City of Portland

General Fund Forecast

FY 2016-17 through FY 2020-21

City Budget Office

April 2016

I. Forecast Summary

The national economic outlook is largely positive, while the local economy continues to grow rapidly. The issues, like housing affordability, exist largely because Portland has become a victim of its own success. Job growth has been widespread and income growth is finally ramping up after years of stagnation. More importantly, the quality of life and lower cost relative to other west coast cities continues to attract the highly educated and wealthy. This has ultimately fueled unprecedented revenue growth for the City, resulting in $25.6 million in additional resources in FY 2016-17 above what is necessary to continue existing programs. The primary drivers behind this forecast include:

- Lodging tax receipts continue to exceed expectations, leading to a $2.2 million increase in the forecast. A change in the administration of utility license taxes will also increase ongoing General Fund revenue by up to $1.0 million.

- In addition to the low inflation cited in the February forecast update, the City is also expecting very small increases in health benefits costs. Relative to previous expectations, this adjustment will save the City $1.7 million in ongoing costs.

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.

Forecast Highlights

New Ongoing: $9.2 million

New One-Time: $16.4 million

Significant Changes Since February:

- Health benefits will rise by less-than-expected in FY 2016-17, saving $1.7 million ongoing

- Increased forecast for transient lodging taxes and a utility license tax law change both increase ongoing revenue

- Increased costs in out-years to comply with new state minimum wage law

Local Economic Highlights

- Home prices up 15.5%, rents also seeing double-digit increases.

- Local unemployment rate dips below 4% for first time.

- Passengers at PDX up nearly 10%.

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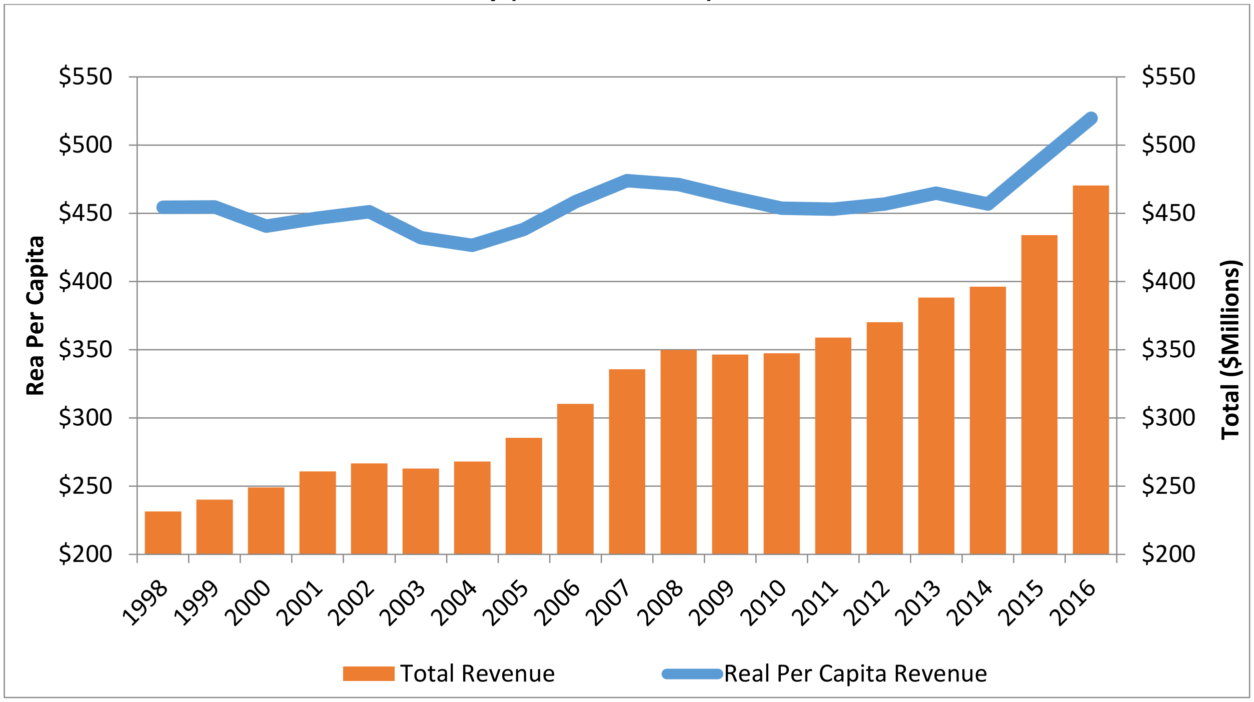
Table 1 summarizes discretionary General Fund resources and expenses through FY 2020-21. As shown in Table 1, the City will have $9.2 million in additional ongoing resources and $16.4 million in one-time resources above projected expenditures, with an additional $4.8 million in fiscal year 2017-18. Current policy states that at least 50% of these funds must be spent on major maintenance and replacement of City assets.

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

	Fiscal Year					
Budget Category	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Total Resources	**$489.7**	**$492.8**	**$489.5**	**$499.1**	**$516.5**	**$532.3**
Total Expenses	**$489.7**	**$467.2**	**$484.7**	**$499.1**	**$516.5**	**$532.3**
Available Ongoing		$9.2	$0.0	$0.0	$0.0	$0.0
Available One-Time		$16.4	$4.8	$0.0	$0.0	$0.0
Total Expenses with Adds & One-Time Spending	**$489.7**	**$492.8**	**$489.5**	**$499.1**	**$516.5**	**$532.3**
Note: Totals may not add due to rounding. FY 2015-16 figures are for the Adopted Budget.						

It is important to note that the $25.6 million surplus is actually closer to $36.8 million, as Council has already directed $11.2 million in additional funds for the declared Housing Emergency over current year budget levels. Just a year ago the forecast identified a surplus of nearly $50 million. The City is experiencing record revenues combined with very low inflation. Figure 1 highlights just how fast revenues have grown over the past two years, in particular. For a decade and a half, the City's major General Fund revenue streams stayed in a relatively narrow range after adjusting for inflation and population – real per capita revenue was at a low of $427 in FY 2003-04 and a high of $474 in FY 2006-07. In the last two years, this figure has jumped to nearly $520. The primary reasons for this are massive growth in business license and transient lodging tax collections, leaving the City budget more exposed in the event of an economic slowdown (see risks on page 4).

FIGURE 1. General Fund Revenue History (2016 estimated)



II. REVENUE/EXPENSE FORECASTS

Significant Changes. With respect to the revenue forecasts, the only significant change was to transient lodging taxes. The impact of Portland becoming a more significant presence in both business and tourism is leading to more hotel construction with at least three new hotels coming to the downtown area in the next year or so. Demand for rooms allowed room rates to jump nearly 10% in 2015, while still increasing occupancy rates by nearly 4%. The result can be seen in the City's dramatic increase in lodging taxes, which have more than doubled in the last five years. Overall, strong revenue growth is also resulting in an increase of $5 million in the assumed beginning balance for FY 2016-17.

TABLE 2. Changes to Revenue Forecasts from February ($millions)

	Fiscal Year		
Resource Category	**April Forecast**	**FY 2016-17 Change**	**Total 5-Year Change**
Property Taxes	$232.8	$0.0	$0.3
Transient Lodging	$30.6	$2.2	$11.4
Business Licenses	$108.1	($0.5)	($2.3)
Utility License/Franchise	$83.8	($0.3)	($2.0)
State Revenues	$16.3	($0.3)	$0.6
Other	$1.8	($0.4)	($1.0)
Total Revenues*	**$461.0**	**$2.8**	**$5.6**
Note: Totals may not add due to rounding. *Not including Beginning Balance			

While unusual for the April forecast, there were several significant changes to the expense forecast. Most notably health benefits costs in FY 2016-17 will be $1.7 million lower than previously expected as both the City's self-insurance rates and Kaiser's premiums will only see very small increases over the current year. The rapid revenue increases will also require the City to make a larger transfer to the General Reserve fund in order to maintain its balance of equal to 10% of General Fund discretionary and overhead revenues, as prescribed by City financial policy. Finally, the State passed a new minimum wage law that will impact the Parks bureau over the next several years. Very preliminary estimates of those costs were included in the out-years of the forecast, effectively changing what would have been ongoing resources to one-time in FY 2016-17. At this point, it seems unlikely that the impact after full implementation in FY 2022-23 will exceed $1 million.

Major Assumptions. This forecast assumes that local economic growth is currently peaking and, though a recession does not appear imminent, growth will wane some in the near-term. We are just beginning to see increases in wages, which will also likely correspond with inflation coming up from its current near-zero level.

IV. Current Economic Conditions

As we approach the beginning of year 8 of the current economic expansion, the local economy is reaching exceptional heights. So much so, that murmurs of a speculative bubble are getting louder, particularly as it relates to the local housing market. Institutional investors and wealthy migrants are crowding out first-time homebuyers and pushing rental rates higher. In order to support the rapidly growing prices in the housing market in the long term, the area will have to start to see more significant income gains.

Table 4 at the end of the document 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.

Employment. Employment growth has remained over 3% for most of the last year. The metro area has added 170,000 jobs since the depth of the recession. Meanwhile, the unemployment rate in Multnomah County has fallen to 3.9%, the lowest level on record.

Major Forecast Risks

Revenue Exposure – The City's General Fund now receives more of its revenue from business license and transient lodging taxes than ever before (over 30%). These revenue streams are highly sensitive to economic conditions and in economic slowdowns are responsible to for driving most of the budget cuts necessary to balance. Even a small slowdown would likely require cuts of $10-$20 million.

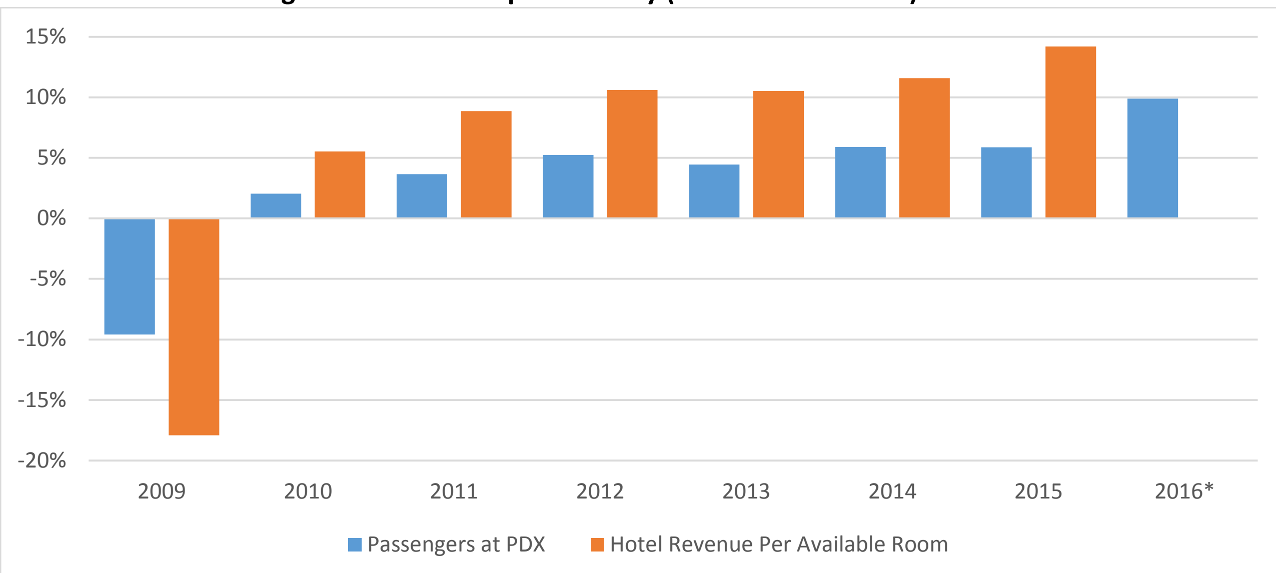
Personnel Costs/Labor Contracts – The City spends about three-fourths of its General Fund discretionary budget on personnel. Furthermore, its largest labor contracts with the Portland Police Association and Portland Fire Fighters Association will be up for renegotiation in the next two years. If these negotiations add costs – particularly if they do so without adding services – this represents a significant forecast risk.

Future Decisions/Obligations – The City has not yet committed ongoing funds related to Parks casual employees or 13 previously grant-funded firefighter positions. In addition, the City has added numerous costs without increasing services, with these two pending decisions potentially adding to that count. As a result, the next recession will likely see larger cuts to services than would have otherwise occurred.

Though the recent news from Intel laying off 12,000 worldwide was certainly unwelcome, it is important to note two things. First, according to reports, less than 800 of those layoffs will be among the 19,500 employees currently in Oregon. Second, and most important for context, the layoffs were not a result of underlying economic conditions, but rather a management decision on the direction of the company.

Commerce. With the exception of the seeming never-ending decline in marine terminal activity following years of labor disputes, local business and tourism activity is booming. Figure 2 shows the annual growth in both hotel revenue and airline passengers through the airport. In both cases, the most recent data show the largest jumps in growth since the expansion began.

FIGURE 2. Annual Change in Hotel and Airport Activity (*2016 Year-to-date)



Source: Port of Portland, CBRE Hotels

Real Estate. Housing affordability is not just about housing prices, but also about incomes. A new analysis done by the Oregon Office of Economic Analysis looks at housing costs relative to income for the metro area illustrates some of the local housing issues.[1] Of the 100 largest metropolitan areas, 31 have similar income profiles, and of those, 28 have lower home prices. On the rental side, Portland has the 26th highest share of renters spending more than 30% of their income on rent, the 26th highest. It should be noted that these figures are for the metro area. Within the City these rates are likely much higher, particularly for renters.

[1] The full presentation can be seen here.

TABLE 4. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA[1]	3/2016	1,132,100	3.2%	Positive
Multnomah County Unemployment Rate[1]	3/2016	3.9%	-0.9%	Positive
Consumer Price Index, Portland-Salem[2]	2H-2015	234.948	0.3%	Neutral
Real Estate				
Median Home Price, Portland Metro[3]	3/2016	$335,000	15.5%	Positive
Housing Units Permitted (Y-T-D)[4]	12/2015	4,411	-12.1%	Neutral
Portland Metro Industrial Vacancy Rate[5]	4Q-2015	4.7%	-0.4%	Positive
Portland Office Vacancy Rate[5]	4Q-2015	8.8%	-0.7%	Positive
Portland Multi-Family Vacancy Rate[5]	4Q-2015	3.2%	0.6%	Positive
Commerce				
Total PDX Air Passengers (Y-T-D)[6]	3/2016	3,819,394	9.9%	Positive
Total PDX Freight (Y-T-D in Tons)[6]	3/2016	54,622	1.8%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons)[6]	3/2016	2,435,496	-8.4%	Negative
Hotel Average Revenue Per Available Room[7]	4Q/2015	$83.27	11.0%	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] Market Action, Publication of RMLS

[4] U.S. Census Bureau

[5] Colliers International, Year Ago Change is percentage point increase/decrease.

[6] Port of Portland, Aviation & Marine Statistics

[7] CBRE Hotels