State of Illinois
COMMISSION ON GOVERNMENT
FORECASTING AND ACCOUNTABILITY
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August 22, 2017

MEMORANDUM

TO: Senator Trotter

FROM: Executive Director Clayton Klenke

RE: Request of August 8, 2017

Below we hope to have answered the questions proposed in your August 8, 2017 letter.

1. **Of the $14 billion in bills currently owed to providers (provider debt), how much of that amount is subject to, currently or in the future, incurring interest under state statutes for prompt pay or timely pay interest?**
According to the Office of the Comptroller, as of June 30, 2017, approximately $5.5 billion in bills were incurring interest under the State's statutes for prompt pay and timely interest.

2. If the state chooses not to refinance this debt and instead continues to carry this provider debt in 2018, approximately how much in timely pay and prompt pay interest charges will be incurred by the State of Illinois during fiscal year 2018 on these unpaid bills?

According to the Office of the Comptroller, approximately $2 million a day in interest is paid on approximately $5.5 billion of bills due, over 90 days old, as of June 30, 2017. Dividing by an average 21 processing days in the month, the daily interest is around $2 million. If we divide the figure by 30 days a month instead, the amount is about $1.83 million in daily interest. Running the $5.5 billion through a range of 9% to 12% over one year, could cost the state $502 million - $668 million.

3. I am also requesting that the Commission perform analysis of the financial impact of two different scenarios.
a) Total interest costs incurred over the next 12 years on $6 billion of provider debt.

The cost in interest, based on the earlier assumption could reach between $6.02 billion - $8.02 billion over 12 years. This is a rough estimate in aggregate assuming a $5.5 billion average, as undoubtedly there would be fluctuations during the fiscal year due to cash flow dynamics.

b) Total interest costs incurred over the next 12 years on $6 billion of general obligation bonds issued under the authorization provided in SB 42.
Public Act 100-0023 (SB 42) allows for the sale of General Obligation Income Tax Proceeds Bonds. The following parameters for the bonds apply:

- Authority for up to $6 billion in bonds,
- Must be sold by December 31, 2017,
- 12-year maturity,
- level principal debt service payments,
- fixed or variable rates as long as rate is under level required in Bond Authorization Act,
- Proceeds to pay unpaid obligations of State vouchers incurred prior to July 1, 2017.

$6.0 billion GO bonds; level principal payment			
Annual Amounts (Interest: First Year - Last Year)			
Interest Rate	Principal	Interest	Payment
4.50%	$500 m	$270 m - $23 m	$770 m - $523 m
5.50%	$500 m	$330 m - $28 m	$830 m - $528 m
6.50%	$500 m	$390 m - $33 m	$890 m - $533 m

Using a 12-year maturity and level principal payments, the interest on the bonds, depending on the interest rate received, would range from a high in the first year of $270 million - $390 million, decreasing to between $23 million - $33 million in the 12th and final year of payment. The total cost in interest over the 12 years of bonds would range from $1.76 billion - $2.54 billion. The actual interest rate and debt service payments would be dependent on variables in the market at the time of sale, such as: the confidence in the State of Illinois' finances, bond agency ratings, the tax status of the sale, current interest rates and the spread for Illinois.

The bonded interest payment amounts decline as the principal is paid off (due to a level principal payment schedule). Also, under the bonding scenario, $6 billion in overdue bills would be paid off, lowering the number and dollar amount of backlogged bills on which interest must be paid and lowering the overall number and dollar amount of backlogged bills.

4. Furthermore, I'm asking COGFA to review the most recent reports from the credit ratings agencies to determine, in the professional opinion of the Commission staff, whether it is possible that the state's credit ratings could be negatively impacted if the state does not utilized this bonding authority to refinance our existing provider debt.

The Commission does not regularly offer opinions on rating agency actions. However, it appears that the rating agencies expect Illinois to use the bond authorization to help lower the bill backlog. Following are quotes from the three main rating agencies on this topic:

In Standard & Poor's July 12, 2017 review and reaffirmation of Illinois' BBB- ratings with a stable outlook, they said, "Bonding to pay down the bill backlog is tantamount to the state financing its operating costs with debt. While this practice would be inconsistent with a higher rating, we believe that it is encompassed in our 'BBB-' rating. Furthermore, given that the state pays elevated annualized interest rates of 9% or 12% on much of its unpaid bills, a debt financing does offers [sic] the potential for fiscal savings."

In Moody's Investors Service July 20, 2017 Rating Action, they reaffirmed Illinois' G.O. rating of Baa3 with a negative outlook instead of lowering the rating. They stated, "The budget legislation includes income tax increases that the state expects will generate about $5 billion in fiscal 2018, which began July 1. Together with internal and external borrowing provisions in the legislation, the tax increases will help contain a backlog of unpaid bills that has been hovering above $14 billion in recent weeks."

In Fitch's July 17, 2017 reaffirmation of the State's BBB rating with a negative outlook, they gave the following opinion, "the state will continue to be challenged to reduce budgetary liabilities that accumulated during the impasse and then to prevent a similar build-up in the future. The enacted fiscal 2018 budget authorizes up to $6 billion in general obligation borrowing to reduce the backlog, although it only provides for debt service for a lower borrowing level and the borrowing plan has not yet been determined. By applying borrowed funds to Medicaid payables, the state will generate federal matching revenues that will further reduce the backlog while also addressing a federal judge's order to increase and bring current Medicaid payments. The state is also authorized to utilize another $2.1 billion in interfund borrowing and use of other state funds to reduce the backlog. While these sources will begin to address the accumulated budgetary liabilities, the state is likely to be left with a still very high balance that will keep pressure on its liquidity."

Taking the above comments of the rating agencies into consideration, there is little likelihood that failure to exercise the authorization granted under SB 42 would be viewed as favorable. Although, ultimately, as previously mentioned, market conditions would determine the State's ratings.

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