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## [Fitch: IL Governor's Budget Proposal Relies on Significant Cost Shifts.](#)

Fitch Ratings-New York-16 February 2018: Governor Rauner's fiscal year 2019 budget proposal for Illinois – which utilizes measures including a pension cost shift to school districts and changes to state employee health insurance to generate a modest surplus – is likely to face significant legislative opposition and Illinois will remain challenged in achieving fiscal balance, Fitch Ratings says. A re-emergence of political stalemate that negatively affects fiscal operations, including a material increase in accounts payable, could trigger a downgrade.

If implemented, the governor's proposed pension cost shifting could pressure budgets for school districts, and would reverse a change implemented just six months ago that increased funding for Chicago Public Schools (CPS). Illinois' accounts payables would remain very high under the governor's budget, but could gradually be reduced over multiple years if some of his most significant proposals were implemented. The $37.6 billion general funds budget does not incorporate any rollback of recent tax increases. But the governor proposes that the legislature consider pension benefit changes to generate $900 million in savings in support of a partial individual income tax rollback. Fitch believes that this proposal too will face significant legislative opposition, and, if enacted, would likely be subject to legal challenge.

ACCOUNTS PAYABLE REMAINS A KEY CHALLENGE

By the end of fiscal year 2019, the governor's budget office estimates unpaid bills will be $7.4 billion, slightly higher than the $7.1 billion average between December 2010 and June 2015, but more than double what the administration considers a long-term target of 30 days. This is down considerably from a peak of $16.2 billion in October 2017, reflecting a $6 billion November 2017 bond sale, receipt of significant federal Medicaid matching funds following the enactment of a state budget after a two-year delay, and interfund borrowing. But the still extraordinary overhang of budgetary liabilities, nearly nine years into the national economic expansion, reflects the depth of fiscal and policymaking challenges Illinois faces.

Material progress in reducing accounts payable appears unlikely over the next several years, absent unexpectedly robust economic and revenue growth. The governor's budget includes the first year of a proposed four year plan to shift pension costs to school districts and public colleges and universities, with $1.4 billion in annual budgetary savings estimated upon full implementation in fiscal year 2022. The administration anticipates dedicating these savings, along with future operating surpluses, to reducing accounts payable over time. At that rate, it could still be many years before accounts payable approaches a level the state considers normal.

CURRENT YEAR GAP

For the current year, the governor estimates a $590 million operating deficit, despite the large tax increase passed in July 2017 and the resulting 20% increase in revenues, and balancing actions taken by the governor earlier this year. Delays in both implementation of budgeted pension changes and the sale of the Thompson Center state office building in Chicago (now forecast in the fiscal 2019 budget) are key factors behind the projected deficit. Additionally, the governor anticipates $1.1 billion in supplemental needs to address unappropriated spending from fiscal year 2017. On a budgetary, or cash, basis, the gaps are addressed mainly through proceeds from last November's GO sale and matching federal Medicaid funds, and the state ends with a $2 billion surplus in the executive budget projection.

FISCAL 2019 BUDGET DEPENDENT ON SIGNIFICANT COST SAVINGS

For fiscal year 2019, the governor projects a $2 billion general revenue funds structural budget gap, or approximately 5% of projected operating sources. To address the gap the governor proposes several steps including shifting the normal costs for pensions to school districts ($490 million) and public colleges and universities ($101 million). Twenty five percent of the normal costs, or $262 million, would shift to most school districts in fiscal year 2019, the first of a four-year transition envisioned by the governor. But CPS (Issuer Default Rating of BB-/Stable), would see an immediate 100% shift costing $228 million. Just last summer, CPS won legislative and gubernatorial approval for the state to cover the normal cost for pensions, in line with other school districts in the state, which this budget proposal would immediately reverse. Fitch believes it is unlikely that the legislature would revisit this change for CPS so quickly, or push higher pension costs onto other school districts. The executive budget calls for increased evidence based funding formula aid of $350 million, or 5%, for school districts.

The governor also proposes removing health insurance from collective bargaining with state employees, and instead giving the administration the ability to impose terms that would yield an estimated $470 million in savings for fiscal year 2019. Other proposed changes to group health insurance include shifting costs to public universities ($105 million) and ending subsidies for retired teachers and community college employees ($129 million).

For fiscal 2019, the governor proposes offsetting the higher pension and group health costs for public colleges and universities with higher operating appropriations. But the pension cost shift would ramp up over three additional years, without any commitment for additional state support in those years. Public colleges and universities could be challenged to absorb these cost shifts, particularly following several years of severely delayed state appropriations that weakened their liquidity positions.

The governor proposes closing the remainder of the $2 billion gap primarily through $600 million in interfund borrowing and $150 million from Medicaid provider rate reductions. Interfund borrowing could become outright transfers without a repayment requirement if the legislature approves a related gubernatorial proposal. And the Medicaid rate cuts would require federal approval, which the budget anticipates would take up to six months to secure.

TAX ROLLBACK NOT BUILT INTO BUDGET PLAN

For fiscal 2018, the legislature's budget (enacted over the governor's veto) included $4.5 billion in new revenue from increases in the individual income tax (4.95% from 3.75%) and corporate income tax rates (7% from 5.25%), and the fiscal 2019 executive budget retains those increases. But the governor proposes the legislature enact pension benefit changes to generate $900 million in savings that the governor would use to fund a rollback of 0.25% of the individual income tax rate to 4.7%. Pension changes, even the considerations model the governor suggests, are likely to face legal challenges given the strong constitutional protections for pension benefits in Illinois. Fitch notes that the fiscal 2019 executive budget does not assume savings from the proposed pension benefit changes.

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