S&P Global Ratings

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Summary:

Scranton, Pennsylvania; General Obligation

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Credit Profile		
US$29.655 mil GO bnds ser 2024 due 11/15/2032		
Long Term Rating	BBB+/Positive	New
Scranton gtd lse rev bnds ser 2016AA due 05/15/2036		
Long Term Rating	BBB+/Positive	Upgraded
Scranton gtd lse rev bnds ser 2016 A due 12/01/2026		
Long Term Rating	BBB+/Positive	Upgraded

Credit Highlights

- S&P Global Ratings raised its long-term rating two notches to 'BBB+' from 'BBB-' on Scranton, Pa.'s general obligation (GO) debt.
- At the same time, S&P Global Ratings assigned its 'BBB+' long-term rating to the city's 2024 GO bonds, with a preliminary par amount of $29.7 million.
- The outlook is positive.
- The rating action reflects our view of the city's improved liquidity position, ability to maintain structural balance without reliance on federal stimulus funds, and reduced contingent liability exposure after the settlement of several material lawsuits.

Security

The city's full faith and credit secures the 2024 GO bonds. The 2024 bond proceeds will currently refund the 2016 GO notes for debt service savings with no extension of maturity.

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 rating reflects our view of the city's improved liquidity position and ability to maintain balanced operations without federal stimulus. Audited results for fiscal 2022 and unaudited results for fiscal 2023 demonstrate balance without the need to utilize American Rescue Plan Act (ARPA) funding for revenue replacement. As a result of proactive financial management, the city has controlled expenditure growth while revenue has consistently outperformed the budget. The majority of the city's $68 million in ARPA funds are allocated to one-time projects. Management estimates 2023 closed with a $3.8 million general fund surplus (around 3% of expenditures). The 2024 budget is balanced and does not include ARPA funds for revenue replacement. We note that the city eliminated the need for cash flow borrowing with the 2024 budget, as its general fund liquidity and reserves have consistently improved.

Furthermore, the city settled various lawsuits for a fraction of initial claims, effectively eliminating material contingent liability exposure.

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 financial and debt profiles have improved significantly, we believe lower wealth and income ratios, coupled with high fixed costs, will remain credit pressures.

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

- Very low wealth and income levels, which have made revenue generation difficult and have spurred high delinquency rates during past recessions;
- Good financial policies and practices and a strong institutional framework score but overall weak management score as a result of very high legacy 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 the tax base and very high fixed costs related to pensions and other postemployment benefits (OPEB).

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 consider environmental risks somewhat elevated as a result of heightened flood risk in several neighborhoods. In September 2023 a major flooding event hit the city, resulting in around $7 million in damages to public infrastructure. We understand that the city is unlikely to receive federal or state emergency assistance and will divert some ARPA funds to support rebuilding efforts. Officials note that the city continues to prioritize stormwater management improvement projects and developing a sustainability and climate action plan. We view 'governance risks as neutral.

Outlook

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

Downside scenario

All else equal, if general fund operations become imbalanced we could revise the outlook to stable. Additionally, a broader economic slowdown and prospective revenue pressure could also lead us to revise the outlook to stable.

Upside scenario

All else equal, if the city continues to demonstrate structural balance and a healthy liquidity position while spending down remaining ARP funds, we could raise the rating. Over the longer term, further upward rating potential is possible if the pension and OPEB liability improves and fixed costs moderate relative to the budget.

Credit Opinion

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

Scranton, the seat of Lackawanna County, has experienced little assessed value (AV) growth, or outright declines, for the past 20 years given both a stagnant economy and the absence of property reevaluations. Lackawanna County recently embarked on its first comprehensive reassessment since 1968, but the county does not expect new valuations to go into effect within the next two to three years. 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. Tax collections have improved in recent years as Scranton has changed some of its collection methods and as economic conditions have improved. Current-year property tax collections exceed 95%.

Primary industries include manufacturing, education, and health care. While manufacturing has been waning over the past 20 years, the local services sector has been 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 in search of greater affordability. Officials report continued downtown development, 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's explore potential rail service between Scranton and New York City. One of the city's emergency rooms closed last year, and we understand that further consolidation may occur among health care services. Reduced health care availability may pressure economic development opportunities, and associated employment loss could negatively impact income tax collections. Given the city's weak wealth and income levels, we expect our assessment of the local economy to remain very weak.

Good policies and practices but weak management assessment as a result of very high fixed costs stemming from legacy retirement liabilities

We assess 'management as weak because of sizable legacy fixed costs (debt, pensions, and retiree health care), which represented 36.9% of total governmental expenditures in 2022. Should these costs come down as debt matures and retirement pressures subside, 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 best practices;
- 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, though officials plan to develop a financial forecast and integrate it with other

financial practices.

Surplus anticipated for 2023, break-even budget in 2024, 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 past four audited fiscal years (2019-2022) as a result of conservative budgeting as well as cost reductions put in place as part of the Act 47 Exit Plan. Preliminary 2023 results indicate that the city closed the year with a $3.8 million surplus (more than 3% of expenditures). The city was able to achieve this while incurring several one-time costs related to litigation settlements and capital costs, and without utilizing ARPA funds for revenue replacement (originally budgeted at $2.3 million). Still, in our view, these stimulus funds may offset some capital spending that might have otherwise come out of the general fund or been deferred.

The 2024 general fund budget is break-even without any ARPA funds budgeted for revenue replacement. It assumes a 1.8% increase in total general fund revenue over the 2023 budget, mostly as a result of increases in earned income tax revenue, real estate transfer taxes, licenses and permits, and intergovernmental reimbursements related to grants. We view revenue assumptions as reasonable. Major revenue includes earned income and other local option taxes (40% of budgeted revenue), real estate taxes (32%), and landfill fees (7%). The city recently received an Act 111 award following arbitration on its firefighters' union contract through 2026, with annual increases that we believe the city can absorb into its budget. It also received an Act 111 award following arbitration on its police union contract. Its clerical union contract is under negotiation and the public works unions contract expires in 2024. After several years of static wages, the city was able to absorb wage and health care increases into its budget. We will assess how the city is able to contain costs over the next several years amid prospects for slowing revenue growth and a tight labor market, particularly for public safety employees. In addition, we believe that capacity to cut spending is somewhat limited as a result of high fixed costs and the comparatively high share of the budget dedicated to public safety.

With a $3.8 million surplus in 2023, the city expects its total general fund balance to increase to nearly $30 million (26% of expenditures). However, the city still has a high level of general fund receivables, which, in our opinion, somewhat overstates reserves. In 2022, the general fund reported net receivables of $16.8 million for taxes and $6.2 million for garbage fees. These receivables are offset by $13.0 million in deferred revenue, but $10.1 million of receivables have no offset on the balance sheet. We adjusted our 2022 available general fund reserves by this amount, as we believe this more accurately reflects the available reserve position. We understand that the city may in the near future receive significant one-time revenue from remaining escrowed funds related to the sale of assets of its sewer authority as well as additional one-time revenue related to the release of reserve funding dedicated to its workmen's compensation program that was required pursuant to a court order. While a portion of these funds may support one-time needs, we believe they could enhance budgetary flexibility.

With the 2024 budget the city eliminated the need for cash flow borrowing. In prior years the city relied on cash flow notes to support months with low liquidity. In 2023 it borrowed $4.9 million, but paid down the balance early. January is typically the low cash point and officials noted that general cash in January 2024 exceeded $10 million (not including $8 million held in the debt service account), highlighting the improved liquidity.

Very weak but improving debt and contingent liability profile

Although Scranton's debt and contingent liability profile remains very weak, it continues to improve as a result of action in prior years, including efforts to reduce debt and fix-out variable-rate debt. Still, the overlapping debt burden remains very high relative to the tax base, at 12.4% of market value. Favorably, 100% of the city's net direct debt matures within 10 years and the city has no additional new money debt plans. As a result, we expect annual debt costs will decrease over time and contribute to an improving debt profile.

Scranton's series 2021 and 2023 GO notes were privately placed with M&T Bank, but we do not view these as contingent liquidity risks.

Pension and OPEB liabilities

As part of its Act 47 Exit Plan, the city implemented measures to reduce 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, 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, 2022:

- Scranton Fireman Pension Plan: 54.5% funded with a net pension liability (NPL) of $43.4 million
- Scranton Police Pension Plan: 69.2% funded with an NPL of $27.2 million
- Scranton Non-Uniformed Pension Plan: 69.4% funded with an NPL of $600,000
- Scranton Fireman OPEB Plan: 0% funded with a net OPEB liability of $58.7 million
- Scranton Police OPEB Plan: 0% funded with a net OPEB liability of $72.9 million
- Scranton Non-Uniformed OPEB Plan: 0% funded with a net OPEB liability of $25.5 million

Funded ratios in each pension plan declined in 2022 as a result of negative investment returns. With strong market performance in 2023, we anticipate funded ratios to improve somewhat with the upcoming valuation. The plans recently updated mortality tables, but we still view some of the plans' assumptions, such as 4.5% salary growth, as optimistic. 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. Favorably, the city recently won a lawsuit aiming to retroactively reinstate the COLAs in the police pension, eliminating liquidity risks and additional cost pressures.

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 2024 budget calls for an additional $200,000 deposit to the trust fund. The city does not have a set amount that it will add to the trust, but plans to contribute as the budget allows. Given the size of these liabilities ($157.2 million across the three OPEB plans) relative to the trust, we believe costs will remain a source of budgetary pressure.

Scranton key credit metrics	Most recent	Historical information		
		2022	2021	2020
Very weak economy				
Projected per capita EBI as % of U.S.	67			
Market value per capita ($)		36,816		
Population		72,844	71,999	72,584
County unemployment rate (%)		4.7		
Market value ($000s)		2,681,854	2,471,521	2,481,348
Ten largest taxpayers as % of taxable value	7.1			
Adequate budgetary performance				
Operating fund result as % of expenditures		4.0	5.8	3.4
Total governmental funds result as % of expenditures		3.8	8.0	(2.4)
Strong budgetary flexibility				
Available reserves as % of operating expenditures		15.2	11.8	6.9
Total available reserves ($000s)		14,912	11,110	6,101
Very strong liquidity				
Total government cash as % of governmental funds expenditures		31	19	15
Total government cash as % of governmental funds debt service		316	149	81
Weak management				
Financial management assessment	Good			
Very weak debt and long-term liabilities				
Debt service as % of governmental funds expenditures		9.9	12.6	18.1
Net direct debt as % of governmental funds revenue	56			
Overall net debt as % of market value	12.4			
Direct debt 10-year amortization (%)	100			
Required pension contribution as % of governmental funds expenditures		12.8		
OPEB actual contribution as % of governmental funds expenditures		14.1		
Very strong institutional framework				

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

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2022 Update Of Institutional Framework For U.S. Local Governments

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