City of Portland

General Fund Forecast

FY 2018-19 through FY 2022-23

City Budget Office

April 2018

I. Forecast Summary

Though growth has slowed, the City's General Fund revenue sources continue to hit record highs, resulting in $22.7 million in additional resources in FY 2018-19 above what is necessary to continue ongoing City programs. Expense pressures from escalating PERS costs, newly negotiated labor contracts, as well as increased demand for City services means that the additional resources will only be available in the near term. In the long-run, the City will need all available revenue to fund the ongoing personnel and program costs that exist today.

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.

Table 1 summarizes discretionary General Fund resources and expenses through FY 2022-23. As shown in Table 1, the City will need to make $0.4 million in ongoing program reductions, but will have $23.1 million in one-time resources above projected expenditures, with an additional $11.7 million in fiscal year 2019-20. City financial policy states that at least 50% of these funds be spent on major maintenance and replacement of City assets.

Forecast Highlights

Ongoing Cut: -$0.4 million

New One-Time: $23.1 million

Significant Changes Since February:

- Minor changes to revenue and expense forecasts
- Increased forecast for utility and state-shared marijuana taxes
- Higher inflation-related forecasts

Local Economic Highlights

- Home prices and rent growth abating, some turning negative
- Local unemployment rate remains near record low
- Traffic through PDX picking up again after short slowdown
- Boom in local hotel construction

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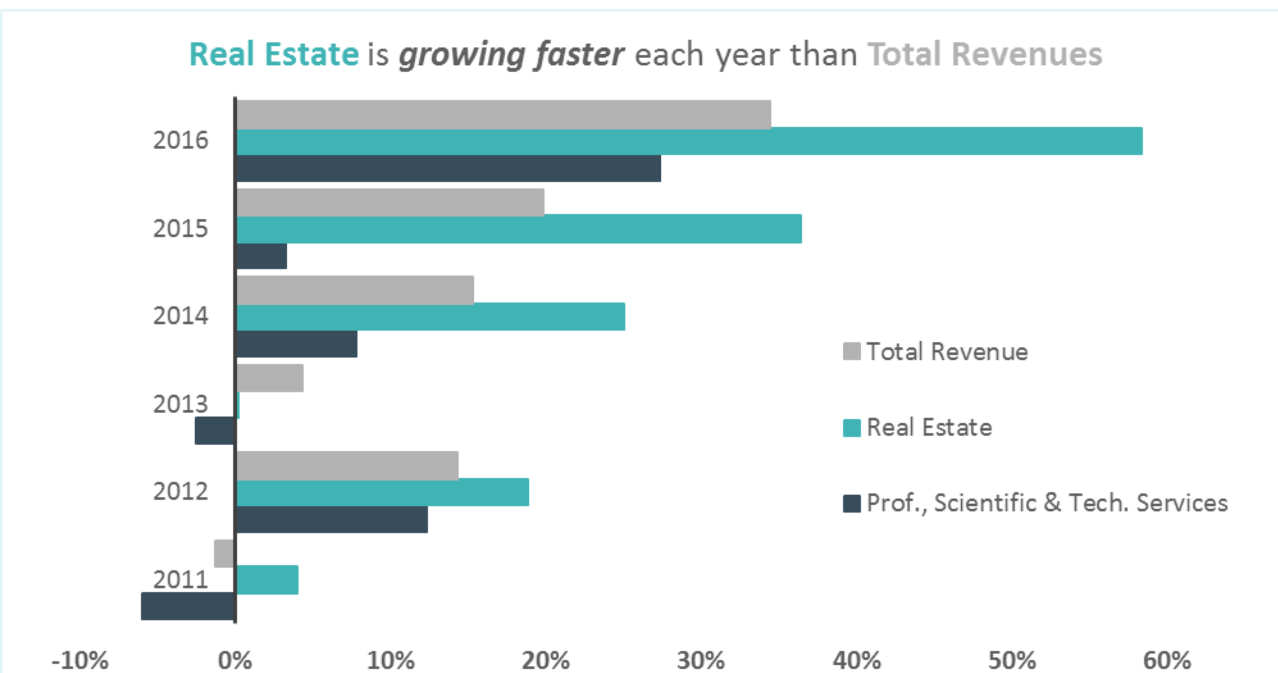
TABLE 1. Discretionary General Fund Five-Year Forecast ($millions)

	Fiscal Year					
Budget Category	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**
Total Resources	**$521.6**	**$536.0**	**$545.5**	**$553.8**	**$569.6**	**$588.5**
Total Expenses	**$521.6**	**$513.3**	**$534.4**	**$551.1**	**$569.6**	**$588.5**
Available Ongoing		$-0.4	$0.0	$0.0	$0.0	$0.0
Available One-Time		$23.1	$11.1	$2.7	$0.0	$0.0
Total Expenses with Adds & One-Time Spending	**$521.6**	**$536.0**	**$545.5**	**$553.8**	**$569.6**	**$588.5**
Note: Totals may not add due to rounding. FY 2017-18 figures are for the Adopted Budget.						

There are three components of the forecast that bear close monitoring over the next six to twelve months:

- Business License Taxes – Though it is always critical to monitor this revenue stream, it is particularly the case as the possibility of a slowdown increases. It is important to note that the City could see reduced taxes even if the economy as a whole does not fall into recession. A significant portion of the dramatic increase the City has seen in these taxes is related to large real estate and business transactions. Market conditions, such as lending standards and interest rates can put a damper on these transactions, even as the economy continues to grow. Figure 1 below illustrates the rapid growth in taxes received from the real estate industry relative to typical business taxpayers.

FIGURE 1. Business License Taxes from Real Estate Expanding Rapidly (Y-o-Y Growth by Tax Year)



- Transient Lodging Taxes – The City has seen a significant increase in the supply of hotel rooms and the construction pipeline suggests that will continue over the next few years. Though the overarching signal is positive (i.e., hotel companies believe that Portland will be an attractive place to visit over the long run), in the short run supply may outstrip demand, resulting in lower room rates. In fact, the City has already seen lower revenue per available room in the last quarter (see table on page 5). An economic downturn could result in a dramatic reduction of transient lodging taxes to the City as a greater number of hotel rooms fight over fewer customers.

- Marijuana Taxes – The recreational marijuana market remains a relatively immature market. However, given the low marginal costs of harvesting the crops, massive amounts of supply have entered the market, pushing down retail prices – and, thus, the taxes associated. So far, this has been more than offset by increased demand, in particular for value added goods, such as oils and edibles. As more states, like California, legalize recreational marijuana, the forecast for marijuana taxes will remain uncertain. Thus far though, Oregon's consumption looks like the two states that legalized before it. Figure 2, provided by the Oregon Office of Economic Analysis, shows sales for each state from the beginning of legalization.

FIGURE 2. Marijuana Sales Since Legalization

II. FORECASTS CHANGES/ASSUMPTIONS

Significant Changes. Nearly all changes to the forecast were minor. With respect to the revenue and expense forecasts, the largest change for FY 2018-19 was less than $1 million to the revenue base. A small increase in the out-years of the utility license tax/franchise fee forecast also added slightly to the available ongoing resources. Meanwhile, the only major change to the expense forecast was an increase in the expectations for inflation, offsetting some of the revenue forecast increases.

Major Assumptions. This forecast assumes that local economic growth will continue to slow, but remain positive. This has already been seen in employment growth figures as the very tight labor market is making it difficult for employers to find workers. Additionally, housing markets conditions are beginning to ease. Fiscal policy around tax cuts – as well as rising, but still low interest rates – will increase inflation pressures. Though a recession does not appear imminent, there are many modest signs of slowing growth. Additionally, uncertainty around state and federal policy could limit investment, as banks have been increasing lending standards over the last 18 months.

III. Current Economic Conditions

As of May, the current economic expansion will be the second longest expansion in U.S. history. The local economy continues to see healthy jobs growth, albeit slower than the expansion's peak, and record low unemployment. Table 2 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 slowed over the last two years from over 3% to around 2% growth. This is typical at this point in the business cycle, as the tight labor market makes it difficult to find workers and higher wages begin to bring people back into the labor force. Adjusted for age, labor force participation (the percentage of working age adults either employed or looking for a job) is back to where it was prior to the Great Recession.

Real Estate. Portland's most recent rapid growth in home prices and rental rates appears to mostly be over, especially as it relates to certain sectors of the rental markets – in particular, small and luxury apartments. One should expect that the home price market will continue to grow, but more modestly, as the combination of low inventory and rising mortgage rates offset each other. For smaller rental units (i.e., studios and 1-bedroom units), rental rates have already started to come down. Given that similar products are the overwhelming majority of what is in the construction pipeline, this downward pressure on rents should continue.[1]

Major Forecast Risks

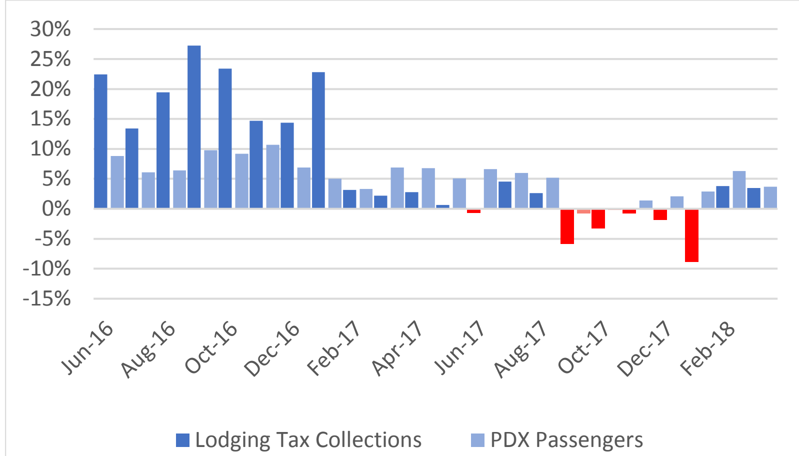
Inflation – The City has been fortunate that the record rise in revenues has occurred while inflation has remained relatively low. The opposite conditions may be on the horizon. About three-fourths of General Fund discretionary spending is personnel. As inflation increases, coupled with expected increases in PERS expenses, the City could see rapidly rising costs coupled with mediocre or worse revenue growth.

Interest Rates – As interest rates rise there are a variety of ways that this can impact the City budget. While, first and foremost, it makes borrowing for capital projects more expensive, it also makes some of the economic activity (e.g., real estate development) that has driven the revenue boom less feasible.

Business License and Transient Lodging taxes – As the City continues to become more dependent on these economically-sensitive revenue sources, it is more exposed in the event of an economic downturn to dramatic revenue decreases.

[1] https://www2.colliers.com/-/media/Files/UnitedStates/Markets/Portland/Research/2018Q1MultifamilyPortlandReportColliers.ashx

FIGURE 3. Lodging Taxes and PDX Passenger Traffic



Commerce. As the City headed into the winter months, a lack of growth in traffic through the airport was coupled with a stall in lodging tax receipts. Though less growth than seen in 2016, that slowdown appears to be little more than a hiccup at this point. Figure 3 shows the annual growth in lodging tax receipts and passenger traffic through the airport.

Inflation. The City, along with many governments, has benefitted recently from a long-run trend of lower inflation (as measured by the federal Bureau of Labor Statistics). From 1984 to 2000, the Consumer Price Index for Urban Clerical Workers for the Portland-Salem OR-WA area – this is the basis for the City's cost-of-living allowances (COLA) grew by an average of 3.4%, while over the last 16 years that average has decreased to 2.1%. For 2017, this rate was 3.6%, the highest in over a decade. Between pressure on wages, relatively low interest rates, and federal fiscal stimulus in the form of tax cuts, a few years of above average inflation appears likely.

TABLE 2. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA[1]	3/2018	1,190,400	2.0%	Positive
Multnomah County Unemployment Rate[1]	3/2018	3.7%	0.1%	Positive
Consumer Price Index, Portland-Salem[2]	2H-2017	250.7	3.6%	Neutral
Real Estate				
Median Home Price, Portland Metro[3]	3/2018	$395,000	6.8%	Positive
Portland Metro Industrial Vacancy Rate[4]	1Q-2018	4.5%	1.0%	Neutral
Portland Office Vacancy Rate[4]	1Q-2018	10.0%	0.4%	Positive
Portland Multi-Family Vacancy Rate[4]	1Q-2018	7.3%	1.3%	Positive
Commerce				
Total PDX Air Passengers (Y-T-D)[5]	3/2018	4,187,056	4.2%	Positive
Total PDX Freight (Y-T-D in Tons)[5]	3/2018	60,201	9.0%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons)[5]	12/2017	11,489,042	12.4%	Positive
Hotel Average Revenue Per Available Room[6]	4Q/2017	$84.07	-1.2%	Neutral

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

[5] Port of Portland, Aviation & Marine Statistics

[6] CBRE Hotels