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ECONOMY: The Housing Bubble – Deflated or Burst?

Edward H. Boss, Jr., Chief Economist

Recent data confirm that the soaring housing boom of the last several years has come to an end. The major concern now is whether the continuing downward adjustment will burst the bubble that had developed in this sector, leading to an economic downturn, or whether the air can be let out gradually causing a soft landing. Data on home sales for July were not encouraging. Sales of existing homes fell 4.1% in July, more than expected, and driving down sales of previously owned homes to a 2 ½ year low while inventories of unsold homes climbed to a record high. In Illinois, home sales for the first half of 2006 eased 2.9% from the same period last year.

The next day, data on new home sales in July were released by the Commerce Department showing a 4.3% drop. More importantly, the inventory of new unsold homes rose sharply to a 6.5 months supply, the highest since November 1995. This overhang of inventory will act as a significant restraint on new construction.

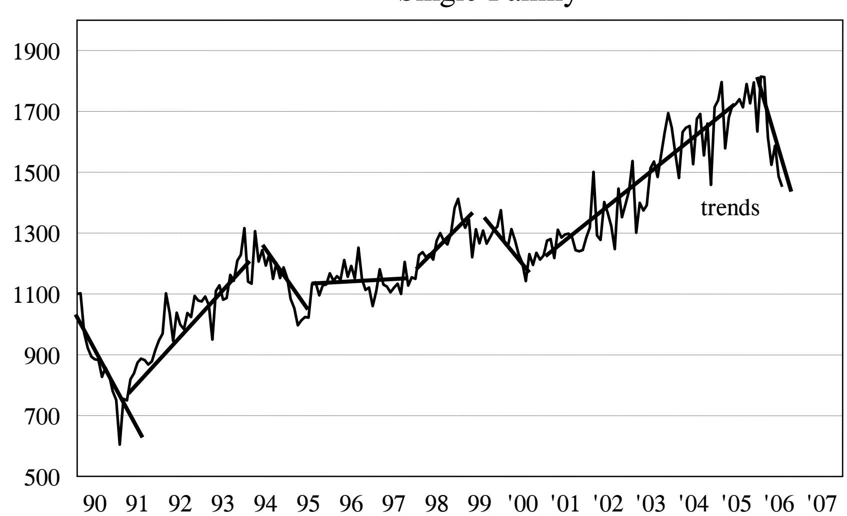
New residential construction already has been weakening for some time. The largest component of new construction is that of single-family homes. As shown in the chart on the following page, after soaring during the first half of the decade, new single-family housing starts fell 2.3% in July from June and are 16.6% below that of a year earlier. The largest decline in new single-family starts in the past year was in the West, where starts were down 25.8%; followed by the Northeast with starts off 26.3%; the Midwest off 18.9%; and the South, falling a lesser 9.1%. Perhaps even more revealing is that new single-family building permits, which are a precursor of future building activity, were off 6.1% in July from June and down a sharp 23.5% from that of a year earlier. Therefore, the latest data showing a continuing softening in home sales and inventory build-ups suggest a continuation of this weakening construction trend.

The inventory build-up is having a negative effect on home prices. The median price of a new home fell to $230,000 in July from $233,000 in June and has been falling since a peak of $250,00 in February, although it was little changed from the $229,200 a year earlier. Moreover, there are a reported growing number of incentives being offered to new home buyers with some developers including free upgrades, large screen flat TVs, absorbing some of the financing costs, or other measures to reduce excessive inventories. There also have been a growing number of projects, particularly in previously hot real estate sectors like Las Vegas, that have been suspended.

There are several factors behind the turnaround in the housing market. Certainly there was speculation as easy money availability caused developers to build as many homes as they could finance. Also mortgage interest rates had fallen to extremely low levels and lenders were using such techniques as interest only loans, raising the prospect that lenders were letting some people into these instruments who would not qualify for a regular loan. Also, the rapid appreciation in home prices made investment in real estate extremely attractive relative to what could be obtained in the bond or equity markets Now these conditions have changed. The 30-year fixed mortgage rate averaged 6.76% in July 2006, up about 100 basis points, or 1%, from July a year ago and a recent low of about 5.50% in early 2005. Even so, this rate is hardly high historically as the current rate is below the average of any year in the 1990s, which averaged 8.12% in the decade, or the double-digit rate in every year of the 1980s, and a high of 16.63% in 1981. Moreover, alternative investments have improved with a rebound in the equity markets.

As of now, the majority of analysts feel a soft landing in housing is more likely than a burst that could be catastrophic to the continuing business expansion. According to Global Insight, a forecasting service of the Commission, in its August 2006 Economic Outlook Review… "Housing activity will continue to decline, chopping about 0.9 percentage point off growth in the second half of the year through its direct GDP contribution." Even with this anticipated softening in housing, higher energy prices, and one more increase in interest rates expected, their forecast is for second-half real GDP growth to be in the low 2% region, down slightly from its previous forecast in the high 2% region.

CHART 1 New Privately-Owned Housing Started Single Family



CGFA

INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS	July 2006	June 2006	July 2005
Unemployment Rate (Average)	4.7%	4.5%	5.8%
Annual Rate of Inflation (Chicago)	1.8%	3.6%	2.6%

	LATEST MONTH	% CHANGE OVER PRIOR MONTH	% CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (July)	6,537	0.3%	1.1%
Employment (thousands) (July)	6,230	0.1%	2.2%
New Car & Truck Registration (July)	54,244	-12.7%	7.8%
Single Family Housing Permits (July)	3,486	-7.7%	-27.2%
Total Exports ($ mil) (June)	3,620	-3.9%	14.6%
Chicago Purchasing Managers Index (August)	57.1	-1.4%	16.1%

REVENUE

August Revenues Perform Well

Jim Muschinske, Revenue Manager

Overall general funds revenues increased $127 million in August. The larger economic sources continued to do well, while some of the other areas posted small losses. Similar to last year, $276 million from the Budget Stabilization Fund was transferred into the General Fund to assist in cash flow. These monies must be paid back into the Budget Stabilization Fund by the end of the fiscal year. August had the same number of receipting days as last fiscal year.

Sales taxes led those sources experiencing increases as receipts rose $65 million. Gross personal income taxes gained $39 million, $35 million net of refunds. Gross corporate income taxes gained $8 million, $7 million net of refunds. Receipts from interest income increased by $8 million, while public utility taxes posted a $6 million advance. Liquor taxes were up $4 million and the inheritance tax managed a $2 million increase.

Despite an overall increase in revenues, a few sources experienced declines, albeit relatively small ones. Cigarette taxes and other sources each fell $5 million. The drop off in cigarette tax receipts was due to a change in tax distribution that went into effect this fiscal year. Insurance taxes and fees as well as corporate franchise taxes and fees each dropped $3 million for the month.

Overall transfers dipped $3 million in August as a $10 million increase in riverboat transfers and a $4 million increase in other transfers were offset by a $17 million drop in lottery transfers. Federal sources gained $19 million for the month.

Year to Date

Overall receipts to the general funds are up $204 million through the first two months of the fiscal year. While most of the economically related sources continue to perform well, some of the smaller sources as well as certain transfers have struggled early on.

Gross personal income tax is up $77 million, or $70 million net of refunds. Sales tax receipts are up $34 million, while gross corporate income tax is ahead by $34 million, or $32 million net of refunds. Interest income has enjoyed a $14 million gain due to higher rates of return and inheritance tax receipts have posted a $10 million advance. Finally, corporate franchise tax has managed to eke out a $1 million gain.

As expected, the Cook County IGT is down $34 million to begin the year, while other sources are behind by $14 million. Due to a change in tax distribution, cigarette taxes are off by $10 million. Public utility taxes have dipped by $3 million.

Overall transfers are up by $82 million. While other transfers are up $118 million due mostly to a large July transfer from the Income Tax Refund Fund, a $32 million falloff in lottery transfers and a $4 million dip in riverboat transfers serve to offset some of those gains. Finally, federal sources are up $42 million over the first two months of the fiscal year.

GENERAL FUNDS RECEIPTS: AUGUST

FY 2007 vs. FY 2006

($ million)

Revenue Sources	AUG. FY 2007	AUG. FY 2006	$ CHANGE	% CHANGE
State Taxes				
Personal Income Tax	$677	$638	$39	6.1%
Corporate Income Tax (regular)	23	15	$8	53.3%
Sales Taxes	653	588	$65	11.1%
Public Utility Taxes (regular)	106	100	$6	6.0%
Cigarette Tax	29	34	($5)	-14.7%
Liquor Gallonage Taxes	15	11	$4	36.4%
Vehicle Use Tax	5	5	$0	0.0%
Inheritance Tax (Gross)	21	19	$2	10.5%
Insurance Taxes and Fees	13	16	($3)	-18.8%
Corporate Franchise Tax & Fees	14	17	($3)	-17.6%
Interest on State Funds & Investments	19	11	$8	72.7%
Cook County IGT	0	0	$0	N/A
Other Sources	36	41	($5)	-12.2%
Subtotal	$1,611	$1,495	$116	7.8%
Transfers				
Lottery	47	64	($17)	-26.6%
Riverboat transfers & receipts	70	60	$10	16.7%
Other	25	21	$4	19.0%
Total State Sources	$1,753	$1,640	$113	6.9%
Federal Sources	$524	$505	$19	3.8%
Total Federal & State Sources	$2,277	$2,145	$132	6.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($66)	($62)	($4)	6.5%
Corporate Income Tax	($4)	(3)	($1)	33.3%
Subtotal General Funds	$2,207	$2,080	$127	6.1%
Short-Term Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	N/A
Total General Funds	$2,483	$2,356	$127	5.4%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 5-Sep-06

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2007 vs. FY 2006

($ million)

Revenue Sources	FY 2007	FY 2006	CHANGE FROM FY 2006	% CHANGE
State Taxes				
Personal Income Tax	$1,295	$1,218	$77	6.3%
Corporate Income Tax (regular)	71	57	$14	24.6%
Sales Taxes	1,244	1,210	$34	2.8%
Public Utility Taxes (regular)	175	178	($3)	-1.7%
Cigarette Tax	58	68	($10)	-14.7%
Liquor Gallonage Taxes	27	27	$0	0.0%
Vehicle Use Tax	7	7	$0	0.0%
Inheritance Tax (Gross)	47	37	$10	27.0%
Insurance Taxes and Fees	20	20	$0	0.0%
Corporate Franchise Tax & Fees	28	27	$1	3.7%
Interest on State Funds & Investments	35	21	$14	66.7%
Cook County IGT	6	40	($34)	-85.0%
Other Sources	74	88	($14)	-15.9%
Subtotal	$3,087	$2,998	$89	3.0%
Transfers				
Lottery	82	114	($32)	-28.1%
Riverboat transfers & receipts	105	109	($4)	-3.7%
Other	200	82	$118	143.9%
Total State Sources	$3,474	$3,303	$171	5.2%
Federal Sources	$825	$783	$42	5.4%
Total Federal & State Sources	$4,299	$4,086	$213	5.2%
Nongeneral Funds Distribution:				
Refund Fund				
Personal Income Tax	($126)	($119)	($7)	5.9%
Corporate Income Tax	($13)	($11)	($2)	18.2%
Subtotal General Funds	$4,160	$3,956	$204	5.2%
Short-Term Borrowing	$0	$0	$0	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	N/A
Total General Funds	$4,436	$4,232	$204	4.8%

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

CGFA 5-Sep-06

GENERAL FUNDS GROWTH NEEDED TO MEET ESTIMATE

FY 2007 ESTIMATE vs. FY 2006 ACTUAL

($ million)

Revenue Sources	July-06 ESTIMATE FY 2007	FYTD 2007	AMOUNT NEEDED FY 2007 EST.	FYTD 2006	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$10,050	$1,295	$8,755	$1,218	$405	4.9%
Corporate Income Tax (regular)	1,873	71	$1,802	57	$75	4.3%
Sales Taxes	7,345	1,244	$6,101	1,210	$219	3.7%
Public Utility Taxes (regular)	1,074	175	$899	178	$3	0.3%
Cigarette Tax	350	58	$292	68	($40)	-12.0%
Liquor Gallonage Taxes	153	27	$126	27	$1	0.8%
Vehicle Use Tax	34	7	$27	7	$0	0.0%
Inheritance Tax (Gross)	262	47	$215	37	($20)	-8.5%
Insurance Taxes and Fees	320	20	$300	20	$3	1.0%
Corporate Franchise Tax & Fees	190	28	$162	27	$8	5.2%
Interest on State Funds & Investments	160	35	$125	21	($7)	-5.3%
Cook County IGT	309	6	$303	40	($7)	-2.3%
Other Sources	455	74	$381	88	$28	7.9%
Subtotal	$22,575	$3,087	$19,488	$2,998	$668	3.5%
Transfers						
Lottery	670	82	$588	114	$32	5.8%
Riverboat transfers & receipts	700	105	$595	109	$15	2.6%
Other	880	200	$680	82	$16	2.4%
Total State Sources	$24,825	$3,474	$21,351	$3,303	$731	3.5%
Federal Sources*	$4,803	$825	$3,978	$783	$36	0.9%
Total Federal & State Sources	$29,628	$4,299	$25,329	$4,086	$767	3.1%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($980)	($126)	($854)	($119)	($40)	4.9%
Corporate Income Tax	(328)	($13)	($315)	(11)	$30	-8.7%
Subtotal General Funds	$28,320	$4,160	$24,160	$3,956	$757	3.2%
Short-Term Borrowing	$0	$0	$0	$0	($1,000)	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	$276	$0	N/A
Total General Funds	$28,596	$4,436	$24,160	$4,232	($243)	-1.0%

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

FY 2007 ESTIMATE vs. FY 2006 ACTUALS

($ million)

Revenue Sources	GOMB JUNE-06 Estimate FY 2007	FYTD 2007	AMOUNT NEEDED FY 2007 Est.	FYTD 2006	GROWTH NEEDED	% CHANGE
State Taxes						
Personal Income Tax	$9,844	$1,295	$8,549	$1,218	$199	2.4%
Corporate Income Tax (regular)	2,074	71	$2,003	57	$276	16.0%
Sales Taxes	7,280	1,244	$6,036	1,210	$154	2.6%
Public Utility Taxes (regular)	1,090	175	$915	178	$19	2.1%
Cigarette Tax	350	58	$292	68	($40)	-12.0%
Liquor Gallonage Taxes	152	27	$125	27	$0	0.0%
Vehicle Use Tax	35	7	$28	7	$1	3.7%
Inheritance Tax (Gross)	255	47	$208	37	($27)	-11.5%
Insurance Taxes and Fees	322	20	$302	20	$5	1.7%
Corporate Franchise Tax & Fees	196	28	$168	27	$14	9.1%
Interest on State Funds & Investments	143	35	$108	21	($24)	-18.2%
Cook County IGT	309	6	$303	40	($7)	-2.3%
Other Sources	505	74	$431	88	$78	22.1%
Subtotal	$22,555	$3,087	$19,468	$2,998	$648	3.4%
Transfers						
Lottery	670	82	$588	114	$32	5.8%
Gaming Fund Transfer	692	105	$587	109	$7	1.2%
Other	933	200	$733	82	$69	10.4%
Total State Sources	$24,850	$3,474	$21,376	$3,303	$756	3.7%
Federal Sources	$4,803	$825	$3,978	$783	$36	0.9%
Total Federal & State Sources	$29,653	$4,299	$25,354	$4,086	$792	3.2%
Nongeneral Funds Distribution:						
Refund Fund						
Personal Income Tax	($960)	($126)	($834)	($119)	($20)	2.5%
Corporate Income Tax	(363)	(13)	($350)	(11)	($5)	1.4%
Subtotal General Funds	$28,330	$4,160	$24,170	$3,956	$767	3.3%
Short-Term Borrowing	$0	$0	$0	$0	($1,000)	N/A
Budget Stabilization Fund Transfer	$276	$276	$0	$276	$0	N/A
Total General Funds	$28,606	$4,436	$24,170	$4,232	($233)	-1.0%

CGFA 5-Sep-06

PENSION
The Financial Condition of the Illinois Municipal Retirement Fund
Dan Hankiewicz, Pension Manager

The Illinois Municipal Retirement Fund (IMRF) serves 2,896 employers including counties, cities, villages, school districts, townships, and other governmental entities and participating instrumentalities. Employees of IMRF employers are required to participate in the retirement plan if they work in an IMRF-qualified position, which must equal or exceed the employer's annual hourly standard of either 600 or 1,000 hours per year.

The table below lists the ten largest IMRF employers:

IMRF Employer	Active Members
DuPage County	3,576
Lake County	2,890
Will County	2,130
Union School District 46	1,998
Winnebago County	1,696
Rockford School District 205	1,633
Kane County	1,377
City of Springfield	1,356
Peoria School District 150	1,326
McHenry County	1,186

IMRF offers three benefit plans: Regular IMRF, Sheriff's Law Enforcement Personnel (SLEP), and the Elected County Official (ECO) plan. The Regular IMRF pension multiplier is 1.67% of the member's final rate of earnings for each of the first 15 years of service, plus 2% for each year of service in excess of 15 years, up to a maximum of 75% of final earnings. Hence, a Regular IMRF member who retires with 30 years of service credit and a final average salary of $32,000 would receive an annual retirement annuity of $17,600. Regular IMRF members contribute 4.50% of salary towards their pension.

The Sheriff's Law Enforcement Personnel Plan is for sheriffs, deputy sheriffs, and selected police chiefs. The SLEP formula was enhanced by P.A. 94-0712 (SB 1693). For SLEP members retiring after July 1, 2004, the pension multiplier is 2.5% of final earnings for each year of service, up to a maximum of 80% of final earnings. A SLEP member retiring with 30 years of service credit and a final average salary of $60,000 would receive an annual retirement annuity of $45,000. SLEP members contribute 7.50% of salary towards their pension and must have at least 20 years of service credit to qualify for an annuity based on the SLEP formula.

The Elected County Officials Plan began in 1997 with the enactment of P.A. 90-0032. A county may adopt the ECO plan via resolution, after which participation is optional for the elected officials of that county. The ECO pension multiplier is 3% of the final rate of earnings for each of the first 8 years of service, plus 4% for each year between 8 and 12 years, plus 5% of each year in excess of 12, up to a maximum of 80% of final earnings. An ECO member retiring with 20 years of service credit and a final average salary of $75,000 would receive an annual retirement annuity of $60,000. ECO members contribute 7.50% of salary towards their pension.

IMRF employers make contributions to the pension fund based on their employees' salaries, ages, and years of service credit. The average employer contribution to IMRF for the Regular Plan was 10.04% of payroll in 2006, an increase of 8.5% over the 2005 average employer contribution of 9.25% of payroll. The average employer contribution for the SLEP plan was 18.25% of payroll in 2006, and the average 2006 employer contribution for the ECO plan was 44.90% of payroll.

The table below shows a nine-year history of active employees, total annuitants, average salary, and average retirement annuity for IMRF:

Illinois Municipal Retirement Fund Statistical Information				
Fiscal Year	Active Employees	Total Annuitants	Average Salary	Average Annuity
1997	146,659	64,056	$23,991	$10,643
1998	150,428	66,272	$24,871	$10,415
1999	155,517	68,331	$25,678	$10,102
2000	159,810	69,862	$26,514	$10,314
2001	164,845	71,432	$27,477	$11,023
2002	167,776	73,360	$28,582	$12,217
2003	167,952	75,775	$29,709	$13,862
2004	168,536	78,242	$30,889	$14,118
2005	170,928	80,719	$31,640	$13,145

The table below outlines the changes in the financial condition of IMRF over the past nine years:

Summary of Financial Condition Illinois Municipal Retirement Fund ($ in Millions)				
Fiscal Year	Accrued Liability	Net Assets	Unfunded Liability	Funded Ratio
1997	$10,808	$10,273	$535	95%
1998	11,861	11,637	224	98%
1999	13,005	13,520	(515)	104%
2000	14,153	15,169	(1,015)	107%
2001	15,319	16,305	(987)	106%
2002	16,560	16,800	(240)	102%
2003	17,966	17,530	436	97%
2004	19,425	18,316	1,109	94%
2005	20,815	19,873	942	95%