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San Bernardino Bankruptcy Plan: Bondholders Hammered While Pensions Kept Whole.

SAN BERNARDINO, Calif. — The Southern California city of San Bernardino wants to repay its pension bondholders just a penny on the dollar while paying the state pension fund Calpers in full under its long-awaited bankruptcy exit plan released on Thursday.

Under the bankruptcy plan, called a plan of adjustment, San Bernardino also intends to virtually eliminate retiree health insurance costs, and outsource its fire, emergency response and trash services.

Gary Saenz, San Bernardino's city attorney, said of the offer to the pension bondholders: "It's obviously a tiny offer. From a fairness point of view, it looks like an insulting offer. But it is not an insult. Given the city's circumstances, it is all the city can afford."

San Bernardino's bankruptcy blueprint follows the approach taken in the recent bankruptcies of Detroit, Michigan and Stockton, California, where bondholder debt and retiree healthcare costs were slashed or eliminated, while pensions emerged relatively unscathed.

In Detroit, general obligation bondholders received between a 22 percent and 66 percent cut to their debt.

The move could likely make capital market lenders more wary about loaning money to struggling cities, and could increase borrowing costs for cities already in debt.

"The city needs a workforce. And you can't have a workforce without pensions," Saenz told Reuters in January.

That issue was the driving force underpinning the bankruptcy plan, another city official said on the condition of anonymity, noting the city has a daily relationship with its workers that it needs to maintain for survival as a municipality, while its Wall Street lenders are wealthy absentee creditors.

San Bernardino proposes paying the Luxembourg-based bank EEPK, holder of $50 million in pension obligation bonds and the city's second largest creditor, a fraction of its original debt, according to the plan, posted on the city's website.

EEPK, along with Ambac Assurance Corp, which insures a portion of the pension bonds, and Wells Fargo, the bond trustee, have the $50 million principal amount of their debt slashed to just $500,000, or a penny on the dollar, under the bankruptcy plan.

Vincent Marriott, a legal representative for EEPK, said the bank would have no comment until it had fully read and considered the plan.

Under San Bernardino's plan, the city also asks that any creditor, including its pension bondholders, who object to its terms be forced to a judicial "cramdown", where the judge overseeing the case orders that the city’s debt cutting wishes be met.

Final approval of a bankruptcy plan, which must be ratified by U.S Federal Bankruptcy Judge Meredith Jury, is likely to take months. Negotiations with city firefighters, who are suing San Bernardino over contract issues, have broken down. The police union still has not signed off on parts of the bankruptcy deal affecting its members. Bondholders are likely to vigorously fight the virtual elimination of their debt under the plan.

In March, San Bernardino revealed terms of a deal with the California Public Employees’ Retirement System (Calpers), its largest creditor.

Calpers, which administers San Bernardino’s pensions, is America’s largest public pension fund, with assets of $300 billion. It is the administrator of pensions for more than 3,000 California state and local agencies, and has long argued that pensions cannot be touched or renegotiated, even in a bankruptcy.

The judges overseeing the bankruptcies of Detroit and Stockton both stated that pension rights are not inviolate in a bankruptcy. But city leaders in Stockton, and now San Bernardino, have chosen not to take on Calpers, despite the fact that the pension giant is hiking city contribution rates by up to 50 percent over the next 10 years.

Under San Bernardino’s bankruptcy exit plan, the city under covenant pledges to pay Calpers all arrears and to continue paying Calpers in full in the future.

San Bernardino, a city of 205,000 that is 65 miles east of Los Angeles, declared bankruptcy in August 2012 with a $45 million deficit. Along with Detroit and Stockton, its bankruptcy is one of a handful that have been closely watched by the $3.6 trillion U.S. municipal bond market.

By REUTERS

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(Editing by Bernard Orr)