real estate

insights

October 2005

Real Intelligence – Real Advantages

In This Issue

Existing-home sales posted their second highest monthly volume on record in August. Resales rose 2.0% in August to 7.29 million seasonally adjusted annualized units. Sales data from New Orleans and other regions affected by Hurricane Katrina were not included in the figure. Strong demand is continuing to push home prices. The median price rose 15.8% from August 2004, with the national median home price at $220,000. The inventory of homes for sale rose to 2.856 million. However, the 4.7-months' supply of homes based on the current sales pace is near historic lows. **For more information, click here.**

Rainy weather. The jury's still out on the impact from Hurricanes Katrina and Rita. In his commentary this month, NAR Chief Economist David Lereah looks at the long-term impact of these disasters, how the hike in gas and heating fuel prices may affect the economy, and if the Fed will continue its rate hikes. **Read more.**

Two observations do not a trend make. Some recent reports in the media have reported home price declines in some areas. But they may misread what is really happening. Looking at longer trends will give a more realistic view of what's happening in the housing sector, and what's ahead for home sales and home price appreciation. **Read more.**

The Times Are a' Changin … but have our tax systems kept pace with those changes? While economic, political, and technological developments have changed how governments raise and spend revenue government finance structures have remained fairly static. A new report from the State and Local Fiscal Research Institute of the REALTORS® National Center for Real Estate Research describes state and local fiscal systems and the trends affecting their revenue and expenditures. **Read more.**

New home sales account for approximately 20 percent of all housing sales in the U.S. Our regional trends report this month looks at housing, starts and new home sales in each of the four regions of the country. **Read more.**

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NATIONAL ASSOCIATION OF REALTORS®

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EQUAL HOUSING OPPORTUNITY

Real Estate Monitor

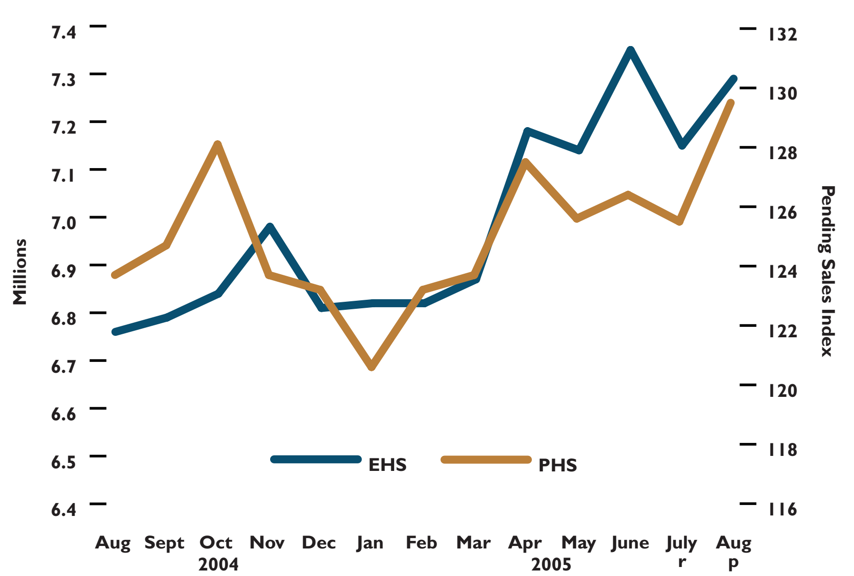
Monthly Indicator	Recent Figures		Likely Direction Over the Next Six Months	Forecast
Mortgage Rates The 30 year fixed mortgage fell in September to an average of 5.77 – a 5 basis points decrease from a month earlier. Rates should hover around 6% by year end, and gradually increase to mid 6% by end of 2006. As long as rates remain at these generational low levels the housing industry should continue to experience good health. **Read more.**	July Aug Sep	5.66 5.82 5.77	↑	Bond investors getting nervous on inflation and want a higher compensating rate premium
Existing-home sales rose 2.0% in August to 7.29 million seasonally adjusted annualized units – their second-highest monthly level on record. Strong demand is fueling sales, as well as home price appreciation which rose 15.8% from a year ago to $220,000. The number of homes for sale is at a 4.7-months' supply. **Read more.**	June July Aug	7,350 7,150 7,290	↔	High pending sales data points to continued sales momentum
New home sales declined in August to 1.24 million seasonally adjusted annualized units – a 10% decrease from July's all-time high. But the three-month moving average is over 1.3 million units, which is exceptionally strong. **Read more.**	June July Aug	1,304 1,373 1,237	↔	A support for new sales related to Katrina and Rita
Housing starts posted 2.009 million units in August. While that is 1.3% below July's starts, it is the fifth month in a row that starts were above the 2-million unit mark. The need to rebuild many properties destroyed by both Hurricanes Katrina and Rita will keep starts elevated for the next 12 months. **Read more.**	June July Aug	2,065 2,035 2,009	↔	Surpassing 2 million new units in 2005 for the first time since 1978
Employment Katrina had a negative effect on the nation's job market in September, as payrolls fell by 35,000, and the unemployment rate increased to 5.1% -- its highest level since May. The good news is that both July's and August's employment figures were revised upward. **Read more.**	July Aug Sept	277 211 -35	↑	Job losses from Katrina turns to job gains when rebuilding kicks in
Purchase applications Mortgage loan applications rose to 493.9 in September after slipping last month. The index remains strong at its second highest on record. Other housing market indicators prove the strength of the market. **Read more.**	July Aug Sept	495.6 489.3 493.9	↔	Robust activity, but need to monitor trends in the use of riskier exotic mortgages
Housing affordability NAR's housing affordability index decreased 2.9% in August to 115.4. Both the median price of an existing home and mortgage rates rose, offsetting a slight increase in the median family income. **Read more.**	June July Aug	118.2 118.8 115.4	↓	High flying home prices cutting into affordability
Inflation As expected, the consumer price index (CPI) rose 0.5% in August, primarily due to a 5.0% increase in fuel prices. Higher fuel costs combined with rising core prices will likely result in an upward trend in the CPI through the autumn of 2006. **Read more.**	June July Aug	0.0% 0.5% 0.5%	↓	Uncomfortably high now due to high oil prices, but expected to come down in 2006

Notes: All rates are seasonally adjusted. Existing home sales, new home sales and housing starts are shown in thousands. Employment growth is shown as month-to-month change in thousands. Inflation is shown as a month-to-month percent change in the Consumer Price Index. Sources: NAR, Bureau of the Census, Bureau of Labor Statistics, Mortgage Bankers Association and Freddie Mac. This report reflects data as of October 9, 2005.

NAR's Pending Home Sales Index

Pending home sales rose to a record level in August, to a reading of 129.5. The index was a 3.2 increase from that in July, and 4.7 percent higher than in August 2004. The index, which is a leading indicator for the housing sector, is derived from pending sales of existing homes. A sale is described as pending when the contract has been signed but the transaction has not been finalized. Pending home sales typically close within one or two months of signing. An index of 100 is equal to the average level of contract activity during 2001, the first year to be analyzed, and was the first of four consecutive record years for existing-home sales. Sales in 2001 were fairly close to the higher volume of home sales expected in the coming decade, well above the levels that were seen in the mid-1990s, so an index of 100 is considered to be historically strong. While home sales remain at remarkable levels, there is ambiguity regarding pending home sales in parts of the South since many transactions in the disaster zone will be postponed. It's unclear how much of that disruption may be offset by spiking sales in surrounding areas. Still, national sales should stay close to record levels over the next two months and housing will continue to support the economy.

Pending Home Sales
(existing home sales lagged by 1-2 months)



Source: NAR Research

The Sun Will Come Out Tomorrow

by David Lereah, *Chief Economist*

The weather can change quickly. All of a sudden, a moderate rain has turned into a torrential downpour for the real estate markets. It seems that everywhere you turn, the real estate business is getting rained on. Accusations are flying, doomsayers are warning, mortgage rates are rising and the media has lost faith in what has been the economy's little engine that could during the past four years.

Here are some of the wet highlights:

- Hurricane Katrina has destroyed hundreds of thousands of residential and commercial properties in our nation's Gulf States, creating chaos and despair among homeowners, renters and real estate professionals.
- The Department of Justice has filed a lawsuit accusing the real estate industry in engaging in anti-competitive practices.
- President Bush's tax commission just announced that housing subsidies, such as the mortgage interest deduction and the capital gains exemption is now on the cutting board.
- The other great housing subsidies—Fannie Mae and Freddie Mac—are also in danger of being whittled down.
- High oil prices are defying gravity. The increases in fuel costs promise to inhibit future economic and real estate activity.

And there's more. Banks are still trying to expand their powers into real estate brokerage activities, threatening the competitive balance of our industry. And the media and Wall Street doomsayers continue to forecast the demise of the housing markets as we know it—via bubbles bursting. If that weren't enough, mortgage rates are now on the rise with the Federal Reserve promising to continue to hike interest rates in the near term.

So are the glory days of real estate behind us? Heck no. Real estate will remain strong, and those in the industry to work together to ensure that the programs and policies that encourage homeownership – the backbone of this economy – continue. With over 100,000 real estate brokerage companies and over 1.2 million Realtors, the National Association of REALTORS® is confident that it will prevail over the Department of Justice's lawsuit. And as happened a decade ago, our industry will come together—REALTORS®, lenders, home builders and other real estate professionals—and protect the very housing subsidies that have made our economy, and more importantly, our families, strong.

There is little irrational property buying in today's real estate markets. The housing markets continue to be fundamentally sound.

Skies Clearing

Looking forward, lower oil prices and the rebuilding of our Gulf States will provide a boost to economic and real estate activity next year. Thirty-year mortgage rates are expected to rise to about 6.7 percent by the end of next year—but is anyone complaining about mortgage rates below 7 percent?

As for the doom and gloom "bubbleologists"—it is ***they*** who are full of hot air. There is little irrational property buying in today's real estate markets. The housing markets continue to be fundamentally sound: mortgage rates are relatively low, supply is relatively lean and demand remains strong. But as interest rates rise during the next twelve months, home sales will modestly drop and inventories will modestly rise. Air will leak out of most of local housing balloons across the nation, but few balloons will pop.

So in the end—sometime towards the end of next year—the sun will come out in the housing industry. Home price appreciation will come back down to reality (4 to 7 percent appreciation), REALTORS® will sell homes- but at a less than record pace—lenders will lend money on home purchases and builders will build new homes. The housing markets will experience a soft landing, and all of us will live happily ever after – well, almost, anyway.

Want more insights from NAR Chief Economist David Lereah? Visit **REALTOR.org** to see some of his latest comments from press interviews and speeches at **www.REALTOR.org/Research.nsf/Pages/housingoverview**

THE FORECAST

by Lawrence Yun, *Senior Forecast Economist*

A recent article in *The New York Times* - "Slowing is Seen in Housing Prices in Hot Markets," may have spooked some homeowners and potential homebuyers. The *Times* article said the average price in Manhattan fell 12.7 percent from the second to the third quarter of 2005 while prices were flat in Massachusetts from July to August, possibly presaging price declines in other markets. But before everyone gets nervous, let's take a short course in interpreting the numbers.

Housing Statistics 101

In viewing the housing market, it is critical to compare conditions on a year over year basis –in other words, if you're looking at the third quarter figures for 2005, for a better comparison look at the third quarter of 2004. The chief reason for this is that a different mix of homes is sold during different times of the year. Families with school-aged children generally prefer moving in early summer so as not to disrupt the school year. These households need a larger home – larger homes generally are more expensive than mid-size or smaller ones. Similarly, a larger percentage of smaller homes are sold in late autumn and winter because many families needing a large home already made their move earlier in the year. It should therefore not be surprising to find that the prices (i.e., the market data) of those homes sold in the autumn months are nearly always lower as compared to the prices of homes sold during the summer months.

But one important note: The lower prices after the summer months does not mean a price decline. It means there were more smaller-sized homes sold. Due to these seasonal variations, year ago comparisons for home prices is a must.

Also, there are some observers who tend to misinterpret the meaning of price changes occurring in the *new homes* market. Median new home prices have risen sluggishly in the recent three months compared to comparable periods a year ago. So the latest 12-month price gain of only 1% is seen as indicative of a weakening trend or even a leading indicator of what may happen to existing home prices. This reasoning is wrong. It is the same trap. Because more new homes are built and sold in the more affordable regions of the country – or even in the more affordable parts of a metro market – this results in lower new home prices than if those new properties were built in pricier areas. It is not plausible for an existing home price to rise at significantly higher rate then a newly built home that is down the street.

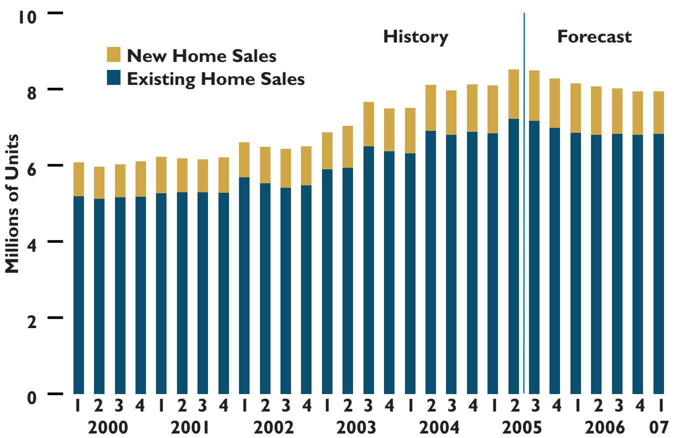
The best way to gauge price changes for assessing homeowners' housing wealth gains is to look at NAR's existing home price series or the constant-quality OFHEO price index from the Office of Federal Housing Enterprise Oversight. Both series have moved closely together in the past. The second quarter gain according to the NAR price series and the OFHEO price index showed an identical 13.4% change. OFHEO prices are not available on a monthly basis, so relying solely on NAR prices, the latest data showed a gain of 15.8% in August 2005 compared to August 2004. That is not only a strong appreciation rate (unlike what was reported in the *Times*), but it is also the highest rate of appreciation in over 25 years. Price growth in the Northeast region was even greater at 16.5%. Monthly local price data from the New York Association of REALTORS® also showed double-digit 12-month price gains from August 2004 to August 2005 in the New York metro region. Some New York homeowners may have thought themselves poorer after reading the *Times* story, but there is no evidence of a true slowdown in home prices.

Looking Ahead

Though price trends are rock solid to date, what about the future? It is true that price *growth* will inevitably slow. The inventory of homes on the market has been steadily rising. The 2.9 million homes on the market in August represents 4.7 months worth of supply at the current record sales pace - relatively high compared to recent trends. But inventory levels will rise even higher once the demand retreats, as it is likely to happen given the rise in the average mortgage rate to near 6% (up from 5.7% range few months back). Mortgage rates will climb higher still – to 6.2% by the end of 2005 and to 6.7% by the end of 2006.

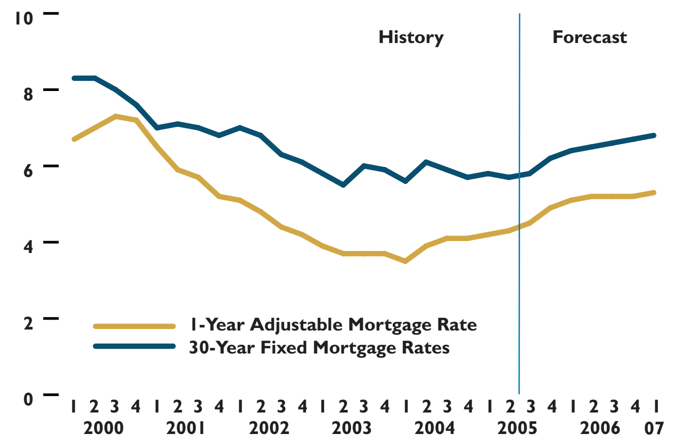
Even then, the anticipated 2 million plus job creation over the next 12 months will provide enough support for the housing sector such that sales activity will be the second highest on record in 2006. Home prices will rise about 5% or by better than $10,000 in housing equity gain for majority of homeowners. The frenzy times may be over. But most certainly, one cannot characterize such market conditions as a slump.

Home Sales
Another record in 2005, then slowing slightly



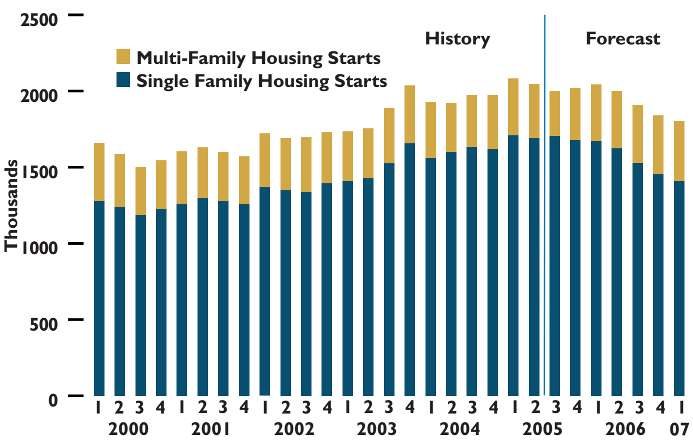
Sources: NAR, Bureau of the Census, NAR Forecast

Mortgage Rates
Rising, but still attractive for homebuying



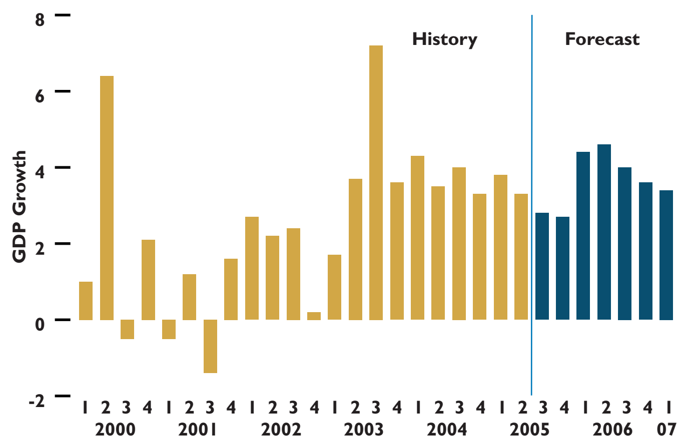
Sources: Freddie Mac, NAR Forecast

Housing Starts
Coming off record levels



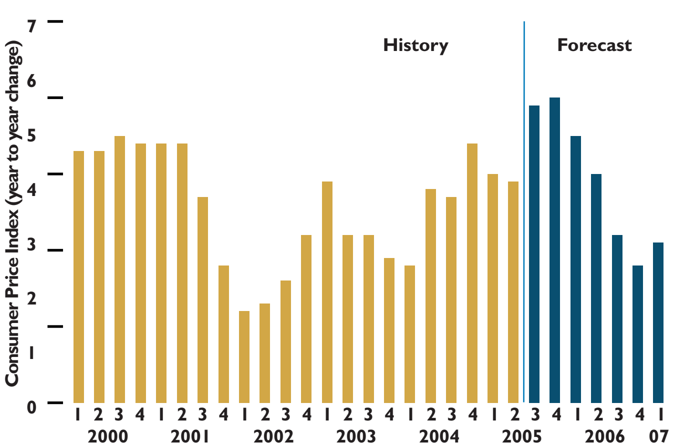
Sources: Bureau of the Census, NAR Forecast

Economic Growth
Underlying health weathering impact of Katrina & Rita



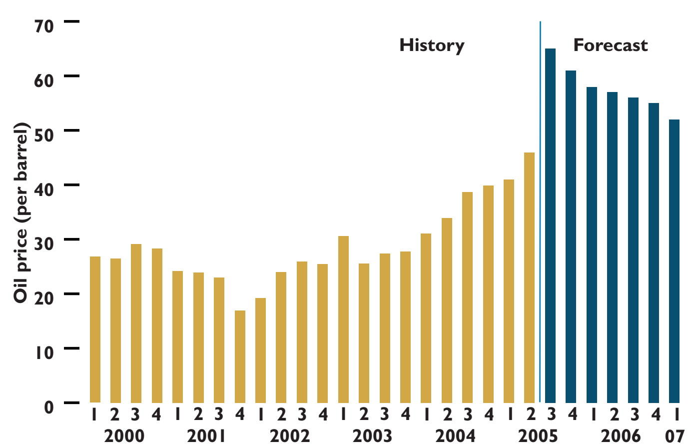
Sources: Bureau of Economic Analysis, NAR Forecast

Inflation
Second half spike primarily due to fuel prices



Sources: Bureau of Labor Statistics, NAR Forecast

Oil Prices



Sources: Department of Energy, NAR Forecast

U.S. ECONOMIC OUTLOOK
October 2005

	2004 IV	2005 I	II	III	IV	2006 I	II	III	IV	2007 I	2003	2004	2005	2006
U.S. Economy														
Annual Growth Rate														
Reall GDP	3.3	3.8	3.3	2.8	2.7	4.4	4.6	4.0	3.6	3.4	2.7	4.2	3.4	3.8
Nonfarm Payroll Employment	1.7	1.6	1.9	1.1	0.7	1.7	1.8	1.9	1.8	1.4	-0.3	1.1	1.6	1.5
Consumer Prices	3.6	2.4	4.2	5.5	3.9	0.6	2.2	2.1	2.2	2.0	2.3	2.7	3.5	2.6
Real Disposable Income	9.1	-3.4	1.5	-2.1	4.1	7.2	4.8	4.7	4.0	4.9	2.4	3.4	1.4	4.1
Consumer Confidence	96	104	102	99	99	100	102	104	105	106	80	96	101	103
Percent Unemployment	5.4	5.3	5.1	5.1	5.2	5.2	5.2	5.0	5.0	5.0	6.0	5.5	5.2	5.1
Interest Rates, Percent														
Fed Funds Rate	2.0	2.5	2.9	3.4	4.0	4.3	4.3	4.3	4.3	4.3	1.1	1.3	3.2	4.3
3-Month T-Bill Rate	2.0	2.5	2.9	3.4	3.9	4.1	4.1	4.1	4.1	4.1	1.0	1.4	3.2	4.1
Prime Rate	4.9	5.4	5.9	6.4	7.0	7.3	7.4	7.2	7.2	7.2	4.1	4.3	6.2	7.3
Corporate Aaa Bond Yield	5.5	5.3	5.1	5.1	5.5	5.8	6.0	6.1	6.1	6.2	5.7	5.6	5.3	6.0
10-Year Government Bond	4.2	4.3	4.2	4.2	4.6	4.8	4.9	5.0	5.0	5.1	4.0	4.3	4.3	4.9
30-Year Government Bond	4.9	4.7	4.5	5.0	5.3	5.5	5.6	5.6	5.7	5.7	5.1	5.1	4.9	5.6
Mortgage Rates, percent														
30-Year Fixed Rate	5.7	5.8	5.7	5.8	6.2	6.4	6.5	6.6	6.7	6.8	5.8	5.8	5.9	6.5
1-Year Adjustable	4.1	4.2	4.3	4.5	4.9	5.1	5.2	5.2	5.2	5.3	3.8	3.9	4.5	5.2
Housing Indicators														
Thousands														
Existing Home Sales*	6,877	6,837	7,223	7,168	6,987	6,850	6,803	6,823	6,796	6,829	6,183	6,784	7,071	6,809
New Single-Family Sales	1,243	1,249	1,297	1,312	1,295	1,289	1,259	1,192	1,141	1,107	1,086	1,203	1,289	1,223
Housing Starts	1,973	2,083	2,044	2,001	2,022	2,042	2,000	1,909	1,841	1,804	1,854	1,950	2,038	1,948
Single-Family Units	1,621	1,709	1,693	1,705	1,681	1,674	1,625	1,528	1,453	1,410	1,505	1,604	1,697	1,570
Multifamily Units	352	374	351	296	340	368	375	382	388	394	349	345	340	378
Residential Construction**	571	584	599	605	606	607	605	595	579	566	509	562	599	596
Percent Change – Year Ago														
Existing Home Sales	8.1	8.2	4.7	5.5	1.6	0.2	-5.8	-4.8	-2.7	-0.3	9.8	9.7	4.2	-3.7
New Single-Family Sales	10.8	5.0	7.8	12.8	4.2	3.2	-2.9	-9.2	-11.9	-14.1	11.9	10.8	7.1	-5.1
Housing Starts	-3.1	8.0	6.3	1.3	2.5	-2.0	-2.2	-4.6	-9.0	-11.7	8.4	5.2	4.5	-4.4
Single-Family Units	-2.2	9.4	5.9	4.3	3.7	-2.0	-4.0	-10.4	-13.6	-15.8	10.3	6.6	5.8	-7.5
Multifamily Units	-7.0	1.9	8.6	-12.6	-3.3	-1.7	6.9	28.7	13.9	7.0	0.6	-0.9	-1.4	11.1
Residential Construction	6.6	7.7	6.1	6.4	6.1	3.8	1.0	-1.8	-4.4	-6.6	8.4	10.3	6.6	-0.4
Median Home Prices														
Thousands of Dollars														
Existing Home Prices	189.3	190.3	209.3	217.3	211.5	203.0	219.3	228.6	221.3	211.8	169.5	185.2	208.4	219.2
New Home Prices	227.8	229.9	228.0	219.2	243.7	246.2	245.1	235.2	259.6	259.3	195.0	221.0	229.7	246.0
Percent Change – Year Ago														
Existing Home Prices	9.7	10.2	13.4	14.8	11.7	6.6	4.8	5.2	4.6	4.4	8.5	9.3	12.5	5.2
New Home Prices	14.4	8.0	5.3	2.4	7.0	7.1	7.5	7.3	6.5	5.3	3.9	13.3	3.9	7.1
Housing Affordability Index	132	133	121	117	118	120	111	107	110	113	138	133	122	112

*Quarterly figures are seasonally adjusted annual rates. / * Existing home sales of single-family homes and condo/coops; ** billion dollars / Source: Forecast produced using Macroeconomic Advisers quarterly model of the U.S. economy. / Assumptions and simulations by Dr. David Lereah and Dr. Lawrence Yun.*

New Home Sales

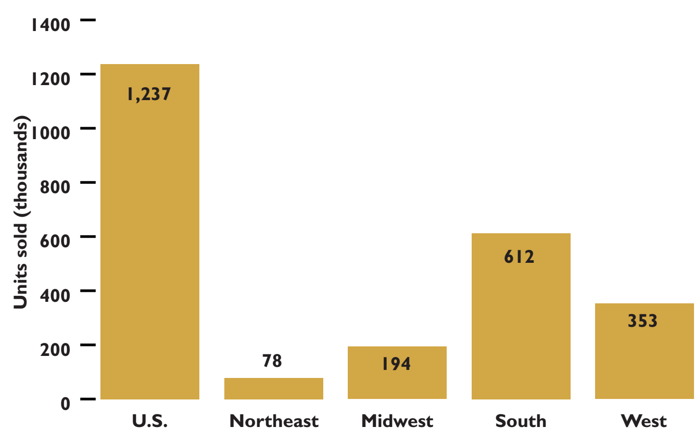
by NAR Staff

The National Association of REALTORS® tracks existing-home sales on national, regional, and state levels. But new home sales also play an important role in the housing market and savvy real estate professionals are increasingly working with new home builders and sellers to take advantage of this additional business. According to NAR's ***Profile of Homebuyers and Sellers***, 21 percent of homebuyers in 2004 purchased a newly constructed home.

That number coincides with the usual make-up of home sales activity. Approximately 15 percent of *all* home sales (includes new + existing) are new homes. In addition to the regular market forces of supply and demand, the percentage share of new homes varies due to the fact that new home supply is contingent on building conditions, cost of production, and local zoning ordinances. For instance, in 1991, 13.9% of total home sales were new homes, versus 15% in 2004. However, despite the annual fluctuations, the overall ratio of new-to-existing home sales has been consistent for the last decade.

Another important statistic is housing starts. A look at housing starts (an indicator of future new home supply) can give real estate professionals important data that could help them in planning for marketing new homes to potential clients. Below is a look at both single-unit housing starts* and new home sales in each of the four regions of the U.S.

New Home Sales*
August 2005



Source: Bureau of the Census
**seasonally adjusted annualized rate*

Northeast

There were 138,000 single housing starts (seasonally adjusted annualized rate) during August in the Northeast – a 2.2 percent increase from July's level, and 1.5 percent above that of August 2005. While new home sales in the region decreased 22 percent from the previous month to a level of 78,000 units, they increased 16.4 percent from August 2004 to August 2005.

Midwest

The Midwest region experienced a decline in both housing starts and new home sales during August. New home sales decreased 10.6% from both July's level and from August a year ago, posting 194,000 seasonally adjusted annualized units. This is the fourth month in a row that new unit sales declined. Housing starts also slipped. With 301,000 single-housing units starts in August, that's a 4.7% decrease from July and a 6.5% decrease from August of 2004.

South

New home sales in the south stood at 612,000 seasonally adjusted annualized units in August. While the volume is a 2.2 percent drop from July's new sales, it represents a 13.1% increase from year ago levels. Single-family housing starts also posted a negative month to month change, but positive year over year comparison. Starts were down 4.4% from July, but up 1.4% from August 2004, with 784,000 seasonally adjusted single unit starts.

The West

Housing starts in the West showed positive performance on both month to month and year over year measurements. The region posted 486,000 single-unit starts in July, for a 11.5% increase for the month, and a 6.1% increase from August 2004 levels. New home sales in the region decreased 17.9% from July's sales volume, but a 3.8% increase from year ago levels, with 353,000 new homes sold.

Tracking New Home Sales

The potential supply of new homes can be monitored by visiting the Census

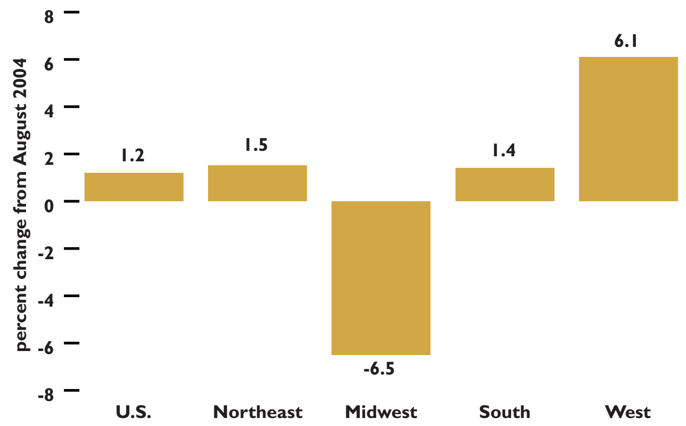
Data on new home sales (new residential construction) and housing starts are collected by the Bureau of the Census. For more detail on the numbers, visit **www.census.gov/newresconst** and **www.census.gov/newhomesales**.

Bureau's web site. The site provides figures on:

- housing permits – the number of new privately owned housing units authorized, but not started
- housing starts – the number of new privately owned housing units started. The data series includes all housing starts, including single-family (1-unit), 2-4 units (such as duplexes), and multifamily units.
- the number of housing units under construction
- the number of new housing units completed

By monitoring these statistics, real estate professionals can analyze supply and demand conditions of the new home market throughout the country.

Single-unit Housing Starts
August 2005



Source: Bureau of the Census

For the latest insights and analysis on new home market data from NAR Research, visit www.realtor.org/research

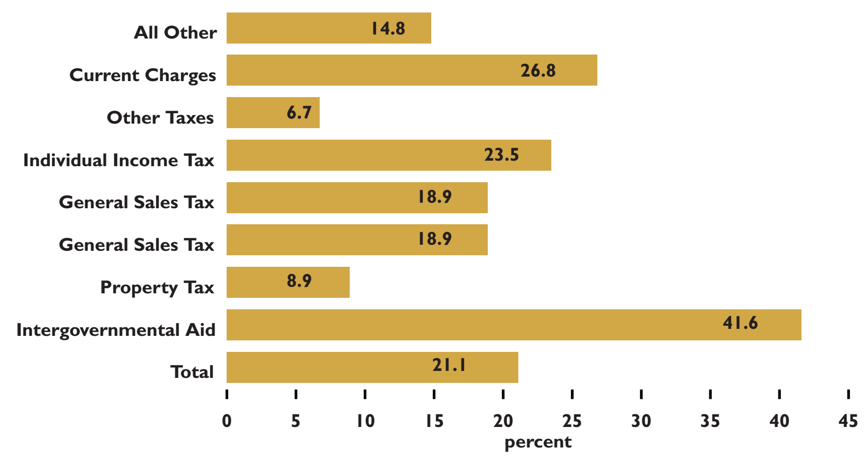
Want more information about new home construction? NAR has a tool for you at ***Real Estate Intelligence***, a collection of historical data on housing starts, housing permits, and new home sales. For information on how to subscribe to this database, click on Buy Research.

State and Local Fiscal Trends and Future Threats

by NAR Staff

Economic, political, and technological developments have dramatically changed how state and local governments raise revenue as well as on what they spend that revenue. The aging of the population, the increasing importance of services and intangible assets in the economy, globalization and shifting responsibilities that frequently lead to unfunded mandates and shortfalls in state and local revenues. However, the finance structures in place to collect state and local taxes have not changed significantly over the past five decades. A new report from the State and Local Fiscal Research Institute of the REALTORS® National Center for Real Estate Research describes state and local fiscal systems and the trends affecting their revenue and expenditures, and challenges that face states and local jurisdictions in the future.

Changes in State and Local Per Capita Revenue by Source
1992-2002



The Study

The study, "State and Local Fiscal Trends and Future Threats" by researchers at the George Washington University* examines how changes in the structure of the U.S. economy are challenging state and local governments in generating revenue. The economy in which most of the state and local revenue systems were designed to operate has been replaced with a high technology, global economy where purchasing services or products from other areas of the world is only a few keystrokes away. Because state and local governments have been unable to impose sales taxes on most electronic commerce, they have lost billions in tax revenue. These losses have put enormous pressure on governments to find alternative sources of revenue or curtail public spending.

In addition, the report details the amounts collected from all sources by state and local governments as of 2002, and looks at the differences that exist across the 50 systems of state and local government in the U.S. Specifically, the report details the relative importance of state government in raising revenues as well as differences in the relative size of state and local governments across the 50 states. The research finds clear differences between the fiscal structures of state and local governments as well as the relative size of state and local governments across different regions of the country.

Major Findings

In 2002, state and local governments collected a total of $1.7 trillion in general revenue, 78.6 percent of which came from their own sources including taxes, current charges and other non-tax revenue. Of the own-source general revenue, 68.3 percent represent tax revenues, while taxes amounted to 53.7 percent of the total general revenue. Taxation remains the most important source of government revenues, albeit the relative importance of tax revenues declined during the 1990s.

State and local government general revenues increased in real terms by 33.6 percent between 1992 and 2002 and by 21.1 percent per capita. On a per capita basis, state and local own source revenues increased by 16.5 percent, state and local taxes by 13.8 percent, and current charges by 28.8 percent. The largest increase in per capita tax revenues came from the individual income tax (23.5 percent), followed by

*The research was conducted by David Brunori, Michael E. Bell, Harold Wolman, Patricia Atkins, Joseph J. Cordes, and Bing Yuan of the George Washington Institute of Public Policy of the George Washington University. The full report is available at **www.realtor.org/ncrer**.

the general sales tax (18.9 percent), the property tax (8.9 percent), and selective sales taxes (8.2 percent). Per capita receipts from the corporate income tax declined by 17.0 percent in real terms. Real per capita federal intergovernmental aid to state and local governments increased by 41.6 percent.

The report also provides detailed information on expenditures for state and local governments in 2002 and notes expenditure trends for the ten previous years. The report also describes differences in expenditure patterns among the states and localities and between state and local fiscal systems. Total state and local expenditures increased in real terms by 38.2 percent from 1992-2002 and by 25.3 percent per capita. The greatest increases occurred in the area of public safety (31.6 percent per capita) and education (28.3 percent per capita). Real state expenditures per capita increased by 28.1 percent compared to 22.4 percent for local governments. The greatest per capita increases in state direct general expenditures were for public safety (38.0 percent) and education (31.6 percent). Similarly, the greatest increases at the local level were for public safety (28.3 percent) and education (26.9 percent).

Services are not generally subject to sales taxes, but services now make up more than half of U.S. personal consumption. This has resulted in a substantial loss of sales tax revenue and greater reliance on other types of taxes.

Challenges for State and Local Governments

A variety of external factors have influenced how state and local government raise revenue. Changing demographics, particularly an aging population, is one such external factor. Older people tend to spend less on taxable items and more on tax-exempt items like healthcare products, putting pressure on sales tax revenue. Similarly, 27 states out of the 41 states with an income tax exempt Social Security income from state income taxation, and 34 of those 41 states exempt at least some public pension income.

The continuing shift toward a service and high technological economy raises many issues for state and local governments. Services are not generally subject to sales taxes, but services now make up more than half of U.S. personal consumption. This has resulted in a substantial loss of sales tax revenue and greater reliance on other types of taxes. Efforts to expand the sales tax base to include more services have largely been unsuccessful. Similarly, intangible assets have never been a major component of subnational tax bases, yet the growth of the technology sector has made intangibles an increasingly important part of the economy. The rapid spread of electronic commerce also has had a profound impact on state and local tax revenue, especially sales tax revenue. State and local governments have largely been unable to impose sales taxes on Internet transactions and stand to lose hundreds of millions of dollars in revenue.

The increases in the number and costs of unfunded federal mandates have also had an effect on state and local public finance. Federal laws regarding public safety, education, welfare services, and health care have put pressure on the ability of state and local governments to meet their normal public service responsibilities. Another trend that has affected state and local government finance has been the shift in governmental responsibilities. State and local governments are spending more on public safety and homeland security issues than ever before. State governments have also assumed a greater role in financing K-12 education, once the province of local governments, and a greater role in welfare, once the province of the federal government.

In addition to the financial pressures from shifting responsibilities, the politics of anti-taxation has limited state and local governments' ability to raise revenue precisely when the demand for services and education spending has increased. Since the late 1970s there has been a concerted effort to politicize, even demonize, taxation.

The report also describes several recent developments that have affected state and local public finances. The most significant development has been the proliferation of tax and expenditure limitations, mainly arising from the public's unhappiness with the property tax. Yet another development affecting the property tax has been the spread of property tax exemptions for non-profit organizations.

Still another development has been the issue of public education finance equalization. Courts in 18 states have ruled that using the property tax to finance public education violates the state constitution. Because local governments have traditionally relied on property taxes to fund K-12 education, the litigation has created significant problems as states struggle to find new ways of financing education.

Importance for REALTORS®

What are the implications of these current and likely future fiscal trends on the real estate sector? The answer is complex because it involves the interaction between state and local taxes, and how the revenues from such taxes are spent. One view is that higher taxes are not good for the economy and are likely to depress real estate values. But some argue that the issue is more complicated, not least because one factor that clearly affects real estate values is the bundle of public services that "comes with" a piece of either residential or commercial property. There is, for example, considerable evidence that home values are positively affected by the quality of local schools, which depends in part on adequate financing of public schools.

One important corollary of this general point is that the effect of taxes on real estate values depends on how the revenues are used. To a very rough first approximation, when revenues are used to maintain or to enhance public services that are valued by households and businesses, the "cost of paying higher taxes" can be offset, either partially or wholly by the "benefits of public services". An implication is that in some cases, raising taxes to finance needed public services can actually maintain or increase real estate values. This process is not likely to occur, however, when tax revenues are used to finance redistributive transfers, and in such cases, raising taxes to finance redistribution may have undesirable, though unintended, effects on local economic activity, and ultimately on real estate values.

Federal laws regarding public safety, education, welfare services, and health care have put pressure on the ability of state and local governments to meet their normal public service responsibilities.

To meet the growing need for credible research and analysis on the impact of state and local fiscal policy, the REALTORS® National Center for Real Estate Research established the State and Local Fiscal Research Institute. The Institute sponsors research and analysis on state and local fiscal policy topics.

Links to Statistical Data Series

To view the latest housing statistics from NAR, click on the links below.

Existing Home Sales – Monthly series

- **August existing home sales and median sales prices** – single-family and condominiums/co-ops
- **Single-family home sales and median sales prices**
- **Condominium/co-op sales and median sales prices**
- The latest EHS statistics in spreadsheet format available **here**

Existing Home Sales and Metropolitan Area Median Home Sales Prices – 2nd Quarter 2005

- 2nd Quarter 2005 **existing home sales by state**
- Existing home sales by state in **spreadsheet format**
- 2nd Quarter 2005 **Median Home Prices by Metropolitan Area**
- Metropolitan Area Home Prices in spreadsheet format

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    - **2nd Quarter 2005 Affordability Index**
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    - **First-time homebuyer Affordability Index**, 2nd Quarter 2005
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