

The new economy

When the recession eases, Illinoisans may find a different financial landscape

by Marcia Frellick

Buz Hoffman, like most other homebuilders, didn't see the full force of this recession coming.

Just three years after sales peaked at \$415 million for the private company he founded, Lakewood Homes in Hoffman Estates, sales plummeted to \$68 million in 2008, according to *Builder* magazine rankings.

"I'm not even going to call it a recession — it's a full-blown depression in real estate," says Hoffman, son of the late Chicago homebuilding legend Jack Hoffman, for whom the Chicago-area village of Hoffman Estates is named.

So now, the company is in a holding pattern, waiting for lenders to extend more credit, for municipalities to ease design restrictions and impact fees (one-time charges for builders and developers) and for the flood of foreclosures to slow. As long as foreclosures continue to mount — Illinois now ranks sixth highest in the nation — home prices are kept lower than the natural laws of supply and demand ordinarily would dictate.

For now, his company is working as a consultant with banks to manage the bulging inventory of properties they've taken over. "You have to be flexible to the point of thinking of things you never would have thought of before," Hoffman says.

Recovery will be painfully slow and will take years, he says. When it comes, he expects to see smaller houses and greener homes being built.

"In the run-up to 2006, it wasn't a question of just having shelter. Having a house became a privilege rather than a necessity. People wanted granite instead of Formica, ceramic instead of vinyl on the floors. Now the builders that survive will have to get back to basics."

That also means basics in green design. Owners have been inundated with the green message and are looking to have at

minimum houses that are better insulated and systems and appliances that are more efficient than in the past, Hoffman says.

Home building is just one of the industries waiting for positive turns in the economic forecast and to see how consumers' lifestyles and desires will emerge after the slump.

And there are reasons for optimism, just more than a year after Lehman Brothers Inc. collapsed in September of 2008, spinning the world into a financial panic.

One of the most positive messages was acknowledgment of relief from the top. Federal Reserve Chairman Ben Bernanke said September 15 that "from a technical perspective, the recession is very likely over."

Stocks have climbed back close to 50 percent since their March 9 low. At the end of September, the consumer confidence index was at 53.1, rebounding from a 42-year low of 25 in February. However, it takes a reading of 100 to signal strong growth.

Retail sales gained 2.7 percent from July to August, the largest jump in three years, thanks in large part to this summer's wildly popular "Cash for Clunkers" program, which offered consumers rebates of \$3,500 and \$4,500 to trade in their older cars and trucks for more fuel-efficient models. Suddenly, beleaguered auto dealers couldn't keep enough cars on the lot.

And in September, national home sales saw a fourth-straight monthly rise. In Illinois, home sales were up in 32 of 99 counties surveyed from August 2008 to August 2009 — up as much as 33.6 percent in DeKalb County, according to the Illinois Association of Realtors.

But one area still mired in the depths of recession is job loss, which continues to climb to levels not seen in 26 years. The number of the nation's unemployed grew to 9.8 percent for September. Bernanke acknowledged in his September economic forecast that although the economic outlook is improving, job loss is likely to persist and the nation likely will see 10 percent unemployment this year. Since December of 2007, the nation has lost a net total of 6.9 million jobs, 342,800 of them in Illinois.

In Illinois, unemployment in August was 10 percent, slightly down from 10.4 percent in July. As in past recessions, current job loss is seen as a lagging indicator — the rest of the economy will get better before we see significant improvement in the jobs forecast.

“Job creation will be slow to bounce back,” says John Challenger, chief executive officer of the national outplacement firm Challenger, Gray & Christmas headquartered in Chicago. “Employers are sitting on the people they have. Before they create a lot of jobs, they will move part-timers to full-time, hire temporary workers and pay overtime.”

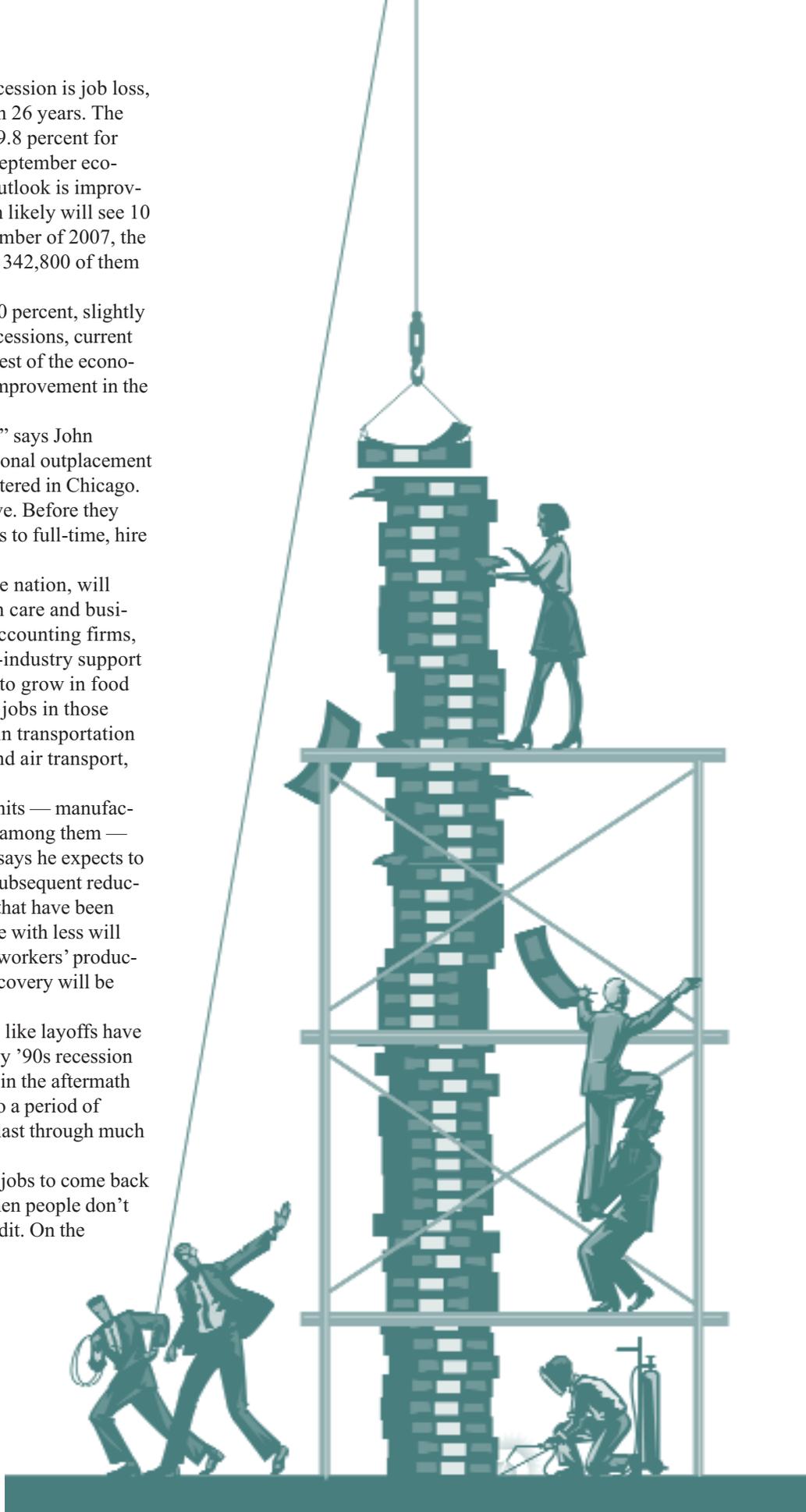
Challenger says Illinois, like the rest of the nation, will move into an economy based more on health care and business services — consulting, law firms and accounting firms, for instance — than on manufacturing, auto-industry support and construction. Illinois will also continue to grow in food and agriculture sectors and will create more jobs in those areas. Chicago will grow as a global leader in transportation and logistics, a hub for shipping, trucking and air transport, he says.

Since some of the areas taking the biggest hits — manufacturing, home building and construction chief among them — were heavily dominated by men, Challenger says he expects to see a more gender-balanced work force and subsequent reduction in the pay gap between the sexes. Staffs that have been pared to the bone and have learned to do more with less will increasingly be looking for ways to measure workers' productivity and base more pay on performance. Recovery will be very slow, Challenger says.

“Nobody's creating too many jobs. It looks like layoffs have slowed down. It took 15 months after the early '90s recession for job creation to recover. It took 19 months in the aftermath of the 2001 recession. Now we've moved into a period of recovery over the summer, which will likely last through much of 2010,” he says.

Analysts and economists also don't expect jobs to come back to pre-recession levels anytime soon. And when people don't have jobs, lenders are not quick to extend credit. On the positive side, since access to credit is harder to get, people who had funded lifestyles that were way beyond their reach are paying down their debt instead of adding to it and saving more. But tighter credit also keeps money from flowing to businesses and families and frustrates consumers trying to move forward.

In Illinois, consumers' complaints about how their debt is being handled — including concerns about mortgage and credit card



debt and actions by collection agencies — were 28 percent higher in 2008 than in 2007, Illinois Attorney General Lisa Madigan reported.

Attempts to resuscitate cash flow — most notably the Fed's drop in the federal funds interest rate from 2 percent to 0.25 percent in December of 2008 and the \$787 billion federal stimulus package approved this year — are helping put money back into consumers' hands, says Andrew Busch, senior fellow on economic matters at the Illinois Policy Institute, a Chicago-based think tank.

"There's a tremendous amount of money floating around in the system," Busch says. "Somehow it will find its way to the consumer. It will be more expensive than it has been because lenders are demanding a higher rate of return. Eventually it will ease. It may take 18 to 24 months to get a stabilization in consumer credit."

During that period, consumers would be wise to stay in the stock market, says Busch, who expects 15 percent to 20 percent growth in stocks over the next 18 months. Companies have reduced employment and inventories, and recent growth has exceeded analysts' expectations in the second half of this year.

The question is what happens after that. Stimulus, credit support and monetary easing come with a cost. They have added to the national debt, and that will have to be addressed at some point. Without a careful exit strategy for those unprecedented programs, Busch says, we will experience a waterfall effect that can lead to massive inflation.

Greg McBride, senior financial analyst for Bankrate.com, views the availability of credit in terms of a pendulum — one that had swung way too far toward easy credit before the financial collapse.

"Before the recession, if you could fog a mirror, you could get a loan," McBride says. "People were getting loans without being able to document their income or prove their credit was good. Now the pendulum has swung to the restrictive side. Ultimately, we will settle in the middle. It will loosen, but we're not going to get close to the go-go days of the housing boom."

McBride predicts we will soon see the return of more of the lower down-payment programs — 5 percent and 10 percent down as opposed to the 20 percent to 25 percent generally required now — but he says no longer will consumers get a house without the three fundamentals: good credit, proof of income and money for a down payment.

Consumers who had counted on their homes to fund their retirements and now have watched the value sink, or those who lost homes they can no longer afford, are also rethinking when they can retire and what that might look like.

Some have cut back on or stopped funding retirement so they can pay other bills. According to an AARP survey this year, 36 percent of people ages 45 to 54 have stopped putting money into their 401(k) or other retirement accounts.

People close to retirement age have watched their investments wither. Even the traditional stock portfolio of 60 percent stocks/40 percent bonds that had weathered previous downturns was taking a hit in 2008 and depleting nest eggs, says certified financial planner Jeff Rose, co-founder of Alliance Investment Planning Group in Carbondale.

"Even in 2001-2002 and prior bear markets, this portfolio had held its own. But in 2008 — traditional portfolios were down 15 to 25 percent. For comparison, in 2002, they were down only about 7 percent [to 10 percent]."

"No one saw this coming. I'm more in the 15 percent to 25 percent in stocks and the rest in bonds right now, depending on the retiree's situation," Rose says.

Many who expected to be in their peak earning years have lost their jobs, and those who haven't may have lost confidence in their 401(k)s as more employers have cut back or stopped the company match. Even if your employer has stopped contributing to it, 401(k)s are still the best retirement vehicle out there, Rose says.

"No other avenues will allow you to save as much pretax," he says. The trick is knowing what you have and educating yourself on the options offered, he says.

When credit eases, home values increase and people have more to spend and more confidence in spending it, retailers may find shoppers' habits have changed, and competition will be fierce. Before the recession, consumers who felt more secure in their jobs and home values had the disposable income to satisfy their curiosity for items such as expensive phones and electronic gadgets and were able to spend more on bigger vehicles and expensive vacations.

A recent IBM study, *Shopper Advocacy: Building Consumer Trust in the New Economic Environment*, shows that tighter budgets and lower confidence have upended consumer behavior and made purchasers more willing to shop only with retailers they trust. Their answers indicated a new wave of fiscal conservatism.

Two-thirds of consumers surveyed said they are postponing purchases or buying fewer items, while 60 percent said they are more often looking for sales and using more coupons.

Shoppers indicated those habits will last even after the economy recovers.

Similarly, in a recent survey by the Consumer Reports National Research Center, 71 percent of respondents said during the economic downturn, they have purchased only what they absolutely needed; 61 percent said they ate dinner out less often; and 58 percent spent less on vacations. Many respondents said they would continue those behaviors after the recession is over.

"I'm very skeptical that we'll have a generation of anything close to the frugality we saw after the Great Depression," McBride says. "American consumers like their fancy cars, their nice restaurants, their big houses and their overpriced coffee. Consumers are striking the balance between cutting back but not living a Spartan existence."

"Instead of \$4 coffee every morning, it will be \$4 coffee three times a week." □

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