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From: Josh Harwood, Metro Fiscal & Tax Policy Director

Subject: Supportive Housing Services Five-Year Forecast FY 2023-24 to FY 2027-28

This report is intended to summarize the five-year forecast for revenue for Metro's Supportive Housing Services (SHS) program originally passed by voters in May 2020. The forecasts presented herein are inclusive of information through the end of October. It should be noted that much of the tax data remains incomplete as taxpayers continue to adapt to the new taxes and true up tax bills from the 2021 tax year. As a result, much of the available data is remains somewhat unclear, which means that some unique data analysis challenges remain. **Please note that this forecast was formally presented to the Finance Review Team[1] (FRT) on December 2, 2022.**

For a variety of reasons – including but not limited to the fact that there are two separate taxes, the unsteady economic emergence from the pandemic, and processing timelines – there are challenges to forecasting and managing the revenues from these taxes. However, it should be noted that even in times of greater economic certainty, the typical "errors" with taxes such as these will be much larger than typical local revenue forecasts. What this means in terms of the figures presented here is that they are conservative in nature in order to reflect that uncertainty. This typically results in higher-than-forecasted actual collections. However, we know that the increased volatility in these taxes means that as they climb higher, the exposure to downturns also increases, resulting in large declines in years when actuals don't meet forecasted expectations. Overall, the forecast presented here strives to be unbiased (i.e., actual collections over the five-year period will largely reflect the actual experience in terms of dollars collected), but cannot know precisely which year the taxes will reflect that downturn in collections. Furthermore, because the majority of collections are skewed toward the end of the fiscal year, management of these revenues, regardless of forecasting errors, is a challenge.

Tax Year 2021 & Current Collections

For FY 2021-22, Metro raised $239.5 million. This was split between business and personal income taxes that totaled $92.7 million and $146.7 million, respectively. The nearly $240 million was significantly higher than the conservative $180 million budgeted for the first year of tax collections. This was discussed as a likely possibility at the FRT meeting in November 2021. Because of the volatility in the taxes and the lag between the initial forecast and the realization of the taxes, forecasts will necessarily be somewhat conservative and typically, though not always, result in higher-than-forecasted collections. In fact, the dynamics of these taxes and the lag in time between the forecast and actual collections, means that when conditions deteriorate quickly, the impact on

[1] The FRT is comprised of the Chief Financial Officers for Metro and each of the three relevant counties (Clackamas, Multnomah, and Washington counties).

tax collections can be severe. In turn, this stresses program management and service delivery, often times when demand for those services is the highest due to worsening economic conditions.

In order to relate the tax collections to the economic activity that generates the taxes, we have to look at the data based on tax years. This represents a significant obstacle in the early years of a tax, as evidenced by a sizable increase in the number of accounts that have been established since the end of the fiscal year and enforcement activities begin.

Highly concentrated tax base. Among the topics previously discussed is the impact that increasing income inequality has had on income taxes. While a high dependency on a small number of taxpayers has historically been a characteristic of business taxes, high-income personal income taxes will exhibit similar behavior. Figure X below looks at the tax accounts that produced the most revenue. The table reflects growth at the high end of the income distribution for both households and individuals.

FIGURE X – FY 2021-22 REVENUE FROM TOP PERCENT OF TAXPAYERS

Top	% of Total
1%	43.3%
5%	64.5%
10%	74.0%
25%	86.3%

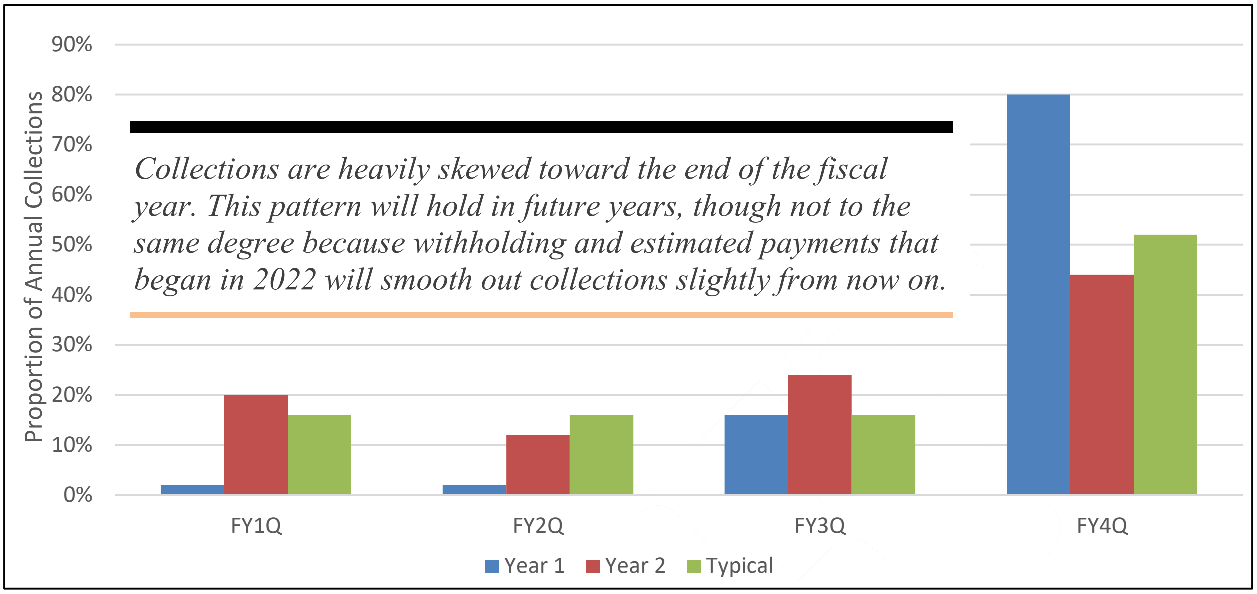
Five-Year Forecast

Although a full fiscal year of tax collections has been completed, there are still taxpayers making first payments into the tax system. This, along with other data challenges, means that we are likely at least a year or two from fully realizing SHS tax data as the primary data source for forecasting the taxes. Furthermore, because the tax is new and relatively unique, a variety of data sources are used to gather the best information needed to forecast these taxes. For business taxes, that largely means using state and other local tax data. Meanwhile for personal taxes, state tax and broader economic data are the primary inputs to the forecast.

Given the level of uncertainty, the scenarios described below are relatively broad, but as time progresses, can serve as indicators as to which path collections may be on. Figure X below shows the amounts forecasted for the three scenarios described below the table. It should be noted, that, similar to a year ago at this time, we expect current year collections to exceed budgeted amounts, but it is too early in the fiscal year to determinatively say that will be the case. *Collections in the current year may even exceed collections from FY 2021-22, but that likely would not be a result from increased economic activity, but rather from the regular ramp-up of a new tax program as new taxpayers are added to the tax rolls.*

FIGURE X – SUPPORTIVE HOUSING SERVICES FIVE-YEAR FORECAST

FIGURE X – ACTUAL AND EXPECTED TAX COLLECTION PROPORTIONS BY QUARTER



Economic Conditions/Risks

Obviously, the overall economic well-being of the region and nation are the most critical to healthy revenue growth. The following section is a discussion of risks primarily to revenue from these specific taxes, not necessarily the economy as a whole.

Geopolitical/Inflation. While the relatively recent increase in inflation hits households' and businesses' bottom lines, it also tends to result in higher tax collections. Of course, that positive collection news is typically offset by rising costs for the programs that receive the funds. While inflation is a risk, some of the real causes of current inflation are examples of broader risks to economies and, ultimately, tax collections. Today, increasing economic dependency can mean that small disruptions are more economically damaging on a larger national and global level.

Demographics/Migration. The combination of relatively high income tax rates and a dramatic increase in the number of jobs that can be at least partially completed remotely will likely impact where people choose to live over time. While it is likely that this phenomenon has not yet taken hold except on the margin

Tax Laws/Work from Home. Local income taxes are often either required or choose to tie to state and/or federal income tax systems. This is done to more efficiently and simply administer the tax collections. As a result, when state and/or federal tax laws change, Metro's taxes may be impacted. It should be noted that this likely occurs for most existing state and local income tax laws. Depending on the taxpayer situation, the local income tax owed by a high-income taxpayer or large business is a small fraction of the taxes each would owe to the federal and state governments. As a result, to the extent to which policy changes at the state and federal level impact taxpayer behavior, local income taxes collections will also be impacted. As a result, administrative regulation often requires irregular, but noteworthy "housekeeping," as local governments need to react to a changing tax environment.

There has been a lot of worthy discussion around the increase in the number of employees working from home during and following the pandemic, and what various impacts this has on communities, urban centers, and migration. Taxes are not immune to those impacts as they are largely associated with where a person lives and/or works. Many states and local governments are realizing the potential impacts of work from home on their revenue streams[2] and discussions have already begun on determining if there is a need for changes to tax codes that reflect this new work from home reality for those that have that capability.[3] The economy is in flux currently with many conflicting indicators. As a "new normal" establishes at worksites around the world, it will become easier to draw robust conclusions as to the totality and timing of these impacts, as well as any subsequent law changes proposed to mitigate those impacts.

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. This means that there is still limited information on the specific underlying drivers of collections this far. What we can say with some certainty is that income tax-dependent governments (including the State of Oregon), is that 2021 was an unusually high year for incomes, and thus, income tax collections. Currently, Metro has budgeted collections of $225 million for FY 2022-23, and, based on currently available information, there does not seem any immediate reason to change that estimate. That said, we will continue to monitor the data and recommend changes as necessary. The initial budget forecast for FY 2023-24, 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.

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[2] This is particularly pronounced in sales taxes where the location of a purchase is generally the determining factor and many sales taxes include a sizable local tax component. For urban centers that collect sales taxes, this has been a prominent issue for years in highly populated areas with different tax rates even within, say, a metro area.

[3] According to the Oregon Office of Economic Analysis, the number of workers working from home as of September 2021 was less than 20% and had fallen from its peak of approximately 36% in May 2020. This figure has likely fallen further since then. https://oregoneconomicanalysis.com/2021/12/16/just-how-much-is-working-from-home-on-the-rise/