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DEPARTMENT OF ECONOMIC SECURITY

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*Your Partner For A Stronger Arizona*

# Arizona Unemployment Insurance Trust Fund Solvency Update

# Overview

- Update the business community on the Arizona Unemployment Insurance Trust Fund status.
- Discuss impacts to the State and its employers of the UI Trust Fund.
- Outline options that can be enacted to mitigate employer risks.



# Topics for Discussion

- Funding of benefit payments
  - Interest Cost
- Impacts of borrowing to continue paying benefits
  - Federal Unemployment Tax Act (FUTA) Credit Loss
- Options to increase contributions to the Trust Fund in order to avoid interest charges and loss of FUTA credit



# Current Trust Fund Status

- The State began borrowing funds from the U.S. Department of Labor (U.S. DOL) on March 22, 2010.
  - As of October 19, 2010 the state has borrowed \$358 Million and repaid \$188 Million. The State has a current loan balance of \$170 Million.
  - The maximum weekly benefit amount in Arizona is \$240 per week.
- Arizona is one of 31 states and 1 U.S. Territory who are currently borrowing from the U.S. DOL to fund benefits.
- Pursuant to the American Recovery and Reinvestment Act (ARRA), interest will not be payable in 2010, reducing the cost of borrowing for at least 2010.



# Impacts of Borrowing

- Interest will accrue beginning in 2011 for:
  - Outstanding loan balances
  - New borrowing
- Interest is estimated to be charged at an average annual rate of 4.6% and calculated on the average daily outstanding balance.
- Projections indicate that the State will need to borrow into calendar year 2013.



## Impacts of Borrowing (Cont.)

- Current projections indicate that the State and its employers will incur interest charges of \$12 - \$13 Million in calendar year 2011. This amount is up from the April projection of \$8 - \$10 Million.
- Interest cannot be paid from regular trust fund collections (i.e. State Unemployment Tax collections).
- Interest must come from an assessment on employers.



# Potential FUTA Implications

- Potential Federal Unemployment Tax Act (FUTA) implications when borrowing funds from the U.S. DOL:
  - The FUTA tax rate is 6.2% on the first \$7,000 of wages an employee earns, but the state's employers receive a 5.4% credit against that rate since the state has a qualified UI program in place.
  - Currently, employers pay a 0.8% FUTA rate (\$56/employee per year).



# Example: FUTA Reductions for Arizona

## January 1<sup>st</sup> and November 10<sup>th</sup> are Key Dates:

- Arizona will have an outstanding loan balance on January 1, 2011. This will be the first January 1 where the state will have a loan balance.
- There will continue to be a loan balance on January 1, 2012. This will be the second January 1 with an outstanding loan balance.
- If the loan balance is not repaid before November 10, 2012, the state's employers would lose 0.3% of the FUTA credit.



# Additional FUTA Considerations

- If economic recovery does not occur, the State and its employers will most likely have an outstanding loan balance that it can not repay by November 10, 2012.
  - Triggers the increased FUTA tax rate for employers.
  - State and employers will incur additional interest charges.
- There is a 25% chance for a double dip recession according to current national economic analysis (Source – IHS Global Insight). This is up 10% from the April Report.



# FUTA Impact

## Schedule of FUTA Offset Credit Reductions if Economic Recovery Does Not Occur

Year	Basic FUTA Increase	Additional FUTA Increase	Potential FUTA Rate
2011	0.0%	0.0%	0.8%
2012	0.3%	0.0%	1.1%
2013	0.6%	Up to 2.7% add-on*	1.4% min. (up to 4.1%)
2014	0.9%	Up to 2.7% add-on*	1.7% min. (up to 4.4%)

\*The 2.7% add-on is based on a calculation completed by the U.S. DOL if the state has an outstanding loan balance on November 10<sup>th</sup> of each consecutive year.

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# Cost Per Employee With FUTA Credit Losses

	Tax Component	CY 2010	CY 2011	CY 2012	CY 2013	CY 2014
<b>Cost per employee</b>	FUTA	\$ 56	\$ 56	\$ 77	\$287	\$308
	State UI Tax	\$145	\$157	\$161	\$161	\$161
	Assessment	<u>\$ 0</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>
	<b>Sub-Total</b>	<b>\$201</b>	<b>\$220</b>	<b>\$245</b>	<b>\$455</b>	<b>\$476</b>
	Job Training Tax	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>
	<b>Total</b>	<b>\$208</b>	<b>\$227</b>	<b>\$252</b>	<b>\$462</b>	<b>\$483</b>

This assumes a “worst case scenario,” under which the state is not able to re-pay federal loans due to continued economic conditions.



# Changes in the Forecast

- The following items have led the Department to revise the Trust Fund projection through 2013:
  - August and September economic forecasts have indicated a slower than expected recovery than what was projected in April 2010.
  - Employer payrolls which were expected to increase slightly into 2011, have been revised downward by 0.2% from April which will result in lower taxable wages and less revenue into the Trust Fund.
  - The unemployment rates for 2010 – 2011 were revised upward by 0.1% and for 2012 – 2013 were revised upward by 0.5%. This will result in higher benefit costs in those calendar years resulting in higher benefit costs than projected in April 2010.
  - The growth in personal income levels was revised downward by 0.3% in 2011, 0.6% in 2012 and 0.5% in 2013. This will result in lower taxable wages and less revenue into the Trust Fund.



# Impact of Changes in the Forecast

- The Trust Fund projection from April indicated that, without any additional revenue from assessments or other sources, the fund balance would be \$15 Million in the third quarter of 2012. The risk of potential FUTA credit losses was moderate due to the low balance of \$15 Million. The fund would go negative again in the first quarter of 2013 due to cash flow issues, but would return positive in the second quarter.
- The revised projection indicates that the fund will have a negative balance through the first quarter of 2013, with no period of solvency before then.
- Due to the fund having a negative balance for the entire 2012 calendar year, the State's employers would lose 0.3% of the FUTA credit they currently receive. This will increase employer FUTA taxes on a per employee basis by \$21 for wages earned in 2012.
- Borrowing from the federal government is also higher in the revised projection, and reaches a high point of \$377 Million in the first quarter of 2011. This is up from the previous projection of \$341.7 Million for the same quarter. This will lead to higher interest costs than originally projected.

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# Options to Address Trust Fund Solvency

All Options Assume Economic Recovery Continues At Current  
Projected Level



## Option 1 – Take No Action:

- Maintain the status quo by borrowing from the federal government.
  - Pro: No interest payable in 2010 due to ARRA provisions, reducing costs to employers. Interest free period is unlikely to be extended by Congress.
  - Con: Does not address long term fund solvency and exposes the State and employers to the risk of FUTA credit reductions if the economy stagnates or declines. Interest payments will be \$12 - \$13 Million in 2011 requiring additional funding outside State unemployment tax collections. Additional interest costs of \$7 - \$8 Million in 2012 would be due as well.
  - Employers would lose 0.3% of FUTA credit in 2012 and their cost per employee for FUTA would rise by \$21.



# Cost Per Employee

<b>Option 1 – Continues borrowing from US DOL and does not generate any additional contributions to the fund. Option assumes interest free period from US DOL ends 12/31/2010.</b>	<b>CY 2010</b>	<b>CY 2011</b>	<b>CY 2012</b>	<b>CY 2013</b>	<b>Total Cost Per Employee</b>
FUTA Tax	\$ 56	\$ 56	\$ 77	\$ 56	\$245
State UI Tax	\$146	\$157	\$161	\$161	\$625
Assessment for Interest <sup>1</sup>	\$ 0	\$ 7	\$ 7	\$ 0	\$ 14
<b>Sub-Total</b>	<b>\$202</b>	<b>\$220</b>	<b>\$245</b>	<b>\$217</b>	<b>\$884</b>
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
<b>Total Taxes Paid</b>	<b>\$209</b>	<b>\$227</b>	<b>\$252</b>	<b>\$224</b>	<b>\$912</b>
UI Trust Fund Beginning Balance (in millions)	\$ 160.0	\$(280.0)	\$(290.0)	\$(120.0)	
Fund Revenue <sup>2</sup>	\$ 350.0	\$ 380.0	\$ 420.0	\$ 500.0	
Fund Outlays	\$(790.0)	\$(390.0)	\$(250.0)	\$(230.0)	
Ending Balance	<b>\$(280.0)</b>	<b>\$(290.0)</b>	<b>\$(120.0)</b>	<b>\$ 150.0</b>	

<sup>1</sup> The \$7 assessment in CY 2011 and CY 2012 is imposed to pay interest charges on federal loans. This option assumes the interest free period ends December 31, 2010. The assessment for interest would be a temporary assessment.

<sup>2</sup> Revenue for 2013 includes \$51 Million collected by the federal government through the FUTA credit loss of 0.3%. The tax will be assessed against wages in 2012, but collected in 2013 by the federal government and applied to the state's account.



## Option 2 – Take Some Action to Increase Revenue:

- Implement a temporary assessment on employers to return the trust fund to solvency.
  - Pro: Various percentages can be applied at different intervals in order to generate sufficient contributions to pay off all federal loans before any FUTA credit reductions and avoiding interest charges. The assessment would be triggered off once the trust fund solvency reaches a level where a full year of benefits are on deposit.
  - Pro: Temporary impact to employers instead of long term cost.
  - Con: Raises taxes for employers commencing in 2011 or 2012 depending on the option chosen.
  - Con: If the assessment is not in place early enough to generate additional contributions into the fund to cause a positive balance by November 10, 2012; employers will begin to lose a portion of the FUTA credit.



# Cost Per Employee

<b>Option 2A – .6% Assessment Beginning in 2011 and continuing through 2012. Option assumes interest free period from US DOL ends 12/31/2010.</b>	<b>CY 2010</b>	<b>CY 2011</b>	<b>CY 2012</b>	<b>CY 2013</b>	<b>Total Cost Per Employee</b>
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$157	\$161	\$160	\$624
Assessment <sup>1</sup>	\$ 0	\$ 42	\$ 42	\$ 0	\$ 84
<b>Sub-Total</b>	<b>\$202</b>	<b>\$255</b>	<b>\$259</b>	<b>\$216</b>	<b>\$932</b>
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
<b>Total</b>	<b>\$209</b>	<b>\$262</b>	<b>\$266</b>	<b>\$223</b>	<b>\$960</b>
UI Trust Fund Beginning Balance (in millions)	\$ 160.0	\$(280.0)	\$(210.0)	\$ 70.0	
Fund Revenue	\$ 350.0	\$ 460.0	\$ 530.0	\$ 460.0	
Fund Outlays	\$(790.0)	\$(390.0)	\$(250.0)	\$(240.0)	
Ending Balance	<b>\$(280.0)</b>	<b>\$(210.0)</b>	<b>\$ 70.0</b>	<b>\$ 290.0</b>	

<sup>1</sup> The .60% assessment on the \$7,000 taxable wage base amounts to \$42 per employee, on average, and should provide sufficient additional contributions to address fund solvency while avoiding loss of FUTA credit reductions. The assessment notice for 2011 would be sent to employers with their regular tax notices in January 2011. The trust fund would have a positive balance by the 2<sup>nd</sup> quarter of 2012. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary (2 years).



# Cost Per Employee

<b>Option 2B – .3% Assessment CY 2011 and .6% Assessment for CY 2012. Option assumes interest free period from US DOL ends 12/31/2010.</b>	<b>CY 2010</b>	<b>CY 2011</b>	<b>CY 2012</b>	<b>CY 2013</b>	<b>Total Cost Per Employee</b>
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$157	\$161	\$161	\$625
Assessment <sup>1</sup>	\$ 0	\$ 21	\$ 42	\$ 0	\$ 63
<b>Sub-Total</b>	<b>\$202</b>	<b>\$234</b>	<b>\$259</b>	<b>\$217</b>	<b>\$912</b>
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
<b>Sub-Total</b>	<b>\$209</b>	<b>\$241</b>	<b>\$266</b>	<b>\$224</b>	<b>\$940</b>
Interest Assessment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
<b>Total</b>	<b>\$209</b>	<b>\$241</b>	<b>\$266</b>	<b>\$224</b>	<b>\$940</b>
UI Trust Fund Beginning Balance (in millions)	\$ 160.0	\$(280.0)	\$(250.0)	\$ 20.0	
Fund Revenue	\$ 350.0	\$ 420.0	\$ 520.0	\$ 460.0	
Fund Outlays	\$(790.0)	\$(390.0)	\$(250.0)	\$(240.0)	
Ending Balance	<b>\$(280.0)</b>	<b>\$(250.0)</b>	<b>\$ 20.0</b>	<b>\$ 240.0</b>	

<sup>1</sup> The .3% assessment in CY 2011 on the \$7,000 taxable wage base amounts to \$21 per employee and the .6% assessment amounts to \$42 per employee, on average, and could provide sufficient additional contributions to address fund solvency while avoiding loss of FUTA credit reductions. The trust fund would have a marginal positive balance by the 3<sup>rd</sup> quarter of 2012. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary (2 years).



# Cost Per Employee

<b>Option 2C – .4% Assessment for CY 2011 &amp; .6% Assessment for CY 2012. Option assumes interest free period from US DOL ends 12/31/2010.</b>	<b>CY 2010</b>	<b>CY 2011</b>	<b>CY 2012</b>	<b>CY 2013</b>	<b>Total Cost Per Employee</b>
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$157	\$161	\$161	\$625
Assessment <sup>1</sup>	\$ 0	\$ 28	\$ 42	\$ 0	\$ 70
<b>Sub-Total</b>	<b>\$202</b>	<b>\$241</b>	<b>\$259</b>	<b>\$217</b>	<b>\$919</b>
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
<b>Sub-Total</b>	<b>\$209</b>	<b>\$248</b>	<b>\$266</b>	<b>\$224</b>	<b>\$947</b>
Interest Assessment	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
<b>Total</b>	<b>\$209</b>	<b>\$248</b>	<b>\$266</b>	<b>\$224</b>	<b>\$947</b>
UI Trust Fund Beginning Balance (in millions)	\$ 160.0	\$(280.0)	\$(240.0)	\$ 30.0	
Fund Revenue	\$ 350.0	\$ 430.0	\$ 520.0	\$ 460.0	
Fund Outlays	\$(790.0)	\$(390.0)	\$(250.0)	\$(240.0)	
Ending Balance	<b>\$(280.0)</b>	<b>\$(240.0)</b>	<b>\$ 30.0</b>	<b>\$ 250.0</b>	

<sup>1</sup> The .4% assessment on the \$7,000 taxable wage base in CY 2011 amounts to \$28 per employee and the .6% assessment in CY 2012 amounts to \$42 per employee, on average, and should provide sufficient additional contributions to address fund solvency while avoiding loss of FUTA credit reductions. The trust fund would have a marginal positive balance by the 3<sup>rd</sup> quarter of 2012. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary (2 years).



# Discussion and Recommendations

