City of Portland

# Five-Year General Fund Financial Forecast

FY 2014-15 through FY 2018-19

Office of Management and Finance

December 2013

There has been little change in the economic outlook for much of the past three years. However, the economic sectors that are now picking up, particularly housing, have more direct ties to the City's revenue streams. Therefore, we are expecting slightly above average revenue growth over the next two to three years. This, coupled with a decision by Council in the Fall Budget Monitoring Process (BMP) to set aside one-time resources for debt repayment, thus creating some ongoing resources, means the City will have a modest amount of available ongoing resources beginning in FY 2014-15. Table 1 summarizes discretionary General Fund resources and expense requirements through FY 2018-19. As shown in Table 1, the City will have the opportunity to add $5.9 million in ongoing program spending, as well as $3.3 million in one-time spending, and remain balanced to expected resources over the five-year forecast horizon. This represents an approximate **1.4% addition** from the projected FY 2014-15 General Fund current appropriation level.

**TABLE 1. Discretionary General Fund Five-Year Forecast ($millions)**

| | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|
| **Budget Category** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| **Total Resources** | **$404.9** | **$423.5** | **$433.5** | **$448.1** | **$463.1** | **$476.8** |
| | | | | | | |
| Available Ongoing Adds[1] | | $5.9 | $0.0 | $0.0 | $0.0 | $0.0 |
| Available One-Time | | $3.3 | $0.0 | $0.0 | $0.0 | $0.0 |
| Reserved for Future Year Balance[2] | $8.2 | $3.8 | $4.6 | $3.7 | $1.6 | $0.0 |
| | | | | | | |
| **Total Expenses with Adds & One-Time Spending** | **$404.9** | **$423.5** | **$433.5** | **$448.1** | **$463.1** | **$476.8** |

[1] The City may spend an additional $5.9 million on ongoing programs and $3.3 million in one-time expenses in FY 2014-15 and still balance ongoing revenues with ongoing expenses throughout the five-year forecast.

[2] These dollars are required in order to fund ongoing programs in future years. For FY 2013-14, the figure represents the current forecasted revenue above the adopted budget, as well as money set aside in the Fall BMP for FY 2014-15.

Note: Totals may not add due to rounding

City financial policies require that the City balance its budget over the entire five-year forecast. This means that, to the extent forecasted revenues in year five of the forecast are insufficient to cover expected costs in the same year, the policy requires cuts be enacted in year one of the forecast to set the budget on a sustainable course. While the December forecast does not require any ongoing cuts, the projections for revenues and expenses are such that the City will need to reserve $3.8 million of FY 2014-

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15 resources in order to balance future year budgets. Also, it should be noted that there was $5.8 million in one-time spending in the FY 2013-14 Adopted Budget, but only $3.3 million is forecast for FY 2014-15 and none is expected for FY 2015-16 and beyond.

**Changes Since April 2013 Forecast**

*Near-term Revenue Forecasts* – While, in general, most of the long-term forecasts for General Fund revenues did not materially change, near-term expectations for both property taxes and business license taxes were bolstered significantly. These increases added to the current year's expected ending balance and allowed for some additional ongoing resources to the forecast.

*Debt Service Reductions* – As part of the Fall BMP, City Council chose to reserve one-time resources from the FY 2012-13 ending balance to pay off remaining debt obligations associated with City Hall debt (two years remaining) and the City's computer-aided dispatch system (three years remaining). By setting aside roughly $8.5 million, around $3.5 million in ongoing resources were no longer needed for these debt service payments, freeing them up for additional ongoing programs.

*Lower COLA Projection* – Very low inflation figures have described much of the last six months. As a result, the December forecast includes significantly lower expectations for future cost-of-living allowances (COLA). For FY 2014-15 alone, this lowered projected expenses by almost $1.5 million.

*PERS Costs* – City costs associated with the Public Employee Retirement System (PERS) are going to be approximately $4.5 million lower in both the current year and FY 2014-15. Most of these savings were realized in the FY 2013-14 Adopted Budget. Future year increases remain somewhat unclear because they are dependent on both investment returns and the result of pending lawsuits from employee groups that are appealing laws passed by the state legislature that were designed to curb pension costs.

**Major Short-Term Financial Forecast Risks**

*Labor Contract Costs* – With the exceptions of the Portland Fire Fighters Association and some Housing Bureau employees, nearly every major union contract with the City expired at the end of FY 2012-13. The City has reached tentative agreements with many bargaining units, and only relatively small new costs have been incurred. No additional costs have been included in this forecast for the agreements.

*Potential Future Obligations* – The City has begun discussions regarding some potentially costly projects that could add significantly to the City's General Fund expenses, potentially using up the additional ongoing resources identified in the forecast. In addition to long term major maintenance and replacement projects, the Willamette River's Superfund project may require some General Fund discretionary resources over the next several years. The City also just received a federal grant allowing the City to avoid laying off 26 firefighters for the next two years. However, when funds run out, the City must either lay off those officers or find additional resources that are not currently projected in this forecast.

*PERS Lawsuits* – To the extent that plaintiffs are successful in repealing the PERS reforms passed by the state legislature, the City may be required to have higher PERS employer rates for the foreseeable future. These rate increases would outstrip any projected revenue increases, thus constraining the City budget.

## Discretionary General Fund Resources

Roughly 90% of discretionary General Fund revenue (excluding beginning fund balance) comes from three sources: property taxes, business licenses, and utility licenses/franchise fees. Most of the remainder comes from transient lodging taxes and state shared revenues, which are comprised of the City's share of state-collected liquor and cigarette revenues. Transfers and various small miscellaneous sources round out the City's discretionary General Fund revenue sources. Table 2 summarizes the forecasts for each of these General Fund revenue sources over the five-year forecast horizon.

**TABLE 2. Discretionary General Fund Resources Five-Year Forecast ($millions)**

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| **Resource Category** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Beginning Balance | $16.0 | $12.3 | $13.2 | $13.0 | $11.7 |
| Property Taxes | $203.2 | $210.5 | $217.1 | $224.5 | $232.3 |
| Transient Lodging | $22.0 | $22.7 | $23.3 | $24.0 | $24.6 |
| Business Licenses | $85.5 | $87.7 | $90.8 | $94.5 | $97.7 |
| Utility License/Franchise | $79.5 | $82.7 | $86.0 | $89.1 | $92.2 |
| State Revenues | $14.6 | $14.8 | $14.9 | $15.1 | $15.3 |
| Transfers | $0.6 | $0.6 | $0.6 | $0.6 | $0.6 |
| Miscellaneous | $2.1 | $2.1 | $2.2 | $2.2 | $2.3 |
| ***Total Resources*** | ***$423.5*** | ***$433.5*** | ***$448.1*** | ***$463.1*** | ***$476.8*** |
| Note: Totals may not add due to rounding | | | | | |

Other than property taxes, which are projected to be slightly above prior forecasts, the largest change in the forecast outlook since April is related to business license tax collections over the next two years. Business License tax collections grew by 31% over the past three years. This forecast assumes that growth will continue in FY 2013-14. Collections will likely moderate going into FY 2014-15, as the stronger economy induces investment and thereby slows profit-taking. Both business license and transient lodging forecasts are highly sensitive to broad economic conditions, and thus present the greatest exposure to the revenue forecast. Furthermore, there is a significant risk of recession during the five-year forecast timeline. The average economic expansion lasts about six years, and if there is no recession during the forecast horizon, the current expansion will have lasted ten years.

## Discretionary General Fund Expenses

The forecast for General Fund expenses is driven largely by a variety of inflation factors, as well as policy decisions. The forecast incorporates a 1.8% cost-of-living adjustment (COLA) for personnel services for FY 2014-15, which is 0.7 percentage points lower than the 2.5% previously forecasted, thus lowering costs by nearly $1.5 million. Other expense assumptions were modestly lower, particularly those associated with PERS, where costs were lowered dramatically – at least in the near-term, pending several lawsuits – through several pieces of legislation at the state level. The summary of these expenses is displayed in Table 3.

**TABLE 3. Discretionary General Fund Expense Five-Year Forecast ($millions)**

| | Fiscal Year | | | | |
|---|---|---|---|---|---|
| **Expense Category** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Bureaus CAL Targets | $362.1 | $381.0 | $394.6 | $409.9 | $424.7 |
| Transfers to Bureaus | $14.9 | $15.1 | $15.4 | $15.7 | $16.0 |
| Council Set-Asides/Special Appropriations | $33.4 | $32.7 | $34.3 | $36.0 | $36.2 |
| One-time Spending Available | $3.3 | $0.0 | $0.0 | $0.0 | $0.0 |
| Available FY 2014-15 Ongoing | $5.9 | $0.0 | $0.0 | $0.0 | $0.0 |
| | | | | | |
| Reserved for Future Year Balancing | $3.8 | $4.6 | $2.7 | $1.4 | $0.0 |
| | | | | | |
| **Total Budget Requirements** | **$423.5** | **$433.5** | **$448.1** | **$463.1** | **$476.8** |

Note: Totals may not add due to rounding

It should be noted that the current forecast assumes that while the most recent labor contracts will be fully funded, any additional costs associated with future labor agreements, *above cost-of-living adjustments,* would add new costs not reflected in the current forecast. Furthermore, the FY 2013-14 Adopted Budget included the expectation of savings from a span-of-control study and an administrative process review. Because no specific savings have yet been identified, the forecast has not assumed any of the expected savings. Any savings from either project will improve the forecast presented here.

## Current Economic Conditions/Forecast Assumptions

Though the loudest and boldest prognostications about where the economy is headed usually get the largest headlines, they have been largely wrong. For several years now, economists have been talking either about a “booming” recovery just around the corner or runaway inflation, neither prediction has proven accurate. At the national level, the economy has simply moved at an average or slightly below average pace for over four years with only the most modest of inflationary trends.

Meanwhile, the local economy has done markedly better than the national average. While the nation remains almost two million jobs below its pre-recession level, the Portland metro area should eclipse its pre-recession level in early 2014. Furthermore, the local real estate market has shown broad strength in both single-family and multi-family prices and permits.

**Economic Indicators/Forecast Assumptions.** Tables 4 and 5 summarize current selected economic indicators and forecasts that helped inform the General Fund forecast. Data is largely positive, particularly real estate-related indicators.

**TABLE 4. Selected Portland Economic Indicators**

| Indicator | Most Recent | Value | Year Ago Change | Recent Trend |
|---|---|---|---|---|
| **Economy** | | | | |
| Total Employment, Portland MSA[1] | 10/2013 | 1,035,200 | 1.3% | Positive |
| Portland MSA Unemployment Rate[1] | 10/2013 | 6.9% | -1.0% | Positive |
| Consumer Price Index, Portland-Salem[2] | 1H-2013 | 228.033 | 1.9% | Neutral |
| **Real Estate** | | | | |
| Median Home Price, Portland Metro[3] | 10/2013 | $270,000 | 12.0% | Positive |
| Housing Units Permitted (Y-T-D)[4] | 10/2013 | 2,987 | 45.0% | Positive |
| Portland Metro Industrial Vacancy Rate[5] | 3Q-2013 | 9.6% | N/A | Neutral |
| Portland Office Vacancy Rate[5] | 3Q-2013 | 9.9% | N/A | Neutral |
| **Commerce** | | | | |
| Total PDX Air Passengers (Y-T-D)[6] | 10/2013 | 12,506,694 | 4.1% | Positive |
| Total PDX Freight (Y-T-D in Tons)[6] | 10/2013 | 173,025 | 0.3% | Neutral |
| Total Port of Portland Marine Freight (Y- T-D in Tons)[6] | 10/2013 | 9,812,760 | -5.7% | Negative |
| Hotel Average Revenue Per Available Room[7] | 3Q/2013 | $95.26 | 10.7% | 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] Market Action, Publication of RMLS

[4] U.S. Census Bureau

[5] Norris, Beggs, & Simpson, Market Research, Year Ago Change is percentage point increase/decrease. Note: Methodological change beginning 1st Qtr., 2013

[6] Port of Portland, Aviation & Marine Statistics

[7] PFK Hospitality Research, LLC

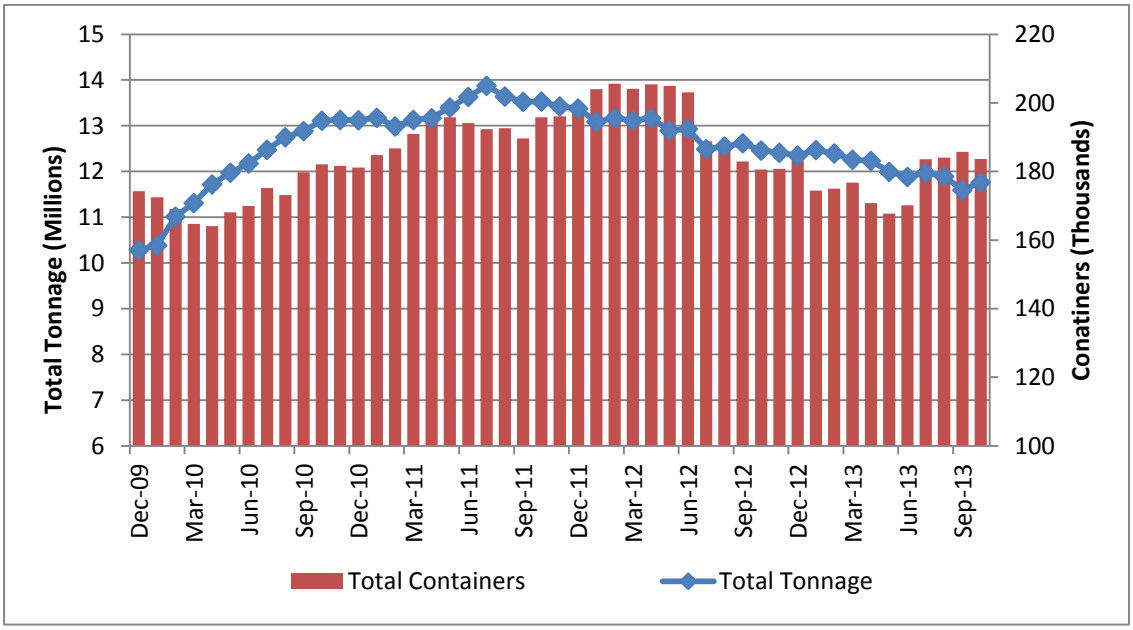
**Economic Risks**

*Federal Fiscal Policy* – Though recent news of a congressional budget deal is certainly welcome – the federal government has not passed a budget in over three years – a component of that deal could be a short-term drag on the economy. Under the deal, more than 1.3 million Americans will lose extended

unemployment benefits in January. Unemployment benefits are one of the most efficient ways that government can stimulate the economy; studies show that a vast majority of unemployment benefits are quickly sent back into the economy through retail spending.

*Local Port Activities* – Governor Kitzhaber recently stepped in to end a long-standing labor dispute at the Port of Portland. This was done in an effort to keep the large Hanjin Shipping Co. making weekly trips to Portland. Hanjin had previously announced that it will discontinue the route to Portland beginning in January. The Port is an important piece in the local economic engine, providing local employers access to global markets. During the disputes, which began nearly two years ago, the Port has suffered from lower productivity, which contributed to the figures shown in the graph below. The graph shows total marine tonnage and number of containers through the port over the last four years. Activity peaked in mid-2011.

**Figure 1. Port of Portland Marine Activity (12-month moving totals)**




*Interest Rates* – The local real estate market, in particular, has benefitted from historically low mortgage rates. This has helped accelerate sales and raise prices. Mortgage rates have risen slightly, but should they rise significantly, they could limit further price appreciation.

**Table 5. Selected Economic Indicator Forecasts**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| *Macroeconomic Indicators* | | | | | | |
| Real Gross Domestic Product[1] | 1.8% | 3.1% | 4.0% | 2.9% | 2.4% | 1.9% |
| Corporate Profits - U.S.[1] | 3.2% | 8.0% | 6.1% | 5.3% | 4.0% | 4.1% |
| Retail Trade Spending - U.S.[1] | 4.3% | 5.4% | 5.4% | 3.5% | 3.7% | 3.6% |
| Unemployment Rate - Portland-Vancouver-Hillsboro MSA[1] | 7.5% | 7.4% | 7.1% | 6.6% | 6.2% | 6.2% |
| Employment Growth - Portland-Vancouver-Hillsboro MSA[1] | 1.9% | 1.9% | 2.7% | 2.5% | 1.5% | 0.8% |
| Retail Trade Spending - Portland-Vancouver-Hillsboro MSA[1] | 3.7% | 5.5% | 6.2% | 4.4% | 4.0% | 3.4% |
| | | | | | | |
| *Prices* | | | | | | |
| CPI-W for Portland-Salem OR-WA | 1.8% | 1.8% | 2.3% | 2.5% | 2.7% | 2.5% |
| CPI-Services For U.S.[1] | 2.3% | 3.5% | 3.9% | 4.0% | 4.1% | 4.1% |
| Producer Price Index - U.S.[1] | 1.4% | 2.3% | 2.6% | 2.3% | 2.3% | 2.2% |
| Natural Gas Prices[2] | -9.5% | -4.0% | -0.1% | 14.3% | 3.7% | 7.1% |
| Electricity Prices[2] | 0.0% | 0.5% | -0.6% | 1.7% | 0.8% | 0.3% |
| | | | | | | |
| *Other Factors* | | | | | | |
| PERS Employer Cost Rates - Tier 1 & 2 | 9.3% | 9.3% | 9.3% | 13.0% | 13.0% | 16.0% |
| PERS Employer Cost Rates - OPSIRP (non-sworn) | 7.7% | 7.5% | 7.5% | 10.5% | 10.5% | 13.0% |
| PERS Employer Cost Rates - OPSIRP (sworn) | 10.4% | 10.3% | 10.3% | 13.5% | 13.5% | 16.5% |
| | | | | | | |

[1] Provided by Moody's/Economy.com

[2] United States Energy Information Administration