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 1\textsuperscript{st}
- 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 BeHandled 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

City Manager

Strategic Direction Team

Ask Team
- Sub-team: Labor
- Sub-team: Debt
- Sub-team: Contracts

Communications Team
- Sub-team: Employees
- Sub-team: Public
- Sub-team: Interested Parties

Mediation Team
- Sub-team: 506 Process
- Sub-team: Fiscal Emergency Alternative Contingency Plan
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

- With Debt Service and Retiree Medical Costs
- Without Debt Service and Retiree Medical Costs
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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