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Fitch: Illinois Veto Jeopardizes School Funding and Ratings.

Fitch Ratings-New York-02 August 2017: Illinois Governor Rauner's veto of Senate Bill 1 (SB1) creates uncertainty as to whether or not Illinois school districts will receive state aid prior to opening for the new school year. Should there be an extended impasse, ratings for the Chicago Board of Education (Issuer Default Rating 'B+' / Negative Outlook) and other Illinois school districts with limited financial flexibility could be at risk, according to Fitch Ratings.

The state budget for fiscal 2018, which was enacted through override of the governor's veto, made school funding contingent upon legislative passage of a new evidence-based formula for distributing school aid. SB1, which meets that requirement, will now return to the legislature for further consideration. Among other adjustments, the governor's changes limit the increase in funding to Chicago Public Schools (CPS) by removing from the formula a \$250 million block grant that the district has historically received and also cutting CPS pension considerations. The governor's action would include putting monies required to fund CPS's normal pension cost in statute instead. Any other aid would require additional legislation, perhaps making it vulnerable to separate budget appropriation this year and in the future.

Although the dispute between the legislature and governor is focused on funding to CPS, the veto threatens the timeliness of the first distribution of general state aid to all K-12 school districts, which is set in statute for Aug. 10. Following a veto, the bill must be read again into the record in the state senate the next time it is in session. The legislature then has 15 days during which it faces three options. First, the house and senate can both agree to the governor's changes; this seems unlikely given the rancour of the debate. Second, the legislature can override the governor's veto with a super-majority vote. This also seems unlikely despite the override of the governor's veto of the fiscal 2018 budget. The budget crisis brought bipartisan agreement to a solution in a way that the school funding formula may not. The third option is to allow the bill to lapse and begin again, likely extending past the first distribution date on Aug. 10.

Resistance among key stakeholders and an absence of consensus create a political environment that remains a negative consideration for the state. A return to political gridlock specifically related to school funding puts at risk the ability of school districts to open all of their schools with a full complement of services. This is a notable difference from the state's fiscal behaviour during its extended budget impasse, during which it consistently appropriated funds for schools and prioritized those payments in its cash flow management. Nevertheless, delayed distribution of school funds would not have a near-term negative effect on the state's 'BBB' Issuer Default Rating. The current Negative Outlook is unrelated to school funding and instead reflects uncertainties related to achieving the revenue and spending assumptions in the fiscal 2018 budget. Delayed distribution may, however, have a negative impact on school district ratings. Some districts should be able to weather a state aid delay by relying on reserves or by short-term borrowing, but others, notably CPS, have much more limited flexibility. Fitch will closely monitor the potential impact an extended impasse may have on Illinois school district credit quality and will take action on a case by case basis as necessary.

For more information on the enacted state budget and school funding, see 'Fitch: Illinois Budget

Mixed News for Locals' (July 2017), available at www.fitchratings.com.

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