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# CITY OF PORTLAND

OFFICE OF MANAGEMENT AND FINANCE

TO: Mayor Sam Adams
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Randy Leonard
Commissioner Dan Saltzman
Auditor LaVonne Griffin-Valade

FROM: Jack D. Graham, Chief Administrative Officer

DATE: December 5, 2012

SUBJECT: FY 2013-14 General Fund Financial Forecast

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I am pleased to submit the initial FY 2013-14 General Fund Five-Year Financial Forecast. The forecast incorporates projected City revenues and spending from FY 2013-14 through FY 2017-18. The forecast will be updated as new information becomes available, and the final five-year forecast will be released no later than April 30th.

The Office of Management and Finance will present the forecast as a report to Council on December 5. We look forward to working with the Council, City bureaus, and the community on the FY 2013-14 budget process.

City of Portland

# Five-Year General Fund Financial Forecast

FY 2013-14 through FY 2017-18

Office of Management and Finance

December 2012

There has been little change in the economic outlook for much of the past 18 months. However, there are several non-economic factors that have emerged since the April 2012 forecast that are driving large General Fund deficits. This, coupled with relatively modest economic growth, means the City will need to make significant ongoing reductions in FY 2013-14. Table 1 summarizes discretionary General Fund resources and expense requirements through FY 2017-18. As shown in Table 1, the City needs to make $25 million in ongoing spending cuts in order to balance spending to expected revenue over the five-year forecast horizon. This requires an approximate **6.5% cut** from the projected FY 2013-14 General Fund current appropriation level.

**TABLE 1. Discretionary General Fund Five-Year Forecast ($millions)**

| | **Fiscal Year** | | | | |
|---|---|---|---|---|---|
| **Budget Category** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** |
| **Total Resources** | **$390.8** | **$407.9** | **$426.9** | **$441.8** | **$453.0** |
| | | | | | |
| Required Ongoing Cuts[1] | -$25.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Available One-Time | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| **Total Expenses with Cuts & One-Time Spending** | **$390.8** | **$407.9** | **$426.9** | **$441.8** | **$453.0** |

[1] An ongoing cut of $25 million in FY 2013-14 is necessary to balance ongoing revenues with ongoing expenses throughout the five-year forecast.

Note: Totals may not add due to rounding

The largest drivers of the current shortfall are budget impacts associated with three non-economic impacts: the establishment of a Multnomah County Library District (reduces property tax collections by an estimated $10 million); budget notes included in the FY 2012-13 Adopted Budget (dictates that certain General Fund budgets be increased by $8.6 million); and the implementation requirements of the City's agreement with the Department of Justice (DOJ) surrounding the City's treatment of the mentally ill (will increase costs $5.4 million beginning in FY 2013-14). The next section describes these impacts in more detail, as well as summarizing other changes to the forecast since April.

City financial policies require that the city balance its budget over the entire five-year forecast. This means that, to the extent forecasted revenues in year five of the forecast are insufficient to cover expected costs in the same year, the policy requires cuts be enacted in year one of the forecast to set the budget on a

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sustainable course. It should be noted that, although there was $23.9 million in one-time spending in the FY 2012-13 adopted budget, no is available one-time revenue is currently expected for FY 2013-14 and beyond. The budget note directions convert a portion of these one-time costs to ongoing, and funding for those programs are contributing to the $15 million ongoing shortfall. A proposed agreement with the County related to Sellwood Bridge funding could create one-time resources of approximately $3 million for FY 2013-14. In order to keep the budget balanced, the City will need to cut the remaining one-time spending or find additional one-time resources beginning in FY 2013-14.

**Major Changes Since April 2012 Forecast**

*Property Taxes/Multnomah County Library District* – The single largest budget issue continues to be related to property taxes. Property taxes account for roughly one-half of General Fund discretionary resources, and total property tax growth is expected to be less than 1% in FY 2012-13, far below that needed to match the City's cost growth. Property taxes will *fall* by almost 3% in FY 2013-14, as the establishment of the County Library District interacts with the state's unique property tax system to effectively "crowd out" City General Fund tax collections. Currently, it is estimated that the City will collect about $10 million less than it otherwise would have had the district not been approved by voters in November 2012. It should be noted that this is a relatively low confidence estimate and that the City will work with the County to refine the estimate over the next several months.

*FY 2012-13 Adopted Budget Notes* – During the budget development process, City Council occasionally includes budget notes that increase costs in future years. For example, budget notes may direct that costs be added in future years for ongoing operations and maintenance for new facilities. For the FY 2012-13 budget, Council directed costs totaling $8.6 million be added to the FY 2013-14 current appropriation levels (CAL) of four bureaus – Housing ($4.6 million), Portland Development Commission ($3.2 million), Office of Neighborhood Involvement ($0.6 million) and Portland Parks Bureau ($0.2 million). By adding these programs to the list of ongoing programs, the impacts are cuts to all City Bureau General Fund budgets by a corresponding amount, absent any other changes.

*DOJ Agreement* – Following the conclusion of a DOJ investigation relating to the Portland Police Bureau's interactions with individuals with mental health issues, the City entered into an agreement with the DOJ that requires the City to add various positions and services to better serve the community. In total, $5.4 million in costs will be associated with the agreement. The City will begin funding some of this in FY 2012-13, but the full ongoing cost will begin in FY 2013-14.

*Bureau Spending Assumptions* – Bureaus rarely spend all of their appropriated budget. The amount not spent falls to balance to be budgeted in the following year. Historically, the amount not spent has exceeded 3% of General Fund budgets. Thus, the forecast incorporated an assumption that no more than 97% of discretionary resources would be spent, with the rest falling to balance. The most recent fiscal year saw that figure rise to more than 99%, as years of budget cuts left bureaus with less budget flexibility. This, coupled with the fact that the current budget includes capturing vacancy savings that would have typically provided both budget flexibility and some unspent balance, has led to a lowering of the expected beginning balance in each year of the forecast. This serves to reduce General Fund discretionary resources by $4-$5 million each year.

*Revenue Forecasts* – Other than the property tax forecast and the bureau spending assumption, the rest of the General Fund revenue forecasts roughly cancelled each other out, as increases in the expectations for transient lodging taxes and state shared revenues (i.e., liquor and cigarette tax distributions) were offset by decreases in the business license tax and interest earnings forecasts. A more detailed description of the business license tax forecast begins on page 4. One other change of note was the inclusion of new revenue stemming from a tax change on telecom companies adopted by City Council in November 2012. The City's Revenue Bureau estimates that this change will bring in $3-$5 million in new revenue to the City. The financial forecast includes the low end of this range beginning in FY 2013-14.

### Major Short-Term Financial Forecast Risks

*Labor Contract Costs* – With the exception of the Portland Fire Fighters Association, nearly every major union contract with the City expires at the end of FY 2012-13. Thus, the City will soon begin negotiating new contract provisions. Over the past several years, the City has added more than $7 million in additional personnel costs through provisions agreed to through collective bargaining, with the majority of the impacts isolated to the last Portland Police Association contract in the fall of 2010. No additional costs have been included in this forecast for pending labor contracts. To the extent that the City can avoid increasing costs, or even garner concessions, the upcoming contracts could serve to help the current budget outlook.

*Federal Fiscal Policy/General Economic Conditions* – Between the debt ceiling crisis in the summer of 2011 and the pending fiscal cliff negotiations this month, the federal government is distorting, and largely hampering, economic activity. The City's most economically-sensitive revenue streams are business license and transient lodging taxes. It is unclear if the recent weakness in business license taxes will persist and transient lodging taxes are continuing a meteoric rise to record figures. However, should the federal government continue to put the brakes on the economy every 12 to 18 months, eventually it could push the vulnerable economy back into recession.

## Discretionary General Fund Resources

Roughly 90% of discretionary General Fund revenue (excluding beginning fund balance) comes from three sources: property taxes, business licenses, and utility licenses/franchise fees. Most of the remainder comes from transient lodging taxes and state shared revenues, which are comprised of the City's share of state-collected liquor and cigarette revenues. Transfers and various small miscellaneous sources round out the City's discretionary General Fund revenue sources. Table 2 summarizes the forecasts for each of these General Fund revenue sources over the five-year forecast horizon.

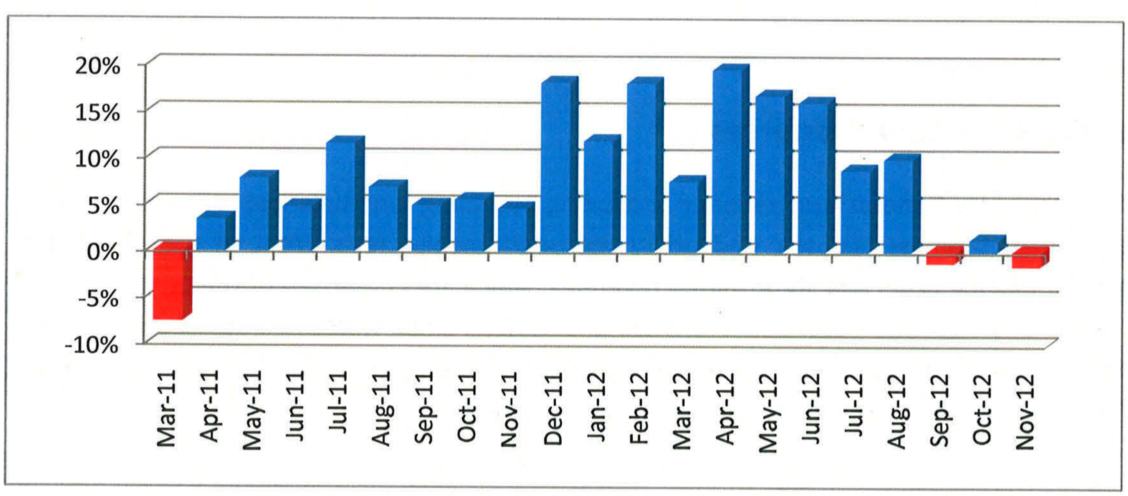
**TABLE 2. Discretionary General Fund Resources Five-Year Forecast ($millions)**

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| **Resource Category** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** |
| Beginning Balance[1] | $8.0 | $6.5 | $8.2 | $8.5 | $8.8 |
| Property Taxes | $190.8 | $197.9 | $205.2 | $212.2 | $217.6 |
| Transient Lodging | $19.1 | $19.9 | $20.4 | $21.4 | $22.3 |
| Business Licenses | $79.1 | $85.9 | $91.3 | $95.6 | $97.9 |
| Utility License/Franchise | $77.3 | $80.6 | $84.3 | $86.5 | $88.6 |
| State Revenues | $13.9 | $14.1 | $14.3 | $14.5 | $14.7 |
| Transfers | $0.8 | $0.8 | $0.8 | $0.8 | $0.8 |
| Miscellaneous | $2.0 | $2.1 | $2.1 | $2.2 | $2.2 |
| ***Total Resources*** | ***$390.8*** | ***$407.9*** | ***$426.9*** | ***$441.8*** | ***$453.0*** |

Note: Totals may not add due to rounding

Other than property taxes, the largest change in the forecast outlook since April is related to expectations of business license tax collections over the next few years. Business license tax growth has exceeded 10% growth for two consecutive years. This forecast assumes that subsequent growth in FY 2012-13 will push collections to pre-recession levels. Both this forecast and that for transient lodging taxes are highly sensitive to broad economic conditions, and thus present the greatest exposure to the revenue forecast. The most recent data suggest potential weakness in business license tax collections over the last several months. Figure 1 below shows the growth rate of business license tax deposits on a 3-month moving total basis. While it is important to not overreact given that the majority of this revenue is collected in the second half of the fiscal year, the recent weakness in suggests the possibility that growth in this source may not be as robust as currently forecasted. Furthermore, there is a significant risk of recession during the five-year forecast timeline. The average economic expansion lasts about six years. The last expansion lasted about five years and if there is no recession during the forecast horizon, the current expansion will have lasted nine years.

**FIGURE 1. Business License Tax Deposits (year-over-year growth, 3-month moving totals)**



To the extent some upside potential exists, the forecast for property taxes may see higher-than-expected growth. Though compression issues are exacerbated by the addition of the County Library District, the potential variance goes both ways. The forecast currently represents a conservative estimate of both the Library District impact, as well as the general property tax conditions. Therefore, should property values rise significantly – particularly in East and Southwest Portland where most property tax compression exists – the City could experience easing compression and, therefore, higher-than-expected property tax collections.

## Discretionary General Fund Expenses

The forecast for General Fund expenses is driven largely by a variety of inflation factors, as well as policy decisions. The forecast incorporates a 2.7% cost-of-living adjustment (COLA) for personal services for FY 2013-14, which is 0.4 percentage points higher than the 2.3% forecasted in April, thus raising costs by slightly less than $1 million. However, this increase was more than offset by a decrease in the expected PERS costs that are included in the forecast. Though General Fund discretionary costs associated with PERS will rise by nearly 50%, the forecast had assumed an even greater increase. Additionally, the forecast incorporates various other adjustments, most notably for the previously mentioned budget notes and DOJ agreement, as well as assumed health care premium costs. Costs associated with health care premiums will be higher than previously forecast in the out-years, as the City's Health Fund attempts to smooth out costs associated with several expensive recent claims. The summary of these expenses is displayed in Table 3.

**TABLE 3. Discretionary General Fund Expense Five-Year Forecast ($millions)**

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| **Expense Category** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** |
| Bureaus CAL Targets | $370.1 | $360.5 | $379.5 | $394.8 | $404.7 |
| Transfers to Bureaus | $15.1 | $15.4 | $15.6 | $13.5 | $13.7 |
| Council Set-Asides/Special Appropriations | $30.6 | $32.0 | $31.8 | $32.5 | $33.5 |
| One-time Spending Available | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Needed Cuts (FY 12-13 ongoing) | -$25.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| | | | | | |
| **Total Budget Requirements** | **$390.8** | **$407.9** | **$426.9** | **$441.8** | **$453.0** |
| Note: Totals may not add due to rounding | | | | | |

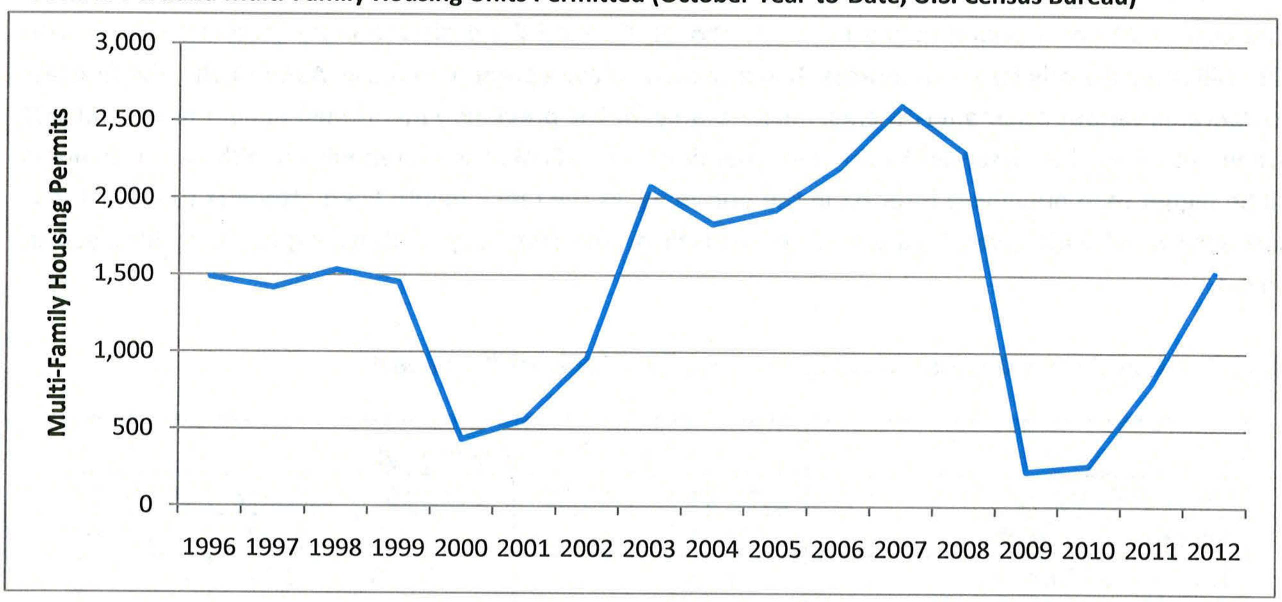
It should be noted that the current forecast assumes that while the most recent labor contracts will be fully funded, any additional costs associated with future labor agreements above cost-of-living adjustments would add new costs not reflected in the current forecast.

## Current Economic Conditions/Forecast Assumptions

There has been somewhat of a reversal of trend in the last several months. For the first time since the recovery started in June 2009, Portland seems to have slowed, while the rest of the state appears to be (finally) growing more steadily. In 2011, from June to October, the Portland Metro Area added 9,100 jobs. Over the same period in 2012, the metro area lost 1,000 jobs.

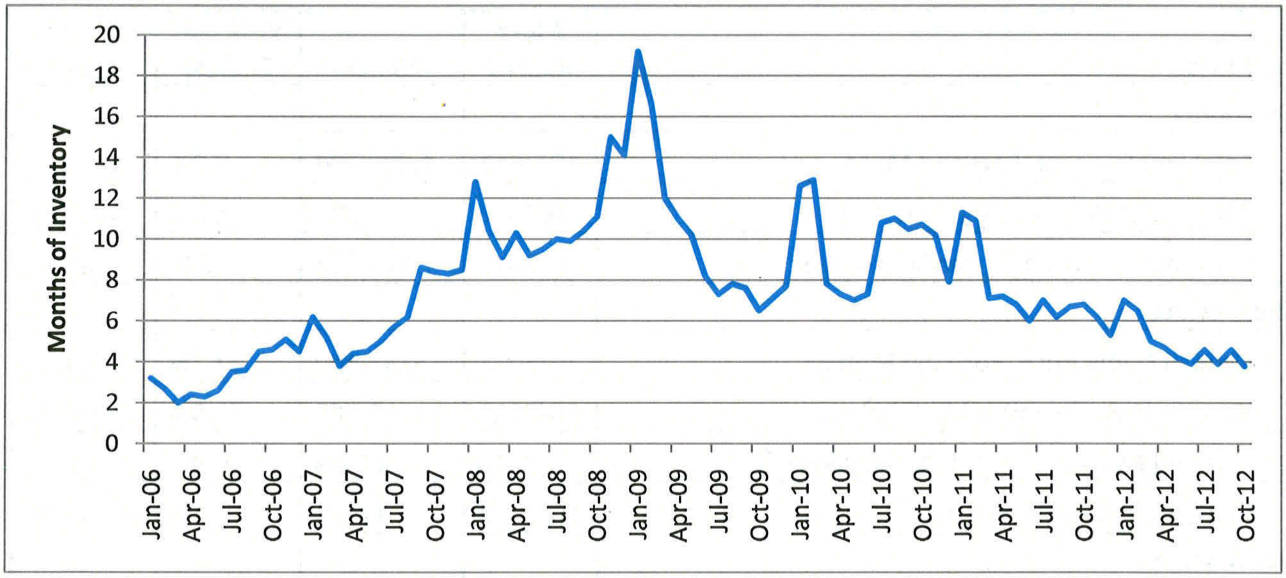
In better news, the real estate market is showing significant growth. Low vacancy rates, coupled with low borrowing costs are spurring apartment construction and demand for single family homes. Figures 2 and 3 show the permit activity for multi-family construction in Portland and the months of inventory[1] for single family home sales for the metro-area. The graphs below starkly illustrates both the housing bubble and the subsequent Great Recession. Meanwhile, along with the most recent permit activity, the pick up in demand for single family homes illustrated in the second graph signals at least a movement toward a more sustainable market.

**FIGURE 2. Portland Multi-Family Housing Units Permitted (October Year-to-Date, U.S. Census Bureau)**




[1] Months of inventory measures how many months of sales it would take to sell all of the existing homes for sale at the current sales pace.

**FIGURE 3. Months of Inventory for Single Family Home Sales for Portland Metro-Area (RMLS)**




**Economic Indicators/Forecast Assumptions.** Tables 4 and 5 summarize current selected economic indicators and forecasts that helped inform the General Fund forecast. Data is more mixed than has been in the recent past, with some slowing in the commerce categories, in particular.

**TABLE 4. Selected Portland Economic Indicators**

| Indicator | Most Recent | Value | Year Ago Change | Recent Trend |
|---|---|---|---|---|
| **Economy** | | | | |
| Total Employment, Portland MSA[1] | 10/2012 | 1,008,200 | 0.9% | Neutral |
| Portland MSA Unemployment Rate[1] | 10/2012 | 7.9% | -1.0% | Positive |
| Consumer Price Index, Portland-Salem[2] | 2Q-2012 | 223.712 | 2.2% | Neutral |
| **Real Estate** | | | | |
| Median Home Price, Portland Metro[4] | 10/2012 | $243,300 | 11.7% | Positive |
| Housing Units Permitted (Y-T-D)[5] | 10/2012 | 2,060 | 73.5% | Positive |
| Portland Metro Industrial Vacancy Rate[6] | 3Q-2012 | 13.6% | -0.8% | Neutral |
| Portland Office Vacancy Rate[6] | 3Q-2012 | 12.9% | -0.1% | Neutral |
| **Commerce** | | | | |
| Total PDX Air Passengers (Y-T-D)[7] | 10/2012 | 12,011,621 | 5.2% | Positive |
| Total PDX Freight (Y-T-D in Tons)[7] | 10/2012 | 172,495 | 3.1% | Positive |
| Total Port of Portland Marine Freight (Y-T-D in Tons)[7] | 10/2012 | 10,403,700 | -8.1% | Negative |
| Hotel Average Daily Rate[8] | 9/2012 | $145.38 | 8.7% | Positive |
| Hotel Occupancy Rate[8] | 9/2012 | 85.0% | 1.3% | Positive |

[1] Oregon Employment Department, Unemployment Rate is seasonally-adjusted, Year Ago Change is percentage point increase/decrease

[2] Bureau of Labor Statistics. CPI-W. Portland-Salem, OR-WA

[3] A measure of local business activity produced by the Oregon Economic Forum, University of Oregon

[4] Market Action, Publication of RMLS

[5] U.S. Census Bureau

[6] Norris, Beggs, & Simpson, Market Research

[7] Port of Portland, Aviation & Marine Statistics

[8] Wolfgang Rood Hospitality Consulting – Downtown Portland Market, Year Ago Change is percentage point increase/decrease

Forecasts for the beginning of a more robust recovery continue to be pushed out. Growth in broad economic indicators, such as Gross Domestic Product, are not expected to reach trend growth rates until at least 2014, a full year later than was forecast in April. While inflation has come up over the last 12 months, it should moderate in the near term without significant labor market support. With limited general demand, energy prices are not expected to show much movement in the near-term.

**Table 5. Selected Economic Indicator Forecasts**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| *Macroeconomic Indicators* | | | | | | |
| Real Gross Domestic Product[1] | 2.2% | 2.1% | 3.9% | 4.2% | 3.4% | 2.7% |
| Corporate Profits - U.S.[1] | 14.4% | 2.3% | 8.3% | 7.9% | 4.9% | 2.2% |
| Retail Trade Spending - U.S.[1] | 5.0% | 3.3% | 5.0% | 4.6% | 3.9% | 4.0% |
| Unemployment Rate - Portland-Vancouver-Hillsboro MSA[1] | 8.2% | 8.5% | 8.0% | 7.1% | 6.4% | 6.0% |
| Employment Growth - Portland-Vancouver-Hillsboro MSA[1] | 1.6% | 1.2% | 2.4% | 3.2% | 2.6% | 1.4% |
| Retail Trade Spending - Portland-Vancouver-Hillsboro MSA[1] | 5.7% | 4.0% | 5.3% | 5.8% | 4.9% | 4.3% |
| | | | | | | |
| *Prices* | | | | | | |
| CPI-W for Portland-Salem OR-WA | 3.3% | 2.7% | 2.8% | 2.5% | 2.3% | 2.3% |
| CPI-Services For U.S.[1] | 3.1% | 4.9% | 3.8% | 3.8% | 3.4% | 3.0% |
| Producer Price Index - U.S.[1] | 1.1% | 2.9% | 4.3% | 2.7% | 2.3% | 2.0% |
| Natural Gas Prices[2] | -9.5% | 10.5% | 4.2% | 4.5% | 1.0% | 2.6% |
| Electricity Prices[2] | 0.0% | 1.0% | 2.0% | 2.0% | 1.9% | 1.9% |
| | | | | | | |
| *Other Factors* | | | | | | |
| PERS Employer Cost Rates - Tier 1 & 2 | 9.3% | 9.3% | 13.7% | 13.7% | 16.0% | 16.0% |
| PERS Employer Cost Rates - OPSIRP (non-sworn) | 7.7% | 7.7% | 11.9% | 11.9% | 13.5% | 13.5% |
| PERS Employer Cost Rates - OPSIRP (sworn) | 10.4% | 10.4% | 14.7% | 14.7% | 16.5% | 16.5% |
| | | | | | | |

[1] Provided by Moody's/Economy.com

[2] United States Energy Information Administration

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Agenda No.

**REPORT NO.**

Title

Transmit FY 2013-14 General Fund Five-Year Financial Forecast (Report)

| INTRODUCED BY Commissioner/Auditor: **Mayor Sam Adams** | CLERK USE: DATE FILED NOV 30 2012 |
|---|---|
| **COMMISSIONER APPROVAL** | LaVonne Griffin-Valade<br>Auditor of the City of Portland<br><br>By: ______ Deputy |
| Mayor—Finance and Administration - Adams | |
| Position 1/Utilities - Fritz | |
| Position 2/Works - Fish | |
| Position 3/Affairs - Saltzman | |
| Position 4/Safety - Leonard | **ACTION TAKEN:** |
| **BUREAU APPROVAL**<br>Bureau: OMF/Financial Services<br>CAO: Jack D. Graham<br>Bureau Head: Rich Goward | DEC 05 2012 ACCEPTED |
| Prepared by: Jeramy Patton<br>Date Prepared:November 28 | |
| Financial Impact Statement<br>Completed ☒ Amends Budget ☐<br>Not Required ☐ | |
| Council Meeting Date<br>**December 5, 2012** | |
| **City Attorney Approval** | |

## AGENDA

**TIME CERTAIN** ☐

**Start time:** _____

**Total amount of time needed:** _____
**(for presentation, testimony and discussion)**

**CONSENT** ☐

**REGULAR** ☒
**Total amount of time needed: 20 minutes**
**(for presentation, testimony and discussion)**

| FOUR-FIFTHS AGENDA | COMMISSIONERS VOTED AS FOLLOWS: | YEAS | NAYS |
|---|---|---|---|
| 1. Fritz | 1. Fritz | ✓ | |
| 2. Fish | 2. Fish | ✓ | |
| 3. Saltzman | 3. Saltzman | — | |
| 4. Leonard | 4. Leonard | ✓ | |
| Adams | Adams | ✓ | |