up to $650 million of the balances available in the State's Special Funds to pay for its ongoing operations. The measure was intended to offset some of the $1.9 billion in General Funds revenue losses due to the reduction of income tax rates. However, due to the requirement that the borrowed amounts be repaid within 18 months, the measure increased future budget stress and extends the current budget crisis into future years. The one-time resource also created an additional gap in the subsequent FY2016 budget year.

The Civic Federation has long opposed borrowing for operations as it did in the FY2016 Budget Roadmap. Instead, the Federation recommended the use of surplus balances in other State funds—a practice known as fund sweeps—and sustainable long-term resources to adequately fund FY2015 operating costs. The State does not have to repay the amounts accessed through fund sweeps.

The budget fix approved for FY2015 included fund sweeps of $1.3 billion. Although this amount does not have to be repaid, it still creates a budget gap in FY2016 because it is unclear if such a large amount of funding could be accessed from the balances of the State's Other Funds in consecutive years.

Seeking Reductions in Group Health Insurance Costs

While opposing the budgeting of $655 million in savings on group health insurance in FY2016, the Civic Federation supports the Rauner administration's efforts to reduce these costs through collective bargaining. The State is currently in discussions with its largest union, Council 31 of the American Federation of State, County and Municipal Employees (AFSCME), on a new contract to replace an agreement that expires on June 30, 2015.[64]

The current three-year contract, which started on July 1, 2012, was intended to achieve significant savings on group health insurance in exchange for wage increases.[65] The State has realized savings under the agreement by increasing employee premiums, raising coinsurance and deductibles and switching Medicare-eligible retirees to Medicare Advantage plans. However, a ruling in 2014 by the Illinois Supreme Court blocked the implementation of a law that eliminated premium-free health insurance for retirees.[66]

A study by the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation found that in 2013 Illinois had the eighth highest average total premium per employee among the

---

[64] The agreement with AFSCME has traditionally been used as a model for the State's other labor agreements.
[65] For more information on group health insurance, see page 54 of this report.
[66] Illinois Supreme Court, *Kanerva v. Weems* (2014 IL 115811, July 3, 2014).

states and that only 14 other states paid a larger share of the total cost of employee premiums.[67] The study also found that the actuarial value or "richness" of Illinois' health insurance program—defined as required deductibles, copayments and coinsurance—at 93% was in line with the national average for state government plans of 92%.[68] That level is far above the 60% value of the Bronze Plan, the least generous plan offered on insurance exchanges mandated by the federal Affordable Care Act.

The Pew and MacArthur study did not cover the time period including the Illinois program changes under the current labor contract. However, State officials believe that Illinois still pays too high a share of premiums, particularly with respect to the coverage of dependents.[69] Based on current numbers for Illinois, 21 states paid a larger share of the total cost of employee health insurance premiums.[70] In addition to increasing premiums in the short term, officials hope to make further changes in plan design in coming years, increasing members' out-of-pocket costs. It remains unclear if these kinds of changes are allowed for retirees based on the 2014 Supreme Court ruling.

Civic Federation Recommendations

The Civic Federation recommends the following measures for the State of Illinois' FY2016 budget to address the State's current fiscal crisis and to provide for its sustainable long-term financial health.

Backlog of Unpaid Bills

The Civic Federation recommends that the State of Illinois eliminate its backlog of unpaid bills within the next five years by establishing spending controls that create annual operating surpluses to pay down the bill backlog.

As shown in this report, the State of Illinois is expected to end FY2015 with an estimated backlog of unpaid bills totaling $6.0 billion. The Governor's recommended FY2016 budget would result in a reduction of the unpaid bills to $5.3 billion, compared to the autopilot budget that would cause the bills to increase to nearly $12.0 billion.[71]

However, as explained in the Civic Federation's opposition to the Governor's recommended FY2016 budget, in order to pay down the bills in FY2016 the spending plan relies on several billions of unattainable savings, primarily $2.2 billion in problematic pension savings.[72] Without additional revenues or other cuts to replace these savings, the backlog of unpaid bills could be expected to grow considerably due to the Governor's FY2016 recommended budget.

The backlog also causes the State to incur significant interest payments that have grown in recent years, mostly due to the fact that the interest is not paid until the actual bill is paid. The State has

---

[67] The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, *State Employee Health Plan Spending: An examination of premiums, cost drivers, and policy approaches*, August 2014 (updated September 2014), pp. 7-8.
[68] The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, *State Employee Health Plan Spending: An examination of premiums, cost drivers, and policy approaches*, August 2014 (updated September 2014), p. 35. The percentage represents the share of the cost of covered services that a health plan pays for an average enrollee.
[69] Testimony by officials of the Illinois Department of Central Management Services at a hearing of the Illinois General Assembly's Commission on Government Forecasting and Accountability, April 14, 2015.
[70] This assumes that the percentages for other states in the Pew and MacArthur study did not change.
[71] For more details on the State's unpaid bills see page 60 of this report.
[72] For an explanation of the unattainable savings in the Governor's recommended FY2016 budget see the issues the Civic Federation opposes on pages 8-13 of this report.

allowed its backlog of group health insurance bills to grow and delayed payments between 273 and 350 days. Just for the portion of the State's bill backlog that is attributable to its group health insurance bills, total annual interest penalties paid have grown from $32.9 million in FY2010 to $106.8 million in FY2014. The State is estimated to spend $96.9 million on interest penalties for group health bills in FY2015 and $103.5 million in FY2016.[73] Group health insurance bills make up $1.5 billion of the total $6.0 billion backlog at the end of FY2015 and are also the longest delayed payments.

It is essential that the Governor and General Assembly limit spending increases and dedicate budget surpluses to paying down the bill backlog to curb the additional cost of government associated with the delay in payment.

Although the current total of unpaid bills is well below the fiscal year-end peak of approximately $8.8 billion in FY2012, the $6.0 billion backlog still represents 19.7% of total FY2015 State-source General Funds resources. In order to create budgetary surpluses to significantly reduce its backlog of bills in each fiscal year, with a goal of completely eliminating the liabilities in the near-term, the State will have to control the growth in discretionary spending while adhering to a strict long-term financial plan.

Revenue Cliff from Income Tax Reduction

The Civic Federation recommends the State of Illinois increase income tax rates in FY2016 to help mitigate the additional $2.1 billion in revenue losses caused by the 25% rate reduction that went into effect January 1, 2015.

Although in its FY2016 State Budget Roadmap the Federation recommended the elimination of the revenue cliff in FY2015 by retroactively increasing the income tax rates in the current fiscal year, it is no longer feasible to administer such a change in the current year. As of the date of this report, the State will have entered into the fifth month of income tax collections at the lower rates of 3.75% for individuals and 5.25% for corporations. Raising the rates retroactively to the beginning of the 2015 calendar year would be overly burdensome to taxpayers. More than 80% of individuals rely on withholding taxes remitted to the State by employers and a retroactive tax increase would now necessitate a sharp increase in the amount set aside from paychecks to compensate for the months already collected at the lower rates. The Illinois Department of Revenue would not be able to administer a retroactive income tax if the rates are not increased before six months of collections take place at a lower rate.[74]

By reinstating a portion of the higher income tax rates to 4.25% for individuals and 6.0% for corporations on January 1, 2016 the State can still offset a large portion of the deficit in the coming year. However, the total revenue produced from the higher rates would only take effect for the second half of the coming fiscal year, greatly reducing the available revenues.

The 25% reduction in the income tax rates for individuals and corporations that took effect on January 1, 2015 created a significant revenue cliff for the State of Illinois beginning in FY2015 and continuing through FY2016. State resources dropped dramatically in the current fiscal year due to the partial rollback of the income tax increase passed in FY2011, which reduced the individual rate to 3.75% from 5.0% and the corporate rate to 5.25% from 7.0%. Total General Funds revenues (excluding fund sweeps of $1.3 billion) decline by $1.9 billion in FY2015 to $34.1 billion and are projected to fall by an

[73] Commission on Government Forecasting and Accountability, Monthly Briefing for the Month Ended: April 2015, pp.8-9.
[74] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.

additional $2.1 billion in FY2016 to $32.0 billion. This amounts to an aggregate two-year decline of $4.0 billion, or 10.9% from the FY2014 total of $36.8 billion.

In light of a $6.0 billion accumulated backlog of unpaid bills at the end of FY2015, the State is not in a position to continue the reduced tax rates without a plan to balance its operating budget and pay down its bills. In addition, savings from the new pension law that were slated to begin in FY2016 are in question due to the ongoing legal challenges and a pending ruling on the law by the Illinois Supreme Court. If the law is upheld the State would benefit from an estimated reduction in its statutory pension payment of $1.2 billion in FY2016. However, the State's annual pension contribution would still grow in future years.

Although temporary taxes or one-time revenues may be used as part of a short-term reaction to a fiscal crisis, it is not sound public policy to engineer unmanageable reductions in State resources without a plan to mitigate those revenue losses.

The Civic Federation recommends that the State increase the individual income tax to 4.25% from 3.75% and the corporate income tax rate to 6.0% from 5.25% on January 1, 2016. This would allow for one full year of lower rates to benefit taxpayers but provide additional revenues to help pay for State costs that are not funded in the Governor's recommended FY2016 budget. Depending on the level of achievable operating cuts and whether other expansions to the tax base are implemented, these rates may need to be higher in the short term. However, based on a comprehensive long-term plan to balance the State's budget and pay down its backlog of bills, the Federation continues to recommend that the higher rates be gradually reduced to 4.0% for individuals and 5.6% for corporations as the State's finances stabilize.

Retirement Income Exemption

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

Unlike the federal government, which taxes certain levels of Social Security and other retirement income, Illinois exempts all retirement income from the State's income tax base.[75] Out of the 41 states that impose an income tax, Illinois is only one of three that exempts all pension income and one of 27 that excludes all federally taxable Social Security income.[76] The Illinois Comptroller reports that this exemption of federally taxable retirement income reduced individual income tax revenues by $2.2 billion in FY2013.[77] The cost of this exemption will increase over time due to a population shift in Illinois, with the number of senior citizens expected to grow from 1.7 million in 2010 to 2.7 million by 2030.[78]

---

[75] 35 ILCS 5/203.

[76] Chicago Metropolitan Agency for Planning, Charting Progress Toward a More Efficient Regional and State Tax System via Indicators, July 18, 2013. http://www.cmap.illinois.gov/about/updates/-/asset_publisher/UIMfSLnFfMB6/content/charting-progress-toward-a-more-efficient-regional-and-state-tax-system-via-indicators (last visited February 5, 2015)

[77] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2013*, p. 6.

[78] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2013*, p. 7.

Excluding Social Security income, all other federally taxable retirement income exempted by Illinois as of 2012 totaled $39.7 billion.[79] If income from individuals with a total adjusted gross income of less than $50,000 were also excluded from this tax base, the total untaxed income in Illinois totaled an estimated $30.8 billion in FY2012. Historically, the retirement tax base grows at a much higher annual rate than regular income. Retirement income in Illinois has grown at an average annual rate of 6.5%, while revenue from the individual income tax has averaged only 2.7% growth over the last 15 years.[80] Including the high growth portion of the income tax base from retirement income would provide for a more sustainable revenue source for the State ranging between $1.5 billion and $2.0 billion annually.

Expanding the Sales Tax Base

The Civic Federation recommends that the State of Illinois expand the sales tax base to include 32 services recommended by Governor Rauner and possibly other consumer-based services. The Federation also recommends that the State temporarily eliminate the sales tax exemption for food and non-prescription drugs to broaden the State's sales tax base. Once the sales tax on services is implemented and the State's backlog of bills is eliminated, the sales tax exemption for food and non-prescription drugs could be reinstated.

According to a recent revenue study issued by the Commission on Government Forecasting and Accountability, Illinois' sales tax base is much narrower than other states' leading to greater volatility and higher rates.[81]

The largest exemption from the sales tax is the exclusion of food and drug purchases from the full State rate of 6.25%. This exemption reduced the State's sales tax revenues by $1.6 billion annually as of FY2013.[82]

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

The most recent estimates show that the broadest taxation of all service purchases including personal and business-to-business transactions could produce revenues totaling $9.3 billion, or $4.1 billion if business-to-business transactions are excluded.[83] However, most states exempt medical services from sales taxes and no state has successfully added all services possible after its sales tax had been established. A narrower application of the sales tax on services that excludes all business-to-business transactions, medical services and professional services and is focused on general consumer services could increase annual General Funds Revenues by $937 million.[84]

During the gubernatorial campaign, Governor Bruce Rauner proposed broadening the sales tax base in Illinois to include 32 services that are currently untaxed, which was estimated to generate an

[79] Internal Revenue Service, SOI Tax Stats – Historic Tables, Illinois 1999-2012. http://www.irs.gov/uac/SOI-Tax-Stats---Historic-Table-2 (last visited on February 7, 2015)

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

[81] Commission on Government Forecasting and Accountability, *Illinois Revenue Volatility Study, Public Act 98-0682*, December 31, 2014, p. 66.

[82] Illinois Comptroller, *Tax Expenditure Report, Fiscal Year 2013*, p. 6.

[83] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.

[84] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.

additional $600 million in General Funds revenue.[85] The largest revenue generating area of the Governor's proposal was taxing professional services such as attorneys ($127 million), custom computer programing services ($57 million), marketing consultants ($30 million) and advertising agencies ($28 million). Other large areas included sewer and refuse services for both residential and industrial use ($46 million), taxing personal rental property ($36 million) and membership fees to golf clubs ($26 million).

The revenue estimate for taxing the 32 services was based on a FY2011 report produced by the Commission on Government Forecasting and Accountability.[86] The items included in the list are expected to be controversial and face intense opposition and legal challenges from a variety of special interest groups.

If enacted, it should be expected that the new State revenues from the additional categories would be delayed for at least two years to allow for implementation.[87] Even after legislative action is taken to authorize taxing services, the complexity of collecting the tax may require new rules for sourcing and other administrative guidelines. Some of the new procedures may require review and approval by the legislature's Joint Committee on Administrative Rules. Other delays due to technology acquisition for businesses that do not currently collect sales taxes and connectivity with the Illinois Department of Revenue's existing systems should also be assumed. Finally, there is a one-month lag between collecting sales taxes and remission to the State.

In all, the range of services not taxed in Illinois represents roughly an $80 billion tax base. Many of these items could immediately bring in additional tax revenues to the State as they are sold by businesses that already collect sales taxes on tangible merchandise and would therefore not need as much lead time to administer the tax. The broader the base, the more effective the expansion will be at providing a more sustainable revenue stream for the State's long-term financial strength.

Unlike many of the new taxes on services, taxing food and drug purchases could immediately bring in additional revenue to the State. Food and drug purchases in Illinois are taxed statewide at a rate of 1.0% but are exempted from the 5.0% sales tax rate collected for the State and additional 0.25% rate collected by the State but passed through to local governments.[88] The exemption for food purchases makes up approximately $1.0 billion of the State's expense. Drugs and medical devices make up the remaining $600 million with non-prescription drugs making up roughly 7.5% of that total.

Although very few States apply their full sales tax rate to food purchases and prescription drugs, most do not exempt non-prescription drugs.[89] While it is a commendable intention to reduce the cost of food and drugs to low income residents of Illinois by exempting those items from sales taxes, such relief is not targeted to low income residents and is provided for all food and drug purchases. As the State faces huge deficits and a backlog of unpaid bills, it cannot currently afford this generous tax expenditure. By eliminating the exemption for food and over-the-counter drugs and applying the full 6.25% sales tax rate to those purchases, the State could bring in much-needed revenue immediately from its 5% portion of the rate and provide some additional resources to local

---

[85] See Appendix B on page 79 for a full list of these services.

[86] Commission on Government Forecasting and Accountability, *Service Taxes 2011 Update*, April 2011, pp. 18-22.

[87] Communication between the Civic Federation and Illinois Department of Revenue, January 21, 2015.

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

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

governments by expanding their portion of the sales tax by 0.25% from their current 1.0% distribution.

Immediate revenue is needed because expanding the State's sales tax base to include additional services will take time to implement. It is important to note that low income residents who qualify for federal food and nutrition assistance, such as SNAP and WIC, do not pay sales taxes on food purchased through these programs. The State can also consider increases in programs directly focused on assisting low income residents such as the Earned Income Tax Credit to help mitigate the additional cost from the elimination of the exemption.

Sweeps and Elimination of Special Funds

The Civic Federation recommends that the State of Illinois pursue the consolidation and elimination of nonessential Special State Funds as part of its annual budget process in order to provide increased transparency and scrutiny over all annual State spending. Additional balances and nonessential funding held in the Special State Funds should be transferred into the General Funds through sweeps as the accounts are consolidated or closed.

Illinois has approximately 550 Special State Funds, which were created to receive earmarked revenues that are only used for designated purposes. Special Funds consist of all State accounts except General Funds, Highway Funds, Bond Financed Funds, Debt Service Funds, Federal and State Trust Funds and Revolving Funds.[90]

Over time the number of Special Funds has increased, consuming ever larger portions of the State budget. Special Funds receive resources through transfers or appropriations from General Funds or directly from other sources, such as designated State taxes and fees and federal grants.

Providing automatic statutory funding in designated funds outside of the State's annual operating budget should be reserved for critical purposes. The Federation is also concerned that the excessive use of fund delineation by the State shields a large portion of the State's annual spending from the scrutiny of the annual budget process.

Local Government Revenue Sharing

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

The City of Chicago and many other local governments in Illinois are facing ongoing financial pressure due to severely underfunded pensions. The laws governing all local government pensions in Illinois are established by the State legislature.[91] State law determines the pension benefits paid to participants and how they are funded, whether by actuarially sound methods or by funding plans that require inadequate government contributions. Under existing law, Chicago is required to

---

[90] Illinois State FY2015 Budget, pp. 1-7 and 9-7. General Funds pay for the regular operating and administrative expenses of most State agencies. Highway Funds support State and local transportation-related activities. Bond Financed Funds pay for capital improvements. Debt Service Funds accumulate money used to pay interest and principal on debt obligations. Federal Trust Funds support grants and contracts between State agencies and the federal government. State Trust Funds hold funds for other entities or individuals. Revolving Funds finance the operation of State agencies that provide services to other State agencies on a cost reimbursement basis and support local capital projects.

[91] These laws are part of the Illinois Pension Code (40 ILCS 5).

increase its statutory pension contributions by $627.4 million next year, exacerbating its structural deficit and rising debt service payments.[92]

Despite such problems, local governments did not share in the additional revenues collected by the State due to the 2011 income tax rate increases. In enacting the tax increases, the State limited the previous 10% share of net income taxes distributed to local governments to only the original 3.0% individual income tax rate and 4.8% corporate income tax rate.[93] This change maximized the revenues available to the State as it attempted to recover from the Great Recession.

Going forward, the State should try to share additional revenues with local governments in light of their financial distress. The recommended tax changes proposed by the Civic Federation do not include increasing the share revenues to local governments from higher income tax rates due to the overwhelming pressure on the State's finances. However, the plan offers the following benefits for local governments:

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

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

- Tax on food and non-prescription drugs: The State's general sales tax rate of 6.25% does not apply to food and drugs; instead, the State taxes these items at 1.0% and distributes the proceeds to municipalities. The Civic Federation's recommendation would tax food and non-prescription drugs at the general sales tax rate until FY2020. As a result, municipalities would receive a 1.25% share, rather than 1.0%.[94] In addition, local governments should be permitted to expand the municipal sales tax to food and non-prescription drugs.[95]

Section 1115 Medicaid Waiver

The Civic Federation recommends that the State continue to pursue a plan by the previous gubernatorial administration that would bring in additional federal funding for Medicaid. The plan is focused on developing more community-based alternatives to institutional care for disabled individuals and appears to be the State's best option to obtain resources to invest in these services.

The State's proposal would use more than $5 billion in new federal funding over five years to overhaul the Medicaid program. The expansion of community-based services accounted for $3.2 billion of the total amount described in the June 2014 application to the federal Centers for Medicare and Medicaid Services (CMS).

---

[92] For more information on the financial condition of the City of Chicago, see The Civic Federation, *City of Chicago FY2015 Proposed Budget: Analysis and Recommendations*, November 3, 2014, http://www.civicfed.org/sites/default/files/City%20of%20Chicago%20FY2015%20Proposed%20Budget%20Analysis.pdf (last visited on February 8, 2015).

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

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

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

The proposal is known as a Section 1115 waiver. Section 1115 of the Social Security Act allows CMS to waive certain Medicaid requirements for experimental, pilot or demonstration projects that promote the objectives of the program.

In order to win federal approval, Illinois must show that its proposal is "budget neutral" to the federal government. Budget neutrality means that federal spending under the waiver does not exceed projected federal spending without the waiver.[96] Neutrality is calculated over the life of the waiver, allowing states to receive upfront federal funding for investments that are projected to generate savings in future years.

The fate of the proposal under the Rauner administration remains unclear. The newly appointed director of the State's main Medicaid agency testified in April 2015 that Illinois will pursue the plan at an appropriate time in order to build needed infrastructure for community services.[97]

Civic Federation Recommendation on Closing of the Murray Developmental Center

The Civic Federation recommends that the State continue the previous administration's plan to reduce Illinois' reliance on institutional care for the disabled by closing the State-operated Murray Developmental Center in Centralia.

Former Governor Pat Quinn planned to close the Murray center in November 2013, but the effort was blocked by a federal lawsuit by parents of residents. In July 2014, a federal judge ruled that the State could proceed with the closing because the parents did not prove they would suffer irreparable harm if the center were shuttered.[98] That decision has been appealed to the 7th U.S. Circuit Court of Appeals.[99]

Before he was elected, Governor Rauner visited the Murray center and pledged to keep it open.[100] State officials recently testified that there will be no closings in FY2016.[101]

The Civic Federation has supported the closure of many of the State's developmental centers as a way to provide more effective and efficient care. State officials have said that it costs an average of $239,000 a year for a resident to live at the Murray facility, compared with approximately $130,000 to $135,000 in a smaller community setting.[102] The movement to community-based care is in line with the U.S. Supreme Court's 1999 opinion in the Olmstead case, which held that the federal Americans with Disabilities Act requires states to provide services in the most integrated setting appropriate to the needs of individuals, consistent with an individual's wishes and available resources.[103]

---

[96] U.S. Government Accountability Office, *Medicaid Demonstration Waivers: Approval Process Raises Cost Concerns and Lack Transparency*, June 2013, pp. 1-2.
[97] Testimony by Felicia Norwood, Director of the Illinois Department of Healthcare and Family Services, at a hearing of the House Human Services Appropriations Committee, April 15, 2015.
[98] Kurt Erickson, "Murray center closure on hold," *The Southern*, July 25, 2014.
[99] Equip for Equality, "Coalition of Disability Groups Urge Court to Allow the State's Closure of Murray Developmental Center to Proceed," news release, April 9, 2015.
[100] Kurt Erickson, "Murray center closure on hold," *The Southern*, July 25, 2014.
[101] Testimony by officials of the Illinois Department of Human Services at a hearing of the House Human Services Appropriations Committee, March 19, 2015.
[102] Defendants Proposed Findings of Fact, March 27, 2014, pp. 19-20, Illinois League of Advocates of the Developmentally Disabled v. Illinois Department of Human Services No. 13-1300 (N.D. Ill filed February 19, 2013).
[103] *Olmstead v. L.C.*, (98-536) 527 U.S. 581 (1999).

BUDGET ANALYSIS

On February 18, 2015, Governor Bruce Rauner presented his recommended budget for the State of Illinois for the fiscal year that begins on July 1, 2015 and ends on June 30, 2016.[104] The FY2016 budget proposal was issued on the third Wednesday in February, as required by State law unless changed by the General Assembly.[105] During the previous six years, the budget was delayed five times.[106]

Since the FY2012 budget, the Governor must present a budget based only on existing revenue sources.[107] The Illinois Constitution and State law require that the Governor's proposed budget be balanced, with proposed spending not exceeding estimated available resources.[108] The legislature must also pass a balanced budget, but the wording is less restrictive, with the General Assembly required to maintain a balance between resources and appropriations.[109] Total expenditures include transfers out of the State's general operating accounts as well as appropriations.[110]

The proposed FY2016 budget covers the first full fiscal year since the partial phaseout of temporary income tax rate increases midway through FY2015. To balance the budget in light of the resulting revenue loss with no tax increases, the Governor's FY2016 proposal has deep spending cuts and a new plan to reduce State pension costs. The budget proposal also includes a "maintenance" budget for FY2016, which is defined as the amount sufficient to fund each agency's core mission and programs after annualizing costs from the prior year, adjusting for rate and price changes and removing one-time costs.[111]

This section provides an overview of the State's fiscal condition and an analysis of the revised FY2015 budget and the Governor's recommended FY2016 budget. The analysis focuses on General Funds, the largest component of the State budget. General Funds support the regular operating and administrative expenses of most agencies and are the funds over which the State has the most control.[112]

Budget Overview

After improving during the previous five years, the State's finances began to deteriorate in FY2015 with the partial rollback of temporary income tax rate increases enacted in 2011.[113] Income tax rates were increased to offset steep declines in State-source revenues caused by the national economic recession that began in December 2007 and officially ended in June 2009. On January 1, 2015, the

[104] Illinois State FY2016 Budget, http://www2.illinois.gov/gov/budget/Documents/Budget%20Book/Budget%20Book%20FY16/FY2016IllinoisOperatingBudgetBook.pdf (last visited on April 18, 2015).
[105] 15 ILCS 20/50-5(a).
[106] In the last six years, the Governor's budgets were issued on the following dates: March 18, 2009; March 10, 2010; February 16, 2011; February 22, 2012; March 6, 2013; and March 26, 2014.
[107] 15 ILCS 20/50-5(a).
[108] Illinois Constitution, Article VIII, Section 2(a); 15 ILCS 20/50-5(a).
[109] Illinois Constitution, Article VIII, Section 2(b); 15 ILCS 20/50-5(a).
[110] Transfers out of General Funds are used to make debt-service payments on previously issued bonds and for other legislatively required purposes. Transfers out in FY2015 are expected to total $4.6 billion.
[111] Illinois State FY2016 Budget, p. 1-4.
[112] The operating budget also includes Other State Funds, which are accounts for activities funded by specific revenue sources that may only be used for specific purposes, and Federal Funds (other than those designated for General Funds), which support a variety of State programs with federal revenues.
[113] Public Act 96-1496, enacted on January 13, 2011.

individual income tax rate, which had been increased to 5.0% from 3.0%, declined to 3.75%. The corporate income tax rate, previously raised to 7.0% from 4.8%, rolled back to 5.25%.[114]

Much of the increased revenue beginning in 2011 was used to pay for the State's accelerating pension contributions. State contributions required under current law grew from $1.6 billion in FY2008 to $6.1 billion in FY2015, while debt payments on pension bonds increased from $467 million in FY2008 to $1.5 billion in FY2015.[115] Illinois paid for its statutorily required General Funds pension contributions in FY2010 and FY2011 by issuing pension bonds, but the State has since made its contributions without borrowing.

Illinois has the most underfunded pension funds of any state[116] and the largest pension burden relative to State revenues.[117] The State's five retirement systems had a total accrued unfunded liability of $104.6 billion at the end of FY2014, based on the market value of assets, and a combined funded ratio of 42.9%.[118] A law designed to reduce the State's pension costs and fund its retirement systems more quickly and completely was enacted in December 2013, but its implementation has been delayed by legal challenges.[119] The Illinois Supreme Court heard oral arguments on the law's constitutionality on March 11, 2015.

In addition to paying for pension costs, increased tax revenues were used to reduce a backlog of unpaid bills that accumulated during the economic downturn. General Funds payables and other liabilities rose to a fiscal year-end peak of approximately $8.8 billion in 2012.[120] That total had declined to $5.8 billion by the end of FY2014.[121]

Largely as a result of the drop in tax rates on January 1, 2015, General Funds income tax revenues are expected to decline by $2.3 billion in FY2015 to $17.5 billion from $19.8 billion in FY2014.[122] Total General Funds revenues are expected to decline by $2.7 billion to $34.1 billion from $36.8 billion.

The FY2015 budget presented in March 2014 by Pat Quinn, who was then Governor, included two proposals: a recommended budget based on an extension of existing income tax rates and a not recommended budget based on the scheduled rollback of the rates. Instead of reducing spending or increasing revenues, the budget passed by the General Assembly in late May 2014 used short-term measures—including borrowing and shifting revenue from FY2014—to cover operating expenses.

---

[114] In addition to these rates, corporations also pay a Personal Property Replacement Tax of 2.5%.
[115] The State's first sale of pension bonds was in 2003.
[116] Pew Center on the States, *The Widening Gap Update*, June 2012, p. 5.
[117] Moody's Investors Service, *Illinois State and Local Governments Face Daunting Pension Challenges*, September 5, 2014, p. 2.
[118] State of Illinois, Office of the Auditor General, *Supplemental Digest of Retirement Systems' Audits for the years ending June 30, 2013 and June 30, 2014*, January 22, 2015. Unfunded liability is the actuarial value of accrued pension benefits that are not covered by pension assets. The funded ratio shows the percentage of accrued pension liability covered by pension assets and is a commonly used measure of the financial health of a retirement system.
[119] Public Act 98-0599, enacted on December 5, 2013.
[120] For more information on this calculation, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2016 Budget Roadmap: State of Illinois Budget Overview, Projections and Recommendations for the Governor and General Assembly*, February 12, 2015, p. 10, http://www.civicfed.org/sites/default/files/REPORT--FY2016IllinoisRoadmap.pdf (last visited on April 18, 2015).
[121] Illinois State FY2016 Budget, p. 3-7.
[122] Illinois State FY2016 Budget, p. 3-55. For information on other factors contributing to the decline in income tax revenues, see page 32 of this report.

The enacted FY2015 budget appeared on paper to be roughly balanced with a modest surplus of $8 million, according to documents filed in connection with State bond sales.[123] General operating expenditures of $35.76 billion exceeded general operating revenues of $35.11 billion by $642 million, but the deficit was closed by authorizing borrowing of up to $650 million from accounts outside General Funds, a practice known as interfund borrowing.

In addition, Medicaid expenses were understated in the FY2015 budget because $600 million in FY2014 General Funds revenues were used to pay for FY2015 Medicaid costs. Spending for elementary and secondary education and human services were also understated in the FY2015 budget—by a total of $400 million—because of revenues diverted into two special funds beginning in February 2015 to support these areas.[124]

Despite these measures, the enacted FY2015 budget did not fully cover known State costs. According to the bond documents, the budget did not include hundreds of millions of dollars in costs that would have to be cut, funded through supplemental appropriations or deferred until the next year as an increase in unpaid bills. Governor Quinn signed the budget but described it as incomplete.[125]

Governor Rauner took office on January 12, 2015. That same day, the new administration announced that the FY2015 budget was in the red by $1.5 billion.[126] The figure was revised slightly to $1.6 billion in a revised FY2015 budget plan issued in conjunction with the Governor's proposed FY2016 budget on February 18.[127]

The $1.6 billion deficit was partly due to Governor Rauner's decision not to proceed with the $650 million in interfund borrowing. Another $556 million reflected proposed supplemental appropriations to cover known costs that were not appropriated in the enacted FY2015 budget.

The other major factor was a shortfall in revenues. General Funds revenues in FY2015 are now expected to lag previous projections by more than $1 billion. Revenues from State sources are down by an estimated $225 million, largely because of unexpectedly low corporate income tax collections. Federal revenues, which consist mainly of reimbursements for State Medicaid spending, are also below expectations. However, the net effect on budgetary results is much smaller than the revenue loss because of related spending reductions.[128]

The revised FY2015 budget issued in February showed "fiscal emergency budget actions" of $1.6 billion to plug the deficit but did not specify the nature of those actions. However, Governor Rauner issued an Executive Order on January 12 that called for a freeze of all non-essential State

---

[123] State of Illinois, General Obligation Bonds, Series of May 2014, *Supplement to the Official Statement*, July 18, 2014, Table 1.
[124] In the FY2015 budget, $200 million was appropriated from the Fund for the Advancement of Education to pay for General State Aid; $101 million was appropriated from the Commitment to Human Services Fund to pay for services for the developmentally disabled; and $99 million was appropriated from the Commitment to Human Services Fund to pay for the Community Care Program in the Department on Aging. The amounts from the Commitment to Human Services Fund were reduced to $98.7 million and $96.8 million in the revised FY2015 budget.
[125] Illinois Government News Network, "Governor Quinn Statement on Fiscal 2015 Budget," news release, May 30, 2014.
[126] Illinois Government News Network, "Readout of GOMB Meeting with Agency Chief Financial Officers," news release, January 14, 2015.
[127] Illinois State FY2016 Budget, p. 3-6.
[128] An exception involves federal reimbursement in the current year for previous year's State spending. The spending reduction is shown in the previous year's budget, while the revenue loss is shown in the current year.

spending.[129] The Governor also sought sweeping authority from the General Assembly to relocate existing funds.[130]

The following table summarizes the State's operating results from FY2010 through FY2014 and shows the FY2015 budget plan as enacted in 2014 and as included in the recommended FY2016 budget. The total deficits at the bottom of the table are financed by delaying payments and transfers to vendors, social service agencies, local governments and State agencies.

State of Illinois General Funds Budget Summary: FY2010-FY2015 (in $ millions)

	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Preliminary	FY2015 Enacted[1]	FY2015 Revised Enacted[2]
Operating Revenues	$27,366	$ 30,164	$ 33,620	$ 36,363	$ 36,758	$ 35,114	$ 34,069
Operating Expenditures[3]	$33,254	$ 34,002	$ 34,097	$ 35,367	$ 36,701	$ 35,756	$ 35,687
Operating Surplus (Deficit)	**$ (5,888)**	**$ (3,838)**	**$ (477)**	**$ 996**	**$ 57**	**$ (642)**	**$ (1,618)**
Borrowing for Operations	$ 3,466	$ 5,426	$ -	$ -	$ -	$ 650	$ -
Operating Surplus (Deficit) after Borrowing for Operations	$ (2,422)	$ 1,588	$ (477)	$ 996	$ 57	$ 8	$ (1,618)
(Accumulated Deficit from Prior Years)[4]	$ (3,673)	$ (6,095)	$ (4,507)	$ (4,984)	$ (3,988)	$ (4,047)	$ (3,931)
(Total Deficit)	$ (6,095)	$ (4,507)	$ (4,984)	$ (3,988)	$ (3,931)	$ (4,039)	$ (5,549)

[1]As of July 2014.

[2]As of February 2015.

[3]FY2010 expenditures include $1.0 billion to repay borrowing related to revenue shortfalls and $26 million in interest on short-term borrowing. FY2011 expenditures include $32 million in interest on short-term and interfund borrowing. FY2012 expenditures include a $356 million repayment of interfund borrowing. FY2013 expenditures include a $132 million repayment of interfund borrowing.

The accumulated deficit amount is lower in revised enacted FY2015 than enacted FY2015 due to a reduction in the estimate of FY2014 expenditures.

Source: Illinois State FY2016 Budget, p. 3-6; State of Illinois, General Obligation Bonds, Series of May 2014, *Supplement to the Official Statement* , July 18, 2014, Table 1; State of Illinois, General Obligation Bonds, Series of April 2014, *Official Statement* , April 10, 2014, p. 14.

Legislation to close the FY2015 budget gap was enacted on March 27, 2015.[131] The solution agreed to by Governor Rauner and lawmakers was to transfer $1.3 billion into General Funds from other State funds and reduce spending by approximately $258 million from the amounts in the revised budget.

The transfers, known as sweeps, are different from interfund borrowing because they do not have to be repaid unless the affected accounts run out of needed resources. Transfers were authorized from 106 different funds, ranging from $250 million from the Road Fund (which is used for road construction and maintenance) to $110,000 from the Low-Level Radioactive Waste Facility Closure, Post-Closure Care and Compensation Fund (which was created to pay costs related to the closure of waste disposal facilities). It should be noted that balances in the affected funds have grown over time, meaning that the amount of surplus resources available in the near future would be smaller.

The legislation also changed FY2015 appropriations. General Funds appropriations for most agencies were reduced by 2.25%, saving approximately $445 million. These reductions were partially offset by increases of $187 million, consisting of $97 million provided to the State Board of Education to assist school districts in financial distress and $90 million to be used at the Governor's discretion to plug budget holes. Supplemental appropriations shown in the revised

---

[129] State of Illinois, Executive Order 15-08, *Executive Order to Address the State's Fiscal Crisis*, January 12, 2015.
[130] Doug Finke, "Illinois House passes plan to fill state's $1.6 billion budget hole," *State Journal-Register*, March 24, 2015.
[131] Public Acts 99-0001 and 99-0002, signed on March 27, 2015.

enacted FY2015 budget were trimmed to $546 million, with $266.4 million to subsidize child care for low income, working families and $114.1 million to pay prison guards.

After the legislation was signed, the administration suspended $26 million in social service and public health grants to programs including those that help people with autism and epilepsy, assist smokers who want to quit and fund burials of indigent residents.[132] State officials testified that the grant suspensions were required because lawmakers would not agree to cuts in other areas, including funding for local governments, and that a total of over $100 million in cuts beyond the legislation passed in March could be needed to balance the budget.[133] Following complaints about the grant suspensions from members of the General Assembly, the Governor said he would reinstate them due to forecasts of higher than expected revenues in FY2015.[134]

[132] Associated Press, "Rauner suspends $26 million in social services, public health grants," *Chicago Tribune*, April 4, 2015.
[133] Statement by Tim Nuding, Director of the Illinois Governor's Office of Management and Budget, Joint Hearing of Senate Appropriations Committees I and II, April 14, 2015.
[134] Doug Finke and Dean Olsen, "Rauner reverses immediate cuts to Autism Program, Tobacco Quitline, other social services," *State Journal-Register*, April 30, 2015.

The next table compares the FY2015 revised enacted budget with the FY2015 budget fix enacted on March 27. The State has not issued an official update of the FY2015 budget plan since the legislation was passed; the figures in the table are Civic Federation calculations based on the legislation. The budget fix shown in the table includes the $26 million in grant suspensions and does not account for any additional revenues.

State of Illinois FY2015 General Funds Budget Changes (in $ millions)

	FY2015 Revised Enacted*	FY2015 Est. Revised **
Operating Revenues		
State Source Revenues	$ 30,393	$ 30,393
Federal Revenues	$ 3,676	$ 3,676
Fund Sweeps to Fix FY2015 Budget	$ -	$ 1,318
Total Operating Revenues	**$ 34,069**	**$ 35,387**
Operating Expenditures		
Appropriations		
Agency Appropriations	$ 25,446	$ 25,446
Proposed Supplemental Appropriations	$ 556	$ 543
(Unspent Appropriations)	$ (950)	$ (930)
(Net Spending Cuts to Fix FY2015 Budget)	$ -	$ (258)
(Grant Suspensions)		$ (26)
Pension Contributions	$ 6,059	$ 6,059
Total Net Appropriations Spent	$ 31,111	$ 30,834
Statutory Transfers Out		
Legislatively Required Transfers	$ 2,385	$ 2,385
Debt Service on Pension Bonds	$ 1,502	$ 1,502
Debt Service on Capital Bonds	$ 690	$ 690
Total Statutory Transfers Out	$ 4,577	$ 4,577
Total Operating Expenditures	**$ 35,688**	**$ 35,411**
Operating Surplus (Deficit)* **	**$ (1,618)**	**$ (24)**
Fiscal Emergency Budget Actions	$ 1,618	$ -
Operating Surplus (Deficit) after Fiscal Emergency Budget Actions	**$ -**	**$ (24)**

*As of February 2015.
**As of April 2015.
***Totals may not add due to rounding.
Source: Illinois State FY2016 Budget, pp. 3-6 to 3-7; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

Including the $26 million in grant suspensions, the enacted fix leaves an operating deficit of approximately $24 million. Several caveats apply to this figure, however. The actual amount of fund sweeps will depend on available fund balances in the affected funds. In general, any balances not available to be swept before the end of the fiscal year would create a budget gap that would have to be closed with other resources or spending cuts. It should also be noted that the $1.3 billion in fund sweeps shown in the table does not include the transfer of $48 million from the Federal High Speed Rail Trust Fund to the General Obligation Retirement and Interest Fund, which is used to make the State's annual debt service payments. This transfer is intended to allow a corresponding reduction in General Funds spending, but it is not clear that the General Funds reduction can be implemented. In addition, the federal revenues included in the table do not account for reductions in reimbursements caused by lower State Medicaid spending. Nor does the table account for any additional spending freezes imposed by the administration.

After working on the current year's budget, the General Assembly turned its attention to the Governor's FY2016 budget proposal. The proposal includes both the maintenance, or autopilot, budget and the recommended budget. With revenues declining to approximately $32.0 billion, maintenance expenditures of $38.2 billion would result in an operating deficit of $6.2 billion. To balance the budget and pay off $505 million of the backlog of unpaid bills, the Governor recommended FY2016 spending of $31.5 billion, a reduction of $3.9 billion from $35.4 billion in FY2015. As previously discussed, expenditures in the FY2015 budget are understated by $1.0 billion due to funding from special funds.

The following table compares the FY2015 budget as of April 2015 with the autopilot and recommended FY2016 budgets.

State of Illinois General Funds Budget Plans: FY2015-FY2016 (in $ millions)			
	FY2015 Est. Revised*	**FY2016** Autopilot	**FY2016** Rec.
Operating Revenues	$ 35,387	$ 32,049	$ 32,000
Operating Expenditures**	$ 35,411	$ 38,210	$ 31,495
Operating Surplus (Deficit)	**$ (24)**	**$ (6,161)**	**$ 505**
Accumulated Deficit from Prior Years	$ (3,931)	$ (3,955)	$ (3,955)
(Total Deficit)	**$ (3,955)**	**$ (10,116)**	**$ (3,450)**

*As of April 2015.
**Totals may not add due to rounding.

Source: Illinois State FY2016 Budget, pp. 3-6 to 3-7; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

It should be noted that the FY2016 autopilot budget understates revenues and overstates expenses compared with the FY2016 recommended budget. In the recommended budget, revenue diversions to two funds outside the General Funds are assumed to be eliminated, generating an estimated revenue increase of $886 million.[135] The autopilot budget is based on the assumption that the revenue diversions continue. In addition, the recommended budget assumes that required General Funds pension contributions are partly offset by $150 million in funding from the State Pensions Fund; no funding from this account is included in the autopilot budget. The autopilot budget also includes statutorily required appropriations that are not included in the recommended budget: $112.9 million in State retiree health contributions for public school teachers and community college employees outside of Chicago, which are covered by continuing appropriation,[136] and $12.1 million for the Chicago teachers' pension fund.[137]

[135] Illinois General Assembly, Commission on Government Forecasting and Accountability, *FY2016 Economic Forecast and Revenue Estimate and FY2015 Revenue Update*, April 29, 2015, p. 23.
[136] The State is statutorily required to contribute $108.3 million for the Teachers' Retirement Insurance Program and $4.6 million for the College Insurance Program in FY2016. Continuing appropriation is statutory authority that allows funds to be spent in the event the legislature fails to appropriate necessary funds or appropriates an insufficient amount for a specified purpose.
[137] 40 ILCS 17/127.

To balance revenues and expenditures, the recommended FY2016 budget includes spending reductions to virtually all areas of State government. The largest single source of savings—$2.2 billion—is a new proposal to reduce pension benefits that have not already been earned by State employees. Under the plan, which has not yet been introduced as legislation, all workers would receive the lower benefits provided to employees hired on or after January 1, 2011.

The Rauner administration believes that the new pension proposal could more easily withstand legal challenges than the law enacted in December 2013.[138] That law would reduce annual benefit increases of current retirees as well as those to be received by existing employees when they retire. However, labor unions argue that the new proposal also violates the Illinois Constitution by impairing public pension benefits.[139]

Governor Rauner has also urged that the State's Constitution be amended to limit pension protections,[140] but the amendment process is neither quick nor easy.[141] Amending the Illinois Constitution requires a three-fifth vote of each chamber of the legislature. An approved proposal may be put on the ballot at the next general election that occurs six months after the General Assembly vote and requires the approval of three-fifths of those voting on the issue.[142] The next general election is scheduled for November 2016.

Proposed FY2016 savings on group health insurance depend on the results of negotiations with the State's largest union, the American Federation of State, County and Municipal Employees (AFSCME), on a new contract to replace an agreement that ends on June 30, 2015. Other recommended spending reductions require changes in State law, approval from the federal government or agreement from federal courts.

Although the proposed FY2016 budget does not include new revenues, Governor Rauner has indicated that he might be open to tax increases after the General Assembly acts on his "turnaround agenda" for the State.[143] That agenda, which is described as "comprehensive reforms to make Illinois more compassionate and competitive," consists of a long list of proposed changes, including altering the State's workers' compensation system and unemployment insurance program and freezing local property taxes for two years.[144]

In a recent State tour, the Governor has focused on the components of the agenda that would reduce the power of labor unions, such as creating local right-to-work zones, repealing the State's Prevailing Wage Act and prohibiting Project Labor Agreements for state-funded projects.[145] Approximately 90% of state employees are covered by collective bargaining agreements.[146]

---

[138] Illinois State FY2016 Budget, p. 2-16.
[139] Council 31 AFSCME, "AFSCME responds to Gov. Rauner's proposed budget," news release, February 18, 2015.
[140] Illinois State FY2016 Budget, p. 2-14.
[141] Paul Merrion, "Amending the Illinois Constitution a tough path for pension reform," *Crain's Chicago Business*, July 16, 2014.
[142] Illinois Constitution, Article XIV, Section 2(a).
[143] Sara Burnett, Associated Press, "Rauner trying to broker mega-deal in Illinois legislature," *Peoria Journal Star*, April 18, 2015.
[144] Illinois State FY2016 Budget, p. 2-13.
[145] Tony Arnold, "Rauner's first 100 days: The fight between unions and Rauner," *WBEZ 91.5 Chicago*, April 20, 2015. In local right-to-work zones, workers would have the right to refrain from joining unions or paying union dues as a condition of employment. The Prevailing Wage Act requires contractors and subcontractors to pay laborers, workers and mechanics employed on public works construction projects no less than the general prevailing rate of wages for work of a similar character in the county where the work is performed. Project Labor Agreements (known as PLAs) are

Legislation related to the turnaround agenda has not yet been introduced, but the Governor on February 9 issued an Executive Order to prevent State workers who do not want to join a union from being required to pay fees (known as fair share fees) to cover non-political union activity.[147] The administration also filed a federal lawsuit seeking to have the order declared legal.[148] Unions responded by filing their own lawsuit in State court, and a St. Clair County judge ruled on April 10 that the State may not withhold the fees from paychecks to nonunion employees while the case proceeds.[149]

The General Assembly usually approves the annual budget in the final days of the spring session, which is scheduled to end on May 31. After the end of May of one calendar year, a three-fifths vote of each chamber, rather than a simple majority, is required for legislation to be effective before June 1 of the next calendar year.[150] House Speaker Michael Madigan has reportedly stated that the General Assembly is likely to have to work well beyond May 31 to pass a budget for FY2016.[151]

The State's decisions on the FY2016 budget will be closely watched by credit rating agencies, which have given Illinois the lowest rating of any state.[152] In a report in February, Moody's Investors Service said implementation of the Governor's recommended budget would be difficult due to political and legal impediments.[153] To the extent the proposal is approved, it would shift financial strain from the State to cities, healthcare providers and other entities scheduled for spending cuts, according to Moody's.

Revenues

The State of Illinois receives annual operating resources from taxes and fees levied by the State, as well as grants and other revenues provided by the federal government to fund its total annual expenditures. The Governor's recommended FY2016 budget includes total revenues of $58.6 billion, of which $32.0 billion are available for General Funds spending.[154] The remaining revenues not included in General Funds are restricted for specific purposes, shared through revolving funds between government agencies, held in trusts or generally not available for discretionary spending by the General Assembly.

Income Taxes

---

agreements between owners of construction projects and construction unions requiring firms hired on the projects to operate as union contractors.

[146] State of Illinois, General Obligation Bonds, Series of May 2014, *Official Statement*, April 25, 2014, p. 10.

[147] State of Illinois Executive Order 15-13, *Executive Order Respecting State Employees' Freedom of Speech*, February 9, 2015.

[148] Monique Garcia, Kim Geiger and Ray Long, "Rauner moves to exempt public workers from paying union fees," *Chicago Tribune*, February 10, 2015.

[149] *Associated Press,* "Judge overturns Rauner order restricting union dues," *State Journal-Register*, April 10, 2015.

[150] Illinois Constitution, Article IV, Section 10.

[151] Rich Miller, "Mike Madigan says budget impasses will send Legislature into overtime," *Chicago Sun-Times*, February 24, 2015.

[152] Illinois' credit is rated A minus by Standard & Poor's and Fitch Ratings and A3 by Moody's Investors Service.

[153] Moody's Investors Service, *State of Illinois: Governor Proposes Retirement Benefit Reforms, Local Aid Cuts to Close 21% Gap*, February 24, 2015.

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

The Governor's recommended FY2016 budget projects a revenue decline from FY2015 due to the first full year of the partial rollback of the temporary income tax increase. On January 1, 2015, the individual income tax rate declined to 3.75% from 5.0% and the corporate income tax rate declined to 5.25% from 7.0%. It should be noted that the State also collects the Personal Property Replacement Tax on behalf of local governments at a rate of 2.5% on corporate income, making the effective corporate income tax rate in Illinois currently 7.75%, after the rollback from 9.5% at the higher rate.

Income taxes are the largest source of State revenues, making up more than half of State-source General Funds revenues. This is true even after the loss in revenue from the rate reductions halfway through FY2015.

Total income tax receipts are projected to decline by $2.7 billion to $17.4 billion in FY2016 compared to the estimated total of $20.1 billion in FY2015. Gross income tax receipts decline by $5.6 billion from a gross total of $22.0 billion in FY2014, the final full year of the higher income tax rates.

After accounting for amounts set aside for refunds and other diversions, net income taxes deposited into the General Funds to pay for annual operating costs of the State decline by $1.9 billion to $15.5 billion in FY2016 compared to $17.5 billion in FY2015.

Net individual income taxes decline by $1.7 billion to $13.2 billion in FY2015 compared to $14.8 billion in FY2015. Some of the decline in FY2016 compared to FY2015 from the full year of lower rates is offset by the elimination of the statutory diversion from the individual income tax to fund education and human service spending outside of the General Funds.[155] In FY2015 statutory diversions of 1/30th of the gross individual income tax receipts to two new funds outside of the General Funds reduced operating revenues by $450 million.[156] The FY2016 income tax projection does not include these diversions but the provisions of the Illinois Income Tax Act that implemented the diversions as of February 1, 2015 would need to be repealed to end these transfers.[157]

From the peak year of FY2014, the final full year of the higher rates, total net individual income tax revenues decline by $3.5 billion.

Net corporate income tax revenues are projected to decline by $326 million to $2.3 billion in FY2016 compared to $2.7 billion in FY2015. The diversions for human service spending and education outside of the General Funds only applied to a small portion of the corporate income tax base attributable to estates and trusts, causing a $2.0 million reduction in General Funds resources in FY2015, which would not occur if the transfers are repealed as proposed by the Governor in FY2016.

The FY2015 corporate income tax receipts have been negatively affected by the expiration of a cap on the net operating loss deduction that expired on January 1, 2015. The income tax increase passed in 2011 included a provision that completely suspended the net operating loss deduction for corporations. This was intended to maximize the amount the State received from the higher rates

155 Public Act 96-1496, enacted on January 13, 2011. The provision can be found at 35 ILCS 5/901 (f) and (g). The diversions apply to taxes received from individuals, estates and trusts.
156 Illinois State FY2016 Budget, p. 4-9.
157 35 ILCS 5/901.

but was amended on December 12, 2011 to allow for up to $100,000 of losses to be deducted. So for C corporations filing taxes in calendar years 2010 and 2011 no net operating loss was allowed and in 2012 through 2014 only up to $100,000 was permitted.

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

After the expiration of the limitation on net operating loss deductions halfway through FY2015, corporate taxpayers began reducing their taxable income by applying current and past losses dating back up to 12 years from their current liabilities. The total effect of this deduction is not yet known but corporate income tax estimates were reduced in January 2015 to account for two straight months of unexpected declines. The December 2014 monthly revenue report from the Commission on Government Forecasting and Accountability (COGFA) showed corporate income tax revenues declining by $89 million from December 2013. Receipts were also $217 million less for the first half of FY2015 compared to the first half of FY2014 (the State's fiscal year runs from July 1 to June 30).

Due to the weak performance, projections of total corporate income tax revenues for FY2015 were reduced by $405 million to $2.7 billion from $3.1 billion in the Governor's Three-Year Projection, which was published on January 1, 2015. It is unclear if the corporate income tax receipts declined strictly due to higher than anticipated net operating loss deductions or if other underlying economic factors also played a part.

The following table shows the total income taxes collected by the State of Illinois from FY2010, the final full year prior to the FY2011 income tax increase, through the projected FY2016 totals.

The table separates the amount collected under the original 3.0% and 4.8% individual income and corporate income tax rates from the increased increments for each year.

State of Illinois Income Total Tax Revenues FY2010-FY2016 (in $ millions)

Income Tax Increment	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015 (Est.)	FY2016 (Proj.)
Personal Income Tax							
Personal Base (3.0%)	$ 9,430	$ 9,430	$ 10,059	$ 10,994	$ 11,033	$ 10,196	$ 11,715
*Personal Increase	$ -	$ -	$ 6,941	$ 7,330	$ 7,355	$ 6,797	$ 2,929
Refund Fund Transfer and Diversions	$ (920)	$ (920)	$ (1,487)	$ (1,785)	$ (1,746)	$ (2,148)	$ (1,464)
Net Personal Income Tax	**$ 8,510**	**$ 8,510**	**$ 15,513**	**$ 16,539**	**$ 16,642**	**$ 14,845**	**$ 13,180**
Corporate Income Tax							
Corporate Base (4.8%)	$ 1,649	$ 2,106	$ 2,045	$ 2,523	$ 2,496	$ 2,300	$ 2,560
*Corporate Increase	$ -	$ 180	$ 938	$ 1,156	$ 1,144	$ 800	$ 240
Refund Fund Transfer and Diversions	$ (289)	$ (435)	$ (522)	$ (502)	$ (476)	$ (436)	$ (462)
Net Corporate Income Tax	**$ 1,360**	**$ 1,851**	**$ 2,461**	**$ 3,177**	**$ 3,164**	**$ 2,664**	**$ 2,338**
Total Income Taxes (net)	**$ 9,870**	**$ 10,361**	**$ 17,974**	**$ 19,716**	**$ 19,806**	**$ 17,509**	**$ 15,518**

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

Source: Illinois State FY2016 Budget, pp. 4-9, 4-10; Illinois State FY2015 Budget, pp. 3-12, 3-13; Illinois State FY2014 Budget, pp. 3-11,3-12.

The table above also includes the amount set aside by the State to pay for annual refunds owed to taxpayers and the new statutory diversion in FY2015. The individual income taxes are set aside to pay for refunds at the same rate of 10.0% in FY2015 and FY2016. Corporate income taxes are set aside at a higher rate of 16.5% to pay for refunding in FY2016 compared to 14.0% in FY2015. This leads to an additional year-to-year loss of net corporate income tax revenues totaling $26 million.

General Funds Revenue

The Governor's budget projects total General Funds revenues in FY2016 of $32.0 billion, or $2.1 billion less than the estimated FY2015 total of $34.1 billion. After accounting for the $1.3 billion in fund sweeps approved by the General Assembly as part of the FY2015 budget fix, total General Funds resources in FY2016 are $3.4 billion less than the FY2015 total of $35.4 billion including the transfers from other state funds to balance the budget.

State-source General Funds revenue decline by $1.6 billion to $27.0 billion from $28.7 billion. The income tax decline of $2.0 billion due to the lower rates are slightly offset by increases in sales taxes and utility taxes.

General Funds revenues from sales taxes in FY2016 are projected to increase by $254 million to $8.2 billion from just under $8.0 billion in FY2015. Public utility tax projections increase by $168 million to $1.2 billion from $1.1 billion in FY2015. The increase in public utility taxes is attributable to a proposed elimination of several programs funded by utility taxes. The Governor's recommended budget increases General Funds revenues by a total of $175 million that would otherwise be transferred to the Supplemental Low-Income Assistance Fund, the Coal Technology Assistance Fund, the Renewable Energy Resources Trust Fund and Energy Efficiency Portfolio Standards Fund. These programs are managed by the Department of Commerce and Economic Opportunity and would necessitate changes to existing State laws to eliminate the statutorily required annual fund transfers.

Statutory transfers in, excluding the fund sweeps in FY2015, decline slightly by $75 million totaling nearly $1.7 billion in FY2016. The decline is mostly represented by the one-time transfer of surplus funds from the Refund Fund to the General Funds totaling $63 million in FY2015. The FY2016 budget does not anticipate a similar surplus in the Refund Fund.

Federal revenues included in the General Funds budget are primarily based on reimbursements for State Medicaid spending.[158] Due to lower expenditures for Medicaid in FY2016, federal revenues decline by $375 million to $3.3 billion compared to $3.7 billion in FY2015.

---

[158] See page 48 of this report for more information on the State's Medicaid Program.

The following table compares amounts included in the Governor's recommended FY2016 budget to current estimates of FY2015 General Funds revenues.

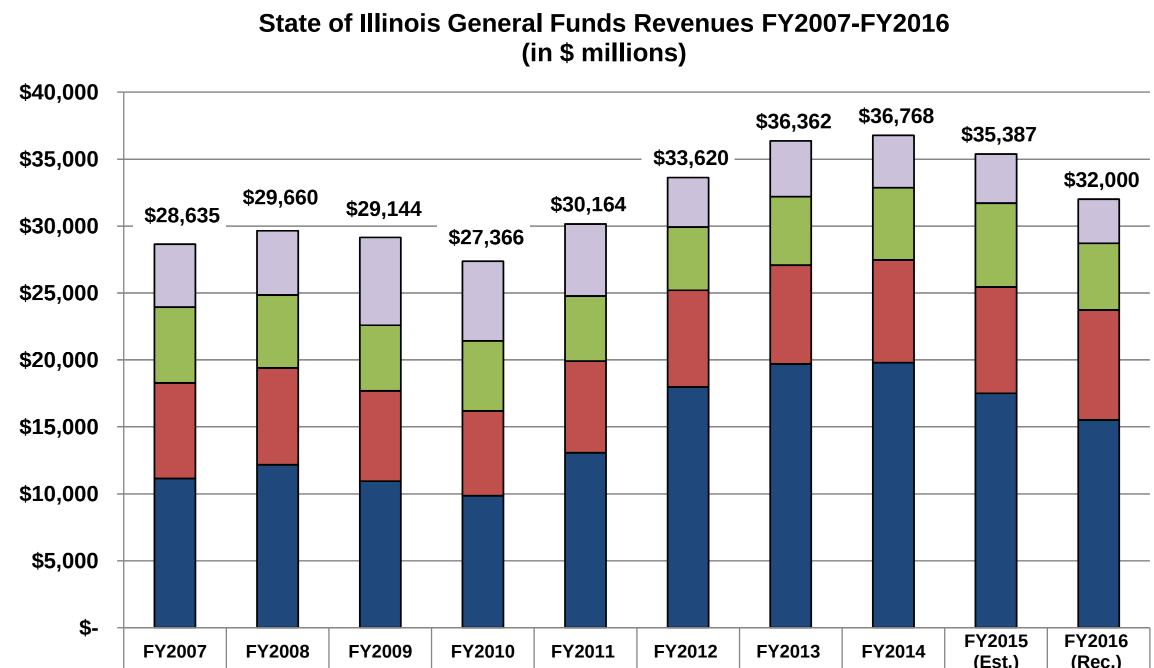
State of Illinois General Funds Revenues: Estimated FY2015 and Governor's Recommended FY2016 (in $ millions)				
	FY2015 Est.	FY2016 Rec.	$ Change	% Change
State Taxes				
Income Taxes (net)	$ 17,509	$ 15,518	$ (1,991)	-11.4%
Personal (net)	$ 14,845	$ 13,180	$ (1,665)	-11.2%
Corporate (net)	$ 2,664	$ 2,338	$ (326)	-12.2%
Sales Taxes	$ 7,950	$ 8,204	$ 254	3.2%
Public Utility Taxes	$ 1,015	$ 1,183	$ 168	16.6%
Cigarette Tax	$ 355	$ 355	$ -	0.0%
Liquor Gallonage Taxes	$ 167	$ 168	$ 1	0.6%
Estate Tax	$ 275	$ 275	$ -	0.0%
Insurance Taxes & Fees	$ 325	$ 340	$ 15	4.6%
Corporate Franchise Tax & Fees	$ 201	$ 201	$ -	0.0%
Interest on State Funds & Investments	$ 17	$ 17	$ -	0.0%
Cook County Intergovernmental Transfer	$ 244	$ 244	$ -	0.0%
Other Sources	$ 599	$ 533	$ (66)	-11.0%
Total State Taxes	**$ 28,657**	**$ 27,038**	**$ (1,619)**	**-5.6%**
Transfers			$ -	
Lottery	$ 682	$ 696	$ 14	2.1%
Riverboat Transfers & Receipts	$ 268	$ 273	$ 5	1.9%
Other	$ 786	$ 692	$ (94)	-12.0%
Total Transfers	**$ 1,736**	**$ 1,661**	**$ (75)**	**-4.3%**
State Revenues	**$ 30,393**	**$ 28,699**	**$ (1,694)**	**-5.6%**
Federal Sources	**$ 3,676**	**$ 3,301**	**$ (375)**	**-10.2%**
Total Revenue	**$ 34,069**	**$ 32,000**	**$ (2,069)**	**-6.1%**
Fund Sweeps	**$ 1,318**	**$ -**	**$ (1,318)**	**na**
Total Including Fund Sweeps	**$ 35,387**	**$ 32,000**	**$ (3,387)**	**-9.6%**

Source: Illinois State FY2016 Budget, p. 3-55; Public Act 99-002.

Despite the FY2016 General Funds revenues decline of $4.8 billion from the peak year of FY2014, total operating resources have increased by $3.4 billion over the last ten fiscal years. This represents an increase of 12.0% from $28.6 billion in FY2007. The revenue growth is attributable to income taxes, which increase by $4.4 billion to $15.5 billion in FY2016 compared to $11.2 billion in FY2007. However, the growth was not consistent over the last 10 years and depended on the increase in rates in FY2011. Excluding the income taxes gained from the higher rates, total General Funds resources are projected to exceed FY2007 by only $534 million, or 1.9%.

Total sales taxes increase by $1.1 billion to $8.2 billion in FY2016 compared to $7.1 billion in FY2007. The gains in sales taxes over the last ten years are offset by losses in federal revenues and other sources. Federal revenues decline by $1.4 billion to $3.3 billion in FY2016 compared to $4.7 billion in FY2007. Other sources of State operating revenue decline by $661 million to $5.0 billion in FY2016 compared to $5.6 billion in FY2007.

The following chart shows the 10-year trend in General Funds revenue by major source from FY2007 through the projections for FY2016.



	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015 (Est.)	FY2016 (Rec.)
Total	$28,635	$29,660	$29,144	$27,366	$30,164	$33,620	$36,362	$36,768	$35,387	$32,000
Federal	$4,702	$4,815	$6,567	$5,920	$5,386	$3,681	$4,154	$3,903	$3,676	$3,301
Other Resources*	$5,638	$5,450	$4,871	$5,267	$4,869	$4,740	$5,138	$5,383	$6,252	$4,977
Sales Taxes	$7,136	$7,215	$6,773	$6,308	$6,833	$7,226	$7,354	$7,676	$7,950	$8,204
Income Taxes	$11,159	$12,180	$10,933	$9,870	$13,076	$17,973	$19,716	$19,806	$17,509	$15,518

*Includes interfund borrowing in FY2011 and fund sweeps in FY2015.
Source: Illinois State Budgets FY2007-FY2016.

As shown in the chart above, both income taxes and sales taxes declined dramatically during the recession that began in December 2007 and lasted until June 2009.[159] Total State-source General Funds revenues declined by $3.4 billion from $24.8 billion in FY2008 to $21.5 billion in FY2010.[160] Total income tax revenues declined by $2.3 billion to $9.9 billion in FY2010 from

[159] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," September 20, 2010.
[160] Illinois State Budgets: FY2009-FY2012.

$12.2 billion in FY2008. Sales taxes declined by $907 million to $6.3 billion in FY2010 from $7.2 billion in FY2008. Although revenues began to stabilize and show marginal growth in FY2011, overall revenue projections remained weak when the State enacted its FY2011 budget.

On January 13, 2011, halfway through the FY2011 fiscal year, the State approved temporary increases for both the personal and corporate income tax rates.[161] The corporate income tax rate was increased from 4.8% to 7.0% and the personal income tax rate was increased from 3.0% to 5.0%.[162] The rate increases, as enacted, were temporary and sunset on January 1, 2015. The personal income tax rate declined from 5.0% to 3.75% and the corporate income tax rate was reduced from 7.0% to 5.25%. Under the current law, the rates roll back again on January 1, 2025, when the personal income tax rate declines to 3.25% and the corporate rate returns to 4.8%.

Higher income tax rates created a greater disparity among revenue sources that support General Funds operations. In FY2007 income taxes made up 39.0% of the State's General Funds resources, while sales taxes accounted for 24.9%, federal revenues 17.9% and other sources 21.9%. The FY2016 projections show income taxes making up 53.5% of General Funds revenues, with sales taxes totaling 20.3%, federal revenues 16.4% and other sources 19.7%. The shift in State revenue funding makes the State much more reliant on a single source of economically sensitive revenue and more vulnerable to downward changes in business cycle.[163]

Appropriations and Expenditures

The recommended FY2016 budget proposes total appropriations of $61.8 billion, including $28.4 billion in General Funds appropriations. The budget proposal also has appropriations of $25.7 billion from Other State Funds and $7.6 billion from Federal Funds.

Proposed FY2016 General Funds expenditures total $31.5 billion. General Funds expenditures include both spending from appropriations and transfers out of General Funds to make interest and principal payments on previously issued bonds, provide funding for local governments and for other purposes.

General Funds support the regular operating and administrative expenses of most agencies and are the funds over which the State has the most control.[164] Other State Funds are accounts for activities funded by specific revenue sources that may only be used for specific purposes. Federal Funds (other than those designated for General Funds) use federal revenues to support a variety of State programs.

---

[161] Public Act 96-1496.

[162] The State also collects a Personal Property Replacement Tax from corporations in Illinois on behalf of local governments of 2.5%, which increases the total effective corporate tax rate to 9.5%.

[163] Government Finance Officers Association, *Best Practices in Public Budgeting*, Practice 4.6: Develop Policy on Revenue Diversification, 2000.

[164] General Funds consist of four funds: the General Revenue Fund, Education Assistance Fund, Common School Fund and General Revenue-Common School Special Account Fund.

Appropriations by Fund Type

The following table shows appropriations by type of fund in FY2012, FY2015 and FY2016. An official update of the FY2015 budget plan has not been issued since legislation affecting that budget was passed in March 2015; the FY2015 figures in the table are Civic Federation calculations based on the legislation.[165]

State of Illinois Appropriations by Fund: FY2012-FY2016 (in $ millions)							
	FY2012	FY2015 Est. Revised*	FY2016 Rec.	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
General Funds	$ 29,550	$ 31,764	$ 28,442	$ (3,322)	-10.5%	$ (1,108)	-3.7%
Other State Funds	$ 19,003	$ 26,960	$ 25,676	$ (1,284)	-4.8%	$ 6,673	35.1%
Federal Funds	$ 9,244	$ 7,881	$ 7,650	$ (231)	-2.9%	$ (1,594)	-17.2%
Total	**$ 57,797**	**$ 66,605**	**$ 61,768**	**$ (4,837)**	**-7.3%**	**$ 3,971**	**6.9%**

*As of April 2015.

Source: Illinois State FY2014 Budget, p. 2-35; Illinois State FY2016 Budget, p. 2-41; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

General Funds appropriations decline by $3.3 billion, or 10.5%, from an estimated $31.8 billion in FY2015 to $28.4 billion in the Governor's recommended FY2016 budget. It is important to understand that FY2015 General Funds appropriations are understated by $1.0 billion due to funding shifts.[166] In addition, proposed General Funds appropriations in FY2016 are understated by $112.9 million because they do not include State retiree health contributions for public school teachers and community college employees outside of Chicago, which are covered by continuing appropriation.[167] Recommended FY2016 General Funds appropriations also do not include funding for the Chicago teachers' pension fund, which totaled $62.1 million in FY2015.[168] Of that amount, $12.1 million is required by State law but not continuing appropriation.[169] Over the five-year period, General Funds appropriations decline by $1.1 billion, or 3.7%, from $29.6 billion in FY2012.

Total appropriations, including appropriations from Other State Funds and Federal Funds, decline to $61.8 billion in the FY2016 recommended budget from $66.6 billion in the estimated FY2015 budget and $57.8 billion in FY2012. Total appropriations do not accurately reflect State spending because spending from Other State Funds and Federal Funds is often significantly below appropriated amounts. In FY2012, for example, actual spending from Other State Funds was $14.9 billion, compared with appropriations of $19.0 billion; actual spending from Federal Funds was $5.4 billion, compared with appropriations of $9.2 billion.[170]

---

[165] Public Acts 99-0001 and 99-0002, enacted on March 27, 2015.

[166] Medicaid costs are understated in FY2015 because $600 million was appropriated in FY2014 for spending in FY2015. A total of $400 million in human services and education costs in FY2015 were funded through revenue diversions to funds outside of General Funds.

[167] The State is statutorily required to contribute $108.3 million for the Teachers' Retirement Insurance Program and $4.6 million for the College Insurance Program in FY2016. Continuing appropriation is statutory authority that allows funds to be spent in the event the legislature fails to appropriate necessary funds or appropriates an insufficient amount for a specified purpose.

[168] Illinois State FY2016 Budget, p. 6-264.

[169] 40 ILCS 17/127.

[170] Illinois State FY2014 Budget, p. 2-35.

The next table compares the FY2016 maintenance, or autopilot, budget with the recommended FY2016 budget. The autopilot budget shows the level of spending authority needed to keep programs and services at the same level as in FY2015. General Funds appropriations of $28.4 billion in the recommended FY2016 budget are $5.4 billion below the maintenance level of $33.9 billion.

State of Illinois Appropriations by Fund: FY2016 Autopilot and Recommended (in $ millions)				
	FY2016 Autopilot	FY2016 Rec.	$ Change	% Change
General Funds	$ 33,850	$ 28,442	$ (5,408)	-16.0%
Other State Funds	$ 27,606	$ 25,676	$ (1,930)	-7.0%
Federal Funds	$ 7,675	$ 7,650	$ (25)	-0.3%
Total	**$ 69,131**	**$ 61,768**	**$ (7,363)**	**-10.7%**

Source: Illinois State FY2016 Budget, p. 3-27.

The FY2016 autopilot budget overstates General Funds appropriations because it does not account for transfers of $150 million from the State Pensions Fund that are included in the recommended FY2016 budget and are used to reduce General Funds pension costs. The State Pensions Fund receives resources from the sale of unclaimed property. From FY2005 through FY2015, the General Assembly authorized average annual transfers of $165.9 million from the account to fund pension contributions.[171] The autopilot budget includes $112.9 million in State retiree health contributions for public school teachers and community college employees outside of Chicago, which are covered by continuing appropriation, while these are eliminated in the recommended FY2016 budget. The autopilot budget also includes $12.1 million for the Chicago teachers' pension fund, which is not included in the recommended budget.

General Funds Appropriations by Category

To understand State spending pressures, it is helpful to examine three components of General Funds appropriations: agency appropriations, pension contributions and group insurance. The legislature generally has more discretion over agency appropriations than the other two spending categories.[172] State pension contributions are based on State law, determined by Illinois' five retirement systems and covered by continuing appropriation. Group insurance consists mainly of health insurance for retirees and employees, which is governed by State law and union contracts.

[171] Illinois General Assembly, Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems: Financial Condition as of June 30, 2014,* February 2015, p. 118.
[172] Most spending changes in the Medicaid program require changes in State law, administrative rules and/or approval from the federal government.

The following table shows appropriations for these components of State spending in FY2012, FY2015 and FY2016. While agency appropriations face a proposed reduction of 5.7% in FY2016 from estimated FY2015, the proposed decreases in pension contributions and group insurance payments amount to 26.2% and 23.6%, respectively. These reductions are discussed in detail below. As previously explained, FY2015 agency appropriations are understated due to funding shifts, and FY2016 agency appropriations are understated because they do not include statutorily required retiree health insurance contributions and contributions to the Chicago teachers' pension fund.

State of Illinois General Funds Appropriations by Category: FY2012-FY2016 (in $ millions)

	FY2012	FY2015 Est. Revised*	FY2016 Rec.	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
Agency Appropriations	$ 23,979	$ 24,140	$ 22,775	$ (1,365)	-5.7%	$ (1,204)	-5.0%
Pension Contributions	$ 4,135	$ 6,059	$ 4,472	$ (1,587)	-26.2%	$ 337	8.1%
Group Insurance	$ 1,436	$ 1,565	$ 1,195	$ (370)	-23.6%	$ (241)	-16.8%
Total	**$ 29,550**	**$ 31,764**	**$ 28,442**	**$ (3,322)**	**-10.5%**	**$ (1,108)**	**-3.7%**

*As of April 2015.

Source: Illinois State FY2014 Budget, pp.2-16, 2-29 and 2-35; Illinois State FY2016 Budget, pp. 3-6, 3-21 and 3-27; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

The next table compares the three components of General Funds appropriations in the FY2016 autopilot budget and the recommended FY2016 budget. Proposed agency appropriations decline by 9.5% from the autopilot budget, while pension contributions are down by 34.4% and group insurance by 35.4%. These reductions are discussed in detail below.

State of Illinois General Funds Appropriations by Category: FY2016 Autopilot and Recommended (in $ millions)

	FY2016 Autopilot	FY2016 Rec.	$ Change	% Change
Agency Appropriations	$ 25,178	$ 22,775	$ (2,403)	-9.5%
Pension Contributions*	$ 6,822	$ 4,472	$ (2,350)	-34.4%
Group Insurance	$ 1,850	$ 1,195	$ (655)	-35.4%
Total	**$ 33,850**	**$ 28,442**	**$ (5,408)**	**-16.0%**

*Pension contributions in the FY2016 autopilot budget do not include transfers from the State Pensions Fund, which are budgeted at $150 million in the recommended FY2016 budget.

Source: Illinois State FY2016 Budget, pp 3-6, 3-27 and 6-74.

The caveats discussed above continue to apply; the FY2016 autopilot budget overstates pension contributions by $150 million because it does not account for transfers from the State Pensions Fund. The autopilot budget includes contributions for retiree health insurance and Chicago teachers' pensions that are not included in the recommended FY2016 budget.

Appropriations by Agency

The recommended FY2016 budget proposes significant spending reductions from both the revised FY2015 budget and the FY2016 autopilot. The table on page 45 shows total appropriations to the ten largest agencies, ranked according to recommended FY2016 total appropriations, for FY2012 and for the FY2016 autopilot and recommended budget. FY2015 appropriations by agency are not shown in the table because a revised breakdown of those has not been made available since legislation on the FY2015 budget was enacted in March 2015. Agency appropriations do not include pension contributions, group insurance or debt service.

The largest agency is the Department of Healthcare and Family Services (HFS), which administers the State's Medicaid program.[173] Total appropriations to HFS decline by $1.6 billion, or 7.7%, from $20.8 billion in the FY2016 autopilot budget to $19.2 billion in the recommended FY2016 budget. Over the past few years, an increasing share of HFS funding has come from Other State Funds. Other State Funds account for 65.0% of total HFS appropriations in the recommended FY2016 budget, compared with 51.6% in FY2012.

The main reason for the funding shift is Illinois' expansion of Medicaid eligibility under the federal Affordable Care Act (ACA). The ACA Medicaid expansion is entirely financed by the federal government through calendar year 2016, and these funds are accounted for outside of General Funds. Illinois Medicaid expenditures are generally reimbursed by the federal government at a current rate of 50.76%. In the General Funds budget, an appropriation of $1 generates federal revenues of 50.76 cents, resulting in net State spending of about 49.24 cents. A budgeted amount of $1 in Other State Funds consists of 50.76 cents of federal reimbursements and 49.24 cents of funds from other sources.

Total appropriations for elementary and secondary education increase by $273.3 million, or 2.8%, to $10.2 billion in the recommended FY2016 budget from $9.9 billion in the autopilot budget. An increase of $473.2 million in General Funds appropriations is offset by a decrease of $200.0 million in appropriations from Other State Funds. This decrease reflects the proposed elimination of revenue diversions to the Fund for the Advancement of Education, which were used to support General State Aid beginning in February 2015.[174]

General State Aid, the State's main spending program for elementary and secondary education, increases by $387.8 million to $4.8 billion in the recommended FY2016 budget from $4.4 billion in the revised FY2015 budget, according to the State Board of Education.[175] General State Aid payments are based on a Foundation Level of funding, which is established by statute and represents the minimum per child amount of financial support that should be available to provide for the basic education of each student.[176] General State Aid is designed to help fill the gap between the Foundation Level and the amount a school district can provide from local property tax revenues and other local resources. The Foundation Level has been unchanged since FY2010 at a per pupil amount of $6,119, which remains the proposed level in FY2016.[177] The State's Education Funding Advisory Board recommended a Foundation Level of $8,897 in FY2016.[178] General State Aid funding proposed for FY2016 represents 95% of the $5.1 billion that would be needed to fully fund

173 Although HFS is Illinois' main Medicaid agency, several other agencies account for a significant share of Medicaid spending. For more information on the Medicaid program, see page 48 of this report.
174 Illinois State FY2015 Budget, p. 3-4.
175 Illinois State Board of Education, *FY2016 Budget Request: Comparison to FY2016 Governor's Recommended Budget*, March 27, 2015.
176 105 ILCS 5/18-8.05(B).
177 Illinois State Board of Education, Division of Funding and Disbursement Services, *General State Aid*, October 15, 2014.
178 Education Funding Advisory Board, *Illinois Education Funding Recommendations*, January 2015, p. 1.

the Foundation Level of $6,119, according to the Board of Education.[179] The Foundation level was 87% funded in the revised FY2015 budget.[180]

Total appropriations for higher education decline by $434.0 million, or 17.7%, from $2.5 billion in the FY2016 autopilot budget to $2.0 billion in the recommended FY2016 budget. Since FY2012 annual appropriations for higher education decline by $590.3 million, or 22.6%. Higher education includes nine public universities, the Illinois Board of Higher Education, the Illinois Community College Board, the Illinois Student Assistance Commission, the Illinois Mathematics and Science Academy and the State Universities Civil Service System. Appropriations for universities decline by 31.9%, or $396.8 million, to $849.1 million in the proposed FY2016 budget from $1.2 billion in the autopilot budget.

The Department of Human Services (DHS) has total proposed FY2016 appropriations of $6.0 billion, a decrease of $541.4 million, or 8.3%, from the autopilot budget. DHS received the largest amount of additional funding for the FY2015 budget in the legislation enacted in March 2015.[181] The legislation provided $266.4 million in supplemental funding for the agency's Child Care Assistance Program, which subsidizes child care for low-income, working families and did not have sufficient appropriations to cover FY2015 costs.[182] DHS also received about $17.8 million in supplemental funding for its Home Services Program, which pays for home care for the physically disabled. These programs and others that received additional funding for FY2015 face significant General Funds reductions in the proposed FY2016 budget. For example, the cost of the child care program is reduced by $135 million in FY2016 by ending subsidies for relatives who provide care, increasing copayments by parents and eliminating coverage for children age six and above.[183] DHS received more than $98 million from Other State Funds in FY2015, but that funding was tied to a revenue diversion from General Funds that is eliminated in the proposed FY2016 budget.[184]

The Department on Aging has total appropriations of $1.0 billion in the proposed FY2016 budget, a decrease of $170.3 million, or 14.0%, from $1.2 billion in the autopilot budget. The agency's budget has grown rapidly in recent years due to its Community Care Program, which is designed to keep seniors out of nursing homes by providing in-home services such as cleaning and meal preparation and community-based adult day services. In the revised FY2015 budget, the Department on Aging had an appropriation from Other State Funds of more than $96.8 million that was related to revenue diversions from General Funds, but this source of funding is eliminated in the FY2016 proposed budget.[185]

Total recommended FY2016 appropriations to the Department of Corrections of $1.48 billion are $32.4 million, or 2.1%, below the autopilot budget. The proposed budget increases the number of positions for correctional officers by 473, but the additional staffing is projected to reduce costs due to decreased overtime work. Proposed FY2016 funding for the Illinois Department of Children and Family Services is down by $167.0 million, or 13.9%, from the autopilot budget. The savings in the

---

[179] Illinois State Board of Education, *FY2016 Budget Request: Comparison to FY2016 Governor's Recommended Budget*, March 27, 2015.
[180] Illinois State Board of Education, *FY2016 Budget Request: Comparison to FY2016 Governor's Recommended Budget*, March 27, 2015.
[181] Public Act 99-0001, enacted on March 27, 2015.
[182] Associated Press, "Lawmakers, Rauner Trying to Negotiate Fix for Budget Gaps," *CBS Chicago*, February 6, 2015.
[183] Illinois Department of Human Services, *Fiscal Year 2016 Budget Request: Agency Briefing*, February 18, 2015.
[184] The $101 million initially appropriated to DHS from the Commitment to Human Services Fund in FY2015 was reduced to $98.7 million in the revised FY2015 budget.
[185] The $99 million initially appropriated to the Department on Aging from the Commitment to Human Services Fund was reduced to $96.8 million in the revised FY2015 budget.

recommended budget come from eliminating services to young adults age 18 to 21 who were in the foster care system.[186] The American Civil Liberties Union has testified that this budget cut would violate a federal consent decree.[187]

Three of the ten largest agencies receive no funding or relatively little funding from General Funds. The Department of Transportation is primarily supported by Other State Funds including the Road Fund, which is funded by motor fuel taxes and vehicle registrations, licenses and fees. The recommended FY2016 budget proposes a $361.7 million, or 12.3%, decrease in Transportation Department appropriations from the autopilot budget, with significant spending reductions for the Regional Transportation Authority and transit districts outside the Chicago area, as well as for Amtrak.[188]

The Department of Commerce and Economic Opportunity (DCEO), which is mainly funded by federal grants, faces a reduction of $326.5 million, or 71.8%, in its support from Other State Funds in the proposed FY2016 budget compared with the autopilot budget. The largest cut involves the State contribution to the federal Low-Income Energy Assistance Program (LIHEAP), which is funded by surcharges on residents' utility bills.[189] Legislation supported by the leadership of the Illinois House would partially privatize the functions of the economic development agency.[190]

The Lottery Department, which receives no General Funds revenues, was established as a separate agency in 2011 to supervise the private manager chosen to run the State's lottery. The Illinois Attorney General's Office in January 2015 voided an agreement to sever ties with the current lottery manager.[191] That termination agreement had been reached by the administration of former Governor Pat Quinn after the lottery manager did not achieve initial revenue goals, but the Attorney General's Office determined that the agreement would not have benefitted taxpayers.

---

186 Illinois State FY2016 Budget, p. 6-78.

187 American Civil Liberties Union, "ACLU tells Senate Committee that proposed DCFS budget cuts violate long-standing consent decree," news release, March 17, 2015.

188 Illinois State FY2016 Budget, pp. 2-32 to 2-33 and 6-161 to 6-169.

189 Steve Daniels, "Rauner wants to seize utility funds for the poor to help balance budget," *Crain's Chicago Business*, February 23, 2015.

190 99th Illinois General Assembly, House Bill 574, House Amendment 1, filed on April 20, 2015. For more information, see Greg Hinz, "State's biz-recruiting to go private under Rauner, Madigan deal," *Crain's Chicago Business*, April 21, 2015.

191 Matthew Walberg, "Lisa Madigan blocks settlement between Illinois Lottery, Northstar," *Chicago Tribune*, January 2015.

State of Illinois All Funds Appropriations for Ten Largest Agencies: FY2012-FY2016 (in $ millions)*

Agency	FY2012	FY2016 Autopilot	FY2016 Rec.	$ Change FY2016 Rec.-Autopilot	% Change FY2016 Rec.-Autopilot	5-Year $ Change	5-Year % Change
Healthcare and Family Services	**$ 14,968.1**	**$ 20,790.9**	**$ 19,196.6**	**$(1,594.3)**	**-7.7%**	**$ 4,228.5**	**28.3%**
General Funds	$ 6,845.1	$ 7,794.6	$ 6,320.1	$(1,474.5)	-18.9%	$ (525.0)	-7.7%
Other State Funds	$ 7,772.9	$ 12,596.3	$ 12,476.4	$ (119.9)	-1.0%	$ 4,703.5	60.5%
Federal Funds	$ 350.0	$ 400.0	$ 400.0	$ -	0.0%	$ 50.0	14.3%
State Board of Education	**$ 10,392.4**	**$ 9,904.3**	**$ 10,177.6**	**$ 273.3**	**2.8%**	**$ (214.8)**	**-2.1%**
General Funds	$ 6,750.4	$ 6,620.8	$ 7,094.0	$ 473.2	7.1%	$ 343.6	5.1%
Other State Funds	$ 61.2	$ 264.7	$ 64.7	$ (200.0)	-75.6%	$ 3.5	5.7%
Federal Funds	$ 3,580.8	$ 3,018.8	$ 3,018.8	$ -	0.0%	$ (562.0)	-15.7%
Human Services	**$ 5,753.1**	**$ 6,552.3**	**$ 6,010.9**	**$ (541.4)**	**-8.3%**	**$ 257.8**	**4.5%**
General Funds	$ 3,458.9	$ 3,571.7	$ 3,163.7	$ (408.0)	-11.4%	$ (295.2)	-8.5%
Other State Funds	$ 561.3	$ 1,267.5	$ 1,157.9	$ (109.6)	-8.6%	$ 596.6	106.3%
Federal Funds	$ 1,732.8	$ 1,713.1	$ 1,689.3	$ (23.8)	-1.4%	$ (43.5)	-2.5%
Transportation	**$ 2,669.9**	**$ 2,932.1**	**$ 2,570.4**	**$ (361.7)**	**-12.3%**	**$ (99.5)**	**-3.7%**
General Funds	$ 21.4	$ 4.9	$ 0.1	$ (4.8)	-98.0%	$ (21.3)	-99.5%
Other State Funds	$ 2,643.9	$ 2,917.9	$ 2,560.9	$ (357.0)	-12.2%	$ (83.0)	-3.1%
Federal Funds	$ 4.6	$ 9.3	$ 9.3	$ -	0.0%	$ 4.7	102.2%
Higher Education**	**$ 2,609.4**	**$ 2,453.1**	**$ 2,019.1**	**$ (434.0)**	**-17.7%**	**$ (590.3)**	**-22.6%**
General Funds	$ 2,092.4	$ 2,023.9	$ 1,592.5	$ (431.4)	-21.3%	$ (499.9)	-23.9%
Other State Funds	$ 92.6	$ 79.1	$ 76.5	$ (2.6)	-3.3%	$ (16.1)	-17.4%
Federal Funds	$ 424.4	$ 350.1	$ 350.1	$ -	0.0%	$ (74.3)	-17.5%
Corrections	**$ 1,300.5**	**$ 1,511.8**	**$ 1,479.4**	**$ (32.4)**	**-2.1%**	**$ 178.9**	**13.8%**
General Funds	$ 1,216.4	$ 1,403.1	$ 1,370.7	$ (32.4)	-2.3%	$ 154.3	12.7%
Other State Funds	$ 84.1	$ 108.7	$ 108.7	$ -	0.0%	$ 24.6	29.3%
Federal Funds	$ -	$ -	$ -	$ -	na	$ -	na
Lottery	**$ 949.2**	**$ 1,227.7**	**$ 1,227.7**	**$ -**	**0.0%**	**$ 278.5**	**29.3%**
General Funds	$ -	$ -	$ -	$ -	na	$ -	na
Other State Funds	$ 949.2	$ 1,227.7	$ 1,227.7	$ -	0.0%	$ 278.5	29.3%
Federal Funds	$ -	$ -	$ -	$ -	na	$ -	na
Commerce and Economic Opportunity	**$ 1,983.1**	**$ 1,545.1**	**$ 1,191.7**	**$ (353.4)**	**-22.9%**	**$ (791.4)**	**-39.9%**
General Funds	$ 32.4	$ 58.0	$ 31.0	$ (27.0)	-46.6%	$ (1.4)	-4.3%
Other State Funds	$ 400.9	$ 454.9	$ 128.4	$ (326.5)	-71.8%	$ (272.5)	-68.0%
Federal Funds	$ 1,549.8	$ 1,032.3	$ 1,032.3	$ -	0.0%	$ (517.5)	-33.4%
Aging	**$ 826.2**	**$ 1,213.5**	**$ 1,043.2**	**$ (170.3)**	**-14.0%**	**$ 217.0**	**26.3%**
General Funds	$ 737.4	$ 1,009.0	$ 937.7	$ (71.3)	-7.1%	$ 200.3	27.2%
Other State Funds	$ 8.4	$ 103.5	$ 4.5	$ (99.0)	-95.7%	$ (3.9)	-46.4%
Federal Funds	$ 80.4	$ 100.9	$ 100.9	$ -	0.0%	$ 20.5	25.5%
Children and Family Services	**$ 1,260.2**	**$ 1,200.8**	**$ 1,033.8**	**$ (167.0)**	**-13.9%**	**$ (226.4)**	**-18.0%**
General Funds	$ 812.5	$ 715.1	$ 556.8	$ (158.3)	-22.1%	$ (255.7)	-31.5%
Other State Funds	$ 440.0	$ 475.1	$ 466.5	$ (8.6)	-1.8%	$ 26.5	6.0%
Federal Funds	$ 7.7	$ 10.5	$ 10.5	$ -	0.0%	$ 2.8	36.4%

*Does not include pension contributions, State group insurance or debt service. Totals may not add due to rounding.

**Includes nine public universities, Board of Higher Education, Community College Board, Student Assistance Commission, Mathematics and Science Academy and State Universities Civil Service System.

Source: Illinois State FY2014 Budget, pp. 2-27 to 2-35; Illinois State FY2016 Budget, pp. 3-19 to 3-27.

Pensions

General Funds contributions to the State's five retirement systems are shown in the recommended FY2016 budget at $4.47 billion.[192] This amount reflects an estimate of the contributions that would be required under a new pension plan that has been discussed by the Rauner administration but not yet introduced as legislation in the General Assembly.[193]

---

[192] General Funds account for approximately 89% of total State pension contributions.

[193] Illinois State FY2016 Budget, pp. 2-15 to 2-17 and 5-1 to 5-4. For more information about Illinois' State and local retirement systems, see The Civic Federation, *Illinois Pension Primer: A Plain-English Guide to Public Employee Pensions in the State of Illinois*, April 22, 2015,

The recommended FY2016 pension contributions are approximately $2.35 billion below the $6.82 billion contributions shown in the FY2016 autopilot budget, which is intended to represent required contributions under existing State law. However, the autopilot budget does not reflect any transfers from the State Pensions Fund to offset General Funds costs, while the recommended budget includes transfers of $150 million from this account.[194] After adjusting for the projected $150 million transfer in FY2016, the recommended pension contributions in that year are $2.2 billion below the amount required by existing State law.

Escalating pension costs have been a major financial pressure for the State in recent years. State contributions required under current law grew from $1.6 billion in FY2008 to $6.1 billion in FY2015, while debt payments on pension bonds increased from $467 million in FY2008 to $1.5 billion in FY2015.[195] Illinois paid for its statutorily required General Funds pension contributions in FY2010 and FY2011 by issuing pension bonds, but the State has since made its contributions without borrowing.

Illinois has the most underfunded pension funds of any state[196] and the largest pension burden relative to State revenues,[197] according to recent reports. The State's five retirement systems had a total accrued unfunded liability of $104.6 billion at the end of FY2014, based on the market value of assets, and a combined funded ratio of 42.9%.[198]

The existing 50-year pension funding plan began in FY1996.[199] After a 15-year phase-in period, the law required the State to contribute a level percentage of payroll sufficient to bring the retirement systems' funded ratios to 90% by FY2045 from approximately 52% in FY1995. However, the funding plan and subsequently enacted changes deferred a large portion of the required State contributions to later years. The 1995 funding schedule does not require the State to make adequate contributions to keep the unfunded liability from growing until approximately FY2030.[200] The unfunded liability has also increased because of lower than expected investment returns, enhanced benefits and changes in mortality rates and other factors.[201]

---

http://www.civicfed.org/sites/default/files/IllinoisPensionPrimer_PlainEnglishGuide.pdf (last visited on April 26, 2015).

194 The State Pensions Fund receives resources from the sale of unclaimed property. From FY2005 through FY2015, the General Assembly authorized average annual transfers of $165.9 million from the account to fund pension contributions.

195 The State's first sale of pension bonds was in 2003.

196 Pew Center on the States, *The Widening Gap Update*, June 2012, p. 5.

197 Moody's Investors Service, *Illinois State and Local Governments Face Daunting Pension Challenges*, September 5, 2014, p. 2.

198 State of Illinois, Office of the Auditor General, *Supplemental Digest of Retirement Systems' Audits for the years ending June 30, 2013 and June 30, 2014,* January 22, 2015. Unfunded liability is the actuarial value of accrued pension benefits that are not covered by pension assets. The funded ratio shows the percentage of accrued pension liability covered by pension assets and is a commonly used measure of the financial health of a retirement system.

199 Public Act 88-0593, signed on August 22, 1994.

200 Commission on Government Forecasting and Accountability, *Illinois State Retirement Systems: Financial Condition as of June 30, 2014,* February 2015, p. 103. The contribution amount that is adequate to keep the unfunded liability from growing consists of the normal cost (the amount needed to cover the present value of benefits earned by system members in each fiscal year) plus interest on the unfunded liability. This contribution, while adequate to prevent growth in the unfunded liability, is not enough to pay down the unfunded liability.

201 Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2015*, August 1, 2014, p. 137.

Previous actions to reduce State pension obligations did not have a significant impact on funding requirements in the short term because they did not affect retirees or current employees. In April 2010, the State created a two-tier benefits system with less generous benefits for workers hired on or after January 1, 2011.[202] Tier 2 employees receive annual benefit increases of 3% or one-half of the annual increase in the Consumer Price Index (CPI), whichever is less. Tier 1 participants—current Illinois retirees and those hired before January 1, 2011—receive automatic annual increases of 3%. New workers' benefits grow more slowly over time because the annual increase is based on a simple rate, while the benefits of retirees and existing employees are increased based on a compounded rate.[203]

In December 2013 the State enacted a new pension law that lowers payments to retirees and employees mainly by reducing annual benefit increases.[204] The new law, which applies to four of the State's five pension systems, also raises retirement ages for younger workers, caps the salary on which pension benefits are based and requires the State to pay off its unfunded pension obligations more quickly and completely than the existing funding plan.[205] It is the State's first actuarially sound pension funding plan, designed to result in 100% funding over 30 years.

The new law was scheduled to take effect on June 1, 2014, but implementation has been blocked by legal challenges from labor unions, employees and retirees. A Sangamon County Circuit Court judge ruled in November 2014 that the law violated the pension protection clause of the Illinois Constitution.[206] The Illinois Supreme Court heard oral arguments in the case in March 2015 and is expected to issue a ruling by June. If upheld, the new law was expected to reduce required General Funds contributions by approximately $1.2 billion in FY2016.[207]

Governor Rauner's pension proposal would freeze Tier 1 benefits as of July 1, 2015. For work after that date, benefits would be paid at the lower Tier 2 level. As a result, benefits paid under Tier 1 do not increase with additional years on the job or salary increases. Although the actuarial analysis that was used to generate the savings estimates was not released with other budget materials, the administration has stated that the plan could cut the State's unfunded pension liability by approximately $25 billion.[208] The proposal applies to the same four retirement systems as the 2013 law and would not apply to public safety workers.

The Rauner administration believes that the new pension proposal could more easily withstand legal challenges than the 2013 law because it does not affect retirees or benefits already earned by

---

[202] Public Act 96-0889, signed on April 14, 2010. This legislation also applies to most non-public safety local government pension funds across the State.
[203] A simple rate increase applies the stated rate only to the initial benefit amount, while a compounded rate increase applies the stated rate to the initial benefit amount plus previously earned increases.
[204] Public Act 98-0599, signed on December 5, 2013.
[205] The new law applies to the Teachers' Retirement System (TRS), the State Employees' Retirement System (SERS), the State Universities Retirement System (SURS) and the General Assembly Retirement System (GARS). The Judges' Retirement System (JRS) is not affected.
[206] Illinois Constitution, Article XIII, Section 5, states: "Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."
[207] For more information on this calculation, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2016 Budget Roadmap: State of Illinois Budget Overview, Projections and Recommendations for the Governor and General Assembly*, February 12, 2015, p. 17, http://www.civicfed.org/sites/default/files/REPORT--FY2016IllinoisRoadmap.pdf (last visited on April 18, 2015).
[208] Illinois State FY2016 Budget, p. 2-17.

existing employees.[209] However, labor unions argue that the new proposal also violates the Illinois Constitution by reducing public pension benefits.[210]

Governor Rauner has also urged that the State's Constitution be amended to limit pension protections,[211] but the amendment process is neither quick nor easy.[212] Amending the Illinois Constitution requires a three-fifths vote of each chamber of the legislature. An approved proposal may be put on the ballot at the next general election that occurs six months after the General Assembly vote and requires the approval of three-fifths of those voting on the issue.[213] The next general election is scheduled for November 2016.

It should also be noted that many Tier 2 members are paying more than the full cost of their benefits, effectively subsidizing the State by helping to pay down the unfunded liability.[214] Tier 2 members of the Teachers' Retirement System, the State's largest pension fund, contribute 9.4% of their salary for pensions (the same as Tier 1 members), but the pension benefit is worth 7%.[215] TRS officials have argued that this subsidy might be considered an unconstitutional income tax that applies only to Tier 2 members.[216]

Another concern involves the possibility that Tier 2 members might eventually be required to be covered by Social Security, which currently does not apply to public school teachers in Illinois. Illinois law limits the growth of salary caps for Tier 2 benefits to a rate that is slower than the growth of the Social Security wage base. At some future time, Tier 2 benefits will not be high enough to meet the minimum standards for exemption from Social Security coverage.[217]

Medicaid

Medicaid is a joint federal-state program that funds medical services for certain categories of low income people, including children and their parents, the disabled and the elderly. For states like Illinois that chose to participate, the federal Affordable Care Act (ACA) extended Medicaid coverage to non-disabled, non-elderly adult citizens without dependent children beginning in January 2014.[218]

Illinois' Medicaid program involves several agencies and has no single, programmatic appropriation in the budget. The best approximation is the Medical Assistance Program at the Department of Healthcare and Family Services (HFS), the State's main Medicaid agency.[219] The Department of Human Services (DHS) and the Department on Aging also account for significant Medicaid spending, as discussed below.

---

[209] Illinois State FY2016 Budget, p. 2-16.
[210] Council 31 AFSCME, "AFSCME responds to Gov. Rauner's proposed budget," news release, February 18, 2015.
[211] Illinois State FY2016 Budget, p. 2-14.
[212] Paul Merrion, "Amending the Illinois Constitution a tough path for pension reform," *Crain's Chicago Business*, July 16, 2014.
[213] Illinois Constitution, Article XIV, Section 2(a).
[214] Teachers' Retirement System of the State of Illinois, *Actuarial Valuation Report: June 30, 2014*, January 22, 2015, p. 15.
[215] Teachers' Retirement System of the State of Illinois, *Topics & Report*, Winter 2015, pp. 1-2.
[216] Teachers' Retirement System of the State of Illinois, *Topics & Report*, Winter 2015, pp. 1-2.
[217] Teachers' Retirement System of the State of Illinois, *Topics & Report*, Winter 2015, pp. 1-2
[218] Cook County's public health system began enrolling Medicaid recipients who would be eligible under the ACA in its CountyCare program in February 2013 under a special agreement with the federal government. Medicaid also covers permanent legal residents.
[219] Roughly 10% of the Medical Assistance Program's appropriations are not part of Medicaid.

The FY2016 budget recommends General Funds appropriations of $6.24 billion to the Medical Assistance Program, a reduction of $893.2 million from a revised $7.13 billion in FY2015. The proposed FY2016 budget is $1.46 billion, or 19.0%, below the FY2016 autopilot budget of $7.70 billion.[220]

Because of the way Medicaid is financed, a reduction of $1.46 billion in appropriations does not reduce the State's operating deficit by the same amount. Medicaid is jointly funded by state and federal governments; in Illinois the federal government currently reimburses most State Medicaid spending at a rate of 50.76%. An exception involves the ACA expansion, which is reimbursed at 100% through calendar year 2016.[221] However, the ACA expansion is handled outside of General Funds in the Illinois budget.

At a federal reimbursement rate of 50.76%, a reduction in General Funds spending of $1 results in a loss of federal revenues of 50.76 cents and a net decline of 49.24 cents in the operating deficit. In the recommended FY2016 budget, the projected reduction in General Funds appropriations of $1.46 billion suggest a revenue loss of about $741 million and a net reduction of about $719 million in the operating deficit.

In addition to General Funds, the Medical Assistance Program receives funding from a number of Other State Funds sources, including rebates paid by prescription drug manufacturers, cigarette taxes and proceeds from the settlement of tobacco-related litigation. Other funding comes from special financing arrangements such as assessments and intergovernmental transfers that are structured to bring in federal matching funds for hospitals and local governments.

The following table shows appropriations to the Medical Assistance Program by fund in FY2012, FY2015 and in the FY2016 autopilot and recommended budgets. Total appropriations decline by $1.6 billion from $20.2 billion in the FY2016 autopilot budget to $18.6 billion in the recommended FY2016 budget. Other State Funds account for 66.5% of total appropriations in the proposed FY2016 budget, up from 53.9% in the FY2012 budget.

HFS Medical Assistance Program Appropriations: FY2012-FY2016 (in $ millions)

	FY2012	FY2015 Revised*	FY2016 Autopilot	FY2016. Rec.
General Funds	$ 6,716.6	$ 7,132.6	$ 7,701.6	$ 6,239.4
Other State Funds	$ 7,853.8	$ 12,735.9	$ 12,489.1	$ 12,395.9
Total	**$ 14,570.4**	**$ 19,868.5**	**$ 20,190.7**	**$ 18,635.3**

*As of April 2015.

Source: Illinois Department of Healthcare and Family Services, *HFS Appropriation Status Report FY2013*; Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget Overview*, February 18, 2015, p. 15; Illlinois State FY2016 Budget, p. 6-138; Communication between Civic Federation and the Governor's Office of Management and Budget.

The enacted FY2015 General Funds budget was understated by $600 million due to FY2015 costs that were funded in FY2014.[222] As part of budget-wide cuts of 2.25% to close an operating deficit

[220] Illinois State FY2016 Budget, p. 6-138.
[221] The federal reimbursement rate declines to 95% in 2017, 94% in 2018, 93% in 2019 and 90% in 2020 and thereafter.
[222] In FY2014 $600 million was appropriated from General Funds to be transferred to the Healthcare Provider Relief Fund and used to pay for FY2015 expenses.

in FY2015, the enacted FY2015 General Funds budget was reduced by $106 million.[223] This represented rate reductions of 16.75% for most healthcare providers for the last two months of FY2015. Hospitals avoided the full effect of the cuts by agreeing to an additional assessment, which requires the payment of $27 million instead of rate cuts of at least $55 million.[224] The effect on the State is the same because a reduction in State Medicaid spending of $55 million would have generated State savings of only about $27 million due to the loss of federal reimbursements.

The growth in Illinois' Medicaid program over the past few years has been mainly related to the ACA expansion, which has attracted more participants than originally projected. HFS initially expected 342,000 newly eligible individuals to sign up by the end of 2017; in fact, 570,000 had enrolled as of January 2015 and 650,000 are expected to participate by the end of FY2016.[225]

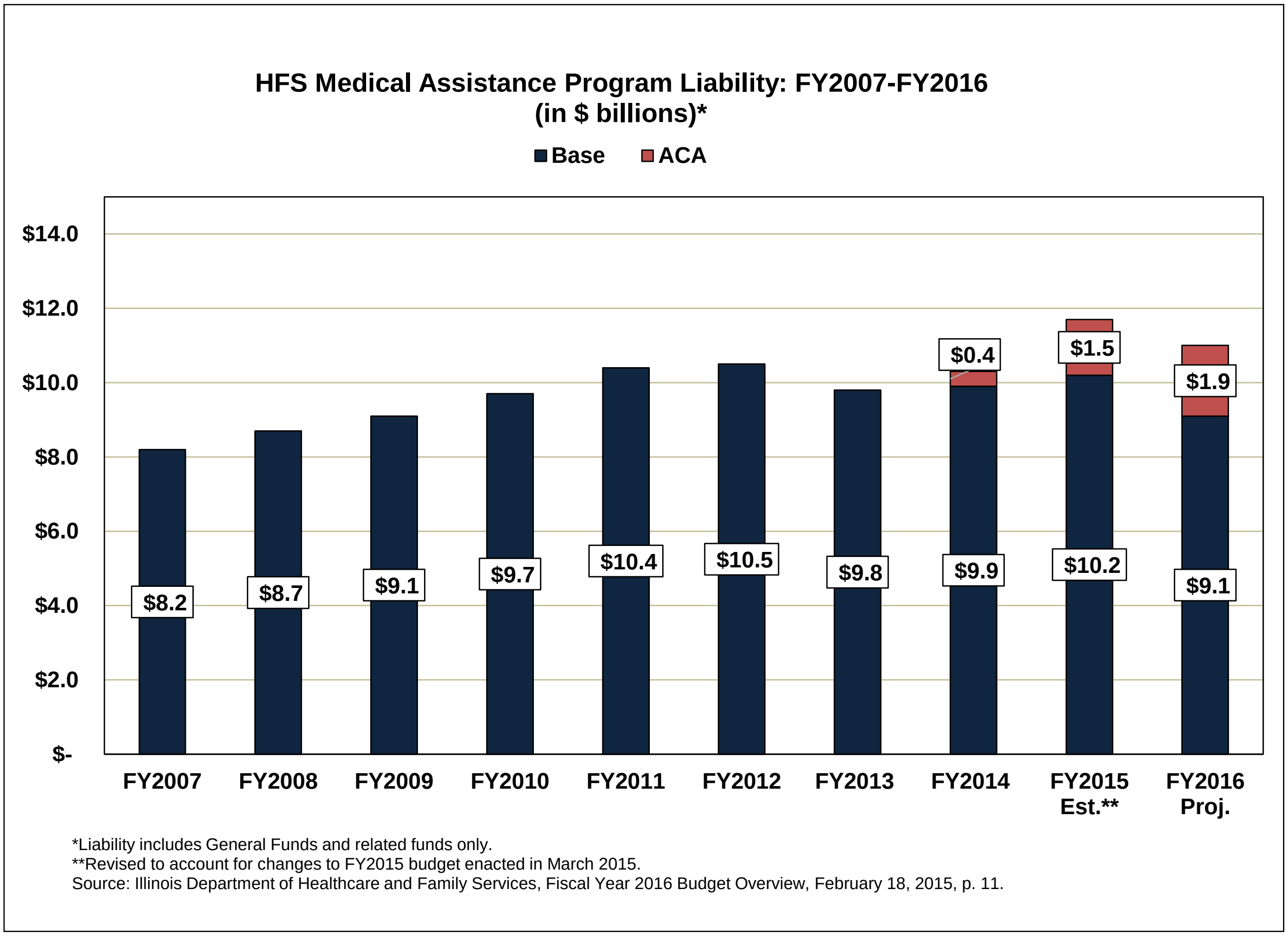
The increase in ACA recipients has offset a decline in other enrollment. While average monthly Medicaid enrollment increased by 509,020 to an estimated 3.29 million recipients in FY2015 from 2.78 million in FY2012, the number of non-ACA enrollees declined by 28,493.[226] That trend is expected to continue in FY2016, with an increase in total enrollment to 3.34 million masking a decline of nearly 61,000 in the number of non-ACA enrollees.

The ACA expansion has also fueled most of the cost increases in the Medical Assistance Program over the last few years, according to HFS.[227] Program liability (including costs covered by the federal government) increased to a projected $11.0 billion from $10.5 billion in FY2012. Base costs, excluding the impact of the ACA expansion, decline to a projected $9.1 billion in FY2016, while ACA-related costs increase to $1.9 billion.

---

[223] Communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, April 24, 2015. For more information on the FY2015 budget revisions, see page 25 of this report.
[224] Illinois Hospital Association, *State Advocacy Alert*, March 26, 2015.
[225] Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget* Overview, p. 8.
[226] Illinois Department of Healthcare and Family Services, Fiscal Year 2016 Budget Overview, p. 10.
[227] Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget Overview*, p. 11.

The following chart shows annual Medical Assistance liability from FY2007 through FY2016, not including special financial arrangements.



The decrease in Medical Assistance costs in FY2013 reflected a law passed in 2012 called the Saving Medicaid Access and Resources Together (SMART) Act.[228] That law was part of a plan designed to close a $2.7 billion gap in Medicaid funding by cutting costs and increasing revenues.

Base costs increased in FY2015 due to major Medicaid legislation in 2014 that restored certain benefits eliminated under the SMART Act and enhanced reimbursement to nursing homes and hospitals.[229] The General Funds impact in FY2015 was estimated at $221.5 million, of which $169.0 million represented rate increases and other payments to healthcare providers.[230] The cost for benefits was estimated at $52.5 billion, with $35.0 million of that amount for the restoration of adult dental benefits.

In the proposed FY2016 budget, the $1.46 billion in General Funds reductions include $320.8 million in rates and services added since the SMART Act; optional rates and services, not required by the federal government, of $290.6 million; and $734.9 million in supplemental payments to

[228] Public Act 97-0689, signed on June 14, 2012.
[229] Public Act 98-0651, signed on June 16, 2014.
[230] Illinois Department of Healthcare and Family Services, *Omnibus Medicaid Bill: Senate Bill 741, as Amended by House Amendment #1*, http://www2.illinois.gov/hfs/SiteCollectionDocuments/FY2015SB741.pdf (last visited on April 29, 2015).

hospitals.[231] The spending cuts generally require changes to State law and administrative rules and in some cases must be approved by the federal government.

The largest single savings—$400 million—involves the State's hospital assessment program, which brings in federal Medicaid revenues for hospitals. Under the program, assessments paid by hospitals are used to draw federal matching funds; most of the hospitals' payments, along with the federal reimbursements, are returned to the hospitals. In the FY2016 budget, $400 million of the amount that has gone back to the hospitals would instead be used by the State to offset General Funds costs. The proposal would require a change in State law, which currently states that hospitals will stop paying assessments if State payments are reduced.[232]

The $400 million per year that hospitals would lose is roughly the same amount they began receiving in FY2015 as part of the Medicaid legislation enacted in 2014.[233] In exchange for serving newly eligible Medicaid recipients under the ACA, who are reimbursed by the federal government at 100%, hospitals received a new pool of annual federal dollars known as the ACA 400.[234] This approximately $400 million is distributed to hospitals in the same way as money received in the assessment program.

Another proposed reduction in FY2016 would increase the eligibility threshold for elderly and disabled individuals to qualify for long-term care services. The Determination of Need (DON) score is used to evaluate an individual's care needs and to identify available resources for meeting those needs. The proposed increase in the DON score would require federal approval.

One of the programs affected by the change is the Department on Aging's Community Care Program, which is designed to keep seniors out of nursing homes by providing in-home services such as cleaning and meal preparation and community-based adult day services. The increase in the DON score—along with other changes—is projected to reduce the cost of the program by about $170 million[235] and eliminate services for thousands of seniors.[236] The program, which is partly covered by Medicaid, cost an average of $865 per person per month in FY2015,[237] while nursing home care costs three to four times that amount.[238] The same DON score applies to Medicaid-funded admission to nursing homes and eligibility for the Community Care Program. However, seniors who lose community services could see their health deteriorate, leading to increased emergency room visits and a greater likelihood of nursing home placement, according to advocates.[239]

The proposed increase in the DON score would also affect DHS' Home Services Program, which is mainly covered by Medicaid and provides support such as personal assistants for people under 60

[231] Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget Overview*, February 18, 2015, p. 14.
[232] 305 ILCS 5/5A-10 (d).
[233] Public Act 98-0651, signed on June 16, 2014.
[234] Illinois Department of Healthcare and Family Services, *Omnibus Medicaid Bill: Senate Bill 741, as Amended by House Amendment #1*, http://www2.illinois.gov/hfs/SiteCollectionDocuments/FY2015SB741.pdf (last visited on April 29, 2015).
[235] Illinois State FY2016 Budget, p. 6-63.
[236] Testimony of Department on Aging officials at House Human Services Appropriations Committee hearing on March 12. 2015.
[237] Illinois State FY2016 Budget, p. 6-64.
[238] Testimony of Department on Aging officials at House Human Services Appropriations Committee hearing on March 12. 2015.
[239] Communication between the Civic Federation and the Illinois Council of Care Coordination Units, April 30, 2015.

with severe physical disabilities. Along with other proposed changes, it is expected to reduce the cost of the program by $110.2 million.[240] Other reductions to the DHS budget would end respite services for families of the developmentally disabled and reduce community services for the mentally ill.[241]

The recommended FY2016 budget also proposes changes to Medicaid managed care. A State law enacted in 2011 required that half of Medicaid recipients be enrolled in managed care by January 1, 2015,[242] and more than 60% are expected to be enrolled by June 2015.[243] In May 2013, the General Assembly passed legislation that allowed hospitals to form their own networks to compete with traditional Health Maintenance Organizations (HMOs), which receive a fixed monthly fee, known as a capitation rate, for each Medicaid enrollee.[244] The new hospital networks, known as Accountable Care Entities or ACEs, would have moved to fully capitated payments over three years, with the State paying care coordination fees in the first 18 months.

The State also provided for the creation of more specialized Coordinated Care Entities (CCEs), which serve seniors and individuals with disabilities. Most CCEs receive a care coordination payment with a portion of the payment contingent on meeting quality outcome targets, while medical and other services are paid on a fee-for-service basis.

The FY2016 budget proposal eliminated fees to ACEs and CCEs, which was expected to reduce appropriations by $60 million.[245] The proposal would cause the newly formed managed care entities to disband, be folded into other organizations or agree to full capitation. Total enrollment in nine ACEs and eight CCEs stands at approximately 580,000.[246] The largest ACE, Advocate Accountable Care, with more than 95,000 enrollees, recently agreed to move to full capitation by the end of calendar year 2015. [247] The move is expected to reduce Medicaid spending by $5.1 million in FY2016.

---

[240] Illinois Department of Human Services, *Fiscal Year 2016 Budget Request: Agency Briefing*, February 18, 2015.
[241] Illinois Department of Human Services, *GRF Walk to DHS FY16 Introduced Budget*, https://www.dhs.state.il.us/page.aspx?item=77073 (last visited on April 30, 2015).
[242] Public Act 96-1501, signed on January 25, 2011.
[243] Illinois Department of Healthcare and Family Services, *Fiscal Year 2016 Budget Overview*, February 18, 2015, p. 5.
[244] Public Act 98-0104, signed on July 22, 2013.
[245] Communication between the Civic Federation and the Illinois Department of Healthcare and Family Services, April 30, 2015.
[246] Illinois Department of Healthcare and Family Services, "HFS and Advocate Health Care announce plan to ensure Medicaid coverage for nearly 100,000: Model Accountable Care Entity agreement serves taxpayers and clients," news release, April 16, 2015.
[247] Illinois Department of Healthcare and Family Services, "HFS and Advocate Health Care announce plan to ensure Medicaid coverage for nearly 100,000: Model Accountable Care Entity agreement serves taxpayers and clients," news release, April 16, 2015.

State Group Health Insurance

General Funds appropriations for the State Employees' Group Insurance Program are $1.195 billion in the proposed FY2016 budget. That represents a decrease of $370 million, or 23.6%, from $1.565 billion in FY2015 and a reduction of $655 million, or 35.4%, from $1.850 billion in the FY2016 autopilot budget.

The Rauner administration plans to achieve these spending reductions mainly through collective bargaining.[248] The State is currently in discussions with its largest union, Council 31 of the American Federation of State, County and Municipal Employees (AFSCME), on a new contract to replace an agreement that expires on June 30, 2015.[249] In FY2016 the proposed State savings would be achieved by more than doubling employees' average share of health insurance premiums to 40% from 17%.[250]

The State group insurance program provides health insurance coverage to employees, retirees and dependents of the State government, the General Assembly, the judiciary and State universities.[251] The program is expected to have 363,162 participants in FY2016, up slightly from 362,692 in FY2015.[252]

In FY2016 the total cost of the program is estimated at $2.8 billion, an increase of $177.1 million, or 6.8%, from $2.5 billion in FY2015.[253] In addition to support from General Funds and member contributions, resources for the program come from the State's Road Fund, other State funds and State universities.

The cost of the group health program declined by $30 million, or 1.1% in FY2015 from the previous year largely due to savings achieved in the current three-year AFSCME contract.[254] The current contract began on July 1, 2012, but was not executed until May 2013, when union members ratified an initial vote taken in March of that year. As a result, health insurance savings were not realized until FY2014.

In exchange for wage increases, AFSCME agreed to increased health insurance costs and other changes for both employees and retirees, including shifting Medicare-eligible retirees to Medicare Advantage plans.[255] The State initially projected health insurance savings of $903 million from the contract, which were partially offset by $222 million in wage increases.[256]

---

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

[249] The agreement with AFSCME has traditionally been used as a model for the State's other labor agreements.

[250] Testimony by officials of the Department of Central Management Services at a hearing of the Illinois General Assembly's Commission on Government Forecasting and Accountability, April 14, 2015.

[251] The program also provides life insurance at a relatively small cost to the State.

[252] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, p. 8.

[253] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, p. 5.

[254] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, pp. 2 and 10.

[255] Medicare Advantage plans are offered by private companies that contract with the federal government to provide Medicare benefits. In addition to Medicare benefits, Medicare Advantage plans provide State retirees with supplemental benefits similar to those offered by the State group insurance plan.

[256] Illinois Department of Central Management Services, *AFSCME 2012-2015 Contract Summary*, Submission to Commission on Government Forecasting and Accountability, April 16, 2013.

A major component of the contract was implementation of a law enacted in 2012 that eliminated premium-free health insurance coverage for retirees.[257] Approximately 91% of the more than 81,900 retirees covered by the State's group insurance program did not pay any health insurance premiums as of January 2011.[258]

The 2012 legislation that eliminated premium-free health coverage for retirees did not specify how retiree health insurance premiums would be determined, leaving that decision to the State's Department of Central Management Services (CMS). As part of the collective bargaining agreement with AFSCME that was signed in May 2013, retirees covered by Medicare were required to pay 1% of their pension benefit amount for health insurance and those not covered by Medicare were required to pay 2%. Those amounts doubled to 2% and 4% in FY2015.[259]

However, the Illinois Supreme Court rejected these changes in a ruling on July 3, 2014.[260] The high court held that State subsidies for retiree health insurance premiums are a pension benefit covered by the pension protection clause of the Illinois Constitution. Because of the ruling, the State agreed to refund $63 million in previously collected retiree health insurance premiums.[261] The State will also forgo estimated annual savings of $128 million.[262]

Despite the adverse ruling on retiree premiums, the State still expects significant savings on other health insurance-related changes for both retirees and employees under the current labor contract. Although CMS has not made available an updated breakdown of savings, officials have said that the move to Medicare Advantage plans saves the State approximately $300 million per year.[263]

Illinois' group health insurance program is relatively generous compared with other states, according to recent reports. A study by the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation found that in 2013 Illinois had the eighth highest average total premium per employee among the states and that only 14 other states paid a larger share of the total cost of employee premiums.[264] The study also found that the actuarial value or "richness" of Illinois' health

---

[257] Public Act 97-0695, signed on June 21, 2012. Before the 2012 changes, the State paid the entire bill for health insurance premiums for those who retired prior to 1998. For those who retired beginning in 1998, the State contributed 5% of the premium cost for each full year of service, up to a maximum of 100% for retirees with 20 or more years of service. General Assembly members and constitutional officers could retire with as few as four years of service and not pay any premiums, and judges could retire with as few as six years of service and not pay premiums.
[258] Commission on Government Forecasting and Accountability, *Request for Proposals to Provide Consulting Services*, February 17, 2011, p. 2.
[259] Illinois Department of Central Management Services, AFSCME Master Contract, Appendix B, http://www2.illinois.gov/cms/Employees/Personnel/Documents/emp_afscme_chg_appendixB.pdf (last visited on April 26, 2015).
[260] Illinois Supreme Court, *Kanerva v. Weems* (2014 IL 115811, July 3, 2014).
[261] "Doug Finke, "State retirees to get letters on insurance premium settlement," *State Journal-Register*, January 22, 2015.
[262] Communication between the Civic Federation and the Illinois Department of Central Management Services, February 24, 2015.
[263] Communication between the Civic Federation and the Illinois Department of Central Management Services, February 24, 2015. This savings figure includes State contributions to retiree health insurance programs for public school teachers and community college employees outside of Chicago, as well as for State employees.
[264] The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, *State Employee Health Plan Spending: An examination of premiums, cost drivers, and policy approaches*, August 2014 (updated September 2014), pp. 7-8.

insurance program—defined as required deductibles, copayments and coinsurance—at 93% was in line with the national average of 92%.[265]

The Pew and MacArthur study did not cover the time period including the Illinois program changes discussed above. However, State officials believe that the Illinois program is still relatively generous, particularly with respect to the coverage of dependents.[266] Based on current numbers for Illinois, 21 states paid a larger share of the total cost of employee health insurance premiums.[267] In the new labor agreement, the administration wants to increase the share of premiums paid by employees to 40% in FY2016. For later contract years, the administration has suggested reducing the actuarial value of the Illinois program to approximately 60%, the level of the least generous plan offered on insurance exchanges mandated by the federal Affordable Care Act.[268]

If budgeted savings cannot be negotiated or are not negotiated in time to take effect in FY2016, unpaid health insurance claims could increase significantly from the current FY2016 estimated backlog of $1.5 billion.[269] Required State interest payments on late bills could also increase in FY2016 from the current estimate of $103 million.[270]

As a result of insufficient funds, healthcare providers for State employees were waiting as long as 350 days to be paid in February 2015, according to COGFA.[271] Those delays could be extended significantly—to as long as 14 months for managed care companies—if budgeted savings are not realized.[272]

---

[265] The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, *State Employee Health Plan Spending: An examination of premiums, cost drivers, and policy approaches*, August 2014 (updated September 2014), p. 35. The percentage represents the share of the cost of covered services that a health plan pays for an average enrollee.
[266] Testimony by officials of the Illinois Department of Central Management Services at a hearing of the Illinois General Assembly's Commission on Government Forecasting and Accountability, April 14, 2015.
[267] This assumes that the percentages for other states in the Pew and MacArthur study did not change.
[268] Illinois State FY2016 Budget, p. 2-18.
[269] Group health insurance bills can be paid out of future year appropriations under an exception to Section 25 of the State Finance Act, 30 ILCS 105/25 (b-4).
[270] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, p. 10.
[271] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, p. 1.
[272] Commission on Government Forecasting and Accountability, *FY2016 Liabilities of the State Employees' Group Insurance Program*, March 2015, p. 1.

Expenditures

Expenditures from General Funds consist of net appropriations spent (appropriations minus unspent appropriations) and statutory transfers out. The next table shows General Funds expenditures in FY2012, estimated expenditures in FY2015 and recommended expenditures for FY2016. As previously noted, the FY2015 figures in the table are Civic Federation calculations based on the legislation.[273]

State of Illinois General Funds Expenditures: FY2012-FY2016 (in $ millions)							
	FY2012[1]	FY2015 Est. Revised[2]	FY2016 Rec.	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
Agency Appropriations	$ 24,011	$ 24,140	$ 22,775	$ (1,365)	-5.7%	$ (1,236)	-5.1%
(Unspent Appropriations)	$ (374)	$ (930)	$ (653)	$ 277	-29.8%	$ (279)	74.6%
Net Agency Appropriations Spent	$ 23,637	$ 23,210	$ 22,122	$ (1,088)	-4.7%	$ (1,515)	-6.4%
Pension Contributions	$ 4,135	$ 6,059	$ 4,472	$ (1,587)	-26.2%	$ 337	8.1%
State Group Insurance	$ 1,436	$ 1,565	$ 1,195	$ (370)	-23.6%	$ (241)	-16.8%
Net Appropriations Spent	**$ 29,208**	**$ 30,834**	**$ 27,789**	**$ (3,045)**	**-9.9%**	**$ (1,419)**	**-4.9%**
Statutory Transfers Out							
Legislatively Required Transfers	$ 2,473	$ 2,385	$ 1,569	$ (816)	-34.2%	$ (904)	-36.6%
Debt Service on Pension Bonds	$ 1,607	$ 1,502	$ 1,419	$ (83)	-5.5%	$ (188)	-11.7%
Other Debt Service[3]	$ 809	$ 690	$ 719	$ 29	4.2%	$ (90)	-11.1%
Total Transfers Out	**$ 4,889**	**$ 4,577**	**$ 3,707**	**$ (870)**	**-19.0%**	**$ (1,182)**	**-24.2%**
Total Expenditures[4]	**$ 34,097**	**$35,411**	**$31,495**	**$ (3,916)**	**-11.1%**	**$ (2,602)**	**-7.6%**

[1]FY2012 agency appropriations in this table are somewhat higher than in previous tables because of continuing appropriations for pensions and retiree health insurance that were not included in previous tables.
[2]As of April 2015.
[3]Includes $356 million in interfund borrowing repayment in FY2012.
[4]Totals may not add due to rounding.
Source: State of Illinois, General Obligation Bonds, Series of May 2014, *Supplement to the Official Statement* , July 18, 2014, Table 1; Illinois State FY2014 Budget, p. 2-29; Illinois State FY2016 Budget, pp. 3-6 to 3-7 and 3-27; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

Total proposed expenditures of $31.5 billion in FY2016 represent a decrease of $3.9 billion from estimated FY2015 and $2.6 billion from FY2012. The two-year spending reduction consists of a $3.0 billion decline in spent appropriations and an $870 million decrease in transfers out. The FY2015 appropriation figure is understated by $1.0 billion due to funding shifts, as previously discussed.

Transfers out include debt service payments on bonds and a wide variety of legislatively required transfers. Debt service transfers for pension bond payments is expected to decline by $83 million in FY2016 to $1.4 billion due to the full retirement of bonds sold in 2010.[274]

[273] Public Acts 99-0001 and 99-0002, enacted on March 27, 2015.
[274] For more information on debt service, see page 68 of this report.

Legislatively required transfers decline by 34.2% to $1.6 billion in the proposed FY2016 budget from an estimated $2.4 billion in FY2015. The next table shows legislatively required transfers in FY2012, FY2015 and FY2016, ranked by their estimated amounts in FY2015.

State of Illinois Legislatively Required General Funds Transfers Out by Fund: FY2012-FY2015 (in $ millions)							
Fund	FY2012	FY2015 Est.	FY2016 Rec.	2-Year $ Change	2-Year % Change	5-Year $ Change	5-Year % Change
Local Government Distributive	$ 1,095.3	$ 1,201.4	$ 634.0	$ (567.4)	-47.2%	$ (461.3)	-42.1%
Public Transportation	$ 437.8	$ 496.2	$ 384.8	$ (111.4)	-22.5%	$ (53.0)	-12.1%
Downstate Public Transportation	$ 170.2	$ 220.6	$ 150.0	$ (70.6)	-32.0%	$ (20.2)	-11.9%
Workers' Compensation Revolving	$ 100.2	$ 96.8	$ 104.1	$ 7.3	7.5%	$ 3.9	3.9%
School Infrastructure	$ 65.1	$ 91.1	$ 87.0	$ (4.1)	-4.5%	$ 21.9	33.6%
Tourism Promotion	$ 30.4	$ 50.4	$ 42.0	$ (8.4)	-16.7%	$ 11.6	38.2%
University of Illinois Hospital Services	$ 45.0	$ 45.0	$ 20.0	$ (25.0)	-55.6%	$ (25.0)	-55.6%
Metropolitan Exposition, Auditorium and Office Building	$ 37.9	$ 37.9	$ 27.9	$ (10.0)	-26.4%	$ (10.0)	-26.4%
Agricultural Premium	$ 23.8	$ 23.8	$ 21.8	$ (2.0)	-8.4%	$ (2.0)	-8.4%
Live and Learn	$ 20.9	$ 20.9	$ 20.9	$ -	0.0%	$ -	0.0%
Audit Expense	$ 17.9	$ 17.6	$ 19.0	$ 1.4	8.0%	$ 1.1	6.1%
Metropolitan Pier and Exposition Authority Incentive	$ -	$ 14.7	$ 15.0	$ 0.3	2.0%	$ 15.0	na
Coal Technology Development	$ 7.6	$ 14.6	$ -	$ (14.6)	-100.0%	$ (7.6)	-100.0%
Presidential Library and Museum	$ 8.0	$ 10.0	$ 8.0	$ (2.0)	-20.0%	$ -	0.0%
Partners for Conservation	$ 12.2	$ 14.0	$ -	$ (14.0)	-100.0%	$ (12.2)	-100.0%
Professional Services	$ 9.2	$ 6.3	$ 9.9	$ 3.6	57.1%	$ 0.7	7.6%
Convention Center Support	$ -	$ 5.0	$ 5.0	$ -	0.0%	$ 5.0	na
All Others	$ 391.9	$ 18.7	$ 19.1	$ 0.4	2.1%	$ (372.8)	-95.1%
Total	**$ 2,473.4**	**$ 2,385.0**	**$ 1,568.5**	**$ (816.5)**	**-34.2%**	**$ (904.9)**	**-36.6%**

Source: Illinois State FY2016 Budget, pp. 3-52 to 3-53; Communication between Civic Federation and Governor's Office of Management and Budget, September 27, 2012.

The largest legislatively required transfer is to the Local Government Distributive Fund, which receives the share of State income taxes that is distributed to local governments. The share had been 10% but was lowered in January 2011 after income tax rates were temporarily increased, so that the State could get the full benefit of the higher rates. Local governments currently receive 8.0% of individual income tax revenues and 9.14% of corporate tax rates.[275] The proposed FY2016 budget cuts the share in half, which would reduce this source of funding to local governments to $634 million from an estimated $1.2 billion in FY2015. The City of Chicago receives approximately 21% of the funding.[276]

Other major reductions from FY2015 involve funding for the Regional Transportation Authority and transit districts outside of the Chicago area, which are cut by a total of $182.0 million from $716.7 million to $534.8 million. Resources for the Tourism Promotion Fund are reduced by $8.4 million, or 16.7%, and the Illinois Thoroughbred Breeders Fund (which isn't shown in the table) is cut by 87.4%, from $1.7 million to $211,000. Funding for other accounts, including the Coal Technology Development and Partners for Conservation Funds, is entirely eliminated.

---

[275] 35 ILCS 5/901(b).

[276] For more information on the Local Government Distributive Fund, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation blog, http://www.civicfed.org/iifs/blog/governor-proposes-significant-reduction-funding-local-governments (last visited on April 26, 2015).

The following table compares total expenditures in the FY2016 proposed and autopilot budgets. Pension contributions are overstated in the FY2016 autopilot budget because they are not reduced by transfers from the State Pensions Fund.

State of Illinois General Funds Expenditures: FY2016 Autopilot and Recommended (in $ millions)				
	FY2016 Autopilot	**FY2016** Rec.	**$ Change**	**% Change**
Agency Appropriations	$ 25,178	$ 22,775	$ (2,403)	-9.5%
(Less Unspent Appropriations)	$ (251)	$ (653)	$ (402)	160.2%
Net Agency Appropriations Spent	$ 24,927	$ 22,122	$ (2,805)	-11.3%
Pension Contributions*	$ 6,822	$ 4,472	$ (2,350)	-34.4%
State Group Insurance	$ 1,850	$ 1,195	$ (655)	-35.4%
Net Appropriations Spent	**$ 33,599**	**$ 27,789**	**$ (5,810)**	**-17.3%**
Statutory Transfers Out			$ -	na
Legislatively Required Transfers	$ 2,482	$ 1,569	$ (913)	-36.8%
Debt Service on Pension Bonds	$ 1,419	$ 1,419	$ -	0.0%
Debt Service on Capital Bonds	$ 710	$ 719	$ 9	1.3%
Total Statutory Transfers Out	**$ 4,611**	**$ 3,707**	**$ (904)**	**-19.6%**
Total Expenditures	**$ 38,210**	**$ 31,496**	$ (6,714)	-17.6%

*In FY2016 Autopilot, no transfers are assumed from the State Pensions Fund. Such transfers amounted to $198 million in FY2014 and $197 million in FY2015 and are projected at $150 million in FY2016.

Source: Illinois State FY2016 Budget, pp. 3-6, 3-27 and 6-74.

Total expenditures decline by $6.7 billion from $38.2 billion in the FY2016 autopilot budget to $31.5 billion in the proposed FY2016 budget. The decrease consists of a $5.8 billion reduction in net appropriations spent and a $904 million reduction in transfers out. A breakdown of the legislatively required transfers in the autopilot budget was not included in the budget document.

Budget Deficit and Unpaid Bills

The recommended FY2016 budget results in a projected total General Funds deficit of $3.5 billion at the end of the fiscal year and a backlog of unpaid bills of $5.3 billion.[277]

The total deficit is the sum of the operating surplus or deficit and the accumulated deficit from prior years. The proposed FY2016 budget shows an operating surplus of $505 million. After deducting the surplus from the accumulated deficit from prior years of $4.0 billion, the total deficit declines to $3.5 billion. The autopilot budget for FY2016 has an operating deficit of $6.2 billion due to the significantly higher spending levels than the recommended FY2016 budget and results in a total deficit of $10.1 billion.

The State has not issued an official update of the FY2015 budget plan since legislation to balance the budget was passed in March 2015; the figures in the table are Civic Federation calculations based on the legislation.[278] The operating deficit of $24 million in FY2015 represents the Civic Federation's assessment of actions taken as of April 2015. The gap could be eliminated through additional spending cuts or revenue increases during the remainder of the fiscal year.

[277] Illinois State FY2016 Budget, pp. 3-6 to 3-7; Civic Federation calculations.
[278] Public Acts 99-0001 and 99-0002, signed on March 27, 2015.

The following table shows the State's General Funds budget plan for FY2012, FY2015 and for the FY2016 autopilot and recommended budgets.

State of Illinois General Funds Budget Results and Plans: FY2012-FY2016 (in $ millions)				
	FY2012	FY2015 Est. Revised[1]	FY2016 Autopilot	FY2016 Rec.
Operating Revenues				
State Source Revenues	$ 29,939	$ 30,393	$ 27,641	$ 28,699
Federal Revenues	$ 3,681	$ 3,676	$ 4,408	$ 3,301
Fund Sweeps to Fix FY2015 Budget	$ -	$ 1,318	$ -	$ -
Total Operating Revenues	**$ 33,620**	**$ 35,387**	**$ 32,049**	**$ 32,000**
Operating Expenditures				
Appropriations				
Agency Appropriations	$ 24,011	$ 24,140	$ 25,178	$ 22,775
(Unspent Appropriations)	$ (374)	$ (930)	$ (251)	$ (653)
Net Agency Appropriations Spent	$ 23,637	$ 23,210	$ 24,927	$ 22,122
Pension Contributions[2]	$ 4,135	$ 6,059	$ 6,822	$ 4,472
State Group Insurance	$ 1,436	$ 1,565	$ 1,850	$ 1,195
Total Appropriations Spent	$ 29,208	$ 30,834	$ 33,599	$ 27,789
Statutory Transfers Out				
Legislatively Required Transfers	$ 2,473	$ 2,385	$ 2,482	$ 1,569
Debt Service on Pension Bonds	$ 1,607	$ 1,502	$ 1,419	$ 1,419
Other Debt Service[3]	$ 809	$ 690	$ 710	$ 719
Total Statutory Transfers Out	$ 4,889	$ 4,577	$ 4,611	$ 3,707
Total Operating Expenditures[4]	**$ 34,097**	**$ 35,411**	**$ 38,210**	**$ 31,495**
Operating Surplus (Deficit)	**$ (477)**	**$ (24)**	**$ (6,161)**	**$ 505**
Accumulated Deficit from Prior Years	$ (4,507)	$ (3,931)	$ (3,955)	$ (3,955)
Total Deficit	**$ (4,507)**	**$ (3,955)**	**$ (10,116)**	**$ (3,450)**

[1]As of April 2015.

[2]In FY2016 Autopilot, no transfers are assumed from the State Pensions Fund. Such transfers amounted to $198 million in FY2014 and $197 million in FY2015 and are projected at $150 million in FY2016.

[3]In FY2012 includes $356 million in interfund borrowing repayment.

[4]Totals may not add due to rounding.

Source: State of Illinois, General Obligation Bonds, Series of May 2014, *Supplement to the Official Statement* , July 18, 2014, Table 1; Illinois State FY2014 Budget, p. 2-29; Illinois State FY2016 Budget, pp. 3-6 to 3-7 and p. 3-27; Public Acts 99-0001 and 99-0002; Civic Federation calculations.

Illinois has dealt with its General Funds deficits by delaying payments owed to vendors, social service agencies, pension funds, school districts and other units of government and making those payments from the next year's revenues. Since FY2010 the State has been allowed to wait until December 31—six months after the end of the fiscal year—to make payments covered by the current year's appropriations.[279] At the end of FY2016, General Funds bills and other payables

[279] 30 ILCS 105/25 (b-2), (b-2.5), (b-2.6) and (m).

would be $3.5 billion under the Governor's recommended budget, down from an estimated $4.0 billion at the end of FY2015.[280]

Other General Funds liabilities are not part of General Funds payables but represent obligations that must be paid from future years' revenues. In general, Section 25 of the State Finance Act requires that bills incurred in a given year be based on that year's appropriations.[281] Under exceptions to Section 25, however, these liabilities can be based on future years' appropriations. This has allowed the State to mask budget deficits by appropriating an insufficient amount to cover costs in one year, knowing that remaining bills could be paid in the next year. The ability to defer Medicaid bills in this way was curtailed by legislation enacted in 2012.[282] The law limited Section 25 liabilities incurred by the State's principal Medicaid agency, the Illinois Department of Healthcare and Family Services, to $700 million in FY2013 and $100 million thereafter, with certain exceptions.[283] Group health insurance liabilities were not limited by the new law.

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

In recent years the State has also accumulated unpaid income tax refunds, an additional General Funds liability that is not a General Funds payable. Unpaid tax refunds, primarily owed to businesses, peaked at $735 million at the end of FY2010.

In addition, the State owes approximately $63 million in back wages to union employees as a result of a dispute over cancelled raises.[284] A Cook County Circuit Court judge in December 2012 ordered the State to pay the back wages when funds were available, and then Governor Pat Quinn agreed to make the payments as part of contract negotiations with the American Federation of State, County and Municipal Employees (AFSCME).[285] The State paid $50 million of the amount owed under legislation enacted in June 2014.[286]

---

[280] For more information, see the Institute for Illinois' Fiscal Sustainability at the Civic Federation, *State of Illinois FY2015 Recommended Operating Budget: Analysis and Recommendations*, May 13, 2014, p. 34.
[281] 30 ILCS 105/25.
[282] Public Act 97-0691, signed on June 14, 2012.
[283] The main exception relates to costs incurred by the end of the fiscal year but not recorded until after June 30.
[284] 99th Illinois General Assembly, House Bill 3763, filed on February 26, 2015.
[285] John O'Connor, "Quinn wants attorney general to drop back-pay lawsuit," *State Journal-Register*, April 25, 2013.
[286] Public Act 98-0675, signed with a line-item veto on June 30, 2014, pp. 1139-1140.

The next table provides estimates of General Funds payables and other General Funds liabilities in FY2012, FY2015 and in the autopilot and recommended FY2016 budgets.

State of Illinois Estimated General Funds Unpaid Bill Backlog at Fiscal Year End: FY2012-FY2016 (in $ millions)				
	FY2012	FY2015 Est.	FY2016 Autopilot	FY2016 Rec.
General Funds Payables	**$ 5,024**	**$ 4,029**	**$ 10,190**	**$ 3,524**
Other General Funds Liabilities				
Healthcare and Family Services	$ 2,100	$ 420	$ 220	$ 220
Human Services	$ 201	$ -	$ -	$ -
Community Care	$ 173	$ -	$ -	$ -
Group Health Insurance	$ 1,183	$ 1,488	$ 1,488	$ 1,488
Income Tax Refunds	$ 72	na	na	na
Back Wages Owed	$ -	$ 63	$ 63	$ 63
Total Other General Funds Liabilities	**$ 3,729**	**$ 1,971**	**$ 1,771**	**$ 1,771**
Total	**$ 8,753**	**$ 6,000**	**$ 11,961**	**$ 5,295**

Source: Civic Federation calculations based on State of Illinois, General Obligation Bonds, Series of May 2014, *Supplement to the Official Statement,* July 18, 2014, Tables 1 and 1A; Illinois State FY2016 Budget, pp. 3-6 to 3-7; State of Illinois General Obligation Bonds, Series of May 2014, *Official Statement* , April 25, 2014, pp. 54-55; Illinois State FY2015 Budget, p. 2-23; Illinois Office of the Comptroller, Section 25 Deferred Liabilities, http://www.ioc.state.il.us/index.cfm/fiscal-condition/section-25/download-pdf-section-25-deferred-liabilities-in-thousands/; Communications between Civic Federation and Governor's Office of Management and Budget and Illinois Department of Revenue.

Total unpaid bills decline to approximately $5.3 billion at the end of FY2016 under the proposed budget, down from $6.0 billion at the end of FY2015. Under the autopilot budget for FY2016, the backlog of bills would grow to $12.0 billion.

Debt Burden and Ratings

In FY2016 the State of Illinois will pay debt service totaling $3.4 billion due on $29.6 billion of principal owed for all outstanding General Obligation Bonds and Build Illinois Bonds.[287] The State currently owes $15.2 billion in interest on these bonds through FY2039 for a total outstanding debt service cost of $44.8 billion.

Although the total debt service represents the entire annual payment due to bond holders during the fiscal year, only a portion of the repayment is made through a transfer from the General Funds. The remaining amounts are paid through transfers from Other State Funds that are funded through separate designated revenue sources. Build Illinois Bonds are paid through sales taxes diverted outside the General Funds and through the Capital Projects Fund. The General Funds debt service transfer for FY2016 totals $2.1 billion, or 7.4% of State-source General Funds resources.

Total Debt

The State is authorized under the General Obligation Bond Act to issue bonds to fund a variety of capital investments including roads, schools, mass transit, environmental projects and other

[287] State of Illinois General Obligation Bonds, Series May 2014, *Official Statement*, April 25, 2014, p. 53, State of Illinois, Build Illinois Bonds, Series March 2014, *Official Statement*, March 11, 2014, p. 20.

facilities.[288] In 2003 the State amended the act to include the authorization to issue Pension Obligation Bonds (POBs), used to increase the assets in its pension funds and make the required annual contributions to the State's five retirement systems. General Obligation (GO) bonds are guaranteed by a pledge of the full faith and credit of the State, which is a legally binding pledge to pay both principal and interest on these loans as required by the bond agreements prior to any other use of State funds.

The State has not yet issued GO bonds in FY2015 and anticipates the possibility of issuing $250 million before the end of the fiscal year.[289] The State authorized issuing an additional $600 million in GO bonds for capital purposes and $1.1 billion in GO bonds for transportation projects in 2015 that have yet to be issued.[290] A total of $3.7 billion in capital GO bonds was issued during FY2014.[291]

Total outstanding capital purpose GO bonds decreased by $192.4 million to $14.1 billion in FY2016 from $14.3 billion in FY2015.[292] The interest owed on the State's outstanding capital-purpose GO bonds decreased by $324.0 million to $7.6 billion in FY2016 from $7.9 billion in FY2015. The combined total debt service owed on all outstanding capital GO bonds totals $21.7 billion in FY2016 compared to $22.3 billion in FY2015.

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

Interest on the $3.5 billion of POBs sold in FY2010 totaled $382 million over five years. The FY2011 bonds, which totaled $3.7 billion, cost the State a total of $1.3 billion of interest over eight years.[293] The FY2011 pension debt included $234 million more principal than the FY2010 POBs, or 6.8%, but the interest owed on the bonds was $897.5 million greater, or 234.8%. The significant increase in the borrowing costs is due to the structure of the FY2011 bonds, which backload the principal repayment into the later years of the bonds and pays mostly interest only until the FY2010 bonds will be completely paid off in FY2015. In FY2016 principal payments on the FY2011 POBs increase by $300 million to $600 million from $300 million in FY2015. Interest payments decline on the FY2011 POBs to $181.9 million in FY2016 from $195.5 million in FY2015, for a combined debt service increase of $286.4 million.

The FY2003 POBs are also backloaded. The State paid interest only on the loan through FY2007. Then annual principal amounts increased to $50 million per year from FY2008 through FY2011 and to $100 million per year from FY2012 through FY2016. Beginning in FY2017, principal

---

[288] 30 ILCS 330/1.
[289] Commission on Government Forecasting and Accountability, *State of Illinois Capital Plan Analysis FY2016*, p. 22.
[290] P.A. 98-0781
[291] Commission on Government Forecasting and Accountability, *State of Illinois Capital Plan Analysis FY2016*, p. 22.
[292] Illinois State FY2016 Budget p. 7-10.
[293] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2015*, August, 1 2014, p 194.

repayment increases annually by increments of $25 million, $50 million or $100 million through FY2033, when $1.1 billion is due in the final year of the loan. More than 75% of the principal borrowed will be repaid in the final 10 years of the debt service schedule leading to interest cost of $11.9 billion over 30 years due on the original $10 billion of borrowed funds.

Total principal owed on all outstanding POBs in FY2016 totals to $12.7 billion, a decrease of $1.3 billion from the total of $14.0 billion in FY2015.[294] The outstanding interest owed on the pension debt declined by $704.7 million to $6.5 billion in FY2016 from $7.2 billion in FY2015. The remaining debt service, including principal and interest, on the State's pension bonds totals $19.2 billion in FY2016 compared to $21.2 billion in FY2015. The State has not issued new POBs since FY2011.

Illinois also depends on several types of revenue bonds to fund capital projects. Unlike GO bonds, revenue bonds are not guaranteed by the full faith and credit of the State but rather pledge a portion of specific state revenues. The largest ongoing revenue bonds are the Build Illinois Bond issuances, which began in 1985. Build Illinois Bonds are backed by a pledge of the State's portion of sales tax receipts.[295] The total bond authorization has been increased by the General Assembly on several occasions since the late 1980s. The State issued a total of $402 million in new Build Illinois Bonds in FY2014 but does not anticipate selling additional bonds under the program in FY2015.[296]

Beginning in FY2010, the new Build Illinois Bonds sold to support the *IllinoisJobsNow!* capital spending program also receive a transfer from the Capital Projects Fund to pay for the increase in debt service. Although the new Build Illinois Bonds are structured to receive additional funding from the revenue package of taxes and fees approved in 2009 to fund the increased capital appropriations, the bonds are still backed by the State's sales tax revenues.[297] The State is required to transfer the larger of 3.8% of its share of the sales taxes collected each year or the certified annual debt service owed on all outstanding Build Illinois Bonds.

In FY2016 the State owes outstanding principal on Build Illinois Bonds totaling $2.7 billion compared to $3.0 billion in FY2015. Interest on the loans totals $1.1 billion in FY2016, which is an decrease of $136.6 million from a total of $1.2 billion in FY2015. Total debt service on all outstanding Build Illinois Bonds decreased by $370.0 million to $3.8 billion in FY2016 from $4.2 billion in FY2014.

[294] Illinois State FY2016 Budget, p. 7-10.
[295] Build Illinois Bond Act, 30 ILCS 425.
[296] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2014*, August 2013, p 191.
[297] For more information on the State capital budget see page 72 of this report.

The following chart shows the total principal, interest and debt service in FY2016 compared to FY2015 for all GO bonds and Build Illinois Bonds currently outstanding.

State of Illinois Total Outstanding General Obligation and Build Illinois Bonds FY2015 and FY2016 (in $ millions)*				
	FY2015	**FY2016**	**$ Change**	**% Change**
Principal				
GO Capital	$14,337.3	$14,144.9	$ (192.4)	-1.34%
GO Pension	$13,975.2	$12,700.0	$ (1,275.2)	-9.12%
Build Illinois	$ 2,982.3	$ 2,748.9	$ (233.4)	-7.83%
Total Principal	**$31,294.8**	**$29,593.8**	**$ (1,701.0)**	**-5.44%**
Interest				
GO Capital	$ 7,923.8	$ 7,599.7	$ (324.0)	-4.09%
GO Pension	$ 7,245.4	$ 6,540.7	$ (704.7)	-9.73%
Build Illinois	$ 1,220.9	$ 1,084.3	$ (136.6)	-11.19%
Total Interest	**$16,390.0**	**$15,224.7**	**$ (1,165.3)**	**-7.11%**
Debt Service				
GO Capital	**$22,261.1**	**$21,744.6**	**$ (516.4)**	**-2.32%**
GO Pension	**$21,220.6**	**$19,240.7**	**$ (1,979.9)**	**-9.33%**
Build Illinois	**$ 4,203.2**	**$ 3,833.2**	**$ (370.0)**	**-8.80%**
Total	**$47,684.9**	**$44,818.6**	**$ (2,866.3)**	**-6.01%**

*At the beginning of the fiscal year, does not include $250 million GO Bond issuance anticipated before the end of FY2015.

Source: Illinois State FY2016 Budget, p. 7-10; General Obligation Bonds, Series May 2014, *Official Statement* , April 25, 2014, p. 53, State of Illinois, Build Illinois Bonds, Series March 2014, *Official Statement* , March 11, 2014, p. 20; State of Illinois, General Obligation Bonds, Series of June 2013, Official Statement, June 26, 2013, p. 50; State of Illinois, Build Illinois Bonds, Junior Obligation Series of June 2013, *Official Statement* , June 15, 2013, p. 18.

The State of Illinois has paid off more principal debt than it has issued over the last five fiscal years leading to a decline of $279.1 million in outstanding principal in FY2016, from the FY2012 total of $29.9 billion. However, the ongoing capital program has led to an increase of capital purpose principal debt of more than $2.7 billion in additional GO bonded debt and $577.7 million in Build Illinois debt compared to FY2012. This increase is offset by repayment of $3.6 billion in POB principal outstanding, which totals $12.7 billion compared to $16.3 billion in FY2012. The State plans to issue an additional $1.1 billion in additional GO bonds in FY2016 and $200 million of Build Illinois Bonds.[298]

Interest owed on the State's outstanding debt has declined by $1.2 billion over the same period, primarily due to the increased interest payments on the State's outstanding POB issuances over the last five years. Interest owed on POBs is $3.0 billion less in FY2016 totaling $6.5 billion compared to $9.5 billion in FY2012. Interest owed on all outstanding GO capital bonds has increased by $1.7 billion to $7.6 billion in FY2016, compared to $5.9 billion in FY2012. Build Illinois Bond interest is $124.1 million higher, totaling $1.1 billion in FY2016 compared to $960.2 million in FY2012.

[298] Commission on Government Forecasting and Accountability, *State of Illinois Capital Plan Analysis FY2016*, p. 22.

The following chart compares the outstanding principal, interest and total debt service on all Build Illinois Bonds, GO capital bonds and POBs from FY2012 to FY2016.

State of Illinois Total Outstanding Debt Service: General Obligation and Build Illinois Bonds Five-Year Comparison FY2012 to FY2016 (in $ millions)*							
	FY2012	**FY2013**	**FY2014**	**FY2015**	**FY2016**	**5-year $ Change**	**5-year % Change**
Principal							
GO Capital	$11,428.9	$12,071.4	$13,487.5	$ 14,337.3	$14,144.9	$ 2,716.0	23.8%
GO Pension	$16,272.8	$15,479.0	$14,686.4	$ 13,975.2	$12,700.0	$ (3,572.8)	-22.0%
Build Illinois	$ 2,171.2	$ 2,896.3	$ 2,798.9	$ 2,982.3	$ 2,748.9	$ 577.7	26.6%
Total Principal	**$29,872.9**	**$30,446.7**	**$30,972.9**	**$ 31,294.8**	**$29,593.8**	**$ (279.1)**	**-0.9%**
Interest							
GO Capital	$ 5,917.6	$ 6,009.1	$ 7,576.5	$ 7,923.8	$ 7,599.7	$ 1,682.2	28.4%
GO Pension	$ 9,538.8	$ 8,754.1	$ 7,986.3	$ 7,245.4	$ 6,540.7	$ (2,998.1)	-31.4%
Build Illinois	$ 960.2	$ 1,328.7	$ 1,133.6	$ 1,220.9	$ 1,084.3	$ 124.1	12.9%
Total Interest	**$16,416.6**	**$16,091.9**	**$16,696.4**	**$ 16,390.0**	**$15,224.7**	**$ (1,191.8)**	**-7.3%**
Debt Service							
GO Capital	**$17,346.5**	**$18,080.5**	**$21,064.1**	**$ 22,261.1**	**$21,744.6**	**$ 4,398.2**	**25.4%**
GO Pension	**$25,811.6**	**$24,233.1**	**$22,672.7**	**$ 21,220.6**	**$19,240.7**	**$ (6,570.9)**	**-25.5%**
Build Illinois	**$ 3,131.4**	**$ 4,225.0**	**$ 3,932.5**	**$ 4,203.2**	**$ 3,833.2**	**$ 701.8**	**22.4%**
Total	**$46,289.5**	**$46,538.6**	**$47,669.2**	**$ 47,684.9**	**$44,818.6**	**$ (1,470.9)**	**-3.2%**

*As the beginning of the fiscal year.

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

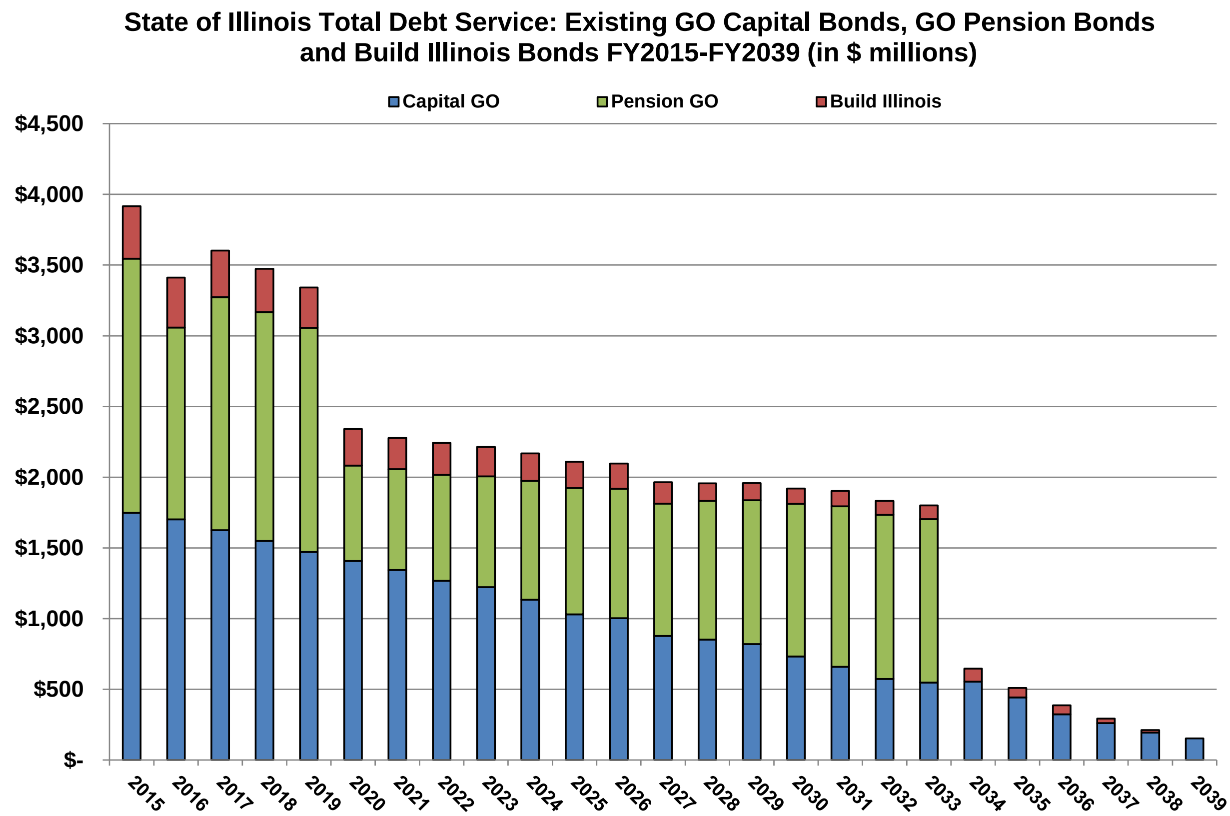
Debt Service

The State's debt service schedule sets forth the principal and interest amounts due to investors for its outstanding bonds on an annual basis. In FY2016 the State is required to pay a total of $3.4 billion for all outstanding GO bonds, POBs and Build Illinois Bonds.[299] The largest portion of this payment is due on capital purpose GO bonds totaling $1.7 billion. Debt service in FY2016 totals $1.4 billion for POBs and $353.7 million for Build Illinois Bonds.

Based on the State's current bonded indebtedness, debt service payments peaked in FY2015 but will only decline marginally through FY2019 to $3.3 billion. Once the State has paid off the FY2011 POBs, debt service declines by $1.0 billion to $2.3 billion in FY2020.

[299] State of Illinois General Obligation Bonds, Series May 2014, *Official Statement*, April 25, 2014, p. 53, State of Illinois, Build Illinois Bonds, Series March 2014, *Official Statement*, March 11, 2014, p. 20.

The following chart shows total debt service for existing Pension Obligation bonds, GO capital bonds and other capital bonds through FY2039.[300]



Source: Illinois State FY2016 Budget, p. 7-10; State of Illinois, Build Illinois Bonds, Series March 2014, *Official Statement*, March 11, 2014, p. 20.

300 For more details on total debt service, see Appendix A on page 78 of this report.

As noted above, the State does not pay for all debt service out of General Funds. Revenue bonds have specific dedicated sources outside the General Funds. GO capital bonds are funded through transfers from the Road Fund, Capital Projects Fund, School Infrastructure and State Construction Fund, in addition to the General Funds.

The enacted FY2016 budget includes debt service transfers from General Funds totaling $2.3 billion, an increase of $96.0 million from FY2015.[301]

The debt service transfer associated with capital GO bonds in FY2016 increases by $29 million, totaling $719 million compared to $690 million in FY2015. Over the last five years the General Funds debt service cost for capital bonds has increased $266 million from a total of $453 million in FY2012. The operating budget incurs higher costs for capital purpose debt service due to the shortfall in revenues in the Capital Projects Fund.[302] Despite an enacted package of revenues to fund the new borrowing associated with the *Illinois Jobs Now!* capital program, the State has incurred additional General Funds cost.

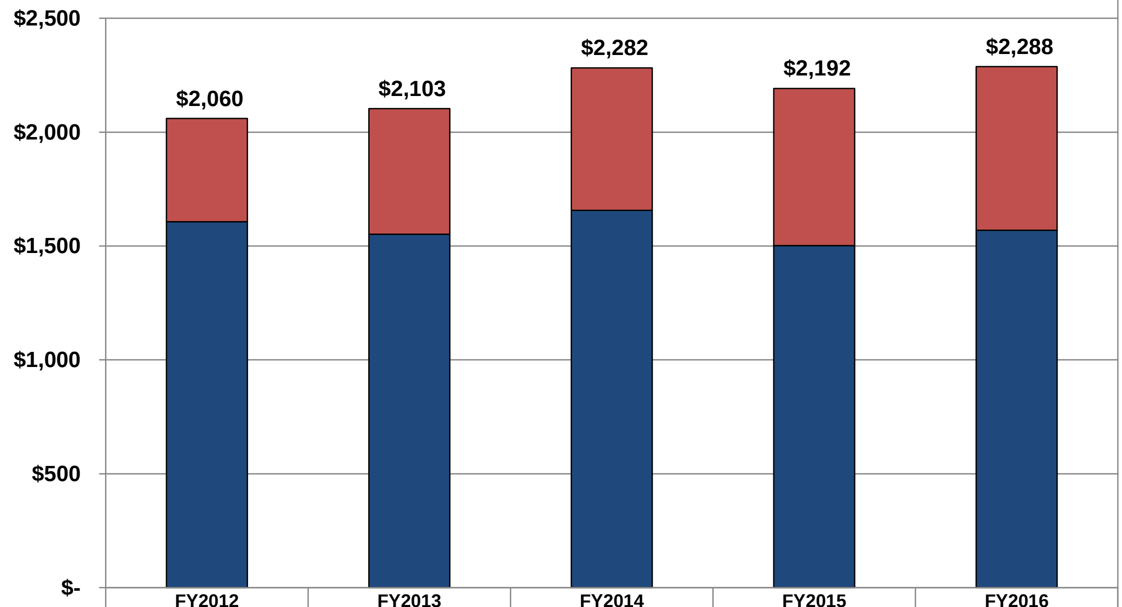
Debt service transferred to pay for POBs has been relatively flat since FY2012 at approximately $1.6 billion through FY2016.

---

[301]Illinois State FY2016 Budget, p. 3-6.
[302] For more information on the Capital Projects Fund see page 77 or this report.

The following chart shows the General Funds cost of debt service paid on the State's General Obligation bonds, both capital and pension related, for FY2012 through FY2016.

State of Illinois General Funds Debt Service Transfer: General Obligations Bonds for Capital and Pensions FY2012-FY2016 (in $ millions)



	FY2012	FY2013	FY2014	FY2015	FY2016
Debt Service Transfer	$2,060	$2,103	$2,282	$2,192	$2,288
Capital	$453	$551	$625	$690	$719
Pensions	$1,607	$1,552	$1,657	$1,502	$1,569

Source: Illinois State FY2016 Budget, p. 3-6; State of Illinois, General Obligation Bonds, Series May 2014, *Supplement to the Official Statement*, July 18, 2014.

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

Bond Ratings

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

Illinois' bond rating is the lowest of all 50 states, leading to dramatically higher borrowing costs than better-rated governments. After the Illinois General Assembly enacted its FY2014 budget without approving reforms to address the State's underfunded retirement systems, two of the three major rating agencies downgraded the State's bond ratings.[303] Both Fitch Ratings and Moody's Investors Service cut the State's rating one level, while Standard and Poor's affirmed its existing A- rating.[304] As of this report the rating agencies have affirmed the same ratings since the downgrades

[303] For more information on the State retirement systems, see page 33 of this report.
[304] Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2014*, August 2013, p. 193.

in FY2014 through FY2015. However, currently all three include a negative outlook, which could lead to further downgrades in the near future.

The following table compares the State's GO bond ratings from all three agencies in FY2014 to the ratings at the beginning of each fiscal year since FY2008, which is the last time the State was rated 'AA' by all three agencies.

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

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

Commission on Government Forecasting and Accountability, *State of Illinois Budget Summary Fiscal Year 2014* , August 2013, pp. 193-195.

The FY2014 downgrades put Illinois on the final step of the 'A' ratings for all three agencies before entering 'BBB' status. Fitch and S&P have downgraded Illinois' rating six steps in the past five years, while Moody's has reduced its level four times. After the State passed pension reform in December 2013, S&P improved its outlook for the State to developing, but shortly after the State enacted the FY2015 budget, the agency reversed the status back to negative.[305]

The State also maintains five derivative instruments, also known as swaps, associated with variable rate bonds with a notional value of $600 million that were sold in 2003. These swap contracts convert the State's variable rate debt to synthetically fixed rate payments through agreements with counterparties that are intended to offset interest rate risk. However, under the terms of the contract, if the State's credit rating falls below a certain threshold the deal is terminated and the State must pay the market value of the deals at the time of the termination. The State also then would continue to pay the variable rate interest on the loans as set forth in the original bond sale. If the ratings for the State's GO bonds fall below Baa3 with Moody's or BBB for Fitch and S&P, then the State would owe whatever the current calculated market value of the swaps were at that time. As of June 30, 2014 the State's swaps portfolio has a negative value of $123.8 million.[306] The State's credit rating would trigger its swaps termination clauses if Moody's reduced its credit rating by four levels or if Fitch or S&P reduced its rating by three levels.

[305] Standard and Poor's, "Illinois Outlook Revised To Developing From Negative On Pension Consensus; Series 2013 GO Debt Rated 'A-'," December 10, 2013; Standard and Poor's, "Illinois Outlook Revised To Negative From Developing Following Enactment Of Fiscal 2015 Budget," July 23, 2014.
[306] State of Illinois, Comprehensive Annual Financial Report, FY2014, p. 121.

Capital Budget

The Governor's recommended FY2016 capital budget includes a total of approximately $19.0 billion in new and reauthorized projects and marks the sixth year of the *Illinois Jobs Now!* capital spending program.[307]

Unlike the State's General Funds budget, which is intended to cover only the cost of the State's operations for the current fiscal year, capital appropriations are reauthorized over multiple years as planning, engineering and construction of capital investments commences. The total spending proposed in the FY2016 capital budget includes funding from the State, grants from the federal government and local matching funds. Since 2005 the capital budget has been proposed in a separate document from the State's operating budget and is not part of the annual General Funds expenditures.

The enacted FY2015 capital budget included $21.0 billion of which $4.2 billion were appropriations and $16.9 billion were reauthorized projects.[308] The $19.0 billion recommended for FY2016 includes $3.3 billion of new appropriations and $15.6 billion of previously approved spending authority proposed for reauthorization.

The FY2015 capital budget was reduced by $250 million due to a line item reduction veto made by Governor Pat Quinn.[309] The funding was originally approved in FY2010 as part of several grants for renovations to the Capitol Complex, in Springfield, Illinois. The $250 million item was a grant to the Architect of the Capitol, which has completed more than $50 million of previous projects already funded through the capital budget.

As part of the recommended FY2016 capital budget, Governor Bruce Rauner proposes reinstating the $250 million of vetoed funding as new spending in FY2016 to pay for delayed maintenance at State owned facilities across the State. The Governor seeks authority to broadly manage the $250 million as a lump sum available to address areas of critical need at veterans' facilities, mental health centers and correctional facilities.[310]

The Capital Development Board would manage the additional $250 million in deferred maintenance funding and prioritize facilities that provide housing for residents on a 24 hour basis seven days a week.[311] The projects would focus on repairs that ensure health, safety and code compliance. Roof repairs and mechanical systems would also be a priority. Although some specific projects are listed as examples of facilities in need of critical repairs, the appropriation would be a lump sum available for the Governor to deploy as critical projects are identified. The recommended FY2016 capital budget estimates that State-owned capital facilities currently have a total of $6.1 billion in delayed maintenance. Including the proposed $250 million increase for FY2016, authorized spending on capital facilities would total $2.3 billion.[312]

Funding for statewide road and bridge construction remains the largest portion of the State's capital expenditures. The proposed FY2016 capital budget included $12.4 billion in total spending for the

---

[307] Illinois State FY2016 Capital Budget, p. 14.
[308] Illinois State FY2016 Capital Budget, p. 20.
[309] Illinois State FY2016 Capital Budget, p. 20.
[310] Illinois State FY2016 Capital Budget, p. 10.
[311] Illinois State FY2016 Capital Budget, p. 10.
[312] Illinois State FY2016 Capital Budget, p. 14.

Illinois Department of Transportation including the annual road program for ongoing surface transportation improvements (roads, bridges and mass transit). Of the total allocated to IDOT, $10.3 billion represents amounts proposed for reauthorization from previous years and $2.2 billion is new funding.[313]

The following table compares the capital budget proposed by the Governor for FY2016 to the enacted capital budget for FY2015.

State of Illinois Capital Budget: FY2015 Enacted Compared to Governor's Recommended FY2016 (in $ millions)				
	FY2015 Enacted	FY2016 Rec.	$ Change	% Change
Reappropriation	$ 16,854.1	$ 15,641.7	$ (1,212.4)	-7.2%
New	$ 4,176.4	$ 3,331.7	$ (844.7)	-20.2%
Total	**$ 21,030.5**	**$ 18,973.4**	**$ (2,057.1)**	**-9.8%**

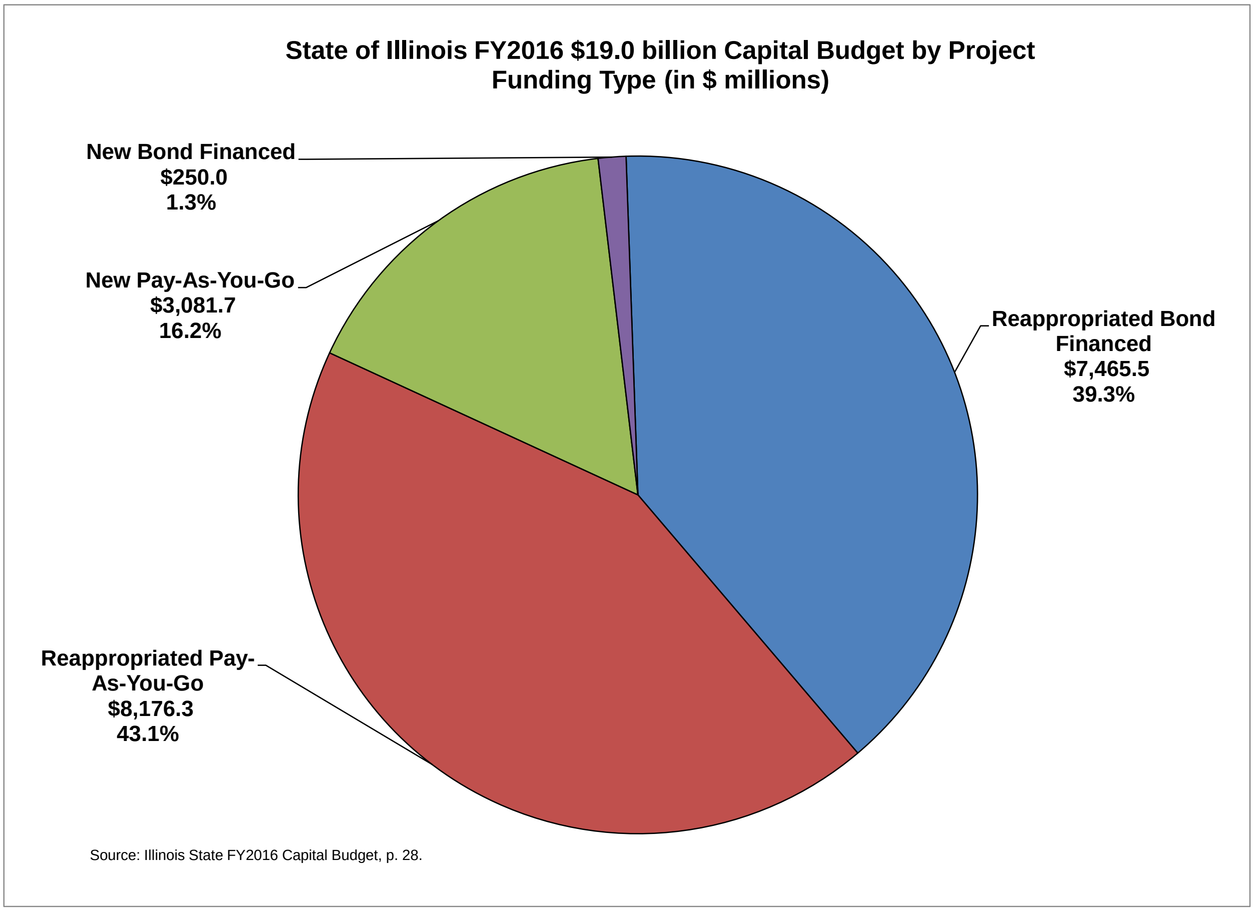
Source: Illinois State FY2016 Capital Budget pp. 13, 14; Governor's Office of Management and Budget, *Fiscal Year 2015, Enacted Budget by Line Item* . http://www2.illinois.gov/gov/budget/Pages/BudgetBooks.aspx (last visited September 30, 2014)

Bond funded projects make up $7.7 billion of the total proposed spending in FY2016, while $11.3 billion are pay-as-you-go projects financed with currently available resources. Of the total $4.2 billion of new appropriations passed in FY2015, $1.2 billion were bond financed projects and $3.0 billion were paid for with available funds. The capital reappropriations approved in FY2015 included $8.7 billion of bond financed projects and $8.1 billion of pay-as-you-go projects.

The largest source of pay-as-you-go funding is federal funds, which make up $932.3 million of the new funding and $4.6 billion of the proposed reauthorization of appropriated funds from prior years, of a total of $5.5 billion in capital funds. Nearly all of capital funding provided to the State is allocated to IDOT for transportation projects. The Governor’s recommended FY2016 capital budget includes new federal transportation funding totaling $594.4 million and reappropriated funds of $4.0 billion. The State collects the second largest source of pay-as-you-go funding through user taxes and fees including motor fuel taxes, vehicle fees, licensing and other related charges. The FY2016 capital budget includes $1.6 billion in new projects funded by user fees and taxes. Reappropriated projects funded by user fees and taxes total $2.6 billion.

[313] Illinois State FY2016 Capital Budget, p. 28.

The following chart shows the total FY2016 capital budget by the type of project funding.

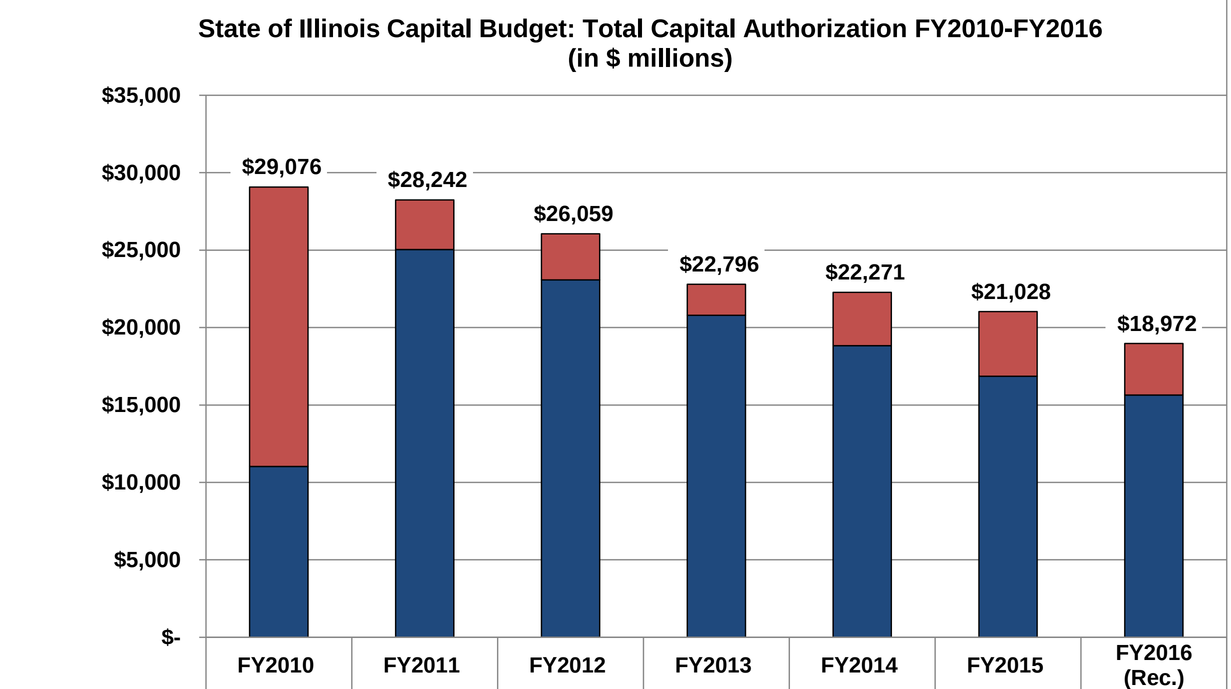


Since FY2010 the total appropriations in the State's capital budget have declined from $29.1 billion to approximately $19.0 billion in FY2016. Due to the addition of new projects and the lack of a comprehensive capital improvement plan to explain the annual prioritization and completion of projects, it is unclear which of the original projects have been completed and how much of the current budget represents additional authorizations passed in the intervening years.

The FY2010 capital budget included $18.0 billion in new projects added to $11.0 billion of reappropriations from previous years. The *Illinois Jobs Now!* program is commonly referred to as a $31.0 billion spending plan due to an additional $3.0 billion of new capital spending approved prior to the FY2010 capital budget in the summer of 2009.

Including the proposed new spending in FY2016, total new projects added to the capital budget since the initial *Illinois Jobs Now!* budget was approved in FY2010 total $19.1 billion. The largest amount of new projects since FY2010 were approved in FY2015 totaling $4.2 billion. Reappropriations increased to $25.0 billion in FY2011 and then declined over the next five years to a total of $15.6 billion in FY2016.

The following chart shows the total capital appropriations approved by the State of Illinois from FY2010 through FY2016.



	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016 (Rec.)
Total	$29,076	$28,242	$26,059	$22,796	$22,271	$21,028	$18,972
New	$18,042	$3,205	$2,978	$2,004	$3,434	$4,174	$3,331
Reappropriation	$11,034	$25,037	$23,081	$20,792	$18,837	$16,854	$15,641

Source: Illinois State FY2016 Budget, p. 28; Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2016*, April 2014, p. 8; Governor's Office of Management and Budget, *Fiscal Year 2015, Enacted Budget by Line Item*. http://www2.illinois.gov/gov/budget/Pages/BudgetBooks.aspx (last visited September 30, 2014)

The State relies heavily on the sale of bonds to fund the capital budget. The original *Illinois Jobs Now!* capital program included approximately $16.2 billion of bond-funded expenditures.[314]

As of December 31, 2013 the State had issued $11.4 billion in bonds to pay for capital projects since the capital program began.[315] A package of dedicated revenue sources was authorized to pay for the additional debt service related to spending on *Illinois Jobs Now!* The new taxes and fees consist of the following:

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

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

[314] Commission on Government Forecasting and Accountability, *FY2016 Capital Plan Analysis*, April 2015, p. 3.
[315] For more details on the State's total debt burden and annual debt service costs see page 63 of this report.

However, the taxes and fees have yet to produce the funding levels projected when *Illinois Jobs Now!* was originally approved. In FY2016 Capital Projects Fund revenues are projected to total $830.4 million compared to the estimated total of $818.4 million in FY2015. However, the legislative projections provided when the spending was approved in FY2010 anticipated $943 million to $1.2 billion annually.

The following table shows the revenues deposited into the Capital Projects Fund from FY2011 through FY2014, estimated revenues for FY2015 and projected FY2016 amounts. The original legislative projections are also included in the table for comparison.

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

Source	Original Projections	FY2011	FY2012	FY2013	FY2014	FY2015 (est)	FY2016 (proj.)
Video Poker Tax*	$288 - $534	$ -	$ -	$ 58.0	$ 114.4	$ 187.0	$ 196.0
Lottery Fund	$ 150	$ 54.1	$ 65.2	$ 135.0	$ 145.0	$ 145.0	$ 145.0
Sales Tax	$ 65	$ 52.0	$ 52.7	$ 54.0	$ 55.0	$ 55.0	$ 55.0
Liquor Tax	$ 108	$ 105.2	$ 114.8	$ 115.1	$ 115.0	$ 119.0	$ 119.0
Vehicle Related	$ 332	$ 294.6	$ 299.7	$ 264.9	$ 304.1	$ 312.0	$ 315.0
Other	$ -	$ -	$ 0.1	$ 0.4	$ 0.4	$ 0.4	$ 0.4
Total	**$943 - $1,189**	**$ 505.9**	**$ 532.5**	**$ 627.3**	**$ 734.0**	**$ 818.4**	**$ 830.4**

*FY2013 includes one-time video poker operator fees totaling $33.5 million.

Source: Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2015* , April 2015, p.10; Illinois Comptroller, *Online Revenue Query by Fund: Capital Projects Fund,* www.ioc.state.il.us (last visited on September 30, 2014).

The largest shortfall in revenues is related to the delay in implementing and taxing legalized video gaming, which was the largest single source of revenues in the approved funding package. Due to administrative delays, the first machines were not put into service until October 2012. Fiscal year 2013 was the first year that the capital budget received revenue from the 30% tax on video gaming. Under to the law establishing legalized video poker, five-sixths of the tax revenues generated are used for capital project funding and the remainder is shared with local governments where the machines are in service.[316]

The estimated FY2016 video gaming revenue totaling $196.0 million is well below the projection of $288 million to $534 million annually. This is largely due to the ability of local governments to opt out of video gaming or to continue existing local bans on the machines.

According to a report from the Commission on Government Forecasting and Accountability, 48.1% of the Illinois population lives in communities where video gaming is illegal. Chicago, where video gaming remains prohibited, represents 21.0% of the State's population.[317] However, the number of residents living in communities where video gaming is banned is on the decline and has dropped from 63.3% in 2009 to 45.0% as of July 2014.[318] According to data available from the Illinois Gaming Board, as of March 2015 there are 19,142 active video gaming terminals in Illinois located in 4,609 establishments, which produced monthly net income of $77.6 million and $19.4 million in State tax revenue.[319]

---

[316] Public Act 96-0034, enacted July 13, 2009.
[317] Commission on Government Forecasting and Accountability, *FY2016 Capital Plan Analysis*, April 2015, p. 9.
[318] Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2016*, April 2015, p. 10.
[319] Illinois Gaming Board, Monthly Video Gaming Report. https://www.igb.illinois.gov/VideoReports.aspx (last visited May 4, 2015)

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

Despite the lower amounts, total revenues in the Capital Projects Funds for FY2015 are expected to exceed the debt service related to the new bonds issued under the *Illinois Jobs Now!* authorization. However, a required annual statutory transfer of $245.2 million from the Capital Projects Fund to the State's General Funds included in the original capital revenue authorization is expected to cause a shortfall in the Capital Projects Fund for FY2015 and FY2016.[320]

When the Capital Projects Fund does not have adequate revenue to cover all of the debt service owed on the new bonds sold under *Illinois Jobs Now!* and other expenses, the State uses resources from the Road Fund or the General Funds to make up the difference. However, these additional debt service costs are repaid in the subsequent year when shortfalls are covered by either fund.

The State used payments from the General Funds to pay for the additional debt service cost in FY2014 not covered by the revenues in the Capital Projects Fund totaling $145.9 million. After repaying the FY2014 shortfall in FY2015 and making the statutorily required payment of $245.2 million, transfers out of the fund not related to capital bond debt service for FY2015 will total $391.1 million. Combined with the $787.2 million in debt service related transfers for FY2015, expenditures from the Capital Projects Fund are estimated to total $1.2 billion. Compared to revenues of $818.4 million the fund will experience an estimated shortfall of approximately $360 million, which will be paid for out of the General Funds.[321]

Similarly, the State expects a shortfall in the Capital Projects Fund in FY2016 after repayment of the FY2015 deficit and the $245.2 million annual transfer is made to the General Funds. Combined with the FY2016 debt service transfer of $778.4 million, the $605.2 million transfer to the General Funds will increase total Capital Projects Fund expenditures to $1.4 billion. This exceeds the projected FY2016 revenues of $830.4 million by $553.2 million.[322]

---

[320] Public Act 96-0034, enacted on July 19, 2009.
[321] Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2016*, April 2015, p. 10.
[322] Commission on Government Forecasting and Accountability, *Capital Plan Analysis FY2016*, April 2015, p. 10.

APPENDIX A: TOTAL DEBT SERVICE

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

State of Illinois Total Debt Service: GO Bonds and Build Illinois Bonds Bonds Principal and Interest (in $ millions)				
Fiscal Year	**Capital GO**	**Pension GO**	**Build Illinois**	**Total Debt Service**
2015	$ 1,747.9	$ 1,797.9	$ 370.0	**$ 3,915.8**
2016	$ 1,701.4	$ 1,356.5	$ 353.7	**$ 3,411.5**
2017	$ 1,625.5	$ 1,647.3	$ 329.7	**$ 3,602.5**
2018	$ 1,549.3	$ 1,618.6	$ 305.9	**$ 3,473.9**
2019	$ 1,471.2	$ 1,586.1	$ 284.3	**$ 3,341.6**
2020	$ 1,407.5	$ 674.6	$ 260.0	**$ 2,342.0**
2021	$ 1,343.4	$ 713.4	$ 221.6	**$ 2,278.4**
2022	$ 1,267.4	$ 749.8	$ 226.0	**$ 2,243.2**
2023	$ 1,222.5	$ 783.7	$ 208.0	**$ 2,214.2**
2024	$ 1,134.0	$ 840.2	$ 194.6	**$ 2,168.7**
2025	$ 1,030.2	$ 892.2	$ 187.2	**$ 2,109.5**
2026	$ 1,002.5	$ 915.4	$ 179.2	**$ 2,097.1**
2027	$ 877.0	$ 936.1	$ 151.6	**$ 1,964.7**
2028	$ 852.3	$ 979.2	$ 124.9	**$ 1,956.4**
2029	$ 819.3	$ 1,018.5	$ 120.7	**$ 1,958.6**
2030	$ 732.3	$ 1,079.0	$ 108.5	**$ 1,919.8**
2031	$ 659.0	$ 1,134.4	$ 109.8	**$ 1,903.2**
2032	$ 573.3	$ 1,159.7	$ 99.8	**$ 1,832.8**
2033	$ 547.9	$ 1,156.1	$ 96.1	**$ 1,800.0**
2034	$ 554.4	$ -	$ 92.3	**$ 646.8**
2035	$ 442.7	$ -	$ 66.6	**$ 509.3**
2036	$ 323.1	$ -	$ 64.0	**$ 387.1**
2037	$ 261.3	$ -	$ 31.3	**$ 292.6**
2038	$ 194.2	$ -	$ 17.5	**$ 211.7**
2039	$ 152.8	$ -		**$ 152.8**
Total	**$ 23,492.6**	**$ 21,038.6**	**$ 4,203.1**	**$ 48,734.3**

Source: Illinois State FY2016 Budget, 7-10; State of Illinois, Build Illinois Bonds, Series March 2014, *Official Statement* , March 11, 2014, p. 20.

APPENDIX B: SERVICE TAXES

The following list of services to be subject to Illinois' sales tax was proposed by Governor Bruce Rauner in July 2014, before he was elected.[323]

General warehousing and storage
Refrigerated warehousing and storage
Mini-storage
Marine towing service (including tugboats)
Packing and crating
Sewer and refuse, industrial and residential use
Travel agent services
Sales of advertising time or space: billboards
Sales of advertising time or space: radio and TV advertising
Advertising agencies
Armored car services
Check and debt collection
Commercial art and graphic design
Commercial linen supply
Interior design and decorating
Maintenance and janitorial services
Marketing consulting services
Printing
Investigation services
Public relations services
Secretarial and court reporting services
Security guards and patrol services
Telemarketing bureaus and other contact centers
Telephone answering services
Testing laboratories (excluding medical)
Custom computer programming services
Information services
Attorneys
Personal property rentals
Chartered flights (with pilot)
Trailer parks (overnight)
Membership fees in golf clubs

[323] Bruce Rauner and Evelyn Sanguinetti, Bring Back Blueprint: Corporate Welfare Reform, July 17, 2014, pp.8-9.