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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re:	Case No. 2012-32118
CITY OF STOCKTON, CALIFORNIA,	D.C. No. OHS-15
Debtor.	Chapter 9
	TRIAL EXHIBITS, TRIAL TRANSCRIPTS, AND LEGISLATIVE HISTORY CITED IN CITY'S SUPPLEMENTAL REPLY BRIEF IN SUPPORT OF CONFIRMATION OF THE FIRST AMENDED PLAN OF ADJUSTMENT, AS MODIFIED (AUGUST 8, 2014)
	Date: October 1, 2014 Time: 10:00 a.m. Dept: Courtroom 35 Judge: Hon. Christopher M. Klein

For the convenience of the Court and parties in interest, the City of Stockton, California ("City") hereby submits copies of the excerpts of the trial exhibits, trial transcripts, and legislative history cited in the City's Supplemental Reply Brief In Support Of Confirmation Of The First Amended Plan Of Adjustment, As Modified (August 8, 2014) ("**Reply**") filed on September 18, 2014. In the case of transcripts, the City has attached copies of only the pages cited in the Reply, along with surrounding pages for context as necessary. In the case of declarations, the City has attached only the pages of the declaration (and, where applicable, exhibits to the declaration) referred to in the Reply, along with surrounding pages for context as necessary.

The City has not attached excerpts that were attached to the Trial Exhibits And Transcripts Cited In City's Supplemental Brief In Support Of Confirmation Of The First Amended Plan Of Adjustment, As Modified (August 8, 2014) [Dkt. No. 1673] ("**First Compendium**"). Instead, the chart below refers back to each excerpts' location in the First Compendium, which had Bates range City Supp. 000001 through City Supp. 000138.

The documents are attached in the order in which they are cited in the Reply. Pages are Bates numbered in the lower right corner. Where a citation appears more than once, the cited document is attached only once, with later citations referring back to the Bates range for the first citation. Abbreviations have the meanings ascribed to them in the Reply.

The column headed "Location in Reply" lists the page and line of the Reply where the citation to the exhibit, transcript, or legislative history may be found.

Citation	Location in Reply	Description	Bates range
1.	4, fn. 4	Transcript, April 7, 2014, at 25:25-26:15 (comments of the City), 42:21-24 (comments of the Court)	City Supp. 000139-000142
2.	6:6-7	124 Cong. Rec. 32,403 (Sept. 28, 1978) (statement of Rep. Edwards)	City Supp. 000143-000144
3.	9:4-5	Leland DTD, ¶¶ 3-10, 18-19	City Supp. 000145-000148, City Supp. 000152-000154
4.	9:6	*Id.* ¶¶ 11-17	City Supp. 000148-000152
5.	9:6-7	Conf. Tr., May 12, 2014, at 160:11-163:6 (testimony of Robert Leland)	City Supp. 000156-000159

Citation	Location in Reply	Description	Bates range
6.	9:9-11	Conf. Tr., May 12, 2014, at 107:19-108:12, 116:5-117:24, 130:10-134:22, 135:21-136:11, 138:23-139:18 (testimony of Robert Leland)	City Supp. 000160-000164, City Supp. 000168-000177
7.	9:12	Chase DTD, ¶¶ 14-20	City Supp. 000178-000181
8.	9:12-13	Conf. Tr., May 13, 2014, at 88:22-89:6, 89:23-91:7 (testimony of Stephen Chase)	City Supp. 000182-000185
9.	9:22-23	Conf. Tr., May 12, 2014 at 162:19-163:6 (testimony of Robert Leland)	City Supp. 000158-000159
10.	10:2	*Id.* at 118:20-120:2	City Supp. 000165-000167
11.	10:3	*Id.* at 169:10-14	City Supp. 000186
12.	10:3-4	Leland DTD, Ex. L, at page 2 of 10	City Supp. 000188
13.	10:8-9	Conf. Tr., May 12, 2014 at 118:20-120:2 and 122:16-123:20 (testimony of Robert Leland)	City Supp. 000165-000167; City Supp. 000190-000192
14.	10:18	Chase DTD, ¶ 3	City Supp. 000193
15.	10:19	*Id.*, ¶ 4	City Supp. 000194
16.	10:20-21	Conf. Tr. May 13, 2014 at 85:19-86:4 (testimony of Stephen Chase)	City Supp. 000195-000196
17.	10:23	*Id.* at 137:24-138:12	City Supp. 000197-000198
18.	11:3	Leland DTD, ¶¶ 14, 16, 26	City Supp. 000199-202
19.	11, fn. 14	Supplemental Plan Supplement In Connection With The First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013) [Dkt. No. 1259, Trial Ex. 3033], Ex. 1.a, at pages 2 and 5	City Supp. 000203-204

Citation	Location in Reply	Description	Bates range
20.	12:12	Wilson DTD, ¶ 15	City Supp. 000031
21.	12:13-14	Jones DTD, ¶ 5	City Supp. 000078-000080
22.	12:17-18	Attachment A1 to Exhibit 2006 at EX 2006_0034 (CTY257708)	City Supp. 000205
23.	12:18-19	Conf. Tr., May 12, 2014 at 151:9-20 (testimony of Robert Leland)	City Supp. 000206
24.	12:20-21	Trial Ex. 2700 at EX 2700_0280-EX 2700_0281 (FRK-CM0001623—FRK-CM0001624)	City Supp. 000207-208
25.	13, fn. 21	H.R. Report 95-595 at 417 (1977)	City Supp. 000209-000216
26.	18:10-11	Disclosure Statement at Summary and §§ I, II.C, and II.D	City Supp. 000217-000235
27.	18:16	Deis DTD, ¶ 32	City Supp. 000033
28.	20:11-12	Conf. Tr., June 4, 2014, at 26:19-27:16, 50:13-21 (testimony of Kim Nicholl)	City Supp. 000048-000049, City Supp. 000051
29.	20:14	*Id.*	City Supp. 000048-000049, City Supp. 000051
30.	20:17	Lamoureux DTD, ¶ 13	City Supp. 000043
31.	20:19-20	Conf. Tr., June 4, 2014, at 20:8-21:10 (testimony of Kim Nicholl)	City Supp. 000022-000023
32.	21:5	*Id.* at 19:14-22	City Supp. 000236-000237
33.	21:6	*Id.* at 28:15-29:8	City Supp. 000056-000057
34.	21:8-9	*Id.*, at 27:17-28:14	City Supp. 000238-000241

Citation	Location in Reply	Description	Bates range
35.	22:3-4	Wilson DTD, ¶ 15	City Supp. 000031
36.	22:4	Deis DTD, ¶ 29	City Supp. 000032-000034
37.	22:4-6	Conf. Tr., June 4, 2014, at 20:1-21:23 and 26:15-29:8; 21:24-22:21; 19:9-22 and 49:4-7	City Supp. 000022-000023; City. Supp. 000238-000241; City Supp. 000022-000026
38.	22:17	Conf. Tr., June 4, 2014, at 49:16-21 (testimony of Kim Nicholl)	City Supp. 000025
39.	22:24-25	*Id.*, at 38:20-39:12, 49:8-13, 52:23-53:1 (testimony of Kim Nicholl)	City Supp. 000027-000028; City Supp. 000025; City Supp. 000054-000055
40.	23:5-6	Conf. Tr., May 12, 2014 at 19:18-20:4 (comments of the Court)	City Supp. 000242-000243
41.	23:9-10	Conf. Tr., May 14, 2014, 70:17-19 (comments of Franklin)	City Supp. 000244-000245
42.	24:2	Conf. Tr., June 4, 2014, at 38:10-19 (testimony of Kim Nicholl)	City Supp. 000027
43.	24:4-5	*Id.*, at 37:10-23	City Supp. 000065
44.	25:12-13	Montes Elig. Decl., ¶ 20	City Supp. 000105-000106
45.	25:13	Deis Elig. Decl., ¶ 39	City Supp. 000107
46.	25:14	Goodrich Elig. Reply Decl., ¶ 8	City Supp. 000108-000109
47.	25:18	Leland DTD, ¶ 37	City Supp. 000246-000248

Citation	Location in Reply	Description	Bates range
48.	25:18	*Id.*, ¶ 18(e)	City Supp. 000154
49.	25:19	Goodrich DTD, ¶ 17	City Supp. 000249
50.	26:8-9	Deis DTD, ¶ 32	City Supp. 000033-000034
51.	26:9	Haase Elig. Decl., ¶ 5	City Supp. 000016-000017
52.	26:9	Millican Decl., Ex. A at 40, Figure 1	City Supp. 000114-000115
53.	26:14	Deis DTD, ¶ 31	City Supp. 000033
54.	26:16	Conf. Tr., June 4, 2014, at 198:12-25 (Franklin closing argument)	City Supp. 000013-000015
55.	27:14	Wilson DTD, ¶ 15	City Supp. 000031
56.	27:14	Deis DTD, ¶ 29	City Supp. 000032-000034
57.	27:18	Jones Elig. Reply Decl., ¶¶ 13-15	City Supp. 000069-000070
58.	27:18	Jones DTD, ¶ 7	City Supp. 000079-000080
59.	27:20	Jones DTD, ¶ 5	City Supp. 000078-000079
60.	27:21	*Id.*	City Supp. 000078-000079
61.	27:24	Jones DTD, ¶¶ 4, 8	City Supp. 000078, City Supp. 000080
62.	29:1	Conf. Tr., June 4, 2014, at 29:20-37:1 (testimony of Kim Nicholl)	City Supp. 000056-000065
63.	29:1	Trial Ex. 3085	City Supp. 000250-000251

Citation	Location in Reply	Description	Bates range
64.	30, fn. 44	Conf. Tr., May 14, 2014, at 19:18-20:3, 88:1-89:16 (testimony of Charles Moore)	City Supp. 000252-000255
65.	30, fn. 44	*Id.* at 103:13-105:8	City Supp. 000087-000089
66.	30, fn. 45	Conf. Tr., May 14, 2014, at 205:19-23 (testimony of David Lamoureux)	City Supp. 000256-000257

Okay. That gets us to this motion that seems to have Franklin unhappy and me a little bit scratching my head, motion for judgment to be entered in favor of plaintiffs. This is a motion that you as defendant made representing the defendant, Mr. Levinson. We have a complaint that was filed. We have an answer. So I think conventionally under Federal Rule of Civil Procedure 12(C) we'd be talking about motion for judgment, but I'm not sure that that's what it is. Somehow Franklin is unhappy about getting judgment in its favor, so maybe you can help me out.

MR. LEVINSON: This is the first one of these I've ever filed, Your Honor. Here's our thing. We have the trial set for 9:30 on Monday, May 12 in both the adversary and on the confirmation issue. And contrary to what Franklin implies, it's not a cram down as to Franklin unless you rule differently on classification. Whatever it is, it will be a hard fought trial. There are many issues that have been raised by very competent briefs. There's a lot of discovery. The first half of the first day of the trial is devoted to motions -- related kind of motions, although less time may be devoted, and then we have a total of four days to do the trial.

When the City was preparing its response to the

66 page summary objection filed by Franklin at the end of February, we started to focus on how we can possibly streamline the trial to get it done during the window that we have available because, as we've told you, timing is important to the City. This is expensive. The longer the bankruptcy, the more it costs the City. The parties, in credit to Franklin, have moved very, very fast on the discovery process in order to accomplish that end. We filed this motion in an attempt to streamline the trial, and we brought it on a shortened time in order to see if we could streamline it sooner rather than later because streamlining the issues at trial would also mean we would streamline the preparation for trial and be more efficient both in terms of time and in terms of cost and distraction.

The adversary proceeding proceeds down alternative routes which, of course, is perfectly permissible. One of them is recharacterization by a disguised secured loan. If they are true leases, what's the amount of administrative rent owing, if any? If a disguised secured transaction, is this loan allowable? Because as you've heard, the City has said it may be enforceable if it's a loan. If it's a disguised loan, what is the value of the collateral and what is the amount of the secured and the deficiency claims? If we want to do is get rid of these issues now to narrow the play.

THE COURT: Mr. Johnston.

MR. JOHNSTON: I think you have a meeting of the minds, Your Honor. What Franklin would request is you enter Count 1 -- grant Count 1, you dismiss Count 5 with prejudice, keep the adversary proceeding in Counts 2, 3 and 4 open and proceed with the scheduling that's already in your scheduling order.

THE COURT: When we originally set up this structure where I engaged in a rather unusual exercise and said we're going to try a confirmation hearing and separate adversary proceeding simultaneously was because there was considerable overlap. Mr. Levinson has made the point that I think I tried to make to you a little earlier, that all these other issues are fair game to talk about in the confirmation trial. And to the extent you've got to move a few pages of a brief from the adversary proceeding brief to the confirmation brief, that's, in the days of modern word processing, not that big a deal. I wouldn't be trying to manage the situation as to pull the carpet out from legitimate issues, but anything that actually simplifies the process will probably help everybody. Remember, I'm only a bankruptcy judge. I can only handle two or three issues.

MR. JOHNSTON: I feel as if Franklin's suggestion would go utmost to simplify the issues. I can't think of a better way to simplify them and have them presented to you in a coherent manner.

THE COURT: Mr. Levinson, why don't I enter judgment on Count 1, dismiss Count 5, not only with prejudice, but just leave the others sitting there recognizing that they're just an overlap to confirmation issues anyway?

MR. LEVINSON: I wouldn't want you to dismiss Count 5 without prejudice. I would want it with prejudice, which is what Franklin is willing to do.

THE COURT: I can say without prejudice. Here's the procedural problem. If I leave any part of the adversary proceeding open, unresolved, then you've got that provision in Rule 54. I've seen this jump up and bite people with some regularity, particularly when I was doing appellate work. 54(B), judgment on multiple claims or involving multiple parties. When an action presents more than one claim for relief, whether as a claim counterclaim, crossclaim or third-party claim, or when multiple parties are involved, the court may direct entry of a final judgment as to one or more, but fewer than all claims or parties, only if the court expressly determines that there is no just reason for delay. Otherwise, any

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broker's contract with his customer is treated no differently than any other contract under section 365 of title II.

Chapter 9 of the House amendment represents a compromise between chapter 9 of the House bill and 9 of the Senate amendment. In most respect this chapter follows current law with respect to the adjustment of debts of a municipality. Stylistic changes and minor substantive revisions have been made in order to conform this chapter with other new chapters of the bankruptcy code. There are few major differences between the House bill and the Senate amendment on this issue. Section 901 indicates the applicability of other sections of title II in cases under chapter 9. Included are sections providing for creditors' committees under sections 1102 and 1103.

Section 902(2) of the Senate amendment is deleted since the bankruptcy court will have jurisdiction over all cases under chapter 9. The concept of a claim being materially and adversely affected reflected in section 902(1) of the Senate amendment has been deleted and replaced with the new concept of "impairment" set forth in section 1124 of the House amendment and incorporated by reference into chapter 9.

Section 903 of the House amendment represents a stylistic revision of section 903 of the Senate amendment. To the extent section 903 of the House bill would have changed present law, such section is rejected. Section 905 of the Senate amendment is incorporated as section 921(b) of the House amendment with the difference that the chief judge of the circuit embracing the district in which the case is commenced designates a bankruptcy judge to conduct the case in lieu of a district judge as under present law. It is intended that a municipality may commence a case in any district in which the municipality is located, as under present law. Section 906 of the Senate amendment has been adopted in substance in section 109(c) of the House amendment.

Section 923 of the House amendment represents a compromise with respect to the notice provisions contained in comparable provisions of the House bill and Senate amendment. As a general matter, title II leaves most procedural issues to be determined by the Rules of Bankruptcy Procedure. Section 923 of the House amendment contains certain important aspects of procedure that have been retained from present law. It is anticipated that the Rules of Bankruptcy Procedure will adopt rules similar to the present rules for chapter IX of the Bankruptcy Act.

Section 924 of the House amendment is derived from section 924 of the House bill with the location of the filing of the list of creditors to be determined by the rules of bankruptcy procedure. The detailed requirements of section 724 of the Senate bill are anticipated to be incorporated in the rules of bankruptcy procedure.

Section 925 of the Senate amendment regarding venue and fees has been deleted.

Section 926 of the House amendment is derived from section 928 of the Senate bill. The provision enables creditors to request the court to appoint a trustee to pursue avoiding powers if the debtor refuses to exercise those powers. Section 901 of the House amendment makes a corresponding change to incorporate avoiding powers included in the Senate amendment, but excluded from the House bill.

Section 927(b) of the House amendment is derived from section 927(b) of the Senate bill. The provision requires mandatory dismissal if confirmation of a plan is refused.

The House amendment deletes section 929 of the Senate amendment as unnecessary since the bankruptcy court has original exclusive jurisdiction of all cases under chapter 9.

The House amendment deletes section 930 of the Senate amendment and incorporates section 507(a)(1) by reference.

The House amendment deletes section 942 of the Senate amendment in favor of incorporating section 1125 by cross-reference. Similarly, the House amendment does not incorporate sections 944 or 945 of the Senate amendment since incorporation of several sections in chapter 11 in section 901 is sufficient.

Section 943(a) of the House amendment makes clear that a special taxpayer may object to confirmation of a plan. Section 943(b) of the House amendment is derived from section 943 of the House bill respecting confirmation of a plan under chapter 9. It must be emphasized that these standards of confirmation are in addition to standards in section 1129 that are made applicable to chapter 9 by section 901 of the House amendment. In particular, if the requirements of section 1129(a)(8) are not complied with, then the proponent may request application of section 1129(b). The court will then be required to confirm the plan if it complies with the "fair and equitable" test and is in the best interests of creditors. The best interests of creditors test does not mean liquidation value as under chapter XI of the Bankruptcy Act. In making such a determination, it is expected that the court will be guided by standards set forth in *Kelley* v. *Everglades Drainage District*, 319 U.S. 415 (1943), and *Fano* v. *Newport Heights Irrigation Dist.*, 114 F. 2d 563 (9th Cir. 1940), as under present law, the bankruptcy court should make findings as detailed as possible to support a conclusion that this test has been met. However, it must be emphasized that unlike current law, the fair and equitable test under section 1129(b) will not apply if section 1129(a)(8) has been satisfied in addition to the other confirmation standards specified in section 943 and incorporated by reference in section 901 of the House amendment. To the extent that *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U.S. 138 (1940) and other cases are to the contrary, such cases are overruled to that extent.

The House amendment deletes section 950 of the Senate amendment as unnecessary. The constitutionality of chapter 9 of the House amendment is beyond doubt.

Chapter 11 of the House amendment is derived in large part from chapter 11 as contained in the House bill. Unlike chapter 11 of the Senate amendment, chapter 11 of the House amendment does not represent an extension of chapter X of current law or any other chapter of the Bankruptcy Act. Rather chapter 11 of the House amendment takes a new approach consolidating subjects dealt with under chapter VIII, X, XI, and XII of the Bankruptcy Act. The new consolidated chapter 11 contains no special procedure for companies with public debt or equity security holders. Instead, factors such as the standard to be applied to solicitation of acceptances of a plan of reorganization are left to be determined by the court on a case-by-case basis. In order to insure that adequate investigation of the debtor is conducted to determine fraud or wrongdoing on the part of present management, an examiner is required to be appointed in all cases in which the debtor's fixed, liquidated, and unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million. This should adequately represent the needs of public security holders in most cases. However, in addition, section 1109 of the House amendment enables both the Securities and Exchange Commission and any party in interest who is creditor, equity security holder, indenture trustee, or any committee representing creditors or equity security holders to raise and appear and be heard on any issue in a case under chapter 11. This will enable the bankruptcy court to evaluate all sides of a position and to determine the public interest. This approach is sharply contrasted to that under chapter X of present law in which the public interest is often determined only in terms of the interest of public security holders. The advisory role of the Securities and Exchange Commission will enable the court to balance the needs of public security holders against equally important public needs relating to the economy, such as employment and production, and other factors such as the public health and safety of the people or protection of the national interest. In this context, the new chapter 11 deletes archaic rules contained in certain chapters of present law such as the requirement of an approval hearing and the prohibition of prepetition solicitation. Such requirements were written in an age before the enactment of the Trust Indenture Act and the development of securities laws had occurred. The benefits of these provisions have long been outlived but the detriment of the provisions served to frustrate and delay effective reorganization in those chapters of the Bankruptcy Act in which such provisions applied. Chapter 11 thus represents a much needed revision of reorganization laws. A brief discussion of the history of this important achievement is useful to an appreciation of the monumental reform embraced in chapter 11.

Under the existing Bankruptcy Act, debtors seeking reorganization may choose among three reorganization chapters, chapter X, chapter XI, and chapter XII. Individuals and partner-

I, Robert Leland, hereby declare:

1. I am a Senior Manager at the consulting firm of Management Partners. I make this declaration in support of confirmation of the City of Stockton, California's ("City") First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013) ("Plan"). I have 39 years of experience in state and local government finance. I served 26 years as the Director of Finance for the City of Fairfield, California, 3 ½ years as Assistant Finance Director for the City of Sacramento, California, and 6 ½ years as a staff consultant to the California Assembly Revenue and Taxation Committee. I was elected President of both the California Society of Municipal Finance Officers and the League of California Cities Fiscal Officers Department, and was a board member of the League of California Cities, the California Asset Management Program, and the California Statewide Communities Financing Authority. I have been creating long-range budget forecasts and spreadsheet models since the early 1980s. Since March of 2012, I have been a consultant to the City on the creation of the City's long-range budget forecasting model.

2. I am the principal author of the Long-Range Financial Plan of the City of Stockton ("Long-Range Financial Plan" or "LRFP"), which is Exhibit B to the Disclosure Statement With Respect To First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013). Based on my past experience and on my experience with the City, I believe that the findings, projections, assumptions, and underlying facts used to create the Long-Range Financial Plan, as supplemented by new and updated financial data generated since the filing of the Disclosure Statement, represent the City's best efforts to forecast its revenues, costs, and overall feasibility under the terms of the Plan.

<u>The City's Revenue And Expense Projections Are Realistic</u>

3. In preparing the LRFP, the City considered as many contingencies as possible in order to develop the most realistic revenue and expense projections that it could to demonstrate solvency over a prolonged period of time. Its revenue and expense projections are conservative relative to the pre-recession magnitude of estimates that got the City into trouble in the first place, but grounded in post-recession reality.

4. The City's basis for its projections of revenues from the property tax (24% of projected FY 2014-15 total revenues) and sales tax (36% of projected FY2014-15 total revenues) begins with the reports prepared by its consultant and auditor, HdL. True and correct copies of the HdL projections of property and sales tax revenues that underpin the LRFP are attached hereto as **Exhibits A** through **K**. The City's property tax forecast goes on to project each of the four elements contributing to property tax growth: estimated changes in ownership, new construction based on projected development levels, Proposition 8 increases based on the potential for valuation recoveries, and the annual Proposition 13 inflator. This analysis militates against unwarranted optimism in the expected growth of future property tax revenues, which under this forecast increases an average of 3.9% annually over the next 10 years. Starting April 1, 2014, sales tax revenues will include approximately $28 million per year in new revenues as a result of the passage of Measure A. On March 5, 2014, the City obtained updated sales tax information from HdL for the third quarter of 2013, but based on subsequent concerns raised by HdL[2] the City determined that it was premature to update its sales tax projections from those in the revised LRFP, which currently grows by an average of 3.4% annually over the next 10 years.

5. The City's projections of utility user tax ("UUT") are also realistic. The foundation for these projections is an analysis of gas, electricity, cable, and telecommunication trends by City consultant MuniServices, and staff assessment of the tax on usage of its water utility. Given the impact of water and energy conservation efforts by utility customers, and changing technology trends affecting usage of telecommunications and cable, it is unlikely the ongoing revenue growth will exceed the 1.5% projected in the LRFP.

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[2] On March 14, 2014, Lloyd deLlamas of HdL provided the following update: "Just as a heads up, we just downloaded the results of Stockton's holiday quarter and the results particularly in the pool receipts were somewhat lower than anticipated. Although all of the pools for the 58 counties were up 7.8% over the same quarter a year ago, Stockton's share of the San Joaquin county pool was only up 3.7%. Stockton's Christmas quarter was surprisingly disappointing. Although total receipts were up 4.5% over last Christmas, the revenues were inflated by adjustments to make up for late payments last quarter. The actual increase after all aberrations are factored was 1.7%. Given these numbers, the growing concerns regarding a continuing drought on the Central Valley's economy and recent speculation that Amazon may convert their tax allocations from the county pools to the three fulfillment centers, we will be re-evaluating the projections provided just a few weeks ago. The data is still in raw form and it normally takes us three weeks to identify and assess all of the variables that impact each quarter's allocation of sales and use tax by the Board of Equalization, update our quarterly economic forecasts and then focus in on projections for individual clients. Brice Russell will be performing this quarter's analysis for Stockton. He and I will work together and provide you updated projections by mid-April."

6. The LRFP does not attempt to predict or project that amount of public facilities fee ("PFF") revenues to be collected for future years. This is because the LRFP is a projection of General Fund revenues and General Fund expenses, and restricted funds, such as PFF revenues, are not General Fund revenues. Franklin has interpreted one statement in the text of the LRFP to mean that the City expects to collect $500,000 in PFF revenues that are available to pay Franklin, even though the Plan does not provide for Franklin to receive these PFF revenues. Franklin's interpretation is not what was intended by the statement.

7. The model attached to the LRFP as Attachment "A" was prepared to mathematically calculate the savings to the General Fund expected to be achieved by the City in future years as a result of the City's restructuring of its various financial obligations. The cost to the City for the lease rent payable under the Golf Course/Park Lease Back was approximately $2.9 million per year. However, the General Fund had not paid all $2.9 million of those lease payments, so it would have been inappropriate to show a $2.9 million savings per year as a result of the City rejecting the Golf Course/Park Leases. At the time of the preparation of the financial model for the LRFP, which was last summer, the City's best estimate of future PFF revenues was such that about $500,000/year of PFF revenues could have been available to make the lease payments if the Golf Course/Park Leases were not rejected. Thus, the financial model showing the savings to the City of the financial restructurings reduced the savings from rejection of the Golf Course/Park Leases from $2.9 million in lease payments, to $2.9 million minus the assumed amount of $500,000 of available PFF revenues, for a net savings to the General Fund of $2.4 million.

8. In March 2014, at Franklin's request, I also prepared a second financial model of the LRFP that, instead of demonstrating the saving of the restructurings to the City, simply shows future projected General Fund revenues and projected General Fund expenditures (Attachment "A-1" to the LRFP). There are no PFF revenues set forth in that financial model since PFF revenues are not General Fund revenues. Attachment A-1 shows zero ongoing net expense to the General Fund for the 2009 bonds owned by Franklin.

9. With respect to the issue of whether the City will collect enough in PFF revenues to satisfy the obligations for which those future PFF revenues must be used, the downturn in development in Stockton and the resulting nosedive in PFF revenues has dramatically decreased the City's ability to make payments from PFFs. While the future expectation is that upon recovery the Stockton market will be able to absorb 700 residential units per year, this is far below the historical peak level of almost 3,000 per year during the early 2000s. And precisely when that recovery will occur is still in question. Since the creation of the housing absorption study by consulting firm Economic & Planning Systems, Inc. ("EPS") in the second calendar quarter of 2013, the City's estimate of residential building permits to be issued from FY2012-13 through 2016-17 has dropped 63% to 1,850, from the EPS original estimate of 4,668. All of the factors discussed in the Direct Testimony Declaration of Steven Chase ("Chase DTD") place significant constraints on the availability of PFF funds for anything other than the infrastructure improvements for which the PFF revenues are collected, and little or nothing for payment of debt service to creditors.

10. The LRFP projects that, with the savings from the financial restructuring described in the Plan as well as new revenues from the passage of Measure A, the City will achieve a balanced and sustainable budget. The projected levels of sales tax revenues, property tax revenues, UUT, and other taxes, fees, and revenues will enable the City to maintain and fund adequate municipal services, including fire and police protection, as well as to satisfy the City's obligations to its creditors as restructured pursuant to the Plan.

<u>The General Fund Reserve Level Contemplated By The LRFP Is Appropriate For The City's Long-Term Sustainability</u>

11. Attached hereto as **Exhibit M** is a true and correct copy of a publication by the Government Finance Officers Association (GFOA) titled "Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (BUDGET and CAAFR)." It is publicly available online at http://www.gfoa.org/downloads/AppropriateLevelUnrestrictedFundBalanceGeneralFund_BestPractice.pdf. In this publication, the GFOA "recommends that governments establish a formal policy

on the level of unrestricted fund balance that should be maintained in the general fund." *Id.* at 1. It further recommends "at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular fund operating revenues or regular general fund operating expenditures." *Id.* at 2. This recommended balance translates to 16.67% of total expenditures.

12. In 2006, the City Council adopted a resolution approving a policy that aspired to maintain in the General Fund a "catastrophic reserve" that is "equivalent to five percent of the General Fund annual appropriations and transfers out" and an "economic contingency/budget uncertainty reserve" that is also "equivalent to five percent of the General Fund annual appropriations and transfers out." *City of Stockton Council Policy No. 700-4, Reserve Policy—General Fund*, adopted by Resolution 06-0299 (June 6, 2006). However, as the City's financial health began to deteriorate, it became clear that this total reserve of 10% was inadequate. The last time the 10% reserve policy is mentioned in a City budget was June 11, 2010, with the release of the FY 2010-11 Annual Budget. In the LRFP, any resources in excess of the more conservative level of 15% of total expenditures are assumed available to be applied toward unmet operating needs, however, it is projected that the City will not achieve a 15% reserve level until FY 2032-33. In its fourth quarter financial review for FY 2013-14 held on February 25, 2014, the City staff report cited the GFOA's recommended reserve policy of two months of operating revenues or expenditures and now recommends moving toward that level of reserve. [3] By inference, this supersedes the City's 2006 policy of a 10% total reserve. Currently, it is projected that the City will not achieve a 16.67% reserve level until FY 2033-34. If the City's finances were more favorable than currently projected, the City could achieve its operating reserve goal earlier.

[3] "The Government Finance Officers Association recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their General Fund of no less than two months of regular General Fund operating revenues or General Fund operating expenditures, which is equivalent to 16.7% of those amounts. Cities with formal reserve policies generally specify between 10-20% reserve levels. The Administration now recommends that the portion of the Ending Fund Balance ($3.1 million) that resulted from the unanticipated refund of County Property Tax Administration Fees (explained in detail later in this report), be retained in the General Fund to help build the available fund balance. With a balance of $3.1 million (or just under 2%), the City is still substantially below these recommended levels. This recommendation is made to provide a small step towards building up one-time monies to meet the many unfunded, but mission critical needs for spending." *See* Council agenda report #14-0202, February 25, 2014, a true and correct copy of which is attached hereto as **Exhibit L**.

13. Franklin's suggestion that a reserve fund of 10% or less is sufficient and that money from this fund is available to pay the 2009 Bond Claim indicates a deep misunderstanding of the purpose of reserves. Reserves are a one-time resource designed to help bridge a downturn in the economy that results in lower revenues than projected, or to help meet an unexpected one-time increase in expenditures. Reserves are not available to pay an ongoing increase in obligations such as the 2009 Bond Claim. If the General Fund began paying the full $2.9 million in 2009 Bond debt service starting in the current fiscal year 2013-14, the General Fund would be in deficit within six years.

14. In addition to these reserves, the LRFP also incorporates a $2 million per year annual contingency (approximately 1% of expenditures). The purpose of this annual contingency is, like an annual operating reserve, to protect the City against financial setbacks. However, whereas an annual operating reserve represents one-time emergency resources to deal with short-term issues, the annual contingency serves as a *long-term* buffer against natural swings in economic conditions. As evidenced by the recent recession, economic downturns can cause a city to fall short of its projections by millions, or even tens of millions, of dollars over several years. Moreover, it may take several additional years for a city's revenues to return to their prior peak year total, much less the level to which revenues would have grown given a continuation of pre-recession trends. For example, in FY2013-14 Stockton is still $36 million below the $203 million in General Fund revenue it received five years earlier in its peak fiscal year of 2008-09, and the City is $93 million below the trended level of revenue produced by a continuation of the General Fund growth rate that occurred in Stockton from FY1996-97 through FY2006-07. The annual contingency is meant to provide a safeguard against these types of long-term setbacks by serving as a "smoothing" mechanism – that is, the annual contingency spreads the impacts of economic downturns over the entire period of the LRFP. This allows the City to make projections of its future finances without having to make predictions about the timing or severity of future recessions, with a reasonable level of assurance that adequate resources will always be available to support the projected level of expenditures.

15. Franklin argues that the $2 million annual contingency is unnecessary, and contends that the City can simply pay that money to Franklin instead. This argument completely misses the importance of the annual contingency to the City's projections and the City's long-term fiscal health. While the City could theoretically eliminate the annual contingency from the LRFP, the LRFP itself would then need to be altered in order to incorporate predictions as to the timing and magnitude of economic swings and the impact of such swings on the City's finances. The reduction in contingency expenditures within the forecast would be offset by the loss of resources from the projected economic downturns. Given the inherent difficulties of predicting recessions, particularly over a 30-year period, budget forecasts do not typically do so, but rather opt for a realistic linear growth trend for revenue and either build in a buffer against future variations or require significantly higher reserves.[4] However, if the City *were* to eliminate its $2 million contingency and incorporate recessions into its revenue forecast, and at the same time increase expenditures by $2 million annually to make payments toward the 2009 Bond Claim, current projections indicate that this would cause the General Fund balance to rapidly erode and result in a deficit within 7-9 years, depending on the timing and severity of the recessions, which in turn would require another restructuring of City finances.

16. The City must be sustainable. The City recognizes that its financial plans and budgets, however sound, will need to be amended as economic and financial circumstances change. Maintaining a healthy reserve is essential to weather the "worst case scenarios" where the City does worse than anticipated. The operating reserves and the annual contingency projected in the LRFP are necessary to sustain the City as a viable municipality. This has been

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[4] The City of Sunnyvale is the "gold standard" for long-range financial plans, in that it has been adopting 20-year budget forecasts bi-annually since the 1980's. Sunnyvale's current reserve policies are as follows: (1) "The General Fund Contingency Reserve will be maintained at 15% of operations costs in year one of the long-term plan, with annual increases based on projected increases in the Consumer Price Index", (2) "The Budget Stabilization Fund will be a minimum of 15% of projected revenues for the first two years of the 20-year planning period. Beyond year two the Budget Stabilization Fund will always have a balance of at least zero", and (3) "The Twenty-Year Resource Allocation Plan Reserve shall be used to levelize economic cycles and maintain stable service levels over the long term." (http://sunnyvale.ca.gov/Portals/0/Sunnyvale/CodesAndPolicies/7.01.01.pdf) Sunnyvale's total projected reserves for FY2013-14 total $92.7 million, which is 63% of its budgeted total requirement of $146.6 million. Sunnyvale does not attempt to predict the timing of recessions, but rather uses relatively linear forecasting trends (as does Stockton); its projected property tax revenue averages 3.8% annual growth from FY2013-14 through 2032-33 (compared to 3.4% for Stockton over the same period), and its sales tax revenue averages 2.9% annual growth (compared to 3.1% for Stockton over the same period).

the City Council's overarching policy objective starting with the AB 506 process initiated in early 2012. This is in the best interests of the City and its residents. Raiding these reserves for payments to Franklin would imperil the City's financial viability.

17. Similarly, if the City were to substitute Franklin's business judgment for its own by submitting a plan that impaired CalPERS, Franklin would fare worse than it would under the City's Plan. If the City were to impair CalPERS, then CalPERS would have an immediate unsecured claim worth approximately $1.62 billion.[5] The claim from CalPERS would represent 73.3% of the unsecured claims pool, compared with a roughly 24.7% share for Retiree Health Benefit Claimants ($545 million) and an approximate 1.58% share for Franklin (even assuming the Franklin claim is in the amount of $35 million as opposed to $10.4 million).

The City's Projections Of Its CalPERS Obligations Are Sound

18. On the expense side, the City's projections of its CalPERS obligations are sound. In September 2013, the City received a long-range projection of CalPERS employer rates[6] for its Safety and Miscellaneous employee plans from its actuary, The Segal Company ("Segal"), using the CalPERS June 30, 2011 valuation, the latest then available, and taking into account the following anticipated changes[7]:

a. Rate smoothing and unfunded liability amortization changes phased in over five years. These changes would result in significant short-term increases in rates, but with fixed periods for amortization, rates would drop as various "layers" of unfunded liability become fully amortized, ultimately leaving only the levy of a rate for "normal" costs with prior unfunded liabilities completely paid off and all employees under the Public Employees' Pension Reform

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[5] This $1.62 billion is the amount which CalPERS claims it would be due as the total of the "Unfunded Termination Liability" for the combined Safety and Miscellaneous plans, using the "Termination Liability Discount Rate" of 2.98%, the yield of the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. Attached hereto as **Exhibits N** and **O** are true and correct copies of excerpts from the CalPERS Annual Valuation Reports as of June 30, 2012 for the Miscellaneous and Safety Plans for the City of Stockton, respectively. See page 28 of Exhibit N and page 28 of Exhibit O for CalPERS' calculation of the "Unfunded Termination Liability" for the Miscellaneous and Safety Plans, respectively. Because the City intends not to terminate the CalPERS contracts, the City has not researched this number and thus does neither agrees nor disagrees with this amount.

[6] The employer rate consists of a "normal cost" rate to pay the cost of service accrued for active employees for the upcoming fiscal year, and an "unfunded rate" to pay the fiscal year's amortized portion of unfunded liability (the amount by which accrued liabilities exceed the actuarial value of assets). These rates are applied to the "PERSable income" of active employees to generate the amounts payable to CalPERS.

[7] A true and correct copy of Segal's rate forecast, with assumptions, is attached hereto as **Exhibit P**.

Act (PEPRA) level of benefits. These changes were subsequently reflected by CalPERS in its June 30, 2012 valuations (which became available after the Segal forecast).

b. Mortality Improvements, reflecting longer beneficiary lifespans, phased in over five years. These were adopted by the CalPERS board in February 2014 and should be reflected in the June 30, 2013 valuation reports due later this year.

c. Discount Rate Reduction. The City's projections include the assumption that an additional reduction of 0.25% in the discount rate (the assumed investment return for actuarial purposes) would be approved by the CalPERS board. If the discount rate is reduced, employer rates go up significantly, given that approximately 70% of CalPERS income comes from investment returns. Two years ago the CalPERS staff recommended a 0.5% reduction in the discount rate, from 7.75% to 7.25%. The CalPERS board enacted half of that amount, a 0.25% reduction to 7.5%, and deferred action on the second half of the staff recommendation. To date the board has not acted on the second 0.25% reduction. Given favorable investment returns the past two years (the forecast assumed a 12.5% CalPERS investment return for FY2012-13), and the cumulative impact of rate increases on member agencies that resulted under (a) and (b) above, there may be a disincentive for the board to act on this item in the near-term. A board workshop on risk has been proposed for later this year. The City's projections, by including a discount rate cut, prudently assume the potential for an additional rate increase.

d. Payroll Adjustments. The unfunded liability portion of pension costs is a fixed amount, but the payment to CalPERS is determined by multiplying the unfunded rate supplied by CalPERS to the City's payroll. There is a three-year lag between the last year CalPERS has actual payroll data from the City (e.g., FY2011-12), and the year for which CalPERS is issuing its newest rate (for FY2014-15), and CalPERS bridges the gap by assuming that the historical payroll last reported increases by 3% annually. If the City's payroll for the rate year in question (FY2014-15) is less than estimated by CalPERS, the unfunded rate provided by CalPERS will prove to be too low to generate the payments expected from the City by CalPERS for purposes of unfunded liability amortization, and in subsequent years that unfunded portion of the rate will need to be increased. This outcome of payroll being less than the CalPERS actuarial projection has proved to be an issue statewide as many cities have cut positions and reduced compensation, as has Stockton, and thus wind up with lower payroll than in the CalPERS actuarial valuation. In an effort to better reflect the impacts on the unfunded portion of the employer rate, Segal's estimates took into account the lower level of payroll in the near-term due to past position cuts and compensation reductions. They also built in the higher payroll long-term due to the three-year phase-in of 120 new police officer positions and other non-sworn staff as part of the City's Marshall Plan on Crime.

e. The Public Employees' Pension Reform Act ("PEPRA"). PEPRA provides for lower benefit levels for "new hires" (this excludes past CalPERS members with less than a six-month break in service, who would retain the higher benefit levels, referred to as "classic" members). Savings will accrue over time as gradual ongoing turnover places "classic" new hires in the City's "tier 2" (an in-between level of benefits between PEPRA and the original or "tier 1" level of benefits) and "non-classic" new hires who will fall into the PEPRA tier. This transition is included in the Segal estimates, which also assume all of the new safety hires under the Marshall Plan come in under PEPRA and are computed under that formula. The City does not yet have official employer rates for PEPRA employees. These are expected in the June 30, 2013 valuation report due later this year. While PEPRA assumes a 50:50 split of total normal cost between employer and employee, this has to be negotiated. If agreement is not reached the City can impose a 50:50 split, but not until 2018.

19. Segal took the estimated rates of each tier using the foregoing assumptions, and computed a weighted overall Safety rate, which was multiplied by forecasted Safety employee "PERSable" income (salary, add-pays, uniform allowance), and a weighted overall Miscellaneous rate, which was multiplied by forecasted Miscellaneous salaries. Salary growth includes the new employees under the Marshall Plan, cost of living adjustments (COLAs), and estimated impact of merit (step) increases.

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Franklin Could Not Get More Money From The City If The Bankruptcy Case Were Dismissed Or If The City Impaired CalPERS

20. Franklin claims that it will do better if the City's bankruptcy case were dismissed because Franklin could obtain a judgment against the City for the amount of the lease payments every six months. But Franklin misses a key point: The City would not have enough money to pay these judgments. Attached hereto as **Exhibit Q** is a true and correct copy of a table showing the loss of budgeted restructuring savings to all funds expected through 2041 as a result of claims made against the City every 6 months. With the possible exception of the Ambac Settlement Agreement, all of the settlements that the City has made with its creditors would be unraveled, and Franklin would be just one out of more than one thousand creditors pursuing individual remedies in state court. The City simply would not have sufficient funds to pay all of the judgments that would be obtained by all of its creditors if the City was no longer afforded bankruptcy protection. These creditors would include CalPERS, holders of Retiree Health Benefit Claims, NPFG, Assured, possibly Ambac, various tort claimants and numerous other creditors. The inevitable resulting chaos would be catastrophic to the City's operations, staff retention, crime prevention, collection of fee and tax revenues, and Stockton's overall desirability for both residents and businesses.

Moore Opinion One – City Has the Resources to Pay Franklin

21. The Expert Report of Charles M. Moore ("Moore Report") posits four arguments in support of its conclusion that the City has plenty of resources with which to pay Franklin: (1) The City's revenue estimates are excessively conservative, and so the General Fund will be better off than is being forecasted, (2) the annual contingency can be eliminated, freeing up $2 million per year, and the level of reserve the City is seeking to maintain can be reduced, both in order to pay Franklin, (3) PFF revenues are available to pay "a significant portion, if not all, of the amounts owing", and (4) the City could undertake other revenue and cost initiatives to improve its finances.

22. *City forecasts are not excessively conservative:* The City's revenue forecast may be conservative relative to the revenue growth experience of the late 1990's and early 2000's,

So the few millions of dollars more would have been reserved, had it been at 10 percent, would have been completely inadequate to have staved off bankruptcy.

Q. Did you ever do those calculations?

A. Have I -- have I ever done the calculations? I haven't specifically calculated them out, but if you want to go back and take a look at the numbers, I can tell you that the $42 million in loss in revenue would have completely swamped whatever additional amount of reserve you would have had -- would not have been adequate.

Q. So in addition to the cash reserve, now 16.7 percent, you also include an annual line item of 2 million dollars for contingency, correct?

A. Correct.

Q. And the reserve and the contingency are both intended to protect the City against financial setbacks, right?

A. Yes.

Q. But unlike the cash reserve, which is established as a percentage of annual expenditures, the contingency is a fixed 2 million dollars per year, right?

A. That's correct.

Q. And under the Long-Range Financial Plan, in a year in which revenues and expenses are accurately forecast, 2 million dollar contingencies are added to the available fund balance at the conclusion of the year, right?

A. That would be the case.

Q. So those are funds that, under the Long-Range Financial Plan, could then be spent on mission-critical spending, right?

A. Well, at the point which you get to the 16.7 percent reserve, we're assuming that you want to get the reserve fully funded before you start spending on other needs no matter how critical they might be. So as it stands now in our forecast, it would take 19 or 20 years to get to that 16.7 percent. So if we have a few good years in that time that add resources, then that might enable us to get to the 16.7 percent desired reserve level sooner than 19 years. And that would be a good thing.

But I think it's unrealistic to expect that the contingency won't be used in each year. In reality, what the contingency is, is a consistent and disciplined hedging strategy to account for the inevitable variations that you're going to have from our forecasted revenues and expenditures. In reality, we're going to have down years, like I just mentioned, with this great recession. We're five years removed from 2009. We are still 42 million dollars below the peak revenue.

So the pluses and minuses don't cancel each other out in the same fiscal year, you're going to have periods of downside -- and that's where we most want to be protected because we're not in the forecast trying to predict the years in which a recession might occur and revenues might be lower. Certainly there will be some good years. But if we don't protect ourselves on the downside, if that contingency were not there, we would have to alter, fairly radically, the projections that we have, and it would not be a pretty picture.

Q. Right. So some years the contingency will get used in the down years. Some years, in the good years, the contingency won't get used and will go to the fund balance, right?

A. To the extent all -- everything's being equal, if you have a year in which you are exactly on target and you didn't have any other expense that needed to tap that contingency, then you would have additional resource -- your fund balance would automatically increase.

Q. A year like last year?

A. Yes.

Q. And once you get to the minimum fund balance, if you have a year like last year, that contingency is going to be spent, right?

A. Well, once you get to the minimum fund balance, which is now, the 16.7 percent, you have the daunting array of needs that the City has not funded, including improving police further than the Marshall Plan, including improving other services that the City has, dramatically increasing deferred maintenance expenditures, replacing the computer system -- the City hopes to not have to wait 20 years to do that. So to the extent that it comes sooner, that would be a significant help in dealing with its rather profound service insolvency.

Q. All the things you described earlier as not being provided for in the budget, right?

A. They are not currently funded.

Q. And so when there is unused contingency in a particular year, it's not going to be saved for a rainy day, right?

A. Well initially I think it will be saved for the rainy day until you get up to the 16.7 percent reserve. Beyond that it will be spent.

Q. Right. After you get to the reserve, it will be spent?

A. And I think the City's feeling that they are so far removed from a solvent situation in terms of services, they desperately need to make some of those expenditures.

Q. So I thought you testified earlier that under the Long-Range Financial Plan the City is service-solvent; is that not correct?

A. Well, they have made -- they have made some major strides. The passage of Measure A enabled the enactment of privilege.

THE COURT: Sustained.

BY **MR. JOHNSTON:**

Q. Now Exhibit 2006 is the most recent version of the Long-Range Financial Plan, correct?

A. This is what was released on March 2nd, that's true.

Q. Is there a more recent version?

A. Not yet. There may well be once the City adopts a budget for the coming year, but this is the most recent now.

Q. Okay. And Exhibit 2006 is the document as to which you believe that the findings, projections, assumptions, and underlying facts used to create the Long-Range Financial Plan, as supplemented by new and updated financial data generated since the filing of this disclosure statement, represent the City's best efforts to forecast revenues, costs, and overall feasibility under the terms of the plan of adjustment; correct?

A. That is correct.

Q. And between last December and this March, you revised the Long-Range Financial Plan in order to account for higher-than-expected property taxes that the City had received, correct?

A. There were -- there were several things that we incorporated. Higher property taxes; the assessor put more value on the roll for the immediate year, '13, '14 fiscal year, than we had regionally been led to believe, so that made an adjustment in property tax.

The City Council also adopted a fourth quarter report for fiscal 2013 that updated revenue and expenditure estimates. The City also implemented a revised Marshall Plan on Crime that had different revenue and expenditure aspects to it. And so we took the opportunity to take those various changes. There were some others, but those were among the major ones.

Q. And you incorporated those changes into the revised version of the plan?

A. Into this Exhibit 2006.

Q. Okay, thank you.

Now, in your testimony, you take issue with a number of the opinions of Franklin's expert Charles Moore, don't you?

A. I do.

Q. And one of the opinions you ascribe to Mr. Moore is that the City's forecasts are excessively conservative, right?

A. I believe the implication from the way he wrote up his text was that we were somehow low-balling the estimates, that we were excessively conservative. I took issue with that.

Q. Take a look at your direct testimony, page 12, paragraph 21;

model that goes into more detail in terms of where we think forecast is going in the future. Again, we're using forward-looking criteria.

Q. Right, but those are the ones you described as "prudently conservative"?

A. I think they are prudently conservative. I think if the City were to count on sort of the irrationally exuberant period of growth as the basis for their estimates, it would do nothing but get us in trouble. We want estimates we can live with so that we can demonstrate that this plan will hang together over 30 years, which is a long period of time.

Q. And in his testimony, former City Manager Bob Deis described the Long-Range Financial Plan as "conservative," didn't he?

A. I believe he has made comments to that effect, and he was the City Manager when the original plan was put together last fall.

Q. In the Long-Range Financial Plan, you describe what a conservative plan actually means; you stated that:

"**Q.** "Conservative modeling assumptions mean that on balance ... we can expect that variances are somewhat more likely to be good news than bad news," didn't you?

A. You have to be an optimist to be in local government. But our feeling is, again, there are major risks on both sides of the equation. And the side we are most concerned about is the downside. And so we are certainly putting numbers together that are both realistic, given the growth factors that we see, and producing an outcome that we believe we can live with over that long period of time.

Q. So is it an accurate statement that variances are somewhat more likely to be good news than bad news? That's a yes-or-no question.

A. That's the way we felt at that particular point in time. We're now finding that some of the factors that we expected to be leading to a more rapid recovery than has been the case, that hasn't materialized. Growth is still slow, unemployment is still high.

One of the things about a forecast is that it's an iterative process. You're constantly taking in new information which you may have felt was true at one point in time, but as circumstances change, you realize you have to adapt to those changing circumstances. I think if I were rephrasing this today, it would not be such an optimistic spin, that we're slightly more likely to be optimistic than pessimistic.

Q. So is the Long-Range Financial Plan no longer reliable?

A. The Long-Range Financial Plan is an living document. It's not a static set of numbers that remain immutable over time. We're constantly getting new information, and as that comes in, we will periodically update. That's what you want the City to do, is respond to changing circumstances over time.

Q. Well, my question is about Exhibit 2006 which is a static document, static set of numbers. Is that set of projections reliable?

A. In fact, any forecast at a particular point in time is just that, in that slice in time, if those numbers are true. You can take a look at it three months from now, they might still be true, or you might have some more information that pushes the impact higher or lower, but that's what you have to stay open to is the new information.

Q. And this document was released in March. As we sit here today in May, the document was released in March --

A. Yeah.

Q. -- is no longer reliable?

A. Ah --

Q. That is a yes or no question.

A. We will get new information in June, when the City proposes in a new budget, we'll get new information in the fall. When the new 2013 valuation comes out, we'll get new information in the fall when the property tax for the coming year comes together. Based on what we know right now, this is an accurate forecast.

Q. Okay. That was the answer I was trying to elicit.

In the Long-Range Financial Plan, you also forecast what would happen if in fact there is more good news than bad news to the tune of, for example, half a percent higher in average revenues, didn't you?

A. Yes.

Q. And if the City did in fact perform better, just a half a percent annually better than projected, the City would generate substantial additional funds, wouldn't it?

A. It would.

Q. How much over the course of the plan?

A. What we define as funds in excess of our reserve goal, under the forecast, it's $236 million, under the scenario of revenues being a half a percent higher each and every year it would be $712 million.

Q. That is?

A. Go ahead.

Q. I was going to say you set forth those numbers at the bottom of page 3 on the Long-Range Financial Plan; correct?

A. That is correct.

Q. And if the City were to realize half a percent higher in annual revenues that money that you just described could be used to pay creditors, couldn't it?

A. The General Fund can be you used for any lawful purpose.

Q. So the answer is "Yes"?

A. It can be used for creditors, but the City is profoundly service insolvent right now. And to the extent the City has additional resources, the first thing they need to address is that service insolvency, they need to get the reserve immediately up to the 16.7 percent, that they have now set as their policy goal for reserve.

They also need to start dedicating resources to meeting needs that are not otherwise provided for in the Long-Range Financial Plan that would be all services in excess of the police, which is at least partially addressed by the Marshall Plan internal service funds are those reserves were eviscerated.

Workers' comp is still running a deficit, deferred maintenance is millions of dollars a year, that should be getting spent that are not -- there are 23-year-old accounting and financial payroll systems that need desperately to be replaced.

There are many, many needs. And under the plan right now, under the forecast that we do feel is reasonable, the City is not going to be in a position to meet some of those needs for nearly 20 years.

So we weren't so fortunate that revenues grew at that rate, which I think is unlikely, but that was the scenario the City wanted to display in the report, so we put that in.

I think the reality is that, like you say, creditors could be paid from that. There are many, many other pressing needs that the City has in addition.

Q. Thank you for the speech. This process will go a lot quicker if you just answer yes or no when it's a yes or no question.

The Long-Range Financial Plan in some cases anticipates using excess funds to pay creditors, doesn't it?

A. We included within the model the contingent payment calculation which is a feature of the agreement with Assured to the extent that revenues exceed the baseline forecast that is within that agreement then there's a sharing of the gain of that amount. There's a small amount that's incorporated as a result of the change in the property tax forecast.

Q. And you testified that that gain sharing approach is the less risky and a more appropriate approach to the payment of creditors, didn't you?

A. It's certainly contained in eliminating the contingency, yes.

Q. I don't know what that means, eliminating the contingency.

A. Well, Mr. Moore recommended that we not have the contingency built into the forecast over time and rely solely on the one-time reserve that could be built up as he modeled as low as 5 percent or as high as the GFOA recommendation, 16.7 percent -- that's the Government Financial Officers' prior years, which resulted in higher property tax revenues, right?

A. I'd have to check to see if the percentage was correct, but yes, the values came in higher. We were expecting to -- based on what the assessor had indicated to us earlier in the fiscal year, we had assumed that the -- that that level of recovery would be a one-year delay, but we wound up putting some of that value on the roll for the '13 -- '13/'14 fiscal years.

Q. Take a look at Exhibit 2017.

A. 2017. That is the first quarter report from February 25th.

Q. And if you look at the third page of that document, Your Honor, that would be -- the Bates stamp of CTY257672.

The paragraph in the middle of the page under revenue talks about property tax revenue, and it says:

"**Q.** "Property values in the City of Stockton experienced a net taxable value increase of 3.6 percent over the prior year, resulting in 2.9 percent increase in projected General Fund revenues, for a total of $44.9 million."

Does that refresh your recollection --

A. Right, it's an increase of 6/10ths of one percent from the fiscal year '13/'14 operating budget.

Q. And you testified that that increase in property tax revenues is one of the reasons why you amended the Long-Range Financial Plan from December, right?

A. Yes. Partly because of the actual collections for that year, and partly because we put together a property tax forecast model rather than using one overall percentage increase, assume for the property tax -- we took the property tax and broke it into its four component parts of new construction, changes in our shift, Prop 8 value increase, and Prop 13, inflator. And by coming up with the contribution that each of those categories makes for property tax increases, we wound up with a revised forecast from what we had before, slightly higher in the near term, then lower in the long-term.

Q. And you did that -- you made those revisions between December of last year when the disclosure statement was approved, and March of this year when the revised Long-Range Financial Plan was released?

A. That's correct.

Q. And I think you touched upon this. In the first decade of the Long-Range Financial Plan, the revised forecast shows greater property tax revenues than the original Long-Range Financial Plan, right?

A. That's correct.

Q. About $17 million more?

A. I'd have to take a look at your exhibit that has the dollar changes.

MR. JOHNSTON: So, Your Honor, what this is is just Exhibit B to the Disclosure Statement that was approved and solicited.

Q. The document just handed you is what we've been calling the original Long-Range Financial Plan; right?

A. Yes, it appears to be from November of last year.

Q. And if you look at Attachment A to that document, under the forecast of general revenues, then the line item "property taxes," if you were to compare the line item in the first decade of the original Long-Range Financial Plan for the revised Long-Range Financial Plan, you would find, wouldn't you, that there's about 17 million in additional property tax revenues projected over the first decade of the forecast?

A. Well, Exhibit 2008 has the numbers you prepared, which is 16.95, about 17.

Q. And you also revised the forecast of property tax revenues for the next two decades --

A. That's correct.

Q. Of the forecast, right?

And for the second decade, until about fiscal year 2031, you now forecast about $3 million less in property tax revenues than the original forecast, right?

A. Yes.

Q. And if you go out to the final decade, you revised the forecast so that property tax revenues are now $40 million lower than than in the original Long-Range Financial Plan, right?

A. Right. We felt the original out-year estimate for property tax gross was overly optimistic in the original. And so we revised it so that the annual increase is -- diminishes below the level that we had in the original plan so that the brunt of the change for property taxes is felt in the last ten-year period.

Q. And the sum total of those changes is that you now actually forecast about $26 million less in property taxes in the revised Long-Range Financial Plan than you did in the original, right?

A. Right. We felt that was the more realistic approach.

Q. Despite the fact the first decade shows a $17 million increase?

A. Well, see, you have to appreciate, one of the things fueling the higher rate of growth in the near term is Proposition 8. Parcels whose value in true market terms has dropped below what their Prop 13 restricted value would be are termed "Prop 8 parcels," and those parcels, the value can increase without limit. Prop 13, the limitation is the California Consumer Price Index of 2 percent, whichever is greater.

And so in the near term, the City has this large chunk of parcels that are Prop 8, and they are going to be contributing more growth in the near term. But as the growth gets them to the point where they graduate back to the Prop 13 category, then they're stuck at the 2 percent growth a year.

So what this model does is focus the growth on when it's really going to be occurring. More of it's going to be occurring in the short-term because of Prop 8, but once those parcels are no longer subject to Prop 8, but they're back under the 2 percent cap of Prop 13, then you're going to get lower ongoing contributions.

Also, the new construction, if you're stuck with 700 units a year, then that new construction element of growth is going to contribute a slightly lesser percent each year as the tax base gets larger, but it's still just 700 units.

So by parsing the calculation of the property tax growth in these four categories, you really come up with more reasonable components, and they lead to higher money in the near term, higher rate of growth, but lesser growth in the long-term, and we wanted to be realistic when building that in.

Q. You didn't know that when you prepared the original Long-Range Financial Plan?

A. Well, we had a lot on our plate, and that's something

I wanted to do for the last year or so. So we finally got some time to do that in the last few months.

Q. In the original Long-Range Financial Plan, did you write anywhere you were going to do that?

A. No, I didn't write I was going to do it. I got the opportunity to do it, and in doing some additional research, we found some additional information from HDL that would help us make those types of estimates.

Q. So you knew you were going to do it, you just didn't say so?

A. No, I didn't know I was going to do it. Like I said, it's an iterative process. As inspiration strikes, you can find ways to improve the model, and hopefully it will continue to be improved every year for the next 30 years.

Q. So, and the model as it currently exists assumes an overall growth of 3.7 percent in fiscal year 14, 15, rises to just over 4 and a half percent in fiscal years '15, '16, and then declines slowly thereafter toward 3 percent by fiscal year '34, '35?

A. Sounds about right.

Q. And that 3 percent growth rate is substantially lower than the City's average rate of growth for property taxes for over the past 15 years, right?

A. Yes, but those past 15 years include that irrational exuberance I mentioned in the housing market. You don't have that type of support in values any more. So one thing, you don't get the kind of change in ownership that you had.

You also have new construction of up to 3,000 units a year for three years in a row, and we're now creeping around a hundred units. In fact, we're only up to 64 units over nine months of the current fiscal year, so recovery is not improving. But once it does, our market absorption study indicates that 700 units a year is a reasonable ongoing assumption. It's much lower than the past.

So you see there are some factors from those prior years that we just don't see being replicated in the future.

Q. And it's your testimony that in fact the last 15 years not only had a dramatic rise but a dramatic fall in revenues, correct?

A. The two don't just automatically cancel out and you say great, this is a good 15-year period. It includes both the greatest run-up and the greatest decline since the 1930s Depression. And there are also various one-time items that bias each of the top three taxes.

The property tax, for example, has the bias of about $3.1 million, in property tax administration fee refunds, and there are biasing factors in the sales tax for the triple-flip payments from the State. And the utility user tax had the period where the rate went down from 8.6 percent and changed its base.

Again, these are reasons why looking backwards don't necessarily provide good foundation for future estimates.

Q. Right. Your testimony is that the last 15 years is a historical anomaly?

A. Yeah, I think it is.

Q. If you were going back the last 15 years, the City's historical property tax growth rate is more like four percent, correct?

A. Well, actually, in my declaration, I've got some specific numbers that we could read from.

Q. Actually, let's take a look at Exhibit 1376, which is the -- what's known as the Ask.

(Pause in the proceedings?)

MR. JOHNSTON: Unfortunately, we have to kill a lot of trees in this process.

THE WITNESS: Yeah, indeed. Okay, what number was it again?

MR. JOHNSTON: 1376.

THE WITNESS: Okay.

BY MR. JOHNSTON:

Q. Are you familiar with this document?

A. Yes. This is our AB506, which stands for Assembly Bill, just written AB506. Yes, I was involved in this.

Q. In the drafting of this document?

A. Yes.

Q. Take a look at what's labeled page 10 of 790.

A. Yes.

Q. The graph there shows average annual growth of major revenues of the City. And if you look at the property tax section, that kind of describes the boom and the bust that you referenced, doesn't it?

A. Um hum, yes.

Q. And that provides that over the last 15 years, the average annual growth rate of property taxes is above four percent, right?

A. Okay, yes.

Q. And then that four percent is -- well, strike that.

Your long-term forecast of property taxes under your Long-Range Financial Plan is less than 75 percent of that historical four percent annual growth rate, right?

A. Right, for the reasons that I mentioned, is that you won't have Prop 8 and you won't have 3,000 units of new construction a year, and you won't have a the credit system that's leading to a rapid run-up in property values.

Q. As far as you know?

A. Well, as far as I know. I think it's a fairly safe bet at this point.

Q. Now, the model that you used to forecast property tax revenues is based, in part, on a projection of new housing units to be built in the City, right?

A. That's correct.

Q. And you received a projection of new units from Steve Chase, the City's Director of Community Development Department, right?

A. Yes. So the first few years of that forecast, he significantly discounted the units likely to be built under the assumption that the -- that we would not -- the EPS study assumed an ongoing level of 700 units a year, but in the initial years they were assuming that we would build up to a period where some backlog would be realized in terms of growth. It would be more like 1100 to 1400 units a year.

And we're into the period now where we should be, under their forecast, be in the 800 units or more, and we're at 64. So clearly, the recovery is not occurring as rapidly, and the City has still got 15.8 percent unemployment, the new construction isn't happening, home sales have been on a fairly steady decline over the last five years. So clearly, the recovery has not kicked in yet.

Q. And so Mr. Chase gave you a significant -- I think your word was "discounted" -- projection of new units discounted from what the EPS study provided; right?

A. That's correct, for about a four-year period.

Q. But you didn't just adopt Mr. Chase's forecast, did you?

A. No, I actually used something a little more projections for the generation of PFF revenues. The City now recognizes that PFF receipts have reached a new low, and because of multiple factors, are likely to remain low for many years to come.

13. As reflected in the declaration of Laurie Montes in support of the City's eligibility petition [Dkt. No. 23], development in Stockton boomed during better economic times. Development permits for residential dwellings reached an average of almost 3,000 per year during the early 2000s. With the crash in the housing market and the global economic downtown, however, development in Stockton has nosedived. During fiscal years 2008-09 through 2011-12, residential dwelling permits averaged only 135 per year. During the last calendar year, the City issued only 97 dwelling permits. As a consequence, PFF receipts have dropped dramatically. The Police and Fire PFF funds are collectively $3.7 million in deficit, having had to receive loans to help pay their share of debt service costs prior to 2012.

Numerous Factors Inhibit The Growth Of PFFs Going Forward

14. In January of 2013, the City commissioned the consulting firm Economic & Planning Systems, Inc. ("EPS") to prepare a development impact review report as part of a comprehensive review of development impact fees. A true and correct copy of this report, which was presented to the City's Development Oversight Commission on June 6, 2013, is attached hereto as **Exhibit A**. Based on the data available at the time, the EPS econometric supply and demand model for new permit activity projected that the City would be issuing approximately 700 units per year by year 2017 of all types of residential housing, provided that all assumptions hold true. The study further forecast a sharp increase beginning in 2014, based on pent up market demand for new housing. However, this projection has not borne out: the City has issued only 64 building permits for residential units in the first 9 months of the current fiscal year. Accordingly, the amount of PFFs that the City will receive this year will be considerably lower than what had been forecasted. Further, at least two of the PFF funds, Fund 940 and Fund 960, which the City proposed to use as a source of debt repayment for the 2009 Golf Course/Park Bonds, currently have negative balances. As a result, the millions of dollars of PFFs that Franklin argues are available to pay them from PFF funds simply do not exist.

15. The EPS model and its forecast of a substantial downgraded demand cycle bring into question the City's former projections of the number of permits that could produce PFF revenues. The EPS projection of 700 units per year was dependent on certain economic factors being met, such as a drop in unemployment and increase in the price point for home sales. Unemployment in Stockton remains high as of February 2014, at 15.9%, and job formation remains slow. Further, price points for new homes remain closer to the $200,000 level, not $300,000. *See* Exhibit A at 48, 72. The City's financial consultants forecast that economic conditions in Stockton will remain depressed for years to come.

16. Another important factor that will suppress PFF receipts is the required overhaul of the City's General Plan and Capital Improvement Program. A General Plan is the document of policies, programs, maps and designations that has hierarchical control over all land use matters. It is the City's plan for future growth in population and land area, and complementary development of land uses types, properties and structures. A Capital Improvement Program is a document intended to guide infrastructure plans that stem from the General Plan. The City currently operates under the 2035 General Plan, which was promulgated in December 2007. The City's Capital Improvement Program is promulgated each fiscal year as a part of the annual budget. As such, the current program was approved in June 2013. Not only must the City develop a new Capital Improvement Program tied to the current General Plan, the City must substantially overhaul the General Plan before it can do so.

17. The 2035 General Plan is premised on an out-dated development plan that does not reflect present economic conditions in Stockton, and must be overhauled to reflect the new reality. Further, the General Plan must be amended to satisfy new state mandates. Recent state mandates related to climate action planning, floodplain management, and carbon footprints ([AB 32, SB 375, and SB 5]), along with the City's settlements with the Attorney General's Office and Sierra Club in October 2008 to cure alleged defects in that plan, required the City to analyze and draft modifications to encourage infill and/or adaptive reuse of vacant and underutilized properties and structures, as opposed to greenfield development. "Infill" describes the development of undeveloped areas already within a city's infrastructure grid. "Greenfield"

development, in contrast, is the development of previously undeveloped lands beyond a city's infrastructure grid. Because the highest PFFs are those issued for permits for the new infrastructure associated with greenfield development, the shift to infill in the updated general plan may constrict both the number of development permits issued and the amount of PFF receipts raised by their issuance.

18. The process to update the General Plan is set to commence in FY 2014-15, when it is anticipated that the Community Development Department will seek initial approval for a comprehensive update. Amendments to the General Plan are subject to Planning Commission recommendation and City Council approval.

19. Franklin's assertion that PFF receipts would be sufficient to pay its claim if development permits average 650 per year is thus a world away from Stockton's reality. For example, for park projects, the General Plan standard for park acreage per 1000 residents imposes a new park construction cost burden that alone is in excess of what 700 housing units per year would generate in income.

20. Finally, another important variable will inhibit future PFF growth: the intense political pressure in Stockton to reduce PFFs and other developer fees in an effort to encourage development. Development is essential to the City's recovery following bankruptcy. Many citizens, among them a number of influential and well-financed developers, believe that to encourage development it is necessary to reduce the amount of fees imposed on new development. The City reduced the Streets PFF rate by half in 2010 as an incentive for development, with the discount scheduled to end on December 3, 2013. However, the City Council extended that 50% rate discount for another year, through December 31, 2014. Because revenue foregone through rate discounts cannot legally be made up through higher levies on future development, these four years of lost revenue cannot be regained. And the political pressure is ongoing: The City's Strategic Initiative III.3 provides policy direction to simplify and reduce development impact fees, so as to stimulate economic development. In 2013, the City conducted a Phase 1 fee study that provided a legal and policy framework to reopen the Fee Schedule accordingly. In 2014, a Phase 2 fee study is now evaluating processing fees.

Programmed for 2015 is a Phase 3 study of PFFs. The entirety of these analyses will be updated once a new General Plan and Capital Improvement Program emerge in the 2016 timeframe.

Limits On The Use Of The Golf Course/Park Properties

21. The restrictions on the use of the Golf Course/Park Bonds Properties severely limit their value, either in leasehold or in fee simple. All three properties are designated as Parks and Recreation by the City's 2035 General Plan. Allowed uses under the Parks and Recreation designation include "City and county parks, golf courses, marinas, community centers, public and quasi-public uses, and other similar and compatible uses." *See* Stockton General Plan 2035 Goals & Policies Report, at 3-7, *available at* http://www.stocktongov.com/files/GoalPolicyReport.pdf. The properties are also designated as Public Facilities by the City's zoning ordinance, the Stockton Development Code. Although the permissible uses for Public Facilities, which include offices, auditoriums, libraries, and similar civic uses, are broader than those for Parks and Recreation properties, these additional uses are typically permitted only with a discretionary permit, which must be approved either by the Planning Commission or by me in my role as Community Development Director after issuing a written finding that the permit is consistent with the 2035 General Plan. Given the limited uses permitted by the 2035 General Plan, a permit allowing residential development of the Golf Course/Park Bonds Properties would be inconsistent with the General Plan and would not be granted.

22. Any changes to the General Plan designation and Zoning District Map designation would require legislative action by the City Council. Those actions and the process that begets them must comport with the strict provisions of the California Planning and Zoning Act (Government Code) and the California Environmental Quality Act (Resources Code). The process requires formal initiation, staffing and funding of the work program, hearings, discretionary decision-making based on the process record and, generally, 18 to 24 months of time. By law, outcomes of this process cannot be pre-determined.

23. The City's zoning ordinance and General Plan are not the only restrictions on the use of the properties. Van Buskirk Golf Course, for instance, sits in a floodplain of the San Joaquin River. Federal Emergency Management Agency ("FEMA") standards prevent

within the interior system.

We're in the process of doing exactly what the strategic plan said "fix a broken general plan." That is at least a two- to three-year exercise that lies ahead of us.

From that, we will then understand what our infrastructure and service needs are. From that, we will then understand how that's to rejigger the fees to compliment the infrastructure needs to comport to the general plan, to accomplish the state's mandate of infill versus outfill.

Q. You mentioned the second factor that you were going to come back to. Did you do that?

A. Yes. The dollars are spoken for, infill versus greenfield development and in fixing a broken general plan is the second factor.

The third factor is largely related to something Mr. Levinson talked about yesterday. We really are fighting for the life of the City and part of it is this general plan refixing fees, refixing and fixing the permit center, and the ability to prosper with economic development and do so quickly and meaningfully. We have much work ahead of us; I'm part of that reconstruction effort.

Q. And the last question: What has been the reason for collecting PFFs?

A. The question really is how much development activity has occurred that therefore generates PFF revenues. We are currently, for the current fiscal year, at 64 single family dwelling units and two multifamily dwelling units.

We had anticipated in the order of nearly double that in an econometric forecast that was conducted a little more than a year ago had called for four times that amount. But we operate in reality, what comes in the door to us.

And what we're finding is a number of factors in Stockton are tamping down and constraining development. They deal with everything from a high, very high vacancy rate, nearly two and a half times that what is recommended for any community. We are above 11 percent vacancy rate.

We have nearly 16 percent unemployment. We have low education. We have jobs coming into the community, but are the jobs that of a full-time employment that can carry the price of a household.

We have low prices within our community still. Sacramento area is one of the fastest equity growing areas within the nation; not so for Stockton.

We are still seeing home sales, relatively new home sales in the mid-200,000s. To break even on a new home, you are looking at the high 200,000s to the low 300,000s just for entry-level stock.

Q. And last thing, you mentioned the study that was done. Is that the EPS study?

A. Which is Exhibit A, I guess, and it is Exhibit A in my declaration.

Q. And what is the status of the conclusions reached in that study?

A. It talked about a pent-up demand with a spiking that went onset approximately now through 2016, and then stabilizing out at about 700 units per year of production. Not just single family dwelling units, but all different types.

We're not seeing that marked response at all, we're seeing the downward response with only 64 single family dwelling units in the door to date this fiscal year.

Q. And just to be clear, you used the number 64 twice and that was the same number you testified to at your deposition.

How current is that number?

A. That number is as current as May 1st. If I may add one more piece of information simply to provide context.

In calendar year 2013, when you looked at the difference between new home construction and demolitions, Stockton had a net productivity of 22 new units.

MR. HERMANN: Your Honor, do you have any further background questions for the witness?

THE COURT: The 64 single family dwellings, is that calendar year-to-date, 365 days?

MR. HERMANN: Fiscal year. That would be the first of ten months, Mr. Chase?

THE WITNESS: That is correct.
THE COURT: All right. The first ten?
THE WITNESS: That is --
MR. HERMANN: July 1st, forward?
THE COURT: Okay. I have the fiscal year.
MR. HERMANN: The City's fiscal year.
THE WITNESS: Yes.

MR. HERMANN:

Q. And again EPS projection was how many in the upwards above 200?

THE COURT: No, I don't have any further questions.
MR. HERMANN: We tender the witness, Your Honor.
THE COURT: Mr. Johnston ....

CROSS-EXAMINATION

BY MR. JOHNSTON:

Q. Good afternoon, Mr. Chase.
A. Good afternoon.
Q. So you testified that you are the Director of the Community Development Department of the City, correct?
A. Correct.
Q. And you've held that position since July 2012?
A. Correct.
Q. Right after the City filed for bankruptcy, basically?
A. Correct.
Q. And that was well after the issuance of the 2009 lease

A. Well that's currently the intent, yes. The City -- I want to impress on how profoundly service-insolvent the City is and how absolutely essential it is to make improvements on that and hopefully not wait 19 years to get there.

Q. So the City is going to exit bankruptcy in a profoundly service-insolvent state?

A. Well, formally we have Measure A, under the Marshall Plan it's not adopted -- doesn't do anything for support -- doesn't allow you --

Q. So the City will exit bankruptcy in a profoundly service-insolvent state?

A. For libraries, administrative support, and recreation, not obviously for police, because the Marshall Plan is making significant improvements, yeah.

Q. You testified in your declaration the City of Sunnyvale is the quote/unquote "gold standard" for long-range financial plans, right?

A. I consider them to be, yes.

Q. Sunnyvale doesn't have contingency in its budget, does it?

A. Actually it has a 15 percent contingency.

Q. Maybe you can show me where to find that.

What I have just handed you is entitled City of Sunnyvale 035 General Fund, long-term financial plan, July, 2012, to June 30, 2023. Have you seen this document before?

City of Stockton

Legislation Details (With Text)

File #:	14-0202 Version: 1		
Type:	New Business	Status:	Agenda Ready
File created:	2/4/2014	In control:	City Council/Successor Agency to the Redevelopment Agency/Public Financing Authority Concurrent
On agenda:	2/25/2014	Final action:	
Title:	FISCAL YEAR 2012-13 FOURTH QUARTER GENERAL FUND BUDGET UPDATE AND YEAR-END PROJECTION RECOMMENDATION It is recommended that the City Council accept this report, adopt a resolution amending the Fiscal Year 2012-13 Annual Budget to address a shortfall in funding for Debt Administration and amend the Adopted Budget Council Resolution 2013-06-25-1601-01, Section 7 to provide for the retention of $3.1 million of the Ending Fund Balance in the General Fund.		
Sponsors:			
Indexes:			
Code sections:			
Attachments:	Attachment A - General Fund 4th Quarter Budget Update Attachment B - Revenue Summary FY 2012-13 Year End Projection Proposed Resolution - 2013-14 Q4 Budget Update		

Date	Ver.	Action By	Action	Result

FISCAL YEAR 2012-13 FOURTH QUARTER GENERAL FUND BUDGET UPDATE AND YEAR-END PROJECTION

RECOMMENDATION

It is recommended that the City Council accept this report, adopt a resolution amending the Fiscal Year 2012-13 Annual Budget to address a shortfall in funding for Debt Administration and amend the Adopted Budget Council Resolution 2013-06-25-1601-01, Section 7 to provide for the retention of $3.1 million of the Ending Fund Balance in the General Fund.

Summary

The City's General Fund budget for Fiscal Year 2012-13 was balanced by making $26 million in reductions to creditors and retirees under the Pendency Plan adopted on June 26, 2012. All reductions included in this Plan/budget were effective through the entirety of the 2012-13 Fiscal Year.

Staff provided the City Council with three previous status reports on the Fiscal Year 2012-13 General Fund - the first quarter results on December 11, 2012, the second quarter results on March 19, 2013 and the third quarter results on June 25, 2013. The third quarter report concluded that based on information available at that point, and assuming trends apparent at that time continued, the General

Fund would end the year with a positive available balance between $6.9 and $8.9 million, depending on whether any portion of the $2 million General Fund Contingency Reserve was used in the last quarter of the year.

The Budget Office has now reviewed and analyzed the preliminary financial activity in the General Fund for the final three months ended June 30, 2013, with results shown in Attachment A. The City has closed its financial records and the year-end audit is in progress, however end of year totals are preliminary and unaudited in this report. Staff does not anticipate significant changes to these amounts. Though we had anticipated a normal schedule, and this year-end budget update report would be presented to City Council within six months of year end, there was more effort needed to close out the 2012-13 year. As was discussed in prior reports, the antiquated financial systems, getting outstanding audits caught up, bankruptcy negotiations, preparation for the 2014-15 budget process and start of labor negotiations, all create competing priorities which delayed this report. Going forward, it will be important to address this issue in order to avoid negative impacts on the implementation of Measures A & B. Staff is requesting additional positions as part of the Measure A & B implementation plan (subject to a separate staff report at this meeting). These added positions will not only support the new sales tax measure but can provide much needed assistance with closing efforts and bringing financial reporting current.

Based on twelve month revenue and expense totals, the General Fund is projected to have ended the year with a positive available fund balance of approximately $16.1 million. This includes $2.0 million in contingency reserve budget that was not used, as well as approximately $828,000 of unused Labor Litigation/Chapter 9 funds.

The Adopted Budget Council resolution directed that the General Fund ending balance in its entirety was to be transferred to the Bankruptcy Fund to be used for claims and related costs to exit bankruptcy. The Government Finance Officers Association recommends, at a minimum, that general -purpose governments, regardless of size, maintain unrestricted fund balance in their General Fund of no less than two months of regular General Fund operating revenues or regular General Fund operating expenditures, which is equivalent to 16.67% of those amounts. Cities with formal reserve policies generally specify between 10 - 20% reserve levels. The Administration now recommends that the portion of the Ending Fund Balance ($3.1 million) that resulted from the unanticipated refund of County Property Tax Administration Fees (explained in detail later in this report), be retained in the General Fund to help build the available fund balance. With a balance of $3.1 million (or just under 2%), the City is still substantially below these recommended levels. This recommendation is made to provide a small start towards building up one-time monies to meet the many unfunded, but mission critical needs for spending. These include significant expenditures for deferred building and facility maintenance, deferred tree maintenance, mobile and portable radios for public safety, proposed technology projects identified in the City-wide Technology Strategic Plan, and additional rate changes to fund accumulated deficits in the City Internal Service Funds (Workers' Compensation - $44.0 million; General Liability-$4.9 million).

The remaining $13 million fund balance will, per prior Council direction, be transferred to the Bankruptcy Fund. These funds will be used to settle the claims of creditors that have been negotiated and to pay for the legal expenses associated with the City's bankruptcy. Settlements could be paid from these funds such as the retiree settlement and the anticipated move to the 400 East Main building as part of the settlement with Assured Guaranty under the plan. The City expects to conclude the bankruptcy case by the end of the fiscal year but we expect additional expenses to conclude the case and to fully implement the plan of adjustment. Should the bankruptcy case continue, due to the aggressive efforts of the one significant creditor that has yet to reach an agreement with the City, these funds would be used for associated legal expenses. If that case were to be long and protracted these funds would not be sufficient to cover all of those expenditures.

The increase in the 2012-13 General Fund available fund balance estimate provided in this report compared to the third quarter report (including no use of Contingency) is approximately $7.2 million. This increase was the result of an increase in revenue estimates in a number of categories, as well as higher than previously projected savings in various expenditure categories described below.

By far the largest change was the unanticipated receipt of a one-time Property Tax Administrative Fee (PTAF) refund in the amount of $3.1 million from San Joaquin County as the result of a court ruling earlier in the year. The remaining variances from the third quarter projections in revenue were improvements in Sales Tax ($382,000), Utility User Fees ($151,000), Refunds and Reimbursements ($720,000) and Rents, Leases and Concessions ($258,000), partially offset by lower than anticipated collections in Indirect Cost Allocations ($329,000) and Program Revenues ($119,000).

Total expenditure savings were up from third quarter estimates by approximately $2.6 million. This represented higher than previously anticipated savings in Labor Litigation and Chapter 9 expenditure ($828,000), as well as higher savings in several City departments and expenditure categories: Fire, Administrative Services, Human Resources, RDA Successor Agency, Grant Match and Tax Collection and Election costs.

Final 2012-13 General Fund year-end revenues are projected in this report at $162.2 million, an increase over the Amended Budget of $6.2 million, or approximately 4%. General Fund expenditures for 2012-13 are estimated at $148.8 million, $9.5 million, or 6.0% below the Amended Budget. Of the $9.5 million in expenditure budget savings, $2.0 million is the result of not utilizing any of the $2.0 million Contingency Reserve budget. Again, this $16.1 million in savings is only possible due to the $26.0 million in cuts made through the City's bankruptcy to balance the budget and the deferral of critical expenditures.

than $0.1 on the dollar. Do you know that?

A. I had read that in your brief.

Q. And there are no revenues received in future years to be used to pay Franklin; correct?

A. There are no payments budgeted within the General Fund forecast. So the Long-Range Financial Plan does not have a specific item in it to pay the 2009 bonds.

Q. Ever again; right?

A. At this point in time, it does not have a specific item in it.

Q. Are you aware of any plans to change the Long-Range Financial Plan to make payments to Franklin in the future?

A. I assumed that that could be influenced by any kind of mediation negotiations that occur, but at this point in time it reflects the current plan of adjustment that was filed.

Q. And the current plan of adjustment that was filed in your current Long-Range Financial Plan provides that revenues in excess of plan will be used for additional mission critical spending; right?

A. Yes, any amount that is in excess of the 16.7 percent reserve level is identified as a mission critical expenditure and we would reach that level in about 19 years when the reserve, hits 16.7 percent, amounts that accrue in excess of that reserve level, which we assume would be maintained over time at 16.7, would be able to be used for the types of things I mentioned earlier, a newer accounting system, improved services in areas other than police, even expanding police, meeting deferred maintenance needs, that sort of thing.

Q. And mission critical spending, as you define it, is basically anything not otherwise specified in the forecast; right?

A. Well, it's our unmet needs.

Q. Well, didn't you testify at deposition that mission critical spending is in fact anything not otherwise specified in the forecast?

A. Anything the forecast starts out with a baseline budget which is what's being done right now and we have the future costs of those baseline services built in. And we have the Marshall Plan on crime which is added, and that adds 164 positions that is built in, and there's no increase in any other positions.

So those are the amounts that we have in the budget, and so anything in excess of reserve is then available to pay for other services and other needs that are unmet.

Q. All right. And so the Long-Range Financial Plan doesn't place any limit on the amount of mission critical spending, does it?

A. On the amount that can accrue?

Q. And the expenses?

A. Yeah, it depends on the health of the revenue base as to what those amounts wind up being.

Q. So if the revenue base is very healthy, it could be half a billion dollars; right?

A. Well at some point you are going to get such a healthy base that Measure A ceases to be in existence, and at that point then you would have to deal with the loss of money that's otherwise built into the plan.

Q. Right. But then the City continues to recover and you've got a billion dollars that could go to mission critical spending; right?

A. Well I think that's a hypothetically very large number that would be in excess of anything that we would be looking at.

Q. Uh-huh. Now in the Long-Range Financial Plan, while you describe what would happen if revenues were half a percent greater than forecast, you didn't describe what would happen if revenues were half or a percent less than forecasted; right?

A. Well, they would be in deficit.

Q. You didn't include any downside model or scenario at all; right?

A. No. The City was interested in showing what would happen if things got better and the focus from the City was they were certainly hoping things would get better and that

I, Stephen Chase, hereby declare:

1. I am the Director of the Community Development Department of the City of Stockton, California ("the City" or "Stockton"). I make this declaration in support of confirmation of the City of Stockton, California's ("City") First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013). In my role as Director of Community Development, I oversee the City's public facilities fees ("PFFs") system, floodplain management, long-range and current planning, building and life safety, and the operations of the City's permit center. Prior to joining the City as the Director of Community Development in July 2012, I was the Planning and Environmental Services Director for the City of Goleta, Deputy Director of Planning and Development for the County of Santa Barbara, Deputy City Manager for the City of San Buenaventura, Aide and Field Deputy to the Board of Supervisors of the County of Ventura, and as a junior level planner for the City of Camarillo and the Counties of Santa Barbara and Ventura.

California's PFF System

2. PFFs are charges levied on new development to pay for development's fair share of infrastructure needs to mitigate the incremental impacts of the development. They are governed by the California Mitigation Fee Act of 1987 (the "Act," also known as California Assembly Bill 1600, or "AB 1600"), codified at Cal. Gov't Code § 66000 *et seq*., which allows cities to charge fees, among them PFFs, to provide a certain level of service or for public infrastructure related to new development. The Act imposes several key requirements on the City's PFF system.

3. First, the Act requires that there be a "nexus" between the level of service and/or infrastructure costs and the fee charged. In order to establish the nexus for a new PFF, the City must identify the purpose of the fee, identify the use to which the fee is to be put, and determine how there is a reasonable relationship between the fee's use and the type of development project on which the fee is imposed. These findings are contained in a fee study prepared by or for the Community Development Department and the Administrative Services Department and submitted to the City Council for approval.

4. Because of the Act's nexus requirement, the permissible uses of PFF receipts are restricted to the purposes for which the PFFs were imposed—in other words, the purposes set forth in the fee study that was required to be undertaken by the City in order to levy the charges.

5. A second key requirement of the Act is that PFF receipts be placed in separate funds allocated to each specific fee purpose. As described in the Vanessa Burke declaration being submitted concurrently, these funds are restricted, meaning that these types of fees can only be collected and used for mitigating the impacts of new development upon infrastructure needs and/or service level demands.

6. Finally the Act requires that PFF receipts be allocated within five years of their collection to a nexus-based capital improvement program, such as the land acquisition, engineering and eventual construction of a freeway interchange. Reimbursement claims are eligible for consideration beyond the five year window.

The Availability Of PFFs To Reimburse The General Fund For Portions Of The Lease Payments On The 2009 Golf Course/Park Bonds

7. The proceeds of the 2009 Golf Course/Park Bonds[2] funded certain infrastructure improvements that would have otherwise been eligible for funding from certain PFF funds. Because of this, the PFF funds from which the improvements would have otherwise been eligible for funding may reimburse the General Fund for the portions of the lease payments on the principal of (but not interest on, as explained below) the 2009 Golf Course/Park Bonds that are allocable to those improvements. The authority to use PFF receipts to refund the principal payments on the 2009 Golf Course/Park Bonds is based on the use of bond proceeds to finance fee-eligible improvements.

8. It is important to note that the City is not *required* to use PFF funds to reimburse the General Fund principal payments. This is because there is no separate pledge agreement *committing* PFF receipts to refund the principal payments made by the General Fund to Franklin. Rather, the City is *permitted* to use PFF funds for this purpose, if it so elects.

[2] Capitalized terms used but not defined herein have the meaning ascribed to them in the First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1204].

TUESDAY, MAY 13, 2014, SACRAMENTO, CALIFORNIA, 1:33 P.M.

THE COURT: All right. We have a witness on the stand, Mr. Chase is still under oath, and with questioning by Mr. Hermann.

DIRECT EXAMINATION (Resumed)

BY MR. HERMANN:

Q. Mr. Chase, when I previously introduced you, I believe I said you were brought on the Stockton team by Mr. Deis in 2013, that's incorrect, isn't it?

A. I was brought onboard in July, 2012.

Q. And was there a predecessor who you replaced?

A. No. For a little bit of background, in the fiscal year 2008-2009, the full-time equivalent count of the Community Development Department was approximately 89. By the time I got there it was 23.

The management team, about 70 percent of the employee staff had exited. The deputy City manager was overseeing that function, along with other departmental functions.

Q. And the second question I asked you this morning that I don't think you got around to, and that is, the reasons why you believe there are fewer PFF revenues available in the future?

A. It really comes down to two considerations in my mind the first, very factual, the dollars are already spoken for. There is in any City or county, there are series of development agreements or reimbursement agreements with the development community that allow for the phasing, the timing, not only of the development itself but of the infrastructure that's going to be built off-site.

In the case of Stockton, there are 16 development agreements and 13 reimbursement agreements. Those agreements have contractually bound the dollars that are on file at this point in time. There is on the books some $17 million contracted for dollars for a variety of projects related to those agreements.

The second part relates to the future. In a very different future than Stockton over the past four years, when Mr. Deis brought me onboard there were three strategic initiatives that the City council had adopted.

One of them was to fix the entire permit processing function. That largely dealt with if we couldn't get that fixed, we couldn't get the common development, for example, going in the community.

The second was to fix the fees and I'll come back to that in a moment.

The third was to fix the general plan, the broken general plan, a broken growth plan for our future. In many respects, new state mandates are calling for the growth plan that Stockton has instead of going outward to go inward, infill versus greenfield.

THE COURT: Recross.

RECROSS-EXAMINATION

BY MR. JOHNSTON:

Q. So touching on what Mr. Hermann asked you at the beginning but went back to at the end, he had asked you if the City could use PFFs to make payments on the 2009 lease revenue bonds, and your answer was related, the City in fact can use PFF revenues if they are appropriately programmed and there is a nexus.

Is that an accurate summary of your answer?

A. And one more important fact, that they are available.

Q. Available, meaning that the fees have actually been collected?

A. And not spoken for.

Q. And not spoken for.

So have the PFFs in this case been appropriately programmed so that they can be used to pay the bonds?

A. The PFFs that are on file with the City are spoken for, not with respect to the 2009 bonds, they were not programmed for such.

Q. And when you say "the PFFs that are on file," do you mean the PFF fees that have been received?

A. Yes.

Q. Is it the case that there is a nexus of the PFFs sufficient to enable payment of the 2009 bonds?

A. The issue that's in front of us is "What is the backstop for the 2009?" "It's the General Fund."

The other issue is, "Is there a nexus between the use of the 2009 bonds and PFFs, and whether or not that nexus has been established and utilized?" And the answer is, "You could make a nexus."

The third issue is "Are there funds available towards that now and into the near future and the far future?" Now, no. Near future, unlikely. Far future, I don't know.

Q. Okay. So --

A. The generation of such revenues has not met the most recent forecasts that have come forward from the experts.

Q. So if I am understanding your testimony, with respect to fees currently on file that are not programmed to pay the 2009 lease revenue bonds, there is a nexus available that could be under appropriate circumstances used for PFFs to pay the lease revenue bonds, but there are currently no PFFs available to make those payments?

A. That's my statement.

Q. Mr. Hermann asked you whether it is now an official position of the City that no interests that PFFs cannot be used to pay interest on the 2009 lease revenue bonds, and it wasn't clear to me what your answer is.

Is your answer that that is now a quote, unquote, official position of the City?

13. Franklin's suggestion that a reserve fund of 10% or less is sufficient and that money from this fund is available to pay the 2009 Bond Claim indicates a deep misunderstanding of the purpose of reserves. Reserves are a one-time resource designed to help bridge a downturn in the economy that results in lower revenues than projected, or to help meet an unexpected one-time increase in expenditures. Reserves are not available to pay an ongoing increase in obligations such as the 2009 Bond Claim. If the General Fund began paying the full $2.9 million in 2009 Bond debt service starting in the current fiscal year 2013-14, the General Fund would be in deficit within six years.

14. In addition to these reserves, the LRFP also incorporates a $2 million per year annual contingency (approximately 1% of expenditures). The purpose of this annual contingency is, like an annual operating reserve, to protect the City against financial setbacks. However, whereas an annual operating reserve represents one-time emergency resources to deal with short-term issues, the annual contingency serves as a *long-term* buffer against natural swings in economic conditions. As evidenced by the recent recession, economic downturns can cause a city to fall short of its projections by millions, or even tens of millions, of dollars over several years. Moreover, it may take several additional years for a city's revenues to return to their prior peak year total, much less the level to which revenues would have grown given a continuation of pre-recession trends. For example, in FY2013-14 Stockton is still $36 million below the $203 million in General Fund revenue it received five years earlier in its peak fiscal year of 2008-09, and the City is $93 million below the trended level of revenue produced by a continuation of the General Fund growth rate that occurred in Stockton from FY1996-97 through FY2006-07. The annual contingency is meant to provide a safeguard against these types of long-term setbacks by serving as a "smoothing" mechanism – that is, the annual contingency spreads the impacts of economic downturns over the entire period of the LRFP. This allows the City to make projections of its future finances without having to make predictions about the timing or severity of future recessions, with a reasonable level of assurance that adequate resources will always be available to support the projected level of expenditures.

15. Franklin argues that the $2 million annual contingency is unnecessary, and contends that the City can simply pay that money to Franklin instead. This argument completely misses the importance of the annual contingency to the City's projections and the City's long-term fiscal health. While the City could theoretically eliminate the annual contingency from the LRFP, the LRFP itself would then need to be altered in order to incorporate predictions as to the timing and magnitude of economic swings and the impact of such swings on the City's finances. The reduction in contingency expenditures within the forecast would be offset by the loss of resources from the projected economic downturns. Given the inherent difficulties of predicting recessions, particularly over a 30-year period, budget forecasts do not typically do so, but rather opt for a realistic linear growth trend for revenue and either build in a buffer against future variations or require significantly higher reserves.[4] However, if the City *were* to eliminate its $2 million contingency and incorporate recessions into its revenue forecast, and at the same time increase expenditures by $2 million annually to make payments toward the 2009 Bond Claim, current projections indicate that this would cause the General Fund balance to rapidly erode and result in a deficit within 7-9 years, depending on the timing and severity of the recessions, which in turn would require another restructuring of City finances.

16. The City must be sustainable. The City recognizes that its financial plans and budgets, however sound, will need to be amended as economic and financial circumstances change. Maintaining a healthy reserve is essential to weather the "worst case scenarios" where the City does worse than anticipated. The operating reserves and the annual contingency projected in the LRFP are necessary to sustain the City as a viable municipality. This has been

[4] The City of Sunnyvale is the "gold standard" for long-range financial plans, in that it has been adopting 20-year budget forecasts bi-annually since the 1980's. Sunnyvale's current reserve policies are as follows: (1) "The General Fund Contingency Reserve will be maintained at 15% of operations costs in year one of the long-term plan, with annual increases based on projected increases in the Consumer Price Index", (2) "The Budget Stabilization Fund will be a minimum of 15% of projected revenues for the first two years of the 20-year planning period. Beyond year two the Budget Stabilization Fund will always have a balance of at least zero", and (3) "The Twenty-Year Resource Allocation Plan Reserve shall be used to levelize economic cycles and maintain stable service levels over the long term." (http://sunnyvale.ca.gov/Portals/0/Sunnyvale/CodesAndPolicies/7.01.01.pdf) Sunnyvale's total projected reserves for FY2013-14 total $92.7 million, which is 63% of its budgeted total requirement of $146.6 million. Sunnyvale does not attempt to predict the timing of recessions, but rather uses relatively linear forecasting trends (as does Stockton); its projected property tax revenue averages 3.8% annual growth from FY2013-14 through 2032-33 (compared to 3.4% for Stockton over the same period), and its sales tax revenue averages 2.9% annual growth (compared to 3.1% for Stockton over the same period).

the City Council's overarching policy objective starting with the AB 506 process initiated in early 2012. This is in the best interests of the City and its residents. Raiding these reserves for payments to Franklin would imperil the City's financial viability.

17. Similarly, if the City were to substitute Franklin's business judgment for its own by submitting a plan that impaired CalPERS, Franklin would fare worse than it would under the City's Plan. If the City were to impair CalPERS, then CalPERS would have an immediate unsecured claim worth approximately $1.62 billion.[5] The claim from CalPERS would represent 73.3% of the unsecured claims pool, compared with a roughly 24.7% share for Retiree Health Benefit Claimants ($545 million) and an approximate 1.58% share for Franklin (even assuming the Franklin claim is in the amount of $35 million as opposed to $10.4 million).

The City's Projections Of Its CalPERS Obligations Are Sound

18. On the expense side, the City's projections of its CalPERS obligations are sound. In September 2013, the City received a long-range projection of CalPERS employer rates[6] for its Safety and Miscellaneous employee plans from its actuary, The Segal Company ("Segal"), using the CalPERS June 30, 2011 valuation, the latest then available, and taking into account the following anticipated changes[7]:

a. Rate smoothing and unfunded liability amortization changes phased in over five years. These changes would result in significant short-term increases in rates, but with fixed periods for amortization, rates would drop as various "layers" of unfunded liability become fully amortized, ultimately leaving only the levy of a rate for "normal" costs with prior unfunded liabilities completely paid off and all employees under the Public Employees' Pension Reform

[5] This $1.62 billion is the amount which CalPERS claims it would be due as the total of the "Unfunded Termination Liability" for the combined Safety and Miscellaneous plans, using the "Termination Liability Discount Rate" of 2.98%, the yield of the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. Attached hereto as **Exhibits N** and **O** are true and correct copies of excerpts from the CalPERS Annual Valuation Reports as of June 30, 2012 for the Miscellaneous and Safety Plans for the City of Stockton, respectively. See page 28 of Exhibit N and page 28 of Exhibit O for CalPERS' calculation of the "Unfunded Termination Liability" for the Miscellaneous and Safety Plans, respectively. Because the City intends not to terminate the CalPERS contracts, the City has not researched this number and thus does neither agrees nor disagrees with this amount.

[6] The employer rate consists of a "normal cost" rate to pay the cost of service accrued for active employees for the upcoming fiscal year, and an "unfunded rate" to pay the fiscal year's amortized portion of unfunded liability (the amount by which accrued liabilities exceed the actuarial value of assets). These rates are applied to the "PERSable income" of active employees to generate the amounts payable to CalPERS.

[7] A true and correct copy of Segal's rate forecast, with assumptions, is attached hereto as **Exhibit P**.

buy time to implement budgetary changes that will enable the City to match its expenditures to available ongoing revenues. Stating as Moore does that Stockton will not use its contingency, and that it thus can be converted to annual payments to pay creditors, assumes that reality will never deviate from the forecast, and that there will never be emergencies or "unexpected events" that will arise. The Moore Report also assumes that the City's reserve goal of two months, or 16.7%, of operating expenditures, a level not projected to be met for 20 years (in FY2033-34), will prove adequate for absorbing all cumulative adverse economic effects for decades to come. In fact, the Moore Report runs scenarios showing how the City can increase payments to Franklin by both eliminating its contingency and maintaining a reserve as low as 5% of total expenditures, a level far below GFOA's recommendation. *See* Ex. M, at 1-2. Moore's Table 1 shows past City reserve levels in the General Fund, which averaged 5.0%, in support of his contention that this should be considered adequate. Neither this 5% average reserve, nor the 10% reserve that the City adopted as a policy in 2006 (and has since replaced with the 16.7% GFOA goal), proved adequate to stave off bankruptcy in 2012.

26. Having adequate reserves gives a City options, and time, to deal with financial adversity, and running out of reserves constrains or eliminates those options. Once the City reaches its reserve goal, and assuming the contingency or a similar mechanism to address forecast volatility is maintained over time, the City will have a reasonable, although not absolute, level of assurance that it can achieve long-term financial sustainability. At that point, the City will have the capacity to address unfunded needs, including the addition of staffing and services to address increased workload demands from a growing community. The City cannot afford to spend *all* revenue gains above forecasted levels that it may realize over time, because gains will be offset at other times by losses from economic downturns. However, the gain-sharing approach of the contingent payments agreement that the City negotiated with Assured Guaranty under the auspices of Judge Perris, rather than the elimination of the forecast contingency or the spend-down of reserves, is the less risky and more appropriate approach to the payment of creditors.

27. *PFF Funds are not available to pay the Franklin Bonds*: As discussed extensively in the Chase DTD, PFF funds are not envisioned to be available to pay the Franklin bonds. The

ARTICLE I
DEFINITIONS

Section 1.01. Definitions. Except as otherwise defined herein, the following words and phrases shall have the following meanings.

"2007 Lease Ask Payments" means, for each Fiscal Year, the payments on the Payment Dates and in the amounts set forth in Schedule 1 hereto

"Actual Core Revenue Increment" means, for each Fiscal Year, the amount, if any, by which the Actual Core Revenues exceed the Baseline Core Revenues, as estimated and reconciled as provided in Section 2.03(c) hereof.

"Actual Core Revenues" means the amount of Core Revenues actually received by the City in a given Fiscal Year, as estimated and reconciled as provided in Section 2.03(c) hereof.

"Agreement" means this Reimbursement Agreement, dated as of _________ __, 2014, between Assured Guaranty and the City, as such agreement may be amended or supplemented.

"Allocable Share" means a fraction, the numerator of which is the principal amount of the Bonds and the denominator of which is the sum of all the principal amounts of all Participating Creditors' Obligations as of July 1, 2012; provided, however, that with respect to the Contingent General Fund Payments (i) payable prior to June 1, 2039, the Allocable Share shall be no less than 78%; and (ii) payable on or after June 1, 2039, the Allocable Share shall be equal to 100%.

"Ambac Settlement Agreement" means the Stipulation and Settlement Agreement, dated as of February 26, 2013, by and among (i) the City, (ii) the Stockton Public Financing Authority, (iii) the 2003 Fire/Police/Library Certificates Trustee (as such term is defined in the Plan of Adjustment), and Ambac Assurance Corporation, which is attached as Exhibit A to the Declaration of Robert Deis in Support of the City of Stockton's Motion Under Bankruptcy Rule 9019 for Approval of Its Settlement with Ambac Assurance Corporation, filed in the Chapter 9 Case on February 26, 2013 [Dkt. No. 725].

"Annexed Area Revenues" means the Core Revenues (except for revenue derived from motor vehicle license fees) generated from any territory annexed to the City after the Effective Date.

"Assured Guaranty" has the meaning set forth in the first paragraph of this Agreement.

"Bankruptcy Court" has the meaning set forth in the recitals of this Agreement.

"Baseline Core Revenues" means, for each Fiscal Year, the amount of Core Revenues set forth for such Fiscal Year on Schedule 4 hereto.

"Bond Insurance Policy" means Municipal Bond Insurance Policy No. 208382-N, dated April 5, 2007, issued by Assured Guaranty (formerly known as Financial Security Assurance Inc.), insuring the scheduled payment of principal of and interest on the Bonds when due.

"Measure A" means a ballot measure that was approved by voters of the City on November 5, 2013, which imposes a three-quarter cent (0.75%) retail transactions and use tax to be applied throughout the entire territory of the City to the fullest extent permitted by law and in accordance with the provisions of Part 1.6 of Division 2 of the Revenue and Taxation Code (commencing with Section 7251) and Chapter 2.3 of Part 1.7 of Division 2 of the Revenue and Taxation Code (commencing with Section 7285.9) effective April 1, 2014, as such measure may be extended by the City Council by its terms.

"MSRB" means the Municipal Securities Rulemaking Board.

"Neutral Accountant" means an accountant or municipal financial advisor having significant experience in the auditing of California municipalities or the finances of such California municipalities.

"Non-Contingent General Fund Payments" means, for each Fiscal Year, the payments required to be made by the City pursuant to Section 2.02 hereof.

"Other Bonds" means Bonds owned by holders other than Assured Guaranty.

"Participating Creditors' Obligations" means (i) the Bonds; and, (ii) in the event that the City enters into a settlement with Franklin that (x) is approved by the Bankruptcy Court at or before confirmation of the Plan of Adjustment and (y) includes participation in the Contingent General Fund Payments, the Stockton Public Financing Authority Lease Revenue Bonds, 2009 Series A (Capital Improvement Projects) (which had a principal amount as of June 28, 2012 of $35,080,000).

"Payees" means, collectively, the Trustee and Assured Guaranty or its assigns. Where this Agreement requires payment to "Payees," such payment shall be made to the applicable Payee(s) as and to the extent provided in Section 2.05.

"Payment Date" means the day on which any payment is due and owing to Assured Guaranty hereunder. If any Payment Date is not a Business Day, Payment Date shall mean the next Business Day; provided, however, interest will accrue at the Prime Rate plus 3% per annum through the date of payment.

"Pension Obligation Bond Claim" means the amount owing on account of the Bonds on June 28, 2012, which is comprised of unpaid principal of $124.28 million plus accrued but unpaid interest as of such date.

"Pension Obligation Bonds Payments" means, collectively, the Non-Contingent General Fund Payments and the Contingent General Fund Payments.

"Plan of Adjustment" means the City's plan of adjustment, as confirmed by an order entered in the Chapter 9 Case.

"Prime Rate" means the floating rate of interest per year identified from time to time as the Prime Rate as published in the "Consumer Rates and Returns to Investor" section of the *Wall Street Journal* or any successor source for such rate. Changes in the rate of interest resulting

Revised City of Stockton Long-Range Financial Plan

ALTERNATIVE FORMAT - ATTACHMENT A1

	11-12	12-13	13-14	14-15	15-16	16-17	17-18	18-19	19-20	20-21
63 **Services & Supplies**										
64 Internal Services-Equipment	12.18	13.40	13.51	14.29	15.10	15.91	16.12	16.33	16.54	16.76
65 General Liability Insurance	2.24	3.18	3.37	3.44	3.49	3.54	3.60	3.65	3.71	3.76
66 Utilities	2.49	2.60	2.65	2.69	2.73	2.77	2.82	2.86	2.90	2.95
67 Maintenance & Repair Services	2.14	2.33	2.60	2.63	2.67	2.71	2.76	2.80	2.84	2.88
68 Labor/Legal Services	3.76	3.95	2.20	2.23	2.26	2.30	2.33	2.37	2.40	2.44
69 General Expenses	6.70	8.74	9.34	10.77	10.91	10.88	9.41	9.49	9.64	9.78
70 Tax Collection & Election	2.09	1.21	2.33	2.68	2.73	2.78	2.85	2.90	2.95	3.01
71 Subtotal Services & Supplies	31.61	35.41	36.00	38.74	39.91	40.90	39.87	40.39	40.98	41.57
72										
73 **Program Support for Other Funds**										
74 Library	3.98	3.91	4.00	4.29	4.88	5.07	5.22	5.40	5.58	5.73
75 Recreation	2.76	2.34	2.85	3.06	3.47	3.61	3.71	3.84	3.97	4.08
76 Golf Courses	-	0.50	0.45	0.48	0.55	0.57	0.59	0.61	0.63	0.65
77 Entertainment Venues	2.44	2.64	2.65	2.49	2.88	3.12	3.21	3.33	3.35	3.45
78 RDA Successor Agency	1.81	0.53	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
79 Downtown Marina	0.05	0.05	0.16	0.16	0.16	0.16	0.16	0.16	0.16	0.16
80 Capital Improvements	0.62	0.83	1.29	1.58	1.58	1.58	1.58	1.58	1.58	1.58
81 Administration Building	-	-	0.07	0.84	0.84	0.84	0.84	1.07	1.07	1.07
82 Grant Match	0.04	0.00	0.40	0.40	0.40	0.30	0.30	0.30	0.30	0.30
83 Development Services	0.15	1.00	1.00	1.00	1.00	1.00	-	-	-	-
84 Other	0.25	0.03	-	0.05	0.05	0.05	0.05	0.05	0.05	0.05
85 Subtotal Program Support	12.09	11.82	13.62	15.10	16.56	17.05	16.42	17.08	17.43	17.80
86										
87 **Debt - Bonds/Other**										
88 Jarvis Utilities Settlement	0.47	-	-	-	-	-	-	-	-	-
89 Marina Settlement	-	-	-	-	-	-	-	-	-	-
90 2003 COPs	-	-	-	-	-	0.07	0.06	0.47	0.25	-
91 2004 Arena Bonds	-	-	-	-	-	-	-	-	-	-
92 2006 LRBs-Parking (SEB)	0.77	0.84	0.91	0.91	0.91	0.91	0.91	0.91	0.91	0.91
93 2006 DBW-Debt - Marina	0.68	-	-	-	-	-	-	-	-	-
94 2007 POBs	5.62	-	-	-	-	-	1.33	1.33	1.33	1.33
95 2007 VRDLRB - 400 E.Main	0.24	-	-	-	-	-	-	-	-	-
96 2009 LRBs-Pub Facil Bonds/CIP	0.65	-	-	-	-	-	-	-	-	-
97 Debt - Other/Admin	0.42	0.21	0.49	0.49	0.49	0.49	0.49	0.49	0.49	0.24
98 Subtotal Debt	8.85	1.05	1.40	1.40	1.40	1.47	2.79	3.20	2.99	2.48
99										
100 **Mission Critical Expenditures**	-	-	-	8.00	8.00	-	-	-	-	-
101 **Efficiencies/Improved Cost Recovery**	-	-	-	(2.50)	(2.50)	(3.00)	(3.00)	(3.00)	(3.00)	(3.00)
102 **Contingency**	-	-	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
103 **Total General Fund Expenditures**	158.60	147.18	160.68	180.52	198.91	204.33	210.39	217.74	224.46	230.28
104										
105 **Surplus(Shortfall)**	1.67	15.05	6.68	11.41	(1.11)	0.73	1.08	(0.02)	(0.45)	(1.19)
106 Transfer to Bankruptcy Fund	(5.59)	(13.01)	-	-	-	-	(0.31)	(0.29)	(0.25)	(0.21)
107 AB 506 Carryover	(2.71)	2.71	-	-	-	-	-	-	-	-
108 Encumbrance/Inventory Adjustment	-	(1.67)	-	-	-	-	-	-	-	-
109 Beginning Available Balance	6.64	-	3.07	9.75	21.16	20.05	20.78	21.55	21.23	20.53
110 **Ending Available Balance**	-	3.07	9.75	21.16	20.05	20.78	21.55	21.23	20.53	19.13
111 **Balance as % of Total Expenditures**	0.0%	2.1%	6.1%	11.8%	10.1%	10.2%	10.3%	9.8%	9.2%	8.4%
112 Vacancy Rate (% of Baseline+COLAs)	4.2%	11.3%	1.0%	2.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

A. Okay.

Q. And the question was: The savings and expenses from the City in the last fiscal year was about $10 million.

The expenses came in about $10 million --

A. Yeah.

Q. -- under budget?

A. About nine and a half, yeah. I got you, yeah. In the chart, yes.

Q. Right. So if you are looking at the chart and you combine the better than budgeted revenues in the lower than budgeted expenses, the City actually had substantially better in the budget last year, didn't it?

A. Yes, it was about a $16 million overall improvement.

Q. And the City decided not to take any of that $16 million to pay any portion of Franklin's claim; right?

A. Well the council action on February 25th was basically to retain about 3.1 million in the General Fund, which was also the amount of the property tax administration fee refund, and the other $13 million were allocated to the bankruptcy fund.

Q. And the bankruptcy fund pays the bankruptcy lawyers?

A. Well, it can pay any costs associated with the entire bankruptcy process. So costs, creditors, the costs of the election for Measure A, yes.

Q. So the monies in the bankruptcy fund, which could be

BANKRUPTCY FUND (012)

History

- This fund has been created as of Fiscal Year 2013-14 to pay for costs associated with City's bankruptcy, including legal fees and bankruptcy project management.
- The Proposed Budget for Fiscal Year 2013-14 separates the resources and costs of bankruptcy activities from other funds so that tracking of bankruptcy expenditures is more transparent.
- The new Bankruptcy Fund begins with the available general fund balance (unaudited) that the Council has committed towards for bankruptcy costs.
- The bankruptcy fund began with the initial Council commitment of $5.6 million at the beginning of Fiscal Year 2012-13 and is increased by additional projected general fund balance ending June 30, 2013.
- These resources are dedicated to negotiating a consensual Plan of Adjustment (or bankruptcy exit plan). The Plan of Adjustment is intended to bring the City's debts in line with our resources, both now and over time.

2013-14 Budget Issues and Changes

- The limited resources in this Bankruptcy Fund will be used to cover costs for Chapter 9 project management, litigation and negotiations with our creditors, with remaining money available to pay our creditors as settlements for claims..

Administration and Support
Bankruptcy Fund - 012
2013-14 Adopted Budget

	FY 2010-2011 Actual	FY 2011-2012 Unaudited Actual	FY 2012-2013 Projected	FY 2013-2014 Adopted Budget
		General Fund	*General Fund*	
Beginning Available Balance	**$ -**	**$ -**	**$ 6,783,838**	**$ 12,504,791**
Revenues				
AB506 Funding		3,500,000		
Chapter 9 Funding			4,548,979	
	-	**3,500,000**	**4,548,979**	**-**
Expenditures				
AB506 Administration & Legal		2,308,453		
Chapter 9 Administration & Legal			7,699,381	5,200,000
Cost Reimbursed from Other Funds			(1,958,855)	(1,907,500)
Known Settlements				5,100,000
Settlement Reimbursed from Other Funds				(1,641,000)
	-	**2,308,453**	**5,740,526**	**6,751,500**
Transfers				
Transfer In - General Fund		5,592,291	6,912,500	
Transfer In - Other				
Transfer Out				
	-	**5,592,291**	**6,912,500**	**-**
Net Annual Activity	**-**	**6,783,838**	**5,720,953**	**(6,751,500)**
Ending Available Balance*	**$ -**	**$ 6,783,838**	**$ 12,504,791**	**$ 5,753,291**

AB506 Carryover	$ 1,108,026	$ -	$ -
Encumbrances	83,521	-	-
Bankruptcy Commitment	5,592,291	12,504,791	5,753,291
	$ 6,783,838	$ 12,504,791	$ 5,753,291

* Available for paying claims and related costs to exit bankruptcy, including possible election costs.

13175-9

95TH CONGRESS *1st Session*	HOUSE OF REPRESENTATIVES	REPORT No. 95-595

PT 1-2

BANKRUPTCY LAW REVISION

REPORT

OF THE

COMMITTEE ON THE JUDICIARY

together with

SEPARATE, SUPPLEMENTAL, AND SEPARATE ADDITIONAL VIEWS

[Including Cost Estimate of the Congressional Budget Office]

[To accompany H.R. 8200]

13175-9

SEPTEMBER 8, 1977.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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§ *1129. Confirmation of plan*

Subsection (a) enumerates the requirement governing confirmation of a plan. The court is required to confirm a plan if and only if all of the requirements are met.

Paragraph (1) requires that the plan comply with the applicable provisions of chapter 11, such as section 1122 and 1123, governing classification and contents of plan.

Paragraph (2) requires that the proponent of the plan comply with the applicable provisions of chapter 11, such as section 1125 regarding disclosure.

Paragraph (3) requires that the proponent have proposed the plan in good faith, and not by any means forbidden by law.

Paragraph (4) is derived from section 221 of present law. It requires that any payment made or promised by the proponent, the debtor, or person issuing securities or acquiring property under the plan, for services or for costs and expenses in, or in connection with, the case, or in connection with the plan and incident to the case, be disclosed to the court. In addition, any payment made before confirmation must have been reasonable, and any payment to be fixed after confirmation must be subject to the approval of the court as reasonable.

Paragraph (5) is also derived from section 221 ofthe Bankruptcy Act. It requires the proponent of the plan to disclose the identity and affiliations of any individual proposed to serve, after confirmation, as a director, officer, or voting trustee of the reorganized debtor. The appointment to or continuance in one of these offices by the individual must be consistent with the interests of creditors and equity security holders and with public policy. The proponent of the plan must also disclose the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation to be paid to the insider.

Paragraph (6) permits confirmation only if any regulatory commission that will have jurisdiction over the debtor after confirmation of the plan has approved any rate change provided for in the plan. As an alternative, the rate change may be conditioned on such approval.

Paragraph (7) incorporates the former "best interest of creditors" test found in chapter 11, but spells out precisely what is intended. With respect to each class, the holders of the claims or interests of that class must receive or retain under the plan on account of those claims or interest property of a value, as of the effective date of the plan, that is not less than the amount that they would so receive or retain if the debtor were liquidated under chapter 7 on the effective date of the plan.

In order to determine the hypothetical distribution in a liquidation, the court will have to consider the various subordination provisions of proposed 11 U.S.C. 510, 726(a)(3), 726(a)(4), and the postponement provisions of proposed 11 U.S.C. 724. Also applicable in appropriate cases will be the rules governing partnership distributions under proposed 11 U.S.C. 723, and distributions of community property under proposed 11 U.S.C. 726(c). Under subparagraph (A), a particular holder is permitted to accept less than liquidation value, but his acceptance does not bind the class.

Property under subparagraph (B) may include securities of the debtor. Thus, the provision will apply in cases in which the plan is confirmed under proposed 11 U.S.C. 1129(b).

Paragraph (8) is central to the confirmation standards. It requires that each class either have accepted the plan or be unimpaired.

Paragraph (9) augments the requirements of paragraph (8) by requiring payment of each priority claim in full. It permits payments over time and payment other than in cash, but payment in securities is not intended to be permitted without consent of the priority claimant even if the class has consented. It also permits a particular claimant to accept less than full payment.

Paragraph (10) contains the feasibility standards. It requires that the court find that confirmation of the plan is not likely to be followed by the liquidation or need for further financial reorganization of the debtor or any successor to the debtor, unless the plan so contemplates (such as under a liquidating plan).

Subsection (b) permits the court to confirm a plan notwithstanding failure of compliance with paragraph (8) of subsection (a). The plan must comply with all other paragraphs of subsection (a), including paragraph (9). This subsection contains the so-called cramdown. It requires simply that the plan meet certain standards of fairness to dissenting creditors or equity security holders. The general principle of the subsection permits confirmation notwithstanding nonacceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan. If it is paid in full, then junior classes may share. Treatment of classes of secured creditors is slightly different because they do not fall in the priority ladder, but the principle is the same.

Specifically, the court may confirm a plan over the objection of a class of secured claims if the members of that class are unimpaired or if they are to receive under the plan property of a value equal to the allowed amount of their secured claims, as determined under proposed 11 U.S.C. 506(a). The property is to be valued as of the effective date of the plan, thus recognizing the time-value of money. As used throughout this subsection, "property" includes both tangible and intangible property, such as a security of the debtor or a successor to the debtor under a reorganization plan.

The court may confirm over the dissent of a class of unsecured claims, including priority claims, only if the members of the class are unimpaired, if they will receive under the plan property of a value equal to the allowed amount of their unsecured claims, or if no class junior will share under the plan. That is, if the class is impaired, then they must be paid in full or, if paid less than in full, then no class junior may receive anything under the plan. This codifies the absolute priority rule from the dissenting class on down.

With respect to classes of equity, the court may confirm over a dissent if the members of the class are unimpaired, if they receive their liquidation preference or redemption rights, if any, or if no class junior shares under the plan. This, too, is a codification of the absolute priority rule with respect to equity. If a partnership agreement subordinates limited partners to general partners to any degree, then the general principles of paragraph (3) of this subsection would apply to prevent the general partners from being squeezed out.

One requirement applies generally to all classes before the court may confirm under this subsection. No class may be paid more than in full.

The partial codification of the absolute priority rule here is not intended to deprive senior creditor of compensation for being required to take securities in the reorganized debtor that are of an equal priority with the securities offered to a junior class. Under current law, seniors are entitled to compensation for their loss of priority, and the increased risk put upon them by being required to give up their priority will be reflected in a lower value of the securities given to them than the value of comparable securities given to juniors that have not lost a priority position.

Finally, the proponent must request use of this subsection. The court may not confirm notwithstanding nonacceptance unless the proponent requests and the court may then confirm only if subsection (b) is complied with. The court may not rewrite the plan.

A more detailed explanation follows:

The test to be applied by the court is set forth in the various paragraphs of section 1129(b). The elements of the test are new departing from both the absolute priority rule and the best interests of creditors tests found under the Bankruptcy Act. The court is not permitted to alter the terms of the plan. It must merely decide whether the plan complies with the requirements of section 1129(b). If so, the plan is confirmed, if not the plan is denied confirmation.

The procedure followed is simple. The court examines each class of claims or interests designated under section 1123(a)(1) to see if the requirements of section 1129(b) are met. If the class is a class of secured claims, then paragraph (1) contains two tests that must be complied with in order for confirmation to occur. First, under subparagraph (A), the court must be able to find that the consideration given under the plan on account of the secured claim does not exceed the allowed amount of the claim. This condition is not prescribed as a matter of law under section 1129(a), because if the secured claim is compensated in securities of the debtor, a valuation of the business would be necessary to determine the value of the consideration. While section 1129(a) does not contemplate a valuation of the debtor's business, such a valuation will almost always be required under section 1129(b) in order to determine the value of the consideration to be distributed under the plan. Once the valuation is performed, it becomes a simple matter to impose the criterion that no claim will be paid more than in full.

Application of the test under subparagraph (A) also requires a valuation of the consideration "as of the effective date of the plan". This contemplates a present value analysis that will discount value to be received in the future; of course, if the interest rate paid is equivalent to the discount rate used, the present value and face future value will be identical. On the other hand, if no interest is proposed to be paid, the present value will be less than the face future value. For example, consider an allowed secured claim of $1,000 in a class by itself. One plan could propose to pay $1,000 on account of this claim as of the effective date of the plan. Another plan could propose to give a note with a $1,000 face amount due five years after the effective date of the plan on account of this claim. A third plan could propose to give a note in a face amount of $1,000 due five years from the effective date of the plan plus six percent annual interest commencing on the effective date of the plan on account of this claim. The first plan clearly meets the requirements of subparagraph (A) because the amount received on account of the second claim has an equivalent present value as of the effective date of the plan equal to the allowed amount of such claim.

The second plan also meets the requirements of subparagraph (A) because the present value of the five years note as of the effective date of the plan will never exceed the allowed amount of the secured claim; the higher the discount rate, the less present value the note will have. Whether the third plan complies with subparagraph (A) depends on whether the discount rate is less than six percent. Normally, the interest rate used in the plan will be prima facie evidence of the discount rate because the interest rate will reflect an arms length determination of the risk of the security involved and feasibility considerations will tend to understate interest payments. If the court found the discount rate to be greater than or equal to the interest rate used in he plan, then subparagraph (A) would be complied with because the value of the note as of the effective date of the plan would not exceed the allowed amount of the second claim. If, however, the court found the discount rate to be less than the interest rate proposed under the plan, then the present value of the note would exceed $1,000 and the plan would fail of confirmation. On the other hand, it is important to recognize that the future principal amount of a note in excess of the allowed amount of a secured claim may have a present value less than such allowed amount, if the interest rate under the plan is correspondingly less than the discount rate.

Even if the requirements of subparagraph (A) are complied with, the class of secured claims must satisfy one of the three clauses in paragraph (B) in order to pass muster. It is sufficient for confirmation if the class has accepted the plan, or if the claims of the class are unimpaired, or if each holder of a secured claim in the class will receive property of a value as of the effective date of the plan equal to the allowed amount of such claim (unless he has agrèed to accept less). It is important to note that under section 506(a), the allowed amount of the secured claim will not include any extent to which the amount of such claim exceeds the value of the property securing such claim. Thus, instead of focusing on secured creditors or unsecured creditors, the statute focuses on secured claims and unsecured claims.

After the court has applied paragraph (1) to each class of secured claims, it then applies paragraph (2) to each class of unsecured claims. Again two separate components must be tested. Subparagraph (A) is identical with the test under section 1129(b)(1)(A) insofar as the holder of an unsecured claim is not permitted to receive property of a value as of the effective date of the plan on account of such claim that is greater than the allowed amount of such claim. In addition, subparagraph (B) requires compliance with one of four conditions. The conditions in clauses (i)–(iii) mirror the conditions of acceptance unimpairment, or full value found in connection with secured claims in section 1129(b)(1)(B).

The condition contained in section 1129(b)(2)(B)(iv) provides another basis for confirming the plan with respect to a class of unsecured claims. It will be of greatest use when an impaired class that has not accepted the plan is to receive less than full value under the plan. The plan may be confirmed under clause (iv) in those circumstances if the class is not unfairly discriminated against with respect to equal classes and if junior classes will receive nothing under the plan. The second criterion is the easier to understand. It is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired. This gives intermediate creditors a great deal of leverage in negotiating with senior or secured creditors who wish to have a plan that gives value to equity. One aspect of this test that is not obvious is that whether one class is senior, equal, or junior to another class is relative and not absolute. Thus from the perspective of trade creditors holding unsecured claims, claims of senior and subordinated debentures may be entitled to share on an equal basis with the trade claims. However, from the perspective of the senior unsecured debt, the subordinated debentures are junior.

This point illustrates the lack of precision in the first criterion which demands that a class not be unfairly discriminated against with respect to equal classes. From the perspective of unsecured trade claims, there is no unfair discrimination as long as the total consideration given all other classes of equal rank does not exceed the amount that would result from an exact aliquot distribution. Thus if trade creditors, senior debt, and subordinate debt are each owed $100 and the plan proposes to pay the trade debt $15, the senior debt $30, and the junior debt $0, the plan would not unfairly discriminate against the trade debt nor would any other allocation of consideration under the plan between the senior and junior debt be unfair as to the trade debt as long as the aggregate consideration is less than $30. The senior debt could take $25 and give up $5 to the junior debt and the trade debt would have no cause to complain because as far as it is concerned the junior debt is an equal class.

However, in this latter case the senior debt would have been unfairly discriminated against because the trade debt was being unfairly over-compensated; of course the plan would also fail unless the senior debt was unimpaired, received full value, or accepted the plan, because from its perspective a junior class received property under the plan. Application of the test from the perspective of senior debt is best illustrated by the plan that proposes to pay trade debt $15, senior debt $25, and junior debt $0. Here the senior debt is being unfairly discriminated against with respect to the equal trade debt even though the trade debt receives less than the senior debt. The discrimination arises from the fact that the senior debt is entitled to the rights of the junior debt which in this example entitle the senior debt to share on a 2:1 basis with the trade debt.

Finally, it is necessary to interpret the first criterion from the perspective of subordinated debt. The junior debt is subrogated to the rights of senior debt once the senior debt is paid in full. Thus, while the plan that pays trade debt $15, senior debt $25, and junior debt $0 is not unfairly discriminatory against the junior debt, a plan that proposes to pay trade debt $55, senior debt $100, and junior debt $1, would be unfairly discriminatory. In order to avoid discriminatory treatment against the junior debt, at least $10 would have to be received by such debt under those facts.

The criterion of unfair discrimination is not derived from the fair and equitable rule or from the best interests of creditors test. Rather it preserves just treatment of a dissenting class from the class's own perspective.

If each class of secured claims satisfies the requirements of section 1129(b)(1) and each class of unsecured claims satisfies the requirements of section 1129(b)(2), then the court must still see if each class of interests satisfies section 1129(b)(3) before the plan may be confirmed. Again, two separate criteria must be met. Under subparagraph (A) if the interest entitles the holder thereof to a fixed liquidation preference or if such interest may be redeemed at a fixed price, then the holder of such interest must not receive under the plan on account of such interest property of a value as of the effective date of the plan greater than the greater of these two values of the interest. Preferred stock would be an example of an interest likely to have liquidation preference or redemption price.

If an interest such as most common stock or the interest of a general partnership has neither a fixed liquidation preference nor a fixed redemption price, then the criterion in subparagraph (A) is automatically fulfilled. In addition subparagraph (B) contains five clauses that impose alternative conditions of which at least one must be satisfied in order to warrant confirmation. The first two clauses contain requirements of acceptance or unimpairment similar to the first two clauses in paragraphs (1)(B) and (2)(B). Clause (iii) is similar to the unimpairment test contained in section 1124(3)(B) except that it will apply to cover the issuance securities of the debtor of a value as of the effective date of the plan equal to the greater of any fixed liquidation preference or redemption price. The fourth clause allows confirmation if junior interests are not compensated under the plan and the fifth clause allows confirmation if there are no junior interests. These clauses recognized that as long as senior classes receive no more than full payment, the objection of a junior class will not defeat confirmation unless a class junior to it is receiving value under the plan and the objecting class is impaired. While a determination of impairment may be made under section 1124 (3) (B)(iii) without a precise valuation of the business when common stock is clearly under water, once section 1129 (b) is used, a more detailed valuation is a necessary byproduct. Thus, if no property is given to a holder of an interest under the plan, the interest should be clearly worthless in order to find unimpairment under section 1124 (3)(B)(iii) and section 1129(a)(8); otherwise, since a class of interests receiving no property is deemed to object under section 1126 (g), the more precise valuation of section 1129(b) should be used.

If all of the requirements of section 1129(b) are complied with, then the court may confirm the plan subject to other limitations such as those found in section 1129 (a) and (d).

Subsection (c) of section 1129 governs confirmation when more than one plan meets the requirements of the section. The court must consider the preferences of creditors and equity security holders in determining which plan to confirm.

Subsection (d) requires the court to deny confirmation if the principal purpose of the plan is the avoidance of taxes (through use of sections 346 and 1146, and applicable provisions of State law or the Internal Revenue Code governing bankruptcy reorganizations) or the avoidance of section 5 of the Securities Act of 1933 (through use of section 1145).

SUBCHAPTER III—POSTCONFIRMATION MATTERS

§ 1141. Effect of confirmation

Subsection (a) of this section makes the provisions of a confirmed plan binding on the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of the creditor, equity security holder, or partner is impaired under the plan and whether or not he has accepted the plan. There are two exceptions, enumerated in paragraph (2) and (3) of subsection (d).

Unless the plan or the order confirming the plan provides otherwise, the confirmation of a plan vests all of the property of the estate in the debtor and releases it from all claims and interests of creditors, equity security holders and general partners.

Subsection (d) contains the discharge for a reorganized debtor. Paragraph (1) specifies that the confirmation of a plan discharges the debtor from any debt that arose before the date of the order for relief unless the plan or the order confirming the plan provides otherwise. The discharge is effective against those claims whether or not proof of the claim is filed (or deemed filed), and whether or not the claim is allowed. The discharge also terminates all rights and interests of equity security holders and general partners provided for by the plan. The paragraph permits the plan or the order confirming the plan to provide otherwise, and excepts certain debts from the discharge as provided in paragraphs (2) and (3).

Paragraph (2) makes applicable to an individual debtor the general exceptions to discharge that are enumerated in section 523(a) of the bankruptcy code.

Paragraph (3) specifies that the debtor is not discharged by the confirmation of a plan if the plan is a liquidating plan and if the debtor would be denied discharge in a liquidation case under section 727. Specifically, if all or substantially all of the distribution under the plan is of all or substantially all of the property of the estate or the proceeds of it, if the business, if any, of the debtor does not continue, and if the debtor would be denied a discharge under section 727 (such

SUMMARY

The following pages summarize certain important information set forth elsewhere in this Disclosure Statement. Capitalized terms are defined in the text of this Disclosure Statement and in the Plan, and any capitalized term used but not defined in the Disclosure Statement shall have the meaning ascribed to it in the Plan. Unless otherwise noted, all references to a "section" are references to a section of title 11 of the United States Code (the "Bankruptcy Code").

The Disclosure Statement contains important information that is not summarized in this Summary and that may influence your decision regarding whether to accept or reject the Plan or may otherwise affect your rights. Please do not rely on this Summary standing alone, and please thoroughly read this entire document and the accompanying materials.

* * * *

The City of Stockton, California (the "**City**"), filed a petition under chapter 9 of the Bankruptcy Code on June 28, 2012 (the "**Petition Date**"), which was designated Case Number 2012-32118 (the "**Chapter 9 Case**"). The United States Bankruptcy Court for the Eastern District of California, Sacramento Division (the "**Bankruptcy Court**"), Chief Judge Christopher M. Klein presiding, entered an order for relief in the Chapter 9 Case on April 1, 2013, as docket no. 843, and the Chapter 9 Case currently is pending before the Bankruptcy Court.

The First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013) (the "**Plan**" proposed by the City), involves claims of approximately $299,505,000 of publicly held securities, certain of which evidence and represent undivided fractional interests in General Fund leases of many of the City's capital assets. Some of these assets are important or even essential to municipal operations. The Plan also addresses and resolves the City's obligations to current and former employees and various other claims. While the Plan permits the City to continue to maintain minimally acceptable levels of vital municipal services for its residents and businesses, and while it devotes substantial resources to the repayment of the City's creditors, it nevertheless further defers infrastructure maintenance as well as the optimal staffing of City service units such as police and fire.

The Plan significantly impairs the interests of former employees and retirees with respect to health benefits. Outside of the Plan, retirement benefits for current and future employees already have been impacted by negotiated changes in the City's labor agreements. Retiree health benefits worth approximately $1 billion for current employees have been eliminated as a result of negotiated agreements. This loss of retiree health benefits constitutes an approximate reduction in pension benefits, which along with certain compensation changes for these employees amounts to a 30-50% reduction from what they otherwise would have received. Additionally, pension benefits for new employees hired after January 1, 2013 have been reduced by approximately 50-70% (including lost retiree health benefits) for all employees and in some cases higher for certain types of employees as a result of changes in state law and changes in labor agreements that the City has negotiated. New hires are also required to pay a greater share of their future pension benefits. Additionally, because of compensation reductions of up to 30% in pensionable income negotiated in 2011 and 2012, the future pensions of employees will be lower than they otherwise would have been, though no further reduction is imposed by the Plan. Such reductions in compensation to City employees have the effect of lowering the costs of pension benefits funded by the City. The City intends to fully fund the contributions to be made for the reduced pension benefits of City employees. Such pension contributions will continue to be made to CalPERS in its capacity as trustee for the City's pension trust for its retired workers and their dependents who are the beneficiaries of this trust, as well as for current employees and their beneficiaries (the City has one contract with CalPERS, but there are three contract groups: police, fire, and miscellaneous).

Payment to holders of General Unsecured Claims—which holders include, but are not limited to, holders of lease rejection claims, the Retiree Health Benefit Claimants, and the holders of Leave Buyout Claims—shall receive cash payment on the Effective Date in an amount equal to a set percentage of the Allowed amount of such Claims. The percentage of the Allowed amount paid on such claims will be the Unsecured Claim Payout Percentage (unless the amount of the Retiree Health Benefit Claims changes, that percentage will be equal to 0.93578% (i.e., $5,100,000 divided by $545,000,000) or such other amount as is determined by the Bankruptcy

Court before confirmation of the Plan to constitute a pro-rata payment on such other General Unsecured Claims. While the City regrets that it cannot pay a higher amount to holders of General Unsecured Claims, the fact is that the City lacks the revenues to do so if it is to maintain an adequate level of municipal services such as the provision of fire and police protection, the maintenance and repair of the City's streets and other public facilities, and the continued availability of important municipal services such as library, recreation, and parks.

The Plan does not alter the obligations of those City funds that are restricted by grants, by federal law, or by California law; pursuant to the Tenth Amendment to the United States Constitution and the provisions of the Bankruptcy Code that implement the Tenth Amendment, such funds cannot be impacted in the Chapter 9 Case. Thus, securities payable solely from restricted funds are not altered by the Plan.

The following chart summarizes key information, including the proposed treatment of the various classes of claims:

Debtor	City of Stockton, California.
Bankruptcy Court	United States Bankruptcy Court for the Eastern District of California, Sacramento Division, The Honorable Chief Judge Christopher M. Klein presiding.
Plan	First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013).
Purpose of the Disclosure Statement	To provide information of a kind, and in sufficient detail, that would enable a typical holder of claims in a Class Impaired under the Plan to make an informed judgment with respect to voting on the Plan.
Balloting Information	Ballots have been provided with this Disclosure Statement to creditors known to have claims that are Impaired under the Plan. Ballots must be returned to and received by the Ballot Tabulator by no later than 4:30 p.m., Pacific Time, on February 10, 2014. Objections to confirmation also must be filed and served by no later than February 10, 2014.
Ballot Tabulator	Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367.

Class 16 Claims of Equipment Lessors	**Unimpaired.** Any equipment leases not specifically rejected by the Rejection Motion will be assumed under the Plan. The City believes that it is current on all such equipment leases and therefore no cure payments are required.
Class 17 Workers Compensation Claims	**Unimpaired.** The City must pay Allowed SIR Claim Portions related to Workers Compensation Claims in full. If not, the City will lose its State workers compensation insurance for those claims in excess of the SIR Claim Portions, exposing the City's current and former workers to grave risk. The City will pay the SIR Claim Portions related to Worker Compensation Claims from the Workers' Compensation Internal Service Fund.
Class 18 SPOA Claims	**Impaired.** The City will honor the SPOA Claims held by SPOA members on the terms and conditions set forth in the SPOA MOU.
Class 19 Price Claims	**Impaired.** The City's settlement with the Price Judgment Creditors will have no material monetary impact on the City, but will enable the City to fulfill its obligations under a previous judgment relating to relocation of residents. The settlement includes agreement on the manner of calculating the number of replacement units the City has produced to date; a methodology for creating a list of persons entitled to preference for housing units; a means for reaching out to the community about the availability of replacement units; the extinguishing of the City's obligation to make relocation assistance payments; and the recognition that any claim for attorney fees is treated as an unsecured claim in the Plan.
Questions:	Questions can be submitted electronically on the City's chapter 9 website (stocktonchapter9.com) or by calling 866-205-3144 and leaving a message. All questions will receive a prompt response.

To the extent that there is any inconsistency between the Plan (including the exhibits and any supplements to the Plan) and the description in the Disclosure Statement, the terms of the Plan (including the exhibits to the Plan) will govern.

I. INTRODUCTION

The City of Stockton, California, filed this Chapter 9 Case on June 28, 2012, less than a week prior to the beginning of its 2012-13 fiscal year. As a result of prior poor fiscal management by the City, overspending on downtown improvement construction projects, the general economic turndown that began in 2008, the resulting decline in real estate transactions and values, high unemployment rates, and generally lower collections of tax revenues and user fees, the City had virtually no General Fund reserves as of the Petition Date. It had slashed its

General Fund workforce by an aggregate of 30% during the preceding three years: sworn police officers were cut by 25%, non-sworn police staffing by 20%, fire staffing by 30%, and non-safety staffing by 43%. It had also reduced compensation by $52 million and cut staffing and service levels by $38 million, for an overall General Fund budget reduction of approximately $90 million during fiscal years 2009-10, 2010-11, and 2012-13.

The City reduced or ceased funding of community-based organizations, stopped replacing worn-out vehicles (including police cars), was sending mechanics in separate vehicles to follow fire engines on emergency calls, and was patching rather than repairing its streets. The City also reduced compensation for all employees from 2008 through 2012. Employee compensation reductions varied, but averaged 10% to 33%, of which 7% to 30% was in pensionable income reductions that would impact future pensions as well as current income. Changes in overtime calculation, health, and other insurance benefits and leave time also occurred. The reduction in compensation resulted in litigation against the City by labor organizations, and labor relations were at an all-time low.

Despite having taken these desperate measures, as of June 2012 the City's General Fund budget for the impending fiscal year was still $25.9 million underwater.[1] The negative balance meant that the General Fund was prohibited from borrowing from the City's restricted funds and that the City therefore could not pay the first payroll of the fiscal year, which was due in July 2012. The City was instead forced to enact its "Pendency Plan" budget, described in Section III.A. below, which enabled it to meet payroll and debt obligations during the Chapter 9 Case.

The City entered bankruptcy only after unsuccessful mediation with its major creditors, although the mediation did produce agreements with the City's labor organizations. The Chapter 9 Case was contentious from the outset, with the so-called capital markets creditors contending that the City was ineligible for bankruptcy relief. Their objections were overruled by the Bankruptcy Court, but only after many months of costly discovery, briefing, legal

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[1] *See* City of Stockton Annual Budget, 2012-13, p. D-1, *available at* http://www.stocktongov.com/files/COS_2012_2013_ProposedAnnualBudget_2012_5_15.pdf.

maneuvering, and ultimately a trial on the City's eligibility to be a chapter 9 debtor. But prior to filing the Chapter 9 Case, during the case, and even during the litigation phase, the City and its creditors were engaging in mediation under the auspices of a court-appointed mediator—a United States Bankruptcy Judge from Oregon. The mediation is ongoing and has resulted in several settlements, the key one relating to retiree health benefits that was negotiated with the Retirees Committee that represents the interests of the retirees. The City has reached settlement agreements with Ambac, NPFG, and Assured Guaranty, but has not reached agreement with Franklin, the holder of approximately $35,080,000 of bond debt.

The Plan, filed with the Bankruptcy Court as of the date hereof, as set forth on **Exhibit A**, represents the City's proposed adjustment of its debts. The Plan is a spartan one. It returns the City to financial and public service provider solvency, but, in the absence of agreements with City creditors whose obligations are secured by leases of City real estate, the Plan includes the potential loss of City control of certain City properties.

The holders of General Unsecured Claims in Class 12, including retiree health benefit claimants, will be paid a percentage of their claims equal to the Unsecured Claim Payout Percentage (unless the amount of the Retiree Health Benefit Claims changes, that percentage will be equal to 0.93578% (i.e., $5,100,000 divided by $545,000,000) or such other amount as is determined by the Bankruptcy Court before confirmation of the Plan to constitute a pro-rata payment on such other general unsecured claims. That is all the City can afford to pay and still maintain even a bare minimum level of City services. In fact, the constituencies that will bear the greatest burden as a result of the City's inability to meet its financing obligations are its current employees, and its retirees who collectively hold approximately $545 million in claims against the City, but who have agreed, after months of negotiations, to accept $5.1 million in satisfaction of those claims. Retirees who are receiving a CalPERS pension but no health benefits from the City will not be affected by the Plan. Retirees who are receiving a CalPERS pension plus health benefits will have their health benefits eliminated.

Current employees of the City have also agreed to forgo health benefits in retirement, which along with changes in compensation results in the loss of their retirement "spike" and reduces their postemployment benefits by 30-50%. The loss of retiree health benefits is a substantial concession of approximately $1 billion that has already been agreed to without compensation for this loss. In addition, most current employees hired before January 1, 2013 have also agreed to a 7-30% reduction in pensionable compensation, which will reduce their future CalPERS pension from what it otherwise would have been.

The Plan will enable the City to pay its future bills, including the reduced compensation payable to its employees, and including its obligations to CalPERS, which will fund pension contributions for its current and former employees. The maintenance of pensions is critical to the City in order to retain employees—particularly police officers—rather than losing them to other local governments, all of which have defined benefit pension plans similar in benefit structure to CalPERS, and the overwhelming majority of which have pension plans administered by CalPERS.

Unlike a corporate chapter 11 debtor, a city in chapter 9 simply cannot be allowed to fail. It must continue to provide police and fire protection to its residents, to maintain streets and highways, to treat its employees and retirees fairly, and generally to create an environment in which its residents can prosper. Unlike a corporation, its assets cannot be liquidated or sold to a competitor in order to satisfy its debts. The City believes that the financial restructuring set forth in its Plan is its current best option for achieving such goals. It will continue to negotiate with its creditors in an attempt to achieve settlements that provide better returns for creditors and better economics for the City. If any additional agreements are reached, the Plan and Disclosure Statement will be modified to reflect those agreements.

As described more fully herein, the City believes that the Plan provides the greatest and earliest possible recoveries to holders of claims while preserving necessary City services and operations. The City thus believes that acceptance of the Plan is in the best interests of creditors and parties in interest, as well as in the best interests of the City's residents and businesses, and that any alternative debt adjustment or restructuring would result in additional delay, uncertainty, expense, litigation, and, ultimately, smaller or no distributions to creditors. Accordingly, **the City urges that you cast your ballot in favor of the Plan.**

A. <u>The Purpose of This Disclosure Statement</u>.

The Bankruptcy Code requires that the proponent of a plan of adjustment in a chapter 9 case prepare and file a "disclosure statement" that provides information of a kind, and in sufficient detail, that would enable a typical holder of claims in a class Impaired under that plan to make an informed judgment with respect to the plan. *See* 11 U.S.C. § 1125. This Disclosure Statement provides such information. ***Creditors and parties in interest should read this Disclosure Statement, the Plan, and all of the exhibits accompanying these documents in their entirety in order to ascertain:***

1. How the Plan will affect their claims against the City;
2. Their rights with respect to voting for or against the Plan;
3. Their rights with respect to objecting to confirmation of the Plan; and
4. How and when to cast a ballot with respect to the Plan.

This Disclosure Statement, however, cannot and does not provide creditors with legal or other advice or inform such parties of all aspects of their rights. Claimants are advised to consult with their attorneys and/or financial advisors to obtain more specific advice regarding how the Plan will affect them and regarding their best course of action with respect to the Plan. As noted below, retirees are advised to consult with the Retirees Committee, which was appointed in April 2013 by the Office of the United States Trustee to represent the interests of the City's approximately 2,400 retirees in the Chapter 9 Case.

This Disclosure Statement has been prepared in good faith and in compliance with applicable provisions of the Bankruptcy Code. Based upon information currently available, the City believes that the information contained in this Disclosure Statement is correct as of the date of its filing. This Disclosure Statement, however, does not and will not reflect some events that occur after October 10, 2013 (and, where indicated, specified earlier dates), and the City assumes no duty and presently does not intend to prepare or distribute any amendments or supplements to reflect such events.

B. Summary of Entities Entitled to Vote on the Plan and of Certain Requirements Necessary for Confirmation of the Plan.

Holders of Allowed Claims in the following Classes are entitled to vote on the Plan because the Claims in each such Class are "impaired" under the Plan within the meaning of section 1124: 1A, 1B, 3, 4, 5, 6, 7, 9, 12, 14, 18, and 19.

The Bankruptcy Court may confirm the Plan only if at least one Class of Impaired Claims has voted to accept the Plan (without counting the votes of any insiders whose claims are classified within that Class) and if certain statutory requirements are met as to both nonconsenting members within a consenting Class and as to any dissenting Classes. A Class of claims has accepted the Plan only when at least more than one-half in number **and** at least two-thirds in amount of the Allowed Claims actually voting in that Class vote in favor of the Plan.

In the event of a rejection of the Plan by any of the voting Classes, the City will request that the Bankruptcy Court confirm the Plan in accordance with those portions of section 1129(b) that are applicable to the Chapter 9 Case, which provisions permit confirmation by a process known as "cramdown" notwithstanding such rejection if the Bankruptcy Court finds, among other things, that the Plan "does not discriminate unfairly" and is "fair and equitable" with respect to each rejecting Class. Other sections of this Disclosure Statement provide a more detailed description of the requirements for acceptance and confirmation of the Plan.

C. Voting Procedures, Balloting Deadline, Confirmation Hearing, and Other Important Dates, Deadlines, and Procedures.

1. Voting Procedures and Deadlines.

The City has provided copies of this Disclosure Statement and ballots to all known holders of Impaired Claims in the voting Classes. Those holders of an Allowed Claim in each of the voting Classes who seek to vote to accept or reject the Plan **must** complete a ballot and return it to the Court-appointed ballot tabulator, Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367 (the "**Ballot Tabulator**")—so that their ballots actually are received by no later than the Balloting Deadline (as defined in the following paragraph), and must be returned directly to the Ballot Tabulator, **not** to the Bankruptcy Court. Note that Ballots do not constitute proofs of claim.

All ballots, including ballots transmitted by facsimile, must be completed, signed, returned to, and actually received by the Ballot Tabulator by not later than February 10, 2014, at 4:30 p.m. Pacific Time (the "Balloting Deadline"). Neither Ballots received after the Balloting Deadline, nor ballots returned directly to the Bankruptcy Court rather than to the Ballot Tabulator, shall be counted in connection with confirmation of the Plan.

2. Date of the Confirmation Hearing and Deadlines for Objection to Confirmation of the Plan.

The hearing to determine whether the Bankruptcy Court will confirm the Plan (the "**Confirmation Hearing**") will commence on March 5, 2014, at 9:30 a.m. Pacific Time in the Courtroom of the Honorable Christopher M. Klein, Chief United States Bankruptcy Judge for the Eastern District of California, in his Courtroom on the 6th floor of the United States Courthouse, 501 I Street, Sacramento, CA 95814. The Confirmation Hearing may be continued from time to time, including by announcement in open court, without further notice.

Any objections to confirmation of the Plan must be filed with the Bankruptcy Court and served on the following entities so as to be **actually received** by no later than February 10, 2014: (a) John M. Luebberke, City Attorney's Office, 425 N. El Dorado Street, 2nd Floor, Stockton, CA 95202; (b) Marc A. Levinson, Orrick, Herrington & Sutcliffe LLP, 400 Capitol Mall, Suite 3000, Sacramento, CA 95814-4497 (counsel to the City); (c) Steven H. Felderstein, Felderstein, Fitzgerald, Willoughby & Pascuzzi LLP, 400 Capitol Mall, Suite 1750, Sacramento, CA 95814 (counsel to the Retirees Committee); (d) Debra A. Dandeneau, Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153 (counsel to NPFG); (e) Jeffrey E. Bjork, Sidley Austin LLP, 555 West 5th Street, Los Angeles, CA 90013 (counsel to Assured Guaranty); (f) David Dubrow, Arent Fox LLP, 1675 Broadway, New York, NY 10019-5820 (counsel to Ambac); (g) James O. Johnston, Jones Day, 555 South Flower Street, 50th Floor, Los Angeles, CA 90071 (counsel to Franklin); (h) William W. Kannel, Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., One Financial Center, Boston, MA 02111 (counsel to the Indenture Trustee); and (i)

Michael J. Gearin, K&L Gates LLP, 925 Fourth Avenue, Suite 2900, Seattle, WA 98104 (counsel to CalPERS). Objections that are not timely filed and served may not be considered by the Bankruptcy Court. ***Please refer to the accompanying notice of the Confirmation Hearing for specific requirements regarding the form and nature of objections to confirmation of the Plan.***

D. Important Notices and Cautionary Statements.

The historical financial data relied upon in preparing the Plan and this Disclosure Statement is based upon the City's books and records. Although certain professional advisors of the City assisted in the preparation of this Disclosure Statement, in doing so such professionals relied upon factual information and assumptions regarding financial, business, and accounting data provided by the City and third parties, much of which has not been audited. The City's most recent audited financial statement (i.e., its Comprehensive Annual Financial Report, or CAFR), which covers the fiscal year ended June 30, 2011, is 282 pages in length, and is not attached hereto. However, it is available on the City's website or upon written request.[2]

The City's professional advisors have not independently verified the financial information provided in this Disclosure Statement, and, accordingly, make no representations or warranties as to its accuracy. Moreover, although reasonable efforts have been made to provide accurate information, the City does not warrant or represent that the information in this Disclosure Statement, including any and all financial information and projections, is without inaccuracy or omissions, or that actual values or distributions will comport with the estimates set forth herein.

No entity may rely upon the Plan or this Disclosure Statement or any of the accompanying exhibits for any purpose other than to determine whether to vote in favor of or against the Plan. Nothing contained in such documents constitutes an admission of any fact or liability by any party, and no such information will be admissible in any proceeding involving the

[2] To locate the CAFR go to http://www.stocktongov.com/files/2011_CAFR.pdf. Alternatively, from the City's website, http://www.stocktongov.com: (1) click "Administrative Services"; (2) then click "Financial Reporting"; (3) then click "Financial Reports"; and (4) then click "CAFR 2011". A printed copy will be mailed to you upon your request mailed to the following address: City Clerk, City Hall, 425 N. El Dorado Street, Stockton, CA 95202. The City's reproduction fee schedule will apply to any such request. More current unaudited financial statements for the City are available on the Electronic Municipal Market Access website maintained by the Municipal Securities Rulemaking Board, available at: http://emma.msrb.org.

City or any other party, nor will this Disclosure Statement be deemed evidence of the tax or other legal effects of the Plan on holders of claims in the Chapter 9 Case. This Disclosure Statement is not intended to be a disclosure communication to the public capital markets and should not be relied upon by investors as such in determining whether to buy, hold, or sell any securities of the City or related entities.

Certain information included in this Disclosure Statement and its exhibits contains forward-looking statements. The words "believe," "expect," "anticipate," and similar expressions identify such forward-looking statements. The forward-looking statements are based upon information available when such statements are made and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. A number of those risks and uncertainties are described below. Readers therefore are cautioned not to place undue reliance on the forward-looking statements in this Disclosure Statement. The City undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Neither the Securities and Exchange Commission nor any other regulatory agency has approved or disapproved this Disclosure Statement, nor has any such agency determined whether this Disclosure Statement is accurate, truthful, or complete.

E. Additional Information.

If you have any questions about the procedures for voting on the Plan, desire another copy of a ballot, or seek further information about the timing and deadlines with respect to confirmation of the Plan, please write to Rust Consulting/Omni Bankruptcy as follows: Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367 (facsimile: 818-783-2737), or write to counsel for the City as follows: Marc A. Levinson, Orrick, Herrington & Sutcliffe LLP, 400 Capitol Mall, Suite 3000, Sacramento, CA 95814-4497 (facsimile: 916-329-4900, email malevinson@orrick.com). Please note that counsel for the City cannot and will not provide creditors with any legal advice, including advice regarding how to vote on the Plan or the effect that confirmation of the Plan will have upon claims against the City. For additional information, City retirees should contact the Retirees Committee. The primary contact for the Retirees Committee is its chairperson, Dwane Milnes, 209-467-0224, dwane.milnes@sbcglobal.net. The secondary contact for the Retirees Committee is Retirees Committee member Gary Ingraham, 209-403-0076, gcingraham@comcast.net.

II. BACKGROUND INFORMATION

A. The City.

The City is a municipal corporation and charter city formed and organized under its charter and the California Constitution. Its governing body is a seven-member City Council (including the position of Mayor, who is elected by popular vote). The City encompasses approximately 65 square miles in northern San Joaquin County. Approximately 300,000 people reside within the City.

B. The City's Financial Problems.

Over the past several years, the City has struggled with massive budget deficits. These deficits have been the result of a combination of plummeting revenues and increasing costs. In the wake of the Great Recession, housing prices plunged while unemployment skyrocketed, which led to substantial declines in the City's property tax and sales tax revenues. Stockton has been among the top-ranked American cities in terms of foreclosures and declines in home prices for the past several years. The median home price has dropped from $397,000 in 2006 to $109,000 as of 2012, a decline of 72%. This collapse in property values and the flood of foreclosures reduced the City's gross property tax collections by roughly 29%, from $61.1 million in fiscal year 2007-08 to $43.6 million in fiscal year 2012-13. Because of California tax laws under Proposition 13, embodied in article 13A of the California Constitution, changes in ownership that occurred at the bottom of the market due to foreclosures and short sales will suppress property values for many years into the future. Adverse economic conditions also caused a drop in the City's income from assessments and development fees.

As the economy suffered, so too did the City's residents, as the City saw its unemployment rate rise steadily from 2007, peaking in early 2011 at 22%. The unemployment rate within the City was 15.5% as of July 2013, and the unemployment rate for the Stockton Metropolitan Area (including San Joaquin County) ranks ninth worst among 372 metropolitan significant ongoing obligations in the form of pensions, health care, compensation, and other benefits for its current and former employees.

A large part of the City's current economic difficulties are the result of imprudent fiscal decisions and poor accounting practices during better economic times. When the City was flush with cash, it made financial decisions and commitments based on the assumption that its economic growth would continue indefinitely. These commitments included unsustainable labor costs, retiree health benefits, and public debt. Past inadequate accounting practices also obscured the severity of the City's impending financial difficulties and in some cases resulted in additional unrecognized liabilities to the City's General Fund. As a result, when the Great Recession hit, the City found its financial obligations quickly outpacing its revenues. Compounding these economic challenges, the City—like all California cities—is limited by law in its ability to generate new revenues. Under California law, the City was unable to increase tax revenues without voter approval. As described herein, on November 5, 2013, Stockton voters passed Measure A, a 3/4 cent sales tax measure that the City placed on the ballot to generate necessary revenues that will enable it to both continue to provide services to its residents and to fund its obligations to its employees and creditors.

C. __The City's Pension Obligations__.

As noted elsewhere herein, the City has negotiated compensation reductions and staff reductions that in turn have reduced the City's obligations to fund contributions to the pension plans of the City's employees (although overall compensation costs and pension obligations will once again rise with the hiring of additional police officers contemplated by the Marshall Plan). Even assuming it were legally possible for the City to further reduce its pension obligations by unilaterally trimming its funding of employee pensions through CalPERS (while somehow providing City employees the level of pension benefits specified in its various labor agreements), the City does not believe underfunding of its CalPERS pension obligations would be in the best interests of either the City or its employees.

The City's employee and retiree pensions are managed through the California Public Employees' Retirement System ("**__CalPERS__**"). The City's General Fund CalPERS obligation for the funding of retirement benefits for its employees in fiscal years 2008-09 through 2010-11, before the City's pension reforms were fully implemented, averaged 13.3% of total General Fund expenditures. By comparison, the City has forecast that its pension obligations from fiscal year 2011-12 through fiscal year 2020-21 (including the CalPERS portion of costs from additional staffing under the Marshall Plan for improved public safety services) will average 15.5% of total General Fund expenditures.[5] A CalPERS defined benefit pension is the industry standard for city employees throughout California. Over 97% of California cities contract with CalPERS for pension benefits, and more than 99% of California city employees are covered by CalPERS or a similar defined benefit plan. Additionally, all county employees in California receive a defined benefit plan from CalPERS or another similar system, and all state employees receive a CalPERS pension. Moreover, of the 26 new cities created in California since 1990, approximately 92% have contracted with CalPERS or a similar plan. When it comes to public employee pensions in California, CalPERS is the primary, and often only, option. This has provided a consistent pension benefit package available to persons employed in public-sector jobs.

The City has no ready, feasible, and cost-effective alternative to the CalPERS system. The City believes that its obligations to CalPERS constitute an executory contract between the two. Under bankruptcy law, executory contracts can only be assumed or rejected (absent some consensual restructuring of the obligations of the executory contract). CalPERS's position is that, under the California statutes governing its activities and operations, it does not have any legal authority to negotiate changes to the pension plans authorized by the California State Legislature to provide reduced benefits, different payment structures for the City, or other modification that would provide material financial relief to the City. Thus, the City believes it has two paths to pursue: assumption of the CalPERS contract or rejection of the CalPERS contract. Under the Plan, the City assumes the CalPERS contract.

City leadership believes that rejecting its CalPERS contract would impose a significant reduction in the City's pension benefits to current retirees—by approximately two-thirds, according to CalPERS. This is in addition to the previously mentioned reductions. This would

[5] See Exhibit B ("Long Range Financial Plan of City of Stockton") to this Disclosure Statement.

result in many retirees receiving benefits below the poverty level. Meanwhile, current employees would likely lose approximately two-thirds of their current-to-date earned benefit. Moreover, such pension cuts would be in addition to the elimination of retiree health benefits that the City has already imposed: the City has completely eliminated retiree health benefits for those approximately 1,100 retirees who were receiving retiree health benefits. The elimination of City-paid health benefits for current retirees and their dependents on average amounted to 30% of their total postemployment benefits (the loss of City-paid health benefits given up by current employees will reduce their future total postemployment benefits 28-41%). Thus, unless the City were in a position to immediately restore approximately two-thirds of the pension benefits of all of its employees, a rejection of the CalPERS contract would violate the City's contracts with its nine labor organizations. Given the City's finances, it is no position to immediately fund two-thirds of the pension benefits of all of its employees.

The City believes that the only means of obtaining relief from its obligation to make contributions to CalPERS to fund the pension plans of its employees is through direct negotiations with the employees and their union representatives, which the City already has accomplished. The City's recent labor agreements made substantial cuts to compensation and benefit packages for current employees, including eliminating their future retirement health coverage (worth approximately $26,000 per employee per year), requiring current employees to pay 100% of the employee share of their CalPERS contribution (7-9% of salary), and imposing compensation reductions that varied, but averaged 10% to 33%, of which 7% to 30% was in pensionable income reductions that would impact future pensions as well as current income.

The City believes that the compensation changes made over the last three years, along with the changes in pension benefits for new hires, have eliminated the excesses in its compensation/pension system. Through changes in labor agreements as well as changes in state law, the City has reduced the pension and health benefits for new hires after January 1, 2013 by 50-70% for all new employees and higher for some types of new hires. The major compensation reductions that have occurred in the last three years will also reduce employee pensions from what they would have been due to reductions in pensionable income.

In light of the severe cuts that City employees and retirees already have experienced, the City believes that any further significant reduction in pension benefits would almost certainly lead to a mass exodus of City employees, as well as leaving the City hampered in its future recruitment of new employees—especially experienced police officers—on account of the noncompetitive compensation package it would be offering new hires. Moreover, due to recent changes in California law, the exodus of City employees would be massive and sudden. In order to preserve their pension benefit levels under new state law, Stockton employees would need to leave the City's employ and obtain employment with another public agency with CalPERS or County Employees Retirement Act of 1937 benefits within six (6) months of the rejection of the City's CalPERS contract. Such a sudden loss of trained and experienced staff would be catastrophic and would seriously jeopardize the City's ability to provide even the most basic of essential public protections.

The City is unwilling to further reduce or eliminate pensions thereby defaulting on its contracts with its nine labor organizations, and, in effect, roll the dice to see if employees flee. In addition to critically impairing the City's ability to recruit new employees, were the City to reject its CalPERS contract, California state law provides that such rejection would also trigger a termination penalty, which CalPERS calculates at $946 million. Even then, the City would still have to fund and operate an alternate pension plan providing market-level benefits in order to remain a competitive employer. The City believes that even if it could locate or establish such a plan, it could not do so at a cost materially lower than the cost of remaining in the CalPERS plan. Additionally, because the City has not participated in the federal Social Security program since 1978, City employees receive no federal pension benefits from that source, and their CalPERS pension is the only "retirement" provided by the City.

The City thus cannot unilaterally abandon the CalPERS system without incurring additional obligations and seriously jeopardizing its ability to recruit qualified employees. The current CalPERS benefits are 85-90% funded according to CalPERS and can be contrasted to the City's retiree health program, which was 0% funded before being terminated.

D. The City's Attempts to Avoid Insolvency.

In light of its economic crisis, the City took drastic steps in an attempt to avoid insolvency, including depleting its reserves, renegotiating labor contracts, unilaterally imposing compensation reduction, cutting jobs and services, defaulting on bond payments, and deferring payouts to retiring employees, among others.

More specifically, the City instituted massive reductions in its workforce and employee compensation. Between fiscal years 2008-09 and 2011-12, the City reduced its General Fund full-time work force by 30%, including large reductions in sworn police positions (25%), non-sworn police positions (20%), fire positions (30%), and non-safety staffing (43%).[6] The City also reduced its pay and benefits to City employees, imposed furloughs, imposed a hiring freeze, and reduced City operational hours. By taking these extreme measures, the City was able to cut approximately $90 million in General Fund expenses over three years from fiscal year 2008-09 through 2011-12.

Despite these heroic efforts, however, the City continued to project annual deficits in the tens of millions of dollars. Revenues remained low, and labor costs, though markedly reduced, were still higher than the City could afford to pay, and were expected to increase. And after four consecutive years of reducing employee staffing, the City could not continue to make additional service reductions without jeopardizing the health, safety, and welfare of its residents. As a result, the City was forced to take further radical steps to balance its budget for fiscal year 2011-12, which included sweeping its remaining available unrestricted funds into its General Fund (thereby depleting critical funds such as workers compensation reserves, liability insurance reserves, equipment replacement funds, and the like), suspending some payments to separating employees, and electing not to pay over $2 million in debt service owed between March 2012 and June 2012. These measures were necessary for the City to maintain sufficient liquidity to continue to operate through June 30, 2012 (the end of fiscal year 2011-12). Even with such measures, however, as of the June 28, 2012, filing of its bankruptcy petition, the City effectively

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[6] See City Budgets for 2008-09, 2009-10, 2010-11, and 2011-12, available on the website of the City of Stockton at http://www.stocktongov.com (from the homepage, click "City Government" and then click "Budget).

had no remaining reserves, and was facing a projected budget shortfall of almost $26 million in fiscal year 2012-13.

E. <u>The City's Participation in Pre-Bankruptcy Negotiations</u>.

Pursuant to Assembly Bill 506 ("**<u>AB 506</u>**"), codified at California Government Code section 53760 *et seq*., the City participated in a "neutral evaluation process" with most of its largest creditors prior to seeking bankruptcy relief. These negotiations occurred over a three (3)-month span, from March 27, 2012 through June 25, 2012, and were conducted under the auspices of the Honorable Ralph Mabey, a former bankruptcy judge and highly accomplished bankruptcy lawyer and mediator. Judge Mabey was selected jointly by the City and its creditors.

While the City was unable to avoid insolvency and bankruptcy through the mediation process, the City was able to reach agreements with almost all of its labor unions. The nine labor unions with which the City conducted negotiations are: (1) Operating Engineers 3 ("**<u>OE3</u>**")—Operations and Maintenance Unit ("**<u>O&M</u>**"); (2) OE3—Water Supervisory Unit; (3) OE3—Trades and Maintenance Unit ("**<u>STAMA</u>**"); (4) IAFF Stockton Firefighters Local 456—Fire Unit; (5) IAFF Stockton Firefighters Local 456—Fire Management Unit, (6) Stockton Police Officers' Association ("**<u>SPOA</u>**"); (7) Stockton Police Management Association ("**<u>SPMA</u>**"); (8) Stockton City Employees' Association ("**<u>SCEA</u>**"); and (9) Mid-Management/Supervisory Level Unit ("**<u>B&C</u>**").[7]

The City reached agreements with eight of these nine labor unions before or not long after the Petition Date. These agreements, in addition to providing for further compensation and benefit cuts, also eliminated retiree health benefits and other compensation claims that these groups would have had against the City in bankruptcy. An agreement with the SPOA, discussed in the section titled "Post-Bankruptcy Negotiations Conducted by Judge Elizabeth L. Perris," was reached in December 2012.

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[7] In addition, the Parking Attendant Services Unit is a bargaining unit of part-time parking attendant workers, but they have little to no benefits and do not regularly negotiate. They are represented by OE3.

to try to get back into CalPERS for a three-year period, at which time they would need to take back those unfunded liabilities and start to pay contributions towards those amounts if they decided that they would want to get back in three years hence.

Q. Okay. So let me take that one at a time.

There's a three-year time period after termination before the City would be able to rejoin CalPERS?

A. That's right.

Q. And what would it have to do if it were to try to reinstate?

A. If it were to try to reinstate, Mr. Lamoureux testified that the City of Stockton would need to take back its unfunded liabilities, and what that means is they would need to make contributions toward those unfunded liabilities to make CalPERS whole again.

Q. All right. I'd like to change subjects a little bit here in order to talk about what would happen if there was a default and the City tried other options it might have with respect to providing pension benefits.

Can you give me, just briefly, what are the options the City might have to try to provide a pension plan for its employees if it were not part of CalPERS?

A. There are basically three options as I see it. The City could start its own pension plan, a single employer type of a pension plan which would mean determining how that plan would operate and so forth, we could pin down the details of that. That would be one option.

The City also, instead of putting in a defined benefit program, put in a defined contribution program.

The third option would be to negotiate with San Joaquin County to enter into the 1937 Act plan that San Joaquin County is currently in.

However, these three options are all secondary to the fact that once the City of Stockton employees are not covered by CalPERS, then they wouldn't be covered by any pension plan or any defined benefit or defined contribution plan and they are currently not covered by Social Security.

And the reason that they are able to not be covered by Social Security is because they have a defined benefit plan. Once that defined benefit plan or any plan is not offered, the employees would need to enter Social Security and to start paying the contributions towards Social Security, which are 6.2 percent that the member pays and 6.2 percent that the employer would pay, for a total of 12.4 percent.

Once you get into Social Security, you can never come out.

Q. All right. I'll come back to that for a second, but let me ask you a couple of questions about the first option. You said setting up the City's own independent pension plan.

Then you add to that what you think your inflation will be long-term. And let's say that in today's economy and projected forward that might be 2 and a half percent. So 2 and a half percent added to 5 percent would be 7 and a half percent in my example.

Q. All right. Mr. Lamoureux testified about what he called "reciprocity" that was also termed "portability."

First of all, can you tell us what that concept means with respect to CalPERS?

A. You know, I'm not sure I finished my last response to your last question.

Q. Go right ahead.

A. Okay.

Q. I apologize.

A. So I talked about how we set the discount rate assumption for public sector plan. And for the example that I gave this plan had assets, 50 percent in stocks and 50 percent in bonds.

The new Stockton plan would have zero assets when it starts out. It would start out with zero assets and it would collect contributions eventually, so the assets would start to accumulate.

But at the outset it would have nothing in the trust and would have a very small amounts until it builds up some assets. So you necessarily couldn't have this 50 percent in stocks and 50 percent in bonds type of allocation, you might have 100 percent in bonds for a few years while you built up your assets.

The return on bonds long-term is lower in my example than it would be for the return on stocks. So that would mean that the discount rate for the Stockton stand-alone pension plan would need to be -- assumed to be lower than 7 and a half percent, because the assets on hand to start with would earn 7 and a half percent.

So the lower the discount rate, that means the less that this pension plan can earn on investments to pay for benefits. As a result, that means the contributions toward the benefits need to be greater to make up for that difference. So that would cause the City of Stockton stand-alone pension plan to have costs that would be greater than the CalPERS pension plan.

Q. All right. And again, I apologize for interrupting your answer. I'd like to move ahead, however, to that issue of reciprocity, as Mr. Lamoureux called it, or portability for a second.

Would you just briefly describe for the Court how that concept fits in with Stockton perhaps trying to start its own new pension plan?

A. So the way that reciprocity works in California is that an employee can move from one employer to another employer, from city to city, or county to county, and not lose his or her pension benefit, so that when the employee ultimately retires its as if that employee had worked with one employer for his or her entire career, and each entity pays for a piece of that benefit.

And the reason this is important is because as you work through your career you get salary increases and without reciprocity your pension benefit at your first employer would be based on your earnings at that first employer, and if you work for another 15 or 20 years you could imagine that your earnings are going to grow.

So your benefit would be much lower from that first employer without reciprocity, so it's a very valuable benefit.

Q. All right. If Stockton were to have its own pension plan, would it be able to be portable to CalPERS?

A. It would need to negotiate reciprocity with CalPERS. And I could see reasons why CalPERS would not want to negotiate reciprocity with Stockton.

First of all, in our example here, Stockton has terminated its contract with CalPERS.

Secondly, the benefits that Stockton would be able to have to its employees who are in the Stockton plan, would likely be lower than the CalPERS benefits, because I mentioned that these employees would be covered by Social

Security, and therefore 12.4 percent of payroll would be going towards Social Security benefits and not toward the new Stockton pension plan. So that would mean that the benefits from Stockton would need to be lower to account for that difference.

So for those reasons, I would I think it would be unlikely that CalPERS would allow reciprocity with the City of Stockton's new pension plan.

Q. Now, I'd like to turn to a demonstrative, if I may.

And, Your Honor, I'm going to -- this has already been shown to counsel, but I'm going to give a copy to counsel and a copy for the Court to look at.

Do you have a copy up there? This would be the Annual Pension Four Scenarios For Safety Employees. If you don't, I'll hand one up to you.

A. I don't see it, unless it's in one of these tabs.

Q. You are probably the most important person to have one.

A. Thank you.

Q. The first page of this demonstrative is entitled Annual Pension Four Scenarios For Safety Employees.

Do you have that in front of you?

A. I do.

Q. And can you describe what the bar chart is that appears on the first page of this demonstrative?

the City of Stockton's First Amended Plan Adjustment. I take it CalPERS stands on those?

MR. GEARIN: We do, Your Honor, actually I believe there are two other components. Briefly, in addition to the ones you mentioned, we filed two other briefs before you that are relevant, modified position with respect to the leader. But the point at this phase of the proceedings is, CalPERS is prepared to rest on the direct testimony declaration of David Lamoureux, and unless the Court directs otherwise, that's what we intend to do.

We intend to participate in the trial through cross-examination as necessary with respect to any issue relevant to CalPERS. But otherwise, we can submit the direct testimony declaration of Mr. Lamoureux. Franklin and the City have both indicated they do not intend to cross-examine Mr. Lamoureux, and we would not have him appear here unless you direct us otherwise.

THE COURT: All right. Thank you. This is a trial where I've intentionally limited time. I treated it as a zero sum game, exactly what I did in the eligibility trial, and I would note that the parties finished early, each having more time available than they actually consumed. And I'm -- although I listened carefully to Franklin's argument, I'm satisfied fifty-fifty, including CalPERS's time coming out of the City's time to the extent there's CalPERS time.

And I of course would retain discretion during the end of trial to make appropriate adjustments that may need to be done, to assure that we have had a full and fair hearing of the issues.

Okay. Next up?

THE COURT: Mr. Bocash is on his feet for the City.

MR. BOCASH: Thank you, Your Honor. Mr. Johnston will join me to make sure I read our stipulation correctly.

The parties did have multiple discussions before today in order to resolve what issues we could and the result is the following stipulation.

THE COURT: And this would be a stipulation between the City of Stockton as plan proponent and the Franklin entities as objectors to confirmation.

MR. BOCASH: Yes, Your Honor. With regard to certain evidentiary issues, the stipulation is as follows:

In an effort to streamline the proceedings by reducing the issues to be decided at the hearing and at trial, the City and Franklin have agreed to the following interdependent stipulations --

THE COURT: Let me ask you to go slowly because I want to make sure that we have a really good transcript.

MR. BOCASH: Of course, Your Honor.

The City hereby withdraws paragraphs 5 through 17 inclusive of the direct testimony declaration of Kenneth

Q. Okay. Thank you.

Let's turn to the last of your opinions which touches on pensions as well.

MR. HILE: Your Honor, I'd like to interpose an objection at this point. Yesterday, we raised the issue of Franklin having used its time.

And now that we have been going two hours this morning of additional Franklin testimony, I would object that their time is up and that they may not present further testimony from this witness or future witnesses based upon Your Honor's ruling at the beginning of the trial that 50 percent of the time would go to each party.

And so I brought this up yesterday afternoon so that at least there would be notice to Franklin about this. So I ask that we at least deal with that issue before we get another maybe hour or two of Mr. Moore's testimony.

MR. JOHNSTON: Well this was precisely why I said that the allocation of time at the beginning of the case would be completely prejudicial. We sat through two days of testimony of City witnesses disassembling and not answering questions and taking up a tremendous amount of time and giving speeches to answers, to yes or no questions.

I can certainly see why the City doesn't want you to hear the testimony of our witnesses, it's not going well for them, but we have substantial testimony to put on. I think

Mr. Moore is going to be done in 15 minutes, but we have another witness after that and we would like to put him on, Your Honor.

THE COURT: We're going to go to noon, I'll let you do that.

MR. JOHNSTON: Thank you.

THE COURT: As to speeches from witnesses and so on, there's a certain amount that falls into the category of "How to control a witness, particularly a hostile witness."

MR. JOHNSTON:

Q. Mr. Moore, let's turn to your third opinion, please.

Can you summarize what your opinion is with respect to the City's pension liabilities?

A. Yes. Quite simply that the City's pension obligations, particularly for the safety plan, are very high, growing, and unpredictable.

Q. And what are the bases for that opinion?

A. Well, certainly when you look at the contributions for the employer, which is what the City of Stockton would be making, compared to peers they are very high and that separation is growing.

Also, the contributions themselves, as you look out over time grow very high. And then lastly the final determination of what the City's contributions are going to be are out of the City's hands and that is determined by

Moore Report. The LRFP incorporated projected PEPRA savings, and assumes the additional positions filled under the Marshall Plan are all hired under PEPRA benefit levels.

35. However, the fact that CalPERS rates are increasing is not cause to assume that these costs are any more unpredictable than the multitude of other expenditures and revenues about which the City must make assumptions. That is life in the budget world. The City makes assumptions about the future growth of all items in its LRFP. The issue of unpredictability is being addressed by CalPERS, which has become more transparent in their dealings with its member agencies: CalPERS staff holds annual briefings and workshops; Chief Actuary Alan Milligan and his staff regularly make presentations at meetings of the League of California Cities and other professional organizations such as the California Society of Municipal Finance Officers; and CalPERS valuation reports have extended the rate projection term from three to six years and provide expanded information. The recent rate smoothing, amortization and mortality improvements enacted by CalPERS, while significantly increasing rates over the next several years, are financially prudent changes that will improve the long-term funded status of the pension system, and reduce employer rates in the long run. Finally, the increase in CalPERS costs is built into the LRFP and the forecast remains balanced, with the City's reserve goal reached by 2034. This should be the ultimate test: even if certain costs increase, does the budget remain balanced? Stockton's LRFP meets that test.

36. In his conclusion, Moore calls for "impairment" of the CalPERS pension obligation, but gives no description of what this scenario would look like, how the City would deal with the termination liability that would be levied by CalPERS against the City, what the implications would be for employee retention if the City is the only major public employer in the state without a defined benefit pension plan, what the legal basis would be for any alternative plan, and what the costs of such an alternative would be. These issues are addressed in the Direct Testimony Declarations of Kim Nicholl and Kurt Wilson.

37. *Pension costs are not an unsustainably high percentage of General Fund expenditures*: Moore compares projected CalPERS costs as a percent of total expenditures and pronounces them "unsustainably high." This is a flawed analysis for several reasons.

First, he compares the peak of CalPERS costs (18.8% of total expenditures), to a median of 8.9% for the period of FY1998-99 through FY2011-12 (see Moore Exhibit 15). That 8.9% figure is significantly biased by the extraordinarily low CalPERS rates levied during the first third of that period, including three years during which the Miscellaneous Plan has zero rates and the Safety Plan averaged rates of 10.1%. In hindsight, no one thinks levying such low rates was a good idea, so including them in a comparison period makes no sense.

Second, CalPERS costs actually rose to 13.7% in FY2009-10, before the City implemented significant pension cost savings measures, including making employees pay their own full share of the employee rate, eliminating Employer-Paid Member Contributions (which had previously increased retirement pay by 9% for Safety employees and 7% for Miscellaneous), and eliminating salary COLAs and various add-pay compensation. This reduced CalPERS costs to 8.9% of total expenditures in FY2011-12.

Third, CalPERS costs only rise to 18.8% in future years because of the addition of 164 employees under the Marshall Plan on Crime. Without these new employees, CalPERS costs are projected to peak at 15.9% of total expenditures. This is only 2.2 percentage points higher than the 13.7% level that existed before the City's pension cost-cutting reforms.

Fourth, the 18.8% figure is a peak amount that begins to fall when CalPERS unfunded liabilities are paid off starting in 2032. By FY2040-41, CalPERS costs are projected to fall to 11.7% of total expenditures.

Fifth, Moore believes the 18.8% represents an unsustainable figure, but compared to what? Each city pays for different costs from its General Fund. The greater the cost of items paid for from the General Fund, the smaller pension costs will be as a percentage of the total expenditures. For example, some cities pay for capital projects out of the General Fund (Stockton does not), or pay for a broader array of services than does Stockton, or their total expenditures are swollen by significant transfers out to other funds because of their budgeting and accounting practices or other factors unique to that city. Such cities would appear to have "lower" pension costs by this measure, simply because the total expenditures and transfers out of the fund boost the base against which the pension costs are measured. Another identical city with the same financial commitment but different fund structure and budgeting practices could appear to have "higher" pension costs using this analysis. Stockton's General Fund has sustained budget cuts that took out many non-personnel services, and the personnel services that are left are weighted toward Safety employees which have proportionately higher pension costs. Therefore, saying a particular percentage is "unsustainable" is unsupportable without factoring in considerations of what the General Fund pays for versus other restricted funds. Again, the test should be whether or not the LRFP is projected to remain balanced, even with the anticipated increase in CalPERS costs (and addition of staff under the Marshall Plan), and it meets this test.

38. *Moore's reference to Vallejo is irrelevant to Stockton:* Whether Vallejo's pension costs are increasing, or its Safety rate and pension costs as a percentage of total expenditures are higher than the comparable figures for Stockton, are irrelevant to the case at hand. Vallejo has, however, taken important steps to balance its budget, including imposing by a unanimous Council vote a new Police contract last fall with a 5% pay cut and higher employee contributions to their health insurance. In March 2014, Vallejo's mid-year budget review showed the General Fund's built-in $5.2 million budget shortfall was reduced to just under $1 million. The $12 million in new annual sales tax revenue from its Measure B is being directed toward one-time needs, although as a general tax it is also available for meeting any General Fund shortfalls. In its revised FY2013-14 Budget, Vallejo's General Fund reserve is 10.2% of total expenditures, including reserves funded with Measure B. Vallejo is also the first city in the nation to implement participatory budgeting, a citywide process now in its second year that promotes civic engagement by allowing residents to decide how to spend a certain amount of public money. Moore mentions none of these considerations in painting Vallejo as "a cautionary tale."

Conclusion

39. The City has endeavored to maintain budgetary solvency through forecasting a higher level of pension costs that even the most recent CalPERS actuarial valuation projections do not incorporate. The City has incorporated inflationary cost increases over time, including modest 2% salary and health COLAs to remain competitive within the labor market. The forecast also builds in higher contributions to replace the City's aging technology, fleet and equipment,

consequently reaches the erroneous conclusion that Stockton's costs are less sustainable than those for these other agencies.

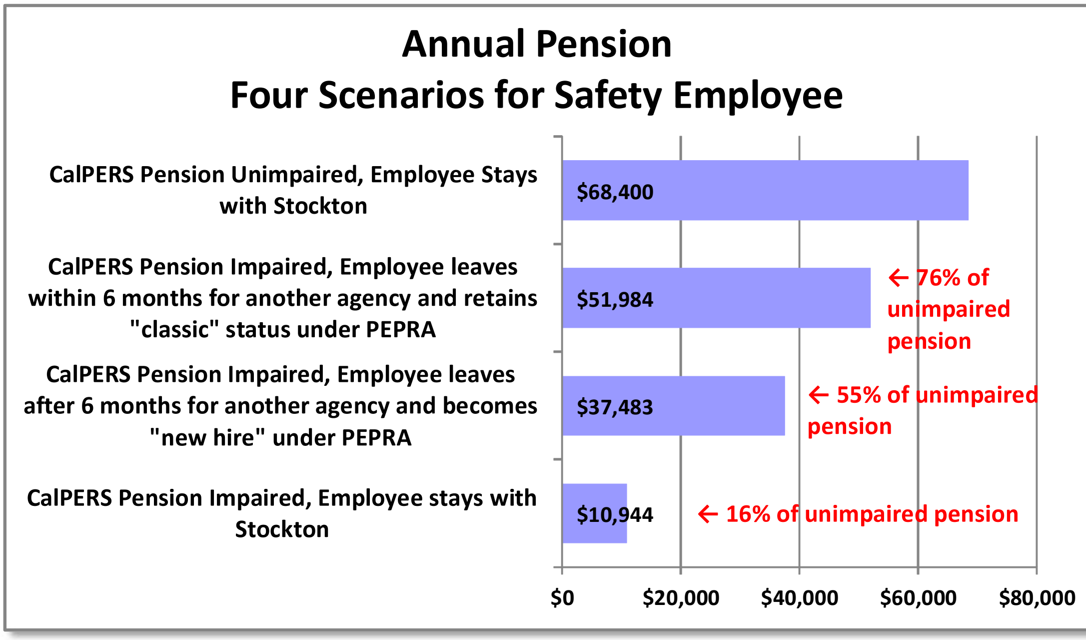
17. Moore also disputes the City's statements as to the reduction in pension benefits that will result from the new pension tiers implemented by the City (including new state PEPRA tiers), but does not provide his own calculation or data. CalPERS, in a pair of reports published in April 2014, a true and correct copy of which is attached hereto as **Exhibit B**, supports the City's calculations as to the impact of the new pension tiers. In fact, the City's pension reductions exceed state-mandated changes and will result in a greater pension reduction for persons hired after January 1, 2013.

18. Based on the errors described above, Moore's conclusions as to the City's calculation of retiree health benefits and the relative size of the City's post-employment benefits are flawed, and without merit.

Executed this 20th day of April, 2014, at Santa Barbara, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Ann Goodrich

Ann Goodrich

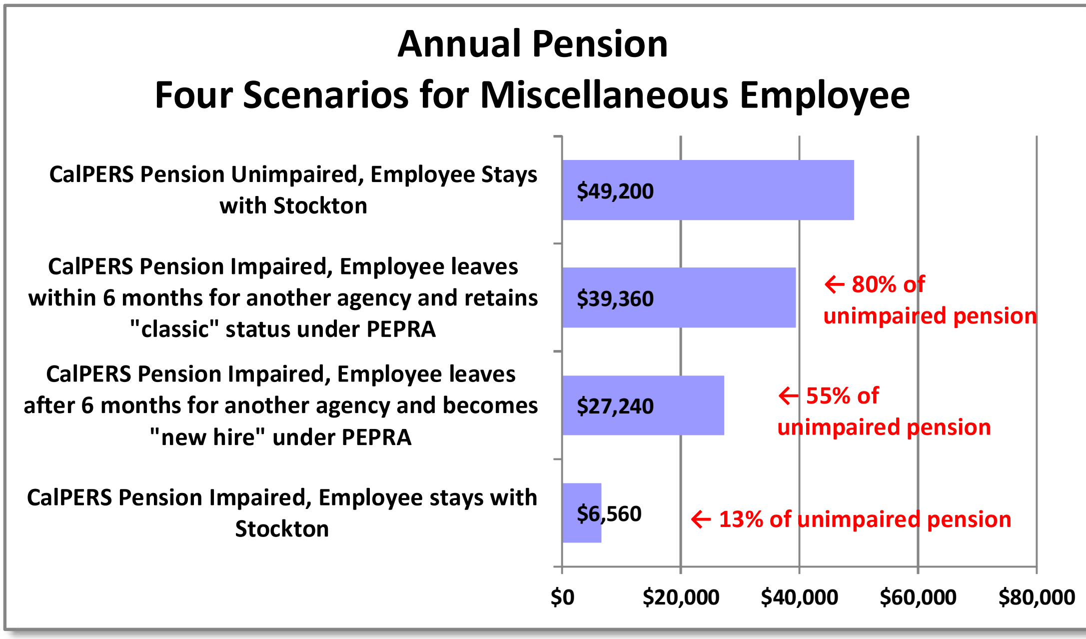


Assumes Safety employee retires at age 50 with 25 years of service, 10 of which already completed with Stockton.
Final Average Salary (FAS) of $91,200

	Annual Pension
Scenario 1: CalPERS Pension Unimpaired, Employee stays with Stockton	
25 years at 3%@50 = 75% of FAS	$68,400
Scenario 2: CalPERS Pension Impaired, Employee leaves Stockton within 6 months, retains "classic" status with new agency under PEPRA	
10 years at 3%@50 = 30% of FAS=$27,360 reduced by 60% in termination pool	$10,944
15 years with other CalPERS or 1937 Act agency at 3%@50 = 45% of FAS	$41,040
	$51,984
Scenario 3: CalPERS Pension Impaired, Employee leaves Stockton after 6 months, is "new hire" with new agency under PEPRA	
10 years at 3%@50 = 30% of FAS=$27,360 reduced by 60% in termination pool	$10,944
15 years with other CalPERS or 1937 Act agency at 2%@50 = 30% of FAS	$27,360
	$38,304
Scenario 4: CalPERS Pension Impaired, Employee stays with Stockton	
10 years at 3%@50 = 30% of FAS=$27,360 reduced by 60% in termination pool	$10,944
15 additional years with Stockton at no pension	$0
	$10,944

Major Assumptions:

Assumes no salary increases.
No reduction applied for spousal continuation.
Does not add Social Security pensions, retiree medical or deferred compensation benefits employee might receive in other agency.
Assumes 50% of Normal Cost employee pays in PEPRA tier is 7% Misc and 11% Safety.
Assumes PEPRA salary cap of $136,440 for non Social Security agency.
If CalPERS is impaired Stockton will lack resources to create a substitute retirement plan.
Under Scenario 3 employee will pay $27,360 in higher employee contributions during the 15 years of employment with other agency.



Assumes Misc employee retires at age 55 with 30 years of service, 10 of which already completed with Stockton. Final Average Salary (FAS) of $82,000.

	Annual Pension
Scenario 1: CalPERS Pension Unimpaired, Employee stays with Stockton	
30 years at 2%@55 = 60% of FAS	$49,200
Scenario 2: CalPERS Pension Impaired, Employee leaves Stockton within 6 months, retains "classic" status with new agency under PEPRA	
10 years at 2%@55 = 20% of FAS=$16,400 reduced by 60% in termination pool	$6,560
20 years with other CalPERS or 1937 Act agency at 2%@55 = 40% of FAS	$32,800
	$39,360
Scenario 3: CalPERS Pension Impaired, Employee leaves Stockton after 6 months, is "new hire" with new agency under PEPRA	
10 years at 2%@55 = 20% of FAS=$16,400 reduced by 60% in termination pool	$6,560
20 years with other CalPERS or 1937 Act agency at 2%@62 (1.3% at age 55) = 26% of FAS	$21,320
	$27,880
Scenario 4: CalPERS Pension Impaired, Employee stays with Stockton	
10 years at 2%@55 = 20% of FAS=$16,400 reduced by 60% in termination pool	$6,560
20 additional years with Stockton at no pension	$0
	$6,560

Major Assumptions:

Assumes no salary increases.
No reduction applied for spousal continuation.
Does not add Social Security pensions, retiree medical or deferred compensation benefits employee might receive in other agency.
Assumes 50% of Normal Cost employee pays in PEPRA tier is 7% Misc and 11% Safety.
Assumes PEPRA salary cap of $136,440 for non Social Security agency.
If CalPERS is impaired Stockton will lack resources to create a substitute retirement plan.

condition?

A. Well, I reviewed a substantial amount of the written material that's been produced in this case. It's contained in Exhibit 2 of my report.

Q. Looking at Exhibit 2, I see a substantial amount of material listed there. I don't want you to go through it all, but briefly could you summarize the general categories of information you reviewed?

A. I would put it into three categories of information. The first category is historical financial information. That includes audited financial statements, actuarial evaluation reports, revenue results going back 15 years.

The second category is the City's long-range financial plan and the various documents that support that.

And then the third category relates to essentially the treatment of Franklin and the various documents associated with the recoveries to Franklin.

Q. What else did you do besides look at documents?

A. I also visited the City.

Q. When did you do that?

A. I visited the City on March 21st of this year.

Q. What did you do when you were there?

A. Well, a colleague of mine, Matt Covingon and I, conducted a walking tour of the entire downtown and waterfront area assisted by Mr. Manual Laguna within the visitor center. I also visited the Swenson and Van Buskirk golf courses, along with Oak Park, and I also drove around the City to a variety of areas, including residential areas.

Q. Did you do anything else to become informed about the City and the subjects you were asked to consider?

A. I read up on the history of the City and I certainly have followed various news articles.

Q. Did anybody help you with your analysis?

A. Mr. Van Conway, the CEO of our firm, along with Matt Covingon and Jeff Peria, who are both out of our Los Angeles office and have extensive experience in California.

Q. How much time did you spend doing your analysis and writing your report?

A. Approximately 70 hours.

Q. And how about the members of your team?

A. Mr. Peria spent approximately 500 hours, and Mr. Covington, approximately 400 hours. The others were de minimis.

Q. Have you done additional work since you wrote your report?

A. Yes. I was deposed. I reviewed the report of the City's rebuttal expert, Ms. Nicholl, rebutting certain parts of my third opinion.

I also read the deposition transcript for Ms. Nicholl.

I have also reviewed a multitude of pleadings that

Q. You mentioned that you visited the City of Stockton in your testimony earlier today; that's the only time that you have personally visited the City of Stockton, correct?
A. Yes.
Q. And although you say you visited the Swenson and Van Buskirk Golf Courses and Oak Park, and toured downtown Stockton, it's true, is it not, you didn't go into City hall?
A. I did not go into City hall, correct.
Q. You didn't talk to any Stockton City employees, did you?
A. That's correct, I did not.
Q. You didn't talk to any Stockton department heads?
A. I did not.
Q. Now, in the City of Detroit case however, you do have access to department heads in Detroit, correct?
A. Yes.
Q. And you do have the opportunity to talk to them about ways that that the City of Detroit can improve the operations, correct?
A. Yes.
Q. But in this case, you didn't have that opportunity, correct?
A. I did not have that opportunity, that's correct.
Q. You didn't talk to any Stockton City Council members, did you?

A. I did not.

Q. In the Jefferson County matter that you testified about in your direct examination where your firm was working on Jefferson County's plan of adjustment, you met with Jefferson County officials to go over their operations and assumptions, did you not?

A. I did.

Q. And you participated in strategy sessions with officials from Jefferson County with respect to what the proposed plan would be, did you not?

A. Yes.

Q. And that was your role as working on behalf of a creditor, correct?

A. Yes.

Q. You didn't ask for any of that access here, did you?

A. I did not.

MR HILE: Your Honor, this actually might be a good breaking point. I'm happy to go forward if you like.

THE COURT: It's a matter of three minutes, so we can break right now. We'll resume at 1:30. Get a hold of the engineering folks in this building.

(Recess.)

WEDNESDAY, MAY 14, 2014, SACRAMENTO, CALIFORNIA, 1:30 P.M.

THE COURT: All right. Mr. Hile, you may proceed.

I think we figured out the light problems, and it change before they might be subject to the reduced amount as a result of a default in the situation that we discussed where the unfunded liability is not paid by the agency?

A. So you're referring to the termination process that was discussed earlier?

Q. Yes.

A. In the event that our board were to decide, they would reduce the benefits in that case so they can afford to not pay the amount due at termination. In the event the employer does not pay the amount due at termination.

In this case, let's say hypothetical, if the benefits have to be reduced by 10 percent, then anyone that's ever worked with Stockton -- and again, it's all hypothetical here -- we don't know what the terms would be.

But let's say a decision was made that everyone's benefit has to be reduced by ten percent. Then even if someone left City of Stockton 15 or 20 years ago, that benefit would be subject to a reduction.

So the amount of time -- even if they left -- I guess the advantage of leaving today versus leaving five years from now would be that, at least the benefits earned between now and five years from now, would not be subject to any reduction because it would be under a new employer. But anything that accrued up to the date they leave City of Stockton or the employer for which benefit are reduced, those benefits would be reduced.

Q. Can an agency, a CalPERS agency, change benefits retroactively for benefits already accrued?

A. Not under current law.

Q. Can a CalPERS agency move new employees to a lower tier?

A. Yes, it can. And the City of Stockton has done so.

MR. HILE: Thank you.

THE COURT: I just want to make sure I understand what your answers were to Mr. Hile. Let me see if I can put a hypothetical. You have two agencies, two contracting agencies. Somebody would qualify for 20-year retirement and worked for exactly 10 years for agency 1 and then moved to agency 2, and agency 1 became a terminated agency that did not pay its unfunded -- its termination liability, and the CalPERS board made a decision with respect to that terminated agency that a 20 percent across-the- board cut was appropriate.

The person who worked 10 years for that agency, and then 10 years for another entity that is in good standing with CalPERS, would get, in effect, a 10 percent reduction by virtue of having worked half of the time for an entity that had a 20 percent reduction?

THE WITNESS: Correct. But in reality, they'll get a full benefit from the second employer and 80 percent from the