



City of Portland
**Quarterly General Fund Budget
and Economic Tracking Report**
FY 2011-12, 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 2010-11 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 2011-12 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 2010-11 YEAR-END & LONG-TERM OUTLOOK

The end of FY 2010-11 began to indicate some of the weakness that characterized much of the summer. Though still subject to some minor fluctuations through the auditing process, it appears that the FY 2010-11 General Fund ending balance will come in only slightly higher (currently estimated at approximately \$300,000) than the budgeted beginning balance for FY 2011-12.

The most prominent weakness, and one that will likely result in lower revenues than forecasted in the longer-term, is in property taxes. Real estate prices, particularly residential home prices, have dropped significantly for the first time since the full implementation of Measures 5 and 50, which sought to limit property tax growth. The interaction of these measures served to allow property tax revenue to grow by a relatively stable and modest rate annually (2% to 4%) through FY 2010-11. However, preliminary data suggest that property taxes will grow by less than 1% in FY 2011-12, due to what is known as property tax compression. It appears that this relative weakness will persist for *at least* one more fiscal year, which will limit property tax collections until such time as housing prices grow again.

The chart on page 2 shows the dramatic increase in the percentage of property taxes lost due to compression. To the extent that weakness in the local housing market persists, General Fund property tax receipts will grow at levels below the long-term trend. It is also important to note the property tax levy for the City's Fire and Police Disability and Retirement system is forecasted to increase throughout the forecast period. This will "crowd out" General Fund collections for those properties in compression.

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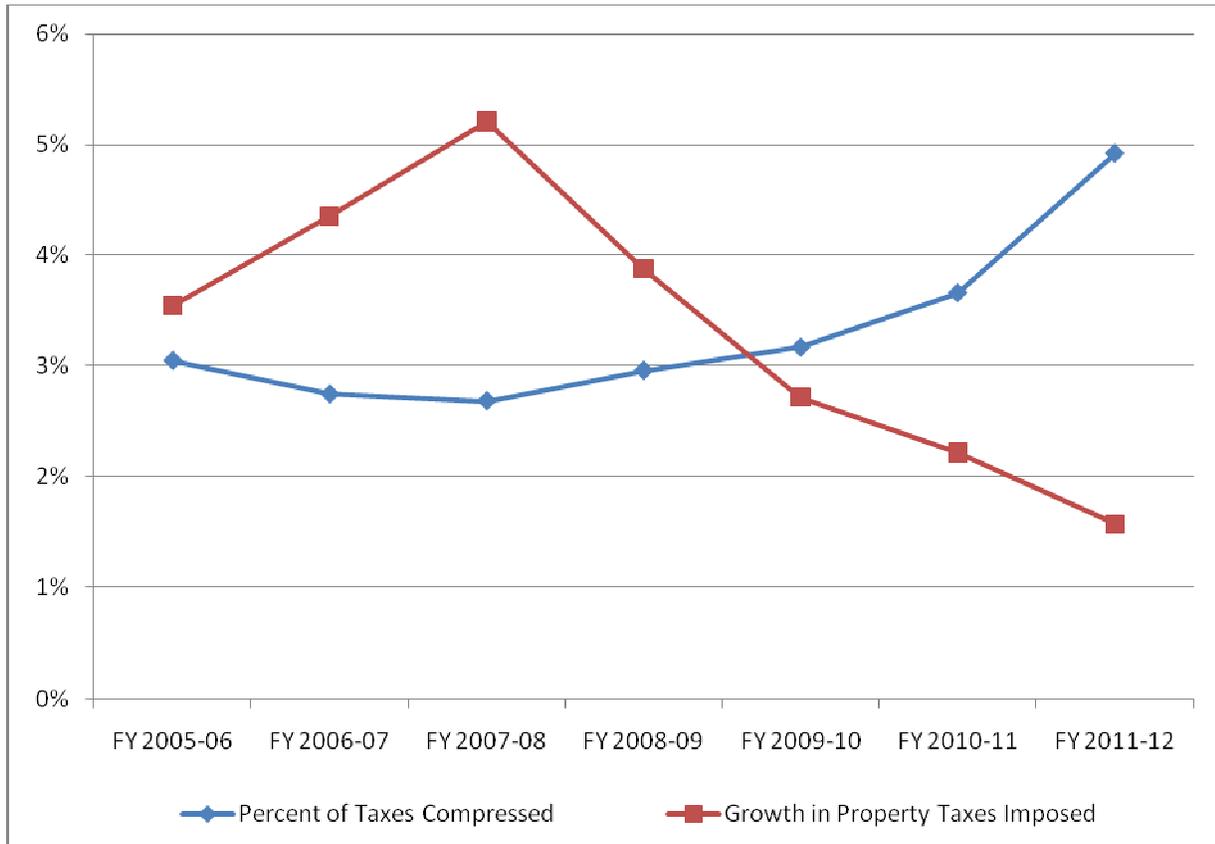
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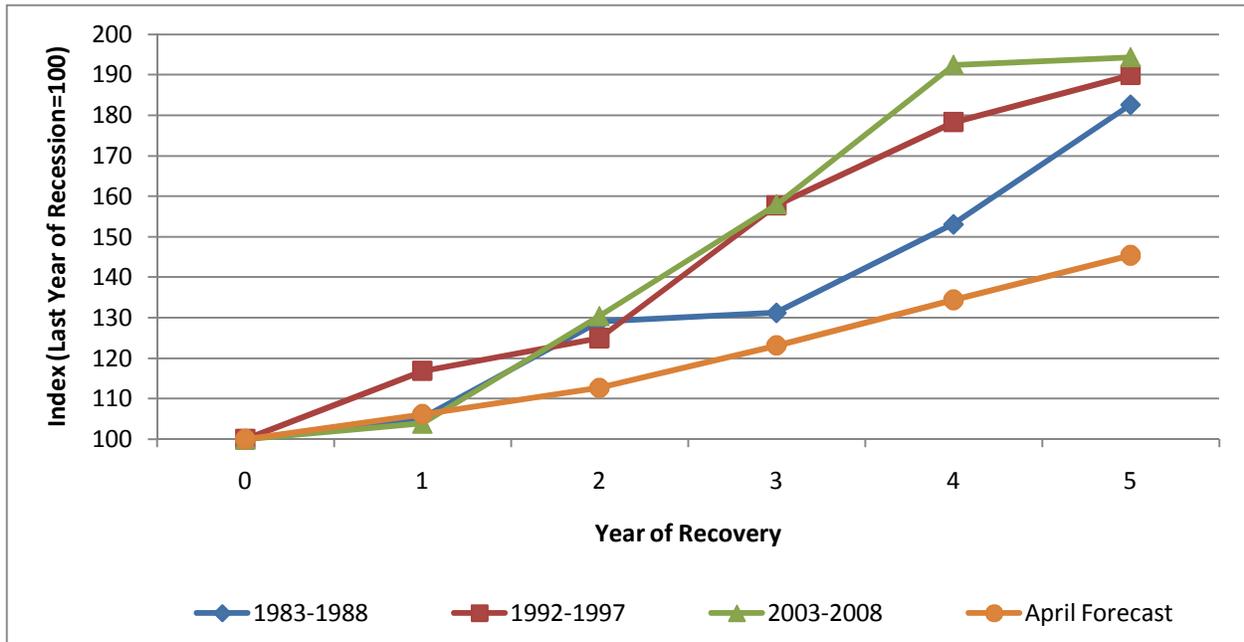
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Figure 1. Property Tax Compression Losses



The City’s revenue streams that ebb and flow with the business cycle – business license and transient lodging taxes – rebounded substantially in FY 2010-11 and show signs early in FY 2011-12 of maintaining a moderate growth path. Past forecasts for both of these revenue sources have typically underestimated near-term receipts, while overestimating receipts in the out-years of the forecast. This is likely due to the fact that these sources rarely grow at a consistent rate over a five-year period. The potential for several years of below par economic growth (see *Current Economic Conditions* section on page 4) is a significant risk to the long-term growth in these taxes. However, it should be noted, as shown in Figure 2, that the current forecast already expects a significantly slower recovery than City has seen in previous economic expansions.

Figure 2. Business License Tax Receipts During Economic Recoveries vs. Current Forecast



The other major General Fund revenue source is Utility License/Franchise Fees. These are likely to grow by close to the long-term trend, as it is largely governed by demographics and utility rate increases. One can expect a slightly more modest growth in the near-term, as households continue to look for ways to cut energy costs. However, in the longer-term, increases in both rates and the number of accounts (i.e., households) will likely lead to more robust growth.

Finally, while inflation has been higher-than-expected during 2011, the relatively weak recovery is expected to allow only modest longer-term inflation, as unemployment remains at historically high levels, limiting wage pressures. Annual city cost-of-living allowance (COLA) wage increases should fall from between 3.5%-4% for FY 2012-13 to around 2% for the remaining years of the forecast. In addition to these cost increases, the City will undergo several labor negotiations that could put upward pressure on expenses.

FY 2011-12 GENERAL FUND REVENUE

Property taxes. Preliminary data suggest that FY 2011-12 property tax collections will be significantly lower than previously forecast. The increase in compression, as noted above, will result in property tax collections coming in at least \$3 million below forecasted levels. Additionally since the April forecast, the state lost a large property tax appeal to Comcast that will result in an additional one-time reduction in FY 2011-12 of approximately \$1 million.

For nearly all of the remaining General Fund revenue sources, it remains too early to make truly reliable estimates of year-end totals. While both business license and transient lodging taxes are tracking above

forecasted levels, the amount received so far represents less than 20% of what the City is expected to receive over the course of the fiscal year. 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 2011-12 Selected General Fund Revenue Source Tracking (\$millions)

Resource Category	Current Budget	Estimated Year-End	Difference
Property Taxes	\$198.0	\$193.8	(\$4.2)
Business License Taxes	\$67.3	\$67.7	\$0.4
Transient Lodging Taxes	\$15.3	\$16.9	\$1.6
State Shared Revenue	\$12.9	\$13.0	\$0.1

FY 2011-12 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. Table 2 summarizes the current budget, estimated year-end totals based on the first three months.

TABLE 2. FY 2011-12 General Fund Expense Tracking (\$millions)

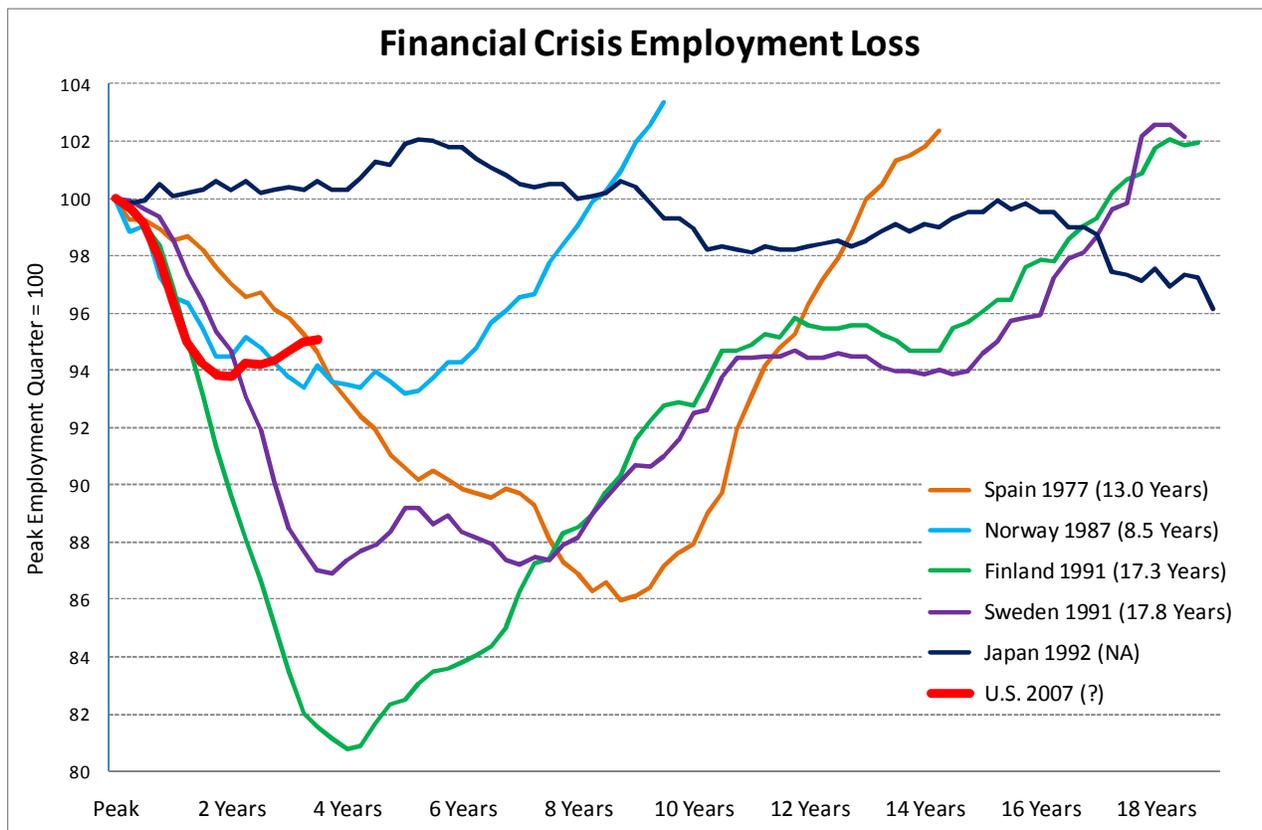
Expense Category	Current Budget	Estimated Year-End	Difference
Personal Services	\$315.2	\$312.3	(\$2.9)
External Materials and Services	\$75.9	\$65.9	(\$10.0)
Internal Materials and Services	\$56.9	\$56.3	(\$0.6)
Other ¹	\$35.9	\$37.5	\$1.6
Total Expenses	\$484.0	\$472.0	(\$12.0)
¹ Includes Capital Outlay, Bond Expenses, Fund Transfers, and Contingency. Compensation Set-aside totaling \$5.2 million is included in personal services.			

Year-to-date total personal services through September were 8.6% above a year ago. Most of the increases were due to new labor contractual obligations, 47% increase in PERS rates, double digit Kaiser premium increases, and 28% increase in overtime and premium pay. Police’s overtime spending through September was \$890,000 above a year ago. While September is too early to estimate year-end external materials and services, and most of the expenditure due to occur after February, year-to-date external material and services is running about 14% above a year ago, but remains under budget. Most of internal material services are within budget or close to original adopted budget. Year-end capital outlay is estimated to be close to last year’s level.

CURRENT ECONOMIC CONDITIONS

It seems to be getting difficult for economic commentators to continue to come up with descriptions for all new data relating to the current economic recovery. While many headlines over the last 18 months have swung wildly from “Summer of Recovery” to “Double Dip Recession Looming,” the reality remains that the economy has largely grown within a relatively narrow range between slightly sub-par growth to mediocre expansion. As less prominent headlines suggest, this is not uncommon following a financial crisis. In fact, comparing the last several years to previous U.S. recessions and recoveries is not the apt comparison, but rather we should likely be comparing our current economic position to those of *other nations’* financial crises recoveries. The figure below illustrates that, while the current experience is painful compared to prior U.S. recessions, it is not significantly atypical of employment losses during financial crises.

Figure 3. Employment Losses in Selected Financial Crises



Source: Reinhart, Carmen and Rogoff, Kenneth, and Oregon Office of Economic Analysis

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. Though these suggest significant positive momentum, it is important to recognize we are still, in many cases, simply bouncing off of historic lows, and have a long way to recover to the previous peak.

Employment. The local unemployment rate reached a post-recession low in May 2011 and has pretty much remained flat since then. The seasonally adjusted rate of 9.1% is lower than all but one month (May 2011 was 9.0%) since December 2008, the epicenter of the economic freefall that began in the fall of 2008. Underlying jobs numbers remain mediocre at best. The beginning of the year showed significant growth, but recent months have stalled as government employment coupled with the still-struggling housing industry has served to offset gains in other sectors. Among the bright spots over the past year were leisure and hospitality (up 3.8%) and educational and health services (up 3.7%). Meanwhile, the largest losses were in government, as 3.1% of jobs were lost from September 2010 to September 2011.

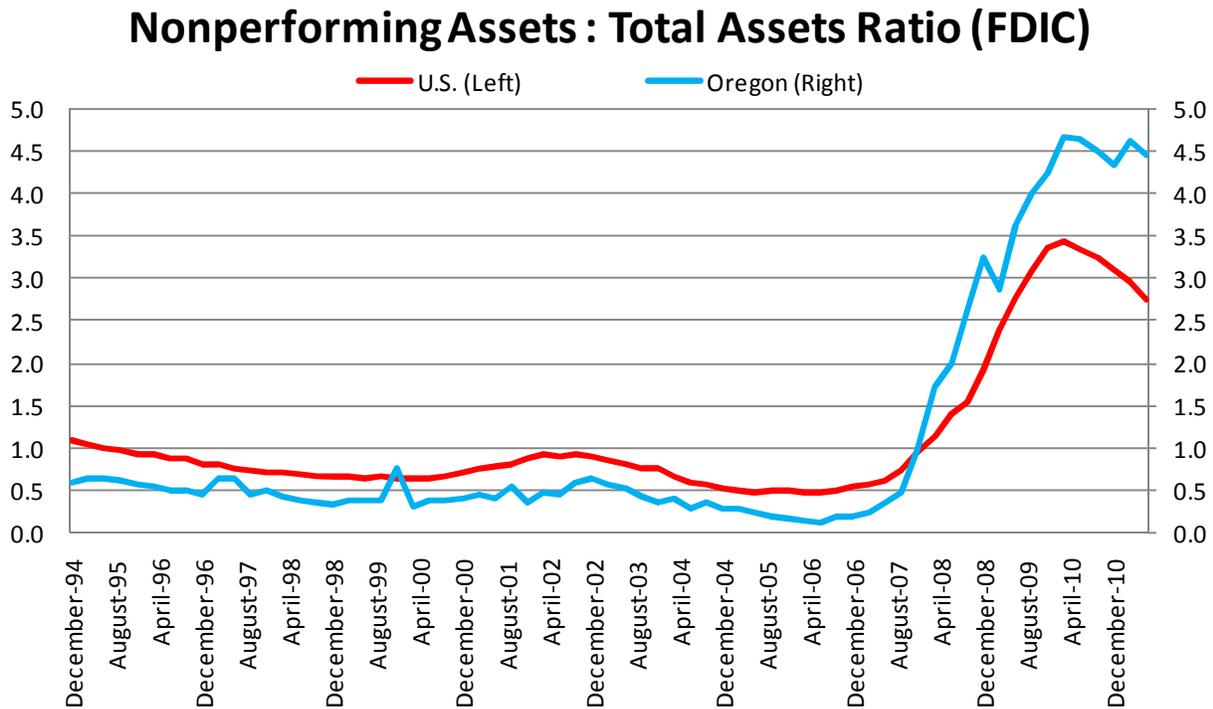
TABLE 3. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA ¹	9/2011	979,700	1.3%	Neutral
Portland MSA Unemployment Rate ¹	9/2011	9.1%	-1.3%	Positive
Consumer Price Index, Portland-Salem ²	2Q-2011	218.9	2.7%	Neutral
Portland Metro Business Index (2002=100) ³	2Q-2011	95.5	-0.6%	Negative
Real Estate				
Median Home Price, Portland Metro ⁴	9/2011	\$230,800	-3.8%	Negative
Housing Units Permitted (Y-T-D) ⁵	9/2011	1,152	96.6%	Positive
Portland Metro Industrial Vacancy Rate ⁶	3Q-2011	8.8%	0.0%	Neutral
Portland Office Vacancy Rate ⁶	3Q-2011	9.3%	-1.1%	Positive
Commerce				
Total PDX Air Passengers (Y-T-D) ⁷	9/2011	10,289,362	4.0%	Positive
Total PDX Freight (Y-T-D in Tons) ⁷	9/2011	149,461	3.3%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons) ⁷	9/2011	10,232,511	4.1%	Positive
Hotel Average Daily Rate ⁸	9/2011	\$131.99	3.7%	Positive
Hotel Occupancy Rate ⁸	9/2011	83.8%	6.0%	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 Grubb & Ellis, Office vacancy is for Central Business District, Year Ago Change is percentage point increase/decrease 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. For those looking for indications of a double-dip recession, housing prices have presented

one of the most convincing cases in 2011. After flattening out in the middle of 2010, prices have indeed “double-dipped” in 2011. Though the latest month-to-month data suggest some stabilizing, prices in Portland have fallen 3.8% from September 2010 to September 2011, according to the Regional Multiple Listing Service. More frightening is that the national data appears to be slightly better than the local markets. The figure below shows the percentage of nonperforming bank assets in Oregon and the United States. This represents the amount of mortgages and other credit lines that are delinquent or in default. While nationally, this percentage appears to be on the decline, local problems remain near peak levels. A contributing factor to this situation is that while Oregon had relatively few sub-prime loans in the last decade, there was widespread use of what is known as Alt-A mortgages later in the decade. These loans were typically given with limited documentation and, because locally they were issued later than most sub-prime mortgages, their terms have reset in the middle of the high unemployment period, compounding the weakness in the housing market.

Figure 4. Nonperforming Bank Assets in Oregon and U.S.



Commerce. On the other side of the economic landscape is export data, as the low value of the dollar and growing demand in parts of Asia have helped to drive shipping activity at the Port of Portland to nearly pre-recession levels. In combination with the weak dollar and relative economic strength of China – which became Oregon’s largest trading partner in 2009 – export data suggest that much of the growth is being driven by local high-tech companies sending component goods to factories around the world for assembly.

Also bucking the modest economic headwinds is the local hotel activity. Both occupancy rates and room rates have greatly exceeded expectations in recent months. This is also represented by a larger national trend. While unclear the exact nature of this phenomenon, speculation is that with corporations sitting on large amounts of cash, the opportunity cost of pursuing business prospects is lower, leading to more business travel.

Inflation. Based on data released August 17th, inflation¹ rose at an annualized rate of 4.2% for the first six months of 2011. 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. While this is expected to wane as the year comes to a close, it persisted long enough that we expect CPI-W for 2011 – which determines the COLA increases for nearly all City employees – to be relatively high, between 3.5% and 4%.

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