Finance, Budget & Tax Office

MULTNOMAH COUNTY OREGON

Budget Office

Fiscal Parameters – ITAX Sunset

Assumptions Underlying Fiscal Parameters for FY 05-06 and FY 06-07

The Budget Office has described a "structural deficit" in the County's General Fund that is brought about by an imbalance between ongoing revenue and forecast expenditure growth. That deficit is estimated to cause the County to *trim 1% - 2%* of baseline expenditures annually over the next five years. In FY 05-06 we are forecasting that the shortfall will fall **within a range of $4.5 - $6.5 million**. This forecast has been developed under the assumption that the actual shortfall will be at the high end of that range.

In addition, the County's temporary local income tax (ITAX) will effectively sunset on June 30, 2006. The tax is expected to generate roughly $126 million in FY 05-06 with most of that revenue dedicated to providing support for local school districts. County programs funded by the ITAX are forecast to cost from $35 - $36 million in FY 06-07. However, the primary assumption underlying this forecast is that there will be no replacement revenue to cover those costs.

The following table highlights the predicament the County finds itself in as we begin planning for the FY 06-07 budget cycle.

Table 1

General Fund - Ongoing Revenue v. Ongoing Expenditures

	Current Year FY 04-05	Next Year FY 05-06	Year 3 FY 06-07	Year 4 FY 07-08	Year 5 FY 08-09
Beginning Balance (BWC)	$ 19.5	$ 21.9	$ 15.7	$ -	$ -
Revenue	305.7	310.4	281.2	290.1	300.4
Expenses	303.3	316.6	327.1	342.0	357.4
Excess/(Deficit)	***2.4***	***(6.2)***	***(45.9)***	***(52.0)***	***(57.0)***
Ending Balance	*$ 21.9*	*$ 15.7*	*$ -*	*$ -*	*$ -*

This table is intended to illustrate what happens if the County takes no corrective action to adjust ongoing expenditures to the revenue available to purchase results. Obviously, we would never adopt a budget that left the General Fund with the massive shortfalls indicated in the table.

The daunting task we face over the next two budget cycles is one of attempting to fund an estimated $327.1 million worth of General Fund programs with only $281.2 million of revenue available to purchase those programs. That gap – *roughly 14% of currently funded programs* – is equivalent to:

- virtually the entire Library system; or
- the entire amount of GF support of the Health Department; or
- half the Sheriff's Office.

Clearly, the choices before the County will not be easy. Those choices are compounded by an uncertain economic landscape and a handful of external factors that are largely beyond our control.

Revenue Assumptions

The state and region have been mired in an economic slump for much of the past three years. During this time, Oregon's unemployment rate has been among the highest in the nation. This slump has been particularly protracted and stubborn when compared to other recessionary periods in recent history.

Over the past several months we have begun to see signs of economic improvement. Assessed value growth, the primary driver behind Property Tax revenues, exceeded 3% in FY 04-05 for the first time in three years. Business Income Tax (BIT) collections in FY 03-04 exceeded $30 million for the first time in five years and that also provides some insight into the economic recovery that now appears to be underway.

It must be cautioned, however, that even if the regional economy were to return to the "white hot" growth levels experienced in the mid-90's it is unlikely that we could grow out of the structural deficit we have described. Why do we believe this to be true?

Let's start with the **Property Tax**. The Oregon constitution has been amended twice over the past 15 years to limit the amount of property tax revenue that schools and local jurisdictions can collect. Measure 5, passed in 1990, limited taxes on individual properties to 1.5% of assessed value. Measure 47, passed six years later, capped assessed value growth for most properties at 3% of the prior year's value. The only way tax revenues can exceed this limit is through the addition of new value.

But, the legislation that implemented Measure 47 (commonly referred to as Measure 50) also set permanent rates for all jurisdictions. As the term implies permanent rates cannot be changed. Actual revenue growth in any given year is, therefore, totally dependent on three factors:

the overall change in assessed value,
the relationship of assessed value to real market value, and
the total dollar amount of Measure 50 permanent rates, local option levies, and other special levies overlaid against the Measure 5 limits.

In addition, property value growth is limited within the City of Portland because *approximately 12% of the total assessed value* in the city is within urban renewal districts. Under the statutes governing urban renewal, values within those districts are frozen until such time as all debt issued on behalf of the district has been retired. There are currently no plans to close out any of the 11 existing urban renewal districts prior to FY 08-09.

This forecast calls for moderate assessed value growth averaging between 3% - 4% annually. In addition, the forecast assumes that Measure 5 compression will cost the General Fund between 4% - 5% of the yield that would otherwise be available.

Figure 1, titled "Major General Fund Revenue Sources", highlights the importance of the Property Tax for overall revenue growth. It accounts for roughly 70% of total General Fund revenue.

Figure 1
Major General Fund Revenue Sources
$'s in Millions

			Forecast [1]		
	FY 04-05	FY 05-06	FY 06-07	FY 07-08	FY 08-09
Property Taxes	$ 184.8	$ 190.2	$ 197.3	$ 205.1	$ 213.8
Business Income Tax	26.7	26.9	27.5	28.0	28.7
Motor Vehicle Rental	10.9	11.2	11.6	12.1	12.6
A&T - Grant/Recording Fees	9.4	9.0	9.0	9.0	9.1
State Shared Revenues [2]	7.2	7.2	7.2	7.2	7.4
US Marshal Per Diem	6.2	6.2	6.2	6.2	6.2
Forest Service	1.3	1.3	1.3	1.3	1.3
	$ 246.5	$ 252.0	$ 260.1	$ 268.9	$ 279.1
All Other General Fund [3]	21.9	21.1	21.1	21.2	21.3
	$ 268.4	$ 273.1	$ 281.2	$ 290.1	$ 300.4
% of Ongoing Revenue (Exclusive of ITAX Revenue)	91.80%	92.30%	92.50%	92.70%	92.90%

Notes:

1. Based on current forecast (December, 2004)
2. State Shared includes Video Lottery and OLCC, Cigarette, and Amusement Device taxes
3. All Other GF excludes Beginning Working Capital (BWC) and ITAX

There are a handful of revenue sources that account for another 22% of the General Fund. Chief among these is the **Business Income Tax (BIT)** which has, historically, been extremely difficult to estimate with a high degree of accuracy. This forecast assumes modest growth in BIT revenues. Average annual growth is expected to fall within a range of 1.5% to 3% over the next five years. It is important to point out, though, that collections in any given fiscal year can fluctuate above or below those "average" figures.

Barring a precipitous decline, such as was witnessed between FY 99-00 and FY 00-01, this forecast could well prove to be conservative. Average annual growth in the BIT, adjusted for rate changes over time, has been slightly greater than 3% since collections were consolidated with the City of Portland's Business License Fee.

The other major sources of revenue in the General Fund are, in order, Motor Vehicle Rental Tax, state grant and recording fee revenue associated with the Assessment & Taxation function, and revenues received through sharing agreements with the State of Oregon.

Motor Vehicle Rental Tax revenue has essentially been flat ever since the events of 9/11/2001. The tourism industry has yet to return to pre-9/11 levels and airport traffic through Portland International Airport (PDX) is the chief driver associated with this revenue.

A&T related revenues have provided a source of good news over the past couple years but there is cause for caution in forecasting these revenues beyond the current year. The low interest rate environment has spurred a record level of mortgage refinancings and this has been the primary source of increased revenue. To put this in perspective, Recording Fee revenues in both FY 02-03 and FY 03-04 nearly doubled what we would expect in a typical year.

State shared revenues (Video Lottery, Liquor Tax, and Cigarette Tax) are a risk factor in this forecast. We have taken a conservative approach to forecasting those sources. In fact, you will note that we have left them flat for the next two years. During the last legislative session proposals were introduced that would have diverted the Video Lottery payments to counties for use in backfilling the state’s budget shortfall. Given that the state is forecasting another fairly significant shortfall we believe these proposals, and perhaps others, may be brought forward again during the upcoming session.

Most of the remaining General Fund revenues – those that account for about 8% of the total – are generated from fees and intergovernmental agreements. Since many of those fees and agreements are set at negotiated, flat rates (i.e.; jail beds leased to the US Marshal) there does not appear to be much opportunity for growth in those sources.

We will certainly be examining fee structures to determine if we can recover a greater share of direct program costs. But, we urge caution that even a 15% increase in total fees and charges would only generate about $700,000 in additional annual revenue.

Expenses

Overall expenditure growth is forecast to range from about 4.5% to 5% annually. At first glance that doesn't appear to be an excessive rate of growth. Keep in mind, though, that revenue growth is only forecast to range from about 2.5% to 3.5%. That imbalance translates to a structural deficit that is **forecast to be $6.2 million in FY 05-06**. We expect revenue growth to gradually improve over the latter half of the forecast period. As a result the annual gap between expenditures and revenue will eventually narrow.

And, if that was the only thing we had to contend with we could probably devise budget strategies to address that shortfall in any number of ways. It may be stating the obvious but the sunset of the ITAX creates a series of pressures that the County has never before experienced – even in the face of four straight years of budget reductions. When the ITAX sunsets the gap between ongoing revenue and expenditures is expected to be ***somewhere between $36 and $40 million.***

We have been extremely fortunate that the federal government has been successful in keeping inflation in check. Labor costs typically tend to drive overall expenditure growth and that is certainly true in this forecast. We have estimated that wage and benefit growth will average from 6% - 7.5% annually throughout this forecast period.

Wage growth, in general, is forecast to follow inflation. Inflation should not reach 3% during this forecast period. But, contractually negotiated classification surveys and merit increases may add as much as one percent annually to basic wage growth. As a point of reference, each percent change in wages translates to an additional $1.25 million in General Fund costs.

We will experience a fairly significant increase (about 4% of payroll) in our PERS rates next year. We expect to have sufficient reserves to offset some of that increase and it is likely any future PERS rate increases will be less onerous.

Multnomah County is not unlike most other organizations in its desire to manage and control employee healthcare costs. Although we have done a very good job of striking a balance between employer and employee cost sharing this forecast still assumes an 8% - 10% annual increase in healthcare costs.

Most other costs are forecast to grow with inflation. However, there is a fairly large portion of the General Fund that is, for lack of a better word, already committed. These costs include debt service payments, the BIT revenue sharing agreement with east county cities, state mandated court costs, and Elections. Many of these costs reflect the County's historical role in the delivery of state services. The agreements under which these responsibilities were set forth are certainly open for renegotiation but it is unlikely we will be able to effect any meaningful change during the upcoming legislative session.

<u>Forecast Risks</u>

There are a number of qualifications that need to be applied to this forecast. We see some significant risks in the short term that cannot realistically be quantified at this time.

- State budget shortfall for FY 05-07 biennium forecast at $1 billion (approximately 9% of the state General Fund.)

- Impact of Measure 37 related to land use and zoning regulations.

- Continued high energy costs and their dampening effect on the economic recovery.

- Federal budget deficits, particularly in light of the administration's emphasis on homeland security and foreign policy initiatives.

Summary

In conclusion, the Budget Office has identified a "structural deficit" that must be addressed in order to balance the FY 05-06 budget. The revenue available to purchase results is estimated to be slightly more than $310 million while the estimated cost of continuing "business as usual" is approximately $316 million.

In the following year the ITAX sunset presents a significant challenge. Programs funded with ITAX revenue are forecast to cost roughly $35 - $36 million in FY 06-07. This forecast assumes the revenue available to purchase results in that year will fall approximately $40 million short of maintaining all the programs currently supported by the General Fund.

Economic recovery will be slow. It is unlikely that we can count on economic growth alone to eliminate the structural deficit. The gap between expenditures and revenues narrows after FY 06-07 but revenue growth is not expected to exceed expenditure growth throughout this forecast.

Detailed expenditure and revenue figures developed for this forecast, along with estimates associated with a handful of Multnomah County economic indicators, are available upon request.