

CITY OF ANNAPOLIS FINANCIAL ADVISORY COMMISSION

c/o Frederick C. Sussman, Esq., Chair

125 West Street, 4th Floor

Annapolis, Maryland 21401

(410) 268-6600

fsussman@councilbaradel.com

May 23, 2020

BY E-MAIL

Mayor and City Council of the City of Annapolis
160 Duke of Gloucester Street
Annapolis, Maryland 21401

Re: Financial Advisory Commission Report on Proposed FY 2021 Operating Budget,
FY 2021 Capital Budget and FY 2022-2026 Capital Program,
FY 2021 Fees and FY 2021 Fines

Dear Mayor Buckley and Members of the City Council:

The Financial Advisory Commission's mission is to provide impartial advice and guidance to the Mayor and City Council about the City's financial well-being, financial policies and procedures, and proposed budgets. We also provide input as requested by the Mayor and City Council on other matters impactful to the financial health of the City. We approach our responsibility with the perspective that our elected officials have a fiduciary obligation to ensure accountability for spending public funds by efficiently and economically appropriating only such funds as are necessary to secure the benefits of home rule.

The Mayor and City Council referred to the Commission for our review and advice the Mayor's proposed FY 2021 Operating Budget and Capital Budget, FY 2022-2026 Capital Program, FY 2021 Fees, and FY 2021 Fines. The Financial Advisory Commission has reviewed and discussed these materials with the City's Finance Director and City Manager, and has reviewed and discussed with the Chair of the City Council's Finance Committee the "Fiscal Year 2021 Budget Report of the Finance Committee of the Annapolis City Council May 11, 2020."

In short, the Commission generally endorses the City Council Finance Committee's report and recommendations regarding the proposed FY 2020 Operating and Capital Budgets, FY 2022-2026 Capital Program, FY 2021 Fines and FY 2021 Fees, subject to the comments below.

The Commission offers the following additional comments:

1. While the Commission has great confidence in staff's representations that the FY 2021 Operating Budget revenue projections are very conservative and reasonable based upon

information now known and reasonably projected about the impact that a COVID-19 economic downturn could have on such revenues, the extent of the economic downturn and its impact on City revenues is not known and remains fluid. This makes it imperative that:

- (i) the Finance Director continue to monitor and make necessary changes to revenue and cash-flow projections, with corresponding recommendations for Operating Budget revisions, up to the point that the City Council adopts the budget; and
- (ii) the Finance Director, City Manager and the Mayor and City Council begin now to develop a plan for mid-year expenditure reductions if anticipated revenues and cash-flows do not materialize, colloquially a “Plan B.” An integral part of this analysis should include identification of levels of revenue and cash-flow shortfalls that would trigger some or all of the Plan B expenditure reductions.

2. To further provide six months to monitor the Operating Budget revenue trend during FY 2021, the Commission suggests that the Mayor and City Council identify and consider not appropriating funds for expenditures deemed non-essential, and place into the Contingency Fund all or a part of the funds that have been proposed for such expenditures. The Contingency Fund allocations would be available for appropriation for the deferred expenditures later in the fiscal year if fiscal conditions warrant.

3. Last year the Commission recommended that, in order to evaluate the future impacts of current budget decisions, future budget presentations should identify significant budgetary recommendations that, if adopted, would result in expenditure impacts beyond the current fiscal year. It does not appear that this recommendation is included in the proposed Operating Budget although future year financial impacts of proposed capital expenditures are reflected in the 5-year Capital Program. This information becomes particularly important where a significant part of the Operating Budget is funded with grants that may be funding sources for ongoing operating expenses today but may no longer be available to fund such ongoing expenses tomorrow, transferring such funding responsibility to the General Fund. The Commission urges that such information be provided to the Mayor and City Council in the FY 2022 budget presentation.

4. The proposed Operating Budget incorporates appropriate use of fund balances and reserve funds to fund non-recurring expenses, thereby reducing reliance on property taxes for such purposes. Expenditures are being appropriately funded by anticipated revenues and fund balances and reserve funds. However, the Commission cautions that a close eye must be kept on such fund balances and reserve funds so that they do not fall below required levels and remain available as a backstop in the event of future fiscal emergencies. The City’s sound fiscal management for many years has built the reserves and fund balances to healthy levels, but one or two unforeseen events can cause a fiscal calamity that might necessitate drawing heavily from reserve funds and fund balances.

5. The Commission has encouraged and supported the use of pay-go to fund capital projects where feasible to reduce reliance on the issuance of debt for such purposes, and, philosophically continues to do so. However, because of the uncertainty of revenue and cash-flow influx during FY 2021 because of the pandemic-related economic downturn, the Commission recommends that reliance on pay-go to fund proposed projects be significantly curtailed in FY 2021. This may mean that such projects be deferred, reduced in scope, or funded from other revenue sources.

6. Because such a large portion of the City's Operating Budget (currently approximately 70% for the General Fund) is driven by personnel-related costs, the Commission historically has urged restraint in adding to the City's personnel costs, and continues to do so. As noted in the Finance Committee Report, the growth in City expenditures continues to outpace the growth of revenues. Personnel costs also have a direct impact on the City's cash-flows. Even though the City is a service industry and heavily relies upon personnel to provide services, the continued growth of expenses, including personnel and pension-related expenses, in excess of the growth of revenues and the associated impact on cash-flows will not be sustainable in the medium to long term. The City may be facing some difficult choices to control personnel costs, including eliminating, reducing or modifying City service and program delivery across the board. If not that, then the City may be facing the prospect of increasing taxes and fees to bring personnel costs into line with revenues and cash-flows. The City should begin now the process of evaluating the feasibility of such actions. As part of this evaluation the City should examine the levels of the City's contributions to employee pensions and/or consider transitioning to retirement programs based on defined contributions from the City and away from programs which guarantee a defined benefit.

In conclusion, the Commission would like to acknowledge the work and responsiveness of Finance Director Jodee Dickinson, City Manager David Jarrell and other City staff. Despite numerous City staffing challenges, these individuals were instrumental in helping to bring forward a fiscally responsible financial program for FY 2021. The Financial Advisory Commission has confidence in their future leadership to keep the City on solid financial footing. The Commission further acknowledges and appreciates the significant budget review work undertaken by the City Council's Finance Committee and the sound comprehensive report that it produced. The entire budget process thus far has been extraordinary considering the significant challenges and uncertainties presented by the COVID-19 pandemic.

The Financial Advisory Commission pledges our continued support to work collaboratively with the Mayor and City Council to chart a fiscally responsible and financially sustainable course

for the future welfare of our City.

Sincerely,

Frederick C. Sussman

Frederick C. Sussman, Chair

cc: David Jarrell, City Manager (By e-mail)
Jodee Dickinson, Finance Director (By e-mail)
Regina C. Watkins-Eldridge, City Clerk (By e-mail)
Jacqueline Lee, Legislative and Policy Analyst
Financial Advisory Commission Members (By e-mail)