CITY OF SALEM, OREGON

TRANSPORTATION

FIVE YEAR FINANCIAL FORECAST

FISCAL YEARS 2013-14 THROUGH 2017-18

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TRANSPORTATION - FUND 155

Executive Summary

Transportation, a component of the public works fund, provides funding for core, day to day operations and maintenance of the city's streets, traffic signals, streetlights, and sidewalks. The fund provides the Public Works Department the ability to act on Council goals that address the long term support of community needs for public safety, livability, environmental health and economic development. Each year this has become more challenging as the nation moves slowly out of the recession. The forecast for transportation presented this year shows that the city must stay the course on being fiscally conservative with spending and maintain an adequate ending working capital balance. However, the gap between available resources and anticipated expenditures is of such a magnitude that the need for additional revenue in transportation needs to be seriously considered. Highlights of this forecast include:

- Revenue growth does not keep pace with the growth in operations costs.
- The higher mandated PERS rates are unsustainable over the five-year forecast period without major expenditure reductions.
- Further budget reductions or an additional revenue source is needed or working capital will be depleted by year one of the forecast.

Forecast Results

The transportation 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, emerging vehicle technologies, worldwide and regional petroleum supplies and prices, consumer behavior, and the growth in primary revenue sources, of which state highway fund revenues provide 70 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, energy costs, and inflationary increases on contracted goods and services. The tables for the expenditure assumptions are included in the appendix.

The primary funding source for transportation is the city's monthly allocation of state highway fund revenues. This fund receives revenue from motor vehicle fuel taxes; heavy commercial vehicle weight/mile taxes; and title, licensing, and registration fees from the Department of Motor Vehicles (DMV). The statewide motor vehicle fuel tax is currently 30 cents per gallon of retail fuel sold. Since the fuel tax revenue is based on the amount of gallons sold, revenues are sensitive to economic factors such as the regional price and availability of fuel, emerging fuel-efficient vehicle technologies, and consumer behavior. The city's allocation is based on a per capita distribution of the portion allocated to cities.

The Oregon Department of Transportation (ODOT) provides a four-year forecast of state highway fund revenues in June of each year. The city uses the ODOT forecast to calculate its anticipated allocation of state highway fund revenues. Based on historical performance, the city currently budgets its revenue and expenditures to 96.5 percent of ODOT's forecasted revenue amount for Salem. The June 2012 ODOT revenue forecast shows only a 1.2 percent increase in state highway fund revenues for Salem from FY 2012-13 to FY 2013-14. The forecast further shows 3.5 percent increases for FY 2014-15 and FY 2015-16, reflecting an anticipated stronger economic recovery, flattening out to a 3 percent increase in FY 2016-17. The city's five-year forecast shows a continued 3 percent increase in state highway fund revenues for FY 2017-18. Given the economic uncertainties facing the nation and Oregon's lagging economic recovery, it is uncertain whether 3 percent or greater increases in state highway fund revenues will be realized.

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

Current Service Level – Schedule A

Schedule A presents the challenges transportation faces if it is to maintain FY 2012-13 service levels over the five-year forecast period. The continued slow-to-no growth in transportation revenue, coupled with the projected increased growth in expenditures, results in depleting working capital to **$0.6 million** by the end of FY 2013-14. This is 38 percent of the targeted fund balance of two months of state highway fund revenue ($1.5 million). This results in insufficient funding for a balanced budget beginning in the second year of the forecast.

Schedule A - FY 2013-14 Five Year Transportation 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	$ 2.4	$ 2.3	$ 1.3	$ 0.6	$ -	$ -	$ -
Current Year Revenue	10.5	10.5	10.8	10.9	11.4	11.7	12.1
TOTAL RESOURCES	12.9	12.9	12.1	11.5	11.4	11.7	12.1
EXPENDITURES							
Base Expenditures	12.4	12.1	12.0	12.4	12.8	13.2	13.7
Less:							
Anticipated Expenditure Savings	-	(0.5)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)
NET TOTAL EXPENDITURES	12.4	11.6	11.5	11.9	12.3	12.6	13.1
Estimated Ending Working Capital	$ 0.5	$ 1.3	$ 0.6	$ (0.4)	$ (0.9)	$ (0.9)	$ (1.0)

* Projected 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 annual anticipated 4 percent expenditure savings over the base budgeted expenditures. The 4 percent savings recognizes the historical trends of the fund's actual spending versus adopted expenditure budgets. As permanent service level cost reductions are implemented over the next five-years, the 4 percent used to calculate anticipated savings on forecasted expenditures may be optimistic and will be re-evaluated.

Schedule B - Transportation Budget Balancing Scenario through FY 17-18

(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	$ 2.3	$ 1.3	$ 1.5	$ 1.5	$ 1.6	$ 1.6
Current Year Revenue	10.5	10.8	10.9	11.4	11.7	12.1
TOTAL RESOURCES	12.9	12.1	12.4	12.9	13.3	13.8
EXPENDITURES						
Base Expenditures	12.1	12.0	12.4	12.8	13.2	13.7
Less:						
Anticipated Expenditure Savings	(0.5)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)
Permanent Reductions Required**		(0.9)	(1.0)	(1.0)	(0.9)	(1.0)
NET TOTAL EXPENDITURES	11.6	10.6	10.9	11.3	11.7	12.1
Estimated Ending Working Capital	$ 1.3	$ 1.5	$ 1.5	$ 1.6	$ 1.6	$ 1.7

* Projected Excludes FY 12-13 reappropriations and carryovers.

** Permanent reductions required starting in FY 13-14 if an additional revenue source is not found.

The permanent reductions totaling $4.8 million over the next five-years will provide for an ending working capital of **$1.7 million** in FY 2017-18. Unless an additional revenue source is secured, these permanent reductions will need to be implemented beginning in FY 2013-14.

Revenue Forecast

The revenue forecast is developed using conservative growth expectations for transportation's resource inflows. It uses available revenue sources and does not assume new or unrealized revenues in the forecasted amounts. Approximately 70 percent of transportation revenues (excluding beginning working capital) come from state highway fund revenue. Table 1 summarizes the five-year revenue forecast by revenue source. The transfer of state highway fund revenue to parks operations is to fund the care and maintenance of the city's street trees and landscaping in the public rights-of-way.

Table 1 (in millions)	Fiscal Year				
Revenue by Source	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18
State Highway Rev. (gross receipts)	$ 8.80	$ 9.11	$ 9.43	$ 9.71	$ 10.00
Less:					
Revenue Transfer to Parks	(1.28)	(1.31)	(1.38)	(1.42)	(1.51)
Net State Highway Revenue	7.53	7.79	8.04	8.28	8.48
Intra City Billings and Transfers	2.26	2.36	2.52	2.62	2.80
Federal Grants	0.31	0.31	0.31	0.32	0.32
All Other Sources	0.76	0.47	0.50	0.51	0.54
Total Current Revenue	$ 10.85	$ 10.94	$ 11.37	$ 11.73	$ 12.15

Expenditure Forecast

The expenditure forecast is developed based on anticipated increases in the cost of labor, materials, and capital. When available, it uses known expenditure information such as labor agreements, vendor contracts, PERS rate and health care cost increases, and inflation factors. Future costs associated with higher PERS obligations for current employees are included beginning in the FY 2013-14. Table 2 summarizes the five-year expenditure forecast by expense category for Schedule B. The assumption tables for all expenditures are included in the appendix.

Table 2 (in millions)	Fiscal Year				
Expenditure Categories	FY 13-14	FY 14-15	FY 15-16	FY 16-17	FY 17-18
Personal Services	$ 5.27	$ 5.48	$ 5.79	$ 5.96	$ 6.34
Materials & Services	6.25	6.38	6.51	6.64	6.78
Capital Outlay	0.04	0.04	-	-	-
Subtotal Expenditures	11.57	11.90	12.30	12.61	13.12
Transfers	0.48	0.50	0.53	0.55	0.58
Less:					
Anticipated Expenditure Savings	(0.50)	(0.52)	(0.54)	(0.55)	(0.57)
Total Expenditures/Schedule A	11.54	11.88	12.29	12.61	13.13
Less:					
Permanent Reductions	(0.91)	(0.99)	(0.97)	(0.92)	(1.03)
Total Net Expenditures/Schedule B	$ 10.6	$ 10.9	$ 11.3	$ 11.7	$ 12.1

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 transportation's resources are summarized below:

- General Fund Support for Street Maintenance
- State Highway Fund Revenue
- Recession

General Fund Support for Street Maintenance – While not the primary funding source for transportation activities, the general fund has historically provided a modest amount of funding for street maintenance. In the 1990s the general fund provided for preventative maintenance activities, in particular funding for annual slurry seal contracts for local and collector streets. Beginning in FY 2004-05, an increasing portion of water/sewer franchise fees was transferred from the general fund to transportation for street maintenance. The transfer reached its highest level in 2009 at $1.4 million. Since that time, the transfer has decreased each year due to general fund budget constraints. The general fund transfer is $400,000 in FY 2012-13, and proposed to be $300,000 in FY 2013-14. The transfer of revenue to support street maintenance in transportation is planned to end completely in 2015.

> Risk Factor – HIGH
> The planned elimination of the transfer from the general fund for street maintenance activities, coupled with flat or slow growing state highway fund revenues will result in insufficient resources to meet anticipated expenditures in transportation. Given the current and forecasted revenue constraints facing the general fund, it is unlikely that any sizeable transfer of funds for street maintenance will be possible for the next several years

State Highway Fund Revenue – The risk involved in having sole dependency on the city's allocation of state highway fund revenues is that it is a revenue source the city has little or no control over. Revenues are impacted by worldwide, national, and regional factors including the availability of fuels, prices, transport costs, refinery capacity, vehicle technology, and consumer behavior. The amount of motor vehicle fuel taxes and DMV fees charged and its allocation is determined by the State Legislature. Actual receipts have not kept pace with original ODOT forecasts published after adoption of Oregon Jobs and Transportation Act in 2009, which raised the motor fuel tax by five cents beginning in January 2011. ODOT has reduced its forecasted growth percentages for the state highway fund three times since June 2010. The June 2012 ODOT forecast for FY 2013 shows 6.4 percent less revenue than what was forecasted in June 2010. The risk to the city is that it may not receive revenues equal to what has been forecasted.

Risk Factor Ranking – MEDIUM

State highway fund revenue can be subject to changes in legislation, technology, petroleum supplies, prices and consumer behavior. Because it is the primary revenue source for transportation, potential changes need to be monitored and, in the case of legislative challenges, defended.

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

Risk Factor-LOW

State highway fund revenues are particularly sensitive to decreases in regional freight movement, which result in lower weight/mile tax revenues. High unemployment tends to negatively impact retail gasoline sales when people are driving less. Likewise, decreased sales of new and used vehicles impacts the title and registration fees component of the state highway fund. 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 - Transportation's PERS employer contribution rate for the two years beginning 2013-14 has increased 48 percent to approximately $500,000. Last year's forecast anticipated a 23 percent increase to $300,000 based on the advisory rates provided by the PERS Board. At that time, the city had planned for an additional $100,000 in transportation PERS costs beginning in FY 2013-14, that amount is now estimated at $200,000. The forecast also assumes a 25 percent PERS rate increase in FY 2015-16 and FY 2017-18. Table 3 details the rates by tier type for comparison. Rates are adjusted every two years to meet pension funding requirements.

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

Risk Factor Ranking – HIGH

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

Health Care Costs – The forecast assumes that health care costs will increase by 10 percent for the next 3 years, 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 $20,000 per year for transportation.

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 77 percent of transportation's workforce is represented by the AFSCME union, and approximately 44 percent of transportation costs are personnel related, making labor agreements a significant cost driver. Wage increases associated with the most recent agreements are incorporated into the forecast. For years beyond these agreements an assumed 1 percent wage increase is used; for non-represented employees a 2 percent increase is assumed in year one, with 1 percent for remaining years.

Risk Factor Ranking – MEDIUM

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

Inflation – The Bureau of Labor Statistics 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. One inflationary factor that can influence the productivity of the street maintenance program is the cost of hot mix asphalt. When the price of asphalt rises, the street maintenance program must either pave fewer streets each year or must increase expenditures in materials and services. Worldwide supplies of asphalt continue to be constrained as refineries become more efficient and produce less of it as a by-product of the refining process. Subsequently, the cost of asphalt has continued to rise.

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
General Fund Support	HIGH	3%
State Highway Revenue	MEDIUM	70%
Recession	LOW	-

Forecast Risk Expenses	Ranking	Percent Total Expense
PERS Employer Rate Increases	HIGH	5%
Health Care Costs	MEDIUM	6%
Labor Agreements/Salary Costs	MEDIUM	25%
Inflation	LOW	-

APPENDIX

Expenditure Assumption Table

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