City of Portland

General Fund Forecast

FY 2018-19 through FY 2022-23

City Budget Office

December 2017

I. Forecast Summary

Local economic growth continues unabated. Bolstered by this growth, the City's business license taxes reached record levels in FY 2016-17 and have grown by nearly 50% in just the last three years. Meanwhile, housing cost growth has moderated somewhat and income growth has finally arrived. The latest data show some slowing generally as firms are having difficulty finding workers and demand for hotel rooms has softened. Regardless, the overall revenue picture for the City remains largely positive after years of record growth.

However, the forecast of ongoing expenses through increased cost-of-living allowances (COLA), PERS employer rates, and ratified labor contracts over the last few months has more than offset modest increases in revenue forecasts. As a result, our preliminary forecast projects that the City will need to **cut $4.5 million in ongoing programs** to balance over the next five years. Additionally, the robust near-term revenue growth will yield **$22.5 million in available one-time resources** in FY 2018-19.

The City balances 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 City enacts cuts 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. Current policy states that at least 50% of one-time funds must be spent on major maintenance and replacement of City assets.

Forecast Highlights

Ongoing Cuts: -$4.5 million

New One-Time: $22.5 million

Significant Changes Since April:

- The rate of forecasted expense growth has steepened due to increased forecasts for PERS rates and COLAs.

- Mostly modest revenue forecast increases, but also added costs through new labor contracts

- New state shared marijuana revenue adds over $1 million ongoing

Local Economic Highlights

- Portland remains one of the top cities for in-migration of highly-educated younger adults

- Local economy is strong, but possibly showing the first signs of weakness in PDX passenger traffic and local lodging taxes

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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**	**$528.8**	**$541.0**	**$555.4**	**$568.3**	**$581.0**
Total Expenses	**$521.6**	**$510.8**	**$527.7**	**$544.0**	**$565.7**	**$581.0**
Ongoing Available/Cuts		-$4.5	$0.0	$0.0	$0.0	$0.0
One-time Available		$22.5	$13.3	$11.4	$2.6	$0.0
Total Expenses with Adds & One-Time Spending	**$521.6**	**$528.8**	**$541.0**	**$555.4**	**$568.3**	**$581.0**
Note: Totals may not add due to rounding. FY 2017-18 figures are for the Adopted Budget.						

II. Revenue/Expense Assumptions

Although we provide precise figures for budget balancing, the forecast is best represented by a range. The projected cut of $4.5 million represents less than 1% of *either* revenues or expenses. At this point, given the uncertainty around business license tax revenue – as well as expense risks associated with the Joint Office of Homeless Service and the unresolved Portland Fire Fighters Association arbitration – an appropriate range of possible outcomes for the final April forecast would be a $10 million surplus to a $20 million deficit. A lot will change over the next few months, especially in light of the level of economic and policy uncertainty at the national level. A number of forecast changes that influence both revenues and expenditures are discussed below:

Revenue Forecasts

Revenue forecasts generally reflect more modest economic growth in the near-term. Property tax growth has been strong, but will not keep up with expense growth over the next few years. The economically sensitive revenue sources are providing conflicting signals. While business license taxes continue to climb to record highs, transient lodging taxes have flattened out or even fallen slightly.

A. The forecast for business license taxes remains the largest source of uncertainty. Receipts last fiscal year grew to $117.9 million from $81.0 million just three years earlier. While it is expected that growth will continue in FY 2017-18, it is unlikely that this level of increased collections is unsustainable over the forecast period. Furthermore, it is somewhat unclear what the impacts of the latest federal tax bill will be on City receipts. Finally, FY 2018-19 will be the first year that the City will be collecting the CEO pay surtax. The expectation is that it will bring in about $2.25 million in FY 2018-19.

Major Forecast Risks

Cyclical Revenue Sources – The record growth in revenue has been largely the result of the City's pro-cyclical revenue streams, particularly business license and transient lodging taxes. In the near-term, these remain largely an upside risk as the City policy dictates conservative revenue forecasting. However, over the longer term, the rapid growth in these revenue sources creates greater exposure for the City's discretionary budget in the event of a downturn.

Personnel Costs/Labor Contracts – The City spends about three-fourths of its General Fund discretionary budget on personnel. Over the last two years, it has already added more than $14 million in ongoing costs with the Fire Fighter contract still unresolved. If the remaining negotiations continue to add costs – particularly if they do so without adding services – this represents a significant forecast risk.

B. The forecast includes an additional $1.1 million in state shared marijuana tax.[1] As of the April forecast, there was a dispute as to when this money would be distributed. Since then, this uncertainty has been resolved and the state distributed the first round of revenue in September. Cities and counties can expect to receive quarterly distributions from now on. The state's forecast for these revenues increases significantly over the life of the forecast as the market for retail marijuana matures.

C. Lodging taxes have exhibited some weakness in recent months. There is the possibility that the relative flood of new hotel rooms in the market has pushed down room rates. However, the recent weakness also aligns with a decline in passenger traffic at Portland International Airport (see Figure 1 on page

Expenses Forecasts

For the first time in several years, there were large changes to the forecasts for the City's ongoing expense obligations around COLAs and PERS costs. These changes, along with costs associated with recently-ratified labor agreements have more than offset increases in revenue forecasts.

A. Early in December, PERS actuaries released advisory employer payroll rates for FY 2018-19. These rates were slightly higher than previously forecasted and the outlook also resulted in higher forecasted rates beginning in FY 2020-21. The financial impact of changes **increased the City's ongoing expenses by approximately $5 million** during the forecast period.

B. Local inflation[2] for the first half of 2017 was at an annualized rate of 4.8%. As a result, the forecast for COLA was increased to 3.8%. The actual rate will be published in mid-January. Each percentage point increase in COLA adds a little less than $3 million in ongoing costs. **Increased expectations for COLA over the five-year forecast period added between $6 million and $7 million in ongoing expenses in the forecast.**

[1] This represents the City's share of the 17% state retail marijuana tax. Note that this is separate from the City's local 3% marijuana tax that is budgeted in a separate fund.

[2] The City currently uses the Bureau of Labor Statistics measurement of CPI-W for the Portland-Salem OR-WA region. This measure will be discontinued after 2017. As a result, the City will change to CPI-W for West Region for City's metro areas with larger than 1.5 million in population for future COLA measurement.

C. Earlier this year, City Council ratified several labor union contracts. Though the contract for the Fire Fighters is still outstanding, already ratified contracts **increase ongoing costs by about $2.2 million beginning in FY 2018-19**. It should be noted that these contracts also have significant one-time costs in FY 2017-18 that will need to be covered this year through compensation set-aside, contingency, or bureau savings.

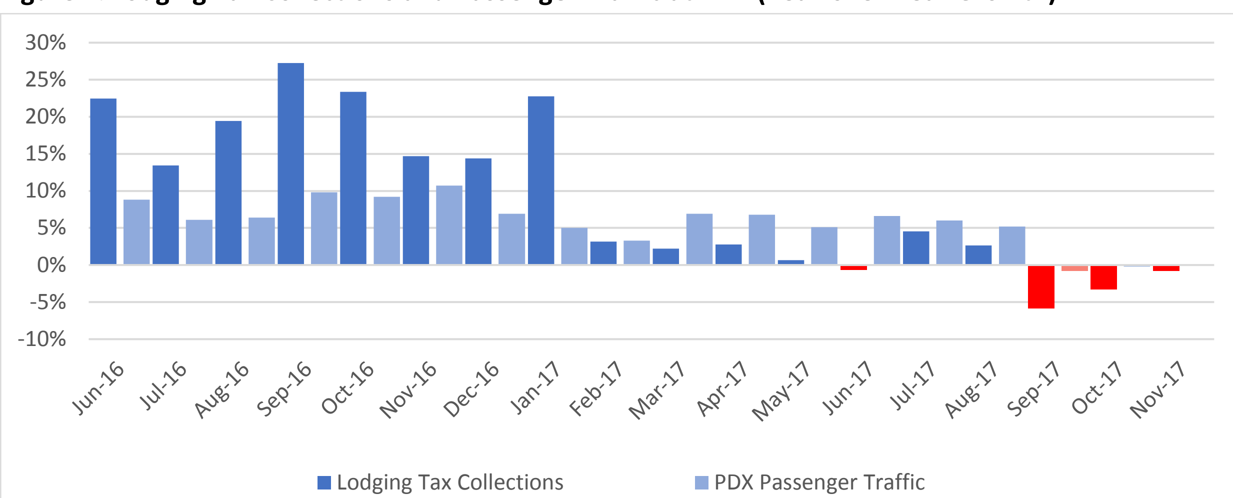
III. Current Economic Conditions

If the current economic expansion lasts another year, it will be the longest since World War II. As is typical with an economic expansion, the Oregon economy is better than the national economy, and the Portland economy is better still. 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 begun to slow over the last year, growing by about 2.5%, down a percentage point from the last few years. October figures show a 2.4% annual increase in jobs in the metro area, with only the construction and leisure/hospitality sectors showing a decrease. Meanwhile, the unemployment rate in Multnomah County has been below 4% for all of 2017, something that had not been done before until December 2016.

Commerce. According to CRBE Hotels, demand for hotel rooms in Portland has slowed markedly in the last 12 months. This has been reflected in both the City's lodging tax collections and a recent flattening of traffic through the airport. Figure 1 below shows both of these trends.

Figure 1. Lodging Tax Collections and Passenger Traffic at PDX (Year-over-Year Growth)



Real Estate. Both rent and home price growth have come down over the past year, but continue to climb. Rent growth, according to Colliers International, fell to 4% in the third quarter of 2017, continuing a downward trend that has characterized the last two years. Meanwhile, home prices have slowed after several years of double-digit increases.

TABLE 2. Selected Portland Economic Indicators

Indicator	Most Recent	Value	Year Ago Change	Recent Trend
Economy				
Total Employment, Portland MSA	10/2017	1,180,400	2.7%	Positive
Portland City Unemployment Rate	10/2017	3.7%	-0.3%	Positive
Consumer Price Index, Portland-Salem	1H-2017	247.9	4.2%	Neutral
Real Estate				
Median Home Price, Portland Metro	11/2017	$377,000	7.2%	Positive
Portland Metro Industrial Vacancy Rate	3Q-2017	3.5%	-0.6%	Positive
Portland Office Vacancy Rate	3Q-2017	7.9%	-0.3%	Positive
Multnomah County Multi-Family Vacancy Rate	3Q-2017	6.4%	-0.4%	Neutral
Commerce				
Total Air Passengers (Y-T-D)	10/2017	15,980,150	4.4%	Positive
Total Freight (Y-T-D in Tons)	10/2017	197,501	6.2%	Positive
Total Port of Portland Marine Freight (Y- T-D in Tons)	11/2017	10,538,532	14.7%	Positive
Hotel Average Revenue Per Available Room	3Q-2017	$128.18	1.4%	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] 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