# Illinois's Initial Fiscal Response to the COVID-19 Recession

**Beverly S. Bunch***

*Illinois had fiscal challenges prior to COVID-19, including a structural budget deficit, large unfunded pension and OPEB liabilities, minuscule reserves, and a significant backlog of bills. The COVID-19 recession has exacerbated Illinois's fiscal condition. This paper describes Illinois's initial fiscal response to the COVID-19 recession as of July 2020. This includes the state's short-term borrowing from the Federal Reserve's Municipal Liquidity Facility program, passage of a FY 2021 budget with a $6.5 billion deficit, and authorization for $5.0 billion in borrowing if additional federal funds and revenues from a proposed graduated income tax are not forthcoming. Under federal legislation approved as of July 2020, the state of Illinois expects to receive more than $5 billion in federal funding for COVID-related expenses. The state is using those funds to provide financial assistance to small businesses, local governments, state agencies, and other individuals and organizations.*

## INTRODUCTION

The state of Illinois faced major fiscal challenges prior to COVID-19, including a structural deficit, large unfunded pension and OPEB liabilities, miniscule reserves, and a significant backlog of bills. COVID-19 has exacerbated those challenges. Federal aid to cover state COVID-related expenses has helped, but Illinois's fiscal situation has become worse as a result of major declines in state revenues. As of July 2020, federal funds could not be used to offset revenue declines due to COVID-19.

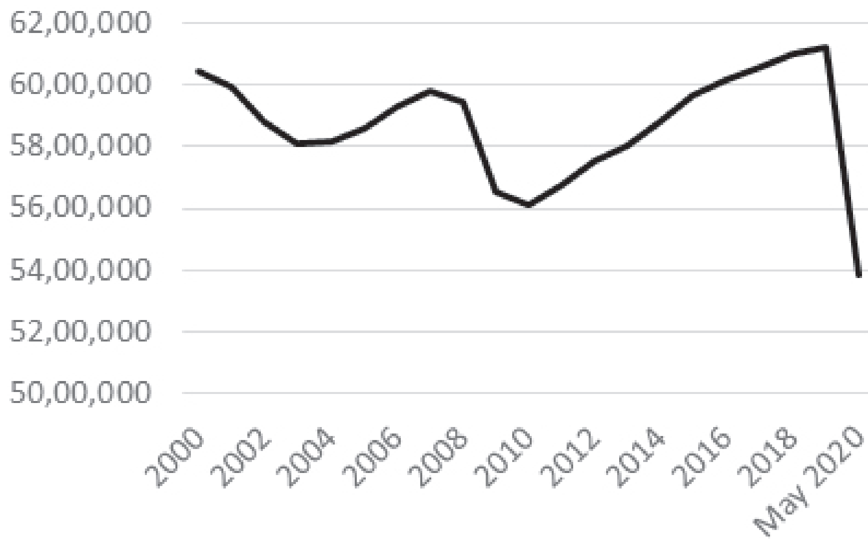
This article provides an overview of the state's fiscal response to COVID-19 and the resulting recession as of July 2020. To provide context, the next section examines the budgetary challenges facing the state of Illinois prior to COVID-19.

## ILLINOIS'S FISCAL SITUATION PRIOR TO COVID-19

Illinois has been slow to recover from prior recessions. The state's nonfarm employment dipped in the 2001 recession and declined again during the Great Recession. As shown in Figure 1, the state's nonfarm employment stayed below the level obtained in 2000 through 2016, more than 15 years later (Illinois Department of Employment Security, 2020). Illinois also has lost population in each

*Beverly S. Bunch is a professor in the Department of Public Administration and in the Center for State Policy and Leadership at the University of Illinois Springfield. She can be reached by email at *bbunc1@uis.edu*.

**Figure 1: Illinois Nonfarm Employment**




Source: Illinois Department of Employment Security (2020).

of the past six years. During the period 2013 through 2019, Illinois's population decreased by 1.7% (U.S. Census Bureau, 2020).

Prior to COVID-19, Illinois was still recovering from the failure to pass a statewide budget in FY 2016 and FY 2017. The lack of a budget, combined with an income tax rate decrease in January 2015, led to the accumulation of $14.7 billion in unpaid vendor bills at the end of FY 2017. During FY 2018, the state issued $6.0 billion in general obligation bonds to repay a portion of the unpaid bills. As of the end of FY 2019, the unpaid bill backlog was $6.0 billion (Mendoza, n.d.).

The budget impasse years also depleted the small amount of funds that had been in the Budget Stabilization Fund. In FY 2017, the legislature appropriated $276 million from the Budget Stabilization Fund without any subsequent repayment. This left the fund with a balance of $3.7 million, which declined to $3.5 million as of the end of FY 2019. This was about 0.01% of the state's general funds budget. The lack of a rainy day fund reserve, combined with a fund balance for the general funds of a negative $7.5 billion as of the end of FY 2019 (Mendoza, 2020), left Illinois with little in reserves to lessen the adverse impact of a recession.

The state's budget got a boost in FY 2018 when the legislature voted to override vetoes from the governor to pass the FY 2018 budget and to increase the individual and corporate income tax rates. The personal income tax rate increased from 3.75% to 4.95%, and the corporate income tax rate increased from 5.25% to 7.0%, effective July 1, 2017, which was the start of FY 2018.

However, the state continued to face large unfunded pension and OPEB liabilities. As of the end of FY 2019, the state's pension plans were funded at 40.3% and had unfunded accrued liabilities equal to $137 billion (Mendoza, 2020). The state has a statutory funding plan to reach a 90% funded level by 2045; however, under this plan, the state's unfunded liabilities are expected to continue to grow until FY 2029 (Commission on Government Forecasting and Accountability, 2017). The state funds its other postemployment benefits (OPEB) on a pay-as-you-go basis and, as of the end of FY 2019, had unfunded OPEB liabilities equal to $54.5 billion (Mendoza, 2020).

Moody's Investors Service (2020) reports that Illinois's adjusted net pension liabilities plus its net tax-supported debt expressed as a percent of gross domestic product were 31.9% in 2018 and 29.8% in 2019. These figures are significantly higher than the 50-state median for 2018, which was 7.8%. Moody's also notes that Illinois's fixed costs as a percentage of its own-source revenues were 36.4% in 2018, which was more than four times the median for all states. Fixed costs include debt service, retirement health benefit contributions, and tread water pension contributions (what it takes to avoid an increase in the accrued unfunded liabilities).

Illinois has a history of issuing bonds for non-capital purposes. Since 2003, the state has issued about $17.2 billion in pension obligation bonds. In 2011, the state issued $1.5 billion in Tobacco Settlement bonds and used the proceeds for operating purposes. As of the end of FY 2020, the state had issued $6 billion in bonds to pay vendor bills and $525 million to fund an accelerated pension benefit payment program (State of Illinois, 2020).

## ILLINOIS'S FY 2020 BUDGET PRIOR TO COVID-19

The FY 2020 budget was the first budget for newly elected Governor J.B. Pritzker. Although budgetary challenges continued, the Democrat-controlled legislature and Democratic governor worked together to pass major initiatives. This included a six-year, $45 billion capital improvement plan, which includes about $22.5 billion in new bond authority; a doubling of the state motor fuel tax rate from 19 cents to 38 cents, with future increases tied to inflation; a tax on recreational marijuana, which became legal as of January 1, 2020; and a new tax on managed health care organizations. Ten percent of the recreational marijuana tax revenue will be transferred to the Budget Stabilization Fund.

The budget also authorized a voter referendum on a proposed constitutional amendment to allow a graduated income tax. The state constitution currently requires a non-graduated tax rate. The General Assembly passed a graduated income tax rate structure that will become effective January 1, 2021, if the graduated income tax rate referendum passes. The governor's office estimates that the proposed graduated income tax would generate about $3.6 billion (after tax credits and local government allocations) in the first full year of implementation.

## ILLINOIS'S INITIAL FISCAL RESPONSE TO COVID-19

The state's revenues were doing reasonably well in FY 2020 prior to the onset of COVID-19. Through March 2020 (three-fourths of the year), general fund receipts were up $1.7 billion compared to the prior year. This included an increase of $765 million in net personal income tax revenues, $104 million in net corporate income taxes, and $249 million in net sales tax revenues (Commission on Government Finance and Accountability, 2020a).

But then COVID-19 hit. On March 20, 2020, Governor Pritzker ordered a statewide stay-at-home order to try to slow the spread of COVID-19. The subsequent loss in jobs, closed businesses, a decision to defer the state income tax deadline from April 15 to July 15 (which pushed the deadline into the following fiscal year), and changes in the stock market would have a significant impact on state revenues.

In mid-April 2020, the Governor's Office of Management and Budget (GOMB) decreased its general fund revenue estimates by $2.7 billion for FY 2020 and $4.6 billion for FY 2021. This represented a 7.3% and 11.9% decrease, respectively, from the February estimates of $36.9 billion for FY 2020 and $38.5 billion for FY 2021 (GOMB, 2020a).

For FY 2020, the GOMB lowered its revenue estimates for net individual income taxes by 6.9%, corporate income taxes by 12.0%, and sales taxes by 8.4%. The GOMB also lowered the estimated transfer into the general fund from lottery and casino gaming revenues by $207 million. In response to the federal government's decision to increase the Medicaid match rate by 6.2 percentage points during the COVID-19 pandemic, along with estimated higher Medicaid liabilities, the GOMB increased its estimated federal revenues by $459 million. However, the GOMB cautioned that the Medicaid revenues would depend on how much reimbursable costs the comptroller could pay by the end of the year. The GOMB estimated that the federal funds from the Coronavirus Aid, Relief, and Economic Security (CARES) Act would be sufficient to cover the state's COVID-related expenses. Based on these assumptions, the GOMB estimated that the state would end FY 2020 with a $255 million deficit (GOMB, 2020a).

The GOMB based its FY 2021 revenue estimates on an economic forecast that assumed large declines in the second and third quarters of calendar 2020 followed by a very gradual recovery. Compared to the February 2020 estimates, the revised estimates for the "big three" revenue sources (which account for about three-fourths of the general fund revenues) included declines of 8.8% for the individual income tax, 17.8% for the corporate income tax, and 17.5% for the sales tax. The individual income tax estimate would have been closer to a 14% decrease if the FY 2020 tax payment, estimated at $1 billion, had not been pushed into FY 2021.

For the April forecast, the GOMB did not revise its FY 2021 federal revenue estimates to take into account the receipt of federal funds related to COVID-19 other than the increased Medicaid match. The GOMB said that the Medicaid match and higher liabilities would be offset by an increase in the backlog of bills. Therefore, the GOMB left the federal revenue estimate essentially flat, with a note that additional federal revenues may be available in FY 2021 to help the state respond to the COVID-19 pandemic.

Illinois does not use a consensus forecast in which the executive and legislative branches work together to develop a single forecast. So, in addition to the GOMB forecast, the legislative Commission on Government Forecasting and Accountability (CGFA) updated its FY 2020 and FY 2021 revenue forecast in May 2020.

The CGFA's revised general fund revenue forecasts were $93 million (0.25%) higher than the GOMB's revised FY 2020 estimate and $80 million (0.22%) higher than the GOMB's revised FY 2021 estimate (CGFA, 2020b).

Given the projected budget shortfalls and liquidity concerns, the state decided to issue short-term debt. The Illinois constitution allows the state to borrow up to 15% of the state's appropriation for the fiscal year in response to deficits or revenue shortfalls. This debt must be repaid within one year from the date the debt is issued (Article IX Revenues, Section 9d).

The state scheduled the sale of $1.2 billion in general obligation certificates for the first week of May 2020 but, due to market conditions, postponed the sale and placed it on a day-to-day sale calendar. After observing wide spreads and high interest rates in the market, state officials decided to borrow funds from the Federal Reserve's new Municipal Liquidity Facility (MLF) program instead of going to the bond market (CGFA, 2020c). On June 5, 2020, Illinois became the first government to borrow from the MLF program.

The Federal Reserve established the MLF program to serve as a back-up provider of liquidity for state and local governments through December 2020. The MLF loans are to be repaid within 36 months, with the interest rates varying depending on the borrower's bond rating. The Federal Reserve authorized the state of Illinois to borrow up to $9.677 billion through the MLF program (Board of Governors of the Federal Reserve System, 2020). Illinois paid 3.82% interest to borrow funds for one year (CGFA, 2020c).

In mid-May 2020, Illinois issued $800 million in general obligation bonds, including $225 million for the pension acceleration payment program and the remainder for capital projects. As noted by S&P Global Rating, this demonstrated "some level of market access" for Illinois (S&P Global Rating, 2020, p. 1). The yield on the 10-year bonds (5.65%) was 452 basis points over the Municipal Market Data (MMD) triple-A rate of 1.13%, and the yield on the 25-year bonds (5.85%) was 396 basis points over the scale's 1.89% (Reuters, 2020). The yield on the one-year maturity was 4.875% (State of Illinois, 2020), which is about one percentage point higher than the interest rate on the one-year MLF borrowing.

The state also deferred a repayment of $400 million from the general fund to the state treasurer's investment program. The repayment originally was scheduled to occur in FY 2020 but was postponed until FY 2021. In addition, the comptroller transferred an additional $323 million from other funds to the general funds, which will need to be repaid within 48 months.

The GOMB also took action on the spending side of the FY 2020 budget. In March/April 2020, the GOMB directed state agencies to freeze travel that is not mission essential (effective March 13), limit all nonessential hiring (effective April 6), and put nonessential purchases and operational spending on hold (GOMB, 2020a and 2020d). The GOMB estimated that this would save the state at least $25 million in FY 2020 (GOMB, 2020a).

As of July 15, 2020, the state also had borrowed $647 million from the federal account of the Unemployment Trust Fund to finance the increase in unemployment benefits (TreasuryDirect, 2020).

## ILLINOIS'S FY 2021 BUDGET

The General Assembly adjourned at the onset of COVID-19 but returned for a four-day session on May 20, 2020. The legislature passed the FY 2021 budget with a vote that largely followed party lines (68-44 in the House and 37-19 in the Senate).

The FY 2021 total budget for the general funds is $42.9 billion, which is 5.8% higher than the FY 2020 budget. The FY 2021 budget includes $39.0 billion for state programs and agencies, $2.2 billion for statutory transfers out, and $1.6 billion to repay FY 2020 short-term borrowing. The estimated revenues are $36.4 billion, resulting in a deficit of $6.5 billion (see Table 1).

If the state receives federal stabilization funds and the voters approve the graduated income tax referendum, then the related revenues will be used to close the gap. If those funds do not occur or are insufficient, then the governor has indicated that he will work with the General Assembly to identify ways to close the budget gap (GOMB, 2020b). The General Assembly also authorized the state to borrow up to $5 billion from the Federal Reserve's MLF and to use $300 million in interfund borrowing.

The FY 2021 budget does not include layoffs or the elimination of programs to help balance the budget (S&P Global Ratings, 2020), but it does include reductions in operational spending of $200 million in the general funds and an additional $140 million in the transportation funds compared to the governor's original proposed budget (GOMB, 2020b). Those figures reflect savings from a partial hiring

**Table 1: State of Illinois FY 2021 General Funds Budget ($ millions)**

| | |
|---|---|
| Revenues | $36,421 |
| | |
| Spending | |
| Expenditures | $39,036 |
| Statutory transfers out | $2,224 |
| Repayment of short-term borrowing | $1,648 |
| Total | $42,908 |
| | |
| Deficit | –$6,487 |
| | |
| Financing sources | |
| Interfund borrowing | $300 |
| Borrowing from the MLF program | $5,000 |
| Income tax revenues or borrowing[a] | $1,274 |
| Total | $6,574 |
| | |
| General funds surplus | $87 |

Source: Governor's Office of Management and Budget, 2020b.

[a] This is an estimate of additional income tax revenue if voters approve the graduated income tax referendum in November 2020. If voters do not approve the referendum, then this will be additional borrowing.

freeze and restrictions on operational spending. The budget summary indicates that the state has more than 3,500 vacant positions in agencies under the governor. The FY 2021 budget authorizes agencies to transfers of up to 8% among agency line items within the same treasury fund, compared to 4% transfer authority in the FY 2020 budget (CGFA, 2020d).

The FY 2021 budget includes level spending for most functions, including education, but provides for an increase in funds for COVID-related spending and several high-priority areas in the Department of Aging and the Department of Children and Family Services (DCFS). The budget includes $8.0 billion in general funds appropriations for the state's Medicaid program, which is $550 million more than in FY 2020 (The Institute for Illinois' Fiscal Sustainability at the Civic Federation, 2020). The budget also fully funds the state's pension contributions in accordance with the statutory formula.

The General Assembly passed related legislation that established a bipartisan Illinois Legislative Budget Oversight Commission to monitor discretionary spending by the governor's office related to federal COVID spending and the state's FY 2021 budget. The legislation requires reporting by the governor's office. It also authorizes the commission to require local governments to report on the spending of federal funding under the CARES Act.

## BOND RATING PERSPECTIVES

In April 2020, all three of the bond rating companies that rate Illinois's general obligation bonds revised the state's bond rating or the outlook associated with an existing rating. S&P Global Rating and Moody's Investors Service revised the outlook from stable to negative, and Fitch Ratings downgraded the state from BBB to BBB– with a negative outlook. As of the end of April 2020, Illinois's general obligation bonds were rated at the lowest investment-grade rating by all three bond rating companies (BBB– with a negative outlook from S&P Global Ratings, Baa3 with a negative outlook from Moody's Investors Service, and BBB– with a negative outlook from Fitch Ratings). A further downgrade would push the state into a junk bond rating category.

S&P Global Ratings stated that Illinois's FY 2021 budget "continues to be precariously balanced, and does not include measures to meaningfully address structural instability" (S&P Global Ratings, 2020, p. 1). S&P Global Ratings also commented that the state's high pension costs and debt service, negligible rainy day fund, and high unpaid bills could limit that state's flexibility in addressing COVID-19 related costs and revenue declines. S&P Global Ratings noted that the condition of the state's pension plans could worsen if market volatility worsened.

Moody's Investors Service said that the change to a negative outlook reflects the expectation that COVID-19 and its economic consequences will add to the state's fiscal challenges. The rating action report said that the likely decrease in tax revenues, along with declines in pension asset value, will "weigh more heavily on Illinois, given its existing weaknesses relative to other states" (Moody's Investors Service, 2020, p. 1). Moody's commented that Illinois may experience liquidity issues that may result in an increase in the state's unpaid bills. Moody's also stated that Illinois may take other actions that add to its long-term liabilities, although federal funds would help offset the increased spending related to COVID-19.

Fitch Ratings said the rating downgrade reflected Fitch's "anticipation of a fundamental weakening of the state's financial resilience given its already tenuous position entering the current severe downturn" (Fitch Ratings, 2020). Fitch stated that it expects Illinois's tax revenues to rebound at a slower pace compared to most other states.

## FEDERAL FUNDS TO ADDRESS COVID-19

As of June 2020, the GOMB estimated that about $5.5 billion in federal aid related to COVID-19 would flow through the state's budget in FY 2020 and FY 2021 (GOMB, 2020c). The biggest component is the state aid from the Coronavirus Relief Fund, which allocated $4.9 billion for Illinois. The city of Chicago and five counties in the Chicago metropolitan area received $1.4 billion in direct aid, leaving the remaining $3.5 billion for the state government.

The state allocated its share of those federal funds as follows: $636 million for small business/child care centers financial assistance, $458 million for household and community support programs (including rental and mortgage assistance programs), $830 million for health care providers for pandemic-related stability payments, $250 million for local governments for reimbursement of COVID-19 related costs, and $1.5 billion for state agency COVID-19 related expenses (GOMB, 2020b).

Other major estimated influxes of federal aid included about $1.1 billion for education (early childhood, primary and secondary, and higher education) and $2.0 billion for transportation. The transportation funds included $1.6 billion for transit and about $450 million for airports (GOMB, 2020c).

## STATE PROGRAMS TO ASSIST SMALL BUSINESSES AND OTHERS

Illinois has established a number of programs to provide assistance to small businesses, local governments, and other individuals/groups that have been adversely affected by COVID-19. The Illinois Small Business Emergency Loan Fund program provides loans of up to $50,000 at low interest rates to small businesses located outside the city of Chicago. Recipients must have experienced a 25% or more decrease in revenues due to COVID-19. The loans are for five years, with no payments for the first six months. The loans must be used for working capital and at least one-half of the loan proceeds must be used for payroll or other eligible employee compensation (Department of Commerce and Economic Opportunity, 2020d).

The Hospitality Emergency Grant Program targets assistance to restaurants, bars, caterers, and hotels that have been adversely affected by COVID-19. As of July 2020, the program had made $14 million in small grants to about 700 entities to help pay for working capital, such as payroll, rent, and technology to support operational changes associated with carry out and delivery. The average grant for bars and restaurants was $14,000 and the average grant for hotels was $30,000 (Department of Commerce and Economic Opportunity, 2020c).

The state redirected $20 million in Community Development Block Grants (CDBG) to fund grants of up to $25,000 under the Downstate Small Business

Stabilization Program. This program provides assistance to small retail and service businesses or other businesses that are considered nonessential by the governor's executive order without the ability for employees to work remotely. The business must be located in a community that does not receive a direct entitlement from CDBG. A municipality can apply for funds and then provide the funds to a business through a participation agreement. As of July 2020, the program had awarded $3.3 million in grants to 160 businesses in 51 downstate communities (Department of Commerce and Economic Opportunity, 2020b).

The state also expects to allocate at least $540 million for the Business Interruption Grants (BIG) program, with one-half of the funds set aside for childcare providers. This program provides grants to small businesses that have experienced losses or business interruption due to COVID-19 related closures. The first round of grants, totaling $60 million, targeted restaurants/bars, barbershops/salons, gyms/fitness centers, and small businesses located in severely economically distressed communities. During the first round, the state awarded grants, ranging in size from $10,000 to $20,000, to more than 2,600 businesses (Department of Commerce and Economic Opportunity, 2020a).

The state treasurer established the Illinois Small Business COVID-19 Relief Program. Under this program, the state treasurer invests state funds in financial institutions for one year at close to zero interest rates. The financial institutions use those funds to provide low-interest loans to small businesses and nonprofits that have been negatively affected by COVID-19. The program also can make loans to organizations that otherwise would not qualify for loans. Individual financial institutions are eligible for up to $25 million. As of July 2020, the treasurer had made up to $500 million available to banks and credit unions (Frerichs, n.d.).

## CONCLUSION

Illinois was in a weak position prior to the COVID-19 recession. The state in essence had no rainy day fund and had accumulated a large amount of liabilities as a result of pushing costs into the future. With a decline in state revenues from the COVID-19 recession, the state is faced with a $6.5 billion deficit in FY 2021. If the voters approve the graduated income tax referendum and the federal government provides substantial additional financial assistance, the state may be able to eliminate at least a portion of the deficit. As Governor Pritzker stated, if the funds are insufficient, then the governor will need to work with the General Assembly to make difficult decisions on how to close the budget gap. Otherwise, the state may turn to its past practice of borrowing and pushing the costs and difficult decisions to future years.

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