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MONTHLY BRIEFING

For the Month Ended: May 2023

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Economy: After a Tough Year, Housing Shows Signs of Improvement

Benjamin L. Varner, Chief Economist

High interest rates and low inventory make for a tough housing market currently. The Federal Reserve's tightening of monetary policy over the last year has led to higher interest rates for mortgages which caused the affordability of housing to be reduced throughout the country. Sales of both existing and new homes slowed significantly in the second half of 2022. While existing homes sales continue to struggle, there have been some signs of a potential rebound in new home sales.

As the country faced high inflation at the beginning of 2022, the Federal Reserve began tightening their monetary policy to lower inflation by slowing the economy. The Fed slows the economy by raising short-term interest rates. By raising these rates, longer term interest rates also rise. Rising interest rates for home mortgages and auto loans increase the overall cost for these types of purchases. These higher costs lead to fewer purchases occurring, thereby, resulting in a slowing of the economy, and, hopefully, reduced inflation.

The Fed began increasing short-term interest rates in March of 2022. The effective Federal Funds rate went from around 0.1% in March of 2022 to its current level of approximately 5.1% after a series of ten rate hikes. Interest rates for mortgages began increasing even before the Fed's policy change based on market expectations for rate increases. According to data from Freddie Mac's Primary Mortgage Market Survey, interest rates for 30-year mortgages were just over 3% at the beginning of 2022, which was close to where they had been since the latter part of 2020. These rates steadily rose throughout 2022 peaking at just over 7%

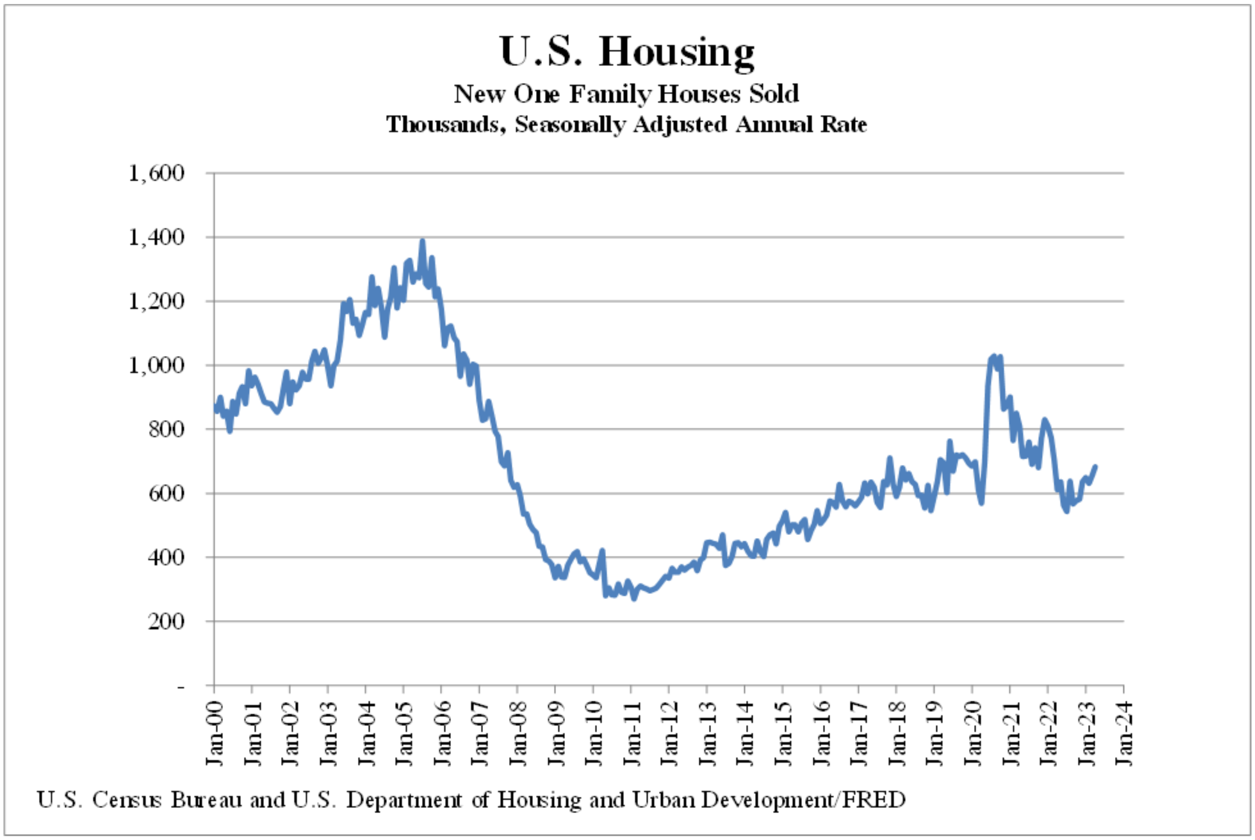
in November of 2022. The weekly average for 30-year mortgages has been around 6.6% in recent weeks.

With this increase in mortgage rates and the run up in housing prices in recent years, housing affordability has trended lower. The National Association of Realtors Housing Affordability Index has fallen significantly over the last year. The Housing Affordability Index (HAI) measures whether or not a typical family earns enough income to qualify for a mortgage loan on a typical home at the national and regional levels based on the most recent monthly price and income data. An index above 100 signifies that a family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home, assuming a 20% down payment. For example, an index score of 130 would indicate that a family earning the median family income has 130% of the income necessary for a median-priced existing single-family home.

In 2020, the affordability index for the U.S. was 169.9. This measure dropped to 148.2 in 2021 and then fell precipitously throughout 2022 after the Fed began raising interest rates in the spring. By March of 2023, the HAI for the U.S. had fallen to 98.6. Looking more locally, the HAI for the Midwest was the highest in the country in March at 133.5. This is down from 166.1 in April of 2022. Housing affordability is currently the worst in the western portion of the country as the HAI for this area was only 71.1. The HAI for the Northeast was just above 100, while the South had a HAI of just below 100.

Increased mortgage rates and declines in housing affordability led to a falloff in both existing and new home sales. According to the National Association of Realtors, existing single-family home sales had a seasonally adjusted annual rate of just under 5.0 million units in April of 2022. This rate steadily fell throughout the rest of 2022 to a low of 3.6 million units in January of 2023. This equaled a decline of almost 28%. In April of this year, this rate had rebounded to a rate of almost 3.9 million units per year.

As shown in the table on the following page, new single-family home sales had a recent peak of just over 1.0 million in the fall of 2020. Just prior to the Fed raising interest rates, the annual rate for new home sales averaged around 725,000. This rate fell to 543,000 in July of 2022. Since then, the rate has mostly gone up with the current rate in April at 683,000. This is an increase of almost 26% off the low seen in July of 2022.

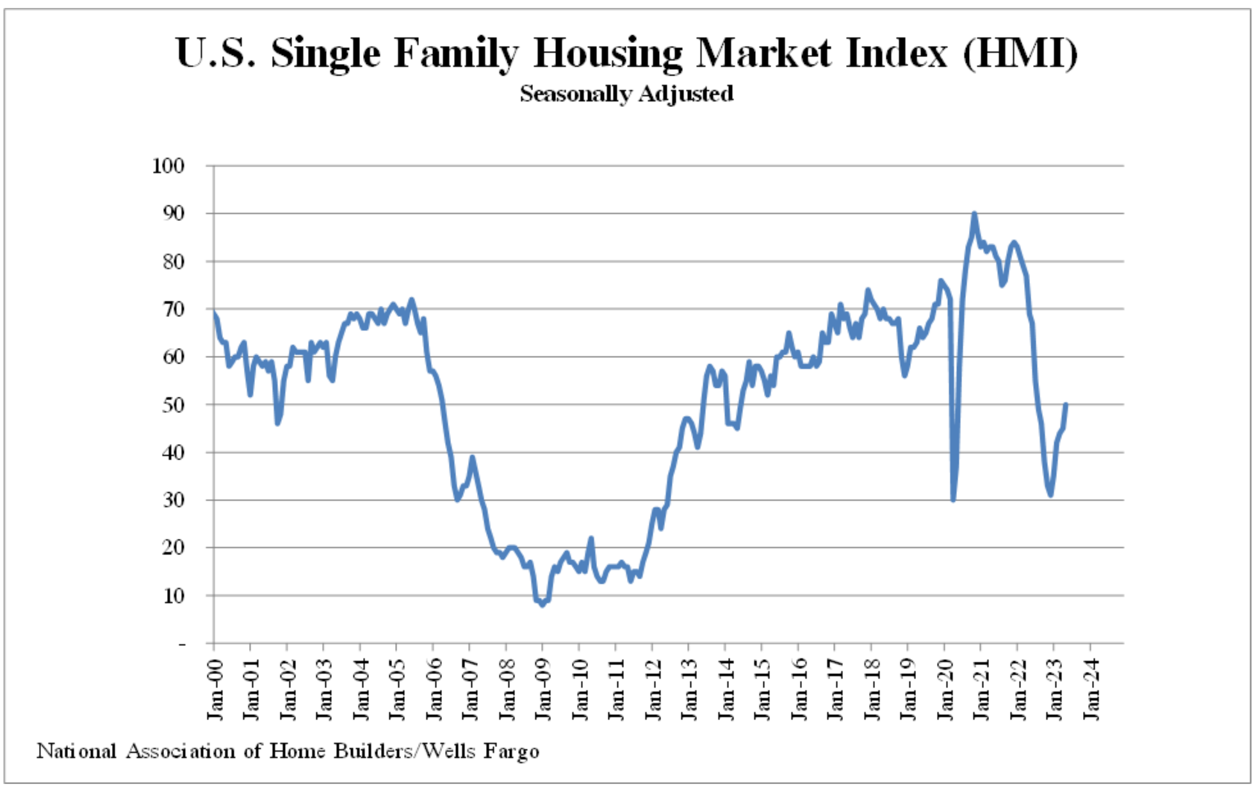


While new home sales have slowed compared to recent years, they have become more attractive to home buyers over the past year as builder incentives and a lack of existing house inventory have led to an increase in the percentage of new homes being offered versus existing homes. In 2019, newly constructed houses made up about 18% of total units available. In recent months, new homes have made up almost 33% of available inventory. One reason that existing houses are in limited supply is that most homeowners have mortgages with interest rates well below what is being offered in the market currently and would likely have to obtain a new mortgage at much higher rates than they are presently paying if they were to move.

While home sales have slowed over the past year, housing prices have remained elevated. According to data from the U.S. Department of Housing and Urban Development, in the first quarter of 2020, the median sales price for a new home in the U.S. was $329,000. This measure soared during the COVID-19 pandemic as demand for new homes increased significantly while supply was hindered. Median new home prices peaked in the fourth quarter of 2022, at just under $480,000. In the first quarter of 2023, prices fell to approximately $437,000. While this was a decline of almost 9%, the median price remains over 32% higher than the beginning of 2020. Much of the recent decline in home values is centered in the West, which saw home prices skyrocket. Prices in the Midwest have not grown quite as quickly in recent years, but have continued to increase in the most recent months.

The rebound in new home construction and sales is expected to continue based on results from the National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index (HMI). The HMI is based on a monthly survey of NAHB members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. As illustrated in the following chart, the index hit a high of 90 during November of 2020 as the demand for housing boomed during the COVID-19 pandemic. The index remained elevated through April of 2022 but began to fall as the effects of the Fed's monetary tightening policy were felt. The index fell to 31 in December of 2022 which was a similar level to that seen during the initial outbreak of the coronavirus. However, since then, the index has increased every month to climb to a level of 50 in May. Strength was observed in both current sales and future sales, while prospective buyer traffic remains subdued.

Overall, the housing market remains somewhat disjointed. While demand for homes remains strong, a lack of inventory, elevated prices, and high financing costs suppress sales. Both existing home and new home sales were restrained during the second half of 2022. New home sales have shown improvement in recent months, while existing home sales have been uneven. Home builders have expressed optimism going forward, but the full effects of the Fed's tightening policy on housing, and the economy as a whole, remains to be seen.



INDICATORS OF ILLINOIS ECONOMIC ACTIVITY

INDICATORS*	LATEST MONTH	PRIOR MONTH	A YEAR AGO
Unemployment Rate (Average) (Apr.)	4.2%	4.4%	4.5%
Inflation in Chicago (12-month percent change) (Apr.)	4.8%	4.4%	7.2%

	LATEST MONTH	CHANGE OVER PRIOR MONTH	CHANGE OVER A YEAR AGO
Civilian Labor Force (thousands) (Apr.)	6,482.4	0.1%	-0.1%
Employment (thousands) (Apr.)	6,207.4	0.2%	0.1%
Nonfarm Payroll Employment (Apr.)	6,126,900	8,500	131,800
New Car & Truck Registration (Apr.)	31,173	-11.6%	6.9%
Single Family Housing Permits (Apr.)	756	-3.9%	-26.0%
Total Exports ($ mil) (Mar.)	7,425.6	11.8%	9.9%
Chicago Purchasing Managers Index (May)	40.4	-16.9%	-33.0%

* Due to monthly fluctuations, trend best shown by % change from a year ago

Pass-Through Entity Tax

Robin Thompson, Revenue Analyst

Beginning in Tax Year 2021, the State recorded a notable uptick in Pass-through Entity (PTE) taxation, and that trend continues to have ramifications in tax revenue patterns. PTE income refers to income that individuals receive from S-corporations, partnerships, and fiduciaries. Income from these sources “pass through” to their members’ individual income statements instead of being reflected as corporate income taxation. This is a tax benefit to these taxpayers as Illinois’ Individual Income Tax Rate is 4.95%, while the State’s Corporate Income Tax rate is 7%.

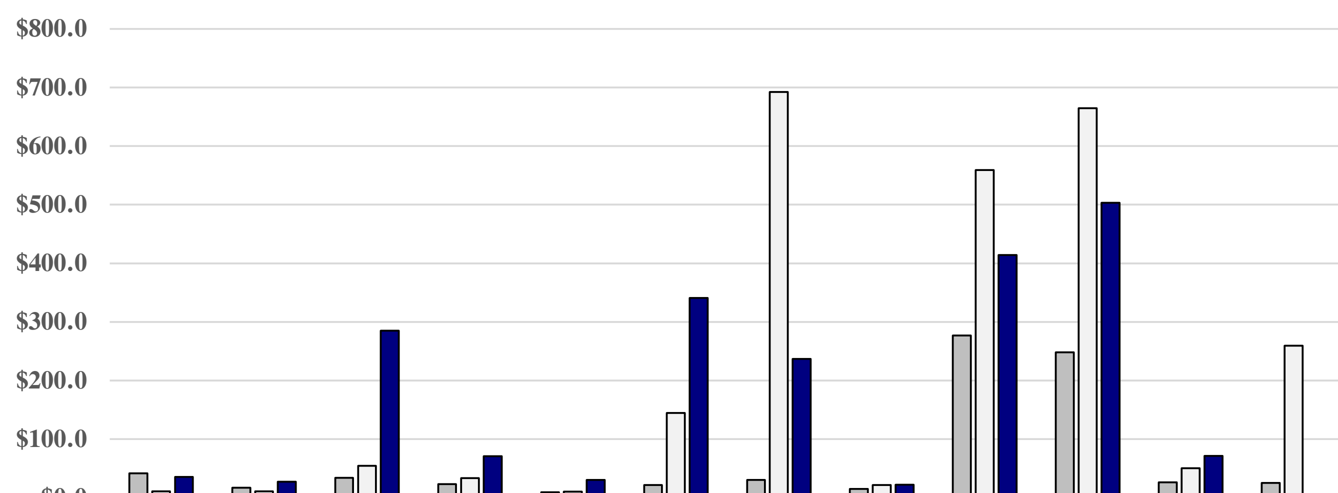
Prior to Tax Year 2021, pass-through withholding was the required payment method for pass-through entities. However, on August 27, 2021 Governor Pritzker signed P.A. 102-0658; creating a new elective tax that taxpayers receiving PTE income could choose to pay instead of via pass-through withholding. This optional PTE tax is equal to 4.95% of the taxpayer’s net income for the year; the same rate as the Individual Income Tax. The stated intent of the legislation was to allow Pass-through Entities the opportunity to receive the maximum benefits of the federal deduction for state and local taxes (SALT). Under federal law, the SALT deduction is capped at a maximum of $10,000 for those paying individual income taxes. P.A. 102-0658 created the optional PTE tax as an “entity level” tax and therefore allows Pass-through Entities to record taxation as a business tax instead of an individual tax. As the SALT deduction cap only applies to individual income taxes, the PTE tax circumvents that maximum limit and allows qualifying S-corporations, partnerships, and fiduciaries the ability to receive the highest possible SALT deduction on their federal return, while still benefitting from the lower tax benefits at the State level. Over 30 states across the country have joined Illinois in implementing this alternative tax.

In Fiscal Year 2021, the Department of Revenue receipted $764 million attributable to PTE taxation. That number ballooned to $2.512 billion in FY 2022. With one month remaining in the fiscal year, this figure is expected to be well over the $2 billion threshold again in FY 2023. P.A. 102-0658 appears to have had a substantial effect on State revenues despite being considered "revenue neutral" legislation. This abnormality seems to stem from changes in taxpayer behavior brought on by the enactment of that Public Act. Specifically, it appears that many individuals who previously reported income from S-corporations, partnerships, or fiduciaries on their personal income statements have opted to pay the PTE tax. This has had the result of moving revenue laterally from Personal Income Tax collections to Business Income Tax collections, thereby creating a change in typical receipt patterns.

The majority of PTE tax revenue comes from the 1065 Partnership and 1120 ST S-Corporation forms although there are several other forms that contribute to PTE revenue. The proportion of PTE revenue derived from 1065 Partnership and 1120 ST S-Corporation forms has risen significantly in recent years, likely indicating the increase in taxpayers utilizing the optional PTE tax. According to the Department of Revenue's *Monthly Collections Remitted to the Comptroller*, in Fiscal Year 2021, the two forms amounted to approximately 83% of PTE funds remitted that year. This number climbed to 93% in FY 2022 and is expected to be near this 93% mark again in FY 2023.

As shown in the graph below, beginning in September of FY 2022, a substantial uptick can be seen over the previous year's PTE monthly revenue totals. This trend has continued through the first 11 months of FY 2023. In fact, PTE tax revenue in FY 2023 has surpassed FY 2021 numbers in every month except for July.

Pass-through Entity Tax Revenue By Month
FY 2021- FY 2023
$ in millions



	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FY 2021	$41.4	$17.0	$34.0	$23.3	$9.1	$21.5	$30.4	$15.1	$276.6	$248.1	$25.9	$24.9
FY 2022	$11.1	$10.6	$54.2	$33.4	$10.5	$144.7	$692.6	$21.4	$559.0	$665.0	$50.3	$259.3
FY 2023	$35.6	$27.0	$284.9	$70.6	$30.5	$340.7	$236.7	$21.9	$414.1	$503.3	$71.3	

One result of the shift in collections brought on by the increased PTE tax revenues involves the need for reallocation of funds to comply with State statute. As mentioned earlier, the higher PTE tax revenues reflected a shift from reported Personal Income Tax collections to Business Tax collections. Following the Illinois Department of Revenue's typical practice, money receipted as Business Tax Collections are allocated to various funds in a percentage that is determined by a designated "Default Split". For each tax voucher that is received, a certain portion of Business Income Tax receipts are disbursed to Corporate Income Tax distributions, to Personal Income Tax distributions, and to Personal Property Replacement Tax (PPRT) distributions. This split is based on prior year activity and projected impacts from a change in law. While these default allocations to PTE were increased in anticipation of the impacts of P.A. 102-0658, a recent review of Tax Year 2021 data found that actual growth in the revenue source exceeded the Department's estimate. As a result, the Personal Property Replacement Tax and Corporate Income Tax received outsized contributions after the law change, with the Individual Income Tax disbursements being underfunded.

The Department of Revenue performs its statutorily required reconciliation process, which it refers to as a True-Up, annually. In previous years, the True-Up has required only minimal reallocations, less than 1% on average. However, because of the significant revenue increase due to the PTE change, the reallocation this year involves larger amounts. In April 2023, the Department of Revenue indicated to the Commission it had completed its Tax Year 2021 reconciliation and calculated the statutorily required True-Up reallocating funds to compensate for the necessary adjustments discussed above. This True-Up is expected to modify tax collections in Fiscal Year 2024 resulting in approximately $861.9 million from the Personal Property Replacement Tax and $215.5 million collected from the Corporate Income Tax being reallocated to the Personal Income Tax disbursements. The total value of this True-Up is expected to be approximately $1.077 billion.

The Department of Revenue reviews, and when needed, updates its Default Split percentages annually after each reconciliation. Updated Default Split percentages will take effect this upcoming July 1st in an effort to avoid this level of True-Up in subsequent years. As discussed in last month's briefing, the result of this reconciliation is an adjustment to the Commission's FY 2024 revenue forecast. While a notable upward adjustment was made to the Personal Income Tax forecast in response to this reconciliation, this growth was offset by downward adjustments in the Corporate Income Tax and PPRT forecasts. However, because the PPRT is a local government distribution and not part of the State's General Funds, the result of this was a net positive adjustment for the State's FY 2024 outlook. This net positive adjustment helps to offset the downward pressure resulting from weaker-than-expected final Income Tax collections in April.

GENERAL FUNDS REVENUES SEE $677 MILLION IMPROVEMENT IN MAY, HELPING TO RECOUP A PORTION OF APRIL'S LOSSES

Eric Noggle, Revenue Manager

General Funds revenues bounced back nicely from April's $1.8 billion decline with growth of $677 million in May, as compared to the same month the year prior. The May increases were experienced across the board, with the most significant growth coming from the Personal Income Tax and Federal Sources. Part of the reason for last month's extensive declines was due to April having one less receipting day in FY 2023. This "lost" day was effectively made up in May, as the extra receipting day helped bolster this month's revenue totals.

Personal Income Tax revenues recouped a segment of its significant April losses (associated with comparatively weaker final tax payments) with growth of $367 million in May. When removing the non-general fund distributions to the Refund Fund and the Local Government Distributive Fund, the net increase was $311 million. In addition, revenue from Federal Sources, which have trailed last year's pace throughout much of the year, rose $252 million in May helping to alleviate some of the sting from last month's declines.

Corporate Income Tax revenues continued its overall positive performance for the fiscal year with an increase of $46 million or $37 million net. Sales Tax revenues also bounced back from an April setback with growth of $52 million or $28 million net of distributions to the Road Fund and other transportation funds.

The remaining State sources had mixed results, but still managed to combine for a $43 million gain. The growth was again led by Interest Income, which continues to benefit from multiple interest rate hikes, increasing another $58 million in May. More modest increases came from Liquor Taxes [+$5 million] and Insurance Taxes [+$3 million]. The growth from these revenue lines helped offset revenue declines from Public Utility Taxes [-$10 million]; the Inheritance Tax [-$7 million]; the Corporate Franchise Tax [-$3 million]; Other State sources [-$2 million]; and the Cigarette Tax [-$1 million].

Transfers In were up a combined $6 million in May. Minor increases in Other Transfers [+$7 million] and Lottery Transfers [+$3 million] effectively offset the decline in Gaming Transfers [-$3 million] and Cannabis Transfers [-$1 million].

Year to Date

When incorporating May's revenue gains into the FY 2023 accrued total, General Funds base revenues are now ahead of last year's pace by $484 million with one month remaining in the fiscal year. When including the revenue gains from ARPA reimbursement funds, the overall growth for the fiscal year improves to $809 million. While this year-to-date growth figure is well below the $2.5 billion high-water mark at the end of February, it is a noticeable improvement over the meager $132 million in growth that resulted after March and April's sizeable declines.

The growth in Personal Income Tax revenues in May helped regain some positive momentum after the sharp decline in these receipts over the last couple of months. Still, Illinois' largest revenue source remains $1.065 billion behind last year's pace through May, or down $931 million on a net basis. Conversely, Corporate Income Tax revenues remain well ahead of FY 2022 levels with year-to-date net growth of $436 million. Net sales tax revenues also remain up a respectable $232 million with one month remaining.

The remaining State sources have combined to grow $311 million through May. Much of this growth continues to come from Interest Income, which has increased $324 million through the first eleven months of the fiscal year. To again put this in perspective, the FY 2022 total for Interest Income was only $30 million. This revenue source was more than double the FY 2022 total in May alone. Other State sources with year-to-date gains through May include Other Sources [up $78 million]; Insurance Taxes [up $30 million]; Corporate Franchise Taxes [up $6 million]; and Public Utility Taxes [up $3 million]. A few sources continue to trail last year's pace. Inheritance Taxes are down $107 million, Cigarette Tax revenues have fallen $19 million, while Liquor Taxes are $4 million lower.

State Transfers In have risen a combined $1.122 billion for the fiscal year with only the month of June remaining. This growth is mainly due to the $1.239 billion increase in the Income Tax Refund Fund Transfer. The Casino Gaming Transfer has added $17 million to this categorical combined increase. The growth from these transfers has helped offset cumulative year-over-year declines in Lottery Transfers [-$77 million]; Other Transfers [-$54 million]; and Cannabis Transfers [-$3 million].

As mentioned earlier, Federal Sources has trailed last year's pace throughout much of FY 2023. Despite May's notable increase of $252 million, base Federal Source revenues are still $686 million behind last year's cumulative totals. Even when incorporating the $325 million gains in federal one-time ARPA reimbursement funds, a combined federal source year-to-date decline of $361 million results.

Summary of Receipts

GENERAL FUNDS RECEIPTS: YEAR TO DATE

FY 2022 vs. FY 2023

($ millions)

Revenue Sources	**FY 2022**	**FY 2023**	**$ CHANGE**	**% CHANGE**
Net Personal Income Tax	$22,759	$21,828	($931)	-4.1%
Net Corporate Income Tax	$4,489	$4,925	$436	9.7%
Net Sales Tax	$9,297	$9,529	$232	2.5%
All Other State Sources	$2,786	$3,097	$311	11.2%
Transfers In	$1,927	$3,049	$1,122	58.2%
Federal Sources [base]	$4,251	$3,565	($686)	-16.1%
Base General Funds	$45,509	$45,993	$484	1.1%
ARPA Reimb. for Essential Gov't Services	$439	$764	$325	N/A
Total General Funds	$45,948	$46,757	$809	1.8%

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Jun-23

MAY FY 2022 vs. FY 2023 ($ millions)				
Revenue Sources	**May FY 2022**	**May FY 2023**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$1,952	$2,319	$367	18.8%
Corporate Income Tax (regular)	208	254	46	22.1%
Sales Taxes	926	978	52	5.6%
Public Utility Taxes (regular)	66	56	(10)	-15.2%
Cigarette Tax	18	17	(1)	-5.6%
Liquor Gallonage Taxes	14	19	5	35.7%
Inheritance Tax	46	39	(7)	-15.2%
Insurance Taxes and Fees	4	7	3	75.0%
Corporate Franchise Tax & Fees	18	15	(3)	-16.7%
Interest on State Funds & Investments	6	64	58	966.7%
Cook County IGT	0	0	0	N/A
Other Sources	23	21	(2)	-8.7%
Total State Taxes	$3,281	$3,789	$508	15.5%
Transfers In				
Lottery	$72	$75	$3	4.2%
Gaming	11	8	(3)	-27.3%
Cannabis	10	9	(1)	-10.0%
Refund Fund	0	0	0	N/A
Other	37	44	7	18.9%
Total Transfers In	$130	$136	$6	4.6%
Total State Sources	$3,411	$3,925	$514	15.1%
Federal Sources [base]	$74	$326	$252	340.5%
Total Federal & State Sources	$3,485	$4,251	$766	22.0%
Nongeneral Funds Distributions/Direct Receipts:				
Refund Fund				
Personal Income Tax	($181)	($214)	($33)	18.2%
Corporate Income Tax	(31)	(37)	(6)	19.4%
Local Government Distributive Fund				
Personal Income Tax	(107)	(130)	(23)	21.5%
Corporate Income Tax	(12)	(15)	(3)	25.0%
Sales Tax Distributions				
Deposits into Road Fund	(15)	(37)	(22)	146.7%
Distribution to the PTF and DPTF	(54)	(56)	(2)	3.7%
General Funds Subtotal [Base]	**$3,085**	**$3,762**	**$677**	**21.9%**
ARPA Reimb. for Essential Gov't Services	$0	$0	$0	N/A
Total General Funds	**$3,085**	**$3,762**	**$677**	**21.9%**

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding 1-Jun-23

GENERAL FUNDS RECEIPTS: YEAR TO DATE				
FY 2022 vs. FY 2023				
($ millions)				
Revenue Sources	**FY 2022**	**FY 2023**	**$ CHANGE**	**% CHANGE**
State Taxes				
Personal Income Tax	$26,697	$25,632	($1,065)	-4.0%
Corporate Income Tax (regular)	5,671	6,184	513	9.0%
Sales Taxes	9,965	10,562	597	6.0%
Public Utility Taxes (regular)	688	691	3	0.4%
Cigarette Tax	228	209	(19)	-8.3%
Liquor Gallonage Taxes	171	167	(4)	-2.3%
Inheritance Tax	564	457	(107)	-19.0%
Insurance Taxes and Fees	383	413	30	7.8%
Corporate Franchise Tax & Fees	199	205	6	3.0%
Interest on State Funds & Investments	19	343	324	1,705.3%
Cook County IGT	244	244	0	0.0%
Other Sources	290	368	78	26.9%
Total State Taxes	$45,119	$45,475	$356	0.8%
Transfers In				
Lottery	$738	$661	($77)	-10.4%
Gaming	128	145	17	13.3%
Cannabis	105	102	(3)	-2.9%
Refund Fund	242	1,481	1,239	512.0%
Other	714	660	(54)	-7.6%
Total Transfers In	$1,927	$3,049	$1,122	58.2%
Total State Sources	$47,046	$48,524	$1,478	3.1%
Federal Sources [base]	$4,251	$3,565	($686)	-16.1%
Total Federal & State Sources	$51,297	$52,089	$792	1.5%
Nongeneral Funds Distributions/Direct Receipts:				
Refund Fund				
Personal Income Tax	($2,470)	($2,371)	$99	-4.0%
Corporate Income Tax	(852)	(897)	(45)	5.3%
Local Government Distributive Fund				
Personal Income Tax	(1,468)	(1,433)	35	-2.4%
Corporate Income Tax	(330)	(362)	(32)	9.7%
Sales Tax Distributions				
Deposits into Road Fund	(117)	(447)	(330)	282.1%
Distribution to the PTF and DPTF	(551)	(586)	(35)	6.4%
General Funds Subtotal [Base]	**$45,509**	**$45,993**	**$484**	**1.1%**
ARPA Reimb. for Essential Gov't Services	$439	$764	$325	N/A
Total General Funds	**$45,948**	**$46,757**	**$809**	**1.8%**

CGFA SOURCE: Office of the Comptroller: Some totals may not equal, due to rounding — 1-Jun-23