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

Chloe Eudaly, Commissioner
Rebecca Esau, Director
Phone: (503) 823-7300
Fax: (503) 823-6983
TTY: (503) 823-6868
www.portlandoregon.gov/bds

BDS Finance Committee

Meeting Notes
Thursday, November 29, 2017

Committee Members Present
Josh Harwood, City of Portland Economist
Eric Hovee, E.D. Hovee & Co.
Peter Hulseman, Northwest Economic Research Center
Rob Humphrey, Development Review Advisory Committee Vice Chair
Jerry Johnson, Johnson Economics
Kirk Olsen, Development Review Advisory Committee
Mike Parusziewicz, Multnomah County
Tom Potiowsky, Northwest Economic Research Center

City Staff Present
Rebecca Esau, BDS
Ray Galinat, BDS
Elshad Hajiyev, BDS
Kathy Lyndon, BDS
Kyle O'Brien, BDS
Yung Ouyang, City Budget Office
Andy Peterson, BDS
Marshall Runkel, Commissioner Eudaly's Office
Kim Tallant, BDS

Handouts
- Financial Summary
- Non-Cumulative Cost Recovery Report
- BDS Revenue Composition
- Workload Measures Report
- Large Projects
- Line Item Expense Budget – Fiscal Year 2017-18 Adopted & prior 4 years actual spending
- General Ledger Line Item Explanations

Welcome & Self-Introductions

BDS Director Rebecca Esau welcomed Finance Advisory Committee members and City staff. Committee members and staff introduced themselves.

Elshad Hajiyev, BDS Senior Business Operations Manager, provided a brief overview of the upcoming budget process. He expressed appreciation for the Committee's time and stressed the importance of their input regarding BDS's finances and financial forecasting, specifically relating to the next 4 to 5 years. In prior years, Elshad led the Financial Advisory Committee meetings and BDS financial planning; he is now handing this responsibility to BDS Interim Budget & Finance Manager Kyle O'Brien. Kyle has been responsible for developing BDS's financial modeling for the last four years.

BDS Finances & Financial Planning Update

Kyle 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. Proposed financial forecasting models will be presented for review and critique at the next meeting, along with the BDS Five-Year Plan.

BDS is primarily fee funded; approximately 1.5% of revenues are expected to come from the City's General Fund in FY 2017-18, down from 3% the previous year. Most fee revenues collected are associated with State-mandated building code 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. BDS's local code programs include Land Use Services, Enforcement, Environmental Soils, Signs, Zoning Compliance, and Site Development. Revenues from these programs are used according to City Code. Currently Enforcement is the only BDS program receiving General Fund monies.

Financially, the bureau is on strong footing, with reserves totaling roughly $90 million. Through October 31, 2017, the bureau's FY 2017-18 cumulative cost recovery rate was 115%. The past year saw strong permit valuations; however, Kyle noted growth in the number of permits is slowing. Additionally, Land Use Services revenues, which usually lead the economy, are down year-over-year.

A brief overview of the bureau's Five-Year Financial Plan was provided to the Committee. Approximately 80-85% 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 Enforcement are forecasted using averages of forecasted economic data.

As directed by City Council, a discussion of BDS expenditures has been added to this year's Finance Committee agenda. An overview of BDS line-item expenditures over the last 4 fiscal years was provided, as well as the current year line-item budget.

Current Economic Trends Discussion

Economic Outlook Discussion

Jerry Johnson kicked off the discussion by stating the economy appears healthy for the next 18 months. Kirk Olsen agreed, adding that there is near certain recession risk within the next 5 years. Eric Hovee generally concurred with this assessment, while adding he expects an economic correction sometime during the next 5 years, but less severe than the previous recession.

Due to this outlook, there was panel consensus to include an adjustment in revenue projections after year two of the BDS 5-year forecast. Kirk recommended referencing the shape of 2005 to 2010. Mike Paruszlewicz recommended looking at applying the low end standard deviation numbers prior to the last recession to the BDS baseline forecast for the worst case scenario.

Housing Affordability

There is not enough housing inventory to accommodate population growth in the greater Portland area. The rate at which housing is becoming more unaffordable is slowing down; however, the slowdown is not expected to result in lower prices. Economists do not see the recent housing activity as a "housing bubble." Per labor economists, Portland income levels are much higher than U.S. averages. Despite steady housing price increases, the ratio of median house price to median income remains low compared to the bubble highs of 2005 and 2006.

Peter Hulseman noted the recent "perfect storm" of migration coupled with job and wage growth as a driver of price increases. However, rising prices should level out as the current migration level (35,000 migrants in FY 2016-17 compared to an average of 14,000) is not viewed as sustainable without the addition of another large job source.

Additionally, high construction costs were presented as a cost driver, with Kirk noting annual increases of 10-12%. Labor shortages resulting from subcontractor supply deficits account for much of this increase, rather than a rise in the price of materials.

With housing supply concerns, the panel did not foresee housing becoming more affordable in the near future. However, some of the Portland supply concerns could be alleviated if factors push populations to the suburbs. Josh Harwood noted amenity development in Vancouver, WA could draw people out of the City. There is also evidence of migration to the suburbs as millennials begin forming households. The current state of the public transportation system is a deterrent to migration out of Portland; however, as our infrastructure begins to transform, movement towards the suburbs should increase.

Another factor to housing affordability is vacancy rates. Jerry stated there is generally a decrease in rents as vacancy rates rise over 5%. With current vacancy rates hovering around that threshold, a slight reduction in rents has been observed.

Single Family

The limited number of available lots is still an issue for single family residence development. Single family homes make up most of the region's housing supply. Portland's cost of living is still cheaper than larger cities like Seattle and San Francisco; however, current prices and lack of available lots may lead to an increase in remodeling instead of new development.

Construction costs coupled with development fees and a low supply of buildable lots have resulted in single family residence development trending mid to high end. Jerry noted that system development charges have also pushed development to the higher end. While instances of redevelopment and infill were noted, it was not viewed to be at a level high enough to provide meaningful supply side impact.

Multifamily

The Portland Metro area will see a decrease going into February 2018 in the multifamily sector. In general, multifamily and mixed-use projects are expected to slow. Jerry noted substantial demand for condos and condo-conversions, while also stating a lack of development in this area. Additionally, Kirk mentioned a slowdown in multifamily investor capital. High construction costs are becoming a deterrent to multifamily development. Inclusionary Zoning regulations, as well as legal issues, were put forth as additional factors hindering multifamily projects from penciling out.

Offices

Like multifamily, offices have witnessed a slowdown of investor capital. Additionally, while jobs are still increasing, a decrease in square foot per employee has been observed. These factors, coupled with high construction costs, may result in lower than expected office development activity.

Hotels

The last 24 months have seen an increase in hotel development, but that activity may not be sustainable. Josh posited this development is related to the Convention Center. Kirk noted that hotel development has a long cycle, with periodic high development activity followed by longer periods of inactivity.

Josh stated that the year-over-year lodging tax is flat. The absence of the annual Intel meeting was a contributing factor, as well as less activity than expected related to the eclipse. If this is the end of the cycle, hotel development activity should decrease. Also, the accessory short-term rental market had an impact by cutting into hotel activity.

Industrial/Retail

Kirk noted a strong investor appetite for industrial development. The industrial supply side has seen growth, with Amazon opening in the Rivergate Industrial District as a prime example. However, it was also mentioned that over the long term, supply is not expected to keep up with demand. In addition, ground floor retail development is expected to slow down.

BDS Expenses

New to this year's Committee was a discussion of BDS expenses for FY 2018-19. There was a recommendation to analyze personnel cost per permit, and to focus on cost efficiencies. Eric concurred, recommending a cost per permit analysis over the last 12-15 years.

Follow up

- Rob Humphrey inquired as to the number of submittals under the current zoning code.
- Kirk asked for an analysis relating to the consequences of revenue over projections compared to under projections, in order to provide context to the Five-Year Forecast.

Next Meeting Details

Kyle said the next meeting will be scheduled for January 9, 2018, and preliminary models will be presented for the Committee's review and critique.

Meeting notes prepared by Kathy Lyndon & Ray Galinat, BDS