

Statement at Organizational Meeting of Blue Ribbon Commission on City's Finances
June 30th, 2008, 7:30PM, City Council Room, City Hall, Annapolis, Maryland
By Richard Israel, Alderman, Ward One

The Blue Ribbon Commission on the City's Finances was established by R-31-08. Every member of the Council, including the Mayor, agreed to be a co-sponsor. I wish to thank each of you for agreeing to serve on the commission.

The fundamental problem with the finances of the City of Annapolis is that the steady rise in revenue in recent years can be expected to level off. Yet, if the trend of recent years continues, there will be a steady rise in expenditures, 85% of which is employee compensation. One way to align revenue with expenditures is by increasing revenue. This could be done by raising the tax rate, by appealing to the State government to increase the "payment in lieu of taxes" (PILOT), or by seeking State authorization to levy a tax which will fall primarily on the city's four million visitors. Another way to address the issue would be to reduce expenditures or at least slow the rate of increase in expenditures.

By law the annual operating budget of the City of Annapolis must be balanced, that is, estimated revenue for the next fiscal year must exceed estimated expenditures. Moreover, there must be an unappropriated surplus amounting to at least 10% of the estimated revenue. Approximately, one-third of the general fund revenue is derived from property taxes. However, approximately 20% of the real property within the city is exempt from property taxes. Moreover, the United States Naval Academy is not within the city's boundaries.

The value of real property, even if it is exempt from taxation, is assessed every three years by the Maryland Department of Assessments and Taxation. The assessed value is to be the market price. For residential property, market value is based on comparable sales. An increase in assessed value is to be phased in over a three year period. There is a 10% annual cap on an increase in assessed value. Although local governments can reduce this cap, Annapolis is chosen not to do this.

When the assessed value of property rises, State law mandates a reduction in the tax rate so that when the lower rate is applied to the increased assessed value, the amount of revenue is the same. However, a local government can raise the tax rate above the constant yield rate if it gives notice and conducts a hearing. Commonly, Annapolis has raised the tax rate to at or near the rate which was established the year before. When this new rate is applied to the increased assessed value, the result is a windfall of additional revenue.

At the end of this year, the Assessor for Anne Arundel County will send notices of reassessment to property owners in Annapolis. Because of the stagnant real estate market, it is expected that the increase in assessed values for such property will level off. If a rate similar to the rate established a year earlier is levied, there will not be the usual windfall of additional revenue.

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One way to bring revenue in balance with expenditures would be to increase revenue. There are several ways to do this. One would be to raise the tax rate above the level at which it was recently set. However, the recent furor over the levying of a \$25 sidewalk fee can be expected to make the members of the Council rather wary of increasing the tax rate, especially in an election year. Another way to bring the operating budget into balance would be to seek from the State an increase in the "payment in lieu of taxes" (PILOT). Although the City provides the State with various services for which the State makes no payment, the State's PILOT has remain unchanged for some years. To justify an increase in the PILOT would require a careful analysis of the city's expenditures to determine what services directly benefited the State but are not paid for.

Because of its unique attractions, approximately four million visitors come to Annapolis. Although these visitors directly benefit from services provided by the city government, the city does not have the authority to levy taxes which would be paid largely by visitors. Under the Municipal Home Rule Article of the Maryland Constitution, such authority would have to be conferred by a general law which applies to all of the municipal corporations. See Md. Const., Art. XIE, Section 5. However, it has been understood that such a law can prescribe criteria, such as a certain number of visitors each year which would effectively limit the number of municipal corporations which could exercise the authority.

An alternative to increasing revenue would be to reduce expenditures or to slow the rate of the increase. Approximately, 85% of the operating budget is devoted to employee compensation. Currently, there are four labor unions which represent different groups of employees. Employee compensation is one of the key subjects of collective bargaining agreements. The commission may wish to review the process by which these agreements are negotiated, ratified and funded. Other expenditures which might be examined are the circumstances in which overtime is paid, the use of contracts for the performance of services and the extent to which these services could be performed by permanent city employees, the process for the purchase of goods and services, the extent to which the report of the Energy Conservation Task Force have been complemented; the preparation and consideration of the operating and capital budgets; the extent to which the expenses of city government should be defrayed by fees and the enterprise funds rather than taxes and the general fund.

Although the resolution which establishes the commission has specific references to the PILOT and it very important that this matter be addressed, the resolution provides that the commission has broad authority to review the city's revenue and expenditures. Moreover, the reference to specific matters does not preclude the consideration of other matters related to the city's finances. I invite you to review the broad range of financial matters and share with us your views and recommendations. Timothy Elliott, Director of Finance, is available to assist you in your work. There is funding for you to supplement this assistance.