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NYT: California City's Return to Solvency, With Pension Problem Unsolved.

Stockton's Struggle: Before Detroit, Stockton, Calif. was the largest city to file for bankruptcy. Now, Stockton is working its way back, and city leaders see lessons in its ordeal for other struggling municipalities.

Battered by a collapse in real estate prices, a spike in pension and retiree health care costs, and unmanageable debt, this struggling city in the Central Valley has labored for months to find a way out of Chapter 9. Now having renegotiated its debt with most creditors, cobbled together layoffs and service cuts and raised the sales tax to 9 percent from 8.25 percent, Stockton is nearly ready to leave court protection.

But what Stockton, along with pretty much every other city in California that has gone into bankruptcy in recent years, has not done is address the skyrocketing public pensions that are at the heart of many of these cases.

"No city wants to take on the state pension system by itself," said Stockton's new mayor, Anthony Silva, referring to the California Public Employees' Retirement System, or Calpers. "Every city thinks some other city will take care of it."

While a federal bankruptcy judge ruled this week that Detroit could reduce public pensions to help shed its debts, Stockton has become an experiment of whether a municipality can successfully come out of bankruptcy and stabilize its finances without touching pensions. It is an effort that has come at great cost to city services and one that some critics say will simply not work once the city starts trying to restore services and hire 120 police officers it promised to get the sales-tax increase passed.

"They wanted to get out of bankruptcy in the worst possible way, and that's just what they did," said Dean Andal of the San Joaquin County Taxpayers Association, which fought the sales-tax increase. "If they go ahead and hire those new police officers, the city will be back in insolvency in four years."

Stockton declared fiscal emergencies in 2010 and 2011, giving it the power to renege on annual pay increases for city workers. City services were slashed. Hundreds of municipal workers were laid off. And many retirees who had been promised health coverage for life learned that they would have to begin paying for it.

"That was the hardest part," Councilman Elbert Holman said, "looking people in the eye and telling them sorry, you are losing your health care, but it's absolutely necessary."

By the time the judge found Stockton eligible for Chapter 9 bankruptcy on April 1, the city had about \$147 million in unfunded pension obligations and about \$250 million in debt from various bond issues.

The years of fiscal emergency and bankruptcy have left their mark, including a skyrocketing crime rate, which city officials and many residents attribute to staffing and service cuts in the Police Department.

"I suddenly realized a few years ago that, just in my tiny, two-block neighborhood, there had been 11 residential burglaries in the previous nine months," said Marci Walker, an emergency room nurse.

Cities go bankrupt for many reasons: a collapse in real estate prices, a spike in pension and retiree health care costs, a burden of debt from expensive city projects. Stockton has experienced all three.

When real estate prices shot up in Silicon Valley in the last decade, many commuters decided that Stockton's cheaper housing was worth the long commute to the Bay Area. That drove up local housing prices, so when the bubble burst it had a bigger impact, giving Stockton one of the nation's highest foreclosure rates.

City leaders had also gone on a construction spree during the flush years, building a new sports arena, a minor-league baseball stadium and a marina. Citizens still bitterly mention the 2006 concert that opened the arena, where Neil Diamond was paid \$1 million to perform.

And through it all, the pension costs for city workers — particularly for police officers and firefighters, who can retire early and draw on those pensions for decades — kept going up.

No part of the city has been left unscathed. Ms. Walker's comfortable neighborhood near the University of the Pacific campus was hit with rising crime almost immediately after the police layoffs. "When the economy got bad and we lost police officers, it all started," she said.

So she started the Regent Street Neighborhood Watch, the first of more than 100 such organizations to sprout up in the city in the last few years.

"We don't confront anybody, we just let them know that we know they're there," Ms. Walker said. She added, "Criminals do not like eyeballs on them."

While the rising crime rate had the biggest effect on the city, other service cuts were also felt, including deteriorating streets and closed libraries and community centers. The other consequences of the downturn — shuttered storefronts, crumbling infrastructure, empty downtown sidewalks — only added to the sense of decline.

"There was just this perception that the city was not safe," Police Chief Eric Jones said. "Downtown was impacted. Many people were reluctant to go down there."

The crime problem is a big reason Stockton chose to keep paying into the Calpers system even as it pared other costs, including its payments to bondholders. Officials say that if the city cuts the rate at which its workers build up their pensions, workers will leave — especially police officers who were recruited with the promise of large, early pensions.

Last year, Stockton asked Calpers for a "hardship exemption," allowing it to slow its contributions. The huge state pension system said no, fearing that if Stockton fell behind, it might never catch up.

Now, even before the ink is dry on Stockton's proposed blueprint for getting out of bankruptcy, skeptics are worried that the plan is not comprehensive enough to solve its problems and that city leaders will not fulfill their promise to use some of that money to hire police officers.

City officials insist their plan will work. "We got the tax, and thank God it passed," Councilman

Holman said. "I have confidence that the numbers line up."

Nor does the Detroit ruling this week make Stockton want to revisit pension reductions. Connie Cochran, a city spokeswoman, said that city workers had already seen their pay and retiree health benefits cut. In addition, she said, Calpers told the city that its only option was to pay a \$970 million termination fee to leave the system, and Stockton could not afford it.

Mayor Silva said the city's plan would help it out of bankruptcy sometime late next spring, if all goes well, after the judge hearing the case has time to rule on its fairness and viability and negotiations can be completed with one final bondholding creditor.

"We will lose the stigma of bankruptcy, and it will buy us time," he said.

One of three new members elected to the City Council in November, Michael Tubbs, said he was convinced that the bankruptcy plan would work, providing \$28 million to \$30 million in revenue each year for the next decade and allowing the city to pay down its debt while still hiring police officers.

"I am incredibly optimistic," said Mr. Tubbs, 23, who grew up in Stockton.

Chief Jones said he was counting on the 120 new officers and planned to hire 40 a year for the next three years. In 2008, Stockton had 441 police officers. By this year, the force had fallen to 350, the second-lowest per capita staffing level in the country. The result, he said, is that all violent crimes rose in the city, which had 58 homicides in 2011 and 71 in 2012, both records.

Even before the sales-tax increase passed, Chief Jones said he had decided to reinstate some of the community outreach programs that were curtailed during the budget crunch, even if that meant slower response times for nonviolent crimes.

"We had to tell the community to be patient, we're going to focus on violent crime," he said.

The impact was immediate. As of mid-November, there had been only 28 homicides this year.

Still, bondholders complain that Calpers will get 100 cents on the dollar for its city debt, while they must make do with much less. Following months of negotiations, most of Stockton's bondholders said they would not try to block the city's plan, but Franklin Templeton Investments was girding for a fight, possibly strengthened by the Detroit ruling that federal bankruptcy law trumps state pension guarantees.

Two Franklin funds hold about \$35 million of bonds that Stockton issued in 2009 and are now in default. Stockton is proposing to pay the two Franklin funds just \$95,000 to discharge all the remaining debt on those bonds, amounting to less than a penny on the dollar.

Douglass Wilhoit Jr., chief executive of the Stockton Chamber of Commerce, agreed that "the elephant in the room is the pension stuff." But he said that he was confident this plan would ease the city out of bankruptcy and start a process that would inevitably come to include some sort of pension changes. "Over all, honestly, I think the bankruptcy process has been a positive experience for Stockton," he said. "We are going to come out of it stronger and better."

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