



CITY OF STOCKTON

OFFICE OF THE CITY MANAGER

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February 24, 2012

Subject: Recommendation to Start AB 506 Process to Attempt to Prevent Insolvency and Bankruptcy

Dear City of Stockton Employee,

The City has changed pay and benefits and reduced its workforce by 25% to cope with shrinking revenues and rising costs. We have been forced to make many unpopular and painful decisions to reduce services and reduce compensation of employees who work for this community. Unfortunately, those cost reductions have not been enough. The City Manager's Office will be advising the City Council on the City's extremely weak fiscal condition on February 28, 2012. That agenda item is available on the City's website for your review. I encourage to read the complete report because it gives a comprehensive explanation of how we got to this situation and options we considered going forward.

You are receiving this letter as a City employee because you may be impacted by actions being considered by the City. Given the City's deteriorating fiscal condition, and its inability to finance current services, debts and obligations, I am recommending to the City Council that they approve actions to begin a confidential neutral evaluation process approved by the State Legislature this year (the AB 506 process). This letter explains the reasons for this, what AB 506 is, and how employees' representatives will be invited to participate.

City's Eroding Fiscal Condition

The City has serious financial problems due to a combination of falling revenues and rising costs including employee benefits, losses in the CalPERS retirement portfolio, payments for debt issued between 2003 and 2009, and rapidly growing retiree medical expenditures. In fact, next year we expect to pay more for retiree health insurance than for our current employees. This program was simply not funded in an actuarially sound way. The Great Recession, dropping property values and foreclosures, the loss of our construction industry and the collapse of the financial markets have hit Stockton very hard. After two decades of losing revenues to the state, this year we lost redevelopment, our main economic development tool.

Despite reductions in the General Fund budget of \$60 million in the last two years, the City still faces costs and obligations, including retiree medical and bonded debt payments, greater than its revenues. Our forecasts indicate the situation will persist this year and into the foreseeable future. A deficit as high as \$39 million is projected in FY 2012/13, and the City has no unrestricted available reserves to make up the gap. A well respected outside financial consulting firm has reviewed the City's finances and has confirmed the City's deteriorating fiscal condition. It has told us that steps are urgently needed now to correct the situation. The City Council believes that further service reductions would jeopardize public health and safety for Stockton's citizens. The Council and I also think employees have borne the brunt of the cost reductions and now it is time to include other creditors as part of the solution.

AB 506 Process

AB 506 is a new law creating a process to restructure a local government's finances short of bankruptcy. It calls for a confidential neutral evaluation process between the City and interested parties using the services of an independent neutral evaluator.

"Interested parties" include the City's major creditors, employee bargaining units, debt holders and guarantors, and pension funds. These "Interested Parties" are invited to participate in a confidential process. The process is designed to offer an opportunity for the Interested Parties and the City to agree voluntarily on a plan to reduce and restructure the City obligations so that the City can remain solvent and functioning. If the parties cannot agree, or if the City reaches a point in its fiscal emergency when "it is or will be unable to pay its obligations within 60 days," then the City could be forced to file for chapter 9 bankruptcy and seek to obtain a court approved plan of adjustment that could bind all creditors.

If you are a represented employee, your employee organization is an Interested Party" and will be invited to represent your interests in the AB 506 process. If you have questions, you should contact them directly. I am sure you will be hearing from them shortly to further advise you. Unrepresented employees will be advised regarding meetings to discuss this process with them.

The City will also be establishing a web page with information regarding the City's fiscal condition and the AB 506 process in the next few weeks to keep both the Interested Parties and the City's citizens informed as to developments in the City's efforts to develop a sustainable financial plan for the future.

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It is unfortunate that despite all of the City's efforts in the past few years that the City's finances have weakened to the point that this is the only option available. We are asking for all the parties that are interested in the welfare of the City and its citizens to work together to successfully meet this challenge, avoiding the protracted and expensive process associated with bankruptcy. Thank you in advance for your cooperation in these efforts.

Some employees may believe that if they quickly retire they will avoid any reductions in their benefits, such as retiree health insurance or other separation payments. While our efforts must be on maintaining the solvency of the City organization and maintaining our ability to deliver services, we strongly believe that a competitive compensation structure for City employees is an important part of both objectives. Again, we believe we are nearing the limits on what we can fairly expect from concessions in balancing our deficits. We also believe that the path to solvency includes dealing with the retiree health issue for current and future retirees. Therefore, it is not at all clear that there would be an advantage to prematurely retire. Please look for my companion memo on temporary measures that I have implemented on separation pay.

We are concentrating on addressing the City's financial situation so it can be a stable municipal organization, with competitive compensation and benefits for our employees. However, it is time to restructure our finances, no different than what various private sector corporations have done, to ensure a healthy and predictable future.

Other than the leave buyout issue, I fully expect no impact to paychecks and benefits as we go through this AB 506 process.

Thank you in advance for your cooperation in these efforts.

Sincerely,

A handwritten signature in black ink, appearing to read "Bob Deis". The signature is fluid and cursive, with a large initial "B" and "D".

Bob Deis
City Manager

CC: Employee Organizations
All Department Heads