ILLINOIS ECONOMIC
and
FISCAL COMMISSION

ILLINOIS BOND WATCHER 2003

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703 STRATTON BUILDING
SPRINGFIELD, ILLINOIS 62706

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2003 BOND WATCHER
INTRODUCTION

One of the responsibilities of the Illinois Economic and Fiscal Commission is to examine the long-term debt of the State of Illinois. Illinois issues several forms of formal long-term debt. State-supported bonds include the State's general obligation bonds, State-issued revenue bonds, and locally-issued revenue bonds that are repaid or secured by the State. Non-State-supported debt consists of those bonds which are issued by authorities created by the State, but for which the State is said to have only a moral obligation or no obligation to repay. In addition, the State incurs several other types of long-term debt not represented by formal debt instruments and, therefore, not covered by this report. These include unfunded pension liabilities, Certificates of Participation, and long-term leases.

This report provides information on the levels of State-supported and non-State-supported bond debt using information provided by the Governor's Office of Management and Budget and the Office of the Comptroller. In an ongoing attempt to provide clear concise information, please note the table entitled Bonds at a Glance. Shown on page ii, the table provides a quick reference for frequently asked questions regarding bond sales, debt service, and bond ratings.

Additional information relating to the State of the Illinois bonded indebtedness may be obtained upon request.

2003 BOND WATCHER
EXECUTIVE SUMMARY

- To help relieve FY 2003 and FY 2004 spending pressures on the General Revenue Fund and to help reduce the State pension systems' unfunded liability, the Illinois sold $10.0 billion in Pension Obligation Bonds. The State's payment to the five retirement systems in FY 2005 will be approximately $1.911 billion (excluding an expected $80.0 from the State Pension Fund per the Pension Laws Commission) and the State's debt service payment will be $496 million equaling $2.407 billion in Pension Fund contributions.

- Due to negative balances in the Unemployment Contribution Fund, the Illinois Department of Employment Security may sell an estimated $1.4 billion in Unemployment Compensation revenue bonds, to be paid back from part of employers' Unemployment Insurance contribution. These bonds will **not** be backed by the full faith and credit of the State.

- The State sold $1.0 Billion at the beginning of FY 2003 and $1.5 billion in May 2003 of short-term debt. Of this amount, the General Revenue Fund will have received $1.675 billion to assist in cash flow difficulties.

- With a $0 balance at the beginning of FY 2004 and based on the Commission's estimate of revenues, the School Infrastructure Fund may fall short of the revenue needed to pay debt service on School Construction bonds in FY 2004. If bond authorization were increased to meet School construction needs, additional funding for debt service may be required.

- Total outstanding State-supported principal for FY 2002 was $12.697 billion. Due to the Pension Obligation bond sale, that level increased 97.3% to $25.051 billion in FY 2003.

- The Governor's Office of Management and Budget estimates general obligation debt service to reach $1,548.1 million in FY 2004, with estimated transfers from the Road Fund of $227.6 million (14.7%), the School Infrastructure Fund $202.2 million (13.1%), and the General Revenue Fund $1.118 billion (72.2%).

- Fitch and Moody's have Illinois' level of debt to personal income between 5.3% and 5.5%. These levels keep Illinois in the moderate debt range, but in the above average category.

- In May both Moody's and Fitch lowered the State of Illinois' rating one level. Both agencies explained that in addition to the short-term borrowing plan, a combination of factors led to this change in status, including the increase by $10 billion for the second year in a row for the state's unfunded pension liability, now at $35 billion.

ILLINOIS BONDS AT A GLANCE

($ in Millions)

	FY 2002	FY 2003	From Previous Year		Estimated	From Previous Year	
			$ Chg.	% Chg.	2004	$ Chg.	% Chg.
Bond Sales*							
General Obligation**	$1,500.0	$11,712.1	$10,212.1	680.8%	$1,600.0	$-10,112.1	-86.3%
Revenue	150.0	182.2	32.2	21.5%	250.0	67.8	37.2%
Locally-issued †	559.0	1,062.0	503.0	90.0%	42.5	-1,019.5	-96.0%
TOTAL	**$2,209.0**	**$12,956.3**	**$10,747.3**	**486.5%**	**$1,892.5**	**$-11,063.8**	**-85.4%**
Outstanding Principal							
General Obligation	$7,629.9	$18,812.6	$11,182.7	146.6%	$19,884.4	$1,071.8	5.7%
Revenue	1,912.7	1,999.2	86.5	4.5%	2,153.3	154.1	7.7%
Locally-issued	3,154.2	4,238.9	1,084.7	34.4%	4,046.6	-192.3	-4.5%
TOTAL	**$12,696.8**	**$25,050.7**	**$12,353.9**	**97.3%**	**$26,084.3**	**$1,033.6**	**4.1%**
Debt Service							
General Obligation	$851.5	$973.4	$121.9	14.3%	$1,548.1	$574.7	59.0%
Revenue	183.0	209.7	26.7	14.6%	218.5	8.8	4.2%
Locally-issued	195.7	217.3	21.6	11.0%	234.7	17.4	8.0%
TOTAL	**$1,230.2**	**$1,400.4**	**$170.2**	**13.8%**	**$2,001.3**	**$600.9**	**42.9%**
General Revenuesⓘ	**$23,378.0**	**$24,761.0**			**$27,126.0**		
G.O. & Revenue Debt Service as % General Revenues	**4.42%**	**4.78%**			**6.51%**		
G.O. Bond Rating							
Moody's	Aa2	Aa3					
Standard & Poor's	AA	AA					
Fitch Ratings	AA+	AA					

* Bond Sales do not include refunding sales.

** G.O. bonds include the $10.0 billion of Pension Obligation Bonds issued in FY 2003, but not Short-term borrowing.

† FY 2002 includes RTA SCIPs and ISFA bonds issued for the Soldier Field renovation. FY 2003 includes RTA SCIPs and MPEA expansion bonds.

ⓘ The FY 2004 General Revenue Estimate uses IEFC's September 2003 estimate.

Sources: Governor's Office of Management and Budget, MPEA, RTA, and ISFA.

SUMMARY OF STATE-SUPPORTED BOND DEBT

State-supported bond debt can be divided into three categories: general obligation debt backed by the full faith and credit of the State, State-issued revenue debt supported by dedicated tax revenue or lease payments, and locally-issued revenue debt supported by the pledge of State taxes or lease payments. Bonds are sold to provide funds either for projects or to refund previously issued bonds.

The State issues general obligation bonds for its continuing capital program that began in FY 1971. Bonds secured by dedicated tax revenues are issued by the State for the Build Illinois program and for Civic Centers. Certificates of participation (COPs) have been authorized and issued by the State to finance the lease/purchase of equipment and the lease/purchase of correctional facilities. Locally-issued revenue bonds supported by State revenue include those issued by the Metropolitan Pier and Exposition Authority (McCormick Place and Navy Pier), the City of Collinsville (State Office Building), the Springfield Airport Authority, the Illinois Sports Facilities Authority (Comiskey Park and Soldier Field), and the Regional Transportation Authority. [The Springfield Airport Authority bonds were paid off in FY 2003, while the City of Collinsville bonds will be paid off in FY 2006.]

The following report looks at various debt-related statistics in an attempt to explain what has occurred in this area and what the potential direction of the State's bonding programs may be in the future. The estimates contained within for FY 2003 are projections by the Illinois Economic and Fiscal Commission based on the Governor's Office of Management and Budget's estimate of FY 2003 bond sales.

CURRENT BOND TOPICS

Pension Obligation Bonds

At the end of FY 2002, the amount of unfunded actuarial accrued liabilities for the five State retirement systems was estimated at $35.0 billion. FY 2003 State appropriations for these retirement systems, including required payments and unfunded liability, were estimated to be $1.635 billion, with FY 2004 reaching $1.86 billion. To help relieve FY 2003 and FY 2004 spending pressures on the General Revenue Fund and to help reduce the unfunded liability, the Governor requested, and the legislature passed Public Act 93-0002. This Act authorized the State to issue $10.0 billion in General Obligation Pension Obligation Bonds (POBs). The proceeds of the bonds will pay the required State contributions to the designated retirement systems in the amount remaining unpaid in FY 2003 and the amount to be paid in FY 2004. After these payments are made, the balance of the Pension Contribution Fund will be appropriated to each of the designated retirement systems in the same proportion of their respective portions of the total actuarial reserve deficiency of the systems. The Governor's Office of Management and

Budget determined these amounts within 30 days after the bond proceeds were deposited into the Pension Contribution Fund.

The taxable 30-year Pension Obligation bonds were sold in June 2003, at a true interest rate cost to the State of 5.047%. The downgrade by two rating agencies did not seem to affect the taxable bond sale, which was sold at the most opportune time to get the best interest rate possible. The State was not originally going to sell all $10 billion of bonds at once, but with the low interest rate and high demand in both the domestic corporate-grade and international markets, the State decided to sell the full amount. Approximately 30%-35% of the bonds were sold internationally. **Debt service to be paid on these bonds will range from $481.0 million beginning FY 2004 up to $1.16 billion in the final years of payoff. The State will not have to begin making principal payments on the bonds until FY 2008, with payments beginning at $50.0 million and ending at $1.1 billion in FY 2033, while interest payments decrease from early highs of $481.0-$496.2 million down to $56.1 million by FY 2033 (See p.18).**

The FY 2004 State funding for the five retirement systems is as follows, with the remaining bond sale proceeds being funneled through the Pension Contribution Fund (PCF).

FY 2004 Retirement Contributions

	State Universities Retirment System	Teachers' Retirement System	State Employees Retirement System	Judges' Retirement System	General Assembly Retirement System	Total
GRF*	$46.1	$60.9	$500.7	$35.0	$5.5	$648.1
CSF**	$250.0	$920.0	$0.0	$0.0	$0.0	$1,170.0
SPF	$15.7	$47.4	$15.2	$1.5	$0.3	$80.0
PCF	$1,468.3	$4,439.9	$1,420.6	$143.2	$28.0	$7,500.0
Total	**$1,780.0**	**$5,468.1**	**$1,936.4**	**$179.8**	**$33.8**	**$9,398.1**

*The General Revenue Fund (GRF) contribution will depend on actual FY 2004 payroll, as the amount shown is based on an employer constribution rate of 13.439% for FY 2004.
**Common School Fund (CSF) includes contributions from the Education Assistance Fund for TRS.

The State Pensions Fund (SPF) receives $80 million a year from unclaimed property.

The Pension Contribution Fund (PCF) received $7.5 billion on July 1st from the Pension Obligation Bond sale.

Source: Pension Laws Commission

Each of the five retirement systems received their portion of bond sale proceeds from the Pension Contribution Fund on July 1st and were able to invest them by the fourth of July weekend. It took a day and a half to get $7.5 billion into the market. All five systems are, at this time, assuming an 8.5% rate of return over the 42-year projection period. The State Universities Retirement System has stated that their investments have earned 7.5% since July.

Pension obligation bonds must be issued on a taxable basis because current federal tax law restricts the investment of the proceeds of tax-exempt bonds in higher-yielding taxable securities. From a purely financial perspective, issuing pension obligation bonds can produce savings for a government if the interest rate paid on the bonds is less than the rate of return earned on proceeds placed in the pension plan [Source: The Government Finance Officers Association].

Normally counties and municipalities issue POBs. Standard & Poor's says that approximately $10 billion in pension obligation bonds were sold in the 1990s by state and local governments. New Jersey issued approximately $2.75 billion of POBs in 1997. The bonds' interest rate was 7.64%, but the pension funds lost 9% in 2000 and –10% in 2001, causing the funds to decline in value from $94 billion to $72 billion. New Jersey had $1 billion in pension shortfalls as of January 2003. Other states are looking at issuing pension obligation bonds to help with their budget shortfalls, such as Oregon ($2.0 billion) California ($1.3 billion), and Wisconsin ($1.5 billion).

Unemployment Compensation Bonds

The Office of Management and Budget is looking into issuing Unemployment Compensation Bonds to help with negative balances in the Unemployment Contribution Fund. As of September 23, 2003, the current balance in Illinois' Unemployment Contribution Fund was -$124.8 million. The Illinois Department of Employment Security projects the following balances for the Trust Fund through calendar year 2008.

Calendar Year	Net Balance (in billions)
2003	-$0.493 to -$0.510
2004	-$1.164 to -$1.206
2005	-$1.484 to -$1.530
2006	-$1.468 to -$1.523
2007	-$1.153 to -$1.335
2008	-$0.622 to -$0.936

The Federal Unemployment Tax Act allows states to take out a loan from the federal government to pay their unemployment compensation obligations, but if the loan is not repaid within one year, the state must pay interest. The Department has taken out federal loans and repaid them in the past, with a loan just paid off in April. With the balance going back into the negatives, the Department is beginning to take out federal loans again to bring up the balance. It has been suggested that Illinois should sell bonds to pay back the federal loans and to shore up the Trust Fund. **The Office of Management and Budget has a preliminary estimate of selling $1.4 billion in bonds, of which $510 million would go to pay off the State's federal loan. The bonds will most likely be sold by the Illinois Department of Employment Security**

as revenue bonds to be paid back from the permanent fund building rate (0.4%) that is a part of employers' Unemployment Insurance contribution. These bonds will not be backed by the full faith and credit of the State.

A very few states have done something like this; Connecticut and Louisiana both issued bonds in the early 1990s. The State of Connecticut sold $1.02 billion of Special Obligation "Special Assessment Unemployment Compensation Advance Fund revenue bonds" that were paid off in 7 years.

More recently, in its 78th Regular Session in 2003 the Texas Legislature gave the Texas Public Finance Authority the authorization to issue up to $2 billion in bonds to pay Benefit Obligations or to repay Federal Advances on unemployment compensation, which they issued in September 2003 an received strong ratings. The $1.43 billion of bonds sold are not an obligation of the State of Texas, and will be paid off from an existing revenue source called the Obligation Assessment which is levied by the Texas Workforce Commission on employers to fund the State's unemployment insurance program.

Short-Term Borrowing

In May 2003, the State issued $1.5 billion in General Obligation Certificates to pay off overdue bills. The distribution of the proceeds were as follows:

- $700 million to the general funds for Medicaid,
- $275 million to the general funds to make State Aid Payments to K-12 school districts,
- $475 million for corporate and personal income tax refunds, and
- $50 million to the Long Term Care Provider Fund to pay medical providers of long term care.

The notes were sold at a true interest cost of 0.997% in May of 2003 and are to be paid back within a year during FY 2004. This is "across fiscal year" short-term borrowing used for a deficit due to emergencies or failures of revenues. Up to 15% of the State's appropriations for the fiscal year may be incurred and must be repaid within one year.

Maturity Date	*Principal Paid*
January 15, 2004	$300 million
March 15, 2004	$250 million
April 15, 2004	$450 million
May 15, 2004	$500 million
Source: Official Statement Addendum, May 20, 2003	

The State can also borrow within a fiscal year, if the short-term debt is to be used for cash flow purposes. Up to 5% of the State's appropriations for the fiscal year may be incurred and must be repaid by the end of that fiscal year. At the beginning of FY 2003, $1.0 Billion in federally tax-exempt Revenue Anticipation Certificates were sold (July 16, 2002) at a true interest cost of 1.4136% to meet the cash flow problems of the State. The proceeds from this sale were disbursed as follows:

- $700 million into the general funds to relieve general cash flow pressures and to provide for the payment of appropriated amounts for medical assistance under the Illinois Public Aid Code- to be paid back from the General Revenue Fund.
- $150 million into the Income Tax Refund Fund-to be paid back from this fund.
- $150 million into the Long Term Care Provider Fund to pay medical providers for their medical assistance under the Public Aid Code-to be paid back from this fund.

This $1.0 billion in short-term borrowing was retired on June 15, 2003. **Of the $2.5 billion in combined short-term borrowing sales in FY 2003, the General Revenue Fund will have received $1.675 billion to assist in cash flow difficulties.**

"Tobacco Securitization" General Obligation Bonds

Since 2000, several states have securitized their future tobacco settlement payments to help with budget gaps. Illinois Public Act 92-0596 authorized $750.0 million in General Obligation "Tobacco Securitization" bonds to be issued in FY 2003 only, with half the proceeds going to the Budget Stabilization Fund, and the other half to the General Revenue Fund. A G.O. tobacco bond is a double-barrel bond using tobacco settlement payments to pay for debt service backed by the State's general obligation pledge, which would be attractive for investors while getting the State a low interest rate.

The Governor's Office of Management and Budget did not issue tobacco securitization bonds in FY 2003. And, although there has been some interest in the legislature to allow issuance of these bonds in FY 2004, it most likely will not occur due to current problems in the tobacco bond market. An Illinois Madison County Circuit Court ruled against Altria Group, Inc., owners of Philip Morris USA, Inc., in a case where smokers sued the company saying they were led to believe light cigarettes were healthier than regular cigarettes (*Price v. Philip Morris*). In the March 21, 2003 judgment, the Altria Group was to pay $10.1 billion in damages, or put up a $12 billion bond while they are appealing the ruling. This ruling, known as the Miles Decision, started a domino effect that is still being played out in the bond market. Immediately, Philip Morris stated that the appeal bond amount was so high, they would not be able to make their Master Settlement Agreement payments of $2.5 billion on April 15 to all of the states, and that they may have to declare bankruptcy.

Within weeks of these statements, Moody's Investor Service (March 31), Fitch Inc. (April 3), and Standard & Poor's (April 9) had all downgraded Philip Morris' credit ratings. Fitch also put a negative watch on the debt for R.J. Reynolds Tobacco Company since they will be facing a similar lawsuit in Madison County in the

Ratings Agency	Ratings Before Miles Decision	Ratings as of 8/28/2003
S&P	A	BBB, on negative watch
Moody's	A1	Baa2, on negative watch
Fitch	A+	BBB, on negative watch
Source: "The Third Leg Falls: S&P, Following Suit, Lowers Tobacco Bonds", *The Bond Buyer*, 8/28/2003		

closing months of 2003. Multiple downgrades by all three ratings agencies leave tobacco securitization bonds at much lower ratings than before the Miles Decision. Standard & Poor's cited that their August round of downgrades were based on "adverse litigation", decline in cigarette market and consumption, "the expected increase in state excise taxes", and the "continued growth of the deep discount manufacturers". Fitch and Moody's have Altria, Philip Morris, and R.J. Reynolds and their subsidiaries on negative watch for possible further downgrades. With consumer court cases against the tobacco manufacturers there is more risk in whether the tobacco companies will have funds to pay the Master Settlement Agreement payments to the States who are using these payments for tobacco bonds.

Virginia has delayed their tobacco bond issue originally slated for Spring 2003, but New York in June and California in September sold over $2.0 billion worth of tobacco bonds each using their states' G.O. pledge to back them. New York, California and Oregon are the only states that have issued tobacco securitization bonds in 2003. Another outcome of the Madison County court case was the downgrading by Moody's of California's revenue anticipation notes sold last fall and scheduled to mature on June 20, 2003. The California tobacco bond sale was to raise cash to redeem these notes. Tobacco securitization bonds are too risky for some, but attractive for other buyers who want the high yields and who are willing to take the risk. Other tobacco bond issuers are feeling the side-effect of the downgrades through added fiscal pressures to New York City, New York counties, Iowa and the District of Columbia who all pledged to fund a "trapping account" as part of their security for their tobacco bonds. If the credit ratings of one or more tobacco companies accounting for a certain percentage of the annual Master's Settlement Agreement payments went below investment grade, these governments would divert excess tobacco settlement funds, after paying debt service on the bonds, to a trapping account as an extra reserve for future debt service on the bonds. This was triggered after Moody's downgraded R.J. Reynolds to Ba1 in the summer of 2003.

Although the Madison County Court case has had subsequent rulings on the amount of the appeal bond to be paid by Altria, the Illinois Supreme Court, in September 2003, reinstated the Judge's lowered appeal bond of $6.8 billion, and stated it would hear this case immediately without it going through an intermediate appellate court review. At the end of October 2003, an Illinois Supreme Court justice ordered an emergency 90-day stay of a class action lawsuit against R.J. Reynolds Tobacco Co. (*Turner, et al v. R.J. Reynolds*) until the Illinois Supreme Court could rule on the Altria case (*Price v. Philip Morris*) and a ruling on whether R.J. Reynolds could get a change of venue for their case due to the similarity to the *Price* case.

School Construction

The School Construction Program is a grant program to help school districts fund building projects and renovations. School districts must provide an application to the

State Board of Education and be approved, then pass a referendum to fund the local share-matching contribution of the project. When these requirements are met, the Capital Development Board awards schools a State grant from bond sale appropriations depending on the priority of needs—disasters, shortage of classrooms due to overpopulation, aging buildings, interdistrict reorganization, health/life safety hazards, accessibility for individuals with disabilities, and other unique priority situations. Applications for funding in FY 2004 were to be submitted by April 1, 2003.

Grant Applications per Fiscal Year	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Applications Received	57	197	157	166	204	94	48
Applications Entitled*	53	161	131	148	97[①]	8[†]	0[†]

*"*Entitlement* signifies that a district has demonstrated a need and is eligible for a grant should sufficient funds be appropriated." (Source: Illinois State Board of Education)

①There were 191 applications entitled in 2002, but approximately ½ were not able to secure their local share and were moved into the 2003/2004 cycles.

† FY 2003 and 2004 entitlements are suspended except for emergency situations. This amount denotes estimated emergency situations.

Of the 97 entitled applications in FY 2002, 70 actually received grants, 1 district dropped out of the process, 2 applications were put on hold and 24 projects remain on the list (Chicago gets 20% as those on the list get funding). The State Board of Education has received 10 applications for FY 2005, as of October 24, 2003. In October, ISBE sent out the request for districts to respond on their capital assessment needs. The Board's report is expected to be offered to the Legislature in January.

Appropriations by Fiscal Year ($ in Millions)	1998	1999	2000	2001	2002	2003	2004	Est. 2005
State Appropriation	$30.0	$327.0	$540.0	$500.0	$740.0	$500.0	$500.0	$0

The FY 2002 appropriation of $740.0 million allowed funding for all FY 2001 projects for districts that were entitled and able to secure their local share of funds. Public Act 92-0598, which was signed into law at the end of FY 2002, increased School Construction authorization by $930 million. The FY 2003 and estimated FY 2004 appropriations of $500 million each, will allow for the funding of 87% of the entitled FY 2002 projects. At least 24 entitled districts will not receive funding even with the $930 million increase in school construction authorization. These numbers do not include FY 2003 applications. The Illinois State Board of Education is not actively soliciting applications, but they are still receiving them from local school districts.

Grants are funded from the School Construction portion of general obligation bond sales. Bonds are sold as needed for the approved construction projects. The proceeds

from the bond sales are placed in the School Construction Fund. Grant amounts to schools for construction projects and costs are paid out of this fund.

Debt service on School Construction bonds is paid for by transfers from the School Infrastructure Fund. This fund receives transfers from the General Revenue Fund in the amount of $60 million a year (approximately 75% of the additional liquor tax increase from IL FIRST), $60 million a year from the cigarette tax ($5 million a month from the cigarette tax increase enacted in FY 2002 to begin April 1, 2003), and 1/7th of the 7% Telecommunications Excise tax from the School Reform Act which had been at $110 million a year, but has recently fallen.

School Infrastructure Fund	1998	1999	2000	2001	2002	2003	Est. 2004
Telecommunications Excise Tax	$35.2	$101.5	$108.5	$114.9	$110.4	$89.7	$69.3
Liquor Tax	-----	-----	$60.0	$60.0	$0.0*	$0.0*	$60.0
Cigarette tax	-----	-----	-----	-----	-----	$15.0	$60.0
TOTAL	**$35.2**	**$101.5**	**$168.5**	**$174.9**	**$110.4**	**$104.7**	**$189.3**

Note: Illinois Economic and Fiscal Commission estimates

**The liquor tax transfer was suspended for FY 2002 and FY 2003 as part of the budget agreement.*

Funds are transferred monthly from the School Infrastructure Fund to the General Obligation Bond Retirement and Interest Fund to pay for the school construction portion of debt service. The following table shows the debt service on school construction bonds tied to transfers from the School Infrastructure Fund.

G. O. Bond Retirement and Interest Fund ($ millions)	**1998**	**1999**	**2000**	**2001**	**2002**	**Est. 2003**	**Est. 2004**
Debt Service tied to transfers from School Infrastructure Fund	n/a	$7.0	$21.0	$49.0	$73.2	$129.5	$202.2

Source: Governor's Office of Management and Budget

The Governor's Office of Management and Budget estimates that the School Infrastructure Fund will pay $202.2 million in debt service in FY 2004. The IEFC estimates $189.0 million in revenues for FY 2004. This figure is lower than in previous years because of recent declines in revenues from the telecommunications tax. Possible reasons for the declines include the emergence of broadband Internet services, competition from mobile wireless service, pre-paid calling cards, and the struggling economy. [See the Commission's October 2003 report *The State's Public Utilities Taxes 2003, pp. 6-10*]. **With a $0 balance at the beginning of FY 2004 and based on the Commission's estimate of revenues, the School Infrastructure Fund may fall short of the revenue needed to pay debt service on School Construction bonds in FY**

2004. If bond authorization were increased to meet School construction needs, additional funding for debt service may be required.

Illinois Sports Facilities Authority- Soldier Field Renovation

In November 2000, the General Assembly passed Public Act 91-0935 amending the Illinois Sports Facilities Authority (ISFA) Act to finance renovations for the Chicago Bears Stadium at Soldier Field and related lakefront improvements. The proposal increased bonding authorization by $399.0 million. The total cost of the project would be $587.0 million with $200.0 million to be paid for by the Bears (with the help of a NFL loan). These bonds would be backed by an increased advance of State hotel tax revenues, to be paid back by ISFA Chicago hotel tax receipts and the City of Chicago's portion of the Local Government Distributive Tax. The original amount placed in the Advance Account of $8 million would be increased to $22.179 million (the "Advance Amount") for FY 2002, and would increase each fiscal year by 105.615% (rounded to the nearest $1,000) until the year 2032.

The ISFA bonds were sold in October of 2001. As part of the bond sale, the ISFA was able to save on debt service for the first two years of the bonds maturity. Therefore, the Advance Amount requested by the Authority was reduced to only $15.172 million in FY 2002, and $19.166 million in FY 2003. The additional amounts approved but not requested during FY 2002 and FY 2003 may be requested at a later date, if needed. Debt service was structured to match revenues available. Less money will be paid toward debt service on the Soldier Field bonds in the first years until the funds are freed up from the retirement of Comiskey Park debt in 2010. The total cost of the Soldier Field and Lakefront Improvement Projects reached $650 million, with approximately $50 million in overruns to be paid for by the Bears, per the original agreement. Soldier Field reopened in September of 2003.

Metropolitan Pier and Exposition Authority-McCormick Place Expansion

In the 92nd General Assembly, the legislature approved an $800.0 million dollar expansion of McCormick Place, increasing bond authorization to $2.107 billion, and lengthening the maximum maturity for these bonds from 30 to 40 years. The bonds to be issued will not use additional taxes, but the law increases the amounts and length of time that McCormick Place receives revenues from the Chicago-based taxes it currently receives. The legislature also diverted the $4.8 million Cigarette Tax from McCormick place to a newly-created fund named the Statewide Economic Development Fund, to be used for the development of downstate projects. To replace the Cigarette Tax revenue, a grant of $5.0 million will be given each year for 7 years from the Department of Commerce and Community Affairs to the related MPEA fund.

On July 2, 2002, the Metropolitan Pier and Exposition Authority issued $1.09 billion series 2002 McCormick Place expansion bonds, $802 million in new funding and $286 million in refunding. Fitch and Standard & Poor's both rated the bonds "AA-". The Authority's pledged tax revenues and reserves, and the State's sales tax pledge are viewed as ample coverage for the bonds.

The expansion will include 470,000 square feet of exhibition space and 250,000 square feet of meeting space including the city's largest ballroom. Currently, the McCormick Place complex includes 2.2 million square feet of exhibit space and 360,000 square feet of meeting room space. The Metropolitan Pier and Exposition Authority (MPEA) has selected Mc4West, LLC as the design/build team for the McCormick Place West Expansion project, comprised of essentially the same team members that delivered the McCormick Place South Building Expansion on schedule and under budget.

BOND SALES

The following table provides information on general obligation and State-issued bond sales, which have occurred during the past two fiscal years.

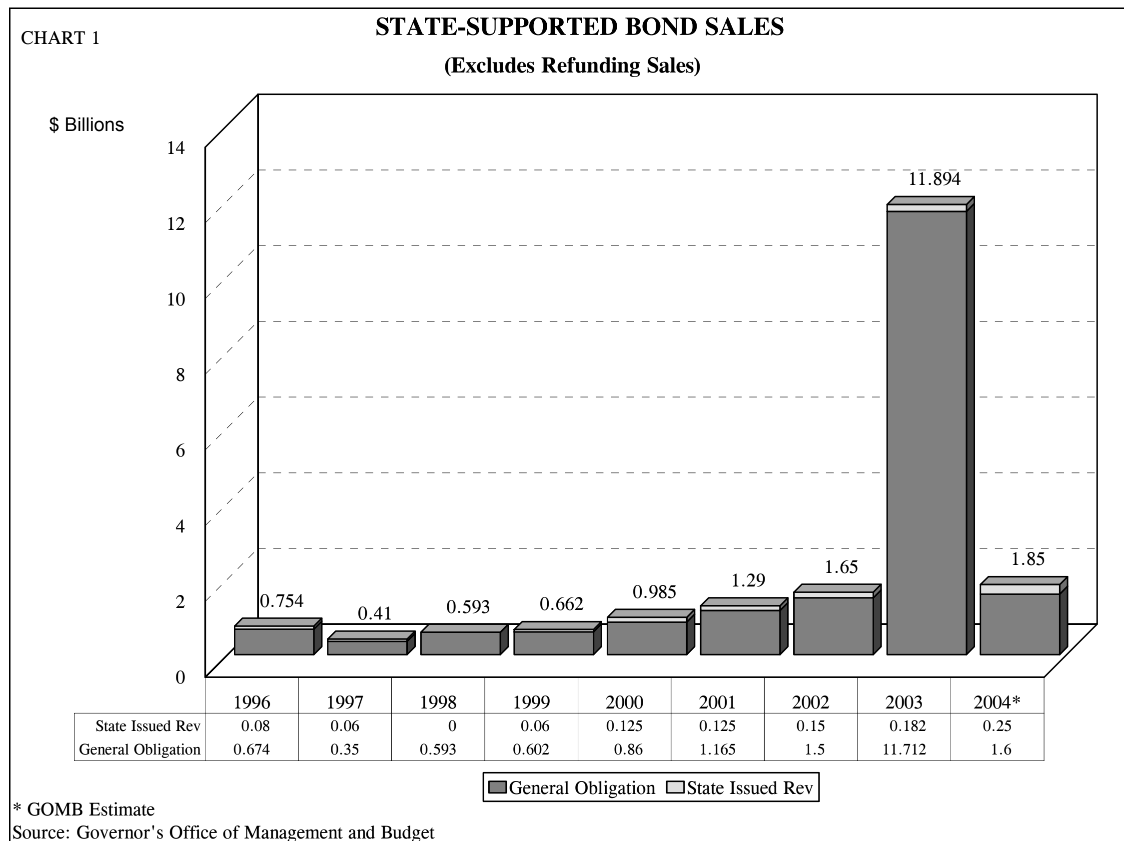
TABLE 1: BOND SALES ($ In Millions)				
Type of Bond	Issuance	Amount	Competitive or Negotiated	Purpose
General Obligation	August 2001	$375.0	Negotiated	Project Funding
Build IL	September 2001	$110.5	Negotiated	Refunding
General Obligation	November 2001	$375.0	Negotiated	Project Funding
General Obligation	December 2001	$318.8	Negotiated	Refunding
General Obligation	February 2002	$375.0	Negotiated	Project Funding
General Obligation	March 2002	$375.0	Negotiated	Project Funding
Build Illinois	April 2002	$150.0	Negotiated	Project Funding
General Obligation	April 2002	$79.7	Negotiated	Refunding
Build Illinois	May 2002	$50.3	Negotiated	Refunding
Build Illinois	2nd Series May 2002	$94.8	Negotiated	Refunding
	Total FY'02	**$2,304.1**		
Type of Bond	Issuance	Amount	Competitive or Negotiated	Purpose
General Obligation	July 2002	$395.0	Negotiated	Project Funding
Revenue Anticipation Certificates	July 2002	$1,000.0	Competitive	Short-Term Borrowing
General Obligation	August 2002	$564.9	Negotiated	Refunding
General Obligation	October 2002	$395.0	Negotiated	Project Funding
G.O. College Savings	October 2002	$62.1	Negotiated	Project Funding
Build Illinois	November 2002	$182.2	Negotiated	Project Funding
General Obligation	December 2002	$400.0	Negotiated	Project Funding
Build Illinois	December 2002	$54.3	Negotiated	Refunding
Build Illinois	March 2003	$75.8	Negotiated	Refunding
General Obligation Certificates	May 2003	$1,500.0	Competitive	Short-Term Borrowing
G.O. Pension Obligation	June 2003	$10,000.0	Negotiated	For Pension Systems
General Obligation	June 2003	$460.0	Negotiated	Project Funding
	Total FY'03	**$15,089.3**		

As Table 1 shows, bonds totaling $2.304 billion were sold during FY 2002, of which $1.650 billion was for project funding. Total bond sales for FY 2003 equaled $15.089 billion. Neither short-term debt, nor Pension Obligation Bonds are for projects, therefore, minus these, the total bond sales would equal $2.589 billion. Of this total, $1.894 billion was for new projects, which represents a 14.8% increase from the FY 2002 level. Table 2 illustrates the changes in bond sales by purpose from FY 2002 to FY 2003.

TABLE 2: TOTAL BOND SALES BY PURPOSE ($ in Millions)				
	FY 2002	FY 2003	$ Change	% Change
Projects	$1,650.0	$1,894.3	$244.3	14.8%
Refunding	654.1	695.0	40.9	6.3%
TOTAL	**$2,304.1**	**$2,589.3**	**$285.2**	**12.4%**

Project and Refunding bond sales for FY 2003 remain fairly consistent with what occurred in FY 2002. The Governor's Office of Management and Budget (previously the Bureau of the Budget) has always sought refundings of bond issues whenever savings would be seen. Although FY 2000 saw no refundings, the State refunded $288.3 million in FY 2001, $654.1 million in FY 2002, and $695.0 million in FY 2003. When bonds are refunded with lower interest rates, they create savings over the remaining life of the refunded bond debt. The ability to refund bonds is dependent on the corresponding bond agreement, whether it allows bonds to be called early, how early, and at what premium (extra percent over the 100% value). To keep their federal tax-exempt status, bonds may only be advance refunded once.

Bonds sold to fund project expenditures are shown in Chart 1 and are further described according to the type of State support.



	1996	1997	1998	1999	2000	2001	2002	2003	2004*
State Issued Rev	0.08	0.06	0	0.06	0.125	0.125	0.15	0.182	0.25
General Obligation	0.674	0.35	0.593	0.602	0.86	1.165	1.5	11.712	1.6

* GOMB Estimate
Source: Governor's Office of Management and Budget

General Obligation Bonds

Chart 1 shows the level of general obligation bond and State-issued revenue bond sales for new money projects since 1996. In FY 2003, the State sold $1.712 billion in general obligation bonds and $182.2 million in State-issued revenue bonds.

Table 3 breaks down general obligation sales for FY 2002 and FY 2003 by purpose. In FY 2003, new project G.O. bond sales increased 14.1% to $1.712 billion, while refunding sales increased 41.8% to $564.9 million.

TABLE 3: G.O. BOND SALES BY PURPOSE
($ in Millions)

	FY 2002	FY2003	$ Change	% Change
Projects	$1,500.0	$1,712.1	$212.1	14.1%
Refunding	398.5	564.9	166.4	41.8%
TOTAL	**$1,898.5**	**$2,277.0**	**$378.5**	**19.9%**

The Governor's Office of Management and Budget's estimate for FY 2004 is $1.6 billion, indicating a decrease in the sale of general obligation project bonds by 6.5%. As of October 2003, G.O. bond sales for FY 2004 include October 2003 Series A bonds for $363.0 million and October 2003 Series B variable rate bonds in the amount of $600.0 million. Of the total $963.0 million of October 2003 bonds, $272.4 million was used for refunding.

State-Issued Revenue Bonds

State-issued revenue bonds consist of bonds sold for the Build Illinois program and the Civic Center program.

Build Illinois. In FY 2003 new money bonds sales for Build Illinois were $182.2 million, and refunding bond sales were $130.1 million. The Governor's Office of Management and Budget estimates $250.0 million of new money bond sales for Build Illinois in FY 2004. In July 2003, $150.0 million in new project Build Illinois bonds were sold. Table 4 compares all Build Illinois bond sales by purpose for FY 2002 and FY 2003.

TABLE 4: BUILD IL BOND SALES BY PURPOSE
($ in Millions)

	FY 2002	FY 2003	$ Change	% Change
Projects	$150.0	$182.2	$32.2	21.5%
Refunding	255.6	130.1	-125.5	-49.1%
TOTAL	**$405.6**	**$312.3**	**-$93.3**	**-23.0%**

Civic Centers. In FY 1992, the State sold $75.0 million in Civic Center bonds for various projects throughout the State. This sale amount was based on the estimated 3-year spending needs so that no additional sales would be required for several years. During FY 1998, the State issued $37.6 million in Civic Center refunding bonds. No Civic Center bonds were sold during FY 1999 or FY 2000. The State sold $50.3 million in Civic Center refunding bonds in FY 2001. There are no plans to issue new project money for the Civic Center program, and no new project money has been issued since 1991 when Governor Edgar placed a moratorium on the program.

Locally-Issued Revenue Bonds

Illinois Sports Facilities Authority. The November 2000 General Assembly passed an increase in authorization of $399.0 million for the Illinois Sports Facilities Authority. In October of 2001 the ISFA sold the $399.0 million in new bonds, insured rating of AAA/AAA, for the renovation of Soldier Field and related lakefront property. There were no bond sales for FY 2003, but the ISFA estimates a new money sale for FY 2004 of $42.5 million.

Metropolitan Pier and Exposition Authority. In 2001 the State increased the MPEA's bonding authorization by $800.0 million. Expansion bonds were sold July 2, 2002 in the amounts of $802.0 million. The only planned issuance for FY 2004 is a $303.7 million refunding.

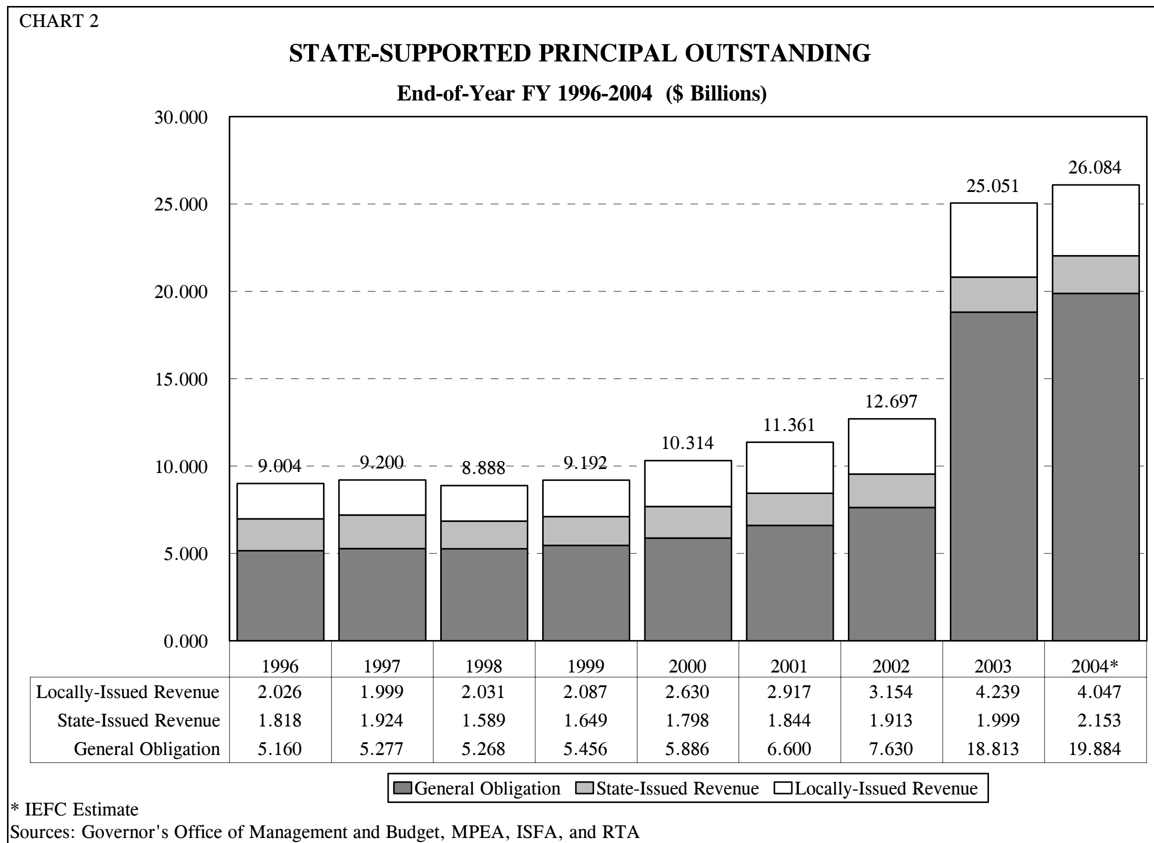
Regional Transportation Authority. The Regional Transportation Authority has State-supported bonds called Strategic Capital Improvement Project (SCIP) bonds. The RTA is to sell their $1.3 billion in SCIPs from FY 2000 to FY 2004. If the full $260.0 million is not issued within the calendar year it is authorized, the remaining amount remains available for future issuance. The RTA has sold the following SCIP bonds:

FY 2000	$260.0 million
FY 2001	$100.0 million
FY 2002	$160.0 million
FY 2003	$260.0 million
Estimated FY 2004	$0

OUTSTANDING DEBT

In FY 2003, short-term debt of $1.0 billion was issued in July 2002 and paid off in June of 2003, while another $1.5 billion in short-term debt was issued in May 2003. To help fund the State's Pension Systems' unfunded liability, Illinois issued $10.0 billion in Pension Obligation Bonds. Short-term borrowing and unfunded pension liabilities, are considered a part of a state's financial picture by rating agencies,

but are not calculated in the State's outstanding debt. With Illinois' sale of Pension Obligation Bonds, $10.0 billion of unfunded pension liability becomes long-term debt.



	1996	1997	1998	1999	2000	2001	2002	2003	2004*
Locally-Issued Revenue	2.026	1.999	2.031	2.087	2.630	2.917	3.154	4.239	4.047
State-Issued Revenue	1.818	1.924	1.589	1.649	1.798	1.844	1.913	1.999	2.153
General Obligation	5.160	5.277	5.268	5.456	5.886	6.600	7.630	18.813	19.884

* IEFC Estimate
Sources: Governor's Office of Management and Budget, MPEA, ISFA, and RTA

Chart 2 indicates that at the end of FY 1996, State-supported principal outstanding totaled $9.004 billion. **By the end of FY 2002, this level increased to $12.697 billion. Total outstanding State-supported principal for FY 2003 increased 97.3% to $25.051 billion.**

General Obligation Bonds

General Obligation principal outstanding at the end of FY 2002 was $7.630 billion. **Outstanding G.O. principal at the end of FY 2003 reached $18.813 billion, an increase of 146.6%, attributed to the $10.0 billion sale of Pension Obligation Bonds.**

State-Issued Revenue Bonds

Since 1998 outstanding principal for State-issued revenue bonds has increased by an average of $94.0 million a year up to the estimated FY 2004 level. All increases since that time have been strictly from the Build Illinois bond program. FY 2004 is estimated to reach $2.153 billion in principal outstanding.

Locally-Issued Revenue Bonds

Principal outstanding for locally-issued revenue bonds saw growth in FY 2000 due to a McCormick Place expansion bond sale of $443.7 million and the first of a series of Regional Transportation Authority "Strategic Capital Improvement Project" bond sales authorized through Illinois First. In FY 2001, principal outstanding increased due to another McCormick Place expansion bond sale of $267.7 million and an RTA SCIP sale of $100.0 million. FY 2002 saw the sale of $399.0 million sale of Soldier Field renovation bonds through the Illinois Sports Facilities Authority and another $160.0 million of RTA SCIPs. The large increase in FY 2003 comes from an $802 million MPEA expansion project bond sale and an RTA SCIP sale of $260 million. The only foreseen increase in outstanding principal for FY 2004 will be from a $42.5 million bond sale by the ISFA.

DEBT SERVICE

As the level of outstanding debt grows, the amount of principal and interest payments, or debt service, increases as well. The following section looks at the required debt service levels for the various types of State-supported debt.

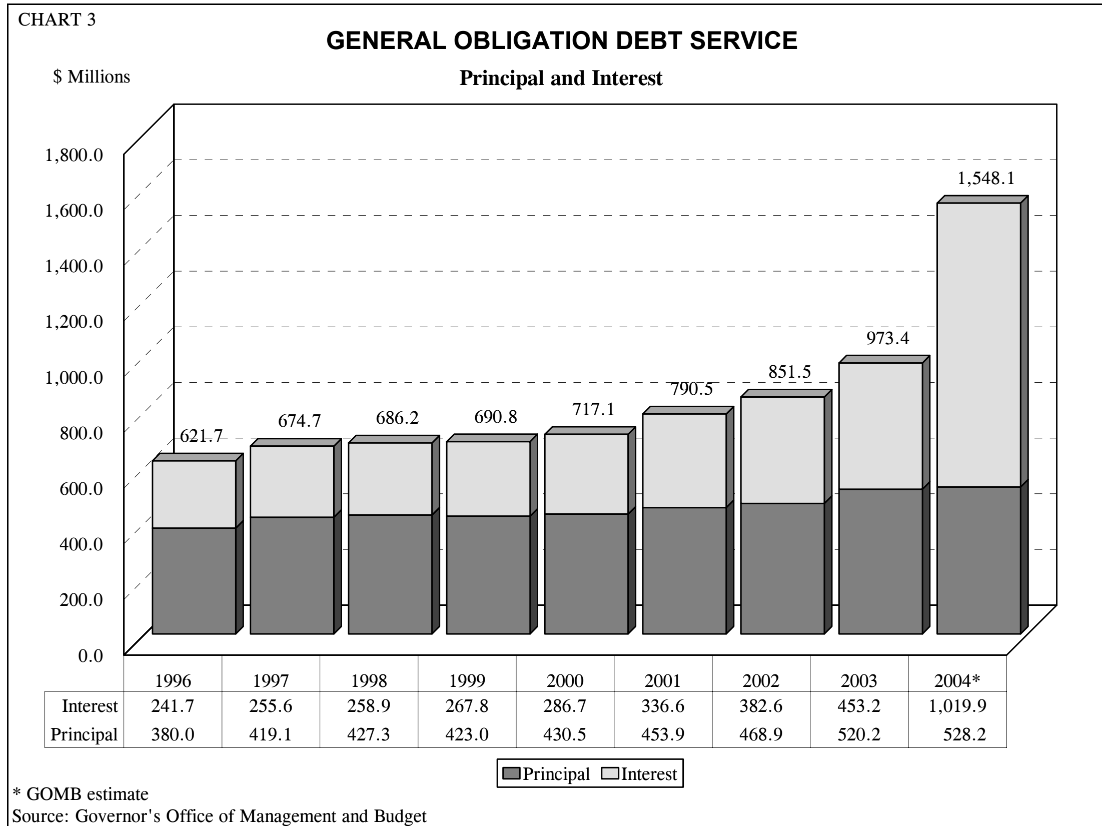
General Obligation

Chart 3, on the next page, shows the amount of required general obligation debt service. G.O. debt service is paid from the General Obligation Bond Retirement and Interest Fund, which receives transfers from the Road Fund (for Transportation A/highways), the School Infrastructure Fund, and the General Revenue Fund. In FY 2003, the Road Fund supported $215.0 million (22.1%) of G.O. debt service, the School Infrastructure Fund $129.5 million (13.3%) and the General Revenue Fund $628.9 million (64.6%). **It is estimated that Road Fund transfers will pay $227.6 million (14.7%), the School Infrastructure Fund $202.2 million (13.1%), and the General Revenue Fund $1.118 billion (72.2%) of the debt service payment for FY 2004.**

General Obligation Debt Service
($ in Millions)

	Estimated FY 2003		Estimated FY 2004	
	Amount	% of Total	Amount	% of Total
Road Fund	$215.0	22.1%	$227.6	14.7%
School Infrastructure Fund	129.5	13.3%	202.2	13.1%
General Revenue Fund	628.9	64.6%	1,118.3	72.2%
TOTAL	**$973.4**	**100.0%**	**$1,548.1**	**100.0%**

Chart 3 shows that FY 2003 principal of $520.2 million added to the $453.2 million in interest equaled a total debt service of $973.4 million, an increase of 14.3%, over the FY 2002 level.



	1996	1997	1998	1999	2000	2001	2002	2003	2004*
Interest	241.7	255.6	258.9	267.8	286.7	336.6	382.6	453.2	1,019.9
Principal	380.0	419.1	427.3	423.0	430.5	453.9	468.9	520.2	528.2

* GOMB estimate
Source: Governor's Office of Management and Budget

The Governor's Office of Management and Budget estimates general obligation debt service to reach $1,548.1 million in FY 2004, an increase of $574.7 million, or 59.0%, over FY 2003. The large increase in debt service comes from the issuance of the Pension Obligation bonds. Debt service will range from $481.0 million beginning FY 2004 up to $1.16 billion in the final years of payoff. The State will not have to begin making principal payments on the bonds until FY 2008, with payments beginning at $50.0 million and ending at $1.1 billion in FY 2033, while interest payments decrease from early highs of $481.0-$496.2 million down to $56.1 million by FY 2033.

The goal of the Pension Obligation Bond plan was to gain budget relief for the General Revenue Fund by using bond proceeds for the State's remaining FY 2003 payment and all of FY 2004 payments. In addition, the bond proceeds would generate approximately $7.5 billion for the five systems to investment which would in theory draw down the unfunded liabilities. **A hold harmless clause was included as part of the legislation for these bonds; it asserts that the State's contribution to each system shall not exceed the contribution it would have paid absent the bonds, and**

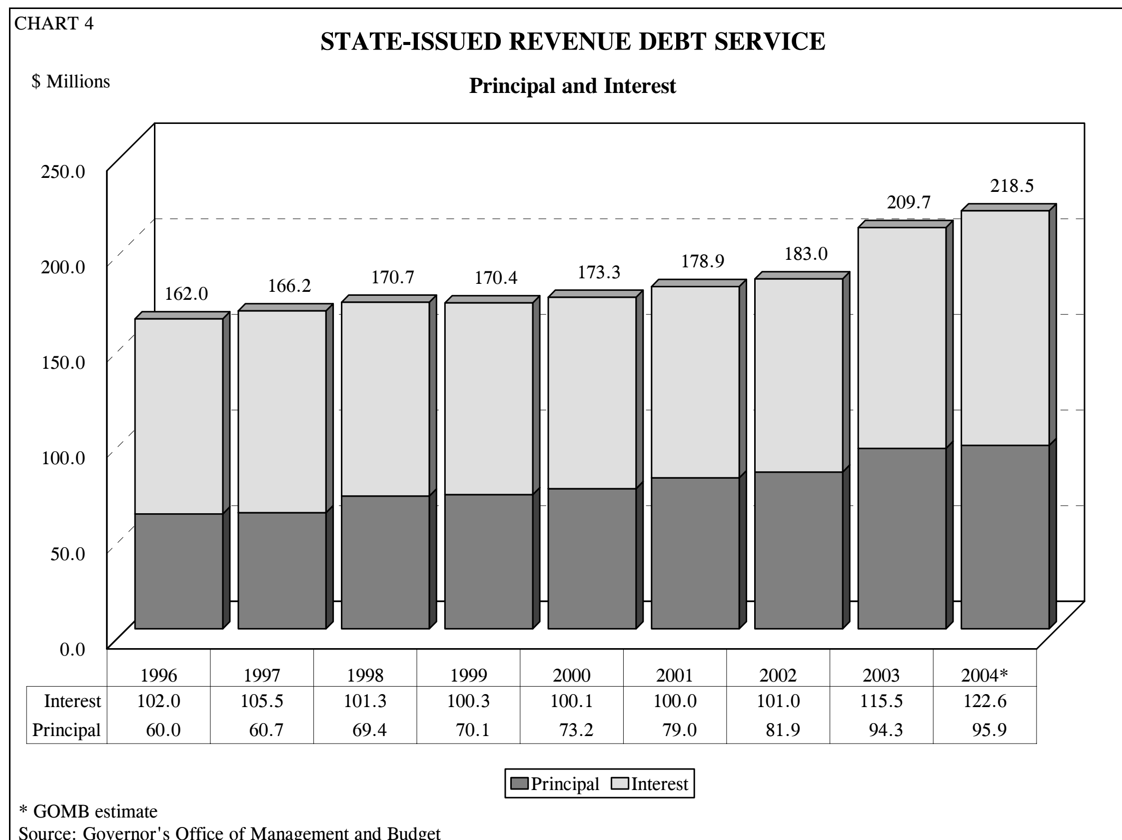
Pension Obligation Bonds Debt Service			
FY ending June 30	**Principal**	**Interest**	**Total FY Debt Service**
2004	$0	$481,038,333	$481,038,333
2005	0	496,200,000	496,200,000
2006	0	496,200,000	496,200,000
2007	0	496,200,000	496,200,000
2008	50,000,000	496,200,000	546,200,000
2009	50,000,000	494,950,000	544,950,000
2010	50,000,000	493,550,000	543,550,000
2011	50,000,000	491,900,000	541,900,000
2012	100,000,000	490,125,000	590,125,000
2013	100,000,000	486,375,000	586,375,000
2014	100,000,000	482,525,000	582,525,000
2015	100,000,000	478,575,000	578,575,000
2016	100,000,000	474,525,000	574,525,000
2017	125,000,000	470,175,000	595,175,000
2018	150,000,000	464,73?,500	614,737,500
2019	175;000,000	458,212,500	633,212,500
2020	225,000,000	449,550,000	674,550,000
2021	275,000,000	438,412,500	713,412,500
2022	325,000,000	424,800,000	749,800,000
2023	375,000,000	408,712,500	783,712,500
2024	450,000,000	390,150,000	840,150;000
2025	525,000,000	367,200,000	892,200,000
2026	575,000,000	340,425,000	915,425,000
2027	625,000,000	311,100,000	936,100,000
2028	700,000,000	279,225,000	979,225,000
2029	775,000,000	243,525,000	1,018,525,000
2030	875,000,000	204,000,000	1,079,000,000
2031	975,000,000	159,375,000	1,134,375,000
2032	1,050,000,000	109,650,000	1,159,650,000
2033	1,100,000,000	56,100,000	1,156,100,000
TOTAL	**$10,000,000,000**	**$11,933,713,333**	**$21,933,713,333**
Source: $10.0 billion G.O. Bonds Pension Funding Series of June 2003 Official Statement (Governor's Office of Management and Budget)			

minus the debt service on these bonds. For example, the State's normal contribution to the State Employees Retirement System would have been $814.0 million in FY 2005, including Early Retirement but without the POBs. Then the System must minus their portion of debt service (SERS = $94.0 million), and the State's payment, due to the bonds and the hold harmless clause, is lowered to $720.0 million. In this way, until the bonds are retired in 2003, the General Revenue Fund is not exposed to payments any higher than those that would have occurred absent the bond sale. **The State's payment to the five retirement systems in FY 2005 will be approximately $1.911 billion (excluding an expected $80.0 from the State Pension Fund per the Pension Laws Commission) and the State's debt service payment will be $496 million equaling $2.407 billion in Pension Fund contributions.**

State-Issued Revenue Bonds

State-issued revenue bonds currently outstanding include Build Illinois and Civic Center bonds. Total debt service costs for the remaining bonds outstanding in this category are shown in Chart 4.

As Chart 4 indicates the $218.5 million of payments on principal and interest estimated in FY 2004 represents an increase of 4.2%, from the $209.7 million level in FY 2003. The amount of principal to be paid in FY 2004 is estimated to be $95.9 million and interest will be $122.6 million.



	1996	1997	1998	1999	2000	2001	2002	2003	2004*
Interest	102.0	105.5	101.3	100.3	100.1	100.0	101.0	115.5	122.6
Principal	60.0	60.7	69.4	70.1	73.2	79.0	81.9	94.3	95.9

* GOMB estimate
Source: Governor's Office of Management and Budget

Build Illinois. These bonds comprise the majority of debt service costs for the State-issued revenue bonds. Total debt service amounts for the Build Illinois program totaled $195.9 million in FY 2003, consisting of $88.4 million in principal and $107.5 million in interest. The Governor's Office of Management and Budget estimates the FY 2004 level of principal and interest payment to be $204.7 million, an increase of 4.5%.

Civic Centers. The State refunded $48.6 million of Series 1990A and $0.7 million of Series 1990B Civic Center bonds in FY 2001 to lower debt service costs through the year 2016. Because these bonds were issued using a level debt service repayment structure, annual debt service costs will remain at approximately $14.0 million per year--$13.8 to $13.9 million annually through FY 2016 and then increased to $14.4 million through FY 2020.

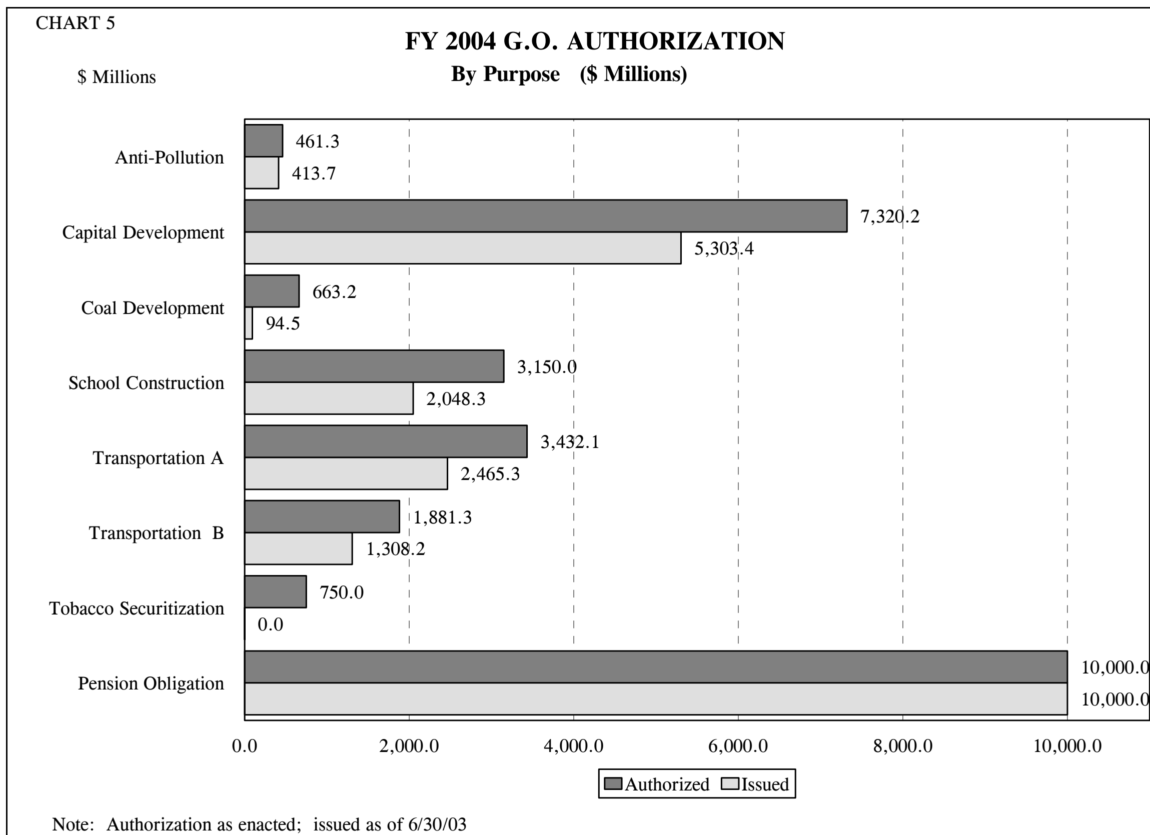
BOND AUTHORIZATIONS

General Obligation Bonds

General Obligation bonds are seen as the most secure issuance by any government because they carry the pledge that the government will pay the bond holders from any and all revenues, no matter what. States wishing to issue debt to aid in their budget crises have begun to use the G.O. pledge in new areas to make the sale of certain types of bonds more attractive in the current market. Illinois is not different having legislated G.O. authorization for Tobacco "Securitization" bonds and more recently Pension Obligation Bonds. With these changes in the General Obligation arena, authorization has become more complicated. Below are authorization levels after legislative changes made over the past years to the General Obligation Bond Act:

General Obligation Authorization Levels						
(in billions)	New Projects	Tobacco	Pension Systems	**Subtotal**	Refunding	**Total**
May 2000	$14.198	N/a	N/a	**$14.198**	$2.839	**$17.037**
June 2001	$15.265	N/a	N/a	**$15.265**	$2.839	**$18.104**
June 2002	$16.908	$0.750	N/a	**$17.658**	$2.839	**$20.497**
April 2003	$16.908	$0.750	$10.000	**$27.658**	$2.839	**$30.497**

The current General Obligation bond authorization for new projects is $16.908 billion, with approximately $4.584 billion unissued since October 31, 2003. The Tobacco "Securitization" bond authorization, which could only be issued in FY 2003, was not issued. The $10.0 billion of Pension Obligation Bonds were sold all in one issuance in June 2003. While the Governor's Budget Book requested a $129.0 million increase in project funding authorization for G.O. bonds no legislation has passed increasing project funding. Chart 5 breaks out authorization levels and amounts issued as of June 30, 2003, across bond fund categories.



Swap Agreements. Another addition to the General Obligation Bond Act, was the authorization to issue "variable rate bonds" and enter into swap agreements. Interest rate swaps are contracts between a bond issuer and a financial institution (bank, insurance company, or broker/dealer), where they agree to swap interest payments for a set amount of time based on a hypothetical amount of money. If entered into at the time of a bond sale it could be a percentage or the full amount of the bond issue. Since there are two traditional forms of borrowing, fixed rate and variable rate, the swap concept allows an issuer to artificially convert one flow of payments to the opposite form, fixed-to-floating or floating-to-fixed. If the issuer's rate over the time period is lower than the financial institution's, the issuer receives payment of the difference. If the issuer's rate is higher, the issuer pays the financial institution the difference. Interest payments between the issuer and the financial institution are netted out with only one payment made by whomever owes the difference. During this time, the issuer is still paying the required debt service to bondholders.

An issuer may choose to enter into a swap for a variety of reasons, such as reducing or fixing interest rate costs or converting part of their debt portfolio to a variable rate mode. Swaps can be used when an issuer does not want to refund outstanding debt. Swaps allow issuers an alternative which increases their flexibility. A variety of features can be used to tailor a swap agreement to fit an issuer's exact needs and reduce risks, including: extensions, reversals, optional termination provisions, and interest rate caps.

State-Issued Revenue Bonds

The Build Illinois program began in 1985 as a $1.3 billion economic development initiative composed of $948.0 million in bonds and $380.0 million in current funding. Since that time, the bond program has been expanded and authorization for the past four years increased:

Build Illinois Authorization Level		
YEAR	**PUBLIC ACT**	**INCREASE**
1999	91-0039	$754 Million
2000	91-0709	61.0 Million
2001	92-0009	688.7 Million
2002	92-0598	264.8 Million

Total Build Illinois bond authorization equals $3.806 billion with $1.236 billion remaining unissued at the end of FY 2003. Timing of the issuance of bonds is dependent on construction schedules. There is no refunding limit placed on Build Illinois bonds. The Governor's Budget Book requested a $15.0 million increase in Build Illinois authorization, but no legislation has passed to increase project funding. Build Illinois authorization is currently $3.806 billion, of which $2.569 billion has been issued.

Locally-Issued Revenue Bonds

In August 2001, the Legislature increased authorization for the Metropolitan Pier and Exposition Authority by $800.0 million for another expansion of McCormick Place. These bonds were issued July 2, 2002. The MPEA has an unissued authorization level of $0.9 million.

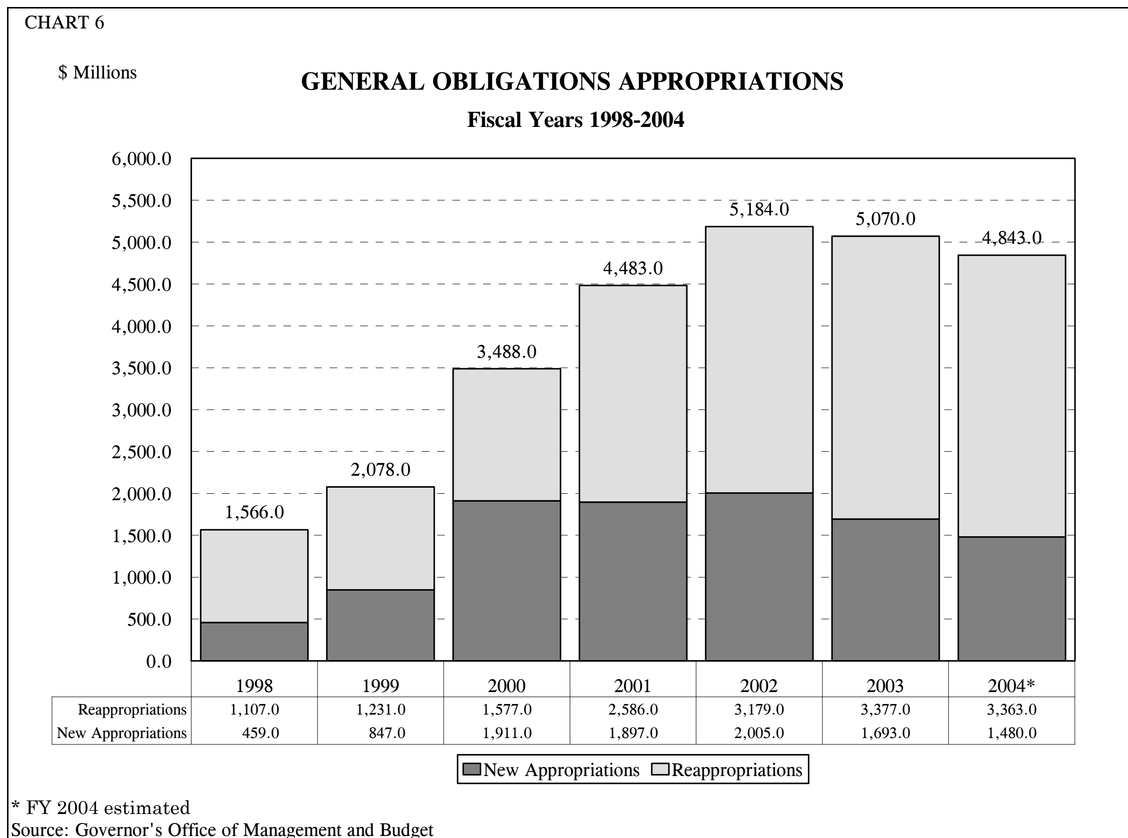
In FY 2001, the General Assembly increased bonding authorization for the Illinois Sports Facilities Authority (ISFA) Act by $399.0 million to finance renovations for the Chicago Bears Stadium at Soldier Field and related lakefront improvements. The bonds were issued in October of 2001. The ISFA has an unissued authorization amount of $78.3 million.

The Regional Transportation Authority has an annual authorization of $260.0 million from FY 2000 to 2004.

APPROPRIATIONS OF BOND FUNDS

General Obligation Bonds

The FY 2004 estimate of total general obligation appropriations is $4.843 billion, down $227.0 million from the FY 2003 level of $5.070 billion. This estimate consists of $3.363 billion in re-appropriations with $1.480 billion in new appropriations. The new appropriation request represents a decrease of $212.5 million, or 12.6%, from the FY 2003 level. Re-appropriations are 69.4% of all appropriations for FY 2004. These figures are presented in Chart 6, along with the corresponding levels going back to FY 1998.

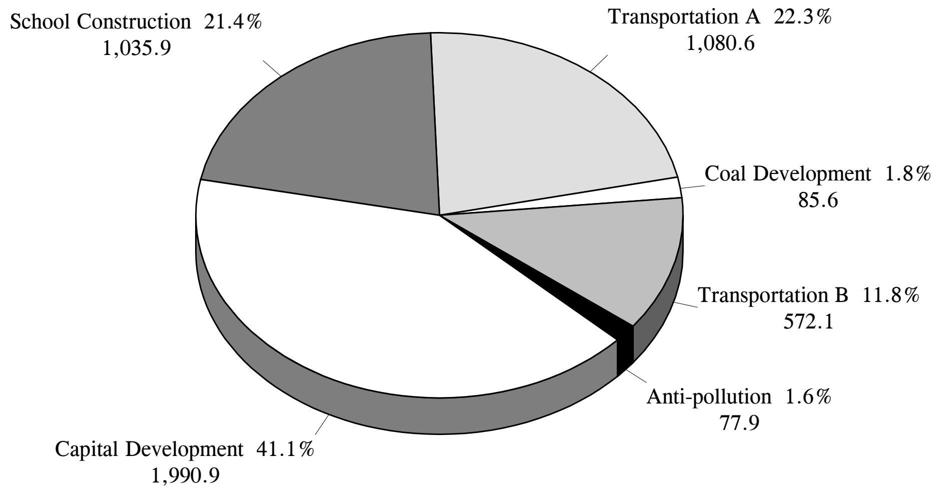


Using the Office of Management and Budget figures, Chart 7 indicates nearly 41.1% of all FY 2004 appropriations (both new and re-appropriations) will come from the Capital Development Fund, down from last fiscal year's 46.6%. Each bond fund category received new appropriations and re-appropriations. As parts of the whole general obligation bond appropriations pie, there were shifts in the percentages from FY 2003 to FY 2004 held by the different bond funds, the other major changes being increases in Coal Development funds from 0.6% to 1.8%, and Transportation A funds from 18.1% to 22.3%.

CHART 7

FY 2004 G.O. APPROPRIATIONS

By Bond Fund ($ Millions)



Note: estimated by the OMB
Source: Governor's Office of Management and Budget

The Capital Development Fund is further broken down in Table 5, using preliminary numbers from the Office of Management and Budget.

TABLE 5: FY 2004 G.O. APPROPRIATIONS
By Capital Development Sub-Categories
($ in Millions)

	Re-Appropriations	New Appropriations	Total
Higher Education	$708.4	$51.5	$759.9
Corrections	331.3	24.0	355.3
Conservation	78.0	17.4	95.4
Mental Health	103.7	30.4	134.1
Other State Facilities	277.5	25.8	303.3
Water Resources	49.9	11.0	60.9
Libraries	0.1	0.0	0.1
Local Governments	142.9	45.0	187.9
Open Land Trust	80.7	5.0	85.7
Bond Sale Expenses	0.0	8.3	8.3
TOTAL	**$1,772.5**	**$218.4**	**$1990.9**

Source: Governor’s Office of Management and Budget, using preliminary numbers

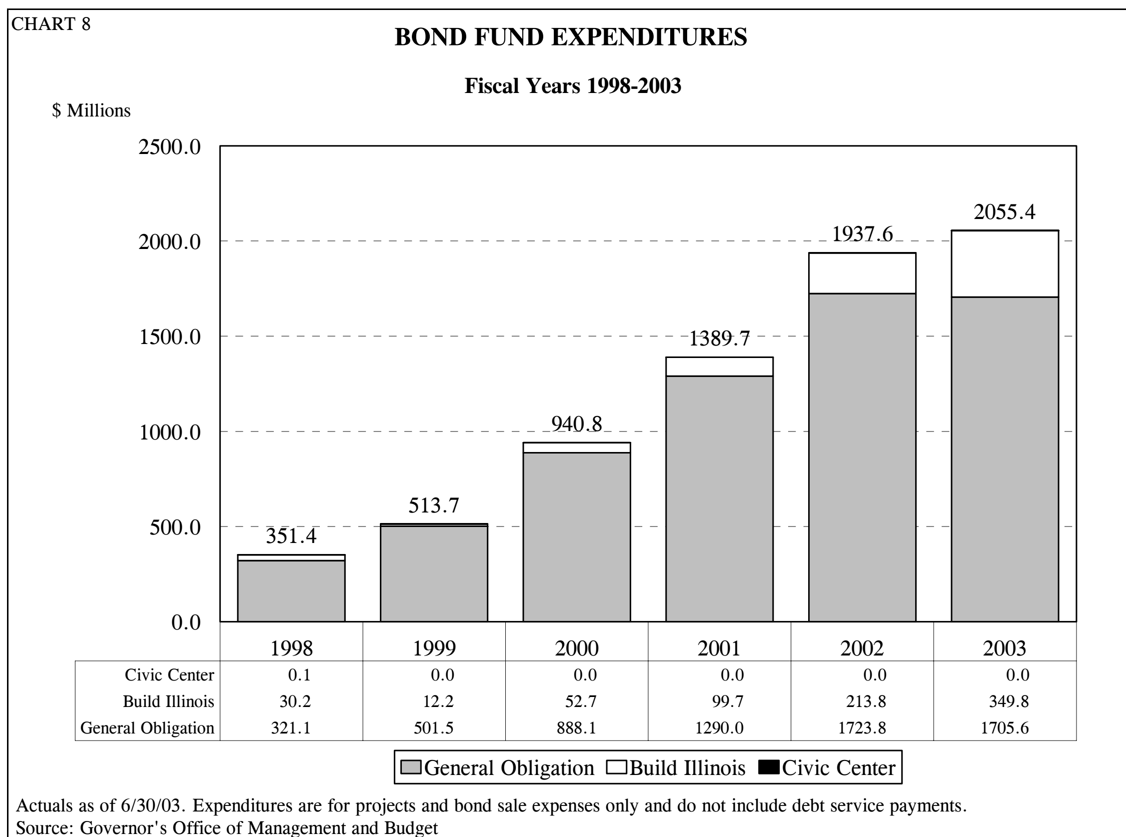
State-Issued Revenue Bonds

Build Illinois. Estimated appropriations from the Build Illinois Bond Fund would total $743.0 million for FY 2004. Of this total, $530.0 million is re-appropriated from the prior year, with $213.0 million of new appropriations.

Civic Centers. There are no appropriations scheduled from the Civic Center Bond Fund for FY 2004.

EXPENDITURES OF BOND FUNDS

Bonds issued for many of the State-supported bond programs are primarily used to fund a specific project and, therefore, spending occurs over a short period of time. However, the general obligation, Build Illinois, and Civic Center programs finance a variety of projects over several years. Chart 8 shows annual expenditures from these funds for projects and bond sale expenses.



	1998	1999	2000	2001	2002	2003
Civic Center	0.1	0.0	0.0	0.0	0.0	0.0
Build Illinois	30.2	12.2	52.7	99.7	213.8	349.8
General Obligation	321.1	501.5	888.1	1290.0	1723.8	1705.6

Actuals as of 6/30/03. Expenditures are for projects and bond sale expenses only and do not include debt service payments.
Source: Governor's Office of Management and Budget

General Obligation Bonds

Spending from the General Obligation bond funds in FY 2003 decreased in almost every category except capital development and Transportation A from FY 2002. During FY 2002, spending from these funds was $1.706 billion, compared to $1.724 billion the prior year, a decrease of 1.1%. The decrease in School Construction Spending was almost matched with the increase in Transportation A spending, while the decrease in Transportation B matched the increase in Capital Development. The remaining categories saw decreases in there spending, which amounted to a total General Obligation spending decrease of $18.1 million.

Table 6: General Obligation Expenditures
by Bond Fund
($ in Millions)

	FY 2003	FY 2002	Diff.	% Diff.
Anti-pollution	21.0	29.0	-8.0	-27.6%
Coal Development	2.2	11.8	-9.6	-81.4%
Transportation A	386.6	308.0	78.6	25.5%
Transportation B	138.4	149.2	-10.8	-7.2%
School Construction	568.3	647.4	-79.1	-12.2%
Capital Development	589.1	578.3	10.8	1.9%
Total	**1,705.6**	**1,723.7**	**-18.1**	**-1.1%**

Source: Governor's Office of Management and Budget

State-Issued Revenue Bonds

Build Illinois. Build Illinois Bond Fund expenditures increased in FY 2003 from $213.8 million to $349.8 million. This reflects an increase of $136.0 million, or 63.6%.

Civic Centers. There was no Civic Center spending in FY 2003, and only $438 was spent in FY 2002.

DEBT RATIOS AND RATING CHANGES

Debt ratios consist of an extremely complex quantity of debt information summed up into one number and are only one piece to the whole ratings puzzle. "The debt ratio process involves a number of arbitrary or imprecise decisions. There is no direct correlation between a state's debt ratio and its rating." The bond rating is a more qualitative process. The "focus is on relative degrees of financial flexibility among states. The debt rankings are a starting point, but by no means the only information considered...Moody's assesses the degree to which the state has fixed obligations that are not captured in the debt rankings", including unfunded pension obligations, contingent debt, etc. [Moody's Special Comment, February 2000].

According to Fitch Ratings, a rating would not be reduced necessarily by shifting debt levels or an economic downturn. "A reduction would most likely be related to the inability of a state's legislature to address these types of imbalances in a timely way".

Illinois' Moderate Debt

Low Debt	below 2%
Moderate Debt	2-6%
High Debt	above 7%
Average	2-4%

The addition of $10 billion in new general obligation debt added to the State's existing $13.2 billion of tax-supported debt increases debt to personal income from 3.1% to 5.5%, according to Moody's May 13, 2003, Rating Update. They list the 50-state median at 2.3% and state that Illinois' "key measures of debt burden are well above-average compared to 50-state medians" (from Moody's rating opinion of the October 2003 Series A and B Bonds). Fitch has the State's debt to personal income rising from 2.8% to 5.3%, including the October 2003 Series A and B issues. **These levels keep Illinois in the moderate debt range, but in the above average category.** Fitch states although the Pension Obligation Bonds were designed to be revenue neutral with reductions in pension payments to offset the debt service on the bonds, the statutory requirement to pay unfunded liability does not count the same as debt liability to bond holders. This is why both Moody's and Fitch lowered Illinois bond rating in May 2003 (See following section on the History of Illinois' Bond Rating).

At least ten states have received downgrades from at least one rating agency since 2001, with Connecticut and California both having been downgraded twice by the same agency. Many more remain on a negative watch list. Ratings downgrades may put some states in the same credit level as they were in the 1990s. The rating agencies are watching states' budget actions to see how they will resolve having "liquidity problems with less flexibility". Standard & Poor's says that with States issuing more debt, their "debt affordability" will be key to their credit analysis. Fitch says that the biggest challenge will be in FY 2004 and FY 2005, where states will have to either raise taxes

and/or incur deeper cuts in their budgets. Fitch states that the one-shot fixes after September 11th were "akin to treading water", and states will need to look at stronger, more broad based measures to deal with long-term financial problems. "The time for temporizing measures has come and gone, and it's time to look at problems squarely and decide what is an appropriate step to take in order to get back into better financial health." (Fitch)

History of Illinois' Bond Rating

In August of 1992, Standard & Poor's and Moody's decreased their Illinois bond ratings due to the State's weak financial operations, liquidity position and budget weakness. In July of 1997, the State's bond rating was upgraded by Standard & Poor's, from AA- to AA, recognizing the State's improved finances. In February 1997 and again in June of 1998, Illinois' general obligation bonds and Build Illinois bonds were upgraded by Moody's Investor Service, and are now rated Aa2. Moody's cited the State's aggressive efforts to pay a backlog of unpaid bills, its recent spending restraint and steady revenue growth, and tight fiscal management as reasons for the upgrade.

Standard & Poor's affirmed its AA rating but revised its outlook upward on the State's credit from stable to positive in the summer of 2000, citing "a deep and diversified economy, an improving financial condition, moderate debt levels," and State cash balances that were $1.351 billion at the end of Fiscal Year 1999 (the highest in the State's history). Due to the economy, S&P revised Illinois' outlook from positive to stable in FY 2002. Standard & Poor's has no states' GO ratings listed with a positive outlook at this time (10/11/2002). States are under great ratings pressures caused by the slow pace of economic recovery. With FY 2003 deficit balances, lack of reserves, and one-time measures that can't be repeated, budgets will have little room to maneuver. Even if economic recovery picks up, there will be a lag in revenues getting better, and a longer lag in ratings upgrades for states.

In June of 2000, Fitch Ratings, which had long maintained an AA rating on the State's general obligation bonds, upgraded the State's bond rating from AA to AA+ citing the return of "fiscal stability, the larger balances carried by the State in recent years and the creation of a reserve account" in this legislative session. Fitch also stated that "the planned bonding is well within the state's capacity; if authorized but unissued bonds, including Build Illinois, are added to outstanding debt, the total would equal about 4.3% of personal income, a moderate level". Fitch raised the State's Build Illinois bond rating to AA+ at the end of February 2001.

RATING AGENCIES	JULY 1997	JUNE 1998	JUNE 2000	MAY 2003
Fitch Ratings	**AA**	**AA**	**AA+**	**AA**
Standard & Poor's	**AA**	**AA**	**AA**	**AA**
Moody's Investor Service	**Aa3**	**Aa2**	**Aa2**	**Aa3**

May 13, 2003, Moody's lowered the State of Illinois' rating from Aa2 to Aa3, after the sale of $1.5 billion in G.O. Certificates, the short-term borrowing plan to pay off overdue bills. On May 23, Fitch lowered Illinois' rating from AA+ to AA. Both agencies explained that in addition to the short-term borrowing plan, a combination of factors led to this change in status, including the increase by $10 billion for the second year in a row for the state's unfunded pension liability, now at $35 billion. Other factors involved are the second annual decline in State tax collections, an increase in the GAAP deficit recorded in the General Fund, budget uncertainty, and the increase of the State's debt ratios due to the issuance of $10 billion in pension obligation bonds over the next year.

Even with the $8 billion influx of funds to the pension systems, the $27.5 billion unfunded liability will still be one of the worst of the 50 states. Both agencies disagreed with the Governor's claims that the pension obligation bond plan would be revenue neutral, since the State is converting $10 billion of soft debt to hard debt, and the State's certainty that it will get 8.5% on pension fund investments. Downgrades affect what is called State tax-supported debt. This includes General Obligation, Build Illinois, Civic Center, and McCormick Place Expansion Project bonds.

Standard & Poor's has not downgraded Illinois at this time, but has placed the State on a negative watch list for possible downgrade. Fitch states that "revenue realization and measures taken to achieve balanced operations will determine future ratings actions" (from Fitch's rating opinion of the October 2003 Series A and B Bonds).

MAXIMUM RATING POSSIBLE
AAA or Aaa

Debt Comparisons: Illinois v. Other States

Chart 9 shows G.O. and State-issued revenue debt service to general funds receipts.

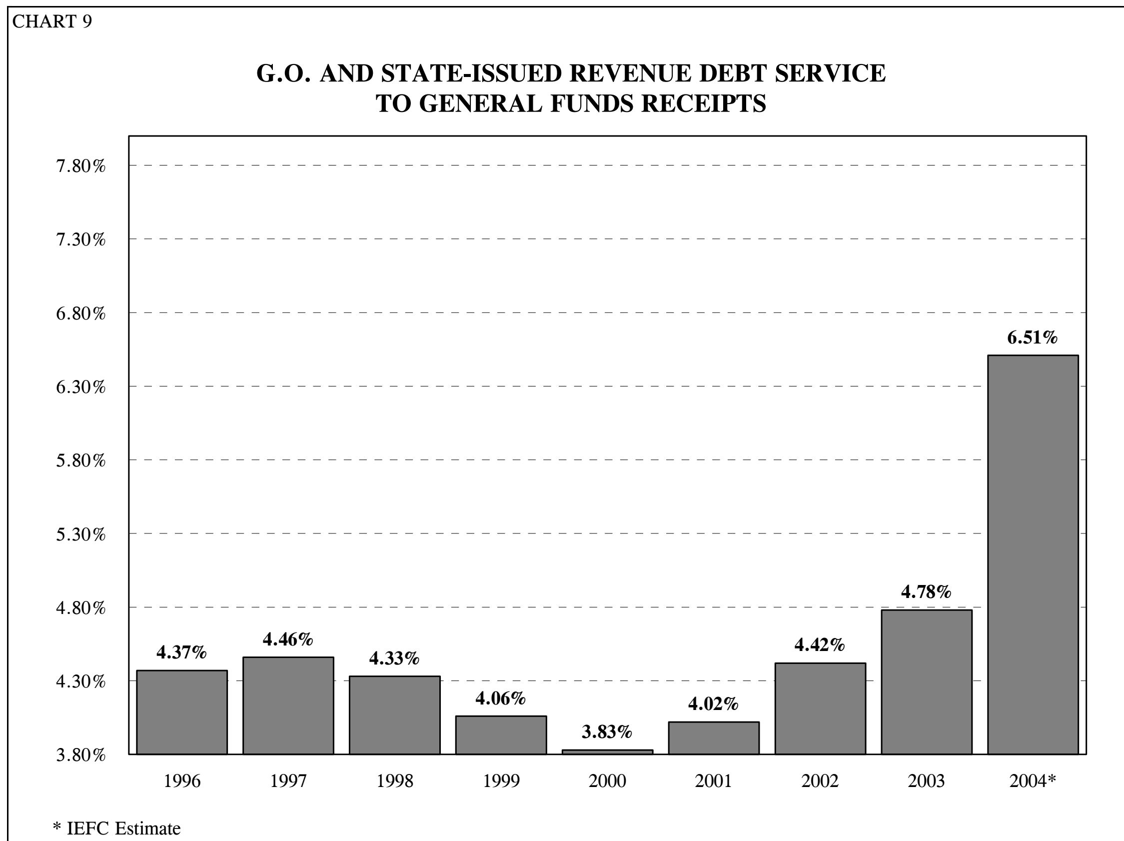
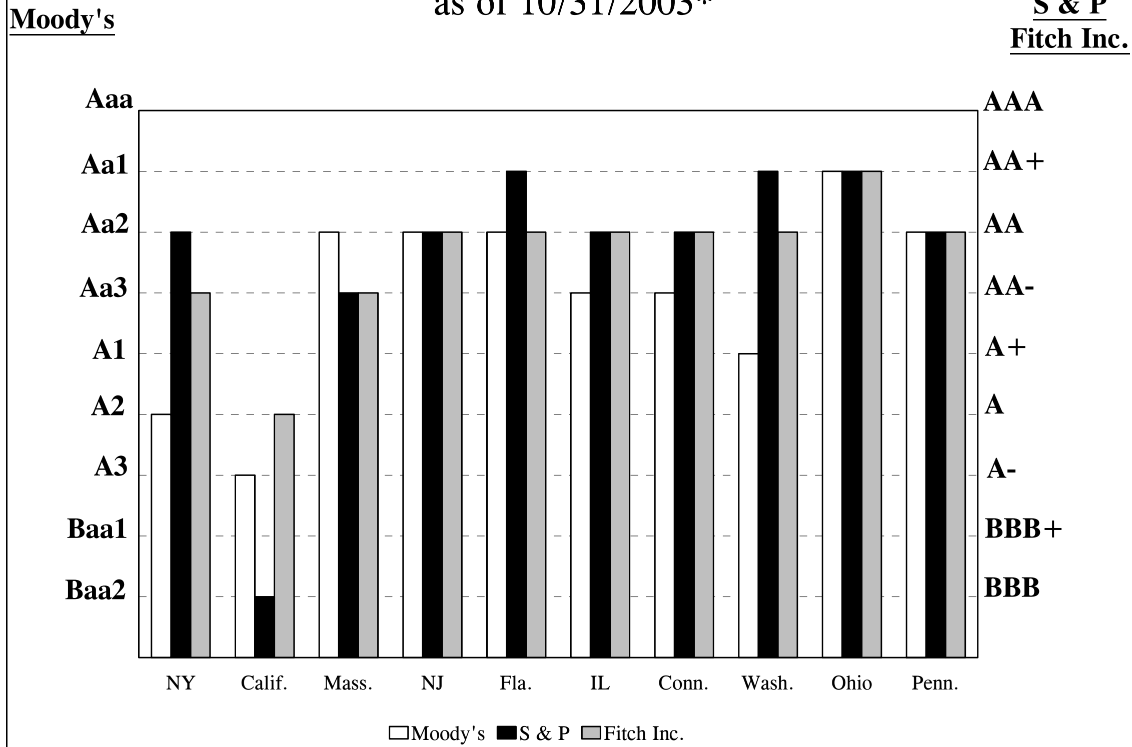


Table 7 shows Illinois' ranking in comparison with the top ten states for the most net tax-supported debt per capita (SOURCE: Moody's 2003 State Debt Medians). [This table uses a measure done by Moody's rating agency with calendar year 2002 data. Previous Bond Watchers used a per capita debt measure from State Rankings that were normally three to four years behind and included non-guaranteed debt.] CY 2001, Illinois was ranked 12th with $908 in net tax-supported debt per capita compared to the average of $810. In 2002, debt per capita rose across the nation with the national average at $838. Illinois is ranked 11th highest at $1,040.

TABLE 7 Net Tax-Supported Debt Per Capita (using net state tax-supported debt as of the end of calendar year 2002)		
RANK	STATE	PER CAPITA DEBT OUTSTANDING
1	Connecticut	$3,440
2	Massachusetts	$3,298
3	Hawaii	$3,111
4	New Jersey	$2,110
5	New York	$2,095
6	Delaware	$1,599
7	Rhode Island	$1,508
8	Washington	$1,507
9	Mississippi	$1,207
10	Kentucky	$1,095
11	**Illinois**	**$1,040**
Range: Connecticut ($3,440) to Nebraska ($38)		

Table 8 lists the ten states that have the highest net tax supported debt in the U.S. In 2002, the national total was $261.3 billion, with Illinois making up approximately 5.0% of that total with $13.1 billion in net tax-supported debt.

TABLE 8: 10 Highest States in Net Tax Supported Debt National Total = $261.3 billion			
RANK	STATE	DEBT (in billions)	% OF NATION
1	New York	$40.1	15.4%
2	California	$28.4	10.9%
3	Massachusetts	$21.2	8.1%
4	New Jersey	$18.1	6.9%
5	Florida	$16.5	6.3%
6	**Illinois**	**$13.1**	**5.0%**
7	Connecticut	$11.9	4.6%
8	Washington	$9.1	3.5%
9	Ohio	$8.6	3.3%
10	Pennsylvania	$8.5	3.3%
Range: New York ($76.6 billion—15.4%) to Alaska ($60.8 million--0.2%)			



Of these states, four have been downgraded since last October (2002). New York was downgraded one level by Fitch and Connecticut was downgraded one level by Moody's. Illinois was downgraded one level by Fitch and Moody's. California has received multi-level downgrades from all three ratings agencies—two levels by Moody's, three levels by Fitch, and four levels by S & P. Of the states in our sample, Pennsylvania has been upgraded one level by both Moody's and S&P.

Ratings Criteria

A state's bonds are rated by financial service agencies to provide a current grade of the state's creditworthiness, that is, its ability to meet its financial commitments. Specifically, a bond rating ranks a state's expected ability to make a full and timely payment of the principal and interest on the specific bonds issued. The major ratings agencies, including Moody's, Standard & Poor's and Fitch, each use their own specific standards and rating scales to develop a state's bond rating. They base their state ratings on four main factors (information supplied by Standard & Poor's):

- Economic factors (especially as they affect the issuer's tax base)—per capita income levels, composition of the employment sector, concentration or reliance on particular industries (manufacturing, farm and service sectors), employer commitment to the community, employment trends, quality of the local labor force, employment and income growth, ability of the bond issuer to promote economic activity, and size-structure-diversity of the tax base. Generally those communities with higher income levels and diverse economic bases have superior debt repayment capabilities. They are better protected from sudden economic shocks or unexpected volatility than other communities. Many communities have sought to replace lost manufacturing jobs with services sector employment. These lower-paying jobs may be of limited benefit.

- Governmental factors—the structure of the government, labor environment, litigation susceptibility and insurance coverage, and the management ability of the issuer. The structure would include political factors, the scope and power of the administration and those services for which the issuer is responsible. The management ability is viewed as the ability to make timely and sound financial decisions in response to economic and fiscal demands. This can be dependent on the tenure of government officials and frequency of elections. The background and experience of key members of the administration are important considerations if they affect policy continuity and ability to reformulate plans. Adherence to long-range financial plans is considered a reflection of good forecasting and planning. Well-documented capital improvement plans should include outlook for capital needs, flexibility to modify the program in difficult economic periods, and ability to finance investment through operating surpluses.

- Debt factors—the pledged sources of repayment, complexity of the repayment structure, outstanding debt levels, and debt burden measures. The analysis of debt focuses on the nature of the pledged security, current debt servicing burden, debt's term matching the useful economic life of the financed project, and future capital needs of the issuer. Investment in public infrastructure is believed to enhance the growth prospects of the private sector. Neglecting critical capital needs may impede economic growth and endanger future tax revenue generation. General obligation bonds are considered self-supporting when the enterprise can pay debt service and operating expenses from its own operating revenues. Such a self-supporting enterprise could use the full faith and credit support of government without diminishing the credit quality of the government's general obligation debt.

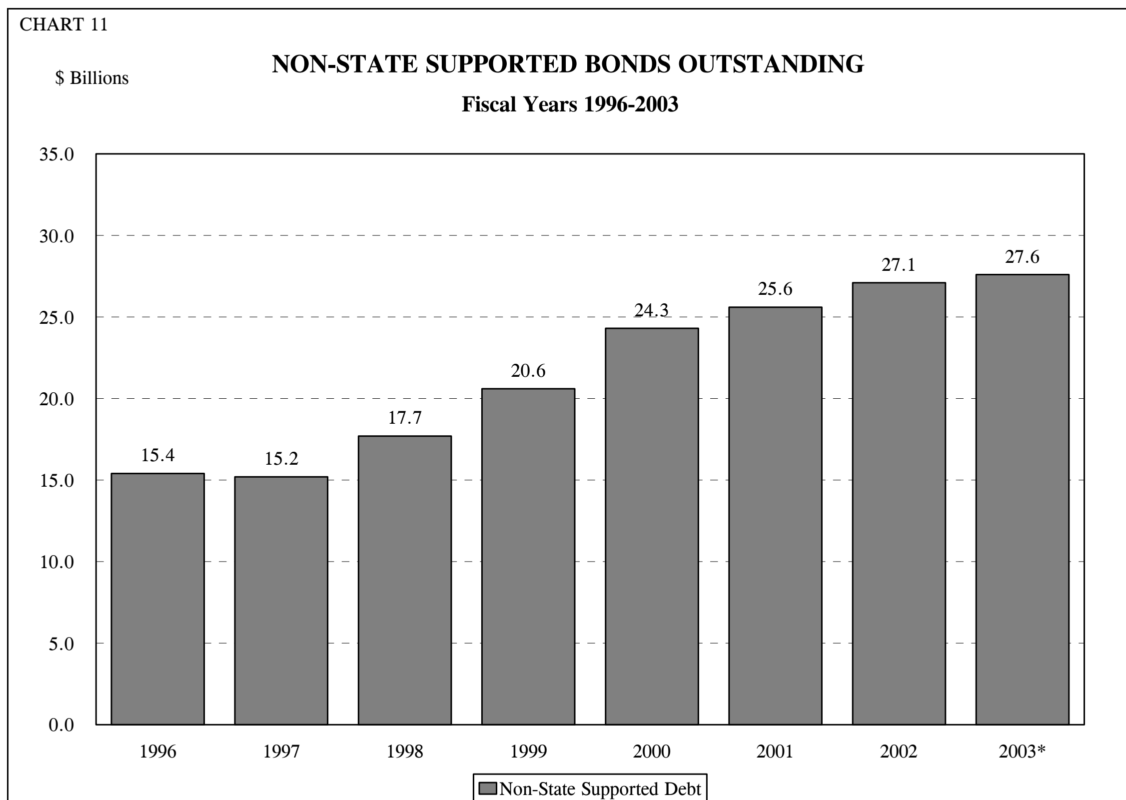
- Financial factors—the current financial position and fund balances of the issuer, a comparison of estimated versus actual revenues, outstanding obligations of the issuer (particularly pension liabilities), accounting and reporting methods, revenue and expenditure structure and patterns, annual operating and budget performance, financial leverage and equity position, contingency financial obligations (such as pension liability funding), composition and stability of revenue streams and expenditures, and the identification of trends. These factors are used to find the financial strengths and weaknesses of an issuer. Diverse revenue sources are preferable and the ability to tax nonresidential commercial activity.

A state's bond rating has an important impact on its ability to issue debt. A higher bond rating, reflecting a lower risk to investors can allow a state to issue bonds at a lower interest rate, therefore, at a lower long-term cost to the state. Conversely, a lower bond rating, reflecting a higher risk to investors will force a state to issue bonds at a higher interest rate, therefore, at a higher long-term cost to the state. Bond ratings are used by a participant in the bond market—bondholders, traders and financial managers—to weigh the relative risks assumed against the yield offered in each series of bonds issued.

SUMMARY OF NON-STATE SUPPORTED BOND DEBT

Non-State-supported debt can be broken down into two categories based on the degree of State obligation: "moral obligation" and "no obligation". In the event of default on moral obligation bonds - although the State is not legally obligated - the Governor must notify the General Assembly of any such shortfall and may include the amount in his budget for possible action by the legislature. No obligation bonds, secured solely by project revenue, have no direct State obligation.

Chart 11 shows the level of outstanding debt for non-state supported bonds as reported by the issuing authorities. The level of non-supported debt has increased since FY 1997. For a more detailed breakout of non-state supported bond outstanding by each bonding authority, please refer to Table 9 on the following page.



Legislation

Public Act 93-0205 created the Illinois Finance Authority (IFA) which is a consolidation of seven existing State bonding authorities: the Illinois Development Finance Authority, the Illinois Education Facilities Authority, the Illinois Farm Development Authority, the Illinois Health Facilities Authority, the Illinois Rural Bond Bank, the Illinois Community Development Finance Corporation, and the Illinois Research Park Authority. The new Authority's bonding authority is $23 billion in

outstanding bonds, excluding refunding bonds which may be issued to refund the bonds of the predecessor Authorities. These bonds are not obligations of the State, but under certain requests to the Governor, some bond issues (up to $500 million) may carry the State's moral obligation pledge. While the consolidation of these authorities will create some savings in administrative costs, the Director of the Governor's Office of Management and Budget has stated that the consolidation was to streamline functions for efficiency and to better control Illinois' image in the marketplace.

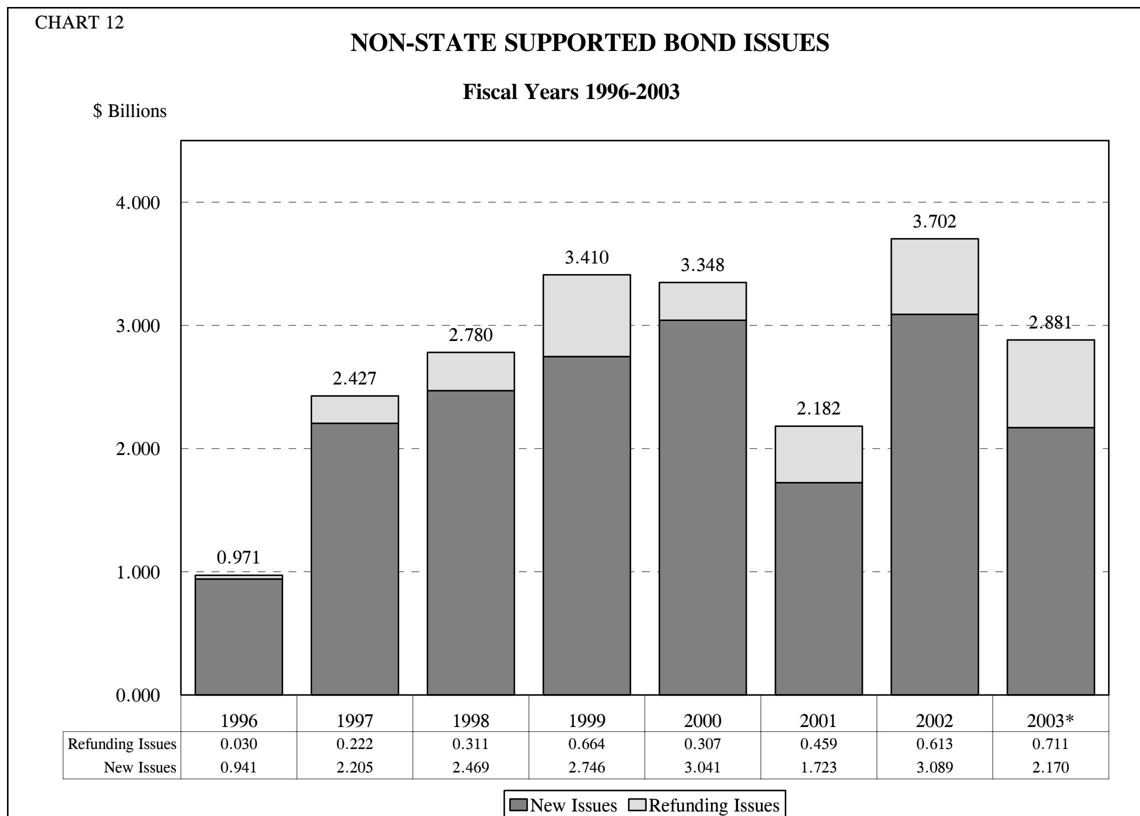
Public Act 93-0167 increased the Illinois Development Finance Authority's bonding authorization by $300.0 million for additional Clean Coal and Energy bonds that could carry the State's moral obligation pledge.

TABLE 9: NON-STATE SUPPORTED DEBT
Bonding Authorities
($ in Millions)

	Kind of Debt	FY 2003 Principal Outstanding
IL Development Finance Authority	Conduit	$6,985.3
IL Educational Facilities Authority	Conduit	2,839.2
IL Farm Development Authority	Conduit	90.6
IL Health Facilities Authority	Conduit	9,377.5
IL Housing Development Authority	User Charge and Moral Obligation	1,798.8
IL Rural Bond Bank	Conduit and Moral Obligation	81.6
IL State Toll Highway Authority	User Charge	742.0
IL Student Assistance Commission	User Charge	3,213.8
Quad Cities Regional Economic Development Authority	Conduit and Moral Obligation	18.8
Regional Transportation Authority (non SCIP)	Conduit	771.9
Southwestern IL Development Authority	Conduit and Moral	258.7
State Universities Retirement System	User Charge	7.3
Upper IL River Valley Devlpt. Authority	Conduit	71.3
Will Kankakee Regional Devlpt. Authority	Conduit	40.7
State Universities	User Charge	1,331.7
TOTAL, NON-STATE SUPPORTED DEBT		**$27,629.3**

Some totals may not equal due to rounding

Bond issuance decreased approximately 22.2% in FY 2003 from FY 2002 levels. New debt issues decreased 29.8%, while refunding issues increased 16.0%. In the past year, both Eastern Illinois University and Illinois State University had their credit ratings increased one level by Moody's, both from A3 to A2.



	1996	1997	1998	1999	2000	2001	2002	2003*
Refunding Issues	0.030	0.222	0.311	0.664	0.307	0.459	0.613	0.711
New Issues	0.941	2.205	2.469	2.746	3.041	1.723	3.089	2.170

Note that Refunding issues continue to increase, which has become an important issue during the current economic climate. With lower interest rates, several bonding authorities have plans for refunding in FY 2004. When bonding authorities are audited, they are now asked whether any current bonds outstanding can be refunded or defeased (paid off), and if so, why they haven't been.

Non-State supported debt includes:

- “User charge” supported debt, which is paid for by charges to the user of the service or the constructed building, road, etc. This type of debt is issued by such authorities as the Illinois Student Assistance Commission (ISAC), the Illinois Housing Development Authority, State universities, and the Illinois State Toll Highway Authority;
- “Conduit debt” is backed by revenues from the project the bonds are sold for or by the local entity benefiting from the project. This debt is issued by such authorities as the Illinois Development Finance Authority, Illinois Educational Facilities Authority and the Illinois Health Facilities Authority; and
- "Moral obligation debt" is that which the State pledges to back in case the issuing authority has insufficient funds to pay the debt. Bonding authorities issuing moral obligation debt must first receive approval from the Governor before each issue. The moral obligation is not legally binding on the State and the General Assembly has discretion on whether the debt will be paid out of State funds.

BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

1) Preparation of annual revenue estimates with periodic updates;

2) Analysis of the fiscal impact of revenue bills;

3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;

4) Periodic assessment of capital facility plans; and

5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html