City of Portland

Quarterly General Fund Budget and Economic Tracking Report

FY 2012-13, 1st Quarter

Office of Management and Finance

INTRODUCTION

This document is intended to summarize the City's current financial status, as well as discuss the current economic environment. The first section looks at how the City ended FY 2011-12 and broadly addresses the City's long-term budget outlook; the second looks at the City's various General Fund revenue streams and expense categories; and the last section describes selected aspects of our local economy. The figures shown here are not an official forecast and, due to the fact that it is early in the fiscal year, no estimation of the FY 2012-13 ending balance is made using current year revenues and expenses. Furthermore, because it is early in the fiscal year, estimates shown of any revenue or expense categories may be subject to significant variation between now and the end of the fiscal year.

FY 2011-12 YEAR-END & LONG-TERM OUTLOOK

The end of FY 2011-12 further illustrated the nature of this recovery – slow, but generally steady growth – and, more importantly, demonstrated the lingering impacts of budget cuts on city bureaus. Though still subject to some minor fluctuations through the auditing process, it appears that the FY 2011-12 General Fund ending balance was *lower* than anticipated. The biggest reason for this was historically high spending by bureaus. Typically, the City spends about 97% of its budget throughout the course of the year. However, in FY 2011-12, the rate of spending was close to 99%, as bureaus continue to manage within budgets that have been squeezed through several years of budget cuts. When combined with new spending approved as part of the City's FY 2012-13 fall Budget Monitoring Process, the result was a $2.4 million deficit for FY 2012-13. Consequently, Council enacted one-time cuts in the current year to offset this deficit.

Budget Risks. In the medium- and long-term, the City faces significant budgetary challenges. In addition to the generally fragile economic conditions, the following summarizes several key factors that could significantly impact the General Fund:

- *Property tax growth uncertainty* – Historically, property taxes have been a relatively stable form of revenue. Given its importance to the General Fund – it provides roughly half of all discretionary revenue – the steady growth in property tax revenue has helped the City avoid the level of cuts seen at the state level. While that will still broadly remain the case, increased property tax

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compression and uncertainty surrounding the impact associated with the recent establishment of the Multnomah County Library District will increase the variability on the City's property tax collections. For example, current estimates call for a roughly $10 million reduction in property taxes from the increased compression associated with the new Library District beginning in FY 2013-14.

- *Pending labor contract negotiations* – The City will be renegotiating most major collective bargaining contracts in 2013, except the Portland Fire Fighters Association (PFFA). Historically, the City's costs rise with each negotiation relative to the preceding contract. Given the current conditions, any increase in costs above the typical cost-of-living allowance (COLA) will likely need to be paid for with cuts from General Fund bureaus and/or programs.

- *Federal government policy* – There remains great uncertainty related to the global, national, and local economies. In particular, Europe continues to languish somewhere between barely stable and insolvent, while the United States may endure another self-inflicted injury with the pending "fiscal cliff" – a combination of government spending cuts and tax increases that may pull a substantial amount of money out of the economy – at the beginning of 2013.

- *PERS costs* – The most recent employer rates (the City pays a proportion of each employee's wages into the retirement system) increased PERS General Fund costs by just under 50%. These rates are expected to increase throughout the five-year forecast horizon as the fund tries to climb back from significant losses suffered in 2008.

FY 2012-13 General Fund Revenue

Property taxes. Preliminary data suggest that FY 2012-13 property tax collections will be slightly lower than previously forecast. Property tax compression – the amount of property tax revenue that the City is unable to collect due to Measure 5 property tax limits – increased significantly from 4.9% of FY 2011-12 taxes to 6.4% in FY 2012-13. The figure was as low as 2.7% in FY 2007-08. Also, assessed values increased by only 1.9%, the smallest increase since Measure 50 was adopted in the 1997. The combination means that current year property tax collections will grow by less than 1% for the first time since FY 1997-98, when Measure 50 caused a decrease in property tax collections. Fortunately, the most recent data suggest that the local real estate market has improved significantly and some construction activity has begun, particularly as it relates to multi-family housing, as developer attempt to capitalize on the region's historically low vacancy rate and rising rents.

For nearly all of the remaining General Fund revenue sources, it remains too early to make truly reliable estimates of year-end totals. However, what we have seen so far is definitely mixed. Business license tax collections are beginning to show some weakening growth. The forecast calls for a modest 5% increase in collections after consecutive years of double-digit growth. Meanwhile, transient lodging taxes and state-

shared liquor and cigarette revenues are outpacing budget projections. Oregon Liquor Control Commission same-store sales data highly suggest that the increased prices for liquor in Washington following the voter-approved privatization of liquor distribution have boosted sales for liquor stores near the border. For Utility License/Franchise Fees, the first quarterly payment for the fiscal year is due November 15th. As a result, the figures presented in Table 1 are largely speculative.

TABLE 1. FY 2012-13 Selected General Fund Revenue Source Tracking ($millions)

Resource Category	Current Budget	Estimated Year-End	Difference
Property Taxes	$197.9	$196.9	($1.0)
Business License Taxes	$76.6	$73.5	($3.1)
Transient Lodging Taxes	$18.1	$19.7	$1.6
State Shared Revenue	$12.9	$13.5	$0.6

FY 2012-13 General Fund Expenses

Through the first quarter of the fiscal year, it is difficult to discern any particular points of note as it relates to General Fund expenses. An important complicating factor in this analysis is that the City's FY 2012-13 Adopted Budget includes a policy of "capturing" vacancy savings from bureaus whenever they have an open position. Because this has not been done before, the ultimate impact on the flow of expenses is uncertain. Table 2 summarizes the current budget, estimated year-end totals based on the first three months.

TABLE 2. FY 2012-13 General Fund Expense Tracking ($millions)

Expense Category	Current Budget	Estimated Year-End	Difference
Personal Services	$316.3	$316.0	($0.3)
External Materials and Services	$74.3	$73.6	($0.7)
Internal Materials and Services	$54.7	$54.1	($0.6)
Other[1]	$45.0	$45.3	$0.3
Total Expenses	***$490.3***	***$489.0***	***($1.3)***

[1] Includes Capital Outlay, Bond Expenses, Fund Transfers, and Contingency. Compensation Set-aside totaling $4.2 million is included in personal services.

Year-to-date personal services through September were 2.6% below a year ago. Most of this drop was due to a noticeable decline in Fire's Bureau's personal services cost, the delayed hiring as a result of the budgeted 90-day vacancy savings beginning on July 1, 2012, and a wage and step increase freeze for non-represented employees until June 2013. As of September 30th, the Fire Bureau, in particular, saw a

significant decrease of 6.8% in personal service costs, resulting from having 5% fewer employees. Based on the latest biweekly data, citywide overtime cost was also reduced by 4.6% from the same period last year, which corresponds to pre- Occupy Portland period (October 6 through November 13, 2011) and is not distorted by the unusually high Police overtime that resulted from the protests. Despite the difficulty of predicting any future events that will cause overtime, it is unlikely that we will witness a repeat of last year's Occupy Portland, which cost the City at least $1 million in Police overtime in November 2011. The combination of a lower expenditure pattern and the unlikely repeat of Occupy Portland is estimated to reduce year-end overtime by $1.5 million from last year's total of $17.5 million. Based on biweekly payroll data, year-to-date employee health benefit and pension costs show an increase of about 3.2% compared with the same period in FY 2011-12. Total benefits are estimated at around $74.3 million, or 4.1% above last year. Overall, year-end personal services are estimated at around $316 million, roughly one percent over last year. The first-year fiscal impact of a new Portland Fire Fighter Association contract is expected to be quite small, but out-year costs are expected to reach $600,000 per year. External material services are projected to fall just within budget at $73.6 million, or approximately 11% higher than last year's $66.2 million. Finally, internal material and services are expected to be close to the budgeted amount of $54.1 million and capital outlay is projected to fall $200,000 below last year's total of $830,000.

CURRENT ECONOMIC CONDITIONS

Table 3 shows many area economic indicators, the relative strength compared to a year ago, and a description of the trend regarding the most recent data points.

Employment. The local unemployment rate tied a post-recession low in September, which was identical to April 2012 reflecting little movement for much of the year. The seasonally adjusted rate of 8.0% is a full percentage point lower than September 2011 and remains well below the statewide figure of 8.7%. Meanwhile, the underlying jobs figures paint a somewhat similar picture. Though growth has once-again stalled slightly toward the end of summer, year-over-year figures generally show broad-based gains. Among the bright spots over the past year were the two rapidly recovering sectors of construction (up 3.8%) and manufacturing (up 3.1%). Meanwhile, modest losses were seen in the other services, education and information sectors.

TABLE 3. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA[1]	9/2012	1,002,100	1.3%	Neutral
Portland MSA Unemployment Rate[1]	9/2012	8.0%	-1.0%	Positive
Consumer Price Index, Portland-Salem[2]	2Q-2012	223.712	2.2%	Neutral
Real Estate				
Median Home Price, Portland Metro[4]	9/2012	$238,300	3.2%	Positive
Housing Units Permitted (Y-T-D)[5]	9/2012	1,851	60.7%	Positive
Portland Metro Industrial Vacancy Rate[6]	3Q-2012	13.6%	-0.8%	Neutral
Portland Office Vacancy Rate[6]	3Q-2012	12.9%	-0.1%	Neutral
Commerce				
Total PDX Air Passengers (Y-T-D)[7]	9/2012	10,818,522	5.1%	Positive
Total PDX Freight (Y-T-D in Tons)[7]	9/2012	154,878	3.6%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons)[7]	9/2012	9,476,912	-7.4%	Negative
Hotel Average Daily Rate[8]	9/2012	$145.38	8.7%	Positive
Hotel Occupancy Rate[8]	9/2012	85.0%	1.3%	Positive

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

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

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

[4] Market Action, Publication of RMLS

[5] U.S. Census Bureau

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

[7] Port of Portland, Aviation & Marine Statistics

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

Real Estate. Finally it appears that the local real estate market has turned a corner. Most price data suggest that the local housing market hit a low for prices early in 2012 – note that all markets are very localized right now, so certain parts of the City have likely not seen any real gains. Furthermore, low vacancy rates and rising rents have supported a sharp increase in apartment construction. It should be noted that it has taken the nearly perfect market conditions of low inventories and record low mortgage rates to turn the market. As a result it remains susceptible to a small downturn in economic conditions.

Commerce. Likely influenced by a labor dispute at the Port of Portland, marine freight movement at the Port is lower compared to last year. Meanwhile, nearly every other commercial activity indicator appears to continue to gain steam as we head toward the holidays. In particular, hotel activity and room rates have helped to fuel record transient lodging tax collections over the last year.

Inflation. Based on data released August 17th, inflation[1] rose at an annualized rate of 2.2% for the first six months of 2012. The total Consumer Price Index is a weighted average of several component prices and much of the increase was driven by increases in commodities prices. Because this increase has failed to fall back, we expect CPI-W for 2012 – which determines the COLA increases for nearly all City employees – to be between 2.5% and 3%.

[1] As measured by the CPI-W for the Portland-Salem area, which is historically referenced for City cost-of-living adjustments.