

Oregon Municipal Handbook

CHAPTER 12: FINANCIAL MANAGEMENT AND TAXATION



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Chapter 12: Financial Management and Taxation

A city's strength and breadth of services depends on its active management of its finances. Financial management includes the following: (1) budgeting and forecasting; (2) accounting and financial reporting, including internal controls and audits; (3) capital planning and asset management, (4) compensation and benefits; and (5) treasury and investment management.

In addition to these topics, this chapter will discuss taxation. Taxation is the primary resource to allow cities to fund essential city services including police, fire, roads, water, parks and more.

I. BUDGETS AND FORECASTING

Budgeting is the process of allocating finite resources to the prioritized needs of an organization.¹ The budget also provides an important tool for the control and evaluation of sources and the uses of resources.

Budgets in the public arena are often considered the definitive policy document because an adopted budget represents the financial plan used by a government to achieve its goals and objectives.² When a unit of government legally adopts a financial plan, the budget has secured the approval of the governing board and reflects:

- Public choices about which goods and services the unit of government will or will not provide;
- The prioritization of activities in which the unit of government will be involved;
- The relative influence of various participants and interest groups in the budget development process; and
- The governmental unit's plan for acquiring and using its resources.³

As discussed below, state law prescribes the framework of the budget adoption process. The basic budget framework requires several steps including public notice, hearing, and two public meetings.⁴ Depending on the size of the city and the goals set forth by its governing

¹ For excellent discussions on the importance of budgeting, see National Center for Education Statistics, *Financial Accounting for Local and State School Systems*, available at: https://nces.ed.gov/pubs2004/h2r2/ch_3.asp (last accessed on Sept. 28, 2023); and University of Wisconsin-Madison, *Local Government Education, Finance and Budgeting*, available at: <https://localgovernment.extension.wisc.edu/finance-and-budgeting/> (last accessed on Sept. 28, 2023).

² *Id.*

³ *Id.*

⁴ ORS 294.305 to 294.565; OAR 150-504-420.

board, this framework can be greatly expanded to accommodate different budgeting models or engagement of the public.⁵

In Oregon, the Department of Revenue (DOR) provides yearly training for budget officers, governing body members and appointed members of budget committees.⁶ The DOR maintains its Local Budgeting Manual, adopted as OAR 150-504-420, providing detailed guidance and forms for meeting the statutory requirements.⁷

In addition to the budgeting framework required by law, this section will provide additional resources and methods not prescribed by law.⁸ For example, this section discusses different methods that cities use to develop the budgets that allow cities to allocate resources to specific goals, rather than historical budgeting. Lastly, this section will discuss the necessity of forecasting resources and expenditures in the future to guide the decision makers when preparing and approving a current budget.

A. Budget Framework: Requirements⁹

Most cities must prepare and adopt an annual budget.¹⁰ A budget is a financial plan estimating the revenues and expenditures for a fiscal year, or biennial budget period.¹¹ A fiscal year begins July 1 and ends June 30.¹² A biennial budget period begins on July 1 and ends June 30 of the second calendar year next following.¹³ Without a budget for the new fiscal year (July 1st to June 30), a city is not able to spend money or incur obligations.¹⁴

⁵ *Id.*

⁶ See Oregon Department of Revenue, *Local Budget Law Training and Resources*, available at: <https://www.oregon.gov/dor/programs/property/pages/local-budget.aspx> (last accessed on Sept. 30, 2023).

⁷ Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

⁸ See, e.g., League of Oregon Cities, *Budgeting Basics*, LOCAL FOCUS, available at: <https://www.orcities.org/application/files/1016/4805/3045/BudgetingBasics2-10-22.pdf> (last accessed on Sept. 28, 2023); Government Finance Officers Association, *Budgeting and Forecasting Topic Library*, available at: <https://www.gfoa.org/materials/topic/budgeting-and-forecasting> (last accessed on Dec. 18, 2023).

⁹ This discussion on the budget framework is courtesy of Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁰ ORS 294.305 to 294.565.

¹¹ *Id.*

¹² ORS 294.311(17).

¹³ ORS 294.323.

¹⁴ ORS 294.305 to 294.565.

i. Prepare the Proposed Budget

Although each city prepares their proposed budget differently, generally, the city manager prepares a proposed budget based on requests by city departments.¹⁵

To guide the preparation of the budget, the city manager provides departments with budget preparation guidelines that may include:

- A budget transmittal letter from the city manager, which provides the overall context for budget development;
- A budget overview, which explains the budgeting philosophy and approach, outlines the budget development process, and refers to major assumptions and changes in the budgetary process from the previous year;
- Fiscal limitations to be observed, such as maintenance of service levels, specific percentage increases or decreases in resource allocations, and personnel hiring guidance;
- A budget calendar of critical dates for budget completion, submission, and review;
- Instructions concerning expenditure items to be budgeted and the detail required for submission; and
- A copy of standard budget preparation worksheets and submission forms.¹⁶

Once departments have developed a departmental budget, departments may present the requested budget to the city manager and/or budget officer.¹⁷ The budget officer will review and adjust the department's requested budget reflecting the city priorities.¹⁸

The different options for developing the budget are discussed below and include: (1) line-item budgeting; (2) performance budgeting; (3) program and planning budgeting; (4) zero-based budgeting, and (5) outcome-focused budgeting.

Budget Message

The budget officer will finalize the budget message, trends, initiatives, and narratives. The budget message gives the public and the budget committee information that will help them understand the proposed budget.¹⁹ It contains a brief description of the financial policies reflected in a proposed budget and, in connection with the financial policies, explains the

¹⁵ See, e.g., City of Salem: <https://www.cityofsalem.net/government/budget-finance/annual-budget/get-involved-in-the-budget-process> (last accessed on Dec. 18, 2023); City of Gresham, <https://greshamoregon.gov/budget/> (last accessed on Dec. 18, 2023).

¹⁶ See, e.g., City of Hillsboro: <https://www.hillsboro-oregon.gov/our-city/departments/finance/budget> (last accessed Dec. 28, 2023).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ ORS 294.403.

important features of the budget.²⁰ The budget message must also explain proposed changes from the prior year's budget and any major changes in financial policies.²¹

Funds

Every city budget will have at least one fund, the general fund, which accounts for the daily operations of the city.²² In practice, a city budget will have several funds, each designed to account for a specific purpose. A budget should include enough different types of funds to clearly show what services and programs a local government is doing and how it is paying for expenditures.²³ See below in fund accounting for more information.

Each year a city's budget provides a brief financial history of each fund.²⁴ To meet this requirement, the annual budget will include detailed information on: the actual revenues and expenditures for the prior two years; the budgeted revenues and expenditures for the current year; the estimated balanced budget as proposed by the budget officer for the coming year which includes columns for the budget approved by the budget committee; and the final budget adopted by the governing body.²⁵ The budget also includes a column for the descriptions of expenditures and resources.²⁶

Organizational Unit and Programs

Within each fund, estimated expenditures must be arranged by organizational unit or program.²⁷ An organizational unit is an administrative subdivision of the local government which is responsible for specific services, functions or activities.²⁸ These are usually identified as departments, divisions, offices, etc.²⁹ For example, a city may be structured into organizational units such as: Police Department, Public Works Department, Office of the City Recorder, etc.

A program is a group of related activities aimed at accomplishing a major service or function.³⁰ Programs could include services and functions such as: fire protection, water, sewers, road maintenance, etc.

²⁰ *Id.*

²¹ *Id.*

²² OAR 150-294-0420.

²³ *Id.*

²⁴ OAR 150-294-0470; ORS 294.358.

²⁵ ORS 294.438.

²⁶ For an example of the typical resources and expenditures found in a city budget, see page 33 of the Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

²⁷ ORS 294.438.

²⁸ ORS 294.311(31).

²⁹ *Id.*

³⁰ ORS 294.311(33).

Object classifications

Within each organizational unit or program, the estimates of line-item expenditures must be detailed by the following object classifications: personnel services, materials and services and capital outlay.³¹ In addition, separate estimates must be made in each fund for special payments, debt service, interfund revenue transfers, operating expenses and general capital outlays that cannot reasonably be allocated to one particular unit or program.³²

This proposed budget is sent to the budget committee.

ii. Appoint a Budget Officer and a Budget Committee

While the city is preparing a budget, the elected officials appoint a budget officer and a budget committee.³³ The budget officer prepares or supervises the preparation of the proposed budget to present to the budget committee.³⁴ Often, the budget officer is the city manager or the finance director.

For the budget committee, the elected officials appoint lay members of the jurisdiction.³⁵ The budget committee comprises of an equal number of lay members as governing board members.³⁶ If the governing body cannot identify enough citizens willing to serve on the budget committee, then the committee is made up of the citizens who have volunteered to serve along with the entire governing body.³⁷

The appointed members of the budget committee must be electors of the city, meaning they must be qualified voters who have the right to vote on the adoption of any measure.³⁸ The members of the budget committee are appointed for staggered three-year terms, and cannot be employees, officers or agents of the city.³⁹ No member of the budget committee can receive compensation for serving on the committee except reimbursement of expenses incurred while serving.⁴⁰

iii. Publish Notice of Budget Committee Meeting

The city must publish notice of the date, place and that public comment will be heard at the budget committee meeting.⁴¹ If the budget officer anticipates that more than one meeting

³¹ ORS 294.388(3).

³² *Id.*

³³ ORS 294.331.

³⁴ *Id.*

³⁵ ORS 294.414(2)

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ ORS 294.414(4) and 294.414(5).

⁴⁰ ORS 294.414(3).

⁴¹ ORS 294.426 and ORS 294.438.

will be needed, it may provide notice of several meetings. Notice is usually one of the following:

- If the only form of notice is newspaper publication, the notice must be published at least twice, five to 30 days before the scheduled budget committee meeting date.⁴²
- If the notice is published both in a newspaper and online, it need only be published once, but the publication must include the website address, and it must be published online for at least 10 days before the meeting.⁴³

iv. Budget Committee Approves the Budget

The budget committee conducts public meetings to hear the budget message delivered at the first meeting of the budget committee by the budget officer, the chief executive officer or the governing body chair.⁴⁴ A budget committee holds at least one meeting for the purpose of receiving the budget message and the budget document, and to provide the public with an opportunity to ask questions about and comment on the budget.⁴⁵

A quorum, or more than one-half of the committee's membership, must be present for a budget committee to conduct an official meeting.⁴⁶ Any action taken by the committee first requires the affirmative vote of a majority of the membership. If only a quorum is present at a meeting, all members must then vote in the affirmative for an action to be taken.⁴⁷

Like a governing body, members of the budget committee are required to declare actual and potential conflicts of interest.⁴⁸ Budget committee members who have actual conflicts of interest may not participate in the discussion or the vote; therefore, it is unlikely that any budget committee member with an actual conflict would attend the budget committee meeting.

The budget committee reviews the budget proposed by the budget officer. One of its most important functions is to listen to comments and questions from interested citizens and consider their input while deliberating on the budget.⁴⁹ The budget committee can revise the proposed budget to reflect changes it wants to make in the local government's fiscal policy provided that the revisions still produce a balanced budget.⁵⁰ When the committee is satisfied, it approves the budget.

⁴² ORS 294.426(5)(a).

⁴³ ORS 294.426(5)(b).

⁴⁴ ORS 294.426(1)(a).

⁴⁵ ORS 294.426(1)(b).

⁴⁶ OAR150-294-0450.

⁴⁷ ORS 294.414; OAR 150-294-0450.

⁴⁸ ORS 244.020; ORS 244.120.

⁴⁹ ORS 294.426(1)(b).

⁵⁰ ORS 294.388(1).

When approving the budget, the budget committee must also approve a property tax rate or the tax amounts that will be submitted to the county assessor.⁵¹

v. Publish Notice of Summary Budget

Upon approval of the budget by the budget committee, the budget officer completes the budget column labeled “approved by budget committee,” noting any changes from the original proposed budget.⁵² A summary of the approved budget, which includes a narrative description of prominent changes to the budget from year to year, is published in the newspaper with the notice of a public hearing to adopt the budget five to 30 days before the hearing date.⁵³

vi. Budget is Adopted by Governing Body

The governing body must conduct a budget hearing by June 30 to receive the budget committee’s approved budget, conduct deliberations and consider any additional public comments.⁵⁴ The council can make any adjustments that it deems necessary (with some restrictions) to the approved budget before it is adopted prior to July 1.⁵⁵

The budget hearing and the resolutions or ordinances necessary to adopt the budget and impose taxes can be conducted at the same public meeting. The types of changes the governing body can make without republishing are:

- Increasing expenditures in any fund in the annual budget up to \$5,000 (\$10,000 in a biennial) or 10%, whichever is greater;
- Reducing expenditures of any funds;
- Reducing the tax rate or amount approved by the budget committee; and
- Adjusting the other resources in each fund—does not require republishing⁵⁶

However, if the expenditure increase needs to be more than \$5,000 in an annual budget, the council must republish the budget summary and hold a second public hearing before July 1st.⁵⁷ If the budget is republished and a second budget hearing is held, the governing body can increase the amount or rate of taxes to be imposed above what the budget committee approved but only up to the city’s permanent rate limit, a voter-approved local option tax rate or dollar amount, and bond principal and interest requirements.⁵⁸

⁵¹ ORS 294.456(1); ORS 310.060.

⁵² ORS 294.428(1).

⁵³ ORS 294.438.

⁵⁴ ORS 294.408; ORS 293.605.

⁵⁵ ORS 294.456.

⁵⁶ ORS 294.456; ORS 294.453.

⁵⁷ ORS 294.456.

⁵⁸ *Id.*

To adopt the budget, the city council enacts a resolution or ordinance which provides the legal authority to: establish or dissolve funds; make appropriations for expenditures; adopt a budget; impose and categorize taxes; and perform all other legal actions pertaining to budgeting and authorizing tax levies.⁵⁹ To accomplish this, cities do not have to pass multiple resolutions or ordinances; rather, all the enactment statements can be combined into one resolution or ordinance, which must be signed by the mayor before submission to the county assessor's office.

vii. Appropriations and Certifies Tax to the County Assessor by July 15

By July 15 of each year, a city must submit two copies of the resolution or ordinance adopting the budget, making appropriations, and imposing and categorizing the tax to the county tax assessor.⁶⁰ In addition, the notice of property tax certification (form LB-50) and successful ballot measures for local option taxes or permanent rate limits must be submitted.⁶¹

In addition to the county tax assessor's copies, a copy of the resolutions must be submitted to the Oregon Department of Administrative Services by July 31.⁶² Finally, a copy of the published adopted budget document, including the publication and tax certification forms, must be submitted to the county clerk's office by September 30.⁶³

viii. Changing the Adopted Budget

After July 1, cities may change appropriations in an adopted budget with resolutions authorizing transfers of funds and supplemental budgets to change the adopted expenditure appropriations and estimated resources.⁶⁴ The resolutions must be approved before more money is spent beyond what is appropriated in the adopted budget. Any changes made to the adopted budget require that the budget remain in balance after the change.

It is unlawful to spend public money in excess of the amounts budgeted.⁶⁵ Public officials can be sued for such actions if the expenditure is found to be malfeasance in office or willful or wanton neglect of duty.⁶⁶ Creating a supplemental budget or a resolution transfer after the expenditure is made does not protect the governing body members from a lawsuit.

⁵⁹ *Id.*

⁶⁰ ORS 294.458; ORS 310.060.

⁶¹ OAR 150-310-0020.

⁶² ORS 221.770.

⁶³ ORS 294.458(5).

⁶⁴ ORS 294.471.

⁶⁵ ORS 294.471(4) and ORS 294.100.

⁶⁶ ORS 294.100.

B. Types of budgeting processes

As discussed above, Oregon law requires local governments to follow specific steps to adopt a budget. However, the development of the budget is largely left to the discretion of the city's governing body and city manager. As discussed below, there are several different methods to prepare a budget and create a link between the services provided and the resources allocated by the city.⁶⁷

Cities generally use the following methods of budgeting: (1) line-item budgeting; (2) performance budgeting; (3) program and planning budgeting; (4) zero-based budgeting, and (5) outcome-focused budgeting.⁶⁸ Many governments use a variety of hybridized versions to address the specific needs of the organization.⁶⁹

i. Line-Item Budgeting⁷⁰

Line-item budgeting is the most widely used approach in many organizations. In line-item budgeting, expenditure requests are based on historical expenditure and revenue data. The line-item budget approach offers simplicity and ease of preparation. This method budgets by organizational unit and object and is consistent with the lines of authority and responsibility in organizational units. As a result, this approach enhances organizational control and allows the accumulation of expenditure data at each functional level. Finally, line-item budgeting allows the accumulation of expenditure data by organizational unit for use in trend or historical analysis.

Although this approach offers substantial advantages, critics have identified several shortcomings including that it presents little useful information to decisionmakers on the functions and activities of organizational units. Since this budget presents proposed expenditure amounts only by category, the justifications for such expenditures are not explicit and are often unintuitive. However, to overcome its limitations, the line-item budget can be augmented with supplemental program and performance information.

ii. Performance Budgeting⁷¹

In a performance budgeting includes narrative descriptions of each program or activity.

⁶⁷ See Government Finance Officers Association, *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting* (1998), available at: https://gfoaorg.cdn.prismic.io/gfoaorg/e4534548-fa06-47ad-9cc8-5f37e6e2f21e_RecommendedBudgetPractices.pdf (last accessed Dec. 29, 2023).

⁶⁸ This discussion on the types of budgeting is courtesy of the National Center for Education Statistics, *Financial Accounting for Local and State School Systems* (2009) available at: https://nces.ed.gov/pubs2009/fin_acct/chapter3_2.asp (last accessed Dec. 28, 2023).

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

The budget is organized into quantitative estimates of costs and accomplishments and focuses on measuring and evaluating outcomes.

The performance approach is considered superior to the line-item approach because it provides more useful information for evaluation. The performance approach does not necessarily evaluate the appropriateness of program activities in relation to reaching an organization's goals or the quality of services or outputs produced. Consequently, the performance approach has become most useful for activities that are routine in nature and discretely measurable such as vehicle maintenance and accounts payable processing. Performance budgeting may offer considerable enhancement to the line-item budget when appropriately applied.

iii. Program and Planning Budgeting⁷²

Program budgeting bases expenditures solely on programs of work regardless of objects or organizational units. Program budget requests and reports are summarized in terms of a few broad programs rather than in the line-item expenditures or organizational units.

This conceptual framework includes the practices of explicitly projecting long-term costs of programs and the evaluation of different program alternatives that may be used to reach long-term goals and objectives. The focus on long-range planning is the major advantage of this approach.

This approach may be limited if there are changes in long-term goals, lack of consensus regarding the city's fundamental objectives, lack of adequate program and cost data, and the difficulty of administering programs that involve several organizational units.

iv. Zero-Based Budgeting⁷³

Zero-based budgeting is a budgeting process that allocates funding based on program efficiency and necessity rather than budget history. As opposed to traditional budgeting, no item is automatically included in the next budget. In zero-based budgeting, every expenditure must be justified annually during the budget development process.

Expenditures are assigned a predicted outcome and costs and then expenditures are then ranked by their importance in reaching a city's goals and objectives. Therefore, when the proposed budget is presented, it contains a series of budget decisions that are tied to the attainment of the city's goals and objectives.

The central thrust of zero-based budgeting is the elimination of outdated efforts and expenditures and the concentration of resources where they are most effective. This is achieved through an annual review of all program activities and expenditures, which results in improved

⁷² *Id.*

⁷³ *Id.*

information for allocation decisions. However, proper development requires a great deal of staff time, planning, and paperwork.

Experience with the implementation of this approach indicates that a comprehensive review of zero-based budgeting decision packages for some program activities may be necessary only periodically. Additionally, a minimum level of service for certain programs may be legislated regardless of the results of the review process. As a result, zero-based budgeting has had only modest application, although the review of program activities makes zero-based budgeting particularly useful when overall spending must be reduced.

v. Outcome-Focused Budgeting⁷⁴

Outcome-focused budgeting is the practice of linking the allocation of resources to the production of outcomes. The objective is to allocate the city's resources to those service providers or programs that use them most effectively. Outcome-focused budgeting argues that mission-driven cities are superior to those that are rule-driven because they are more efficient, are more effective in producing desired results, are more innovative, are more flexible, and have higher employee morale.

City budgeting is becoming increasingly outcome-focused because it is closely linked to the planning process in governments. For a city to focus on outcomes, goals and objectives must be identified and tied to budget allocations for the achievement of those objectives.

C. Forecasting⁷⁵

Forecasting is used to inform and assist in decision-making. Forecasting imparts a long-term perspective to the budgeting process and emphasizes financially sustainable decisions. The Government Finance Officers Association (GFOA) recommends that cities should forecast major revenues and expenditures several years into the future.

Cities should consider that adoption of financial policies might be particularly helpful for promoting interest in financial forecasting. Such policies could include: (1) a reserve policy, which establishes the desired level of reserves to maintain; (2) a policy that requires recurring expenditures to be less than recurring revenues; (3) a long-financial planning policy, which commits officials to considering the long-term implications of decisions made today, and (4) capital improvement plans.

The forecast, along with its underlying assumptions and methodology, should be clearly stated and made available to stakeholders in the budget process. The assumptions should be

⁷⁴ *Id.*

⁷⁵ See Government Finance Officers Association, *Financial Forecasting in the Budget Preparation Process*, available at: <https://www.gfoa.org/materials/financial-forecasting-in-the-budget-preparation-process> (last accessed Dec. 18, 2023).

made very clear, simple, and explain how the assumptions lead to the forecast. The key steps in a sound forecasting process include the following:

i. Define Assumptions⁷⁶

The first step in the forecasting process is to define the fundamental issues impacting the forecast. The results will provide insight into which forecasting methods are most appropriate and will help create a common understanding among the forecasters as to the goals of the forecasting process. There are four key questions to consider when defining assumptions for the forecast:

- *What is the time horizon of the forecast?*
- *What is the objective of the government's forecasting policy?* For example, a “conservative” forecast underestimates revenues and builds in a layer of contingencies for expenditures. This might make it harder to balance the budget but reduces the risk of an actual shortfall. On the other hand, an “objective” forecast seeks to estimate revenues and expenditures as accurately as possible, making it easier to balance the budget, but increasing the risk of an actual shortfall.
- *What are the political/legal issues related to the forecast?* Be aware of current laws or expected changes in laws that affect forecasts.
- *What are the major revenues and expenditure categories?*

The assumptions used for a budget forecast should be documented for future reference to allow each financial forecasting process to utilize the same assumptions.

ii. Gather Information⁷⁷

To support the forecasting process, cities should use statistical data as well as the accumulated judgment and expertise of individuals such as department heads. Gathering information increases the forecaster's knowledge about the forces impacting revenues and expenditures, including potential disruptive events and trends. Such information allows the forecaster to build quantitative models more intelligently and to make a forecast using his or her own judgment.

⁷⁶ *Id.*

⁷⁷ *Id.*

iii. Preliminary/Exploratory Analysis⁷⁸

The preliminary analysis should examine the historical data and relevant economic conditions. This analysis improves the quality of the forecast both by giving the forecaster better insight into when and what quantitative techniques might be appropriate.

In particular, the forecaster should look for evidence related to:

- **Business cycles.** Does the revenue (or expenditure) tend to vary with the level of economic activity in the community or are they independent of cycles? How do broader market forces impact key expenditures, such as pension contributions affected by investment returns?
- **Demographic trends.** Are population changes affecting service demands and/or revenues?
- **Outliers and historical anomalies.** Does the data contain any extreme values that need to be explained? It could be that these represent highly anomalous events that don't add to the predictive power of the data set.
- **Relationships between variables.** Are there important relationships between variables that could aid in forecasting?

iv. Select Methods of Forecasting⁷⁹

After running a preliminary analysis, the city should select one or more forecasting methods. The three basic models of forecasting to consider include:

- **Extrapolation.** Extrapolation uses historical revenue data to predict future behavior by projecting the trend forward.
- **Regression/econometrics.** Regression analysis is a statistical procedure based on the relationship between independent and dependent variables. If a linear relationship exists between the independent and dependent variables, one or more of the independent variables can be used to predict future revenues or expenditures.
- **Hybrid forecasting.** Hybrid forecasting combines knowledge-based forecasting, a type of forecasting that uses the forecaster's own experience as the basis for the forecast with a quantitative method of forecasting. Hybrid forecasting methods are very common in practice and can deliver superior results.

⁷⁸ *Id.*

⁷⁹ *Id.*

II. ACCOUNTING AND FINANCIAL REPORTING

Accounting and financial reporting for state and local governments is highly specialized. Even accountants and auditors familiar with corporate accounting and financial reporting, but new to the public sector, must immediately face the daunting challenge of familiarizing themselves with the local government rules, guidelines, and practices.

The Governmental Accounting Standards Board (GASB) provides guidance in its statements, codified in the publication known as *Government Accounting, Auditing, and Financial Reporting*, also known as the “GAAFR Blue Book.”⁸⁰ The Blue Book includes the GFOA's current best practices on accounting, auditing, and financial reporting, all of the guidance of the GASB, as well as the GFOA's current best practices.⁸¹

A. Fund Accounting

Fund accounting is a system of specialized accounting to track the amount of cash assigned to different purposes and the usage of that cash. The intent of fund accounting is not to track whether an entity has generated a profit, since this is not the purpose of a local government. Funds are used by governments because they need to maintain very tight control over their resources, and funds are designed to monitor resource inflows and outflows, with particular attention to the remaining amount of funds available. Fund accounting emphasizes accountability rather than profitability. In this method, a fund consists of a self-balancing set of accounts, and each is reported as either unrestricted, temporarily restricted or permanently restricted based on the provider-imposed restrictions.

Every city budget will have at least one fund, the general fund, which accounts for the daily operations of the city.⁸² There are seven types of funds used in most city budgets:⁸³

- **General Fund** – records expenditures needed to run the daily operations of the local government and the money that is estimated to be available to pay for these general needs.
- **Special Revenue Fund** – accounts for money that must be used for a specific purpose and the expenditures that are made for that purpose.

⁸⁰ See Governmental Accounting Standards Board, *Government Accounting, Auditing, and Financial Reporting*, available at: <https://www.gfoa.org/egaifr> (last accessed Dec. 18, 2023).

⁸¹ *Id.*

⁸² This discussion on funds is courtesy of League of Oregon Cities, *Budgeting Basics*, LOCAL FOCUS (First Quarter 2022), available at: <https://www.orcities.org/application/files/9116/7814/3966/Q12023LF.pdf> (last accessed May 31, 2023).

⁸³ *Id.*

- **Capital Project Fund** – records the money and expenditures used to build or acquire capital facilities, such as land, buildings or infrastructure. This is a type of special purpose fund and is only used while a project is being completed.
- **Debt Service Fund** – records the repayment of general obligation and revenue bonds and other financing obligations. The expenditures in the fund are the principal and interest payments. Money dedicated to repay these obligations cannot be used for any other purpose.
- **Trust and Agency Fund** – accounts for money that is held in trust for a specific purpose as defined in a trust agreement or when the government is acting as a custodian for the benefit of a group. Example: gifts of investments or securities given to the city with provisions that the income be used to aid the library or park system.
- **Reserve Fund** – accumulates money to pay for any service, project, property or equipment that the city can legally perform or acquire. It functions as a savings account. A special resolution or ordinance of the governing body is needed to set up a reserve fund. Example: money set aside to pay for the future replacement of city vehicles at the end of their useful lives.
- **Enterprise Fund** – records the resources and expenditures of acquiring, operating and maintaining a self-supporting facility or service—such as a city water or wastewater utility.

For most funds, the accounting basis, or when revenue and expenditures are recognized and counted against the fund, is a modified accrual basis which involves recognizing revenue when it becomes both available and measurable, rather than when it is earned.⁸⁴ Expenditures, a term preferred over expenses for modified accrual accounting, are recognized when the related liability is incurred.⁸⁵

B. Audits⁸⁶

Except as discussed below, most cities are subject to Oregon’s Municipal Audit Law.⁸⁷ An audit is an independent assessment of the government’s external and internal budgetary controls. performed at least once each calendar or fiscal year.⁸⁸

⁸⁴ See, e.g., City of Molalla, *Finance*, available at: <https://www.cityofmolalla.com/finance/page/budgets> (last accessed Dec. 12, 2023); ORS 294.333(1) (“municipal corporation shall record its revenues and expenditures, on a fund by fund basis, using the cash basis, the modified accrual basis or the accrual basis of accounting, at the discretion of the municipal corporation.”)

⁸⁵ *Id.*

⁸⁶ See League of Oregon Cities, *FAQ on Municipal Audits* (2018), available at: <https://www.orcities.org/application/files/8716/8721/7532/FAQ-MunicipalAudits-updated5-23.pdf> (last accessed Dec. 28, 2023).

⁸⁷ ORS 297.405 to 297.740 and 297.990.

⁸⁸ ORS 297.425.

Starting on January 1, 2024 with 2023 House Bill 2110, cities with expenditures more than \$1 million must have their financial statements reviewed or audited by an accountant licensed as a municipal auditor.⁸⁹ Cities with combined expenditures of more than \$250,000 but less than \$1 million, and whose financial statements have been reviewed by a licensed municipal auditor, may file “review reports” with the secretary of state within 180 days after its fiscal or calendar year ends.⁹⁰ A city with combined expenditures less than \$250,000, and whose chief fiscal officer is bonded for the total amount of money received during the year may file unaudited financial statements with the secretary of state within 90 days after its fiscal year ends.⁹¹

Cities report the results of their annual operations in an annual comprehensive financial report (ACFR), the equivalent of a business's financial statements.⁹² An ACFR includes a single set of government-wide statements, for the entire government entity and individual fund statements.⁹³ The Governmental Accounting Standards Board (GASB) establishes standards for ACFR preparation.⁹⁴

Audits are required to inquire into:

- The methods followed by the city in recording, summarizing and reporting its financial transactions and financial condition;
- The accuracy and legality of the transactions, accounts, records, files and financial reports of the officers and employees of the city as they relate to fiscal affairs;
- The city’s compliance with the requirements, orders and regulations of public officials which pertain to the financial conditions and operations of the city;
- The city’s compliance with the legal provisions of federal laws, state laws, charter provisions, court orders, ordinances, resolutions, and rules and regulations issued by any governmental entity; and
- The city’s compliance with programs wholly or partially funded by federal, state or other local government agencies.⁹⁵

Independent auditors review the ACFR and prepare an opinion on whether the city’s financial statements: (1) adequately disclose material information; (2) present fairly its financial position; and (3) show results of its operations in conformance with generally accepted

⁸⁹ ORS 297.435

⁹⁰ *Id.*

⁹¹ ORS 297.435.

⁹² See ORS 297.415 (“requiring periodic reports of financial condition and financial operations be prepared and submitted to the Secretary of State”). The “minimum standards” adopted by the Secretary of State are in OAR 162, divisions 10 (audits) and 40 (reviews).

⁹³ See Governmental Accounting Standards Board, *Government Accounting Statement Nos. 34 and 37*.

⁹⁴ *Id.*

⁹⁵ ORS 297.425, OAR 162-010-0020.

accounting principles (also known as GAAP).⁹⁶ Qualified audits mean there are concerns with a city's practices which should be rectified.⁹⁷ A good audit, preferably unqualified, is a necessity when attempting to incur debt at a reasonable interest rate.

Audit reports must be filed with the Audit Division of the Oregon Secretary of State's Office within six (6) months after the close of the city's calendar or fiscal year under audit.⁹⁸ Upon receipt of its audit, the city is required to provide copies of the audit to each member of its governing body who was in office during the applicable year of the audit and who currently holds office.⁹⁹ The city is then required to review the audit to determine if any deficiencies in the city's financial operations were found.¹⁰⁰ Copies of all financial statements, whether unaudited, reviewed, or audited, must be filed with the secretary of state.¹⁰¹

The Government Finance Officers Association (GFOA) recommends that cities establish audit committees, made up of appropriate audit committee members, that are responsible for review, oversight, establishing procedures, and providing a written report.¹⁰² An audit committee is a practical means for a governing body to provide much needed independent review and oversight of the government's financial reporting processes, internal controls, and independent auditors. An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns.¹⁰³ By effectively carrying out its functions and responsibilities, an audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices, and that the independent auditors, through their own review, objectively assess the government's financial reporting practices.¹⁰⁴

D. Internal Controls

Cities across the United States face increasing local government fraud and embezzlement from inside of the organization. Some examples of such theft include theft of cash, fuel, and inventory; electronic vendor payment fraud; expense reimbursement schemes; and purchasing and fraudulent return schemes. Many of the recent local government fraud and embezzlement cases are for tens of thousands, hundreds of thousands, or even millions of dollars.

⁹⁶ See Government Auditing Standards, a set of standards for government entities also known as Generally Accepted Government Auditing Standards (GAGAS), also known as the Yellow Book, available at: <https://www.gao.gov/products/gao-21-368g> (last accessed on Dec. 28, 2023).

⁹⁷ *Id.*

⁹⁸ ORS 297.465(2).

⁹⁹ *Id.*

¹⁰⁰ ORS 297.466.

¹⁰¹ ORS 297.465.

¹⁰² Government Finance Officers Association, *Audit Committees*, available at: <https://www.gfoa.org/materials/audit-committees> (last accessed on Dec. 28, 2023).

¹⁰³ *Id.*

¹⁰⁴ *Id.*

In one extreme example, Rita Crundwell, the city comptroller of Dixon, Illinois, stole \$53 million of public funds across 20 years, using the funds to build one of the nation's leading quarter horse breeding empires, all while forcing staff cuts, police budget slashing, and neglect of public infrastructure.¹⁰⁵ In Oregon, West Linn Finance Director Elma Magkamt admitted in 2007 to embezzling \$1,411,561 from the city using a city signature stamp to forge checks.¹⁰⁶

Proper internal controls keep any organization and its employees safe from fraud and its repercussions. Understanding the fraud triangle is important to explain why workers commit fraud at a workplace.¹⁰⁷ It consists of three elements responsible for fraud – pressure, rationalization, and opportunity.¹⁰⁸ The first element of the triangle is the *pressure* to commit the crime to solve their financial problems.¹⁰⁹ Examples of financial issues include the inability to pay bills, having a drug or alcohol addiction, or wanting status, such as a bigger house or fancy car.¹¹⁰ The second element of the fraud triangle is the opportunity, or ways to commit fraud with the lowest amount of risk.¹¹¹ Examples of fraud opportunities may include lying about the number of hours worked, sales numbers, or productivity to receive higher pay.¹¹² The last element of the triangle is rationalization that person believes that they are doing the right thing.¹¹³ Such rationalizations may include that they were “borrowing” the money, they feel entitled to the money or they were just trying to pay their bills and provide for their family.¹¹⁴

A strong system of internal controls not only deters fraud but also supports greater efficiency and legal compliance within the local government business function.¹¹⁵ Segregation of duties is a key internal control that should be implemented wherever possible.¹¹⁶ For example, once accounts payable cuts a check, someone other than accounts payable should mail it.¹¹⁷ Bank deposits should be made by someone other than the person who records the

¹⁰⁵ For a chilling documentary of the largest case of municipal fraud in American history, see *ALL THE QUEEN'S HORSES* (Helios Digital Learning and Kartemquin Films Production 2018).

¹⁰⁶ See City of West Linn, *Embezzlement – 4 Years Later*, available at: https://westlinnoregon.gov/sites/default/files/fileattachments/finance/page/6347/wl_embezzlement_4_years_later_may09.pdf (last accessed on Dec. 28, 2023).

¹⁰⁷ See Todd Clemens, *The Fraud Triangle: Incentive, Opportunity, and Rationalization* (Apr. 7, 2021), available at: <https://accountants.sva.com/biz-tips/fraud-triangle-opportunity-incentive-and-rationalization#:~:text=Herepercent20arepercent20apercent20fewpercent20examples,proprietarypercent20companypercent20informationpercent20toppercent20competitors> (last accessed on Dec. 3, 2023).

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ See James Seaman, *A Beginner's Guide to Internal Controls*, GOVERNMENT FINANCE REVIEW, Oct. 2022, available at: https://gfoaorg.cdn.prismic.io/gfoaorg/86947daa-4e82-471e-8d6b-ab027d7c0b2f_InternalControls-gfr1022.pdf (last accessed Dec. 18, 2023).

¹¹⁶ *Id.*

¹¹⁷ *Id.*

deposits.¹¹⁸ The person who deposits funds or writes checks should not be the person who completes the bank reconciliation or posts to the general ledger.¹¹⁹

Segregation of duties holds individuals accountable.¹²⁰ Bank reconciliations should be completed in a timely manner, and any differences should be investigated and resolved right away.¹²¹ An additional best practice is to periodically review your organization’s vendor listing.¹²² Any vendor that has been added to the list, or a vendor that isn’t on the government’s approved list, is a red flag.¹²³ Vendors should be reviewed and approved before any payments are made to them.¹²⁴

III. CAPITAL PLANNING AND ASSET MANAGEMENT

4 SIMPLE TIPS TO EFFECTIVE INTERNAL CONTROLS

1. Make sure management sets the tone with sound ethical practices.
2. Establish communication, transparency and openness about public funds from the top down.
3. Engage in cross-functional dialogue about the organization's strategic, operational, financial, compliance and reputational risks.
4. Conduct a supervisory review on the accounts payable disbursements, deposit register and bank reconciliations.

Capital planning and asset management is essential for a thriving community.¹²⁵ It is important for cities to document the deficiencies to its infrastructure and decide how to allocate its limited budget between competing projects and interests. The GFOA has developed an approach to financial decision-making called “Financial Foundations for Thriving Communities. This framework seeks to solve the challenges inherent in managing shared financial resources.”

Although there is no “magic bullet” for capital planning, the GFOA suggests several keys to successful capital planning practices. In a case study of Wake County, North Carolina, the GFOA suggests the following are the keys to a strong financial foundation.

1. **Establish a long-term vision.** Forecasting capital revenue that looks at least three years into the future. The long-term vision must be balanced with the short-term goals. These goals and priorities help define the community needs and are used to determine capital investments.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ For a detailed discussion by the GFOA, see Shayne Kavanagh and Katie Ludwig, *Capital Planning and the GFOA Financial Foundations Framework*, 2019, available at: https://gfoaorg.cdn.prismic.io/gfoaorg/7a0cba9e-ea94-4dab-b09b-1c8320198633_CapitalPlanningWakeCounty.pdf (last accessed Dec. 18, 2023).

2. **Take a principled approach to capital investment.** For financial stability, a city may consider investments that provide operating expense savings or will help maintain the current capital assets. For example, a city may consider energy saving projects or renovations that improve service delivery. Cities are encouraged to define a small, meaningful set of criteria to guide capital investment decisions.

3. **Provide a fair distribution of costs and benefits among generations.** Since capital assets may have a life span measured in decades, there may be a good chance that many citizens who are present when the asset is acquired will no longer be in the community when the asset reaches the end of its useful life. Wake County tries to stay within the “80/20 rule,” where 80% of the project is financed by debt, and the remaining 20% is funded by cash. Cities may wish to define the acceptable mix of debt and cash financing for capital projects.

4. **Institutionalize the long-term view.** Cities are encouraged to develop master plans, using extensive public input to gain a clear, long-term vision for services. Master plans are great for capital projects, like building a new facility. Many cities create a capital improvement plan (CIP) that is updated yearly to identify funding and the scope of the project. The CIP can be reviewed yearly to address the purpose, timing, and cost of the projects.

5. **Create clear rules for debt limitation.** Cities should consider adopting a policy that puts limits on the amount of debt a city will incur. This limit allows a city to maintain its bond ratings, a limit that allows a city to borrow debt at a cheaper rate. There are several different ways to limit debt such as limiting the debt service fund to a percentage of the general fund, requiring that a large percentage of the debt principal is paid within a time such as 10 years and the “80/20 rule” discussed earlier. Establishing these clear rules allows that debt to be considered within the city’s financial means.

6. **Dedicate revenue stream for capital investments.** To ensure that the necessary resources are available, cities can dedicate a portion of their funding for debt and capital investment. Wake County assigns roughly 29% of its property taxes for debt and capital purposes.

7. **Active monitoring of policy implementation.** Cities are encouraged to regularly measure and monitor the implementation of their policies to ensure that, when looking forward, the cities will continue to meet the financial policies. Wake County utilizes a dashboard to monitor its debt and capital financial model. This expected future position is helpful rather than forcing adjustments when it is too late.

IV. COMPENSATION AND BENEFITS

Cities should consider their financial obligations toward its employees, in particular, Oregon Equal Pay Act, Oregon Public Employee Retirement System (PERS), and the Affordable Care Act (ACA).

A. Pay Equity

The Oregon Equal Pay Act requires Oregon employers to pay employees equitably, when doing comparable work with similar qualifications.¹²⁶ In other words, Oregon prohibited discrimination between employees on the basis of an employee’s status as a member of a protected class in the payment of wages or other compensation for work of comparable character.¹²⁷ “Protected class” is defined as “a group of persons distinguished by race, color, religion, sex, sexual orientation, national origin, marital status, veteran status, disability or age.”¹²⁸

Employers may pay employees for work of comparable character at different compensation levels if the difference in compensation levels is based on a bona fide factor that is related to the position and is based on:

- A seniority system
- A merit system
- A system that measures earnings by quantity or quality of production, including piece-rate work
- Workplace locations
- Travel, if travel is necessary and regular for the employee
- Education
- Training
- Experience, or
- Any combination of these factors, if the combination of factors accounts for the entire compensation differential.¹²⁹

Oregon created a “safe harbor,” an incentive for employers to complete a pay equity study.¹³⁰ An employer may avail itself of the “safe harbor” if: (1) an equal-pay analysis of the employer’s pay practices was completed within three years before the date that the employee filed the action; and (2) the employer has made reasonable and substantial progress toward eliminating unlawful wage differentials.¹³¹ If the “safe harbor” is granted by a court, the employee’s compensatory and punitive damages are disallowed, but the employer would be responsible for up to two years’ back pay, plaintiff costs, and reasonable attorneys’ fees.¹³²

According to many legal experts in the field of compensation, the gold standard to determine whether pay is equitable is to utilize a regression analysis of comparable employees.

¹²⁶ ORS 652.210 to 652.235.

¹²⁷ ORS 652.220(1)(b).

¹²⁸ ORS 652.210(6).

¹²⁹ ORS 652.220(2); OAR 839-008-0015.

¹³⁰ ORS 652.235

¹³¹ *Id.*

¹³² *Id.*

Courts have upheld disparities in pay where a regression analysis demonstrates that pay is less than two standard deviations of the mean.¹³³

For employees that are below the minimum pay amount, you must raise the employee's pay.¹³⁴ If an employee is above the maximum pay, you cannot reduce the employee's salary.¹³⁵ However, you may wish to use a strategy to hold the employee's pay by not granting all cost-of-living allowances until the employee below the maximum pay.

B. Oregon Public Employee Retirement System

Oregon's Public Employees Retirement System (PERS) is a retirement and disability fund for public employees.¹³⁶ Roughly 95% of Oregon's state and local government employees participate in the system.¹³⁷

Independent studies have found that Oregon PERS was one of the most generous pension plans ever devised, causing unfunded liability for Oregon employers and reducing economic incentives to promote longer tenure.¹³⁸ The system is currently funded by the employer as a percentage of the employee's pay and the investments made by the Oregon PERS Board.¹³⁹ Since the mid-1990s, concerns about the unfunded liability have caused the Oregon Legislature to adjust the formulas for new employees.¹⁴⁰

The unfunded actuarial liability (UAL) exists when a pension plan's liabilities (i.e., money the system owes to current and future retirees) are greater than its assets (i.e., money coming into the plan).¹⁴¹ The UAL is calculated for each PERS employer and impacts the

¹³³ See, e.g., *Adams v. Ameritech Servs., Inc.*, 231 F.3d 414,424 (7th Cir. 2000) (noting that in employment discrimination cases, "[t]wo standard deviations is normally enough to show that it is extremely unlikely ... that [a] disparity is due to chance."); *Cullen v. Indiana Univ. Bd. Of Trustees*, 338 F.3d 693, 702 (7th Cir. 2003) (explaining in Equal Pay case that "generally accepted principles of statistical modeling suggest that a figure less than two standard deviations is considered an acceptable deviation").

¹³⁴ ORS 652.220.

¹³⁵ *Id.*

¹³⁶ See State of Oregon, *Oregon PERS History* (3d ed. 2021), available at: <https://www.oregon.gov/pers/Documents/General-Information/PERS-History.pdf> (last accessed Dec. 18, 2023).

¹³⁷ See State of Oregon, *What is PERS?*, available at: <https://www.oregon.gov/pers/emp/pages/what-is-pers.aspx> (last accessed Dec. 18, 2023).

¹³⁸ E.g., Kevin E. Cahill et al, *Pension Generosity in Oregon and its Impact on the K12 Workforce*, U.S. BUREAU OF LABOR STATISTICS (April 2016), available at: <https://www.bls.gov/osmr/research-papers/2016/ec160030.htm> (last accessed Dec. 18, 2023).

¹³⁹ See State of Oregon, *Guide to Understanding Unfunded Actuarial Liability* (2021), available at: <https://www.oregon.gov/pers/EMP/Documents/UALRP-Guides/Guide-to-understanding-UAL.pdf> (last accessed Dec. 18, 2023).

¹⁴⁰ See State of Oregon, *Oregon PERS History* (3d ed. 2021), available at: <https://www.oregon.gov/pers/Documents/General-Information/PERS-History.pdf> (last accessed Dec. 18, 2023).

¹⁴¹ See State of Oregon, *Guide to Understanding Unfunded Actuarial Liability* (2021), available at: <https://www.oregon.gov/pers/EMP/Documents/UALRP-Guides/Guide-to-understanding-UAL.pdf> (last accessed Dec. 18, 2023).

employer’s share to cover the employer’s UAL.¹⁴² Oregon’s public employers have little control over the pension plan or investments, so it is understandable that they become very concerned about how the UAL impacts the rates and the increasing percentages of employee’s pay to fund the UAL.¹⁴³

C. Affordable Care Act

Cities, like private employers, are subject to the federal Affordable Care Act (ACA) if the city has 50 or more full-time employees and only for full-time employees.¹⁴⁴ Such employers must either offer minimum essential coverage that is “affordable” and that provides “minimum value” to their full-time employees (and their dependents), or potentially make an employer shared responsibility payment to the Internal Revenue Service.¹⁴⁵

Since many cities that employ 50 or more full-time employees provide health insurance to their employees, the issue is when a part-time or seasonal employee triggers the insurance requirement. Under the ACA, a full-time employee is an employee with an average of at least 30 hours of service per week for an employer.¹⁴⁶

VI. REVENUE SOURCES

City governments throughout Oregon collect revenue from a variety of sources, including taxes, user charges, intergovernmental payments, and various other sources. Depending on specific services offered by the city, the specific source of revenue can vary considerably from government to government.

A. Oregon Property Tax System

Property taxes are the second largest source of state and local tax revenues, with income tax being the largest source.¹⁴⁷ Property taxes, however, are the largest source of tax revenues for cities.¹⁴⁸ Property taxes thus play a vital role in funding the essential services that cities provide, including police, fire, roads, parks and more.¹⁴⁹ Property tax revenues also fund other

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ IRC § 4980H(c)(2)(A); 26 CFR § 54.4980H-1(a)(4).

¹⁴⁵ IRC §§ 36B, 4980H(a)-(b), 5000A(f).

¹⁴⁶ IRC § 4980H(c)(4); 26 CFR § 54.4980H-1(a)(13), (18).

¹⁴⁷ See League of Oregon Cities, *City Property Tax Report*, available at:

https://www.orcities.org/application/files/4015/7480/9685/City_Property_Tax_Report_2016.pdf (last accessed Dec. 18, 2023).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

essential local government services through taxes imposed by counties and special districts.¹⁵⁰ Lastly, property taxes provide approximately one-third of the state’s education budget, bringing in more than \$3.5 billion for schools in 2014-15.¹⁵¹

i. Permanent Tax Rate

In Oregon, the unique property tax system was established in the Oregon Constitution and modified by the voters by ballot measure. Prior to 1996, the Oregon Constitution limited the amount of property taxes that a local government may levy without a vote of the people.¹⁵² In 1990, the first property tax limitation came with the passage of Measure 5.¹⁵³ As discussed below, Measure 5 imposed tax rate limits on local governments: one for schools (kindergarten through community colleges), and one for all other local governments.¹⁵⁴

In November 1996, the voters adopted Ballot Measure 50.¹⁵⁵ Measure 50 created a new property tax system by repealing the tax base system and replacing it with a permanent tax rate system with some local options and the concept of maximum assessed value.¹⁵⁶

After Ballot Measure 50 was adopted, the Oregon Legislature adopted enabling laws and the state established each jurisdiction’s permanent property tax rate.¹⁵⁷ No action of a city may increase the permanent rate.¹⁵⁸ The permanent tax rate is applied to the assessed value of property, which is the lower of either the real market value or the maximum assessed value of the property each year.¹⁵⁹

ii. Other Tax Levies

There are only two ways a city may increase its property tax collections: (1) to request voter approval of local option levies for either operating or capital purposes; or (2) to request voter approval of general obligation bonds to finance capital costs and the authority to levy a

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² This limitation, first adopted in 1916, was repealed and replaced by Ballot Measure 50 in 1996. *See* League of Oregon Cities, *FAQ on Measures 5 & 50* (March 2023), available at: https://www.oregocities.org/application/files/2216/8685/9599/FAQonMeasures5and_50-updated5-23.pdf (last accessed Dec. 18, 2023).

¹⁵³ OR Const Art XI, § 11(b).

¹⁵⁴ *Id.*

¹⁵⁵ Oregon Department of Revenue, *A Brief History of Oregon Property Taxation* (2009), available at: <https://www.oregon.gov/DOR/programs/gov-research/Documents/303-405-1.pdf> (last accessed Dec. 28, 2023).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ Oregon Department of Revenue, *Maximum Assessed Value Manual* (2018), available at: https://www.oregon.gov/dor/forms/FormsPubs/maximum-assessed-value-manual_303-438.pdf (last accessed Dec. 28, 2023).

property tax to pay those bonds.¹⁶⁰ The three types of levies available to cities, including the tax rate, are described in the table below.

Type of Levy	Length	Purpose	Other Limitations
Permanent Tax Rate	Indefinite	General	Subject limitations to M5
Local Option Levy -- Fixed Dollar	Up To 5 Years	Any purpose	Levy the same dollar amount each year, subject to M5 limitations and special compression ¹⁶¹
	Up to 10 years	Capital purposes only	
Local Option Levy -- Fixed Rate	Up To 5 Years	Any purpose	Levied as maximum rate per \$1,000 AV; must estimate amount raised for each year, subject to M5 limitations and special compression ¹⁶²
	Up to 10 years	Capital purposes only	
General Obligation Bond Levy (Capital)	Term of bonds	“Capital costs” as defined in the Oregon Constitution	Restricted to annual principal and interest payments; not subject to M5 limitations ¹⁶³

Local option levies for capital purposes include the acquisition of land, the acquisition of buildings, additions to buildings that increase its square footage, construction of a building, the acquisition and installation of machinery and equipment that will become an integral part of a building, or the purchase of furnishings, equipment, or other tangible property with an expected life of more than one year.¹⁶⁴

iii. Assessed Value

As discussed above, by July 15 of each year, a city must submit two copies of the resolution or ordinance adopting the budget, making appropriations, and imposing and categorizing the tax to the county tax assessor.¹⁶⁵

Counties are responsible for determining the value of properties, calculating taxes, and collecting the taxes.¹⁶⁶ The amount of property tax assessed is based on two conditions: 1) the

¹⁶⁰ Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁶¹ ORS 280.060.

¹⁶² *Id.*

¹⁶³ OR Const Art XI, § 11.

¹⁶⁴ ORS 280.060.

¹⁶⁵ ORS 294.458(3)(a).

¹⁶⁶ ORS 308.232; Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

assessed value of property, and 2) the amount of taxes that each taxing district is authorized to raise.¹⁶⁷

Measure 50 created two values for each property. Property is taxed on its assessed value. The assessed value, as shown on Oregon tax statements is the *lower* of either the real market value or the maximum assessed value of the property.¹⁶⁸

Tax Rate Example on \$250,000 Assessed Value House

Taxing Entity	Tax Rate (per \$1,000)	Assessed Value	Total Tax
City	\$4.00	\$250,000	\$1,000.00
County	2.66		665.00
Park Dist.	1.25		312.50
Total	\$7.91		\$1,977.50

The real market value (RMV) is the value of the property as of January 1 each year and is determined by the assessor based on the previous calendar year’s actual real estate market activity for like properties.¹⁶⁹ For new properties, appraisers apply standardized appraisal methods to determine the property’s real market value (RMV).¹⁷⁰ Usually, existing real property accounts are not physically reappraised every year, but instead their real market values are trended, based on sales of similar properties.¹⁷¹

The maximum assessed value was established for each property based on a calculation that was made in the year after Measure 50 was approved.¹⁷² Maximum assessed values were established in 1997 as the 1995-96 real market value minus 10 percent.¹⁷³ The maximum assessed value increases by three percent a year plus additions for new construction, subdivision, remodeling, rezoning, loss of special assessment or exemption.¹⁷⁴

Because assessed values were initially established at levels below real market values, and because the real estate market has appreciated at a rate of more than three percent in most years since Measure 50 passed, the assessed values of many properties are substantially lower than their real market values.¹⁷⁵ This means that assessed values may continue to increase even though the real market value of a property can be falling as a result of current market

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ ORS 308.210; ORS 308.250

¹⁷⁰ See Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ OR Const. Art. XI, § 11.

¹⁷⁴ *Id.*

¹⁷⁵ See League of Oregon Cities, *FAQ on Measures 5 & 50* (March 2023), available at: https://www.orcities.org/application/files/2216/8685/9599/FAQonMeasures5and_50-updated5-23.pdf (last accessed Dec. 18, 2023).

conditions.¹⁷⁶ Once the real market value falls below the maximum assessed value, it becomes the assessed value for tax purposes that year.¹⁷⁷ This means that it is possible for a city to see less than 3% growth in their tax levies if enough properties in the area have a market value below their maximum assessed value.¹⁷⁸

ii. Compression

County assessors calculate the taxes for each taxable property for the taxing entities. Cities certify property taxes as a rate per \$1,000 of assessed value and levies for municipal bonds and local option levies for a fixed dollar amount.¹⁷⁹ For the fixed dollar amounts, the assessor must convert these tax amounts into tax rates.¹⁸⁰

Compression Example on \$250,000 RMV House

For each property, the assessor must test to ensure that all of the certified taxes for each taxing district are within the limits set by Measure 5.¹⁸¹ Taxes are separated into two categories: for education and for all other

Taxing Entity	Tax Rate (per \$1,000)	Tax Before M5 Limit	Reduction Due to M5	Amt. Billed After Compression
City	\$7.50	\$1,875	(\$703.12)	\$1,171.88
County	5.50	1,375	(515.63)	859.37
Park Dist.	3.00	750	(281.25)	468.75
Total	\$16.00	\$4,000	(\$1,500)	\$2,500
Measure 5 Limit	\$10.00	\$2,500		

government services.¹⁸² If the amount of tax calculated for a property is more than \$5 per \$1,000 of real market value for education, or \$10 per \$1,000 of RMV for all other government purposes, the taxes in the category are reduced (“compressed”) to fall within the limit.¹⁸³ Voter approved debt service is not included in the \$10 limit; so the actual total tax rate may be higher than \$10, but the portion that goes for operations may not exceed \$10.¹⁸⁴ All property tax levies except levies for general obligation bonds are subject to compression.¹⁸⁵ Note that the values used are for real market value, not the maximum assessed value used under Measure 50.¹⁸⁶

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ ORS 294.458.

¹⁸⁰ ORS 310.090.

¹⁸¹ OR Const Art XI, § 11b.

¹⁸² See Oregon Department of Revenue, *Local Budgeting Manual*, available at:

https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁸³ OR Const Art XI, § 11b.

¹⁸⁴ OR Const Art XI, § 11b.

¹⁸⁵ *Id.*

¹⁸⁶ OR Const Art XI, § 11.

Local option levies are subject to “special compression.”¹⁸⁷ This means that local option levies are reduced (to zero if necessary) before other levies are reduced to bring the total tax on the property down to the Measure 5 limit.¹⁸⁸ If a property is subject to multiple local option levies then all local option levies are reduced proportionally.¹⁸⁹ If the property remains in compression after all local option levies have been reduced to nothing, then all the remaining, compressible levies are reduced proportionally until the remaining compressible levies are equal to \$10 per \$1,000 of real market value.¹⁹⁰

iii. Tax Collection

The county tax collector is responsible for collecting all property taxes.¹⁹¹ The tax collector mails the property tax statements and receives the payments.¹⁹² If a taxpayer fails to pay on time, the tax collector computes the delinquent interest they owe and mails a notice of delinquency.

After taxes on real property have been delinquent for three years, the tax collector begins foreclosure proceedings on the property.¹⁹³ At the end of the foreclosure process, the property is sold to satisfy the tax lien.¹⁹⁴

The tax collector prepares a tax percentage distribution schedule from the tax roll information provided by the assessor.¹⁹⁵ The amount of tax imposed for each taxing district is divided by the total tax imposed in the county to determine each districts’ distribution percentage.¹⁹⁶ The percentage distribution schedule is given to the county treasurer.¹⁹⁷

When taxes are paid, the treasurer distributes a proportionate share to each taxing district according to the schedule.¹⁹⁸ All districts also share the loss when refunds are made. A county

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ See Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ ORS 311.390; See Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁹⁶ See Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

court may opt to make an advance distribution to a taxing district from the county general fund of the entire amount anticipated to be collected from that district's taxes.¹⁹⁹

The treasurer distributes the tax money and the interest earned on it to the taxing districts using the percentage distribution schedule.²⁰⁰ When disbursing tax moneys, the treasurer sends each district a statement showing the amount of taxes being distributed.²⁰¹

C. State Shared Revenue

Over the years, Oregon cities and the state of Oregon have developed a number of shared revenue streams.²⁰² Many of the revenues shared are the result of agreements in which cities have given up their right to regulate or establish taxes or fees on an activity in exchange for a promise by the state of a share of revenue from its regulation or taxation of the activity.²⁰³

Currently, cities share with the state for the following: (1) liquor; (2) cigarettes; (3) highway trust funds (gas taxes), (4) 9-1-1 emergency tax revenues, and (5) marijuana. The specific formulas for distribution, restrictions on the use of the tax revenues and whether a local tax is preempted is discussed below.

For some of the state-shared revenues listed below, the distributions are based, at least in part, by how many people reside in each city, also known as per capita distributions.²⁰⁴ Per capita distributions for revenue sources are calculated based on certified population statistics from Portland State University's Center for Population Research (PSUCPR).²⁰⁵ Population estimates compiled each July are typically certified on December 15, and thereafter begin to govern the distributions.²⁰⁶

For cigarettes and gas taxes, and in counties with populations greater than 100,000, a city must certify that it provides at least four of the following municipal services: fire protection; police protection; street construction, maintenance and lighting; sanitary sewers; storm sewers; planning, zoning and subdivision control; or one or more utility services.²⁰⁷ For liquor sales and

¹⁹⁹ ORS 311.392.

²⁰⁰ ORS 311.390.

²⁰¹ See Oregon Department of Revenue, *Local Budgeting Manual*, available at: https://www.oregon.gov/dor/forms/FormsPubs/local-budgeting-manual_504-420.pdf (last accessed on Sept. 30, 2023).

²⁰² See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ See ORS 221.760 (imposing certification requirement for cities in counties with a population greater than 100,000 to receive revenues from cigarette, gas and liquor taxes). As of 2023, counties with a population greater

cities located in counties with populations greater than 100,000, to receive the per capita disbursement to cities, cities must certify that it provides four of the aforementioned services.²⁰⁸

Annually, the League of Oregon Cities releases a report with the estimated state shared revenue forecasts and recent legislative and administrative changes that impact cities. For example, the LOC provided the following report for 2024 state shared revenue estimates: <https://www.orecities.org/application/files/7317/0726/5239/2024SSRFullReport.pdf>.

i. Liquor Taxes²⁰⁹

Cities may not impose a tax or fee on malt beverages or any alcoholic liquors²¹⁰. Cities also are restricted on the amount they may impose for licensing fees.²¹¹ The state imposes a sales tax on distilled spirits, beer and cider, and wine.²¹² Currently, distilled spirit sales make up more than 95% of this revenue source and the state sets the markup formula using the wholesale price.²¹³ Oregon's beer and cider tax is one of the lowest in the country at approximately 8 cents per gallon, or about 4 cents on a six-pack.²¹⁴

Cities' share of this state shared revenue source is 34%, of which 20% is distributed per capita, with 14% distributed using a formula that factors in property taxes, population, and income.²¹⁵ The three major contributors to this revenue source are: the sale of distilled spirits; liquor licensing fees; and taxes on beer, wine and cider.²¹⁶

The 14% liquor revenue share to cities uses an adjusted population formula that factors in per capita property taxes and per capita income of each city.²¹⁷ For liquor sales and for cities located in counties with populations greater than 100,000, to receive the 20% per capita

than 100,000 are: Clackamas, Deschutes, Douglas, Jackson, Lane, Linn, Marion, Multnomah, Washington and Yamhill.

²⁰⁸ ORS 471.810(1)(b).

²⁰⁹ ORS 221.760 to 221.770; ORS 471.810; ORS 473.005 to 473.060.

²¹⁰ ORS 471.045; ORS 473.190.

²¹¹ ORS 471.166.

²¹² ORS chapter 473.

²¹³ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orecities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²¹⁴ *Id.*

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ ORS 221.770.

disbursement, cities must certify that it provides four municipal services.²¹⁸ The funds derived from liquor taxes is unrestricted.²¹⁹

ii. Cigarette Taxes

The 1965 Oregon Legislative Assembly, in cooperation with counties and cities, referred a cigarette sales tax to the voters with a 50-50 sharing between the state and local governments.²²⁰ The referendum passed decisively by a 63% majority.²²¹

In November 2020, voters passed Measure 108, which increased cigarette taxes, increased the cap on the cigar tax, created a tax on vape products, and preempted cities from taxing vape products.²²² After the increase, cities' share of that revenue is a meager 0.6% of the tax.²²³ Cities do not receive shared revenue on tobacco products other than cigarettes, including cigars, moist snuff, chewing tobacco, pipe tobacco, and now vape.²²⁴ Cities may not impose a tax on the sale or the use of tobacco products.²²⁵ Cities may not impose a tax on the sale of vape.²²⁶

Over the years, revenues from cigarette taxes have dramatically declined from the Legislature and due to the drop in smoking.²²⁷ This revenue source is projected to continue trending downward—as it has for more than 10 years—as smoking decreases.²²⁸ Funds derived from cigarette taxes are unrestricted.²²⁹

iii. Marijuana Tax²³⁰

In November 2014, Measure 91 passed and allowed recreational marijuana sales and imposed a tax on marijuana products.²³¹ The state imposes a 17% sales tax on recreational

²¹⁸ ORS 471.810(1)(b).

²¹⁹ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²²⁰ See Association of Oregon Counties, *Shared Revenue Agreements*, (January 2015), available at: https://drive.google.com/file/d/0B4bfmUJ9POS_c0VpQVQ3MUVTa1k/view?resourcekey=0-hGO0oj8P5faS03r4f5g3rA (last accessed Dec. 18, 2023).

²²¹ *Id.*

²²² See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²²³ *Id.*

²²⁴ *Id.*

²²⁵ ORS 323.640.

²²⁶ Measure 108 (2020).

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ Measure 91 (2014) (legalizing recreational marijuana sales); ORS chapter 475C; Measure 110 (2020).

²³¹ See Oregon Measure 91 (2014), available at: <https://www.oregon.gov/olcc/marijuana/documents/measure91.pdf> (last accessed Dec. 18, 2023).

marijuana products.²³² Until the end of 2020, cities received 10% of the state’s total tax revenues (minus expenses) on recreational marijuana products.²³³

In November 2020, Measure 110 decriminalized possession of small amounts of street drugs and shifted the allocation of state marijuana revenue distributions.²³⁴ Currently, cities share \$1,125,000 quarterly, or \$4,500,000 annually, which is indexed to inflation beginning in 2022. For state revenues, 75% of the shared revenue is distributed to eligible cities on a per capita basis, and 25% is distributed based on the number of licensed premises in the city.²³⁵ Note that the license-portion (25%) of the distribution is particularly hard to forecast as shops open and close.²³⁶ Funds derived from marijuana taxes is unrestricted because the former language “to assist local law enforcement” language was deleted in 2017.²³⁷

Distributions are made quarterly to cities that certify that they do not ban any marijuana license type within city limits.²³⁸ This certification had been required quarterly with the Oregon Liquor Control Commission (OLCC), but in 2020 moved to an annual certification with the Oregon Department of Administrative Services (DAS), similar to other shared revenue certifications.²³⁹

A city may adopt an ordinance imposing a tax on retail sale of recreational marijuana (not medical marijuana), but state law requires the city refer the ordinance to the electors of the city for approval.²⁴⁰ In addition, a city may not impose more than a 3 percent tax.²⁴¹ Most cities have an agreement with the Oregon Department of Revenue (DOR) to have the state collect their local tax at the same time the state tax is collected.²⁴² However, that local tax revenue is not considered a state shared revenue.

²³² ORS 475C.009.

²³³ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ ORS 475B.345.

²⁴² See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

iv. Highway Trust Fund (Gas Taxes)

The Oregon Highway Trust Fund supports the construction, reconstruction, preservation, maintenance, repair and improvement of streets and roads.²⁴³ To fund the Highway Trust Fund, the state imposes a sales tax on a certain number of cents per gallon of fuel and imposes fees on certain registrations.²⁴⁴ Using a melded computation of the various tax and fee increases over time, cities receive approximately 20% of the Highway Trust Fund.²⁴⁵

In 2017, the Legislature approved a comprehensive transportation funding package that significantly increased cities' per capita funding.²⁴⁶ The package included a 10-cent gas and use fuel tax increase and a 53% increase in the weight-mile tax (both phased in over a seven-year period), along with graduated registration and title fee increases.²⁴⁷ Full implementation of annual gas tax increases has been met.

From the cities' total allocation, \$2.5 million is directed annually off the top to the special city allotment fund. The allocation is matched and administered by the Oregon Department of Transportation (ODOT) to provide competitive grants to small cities with a population less than 5,000.²⁴⁸ This is in addition to their per capita allocation.²⁴⁹ The 2017 transportation package also included a new 1% statewide payroll tax, a 0.5% privilege tax/use tax on certain "new" vehicles, and a \$15 bicycle tax.²⁵⁰ Those additional taxes are not included in the per capita disbursements, but cities may be eligible for additional funds from programs funded by these taxes.²⁵¹ Cities may use the gas taxes for the construction, reconstruction, and maintenance of highways, roads, streets, bike paths, foot paths and rest areas.²⁵²

²⁴³ ORS 184.657; ORS chapter 319; ORS 366.739 to 366.752; ORS 366.785 to 366.820; ORS 803.420; ORS 803.090.

²⁴⁴ *Id.*

²⁴⁵ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²⁴⁶ OR HB 2017 (2017).

²⁴⁷ *Id.*

²⁴⁸ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²⁴⁹ ORS 366.805.

²⁵⁰ OR HB 2017 (2017).

²⁵¹ OR HB 2017 (2017).

²⁵² ORS 366.790; OR Const Art IX, § 3a.

As discussed below, cities may impose a gas tax, but it must be referred for voter approval of a new or increased local fuel tax.²⁵³ Approximately 30 cities have a gas tax, and the rate varies—generally 1 to 3 cents per gallon.²⁵⁴

v. 9-1-1 Emergency Communication Tax Revenues²⁵⁵

Cities that operate a public safety answering point (PSAP) provider connected to the statewide network receive this shared revenue.²⁵⁶ Since less than 20 of the 45 PSAPs in Oregon are operated by cities, most of these shared revenues are directed to the PSAPs managed by counties or a regional entity.²⁵⁷

The PSAPs are only partially funded through the state’s Emergency Communications Tax, with the balance of operating costs coming primarily from property taxes.²⁵⁸ Local governments receive approximately 60% of 9-1-1 taxes, but the taxes generally covered less than 25% of the costs of total PSAP operations before the recent rate increases.²⁵⁹ The revenues received from the 9-1-1 taxes are restricted.²⁶⁰

C. Local Tax Efforts²⁶¹

A city’s power to tax derives from the home rule charter granted by Article XI, section 2 of the Oregon Constitution. Where not preempted by the Oregon Legislature, cities can enact local taxes. The Oregon Supreme Court held that Multnomah County, a statutory county, had the same powers as a home rule county and therefore had the authority to levy taxes.²⁶² The court refuted the argument that sales and income taxes are traditional state concerns and held that the constitutional grant of power to a home rule county includes the power to levy an income

²⁵³ ORS 319.950.

²⁵⁴ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²⁵⁵ ORS 403.200 to 403.250; OAR 104-080-0195 to 104-080-0210.

²⁵⁶ *Id.*

²⁵⁷ See League of Oregon Cities, *2022 State Shared Revenue Report with Estimates*, available at: <https://www.orcities.org/application/files/1416/4520/8358/2022SSRFullReport-Revised.pdf> (last accessed Dec. 18, 2023).

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ See ORS 403.240(9) and OAR 104-080-0195 for permitted expenditures associated with 9-1-1 costs.

Intergovernmental agreements might also restrict use of revenues.

²⁶¹ See League of Oregon Cities, *Discretionary City Revenue Sources* (Apr. 2018), available at: <https://www.orcities.org/application/files/5215/7487/1825/RevenueSources.pdf>. (last accessed Dec. 18, 2023).

²⁶² *Multnomah Kennel Club v. Department of Revenue*, 295 Or 279 (1983).

tax.²⁶³ Similarly, cities have a home rule authority that allows cities to levy a tax, unless preempted.²⁶⁴

The Oregon Legislature has preempted a city’s ability to enact taxes for: telecommunications to fund 9-8-8 services; commercial activity; insurance providers; animal racing; real property transfers; cigarettes; alcoholic beverages; lottery tickets or lottery game retailers; real estate broker business licenses; and federal old age and survivors insurance and Railroad Retirement Act benefits.²⁶⁵ In addition to preemption, the Legislature has enacted cap and/or time limitations on the municipal authority to tax: property taxes; sale of marijuana items; local fuel taxes; system development charges; lodging taxes, and telecommunications carrier privilege taxes.²⁶⁶

These local taxes can be grouped into three categories – income taxes, sales/excise taxes, and fees for services.

i. Income Taxes

As discussed above, unless preempted, cities can tax the income of businesses or individuals pursuant to a city’s home rule authority.

Local income taxes can come in the form of a personal income tax, business license tax, corporate income tax, or payroll tax. Currently, Multnomah County taxes the personal income of individuals, and the city of Portland taxes the businesses through a business license tax.²⁶⁷ The city of Eugene also taxes payroll.

ii. Sales/Excise Taxes

Sales taxes are levied on the sale of goods and services. In 1985, Oregon voters overwhelmingly rejected statewide sales taxes, and statewide, Oregonians have rejected a general sales tax proposals six times.²⁶⁸

Local sales taxes can include an admissions tax for performances, entertainment and sporting events, a local gas tax, a local marijuana tax, a motor vehicle rental tax, a restaurant tax,

²⁶³ *Id.*

²⁶⁴ *LaGrande/Astoria v. PERB*, 281 Or 137, 153-55 (1978). *See also* 33 Or Op Atty Gen 238 (May 1, 1967) (finding that cities have the authority to enact provisions imposing income or sales taxes).

²⁶⁵ *See* League of Oregon Cities, *Legal Guide To Oregon’s Statutory Preemptions Of Home Rule* (2019), <https://www.oregocity.org/application/files/4715/7904/6324/StatutoryPreemptionSummary02-10-19.pdf> (last accessed April 27, 2023)

²⁶⁶ *Id.*

²⁶⁷ *See* City of Portland, *Revenue Division*, available at: <https://www.portlandoregon.gov/revenue/index.cfm?&c=29320> (last accessed on Dec. 29, 2023).

²⁶⁸ *See* The Associated Press, *Oregon Voters Overwhelmingly Reject a Sales Tax*, N.Y. TIMES, Sept. 19, 1985, available at: <https://www.nytimes.com/1985/09/19/us/oregon-voters-overwhelmingly-reject-a-sales-tax.html> (last accessed Dec. 18, 2023).

a retail sales tax for specific goods, a transient lodging tax (TLT), and a utility consumption tax. Given the deep opposition to a general sales tax in Oregon, it appears that Oregonians are reluctant to pass sales taxes. Only for a handful of cities, voters have adopted a specific sales tax for food and beverages.²⁶⁹

As discussed below, for transient lodging tax, local gas taxes, and local marijuana taxes, the Oregon Legislature imposed additional restrictions in the use of such funds.

*Transient Lodging Tax*²⁷⁰

Transient lodging taxes (TLTs) are taxes for temporary lodging at hotels, motels, campgrounds, and other temporary lodgings. Oregon has a statewide TLT, and cities can also charge a local TLT subject to certain limitations.²⁷¹

The limitations require that for new or increased local lodging taxes, 70% must be used for tourism promotion or tourism-related facilities, and the remaining 30% is unrestricted in use.²⁷² For the existing local lodging taxes, cities are required to maintain the percentage of existing lodging tax used for tourism promotion and tourism facilities.²⁷³

Many cities pass on transient lodging tax revenues to third parties, such as a chamber of commerce or an event organizer. Cities should carefully restrict use of such revenues by such organizations and/or require reporting to ensure they are complying with the state statutes that restrict the use of transient tax revenues.

Local Gas Taxes

In many cities, the taxes shared from the State Highway Fund are the primary source of street funding.²⁷⁴ Many cities have found that the shared gas taxes are not sufficient to address the backlog of street improvements. Cities have looked to local funding options, such as local fuel dealer license taxes, or “local gas taxes.”

²⁶⁹ See Les Zaitz, *Restaurant Tax Coming to Cannon Beach*, THE OREGONIAN (Nov. 3, 2021), available at: <https://www.oregonlive.com/politics/2021/11/restaurant-tax-coming-to-cannon-beach-estacada-will-tax-marijuana-sales-after-tuesdays-vote.html> (last accessed Dec. 18, 2023); Kathleen Stinson, *Prepared Food Tax is not New Oregon*, CANNON BEACH GAZETTE, Jul. 27, 2021, available at: https://www.cannonbeachgazette.com/news/prepared-food-tax-is-not-new-oregon-other-communities-have-passed-similar-measures/article_0a3533f0-ceed-11eb-bf68-3f0b06264caf.html (last accessed Dec. 18, 2023).

²⁷⁰ ORS 320.300 to 320.350; League of Oregon Cities, *Lodging Tax*, available at: <https://www.orcities.org/resources/reference/topics-z/details/lodging-tax> (last accessed Dec. 18, 2023); League of Oregon Cities, *Legal Guide to Collecting Transient Lodging Tax in Oregon* (June 2021), available at: https://www.orcities.org/application/files/4116/2464/5603/TLT_Guide_-_Updated_6.25.2021.pdf (last accessed Dec. 18, 2023).

²⁷¹ ORS 320.300 to 320.365.

²⁷² ORS 320.350.

²⁷³ ORS 320.345.

²⁷⁴ See League of Oregon Cities, *Local Gas Tax*, available at: <https://www.orcities.org/resources/reference/topics-z/details/local-gas-tax> (last accessed Dec. 29, 2023).

In Oregon, local gas tax ordinances levy a business license tax on fuel dealers. The amount of tax levied is set as a certain number of cents per gallon of motor vehicle fuel sold by the dealer. A city, county or local government must submit the proposed new or increased gas tax to the electors for their approval, prior to enacting or amending any charter, provision, ordinance, resolution or other provision taxing fuel for motor vehicles.²⁷⁵

For more information, please see the League of Oregon Cities' Model Motor Vehicle Fuel Tax Ordinance (April 2020) - <https://www.orcities.org/resources/reference/topics-z/details/local-gas-tax>

Local Marijuana Tax

The Legislature has the sole authority to “impose a tax or fee on the production, processing or sale of marijuana items,” thereby preempting local governments from imposing their own tax except as provided by the law.²⁷⁶

Cities may adopt an ordinance imposing a tax or fee of up to three percent on the sale of marijuana items by a retail licensee.²⁷⁷ The ordinance must be referred to the voters in a statewide general election, meaning an election in November of an even-numbered year.²⁷⁸ In 2016, the Legislature adopted a restriction on local governments by providing that a local tax may not be imposed on a medical marijuana patient or caregiver.²⁷⁹

For more information, please see Chapter 27: Marijuana Law.

iii. Fees for Services

Cities count on a variety of fees for revenue, including business license fees, franchise fees, land use and planning fees, parking fees, and development and permit fees. Like taxes, fees for services are within the city's power granted by Article XI, section 2 of the Oregon Constitution. Where not preempted by the Oregon Legislature, cities can enact local fees. However, courts have found that where the Oregon Legislature has not given a clear statement of intent to preempt a local government from enacting regulations, that a city is not precluded from enacting additional fees.²⁸⁰

²⁷⁵ ORS 319.950.

²⁷⁶ ORS 475C.453.

²⁷⁷ *Id.*

²⁷⁸ *Id.*

²⁷⁹ *Id.*

²⁸⁰ *Northwest Natural Gas, Co. v. City of Gresham*, 359 Or 309 (2016) (finding ORS 221.450 is not an unambiguous expression of an intent to preclude local governments from imposing a privilege tax in the city right of way limited to five percent of the utilities' gross revenues earned within the city).

There are a few fees for which the Oregon Legislature imposed additional restrictions on a city’s ability to collect revenue. One example are system development charges (SDCs).²⁸¹ SDCs are a one-time fee imposed on new development to equitably recover the cost of expanding infrastructure capacity to serve new customers.²⁸² SDCs are not taxes—they are collected for a specific purpose and provide a distinct benefit to the persons who pay the fee. SDC revenue must be used to provide needed capital improvements.

Another example of the Oregon Legislature imposing additional restrictions on a city’s ability to collect revenue is a local improvement district (LID).²⁸³ An LID allows a group of property owners to share in the cost of infrastructure improvements, most commonly for roads, sidewalks, or storm water.²⁸⁴ A shared LID project ensures economies of scale and avoids piecemeal infrastructure development.²⁸⁵ Generally, the city finances the public improvement and the property owners benefited repay the city.²⁸⁶ Property owners benefited can pay assessments in full or by installments with a lien on the property.²⁸⁷ There is a required assessment procedure and financing methodology to follow.²⁸⁸

E. Tax Increment Financing

Another option available to cities is the use of tax increment financing, also known as “urban renewal.”²⁸⁹ Tax increment financing funds projects within urban renewal areas by earmarking property tax revenue from increases in assessed property value within an urban renewal area.²⁹⁰ Essentially, the tax increment financing process splits tax revenue from properties within the urban renewal area into two components: base revenue and incremental revenue.²⁹¹ Base revenue is the level of property tax revenue available before the urban renewal area is established and is unaffected by urban renewal.²⁹² Incremental revenue is the revenue that exceeds base revenue and is (ideally) generated by development projects in the urban renewal

²⁸¹ ORS 223.297 to 223.316; League of Oregon Cities, *Model System Development Charge Ordinance for Oregon Cities* (February 2019), available at: <https://www.oregocities.org/application/files/3816/8721/7848/Model-SystemDevelopmentChargesOrdinance-updated5-23.pdf> (last accessed Dec. 29, 2023).

²⁸² ORS 223.001 to 223.295.

²⁸³ *Id.*

²⁸⁴ *Id.*

²⁸⁵ *Id.*

²⁸⁶ *Id.*

²⁸⁷ *Id.*

²⁸⁸ ORS 223.001.

²⁸⁹ ORS chapter 457 gives cities the authority to activate an urban renewal agency to utilize tax increment financing.

²⁹⁰ See League of Oregon Cities, *Chapter 26: Economic Development*, MUNICIPAL HANDBOOK, , available at: https://www.oregocities.org/application/files/3016/6636/8249/Chapter_26_-_Economic_Development_EDITED.pdf (last accessed Dec. 18, 2023); League of Oregon Cities, *FAQ on Urban Renewal* (Apr. 2018), available at: <https://www.oregocities.org/application/files/6416/8721/7421/FAQ-UrbanRenewal-updated5-23.pdf> (last accessed Dec. 18, 2023).

²⁹¹ *Id.*

²⁹² *Id.*

area.²⁹³ Incremental revenues are allocated to the urban renewal agency to finance urban renewal projects.²⁹⁴

VII. DEBT MANAGEMENT

Most cities find it necessary to borrow money from time to time. Oregon cities can borrow money in a wide variety of ways and from a variety of sources. The choices a city makes can have a significant effect on the cost of the borrowing and the speed at which the borrowing can be done.

For most borrowings, a city can either: select a lender and work with that lender to structure the borrowing and set interest rates (a negotiated sale); preliminarily structure a borrowing and do “requests for proposals” to select a lender to finalize the borrowing structure and set interest rates (sometimes called a “quasi-competitive sale”); or structure the borrowing and invite bids from the public to set interest rates (a “competitive sale”).²⁹⁵

A. Types of Borrowings

i. Bonds

A “bond” is simply the written promise of a city to pay a specified principal amount on a specified date, together with interest. Bonds typically pay interest every six months, and principal every year. If a city issues \$2 million in principal amount of bonds, a portion of the principal would be due each year, so that the annual debt service over the life of the bonds was about the same. The main categories of bonds that Oregon cities use are:

1. *General obligation bonds.*

General obligation bonds are bonds that are secured by the power of the city to levy an additional property tax, outside of constitutional limits, that is sufficient to pay the bonds. This tax is dedicated solely to pay the bonds and cannot be used by the city for other purposes. The amount and rate of the tax are said to be “unlimited” because a city may levy whatever amount is necessary to collect enough taxes to pay the bonds.

²⁹³ *Id.*

²⁹⁴ *Id.*

²⁹⁵ This discussion on the types of borrowings and types of financing is courtesy of League of Oregon Cities, *Guide to Borrowing and Bonds for Oregon Municipalities* (March 2018), available at: <https://www.orcities.org/application/files/7115/6036/0907/GuidetoDebtIssuanceFINAL03-23-18-print.pdf> (last accessed Dec. 18, 2023).

Because the property tax system is considered to be very reliable and stable, and the taxes that can be levied to pay the bonds are not limited, general obligation bonds are regarded as very secure and are usually the least expensive way for a city to borrow money.

Although the property taxes a city imposes to pay general obligation bonds are not limited, a city's ability to issue general obligation bonds is substantially limited by the Oregon Constitution and statutes. General obligation bonds must be approved by the city's voters and can only finance "capital costs." General obligation bonds are usually issued as long-term, fixed-rate bonds, but they can be issued as short-term bonds, or variable rate bonds. In addition, the "lending of credit" provision of the Oregon Constitution prevents general obligation bonds from being used to finance certain kinds of projects with substantial involvement by private businesses.²⁹⁶

The issuance of general obligation bonds must be approved by a majority of the city's voters who vote in that election ("simple majority" approval), during an election held in May or November, or as part of another election for which a majority of registered voters cast ballots ("double majority" approval).²⁹⁷ As a practical matter, a majority of registered voters infrequently cast ballots at city elections, so general obligation bond elections are usually held in May or November.

General obligation bonds may only be issued to finance "capital costs." Capital costs are defined as costs of land and of other assets having a useful life of more than one year, including costs associated with acquisition, construction, improvement, remodeling, furnishing, equipping, maintenance or repairing real or personal property that has a useful life of more than one year. The Oregon Constitution also specifically states that "capital costs" does not include costs of routine maintenance or supplies.²⁹⁸

The weighted average maturity of general obligation bonds may not exceed the weighted average life of the capital costs that are financed with those bonds.²⁹⁹ This means that cities cannot issue long-term bonds to finance short-lived assets (i.e. cannot use all of the proceeds of bonds that mature over 30 years to finance computers that have a useful life of five years). However, because the limit is based on averages, it rarely affects bond issues that finance a variety of projects, including long-life assets such as land or buildings.

Oregon election laws require that the ballot measure approving the bonds state, in clear and simple language: the amount of the bonds that will be authorized; the purposes for which the

²⁹⁶ Article XI, Section 9 of the Oregon Constitution says "No... city..., by vote of its citizens, or otherwise, shall... raise money for, or loan its credit to, or in aid of, any [joint] company, corporation or association." This poorly understood provision of the Oregon Constitution prevents cities from using general obligation bonds to finance certain kinds of projects that involve corporations or other artificial entities such as most private businesses.

²⁹⁷ OR Const Art XI, § 11k; OR Const Art XI § 11(8).

²⁹⁸ OR Const Art XI, § 11L(1) and (5).

²⁹⁹ OR Const Art. XI § 11L(4).

bond proceeds will be spent; and that property taxes may increase.³⁰⁰ Oregon election laws do not require the ballot to contain an estimate of the taxes or tax rates that will be imposed to pay the bonds, but estimates are commonly included in the ballot.³⁰¹

2. Full faith and credit bonds.

Full faith and credit bonds are used to finance many city projects that do not have their own revenue streams; they are almost always used to finance local improvement projects, and they are often used when a city borrows from a state agency.

Full faith and credit bonds are secured by a pledge of the city's full faith and credit.³⁰² Such a pledge commits the city to pay the bonds from all lawfully available funds of the city, and any taxes that are within the authority of the city to levy. The full faith and credit pledge allows a city to use a basket of revenues to secure or repay the debt, rather than one revenue stream as with revenue bonds.

Full faith and credit bonds can be secured with permanent rate levies, local option levies, and other revenues such as gas taxes, income taxes, and sales taxes. However, unlike general obligation bonds, full faith and credit bonds are not secured by the power to levy a property tax outside the limits of Article XI, Sections 11 and 11b of the Oregon Constitution. Local option levies, because of their short term and compression risk, may not provide substantial security for full faith and credit bonds.

No single statute places an overall limit on city full faith and credit bonds. However, city charters may impose limits on full faith and credit bonds. The most common charter limits on full faith and credit bonds require that city voters approve those bonds.

A city may issue revenue bonds for any lawful purpose, but the city must either authorize the bonds by non-emergency ordinance and wait at least 30 days, or publish a notice describing the bonds and wait 60 days.³⁰³ While the city is waiting, citizens may file a petition to refer the question of issuing the bonds to an election.³⁰⁴ A city may pledge its full faith and credit to secure those bonds.³⁰⁵

A city may issue bonds in the form of financing agreements, but only to finance costs of real or personal property that is needed by the city.³⁰⁶ A city may

³⁰⁰ See ORS 250.037; Oregon Department of Revenue, *A Guide to Writing Ballot Measures for Property Taxing Authority* (July 2022), available at: https://www.oregon.gov/dor/forms/FormsPubs/tax-election-ballot-measures_504-421.pdf (last accessed Dec. 29, 2023).

³⁰¹ *Id.*

³⁰² ORS 287A.315.

³⁰³ ORS 287A.150.

³⁰⁴ *Id.*

³⁰⁵ ORS 287A.315.

³⁰⁶ ORS 271.390.

pledge its full faith and credit to secure those financing agreements.³⁰⁷ The weighted average life of the financing agreement cannot exceed the weighted average life of the real and personal property that is financed. A financing agreement is a single borrowing and may be for a large amount. Investors in the bond market are accustomed to buying bonds in increments of \$5,000. Those \$5,000 increments have a variety of names but are often called “certificates of participation” or “full faith and credit obligations.”

3. Revenue bonds.

Revenue bonds come in many types, including sewer, water or electric utility revenue bonds, urban renewal or “tax-increment” bonds, and conduit revenue bonds for private projects. Revenue bond” they usually mean a bond that is payable solely from a specified type of revenue.

The types of revenues that can be used to secure revenue bonds vary substantially. As a result, some revenue bonds are very secure and credit-worthy (sometimes even better than an issuer’s full faith and credit bonds), and some are so poorly secured they cannot be sold on reasonable terms.

Similar to full faith and credit bonds, revenue bonds may be issued for any lawful purpose, but the city must either authorize the bonds by non-emergency ordinance and wait at least 30 days, or publish a notice describing the bonds and wait 60 days.³⁰⁸ While the city is waiting, citizens may file a petition to refer the question of issuing the bonds to an election.³⁰⁹ Cities may revenue bonds in the form of financing agreements and “revenue obligations,” and only for costs of real or personal property that is needed by the city.³¹⁰

Revenue bonds are usually payable solely from the revenues of the system that is financed with the bonds. Purchasers of revenue bonds usually require the city to make many promises (called “covenants”) about how the city will operate the utility system that produces the committed revenues and how the city will impose rates and charges for services from that system. Since the covenants affect the operating decisions, it is important to understand the covenants and to seek alternatives if the covenants will impede the city’s ability to operate the system. For instance, investors and rating agencies often want to see pledged revenues exceed the debt service requirement by 10-25% (referred to as debt service coverage). This may cause rates to increase substantially and put a strain on rate payers.

Revenue bonds can sell on favorable terms if they are issued for essential services for which the city faces little or no effective competition such as sewer, water and electric systems. Revenue bonds may not sell on favorable terms if they are issued to finance non-essential

³⁰⁷ ORS 287A.315.

³⁰⁸ ORS 287A.150.

³⁰⁹ *Id.*

³¹⁰ ORS 271.390.

services such as golf courses, internet services or cable television, because customers may stop purchasing services if the rates get too high.

4. Bonds for a Particular Purpose – Local Improvement Districts

Local improvement district bonds are issued when a city constructs public improvements that benefit nearby property and forms a local improvement district. To fund the improvements, the city will be able to assess the properties that benefit from the improvements. However, a city is not able to assess the costs until the projects are complete and state law allows property owners to pay those assessments with interest over 10 years. A city may choose to issue LID bonds to finance the costs of improvements.

LID assessments are the first lien on the property that is assessed, subject only to state and federal tax liens. Since LID assessments are hard for investors to understand, cities usually pledge their full faith and credit to attract investors and lower the bond interest cost.

5. Refunding Bonds

“Refunding bonds” are bonds a city issues to refinance and pay off bonds the city previously issued. Oregon law broadly authorizes cities to issue refunding bonds for outstanding general obligation, full faith and credit, and revenue bonds by simply passing a resolution. Refundings are typically undertaken to reduce interest costs if current market rates are less than the rates on the outstanding bonds. However, cities may also issue refunding bonds to restructure debt service, adjust covenants or change the security.

Refunding bonds are typically secured in the same way as the bonds that are being refunded. However, a city often can change the security for the refunding bonds. In order to achieve debt service savings, the refunded bonds must have a call feature that is a provision that allows the bonds to be prepaid prior to their original maturity. Most municipal bonds are callable beginning approximately 10 years after they are issued. The date on which the bonds can be prepaid is often referred to as the “call date.”

ii. Other types of borrowing

- **Certificates of Participation** (sometimes referred to as COPs) on which annual debt service payments are subject to annual appropriation. Borrowings that are subject to appropriation usually have higher interest rates than borrowings that are not. Recent changes in Oregon law allow most cities to do general fund obligations, and certificates of participation have become relatively uncommon.
- **General Fund Obligations, or Limited Tax Obligations**, which are similar to COPs but are a binding obligation payable from all resources of the general fund rather than to annual appropriation. Some city charters do not permit this kind of borrowing.

- **Loan Agreements** are often used when a city borrows from a bank.
- **Lease-Purchase Agreements** are commonly used to purchase equipment from vendors.
- **Tax Anticipation Notes (TANs)** are short-term instruments sold in anticipation of tax receipts and assist in cash flow needs between July and November when property tax payments are received.
- **Bond Anticipation Notes (BANs)** are similar to TANs but are sold in anticipation of selling a bond and provides interim funds for financing the project.
- **Lines of Credit** allow a city to borrow money in increments, and only pay interest on the amount that is borrowed. They are popular for interim financing when the city cannot invest its borrowed money at the rate the city pays on the borrowing.

B. Tax-exemption and other federal subsidies

The United States Internal Revenue Code allows local governments to borrow at low, tax-exempt interest rates. An investor who purchases a tax-exempt bond does not have to pay federal income tax on the interest, and therefore is willing to accept a lower interest rate.

The tax-exemption is controlled by the U.S. Congress and the Internal Revenue Service and the regulations relating to the tax-exemption are very long and complex. Those regulations generally place substantial restrictions on the ability of borrowers to invest the proceeds of tax-exempt borrowings (the “arbitrage regulations”) and substantial restrictions on the ability of borrowers to allow special private use of facilities financed with tax-exempt obligations (the “private activity bond rules”).

The availability of the tax-exemption or subsidy bonds can have a dramatic effect on the cost of a city borrowing. The tax-exemption is often estimated to reduce the annual interest rate on a borrowing by two percent.

Nationally recognized bond counsel helps cities and other local government borrowers determine whether a particular project is eligible for tax-exempt or subsidy bond financing. Because the difference in cost is so substantial, it is usually very important to have bond counsel determine whether a project will qualify for tax-exempt or subsidy bond financing as soon as possible.

C. Debt Limits

The principal amount of outstanding general obligation bonds of a city cannot exceed three percent of the real market value of the taxable property in the city. However, that limit does not apply to general obligation bonds that are issued to finance local improvement districts.

There is no general statutory limitation on the amount of revenue bonds that a city may issue. However, individual city charters may impose special limitations. The amount of bonds that may be issued to finance local improvement districts under ORS Chapter 223 is separately limited to 3% of the real market value of the city.

The city charter may also contain debt limits, either on long-term or short-term financing. Consult your city attorney when the governing body wishes to obtain debt financing.

D. Disclosure

Bonds and other borrowings of a city are securities. When a city sells securities in the public securities markets, the city is obligated to prepare a document (called an “Official Statement”) that must describe all the important factors that an investor should consider when deciding whether to purchase the city’s securities. The Official Statement is usually prepared by an outside expert, but the city is legally responsible for the content of the document. Preparation of an Official Statement can be a significant expense.

If the city makes inaccurate or incomplete statements in connection with an offering of securities it may constitute “securities fraud” under federal and state securities laws. Securities fraud can subject public officials to personal liability and, in dramatic cases, criminal penalties.

Because investors will use the Official Statement to make decisions about purchasing the city’s securities, and because inaccuracies and omissions can be grounds for liability claims against the city and its public officials, it is important that the Official Statements be prepared carefully and accurately.

Many cities that have issued securities recently are required to post annual updates of financial and operating information with the Municipal Securities Rulemaking Board, through its internet data base called “EMMA.” You can find recent securities disclosures for your city at emma.msrb.org. Public officials should try to ensure that their cities are complying with their obligations under the federal and state securities laws. Official statements and other disclosure documents are not usually required when a city borrows from a state agency or a commercial bank.