Report on Illinois Debt

Senator Mark Kirk

October 2011

Growing Crisis In Unsustainable Debt

In Consultation With Sovereign Debt Advisory Board

Henry Feinberg, Chairman

October 6, 2011

Senator Mark Kirk
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Senator Kirk:

As chairman of your Sovereign Debt Advisory Board, I am writing to inform you that the Advisory Board unanimously agrees with the general findings of your Illinois Debt Report. This report focuses a timely light on Illinois' seminal financial issue: the consequences of a failure of Illinois leadership regarding spending and debt, and the considerable ongoing negative implications for every Illinois resident, taxpayer, employee, employer, school districts and other local government entities.

Illinois has substantial growing debts and unfunded liabilities. In the coming years, Illinois taxpayers will have to pay off $31.4 billion in bonded debt and $82.6 billion in unfunded liabilities. This totals $114 billion in effective debt, a staggering $24,000 per household. According to a Standard and Poor's study, Illinois' per capita debt and unfunded liabilities amount to more than three times Wisconsin's or Michigan's and more than twice those of Missouri, Indiana or Iowa.

The result of this debt load is that Illinois has become a greater credit risk than almost any other state and, consequently, has had to offer higher bond yields resulting in higher interest payments than most other states. Over time, these higher interest payments have consumed more and more of the available budget, leaving less money for important priorities such as infrastructure improvements, police and education. If Illinois' spending, debt and other financial obligations continue on their current trajectory, we could see interest costs grow until the day no one is willing to lend to Illinois, manifesting a destructive cycle of debt.

As an Illinois state bankruptcy is not a legal option and a Federal bailout is unlikely, Illinois must aggressively make the necessary changes to preserve its future. We cannot squander our inherent competitive capabilities of advanced infrastructure, quality education, technological innovation and capital market access. This report clearly illuminates Illinois' desperate financial situation and encourages the urgent conversation about what we can do to ensure that Illinois will continue to be a leading state in the country and Chicago a leading city in the world.

Sincerely,

Henry J. Feinberg
Chairman, Sovereign Debt Advisory Board

Contents

Acknowledgements

Senator Mark Kirk and his staff compiled this report.

Senator Kirk's Sovereign Debt Advisory Board gave informal advice related to the content of this report and had advanced notice of the report's content. The Sovereign Debt Advisory Board members may not agree with this report on all points, but they do agree on the report's major findings.

Debt Advisory Board

Henry J. Feinberg (Chairman), Executive Chairman, Yield Management Systems

Ronald P. Bernardi, President, Bernardi Securities, Inc.

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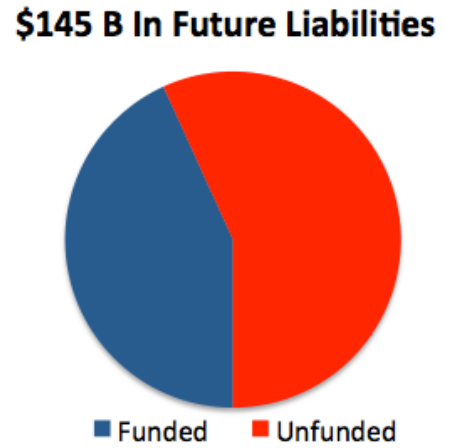
Executive Summary

The trajectory of Illinois fiscal policy over the last decade has put the State on a path to insolvency. Despite unprecedented tax increases, the State spends more than it collects and must borrow money at an alarming rate to meet current obligations. Illinois has also accumulated over $145 billion in future pension obligations, more than half of which (56.8 percent) are unfunded. [1]



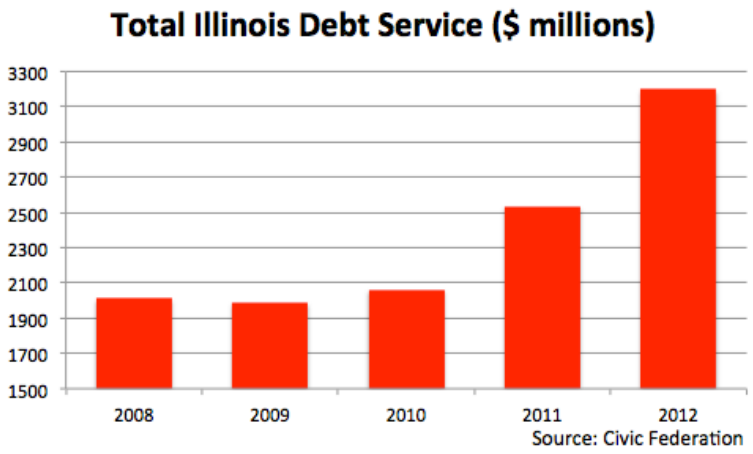
Source: Commission on Government Forecasting and Accountability, 3/11

The price of the Illinois borrowing is high. It costs billions each year to finance the State's debt and billions more in lost tax revenue as wage-paying businesses – and the jobs they create – either leave Illinois or close their doors. The State pays a price for its dwindling population, perhaps most markedly in Chicago, the nexus of the State's economy, where each household would have to write a check for $78,000 to cover its share of today's State debt plus money owed by Cook County and the City of Chicago. Finally, with a business climate among the nation's feeblest, Illinois' debt is costing billions in lost economic growth opportunities.

Evidence of the State's financial malaise is in the numbers. Politically, they lean neither right nor left. Instead, they point to a steep downward spiral for the State's economy fueled by unchecked spending, burdensome taxes, high-cost debt, and unfunded future pension and retiree health benefits. Here are some of the telling data points.

- Illinois owes its creditors $31 billion today. If current spending trends continue, State debt could rise another 50 percent to $45 billion by 2016.
- Illinois owes $8.3 billion in unpaid bills. That's 10 times higher than the level in 2002. The Governor wanted to borrow to meet these obligations.[2]
- Illinois debt service (interest) is approaching $3 billion a year.[3] That's four times the amount needed to plug the $712 million budget deficit at the Chicago Public Schools.[4] (Note: CPS itself pays more than $470 million in debt service.[5])
- In 2009,[6] Illinois only had money to pay for half (51 percent) of its future liabilities, the worst of all the states in U.S.
- Cook County's effective debt tops $22 billion. [7]
- Chicago's effective debt is estimated to top $63 billion.[8]

Taken altogether, Illinois' federal, state, and local per capita indebtedness is rising – shockingly – to levels comparable to Portugal, Ireland, Greece, and Spain.[9] Like Europe's crisis states, Illinois is in danger of borrowing more than this generation or the next … or the next … can repay.



Indeed, the State has put itself in a classic "debt spiral." It borrows to cover deficit spending, so credit ratings fall and interest rates rise. Taxes go up but tax receipts still fall short because businesses aren't growing and taxpayers are moving to other states. So, as if it were paying off a mortgage loan with a credit card, the government starts the cycle all over again by borrowing more and paying higher interest for the privilege.

Making this cycle all the more vicious in Illinois is the economic stagnation that has ensued. The State has lost nearly 130,000 jobs in the last decade and, aided by the nation's economic woes, the number of Illinois unemployed (627,762) is nearly double what it was in 2001.[10] Population in neighboring states – Wisconsin, Indiana and Missouri – is growing twice as fast largely due to the flight of jobs and businesses from Illinois. On a per capita basis, debt and unfunded liabilities in Illinois are three times higher than in Wisconsin and Michigan, and twice the levels in Indiana, Iowa and Missouri.

It will not be easy to reverse the trends that have changed Illinois, once the vibrant home of the world's 17th largest economy, into the 48th worst business climate in the country, the State with the worst credit rating[11] and the State with the poorest funding ratio for future liabilities. Illinois government has to put its fiscal house in order before the State can stanch the outflow of people, commerce, and money. There can be no more "playing it forward," no more living beyond its means, no more spending now and cutting later, no more borrowing against the next generation's prosperity.

Instead, it is time for an exercise of political will and fiscal discipline to control spending, constrain debt, and manage future obligations – just as so many Illinois

counties, cities and school districts have over the past few years. Otherwise, our children – and our children's children – will be subject to a kind of economic serfdom born of the indebtedness this generation incurred but didn't have the courage to pay. Failing to act on the reality set forth by the mountains of debt this report highlights would point to a bankruptcy of government leadership on a scale unprecedented, even in Illinois.

Introduction

This report is intended to provide a new context for Illinois' debt and document the consequences of fiscal scenarios in other states and foreign countries.

Financially, no state in the union is worse off than Illinois.[12] The amount of money needed to operate the State requires unsustainable levels of borrowing, so much so that agencies who rate the State's ability to repay have given Illinois the lowest credit rating of all the states in the U.S.[13] The deteriorated credit rating is a costly symptom of the State's inability to live within the scope of its revenues and manage the growth of its future pension, retiree health and other obligations.

General Obligation Credit Ratings			
Rank	State	Rating	Outlook
1*	IA	Aaa	Stable
1*	IN	Aaa	Stable
1*	MO	Aaa	Stable
48	AZ	Aa3	Negative
49	CA	A1	Stable
50	IL	A1	Negative

Source: Moody's Investor Service

Illinois has lowest credit rating of all 50 states from Moody's. Neighbors Iowa, Indiana and Missouri along with seven other states share the top rating of "Aaa" with a "stable" outlook.

Amount Each Chicago Household Owes	
Chicago	$59,822
Cook County	$11,607
Illinois	$6,615
United States	$149,504
Total	**$227,548**

This year Illinois will spend $34.2[14] billion and receive only $33.2 billion[15] in tax revenue, adding another $1 billion in new debt to the State's already burdensome $31 billion[16] outstanding balance. In addition to debt on the books, the State has unfunded future liabilities in excess of $82 billion.[17] Under the current spending trends, long-term Illinois debt could increase 50% in just five years (2016).[18] If it does, not only will 10 cents on every tax dollar have to be earmarked for debt repayment, but also the State will have a difficult time obtaining more credit.

Looked at another way, state government debt amounts to $6,615 per Illinois household (see chart). Add Federal and local government debt to the equation and the situation is even more alarming. Each Chicago household, for example, actually has debts of $227,548 due to borrowing by each of its governments.

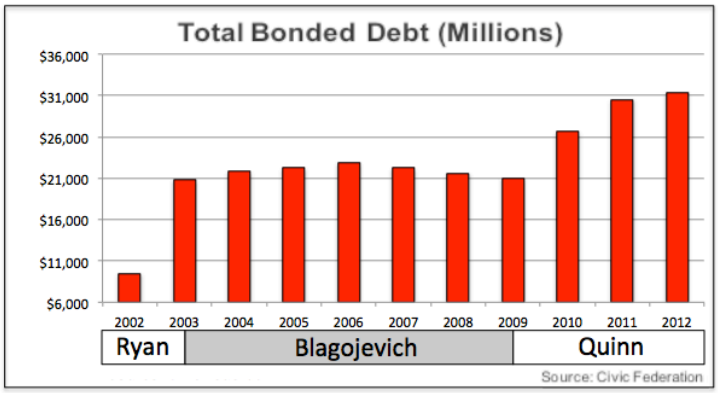
Four Troubling Trends

Four troubling fiscal trends threaten the immediate and longer-term financial prosperity of Illinois. Each is emblematic of a shortsighted, "pay it forward"

attitude of State leaders when it comes to spending, bill paying, borrowing, pensions and other future obligations.

1. The State and certain municipalities have incurred unmanageable debt obligations.

Illinois started the year with a budget gap of at $13 billion,[19] and bonded indebtedness of at least $45 billion.[20] The State also has unpaid bills of $8.3 billion,[21] and unfunded future obligations of $82.6 billion,[22] primarily pensions and employee healthcare. The level of debt means that every household in Illinois owes $28,975 in state and local debt. The City of Chicago and Cook County have unfunded liabilities of $108 billion, constituting an unfunded municipal liability of $63,525 per household for most families in the City of Chicago.[23]

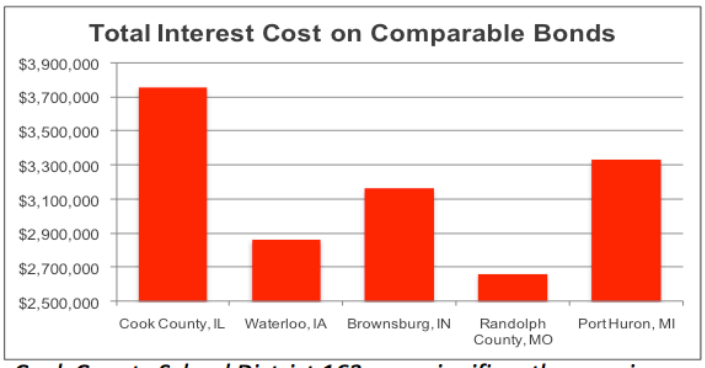


Illinois' total bonded debt has increased sharply over the past few years.

Considering the debt of the United States,[24] as well as the debt and the combined unfunded liabilities of Illinois,[25] Cook County and the City of Chicago,[26] each household in the City of Chicago would have to pay more than $225,000 to cover the current debt.

Apart from the obvious problem of carrying more debt that it should reasonably incur, the current levels of debt are responsible for increasing the yield on Illinois general obligation bonds. In other words, Illinois has to pay more for every dollar it borrows at the state and local level.[27] In one recent bond offering, Illinois paid $550 million more in debt service over the life of the issued bonds compared to what the cost would have been if Illinois had maintained a higher credit rating.[28]

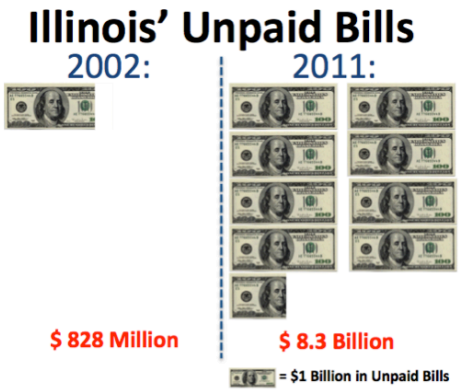
When the State of Illinois' credit rating declines, and its cost of borrowing goes up it also triggers higher borrowing costs for all communities inside the State. This phenomenon, the "halo effect," happens because states with less free cash are less likely to make timely transfer payments to local



Cook County School District 163 pays significantly more in interest costs than other Midwestern municipalities. This is due in part to Illinois' high debts.

governments or serve as a backstop to faltering cities and counties, which increases risk to lenders. This means municipalities, even fiscally responsible municipalities, must pay more because of the diminished Illinois credit rating.[29] In fact, Cook County School District 163 had to pay a higher net interest expense because of this "halo effect" compared to what several other Midwestern creditors would have paid for a comparable offering: $893,109 more than Waterloo, Iowa; $592,706 more than Brownsburg Redevelopment Authority, Indiana; $1,096,437 more than Randolph County School District 81, Missouri and $420,890 more than Port Huron Area School District, Michigan.[30]

2. Illinois borrows to sustain current spending rather provide capital for future investment.



Illinois has failed to pay bills due to vendors. In 2002, Illinois owed only $828 million in unpaid bills. This year it is projected to be $8.3 billion.

The recent 66% personal income and 46% corporate tax increases[31] were justified as a means to pay overdue bills. So far, the revenue from these increases has been used to pay Medicaid, public pensions, and $1.7 billion in new spending.[32] The State has not yet used the revenues to pay overdue bills.[33]

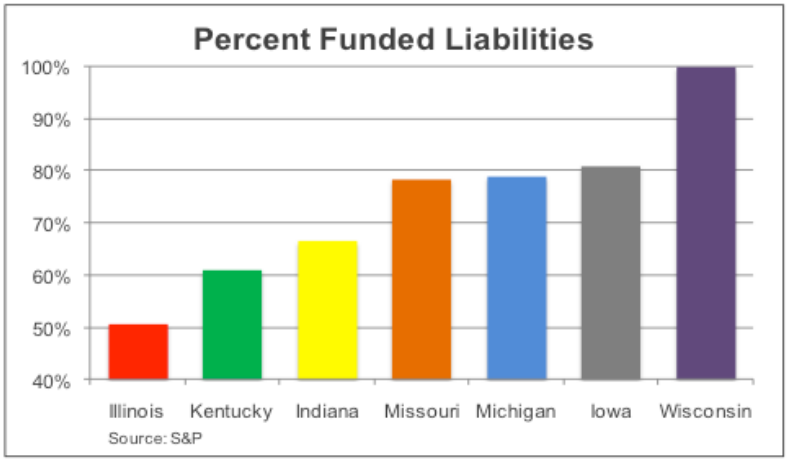
Illinois is delaying payment of $8.3 billion[34] in overdue bills (in 2002 Illinois had less than $1 billion in unpaid bills[35]). The governor has pursued rolling these unpaid bills over into new, high-priced bonded debt to be paid by future Illinois taxpayers.[36]

Illinois began borrowing to directly or indirectly pay short-term obligations as early as 2001.[37] Additionally, Illinois and Illinois' municipalities have sold long-term cash yielding assets to pay for immediate operating costs.[38]

3. Illinois is in the habit of failing to budget for long-term obligations.

By percentage, Illinois funds the smallest share of its future liabilities (including the liabilities of its major pension accounts) of any state in the nation, funding only 51% of future pensions, retiree health benefits and other obligations in 2009. Wisconsin covers 99.8% of its liabilities, Iowa 80.9%, Missouri 78.2%, Michigan 78.9%, Indiana 66.4% and Kentucky 60.9%.[39]

Illinois has failed to fund over $82.6 billion in future pension, retiree health benefits and other obligations.[40] That's $17,392 per Illinois household.



Illinois' neighbors have funded their pension accounts and other future obligations much more completely than Illinois. These payments will need to be made at a later date.

The Congressional Budget Office lists the Illinois State Employees Retirement System as the least funded large public pension account in the US, funded at only 43%.[41] Cities and counties hold significant unfunded liabilities as well. Cook County and its municipalities have $108 billion in such obligations.[42] Although different from bonded debt, unfunded liabilities, like bonded debt, must be paid by law at a future date and therefore compete with bonded debt for future tax revenues.

Eight Worst Funded Pension Programs

Fund Name	% Funded	State
Illinois State Employees Retirement System	**43%**	**IL**
Connecticut State Employees Retirement System	44%	CT
Illinois State Universities Retirement System	**46%**	**IL**
West Virginia Teacher's Retirement System	47%	WV
Kentucky Employees' Retirement System	47%	KY
Missouri Dept. of Trans. And Highway Patrol	47%	MO
Indiana State Teachers Retirement Fund	48%	IN
Illinois Teachers Retirement System	**48%**	**IL**

Source: Congressional Budget Office

Current debts, growing commitments for retiree health and growing pension commitments must all be paid for with future taxes and assumed earnings. Given structural imbalances, this increases the likelihood of future tax increases.

4. Revenue collections are adversely affected by job and population losses and by a severely diminished housing market.

Illinois has lost 197,902 jobs, or 3.2% of its total employment since January 2001.[43] The City of Chicago lost approximately 7% of its population, 200,418 people, in the same period.[44] Between 2000 and 2006, New York grew by 206,148 people (2.6%)[45] and Los Angeles grew by 154,558 people (4.2%).[46] Cook County Illinois has lost 3.4% of its population (182,162 people) while Lake County Indiana increased its population 2.4% (11,444 people).[47]

Population by City	% Change
Chicago	(7.0%)
New York	2.6%
Los Angeles	4.2%

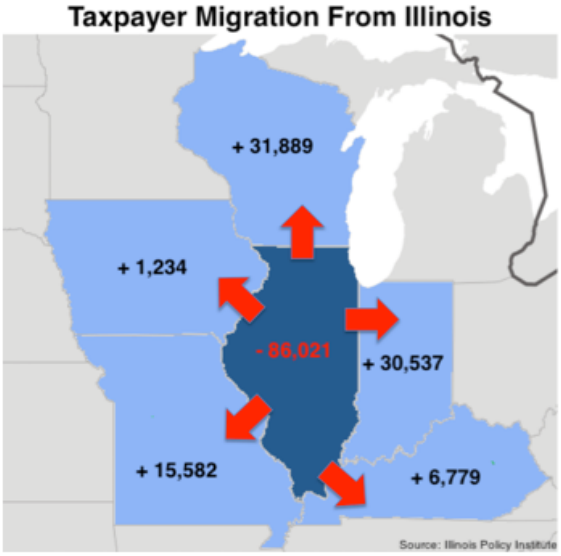
Population by County	% Change
Cook County, IL	(3.4%)
Lake County, IN	2.4%
Lake County, IL	9.2%
Kenosha County, WI	11.3%

Source: U.S. Census Bureau

Property tax collections have dropped nationwide, too, often leading to property tax rate hikes.[48] Exacerbating the problem in Chicago, the home price index has continued to drop while the national rate has begun to improve.[49]

Even Illinois counties that increased population grew slower than communities across state lines. Lake County Illinois increased its population 9.2% while Kenosha County Wisconsin increased its population 11.3%.[50]

Lost population means higher per-capita cost of debt repayment and unfunded liability financing. If Illinois had the same population growth rate as Indiana, per household debt would be approximately $400 lower than it is today.[51]



Illinois saw population flight to nearby states between 1995 and 2007.

Illinois citizens face higher taxes and larger debts because so many of their fellow citizens have moved to other, more fiscally responsible states. The State lost 86,021 net taxpayers between 1995 and 2007 to neighboring states. Taxpayer flight between 1995 and 2007 cost Illinois an estimated $2.4 billion in tax revenue.[52]

Illinois remains the fifth largest industrialized state and ranks 17th in size among world economies,[53] but population declines and slow growth threaten its status over the long-term. The State retains advantages in education, infrastructure and access to capital, as well as hundreds of other intangible benefits.

However, the uncertain fiscal climate, coupled with increased taxes and persistent budget deficits cause businesses already in the State to explore options in other states. These fiscal realities act as a strong deterrent to new business development and investment.

The last five years are a case in point. According to CEO Magazine, five years ago Illinois ranked 8th in the U.S. for its business climate and ability to grow jobs. Today, Illinois ranks 48th on the same list, ahead of only New York and California. Not surprisingly, the places rated best for business are states like Texas, North Carolina and Florida[54] where taxes remain low and business investment is encouraged as a means of stimulating job growth. Embarrassingly, Wisconsin and Indiana have actually used Illinois' financial situation as the centerpiece of marketing campaigns to lure people and companies out of Illinois.[55] Illinois' response is to give tax breaks to large employers[56] and ignore the burden that has been placed on small businesses that produce the bulk of the State's corporate tax revenue and jobs.

Best States for Business	
1st	Texas
2nd	North Carolina
3rd	Florida

48th	Illinois
49th	California
50th	New York

Source: CEO Magazine

Over the past five years, Illinois has gone from being ranked 8th in the nation for job growth climate to 48th.

Destructive Cycle of Debt

Spending in Illinois has exceeded revenues since 2007.[57] The State has borrowed heavily to cover its short and long-term spending, while it has underfunded its long-term commitments. As the State's fiscal stability has declined, investors have demanded higher interest payments to lend Illinois money. As a result, Illinois incurs the highest cost to borrow money of any state.[58] Since 2008, Standards & Poor's has downgraded Illinois' general obligation bonds ratings twice.[59]

The practical effect on the citizens of Illinois is scarcity of resources for critical state needs while Illinois will spend $2.7 billion servicing its debt in 2011.[60] Taxes spent on debt service cannot be invested in schools or roads, which then have to be financed through still higher taxes.

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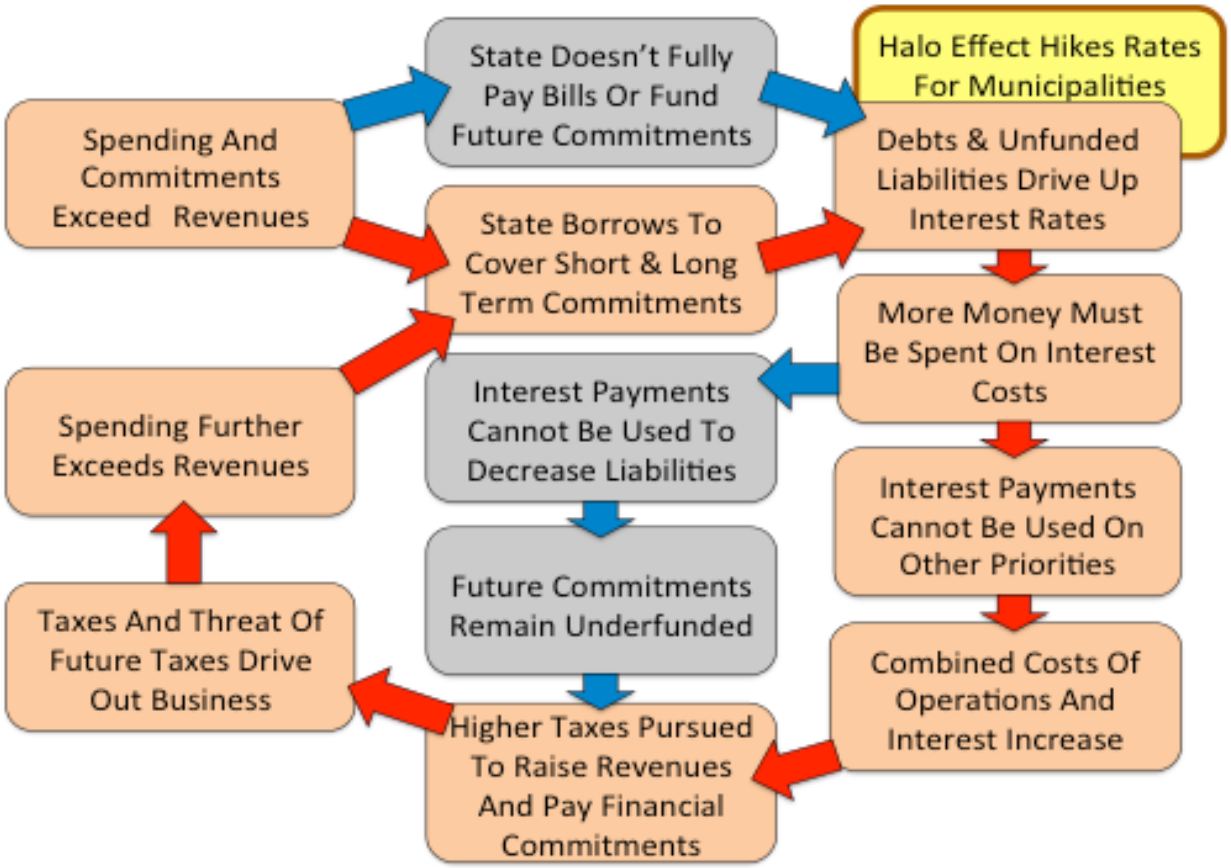
Tax increases damage the business climate. Businesses have to manage costs to succeed and when taxes rise unpredictably as a result of fiscal mismanagement, there is an urge to domicile in a more business-friendly state. Unfortunately, Illinois knows this problem all too well. Major employers – CME Group, Sears, Motorola, Caterpillar, and Jimmy Johns[61] – have considered leaving the State in response to huge corporate tax increases, and a

Crain's Chicago Business study revealed that 25% of small businesses have considered leaving Illinois.[62]

A business exodus narrows the tax base and offsets revenue gains from tax increases. It can also cause higher unemployment and increases in expenditures on social programs. Without offsetting budget cuts, this has the cumulative effect of forcing even higher taxes and greater borrowing. Thus a destructive self-reinforcing cycle of debt arises[63] with unpaid bills, unfunded liabilities and uncontrolled spending locked in a spiral toward insolvency.



The destructive cycle of debt is driven by excess spending and commitments financed by debt. As debt grows and investor confidence wanes, borrowing expenses escalate, driving the economy deeper into debt and creating a significant drag on the economy. See Appendix A for a complete discussion.

Again, Illinois has firsthand experience with the problem. In 2009, the State had the worst funding ratio of long-term obligations of all 50 states. Its pension funds are headed toward insolvency because the State has not been putting aside money to fund its obligations to retirees. Overall, Illinois pensions are funded at just 43.2%[64] - the least funded in the nation,[65] and the Illinois State Employees Retirement System is the worst funded public pension account in the nation, only financing 43% of liabilities.[66] The Securities and Exchange Commission (SEC)

recently investigated Illinois' pension system for potential fraud.[67] Illinois has total unfunded liabilities of over $82.6 billion.[68] Illinois also has $8.3 billion in unpaid vendor bills.[69]

Illinois' liabilities are vastly understated. Long overdue bills, unfunded pension liabilities and growing retiree commitments, while not debt, are obligations and these obligations compete with bonded debt for future tax dollars. These unfunded commitments may prove to be too burdensome on the business climate, as there are numerous legal barriers to reducing these obligations. These legal barriers also constrain the ability of municipalities, including fiscally responsible municipalities, to manage their long-term commitments.[70]

These circumstances undermine confidence in state bonds and cause yields to rise, so the government has to pay higher interest costs on debt. Local government obligations further undermine investor confidence, such as the $108 billion owed by Cook County.[71]

Comparison with Other Sovereigns

U.S. States

Illinois is not the only state with significant fiscal challenges. The recession and its lingering effects on economic growth have hit many states hard. But most states have addressed near term revenue shortfalls with large scale spending cuts. Large states like California[72] and New York[73] have worked hard to get control of their budgets and improve the climate for economic growth. Illinois has deployed a tax increase strategy and its results are sadly apparent.

State	Strategy
Illinois	Tax Increase
Connecticut	Tax Increase
New York	Cut Expenses
California	Cut Expenses
Wisconsin	Cut Expenses
Michigan	Cut Expenses

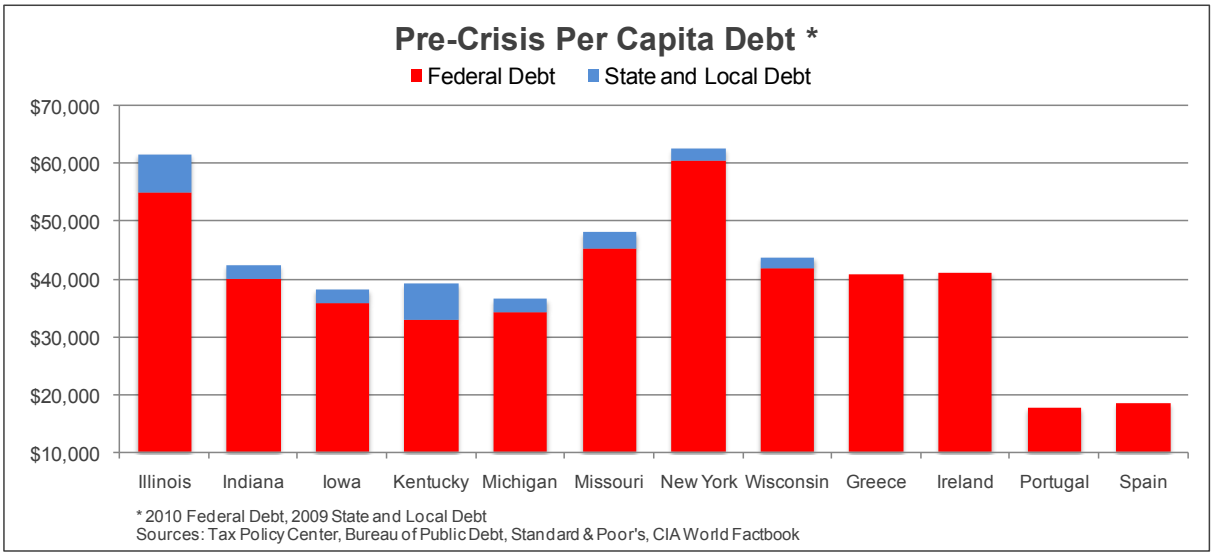
Many states found themselves in fiscal trouble in recent years. Illinois' strategy to increase taxes to combat deficits is uncommon.

Competing states like Wisconsin[74] and Indiana[75] have balanced their budgets. Even Michigan has cleaned up its fiscal act and is implementing reforms to produce further spending cuts.[76] Almost half of the fifty states have considered legislation to rein in long-term liabilities.[77] In July 2011, Illinois and Connecticut were alone in having passed broad-based tax increases to deal with their budget problems. A report found tax increases in Illinois and Connecticut accounted for the majority of state tax increases nationwide.[78]

Illinois' debt fares poorly compared to other states, too. In January, Illinois had the highest borrowing costs of any state.[79] Along with California, Illinois' General Obligation Bonds have Moody's lowest rating of the 50 states. However, Illinois also has a negative outlook from Moody's, while California bonds do not.[80] Following spending cuts, California has been able to lower its borrowing costs as much as 88%.[81]

European Crisis States

Illinois should be warned by the crises in the nations of Portugal, Ireland, Greece, and Spain on the difficulties of fiscal reform during a debt crisis. Even with significant international assistance, Greece, Ireland and Portugal have had to initiate heavy austerity measures.[82]



As the above graph shows, before the crises Illinois per capita state and federal debt levels exceeded the total debt levels in the European crisis states. Although Illinois' sovereign income is higher than that of Ireland, Portugal or Greece, the overall debt load relative to income is still high.[83]

Conclusion

Illinois is in real fiscal trouble. This situation diverts funds away from key priorities and creates a drag on the economy. Illinois must make sacrifices today, balance its budget, and put its fiscal house in order to encourage future economic growth. The costs, both monetary and social, are too high to do nothing. By resolving these issues, Illinois can regain its status as an economic powerhouse and ensure future growth.

Illinois is at the crossroads of our nation. It has one of the largest airports in the world. One quarter of the nation's freight rail travels through Chicago (about 37,500 railcars each day). It has the third most miles of Interstate in the nation and the fifth most vehicle miles traveled. It is closer to everywhere than anywhere. Illinois has the City of Chicago, a vibrant financial hub of worldwide importance with thousands of intangible benefits. It has many of the world's finest academic institutions and a well-educated population. Illinois has great water resources, including Lake Michigan. The State is strong in agriculture and manufacturing. Illinois has many competitive advantages that need to be strengthened by significant and serious fiscal reform. The recent fiscal irresponsibility and out of control spending needs to cease in order for the State to regain its place as an economic leader.

Appendix A – Cycle of Debt

1. Spending Exceeds Revenues

Since 2008, Illinois spending exceeded revenues, creating debt. In 2011, Illinois will spend $33.67 billion and will receive only $30.61 billion in tax revenue.[84]

Spending Exceeds Revenue - Estimated Totals (Billions)			
Fiscal Year	2008	2009	2010
Spending	30.35	32.96	32.17
Revenues	29.66	29.14	27.09
Operating Deficit	0.69	3.82	5.08

Source: Illinois Policy Institute

In the current fiscal year, revenues should increase due to the anemic economic recovery and the Governor's tax increase. However, Illinois leaders approved $1.7 billion in new spending, preventing much of the tax increase from being used to reduce debt.[85] The Office of the Comptroller reported recent tax increases were used to pay for Medicaid and public pensions and would not be used to pay off overdue bills.[86]

2. Illinois Borrows to Cover Short & Long Term Obligations while Failing to Pay Bills or Provide for Future Obligations

Earlier this year, the Governor wanted to borrow $8.75 billion of 15-year bonds to pay bills.[87] Illinois has approximately $8.3 billion[88] in unpaid vendor bills.[89] According to the Donors Forum 2010 report, over 1/3 of Illinois non-profits who did work for Illinois received late payments from the State, "in virtually all cases leading to cash flow problems."[90] Illinois continues to borrow to pay bills, and has sold long-term assets to pay short-term operating costs. Last November, Illinois sold $1.5 billion of its tobacco settlement bonds to generate cash.[91] This has been a persistent problem. As early as 2001, $10 billion in bonds were issued with the intention of assisting pension funds, but $2.7 billion of these bonds were instead spent on 2001 pension payments and interest costs, liberating dollars to be spent on additional operating costs.[92]

3. Debts And Unfunded Liabilities Drive Up Interest Rates

The credit rating of the State of Illinois has been declining since 2007. Along with California, Illinois holds Moody's lowest rating of the 50 states. However, Illinois also has a negative outlook from Moody's, which California does not.[93] Standard and Poor's downgraded Illinois' credit rating twice over the past five years.[94]

State of Illinois General Obligation Bond Ratings			
Fiscal Year	Moody's	S&P	Fitch
2009	A1	AA-	A
2010	A2	A+	A
2011	A1	A+	A-

Source: Commission on Government Forecasting and Accountability, State of Illinois Budget Summary: Fiscal Year 2011
Credit: The Institute for Illinois' Fiscal Sustainability

Along with a decline in its credit rating, the cost to Illinois and its local communities to borrow money is rising.[95] All debts impact the creditworthiness of the State. According to lenders, unfunded liabilities and unpaid bills are seen as competing future obligations, reducing creditworthiness. The State of Illinois $82.6 billion in unfunded liabilities[96] and $8.3 billion[97] in unpaid bills[98] is part of the reason the State's credit rating is declining.

4. Higher Interest Costs

Illinois may pay approximately $550 million extra in costs of borrowing for a single year due to its lower credit rating.[99]

5. Interest Payments Cannot Be Used for More Teachers or Police Officers – or to Lower Future Debts

Higher interest paid on debt cannot be used to support new teachers or police officers. Illinois must cover these additional burdens unlike more creditworthy states. Earlier this year, the Governor's budget director, David Vaught, wrote that Illinois had "$9 billion or $10 billion in overdue bills that must be paid."[100] Small business vendors and medical facilities who do business with Illinois suffer from delayed and ignored payments.[101] Illinois' missed and delayed payments have caused numerous problems. For example, the Shawnee Development Council, a non-profit assisting frail seniors, had to shut down due to late state payments, prisons' bullet purchases were refused without cash up front and a substance abuse

center had to cut jobs and delay appointments because the State was not paying its bills in a timely fashion.[102] Roads, airports and rail, Illinois' competitive edges in the national economy, have suffered to the point where the American Society of Civil Engineers gave the State's infrastructure low marks.[103]

6. Higher Taxes To Raise Revenues and Pay Liability Obligations

In an attempt to close the fiscal gap, the Illinois State Legislature passed and the Governor signed and enacted a $7 billion dollar tax increase equivalent to 20% of the State's general-fund budget. This tax increase did not balance Illinois' budget.[104] After these tax increases the Governor pursued debt consolidation bonds to pay old bills.[105]

7. Taxes and Threat Of Future Taxes Drive Out Business

The Illinois Chamber of Commerce anticipates a "very negative impact" from increases in taxes passed this year.[106] Bond debt, unpaid bills, and unfunded liabilities are all must be paid at some point, which means Illinois' massive bond obligations, its $82 billion in unfunded liabilities[107] and its $8.3 billion[108] in unpaid bills[109] must all be paid for some day in taxes. Numerous Illinois businesses have left Illinois or have discussed leaving Illinois in the wake of the recent tax hikes while others have received specialized tax breaks to remain in the State.[110] Both losing businesses and exempting businesses from taxes narrow the taxable base. Other states, such as Indiana, Wisconsin[111] and New Jersey[112] have tried to encourage companies to leave for their states and their states' business environments.

Illinois' lost business is also visible in demographic shifts. Illinois' employment has decreased by 197,902 since January 2001, meaning the State has lost 3.2% of jobs since that date.[113] Cook County and Lake County Illinois have seen lower population growth rates over 2000-2010 period than their neighboring counties across state borders. [114]

8. Spending Further Exceeds Revenues

The problems of Illinois' fiscal situation has left Illinois in a worse fiscal position from where it started, now in a dangerous spiral of debt. The jumps in total general-obligation and capital debt over the past decade are a symptom of this

deeper issue. The worsening fiscal outlook reinforces itself, illustrating the unsustainability of continued debt-based financing of the state government.

Appendix B – Unsustainable Future Debt Date

For the past three fiscal years, the state of Illinois has depended on federal dollars to cover the cost of operating the state government and its agencies. Since the State has not adequately funded pension liability – in fact, it has the second lowest funding ratio in the country – it must pay a portion of promised pension benefits from current revenues, as well.

The recession and poor pension planning has left Illinois dependent on new debt to balance its budget for the past two years. It started FY10 with approximately $25 billion in outstanding bond obligations.

If we assume that:

- There is 3% per annum growth in tax receipts as well as gross state product over the next five years,
- The state depends on and receives over $12 billion from municipal bond markets to fill budget gaps until the economy rebounds and revenues rise,
- The state has not fully funded pensions,
- Illinois cannot call on federal stimulus dollars for operating costs,

Then by 2016, long-term debt will grow by 50%, and debt service will take almost 10 percent of projected state taxes and fees. The State's interest cost for current debt is fixed. An increase of 100 basis points will take debt service to more than 10 percent of state revenues.

Fiscal Year	Fiscal Year End Debt Balance	New Debt	Debt Service	Debt Service as % of State Revenue
2009	$25,000			
2010	$26,637	$1,250	$1,601	8.3%
2011	$30,555	$1,800	$1,652	7.3%
2012	$31,416	$2,500	$1,856	8.1%
2013	$33,799	$3,000	$2,091	8.9%
2014	$36,332	$3,150	$2,349	9.7%
2015	$37,516	$1,800	$2,449	9.8%
2016	$38,399	$1,500	$2,484	9.7%

Source: http://www2.illinois.gov/budget/Documents/FY%202012/FY12_Operating_Budget.pdf; Chapter12-11, "Standard Measure of Debt Burden", "Estimated Annual Issuance for General Obligation and Build Illinois Capital Bonds"; State Revenue derived from Chapter 2-35, "Table II-B – General

Funds Revenues by Source" is calculated by subtracting "Federal Sources" from "Total Revenues General Funds" for FY10-12, then estimated to grow at 3% annually

Appendix C – Greek Austerity Package

Initial Changes

- 15% cut in nominal public sector wages;
- 30% cut in wages of employees of state-owned enterprises;
- Cuts in nominal pension rates of 10% in the public and private sector;
- 9.6% reduction of spending on social services, including on pensions, medical care, and pharmaceutical benefits;
- 33% increase in taxes on fuel, cigarettes, and alcohol; and
- 20% across-the-board increase in the Value Added Tax rate (VAT).

Source: Congressional Research Service

Recent Changes

Spending Cuts € 14.27 Billion		
Cutting Public Sector Wages	€	2.195
Cuts in Social Benefits	€	5.160
Increase in Social Benefit Contributions	€	3.246
Close or Merge Public Entities and Subsidies	€	1.240
Fighting Tax Evasion	€	3.003
Cuts in Public Investment Spending	€	0.950
Defense Cuts	€	0.533
Cuts in Healthcare Spending	€	2.120
Privatizations	€	0.050
Tax Increases € 14.08 Billion		
"Solidarity Levy" - 1% - 5% Income Tax Hike		
Lowered Tax-Free Threshold from €12,000 to €8,000		
Higher Property Taxes		
VAT Increase on Restaurants and Bars from 13% to 23%		
Luxury Levies on Yachts, Pools and Cars		
Removal of Certain Tax Exemptions		

Source: Thompson Reuters

Appendix D – State Data

Illinois

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
24,297	62,439	86,736	619,522
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
1,882	4,837	6,719	47,993
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
50.6%		3.9%	14.0%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
3.3%	(0.7%)	A+ Negative

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Wisconsin

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
11,240	193	11,433	239,121
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
1,988	34	2,022	42,125
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
99.8%		4.7%	4.8%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
6.0%	3.4%	AA Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Indiana

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
3,240	12,266	15,506	258,378
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
504	1,910	2,414	40,233
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
66.4%		1.3%	6.0%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
6.6%	(1.2%)	AAA Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Appendix D – State Data (cont.)

Michigan

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
6,320	15,420	21,740	362,325
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
634	1,547	2,181	36,350
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
78.9%		1.7%	6.0%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
(0.6%)	(10.7%)	AA- Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Missouri

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
5,639	11,448	17,087	237,336
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
942	1,912	2,854	39,639
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
78.2%		2.4%	7.2%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
7.0%	3.1%	AAA Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Kentucky

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
9,100	17,912	27,012	154,345
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
2,109	4,152	6,261	35,777
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
60.9%		5.9%	17.5%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
7.3%	3.8%	AA- Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Appendix D – State Data (cont.)

Iowa

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
2,160	5,085	7,245	136,738
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
718	1,691	2,410	45,471
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
80.9%		1.6%	5.3%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
4.1%	4.1%	AAA Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Minnesota

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
6,068	17,625	23,693	257,514
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
1,152	3,347	4,499	48,902
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
72.8%		2.4%	9.2%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
7.8%	5.1%	AAA Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Appendix D – State Data (cont.)

Texas

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
12,889	24,696	37,585	1,138,684
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
520	997	1,517	45,970
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
84.1%		1.1%	3.3%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
20.6%	15.0%	AA+ Stable

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Florida

Approximate Totals and Extrapolations *			
Debt (Millions)	UAAL (Millions)	Debt+UAAL (Milllions)	GSP (Millions)
24,628	18	24,646	704,118
Debt Per Capita	UAAL Per Capita	Debt+UAAL Per Capita	GSP Per Capita
1,329	1	1,330	39,118
Pension Funded Ratio		Debt/GSP	Debt + UAAL/GSP
87.1%		87.1%	87.1%

*2009
Source: S&P "U.S. States' Pension Funded Ratios Drift Downward

Population Change *	Employment Change *	S&P Rating
17.6%	18.5%	AAA Negative

*2000 - 2010
Source: U.S Census Bureau

*2000 - 2008
Source: U.S Census Bureau

Notes

[1] See the 3/2011 report by the Commission on Forecasting and Accountability.
[2] See Reuters, 6/2/11
[3] See *Crain's*, 2/7/11
[4] See *Chicago Tribune*, 6/16/11
[5] See Chicago Public Schools FY2009-FY2011 Debt Service Funds
[6] 2009 data was the most recent year with data that analyzed unfunded liabilities nationally.
[7] According to the Cook County Treasurer's office, Cook County has $22,534,829,509 in debt.
[8] According to the Cook County Treasurer's office, the City of Chicago has $63,527,063,142 in debt.
[9] To find total debt load, we added the 2009 state and local debts of each state (as found in Appendix D) to the share of federal debt assigned to each state. We have assigned each state a share of the federal debt equal to the Total Public Debt Outstanding (as of July 11, 2011) times the percentage of taxes collected by from each state by the IRS in 2009. For European states, we have used the 2009 CIA World Factbook per capita debt figures.
[10] See Bureau of Labor Statistics, total Illinois employment was 6,089,069 on July 2001 and has fallen to 5,960,151 in July 2011 – a change of 128,818 over a decade. Total Illinois unemployment was 319,385 in January 2001 and was 627,762 in July 2011, the most recent number.
[11] Illinois is Moody's lowest rated state, with general obligation bonds receiving a rating of A1 with a negative outlook. See Moody's Investors Service, "Special Comment: Illinois 2012 Budget Ends Deficit Financings, But Leaves Pension and Payment Backlog Issues Unaddressed," 8/11/11 and Crain's, 8/12/11.
[12] See Bloomberg, 1/3/11
[13] Illinois is Moody's lowest rated state, with general obligation bonds receiving a rating of A1 with a negative outlook. See Moody's Investors Service, "Special Comment: Illinois 2012 Budget Ends Deficit Financings, But Leaves Pension and Payment Backlog Issues Unaddressed," 8/11/11 and Crain's, 8/12/11.
[14] See Illinois Policy Institute, 7/1/11
[15] See Civic Federation, 3/11/11
[16] See Civic Federation, 5/9/11
[17] See the 3/2011 report by the Commission on Forecasting and Accountability
[18] See Appendix B for calculations and methods.
[19] See Bloomberg, 1/3/11
[20] This refers to outstanding bond debt. See State Treasurer Dan Rutherford's "No More Debt" report for data
[21] See *Crain's*, 9/26/11
[22] Refers to unfunded actuarial liability. See the 3/2011 report by the Commission on Forecasting and Accountability
[23] See *Chicago Sun-Times*, 6/22/11
[24] In 2010, Illinois provided approximately 5% of IRS tax collections, according to the Tax Policy Center. On July 5, 2011, the total public debt outstanding equaled $14.34 trillion. 5% of this is $710 billion, or $149,504 for each of the 4.7 million households in Illinois.

[25] Illinois had unfunded liabilities of $82.6 billion according to the 3/2011 report by the Commission on Forecasting and Accountability, or $17,397 for each of the 4.7 million households in Illinois. However, these numbers include both state and local unfunded liabilities. To avoid double counting, we have not included any of this total in our overall calculation. Instead we used per household bonded debt, $31.416 B for 2012 - $6,615 for each of the 4.7 million households in Illinois.
[26] See *Chicago Sun-Times*, 6/21/11
[27] See the State Treasurer Dan Rutherford's "No More Debt" report and The Civic Federation's "Cost Of The Crisis" Report
[28] Illinois spent $550 million additional dollars to service its debt during the Build America Bond Program (BAB). See Civic Federation, 8/30/10
[29] See *The Bond Buyer*, 9/9/11
[30] Comparison of issuances: Cook County, IL 6/13/11; Waterloo, IA 6/14/11; Brownsburg Redevelopment Authority, IN 6/8/11; Port Huron Area, MI 6/13/11. Data from Thomson Municipal Market Data and Bloomberg.
[31] See *The New York Times* 1/12/11
[32] See The Associated Press, 2/17/11
[33] See *Chicago Tribune*, 1/6/11 and Moody's, "Special Comment: Illinois 2012 Budget ends Deficit Financing, But Leaves Pension and Payment Backlog Issues Unaddressed," 8/11/11, pg. 3.
[34] See *Crain's*, 9/26/11
[35] See "State Can't Afford To Pay Corporate Tax Refunds," *Chicago Daily Herald*, 10/2/02
[36] See Reuters, 6/2/11
[37] See *The Wall Street Journal*, 6/4/11
[38] See Business Insider, 6/15/11
[39] See Appendix D.
[40] This number refers to total unfunded accrued actuarial liabilities for the state. For full statistics, see the 3/2011 report by the Commission on Forecasting and Accountability. This is $17,392 for each of the 4.7 million households in Illinois.
[41] See Congressional Budget Office
[42] See *Chicago Sun-Times*, 6/21/11
[43] See Bureau of Labor Statistics, These numbers reflect change in employment from January 2001 (6,157,990) to July 2011 (5,960,088). At the time of this report's completion later numbers were still preliminary.
[44] See *USA Today*, 2/18/11
[45] See U.S. Census Bureau
[46] See U.S. Census Bureau
[47] See U.S. Census Bureau
[48] See *The Wall Street Journal*, 7/16/11
[49] See *Chicago Sun-Times*, 5/31/11 and *The New York Times*, 7/7/11
[50] See U.S. Census Bureau
[51] According to a report from the Civic Federation, Illinois had debts of $31.416 B for 2012. This is $6,615 for each of the 4.7 million households in Illinois. If population had grown 6.6% in Illinois over the past decade, and individuals per household had remained constant, this would

have meant 5.05 million Illinois households in 2010. Per household, Illinois debt would be $6,217 under these circumstances.

[52] See Illinois Policy Institute, 1/12/11
[53] See the State of Illinois Presentation to Municipal Forum of New York, 4/14/11
[54] See CEO Magazine
[55] See *The Christian Science Monitor*, 1/13/11
[56] See *The Wall Street Journal*, 5/14/11; See Reuters, 1/12/11; WBBM, 6/9/11; *Chicago Tribune*, 3/10/11
[57] See the Fiscal Year 2009 Illinois State Budget, General Funds – Comparative Budget Results & Plans: FY2007-FY2009
[58] See *The Wall Street Journal*, 1/7/11
[59] See "History of U.S. State Ratings," Standard & Poor's, 7/7/11
[60] See Civic Federation, 3/4/10
[61] See Reuters, 1/12/11; *Chicago Tribune*, 3/10/11; *Chicago Tribune*
[62] See Crain's, 2/2/11
[63] See Appendix A for a discussion of the cycle of debt.
[64] See the 3/2011 report by the Commission on Forecasting and Accountability
[65] See BusinessWeek, 5/6/11
[66] See Congressional Budget Office
[67] See *Wall Street Journal*, 1/25/11
[68] See the 3/2011 report by the Commission on Forecasting and Accountability
[69] See *Crain's*, 9/26/11
[70] See "Public Pension Plan Reform: The Legal Framework" 2010
[71] See *Chicago Sun-Times*, 6/21/11
[72] See *Financial Times*, 6/18/11
[73] See *The New York Times*, 3/19/11
[74] See Fox6.com, 6/16/11
[75] See *The Journal Gazette*, 7/2/11
[76] See BusinessWeek, 6/21/11; Michigan Department of Treasury
[77] See *The Wall Street Journal*, 7/7/11
[78] See *The Wall Street Journal*, 7/7/11 and National Conference of State Legislatures, "State Tax Update: August 2011"
[79] See *The Wall Street Journal*, 1/7/11
[80] See Bloomberg, 1/3/11
[81] See Bloomberg, 9/14/11
[82] Details provided by the Congressional Research Service. See Appendix B for other details.
[83] See tables in Appendix D.
[84] See Civic Federation, 9/26/11
[85] See The Associated Press, 2/17/11
[86] See Reuters, 6/2/11
[87] See Reuters, 6/2/11
[88] See *Crain's*, 9/26/11
[89] See The Associated Press, 2/17/11
[90] See Donors Forum, 1/2010
[91] See Bloomberg, 1/3/11

[92] See *The Wall Street Journal*, 6/4/11
[93] See Bloomberg, 1/3/11
[94] See "History of U.S. State Ratings," Standard & Poor's, 7/7/11
[95] See *The Wall Street Journal*, 1/7/11
[96] See the 3/2011 report by the Commission on Forecasting and Accountability
[97] See *Crain's*, 9/26/11
[98] See The Associated Press, 2/17/11
[99] See the State Treasurer Dan Rutherford's "No More Debt" report and The Civic Federation's "Cost Of The Crisis" Report
[100] See The Associated Press, 2/17/11
[101] See Illinois Statehouse News, 5/3/11
[102] See The Associated Press, 5/13/10
[103] See *The State Journal-Register*, 2/10/10
[104] See *The Wall Street Journal*, 6/4/11
[105] See *The Wall Street Journal*, 1/7/11
[106] See Reuters, 6/2/11
[107] See *Crain's* 4/26/11
[108] See *Crain's*, 9/26/11
[109] See The Associated Press, 2/17/11
[110] See *The Wall Street Journal*, 5/14/11; See Reuters, 1/12/11; WBBM, 6/9/11; *Chicago Tribune*, 3/10/11
[111] See *The Christian Science Monitor*, 1/13/11
[112] See The Associated Press, 1/24/11
[113] See Bureau of Labor Statistics, These numbers reflect change in employment from January 2001 (6,157,990) to July 2011 (5,960,088). At the time of this report's completion later numbers were still preliminary.
[114] See U.S. Census Bureau