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ECONOMY: Moderate Pickup, But Less Than Expected

The U.S. economy, as measured by "real" or inflation-adjusted gross national product (GDP), rose at a 3.7% annual rate in the third quarter of calendar 2004, up from a 3.3% annual rate in the previous quarter as the economy emerged from a soft patch. While the growth rate reported in this advance report by the Commerce Department showed improvement, it was below the predictions of several private economists who were looking for somewhere around a 4%-to-4.5% growth rate. Even so, third quarter growth was above the long-range trend rate of advance for the U.S. economy and was the 12th consecutive quarter, or third consecutive year, of economic advance as shown in the chart below.

INSIDE THIS ISSUE

PAGE 1 - **ECONOMY:** Moderate Pickup, But Less Than Expected

PAGE 3: IL Economic Indicators

PAGE 3: October FY 2005 Special Transfers

PAGE 5 - **REVENUE:** Federal Sources Wipe Out Other Revenue Gains in October

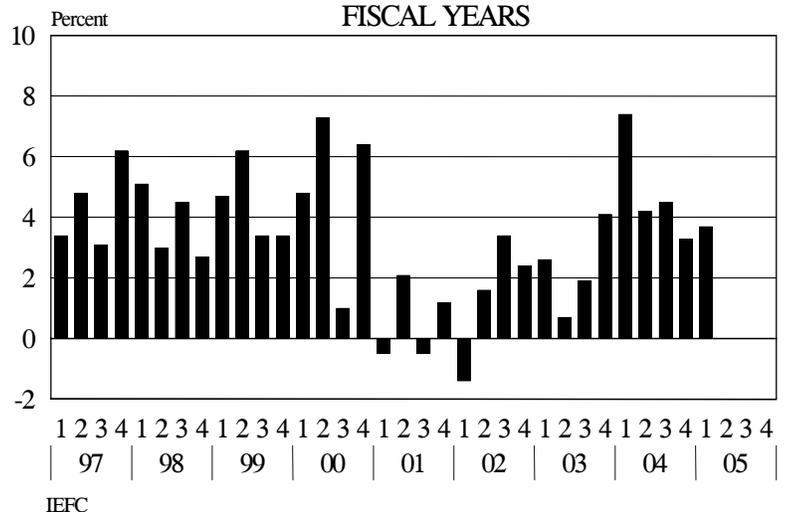
PAGE 7-10: Revenue Tables

PAGE 11: **PENSIONS:** The FY 2006 SERS Certified Contribution



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CHART 1 CHANGE IN REAL GDP FISCAL YEARS



Moreover, as pointed out by the Commerce Department, this advance estimate is based upon incomplete data and will be revised twice more. For example, the advance report on GDP during the previous quarter was originally reported at a 2.8% annual rate before eventually being raised to its current final annual rate of 3.3%.

The major contributors to the acceleration of growth in the third quarter were consumer spending, business investment in equipment and software, government spending, and residential construction. These positives were partly offset by lower inventory accumulation by business and increased imports, which detract from growth, the latter probably due in large part to the higher price of oil. Real final sales, GDP less the change in private inventories, rose at a faster 4.2% annual rate.

Particularly impressive was consumer spending, which accelerated to 4.6% annual rate following a modest 1.6% annual rate of increase during the previous quarter. The greatest gain in spending was for long-lasting durable goods including autos, which accelerated to a 16.8% annual rate in contrast to a decrease of 0.3% in the previous quarter, although there were annual rates of gain of 3.9% and 2.7% in non-durable goods and services spending, respectively. The gain in consumer spending cannot be overstated as it generally accounts for about two-thirds of total spending in the U.S. economy. Indeed, the run down in inventories, which detracts from current

quarter GDP, may have been involuntary due to the strong sales picture. As inventory levels are replenished, this would then add to GDP growth in future quarters.

Business spending, real nonresidential fixed investment, remained strong during the quarter, rising at an 11.7% annual rate, similar to the 12.5% rate of the previous quarter. This is the sixth consecutive quarterly increase in this sector following a modest 4.4% gain in all of 2003, and declines of 2.4% and 7.9% in 2002 and 2001, respectively. Real federal government spending increased at a 4.6% rate, up from 2.7% in the second quarter, as national defense rose by 9.3% while nondefense spending contracted at a 4.7% rate, and real state and local government spending declined at a 0.5% rate, down from an increase of 1.9%.

Despite the positive economic news, more than the usual number of uncertainties exist. Among the more important are: the price of oil, threats of terrorist attacks, and conditions in Iraq and Afghanistan. It is important, however, to recognize that the economy has continued to improve despite these overhangs. Consumer spending has improved despite some wavering in consumer confidence readings, business spending has been strong as recently reflected in the Chicago Purchasing Manager's report which indicated the strongest reading in their index in October in 17 years, and inflation has remained tame despite a rise in oil prices to record levels before easing recently.

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

<u>INDICATORS</u>	<u>September 2004</u>	<u>August 2004</u>	<u>September 2003</u>
Unemployment Rate (Average)	6.0%	6.1%	6.9%
Annual Rate of Inflation (Chicago)	-1.3%	6.3%	2.1%
—————			
	<u>LATEST MONTH</u>	<u>% CHANGE OVER PRIOR MONTH</u>	<u>% CHANGE OVER A YEAR AGO</u>
Civilian Labor Force (thousands) (September)	6,427	0.6%	1.4%
Employment (thousands) (September)	6,044	0.7%	2.3%
New Car & Truck Registration (September)	60,219	-10.0%	-11.5%
Single Family Housing Permits (September)	4,242	-13.2%	0.8%
Total Exports (\$ mil) (August)	2,615	5.7%	25.6%
Chicago Purchasing Managers Index (October)	68.5	10.7%	24.5%

October FY 2005 Special Transfers

Lynnae Kapp, Bond Analyst

Special transfers to the General Fund were a part of the enacted FY 2005 budget [Public Act 93-0839]. These special transfers include: administrative chargebacks [30 ILCS 105/8h] and statutory transfers [30 ILCS 105/8.43 and 8k]. Administrative chargebacks in October were \$12.5 million with a year-to-date total of \$51.5 million. [In

October, an earlier \$7 million chargeback from the Supplemental Low Income Energy Fund was rescinded]. Statutory transfers for October are approximately \$63.4 million including the School Technology Revolving Loan Fund transfer of \$46.8 million to the Common School Fund. Year-to-date statutory transfers equal \$215.5 million, nearing its expected \$265.4 million over the total fiscal year. Total special transfers to date for the fiscal year are \$267.0 million.

Special Transfers for October FY 2005				
FUND #	FUND NAME	Chargebacks	Statutory Transfers	TOTALS
0018	Transportation Regulatory Fund	\$97,549		\$97,549
0021	Financial Institution Fund	\$315,981		\$315,981
0022	General Professions Dedicated Fund	\$59,799		\$59,799
0026	Live & Learn Fund	\$1,096,866		\$1,096,866
0078	Solid Waste Management	\$317,419		\$317,419
0089	Subtitle D Management Fund		\$3,006,000	\$3,006,000
0129	State Gaming Fund	\$4,549,590		\$4,549,590
0163	Weights and Measures	\$131,345		\$131,345
0214	Brownfields Redevelopment Fund	\$309,322		\$309,322
0218	Professions Indirect Cost Fund	\$341,483		\$341,483
0238	IL Health Facilities Planning Fund		\$2,351,000	\$2,351,000
0258	Nurse Dedicated & Professional Fund	\$203,445		\$203,445
0286	IL Affordable Housing Trust	\$243,489		\$243,489
0298	Natural Areas Acquisition Fund	\$762,295		\$762,295
0299	Open Space Lands Acquisition and Development	\$1,303,203		\$1,303,203
0323	Motor Vehicle Review Board Fund	\$8,821		\$8,821
0363	Dent. Business Service Spec. Ops Fund	\$261,447		\$261,447
0373	State Treasurer's Bank Service	\$1,099		\$1,099
0386	Appraisal Administration Fund	\$33,790		\$33,790
0452	IL Tourism Tax	\$148,097		\$148,097
0483	Secretary of State Special Services	\$43,943		\$43,943
0502	Early Intervention Services Revolving Fund	\$743,449		\$743,449
0550	Supplemental Low Income Energy Fund	-\$7,029,392		-\$7,029,392
0571	Energy Efficiency Trust Fund	\$194,091		\$194,091
0576	Pesticide Control	\$38,899		\$38,899
0612	Wireless Service Emergency Fund	\$253,973		\$253,973
0705	Whistleblower Reward & Protection Fund		\$750,000	\$750,000
0728	Drug Rebate Fund	\$6,757,347		\$6,757,347
0733	Tobacco Settlement Recovery Fund		\$10,000,000	\$10,000,000
0763	Tourism Promotion	\$52,796		\$52,796
0770	Digital Divide Elimination Fund	\$403,523		\$403,523
0850	Real Estate License Administration	\$103,472		\$103,472
0863	Cylce Rider Safety Training Fund	\$81,636		\$81,636
0888	Design Professionals Administration & Investigation Fund		\$500,000	\$500,000
0921	DHS Recoveries Trust	\$315,318		\$315,318
0922	Insurance Producer Administration	\$121,724		\$121,724
0925	Coal Technology Development Assistance Fund	\$176,342		\$176,342
0993	Public Infrastructure Construction Loan Fund	\$23,579		\$23,579
0569	School Technology Revolving Loan Fund to Common School Fund	\$0	\$46,775,000	\$46,775,000
	OCTOBER TOTAL	\$12,465,740	\$63,382,000	\$75,847,740
	YEAR TO DATE TOTAL	\$51,464,815.00	\$215,503,994.94	\$266,968,810

REVENUE

Federal Sources Wipe Out Other Revenue Gains in October

Jim Muschinske, Revenue Manager

General revenue receipts in October, excluding Budget Stabilization Fund and Pension Contribution Fund transfers, declined by \$250 million. While most of the more closely-tied economic sources performed well, a comparatively weak month for federal sources erased all gains from non-federal sources. The abrupt decline in federal sources was not surprising, however, as last October benefited from the second and final installment of \$211 million in federal fiscal relief to the State. October had two less receipting days compared to the prior year.

Gross personal income tax receipts led gainers with an advance of \$49 million (\$53 million net of refunds). Gross corporate income tax added \$17 million (\$15 million net of refunds), while sales taxes increased by \$15 million. Cigarette tax rose by \$9 million as a result of the final month of a distribution change. Both corporate franchise taxes and other sources each provided a \$6 million gain. Interest income rose a modest \$2 million, while liquor taxes managed to post a \$1 million increase.

Overall transfers rose \$58 million in October. The increase was attributed to \$64 million in gains in other transfers attributed to chargebacks and statutory transfers, and a \$6 million increase in riverboat transfers and direct receipts

(\$5 million in chargebacks are included in the Gaming Fund transfer). Those gains were partially offset by an \$11 million decline in lottery transfers. Finally, as mentioned earlier, federal sources experienced a significant decline of \$377 million due to last year's federal flexible grant.

In October, \$276 million in Budget Stabilization Fund transfers were made to the general funds to assist in cash flow. As in past years, these transfers must be repaid to the Fund by the end of the fiscal year.

Year to Date

Through the first four months of FY 2005, excluding Budget Stabilization and Pension Contribution funds transfers, receipts are up \$118 million over the same period of last fiscal year. With few exceptions, virtually all revenue sources experienced gains over the same period of last year.

Sales tax receipts contributed the most to the year to date increase as receipts posted gains of \$112 million. Gross personal income tax revenue is up \$106 million, or \$129 million net of refunds. Gross corporate income tax is up \$100 million, or \$89 million net of refunds. Other sources to the general funds are up \$78 million, while due to a distribution change in FY 2005, cigarette tax receipts are up \$50 million. Inheritance tax is ahead by \$25 million, and all other sources

experiencing gains contributed an additional \$32 million. Only three sources experienced declines thus far in FY 2005 with public utility taxes off \$9 million, interest income down \$9 million, and vehicle use tax off \$1 million.

Overall transfers in the first third of the fiscal year were up \$532 million. However, \$434 million of that gain was due to transfers from the Medicaid Provider Relief Fund resulting from last fiscal year's short-term borrowing. Excluding that transfer, all other transfers would be up \$98 million, comprised of an increase of \$71 million in other transfers, a \$23 million increase in lottery transfers, and

a \$4 million increase in riverboat transfers and receipts (which includes a \$5 million chargeback from the State Gaming Fund).

While federal sources are down \$910 million over the first four months, \$434 million in transfers in from the Medicaid Provider Fund could be considered "federal money" as it represents the federal reimbursement stemming from spending made available due to last year's short-term borrowing. If viewed in that context, the year-over-year decline in federal sources would be lessened to \$476 million, with that decline being mostly attributed to \$422 million in flexible federal grants received last fiscal year.

GENERAL FUNDS RECEIPTS: OCTOBER

*FY 2005 vs. FY 2004
(\$ million)*

Revenue Sources	OCT. FY 2005	OCT. FY 2004	\$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	\$590	\$541	\$49	9.1%
Corporate Income Tax (regular)	42	25	\$17	68.0%
Sales Taxes	541	526	\$15	2.9%
Public Utility Taxes (regular)	68	98	(\$30)	-30.6%
Cigarette Tax	42	33	\$9	27.3%
Liquor Gallonage Taxes	12	11	\$1	9.1%
Vehicle Use Tax	3	3	\$0	0.0%
Inheritance Tax (Gross)	19	21	(\$2)	-9.5%
Insurance Taxes and Fees	0	6	(\$6)	-100.0%
Corporate Franchise Tax & Fees	18	12	\$6	50.0%
Interest on State Funds & Investments	5	3	\$2	66.7%
Cook County IGT	54	54	\$0	N/A
Other Sources	25	19	\$6	31.6%
Subtotal	\$1,419	\$1,352	\$67	5.0%
Transfers				
Lottery	41	53	(\$12)	-22.6%
Riverboat transfers & receipts	68	62	\$6	9.7%
Medicaid Provider Relief Fund	0	N/A	\$0	N/A
Other	89	25	\$64	256.0%
Total State Sources	\$1,617	\$1,492	\$125	8.4%
Federal Sources	\$193	\$570	(\$377)	-66.1%
Total Federal & State Sources	\$1,810	\$2,062	(\$252)	-12.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$59)	(\$63)	\$4	-6.3%
Corporate Income Tax	(\$10)	(8)	(\$2)	25.0%
Subtotal General Funds	\$1,741	\$1,991	(\$250)	-12.6%
Budget Stabilization Fund Transfer	\$276	\$0	\$276	N/A
Pension Contribution Fund Transfer	\$0	\$148	(\$148)	N/A
Total General Funds	\$2,017	\$2,139	(\$122)	-5.7%

IEFC SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding

4-Nov-04

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2005 vs. FY 2004

(\$ million)

Revenue Sources	FY 2005	FY 2004	CHANGE FROM FY 2004	% CHANGE
State Taxes				
Personal Income Tax	\$2,459	\$2,353	\$106	4.5%
Corporate Income Tax (regular)	322	222	\$100	45.0%
Sales Taxes	2,214	2,102	\$112	5.3%
Public Utility Taxes (regular)	318	327	(\$9)	-2.8%
Cigarette Tax	183	133	\$50	37.6%
Liquor Gallonage Taxes	50	43	\$7	16.3%
Vehicle Use Tax	12	13	(\$1)	-7.7%
Inheritance Tax (Gross)	88	63	\$25	39.7%
Insurance Taxes and Fees	94	80	\$14	17.5%
Corporate Franchise Tax & Fees	60	49	\$11	22.4%
Interest on State Funds & Investments	13	22	(\$9)	-40.9%
Cook County IGT	130	130	\$0	0.0%
Other Sources	142	64	\$78	121.9%
Subtotal	\$6,085	\$5,601	\$484	8.6%
Transfers				
Lottery	184	161	\$23	14.3%
Riverboat transfers & receipts	263	259	\$4	1.5%
Medicaid Provider Relief Fund	434	0	\$434	N/A
Other	355	284	\$71	25.0%
Total State Sources	\$7,321	\$6,305	\$1,016	16.1%
Federal Sources	\$1,313	\$2,223	(\$910)	-40.9%
Total Federal & State Sources	\$8,634	\$8,528	\$106	1.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	(\$252)	(\$275)	\$23	-8.4%
Corporate Income Tax	(\$82)	(\$71)	(\$11)	15.5%
Subtotal General Funds	\$8,300	\$8,182	\$118	1.4%
Budget Stabilization Fund Transfer	\$276	\$226	\$50	22.1%
Pension Contribution Fund Transfer	\$0	\$669	(\$669)	N/A
Total General Funds	\$8,576	\$9,077	(\$501)	-5.5%

SOURCE: Office of the Comptroller, State of Illinois: Some totals may not equal, due to rounding.

IEFC

4-Nov-04

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2005 ESTIMATE vs. FY 2004 ACTUAL

(\$ million)

	Aug-04	FYTD	AMOUNT	FYTD	GROWTH	%
	ESTIMATE		NEEDED			
<u>Revenue Sources</u>	<u>FY 2005</u>	<u>2005</u>	<u>FY 2005 EST.</u>	<u>2004</u>	<u>NEEDED</u>	<u>CHANGE</u>
State Taxes						
Personal Income Tax	\$8,572	\$2,459	\$6,113	\$2,353	\$231	3.9%
Corporate Income Tax (regular)	1,308	322	\$986	222	(\$171)	-14.8%
Sales Taxes	6,457	2,214	\$4,243	2,102	\$14	0.3%
Public Utility Taxes (regular)	1,090	318	\$772	327	\$20	2.7%
Cigarette Tax	450	183	\$267	133	\$0	0.0%
Liquor Gallonage Taxes	147	50	\$97	43	\$13	15.5%
Vehicle Use Tax	35	12	\$23	13	\$1	4.5%
Inheritance Tax (Gross)	265	88	\$177	63	\$18	11.3%
Insurance Taxes and Fees	371	94	\$277	80	(\$5)	-1.8%
Corporate Franchise Tax & Fees	168	60	\$108	49	(\$6)	-5.3%
Interest on State Funds & Investments	54	13	\$41	22	\$8	24.2%
Cook County IGT	450	130	\$320	130	\$22	7.4%
Other Sources	500	142	\$358	64	(\$17)	-4.5%
Subtotal	\$19,867	\$6,085	\$13,782	\$5,601	\$128	0.9%
Transfers						
Lottery	575	184	\$391	161	(\$18)	-4.4%
Riverboat transfers & receipts	642	263	\$379	259	(\$23)	-5.7%
Medicaid Provider Relief Fund	433	434	(\$1)	0	N/A	N/A
Other	1,044	355	\$689	284	(\$186)	-21.3%
Total State Sources	\$22,561	\$7,321	\$15,240	\$6,305	(\$100)	-0.7%
Federal Sources	\$4,255	\$1,313	\$2,942	\$2,223	(\$24)	-0.8%
Total Federal & State Sources	\$26,816	\$8,634	\$18,182	\$8,528	(\$124)	-0.7%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$864)	(\$252)	(\$612)	(\$275)	\$77	-11.2%
Corporate Income Tax	(318)	(\$82)	(\$236)	(71)	\$135	-36.4%
Subtotal General Funds	\$25,634	\$8,300	\$17,334	\$8,182	\$88	0.5%
Budget Stabilization Fund Transfer	\$276	\$276	\$0	\$226	\$0	N/A
Pension Contribution Fund Transfer	\$0	\$0	\$0	\$669	(\$726)	-100.0%
Total General Funds	\$25,910	\$8,576	\$17,334	\$9,077	(\$638)	-3.5%
IEFC						4-Nov-04

GENERAL FUNDS PERFORMANCE TO DATE
GOVERNOR'S OFFICE OF MANANGEMENT AND BUDGET

FY 2005 ESTIMATE vs. FY 2004 ACTUALS

(\$ million)

	*GOMB AUG-04 Estimate FY 2005	FYTD 2005	AMOUNT NEEDED FY 2005 Est.	FYTD 2004	GROWTH NEEDED	% CHANGE
Revenue Sources						
State Taxes						
Personal Income Tax	\$8,406	\$2,459	\$5,947	\$2,353	\$65	1.1%
Corporate Income Tax (regular)	1,129	322	\$807	222	(\$350)	-30.3%
Sales Taxes	6,431	2,214	\$4,217	2,102	(\$12)	-0.3%
Public Utility Taxes (regular)	1,102	318	\$784	327	\$32	4.3%
Cigarette Tax	400	183	\$217	133	(\$50)	-18.7%
Liquor Gallonage Taxes	147	50	\$97	43	\$13	15.5%
Vehicle Use Tax	37	12	\$25	13	\$3	13.6%
Inheritance Tax (Gross)	240	88	\$152	63	(\$7)	-4.4%
Insurance Taxes and Fees	347	94	\$253	80	(\$29)	-10.3%
Corporate Franchise Tax & Fees	175	60	\$115	49	\$1	0.9%
Interest on State Funds & Investments	45	13	\$32	22	(\$1)	-3.0%
Cook County IGT	450	130	\$320	130	\$22	7.4%
Other Sources	732	142	\$590	64	\$215	57.3%
Subtotal	\$19,641	\$6,085	\$13,556	\$5,601	(\$98)	-0.7%
Transfers						
Lottery	578	184	\$394	161	(\$15)	-3.7%
Gaming Fund Transfer	653	263	\$390	259	(\$12)	-3.0%
Medicaid Provider Relief Fund	433	434	(\$1)	0	N/A	N/A
Other	1,154	355	\$799	284	(\$76)	-8.7%
Total State Sources	\$22,459	\$7,321	\$15,138	\$6,305	(\$202)	-1.3%
Federal Sources	\$4,255	\$1,313	\$2,942	\$2,223	(\$24)	-0.8%
Total Federal & State Sources	\$26,714	\$8,634	\$18,080	\$8,528	(\$226)	-1.2%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	(\$841)	(\$252)	(\$589)	(\$275)	\$100	-14.5%
Corporate Income Tax	(271)	(82)	(\$189)	(71)	\$182	-49.1%
Subtotal General Funds	\$25,602	\$8,300	\$17,302	\$8,182	\$56	0.3%
Budget Stabilization Fund Transfer	\$276	\$276	\$0	\$226	\$0	N/A
Pension Contribution Fund Transfer	\$0	\$0	\$0	\$669	(\$726)	-100.0%
Total General Funds	\$25,878	\$8,576	\$17,302	\$9,077	(\$670)	-3.7%

* The GOMB forecast includes the \$433 million from the Medicaid Provider Fund in their estimate of federal sources. The Comptroller's Office records that money as a transfer in. For comparison purposes, the GOMB's federal source estimate was adjusted to take this into account [\$4.255 billion + \$433 million = \$4.688 billion].

PENSIONS
The FY 2006 SERS Certified
Contributions

Tim Blair, Pension Manager

On October 19, 2004, the Board of Trustees of the State Employees' Retirement System (SERS) certified the required FY 2006 contribution. There are three components to the FY 2006 certification: the regular contribution per the 1994 funding plan; the contribution to fund the FY 2002 ERI; and a contribution to pay a portion of the debt service for which SERS is responsible. Table 1 shows the FY 2006 certified amounts and how those amounts compare to the FY 2005 certified amounts.

As Table 1 (on the following page) illustrates, the total FY 2006 contribution to SERS increases by \$190.9 million from the FY 2005 level. The regular contribution calculated per the funding plan plus the required ERI contribution actually increased by \$257.9 million from FY 2005 to FY 2006, while the debt service SERS collects actually decreases by \$67.0 million.

The reduction in debt service reflects that SERS actually collected the FY 2004 and FY 2005 debt service in FY 2005, while only the FY 2006 debt service is being collected in FY 2006. It should be noted the debt service collected by SERS is not retained by SERS, but rather transferred to the GO Bond Retirement and Interest Fund to pay part of the FY 2006 debt service on the Pension Obligation Bonds issued in 2003.

Public Act 93-0839 first required SERS to collect debt service in FY 2005. Allowing SERS to collect debt service through agency payrolls requires non-GRF funds (including federal funds) to pay part of the debt service. Some of the proceeds of the pension funding bonds reduced the unfunded liability of SERS, including some liability that is associated with employees at agencies that are funded by non-GRF and federal funds. Public Act 93-0839 provides a mechanism for non-GRF and federal funds to pay a share of the debt service on bond proceeds that were used to reduce the SERS unfunded liabilities.

According to SERS, about 35% of State payrolls are from non-GRF funds and federal funds. So, the additional amount that agencies must contribute to debt service due will save the State an estimated \$24.2 million (35% of \$69.2 million) in GRF in FY 2006. Of course, the reduction in GRF is due to increased contributions of \$24.2 million from other State and federal funds.

On November 9, 2004, the Economic and Fiscal Commission will hold a meeting at 9:00 a.m. in Room D-1 of the Stratton Office Building to discuss the options for funding the liability created by the 2002 SERS ERI. In addition to discussing the funding of the ERI, this meeting will also provide complete information regarding the FY 2006 certified contributions for all of the State-funded retirement systems and the financial condition of the State-funded retirement systems as of June 30, 2004.

TABLE 1

STATE EMPLOYEES' RETIREMENT SYSTEM
Certified Contributions
(\$ in millions)

Contribution	FY 2005		FY 2006		Increase	
	Amount	Rate	Amount	Rate	Amount	Rate
Regular	\$362.3	10.265%	\$409.7	11.695%	\$47.4	1.430%
2002 ERI	70.0	1.983%	280.5	8.006%	210.5	6.023%
Debt Service	136.2	3.859%	69.2	1.974%	(67.0)	(1.885%)
TOTAL	\$568.5	16.107%	\$759.3	21.675%	\$190.9	5.568%