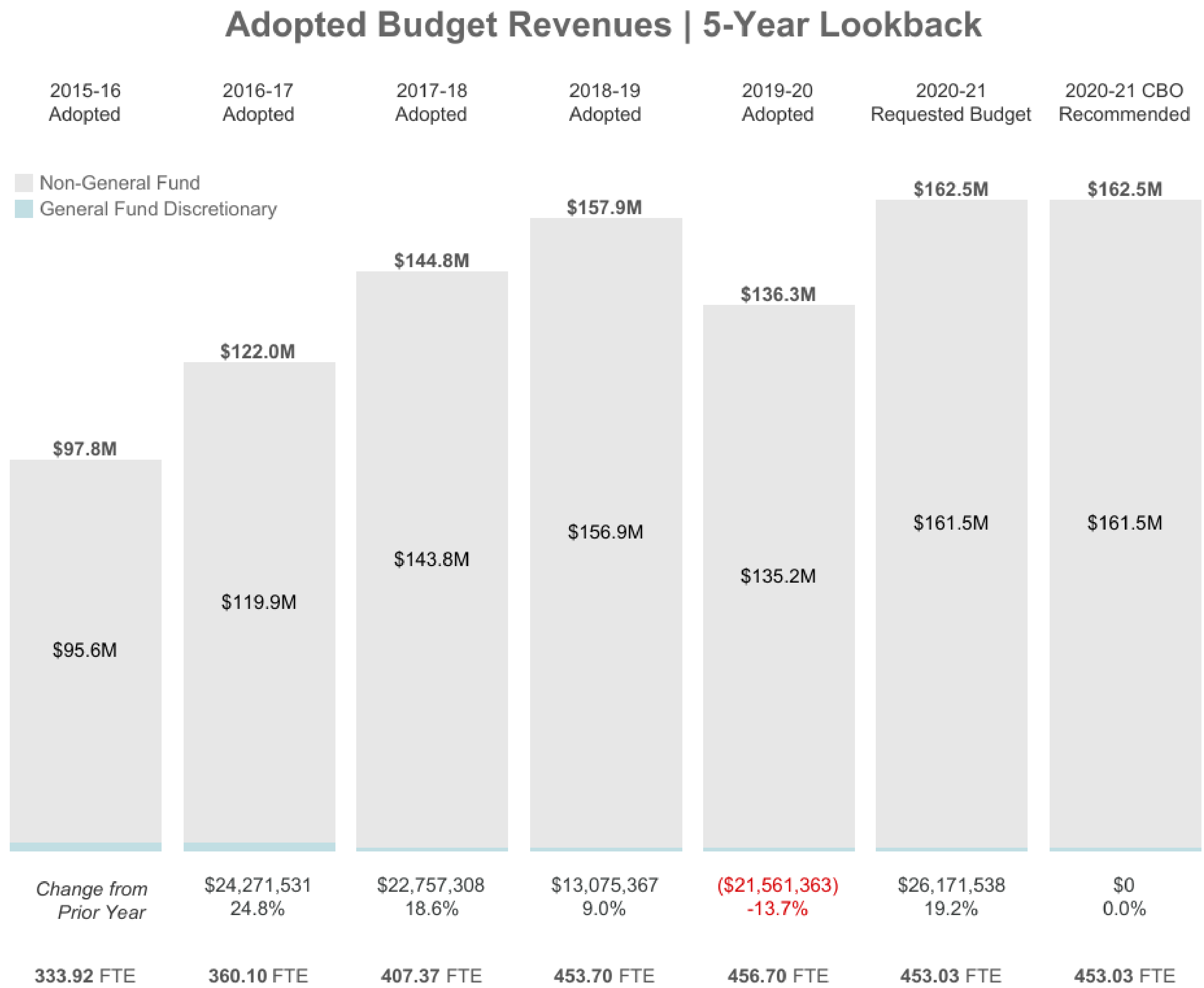
City Budget Office

# Bureau of Development Services

*Analysis by Yung Ouyang*




## INTRODUCTION

The downturn in development that began in FY 2017-18 continued through FY 2018-19. Revenues collected by the Bureau of Development Services (BDS) have stabilized in FY 2019-20, and workload remains elevated. While the bureau expects FY 2020-21 to be a year of moderate revenue growth, it nevertheless expects to continue to draw on reserves to pay for operations. The current five-year forecast indicates that the bureau will have to draw down on reserves each year over the five-year period, although cost recovery is expected to be above 90% each year for the bureau as a whole. The bureau's hiring freeze remains in place, but with an exception process in place for specific circumstances where there is proven workload need.

BDS is not requesting to add new positions in the FY 2020-21 Requested Budget and has no decision packages to review. However, the internal costs associated with facility space rental will increase by $3.2 million due to the City's implementation of a blended rate model, and the bureau states that as one of the reasons for having to increase fees. Most programs are increasing their fees by 5%, and three programs are raising fees by much greater levels. Only one program, Zoning Enforcement, does not plan to increase fees in FY 2020-21. This review summarizes key issues related to the bureaus' five-year financial plan, reserve balances, fee increases, and performance metrics; and discusses notable operating shortfalls in the Neighborhood Inspections program.

# BASE BUDGET KEY ISSUES

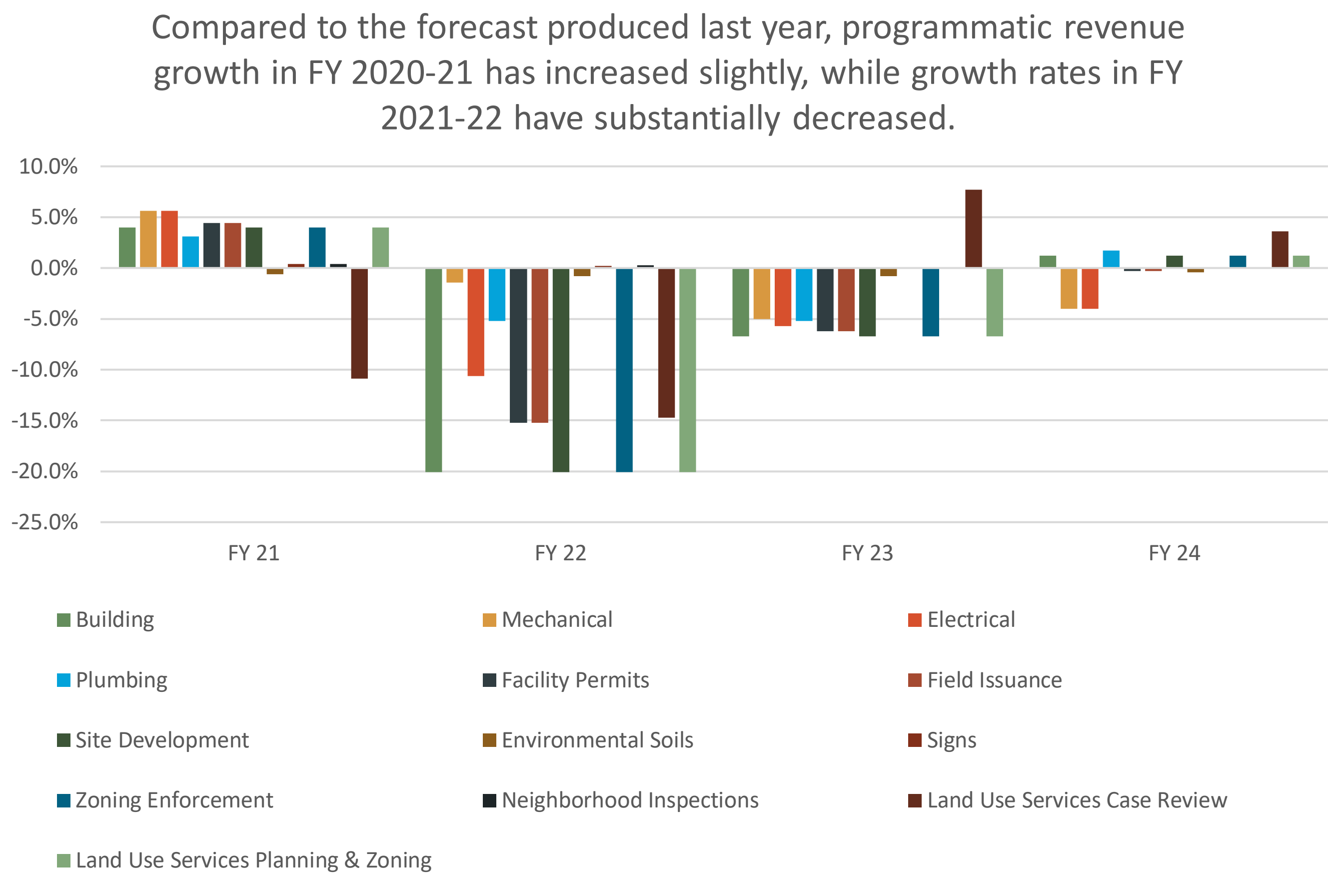
## Development Downturn and the Five-Year Financial Plan

After several years of record high levels of construction in Portland, BDS began noting declines in land use review applications and revenues in early FY 2017-18, and the bureau responded by significantly drawing on the Land Use Services (LUS) program's reserves. Internal actions to mitigate costs include the bureau instituting a hiring freeze in LUS. In the following months, permit applications and revenues in other programs began to gradually decline, and the hiring freeze was expanded to the rest of the bureau by November 2018. Hiring at BDS is currently paused with an exception process in place for specific circumstances where there is a workload need. The bureau also instituted other cost cutting measures such as reducing spending on overtime and the elimination of training and out-of-town travel expenses.

Much of the financial declines are the result of fewer large commercial projects, which generate a significant portion of BDS revenues. Programmatic revenues in Licenses & Permits and Charges for Services decreased by 10.3% from FY 2017-18 to FY 2018-19. Thus, revenues fell more precipitously than the workload that responds to customers' or community members' requests for service. As was the case in FY 2008-09, and is the case currently, the number of larger commercial projects declined substantially and set forth a multi-year financial challenge within BDS. At present BDS is experiencing a decline in multifamily permit applications when compared to the previous years. Large multifamily developments have constituted most of the large project activity at the bureau during the economic recovery, but this market has recently slowed. Due to valuation being the basis for major fee calculation methodology, the loss of those large, high value projects dramatically impacted the bureau's fee revenue. However, while revenues declined, workload did not decline substantially as a greater number of lesser value permits continued to be processed.

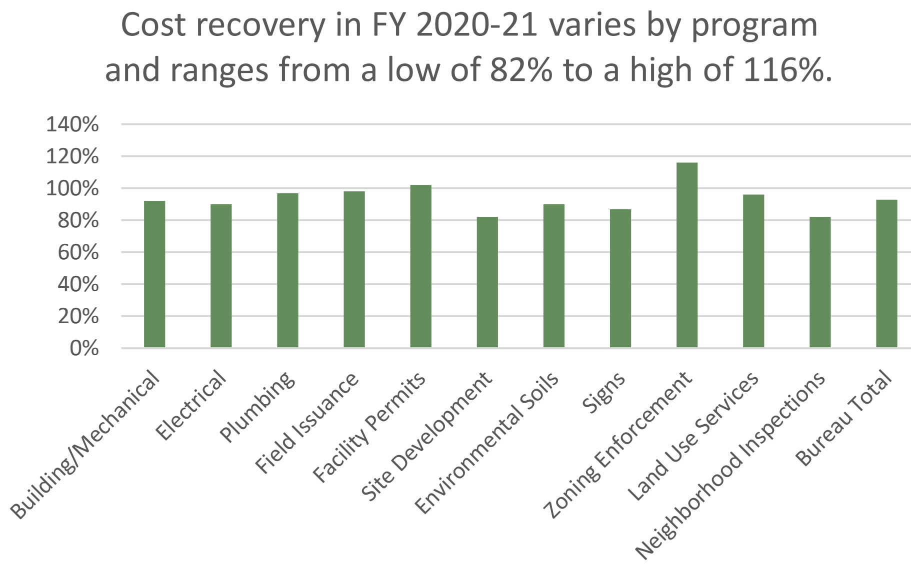
Economic projections have the US economy continuing to grow during 2020, but at a more subdued pace. In the coming five years, BDS expects a handful of extremely large projects to generate a substantial amount of fee revenue. However, there are still risks to the economy that introduce considerable uncertainty to projections. It is possible that BDS will experience revenue volatility amid an aggregate economic expansion. Large project activity contributes to this volatility, as the timing and size of such projects are difficult to predict. In addition, the construction industry does not necessarily expand and contract in conjunction with the aggregate economy.

Except for Land Use Services Case Review, BDS forecasts modest growth rates in revenues for its programs in FY 2020-21. This contrasts with its forecast for FY 2020-21 that was submitted in its FY 2019-20 Requested Budget, which showed minor decreases in most programs. On the other hand, the new forecast for FY 2021-22 shows substantial reductions in growth rates compared to the one submitted last year. It should be noted that these projections for programmatic revenue growth rates are prior to fee changes.




The current five-year plan assumes minimal increases for revenues in most programs in FY 2020-21, with the exception of Land Use Services Case Reviews, whose revenues are projected to decline by 1.9%. As these land use reviews usually lead the development cycle, BDS projects sharper revenue declines starting in FY 2021-22, the second year of the plan. This is in stark contrast to what was projected for the same year in the bureau's previous iteration of its five-year forecast submitted for the FY 2019-20 budget development process, which showed strong growth rates in most programs' revenues in FY 2021-22.

BDS notes that its forecasted fee revenues reflect the increase permit charges for most of its programs in FY 2020-21 (as opposed to the forecasted growth rates, which do not include fee changes). For the programs with fee changes, these increases are 5%, with the exception of the Signs program and the relatively new Field Issuance Remodel program[1], whose rates are projected to be raised by 15%, and the Environmental Soils program, whose rates are projected to be raised by 10%. Fees are not raised for a program that has healthy reserves - Zoning Enforcement. Except for the Facilities Permits and the Zoning Enforcement programs, despite the increase in fees, no other program is expected to achieve cost recovery in FY 2020-21, and as such, will draw on reserves. Cost recovery next year for these programs that are projected to operate at a deficit range from a low of 82% (Site Development and Neighborhood Inspections) to 98% (Field Issuance).




While the bureau's reserves are intended to maintain staffing levels through a downturn (see section on Program Reserves Review below), BDS nevertheless projects to fill only half of the bureau's current vacancies during the five-year forecast period in order to maintain fiscal stability, thus leaving 40.5 FTE vacancies remaining at the end of the five year period.

## Additional Costs that Affect Fee Increases - City's New Blended Rental Rate

Many bureaus across the City are facing increased cost pressures from the implementation of the blended rate with OMF-Facilities Services, wage increases implemented by OMF-Human Resources for pay equity, and increased exposure for non-represented merit increases over the last year for staff that were formerly at the top-of-range before the class/compensation bands were widened. High level estimates suggest potential impact to BDS as follows:

- $3.2 million increase in IAs with OMF (rent, etc.) for the blended rate program;
- About $300,000 in pay equity increases;
- About $100,000 in increased cost exposure for merit pay for non-represented employees that are no longer at top of range due to implementation of the new classification and compensation structure.

BDS has been able absorb the personnel cost increases, including pay equity and merit cost increases within the current fee structures; however, as noted above, most programs are currently operating below cost recovery in FY 2019-20.

The bureau's budget for internal materials & services (IMS) is increasing by $5.8 million from the FY 2019-20 Revised Budget, or 53%. The increase to BDS's IA with OMF-Facilities in FY 2020-21 is approximately

[1] BDS enforces the City's sign requirements, including electrical signs, A-board, and non-illuminated signs with a licensing program. The Field Issuance Remodel program is designed to serve specific types of residential remodel projects, and enrolled contractors pay an hourly rate for plan review and inspection services.

$4.6 million, which includes the $3.2 million in increased rental expenditures due to blended rates, plus a shift in the way the Jacobs Center lease and sublease are budgeted from external materials & services to internal materials & services, $175,000 for increased security services, and an additional $200,000 in maintenance. The other notable portion of the increase in the bureau's budget for IMS is an increase in Bureau of Technology Services (BTS) expenditures allocated to BDS due to the AMANDA Sustainment Plan[2] and increases to BTS service charges. The overall increase in budgeted BTS interagency expense is over $1 million.

With regards to the blended rate set to be implemented in FY 2020-21, the City will be changing the way in which it allocates facilities rental rates to bureaus in the downtown area. The goal of establishing an equalized, or blended, rate was to provide greater cost certainty to bureaus, especially in light of the high costs associated with the renovation of the Portland Building. Currently BDS is directly allocated rent for the 1900 Building and leases space in the Jacobs Center. Starting in FY 2020-21, rates will be pooled and blended across multiple downtown buildings, including the leased spaces in the Jacobs Center, resulting in additional expense of $3.2 million with no associated increase in service levels for BDS.

Concerning personnel costs, the hiring freeze at BDS is ongoing and there is currently no scheduled end date; however, the bureau has had an exception process in place in order to allow the bureau to fill positions where demand for services justifies hiring additional personnel. BDS will fill positions as necessary to meet demand for service. The number of positions held vacant will depend on future demand for services, employee turnover and retirements, as well as the availability of qualified candidates in the recruitment and hiring process. The bureau's Five-Year Financial Plan assumes that half of all bureau vacancies will be filled over the forecast period. BDS states that vacant positions are budgeted in order to provide for a quick response associated with increased demand for services by filling positions to meet workload. The bureau currently has 79 out of 453 FTEs that are vacant.

Both rising personnel costs and increases in OMF IA expenditures are included in the BDS Requested Budget and 5-Year Financial Plan. As fees make up over 98% of bureau revenues, BDS states that it must set fees and charges for service at levels which cover the costs of providing those services, and so the primary impact of rising costs is increases to fees. BDS raised fees to most programs in FY 2019-20 and is proposing an additional 5% increases to most programs' fees in FY 2020-21. The bureau states that it strives to keep fee increases as low and gradual as possible in order to minimize the impact to customers and the development industry. The $3.2 million annual impact of the blended rates is about 4% of the bureau's projected expenditures in FY 2020-21; without this impact, BDS has indicated that it would not need to propose fee increases in most programs in FY 2020-21.

## Program Reserves Review

Since the Great Recession, BDS has gradually raised its reserve goals so that most programs now have reserves goals equal to 50% of annual costs or funding for six months of operations. Beginning in FY 2020-21, two more programs (Signs and Environmental Soils) will have their reserve goals increased up to 75% of annual costs or funding for nine months of operations. This will bring the number of programs with 75% of annual costs as their reserve goals to four out of eleven, with the other seven programs continuing to have 50% as their goal. BDS states that due to the relatively small size of these two programs, fluctuations in demand and the costs of providing services can have a large impact on reserve levels. Hence, the programs will have greater financial stability and will be better able to endure a downturn if they maintain a higher level of reserves.

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[2] AMANDA is the replacement for TRACS, the City's permitting software, and is a component of the Portland Online Permitting System (POPS).

The bureau states that the goal of the reserve is to allow the bureau time to recognize and respond to unanticipated declines in revenues and to maintain the staffing needed to carry out its obligation to provide services on permits for which BDS has already been paid but the bureau has not yet completed. However, BDS emphasizes that the reserves are not intended to maintain existing budget levels despite reduced construction activity. Moreover, the reserves should not insulate the programs from making budget adjustments in response to lower revenues and lower workloads over the long-term. BDS has researched other funds and concluded that the six-month reserve level is consistent with several of the State of Oregon's funds. While research conducted on comparable cities during FY 2004-05 yielded inconsistent results, CBO recommends that BDS again study the reserve goals of these jurisdictions' development services programs once the current downturn subsides.

The table below lists, by program, the FY 2020-21 year-end reserves, inclusive of fee increases, compared to goals for them (either 50% or 75% of total annual costs):

| **Program** | **FY 2020-21 year-end reserves as estimated % of total annual costs** | **Goal attained in FY 2020-21?** | **Goal attained by end of 5-Year Forecast?** |
|---|---|---|---|
| Building/Mechanical | 108% | Yes | Yes |
| Electrical | 97% | Yes | Yes |
| Plumbing | 134% | Yes | Yes |
| Field Issuance | -40% | No | No |
| Facility Permits | 135% | Yes | Yes |
| Site Development | 111% | Yes | Yes |
| Environmental Soils | -22% | No | No |
| Signs | -47% | No | No |
| Zoning Enforcement | 252% | Yes | Yes |
| Land Use Services | 39% | No | No |
| Neighborhood Inspections | 9% | No | No |
| **Bureau Total** | **90%** | Yes | Yes |

The table shows a mixed picture for BDS's program reserves. Out of the bureau's 11 programs, seven are expected to meet their reserve goals by the end of next year. Four programs – Environmental Soils, Signs, Land Use Services, and Neighborhood Inspections - will continue to face challenges meeting their reserve goals as in prior years, while the Field Issuance Remodel program is relatively new. When compared to the five-year forecast completed in FY 2018-19, the situation is more positive, reflecting the bureau's forecasted revenue increases. The forecast completed for the FY 2019-20 budget development process indicated that seven programs would not reach their reserve goals by the end of the five-year period. In contrast, the current five-year forecast shows that five of the 11 programs will be below their reserve goals by the end of the forecast period.

It should be noted that while some programs may have negative reserves, the bureau has just one fund that all program expenditures are paid out of. Therefore, individual programs may operate with reserve deficits for a period of time while BDS takes measures to address both program revenues and expenditures to achieve fiscal stability. Bureau-wide, reserves stood at about $86 million at the beginning of FY 2019-20. Although reserves for FY 2020-21 for the bureau are expected to be above the bureau goal, an overall drawdown on the cumulative reserves is projected through the Five-Year Forecast period and has already begun in FY 2018-19. Throughout this the five-year period, reserves for the bureau are projected to remain above the bureau's 50% minimum target each year. As a result of this forecast, the bureau plans to only fill half of the bureau's current vacancies over the five-year period, leaving 40.5 FTEs vacant at the end of the forecast period.

Overall, CBO notes that the current drawdown on reserves is consistent with BDS's plan for a downturn in development. The reserve levels *should* be below their established goals when the bureau is making reserve draws due of decreased development activity, as that is the purpose of the reserve. BDS has prudently built up the reserves for most of its programs since the Great Recession and is appropriately drawing down on them during the current downturn.

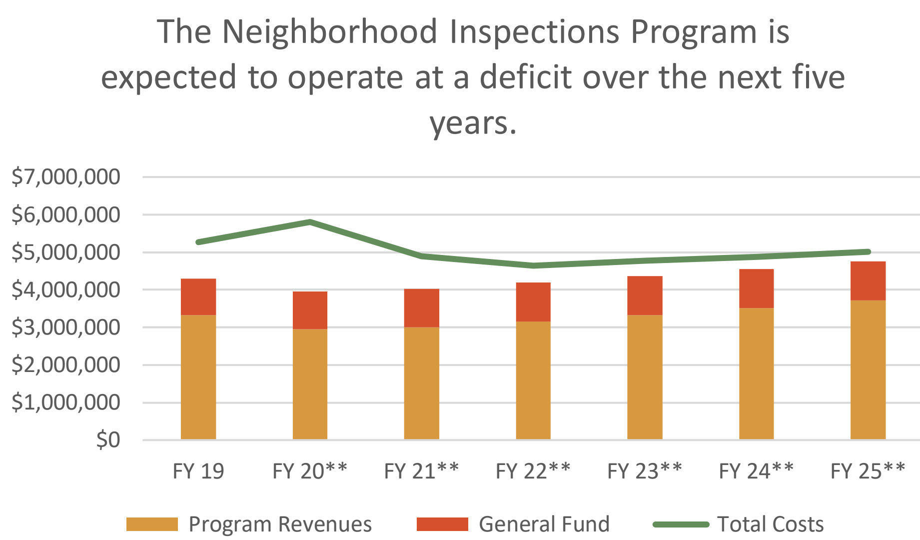
## Neighborhood Inspections Funding Adequacy

With the elimination of an ongoing General Fund allocation of almost $1.1 million for the Land Use Services program during the FY 2017-18 budget development process, the Neighborhood Inspections program remains the bureau's only program receiving any General Fund resources. However, even with this subsidization of about $1.0 million in General Fund resources each year, cost recovery in FY 2020-21 is expected to be at only 82%. Indeed, even with the higher cost recovery percentages in the outyears of the forecast, BDS projects the program's reserves to become negative by the end of FY 2021-22 and continuing to decrease to a low of -$1.0 million by the end of the five-year period.

Neighborhood Inspections is supported from fees, charges for services, lien revenue, and General Fund resources. In FY 2009-10, the bureau established a proactive lien collection program that resulted in ongoing additional cash inflow to the program, enabling it to achieve full cost recovery that year after many years of operating at a deficit. In addition, the program has had to rely increasingly on fines, penalties, and liens. BDS notes that these revenues are unstable and are dependent upon the economy, complaints, and collection efforts. Most program activities also do not result in fines and penalties being assessed. And the bureau emphasizes that the program strives to bring violators into compliance with City codes during the early stages of complaints and investigations, with 80%-90% of violation cases gaining compliance prior to the assessment of penalty charges.

BDS believes that ongoing General Fund resources is an appropriate source of funding for Neighborhood Inspections because of the direct public benefit from this program. However, the bureau states that even with ongoing General Fund support, the program may not always be able to maintain cost recovery, and reserves are projected to drop significantly below the program's goal for them. As noted above, the program is projected to draw down on reserves for the entire Five-Year Forecast period, dropping below its 50% goal in FY 2019-20 and ending FY 2024-25 with a reserve balance of negative $1.0 million. Fee increases of 5% are assumed in FY 2020-21 and the following four years of the forecast period. The 50% reserve goal for Neighborhood Inspections is intended to ensure the program's financial stability, but without further increasing fees or additional ongoing General Fund support, the program may not be able to reach cost recovery and achieve stability.

Thus, CBO advises the bureau to closely monitor the financial adequacy of the program's revenues and reserves for at least the next five years, and as needed, highlight the expected service trade-offs to Council and develop additional mitigation strategies for Council's input. As noted earlier, the program can operate with a reserve deficit for a time while BDS takes measures to address both revenues and expenditures to achieve fiscal stability because the bureau has only one fund that all of its programs' expenditures are paid out of.




**Projections

## Performance Measure Review

Measures of workload related to development or construction activity show mostly minor increases, consistent with a stabilization of construction/development. Efficiency measures are also generally expected to stay the same. As a result of improvements in FY 2019-20, BDS's targets for three measures - percentage of residential plans reviewed by all bureaus within scheduled end dates, percentage of commercial permit (new construction) first review done within 20 days of application intake, and percentage of Type II Land Use Reviews application completeness review done within 14 days of application intake – have been substantially raised from the FY 2019-20 target levels. However, two efficiency measures – percentage of pre-issuance checks completed within two working days of last review approval and percentage of building permits issued over the counter the same day as intake – have their targets declining from their FY 2019-20 targets, also in response to actual performance in the current year.

## SUMMARY OF REQUESTS AND RECOMMENDATIONS

Below is a summary of the Bureau of Development Services' total budget which is entirely contained in the Development Services Fund.

### Bureau of Development Services - All Funds

| | | 2019-20 Adopted Budget | 2020-21 Requested Base (A) | Bureau Decision Packages (B) | CBO Recommended Adjustments (C) | Total Recommended Budget (A+B+C) |
|---|---|---|---|---|---|---|
| Expense | Personnel | $57,426,597 | $59,854,191 | $0 | $0 | $59,854,191 |
| | External Materials and Services | $9,014,476 | $7,550,587 | $0 | $0 | $7,550,587 |
| | Internal Materials and Services | $10,887,912 | $16,780,453 | $0 | $0 | $16,780,453 |
| | Debt Service | $1,443,126 | $1,500,820 | $0 | $0 | $1,500,820 |
| | Fund Transfers - Expense | $2,536,838 | $2,851,340 | $0 | $0 | $2,851,340 |
| | Contingency | $55,006,712 | $73,949,808 | $0 | $0 | $73,949,808 |
| | Total | **$136,315,661** | **$162,487,199** | **$0** | **$0** | **$162,487,199** |
| Revenue | Beginning Fund Balance | $80,615,435 | $84,323,897 | $0 | $0 | $84,323,897 |
| | Charges for Services | $13,326,191 | $20,836,016 | $0 | $0 | $20,836,016 |
| | Fund Transfers - Revenue | $1,075,775 | $1,033,601 | $0 | $0 | $1,033,601 |
| | Interagency Revenue | $1,233,328 | $1,868,353 | $0 | $0 | $1,868,353 |
| | Licenses & Permits | $35,848,891 | $49,624,596 | $0 | $0 | $49,624,596 |
| | Miscellaneous | $4,216,041 | $4,800,736 | $0 | $0 | $4,800,736 |
| | Total | **$136,315,661** | **$162,487,199** | **$0** | **$0** | **$162,487,199** |