



THE IMPACT OF THE 2007-2010 FINANCIAL CRISIS
ON THE STATE OF NEVADA

PRESENTED TO
THE FINANCIAL CRISIS INQUIRY COMMISSION
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Mr. Angelides and members of the Financial Crisis Inquiry Commission:

I am honored to have this opportunity to describe how the current economic crisis has impacted Nevada's economy and the state's ability to provide services to its residents.

As you are well aware, the nation is still in the shadow of the deepest recession since the depression of the 1930's. The Great Recession was caused by the implosion of a nationwide real estate bubble of unprecedented magnitude. The formation of this bubble had wide ranging effects on the nation's economy.

- The rise in home prices fueled consumer confidence and consumer spending. Increasing prices meant increasing home equity that provided consumers with easy access to money for debt-financed purchases that were beyond the means of earnings from salaries and wages. The U.S. Federal Reserve estimates that homeowners extracted seven times more equity from their homes in 2005 than they did in 1996, spending two thirds of it on personal items, home improvements, and credit card debt.
- Activity in the housing market fed the desire for more — and more expensive — homes, which in turn led to increased construction and construction related jobs and purchases.

- A nation obsessed with rising home prices led to speculation as well as innovations in lending practices and financial instruments that further inflated the housing market. The resulting relaxed lending standards, mortgage-backed securities and collateralized debt obligations posed unknown and unknowable risks.

During the real estate bubble, Nevada's economy was positively impacted by euphoric consumers from the rest of the nation and world. Visitors to the state bolstered retail sales and gaming establishments, contributing to state coffers.

Although Nevada's real estate bubble was later to form, it was among the nation's largest. According to the Standard and Poor's Case-Shiller Home Price Index, in 2004 Las Vegas home prices were increasing the fastest of the 20 major metropolitan areas tracked, soaring more than 50% year-over-year. This in turn inflated the state's construction sector, resulting in a larger proportion of relatively high-paying construction-related jobs than any other state.

The rupture of the real estate bubble produced a liquidity shortfall that caused the collapse of large financial institutions and necessitated the bailout of organizations deemed "too-big-to-fail." However, the federal government's intervention was not enough to prevent the collapsing bubble from devastating investors and consumers. The ensuing financial crisis led to the deepest economic downturn in a generation. To date, the national recovery is anemic at best. Plummeting home prices nationwide have resulted in plummeting consumer confidence and spending. The loss of wealth means fewer and more frugal visitors to Nevada.

The economic downturn in Nevada is severe and continuing.

- Nevada home prices have fallen faster and further than in any other state. **Figure 1** shows data from the Standard and Poor's Case-Shiller Home Price Index for Las Vegas and summarizes the data for the other metropolitan areas. To date, home prices in Las Vegas have fallen 56.5% from the peak reached in August 2006. The seasonally adjusted June 2010 home price index, which is 5.1% below that of June 2009, is the lowest in a decade. Nearly two-thirds of Nevada homes are worth less than their mortgages, the highest rate in the country, and the number of Nevada home foreclosures, also highest in the nation, is nearly four times the national average.
- As shown in **Figure 2**, the issue of building permits for single family homes has declined to levels not seen since the early 1980's, even though the state's population has surged by more than a factor of three — an increase of 1.8 million residents — in the intervening decades.
- State employment has dropped substantially (**Figure 3**) and with it, the amount of wages and salaries available for Nevada residents to spend (**Figure 4**). Officially, Nevada has lost 179,000 jobs since the recession began in December 2007, tumbling 13.9%. However, if measured against the historical trend, the job loss is more than twice as large. Meanwhile, inflation-adjusted wages and salaries in Nevada are down 16.6%, sinking to 2004 levels.
- Nevada's seasonally adjusted jobless rate is highest in the nation and still rising (**Figure 5**). Since the beginning of the recession, Nevada's jobless rate has jumped

9.1-percentage-points, to 14.3% from 5.2% in December 2007, climbing more than any other state and more than twice as far as average rate increase. Nevada's jobless rate is 1.1-percentage-points above the second highest rate, posted by Michigan, and is 4.7-percentage-points above the national average. The state's Unemployment Insurance Trust Fund is depleted and nearly \$500 million has been borrowed from the federal government for payment of unemployment claims. It will be years before the Trust Fund is replenished.

Nearly 70% of Nevada state General Fund revenues are generated by discretionary consumer activity (**Figure 6**). The two largest revenue sources — sales tax receipts and gaming fees — contribute more than half of the total. When consumers tighten their purse strings, as they are now doing, the impact on the state's ability to provide necessary services is significantly curtailed.

The state's tourist based economy has been hit hard, and sales tax revenues (**Figure 7**) and gaming win (**Figure 8**) have both plunged.

- Inflation-adjusted sales tax receipts have posted year-over-year declines for the past 4.5 years, plunging 46.8% since the peak reached in December 2005. Collections are now down to the levels of the late 1990's, and still falling. Per capita receipts are the lowest on record.
- Gaming fee receipts have also fared poorly. Gaming win — the amount casinos keep after wager payouts have been made — have plunged and, with the increased competition posed by other states offering legalized gambling, it is not clear that a full recovery is possible.

Nevada's state government is exceptionally lean. In fiscal year 2008 (the most recent year of data), the U.S. Census Bureau reports Nevada per capita own-source revenues were among the lowest in the country. The state's per capita government labor force is also among the leanest. Nevada thus has only limited ability to make cuts without hurting the benefits it provides to its citizens.

Allocation of the state's resources is shown in **Figure 9**. Nevada's commitment to funding local school districts for elementary and secondary education is statutorily set and represents the largest share of the state's budget. The second largest share supports human and social services, including Medicaid and transfer payments. While the state's k-12 population is not currently increasing substantially, the recession has resulted in soaring growth in the number of residents requiring welfare assistance, even as the state's ability to provide such assistance is declining. As shown in **Figure 10**, over the past 3.5 years, the state's Medicaid recipients have increased by more than 50%, the number receiving Temporary Assistance for Needy Families (TANF) has nearly doubled, and the number collecting Supplemental Nutrition Assistance Program (SNAP) payments is nearly 2.4 times larger. These caseloads are likely to climb further as unemployment insurance benefits expire for Nevadan's unable to find work.

State General Fund revenues declined in fiscal years 2008 and 2009, and the revenue enhancements enacted to augment fiscal year 2010 spending have barely kept pace with inflation (**Figure 11**). The state has drained its rainy day fund and spent the monies in all other available reserve accounts in order to maintain services. Increased Federal

Medical Assistance Percentages (FMAP) along with distributions from the American Recovery and Reinvestment Act of 2009 (ARRA) have helped immensely, but are not enough to prevent the need for deep spending cuts in the 2011-2013 biennial budget currently being prepared. Under current law, the shortfall is huge, approaching an amount equal to half of the General Fund. The state's fragile economy will be hard pressed to raise the necessary revenues or absorb such drastic reductions.

Nevada is grateful for the federal support provided to its residents during this recession. Extensions to Unemployment Insurance Benefits are assisting out-of-work Nevadans and helping to curb growth of the state's already soaring welfare caseloads. In addition, ARRA and FMAP funds have been used to reallocate resources in fiscal years 2009, 2010 and 2011. In total, these funds provided more than \$800 million in fiscal relief to the state's General Fund. Other ARRA monies have been used to help the state's faltering economy. Nonetheless, Nevada's state budget has been cut to the bone and the economy remains distressed. Without a strong national economic recovery forthcoming in the very near future or additional resources from the federal government, the prospects for Nevada's citizens are bleak,

Thank you for providing me this opportunity to address your commission and explain our economic situation.

Sincerely,



Andrew Clinger, Director
State of Nevada
Department of Administration

Figure 1. Case-Shiller Seasonally Adjusted Home Price Index

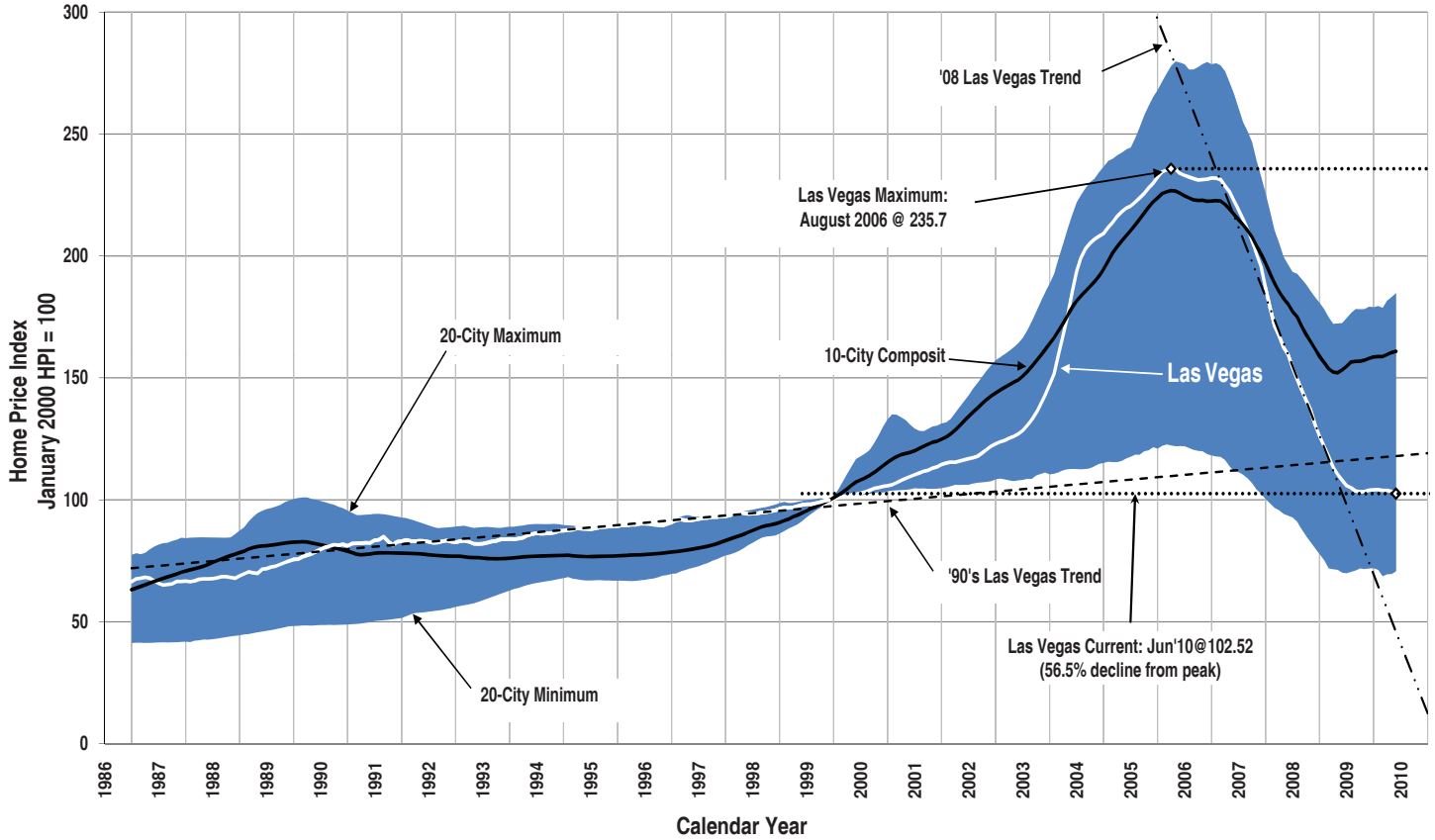


Figure 2. Nevada Single Family Home Permits Issued Each Month

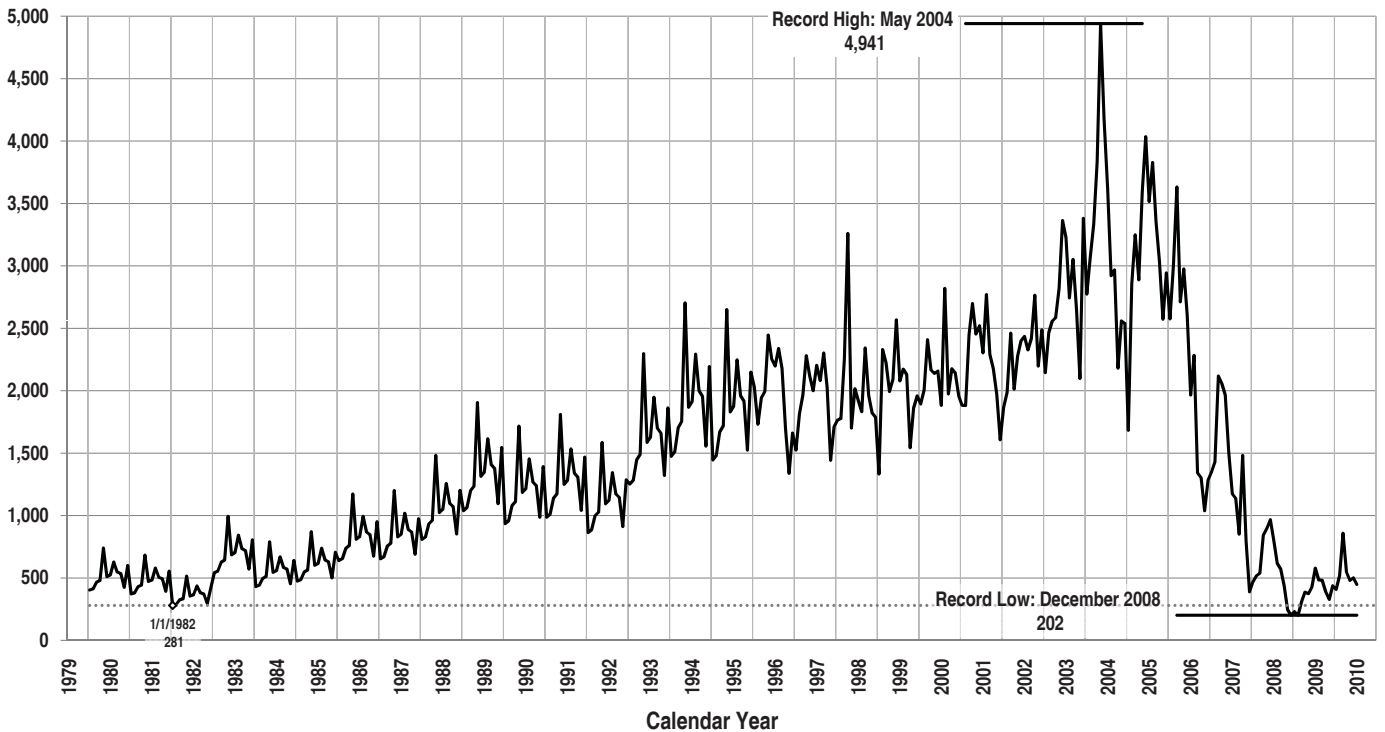


Figure 3. Nevada Employment

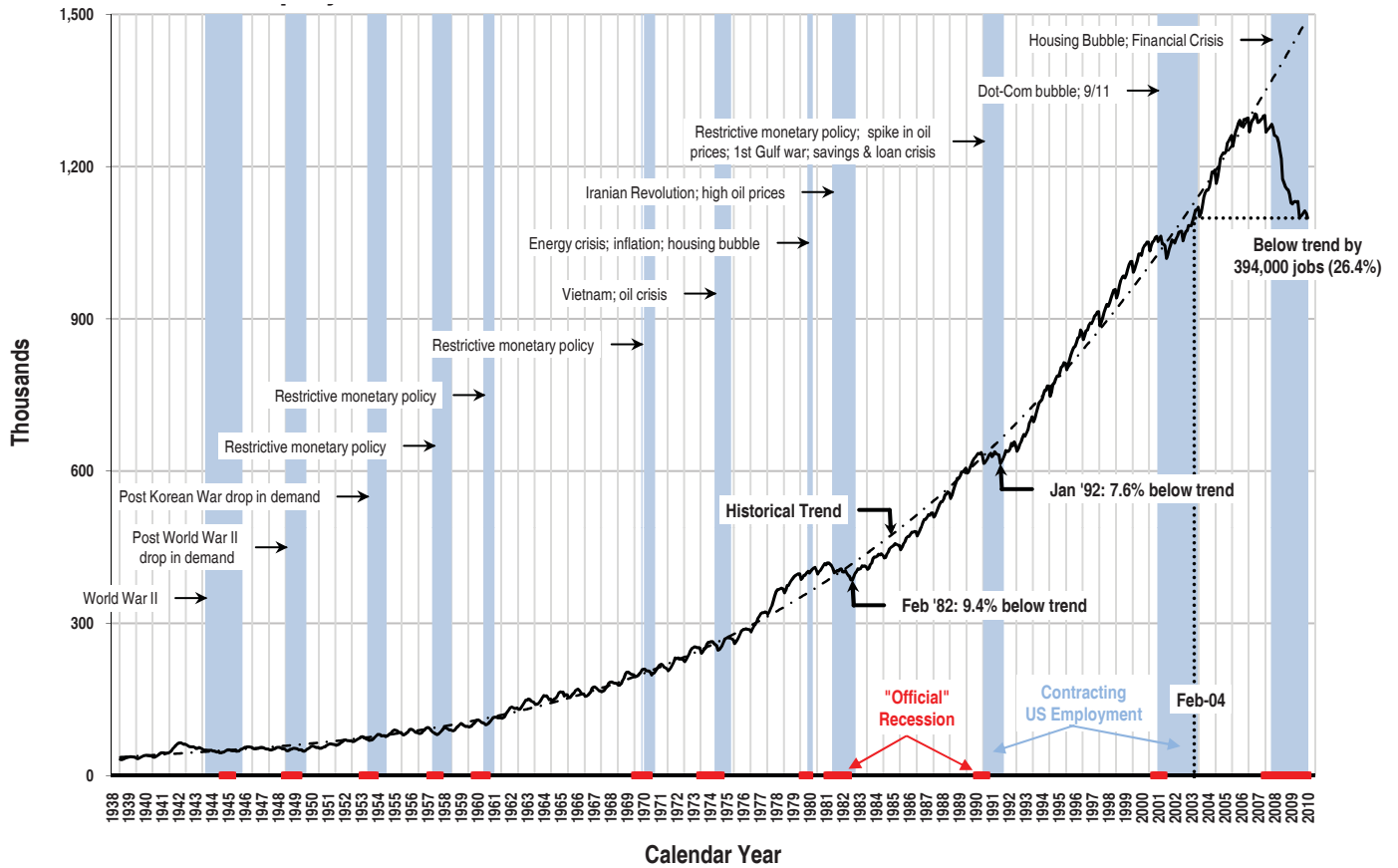


Figure 4. Nevada Inflation-Adjusted Wage & Salary Disbursements

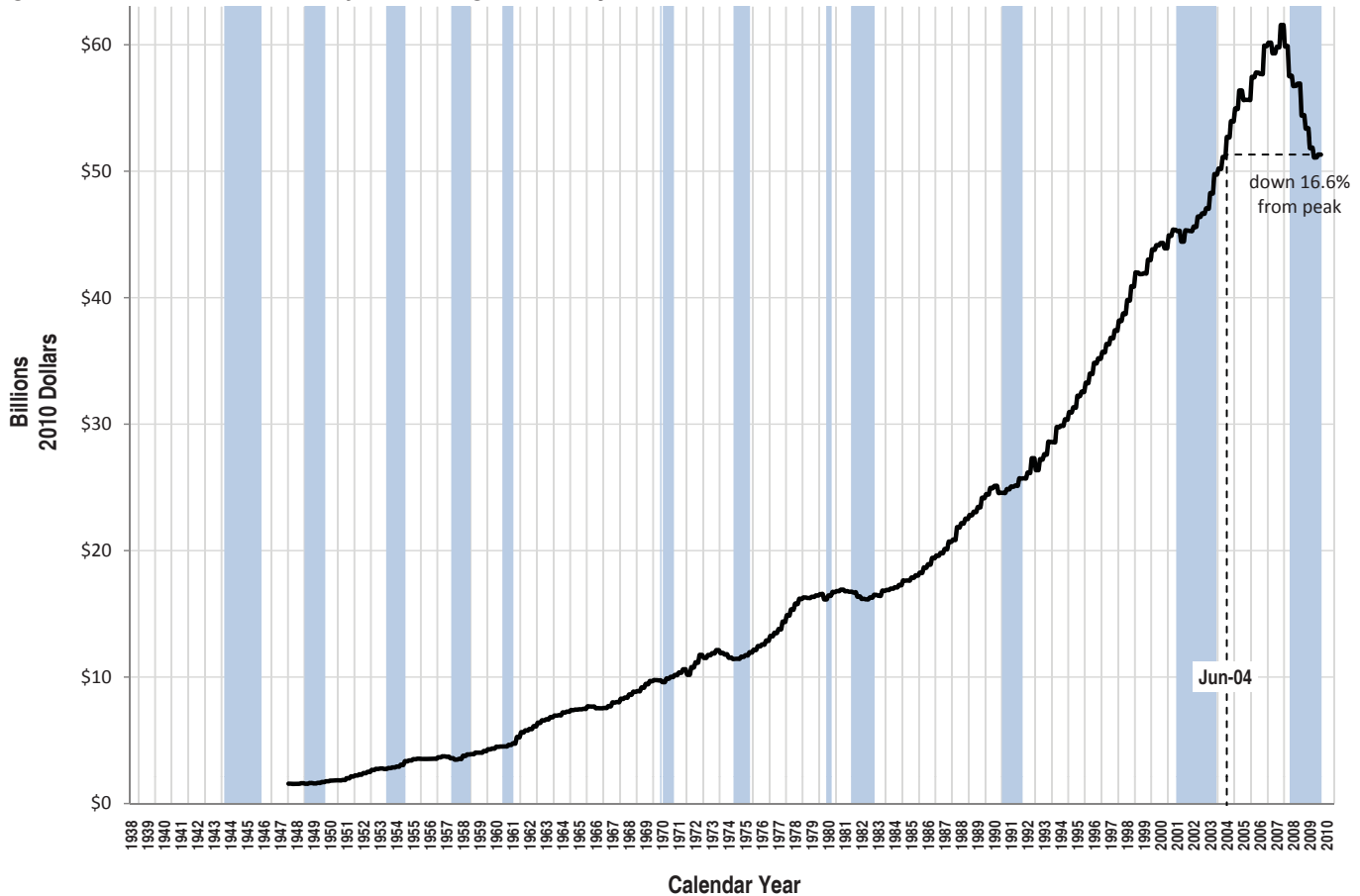


Figure 5. U.S. and Nevada Unemployment

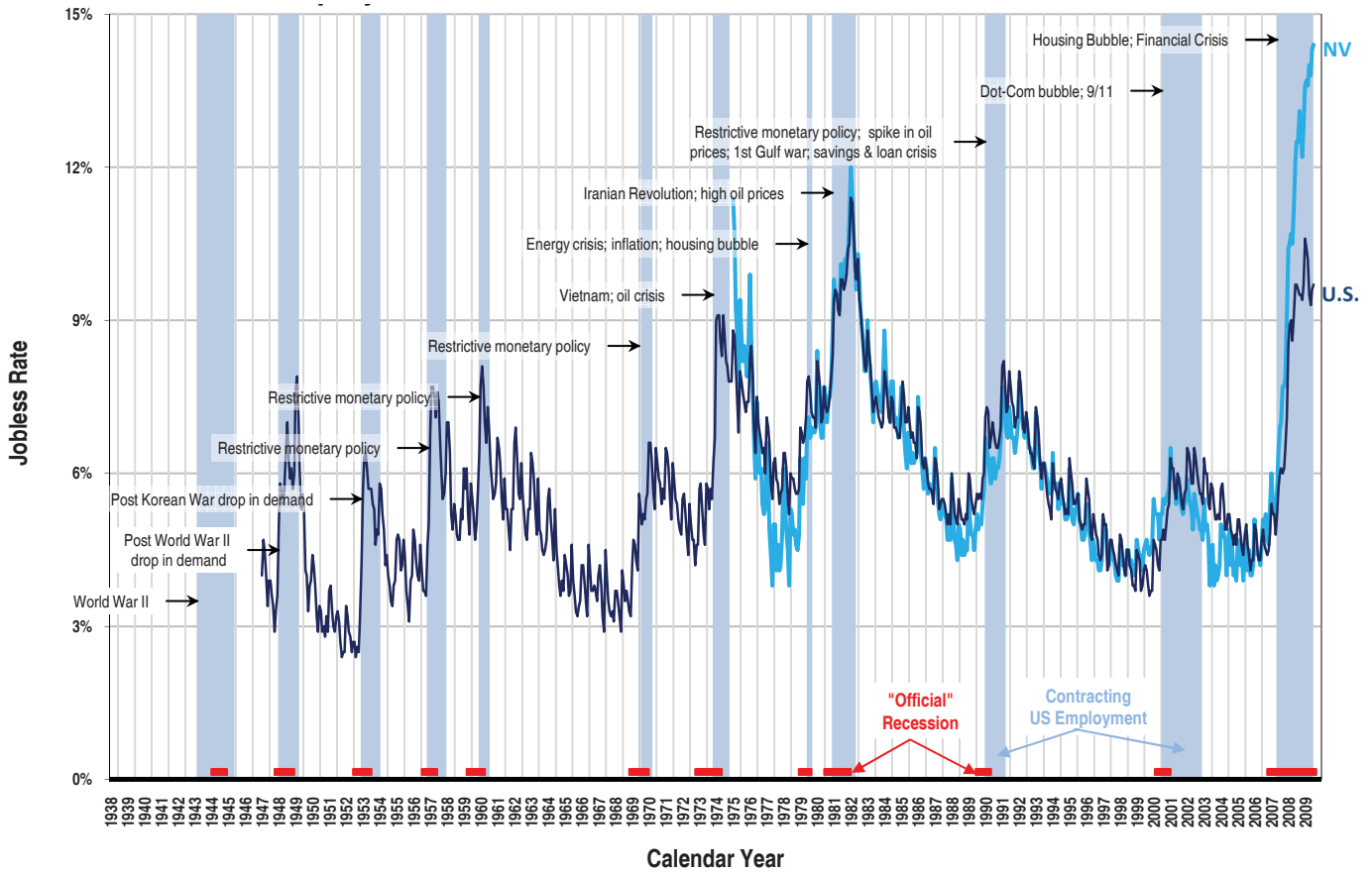


Figure 5. Sources of Nevada General Fund Revenues

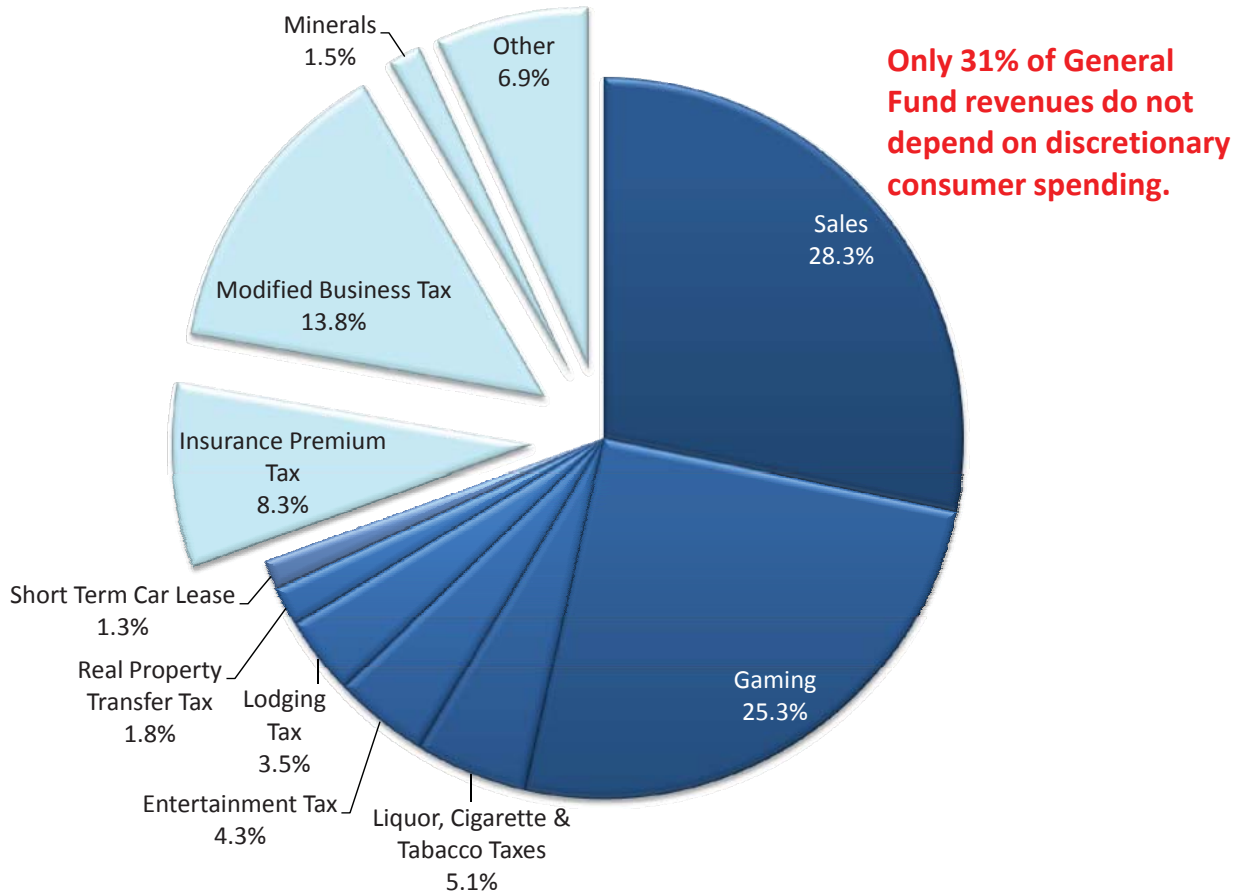


Figure 7. Inflation-Adjusted Average Daily State Sales Tax Receipts

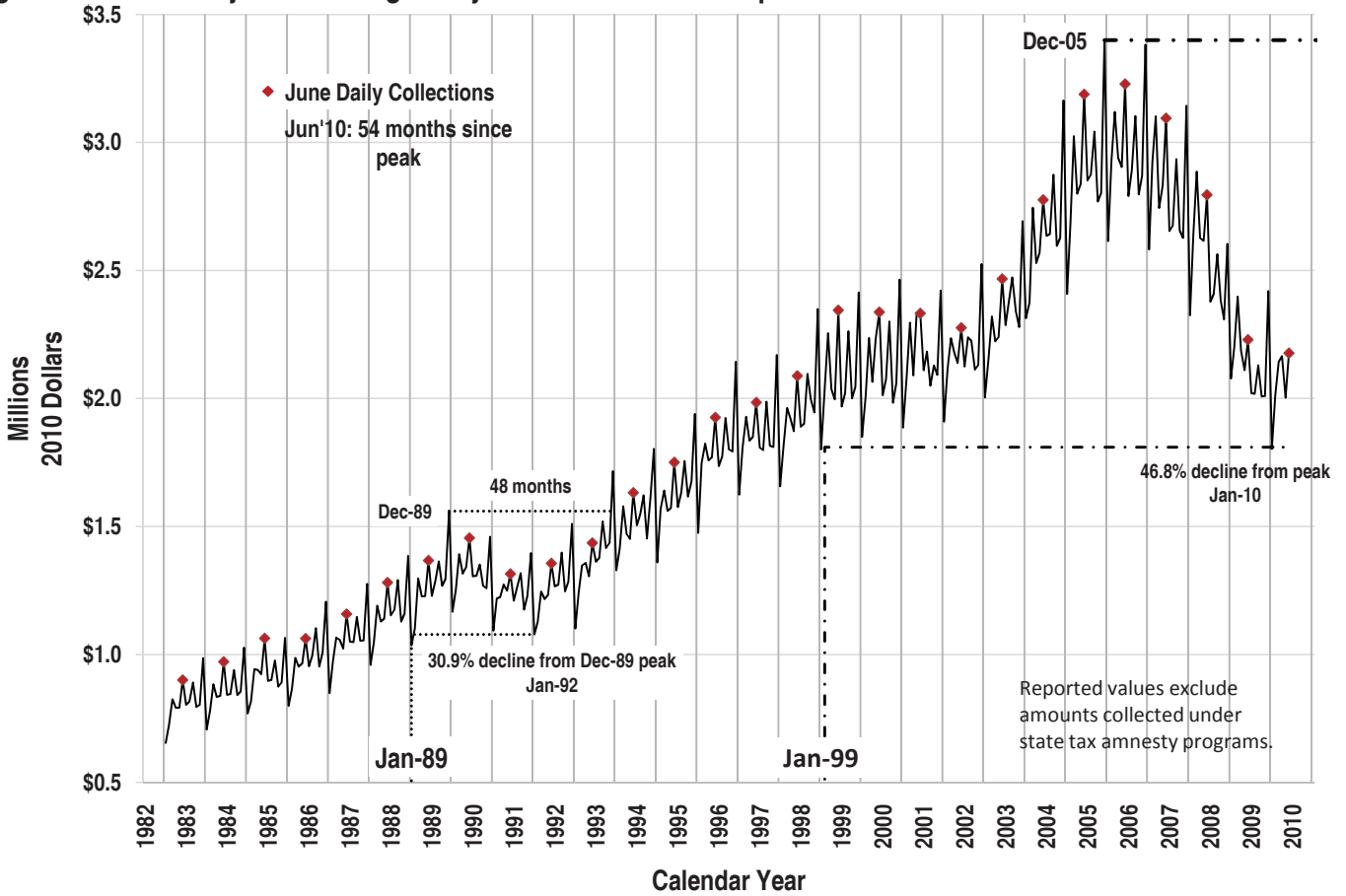


Figure 8. Inflation-Adjusted Statewide Average Daily Gaming Win

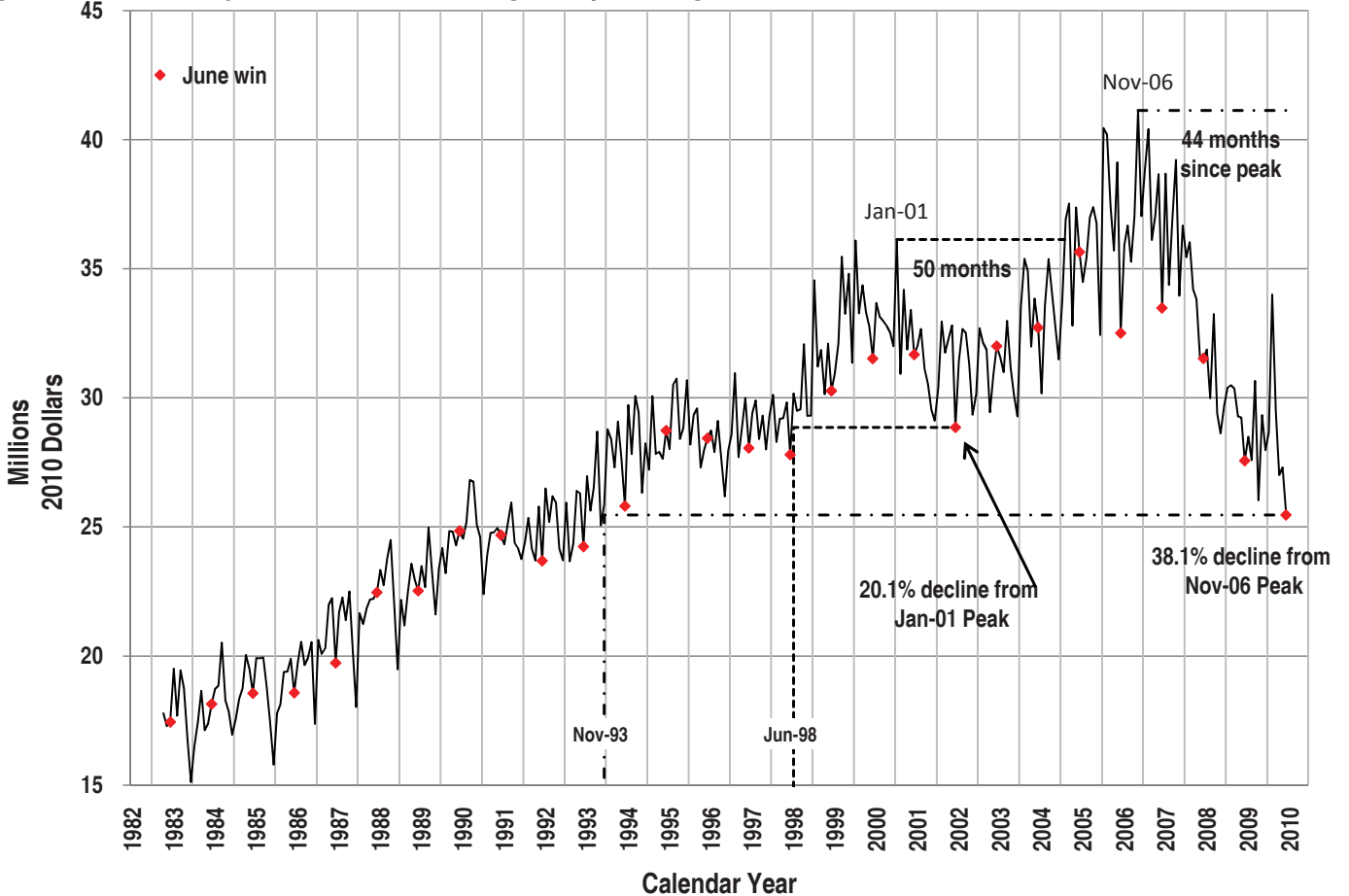


Figure 9. Nevada General Fund Expenditures by Function

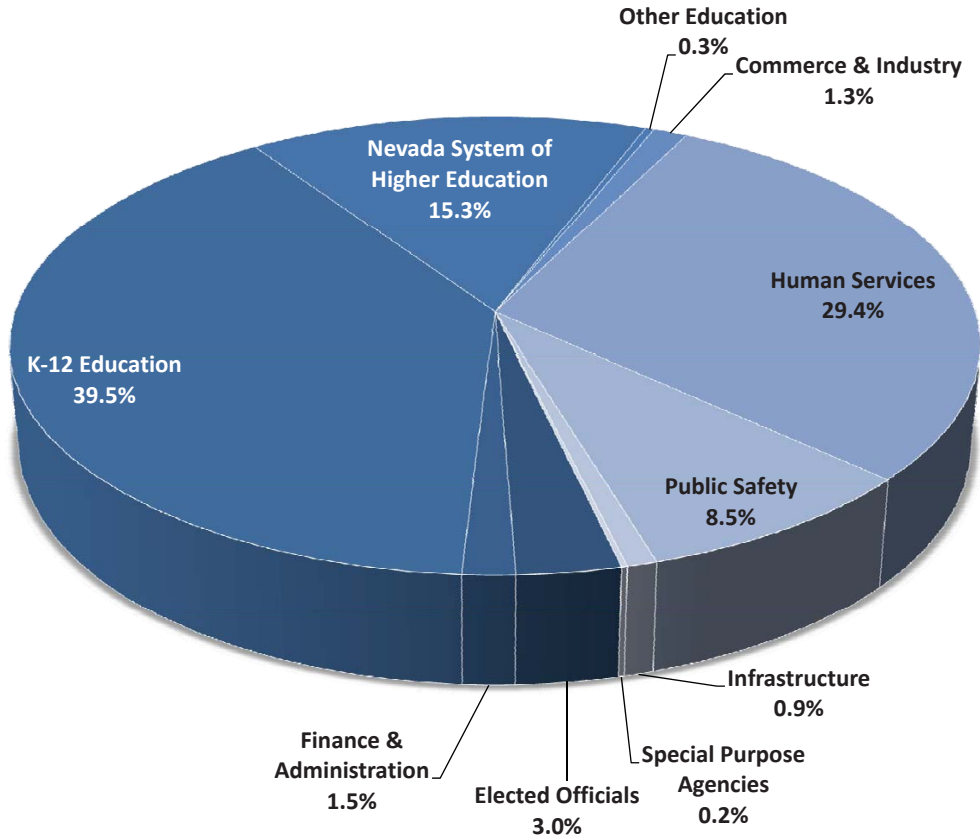


Figure 10. Year-Over-Year Change in Nevada Caseloads

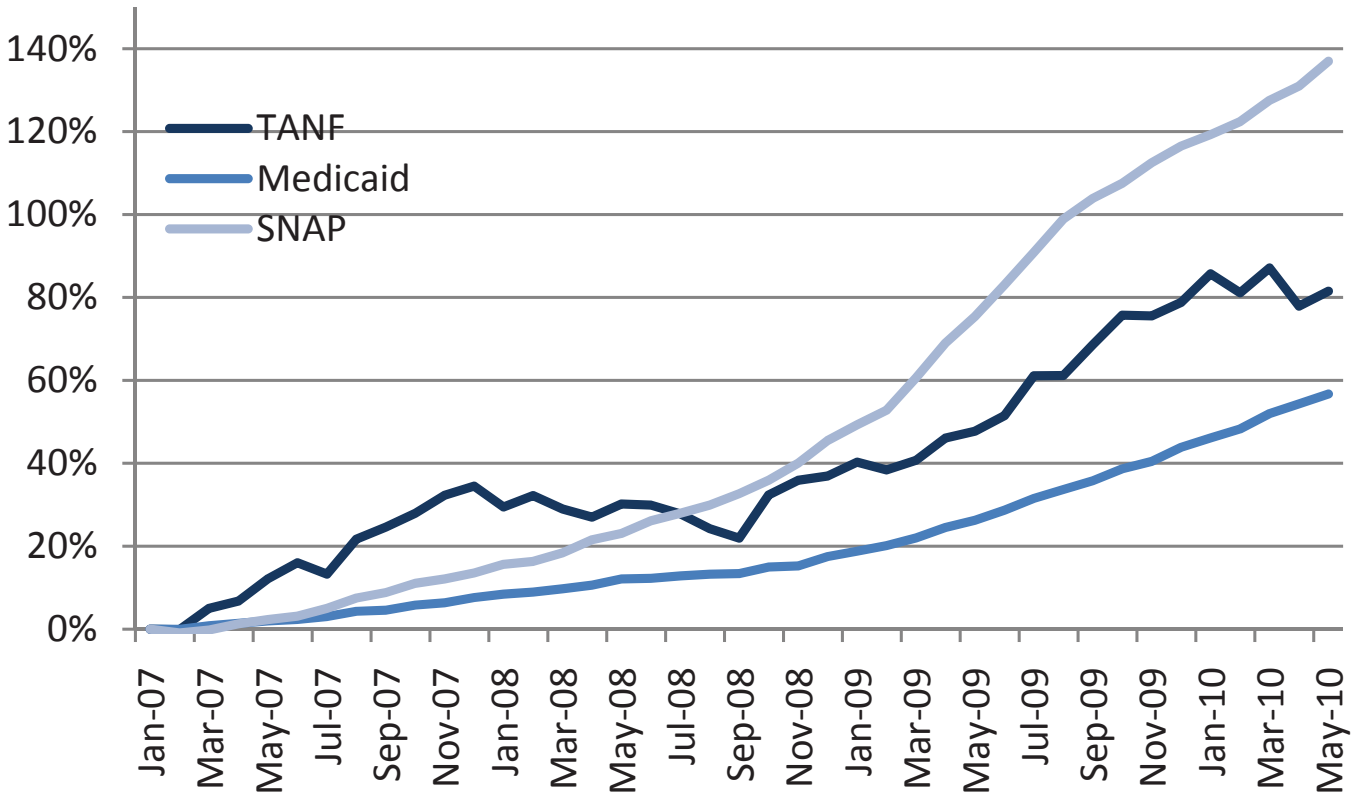


Figure 11. Nevada General Fund Revenues

