BDS Financial Advisory Committee
Meeting Notes
Monday, November 13, 2023

FAC Members Present:
Amy Vander Vliet, Oregon Employment Department
Jeff Renfro, Multnomah County
Jenny Liu, Portland State University
Jerry Johnson, Johnson Economics
Josh Harwood, Metro
Lauren Golden Jones, Development Review Advisory Committee (DRAC)
Martha Williamson, Vega Civil Engineering, LLC
Matthew Gierach, City of Portland Debt Manager
Mike Wilkerson, ECONorthwest
Peter Hulseman, City of Portland Economist
Tom Potiowsky, Portland State University

City Staff Present:
Angel Landron Gonzalez, Portland Housing Bureau (PHB)
Ayman Abualajin, Portland Housing Bureau (PHB)
Beth Benton, Property Compliance Manager, Bureau of Development Services (BDS)
Brenda Fahey, Technology, Training, and Continuous Improvement (TTCI), Bureau of Development Services (BDS)
Carmen Rubio, Commissioner
Dave Tebeau, Inspections Services Manager, Bureau of Development Services (BDS)
David Kuhnhausen, Permitting Services Manager, Bureau of Development Services (BDS)
Doug Morgan, Plan Review Services Manager, Bureau of Development Services (BDS)
Elizabeth Hilt, Financial Analyst, Water
Elshad Hajiyev, Deputy Director, Bureau of Development Services (BDS)
Jill Chen, Portland Housing Bureau (PHB)
Kathy Lyndon, Financial Analyst, Bureau of Development Services (BDS)
Kevin Bumatay, Portland Bureau of Transportation (PBOT)
Kim Tallant, Land Use Services Manager, Bureau of Development Services (BDS)
Kyle O'Brien, Budget & Finance Manager, Bureau of Development Services (BDS)
Leesha Posey, Equity Communications & Policy Development Manager
Mary Leung, Financial Analyst, Water
Matt Scott, Bureau of Environmental Services (BES)
Megan Beyer, Commissioner's Staff Rep
Rebecca Esau, Bureau Director, Bureau of Development Services (BDS)
Sangeen Khan, Financial Analyst, City Budget Office (CBO)
Tony Barnes, Prosper Portland
Will Terry, Portland Bureau of Transportation (PBOT)

Handouts

- Financial Summary
- Business Continuity Plan Summary

- Non-Cumulative Cost Recovery Report
- Workload Measures Report
- Large Projects – 6-month comparison
- Budget & Reserves Charts

1. Welcome

BDS Director Rebecca Esau welcomed Financial Advisory Committee (FAC) members and City staff and convened the meeting by expressing appreciation to the committee members for their participation and input.

2. Self-Introductions

Attendees made self-introductions.

3. BDS Finances & Financial Planning Update

Bureau's Current Financial State

Bureau of Development Services (BDS) Budget & Finance Manager Kyle O'Brien began by setting a framework for FAC meetings. This first meeting serves to provide an overview of the bureau's current financial state while looking to the Committee for insight on the economy. This meeting will be crucial as BDS projects revenues for the next five years.

BDS Budget & Finance Manager Kyle O'Brien explained that the bureau is established as an operating fund, meaning it is primarily funded by fees and charges for services with very little support from the General Fund. This ties BDS revenues closely to the construction industry. As such BDS has its own reserves, and reserve goals are set to ensure continuity of operations. The overall bureau reserve goal is 50% of annual expenditures with the Building/Mechanical Program, Environmental Soils Program, Signs Program, and Land Use Services reserve goals set at 75%. Services provided by Land Use Services take place at the leading edge of the development cycle, with program revenues and workload highly susceptible to any fluctuations in the construction development cycle; therefore, a program reserve goal of 75% is prudent and provides BDS with the necessary time to react should reserves drop below this goal. The Building/Mechanical program performs structural and mechanical inspections that are usually the last stage in the bureau's work on development projects. The higher reserve goal ensures the bureau has enough resources to provide inspections services that were prepaid by developers and homeowners. The current programmatic reserve goals and bureau total minimum reserve level allow the bureau to better manage unpredictable fluctuations in economic conditions.

Portland construction activity, large project activity, and bureau revenues have declined. There is also little demand for new hotel or office spaces, and multifamily apartment development has been impacted by interest rates and decreasing values. BDS is expecting an 18-month period of low permitting activity. As such, the bureau is taking steps to reduce the monthly draw on reserves as reserves must last through the duration of this development downturn. In FY 2022-23, BDS drew $12M in reserves the entire fiscal year. There is currently $37M remaining in reserves and BDS is drawing at an unsustainable rate of $3M per month from reserves.

To reduce the Bureau's expenditures, the following cost-saving measures have been implemented or are in progress:

- Hiring freeze, offering voluntary schedule reductions, reducing overtime spending as well as non-essential spending on training, etc.
- Layoff of temporary employees (including returned retirees) and contract employees
- Layoff of nine probationary employees
- Layoff of 56 employees spread across all divisions and include management and non-management positions, both union- and non-represented. The proposed layoffs are 15% of the bureau's workforce, as opposed to the layoffs of 50% of the workforce done in 2009. The approximate labor cost savings is $717K savings per month.

The majority of BDS fee revenues are associated with State-mandated building code programs, including Building, Mechanical, Plumbing, and Electrical. State statutes regulate these programs and prohibit revenue collected by them to be used for local code enforcement programs. BDS's local code programs include Land Use Services, Property Compliance Inspections, Environmental Soils, Signs, Zoning Compliance, and Site Development. Revenues from these programs are to be used on the programs generating the revenues, according to City Code.

Historically, Land Use Services received General Fund monies; however, that support ended in FY 2017-18. The Neighborhood Inspections, Liquor Licensing and Noise enforcement programs receive a small amount of General Fund support.

Overview of BDS's Forecasting Model

A brief overview of the bureau's Five-Year Financial Plan modeling was provided to the Committee. Over 80% of revenues are forecasted by econometric modeling, using data from Moody's, Northwest Economic Research Center (NERC), and State of Oregon Office of Economic Analysis (OEA) in addition to bureau data for land use case reviews, permit numbers, valuations, and revenues. Specifically, the Building, Mechanical, Plumbing, Electrical, and Land Use Services fee revenues are econometrically forecasted. The Facility Permit Program (FPP) and the Field Issuance Remodel (FIR) rates are a weighted average of the Building, Mechanical, Plumbing, and Electrical growth rates. Site Development and Zoning Enforcement growth rates are based on the Building Program rates. Environmental Soils, Signs, and Enforcement are projected using averages of forecasted economic data such as population, housing price index and employment.

Overview of BDS Expenditures

Expenditure projections are based on current expenditures with consideration for inflation, expected increases to labor costs, and special projects. Personnel expenses are by far the largest cost, accounting for over 70% of overall BDS expenditures.

Large Projects

Bureau of Development Services (BDS) revenues are heavily reliant on large project revenues. The revenue BDS collects is based on project valuation. BDS closely monitors large project activity and makes necessary adjustments in the revenue projections to incorporate known and expected large project activity.

4. Current Economic Trends Discussion

Economic Outlook Discussion

Kyle began the economic outlook discussion by asking for the committee's honest opinion of current economic expectations such as inflation and interest rates in addition to the potential effects on development in Portland in the next 12 months.

City of Portland Economist Peter Hulseman shared that interest rates are not expected to decrease until the end of 2024. Unemployment has ticked up at the national level and there has been less voluntary quitting; however, there's a reduction in total number of new jobs being created.

Amy Vander Vliet with the Oregon Employment Department shared the risk of a recession is still very real in the current inflationary climate; however, the consensus outlook among economists has shifted from an economic downturn next year to a "soft landing" scenario. The Federal Reserve's interest rate hikes are expected to be just enough to slow the economy and tame inflation without triggering a recession. Inflation has slowed considerably this year. The labor market has cooled but remains strong: In both Oregon and the nation, job openings have come off their post-pandemic highs and are approaching pre-pandemic levels; job growth has slowed to a more sustainable pace; and the unemployment rate remains near historic lows.

Finance Advisory Committee members Jerry Johnson and Lauren Golden Jones expressed sentiment that there is a recession in the commercial construction sector. Kyle added BDS is in a permitting recession. The drop-in new construction activity is due to higher interest rates making it more and more difficult for commercial projects to underwrite and pencil out. There is very little new development on the 2024 horizon because it is cheaper to buy existing commercial buildings at reduced prices. New housing developments are expected to mostly occur in Portland suburbs as development there is cheaper. Leases on office spaces are gradually coming to an end, and many tenants are expected to not renew their leases. Josh Harwood, with Metro, and Jeff Renfro, with Multnomah County, advised to focus on local data instead of higher-level trends in the current economic environment.

Finance Advisory Committee member Mike Wilkerson stated the main demand for permitting is housing, and there is little demand for office and hotels. The financing and equity side of the equation is challenging for development to occur in Portland; however, Mike mentioned there is demand in other Oregon regions instead of the Portland metropolitan area. Lauren Golden Jones stated rents are just as high in the suburbs as in the City of Portland, but the value is perceived to be in the suburbs.

Amy Vander Vliet stated the population growth is expected to mainly come from in-migration over the next five years. Population growth in Portland was slowing before the pandemic since 2015. People are moving into the area, but more people are moving out since Portland is less affordable than other areas in Oregon. Jerry Johnson stated in-migration by itself does drive development and that rental rates must cover replacement costs.

As multifamily building values are decreasing, creativity is needed to increase the housing supply. Mike Wilkerson noted the fundamentals facilitating Portland's growth are broken, development drivers are lacking, and incentives do not exist for private sector development. In the public sector, all the housing bonds have been spent and there are no forecasts for large projects.

In order for there to be investment in Portland, the City task force will need to focus on public safety, cleanliness and homelessness/housing. In addition, the overall tax value proposition must be reviewed such as looking at the level of taxation relative to the level of service delivery. There needs to be a new vision for downtown Portland such as converting office buildings to mixed-use buildings. Jerry Johnson mentioned that downtown safety is a concern and will need to be stabilized before an economic recovery will occur. It will take time to repair Portland's damaged reputation to institutional investors.

Kyle asked if there was anything in particular BDS should monitor to indicate a rebound in Portland development activity, and if an 18-month downturn is an optimistic or realistic timeline for permitting activity. Mike Wilkerson suggested the indicator to watch for is commercial construction transaction volume since there is high uncertainty with cap rates.

The consensus among Financial Advisory Committee (FAC) members is that an estimated 18-month downturn is an optimistic outlook. FAC members agreed it is more realistic to expect development activity to hit the bottom within the next 18 months, followed by a slight recovery. Interest rates may stay high for an extended period and it will most likely take the Portland economy some time to recover.

5. Next Meeting Details

The next FAC meeting is scheduled for Wednesday, January 3, 2024.

Meeting notes prepared by Kathy Lyndon and Ray Galinat, BDS