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I. Introduction

In the broadest of terms, this report attempts to outline strategies towards two essential goals: maintaining budgetary predictability and orienting the City towards achieving longer term budgetary and financial solutions rather than the short term and sometimes circumscribed fixes that have characterized too much of the City's historical approach. Incorporated in our strategy is a means to achieve a timely exit from Act 47 oversight.¹ We will also present a model for sustainable budgeting practices, which would help achieve the high quality of City services that Scrantonians expect and that would further allow the City to make significant—and needed—infrastructure and other capital investments. A failure to *comprehensively* execute on the recommendations outlined and discussed below will require the City to raise total Real Estate Tax revenues by at least 119 percent over the 2013 level to meet the projected 2017 deficit. The City would also almost certainly remain in Act 47 and be forced to drastically cut City services to a far greater extent than anything recommended below.

As the City begins the implementation of many of its broader strategies over the course of the coming months, we must arrive at a more detailed understanding of what each approach entails and what contingency plans the City may follow should some of these possible approaches become challenged. Moreover, it is vital that the City act according to a timeline that is defined in months—and, in some cases, even weeks—as pressure from various stakeholders continues to mount and the very real consequences of forestalling action become more acute.

Generally speaking, it is vitally important that the individual elements of the overall strategy occur, essentially, in tandem. Each stakeholder must also genuinely “give” something and become a true part of the recovery effort; there cannot be any stakeholders who benefit unusually from any of the proposed changes or, really, any who simply do not share in the burden.

For the purpose of this analysis, primary stakeholders include: the City of Scranton, the Scranton City Council, Lackawanna County, the City's representation in the Pennsylvania General Assembly, representatives of the Commonwealth of Pennsylvania, the various public authorities operating within the City, the City's Collective Bargaining Units, the City's Act 47 Coordinator (the Pennsylvania Economy League), the business community, the investment community, non-profits, and, of course, the public. The City Council of the City of Scranton deserves a special note of thanks for their generous support and accessibility.

Naturally, each and every strategy outlined below must be carefully vetted according to all the possible dimensions the problems surrounding each of these strategies may take, including the reception of stakeholders. Given the need that every available option must be taken seriously, each option explored herein must be the subject of further discussion and closer examination as execution is prepared. Accordingly, a series of recommendations will be set forth at the conclusion.

¹ Municipal Financial Recovery Act. 1987. <http://www.legis.state.pa.us/WU01/LI/LI/US/HTM/1987/0/0047..HTM>

² The 2013 millage rate for land and improvements were 117.975 and 25.656 respectively the 2014 rates were 184.867 and 40.202. This amounts to a 57 percent

II. Approach and Methodology

Beginning formally on January 1st, 2014, HJA Strategies, LLC. was engaged by the Greater Scranton Chamber of Commerce to conduct, on behalf of the City of Scranton (“the City”), a thorough and comprehensive analysis of the City’s budget and, moreover, offer recommendations on how the City might improve its financial position going forward. This formal engagement period ended on June 30th, 2014.

As the City’s 2014 budget had been prepared by the prior administration, much of our focus centered on the City’s 2015 budget—as well as how various decisions made in the near term might affect future budgets through 2018, according to several scenarios. Although we did not and will not make any particular recommendations with respect to amending the 2014 budget itself, a careful analysis of this and prior budgets was deemed necessary to understand the City’s financial situation and to construct any sort of reasonable future financial scenario. We feel that the 2014 budget was, for the most part, a fair representation of assumptions and expectations; though, as is almost always the case, it will require, and has already required, some sort of re-calibration. As much as possible, our recommendations are oriented around the true financial performance of the City and other related entities (e.g., the Scranton Parking Authority); we will note whenever, for one reason or another, data related to actual financial performance was unavailable.

Though our services were supported by the Greater Scranton Chamber of Commerce, our relationship with the Chamber extended no further than periodic updates on our progress and periodic discussions with Chamber members and its Executive Committee. For the purposes of our services, activities, and recommendations, the Chamber’s position has not been privileged above any other City stakeholder. Our services were performed entirely for the benefit of the City of Scranton.

Our primary working group was the City of Scranton’s leadership team, with the Business Administrator being our most vital partner. Indeed, the Business Administrator’s comprehensive plan, which was prepared at the outset of the Mayor’s administration, has served as the indispensable foundation and road map for our own work. We also presented our initial analysis at a public meeting of the City Council and have worked consistently with the Council President throughout our engagement. Working in cooperation with the City Council has been quite fruitful over the course of our engagement and their willingness to deeply engage in the City’s recovery efforts has rendered an uncommon service to Scranton. The City’s Act 47 Coordinator, the Pennsylvania Economy League, has also been an invaluable collaborator in our work. Their expertise and knowledge of the City and Pennsylvania more broadly is a true resource.

Over the course of our engagement we have met with a number of local stakeholders, as well as other external stakeholders, largely in the financial sector. We have presented our analysis at two public meetings and maintained regular contact with the City’s press, including participating in an editorial board meeting—along with the Mayor and Business Administrator—of the Scranton *Times-Tribune*. As mentioned above, we have met with the Greater Scranton Chamber of Commerce, and regularly worked with the Pennsylvania Economy League, as well as representatives from the Commonwealth of Pennsylvania’s Department of Community and Economic Development. We have also met with Senator John Blake and his team on several occasions. Finally, we reported our findings to the Scranton Sewer Authority.

As mentioned above, we had the opportunity to meet with several external stakeholders from the investment, bond insurance, and banking communities on a variety of issues related to the City's finances. We have met with representatives from Ambac, which insures a sizable portion of the City's debt. We have also met with representatives from MBIA and Radian, who insure Scranton Parking Authority debt, which the City now guarantees. Janney Montgomery Scott has also been a resource in some of our broader conversations on the City's debt structure, which they have ample knowledge of. We did also meet with a number of potential vendors who may seek to offer services to the City. Finally, since their engagement by the City as its Financial Advisor, we have coordinated with PFM, who have lent their expertise to many parts of our work and who will be pivotal in the execution of several of this report's recommendations, particularly in the areas related to debt.

Though we have had the opportunity to meet with a truly great number of vital stakeholders, we were unable to facilitate two critical meetings. While we did have the chance to participate in general discussions with representatives from the University of Scranton, Lackawanna College, and the Geisinger Health System, we did not have the opportunity to have direct conversations about improving the City's relationship with its large not-for-profit stakeholders and revisiting the perennial issue of Payments in Lieu of Taxes ("PILOTs"). Recommendations in that regard will be made below, but fuller discussions must be facilitated.

Secondly, we have not been able to meet with the City's pension actuarial. The City would benefit greatly from obtaining more recent information from the City's actuarial in order to achieve a far more detailed understanding of the true scope of the issues surrounding the pension—a vital step for developing comprehensive solutions to one of the greatest challenges facing the City. The City has initiated this process and expects to receive further information in the coming quarter.

As will become clear below, the City's top priority must be to address its pension and debt liabilities (which includes the now \$22.2 million court award and the guarantee of the Scranton Parking Authority's roughly \$53 million in debt), along with all of their component parts. A failure to do so will leave the City unable to maintain even its current level of services and further require truly significant increases in all major forms of taxation (namely the City's Real Estate and Earned Income Taxes).

III.

Assumptions – Unpacking the Budget

III.

A. Appropriation Benchmarking

Scranton’s 2014 budget appears profoundly different than the City’s 2013 adopted budget, a fact most evidenced by the City’s total expenditures increasing from a total of \$81 million in 2013 to \$130 million in 2014.

Carefully accounting for this change and establishing an adjusted “true appropriation” for the City is a vital first step for conducting any sort of budget analysis. Such a true appropriation for the 2014 budget year may be established at \$99.5 million, which amounts to an \$18.3 million or 22.56 percent increase over 2012. We will explain our methodology for arriving at this adjusted figure below.

The largest component of this year-over-year change is the budgeting of a \$22.2 million court award to the City’s Collective Bargaining Units (“CBUs”). However, the inclusion of this item in the budget is misleading. Whatever approach the City eventually takes to pay for the judgment—and this will be discussed in more detail below—it will necessarily take the form, in *the City’s budget*, of installment payments over time. For example, in one of the simpler scenarios, if the CBUs were to be paid the full amount (plus interest) up front, the City, not having an amount of approximately \$22.2 million immediately available to redirect for this purpose, would have to make this payment with some sort of debt issue and, hence, join the City’s debt service budget line. No payments of any kind towards the court award have been made thus far. And so, for the purposes of our 2014 model, the \$22.2 million court award will be removed, with 200,000 maintained to reflect the amount normally budgeted for this purpose (i.e., paying non-extraordinary court awards). This brings total budgeted expenses to \$108.2 million.

The next largest reduction comes from a change in the City’s Tax Anticipation Note (“TAN”) appropriation. In the drafted 2014 budget, the City anticipated a \$17 million TAN. However, the City only took out a \$12 million short-term borrowing (with about \$700,000 in added expense), bringing the TAN appropriation down by \$4.3 million and the total to \$104 million. In addition, the City’s annual debt service payment was \$1.4 million less than anticipated, lowering the total to \$102.6 million. Finally, the amount the City left unpaid for the prior year’s pension obligation was \$4 million lower than previously anticipated, bringing the total to \$98.6 million. However, higher-than-anticipated employee expenses—almost entirely in health care—add \$979,000 to the budget appropriation, giving us a final adjusted total projected “true appropriation” of \$99.5 million.

| Category | Amt. Change | Total |
|--|-----------------|-------------------------|
| | | \$130,195,163.00 |
| Less Direct Compensation | \$87,147.00 | \$130,108,016.00 |
| Less Interest & Debt Excluding Tans | \$1,378,881.00 | \$128,729,135.00 |
| Less TAN Repayment | \$4,295,070.00 | \$124,434,065.00 |
| Less Unpaid Prior Year Pension | \$4,000,000.00 | \$120,434,065.00 |
| Less Court Awards | \$22,000,000.00 | \$98,434,065.00 |
| | | |
| Add Health Insurance | \$1,020,545.00 | \$99,454,610.00 |
| Add Other Employee Expenses | \$45,872.00 | \$99,500,482.00 |

Figure 1. “True Appropriation” Adjustments

III.

B. Revenue Benchmarking

Operating Revenues increased by \$16.2 million between 2014 and 2013, largely driven by a 57.86 percent increase in *total* Real Estate Tax revenues (rising \$10.2 million in absolute terms).² The Real Estate Tax increase accounts for 63.14 percent of the operating revenue increase, with 14.06 percent coming from increased Refuse Revenues—reflecting a fee increase from \$178 to \$300—and bringing in an additional \$2.3 million in revenues. At least according to the drafted 2014 budget, all other revenues, in addition to greater Real Estate Taxes and Refuse Fees, are expected to rise by \$3.7 million (this number takes into account a projected \$1.2 reduction in EIT collections and a small reduction in interfund transfers).

On a macro level, there are several differences that must be accounted for between the drafted 2014 budget and our projection. First, the \$1.7 million sale of assets, which was not forthcoming, must be removed from the revenue projection; the \$2 million in additional liquid fuels money must be as well, as it will not be delivered to the City. As is true on the expense side, the TAN must be reduced to the amount borrowed, or \$12 million; similarly, the \$28 million allocation for bond issue proceeds—which, at one time, was supposed to cover the judgment and the increased

² The 2013 millage rate for land and improvements were 117.975 and 25.656 respectively the 2014 rates were 184.867 and 40.202. This amounts to a 57 percent increase in both the land and improvement millages. The Real Estate Tax revenue line includes the Current Real Estate Tax, Delinquent Real Estate Tax, and Real Estate Taxes 2011 - Unfunded Debt

Minimum Municipal Obligation pension payment—must be removed. Finally, market-based revenue opportunities, proposed at \$200,000, are projected to offer a true yield of \$25,000 or, perhaps, nothing at all given the current stage of implementation.

Thus, our adjusted revenue projection stands at \$94.7 million. And, if we measure this projection against our “true appropriation,” the 2014 deficit amounts to \$4.8 million.

| Category | Amt. Change | Total |
|------------------------|-------------------|-------------------------|
| | | \$130,536,998.00 |
| Miscellaneous Revenues | (\$175,000.00) | \$130,361,998.00 |
| Sale of Assets | (\$1,700,000.00) | \$128,661,998.00 |
| Interfund Transfers | (\$1,987,418.00) | \$126,674,580.00 |
| Tax Anticipation Notes | (\$4,000,000.00) | \$122,674,580.00 |
| Bond Issue Proceeds | (\$28,000,000.00) | \$94,674,580.00 |
| | | |
| True Appropriation | | \$99,500,482.00 |
| | | |
| Adjusted Deficit | | \$4,825,902.00 |

Figure 2. “True Revenue” Adjustments

As with most cities, the City’s Real Estate Tax provides the City with its greatest single source of revenue in the 2014 projection. Over time, however, the City’s real estate tax revenues have remained proportionately depressed due, in part, to the City’s high Earned Income Tax.

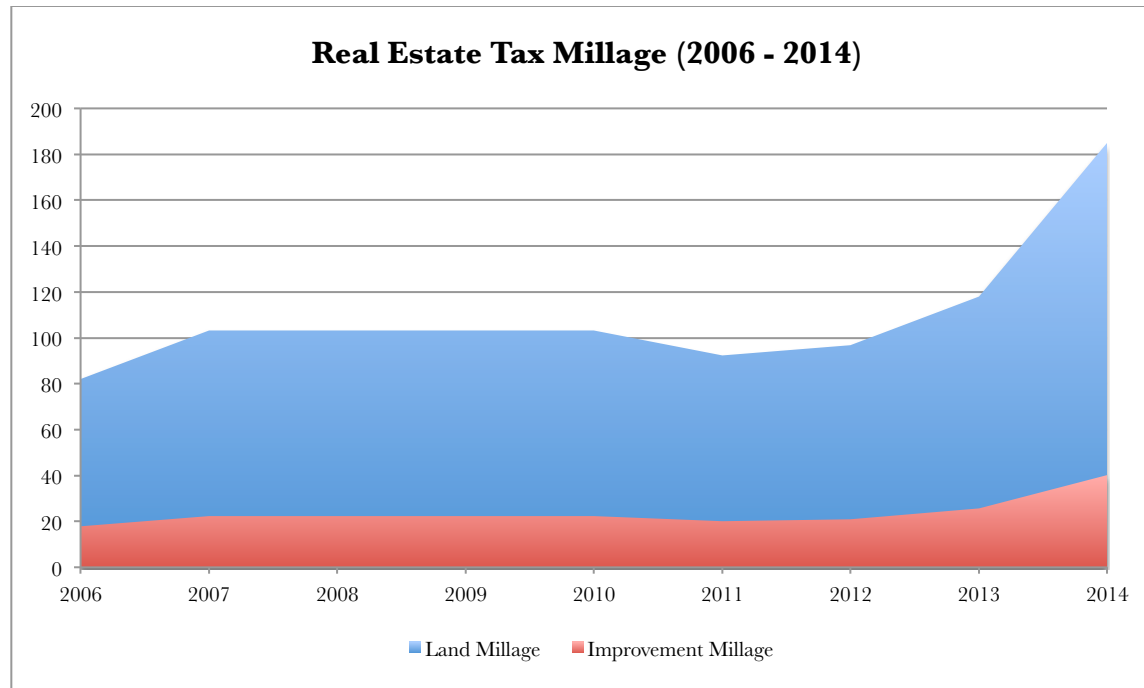


Figure 3. Real Estate Tax Millage (2006 – 2014)

From 2006 to 2014, the City’s total Real Estate Tax millage increased by 125 percent. But, from 2006 to 2012, the City’s total real estate millage did not increase—in fact, it *decreased* between 2010 and 2012. Although it is important to provide as much relief as possible for City taxpayers, it is vital to make small annual increases in the City’s millage in order to keep up with ever-rising expenses. If the City, however, maintained a small annual tax increase, the need for the City to so drastically spike the tax rate would have dissipated (though it would still need to be raised accordingly in order to help meet the expanding deficit):

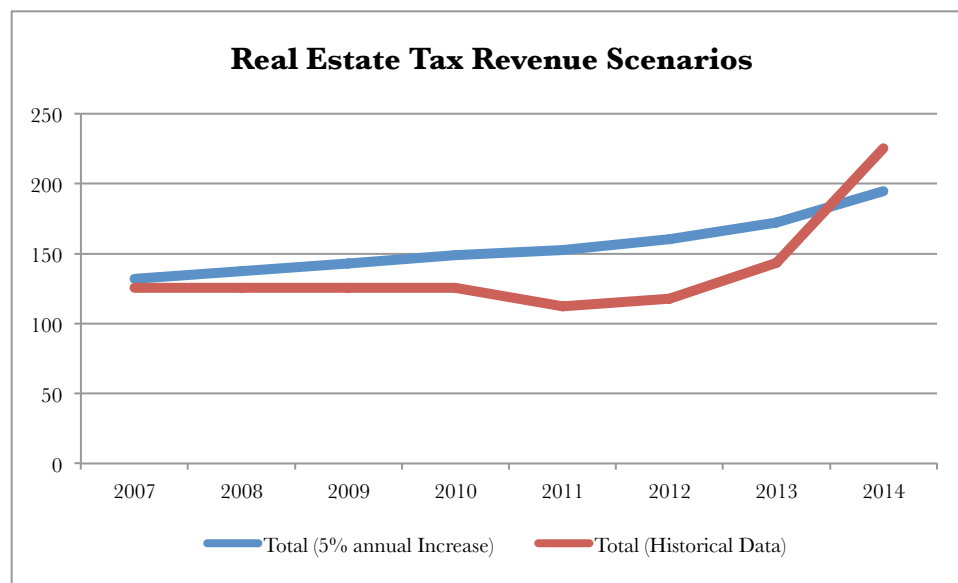


Figure 4. Real Estate Tax Revenue Scenarios

We note that there has not been a reassessment since the late 1960s. In our work, this is unusual and raises some concern. According to a projection by the State Tax Equalization Board, the Pennsylvania Economy League calculated, in their 2012 Recovery Plan, that that the City could be getting \$1.35 for every \$1 collected today, should a reassessment be allowed.³ In addition, failing to hold a reassessment raises the level of inequity in the distribution of property taxes across the City. By not conducting a reassessment, moreover, the County disincentivizes new construction and renovations in the City, since new construction bears the brunt of the tax burden as it is assessed at a price far more reflective of the market value. While we recognize that there are many people on fixed incomes, having one portion of the population being a beneficiary of this system and another inequitably affected. Economic development, for example, may be greatly hampered by the current state of the assessment. The County, however, ultimately decides whether or not a reassessment may be undertaken in the City. The Mayor should make it a priority to request a reassessment. He should personally request this in a letter to the Board of Commissioners and/or in the appropriate public meeting.

³ Pennsylvania Economy League, Central PA LLC, “Revised and Updated Act 47 Recovery Plan For the City of Scranton,” Aug. 2012., 32.

III.

C. Budget Pressures

By establishing our true appropriation and true deficit, we can begin to develop some budget metrics and benchmarks, as well as begin to determine where the significant budget pressures facing the City truly lie. We can also begin to explore how the City's budget measures up against a collection of "peer cities."⁴

The single largest group of the City's appropriations—as is true with nearly all cities—is in employee-related expenses. And, since 2006, the proportion of the City's overall appropriation made up of each macro category has remained relatively constant⁵:

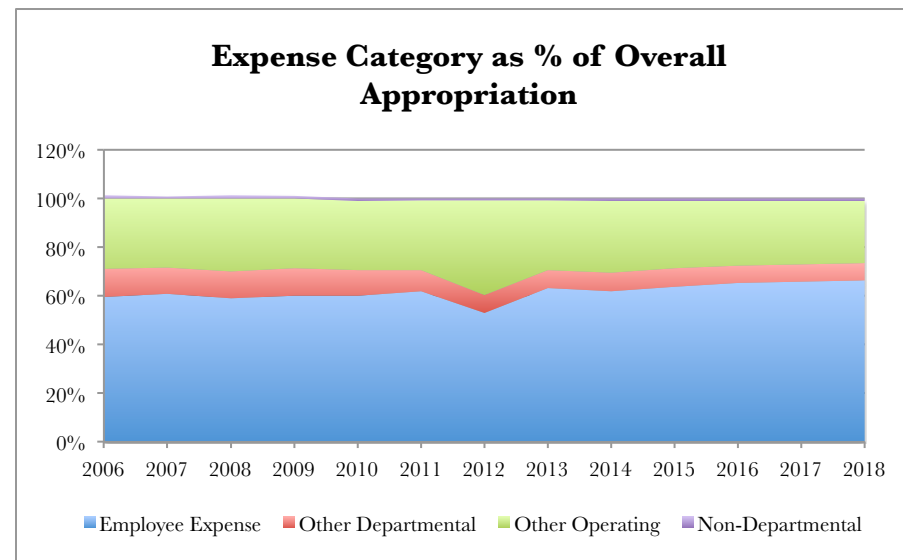


Figure 5. Expense Category as % of Overall Appropriation

⁴ Peer cities were selected based on a number of qualities, including, but not limited to, demographics (population, age distribution, homeownership rates), economic fundamentals (job distribution, historical legacies), and geographic distribution. For the sake of easing the comparative process, all peer cities are located within Pennsylvania. The peer cities are: Allentown, Bethlehem, Erie, Harrisburg, Lancaster, Reading, and Wilkes-Barre.

⁵ The downward spike in 2012 reflects when the City laid off several Fire personnel and then moved to hire them back in the following year.

Salary, health insurance costs, and the City's pension contributions are the largest components of the employee expense, with various forms of direct compensation (e.g., longevity, overtime, and social security) and worker's compensation accounting for the remainder. The proportion of the total appropriation constituted by employee expenses hovers between 60 and 63 percent, but are projected to climb somewhat, reaching 66 percent in 2018. This rise, as will be explained in more detail below, may largely be accounted for by growing pension and health insurance costs.

Other operating expenses tend to comprise roughly 29 percent of the total allocation, but are projected to fall to 26 percent by 2018. The lion's share of other operating expenses may be accounted for by short and long term debt service payments, with court awards sometimes becoming significant (as is the case with the *proposed* 2013 and 2014 budgets, which reflect the judgment-related debt; as noted, however, these expenses were not actually paid out). Other departmental expenses have been declining, from a high of 11 percent in 2006 to 7 percent in 2012; we project that this expense category will stay essentially in this range for the duration of the projected period. Finally, non-departmental expenses are a relatively trivial allocation for the City, never reaching much more than 1 percent and maintaining that amount consistently.⁶

⁶ A full breakdown of the expense items present in each category may be found in the Appendix.

In the below figure, one sees that expenses have grown moderately since 2006 but begin to accelerate after 2013.⁷ This growth is essentially driven by growing employee expenses, with increased debt service payments accounting for most of the remainder:⁸

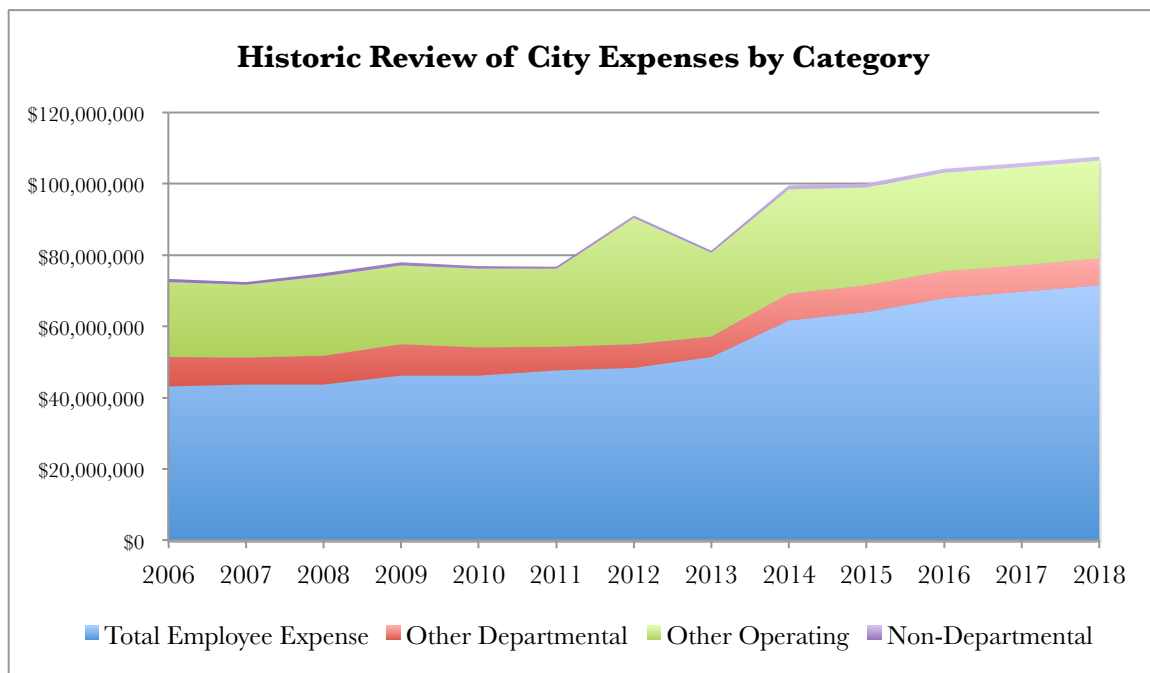


Figure 6. Historic Review of City Expenses by Category

If we examine employee expense trends more closely, we see that health insurance, and particularly pension payments, begin to comprise a greater and greater proportion of this category—again, the City’s most significant:

⁷ The spike in 2012 may be explained by both an extraordinary and sudden increase in short and long term debt service payments.

⁸ It should be noted that though some of the City’s long term debt services increases are currently known and have been applied to the models referenced in this section, there will necessarily be changes in the City’s debt structure depending on how the City approaches the judgment, the Scranton Parking Authority, and a broader restructuring. Following one of the more likely scenarios, our projection adds \$1.3 million in debt service to account for a possible initial deal on a \$5 million portion of the judgment, beginning in 2015. Other scenarios involving the debt will be discussed and modeled below.

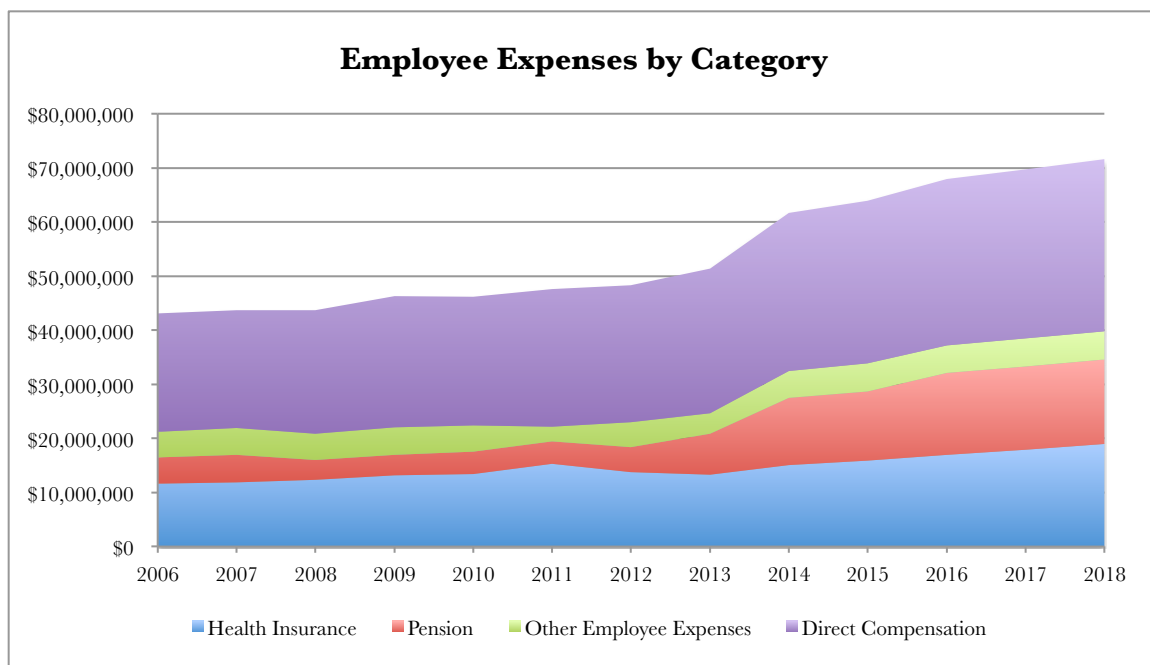


Figure 7. Employee Expenses by Category

First, it is important to recognize the rate of growth in employee expenses—approximately 44 percent between 2006 - 2014 and are projected to grow by 66 percent between 2006 - 2018. In contrast, the City’s Earned Income Tax, the single largest source of revenue until 2014, increased by just 24 percent between 2006 and 2014. If we break down this category still further, we will begin to see which departments constitute the majority of spending. Let’s begin by looking at a graph of personnel expenditures without adding the Bureaus of Police and Fire to the data set:

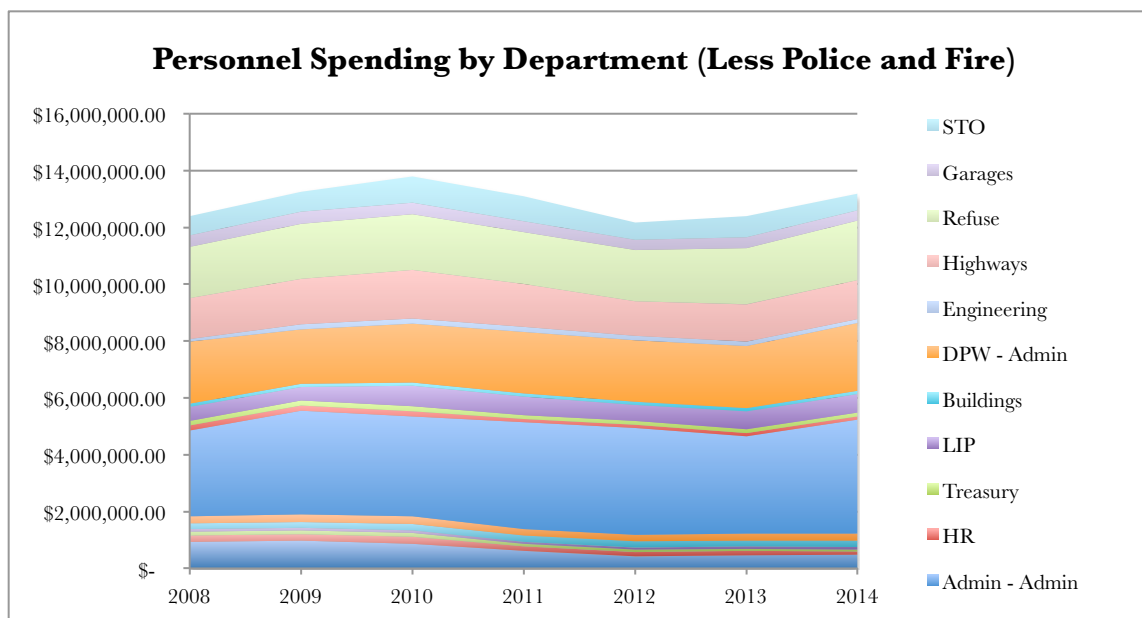


Figure 8a. Personnel Spending by Department (Less Police and Fire)⁹

The essential point of this figure is that, since 2008, departmental personnel spending has remained relatively flat. Nine departments have increased their personnel spending and eight have *decreased* their personnel spending. Across these departments, and since 2008, spending increased in the eight growth departments by an aggregate of \$1.7 million and, in the nine loss departments, spending decreased by \$900,000. Thus, between 2008 and 2014, spending only increased by \$800,000, which is 1 percent of the projected 2014 total personnel spend.

⁹ Single Tax Office (“STO”); Human Resources (“HR”); Licenses, Inspections, and Permits (“LIP”)

III.

D. Study of the Bureaus of Police and Fire

However, if we add the Bureaus of Police and Fire into the picture, the trends are quite different:

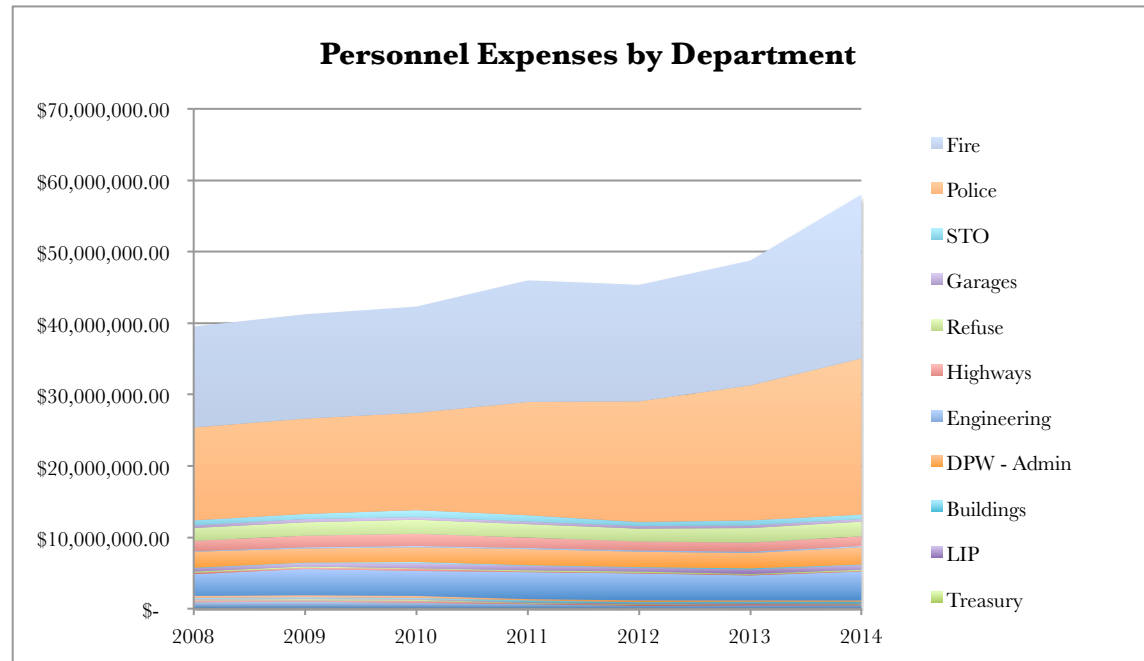


Figure 8b. Personnel Expenses by Department

Absolute Bureaus of Police and Fire spending is significantly greater than the other departments' spend and also has grown at a far faster rate—particularly since 2012. Across all the departments that saw growth between 2008 and 2014, the average rate of growth was 24 percent. The Bureaus of Police and Fire's personnel spending, on the other hand, grew by 68 percent and 62 percent respectively. Although this pattern is not at all atypical of cities, it is notable for its scale in the case of Scranton. It is also important to note that personnel spending (salaries and benefits) in both the Bureaus of Police and Fire account for 99 percent of their total departmental spends, with professional services and equipment accounting for the remainder.

Although salary and wages in the Bureaus of Police and Fire have increased significantly since 2008—49 percent and 59 percent respectively—they are markedly outpaced by the growth of pension expenditures: 261 percent for the Bureau of Fire and 451 percent for the Bureau of Police. Thus, one of the most significant bases of change in the City’s budget is the growth in Police and Fire pension obligations.

This, far more than any staffing-related issue, is one of the fundamental reasons why Scranton’s spending on the Bureau of Police, and, to an even greater extent, the Bureau of Fire, out paces its peer cities. First, below is a breakdown of the number of Police and Fire personnel in each of Scranton’s peer cities:¹⁰

¹⁰ The personnel numbers for the Police and Fire services recorded above are the total number of Full Time Equivalents, both uniform and non-uniform, unless otherwise noted. Thus, full time clerks and support personnel will be included in the totals, but not part time positions, such as crossing guards. Without having a specific knowledge of each city’s police force, it is difficult to ascertain, in certain cases, which personnel are uniformed and which are non-uniformed; the nomenclature varies from city to city. Some cities have moved away from having uniformed officers from serving in clerical functions and some other support functions and do not indicate this. For this reason, a non-uniformed clerk in one city may be uniformed in another. Union membership is also a complicating factor, as a clerk may not be a member in a Fraternal Order of Police local lodge but have membership in a clerical union or another body such as the Communication Workers of America. There is not as much variance in the various rosters of fire personnel, though several departments include other forms of emergency medical services. Still, by reviewing the personnel tables of each Police and Fire service, we have, to the best of our ability, made a calculation as to the number of uniformed and non-uniformed personnel in each of the selected peer cities’ departments. We are confident that these measures will serve as an adequate means of comparison. However, should comparisons between Police and Fire services be necessary for anything other than purposes of discussion, an analysis should be undertaken by a subject matter expert.

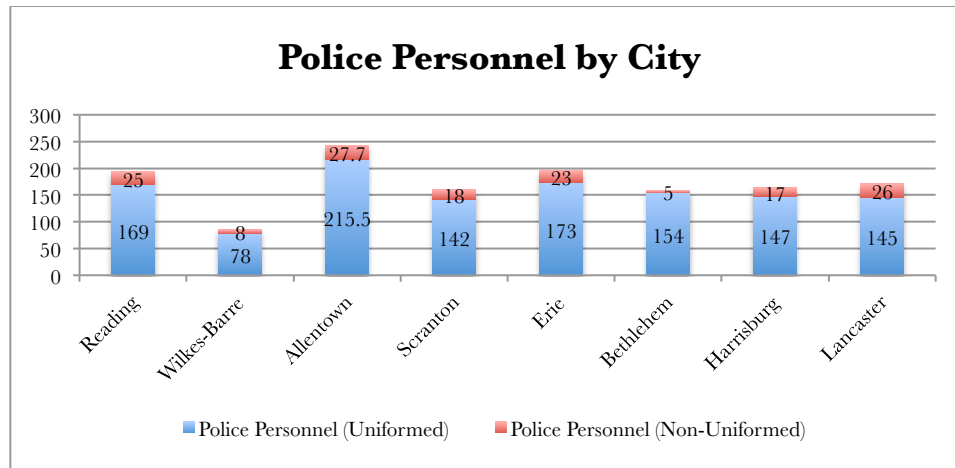


Figure 9. Police Personnel by City

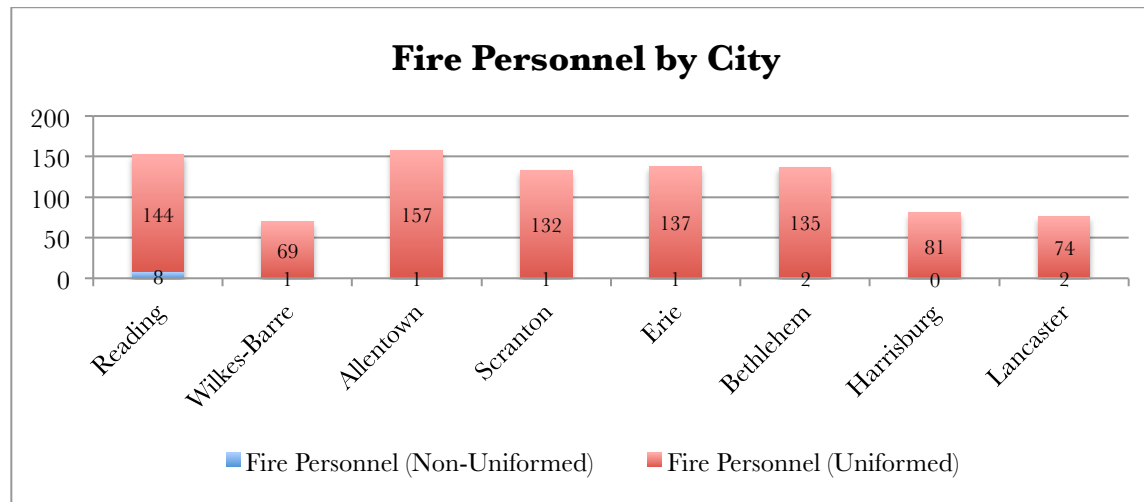


Figure 10. Fire Personnel by City

Unsurprisingly, uniformed personnel make up the majority of each police and fire service. However, it will help to adjust the absolute figures in a way to better compare these cities, which vary in population from Wilkes-Barre's 41,243 to Allentown's 118,974. Therefore, we will look at the number of Police and Fire personnel per 10,000 city residents:

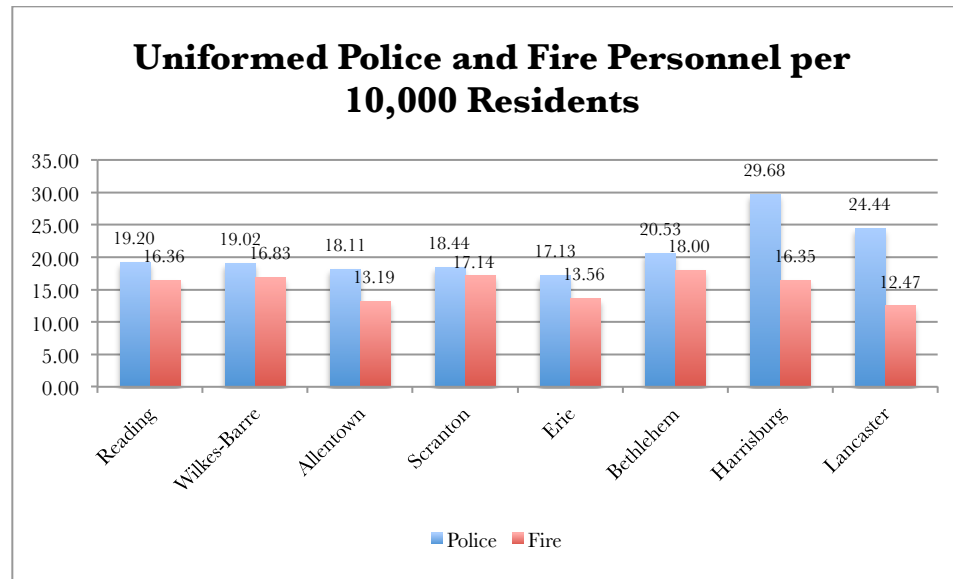


Figure 11. Uniformed Police and Fire Personnel per 10,000 Residents

The average police personnel per 10,000 residents is 20.82, putting Scranton below the average, though the standard deviation is high among the group (mostly due to Harrisburg and Lancaster's presence). Scranton has 2.38 fewer police personnel than the average. Indeed, Scranton is actually on the lower end out of those measured, coming in at 6 of 8. However, Scranton has the second highest fire-personnel per 10,000 residents and is above the average; Scranton has 1.65 more fire personnel than the average. Although Scranton is on the higher end, its deviation from the average is not so great as to make absolute personnel numbers a point of immediate and grave concern. As we will see below, rising pension and, to a lesser extent, health care costs are of greater concern than staffing.

Now, let's view what each Police and Fire service pays in aggregate Salary and Benefits per 10,000 residents:¹¹

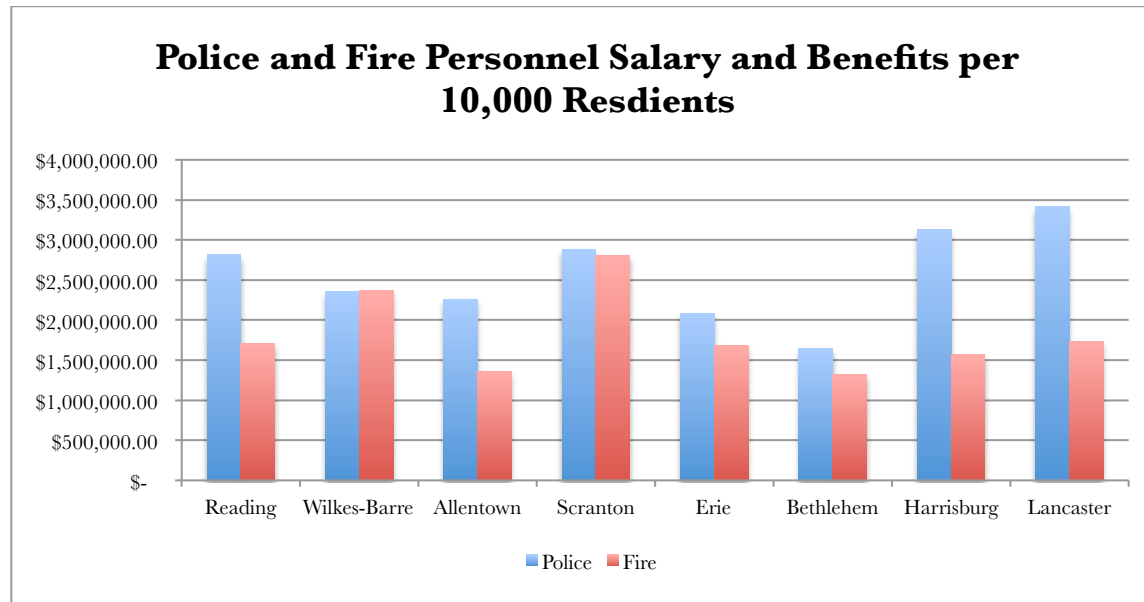


Figure 12. Police and Fire Personnel Salary and Benefits per 10,000 Residents

Though Scranton's police spending is 3rd among the group, it spends only about \$310,000 more than the average per 10,000 residents. Scranton's fire spending, which is first among the group, is nearly \$1 million greater than the average, or \$984,981 per 10,000 residents.

More broadly, and to have a better understanding of the budgetary burden maintaining these services places on each City, we will chart what proportion Police and Fire salary and benefits spending accounts for among overall expenses:

¹¹ Lancaster's Fire personnel salary and benefits number uses a calculated average of how much a given Fire service among the peer cities spends on Salary and Benefits (96 percent) as only the total Lancaster Fire Department's spend was forthcoming.

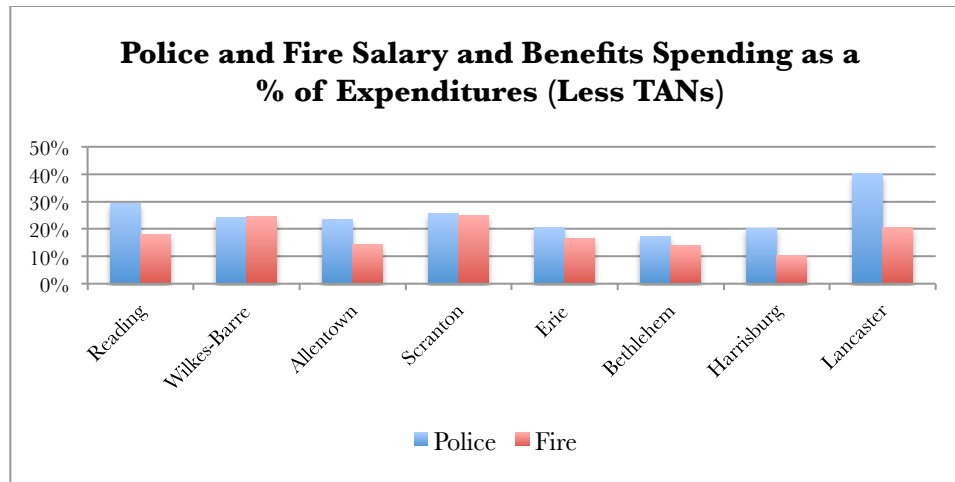


Figure 13. Police and Fire Salary and Benefits Spending as a % of Expenditures (Less TANs)

Another point of note, which can be seen somewhat above, is that the ratio between the City's Bureau of Police and Fire spending. A best practice is for a City to hold the Fire service's overall appropriation at approximately 60 percent of the Police's. As you can see below, the ratio among Scranton's peer cities varies, but Scranton is at the high end:

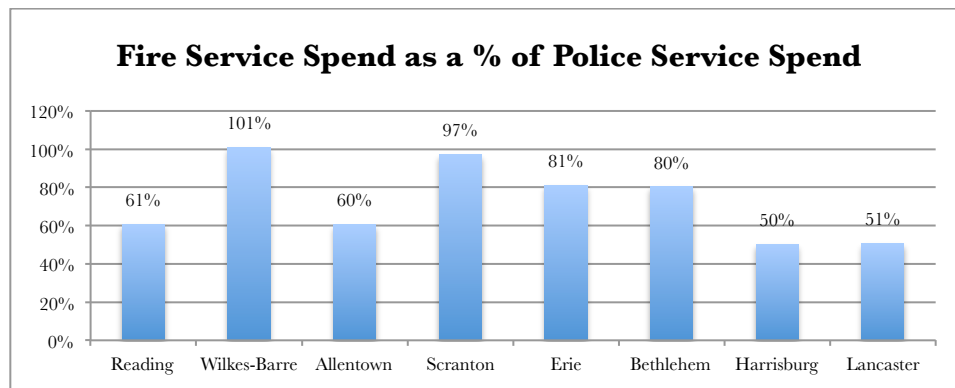


Figure 14. Fire Service Spend as a % of Police Service Spend

Notably, Wilkes-Barre has a similar ratio, which is, essentially, a function of the parity clause that has been written into the Fire bargaining agreements in both municipalities.¹² The inclusion of this clause should be a topic of discussion in future contract negotiations.

But what causes Scranton's costs to be high—particularly for the Bureau of Fire? As seen above, Scranton's staffing in both Bureaus is not high enough to explain the extent of the disparity in overall cost. Personnel numbers are relatively close to the norm. And, as seen below, the magnitude of the City's Police and Fire service coverage is less than many of its peers:

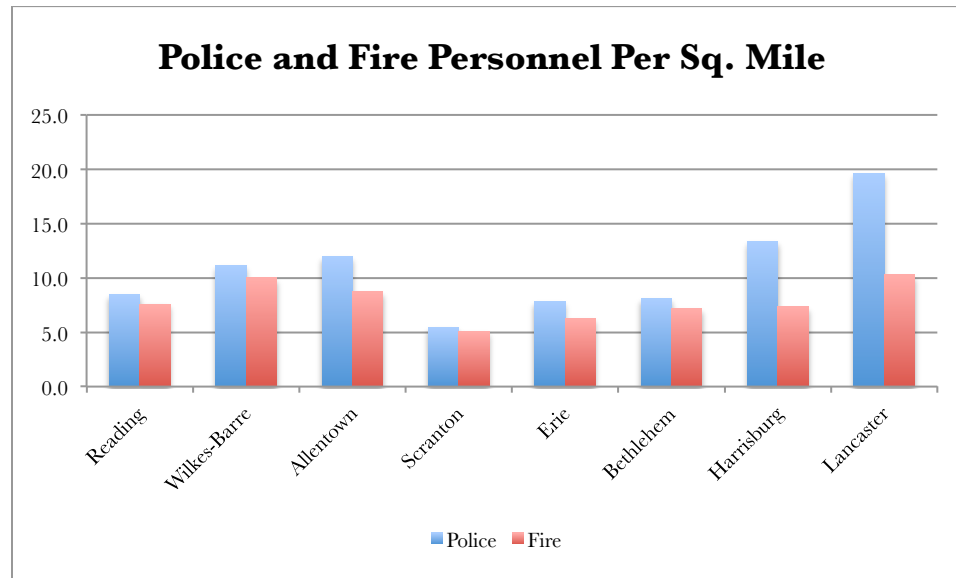


Figure 15. Police and Fire Personnel Per Sq. Mile

Although Scranton's Police and Fire presence per square mile is lower than each of its peer cities, there is an important caveat. First, roughly 7 square miles of Scranton's total 26 square mile land area is taken up by the uninhabited area surrounding the Montage Mountain resort;

¹² The language in Scranton's agreement, in this regard, reads: "The parties agree that the members of the bargaining unit covered by this Agreement shall achieve complete economic parity with the members of the Scranton Police Department by January 1, 1986 and shall maintain that party in all economic respects for the duration of this Agreement. This economic parity shall include base wage rate of the bargaining unit and that of the Police Department, but shall also include all other matters directly or indirectly impacting upon the total economic value and/or compensation or other monies paid to, or on behalf of, the members of the bargaining units during the course of each year of his contract."

incorporating this into the calculation for the City's land area would bring Scranton's number to roughly 7 for both Police and Fire, which would be much closer to the peer cities' average.

The disparity in cost may be primarily accounted for by two factors: the table of organization in each Bureau and, to a greater extent, the cost of their pension plans.

While the Bureau of Police has a relatively standard ranking structure, the Bureau of Fire is more "top-heavy" than many of its peers; i.e., the proportion of high-ranking officers to lower ranking officer is high¹³:

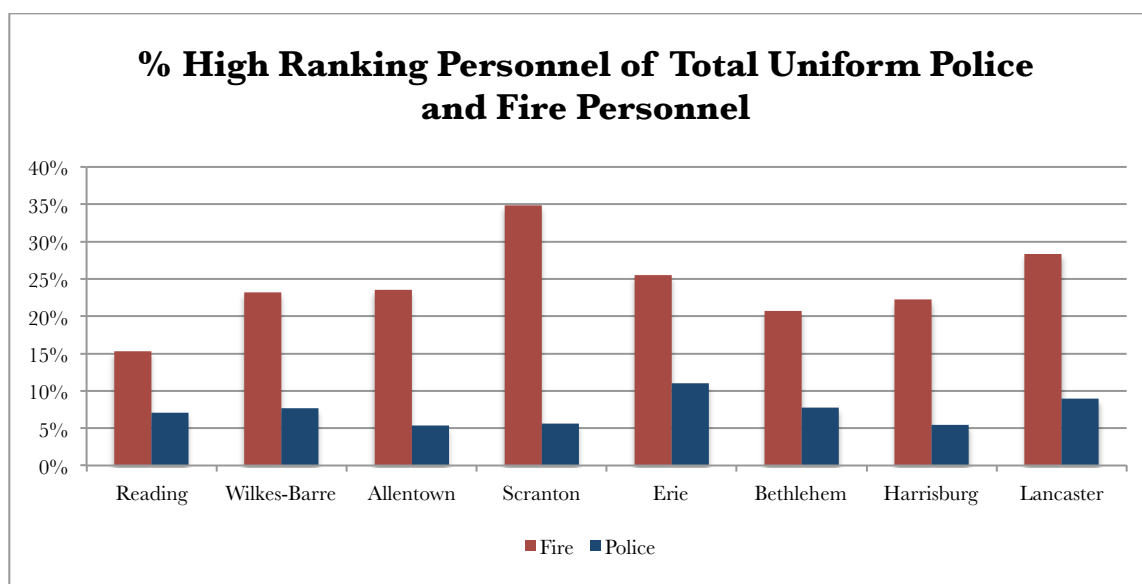


Figure 16a. % High Ranking Personnel of Total Uniform Police and Fire Personnel

¹³ A rank of Lieutenant or greater is considered high for both Police and Fire. Although the nomenclature for some ranks varies by department, this provides a useful dividing line. The calculated number of uniform personnel is used for this analysis.

One rank that is relatively constant across various fire services is the rank of Captain, which breaks down as follows:

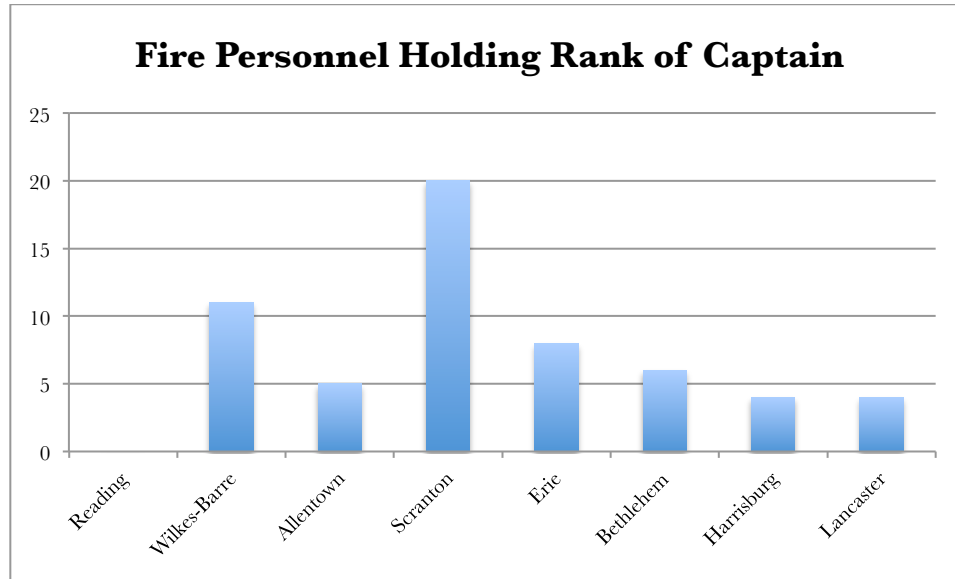


Figure 16b. Fire Personnel Holding Rank of Captain¹⁴

As the City begins to tackle its rising appropriations, it is imperative that it develop strategies to address this disparity and consider altering the ranking structure accordingly.

Second, the amount of money Scranton must pay towards its Police and Fire pension funds, especially when the figures are normalized for the variation in population among the peer cities, may explain a great deal of the particular financial strain on the Bureaus. Even in absolute terms, Scranton exceeds all of its peers significantly across all Fire services and all but one Police service:

¹⁴ Reading currently has no Captains in its Fire Department. Scranton has 19 Captains and 1 Administrative Captain.

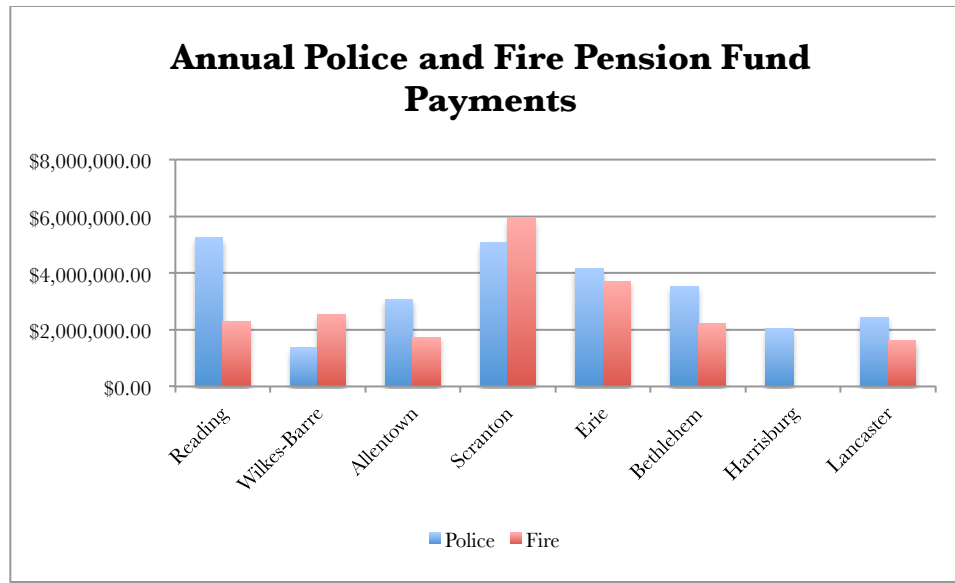


Figure 17. Annual Police and Fire Pension Fund Payments¹⁵

Below are some additional ways to understand the extent of the burden the pension fund payments place on the budget:

¹⁵ Harrisburg does not have to make any contribution to its Fire pension fund beyond the state subsidy. A pension bond issued several years ago provided the funding.

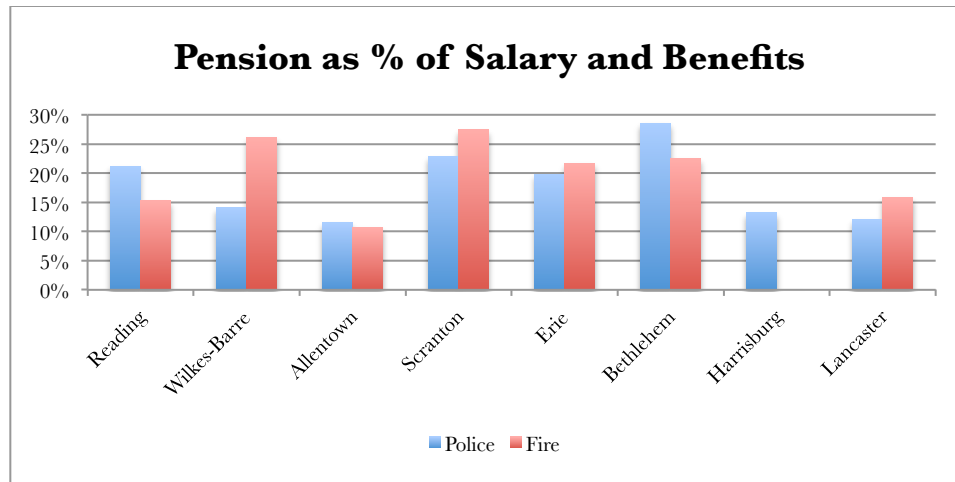


Figure 18. Pension as % of Salary and Benefits

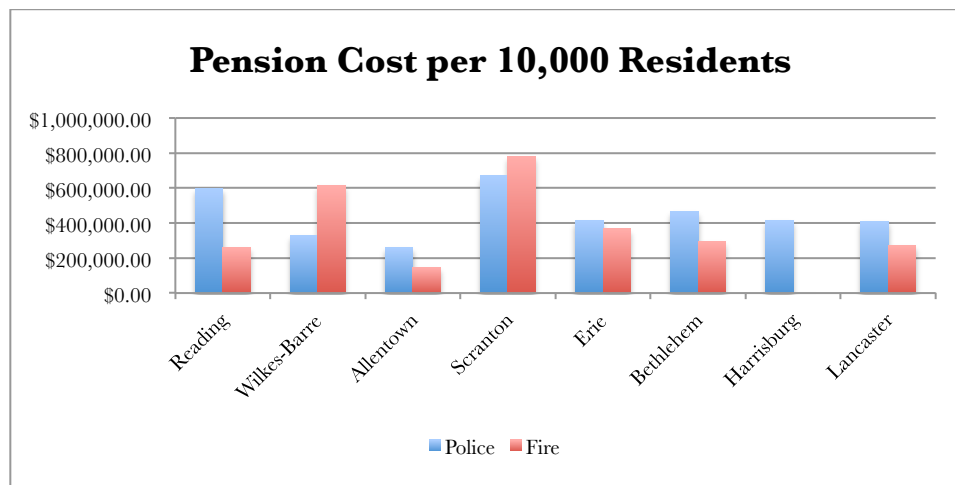


Figure 19. Pension Cost per 10,000 Residents

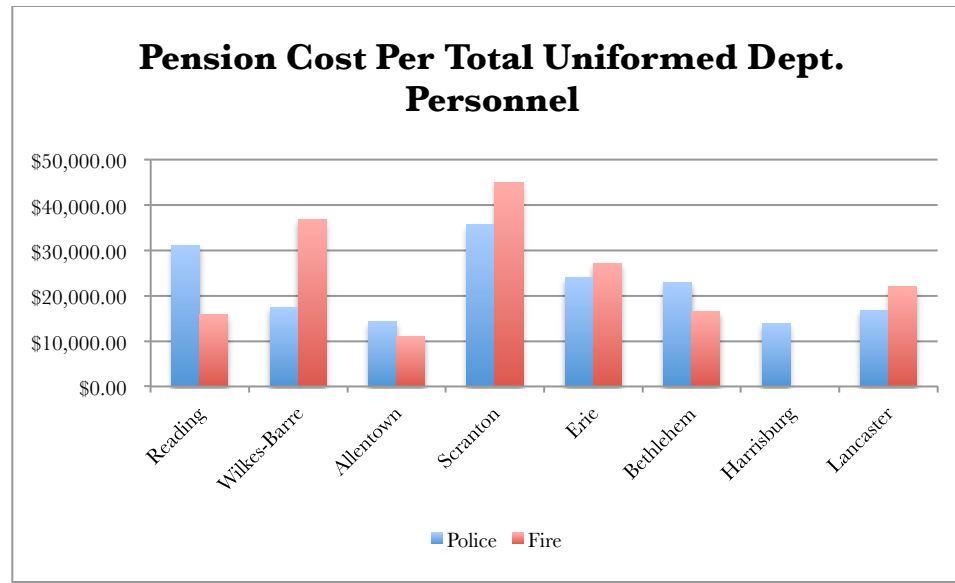


Figure 20. Pension Cost Per Total Uniformed Dept. Personnel

The essential point of the preceding analysis of the Bureaus of Police and Fire is to understand how one may account for the different aspects of one of the City’s greatest drivers of expenses. Indeed, within the Bureaus of Police and Fire, rising pension costs, in particular, are adding an ever-increasing burden on the overall budget.

The current financial situation in the Bureaus—which, as seen above, has an outsize effect on the City’s own finances—is unsustainable in the long term. Thus, the City and its associated Collective Bargaining Units must reopen contract negotiations, ahead of 2017, to begin meaningful discussions oriented towards establishing longer term solutions that recognize the years of service and commitment of those currently employed and in retirement while, at the same time, addressing the City’s financial obligations going forward. As will be discussed below, reforming the pension system, in particular, must be a point of focus.

III.

E. Pressure from the Pension

Between 2006 and 2014, the pension appropriation grew by 153 percent; by 2016, which is projected to mark the next significant increase in the City's Minimum Municipal [pension] Obligation ("MMO"), it will have grown by 209 percent.

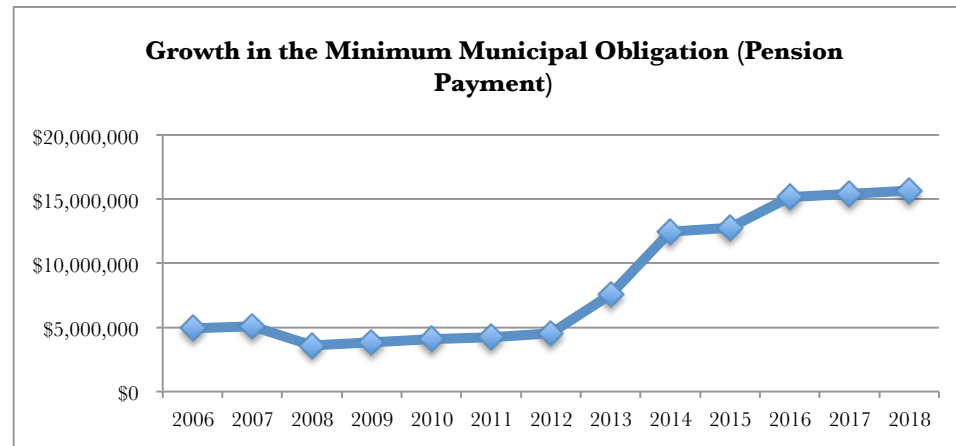
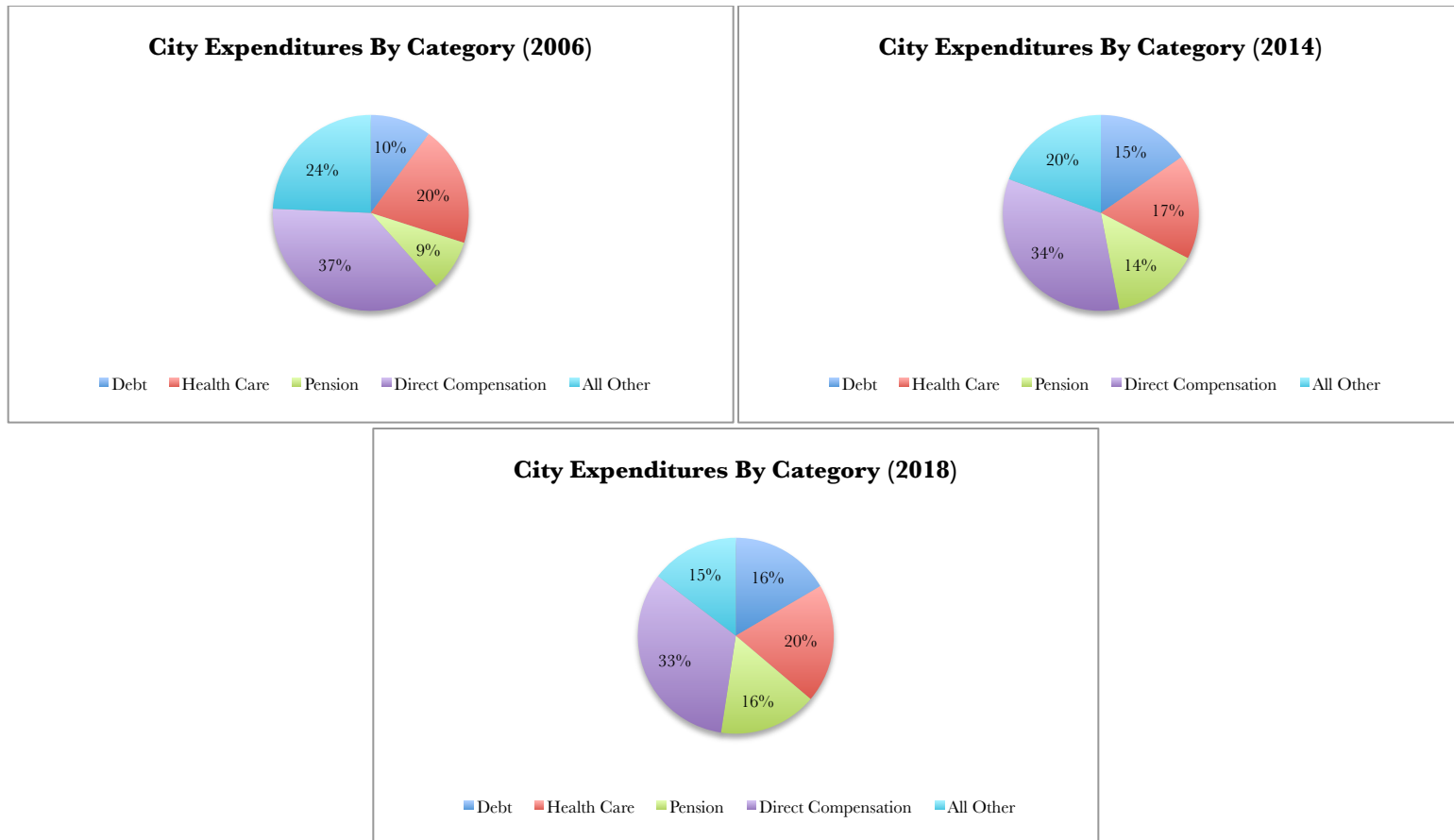


Figure 21. Growth in the Minimum Municipal Obligation (Pension Payment)

If we add some context to the City's growing MMO illustrated above, we can see that the pension payment comprises an ever-greater proportion of the City's budget:



Figures 22, 23, 24: City Expenditures by Category

Keeping the annual pension appropriation at an amount less than 8 percent of the budget would be a healthy goal for the City. As we can see, in 2006, the City met this criterion. Today, however, the City is well outside of this range and has seen the cost rise by \$7.5 million in absolute terms, with a projected \$3 million increase in 2016.

Debt, too, is rising at an unsustainable rate. Using a model that incorporates projected payment on a \$5 million portion of the judgment but no change to the City's guarantee of Scranton Parking Authority or its other debt obligations, debt grows from 10 percent of the budget in 2014—which is a relatively healthy figure—to 16 percent in 2018. Various comprehensive restructuring efforts ought to be carefully examined, and, potentially, pursued after dealing with the immediate crisis presented by the judgment. Failing to bring the current debt burden further under control will lead the City to remain in a position that leaves it unable to take out new debt at a reasonable price for necessary capital and infrastructure improvements.

IV. Facing the City's Long-term Liabilities: Debt, Parking and Pension

A. Introduction

In January of 2014, the Business Administrator prepared a plan that carefully set out a general strategy to address the major “debt related” issues, which, indeed, pose the most immediate threats to the City’s finances. Special attention was paid to addressing the \$22.2 million judgment and the City’s relationship with the Scranton Parking Authority, whose debt the City guarantees. We consider this plan to be the foundation of our own work and wholeheartedly endorse this element of the City’s comprehensive recovery plan and follow its approach closely. Although the City’s pension obligation is not—at least in the sense commonly used—debt, it shares many of its fundamental qualities. In short, the City’s pension payment presents a long-term obligation that the City must pay down and budget for annually.

When approaching a municipality’s finances, there are two fundamental components that must be considered. The first is the budget, which serves, essentially, as a strategic plan. The second is the actual activity of the City, represented best by its revenue cycle and regular payments. The primary concern of this category is maintaining solid and regular cash flows, which the City has historically struggled with (as evidenced by this year’s \$12 million TAN).¹⁶ While we do have access to the City’s currently proposed and historic budgets, the true amounts for collected revenues and paid out expenses are limited to 2012 and prior years. However, the City does not have a current 2013 audit and we have relied on data from the City’s internal accounting system for revenue cycle data.

A preliminary observation was—and, as demonstrated by the above analysis, remains—that the sheer size of the City’s pension obligation, long term debt payments, and current debt guarantees greatly compress the amount of discretionary funds available to the City to make critical improvements to infrastructure, conduct repairs, hire new staff, and pay for other capital investments (e.g., new City vehicles). Moreover, these obligations contribute to an additional vicious cycle in which the City cannot maintain levels of staffing in key departments that would better ensure proper revenue collection and the performance of thorough auditing functions.

¹⁶ Of course, TANs are not an unusual financing mechanism for municipalities to use, particularly given the nature of their revenue cycles. However, the size of and NIC on Scranton’s TANs are of concern. Scranton has previously experienced extreme shortages of cash, notably in 2012, and routinely struggles to collect all of the revenues owed to it. Reflecting the City’s current financial position, this year’s TAN had an NIC of 9 percent. Under a special “lockbox” arrangement, the City paid an NIC of approximately 5 percent in 2012 and 2013. In years prior, Scranton generally took out TANs at prevailing market rates—about 1-2 percent. Notably, some of Scranton’s peer cities, Allentown, Bethlehem, Lancaster, and Reading, did not file for TANs this year, while Harrisburg did.

IV.

B. A Review of the City's Debt

The City of Scranton currently has approximately \$98 million in outstanding debt principal paid out of its general fund, most of which was taken on early in the 2000s to fund capital projects, refundings, workers compensation, the pension, and other investments.¹⁷ The outstanding debt is about 99 percent of the projected budget appropriation in 2014 and debt service payments make up 11 percent of the 2014 projection.

Between 2001 and 2009, the City reduced its staffing compliment by 5 percent, which is a relatively normal change if population trends and alterations in the ways services are delivered are taken into account. In short, it does not represent a City struggling with substantial distress. Beginning in the late 2000s, however, as the deficit grew and City began to experience far more drastic financial problems, the City began to reduce personnel at a faster rate. Between 2009 and today—a shorter period of time than 2001 to 2009—the City reduced staffing by 12 percent. In addition, the City began to take out more significant and high interest rate debt for the purpose of deficit financing and refunding prior bonds.

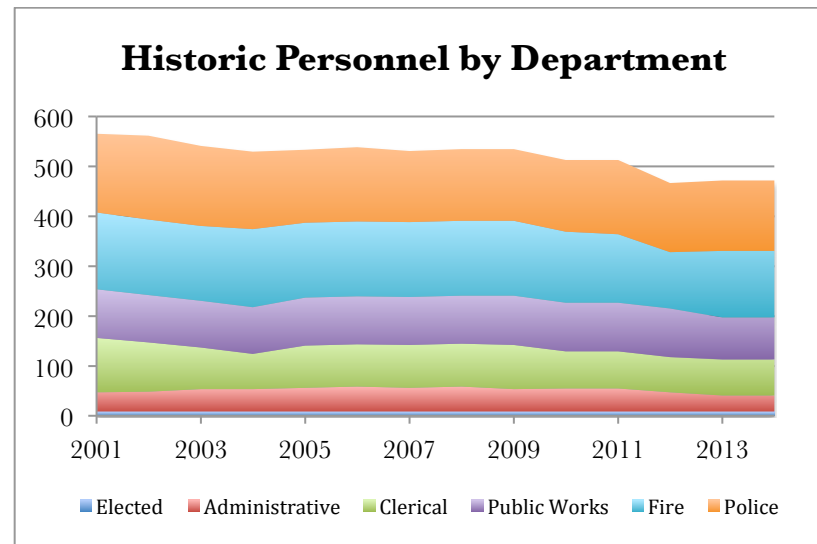


Figure 25. Historic Personnel by Department

¹⁷ The City also pays, from its general fund, debt service on 2004 Scranton Sewer Authority bonds, as well as 2006 and 2008 Scranton Redevelopment Authority Bonds.

As is true of many older cities, these significant financial problems developed over an extended period of time—often as the result of climbing pension, health care, and debt liabilities—that then reach a boiling point when adverse economic conditions emerge (as was the case in 2007-2009). The City began taking on these higher interest “bad debts”—i.e., deficit financing and “scoops,” or refunding of formerly required debt service payments—in 2008. The total face value of this debt is \$24.4 million and climbs to \$35 million when taking interest payments into account.¹⁸ This is approximately 25 percent of the City’s current outstanding debt.

In order to paint a truer picture of the City’s debt obligations, one must consider the debt of the defaulted Scranton Parking Authority, whose debt the City guarantees. According to this arrangement, whatever debt service payments the SPA cannot pay for out of its own revenues, the City must make up the difference. The total outstanding debt of the Scranton Parking Authority is approximately \$53 million and its debt service payment for 2014 is \$3.4 million. In 2014, for example, due to SPA’s underpayment, the City is on track to pay \$2.5 million towards SPA’s debt service, which is 74 percent of the Authority’s total payment.

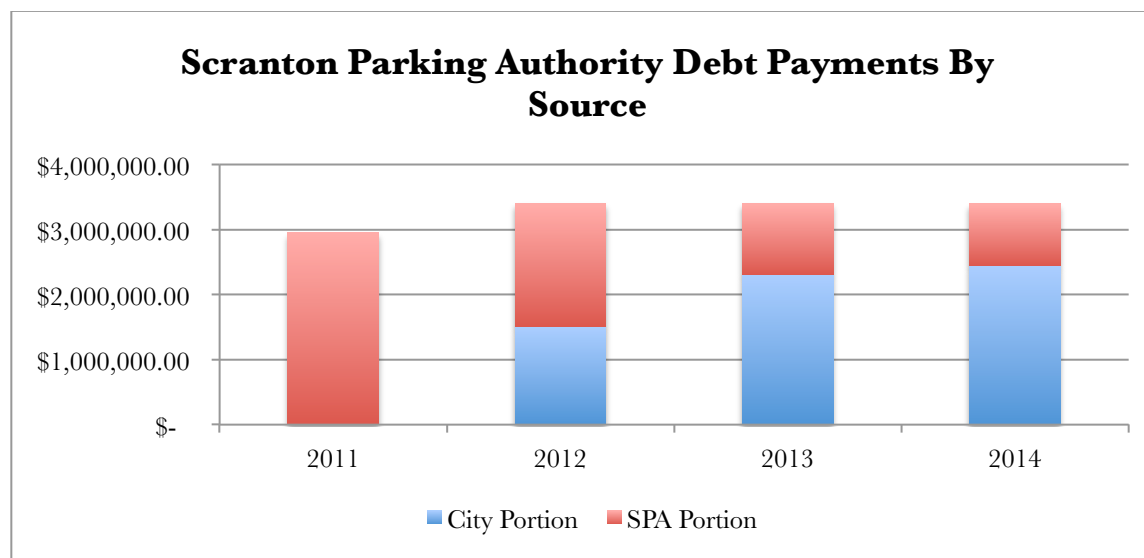


Figure 26. Scranton Parking Authority Debt Service Payments by Source

¹⁸ The bonds referred to above are: Series A of 2012 (Unfunded Deficit Financing); Series B of 2012 (Refunding of Nov-Dec 2012 Portion of Debt Service Payments for 2003 A,B,C & D Bonds); Series C of 2012 (Unfunded Deficit Financing); Series A of 2013 (Refunding of Feb-Dec 2013 Portion of Debt Service Payments for 2003 A, B, C & D Bonds)

This figure shows a troubling trend for the City; essentially, SPA evidences an increasing inability to make its debt payments as operating costs grow and revenues flounder. SPA revenue is clearly inadequate to service current levels of debt. Particularly, if one were to factor in the cost of the receiver, other administrative costs, as well as needed capital investments, maintenance, and repair, the City's ability to cover this payment with any degree of comfort becomes an increasingly daunting proposition. Even if one were to pledge the meter, parking ticket, and parking tax revenues, as well as the current portion of direct SPA payments on the debt, a deficit of \$900,000 would remain in 2014:¹⁹

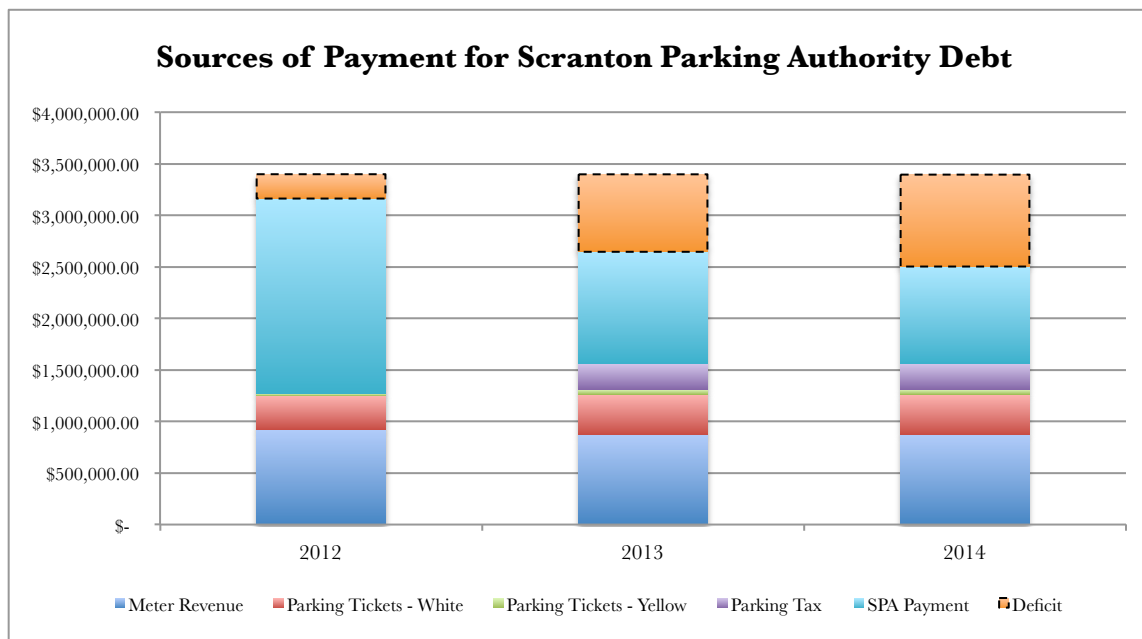


Figure 27. Sources of Payment for Scranton Parking Authority Debt

Given that the City would not be able to meet this obligation without significantly raising fine/tax amounts and collection rates or redirecting current general fund revenues, continuing to manage this debt obligation under the current framework remains problematic. At the same time, Scranton Parking Authority properties remain subject to external disruptive forces, such as increased surface parking opportunities, competitive pricing from other parking entities, and, indeed, new construction which might absorb its own parking.

¹⁹ This projection carries forward 2013 revenue actuals to 2014.

If we assume that the City's portion of its payment towards SPA's debt remains constant—which, according to current trends, may be generous—we must add this to the City's overall long-term debt burden:

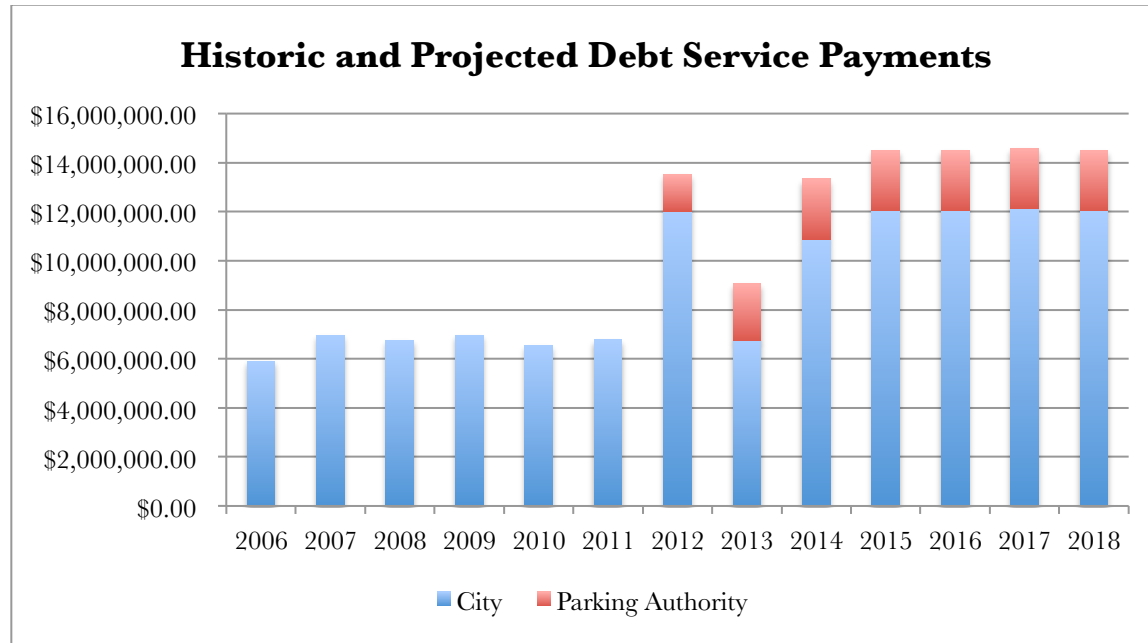


Figure 28. Historic Debt Service Payments

Much of the preceding discussion must be accounted for when considering the costs and benefits of “in housing” the Scranton Parking Authority’s assets (namely, the garages). Beyond the challenges outlined above, the City simply does not have the capacity or bandwidth to manage the parking garages, their maintenance, and be able to ensure high yields of currently collected revenues. Our general approach to addressing the issues facing the City always suggests orienting the City towards fewer moving parts and more clarity. “In housing” SPA’s assets would have the exact opposite effect. Finally, were the City to become the owner and operator of the garages, there would doubtless be needs for significant capital improvements going forward that would necessarily add even more debt to the already burdened City.

Therefore, we believe that the City would benefit from and should consider a sale of the Scranton Parking Authority's assets through an auction. This process ought to be run by an outside professional dedicated to establishing the best value in either the whole of the Authority or the sum of its parts. This process should begin immediately.

After moving to dissolve SPA and selling its assets, the City will need to address the residual portion of the Authority's debt. This debt would then be temporarily added to the City's existing debt structure. The residual debt, moreover, will be reduced by the amount that the Authority's assets yield in a sale. We rely, in part, on the most recent parking demand study, which indicated a value of \$22 million. In the simplest scenario, this would reduce the overall debt obligation from \$53 million to \$31 million. It will be then be necessary to restructure the remaining debt. Preliminary modeling involving such a restructuring will be discussed further below.

Ultimately, however, the market must be pursued to determine the value of SPA assets. Indeed, in certain cases, the value of the land underneath the improvements may exceed the value of the improvements themselves, driving up the price beyond the assessed value of the garages listed in the report.

IV.

C. The Judgment

Perhaps the largest and most immediate challenge facing the City is the \$22.2 million judgment, which constitutes 23 percent of the City's revenues. This amount reflects an arbitration award meant to refund the City's Police and Fire unions in back pay; and, according to Pennsylvania statute, the judgment carries an annual fixed 6 percent interest rate. That being said, the Collective Bargaining Units ("CBUs") have a right to execute on the judgment whenever they deem it appropriate to do so, although there are some limitations to this ability. Therefore, developing both an immediate solution to reduce the pressure the judgment places on the City and a longer-term solution to fully pay down the judgment are necessities.

The City has approached this problem in various ways, yet none, thus far, have been successful. One unsuccessful strategy was the City's attempt to issue bonds in order to cover the judgment in full—this approach is reflected in the proposed 2014 budget, for example. In order to more quickly reduce the pressure caused by the judgment and introduce some much needed breathing room, the City is currently pursuing a strategy, under the leadership of the Business Administrator, in which a \$5 million up-front payment will be made to the CBUs by issuing debt. Although the exact terms of the offering are not known, we have estimated that this deal will add an additional \$1.3 million in debt service beginning in 2015, should the deal be executed on. A pledge of the City's Worker's Compensation reserves, along with an adjustment to the reserve's funding ratios if authorized by the Commonwealth of Pennsylvania, will serve as collateral.²⁰

²⁰ City is currently in negotiations with the Department of Labor and Industry to authorize the change to the funding ratio.

Although we fully endorse this approach and recommend its continued pursuit, we believe an investigation into alternative approaches must be maintained should the current approach fail to materialize. Moreover, even if the current plan is successful, \$17 million of the judgment will remain and continue to collect interest bringing the total to \$18 million in year one. According to one line of thought, the City will be able to approach traditional investors to fund the balance of the judgment after it has restored its credit rating in a few year's time. This approach is, of course, entirely contingent on the City's ability to restore its credit rating, which is, in turn, directly dependent on the City's ability to restore its budget and finances. Naturally, there is a considerable amount of risk to this approach as, even if everything according to current projections proceeds perfectly, any sort of unforeseen difficulty could squander the plan and leave the City in a very challenging position. Finally, it would not be unlikely for rates to climb further in the coming years, which adds an additional incentive to act more comprehensively in the near term.

IV.

D. An Alternative Approach – Pursuit of a More Comprehensive Debt Restructuring

As we have seen above, the City has many debt obligations and the promise of more to come in the future, regardless of the specific strategy pursued with respect to the Scranton Parking Authority and the judgment. An alternative approach that must be thoroughly explored would be to restructure a portion of the City's debt and package it with the judgment (or the \$17 million balance) and the residual debt left by a sale of the Scranton Parking Authority's assets. This would likely be done through a third party investor, who understands the economic risk involved, the outlines of the recovery strategy, and the strength of the present team put in place. When compared to several of Scranton's peer cities, Scranton's annual debt service payments exceed all other municipalities in absolute terms:

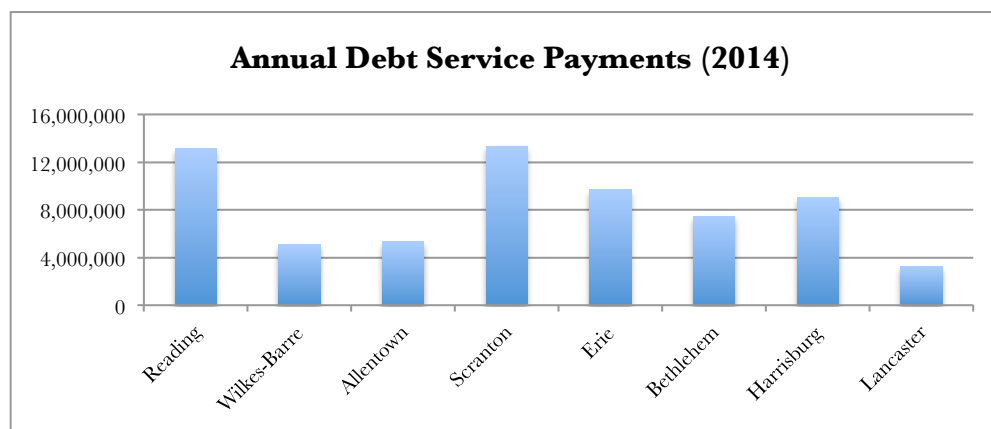


Figure 29. Annual Debt Service Payments

Although Scranton's annual debt payment is only \$200,000 more than Reading's, it is \$4.3 million more than Harrisburg (the third highest) and \$5.9 million more than Bethlehem (the fourth highest). It should be noted that Wilkes-Barre, Lancaster, Harrisburg, and Bethlehem all have fewer people than Scranton—and correspondingly smaller budgets—while Erie, Allentown, and Reading all have greater overall expenses.

To look at this from another angle, we measured Scranton's debt service payments as a proportion of overall expenditures, excluding TANs:

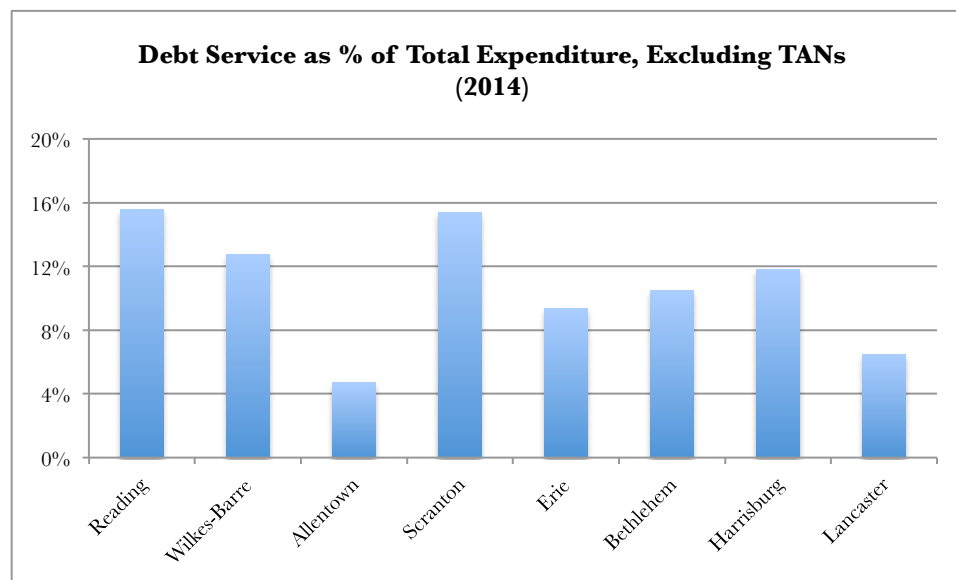


Figure 30. Debt Service as % of Total Expenditure, Excluding TANs (2014)

Scranton's debt burden, especially when measured against several of its peers, is particularly onerous. We would like to see Scranton's debt service decline to somewhere in between 10 and 12 percent; although this may still be considered to be somewhat high—unless the debt service largely reflects a history of capital investment—keeping annual debt service payments in this range will help the City defease its debt obligation, thus building equity, and moving closer to being able to borrow for needed infrastructure and capital investment. Therefore, some form of refinancing on a portion of the City's current debt would be welcome. But, as Scranton begins to address the judgment and the issues posed by the Scranton Parking Authority, a broader refinancing incorporating these new debts, could be extraordinarily beneficial to the City.

Due to the nature of the City's finances, it is vital that the City consider all options available to it, including those presented by investors more amenable to alternative debt markets. As outlined above, continuing to pursue traditional markets at a somewhat unknown timeline presents risks

as well as advantages. In all likelihood, an alternative market investor would not be interested in any discrete portion of the City's debt in itself. Quite simply, the amount would be too small for mustering significant interest. Rather, their approach would be more suited to a broader restructuring of some portion of the City's debt or a larger offering. Some potential scenarios are included below (all are based on 20-year bonds):

1. The sale of bonds to cover an initial \$5 million payment on the judgment award
2. A restructuring of the City's Series B of 2003, C of 2003, and D of 2003 that would occur in Spring 2015.
3. A restructuring of the Scranton Parking Authority's residual debt after a sale of all parking assets, assuming a need to issue a general obligation bonds for approximately \$31 million
4. The issuing of approximately \$53 million in bonds to cover the approximately \$22 million judgment and the residual SPA debt

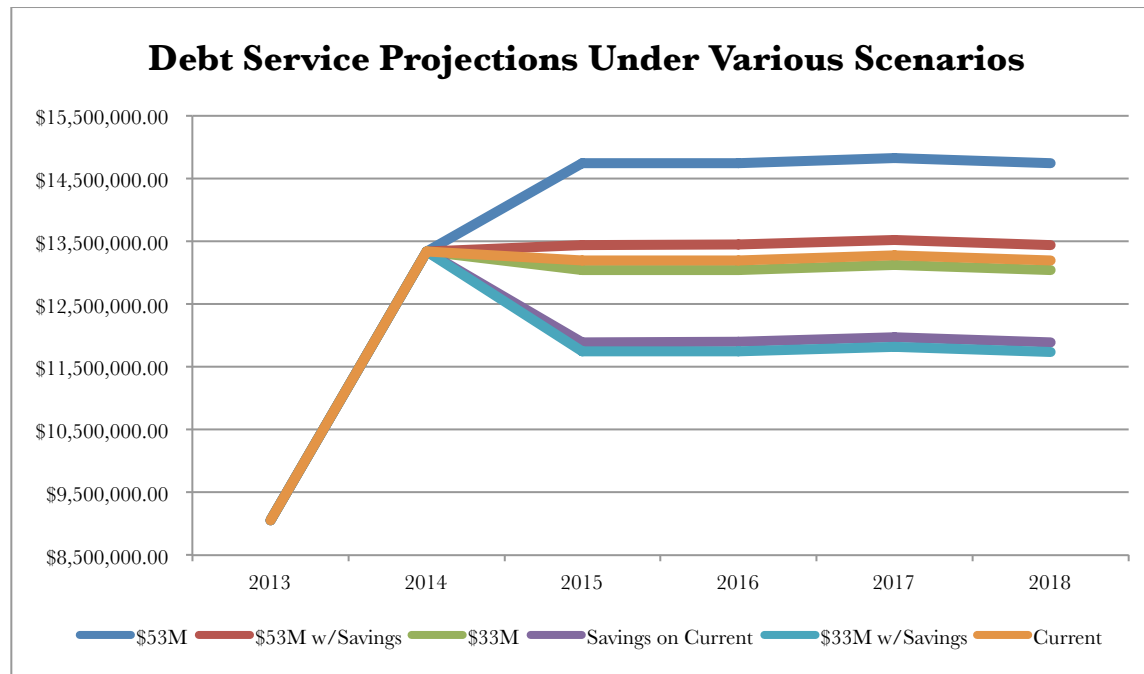


Figure 31. Debt Service Projections Under Various Scenarios

| | 2015 | 2016 | 2017 | 2018 |
|--------------------|------------------|------------------|------------------|------------------|
| \$53M | \$1,550,000.00 | \$1,550,000.00 | \$1,550,000.00 | \$1,550,000.00 |
| \$5M | \$1,300,000.00 | \$1,300,000.00 | \$1,300,000.00 | \$1,300,000.00 |
| \$53M w/Savings | \$250,000.00 | \$250,000.00 | \$250,000.00 | \$250,000.00 |
| \$33M | \$(150,000.00) | \$(150,000.00) | \$(150,000.00) | \$(150,000.00) |
| Savings on Current | \$(1,300,000.00) | \$(1,300,000.00) | \$(1,300,000.00) | \$(1,300,000.00) |
| \$33M w/Savings | \$(1,450,000.00) | \$(1,450,000.00) | \$(1,450,000.00) | \$(1,450,000.00) |

Figure 32. Projected Total (Savings)/Cost on Various Debt Scenarios

We recommend that the City proceed on a thorough review of a refunding of its 2003 series debt immediately. Indeed, the cost savings potential from this refunding could cancel out the added cost of the \$5 million borrowing to make an initial payment towards the court award. However, it would move the interest rate a good deal higher (to approximately 7 percent) over the current rates tied to the debt.

Of course, there are certainly additional possibilities, namely the restructuring of the City's later debt. However, there are caveats on each of these further possibilities that stem from certain aspects of the debt—e.g., the terms of certain bond covenants or the debt's status as callable or non-callable. The possibility of executing on such options should be examined, however, as a broader restructuring could result in greater cost savings.

In our conversations with some alternative market investors and their partners, they have suggested that they would be willing to offer a competitive rate to the City and that various measures could be taken, perhaps included in the associated bond covenants, to make this restructuring or offering more amenable to the investors—and, indeed, the City—such as by having a dynamic rate tied to the debt and adjusting it favorably if certain benchmarks are met. Other possibilities could include establishing clear collateral or placing priority liens on certain City revenues or assets. The City could also lobby for additional measures to be related to this restructuring, such as achieving lower rates on the City's TANs.

Naturally, one must acknowledge that any debt issue, especially one as significant as the above, has several moving parts and that it is hard to reflect specific rates or pricing without conducting a truly thorough financial analysis. The City should engage with its financial advisor as soon as possible to conduct such an analysis, once a general strategy is determined.

We believe that this alternative market strategy needs to be immediately analyzed in parallel to approaching the traditional markets in a few years time because of the stabilizing effect that it would have on the City's debt and, moreover, its ability to offer much-needed predictability for the budget. Moreover, the City might benefit from exploring certain bond covenants in these deals that would encourage a commitment to defeasing the debt and building sufficient revenue to recreate the capacity to borrow in a credit-competitive way for capital spending. The City would benefit from having a cleaner and clearer debt picture, even if engaged at somewhat of a premium, given the necessity of paying down outstanding debt and rebuilding the City's equity base.

One aspect of the debt strategy that should be immediately implemented is to follow the Business Administrator's plan to direct the City's improvement millage through a single payer agent to pay down its debt obligations. The City's millage on improvements, according to 2014 assessed values, would need to increase by 24 percent to cover the currently projected 2014 debt service payments (40.202 mills to 49.864 mills).

Generally speaking, it is our firm belief that the City rely less on assumptions and strive for greater degrees of certainty in its budgeting. If the City truly wishes to begin and then maintain a strong recovery it must achieve greater stability relative to its debt, even if a piecemeal approach were to offer somewhat better rates. We do not dispute, however, the need to pursue the Business Administrator's plan to offer the CBUs an initial \$5 million payment, if it proves possible. Clearly, additional work needs to be done to fully analyze this picture, but we believe the next several months should sharply focus on a process that lays out these various analytical models in greater and precise detail.

IV.

E. Addressing the Pension

According to our analysis, the City's aggregate pension obligation presents the single most significant challenge to establishing long-term financial stability. The City's ratio of the three pension funds' assets to liabilities, for example, has become less favorable for all years data is available.

In essence, a pension shares many of the qualities of any sort of fund. It has assets—usually a portfolio of stocks, bonds, other forms of equity and debt, etc.—and liabilities, or the amount it owes the pension fund's beneficiaries in its form of deferred compensation. But, given the specific nature of pension funds and the often-significant amount of time between when a beneficiary joins a workforce and retires, certain assumptions necessarily become part of any analysis surrounding a pension fund. Typically, the pension benefit owed to a retiree is calculated by multiplying a fixed percentage to the employee's final salary by the number of years of that employee's service. The retiree is then guaranteed to receive this benefit every month—i.e., she receives a “defined benefit.” This differs from a defined contribution fund, such as a 401(k), in which the employer contributes to an investment account tied to the employee but does not guarantee a certain amount of benefit to be dispersed to the employee upon retirement.

The Commonwealth of Pennsylvania has over 3,200 local government pension plans or approximately 25 percent of the nation's total.²¹ Across the Commonwealth, between 2001 and 2011, the aggregate unfunded liability of the Commonwealth's pension funds increased markedly, in large part due to declining asset valuations stemming from adverse market conditions. Between 1988 and 2001, the Commonwealth's aggregate unfunded liability grew from \$2.8 billion to \$3.9 billion; between 2001 and 2011 the aggregate unfunded liability increased by \$4.5 billion to \$8.4 billion (though this marks a decrease from 2010, down from \$8.6 billion).²² Unsurprisingly, funds whose actuarial assumptions include higher rates of return on their investments—reflective of their interest rate assumptions—suffered greater losses during this period due to their need to make riskier investments.

The City's pension system is divided into three basic funds: Police, Fire, and Non-Uniformed. Unfortunately, the most recent available data on the pension comes from the 2011 audit, which was issued in January 2013.²³ We had hoped to meet with the City's pension actuarial by this time, but, for various reasons, ranging from scheduling to statutory considerations, this has not been achieved. However, the City expects to receive updated data from its actuarial in the coming weeks or months. The actuarial assumptions employed by Scranton's pension fund are:

1. A rate of return on present and future fund assets at 8 percent annually, net of investment-related expenses
2. A projected salary increase of 5 percent annually
 - a. With a cost of living increase of 5 percent for members hired *before* July 1st, 1987
 - b. With a cost of living increase of 2.5 percent for disabled members and widows of members hired July 1st, 1987

With regard to contributions, the 2011 audit reports the following:

Police are required to contribute 3.5% of covered payroll for members hired on or after July 1, 1987. For members hired prior to July 1, 1987, the police are required to contribute 4.0% of covered payroll. Firemen are required to contribute 3.5% of covered payroll for members hired on or after July 1, 1987. For members hired prior to July 1, 1987, the Firemen are required to contribute 4.0% of covered payroll. Non-uniformed nonunion employees are required to contribute 3% of covered payroll but not more than \$22 per month if hired after July 1, 1987. Non-uniformed nonunion employees shall contribute \$24 per month if hired before July 1, 1987 or amounts as determined by ordinance.²⁴

²¹ Anthony W. Salomone, "Status Report on Local Government Pension Plans," Public Employee Retirement Commission of the Commonwealth of Pennsylvania, Harrisburg, PA, Dec. 2012, 1

²² *Ibid*, 14

²³ Robert Rossi & Co., Certified Public Accountants, "City of Scranton Independent Auditor's Report, December 31, 2011," Jan. 2013.

²⁴ *Ibid*, 62

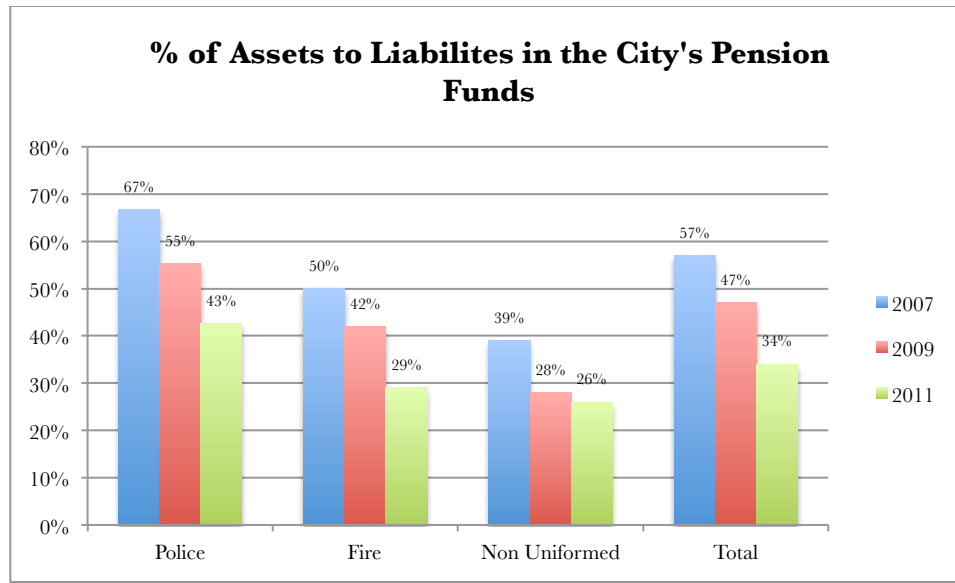


Figure 33. % of Assets to Liabilities in the City's Pension Funds²⁵.

The total funding ratio for the City's three current funds in 2011 was 34 percent, giving the City's pension funds, in aggregate, a "Severely Distressed" rating according to the Public Employees Retirement Commission ("PERC") of the Commonwealth of Pennsylvania. Only 3 percent of self-insured, defined benefit municipal pension plans have a funding ratio less than 50 percent.²⁶

²⁵ *Ibid*, 62-66

²⁶ *Op. Cit.*, Salomone, 12

In addition, the City's funding ratio's rate of decrease has been substantial:

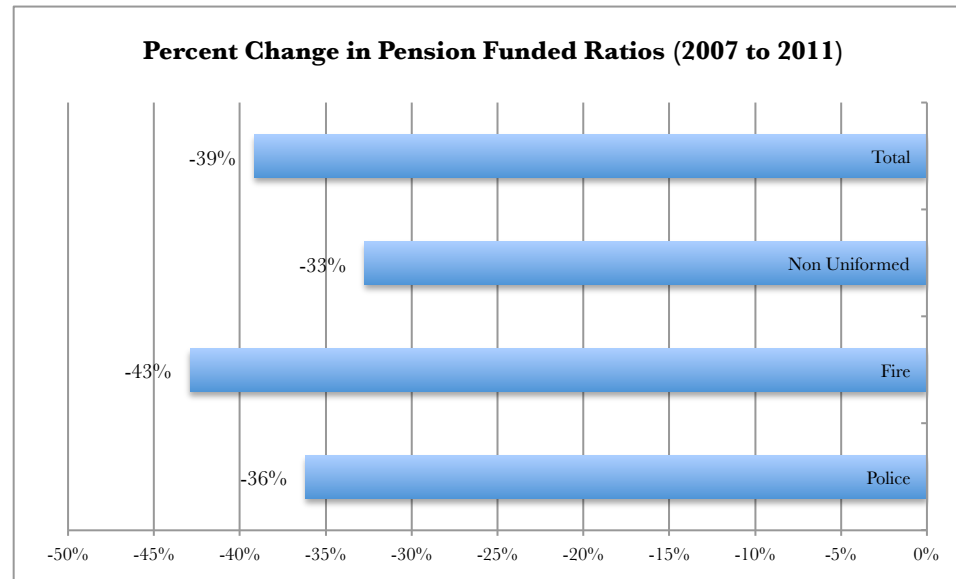


Figure 34. % Change in pension Funded Ratios (2007 to 2011)

To put Scranton's unfunded liability in some degree of perspective, the below graph compares Scranton's funded liabilities in its Police and Fire pension funds to a selection of its peer cities (i.e., how much of the liability is covered by current fund assets):

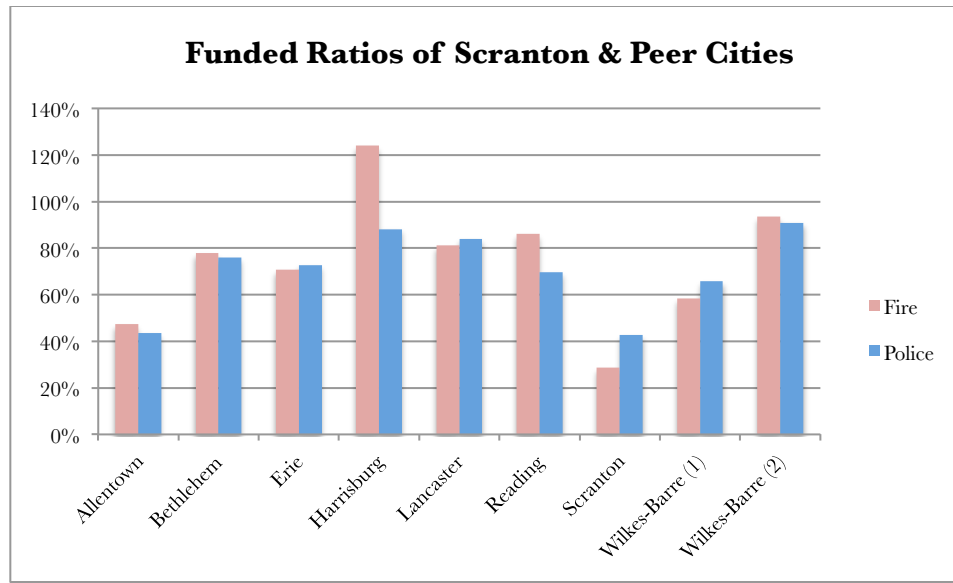


Figure 35. Funded Ratios of Scranton and Peer Cities²⁷

Each year, the Public Employees Retirement Commission assigns the City with a Minimum Municipal Obligation (“MMO”)—i.e., the City’s minimum payment to its pension funds—based on the plans’ biennial actuarial valuation in order to meet the calculated *minimum* actuarial requirements. The Commonwealth, in addition to the MMO, also contributes funding to the City’s pension, which is and is projected to remain at approximately \$3 million. Since 2010, the City’s MMO has grown from \$4.1 million to \$12.4 million, or by 203 percent. As is true throughout the Commonwealth, though magnified in the case of Scranton, market losses paired with rising utilization largely drove this increase. According to our projections, the City’s MMO will rise sharply in 2016, a change which reflects the end of pension smoothing. Were the MMO to remain approximately at that level through 2018—projected to reach \$15.7 million—then the City’s MMO will have increased by 281 percent since 2010.

²⁷ *Op. Cit.*, Salomone, 35-106 (Selections from compiled data table); Wilkes-Barre has two separate pension funds each for its Police and Fire retirees.

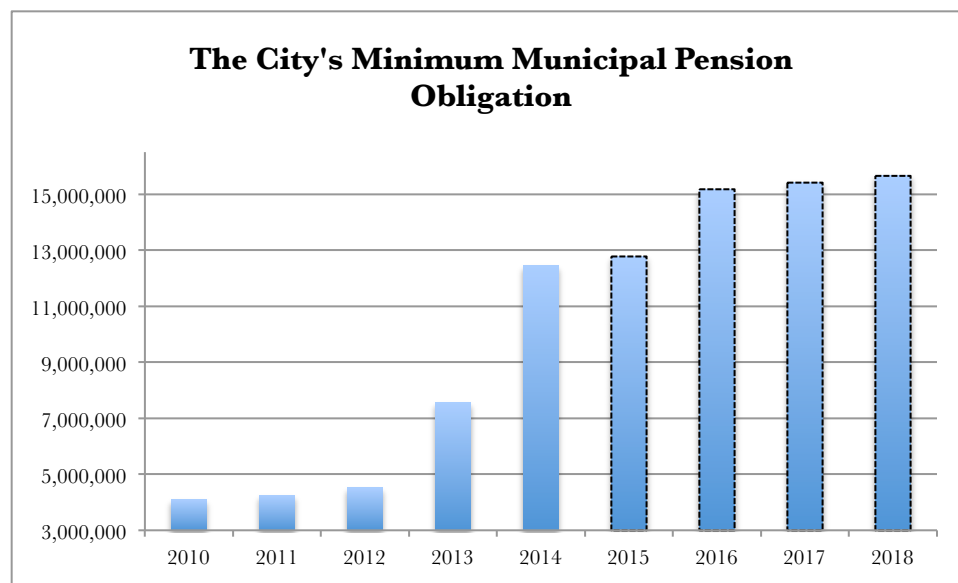


Figure 36. The City's Minimum Municipal Pension Obligation

As more employees retire and begin to claim their pension benefits, demand on the fund is likely to go up. As we do not have actuarial data since 2011 and, given the general trend, it is likely that the aggregate liability has only grown. Moreover, the aspect of the court award affecting retirees must be factored into the actuarial data. Currently—according to an estimate by an actuary hired by Larry Durkin, the attorney for the Composite Pension Board—the ruling is expected to add an additional \$6.9 million to \$10.5 million to the overall liability.²⁸ If the high estimate is to be realized, it would account for 6 percent of the funds' most recent total accrued liability of \$173 million.

It is important to emphasize that, as its name suggests, that the MMO is a statutorily required *minimum* contribution. By only paying the MMO, the City is essentially operating according to a “pay-as-you-go” approach. This approach reflects a cash flow strategy rather than an attempt to establish true fiscal and budgetary stability. Pursuing the latter course would not merely meet a “best practice” but is essential if the City wishes to approach future stability. If substantial amounts of cash are *not* injected into the pension fund over the next several years—a move that would have the effect of reducing the MMO—the portion of the City's budget comprised by the pension payment will continue to climb, crowd out

²⁸ Terrie Morgan-Besecker, “Arbitration award to cost Scranton pension fund \$6.9M to \$10.5M,” Scranton Times-Tribune, Scranton, Pennsylvania, 24-Apr-2014.

discretionary spending, diminish the City's ability to build equity (and thus pay for capital improvements), and lead the City to pursue further tax increases.²⁹

To meet this end, the City must pursue three strategies:

First, we believe that the City must move to monetize select assets in order to make a significant one-time payment into the pension funds. The primary asset under review is the Scranton Sewer Authority. Accordingly, the City should conduct a thorough review of its current assets, and, if the City does not own an asset outright, the nature of its relationship to the asset should be carefully assessed and recorded.

Currently, it appears that the revenues of sewer pipes are pledged to the debt of the Scranton Sewer Authority. The license, however, remains with the City. We strongly believe that the City should engage a qualified advisor to offer counsel to the City on the issues surrounding a potential sale of the Scranton Sewer Authority. The sale itself could take various forms—e.g., an outright sale (public to public transaction) or a long term management contract, which would have the effect of preserving the option for future leadership to determine the status of the Authority. A sale of the Scranton Sewer Authority, which *nets* the City \$20 million—i.e., after dealing with necessary debt-related issues, other expenses, and the payment to the Borough of Dunmore—could save the City approximately \$1.5 million on its MMO annually, should other variables related to the pension hold. Of course, this figure is illustrative and subject to the true obligation as determined by the State actuary.

Second, the City needs to enact a non-resident earned income tax by accessing a mechanism included in Act 205—the Commonwealth's primary pension relief statute—and granted to municipalities whose pension funds fall under the "Severely Distressed" category. More than 40 municipalities in Pennsylvania have this tax in place; more than half of Act 47 municipalities have a *non*-Act 205 non-resident earned income tax. Unlike the non-resident earned income tax enabled under Act 47, establishing this tax under Act 205 does not need court approval. However, the

²⁹ Though the City might want to consider the possibility of a Chapter Nine bankruptcy strategy, it is our opinion, at this time, that the costs of such a bankruptcy would be quite expensive and the benefits limited. We do recognize, however, that if a comprehensive strategy is not put forward and followed, the City's finances will continue to be stressed to such an extent that this option would merit further consideration. While a bankruptcy could have a leveling effect on the City's current debt burden—taking out new debt, of course, would become far harder if the City were to seek bankruptcy protection—it is unclear if it would have any significant affect on the City's pension obligation, which is the greater liability. That being said, three essential considerations stand in the way of bankruptcy. First, despite the scale of the City's liabilities, they do not match the levels of distress of other government entities that have entered into Chapter Nine protection (e.g., Detroit, Michigan, Jefferson County, Alabama, and municipalities forced into bankruptcy by extremely adverse court rulings (although Scranton's \$22.2 million judgment is no doubt substantial, accounting for about 20 percent of the City's 2014 revenues, a \$20 million judgment that forced Westfall Township, Pike County, Pennsylvania into Chapter Nine protection was 2000 percent of the Township's 2010 revenues; Westfall Township is the only government entity in Pennsylvania to have successfully entered Chapter Nine protection). Second, Scranton has the capacity to close its deficit, albeit by substantial revenue increases. The City is, in other words, not close to being "tax dead"—i.e., taxes could be raised to cover expenses if necessary. Steps to this effect would almost certainly occur before bankruptcy is considered. Third, and related to the former point, the Commonwealth of Pennsylvania would have to allow a Chapter Nine bankruptcy petition to move forward. It is not unlikely that the Commonwealth would pursue a strategy similar to its approach in Harrisburg. Nevertheless, bankruptcy must remain a viable option given the financial the stress the City is under, provided it does not first take meaningful positive steps forward.

sole function of this tax is to provide additional funding towards severely distressed pensions. While it is within the City's power to enact this tax immediately, the City must make it a priority to engage with commuters, businesses, and other stakeholders to assess the impact of the tax and fully explain its basis. The City cannot afford to repeat the last experience with attempting to institute a non-resident earned income tax. Such a tax authorized under Act 205 is not an easy way out or a way to dodge a political bullet, but rather one part of a revival that all who share in Scranton's assets must contribute to.

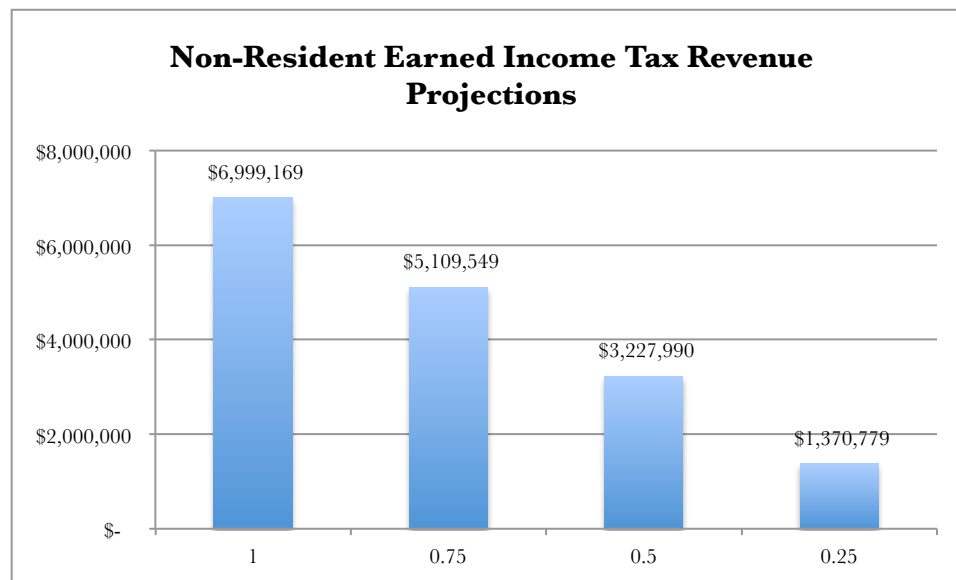


Figure 37. Non-Resident Earned Income Tax Revenue Projections³⁰

Third, the City needs to immediately commence negotiations with the CBUs and appeal to the unions to reopen contract negotiations prior to the scheduled contract negotiations in 2017. Namely, the City ought to move to negotiate broad-based pension reforms as they might affect new hires. More specifically, it is vital that the City explore requiring the pension funds' beneficiaries to begin contributing more towards their pensions, with a particular focus on new hires; changes to the age of eligibility and the calculation of retirement benefits should be further explored, as well as the

³⁰ These projections were made by multiplying the various rates by total non-resident earnings in the second quarter of 2012 (most recent available data). This gives us the quarterly rate. And, given that the payment to Scranton of an individual commuter must be calibrated against the EIT in his or her own municipality, adjustments were made to revenues accordingly.

structure of the benefit funds going forward (e.g., switching to a defined contribution benefit structure or some form of hybrid defined benefit/contribution structure). Should State legislation be required to enact any of the above reforms, especially changes to the structure of benefit plans, the City must explore that route whenever appropriate.

Ultimately, the city's annual payment should be indexed to roughly 8 percent of its overall appropriation, despite the fact that this would be on the high end of the acceptable range, if not exceeding it. The City's portion must be reduced to approximately \$9 million. Therefore, the City requires another funding source to bring the MMO down to this amount, the non-resident earned income tax (under Act 205) in addition to "superfunding" the pension through an asset sale.

IV.

F. New Revenues, Meeting the Deficit, and Reducing the MMO

According to one of our basic projections, which includes \$1.3 million in projected debt service to cover the initial \$5 million payment and the maintenance of the City's current arrangement with the Scranton Parking Authority, the City faces an \$8.6 million deficit in 2015 and a \$12.6 million deficit in 2016. Assuming other revenues remain essentially flat, total Real Estate Tax revenues would need to be increased by 31 percent in 2015 and 11 percent in 2016 in order to cover this projected deficit with a small surplus of approximately \$50,000 in each year.

| | 2014 | 2015 (31%) | 2016 (11%) | 2017 (4%) |
|---|-----------------|-----------------|-----------------|-----------------|
| Total Real Estate Tax Revenues | \$27,943,903.00 | \$36,606,512.93 | \$40,633,229.35 | \$42,339,824.99 |
| Total New Revenues | | \$8,662,609.93 | \$12,689,326.35 | \$14,395,921.99 |
| Projected Deficit | | (\$8,612,594) | (\$12,642,137) | (\$14,329,308) |
| Adjusted Deficit with New Revenues | | \$50,015.93 | \$47,189.35 | \$66,613.99 |

Figure 38. (Deficit)/Surplus Projections with Only Real Estate Tax Increase

Should the revisions to Act 47, as they stand now, pass through the Pennsylvania General Assembly and be signed into law by the Governor, the City would be able to increase its Local Services Tax ("LST") by a factor of three, adding an additional \$3.3 million in revenues. This reduces the projected 2015 deficit to \$5.3 million and the projected 2016 deficit to \$9.3 million. It should be noted that a portion of the LST revenues, following the suggestion of the Business Administrator, would be dedicated to paying judgment debt-related payments. However, given that the ultimate passage of the Act 47 revisions is unknown, and that the current provisions of the law related to revenue raising capacity could be changed, it would be unwise, given the magnitude of the City's financial difficulties, to rely on this revenue source alone.

A $\frac{3}{4}$ point non-resident tax, enacted under the authority of Act 205, would yield \$5.15 million per four quarters of collection. Incorporating this tax would lower the deficits to \$190,000 and \$4.2 million, respectively. It must be noted that the revenues for this tax may only be applied to the City's pension obligations. Therefore, some portion of the revenues from the general fund currently being used to cover the pension payment, with the implementation of an Act 205 tax, will be subject to redirection towards other uses.

Finally, the City should move to increase total Real Estate Tax (RET) revenues by 18 percent, 6 percent, and 4 percent between 2015 and 2017. This will allow the deficit, using the above model, to be closed and offer the City a significant surplus in year one and a smaller surplus going forward. While it is generally a best practice to achieve a roughly 3 percent surplus, the City should, instead, consider using these additional revenues, whenever possible, to help extend the City's pension payment beyond the Minimum Municipal Obligation. However, as we will see below, additional funding will be needed to help pay down coming debt obligations for the remainder of the judgment award, the residual SPA debt, and any future infrastructure investment.

| | 2014 | 2015 (18%) | 2016 (6%) | 2017 (4%) |
|---|-----------------|-----------------|-----------------|-----------------|
| Total Real Estate Tax Revenues | \$27,943,903.00 | \$32,973,805.54 | \$34,952,233.87 | \$36,350,323.23 |
| LST | \$1,650,000.00 | \$4,950,000.00 | \$4,950,000.00 | \$4,950,000.00 |
| Act 205 (.75 pts.) | - | \$5,109,549.09 | \$5,109,549.09 | \$5,109,549.09 |
| <i>Increase</i> | | | | |
| Total Real Estate Tax Revenues | - | \$5,029,902.54 | \$7,008,330.87 | \$8,406,420.23 |
| LST | - | \$3,300,000.00 | \$3,300,000.00 | \$3,300,000.00 |
| Act 205 (.75 pts.) | - | \$5,109,549.09 | \$5,109,549.09 | \$5,109,549.09 |
| Total New Revenues | - | \$13,439,451.63 | \$15,417,879.96 | \$16,815,969.31 |
| Projected Deficit | | (\$8,612,594) | (\$12,642,137) | (\$14,329,308) |
| Adjusted Surplus/(Deficit) with New Revenues | | \$4,826,857.63 | \$2,775,742.96 | \$2,486,661.31 |

Figure 39. (Deficit)/Surplus Projection with Additional New Revenues

However, to only address the above model would be to ignore the necessity of developing some solution to the City's additional debt obligations, either in the form of issuing debt to cover the balance of the judgment award—likely to be \$17 million—or a more comprehensive restructuring. The below illustrates the impact on the budget of three approaches to the City's long term debt obligations:

| | 2015 | 2016 | 2017 |
|---|---------------|----------------|----------------|
| \$53M | \$1,550,000 | \$1,550,000 | \$1,550,000 |
| \$5M | \$1,300,000 | \$1,300,000 | \$1,300,000 |
| \$53M w/Savings | \$250,000 | \$250,000 | \$250,000 |
| \$33M | (\$150,000) | (\$150,000) | (\$150,000) |
| Savings on Current | (\$1,300,000) | (\$1,300,000) | (\$1,300,000) |
| \$33M w/Savings | (\$1,450,000) | (\$1,450,000) | (\$1,450,000) |
| Base Projected Deficit | (\$7,312,594) | (\$11,342,137) | (\$13,029,308) |
| Adjusted Deficit | 2015 | 2016 | 2017 |
| \$53M | (\$8,862,594) | (\$12,892,137) | (\$14,579,308) |
| \$5M | (\$8,612,594) | (\$12,642,137) | (\$14,329,308) |
| \$53M w/Savings | (\$7,562,594) | (\$11,592,137) | (\$13,279,308) |
| \$33M | (\$7,162,594) | (\$11,192,137) | (\$12,879,308) |
| Savings on Current | (\$6,012,594) | (\$10,042,137) | (\$11,729,308) |
| \$33M w/Savings | (\$5,862,594) | (\$9,892,137) | (\$11,579,308) |
| Total New Revenues | \$13,439,452 | \$15,417,880 | \$16,815,969 |
| Adjusted Surplus w/ New Revenues | 2015 | 2016 | 2017 |
| \$53M | \$4,576,858 | \$2,525,743 | \$2,236,661 |
| \$5M | \$4,826,858 | \$2,775,743 | \$2,486,661 |
| \$53M w/Savings | \$5,876,858 | \$3,825,743 | \$3,536,661 |
| No Change | \$4,853,052 | \$2,803,509 | \$2,515,538 |
| \$33M | \$6,276,858 | \$4,225,743 | \$3,936,661 |
| Savings on Current | \$7,426,858 | \$5,375,743 | \$5,086,661 |
| \$33M w/Savings | \$7,576,858 | \$5,525,743 | \$5,236,661 |

Figure 40. Projected (Savings), Costs and (Deficit)/Surplus Scenarios

As should be clear from the above, a failure to take comprehensive action on the City's debt and add additional revenues will leave the City with a far deeper deficit. Although the precise form of the City's plan to address its outstanding debts remains unknown, it will have to move on that front quickly. Without adding additional other sources of revenue, the need to raise property taxes significantly will become acute.

As suggested above, the City's surplus should be directed towards funding the pension. However, we also believe that it should be used, in part, to cut the City's Mercantile and Business Privilege taxes on the order of \$500,000 in year one, \$1,000,000 in year two, and then in its entirety by year three. In essence, this seeks to eliminate a particularly onerous tax to the business community and its reasoning will be explained further below.

V. Operational Improvements and Strategic Initiatives

A. Reducing Health Care Costs

i. *Wellness Coaching*

Several private corporations and some municipalities—notably Chicago—have introduced the “Safeway model” to cut health care costs.³¹ The Safeway model works by installing a premium structure wherein employees are rewarded for healthy behavior—e.g., quitting smoking, losing weight, etc.—through lower premium payments; likewise, employees are penalized for unhealthy behaviors. While this model has its advantages, it is methodologically difficult to fairly tie the successes or failures of an individual’s efforts to become healthier to a universal metric. In addition, a strict incentive/disincentive structure may lower employee morale and unity; it can also foster a sense of helplessness and unfairness.

Wellness coaching, however, can be an incredibly valuable tool for lowering healthcare costs *and* improving overall employee health. A 2010 study from the *Journal of Health Affairs* found that for every dollar a firm invested in wellness programs, it would save \$3.27 on medical costs and \$2.73 on absenteeism-related costs.³² Indeed, more and more corporations are adopting wellness programs as the evidence for significant cost savings continues to mount. In 2009, corporate employers spent \$260 per employee on wellness programs. This year, the same corporate employers report that they will spend an average of \$521 per employee on wellness-based incentives—more than double the figure four years ago.³³

The City should also see if it can negotiate a deal with its health insurance provider to offer a “wellness allowance.” Aetna, for example, offers its larger clients—and Scranton should fall into this category—a \$75,000 stipend to pay for wellness programs such as baseline health and fitness screenings.³⁴

³¹ Steven A. Burd, “How Safeway Is Cutting Health-Care Costs,” Wall Street Journal, 12-Jun-2009.
<http://online.wsj.com/article/SB124476804026308603.html>

³² K. Baicker, D. Cutler, and Z. Song, “Workplace Wellness Programs Can Generate Savings,” *Health Aff*, vol. 29, no. 2, pp. 304–311, Feb. 2010.
<http://content.healthaffairs.org/content/29/2/304>

³³ Ed Emerman, “New Health Care Survey Finds Spending on Wellness Incentives Has Doubled in the Last Four Years,” Feb. 2013.
<http://www.businessgrouphealth.org/pressroom/pressRelease.cfm?ID=207>

³⁴ Jane Adler, “Workplace Wellness Helps Curb Health Care Costs,” *Crain’s Chicago Business*, 2013. [Online]. Available:
<http://www.chicagobusiness.com/healthiest-employers/workplace-wellness-helps-curb-health-care-costs.html>

ii. City-run Health Centers

One unique and effective way to cut costs and improve general employee wellness would be to establish a series of City-run health centers. Essentially, the City would in-house the majority of primary medical services to City-funded and -operated centers. All those covered by the City's health care plan would be eligible to visit these primary care centers. The City would hire its own team of doctors and pay them on a salaried basis—rather than on the fee-for-service model. Moving away from a fee-for-service model provides an incredible cost savings opportunity for the City and also refocuses attention towards preventive care, which is immensely important for any workforce that deals with chronic ailments, such as diabetes. Staff doctors would also be able to provide a degree of personal attention that is hard to maintain in a large, standard medical practice.

Montana, for example, introduced the nation's first State-run primary care center in 2012. The center is meant to serve the 11,000 Helena-area people covered by the State's health insurance plan. Many in the State initially attacked Montana for establishing such a seemingly expensive program; but, as of July 2013, the State has actually *saved* \$1,500,000 on health care costs. Moreover, by insourcing some health care services, the State has been able to identify and address several chronic health issues early. Through mandatory preliminary screenings, Montana identified 600 people with diabetes, 1,300 people with high cholesterol, 1,600 people with high blood pressure, and 2,600 patients diagnosed as obese. This allows the State to significantly cut future costs by reducing the need to provide coverage for highly expensive treatments rather than cheaper preventative care.³⁵ Lakeland, Florida, saved \$1.1 million in the first year of opening a health clinic. Employee participation grew from 67 percent to 87 percent in the first few years after the clinic opened.

The City health center in Wilmington, Delaware, for example, reported that, in the 2011-12 fiscal year, 72 percent of clinic visits were related to chronic disease management. In addition, increasing the availability of preventative care will help cut down on lengthy and expensive employee absences.³⁶ Of course, employees will still be able to visit outside practitioners for specialized treatment.

³⁵ Dan Boyce, "Montana's State-Run Free Clinic Sees Early Success : NPR," NPR.org, 30-Jul-2013. [Online]. Available: <http://www.npr.org/2013/07/30/206654000/montanas-state-run-free-clinic-sees-early-success>. [Accessed: 12-Aug-2013].

³⁶ Julian March, "MyReporter - Why did city of Wilmington open employee health clinic?," StarNewsOnline.com, 26-May-2013. [Online]. Available: <http://www.starnewsonline.com/article/20130526/ARTICLES/130529630>. [Accessed: 12-Aug-2013].

iii. Introducing Competition

One way to drive down overall costs is to introduce more competition into the health care process. New York City, for example, announced at the end of the Bloomberg Administration that it would be putting its health care contract out to bid. Its current provider, EmblemHealth responded by announcing that it would not raise the City's rates for the first time in fifteen years.³⁷

V.

B. Shared Services

We do think that the City must immediately consider, with the support of its representatives to the Pennsylvania General Assembly, Lackawanna County officers, and other stakeholders in neighboring communities, the pursuit of shared services, as well as regionalized departments and delivery systems. We recommend that the Mayor appoint a commission of various stakeholders and leaders from both government and outside government to begin such a study in a professionally facilitated format. The Pennsylvania Economy League performed an exploration of the potential and current impact of various shared services programs in its service area, which serves as a good basis for future efforts—though Scranton was not a particular focus of the study.³⁸

When looking at the City and the greater Scranton area, we believe regionalized services could help reduce costs, improve services, and allow, when appropriate, for innovative investment in community safety and infrastructure maintenance and investment. Examples of successful shared services in the region includes Operation Gang Up, which provides local police forces with additional tools and expertise on tackling gang-related crime.

In general, and given the current statewide environment for shared services, reforms in this regard should be viewed largely as a supplement to existing City services and a chance to improve the quality of certain services. Naturally, cost savings should be pursued, but developing better services for Scrantonians by brining in regional expertise and resources is of course a priority.

³⁷ AP, "NYC to put health-insurance contract to bid," *Wall Street Journal*, 02-Aug-2013.
<http://online.wsj.com/article/AP35481920bb0e44238a3d6205b5a525a6.html>

³⁸ Pennsylvania Economy League, Central PA, "The Economic Impact of Shared Services in Pennsylvania and an Examination of Shared Service Delivery in Selected Counties," Aug. 2009.

V.

C. Budgeting Practices

We believe the City, in the interest of fiscal best practices and accuracy, ought to use, in its 2015 budget, the data from its most recent audit (which will be from 2013). This should of course reflect changes in certain fees, notably those related to parking and refuse. Preparing a timely audit has been a perennial problem for the City, which, in large part, can be explained by two issues. First, the City lacks the necessary staffing to prepare the audit in a timely fashion and has often relied on interns or already drastically overburdened staff members to do so. Naturally this slows down the process significantly as, due to current vastly diminished staffing levels, audit preparation is, by necessity, not among the first priorities of the city departments that must contribute to its preparation. Second, the City cannot fully close out its portion of audit preparations without first receiving information from its component units—namely the Scranton Sewer Authority and the Scranton Parking Authority. This process has only worsened after the Scranton Parking Authority’s default and entrance into receivership. Unless steps are taken to ensure that these bodies issue their required materials in a timely fashion, the positive impact of potential improvements on the City’s end will be limited.

Throughout this period of transition, the City would be best served by budgeting prior year actuals unless there is clear and convincing documentation—satisfactory to the Mayor, City Council, and Business Administrator—that demonstrates precisely why an enhancement in a prior years’ collection rate should be budgeted. For example, if there is an increase in a particular tax or if a new PILOT comes online, then the City would have reasonable grounds for adding that to the budget’s revenue projection. Too often, the City has budgeted on an anticipatory basis—and the City often fails to meet these expectations—making it hard to manage cash and grasp what its true budget is, which further requires the City to engage in last-minute fixes. For example, an interfund transfer of liquid fuels funds from the Commonwealth was included in the 2014 budget at \$3.8 million. However, there was no specific commitment stipulating this increase in the allocation; instead, the City received just \$1.5 million.

A feature of this problem is the City’s inability to carefully monitor and fully implement its revenue raising capacity. Once again, this is related to a dearth of staff in the various departments responsible for managing this process. Thus, adding one or two staff to assist with the revenue cycle process—perhaps supported by a grant—would bring the City enormous “bang for its buck.” Alternative solutions, such as employing additional interns, could help alleviate some of the pressure on existing staff as well. However, it must be said that even with more staff the City still faces a rather daunting collection process. Because of the sheer number of fees that the City budgets in relation to licenses and permits, it may be hard for an even a significantly larger body or revenue officers of any capacity to collect these revenues fully. Currently, the City is responsible for monitoring and collecting on 36 licenses and permits, including distinct permits for music, pinball, and electronic machines, as well as arcades and “video amusements.” Eliminating or consolidating some of these revenue items could be more beneficial, especially considering current staffing levels, than trying to deliver on all of them. Indeed, because of the relatively small size of many of these revenues, staff could be redirected to areas of higher importance.

We further believe that there should be a quarterly report to the Mayor, Council and the public, of actual revenues against budget. We find that these reporting mechanisms well-serve a municipal body and encourage its members to be well informed. This sort of mechanism further allows stakeholders to give guidance when periodic calibrations and adjustments to the budget need to be made.

V.

D. Payments in Lieu of Taxes (PILOTs)

The most common form of a Payment in Lieu of Taxes (“PILOT”) is a payment to a local government by an entity that is otherwise exempt from property taxes. For example, a government building or higher education institution exempt from a property tax payment may offer the City a PILOT instead. PILOTs can also be used as an economic development tool wherein a new development would pay a PILOT to the City as opposed to property taxes. Though we have not yet had meaningful discussions with appropriate stakeholders on this topic directly, we believe the City should strive to achieve a \$1.5 million annual PILOT target for 2015, 2016, and 2017. However, it is vitally important that these PILOTs not simply be a mechanism to plug holes in the general fund. Rather, they should be directed towards specific projects or expenses that the PILOT payer would support, such as capital and infrastructure improvements or public safety. For example, a PILOT may be used to match grants from the Pennsylvania Department of Transportation for the purpose of pothole repair, road paving, and street light maintenance. When both the PILOT payer and the public can see a tangible result of the PILOT payment, PILOT payments are much more likely to occur and may, moreover, serve to benefit the profile of the payer.

In addition to PILOT payments in themselves, Scranton enjoys a uniquely rich environment of for-profit and not-for-profit companies dealing with some of the most dynamic challenges in business today: manufacturing, higher education, and health care, for example. The leadership teams of these institutions thoroughly understand how a business or public entity might apply best practices to areas such as supply chain management and revenue cycles. Recognizing, as detailed above, that the City’s work force has been curtailed by virtue of other growing debt, pension, and health care costs, the City, in working with the Greater Scranton Chamber of Commerce, might seek to identify individuals or teams who could assist in the preparation of analyses, data reports, and best practice reviews in a way that could be truly beneficial to the City and its stakeholders. For example, we have seen situations in which a large corporation would lend an executive for a period of time in order to conduct an analysis of a particular issue and develop a report in areas of: operational improvement, IT, management, and health care utilization. In each of these cases, the subject City has benefited remarkably from the partnership, not only in actually performance improvement but also from the creativity and engagement with this solution-oriented approach.

One important aspect of PILOTs is their capacity to foster the recruitment of new business. A new project might be given some form of tax abatement in exchange for a PILOT payment exclusively to the City, which is often perceived to be more amenable to the business and would not cause the City any significant reduction in its own revenue.

V.

E. Targeted Elimination and Reduction of Taxes, Expansion of Grants and Incentives

As the City moves forward on its recovery plan, it should identify certain taxes for elimination, provided the successful and timely implementation of the plan and its components. As it is likely that the City will raise additional revenues through some combination of real estate, local services, and Act 205 supported taxes, it should seek to tie these to a corresponding reduction—with the goal of an eventual elimination—of the various Mercantile/Business Privilege taxes. Any reduction to these taxes would be seen as a welcome gesture by the City to the business community, as these taxes are considered to be a particular disincentive to do business in Scranton. Given the necessary strain that some of the new and expanded forms of revenue will place on the business community and the people who work in the City, a review of these taxes will provide some relief and add an additional incentive to conduct business in the City and keep jobs in Scranton. While we think it is too early to eliminate those two taxes, if the City is to execute on the components of the recovery plan, and it performs in alignment with expectations, we expect the City to be in a position to fully eliminate those taxes by the 2017 budget, beginning a phase out of the gross receipts taxes beginning in 2015. In eliminating those taxes, new development recruitment could, as described above, be encouraged by PILOTs, which would help further bridge the potential elimination of these taxes.

In addition, Scranton enjoys an unusually engaged Chamber of Commerce, whose understanding of the region's vital performance indicators and the concerns of the region's business is quite remarkable. There is no doubt that the Greater Scranton Chamber of Commerce has the wherewithal to be a meaningful partner to the City and other stakeholders. The City, in partnership with the Chamber, should expand its Office of Economic and Community development, in order to put together a strategic plan for business recruitment and retention, paying special attention to utilizing various State and Federal incentive programs.

V.

F. Exploration of a New Refuse Collection and Storm Water Authority

Although this recommendation remains only at a provisional stage, the City should seek to analyze the costs and benefits of establishing a new public authority that would absorb the City's refuse collection function and develop a storm water management capacity distinct from that of the current sewer system. The City could use its parks and other public lands as locations for attractive storm water pooling ponds. The Department of Public Works – Bureau of Refuse would be dissolved and its personnel would be shifted to the new authority. A preliminary analysis suggests that a \$1.5 million surplus from the Bureau of Refuse would be lost if the City were to seek to form this new authority in 2015.

However, there would be three primary advantages. The first advantage would be to limit the City's need to continue to pay the benefits of these employees and transfer this cost over to the authority. Second, the potential of the authority to collect storm water revenue fees or initiate an impervious surface tax would add a potentially significant new source of revenue for the City that does little to discourage positive economic activity and, in fact, could put downward pressure on sewer rates as they will have less of a need to treat extraneous storm water. Finally, the authority would have access to at least two defined revenue streams—refuse collection and storm water-related fees/taxes—that it could use to issue revenue bonds for much-needed infrastructure projects.

VI. Recommendations

We make the following recommendations:

- Immediately begin the process of initiating the sale of the Scranton Parking Authority in its entirety
- Reopen the City's contracts with its Collective Bargaining Units, focus on negotiating appropriate health care, and, especially, pension reforms (e.g., higher contributions, migration towards a defined contribution or hybrid plan for new hires, later pension eligibility dates), as well as changes to starting salaries, time between steps, and ranking standards/distribution. Determine the need for State legislation, if appropriate, for implementing negotiated reforms
- Establish an Act 205 tax, at .75 points, which allows the City to tax residents and non-residents alike, but *only* for purposes of funding the City's pension; this would raise \$5.1 million in the first four quarters of collection. More than 40 municipalities in Pennsylvania have this tax in place; more than half of Act 47 municipalities have a *non*-Act 205 non-resident earned income tax.
- Assuming the passage of the Act 47 revisions, tripling the Local Services Tax Rate, which would raise \$4.95 million (\$3.3 million over the amount budgeted in 2014). A portion of this revenue ought to be directed towards covering debt related to the judgment, should the \$5 million initial payment come to fruition
- Initiate the sale of the Scranton Sewer Authority in an offering to both public and private entities, subject to legal review. Upon completion of the sale, direct the entirety of the proceeds to the pension fund
- A property tax increase of 18 percent, 6 percent, and 4 percent in 2015, 2016, and 2017 respectively
- Thoroughly restructure a portion of the City's existing debt, the residual debt of the Scranton Parking Authority, and judgment-related debt.
- Phase out the City's gross receipts taxes (Business Privilege and Mercantile Taxes) beginning with a 25 percent reduction in year one, a 50 percent reduction from 2014 levels in year two, and a full elimination by year three.
- Initiate a reassessment. The Mayor should make a formal request to the County either by letter or personal appearance, requesting the reassessment.
- Appoint a commission of various stakeholders and leaders from both government and outside government to develop a study on the implementation of various shared services programs
- Review the possibility of dissolving the Bureau of Refuse and migrating personnel to a new refuse collection and storm water runoff public authority
- Conduct a thorough review of the City's current assets
 - If it is determined that the City does not own an asset outright, the nature of its relationship to the asset should be carefully assessed and recorded.

APPENDIX

Glossary

Scranton: “The City”

Minimum Municipal Obligation. This refers to the minimum the City must pay towards its pension fund, abbreviated as “MMO.”

Scranton Parking Authority: “SPA”

Scranton Sewer Authority: “SSA”

Tax Anticipation Note: “TAN”

The Judgment: refers to the \$22.2 million back pay award to the City’s police and fire unions

Unfunded Liability: the amount of money missing that would be necessary to completely fund a pension plan. This is often expressed as a “funded ratio,” or the assets measured against the liabilities. This, in turn, is often expressed in percentage terms. A pension plan with a \$100 million total projected liability with \$60 million in assets would have an unfunded liability of \$40 million and a funded ratio of 60 percent.

Budget Line Items – Revenues:

1. Real Estate Taxes

Current Real Estate Tax

Delinquent Real Estate Tax

Real Estate Taxes 2011 Unfunded Debt

2. Landfill / Refuse Fees

Landfill Tipping Fee - \$300 Rate

Delinquent Refuse Disposal Fee

3. Utility Tax

4. Local Taxes (Act 511)

Real Estate Transfer Tax

Delinquent Real Estate Transfer Tax

Current Wage Tax

Delinquent Wage Tax

Undefined Wage Tax

Mercantile Tax 1.0 Mills

Mercantile-Delinquent

888 Tax

Emergency & Municipal Services Tax (LST)

Delinquent Bus. Priv. Tax

Bus. Priv. Tax

Parking Tax

Amusement Tax

5. Penalties & Interest / Delinquent Taxes

Pen/ Interest /Dlq Real Estate

Pen/Dlq Bus. Priv. Tax

Pen/ Interest /Dlq Rl.Est.Regis

Advertising/RI.Est.Regis
Tax, Refuse, Demolition Lien And
Condemnation Search Fees
Filing Fees - Delinquent Accounts

6. Licenses And Permits

Electrical Permits
Plumber Licenses
Electrician Licenses
Mechanical Permits
Mechanical Licenses
Contractor Licenses
Scale Licenses
Beverage Licenses
Building Permits
Junkyard Licenses
Parking Facilities
Sign Hangers Licenses
Dog & Kennel Licenses
Lodging Licenses
Eating & Drinking Licenses
Gasoline Pump Licenses

Music Machine Permits
Pinball Machine Permits
Milk Licenses
Parking Meter Permits
Plumber Permits
Sign Permits
Taxi Driver Permits
Theatre Licenses
Temp. Peddler Permit
Transient Merchant Licenses
Pools & Billiards Licenses
Bowling Licenses
Daily Entertainment License
Electronic Machine Permit
Video Amusements
Amusement Rides
Dumpster Permits
Arcade Licenses
Job Trailer Permits
Non-Class Lic. & Permits

Second-Hand Dealer Revenue
Sign Permits/Construction
Reinspection Fees
Rental Inspection
Adult Day Care
Child Day Care
Personal Boarding Care
Journeyman License
Sanitation Hauler Fee
Housing Rental Licenses
Stop Work Orders
Building Code State Fee
Third Party Plan Reviews

7. Fines, Forfeits & Violations

Fines & Forfeits/Miscellaneous
Police Fines
Parking Tickets-Yellow
Parking Tickets-White
Fines & Penalties - State
Parking Meter Permits

Taxi Driver Permits
Police Towing/Storage Fees

8. Interest Earnings

Interest-Fncb Escrow
Worker's Comp
Interest -Cash-Checking
Interest-Payroll Checking Acct
Interest-New Investment Account 99
Miscellaneous Revenue

9. Rents And Concessions

10. Intergovernmental Reimbursement

OECD Reimbursement -- Demolition
Program
Intergovernmental Reims SSA
Supplemental State Aid Pension
Hazardous Waste Removal
Attorney General Drug Tsk (9383)
Act 101
DCA Act 47 Loan
DCA Act 47 Loan
Liquid Fuels-Current (A)

Bridge Inspection Revenue

FEMA Emergency Payments
FEMA Emergency Payments

Non Profit Voluntary

Act 13 Unconventional Gas Well Fund
Usage

SAFER Grants

School Resource Officer

COPS Hiring - Special Cities

Parks & Rec Specialist Reimbursement

Total Intergovernmental Reimbursements

11. Payments In Lieu Of Taxes

12. Departmental Earnings

Parking Meters
Board Of Zoning
Pave Cuts - PAWC
Pave Cuts - Pg Energy
Pave Cuts - Other
Report Copies-Fire/Pol
Fire/Pol Burglar Alarms
Parking Authority

Dept. Rescue 1 Billings

Other Aggregated Service Revenue

Keystone Landfill Capital Donations

13. User Fees

14. Misc. Revenues/Cable TV

Other-Not Classified
CAT-V Revenue
Donated Revenue
Other Financing Source
Golf Course Money
Scranton Sewer Author Payment
Udag Revenues
Advance On Delinquent Real Estate Taxes
(A)
Advance From Scranton Housing Authority
Proceeds From 2006 Bond Issuance
Proceeds From 2008 Bond Issuance
Sale Of Parking Meters
Unfunded Debt Proceeds
Search Fee
Market-Based Revenue Opportunities

Repayment From Ice Box Development
 Sale Of Assets
15. Interfund Transfers
 COPS Ahead Revenue
 Transfers In From Other Funds Inc Wc
 Transfers In From Liquid Fuels
 Transfer Special Cities
 Worker's Comp Reimbursement To Gen Fund

16. Tax Anticipation Notes

Tan Series A
 Tan Series B
 Total Tax Anticipation Notes

Budget Line Items – Expenses:

1. Employee Expenses

Direct Compensation:

Standard Salary
 Other Salary (Misc.)
 Longevity Salary
 Overtime Salary
 Court Appearance Salary

Social Security
Other Employee Expenses
 Uniform Allowance
 Health Insurance
 Life/Disability Insurance
 Unemployment Insurance
 OPER TSF - Worker Comp TR
 City 10% Early Retirement
 City Pension
 Police Education Allowance

2. Other Departmental Expenses

Professional Services
 Service & Maintenance Fee
 Bank Fees & Charges
 Contracted Services
 Printing & Binding
 Postage & Freight
 Advertising
 Rental Vehicles & Equipment
 Dues & Subscriptions

Misc. Services-Non Classified
 Stationary/Office Supplies
 Gas, Oil, Lubricants
 Equip/Vehicle Repair/ Maintenance
 Maintenance -Emergency Generators
 Small Building Maintenance
 Clean Air Maintenance
 Bldg Repair Suppl/Maintenance
 Medical, Chemical, Lab Supplies
 Construction/Paving Material
 Paint/Sign Material
 Small Tools/Shop Supplies
 Parks/Recreation Supplies
 Guns/Ammo
 Materials/Supplies (Misc)
 Tires
 Salt
 Travel/Lodging
 Air Packs Rehab/Supplies
 Telephone

Sewer Charges
 City Steam
 PG Energy Gas
 PAWC-Water
 Electrical
 Street Lighting
 Building Supplies
 Street Lighting Service/ Maintenance
 Training & Certification
 Self Insurance
 Landfill
 Performing Arts
 Spring/Summer Program
 Capital Expenditures
 Equipment Maintenance /Leases
 Maintenance Communication Equip
 Special Operations Training Equipment
 Maintenance — Equipment
 Maintenance Superfund Site
 General Equipment

Property Insurance
 Liability/Casualty Insurance
 Police-Transfers Out-Cops Ahead
 Maintenance -Preventative
 Depreciable Infrastructure

3. Operating Expenses

Total Boards & Commissions
 Interest & Debt Excluding TANS
 SPA Debt Service
 State Loan Repayment
 TAN Series A & B
 Contingency
 Accrual For Prior Year Obligations
 Unpaid Prior Year Pension
 Court Awards
 Other Operating Expense

4. Non Departmental Expenses

Tax And Misc Refunds
 TCC Expense
 SPA Citation Issuers

SPCA - Animal Control
 Single Tax Office Audit
 Personnel Cost Adjustment
 Flood Protection System
 Capital Transfer/ Expend
 Operating TSF To Other Funds
 Contractual Back Pay
 Retroactive Bonuses
 Court Awards
 Bank Fees And Charges