States' Budgets Blow as Housing And Credit Markets Crash

by Mary Jane Freeman

The crashing $20 trillion housing market, which is triggering multi-billion-dollar loan losses and write-downs at America's largest banks, and millions of household foreclosures, is bringing an abrupt halt to the "revenue recovery" most U.S. states had in their 2005 and 2006 fiscal years. County and city budgets, too, will take a beating, as the mortgage and banking blowout expands.

State after state since mid-October has announced revenue shortfalls: California has a $10 billion shortfall, while Florida, Maryland, and Virginia each called special legislative sessions to deal with $1 billion-plus budget holes. Rhode Island's deficit doubled from $200 million to $400-450 million, its revenue-estimating conference reported Nov. 9. Eight to ten more states, including Arizona and Nevada, which were both formerly hot housing markets, have already announced shortfalls in the $250-500 million range as well. This news comes after only the first quarter of the new fiscal year which runs from July 1, 2007 to June 30, 2008 for 46 states. Impending disaster on state budgets resulting from this mortgage bubble/banking crisis, is epitomized in the cases of Maryland and New York, which are detailed below.

As this picture shows, only Federal action, as put forward in Lyndon LaRouche's proposed Homeowners and Bank Protection Act, and then the Emergency Recovery Act, can stanch the bleeding.

Relying on a Bubble

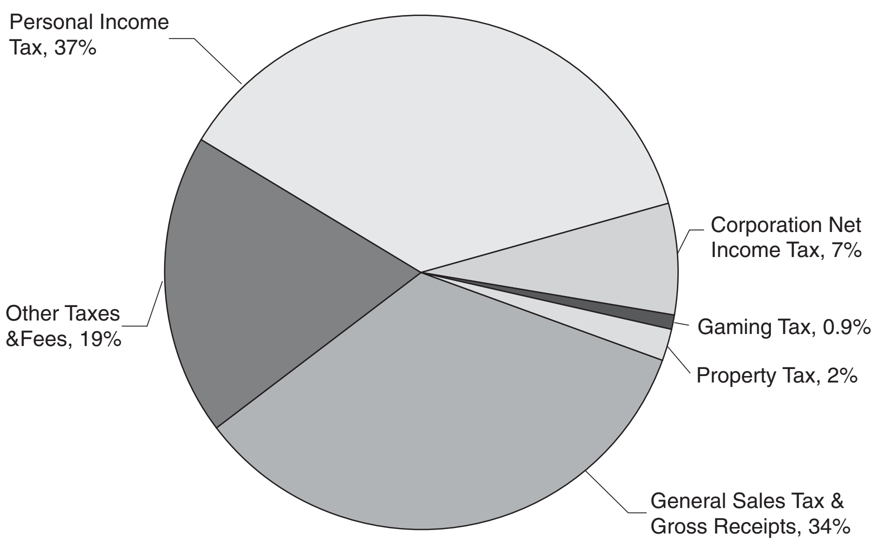
A complex of interrelated relationships exists between the housing industry and the revenue streams of our state and local governments (**Figure 1**). These involve three aspects of the housing sector: the production of homes, the sale of homes, and the property assessment of homes, which contributes a large amount of tax revenue to the budgets of county and local governments. Three parts of the revenue side of the budget are affected: 1) the personal income tax, 2) the sales tax, and 3) the property tax collected against the assessed valuation of homes.

On the question of personal income tax: The production of homes, as well as home improvements, leads to the employment of construction workers, electricians, plumbers, and others, as well as the workers who produce the cement, bricks, glass, lumber, and steel that go into a home. In most states, and many local governments, these workers pay personal income tax. Individuals who realize a capital gain from the sale of a home, above a certain level, also pay capital gains tax as part of their personal income tax.

With respect to the sales tax: The tax on the sale of residential construction materials represents *one-sixth to one-fifth* of all collected sales tax revenues. The purchase of home appliances, from dishwashers to stoves to air conditioners, for new homes, as well for refurbishing existing homes, also contributes a considerable sum to sales tax. In addition, as *EIR* has documented, between 2001 and early 2007, the practice of cash-out refinancing—the extraction of cash from the inflated value of homes—produced $400-600 billion in cash per year, a large portion of which was spent on buying consumer goods. This swelled state, county, and local sales tax revenues too.

With respect to property tax: The vast inflation in the price

FIGURE 1
State Government Revenue Sources



Sources: National Conference of State Legislatures, Fiscal Affairs Program; National Associatiion of State Budget Officers; and *EIR*.

of homes led to higher home assessments and property tax payments, which swelled the tax collections of especially county and local governments.

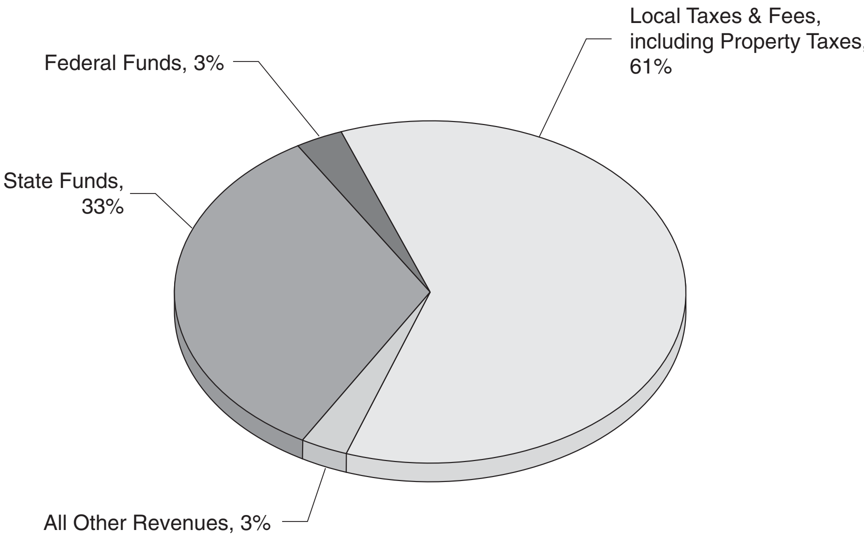
Now, all three aspects of budget revenues, which caused tax revenues to bulge, are vanishing.

The most direct impact is the collapse of sales tax revenues as sales of new and existing homes plummet. The Schwab Center for Financial Research reports that third-quarter 2007 new home sales fell 21.2% from one year ago. Existing home sales in September 2007 were a whopping 19% lower than September 2006, while the full year's 2007 sales are headed to be 12.5% below the 2006 total. The 2008 outlook is worse, the National Association of Realtors reported on Nov. 13.

Key to the 2004-07 revenue picture for state and local governments is that, as in the late 1990s, elected officials crafted budgets based on taxing revenues generated from fictitious wealth. Then it was the stock market and IT bubbles, and today it is the housing bubble. In both cases, former Federal Reserve chairman Alan Greenspan deliberately set the conditions upon which these de facto Ponzi schemes would flourish. With the bursting of the bubble in 2000, state budgets suffered multi-billion deficits for years. Now the orchestrated housing boom, with a plethora of exotic mortgage instruments which created unsustainable high-priced land and home values and a building boom, is wiping out state and local budgets by the tens of billions, as it blows apart.

FIGURE 2

County Revenues by Source



Sources: National Association of Counties and *EIR*.

Revenue Sources Evaporate

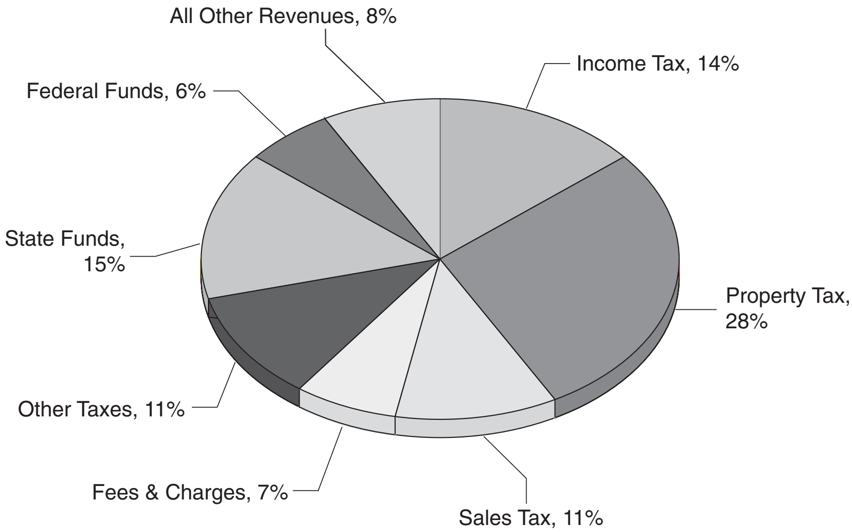
A state that epitomizes the most severe impact of the housing market blowout upon revenues, is Florida. The state, which collects no personal income tax, primarily relies on sales tax revenues. As reported on Nov. 6, Florida's new fiscal year (2007-08) was off to a dismal start, with general fund revenues down $93.5 million from expected revenues, Of that, nearly 84%, or $78.2 million, results from a sales tax shortfall.

A special legislative session in October, prior to this bad news, was held in order to close an estimated $1.1 billion revenue gap, expected to hit in the 2008-09 fiscal year. Amy Baker, coordinator of Florida's Economic and Demographic Research Office, which issued the November estimate, quipped, "We don't even have the recovery starting until 2009 now, well into 2009. It's all related to the housing industry." The housing boom has been "the catalyst of everything," with double-digit "growth in values and appreciation and construction starts, and when it evaporated . . . it took the steam out of the economy," she said. Baker was proven right on Nov. 14, when yet another revised revenue estimate was released which announced a second $1.1 billion shortfall for the current budget year. Indeed, Florida expects only 93,000 new homes to be built next year, which would be a 65.8% fall in new home starts, from their high in 2005 of 272,000 homes.

The housing crash's impact on counties is just beginning to take hold. Nearly two-thirds of counties' revenues derive from property and sales taxes, as well as fees (**Figure 2**). Take San Luis Obispo County, Calif. It reported the worst home sales figures in 18 years, with sales of homes purchased with jumbo loans ($417,000 or more) falling 48.5%, August to September, while those bought with conventional loans fell 12.9%. This is projected to help create a $20 million budget deficit next year. As the Arizona "hot" housing market crashes, Maricopa County officials reported on Nov. 14 that sales-tax collections have shriveled such that it will likely be $25-35 million in the red by June 30, 2008—the end of its fiscal year. County Supervisor Andy Kunasek said they budgeted for the "worst-case scenario," but "it appears we weren't as pessimistic as we should have been." Maricopa is imposing 5% administrative cuts and freezing non-emergency spending, in the hopes that it won't have to do more.

Cities' revenues will also begin to collapse as new property assessments catch up with falling property values. Cities derive almost a third of their revenues from property and sales taxes, as well as fees, many of which are associated with home sales and ownership (**Figure 3**). "If the housing market continues to flatten out or even decline, we're in for some tough times for cities," Christopher Hoene of the National League of Cities said in mid-October. In Michigan, the *Daily Tribune* reported on Oct. 29 that cities in Oakland County "are headed

FIGURE 3
Municipal Revenue Sources



Sources: National League of Cities and *EIR*.

for an unprecedented financial crisis." The price of homes sold in the county dropped more than 10% between 2005 and 2006, while sales are "down sharply ... foreclosures are doubling and declines in property values" are accelerating. As equalized property values (home property assessments) catch up to falling market sale prices, county and city property taxes will collapse, hammering local budgets. The Michigan Municipal League's tax expert and director of state affairs, Summer Minnick, expects double-digit drops in property tax income to cities next year.

Maryland: Foreclosures Rise

The Maryland legislature continues its special session as of Nov. 15, in an attempt to plug a $1.7 billion budget hole, which grows wider daily. The current plan is to cobble together a bailout scheme which includes tax increases, $500,000 in cuts, and several accounting gimmicks. The housing foreclosure debacle will increase the need and demand for public services, just as the legislature and Gov. Martin O'Malley move to impose cuts. The urgent need to expand the resources of the public health sector, for example, is shown by the soaring rate of AIDS in Baltimore, which has developed as economic conditions of life devolved with the "post-industrial society" obliteration of the steel and manufacturing sector there. (See *EIR*, Nov. 16, 2007.)

As in the 2001-02 budget crises, legislators in Maryland and other states are operating on the wrong axiom: belief in the "new economy." Sustainable revenue growth can only occur if it is tied to the productive, rather than the speculative, economy. Thus Maryland's former Comptroller, Donald Schaefer, warned in his final Board of Revenue Estimates report on Dec. 13, 2006, that the state's housing market had "outperformed" the national trend since 2001, but had then "turned.... Housing-related industries including construction, finance, and real estate will join with a declining manufacturing sector...."

Schaefer's warning that the housing market driver to the state's economic growth would become a "drag," has come true. Already in 2006, the construction industry growth, spurred by booming residential construction, had slowed to 1.7%, compared to an average 4.4% in 2004 and 2005. He projected a further decline to 1.5% in 2007 due to falloff of residential construction. In fact, the Maryland housing bubble has burst. Unsold home inventories climb, foreclosures have soared (**Figure 4**), and sales of single-family homes have plummeted 21% from 2004 to the second quarter 2007 (**Figure 5**).

This decline has made a direct hit on the state's revenues. As of December 2006, Maryland projected that for the current fiscal year (2007-08), the revenues into the General Fund were to be $13.45 billion. Of this amount, a full 57% was to be generated from income taxes. Another 27% of the total, or $3.62 billion, was to be generated from the sales and use taxes' category.

However, in September 2007, the state revised its revenue figures, estimating that, for the current fiscal year, revenues would be $133 million lower than the December 2006 projection, due largely to a $116 million fall in sales tax revenues. Of the total sales tax collected by the state, the construction material sales tax comprises almost 16%. Therefore, the fall in the construction materials' sales tax would come out to be a minimum of $18 million. But this is just one aspect of the fall; there are many other parts of the budget where the housing collapse is producing revenue losses.

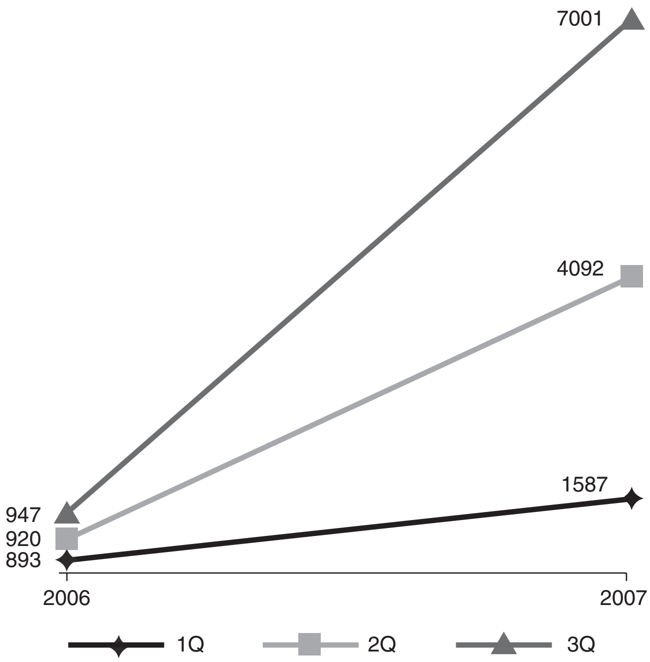
Furthermore, the actual revenue shortfall for the fiscal year 2008 and 2009 budgets will be far greater than the Maryland government is presently prepared to admit, as the housing and banking crises accelerate.

New York: Bank Losses Mean Budget Blowout

The multi-billion budget shortfalls resulting from the huge losses and write-downs among the nation's biggest banks in New York State, epitomize the other side of this mortgage/banking crisis. "The securities industry has been rocked by turmoil in the housing and credit markets," and "these events will exact a toll on profits, bonuses, jobs and tax revenues," New York State Comptroller Thomas P. DiNapoli wrote in an Oct. 30, 2007 report. That was his prelude to an-

FIGURE 4

Maryland Foreclosures Explode, Accelerating Each Quarter Year-Over-Year

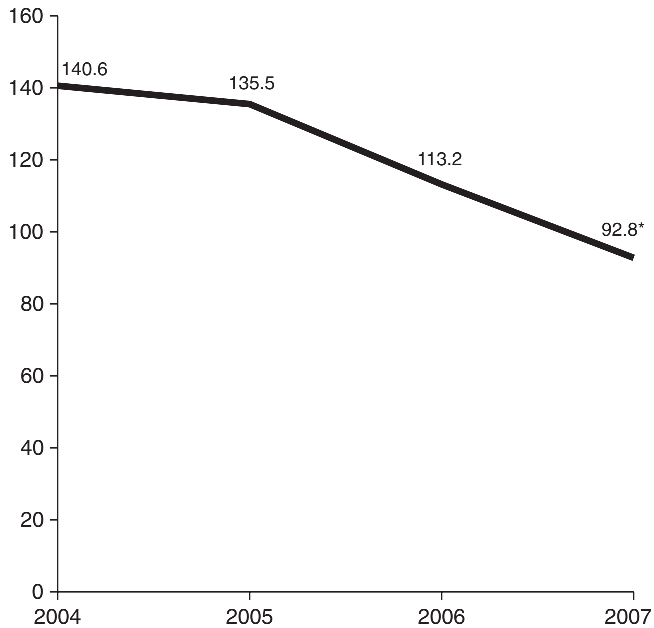


Sources: Maryland Department of Housing and Community Development, second quarter report; *EIR*.

FIGURE 5

Maryland Single-Family Home Sales Plummet 21%

(2004 Through 2007 Second Quarter, Thousands)



Sources: National Association of Realtors and *EIR*.

* Second quarter number is annualized.

nouncing a $500 million tax revenue shortfall, due largely to a 65% drop in third-quarter 2007 profits at the seven largest securities firms headquartered in New York City.

As the Wall Street fantasy world of paper hyper-profits vanishes, the New York City and State governments are projecting burgeoning budget gaps for the next several fiscal years, revising upward the gap projections made only three months earlier.

Never have two large government entities depended so much on the fruit of speculation. Financial firms generate 23% of New York City's personal income, and thus, approximately the same percent of its personal income tax. The taxation of securities industry profits accounts for almost 9% of the city's tax revenue. In the case of New York State, taxation of securities industry profit accounts for 20% of the state's tax revenue, according to DiNapoli's report. New York City Budget Director Mark Page wrote in a memorandum to City Department heads Oct. 30, that New York City's budget shortfall would reach $2.7 billion in Fiscal Year 2009. But Page's loss projection is $1.15 billion greater than what he projected only this past July. For the fiscal years 2010 and 2011, Page projects budget shortfalls of $4.8 billion and $6.5 billion.

New York State's Budget Division projects a $4.3 billion budget gap for FY 2009, a $0.7 billion revision upward from its projection of the gap during July, as well as $6.2 billion in 2010 and $7.9 billion in 2011.

On Oct. 30, mad-dog New York City Mayor Michael Bloomberg ordered budget cuts of 2.5% this fiscal year (2008), and 5% for FY 2009. He also ordered a hiring freeze for "jobs with an immediate impact upon health and safety," according to *Bloomberg News* on Oct. 31.

Yet, New York City and State might be accused of using "too cheerful" projections. The housing collapse and banking credit crisis is now gathering force, and the fall in Wall Street's revenues has a long, long way to go.

LaRouche: Return to a Productive Economy

As the loan losses of the major banks pile up, foreclosures accelerate, employment in the manufacturing-productive sectors declines, energy prices climb, and tax revenues shrink, legislators and elected officials will be in constant special session. Governors' January budget proposals will have to factor in billions of dollars of revenue loss. Threatened are basic public services of schools, police, fire, and public health jobs and programs, as well as transportation infrastructure spending. Millions of people who rely on city, county, and state government services, especially when they've lost a home or job, will find little help as programs are cut to bail out budgets.

A sustainable tax base must be restored to ensure the future of the nation. Lyndon LaRouche's FDR-styled rescue of homeowners and state and Federal chartered banks, detailed in the Homeowners and Bank Protection Act of 2007 (see www.larouchepac.com), coupled with his Economic Recovery Act of 2006, provide the only exit from the budget disaster frenzy fueled by foolish clinging to the City of London-directed speculative economy.