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TO: Bill Farver, Chief Operating Officer

FROM: Mark Campbell, Deputy Budget Manager

DATE: May 15, 2008

SUBJECT: Year End General Fund Forecast

I have completed a review of General Fund revenues and department spending through the third quarter of the current fiscal year. Based on this review I estimate that the final fund balance could be higher than forecast for the FY 2009 budget. There are a number of factors that contribute to this analysis and we will need to earmark some of the additional revenue to provide for unbudgeted commitments.

Overall revenue growth has continued to outpace the budget estimates to this point in the year. It appears likely that General Fund revenue will slightly exceed the level forecast in October. Expenditure patterns are a little bit more difficult to forecast with as high a degree of accuracy. Department spending through March is well below the threshold level we would expect at this point in the year. A closer review suggests that, after accounting for budget appropriations reserved for open labor contracts, overall expenditures will end up close to historical levels. Historically, departments spend about 98% of their appropriations.

Revenue Forecast

The economic landscape has changed quite a bit since the initial General Fund forecast was developed. However, the factors contributing to a softening of the national economy have, until recently, been largely unrealized in Portland and the region. Business Income Tax (BIT) collections, for example, continue to exceed expectations and may reach $60 million for the current fiscal year.

The following table highlights the change in the General Fund revenue forecast from October to April:

FY 2008, Q3 (April)	$403,410,000
FY 2008, Q1 (October)	399,735,000
Variance Over/(Under)	$ 3,675,000

This represents a positive variance of slightly more than one percent of General Fund revenues. Although net revenues are up from the previous forecast there are a few sources that will need to be monitored closely as they may have a negative impact on the FY 2009 budget.

As has been the case over the past few years, BIT revenues will likely exceed both the budget and the first quarter forecast. BIT revenue has been up in every quarterly forecast for the past three years. This trend is likely to be reversed in the coming quarters. Here is an overview of the BIT for FY 2008 as well as the budget estimate for FY 2009:

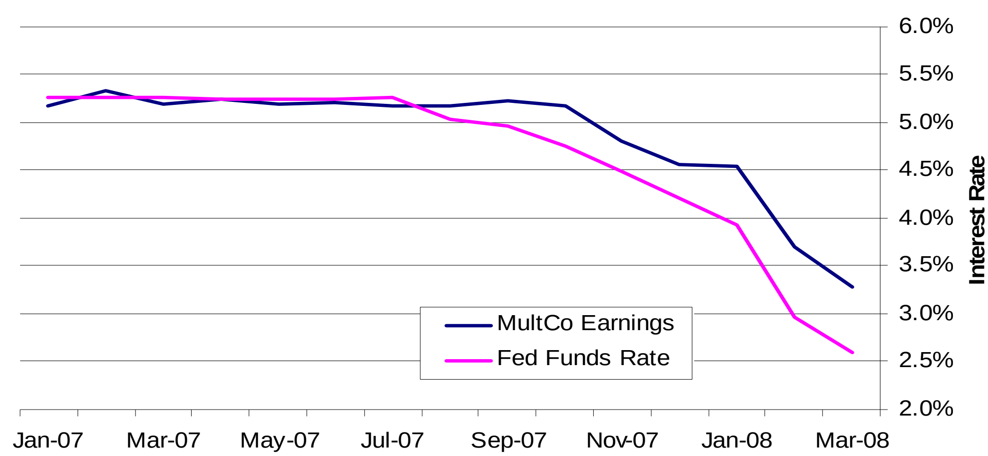
FY 2008 Budget	$52,215,000
FY 2008 Q1 Forecast	$56,251,000
FY 2008 Q3 Forecast	$60,000,000
FY 2009 Budget	$54,845,000

Should BIT revenue reach $60 million it would represent a ***4.5% increase*** over collections in the previous fiscal year. The first quarter forecast assumed BIT revenues would decline by 2% to reflect slowing economic conditions.

The increase in the BIT accounts for virtually all of the additional revenue in this forecast. There are a handful of other revenue sources that net to the balance. These include Recording Fees, Interest Earnings, US Marshal reimbursements, and Indirect Costs. Overall these sources are down by less than $100,000 from the first quarter forecast but the decline is most pronounced in two sources that have implications as we head into the new fiscal year.

Interest earnings could be down more than half a million dollars from the first quarter forecast. It should be noted that the previous forecast was developed prior to the latest round of interest rate cuts by the Federal Reserve Bank. As late as November, we were earning over 5% on our investment portfolio. The current yield annualizes to a rate of 3.7% and, as a rule of thumb, each percent change in the interest rate translates to about a million dollars of General Fund earnings.

The first quarter forecast assumed that our investment portfolio would yield an annualized 4.5% rate of return. As the following chart highlights, earnings have declined along with recent changes in the federal funds rate.



Likewise, we are seeing the first glimpse of a housing slowdown in our Recording Fee revenues. This will be the first year in the past five that Recording Fee revenue will fall below $5 million. The estimate for the current year is now $4.4 million, <u>down about $300,000 from the first quarter forecast</u> and more than a million dollars lower than the budget for FY 2008.

US Marshal reimbursements are forecast to generate about $5.7 million in General Fund revenue this year. That is <u>up about $300,000 from the first quarter forecast</u>. The increase is reflective of two things. The Sheriff's Office negotiated a new per diem rate with the Marshal's Service that became effective in March. Although the budget for FY 2008 was developed on the basis of a higher rate the Marshal's Service is also using between six and ten beds more per day than was assumed in the budget. The combination of the new rate and higher bed day usage is the basis for the increase in the forecast.

Other miscellaneous departmental revenues and indirect costs are estimated to be <u>about $425,000 higher</u> than originally forecast. This largely represents changes in volume (e.g; number of food handler licenses, restaurant inspections) and the addition of dedicated grant revenues throughout the year.

The following table highlights the change in estimated FY 2008 revenues since the Q1 forecast was developed last fall.

Increase in BIT	$3,750,000
Reduction in Interest Earnings	(500,000)
Reduction in Recording Fees	(300,000)
Increase in US Marshal Reimbursement	300,000
Increase in Other Misc/Indirect Costs	425,000
Total – Net Change in Revenues	**$3,675,000**

<u>**Department Spending**</u>

In an average year departments spend about 98% of budgeted appropriations. I have done a straight line spending projection based on year-to-date (YTD) actuals through March. The benchmark spending should be at 75% - representing three-quarters of the year. Total YTD spending is currently tracking at about 67%, which annualizes to approximately 92% of appropriations.

This represents such an aberration from historical spending patterns that there are certainly factors to explain the wide variance. The first quarter forecast used the 98% historical figure to estimate the FY 2009 carryover. Department current year estimates (CYE) submitted with program offers generally validated this estimate.

Estimated Savings @ 98%	$6,615,000
Department CYE Submitted 2/14	$6,879,000

The updated forecast indicates a slightly lower overall level of spending that could translate to additional savings. It is also unlikely that the entire General Fund contingency will be allocated before the end of the year and, as of May 1st, that balance is estimated to be $1.4 million.

A closer examination of spending patterns suggests that most of the additional forecast savings are related to Personal Services costs. Much of this has to do with the status of labor contracts with the Multnomah County Corrections Deputies Association (MCCDA), the Fraternal Order of Parole and Probation Officers (FOPPO), and the Juvenile Custody Services Specialists (JCSS). When the FY 2008 budget was prepared it assumed a 2.7% cost of living adjustment (COLA) for all employees. Contract negotiations with these three groups have yet to be completed and, therefore, the COLA budgeted for them will not be allocated this year.

Another factor that impacts the forecast for Personal Services has to do with the way that PERS costs were estimated in the FY 2008 budget. The rate charged to non-uniformed employees in the Oregon Public Services Retirement Plan (OPSRP) are about a percent higher than the rates charged to "regular" PERS employees. The opposite is true for uniformed employees. The first quarter forecast assumed that all employees would be charged at a weighted average of the higher rates.

This would tend to produce a more conservative – higher level of spending – Personal Services costs. A more thorough analysis of the County's demographics indicates that only about 20% of the workforce is covered under the OPSRP program. Most departments will, thus, realize some savings from the effect of having lower PERS costs. I estimate this additional savings to be slightly less than $1 million. These savings should be viewed as a one-time-only resource because the FY 2009 budget was built using the correct, updated PERS rates.

When I account for these two factors General Fund expenditures are forecast to be about 97.5% of appropriations, which is much closer to historical spending patterns.

Impact on Ending Fund Balance

The Approved Budget assumed that the General Fund balance would be $53 million. This is the source of one-time-only (OTO) funds in the FY 2009 budget.

Forecast FY 2009 BWC	$53,109,000
(Less) General Fund Reserve	(14,000,000)
Available for OTO Uses	$37,109,000

Based on the revised forecast I estimate that the General Fund balance available for use in FY 2009 will be higher than budgeted. Given the sources that generated the additional forecast carryover it is virtually certain that this should be treated as OTO revenue.

However, we will need to reserve a portion of the additional carryover in order to provide for labor contract settlements that I previously described. There are also a few risks to the FY 2009 budget that have been identified and we will want to be prepared to address them.

I have estimated that we will need to hold approximately $2.1 million aside to provide an FY 2008 COLA to the three labor unions who have open contracts. This is based on the assumption that the COLA will mirror the increase provided for other bargaining units. That amount would be split between the Sheriff's Office (about 75% of the total) and DCJ (25% of the total.) This represents the total estimated liability, including overtime and premium pay, although it is likely that some of the costs will be incurred in funds other than the General Fund.

We will need to allocate an additional $500,000 to provide funding for Class/Comp studies based on the contract between the County and AFSCME/Local 88. This is in addition to approximately $750,000 that I expect we will carry over into next year.

As a result of the Employee Relations Board (ERB) ruling in the case of MCCDA v. Multnomah County we will need to bargain with the union over issues related to the integration of a number of positions into the Pretrial Supervision continuum of services. At this time we have not made provision for any costs that might be incurred as a result of these negotiations.

I expect we will begin to feel the impact of the softening economy during the upcoming fiscal year. I believe the revenue forecast for FY 2009 was fairly conservative based on the economic conditions at the time it was developed. The economic slump has accelerated at a pace that, frankly, neither I nor other economic analysts anticipated. This can best be illustrated by the various interest rate reductions made by the Federal Reserve over the past several months. In November the federal funds rate was still hovering around 4.5%. Today it is at 2%.

The specific revenues that may be impacted by an economic downturn are Property Tax, BIT, Recording Fees, and Interest Earnings. I am certain that Interest Earnings are budgeted too high based on the recent actions of the Federal Reserve. It is also likely that Recording Fees will need to be revised downward based on recent trends. Although it is not linked to the economy the revenue we have received from the City of Portland for the P57 program is likely to be reduced in FY 2009.

The table below highlights my preliminary reduction estimates for those sources:

Interest Earnings	$(1,800,000)
City of Portland	(915,000)
Recording Fees/A&T Grant	(460,000)
Total – Net Change in Revenues	**$(3,175,000)**

I have modeled a downturn in the BIT that assumes a recession similar to the most recent one. BIT revenues declined in FY 2001 by 12% - a similar reduction would take nearly $7 million out of our revenue stream. I am not inclined to adjust the BIT revenue at this point because the amount budgeted for FY 2009 is already about $5.2 million lower than estimated FY 2008 collections. We will want to revisit this assumption in the fall.

Summary and Recommendations

Based on a YTD review (through March) it is likely that the General Fund ending balance will exceed the previous forecast. FY 2008 revenue growth will provide about $3.6 million more than is estimated for FY 2009 Beginning Working Capital. Year end spending forecasts are a little more difficult to predict but overall spending should be lower than estimated in the first quarter forecast.

At a minimum, we will also need to reserve funds to cover labor contract obligations. I estimate that we will need to add approximately $2.6 million to contingency to cover retroactive wages and Local 88 Class/Comp studies. I would also recommend that we weigh any decisions regarding additional spending against the potential outcome of ongoing contract negotiations.

There are a number of risks to the forecast for FY 2009 and we will need to address those in some way. The softening economy presents the single biggest risk in the short term. I would, therefore, **encourage you to devote $3 million to a "Rainy Day Fund"** which would be in addition to budgeted reserves and contingency. This fund could be accessed if economic conditions have a more negative impact on our revenues than I assumed in the previous forecast.

If applied in this way **we would allocate all of the forecast additional BWC** to ensure the maintenance of core programs and provide funding to meet contractual obligations. Any additional departmental savings above this forecast could be considered as a source to fund OTO projects. I have attached the estimated savings we might expect from each department for your consideration. The revised projection also provides a comparison to the current year estimate provided by the departments in February.

Estimate Underspending by Department
Comparison of Forecast Used for Executive Budget to Department CYE Submitted w/ Program Offers

	October (Budget) Forecast	Dep't CYE (as of 2/15)	Revised Forecast	Wage Settlement Estimates	Other FY08 Uses	Net Revised CYE (as of 5/1)	% of Budget
NonDepartmental	$ 336,348	$ 200,000	$ (3,282)			$ (3,282)	
District Attorney	393,953	358,738	561,321			561,321	2.85%
County Human Services	907,181	1,151,952	2,258,259		(1,500,000)	758,259	1.67%
Health	1,073,510	(414,929)	864,528			864,528	1.61%
Community Justice	1,072,446	1,749,657	2,106,743	(500,000)	(125,000)	1,481,743	2.76%
Sheriff's Office	1,971,926	2,271,863	2,637,971	(1,600,000)	(110,000)	927,971	0.94%
County Management	635,960	1,072,666	1,758,057		(150,000)	1,608,057	4.82%
Community Services	224,307	489,756	610,259			610,259	5.44%
Total - All Departments	$ 6,615,630	$ 6,879,703	$ 10,793,856	$ (2,100,000)	$ (1,885,000)	$ 6,808,856	2.03%
Overall Forecast Savings	2.00%	2.05%	3.22%				

Notes:
Wage Settlement Estimates = MCCDA, FOPPO, and JCSS Contracts Still Being Bargained, Carryover Assumed FY 2008 COLA