Navigating Through the Financial Impacts of the Covid-19 Pandemic

By Karen Dojan, CPA, Principal, Weyrich, Cronin, Sorra

As Marylanders brace for the "second wave" of the novel coronavirus COVID-19, members of the Maryland Municipal League (MML) are also bracing for the financial turmoil the pandemic will be causing for the next several years.

In March 2020, actions by Maryland's Governor Larry Hogan in response to COVID-19 brought about fundamental changes to how Marylanders live and work. The closure of all non-essential businesses on March 23rd was probably the most impactful order issued, as it closed numerous businesses and caused Maryland's unemployment claims to skyrocket. Initial unemployment claims which had been reported at approximately 2,000 for the first week in March jumped to over 108,000 the first week in April, leading to an overall unemployment rate of near 10% throughout the State for most of the spring.

In addition, as traditional office occupations suddenly were forced to pivot to telework, highways and roads which had been packed with commuters every day were suddenly free flowing. Some municipal offices were closed to the public and non-essential employees and moved to telework options if possible, as well. Town Halls, once a bustling center for many local communities, were suddenly quiet. And public meetings, a staple of our local government democracy, were suddenly shifted to "Zoom" or teleconferences.

Today, some operations have returned to a semblance of normalcy, but many of the fundamental changes brought about by COVID-19 will have far reaching effects on the MML's members. Most municipalities were in the process of beginning their annual budget when the government closures first began. Budgets which may have seemed optimistic in the early stages suddenly faced uncertainty. This was fueled by comments from the Comptroller of Maryland, Peter Franchot, on May 14, 2020 describing "…a snapshot of an economic nightmare" when laying out the projected budget shortfalls for fiscal 2020, 2021 and 2022 to the Maryland Board of Revenue Estimates. Major uncertainty surrounded budget estimates for various General Fund revenue sources including local income tax receipts, property tax collections, Highway User Revenues, and various State of Maryland grant programs such as State Aid for Police Protection and Program Open Space.

Fortunately, the State and most local municipalities have been able to hold their own for the time being. Federal funding from the Coronavirus Relief Fund (CRF), provided by the Coronavirus Aid, Relief, and Economic Security (CARES) Act have provided more than $2.3 billion in direct funding to the State of Maryland, its counties, and local governments with a population of greater than 500,000. Some of these larger governments have also passed assistance through to local jurisdictions in the way of grants for COVID-19 related expenses such as the acquisition of personal protective equipment (PPE), increased sanitation costs for municipal buildings, telework and teleconference technology, and other expenditures directly related to management of the pandemic. However, funds cannot be utilized to make up for lost revenues or collections related to the pandemic.

the overall job market and employment rates. Income taxes are currently maintaining projected levels, bolstered by enhanced Federal unemployment benefits and extended benefit periods. However, long-term unemployment beyond the extended benefit period

COVID-19 has already caused a disruption to general economic conditions. But with so much uncertainty related to the "second wave" and development of a widely available vaccine, economic volatility will be with us for at least the current if not subsequent fiscal years.

Future Uncertainty

Future economic uncertainty still remains, though. As we begin a new fiscal year, budgets have been enacted based on each municipality's best efforts to determine the future. But several unknowns remain.

Property tax revenues are a major source of general funding for almost every municipality with taxes based on State assessed values. Currently, bolstered by historically low interest rates, the housing market is very strong and assessed values remain high. However, should any disruption in the housing market occur such as sustained unemployment, a rise in foreclosures, or rising interest rates, assessed values could fall as they did during the Great Recession in 2008. This would lead to reduced values and a lower overall revenue source for years to come.

Local allocation of income taxes, another major source of general funding, is based on an area's employment rates. Yet uncertainties remain as to

may lead to lower revenues in future quarters.

An overall weakening of the job market and employment rates will also have an impact on collection efforts for many municipalities. Numerous municipalities are responsible for providing utility (i.e., water, sewage, electricity) and sanitation services for their residents. Prolonged unemployment and an overall lagging economy may impact the receipt of payments. Customers who once made timely payments may fall behind in their obligations. This can cause significant disruption to needed cash flow, as primary contractors and employees will continue to require timely payment from the municipality.

As seen in prior times of uncertainty, other reductions may occur in housing developments and permit fees, admission and amusement taxes, Highway User Revenues and availability of grant funds.

A Call to Action

The first step is to recognize that we are in an unprecedented situation.

Leadership in a time of crisis requires early recognition of risk and thoughtful planning to mitigate that risk to the best of your ability. Reaction to events as they unfold is never a plan and will almost always lead to unintended consequences.

Now is the time for municipal officials to assess their government's current economic health. Establishment of a task force, including elected officials and key management personnel, which will review the current state of the municipal finances and forces that may impact current and future revenues and expenditures is key. This focus should not only be on the near term (the next six months), but the potential long-term impact which this crisis may impose.

Once the task force has been established, an overall analysis should begin with currently available reserves (unassigned fund balance) and available cash. This initial analysis will also include a review of projected budget performances, projected revenue streams, and an analysis of current expenditure levels.

Ensuring that your government has available cash flows to meet current required spending levels is also crucial. Will you be able to meet your obligations to provide essential services? What about unforeseen expenditures such as a major water main break, road repair or natural disaster? How could a delayed revenue stream impact your cash position? Be creative and look for the "what ifs" to prepare for the unexpected.

A key budgeting tool may be the inclusion of a "contingency" line item in your budget since no one knows what the future will hold. Typically, construction projects utilize a 5 to 10 percent contingency for the unknown which almost always occurs. This may be a good benchmark for your municipality to consider. The contingency could cover such items as additional costs related to sanitation of your municipal facilities, personnel coverage for key positions in the event of a prolonged illness, increased employee benefit costs, etc.

As part of your analysis, consider the timing of major capital expenditures. Will you need these funds to meet current needs? Should you consider additional debt at current low interest rates to fund capital projects to ensure future cash reserves? Can a major project be deferred until the current uncertainty is resolved?

Once you have assessed your current needs, look at what the future recovery periods may hold. Consider the possibility that revenue streams from major sources may be impacted. As discussed earlier, property and income taxes may be adversely affected if the general economy is slow to recover. What reserves may you need to fund future budget shortfalls in the coming years? And how may this impact future plans for deferred maintenance.

To date, the Federal government has focused on assistance to the American worker and small business through increased unemployment benefits, Payroll Protection Program loans, and direct stimulus payments. The $2 trillion CARES Act provided only $2.3 billion dollars in direct funding to states and local governments, or 1/10th of a percent of the entire funding package. Local governments are on the front line of the pandemic, and may well need assistance to combat projected revenue shortfalls. Municipal officials should communicate with their Federal counterparts in Congress to make sure that they are aware of the challenges you are facing through lost revenues. Encourage future funding packages to include funds for local municipalities to not only cover increased expenses, but also revenue shortfalls. This is especially important where revenues have been impacted by reduced user fees for revenue streams such as parking facilities, hotel/motel taxes, recreation charges, etc. that your municipality may rely on to provide general funding and employment.

Communication is Key

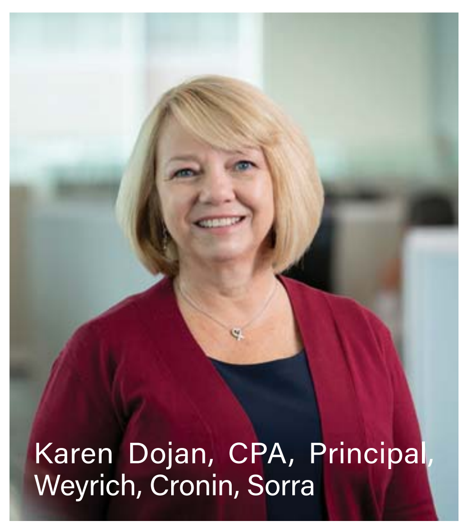
Collaboration by all key members of management and governance will provide additional perspectives to the process. Employees who are involved in the day to day operations of the municipality are key to knowing where potential cost savings can be found, and what costs are necessary to meet federal and state COVID-19 mandates. They will also be able to provide perspective on proposed operational cutbacks that may be considered in the short term, but may ultimately end up being detrimental in the long run.

Throughout the process, keep the public informed. Most people, when asked what they want in times of uncertainty want honest communication from their leaders. Knowing that their local leaders are aware of the situation and are proactively preparing for what is and may yet occur can promote a sense of well-being in your community. This will also promote buy-in from the public should difficult choices, such as an increase in property tax rates, additional fees, or reduced services, need to be made. Transparency during the process is key to promoting support if difficult choices are required to address future budget shortfalls.

Leadership in Time of Uncertainty

The COVID-19 pandemic has revealed the necessity for strong, effective leadership, especially at the local level. Municipal leaders must bear the burden of balancing current needs against the future well-being of the community. This balancing act requires the ability to see beyond the immediate need or the easy choice. Those who are perceived as great leaders have the ability to adapt to what is required to remain effective for the good of all.

It is typically the leadership at the local level which is most crucial in times of adversity. Local officials are the ones closest to and most well-known to the people and businesses affected, and therefore looked to first for guidance and answers. Federal or State officials rarely know personally how the individual is affected, but the Mayor and the Council Member sure do. Maryland's municipal officials have stepped up in this time of crisis, showing their resilience in these times of uncertainty. Grass roots leadership will guide us through these times, and local officials have proven that they are here to lead!


Karen Dojan, CPA, Principal, Weyrich, Cronin, Sorra