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Stockton Proposes Bankruptcy Exit Plan.

Stockton, Calif., released a draft of its plan for exiting Chapter 9 bankruptcy, which it expects to file in federal bankruptcy court in early October.

“The plan is a Spartan one,” the draft said. “It returns the city to financial and public service provider solvency, but, in the absence of agreements with city creditors whose obligations are secured by leases of city real estate, the plan includes the potential loss of city control of certain city properties.”

The city disclosed a preliminary deal with bond insurer National Public Finance Guarantee about \$88 million of outstanding bonds insured by the guarantor.

The city agreed to resume lease payments on \$45.1 million of NPFG-wrapped obligations for the city’s sports arena, and \$43.7 million of debt secured by parking garages, thus guaranteeing continued city control of the properties, according to the draft plan.

“We’re pleased to have reached a settlement agreement with the City of Stockton that should expedite its exit from bankruptcy,” said Kevin Brown, a spokesperson for National.

However, the draft plan says Stockton is still negotiating with Assured Guaranty over \$124.3 million of insured pension obligation bonds, which are unsecured.

“As this document was being finalized, the city was in negotiations with this creditor and had developed the outlines of a negotiated settlement,” the draft said.

A spokesperson for Assured declined to comment.

Stockton said it had not reached an agreement with Franklin Advisers, Inc., Franklin High Yield Tax Free Income Fund, and Franklin California High Yield Municipal Fund, which together own around \$35 million of the city’s lease revenue bonds.

Prior to releasing its plan, Stockton had negotiated with 18 sets of creditors, including bondholders. Those include its employee unions as well as other stakeholders Dexia Credit Local, Union Bank and the U.S. Department of Housing and Urban Development.

“If agreements are reached with Assured and/or Franklin, Stockton might avert a fight over whether the plan is ‘fair and equitable,’” according to a Municipal Market Advisors report written by managing directors Matt Fabian, Lisa Washburn, and Bob Donahue. “This could mean that the relative priority of [the California Public Employees’ Retirement System] in a Chapter 9 bankruptcy may remain murky since it would not be subject to a court decision.”

They added that the plan’s release could be a nudge to help ink settlements to speed the process to exit bankruptcy.

“The plan contains a placeholder for a confirmation hearing in 2014, which would put the city on

track for a relatively quick emergence from Chapter 9," MMA analysts said.

National and Assured previously led efforts to keep the city's bankruptcy case from moving forward, contending that bondholders should not be lower in seniority to pension liabilities.

Stockton's draft plan will not impair the city's obligations to CalPERS for pensions.

"The maintenance of pensions is critical to the city in order to retain employees — particularly police officers — rather than losing them to other local governments, all of which have defined benefit pension plans, and the overwhelming majority of which have pension plans administered by CalPERS," city officials said in the draft plan.

The plan will, however, impair retiree health benefits. Claimants will be paid a portion of their claims equal to the unsecured claim payout percentage of 0.94796%. Current employees of the city also agreed to forgo health benefits in retirement, which reduces their post-employment benefits by 30% to 50%, the city estimated.

The loss of retiree health benefits, wiping out the city's obligations after the settlement payout, is a substantial concession of approximately \$1 billion, the draft said.

"By continuing to fully fund its pension obligations, Stockton has both acted in accordance with applicable constitutional and statutory law and acknowledged the importance of a secure retirement to its current employees and retirees, and the positive impact that pensions have on recruitment and retention of quality public servants," CalPERS said in a statement. "We look forward to working with the city as a valued CalPERS employer as the City moves forward toward a healthier future."

The plan depends on the passage on November 5 of a ballot measure to impose a 3/4 cent sales tax increase, the city said. If the measure fails, the plan's projections will not be achievable.

"Not only will the city be unable to fund the plan, but it will be unable to pay its current operating costs," the draft said. "The result will be further and significant staff and service reductions, reaching across virtually all city departments."

The Central Valley city of 300,000 declared bankruptcy in June 2012, after struggling to recover from the housing downturn and years of fiscal emergencies. As a result of prior poor fiscal management, overspending on construction projects, the economic downturn and resulting decline in home values, and lower tax revenues, the city had virtually no general fund reserves.

In the past three years, the city has cut its general fund workforce by 30%, reduced compensation by \$52 million and cut staffing and service levels by \$38 million.

Stockton released its proposed bankruptcy exit plan on its website on Friday. It will hold a press conference on Tuesday to provide further information on its plan of adjustment and answer questions about the bankruptcy process. The city council will take up the draft in a special meeting on October 3.

The council must authorize City Manager Bob Deis to file the plan in court, where it must then receive approval from U.S. Bankruptcy Judge Christopher Klein.