Plan of Adjustment and Disclosure Statement

Stockton City Council

October 3, 2013

Note: Slide 26 Amended Post-Council Meeting

Bankruptcy Recap

- 2008-2012: Four years of financial decline, massive budget cuts and fiscal emergencies
- Feb 2012: AB 506 Mediation approved
- June 2012: AB 506 process concludes, Bankruptcy declared, Pendency Plan Budget approved
- Jul-Mar: Mediation & negotiations, eligibility for chapter 9 contested
- Apr 2013: City granted chapter 9 eligibility
- Apr-Sep: More mediation & negotiations
- Oct 2013: Plan of Adjustment to be submitted
- Nov 2013: Measure A election
- Oct 2013-March 2014: Court proceedings & continued mediation

City Prepares Restructuring Plan Under Bankruptcy Law

Chapter 11/13 Private Sector	Chapter 9 Public Sector
Court can direct policy, major business decisions & budget cuts	City Council sets policy & budget; Court may only approve or reject
Company assets can be liquidated	City must remain a going concern, continue to provide adequate services
Creditors, or a trustee may submit restructuring plans	Creditors cannot submit restructuring plans; City prepares plan of adjustment

Court Filings Seek Court Approval to Exit Bankruptcy

- Plan of Adjustment
  - Specifies treatment of creditor obligations
  - Document on which creditors vote
- Disclosure Statement
  - Explanation of plan to creditors
  - Demonstrates financial feasibility
- Timeline
  - Submit to court in early October
  - Process likely to take 6 months
  - Negotiations & mediation continue
  - Plan may change before trial on confirmation of plan

Bankruptcy Code Requirements

- Staff report and public explanation **<u>is not a solicitation for a vote on the plan by creditors</u>**
  - Solicitation of creditors is prohibited by Bankruptcy Code prior to court approval of disclosure statement
- Under State law, City has duty to do public's business in open and transparent manner
  - Disclosure statement should be reviewed and approved by Council in <u>public</u> prior to filing
  - Incumbent on public agency to explain reasoning
  - Voters need to know specifically how Measure A tax will be used to exit bankruptcy and fund Marshall Plan on Crime

At Stake for City

- We are negotiating and restructuring huge amounts of debt and other obligations; in excess of $2 billion over time
  - Affects employees, retirees, debt holders and others
- Control of public assets under lease agreements an issue:
  - Buildings, parks, the arena, parking lots, golf courses
  - Have to separate essential from non-essential facilities
- Passage of Measure A required to maintain City’s viability
  - Needed to balance budget without further staffing and service cuts, to fund Marshall Plan on Crime, and enable the City to exit bankruptcy

City Principles Guide Plan of Adjustment

1. The outcome must be a sustainable City government that provides for health, safety and welfare of the community
2. Plan must be balanced among interested parties in an equitable manner consistent with continued delivery of basic municipal services
3. Financial stability will be achieved over at least 10 years; General Fund must get immediate relief and have reduced risk for future
4. Protect essential assets – collateral counts

1. Safe & Sustainable City

- Public safety must be number one priority
  - Marshall Plan to fund increased police staffing and other evidence-based improvements
- Must be able to attract and retain quality workforce to maintain public services
  - Compensation and retirement benefits must be competitive and sustainable
  - Viability means avoiding a mass exodus of employees

2. Balanced & Equitable Plan

- It's about providing services
  - Plan must augment public safety services
  - Plan must avoid further degrading other public services
  - Plan must treat creditors fairly
- Impact balanced among groups
  - Employees
    - Reduced compensation & retirement benefits
  - Retirees
    - Elimination of retiree medical
  - Debt holders & claimants
    - Reduced/delayed payments of debt obligations
  - Residents & businesses
    - Past service level cuts, proposed tax increase

3. Financial Stability

- Long-Range Financial Plan demonstrates fiscal solvency over 30 year period, feasibility of plan of adjustment
  - Critical to show long-term impacts of policy decisions and budget assumptions
  - Need 30 years to capture all phases of PERS rates changes including decline
  - Debt obligations run 20-30 years
- Conservative and reasonable revenue estimates
  - Do not repeat mistake of unsustainable assumptions that led to bankruptcy
- Requires both chapter 9 restructuring savings and new revenue from Measure A

Restructuring Treatment & Savings

Labor Costs

Retiree Costs

Debt Obligations

Other Reductions

Labor Costs

- Principles:
  - Keep compensation competitive with the marketplace to recruit & retain employees
  - Eliminate items above the labor market
  - Compensation must be affordable over the long-term
- Original AB 506 Ask targeted savings ($46.4M through FY20-21)
- $39.6M (85%) negotiated with Bargaining Units; savings built into baseline budget
  - Does not include compensation reductions from 2009, 2010 and 2011 (9-23% comp cuts, benefit reductions)

Retirement Costs

- Unfunded liability of retiree medical ($544M) exceeded that of pension ($172M)
- Goals: achieve radical cost reductions while maintaining viable workforce
  - City must remain going concern, can’t risk cuts that cause mass exodus of employees
- CalPERS is standard (99% of city /county employees statewide have this or a functionally equivalent plan)
  - Retain PERS pension, but reform & reduce costs
  - Eliminate retiree medical

City Pension Reforms

- Employees now pay 100% of employee share of PERS (7% Misc, 9% Safety) – immediate savings
- This eliminates 7-9% higher retirement pay under EPMC (retirement spiking) for most
- Substantial 30-50% reduction in benefits for new employees (2nd tier)
- Additional compensation cuts of 9-23% reduces final compensation for retirement from what they would have been

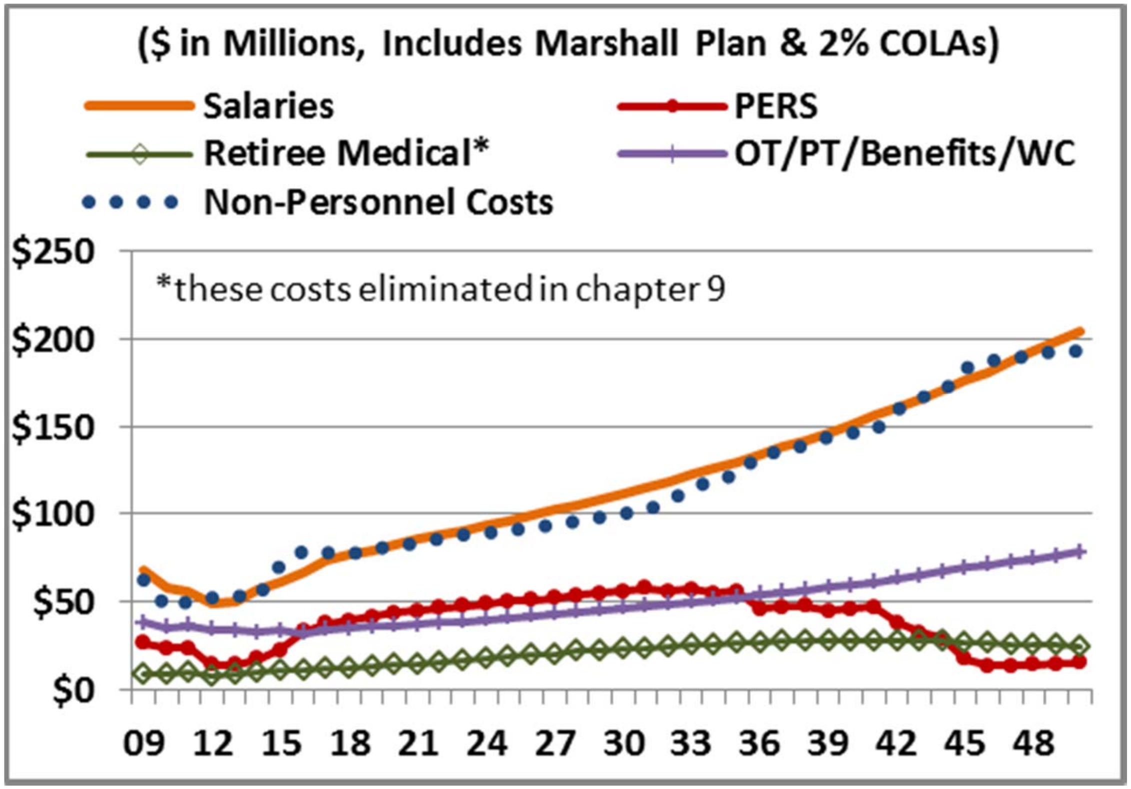
Two Groups of Retirees Are Impacted Differently

- Older group retired before benefit enhancement of early-2000's
  - Receive average $24,000 PERS benefit, not eligible for retiree medical benefits
  - No change
- Younger group received enhanced retirement benefits
  - Receive average $51,000 PERS benefit, plus retiree medical worth up to $26,000 per year
  - Most of this group do not receive Social Security from Stockton employment
  - Approximately 34% reduction in overall retirement benefits for this group

Two Groups of Employees Are Impacted Differently

- Employees (prior to Jan. 1, 2013) continue to receive Tier 1 PERS benefits as modified by certain City reforms, but lose retiree medical benefit
  - Overall retirement benefit loss ranges from 34-50%
- New and future employees (after Jan. 1, 2013) receive lower Tier 2 PERS benefits (PEPRA), and lose retiree medical benefit
  - Overall retirement benefit loss up to 70%

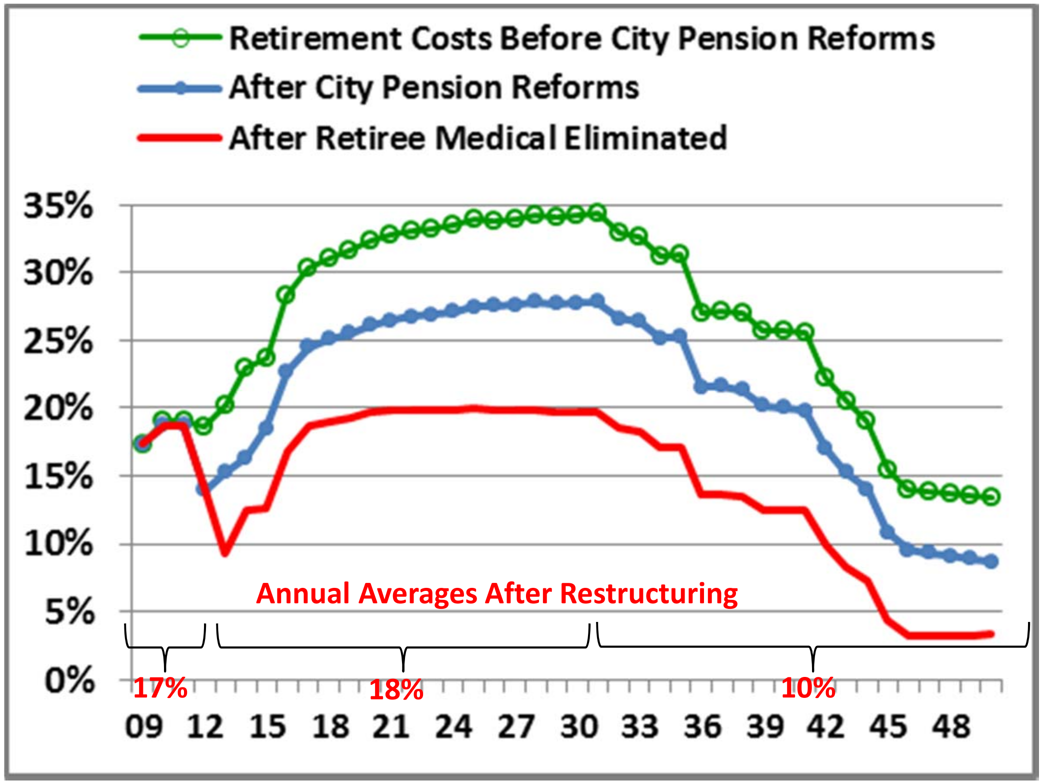
Pension Costs Do Not Overwhelm General Fund Budget



Must consider PERS costs in context of overall General Fund costs

- Salaries and non-personnel costs much higher impact
- PERS rises, flattens, then drops as unfunded liability paid off
- In long-term "other" personnel costs (overtime, part-time, health, benefits, workers comp) will exceed PERS
- Retiree medical will be eliminated; this is major element of retirement costs

General Fund Retirement Costs as Percent of Total Expenditures



Retirement costs for all lines based on projected PERS rates and retiree medical costs growth from The Segal Company (independent actuary)

- City Pension Reforms
  - Employees pay own 7-9%
  - EPMC (legal spiking) cut
  - 2nd tier (30-50% benefits cut for new hires)
  - 9-23% compensation cut reduces PERS costs
  - $659M GF savings, $900M all funds
- Elimination of Retiree Medical
  - $812M GF savings, $1.54B all funds
- Grand Total
  - $1.47B GF savings, $2.44B all funds

CalPERS

- Not enough retirement savings?
- Reject PERS contract?
- Who is PERS? A creditor or conduit?
- Options in bankruptcy?
- Impact on City's capacity?

Debt Obligations

- Principles:
  - Minimize General Fund (GF) debt for unsecured obligations
  - Minimize GF backstop & shift burden where legally payable to non-GF sources
  - Establish payments at levels City can pay over time without placing essential services at further risk of cutbacks
  - Retain essential facilities pledged as collateral

Debt

2003 Certificates of Participation ($12.6M, Ambac)

Agreement Reached

- Lease assumed under previous agreement with Ambac
  - Bonds secured by Redevelopment funds pledge, and by leases related to Maya Angelou Library, main police facility, 3 fire stations
  - Essential facilities could not be lost or face disruption
  - Value of collateral at least equal to outstanding debt
  - Ambac first to make a deal with City
- Agreement restructuring reduces short-term GF exposure, allows reserve use
  - Potential haircut of 19.5% if Redevelopment revenues inadequate; debt service capped at 80.5%
  - If Redevelopment revenues grow as projected, Ambac would not suffer haircut (and would not in a cram down)

Debt

2004 Arena Lease Revenue Bonds ($45.1M, NPFG)

Agreement Reached

- City assumes modified lease payments on these bonds
  - Most payments would be made even in event of rejection due to nature of obligation
  - Secured by Arena (still in City possession) & pledge of Redevelopment revenues
- Projected Redevelopment revenue growth should cover debt service
  - Pending agreement caps City exposure & allows reserve use; reduces GF risk from current situation, provides for refinancing to save about 3%
- Alternative: reject lease, NPFG could have taken control of Arena
  - City would no longer be able to perform pursuant to (Thunder) license agreement
  - Thunder would need to negotiate new agreement to remain in facility
  - NPFG could also have closed the facility, yet still receive Redevelopment payments

Debt

2004 Parking Lease Revenue Bonds ($31.6M, NPFG)

Agreement Reached

- City GF released from obligations to make lease payments on these bonds
  - Secured by leases on Market, Coy, Arena parking garages
  - NPFG previously took possession of garages, but under pending agreement these will revert to City; a benefit
- Payment stream revised
  - Originally $1.9M/year at 2% growth to 2035
  - Now $1.4M/year, starting $1.6M/yr in 2019 with 2% growth to 2047 – total NPV Reduction of 12%
- New parking authority enterprise to be created
  - Contracting out savings, automation to boost revenues, cover payments without GF backstop – creates GF firewall
  - Regaining garages allows economies of scale, improved economic development efforts for downtown

Debt

2006 SEB Lease Revenue Bonds ($12.1M, NPFG)

Agreement Reached

- City assumes lease that secured these bonds
  - Bonds built garage for SEB
- SEB houses essential City services, so bonds will not be impaired
  - Budget continues $900,000 annual payments, reimbursed by Parking and Police PFF funds
  - No net impact on General Fund
  - Always have maintained this debt payment as current due to essential nature of building and relatively small amount owed

2006 Marina Loan ($10.8M, Dept of Boating & Waterways)

- No enforceable obligation
  - Structured as debt obligation, which is not consistent with state law
  - State has lien on gross revenues from marina (but no operating income after expenses)
  - Rejection of GF backstop saves GF $684,000 annually
- DBW could elect to take over marina operations
  - Marina operates at a loss, so this would eliminate GF's $160,000 annual subsidy
  - State has indicated this is its desire, more discussion needed
- Negotiation continues, but City will cooperate with State to keep Marina open so long as GF not adversely impacted

Debt

2007 Pension Obligation Bonds ($124.3M, Assured Guaranty)

Agreement Reached

- Pension Obligation Bonds (POB) refinanced unfunded liability owed to CalPERS
- Bonds are unsecured
- Under agreement reached October 2
  - City applies Ask payments proposed for 400 E Main to POBs
  - City makes 17% of payments from non-General Fund sources to POBs based on payroll in special funds running out to July 1, 2053
  - Creditor will receive contingent payments against debt service if performance of core revenues in future years exceeds City forecast
  - City will make payments of $250,000 per year starting in 2023, moving to $350,000 per year in 2042-2052
  - Creditor will support City plan of adjustment
  - Estimated NPV is 51.82% from non contingent payments only, plus upside from contingent payments

Debt

2007 Admin Bldg Variable Rate Bonds ($40.4M, Assured Guaranty)

Agreement Reached

- Paid for acquisition of 400 E. Main, to be new city hall
- Assured obtained possession through unlawful detainer action before bankruptcy
- Under tentative agreement reached October 2
  - City will agree to transfer title to creditor and allow creditor to sell building in exchange for voiding debt
  - City will be allowed to lease 65,000 sf of space in building for 8-12 years at an advantageous rate
    - Avoids move of IT Department
    - Assists creditor in selling building
    - Allows City options for refurbishing existing City Hall

Debt

2009 Capital Project Lease Rev Bonds ($35.1M, Franklin)

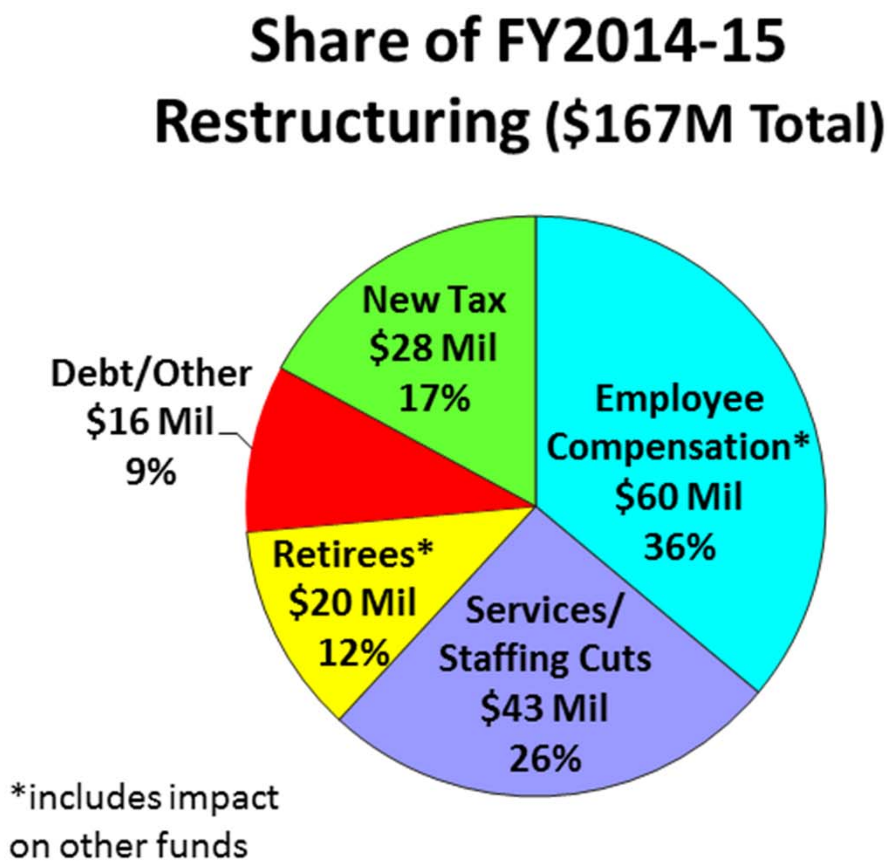
- City rejects lease relating to these bonds
  - Repaid City loans to construct fire station, police communications center, parks & street projects
  - Leased property/collateral: Oak Park, Swenson & Van Buskirk golf courses
  - Rejecting lease saves GF approx. $65M
  - GF Obligation – Annual debt service $2.9M – High GF exposure
- Franklin could take collateral (leasehold interest in facilities)
  - But can't sell them or use for other purpose
  - Facilities operate at a loss, would free up $700,000 annual GF subsidy
- Franklin could elect not to take facilities
  - City then permitted, but not required, to continue to operate facilities
- Negotiation continues
  - Will not risk services to pay debt
  - Measure A will provide negotiating room

Other Reductions

- SPOA Settlement – Agreement reached
  - Negotiated 44 hours leave in exchange for $8.5M claim
- Sick Leave Buyout
  - Claims for payment of sick leave hours to be determined
- Jarvis Judgment
  - No payment of $32M from GF to Water/Wastewater re Prop 218 case
- Marina Towers Settlement – Agreement reached
  - Land swap worth $864-890K for $1.9M in payments due for parcel which is part of ballpark
- Price Settlement
  - Negotiations pending, claim amount in dispute (around $1.4M)
- Main Hotel
  - Last $500K payment for redevelopment project will not be made
- Sports Teams – Thunder agreement reached
  - Thunder agreed to restructuring that could save the City $186,000-225,000/year
  - Ports still in negotiations

Financial Plan

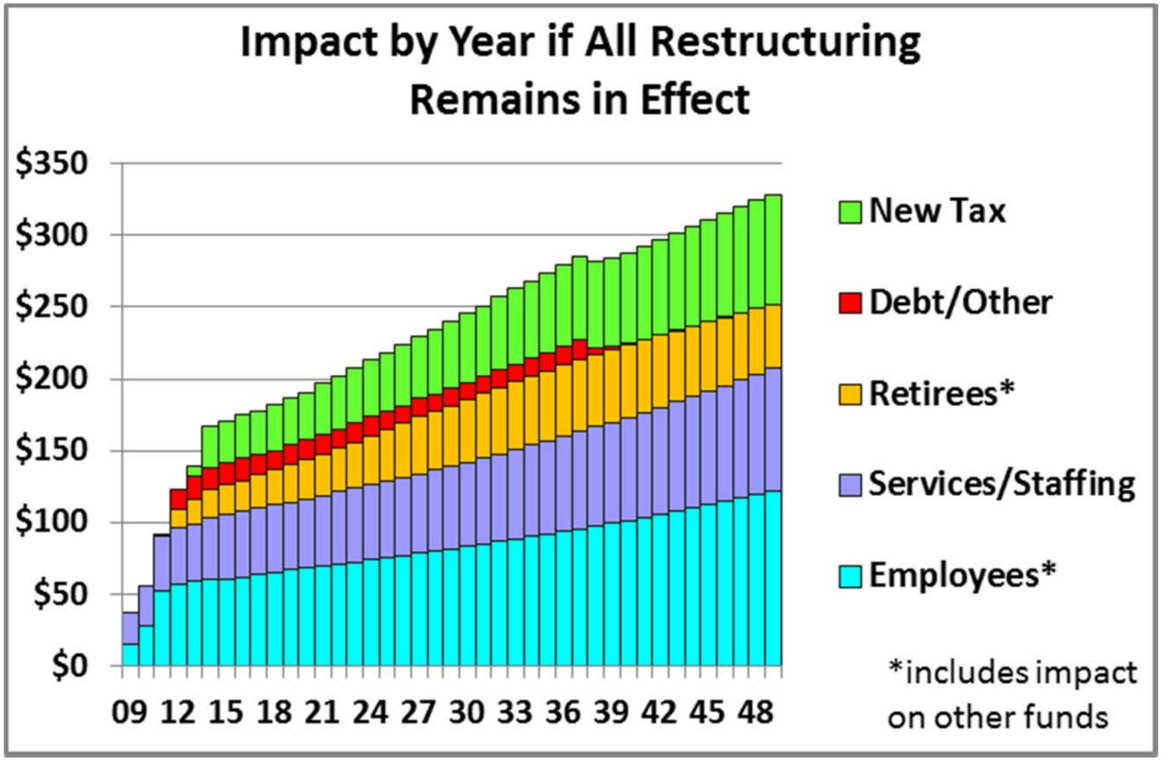
Impact of Restructuring: Snapshot



- New tax assumes passage of Measure A
- Employee compensation and services/staffing cuts started in 2009, total $90M to date
- Employees & retirees in other funds affected by restructuring savings
- Debt negotiations are ongoing

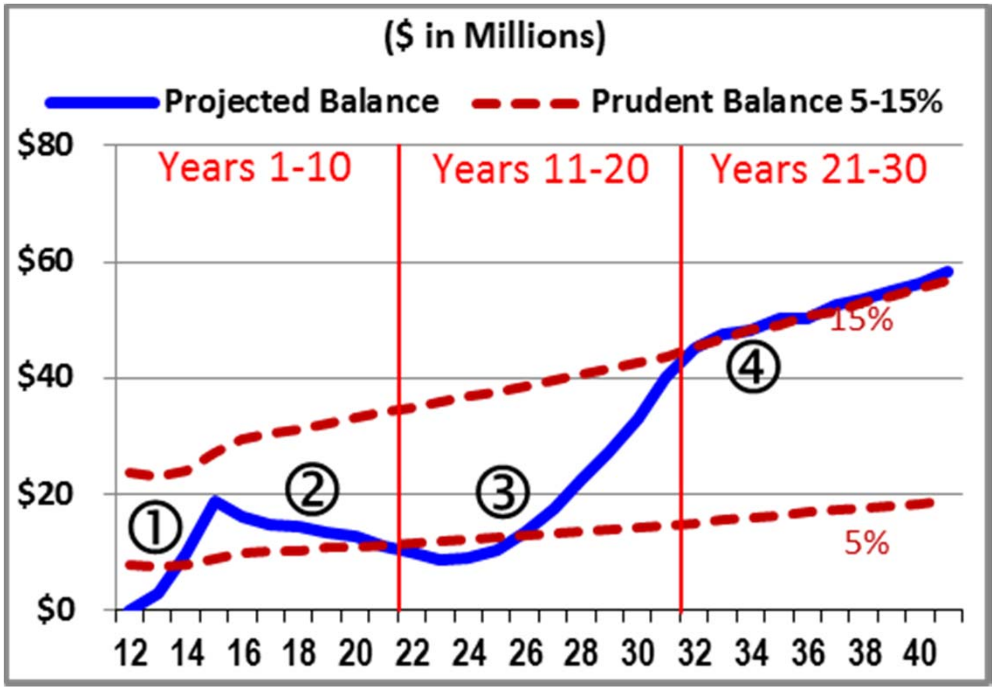
Financial Plan

Impact of Restructuring: Long-Term



- Employee comp and service/staffing cuts continue to increase in value of avoided costs with inflation
- Retiree medical is a closed system (no new members) so out-year savings ebbs with decline in beneficiaries
- Debt savings is based on specific terms
- Tax duration will depend on economic health of the City

Key Changes Affecting General Fund Balance

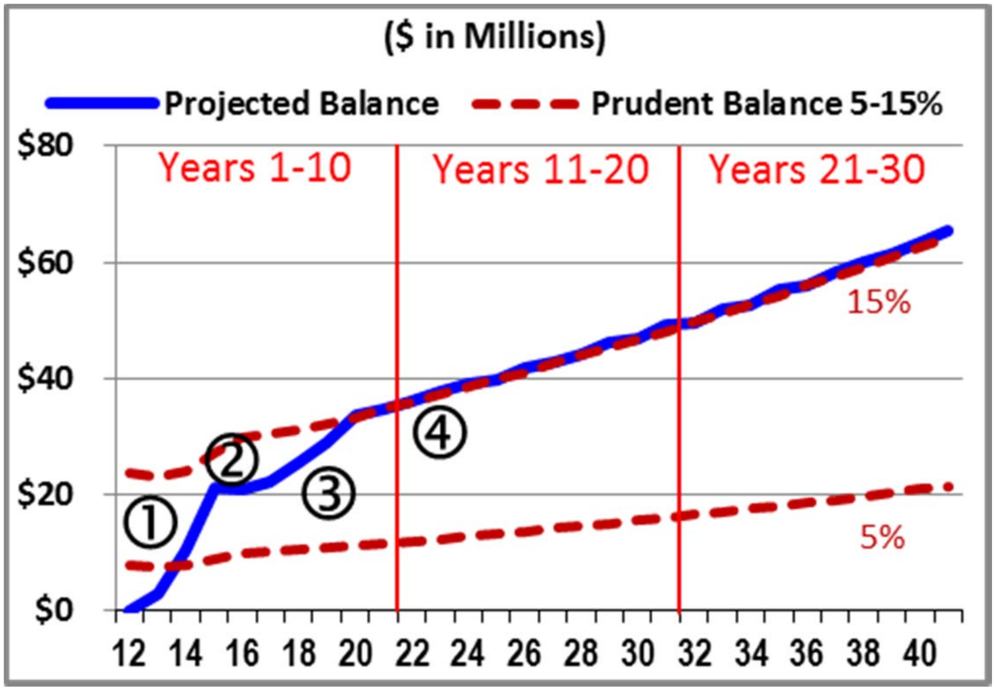


15% is just under GFOA-recommended reserve of two month's operating expenditures (16.67%)

1. Balance rises with new tax revenue, pre-Marshall Plan
2. Balance declines with higher PERS rates and new Marshall Plan spending
3. Balance stabilizes, then increases as PERS rates level off and then decline, and with impact of lower debt expenditures
4. When balance reaches 15%, resources in excess of that are used to restore services and fund unmet needs ($253M through FY40-41), maintains stable reserve

Financial Plan

Impact of 0.5% Ongoing Core Revenue Growth Above Forecast

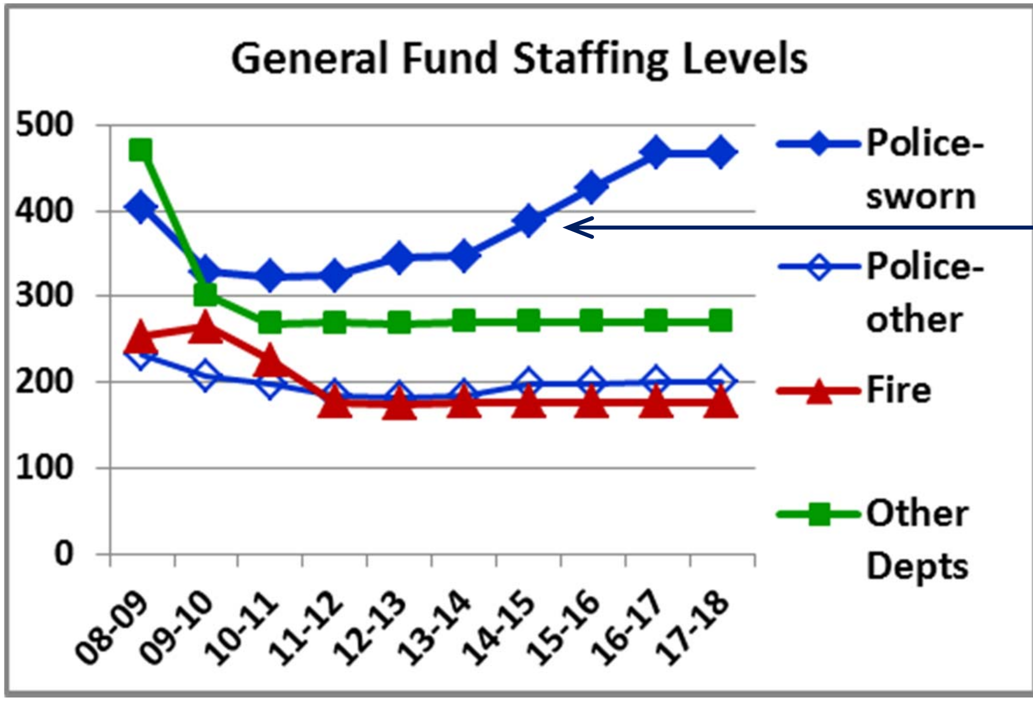


Revenue projections are conservative, so improvement possible; small ongoing compounded growth can make significant difference

1. Balance rises with new tax revenue, pre-Marshall Plan
2. Balance declines with higher PERS rates and new Marshall Plan spending
3. Balance stabilizes, then increases as PERS rates level off and then decline, and with impact of lower debt expenditures
4. When balance reaches 15%, resources in excess of that are used to restore services and fund unmet needs ($735M through FY40-41), maintains stable reserve

Financial Plan

Staffing Increase
Focused on Public Safety

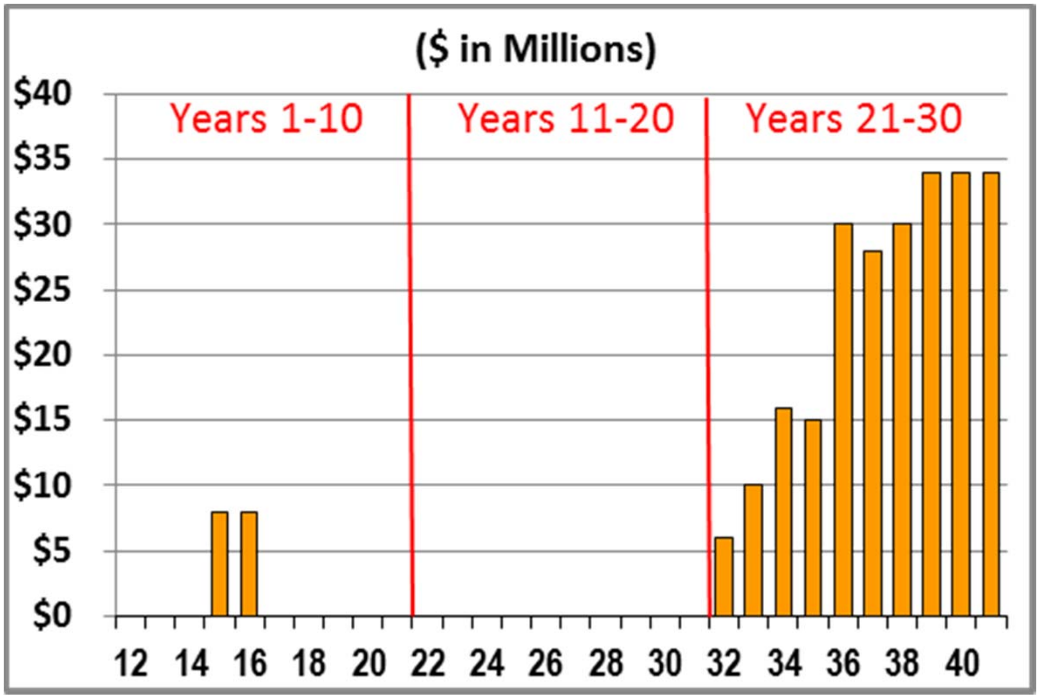


- Marshall Plan
- Adds 120 police officers over 3 years
- Expands Ceasefire & Peacekeeper programs, crime analysis
- Creates Violence Reduction Office
- Boosts code enforcement & neighborhood teams

Baseline forecast does not fund any other increases in staffing besides Marshall Plan

Financial Plan

Funding Capacity for Mission Critical Needs

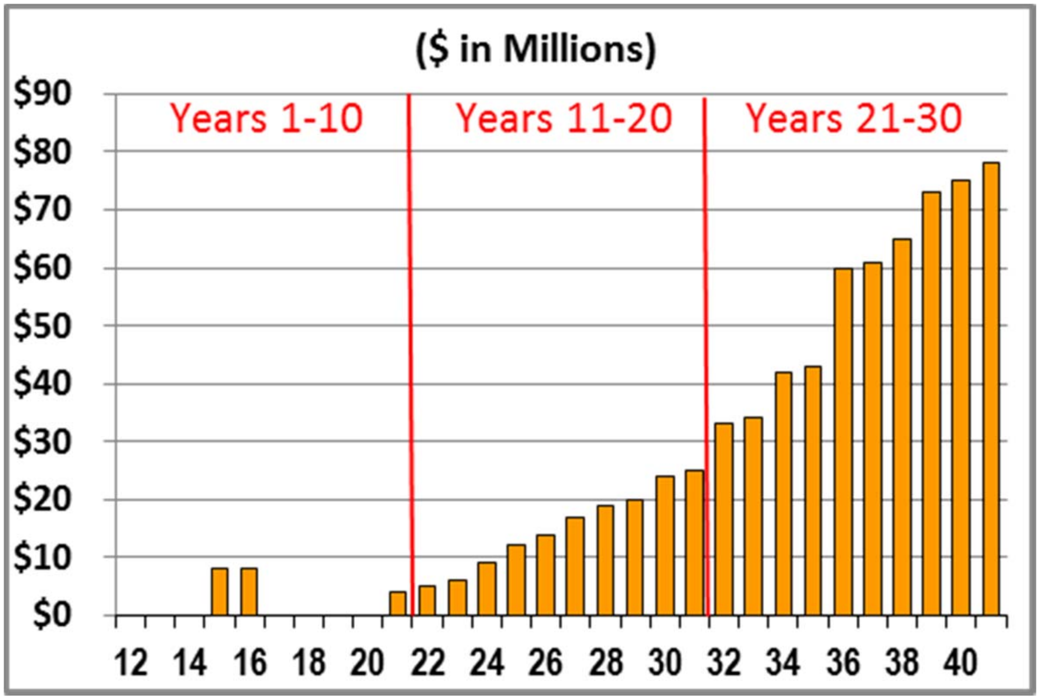


Capacity to address unmet needs resumes starting in early-2030's; 30-year total of $253M

- Many unmet needs remain:
  - Replace 22-year old financial systems
  - Infrastructure maint.
  - $40M Workers Comp Fund deficit
  - Admin building improvements
  - Measure K matching funds
  - Phase II of added Police staffing
  - Creditor payments

Financial Plan

Impact if Core Revenue Growth 0.5% Higher Than Forecast



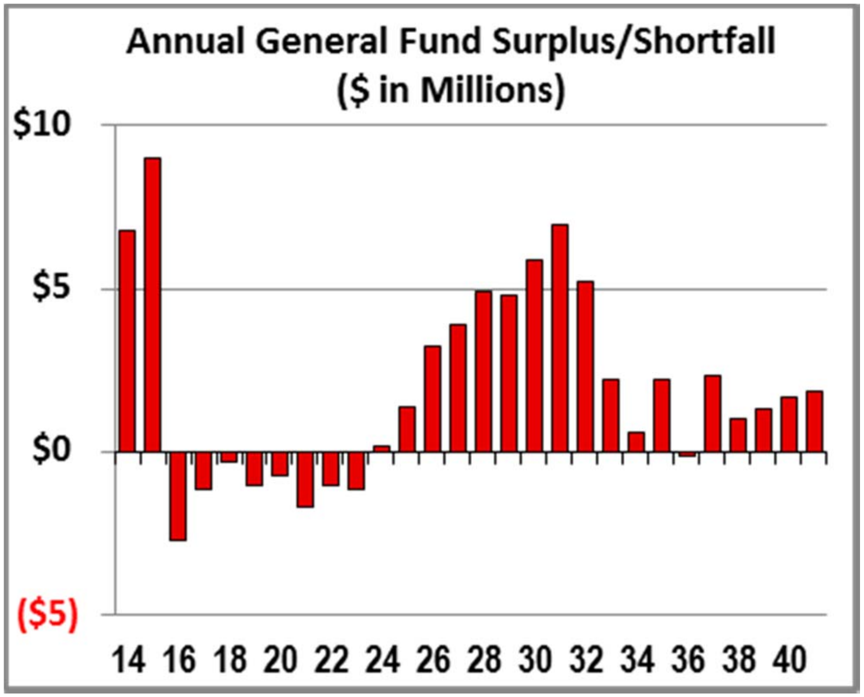
Capacity to address unmet needs resumes starting in early-2020's; 30-year total of $735M

- Many unmet needs remain:
  - Replace 22-year old financial systems
  - Infrastructure maint.
  - $40M Workers Comp Fund deficit
  - Admin building improvements
  - Measure K matching funds
  - Phase II of added Police staffing
  - Creditor payments

Financial Plan

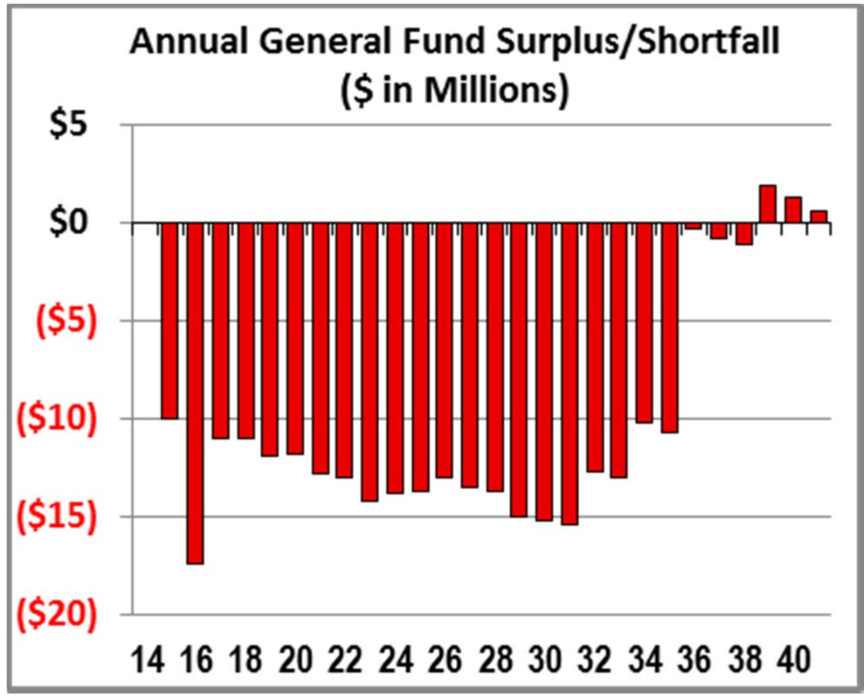
What if Tax Measure Fails?

- Measure A Approved



Marshall Plan implemented, budget runs surpluses, adequate reserves

- Measure A Fails



No Marshall plan, requires $11M added ongoing cuts to offset deficits, potentially more cuts later

Sample General Fund Budget Cuts Without Measure A

- $4.0M Library
  - Leads to loss of City library system
- $2.8M Recreation
  - Leads to loss of City recreation program
- $4.2M Fire
  - 14% staffing cut
  - Leads to station closures

- $11.0M Total Cuts

- On top of $90M in cuts made since FY09-10
  - $52M compensation cuts
  - $38M staffing/service cuts
- GF staffing cuts made during FY10-12:
  - Police-sworn: -25%
  - Police-other: -20%
  - Fire: -30%
  - Other Departments: -43%

Policy Options for Council

- Staff recommends Council adopt resolution authorizing City Manager to file plan of adjustment and disclosure statement
  - Filing in early October desirable to have information available prior to Measure A vote
  - Council may make changes to the plan, which would dictate changes to disclosure statement
- Consensual plan desired
  - But not at expense of General Fund solvency, further service reductions, or loss of Marshall Plan on crime
- Final chapter in bankruptcy, sets stage for City's economic recovery

Questions ?

Thank you.