

CITY OF ANNAPOLIS FINANCIAL ADVISORY COMMISSION
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May 9, 2024

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 2025 Operating Budget,
FY 2025 Capital Budget and FY 2026-2030 Capital Program,
FY 2025 Fees and FY 2025 Fines

Dear Mayor Buckley and Members of the City Council:

The Financial Advisory Commission is pleased to submit to the Mayor and City Council the Commission's report on the proposed FY 2025 Operating and Capital Budgets, FY 2026-2030 Capital Program, FY 2025 Fines, and FY 2025 Fees.

As the Commission did last year, the Commission generally endorses the proposed FY 2025 Capital Budget, FY 2026-2030 Capital Program, FY 2025 Fines, and FY 2025 Fees, but the Commission takes no position on specific Capital Projects, Fines and Fees. The Commission notes that based upon the City's recent Debt Affordability analysis performed by the City's financial advisors, the financing of capital projects through the issuance of debt appears to be affordable and will keep the City's outstanding debt below self-imposed debt limits. The Commission further notes and commends the detailed review and revision of City fees and charges so that the costs of programs and regulatory processes are supported by fees and charges that are passed along to users rather than being borne by taxpayers.

The Commission issues a tentative endorsement for adopting the proposed FY 2025 Operating Budget, while emphasizing the urgency of continuing to manage the structural deficit that has confronted the City for many years.

The following is an outline of our review process, our brief analysis of the proposed FY 2025 Operating Budget, and recommendations to address 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 2025 Operating Budget and Capital Budget, FY 2026-2030 Capital Program, FY 2025 Fees, and FY 2025 Fines. The Financial Advisory Commission reviewed and discussed these materials with the City's Finance Director and received from the Finance Director well-prepared 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 2025 Budget that were received by and presented to the City Council and its Finance Committee.

Throughout the FY 2024 budget year, the City Manager, Finance Director, Department Directors, and the rest of the Administration's team performed their jobs and responsibilities admirably. Their ability to manage the City's FY 2024 budget and accompanying structural deficit was aided in part by the continued availability and infusion of short-term federal ARPA funds, conservative revenue estimates in planning the FY 2024 budget, and staff vacancies in various departments that aided in reducing salary and benefit expenses. Even though the City anticipates realizing a nearly \$6.9 million dollar Operating Budget surplus at the conclusion of FY 2024, the City must continue to be extremely vigilant in managing expenses and revenues going into FY 2025, and thereafter in subsequent budget years.

While current budget projections show that anticipated revenues resulting from last year's triennial property tax reassessments may mitigate some of the structural deficit challenges, the full benefits of those property reassessments are tempered by the realization that Homestead Credits used by many City property owners will cap the amount of potential property tax revenue the City may realize. Furthermore, the assessable commercial property tax base may be under measurable stress in the core downtown area due to anticipated City Dock renovations and other current/anticipated upgrade initiatives. Commercial property tax assessments consider revenue generated on commercial property, as well as the value of the land and structures on that property.

As we cautioned in our report last year, ongoing efforts must be intensified to reduce or eliminate any structural deficits. Even though the proposed FY 2025 Operating Budget does not reflect a structural deficit, these financial planning efforts must continue unabated to avoid future structural deficits.

ANALYSIS & RECOMMENDATIONS

The Commission offers the following analysis and recommendations, some of which are drawn from the Commission's report to the City Council over the past three years. The City must continue to manage the City's potential structural deficit challenge with a sense of urgency. Our further specific comments follow:

- 1) At present, the City Council is confronted with limited options. Because of the City's limited revenue enhancement options, significant reduction in City expenses coupled with a potential future property tax increase may be unavoidable. Discussions with the County on pursuing joint public safety and other service-related agreements as a way to reduce City expenses should be pursued.

It is the FAC's view that the only viable areas to reduce expenses to the extent necessary may be through a reduction in salary and benefit expenses, reducing contractual services, and lowering future interest expense obligations by managing the acquisition of new debt. On the revenue side, the City Council may need to consider increasing the property tax rate. At present, it is estimated that each one (1) cent increase in the property tax rate will yield \$800K in new revenue to the City. The City must then commit to keeping future expenses in-line with anticipated revenues. More specifically, the City must vigorously manage salary and benefit expenses going forward, which leads the next recommendation.

- 2) As noted in previous FAC budget reports, 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 past structural deficits. Personnel costs also have a direct impact on the City's cash-flows. A large portion of the City's Operating Budget (currently approximately 68% 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.

In particular, the City Council should analyze and carefully evaluate the necessity for personnel position enhancements that are proposed in the FY 2025 budget and approve only those that are demonstrated to be essential rather than merely desirable. And, to the extent that additional positions are authorized in the budget, strong consideration should be given to eliminating a comparable number of authorized positions.

Furthermore, the City must continue to exhibit resolve in collective bargaining negotiations by making clear the fiduciary relationship that exists between City government and its citizens that creates a "duty of good faith" to responsibly manage taxpayer monies in the financial administration of the City's affairs.

- 3) In prior communications to the Mayor and Council, the Commission urgently recommended transitioning from budgeting focused on a line-item incremental approach to a more performance-based budgeting model. The FAC again emphasizes the urgent need to adopt this process for future budgeting. A "priority-based" and "performance-based" budgeting process will lead to (a) increased efficiencies in City government, (b) establishment of a consensus on important core services, (c) a prioritization of the use of citizen and business tax dollars, and (d) establishment of accountability on how those dollars are spent. We understand that during the FY 2024 budget year City staff and the Mayor and Council worked to identify spending priorities

and related performance measures. While these efforts may not have evolved into a full-blown “priority-based” and “performance-based” budgeting process, they are a step in the right direction and encourage the continuation and expansion of such efforts.

- 4) As noted in previous FAC recommendations, the City’s budgeting process appears to continue to lack 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 2024 budget. However, the City still does not have a clear and unifying WHY behind this annual process. The City still follows a bottom-up approach to budgeting, in which department heads individually determine their priorities and performance measures as a basis for their funding requests. However, adopting a strategic focus will instill a top-down budgeting approach in which department heads are focused on an overall vision and mission for the City and where priorities and performance measures are traceable directly back to the overall vision and mission.

The City is in the process of adopting a new 20-year Comprehensive Plan. The Commission believes that the Plan’s goals, objectives and implementation strategies can serve as a focal point for the development of annual budgets that align with the City’s vision and mission and form a sound foundation for subsequent annual budgets that logically build upon the successful outcomes of a previous year’s strategically focused and implemented budget. We also believe such an effort will contribute significantly to eliminating future lapses into structural deficits. As such, we encourage the City to make this effort a top priority in the coming fiscal year.

CONCLUDING REMARKS

The Financial Advisory Commission acknowledges and commends recent efforts undertaken by the City for improvements in its budgetary process. However, as the Commission said over the past three years, continued urgent work is still required with the uncertainty of future revenues and the ongoing looming threat of a structural deficit. While no Operating Budget structural deficit is projected for FY 2025, that is no reason to reduce vigilance on budgetary matters.

We commend the Director of Finance for her diligence in managing and forecasting the City’s financial challenges. FY 2025 revenue challenges are clearly enumerated on page 6 of the FY 2025 Budget presentation given to the Financial Advisory Commission. The FAC concurs with the Director of Finance’s assessment in addition to those issues noted in this and previous budget reports.

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

that have proven prescient in forecasting the financial opportunity and challenges the City should address expeditiously. Failure to do so may be consequential to the future financial viability of the City.

Sincerely,

Frederick C. Sussman

Frederick C. Sussman, Chair

cc: Michael Mallinoff, 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)