MUNICIPAL RESEARCH

Stockton & Detroit Exit Bankruptcy – Key Takeaways

November 2014

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Stockton's bankruptcy exit plan was approved on October 30, followed by Detroit's plan on November 7. Northern Trust Credit Research expects the outcomes in these cases will have limited precedence for future cases. Because exit plans are developed by the entity in bankruptcy and determined through negotiation, the process of municipal bankruptcy is highly varied and political. The presiding federal judge serves to accept or reject the plan, but has very little effect on development of the plan itself. While outcomes will continue to vary, much can be learned from these cases.

Here are some key takeaways from the plans:

- **Pensions** were treated more favorably than all other creditors in both cases. Stockton's plan was approved without any impairment. In Detroit, General Obligation Unlimited Tax (GO ULT) bondholders allowed 26% of their voter-approved tax levy to be redirected to pension payments. Given the political implications, pensions are prone to be more protected than bonds in future bankruptcies.
- **Other Post-Employment Benefits (OPEB), such as retiree healthcare,** can be subject to severe cuts. In both of these cases, severe cuts to OPEB were used to justify limited or no pension cuts given the shared creditor.
- **General Obligation Unlimited Tax Bonds (GO ULT)** were treated better (in Detroit) than other non-pension debts based on the protection of voter approval. There are a great many GO ULT bonds in the market that are not secured by voter-approval. It is questionable if GO ULT bonds without statutory lien or voter approval would be treated any better than unsecured debt in future cases.
- **General Obligation (GO) and General Obligation Limited Tax Bonds (GO LT)** are, in the vast majority of cases, likely to be treated as unsecured
- **Certificates of Participation (COP)** are, unless tied to a specific revenue stream, likely to be treated as unsecured
- **Lease Bond** recovery will depend on how essential the entity envisions the leased asset. Buildings are typically deemed more essential than assets like parks and golf courses.
- **Pension Obligation Bonds** (POBs) can come in various forms, but they are most often unsecured and are likely to be treated as such with greater potential for weak recovery.
- No impairments were made to bonds deemed "**special revenue**." This includes bonds secured by specific revenues including sales taxes, state aid and utility revenues.
- Recovery plans may include land or asset transfers. As seen in Detroit, this gets the creditor involved in recovery through development of land or management/ownership of assets.

The exit plans have been deemed feasible by the court; however, real fiscal recovery will likely be a challenge. It remains unclear if these plans will be sufficient since sustained fiscal recovery requires economic prosperity and management restructuring just as much as it requires liability reduction. A key example of continued fiscal stress post-bankruptcy is Vallejo, California which exited in 2011 and continues to struggle with burdensome pensions and limited economic growth. This is particularly concerning for Detroit where oversight power will be limited and management/leadership change has not been substantial.

	Detroit, MI Exit Plan	Stockton, CA Exit Plan
Pensions	$3+ billion overall liability • including state and philanthropic support, approximately 85% recovery expected • individual benefits cut up to 4.5% with elimination or reduction of cost-of-living adjustments	No impairments proposed by city despite judge ruling that pensions can be impaired
OPEB	10-13% recovery	Less than 10% recovery
GO ULT	$388 million • bondholders will recover 74 cents on the dollar • remaining 26-cent levy now dedicated to pensions	No debt
GO LT	$163 million • 34% recovery	No debt
Leases, COPs and POBs	$1.1 billion pension bonds — Insurer FGIC is creditor: • recovery includes control of Joe Louis Arena site, potentially turning it into housing and retail development $333 million pension bonds — Insurer Syncora is creditor: • 14% recovery plus notes and long-term lease on parking structure and tunnel to Canada	• $11.2 million lease: administrative building and parking — 100% recovery • $12.2 million lease: police, fire, library properties — 100% recovery • $44.6 million lease: Stockton arena — 95% recovery • $30.8 million lease: parking garages — 77% recovery • $40 million lease (office building): building will be transferred to creditor • $34 million lease: golf course and parks — up to 12% recovery (creditor expected to appeal) • $121.8 million pension obligation bonds — 50-55% recovery
Special Revenue Bonds	No impairment proposed	No impairment proposed

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