City of Portland, Oregon
Bureau of Development Services
Business Operations and Finance Services
FROM CONCEPT TO CONSTRUCTION

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BDS Finance Committee

Meeting Notes
Friday, December 9, 2016

Committee Members Present
Josh Harwood, City Economist
Eric Hovee, E.D. Hovee & Co.
Mike Paruszkiewicz, NW Natural (Call-in)
Mike Wilkerson, ECONorthwest
Tom Potiowsky, PSU Northwest Economic Research Center (Call in)

City Staff Present
Rebecca Esau, BDS
Elshad Hajiyev, BDS
Mitch Nickolds, BDS
Dora Perry, BDS
Ray Galinat, BDS
Deborah Sievert Morris, BDS
Ross Caron, BDS
Andy Peterson, BDS
Kyle O'Brien, BDS
Paul Scarlett, BDS
Seth Lemler, BES
Matt Grumm, Commissioner Saltzman's Office

Handouts
- Financial Summary
- Non-Cumulative Cost Recovery Report
- BDS Revenue Composition
- Workload Measures Report
- Bureau Budget Goals and Strategy
- Large Projects

Welcome & Self-Introductions
BDS Director Paul Scarlett welcomed Finance Committee members and City staff. Committee members and staff introduced themselves.

Mr. Scarlett provided a brief overview of the upcoming budget process, while expressing his appreciation for the Committee's time and stressing the importance of their input regarding BDS's finances and financial forecasting.

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BDS Finances & Financial Planning Update

BDS Finance Manager Elshad Hajiyev started off setting a framework for the upcoming Finance Committee meetings. This first meeting serves to provide an overview of the bureau's current financial state, while looking to the committee for economic insight, both nationally and locally. At the next meeting Mr. Hajiyev and Mr. O'Brien will present proposed financial forecasting models for review and critique, along with the BDS Five-Year Plan.

Mr. Hajiyev noted that BDS is primarily fee funded. Approximately 3% of revenues come from the General Fund in FY16-17, down from 4% in the previous year. The majority of fee revenues collected are associated with State mandated programs, including Building/Mechanical, Plumbing, and Electrical. State statutes regulate these programs and prohibit revenue collected by them to be used for other local code enforcement programs. Local programs include Land Use Services, Neighborhood Inspections, Environmental Soils, Signs, Zoning Compliance, and Site Development. Revenues from these programs are used according to City Code. Only Land Use Services and Neighborhood Inspections have received General Fund monies.

Financially, the bureau is on strong footing. Through October 31, 2016 the bureau's FY16-17 cumulative cost recovery rate was 129%. Reserves totaled about $76 million. Workload has been high, and the bureau has many multifamily projects in the works. Project submittals have been more diverse over the past 12-24 months.

Mr. Hajiyev gave a brief overview of the bureau's Five-Year Financial Plan. Approximately 84% of revenues are forecasted by econometric modeling. Specifically, the Building, Mechanical, Plumbing, Electrical, and Land Use Services fee revenues are econometrically forecasted. The Facility Permit Program (FPP) rates are a weighted average of the Building, Mechanical, Plumbing, and Electrical growth rates. Site Development and Zoning Enforcement growth rates are based on the Building Program rates. Environmental Soils, Signs, and Neighborhood Inspections are forecasted using averages of forecasted economic data.

Mr. Harwood noted that the bureau's Five-Year Plan has the added complexity of forecasting both how much revenue will be collected over the next five fiscal years and also when those revenues will be collected.

Current Economic Trends Discussion

<u>Moody's Scenarios and Economic Data:</u>

Mr. Hovee began the discussion inquiring as to the bureau's use of Moody's scenarios. Mr. Hajiyev stated BDS uses Moody's baseline and worst-case scenarios. Mr. Hovee recommended using multiple projections due to the increased uncertainty over the next

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24 months. Mr. Harwood noted that the economic forecast is holding steady, but the confidence interval has widened.

Mr. Wilkerson added that in some areas certainty is increasing; namely increased interest rates, and dropping value of tax credits. Mr. Wilkerson expects the latter to have a negative effect on low-income housing. Developers may not receive enough in tax credits to make low income housing feasible. Projects may no longer pencil out.

Another issue is the stock market. Mr. Wilkerson noted that if current market highs do not maintain, this may result in higher demand for real estate. In a bear market people might look to real estate as an alternative investment.

Housing Affordability

Mr. Hovee stated that Portland may be in more of a housing price bubble than previously thought. Mr. Potiowsky added to this discussion that price increases have slowed from a year ago, indicating a settling of the housing market. Mr. Wilkerson countered that prices are still increasing at double the U.S. average, around 11%. If Inclusionary Zoning (IZ) and other affordability measures do not work as intended, they could exacerbate affordability issues. It is possible high prices in Portland could result in a 'flight' out of the city to west side suburban development. Per Mr. Hovee, the suburban market is more robust than in previous years, with a focus leaning toward higher end price points.

Per labor economists, Portland income levels are much higher than normal and U.S. averages. Though there are steady price increases, the ratio of median house price to median income remains low compared to the bubble highs of 2005 and 2006. Even so, the environment will be tougher going forward for home buyers, especially with rising interest rates if home prices don't moderate in turn.

Mr. Wilkerson noted a large number of renting households in the $100k - $150k income ranges. Additionally, 30% of people ages 18-30 are living with parents, while the number of people per household is increasing. Some of these people could eventually move into the purchasing market, thereby increasing demand. So far, the transition from renting to ownership is not happening. Additionally, Mr. Hovee mentioned many professionals feel the need to be "mobile" in the current labor market, which could indicate a longer term demand for rentals for higher income households.

Mr. Harwood referenced migration into Portland and surrounding areas as a factor increasing housing prices. He also noted uncertainty regarding the degree to which prices can rise before increased cost becomes a deterrent, thereby slowing migration.

Multifamily

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There was consensus that the multifamily market will be impacted by local policy changes, especially Inclusionary Zoning. From an operational standpoint, Mr. Wilkerson predicted longer gap between Land Use (LUS) applications and initial building permit applications than normal, due to the increase in LUS applications before February 1, 2017 code changes. Developers are getting their LUS applications in early to beat the IZ policy changes, though they may not be ready to file their permits for some time. Rebecca Esau added that as of December 9, 2016 the bureau has received LUS reviews accounting for approximately 16,000 future housing units which are grandfathered in with the current code for three years. The bureau can expect more grandfathered units prior to February 1, 2017, though no estimate was given. Mr. Harwood posited that the true effects of IZ will not be known for a few years due to the current increase LUS applications prior to IZ implementation.

There is a concern that IZ will restrict supply, which in turn will increase prices. A common theme was that IZ will have a negative impact on high density development. Mr. Wilkerson stated that IZ disproportionately effects high density development, leading to far fewer large projects. The expectation is to see an increase in 19 or fewer unit projects to avoid IZ regulations. Based on this expectation Mr. Wilkerson inquired how smaller scale development will affect BDS revenues. Mr. Scarlett responded that as long as the same number of units is built there should be minimal impact on cost recovery because these projects will be less complex.

The consensus is that to create a perfect system, IZ should be evaluated on a project by project basis. Development incentives could be offered to offset the negative effects on supply. The policy as currently discussed is not on a project by project basis. The committee agreed that from a forecasting perspective it would be prudent to assume less large project development going forward.

Rent control is another possible local policy change which can have an impact on the Five-Year Financial Plan, though that discussion is still in the nascent stages. Any rent control measure is likely at least 2-3 years in the future. Mr. Hovee stated that if talks on rent increase caps come to fruition there will be a negative effect on remodels.

Offices

At least in the short term, office development is tied more closely to employment. With current strong job growth and migration of companies to Portland, the labor market is presently thriving. Mr. Hovee informed that though there may not be a strong correlation between offices and multifamily in the short term, in the long term a decrease in office development would result in a decrease in demand for multifamily.

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Going forward, office development will be a larger share of the total, mostly due to the decrease in multifamily rather than an increase in office construction. A general lack of parking was discussed as a deterrent to office projects.

Hotels

The current level of development is not sustainable. Mr. Wilkerson noted that we are bordering on overdeveloping where previously Portland was under built in this aspect. Restrictions on Airbnb type rentals are something to monitor going forward.

Mr. Harwood mentioned that the strong hotel development of the past couple years could be a sign that Portland is becoming an international city, like San Francisco and Seattle, rather than a regional city. It signals Portland is a destination. If this theory holds true, it bodes well for future development.

Single Family

The limited number of available lots is an issue, though demand is strong. Increases in interest rates can affect the price of single family homes if they are severe enough to influence demand. Higher interest rates tend to decrease price pressure in the single family market.

Next Meeting Details

Mr. Hajiyev said the next meeting will be scheduled for early January 2017, and he and Mr. O’Brien will have preliminary models for the Committee’s review and critique.

Meeting notes prepared by Ray Galinat, BDS