

Memorandum

To: The Mohnton Borough Council and Mayor

From: Paul Janssen, Director, the Center for Excellence in Local Government (CELG) at Albright College

Re: Review of the Mohnton Borough General Fund Budget

Date: February 9, 2022

On January 21, 2022, Mohnton Borough executed a contract with the Center for Excellence in Local Government to provide services through the Municipal Financial Stabilization Program funded by the Berks County Commissioners and the Berks County Community Development Office. As the title indicates, the program was designed to assist municipalities in Berks County through CELG in achieving financial stability especially during the COVID pandemic. CELG is currently under contract with seven different entities (Boroughs of West Reading, Mt. Penn, Womelsdorf, Bernville, Antietam Valley Municipal Authority, and the Central Berks Regional Police Department) in addition to Mohnton in Berks County. The services focus on budget development and projecting a long term budget for effective planning, opportunities for inter government cooperation for enhanced services, Effective policies and procedures for GAAP accounting standards for handling Borough finances, and reviewing policies and procedures for enhanced revenues and cost containment strategies.

Tonight the focus is on the immediate finances for the Borough in the General Fund as this is the operating fund for the Borough, All administrative, codes, police, and most public works funding for Borough operations come from the General Fund. In addition, all other funds for the Borough are special use funds with dedicated funding sources generated for those project and expense uses.

While the 2022 General Fund Budget is the current focus of the budget review, after the meeting tonight CELG, will embark on a complete reconstruction of the General Fund and all of the numerous special use funds, including the Sewer Fund, Liquid Fuels, the Fire Fund, the MS(4) fund, and the Capital Fund.

It is the General Fund which has the current focus as Borough Code provides for what is called a budget reopener following a municipal election. The purpose of the reopener is to adjust property taxes if the new Borough Council believes that the adopted budget in place for that year has issues which require attention. That, in fact, is the case for the current Mohnton Borough Council.

None of the special use funds have the current demand for review as the revenues are already set and allow for review in the next stage of the budget work.

In order to fully understand the current status of the 2022 General Fund budget a review of the previous three years of budgets needs to be completed both for revenues and expenses.

During the past two weeks the 2019-2021 budgets were reconstructed and verified through audit work and trial balance reports. Special thanks goes to Roxanne N. McMurtry, CPA, Senior Manager, of Herbien & Company your appointed auditor for supporting and verifying the reconstructed report. All of the funds reported in the spreadsheet which we will be viewing tonight were developed with the Borough Trial Balance reports from 2019 – 2021 and the actual Borough Audits. Both Ms. McMurtry and I have reviewed the documentation and have verified the spreadsheet. While the 2021 audit is not complete, the pre-audit work was completed in November, 2021 and the trial balance has been reviewed and verified.

The report tonight is a factual presentation of the current status of the Mohnton Borough General Fund. Issues as to why and how decisions were made are not part of the report. The purpose of the reopener is to adjust property taxes if the new Borough Council believes that the adopted budget in place for that year has issues which require attention. That in fact is the case for the current Mohnton Borough Council. I will be happy to take questions but the report speaks for itself. The rationale for when and why the decisions were made are for Borough Council, Mayor and you the citizens of Mohnton Borough to decide.

Before the review of individual accounts occurs we need to review the trends in the fund balance with the General Fund. General Fund balances are typically recommended to be at least 25% of expenses due to a number of reasons:

First, most municipal revenues are delayed in the beginning of the fiscal year (January) due to the issuance of the property tax bills which are not even mailed until mid-February and are received in April of each calendar year. The property tax in Mohnton accounts for over 33% of General Fund revenues. Operational expenses are fairly regular so the need for revenues to handle expenses from January until May each year requires reserves.

Second, the recession of 2008 is a testament to the impact economic conditions can have on a municipality. Across the board, the earned income tax, the transfer tax, and even the property taxes were severely impacted. Many municipalities were forced into double digit tax increases and layoffs they did not have adequate reserves to weather the revenue reductions.

Third, unexpected events and emergencies force municipalities into unbudgeted expenses as they react to unexpected issues. Reserves give them the financial independence to make those decisions.

A quick look at the Borough of Mohnton General Fund balances each year show a wide variance between budget projections and actual performance.

The 2019 budget began with a balance of \$ 415,641.00 or 24% of the budgeted expenses of \$ 1,705,644.00. Unfortunately the budget was adopted with a deficit of \$127,500.00. The actual performance of the budget continued to produce a deficit of \$109,364.17. This deficit reduced the fund balance to only \$ 241,876.83 or 18% of the 2020 budget.

The 2020 budget began with budgeted revenues of \$ 1,608,044.00 and budgeted expenses of \$ 1,672,444.00 which results in a \$64,000 deficit. The actual performance of the budget however had expenses of only \$1,317,928.00 and resulted in a surplus of \$ 271,881.00 and restored the fund balance

of \$ 578,157.83 and 35% of the 2021 budget. The surplus was generated by reducing expenses by \$ 354,516.00 or 27%. Revenues were actually almost \$20,000 below budget. Of course, if you spend almost 27% under your budget it raises the question of whether the full expense budget is actually needed or did the Borough Council simply defer decisions that they could just to restore the fund balance. Hindsight is 20/20 however, the fund balance was restored to a safe level of 35% of the 2021 Budget.

The 2021 budget began with budgeted revenues of \$ 1,791,100.00 and budgeted expenses of \$ 1,647,187.00 which results in \$ 143,913.00 surplus raising the projected fund balance to \$ 722,070.83 or 44% of the budgeted expenses. Very robust!

The actual performance of the 2021 budget is very different. The Borough Council listed the ARPA Grant from Congress as a 2021 budget line item even though it wasn't even announced until April 2021 and received in July of 2021. Revenues out performed the budget projection by \$ 46,962.97 due almost exclusively to the Earned Income Tax and Transfer Tax outperforming the budget projection by over \$100,000.00.

It is on the expense side where the performance of the budget bears little resemblance to the actual decisions made during the year. The adopted Budget had expenses of \$ 1,647,187.00 however, the actual expenses ended the year at \$ 2,143,751.49 almost \$500,000.00 over budget. That caused a budget deficit of \$ 305,688.52 and reduces the Borough's fund balance to \$ 272,469.31 or 18% of the previous Borough Council's adopted 2022 General Fund balance. To make matters worse the 2022 adopted budget includes a deficit of \$ 57,822.17 further reducing the 2023 projected fund balance to \$ 214,647.14 or only 11% of the current year's operating budget.

A part of the work that the Center for Excellence in Local Government is providing is a detailed reconstruction of the revenues and expenses which have impacted the 2021 budget. CELG is also provide a detailed recommendation for a revised 2022 General Fund budget accurately reflecting the revenues and expenses detailed therein.

If the current proposed tax increase is not implemented, the Borough will face a cash flow problem in the first quarter of 2023 or Council will be forced to dramatically cut services to restore the fund balance to at least a minimum level of 20%. At best the Borough Council will be facing both budget cuts and the tax increase to simply build the fund balance back to 20% or \$375,000.

One comment that has been made about the Boroughs financial position is there are multiple accounts which have funds. The concern about this statement is why have these funds been accumulated. Was there a fiduciary requirement for the funds or was the Council simply generating fund balances. There are two (among all others) accounts which will be examined in the next round of work which have significant funds. The first is the sewer fund which each resident of the Borough who has public sewer pays into and is for the direct and specific purpose of maintaining the collection and treatment process of the Borough. The second fund is the MS(4) fund which has been developed to finance the DEP mandated projects to meet EPA required storm water effluent quality projects.

What are some of the decisions which have placed the Borough in its current position?

Revenues

1. Property tax revenues have routinely been over budgeted by at least \$30,000. A simple look back at previous budgets would cause a reduction in the account.
2. Real Estate Transfer Taxes have been underestimated as they should be as reliance on housing and property sales can be devastating in a recession when they cease.
3. Earned Income Taxes again were overestimated in 2019 and 2020, then reduced in 2021 when the tax generated additional funds. The 2022 budget is underestimated given the inflation which has been forecast since last fall.
4. The American Rescue Plan funds are a two year grant which normally would have added almost \$316,000 for long term financial stability for the Borough. Unfortunately the 2021 grant has been spent and there is still a budget deficit and the 2022 grant only minimizes the losses in 2022.
5. The next area of review is the Refuse Revenues and expenses. There was a minimal surplus in revenue and expenses in the fund in 2019, however since then the service has had losses of over 17,000 in 2020, in 2021 and projected to be a loss of over \$72,000 in 2022, utilizing historical data. That \$72,000 is not included in the budget projections for 2022. CELG will conduct an in depth analysis and recommendation for stabilizing this fund. Again there was no historical look back at the performance of the fund. Also of concern is that there are no current records (2021) of any delinquent collection although there is an indication the firm of Portnoff & Associates has over \$200,000 in unpaid bills since 2017 which it is pursuing. CELG will perform a detailed review of this area of revenue and expenses.

Expenses

1. The Secretary/Treasurer compensation has routinely been underestimated by 5k-7k annually, however in 2021 the compensation paid was almost \$18,000 above budget. Typical budget controls would require either a formal approved personnel policy with a Borough Council vote, or a budget amendment approved by Borough Council to record the excess expenditures.
2. There were repairs to the park of almost \$23,000 which were over 500% of the approved budget. Again a budget amendment would have memorialized the expense.
3. The 2022 budget for the Police Department had to be recreated based on the 2021 documented expenses as the prior Council simply put a lump sum budget for police expenses, salaries, payroll taxes and insurances. This will be verified in the next budget review.
4. The prior Borough Council spent **\$ 241,970.34** to buyout the lease for a fire truck which was financed at 3.84% from 2015 through 2030. The payment was made in 2021 and records are clear that it was an unbudgeted expense. Further, the Council had already spent over \$72,409.66 in interest in the first six years to then save 47,215.84 over the final nine years. Additionally, they did not even lower the fire tax which was collected for the express purpose of supporting the fire company and paying this annual payment of

\$31,304.36. The \$241,970.34 came directly out of the General Fund and was unbudgeted and was a major contributor to the \$300,000 plus budget deficit.

5. The next issue of real concern is the portion of the budget which deals with refuse. I have broken out the refuse revenues and the refuse expenses so that we can easily follow the issue. Revenues are under projections in 2019 by \$10,000 and expenses were over budget by 14,000 resulting in an overall surplus of \$15,000. In 2020 however, revenues were \$27,000 under projections and \$27,000 over expenses resulting in deficit of over \$17,000. 2021 experienced revenues under projections of \$67,000 and expenses over budget of \$45,000 creating a deficit of almost \$60,000, also a large part of the deficit in 2021. Even more disconcerting is the same over budgeting of revenues and under budgeting of expenses occurred in 2022. The budget projection is a \$24,308 surplus which is unsupportable with a simple review of the past 3 years. The actual projection is for another deficit of \$72,000 which is not part of the budget analysis above. The only opportunity to impact this performance is the fact that Portnoff and Associates is pursuing delinquent tax bills of over \$153,000 developed since 2017 a reportedly given to them to collect in 2021. Unfortunately, experience dictates that the collection process typically takes a couple of years to return dividends. The trash fee deficit will need to be revisited this year once we have a solid understanding of the performance of collections and justification of the expenses.
6. The final issue contributing to the budget issues the current council is facing was the decision to purchase a new street sweeper for the public work operation. Again this was an unbudgeted expense of 239,601.12. There are many issues which create a real problem with this decision. The decision to purchase to purchase the sweeper was made after the decision to buy out the fire truck lease. Even if you accept the ARP funds receipt the Council spent \$481,571.46 on two pieces of equipment which will be in operation in the Borough for the next 15-20 years. The ARP funds will only offset the expense by \$315,892. In addition the Borough Council paid of the truck with a final check dated in December 2021, almost 30 days before the sweeper was delivered. Also this type of sweeper does a great job but is maintenance dependent, The Council did not even provide a budget for its maintenance. Annual operational maintenance will require a budget of \$7,000 to \$15,000 annually to service the broom brushes, vacuums, two engines, and the hydraulics. Finally the department only has 3 three employees and will lose one anytime the sweeper is in operation and only one employee should operate the vehicle due to the training and responsibility for proper operations.

In summary, this is going to be a daunting task for Borough Council to stabilize the finances and will probably require two very lean years of operations. Even with the Tax increase the budget surplus is only projected to be \$63,000 and without significant delinquent refuse collections or a rate increase the surplus could shrink to a minor gain or even another overall deficit.