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Stockton's Costly Bankruptcy May Not Tempt Other Cities.

Stockton, California, is emerging from bankruptcy saddled with legal bills and a damaged reputation that will deter other U.S. cities from seeking a path through court to cut their debts.

"The leaders of distressed U.S. municipalities will continue to pursue other options before setting in motion the long and costly process that bankruptcy implies," Chris Morgan, director in the San Francisco office of Standard & Poor's, said yesterday in a statement after a judge approved the city's debt-adjustment plan. "We believe that the implications of Stockton's exit from bankruptcy will be modest."

Stockton, a city of 298,000 about 80 miles (130 kilometers) east of San Francisco, filed for bankruptcy in June 2012 after the housing market collapsed, retiree health-care costs mounted and tax revenue eroded. It was one of three California cities to file for bankruptcy that year.

U.S. Bankruptcy Judge Christopher Klein in Sacramento, California, yesterday approved Stockton's plan to exit court protection by paying bond investors pennies on the dollar while shielding public pensions. In doing so, he warned other cities about the costs of municipal bankruptcy and said it "shouldn't be entered into lightly."

As of May, the city had paid lawyers and other advisers almost \$14 million, according to court filings.

The bankruptcy filing was unavoidable, Connie Cochran, a Stockton spokeswoman, said in a phone interview.

'Insolvent' City

"We were insolvent both from a service perspective and fiscally," she said. "We recognize that we need to live within our means and follow the plan that we've developed."

Stockton will begin to exit bankruptcy once the judge sets a date, possibly by the end of the year, Cochran said.

The plan calls for a \$5.1 million contribution for canceling retiree health benefits. Also, Stockton voters last year approved a proposal to increase the city's sales tax to 9 percent to generate about \$28 million annually, which would go toward exiting bankruptcy, restoring city services and paying for law enforcement.

The police department is having trouble keeping employees, who are leaving because of low pay, said Kathryn Nance, president of the Stockton Police Officers' Association, which represents about 360 officers.

"It's still going to be a very long road just to get back to where we were before," Nance said in a phone interview. "We are the lowest-paid police force in the county and with the compensation packages and benefits, people are leaving to go to other agencies."

‘Doesn’t Change’

The bankruptcy exit “doesn’t change the difficult economic environment” in the city, said S&P’s Morgan. In assessing its creditworthiness, “the main thing we’re going to be looking at is a willingness to meet their obligations and their overall financial health,” he said in a phone interview.

The city passed on an option presented by Klein to end its contract with the California Public Employees’ Retirement System, the biggest U.S. public pension fund. Doing so would have reduced pensions by 60 percent and caused many employees to leave, Marc Levinson, Stockton’s lead bankruptcy attorney, had warned.

Still, Klein’s ruling could set up future challenges from California cities burdened by retiree obligations.

“Local governments will now have more negotiating leverage with labor unions, who cannot count on pensions as ironclad obligations, even in bankruptcy,” Gregory Lipitz, a vice president and senior credit officer at Moody’s Investors Service, said in a research note yesterday.

Detroit Plan

Stockton’s bankruptcy was dwarfed by Detroit’s. The city of about 700,000 filed a record \$18 billion municipal bankruptcy last year, saying decades of decline left it unable to provide basic services while still meeting financial obligations. Its plan to trim about \$7 billion in debt by reducing some bond recoveries and cutting retiree benefits goes up for court approval next week.

“Ultimately, the decision in Stockton highlights a unique and unfortunate situation brought on by the financial collapse of 2008, and thankfully not a situation that the overwhelming majority of municipalities have to face,” Teague Paterson, a pension attorney at Beeson, Tayer & Bodine, said in a statement.

The case is In re Stockton, 12-bk-32118, U.S. Bankruptcy Court, Eastern District of California (Sacramento).

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