Boom and Bust in Stockton, California

When Ann Johnston (left), Mayor of Stockton, California, informed the city council in March that Stockton was about to go bankrupt, making it the largest municipal bankruptcy in history, it took her six hours to explain why. The primary reason was overborrowing, overspending, and thinking that the good times would go on forever. They didn't.

Between 1998 and 2005 prices of real estate in Stockton, about 75 miles from Sacramento, tripled. For a time Stockton was attractive as a lower-cost bedroom community alternative to Sacramento as home buyers were priced out of that market. Revenues from builder fees and sales and property taxes soared, and then-Mayor Gary Podesto took advantage. First was a luxury downtown sports arena anchored by a Sheraton hotel followed by the redevelopment of the waterfront into a marina and riverwalk. Then came the inevitable expansion of government and generous pensions, including "Lamborghini" benefits for city workers: if someone worked for the city for one month he (and his spouse) became eligible for retiree healthcare benefits *for life*. To house its burgeoning payroll, the city purchased a high-rise municipal office building at the top of the market for $35 million.

All that has changed. The office building is now vacant, homes in the high-end Weston Ranch development that sold for $450,000 are now listed for sale at $100,000 with few buyers. Unemployment is at 16 percent, and crime has soared. *Forbes* ranks Stockton as one of the three worst cities to live in in the country.

Johnston told the council that they couldn't make the interest payment on their indebtedness, that the city's deficit is approaching $40 million (on a budget of $165 million, down from $217 million just three years ago), and that its unfunded healthcare liabilities now exceed $400 million. It gets worse. 94 pensioners are receiving more than $100,000 a year, twice the number in similar-sized cities. The pension plan is underfunded, its healthcare promises are completely unfunded, the Sheraton hotel was purchased at fire sale prices by the University of the Pacific which has turned it into dorms for its students. Stockton boasts the second-highest foreclosure rate in the country and its Shelter for the

Homeless is at 125 percent of capacity. Ratings agencies Moody's and Standard and Poor's rate Stockton's $341 million of indebtedness at junk status. And when Krispy Kreme advertised for jobs last year 400 people showed up to apply.

Unless Stockton is able to negotiate enormous cuts in pension and healthcare benefits, it will be forced to stop making those payments altogether. And that will have an impact far beyond Stockton. When Meredith Whitney made her prediction in September 2010 that 50 to 100 municipalities, like Stockton, would go into default, the bond market dropped sharply. In March on *CNBC* Whitney reiterated her prediction, specifically noting Stockton:

> You have Stockton, California, that is on the brink of bankruptcy. You have five cities, including Detroit, which [are] on the brink of insolvency. It's fascinating, because there's been so much back-room political maneuvering to keep these cities from going bust.

The state of California has moved heaven and earth to keep cities in trouble like Stockton from declaring bankruptcy for the negative impact it would have on their ability to continue to borrow at low interest rates. Said Whitney: "There's been every effort on the part of the states to prevent this tidal wave of defaults [from happening], which is going to happen sooner or later…You're either willing to see if or you'll shut your eyes…"

They're coming because as the states continue to labor under the weight of past extravagances paid for through issuing debt they are finding it necessary to push down its expenses onto local municipalities and towns which, like Stockton, don't have the resources.

For whatever comfort it may give Stockton Mayor Ann Johnston, she is not alone. Yonkers, New York, Mayor Mike Spano just appointed a commission to look into his city's "Great Unraveling," explaining:

> [Yonkers has] a budget of about $1 billion and a budget gap in the upcoming year that looks like it can't be bridged. There are reasons aplenty. Like many urban centers the Yonkers' manufacturing base disappeared, the middle-class moved out and the people simply can't afford the property and sales tax burden that ensued. Anti-tax fervor hit and elected officials refused to raise recurring revenues. Gimmicks, one-shots, borrowing for operating expenses, assets sales, and assorted maneuvers 'kicked the can down the road' for a couple of years…The city has now run out of gimmicks.

When government officials decide that something can go on forever and then promise, borrow and spend accordingly, reality eventually sets in. Stockton is just the most recent and obvious example.