



CITY OF STOCKTON

OFFICE OF THE CITY MANAGER

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October 1, 2012

Dear City of Stockton Employees,

CITY BANKRUPTCY UPDATE AND STATE APPROVED PENSION CHANGES

City Bankruptcy Update

The purpose of this letter is to give you a brief update on the status of the City's bankruptcy and to assure you that the City of Stockton is continuing to operate normally during the bankruptcy, including paying its employees, vendors and service providers.

As you know, the City of Stockton filed for bankruptcy protection on June 28, 2012. We submitted our bankruptcy budget, which also acts as our operational plan, to the Bankruptcy Court. This plan is referred to as the "Pendency Plan". This was done because State law requires cities to adopt a balanced budget. In addition, the Plan provides the budget for how the City will continue to operate during the fiscal year with the confidence that we can pay our employees and our vendors and provide the services that preserve basic quality of life, public health and safety to the residents of Stockton.

We understand employees may have concerns about whether or not the City has enough money to make payroll. You may have seen news reports about how other cities facing bankruptcy have indicated they do not have enough cash to make payroll. That is not the case in Stockton. One of the reasons the City acted when it did to file for bankruptcy protection was to confront the reality of our finances and deal with the City's finances in an orderly, thoughtful manner that would insure stability for the citizens of Stockton and for our employees. Our budget is balanced for this fiscal year and there are sufficient funds to make payroll. The services you provide are critical to the everyday operations of the City. We rely on our employees and will continue to pay you as we have since our fiscal crisis began.

In municipal bankruptcy, the City determines what expenses are paid without approval required by the Bankruptcy Court. Salaries and vendor expenses incurred in the normal course of business are essential to continue services to the community, which is the

role and responsibility of the City and not a decision made by the Bankruptcy Court. Municipal bankruptcies can take a few years to resolve, but we hope that our bankruptcy would be much shorter. In the meantime, the City is still open and operating and paying its bills to employees, vendors and service providers.

Eligibility

The City's bankruptcy is progressing in federal court. The first phase of this process is about the City's eligibility to file for bankruptcy. "Eligibility" is a determination by the Bankruptcy Court about whether or not the City is insolvent. Some of the City's largest creditors, primarily debt holders and insurers of bonds, have challenged the fact that the City is insolvent. These creditors have filed objections with the court indicating they believe that Stockton has not cut compensation and services enough and has not adjusted pensions for current retirees or future pensions for current employees. In working with experienced attorneys, we feel confident that we are "eligible" and insolvent.

The City has made decisions that allow us to continue to provide a modest level of service to protect the health and safety of our community and to remain a competitive employer. We can make a strong business case that there have been significant service reductions to the citizens of Stockton and that employees have absorbed millions in continuing concessions over the past four years. In fact, employee concessions made in the years prior to filing for bankruptcy and just after, are equal to or greater than adjustments being requested of our largest creditors.

Preserving the defined pension benefits through CalPERS is important to being able to maintain an effective workforce to provide services to the public. However, as I mentioned before, this benefit is becoming more expensive. In order to maintain this benefit for all 2400 retirees and current employees, the City had to eliminate the retiree health benefit that was never properly funded for almost 20 years. Similar to when you make the minimum payment on your VISA bills, the unpaid principal and interest keep accruing. The City got so far behind there was no way to recover. Through pay and benefit reductions and the loss of City-paid retiree medical, employees have given their fair share to reducing the City's costs and we are aggressively defending this position.

Mediation

It may take several months for Judge Christopher Klein to determine the City's eligibility. In the meantime, he has assigned Judge Elizabeth Perris, a Bankruptcy Court Judge from Oregon, to work with the City and its creditors using a mediation process that will hopefully resolve some of these matters and allow the City's bankruptcy to move to completion.

State Pension Reform

The State of California recently approved changes in public employee pensions statewide in California. We understand that many employees are concerned about how they might be impacted by these changes and there have been rumors about current employee pensions being reduced. Here are the facts:

First, the vast majority of the changes in the bill only apply to newly hired employees who have a hire date after January 1, 2013.

The legislation makes the following changes: a three year final average salary calculation period; no more EPMC (Employer Paid Member Contributions); a requirement that employees pay 50 percent of the normal cost (not the total cost); and, for agencies like Stockton that do not have Social Security, the maximum salary a pension can be based on is \$132,000. For Stockton, the retirement benefit formula for non-safety employees is 2 percent at age 62 and 2.7 percent at age 57 for safety. These changes only apply to new employees, hired after January 1, 2013, and not to you as a current employee.

In fact, many of the State's changes were already agreed to between the City and its unions for our newly hired employees as part of the negotiations that have taken place over the past two years. The State required changes are not that different from what we had already planned. Additionally, some of the changes introduced by the legislation relate to retirement systems developed under the County Employees' Retirement Act of 1937, such as the plan offered by San Joaquin County.

The changes that could impact you as a current employee are very limited and would require negotiations before they could be implemented.

The new State rules limit current non-safety employees' ability to work for CalPERS agencies after retirement, and eliminates the ability to purchase service credit or "Air Time" after January 1, 2013. The only change that could impact current employees while employed is how much of the cost of their retirement that an employee pays while employed.

The legislation allows agencies to negotiate for current employees to pay 50% or more of the "Normal Cost" of the employee's retirement. This can only be done after agreement with employee groups, and there are limits in the law about how much the employee can pay. As you know, last year all City of Stockton employees started paying their own CalPERS employee contributions. The employee contribution is part of the "Normal Cost," so we have already implemented part of this change. While there is a part of the "Normal Cost" also included in the employer's rates (the portion contributed by the City), the City would have to get agreement from employee groups before it could have employees start helping to pay a portion of this cost. The City has

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closed contracts with all employee groups but Police, until July 1, 2013, and has not had any discussions about changes in employee concessions or CalPERS contributions for next year.

I hope this has helped to address some of your questions or concerns. Additional information about the City's Chapter 9 filing is available on the City's web site from a link on the home page, www.stocktongov.com.

As the bankruptcy continues, we will keep your employee organizations informed of the status and issues that might impact our employees.

In the meantime, I hope you stay with us. If we can get through this bankruptcy process, which is our highest priority, I can confidently say the future will be brighter for the City of Stockton.

Sincerely,

A handwritten signature in black ink, appearing to read 'Bob Deis', written in a cursive style.

BOB DEIS
CITY MANAGER

BD:ndm

cc: City Council
Representatives of Stockton's employee groups