

CITY OF ANNAPOLIS FINANCIAL ADVISORY COMMISSION

c/o James A. Cardillo, Chair
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May 18, 2026

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 2027 Operating Budget, FY 2027 Capital Budget and FY 2027-2031 Capital Improvement Program, FY 2027 Fees and FY 2027 Fines

Dear Mayor Littmann and Members of the City Council:

The Financial Advisory Commission (FAC) is pleased to submit to the Mayor and City Council its report on the proposed FY 2027 Operating and Capital Budgets, FY 2027-2031 Capital Program, FY 2027 Fees, and FY 2027 Fines.

The Commission generally endorses the proposed FY 2027 Operating Budget, FY 2027 Capital Budget, FY 2027-2031 Capital Program, FY 2027 Fees, and FY 2027 Fines, but the Commission takes no position on specific Capital Projects, Fees, and Fines. The Commission notes that, based upon the City's recent Debt Affordability analysis performed by the City's bond 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 fines 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 following is an outline of our review process and recommendations to address the areas of concern we have identified.

REVIEW PROCESS

The Mayor and City Council referred to the Commission for our review of the Mayor's proposed FY 2027 Operating Budget and Capital Budget, FY 2027-2031 Capital Improvement Program, FY 2027 Fees, and FY 2027 Fines. The Financial Advisory

Commission reviewed and discussed these materials with the City's Finance Director and was also invited to participate in Working Sessions with the Finance Committee and other Council Members. These sessions also included the ability to hear directly from the City's debt financing consultants.

Current budget projections show that anticipated revenues resulting from the triennial property tax reassessments are mitigating some of the City's revenue pressures, though the full benefits of those property reassessments are tempered by the Homestead Credits used by many City property owners that 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.

The proposed FY 2027 Operating Budget presents a structural deficit within the General Fund as FY 2027 Expenditures exceed FY 2027 Revenues. This structural deficit requires the City to make use of available fund balances to offset the net single year cash outflows. Structural deficits have been presented in the Operating Budget by the City in all Fiscal Years since FY 2023. The overly conservative estimates of increases in General Fund Expenditures (GFE) are rarely realized, leading to material surpluses by Fiscal Year end. Accordingly, General Fund Surpluses generated by underspend are carried forward to maintain reserve balances, offset future budgeted deficits and allocated to one-time use funds. The FAC collectively presents a concern that the one-time use funds may be allocated to special projects that have not received as much rigor as similar projects in the Operating Budget.

While the FAC acknowledges the City continually spends below its proposed Operating Budget, the continued over projection of spending increases creates the appearance of a less than stable financial position. The City already maintains a budget stabilization fund and Capital reserve fund to address potential overspend in any single Fiscal Year. Accordingly, the FAC suggests that City Management implement measures to present a more realistic increase in projected expenditures within future Operating Budgets as well as refine the process by which surpluses are allocated.

ANALYSIS & RECOMMENDATIONS

The Commission offers the following analysis and recommendations, some of which are drawn from the Commission's previous reports to the City Council over the past five years. The City must continue to manage the City's potential structural deficit challenge with a sense of urgency by taking action on the suggestions provided in this letter. 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, strict management of City expenses coupled with a potential future property tax rate increase may be unavoidable. The City should strive to avoid property tax rate increases as continued raises may incentivize residents to leave the City, thereby exacerbating future revenue generation. Discussions with the County on pursuing joint public safety and other service-related agreements to reduce City expenses should be pursued.
2. 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. 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 to the next recommendation.
3. As noted in previous FAC budget reports, the growth in City expenditures (12.0% in this budget), 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 budgeted structural deficits. Personnel costs also have a direct impact on the City's cash flows. A large portion of the City's Operating Budget (approximately 70% for the General Fund) is driven by personnel-related costs, plus an unidentified additional amount for contractual services in the presence of unfilled positions. The Commission has historically urged restraint in adding to the City's personnel costs and continues to do so. In addition, the FAC recommends incorporating assumptions for vacancy and latency across all departments, particularly Public Safety, into future operating budgets to better reflect actual experience. The FAC believes incorporating vacancies or latencies will present a more accurate operating budget and resolve the appearance of a structural deficit in future budget presentations.
4. In particular, the City Council should analyze and carefully evaluate the necessity for personnel position enhancements that are proposed in the FY 2027 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.
5. 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. The

FAC continues to believe that, to carry out its chartered mission, it must have a role in the collective bargaining process. This is best achieved by having the financial impacts of potential negotiation outcomes circulated to the FAC, a designee FAC member present as an observer during the negotiation process, and a subsequent post-mortem evaluation of the negotiation process by the FAC with accompanying recommendations delivered to the Mayor and City Council. The FAC also strongly suggests either omitting potential financial impacts of union negotiations from future operating budgets or finalizing negotiations before the creation of future operating budgets.

6. 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, in past years, City Management 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.
7. As noted in previous FAC recommendations, the City’s budgeting process continues 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 2027 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.
8. The FAC also recommends a further refinement of the capital budgeting process to include the circulation of criteria leading to the prioritization of projects, as well as establishing long-term spending levels that are guided by long-term revenue projections and available debt capacity.
9. Debt capacity for the City is dictated by the level of debt service payments to total GFE. The FAC is concerned that continued expected increases in GFE create an incentive to continuously expand the City's debt burden. Whether realized or

budgeted, these increases may also overaccelerate capital spending. This risks exceeding the ability of City revenues to provide for the long-term maintenance of both new and existing assets. To address this, the FAC suggests refining existing policy on new debt issuance to include the revenue generating capacity of the City, thereby better matching cash sources with cash uses.

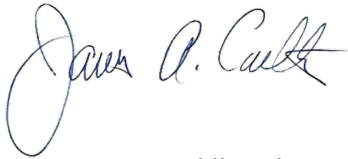
10. Future budget cycles must be designed to include the FAC earlier and meaningfully so that the FAC is prepared to provide timely advice and insights. Accordingly, the FAC requests input into the creation of the FY28 Budget Timeline including a discussion and subsequent agreement on deliverables that will be circulated in advance of working sessions and meetings. The FAC specifically requests the early distribution of Mayor and City Council priorities and also reestablishing the creation and distribution of supporting budget presentations that were made available in previous years.

CONCLUDING REMARKS

As the Commission said over the past four years, continued urgent work is still required with the uncertainty of future revenues and the potential for structural deficits. While the FY 2027 Operating Budget suggests a structural deficit in the General Fund, the FAC believes that the City will generate a surplus due to an overconservative budgeting process for departmental expenditures. That is no reason to reduce vigilance on budgetary matters or to further delay a spending affordability function in the budgeting process. The FAC welcomes any opportunity to work with the Mayor, City Council and City Management on our specific recommendations before and during the next budgeting cycle. In addition, we stand by to assist the Finance Committee in its periodic review of the ongoing financial performance of the City's financial position throughout the fiscal year.

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 opportunities and challenges the City should address expeditiously. Failure to do so may be consequential for the future financial viability of the City.

Sincerely,

A handwritten signature in blue ink, reading "James A. Cardillo". The signature is fluid and cursive, with the first name "James" being the most prominent.

James A. Cardillo, Chair

cc: Yolanda L. Lewis, City Manager (By e-mail)
Joel Pallikal, Acting Finance Director (By e-mail)
Regina C. Watkins-Eldridge, City Clerk (By e-mail)
Financial Advisory Commission Members (By e-mail)