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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 12-32118 (CMK) D.C. No. OHS-15 Chapter 9 Adv. Proceeding No. 13-02315-C
WELLS FARGO BANK, NATIONAL ASSOCIATION, FRANKLIN HIGH YIELD TAX-FREE INCOME FUND, AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND, Plaintiffs. v. CITY OF STOCKTON, CALIFORNIA, Defendant.	**FRANKLIN HIGH YIELD TAX-FREE INCOME FUND AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND'S EVIDENTIARY OBJECTIONS TO DIRECT TESTIMONY DECLARATION OF ROBERT LELAND IN SUPPORT OF CONFIRMATION OF FIRST AMENDED PLAN FOR THE ADJUSTMENT OF DEBTS OF CITY OF STOCKTON CALIFORNIA (NOVEMBER 15, 2013)** Date: May 12, 2014 Time: 9:30 a.m. Dept: C, Courtroom 35 Judge: Hon. Christopher M. Klein

Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund (collectively, "<u>Franklin</u>") respectfully submit the following evidentiary objections to the *Direct Testimony Declaration Of Robert Leland In Support Of Confirmation Of First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013)* [Docket Nos. 1388-92 / Adv. Pro. Docket Nos. 81-85]. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

PARAGRAPH OBJECTED TO	GROUNDS FOR OBJECTION
3. In preparing the LRFP, the City considered as many contingencies as possible in order to develop the most realistic revenue and expense projections that it could to demonstrate solvency over a prolonged period of time. Its revenue and expense projections are conservative relative to the pre-recession magnitude of estimates that got the City into trouble in the first place, but grounded in post-recession reality.	Franklin objects to the statements in this paragraph because they are vague and lack foundation. FED. R. EVID. 602. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.
4. The City's basis for its projections of revenues from the property tax (24% of projected FY 2014-15 total revenues) and sales tax (36% of projected FY2014-15 total revenues) begins with the reports prepared by its consultant and auditor, HdL. True and correct copies of the HdL projections of property and sales tax revenues that underpin the LRFP are attached hereto as **Exhibits A** through **K**. The City's property tax forecast goes on to project each of the four elements contributing to property tax growth: estimated changes in ownership, new construction based on projected development levels, Proposition 8 increases based on the potential for valuation recoveries, and the annual Proposition 13 inflator. <u>This analysis militates against unwarranted optimism in the expected growth of future property tax revenues, which under this forecast increases an average of 3.9% annually over the next 10 years</u>. Starting April 1, 2014, sales tax revenues will include approximately $28 million per year in new revenues as a result of the passage of Measure A. On March 5, 2014, the City obtained updated sales tax information from HdL for the third quarter of	Franklin objects to the statements in this paragraph because Mr. Leland's description of the HdL projections are not the best evidence of those documents. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the italicized statements in this paragraph because they are inadmissible hearsay. FED. R. EVID. 801, 802.

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2013, but based on subsequent concerns raised by HdL[2] the City determined that it was premature to update its sales tax projections from those in the revised LRFP, which currently grows by an average of 3.4% annually over the next 10 years. *fn2: On March 14, 2014, Lloyd deLlamas of HdL provided the following update: "Just as a heads up, we just downloaded the results of Stockton's holiday quarter and the results particularly in the pool receipts were somewhat lower than anticipated. Although all of the pools for the 58 counties were up 7.8% over the same quarter a year ago, Stockton's share of the San Joaquin county pool was only up 3.7%. Stockton's Christmas quarter was surprisingly disappointing. Although total receipts were up 4.5% over last Christmas, the revenues were inflated by adjustments to make up for late payments last quarter. The actual increase after all aberrations are factored was 1.7%. Given these numbers, the growing concerns regarding a continuing drought on the Central Valley's economy and recent speculation that Amazon may convert their tax allocations from the county pools to the three fulfillment centers, we will be re-evaluating the projections provided just a few weeks ago. The data is still in raw form and it normally takes us three weeks to identify and assess all of the variables that impact each quarter's allocation of sales and use tax by the Board of Equalization, update our quarterly economic forecasts and then focus in on projections for individual clients. Brice Russell will be performing this quarter's analysis for Stockton. He and I will work together and provide you updated projections by mid-April."*	
5. The City's projections of utility user tax ("UUT") are also realistic. The foundation for these projections is an analysis of gas, electricity, cable, and telecommunication trends by City consultant MuniServices, and staff assessment of the tax on usage of its water utility. Given the impact of water and energy conservation efforts by utility customers, and changing technology trends affecting usage of telecommunications and cable, it is unlikely the ongoing revenue growth will exceed the 1.5% projected in the	Franklin objects to the underlined statements in this paragraph because they are vague, speculative, and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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LRFP.	
6. The LRFP does not attempt to predict or project that amount of public facilities fee ("PFF") revenues to be collected for future years. This is because the LRFP is a projection of General Fund revenues and General Fund expenses, and restricted funds, such as PFF revenues, are not General Fund revenues. Franklin has interpreted one statement in the text of the LRFP to mean that the City expects to collect $500,000 in PFF revenues that are available to pay Franklin, even though the Plan does not provide for Franklin to receive these PFF revenues. Franklin's interpretation is not what was intended by the statement.	Franklin objects to the statements in this paragraph because Mr. Leland's description of the Long-Range Financial Plan is not the best evidence of that document. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they assume facts not in evidence and misstate Franklin's arguments.
7. The model attached to the LRFP as Attachment "A" was prepared to mathematically calculate the savings to the General Fund expected to be achieved by the City in future years as a result of the City's restructuring of its various financial obligations. The cost to the City for the lease rent payable under the Golf Course/Park Lease Back was approximately $2.9 million per year. However, the General Fund had not paid all $2.9 million of those lease payments, so it would have been inappropriate to show a $2.9 million savings per year as a result of the City rejecting the Golf Course/Park Leases. At the time of the preparation of the financial model for the LRFP, which was last summer, the City's best estimate of future PFF revenues was such that about $500,000/year of PFF revenues could have been available to make the lease payments if the Golf Course/Park Leases were not rejected. Thus, the financial model showing the savings to the City of the financial restructurings reduced the savings from rejection of the Golf Course/Park Leases from $2.9 million in lease payments, to $2.9 million minus the assumed amount of $500,000 of available PFF revenues, for a net savings to the General Fund of $2.4 million.	Franklin objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because Mr. Leland's description of Attachment "A" to the LRFP is not the best evidence of that document. FED. R. EVID. 1002.
8. In March 2014, at Franklin's request, I also prepared a second financial model of the LRFP that, instead of demonstrating the saving of the restructurings to the City, simply shows future projected General Fund revenues and projected General Fund	Franklin objects to the statements in this paragraph because Mr. Leland's description of Attachment "A-1" to the LRFP is not the best evidence of that document. FED. R. EVID. 1002.

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expenditures (Attachment "A-1" to the LRFP). There are no PFF revenues set forth in that financial model since PFF revenues are not General Fund revenues. Attachment A-1 shows zero ongoing net expense to the General Fund for the 2009 bonds owned by Franklin.	
9. With respect to the issue of whether the City will collect enough in PFF revenues to satisfy the obligations for which those future PFF revenues must be used, the downturn in development in Stockton and the resulting nosedive in PFF revenues has dramatically decreased the City's ability to make payments from PFFs. While the future expectation is that upon recovery the Stockton market will be able to absorb 700 residential units per year, this is far below the historical peak level of almost 3,000 per year during the early 2000s. And precisely when that recovery will occur is still in question. Since the creation of the housing absorption study by consulting firm Economic & Planning Systems, Inc. ("EPS") in the second calendar quarter of 2013, the City's estimate of residential building permits to be issued from FY2012-13 through 2016-17 has dropped 63% to 1,850, from the EPS original estimate of 4,668. All of the factors discussed in the Direct Testimony Declaration of Steven Chase ("Chase DTD") place significant constraints on the availability of PFF funds for anything other than the infrastructure improvements for which the PFF revenues are collected, and little or nothing for payment of debt service to creditors.	Franklin objects to the underlined statements in this paragraph because they are vague, speculative, and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because Mr. Leland's description of the EPS study is not the best evidence of that document. FED. R. EVID. 1002.
10. The LRFP projects that, with the savings from the financial restructuring described in the Plan as well as new revenues from the passage of Measure A, the City will achieve a balanced and sustainable budget. The projected levels of sales tax revenues, property tax revenues, UUT, and other taxes, fees, and revenues will enable the City to maintain and fund adequate municipal services, including fire and police protection, as well as to satisfy the City's obligations to its creditors as restructured pursuant to the Plan.	Franklin objects to the statements in this paragraph because Mr. Leland's description of the LRFP is not the best evidence of that document. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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11. Attached hereto as **Exhibit M** is a true and correct copy of a publication by the Government Finance Officers Association (GFOA) titled "Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (BUDGET and CAAFR)." It is publicly available online at http://www.gfoa.org/downloads/ AppropriateLevelUnrestrictedFundBalance GeneralFund_BestPractice.pdf. In this publication, the GFOA "recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund." *Id*. at 1. It further recommends "at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular fund operating revenues or regular general fund operating expenditures." *Id*. at 2. This recommended balance translates to 16.67% of total expenditures.	Franklin objects to the statements in this paragraph because Mr. Leland's description of the GFOA Best Practices document is not the best evidence of that document. FED. R. EVID. 1002.
12. In 2006, the City Council adopted a resolution approving a policy that aspired to maintain in the General Fund a "catastrophic reserve" that is "equivalent to five percent of the General Fund annual appropriations and transfers out" and an "economic contingency/budget uncertainty reserve" that is also "equivalent to five percent of the General Fund annual appropriations and transfers out." *City of Stockton Council Policy No. 700-4, Reserve Policy—General Fund*, adopted by Resolution 06-0299 (June 6, 2006). <u>However, as the City's financial health began to deteriorate, it became clear that this total reserve of 10% was inadequate.</u> The last time the 10% reserve policy is mentioned in a City budget was June 11, 2010, with the release of the FY 2010-11 Annual Budget. In the LRFP, any resources in excess of the more conservative level of 15% of total expenditures are assumed available to be applied toward unmet operating needs, however, it is projected that the City will not achieve a 15% reserve level until FY 2032- 33. In its fourth quarter financial review for FY 2013-14 held on February 25, 2014, the City staff report cited the GFOA's recommended reserve policy of two months of operating revenues or expenditures and now recommends moving toward that level of reserve.[3] <u>By inference,</u>	Franklin objects to the statements in this paragraph because Mr. Leland's descriptions of the City Council resolution, the LRFP, and the staff report are not the best evidence of those documents. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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this supersedes the City's 2006 policy of a 10% total reserve. Currently, it is projected that the City will not achieve a 16.67% reserve level until FY 2033-34. If the City's finances were more favorable than currently projected, the City could achieve its operating reserve goal earlier. fn3: "The Government Finance Officers Association recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their General Fund of no less than two months of regular General Fund operating revenues or General Fund operating expenditures, which is equivalent to 16.7% of those amounts. Cities with formal reserve policies generally specify between 10-20% reserve levels. The Administration now recommends that the portion of the Ending Fund Balance ($3.1 million) that resulted from the unanticipated refund of County Property Tax Administration Fees (explained in detail later in this report), be retained in the General Fund to help build the available fund balance. With a balance of $3.1 million (or just under 2%), the City is still substantially below these recommended levels. This recommendation is made to provide a small step towards building up one-time monies to meet the many unfunded, but mission critical needs for spending." *See* Council agenda report #14-0202, February 25, 2014, a true and correct copy of which is attached hereto as **Exhibit L**.	
13. Franklin's suggestion that a reserve fund of 10% or less is sufficient and that money from this fund is available to pay the 2009 Bond Claim indicates a deep misunderstanding of the purpose of reserves. Reserves are a one-time resource designed to help bridge a downturn in the economy that results in lower revenues than projected, or to help meet an unexpected one-time increase in expenditures. Reserves are not available to pay an ongoing increase in obligations such as the 2009 Bond Claim. If the General Fund began paying the full $2.9 million in 2009 Bond debt service starting in the current fiscal year 2013-14, the General Fund would be in deficit within six years.	Franklin objects to the underlined statements in this paragraph because they assume facts not in evidence and misstate Franklin's arguments. Franklin further objects to the statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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14. In addition to these reserves, the LRFP also incorporates a $2 million per year annual contingency (approximately 1% of expenditures). The purpose of this annual contingency is, like an annual operating reserve, to protect the City against financial setbacks. However, whereas an annual operating reserve represents one-time emergency resources to deal with short-term issues, the annual contingency serves as a *long-term* buffer against natural swings in economic conditions. As evidenced by the recent recession, economic downturns can cause a city to fall short of its projections by millions, or even tens of millions, of dollars over several years. Moreover, it may take several additional years for a city's revenues to return to their prior peak year total, much less the level to which revenues would have grown given a continuation of prerecession trends. For example, in FY2013-14 Stockton is still $36 million below the $203 million in General Fund revenue it received five years earlier in its peak fiscal year of 2008-09, and the City is $93 million below the trended level of revenue produced by a continuation of the General Fund growth rate that occurred in Stockton from FY1996-97 through FY2006-07. The annual contingency is meant to provide a safeguard against these types of long-term setbacks by serving as a "smoothing" mechanism – that is, the annual contingency spreads the impacts of economic downturns over the entire period of the LRFP. This allows the City to make projections of its future finances without having to make predictions about the timing or severity of future recessions, with a reasonable level of assurance that adequate resources will always be available to support the projected level of expenditures.	Franklin objects to the statements in this paragraph because Mr. Leland's description of the LRFP is not the best evidence of that document. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.
15. Franklin argues that the $2 million annual contingency is unnecessary, and contends that the City can simply pay that money to Franklin instead. *This argument completely misses the importance of the annual contingency to the City's projections and the City's long-term fiscal health. While the City could theoretically eliminate the annual contingency from the LRFP, the LRFP itself would then need to be altered in order to incorporate predictions as to the timing and magnitude of economic swings*	Franklin objects to the underlined statements in this paragraph because they assume facts not in evidence and misstate Franklin's arguments. Franklin further objects to the italicized statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the italicized statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to

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and the impact of such swings on the City's finances. The reduction in contingency expenditures within the forecast would be offset by the loss of resources from the projected economic downturns. Given the inherent difficulties of predicting recessions, particularly over a 30-year period, budget forecasts do not typically do so, but rather opt for a realistic linear growth trend for revenue and either build in a buffer against future variations or require significantly higher reserves.[4] *However, if the City were to eliminate its $2 million contingency and incorporate recessions into its revenue forecast, and at the same time increase expenditures by $2 million annually to make payments toward the 2009 Bond Claim, current projections indicate that this would cause the General Fund balance to rapidly erode and result in a deficit within 7-9 years, depending on the timing and severity of the recessions, which in turn would require another restructuring of City finances.* fn4: *The City of Sunnyvale is the "gold standard" for long-range financial plans, in that it has been adopting 20-year budget forecasts bi-annually since the 1980's. Sunnyvale's current reserve policies are as follows: (1) "The General Fund Contingency Reserve will be maintained at 15% of operations costs in year one of the long-term plan, with annual increases based on projected increases in the Consumer Price Index", (2) "The Budget Stabilization Fund will be a minimum of 15% of projected revenues for the first two years of the 20-year planning period. Beyond year two the Budget Stabilization Fund will always have a balance of at least zero", and (3) "The Twenty-Year Resource Allocation Plan Reserve shall be used to levelize economic cycles and maintain stable service levels over the long term." (http://sunnyvale.ca.gov/Portals/0/Sunnyvale/CodesAndPolicies/7.01.01.pdf) Sunnyvale's total projected reserves for FY2013-14 total $92.7 million, which is 63% of its budgeted total requirement of $146.6 million. Sunnyvale does not attempt to predict the timing of recessions, but rather uses relatively linear forecasting trends (as does Stockton); its projected property tax revenue averages 3.8% annual growth from FY2013-14 through 2032-33 (compared to 3.4% for Stockton over the same period), and its sales tax revenue*	which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because Mr. Leland's description of Sunnyvale's long-range financial plan is not the best evidence of that document. FED. R. EVID. 1002.

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averages 2.9% annual growth (compared to 3.1% for Stockton over the same period).	
16. The City must be sustainable. The City recognizes that its financial plans and budgets, however sound, will need to be amended as economic and financial circumstances change. Maintaining a healthy reserve is essential to weather the “worst case scenarios” where the City does worse than anticipated. <u>The operating reserves and the annual contingency projected in the LRFP are necessary to sustain the City as a viable municipality.</u> This has been the City Council’s overarching policy objective starting with the AB 506 process initiated in early 2012. <u>This is in the best interests of the City and its residents. Raiding these reserves for payments to Franklin would imperil the City’s financial viability.</u>	Franklin objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland’s knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.
17. Similarly, if the City were to substitute Franklin’s business judgment for its own by submitting a plan that impaired CalPERS, Franklin would fare worse than it would under the City’s Plan. If the City were to impair CalPERS, then CalPERS would have an immediate unsecured claim worth approximately $1.62 billion.[5] The claim from CalPERS would represent 73.3% of the unsecured claims pool, compared with a roughly 24.7% share for Retiree Health Benefit Claimants ($545 million) and an approximate 1.58% share for Franklin (even assuming the Franklin claim is in the amount of $35 million as opposed to $10.4 million). fn5: This $1.62 billion is the amount which CalPERS claims it would be due as the total of the “Unfunded Termination Liability” for the combined Safety and Miscellaneous plans, using the “Termination Liability Discount Rate” of 2.98%, the yield of the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. Attached hereto as **Exhibits N** and **O** are true and correct copies of excerpts from the CalPERS Annual Valuation Reports as of June 30, 2012 for the Miscellaneous and Safety Plans for the City of Stockton, respectively. See page 28 of Exhibit N and page 28 of Exhibit O for CalPERS’ calculation of the “Unfunded Termination Liability” for the Miscellaneous and Safety Plans, respectively. Because the	Franklin objects to the statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the statements in this paragraph because they contain improper legal conclusions. FED. R. EVID. 701. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland’s knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because they misstate Franklin’s arguments.

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City intends not to terminate the CalPERS contracts, the City has not researched this number and thus does neither agrees nor disagrees with this amount.	
18. *On the expense side, the City's projections of its CalPERS obligations are sound*. In September 2013, the City received a long-range projection of CalPERS employer rates[6] for its Safety and Miscellaneous employee plans from its actuary, The Segal Company ("Segal"), using the CalPERS June 30, 2011 valuation, the latest then available, and taking into account the following anticipated changes[7]: a. Rate smoothing and unfunded liability amortization changes phased in over five years. These changes would result in significant short-term increases in rates, but with fixed periods for amortization, rates would drop as various "layers" of unfunded liability become fully amortized, ultimately leaving only the levy of a rate for "normal" costs with prior unfunded liabilities completely paid off and all employees under the Public Employees' Pension Reform Act (PEPRA) level of benefits. These changes were subsequently reflected by CalPERS in its June 30, 2012 valuations (which became available after the Segal forecast). Act (PEPRA) level of benefits. These changes were subsequently reflected by CalPERS in its June 30, 2012 valuations (which became available after the Segal forecast). b. Mortality Improvements, reflecting longer beneficiary lifespans, phased in over five years. These were adopted by the CalPERS board in February 2014 and should be reflected in the June 30, 2013 valuation reports due later this year. c. Discount Rate Reduction. The City's projections include the assumption that an additional reduction of 0.25% in the discount rate (the assumed investment return for actuarial purposes) would be approved by the CalPERS board. If the discount rate is reduced, employer rates go up significantly, given that approximately 70% of CalPERS income comes from investment returns. Two years ago the CalPERS staff recommended a 0.5% reduction in the discount rate, from 7.75% to 7.25%. The CalPERS board enacted	Franklin objects to the italicized statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the italicized statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because Mr. Leland's description of the Segal valuation is not the best evidence of that document. FED. R. EVID. 1002.

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half of that amount, a 0.25% reduction to 7.5%, and deferred action on the second half of the staff recommendation. To date the board has not acted on the second 0.25% reduction. *Given favorable investment returns the past two years (the forecast assumed a 12.5% CalPERS investment return for FY2012-13), and the cumulative impact of rate increases on member agencies that resulted under (a) and (b) above, there may be a disincentive for the board to act on this item in the near-term.* A board workshop on risk has been proposed for later this year. The City's projections, by including a discount rate cut, prudently assume the potential for an additional rate increase. d. Payroll Adjustments. The unfunded liability portion of pension costs is a fixed amount, but the payment to CalPERS is determined by multiplying the unfunded rate supplied by CalPERS to the City's payroll. There is a three-year lag between the last year CalPERS has actual payroll data from the City (e.g., FY2011-12), and the year for which CalPERS is issuing its newest rate (for FY2014-15), and CalPERS bridges the gap by assuming that the historical payroll last reported increases by 3% annually. If the City's payroll for the rate year in question (FY2014-15) is less than estimated by CalPERS, the unfunded rate provided by CalPERS will prove to be too low to generate the payments expected from the City by CalPERS for purposes of unfunded liability amortization, and in subsequent years that unfunded portion of the rate will need to be increased. *This outcome of payroll being less than the CalPERS actuarial projection has proved to be an issue statewide as many cities have cut positions and reduced compensation, as has Stockton, and thus wind up with lower payroll than in the CalPERS actuarial valuation.* In an effort to better reflect the impacts on the unfunded portion of the employer rate, Segal's estimates took into account the lower level of payroll in the near-term due to past position cuts and compensation reductions. They also built in the higher payroll long-term due to the three-year phase-in of 120 new police officer positions and other non-sworn staff as part of the City's Marshall Plan on Crime.	

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e. The Public Employees' Pension Reform Act ("PEPRA"). PEPRA provides for lower benefit levels for "new hires" (this excludes past CalPERS members with less than a six-month break in service, who would retain the higher benefit levels, referred to as "classic" members). Savings will accrue over time as gradual ongoing turnover places "classic" new hires in the City's "tier 2" (an in-between level of benefits between PEPRA and the original or "tier 1" level of benefits) and "non-classic" new hires who will fall into the PEPRA tier. This transition is included in the Segal estimates, which also assume all of the new safety hires under the Marshall Plan come in under PEPRA and are computed under that formula. The City does not yet have official employer rates for PEPRA employees. These are expected in the June 30, 2013 valuation report due later this year. While PEPRA assumes a 50:50 split of total normal cost between employer and employee, this has to be negotiated. If agreement is not reached the City can impose a 50:50 split, but not until 2018. fn6: The employer rate consists of a "normal cost" rate to pay the cost of service accrued for active employees for the upcoming fiscal year, and an "unfunded rate" to pay the fiscal year's amortized portion of unfunded liability (the amount by which accrued liabilities exceed the actuarial value of assets). These rates are applied to the "PERSable income" of active employees to generate the amounts payable to CalPERS. fn7: A true and correct copy of Segal's rate forecast, with assumptions, is attached hereto as **Exhibit P**.	
19. Segal took the estimated rates of each tier using the foregoing assumptions, and computed a weighted overall Safety rate, which was multiplied by forecasted Safety employee "PERSable" income (salary, add-pays, uniform allowance), and a weighted overall Miscellaneous rate, which was multiplied by forecasted Miscellaneous salaries. Salary growth includes the new employees under the Marshall Plan, cost of living adjustments (COLAs), and estimated impact of merit (step) increases.	Franklin objects to the statements in this paragraph on the ground that Leland's description of the Segal valuation is not the best evidence of that document. FED. R. EVID. 1002.

PARAGRAPH OBJECTED TO	GROUNDS FOR OBJECTION
20. Franklin claims that it will do better if the City's bankruptcy case were dismissed because Franklin could obtain a judgment against the City for the amount of the lease payments every six months. But Franklin misses a key point: The City would not have enough money to pay these judgments. Attached hereto as **Exhibit Q** is a true and correct copy of a table showing the loss of budgeted restructuring savings to all funds expected through 2041 as a result of claims made against the City every 6 months. *With the possible exception of the Ambac Settlement Agreement, all of the settlements that the City has made with its creditors would be unraveled, and Franklin would be just one out of more than one thousand creditors pursuing individual remedies in state court. The City simply would not have sufficient funds to pay all of the judgments that would be obtained by all of its creditors if the City was no longer afforded bankruptcy protection. These creditors would include CalPERS, holders of Retiree Health Benefit Claims, NPFG, Assured, possibly Ambac, various tort claimants and numerous other creditors. The inevitable resulting chaos would be catastrophic to the City's operations, staff retention, crime prevention, collection of fee and tax revenues, and Stockton's overall desirability for both residents and businesses.*	Franklin objects to the underlined statements in this paragraph because they assume facts not in evidence and misstate Franklin's arguments. Franklin further objects to the italicized statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the italicized statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.
21. The Expert Report of Charles M. Moore ("Moore Report") posits four arguments in support of its conclusion that the City has plenty of resources with which to pay Franklin: (1) The City's revenue estimates are excessively conservative, and so the General Fund will be better off than is being forecasted, (2) the annual contingency can be eliminated, freeing up $2 million per year, and the level of reserve the City is seeking to maintain can be reduced, both in order to pay Franklin, (3) PFF revenues are available to pay "a significant portion, if not all, of the amounts owing", and (4) the City could undertake other revenue and cost initiatives to improve its finances.	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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22. <u>*City forecasts are not excessively conservative*: The City's revenue forecast may be conservative relative to the revenue growth experience of the late 1990's and early 2000's, upon which the City based many decisions that got it into financial trouble, but the LRFP contains realistic, not low-ball, estimates of future revenues</u>. The compound annual growth rate (CAGR) of total General Fund revenues from FY1997-98 through FY2005-06 was 7.3%, as compared to the City's current revenue forecast from FY2012-13 through FY2040-41, which has a CAGR of 2.4%. <u>The City's forecast is balanced, and assumes that it must live within that rate of revenue growth.</u> <u>**However, the Moore Report faults the City's future revenue estimates for being conservative as compared to the experience of the past 15 years, and contends that this period, with its dramatic rise and fall in revenues, should be the basis for future tax growth projections: "This historical period includes a full economic cycle containing both an abnormal boom as well as a severe financial crisis. Given these facts, the material differences in the property and sales tax growth rate assumptions over the forecast period are conservative when compared to available historical data." (Moore Report, at 4). This period is not an appropriate basis for future revenue projections, and the City has properly not used it for such, due to several considerations that Moore has ignored:**</u> a. <u>***Property Tax*: Moore ignores that in FY2012-13 the City received a $3,093,000 settlement from San Joaquin County in refunded property tax administration fees that are booked as property tax revenues. This caused the percentage growth in property tax for FY2012-13 to jump to 6.3%, masking the true underlying growth in recurring revenues of 0.7%. Taking this consideration into account reduces the CAGR for FY1977-78 through FY2012-13 cited by Moore from 4.3% to 3.8%. Further, the years from FY1997-98 through FY2007-08 saw extraordinary property tax growth with a CAGR of 9.4%. This was fueled by loose credit standards that no longer exist. The ensuing**</u>	Franklin objects to the underlined statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the bolded statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because Mr. Leland's description of HdL's webpage is not the best evidence of that document. FED. R. EVID. 1002. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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real estate market crash, with Stockton at "ground zero" for foreclosures, resulted in five consecutive years of negative growth, and given the lag time in posting values that occurs with an annual lien date, the City experienced a CAGR of -6.5% from FY2008-09 through 2012-13 (omitting the one time refund booked as tax revenue). FY 2012-13 is the conclusion of the period cited by Moore, so there are no "recovery years" of post-recession impact included. However, the City expects 3.0% revenue growth in FY2013-14 (omitting the one-time refund in FY2012-13). Rather than relying on the net historical change from a period characterized by wildly gyrating revenues, and which is further biased by the sizeable one-time refund, the City utilizes a forward-looking property tax forecast model that examines the four major elements of property tax growth and develops separate growth estimates for each one of these elements: growth from new construction, growth from changes in ownership, growth from properties subject to Proposition 8 (for which annual value growth can increase without limit until the Proposition 13 value level is reached), and the Proposition 13 inflator for all other properties. This model is not based on wishful expectations, but rather on (a) data on property turnover and the portion of the tax roll split between Prop 8 and Prop 13, as provided by HdL, the City's property tax auditor, (b) the projected level of new housing units forecasted by the City's Community Development Department, aided by a market absorption study prepared by Economics and Planning Systems, and (c) actual market values and Prop 13 growth rates. Looking at history alone might indicate that this Prop 13 inflator should be 2%, but this is not a fixed amount. Rather, it is based on California Consumer Price Index (CCPI) change, capped at 2%, and the latest CCPI data provides that for FY2014-15 this inflator will only be 0.454%, not 2%, according to HdL. What period of history is used for annual new housing units could suggest either the 2,988 average from FY2002-03 through FY2004-05, or the 1,333 average from FY1998-99 through FY2012-13, or the 105 average of the past	

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four years. These are all reasons to look forward, not backward, for the underlying assumptions for revenue growth in the City's budget forecast. When this information is pulled into the property tax model, it can be seen that there are limits to the magnitude of annual growth, and that certain growth elements, such as new construction, will diminish in percentage over time as the maximum of 700 new units per year expected once the economy fully recovers are computed as part of an ever larger valuation base, and that Prop 8 increases will go away altogether over time as parcels regain their Prop 13 value and resume being limited to growth not to exceed 2% annually. The result is a growth rate that starts at 4.5% in FY2014-15 but slowly declines over time to 2.8% by FY2040-41, with a CAGR from FY2012-13 through FY2040-41 of 3.1%. Moore's statement that the Council's action on February 25, 2014 to increase the property tax estimate for FY2013-14 shows the City's growth numbers are conservative is mistaken. The higher revenue in 2013-14 is not an indication that ongoing growth will be higher, only that assessed value increases are starting sooner than previously expected. b. ***Sales Tax*. Sales tax revenues experienced pre-recession growth of 9.4% (CAGR from FY1997-98 through FY2005-06). With no lag time similar to the property tax, sales tax revenues began to fall in "real time" to the economic downturn. With the high unemployment and foreclosure rates, the sales tax registered an even higher negative CAGR, at -8.7%, for the period of FY2006-07 through 2009-10. The last three years have been the recovery period for the recession, and resulted in a sales tax CAGR of 6.9% for the period FY2010-11 through 2012-13. This growth has been biased by a large pent-up demand for motor vehicle sales, accounting for one-half to two-thirds of the growth according to MuniServices, a sales tax auditing firm. The last two years have also seen major online sellers, such as Amazon, begin paying California taxes, which are allocated to cities through the countywide pools. In FY2012-13, a further**	

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bias was a one-time higher "triple flip" adjustment from the State[8], fully $1.2 million higher than if the payment had simply grown by the same rate as the 0.75% local portion of the sales tax; this resulted in a 7.0% growth over the prior year, whereas with a normal triple flip payment the growth would have been only 3.7%, and the resulting CAGR over the entire period would have been reduced from Moore's 3.8% to 3.5%. In FY2013-14, one year beyond the time period selected by Moore, the sales tax growth drops to 0.6% (or rises to 3.9% without the bias of the abnormally large triple flip payment in FY2012-13). HdL projects lower growth going forward, with the dissipation of the pent up vehicle demand, and the full incorporation of online purchases into the base for comparison purposes. HdL also reports that the City experienced lower growth than the statewide average for the holiday quarter of 2013, and that Amazon may alter its payments in a way that benefits the three cities in which it has fulfillment centers in California, while taking revenue away from everyone else, including Stockton. The City's forecast assumes a growth rate that is 4.0% in FY2014-15 but slowly declines over time to 3.0% by FY2040-41, with a CAGR from FY2012-13 through FY2040-41 of 3.2%. A major factor acting to suppress the growth of future revenues is that since 1979, consumers have been spending a growing share of their income on services, which are not taxed, with a correspondingly declining share on taxed items. In an August 2013 report, the California Legislative Analyst stated that:"consumer spending on taxable items peaked in 1979, when consumers spent 53 cents of each dollar on taxable items. Since then, the state's sales tax base, 'taxable sales,' has grown 1.4 percentage points slower annually than the state's economy. As a result, consumers now spend 33 cents of each dollar on taxable items. This shift in consumer spending has occurred primarily because prices for services have grown four times as much as prices for goods since 1980, leading consumers to	

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spend an increasing share of their income on services." See Legislative Analyst Office, "Why Does The Sales Tax Grow Slower Than The Economy?", *available at* http://www.lao.ca.gov/reports/2013/tax/Sales-tax/Sales-tax- 080513.aspx. The California sales and use tax does not tax services, which is different from the Michigan sales and use tax, which does tax a variety of services, including consulting services. See Plante & Moran, PLLC, "Michigan Use Tax Expanded To Include Services", *available at* http://www.plantemoran.com/perspectives/articles/2009/Pages/michigan-use-tax-expanded-toinclude- services.aspx. c. *Utility Users Tax*: The UUT is affected by the rates imposed by utility providers, the conservation practices of customers (especially for water and electricity usage), and by technology trends affecting cable TV and telecommunications. The UUT pre-recession growth was 6.1% (the CAGR from FY1997-98 through FY2004-05). In addition to the effects of the recession, the UUT incurred a significant change that biases the use of historical growth for future year estimates. Between July 2004 and July 2006 the UUT rate was reduced in stages from 8% to 6%. Measure U of 2008 was placed on the ballot by the City to modernize the UUT ordinance to treat taxpayers equally regardless of what technology they used for video services and telecommunications. Specifically, it was intended to protect the tax from litigation alleging that local phone taxes should have been repealed when the federal government ceased taxing long-distance calls in 2006, and to extend the tax to new technologies such as text messaging. As a trade-off to the taxing of new technologies, and to head off a potential measure to cut the tax to 2% or eliminate it altogether, Measure U included a commitment to maintain the UUT at no higher than 6%. This rate reduction, together with the impacts of conservation, the recession, and changing technology trends (such as reduced cable TV and landline usage), resulted in a CAGR of -7.1% over FY2005-06 and FY2006-07. Thereafter through FY2012-13 the UUT experienced a CAGR	

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of only 1.0%. Clearly, the change in tax rate and base makes prior year experience unsuitable for future projections. The City retains MuniServices to conduct UUT audits and advise on revenues; its estimate for FY2013-14 is for 0.8% growth. In FY2014-15 the budget model assumes 0.75% growth, increasing to 1.5% in FY2015-16, and the CAGR through FY2040-41 is 1.4%. d. ***Conclusion*: History is not always the best indicator of future trends. The Moore Report at page 16 states, in the context of retiree health payments, "it is inappropriate to extrapolate a projection of future liability from historical data" and that "future liabilities should be derived from forward-looking assumptions about the future costs of providing health care benefits." This advice should have been followed in his discussion of revenue forecasting. The City employs a forward-looking approach that incorporates data relevant to the estimation of future revenues, rather than relying on an historical average rate of growth that is biased by the "irrational exuberance" of the pre-recession housing bubble, followed by the worst recession since the 1930's, which also includes unique biases relative to each of the three major revenue sources that a more careful review would have uncovered. The City's revenue estimates are realistic and do not eliminate the downside risk of reduced revenues in the event of economic downturns.** fn8: HdL explains the "triple flip" as follows: "In March 2004, California voters approved Proposition 57, the California Economic Recovery Bond Act, which authorized the issuance of up to $15 billion in bonds to close the State's budget deficit. $10.9 billion of these bonds were issued in 2004 and the remainder in 2008. To guarantee bond repayment, the state promulgated Revenue and Taxation Code Section 6201.5 which established an excise tax equal to one quarter percent (.25%) of the sales price of property subject to the state's sales and use tax and simultaneously lowered the Bradley Burns Uniform Sales Tax 1% rate by one-quarter percent (.25%) to three-fourths of one percent	

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(.75%). The bonds are repaid from the .25% excise tax plus transfers from the Budget Stabilization Account (BSA), a special reserve established in the State's general fund approved by Proposition 58. The quarter-percent reduction in local sales tax is recovered through a series of revenue swapping procedures. These exchanges are referred to as the "triple flip." The triple flip will continue until the Economic Recovery Bonds are retired which the Department of Finance anticipates will occur in Spring 2016." (https:// www.hdlcompanies.com/ index.aspx?page=100)	
23. *The annual contingency is a critical element of the long-term forecast*: The Moore Report asserts that an accurate forecast needs no contingency. Were it only so simple. The role of a contingency is critical in a long-range forecast. We all strive for accuracy, but a budget is not an audit of something that has already occurred, but rather a prediction of a future which has not yet occurred. The LRFP is based on reasonable and realistic assumptions, but there is no guarantee that the forecast will in all respects be met, every year, for 30 years. The reality is that revenues and expenditures will deviate from the forecast. The purpose of the contingency, as explained in paragraphs 14 and 15, is to provide a "smoothing" mechanism, or buffer, against these future variations. These changes to base revenues and expenditures will compound over time, so the longer the forecast, the higher the potential volatility. Building in an annual $2 million contingency, the equivalent of about 1% of total expenditures, spreads the impacts of economic downturns over the entire period of the LRFP. This allows the City to make projections of its future finances without having to make predictions about the specific timing or severity of future recessions.	Franklin objects to the statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
24. *The Plan of Adjustment for the City of Detroit, which Moore's firm represents, also contains an annual "Contingency" starting in FY2014-15 which "reflects amounts reserved for unexpected events", in amounts ranging from $10.4 million to $12.6 million. These amounts are equal to approximately 1% of the sum of operating expenditures, restructuring costs, secured claim payments and debt service from FY2014-15 through*	Franklin objects to the statements in this paragraph because Mr. Leland's description of the Plan of Adjustment for the City of Detroit is not the best evidence of that document. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph on the ground that they misstate the opinions of Mr. Moore. Franklin further objects to the italicized statements in this paragraph because they lack foundation. FED. R. EVID. 602. Franklin

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FY2022-23. <u>In his deposition, Moore claimed that this contingency was inserted as a hedge against "aggressive revenue estimates" that creditors had advocated including in the Detroit financial plan. When questioned as to how the City would deal with an economic downturn, however, he conceded that this contingency, as well as the fund balance, could also be used to help cover revenue shortfalls</u>. The fund balance, although not shown in Detroit's Disclosure Statement/Financial Plan, was represented to be $80- 85 million, which would be roughly 7% of the approximately $1.1 billion of Detroit's total General Fund expenditures (well below GFOA's 16.7% reserve recommendation, which Moore referred to as "guidelines").	incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
25. A contingency plays a different role than is served by an available fund balance reserve, which is a one-time resource. Maintaining a fund balance reserve allows the City to bridge cash flow variations within each fiscal year, and in the event of an economic downturn, to buy time to implement budgetary changes that will enable the City to match its expenditures to available ongoing revenues. Stating as Moore does that Stockton will not use its contingency, and that it thus can be converted to annual payments to pay creditors, assumes that reality will never deviate from the forecast, and that there will never be emergencies or "unexpected events" that will arise. The Moore Report also assumes that the City's reserve goal of two months, or 16.7%, of operating expenditures, a level not projected to be met for 20 years (in FY2033-34), will prove adequate for absorbing all cumulative adverse economic effects for decades to come. In fact, the Moore Report runs scenarios showing how the City can increase payments to Franklin by both eliminating its contingency and maintaining a reserve as low as 5% of total expenditures, a level far below GFOA's recommendation. See Ex. M, at 1-2. Moore's Table 1 shows past City reserve levels in the General Fund, which averaged 5.0%, in support of his contention that this should be considered adequate. Neither this 5% average reserve, nor the 10% reserve that the City adopted as a policy in 2006 (and has since replaced with the 16.7% GFOA goal),	Franklin objects to the statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph on the ground that they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because Mr. Leland's description of the GFOA recommendation is not the best evidence of that document. FED. R. EVID. 1002. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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proved adequate to stave off bankruptcy in 2012.	
26. Having adequate reserves gives a City options, and time, to deal with financial adversity, and running out of reserves constrains or eliminates those options. Once the City reaches its reserve goal, and assuming the contingency or a similar mechanism to address forecast volatility is maintained over time, the City will have a reasonable, although not absolute, level of assurance that it can achieve long-term financial sustainability. At that point, the City will have the capacity to address unfunded needs, including the addition of staffing and services to address increased workload demands from a growing community. The City cannot afford to spend *all* revenue gains above forecasted levels that it may realize over time, because gains will be offset at other times by losses from economic downturns. However, the gain-sharing approach of the contingent payments agreement that the City negotiated with Assured Guaranty under the auspices of Judge Perris, rather than the elimination of the forecast contingency or the spend-down of reserves, is the less risky and more appropriate approach to the payment of creditors.	Franklin objects to the underlined statements in this paragraph because they are speculative and lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
27. *PFF Funds are not available to pay the Franklin Bonds*: As discussed extensively in the Chase DTD, PFF funds are not envisioned to be available to pay the Franklin bonds. The Moore Report projects the funds likely produced by 600-700 new housing units annually and concludes that all of that revenue can be utilized for Franklin bond payments. These assumptions are incorrect for the following reasons: First, most of the PFF money collected must be used to pay for projects to mitigate growth as defined by the AB 1600 nexus study adopted by the City pursuant to state law, rather than for debt service. That nexus study established the relationship between future development and the projects needed to mitigate the impacts of this planned growth. Developers expect these projects to be funded and can legally challenge the level of PFFs if funding is not set aside within five years for identified projects. The nexus study	Franklin objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because Mr. Leland's description of the nexus study is not the best description of that document. FED. R. EVID. 1002. Franklin further objects to the statements in this paragraph because they lack foundation. FED. R. EVID. 602. Franklin further objects to the underlined statements in this paragraph because they are improper legal conclusions. FED. R. EVID. 701. Franklin further objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of*

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itself is dated, as is the City's General Plan, which was successfully challenged in court on the basis of being sprawl inducing. <u>The General Plan needs to be updated, and the City is legally committed to reducing sprawl and building more in the downtown area. This may change the scale of projects required to be funded, but may also require a reduction in the rate, which could leave proportionately fewer PFF resources than under the current rate structure</u>. Second, the competition for PFF resources is intense, especially for street projects. <u>The City's Capital Improvement Program for FY2013-14 through 2017-18 identifies $440 million of unfunded transportation projects; even with receipt of state or federal grant funds, a significant portion of these unfunded costs would have to be paid from the Streets PFF fund. Also competing for Streets PFF funds are $16 million in accumulated PFF program credits and other reimbursement obligations payable to developers.</u> <u>Third, the rate of fees imposed is also an issue. The City reduced the Streets PFF rate by half in 2010 as an incentive for developers. This discount was scheduled to end effective December 3, 2013, but the City Council extended that 50% rate discount for another year, through December 31, 2014. Revenue foregone through rate discounts cannot legally be made up through higher levies on future development.</u> <u>Fourth, for park projects, the General Plan standard for park acreage per 1000 residents imposes a new park construction cost burden in excess of what 700 housing units per year would generate in income.</u> <u>Fifth, the Police and Fire funds are collectively $3.8 million in deficit, having had to receive loans to help pay their share of debt service costs prior to 2012.</u>	*Testimony Of Robert Leland.*
28. <u>The PFF monies are not pledged to pay the Franklin bonds</u>. When the bonds were sold, the City believed it could pay for the bonds using PFFs rather than the General Fund, which was an incorrect assumption. New housing peaked at 3,024 new units in FY2002-03, followed by 2,959 in 2003-04 and 2,977 in 2004-05. Thereafter, permits for	Franklin objects to the underlined statements in this paragraph because they are improper legal conclusions. FED. R. EVID. 701. Franklin objects to the remainder of this paragraph because it is speculative and lacks foundation. FED. R. EVID. 602. Franklin further objects to the remainder of this paragraph because it consists of opinion testimony that is inadmissible

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new housing units dropped dramatically, first to 1,621 in 2005-06, then 689 in 2006-07, and in 2007-08, the year before the bonds were sold, to 283. In the past five years, new housing has been stagnant, with 171, 162, 98, 109, and 109 new units for each year, respectively. Even when the bonds were sold, housing was not being built at a rate that would have supported the debt service, especially when all the competing demands for these limited funds are taken into account. Moore states "the City already is experiencing a real estate recovery." To the contrary, no recovery is happening yet in terms of new construction, and just when that recovery will occur is still in question. The City has issued only 64 building permits for new housing in the first 9 months of the current FY2013- 14. Since the creation of the housing absorption study by consultant EPS in June 2013, the City's estimate of homes to be issued building permits from FY2012-13 through FY2016-17 has dropped 63% to 1,850, from the original EPS estimate of 4,668. As a result of all of these factors, the millions of dollars of PFFs that Franklin argues are available to pay their bonds simply do not exist.	given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
29. *The City has undertaken significant revenue and cost initiatives*: a. *Revenue Increases*: The City has been criticized for not adopting more revenue increases. The Direct Testimony Declaration of Robert Deis ("Deis DTD") addresses the revenue measures considered by the City, the polling it undertook to determine what could feasibly be passed by the voters (who must approve any tax increase), the need to accompany a tax increase with improved services, the low regard among voters for a tax increase to pay obligations to creditors (whether employees, retirees or debtholders), and the narrow margin by which the 0.75% local sales tax was approved in the form of Measure A in November 2013. The Deis DTD cites the history of utility user tax rate reductions and the adoption of Measure U, which expanded the tax base but limited the rate to 6%, down from 8% in 2004. Polling indicated that a measure imposing both a UUT increase and a sales tax increase would not have passed.	Franklin objects to the statements in this paragraph because the FM3 report is the best evidence of polling data. FED. R. EVID. 1002. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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b. *Cost Efficiencies*: The Moore Report criticizes the City for "assuming a total of just $3.0 million in one-time efficiency enhancements over the entire forecast period". <u>The Moore Report misunderstands the way the efficiency savings works in the forecast. The City has embarked on a process of identifying potential cost efficiencies or improved cost recoveries, which are ways to reduce net costs without having to also reduce service levels to the public. Some of these savings may be short-term in nature, and some may be ongoing, but collectively the forecast assumes they will average a total $3 million in savings annually from what baseline operating expenditures would otherwise be. *Each* year the savings is *not* realized, the ending fund balance would be reduced by $3 million, so it behooves the City to identify and implement appropriate savings measures, and if any savings action comes to an end, to find another measure to replace it. At another point the Moore Report criticizes the "one-time" savings for not growing in value over time; such growth was not assumed because it is not envisioned that this will be a single action that if left implemented would grow in value by the inflation rate over time, but rather a combination of items that might be worth over $3 million in some years, and under $3 million in others, but would average to $3 million in *annual* savings over time.</u> c. <u>*Support for Entertainment Venues*: While the Moore Report claims it is not "dictating to the City how to conduct its affairs," it goes on to state that General Fund support of the entertainment venues "is particularly difficult to justify" and if ended, could be used to pay Franklin. These operating and administration subsidies to the Stockton Arena, Bob Hope Theater, Oak Park Ice Area, and Ballpark total $2.7 million annually. These facilities are important to the economic vitality and quality of life for residents. There cannot be a long-term recovery if the community does not offer some amenities to its residents. Even if public safety is the top priority, that cannot be all that a city has to offer its residents; there has to be a balance in services offered for long-term economic development efforts to succeed. One of the areas in which</u>	

PARAGRAPH OBJECTED TO	GROUNDS FOR OBJECTION
restructuring savings is being sought is to bring the support of the minor league ice hockey and baseball teams more into line with industry standards, which is expected to reduce costs by $357,000 annually, and this is incorporated into the budget forecast. d. *Golf Course Subsidy*: The Moore Report questions inclusion of the $450,000 subsidy to golf course operations on an ongoing basis: "Given that the City proposes to relinquish possession of the golf courses under the Plan, there will be no future subsidy and those funds also could be used to pay the City's obligation." As Moore points out, the subsidy totals $21.2 million over the life of the LRFP. This is the amount of loss that Franklin would incur over that period if it chose to assume operation of the golf courses. The courses are already run by an experienced private operator (KemperSports), so the likelihood of further efficiencies is low, and given competition from other courses in the region, the courses would likely lose significant rounds played if a major greens fee increase were imposed to try to close the gap, so the operating loss should be a very real concern to Franklin. Furthermore, as reported by the New York Times on April 19, according to the National Golf Foundation, golf has lost five million golfers over the past decade, and 20% of the existing 25 million golfers are "apt to quit over the next five years." A true and correct copy of this article is attached hereto as **Exhibit R**. The LRFP took the prudent approach of including the operating subsidy, on the assumption that no party outside of the City would be willing to operate money-losing golf courses. The trade-off for the City is that the courses offer a recreational amenity to its citizens, and it recognizes that few public recreational facilities of any sort pay their own way.	
30. Treatment of Retirees: The Moore Report on page 17 cites the $416.7 million unfunded actuarial accrued liability (UAAL) for the City's retiree health benefits as of June 30, 2011 determined by Segal, and then compares it to "an unfunded liability with a present value of $258.4 million for the Safety Plan and $153.4 million for the Miscellaneous Plan", a total of $411.8	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the underlined statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID.

<table>
<tr><th>PARAGRAPH OBJECTED TO</th><th>GROUNDS FOR OBJECTION</th></tr>
<tr><td>million for the City's pension benefits as of June 30, 2012. <u>This is an inconsistent, apples-and-oranges comparison in two respects. First, the numbers are from different time periods: the retiree health liability was valued at June 30, 2011, and the pension liability a year later, at June 30, 2012. Second, retire health was valued using the unfunded actuarial accrued liability calculation, while the CalPERS figures Moore cites are for a market value calculation. In the same page of the CalPERS report, three lines earlier, is the correct comparable figure, the "Unfunded Accrued Liability (AVA) Basis" (AVA stands for Actuarial Value of Assets); using these numbers for June 30, 2012 the Safety Plan is $144.3 million and the Miscellaneous Plan is $62.3 million, for a total of $206.6 million. However, for a comparison to the same June 30, 2011 valuation date as Moore cites for the retiree health, the comparable unfunded actuarial accrued liability for pension benefits is $117.0 million for Safety and $54.9 million for Miscellaneous, for a total of $171.9 million.</u></td><td>702. Franklin incorporates by reference herein the Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.</td></tr>
<tr><td>31. The City disputes Moore's methodology regarding calculation of retiree health claims. However , using consistent June 30, 2011, figures for unfunded actuarial accrued liability in lieu of Moore's numbers, significantly changes the overall recovery rate cited by Moore, reducing it from 53.4% to 28.8%.[9]

fn9: Revised calculation as follows:

($ in millions)
Pension Unfunded Liability
Retiree % of PV of Projected Benefits
Retiree Share of Pension Unfunded Liability
PV Retiree Health (Unfunded Accrued Actuarial Liability)
Total Combined Claim (Moore Methodology)
Retiree Share of Pension Unfunded Liability
Retirees Settlement
Total
% of Combined Claim (Moore Methodology)

Moore Report
<table>
<tr><th><u>Safety</u></th><th><u>Misc</u></th><th><u>Total</u></th></tr>
<tr><td>$258.4</td><td>$153.4</td><td>(6/30/12 market value)</td></tr>
<tr><td><u>71.3%</u></td><td><u>68.4%</u></td><td>(unknown source)</td></tr>
<tr><td>184.2</td><td>104.9</td><td>289.2</td></tr>
<tr><td></td><td></td><td><u>261.9</u> (6/30/11)</td></tr>
<tr><td></td><td></td><td>551.1</td></tr>
<tr><td></td><td></td><td>289.2</td></tr>
<tr><td></td><td></td><td><u>5.1</u></td></tr>
<tr><td></td><td></td><td>294.3</td></tr>
<tr><td></td><td></td><td>53.4</td></tr>
</table>
Using Comparable Figures</td><td>Franklin objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.</td></tr>
</table>

PARAGRAPH OBJECTED TO	GROUNDS FOR OBJECTION
Safety Misc Total $117.0 $54.9 (line 6, p. 11 of PERS 6/30/11 valuation) 58.2% 55.7% (line 1d/1e, p. 11 of PERS 6/30/11 valuation) 68.1 30.6 98.7 261.9 (6/30/11) 360.6 98.7 5.1 103.8 28.8	
32. Moore's analysis of CalPERS costs is simplistic and wrong. The report demonstrates no understanding of what is driving CalPERS rate changes (which apply across the board statewide and are not unique to Stockton), and does not recognize that the LRFP builds in pension rate increases in excess of what CalPERS currently projects and that the City projects a balanced budget over a 30-year period, using revenue estimates that Moore believes are "conservative."	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
33. *The Moore Report's Comparison of Rates Among Cities is Invalid*: Moore compares CalPERS employer rates from a group of cities with populations of 200,000 to 500,000 to that of Stockton and pronounces that "the City's contribution rates are well above peer cities and are projected to grow rapidly." CalPERS rates for nearly all cities are expected to grow rapidly, due to the rate smoothing and unfunded liability amortization changes and mortality improvement changes discussed in paragraph 18. Due to these changes in CalPERS rate-setting policies, rates will go up in the near-term, then level off and eventually drop as unfunded liabilities are paid off over fixed time periods, rather than being amortized over a rolling 30-year period. This is not discussed by Moore. There are also unique aspects to each city, large or small, that influence their CalPERS employer rates. Stockton's employer rate for FY2014-15 is 41.385% of payroll, but there are smaller cities than Stockton that have higher rates, such as Placentia (population 52,000) which has a safety rate of 50.865%. Moore focuses on Safety rates, but his own data shows that Stockton's FY2014-15 Miscellaneous rate of 20.090% only ranks 8th out of his 12 comparison cities, below the median rate of	Franklin objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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22.125%. San Bernardino is also bankrupt, but its Safety rate for FY2014-15 is only 31.455%, which is *below* the median Safety rate of 34.035%, so the correlation between CalPERS rates and city financial health is not clear. Moore's survey seems to assume that employer rates are the determining factor in the magnitude of city retirement costs. This is simply not true, for the following reasons: First, if a city picks up all or a portion of the employee rate, then this action results in an additional city pension cost that is not reflected in the employer rate. Stockton does not pick up the employee's share of the rate, but many other cities do, meaning that some cities that rank lower in employer rate than Stockton are really paying up to eight percentage points more in total rate for Miscellaneous employees, and up to nine percentage points more for Safety employees. This is not reflected in Moore's survey. Second, the survey ignores whether or not a city belongs to Social Security. A city that belongs to Social Security (Stockton does not) would pay another 6.2% of payroll for retirement-related costs, a reality that is not reflected in Moore's survey. CalPERS reports that there is no difference between employer rates of cities not in Social Security and those that are part of Social Security but do not "coordinate" their PERS benefits with Social Security. There is a negligible potential impact in normal cost rate for a given city that elects to coordinate versus not to coordinate. For any employer who is part of a risk pool, CalPERS currently does not calculate a different employer rate for an employer depending on whether they have Social Security or are coordinated. Third, one must consider whether a city has sold pension obligation bonds (POBs). The debt service paid on POBs is a pension-related cost that must be taken into account, because the employer rate of a POB city would otherwise be higher than shown in the survey if they had not issued a POB. Just how much higher the employer rate would be is a reflection of the size of the POB and when the proceeds were deposited with CalPERS, which will determine the impact of the POB on reducing the unfunded liability of that city. The total retirement costs of the city will be impacted by the POB size, structure and	

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interest rate, which is also a function of when the POB was issued. Stockton sold POBs, but the timing was bad as the economic performance of CalPERS thereafter significantly reduced the value of the City's POB proceeds deposited with CalPERS. Without accounting for these variables regarding POBs, the employer rate alone is an inadequate indicator of total pension-related costs. Fourth, some cities have Employer-Paid Member Contribution (EPMC) benefits, which increase employee retirement pay by 7-9%. The cost of this benefit is paid separately rather than recovered as part of the employer rate. Stockton does not have EPMC, but for those cities that do, you would have to add to their employer rate an "EPMC cost equivalent rate" to reflect the additional burden. EPMC costs are not factored into the Moore survey. Fifth, some cities pay retirement-related benefits such as deferred compensation and retiree medical. Stockton does not. Cities that do pay these benefits have "hidden" retirement costs that the Moore survey does not detect because it assumes that CalPERS employer rates are the sole determinate of a city's retirement cost burden. Sixth, an important consideration in the level of a given city's employer rates is the level of city payroll relative to the city's annual unfunded liability contribution. This unfunded contribution is a fixed amount and is collected via an "unfunded rate" applied, along with the "normal cost" rate, to what CalPERS projects the city's payroll will be in the contribution year; the normal cost and unfunded rates together comprise the overall "employer rate" that is being compared in Moore's Exhibit 12. However, two cities may have identical normal costs and unfunded liability contributions, and yet city A with a larger payroll will have a lower unfunded rate compared to city B, making city A's overall employer rate lower than city B's, and thus making it appear as if city B's pension burden is greater, when it is in fact the same. A city that has significantly reduced its payroll through position and compensation cuts (such as Stockton), has a lower payroll relative to its fixed unfunded contribution, and thus CalPERS has to charge it a higher	

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unfunded rate just to collect the same unfunded contribution compared to prior years; in Moore's comparison, a city such as Stockton comes out with a higher rate, but that higher rate may not be indicative of increased pension costs. Without looking at the actual unfunded amounts due, Moore's comparison of cities' employer rates at a single point in time to gauge pension cost burdens misses the mark. Seventh, the employer rate of a given city may appear low relative to another city simply by virtue of how that city has chosen to implement employee cost sharing, where employees agree to bear a greater share of pension costs than dictated by the level of the employee rate. Two identical cities with the same cost sharing, say 2%, will have different employer rates depending on which of two implementation approaches they select, even though the overall financial impact on the two cities is the same. In city A, a formal contract amendment is implemented, which increases the employee rate by 2%; this action reduces the employer rate by 2% to compensate. In city B, an employer independent agreement (EIA) is implemented, through which the affected bargaining groups pay the city 2% through payroll deductions; in this case the city's employer rate levied by CalPERS is unchanged, meaning they pay the same amount to CalPERS, but the city is reimbursed the 2% of payroll from the employees and thus achieves the same net dollar savings as city A. Stockton has a minor cost sharing from fire employees, but without knowing the cost-sharing arrangements that may apply to each of the other survey cities, one would have no way of knowing whether some of those rates are effectively overstated or understated, relative to actual net pension costs. Moore's survey is silent as to cost sharing impacts. Eighth, the survey measures only tier one rates of the cities, and does not take into account whether or not a city has implemented second tier rates at lower benefits than for tier one employees. PEPRA only applies to new employees that are also new to public pension systems. When cities implement second tier plans (such as Stockton did in 2012), new employees who	

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are not subject to the PEPRA reductions (meaning they are already members of PERS or a reciprocal public pension system), will still be subject to the lower "second tier" benefit levels, which will reduce the pension costs of these cities. Not all cities have done this. Without taking the future impact of second tier benefit plans, and PEPRA, into account, looking only at tier one rates is misleading as to the ongoing retirement costs of a given city. There are other reasons for the disparity in rates among cities, including: benefit levels contracted for by the city; demographic issues such as age distribution of employees (which can be affected by budget cuts removing the youngest employees); level of disability retirements; and whether or not a city has an annual side fund payment (relevant to smaller cities that are pooled plan participants). None of the extenuating circumstances discussed above are acknowledged by Moore. Moore's failure to address these important factors renders his comparison of city CalPERS rates meaningless.	
34. *CalPERS rates are increasing, but the City's forecast accounts for this*: Moore's report takes a Chicken Little "the sky is falling" tenor when it comes to his discussion of CalPERS rate increases. Yes, rates are increasing, for the reasons discussed in paragraph 18 above, although none of these reasons are acknowledged by Moore, who prefers to use inflammatory terms such as "extremely high… increasing dramatically... unpredictable and literally out of the City's control." Moore acknowledges that there is a cycle to these rate changes: they will increase in the near-term, taper off as the cost savings from the PEPRA are realized through employee turnover (with new hires receiving lower benefits), and then significant reductions will occur over the long-term as unfunded liability is paid off (rather than being rolled over), ultimately leaving only a normal cost rate with no unfunded liability. Moore acknowledges that increases in CalPERS rates are built into the LRFP, but questions why the City's Safety rate is less than the CalPERS rate projection for FY2019-20 from its June 30, 2012, valuation. This is because the CalPERS projections do not yet include PEPRA impacts, which will	Franklin objects on the ground that the statements in this paragraph misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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reduce the composite rate (weighted by distribution of employees among three tiers of plan benefits) over time; this is stated on pages 26 and A-17 of the CalPERS valuations attached to the Moore Report. The LRFP incorporated projected PEPRA savings, and assumes the additional positions filled under the Marshall Plan are all hired under PEPRA benefit levels.	
35. However, the fact that CalPERS rates are increasing is not cause to assume that these costs are any more unpredictable than the multitude of other expenditures and revenues about which the City must make assumptions. That is life in the budget world. The City makes assumptions about the future growth of all items in its LRFP. The issue of unpredictability is being addressed by CalPERS, which has become more transparent in their dealings with its member agencies: CalPERS staff holds annual briefings and workshops; Chief Actuary Alan Milligan and his staff regularly make presentations at meetings of the League of California Cities and other professional organizations such as the California Society of Municipal Finance Officers; and CalPERS valuation reports have extended the rate projection term from three to six years and provide expanded information. The recent rate smoothing, amortization and mortality improvements enacted by CalPERS, while significantly increasing rates over the next several years, are financially prudent changes that will improve the long-term funded status of the pension system, and reduce employer rates in the long run. Finally, the increase in CalPERS costs is built into the LRFP and the forecast remains balanced, with the City's reserve goal reached by 2034. This should be the ultimate test: even if certain costs increase, does the budget remain balanced? Stockton's LRFP meets that test.	Franklin objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because they assume facts not in evidence. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
36. In his conclusion, Moore calls for "impairment" of the CalPERS pension obligation, but gives no description of what this scenario would look like, how the City would deal with the termination liability that would be levied by CalPERS against the City, what the implications would be for employee retention if the City is the only major public employer in the state without a	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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defined benefit pension plan, what the legal basis would be for any alternative plan, and what the costs of such an alternative would be. These issues are addressed in the Direct Testimony Declarations of Kim Nicholl and Kurt Wilson.	Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
37. *Pension costs are not an unsustainably high percentage of General Fund expenditures*: Moore compares projected CalPERS costs as a percent of total expenditures and pronounces them "unsustainably high." This is a flawed analysis for several reasons. First, he compares the peak of CalPERS costs (18.8% of total expenditures), to a median of 8.9% for the period of FY1998-99 through FY2011-12 (see Moore Exhibit 15). That 8.9% figure is significantly biased by the extraordinarily low CalPERS rates levied during the first third of that period, including three years during which the Miscellaneous Plan has zero rates and the Safety Plan averaged rates of 10.1%. In hindsight, no one thinks levying such low rates was a good idea, so including them in a comparison period makes no sense. Second, CalPERS costs actually rose to 13.7% in FY2009-10, before the City implemented significant pension cost savings measures, including making employees pay their own full share of the employee rate, eliminating Employer-Paid Member Contributions (which had previously increased retirement pay by 9% for Safety employees and 7% for Miscellaneous), and eliminating salary COLAs and various add-pay compensation. This reduced CalPERS costs to 8.9% of total expenditures in FY2011-12. Third, CalPERS costs only rise to 18.8% in future years because of the addition of 164 employees under the Marshall Plan on Crime. Without these new employees, CalPERS costs are projected to peak at 15.9% of total expenditures. This is only 2.2 percentage points higher than the 13.7% level that existed before the City's pension cost-cutting reforms. Fourth, the 18.8% figure is a peak amount that begins to fall when CalPERS unfunded liabilities are paid off starting in	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

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2032. By FY2040-41, CalPERS costs are projected to fall to 11.7% of total expenditures. Fifth, Moore believes the 18.8% represents an unsustainable figure, but compared to what? Each city pays for different costs from its General Fund. The greater the cost of items paid for from the General Fund, the smaller pension costs will be as a percentage of the total expenditures. For example, some cities pay for capital projects out of the General Fund (Stockton does not), or pay for a broader array of services than does Stockton, or their total expenditures are swollen by significant transfers out to other funds because of their budgeting and accounting practices or other factors unique to that city. Such cities would appear to have "lower" pension costs by this measure, simply because the total expenditures and transfers out of the fund boost the base against which the pension costs are measured. Another identical city with the same financial commitment but different fund structure and budgeting practices could appear to have "higher" pension costs using this analysis. Stockton's General Fund has sustained budget cuts that took out many non-personnel services, and the personnel services that are left are weighted toward Safety employees which have proportionately higher pension costs. Therefore, saying a particular percentage is "unsustainable" is unsupportable without factoring in considerations of what the General Fund pays for versus other restricted funds. Again, the test should be whether or not the LRFP is projected to remain balanced, even with the anticipated increase in CalPERS costs (and addition of staff under the Marshall Plan), and it meets this test.	
38. *Moore's reference to Vallejo is irrelevant to Stockton*: Whether Vallejo's pension costs are increasing, or its Safety rate and pension costs as a percentage of total expenditures are higher than the comparable figures for Stockton, are irrelevant to the case at hand. Vallejo has, however, taken important steps to balance its budget, including imposing by a unanimous Council vote a new Police contract last fall with a 5% pay cut and higher employee contributions to their health insurance. In March 2014,	Franklin objects to the statements in this paragraph because they misstate the opinions of Mr. Moore. Franklin further objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702. Franklin further objects to the statements in this paragraph because they assume facts not in evidence. Franklin further objects to the

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Vallejo's mid-year budget review showed the General Fund's built-in $5.2 million budget shortfall was reduced to just under $1 million. The $12 million in new annual sales tax revenue from its Measure B is being directed toward one-time needs, although as a general tax it is also available for meeting any General Fund shortfalls. In its revised FY2013-14 Budget, Vallejo's General Fund reserve is 10.2% of total expenditures, including reserves funded with Measure B. Vallejo is also the first city in the nation to implement participatory budgeting, a citywide process now in its second year that promotes civic engagement by allowing residents to decide how to spend a certain amount of public money. Moore mentions none of these considerations in painting Vallejo as "a cautionary tale."	statements in this paragraph because they lack foundation. FED. R. EVID. 602. Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*
39. The City has endeavored to maintain budgetary solvency through forecasting a higher level of pension costs that even the most recent CalPERS actuarial valuation projections do not incorporate. The City has incorporated inflationary cost increases over time, including modest 2% salary and health COLAs to remain competitive within the labor market. The forecast also builds in higher contributions to replace the City's aging technology, fleet and equipment, undertake deferred maintenance. and slowly rebuild reserves in both its General Fund and Workers Compensation Fund. Service level solvency is being addressed through the implementation of the Marshall Plan on Crime, made possible by voter approval of Measure A. The additional $28 million in annual sales tax revenue from Measure A allows for the hiring of 120 police officers to achieve 1.6 sworn officers per 1000 residents. and another 43 support staff. (which help offset the 98 police officers and 47 police support staff positions eliminated in earlier budget cuts). while building up adequate reserves and avoiding the need for additional service level cuts to balance the General Fund budget. These levels of budgetary commitments and public safety improvements may not attain the ultimate in budgetary vitality and public safety staffing levels. but they do allow the City of Stockton to emerge from bankruptcy with a demonstrably sustainable financial plan over	Franklin objects to the statements in this paragraph because they consist of opinion testimony that is inadmissible given that Mr. Leland's knowledge, skill, experience, training and education do not render him qualified as an expert regarding the matters to which he is testifying. FED. R. EVID. 702.

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a far longer time frame (30 years) than proposed by other bankrupt cities, such as Vallejo (5 years) or Detroit (10 years).	
Exhibit R (NY Times article: "In a Hole, Golf Considers Digging a Wider One")	Franklin incorporates by reference herein the *Motion Of Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund To Exclude Portions Of Testimony Of Robert Leland.*

Dated: April 25, 2014

JONES DAY

By: */s/ Joshua D. Morse*
James O. Johnston
Joshua D. Morse
Charlotte S. Wasserstein

Attorneys for Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund