Civic Committee

State Finance Update

December 10, 2020

Introduction

For more than a decade, the Civic Committee has been involved with Illinois state finance issues. Beginning with *Facing Facts* in 2006, and most recently with *Restore Illinois: A Foundation for Growth* in 2019, we have served as a truth-teller on state finance issues, consistently urging the State to soberly assess its financial situation and take comprehensive action to put Illinois back on the right path.

Over the first several months of this year, Civic Committee staff worked on *Restore Illinois 2.0*, to update the framework and policy options for a comprehensive plan that had been set out in Restore Illinois. The outlook for the economy and State finances drastically changed in March when we were scheduled to release the report with the advent of the coronavirus pandemic. As a result, while continuing our work consistent with the principles set out in *Restore Illinois 2.0*, we hit pause on its detailed analytic work and shifted gears toward evaluating the impact of the coronavirus on the economy and State budget.

We met with State legislators and stakeholders throughout the summer to get their take on the budget situation and their thoughts on the path forward. One point that all agreed on was that nothing of substance would be taken up by the legislature until after the election and the fate of the constitutional amendment to allow a graduated income tax was known. Despite the clear worsening of the State's budget situation as a result of the pandemic, State leadership was unwilling to take meaningful and comprehensive steps to address Illinois' fiscal situation.

It was amid this backdrop that we considered our position on the referendum to change the Illinois Constitution to allow a graduated income tax.

Graduated Income Tax Amendment

As we described in past updates to the Civic Committee, the referendum on the ballot would have amended the Illinois Constitution to allow for a graduated income tax. If the amendment had passed, Public Act 101-0008, which set the graduated personal income tax rate structure and increased the corporate income tax, would have automatically become law.

While we recognized that the new tax would have provided much-needed revenue, it was not part of a comprehensive fiscal plan to address all of the State's financial challenges, especially its long-term obligations such as pensions and debt, and to change the narrative about Illinois as a place to grow and locate businesses and jobs.

On September 29th, we released a statement and policy position outlining our opposition to the referendum. We highlighted that it represented a piecemeal tax plan rather than a comprehensive fiscal plan. We also published an op-ed in the *Chicago Tribune* and garnered additional media coverage which we believe was effective in making our case.

The Graduated Income Tax amendment failed, with only 46.6% of voters voting yes, far short of the vote threshold necessary for the amendment to pass – 60% of those voting on the question or a majority of those voting in the election.

General Funds Budget Outlook

The graduated income tax and other elements of the Governor's "Fair Tax" package would have provided some fiscal relief, raising approximately $3.6 billion a year in its first full year of implementation. Although this additional revenue would not have been enough to solve the State's fiscal challenges, the failure of the amendment was viewed negatively by credit rating agencies because the additional revenue would have been a structural solution that could have ameliorated budget pressures.

Indeed, the State's budget is under significant strain due to the COVID pandemic coupled with its long-term fiscal issues. The Governor's Office of Management and Budget (GOMB) released new five-year budget projections on November 13th which show a somewhat improved view of the State's finances than were projected at the beginning of the pandemic. The GOMB now estimates a FY21 deficit of $3.9 billion (rather than $6 billion) due to higher than expected sales and income tax revenues. The smaller projected deficit for FY21 is welcome news, but FY22-FY26 show sustained damage to the budget with projected deficits in the range of $4-5 billion a year.

These updated projections have given a bit more clarity to the budget situation, and the Governor Pritzker has announced some steps to help close this year's budget deficit. First, he has asked agency heads to identify 5% in cuts for the current fiscal year and 10% for next fiscal year. To date, potential cuts or how much those cuts may represent have not been made public. In addition, on November 25th, the State announced that it plans to issue $2 billion of debt through the Federal Reserve's Municipal Liquidity Facility (MLF). The details of the debt issuance, including interest rate and repayment term, have not been announced yet. In addition, the Governor has continued to press for help from Washington to support state and local governments deal with the significant impact of COVID on their budgets.

While these measures will help whittle down the budget gap for FY21, there are concerns that they will be insufficient to eliminate the budget deficit and that the bill backlog will increase further.

Next Steps

Despite the State's current fiscal challenges, at this point it is unclear when the legislature will meet again. The Fall Veto Session, which had been scheduled in November after the election, was cancelled and there are no approved mechanisms for either chamber to meet either separately or together to take legislative actions virtually (although the Senate can hold meetings and hearings virtually). It is possible that legislators will meet for a lame duck session in January before newly elected lawmakers are sworn in on January 15th, but the specter of COVID resurgences and uncertainty regarding who will be elected Speaker of the House has put that up in the air as well. At this writing, it is unclear if Speaker Madigan has the votes to maintain his leadership post, which he has held for four decades. In addition, there will be new leadership in the Senate Republican caucus as long-time Leader Bill Brady stepped down, and State Senator Dan McConchie was voted his replacement.

Under the current circumstances, we do not plan to issue a new report or do a broad public awareness campaign. We continue to meet with legislators and key stakeholders to press for support for a comprehensive fiscal plan and offer ourselves as a resource to legislators, the Governor's office, and key stakeholders as they move to address these issues.

City Budget Summary

Along with the fiscal issues at the state level, the City of Chicago is facing some of its most difficult fiscal challenges in history, with a two-year budget deficit of $2 billion (almost $800 million this year and $1.2 billion for 2021). Amid these financial challenges, City Council passed a budget for FY21 on November 24th.

The City's budget relies heavily on "scoop and toss," which refinances current debt in a way that helps the City's cash flow now but will drive up costs in the future. The City will issue $1.7 billion of General Obligation (GO) and Sales Tax Securitization Corporation (STSC) bonds to refinance existing GO and STSC debt, which would provide $448 million in budget relief this year and $501 million for next year.[1] City budget documents indicate that this refinancing will increase debt service costs above the previous level in every year from 2023 to 2050, and that total debt service will increase by $2 billion over that time.[2]

The FY21 budget includes more than $500 million in structural solutions, representing more than $250 million in both personnel and non-personnel savings and efficiencies and an additional $262 million in improved financial management. It also calls for $76 million in TIF surplus funding and taking $30 million from the City's Rainy Day Fund.

Lightfoot's budget also includes some tax increases:

- The property tax levy will increase by $94 million for FY21 (and annually at the rate of inflation thereafter);
- The City's gas tax will increase by three cents a gallon, which is expected to raise $10 million in revenue; and

[1] It is important to note that these figures are based on the assumption that the City will refinance debt at 4%, which is a full percentage point below current rates for the City. Source: https://www.chicagobusiness.com/greg-hinz-politics/lightfoot-borrowing-cost-city-taxpayers-extra-2-billion

[2] The $2 billion figure is in nominal dollars. The City estimates that refinancing this debt will save the city approximately $31 million in current dollars, but that estimate is based on a 4% average inflation rate assumption which we believe is overly optimistic. Source: Ibid.

- The tax on cloud computing will be boosted to 9% from its current level of 7.25%, bringing in an additional $15 million in revenue.

Finally, the City plans to issue $3.7 billion in GO bonds to help finance its new five-year capital plan, which totals approximately $11.7 billion.[3] This capital plan provides the largest increases in spending for transportation projects (22.5% of capital spending, an increase of $1 billion compared to the previous capital plan), neighborhood infrastructure projects (15.1% of capital spending, an increase of approximately $800 million) and economic development (7.1% of capital spending, an increase of $455M). Other large portions of capital spending in the plan include aviation (19% of capital spending), water systems (14.2% of capital spending), and sewer systems (7.9% of capital spending) did not receive increases over the last capital plan.[4] This plan does not have an identified source of revenue to service the debt, and concerns have been raised about issuing this debt given the current economic and fiscal environment.

The City will continue to face fiscal challenges depending upon the continued impact of COVID and will have to find a way to handle its increasing leverage. Its Rating Outlook has been revised to Negative by Fitch Ratings, S&P Global Ratings, and Moody's.

In addition, it is still unclear how the City's sister agencies – Chicago Public Schools, Chicago Transit Authority, Chicago Housing Authority, City Colleges of Chicago, and the Chicago Park district – will be able to weather the downturn.

We will continue to monitor the budget situation of the City and its sister agencies as it unfolds.

[3] https://www.civicfed.org/civic-federation/blog/city-chicago-releases-117-billion-five-year-capital-plan

[4] The remaining areas of capital spending and their share of the capital budget are economic development (7.1%), aldermanic menu (4.6%), municipal facilities (4.3%), lakefront (1.3%), and cityspace (.7%). Source: Ibid.