

Date: August 28, 2023
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 Cc: Patricia Rojas, Metro Housing Director; Rachael Lembo, Metro Finance Manager; Antionette Payne, Joint Office of Homeless Services Finance Director; Adam Brown, Clackamas County Deputy Director
 From: Josh Harwood, Metro Fiscal & Tax Policy Director
 Subject: FY 2022-23 SHS Taxes Fiscal Year-End (FYE) and FY 2023-24 Forecast Update

This report is intended to summarize FY 2022-23 tax collections for Metro’s Supportive Housing Services (SHS) program. It also provides updated interim guidance on expected collections for FY 2023-24. The following pages summarize details available through June 30, 2023.

FY 2022-23 Results

During FY 2022-23, \$336.6 million was raised for supportive housing services. This was split between business and personal income taxes that totaled \$152.5 million and \$184.1 million, respectively. This was significantly higher than the conservative \$225 million budgeted by Metro for the FY 2022-23 fiscal year. The second year of tax collections saw a unique mix of late payers from Tax Year 2021, regular and extension filers for Tax Year 2022, and withholdings and estimated payments for Tax Year 2023. In the future, we should expect less revenue from prior year collections due to fewer late filers.

FIGURE 1 – GROWTH IN SELECTED TAXES FY 21-22 TO FY 22-23 (CITY OF PORTLAND REVENUE DIVISION)

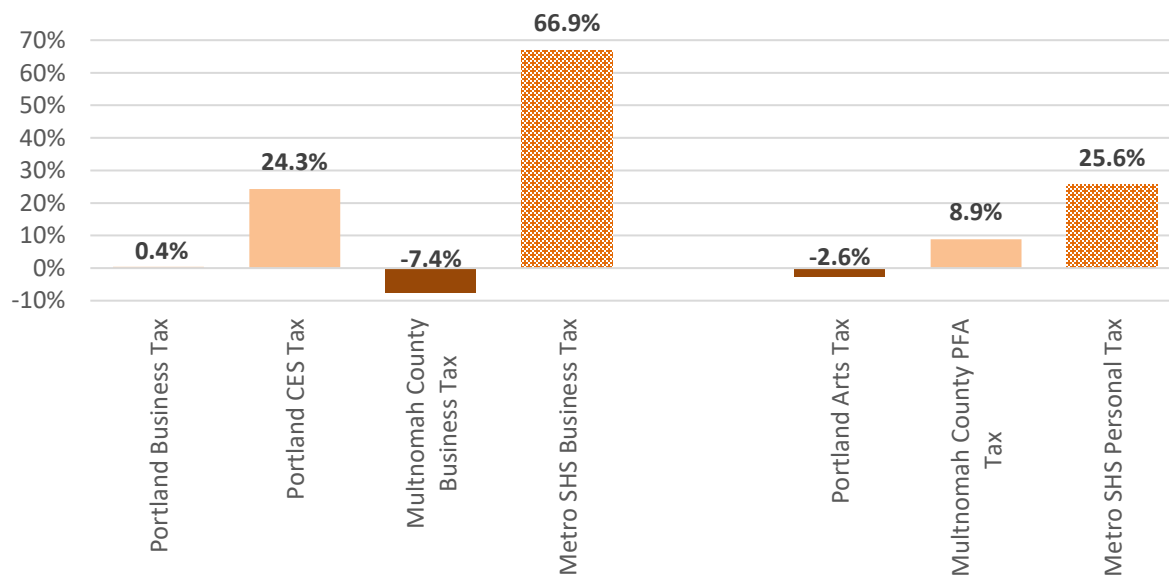


Figure 1 summarizes the annual growth over the last fiscal year for several of the local business and personal income taxes collected by the City of Portland Revenue Division. This chart illustrates that

Metro tax revenue grew significantly faster than other local taxes between FY 2021-22 and FY 2022-23. The comparison highlights several key points:

First -Year Late Payers. Approximately \$40 million can be attributed to taxpayers that paid their 2021 taxes (due April 2022) in FY 2022-23. While we can expect the volume of late payers to drop significantly in FY 2023-24, early indications are that there remains a significant amount of uncollected taxes from Metro residents dating back to tax year 2021. For those taxpayers discovered in the current fiscal year, three years' worth of taxes will be collected in FY 2023-24, inflating collections in the current year and potentially leading to large forecast variances.

Tri-County Trends. The Metro SHS taxes are the only taxes in the chart above that impact taxpayers outside of the City of Portland and Multnomah County. That the Metro SHS Tax growth significantly outpaced the other taxes illustrates is further evidence of the fact that population and job numbers have not recovered in Multnomah County to the same extent that Clackamas County and Washington County have experienced. State data shows that Multnomah County saw a decrease in taxpayers in 2021, but given the myriad of conditions experienced during the pandemic, it is not yet clear what the root cause is of the decline or if it will persist.

Business Tax Boom. Business taxes have remained at historically high levels. Whereas goods-producing companies thrived in the beginning of the pandemic recovery, service-sector companies (e.g., leisure and hospitality) are now experiencing a surge in activity. The inability of companies to hire, while hurting long-run growth prospects, can actually increase profitability in the short run. Lower costs in the short run from an inability to hire workers, in combination with higher demand (i.e., prices) for goods and services means that businesses are more profitable with each unit of output, even if they can't expand to meet the entire market.

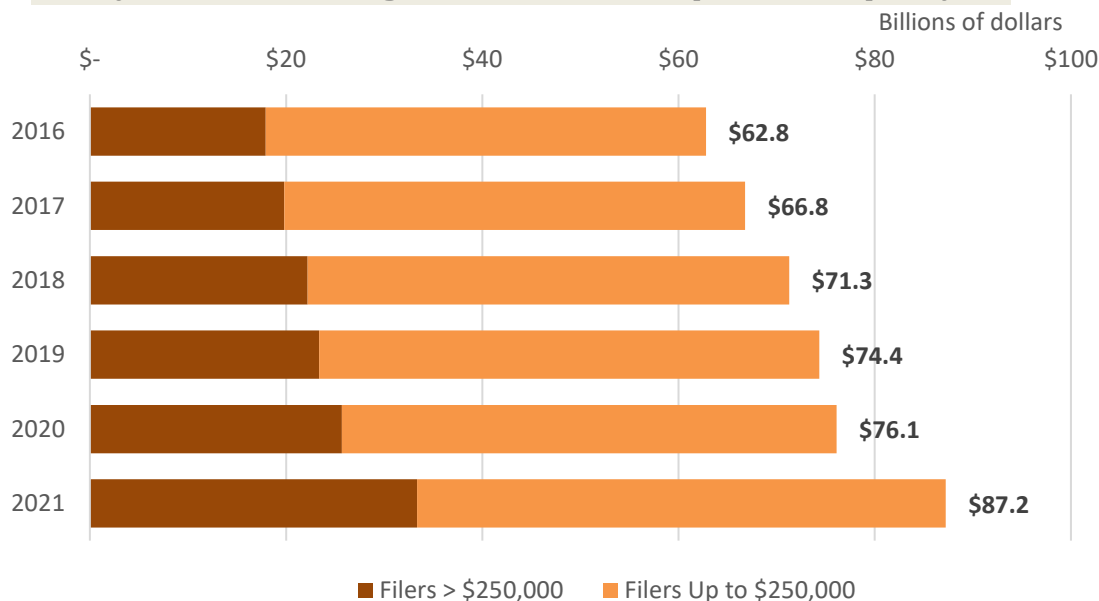
FY 2023-24 Forecast

The original expectations for collections appear to have underestimated the size of the tax base. Data published in June by the Oregon Department of Revenue showed a dramatic increase in incomes in 2021, even as the economy contended with the pandemic. While information remains somewhat limited with respect to the SHS taxes, we can glean some pertinent insights from state income tax figures by county through Tax Year 2021 (the first year of the SHS taxes).



FIGURE 2 – TRI-COUNTY ANNUAL GROWTH IN INCOME & TAX RETURNS

Taxpayers with more than \$250,000 in annual gross income made up just over 6% of total returns in Tax Year 2021, **but accounted for nearly 70% of the total growth** in income compared to the prior year



Source: State of Oregon Department of Revenue, Data as of 6/23

The graph illustrates the income boom that took place in 2021. Much has been made of the declining local population, and we can also see a decrease in the total number of returns filed by residents of the tri-county area. However, if we look at only those with incomes over \$250,000, we see a large jump in both the number of returns, but more importantly, in the total income for those earning over \$250,000. For instance, even though data provided by the Oregon Department of Revenue show an overall *decrease* of 1.1% in the total number of returns for the tri-county region between 2020 and 2021, there was a 14.6% *increase* in total adjusted gross income.¹ **This difference accounts for about \$40 million annually of previously unexpected collections and is expected to continue in FY 2023-24.**

Based on the information gleaned over the past few months, we now believe a **reasonable forecast for FY 2023-24 SHS taxes would be \$320 million,² which is about \$85 million above budgeted forecasts made in November 2022.** Adjustments of this magnitude will be increasingly uncommon, as more information from returns is processed. **However, potential remains for large forecast errors (+/- \$50 million) in FY 2023-24.** This occurs, in part, because each enforcement action can yield up to three years’ of taxes for each taxpayer (tax years 2021, 2022, and 2023). Currently, the forecast assumes a slightly lower level of prior year taxes than was experienced in FY 2022-23 because the simplest enforcement actions have already taken place.

While increasing incomes are good for both households and government revenues, the pattern of fewer returns, but more income, is unsustainable. **The largest risk to the forecast is households either moving away from the area or, more likely, that those moving into the area will choose to locate in greater numbers outside of Metro’s boundaries. However, at least the**

¹ <https://www.oregon.gov/dor/gov-research/pages/research-reports-and-statistics.aspx>

² Note: this represents the forecast for collections distributed September 2023 to August 2024. Going forward, Metro and the three counties have agreed to recognize revenue on a modified accrual basis. Historical figures will reflect this 12-month period going forward.

near term, the higher-than-expected tax base will overwhelm changes that occur through taxpayer behavior, resulting in higher collections than previously anticipated. The five-year forecast in November will contemplate the impact that a secular decline in the number of returns, and thus, income, would have on collections. Regardless of the conditions on the ground in Portland, there are financial incentives for households to live outside of Multnomah County and even the state. The SHS and Multnomah County's Preschool for All taxes have increased that incentive. We will continue to watch migration patterns as Oregon has historically received less than its share of high-income individuals.³

Next Steps

Though taxes were due April 18th, many taxpayers (particularly those with the highest incomes) chose to extend the filing of their actual return with the necessary income information to verify the tax payment until October. What we can say with some certainty is that 2021 and 2022 were unusually high years for incomes, and therefore, collections for governments that depend on income tax (including the State of Oregon, which is about to issue a record income tax kicker after collections ballooned the last two years). Currently, Metro has budgeted collections of \$234 million for FY 2023-24. Based on the latest data, we believe that the forecast should be increased significantly. That said, we will continue to monitor the data and recommend changes as necessary. The initial budget forecast for FY 2024-25, as well as a full five-year forecast, will be presented to the Financial Review Team - comprised of the Chief Finance Officers from Metro and each the three counties - in late November.

³ <https://oregoneconomicanalysis.com/2023/03/21/oregons-regional-income-distributions/> (slide 7)