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Mingus Mapps, Commissioner
Carmen Rubio, Commissioner
Dan Ryan, Commissioner
Rene Gonzalez, Commissioner
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CITY OF PORTLAND, OREGON

Memorandum

To: Mayor Ted Wheeler
Commissioner Mingus Mapps
Commissioner Carmen Rubio
Commissioner Dan Ryan
Commissioner Rene Gonzalez
Auditor Simone Rede

Cc: Michael Jordan, City Administrator
Jonas Biery, Deputy City Administrator of Budget and Finance, Chief Financial Officer
Ruth Levine, City Budget Director
City Bureau Directors
City Elected Officials Executives

From: Peter Hulseman, City Economist
Date: December 9, 2024
Subject: December General Fund and Clean Energy Surcharge Forecast

This memorandum is intended to communicate the preliminary General Fund Financial Forecast figures for FY 2025-26 through FY 2029-30, which forms the initial basis for the FY 2025-26 General Fund budget. Additionally, this memo communicates any updates to the Clean Energy Surcharge revenue forecast. Please contact Peter Hulseman (peter.hulseman@portlandoregon.gov) if you have any questions.

Revenue & Expenditure Projections

Table 1 summarizes discretionary General Fund resources and expenses through FY 2029-30. As shown in Table 1, the General Fund is facing required expected reductions of $21 million of ongoing expenses, which is roughly equivalent to an 8% reduction for most General Fund allocations[1]. Additionally, there is a one-time gap of $5.8 million in FY 2025-26. This forecast will be updated in February 2025 and finalized near the end of April 2025.

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1 Per Mayor's Budget Guidance, this amount excludes reductions to legal obligations, elected offices, the Portland Police Bureau (PPB), Portland Fire & Rescue (PF&R), and the Bureau of Emergency Communications (BOEC).

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

	Fiscal Year					
Budget Category	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**2029-30**
Total Resources	719.2	746.4	784.3	819.7	848.6	877.0
Total Expenses	719.2	773.2	779.2	819.7	842.9	869.0
Available Ongoing		**-21.0**	0.0	0.0	5.7	0.0
Available One-Time		**-5.8**	5.1	0.0	0.0	8.0
Total Expenses with Adds & One-Time Spending	719.2	746.4	784.3	819.7	848.6	877.0
Note: Totals may not add due to rounding. FY 2024-25 figures are reflective of the Adopted Budget						

The expenses indicated in Table 1 include all current ongoing allocations approved by City Council as of FY 2024-25 and include assumptions regarding increased personnel expenses and legal mandates, as directed by City Financial Policy. These expenses include ongoing Current Appropriation Level ("CAL") Target adjustments passed during the FY 2024-25 Fall Budget Monitoring Process.

Consistent with requirements of a balanced forecast, the years following FY 2025-26 show no ongoing deficits. However, as described in the previous paragraph, only expenses already approved by Council through a budget ordinance or dictated by City Financial Policy are included. New expenses, such as those related to ongoing or future labor bargaining, new legal obligations, emerging Council priorities, or health benefits increases above the market wide trend are not included in the expense forecast.

Last year's forecast for FY 2025-26 showed no anticipated new ongoing resources. Since the Adopted Budget was passed, there have been several new Council approved expenses including the Flood Safety Benefit Fee and increases in health benefits above assumed inflation. On the revenue side, there was a reduction in the property tax forecast, as described below. Combined, these changes are largely responsible for the required reductions.

City Financial Policy[2] dictates that ongoing requirements do not exceed forecasted ongoing resources over the five-year forecast window. After a reduction of $21 million in ongoing expenses, the General Fund is forecasted to have revenues adequate to match ongoing projected expenses in each year of the forecast after FY 2025-26. However, in FY 2025-26, there is an additional gap of $5.8 million that will need to be covered by one-time resources or further ongoing reductions. This one-time gap is largely due to the change in forecasted property taxes, which reduced expected revenue in FY 2024-25 and FY 2025-26, but increased the annual growth in FY 2026-27 and beyond (described in more detail in the property taxes section below). Current year bureau underspending, which is typically identified towards the end of the budget process, is one potential source for the $5.8 million of one-time needed to close the FY 2025-26 forecast gap[3].

2 https://www.portland.gov/policies/finance/comprehensive-financial-management-policies/fin-203-financial-planning

3 The current assumption for bureau underspending in the forecast is $6 million. This is a conservative estimate that will be updated in subsequent forecasts as projections grow more accurate.

Figure 1 shows forecasted revenues and expenses prior to the $21 million reduction in ongoing expenses, and Figure 2 shows forecasted revenues and expenses after the reduction (with the remaining one-time gap). Expenses will grow most dramatically during the PERS biennial increases in FY 25-26 and FY 27-28. As indicated in prior forecast memos, the slow growth in property tax revenue combined with increasing personnel and benefits costs provides little to no available revenue in the out-years of the forecast—meaning the funding of expenses beyond what was already approved by Council or assumed due to inflation will likely require further reductions unless conditions improve.

Figure 1: Forecasted Revenues and Expenses, Prior to Cuts and Balancing[4]

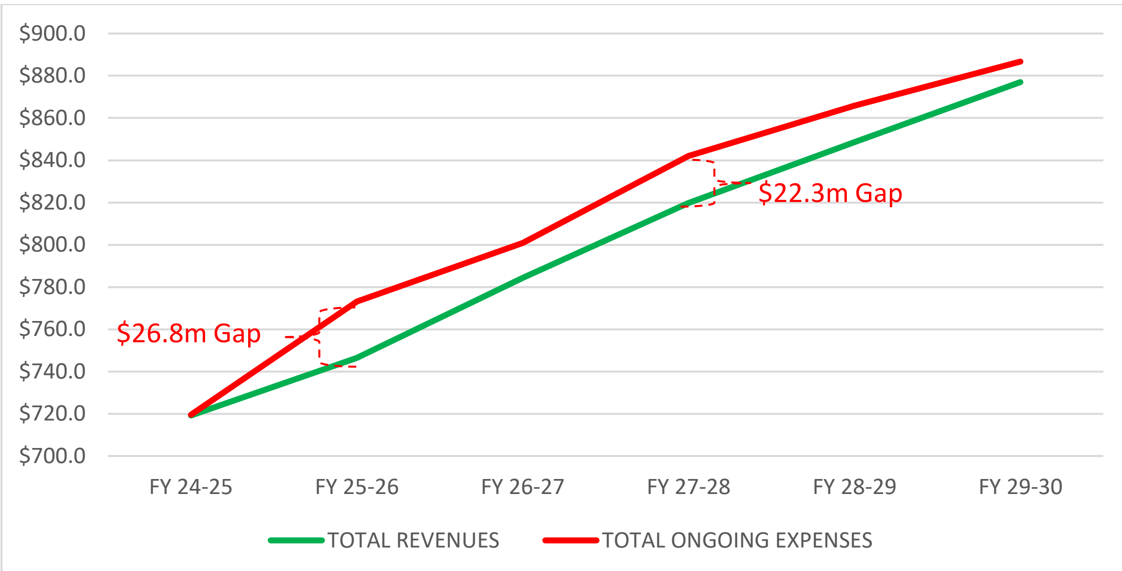
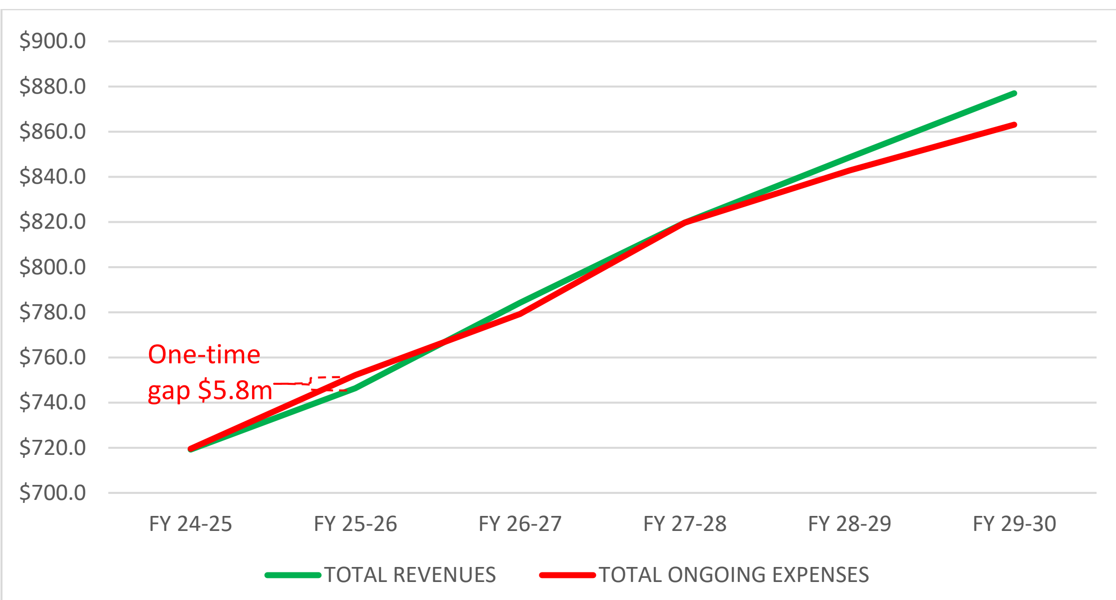


Figure 2: Forecasted Revenues and Expenses, After Reductions and Balancing



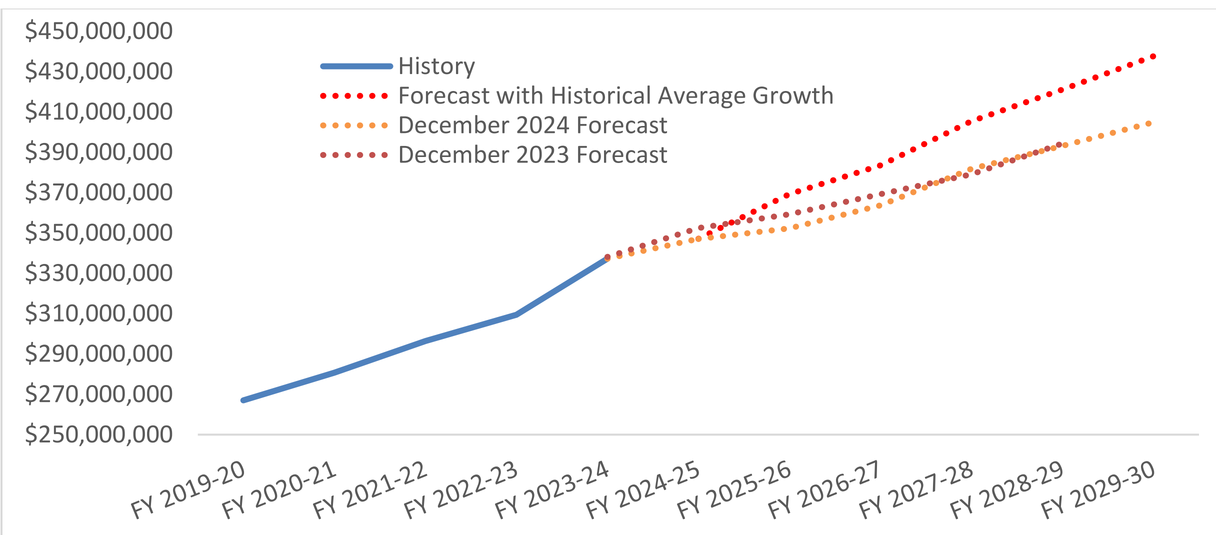
4 Ongoing reductions or additions are inflated in the balanced forecast. Meaning that a reduction of $21 million is roughly equivalent to $22.3 million in FY 2027-28.

Property Taxes

Due to anticipated declines in office property values in the downtown core, the December 2023 forecast included an historically low Assessed Value (AV) growth rate of 2.5% over the entirety of the five-year forecast. As a reminder, the Maximum Assessed Value[5] of a property is the lower of either 1) the 1995 value plus 3% annually, or 2) the Real Market Value (RMV)[6]. While it was unlikely that there would be five consecutive years of historically slow growth, this assumption provided flexibility to adjust the forecast for when the actual declines made it into assessments. This year's forecast updates that assumption based on recently released assessment data. Changes from prior forecasts can be seen in Figure 3.

While the December 2023 and December 2024 forecasts have similar ending points—approximately $33 million below what would be expected with historically average property tax growth—the path to get there is dramatically different (see Figure 3 below). This is largely because instead of being spread out through the life of the forecast, the substantial declines in office space property values began in FY 2024-25 and are expected to continue into FY 2025-26. Excluding property taxes returning from Tax Increment Financing (TIF) districts, assessed value growth for FY 2024-25 was approximately 1%, which is the lowest growth rate that Portland has experienced since Oregon's property tax reform of 1997. FY 2025-26 is expected to have equally slow assessed value growth, before downtown office space property values reach their nadir and then shift back to more normal AV growth (3%). The result is roughly $12.2 million less in property taxes than previously anticipated for FY 2025-26[7]. This explains both a portion of the ongoing gap as well as the one-time gap. After FY 2025-26, forecasted revenue growth will line-up with expense growth as property tax revenues grow closer to the historical average, meaning that one-time funds or additional ongoing reductions are needed to bridge to the anticipated recovery.

Figure 3: Property Taxes History and Outlook

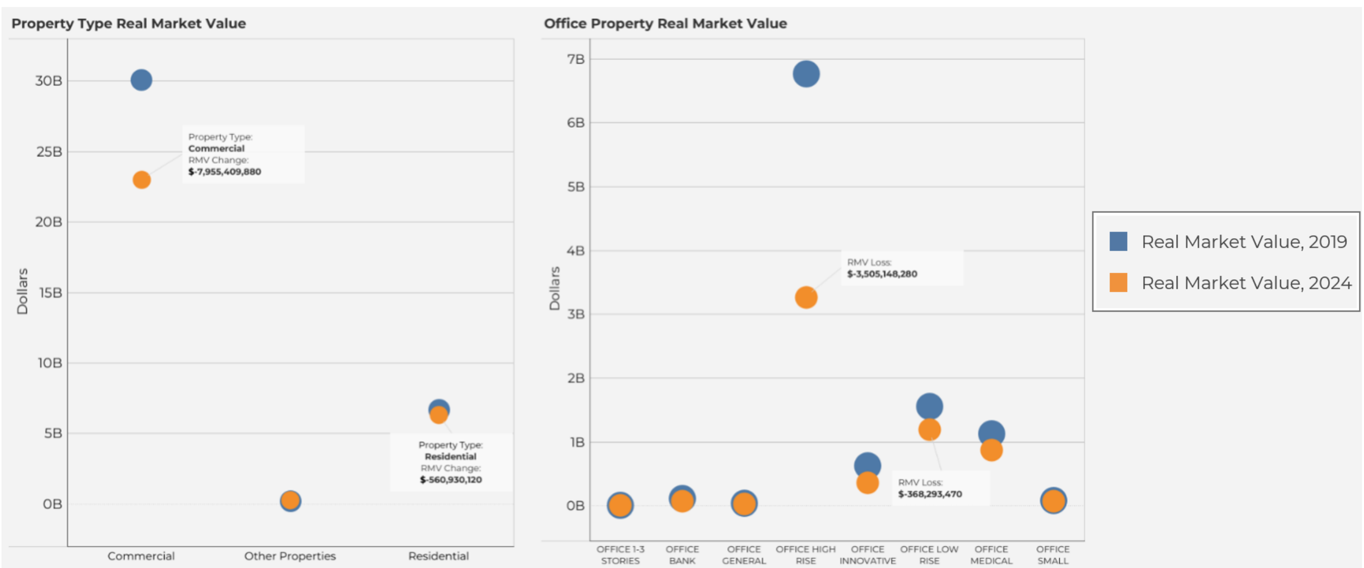


5 Maximum Assessed Value and Assessed Value are used interchangeably in this memo.
6 See slide 20 for more information on property taxes: https://www.portland.gov/budget/documents/citywide-fiscal-outlook-work-session-presentationoctober-22-2024/download
7 Forecasted current year (FY 2024-25) collections impact beginning fund balance for the budget year (FY 2025-26). Meaning that a reduction in forecasted current year collections is accounted for as a reduction in available FY 2025-26 resources. The $12.2 million reduction is made up of a roughly $5.2 million reduction in current year collections, and a $7 million reduction in FY 2025-26 collections.

Figure 4, provided by the Multnomah County Central Budget Office, gives a closer look at what is driving the tepid assessed value growth—substantial declines in office space Real Market Values (RMV). For many downtown offices, RMV has fallen far enough to become the Maximum Assessed Value, which is causing negative AV growth for a significant portion of high-value properties in the downtown core. This also increases the uncertainty in the forecast, as RMV is more volatile than property taxes as a whole, since AV growth generally has a floor of 3% when property values are increasing. While there is likely to be one more year of declining AV for downtown office space, an outright decline in the City's property tax revenue is not anticipated as downtown office space accounts for just over 4% of the City's property tax roll.

In most years, the property tax forecast does not change after the December Forecast release. However, given the abnormally high level of uncertainty, there is the potential for material updates to this forecast in February or April after further scenario analysis is conducted in conjunction with the Multnomah County Central Budget Office.

Figure 4: Downtown Property Values[8]



Business License Taxes

The Business License Tax is a 2.6% net income tax on business activity in the City of Portland. Since this is based on business activity, a business does not need to have employees in Portland to pay the tax. Since a substantial portion of this tax revenue is paid by large national corporations, corporate profits and margins tend to be a strong leading indicator.

As corporate profit margins returned to more normal levels after the pandemic, there was an anticipated decline in BLT revenues for FY 2022-23. Actual receipts for FY 2022-23 surpassed expectations, leading to a reduction in the forecast for FY 2023-24 under the assumption that many

8 Special thanks to the Multnomah County Central Budget Office, Jeff Renfro (County Economist), Evan Kersten (Senior Budget Analyst), and Jenna Bryant (Hatfield Fellow) for this chart and analysis.

firms overpaid in FY 2022-23 and would file for substantial refunds during the next fiscal year. As Figure 5 shows, this is largely what came to pass: total refunds in FY 2023-24 were $58 million, over twice the FY 2022-23 amount of $27 million, and FY 2023-24 saw a decline in Business License Tax (BLT) receipts of roughly 10%[9]. Current year collections and refunds are tracking with expectations, and the current forecast is that FY 2024-25 revenue will be back to $206 million. Figure 6 shows the five-year BLT forecast.

Figure 5: Business License Refunds

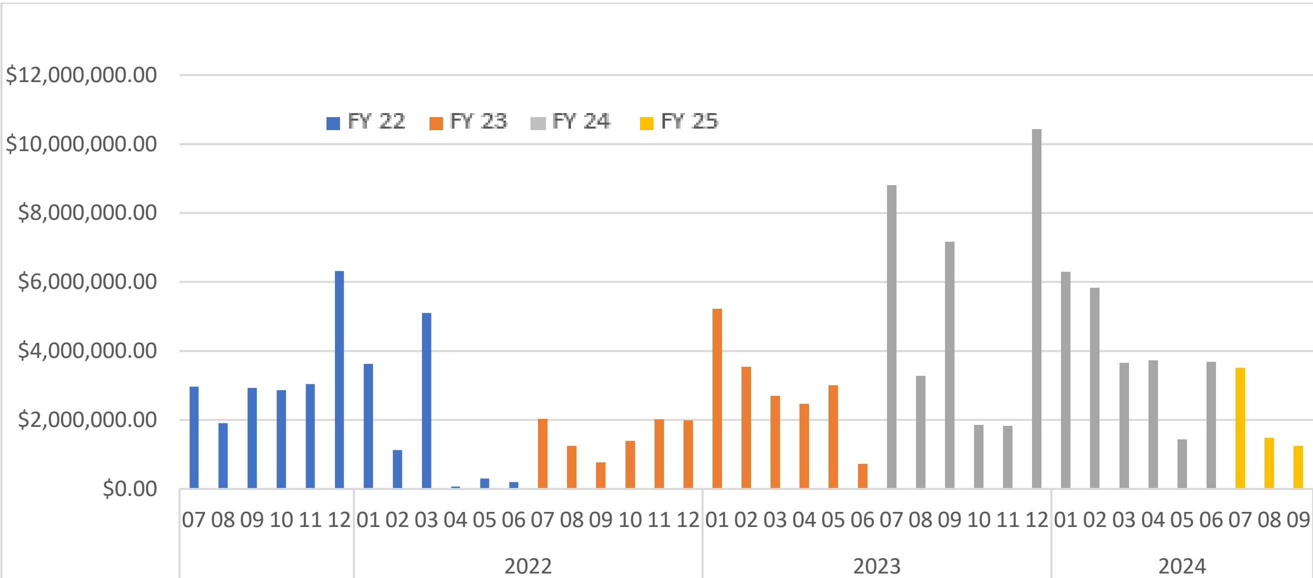
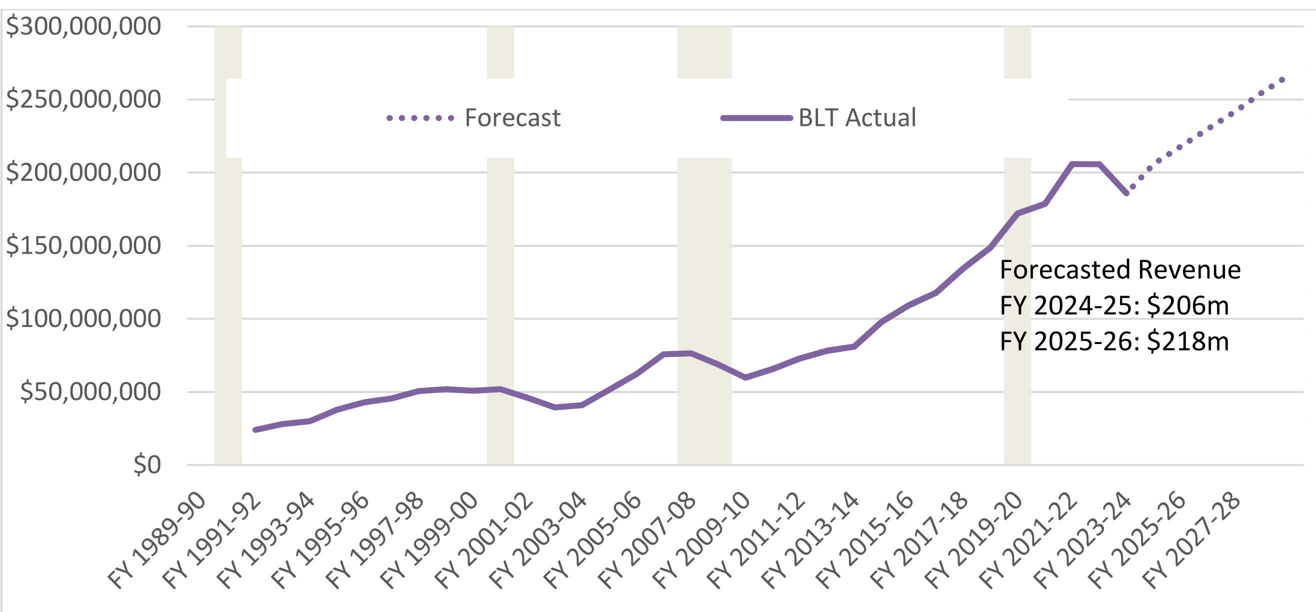


Figure 6: Business License Tax Forecast[10]



9 $206 million in FY 2022-23 to $186 million in FY 2023-24
10 Gray shading indicates recessions.

Other General Fund Revenues

The revenues discussed below are anticipated to make up roughly a quarter of General Fund Discretionary revenue in FY 2025-26. In the current year (FY 2024-25), lagging receipts in State-shared Revenue and Transient Lodging Taxes have been made up for by strong receipts in Utility License/Franchise Fees. On net, there is little change to anticipated combined revenue from these sources in the current Fiscal Year.

Utility License/Franchise Fees—The longer-term secular declines in this revenue source (e.g., lower expectations for telecom-related revenue due to “cord-cutting”) were captured in prior forecasts. Revenues have increased in alignment with rate increases from private utility payers.

Transient Lodging Taxes—This revenue stream was the most adversely affected by the COVID-19 Pandemic, and growth has slowed over the prior 24 months suggesting a new, lower baseline than pre-pandemic. The forecast calls for continued slow growth with a lower baseline. This revenue stream is not anticipated to match its pre-pandemic peak over the duration of the forecast.

State-shared Revenue—This revenue source is comprised largely of state liquor taxes, but also includes state marijuana and cigarette taxes. This revenue has grown as expected, and the outlook remains stable.

Conclusion

Fiscal Year 2025-26 was previously anticipated to be a tight budget cycle with $0 forecasted available ongoing resources in the prior forecast (April 2024). Newly adopted expenses combined with a reduction in the property tax forecast has contributed to a budget gap of $21 million in ongoing and $5.8 million in one-time resources. Given the slow forecasted growth of property taxes—the largest General Fund revenue source—there is not anticipated to be substantial revenue flexibility until the final year of the forecast unless the property tax outlook improves.

Clean Energy Surcharge

Clean Energy Surcharge revenue, which supports the Portland Clean Energy Community Benefits Fund, was closely aligned to the forecast last year. Fiscal Year 2023-24 revenue totaled $199 million against a forecast of $190 million; however, it is anticipated that Fiscal Year 2024-25 revenue will be slightly lower as prior year payments continue to decline. Over the five-year time span forecasted revenues are tracking with the December 2023 forecast, and there is no change to the forecasted revenues for previously adopted Climate Investment Plan. Annual average projected revenues of $203 million are aligned with projected average annual program expenditures over the five-year forecast.

Figure 7: Clean Energy Surcharge Revenue Forecast