

# **Fiscal Impact Analysis Relating to City Growth and Annexations: Final Report**

Prepared by

## **ECONorthwest**

Pioneer Tower, Suite 1460  
888 SW Fifth Ave.  
Portland, OR 97204-2028  
(503) 222-6060

January 2001  
Project 6650  
© ECONorthwest 2001



# Table of Contents

---

<b>TABLE OF CONTENTS .....</b>	<b>I</b>
<b>EXECUTIVE SUMMARY .....</b>	<b>III</b>
<b>SECTION 1 INTRODUCTION .....</b>	<b>1</b>
<b>PURPOSE .....</b>	<b>1</b>
<b>ANALYTIC APPROACH AND KEY ASSUMPTIONS.....</b>	<b>2</b>
POPULATION AND EMPLOYMENT FORECASTS .....	3
PUBLIC COST FORECASTS .....	3
<i>Capital cost forecasts</i> .....	3
<i>Operation and maintenance cost forecasts</i> .....	4
REVENUE FORECASTS .....	5
<i>Capital revenue forecasts</i> .....	5
<i>Operation and maintenance revenue forecasts</i> .....	5
<i>Limitations of long-run fiscal analysis</i> .....	6
<b>ORGANIZATION OF THE REPORT .....</b>	<b>7</b>
<b>SECTION 2 FISCAL IMPACTS OF CITY GROWTH.....</b>	<b>9</b>
<b>POPULATION AND EMPLOYMENT ESTIMATES.....</b>	<b>9</b>
<b>FISCAL IMPACTS RELATED TO CAPITAL BUDGETS.....</b>	<b>11</b>
STREETS, PARKS, AND MUNICIPAL FACILITIES .....	11
WATER AND SEWER CAPITAL.....	17
<b>FISCAL IMPACTS RELATED TO OPERATIONS AND MAINTENANCE BUDGETS.....</b>	<b>20</b>
GENERAL FUND .....	21
<i>Growth Scenario</i> .....	21
<i>No-Growth Scenario</i> .....	23
<i>Growth versus No-Growth</i> .....	25
<i>Fiscal Impacts of Improved Level of Service</i> .....	26
PUBLIC WORKS FUND (TRANSPORTATION SERVICES).....	31
<i>Growth Scenario</i> .....	31
<i>No-Growth Scenario</i> .....	33
<i>Growth versus No-Growth</i> .....	33
<i>Fiscal Impacts of an Improved Level of Service (Perpetual Maintenance)</i> .....	34
WATER AND SEWER FUND.....	34
<i>Growth Scenario</i> .....	34
<i>No-Growth Scenario</i> .....	36
<i>Growth versus No-Growth</i> .....	36
<b>SECTION 3 ANNEXATION OF JAN REE.....</b>	<b>38</b>
<b>POPULATION AND EMPLOYMENT ESTIMATES.....</b>	<b>38</b>
<b>FISCAL IMPACTS RELATED TO CAPITAL BUDGETS.....</b>	<b>38</b>

<b>FISCAL IMPACTS RELATED TO OPERATIONS AND MAINTENANCE BUDGETS.....</b>	<b>40</b>
GENERAL FUND .....	40
PUBLIC WORKS FUND (TRANSPORTATION SERVICES).....	41
WATER AND SEWER FUND.....	42
<b>SECTION 4 ANNEXATION OF EAST SALEM.....</b>	<b>44</b>
<b>POPULATION AND EMPLOYMENT ESTIMATES.....</b>	<b>44</b>
<b>FISCAL IMPACTS RELATED TO CAPITAL BUDGETS.....</b>	<b>44</b>
<b>FISCAL IMPACTS RELATED TO OPERATIONS AND MAINTENANCE BUDGETS.....</b>	<b>45</b>
GENERAL FUND .....	45
PUBLIC WORKS FUND (TRANSPORTATION SERVICES).....	46
WATER AND SEWER FUND.....	47
<b>SECTION 5 FISCAL IMPACTS BY LAND USE.....</b>	<b>49</b>
<b>GENERAL FUND.....</b>	<b>49</b>
<b>PUBLIC WORKS FUND (TRANSPORTATION SERVICES DIVISION).....</b>	<b>51</b>
<b>WATER AND SEWER FUND.....</b>	<b>52</b>

# Executive Summary

---

## INTRODUCTION AND PURPOSE

This report complements the *Salem Futures* project by estimating how growth will impact the City’s fiscal position over the next twenty years. Specifically, through this report, policymakers seek answers to the following questions:

- How much is the City likely to spend on operations, maintenance, and capital during 2000-2020 if the *Salem Futures* projections of population and employment growth, and the development they are expected to engender, prove accurate? For comparison, what would the expenditures be if population, employment, and land uses did not change? And, under both assumptions, how much would the City receive in taxes and fees to pay for those services?
- Were the City to annex parts of unincorporated Marion County (Jan Ree and the East Salem Sewer Area), how would the cost of serving the new population compare to the revenues they would contribute to the City’s budget?
- How does the net fiscal impact on the City budget differ by type of land use? Are residences or businesses more likely to “pay their own way”?

While growth affects a variety of school and special districts that serve Salem residents, *this study focuses exclusively on the municipal budget*, and specifically on services provided through three key funds: the General Fund, the Public Works Fund (Transportation Services), and the Water and Sewer Fund. The City has five other funds that we did not consider in this study because they are financed through user fees or charges<sup>1</sup>.

## ANALYTIC APPROACH AND KEY ASSUMPTIONS

This study estimates the fiscal impact of growth and annexation on the City of Salem and, thus, on the citizens of Salem who pay for City services through taxes, utility rates, and fees. Four basic steps guide all fiscal impact methods:

- Estimate growth. This study evaluates the City’s fiscal position under two alternative scenarios: growth, and no growth. The growth scenario

---

<sup>1</sup> Those funds are the Airport Fund, the Building and Safety Fund, the Emergency Services Fund, the Willamette Valley Community Center Fund, and the City Services Fund (City’s Internal Fund).

adopts the population and employment forecasts developed through the *Salem Futures* project. The no-growth scenario assumes the population and employment within Salem’s city limits will remain largely unchanged over the next 20 years<sup>2</sup>.

- Translate the measures of growth into consequent public costs. We estimate public-service costs for capital, operation, and maintenance. On the *capital* side, we draw our cost estimates primarily from the City’s capital-improvement plan (CIP), assuming full-buildout of the facilities identified in the various facility master plans (e.g., water, sewer, storm water, transportation, municipal facilities, and parks). Underlying the capital forecasts is an assumption that the City will maintain the *level of service* as it exists in the year 2000—with three exceptions. *The study assumes the City will improve its fire, park, and library services during 2000-2020.*

We forecast *operation and maintenance costs* using detailed service and cost information obtained through interviews with department heads and financial analysts. *Our analysis does not assume revenue-constrained spending*; instead we asked City staff to consider how much their departments would have to spend to hold their levels of service constant<sup>3</sup>.

- Forecast revenues induced by growth. The City relies on a variety of taxes and charges to fund its capital, operation, and maintenance budgets. Property taxes play a key role on both the capital and O&M sides, underwriting the City’s general obligation bonds and serving as the General Fund’s principle source of revenue. To forecast property tax revenues from growth, we project the increase in assessed valuation associated with the construction of new residential dwellings and businesses—consistent with the *Salem Futures* project. We then multiply the predicted increase in assessed values for operations by the City’s existing tax rate. Other revenues are related to population and employment levels. For example, as growth occurs, the City will levy more parking violations, overdue library charges, and senior center fees. Similarly, as the City grows, so too will state-shared revenues associated with highway funds, alcohol taxes, and cigarette taxes.
- Compare the growth-induced costs to revenues. If costs exceed revenues, the City incurs a deficit.

---

<sup>2</sup> Specifically, “no growth” means that the number and location of structures and land uses in Salem does not change over the next twenty years. However, per the Council’s request, we have assumed that employment in State government will continue to grow as forecast in the *Salem Futures* project.

<sup>3</sup> Again, we assume three departments actually increase their level of service under the no-growth scenario.

## KEY FINDINGS

### POPULATION AND EMPLOYMENT FORECASTS

***Salem Futures* assumes balanced growth.** The *Salem Futures Phase I* report, which underlies this study, shows Salem's population growing at an average annual rate of 1.7 percent and employment growing at 1.3 percent annually. Across land use types, the projected growth is balanced. The population in single-family and multi-family dwellings increase at similar rates (1.8 percent versus 1.5 percent, respectively) as does employment in the commercial/office, industrial, and education sectors (each at 1.5 to 1.6 percent annually). *Salem Futures* predicts sub par growth in the government sector, with jobs increasing at only 0.5 percent.

### CAPITAL COSTS AND FINANCING

**Proposed capital improvements in the areas of streets, parks and municipal facilities are split evenly between growth and no growth projects.** The City's existing CIP (funded and unfunded) consists of more than \$560 million of proposed enhancements to the City's streets, municipal facilities (fire, library, and office space), and parks. Of that total, we estimate 45 percent of the CIP's value (\$251 million) in these areas is attributable to growth. The remaining 55 percent of the CIP's value (\$310 million) *would be expended regardless of growth* (i.e., no-growth projects). Key no-growth projects include the remodeling, relocation, and construction of new fire stations and branch libraries; the repair and restoration of numerous roads that can no longer be maintained through regular means; and the acquisition of new parkland (see **Error! Reference source not found.** in the main report).

**Growth pays its share of capital costs for parks but less than its share of costs for streets and municipal facilities.** For each project category, we reviewed the CIP to determine the share total project costs associated with growth (as described above) and compared that to the share project financing supported by growth. Growth pays for capital projects through system-development charges (SDCs), developer-reimbursement funded programs, and property taxes—which repay general-obligation bond debt. We estimate that growth will underwrite a \$147.1 million share of the street-capital program, which is about 79 percent of the capital costs they will impose on the transportation system during 2000-2020. In the municipal facilities area, growth will contribute \$12.8 million in financing, or only 64 percent of the costs they impose. This finding is driven by the fact that the City does not levy a SDC or developer charge to finance municipal facilities. In the parks area, growth will pay somewhat more than its share (131 percent). In this area, the City recoups 100 percent of growth-related costs through SDCs; growth additionally supports no-growth projects through property taxes (see **Error! Reference source not found.**, **Error! Reference source not found.**, and **Error! Reference source not found.** in the main report).

**Salem would undertake the majority of planned water, sewer, and storm water capital projects in the absence of growth; Growth will pay a fair share of project costs through SDCs and developer reimbursements.** The

Water and Sewer Fund CIPs includes more than \$770 million of proposed enhancements to the City's municipal utility systems. Of that total, an estimated 35 percent of the plan's value (\$267 million) is attributable to growth. The remaining 65 percent of plan's value (\$503 million) would take place regardless of growth (see **Error! Reference source not found.** in the main report). We estimate that approximately 33 percent of the capital improvements costs will be funded by SDCs and developer contributions, which is approximately equal to the growth-related costs identified in the CIP. For the City to fully recover growth-related costs from new development, the City will need to implement a stormwater SDC (see **Error! Reference source not found.**).

## **OPERATION AND MAINTENANCE COSTS AND REVENUES**

**Under the study's growth scenario, the City will encounter modest deficits in the General Fund as it attempts to accommodate growth and improve levels of service.** Assuming the City builds two new fire stations and two branch libraries within the next five years and begins acquiring parkland, we anticipate modest deficits during 2000-2015. In short, the proposed level of service improvements will weaken the City's fiscal position unless citizens approve a new revenue source or the City allows the level of service to fall in other areas (see **Error! Reference source not found.**). Our findings are reported in constant year 2000 dollars.

Our projected deficits remain relatively small for two reasons. First, officials in the Fire Department indicate they will be able to accommodate growth at a below average marginal cost because of the compact nature of the City's growth. Consequently, the expenditures in the department—the Fund's second largest—grow at about one-half the rate of population growth. Second, the study assumes no improvement in the Police Department's level of service in the growth scenario.

**The City's fiscal position in General Fund would be slightly stronger under growth scenario than under the no-growth scenario.** We anticipate a somewhat stronger fiscal position under the growth scenario for the following reasons. First, on the revenue side, we predict that the majority of City's funding sources will increase in proportion with population and employment growth. This has been the case in the 1990s, and we anticipate it will continue to be the case during the forecast period. On the expenditure side, we find that several departments will grow at the same rate as population and employment, particularly those that have explicit population-based service standards. However, the Fire Department, the General Fund's second largest, anticipates that it can serve growth at a marginal cost that is below its current average. Put differently, the Department anticipates economies of scale as the City grows, which are created by the geographically compact nature of growth. The growth scenario takes advantage of these economies of scale. The no-growth scenario does not.

**Salem's street maintenance program will incur increasingly large deficits as the City grows.** The City relies primarily on State Highway Fund revenues to finance street-maintenance activities, and for the purposes

of this study, we assume it will continue to do so during 2000-2020. Consistent with state projections, we predict a gradual erosion of per capita Highway Fund distributions over the forecast period. Consequently, we estimate the Transportation Division will incur deficits in its road maintenance program that will increase from \$0.4 million in 2005 to \$1.3 million in 2020 (see **Error! Reference source not found.**).

Under the no-growth scenario, we estimate deficits of similar magnitudes. This suggests that the most critical issue facing the Public Works Department is not the rate of city growth but rather the Department's method of finance. If projections by the Oregon Department of Transportation prove accurate—and per capita highway fund distributions fall—the City's street maintenance standard will decline. If state policymakers or voters were willing to increase gasoline taxes to ensure that per capita distributions kept pace with inflation, the Division's fiscal position would strengthen.

**Billing rates for water, sewer, and storm water services are lower under the growth scenario.** Salem is required to set rates that will recover the anticipated operation and maintenance and capital costs of the water, sewer, and storm water systems. Under the growth scenario, we project a general decrease in the O&M costs per unit of consumption over the 20-year period, because billing units (water consumption) grow faster than projected costs. Under the no-growth scenario, the opposite is true – there is a general increase in the O&M costs per unit of consumption because regulatory-driven O&M costs are still included in the forecast, however, billing units are significantly lower. This is particularly true for the wastewater system where a significant portion of the future O&M costs are related to addressing existing deficiencies and regulatory requirements (see **Error! Reference source not found.**, **Error! Reference source not found.**, **Error! Reference source not found.**, and **Error! Reference source not found.**).

## **ANNEXATIONS**

**Annexation of the Jan Ree area would slightly strengthen the City's fiscal positions in the General Fund, weaken the fiscal position in the Water and Sewer Fund and would be fiscally neutral in the Public Works Fund.** Overall, we estimate the annexation of Jan Ree would contribute to a slight surplus in the general fund. In total, general-fund expenditures and revenues would increase by \$5.3 million. On the revenue side, property-tax revenue would increase by 10 percent or \$3.3 million with annexation. The percentage change in property tax revenue is below the change in population (12.5 percent)—implying that assessed values per capita in Jan Ree are below the existing City average. Offsetting the below-average increase in property-tax receipts would be lower than average spending by the Fire Department. Assuming construction of the new East Salem station, the department indicates that the area could be served at a low marginal cost (see **Error! Reference source not found.**).

Through the annexation of Jan Ree, the City would assume responsibility for maintaining and operating its 40 miles of roadway. The annexation would result in an 8 percent expansion in the number of road miles under the City's jurisdiction. We predict that—given that the area has fewer road miles per capita than the City itself—the annexation of Jan Ree area would be fiscally advantageous from the Public Works Fund's perspective—*assuming today's level of service* (see **Error! Reference source not found.**).

The City already provides water and sewer services to the Jan Ree area, and in doing so, assesses an outside-City surcharge. With annexation, we assume the City would remove the surcharge, which would reduce the Fund's net revenues by \$1.0 million (see **Error! Reference source not found.**).

On the capital side, the annexation of Jan Ree would entail a \$12.6 million investment in parks, \$2.8 million in municipal facilities, and \$9.5 million in storm water facilities (see Table 21).

**Annexation of the East Salem area would be fiscally positive in the General Fund and Public Works Funds, and fiscally negative in the Water and Sewer Fund.** We estimate the annexation of East Salem would generate a modest surplus in the general fund. In total, expenditures would increase by \$3.6 million, which would represent a 5.0 percent increase in spending. The Fire Department's expenditures would not increase with the annexation of the East Salem area. Again, officials assume the City will construct a new fire station near the area—*regardless of annexation*. On the revenue side, property-tax revenue would increase by 6.9 percent or \$2.3 million with annexation. The percentage change in property tax revenue is below the change in population (9.1 percent)—implying that assessed values per capita in East Salem are below the existing City average (see **Error! Reference source not found.**).

Through the annexation of East Salem, the City would assume responsibility for maintaining and operating its 30 miles of roadway. The annexation would result in a 6 percent expansion in the number of road miles under the City's jurisdiction. We predict that—given that the area has fewer road miles per capita than the City itself—the annexation of East Salem area would be fiscally advantageous from the Public Works Fund's perspective—*assuming today's level of service* (see **Error! Reference source not found.**).

The City does not expect any changes to wastewater system operation and maintenance costs as a result of the annexation of the East Salem area; however, the City would need to provide additional water services to East Salem, if annexed. The City would also incur additional costs to provide stormwater services. The water and sewer rates charged to customers in the East Salem area would likely change as a result of annexation. The increase in costs to the water system would be almost entirely offset by the corresponding increase in revenues. On the other hand, increases in sewer rate revenues are not projected to cover the increased costs for stormwater. The combined impact would be a decrease in net revenues of about \$216,000 (see **Error! Reference source not found.**).

On the capital side, the annexation of East Salem would entail a \$7.7 million investment in parks, \$0.7 million in municipal facilities, and \$8.4million in storm water facilities (see **Error! Reference source not found.**).

## **FISCAL IMPACTS BY LAND USE**

**Single-family, commercial/office, and industrial uses contribute more in General Fund revenues than they generate in service costs.** Our analysis of revenue and expenditure sources indicates that single-family, commercial/office, and industrial uses tend to contribute more in General Fund revenues than they demand in services. From our analysis, one might conclude that the City should aggressively pursue commercial and industrial development to strengthen its fiscal position. However, an exclusive focus on these activities would not be sustainable in the long run. Indeed, a non-residential focus with little accompanying housing would produce a community with traffic congestion and long commutes. Moreover, were the City to shun multi-family housing to foster its budget, the policy would have impacts on neighboring communities and would deprive Salem businesses of access to workers, not to mention conflicts with other City and state goals and policies (see **Error! Reference source not found.**) .

**Salem's reliance on the State Highway Fund implies that residential uses contribute more to transportation O&M financing than non-residential uses.** Decision-makers should note that as the City adds non-residential land, such annexations generate street-related costs but do not produce new revenues because the City's population—the factor used to distribute resources under the State Highway Fund's formula—remains unchanged (see **Error! Reference source not found.**).

**Salem has the ability to design utility rates to charge individual land uses based on their costs of service.** The City is in the process of developing new user rates to reflect the cost distributions (see **Error! Reference source not found.**). Assuming cost of service rates are implemented, each land use's share of revenue should roughly offset its respective costs.

## **CONCLUSION**

The charge of this study was to describe long-run fiscal impacts under conditions of growth and no growth. There are no models in general—and none for Salem—that can simultaneously deal with even a handful of the most significant economic and policy variables that will determine the City's fiscal position over the next 20 years. Thus, we were in the position of having to describe the future using scenarios, whose results derive from some assumptions that we believe are reasonable (understandable, intuitive, and consistent with the best practices described in the professional literature).

Hence, our caveat: we do not believe that the results of this report can be summarized accurately in a few sentences. The results are contingent: *if* you accept these assumptions about data and relationships, *then* the fiscal implications are these. But there will always be a legitimate debate about the data and relationships.

Our focus in this report has been to make the data and relationships we are using clear so that people can evaluate them. If they are judged reasonable, then there is a presumption that the results they generate are also reasonable. Possibly the most important result of this study is not the bottom-line conclusion, but the discussion it might encourage about the relationships between growth and fiscal impacts, and the implications development planning and public services.