[Bond Case Briefs]

Municipal Finance Law Since 1971

[A Debt Affordability Study Sounds Wonky. But Illinois Needs One, Pronto.]

The Pew Charitable Trusts recently found that 23 states do not publish debt affordability studies. Illinois, which we know is a high debt state, is among those that do not.

What is a debt affordability study? It is a document that describes all of the state's outstanding debt by type. For example, there is debt supported by taxes—such as general obligation bonds and pensions—versus debt supported by a revenue stream, such as that of the tollway. The study in turn projects out future indebtedness for items such as state buildings or roads based on the capital budget.

Finally, based on state policy, the study sets constraints—specifying, for example, that annual debt service on tax-supported bonds cannot be more than 5 to 10 percent of revenues. Or setting benchmarks for total debt relative to GDP. These parameters are often based on what peers are doing and/or what the rating agencies feel is reasonable.

Because the study is forward-looking, the state must accurately, to the extent possible, project future revenues and then determine if it can live within those constraints. The best studies have been conducted by states such as Rhode Island, Georgia and North Carolina, which include pension and health care benefit payments as debt. So these payments are added to annual debt service when applying constraints. (According to the Boston College Center for Retirement Research, Illinois debt service and the actuarial required contribution for pensions relative to revenues is the highest in the nation at close to 39 percent, while the median for all states is 8.2 percent.)

In some states, there are appointed commissions that develop the study. But in Illinois, we should charge the budget office with the study as it needs to be coordinated with capital budgeting and outlays for items such as pension payments.

If Illinois had this best practice in place a few years back, perhaps we would not be in the fiscal mess we now face. But it's not too late. The state can still adopt a study and, like most places, update it annually. Because Illinois would blow through any reasonable constraints, the document should be aspirational and complied with over time.

Still, a debt affordability study would force the governor and the Legislature to understand the magnitude of our problem and see how trade-offs such as debt and pensions can crowd out other essential services, such as education. This sort of transparency would also be a useful guide for the voting public.

Finally, in a state that recently flirted with junk bond status, it's worth mentioning that adopting this practice is a plus with the rating agencies.

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