### Administrative Services - General Fund

<table>
<thead>
<tr>
<th></th>
<th>2008-09 Budget</th>
<th>2008-09 Revised</th>
<th>2009-10 Proposed</th>
<th>Amount Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General Fund Guideline</strong></td>
<td>3,176,914</td>
<td>2,581,123</td>
<td>2,334,442</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries + Benefits</td>
<td>2,461,613</td>
<td>1,924,425</td>
<td>1,747,124</td>
<td>(177,301)</td>
<td>(9%)</td>
</tr>
<tr>
<td>Services</td>
<td>617,150</td>
<td>558,557</td>
<td>501,081</td>
<td>(57,476)</td>
<td>(10%)</td>
</tr>
<tr>
<td>Materials and Supplies</td>
<td>69,794</td>
<td>69,794</td>
<td>69,810</td>
<td>16</td>
<td>0.02%</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>28,347</td>
<td>28,347</td>
<td>16,427</td>
<td>(11,920)</td>
<td>(42%)</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>3,176,914</td>
<td>2,581,123</td>
<td>2,334,442</td>
<td>(246,681)</td>
<td>(10%)</td>
</tr>
</tbody>
</table>
City of Stockton
Budget, Finance and Economic Development Committee

DEBT PROGRAM UPDATE
April 23, 2009

Discussion Items

- Debt Overview
- Debt Policies
  - Capital Project Financing
  - Land-Secured
- Credit Rating Agencies and Investor Relationships
- Emerging Debt Issues
  - Tax and Revenue Anticipation Note (TRAN) for FY 2009-10
  - 2007 Variable-Rate Demand Obligation (VRDO) Lease Revenue Bonds – 400 E. Main Building Acquisition
  - 2009 Public Facility Fee (PFF) Capital Infrastructure Lease Revenue Bonds
  - Delta Water Supply Project Financing
Stockton's General Fund-Backed Debt
Outstanding Debt - Estimate as of June 30, 2009

• Six debt issuances guaranteed by General Fund, totaling $271.3 million

• Five of the six debt issues have dedicated revenue streams outside the General Fund tax revenue base

• The sixth debt issuance, Pension Obligation Bonds of $125.0 million, appropriated across all City funds
  - Repayment from amounts previously budgeted for payment of City's annual required contributions to Cal PERS
Additional Debt Administered by the City's Debt Program

Outstanding Debt – Estimate as of June 30, 2009

- Housing Notes = $23.44 million
- Capital Equipment Leases = $923 thousand
- Redevelopment Agency = $111.77 million*
- MUD Utility Enterprise = $132.23 million
- Land-Secured Bond Districts = $172.75 million

* Stockton Redevelopment Agency total excludes $59.9 million in RDA issuances backed by the General Fund (included in previous slides). Total RDA estimated outstanding debt (as of 6-30-09) totals $171.67 million with the inclusion of the $59.9 million ($13.3 million in 2003 Housing Certificates of Participation and $46.6 million in 2004 Stockton Arena Lease Revenue Bonds).

Debt Policies

- Two Debt Policies annually updated
  - Capital Project Financing
  - Land-Secured
- Policies reviewed by the internal Debt Committee
- Revisions to Debt Policies will be reviewed by Budget & Finance Committee in May
- Council approval of revised Debt Policies with the FY 2009-10 Budget Resolution
Debt Policy Revisions Made Last Year

- Flexibility for Debt Committee to make *mid-year revisions* in reaction to municipal bond financial market events
- Stricter inter-fund loan borrowing requirements
  - Loan term limited to *no more than 5 years*
  - *Require loan documents* signed / approved by affected department directors
- *Tax-Exempt Lease Financing policies* for major equipment and energy-saving improvement projects
- Requirement for *competitive bidding* and *prevailing wage pay* for acquisition agreements on all future Land-Secured debt issuances

Credit Rating Agencies and Investor Relationships

- Pro-active information sharing
- Rating agencies have a particular interest in the City's General Fund financial outlook
- Current General Fund "Issuer" Ratings
  - Standard & Poor's: A+ with negative outlook
  - Negative Outlook attached to rating in September, 2008
  - Moody's Investors Service: A2, on "Watchlist"
  - Downgraded from A1 to A2 in July, 2008
  - "Watchlist" for potential downgrade added March, 2009
- Meeting with S&P and Moody's May 11th & 12th
Emerging Debt Issues:
Tax and Revenue Anticipation Note (TRAN)

- Scheduled for Council consideration April 28\textsuperscript{th}
- Provides short-term borrowing to meet General Fund cash liquidity needs throughout the year
- Covers cash flow shortfalls during year
  - For example: Timing differentials - property taxes ($32 million)
  - January @ 53%; April @ 27%; June @ 20%
- Size of the note estimated not to exceed $30 million; finalization of sizing currently being researched
- City's participation with California Statewide Communities Development Authority (CSCDA) since inception in 1994

Emerging Debt Issues:
2007 Variable Rate Demand Lease Revenue Bonds - 400 E. Main Building Acquisition (400 E. Main)

- Tax-Exempt 2007 Series A = $36.5 million and Taxable 2007 Series B = $4.27 million
  - Assured Guaranty insured; Dexia liquidity facility
  - Issuer underlying rating S&P "A"
  - All debt service payments funded by net rent revenues from private sector tenants recorded in a Special Revenue Fund
  - Weekly interest rate resets averaging 3.08\% (tax-exempt) and 4.4\% (taxable) since November, 2007
  - Annual interest savings of $1.1 million compared to fixed rate quoted at time of issuance (4.91\%)
  - Majority private sector occupied; City IT Department re-located to building in December 2008
Emerging Debt Issues:
Public Facility Fee (PFF) Capital Infrastructure Lease Revenue Bonds

- Bond issue postponed 2/24/09 due to investor yield requirement higher than 7% interest rate limit in bond documents

- Rationale for Bond Financing of PFF Projects
  - Each PFF function should pay for its own capital needs (streets, parks, police, etc.); Retain integrity of funds' purpose
  - Match future PFF revenues to capital project costs and bond repayments
  - Inter-fund borrowing method should not be permitted without a specific payback plan; Maximum term of 5 years
Public Facility Fee (PFF) Capital Infrastructure Lease Revenue Bonds: Debt Financing Approach

- 30 yr fixed-rate lease revenue bonds
- PFF bond issue rating: S&P A with negative outlook
- Estimated issue size - $30 to 36 million
- PFF revenue projected conservatively given current low-levels of building permit / PFF revenue collection history
- Lease Revenue Bonds secured by General Fund and a pool of City assets (three parks valued at $36.33 million)
- Annual debt service payment = approximately $3.3 million
  - PFF revenues are source of bond repayment

Emerging Debt Issues:
Delta Water Supply Project Debt Financing

- Facilities to be financed:
  - Intake and Pump Station
  - 30 Million Gallons/Day Treatment Plant and Pipelines
- Portion paid via new development (TBD)
- Project cost estimate: approximately $200 million
- Rate and Fee Study underway
- Plan of Finance underway
- Timing of rate and fee approval (July, 2009)
- 1st phase financing of $112 million (August, 2009)
Questions
MINUTES  
BUDGET/FINANCE/ECONOMIC DEVELOPMENT COMMITTEE  
APRIL 13, 2009

Council Chambers, 425 N. El Dorado Street, City Hall Second Floor, 3:00 PM  
STOCKTON, CALIFORNIA

- ANNOTATED AGENDA -

Call to Order: 3:00 P.M.

Roll Call 3:00 PM
Present:
Councilmember Holman
Vice Chair Miller
Chair Fitchen

The following City staff and members of the Public were in attendance:

Mary Morley, IT
Patti Johnson, Deputy Director IT
Dessa Chang, Community Services
Nicole Mamorno, Administrative Aide
Janet Salvetti, Assistant Finance Director
Dianna Garcia, Director Human Resources
Mahin Shah, Budget
Mark Moses, Chief Financial Officer
Kimberly Trammel, Budget
Joe Maestretti, Budget Manager
Carol Marshall, Budget
City Attorney Ren Nosky
Pam Sloan, Community Services Director
Interim Police Chief Blair Ulring
City Auditor Mike Taylor
Darrell Rainer, IT
Paul Willette, Fire
City Manager J. Gordon Palmer, Jr.
Assistant City Clerk Bonnie Paige
David Siders, The Record
Gordon MacKay, Deputy Director O&M, Public Works
Greg Brazile, Library
Mike Miller, Public Works
John Beckman, BIA
Melissa Price, Municipal Utilities
Kathleen Von Achen, Finance Officer
Gary Dickson, Public Works
Bob Murdoch, Interim Public Works Director
Gina Delucchi, Community Services
Adolfo Cruz, Community Services
Ethel Francois, Human Resources
Debbie Shipp, Human Resources
Robyn Burror, Public Art Manager
Maricela Calvo, HRD
Patricia Frederick, Public Member
David Harrington, Public Art Advisory Committee
Scott Runion, Public Member
Alan Pettet, Midtown PAC
Tom Bow, Public Art Advisory Committee

ISSUE(S) TO BE DISCUSSED:

1. **Public Comment 3:00 PM**

   **Patricia Frederick**

   Ms. Frederick, representing the Jane Frederick Continuation High School spoke in support of Public Art Manager Robyn Burror and asked the Committee to reconsider eliminating Ms. Burror’s position.

   **David Harrington, Public Art Advisory Committee member**

   Mr. Harrington spoke in support of a full time Public Art Manager. He stated that currently the salary for this position comes from the CIP fund and not from the General Fund.

   **Scott Runion**

   Mr. Runion spoke in support of retaining Robyn Burror as the Public Art Manager. He spoke regarding Ms. Burror’s knowledge of managing a public art program.

2. **Department 2009-10 Budget Reviews: 3:09 PM**

   **Public Works 3:09 PM**

   Interim Public Works Director Bob Murdoch provided a budget report with the aid of a PowerPoint presentation (filed) and answered questions from Committee members.

   The Committee members posed questions and comments regarding the following:
   1) How much is being saved by not maintaining the drinking fountains
   2) Has research been conducted regarding an alternative way of charging at the boat launches, such as the method used at camping grounds
   3) Stop lights (2 locations)

   **Human Resources 3:19 PM**
Dianna Garcia, Director of Human Resources provided a budget overview with the aid of a PowerPoint presentation (filed).

Committee members expressed appreciation on the following points of interest as presented in the report:
- Working toward paperless operation
- Streamlining of processes - viewing department as accountable and providing customer service to other departments

The Committee asked for an explanation of other expenses, to which Ms. Garcia responded.

Community Services 3:26 PM

Pam Sloan, Director of Community Services provided a budget report to the Committee with the aid of a PowerPoint presentation (filed) and answered questions from the Committee.

The Committee discussed the following issues regarding the funding of the Library and services offered:

Salary and benefits
Late fees, fines and collections
Reduction of hours of operation - furlough days
Revenues - fee for internet use, videos
Providing supplies and faxing services

Vice Chair Miller requested staff to review how the implementation of furlough days affect the services to the community. (CM to follow up)

Regarding the Recreation budget, the Committee posed the following questions:

Will the classification conversion from Sr. Analyst to Program Manager II be a promotion or new position and will this change have a long term benefit to the department;
Generating additional revenue streams - increasing the use of the City's venues; recruiting outside events and prioritizing the steps in the action plan as submitted by the consultant;

Vice Chair Miller expressed the Committee's desire to confirm that any changes to department structure will have a long term benefit to the department going forward and not just in reaction to the current budget situation.

Questions regarding the Enterprise fund included:

- The operation of Lyons Golf Course
- Increased revenue
- Materials and supplies

Administrative Services 3:59 PM

Mark Moses, Director of Administrative Services and Chief Financial Officer provided a general fund budget report to the Committee with the aid of a PowerPoint presentation (filed).

3. Debt Program Status 4:05 PM

Mark Moses, Director of Administrative Services and CFO provided an overview of the Debt Program with the aid of a PowerPoint presentation (filed).

The following issues were discussed:
- Debt Overview
- Debt Policies
- Capital Project Financing
- Land-Secured
- Credit Rating Agencies and Investor Relationships
- Emerging Debt Issues
- Tax and Revenue Anticipation Note (TRAN) for FY 2009-10
- 2007 Variable-Rate Demand Obligation (VRDO) Lease Revenue Bonds - 400 E. Main Building Acquisition
- 2009 Public Facility Fee (PFF) Capital Infrastructure Lease Revenue Bonds
- Delta Water Supply Project Financing

Kathleen Von Achen, Finance Officer speaking to the Credit Rating Agencies and Investor Relationships continued the report to the Committee:

Mark Moses, Director of Administrative Services and CFO presented the Emerging Debt Issues and responded to questions from the Committee members regarding performing under the fixed rate for the life of the loan and if the City can find a lower fixed rate.

Mr. Moses and Ms. Von Achen responded to the Committee members regarding 1) why Moody's downgraded the City's rating from A1 to A2; 2) will Moody's upgrade the City's rating if reserves are built up; 3) is the city on track to close the gap between expenses and revenues; and 4) an explanation of Watchlist.

Kathleen Von Achen, Finance Officer spoke to the Public Facility Fee (PFF) Capital Infrastructure Lease Revenue Bonds.

John Beckman, BIA questioned prevailing wage on land uses to which Mark Moses responded.
City Attorney Ren Nosky confirmed that prevailing wage on land uses is required by labor code.

Mark Moses, Chief Financial Officer filed the following documents:
Standard & Poor's Ratings Direct, dated March 9, 2009
Moody's Investors Service rating update, dated February 13, 2009
California Municipal Bond Advisor, dated April 2, 2009
Capital Financing and Debt Management Policy, dated May 20, 2008

City Manager J. Gordon Palmer, Jr. updated the Committee stating that:

1) Federal monies are coming in from the Department of Justice which will help fund some of the PeaceKeepers and a number of Police Officers;
2) The City submitted an application to the Federal Government for money for the COPS Grant fund as the budget had proposed; and,
3) next week staff will come before the Committee with Budget vs. Actuals through March.

Tom Bowe, Acting Chair Public Art Advisory Committee

Mr. Bowe requested that the Committee consider an exception to eliminating the position of the Public Art Manager. He expressed his concern over eliminating Robyn Burror's position and the long term effect this decision will have on the program.

Chair Fritchent responded to Mr. Bowe, stating that the Committee is still researching and reviewing the proposed elimination of the Public Art Manager.

Vice Chair Miller

Vice Chair Miller brought forward some questions regarding the elimination of the Director of Library Services and creating a new position of City Librarian. Vice Chair Miller expressed her concerns as far as long range implications to the organization. 1. It is not a City Library, but rather a City/County Library System; and, 2. Will the individual overseeing a major City/County operation hold requirements that are on a par with what has been provided in terms of oversight and qualifications.

Pam Sloan Director of Community Services and Dianna Garcia, Director of Human Resources provided a response to Vice Chair Miller's concerns.

Vice Chair Miller requested more time and more information as it appears the City is downgrading Stockton's commitment to library services. She stated it is a critical component of what the City provides to the community.

Vice Chair Miller addressed the Public Art Manager position and her concerns.
Vice Chair Miller spoke regarding fees and shared suggestions from City employees regarding new services and asked that staff research all possibilities.

Committee Member Holman expressed his concerns regarding other streams of revenue and asked if staff is thinking outside the box regarding the creation of new streams of revenue and asked that this information be provided to the Committee.

RECOMMENDATIONS

- The next meeting of the Budget/Finance/Economic Development Committee will take place on Monday, April 20, 2009 at 3:00 p.m.

Adjournment

______________________________
COUNCILMEMBER DALE FRITCHEN, CHAIR

______________________________
VICE MAYOR KATHY MILLER, VICE CHAIR

______________________________
COUNCILMEMBER ELBERT HOLMAN, JR.
PREPARED BY: THE OFFICE OF THE CITY CLERK
Summary:
Stockton, California; Appropriations; General Obligation

Primary Credit Analyst:
Chris Morgan, San Francisco (1) 415 371 5032; chris_morgan@standardandpoors.com

Secondary Credit Analyst:
Misty Newland, San Francisco (1) 415 371 5073; misty_newland@standardandpoors.com

Table Of Contents

Rationale
Outlook
Summary:
Stockton, California; Appropriations; General Obligation

Credit Profile

<table>
<thead>
<tr>
<th>Stockton POBs</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unenhanced Rating</td>
<td>Stockton ICR due 12/31/2009</td>
<td>A+/Negative</td>
</tr>
<tr>
<td>Long Term Rating</td>
<td>Stockton Redevelopment Agg rev bonds (Stockton Events Ctr Arena Proj) ser 2004 dtd 03/26/2004 due 06/30/2007-2025 2028 2036</td>
<td>A(SPUR)/Negative</td>
</tr>
<tr>
<td>Unenhanced Rating</td>
<td>Stockton Pub Finc Auth, California</td>
<td>Stockton, California</td>
</tr>
</tbody>
</table>

Rationale

Standard & Poor's Ratings Services affirmed its 'A+' issuer credit rating (ICR) on the City of Stockton, Calif. In addition, Standard & Poor's affirmed its 'A' long-term rating and underlying rating (SPUR) on the outstanding lease revenue bonds, certificates of participation (COPs), and pension obligation bonds (POBs) for which the city is the obligor. The preexisting negative outlook reflects our assessment of a sharply deteriorating revenue environment stemming from housing market stress.

The ICR reflects the city's general obligation, including the obligation to levy ad valorem property taxes without limit as to rate or amount. The city's lease revenue bonds are secured by lease payments to be made by the city for the use and occupancy of certain leased premises. The COPs represent interests in lease payments to be made by the city for the use and occupancy of certain other leased premises. The city has covenanted to budget and appropriate rental payments to meet its obligations under the lease agreements supporting both the lease revenue bonds and the COPs. The POBs are secured by all city funds lawfully available to make payments on the POBs.

Strengthening credit factors that, in our opinion, influence the city's rating include its:

- Economic role as a market center for a surrounding agricultural region that is also tied to nearby large urban regions;
- Supplemental revenues from a special voter-approved sales tax to fund public safety services; and
- Strong financial policies and practices.

Limiting credit factors, in our opinion, to the city's credit quality, include its:

- Financial stress associated with a sharp economic downturn; and
• Potential economic vulnerability from merely adequate median household effective buying income (EBI) and a high unemployment rate.

Located 83 miles east of San Francisco, the City of Stockton serves an area that encompasses a slowly-growing population of 289,927 and has a sizeable and diverse assessed value of $22.6 billion. Recently a major recipient of spillover real estate demand from the San Francisco Bay Area and the Sacramento region, we understand that the city has been particularly exposed to the housing market downturn, with a 0.8% decline in its assessed value for fiscal 2009. Suggesting vulnerability to this trend, in our opinion, is the city's merely adequate median household effective buying income of 87% of the U.S. median. In addition, the city's non-seasonally adjusted unemployment rate jumped to what we consider to be a high preliminary 15.8% level in December 2008 from 11.5% in the prior year.

We note that the city started to experience financial strain during the past year, which we understand precipitated a Feb. 19, 2009 request from a council member for information from the city attorney on the issues surrounding the option of declaring bankruptcy. We understand from management that that this request stemmed from the council member's effort to better understand the city's financial situation, rather than a recent change in the city's financial outlook or policies, and that the city attorney has not responded with a specific timeline on reporting back to the council regarding this issue.

The city has been taking substantial steps, in our view, to address a significant revenue downturn. In November 2008, the city suspended a prioritization of service effort in favor of $19.16 million in expenditure cuts (9.6% of fiscal 2008 expenditures) that were designed to match a downward revision in its fiscal 2009 revenue forecast. The bulk of these expenditure cuts have been implemented as planned, although we understand that police department cuts have been complicated by a compensation dispute between the city and the police bargaining unit that has been tentatively resolved by lowering compensation levels in lieu of layoffs. Management says it expects these cuts to result in a virtually unchanged general fund balance in absolute terms from the $96 million or 5.6% of expenditures, at the end of fiscal 2008.

This forecast of balanced operations notwithstanding, we believe that there could continue to be challenges for the city in reaching its financial goals. We understand that the police department cuts have been politically controversial, not least because voters approved a sales tax to support enhanced public safety services. In January 2009, the city also eliminated a legally contested 911 fee that funded public safety operations, of which about $1.0 million will be absorbed by an approximately $3.8 million contingency in the city's current budget forecast. Lastly, the turnover of the city's mayor and five of its seven city council members in January 2009 creates the potential for policy shifts that we believe could affect the city's financial operations or delay currently proposed budgetary gap-closing measures.

The city's management practices are considered 'strong' under Standard & Poor's Financial Management Assessment (FMA). An FMA of 'strong' indicates that we believe the city's financial practices are strong, well embedded, and likely sustainable.

The city's direct and overlapping debt burden translates into what we consider a moderate 4.6% of market value and $3,558 per capita or 4.0% of market value and $3,127 per capita when excluding its POBs. Fiscal 2007's carrying charges, totaled -- in our view -- a low 4.2% of government-wide expenditures; the city has identified specific revenue streams to avoid putting pressure on general fund operations. We understand that the city
postponed its series 2009A sale partly due to investor concerns regarding the bankruptcy comment. Management has indicated that the city may still issue $5 million in the near term to allow it to close on a pending property sale from an overlapping school district.

Outlook
The negative outlook reflects what we view as the threat to the city’s financial position posed by the sharp downturn in revenues driven by local economic stress that does not appear to be abating. Although the city has very limited short-term control over local economic trends that affect its property and sales tax revenues, we think that the cuts the city has launched to address the forecasted fiscal 2009 revenue declines, while not entirely sustainable in the medium term, will tend toward achieving structural balance. Should these adjustments be insufficient for the city to maintain at least what we consider an adequate fiscal 2009 ending general fund balance, the rating is likely to be lowered. By contrast, accurate fiscal 2009 revenue projections and evidence that this year’s cuts have stabilized the city’s available balance at what we view as a good level would support a return to a stable outlook.

### Ratings Detail (As Of March 9, 2009)

**Stockton cert of part (Redevel Hsg Proj) ser 2003A**

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
</table>

**Stockton cert of part (Redevel Hsg Proj) ser 2003B**

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
</table>

**Stockton Pub Fincg Auth Ise rev bnds (Pkg And Cap Projects)**

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
</table>

**Stockton Pub Fincg Auth, California**

**Stockton Pub Fincg Auth Ise rev bnds (Stockton) (Building Acquisition Financing Project) ser 2007A**

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Term Rating</td>
<td>AAA/A-1/ Stable</td>
<td>Affirmed</td>
</tr>
</tbody>
</table>

**Stockton Pub Fincg Auth (Stockton) Ise rev bnds (Building Acquisition Financing Project) ser 2007B**

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A(SPUR)/Negative</th>
<th>Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long Term Rating</td>
<td>AAA/A-1/ Stable</td>
<td>Affirmed</td>
</tr>
</tbody>
</table>

Many issues are enhanced by bond insurance.

Complete ratings information is available to RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Ratings in the left navigation bar, select Find a Rating.
Rating Update: Stockton (City of) CA

MOODY'S AFFIRMS STOCKTON (CA) A2 ISSUER RATING

A3 Pension Obligation and Baa1 Lease Ratings Also Affirmed

Municipality
CA

Opinion

NEW YORK, Feb 13, 2009 -- Moody's Investors Service has affirmed the City of Stockton's A2 Issuer Rating, the A3 rating on the city's Taxable Pension Obligation Bonds, 2007 Series A&B, and the Baa1 rating on its Lease Revenue Refunding Bonds, 2006 Series A. The current rating incorporates the severe weakness in the city's real estate market and local economy, which nonetheless is likely to experience long-term growth. The rating also includes the city's narrow financial position and limited financial flexibility. Both of these factors are detailed in our July 7, 2008 rating report. The affirmation recognizes the continued weakening of the local tax base, which to date remains consistent with the current rating. The affirmation also incorporates the marginally weaker than expected fiscal 2008 results, the city's slow reaction to budgetary assumptions that proved optimistic, and, importantly, its recent tangible actions to bring its fiscal 2009 budget into balance. Significant challenges remain for the city in the current and next fiscal year; the potential for downward movement in the rating remains in the event that the city is unable to achieve financial stability over that period.

The city's assessed value (AV) decreased 1.3% in fiscal 2009, as double-digit growth in commercial, industrial and even vacant land was more than offset by the decline in residential AV. Growth in the non-residential sectors and a 2% CPI adjustment helped mitigate the $1.5 billion Proposition 8 reduction of residential AV initiated by the county assessor, netting a $275.3 million decrease to a still large $21.2 billion AV in fiscal 2009. The city reports that the county is considering further Proposition 8 reductions to residential parcels; fiscal 2010 AV is therefore likely once again to decrease. Market values are projected to continue to decline; arguably, they are reaching levels at which they could be considered underpriced, suggesting that the bottom may be approaching. The local economy continues to weaken, with unemployment reaching 14.5% as of November 2008, up from 10.8% the prior year. However the number employed also grew year-over-year, consistent with a still growing, if not thriving, economy.

The city's financial position remains narrow and its flexibility limited, even when resources outside the General Fund are taken into account. Fiscal 2008 results were somewhat weaker than the prior year, but not sufficiently so to warrant a rating downgrade. The General Fund's cash position declined from a weak $4.0 million (2.1% of revenues) to an even narrower $3.5 million (1.8%). However the city has external resources to supplement the General Fund in its Capital Improvement Fund, and selected Internal Service Funds and Special Revenue Funds. These Funds contribute much needed liquidity, adding $62 million in available cash and investments in fiscal 2008, up from $56 million the prior year. Unlike its cash, the total fund balance in the city's General Fund increased, but unreserved fund balance decreased by $6.1 million to $9.6 million, representing 5.0% of revenues (vs. 8.2% in fiscal 2007.) Available fund balances represented 18.7% of revenues in fiscal 2008, down from 21.3% in the prior year, assuming total fund balances in the General Fund are supplemented with total fund balances in the unrestricted Capital Improvement Fund, and unrestricted fund balance in selected Internal Service Funds and Special Revenue Funds, yields. The city's declining cash and fund balance positions clearly are negative credit factors, and its financial performance in the current year will be critical to maintaining the current rating.

The city has recently taken action to control expenses, a key factor in the current rating affirmation. Moody's views this as a signal of change in the city's approach to financial management, which until now had been fairly ineffective. The city was late in amending its budget to incorporate underperformance in key revenues. The city's original budget assumed 5% increases in both property and sales tax revenues. It became clear early in the fiscal year that these assumptions were optimistic, but it was not until November, nearly halfway through the current fiscal year, that the council adopted a revised budget. The revised budget was a dramatic change from the original, incorporating more realistic revenue assumptions (year-over-year decreases in property and sales tax revenues of 14% and 5% respectively) and implementing expenditure cuts which resulted in a balanced budget (vs. the $3.3 million deficit in the original). While this was a strong step, it was not clear until recently that the budgeted expenditure cuts would be realized. Most notably, the city's police department has been vocal in its opposition to the $4.9 million in service reductions and $2.7 million in combined hiring freeze and furlough equivalent reductions incorporated into the budget. Last week the city manager announced layoffs of 29 police officers, as well as layoffs and reorganizations of high-level city...
administrators. With this action, the city expects it is well on its way towards achieving the expenditure reductions assumed in its revised budget.

Strong management is going to be necessary to ensure that the current year budget will remain on track, and that the fiscal 2010 budget will be balanced as well. Moody's notes that a portion of the balance in the fiscal 2009 General Fund budget is achieved through draws on balances of funds cited as supplements above. Thus, achieving balance in fiscal 2010 will be even more critical, as total resources are likely to be even narrower at the end of the current year. Next year's budget is expected to require additional expenditure cuts given the anticipated decrease in AV; the political and managerial will to carry out these cuts will be sorely tested. Moody's affirmation of the current rating is based in large part on management's recent strong action to restore balance to its budget, and presumes such actions will continue as needed to maintain balance in the coming year. Given the magnitude of the challenge, significant risk remains that fiscal 2009 and/or 2010 will not be balanced, which would result in severe downward pressure on the rating.

Moody's notes the city's variable rate debt as posing a modest risk to the city's debt profile, which is manageable. The payments on the city's lease obligations are just under 4% of revenues, allowing that obligations paid by redevelopment housing funds are self-supporting given strong debt service coverage. The city's obligations include $40.8 million in variable rate debt, $36.5 million of which is tax exempt and $4.27 million taxable. The city already has experienced major interest rate spikes and has had some of the tax-exempt and significant portions of the taxable debt 'put' back. The city has addressed the 'puts' in part by purchasing these bonds for its investment portfolio, which is large enough at approximately $250 million to absorb them. When the city chooses not to purchase 'put' bonds, they are 'put' to the liquidity facility provider, Dexia. At this time previously tendered taxable variable rate bonds totaling $2.9 million are being held as bank bonds; an additional $900,000 is in the process of being remarketed, and would be added to the bank bond balance if these efforts are not successful. Because they are lease obligations, the bank can not accelerate repayment, so the city's risk is limited to the bank interest rate. The city does not have any swaps outstanding.

KEY STATISTICS

2006 population: 290,141

2000 per capita income: $15,405 (67.8% of state level)

2000 median family income: $40,434 (76.3% of state level)

2009 full valuation: $21.2 billion

FY08 total General Fund balance: $23.1 million (12.0% of revenues)

FY08 Unreserved General Fund balance: $9.6 million (5.0% of revenues)

FY08 Available fund balance: $36.2 million (18.7% of revenues)

Net peak lease payment as% of 2008 General Fund revenues: 3.7%

The last rating action for the City of Stockton was July 7, 2008 when the city's Issuer Rating was lowered to A2 to A1, its Pension Obligation Bond ratings lowered to A3 from A2, and the rating on its Lease Revenue Refunding Bonds, 2008 Series A was lowered to Baa1 from A3.

The principal methodology used in rating the current offering was Local Government General Obligation and Related Ratings (formerly, Determinants of Credit Quality), which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Rating Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

Analysts

Dari Barzel
Analyst
Public Finance Group
Moody's Investors Service

Michael Wartz
Backup Analyst
Public Finance Group
Moody's Investors Service
CREDIT RATINGS ARE MOODY'S INVESTORS SERVICE, INC.'S (MIS) CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

© Copyright 2009, Moody's Investors Service, Inc. and/or its licensors including Moody's Assurance Company, Inc. (together, "MOODY'S"). All rights reserved.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RE SOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All Information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or related to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."
Fitch: Los Angeles Longer-Term Outlook to "Negative" from "Stable" On Budget Challenges

(Apr. 1) — Fitch Ratings changed its longer-term outlook for Los Angeles to "negative" from "stable" because the city faces "declines in key taxation revenues," the rating agency said. An outlook change does not mean a downgrade is imminent, but it does signal a rating change is possible if current trends continue. The city's diverse economy and sizable reserves are a strength, Fitch said. We add that L.A. is a solid double-A credit.

Stockton's Bonds on Watchlist for Downgrade; Moody's Cites Large Deficit Pressure

(Apr. 1) — Moody's said it might lower the City of Stockton's ratings because of a $28 million projected deficit in fiscal 2010. The city faces at least a 15% cut in expenditures and needs labor union concessions, Moody's said. The city's issuer rating is A2, its lease-revenue bonds are currently rated Baal, and its taxable pension obligation bonds, A3. City staff has proposed cutting 200 general fund positions as part of a budget solution.

Los Angeles County MTA Sales Tax Bonds Upgraded to AA+; Resilience Even in Down Times

(Apr. 1) — Los Angeles County Metropolitan Transportation Authority sales tax revenue bonds were upgraded to AA+ from AA by Standard & Poor's. "We expect that high debt service coverage should protect against expected declines in pledged revenue through stressful economic cycles," S&P said in a statement. The size and stability of Los Angeles County's economy is a "key credit strength" for the sales tax bonds, S&P said.

Berkeley G.O. Bonds Upgraded to One Notch Below AAA Thanks to Solid Financial Reserves

(Mar. 31) — Standard & Poor's upgraded the "underlying" rating on Berkeley's general obligation bonds to AA+, or one notch below triple-A. Maintenance of "very strong reserve levels" and "proactive" budget management, along with stability provided by the presence of UC Berkeley, helped raise the rating, S&P said. The city's lease bonds rose a notch to AA. An "underlying" rating is the grade that applies in the absence of bond insurance.

California, Package-Delivery Company UPS Now Share Same "Global Scale" Moody's Rating

(Mar. 20) — On a "global scale" that examines risk of repayment and other factors, Moody's Investors Service now ranks State of California taxable bonds at the same Aa3 level as debt of UPS, the world's biggest package-delivery company. Here is an idea. Let's have UPS run the state instead of Arnold and the sorry excuse for a legislature. Then budgets would be "delivered" on time, and UPS/California would probably live within its means.

Baldy Mesa Water District Public Facilities Corp.
Bonds, COPs Put on a "Watch" List by S&P

(Mar. 10) — S&P put two debt issues from Baldy Mesa Water District Public Facilities Corp. on "watch" for potential downgrade pending review of financial statements. The action affects Series 2008 (A.D. No. 2) refunding improvement bonds and 2006 COPs. This district was merged into an entity (the Victorville Water District) in 2007 and the accounting problem is similar to one we discuss above. The city better get on this.

Bond Advisor Subscription Information

Celebrating 25 Years of Helping Investors!

Please go here to learn about subscribing.

Victorville Needs to Address Questions Over Draft Audit to Avoid "Negative" Press

(Mar. 10) — Whether or not Victorville officials agree with a draft audit saying the city didn't maintain "adequate" accounting records for fiscal 2007, S&P already put certain tax-exempt bonds on a "watch" list pending more updates. The city should get a handle on this as soon as possible to avoid "bad press." We should note that past accounting problems in San Diego (since fixed) caused downgrades, but no problems with covering payments on bonds.