### City of Portland



## **Five-Year General Fund Financial Forecast**

FY 2012-13 through FY 2016-17 Office of Management and Finance April 2012

The Portland economy continues to grow, albeit at rates well below what one would expect for an economic recovery. This, coupled with a continued weak local housing market, means the City will need to make significant ongoing reductions in FY 2012-13. Table 1 below summarizes discretionary General Fund resources and expense requirements through FY 2016-17. As shown in Table 1, the City needs to realize \$14.7 million in ongoing spending cuts in order to balance spending to expected revenue over the five-year forecast horizon. This requires approximately **4% cuts** from General Fund bureau current appropriation levels. It is critical to note that this forecast also *does not include the potential impact of a new library district* to be voted on in November, which, based on a prior analysis completed by Multnomah County, would require 2% to 2.5% cuts from current appropriation levels beginning in FY 2013-14.

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

	Fiscal Year						
Budget Category	2012-13	2016-17					
Total Resources	\$400.0	\$411.2	\$428.2	\$446.4	\$462.4		
Required Ongoing Cuts <sup>1</sup>	-\$14.7	\$0.0	\$0.0	\$0.0	\$0.0		
Available One-Time	\$13.4	\$0.0	\$0.0	\$0.0	\$0.0		
Total Expenses with Cuts & One- Time Spending	\$395.2	\$410.2	\$428.2	\$446.4	\$462.4		
Reserved for Five-Year Balancing	\$4.9	\$1.0	\$0.0	\$0.0	\$0.0		

<sup>&</sup>lt;sup>1</sup> An ongoing cut of \$14.7 million in FY 2012-13 is necessary to balance ongoing revenues with ongoing expenses throughout the five-year forecast.

Note: Totals may not add due to rounding

The largest driver of the current shortfall is a significant decrease in the expectations for property tax revenue growth over the next several years. Though the forecast for property taxes increased slightly since December, falling property values are expected to limit property tax revenue growth to rates below historical levels. Property tax compression is resulting from the interaction of Measures 5 and 50 (passed by voters in the 1990s) and decreasing real market values. Also contributing to the need for cuts are higher near-term inflation than was anticipated a year ago and approximately \$3 million in spending beginning in FY 2012-13 that was added through budget notes as part of the FY 2011-12 adopted budget.

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Josh Harwood, City Economist 503-823-6954 Josh.Harwood@portlandoregon.gov **Kourosh Ghaemmaghami**, Senior Economist 503-823-6957 Kourosh.Maghami@portlandoregon.gov 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 sustainable course. In order to achieve this, the forecast requires that \$4.9 million in FY 2012-13 be reserved in order to ensure the budget is balanced over the five-year forecast horizon. Finally, it should be noted that, although there was \$22.5 million in one-time spending in the FY 2011-12 adopted budget, there is only \$13.4 available for FY 2012-13 and none in subsequent years. Thus, in order to keep the budget balanced, the City must cut the \$13.4 million in one-time spending or find additional one-time resources beginning in FY 2013-14 — this is in addition to any changes, such as the establishment of the library district, that change the forecast for ongoing revenues between now and the next budget cycle.

#### **Major Changes Since December Forecast**

Inflation/Benefits — Final inflation figures were published by the Bureau of Labor Statistics in February. The local CPI-W rate of 3.3% was lower than the forecasted rate of 3.8%, thus lowering forecasted personnel costs by approximately \$1 million. Slightly larger declines were realized in the forecast for health benefit costs, as a combination of lower-than-expected premium increases and the use of Health Fund reserves served to lower the City's FY 2012-13 General Fund health benefit costs by \$1.6 million.

PERS – The cost savings from inflation were more-than-entirely offset by increases in the expected Public Employee Retirement System (PERS) employer contribution rates. These rates change every two years depending on the health of the pension fund. In November 2011, advisory rates were sent to jurisdictions in effort to allow for better planning for the substantial increases set to occur beginning in FY 2013-14. The City includes expected changes in costs related to PERS in the five-year financial forecast, so when the November rates came out, there was no change needed to expected future costs. However, an email received in mid-April suggested that the advisory rates provided earlier were, in fact, likely too low. As a result, over \$2.5 million in costs were added to the forecast, limiting ongoing available dollars. This change did make some one-time funds available in FY 2012-13, as the PERS increases will not occur until FY 2013-14. The actual rates for FY 2013-14 and FY 2014-15 will be released near the end of September. The current rate forecast is included in the table at the end of this document.

Revenue Forecasts – There were several minor changes to the revenue outlook. The most notable was in business license taxes, where higher-than-expected April returns boosted the forecast for FY 2012-13 by approximately \$2.5 million. A slight increase in the property tax forecast was offset by a decrease in the expectations for utility license taxes and franchise fees. Other changes to the revenue outlook were small and generally positive.

#### **Financial Forecast Risks**

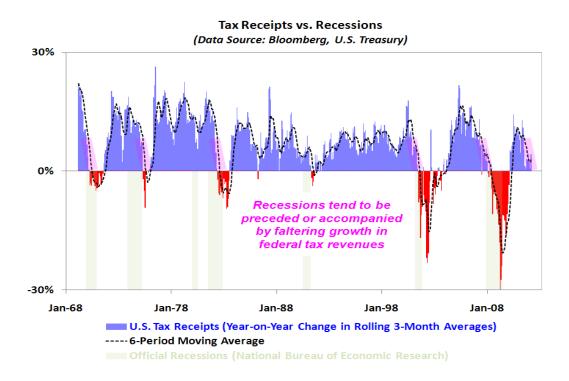
Multnomah County Library Permanent District – A primary risk to this forecast is the possibility that voters will establish a permanent library district in November. The County Board has said it will ask voters to renew the existing local option property tax levy in May. Regardless of the outcome of that election, there would be no General Fund impact. However, the Board also announced its intention to ask voters to approve the establishment of a permanent district in November. If approved, the City would see a

significant drop in property tax collections beginning in FY 2013-14. Based on preliminary calculations done by the county in December 2011, the City would have collected approximately \$7 million less in General Fund property taxes had a district been in place for FY 2011-12. However, because property values have continued to deteriorate, it is expected that a new district with *the same levy rate included in the December study* would have an even greater impact should it come into effect in FY 2013-14.

Labor/PERS Costs — The City includes a variety of assumptions in its forecast for General Fund discretionary expenses. Among the most important are the increases resulting from cost-of-living allowances and PERS costs. Over the past several labor contract negotiations, most notably with the Portland Police Association, the City has signed contracts with costs that exceed the inflationary costs included in the five-year financial forecast. To the extent that this trend continues — the City is negotiating with the Portland Firefighters Association currently — actual expenses will exceed the current forecast.

Recession Risk — Few economic forecasts, if any, are calling for a recession in 2012 or 2013. However, economic growth is slow enough that it remains vulnerable to an external shock. Though difficult to quantify empirically, certainly the after effects of last spring's tsunami in Japan contributed to a slowing economy last summer, as supply chains were disrupted. Figure 1 takes a very high level look at the relationship between federal government tax revenues and recessions. The important note is that over the previous four decades, the nation has experienced at least a minor recession any time the year-over-year growth in revenues has reached the point that it currently sits. This risk is particularly acute as it relates to business license and transient lodging taxes.

FIGURE 1. Federal Tax Revenue Growth and Recessions



Federal Government Policies — As we head toward the second half of 2012 there remain many unanswered federal policy questions, particularly those related to tax rates and the debt ceiling. The Bush tax cuts, originally set to expire for 2011, were given a two-year reprieve, which means they are scheduled to expire at the end of this year. Meanwhile, the debt ceiling debate that paralyzed markets in mid-2011 is set to replay itself out shortly after the November election. As there is little confidence in Congress to successfully navigate these policy waters (a Gallup poll in November found Paris Hilton and communism with higher approval ratings), the uncertainty increases risk for those making business decisions. Over the last several years, the federal government has gone from at least attempting to help the economy (stimulus) to acting largely apathetic (stagnation following the 2010 mid-term elections) to ultimately being actively disruptive (debt ceiling debate).

## **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. 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	2012-13	2013-14	2014-15	2015-16	2016-17		
Beginning Balance <sup>1</sup>	\$19.4	\$16.7	\$13.3	\$12.8	\$13.3		
Property Taxes	\$197.7	\$203.1	\$210.2	\$217.9	\$225.9		
Transient Lodging	\$18.1	\$18.1	\$19.4	\$20.1	\$20.9		
Business Licenses	\$76.2	\$81.1	\$88.9	\$94.8	\$98.6		
Utility License/Franchise	\$72.2	\$75.0	\$78.4	\$81.9	\$84.5		
State Revenues	\$12.9	\$13.1	\$13.5	\$13.7	\$13.5		
Interest Income	\$0.9	\$1.3	\$1.6	\$2.0	\$2.4		
Transfers	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8		
Miscellaneous	\$2.0	\$2.1	\$2.2	\$2.3	\$2.4		
Total Resources	\$400.0	\$411.2	\$428.2	\$446.4	\$462.4		

<sup>1</sup> FY 2012-13 beginning balance includes estimated unspent budget from FY 2011-12 and \$9.1 million of FY 2011-12 revenue held over for future years in order to balance the five-year forecast. Note: Totals may not add due to rounding

Changes in the forecast outlook since December are mostly related to expectations of business license tax collections over the next few years. It appears that business license tax growth in the current year will

approach or exceed 10% growth for the second consecutive year. 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.

To the extent some upside potential exists, the forecast for property taxes may see higher-than-expected growth. Though compression issues will be with us for the foreseeable future – it would take 6% growth in property values for ten consecutive years to reach the same ratio of assessed value to real market value that we experienced prior to the recession – it is possible the housing market may show some signs of life earlier than currently forecast. Also, it is critical to remember that because compression happens at the individual property level, it matters not just how much values fall, but where in the City it occurs.

# **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 3.3% cost-of-living adjustment (COLA) for personal services for FY 2012-13, which is 0.5 percentage points lower than the 3.8% forecasted in December, thus lowering costs by approximately \$1 million. Additionally, the forecast incorporates various other adjustments, most notably for assumed health care premium costs and out-year PERS costs. Costs associated with health care premiums will be lower than originally forecasted in December, but costs for PERS beginning in FY 2013-14 will be higher than forecasted. The PERS costs are part of the reason that some resources in the near-term will be required to go unspent in order to balance in future years. The summary of these expenses is displayed in Table 3.

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

	Fiscal Year						
<b>Expense Category</b>	2012-13	2013-14	2014-15	2015-16	2016-17		
Bureaus CAL Targets	\$350.0	\$361.4	\$378.8	\$398.0	\$411.7		
Transfers to Bureaus	\$16.9	\$17.1	\$17.4	\$17.6	\$17.8		
Council Set-Asides/Special Appropriations	\$29.6	\$31.7	\$32.0	\$30.9	\$32.0		
One-time Spending Available	\$13.4	\$0.0	\$0.0	\$0.0	\$0.0		
Needed Cuts (FY 12-13 ongoing)	-\$14.7	\$0.0	\$0.0	\$0.0	\$0.0		
<b>Total Budget Requirements</b>	\$395.2	\$410.2	\$428.2	\$446.4	\$462.4		
Reserved for Five-Year Balancing	\$4.9	\$1.0	\$0.0	\$0.0	\$0.0		
Note: Totals may not add due to rounding	<u> </u>		1				

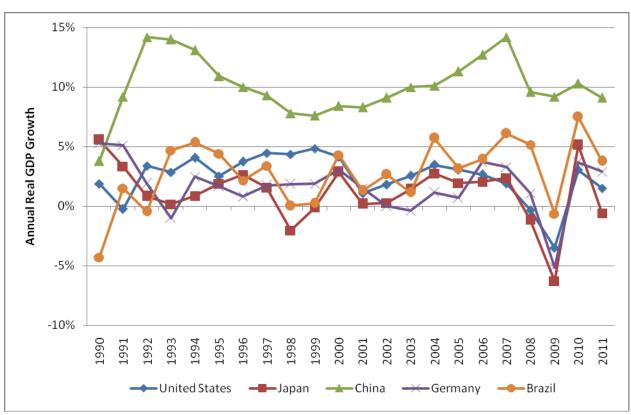
The current forecast assumes that while the most recent labor contracts will be fully funded, any additional costs associated with future labor agreements above cost-of-living adjustments would add new costs not reflected in the current forecast.

## **Current Economic Conditions/Forecast Assumptions**

The current forecast generally assumes a continuation of the current slow growth. Once again in 2012, we may be seeing a three-peat of 2010 and 2011, when solid growth at the beginning of the year gave way to slowness over the summer. This section of the forecast will briefly discuss the international, national, and state and local economies, followed by a table and brief description of selected economic indicator forecasts that helped inform the forecast.

International Economy. Much has been made of China's meteoric economic growth over the past two decades. Portland has been a beneficiary of that growth through its relationship with China as an export market. Figure 2 below shows the growth rate of some of the world's largest economies. Note that while the recession clearly shows up in China's growth rate, it serves merely to decrease annual growth to less than 10%. Another large, emerging economy is Brazil. While its growth has been more uneven than China's, it had only a small contraction in 2009. On the other side of the coin is Japan, where five of the last 14 years have seen the economy shrinking. How long China and other parts of Asia can continue this strong growth remains to be seen, but the implications for the local economy are significant, as shown in figure 5 on page 9.





**National Economy.** As the national economy struggles to emerge from the Great Recession, it is interesting to look at the contrast between certain industries that have historically followed similar paths, but have diverged recently. In this case, this contrast can be seen in the growth paths in auto sales versus housing starts. Figure 3 shows these indicators since 1990. Both are highly sensitive to the business cycle and a cursory look might suggest that housing starts actually "lead" auto sales (i.e., an increase of decrease in housing starts precedes a similar movement in auto sales). However, the most recent data suggest that auto sales are recovering at a steady clip, while housing starts have shown only modest gains and remain well below historical averages.

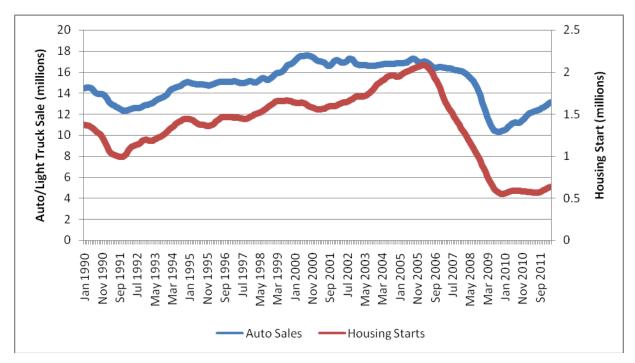


FIGURE 3. Auto Sales and Housing Starts (Annualized 12-month moving average)

At the depths of the last recession, auto sales and housing starts were occurring at unsustainably low rates. For example, at the rates of production/sales experienced in early 2009, it would have taken 279 years to replace the existing housing stock and 25 years to replace all of the cars and light trucks on the road. Based on data from the various federal agencies, typical replacements rate are around 130 years for the housing stock and 13 years for cars and light trucks. Though there are reasons, such as lower demand for housing because of larger households from children living with parents longer, to suggest that we may not get back to the historic replacement rate, most data suggest we have over-corrected with respect to housing starts and that some substantial "natural" growth should occur over the next several years.

**State and Local Economy.** Boosted by the aforementioned growth in Asia, exports have been one indicator that has taken a more traditional path during this economic recovery. Figure 4 shows that, based on the value of exported goods, Oregon exports have nearly recovered completely.

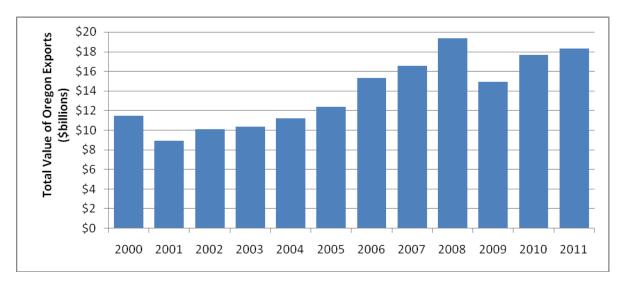


FIGURE 4. Value of Oregon Exports (World Institute for Strategic Economic Research)

Figure 5 provides some detail with respect to what products the state is exporting, largely through the Port of Portland. It should be noted that because the data is based on the value of the product, price changes, particularly with respect to agricultural products, can drive changes from one year to the next. Also, the influence of the high tech industry sector is evident in the graph. Computer and electronic products account for roughly one-third of all export dollars. Also of note, the transportation equipment sector took a large hit in the last recession and remains exporting only about half as much as it did prior to the recession. More detail will be provided in an upcoming issue brief later this summer.

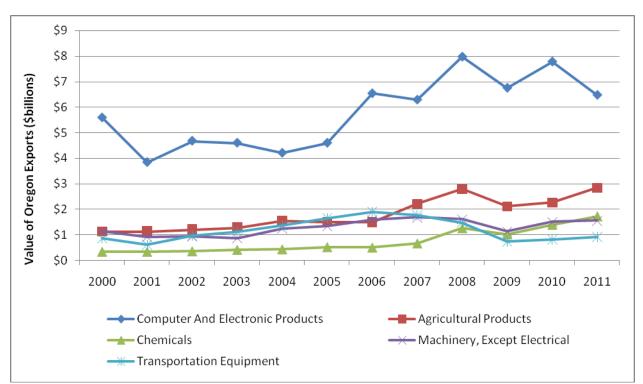


FIGURE 5. Value of Oregon Exports for Selected Categories (World Institute for Strategic Economic Research)

Finally, figure 6 takes a look at which countries import the most Oregon goods. China became the state's largest trading partner in 2009 – as recently as 2005, it was fifth. Again, one can see the influence the high tech sector has on these figures with Malaysia occupying a spot in the top five. While the data is not available by company, Intel has multiple assembly plants in Malaysia and China.

\$4.5 \$4.0 \$3.5 Value of Oregon Exports (\$billions) \$3.0 \$2.5 \$2.0 \$1.5 \$1.0 \$0.5 \$0.0 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 China Canada → Malaysia Japan South Korea

FIGURE 6. Value of Oregon Exports to Selected Countries (World Institute for Strategic Economic Research)

**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 <sup>1</sup>	3/2012	988,100	1.1%	Neutral
Portland MSA Unemployment Rate <sup>1</sup>	3/2012	7.9%	-1.7%	Positive
Consumer Price Index, Portland-Salem <sup>2</sup>	4Q-2011	221.5	3.3%	Neutral
Real Estate				
Median Home Price, Portland Metro <sup>3</sup>	3/2012	\$215,700	0.3%	Neutral
Housing Units Permitted (Y-T-D) <sup>4</sup>	3/2012	541	104%	Positive
Foreclosure Activity <sup>5</sup>	3/2012	327	19.3%	Negative
Portland Metro Industrial Vacancy Rate <sup>6</sup>	4Q-2011	14.2%	-0.8%	Positive
Portland Office Vacancy Rate <sup>6</sup>	4Q-2011	13.0%	1.2%	Neutral
Commerce				
Total PDX Air Passengers (Y-T-D) <sup>7</sup>	3/2012	3,033,034	2.7%	Positive
Total PDX Freight (Y-T-D in Tons) <sup>7</sup>	3/2012	50,178	5.3%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons) <sup>7</sup>	3/2012	3,221,243	-7.5%	Negative
Hotel Average Daily Rate <sup>8</sup>	2/2012	\$116	-2.2%	Neutral
Hotel Occupancy Rate <sup>8</sup>	2/2012	65.0%	-5.6%	Negative

<sup>&</sup>lt;sup>1</sup> Oregon Employment Department, Unemployment Rate is seasonally-adjusted, Year Ago Change is percentage point increase/decrease

Growth in broad economic indicators, such as Gross Domestic Product, are not expected to reach trend growth rates until at least 2013, let alone exceed trend, as occurs with most economic recoveries. 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.

<sup>&</sup>lt;sup>2</sup> Bureau of Labor Statistics. CPI-W. Portland-Salem, OR-WA

<sup>&</sup>lt;sup>3</sup> Market Action, Publication of RMLS

<sup>&</sup>lt;sup>4</sup> U.S. Census Bureau

<sup>5</sup> RealtyTrac

<sup>&</sup>lt;sup>6</sup> Norris, Beggs & Simpson, Market Research, Office vacancy is for Central Business District, Year Ago Change is percentage point increase/decrease

<sup>&</sup>lt;sup>7</sup> Port of Portland, Aviation & Marine Statistics

<sup>&</sup>lt;sup>8</sup> Wolfgang Rood Hospitality Consulting – Downtown Portland Market, Year Ago Change is percentage point increase/decrease

**Table 5. Selected Economic Indicator Forecasts** 

	2011	2012	2013	2014	2015	2016
Macroeconomic Indicators						
Real Gross Domestic Product <sup>1</sup>	1.7%	2.4%	2.8%	4.0%	3.7%	2.9%
Corporate Profits - U.S. <sup>1</sup>	4.2%	2.5%	2.8%	13.0%	12.0%	3.2%
Retail Trade Spending - U.S. <sup>1</sup>	7.7%	6.0%	4.0%	4.5%	4.1%	3.8%
Unemployment Rate - Portland-Vancouver- Hillsboro MSA <sup>1</sup>	9.1%	7.7%	7.9%	7.2%	6.4%	5.8%
Employment Growth - Portland-Vancouver- Hillsboro MSA <sup>1</sup>	1.8%	1.3%	1.3%	2.5%	3.1%	2.4%
Retail Trade Spending - Portland-Vancouver- Hillsboro MSA <sup>1</sup>	7.0%	6.4%	4.3%	4.9%	5.3%	4.8%
Prices						
CPI-W for Portland-Salem OR-WA	3.3%	2.3%	2.8%	2.7%	2.0%	1.8%
CPI-Services For U.S. <sup>1</sup>	1.7%	4.9%	3.5%	3.5%	4.1%	3.6%
Producer Price Index - U.S. <sup>1</sup>	7.0%	3.2%	2.8%	2.1%	2.1%	2.2%
Natural Gas Prices <sup>2</sup>	-2.0%	-0.2%	0.7%	0.6%	2.9%	3.3%
Electricity Prices <sup>2</sup>	-4.3%	0.9%	0.9%	1.3%	1.9%	1.5%
Other Factors						
PERS Employer Cost Rates - Tier 1 & 2		9.3%	9.3%	14.5%	14.5%	16.0%
PERS Employer Cost Rates - OPSIRP (non-sworn)		7.7%	7.7%	11.5%	11.5%	13.0%
PERS Employer Cost Rates - OPSIRP (sworn)		10.4%	10.4%	15.0%	15.0%	16.5%
<sup>1</sup> Provided by Moody's/Economy.com <sup>2</sup> United States Energy Information Administration						

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