



DEPARTMENT OF ECONOMIC SECURITY

Your Partner For A Stronger Arizona

Arizona Unemployment Insurance Trust Fund Solvency

Overview

- Inform the business community of 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 will begin borrowing funds from the U.S. Department of Labor (U.S. DOL) in March 2010.
 - The Trust Fund currently has \$36 Million on deposit.
 - The maximum weekly benefit amount in Arizona is \$240 per week.
- Currently 30 states and 1 U.S. Territory are 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.
- At the end of calendar year 2012, the trust fund is projected to have a very small and temporary positive balance.



Impacts of Borrowing (Cont.)

- Current projections indicate that the State and its employers will incur interest charges of \$8 - \$10 Million in calendar year 2011.
- Interest cannot be paid from regular trust fund collections (i.e. State Unemployment Tax collections).
- Interest must come from either an assessment on employers, a general fund appropriation, or redirection of other existing State funds.



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 1st and November 10th 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 15% chance for a double dip recession according to current national economic analysis (Source – IHS Global Insight).



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 10th of each consecutive year.



Cost Per Employee With FUTA Credit Losses

	Tax Component	CY 2010	CY 2011	CY 2012	CY 2013	CY 2014
Cost per employee	FUTA	\$ 56	\$ 56	\$ 77	\$287	\$308
	State UI Tax	\$145	\$158	\$161	\$161	\$161
	Assessment	<u>\$ 0</u>	<u>\$ 5</u>	<u>\$ 5</u>	<u>\$ 5</u>	<u>\$ 5</u>
	Sub-Total	\$201	\$219	\$242	\$452	\$473
	Job Training Tax	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ 7</u>
	Total	\$208	\$226	\$249	\$459	\$480

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





Future Events

- Based on national data and Arizona information, the current projection model indicates:
 - The unemployment rate is expected to remain steady and slowly decline in late 2010.
 - Employer payrolls are expected to increase slightly into 2011, but not significantly enough to address Trust Fund solvency.
 - The average employer tax rate for state unemployment taxes will rise to 2.25% in 2011 and 2.30% in calendar years 2012 and 2013.



Options to Address Trust Fund Solvency

All Options Assume Economic Recovery Continues At Current
Projected Level



Option 1:

- 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 may 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 \$8 - \$10 Million in 2011 requiring additional funding outside State unemployment tax collections.



Cost Per Employee

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.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment for Interest ¹	\$ 0	\$ 5	\$ 0	\$ 0	\$ 5
Sub-Total	\$202	\$219	\$217	\$217	\$855
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total Taxes Paid	\$209	\$226	\$224	\$224	\$883
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(250.0)	\$(200.0)	\$ 0.0	
Fund Revenue	\$ 350.0	\$ 400.0	\$ 450.0	\$ 450.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(250.0)	\$(200.0)	\$ 0.0	\$ 250.0	

¹ The \$5 assessment in CY 2011 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.



Option 2:

- 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: Raise taxes for employers commencing in either 2010 or 2011. The cost to employers could range from \$35 per employee to \$70 per employee, depending on which assessment option is 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

Option 2 – 1% Assessment Beginning in 2010 and continuing through 2011. Option assumes interest free period from US DOL ends 12/31/2010.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$ 224
State UI Tax	\$146	\$158	\$161	\$161	\$ 626
Assessment ¹	\$ 70	\$ 70	\$ 0	\$ 0	\$ 140
Sub-Total	\$272	\$284	\$217	\$217	\$ 990
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$279	\$291	\$224	\$224	\$1,018
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(100.0)	\$ 150.0	\$ 400.0	
Fund Revenue	\$ 500.0	\$ 600.0	\$ 500.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(100.0)	\$ 150.0	\$ 400.0	\$ 700.0	

¹ The 1% assessment on the \$7,000 taxable wage base amounts to \$70 per employee, on average, and provides sufficient additional contributions to address fund solvency while avoiding interest charges and loss of FUTA credit reductions. The trust fund returns to a positive balance in the 2nd quarter of 2011. Notifications of the assessment would be sent to employers in the fourth quarter of 2010. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Cost Per Employee

Option 2A – A .5% assessment in 2010 and a 1% assessment in 2011. Option assumes interest free period from US DOL ends 12/31/2010.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment ¹	\$ 35	\$ 70	\$ 0	\$ 0	\$105
Sub-Total	\$237	\$284	\$217	\$217	\$955
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$244	\$291	\$224	\$224	\$983
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(150.0)	\$ 50.0	\$ 300.0	
Fund Revenue	\$ 450.0	\$ 550.0	\$ 500.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(150.0)	\$ 50.0	\$ 300.0	\$ 600.0	

¹ The assessment is applied to CY 2010 at .5% and in 2011 at 1%. The contributions collected will generate a positive balance in the fund by the second quarter of 2011 thus avoid interest charges and FUTA credit reductions. Notifications of the assessment would be sent to employers in the fourth quarter of 2010. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Cost Per Employee

Option 2B – A .5% assessment in 2011 and a 1% assessment in 2012. Option assumes interest free period from US DOL ends 12/31/2011.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment ¹	\$ 0	\$ 35	\$ 70	\$ 0	\$105
Sub-Total	\$202	\$249	\$287	\$217	\$955
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$209	\$256	\$294	\$224	\$983
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(250.0)	\$(100.0)	\$ 250.0	
Fund Revenue	\$ 350.0	\$ 500.0	\$ 600.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(250.0)	\$(100.0)	\$ 250.0	\$ 550.0	

¹ The assessment is applied to CY 2011 at .5% and in 2012 at 1%. The contributions collected will generate a positive balance in the fund by the second quarter of 2012 thus avoid interest charges and FUTA credit reductions. Notifications of the assessment would be sent to employers with their regular tax notices in January 2011. This option assumes that the federal government extends the interest free borrowing period through December 31, 2011. **Currently, there is no certainty that the interest free period will be extended and a provision to do so is not included in any proposed legislation at the federal level.** The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Cost Per Employee

Option 2C – .75% Assessment Beginning in 2010 and continuing through 2011. Option assumes interest free period from US DOL ends 12/31/2010.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment ¹	\$ 53	\$ 53	\$ 0	\$ 0	\$106
Sub-Total	\$255	\$267	\$217	\$217	\$956
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$262	\$274	\$224	\$224	\$984
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(100.0)	\$ 50.0	\$ 300.0	
Fund Revenue	\$ 500.0	\$ 500.0	\$ 500.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(100.0)	\$ 50.0	\$ 300.0	\$ 600.0	

¹ The .75% assessment on the \$7,000 taxable wage base amounts to \$53 per employee, on average, and provides sufficient additional contributions to address fund solvency while avoiding interest charges and loss of FUTA credit reductions. The trust fund would have a positive balance by the 2nd quarter of 2011. The assessment notice for 2010 would be sent to employers in the fourth quarter of 2010. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Cost Per Employee

Option 2D – .75% Assessment Beginning in 2011 and continuing through 2012. Option assumes interest free period from US DOL ends 12/31/2010.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment ¹	\$ 0	\$ 58	\$ 53	\$ 0	\$111
Sub-Total	\$202	\$272	\$270	\$217	\$961
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$209	\$279	\$277	\$224	\$989
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(250.0)	\$(100.0)	\$ 250.0	
Fund Revenue	\$ 350.0	\$ 500.0	\$ 600.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(250.0)	\$(100.0)	\$ 250.0	\$ 550.0	

¹ The .75% assessment on the \$7,000 taxable wage base amounts to \$53 per employee, on average, and provides sufficient additional contributions to address fund solvency while avoiding loss of FUTA credit reductions. There would be an additional assessment of \$5 per employee to pay for interest costs associated with borrowing in 2011. 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 2nd quarter of 2012. This option assumes the interest free period ends December 31, 2010. The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Cost Per Employee

Option 2E – .75% Assessment Beginning in 2011 and continuing through 2012. Option assumes interest free period from US DOL ends 12/31/2011.	CY 2010	CY 2011	CY 2012	CY 2013	Total Cost Per Employee
FUTA Tax	\$ 56	\$ 56	\$ 56	\$ 56	\$224
State UI Tax	\$146	\$158	\$161	\$161	\$626
Assessment ¹	\$ 0	\$ 53	\$ 53	\$ 0	\$106
Sub-Total	\$202	\$267	\$270	\$217	\$956
Job Training Tax	\$ 7	\$ 7	\$ 7	\$ 7	\$ 28
Total	\$209	\$274	\$277	\$224	\$984
UI Trust Fund Beginning Balance (in millions)	\$ 150.0	\$(250.0)	\$(100.0)	\$ 250.0	
Fund Revenue	\$ 350.0	\$ 500.0	\$ 600.0	\$ 500.0	
Fund Outlays	\$(750.0)	\$(350.0)	\$(250.0)	\$(200.0)	
Ending Balance	\$(250.0)	\$(100.0)	\$ 250.0	\$ 550.0	

¹ The .75% assessment on the \$7,000 taxable wage base amounts to \$53 per employee, on average, and provides 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 2nd quarter of 2012. This option assumes the interest free period ends December 31, 2011. **Currently, there is no certainty that the interest free period will be extended and a provision to do so is not included in any proposed legislation at the federal level.** The assessment would be temporary and would be discontinued once trust fund solvency reaches one year's worth of benefit costs.



Discussion and Recommendations



Arizona Unemployment Insurance Trust Fund Solvency Addendum



Definitions

- **FUTA** – Federal Unemployment Tax Act - Comprises the laws governing the Unemployment Insurance Program at the federal level and outlines requirements for the state programs. The FUTA tax rate is 6.2%, but a state which has an approved unemployment insurance program is given a 5.4% credit against that rate. Arizona has an approved UI program, and therefore its employers pay a FUTA tax of .8%.
- **Taxable Wage Base (Federal)** – The federal taxable wage base for the calculation of the FUTA is the first \$7,000 of wages per employee per year.
- **FUTF** – Federal Unemployment Insurance Trust Fund – The fund managed by the US Department of Labor that is used to collect and disburse funds collected under FUTA. FUTA collections are used for administration of the unemployment insurance program at the federal and state level. Excess collections are held on deposit and are loaned to state when their funds have solvency issues. The fund is also used for Supplemental Budget Requests (SBR).
- **FUTA Credit Reduction** – Any state which has outstanding loans from the federal government on January 1 in two or more consecutive years, and does not repay the loan balance by November 10th of the second or succeeding years will incur a reduction in the 5.4% FUTA credit. The reduction is .3% starting in the second year and increases .3% each year thereafter until the loan is repaid. In addition, if the state has an outstanding loan balance in the third year, additional reductions are taken (up to 2.7% per year) in order to assist the state in paying down the loan balance. The additional FUTA collections are credited against the state's outstanding loan balance. It is the federal government's method for assisting the state in repaying loans if no action is taken at the state level to improve trust fund solvency.



Definitions (Cont.)

- **Federal Loans** – For states whose trust funds have reached a negative balance, the federal government has a loan program that allows states to borrow funds from the FUTF in order to continue benefits to claimants. The loans normally accrue interest and if not paid back timely will result in loss of FUTA credit in order to repay the loan balance. Under the American Reinvestment and Recovery Act (ARRA), interest on outstanding loans is waived through December 31, 2010. Interest will begin accruing and become payable on any outstanding balance, or new borrowing, in 2011.
- **Federal Loan Interest** – The federal government charges interest on outstanding loan balances at a rate equal to the interest the funds would have earned if still deposited in the FUTF. On average, the interest rate is 4.6% based on prior earnings on the FUTF. Interest charges are calculated on the average daily outstanding balance for the period. Interest is not charged if the state is able to repay its loan before September 30 and does not borrow any additional funds between October and December of the same year. The funds must come from a different source (i.e. General Fund, Employer Assessment or redirection of another fund source). **Currently, several business organizations and state groups are lobbying Congress to extend the interest free period beyond December 31, 2010. At this time, there is no certainty that an extension of the interest free period will be included in any forthcoming legislation. In addition, extension of the interest free borrowing period will have not impact on the potential reduction of FUTA credits.**



Definitions (Cont.)

- **SUTA** – State Unemployment Tax Act – Comprises the state statutes which govern the unemployment insurance program in the state. Codified at A.R.S. Title 23, Chapter 4.
- **Taxable Wage Base (Arizona)** – Arizona’s taxable wage base for calculation of the state unemployment tax is the first \$7,000 of wages per employee per year.
- **UI Trust Fund** – The Arizona unemployment insurance trust fund. The fund is held at the US Treasury and managed by the Arizona Department of Economic Security. It is used to pay unemployment benefits to Arizona claimants.
- **Job Training Tax** – A.R.S. § 41-1544 governs the Job Training Tax, a .1% tax on the first \$7,000 of wages (or \$7 per employee) that is to be used for training workers. The fund is administered by the Arizona Department of Commerce.



Examples of Tax Calculations

- FUTA Tax Calculation (no credit reduction):
 - $\$7,000 * .008 = \56.00
- FUTA Tax Calculation (1st year of credit reduction = .3% additional FUTA due):
 - Regular FUTA = $\$7,000 * .008 = \56.00
 - Additional FUTA due = $\$7,000 * .003 = \21.00
 - Total FUTA Cost = $\$77.00$
 - The \$21 additional FUTA per employee collected is credited against the state's loan balance in the year it is collected.
- FUTA Tax Calculation (2nd year of credit reduction = .6% additional FUTA and up to 2.7% add-on reduction):
 - Regular FUTA = $\$7,000 * .008 = \56.00
 - Additional FUTA due = $\$7,000 * .006 = \42.00
 - 2.7% Add-on FUTA = $\$7,000 * .027 = \189.00
 - Total FUTA Cost = $\$287.00$
 - The \$231 additional FUTA per employee collected is credited against the state's loan balance in the year it is collected.



Timelines

- The trust fund will return to solvency sometime between 2011 and 2013 depending on which option is chosen to address the trust fund issue.
- State unemployment insurance tax rates for employers will not begin to decline until the ratio of trust fund balance to the total taxable payrolls reaches at least 3.0% (i.e. the trust fund balance must be at least 3.0% of total taxable payrolls before rates would begin to go down).
 - Current projections indicate that the trust fund will not reach the 3.0% threshold until at least 2013 unless some action is taken to increase contributions.



Timelines (Cont.)

- The assessments outlined in the options portion of the main presentation would commence in either 2010 or 2011 and would be payable as follows:
 - Options That Begin Assessments in 2010:
 - Employers would be notified of the 2010 assessment in the 4th quarter of 2010 through a special notice and the assessment would be payable with their 4th quarter tax payment in January 2011.
 - Employers would receive notice of the assessment for 2011 with their regular tax notices that are sent in January 2011 and the assessment would be due along with their quarterly tax payments which are due 30 days after the end of each quarter.
 - Options That Begin Assessments in 2011:
 - Employers would be notified of the 2011 assessment with their regular tax notices that are sent in January 2011 and the assessment would be due along with their quarterly tax payments which are due 30 days after the end of each quarter.
 - Employers would be notified of the 2012 assessment with their regular tax notices that are sent in January 2011 and the assessment would be due along with their quarterly tax payments which are due 30 days after the end of each quarter.



Arizona Unemployment Tax Rates Over Time

Calendar Year	Average Tax Rate	Tax Paid
2000	1.02%	\$71.40
2001	.82%	\$57.40
2002	.80%	\$56.00
2003	.80%	\$56.00
2004	1.04%	\$72.80
2005	1.43%	\$100.10
2006	1.48%	\$103.60
2007	1.52%	\$106.40
2008	1.39%	\$97.30
2009	1.36%	\$95.20
2010	2.08%	\$145.60

Tax paid is calculated in the \$7,000 taxable wage base.

