ILLINOIS ECONOMIC
and
FISCAL COMMISSION

FY 2005 LEGISLATIVE CAPITAL PLAN ANALYSIS

APRIL 2004
703 STRATTON BUILDING
SPRINGFIELD, ILLINOIS 62706

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INTRODUCTION

State statute requires the Office of Management and Budget to prepare and submit an assessment of the State's capital needs both current and five years forward (20 ILCS 3010/1). This is presented as part of the Governor's Budget. The Illinois Economic and Fiscal Commission, in turn, is statutorily required to submit a 5-year capital plan analysis based on this information (25 ILCS 155/3).

The Capital Plan Analysis is divided into two sections. The first part of the report uses the Governor's five-year capital expenditure plan, which lists projects to be funded from the FY 2005 appropriation request. This analysis is based on what is contained in the expenditure plan of the budget book and the Office of Management and Budget's proposed legislation. It is used as a basis for looking at the Governor's project priorities and should provide insight into what can be expected to occur if the Governor's budget recommendation is approved.

The second part of the report looks at what is contained in the capital portion of the Governor's FY 2005 recommended budget. It details the amount of additional General Obligation and Build Illinois bond authorization requested, the level of proposed bond sales, future debt issuance, and annual debt service. This report also shows the Governor's recommended appropriations for State capital needs. Although the FY 2003 Pension Obligation Bonds are not a part of the Capital Budget, they will be noted throughout the report since they impact the State's debt.

In mid-April, the Comptroller's Bonded Indebtedness and Long-Term Obligations report for FY 2003 was released. The report states that Illinois' long-term debt is approximately $52 billion. This figure includes non-State-supported 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. This report on Capital Appropriations does not include information on the Authorities' debt. This will be included in the Commission's November Bond Watcher report.

EXECUTIVE SUMMARY

- The FY 2005 budget request for the capital program includes new appropriations of $3.244 billion and reappropriations of $7.928 billion, for a total of $11.172 billion. The current FY 2004 new appropriations of $3.388 billion represent 32.3% of the $10.5 billion total capital appropriation request, while FY 2005 new appropriations represent 29.0% of the total capital appropriation request.

- There are no requested new appropriations from the General Revenue Fund in the FY 2005 Capital Plan. Legislation introduced by the Office of Management and Budget amends certain reappropriations in the amount of $17.7 million that in previous public acts came from the General Revenue Fund, but will now come from other funds-- Build Illinois Bond Fund, Road Fund, and Capital Development Fund.

- The Governor is requesting $550.0 million in School Construction Funds in FY 2005 as part of an enhanced School Construction Program with an additional $2.2 billion in spending over four years for construction and maintenance projects.

- The Governor has included $2.194 billion in new appropriations for IDOT from various funds. Appropriations include $500.0 million in Transportation Series "A" Bond Funds and $117.2 million from Transportation Series "B" Bond Funds, which are part of a larger $2.0 billion four-year, plan for transportation projects.

- For FY 2005, general obligation bond and Build Illinois bond sales of $1.5 billion and $350 million, respectively, are anticipated. The G.O. debt service payment for FY 2005 would be comprised of approximately $538.3 million in principal, $547.8 million in interest, and $496.2 million in POB interest.

- Of the combined new and reappropriations for FY 2005, the $1.913 billion for Capital Development comprises 36.5% of the total. Transportation A and School Construction funds are the next two largest segments of general obligation appropriations, funded at $1.29 billion (24.6%) and $1.284 billion (24.5%). The $607.3 million for Transportation B funds would account for 11.6% of the total annual appropriations. Coal Development and Anti-pollution appropriations would represent $85.6 million (1.6%) and $62.8 million (1.2%) of the total, respectively.

- In March 2004, the State sold $829 million in G.O. new project and refunding bonds. Moody's lists Illinois as stable at the Aa3 rating level, while Standard & Poor's continues to affirm Illinois' AA rating, although the State remains on the negative watch list. Fitch also keeps Illinois' rating at AA and stated in its outlook for the March issuance that "The state's ability to achieve its projections and maintain balance, along with stabilizing its pension funding, will be a primary factor in future ratings actions."

FY 2005 RECOMMENDED CAPITAL APPROPRIATIONS

This section of the report is based on the Governor's five-year capital expenditure plan. Instead of using the Capital Budget released by the Governor's Office on March 23, 2004, the Commission used the legislation introduced to implement the plan, as it contains more specific information (HB 7288 and SB 3374 were introduced on March 25, 2004, and are identical). The capital projects are paid from several sources, such as bond funds, various revenue funds, and Federal/Trust funds. Bond funds used for FY 2005 include: Build Illinois, Capital Development, School Construction, Anti-Pollution, Coal Development and Transportation A and B funds. The FY 2005 budget request for the capital program includes new appropriations of $3.244 billion and reappropriations of $7.928 billion, for a total of $11.172 billion. The following table is a breakout of the amount of appropriations by fund type:

TABLE 1:
FY 2004 CAPITAL PROGRAM APPROPRIATIONS
($ Millions)

FUND TYPE	*NEW APPROPRIATIONS*	*REAPPROPRIATIONS*	*TOTAL*
Bond	$1,585.8	$4,053.3	$5,639.1
Revenue	1,450.7	2,743.7	4,194.4
Federal/Trust	111.2	314.6	425.8
TOTAL	***$3,388.4***	***$7,111.6***	***$10,500.0***

TABLE 2:
FY 2005 CAPITAL PROGRAM REQUESTED APPROPRIATIONS
($ Millions)

FUND TYPE	*NEW APPROPRIATIONS*	*REAPPROPRIATIONS*	*TOTAL*
Bond	1,644.1	4,760.1	6,404.2
Revenue	1,365.7	2,839.7	4,205.4
Federal/Trust	234.2	327.9	562.1
TOTAL	***3,244.0***	***7,927.7***	***11,171.7***

The current FY 2004 new appropriations of $3.388 billion represent 32.3% of the $10.5 billion total capital appropriation request. Approximately $3.244 billion, or 29.0%, of the $11.172 billion requested for FY 2005 represent new appropriations for renovation or construction projects.

There are no requested new appropriations from the General Revenue Fund in the FY 2005 Capital Plan, and only $3.3 million was appropriated from the GRF in FY 2004. Also, FY 2005 capital plan legislation amends certain reappropriations in the amount of $17.7 million that in previous public acts came from the General Revenue Fund, but will now come from other funds-- $14.1 million from the Build Illinois Bond Fund for IDOT, $2.4 million from the Road Fund for IDOT, and $1.2 million from the Capital Development Fund for various agencies.

The budget request for appropriations to the Capital Development Board (CDB) for capital projects, including new appropriations and reappropriations, totals $2.996 billion from the following funds:

TABLE 3: FY 2005 CAPITAL DEVELOPMENT BOARD REQUESTED APPROPRIATIONS
($ Millions)

FUND TYPE	***NEW APPROPRIATIONS***	***REAPPROPRIATIONS***	***TOTAL***
Capital Development	$216.4	$1,249.4	$1,465.8
School Construction	550.0	734.1	1,284.1
School Infrastructure	0.0	1.2	1.2
General Revenue	0.0	7.4	7.4
Build Illinois	1.3	218.4	219.7
Asbestos Abatement	0.0	1.6	1.6
Tobacco Settlement	0.0	13.0	13.0
Fund for Illinois' Future	0.0	3.0	3.0
TOTAL	$767.7	$2,228.1	$2,995.8

Approximately $767.7 million, or 25.6%, of the $2.996 billion requested for the CDB for FY 2005 represents new appropriations for the renovation or construction of facilities. The only new appropriations for the CDB are from the Capital Development ($216.4 million), School Construction ($550.0 million), and Build Illinois ($1.3 million) funds. The General Revenue funding requested for the CDB includes $7.4 million in reappropriations only. The remainder of the Governor's request of new appropriations would be appropriated to specific agencies. In FY 2004 actual appropriations for CDB equaled $2.706 billion, including $705.2 million in new appropriations. Of this amount $10.6 million came from the General Revenue Fund, all from reappropriations.

CAPITAL PROJECTS BY AGENCY

The projects in this section are only those for which a new appropriation is being sought (i.e. reappropriations are not listed). Below are selected new capital projects receiving bond fund proceeds, listed by agency. Due to the changes in format of the Capital Budget presented by the Office of Management and Budget, the appropriations as they are to be spent over the five-year plan are not available. Therefore, the amounts presented (listed in $1.0 million increments) will be the total required appropriations through FY 2009, in one lump sum. Some of the appropriation requests for these projects represent the entire cost of the project; for others, however, only a portion of the total amount recommended will be spent in FY 2005. **The Commission was not able to do a break out of FY 2005's five year spending plan due to fund amounts listed in the Capital Plan booklet not adding to their totals.**

Agriculture

The Governor's capital budget request of $10.5 million in new appropriations for the Department of Agriculture would all be paid primarily from the Capital Development Fund (CDF), $9.6 million, with another $0.8 million from the Agriculture Premium Fund for various projects at both the Springfield and DuQuoin State Fairgrounds. The two largest projects will be: $5.4 million to finish replacing show horse barns and $4.3 million to upgrade the electrical system, both at the Springfield site.

Office of the Architect

The Office of the Architect replaced the Legislative Space Needs Commission, and would receive approximately $1.3 million from the Capital Development Fund for work on the State Capitol.

Capital Development Board (CDB)

The Governor is requesting $550.0 million in School Construction Funds and $2.0 million in Capital Development funds for the Capital Development Board. Previously the Illinois State Board of Education (ISBE) worked with CDB to administer the School Construction grant program, but the Governor is proposing to run the program through the Capital Development Board with ISBE used in an advisory capacity only, however this change will require legislative approval. The Governor would like to enhance the School Construction Program with an additional $2.2 billion in spending over four years for construction and maintenance projects. The sale of additional bonds for school construction will likely need additional funding for debt service. Spending would begin with $500 million for construction and $50 million for maintenance in the FY 2005 five-year capital plan (See School Construction topic on page 10). The remaining $2.0 million in FY 2005 would go for emergency situations towards any statewide construction.

Central Management Services (CMS)

The Governor's recommendation of $20.7 million in new appropriations for CMS comes primarily from the Build Illinois Bond Fund--$18.6 million for vehicles and equipment. The remaining $2.1 million comes from the Capital Development Fund for roofing system repairs and fire department hookups throughout the State.

Commerce and Economic Opportunity (formerly Commerce and Community Affairs)

The $121.8 million in new appropriations for DCEO comes entirely from the Build Illinois Bond Fund. These projects are a part of the Governor's Opportunity Returns plan which is designed to improve infrastructure, encourage new industries, and ultimately create new jobs. Some of these projects are listed below:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Statewide grants for economic development and infrastructure	$86.0
• Statewide Prime Sites grants and loans	15.0
• Argonne National Lab: Ricketts Regional Biocontainment Lab	6.7
• IL Institute of Technology: Biomedical Research Center improvements	4.0
• Statewide Port Development Revolving Loan Program grants	4.0
• Argonne National Lab: Rare Isotope Accelerator Science Center	3.0
• Rockford: Applied Manufacturing Research & Technical Center	1.6
• Argonne National Lab: Advanced Protein Crystallization Facility	1.5

Corrections

The Department of Corrections would receive $28.2 million in new appropriations, $13.7 million from CDF for various projects and $14.5 million from the Build Illinois Bond Fund for vehicles and equipment. These projects will occur around the State at correctional centers and Illinois youth centers, and include:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Shawnee Correctional Center: replace windows	$4.4
• Sewers/Flood Systems/Wells: Centralia, Dixon, Dwight, IYC at Warrenville	2.6
• Roofing: Dixon, Logan, Pontiac, Sheridan, Vienna, IYC at Pere Marquette	2.1
• Statewide bondable capital improvements	2.0
• Electrical: Dixon, Vienna	1.7
• Dwight Correctional Center: renovate Clara Barton C8	0.6
• Sheridan Correctional Center: moveable equipment for Drug Treatment Program	0.3

Environmental Protection Agency (EPA)

The Environmental Protection Agency would receive $19.0 million from the Anti-Pollution Bond Fund for deposit into the Water Revolving Fund.

Board of Higher Education (BHE)

The FY 2005 capital plan budget submitted by the Governor recommends $91.7 million in new capital appropriations to BHE, all from CDF. The composition of BHE's capital budget is slightly different from that of the other State agencies. Portions of higher education's maintenance projects are funded through a Capital renewal program for repairs and maintenance, which allocates amounts statewide to the various State universities and the Illinois Community College Board. The Enhanced Construction Program for ICCB is part of a $250.0 million initiative to upgrade or replace temporary facilities that have outlived their useful life. The projects are listed below:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• IL Community College Board: Enhanced Construction Program	$50.0
• U of I (all locations): capital renewal and projects	13.7
• IL Community College Board: capital renewal	9.1
• SIU (both locations): capital renewal and projects	8.5
• Capital Renewal at other state universities	8.1
• IL Math & Science Academy: teacher develop and student enrichment center	1.9
• University Center of Lake County: construct a facility	0.4

Illinois Finance Authority

The Illinois Finance Authority would receive $500,000 for loans to fire departments from the Fire Truck Revolving Loan Fund.

Illinois Historic Preservation Agency

Approximately $2.6 millions would go to the Historic Preservation Agency, with $2.3 million from the Capital Development Fund and $0.3 million coming from the Build Illinois Bond Fund for vehicles and equipment. Projects will occur at Lincoln's Log Cabin Historic sites, Blackhawk Historic Area, Cahokia Mounds and Bishop Hill.

Human Services

The Governor is recommending $28.7 million in new capital appropriations for the Department of Human Services from the Capital Development ($27.4 million) and the Build Illinois Bond ($1.3 million) funds. The majority of the funds will be used for maintenance and renovation projects at State Mental Health Centers (MHC) and Developmental Centers (DC). A few of the specific projects are listed below:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Shapiro DC: replace steam & condensate system, replace roofs	$7.7
• Choate MHC: refurbish steam line tunnels, upgrade roofing	4.2
• Howe DC: renovate 10 residences & 1 neighbor home	3.8
• Kiley DC: facility gas conversion, replacing residential roofs	3.1
• Ludeman DC: renovate residential units, windows	2.5
• Alton Forensic Center: Emergency duress & video security system	1.2
• Tinley MHC: relocation of Tinley residents to Madden & Read	0.5

Medical District Commission

The Governor's FY 2005 budget recommends a total of $4.3 million in appropriations for the Medical District Commission from the Capital Development Fund. The funds will be used at the Medical Center District in Chicago for land acquisition and site development, and structural repairs at the Enterprise Center.

Military Affairs (DMA)

The Governor is requesting $2.3 million for the Department of Military Affairs, $2.1 million from the Capital Development Fund and $0.2 million from the Illinois National Guard Armory Construction Fund for rehabilitation and renovation of DMA facilities at the following sites:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Galesburg Armory: plan construction of new armory	$1.8
• Aurora Armory: plan Army Aviation Support Facility	0.3
• To buy land and construct parking lots	0.2

Natural Resources

The Department of Natural Resources would receive $118.8 million in new appropriations under the Governor's capital plan, from various bond, federal/state trust funds and revenue funds. This amount includes $73.9 million from the Capital Development Fund, $6.9 million in Build Illinois Funds, $15.1 million in federal/state trust funds. An additional $22.9 million from specific natural resource-related funds, such as: State Migratory Waterfowl Stamp Fund, Park & Conservation Fund, State Boating Act Fund, Conservation 2000 Projects Fund, Wildlife & Fish Fund, and the Illinois Habitat Fund, to name a few. Some of the big-ticket programs are listed below:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Randolph County: construct Sparta World Shooting Complex Phase 1	$29.0

• Parks and Trails (bike, recreational, snowmobile, & off-highway vehicles)	10.6
• Illinois River Basin Conservation Reserve Enhancement Program	10.0
• Statewide Museums Improvement Program grants	9.0
• Flood Control ongoing projects (State & Federal)	7.9
• Conservation 2000 program	7.9
• Lake Michigan shoreline protection	6.7
• Corps of Engineers – Match for environment/habitat restoration	2.7

Prisoner Review Board

The Prisoner Review Board would receive $43,800 from the Build Illinois Bond Fund for vehicles and equipment.

Public Aid

Public Aid would receive $921,400 from the Build Illinois Bond Fund for vehicles and equipment.

Department of Revenue

The Governor is requesting $5.8 million in new capital appropriations for the Department of Revenue in FY 2005. The $5.7 million in appropriations from CDF would pay for projects at the Willard Ice Building: replacing the curtain wall and upgrading the parking ramp lighting. Revenue would also receive $122,000 in Build Illinois Bond Funds for vehicles and equipment.

Secretary of State

A total of $2.1 million in new appropriations from the CDF is recommended for the Secretary of State for new construction and maintenance of buildings under their jurisdiction.

State Police

The Governor is requesting $21.6 million for the State Police. Of this amount, $16.7 million would come from the Build Illinois Bond Fund for vehicles and equipment. The remaining $4.9 million from the CDF would pay for upgrading firing ranges at Pontiac (District 6) and Effingham (District 12), and to acquire land and plan for a Metro-East Forensic Science Lab.

Supreme Court

The Courts would receive $401,000 to repair roofs at the Appellate Court Building at Mount Vernon and the Supreme Court Building at Springfield, and to repair the exterior of the Appellate Court Building in Ottawa.

Transportation (IDOT)

The Governor has approved $2.194 billion in new appropriations for IDOT from various funds. Appropriations include $500.0 million in Transportation Series "A" Bond Funds and $117.2 million from Transportation Series "B" Bond Funds, which are part of a larger $2.0 billion four-year, plan for transportation projects. The Build Illinois Bond Fund would contribute $15.9 million of which $6.9 million is for vehicles and equipment. The State Construction Account Fund and the Road Fund would be appropriated in the amounts of $1.065 billion and $239.0 million, respectively. Federal Funds would make up approximately $219.1 million of funding, while $37.4 million would come from such funds as the Grade Crossing Protection Fund, Federal High Speed Rail Trust Fund, State Rail Freight Loan Repayment Fund, Rail Freight Loan Repayment Fund, and Airport Land Loan Revolving Fund.

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• Statewide: transportation-related construction	$1,699.2
• Federal/Local: financial assistance to airports	204.0
• Statewide: Transportation B grants	81.0
• Statewide: Formal Contracts (A) & (B)-Maintenance, Traffic & Physical Research	38.3
• Statewide road apportionments	35.8
• Grade Crossing protections/separations	26.3
• Federal/State grants for mass transit	21.0
• Grants to air navigation	16.2
• Operation Greenlight Program	15.0
• Township bridges	15.0
• Rail: freight and high speed	12.6

Veterans' Affairs

The Governor's budget requests $17.4 million in new capital appropriations for the Department of Veterans' Affairs primarily from the Capital Development Fund ($17.2 million). The Build Illinois Bond Fund would fund $176,000 for vehicles and equipment. The facilities to receive appropriations are:

PROGRAMS ($ millions)	FY 2005 Total thru FY 2009
• LaSalle VA: 80 bed expansion	$11.6
• Manteno VA: emergency exits, fire alarms, humidifiers, sewers, new construction	4.9
• Quincy VA: replace HVAC equipment and controls	0.7

FY 2005 BUDGET BOOK REVIEW:
TOPICS

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 and State Board of Education award schools a State grant from bond sale appropriations depending on the priority of needs, which are ordered from highest to lowest as follows—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 2005 must to be submitted by April 1, 2004.

Grant Applications per Fiscal Year	1998	1999	2000	2001	2002	2003	2004	2005
Applications Received	57	197	157	166	204	94	49	87
Applications Entitled*	53	161	131	148	97[Φ]	8[†]	7[†]	4[†]

*"*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)
[Φ]There 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 through 2005 entitlements are suspended except for emergency situations. This amount denotes estimated emergency situations.

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. Of the 97 entitled applications in FY 2002, 24 projects remain on the list (Chicago gets 20% of total funding spent) and 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.

Appropriation 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	$550.0

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 which began April 1, 2003), and 1/7th of the 7% Telecommunications Excise tax from the School Reform Act which fell to under $100 million in FY 2003 and still has not totally recovered. As the annual liquor and cigarette tax revenues deposited into the School Infrastructure Fund are set amounts, the telecommunications tax revenues become the main factor in deciding whether revenues will be enough to cover the School Construction portion of debt service.

School Infrastructure Fund ($ in Millions)	1998	1999	2000	2001	2002	2003	Est. 2004	Est. 2005
Telecom. Excise Tax	$35.2	$101.5	$108.5	$114.9	$110.4	$89.7	$89.9	$92.4
Liquor Tax	----	----	$60.0	$60.0	$0.0*	$0.0*	$60.0	$60.0
Cigarette Tax	----	----	----	----	----	$15.0	$60.0	$60.0
TOTAL	**$35.2**	**$101.5**	**$168.5**	**$174.9**	**$110.4**	**$104.7**	**$209.9**	**$212.4**

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 & Interest Fund ($ in Millions)	1998	1999	2000	2001	2002	2003	Est. 2004	Est. 2005
Debt Service tied to transfer from School Infrastructure Fund	N/A	$7.0	$21.2	$49.4	$73.2	$127.5	$159.4	$207.0

Source: Office of the Comptroller's Annual Fund Transfer Report

The Office of Management and Budget estimates that the School Infrastructure Fund will pay $207.0 million in debt service in FY 2005. The IEFC estimates $212.4 million in revenues for FY 2004. Governor Blagojevich is requesting in his Capital Plan to enhance the School Construction Program with an additional $2.2 billion in spending over four years for construction and maintenance projects. Spending would begin with $500 million for construction and $50 million for maintenance in the FY 2005 five-year capital plan. Selling $550 million in G.O. bonds a year for the next 4 years would increase the debt service payment level by increments of approximately $36-$40 million each year (using 30 and 25 year level debt service payment scenarios at a 5.25% interest rate) from

FY 2005 to FY 2008. **If bond authorization does increase, additional funding for debt service may be required.**

If the Governor's School Construction increase were approved, the 24 FY 2002 projects would receive money first since they have actually been entitled. Applications for FY 2003 and after will have to go through the entitlement process before funds are appropriated. The Capital Plan states that "recent data suggests that Illinois school districts have self-assessed their needs at over $6 billion with $3.8 billion of that simply needed to repair and upgrade existing facilities" (p. 31).

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 has taken out federal loans to bring up the balance. Public Act 93-0634 created the Illinois Unemployment Insurance Trust Fund Financing Act which authorizes the Illinois Department of Employment Security to issue up to $1.4 billion in revenue bonds, with a maximum maturity of 10 years allowed, of which $510 million would go to pay off the State's federal loan. As part of an agreement between employer groups and labor, the debt service on the bonds will 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. IDES plans to sell the first $500 million of these bonds sometime in 2004.

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

State short-term debt may be incurred for two reasons—to resolve cash flow problems, or to meet deficits caused by emergencies or failures of revenue.

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

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 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. As of April 16, 2004, the State has made its January, March and April payments.

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 received $1.675 billion to assist in cash flow difficulties.** The following table shows the State's history of short-term borrowing:

Date Issued	Amount Issued ($ millions)	Date Retired
June-July 1983	$200	May 1984
February 1987	$100	February 1988*
August 1991	$185	June 1992
February 1992	$500	October 1992*
August 1992	$600	May 1993
October 1992	$300	June 1993
August 1993	$900	June 1994
August 1994	$687	June 1995
August 1995	$500	June 1996
July 2002	$1,000	June 2003
May 2003	$1,500	May 2004
Source: Bureau of the Budget *****Across fiscal year borrowing		

Pension Obligation Bonds

At the end of FY 2002, the unfunded actuarial accrued liability for the State's five retirement systems was $35.0 billion. The FY 2003 State appropriations for the retirement systems totaled $1.635 billion, with FY 2004 appropriations 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 liabilities, the Governor requested, and the legislature passed HB 2660 (Public Act 93-0002). This Act authorized the State to issue $10.0 billion in General Obligation Pension Obligation Bonds (POBs), with a portion of the proceeds to be used to pay back the General Revenue Fund for required State contributions to the designated retirement systems, $300 million in FY 2003 and $1.86 billion in FY 2004. The remaining proceeds were divided up between each of the designated retirement systems in their respective portions of the total actuarial reserve deficiency of the systems.

The taxable 30-year General Obligation Bonds Pension Funding Series were sold in June 2003, at a true interest rate cost to the State of 5.047%. Pension obligation bonds must be issued on a taxable basis due to current federal tax law restricting the investment of the proceeds of tax-exempt bonds in higher-yielding taxable securities. The POB sale caused a downgrade in Illinois' rating by two agencies, but that did not seem to affect the taxable bond sale. Although the State had not intended to sell all $10 billion of bonds at once, low interest rates and high demand in both the domestic corporate-grade and international markets gave the State the opportunity 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 Bond proceeds were used (or deposited) as follows:

Fees and Commissions	$41.7 million
G.O. Bond Retirement and Interest Fund	$481.0 million
Pension Contribution Fund	$9,477.3 million
Total Bond Proceeds	***$10,000.0 million***

The $41.7 million for fees and commissions includes a net bond discount of $2.9 million, as well as an underwriters' discount and a cost of issuance totaling $38.8 million. The next $481.0 million was deposited into the Capitalized Interest Account of the General Obligation Bond Retirement and Interest Fund (GOBR & I), to be used to pay the first year of debt service on the bonds, which consists of interest only. The rest of the proceeds were deposited into the Pension Contribution Fund.

Of the $9.477 billion of available POB proceeds, $7.317 billion was contributed to the State-funded retirement systems in proportion to their unfunded liabilities, in order to reduce those unfunded liabilities. It should be noted that Public Act 93-0002 did add a provision to the current funding plan to reflect this additional employer contribution. The provision sets the maximum annual employer contribution to each system at the amount that would have been contributed without the bond issuance, minus total debt service payments applicable to the system for that fiscal year. 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 $7.3 billion into the market. The three largest systems are, at this time, assuming an 8.5% rate of return over the 42-year projection period, while the Judges and General Assembly retirement systems use 8.0%. 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].

Of the remaining $2.16 billion, $300 million was used to reimburse GRF for the final portion of the FY 2003 State contributions to the retirement systems. In addition, the next $1.86 billion had been reserved in order to reimburse GRF for all of the FY 2004 employer contributions to the State-funded retirement systems. In other words, any employer contribution made from any State fund to any of the retirement systems triggered a transfer from PCF to GRF, from the FY 2004 estimated amount of $1.6 billion up to the total available $1.86 billion. Any unexpended amounts would be transferred in FY 2005 (under the same conditions), and would be used to reduce the required GRF contributions for FY 2005. While only $1.6 billion was assumed to be transferred in FY 2004, through February, it appeared that the transfers were on pace to reach the total remaining $1.86 billion.

In March of 2004, the General Assembly passed Public Act 93-0665 (HB 585), which significantly changed this process by ordering remaining monies in the Pension Contribution Fund to go directly into the various systems (approximately $465 million). In FY 2004, pension contributions made by funds other than general revenue will now be paid into the general funds instead of to the retirement systems. The impact of this legislation will be to stop the Pension Contribution Fund transfer into the general funds at approximately $1.395 billion, while starting subsequent transfers ($48 million from the State Pension Fund) and direct receipts of monies from other funds ($50 million) into the General Revenue Fund that would have instead paid retirement contributions to the systems. In total then, FY 2004 general funds revenues will be impacted by $1.493 billion rather than the earlier assumed $1.6 billion, a difference of $107 million. The State Universities Retirement System, the Teachers' Retirement System, the Judges' Retirement System, and the General Assembly Retirement System all received the remainder of their expected payments for FY 2004. The State Employees' Retirement System received the remainder of Pension Contribution Funds which was expected to be an overpayment, but which ended up being a disputed $65-$80 million short. As a part of Public Act 93-0002, SERS will receive a continuing appropriation for the FY 2004 shortage from the General Revenue Fund.

Per current law, the State-funded retirement systems have certified the required FY 2005 employer retirement contributions. The following table summarizes the FY 2005 required contributions to the State-funded retirement systems, as certified by the systems in November. It should be noted that the SERS and TRS certified amounts include the required FY 2005 contribution for the 2002 Early Retirement Incentive Program (ERI). The following table provides the amount of debt service by which each system reduced the State retirement contributions. Even though the Systems do not receive this amount, the State is required to contribute that amount to the General Obligation Bond Retirement and Interest Fund. Therefore, the amount of debt service attributable to each system is added to the FY 2005 retirement contribution amount to determine total State cost for each system for FY 2005.

FY 2005 Certified Contributions to the State Retirement Systems
($ in millions)

System	GRF/CSF	*SPF*	Total Contribution	Debt Service	Total State Cost
TRS	$ 858.0	$ 44.2	$ 902.2	$ 293.7	$ 1,195.9
SERS	720.0	18.7	738.7	93.8	832.5
SURS	254.6	15.4	270.0	97.2	367.2
JRS	30.6	1.4	32.0	9.6	41.6
GARS	4.5	0.2	4.7	1.8	6.5
Total	$ 1,867.7	$ 80.0	$ 1,947.7	$ 496.2	$ 2,443.8

Commission staff estimates that $80.0 million from the State Pensions Fund will be contributed to the retirement systems in FY 2005, based on each system's portion of total unfunded liabilities for all systems combined. If the amount distributed from the State Pensions Fund is smaller than $80.0 million, the amount that would have to be contributed from GRF and other funds will have to be proportionally larger.

The next table provides the funded ratio of each system and the combined funded ratio, as well as the unfunded liabilities of each system and the total unfunded liabilities of all systems combined. Columns 1 and 2 provide the financial condition of the systems on June 30, 2003, immediately prior to the distribution of $7.3 billion in Pension Obligation Bond proceeds. Columns 3 and 4 provide the financial condition of the systems after the proceeds were received in early July.

State-Funded Retirement Systems Funded Ratios and Unfunded Liabilities ($ in millions)				
	Without Bond Proceeds		With Bond Proceeds	
System	**Funded Ratio (1)**	**Unfunded Liabilities (2)**	**Funded Ratio (3)**	**Unfunded Liabilities (4)**
TRS	49.3%	$ 23,808.6	58.5%	$ 19,478.6
SERS	42.6%	10,091.9	50.5%	8,705.9
SURS	53.9%	8,311.0	61.8%	6,879.0
JRS	30.7%	746.2	43.9%	604.2
GARS	25.3%	146.8	39.1%	119.8
Total	48.6%	$43,104.5	57.3%	$35,787.5

Effectively, the distribution of the bond proceeds reduced the unfunded liabilities of the Systems by the amount of those proceeds ($7.3 billion). This, in turn raised the funded ratio of the systems combined by 8.7%, with TRS, by far the largest of the State-funded systems, realizing a 9.2% increase in the funded ratio.

Variable Rate Bonds and Swaps

Public Act 93-0009 gave the State 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 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. Illinois issued its first variable rate bonds in the General Obligation Series B of October 2003 issuance.

STATE DEBT

Authorization

General Obligation bonds are the most secure issuance by any government because they carry the pledge that the government will pay the bondholders 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 no 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:

TABLE 4
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**
January 2004	$16.927	$0.0	$10.000	**$27.677**	$2.839	**$29.766**

The current General Obligation bond authorization for new projects is $16.927 billion, after the increase of $19 million in Anti-Pollution bonds approved in January 2004, with approximately $4.1 billion unissued since April 2, 2004. The $10.0 billion of Pension Obligation Bonds were sold all in one issuance in June 2003, while Tobacco "Securitization" bond authorization has expired.

The following table lists the General Obligation Bond authorization level per statute, what has not been issued, and the remaining authorization "Available" after expected FY 2004 appropriations, as of February 29, 2004.

TABLE 5 The Status of General Obligation Bonds as of 2/29/04				
(in billions)	**Authorization**	**Un-Issued**	**Appropriated†**	**Available**
Capital Facilities	$7.320	$1.889	$7.120	$0.200
School Construction	$3.150	$0.840	$3.082	*$0.068
Anti-Pollution	$0.480	$0.042	$0.476	$0.004
Transportation A	$3.432	$0.740	$3.595	-$0.163
Transportation B	$1.882	$0.524	$1.849	$0.033
Coal Development	$0.663	$0.569	$0.175	$0.488
Sub-Total	$16.927	$4.604	$16.297	$0.630
Tobacco bonds	$0.750	$0.750	$0	$0.0
Pension bonds	$10.000	$0	$10.000	$0
Total	**$27.677**	**$5.354**	**$26.297**	**$0.630**
	Limit	**Un-Issued**	**Outstanding**	**Available**
Refunding°	$2.839	$1.027	$1.813	$1.027
Source: Illinois Office of the Comptroller, "Recap of General and Special Obligation Bonded Indebtedness and Update of Comparisons of General and Special Obligation Bond Activity"				

†Includes cumulative expenditures for prior years up through FY 2003 and FY 2004 appropriations and reappropriations.

***Only $24 million of the School Construction Fund "available" is for the $3.05 billion School Infrastructure Program.*

°Refunding is limited only by how much is outstanding at one time. As principal amounts are paid off, those amounts become available for future refundings.

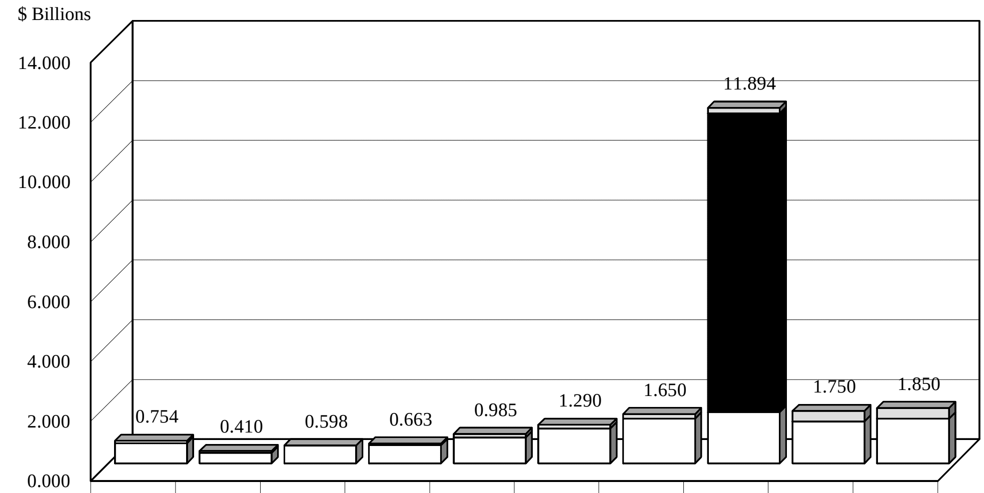
Although neither the Budget Book nor the Capital Plan discuss specific authorization changes to General Obligation or Build Illinois bonds, the Capital Plan suggests two long-term programs--an additional $2.2 billion over 4 years for the School Construction Plan, of which $550 million would be appropriated in FY 2005, and a $2 billion-5 year program for roads (Transportation A) with a $500 million appropriation in FY 2005. G.O. bond debt authorization would have to be increased by the legislature for both of these programs.

Bond Sales

The State's capital program is primarily financed through the issuance of general obligation bonds, which are backed by the full faith and credit of the State. The administration has changed the number of G.O. bond sales from four small sales to two large ones. "This change allows the state to largely drain the pool of bond proceeds for capital projects to save on interest and issuance costs (Bond Buyer, "Borrowing, Illinois Style: Partisans Split Over State's New Approach", 3/2/2004). For FY 2005, general obligation bond and Build Illinois bond sales of $1.5 billion and $350 million, respectively, are anticipated. Chart 1 shows only new money bond sales.

CHART 1 **STATE-SUPPORTED BOND SALES**

(Excludes Refunding Sales)



	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
State-Issued Revenue	0.080	0.060	0.000	0.060	0.125	0.125	0.150	0.182	0.350	0.350
Pension Bonds								10.000		
General Obligation	0.674	0.350	0.598	0.603	0.860	1.165	1.500	1.712	1.400	1.500

General Obligation ■Pension Bonds State-Issued Revenue

* OMB Estimates, including Pension Obligation Bonds

As of March 31, 2004, $1.15 billion of new project general obligation bonds and $350 million of new project Build Illinois bonds will have been sold for FY 2004. Refunding sales for FY 2003 include $637 million in general obligation bonds, of which $40 million was a part of the October 2003 Series B variable rate bonds. The Office of Management and Budget has proposed sales of $1.5 billion of general obligation bonds for projects in FY 2005 and $350 million for Build Illinois bonds.

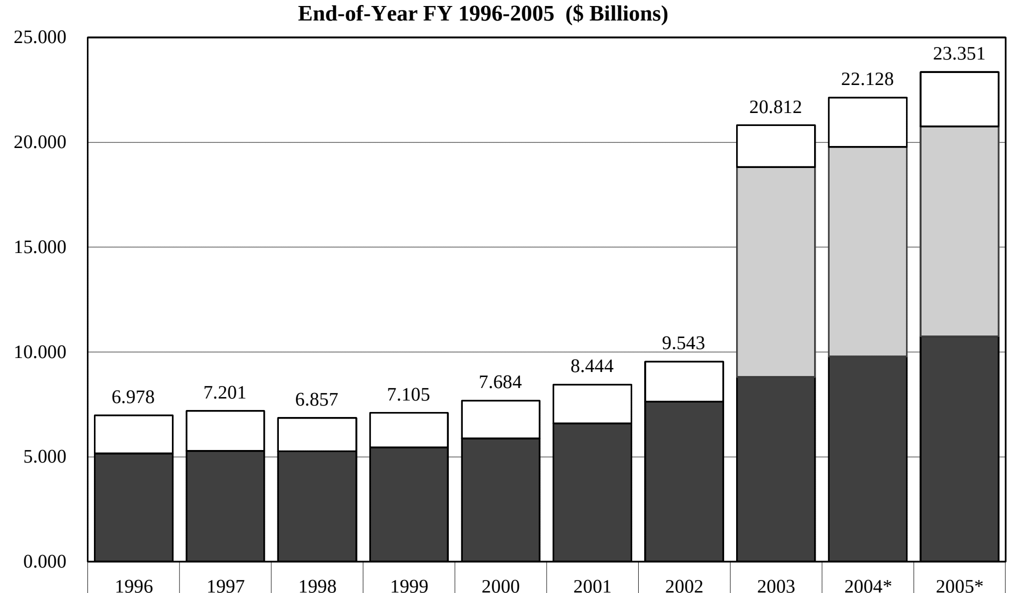
Debt Outstanding

The following sections for principal outstanding and debt service will have a separate listing concerning the $10.0 billion in Pension Obligation bonds, since they are not a part of the capital plan, but do affect the State's outstanding debt and bond rating. Chart 2 indicates that at the end of FY 1996, State-supported principal outstanding totaled almost $7.0 billion. By the end of FY 2002, this level increased to $9.5 billion. Total outstanding State-supported principal for FY 2003 increased to $20.8 billion, a 118.1% increase over the FY 2002 level, due to the sale of the $10.0 billion Pension Obligation Bonds. Without the Pension Obligation Bonds, debt would have increased to $10.8 billion, an increase of 13.3%. Estimates for FY 2004 and FY 2005 are $22.1 billion and $23.4 billion, respectively.

CHART 2

STATE-SUPPORTED PRINCIPAL OUTSTANDING

End-of-Year FY 1996-2005 ($ Billions)



	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
State-Issued Revenue	1.818	1.924	1.589	1.649	1.798	1.844	1.913	1.999	2.349	2.603
Pension Bonds								10.000	10.000	10.000
General Obligation	5.160	5.277	5.268	5.456	5.886	6.600	7.630	8.813	9.779	10.748

General Obligation · Pension Bonds · State-Issued Revenue

Sources: Office of Management & Budget, Office of the Comptroller

As Chart 2 demonstrates, the level of outstanding general obligation principal has been growing steadily since 1998. From FY 2000 to FY 2004, excluding the pension bonds, bond sales went from $5.9 billion to $9.8 billion, which represented an increase in outstanding principal on an average of $975.0 million per year, with half the increase related to Illinois FIRST programs in addition to the baseline capital program. With the Pension Obligation Bonds in FY 2003, G.O. principal outstanding more than doubled. The $10.0 billion in principal for the pension bonds will not decrease until principal payments on it start in FY 2008.

State-issued outstanding principal is made up of Build Illinois and Civic Center bonds. The Civic Center program has been dormant since the early 1990s and will be paid off in FY 2021. The Build Illinois program has been around since 1985 and seen several expansions which lead to a steady rise in principal outstanding from FY 1998 to FY 2003. The higher level of Build Illinois bond sales in FY 2004 and 2005 of $350 million, will add approximately $350 million in principal outstanding for FY 2004 and $250 million for FY 2005 after debt service payments are subtracted.

Debt Service

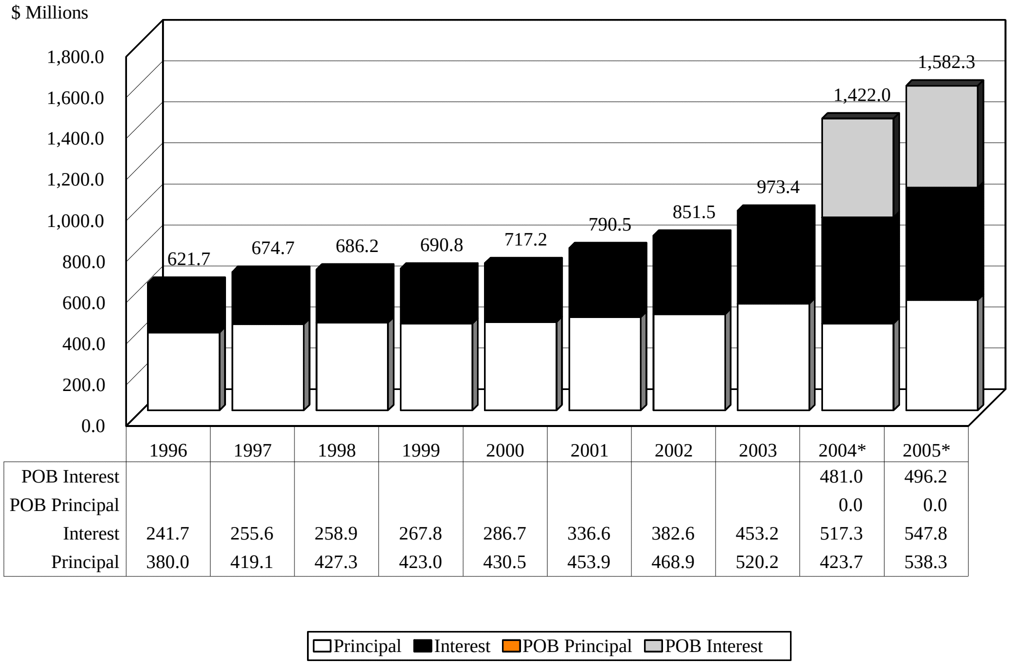
Of the recent $829 million G.O. bond sale approximately $484 million (Series A) was for new project funding. This was sold as $244 million in serial bonds (various maturities) with a maximum 20-year maturity; $65 million in term bonds (one maturity) with a 25-year maturity; and $175 million of term bonds with a 30-year maturity. The Pension Obligation Bonds of June 2003 were sold as $600 million of serial bonds with a maximum 12-year maturity; $375 million in term bonds with a 15-year maturity; $1.375 billion in term bonds with a 20-year maturity; and $7.65 billion in term bonds with 30-year maturity. The increase in some maturity levels added to the shift in repayment structures from level principal payments to some “backloaded” principal payments “have pushed out the average life of state debt to 16.9 years compared to the previous figure of 9.9 years” (Bond Buyer, “Illinois’ Big Borrowing: State Lays Out $2 Billion Fiscal ’05 Bonding Plan”, 3/23/2004). This change has been noted by rating agencies. Fitch Ratings’ comment on the March 2004 G.O. sale said, “The pension bond substantially reduced the amortization rate of general obligation bonds as level debt service was sought: previously, nearly 60% were retired within ten years, but now only about 27% of principal is so amortized, a slow rate.”

Based on expected general obligation bond sales, debt service for the G.O. portion of the capital program is expected to increase from an estimated $941.0 million in FY 2004 to $1.1 billion in FY 2005. This is an increase of $145.1 million or 15.4% in debt service payments. With Pension Obligation bond debt service included, FY 2004 payments will be $1.4 billion and FY 2005 almost $1.6 billion, an increase of $160.3 million, or 11.3%. Pension Obligation bond debt service is listed separately as it is not a part of the capital plan; a discussion of POB debt service IS at the end of this section. Through refunding bond sales to restructure debt, OMB plans on generating a savings of $130 million in debt service.

As shown in Chart 3, FY 2004, debt service will consist of $423.7 million in principal, $517.3 million in interest, and $481.0 million in POB interest. The debt service payment for FY 2005 would be comprised of approximately $538.3 million in principal, $547.8 million in interest, and $496.2 million in POB interest.

CHART 3 **GENERAL OBLIGATION DEBT SERVICE**

Principal and Interest



	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
POB Interest									481.0	496.2
POB Principal									0.0	0.0
Interest	241.7	255.6	258.9	267.8	286.7	336.6	382.6	453.2	517.3	547.8
Principal	380.0	419.1	427.3	423.0	430.5	453.9	468.9	520.2	423.7	538.3

* The FY 2005 breakout reflects bond sales year -to -date only. Source: OMB, Office of the Comptroller

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 2004, the Road Fund is estimated to transfer approximately $193.8 million of G.O. debt service, the School Infrastructure Fund $159.4 million and the General Revenue Fund $1.07 billion (including POBs). It is estimated that Road Fund transfers will pay $244.0 million, the School Infrastructure Fund $207.0 million, and the General Revenue Fund $1.17 billion of the debt service payment for FY 2005 (including POBs).

TABLE 6: GENERAL OBLIGATION DEBT SERVICE BY FUND						
($ Millions)	FY 2002 Amount	FY 2003 Amount	FY 2004 Amount	FY 2004 % of Total	Amount	FY 2005 % 0f Total
Road Fund	$195.7	$215.0	$193.8	20.6%	$244.0	21.7%
School Infrastructure Fund	73.2	129.5	159.4	16.9%	207.0	18.4%
General Revenue Fund	582.6	628.9	587.7	62.5%	673.0	59.9%
SUBTOTAL	**$851.5**	**$973.4**	**$940.9**	**100.0%**	**$1,124.0**	**100.0%**
General Revenue Fund for POBs	0.0	0.0	481.0	N/a	496.2	N/A
TOTAL	**$851.5**	**$973.4**	**$1,421.9**	N/a	**$1,620.2**	N/A
* FY 2005 projections are as they appear in the FY 2005 Budget Book						

The Governor's Office of Management and Budget estimates general obligation debt service to reach $1.6 billion in FY 2005. The large increases since FY 2003 in debt service are due to 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.

A hold harmless clause was included as part of the legislation for these bonds, which asserts that the State's contribution to each system shall not exceed the contribution it would have paid absent the bonds, and minus the debt service on these bonds. For example, the State's contribution to the State Employees Retirement System would have been $832.5 million in FY 2005, including Early Retirement but without the POBs. Due to the hold harmless clause, the System must minus their portion of debt service (SERS = $93.8 million) from the State's payment, and will receive $738.7 million as contribution for the system. In this way, until the bonds are retired in FY 2033, 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 $1.948 billion (excluding an expected $80.0 from the State Pension Fund) and the State's debt service payment will be $496.2 million equaling $2.444 billion in Pension Fund contributions. (**A more complete discussion about the Pension Systems and Pension bonds is located on page 15.) A table of the debt service payments for the Pension Obligation bonds is located on the following page.

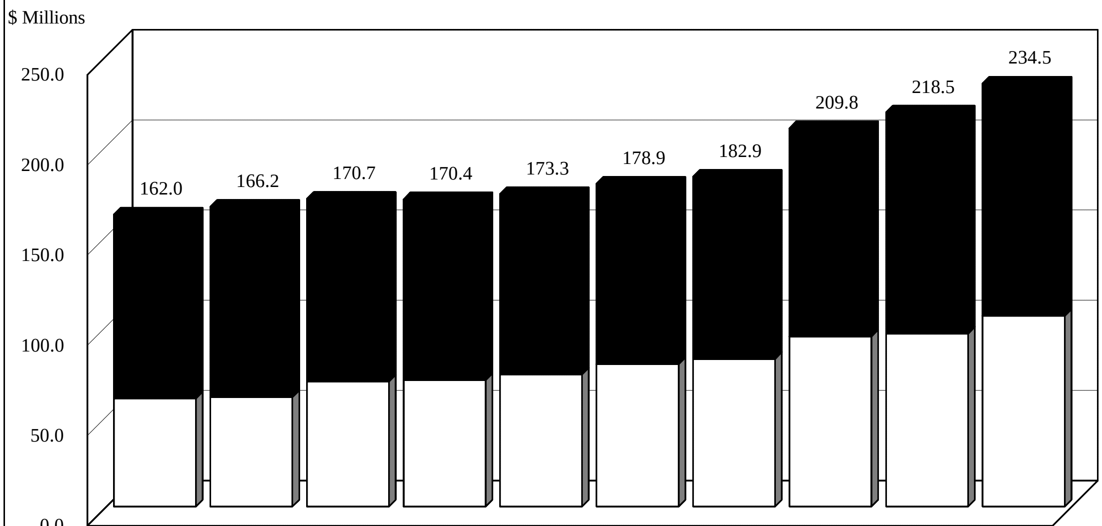
Table 7: Pension Obligation Bonds Debt Service			
FY ending June 30	**Principal**	**Interest**	**Total FY Debt Service**
2004	$0	$481,038,333	$481,038,333
2005	0	496,200,000	496,200,000
2006	0	496,200,000	496,200,000
2007	0	496,200,000	496,200,000
2008	50,000,000	496,200,000	546,200,000
2009	50,000,000	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	464,737,500	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)			

Chart 4 shows debt service for Build Illinois and Civic Center bonds. FY 2004 debt service will be approximately $218.5 million, an increase of 4.1% from the FY 2003 level. FY 2005 is estimated to be $234.5 million, an increase of 7.3% over the FY 2004 level.

CHART 4

STATE-ISSUED REVENUE DEBT SERVICE

Principal and Interest



	1996	1997	1998	1999	2000	2001	2002	2003	2004*	2005*
Interest	102.0	105.5	101.3	100.3	100.1	100.0	101.0	115.5	122.6	128.8
Principal	60.0	60.7	69.4	70.1	73.2	79.0	81.9	94.3	95.9	105.7

☐Principal ■Interest

* The FY 2005 breakout reflects bond sales year -to -date only. Source: OMB, Office of the Comptroller

Fiscal Year 2004 debt service for Build Illinois bonds is expected to be $204.7 million, comprised of $89.7 million in principal payments and $115.0 million in interest. FY 2005 Build Illinois debt service payments are estimated to be $220.7 million, of which $99.2 million will be for principal payments and $121.5 million for interest payments.

Debt service for Civic Center bonds in FY 200 will total $13.8 million with the principal portion equaling $6.2 million and interest payments equaling $7.6 million. Civic Center bonds debt service payments for FY 2004 will be approximately $13.8 million, comprised of $6.5 million in principal and $7.3 million in interest.

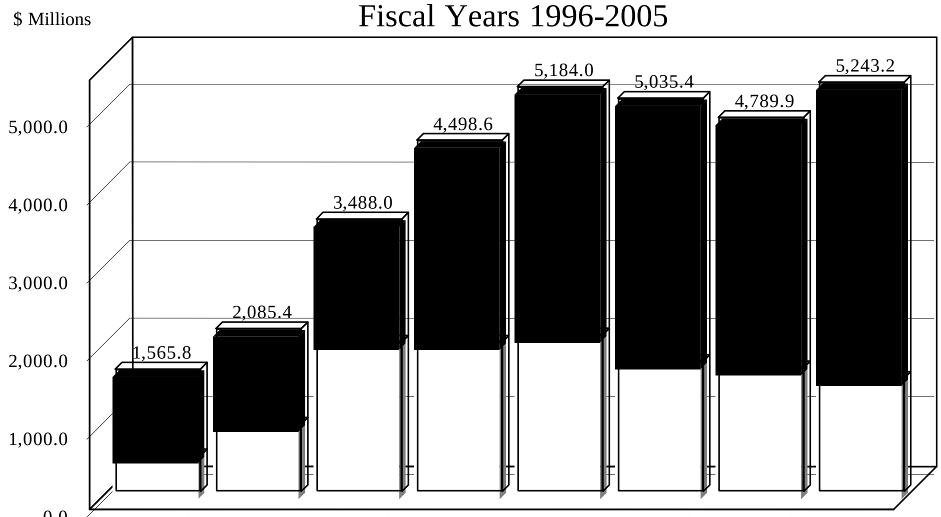
Appropriations

The FY 2004 Capital Budget book contains requests for capital appropriations from general obligation bond funds totaling $5.243 billion. The total includes $1.447 billion in new general obligation appropriations and $3.796 billion in reappropriations, which represent a decrease of $138.9 million, or 8.8%, in new appropriations and an increase of $592.2 million, or 18.5%, in reappropriations from the FY 2004 levels. The total appropriations requested from general obligation bond funds for FY 2005 represent an increase of $453.3 million, or 9.5%, over FY 2004. The annual appropriations from FY 1998 to the recommended FY 2005 amounts are illustrated in Chart 5.

CHART 5

GENERAL OBLIGATION APPROPRIATIONS

Fiscal Years 1996-2005



	1998	1999	2000	2001	2002	2003	2004*	2005*
Reappropriations	1,106.7	1,223.7	1,577.0	2,586.2	3,178.9	3,370.0	3,204.1	3,796.3
New Appropriations	459.1	861.7	1,911.0	1,912.4	2,005.1	1,665.4	1,585.8	1,446.9

New Appropriations Reappropriations

*FY 2004 based on the Capital budget book, FY 2005 based on HB 7288 and SB 3374

Charts 6 and 7 provide additional information on the requested general obligation appropriations for FY 2005 broken down by bond fund. Chart 6 shows the approximate percentages each bond fund represents of the total appropriation request (including both new and reappropriations). As shown in this chart, the $1.913 billion for Capital Development comprises 36.5% of the total. Transportation A and School Construction funds are the next two largest segments of general obligation appropriations, funded at $1.29 billion (24.6%) and $1.284 billion (24.5%). The $607.3 million for Transportation B funds would account for 11.6% of the total annual appropriations. Coal Development and Anti-pollution appropriations would represent $85.6 million (1.6%) and $62.8 million (1.2%) of the total, respectively.

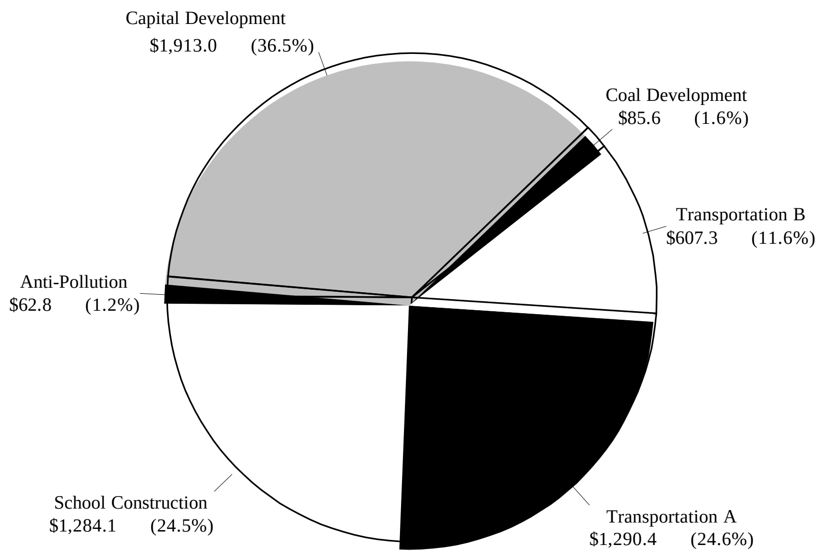
CHART 6

FY 2005 G.O. APPROPRIATIONS

By Bond Fund

($ in Millions)

Total: $5.243 Billion = 100%



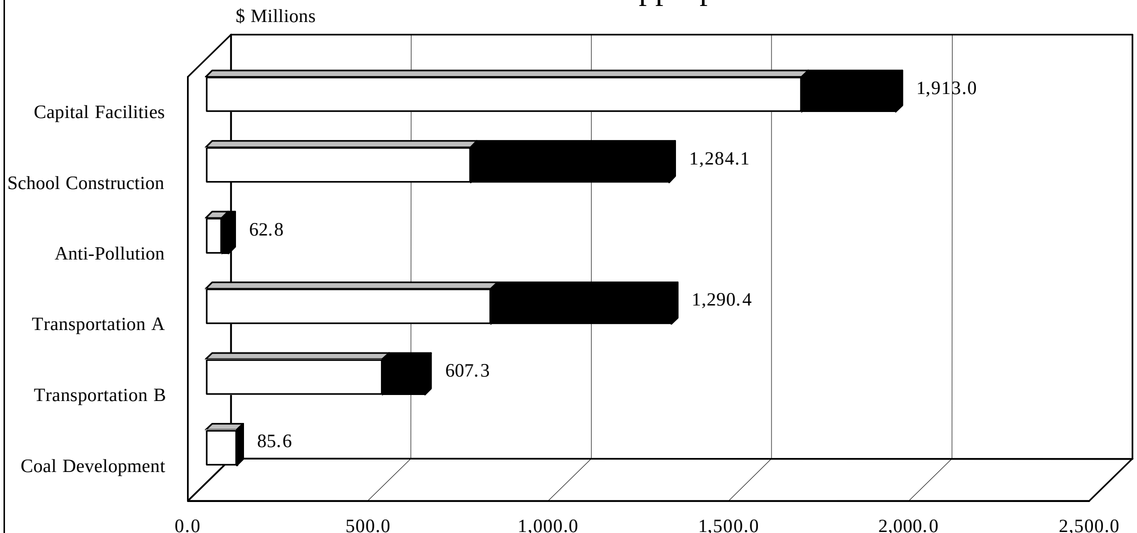
Note: based on HB 7288 and SB 3374 includes new and reappropriations

Chart 7 shows the requested appropriations broken down by categories into new and reappropriations. The Governor's FY 2005 Capital Budget requests new G.O. bond fund appropriations totaling $1.447 billion for all general-purpose categories. New appropriations would be highest for School Construction ($550.0 million) and Transportation A ($500.0 million). Capital Facilities and Transportation B categories would receive new appropriations of $260.7 and $117.2 million, respectively. The Anti-Pollution category would receive $19.0 million.

CHART 7

FY 2005 G.O. APPROPRIATIONS

New v. Reappropriations



	Capital Facilities	School Construction	Anti-Pollution	Transportation A	Transportation B	Coal Development
Re-appropriations	1,652.3	734.1	43.8	790.4	490.1	85.6
New Appropriations	260.7	550.0	19.0	500.0	117.2	0.0

Note: based on HB 7288 and SB 3374

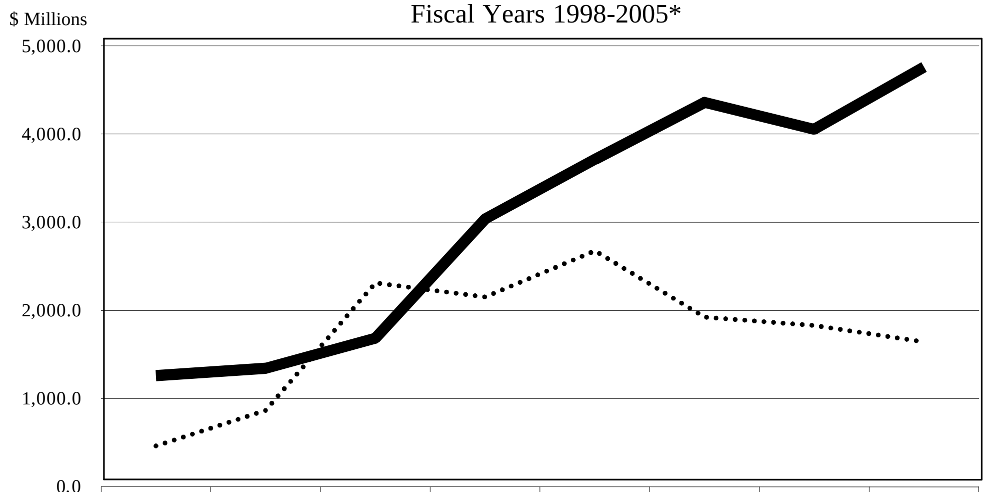
The FY 2005 appropriations request from Build Illinois bond fund equals $1.161 billion, made up of $197.2 million in new appropriations and $963.8 million in reappropriations. The total appropriations request for FY 2005 from all bond funds combined is $6.404 billion, which is an 8.9% increase from the FY 2004 level of $5.880 billion.

Chart 8 shows the amount of new appropriations versus reappropriations of all bond funds combined for fiscal years 1998 through 2005. Reappropriations are unused funds appropriated in a previous fiscal year that are being tapped for use in the current fiscal year. As the chart shows, fiscal years 2000 through 2002 showed new appropriations above the $2.0 billion mark. In FY 2003 new appropriations dipped below that level and they have declined each year through FY 2005. The Governor is requesting $1.644 billion in new appropriations from all bond funds, a decrease of 10.0% over the previous fiscal year.

CHART 8

NEW APPROPRIATIONS v. REAPPROPRIATIONS
Of Combined Bond Funds

Fiscal Years 1998-2005*



	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004*	FY 2005*
Reappropriations	1,261.4	1,345.1	1,685.4	3,038.5	3,714.7	4,361.4	4,053.3	4,760.1
New Appropriations	461.5	866.8	2,312.5	2,151.8	2,673.0	1,923.8	1,826.5	1,644.1

Reappropriations •• New Appropriations

Note: based on HB 7288 and SB 3374
Includes Build Illinois and Civic Center Bond Funds

The Governor's proposed budget includes an appropriation to the Office of Management and Budget in the amount of $1.8 million for costs of issuance associated with bond programs and $0.1 million for administrative expenses of the School Construction Program.

Debt Ratios and Bond Ratings

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%

Including the $10 billion of Pension Obligation Bonds Moody's and Fitch have Illinois' tax-supported debt to personal income at 5.4% to 5.5%, "an above-average level but still within the moderate range. If they excluded the pension bonds, debt would be 3.1% of personal income. Fitch has stated that 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 challenges 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.

Moody's placed many states on a negative watch list, including Illinois, at the end of FY 2002 due to the economic problems states were going through nationwide.

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**

MAXIMUM RATING POSSIBLE
AAA or Aaa

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. Other factors involved were 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.

Even with the influx of funds to the pension systems, Illinois' 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.

In March 2004, the State sold $829 million in G.O. new project and refunding bonds. No further downgrades have occurred. Moody's lists Illinois as stable at the Aa3 rating level, while Standard & Poor's continues to affirm Illinois' AA rating, although the State remains on the negative watch list. Fitch also keeps Illinois' rating at AA and stated in its outlook for the March issuance that "The state's ability to achieve its projections and maintain balance, along with stabilizing its pension funding, will be a primary factor in future ratings actions." (from Fitch Ratings opinion on General Obligation Bonds Series A and B of March 2004).

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