City of Portland

General Fund Forecast UPDATE

FY 2016-17 through FY 2020-21

City Budget Office

February 2016

The City Budget Office is releasing an update to the December five-year financial forecast that incorporates new information on inflation, business license and transient lodging revenue, and a Council decision to allocate money to affordable housing development. This update also includes information on the General Fund's performance in FY 2015-16 as well as the latest local economic indicators. Though local economic conditions are strong, certain aspects of the national and global economies are beginning to show signs of weakness. In the near term, the City financial picture continues to improve, as it appears tax year 2015 will be another record year for business license tax revenues. Largely resulting from a higher business license tax forecast, CBO now projects that the City will have ***$4.4 million in excess ongoing revenue and $15.9 million in excess one-time revenue*** in the FY 2016-17 budget. Both the ongoing and one-time figures are up from December, consistent with what one would expect given current economic conditions. A final budget forecast will be released in late April and significant forecast changes remain a possibility, though it is unlikely the City will see the magnitude of forecast change seen last year.

CHANGES SINCE DECEMBER 2015 FORECAST

Inflation – Local inflation remains very low, as a pronounced slump in energy prices has moderated costs in many sectors of the economy. The CPI-W for Portland rose only 0.3% from the second half of 2014 to the second half of 2015, the smallest increase since 1986. The December forecast included a higher expectation of 1.7% for FY 2015-16 cost-of-living allowances (COLA), which are tied to the CPI-W. City collective bargaining contracts have a minimum COLA of 1%. If non-represented employees receive a 1% COLA also – a decision City Council will make as part of the budget process – the City will see ongoing General Fund savings of approximately $1.7 million.

Lodging Tax Receipts to HIF – In December, City Council pledged lodging tax revenue from short-term rentals to the Housing Investment Fund. The forecast impact of that action was to move $1.2 million in General Fund ongoing resources to the HIF.

UPDATE HIGHLIGHTS

New Ongoing: $4.4

New One-Time: $15.9 million

Significant Changes Since December:

- COLA for FY 2016-17 of 1.0% vs. 1.7% forecast.

- Volatile revenue sources continue to boom. Business license tax forecast up $8 million.

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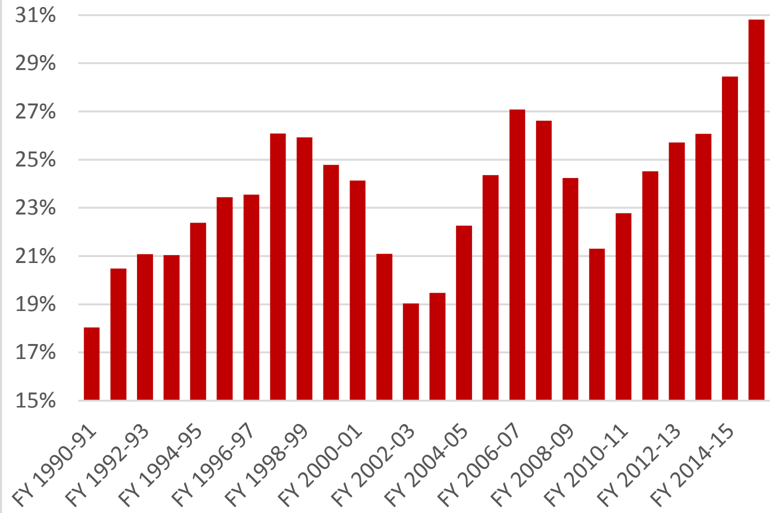
Revenue Forecasts – Reflecting recent robust economic growth, nearly every change to revenue forecasts is positive. In particular, the forecasts for business license and transient lodging taxes increased significantly. Specifically, the forecast for business license taxes increased to $108 million for FY 2015-16, more than 33% above collections from just two years ago. As a result, the City's business license and transient lodging taxes – the City's most volatile revenue sources – now comprise a greater portion of the General Fund than at any time in the past 25 years. As a result, the City's General Fund budget is more exposed to an economic downturn, as can be seen in the graph.

Figure 1. BLT/TLT as a Percent of Major General Fund Revenue

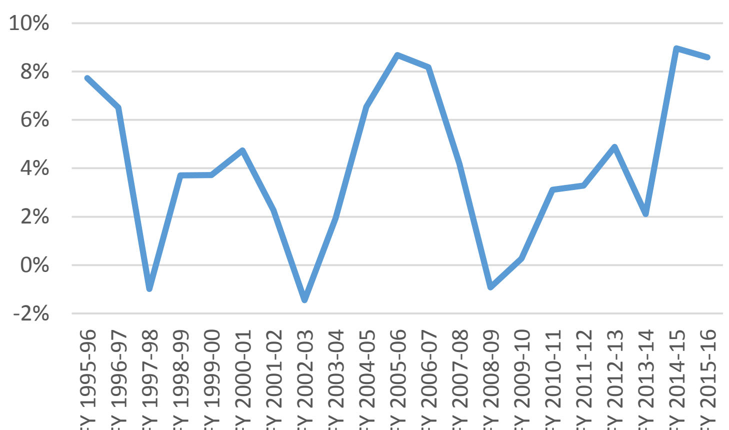


FY 2015-16 GENERAL FUND TRACKING

Consistent with a strong local economy, there is little evidence to suggest that the City is at risk of not meeting projected revenue levels. On the expense side, even though individual bureaus may run up against budget constraints, the General Fund as a whole does not appear in danger of exceeding budgeted levels. Often, the largest risk at this point in the fiscal year is business license taxes; however, based on collections to date, if anything business license taxes are poised to exceed the forecast.

Revenues. With the exception of property taxes, it is still too early in the fiscal year to narrowly estimate year-end totals for General Fund revenue sources. That said, it is apparent that we have reached revenue growth levels rarely seen before in the City. FY 2015-16 has a chance to match or exceed the revenue growth of FY 2014-15, which was the fastest growth in the last 20 years. Figure 2 summarizes revenue growth for the five largest General Fund revenue sources.

Figure 2. Annual Revenue Growth for Five Largest General Fund Sources



Most revenue sources are tracking above forecasted levels. However, the amount received so far for business license taxes, utility taxes, and transient lodging taxes represents less than one-quarter of what the City is expecting to receive over the course of the fiscal year. As a result, the figures presented in Table 1 remain subject to significant variability.

TABLE 1. FY 2015-16 Selected General Fund Revenue Source Tracking ($millions)

Resource Category	Current Budget	Estimated Year-End	Difference
Property Taxes	$220.6	$224.8	$4.2
Business License Taxes	$100.5	$108.0	$7.5
Utility License Taxes/Franchise Fees	$83.5	$85.5	$2.0
Transient Lodging Taxes	$26.5	$29.4	$2.9
State Shared Revenue	$16.2	$16.8	$0.6

Expenses. With half of the fiscal year complete, certain spending patterns are beginning to emerge related to General Fund expenses. Unlike revenues, expenses generally follow a more stable and even pattern over the course of the fiscal year, with the possible exception of external materials and services, which see a large bump in spending at the end of the year. Table 2 summarizes the current budget and estimated year-end totals based on the first six months of FY 2015-16.

TABLE 2. FY 2015-16 General Fund Expense Tracking ($millions)

Expense Category	Current Budget	Estimated Year-End	Difference
Personnel Services	$361.0	$359.5	($1.5)
External Materials and Services	$93.2	$89.0	($4.2)
Internal Materials and Services	$59.0	$57.6	($1.4)
Other[1]	$75.8	$75.8	$0.0
Total Expenses	***$589.0***	***$581.9***	***($7.1)***

[1] Includes Capital Outlay, Bond Expenses, Fund Transfers, and Contingency. Compensation Set-aside and reserved contingency of totaling $7.4 million is included in personnel services.

Consistent with historical practices, bureaus appear to be spending somewhat cautiously. Typically, when bureaus are asked to propose cuts – as was done this year – they are more judicious during the current fiscal year in case some of those cuts are taken. Conversely, when there is no immediate "threat" to the budget, bureaus tend to spend closer to their budgeted amounts.

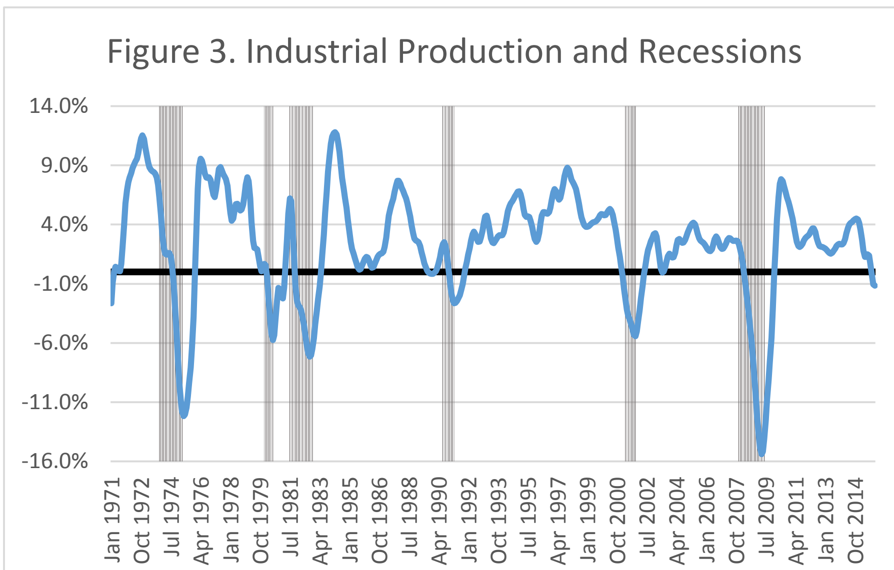
CURRENT ECONOMIC CONDITIONS

A telltale sign that the economy has reached some sort of peak expansion is the increasing number of analysts/economists projecting that a recession may be just around the corner. There are certainly some weaknesses at the national level (see Commerce section below), mostly related to lower energy prices which, while bad for some industries, provide a boost to many others. Though overall growth slowed at the end of the year, GDP growth in the middle of the year was the fastest since the recovery began nearly five years earlier.

Table 4 at the end of the document shows a handful of economic indicators, the relative strength compared to a year ago, and a description of the trend regarding the most recent data points.

Employment. The local unemployment rate for Multnomah County residents has likely reached full employment levels and job growth has been tracking at about the long-term average for the Portland metro-area. The December seasonally-adjusted unemployment rate for Multnomah County reached a post-recession low of 4.7%, matching the lowest level seen during the last economic expansion. Similarly, job growth has accelerated to levels not seen since 2006. Preliminary December data indicate that employment growth for 2015 in the Portland metro area was 3.3%. For 2015, the biggest gains were in education and health services, and professional and business services. Overall job growth was broad-based with no major sector experiencing declines locally.

Commerce. With the exception of the continued deterioration of the marine terminal activity at the Port, local economic activity has been robust. The airport continues to see increases in both passenger and freight movement, while the construction boom continues, especially in the Central City and close-in neighborhoods. What weakness does exist tends to be national or international in scope, and much of that relates to very low energy prices. One broad indicator of note is industrial production. Figure 3 shows the year-over-year growth in industrial production.[1] The shaded areas denote periods in which the national economy was in recession according to the National Bureau of Economic Research. One should note that whenever this indicator is at its current level, the economy is already in recession. The optimistic view is that this time is different because the index is being driven down almost entirely by energy prices. The pessimistic view sees this and the strong dollar as making it more difficult for U.S. companies to sell their goods internationally -- signs that the economy is in a very precarious place in spite of relatively tight labor markets.



Real Estate. Whether home sales or the rental market, all indicators show housing demand vastly outstripping supply. Furthermore, because of the lack of building during the recession, it will likely take several years of aggressive building to get to a balanced market. On the home buying side of the market, inventory continues to fall and expectations are for a very competitive sellers' market over the next six to twelve months. At the current rate of sales, there are only 1.2 months' worth of homes available for

[1] Published monthly the Federal Reserve Bank: http://www.federalreserve.gov/Releases/g17/current/default.htm

purchase. As for the rental market, supply is on its way, but it begins with the high end of the market, as that is where the largest profit margins exist for builders. It also is likely not enough in the short term to bring down lease rate pressures. In spite of all of the building, the metro area has only developed one housing unit for every three jobs created over the last five years. Within the City of Portland, these pressures are even greater.

TABLE 4. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA[1]	12/2015	1,136,500	10.3%	Positive
Multnomah County Unemployment Rate[1]	12/2015	4.7%	-0.8%	Positive
Consumer Price Index, Portland-Salem[2]	2H-2015	236.882	0.3%	Negative
Real Estate				
Median Home Price, Portland Metro[3]	12/2015	$320,000	8.5%	Positive
Housing Units Permitted (Y-T-D)[4]	11/2015	3,854	-17.4%	Positive
Portland Metro Industrial Vacancy Rate[5]	3Q-2015	8.9%	1.4%	Neutral
Portland Office Vacancy Rate[5]	3Q-2015	9.5%	-1.1%	Positive
Portland Multi-Family Vacancy Rate[5]	3Q-2015	2.5%	0.0%	Neutral
Commerce				
Total PDX Air Passengers (Y-T-D)[6]	12/2015	16,850,952	5.9%	Positive
Total PDX Freight (Y-T-D in Tons)[6]	12/2015	228,428	3.7%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons)[6]	12/2015	8,380,848	-35.0%	Negative
Hotel Average Revenue Per Available Room[7]	3Q/2015	$124.06	15.2%	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.

[6] Port of Portland, Aviation & Marine Statistics

[7] PFK Hospitality Research, LLC