S&P Global
Ratings

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Summary:

Scranton, Pennsylvania; General Obligation

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Summary:

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Credit Profile		
Scranton gtd lse rev bnds ser 2016AA due 05/15/2036		
Long Term Rating	BBB-/Positive	Upgraded, Removed from CreditWatch
Scranton gtd lse rev bnds ser 2016 A due 12/01/2026		
Long Term Rating	BBB-/Positive	Upgraded, Removed from CreditWatch

Credit Highlights

- S&P Global Ratings raised its rating to 'BBB-' from 'BB+' on Scranton, Pa.'s general obligation (GO) debt and removed the rating from CreditWatch with negative implications, where it was placed on March 13, 2023, following our receipt and review of financial information, including 2021 audited financial statements.
- The outlook is positive.
- The upgrade to 'BBB-' reflects the city's continued improvement in its liquidity position and balanced financial operations, without reliance on federal stimulus.
- The positive outlook reflects our expectation that we could raise the rating in the next two years if the city's reserve and liquidity position continues to improve, decreasing the need for cash flow borrowing, while maintaining structural balance.

Security

The city's series 2016 and 2017 GO debt is secured by its full-faith-and-credit pledge. The city's series 2016A and AA (taxable) guaranteed lease revenue bonds, issued by the Redevelopment Authority of the City of Scranton, are secured by a pledge of payments from the city pursuant to the sublease and guaranty agreement between the authority and the city. The sublease constitutes a GO of the city and the full-faith-and-credit and taxing power is pledged for debt service. The city may levy ad valorem tax without limit to rate or amount on all taxable property within its borders.

Credit overview

The upgrade reflects the city's improved cash position and ability to maintain balanced operations without federal stimulus. The city allocated a small portion of the $68 million in American Rescue Plan Act (ARPA) funding toward revenue replacement in 2022, but due to stronger than budgeted revenue growth, the city did not use any ARPA funds for operations, and most of the funds will go toward one-time projects. Management estimates 2022 closed with a $4.1 million (3.8%) general fund surplus. The 2023 budget is break-even, and again includes a small amount of ARPA funding, but management expects it will not need to utilize the ARPA funds for revenue replacement as revenue continues to outpace budget.

Scranton exited the Commonwealth's Act 47 program in January 2022, after having adopted measures to address legacy costs related to pensions, health care, wages, and debt service, putting it on a path toward fiscal stability. While the city's financial and debt profiles have improved significantly, we believe Scranton's lower wealth and income ratios, coupled with high fixed costs, will remain credit pressures. If, over the next two years, the city continues to demonstrate structural balance and improve its liquidity position, eliminating the need for cash flow borrowing, we would likely raise the rating. Over the longer term, further upward rating potential is possible if the city's pension and other postemployment benefits (OPEB) liability improves and it addresses its high fixed costs.

The rating further reflects our opinion of the city's:

- Very low wealth and income levels, which have made it difficult for the city to generate revenue and have spurred high delinquency rates during past recessions;
- Standard financial policies and practices and a strong institutional framework score, but overall weak management score due to the city's very high fixed costs;
- Structurally balanced financial performance and improving reserve and liquidity position; and
- Very weak debt and liability profile, with a large overall net debt burden relative to its tax base and very high fixed costs related to pensions and OPEB.
- The city has engaged a new auditor for its 2022 financial statements, and expects these statements to be released on a timelier basis, with a target of early fall 2023. Upward rating potential may be limited, if audited financial statements continue to be delayed.

Environmental, social, and governance

We view social capital risks as a negative consideration in our credit analysis because the city's weak sociodemographic profile has inhibited its ability to collect revenue and may cause greater demand for services in the future. We view the city's governance and environmental risks as neutral in our credit analysis, though we note that the city is addressing environmental risks and is working toward adopting a sustainability and climate action plan.

Outlook

The positive outlook reflects there is a one-in-three chance that we could raise the city's rating over the next two years.

Downside scenario

If the city's general fund operations become imbalanced or if our understanding of the city's financial position is limited because of material delays in providing audited information, we could revise the outlook to stable or take downward rating action.

Upside scenario

If the city can continue to improve its liquidity position, decrease its reliance on cash flow borrowing, maintain structural balance without reliance on one-time revenue, and provide timely audited financial information, we could raise the rating.

Credit Opinion

Very weak economic base has posed challenges to revenue generation but shows signs of improvement

Scranton, the county seat for Lackawanna County, has experienced very little assessed value (AV) growth over the last 20 years, due to both a stagnant economy and the absence of reevaluations of properties. Lackawanna County recently embarked on its first comprehensive reassessment since 1968, but the county does not expect new valuations to go into effect until Jan. 1, 2026. Pennsylvania requires revenue neutrality following a reassessment, so we do not expect the city's property tax revenue to change materially; however, it will likely need to plan for a higher level of appeals. The city has very weak wealth and income metrics, which has resulted in a high level of tax delinquencies in the past. Favorably, management reports that tax collections are improving, as Scranton has changed some of its collection methods and economic conditions improve. Current-year property tax collections are around 89%.

The county's primary industries include manufacturing, education, and health care. While manufacturing has been waning over the last 20 years, the local services sector has remained steady. The metro area has above-average concentrations of employment in hospitals, nursing homes, and social services organizations. The city has seen some momentum in new residents moving to the city in search of greater affordability. Officials report continued development in downtown, bolstered by state and local investments and small business loans. There is also some longer-term upside potential as Amtrak and the Pennsylvania Northeast Regional Railroad Authority explore potential rail service between Scranton and New York City. Despite recent developments, given the city's weak wealth and income levels, we expect our assessment of the local economy to remain very weak.

Standard policies and practices, but weak management assessment due to its very high debt, pension, and OPEB burden

We view the city's management as weak because of its sizable fixed costs (debt, pensions, and retiree health care), which represented 35.8% of total governmental expenditures in 2021. Should these costs come down as the city debt is retired and pension reforms improve annual required costs, our assessment could also improve.

Key financial policies and practices include:

- Monthly budget-to-actual reports presented to the city council and regular budget adjustments;
- A five-year, rolling capital projects list that identifies projects, costs, and funding sources;
- An investment policy that aligns with state statutes and Government Finance Officers Association (GFOA) best practices and requires monthly reports on investments, but the city has not begun its monthly reporting because it does not have investments beyond cash in checking accounts;
- A policy that sets a target unassigned general fund balance of 8% of the upcoming year's expenditures and a minimum of 3%, with a replenishment mechanism;
- A debt policy, adopted in September 2022, that includes affordability metrics such as limiting general fund-supported debt service to 10% of expenditures, targets no less than 60% of par amortized in 10 years, limits variable-rate debt to 15% of debt outstanding, and prohibits derivatives; and
- No long-term financial planning.

Surplus projected for 2022, break-even budget in 2023, and improving reserve and liquidity position

After adjustments for significant one-time expenditures and transfers related to the sale of the Scranton Sewer Authority and funding its pension plans, the city achieved general fund surpluses of 1% to 6% in the last three audited fiscal years (2019-2021) due to conservative budgeting and to cost reductions put in place as part of the city's Act 47 Exit Plan. Preliminary 2022 results indicate the year closed with a 3.8% surplus. The original 2022 budget included $4 million of ARPA funds to be used for revenue replacement; however, due to stronger than budgeted tax revenue, the city did not use any ARPA funds toward general operating expenses, which we view as a credit positive. Still, these stimulus funds may offset some capital spending that might have come out of the general fund or would have been deferred.

The 2023 general fund budget is break-even, inclusive of $2.3 million of ARPA for revenue replacement; however, management expects it will not need to use any ARPA funds for operations as revenues are trending better than budget. The 2023 budget assumes a 5% increase in total general fund revenue over the 2022 budget, mostly due to increases in earned income tax revenue and intergovernmental reimbursements related to grants. We view the city's revenue assumptions as reasonable, and the city's year-to-date estimates show the city meeting their estimates in their largest revenue streams, which include Act 511 taxes (37.5% of budgeted revenue), real estate taxes (33%), and landfill fees (7%). Budgeted 2023 expenditures also increased by 5% over the 2022 budget, with the largest increase in public works administration. The city recently settled its firefighters' union contract through 2026, with annual increases that we believe the city can absorb into its budget. Its clerical and public works unions are under active contract, but the city's police contract is in the arbitration process. We will be watching how the city is able to contain costs, given the pressures of inflation and a tight labor market. Additionally, we believe that the city's capacity to cut spending is somewhat limited due to its high fixed costs.

With a $4 million surplus in 2022, the city expects its total general fund balance to increase to $26.2 million (24% of estimated expenditures). However, the city still has a high level of general fund receivables, which, in our opinion, overstates reserves. In 2021, the general fund reported receivables of $16.7 million for real estate taxes and $7 million for garbage fees. These receivables are offset by $13.3 million of unavailable revenue; however, $10.4 million of receivables have no offset on the balance sheet. We adjusted our 2021 available general fund reserves by this amount, as we believe this more accurately reflects the city's available reserve position.

Scranton typically issues tax revenue anticipation notes (TRANs) each year for cash flow purposes. It issued $4.9 million in January 2023, which was $5.1 million less than in 2022, reflecting continued improvement in the city's cash position. The city pays down its TRANs monthly, and is projected to pay down the 2023 notes by June or July this year, well before the final maturity date of Dec. 31, 2023. Due to the city's improved financial performance, we now view its liquidity position as very strong.

Very weak but improving debt and contingent liability profile

Although Scranton's debt and contingent liability profile remains very weak, it continues to improve from previous years, due largely to management reducing debt and refinancing variable-rate debt into fixed-rate. Still, the city's overall liability remains very high relative to its tax base, at 20.3% of market value. Amortization of its approximately $76.4 million of net direct debt is rapid, with 100% of par scheduled to be retired in the next 10 years. Due to above-average amortization and limited additional debt plans, we expect annual debt costs will likely continue to decrease and contribute to an improving debt profile.

Scranton's series 2021 GO bonds were privately placed with M&T Bank, but we do not view this as a contingent liquidity risk. The city no longer has any variable-rate debt outstanding.

Pension and other postemployment benefits:

As part of its Act 47 Exit Plan, the city implemented corrective measures to reduce its unfunded pension liabilities, including freezing pension cost of living adjustments (COLAs) and increasing employee contributions, resulting in improved funded ratios and lower actuarially determined contributions; however, the unfunded liabilities remain large, and contributions still make up a significant portion of the budget.

OPEB liabilities are very high and are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, is likely to lead to escalating costs.

Scranton participated in the following plans as of Dec. 31, 2021:

- Scranton Fireman Pension Plan: 61.6% funded, with a net pension liability (NPL) of $34.6 million;
- Scranton Police Pension Plan: 83.4% funded, with an NPL of $14.4 million;
- Scranton Non-Uniformed Pension Plan: 84.4% funded, with an NPL of $1.7 million;
- Scranton Fireman OPEB Plan: 0% funded, with a net OPEB liability of $72.9 million;
- Scranton Police OPEB Plan: 0% funded, with a net OPEB liability of $90.6 million; and
- Scranton Non-Uniformed OPEB Plan: 0% funded, with a net OPEB liability of $31.9 million.

Funded ratios of each of the city's pension plans improved in 2021 as the plans built off prior-year reforms and contributions were well above both our static and minimum funding progress thresholds. The plans updated their mortality tables with this most recent actuarial valuation, which we view as favorable. However, we still view some of the plans' assumptions to be optimistic, such as 4.5% salary growth. We also view the plans' 7.25% assumed rate of return as aggressive relative to S&P Global Ratings' guideline of 6.0%, which could lead to contribution volatility. Additionally, a lawsuit was filed against the city and police pension fund in 2021 to retroactively reinstate the COLAs because of the improved funded levels. The matter is pending, but could weaken plan funding if the court rules in favor of the plaintiffs.

Under the terms of collective bargaining agreements with its police and firefighters and clerical and public works employees, the city is required to provide health insurance to retiring employees who meet the criteria specified in each contract. Scranton funds this OPEB obligation on a pay-as-you-go basis, but did recently deposit $2 million into a newly created OPEB trust fund. The city does not have a set amount it will add to the trust at this time, but plans to make contributions the budget allows. Given the size of these liabilities ($195.4 million across the three OPEB plans) relative to the trust, we believe future costs will likely be a budgetary stress for the city.

Scranton--Key credit metrics

	Most recent	Historical information		
		2021	**2020**	**2019**
Very weak economy				
Projected per capita EBI % of U.S.	63			
Market value per capita ($)	34,327			
Population		71,999	72,584	72,686
County unemployment rate (%)	4.7			
Market value ($000)	2,471,521	2,471,521	2,481,348	2,365,108
Ten largest taxpayers % of taxable value	7.0			
Adequate budgetary performance				
Operating fund result % of expenditures		5.8	3.4	1.5
Total governmental fund result % of expenditures		8.0	(2.4)	1.7
Adequate budgetary flexibility				
Available reserves % of operating expenditures		11.8	6.9	1.8
Total available reserves ($000)		11,110	6,101	1,561
Very strong liquidity				
Total government cash % of governmental fund expenditures		19	15	10
Total government cash % of governmental fund debt service		149	81	74
Weak management				
Financial Management Assessment	Standard			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		12.6	18.1	12.9
Net direct debt % of governmental fund revenue	68			
Overall net debt % of market value	20.3			
Direct debt 10-year amortization (%)	100			
Required pension contribution % of governmental fund expenditures		12.8		
OPEB actual contribution % of governmental fund expenditures		10.3		
Very strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits.
Data points and ratios may reflect analytical adjustments.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022