City of Salem, Oregon
Five Year Forecast
General Fund

Fiscal Years 2013-14 through 2017-18

New Hoodview Neighborhood Park

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Executive Summary

The city continues to manage its resources in a fiscally prudent manner and has made changes in service delivery as needed to work our way out of the prolonged recession. The general fund provides core, day to day operations in the areas of public safety, planning, code enforcement, municipal court, parks and recreation, urban development outside of Urban Renewal Areas, and a proportionate share of centralized services, including the City Manager's Office, finance, fleet, human resources, information technology and legal. The general fund services are delivered in a way that ensures compliance with federal, state and city regulations and implements City Council goals and direction. Providing general fund services has become more challenging each year as the nation slowly moves out of the recession. The forecast presented this year continues to show the city must stay the course on being fiscally conservative with spending and maintain an adequate ending working capital balance until our revenue picture improves. Highlights of this forecast include:

- Current revenue growth does not keep pace with the growth in operations costs.
- Marion County real market values on residential properties have declined by 24 percent in the last four years.
- Measure 5 tax compression increased at a higher rate than anticipated in prior years, primarily caused by the real market value declines.
- The higher mandated PERS rates are unsustainable over the five year forecast period without major expenditure reductions.
- Without further budget reductions each year the working capital will be depleted by year four of the forecast.

Economic Outlook

National

The forward momentum continues to build at a slow but steady pace for the US economy. The housing market has gradually started to strengthen, the most recent unemployment rate has fallen to 7.8 percent, auto sales are growing and state government revenues are forecasted to improve in the coming year. These improvements are encouraging, but a much more rapid recovery is needed to significantly impact city general fund revenues.

In the State of Oregon's December 2012 forecast report, the national economic review indicated that the US economy is "crawling into the winter" with overall gross domestic product growth in 2012 expected to be 2.1 percent with 2013 projections of 1.8 percent. The slowdown in the global economy has impacted exports to Europe and China, and business spending on equipment has declined; both key drivers of the recovery.

On the brighter side two key recovery drivers are showing favorable increases. The housing industry appears to be recovering as demand is increasing for both multi and single-family homes. The National Association of Realtors reported that pending home sales increased in November for the third straight month and reached the highest level in two-and-half years. Their chief economist stated that home sales are recovering now based solely on fundamental demand and favorable affordability conditions. Vehicle sales continue to reflect high demand due to favorable credit conditions and the need to replace aging fleets.

The US Department of Labor report shows job growth of 155,000 in December; the average monthly growth for 2012 is 150,000 jobs. The growth was enough to keep the unemployment rate steady at 7.8 percent, but is still weak relative to historical standards following a recession. While these figures are disappointing considering the number of people still unemployed, they point to improved conditions. The drivers for job gains for December were from health care, food services, construction and manufacturing. However, it is speculated that Hurricane Sandy may have influenced the gains seen in construction and manufacturing for this period.

As the US federal policy environment continues to create uncertainty, it influences the degree of risk-taking by businesses and consumer confidence. The Federal Reserve's monetary policy of quantitative easing and tying the continuation of this policy to goals of lower unemployment and inflation should keep money market rates near current lows through mid-2015. Some aspects of the "fiscal cliff" have been addressed, but addressing the federal spending cuts and debt ceiling that were deferred to the 113th Congress are still to be resolved in 2013, which may cause additional uncertainty in the market.

Oregon

The Oregon Economic and Revenue Forecast for December 2012 described the state's economic growth as "stuck in low gear." Growth is slow and steady but tends to come in "fits and starts - a strong quarter or two followed by a weak quarter or two." Oregon's recovery reflects what is occurring nationally with some notable differences.

The recent global slowdown is largely attributed to the decline in the global manufacturing cycle which has impacted orders and shipments across a wide range of Oregon products. In 2012, exports to the state's largest trading partners were flat or declining. All Asian economies combined, representing 59 percent of Oregon exports, have seen trade decline. China and Malaysia, which accounted for approximately 30 percent of all exports in 2011, are currently down 21 percent year-to-date. Japan and South Korea, at 15 percent of the state's total exports, are flat for the year. On the bright side, the 19 percent of trade to North American countries (Canada, Mexico and Costa Rica), continues to grow with many of these exports related to farm and mining equipment.

The Oregon Economic and Revenue Forecast stated that home prices are rising in the Portland-Metro Statistical Area, however, the remainder of the state has yet to see a sustained uptick. The Zillow Home Value Index estimates the median home price in the state at $196,400, up 2.8 percent year over year. Housing starts for Oregon have generally followed the national trends. Housing permits continue to grow from a very low base. Recent permit activity is approximately 40-50 percent larger than a year ago; increasing about 90 percent from the low point during the recession. Most of this activity is in multi-family construction which is building at about 75 percent of the industry's long-term average, and the number of units with single-family construction at about 50 percent of its average. While this is encouraging and exhibits an industry that is poised for growth, that growth is projected to be modest over the next two years. Significant additional construction activity is needed to reach the pre-recession construction activity.

The job market continues to expand slowly; 25,000 jobs in the past year. It is anticipated that job growth will be subdued into early 2013 with a rise to previous 2008 peaks sometime in 2014. The reported November 2012 Oregon unemployment rate was 8.4 percent, which is above the national rate but is trending down. Over the past year, job gains have been widespread across the private sector with the largest gains in professional and business services, hospitality, and retail. Manufacturing gains were primarily in durable goods, particularly metals and machinery. Not surprisingly, public sector employment fell over the same period; however this loss has decreased in recent months.

Salem

The December Oregon Economic Forecast reported that the Willamette Valley region saw its first positive employment growth in the third quarter of 2012 with an increase of 0.4 percent from the previous year; the combined Salem metropolitan area growth was 0.2 percent. Overall, this region is having a difficult recovery due to the lack of sustained job gains. The unemployment rate was 8.7 percent for the third quarter, down 0.8 percent from the prior year rate of 9.5 percent. The state does expect employment growth for the region to rise early in 2013 due to stronger job gains predicted for the Salem and Eugene Metro Statistical Areas. Since May 2012, SEDCOR, Business Oregon, and the city, report more inquiries from manufacturing sector businesses interested in locating in Salem – from agriculture to high tech firms. In addition, we believe some local traded sector companies are positioning to expand and grow within the next year. Other traded sector businesses are retooling their operations in Salem and reinvesting in equipment. Although these trends have not yet translated into noticeable increases in local jobs or private investment, they are positive indicators the local economy is improving.

Marion County real market values on residential properties have declined by $1.6 billion (24 percent) in the last four years, which has significantly increased the incidence of property tax compression over this period. Polk County has not experienced this rate of decline and is not experiencing compression for general government services at this time. The foreclosure rate for both counties is .02 percent compared to the state rate of .04 percent. RealtyTrac estimated that one in every 4,291 homes in Salem received some form of foreclosure filing; the form can be from a delinquent notice to a bank required foreclosure filing. The Zillow Home Value Index estimates the November 2012 median home price in Salem at $153,300 down 0.9 percent year over year. The median home value in November 2008 was $189,000. The 2012 index, quarter-over-quarter, shows a slight increase of 0.3 percent which may indicate that values have reached their lowest levels and will begin to rise in 2013. On a more positive side, although low, housing starts for Salem have seen an increase in the past year, most notably in multifamily construction permits. Single-family permits began to show gains in FY 2011-12, rising from 157 issued permits in FY 2010-11 to 173. For FY 2012-13, 92 permits have been issued for the first six months of the year. Multifamily permits have increased year over year starting from 7 permits issued in 2010-11 to 17 permits issued for the first six months of FY 2012-13.

The city’s population grew by 0.5 percent in 2012; the ten year average is 1.04 percent.

The Portland State University Population Research Centers' certified estimate of Salem's population for 2012 is 156,455.

In summary, Salem's index of economic activity, while improving, is still at a very low growth rate and reflects the "slow and steady" message coming from state economists. This will mean the city will need to continue to make ongoing reductions in FY 2013-14 and over the five year forecast period.

Forecast Results

The general fund forecast provides a view into the financial impact of the city's services, priorities and policies in relation to projected economic activity through 2018. This view is influenced by US and state economic factors and trends, local business activity and property development, and the growth in primary revenue sources, of which property taxes provides 57 percent of the fund's total resources. Additionally, the forecast includes a variety of assumptions for expenditure activity over five years. The primary drivers of expense increases include wages, PERS and health care costs. The volatility in fuel and energy costs and inflation contribute to expense increases; however, for this forecast period they are not considered primary cost drivers. The forecast uses the accumulated savings from the FY 2011-12 ending working capital balance to absorb the first year of the PERS rate increases which begin in FY 2013-14. The tables for the revenue and expenditure assumptions are included in Appendix A of this report.

The forecast is presented in two schedules; the values are in millions and have been rounded to the nearest hundred thousand. Each scenario builds out the forecasted years using the Projected FY 2012-2013 as the base year. The base year uses currently available information on revenues received as of December 2012 to re-project revenues trends and adjusts the expenditure base for known on-going service level costs and adjustments.

Current Service Level – Schedule A

Every year during the recession, the forecast shows a schedule that predicts what will happen if we maintain current levels of service. In this forecast, the continued slow to no growth in all general fund revenue sources coupled with the projected increased growth in expenditures results in depleting the working capital to **$4.7 million** by the end of FY 2015-16. This is below the 10 to 15 percent target contained in the city's financial policies for available beginning working capital in the following year and is insufficient funding for a balanced budget beginning in the fourth year of the forecast.

Schedule A - FY 2013-14 Five Year General 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	$ 14.6	$ 17.8	$ 17.7	$ 15.5	$ 11.7	$ 4.7	$ -
Current Year Revenue	96.9	98.0	99.0	99.9	101.4	102.7	104.2
Du Jour Borrowing	4.8	4.8					
TOTAL RESOURCES	116.3	120.6	116.7	115.4	113.1	107.4	104.2
EXPENDITURES							
Base Expenditures	103.7	103.1	106.3	108.9	113.7	116.3	121.6
Less:							
Unspent Contingency		(2.3)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Anticipated Expenditure Savings		(2.7)	(2.8)	(2.9)	(3.0)	(3.1)	(3.2)
Du Jour Borrowing	4.8	4.8					
NET TOTAL EXPENDITURES	108.5	102.9	101.2	103.7	108.4	110.9	116.1
Estimated Ending Working Capital	**7.8**	**17.7**	**15.5**	**11.7**	**4.7**	**(3.5)**	**(11.9)**

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

Budget Balancing Scenario- Schedule B

A budget balancing solution requires continuing the service level reductions implemented in FY 2012-13, and adding further reductions to on-going service levels over the five year period. It assumes a drawdown of the beginning working capital starting in FY 2013-14, and annual anticipated 2.75 percent expenditure savings over the base budgeted expenditures. The expenditure savings recognizes the historical trends of general fund actual spending verses adopted expenditure budgets. As permanent service level cost reductions are implemented over the next five years, the 2.75 percent used to calculate anticipated savings may be optimistic and will be re-evaluated each year.

The permanent reductions totaling $9.7 million over the next five years will provide for an ending working capital of **$6.3 million** in 2017-18; or 6 percent of the targeted ending working capital based on current year revenue.

Schedule B - General Fund Budget Balancing Scenario through FY 2015-16
(in millions)

	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	$ 17.8	$ 17.7	$ 16.0	$ 13.6	$ 10.5	$ 8.8
Current Year Revenue	98.0	99.0	99.9	101.4	102.7	104.2
TOTAL RESOURCES	115.8	116.7	115.9	115.0	113.2	113.0
EXPENDITURES						
Base Expenditures	103.1	106.3	108.4	112.2	112.3	115.0
Less:						
Unspent Contingency	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Anticipated Expenditure Savings	(2.7)	(2.8)	(2.8)	(2.9)	(2.9)	(3.0)
Permanent Reductions Required		(0.5)	(1.0)	(2.5)	(2.7)	(3.0)
NET TOTAL EXPENDITURES	98.1	100.7	102.3	104.5	104.4	106.7
Estimated Ending Working Capital	**17.7**	**16.0**	**13.6**	**10.5**	**8.8**	**6.3**

***Excludes FY 12-13 Du Jour Borrowing, reappropriations and carryovers**

Revenue Forecast

The revenue forecast is developed using conservative growth expectations of the fund's revenue. It uses available revenue sources and does not assume new or unrealized revenues in the forecasted amounts. Approximately 78 percent of general fund resources (excluding beginning working capital) come from three external revenue sources: property taxes, franchise fees, and state shared revenues. Table 1 summarizes the five year revenue forecast by revenue source.

Table 1	**Fiscal Year**				
Revenue by Source	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Property Taxes	$ 56.4	$ 57.0	$ 58.2	$ 59.2	$ 60.4
Franchise Fees	15.9	16.0	16.1	16.2	16.2
State Shared Revenue	4.6	4.7	4.8	4.9	5.0
Fines, Penalties & Forefeitures	2.7	2.7	2.7	2.7	2.7
Fees For Services	1.7	1.7	1.7	1.7	1.7
Other fees, rents, permits & license	2.8	2.8	2.8	2.8	2.8
Other Agencies & Grants	2.8	2.8	2.8	2.7	2.7
Indirect Cost Allocation/Internal Chgs	11.1	11.2	11.3	11.4	11.5
Tranfers	0.7	0.7	0.7	0.7	0.7
Interest Income	0.1	0.1	0.1	0.2	0.2
Miscellaneous	0.2	0.2	0.2	0.2	0.3
Total Current Revenue	99.0	99.9	101.4	102.7	104.2

Expenditure Forecast

The expenditure forecast is developed based on "most likely" increases in the costs of labor, materials and capital outlay. When available, it uses known expenditure information such as labor agreements, vendor contracts, the most recent information for the PERS rate and health care cost increases, and inflation factors. Future costs associated with higher PERS obligations for current employees are included in FY 2013-14, FY 2015-16 and FY 2017-18. The assumption tables for all expenditures are included in Appendix A.

Table 2 summarizes the five year expenditure forecast by expense category for Schedule B/Budget Balancing Scenario. The total base expenditures for FY 2015-16 and 2016-17 are unchanged due to $5 million in accumulated cost reductions through FY 2016-17and, the elimination of the transfer for a three year reinsurance premium which begins in calendar year 2014. This premium is required by the Patient Protection and Affordable Care Act program. Cost rises again in FY 2017-18 due to the projected 25 percent increase in PERS costs.

Table 2 - Schedule B Expenditures	**Fiscal Year**				
Expenditure Categories	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Personal Services	$ 78.6	$ 80.9	$ 85.1	$ 87.2	$ 91.9
Materials & Services	24.0	24.5	25.1	25.7	26.4
Capital Outlay	0.1	0.1	0.1	0.2	0.2
Accumlated Permanent Reduction		(0.5)	(1.5)	(4.0)	(6.7)
Subtotal Department Expenditures	**102.7**	**105.0**	**108.8**	**109.1**	**111.8**
Transfers	1.1	0.9	0.9	0.7	0.7
Contingency	2.5	2.5	2.5	2.5	2.5
Total Base Expenditures	**106.3**	**108.4**	**112.2**	**112.3**	**115.0**

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 city 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 general fund's resources are summarized below:

- Property Tax Limitation Measures and Collections
- Enacted Local Option Levies
- State Shared Revenues
- Franchise Fees Revenues
- Recession

Property Tax Limitation Measures & Collections – The largest driver of the current revenue shortfall is the continued slow growth in property tax revenues. The slow growth comes from two factors: Measure 5 compression, and the lack of new property growth caused by a slow recovery in new housing starts, commercial construction, and business investments in new equipment. Falling property values are expected to limit property tax revenue growth to 1 percent over the five year forecast period, well below historical revenue growth rates of 5 to 5.5 percent experienced prior to 2009. The declining market values move more properties into the $10 per $1,000 tax rate cap, and may also re-set Measure 50 tax assessed value to a lower amount, creating a permanent erosion on tax revenue over the long term.

The effects of Measure 5 property tax compression in Marion County have escalated in the past two years as more real market values of homes have declined. Salem's tax revenues loss from compression for FY 2012-13 is $1.1 million; $300,000 above last year's estimated amount (see graph B-4 in Appendix B). Currently Polk County is not experiencing significant losses to compression on general government so was not considered in this analysis.

Historically, compression losses were offset by a robust economy that increased property market values at rates in excess of 3 percent, slowing the number of homes subject to compression, and it created new housing which added new revenue sources to the tax rolls. Graph B-3 in Appendix B shows a decrease in the median value of housing in the last five year of 26.2 percent.

> Risk Factor Ranking – HIGH
> The League of Oregon Cities (League) lists property tax reform as one of its top priorities for legislative change in the 2013 session. They are proposing a constitutional amendment to re-set the taxable assessed value when property is sold or constructed. The League states that if the legislature refers this measure to the voters for approval, it will be a step towards redressing the inequities in the current property tax system by recalculating taxes based on a property's market value at the time of sale. This will provide a more equalized treatment of taxpayers with similar market values.

Enacted Local Option Levies – The tax revenue from a voter approved Local Option Levy is reduced if a property's tax bill is compressed due to the Measure 5 limit of $10 per $1,000. The loss in real property values mentioned previously has diminished the viability of an operating levy as a solution for closing the city's funding gap. All properties currently in compression would not be required to pay for the levy and the levy could move more properties into compression, further reducing the revenue amount to be collected. Additionally, if another jurisdiction were to be successful in passing a local option levy within Marion and Polk County, the results would not only reduce that jurisdiction's revenue collections, it may also impact the city's tax collections.

> Risk Factor Ranking – HIGH
> The League has this as one of its top priorities for legislative change in the 2013 session. They are proposing to remove Local Option Levies from the $10 cap limitation. Removing the cap would provide voters with local control over

additional funding for city services they wish to receive. A "yes" vote would mean that all property tax payers who would benefit from the services funded by a special levy would share the cost of that levy, whether or not their property was in compression.

State Shared Revenues – Revenues from liquor, cigarettes and 911 taxes are expected to have 1 percent growth over the forecast period, which is below historical trends. Liquor taxes are continuing to remain steady, while cigarette taxes are flat to declining, possibly due to changes in consumer behavior. The 911 tax is set to expire in December 2014; its renewal is highly likely. At the present time, there are no indications that the state will use these revenues to help resolve their budget balancing challenges.

Risk Factor – MEDIUM
The state has not indicated that these revenues will be re-directed to resolve their budget challenges; however the legislative session has not yet convened. One of the league's legislative priorities is to support the 911 tax renewal, and will seek to make the tax permanent, modify the $.75 tax rate to ensure adequate resources to support the system long term, and subject pre-paid cell phone and VoIP services to the tax.

Franchise Fee Revenues – Over the five year forecast, growth in franchise fees are projected at zero to a minus 1 percent change year-over-year. Growth in this revenue is influenced by the provider's billing rate, new customer growth and the impact of weather on energy use. The revenue from utility and refuse haulers is assumed to remain relatively flat over the forecast period. NW Natural Gas decreased rates in November as they are experiencing an oversupply of this resource. Telecommunications will continue to decline as customers move to other available forms of communicating that are not subject to a franchise fee. Franchise fee revenue increased last year because of updates to the Salem Revised Code which allowed the city to capture telecommunication franchise fees from all users of the city's right-of-way.

Risk Factor Ranking – LOW
Franchise fee revenue can be subject to changes in legislation, technology and consumer behavior. Because it is one of the three primary revenue sources in the general fund, potential changes need to be monitored and, in the case of legislative challenges, defended.

Recession – Ben Bernanke, Chairman of the Federal Reserve, told Congress in the fall that the US economy will fall back into recession and fewer jobs will be created in 2013 if Congress allows the automatic tax increases and spending to take effect at 2012 year end. 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 city's PERS employer contribution rate for the two years beginning FY 2013-14 has increased 48 percent versus 23 percent forecasted last year based on the advisory rates provided by the PERS Board. At that time, the city had planned for an additional $1.7 million in general fund PERS costs beginning in FY 2013-14, that amount is now estimated at $2.9 million. The current forecast uses the higher actual beginning working capital realized in FY 2012-13 to absorb the first year cost of the $2.9 million increase. The forecast also assumes a 25 percent PERS rate increase in FY 2015-16 and again in FY 2017-18 for all three tiers. Last year's forecast assumed a range of increases across the three tiers between 22 percent and 28 percent for FY 2015-16. Below is a table of the rates by tiers for comparison, rates are adjusted every two years to meet pension funding requirements. See appendix A for a complete table of PERS related expenses.

PERS Employer Contribution Rates					Projected Rate	
Table 3	**FY 07/08**	**FY 09/10**	**FY 11/12**	**FY 13/14**	**FY 15/16**	**FY 17/18**
Tier 1 & 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%
OPSPR - General	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 employer contributions needed to provide for benefit payments to members that are 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 each year 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 $145,000 per year for the general fund.

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 the city's workforce is represented by one of the four unions: SPEU (police), IAFF (fire), PCEA (911 communications) and AFSCME (general unit). Approximately 75 percent of general fund 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
Three labor agreements (AFSCME, PCEA and IAFF) will expire on June 30, 2013. The IAFF and PCEA unions have mandatory arbitration rights for contract disputes and state mandated requirements related to comparable agency market wages and benefits. 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 the inflation factor on all general goods and services in the forecast.

Risk Factor Ranking-LOW
The risk 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 did influence 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 are monitored closely and, when possible, steps will be taken to lower the city's exposure.

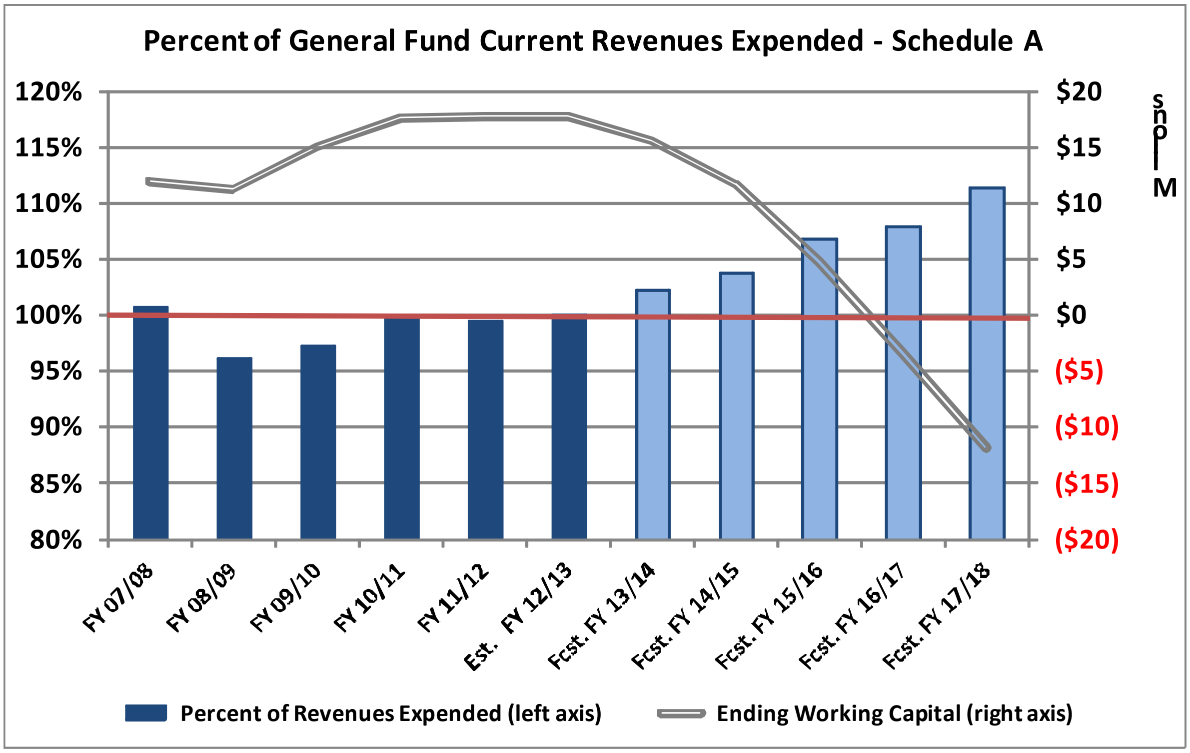
Forecast Risk Revenue	**Ranking**	**Percent Total Revenue**
Property Tax Limitations	HIGH	57%
Local Option Levies	HIGH	
State Shared Revenue	MEDIUM	5%
Franchise Fee Revenue	LOW	16%
Recession	LOW	

Forecast Risk Expenditures	**Ranking**	**Percent Total Expense**
PERS Employer Rate Increases	HIGH	9%
Health Care Costs	MEDIUM	10%
Labor Agreements/Salary Costs	MEDIUM	29%
Inflation	LOW	

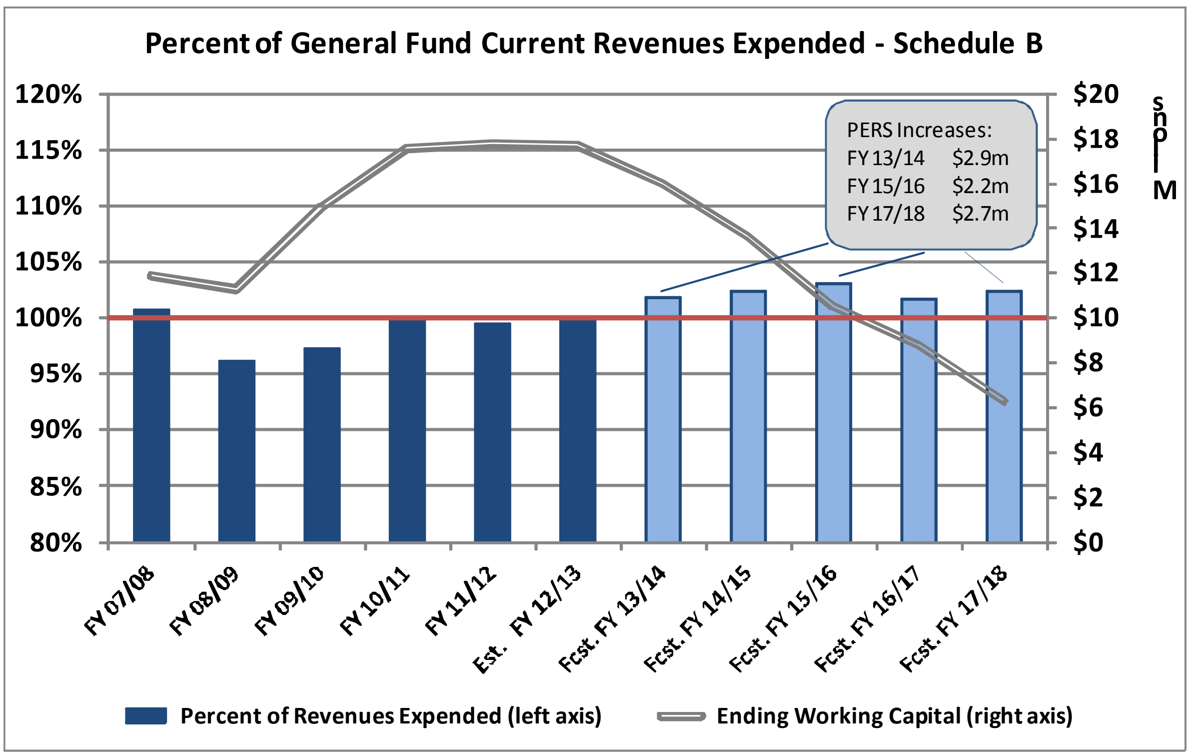
APPENDIX A - ASSUMPTIONS FOR FORECAST

APPENDIX B – PROPERTY TAX TABLES

APPENDIX C - OTHER BACKGROUND INFORMATION



Percent of General Fund Current Revenues Expended - Schedule A
120%
115%
110%
105%
100%
95%
90%
85%
80%
$20
$15
$10
$5
$0
($5)
($10)
($15)
($20)
Millions
FY 07/08
FY 08/09
FY 09/10
FY 10/11
FY 11/12
Est. FY 12/13
Fcst. FY 13/14
Fcst. FY 14/15
Fcst. FY 15/16
Fcst. FY 16/17
Fcst. FY 17/18
Percent of Revenues Expended (left axis)
Ending Working Capital (right axis)



Percent of General Fund Current Revenues Expended - Schedule B
PERS Increases:
FY 13/14 $2.9m
FY 15/16 $2.2m
FY 17/18 $2.7m
120%
115%
110%
105%
100%
95%
90%
85%
80%
$20
$18
$16
$14
$12
$10
$8
$6
$4
$2
$0
Millions
FY 07/08
FY 08/09
FY 09/10
FY 10/11
FY 11/12
Est. FY 12/13
Fcst. FY 13/14
Fcst. FY 14/15
Fcst. FY 15/16
Fcst. FY 16/17
Fcst. FY 17/18
Percent of Revenues Expended (left axis)
Ending Working Capital (right axis)

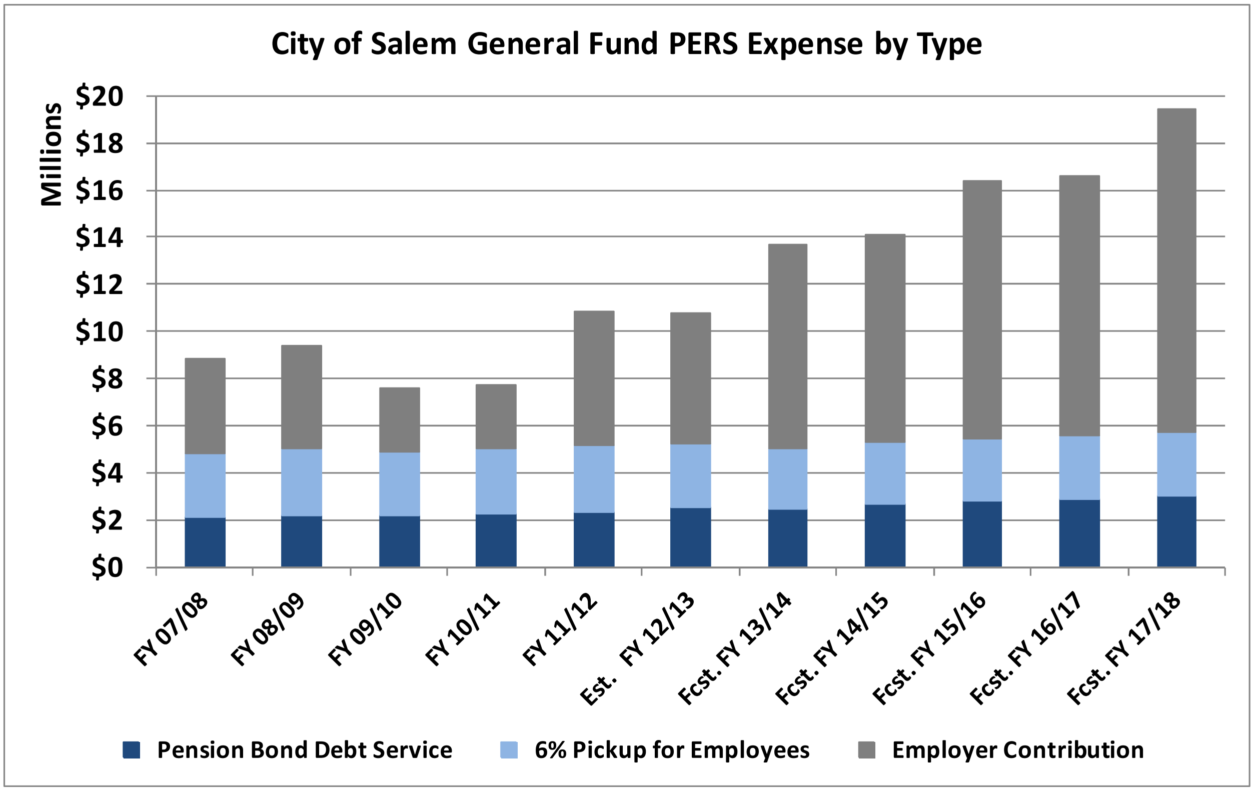
Revenue Assumption Table

	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18
REVENUE:	% Increase	% Increase	% Increase	% Increase	% Increase
Property tax - driven by growth in AV	1.00%	1.00%	1.00%	1.00%	1.00%
Electric franchise	0.00%	0.00%	0.00%	0.00%	0.00%
Telecomunications franchise	-1.00%	-1.00%	-1.00%	-1.00%	-1.00%
Natural gas franchise	-1.00%	-1.00%	0.00%	1.00%	1.00%
Refuse franchise	0.00%	0.00%	1.00%	1.00%	1.00%
Cable TV franchise	0.00%	0.00%	0.00%	-1.00%	-1.00%
Water and sewer franchise[1]	10.73%	3.75%	2.21%	2.38%	2.38%
Fees for service	1.00%	1.00%	1.00%	1.00%	1.00%
Planning fees (site and dwelling plans)	1.00%	1.00%	1.00%	1.00%	1.00%
Other fees	1.00%	1.00%	1.00%	1.00%	1.00%
Licenses/permits	1.00%	1.00%	1.00%	1.00%	1.00%
ICAP	1.00%	1.00%	1.00%	1.00%	1.00%
Other internal charges	1.00%	1.00%	1.00%	1.00%	1.00%
State shared revenue	1.00%	1.00%	1.00%	1.00%	1.00%
Other agencies	1.00%	1.00%	1.00%	1.00%	1.00%
Grants	1.00%	1.00%	1.00%	1.00%	1.00%
Fines/penalities	1.00%	1.00%	1.00%	1.00%	1.00%
General factor for remaining revenue	1.00%	1.00%	1.00%	1.00%	1.00%

[1] Prior to FY 12/13, water and sewer franchise fees were applied to gross revenue for in-city customers and adjusted for debt service. As a result of the 2012 refinancing, franchise fees are now calculated on gross revenue for the in-city customers without an adjustment for debt service. The FY 13/14 revenue assumption increase is also influenced by current and pending rate increases effective January 1st of 2013 and 2014.

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%



City of Salem PERS Related Expenses by Category (General Fund)

Description	Actual FY 06/07	Actual FY 07/08	Actual FY 08/09	Actual FY 09/10	Actual FY 10/11	Actual FY 11/12	Adopted Bgt FY 12/13	Forecast FY 13/14	Forecast FY 14/15
Tier 1 / Tier 2 PERS Contribution Rate	10.75%	8.65%	8.65%	6.12%	6.12%	12.93%	12.93%	19.06%	19.06%
OPSRP - General Services Contribution Rate	5.18%	8.96%	8.96%	4.37%	4.37%	9.14%	9.14%	14.68%	14.68%
OPSRP - Police and Fire Contribution Rate	8.79%	12.23%	12.23%	7.08%	7.08%	11.85%	11.85%	17.41%	17.41%
Employer Contribution	$4,376,851	$4,041,340	$4,383,359	$2,703,620	$2,732,386	$5,685,129	$5,790,854	$8,693,944	$8,814,453
Employee Contribution	4,376,851	2,714,498	2,847,979	2,707,190	2,730,498	2,787,819	2,727,160	2,584,040	2,621,650
Pension Obligation Bond Debt Service	2,859,230	2,106,390	2,175,020	2,159,049	2,288,700	2,356,310	2,502,100	2,430,920	2,672,740
Total PERS Related Expense	**$11,612,932**	**$8,862,228**	**$9,406,358**	**$7,569,860**	**$7,751,584**	**$10,829,258**	**$11,020,114**	**$13,708,904**	**$14,108,843**
Total Personal Services	**$67,157,133**	**$69,752,895**	**$71,944,913**	**$66,787,405**	**$68,526,499**	**$73,164,786**	**$75,610,470**	**$78,646,448**	**$80,972,088**
PERS Expense as a percentage of Total Personal Services	**17.29%**	**12.71%**	**13.07%**	**11.33%**	**11.31%**	**14.80%**	**14.57%**	**17.43%**	**17.42%**

Source: City of Salem Financial System (FIMS); PERS Valuation Reports

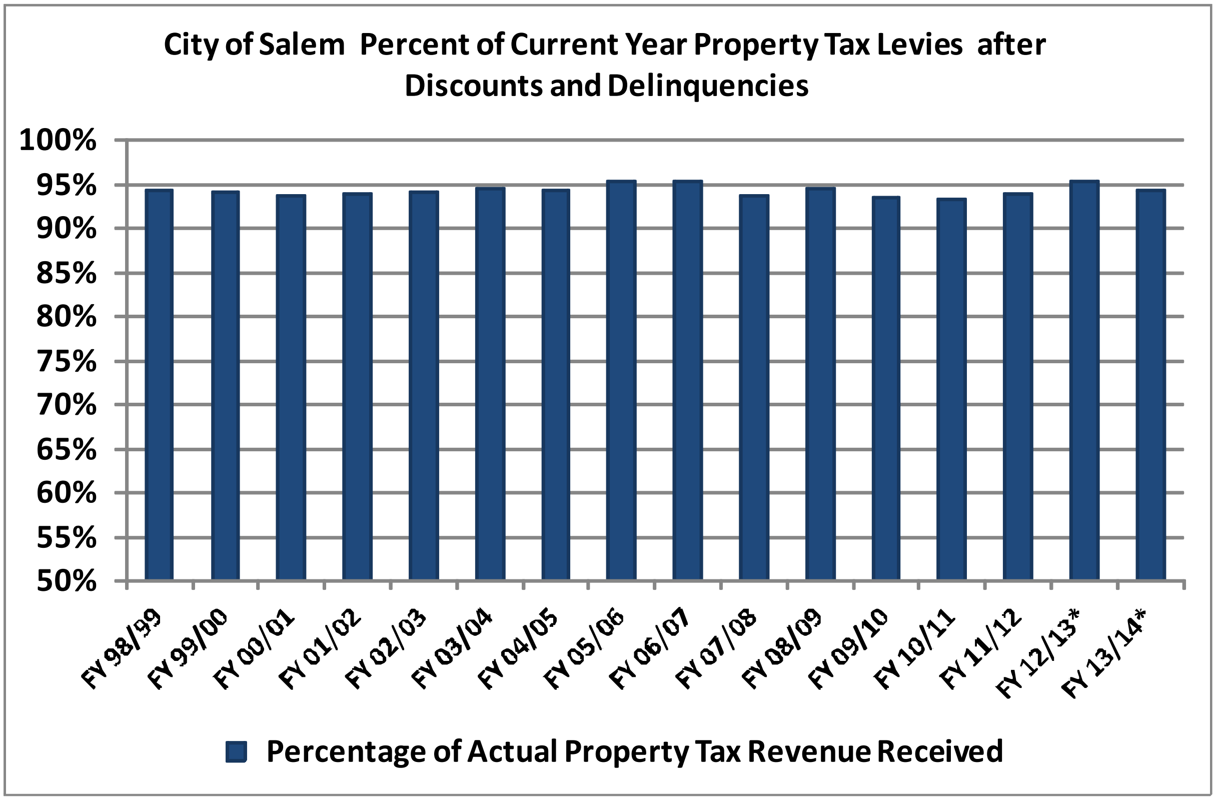
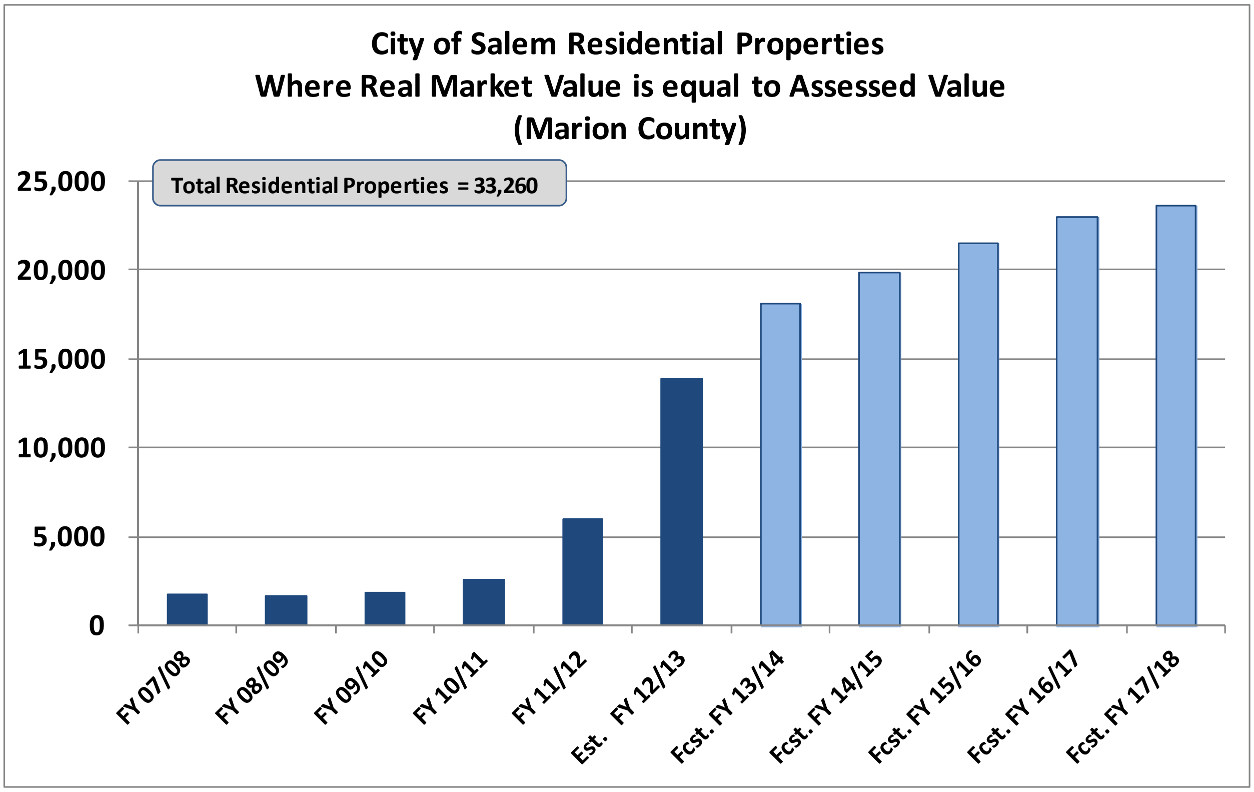


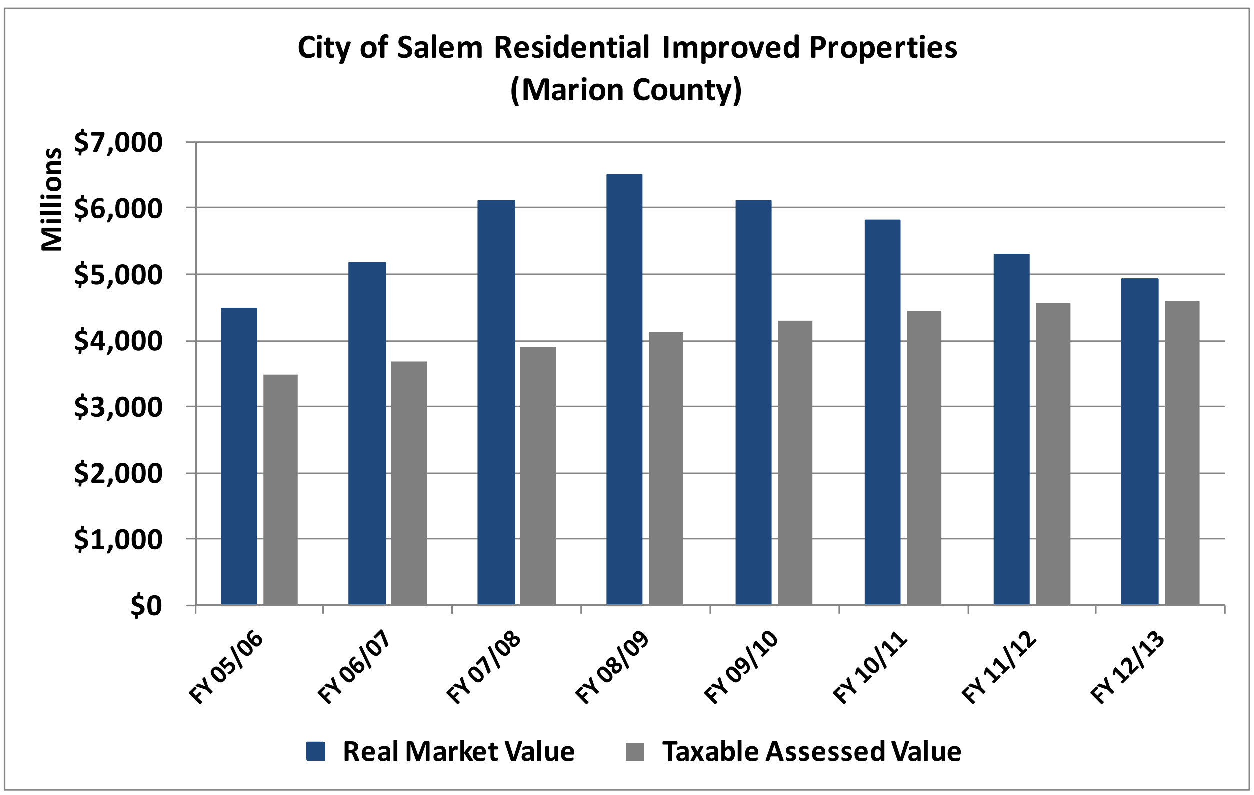
Table 2 - Historic Changes in Property Tax Levies

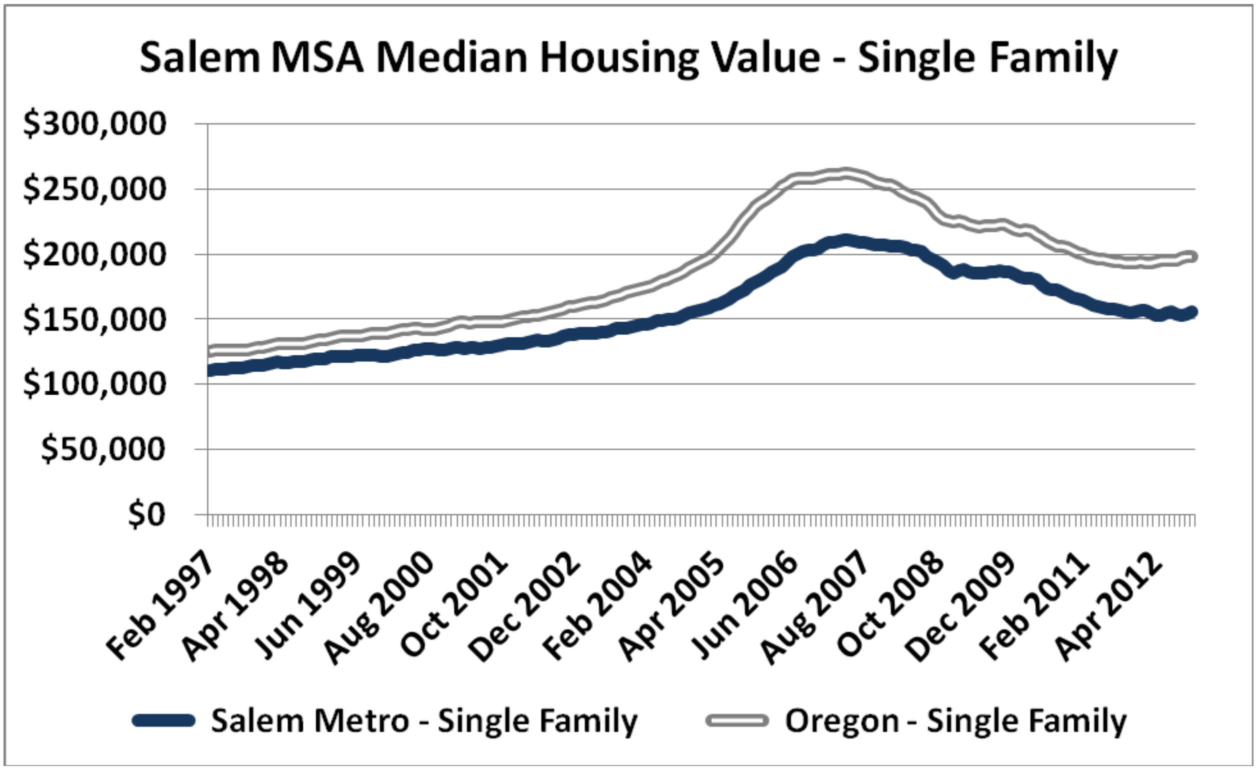
Since the Passage of Measure 50

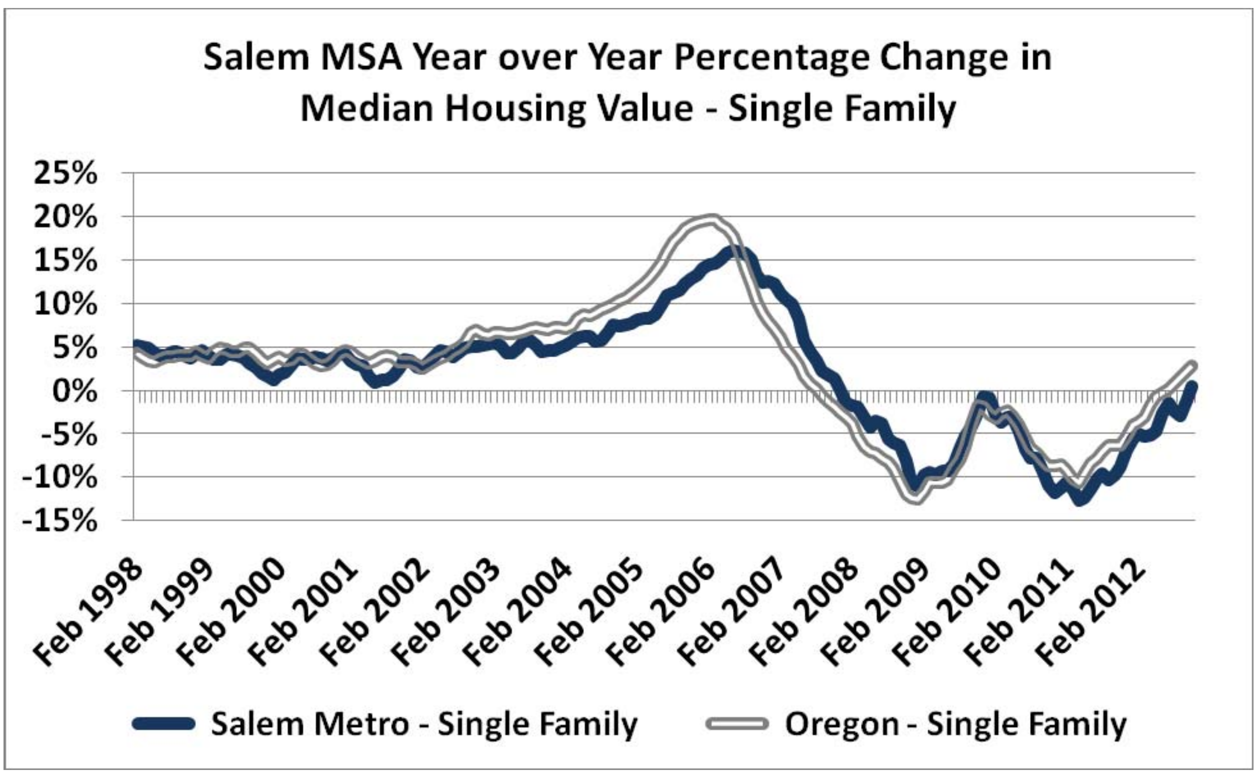
Fiscal Year	Levy	Increase		Actual	Increase
FY 98/99	$31,275,110	-		$29,483,232	-
FY 99/00	33,213,490	6.2%		31,239,718	6.0%
FY 00/01	35,000,560	5.4%		32,787,613	5.0%
FY 01/02	36,754,990	5.0%		34,517,563	5.3%
FY 02/03	38,815,890	5.6%		36,495,536	5.7%
FY 03/04	40,564,780	4.5%		38,309,011	5.0%
FY 04/05	42,316,780	4.3%		39,880,157	4.1%
FY 05/06	44,234,820	4.5%		42,212,928	5.8%
FY 06/07	46,747,260	5.7%		44,535,508	5.5%
FY 07/08	49,708,758	6.3%		46,619,613	4.7%
FY 08/09	51,979,085	4.6%		49,177,277	5.5%
FY 09/10	53,837,888	3.6%		50,330,937	2.3%
FY 10/11	55,258,870	2.6%		51,547,855	2.4%
FY 11/12	56,245,200	1.8%		52,765,171	2.4%
FY 12/13*	56,216,930	-0.1%		53,542,934	1.5%
FY 13/14*	57,390,154	2.1%		54,080,976	1.0%

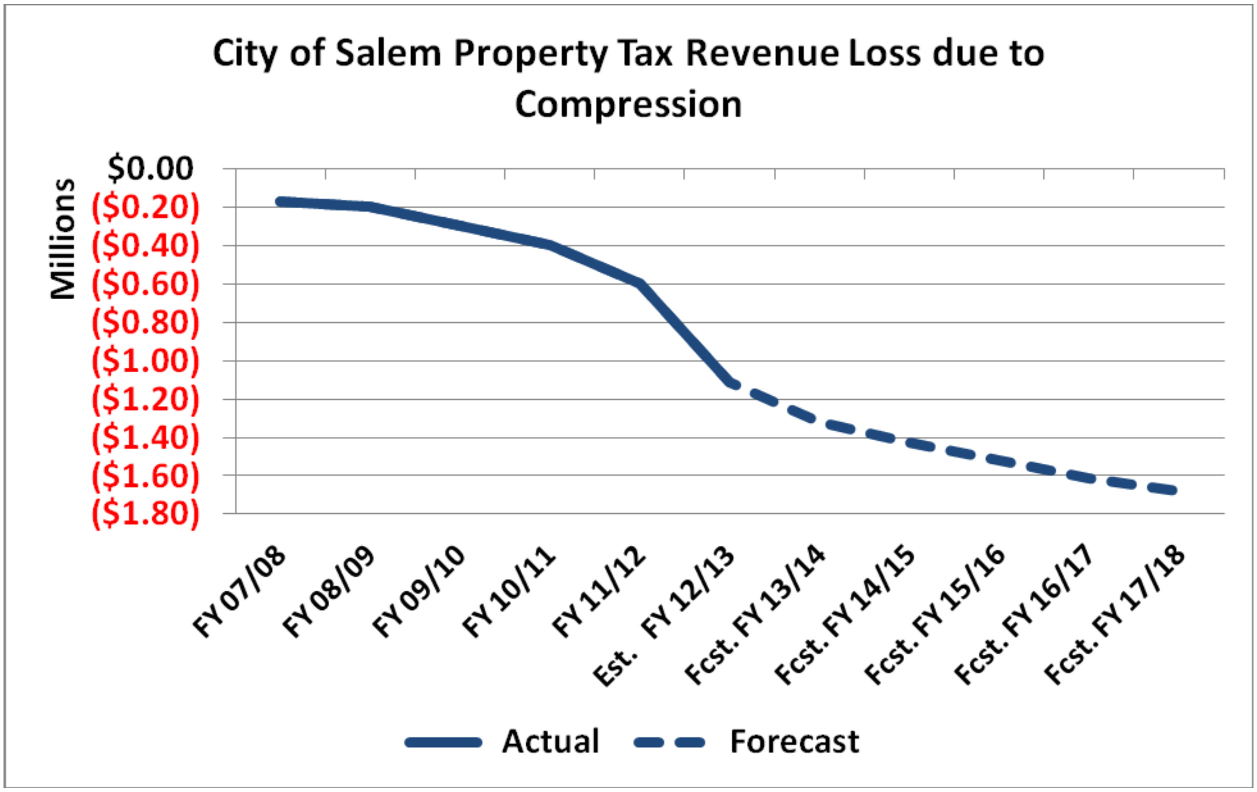
*** Projected**


City of Salem Residential Properties
Where Real Market Value is equal to Assessed Value
(Marion County)
Total Residential Properties = 33,260
25,000
20,000
15,000
10,000
5,000
0
FY 07/08
FY 08/09
FY 09/10
FY 10/11
FY 11/12
Est. FY 12/13
Fcst. FY 13/14
Fcst. FY 14/15
Fcst. FY 15/16
Fcst. FY 16/17
Fcst. FY 17/18


City of Salem Residential Improved Properties
(Marion County)
Millions
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
FY 05/06
FY 06/07
FY 07/08
FY 08/09
FY 09/10
FY 10/11
FY 11/12
FY 12/13
Real Market Value
Taxable Assessed Value


Salem MSA Median Housing Value - Single Family
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$0
Feb 1997
Apr 1998
Jun 1999
Aug 2000
Oct 2001
Dec 2002
Feb 2004
Apr 2005
Jun 2006
Aug 2007
Oct 2008
Dec 2009
Feb 2011
Apr 2012
Salem Metro - Single Family
Oregon - Single Family


Salem MSA Year over Year Percentage Change in Median Housing Value - Single Family
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
Feb 1998
Feb 1999
Feb 2000
Feb 2001
Feb 2002
Feb 2003
Feb 2004
Feb 2005
Feb 2006
Feb 2007
Feb 2008
Feb 2009
Feb 2010
Feb 2011
Feb 2012
Salem Metro - Single Family
Oregon - Single Family


City of Salem Property Tax Revenue Loss due to Compression
Millions
$0.00
($0.20)
($0.40)
($0.60)
($0.80)
($1.00)
($1.20)
($1.40)
($1.60)
($1.80)
FY 07/08
FY 08/09
FY 09/10
FY 10/11
FY 11/12
Est. FY 12/13
Fcst. FY 13/14
Fcst. FY 14/15
Fcst. FY 15/16
Fcst. FY 16/17
Fcst. FY 17/18
Actual
Forecast