



Stockton Fiscal Woes Are Not a Surprise (3/7/12)

Economic and Fiscal Strains Are Longstanding

Stockton, CA, with a population of approximately 300,000, is the largest city to skip a debt service payment following the recent recession. What makes Stockton's current morass any different from those of Harrisburg Pennsylvania, Jefferson County Alabama, and Vallejo California? In these three situations, for the most part, stress is directly attributable to specific faulty decisions, actions, and in the case of Jefferson County, corruption and criminal activity. In other words, the problems are specific to each issuer, and are not indicative of any larger economic trend.

Stockton's fiscal distress, on the other hand, is directly attributable to the core components of fundamental credit analysis which are: economy, finances, debt, and management. These problems were clearly visible and discernible over an extended period of time, and predate the recession that "officially" started in December 2007.

In our opinion, Stockton's duress, while severe, is not a harbinger of large scale credit deterioration, default, or bankruptcy filings to come in the municipal market as previously stated by Meredith Whitney back in December 2010.

Stockton's fiscal woes are illustrative of the need to adhere to disciplined fundamental credit analysis. This is a core RSW philosophy. We seek to identify *tomorrow's issues today*.

Consider some of the following longstanding easily identifiable credit weaknesses:

- The unemployment rate was as high as 10% ten years ago (21% in June 2010).
- The unemployment rate by June 2006 "*improved*" to 9.1% - more than double the state average at that time; S&P credit rating at this time was "A+".
- Wealth levels over the past decade remain low when compared to national averages. Effective buying power has consistently averaged no more than 80% of national household medians.
- Direct debt more than tripled in a two year time frame to \$375 million in June 2008, and doubled one year later to \$759 million.
- Real estate speculation and growth was largely attributed to new housing development for commuters with 60 to 80 mile return drives to the San Francisco-Oakland metropolitan area.



The premise of this article is not to outline or update the chronology of events surrounding Stockton's current missed debt payments, possible work out, or potential bankruptcy filing. The premise is solely to state that fundamental weakness was long present.

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