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M E M O R A N D U M

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Re: Legislative Report

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Closing The Door on Election '14

The votes have now been counted, the voters have spoken, and we have a new Governor-elect on the horizon. The new Governor's Transition Team has been named and a segue from the Pat Quinn administration to the Bruce Rauner administration has begun.

Pundits galore have been assessing why Pat Quinn who, according to polls was streaking as Election Day neared, lost the election by the margin he did. Yes, he didn't do as well as he could have in the City of Chicago and Cook County. Yes, he lost margin in the collar counties. And, yes to a plethora of other reasons. Yes, his message didn't ruminate with the electorate. But, in all of those assessments there is one common denominator … the public simply lost confidence in him. Quinn's popularity has been in the tank for the last two years. Poll after poll showed a feeling by the public that the state was heading in the wrong direction. His only hope as campaign season reached high gear was to take the spotlight off of himself and make his opponent seem worse. And that's what we saw in ad after ad that was broadcast between June and November 4. Quinn's strategy failed for only one reason, and a big one. Voters decided that the devil they *didn't know* was preferable to the devil they knew. They didn't feel confident that Quinn was the engineer who could get the train to the final destination. Now Governor-elect Rauner has some huge decisions to make, and quickly. And Illinoisans decided he should be the one to try to fix the mess.

From the statements and activities that have been made or taken place since Election Day a few things have become evident.

First, anything significant occurring during the legislative veto or January lame duck session is nil, including consideration of any income tax extension. The Governor-elect has requested that no major decisions be made until he takes over and, for the most part, legislative leaders have indicated they will honor that request. The possible exception may be a minimum wage and that's not for certain. The General Assembly apparently is also looking at the results of November 4 as a referendum on the tax question and will looking at Rauner for direction. So the tax increase will sunset on December 31 as planned unless Rauner intervenes, which he most probably will not. If he then decides that he wants it back after the new legislative session begins in January he may be in for Excedrin headache # 2015. Regardless of the public policy aspect of adequate revenue and the need for the state to be able be able to pay its bills for the remainder of the fiscal year, politically it's a different story. Candidate Rauner wanted the tax increase to sunset, and so it will. If Governor Rauner wants it back he's going to have to help get it passed and "own it".

Second, while there is inherently going to be philosophical differences between the new governor and the Democratic legislature, there will also be copious amounts of cooperation. This isn't the first time that a Republican governor and Democratic legislature have existed. Governors Thompson, Edgar and Ryan all had many accomplishments under that circumstance. The same will occur with Rauner if he reaches out in the spirit of cooperation and avoid acting like the new Sheriff in town ala Dan Walker.

Third, the new broom will sweep clean. Expect new agency directors to be named beginning in late November through the holidays. There is no telling what may be the end result of major initiatives that the Quinn administration put forward. They may be too advanced to drop completely, but they may be recalibrated to fit the vision of the new administration.

Fourth, legislative Republicans are in for an awakening. Most have never served with a GOP governor and if they can't be convinced to support Rauner initiatives then Democrats most certainly will back off, or will be in a position to extract whatever they can. Governor-elect Rauner's toughest task will be to get majorities of Republican House and Senate members to support any revenue and budget cutting plans he has. Recently, WTTW-TV in Chicago, the local PBS outlet, assembled a post-election panel that included a House and Senate Republican leader to discuss state issues going forward. Each was asked whether or not they were open to discussing revenue. Both, unequivocally, said no. Posturing? Maybe. Then again, maybe not.

And it's one thing to talk about budget cuts but another to actually vote to do it, especially when it may cause pain and upheaval and when more revenue can avoid it. There may be inefficiencies and maybe even some fraud in state government, but not $3.6 billion worth. Looking at the totality of the problems that lay ahead, this may be a sign that Governor-elect Rauner may have to climb what amounts to Mt. Everest to accomplish what he needs to get the state back on track.

Another Day Older and Deeper in Debt

In what most certainly may be considered an anti-climactic decision, a Sangamon County circuit court judge has deep-sixed the legislature's three-year attempt at fashioning pension reform. The ruling was not unexpected after the Illinois Supreme Court ruled a far more meager attempt at limiting state retiree health care benefits unconstitutional last summer. After that, too most state policy and political observers it wasn't a matter of "if" the larger reform package would be trashed, but "when". The first part of "when" happened last week. It is now expected that the Illinois Supreme Court will allow an expedited hearing so the second part of "when" can occur and the General Assembly and the new governor can try to come up with an alternative that can pass legal muster. Is it possible that the Supreme Court will rule the reform package constitutional? Sure. Is it probable? Don't bet the house on it.

There was also another court action last week tied to pension reform that will also have some financial repercussions for the state and that involves the money that had been paid by retirees for a portion of state health care benefits since July, 2013. Last week the decision was made that those payments must be refunded … an estimated $60 million. The state has until December 18 to provide a repayment schedule and it's expected that those refunds will be made beginning in the spring.

So, as the new governor and legislature prepare to embark on their journey together they'll have some very unpleasant fiscal scenarios staring them in the face.

First, they'll have to contend with a budget for the current fiscal year that's at least $800 million out of balance. On order to leave Springfield with a "balanced budget" in May the General Assembly added $167 million to revenue estimates in order to make the numbers work. Then, they approved $650 million in inter-fund borrowing that has to be paid back with interest. They also pushed some health insurance payments to FY 2016, adding to the problem.

Second, on top of that the state will be losing $1.6 billion in revenue on January 1 when most of the temporary income tax disappears. Observers have cautioned that the state may run out of revenue by early spring.

Third, with no pension reform plan in place to save resources it is expected that pension payment costs for FY 2016 will increase by an estimated $600 million. Add to that the $60 million in refunds to be paid as reimbursement to current state retirees.

Fourth, not only does the expiration of the temporary state income tax cause a $1.6 billion deficit during FY 2015, but since the expiration occurs midway through the state's fiscal year double that for FY 2016, to $3.2 billion.

Governor-elect Rauner has already indicated that the state's finances are abysmal. The question is how he and legislative leaders can pull together to create some viable plan for short term solvency. That question is more immediate than discussing longer term issues like comprehensive tax reform and others.

Transitioning

One of the hallmarks of our democracy is our ability to seamlessly move from one governmental administration to another after elections take place. It's not an easy task and requires hours and hours of time invested by literally hundreds of individuals in order to make it seem effortless. While the media will focus on some of the more major aspects or issues that may come to the fore or that may be expected to be address first, the actual nuts and bolts of getting up to speed on every aspect of state government, conducting searches for qualified individuals to head state departments and others to help develop and carry out policy, creating a plausible governing agenda, and reaching out to outliers to try to develop some harmony at the administration begins requires thousands of hours and just as many decisions. The Illinois Constitution allows two months for all that to occur. For some that's barely enough time to make a decision on buying a new car let alone take over the reins of government, but we expect that the people we elect will be resourceful and will be up to the task.

Governor-elect Rauner started right out of the box by naming a transition team shortly after Election Day. The team is headed by Lt. Governor-elect Evelyn Sanguinnetti and includes many diverse voices. Their job will be to review the current state of the state, report findings back to the Governor-elect, and help develop suggestions and an overall plan for the new administration. Last week a number of transition committees were announced that cover just about every major topical area that the new administration will have to address both in the short and long term. Those committees cover Education, Healthcare and Human Services, Infrastructure, Agriculture, Intergovernmental Efficiencies and Local Government, Economic Development, Energy and Environment, Public Safety, Government Operations and Veterans. It is presumed that they will complete their work prior to the January 12 Inauguration. It is also expected that any major recommendation put forward by these groups will be utilized for major policy announcements before the Inauguration, as part of the Governor-elect's inaugural speech, and for his late January State of the State message. New Governors like to put their own mark on government operations from the get-go so some announcements just before the holidays would not be out of the ordinary.

Also, the Governor-elect will have to identify individuals to replace all current agency directors and other administrative personnel. It's a thankless task once you get past the top echelon but the top tier should be named well before January 12 so that the Senate can proceed with confirmation hearings as quickly as possible. By the end of March most of the new administration should be completely in place.

To Tax or Not To Tax, That Is The Question

Early on during his 2014 election campaign Governor Quinn made a bold move and went "all in" on making the temporary income tax permanent. That move failed and the leadership of the General Assembly has announced that the tax will be allowed to expire on December 31. Can the legislature act sometime during the session to re-impose it? Yes. Can they make it retroactive back to January 1? Yes, again. Will they? That's where the terrain gets rocky.

Political issues aside, Governor-elect Rauner's campaign pronouncements during argued for the expiration of the temporary tax, an expansion of state service taxes, freezing property taxes and general reform of the tax code to end "corporate welfare". That's an agenda that will require some pretty heavy lifting. Add to that the assertions that there would be more money for schools, public works and various other spending categories and the load gets even more burdensome. The upcoming half-fiscal year loss in revenue to the state from the expiration of the income tax will be $1.6 billion and a full $3.6 billion for FY 2016. To provide a replacement for that amount of lost revenue won't be easy, especially since it's going to take the legislature to go along … never a sure thing when anything to do with increasing revenue is concerned.

Governor-elect Rauner's jobs agenda that was released last summer called for replacing lost income tax revenue with expanded services taxes that would include warehousing, storage, mini-storage, residential and commercial sewer and refuse, travel agencies, advertising, interior design and decorating, janitorial services, printing, attorneys, public relations agencies among others … a total of 32 categories. But if approved the plan would raise only $600 million or 12% of what would be lost by the expiration of the income tax. Illinois currently places sales or service taxes on 17 categories, the smallest number in the Midwest. Iowa has the most with 94. A majority of states in the Midwest have categories in the mid-20s. But can the General Assembly and the public accept the "sticker shock" of seeing taxes suddenly appear on refuse collection, attorney's fees or other services? Moreover, in an editorial last week the Chicago Tribune called for expansion of sales and service taxes to include *everything*. Their rationale is that Illinois has moved to a service economy so our tax system should reflect that change. While that premise may be true it's questionable whether or not the General Assembly is ready for that broad of reform.

Since Election Day the Governor-elect has broadened some of his tax-related comments to include calls for general reform of the Illinois tax code. There are many weighty issues involved in making such major decisions including whether the amount of revenue raise with the change will equal the amount being lost, whether it can be implemented quickly so revenue a severe dip in resources won't occur, and whether or not a majority of legislators will be willing to face the music in their districts from a decidedly vocal constituency who feel they already pay enough. Citizens are very skeptical and distrustful of government. They fear that in the end they will be the losers as they will be forced to pay more with no end to the crisis in sight. That electoral attitude makes it very difficult for legislators to consider major tax policy changes, and that will no doubt be the ultimate factor that determines the success of failure of any new policies that the new Governor puts forward.

Back To The Drawing Board

When the Sangamon County circuit court ruled Senate Bill 1, the legislature's attempt a comprehensive pension reform, unconstitutional last week there was no surprise at the decision. After the Illinois Supreme Court ruled against a much less extensive health care benefit last summer bouncing the more comprehensive measure was only a matter of time. The Attorney General will ask for and most probably be granted a request for an expedited hearing before the Supreme Court and the expectation will be that the Court will put the final nail in Senate Bill 1's coffin sometime in the late spring. But then what? Everyone is hoping that when the Supreme Court does issue its final ruling it also provides some sort of constitutional pathway toward successful reform provisions. We know what won't work, but what will? There's no guarantee that they will give guidance, but without it finding a timely solution will be practically impossible. In the meantime the fiscal pressures to adequately fund pension liabilities will take precedence over most everything else. From the new Governor to legislative leaders, everyone has been asked for their alternative should the Supreme Court do what's expected. Rightfully, no one's providing any clues until the ink is dry on the decision.

The recent need to provide hundreds of millions of dollars of additional pension funding each year has been based on a schedule the legislature enacted in 1994 to fully fund pension liabilities by 2045. The quirky way in which it was devised, allowing the state to avoid actually paying pension debt until 2010, and missing a pension payment, diverting proceeds from bond sales that were supposed to go toward pension payments have all exacerbated the problem. But, those bad decisions must still be addressed as the state attempts to crawl out from under the mammoth pension rock. And with the additional funds from the temporary income tax not available finding the additional $681 million to conjure up next year's pension payment will be an interesting exercise.

One idea that has been mentioned in the past and they may be seriously considered is changing the schedule, similar to refinancing a loan. By adding ten or so years and evening out the payments over that period it might provide some relief. The upside is that unlike the current "ramp" payments can be equalized as much as possible over the term. The downside is that the unfunded liability would grow in the short term and would require millions more dollars to achieve the desired 90% or 100% funding level. The legislature and Governor may also have to look at some type of dedicated pension payment fund that would be used exclusively to ease the pain of increasing yearly payments in absence of a comprehensive reform plan.

Governor-elect Rauner has also advocated moving newly hired state employees to a 401K type of system rather than the current defined benefit plan. Assumed opposition from labor unions and unanswered questions revolving around paying down current unfunded liabilities when those funds would be diverted to 401K plans have yet to be answered. There is also the question of whether or not the powers that be want to engage in a discussion of a phase out of the state paying the employer share of school district pension costs outside of Chicago … only 20% of state pension payments go toward state employee pensions. So as discussions begin with new and creative pension reform plans it is expected that anything and everything will be on the table.

Minimum Wage Hike Not A Done Deal

Efforts to increase the state's minimum wage prior to the January 14 end of the current General Assembly session may have stalled even though the results of the Election Day advisory referendum were overwhelmingly in favor and some supporters would like to present Governor Quinn one last victory before he leaves office. Governor-elect Rauner seemed to offer little resistance to the idea, even though he has asked that no major policy decisions be made before the takes office. Rauner has indicated in the past that he supports efforts to increase the minimum wage but included in a package in conjunction with business friendly reforms.

During the first veto session week the Senate began to move Senate Bill 68 and amended it in committee to include an increase in the minimum wage to $10.00 effective July 1, 2015, $10.50 effective July 1, 2016, and $11.00 effective July 1, 2016. The bill was placed in the order of 3rd Reading but did not receive final action. Even if it is approved by the Senate when the legislature returns to Springfield on December 2 its future in the House looks cloudy.

One of the hurdles to overcome is opposition by state not-for-profit social service agencies. Since they receive the bulk of their funding from the state, and since the state will be hard-pressed for cash once the temporary income tax increase expires, there is no guarantee that they will receive extra funds to cover to increased cash outflow. In the past state appropriations took into account the impact of a higher minimum wage on these agencies but with an expected budget shortfall ahead in FY 2015 and more severe budgetary pressure in FY 2016 there are aren't confident that their concerns will be addressed.

In order to be effective immediately between June 1 and December 31 a bill is required to have a three-fifths majority to become effective immediately. Since that can be a tall order any time important legislation is considered the language of the Senate amendment provides for the effective date of June 1, thereby requiring only a simple majority to pass. But, the minimum wage increase has had difficulty in the House before so finding the votes there won't be easy, and just as Quinn has his supporters to want the minimum wage bill to be his parting gift, he also has many detractors who for various and sundry reasons don't feel it's a necessity. They would rather wait and see what develops with Quinn's replacement. Because of the delayed effective date the legislature has the option of waiting until anytime before their January adjournment to act on this issue so the Governor has until he leaves office on January 12 to convince the General Assembly to act accordingly.

Session Schedule/Deadline Dates

Here are relevant dates for the legislative session:

- December 2, 3, 4 – second veto session week
- January 12 – State Officials Inaugurated
- January 14 – General Assembly session begins