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**SPECIAL REPORT  
ON ILLINOIS' FINANCES  
AND FUTURE**  
*ADDENDUM TO THE DTA REPORT FOR THE  
PERIOD ENDING DECEMBER 31, 2018*

# SPECIAL REPORT ON ILLINOIS' FINANCES AND FUTURE

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## SUMMARY

- The unpaid bill backlog continues to force the Office of the Comptroller into crisis management, impede timely bill processing, cause instability for state programs, and create unnecessary and costly late payment interest penalties.
- Not all revenue assumptions the fiscal year 2019 budget relies upon are expected to be realized.
- Budgeted revenue shortfalls of the fiscal year 2019 budget are expected to cause a \$1.5 billion to \$2 billion increase in the bill backlog.
- Temporary tools to manage the backlog granted under the current budget do not resolve systemic budgetary issues. Dedicated funding is needed to lower the bill backlog.
- The budget deficit will continue to grow, and the state risks future credit rating downgrades, in the absence of realistic and responsible budgets.

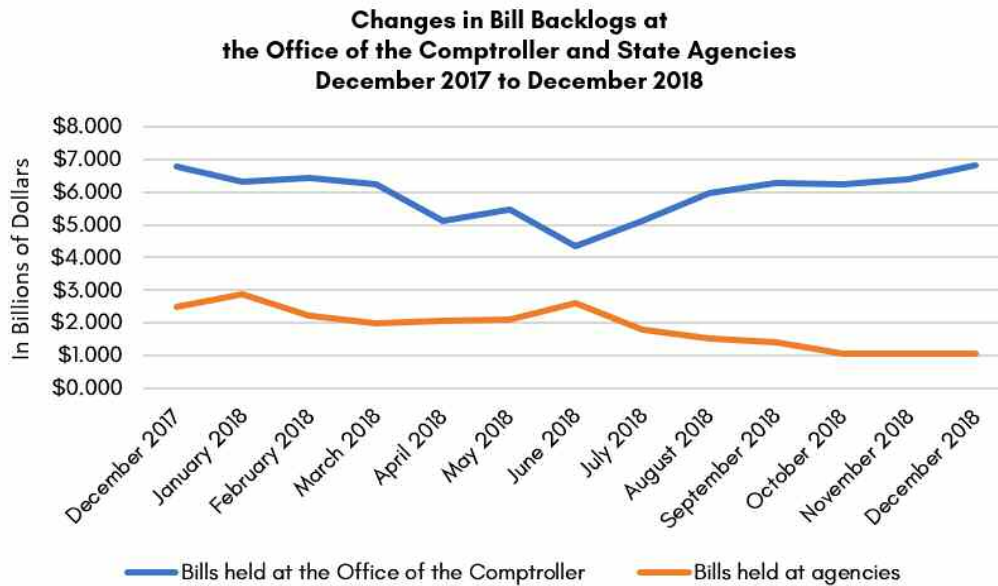
On November 8, 2017, the General Assembly overrode Governor Rauner's veto of the Debt Transparency Act (P.A. 100-0552), legislation initiated by Comptroller Susana A. Mendoza. In January 2018, the Office of the Comptroller published the inaugural Debt Transparency Act (DTA) Report Summary, covering the existing liabilities held at the Office of the Comptroller and at state agencies as of December 31, 2017. Henceforth, state agencies must provide monthly updates on liabilities at the agency level, including the escalating cost of late payment interest penalties, which are now made public in a monthly report and analysis. The DTA Report Summary was critical for policymakers during the fiscal year 2019 budget process in identifying which state agencies lacked adequate appropriations to process their bills for payment.

This special report presents a one-year review of the DTA and an overview of the state's ongoing fiscal challenges in relation to the state's bill backlog. It also highlights future financial pressures facing the state.

## Calendar Year 2018 in Review...

Following a tumultuous two-year budget impasse that ended with a fiscal year 2018 budget, which included the utilization of nearly \$6.5 billion in General Obligation bond proceeds to help pay down old bills, the state's estimated unpaid bill backlog dropped from a record-high of \$16.675 billion in November 2017 to a DTA-adjusted \$9.161 billion by the end of the 2018 calendar year.<sup>1</sup>

Following the receipt of the nearly \$6.5 billion in bond proceeds, along with additional state revenues during the 2018 fiscal year, the amount of unpaid bills at the Office of the Comptroller has been as low as \$4.426 billion (end of day July 13, 2018), and as high as \$6.929 billion (end of day December 19, 2018).<sup>2,3</sup> The chart below illustrates the make-up of bills held at the agency level and those pending at the Office of the Comptroller since December 2017, the month after the bond proceeds were used to cut the backlog virtually in half.



Though the backlog changes daily, in the past year, the amount of unpaid bills held at the Office of the Comptroller has not been under \$5.2 billion since July 2018. While the backlog at the Office of the Comptroller generally declined between December 2017 and June 2018, it has since increased each month as more bills are being submitted to the Office due to an enacted 12-month budget. The \$1.069 billion in bills estimated at the agency level as of December 31, 2018 reflects the lowest reported agency backlog since December 2010.

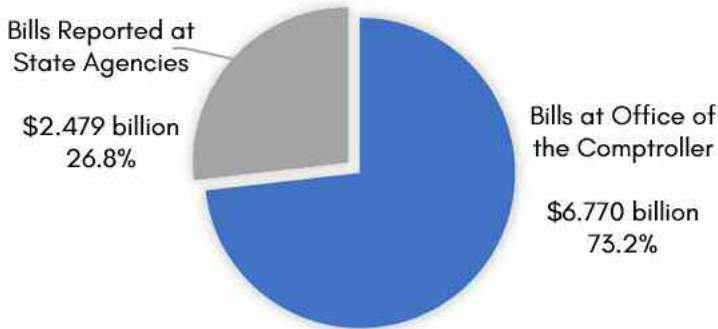
<sup>1</sup> The \$6.5 billion in bond proceeds includes \$482 million in premium from the sale.

<sup>2</sup> Includes a full year of revenue from the July 2017 income tax increase and the increased federal reimbursements in late 2017 that resulted from the payment of medical bills via bond proceeds.

<sup>3</sup> Bills held at the Office of the Comptroller are bills that have been processed by the appropriate state agency, with sufficient appropriation authority, and sent to the Office for payment to the respective vendor or provider.

## Estimated General Funds Bill Backlog

as of December 31, 2017  
Total = \$9.249 billion

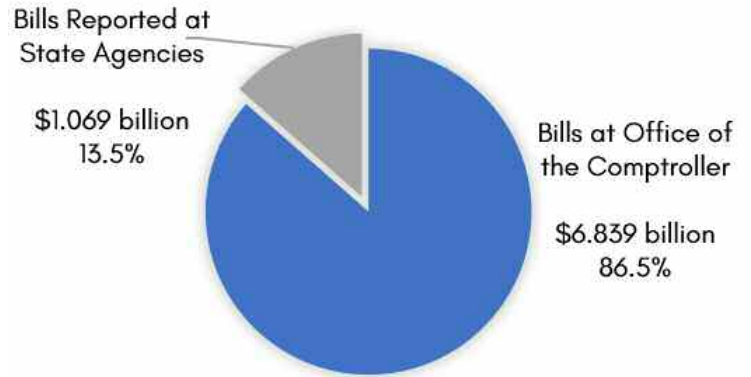


**December 31, 2017**

- Total estimated unpaid bill backlog: \$9.249 billion<sup>4</sup>
- Agency liabilities (includes late interest penalties): \$2.479 billion<sup>5</sup>
- Office of the Comptroller liabilities: \$6.770 billion
- Agency estimated pending liabilities: \$1.201 billion<sup>6</sup>
- Unfunded agency liabilities: at least \$2.3 billion
- Reported late payment interest penalties: \$887 million (\$675 million included in \$2.479 billion agency liabilities)<sup>7</sup>

## Estimated General Funds Bill Backlog

as of December 31, 2018  
Total = \$7.908 billion



**December 31, 2018**

- Total estimated unpaid bill backlog: \$7.908 billion
- Agency liabilities (includes late interest penalties): \$1.069 billion
- Office of the Comptroller liabilities: \$6.839 billion
- Agency estimated pending liabilities: \$1.477 billion
- Unfunded agency liabilities: at least \$1.5 billion
- Reported late payment interest penalties: \$450 million (almost \$31 million included in \$1.069 billion agency liabilities)

While the two charts above appear to show progress in reducing the state's backlog of unpaid bills, it is important to keep in mind that the total estimated bill backlog was \$6.560 billion at the close of December 31, 2014, prior to the budget impasse that resulted in the largest increase of backlogged bills in state history. Additionally, it is expected that the backlog will continue to rise until the underlying systemic budgetary issues are resolved. A full review of the composition of pending bills at the Office of the Comptroller and at the agency level is provided in each monthly DTA report.

The implementation of the current fiscal year's budget is dependent on the reliability of the revenues presented to support it. Questionable revenue assumptions, discussed later in this report, raise concerns as to how the state will keep pace with the flow of bills submitted to the Office of the Comptroller. Such a misalignment of revenues to expenditures would be a problem in any annual budget exercise. However, given that the fiscal year 2019 budget also failed to address the current backlog of bills, which was an estimated \$6.775 billion on the first day of the fiscal year, taking significant steps in 2019 to pay down the backlog of unpaid bills - or even keeping it static - is impossible.

Temporary budgetary tools, such as authorizing the Office of the Comptroller to interfund borrow and allowing the State Treasurer's Office to invest the state's portfolio into backlogged receivables, have been helpful in preventing the backlog from

<sup>4</sup>Total estimated backlog as reported by Debt Transparency Report Summary Vol. 1, No. 1. The amount is higher than the \$9.246 billion originally reported due to a late agency submission.

<sup>5</sup>Amount is higher than the \$2.476 billion reported in DTA Report Summary Vol. 1, No. 1 due to a late agency submission.

<sup>6</sup>Includes General Funds and Health Insurance Reserve Fund only.

<sup>7</sup>More than \$143 million in late payment interest penalties paid by the Office of the Comptroller in calendar year 2017.

experiencing massive increases in the past year. However, more direct intervention to address the systemic budgetary imbalance and backlog of bills is needed.

In previous years, for example, the Legislature devoted funding in the budget specifically to pay down old bills. A return to this practice is necessary to decrease the bill backlog.

The major ratings agencies have cited Illinois' rising backlog as a reason for previous ratings downgrades. All three major ratings agencies currently rate Illinois' General Obligation bonds at no higher than two notches above speculative grade.<sup>8</sup> Among other negative impacts, these poor bond ratings cost taxpayers more when the state borrows for major initiatives, such as repairs to roads and bridges and other infrastructure needs.

Moody's Investors Service specifically noted that one way Illinois can improve its near-junk bond rating is to show "progress in reducing payment backlog" and "prevent renewed build-up of unpaid bills."<sup>9</sup>

Recovery from Illinois' budgetary problems, exacerbated by a two-year budget impasse, will take years of responsible budgets with adequate resources to meet the state's many obligations.

### **The Albatross Caused by Poor Budgetary Practices: Late Payment Interest Penalties...**

When payments to providers and vendors of state services and goods are delayed, state law requires, in certain instances, the payment of additional late payment interest penalties. The intent of the law is to encourage the state to pay its bills on time and to deter unbalanced budgets. However, a chronic bill backlog, which tripled during the two-year budget impasse, combined with insufficient resources, has resulted in a tremendous amount of late payment interest penalties. The impasse period created a \$1.14 billion spike in accrued late payment interest penalties on delayed accounts receivables. The state accrued more in late payment interest penalties during the two-and-a-half-year impasse period than it had in the *previous 18 years combined*.

This unprecedented growth in late payment interest penalties has created a substantial liability, which will have to be addressed in future budgets. These penalties have historically not been accounted for in budgeted appropriations. However, the Office of the Comptroller worked to pass legislation that requires future budget proposals to identify how late payment interest penalties will be accounted for in relation to those programs required to pay such penalties.

As stated earlier in this report, as of December 31, 2018, an estimated \$450 million in late payment interest penalties is pending at the Office of the Comptroller and state agencies. Of this amount, nearly \$369 million was pending at the Office of the Comptroller, which includes \$159 million payable from GRF and \$165 million from the Health Insurance Reserve Fund. Throughout calendar year 2018, the state paid out more than \$711 million in late payment interest penalties, of which almost \$96 million was drawn from the General Revenue Fund and nearly \$580 million from the Health Insurance Reserve Fund.

This total sum of late payment interest penalty liabilities imposes a strain on the current fiscal year, particularly on medical programs at the Department of Healthcare and Family Services (HFS) and in the Group Health Insurance Program at the Department of Central Management Services (CMS), since such payments are drawn from the same annual appropriations the Legislature budgeted for those programs. Therefore, payments for late payment interest penalties effectively divert state funds from their intended purpose.

### **Revenue Questions in Fiscal Year 2019...**

The fiscal year 2019 budget provides for \$38.5 billion in general funds expenditures, an increase of about \$1.2 billion GRF from fiscal year 2018. This increase in additional expenditures went toward appropriations for core program funding for

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<sup>8</sup>Moody's Investor Service's rating of Baa3 and S&P Global's rating of BBB- for Illinois' General Obligation bonds are one notch above speculative grade (junk status). Fitch Ratings' BBB rating is two notches above speculative.

<sup>9</sup>Moody's Investors Service, "Rating Action: Moody's confirms Illinois' Baa3 GO and related ratings, affecting \$32 billion of debt; outlook negative," July 20, 2017.

elementary and secondary education, group health insurance, higher education, Medicaid, human services, pensions, and general government operations. These appropriations were based on \$38.5 billion in revenues, with an estimated \$14 million surplus. However, included in the fiscal year 2019 budget are a number of revenue assumptions that may not be realized by the end of the fiscal year. The Governor's Office of Management and Budget outlined in its fiscal year 2019 economic and fiscal policy report a reduction of roughly \$535 million in revenue included in the fiscal year 2019 budget that is unlikely to be realized by the end of the fiscal year.<sup>10</sup>

The first budgetary hole is the sale of the James R. Thompson Center in Chicago, which was expected to generate \$300 million for the 2019 fiscal year. Since 2015, the Thompson Center sale has been a regular revenue feature of budget proposals. However, continued delays have made the sale unlikely to be executed by the end of the fiscal year. Additionally, the Governor's Office of Management and Budget has outlined a decrease of \$285 million in expected federal revenue sources.

Of particular note to the Office of the Comptroller is the interfund borrowing assumed in the fiscal year 2019 budget. Over the past year, the Office of the Comptroller has utilized budgetary tools authorized by the Legislature to access more liquidity to refinance and pay a portion of backlogged bills, including interfund borrowing. The fiscal year 2019 budget assumes \$800 million in interfund borrowing from various special state funds. This \$800 million was considered "revenue" in the current fiscal year budget, and it was expected that the Office of the Comptroller would not repay these borrowed funds until some time after the close of the fiscal year. However, during fiscal year 2019, the Office has only been able to utilize \$250 million (which must be repaid by law) of this \$800 million due to lack of liquidity in available funds, and given this limited capacity, the Office does not anticipate additional interfund borrowing before the authority expires March 1, 2019. Therefore, \$550 million in interfund borrowing "revenue" listed for fiscal year 2019 is likely to be unrealized—which is more than the \$400 million estimated by the Governor's Office of Management and Budget.<sup>11</sup>

The Governor's Office of Management and Budget lists some positive revenue changes in its fiscal year 2019 report, with higher than expected—\$380 million more—in projected income tax receipts and \$118 million more in transfers in state coffers.<sup>12</sup>

These positive revenue changes, plus the preceding negative changes and an additional decline of \$48 million in other revenue, lead to an adjusted negative change in projected revenue for fiscal year 2019 of \$685 million. Additionally, the Governor's Office of Management and Budget projects an increase in expected expenditures of \$26 million, resulting in a revised estimated budget deficit of \$566 million. However, these changes are not the only possible unrealized revenue in fiscal year 2019.

Another lingering uncertainty is the \$445 million in assumed savings from the new pension buyout plan. While the Teachers' Retirement System (TRS), State Employees' Retirement System (SERS) and State Universities Retirement System (SURS) have been working for several months to implement buyout plans, SURS' plan may not roll out until the end of fiscal year 2019. Until the buyouts are completed, it is unknown how much of the assumed savings will be realized for fiscal year 2019. Taken with the revenue adjustments outlined by the Governor's Office of Management and Budget, this represents a significant potential reduction in available revenue in fiscal year 2019.<sup>13</sup>

### **Pressures Facing the Office of the Comptroller...**

In crafting a fiscal year 2019 budget, the Legislature first included about \$1.2 billion in supplemental spending authority to complete fiscal year 2018. This supplemental funding was needed to address accrued liabilities, as identified in previous DTA submissions, that included, in part, \$405 million for the Department of Corrections, \$443 million for Healthcare and Family Services for Medicaid, and \$63 million to various state agencies for state employee backpay dating to fiscal year 2012. This additional appropriation was approved at the end of the 2018 fiscal year, so paying for these programs was carried into the

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<sup>10</sup>2018 Illinois Economic and Fiscal Policy Report produced by the Governor's Office of Management and Budget.

<sup>11</sup>Public Act 100-0587 sunsets the Office of the Comptroller's interfund borrowing authority on March 1, 2019.

<sup>12</sup>This includes a revision to the total income tax refund fund transfer.

<sup>13</sup>2018 Illinois Economic and Fiscal Policy Report produced by the Governor's Office of Management and Budget, pages 6-7.

lapse period. The Office utilized interfund borrowing and portfolio lending from the State Treasurer’s Office to address these bills during fiscal year 2019.

The Office of the Comptroller’s current authority to interfund borrow was initially provided for in the budget for fiscal year 2018, during which \$533 million was borrowed from other state funds. In total, combining the amounts from fiscal years 2018 and 2019, more than \$783 million has been borrowed, of which approximately \$655 million has yet to be repaid.

In the fall of 2018, the Offices of the Treasurer and Comptroller used another budget tool by entering into a series of intergovernmental agreements utilizing, for the first time, the new State Treasurer lending initiative, which accesses liquidity within the state’s investment portfolio to refinance backlogged bills that are incurring late payment interest penalties. The utilization of this tool made it possible for the Comptroller to address bills that were delayed by as much as two years as a result of having no budget, and thus no appropriation authority. With the passage of the supplemental appropriation, the Comptroller had to apply this lending tool to address these long-standing liabilities. To date, the Treasurer’s Office has invested \$700 million to pay down these liabilities, with a projected six-month savings to taxpayers in lower interest penalties of between \$18 million and \$29 million. About \$685 million is due to be repaid to the state’s portfolio by May 2019, at interest rates between 3.59 percent and 3.78 percent.<sup>14</sup> This repayment is scheduled to occur at a time when receipts to the state are at their highest, due to income tax receipts. However, such repayment will limit the Comptroller’s flexibility to address other pending bills.

Outstanding Investments Through Treasurer Investment Program					
Public Act 100-1107 (15 ILCS 520/22.5)					
Fund #	Fund Name	Tranche #	Maturity Date	Interest Rate	Principal still owed
0278	Income Tax Refund	1	3/28/2019	3.59%	\$ 100,000,000
0278	Income Tax Refund	2	3/28/2019	3.59%	\$ 100,000,000
0011	Road	3	4/5/2019	3.62%	\$ 100,000,000
0902	State Construction Account	4	4/17/2019	3.66%	\$ 100,000,000
0902	State Construction Account	5	4/17/2019	3.66%	\$ 100,000,000
0257	AML Reclamation Set Aside	6	4/24/2019	3.73%	\$ 50,000,000
0019	Grade Crossing Protection	6	4/24/2019	3.73%	\$ 50,000,000
0902	State Construction Account	7	5/1/2019	3.78%	\$ 70,000,000
0142	Community Developmental Disability	7	5/1/2019	3.78%	\$ 15,000,000
<b>Total</b>					<b>\$ 685,000,000</b>

With the shortfall in budgeted revenue, the Office continues to engage in cash management strategies in order to meet the core obligations for debt service, pension payments, human/social services, payrolls, educational and medical programs. Depending on the month, factoring in the ebb-and-flow cycle of the state’s revenue receipts, there are limited discretionary general funds available to address other ongoing state programs and government operations. Utilizing borrowing tools during the low receipt months has enabled the Office to address certain bills that would have otherwise gone unpaid, but these tools do not resolve the systemic budgetary issues that still face the state. Generally, while the oldest commercial voucher is dated four months back, it is notable that \$1.2 billion of the \$2.2 billion in required transfers still linger from authorization provided in fiscal years 2017 and 2018.

<sup>14</sup>\$15 million that was part of the borrowed amount due for repayment 5/1/2019 was paid back early on 12/14/2018, plus the \$67,725 pro-rated amount of interest due.

Any measurable progress on paying these liabilities, as well as the rest of the impending \$7 to \$8 billion backlog, will require a recovery plan from policy makers. Until this occurs, the Office is forced to remain in a “crisis management mode” in processing bills. All told, the budgeted revenue shortfalls of the fiscal year 2019 budget will grow the backlog between \$1.5 and \$2 billion.

### **Pressure Points Going Into Fiscal Year 2020...**

As the second half of the 2019 fiscal year begins, there are a number of fiscal pressures that remain and will add to the challenges of a fiscal year 2020 budget. As stated previously, \$696 million in unrealized revenue in fiscal year 2019, plus whatever savings remain to be realized of the projected \$445 million from the pension buyout will create a revenue shortfall of between \$500 million and \$1 billion that will carry over to fiscal year 2020.

Fiscal year 2020 will also see a \$679.9 million increase in certified state contributions to the pension systems, a roughly \$350 million increase in evidence-based funding for elementary and high schools, and \$405.5 million in interfund borrowing due for repayment.

As reported, an additional \$170 million to \$500 million in court-ordered state employee step adjustments, plus 7 percent per year interest, as a result of the collective bargaining agreement, is owed but has not been accounted for in terms of budget revenue.<sup>15</sup> A significant backlog will remain heading into fiscal year 2020, including at least \$1.44 billion in Group Health Insurance Program bills that CMS may not have sufficient appropriated deposits from the General Revenue Fund to cover.<sup>16</sup>

Finally, certain uneven indicators measuring national economic trends reveal that state policymakers should be mindful that a downturn in the market is possible in the near future. As highlighted in the January 2019 Comptroller’s Quarterly report, Illinois is woefully ill-prepared for an economic downturn given the state’s massive liabilities and lack of contingency funds.

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<sup>15</sup>According to a report, the Pritzker Administration announced state employees will be placed on the correct step of the state pay plan on April 1, 2019. *State Journal-Register*, 1/28/2019

<sup>16</sup>According to data provided in the Governor’s fiscal year 2019 budget book.