UPDATE ON ILLINOIS’ ECONOMIC AND FISCAL CHALLENGES & RESPONSES

PRESENTATION TO THE BOARD OF TRUSTEES OF THE UNIVERSITY OF ILLINOIS
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ECONOMIC AND FISCAL UPDATE
OUTLINE

• Recent IGPA activities on Fiscal Topics
• Economic Overview
  – Illinois Unemployment
  – Illinois Labor Force & Nonfarm Employment
• Fiscal Overview
  – Update on Unpaid Bills
  – Pension Reform
  – Phase-Out of Temporary Tax Rates
  – Illinois’ Bond Rating
• Summary
RECENT IGPA ACTIVITIES ON FISCAL TOPICS

• Fiscal Futures team briefed lawmakers on budget transparency
• Three Fiscal Futures’ reports released at summit:¹
  • New Projections from IGPA’s Fiscal Futures Model
  • Economic impact of January 2011 tax increases in Illinois (e.g., effect on employment)
  • Other states’ use of temporary tax increases

¹. All available at: http://igpa.uillinois.edu/fiscalfutures
ECONOMIC OVERVIEW
ECONOMIC OVERVIEW – ILLINOIS & US UNEMPLOYMENT

Unemployment Rate in Illinois (ILUR)
Civilian Unemployment Rate (UNRATE)

January 2010
IL Rate: 11.3%

October 2009
US Rate: 10.0%

November 2013
IL Rate: 8.7%

November 2013
US Rate: 7.0%

Shaded areas indicate US recessions. 2013 research.stlouisfed.org
ECONOMIC OVERVIEW – UNEMPLOYMENT

<table>
<thead>
<tr>
<th>State</th>
<th>May 2013 (Six Months Ago)</th>
<th>November 2013</th>
<th>Change</th>
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</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>9.1%</td>
<td>8.7%</td>
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<tr>
<td>Michigan</td>
<td>8.4%</td>
<td>8.8%</td>
<td>+0.4%</td>
</tr>
<tr>
<td>Indiana</td>
<td>8.3%</td>
<td>7.3%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>7.0%</td>
<td>6.3%</td>
<td>-0.7%</td>
</tr>
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</table>

Shaded areas indicate US recessions. 2013 research.stlouisfed.org
**Cause for Concern: Labor Force and Payrolls**

Labor force for November 2013 is down 116,500 from February.

Employment has recovered somewhat, but is still well below 2008 levels.

Shaded areas indicate US recessions. 2013 research.stlouisfed.org
FISCAL OVERVIEW
UNPAID BILLS: A TEMPORARY IMPROVEMENT

- Factors “allowed Illinois to pay all of its General Funds bills from the previous fiscal year earlier than at any time since 2009”
  - Stronger first quarter FY 2014 revenues
  - “April Surprise” surge in 2013 income tax receipts
  - Higher sales tax revenue
  - Transfer of $400 million from Income Tax Refund Fund
  - Fewer lapse period transactions

- However, the future is ominous. “The fiscal year 2014 budget could counteract much of the fiscal progress made last fiscal year...[and the path ahead] is particularly troubling as fiscal year 2014 is the last full year of added revenue from the temporary income tax increase”

PENSION REFORM: ONLY A PARTIAL FIX

ILLINOIS ALL-FUNDS STRUCTURAL BUDGET GAP PROJECTIONS, PRE & POST DECEMBER 2013 PENSION REFORMS, WITH & WITHOUT ADJUSTMENT FOR CHANGE IN UNFUNDED PENSION LIABILITIES, EXISTING TAX LAW

Source: IGPA’s Fiscal Futures Model, December 2013

Note: Estimates from TRS are preliminary.
WHAT IF HIGHER TAX RATES WERE EXTENDED?

ILLINOIS ALL-FUNDS STRUCTURAL BUDGET GAP PROJECTIONS, PRE & POST PENSION REFORMS, WITH & WITHOUT ADJUSTMENT FOR CHANGE IN UNFUNDED PENSION LIABILITIES, ASSUMES TAX RATES STAY AT 2011-14 LEVELS

Source: IGPA's Fiscal Futures Model, December 2013   Note: Estimates from TRS are preliminary
ILLINOIS’ BOND RATINGS

<table>
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<th>Year</th>
<th>S&amp;P</th>
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<th>Fitch</th>
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<td>Aa2</td>
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<tr>
<td>2013</td>
<td>A-</td>
<td>A3 (neg.)</td>
<td>A- (neg.)</td>
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Standard & Poor’s, December 2013: "Although we view the consensus achieved by Illinois on [pensions] as positive from a credit standpoint, the developing outlook reflects the implementation risk - legal and budgetary - associated with various provisions of the pension reform, as well as the overall structural budget challenges facing the state."


SOURCES:
Current Data: http://www.ioc.state.il.us/index.cfm/fiscal-condition/bond-ratings/
Historical: http://www.census.gov/prod/2011pubs/12statab/stlocgov.pdf,
http://www.census.gov/compendia/statatab/past_years.html
Illinois’ sold taxable GO bonds in December 2013 with yields 174 basis points (1.74%) above similarly maturing Treasury securities.

- Which is 68 basis points (0.68%) lower than spread for comparable April 2013 sale.

- This represents approximately $25 million in interest cost savings for the State.

- Pension reform has also provided bond market benefits to Illinois local governments.

Sources: EMMA, Municipal Market Access; www.treasury.gov.
SUMMARY

• The Illinois economy is showing signs of weakness, which may add to Illinois’ budget woes

• Illinois’ bill backlog has temporarily improved, but is expected to worsen again

• Pension reform helps to address budget gap but does not fully solve the state’s fiscal problems
  – Even if combined with higher tax rates

• Illinois’ bond ratings continue to be poor
  – Big improvement in borrowing costs in December
  – Still threatened by uncertainty and fiscal inaction
FOR MORE INFORMATION:

IGPA.UILLINOIS.EDU