

PORTLAND'S FINANCIAL CONDITION: Funding infrastructure should be high priority

April 2017



Portland City Auditor
Audit Services Division



Winner of 2017
Gold Hermes Creative Award
for Publication Design



Production / Design
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April 12, 2017

TO: Mayor Ted Wheeler
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Tom Rinehart, Chief Administrative Officer, Office of Management and Finance

FROM: Mary Hull Caballero, City Auditor

SUBJECT: Audit Report: *Portland's Financial Condition: Funding infrastructure should be high priority* (Report #490)

Local governments produce a great deal of financial information, but most of it reflects a single snapshot in time. This report focuses on historical trends over five years, allowing decision-makers to visualize the City's course, consider options, and make adjustments to improve the City's long-term financial health. We found that although Portland's financial condition is currently stable, there are long-term challenges the City must address.

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 appreciate the Office of Management and Finance for implementing the recommendations from our prior Financial Condition report. The Office is now producing a Popular Annual Financial Report and presenting Council with an annual assessment of how the City's long-term financial position could be improved. Management and Finance's discussion of the City's financial health and options improves decision-making and transparency.

Mary Hull Caballero
City Auditor

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Summary

What is financial condition?

This report provides residents and public officials with information on the City of Portland's financial health. The report uses information, primarily from the City's audited Comprehensive Annual Financial Report and identifies favorable and unfavorable trends at a high level. Monitoring City finances over time enables public officials and residents to assess the City's financial condition and fiscal sustainability and identify problem areas that may need attention.

A financially sustainable city can meet its obligations and provide public services on an ongoing basis. It can address effects of fiscal interdependency between governments, withstand economic disruptions, and respond to changes in the environment. A financially stable city collects enough revenue to pay its short and long-term bills and finance major needs without shifting disproportionate costs to future generations.

How is Portland's financial health?

Portland's financial health is stable. Revenues have increased, debt is down, the City has a balanced annual budget, and the City's liquidity and credit ratings are strong. The City needs to monitor its increasing liabilities and unmet infrastructure needs. During our audit, we found:

- The City's total net position continues to decline. Net position is the difference between what a government owns and what it owes. Some of the reason for the decline is due to increased liabilities, which the City has little control over. This is largely because of the City's pension system for police and fire, as well as policy and assumption changes for the Oregon Public Employees Retirement System.
- Some of the City's assets are losing value faster than the City can make repairs. This also affects the City's net position and is an area where the City does have control. While the City is making significant investments in its water, sewer, and stormwater assets, most transportation infrastructure is in fair to poor condition. It will be up to the Council to use the new 10-cent per gallon gas tax wisely to invest in the City's streets.

In previous versions of this report, we recommended that the Office of Management and Finance provide Council with an annual analysis of the how the City's long-term financial position

could be strengthened. The Office is making progress towards this recommendation by producing a Popular Annual Financial Report for the first time this year, and presenting Council with a long-term fiscal health snapshot. Continued evaluation of the factors contributing to the decline in net position can enable Council to take actions to slow the decline.

Key indicators and results

Indicator	Overall 5 year trend	Interpretation
Revenues per resident	↑	OK
Percent of City property tax dollars supporting the General Fund	↓	
Expenses per resident	↑	
City outstanding debt principal per resident	↓	OK
Credit ratings for outstanding debt	Above minimum City standard for 2016	OK
City net position	↓	
City liquidity	Above standard of \$1 current asset per \$1 current liability	OK
Asset condition	No trend. 2015 data shows condition varies widely by asset.	

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

Revenue and Expenses

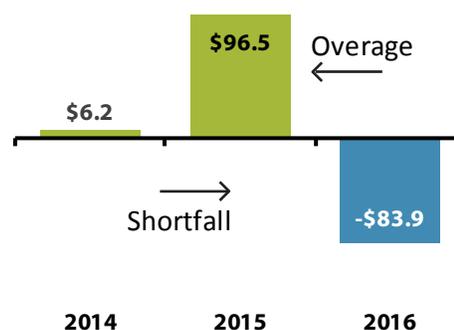
Why are revenues and expenses important?

Revenues are necessary for government to provide services to residents. Diverse sources of revenues can help the City weather a downturn in the economy. Expenses are government's cost of providing public services, not just what the government spent (expenditures) during the year. Some common expenses are salaries and wages, pension obligations, and asset depreciation. The City can have a balanced budget each year based on its anticipated resources and budget expenditures, but actual revenues may not equal or exceed the total costs of the services provided.

Both revenues and expenses have grown

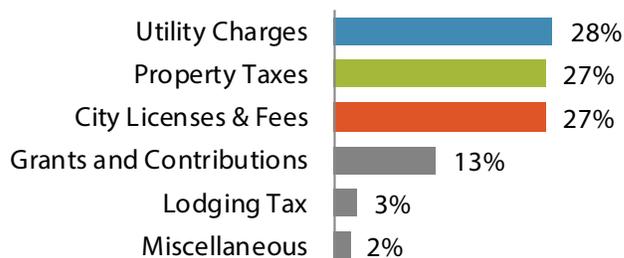
Total revenues were \$1.9 billion in 2016, an increase of 13 percent over 2014. City costs were \$2 billion, an 18 percent increase during that same time. City revenues were more than expenses in two out of the last three years.

Full government cost is sometimes more or less than City revenues (millions)



Source: Portland financial reports

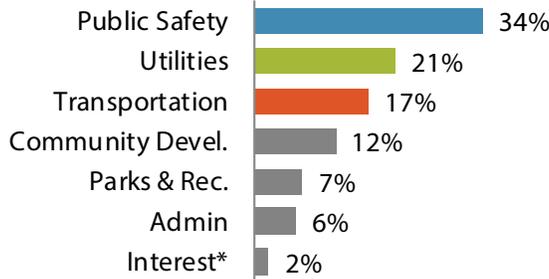
Revenue sources are diversified



Source: Portland Financial Reports

The City's revenues continue to be diverse. During the last five years, lodging taxes more than doubled to about \$51 million, and licenses and fees increased 27 percent to \$517 million. The only decrease was in the area of grants, as federal stimulus spending declined.

Public Safety has the highest proportion of cost in 2016



Source: Portland Financial Reports

* Interest on long-term debt for services. Interest for utilities is included in its service area.

City services cost \$2 billion in 2016. Public safety costs continued to be the largest City expense, at \$676 million, a 28 percent increase from five years ago. Public utility programs and the City's transportation programs were the second and third largest, at \$423 million and \$330 million, respectively. Their share of City costs did not significantly change from five years ago.

Less than half of City property taxes fund general operations

The City collected \$502 million in property taxes in 2016, an increase of 8 percent since 2012. Only 45 percent went to the City's General Fund to be used to pay for public safety, parks, and community development, among other services.

Where the City spent its portion of your property tax dollar



Source: Portland Financial Reports

Urban renewal claimed 25 cent of each property tax dollar. These funds pay off debt for improvements in urban renewal areas. The Fire and Police Disability and Retirement Fund accounted for 24 cents of each dollar. These funds pay the disability benefits for current police and firefighters and retirement payments for those hired prior to 2007. These proportions were similar to five years ago.

Debt

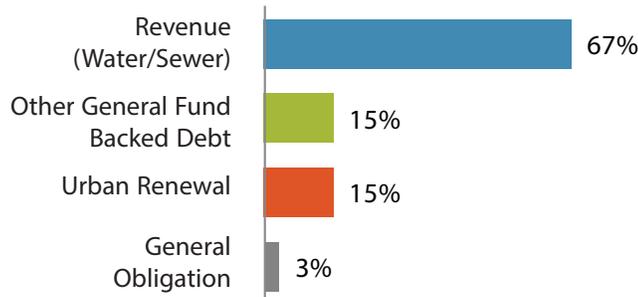
Why is debt important?

The City borrows money to pay for capital improvements, ranging from sewer pipes to community centers. Debt financing allows the City to spread the costs of large projects across many years, so future taxpayers who benefit from the project will pay for a portion of the improvements.

Debt per person went down 12 percent

The City's total outstanding debt declined since 2012, from \$3.5 billion to \$3.3 billion. In 2016, total debt per resident was \$5,256.

About 2/3 of City debt is for water and sewer improvements



Most of the City's debt funds water and sewer infrastructure improvements. These revenue bonds are repaid from water and sewer rates charged to customers. These bonds increased slightly to \$2.2 billion in 2016. Most other types of bonds decreased over the five-year period.

Source: Portland Financial Reports

Favorable credit ratings decrease City costs

As of February 2017, about 32 percent of the City's debt has the highest rating (Aaa), including bonds supported by property taxes. This quality means lower borrowing costs. The remaining 68 percent of City debt has lower, but still good rating, meaning that ratings agencies view the City's debt as a good credit risk.

32%
Portland bonds with the strongest (Aaa) credit rating

68%
Portland's bonds rated below Aaa, are rated Aa1 to Aa3 (very strong)

Why are capital assets important?

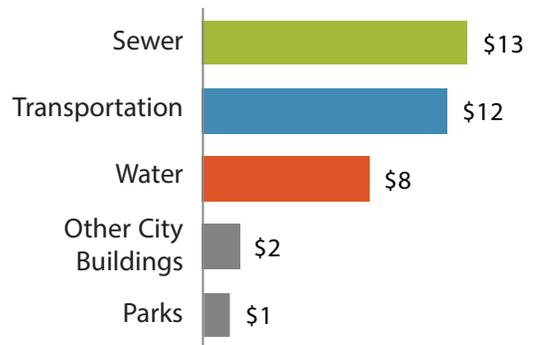
The City uses physical infrastructure (capital assets), such as streets and fire stations, to provide services. The condition of these assets impacts the quality of services residents receive. Good asset management requires investment in regular, preventive maintenance. This increases the life of the asset and reduces costs. Lack of preventive maintenance risks early asset failure and increased expenditures.

City manages assets valued at \$36 billion

The 2016 Citywide Asset Report estimates the replacement value of the City's physical infrastructure at \$36 billion. Replacement value is an estimate of the cost to buy or rebuild the asset.

City sewer, transportation and water infrastructure would cost the most to replace

(billions)

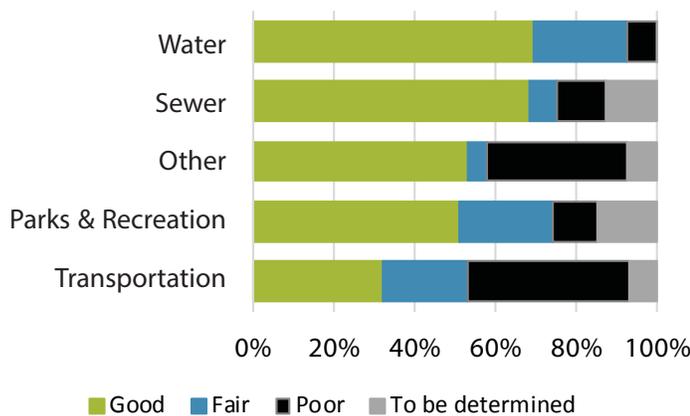


Source: 2016 Citywide Asset Report

Condition of City assets varies

Most water and sewer assets are in good condition (about 69 percent). The Bureau of Transportation reports the lowest percentage of assets in good condition (33 percent) for streets, sidewalks, bridges, and streetlights.

Most water and sewer infrastructure is in good condition. Transportation lags.



Source: 2016 Citywide Asset Report

Portland voters approved a 10-cent a gallon gas tax, most of which will support paving and repair projects. The tax went into effect January 1, 2017.

Financial and Operating Position

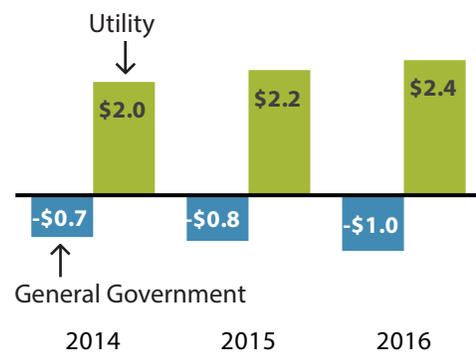
Why are financial and operating position important?

Net position measures the difference between what a government owns and what the government owes. The change in net position tells us whether Portland's financial position has improved or declined based on decisions and actions in the previous year. Liquidity is the City's ability to pay its short-term bills.

Utility infrastructure investments improve financial position

Additional investments in water and sewer infrastructure have more than offset the reduction in value as assets age. Over the last three years, utility net position increased 16 percent, to about \$2.4 billion. This was funded by increases in water and sewer rates.

Utility net position improved, but general government net position declined (billions)



Source: Portland financial reports

General government financial position is below zero and declining

Portland's net position for general government is negative \$1 billion. These services include public safety, parks and recreation, community development, transportation, and City administrative services. The negative \$1 billion is largely because of Portland's previous pension system for fire and police. Under that 'pay as you go' system, the City did not set aside any money for future payments. Portland has a dedicated property tax levy to raise the money needed each year for those retirement payments, but the total future cost is over \$3 billion. Police officers and firefighters hired



Source: Audit Services Division

in 2007 and later are enrolled in a different, pre-funded retirement system, but it will be many years before the pension liabilities from the previous City retirement system are paid.

Some of the reasons for the recent decline in net position are outside City Council's control. For example, part of the decline in 2016 is because of changes in policy and assumptions for the state retirement system. Other factors, such as streets and other infrastructure declining in value faster than the City makes repairs, are solely the responsibility of City Council.

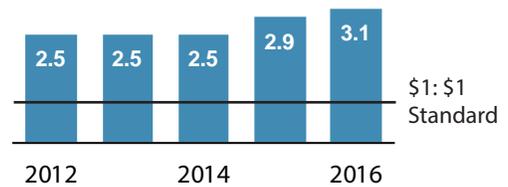


Source: Audit Services Division

City liquidity remains positive

Liquidity is measured by a ratio of current assets to current liabilities. Current assets are those 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. It may indicate a cash flow problem. City liquidity has varied over time but has stayed above the \$1: \$1 ratio for the last five years.

Liquidity has improved in the last two years



Source: Portland financial reports

Demographics

Why are demographics important?

Economic and demographic information highlights community needs and resources. Some indicators are also the basis used by federal and state government to allocate funding for services.

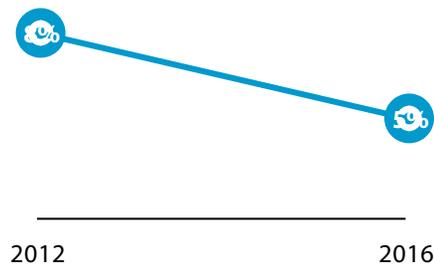
Population increased 7 percent

Portland's population increased from 585,845 in 2012 to 627,395 in 2016. In 2016, Portland made up 15 percent of Oregon's total population.

Portland's unemployment rate continues to decline

Portland's unemployment rate decreased from 8 percent in 2012 to 5 percent in 2016. The City's level has mirrored the national unemployment rate for the last five years, reflecting an economic recovery.

Unemployment levels decreased 3 percentage points from 2012



Source: U.S. Bureau of Labor Statistics

Income per resident has been fairly steady

Since 2012, the Portland area's income per resident was less than the national average for metropolitan areas. Income per resident in the Portland area was \$49,008 in 2015 – an increase from \$47,112 in 2012. The national average increased about 2 percent during the same time, from \$49,318 to \$50,430.

97%
Average Portland income
per resident compared to the
national average

Scope and methodology

The objective of this report was to provide a high-level overview of City finances and trends for the public. 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 from Fiscal Years 2012 to 2016. 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 <ul style="list-style-type: none"> • City Revenues • Revenues per Resident • Revenues by Source • Property Tax 	<ul style="list-style-type: none"> • Portland Comprehensive Annual Financial Reports: <ul style="list-style-type: none"> ◦ Government-Wide Statement of Net Position ◦ Combining Statement of Revenues, Expenditures, and Changes in Fund Balance for Non Major Governmental Funds ◦ General Fund Schedule of Revenues and Expenditures ◦ Fire and Police Disability and Retirement Fund Schedule of Revenues and Expenditures
Expense <ul style="list-style-type: none"> • City Expense • Expense per Resident • Expense by Service Area 	<ul style="list-style-type: none"> • Portland Comprehensive Annual Financial Reports – Government-Wide Statement of Activities
Financial and Operating Position <ul style="list-style-type: none"> • City Net Position • City Liquidity 	<ul style="list-style-type: none"> • Portland Comprehensive Annual Financial Reports – Government-Wide Statement of Net Position
Debt <ul style="list-style-type: none"> • City Debt • Debt per Resident • Debt by Type 	<ul style="list-style-type: none"> • Portland Comprehensive Annual Financial Reports – Ratios of Outstanding Debt by Type • Notes to the Financial Statements • Annual Debt Report
Capital Assets <ul style="list-style-type: none"> • Replacement Value of Capital Assets • Condition of Assets 	<ul style="list-style-type: none"> • 2016 Citywide Asset Report
Demographic and Economic <ul style="list-style-type: none"> • Population • Unemployment • Income per Resident 	<ul style="list-style-type: none"> • Portland State University Center for Population Research • U.S. Bureau of Labor Statistics • U.S. Bureau of Economic Analysis

Scope and methodology

Indicators are measured according to generally accepted accounting principles and use full-accrual accounting rather than a cash basis. A cash basis records revenue that came in and what was spent. This is what the City uses to prepare and balance the annual budget. Full accrual is different. It 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.

To account for inflation and unless noted otherwise, we expressed most financial data in constant dollars. 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 Comprehensive Annual Financial Reports, we relied on the work performed by the City's external financial auditors. Our intent was to provide reasonable assurance that the reported information presented a fair picture of the City's financial health.

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 & City of Portland Citywide Assets Reports
<http://www.portlandoregon.gov/cbo/>

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

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.

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Report #490, April 2017

Audit Team: Kristine Adams-Wannberg, Kari Guy

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/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:

Portland Building Reconstruction: City faced with important post-planning decisions to ensure project success (#482, December 2016)

Americans with Disabilities Act: Coordination gaps complicate City response (#476, December 2016)

2016 Community Survey: Portlanders' ratings of city livability drop to new low (#485, November 2016)

