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A Message From the City That Went Bankrupt

Creditors seem not to realize that in Stockton, Calif., we can't simply dissolve ourselves and sell off assets.

By BOB DEIS

Stockton, Calif.

How did the city of Stockton, Calif. (pop. 300,000) go bankrupt in June? It's not the simplistic story that so many pundits claim. And I'd know: I'm Stockton's city manager—effectively a CEO who reports to the City Council.

Bankruptcy is a costly, undesirable process, but sometimes it's the only way to keep a city viable and continue providing for public health and safety. This was the case in Stockton after California's Central Valley was hit hard by the recession. Over the past four years, the city's property values have fallen 70%, unemployment has been as high as 22% (now 17.2%), and household income is 20% below the state average.

All the while, payments for debt issued from 2003-09 started increasing—so much so that in fiscal year 2012 we owed 600% of what we paid in 2007, before the recession. This is because debt had been "back-loaded" on the mistaken assumption that revenues would increase over time—a risky fiscal structure, but one the financial markets blessed as they extended credit to the city.

Stockton's reform-minded City Council hired me in July 2010 to get the city's fiscal house in order. Since 2009, the council has cut police officers by 25%, fire staffing by 30% and other "General Fund" workers by 43%, while cutting employee pay by 9%-23%. It added unpaid furlough days and required the city's 1,420 employees to contribute more toward their health care. Such changes were unprecedented but still not enough.

By early 2012, it was clear that Stockton was insolvent and needed to pursue drastic action. In February, pursuant to state law, the city initiated mediation with its largest creditors to try to avoid bankruptcy. It identified three main areas for potential cost-cutting: retiree health benefits, debt service and labor. Simply dissolving the city and selling all assets to pay creditors isn't an option, since we have to continue providing services to residents. Ultimately we renegotiated contracts with eight out of nine labor groups. But there were no changes with our capital-market creditors and the overall savings were inadequate, so bankruptcy became necessary to force restructuring.

This set off much uninformed commentary. Moody's opined in July that Stockton's "willingness to pay may be eroding," yet the rating agency still hasn't responded substantively to my request that

it back up this assertion. Bond insurer Assured Guaranty, which is obligated to protect certain Stockton bondholders against various risks (including bankruptcy), has offered no counteroffer in response to our restructuring proposal—only two press releases and the assertion that the "City Council had failed to make politically tough decisions."

Anyone who thinks that should view the emotional video of the June 26 meeting when the council slashed funding for retiree health care. Over the next two years, city-paid retiree health benefits will be completely eliminated, wiping out this inherited \$540 million unfunded liability.

Also painful is our public safety situation. We are the 10th-most violent city in America. Rates of violence are increasing by double digits, with our murder rate on track to surpass last year's record of 58 murders. We have the second-lowest police staffing levels in the country for a large city, and often Stockton Police can respond only to "in-progress" crimes. Oakland, a nearby city with similar crime challenges, has 44% more police officers per capita. With high poverty rates and gang activity, we cannot turn our back on public safety due to creditor pressure.

Nor can we leave the CalPERS state pension system. CalPERS should be reformed, but if Stockton didn't offer an industry-standard pension plan, we simply would not be able to staff an already challenged police department.

It is unrealistic for creditors to posit that Stockton reject existing pension obligations. The city is fiercely competing for qualified individuals, particularly police officers and senior management, and since reducing our compensation we have already lost 45 officers to other cities. We cannot just pluck people from the unemployment lines—the requirements to be a police officer are demanding and 99% of applicants do not qualify or, if hired, wash out.

Stockton's restructuring proposal doesn't single out any creditors disproportionately. Considering the city's cost-cutting actions, citizens, employees and retirees have endured far more cuts—and created far more savings—than the capital-market creditors.

Our City Council has shown courage and developed a plan, unlike other levels of government. It has reduced services and employee compensation and has faced retiree health-care costs head on. We are trying to be responsible in dealing with our creditors, but in the process we cannot destroy a community and its hope for the future.

Instead of challenging this bankruptcy from corporate offices, our creditors should stay in Stockton for a hot summer week with their windows wide open.

Mr. Deis is city manager of Stockton, Calif.

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