

CITY OF ANNAPOLIS FINANCIAL ADVISORY COMMISSION

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May 17, 2022

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 2023 Operating Budget,
FY 2023 Capital Budget and FY 2024-2028 Capital Program,
FY 2023 Fees and FY 2023 Fines

Dear Mayor Buckley and Members of the City Council:

The Financial Advisory Commission is issuing an UNFAVORABLE REPORT on the proposed FY 2023 Operating Budget and, as such, will NOT ENDORSE approval of FY 2023 Operating Budget in its present form. Approving the proposed FY 2023 Operating Budget as presented is not consistent with prudent financial management, or exercising fiduciary responsibility over taxpayer dollars.

In sum, the FY 2023 Operating Budget uses short-term federal subsidies to mask a structural deficit between rising expenses and the lower revenues experienced during the ongoing COVID-19 pandemic. The FY 2023 Operating Budget worsens the gap and risks a financial crisis for the City as early as FY 2025, after the federal subsidies are expected to end. While there is reason to believe that we may be emerging from the pandemic and that revenues will increase due to likely increased local economic activity, there is no assurance this emergence will occur fully in the near term or that revenues will soon return to a pre pandemic level, let alone rise to match the increased expenses contained in the FY 2023 Operating Budget. The Commission urges action now to address the structural deficit rather than pin the City's hopes on the uncertain timing and degree of such expected resurgence of revenues. The potential growth in revenue is not guaranteed, unlike the growth in expenses which is certain absent immediate action.

While the Commission generally endorses the proposed FY 2023 Capital Budget, FY 2024-2028 Capital Program, FY 2023 Fines and FY 2023 Fees, the Commission takes no position on specific Capital Projects, Fines and Fees.

Following is an outline of our review process, our analysis of the proposed FY 2023 Operating Budget, and recommendations on addressing the deficiencies we have identified.

REVIEW PROCESS

The Mayor and City Council referred to the Commission for our review and advice the Mayor's proposed FY 2023 Operating Budget and Capital Budget, FY 2024-2028 Capital Program, FY 2023 Fees, and FY 2023 Fines. The Financial Advisory Commission has reviewed and discussed these materials with the City's Finance Director and City Manager, and received from the Finance Director and City Manager well-prepared Operating and Capital Budget presentations. Finally, the Financial Advisory Commission received a Debt Capacity Update report from Davenport, the City's financial advisor, regarding the City's debt affordability. In total, we have received many of the same documents and presentations on the FY 2023 Budget that were received by and presented to the City Council and its Finance Committee.

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 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.

During the COVID-19 pandemic over the past 26 months, the City Manager, Finance Director, Department Directors and the rest of the Administration's team performed their jobs and responsibilities in a challenging economic environment. They have managed the City's FY 2022 budget and accompanying shortfalls in typical anticipated revenues, aided in large part by significant infusions of short-term federal ARPA funds assistance. However, in light of the uncertainty as to how the City, State and rest of the country will emerge from the COVID-19 pandemic's economic impacts, and the emerging inflationary pressures and likely continuing supply-side dislocations in the overall economy, the City must be extremely vigilant in managing expenses and revenues going into what may be an even more challenging FY 2024 and, thereafter, FY 2025. Ongoing efforts must be intensified to reduce or eliminate structural deficits for when federal revenue infusions have ended. These financial planning efforts must begin now.

ANALYSIS & RECOMMENDATIONS

The Commission offers the following analysis and recommendations, some of which are drawn from the Commission's report to the City Council last year. The necessity of having to reiterate some of our recommendations from last year suggests, in our view, a lack of appreciation for the potential financial challenges confronting the City over the coming years. Crisis financial management is not appropriate. Our further specific comments follow:

1. The proposed FY 2023 Operating Budget reflects an approximately \$1,500,000 structural deficit that will be filled with the use of ARPA funds. Staff anticipates that a structural deficit will continue at least through FY 2024 and be filled again with the use of ARPA funds to the extent that property tax revenues and other recurring revenues do not increase sufficiently to fund recurring expenses. The Commission believes that sufficient and available expense reductions are not being made in the FY 2023 Operating Budget to begin to mitigate the structural deficit.

2. The Commission questions whether it is fiscally prudent for the City Council to adopt the proposed Operating Budget absent conclusion of the collective bargaining negotiations and subsequent ratification of the collective bargaining agreements. Further, the Commission notes that approving the FY 2023 Operating Budget in this instance may not comply with City Code 3.32.060.D., which stipulates that collective bargaining *“agreement(s) must conform to the City’s fiscal year or years and be submitted to the Mayor by the third Monday of March so as to allow the financial impact of any negotiations to be included in the Mayor’s annual budget submission under [Section 6.16.010](#)”*.

Salary and benefits account for over 70% of general fund expenditures and this percentage has increased in recent years. Approving a budget without knowing what commitments the City may undertake in such agreements is financially imprudent and at odds with City Code governing the collective bargaining and budgeting process. Attempting to forecast those commitments in the FY 2023 budget is showing the City’s “hand” and may weaken the City’s negotiating position.

One possible solution to this predicament is for the FY 2023 operating budget to reflect salary and benefit costs under the expired agreements and stipulate that collective bargaining agreements ratified after approval of the FY 2023 budget will await implementation until the FY 2024 budget, without a retroactivity clause. In so doing, the City will be approving and operating under a valid and known set of salary and benefit financial obligations for FY 2023.

3. The growth in City expenditures, attributable in large part to rising personnel-related costs, continues to outpace the growth of revenues, contributing in large part to the City’s structural deficit. Personnel costs also have a direct impact on the City’s cash-flows. A large portion of the City’s Operating Budget (currently approximately 71% 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.

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, is not sustainable. The City must address now the difficult choices to control personnel costs, including eliminating, reducing, or modifying City service and program delivery, or face 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 must 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.

As a possible means of reducing public safety expenses, the City also should explore the practicality and financial feasibility of joint City and County sharing of certain public safety functions.

4. The City Council must take an aggressive approach to proactively identify productivity and other improvements in service delivery models or plan for cuts in service levels to limit growth in spending to growth in revenues. In prior communications to the Mayor and Council, the Commission urgently recommended next steps preparatory to transitioning from a line-item incremental approach to performance-based budgeting for planning and consideration of future budgets. A "priority-based" and "performance-based" budgeting process will lead to (a) increased efficiencies in City government, (b) establish consensus on important core services, (c) prioritize the use of citizen and business tax dollars, and (d) establish accountability on how those dollars are spent. We renew our recommendation.

5. Over the past several years, the Commission has repeatedly recommended that, 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 appears this recommendation has not been implemented for the proposed FY 2023 Operating Budget, although future year financial impacts of proposed capital expenditures are reflected in the 5-year Capital Program. This Operating Budget information becomes particularly important where a significant part of the Operating Budget is funded with federal and State grants and less predictable revenue streams generated from fees and other ancillary receipts, that may be funding sources for ongoing operating expenses today but may no longer be available at desirable, needed, and appropriate levels to fund such ongoing expenses tomorrow, thereby transferring such funding responsibility to the general tax revenues in in the General Fund. The Commission urges that such information be provided to the Mayor and City Council prior to the adoption of the FY 2023 Operating Budget and, thereafter, in the FY 2024 and subsequent budget presentations.

6. The City's Transportation system has never been self-sustaining, and, as a public transit system, is not likely to be self-sustaining. This challenge is even more serious given the expected redirection of parking revenues resulting from the recent PPP Hillman Garage Agreement. Because the Transportation Fund is not self-sustaining, it requires annual subsidies from the City's General Fund, including parking revenues. To reduce and stabilize reliance on support from the General Fund, the City must explore ways to enhance Transportation system revenues and reduce its operational expenses. As part of this evaluation, the City should explore whether any reasonable, cost effective, opportunities exist for the City to operate its Transportation system more efficiently and as part of a regional approach to providing public transportation.

7. The City's budgeting process lacks a clear and unifying strategic focus. We know WHAT is required by law (i.e. a balanced budget), and that much, i.e., a balancing of the budget, is achieved in the FY 2023 budget. However, we do not have a clear and unifying WHY behind this annual process. The City presently follows a bottom-up approach to budgeting, whereby department heads individually determine their priorities and performance measures as a basis for their funding requests. Adopting a strategic focus will instill a top-down budgeting approach focused on an overall vision and mission for the City that puts all department heads on the same page where priorities and performance measures are traceable directly back to the overall vision and mission for the City.

We understand that, in 2012, the City developed a strategic plan, but this plan was not adopted by the City Council. We encourage the City Council to review that proposed 2012 strategic plan and undertake a new strategic planning effort for the City, with the goal of having a strategic plan in place prior to preparing for the FY 2024 Budget. We believe that a strategic plan, defining the core services to be delivered, and the efficient and effective methods in which these services are to be delivered, will lead to a budget that aligns with the City's vision and mission and forms a sound foundation for subsequent annual budgets that logically build upon the successful outcomes of a previous year's strategically focused and implemented budget.

CONCLUDING REMARKS

As the Commission said last year, there is urgent work to be done with the uncertainty of revenues and the ongoing structural deficit. This past year's commendable management of expenses in an unusually challenging time, with the assistance of federal funding, is no reason to reduce vigilance on budgetary matters. The Commission is concerned that the FY 2023 budget has not addressed the issues noted herein in a meaningful way.

We pledge our continued commitment to provide the Mayor and City Council an unvarnished and forthright assessment of the City's financial outlook in a resolute effort to chart the most fiscally responsible and financially sustainable course for the future welfare of our City. We urge the Mayor and City Council to begin implementing the Commission's recommendations now, even with small incremental steps. Failure to do so may be consequential to the future financial viability of the 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)
Financial Advisory Commission Members (By e-mail)