CITY OF SALEM, OREGON

BUILDING AND SAFETY FUND

FIVE YEAR FINANCIAL FORECAST

FISCAL YEARS 2013-14 THROUGH 2017-18

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Executive Summary

The building and safety fund continues to ensure public safety while providing predictable, efficient and friendly service. Building and safety provides plan review, permitting and inspection of residential and commercial construction, non-construction permits and regulatory licenses.

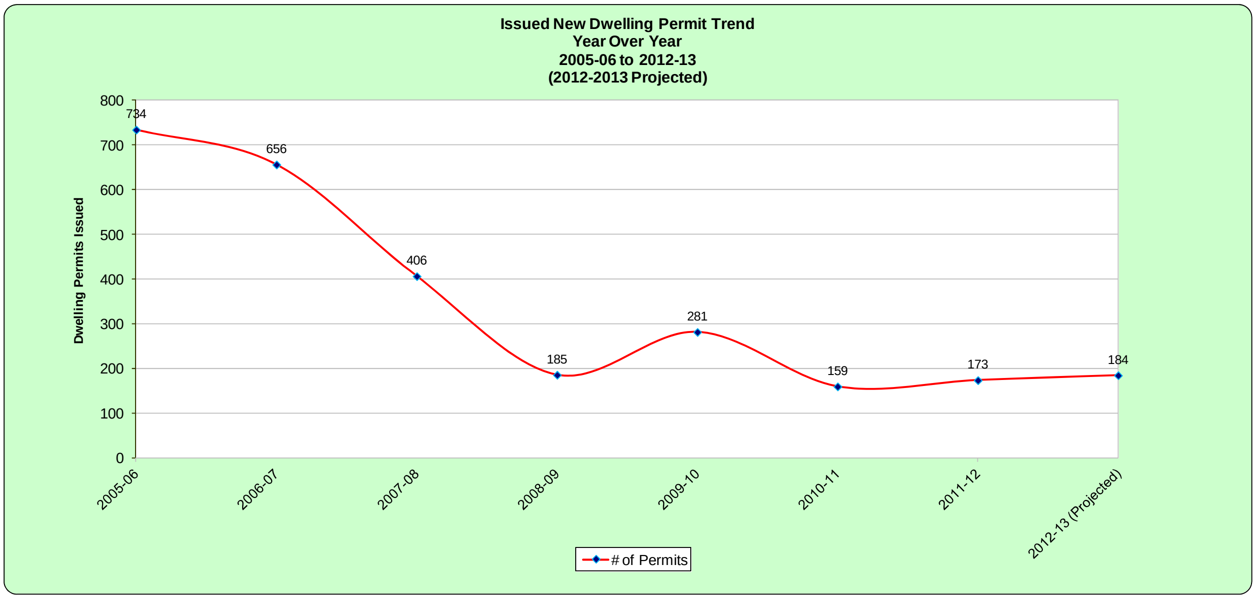
As the nation slowly moves out of the recession, permitting activity has begun to show a slight increase. There is only one forecast scenario (Schedule A) presented this year because even with slight increases in staffing to meet workflow increases, the fund is able to present a balanced budget.

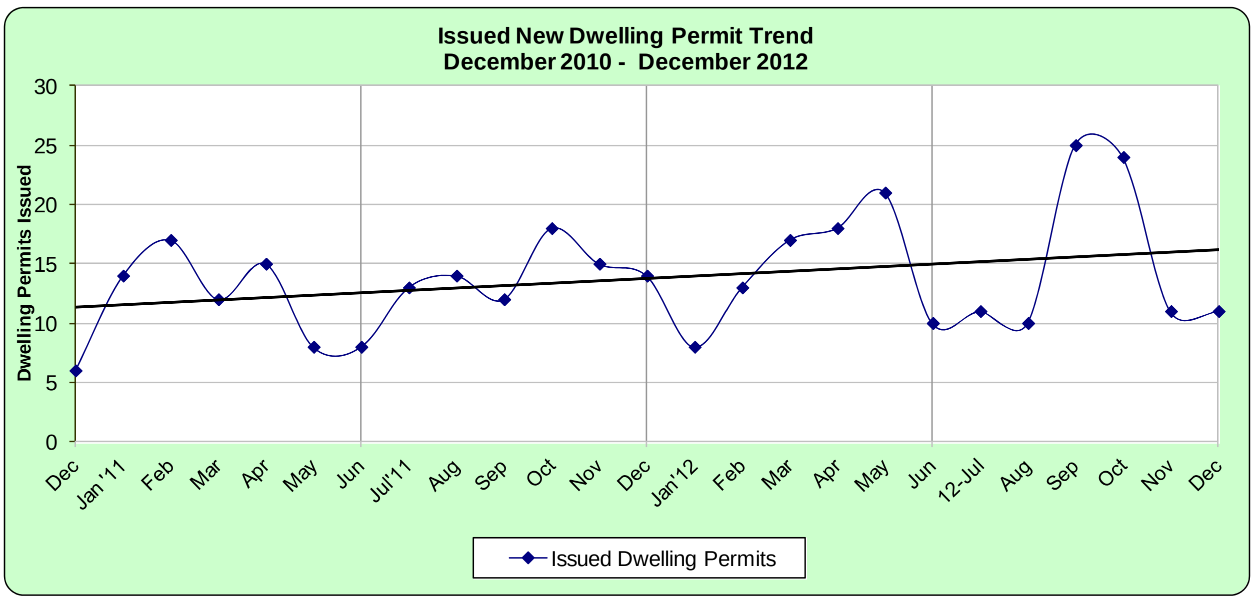
Over the forecast period the fund does make use of its capital asset reserve for its intended purpose which results in a slight decrease in ending fund balance (working capital). Over the forecast period, fund balance continues to exceed the requirements of the service stabilization reserve and contingency. Highlights of this forecast include:

- An estimated 2 percent annual increase in revenues to account for increased permitting activity.
- Projected revenue increases for building permits and other revenue include the tentative implementation of indexing fees to the Consumer Price Index (CPI) in January of 2015.
- Increased workflow may require decisions regarding increasing staff to meet demand.
- PERS increases have a significant effect on fund expenses.

Economic Outlook

While permit activity has not recovered to pre-recession levels, the activity has begun to show a “slow and steady” recovery as many economic indicators and state economists have predicted.





- Permitting activity for new dwelling permits decreased drastically leading up to the 2008 recession.

- After hitting a low point in FY 2008-09 (185 permits), there was an uptick in activity for FY 2009-10 (281 permits) driven by multiple incentives for first time home buyers.

- After the expiration of the incentives, FY 2010-11 permits declined below the FY 2008-09 low (to 159 permits).

- FY 2011-12 permits increased 8.8 percent over FY 2010-11 (to 173 from 159).

- FY 2012-13 permits total 92 through December (184 projected for year-end if trend continues, for an additional 6.4 percent increase over FY 2010-11).

- Multifamily permits have increased even more substantially, from 7 in FY 2010-11, to 9 in FY 2011-12, to 17 through December in FY 2012-13.

Forecast Results

The building and safety forecast provides a view into the financial impact of typical operating decisions and service priorities of the fund in relation to projected business activity through 2018. This view is influenced by management decisions to increase staffing levels to accommodate the expected increase in workflow. Additionally, the forecast leverages the same assumptions for expenditure activity over five years as the general fund. Primary drivers of expense increases include wages, PERS, health care costs, energy costs, technology improvements, and inflationary increases. Tables for the expenditure assumptions are included in the appendix section of this report.

This forecast is presented in a single schedule as the fund only slightly reduces its fund balance over the course of the five years and maintains the six-month service stabilization reserve and a sound capital asset reserve. While there is a reduction in the fund balance from $3.62 million to $3.34 million over the forecast, the $3.34 million fund balance at the end of the forecast is adequate to cover budget contingencies, capital assets reserves, and the service stabilization reserve that is filed with the State of Oregon’s Building Codes Division.

Values are in millions and have been rounded to the nearest ten thousand. The schedule builds out the forecasted years using the 5 month actuals of FY 2012-13 as the base year, to re-project fiscal year revenue trends and adjust the base for known on-going service level changes.

Current Service Level – Schedule A

Schedule A - FY 2013-14 Five Year Building & Safety Fund Financial Forecast

(in millions)

	FY 12-13 Budget	FY 12-13 Projected*	FY 13-14 Forecast	FY 14-15 Forecast	FY 15-16 Forecast	FY 16-17 Forecast	FY 17-18 Forecast
RESOURCES							
Beginning Working Capital	$ 3.39	$ 3.57	$ 3.62	$ 3.53	$ 3.46	$ 3.39	$ 3.37
Current Year Revenue	1.92	2.90	2.96	3.04	3.16	3.29	3.42
TOTAL RESOURCES	5.31	6.47	6.58	6.58	6.63	6.68	6.79
EXPENDITURES							
TOTAL EXPENDITURES	3.17	2.84	3.05	3.11	3.24	3.31	3.45
Estimated Ending Working Capital	2.14	3.62	3.53	3.46	3.39	3.37	3.34

*** Projected Excludes FY 12-13 reappropriations and carryovers.**

Revenue Forecast

Building permit data shows activity has stabilized and moved into a period of slow growth. The good news is that the housing permits are on the rise and valuations are increasing for both residential and commercial projects. This is consistent with Economist Tim Duy's prediction that slow, steady growth will continue. Based on these reports and information from the National Homebuilders Association, a 2 percent increase in revenues has been applied each year. In addition, the fund will work with the building community to implement an annual increase to permits based on an agreed Consumers Price Index (CPI) starting in January 2015.

Table 1	**Fiscal Year**				
Revenue by Source	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Building Permits	$2.79	$2.87	$2.99	$3.11	$3.23
Other	0.05	0.05	0.05	0.06	0.06
Intrafund-Budgeted Transfer	0.12	0.12	0.12	0.12	0.13
Total Current Revenue	2.96	3.04	3.16	3.29	3.42

Expenditure Forecast

The expenditure forecast is developed based on “most likely” increases in the cost of goods and services. When available, it uses known expenditure information such as labor agreements, vendor contracts, PERS rate and health care cost increases, and inflation factors. Future costs associated with higher PERS costs are included beginning in FY 2013-14. The assumption tables for all expenditures are included in the appendix.

Table 2	Fiscal Year				
	2013-14	2014-15	2015-16	2016-17	2017-18
Personal Services	$ 2.16	$ 2.21	$ 2.32	$ 2.38	$ 2.51
Materials & Services	0.87	0.88	0.90	0.91	0.92
Captial Outlay	-	-	-	-	-
Subtotal Department Expenditures	3.03	3.09	3.22	3.29	3.43
Transfers	-	-	-	-	-
Contingency	0.02	0.02	0.02	0.02	0.02
Total Base Expenditures	3.05	3.11	3.24	3.31	3.45

Financial Forecast Risks and Rankings

Risks to Revenue Forecast

The forecast acknowledges that there are risks associated with sustaining the resources needed to fund current and future services. Each identified risk is evaluated on the degree it will impact service delivery and assists in determining courses of action to be taken over the five year period.

The identified risks to the building and safety fund's resources are summarized below:

- Building Permit Revenue
- Recession

Building Permit Revenue – Building permit revenue accounts for 88 percent of all revenue of the building and safety fund. As such, changes in this revenue source can have a drastic effect on the fund revenues overall. From a peak in the measured information of new dwelling (SFD/Duplex) permits issued by year in FY 2005-06 of 734, annual activity decreased 78 percent to 159 permits issued in FY 2010-11. Activity appears to have stabilized and begun to show a modest increase year over year, which is consistent with state economists' projections.

> Risk Factor Ranking – HIGH
> Because this revenue is derived from activity that is influenced primarily by outside sources (supply/demand, consumer confidence, credit availability, economic health, etc), and at the same time represents such a large percentage of the total revenue for the fund, even slight swings in this revenue source can have drastic effects. Activity is measured on a monthly basis and economic trends are reviewed to help ensure the city can respond to changes accordingly.

Recession – The risk of a recession is difficult to measure at this time due to the uncertainties in Congress and the continued slow economic growth that makes the US economy vulnerable to an external shock. As of November, economists estimate the risk of a recession occurring within six months between 28-32 percent.

Risk Factor – LOW

While a recession is not a primary driver for modeling assumptions, it is considered a potential risk should slow economic growth, low job growth and unanswered federal policies continue into the out years of the five year forecast.

Risks to Expenditure Forecast

The following summarizes identified risks to the expenditure forecast. Each identified risk is evaluated on the degree it will impact service delivery and assists in determining courses of action to be taken over the five year period.

- PERS Employer Rate Increases
- Health Care Costs
- Labor Union Agreements
- Inflation

PERS Employer Rate Increases - The overall PERS employer contribution rate for the city will increase 48 percent for the two years beginning in FY 2013-14. Building and safety's total contribution will increase from $149,000 to $240,000, a total increase of 61 percent, resulting from increases to staffing levels. Last year's forecast anticipated a 23 percent increase based on the advisory rates provided by the PERS Board. At that time, the fund had planned for an additional $34,000 in PERS costs. Beginning in FY 2013-14 that amount is now estimated at $91,000. The forecast also assumes a 25 percent PERS rate increase in FY 2015-16 and FY 2017-18. A table of the rates by tiers is provided for comparison. Rates are adjusted every two years to meet pension funding requirements.

Table 3	Actual FY 07/08	Actual FY 09/10	Actual FY 11/12	Actual FY 13/14	Projected FY 15/16	Projected FY 17/18
Tier 1 and 2	8.65%	6.12%	12.93%	19.06%	23.83%	29.78%
OPSRP Fire & Police	12.23%	7.08%	11.85%	17.41%	21.76%	27.20%
OPSRP General Services	8.96%	4.37%	9.14%	14.68%	18.35%	22.94%

Risk Factor Ranking – HIGH

The significantly higher rates reflect the continued low investment earnings on the pension fund assets and the level of contributions needed to make benefit payments to members not paid for from these earnings. All PERS member employers are experiencing similar increases. PERS estimates the contribution rate increases will cost Oregon PERS employers about $900 million more in the 2013-15 biennium; local governments will carry about $260 million of this cost. The PERS Board is directed to provide policy advice to the Legislature on proposed changes to PERS in the upcoming session. If additional PERS reforms are not enacted by the Legislature, or if revenue forecasts are not realized, the city may be required to make some mid-year cost reductions in FY 2013-14 to meet the forecasted working capital target over the five year period.

Health Care Costs – The forecast assumes that health care costs will increase by 10 percent for the next three years of the forecast which is slightly lower than the national standard but still within industry trends. The city's rates are developed annually based on a formal analysis with the assistance of a consultant knowledgeable in the industry. Rates are set based on a review of national and state-wide health care cost trends, legislative health care reforms, and primarily, from the city's claims activity from previous years. The forecast includes the Patient Protection and Affordable Care Act program for transitional reinsurance. This program requires the collection of a fee from health insurance issuers for three calendar years (2014-2016) to fund a reinsurance premium stabilization fund. The fee is estimated at $63 per "covered lives," which equates to a cost of about $4,340 per year for building and safety.

Risk Factor Ranking – MEDIUM
Health care costs could be higher or lower depending on a variety of difficult-to-forecast measures including; increased costs in the health care industry, future illnesses affecting the amount of filed claims or the impacts associated with the Patient Protection and Affordable Care Act due to go into effect in 2014.

Labor Agreements – Approximately 78 percent of building and safety's workforce is represented by AFSCME. Approximately 73 percent of building and safety's service costs are personnel related, making labor agreements a significant cost driver. Wage increases associated with the most recent agreements are incorporated into the forecast. For years beyond these agreements an assumed 1 percent wage increase is used. For non-represented employees a 2 percent increase is assumed in year one, with 1 percent for remaining years.

Risk Factor Ranking – MEDIUM
The AFSCME labor agreement will expire on June 30, 2013, and negotiations will begin this winter. The risks associated with increased costs from future labor negotiations are difficult to measure at this time.

Inflation – The Bureau of Labor Statistic reported in August that the Consumer Price Index-All Urban Consumers (CPI-U) for the Portland-Salem, OR-WA area increased 1.2 percent in the first half of 2012, up 2.5 percent from a year ago. For purposes of forecasting, 1.6 percent was used as a CPI-W on all general goods and services.

Risk Factor Ranking – LOW
The risks of higher inflation is regularly debated by economists as the Federal Reserve continues the use of quantitative easing monetary policies to increase economic activity. Rising gasoline prices in mid-2011 influenced cost of living indexes; however the index as of October is declining as energy prices have fallen. We expect energy prices to continue to fluctuate over the forecast period, and this risk factor may rise to a higher level in future forecasts.

Over the five year forecast period risk factors with medium rankings will be monitored and action will be taken should they begin to move to a higher risk status. All high ranking risks will have active engagement of staff to work towards effectively lowering the city's exposure.

Forecast Risk Revenue	Ranking	Percent Total Revenue
Building Permit Revenue	HIGH	88%
Recession	LOW	

Forecast Risk Expenditures	Ranking	Percent Total Expense
PERS Employer Rate Increases	HIGH	11%
Health Care Costs	MEDIUM	11%
Labor Agreements/Salary Costs	MEDIUM	29%
Inflation	LOW	

APPENDIX

Expenditure Assumption Table

WAGE PROJECTIONS:	FY 13-14 % Increase	FY 14-15 % Increase	FY 15-16 % Increase	FY 16-17 % Increase	FY 17-18 % Increase
Market Adjustment - AFSCME	1.00%	1.00%	1.00%	1.00%	1.00%
Market Adjustment - Police (SPEU)	2.00%	1.00%	1.00%	1.00%	1.00%
Market Adjustment - Fire (IAFF)	1.00%	1.00%	1.00%	1.00%	1.00%
Market Adjustment - Non-Represented	2.00%	1.00%	1.00%	1.00%	1.00%
ANNUAL PERCENTAGE CHANGE IN BENEFIT PROJECTIONS:					
Health - All Other	10.00%	10.00%	10.00%	8.80%	9.20%
Dental	7.00%	7.00%	7.00%	7.00%	7.00%
Vision	5.00%	5.00%	5.00%	5.00%	5.00%
Worker's Compensation	2.00%	2.00%	2.00%	2.00%	2.00%
Life Insurance and Disability Insurance	0.00%	0.00%	0.00%	0.00%	0.00%
Retirement - Employer Tier 1 & 2	47.00%	0.00%	25.00%	0.00%	25.00%
Retirement - Employer - OPSRP Non-Safety	60.60%	0.00%	25.00%	0.00%	25.00%
Retirement - Employer - OPSRP Police and Fire	46.90%	0.00%	25.00%	0.00%	25.00%
PERS RATE ON ELIGIBLE EARNINGS:					
Retirement - Employer Tier 1 & 2	19.06%	19.06%	23.83%	23.83%	29.78%
Retirement - Employer - OPSRP Non-Safety	14.68%	14.68%	18.35%	18.35%	22.94%
Retirement - Employer - OPSRP Police and Fire	17.41%	17.41%	21.76%	21.76%	27.20%
MATERIALS AND SERVICES:					
Base	1.60%	1.60%	1.60%	1.60%	1.60%
Natural Gas	-1.00%	-1.00%	0.00%	1.00%	1.00%
Electric	0.00%	0.00%	0.00%	0.00%	0.00%
Refuse Disposal	0.00%	0.00%	1.00%	1.00%	1.00%
Radio Communications	3.50%	3.50%	3.50%	3.50%	3.50%
Motor Pool (Fleet Services)	2.00%	2.00%	2.00%	2.00%	2.00%
Liability Insurance	0.00%	0.00%	0.00%	2.00%	2.00%