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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 2012-32118 D.C. No. OHS-15 Chapter 9 **DECLARATION OF KENNETH DIEKER IN SUPPORT OF CITY'S SUPPLEMENTAL MEMORANDUM OF LAW IN SUPPORT OF CONFIRMATION OF FIRST AMENDED PLAN FOR THE ADJUSTMENT OF DEBTS OF CITY OF STOCKTON, CALIFORNIA (NOVEMBER 15, 2013)**[1] Date: May 12, 2014 Time: 9:30 a.m. Dept: Courtroom 35 Judge: Hon. Christopher M. Klein

[1] Paragraph 13 of the Order Modifying Order Governing The Disclosure And Use Of Discovery Information And Scheduling Dates Related To The Trial In The Adversary Proceeding And Any Evidentiary Hearing Regarding Confirmation Of Proposed Plan Of Adjustment (Dkt. No. 1242, modifying Dkt. No. 1224) contemplates that the Parties will submit direct testimony declarations for their respective witnesses by April 21, 2014. Accordingly, the declarations submitted in support of this Supplemental Memorandum do not contain all of the information and do not attach all of the evidence that will be included in the direct testimony declarations that will be filed on April 21.

I, Kenneth Dieker, hereby declare:

1. I am the Principal of Del Rio Advisors, LLC, an independent Municipal Finance Advisor that I founded in 1991. I make this declaration in support of the City of Stockton, California's ("the City" or "Stockton") Supplemental Memorandum Of Law In Support Of Confirmation Of First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013). I advise municipal issuers on their bond issuances, including providing analyses of market conditions, bond marketability, interest rates, and bond pricing and structuring. I have over 27 years of experience in this field. I have served as a financial advisor to the City continuously since March of 2011 in connection with this case and related matters. During that period I have also served as the City's Interim Debt Manager. In addition, as a stand-alone engagement, during 2008 and 2009 I was retained by the City as the financial advisor for the City on the 2009 Golf Course/Park Bonds.[2]

The Structure Of The 2009 Golf Course/Park Bonds

2. In its Summary Objection of Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund to Confirmation of First Amended Plan of Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. 1273] ("Summary Objection"), Franklin mischaracterizes the 2009 Golf Course/Park Bonds as a "loan" from Franklin to the City. This is a misstatement of the actual structure of the 2009 Golf Course/Park Bonds.

3. Attached hereto as **Exhibit A** is a true and correct copy of the indenture for the 2009 Golf Course/Park Bonds ("Indenture"); attached hereto as **Exhibit B** is a true and correct copy of Stockton City Council Resolution No. 08-0372; and attached hereto as **Exhibit C** is a true and correct copy of Stockton Public Financing Authority Resolution No. 08-04. As reflected on page 1 of the Indenture, page 2 of the City Council Resolution, and page 2 of the PFA Resolution, the Financing Authority—not the City—authorized the issuance of the 2009 Golf Course/Park Bonds. It was the Financing Authority that issued the official statement for the 2009

[2] Capitalized terms used but not defined herein have the meaning ascribed to them in the First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1204].

Golf Course/Park Bonds ("Official Statement"), a true and correct copy of which is attached hereto as **Exhibit D**, on August 20, 2009. To accomplish the transaction, the City leased nonresidential real property to the Financing Authority, which subleased the property back to the City. Attached hereto as **Exhibits E** and **F** are true and correct copies of the lease to the Financing Authority and the sublease to the City, respectively. The Financing Authority then assigned its right to receive rental payments (along with certain other rights relevant to the enforcement of remedies) under the lease agreement to a trustee. Finally, the Financing Authority issued the 2009 Golf Course/Park Bonds and transferred the proceeds to the City for expenditure on capital improvements.

4. When Franklin purchased the 2009 Golf Course/Park Bonds, it paid the proceeds to the 2009 Bond Trustee. These proceeds were held in trust in a project fund. When the City made a written requisition, monies were withdrawn to fund improvements to various fire station facilities, the expansion and relocation of a police communication center, the acquisition and construction of parks, and street improvements. Exhibit D, pp. 15-16.

Franklin Accepted, And Was Compensated For, The Risk Of The 2009 Golf Course/Park Bonds

5. Franklin purchased the 2009 Golf Course/Park Bonds in 2009, in the middle of the "Great Recession." In the Official Statement, Franklin was put on notice that the City's economic condition was dire. The Official Statement contained a discussion of Councilmember Dale Fritchen's request in February 2009 that the City Attorney's Office prepare "an informational presentation on municipal bankruptcy," noting how "everyday there's individuals who bump into me and tell me, 'why doesn't the City just go bankrupt.'" Exhibit D, p. 27. As a result, the 2009 Golf Course/Park Bonds reflect this higher risk by providing Franklin with a greater return.

6. A proper understanding of the 2009 Golf Course/Park Bonds requires some historical context. The Financing Authority originally approved the transaction on September 9, 2008. On September 15, 2008, however, Lehman Brothers filed for bankruptcy protection, leaving many investors shaken and many markets in free fall over the ensuing weeks. The Dow Jones Industrial Average dropped from 13,058 in the second quarter of 2008 to a low of 6,547 in the second quarter of 2009. Interest rates spiked as well. This is reflected in the pre-pricing book

that I prepared for the August 2009 sale, a true and correct copy of which is attached hereto as **Exhibit G,** which is described in greater detail below. Contained on page one of the pre-pricing book is a table of interest rates and on page two is a chart of the same rates showing the Bond Buyer 20-Bond Index, the Bond Buyer 11-Bond index and the Bond Buyer Revenue Bond index along with both 10-yr and 30-yr U.S. Treasury rates over the previous year. The Bond Buyer indices are published each Thursday and are reflective of a pool of underlying transactions that make up the respective index. As displayed on these two pages, the Bond Buyer Revenue Bond Index went up from 5.17% on August 28, 2008 to 6.48% on October 16, 2008. *Id.*

7. The bond market in late 2008 through 2009 was understandably unstable. As one illustration of the bond market during this period, I was the Financial Advisor on an AA- Water Revenue Bond transaction for another Northern California city. The financing was to provide approximately $18 million of new money for projects and be repaid over a 30-year period. The bonds were publicly offered in October 2008, but only a few buyers showed interest. Buyers appeared to be hoarding cash and sitting on the sidelines waiting to see the outcome of the financial crisis. We were ultimately successful in placing the bonds as a private placement with a bank, but had to lower the amount issued to $9.25 million and shorten the term to 25 years.

8. The bond market did stabilize somewhat when President George W. Bush signed the Emergency Economic Stabilization Act (sometimes referred to as the Toxic Asset Relief Program ("TARP")) into law on October 3, 2008, which provided up to $700 billion to be used to purchase troubled assets. However, those same dollars were directly infused into the banking system to provide much needed liquidity. Interest rates remained very choppy through the end of 2008 with the Bond Buyer Revenue Bond Index dropping under 6.00% on November 13, 2008 but climbing again to 6.39% on December 11, 2008. At the beginning of 2009, interest rates began a steady decline reaching 5.67% on February 12, 2009.

9. In February of 2009, the City initially attempted to market the 2009 Golf Course/Park Bonds. On February 19, 2009, the 2009 Golf Course/Park Bonds were offered in a public offering, and the City entered into a Bond Purchase Agreement with RBC Capital Markets as the underwriter for the 2009 Golf Course / Park bonds, with closing (delivery of and payment

for the 2009 Golf Course/Park Bonds) scheduled to occur approximately 2 weeks later. That same night, February 19, 2009, Councilmember Dale Fritchen requested information from the City Attorney's office on municipal bankruptcy as described above. The buyers of the 2009 Golf Course/Park Bonds who had placed orders with RBC Capital Markets, upon hearing this information, demanded that the City release them from those orders, and RBC was forced to request that the City cancel the sale pursuant to the Bond Purchase Agreement. The City granted the buyers' request. The deal then sat dormant for a number of months.

10. Later that year, RBC Capital Markets investment banker Bob Williams approached me about reviving the deal. His firm had a potential buyer (Franklin) interested in the 2009 Golf Course/Park bonds. The City was still interested in moving forward and I was involved in the process of updating the official statement and the underlying rating. By that time, Councilmember Fritchen had publicly raised the risk of bankruptcy and developers had begun petitioning the City Council for lower development fees in response to the economic downturn. The City was in shaky economic condition, and the interest rates on the 2009 Golf Course/Park Bonds and their two-term bond structure reflect that risk.

11. Based on my 23 years of experience in this field (as of 2009), I believe that the 2009 Golf Course/Park Bonds, compared to the City's other existing bond issuances and to bond transactions of other issuers being offered at the time, were sold to Franklin at higher yields and with a term bond structure that clearly compensated Franklin for their risky investment. Attached hereto as **Exhibit G** is a true and correct copy of the pre-pricing book that I prepared for the August 2009 sale, which contains general market interest rate historical information and recent municipal market articles, and compares the 2009 Golf Course/Park Bonds with other bond deals from the same time period.

12. It is part of my normal process when pricing bonds to prepare a pre-pricing book that shows general market interest rates, articles related to the bond market at the time of the sale, and several comparable sales for other transactions being sold around the same time. I use this book to educate the issuer at the time of sale as to the market conditions, allowing the issuer to make an informed decision about the final pricing. As the comparison in Exhibit G demonstrates,

Franklin offered to purchase the deal with two term bonds: one with a coupon of 6.75% with a yield to maturity of 7.00% maturing in 2029 with sinking fund payments from 2013 to 2029, and another with a coupon of 7.00% with a yield to maturity of 7.15% maturing in 2038 with sinking fund payments from 2030 to 2038. Term Bonds are typically used to aggregate the principal amount of the offering into larger single maturities with a single interest rate based on the maturity date. Principal is amortized through sinking account payments that pay off portions of the term bond early. In my experience, this structure is preferred by large institutional buyers who want a large single maturity, and are not willing to accept a lower rate for earlier amortization. In contrast, a serial bond structure takes advantage of the yield curve (the fact that interest rates tend to be lower for shorter maturities) by breaking each principal amortization payment into a separate bond with its own maturity. This achieves a lower overall cost for the issuer, but means many smaller pieces of the bonds and a lower return to an institutional buyer who wants to buy a large amount of a transaction. The 2009 Golf Course/Park Bonds had only two large term bonds, and no serial bonds, because they were designed for a single purchaser – Franklin.

13. When I compare this to the other deals from the same time period, all of them have both a serial and term structure where the serial maturities allow an issuer to take advantage of lower yields at the shorter end of the yield curve only terming bonds for a particular institution or at the long end of the yield curve where the curve flattens. The presentation I prepared uses the AAA Standard and Poor's ("S&P") scale published each day in the Bond Buyer and compares, on a maturity by maturity basis, the spread to the AAA S&P scale from the date of that sale to the spread on the date of the 2009 Golf Course/Park Bonds sale. The tables also compare the actual spreads between deals.

14. At the time of the issuance of the 2009 Golf Course/Park Bonds, the City was rated A by Standard & Poor's with a Negative Outlook. However, at that time in general, the market considered lease transactions with a general fund promise to pay and underlying leased assets to be stronger than other transactions, such as redevelopment tax increment or land-secured assessment and Mello-Roos transactions, but not as strong as general obligations bonds for school

districts with the ability to put the full amount of debt service on the property tax role and collect on property owner tax bills or water and sewer bonds backed by the ability to increase user rates and charges.

15. Comparing the S&P spread allows an issuer to evaluate deals that may be sold at different times. Spreads do widen and narrow from time to time so the closer to the sale date, the less likely the analysis will pick up spread movements. This is not an exact science, and the municipal market is not as efficient as pricing on U.S. Treasuries and stocks. However, as reflected by the Comparable Sales analysis in Exhibit G, the spreads for the BBB-rated (lower rating than the 2009 Golf Course/Park Bonds) San Francisco Redevelopment Financing Authority, Tax Allocation Bonds deal sold on August 20, 2009 ranged anywhere from +217bp in 2013, +187bp in 2029 to +180bp in 2038 over the AAA S&P scale. Exhibit G at 1. Tax allocation bonds were considered weaker credits because the agencies have no taxing authority and are subject to movements in assessed values, compared with the City's General Fund, the source of payment for the 2009 Golf Course/Park Bonds, which can pay from all available resources. Even the S&P A-rated (same rating as the 2009 Golf Course/Park Bonds) Lancaster Redevelopment Agency deal sold on August 17, 2009 ranged from +225bp in 2013, +196bp in 2029 to +207bp in 2038.

16. One can make the same comparison for each of the deals on the four comparable sales pages. The City of Oakland, General Obligation Bonds from July 22, 2009 show the narrowest spreads, ranging from +83bp in 2013, +92bp in 2029 to +105.2bp in 2038. In contrast, the 2009 Golf Course/Park Bonds range from +531bp in 2013, +243bp in 2029 to +221bp in 2038 for an average non-weighted spread of +308.5bp as compared to the +197.1bp for the San Francisco issue, +216bp for Lancaster, and +101.1bp for Oakland. Moreover, Franklin offered to buy these as two term bonds with sinking fund payments at 6.75% and 7.00% respectively, meaning that the City pays that interest rate for the entire term of the bond, compared to transactions where a serial and term structure is used to reduce the cost to the issuer. The bottom line is that Franklin obtained a beneficial spread to other comparable issues of between 92.5 bp (.925%) and 207.4 bp (2.074%) for the 2009 Golf Course/Park Bonds.

17. In light of this analysis, I believe Franklin saw an investment opportunity where other buyers were wary, and that in exchange, Franklin could obtain higher yields than other comparable issues pricing around the same time.

City Gained Valuable Concessions In Its Settlements With Ambac, Assured, And NPFG

18. During mid to late 2013, as the City's financial advisor, I participated in many of the City's negotiations with Ambac, Assured, Franklin, and NPFG. After devoting thousands of hours to negotiations with these creditors, the City has reached agreements with three of them: Ambac, Assured, and NPFG. I am familiar with the terms of these three agreements.

19. On pp. 46-47 of its Summary Objection, Franklin presents a chart that purports to show the distributions that the City will make to Ambac, Assured, and NPFG. This chart is seriously misleading, and does not accurately characterize the settlements that the City reached with these creditors.

20. The first major flaw in Franklin's characterization of the settlement distributions to Ambac, Assured, and NPFG is that Franklin fails to take into account the valuable concessions that each settlement gave the City. The most valuable concession was the reduction of the potential exposure for the General Fund to provide any subsidy to make future debt service payments on the restructured transactions. Because of the importance of the General Fund to the City's financial health, limiting its long-term exposure is essential to the City's continuing viability.

21. Second, Franklin's chart fails to mention the collateral implicated by each deal. Ambac, Assured, and NPFG each control collateral that is significantly more valuable to the City's ongoing health than the leased properties underlying the 2009 Golf Course/Park Bonds. The properties underlying the debt insured by each of these creditors serve important municipal functions, and the City, in the exercise of its business judgment, has determined that they cannot be sacrificed.

22. Finally, Franklin's chart is simply wrong on some of the numbers for the settlements with Ambac, Assured, and NPFG:

Ambac Settlement. The Ambac Bonds, aka the Certificates of Participation, Series 2003 A&B (Housing Projects) ("2003 COPS"), are insured by Ambac. The 2003 COPs were sold as a General Fund lease transaction with the leased premises as the Main Police Facility, Fire Stations 1, 5 and 14 and the Maya Angelou Library. These are essential City assets that provide, at least in the case of the Main Police Facility and the three fire stations, a critical health and safety function for the City. In addition to the lease payments by the City, the 2003 COPs are payable under a Reimbursement Agreement from 20% housing set-aside tax increment which encompasses all of the City's project areas. The 2003 COPs are also subordinate to tax allocation housing bonds sold by the redevelopment agency in 2006. The City negotiated with Ambac to structure a deal that capped the amount of General Fund subsidy required in any given year to 80.50% of annual debt service. First, to the extent needed, the reserve fund for the bonds will be used to pay any shortfall of debt service until exhausted. If a shortfall remains, the General Fund will subsidize payments up to 80.50% of annual debt service. If the City reaches the 80.50% cap, Ambac will make any remaining payments until bondholders are paid in full. If and when tax increment grows in excess of annual debt service, the Ambac payments will be on the Recognized Obligation Payments Schedule ("ROPS"), a schedule delineating the enforceable obligations of Stockton's former Redevelopment Agency, to be repaid from tax increment. Once the Ambac payments are repaid in full, any draws on the reserve fund will also be on the ROPS to be repaid from tax increment. Since the structured transaction revolves around changes in assessed values within all the project areas and the ultimate receipt of tax increment from those project areas, it is impossible to predict the present value impairment to Ambac. If economic growth in the City returns, it is likely this obligation will be paid in full. However, the timing of those repayments could be delayed depending on how much tax increment is available each year and how much the Ambac payments accrue interest before they are repaid.

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__NPFG SEB Settlement__. The NPFG SEB Bonds, aka the 2006 Lease Revenue Refunding Bonds, Series A, were sold as a standard General Fund lease transaction with the Stewart/Eberhart Building and the adjacent parking garage as the leased premises. Also known as the Essential Services Building, the Stewart/Eberhart Building houses many essential city departments including Public Works. Because of the essential status of the leased premises, the City assumed this lease, has made all payments in full and on time and the bonds remain unimpaired.

__NPFG Arena Settlement__. The NPFG Arena Bonds, aka the Redevelopment Agency of the City of Stockton, Revenue Bonds, Series 2004, were sold as a General Fund lease transaction pursuant to which the City makes leases payments to the Redevelopment Agency (now the Successor Agency to the Redevelopment Agency) for the right to the use and occupancy of the Stockton Events Center and Arena. In addition, there is a pledge of tax increment from the West End Project Area where Pledge Payments are made to the City under a Pledge Agreement and those monies are used to pay debt service each year. If there is a shortfall, the General Fund provides a backstop to subsidize any required payment not otherwise satisfied. The City and NPFG negotiated knowing that the Pledge Payments will be paid regardless of the General Fund payments. Currently tax increment from the West End project area is not sufficient to fully repay the bonds each year. The City and NPFG agreed to a reduced schedule of payments and took this agreement to the California Department of Finance for approval under AB x1 26 and AB 1484 provisions. The General Fund remains as the backstop, but on a schedule that further reduces the need for future General Fund subsidies. The City was faced with a possible shuttering of the facility and the possible collateral economic damage to the downtown while the local taxpayers would still be paying for the obligation in full from property tax payments paid via tax increment. The actual repayment of this obligation, much like on the 2003 COPs, is dependent upon future assessed values and the flow of tax increment.

NPFG Parking Settlement. NPFG Parking Bonds aka Lease Revenue Bonds, Series 2004 (Parking and Capital Projects). These bonds were sold as a standard lease transaction with three parking garages (Arena, Ed Coy and Market Street) serving as the leased premises. The City and NPFG agreed to form a new Parking Authority, the City agreed to move all of the City's parking assets into the new Parking Authority, and NPFG agreed to a reduced payment schedule in exchange for a gross revenue pledge from the new Parking Authority revenues. The leased assets remain the same, and the City anticipates that the parking revenues—as opposed to the General Fund—will pay the debt service on the restructured obligation.

Assured Guaranty Settlement. The Assured Guaranty Settlement affects both the Pension Obligation Bonds, aka 2007 Taxable Pension Obligation Bonds, Series A and Series B (the "POBs"), and the Assured Office Bonds, aka the Variable Rate Demand Lease Revenue Bonds, 2007 Series A and Taxable 2007 Series B (Building Acquisition Financing Project) (the "VRDOs"). Assured Guaranty has asserted that the POBs have special status because they represent the same underlying liability as the City's other pension funding obligations (which are being assumed under the Plan) and are thus obligations imposed by law (which City confirmed at the time of issuance of the POBs through a validation action under California Code of Civil Procedure section 860 et seq.). The Assured Guaranty Settlement shifts the proposed "Ask" payments originally slated for the Assured Office Bonds to the POBs along with $250,000 of additional payments each year starting in 2023. The City also agreed to pay the portion of debt service payable on the POBs from restricted funds to the POBs. These restricted fund payments would otherwise go to pay pension benefits or to repay the POBs; these restricted funds are not part of the General Fund.

At the time of the "Ask", the restricted fund payments were estimated at 17.38%, consisting primarily of water/sewer, gas tax, and Measure W funds. The ratio of City employees compensated solely or partially from the General Fund and those compensated from Restricted Funds varies from year to year, depending on, among other things, the number of employees paid from each fund. Based on historical and projected data, a reasonable estimate of the amount of pension obligations that are funded from Restricted Funds is about 17%. Assured and the City agreed on this percentage as a fixed amount each year. Because approximately 17% of City's pension obligations may lawfully be funded by special fund revenue, such revenues may be used to pay 17% of the debt service obligations on the POBs.

The VRDOs were sold as a standard General Fund lease with 400 E. Main serving as the leased premises. In exchange for shifting the "Ask" payments from the VRDOs to the POBs, Assured agreed to terminate the lease payments under the VRDOs. The City also entered into a near-term lease for office space in the building to turn such space into City Hall. Although from the City's perspective the VRDOs obligation was terminated, the City agreed to possession by Assured of 400 E. Main with title to shift at some future date.

The Assured POBs settlement was an essential part of the overall deal struck between the City and Assured, overseen by Judge Perris, which was necessary to ensure the City's continued use of 400 E. Main for the next 12 years. The Assured POBs settlement provides for payments from the City's restricted funds, which the City believes will be available to make those payments. The POBs funded payment of pension benefits for City employees, including current and retired City employees whose compensation and benefits were paid by monies from the General Fund as well as those whose compensation and benefits were paid by monies from Restricted Funds. As explained in the declaration of Vanessa Burke in support of the City's eligibility for bankruptcy relief [Dkt. No. 62], such Restricted Funds may not be used to pay General Fund obligations unrelated to such Restricted Funds. They may, however, be used to pay obligations related to the Restricted Funds.

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Assured also is entitled to certain Contingent Payments based on a formula that measures the amount of those payments by reference to the amount by which the City's general fund revenues exceed the City's budget forecast over time. There is no assurance that any contingent payments will be made and the amount of those payments cannot therefore be calculated or determined at the present time.

Executed this 31st day of March 2014, at Modesto, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Kenneth Dieker