

Transforming Stockton: The Reality Of Bankruptcy For A City

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Why Are We Here?

A Case Study In
Repairing A
Dysfunctional
Organization During
A Financial Crisis

OR

“How To Keep
Your Eye On The
Ball When The
Crowd Is Yelling
At You . . .”

Stockton, California



Key Takeaways?

- How Can You Repair Or Move Organization Forward During Financial Crisis?
- How Do You Assess/Determine Depth Of Crisis?
- How Do You Design A Framework For A Solution?
- What Is The Role Of The City Manager And How Is Our Profession Preventing Or Correcting These Situations?

Stockton, CA



- 300,000 People
- 70 Miles East Of San Francisco
- Deepest Inland Port
- Confluence Of Freeways And Railroads
- North End Of Central Valley
- Striking Gap Between Haves And Have-nots

Stockton, CA

- 50% More Murders Than Chicago Per Capita
- 2nd Highest Crime Rate In CA
- 1 In 4 Drop Out Of High School
- 84.5% Students Are Eligible For Assistance
- 3rd Most Illiterate City In U.S.
- 14.6% Unemployment
- Foreclosure Epicenter
- Income 32% Less Than CA Average



Recession Hit Stockton Hard

- Unemployment Was 22-23%
- Single Family Home
 - Was Worth \$400,000
 - Is Worth **\$146,000**
 - **Low of \$118,500 in 2009**



I Arrived July, 2010

- Budget Was Balanced The Week Prior By:
 - Eliminating 25% Of Police Officers
 - Eliminating 40% Of Non-Safety Staff
 - Broke Multi-Year Labor Contracts
 - Declaring Fiscal Emergency
 - Police & Fire Unions Sued

First Up—Diagnosing Organizational Capacity—Got 6 Months!

- People & Culture
- Finances
- Systems & Infrastructure
- Direction

People & Culture

- A Dysfunctional Family—Battered
- Line Staff OK
- Mid & Senior Management, NOT
- Special Interests Pursued Their Goals With Vigor & Success – Pushed Management Out of Way
- No Professional Development

Finances

- Upcoming GF Deficit \$25 million, No \$30 Million, No \$37 Million!
- \$155 Million GF Total
- Closed Multi-year Labor Contracts w/ COLAs
- Binding Arbitration For Fire
- OPEB Unfunded Liability \$540 Million
- Workers Comp. Fund minus \$40 Million

Finances (Cont.)

- Liability Fund minus \$6 Million
- Medical Insurance Fund minus \$5 Million
- Leave Payout Fund minus \$3 Million
- Redevelopment Agency Illegally Wrote \$11 Million In Checks

Systems/Infrastructure

- Permit & Financial Systems 20+ Years Old
- No Maintenance Management Systems
- No Sense of “How Are We Doing”?
- Mid and Senior Management Illegally Obligated City Repeatedly
- Limited Internal Controls
- Employee Benefits Not Managed

Direction

- None
- Unspoken... “Lie Low & Don’t Make Waves”
- Don’t Offend The Power Structure
- I Will Out Last You—We Eat City Managers
- This Is How We Always Did It
- I’m Not Paid To Think, Problem Solve, etc.
- Leadership Will Get You In Trouble



HELP!!!!!!

What Models To Follow?

How Do You Eat an 800 Lb Gorilla?

Don't Panic . . .

Not All At Once . . .

One Bite At a Time



No Perfect Model To Follow

- 2 Models/Philosophies For Action
 - Modified 12 Step AA Program!
 - Emergency Operations Concept (SEMS & NEMS)

12 Step, Now Deis 6 Step Program

- Admit You Have A Problem
- Conduct A Fearless Inventory of Yourself
- Are Your Mistakes 5 or 100% Of The Problem?
- Make Amends or Fix
- Admit It When You Were Wrong
- The Truth Will Set You Free!

Emergency Operations Model

- Bankruptcy Is Similar To a Flood, Earthquake, etc.
- Create/Open Emergency Operations Center (parallel to Org.)
 - Focus On Bankruptcy or Financial Restructuring
 - Debt
 - Labor
 - Legal
 - Facilities

Radical Surgery Needed

Stakeholders

- Need City Council Buy-in
- Need Community Leaders Buy-in
- Would Like To Have Employee—Labor Buy-in

City Council Buy-in

- They Knew Things Were Bad
- They Had Good Value System
- Motivated To Fix City
- In It For The Right Reasons
- Key For CM....Help Them Get Control!
- Need to Be Cognizant of Relationship in High Stress Environment

City Council Strategic Plan

- Honest “Inventory of Ourselves (City)”
- Set 4 Goals—Commitment To Stay Course
 - Get Fiscal House In Order
 - Dealing With Crime
 - Facilitate Economic Development
 - Build Organizational Capacity
- 37 Strategic Initiatives To Effectuate Goals
 - Goals Must Translate To Outcomes
 - Outcomes Produce Credibility Which Gets You Support

Community Leader Buy-in

- Who Has The Biggest Check Books?
- Who Are The Opinion Leaders?
- Who really cares?
- Draw Them Into The City
- Careful With City Council

Employee/Labor Buy-in

- Honest Communication—You Pay For The Sins Of Your Predecessors
- Don't Sugar Coat It
- Share Financial Forecasts
- Share Your Value System
- Don't Over Commit or Under Deliver

Conducting “Fearless Inventory Of Ourselves”

- 80% Of General Fund Was Police & Fire
- 80% Of Costs Are Labor
- Are We Paying A Fair Wage? What Is Fair?

- Here Is What We Found.....

OPEB Unfunded Liability Of \$540 Million

- “Pay Go” at 15% Of Payroll
- “ARC” at 40% Of Payroll
- Medical Insurance For Retirees & Spouse—Free
- No Minimum Service Requirement
- 100% Coverage

Employee Medical & Related Benefits

- No Employee Contribution
- 100% Coverage
- Self-Insured And Nobody “Minding The Store”
- No RFP For 20 Years

Hidden Pays

- Longevity
- Vacation Sell-back
- Premium For Front & Back of Fire Truck
- Master Officer
- Etc.

Other

- Employees Did Not Contribute to Retirement Costs
- Annual Vacation Granted On July 1st
- Total Compensation 10-25% Over Market
- Fire Had Mandatory Staffing in Labor Contract While Sworn Police cut 25%
- Overtime Management Non-Existent

“Admit It When You Are Wrong” & “Make Amends and Fix”

- 10 Point Plan For Fiscal Sustainability
- Ballot Measure To Eliminate Binding Arbitration For Fire
 - Very Challenging
 - Ultimately Prevailed
 - The Barge Is Changing Direction!
- \$37 Million Strategy For Deficit FY 11-12
 - \$25 Million Funded By Compensation Reductions
 - \$12 Million Funded By Staffing Cuts—Mostly From Fire

“Make Amends and Fix” (cont.)

- Approached Labor With Closed Contracts
- Didn't Want To Bargain & Didn't Believe The Numbers
- Declared Another Fiscal Emergency
- Imposed
- Labor Sued Again

And There Is More!

2012 Crime Wave

- 71 Murders (50% More Than Chicago)
- 400 People Shot
- 1,000 Guns Confiscated

We Need to Respond to Immediate Needs AND
Plan For Future

FY 12-13 Preparation

- \$25 Million Deficit (After 3 Years of \$90 Million In Total)
- Books Are “BAD”
- Oh My God, What Is Left To Cut?
- Forces A Very Basic Conversation
 - What Is A Viable City?
 - Why Do We Exist?
 - We Still Have To Provide Services & Protect The Citizenry – Private Sector Different

Context For Moving Forward

- Already Cut Sworn Police By 25%
- Already Cut Fire By 30%
- Already Cut All Others By 43%
- Compensation Is Now At Average Or Below—9-23% Cut Over Two Years
- What Is Left For Options?
 - New Taxes
 - Retiree Medical
 - Debt

New Taxes

- California Law Puts It In Hands Of Voters
- Citizens Won't Tax Themselves For:
 - Same Terrible Services
 - Free Retire Medical
 - Explosion Of Debt
- Later Confirmed By Polling

Pre-Bankruptcy Discussion

- Debt and Retiree Medical Can Only Be Handled In Chapter 9
- Got A Second Opinion
- Confirmed Our Status & We're Off To The Races!
- Open Up The Emergency Operations Center For Bankruptcy!
 - Created EOC Largely With Contractors



Organizational Backdrop

- Devastated By Run-up To Bankruptcy
- Lost 43% Of Non-Safety Staffing, 30% Of Fire And 25% In Sworn Police
- Cut Over \$90 Million In Annual Expenditures Trying To Avoid Bankruptcy
 - Transferred Millions From Internal Service Funds, And Equipment/Technology Replacement (Workers Comp Fund -\$40M, Liability Fund -\$8M)
- Police Staffing Is At Least 30% Lower Than Minimum Per Industry Standards
- **Bottom Line: City Must Regain A Service Solvent Posture**



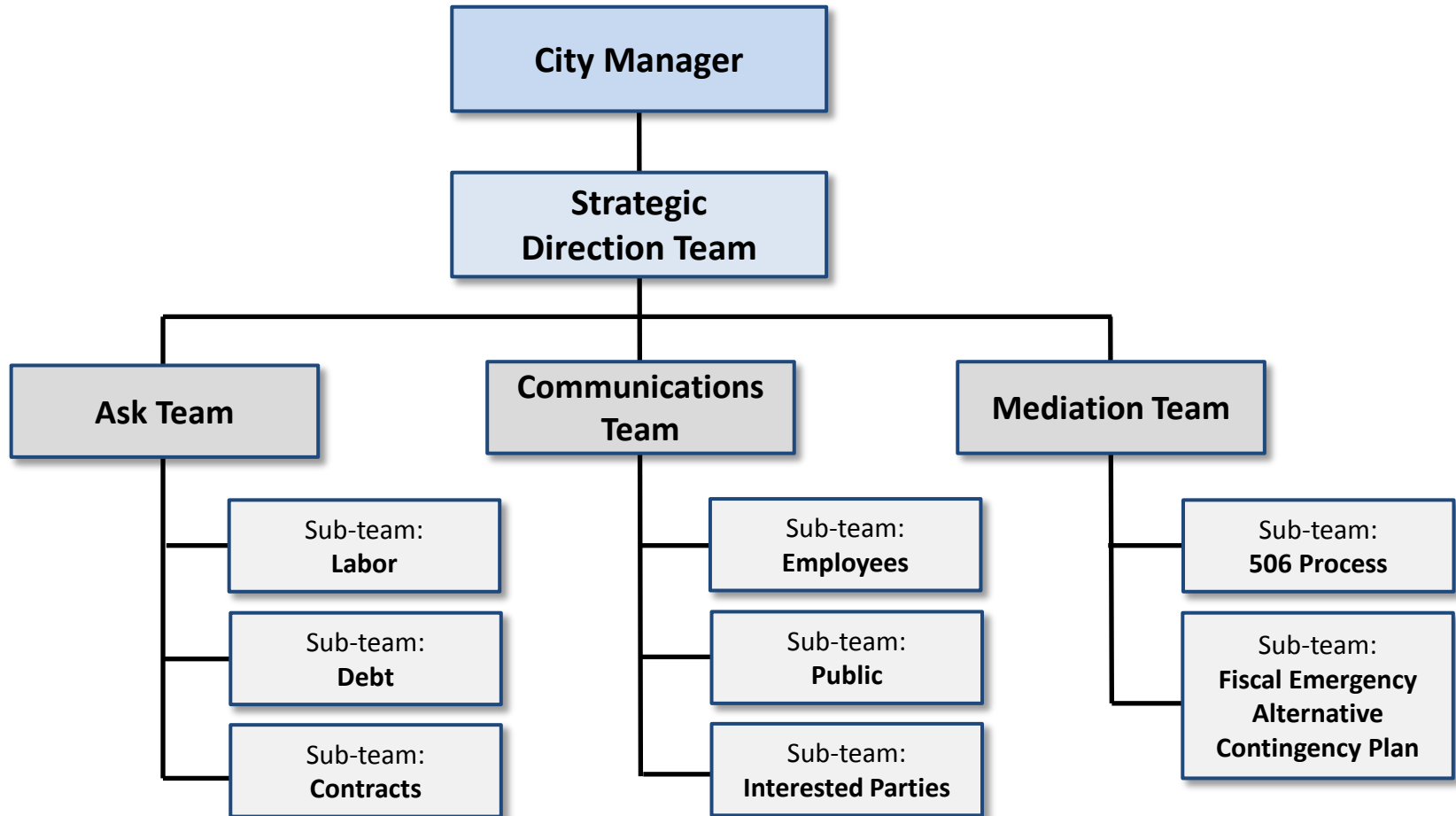
Findings From Second Opinion

- Insolvent From A Services And Budget Perspective; Perilously Close To Cash Insolvency
- City Focused On Current Expenditures
- Solutions Will Require Consideration Of All Expenditures Including Debt And Promises With Respect To Retiree Healthcare
- Liquidity Has Entered The Red Zone
- Must Get Ready For Bankruptcy Or City Could Go Into An Uncontrolled Default

Key Recommendations

- Maximize General Fund Liquidity
- Immediately Begin Pre-bankruptcy Proceedings To Address Debt Obligations And Unfunded Liabilities
- Develop Plans:
 - To Transition To Sustainable Service Delivery Approaches
 - To Rebuild Service Delivery Solvency, Including Consideration Of New Revenues

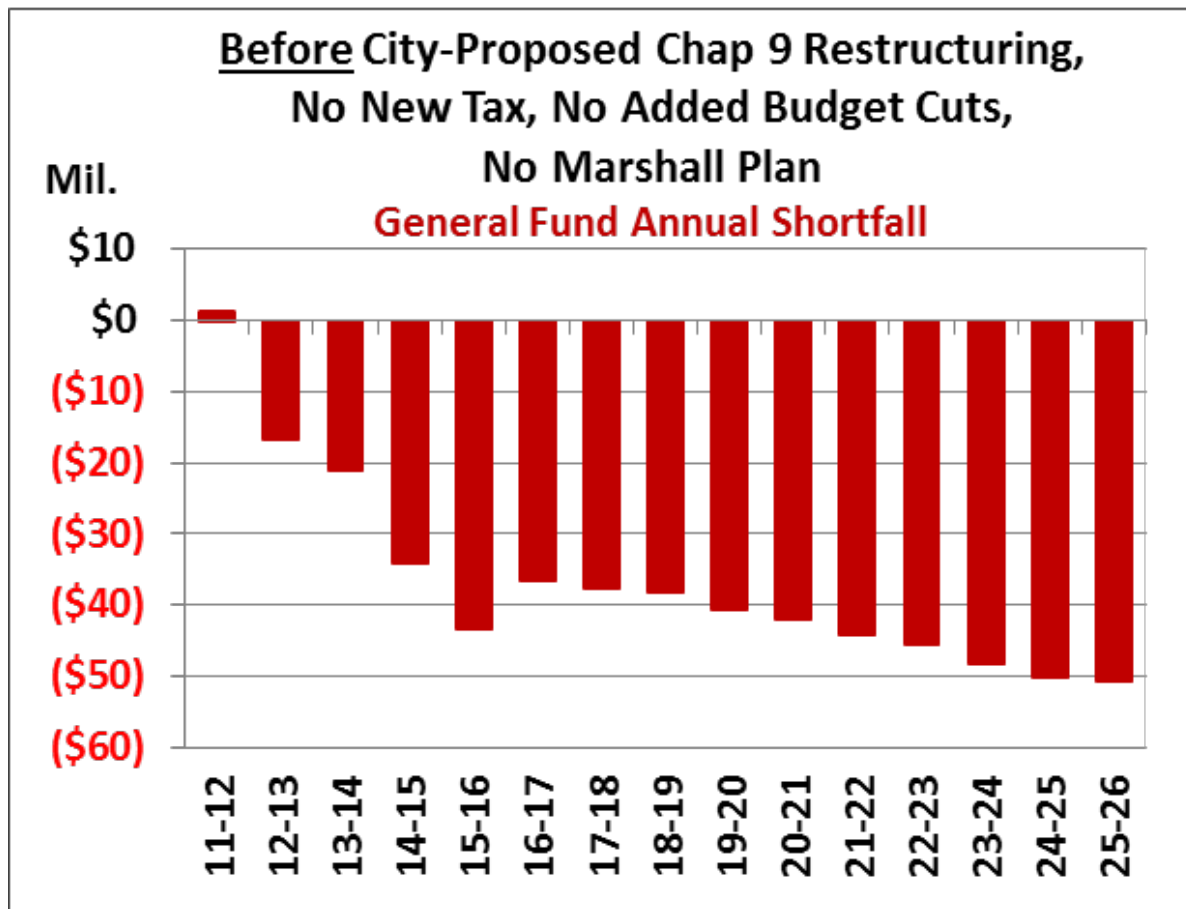
Emergency Operations Center



Main Challenges for Team

- Understand And Implement Pre-bankruptcy Process
- Build Fiscal Model
- Develop Restructuring Plan Or “Ask”
- Develop A Budget For 2012 / 13 Assuming Bankruptcy
- Mediate Solutions To Maximum Degree Possible
- Develop Message And Communicate

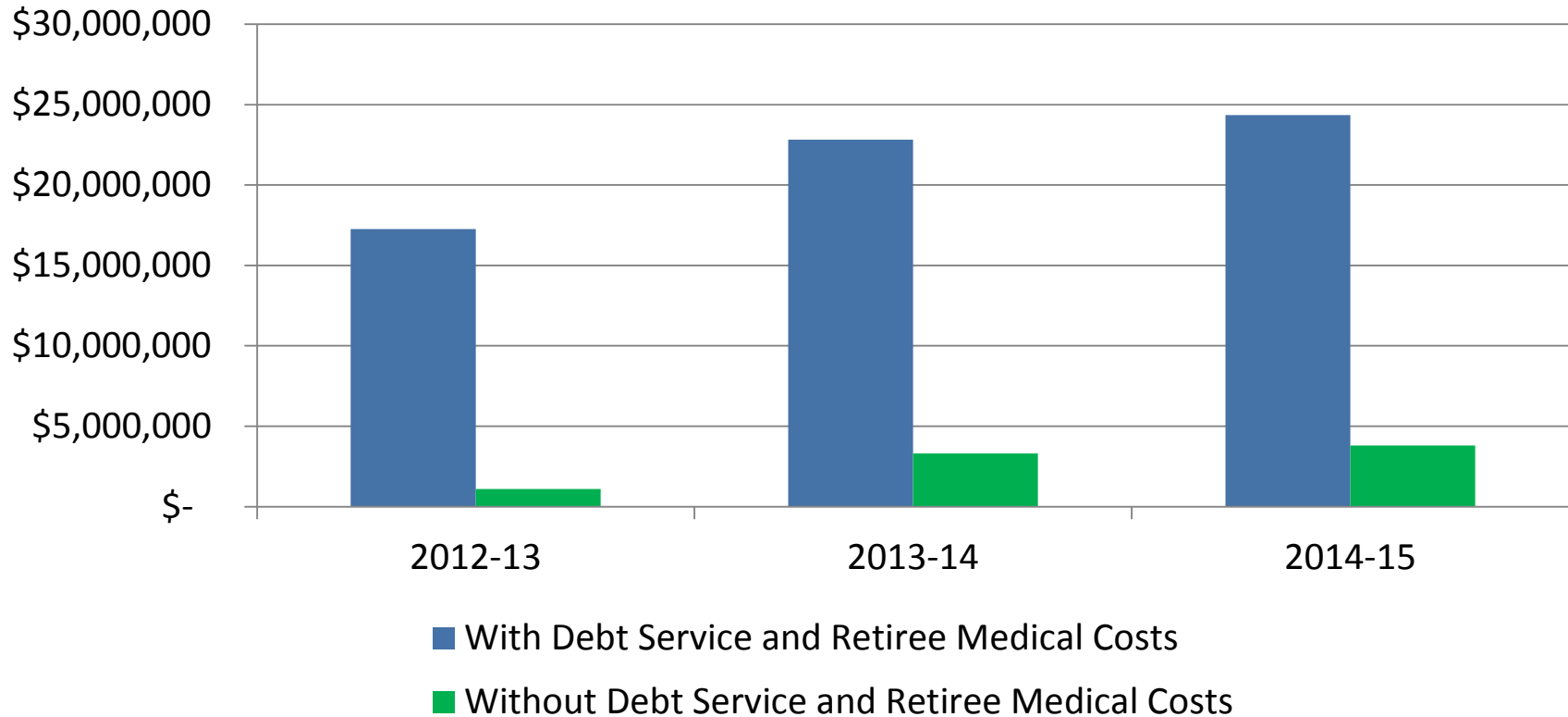
Initial Fiscal Forecast Pre-Chapter 9



- Revised Baseline Revenue/Expense
- Includes Fiscal Stabilization Expense (ISF, Maintenance, Colas)
- Includes “Mission Critical” Expense
- Property Sales & Efficiencies Included

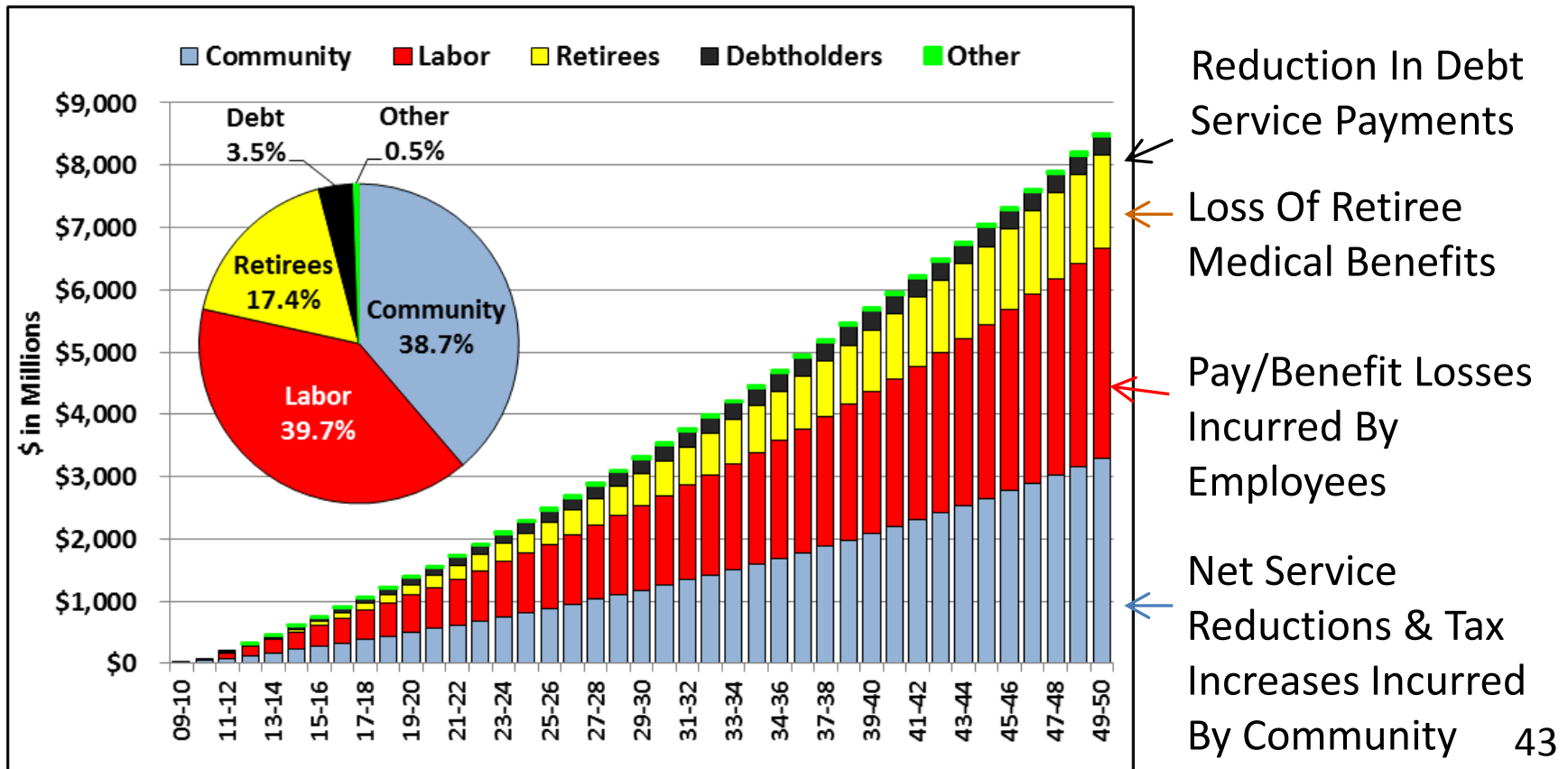
The Significance of Debt Service and Retiree Medical Costs

Anticipated Deficit



Ask Impacted Everyone

- Cumulative Impact Starting With Cuts In FY09-10 Assuming Losses Not Restored; New Taxes Add To & Service Increases Subtract From Community Category





General City Principles for AB 506 Ask

- 1. Avoidance Of Future Cash Insolvency Requires Substantial Reduction In The City's Obligations**
- 2. A Foundation Built On Principles Of Fairness And Equity**
 - Considers Security And Available Sources Of Payment For Obligations
- 3. End Results**
 - Sustainable City Government That Provides For The Health, Safety And Welfare Of The Community.
 - Solvency From A Budgetary And Service Delivery Standpoint.



General City Principles for AB 506 Ask

- 4. Financial Stability Over A Period Of At Least Ten Years**
 - All Costs Of Services Covered
 - Appropriate Reserve Levels Maintained With Recurring Revenues.

- 5. Realign Expenditures With Available Resources, while**
 - Balancing Interests of Stakeholders In An Equitable Manner
 - Prioritizing The Continued Delivery Of Basic And Satisfactory Municipal Services.

Mediation Attempt With Creditors

- Developed 790 Page ASK Of Our Creditors
- Retirees & Unions Tried, Credit Markets Did Not
- Failed To Achieve Goals—Not Enough Time
- Filed For Bankruptcy On June 28, 2012
- Balanced FY 12-13 Budget By Suspending Debt Payments & Reducing Retiree Medical By 2/3rd

Capital Market Creditors—Bond Holders, Trustees and Insurers

- Refused To Negotiate
- Bullies
- Pursued Negative PR Campaign
- Did Not Understand City Finances
- Did Not Understand Municipal Bankruptcy
- Fought Our Eligibility For Ch 9 Protection

Result Of Eligibility Court Fight?

- Judge Repeatedly Admonished Them
- Judge Concurred With Our Argument
- Judge Confirmed Our Insolvency
- Judge Confirmed Our “Good Faith” & Their Bad Behavior
- Judge Suggested We Pursue Attorney Fees

What's Next?

- 12 Of Our 19 Creditors Got Deals
 - Labor Agreed to 90% Of Our Ask—Fear Of Worst Case
 - Labor Agrees With Our Numbers
 - Plan Of Adjustment—October 1, 2013
 - Either Consensual Or “Cram Down”
 - Stockton’s “Marshall Plan On Crime” Adopted
 - Result Of Year-long Project To Design New Strategic Approach On Crime

What's Next? (cont.)

- The Reformed City of Stockton Is Now Restructured With New Department Head Team
- Tax Increase on Ballot November 5:
 - Fund Bankruptcy Exit
 - Fund Marshall Plan On Crime

Cause Of Bankruptcy?

- Mostly Poor Governance & Management
- Stockton, Detroit & San Bernardino
 - On Path For 10-20 Years (Denial or Incompetence)
 - Corrupting Culture
 - Special Interest vs. City Fiduciary Responsibility
 - Lack of Leadership
 - Lack of Competence
 - Lack of Accountability
 - Disinterested Community

What Is The City Manager's Role In These Troubled Cities?

- Evaluate Policy Decisions For Impacts & Provide Recommendations
- Always Offer Alternatives
- If They Are Dead Set On Shirking Their Fiduciary Role, Recommend Against It In Public
- Facts, Analysis & Data Are Key . . . With A Dose Of Courage
- Opinion Leaders & Big Check Writers – e.g. Bank Of Stockton

City Manager's Role (cont.)

- Are We Providing The Necessary Leadership?
- When Are We Aiding Bad Governance?
- Are We Continuously Improving & Learning From Past Mistakes?
- Are We Maintaining High Professional Standards?

It's Been The Best Of Times & The Worst Of Times



- Stress!
 - Anger!
 - Appreciation
 - Respect



It's For The Generations!

Questions/Comments?

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