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Date:	November 27, 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
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Subject:	Supportive Housing Services Taxes – Five-year Forecast

This report is intended to provide updated five-year tax collection forecasts for Metro's Supportive Housing Services (SHS) program. It should be noted that first-year tax collection data is still coming in, so these forecasts may be subject to large variances, particularly in the final years of the forecast. A more complete discussion of possible outcomes is included in the *Risks* section of this document. It also provides updated interim guidance on expected collections for FY 2023-24. The following pages summarize details available through October 2023. Estimates may be adjusted in March in advance of counties finalizing budgets.

The forecast was discussed with the Financial Review Team (FRT) and Joint Leadership Team in November. Counties will incorporate the forecast as part of their FY 2024-25 budget development and long-term plans.

Executive Summary

- **A record runup in household wealth and corporate profits helped push the underlying taxbase, from which the SHS Taxes are collected, significantly higher than prior estimates. Collections are still coming in from Tax Year 2021, but they will likely approach $300 - $325 million – up to 30% higher than originally estimated.**

- **Enforcement actions conducted by the SHS tax administrator (Portland Revenue Division) continue to bring in significant revenue from prior years as non-filers are assessed the taxes.**

- **The forecast presented here is notably less conservative than prior forecasts. The combination of continuing to collect from Tax Years 2021 and 2022, along with county-level income data provided by the state, support this change. As a result, the large increases in the latest forecasts are unlikely to be duplicated moving forward.**

- **Locational data is opaque and lacks definition. For instance, it is not clear where income earned by an individual that works in Washington County, but lives in Multnomah County, should be attributed. Further data challenges include the fact that business income is typically attributed to the headquarters, which can have little relation to where the work is being done or the taxes are being assessed.**

Current Conditions

Economic forecasts made during the early days of the pandemic vastly underestimated how the economy would perform coming out of the pandemic. Federal fiscal support, in the form of stimulus checks for households and forgivable loans for businesses, buoyed balance sheets and resulted in higher revenues at all levels of government. As consumers make up over two-thirds of gross domestic product (GDP), fiscal supports in the form of stimulus checks and child tax credits were spent and propped up the economy even as people were somewhat limited (i.e., pandemic travel restrictions) in how they could spend their funds.

The economy has behaved much like a tine that is hit and then oscillates with a decreasing vibration. The shock of the pandemic effectively stopped economic activity, while fiscal stimulus allowed incomes to continue. As consumers became more comfortable, they first spent on durable goods and products, as travel and other leisure spending was curbed. Then consumers shifted toward services to satisfy pent up demand for travel and entertainment. The result has been a haphazard or irregular recovery where the specific timing and industry are critical to understanding how someone is experiencing the recovery. This is likely part of the reason that consumer surveys report that one's own finances are good, while perceptions of the general economy are bad.

> *"The 37% rise in net worth (from 2019 to 2022), which was more than double the next-largest upswing on record, was largely fueled by asset growth — specifically home values and stock market gains," Fed researchers said.*

The latest Fed Survey of Consumer Finances gives some indication of the degree to which household finances were actually strengthened during the pandemic.[1] Households gained at all income levels, but especially at the top of the income range, slightly increasing income inequality. Across racial/ethnic characteristics, wealth gaps narrowed between non-Hispanic whites and other racial categories, but large differences still remain. For instance, median household wealth among Black families rose by 60%, while wealth among white household grew by 31%. However, median Black family wealth remains a fraction of the wealth of the median white family.

Program Forecast

The following reflects the best guess, given current economic conditions and existing data, as to the amount of collections through FY 2028-29. **Compared to prior forecasts, the current forecast is less conservative in nature – a little under 30% higher over the life of the program.**[2] After collection costs and Metro administration, the revenue is distributed in the following proportions: Multnomah County – 45.3%, Washington County – 33.3%, and Clackamas County 21.3%.

[1] https://www.federalreserve.gov/publications/files/scf23.pdf

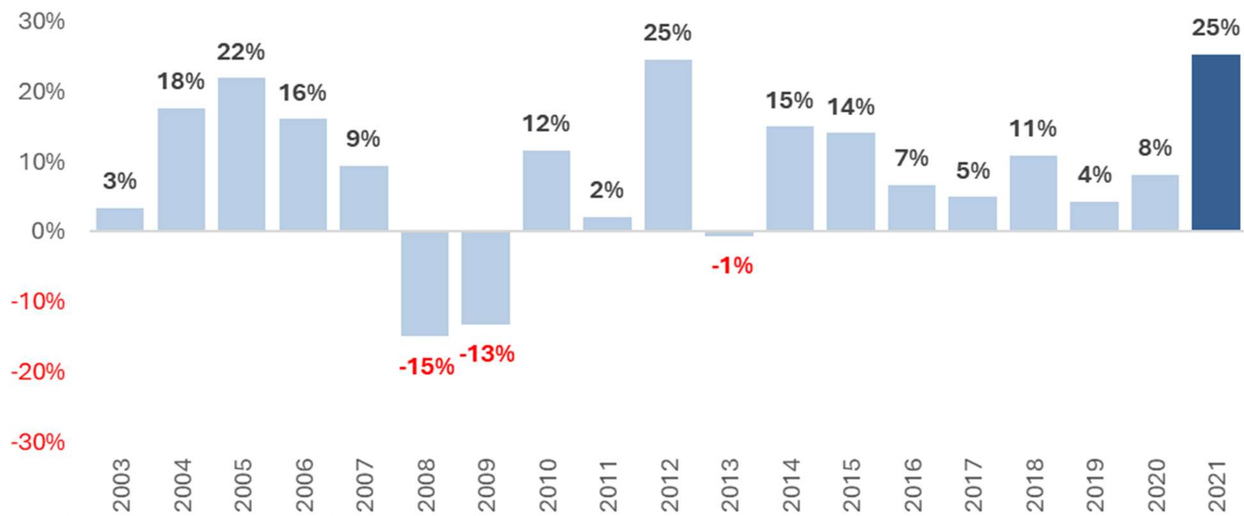
[2] Assuming a 5% inflation in the out-years of the Fall 2022 five-year forecast (using actuals through FY 23) and a 4% inflation factor for the ballot measure estimate.

FIGURE 1. SHS Five-year Revenue Forecast/Distributions

	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29
Forecasted Tax Revenue	**$ 356.7**	**$ 374.5**	**$ 378.7**	**$ 404.0**	**$ 420.2**	**$ 437.0**
Tax Collection Costs	10.8	11.1	11.4	11.8	12.1	12.5
Net Collections	345.9	363.4	367.3	392.2	408.1	424.5
Metro Admin	**$ 17.3**	**$ 18.2**	**$ 18.4**	**$ 19.6**	**$ 20.4**	**$ 21.2**
Partners	**$ 328.6**	**$ 345.2**	**$ 348.9**	**$ 372.6**	**$ 387.7**	**$ 403.3**
Clackamas	70.1	73.7	74.4	79.5	82.7	86.0
Multnomah	149.0	156.5	158.2	168.9	175.7	182.8
Washington	109.5	115.1	116.3	124.2	129.2	134.4

Information both from local SHS tax collections as well as state data suggest that the tax base is higher than originally estimated. The chart below shows the significant growth high-income earners experienced in Tax Year 2021, and initial data suggests that Tax Year 2022 was higher still. As such, it is expected that FY 2022-23 revenue collections were not as much of an outlier but rather an indication of a larger tax base.

FIGURE 2. Annual Growth in Income for Oregon Tax Returns over $250,000



Although there are now two full fiscal and tax years' worth of data, these are not likely entirely indicative of what we can anticipate moving forward due to the nature of the income being taxed and the timing of payments as implementation ramped up. Key limitations include:

- We continue to see large personal income tax payments for Tax Year 2021 - $13.7 million so far in the current fiscal year. At this point, it is not clear to what extent this may be attributed to the nature of the tax and how payers may show up in some years but not others based on major life events or other income fluctuations; if taxpayers may simply be late in paying for 2022 or are on a payment plan; or if this reflects larger demographic shifts and high income earners moving outside of Metro.

- While FY 2022-23 was the second year of the taxes, it served as the first full year of taxes for businesses. This is because some businesses have fiscal years that don't align with calendar years. For instance, a company may have a fiscal that ends in October. Those businesses were not required to start filing until the second fiscal year of the tax.

- Approximately a quarter of the personal income tax revenue in FY 2022-23 was actually collected as part of the withholding tax. At this point, that revenue is tied to the employer, not individuals. This is a major caveat to any analysis looking at taxpayer trends and behavior.[3]

- Finally, because these taxes are relatively unusual, many individuals and businesses did not realize they were liable. Some of those taxpayers likely experienced a one-time transaction yielding income above the thresholds, such as selling a home or business, but may be below the exemption in other tax years. Others may be part of the regular tax base and presumably will file on time for future tax years. To the extent that the tax administrator – the City of Portland's Revenue Division – is successful in contacting delinquent taxpayers, more money will be received in FY 2023-24 and possibly less in FY 2024-25.

Metro will continue to monitor and will articulate any new estimates for how FY 2023-24 may end to the FRT through their quarterly meetings.[4]

Forecast Assumptions and Risks

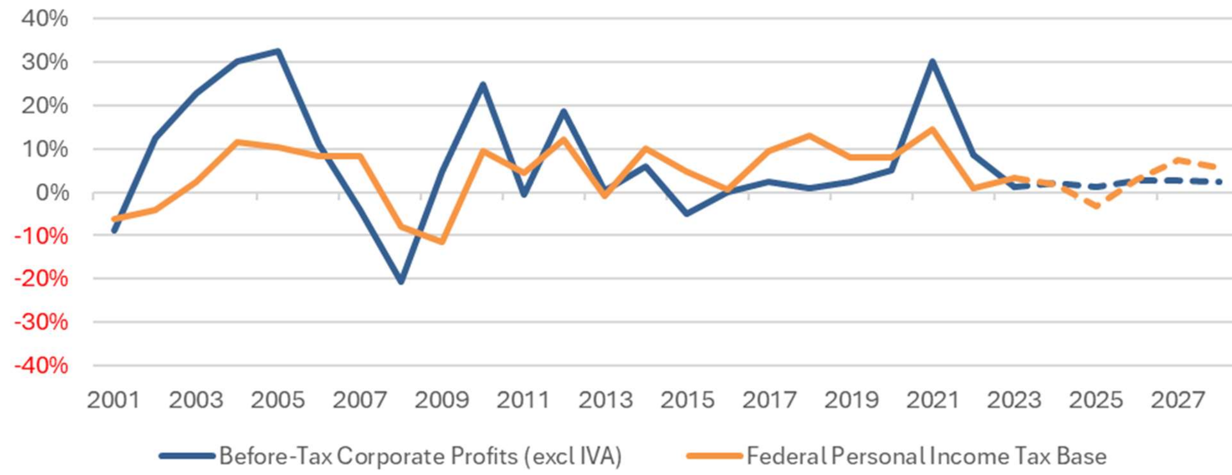
This initial five-year forecast largely assumes that the Fed will continue to manage interest rates in such a manner as to avoid a recession. This is a marked change from a year ago, when economists generally forecasted at least a minor recession. However, due to the sensitivity to economic changes and the newness of the taxes, even minor changes in the economic outlook can yield large changes in expected collections.

National economic trends have a greater influence on Supportive Housing Services tax revenue than local factors. The figure below shows the history and forecast for two correlated time series. These inputs call for slow growth, but no downturn. Our national vendor, along with most economists, forecasted a recession a year ago that failed to materialize. Given the volatility in the history of these time series, we can expect that the actual experience will be less "smooth" than the current forecast. **However, the key point for purposes of the forecast is that there is not a forecast of a recession, nor a retrenchment of incomes from the highs of 2021.**

[3] The tax administrator is working on a report that will address this issue, but due to system changes, this information may not be available for several more months.

[4] The amount of collections depends not only on the amount of tax liability, but also on the processing and enforcement actions taken by the tax administrator, Portland's Revenue Division. Enforcement actions take a variety of forms. Typically, the administrator gleans information suggesting that an individual or business should have filed SHS taxes - but did not - through data sharing agreements with other taxing authorities, such as the State of Oregon. The administrator sends a letter requesting that the taxpayer follow up to clarify why they did not file. For example, the taxpayer may have income that is exempted from local taxes, such as PERS income. To the extent that the tax administrator is successful in contacting delinquent taxpayers, more money will be received in FY 2023-24 and possibly less in 2025.

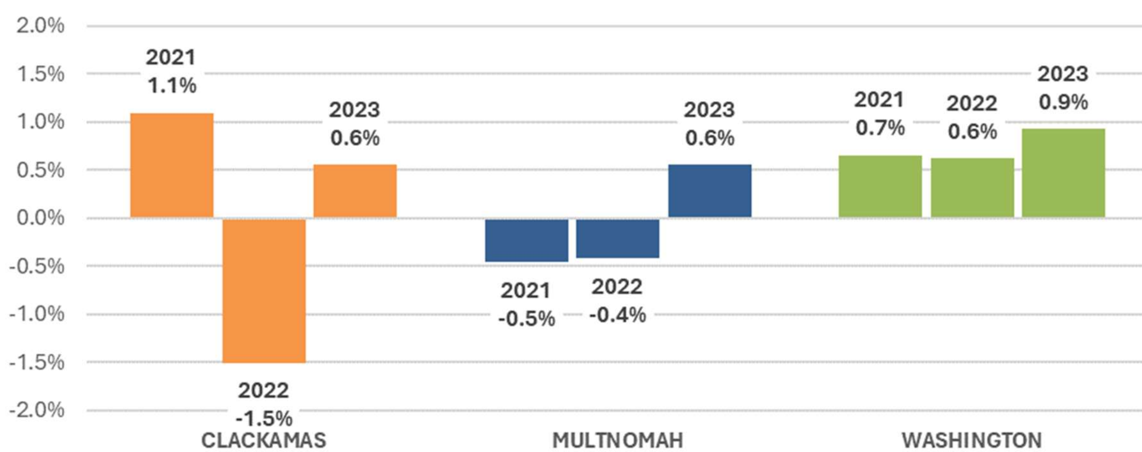
FIGURE 3. Annual Growth in Selected Forecast Inputs



Migration patterns

It is too early in the decade to know the degree to which these taxes impact migration decisions. Furthermore, it is impossible to fully disentangle taxes from other factors. On the margin, there will always be some tax "loss" when neighboring geographies have different tax systems – like Oregon and Washington. Most notably, these taxes exacerbate the already disparate tax treatment between Oregon and Washington that incentivizes earning income in Washington to avoid income taxes and spending that income in Oregon to avoid sales taxes.[5] While it is reasonable to assume that some households may make a financial decision to move out of the region, that incentive has been in place for decades. It is more likely that fewer households will move into Multnomah County than otherwise would have. However, the most recent preliminary data from Portland State's Population Research Center suggest that in-migration returned to Multnomah County in 2023.

FIGURE 4. Preliminary estimates from the Portland State University Population Research Center[6] for 2023 show slight gains in population for all three counties compared to 2022.



[5] Further complicating matters is [Washington's new capital gains income tax](), which largely eliminates the income tax benefit of moving to Washington from Oregon in order to realize a large sale of a business or equities.

[6] https://www.pdx.edu/population-research/population-estimate-reports

Demographics

Overall demographics work in both directions as it relates to tax collection. The two largest generations alive are baby boomers and millennials. Currently, that means that those in their peak earning years (generation X) are a somewhat smaller cohort. This serves as a headwind on income growth. However, we also know that baby boomers have benefitted financially from exceptionally low interest rates for most of their earning and investing years. This has created an enormous amount of wealth among that generation – about half of all wealth is held by baby boomers and one-quarter of that is in real estate.[7] If the Fed can continue to be successful with fighting inflation and bring interest rates back down, there will be a large number of transactions that could push some incomes over the income tax exemption thresholds.

Federal Fiscal Policy/Semiconductors

State economists are anticipating $40 billion in investment and 6,000 new jobs as part of state and federal support for the semi-conductor industry.[8] Based on existing employment patterns, most of those new jobs would be inside the Metro region. While this is welcome economic news, it will likely further stress the existing tight labor and housing markets.

Although most of the jobs in and of themselves will not push someone into the tax, some will, and those companies' management and executive ranks will expand. Washington County will likely continue to see an outsized share of this activity in the region in terms of employment, but housing costs will play a large role in where those workers live.

Fed Policy/Inflation

This forecast assumes that higher interest rates will persist in response to stubborn inflation reading above the Feds' stated target of 2%. Some economists are still calling for a mild recession, but that seems more a result of sticky assumptions that a sober reading of the most recent economic data.

Fiscal policy may prove more elusive as Congress continues to struggle to make policy of any kind. While we have thus far averted a government shutdown, that is only for a couple of months. S&P believes that every week the government shuts down loses 0.15% of GDP growth. We are assuming that inflation, driven by the tight labor market, will rise again before falling to its 2% target.

Tax Data/Statistics

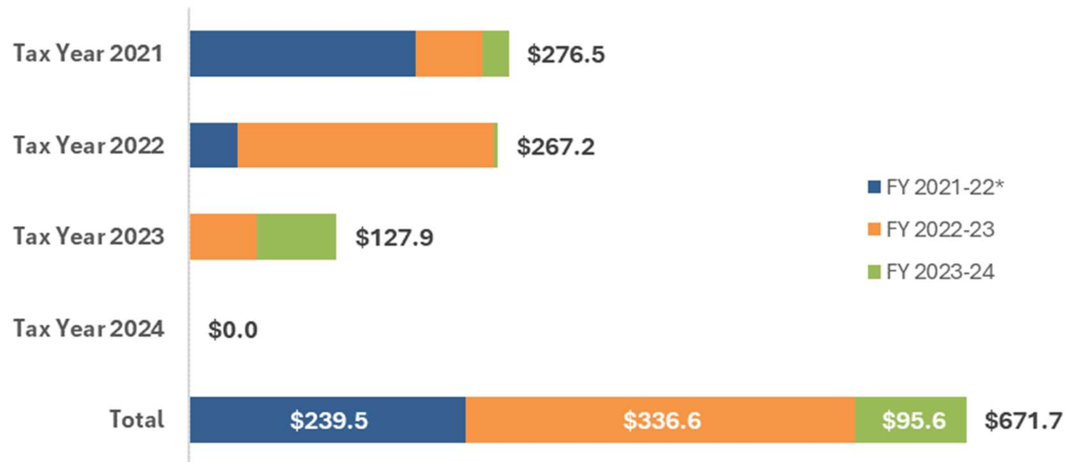
The following section presents summary statistics from either Tax Year 2021 or Fiscal Year 2022-23, as those are the most complete sets of data thus far. It should be noted that tax year information can change with late payers, amended returns, and audits several years after vast majority of the taxes have been collected.

Fiscal year and tax year totals will slowly converge. However late filers will initially have an outsized influence on fiscal year totals and have made defining the tax base difficult, as it grows with

[7] https://tinyurl.com/mp47tdx5
[8] https://www.oregonlive.com/silicon-forest/2023/08/oregon-economists-forecast-thousands-of-new-semiconductor-jobs-tens-of-billions-in-new-investment.html

additional receipts from 2021. Through October 2023, over $20 million had been collected for each of Tax Years 2021 and 2022 since just July.[9]

FIGURE 5. SHS tax revenue collections by Fiscal and Tax Year (in millions)



Late Payers

The biggest proportion of late payers has been on the personal tax side. In the absence of complete 2021 Tax Year information, state income tax figures by county published in June provide some guidelines to determining Metro's personal income tax base. Those figures suggest that there is still a substantial amount of taxes to be collected from the first year of the tax. Ongoing enforcement actions have been fruitful in both collecting taxes from 2021 but also in collections from subsequent years as those individuals are added to the tax rolls.

Non-Calendar Fiscal Years

The second fiscal year of business taxes should largely be viewed as the first "complete" year of business taxes, because many businesses have fiscal years that do not align with calendar years. For those that begin well into the calendar year, FY 2022-23 was the first year for which they were required to file taxes.[10] Under current law, the final year of the taxes will, in effect, reflect a year of collections for only those businesses with off-cycle fiscal years.

Geography

There are several reasons why it is difficult to determine where, geographically speaking, the taxes come from. From a data standpoint, limitations include incomplete or inaccurate returns, the interaction of credit carried forward and applied to other tax years, and the inability to tie withholding payments to individuals at this time.

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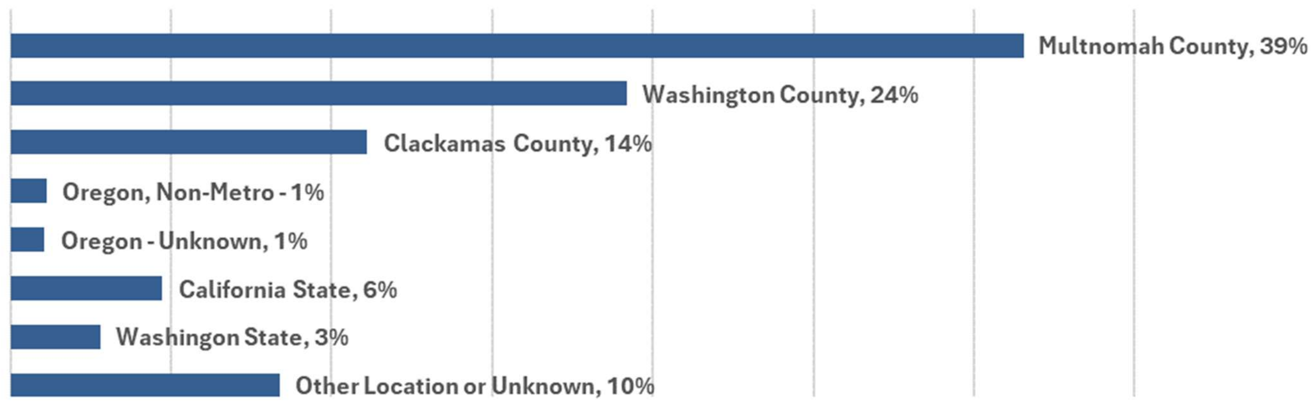
[9] In September 2023, Metro updated its accounting process to show tax revenue on an accrual rather than cash basis to align with governmental accounting rules. This means that collections for July 2023, received by Metro and disbursed to County partners in August 2023, were recorded as revenue in FY 23. However, for the sake of consistency in this memo, we are using July 1st as the start date for charts and figures.

*Revenue received prior to July 1, 2021, is included in the FY 2021-22 figures.

[10] The taxes apply to tax years beginning on or after January 1, 2021. For a business with a fiscal year that starts in June, they were not required to file taxes until FY 2022-23.

From a policy perspective, there are not clearly defined methods for allocating the source of tax revenue. On the business side, complications stem from both different entity structures[11] and businesses that have multiple locations. On the personal side, there are taxpayers who work in one county and live in another or outside of Metro altogether. In an era of hybrid work, there is not data to allocate their tax bill between the jurisdictions. And, finally, in both cases, there are significant tax dollars coming from outside the region. With those caveats, the best data currently available indicates that approximately 77% of FY 2022-23 tax revenue came from the tri-counties.

FIGURE 6. FY 2022-23 SHS Tax Collection Geographical Distribution



Industry

Businesses self-report industry data as part of their filing process. In FY 2022-23, approximately 14% of business tax accounts did not include their NAICS[12] code in their return[13]. The data we do have shows growth across nearly all industries, particularly in trade and manufacturing. The notable exception is real estate and rental and leasing, which dropped from 27% of tax revenue with a NAICS code in FY 2021-22 to 16% in FY 2022-23. Large growth can be seen in trade and manufacturing industries reflecting strong consumer spending.

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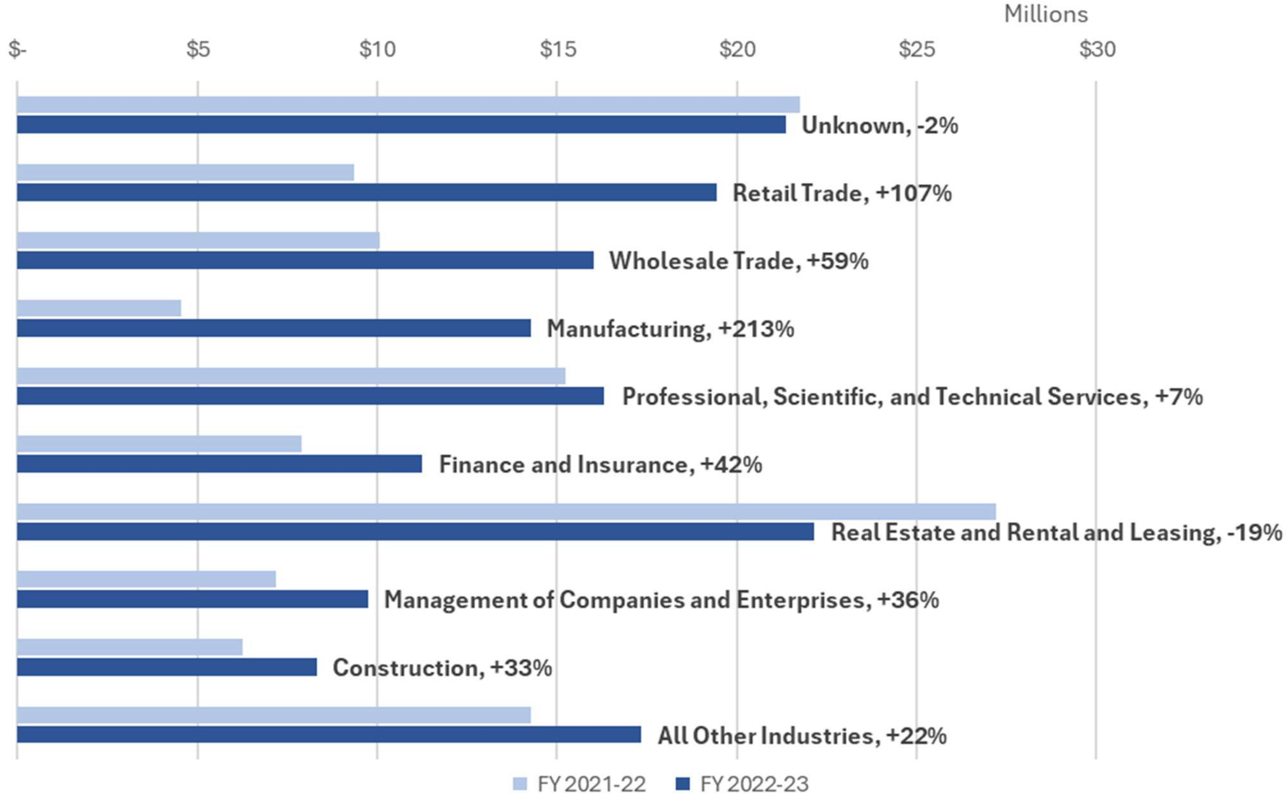
[11] Taxes are collected on different types on business entities (i.e., C Corp, LLC, Partnership, etc.). Furthermore, many businesses have multiple locations but pay one tax bill. For instance, a bank may have branches throughout the metro area, but on its tax bill it would only reference the headquarters, which in this case, is in another state altogether.

[12] North American Industry Classification System

[13] The analysis includes over $40 million in SHS Personal Income Tax returns that provided a NAICS code for Sole Proprietors.

FIGURE 7. Change in Collections by Industry, FY 2021-22 to FY 2022-23

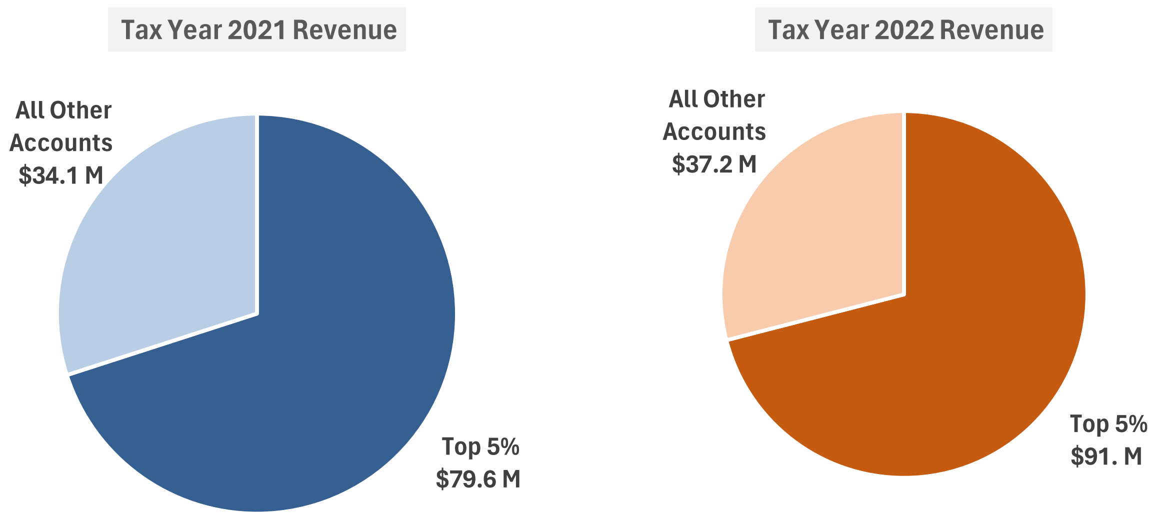


Reliance on Top Taxpayers

The following analysis compares collections for both Tax Years (2021 and 2022) and Fiscal Years (2021-22 and 2022-23). A tax year comparison helps to understand more about the total tax base, including new accounts that just paid prior year taxes. Looking at fiscal years illustrates more about revenue collection patterns, although this is expected to shift over time following the first few rounds of enforcement actions. Both tax and fiscal year analyses show that the top taxpayers account for a significant portion of the total revenue.

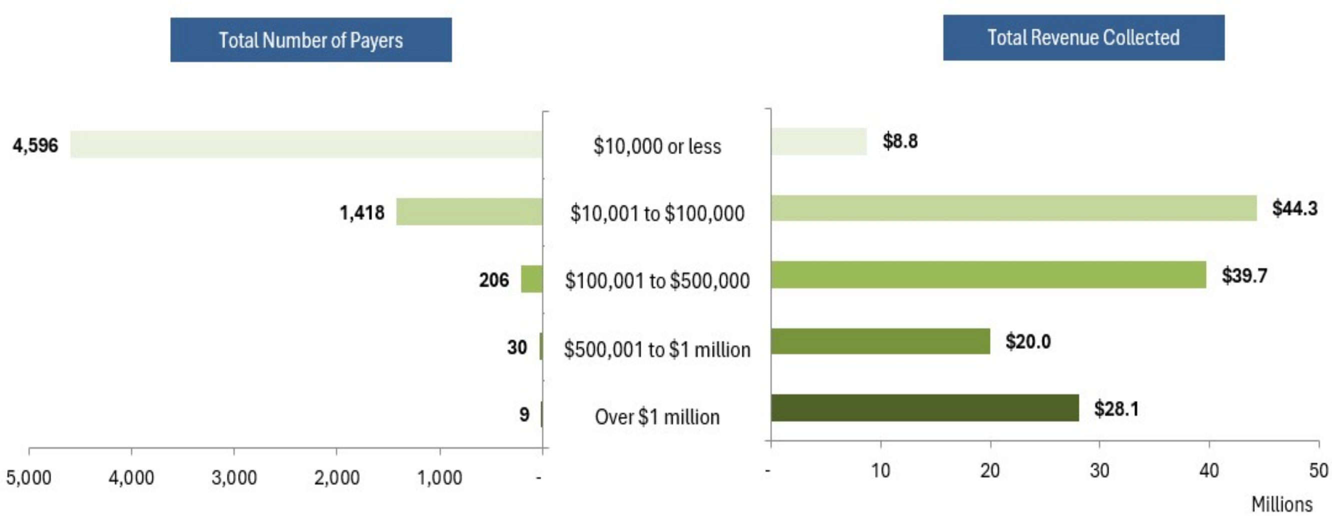
For both Tax Years 2021 and 2022, approximately 70% of the total business tax revenue came from the top 5% of all payers. That 5% represents a significant range, from roughly $60,000 on the low end to a high of $6.5 million in Tax Year 2021 and $8.0 million in 2022. In contrast, the median for all business taxpayers was $466 in 2021 and $300 in 2022.

FIGURE 8. SHS Business Tax Revenue Collection, top payers as percent of total collections.



For Fiscal Year 2022-23, the majority of *business* tax revenue – 62% - came from accounts that paid more than $100,000 in taxes. These accounts were less than 4% of total business taxpayers. The charts below show the total number of accounts broken down by the amount paid left) and how much total revenue was collected from those accounts (right). As of November 2023, a significant portion of the personal tax collections are still linked to withholding accounts (employers) rather than individuals, making inclusion of personal taxes potentially misleading.

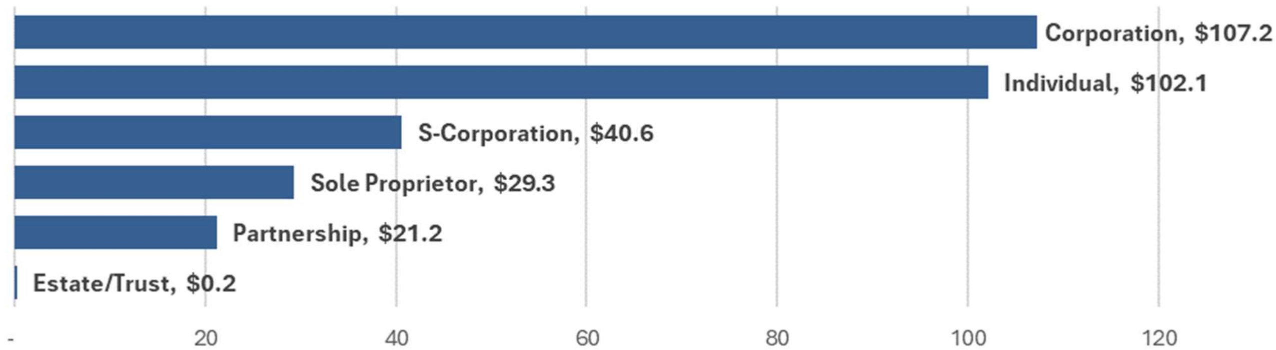
FIGURE 9. SHS Business Tax Revenue Collection, number of accounts by payment and total revenue collected.



Entity Type

The following reflects the type of taxpayer for taxes paid in FY 2022-23. Corporate profits have ballooned over the past five years and the largest companies appear to be the among the largest beneficiaries. C Corporations were the largest contributor in FY 2022-23 reflecting the relatively good health of the nation's largest businesses. The other types of business listed below typically do not pay any federal or state income taxes, but rather have their income "pass through" to the business owners, who are then taxed on their individual tax return. In the case of SHS taxes, both the entity and the individual are taxed. Individuals are then allowed to take a deduction of the personal SHS taxes in the amount of their share of the entity's taxes on their individual tax return in order to avoid the same income being taxed twice.

FIGURE 10. FY 2022-23 Revenue Collections by Entity Type[14]



[14] This data reflects the type of taxpayers. For non-individuals, this means the legal formation of the business entity that is being taxed. For context, C corps tend to be larger corporations, while the other types are used for smaller or specific types of companies.