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Fitch Ratings: Illinois' Revenue Picture Improves but Fiscal Questions Remain

Fitch Ratings-New York-09 May 2019: Robust revenues collections for April provide some short-term budgetary relief for Illinois, but significant uncertainties remain regarding structural budget balance, including for next year, says Fitch Ratings.

Illinois' 'BBB' Issuer Default Rating (IDR) reflects a historical pattern of weak operating performance and irresolute fiscal decision-making. The Negative Rating Outlook reflects our assessment that near-term fiscal challenges will pressure the rating.

Fitch has indicated that we would lower the state's IDR if Illinois returned to a pattern of deferring payments for near-term budget balancing. A reported 32% year over year (yoy) gain in monthly general funds tax receipts for April 2019 has alleviated immediate pressure in Illinois' fiscal 2019 budget. The state's commission on government forecasting and accountability (COGFA) also reports that for the fiscal year to date (FYTD), general funds tax receipts are up nearly 10% – as of March that growth was just under 6%.

Based on these strong collections, the governor's office of management and budget (GOMB) and department of revenue (DOR) will revise forecast personal and corporate income tax revenues for fiscal 2019 up by approximately $1.4 billion, or 7% from the estimate included in the February executive budget proposal. This largely resolves what GOMB previously estimated as a $1.6 billion deficit for the current year, and addresses part of Fitch's rating sensitivities related to the Negative Outlook.

The sustainability of the April revenue surprise is uncertain, but will be critical in assessing how much this helps in addressing Illinois' structural budget gap, particularly for next fiscal year. Total gross personal income tax revenues through April were up more than $1.8 billion from the prior year, or just over 10%. COGFA's initial assessment is that non-wage income tax revenues were a key component of the April gains. Non-wage revenues consist mainly of capital gains related income and are notoriously volatile. Non-wage taxpayer responses to the December 2017 federal tax changes (commonly referred to as the Tax Cuts and Jobs Act), as well as the state's own income tax increase that was effective July 1, 2017, further complicate the revenue picture.

Fitch notes sales tax collections are also up at a very healthy pace of more than 7% yoy, or nearly $500 million, but that pace is also unlikely to be sustained. Growth accelerated rapidly following the Oct. 1, 2018 effective date of state regulations regarding remote, mainly online, sellers, following last June's Wayfair U.S. Supreme Court decision. Through September, sales tax receipts had been growing at less than 4% yoy. After October, that FYTD growth rate spiked to 5.5% and has climbed since then. By next October, Fitch anticipates some of that growth will fall off following a full year of the regulations being effective.

It is far from clear how much of the revenue gains in April 2019 are likely be maintained in future years. While acknowledging this uncertainty, GOMB and DOR have revised their estimate of fiscal

2020 revenues upwards by roughly $800 million. This revision allows the state to delay, and possibly avoid entirely, a potentially costly proposal to extend the pension amortization by seven years, while maintaining the comparatively weak 90% funding target. The re-amortization is one element in a five-part plan outlined earlier this year by the administration (see “Fitch Ratings: IL Pension Plan Frames the Rating Picture; Budget Details Still Key,” Feb. 19, 2019).

If the upward revenue adjustment reflects sustainable revenue growth and the pension re-amortization is not implemented next year, this would reduce the use of non-recurring measures in the budget by nearly $900 million (the previously estimated savings from the re-amortization). The remaining non-recurring revenue measures in the governor’s fiscal 2020 executive budget would be 1%-2% of the proposed $38.7 billion general funds operating budget. These include initial licensing fees from legalization of cannabis ($170 million) and sports wagering ($200 million), and a tax amnesty plan ($175 million) (see “Fitch Ratings: IL Illinois Governor’s Budget Plan Would Make Insufficient Progress,” Feb. 26, 2019).

The governor framed his executive budget plan as a bridge budget that would buy time until the state is able to implement his proposed graduated income tax and then achieve more substantive fiscal progress. This new tax requires a state constitutional amendment that must be approved by legislative super-majorities (which Democrats have in both chambers) and then by voters, either by a super-majority of those voting on the amendment or a simple majority of all those voting in the election. While the state Senate recently approved the measure, and related bills to set tax rates, the legislation must still clear the House and then gain voter approval. Fitch estimates the earliest it could be approved would be in the November 2020 general election with implementation on Jan. 1, 2021, more than 18 months from now.

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