City of Salem, Oregon General Fund Five-Year Financial Forecast

FISCAL YEARS 2014-15 THROUGH 2018-19

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EXECUTIVE SUMMARY

The General Fund's forecast continues to project minimal revenue growth and the need to hold the line on expenditures in order to maintain adequate ending working capital over the five-year period. The national and state economies are improving at a steady, but slow pace. However, local governments are still experiencing slowly recovering revenues, which are insufficient to provide both essential services to the community and improvements needed for aging facilities and infrastructure.

In response to the 2008 recession, the City of Salem continues to manage its resources in a fiscally prudent manner and made changes in service delivery to ensure ongoing day-to-day operations in the areas of public safety, planning, code enforcement, municipal court, parks and recreation, urban development, and the central services that support them. The key message of this forecast is the ongoing fiscal challenge faced by the City, which includes:

- Current revenue growth does not keep pace with the growth in current operations costs.
- Growth in the property tax revenue year-over-year ranges between 1.6 percent and 2.5 percent, still below historical levels of up to 5.5 percent.
- Forty-eight percent of Salem residential properties in Marion County have real market value equal to tax assessed value making those properties susceptible to compression.
- Ending working capital will be depleted by year four of the forecast without additional expenditure reductions.
- PERS reductions are forecast assuming a positive result with the lawsuits and market changes. If those results do not occur, reductions in operations will need to be made much earlier than demonstrated in Schedule B.
- On the positive side, the General Fund's beginning working capital will allow us to forecast another year of stable, though lean, operations.

ECONOMIC OUTLOOK

Prepared by Tim Duy, Economic Consulting, LLC

National–2013 was another year of slow and steady growth for the US economy. While on the surface disappointing, the outcome reflected the resiliency of the economy considering the unusual number of negative shocks faced over the past year. Notably, fiscal policy was very contractionary as the pattern of flat spending since the recession was paired with sharp tax increases. In addition, the foreign growth slowdown that weighed on manufacturing in 2012 extended into early 2013. These negative forces only exacerbated the challenge the economy faced as the lingering damage from the financial crisis deterred household spending.

Very supportive monetary policy on the part of the Federal Reserve, however, created an accommodative financial backdrop to help offset these negative forces. Low interest rates, particularly in the early part of 2013, helped support the ongoing recovery in the housing market. Rising home prices in turn helped rebuild household balance sheets. Moreover, firms continued to invest in new plants and equipment, albeit at a slower pace than the previous year, while foreign economies stabilized. On balance, the national economy likely slowed to around 2% in 2013, down from 2.8% in 2012.

A re-acceleration of growth in 2014 is anticipated, albeit still at a moderate pace compared to past recoveries. The fiscal drag will be moderating over the course of the year; while monetary policy is expected to remain supportive (the Federal Reserve does not anticipate raising interest rates until 2015). Moreover, the risks of a hard landing in China or a breakup of the European Monetary Union look diminished compared to last year. With these negative impacts waning, the normal cyclical dynamics, including continuing improvement in the housing market, are likely to again become dominant forces.

***State*–**Like last year, the Oregon economy has largely followed the pattern of the US recovery–slow and steady relative to previous economic expansions. That said, job growth did accelerate in 2013 as the regions outside of Portland are all finally showing some improvement. The specific factors weighing on these regions eased over the course of the past year. Improvement in housing activity and tourism were evident in Bend in particular. The UO Index of Economic Indicators points toward continued expansion while the UO Oregon Measure of Economic Activity currently indicates growth near the average since 1990.

***Salem*–**Economic activity in Salem built upon the foundations laid in 2012. The housing recovery was evident in ongoing gains in residential sales and building activity; the value of residential construction rose during the first nine months of 2013. Housing prices have stabilized; gains are modest at best, especially compared with Bend and Portland. Tourism and travel activity supported the region, with higher lodging revenues and jobs in the leisure and hospitality sector. The health and education sector continued to add jobs, while manufacturing and financial jobs continued to move sideways. Overall job growth will be close to 2.3% for the year, somewhat better than the 2.0% forecast. Note, however, that as indicated by the UO Measure of Activity for Salem, growth remains slow compared to past recoveries.

Nonfarm Payroll Growth Forecasts

Oregon Forecasts: Fourth Quarter 2012 to Fourth Quarter 2013
Salem Forecast: Dec12 to Dec13

	OR	OR (OEA)	Salem MSA
2013	1.7%	1.9%	2.3%
2014	2.5%	2.4%	2.1%

Note: OR in the above table refers to outcomes using Dr. Duy's model loosely conditioned on forecasts of national variables from the Oregon Department of Economic Analysis. OR (OEA) refers to the official state forecast.

Local Revenue Implications–Similar to last year, improving economic conditions and stronger housing markets throughout 2013 should have a positive revenue impact in the following fiscal year. There will be a lag, however, before additional construction is added to tax rolls. Current year revenue forecasts are reasonable considering past economic conditions (which set current taxes, particularly property taxes). Considering current economic conditions and assuming the expansion remains in place, there is some modest upside risk to the revenue forecast.

FORECAST RESULTS

The General Fund forecast is an analysis of the fund's financial condition based upon reasonable economic assumptions. It provides a view of the financial impact of the City's services framed within national, state, and local economic activity and trends for both revenue sources and cost drivers. Legislated and economic influences on property tax–the fund's largest single revenue source–continue to overshadow revenue growth. The primary drivers of cost increases for the fund remain wages, PERS, and health care costs. This forecast demonstrates the ongoing structural imbalance in the rate of growth between General Fund revenues and expenditures. Balancing the budget in the later years of the forecast will require significant expenditure reductions absent more robust growth in revenues. It is important to note that the information provided in this forecast is not a prediction of what will occur, but a view of what could occur if all the forecast assumptions are realized.

The presentation of the General Fund forecast, which includes two schedules, is built referencing the FY 2013-14 Projected column as the base year. The base year includes currently available information on revenues received as of December 2013, to project year-end receipts and forecast future year trends. The expenditure base is adjusted for all known and projected service level costs.

Current Service Level–Schedule A

The City's annual financial forecast for the General Fund includes two forecast schedules. The first schedule, which appears below as Schedule A, demonstrates continuation of current service levels with assumptions for inflationary factors to increase service costs and estimates for revenue growth or decline. Schedule B demonstrates the same data that appears in Schedule A with the addition of actions that would be required to ensure the forecast remains balanced throughout the five-year period.

Schedule A illustrates a level of projected increase in revenues lower than the anticipated growth in expenditures. In the first year of the forecast period, anticipated revenues increase by 1.5 percent over FY 2013-14 projections, while net expenditures increase by approximately 3.1 percent. Schedule A includes an assumption for anticipated expenditure savings. However, the percentage factor used to estimate savings has been lowered to 1.25 percent. Lowering the rate of anticipated savings by 1.50 percentage points from the prior forecast reflects a re-evaluation of each General Fund department's capacity to continue to realize savings. In addition, Schedule A records $1.9 million in savings derived from legislated PERS rate relief.

The assumptions in Schedule A result in the depletion of beginning working capital by the conclusion of the third year of the forecast, FY 2016-17, to $9.7 million, which is below the minimum in the City's financial policies. By the fourth year of the forecast, the assumptions demonstrate expenditures exceeding total resources.

SCHEDULE A–FY 2014-15 Five-Year General Fund Financial Forecast

(Values in Millions)	FY 13-14 Budget	FY 13-14 Projected	FY 14-15 Forecast	FY 15-16 Forecast	FY 16-17 Forecast	FY 17-18 Forecast	FY 18-19 Forecast
RESOURCES							
Beginning Working Capital	$ 18.2	$ 20.8	$ 19.3	$ 16.3	$ 9.7	$ 3.4	$ 0. 0
Current Year Revenues	99.6	98.2	99.8	101.8	103.8	105.8	107.9
TOTAL RESOURCES	**117.8**	**119.0**	**119.1**	**118.1**	**113.5**	**109.2**	**107.9**
EXPENDITURES							
Base Expenditures	106.9	99.7	108.3	112.1	113.8	117.7	119.4
Less:							
Unspent Contingency		0.0	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Anticipated Expense Savings		0.0	(1.3)	(1.4)	(1.4)	(1.4)	(1.5)
Anticipated PERS Savings		0.0	(1.9)	0.0	0.0	0.0	0.0
TOTAL NET EXPENDITURES	**106.9**	**99.7**	**102.8**	**108.4**	**110.1**	**113.9**	**115.7**
Estimated Ending Working Capital	**$ 10.9**	**$ 19.3**	**$ 16.3**	**$ 9.7**	**$ 3.4**	**$ (4.7)**	**$ (7.7)**

Budget Balancing Scenario–Schedule B

To provide a balanced budget throughout the forecast period, Schedule B includes the same projection of anticipated expenditure savings in Schedule A and adds a level of permanent reductions beginning in FY 2016-17, which equate to $6.0 million over three years. In addition, this scenario includes the impact of PERS savings derived from legislated changes and reduced rate assumptions beginning in FY 2015-16, which are based upon recent PERS Board advisory information.

With these assumptions in Schedule B, beginning working capital continues to decline and fall below the level prescribed in City policy. However, it remains positive providing for balanced budgets and by the end of the forecast period begins to recover to a level of $10.7 million with a significantly reduced service level.

It is important to note that any anticipated PERS savings may be impacted by the outcome of current legal challenges to the 2013 legislated changes as well as economic conditions that influence rate assumptions. If the PERS savings noted in Schedule B are not realized and absent further growth in revenues, additional expenditure reductions will be needed to maintain working capital at the City Council policy level.

SCHEDULE B–General Fund Budget Balancing Scenario Through FY 2018-19

(Values in Millions)	FY 13-14 Budget	FY 13-14 Projected	FY 14-15 Forecast	FY 15-16 Forecast	FY 16-17 Forecast	FY 17-18 Forecast	FY 18-19 Forecast
RESOURCES							
Beginning Working Capital	$ 18.2	$ 20.8	$ 19.3	$ 16.3	$ 12.0	$ 9.1	$ 8.4
Current Year Revenues	99.6	98.2	99.8	101.8	103.8	105.8	107.9
TOTAL RESOURCES	**117.8**	**119.0**	**119.1**	**118.1**	**115.8**	**114.9**	**116.4**
EXPENDITURES							
Base Expenditures	106.9	99.7	108.3	112.1	113.8	117.7	119.4
Less:							
Unspent Contingency		0.0	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
Anticipated Expense Savings		0.0	(1.3)	(1.4)	(1.4)	(1.4)	(1.5)
Anticipated PERS Savings		0.0	(1.9)	(2.3)	(2.4)	(3.9)	(4.0)
Permanent Reductions		0.0	0.0	0.0	(1.0)	(2.5)	(2.5)
Ongoing Permanent Reductions		0.0	0.0	0.0	0.0	(1.0)	(3.5)
TOTAL NET EXPENDITURES	**106.9**	**99.7**	**102.8**	**106.1**	**106.7**	**106.5**	**105.7**
Estimated Ending Working Capital	**$ 10.9**	**$ 19.3**	**$ 16.3**	**$ 12.0**	**$ 9.1**	**$ 8.4**	**$ 10.7**
Comparing Revenues and Expenditures in Schedule B							
Current Revenues	***99.6***	***98.2***	***99.8***	***101.8***	***103.8***	***105.8***	***107.9***
Net Expenditures	***106.9***	***99.7***	***102.8***	***106.1***	***106.7***	***106.5***	***105.7***

REVENUE FORECAST

Consistent with prior year financial forecasts, the revenue estimates presented in this document rely on conservative expectations for growth. The forecast uses available revenue sources augmented with assumptions for growth or, in some cases, decline. Assumptions are derived from analysis of county property tax records, adjustments in utility rates or costs, local building activity, legislated changes, recent historical trends, and other economic drivers. Approximately 78 percent of General Fund revenues, which excludes 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. Appendix A provides a more detailed view of projected General Fund revenues for the forecast period.

Table 1	**Fiscal Year**				
Revenue By Source	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Property Taxes	$57.0	$58.5	$59.9	$61.5	$63.0
Franchise Fees	15.7	15.9	16.1	16.2	16.4
State Shared Revenue	4.7	4.8	5.0	5.1	5.2
Fines, Penalties and Forfeitures	2.7	2.7	2.7	2.7	2.7
Fees for Services	1.8	1.8	1.9	1.9	1.9
Other Fees, Rents, Permits, Licenses	3.1	3.1	3.2	3.2	3.2
Other Agencies and Grants	2.5	2.5	2.5	2.5	2.5
Indirect Cost Allocation/Internal Chgs	10.7	10.9	11.0	11.2	11.3
Transfers from Other Funds	1.2	1.2	1.2	1.2	1.2
Interest Income	0.1	0.1	0.1	0.1	0.1
Miscellaneous	0.3	0.3	0.3	0.3	0.3
Total Current Revenue	$99.8	$101.8	$103.8	$105.8	$107.9

EXPENDITURE FORECAST

The base forecast for the General Fund is developed using cost escalation information from labor agreements, health insurance consultant analysis, up-to-date PERS rate information, vendor contracts, the Consumer Price Index, and other research to inform five years of expense inflation factors. The assumption tables used 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. Increased rates for PERS obligations for current employees prompt increases in personal services for both FY 2015-16 and FY 2017-18. The area of the table with italicized text demonstrates the effect on base expenditures of anticipated savings (including potential PERS savings), unspent contingency, and permanent reductions initiated in FY 2016-17 in the "Total Net Expenditures" row.

Table 2–Schedule B Expenditures	**Fiscal Year**				
Expenditure Categories	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Personal Services	$ 81.1	$ 84.6	$ 86.0	$ 89.6	$ 91.1
Materials and Services	23.6	23.8	24.1	24.4	24.7
Capital Outlay	0.6	0.6	0.6	0.6	0.6
Subtotal Operating Expenditures	**$105.3**	**$109.0**	**110.7**	**$114.6**	**$116.4**
Transfers to Other Funds (facility and information technology asset maintenance projects)	0.5	0.6	0.6	0.6	0.5
Contingency	2.5	2.5	2.5	2.5	2.5
Total Base Expenditures	**$108.3**	**$112.1**	**$113.8**	**$117.7**	**$119.4**
Less:					
Unspent Contingency	*(2.3)*	*(2.3)*	*(2.3)*	*(2.3)*	*(2.3)*
Anticipated Savings	*(1.3)*	*(1.4)*	*(1.4)*	*(1.4)*	*(1.5)*
Anticipated PERS Savings	*(1.9)*	*(2.3)*	*(2.4)*	*(3.9)*	*(4.0)*
Permanent Reductions			*(1.0)*	*(2.5)*	*(2.5)*
Ongoing Permanent Reductions				*(1.0)*	*(3.5)*
Total Net Expenditures	***$102.8***	***$106.1***	***$106.7***	***$106.5***	***$105.7***

FINANCIAL FORECAST RISKS AND RANKINGS

Risks to Revenue Forecast

The forecast acknowledges that there are risks associated with the resources needed to sustain the current level of City services, now and into the future. Each identified risk is evaluated on the degree it will impact service delivery. These evaluations of existing and potential resources assist in determining actions to be taken over the five-year period to ensure a balanced budget. The identified risks to the General Fund's resources are summarized below.

Property Tax Limitation Measures–The continued slow growth in property tax revenue is the major contributor to the gap between the cost of General Fund services and the revenue needed to support the expense. Measure 5 compression, the post recession lag in new construction, and low growth in real property values on existing houses are the primary causes. On the positive side, this past year Salem's housing prices stabilized, building permits for new construction increased, and area businesses began expansion–improvements to our local economy that have the potential to influence property tax revenues. The forecast includes an approximate 1.6 percent increase in revenue derived from property taxes–current year receipts plus previously uncollected amounts from prior years. This annual growth rate increases to 2.5 percent for the remaining four years. The optimistic view in the later years of the forecast includes continued growth in the economy creating increases in development activity and housing prices, which should result in an increased return on tax revenues. The forecasted growth assumption is still well below historical revenue growth rates of up to 5.5 percent experienced prior to 2009.

Marion County–The effects of Measure 5 property tax compression continue to suppress Salem's growth in total tax revenue collections. If the levy for general government taxes exceeds the $10 per $1,000 tax rate of a property's real market value compression has occurred, and the amount to be collected is reduced until the limitation is met. Currently, 48.2 percent of Marion County's residential properties in Salem have a tax assessed value equal to their real market value and are experiencing some level of compression. Salem's tax revenue loss from compression for FY 2013-14 is $1.09 million, as compared to FY 2012-13 at $1.10 million (see compression graph on page B-4 in Appendix B). The forecast assumes that over the next five years, Salem's compression impact will remain above $1.10 million, increasing at a rate of 6 to 7 percent annually. When real market values begin to experience annual growth rates in excess of 5 percent, Salem's tax losses due to compression will begin to decline.

Polk County–At a current general government tax rate of $9.2974, West Salem is not experiencing compression. However, as of FY 2013-14 it does have a higher percentage of residential property (61 percent) where the real market value is equal to tax assessed value. Historically, the county tax assessor reported the West Salem area's year-over-year real market value growth at 2.2 percent or greater. In FY 2012-13 the assessor's office reported a year-over-year decline in market value of -1.34 percent, this change caused more homes to have reduced tax assessed values, which resulted in a decrease to FY 2013-14 taxes to be collected.

> <u>Risk Factor Ranking–HIGH</u>
> Compression and lowered property values affect the projected rate of growth in taxes to be collected over the five-year forecast. Growth in real market property values at a rate of 5 percent or greater would be welcomed but property tax reforms are still needed to correct the inequities of the overall tax system. The League of Oregon Cities (League) property tax referral measures introduced in the 2013 legislative session failed and will not be re-introduced by the League during the 2014 session. Instead, League staff will focus their efforts on communicating the negative impacts of Measure 5 and 50 and the need for tax reform, in addition to strengthening stakeholder alliances in preparation for the 2015 session. The City will remain actively involved with this effort.

Enacted Local Option Levies–The property tax rate limitation of Measure 5 also applies to voter-approved tax operating levies. Taxes to be collected from a voter approved local option levy are compressed first, before collections from a jurisdiction's permanent tax rate are affected. This means properties in compression when the levy was enacted would not pay for the levy, and additional properties may become compressed as a result of the levy, further reducing collections. Also, compression can cause the enactment of a local option levy in one jurisdiction to reduce the permanent rate tax collections of another jurisdiction within the same county.

> <u>Risk Factor Ranking–HIGH</u>
> The Measure 5 rate limitation negatively impacts the voters' ability to have local control over the level of services they wish to fund and receive, and creates inequities with who pays for the services the levy is to provide. The possibility of a neighboring jurisdiction enacting a special operating levy that could reduce Salem's tax revenue is also a concern. The League's 2013 referral measure to remove local option levies from the compression rate cap failed. As noted above, efforts to communicate the need for property tax reform will continue.

State Shared Revenues–Revenues from liquor and revenue sharing are expected to have 1.2 percent growth in the first year of the forecast period with 3 percent increases over the remaining years. Liquor taxes are continuing to experience small but steady growth, the recent changes in the State of Washington's liquor distribution laws and taxes are also a contributing factor. Cigarette taxes are expected to be flat over the five-year period; the $0.13 tax increase is not included in distributions to cities and counties. A decline in this revenue is anticipated as the increase in price, due to the tax, will likely impact consumer behavior. The 911 tax revenue is expected to be flat over the forecast period. The 2013 legislature approved extending the sunset date for the tax to January 2022, without an increase to the $.75 rate, but did not approve taxing prepaid cell phones and Voice over Internet Protocol (VoIP) users, so no additional tax revenue will be realized.

Risk Factor–MEDIUM

Policy changes are needed for the 911 system to be adequately funded for the emergency services it provides. State shared revenue sources must be defended against legislation that diverts portions of these revenues to resolving state budget challenges.

Franchise Fee Revenues–Franchise fee revenue growth for energy utility providers is projected to be 1 to 2 percent over the forecast period. In November 2013, NW Natural Gas increased residential and commercial rates, 0.8 and 4.8 percent respectively due to slightly higher wholesale gas prices. PGE received an overall 4.3 percent rate increase beginning in January 2014 reflecting the increased cost of providing its services. The City's water and wastewater franchise fee projected growth is 5 percent in the first year of the forecast based upon projections from the City's biennial Water/Sewer Cost of Service Analysis. The rate of growth declines to 2.5 percent in the remaining years of the forecast primarily due to the estimated affect of water conservation. No growth is anticipated in cable franchise revenue over the forecast period. Refuse hauler franchise fees are projected to increase by 1 percent. Telecommunications is expected to continue to decline by -4.0 percent year-over-year as customers move to less expensive forms of communicating and due to the state's statutory restrictions on how cites can charge these fees to telecommunication companies.

Risk Factor Ranking–MEDIUM

Growth in this revenue is difficult to predict as it is influenced by the provider's billing rate, customer growth, conservation, legislation, and weather. The League anticipates further legislative attempts to preempt local authority related to franchise fees and other right-of-way policies in the 2014 session. These fees are one of the three primary, external revenue sources in the General Fund. Potential changes need to be monitored and, in the case of legislative challenges, defended.

Risks to Expenditure Forecast

This summary presents risks to the expenditure forecast by evaluating the degree by which each identified risk will impact service delivery. This assessment assists in determining actions to be taken over the five-year period.

PERS Employer Rate Increases–A great deal of change has occurred in the investment market and through state legislation in the past year that may influence future PERS employer rates. The advisory PERS rates for the 2015-2017 rating period have declined from 2013 projections. This is due to the legislative reforms now in effect and the higher than expected investment returns on the PERS portfolio for 2013. While both of these factors are favorable for employers, the legislative reforms are not without challenges. In addition, Governor Kitzhaber has made it clear that with the passage of the 2013 reform bills further PERS legislative changes are now "off the table" for the remainder of his term.

Lawsuits have been filed on SB 822 and SB 861 and a decision by the Oregon Supreme Court may not be known until summer. The decision could possibly impact the current rate relief of 4.4 percentage points now in effect as well as rates going forward should these bills be ruled unconstitutional. Because of this uncertainty, the forecast assumes a 22 percent PERS rate increase in FY 2015-16 and FY 2017-18 for all three tiers based on the current year base rates, which do not include the 4.4 percentage point rate relief.

Below is a table of the rates by tier 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 and 2	8.65%	6.12%	12.93%	19.06%	23.25%	28.37%
OPSRP General Service	8.96%	4.37%	9.14%	14.68%	17.91%	21.85%
OPSRP Fire and Police	12.23%	7.08%	11.85%	17.41%	21.24%	25.91%

Risk Factor Ranking–HIGH
The lawsuit outcomes will have an immediate impact on employer rates. Should the legislation be declared unconstitutional, it is anticipated that the PERS Board will recover the needed contributions by increasing future rates. The forecast assumes a higher increase in rates than the PERS advisory rates for this reason.

Health Care Costs–The City's rates are developed annually with the assistance of a consultant knowledgeable in the industry. The rate analysis is based on a review of national and statewide health care cost trends, legislated health care reforms, the required cash reserves to meet obligations year-over-year and the City's claims activity from previous years. The rate of increase for health benefits premium costs is assumed to decline over the five-year period; see Appendix A for the detailed assumption table. The Patient Protection and Affordable Care Act program for transitional reinsurance premium charged on employer plans is included in the calculated rates.

Risk Factor Ranking–MEDIUM
Health care costs could be higher or lower depending on a variety of factors, which are difficult to predict, including increased costs in the health care industry, the amount of filed claims, and future impacts associated with the Patient Protection and Affordable Care Act.

Labor Agreements–Approximately 78 percent of the City's workforce is represented by one of four unions–SPEU (Police), IAFF (Fire), PCEA (911 Communications), and AFSCME (general unit). Approximately 75 percent of General Fund expenses are personnel related making labor agreements a significant cost driver. Wage increases associated with the most recent agreements are incorporated in the forecast. For the years beyond the term of these agreements an assumed one percent wage increase is used. A 2 percent increase is assumed in the first year of the forecast for non-represented employees with 1 percent used in the remaining four years. The increased rate is intended to project the impact of correcting potential inequities in pay relationships between supervisors and the represented staff they supervise, as well as align compensation for some non-represented classifications with the average salary for comparable jobs.

Risk Factor Ranking–MEDIUM
Three labor agreements (AFSCME, PCEA and IAFF) have been ratified, and will expire on June 30, 2015. Negotiations are underway for the Police (SPEU); the current agreement which will expire on June 30, 2014. The risks associated with increased costs from future labor negotiations beyond FY 2014-15 are difficult to measure at this time.

Inflation–The Bureau of Labor Statistics reported in August that the Consumer Price Index-All Urban Consumers (CPI-U) for the Portland-Salem, OR-WA area (not seasonally adjusted) increased 1.3 percent in the first half of 2013 for an annual change of 2.2 percent. The increase was influenced primarily by higher prices for shelter (1.8 percent) and food (1.7 percent). Energy prices declined 1.1 percent since the second half of 2012; natural gas (-4.2 percent), followed by electricity (-1.6 percent) and gasoline (-0.4 percent). For purposes of this forecast, 1.2 percent was used as the inflation factor on general goods and services.

Risk Factor Ranking–LOW
Inflation is expected to remain relatively low over the forecast period for the goods and services that the City purchases. Energy price fluctuations will be monitored but are not anticipated to be significant risks at this time.

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	58%
Local Option Levies	HIGH	
State Shared Revenue	MEDIUM	4.8%
Franchise Fee Revenue	MEDIUM	15.5%

Forecast Risk–Expenditures	**Ranking**	**Percent Total Expense**
PERS Employer Rate Increases	HIGH	7.3%
Health Care Costs	MEDIUM	10.6%
Labor Agreements/Salary Costs	MEDIUM	40.8%
Inflation	LOW	

APPENDIX A-ASSUMPTIONS FOR FORECAST

Percent of General Fund Current Revenues Expended-Schedule A A1
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APPENDIX C-OTHER BACKGROUND INFORMATION

State of Oregon Economic Indicators, November 2013
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Salem Economic Outlook Charts, from Timothy A. Duy
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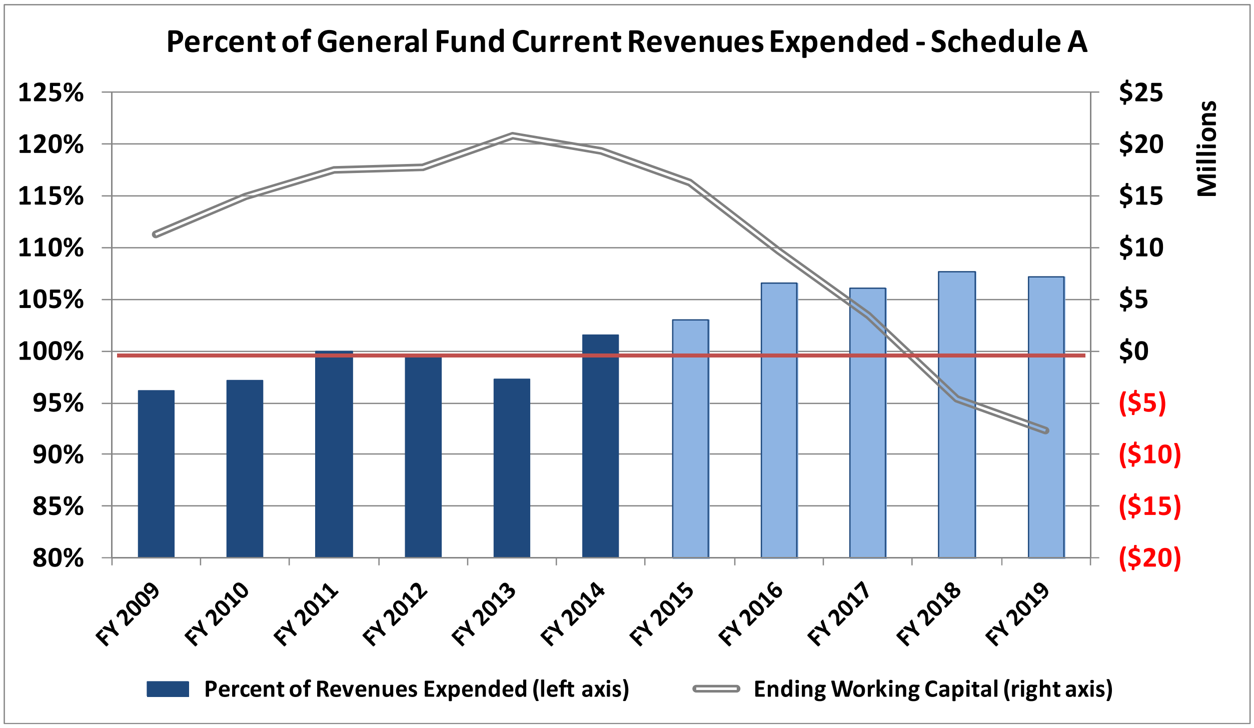
Salem Residential Building Permits, New Values C3
Willamette Valley Residential Housing Sales C4
Salem Value of Residential Construction C4

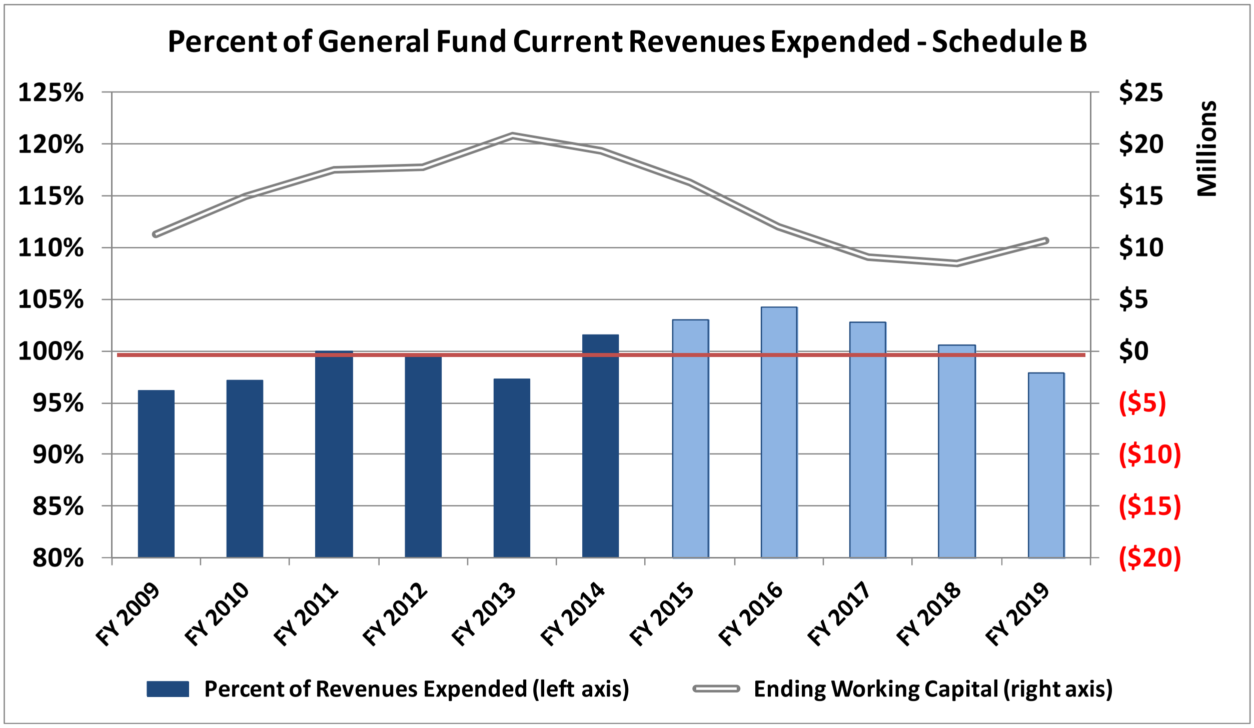
City of Salem Population C5

Unemployment Rate-Salem MSA Versus Oregon C5

Salem MSA 2013 Non-Farm Employment C6



Percent of General Fund Current Revenues Expended - Schedule A
125%
120%
115%
110%
105%
100%
95%
90%
85%
80%
$25
$20
$15
$10
$5
$0
($5)
($10)
($15)
($20)
Millions
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Percent of Revenues Expended (left axis)
Ending Working Capital (right axis)



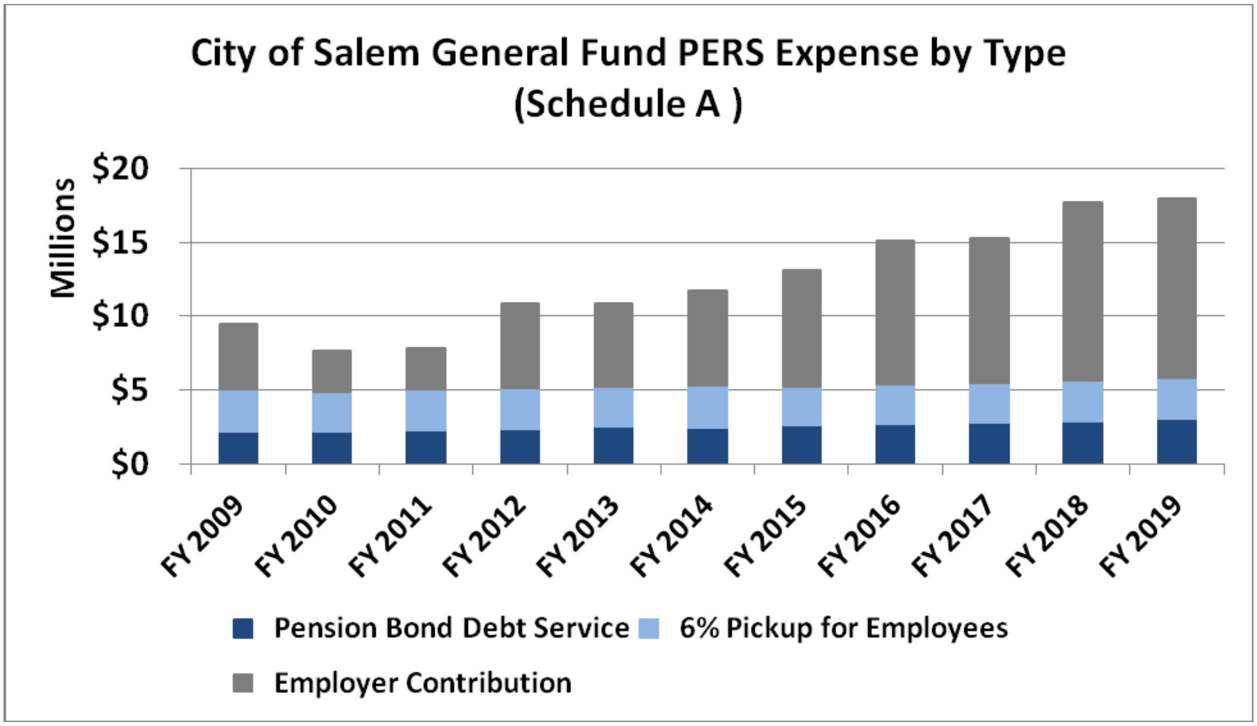
Percent of General Fund Current Revenues Expended - Schedule B
125%
120%
115%
110%
105%
100%
95%
90%
85%
80%
$25
$20
$15
$10
$5
$0
($5)
($10)
($15)
($20)
Millions
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Percent of Revenues Expended (left axis)
Ending Working Capital (right axis)

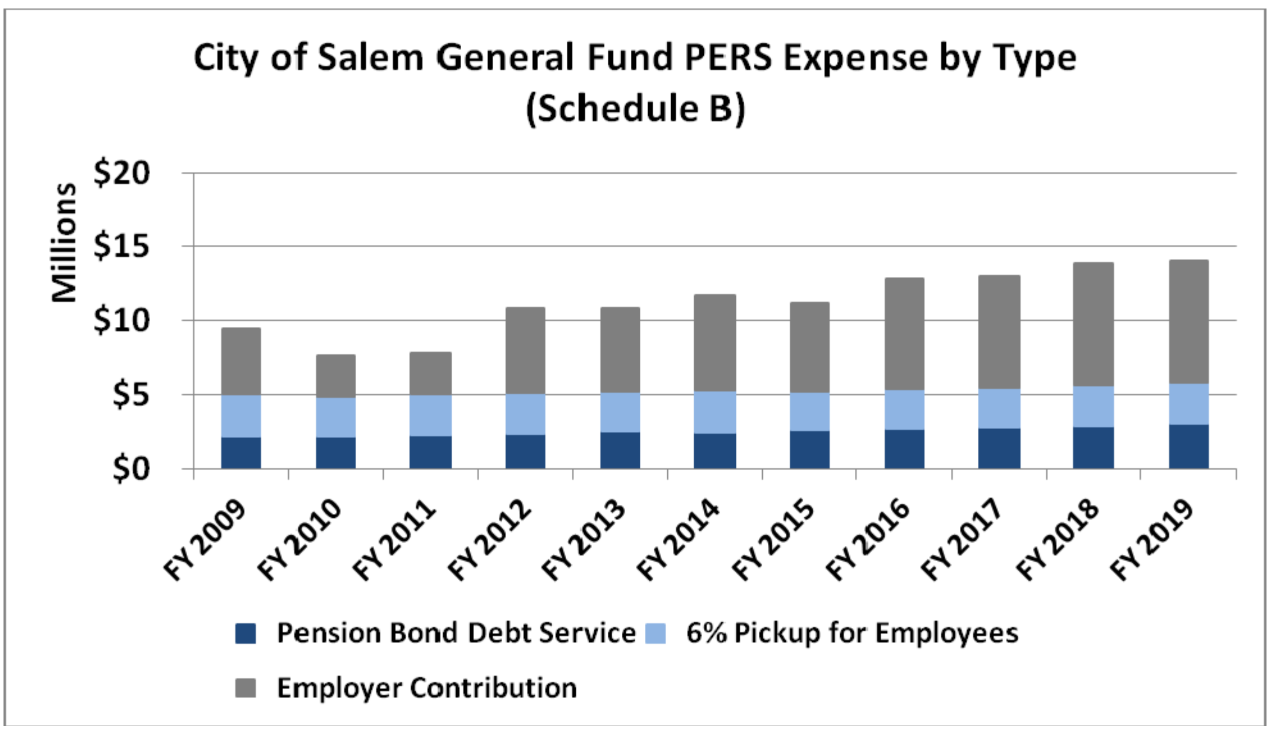
REVENUE ASSUMPTION TABLE

REVENUE	FY 14-15 % Increase	FY 15-16 % Increase	FY 16-17 % Increase	FY 17-18 % Increase	FY 18-19 % Increase
Property tax - driven by growth in AV	1.64%	2.54%	2.53%	2.52%	2.51%
Electric franchise	2.20%	2.00%	2.00%	2.00%	2.00%
Telecommunications franchise	-4.00%	-4.00%	-4.00%	-4.00%	-4.00%
Natural gas franchise	1.00%	1.00%	1.00%	1.00%	1.00%
Cable TV franchise	0.00%	0.00%	0.00%	0.00%	0.00%
Water and sewer franchise	5.08%	3.32%	3.25%	2.57%	2.58%
Fees for service	2.00%	2.00%	2.00%	2.00%	2.00%
Planning fees (site and dwelling plans)	2.00%	2.00%	2.00%	2.00%	2.00%
Other fees	1.20%	1.20%	1.20%	1.20%	1.20%
Licenses/permits	1.50%	1.50%	1.50%	1.50%	1.50%
ICAP	-4.00%	1.50%	1.50%	1.50%	1.50%
Other internal charges	1.20%	1.20%	1.20%	1.20%	1.20%
State shared revenue	2.40%	2.40%	2.40%	2.40%	2.40%
Other agencies	1.00%	1.00%	1.00%	1.00%	1.00%
Grants	0.00%	0.00%	0.00%	0.00%	0.00%
Fines/penalties	0.00%	0.00%	0.00%	0.00%	0.00%
General factor for remaining revenue	1.20%	1.20%	1.20%	1.20%	1.20%

EXPENDITURE ASSUMPTION TABLE

WAGE PROJECTIONS	FY 14-15 % Increase	FY 15-16 % Increase	FY 16-17 % Increase	FY 17-18 % Increase	FY 18-19 % Increase
Market adjustment-AFSCME	1.50%	1.00%	1.00%	1.00%	1.00%
Market adjustment-Police (SPEU)	1.00%	1.00%	1.00%	1.00%	1.00%
Market adjustment-Fire (IAFF)	0.00%	1.50%	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%	8.00%	5.00%	5.00%	5.00%
Dental	7.00%	5.80%	3.80%	3.00%	3.00%
Vision	16.00%	10.00%	5.00%	3.00%	3.00%
Worker's compensation	4.30%	5.00%	5.00%	5.00%	5.00%
Life insurance	8.70%	1.00%	1.00%	1.00%	1.00%
Disability insurance	28.00%	2.00%	2.00%	2.00%	2.00%
Retirement-Employer Tier 1 and 2	0.00%	22.00%	0.00%	22.00%	0.00%
Retirement-Employer-OPSRP General	0.00%	22.00%	0.00%	22.00%	0.00%
Retirement-Employer-OPSRP Police and Fire	0.00%	22.00%	0.00%	22.00%	0.00%
PERS RATE ON ELIGIBLE EARNINGS					
Retirement-Employer Tier 1 and 2	19.06%	23.25%	23.25%	28.37%	28.37%
Retirement-Employer-OPSRP General	14.68%	17.91%	17.91%	21.85%	21.85%
Retirement-Employer-OPSRP Police and Fire	17.41%	21.24%	21.24%	25.91%	25.91%
MATERIALS AND SERVICES					
Base	1.20%	1.20%	1.20%	1.20%	1.20%
Postage	4.00%	1.20%	1.20%	1.20%	1.20%
Natural gas	1.00%	1.00%	1.00%	1.00%	1.00%
Electricity	2.20%	2.00%	2.00%	2.00%	2.00%
Radio Communications	0.00%	0.00%	0.00%	0.00%	0.00%
Motor Pool (Fleet Services)	2.80%	1.20%	1.20%	1.20%	1.20%
Liability Insurance	0.00%	0.00%	0.00%	0.00%	0.00%


City of Salem General Fund PERS Expense by Type
(Schedule A)
Millions
$20
$15
$10
$5
$0
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Pension Bond Debt Service
6% Pickup for Employees
Employer Contribution


City of Salem General Fund PERS Expense by Type
(Schedule B)
Millions
$20
$15
$10
$5
$0
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Pension Bond Debt Service
6% Pickup for Employees
Employer Contribution

City of Salem General Fund PERS Related Expenses (in millions)

Description	Actual FY 07/08	Actual FY 08/09	Actual FY 09/10	Actual FY 10/11	Actual FY 11/12	Actual FY 12/13	Budget FY 13/14	Forecast FY 14/15	Forecast FY 15/16
Tier 1 / Tier 2 PERS Contribution Rate	8.65%	8.65%	6.12%	6.12%	12.93%	12.93%	19.06%	19.06%	23.25%
OPSRP - General Services Contribution Rate	8.96%	8.96%	4.37%	4.37%	9.14%	9.14%	14.68%	14.68%	17.91%
OPSRP - Police and Fire Contribution Rate	12.23%	12.23%	7.08%	7.08%	11.85%	11.85%	17.41%	17.41%	21.24%
Employer Contribution	$4.0	$4.4	$2.7	$2.7	$5.7	$5.5	$8.3	$7.9	$9.8
Employee Contribution	2.7	2.8	2.7	2.7	2.8	2.7	2.7	2.6	2.7
Pension Obligation Bond Debt Service	2.1	2.2	2.2	2.3	2.4	2.5	2.4	2.6	2.7
Total PERS Related Expense:	$8.9	$9.4	$7.6	$7.8	$10.8	$10.8	$13.4	$13.1	$15.1
Total Personal Services	$69.8	$71.9	$66.8	$68.5	$73.2	$75.6	$79.1	$80.8	$84.3
PERS Expense as a percentage of Total Personal Services:	12.71%	13.07%	11.33%	11.31%	14.80%	14.24%	16.98%	16.25%	17.92%

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

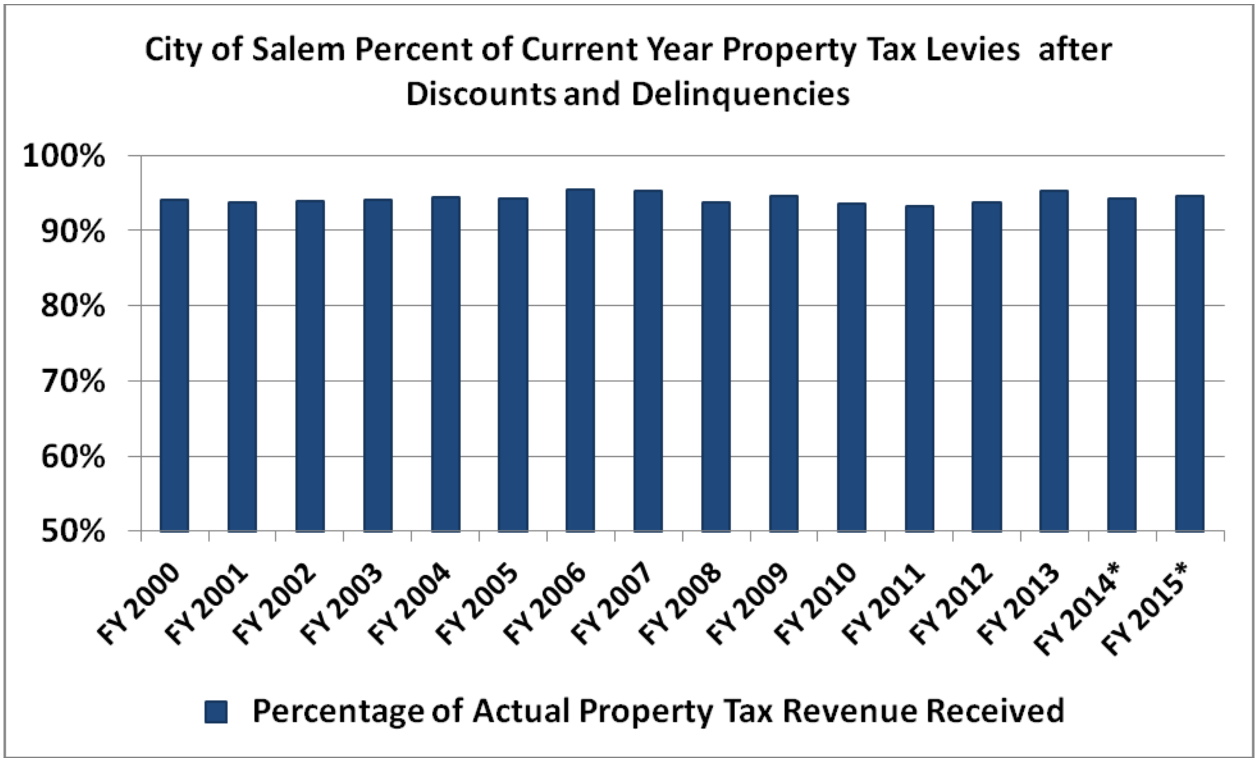
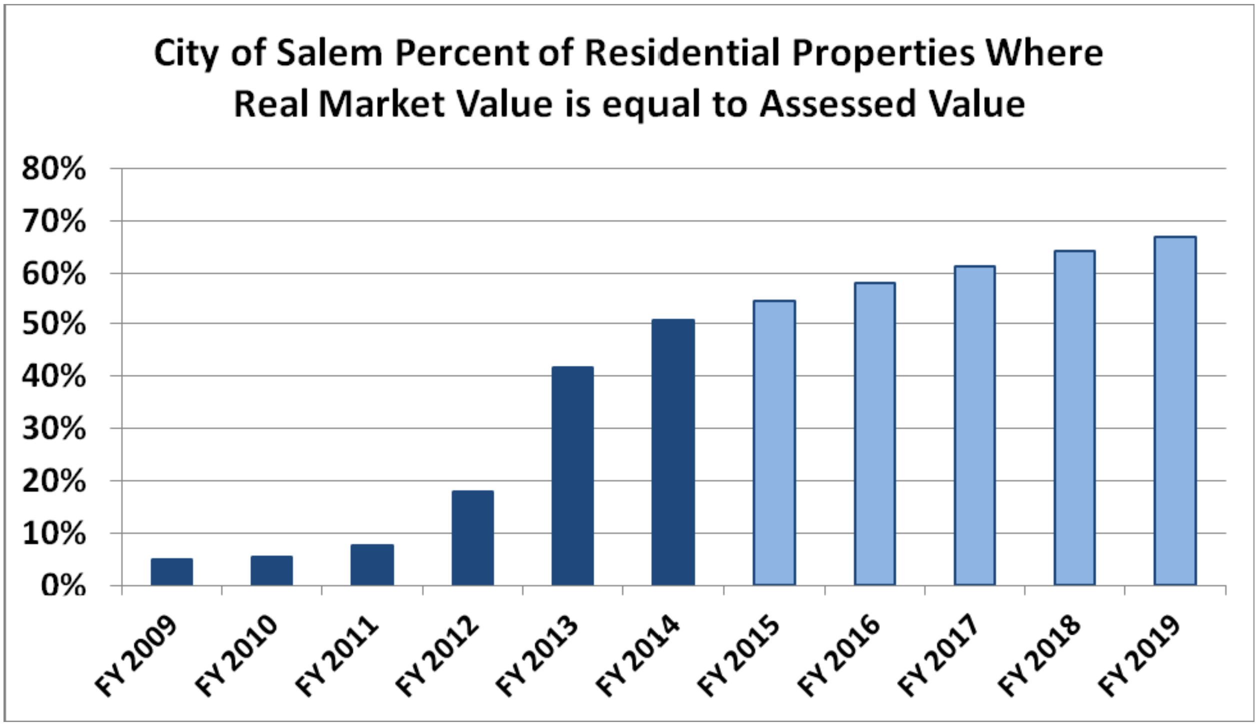
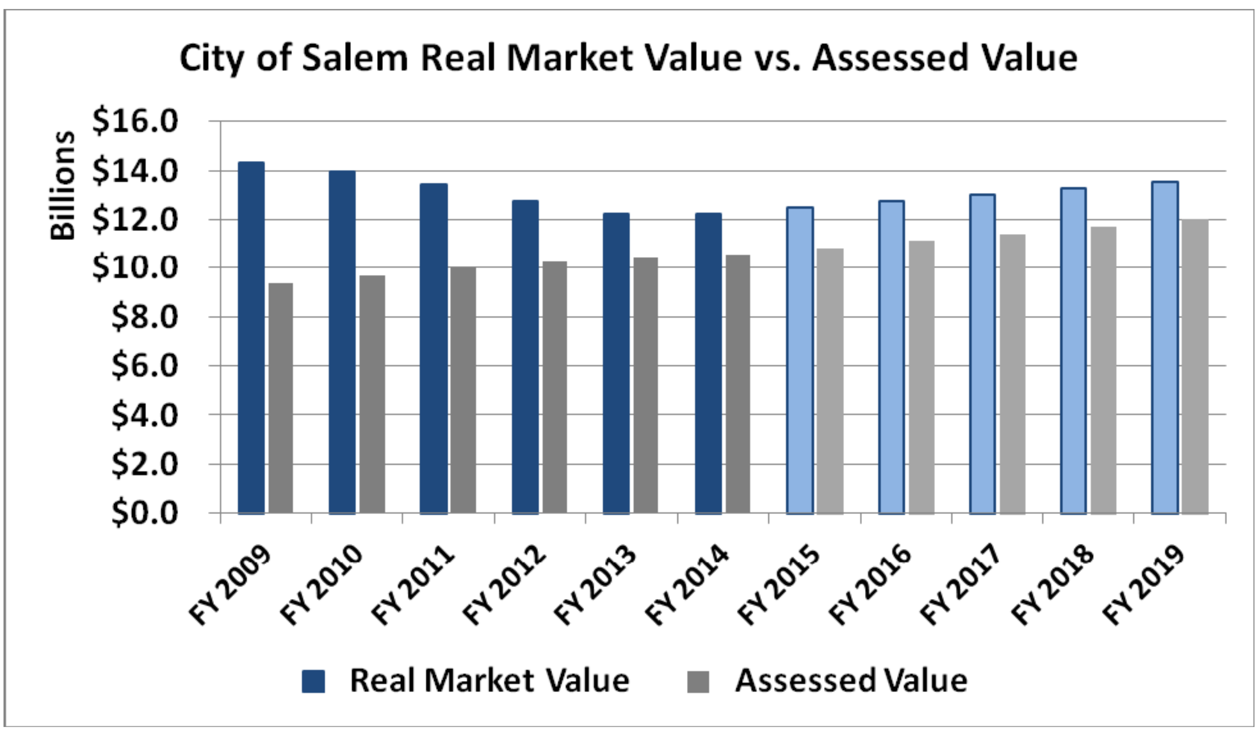
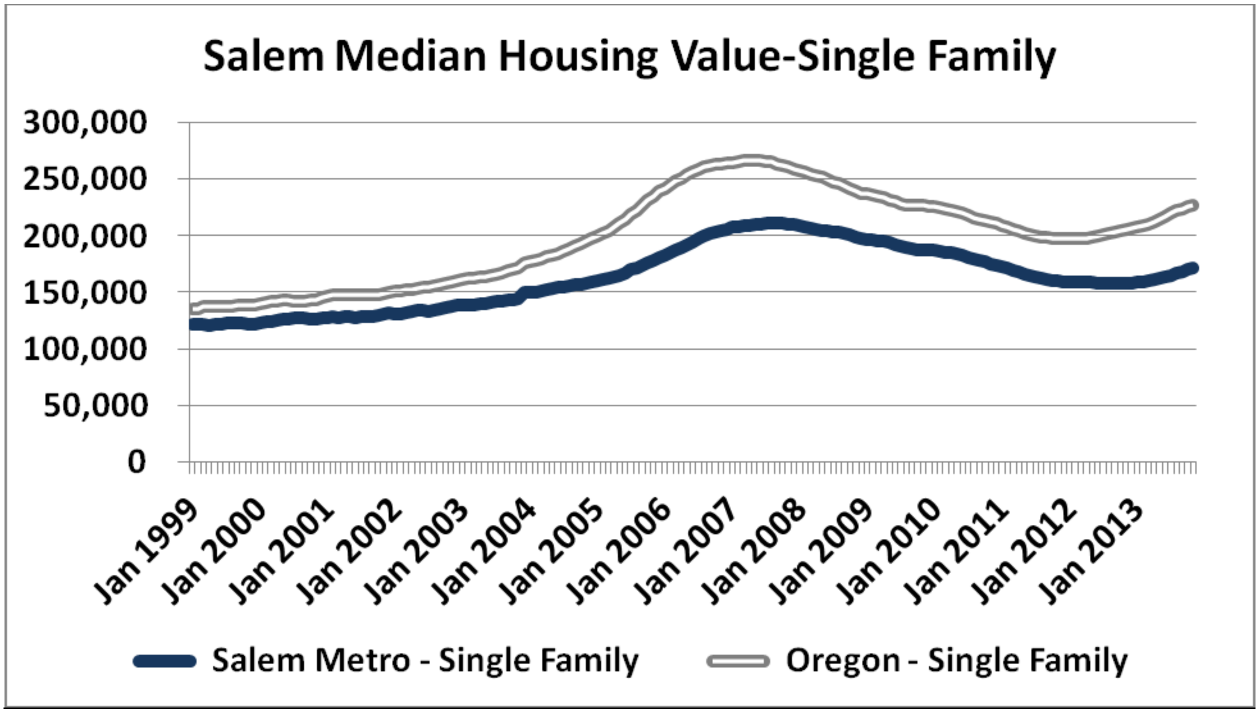


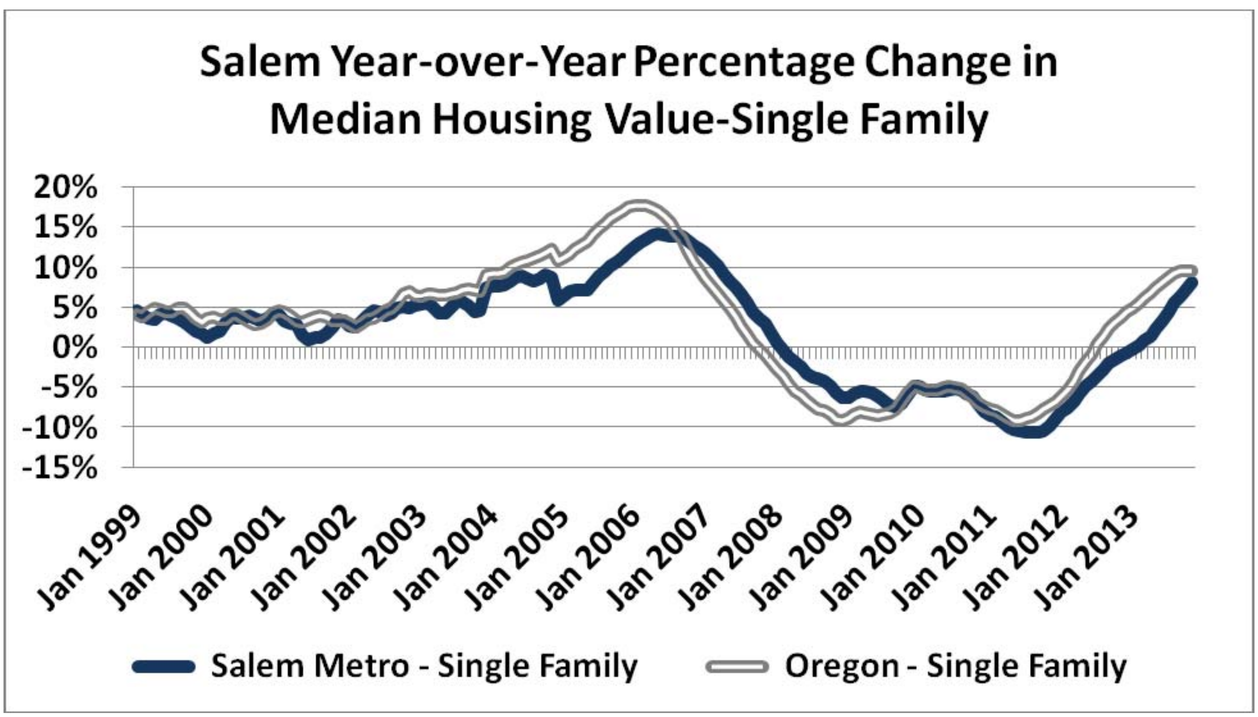
Table 2 - Historic Changes in Property Tax Levies Since the Passage of Measure 50					
Fiscal Year	Levy	Increase		Actual	Increase
FY 2000	$33,213,490	-		$31,239,718	-
FY 2001	35,000,560	5.4%		32,787,613	5.0%
FY 2002	36,754,990	5.0%		34,517,563	5.3%
FY 2003	38,815,890	5.6%		36,495,536	5.7%
FY 2004	40,564,780	4.5%		38,309,011	5.0%
FY 2005	42,316,780	4.3%		39,880,157	4.1%
FY 2006	44,234,820	4.5%		42,212,928	5.8%
FY 2007	46,747,260	5.7%		44,535,508	5.5%
FY 2008	49,708,758	6.3%		46,619,613	4.7%
FY 2009	51,979,085	4.6%		49,177,277	5.5%
FY 2010	53,837,888	3.6%		50,330,937	2.3%
FY 2011	55,258,870	2.6%		51,547,855	2.4%
FY 2012	56,245,200	1.8%		52,765,171	2.4%
FY 2013	56,216,930	-0.1%		53,542,934	1.5%
FY 2014*	57,390,154	2.1%		54,080,976	1.0%
FY 2015*	58,894,346	2.6%		55,730,615	3.1%

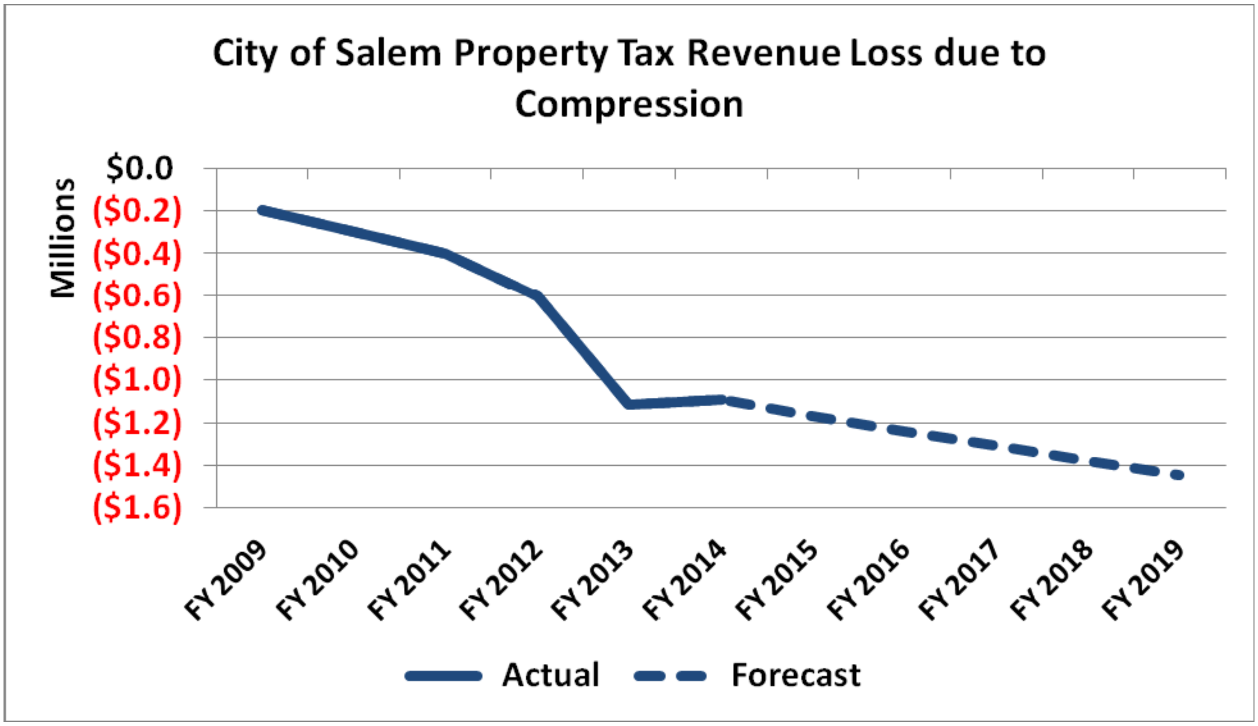
*** Projected**

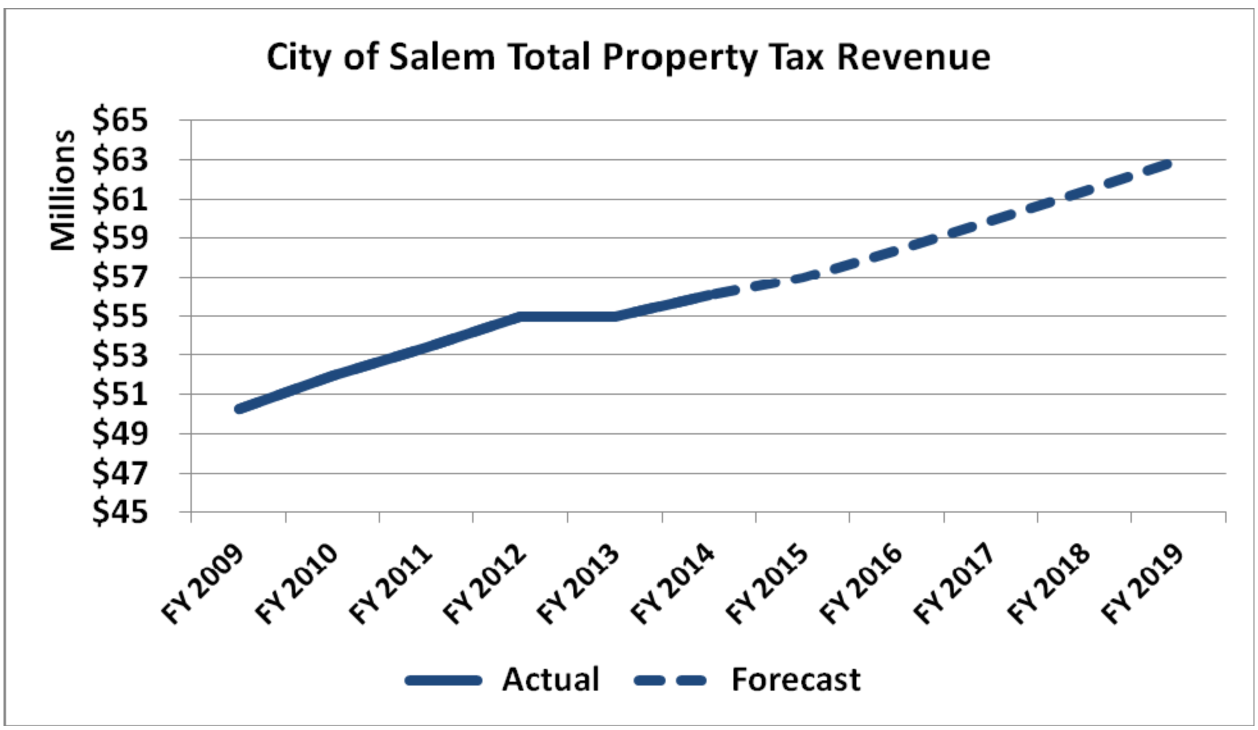

City of Salem Percent of Residential Properties Where Real Market Value is equal to Assessed Value
80%
70%
60%
50%
40%
30%
20%
10%
0%
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019

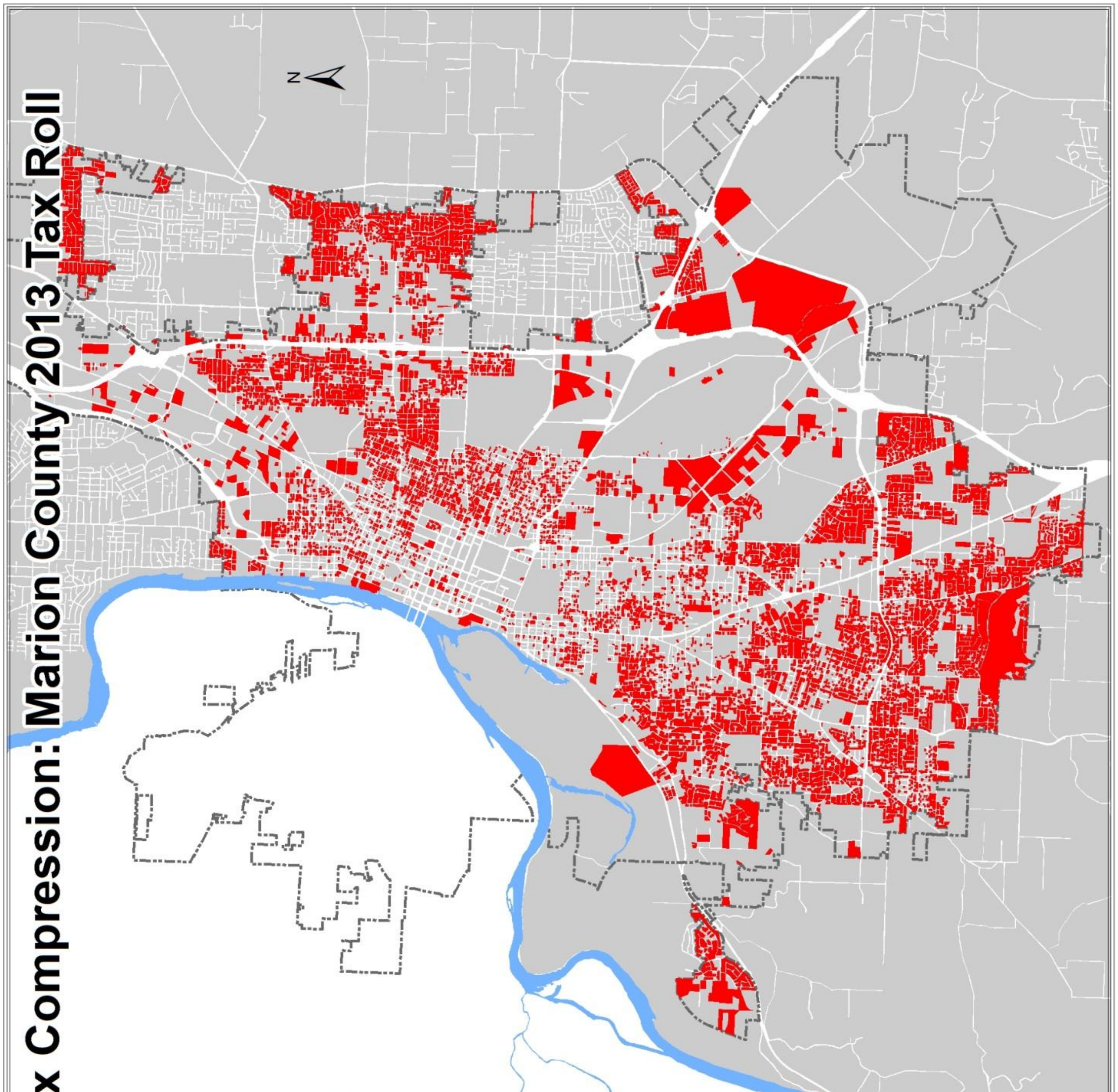

City of Salem Real Market Value vs. Assessed Value
Billions
$16.0
$14.0
$12.0
$10.0
$8.0
$6.0
$4.0
$2.0
$0.0
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Real Market Value
Assessed Value


Salem Median Housing Value-Single Family
300,000
250,000
200,000
150,000
100,000
50,000
0
Jan 1999
Jan 2000
Jan 2001
Jan 2002
Jan 2003
Jan 2004
Jan 2005
Jan 2006
Jan 2007
Jan 2008
Jan 2009
Jan 2010
Jan 2011
Jan 2012
Jan 2013
Salem Metro - Single Family
Oregon - Single Family


Salem Year-over-Year Percentage Change in Median Housing Value-Single Family
20%
15%
10%
5%
0%
-5%
-10%
-15%
Jan 1999
Jan 2000
Jan 2001
Jan 2002
Jan 2003
Jan 2004
Jan 2005
Jan 2006
Jan 2007
Jan 2008
Jan 2009
Jan 2010
Jan 2011
Jan 2012
Jan 2013
Salem Metro - Single Family
Oregon - Single Family


City of Salem Property Tax Revenue Loss due to Compression
Millions
$0.0
($0.2)
($0.4)
($0.6)
($0.8)
($1.0)
($1.2)
($1.4)
($1.6)
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Actual
Forecast


City of Salem Total Property Tax Revenue
Millions
$65
$63
$61
$59
$57
$55
$53
$51
$49
$47
$45
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
Actual
Forecast



Property Tax Compression: Marion County 2013 Tax Roll
N
Compression
City Boundary
CITY OF Salem AT YOUR SERVICE
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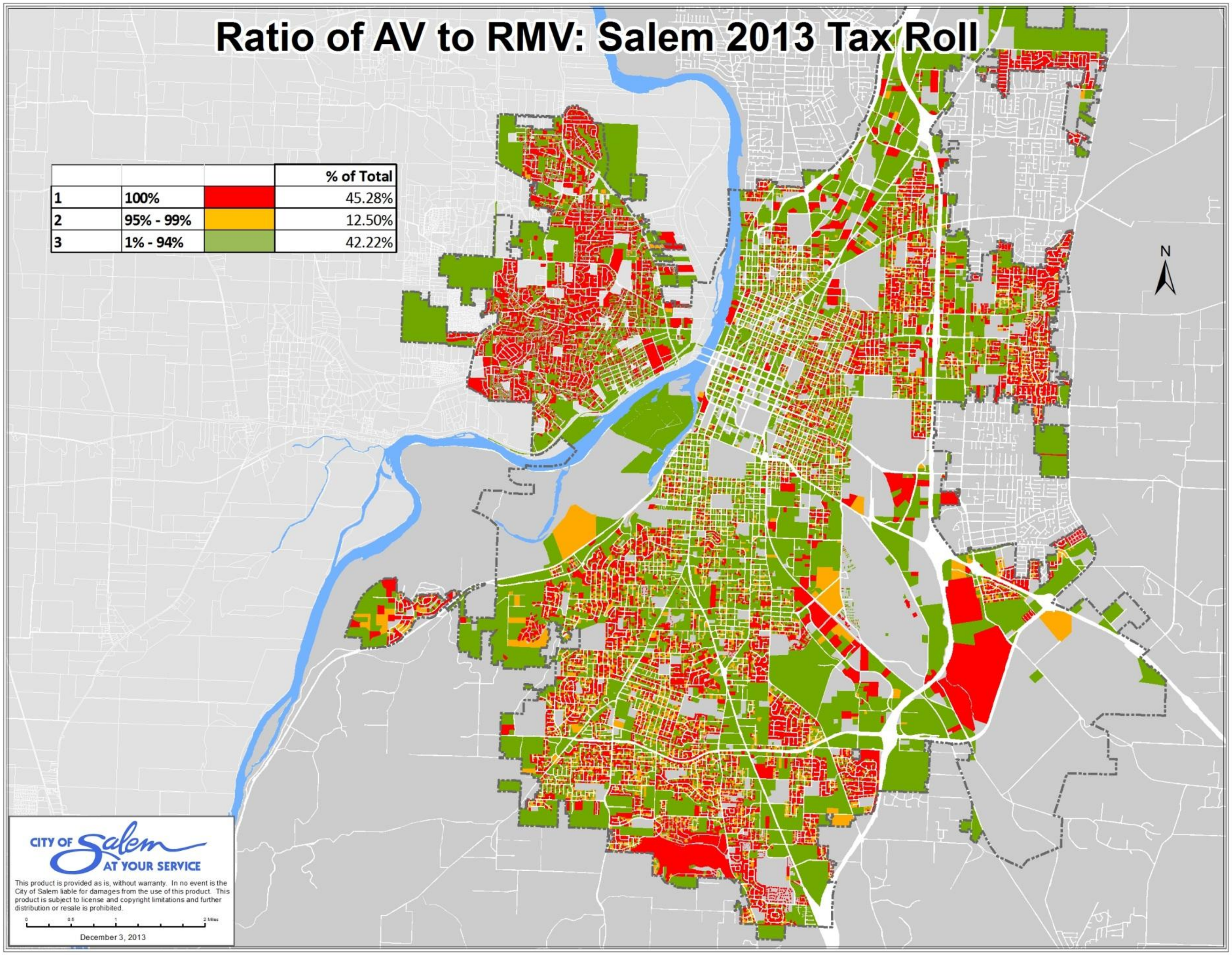
November 12, 2013


Ratio of AV to RMV: Salem 2013 Tax Roll
% of Total
1 100% 45.28%
2 95% - 99% 12.50%
3 1% - 94% 42.22%
N
CITY OF Salem
AT YOUR SERVICE
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0 0.5 1 2 Miles
December 3, 2013

STATE OF OREGON ECONOMIC INDICATORS™

A program of the College of Arts and Sciences and its Department of Economics

NOVEMBER 2013

How can I interpret the Oregon Measure of Economic Activity?

A reading of "zero" corresponds to the average growth rate for that particular region. In other words, the measures identify periods of fast or slow growth relative to trend.

What is the significance of the moving-average measures?

The monthly measures can be very volatile. To reduce the noise, it is helpful to focus on the average of the most recent data.

Is this approach used elsewhere?

Yes, the Chicago Federal Reserve Bank uses the same basic approach to measure both national and regional economic activity.

What is the difference between the two measures?

The Oregon Measure of Economic Activity uses a methodology that allows for the incorporation of a larger number of variables. The University of Oregon Index of Economic Indicators focuses on a narrower set of variables using a different methodology used by the Conference Board to compute leading indicators for the United States. Using different indicators allows for a more complete picture of the Oregon economy.

Contact
Timothy A. Duy
Director, Oregon Economic Forum
Department of Economics, University of Oregon
541-346-4660 · duy@uoregon.edu
econforum.uoregon.edu

Review

The Oregon economy continued to post moderate gains in November. The Oregon Measure of Economic Activity rose to 0.39 in November, up from a revised -0.02 the previous month. The three-month moving average, which smooths month-to-month volatility in the measure, is -0.06 where "zero" for this measure indicates the average growth rate over the 1990-present period. Similar to recent months, manufacturing activity contributed positively to the index, while the impact of construction activity was effectively neutral. Employment measures in the construction sector contributed positively to the measure. The household sector had a neutral effect, while employment in the trade, transportation and utilities employment component supported a positive contribution from the services sector.

The University of Oregon Index of Economic Indicators™ gained 0.6 percent in November; the UO Index has risen in eleven of the past twelve months. Initial unemployment claims dropped sharply and are now in a range consistent with strong job growth in Oregon, suggesting that the pace of hiring may accelerate in the months ahead. Residential building permits (smoothed) were unchanged from October; permitting activity leveled-out at around 1,100 permits per month after rising to the 1,300 range earlier in the year. Core manufacturing (nondefense, nonaircraft capital goods) new orders rebounded, although have remained roughly unchanged since January 2013. Weekly hours worked in the Oregon manufacturing sector continue to hover near recent highs. The weight distance tax, a measure of trucking activity, rose to its highest level since January 2008. The improvement in the measure during 2013 is consistent with moderate gains in activity.

Overall, the two indicators point to sustained expansion in Oregon at an average pace of activity. The recovery will likely continue in 2014 as lessening fiscal drag and supportive monetary policy contribute to moderately stronger growth next year.

Contributions to Oregon Measure of Economic Activity–November 2013

	Manufacturing	Construction	Households	Services
ISM Manufacturing: Imports Index	0.06			
ISM Manufacturing: Supplier Deliveries Index	0.01			
Manufacturing Employment, Oregon	0.03			
Hours, Manufacturing Production Workers, Oregon	0.14			
Port of Portland, Twenty-Foot Equivalent Units (TEU)	-0.06			
Manufacturing Exports, Oregon	-0.01			
New Private Housing Units Authorized By Building Permit, Oregon		-0.09		
Construction Employment in Oregon		0.06		
Natural Resources and Mining Employment, Oregon		0.07		
Employment Services Employment, Oregon			0.01	
Initial Unemployment Claims, Oregon			0.16	
Civilian Labor Force, Oregon			-0.04	
Unemployment Rate, Oregon			-0.03	
Interest Rate Spread			-0.05	
S&P500 Stock Index			0.03	
Consumer Sentiment, University of Michigan - Reuters			-0.09	
Educational and Health Services Employment, Oregon				-0.01
Financial Activities Employment, Oregon				-0.01
Government Employment, Oregon				0.01
Leisure and Hospitality Employment, Oregon				-0.07
Professional and Business Services Employment, Oregon				0.04
Other Services Employment, Oregon				0.06
Trade, Transportation and Utilities Employment, Oregon				0.16
Total By Sector	**0.17**	**0.04**	**0.00**	**0.18**

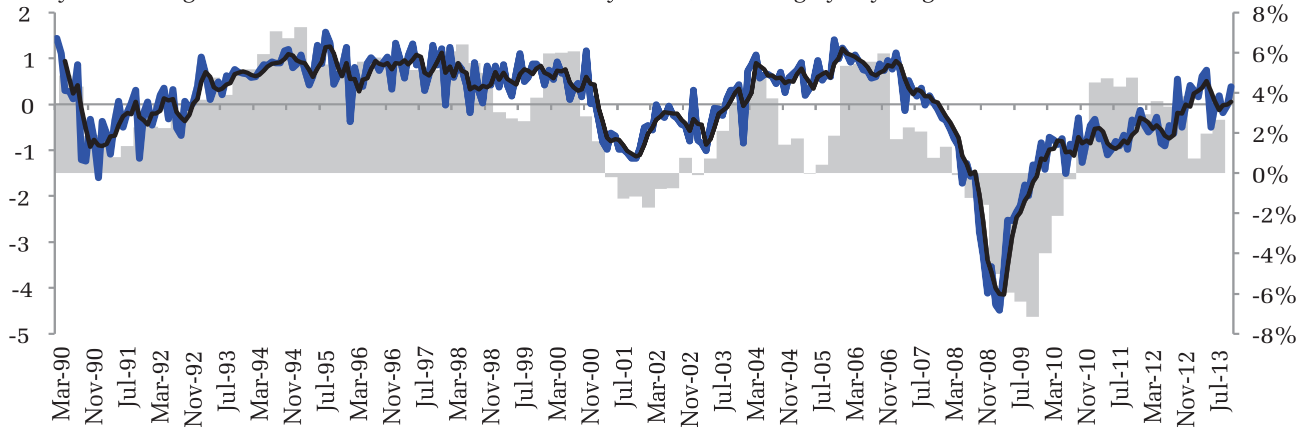
	Sep-13	Oct-13	Nov-13
Oregon Measure of Economic Activity	-0.19	-0.02	0.39
Three-Month Moving Average	-0.02	-0.01	0.06

Released: January 15, 2014.

UNIVERSITY OF OREGON ECONOMIC INDICATORS™

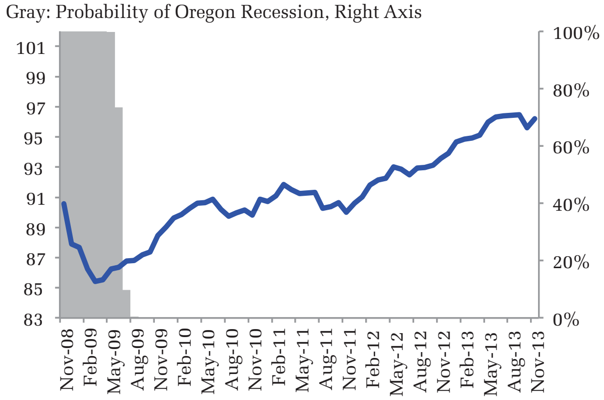
Oregon Measure of Economic Activity

Black: Three Month Moving Average, Left Axis
Gray: Real Oregon Personal Income less Transfer Payments, % Change y-o-y, Right Axis



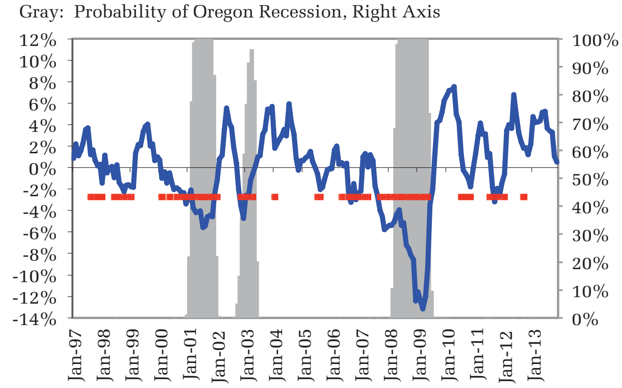
UO Index of Economic Indicators

Blue: UO Index, 1997=100, Left Axis
Gray: Probability of Oregon Recession, Right Axis



UO Index of Economic Indicators, % Change

Blue: 6-Month Percentage Change, Annualized
Red: 6-Month Diffusion Index Declines More Than 50%
Gray: Probability of Oregon Recession, Right Axis



University of Oregon Index of Economic Indicators – Summary and Components

	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13
UO Index of Economic Indicators,™ 1997=100	96.3	96.4	96.4	96.5	95.6	96.2
Percentage Change	0.4	0.0	0.1	0.0	-0.9	0.6
Oregon Initial Unemployment Claims, SA*	6,734	6,767	6,685	6,332	6,286	5,627
Oregon Employment Services Payrolls, SA	35,251	35,693	35,713	35,084	34,105	34,490
Oregon Residential Building Permits, SA, 5 MMA*	1,293	1,214	1,217	1,131	1,126	1,120
Oregon Weight Distance Tax, SA,	107.03	109.50	104.75	109.45	106.64	109.69
Oregon Manufacturing Average Weekly Hours, SA	41.44	40.89	41.13	41.22	40.77	40.88
U.S. Consumer Sentiment, SA, 5 MMA	80.2	81.7	82.4	82.7	80.4	78.6
Real Manufacturers' New Orders for Nondefense, Nonaircraft Capital Goods, $ Millions, SA	42,394	40,898	41,363	40,758	40,422	42,197
Interest Rate Spread	2.21	2.49	2.66	2.73	2.53	2.64

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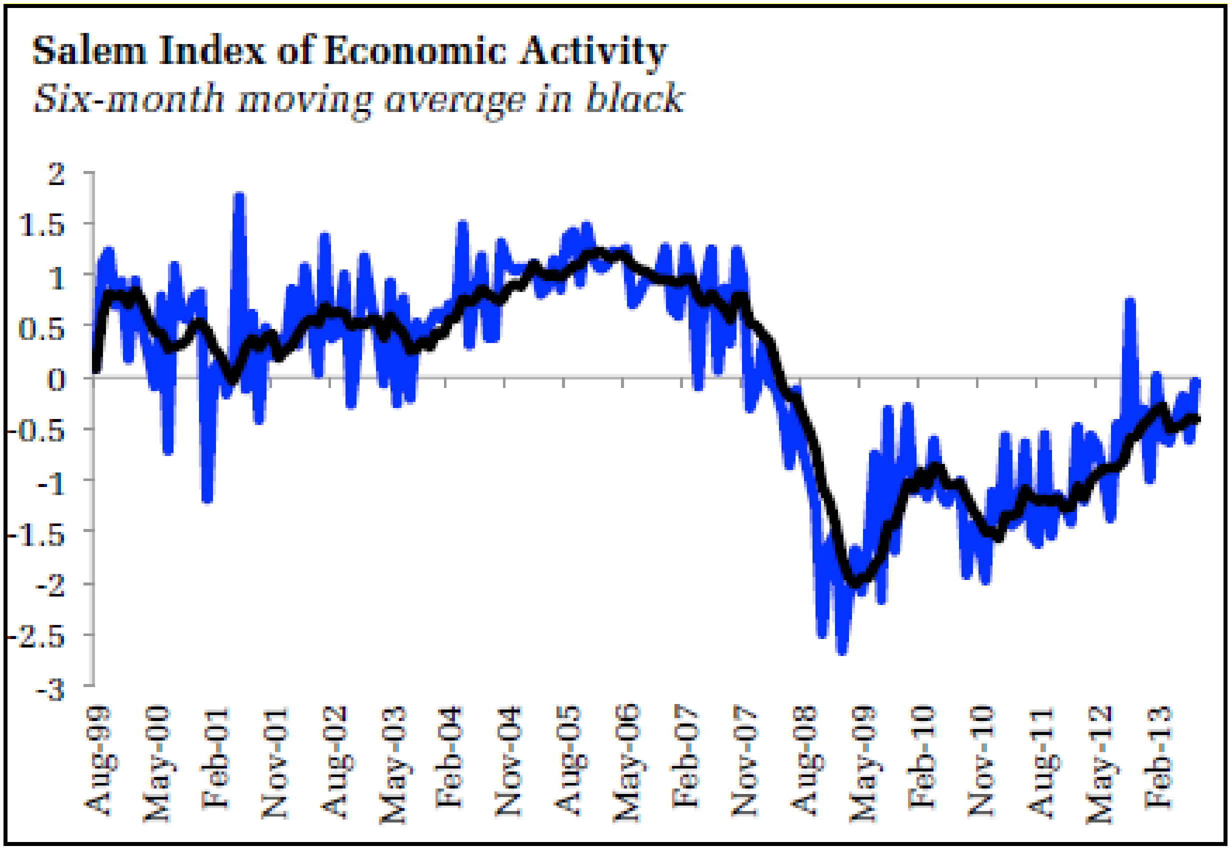
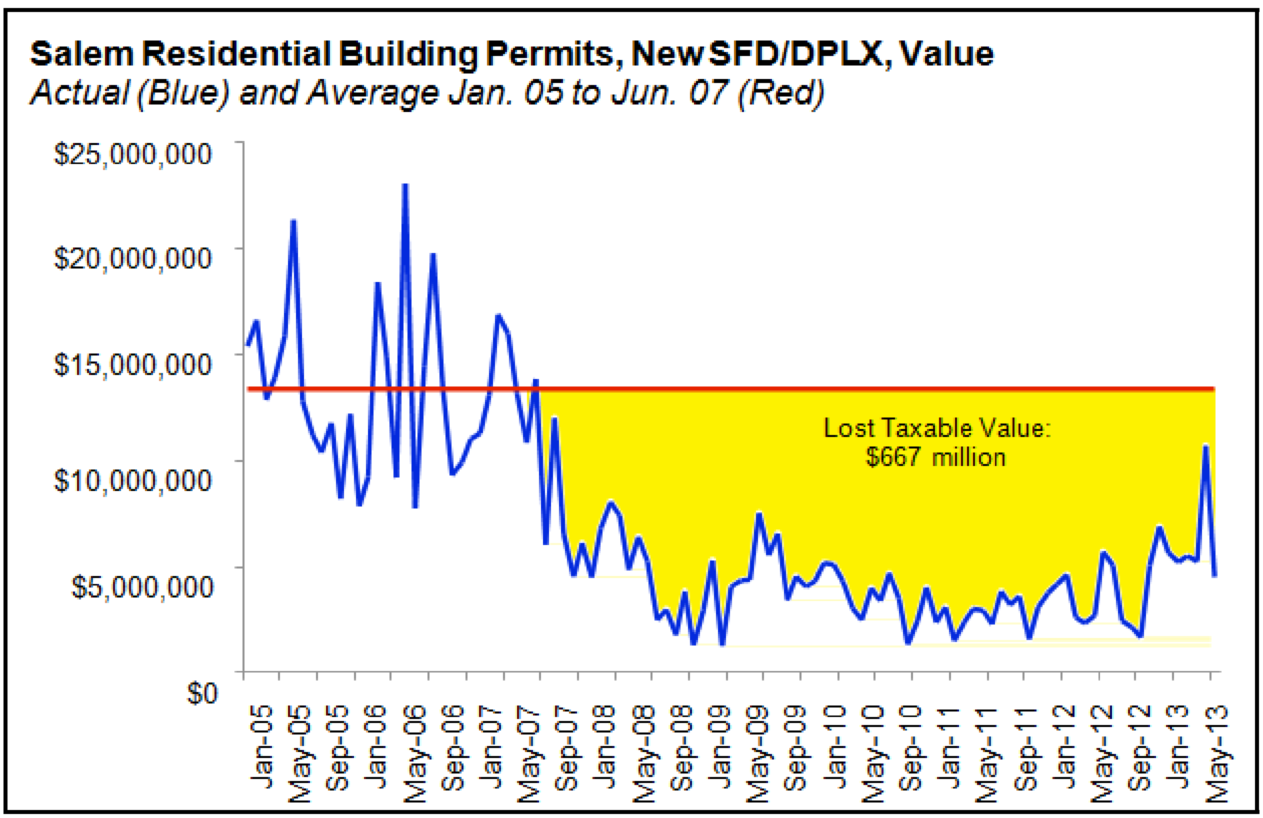
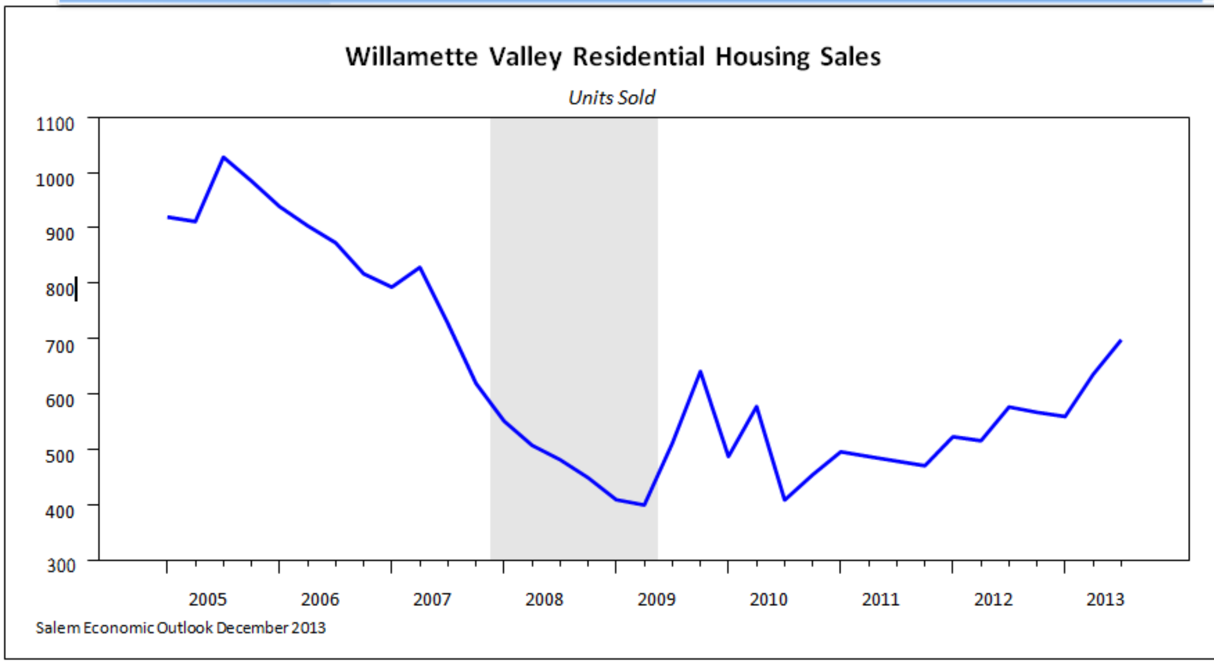
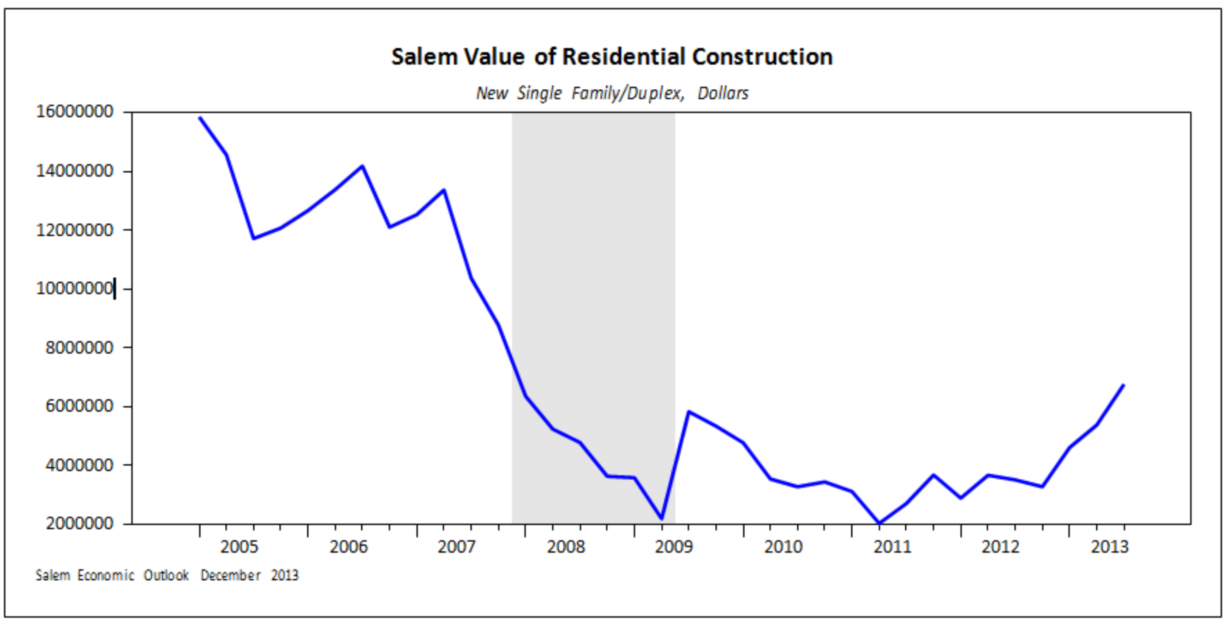
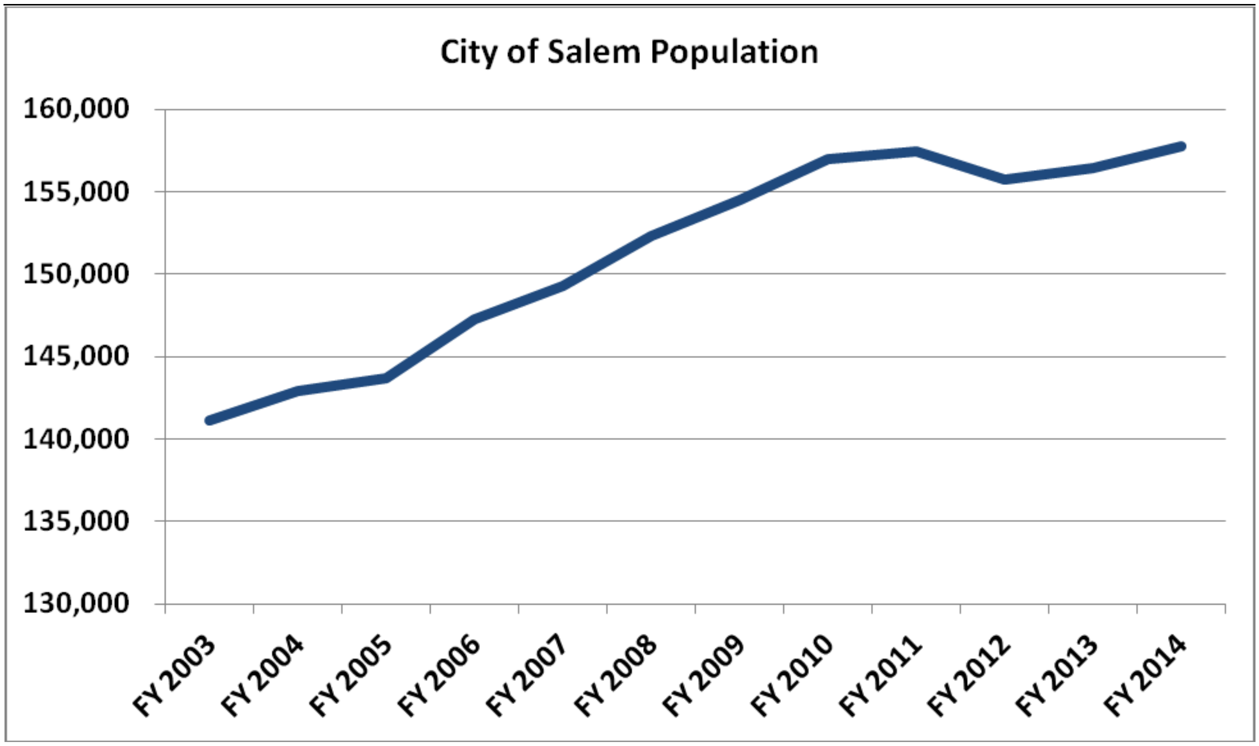
College of Arts and Sciences

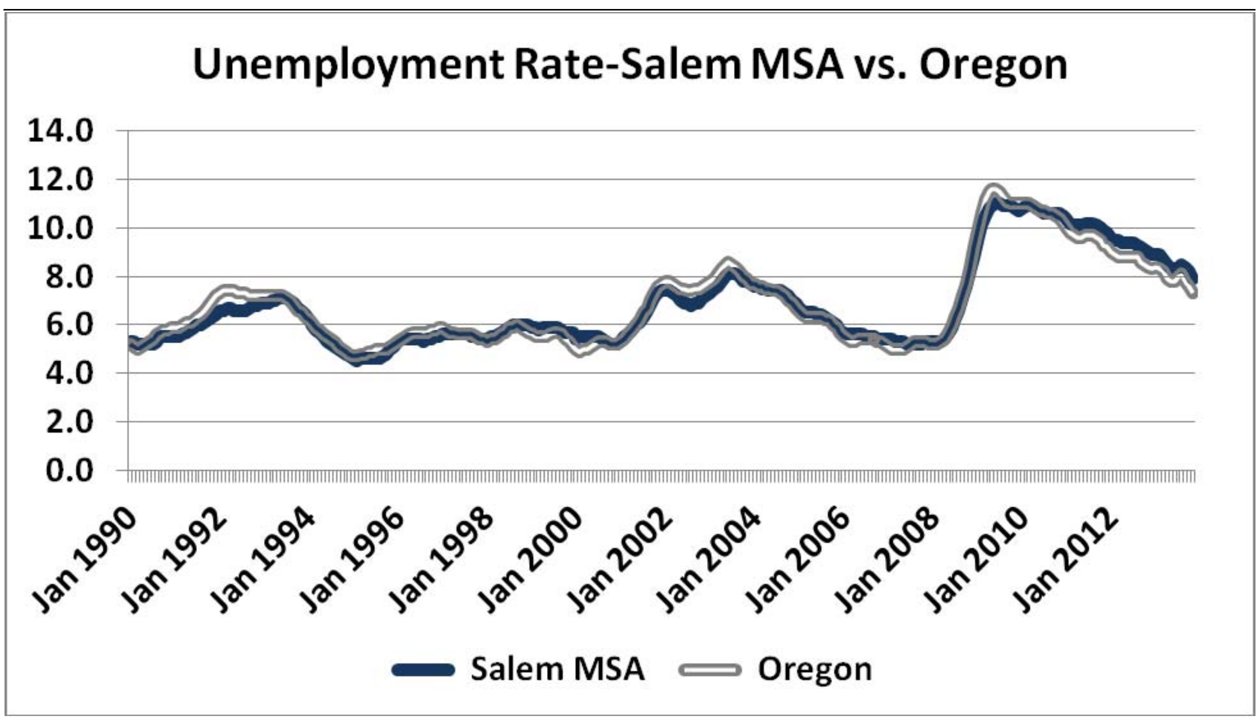

Salem Index of Economic Activity
Six-month moving average in black
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
Aug-99
May-00
Feb-01
Nov-01
Aug-02
May-03
Feb-04
Nov-04
Aug-05
May-06
Feb-07
Nov-07
Aug-08
May-09
Feb-10
Nov-10
Aug-11
May-12
Feb-13


Salem Residential Building Permits, New SFD/DPLX, Value
Actual (Blue) and Average Jan. 05 to Jun. 07 (Red)
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
Lost Taxable Value:
$667 million
Jan-05
May-05
Sep-05
Jan-06
May-06
Sep-06
Jan-07
May-07
Sep-07
Jan-08
May-08
Sep-08
Jan-09
May-09
Sep-09
Jan-10
May-10
Sep-10
Jan-11
May-11
Sep-11
Jan-12
May-12
Sep-12
Jan-13
May-13


Willamette Valley Residential Housing Sales
Units Sold
1100
1000
900
800
700
600
500
400
300
2005
2006
2007
2008
2009
2010
2011
2012
2013
Salem Economic Outlook December 2013

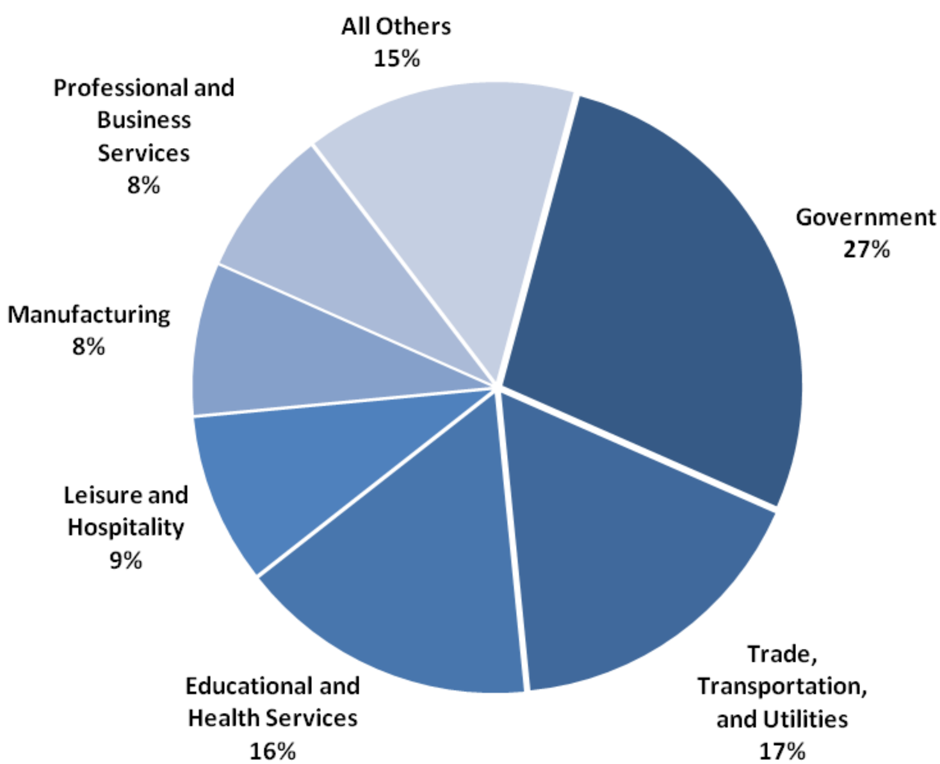

Salem Value of Residential Construction
New Single Family/Duplex, Dollars
16000000
14000000
12000000
10000000
8000000
6000000
4000000
2000000
2005
2006
2007
2008
2009
2010
2011
2012
2013
Salem Economic Outlook December 2013


City of Salem Population
160,000
155,000
150,000
145,000
140,000
135,000
130,000
FY 2003
FY 2004
FY 2005
FY 2006
FY 2007
FY 2008
FY 2009
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014


Unemployment Rate-Salem MSA vs. Oregon
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Jan 1990
Jan 1992
Jan 1994
Jan 1996
Jan 1998
Jan 2000
Jan 2002
Jan 2004
Jan 2006
Jan 2008
Jan 2010
Jan 2012
Salem MSA
Oregon

Salem MSA 2013 Non-Farm Employment

Category	Average Employment
Government	39,427
Trade, Transportation, and Utilities	24,218
Educational and Health Services	22,973
Leisure and Hospitality	13,064
Manufacturing	11,718
Professional and Business Services	11,455
Financial Activities	7,064
Construction	6,691
Other Services	4,982
Mining and Logging	1,164
Information	1,000
Total:	143,755



*** Source: Oregon Employment Department 2013 Non-Farm Employment (Average as of Nov 2013)**