

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

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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 2024 Operating Budget,
FY 2024 Capital Budget and FY 2025-2029 Capital Program,
FY 2024 Fees and FY 2024 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 2024 Capital Budget, FY 2025-2029 Capital Program, FY 2024 Fines, and FY 2024 Fees.

While the Commission generally endorses the proposed FY 2024 Capital Budget, FY 2025-2029 Capital Program, FY 2024 Fines, and FY 2024 Fees, the Commission takes no position on specific Capital Projects, Fines and Fees.

The Commission issues a tentative endorsement for adopting the proposed FY 2024 Operating Budget, while emphasizing the urgency of immediately addressing the very real structural deficit confronting the City and threatening its ability to effectively and efficiently manage and ensure the future benefits of home rule.

The following is an outline of our review process, our analysis of the proposed FY 2024 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 2024 Operating Budget and Capital Budget, FY 2025-2029 Capital Program, FY 2024 Fees, and FY 2024 Fines. The Financial Advisory Commission has reviewed and discussed these materials with the City's Finance Director and received from the Finance Director 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 2024 Budget that were received by and presented to the City Council and its Finance Committee.

Throughout the FY 2023 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 2023 budget and accompanying structural deficit was aided in large part by the continued availability and infusion of short-term federal ARPA funds, conservative revenue estimates in planning the FY 2023 budget, and staff vacancies in various departments that aided in reducing salary and benefit expenses. Even though the City managed to realize a surplus at the conclusion of FY 2023, it must continue to be extremely vigilant in managing expenses and revenues going into FY 2024, and thereafter in subsequent budget years.

While current budget projections show that anticipated revenues resulting from upcoming 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 structural deficits that again have been clearly identified and discussed in the FY 2024 budget deliberations. These financial planning efforts must continue unabated.

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 two years. The necessity of having to reiterate some of our recommendations from past years may suggest, in our view, a lack of appreciation for the potential financial challenges confronting the City over the coming years. The urgency of seriously addressing the City's structural deficit challenge should not and cannot be ignored. Our further specific comments follow:

- 1.) The Finance Director outlined in a very clear graphical presentation for the City Council and Financial Advisory Commission the structural deficit that confronts the City (Exhibit A). In FY 2025 the City is projected to experience a \$3.5M deficit that will grow to an \$8.0M deficit in FY 2027 absent a concerted effort to immediately plan for a reduction in expenses or a generation of increased revenues through further tax and fee increases.

At present, the City Council is confronted with limited options due to prior inaction on this threat to the City's financial well-being and future benefits of home rule. A significant reduction in City expenses coupled with a potential 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 are increasingly inevitable. It is the FAC's view that the only viable areas to reduce expenses to the extent necessary are through a reduction in salary and benefit expenses, reducing contractual services, and lowering future interest expense obligations by limiting 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 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 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 2024 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.

As part of the City's evaluation of personnel-related costs, the FAC commends the City for beginning to explore and evaluate the transition to retirement programs based on defined contributions from the City and away from programs that guarantee a defined benefit.

Furthermore, the City must exhibit greater resolve in future 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 renew our recommendation.

- 4.) 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 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.

In 2012, the City developed a strategic plan, but this plan was not adopted by the City Council. The FAC has been informed that the City is currently revisiting that proposed 2012 strategic plan and will undertake a new strategic planning effort. 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. 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 two years, continued urgent work is still required with the uncertainty of future revenues and the ongoing structural deficit. While the soon to be concluded FY 2023 fiscal year yielded a welcomed respite from a potential deficit with the assistance of federal ARPA funding and staff vacancy generated savings, it is no reason to reduce vigilance on budgetary matters. The Commission is concerned that the proposed FY 2024 budget has not fully addressed in a meaningful way the issues noted in our budget report from last year. We are also perplexed as to why the City Council has not undertaken earnest deliberations focusing on appropriate solutions for eliminating the structural deficit.

We commend the Director of Finance for her diligence in managing and forecasting the City's financial challenges. Those challenges are clearly enumerated on page 6 of the FY 2024 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)

**General Fund Recurring Revenues & Expenditures
FY2018 - FY2027
ARPA & Remaining Structural Deficit**



Exhibit A