City of Portland

Five-Year General Fund Financial Forecast

FY 2011-12 through FY 2015-16

Office of Management and Finance

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This document presents the City of Portland's Five-Year Financial Forecast. Table 1 below summarizes discretionary General Fund resources and expense requirements through FY 2015-16. As shown in Table 1, the City is projected to need to make $1.5 million in ongoing spending cuts in order to meet current service levels over the five-year forecast horizon. In comparison to the December forecast, slightly higher revenue forecasts were more than offset by increases in projected spending associated with labor contracts.

Though resources exist to make a larger portion of spending ongoing for the five-year forecast, this is only a result of one-time revenues that are being spread over five years. In order to avoid cuts in year six, these one-time resources are appropriately reflected as one-time spending. Table 1 reflects a proposed allocation of these one-time resources in each year of the forecast. Such an allocation would reserve $10 million in FY 2011-12 for future year spending. It should be noted that there are insufficient resources forecasted to fund the current level of one-time spending throughout the forecast horizon.

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

	Fiscal Year				
Budget Category	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Total Resources	**$405.6**	**$408.3**	**$423.9**	**$439.7**	**$454.2**
Necessary Ongoing Cuts[1]	-$1.5	$0.0	$0.0	$0.0	$0.0
One-Time Spending	$17.4	$5.0	$4.0	$3.4	$2.5
Total Expenses with Cuts & One-Time Spending	**$395.6**	**$401.4**	**$419.6**	**$437.1**	**$454.2**
Reserved for Future Spending	*$10.0*	*$6.8*	*$4.4*	*$2.6*	*$0.0*

[1] An ongoing cut of $1.5 million in FY 2011-12 is necessary in order to balance ongoing revenues with ongoing expenses throughout the five-year forecast.

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

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comes from transient lodging taxes and state shared revenues, which are comprised of the City's share of state-collected liquor and cigarette revenues. Interest income, 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	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Beginning Balance[1]	$36.3	$21.9	$18.9	$16.9	$15.7
Property Taxes	$198.0	$203.9	$210.1	$216.3	$222.8
Transient Lodging	$15.2	$17.2	$18.8	$19.7	$19.7
Business Licenses	$67.4	$73.7	$80.4	$87.0	$91.9
Utility License/Franchise	$70.8	$74.2	$77.7	$81.0	$85.1
State Revenues	$12.4	$12.6	$12.7	$12.9	$13.0
Interest Income	$1.1	$1.4	$1.9	$2.3	$2.3
Transfers	$1.7	$0.6	$0.6	$0.6	$0.6
Miscellaneous	$2.7	$2.8	$2.9	$3.0	$3.1
Total Resources	***$405.6***	***$408.3***	***$423.9***	***$439.7***	***$454.2***

[1] FY 2011-12 beginning balance includes $8.1 million of forecasted and unbudgeted FY 2010-11 revenue, estimated unspent budget from FY 2010-11, the recognition of $16.8 million accrual, and $3.9 million of FY 2009-10 revenue held over for FY 2011-12 spending.

The forecast outlook since December generally remains unchanged, reflecting an expectation of modest economic growth, below that of a "typical" economic expansion. Of course, the preceding recession was anything but "typical" and economies coming out of financial crises have a harder time finding firm economic footing. Among the modest changes was a slightly lower property tax forecast, as conditions in the housing market have worsened since December. While General Fund property taxes are generally insulated from market conditions because of voter-approved Measures 5 and 50, changes to the real market values of properties will have an impact at the margins. Business License revenue collections in FY 2010-11 are expected to come in modestly higher than the December forecast numbers. Meanwhile, in spite of slow consumer spending growth, lodging tax revenue collections are appearing healthier than previously expected, resulting in increases to the forecast. Finally, the forecast for Utility License/Franchise Fee revenue was essentially unchanged as increases in cable/telecom collections were largely offset by decreases in the expectations for collections from other utility providers. Table 3 describes changes in the forecasts for FY 2011-12 from the December 2010 forecast for various revenue sources.

TABLE 3. Discretionary General Fund Revenue Forecast Changes Since December ($millions)

	Time Period	
Revenue Category	**2011-12**	**Five-Year Forecast**
Property Taxes	-$1.1	-$8.2
Transient Lodging	$0.5	$10.6
Business Licenses[1]	$0.9	-$1.6
Utility License/Franchise	$0.3	$1.5
State Revenues	$0.1	$0.5
Interest Income	$0.0	$0.0
Transfers	$1.1	$1.1
Miscellaneous	$0.0	$0.0
Total Discretionary Revenue	***$1.8***	***$3.9***

[1] The growth path for business license revenue was changed since the December forecast resulting in near-term increases relative to December, but out-year decreases. In neither case is the change significant relative to the historical volatility of Business License taxes.

Risks to Revenue Forecast

It should be noted that this forecast represents a conservative expectation of revenue flows. However, significant risks remain related to the City's General Fund revenue sources. Many of these risks are summarized below.

- **Potential Multnomah County Library District** – The Multnomah County Library is currently funded, in part, from a local option property tax levy that is expiring next year. The County will refer to voters a measure that will in all likelihood either renew the current levy at a higher rate or establish a permanent levy. While voter approval of either scenario would result in lower General Fund property taxes to the City, the establishment of a permanent district would have a much larger impact – a decrease of at least $5 million is likely.

- **Economic Conditions** – While the forecast is built on the expectation of slow economic growth, it does not assume that the U.S. will fall back into a recession. Should the economy deteriorate rapidly, especially in the near-term, the City could realize lower revenue, particularly in business licenses. It should be noted that this is also a risk on the upside, as a stabilizing housing market and sharper increases in job growth could help push revenues above forecasted levels.

- **Audit Recoveries** – The forecast assumes no audit recoveries in Utility License/Franchise Fee revenue because these revenues are viewed as particularly unstable and one-time in nature. To the extent that the City recovers revenue through this avenue, revenues will exceed the forecast.

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 1.2% cost-of-living adjustment (COLA) for personal services for FY 2011-12, slightly higher than the 1.0% assumed in the December forecast. This increases ongoing expenditures by approximately $400,000 annually relative to December. Additionally, the forecast incorporates various other adjustments, most notably the police labor agreements, which increase costs in FY 2011-12 by $2.9 million. Finally, because the City balances its budget over the entire five-year forecast, it is expected that some resources in some years will be required to go unspent in order to balance in future years. The summary of these factors is displayed in Table 4.

TABLE 4. Discretionary General Fund Expense Five-Year Forecast ($millions)

	Fiscal Year				
Expense Category	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Bureaus & Programs	$354.7	$367.1	$382.2	$399.5	$417.6
Planned One-Time[1]	$0.2	$0.2	$0.2	$0.2	$0.2
New One-Time	$6.9	$5.0	$4.0	$3.4	$2.5
Continue Existing One-time	$10.5	$0.0	$0.0	$0.0	$0.0
Council Set-Asides	$21.4	$24.4	$27.6	$28.2	$28.0
Labor Contracts	$3.2	$4.6	$5.5	$5.7	$5.9
Needed Cuts (FY 11-12 ongoing)	-$1.5	$0.0	$0.0	$0.0	$0.0
Total Budget Requirements	**$395.6**	**$401.4**	**$419.6**	**$437.1**	**$454.2**
Reserved for Future Spending	*$10.0*	*$6.8*	*$4.4*	*$2.6*	*$0.0*

[1] Per council ordinance, assumes $200,000 in annual one-time funding for the Regional Arts & Culture Council.

The current forecast assumes a 2.1% cost-of-living adjustment in FY 2012-13 growing to approximately 3% in each of the out years of the forecast. It also 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. Finally, future costs associated with increasing PERS obligations for current employees are included beginning in FY 2013-14 and FY 2015-16.

Risks to Expense Forecast

The following summarizes significant risks to the current forecast as they relate to expenses. To the extent that the expectations for any of these factors differ from what is realized, the forecast is at risk.

- **Continue One-time Expenses** – There are not enough resources to continue funding all of the currently one-time funded programs throughout the five-year forecast. Should these expenses be expanded, there could be a greater need for cuts in the event of a revenue downturn.

- **Inflation** – Commodities prices have stoked fears of rampant inflation. Absent underlying wage pressure, which in the current labor market in nonexistent, presumably limits the potential of a wage-price spiral. However, should prices escalate for a sustained period, there would be substantial increases in expenses above the current forecast. Ultimately, because a large majority of the forecast is based on inflation expectations, the exposure to the forecast from deviations in inflation could significantly move in either direction.

- **Benefit Costs** – Large increases in health care benefits and PERS costs are incorporated in the forecast; however the actual costs could be higher or lower depending on a variety of difficult-to-forecast measures (e.g., financial market activity).

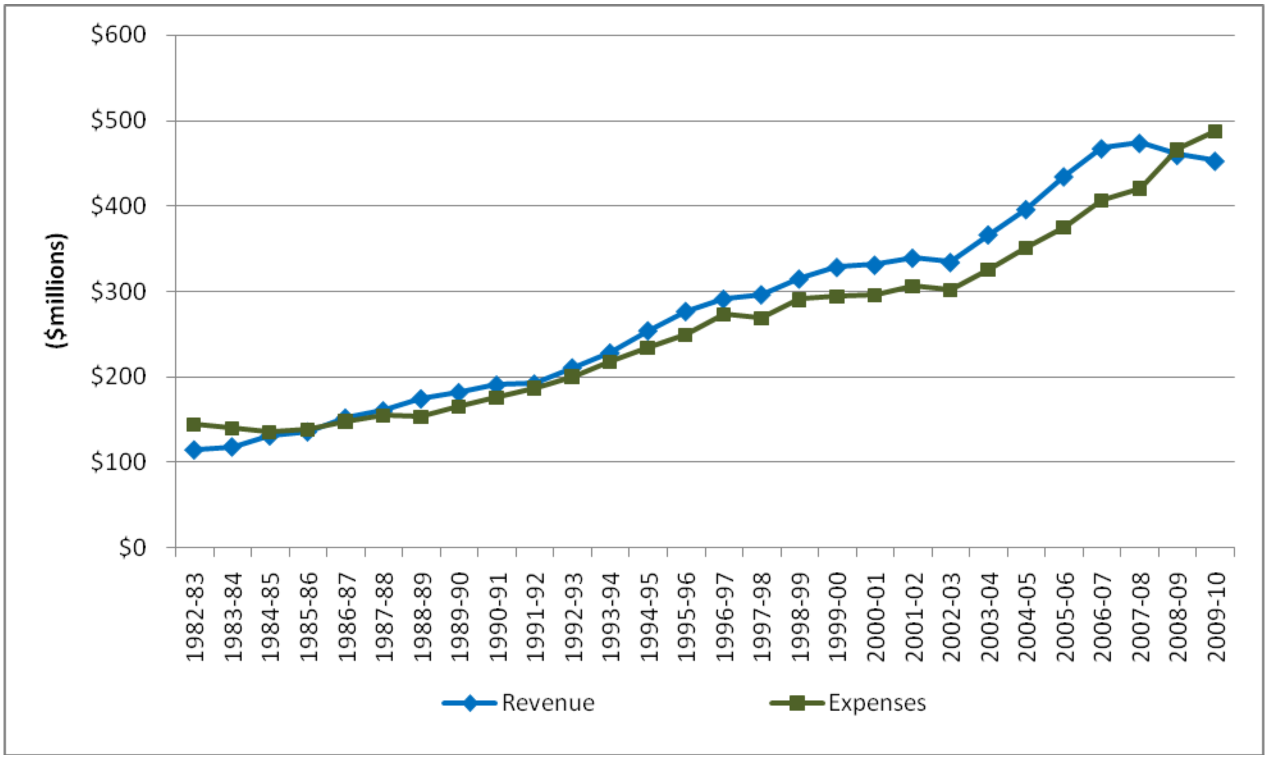
- **Future Labor Contracts** – Because the vast majority of City costs are related to personnel and most of those costs are driven by labor agreements, there is significant risk associated with increase cost from future labor negotiations. Costs associated with the most recent agreements are incorporated into the five-year forecast.

- **Public Safety Requirements** – Costs related to Police and Fire account for well over half of discretionary General Fund spending. Demands for these services could drive City expenses higher.

Long-Term Trends

This section of the forecast is intended to provide background information regarding the long-term trends associated with the City's General Fund revenues and expenses. As has been pointed out earlier, we would not necessarily expect that the future would be reflective of the past, due to the nature of the recent downturn. Indeed, we are expecting more modest growth than typically accompanies economic recoveries. Figure 1 shows how General Fund revenues and expenses have grown since FY 1982-83. In spite of the most recent downturn, revenues growth has generally outpaced expense growth, growing by 5.2% annually versus 4.6% for expenses. However, the instability of the last ten years has flipped those broader trends, with expense growth outpacing revenue growth.

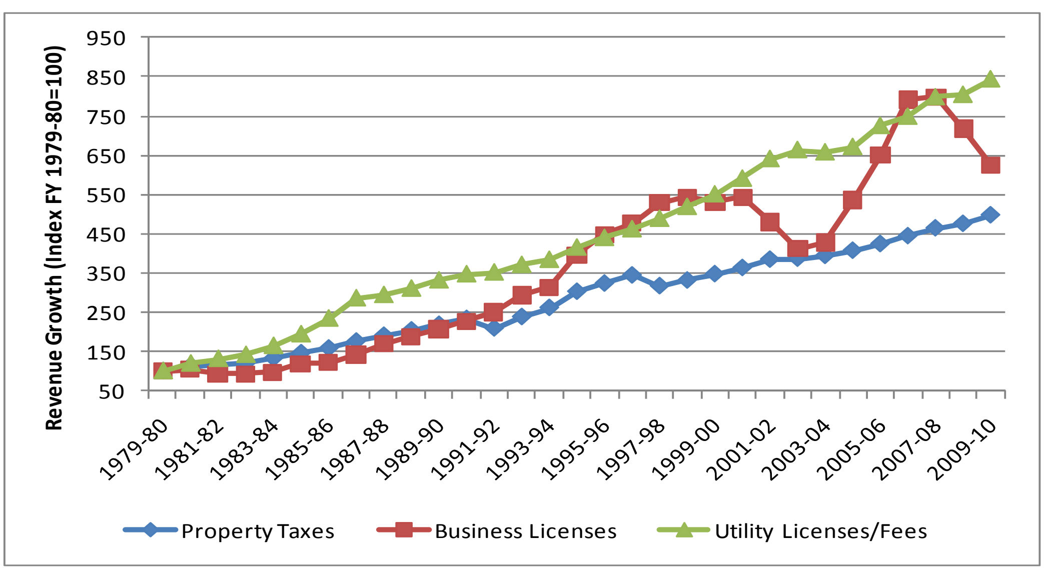
FIGURE 1. Historical General Fund Revenue and Expenses



Discretionary General Fund Revenues

Property taxes, Business License taxes, and Utility Licenses/Fees usually account for approximately 90% of discretionary General Fund revenues, net of beginning balance. While Business License taxes are volatile (i.e., business cycle dependent), the other two main sources tend to grow by relatively stable percentages every year. Figure 2 below shows how each has tracked since FY 1979-80.

FIGURE 2. Growth of Selected General Fund Revenue Sources



It is important to note that the first year that property taxes were fully impacted by Measures 5 and 50 was FY 1997-98. Since that time, property taxes have avoided the large increases and subsequent decreases in real market values that characterized much of the last decade. Over the last three decades, property taxes have grown by a compound average annual rate of 5.3%, compared with 3.8% average annual growth since FY 1997-98. Meanwhile, the comparable 30-year growth rates in Business License taxes and Utility Licenses/Fees are 6.1% and 7.1%, respectively. Over the last decade, growth in Business Licenses has been muted significantly by two recessions, while Utility Licenses/Fees have continued to climb.

The remainder of discretionary General Fund revenue contains transient lodging taxes, liquor and cigarette revenue collected by the State and distributed to counties and cities, interest income earned on General Fund cash balances, as well as various transfers and other miscellaneous income. Transient lodging taxes tend to behave similarly to Business Licenses, though because they are only about one-quarter the size, do not inflict the same amount of damage on the City's budget during economic downturns. State shared revenue moves largely with population growth, as liquor consumption tends to be inelastic with respect to the economy and accounts for nearly 95% of these revenues. Interest income will depend largely on prevailing interest rates, which are currently very low by historical standards resulting in interest income waning in recent years. Transfer and miscellaneous revenue are subject to policy decisions and various inconsistent revenues, thus making it nearly impossible to apply any consistent metric to it.

General Fund Expenses

Total General Fund expenses are driven almost entirely by personal services costs and materials and services, both external and internal. These sources account for more as much as 95% of General Fund expenses. In addition to simply adding workers, personal services costs are driven by cost-of-living increases (e.g., inflation and labor contracts) and escalations in benefit casts, both for pensions and health insurance. Materials and services expenses are more flexible, thereby making them historically more volatile, as the City looks to cut costs in economic downturns. Figure 3 below illustrates this trend.

FIGURE 3. Growth of Selected General Fund Expenses