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FROM	NAME & TITLE	Robert Cenname, Budget Director	CITY of BALTIMORE <b>MEMO</b>	
	AGENCY NAME & ADDRESS	Bureau of the Budget and Management Research Room 432, City Hall (410) 396-4774		
	SUBJECT	City Council Bill 19-0162R—Informational Hearing- Baltimore’s Fiscal Readiness for Kirwan		

DATE:

TO

The Honorable President and  
Members of the City Council  
City Hall, Room 400

December 3, 2019

City Council Bill 19-0162R has been introduced for the purpose of requesting the Department of Finance to brief the City Council on the City’s fiscal readiness for the recommendations that the Kirwan Commission on Innovation and Excellence in Education has put forward. The Commission’s recommendations to increase education funding and to alter school funding formulas would have a significant impact on Baltimore City.

The following memo outlines the City’s historical support for City Schools, the current “Bridge to Kirwan” funding arrangement, and our perspective on the Kirwan Commission recommendations and the City’s financial readiness.

**Operating Support**

***History***

Per current State law, local jurisdictions’ contributions for school funding are wealth-equalized based on property and income wealth. This means that by design, wealthier jurisdictions contribute more local dollars for schools and rely less on State support, while poorer jurisdictions are required to commit fewer local dollars and rely more on State support. The City’s annual required contribution, referred to as Maintenance of Effort (MOE), is adjusted each year based on changes in both enrollment and relative wealth. In many years the City has voluntarily contributed more than required by statute. For example, between Fiscal 2001 and Fiscal 2009, when declining enrollment led to lower MOE requirements, the City chose to maintain School funding each year rather than reduce contributions at a cost of \$41.8 million. In addition, in Fiscal 2017 the State mandated an additional \$10 million contribution from the City above MOE.

***Bridge to Kirwan***

Between Fiscal 2018 and 2020, the City made a significant three-year \$99.2 million commitment of funding above the Fiscal 2017 MOE level to protect City Schools from declining State formula aid and rising costs. The bridge funding legislation (HB684 of 2017) required that \$10 million of that commitment be a permanent increase beyond the three-year period. The remaining aid was provided by the City in the form of in-kind services for school health and risk management. In Fiscal 2020, the final year of the formal agreement, the City is providing a total of \$38 million above baseline including \$13 million of cash and \$25 million of in-kind services. The in-kind services were funded from Fund Balance reserves, and the City does not have a recurring source of funding to continue them.

To summarize, in thirteen of the last twenty fiscal years, City contributions have exceeded the MOE funding formula requirement, some per State mandates but most via voluntary City contributions. In

Fiscal 2020, the City is providing \$89.8 million more annually than was required by the State's MOE funding formula.

### ***Peer Jurisdiction Comparison***

Charts that reflect education spending as a percentage of the City's operating budget as compared to other jurisdictions often fail to tell the entire story due to differences in the compared data. There are four key differences that make these comparisons problematic and confusing:

1. Baltimore City's budget only includes the City's contribution to City Schools, whereas the budgets of many other counties include the entire school district budget including local, State, and federal sources.
2. The City is unique among Maryland jurisdictions in that Baltimore is responsible for the maintenance of all roads (excluding interstate highways) within City limits. In turn, the City's operating budget reflects \$143.3 million of transportation-related spending from State Highway User Revenues (HUR).
3. The City budgets for solid waste collection and disposal costs in its General Fund, whereas many other counties have created a separate fee-based entity or enterprise fund for this purpose.
4. The City is much more reliant on grant funding than other counties for services such as employment development, health services, and homeless services, among others. Those funds are not discretionary and cannot be used for education but are still included in the City's operating budget. Each of these factors leads to inaccurate assumptions when comparing the City's budget and contributions with other Maryland jurisdictions.

The better comparison is to look at a school district's budget and analyze the split of funding between local, State, and other sources. The Maryland Department of Legislative Service provides this comparison in their annual "Overview of Local Government Finances." In Fiscal 2019, Baltimore City Public Schools' funding was split between City (21.7%), State (69.9%), and federal (8.5%) sources. These ratios are not unusual and are similar to other lower-wealth counties such as Allegany, Wicomico, Somerset, and Caroline.

In summary, the City has provided strong operating support for City Schools, always meeting and often exceeding statutory requirements, even in the context of Baltimore's weak tax base. Baltimore is not an outlier in contributing to its school system when compared to other low-wealth jurisdictions.

### **Capital Support**

Unlike operating support, State funding for school construction is not wealth equalized. This means that lower-wealth jurisdictions do not receive a greater share of these State funds based on need or building condition. Additionally, many wealthier counties have chosen to aggressively supplement State construction funding with their own local contributions. Baltimore City has not had the fiscal capacity to keep pace on these investments.

One historical reason for this imbalance is the State's decision during the Great Recession to divert money from the Transportation Trust Fund to the State's own General Fund, and away from local jurisdictions. Baltimore was crushed by this action and has not recovered. At its peak in Fiscal 2007, the City received

\$227.3 million of Highway User Revenue (HUR) and used \$73.4 million for local transportation capital projects. In Fiscal 2020, the City received only \$157.4 million of HUR, most of which supported operating costs, leaving only \$14.1 million for capital projects. In turn, increasing pressure was placed on the City's own General Obligation (GO) Bond capacity and County Transportation Bond programs, both of which lead to debt service costs that are the City's responsibility. City Schools competes for limited funding against a variety of other pressing City needs for capital funds, including transportation, economic development, housing, City buildings and facilities, and IT modernization. In Fiscal 2020, the City allocated \$19 million of its \$80 million GO Bond allocation for City Schools.

Recognizing the need for dedicated investment, the State passed legislation in 2013 for the 21st Century Schools construction program, which leverages the bonding authority of the Maryland Stadium Authority to borrow over \$1 billion for school modernization projects in Baltimore City. The intent of the program was for three parties - the City, the State of Maryland, and Baltimore City Schools – to each contribute one-third of the debt service costs, expected to be \$20 million annually. In the Memorandum of Understanding between the three parties, the City dedicated three revenue sources for this purpose: the Beverage Container Tax, 10% of Horseshoe Casino lease revenues, and 50% of Casino Table Games proceeds.

Over the first five years of the program, from Fiscal 2014 to Fiscal 2018, the City exceeded its required contribution each year. Meanwhile, City Schools was waived from its payments and made no contributions in Fiscal 2014, Fiscal 2015, and Fiscal 2016. Additionally, the State waived its own contribution in Fiscal 2014 and Fiscal 2015. The net result is that, through Fiscal 2018 the City has made \$33 million of contributions above the required amount, and has contributed 56% of the total funds for the 21st Century Schools Program.

Looking ahead, House Bill 1 and Senate Bill 1 – the Built to Learn Act – have been pre-filed in the General Assembly for consideration during the 2020 legislative session. These bills are modeled on legislation that passed the House of Delegates during the 2019 session (House Bill 727). The 2019 legislation would have dedicated a portion of the State's Education Trust Fund revenue to back bonds for school construction projects across the state, to be managed by the Maryland Stadium Authority. Funding for local projects would be subject to the same cost share requirements as the existing State school construction program. Under the bill, Baltimore could receive up to \$400 million in additional school construction dollars, but would require a match of \$39 million above and beyond what the City contributes under the existing program.

### **Kirwan Commission**

As of November 2019, the Kirwan Commission completed its study of how to improve the State's education system, endorsing and publicizing the county-by-county costs that will be required to implement the recommendations. The initial numbers for Baltimore City are staggering. The City would be asked to contribute an additional \$138 million above current MOE levels in Fiscal 2022, which would grow to an additional \$329 million by Fiscal 2030. Adjusted for inflation, the Fiscal 2030 requirement is \$266 million in Fiscal 2020 terms. ***That means the City would need to make the equivalent of a \$266 million annual cut to its current budget over a ten-period, with \$138 million required in the first year in Fiscal 2022.*** The Commission's recommendations are expected to be considered and debated by the General Assembly during the 2020 session.

## **Financial Readiness**

This Council bill specifically asked for the Department of Finance's thoughts on the City's readiness for Kirwan. Our perspective is as follows:

Over the last three fiscal years, Kirwan has been the backdrop for every financial decision the City has made. The Department of Finance has consistently urged the Mayor, City Council, and operating agencies to avoid any new recurring cost commitments in the lead-up to the Kirwan Commission recommendations. In the Fiscal 2019 and Fiscal 2020 budgets, rather than create new recurring commitments, we successfully directed most surplus revenues to a backlog of one-time capital needs, such as IT systems modernization, Police technology upgrades mandated by the consent decree, public markets, recreation, transportation projects, and City building upgrades.

For the Fiscal 2021 budget planning process, agencies have been advised to rank services in order of importance and develop a list of budget reductions, totaling a 5% reduction that could be implemented over a two-year period. This planning exercise will help the Mayor and Senior Staff to begin contemplating potential service reductions and their impact. Concurrently, Finance has been working on refreshing its 10-Year Financial Plan, which will include additional savings ideas, such as revenue enhancements, service efficiencies and/or reductions, employee benefit changes, and other financial reforms.

Finance will be prepared with options, but we would caution that just having a list of options does not make them easy to implement or any less painful. Many savings options will encounter strong resistance from numerous stakeholders including unions, residents, advocates, businesses, City employees and retirees, and City agencies, among others. Some options will require City Council or State legislative approval, while others may require changes to collective bargaining agreements that must be negotiated. ***Achieving savings totaling \$266 million is an enormous cost that represents over 24% of the City's entire discretionary General Fund operating budget.***

Further, we must remember that Baltimore is still in a tenuous financial position, with crumbling infrastructure, high service demands, and a low tax base. The national economy has likely peaked after a decade-long expansion which makes a recession likely in the near future. And, tax rates are already the highest in the State, which serve as a barrier to attracting new investment and limit the City's options for generating more revenue. A new financial mandate of this magnitude poses a significant risk to the City's financial position and in its ability to deliver core services to its citizens.

The Department of Finance supports this resolution and we look forward to sharing our perspective at the hearing for City Council Bill 19-0162R.

cc: Henry Raymond  
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