PORTLAND'S FISCAL SUSTAINABILITY AND FINANCIAL CONDITION:
Maintenance needs and pension costs challenge long-term position

June 2015

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Office of the City Auditor
Portland, Oregon

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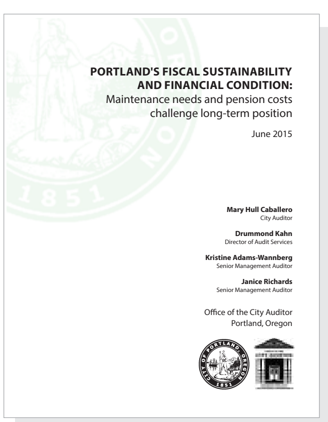

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June 29, 2015

TO: Mayor Charlie Hales
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Steve Novick
Commissioner Dan Saltzman
Fred Miller, Chief Administrative Officer, Office of Management and Finance

SUBJECT: Audit Report: *Portland's Fiscal Sustainability and Financial Condition: Maintenance needs and pension costs challenge long-term position* (Report #470)

There is no shortage of financial data produced by local governments, though much of it reflects a single snapshot in time. This report focuses on historical trends, allowing decision-makers to visualize the City's trajectory, consider options, and make adjustments to improve long-term outcomes.

Our approach is based on criteria provided by the International City/County Management Association. It is used by governments in our region and across the country, including Metro and Multnomah County, to provide big-picture context for information drawn from annual financial statements.

We reiterate our recommendation from our 2013 Financial Condition report that the Office of Management and Finance provide Council with an annual assessment of how the City's long-term position could be improved. We believe a yearly discussion of options would improve decision-making and transparency.

We will follow-up next year with the Commissioner-in-Charge of the Office of Management and Finance and the Chief Administrative Officer for a status report on the steps taken to address our recommendation.

Mary Hull Caballero

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INTRODUCTION

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Why we do a fiscal sustainability report

This report provides residents and public officials with information on the City of Portland's financial health. While useful information is presented in various City documents, such as the Comprehensive Annual Financial Report and the Adopted Budget, this report is intended to provide financial and demographic information so it can be read and understood by a wide audience. In presenting the measures, we identify both favorable and unfavorable trends in City finances at a high level, and we make recommendations where needed.

Many of these indicators are based on full accrual financial information rather than a cash basis. A cash basis records revenues that came in and what was spent, which is what the City uses to prepare and balance the annual budget. A full accrual basis includes revenues earned during the year whether or not they were received and all expenses incurred even if not paid. It also includes liabilities and depreciation costs.

We also present liability information for the City. In some cases, such as for pension and post-employment benefit liabilities, these are actuarial calculations that represent the present value of costs projected into the future. For example, we present estimates of future spending for the City's Fire and Police Disability and Retirement System, as prepared by their actuary.

The data generally covers a 10-year period, from Fiscal Year 2004-05 (2005) through Fiscal Year 2013-14 (2014). City fiscal years run from July 1 to June 30.

What is fiscal sustainability?

There is currently no universally accepted definition of fiscal sustainability. According to the Governmental Accounting Standards Board, the term is tied with the idea of inter-generational equity or fairness, which considers the degree to which future generations of taxpayers will have to address the fiscal consequences of current policies. The Board's tentative definition is:

> *Fiscal sustainability is a government's ability and willingness to generate inflows of resources necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits.*

A fiscally sustainable city can meet its financial obligations and support public services on an ongoing basis. It can address the effects of fiscal interdependency between governments, withstand economic disruptions, and respond to changes in the underlying environment in which a government operates. A financially stable city collects enough revenue to pay its short and long-term bills and to finance major infrastructure needs without shifting disproportionate costs to future generations. In addition, the concept also includes the governmental structure and willingness to make decisions that will keep the government fiscally sound.

We monitor financial condition and fiscal sustainability by reviewing trends in several areas, such as

- Revenues and expenses
- Net position and liquidity
- Liabilities, such as outstanding debt, pension, and other post-employment benefit liabilities
- Demographics and economy

Monitoring these areas over time enables public officials and residents to assess a city's fiscal sustainability and to identify problem areas that may need attention.

SUMMARY

SUMMARY

Findings

Portland's financial health is currently stable, but increasing liabilities, unmet infrastructure maintenance needs, and growing debt weaken the City's ability to provide existing levels of service on an ongoing basis. During our audit, we found:

- The City is doing well in the short-term. Its revenue base is diverse, and total City revenues and revenues per resident are increasing. The City has favorable liquidity and good credit ratings. It also benefits from financial policies that help in monitoring and multi-year planning.
- The City's long-term financial position is more problematic. In 8 of the last 10 years, total City expenses (including liabilities and depreciation costs) have been greater than its incoming revenues. The City's net position continues to decline due to unfunded liabilities and deferred maintenance.
- Revised financial policies may aid Council in providing additional one-time funding for infrastructure needs if the policies are followed. A more permanent solution may be needed to address growing maintenance requirements.

Street repairs

Source: Portland Bureau of Transportation

Recommendations

In our report on this topic two years ago, we made two recommendations to the Office of Management and Finance:
To provide Council with an annual analysis of the City's financial position, including development of benchmarks, and to provide ideas on how the City's position could be strengthened. We suggested Management and Finance present this analysis after the external financial audit's completion. The Mayor and Management and Finance were supportive of the recommendations.

Management and Finance began to implement the recommendations, but the effort was suspended. Management and Finance should renew its efforts to prepare an annual analysis.

Key indicators and results

Indicator	Overall 10 year trend	Interpretation
Revenues per resident	↑	OK
Percent of City property tax dollars supporting the General Fund	↓	Caution
Expenses per resident	↓	OK
City employees per 1,000 residents	↓	OK
City outstanding debt principal per resident	↑	Caution
Credit ratings for outstanding debt	Above minimum City standard for 2014 (except Hydro)	OK
City net position	↓	Caution
City liquidity	Above standard of \$1 current asset per \$1 current liability	OK
Funded ratios for pension liabilities and other post-employment benefits	Mixed - criteria is 80% funded ratio 0% for FPDR and OPEB 88% for PERS in 2013	Caution FPDR *and* OPEB OK PERS
Asset condition	No trend. 2014 data shows condition varies widely by asset.	Caution

Source: International City/County Management Association's *Evaluating Financial Condition: A Handbook for Local Government* for most criteria and Audit Services analysis for overall trends

SUMMARY

INDICATORS

REVENUE INDICATORS

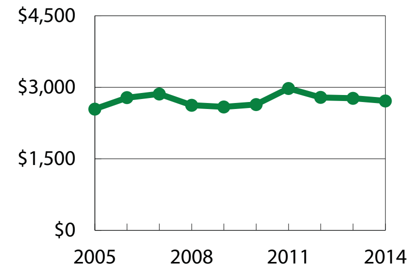
About the indicators

Revenues determine the capacity of a local government to provide services. Below, we show detail on City revenues per resident, City property taxes, and utility revenues.

City revenues increased between 2005 and 2014

Total City revenues are up 17 percent, from $1.4 billion in 2005 to $1.6 billion in 2014. Total revenue per resident increased 7 percent during this time, from $2,543 to $2,714. Both declined after peaking in 2011, but remain above 2005 levels. Portland's population has grown 9 percent during the 10 years.

Revenue per resident (adjusted)



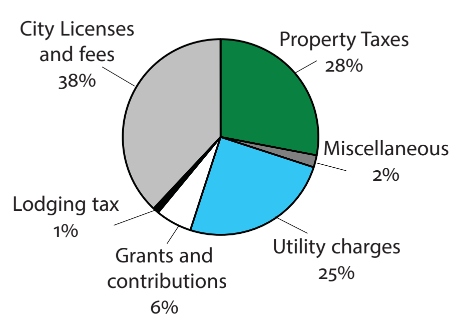
Source: Portland CAFRs and PSU Center for Population Research

Diversified revenue sources help the City weather downturns

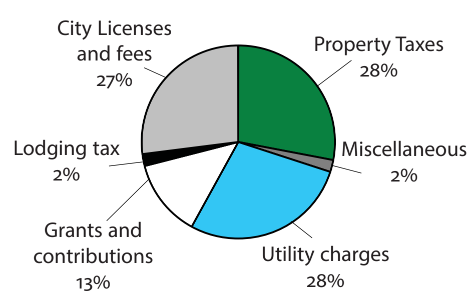
Revenues are diversified among sources that are more stable, such as property taxes and utility charges, and revenues that fluctuate with the economy, such as business licenses and lodging taxes. The composition of City revenues changed from 2005 to 2014, with decreases in more volatile City licenses and fees offset by increased grants and contributions from other governments. One-time capital grants peaked in 2011 with large federal grants for transportation projects, such as the Eastside Streetcar line – completed in 2013 – and the realignment of Moody Avenue – completed in 2011.

Revenues by source (adjusted)

2005 ($1.4 billion)



2014 ($1.6 billion)



Source: Portland CAFRs

Where each dollar of City property tax goes

City property taxes pay for a variety of services. Almost half go to the General Fund to pay for services such as parks, police, and fire protection. Taxes paid to the Fire and Police Disability and Retirement Fund are used to pay for retirement and disability costs for active and retired police and firefighters. Urban renewal funds collect property taxes to pay off debt incurred for improvements. Voters may also approve property taxes for other purposes, such as special levies or bonds, and those are also deposited in dedicated funds.

Total property taxes going to the City of Portland grew by 14 percent, from $397 million in 2005 to $454 million in 2014. The services and obligations of City property tax dollars have shifted over the last 10 years, with an increasing percentage supporting urban renewal debt and a reduced share going to the General Fund.

2005 City property tax dollar ($397 million, adjusted)

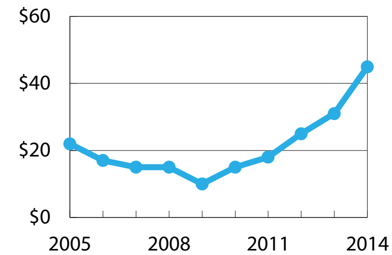
2014 City property tax dollar ($454 million, adjusted)

Source: Portland CAFRs

Growing losses due to property tax limits

All general government property taxes must fit within a limit of $10 per $1,000 of real market property value. This includes taxes levied by the City of Portland, Multnomah County, Metro, Port of Portland, and other taxing districts. If the limit is exceeded, local option levies, such as the Children's Levy, are reduced first, or 'compressed,' to zero if necessary. If further reductions are needed to reach the limit, all other taxes are reduced on a proportional basis.

City property tax losses from compression (millions, adjusted)



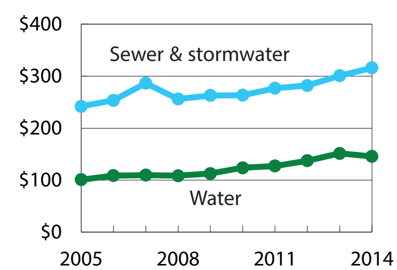
Source: Tax Supervising and Conservation Commission

Reductions in real market value caused by declining home prices, combined with increases in retirement fund costs and higher urban renewal taxes, increased compression losses in recent years. The new Library District, effective in July 2013, also contributed to compression losses. The Multnomah County Tax Supervising and Conservation Commission reported in 2014 that government losses from compression were at an all-time high. The City's compression losses were $31 million in 2013 and $45 million in 2014.

Utility revenues increasing

Revenues for sewer and stormwater fees (Environmental Services) increased 31 percent, from $242 million in 2005 to $316 million in 2014. Water revenues increased 44 percent, from $101 million to $146 million over the same period. These revenues are not discretionary and must be spent on water and sewer services.

Utility Revenues
(millions, adjusted)



Source: Portland CAFRs

EXPENSE INDICATORS

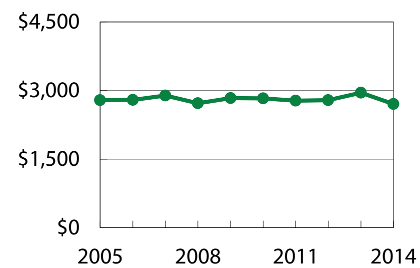
About the indicators

Expenses are government's costs of providing services. Some common expenses are salaries and wages, pension obligations, and asset depreciation. Below, we show City expense per resident and by service area. We also show how many employees work for the City.

City expense per resident was mostly steady

City expense per Portland resident was steady most of the 10 years. In comparing 2005 and 2014, expense declined slightly from $2,790 per resident to $2,704. Total City costs increased from $1.5 billion to $1.6 billion, a 6 percent increase.

Expense per resident (adjusted)



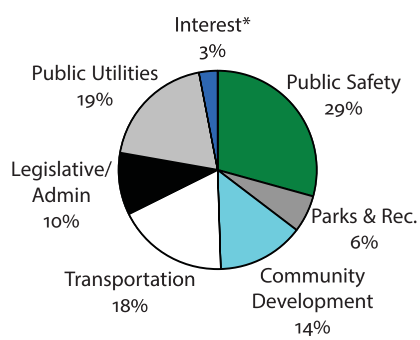
Source: Portland CAFRs and PSU Center for Population Research

Public safety services remain the single largest City expense

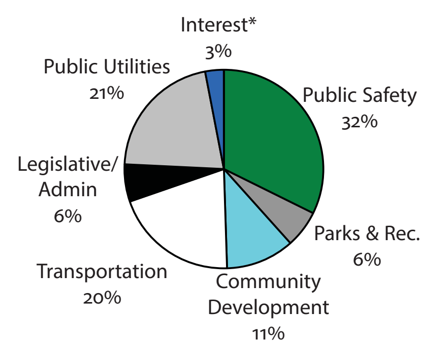
For the last 10 years, the City's largest expense by service area was for Public Safety services. These include police, fire, emergency communications, and emergency management functions. In 2014, public safety expenses were $524 million and represented 32 percent of the total City expense. This is a 16 percent increase from 2005, when it was $453 million.

Expense by service area (adjusted)

2005 ($1.5 billion)



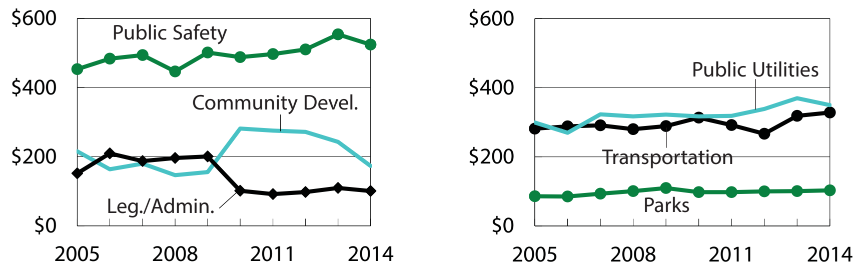
2014 ($1.6 billion)



Source: Portland CAFRs

* Interest on long-term debt is for governmental activities only. Interest for business activities (largely public utilities) is included in their respective service area.

Expense by service area (adjusted, millions)



Source: Portland CAFRs

Public Utilities were 21 percent of City expenses in 2014. Water, hydropower, and sewer services combined increased 17 percent from 2005 to 2014, from $299 million to $350 million, respectively.

Transportation costs were $328 million in 2014, and were 20 percent of total City expense. Service area costs trended slightly up until 2011 and 2012. Decreases were caused by reduced federal revenues. Expenses rose in 2013 because of payments for the Portland-Milwaukie Light Rail and the Sellwood Bridge projects.

Community Development costs fluctuated during the 10 year period. Some of these expenses include development services, housing, and urban renewal. This service area was $173 million in 2014, representing 11 percent of the City's costs. Some of the change is from a 2010 re-categorization of the Special Finance and Resource Fund from the Legislative/Administration area to Community Development. The fund holds urban renewal bond proceeds.

The number of City employees per resident was steady

Total City employment was largely steady over 10 years, from 5,679 to 5,562 employees. The number of employees decreased from 10 to 9 employees per 1,000 Portland residents during the same time period. The number of public safety employees remained at four employees per 1,000 residents until 2013, when it decreased to three per 1,000 residents.

City employees

Source: Portland SAP system, BHR position management system, PDC CAFRs

DEBT INDICATORS

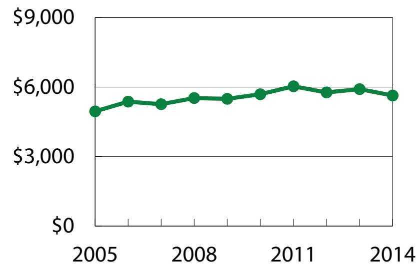
About the indicators

The City borrows money to pay for capital improvements, ranging from sewer pipes to computer systems, and to finance urban renewal programs. Below, we show debt per City resident and details on the trends, uses, ratings, and annual debt service costs for various types of City debt.

Debt per resident increased

The City's total outstanding debt increased 24 percent from 2005 to 2014, from $2.7 billion to $3.4 billion. In 2014, the total outstanding debt per resident was $5,630. This is an increase of 14 percent from 2005.

Debt per resident (adjusted)



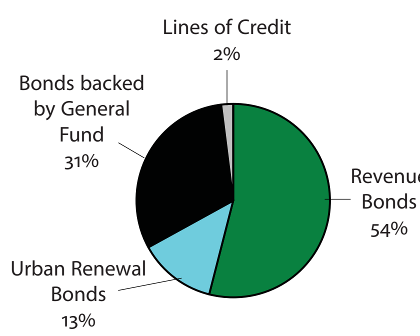
Source: Portland CAFRs and PSU Center for Population Research

The majority of debt is for revenue bonds

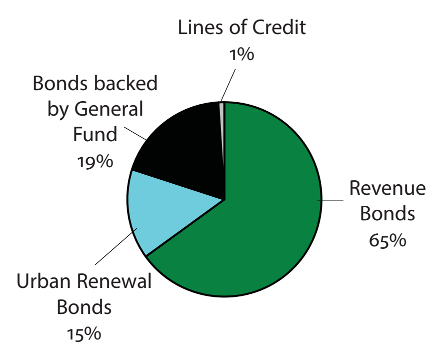
Sixty-five percent of the City's outstanding debt is for revenue bonds. Revenue bonds are backed by dedicated sources, such as water and sewer fees. They finance new or improved infrastructure for City services and include water, sewer, gas tax, and hydroelectric power bonds. The assets purchased or improved with these bonds are shown on the City's statement of net position. Outstanding debt for revenue bonds increased 49 percent from 2005 to 2014, from $1.5 billion to $2.2 billion.

Debt by type (adjusted)

2005 ($2.7 billion)



2014 ($3.4 billion)



Source: Portland CAFRs

Almost all of the revenue bonds are for sewer infrastructure ($1.6 billion) and water system improvements ($0.6 billion). Major water and sewer projects include the Combined Sewer Overflow (the Big Pipe project), enhanced water treatment to meet federal requirements, and replacing aging infrastructure.

The City has no specific limit on the amount of revenue bonds it may issue, but debt capacity is restricted by existing bond covenants and available repayment resources. City debt policy requires that before a new bond is issued, the City develop a financial plan to show the required rates and charges to support the debt and the ratepayer impact.

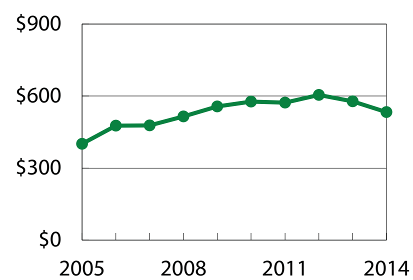
City debt backed by the General Fund decreased

Debt backed by the General Fund includes General Obligation bonds approved by voters and paid with property taxes as well as bonds paid from other General Fund resources, such as lodging taxes. It also includes bonds to be paid from dedicated revenues, such as spectator facilities revenues, with property taxes used as a guarantee. Bonds backed by the General Fund decreased 22 percent from 2005 to 2014, from $839 million to $654 million. General Obligation bonds totaled $76 million in 2014 for fire stations, parks, and public safety.

City debt policy limits bonds backed by the General Fund as a percentage of real market value of property within the City. According to OMF, the City has always operated within those limits.

The use of urban renewal debt has slowed recently

Urban renewal debt
(millions, adjusted)



Source: Portland CAFRs and Office of Management and Finance

Urban renewal debt grew 33 percent from 2005 to 2014, from $401 million to $533 million. Debt peaked at $605 million in 2012, then fell to $533 million in 2014. Most of the decrease is attributed to limited urban renewal activity in 2013 and no activity in 2014. This debt pays for housing and economic development programs in urban renewal areas, with the expectation that property values will increase because of the investments. Urban renewal debt is backed by property taxes, with the increase in value used to pay off the debt.

2014 Urban renewal debt by area
(millions, rounded)

Urban Renewal Area	Debt Outstanding
Convention Center	$95
River District	$71
North Macadam	$71
Interstate Corridor	$70
Downtown Waterfront	$65
South Park Blocks	$54
Central Eastside	$33
Lents	$32
Airport Way	$29
Gateway	$13
TOTAL	**$533**

Source: City of Portland CAFR and Office of Management and Finance

Some investments in urban renewal areas, such as parks or transportation improvements, result in new assets owned by the City. However, other investments, such as business and housing grant and loan programs, result in assets owned by others.

The City sets a limit on the amount of debt that may be issued in each urban renewal area as part of the plan for each area.

How much debt is too much?

City debt policies are consistent with best practices. General Fund-backed debt is within limits set by City policy, and nearly all ratings for outstanding debt meet City policy for a minimum of above-average credit quality. About 12 percent of the City's debt has the highest rating, including General Obligation Bonds. This high quality means lower borrowing costs. The remaining 88 percent of City debt has lower, but still good ratings. This indicates that the rating agencies view the debt as a low credit risk.

Debt Ratings

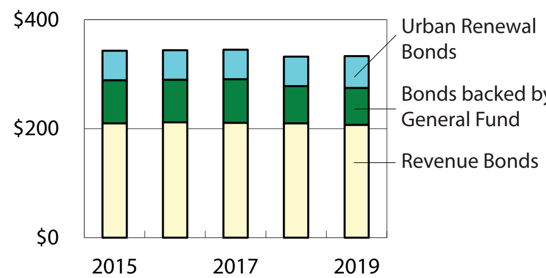
Type	% of City total	Moody's Rating	Credit Quality
General Obligation Bonds	2%	Aaa	Strongest
First Lien Water Revenue Bonds	10%	Aaa	Strongest
Other Full Faith and Credit Obligations	18%	Aa1	Very strong
Other Revenue Bonds	51%	Aa1 to Aa3	Very strong
Urban Renewal Bonds	16%	Aa3 to A2	Very strong to above-average
Lines of Credit	3%	Not rated	Not rated
Hydroelectric Power Bonds	<1%	Baa1	Average

Source: Annual Debt Report FY 2013-14

Debt financing allows the City to spread the costs of large capital projects across multiple years, so future taxpayers who benefit from the project will pay for a portion of the project.

Increasing debt payments, however, squeeze general government revenues and ratepayers. In each of the next five years, the City must dedicate more than $330 million to pay principal and interest on outstanding bonds. This decreases funds available for other City services, such as maintaining capital assets. Property taxes dedicated to pay off urban renewal area debt service are not available to other taxing districts, such as local school districts. Increases in rates and charges needed to pay off the debt raise the cost of living in Portland.

Projected debt service payments
(millions, unadjusted)



Source: Portland CAFRs and Office of Management and Finance

In addition to limiting new urban renewal debt, in November 2013 Council voted to use surplus General Fund money to pay off some debt. This included paying off a $3 million Parks line of credit and setting aside more than $8 million to pay other debt. Paying off the line of credit frees up about $400,000 each year for Parks to spend on infrastructure and maintenance projects. Paying the other debt makes $3.5 million available for the City to use for other purposes.

Following a recommendation from our 2011 Fiscal Sustainability and Financial Condition report, the Office of Management and Finance now prepares an annual debt report with detailed information on bond sales and trends and includes indicators that look at specific categories of debt. The report notes that a single indicator might provide an incomplete picture of the City's financial health, and that indicators for specific categories of debt provide more useful information, because risks and other conditions vary.

OMF's annual debt report should help City managers determine the true cost of providing services and the best approaches for financing them over the long term to ensure that the use of debt to fund current projects does not unfairly burden future City residents.

About the indicators

An "unfunded liability" is the current value of future payment obligations for which reserves have not been set aside. Information on pension and post-employment benefit liabilities is provided below. Pension and other post-employment financial information was not adjusted for inflation, because the actuarial estimates are based on a point in time and calculation assumptions may vary from estimate to estimate.

Fire and Police Disability and Retirement unfunded liabilities will increase taxpayer costs

Portland voters created the Fire and Police Disability and Retirement Fund (FPDR) in 1948 for the benefit of sworn officers of the Bureaus of Police and Fire. The Fund was set up as a 'pay-as-you-go' retirement system funded by a dedicated property tax levy.

A pay-as-you-go plan does not set aside funds to pay for future benefits. Instead, the plan must collect sufficient revenues through the dedicated property tax each year to pay the annual costs. Because the plan does not reserve revenues for future retirements, it has an unfunded liability estimated at $2.5 billion as of June 30, 2014. This means that the City has promised future retirement benefits of $2.5 billion without money saved to support them.

Firefighters at work

Source: Portland Fire & Rescue

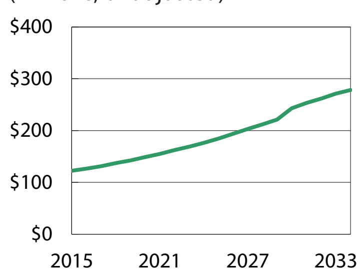
During the past 10 years, voters approved two Charter amendments to change the system. In 2006, voters approved changing to a funded retirement plan for new hires. Beginning in 2007, new police officers and firefighters enrolled in the Oregon Public Employee Retirement System, a pre-funded retirement plan. With this change, taxpayers pay for two generations of retirees – funding the pension costs of current retirees and pre-funding the pensions for police and firefighters hired after 2007. In November 2012, voters again approved amendments estimated to decrease taxpayer funded benefits by almost $47 million over a 25-year period.

Oregon Supreme Court Building

Source: Oregon Judicial Department

Recent legislative and accounting changes have also contributed to a decrease in expected Fund costs. In total, these changes accounted for most of a $400 million decrease in the expected liability as of June 30, 2014. In April 2015, the Oregon Supreme Court overturned part of the legislative changes. The City did not expect to know the impact of this ruling on Fund costs until August 2015.

FPDR projected annual costs
(millions, unadjusted)



Source: Milliman, prior to Oregon Supreme Court ruling

Despite these changes, growing costs continue to present risks to taxpayers, the City, and other local governments. Total annual costs for pay-as-you-go and pre-funded retirement plans are estimated to increase from $122 million in 2015 to $278 million in 2034, not adjusted for inflation. Pension costs for the pay-as-you-go plan will likely continue to rise for 20 years, until all of those employees are retired.

The Fund's property tax levy is estimated to increase about 30 percent over the next five years. Increases to the tax levy impact tax compression, which may decrease revenue available to other local governments and particularly to special levies, such as the Children's Levy.

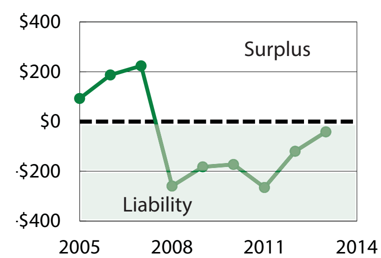
The Fund's property tax rate is limited by City Charter to $2.80 per $1,000 of property value. The City monitors the Fund's funding status through biennial actuarial valuations. The actuary also analyzes whether the tax levy will be adequate to pay for the system. If the tax rate reaches the limit, any costs not supported by the levy must be funded from the City's General Fund. As of June 30, 2014, most economic scenarios used in the actuarial analysis show the levy being sufficient, but 4 percent of scenarios show the levy exceeding the tax limit in at least one year through 2034.

The City's Public Employee Retirement System liability decreased in recent years

All civilian City employees, and nearly all sworn fire and police personnel hired after December 31, 2006, are participants in the Public Employee Retirement System (PERS). This is the pre-funded retirement plan for the State of Oregon and many local governments and districts in Oregon.

The City's estimated retirement system liability as of December 31, 2013, was $42 million. For three of the last 10 years, the City had no liability because it paid the liability in full and covered the obligation with $300 million in pension obligation bonds. However, according to the Office of Management and Finance, changes, primarily in the investment market, created a liability for the City beginning in 2008. The liability has decreased in recent years because of improved earnings and retirement system reforms.

PERS liability (millions, unadjusted)
$0 = Fully Funded

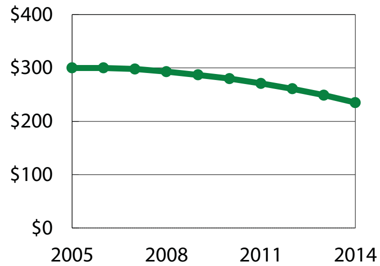


Source: Portland CAFRs and Milliman, prior to the Oregon Supreme Court ruling

Assumptions used in a liability estimate may differ from those used in prior projections. The estimate helps the City and creditors determine demands on the City's future cash flows. The liability is one of many measures that credit rating agencies consider when assessing City funds' credit-worthiness.

As of June 30, 2014, the City had about $235 million in principal outstanding on the pension bonds, and 15 years of debt service remaining. According to Management and Finance, the pension debt produces savings over the life of the obligation, compared to what the City would have been charged through the retirement system.

Pension debt principal
(millions, unadjusted)



Source: Portland CAFRs

One of the most recognized measures of the financial health of a pension plan is the "funded ratio." This ratio is the level of assets in the plan divided by the current value of its liabilities. If a plan were 100 percent funded, its assets plus investment returns would, in theory, be sufficient to pay all of the benefits that plan members earned. A plan that is less well-funded would run out of money (assets), while still owing benefits to its members.

Many experts find a funded ratio of 80 percent or more to be acceptable for a pension system. The City is part of the State and Local Government Rate Pool, which allows its members to combine their related resources. The rate pool had a funded ratio of 88 percent at the end of December 2013.

In 2014, the Oregon Supreme Court overturned some of the pension reforms passed by the Oregon Legislature. The changes reduced retirees' cost-of-living adjustments and eliminated payments for out-of-state residents intended to address state tax liabilities on their benefits. The reforms reduced public employers' unfunded liabilities and required contributions into the retirement system. The anticipated cost change based on the court ruling was not known at the time this report was published.

Post employment benefits are not pre-funded

In addition to pension benefits, the City provides other post employment benefits (OPEB) for eligible retirees. These benefits are part of a total compensation package and are used to attract and retain qualified employees. The City does not pay for post-retiree health benefits, but does allow retirees to purchase health insurance at the City's group rate until age 65. This creates an implicit subsidy. The City also contributes toward Medicare companion insurance through the state PERS Retirement Health Insurance Account (PERS-RHIA). These two provisions are required by state statute. In addition, the City pays medical costs through the Fire and Police

Disability and Retirement Fund for retired police officers and firefighters for service-related disabilities and injuries.

2014 OPEB liabilities and ratios
(Industry target is 80%)

	Liability (UAAL, millions)	**Funded Ratio**
Insurance continuation	$104	0%
PERS - RHIA	$4	0%
FPDR Subsidy	$12	0%

Source: City of Portland CAFR, and Milliman

The City's current unfunded liability for insurance continuation is $104 million and the Fund subsidy is $12 million. The liability for the insurance account is $4 million. These are based on varying time periods. The City's three post employment benefits have a funded ratio of zero percent.

The City offers post employment benefits on a pay-as-you-go basis rather than pre-funding the benefits. The pay-as-you-go method is used by many employers who are unable to fund the benefits in advance. The problem is that this method creates a persistent liability that is not matched by a dedicated funding source. Council was made aware of this in June 2008, when it accepted a report from Management and Finance on the topic.

CAPITAL ASSETS INDICATORS

About the indicators

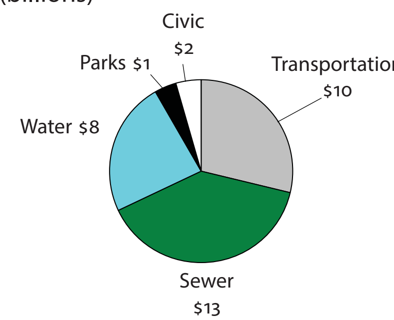
The City uses physical infrastructure to provide services to residents. Some examples are City streets and water lines. How these assets are cared for can impact the quality of services residents receive. Good asset management requires the City's investment in regular preventive maintenance. It increases the life of the asset and reduces costs. The risk in not maintaining the City's infrastructure is early failure of assets and increased costs.

City manages assets worth $34 billion

The 2014 Citywide Assets Report estimates the replacement value of the City's physical infrastructure assets at $34 billion.

The replacement value of assets is a different number than is reported in the City's financial reports and discussed in the net position section of this report. The financial reports estimate the value of an asset as it declines over time due to wear and tear. The replacement value is an estimate of the money that would be needed to buy or rebuild the asset in the current year. Each bureau has its own methodology to estimate replacement value.

Replacement value of City assets (billions)



Source: 2014 Citywide Assets Report

Condition of City assets varies

The Citywide Assets Report includes estimates of asset condition reported by bureau. The Bureau of Environmental Services reports the highest percentage of assets in good condition (70 percent) for sewer and stormwater infrastructure. The Bureau of Transportation reports the lowest percentage of assets in good condition (33 percent) for the streets, sidewalks, bridges, and streetlights.

Bureau estimates of asset condition

	Good	Fair	Poor	To be determined
Civic	51%	15%	25%	8%
Environmental Services	70%	14%	17%	0%
Parks and Recreation	51%	22%	11%	15%
Transportation	33%	21%	45%	1%
Water	69%	23%	8%	0%

Source: 2014 Citywide Assets Report

Funding gaps limit maintenance

The Citywide Assets Report includes an estimate of the annual gap between infrastructure funding needs and funding levels. The funding gap is reported in three categories:

1. Repair and replacement
2. Mandates to improve assets to meet regulatory requirements
3. Capacity increases to address service deficiencies

Like asset value and condition, each bureau has a different methodology for estimating the funding gap. The additional annual funding needed to bring existing assets up to current service levels and meet regulatory mandates is estimated at $304 million.

Only the Parks and Recreation and Environmental Services bureaus noted funding gaps to increase capacity. Parks estimates needing $48 million per year to include new park facilities in underserved areas. Transportation does not estimate any costs to increase capacity, noting that unpaved streets and sidewalks are not maintained by the City.

Annual funding gap (rounded, millions)

	Repair, Replacement	Mandate	Capacity	Total
Civic	$23	$0	$0	$23
Environmental Services	$5	$0	$7	$12
Parks and Recreation	$17	$8	$48	$84
Transportation	$181	$0	$0	$181
Water	$16	$0	$0	$16
Total:	$242	$8	$55	$304

Source: 2014 Citywide Assets Report

A lack of Citywide priorities to guide decision-making for use of limited resources has led to insufficient funding for capital asset maintenance and replacement needs. As we reported in our 2015 audit, *City Budget Process: Timing, roles, and decision-making need improvement*, City Council has not been successful in setting overall City priorities. In that audit, we recommended that Council establish Citywide priorities for use in budget and other strategic planning decisions.

Deferring maintenance leads to higher future costs. As we noted in our 2013 *Street Pavement: Condition shows need for better stewardship* audit, Council gave higher priority in recent years to fund new projects, which limited funding available for street maintenance.

In 2014 and early 2015, voters and City Council took steps to improve infrastructure funding. Voters approved a $68 million bond levy dedicated to Parks infrastructure repairs and improvements. The City also amended its financial policies to:

- Allocate at least 50 percent – increased from 25 percent – of General Fund discretionary revenue that exceeded beginning fund balance to infrastructure maintenance or replacement in the fall budget monitoring process.
- Allocate at least 50 percent of one-time General Fund discretionary revenue identified in the 5-year financial forecast to infrastructure maintenance or replacement through the budget process.
- Require bureaus to include a funding plan for operation and maintenance costs of new or additional capital improvements as part of the Adopted Budget.

Portland City Hall

Source: City of Portland

While the change to financial policies and the bond levy are good steps, they do not produce a consistent, permanent funding stream. Additionally, Council has not followed existing policies regarding infrastructure funding in the past. As early as FY 2001-02, Council identified deteriorating physical infrastructure as an immediate strategic priority. Since that time, the situation has worsened and limited action has been taken to address the issue. Without identifying infrastructure maintenance as a clear priority, spending to that priority, and following policy, it is likely the funding gap will continue to persist.

FINANCIAL AND OPERATING POSITION

About the indicators

Net position is a government's financial standing at a given point in time. This compares to operating position, which is a government's ability to balance its budget, to maintain reserves for emergencies, and to have enough money to pay its bills on time. We present measures for net position and liquidity below that track the City's financial standing and operating position.

The City's total net position decreased since 2005

Net position measures the difference between what the City owns (its assets) minus what it owes (its liabilities). The change in net position is important. It indicates how much the City's financial position has improved or worsened as a result of events and transactions made during the period. A decline in net position means that current costs are being shifted to future taxpayers.

Peninsula Park rose garden fountain

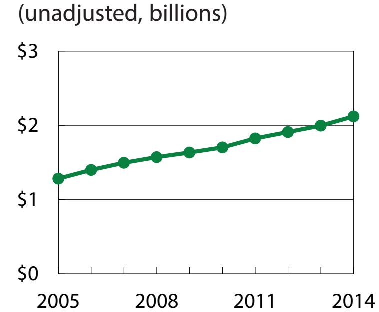
Source: Portland Parks & Recreation

The City's total net position declined 9 percent from 2005 to 2014, from $2.9 billion to $2.7 billion. Net position is counted separately for the City's business activities supported by rates, such as water and sewer services, and all other governmental activities, such as parks and transportation systems. We include the net position of the Portland Development Commission with the governmental activities.

Infrastructure investment increased net position for self-supporting services

Business net position grew 66 percent from 2005 to 2014, from $1.3 billion to $2.1 billion. Most of this amount, $2.0 billion, is invested in capital assets for water and sewer systems.

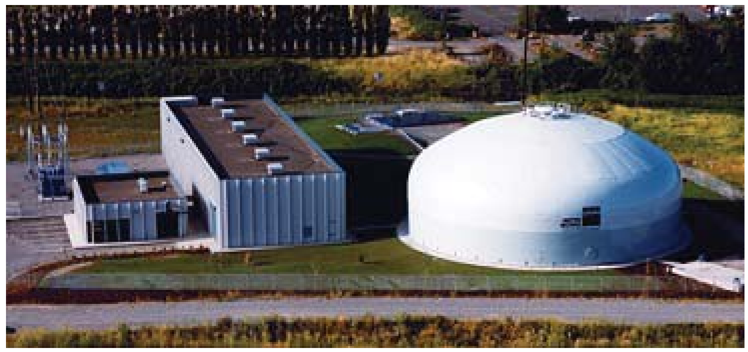
Business net position
(unadjusted, billions)



Source: Portland CAFRs

As water and sewer revenue bonds are paid off and new projects are completed, business net position should continue to increase.

Columbia south shore well field (water pump station)

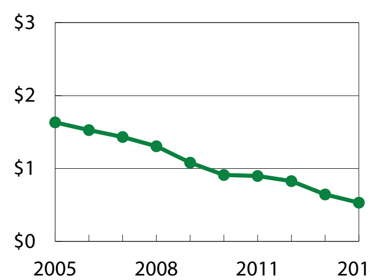


Source: Portland Water Bureau

Declines in governmental net position indicate worsening financial condition

Governmental net position declined 67 percent from 2005 to 2014, from $1.6 billion to $500 million. The two largest factors in the decline are a decrease in the value of capital assets (primarily transportation infrastructure) and an increase in pension liabilities. A decrease in the value of capital assets is due to wear and tear as assets age (depreciation). Assets declined faster than reinvestment in new or improved assets. Failure to maintain assets pushes higher costs to future years.

Governmental net position
(unadjusted, billions)



Source: Portland CAFRs

This decline in governmental net position is also linked to the growing Fire and Police Disability and Retirement Fund pension obligation. The current net position figure includes only $1.4 billion of the estimated unfunded liability of $2.5 billion. If the full Fund pension liability was included, the City's net position for governmental activities would be below zero, at negative $537 million. Beginning in 2015, the City will be required by new accounting rules to include the full pension liability in its net position calculation.

The Portland Building

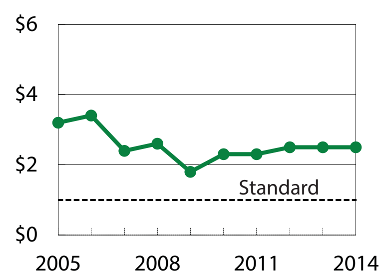
Source: Audit Services Division

The ongoing decline in governmental net position means that the City is shifting current costs – for maintaining assets and paying pension costs – to future generations. The decline in governmental net position, and the key reasons for the decline, should be analyzed annually to ensure the City maintains a strong financial condition into the future. This analysis should be presented to Council each year with the financial audit report.

City liquidity remains positive

Liquidity is the City's ability to pay its short-term bills. It is measured by a ratio of current assets to current liabilities. Current assets include cash and assets that can be converted into cash or used within 12 months. Current liabilities are bills the City intends to pay within 12 months. A low ratio, below $1 of assets to $1 of liabilities, is a warning trend and may indicate a cash flow problem and the need for short-term borrowing.

City liquidity ratio
($1 asset : $1 liability standard)



Source: Portland CAFRs

City liquidity (including Portland Development Commission) has varied over time, but in the last five years has leveled out. It stayed above the ratio of $1:$1 for the 10-year period.

DEMOGRAPHIC AND ECONOMIC INDICATORS

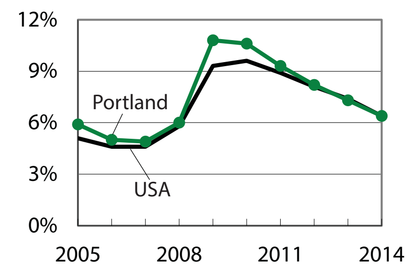
About the indicators

Economic and demographic information highlights community needs and resources. This section presents data on unemployment, jobs, income per resident, property values, and city employment.

The Portland area is continuing an economic recovery

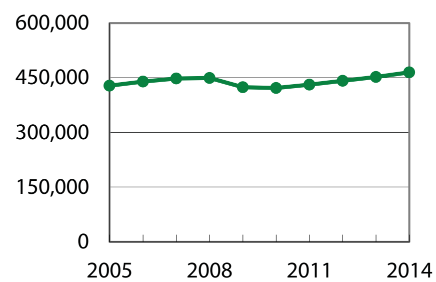
Portland's unemployment rate was about 6 percent in 2014. The rate was higher than the national unemployment rate until 2012, when the rates matched.

Unemployment



Source: U.S. Bureau of Labor Statistics

Jobs in Multnomah County



Source: Oregon Employment Department

There were about 465,000 jobs in Multnomah Country in 2014. This is a 9 percent increase compared to 10 years ago. The number of jobs rose every year from 2003 through 2008. It decreased in 2009 and 2010, but recovered in recent years.

In 2014, the Trade, Transportation, and Utilities sector had the largest percentage of jobs in Multnomah County, at 18 percent. This industry includes wholesalers, retail stores, and transportation workers. Professional and Business Services and Government jobs were both 16 percent of the total.

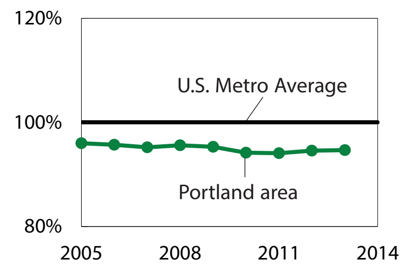
2014 Jobs in Multnomah County

Industry	Count	% of Total
Trade, Transp. & Utilities	83,666	18%
Prof. & Business Serv.	73,333	16%
Government (Fed. State & Local)	73,463	16%
Education & Health *	67,299	15%
Leisure and Hospitality	52,973	11%
Manufacturing	33,768	7%
Finance	27,951	6%
Construction	20,401	4%
Other Services	19,637	4%
Information	10,547	2%
Nat. Resources & Mining	1,794	<1%

Source: Oregon Department of Employment
* Private, non government

Since 2005, the Portland area's income per resident was less than the national average for metropolitan areas. Income per resident in the Portland area was $44,512 in 2013 – a slight increase from $43,974 in 2005. The national average increased about 3 percent during the same time, from $45,799 to $47,005. Data for 2014 was not available at the time of publication.

Income per resident
(Percent of U.S. metro average)

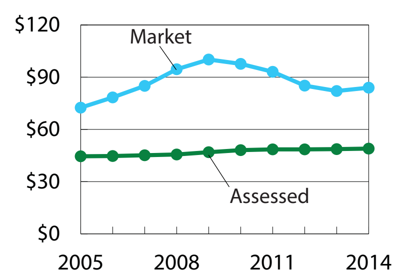


Source: U.S. Bureau of Economic Analysis

Property values are higher than they were 10 years ago

Market values of Portland properties increased 16 percent, from $72 billion in 2005 to $84 billion in 2014, while assessed values increased 10 percent, from $45 billion to $49 billion, during the same time frame. The gap between assessed values and market values is due to the limitation set by Measure 50. This 1997 statewide ballot measure limited assessed value growth to 3 percent per year in most properties. The City of Portland's property tax revenues are based on assessed values rather than market values. According to the Office of Management and Finance, because property tax revenues are based on assessed values, the revenues are relatively stable. Non-economic issues, such as the establishment of other taxing districts, however, can decrease property tax revenues to the City.

Total property values
(billions, adjusted)



Source: Multnomah County Tax Supervising and Conservation Commission

Population increased over the past 10 years

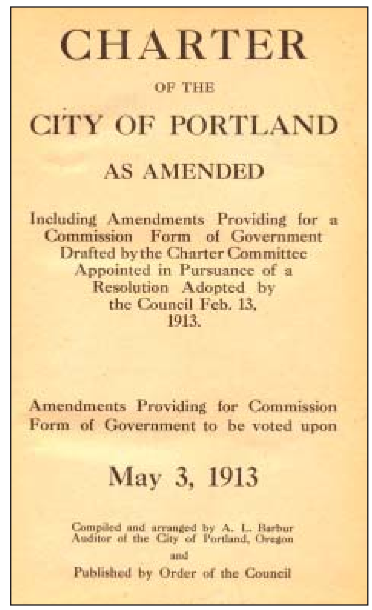
Portland's population increased about 9 percent over the past 10 years, from 550,560 in 2005 to 601,510 in 2014. In 2014, Portland accounted for about 15 percent of Oregon's total population.

About the indicators

Decision-making capacity is a government's ability to make decisions to keep it financially sound. Among factors that impact this capacity are an entity's form of government, delivery of core services, and its decision-making processes.

Portland's form of government presents benefits and challenges in governing the City

The City of Portland is the last remaining large city in the United States using a commission form of government. In a commission form of government, the elected City Council's legislative functions include adopting the City budget and passing laws, policies, and regulations that govern the City. The Mayor and Commissioners also serve as administrators of City departments, individually overseeing bureaus and carrying out policies. The Mayor assigns departments and bureaus and has discretion to change assignments at will.



CHARTER

OF THE

CITY OF PORTLAND

AS AMENDED

Including Amendments Providing for a Commission Form of Government Drafted by the Charter Committee Appointed in Pursuance of a Resolution Adopted by the Council Feb. 13, 1913.

Amendments Providing for Commission Form of Government to be voted upon

May 3, 1913

Compiled and arranged by A. L. Barbur
Auditor of the City of Portland, Oregon
and
Published by Order of the Council

Any form of government has strengths and weaknesses. In 2007, one civic group identified some benefits of the commission form in attracting strong leaders, providing opportunities to implement innovative policies and projects, and providing the public with greater access to City leaders. That same year, the Charter Review Commission identified a number of drawbacks, such as difficulty coordinating service provision, varying levels of bureau responsiveness, and challenges for City Council members in developing citywide strategies and policies.

The City funds some services that may be more appropriate for other jurisdictions to supply

To provide services more efficiently, Multnomah County and Portland agreed in 1983 which jurisdiction would provide particular types of services. As a result, Portland focused on "urban services," such as police, fire, parks, water, sewers, and streets. The County focused on human services and state-mandated responsibilities, such as health, social services, elections, tax collection, prosecution and jails.

Over the years, the City funded some services that may be outside of the City's agreed-upon functions. Some examples are education funding and affordable housing. While funding these services can be worthwhile, it raises questions about inefficient service delivery and public accountability for multiple levels of local government. In our 2013 audit, *Urban Services Policy and Resolution A: Core City services not articulated; 30-year old commitments obsolete*, we recommended the City develop and document a clear list of City responsibilities and update Resolution A and the Urban Services Policy.

City processes are subject to public scrutiny

The public has various ways to inspect how the City spends resources. State statutes, for example, outline how the City's budget is adopted and amended, as well as the requirements for public hearings. The annual audit of the City's Comprehensive Annual Financial Report is performed by an independent financial auditor under contract to the City Auditor. There are also opportunities for residents to volunteer on City advisory boards and commissions. In our 2015 audit, *City Budget Process: Timing, roles and decision-making need improvement*, however, we found that Council does not set citywide priorities. This leads to questions about the value of public input and performance data for decision-making.

Comprehensive policies help the City manage its finances

City financial policies guide, and at times restrict, how the City spends its resources. Portland's financial policies meet many best practices established by the Government Finance Officers Association and address a number of different subject areas, such as financial planning and budgeting, revenue policies, infrastructure management, and debt management. Some examples include requiring five-year financial plans for many bureaus and funds, as well as establishing the City's General Reserve Fund and limiting how it may be used.

Indicators

Trend information is important for financial analysis. Comparative data can also provide context. There are similarities between some governments, but there are also important differences. According to Management and Finance, Portland's public safety retirement fund, for example, makes comparisons challenging. These may require investigation before making conclusions as to a city's relative financial performance, and we recommend readers be cautious.

We provide Portland's 2014 financial information in comparison with the average of five other jurisdictions, Charlotte, NC; Denver, CO; Kansas City, MO; Sacramento, CA; and Seattle, WA. To be as comparable as possible, the information is based on each jurisdiction's "primary government." For Portland, the financial information does not include the Portland Development Commission, and for other cities, it does not include their sub-units, such as visitors' authorities. Because of this, the Portland figures may be different than presented in previous sections of this report.

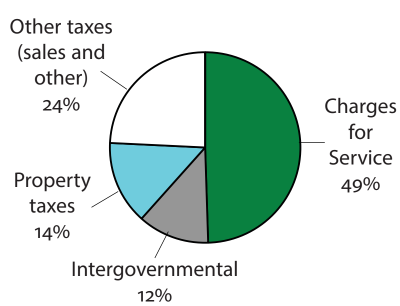
Portland relies more on property taxes and intergovernmental revenues

In 2014, Portland had about $1.6 billion in revenues, compared with the other-city average of $2.0 billion. Revenue per resident was $2,663 in Portland, compared to $3,316 in the other-city average. In both Portland and the other cities, about half of those revenues came from charges for services, such as water and sewer services.

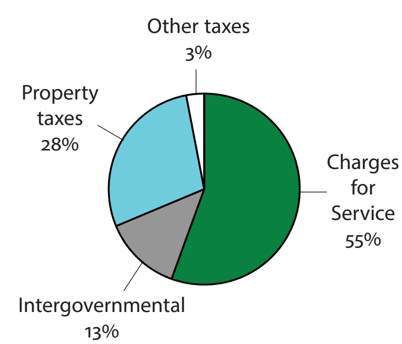
Portland relies more on property taxes than other cities. The other-city average relies more on other taxes, such as sales and income taxes, in their revenue mixes.

2014 Revenues by source (primary government)

Other-city average ($2.0 billion)



Portland ($1.6 billion)



Source: Portland and other city CAFRs

Many of Portland's service expenses are comparable to other cities

In 2014, Portland's expenses were $1.6 billion, while the other-city average was about $1.8 billion. Expense per resident was $2,693 for Portland, compared to $2,967 in the other-city average.

Portland provides many similar services as other local governments, such as public safety and transportation. Unlike some governments, Portland's City government does not operate an airport or have a public health function.

2014 Expense by service area (primary government)

Expense	Other city Avg.	Portland
Public Safety	24%	32%
Public Utilities (water & sewer)	16%	22%
Transportation & Parking	10%	20%
Community Development	6%	10%
Parks, Rec & Culture	7%	6%
Legislative/Administration	9%	6%
Interest (Gov. activities only)	3%	3%
Public Health	3%	0%
Other (airports & electric utility)	22%	0%

Source: Portland and other city CAFRs

In 2014, Portland was similar to the other-city average costs for Parks, Recreation, and Culture as well as for Legislative/Administrative services. The Parks service area was 6 percent of expenses for Portland compared to 7 percent for the average. Legislative/Administrative services were 6 percent for Portland compared to 9 percent for the average.

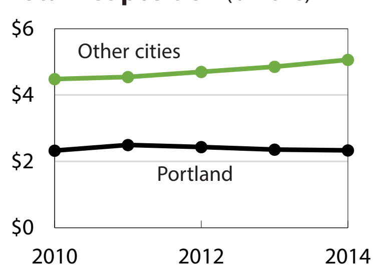
Portland also had differences from other jurisdictions. Public safety costs, for example, were 32 percent for Portland as opposed to 24 percent for the average. About 20 percent of Portland's expense was for Transportation, compared to 10 percent for the other-city average.

Portland's outstanding debt is slightly lower

Portland had about $3.6 billion in debt principal outstanding in 2014. This is less than the other-city average of $3.7 billion. Debt per resident in Portland was $5,928 and $5,947 for the other-city average. Urban renewal is included in Portland's calculation.

Portland's net position is less than the other-city average

Total net position (billions)



Source: Portland and other city CAFRs

In 2014, Portland had a total net position of $2.3 billion. The other-city average was $5.1 billion. Portland's net position has been relatively steady for five years, while the other-city average has increased slightly.

RECOMMENDATIONS

The City should analyze the causes of its declining net position

In our last report, we recommended management analyze the reasons for the decrease in net position. Although Management and Finance agreed with the recommendation, it was not completed. This recommendation remains valid.

To improve the City's long-term financial health, we recommend that the Mayor require the Office of Management and Finance (OMF) to provide Council with an annual analysis of how the City's long-term financial position could be strengthened. We further recommend this be an annual presentation to the Council after the completion of the external financial audit, with analysis that includes:

- Development of benchmarks to measure, track, and maintain a strong financial position into the future.
- Evaluation of the contributing factors to the decline in net position and recommendations from Management and Finance on actions to mitigate the decline.

SCOPE AND METHODOLOGY

SCOPE AND METHODOLOGY

Report scope and methodology

The methodology used in this report is based on *Evaluating Financial Condition: a Handbook for Local Government* by the International City/County Management Association. We also reviewed background information on fiscal sustainability from the Governmental Accounting Standards Board.

The report focuses on Citywide finances. It includes the City of Portland's Governmental Activities and Business Activities. Our methodology also includes the Portland Development Commission as defined by the annual Comprehensive Annual Financial Report. The indicators were selected by the Audit Services Division.

Information for the report came primarily from the City's independently audited Comprehensive Annual Financial Reports. Other sources were also used. The primary sources for the indicators are listed in the following table.

Primary data sources used

Indicators	Source (may be used for multiple indicators)
Revenues • City Revenues • Revenues per resident • Revenues by source • Property Tax	• Portland Comprehensive Annual Financial Reports (CAFRs): o Government-Wide Statement of Net Position o Combining Statement of Revenues, Expenditures, and Changes in Fund Balance for Non Major Governmental Funds o General Fund Schedule of Revenues and Expenditures o Fire and Police Disability and Retirement Fund Schedule of Revenues and Expenditures
Expense • City Expense • Expense per Resident • Expense by Service Area • City Employees	• Portland CAFRs – Government-Wide Statement of Activities • Portland SAP system • Portland Development Commission CAFRs
Financial and Operating Position • City Net Position • City Liquidity	• Portland CAFRs – Government-Wide Statement of Net Position
Debt • City Debt • Debt per Resident • Debt by Type • Urban Renewal Debt • Urban Renewal Debt by URA • Projected Debt Service payments	• Portland CAFRs – Schedule of Bond Principal Transactions • Notes to the Financial Statements • Annual Debt Report
Pension & Liabilities • FPDR Projected Annual Costs • PERS Funded Ratio • PERS Liability • Pension Debt Principal • OPEB Liabilities and Ratios	• FPDR Actuarial Valuation and Levy Adequacy Analysis, Jan. 27, 2015 • Milliman Pension Actuarial Valuation Report for the City of Portland, June 30, 2014 • Portland CAFRs o Schedule of Bond Principal Transactions o Notes to the Financial Statements – Other Post Employment Benefits
Capital Assets • Replacement Value of Capital Assets • Condition of Assets • Funding Gaps	• 2014 Citywide Assets Report
Demographic and Economic • Population • Unemployment • Jobs in Multnomah County • Income per resident • Property Values	• Portland State University Center for Population Research • U.S. Bureau of Labor Statistics • State of Oregon, Department of Employment • U.S. Bureau of Economic Analysis • Multnomah County Tax Supervising and Conservation Commission Reports

SCOPE AND METHODOLOGY

Indicators	**Source** (may be used for multiple indicators)
Other City Comparisons (5-City Averages) • Revenues • Revenues per Resident • Revenues by Source • Expenses • Expenses per Resident • Expense by Service Area • Debt • Debt per Resident • Net position	• City CAFRs and budget documents - Charlotte, NC; Denver, CO; Kansas City, MO; Sacramento, CA; Seattle, WA; Portland, OR o Government-Wide Statement of Activities o Ratios of Outstanding Debt by Type • U.S. Bureau of Economic Analysis

In order to account for inflation and unless noted otherwise, we expressed most financial data in constant dollars. We adjusted dollar amounts for each prior year to equal the purchasing power in FY 2013-2014. We used the Portland-Salem Consumer Price Index for All Urban Consumers, as reported by the Bureau of Labor Statistics, U.S. Department of Labor. Unless otherwise stated, financial data are based on the City's fiscal year. In many cases, numbers are rounded for ease of use and reporting.

We reviewed information for reasonableness and consistency. We questioned or researched data that was not reasonable or needed additional explanation. We did not, however, audit the accuracy of source documents or the reliability of the data in computer-based systems. As nearly all financial information presented is from the City's CAFRs, we relied on the work performed by the City's external financial auditors.

We chose comparison cities due to their similar population size and government services provided. These are the same jurisdictions used in various audit reports.

Our review of data was not intended to give absolute assurance that all information was free from error. Rather, our intent was to provide reasonable assurance that the reported information presented a fair picture of the City's financial health. In addition, while the report offers financial highlights, it does not thoroughly determine the reasons for negative or positive performance. More analysis may be needed to provide such explanations.

This report was independently developed by the Office of the City Auditor and is intended for the general public as a high-level report. This report is the result of a performance audit, and was not part of the City's annual financial audit on the City's financial statements. Expressions of opinion in the report are not intended to guide prospective investors in securities offered by the City and no decision to invest in such securities should be made without referencing the City's audited CAFRs and official disclosure documents relating to a specific security.

For more information on the City's finances, please visit the following websites:

City of Portland Comprehensive Annual Financial Reports and Annual Debt Reports
http://www.portlandoregon.gov/brfs/

City of Portland Adopted Budgets
http://www.portlandoregon.gov/cbo/

Fire and Police Disability and Retirement Fund Actuarial Valuations
http://www.portlandonline.com/fpdr

Multnomah County local government budgets, indebtedness, property taxes and other financial information
http://tsccmultco.com/

City of Portland Citywide Assets Reports
http://www.portlandoregon.gov/bps

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESPONSES TO THE REPORT

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CITY OF PORTLAND

OFFICE OF MANAGEMENT AND FINANCE

To: Drummond Kahn, Audit Services
Kristine Adams-Wannberg, Audit Services

From: Fred Miller, Chief Administrative Officer Fred Miller
Ken Rust, Chief Financial Officer KLR

Date: June 5, 2015

Subject: Portland's Fiscal Sustainability and Financial Condition report

This is the third Fiscal Sustainability and Financial Condition report produced by Audit Services and is probably the best to date. We believe that you may have benefitted from some of our comments in the past. But, there is still lots of work to do.

Our primary concern is that the report lead to a better understanding of relevant issues by the Council and the public. We note that you, too, want it to be "read and understood by a wide audience." Attention to our comments could help meet that objective.

Our major point of agreement is that the City needs to spend more resources to maintain its assets. To that end, the Council spent a considerable amount of time attempting to get a road finance/street maintenance measure approved; it passed a resolution requiring that 50% of surplus general funds in the Fall BMP be used for assets in parks, transportation, or emergency preparedness; it allocated more than $20 million of the General Fund surplus for the FY 2015-16 budget to infrastructure investment; and the Council has committed to a significant one-time and ongoing investment in improving the Portland Building. The Council is aware of the need for more resources for assets and has acted accordingly.

It is important that you have pointed out that our funding for Fire & Police Disability & Retirement (FPDR) is sufficient under most scenarios. We believe that has been missing in the past. However, the logic does not carry forward to the discussion of Net Position.

The discussion of Net Position, as in previous years, is deficient. It does not lead to a better understanding of the issues:

- You should acknowledge that you do not consider all of the City's assets when making this comparison. For example, the City's most valuable asset is most likely Forest Park. It is considerably undervalued at a little over $1,000 per acre in your analysis. The same goes for other assets—especially green assets.
- Then, your analysis treats the FPDR liability as a huge issue. It would be more informative for the public to reiterate that there is funding available for the FPDR program.
- Your analysis should also reflect the information that OMF shared with the City Council when the FY 2013-14 CAFR was presented to them for their acceptance. At that City Council meeting we described very specifically how the current GAAP measurement of Net Position fails to consider other resources and future revenues that serve to reduce or eliminate liabilities associated with certain of the City's bonds payable and pension liabilities. Even the City's external auditors, Moss Adams,

agreed with our approach to re-stating Net Position for purposes of more accurately reflecting the City's fiscal health. Consideration of these other resources completely changes the conclusions one can reach about the City's Net Position, and by so doing helps to better illuminate the real long-term funding issue that Council needs to address: infrastructure.

The analysis of Net Position concludes that a huge shift in financial burden to future generations is occurring. Earlier in the report, the analysis indicated that our current generation was paying for two retirement programs. This is inconsistent. Inter-generational equity was discussed, yet, we've never seen the Auditor do an analysis of the issue. It could be argued that our current generation is reaping huge benefits from the investments of previous generations. The same may well be true of future generations. To treat inter-generational equity as if it begins today without evaluating the implications of past investments misrepresents the issue. Additionally, it was commented that incurring long-term debt could burden future generations. Generally, that is the objective. Debt financing is used for capital projects that will be used years into the future and requires the users and beneficiaries of those projects to repay the bonds. This is not a problem; it is the intent. In fact, to do otherwise would raise the exact intergenerational equity concerns that you highlight in your report; current citizens paying for investments that will serve Portlanders on into the future.

Also, with respect to public understanding, the statement that expenses were higher than revenues for eight of the ten past years invites misunderstanding. Generally, we think the public appreciates that we must have a balanced budget from a cash position. The Council has done that. Using GAAP measurements without recognizing other revenues and resources that help to fund City liabilities can result in misleading conclusions.

You made reference to a commitment that we keep the Council informed about financial matters and then suspended the effort. That's incorrect. We are continuing to inform them. In our regular meetings with Council members, both the CAO and CFO discuss these issues. That effort has not been suspended, but in fact is more robust than ever.

We are hopeful that your future reports will deal more directly with some of these issues. If there is any misunderstanding about them, we are happy to have our staff hold some briefings with your office.

CITY BUDGET OFFICE

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CITY OF PORTLAND, OREGON

TO: Drummond Kahn, Director of Audit Services

FROM: Andrew Scott, City Budget Director

DATE: June 16, 2015

SUBJECT: Fiscal Sustainability and Financial Condition Report

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Thank you for the opportunity to respond to your latest report, *Portland's Fiscal Sustainability and Financial Condition*. In general, the City Budget Office concurs with the response from the Office of Management and Finance. Although your report highlights some key issues, the exclusive use of GAAP measurements leaves out important information that would provide useful context for the reader.

We appreciate your use of the Citywide Assets Report to note that there is a large and growing infrastructure backlog. That report, which has been required by City financial policy for a number of years, provides important information to Council about the condition of City assets. Based on that report and a capital assets work group convened by CBO in 2014, Council has dedicated significant new resources to infrastructure repair and maintenance and changed City financial policy to dedicate 50% of one-time General Fund dollars for this purpose. The City Council is considering additional options to provide a more permanent funding source. It is worth noting that a lack of infrastructure funding is a national problem created over decades, and the solution will be multi-faceted and involve additional debt, additional revenue, and a reduction in other City services. A financially resilient government ensures that it has achieved the appropriate balance between those options.

The City has had very strong financial policies for many years. We are a national leader when it comes to fiscal sustainability and resiliency, and the actions taken during and after the Great Recession have strengthened our financial position. Few if any large cities in America made it through the recession without using any of their General Fund reserves while avoiding the use of financial gimmicks and maintaining a strong credit rating. The actions taken since the recession to invest in infrastructure, use one-time resources to pay off debt, and shore up core services continue Portland's tradition of strong fiscal management.

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Portland's Fiscal Sustainability and Financial Condition: Maintenance needs and pension costs challenge long-term position

Report #470, June 2015

Audit Team: Kristine Adams-Wannberg
Janice Richards

This report is intended to promote the best possible management of public resources. This and other audit reports produced by the Audit Services Division are available for viewing on the web at: www.portlandoregon.gov/auditor/auditservices. Printed copies can be obtained by contacting the Audit Services Division.

Mary Hull Caballero, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

City Procurement: Contracting process needs Council intervention (#446A, June 2015)

Surplus Real Property: Policy, central management, and inventory of real property holdings needed (#461, April 2015)

City Attorney's Office: Good practices in place; next steps include strategic plan, measures, and post-contract evaluations (#459, March 2015)