



**City of
Portland, Oregon**
Bureau of Development Services
FROM CONCEPT TO CONSTRUCTION

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BDS Financial Advisory Committee
Meeting Notes
Wednesday, December 5, 2018

FAC Members Present:

Josh Harwood, City of Portland Economist
Holly Huntley, Development Review Advisory Committee
Peter Hulseman, Northwest Economic Research Center
Jerry Johnson, Johnson Economics
Mike Paruszewicz, Northwest Natural
Jeff Renfro, Multnomah County
Mike Wilkerson, ECONorthwest

City Staff Present:

Beth Benton, BDS Property Compliance Inspection Manager
Tyler Bump, BPS
Claudio Campuzano, Parks
Alex Cousins, BDS Communications Manager
Rebecca Esau, BDS Director
Brenda Fahey, BDS Business Operations
Mark Fetters, BDS Business Operations
Ray Galinat, BDS Budget & Finance
Darryl Godsby, Commercial Inspections Manager
Elshad Hajiyev, BDS Senior Business Operations Manager
David Kuhnhausen, BDS Permitting Services Manager
Kathy Lyndon, BDS Budget & Finance
Erin Mick, Water Bureau
Doug Morgan, Interim Plan Review Services Manager
Kyle O'Brien, BDS Budget & Finance Manager
Yung Ouyang, City Budget Office
Dora Perry, BDS Equity & Policy Manager
Andy Peterson, BDS
Elisabeth Reese Cadigan, BES
Cory Stanley, Fire
Kim Tallant, Land Use Services Manager
Dave Tebeau, Residential Inspections Manager
Duane Whitehurst, Technology Capital Project Manager

Handouts

- Financial Summary
- Business Continuity Plan Summary
- Non-Cumulative Cost Recovery Report
- Workload Measures Report
- Large Projects – Valuation \$15 Million or More
- Large Projects – 6-Month Comparison
- Line Item Budget
- Explanation of Line Items

1. Welcome / Self-Introductions

BDS Director Rebecca Esau welcomed Financial Advisory Committee (FAC) members and City staff and convened the meeting. Director Esau expressed appreciation for the committee members in attendance and their input. Attendees made self-introductions.

2. BDS Finances & Financial Planning Update

Bureau's Current Financial State / FY 2017-18 Performance

BDS Senior Business Operations Manager Elshad Hajiyev reviewed the handout **Financial Summary** and gave an update on BDS's finances over the last several months. FY 2017-18 was a good year for BDS but did not achieve the double-digit percent increases in permit valuation of previous years. Revenues and expenditures were close to projections and \$1 million was added to overall reserves.

Signs of market cooling began in FY 2017-18, particularly with Land Use Services, and have become more pronounced in FY 2018-19. Evidence for this is a substantial decrease in the number and size of permit submittals, particularly multi-family, which fueled the recent boom in construction activity. The result has been the BDS Business Continuity Plan (BCP) showing 4 out of 5 triggers active since September 2018. Elshad Hajiyev then reviewed the **Business Continuity Plan Summary**, which was developed in 2009 to track the bureau's performance and financial health. The only trigger not in "red" status is reserves, which are healthy, but are being drawn down at rates similar to rates during the last recession. The difference at this time is BDS has much more in reserves. Land Use Services (LUS) stopped hiring in the beginning of the current calendar year and is holding several positions vacant. Additionally, the BCP triggers have led to a 3-month hiring freeze through January 31, 2019. The freeze will be reevaluated in January and most likely be extended. BDS is still hiring for certain positions that are needed for business reasons, but other hiring is frozen.

Overview of BDS's Forecasting Model

BDS 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 economic insight, both nationally and locally. Proposed financial forecasting models will be presented for review and critique at the next meeting, along with the five-year programmatic growth rates.

BDS is primarily fee funded, with approximately 1% of revenues (approximately \$950,000) coming from the City's General Fund in FY 2018-19 to support the Neighborhood Inspections Program. 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 other local code enforcement programs. BDS's local code programs include Land Use Services, Enforcement, 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.

A brief overview of the bureau's Five-Year Financial Plan modeling was provided to the Committee. Approximately 80% of revenues are forecasted by econometric modeling, using data from Moody's, Northwest Economic Research center (NERC), and Office of Economic Analysis (OEA) in addition to bureau data regarding 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) 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.

Kyle O'Brien referenced the handouts **Line Item Budget** and **Explanation of Line Items** and explained that personnel makes up nearly two-thirds of the bureau's expenditure budget. In addition, Kyle reviewed the handouts **Large Projects – Valuation \$15 Million or More** and **Large Projects – 6-Month Comparison**. The number and valuations of large projects are experiencing year-over-year decreases.

Mike Parusiewicz (NW Natural) asked how long the BCP indicators have been red. Kyle O'Brien responded that some (LUS) have been red since last year, while others are more recent. Many indicators have been consistently red since this summer.

Additionally, "commercial" permits were defined as permits with commercial end uses and/or residential end uses with 3 or more units.

3. Current Economic Trends Discussion

Economic Outlook Discussion

Jerry Johnson (Johnson Economics) kicked off the discussion by stating that indicators are performing as expected and emphasized the importance of BDS' response. There isn't as much development in the pipeline, and activity will be slower going forward. Reserves are expected to be at high levels now due to where we are in the business cycle. Kyle added that the building permit decline came sooner than expected.

Mike Wilkerson (EcoNorthwest) mentioned that the slowdown could be seen coming last year, and hopefully BDS has been planning for downside. The challenge now is projecting and preparing for the uptick.

Mike Wilkerson stated the decrease in development submittals will likely last through 2019, and that a recovery would mainly be led by residential multifamily as other sectors are overbuilt. City Economist Josh Harwood added that most sectors are trending down, and the overall trend should continue downward, even if there is a short-term recovery in 1 or 2 sectors. Additionally, Jerry Johnson noted decreased City of Portland activity resulting from development shifting to the suburbs.

In relation to BDS revenue projections, any future increase in submittals will most likely be for cheaper, lower valuation projects. Mike Wilkerson suggested that revenue modeling will be complicated by not knowing the effects of residential infill or how the recently passed Affordable Housing Bond will be used. Jerry Johnson added that forecasting at a jurisdictional level is much harder than regional, and that Portland has suffered from some competitive disadvantages.

Elshad Hajiyev noted the bureau's lack of control over revenues, and therefore the need to control expenditures. Bureau managers are working to ensure steps are taken earlier this time around.

Josh Harwood asked if a change in the permit flow pipeline has been observed, namely a slowdown in the process or increased cancellation of projects. Director Esau stated this is not the case. BDS Land Use Services Manager Kim Tallant mentioned an increase in plan set changes after going through land use review; i.e. trying to build higher, changing materials, attempts to save on costs.

Personnel Costs

Mike Parusiewicz asked how personnel costs are projected. Josh Harwood stated that projections are calculated from current salaries, plus projected COLAs based on the West Regional Consumer Price Index, plus projected PERS contributions. Josh added that COLAs will be higher than they've been in years, in addition to a 4-6% increase for PERS.

Construction Costs

Jerry Johnson noted a shortfall in the labor movement toward the trades. Mike Wilkerson added that construction is the largest growing sector but is not keeping up with demand. However, once the slowdown takes hold, the decrease in construction should help address the labor shortage. Mike Parusiewicz mentioned that inflation is already at problematic levels, and construction costs generally plateau rather than rebound.

Affordable Housing

Kyle O'Brien asked if there was any new information regarding Affordable Housing. Tyler Bump (Bureau of Planning & Sustainability) stated the Housing Bureau needed to be at the meeting to speak on the topic. Jerry Johnson noted that condo projects are unworkable under the current structure.

Kyle O'Brien saw that some projects are looking to pay a fee-in-lieu and questioned the effectiveness of the deterrent. Mike Wilkerson responded that developers would rather pay a fee-in-lieu, but as Average Median Income (AMI) increases Inclusionary Housing (IH) becomes more attractive. Tyler Bump added that AMI is closing on market rates. Additionally, Jerry Johnson noted the 99-year rule has proven to be problematic.

Kyle O'Brien inquired as to the potential effects of IH on recovery. Mike Wilkerson stated that if properly calibrated, IH should have no effect. Jerry Johnson expressed concern as to the probability that proper calibration would occur, noting that calibration needs to be done at the parcel level.

Single Family

Jerry Johnson noted that homebuilders are having trouble hitting the market (\$350-400K) as costs are too high; homes are for sale, but product is not moving as quickly as in recent years. Mike Parusiewicz added that few units will be built over the next couple years. However, population growth is projected to continue leading to rent increases, which will incentivize more construction. Mike Wilkerson mentioned that Portland is different from the surrounding region due to regulations (i.e. Residential Infill).

Hotels/Office/Retail

Mike Wilkerson said the last cycle was rare and now hotels/retail are overbuilt, and office has more in the pipeline than the market indicates with little activity. Jerry Johnson noted a downward trend in office space needed per employee, and said that the main retail tenants are restaurants which might be saturated.

There was consensus that the next 12-18 months should see continued declines. However, Josh Harwood noted that recent declines were from historically high levels. Mike Wilkerson added that Portland has benefitted from down cycles in the past as in-migration increases due to lower costs. However, even though Portland is still one of the most affordable cities on the West Coast, costs have increased to a point where the benefit may not materialize this time around.

4. Next Meeting Details

The next FAC meeting is scheduled for Wednesday, January 9, 2019.

Meeting notes prepared by Mark Fetters, Kathy Lyndon, Ray Galinat, BDS