PAUL R. GLASSMAN (State Bar No. 76536)
FRED NEUFELD (State Bar No. 150759)
MARIANNE S. MORTIMER (State Bar No. 296193)
KATHLEEN D. DeVANEY (State Bar No. 156444)
STRADLING YOCCA CARLSON & RAUTH
A Professional Corporation
100 Wilshire Blvd., 4th Floor
Santa Monica, CA 90401
Telephone: (424) 214-7000
Facsimile: (424) 214-7010
E-mail: pglassman@sycr.com
fneufeld@sycr.com
mmortimer@sycr.com
kdevaney@sycr.com

GARY D. SAENZ (State Bar No. 79539)
CITY ATTORNEY
300 North "D" STREET, Sixth Floor
San Bernardino, CA 92418
Telephone: (909) 384-5355
Facsimile: (909) 384-5238
E-mail: saenz_ga@sbcity.org

Attorneys for Debtor
City of San Bernardino

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
RIVERSIDE DIVISION

In re CITY OF SAN BERNARDINO, CALIFORNIA, Debtor.	Case No. 6:12-bk-28006-MJ Chapter 9 **THIRD AMENDED DISCLOSURE STATEMENT WITH RESPECT TO THE THIRD AMENDED PLAN FOR THE ADJUSTMENT OF DEBTS OF THE CITY OF SAN BERNARDINO, CALIFORNIA (JULY 29, 2016)** <u>Plan Confirmation Hearing</u> Date: October 14, 2016 Time: 10:00 a.m. Place: Courtroom 301 3420 Twelfth Street Riverside, CA 92501-3819

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I. INTRODUCTION

The City of San Bernardino, California (the "City") filed a petition under Chapter 9 of Bankruptcy Code on August 1, 2012 (the "Petition Date"), Case No. 6:12-28006-MJ (the "Bankruptcy Case"). This "Third Amended Disclosure Statement With Respect to the Third Amended Plan for the Adjustment of Debts of the City of San Bernardino, California" ("Disclosure Statement") provides important information to the holders of claims against the City regarding the City's "Third Amended Plan for the Adjustment of Debts of the City of San Bernardino, California (July 29, 2016)" ("Plan"). A copy of the Plan is attached as Exhibit 1 to the Appendix of Exhibits accompanying this Disclosure Statement ("Appendix").

This Disclosure Statement is being sent to you because the City is asking creditors to vote to accept the Plan. The Bankruptcy Court has approved this Disclosure Statement as containing information of a kind, and in sufficient detail, to enable creditors to make informed judgments about the Plan. The information in this Disclosure Statement is presented as follows: Section II explains the events and circumstances leading to the City's filing of the Bankruptcy Case; Section III summarizes the significant events that have occurred during the administration of the Bankruptcy Case; Section IV describes the City's assets and liabilities, including a description of the proofs of claim filed in the Bankruptcy Case; Section V summarizes the classification and treatment of claims under the Plan and other important information concerning the Plan; Section VI discusses the procedures for voting on the Plan and the legal requirements for confirmation of the Plan; and Section VII presents a discussion of certain risk factors to be considered in connection with the Plan.

As discussed in detail in this Disclosure Statement, the City commenced the Bankruptcy Case when the City realized that it was at risk of running out of funds needed to provide essential municipal services to City residents. The causes of the City's bankruptcy are discussed in Section II. Today, the City has in place settlements with most of its principal creditors, those settlements are all incorporated into the Plan, and the City has made significant progress at restructuring the delivery of municipal services. The City's settlement with the California Public Employees' Retirement System ("CalPERS") regarding the City's continued funding of employee pension benefits is discussed in Section III.D. The City's settlement with the official Retiree Committee regarding the continued funding of retiree pensions and the restructuring of retiree health benefits is discussed in Section III.E. The City's settlements with the police, firefighters and other employee unions are discussed in Section III.G, IV.A.8 and V.A.2.j. The City's settlements with the bondholders who own City issued bonds are discussed in Section III.F and V.A.2.l. Annexation of the City into the San Bernardino County Fire Protection District ("County Fire"), and having County Fire provide fire suppression and emergency medical response services instead of the current City Fire Department is discussed in Section V.C.1.a. The City's contracting out of solid waste and recycling, sweeping and right-of way clean up services to Burrtec Waste Industries, Inc. ("Burrtec") is discussed in Section V.C.5. The City's insurance coverage for personal injury claims is discussed in Section V.C.1.b. The City's revised Long Term 20-Year Financial Model (the "Financial Model") in support of the financial feasibility of the Plan is attached as Exhibit 3 to the supplemental Appendix and discussed in Section VI.D. Other settlements and restructuring efforts are discussed throughout this Disclosure Statement.

The Plan represents a major step forward for the City in its efforts to exit bankruptcy and breathe new life into the City's economy. **All of the City's principal creditor constituencies that initially opposed the City's restructuring efforts now support the Plan.** That includes the City's police, fire and other unions, the official Retirees Committee and CalPERS and the holder of the City's bonds. The City reached a comprehensive settlement with CalPERS, the unions and the Retiree Committee which provides that, **if the Plan is confirmed, the City will continue to make its payments and comply with its other obligations to CalPERS, thereby preserving, not reducing, employee and retiree pension benefits.** As part of those settlements, employees have agreed to contribute more to their pension plans and to make certain other employee benefit concessions, and the Retiree Committee has agreed to the restructuring of retiree health benefits changes that went into effect on January 1, 2015 – all to help the City dig out from its financial insolvency while preserving pension benefits. The Plan also has the support of all of the holders of the City's bonds, and the holders of the City's pension obligation bonds have recently agreed to take a substantial reduction on their claims as well. Under the Plan, the City's creditors are making substantial sacrifices to help get the City back on its feet.

Every dollar of savings from the compromises with the City's creditors is going into rebuilding the City's badly depleted infrastructure and modernizing the delivery of municipal services. Within the last year, the City completed a Strategic Plan with input from City residents and businesses, which formed the basis for the City's recovery plan submitted as an exhibit to the City's original disclosure statement in May 2015. In November 2015, the City developed a Police Services Five Year Resources Plan to rebuild, modernize and properly equip the Police Department to make a significant dent in reducing crime in the City, and has budgeted $17.6 million to implement that five year plan. That money will go to hiring new police officers (the number of officers is 30% less today than in 2009), modernizing the Police Department's technology and replacing the department's aging fleet of vehicles. A copy of the Staff Report for the Five-Year Police Resources Plan is included in the Appendix at Exhibit 11, and parties are encouraged to review it. All the evidence shows that reducing crime will not only positively impact the daily lives of the City's residents, but will also stimulate economic development, and the resulting higher tax revenues will enable the City to renew funding City services that were cut back before and during the Bankruptcy Case. The Financial Model on which the Plan is based also budgets funds for road and street maintenance and repair, building upgrades, parks, libraries, community centers and other essential services which have been neglected for a long time due to the lack of funds.

The Plan, and the City's settlement with the union representing the City's firefighters, will allow the City to provide better firefighting and emergency medical response ("EMR") services by annexing the City into the County Fire District and utilizing the greater and more modern capacity of the County Fire District to provide City residents with fire and EMR services. The City's firefighters have transitioned over to County employment, and their cooperation in this process, and the concessions they have made, has saved the City substantial sums of money. In addition to replacing the City Fire Department to provide better services at lower cost, the City has contracted for the delivery of solid waste and recycling, sweeping and right-of-way cleanup services to a private contractor, Burrtec Waste Industries ("Burrtec"), which decision had the support of the affected City employees. Every dollar of savings from regionalizing or contracting out City services (including in other areas under consideration) is going to rebuilding the City and improving the delivery of other City services.

The City has a long road ahead of it to reach a level of municipal services the residents are entitled to expect. The Plan and the Financial Model on which it is based dedicate as much as the City's resources as they can to providing municipal services to City residents to reach reasonable levels of services over time. That leaves very little to pay creditor claims. Under the Plan, the City will make a distribution of 1% on General Unsecured Claims, because City municipal services were cut to the bone in the years before the Petition Date and in the early days of the Bankruptcy Case, and the City needs to dedicate every dollar available to it to rebuild those municipal services. A description of how much the City was forced to cut back due to lack of funds is discussed in Section III.J below.

All creditors will be better off with the City thriving again, in terms of safer streets, more jobs and greater opportunity. Confirmation of the Plan and the consequent City exit from bankruptcy is a major step in that direction. The City asks all creditors, including retirees, who receive Ballots to take the time to check the box for accepting the Plan and return the Ballot to the Ballot Tabulator.

A. Purpose of the Disclosure Statement

The Bankruptcy Code requires that the proponent of a plan of adjustment prepare and file a disclosure statement that provides information of a kind, and in sufficient detail, that would enable a typical holder of claims in a class impaired under that plan to make an informed judgment with respect to the plan. This Disclosure Statement provides such information. ***Creditors and parties in interest should read this Disclosure Statement, the Plan, and all of the exhibits and any supplements accompanying these documents in their entirety in order to ascertain how the Plan will affect creditor claims against the City and how to cast a ballot with respect to the Plan.***

This Disclosure Statement cannot and does not provide creditors with legal, tax or other advice or inform such parties of all aspects of their rights. Claimants are advised to consult with their attorneys and/or financial advisors to obtain more specific advice regarding how the Plan will affect them and regarding their best course of action with respect to the Plan. In addition, retirees are advised to consult with the Retiree Committee.

This Disclosure Statement has been prepared in good faith and in compliance with applicable provisions of the Bankruptcy Code. Based upon information currently available, the City believes that the information contained in this Disclosure Statement is correct as of the date of its filing. This

Disclosure Statement, however, does not and will not reflect some events that may occur after Bankruptcy Court approval of the Disclosure Statement, and the City presently does not intend to prepare or distribute any supplements to reflect such events.

As required by the Bankruptcy Code, the Plan classifies the claims of the City's creditors into classes based upon the different legal rights of creditors, and proposes to pay each class of creditors in accordance with the City's financial ability. The City must continue to provide its citizens with basic essential services, maintain its streets and buildings, and create an environment in which its residents can safely live and work. In order to do so, the Plan has no choice but to impair certain of the City's creditor's claims to provide the City with a feasible financial foothold going forward. The City believes that the financial restructuring set forth in the Plan represents the best option for the City to achieve this outcome, and to return the City to solvency.

For the reasons set forth in this Disclosure Statement, the City believes that the Plan provides the greatest and earliest possible recoveries to creditors while preserving necessary City services and operations. Acceptance of the Plan is in the best interests of creditors as well as the best interests of the City's residents and businesses. The alternative to accepting the Plan is only additional delay, uncertainty, expense, litigation, and, ultimately, smaller or no distributions to creditors. Therefore, the City urges that you cast your ballot in favor of the Plan.

B. Summary of Treatment of Claims and Other Information

The following chart summarizes key information about the Plan and this Disclosure Statement, including the proposed treatment of the various classes of claims. **Please do not rely on the chart alone. The Disclosure Statement has important information that is not contained in the chart and that may influence your decision regarding whether to vote to accept the Plan. Please thoroughly read this entire document and the accompanying materials.**

Debtor	City of San Bernardino, California.
Bankruptcy Court	United States Bankruptcy Court for the Central District of California, Riverside Division, The Honorable Meredith A. Jury presiding.
Plan	Third Amended Plan For The Adjustment Of Debts Of The City Of San Bernardino, California (July 29, 2016).
Purpose of the Disclosure Statement	To provide information of a kind, and in sufficient detail, that would enable a typical holder of claims in a Class Impaired under the Plan to make an informed judgment with respect to voting on the Plan.
Balloting Information	Ballots have been provided with this Disclosure Statement to creditors known to have claims that are Impaired under the Plan. Ballots must be returned to and received by the Ballot Tabulator by no later than 4:00 p.m., Pacific Time, on Friday September 2, 2016. Objections to confirmation also must be filed and served by no later than September 2, 2016.
Ballot Tabulator	Rust Consulting/Omni Bankruptcy, 5955 De Soto Avenue, Suite 100, Woodland Hills, CA 91367
Confirmation Hearing and Confirmation Objections	A hearing regarding confirmation of the Plan will be held by the Bankruptcy Court on October 14, 2016, commencing at 10:00 a.m., Pacific Time, and may be continued from time to time without further notice other than as may be given at the hearing and/or in the docket of the City's chapter 9 bankruptcy case.
Treatment of Claims	If the Bankruptcy Court confirms the Plan and the Plan becomes effective, claims will be treated as follows:
Administrative Claims	Post-petition claims meeting the definition of Administrative Claims will be paid in full, except to the extent that the holder of an Administrative Claim agrees to different treatment.
Class 1 Claims: 1996 Refunding Bonds Claims	**Impaired.** This Class is comprised of approximately $6 million of Claims relating to the 1996 Refunding Bonds. These Claims will be paid in accordance with the terms of the 1996 Trust Indenture, as amended by the 1996 Refunding Bonds Amendment, and the 1996 Refunding Bond Agreements (City Hall), which the City will assume on the Effective Date. As part of those amendments, a surety will replace funds held in a "Reserve Fund" (as such term is defined in the 1996 Trust Indenture), with such funds to be released to the City for use for capital expenditure purposes in accordance with federal tax covenants.
Class 2 Claims: 1999 Refunding Certificates of Participation Claims	**Impaired.** This Class is comprised of approximately $7.9 million of Claims relating to the 1999 Refunding Certificates of Participation. These Claims will be paid in accordance with the terms of the 1999 Trust Agreement, as amended by the 1999 Refunding Certificates of Participation Amendment, and the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle), which the City will

	assume (as amended by the 1999 Refunding Certificates of Participation Amendment) on the Effective Date. As part of the amendments and assumptions provided for in the 1999 Refunding Certificates of Participation Amendment, the Police Station Lease will be prepaid in full from funds in the Capital Reserve Fund and the debt service Reserve Fund (as such terms are defined in the 1999 Trust Agreement), and the City will redeem an amount of the 1999 Refunding Certificates of Participation equal to the principal components of the Police Station Lease payments to be paid. Upon such prepayment, the Police Station Lease will be terminated, and thereafter, neither the JPFA, National nor the 1999 Refunding Certificates of Participation Trustee will have any interest in the Police Station. In addition, once the Police Station Lease payments have been made, the City will have the right to use any excess funds in the Capital Reserve Fund for capital expenditure purposes in accordance with federal tax covenants.
Class 3 <u>Secured Claims: CIEDB Harriman Project Claims</u>	**Unimpaired.** This Class is comprised of Claims held by CIEDB with respect to the Harriman Project. These Claims will be paid in accordance with those CIEDB Documents relating to the CIEDB's financing of Harriman Project.
Class 4 <u>Secured Claims: CIEDB Pavement Project Claims</u>	**Unimpaired.** This Class is comprised of Claims held by CIEDB with respect to the Pavement Project. These Claims will be paid in accordance with those CIEDB Documents relating to the CIEDB's financing of the Pavement Project.
Class 5 <u>Secured Claims: Police Station AC Financing Claims</u>	**Impaired.** This Class includes the claims of Western Alliance Equipment Finance, Inc. in relation to the Police Station AC Financing Agreement. Under the Plan, the collateral securing the City's payment obligations under the Police Station AC Financing Agreement will be relinquished to Western Alliance, the City will have no further obligations under the Police Station AC Financing Agreement, and Western Alliance will have a General Unsecured Claim for any unpaid amounts due under the Police Station AC Financing Agreement (approximately $475,000).
Class 6 <u>Secured Claims: Burgess Claims</u>	**Impaired.** The maturity date with respect to the Burgess Documents is in 2019, at which time a large balloon payment (approximately $1.1 million) is due to Burgess. Under the Plan, the Burgess Documents will be amended to extend the maturity date until 2022, and the balloon payment will be amortized over that 3-year period with interest continuing to accrue through the new maturity date on the unpaid principal balance at the current interest rate set forth in the Note (5%) which will be paid on January 1 and July 1 of each ear of the 3 year extend period. The Burgess Documents will also be amended to provide that Burgess has granted the City the option until April 30, 2017 to pay the principal amount due under the Note at a 10% discount (the "Discounted Payoff"), plus all accrued and unpaid interest at the rate set forth in the Note through the date that the Discounted Payoff payment is made. The City exercised its option to make the Discounted Payoff payment in June 2016, and then conveyed the Fire Maintenance Facility to the County Fire District in connection with annexation of the City into the County Fire

	District.
Class 7 Claims on Restricted Revenue Bond and Note Payable Obligations	**Unimpaired.** The City will continue to apply restricted revenues to pay the Restricted Revenue Bond and Notes Payable Obligations in the ordinary course of business pursuant to the applicable documents.
Class 8 CalPERS Claims	**Unimpaired.** The Claims of CalPERS will be paid in accordance with the City's settlement agreement with CalPERS and all terms of the settlement agreement are be deemed incorporated into the Plan. The settlement agreement provides for, among other things, (i) payment of certain arrearages to CalPERS; (ii) payment of certain additional administrative costs of CalPERS; and (iii) a covenant not to impair CalPERS under the Plan. Notwithstanding anything in the Plan to the contrary, nothing in the Plan is intended to or does impair or interfere with the rights of the City and CalPERS under the Mediator's Order.
Class 9 PARS Claims	**Impaired.** The City has entered into a settlement with the holders of the PARS Claims. Pursuant to the settlement: (i) the PARS Plans will be rejected, and the City will waive any and all claims to the funds held within the PARS Trust and the 415 Trust as of the date of termination of the PARS Plans, (ii) the amounts remaining in the PARS Trust and the 415 Trust (approximately $1.92 million) will be distributed to the PARS Participants pursuant to agreed-upon allocations, and the City will endeavor to make each such distributions in a manner that will minimize adverse tax consequences for each PARS Participant, (iii) the City will make a distribution of $290,000.00 on the later of the Effective Date or July 5, 2017, and a distribution $290,000.00 on the later of the Effective Date or July 5, 2018, in each case to the PARS Participants pursuant to agreed-upon allocations, and (iv) the City will be discharged from any and all obligations to further fund any PARS Plan or to make any other distributions on account of the PARS Claims.
Class 10 Consenting Union Claims	**Impaired.** The City has entered into settlements with all of the unions representing its seven bargaining units that establish the amount of the claim of each union and its members. The Consenting Union Claims are Class 13 General Unsecured Claims for all purposes, including for voting of, and distributions, on the claims.
Class 11 Retiree Health Benefit Claims	**Impaired.** Under the Plan, the holders of the Retiree Health Benefit Claims will receive the rights and benefits set forth in the Retiree Settlement, including that their pension benefits will not be impaired, but retiree health benefits have been modified.
Class 12 POB Claims	**Impaired.** The POB Claims will be paid in accordance with the settlement between the City and the POB Creditors. Pursuant to the terms of that settlement, the City will make installment payments over a thirty-year term, starting one year after the City's Plan is confirmed. The City will make payments of $1 million to $2.5 million per fiscal year until 2046 instead of the $3.3 million

	to $4.7 million per fiscal year owed under the terms of the 2005 pension bond agreement. The payments constitute a 40% recovery on the POB Claims, in full settlement of the litigation commenced by the POB Creditors regarding the payment priority of their claims, and the POB Creditors now support confirmation of the Plan.
Class 13 General Unsecured Claims	**Impaired.** On the Effective Date of the Plan or as soon as reasonably practicable after the Effective Date, Holders of Allowed Class 13 General Unsecured Claims will receive a 1% distribution on their claims.
Class 14 Convenience Class Claims	**Impaired.** Within 30 days after the Effective Date, each holder of an Allowed Convenience Class Claim will receive the lesser of the Allowed amount of the Claim or $100 at the election of the holder of the Allowed Convenience Class Claim.
Questions:	Questions can be submitted electronically on the City's Chapter 9 website (www.sanbernardinochapter9.com) or by calling 800-572-9583 and leaving a message. All questions will receive a prompt response.

Many capitalized terms are used and defined in this Disclosure Statement and in the Plan. Capitalized terms used but not defined in this Disclosure Statement have the meaning ascribed to them in the Plan.

C. Summary of Entities Entitled to Vote on the Plan and of Certain Requirements Necessary for Confirmation of the Plan

Holders of Allowed Claims in the following Classes are entitled to vote on the Plan because the Claims in each such Class are "Impaired" under the Plan within the meaning of section 1124 of the Bankruptcy Code: Class 1 – 1996 Refunding Bonds Claims; Class 2 – 1999 Refunding Certificates of Participation Claims; Class 5 – Police Station AC Financing Claims; Class 6 – Burgess Claims; Class 9 – PARS Claims; Class 10 - Consenting Union Claims; Class 11 – Retiree Health Benefit Claims; Class 12 – POB Claims; Class 13 – General Unsecured Claims; and Class 14 – Convenience Class Claims. **Class 10 (Consenting Union Claims) and Class 11 (Retiree Health Benefit Claims) are created for claim description purposes only and are Class 13 General Unsecured Claims for all other purposes under this Plan, including for voting on the Plan and for distributions under a confirmed Plan.**

The Bankruptcy Court may confirm the Plan only if at least one Class of Impaired Claims has voted to accept the Plan and if certain other legal requirements are met with respect to Classes of creditors who do not vote to accept the Plan, and with respect to individual creditors who do not vote to accept the Plan. A Class of Impaired Claims has accepted the Plan only when more than one-half in number and at least two-thirds in dollar amount of the Allowed Claims voting in that Class vote in favor of the Plan.

In the event of a rejection of the Plan by any of the voting Classes, the City will request that the Bankruptcy Court confirm the Plan in accordance with the "cramdown" provisions of section 1129(b) of the Bankruptcy Code applicable to the Bankruptcy Case. These provisions permit confirmation of the Plan notwithstanding rejection of the Plan by any of the voting Classes if the Bankruptcy Court finds, among other things, that the Plan does not discriminate unfairly and is fair and equitable with respect to each rejecting Impaired Class. Other sections of this Disclosure Statement provide a more detailed description of the requirements for acceptance and confirmation of the Plan.

D. Voting Procedures, Balloting Deadline, Confirmation Hearing, and Other Important Dates, Deadlines, and Procedures

1. Voting Procedures and Deadlines

The City has provided copies of this Disclosure Statement, the Plan, Appendix and Ballots to all known holders of Impaired Claims in the voting Classes eligible to vote on the Plan. Those holders of an Allowed Claim as of June 16, 2016 in each of the voting Classes who seek to vote to accept or reject the Plan must accurately complete a Ballot and return it to the Court-appointed Ballot tabulator, Rust Consulting/Omni Bankruptcy, 5955 De Soto Avenue, Suite 100, Woodland Hills, CA 91367 (the "Ballot Tabulator"), so that their Ballots actually are received by no later than the Balloting Deadline (as defined in the following paragraph). ***The ballots must be returned directly to the Ballot Tabulator, not to the Bankruptcy Court.*** Note that Ballots do not constitute proofs of claim.

All Ballots must be completed, signed, returned to, and actually received by the Ballot Tabulator by not later than 4:00 p.m. Pacific Time, Friday, September 2, 2016 (the "Balloting Deadline"). Ballots received after the Balloting Deadline, and Ballots returned directly to the Bankruptcy Court rather than to the Ballot Tabulator, will not be counted in connection with confirmation of the Plan.

2. <u>Plan Confirmation Hearing Date and Deadlines for Objections to Confirmation of the Plan</u>

The hearing to determine whether the Bankruptcy Court will confirm the Plan (the "Confirmation Hearing") will commence on October 14, 2016, at 10:00 a.m. before the Honorable Meredith A. Jury, United States Bankruptcy Judge for the Central District of California, in Courtroom 301 of the United States Courthouse, 3420 Twelfth Street, Riverside, California 92501. The Confirmation Hearing may be continued from time to time, including by announcement in open court, without further notice.

Any objections to confirmation of the Plan must be filed with the Bankruptcy Court and served on the following entities so as to be **<u>actually received</u>** by each of them no later than September 2, 2016: (i) City Attorney's Office, 300 North "D" Street, Sixth Floor, San Bernardino, CA 92418, Attention: Gary D. Saenz, City Attorney (the City); (ii) Stradling Yocca Carlson & Rauth, P.C., 100 Wilshire Blvd., 4th Floor, Santa Monica, CA 90401, Attention: Paul R. Glassman, Fred Neufeld and Marianne S. Mortimer (counsel to the City); (iii) Bienert, Miller & Katzman, PLC, 903 Calle Amanecer, Suite 350, San Clemente, CA 92673, Attention: Steven J. Katzman, Anthony Bisconti and Anne A. Uyeda (counsel to the Retiree Committee), (iv) Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153 Attention: Debra A. Dandeneau (counsel to National Public Guarantee Finance Corporation); (v) Paul Aronzon, Linda Dakin-Grimm, Thomas Kreller, Milbank, Tweed, Hadley & McCloy LLP, 601 South Figueroa Street, 30th Floor, Los Angeles, CA 90017 (counsel to Ambac Assurance Corporation); (vi) Ballard Spahr LLP, 1735 Market Street, 51st Floor, Philadelphia, PA 19103-7599 Attention: Vincent J. Marriott, III (counsel to COMMERZBANK Finance & Covered Bond S.A f/k/a/ Erste Europäische Pfandbriefund Kommunalkreditbank AG in Luxemburg); (vii) K&L Gates LLP, 10100 Santa Monica Boulevard, Seventh Floor, Los Angeles, California 90067, Attention: Michael B. Lubic (counsel to the California Public Employees' Retirement System); (viii) Felderstein Fitzgerald Willoughby & Pascuzzi LLP, 400 Capitol Mall, Suite 1750, Sacramento, California 95814 Attention: Steven Felderstein (counsel to the California Public Employees' Retirement System); (ix) Duane Morris LLP, One Market Plaza, Spear Street Tower, Suite 2200, San Francisco, CA 94105-1127 Attention: Ron M. Oliner (counsel to the San Bernardino Police Officers Association); and

(x) San Bernardino City Professional Firefighters, Local 891, SulmeyerKupetz, APC, 333 S. Hope St., 35th Floor, Los Angeles, CA 90071 Attention: David M. Goodrich (counsel to the San Bernardino City Professional Firefighters, Local 891). Objections that are not timely filed and served may not be considered by the Bankruptcy Court. ***Please refer to the accompanying notice of the Confirmation Hearing for specific requirements regarding the form and nature of objections to confirmation of the Plan.***

E. <u>Important Notices and Cautionary Statements</u>

The historical financial data relied on in preparing the Plan and this Disclosure Statement is based upon the City's books and records. Although certain professional advisors of the City assisted in the preparation of this Disclosure Statement, in doing so such professionals relied upon factual information and assumptions regarding financial, business, and accounting data provided by the City and third parties. The status of the City's financial audits is discussed below in Section III.I.

The City's professional advisors have not independently verified the financial information provided in this Disclosure Statement, and, accordingly, they make no representations or warranties as to its accuracy. Although reasonable efforts have been made to provide accurate information, the City does not warrant or represent that the information in this Disclosure Statement, including any and all financial information and projections, is without inaccuracy or omissions, or that actual values or distributions will comport with the estimates set forth herein.

No entity may rely upon the Plan or this Disclosure Statement or any of the accompanying exhibits for any purpose other than to determine whether to vote in favor of or against the Plan. Nothing contained in such documents constitutes an admission of any fact or liability by any party, and no such information will be admissible in any proceeding involving the City or any other party, nor will this Disclosure Statement be deemed evidence of the tax or other legal effects of the Plan on holders of claims in the Bankruptcy Case. This Disclosure Statement is not intended to be a disclosure communication to the public capital markets and should not be relied upon by investors as such in determining whether to buy, hold, or sell any securities of the City or related entities.

Certain information included in this Disclosure Statement and its exhibits contains forward-looking statements. The words "believe," "expect," "anticipate," and similar expressions identify such forward-looking statements. The forward-looking statements are based upon information available when such statements are made and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. A number of those risks and uncertainties are described below. Readers are cautioned not to place undue reliance on the forward-looking statements in this Disclosure Statement. The City undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. This Disclosure Statement is not required to be submitted to the Securities and Exchange Commission ("SEC") or any other regulatory agency or body for approval, and has not been approved, disapproved or determined to be adequate, accurate, truthful, or complete by the SEC or any other regulatory agency or body.

F. Persons to Contact for Further Information

If you have questions about the procedures for voting on the Plan, want another copy of a ballot, or seek further information about the timing and deadlines with respect to confirmation of the Plan, please write to either: (1) City of San Bernardino Plan of Adjustment, c/o Rust Consulting/Omni Bankruptcy, 5955 De Soto Avenue, Suite 100, Woodland Hills, CA 91367; or (2) Stradling Yocca Carlson & Rauth, P.C., 100 Wilshire Blvd., 4th Floor, Santa Monica, CA 90401, Attention: Paul R. Glassman, Fred Neufeld and Marianne S. Mortimer (facsimile: 424-214-7010; Email: pglassman@sycr.com, fneufeld@sycr.com or mmortimer@sycr.com). Please note that counsel for the City cannot and will not provide creditors with any legal advice, including advice regarding how to vote on the Plan or the effect that confirmation of the Plan will have upon claims against the City. For additional information, retirees should contact the Retiree Committee. Counsel to the Retiree Committee is Bienert, Miller & Katzman, PLC, Attn: Steven J. Katzman, Anthony Bisconti and Anne A. Uyeda, 903 Calle Amanecer, Suite 350, San Clemente, CA 92673, phone (949) 369-3700.

II. THE CITY'S FISCAL CHALLENGES LEADING TO ITS BANKRUPTCY FILING

The City is a municipal corporation formed and organized under the City Charter and the California Constitution. It is governed by a seven-member Common Council and a Mayor elected by popular vote. The City has approximately 213,000 residents, serves as the county seat for San Bernardino County, and occupies an area of approximately 59 square miles.

A. The City's Financial Problems Prior to the Petition Date

Beginning in the 1980s, the City faced a number of economic challenges such as job losses from the closure of several major employers in the area like Kaiser Steel and the Santa Fe Rail Yard, as well as the loss of business generated by people traveling between Los Angeles and Las Vegas after Interstate 15 was re-routed roughly fifteen miles west of the City. In 1995, another economic blow hit the City when Norton Air Force Base closed as part of the United States' Base Closure and Realignment Act which resulted in the loss of a significant number of jobs.

The housing construction boom of the early to mid-2000s led to speculation in the residential housing market, and San Bernardino experienced an influx of people seeking housing more affordable than that available in Los Angeles, Orange and San Diego Counties. The new home construction and real estate boom provided a boost to the City's economy, but also increased the demand for services. When the real estate boom went bust and the Great Recession hit, San Bernardino was particularly hard hit.

Between 2007 and 2012, San Bernardino residential housing prices plummeted resulting in significantly lower property tax revenues. Speculation in San Bernardino's housing market made it particularly vulnerable when the housing bubble burst, and the Riverside-San Bernardino-Ontario metro area had one of the nation's highest foreclosure rates in 2012. San Bernardino's foreclosure rate was 3.5 times greater than the national average in 2012. The median single family home sales price peaked in 2007, and remained over 40% below that peak in June of 2012. In addition to declines in residential real estate prices, commercial properties dropped in value and continued to search for a bottom as of 2012. Since peaking in the 2008-09 fiscal year, City property tax revenues dropped between $4 million and $7 million each year from that peak. Given continued housing market weakness and the constraints imposed by Proposition 13 on property tax increases, property tax revenues likely will grow only modestly for years to come.

Sales tax revenues also dropped due to increased unemployment and lower per-capita incomes caused by the loss of the major employers and job losses caused by the Great Recession and real estate market crash. Since June 2008, the City suffered from double digit unemployment and the unemployment rate was 16.9% as of June 2012, notably higher than the State of California's and more than twice the June 2012 national rate of 8.2%. By 2010, roughly 34.6% of the City's population was classified as poor. In 2011, the U.S. Census Bureau ranked the City as the second poorest in the nation behind only Detroit. Not surprisingly given these statistics, sales tax revenue declined significantly from its peak level of $36.7 million in 2005-06 to a low of $20.4 million in 2009-10, a decline of over $16 million or 44%. While sales tax revenues increased modestly since the 2009-10 low, those revenues are not projected to increase significantly in the near term. In addition to declining real property and sales tax revenues, the City suffered essentially flat or lower revenues from franchise taxes, user utility taxes, business registration, licenses and permits, revenues from other agencies and other miscellaneous revenues from sources such as fines, penalties and the transient occupancy tax.

In 2011, Governor Brown signed legislation eliminating redevelopment agencies throughout the State of California. In December of 2011, the California Supreme Court upheld this legislation and ordered the dissolution of all redevelopment agencies effective as of February 1, 2012. This resulted in the loss of further resources to support economic development programs in the City and funds allocated for general government functions. The loss of redevelopment agency funds further exacerbated the City's financial struggles.

Given these economic declines, the City struggled with budget deficits in the four consecutive fiscal years prior to the Petition Date. Since the end of fiscal year 2008-09, the City's General Fund revenues dropped while its General Fund expenditures remained the same or increased. As a result, the City's General Fund budget deficits in those four consecutive fiscal years totaled over $25 million. To address those budget deficits, the City exhausted its General Fund reserves, cut jobs, cut services, sold assets, implemented revenue measures, increased transfers from other funds, and used other mechanisms to maintain cash liquidity and continue essential operations.

B. <u>The City's Attempts to Avoid Insolvency</u>

While the City was aware prior to late June of 2012 that its revenues had declined during the Great Recession and it was struggling financially, the City believed that it had taken the appropriate steps to address budgetary issues and reduce expenditures. Labor costs have been and are the City's largest General Fund expenditure. Governmental service delivery is labor-intensive and relies on City employees to patrol streets, repair and maintain infrastructure, respond to emergencies, staff libraries and community centers, and deliver other direct and supporting services to operate the City. For several fiscal years prior to the Petition Date, the City tried to balance its budgets by negotiating reductions in employee costs and eliminating positions, while continuing to provide basic essential services – all of which resulted in service level reductions to the community. The City eliminated over 250 positions between 2009 and 2012, despite population growth of nearly 25,000 people.

In the 2012-13 fiscal year, personnel costs were projected to account for roughly 78% of all General Fund budgeted expenditures, about 75% of which were for public safety personnel. Charter Section 186 ("Section 186") establishes the base salaries for members of the San Bernardino Police and Fire Departments, and mandates a process of determining such salaries based on the arithmetic average of the monthly salaries paid in ten California cities with populations between 100,000 and 250,000 selected by the City and the police and firefighters. As such, under the Charter, the process of determining the salaries paid to the City's police and firefighters is independent of and unrelated to the City's fiscal condition. Despite the City's efforts to reduce personnel costs by negotiating concessions, eliminating positions and leaving vacancies unfilled, the City's cost per employee rose steadily as pension costs increased. This forced the City to further reduce staff and services in an effort to balance budgets without receiving any corresponding reduction in its overall personnel costs.

A key factor in the City's inability to balance its budgets was its pension costs. In absolute dollars, the City's employee General Fund pension costs rose from $6.2 million in 2000-2001 to about $14.25 million in 2014-15 and were expected to be almost $19 million in 2015-16. As of June 30, 2012 (one month before the City filed its Bankruptcy Case), CalPERS reported that the City's employee pension plans had unfunded actuarial accrued liability of $323.1 million. In addition to paying the normal cost of employees' pensions, the City is required to make payments related to the unfunded actuarial accrued liability.

C. <u>The City Learns It Is Deeply Insolvent</u>

While the City had been in economic decline since 2008 (and generally since the 1980s), the magnitude and scope of the City's cash insolvency and budgetary insolvency was not understood fully until a short time prior to the Petition Date. Even as late as early April 2012, the City Manager believed that the actual budget deficit of the General Fund was only $3.183 million (as reflected in the City's fiscal year 2011-12 Mid-Year Budget Workshop agenda dated April 3, 2012), and the City took steps to reduce that deficit and balance its budget at that time. Unfortunately, this estimate of the City's General Fund budget deficit was inaccurate and the City's subsequently completed Comprehensive Annual Financial Report reflects that the actual budget deficit for the 2011-12 fiscal year was $7.8 million. Making matters worse, the City-wide implementation of new financial accounting software and other circumstances resulted in a significant backlog of accounting work and, as a result, the City was not aware until June of 2012 that it had a cash deficit of millions of dollars in its General Fund. The City discovered it was on the edge of a very deep fiscal abyss only after the City's new Finance Director completed a detailed analysis of the City's financial condition in late June of 2012.

Beginning in May of 2012, the City's new Finance Director began analyzing the City's financial condition and developing a budget for the 2012-13 fiscal year, resulting in a report by the City's Finance Department entitled "San Bernardino Budgetary Analysis and Recommendations for Budget Stabilization" dated July 9, 2012 (the "Budget Report").[1] The key points of the Budget Report included that: (1) the City faced a General Fund budget deficit preliminarily estimated to be over $45.8 million in the 2012-13 fiscal year; (2) the City had depleted all of its General Fund reserves and reserves in its internal service fund accounts and other funds to cover the substantial budget deficits in the last four consecutive fiscal years; and (3) immediate and substantial action had to be taken to reduce spending and preserve cash for the City to continue to provide essential services to the City's residents.

Equally or more dire than the City's enormous financial hole was the fact that the City faced a severe cash liquidity crisis. As news of the City's financial problems spread, its fiscal situation and cash flow crisis grew worse. A Staff Report dated July 18, 2012,[2] explained that: (1) it was likely that the City could not meet its payroll and other financial obligations in the next 30 to 60 days, including debt obligations and lease payments for critical City assets; (2) an unusually large number of employees were retiring or leaving the employ of the City, triggering immediate payment of large vacation and

[1] The Budget Report is available on the City's website at: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

[2] The Staff Report is available on the City's website at: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

sick leave pay accruals; (3) the City's credit line had been terminated; (4) vendors were demanding cash up front before providing essential materials, goods and services to the City; (5) the City had no ability to access short term credit markets to solve its cash flow problems and no reserves; and (6) cash flow projections showed that the City had monthly General Fund deficits ranging between about $2 and $5.6 million from July through September.

The City also faced huge deficits in its Internal Service Funds. The City has historically established Internal Service Fund accounts pursuant to accepted governmental accounting practices for fleet services (vehicles, vehicle maintenance and related costs), liability and property insurance (for the City's self-insurance program and payment of claims), worker's compensation insurance, unemployment insurance, telephone support (for the City's communication system), utilities (for the City's utility costs) and central services (for reproduction and copying services). All the reserves in the City's Internal Service Fund accounts had been depleted, and its worker's compensation and liability and property insurance funds were underfunded by an estimated $20 million. The need to replenish funding for long term liabilities in the City's Internal Service Funds contributed to and was in addition to the City's projected $45.8 million budget deficit for fiscal year 2012-13.

At the same time, the City had other long term debt obligations on which payments were coming due, including outstanding bond indebtedness in a par amount of approximately $90 million, and lease obligations approaching $16 million for critical City assets such as City Hall, police, library and fire facilities, fire engines, police vehicles, fire station alerting systems, refuse trucks and other critical equipment, and for infrastructure loans for capital improvements. In addition, certain creditors were threatening to levy on City assets (including City bank accounts) to enforce their claims against the City, which could have resulted in creditors seizing funds the City had earmarked for making its August 2012 payroll.

D. <u>The City's Declaration of Fiscal Emergency and Filing of the Bankruptcy Case</u>

Facing an immediate liquidity crisis and the fact that the City was be unable to meets its financial obligations, City staff recommended that the City consider a declaration of fiscal emergency and filing for Chapter 9 bankruptcy protection. Following presentations, discussions and public comments at three noticed meetings held on July 10, July 16 and July 18, 2012 regarding the City's budget for the fiscal year 2012-13 and the possibility of filing of a petition under Chapter 9, a majority of the Common Council voted to declare a fiscal emergency and passed Resolution No. 2012-205 finding that: (1) the City is or will be unable to pay its obligations within the next 60 days, and that the financial state of the City jeopardizes the health, safety or well-being of the residents of the City absent the protections of Chapter 9; and (2) given the City's dire financial condition, it was in the best interest of the City to declare a fiscal emergency. The City's dire cash flow crisis presented a fiscal emergency that translated into a service emergency and would negatively affect the health, safety and well-being of its citizens if City employees, including police, fire and other essential workers, were not paid and did not report for work. On July 18, 2012, the Mayor and Common Council determined that "given the City's dire financial condition and taking into consideration the advice of City staff and counsel, it was in the best interests of the City to seek protection under Chapter 9 of the Bankruptcy Code" and passed Resolution No. 2012-206 authorizing the filing of a voluntary petition under Chapter 9 of the Bankruptcy Code.[3] The City filed its chapter 9 petition for relief under the Bankruptcy Code commencing the Bankruptcy Case on August 1, 2012.

E. <u>Adoption of City's Fiscal Emergency Plan</u>

In order to preserve enough cash to meet its August 2012 payroll and provide essential services through the end of September 2012 assuming that a Chapter 9 case would be filed, the City approved its Fiscal Emergency Plan on July 24, 2012 (the "Fiscal Emergency Plan").[4] Pursuant to the Fiscal Emergency Plan, the City did not make certain debt payments then due, including: (1) a payment on bonds due on July 20, 2012 in the amount of over $3.3 million; (2) bi-monthly payments to fund retiree health plan obligations due in the first quarter of the fiscal year; and (3) trade payables due and owing in an amount of over $6 million. These and other measures to preserve cash were necessary to maintain liquidity so that the City would have enough cash to make its August 2012 payroll and continue essential operations.

[3] Resolution Nos. 2012-205 and 2012-206 are available on the City's website at: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

[4] The Fiscal Emergency Plan is available on the City's website at: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

Given the magnitude of its financial problems, the City determined that it could not borrow money from the private credit markets to meet its obligations because it could not demonstrate the ability to pay back any such loan with revenues generated in the same fiscal year. In addition, the City believed that other practical issues, as well as legal and accounting requirements, also limited the City's ability to raise or borrow money to close revenue shortfalls on an expedited basis. The City's property tax revenue is limited by Proposition 13, and the City's ability to raise any other taxes is limited by Proposition 218 which requires that a majority of voters approve any new or increased general tax (the proceeds of which can be used for any purpose) and that a two-thirds majority approve any new or increased special tax (one expressly limited to a specific purpose). Locally, voters' enactment of Measure Z (a 0.25 percent district tax for 15 years enacted in 2006) to be used to fund more police officers and support personnel and anti-gang and anti-crime operations, left the City with limited opportunities to burden its citizens (a high percentage of who have limited incomes and live below the poverty level) with new general purpose taxes. The immediate severity of the City's cash flow problems and the time required to enact a ballot measure ruled out a tax increase as a viable expedient option.

III. ADMINISTRATION OF THE BANKRUPTCY CASE

A. <u>Implementation of the Pendency Plan</u>

Subsequent to the Petition Date, the City implemented a series of interim financial plans to grapple with its fiscal emergency. In September 2012 and on October 1, 2012, the Common Council approved the budget set forth in a Pre-Pendency Plan (as adjusted by a 9-Point Adjustment Plan) which subsequently was incorporated into and modified by the City's Pendency Plan adopted on November 26, 2012 as Resolution No. 2012-278.[5] On April 22, 2013, the City adopted its final budget for fiscal years 2012-13 and 2013-14 which further implemented the Pendency Plan.[6] The City budgets for fiscal years 2014-15 and 2015-16 have continued certain of the expenditure reductions in the Pendency Plan and implemented other measures to align expenditures with revenues.[7] These efforts

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[5] The Pre-Pendency Plan and Pendency Plans are available at: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

[6] The City's budget for fiscal years 2012-13 and 2013-14 was adopted as Resolution No. 2013-76.

have enabled the City to survive financially, manage its ongoing fiscal emergency, and provide essential governmental services to its residents until approval of the Plan.

Some of the Pendency Plan's cost-saving measures required modifications to the terms and conditions of employment of the City's employees. In late January 2013, the City reached agreements with four of the seven unions representing City employees on modifications to the terms and conditions of employment, as set forth in Resolution Nos. 2013-22, 2013-23, 2013-24, and 2013-25. As to the three unions that would not agree, the City imposed the modifications, as set forth in Resolution Nos. 2013-18, 2013-19, and 2013-20. The City subsequently reached agreements with the three non-consenting unions, which agreements are discussed below in Section III.G.

B. <u>Eligibility Litigation</u>

If a city files for chapter 9 relief, it must prove that it is eligible for such relief under Bankruptcy Code Sections 109(c) and 921(c). A hearing was held in the Bankruptcy Court on August 28, 2013 to determine the City's eligibility for chapter 9 relief. On September 17, 2013, the Bankruptcy Court entered an order determining that the City was eligible, and on October 16, 2013, the Bankruptcy Court issued an opinion explaining the reasons for its ruling. The ruling is published as *In re City of San Bernardino*, 499 B.R. 776 (Bankr. C.D. Cal. 2013). CalPERS, which had objected to the City's eligibility for chapter 9 relief, took an appeal from the eligibility ruling. However, the City and CalPERS later entered into a comprehensive settlement, and CalPERS will dismiss the appeal when the City's Plan becomes effective.

C. <u>Mediations Conducted by Judge Gregg Zive</u>

On September 5, 2013, the Bankruptcy Court entered an order appointing the Honorable Gregg Zive, U.S. Bankruptcy Judge for the District of Nevada, as case mediator, and ordered the City and its principal creditor constituencies to participate in mediation and use the mediation for the purpose of achieving a Chapter 9 plan of adjustment. The mediation parties included the City, CalPERS, the City's secured and unsecured bond holders, the unions representing police and fire safety employees (the SBPOA and SBCPF), and the Official Committee representing the interests of several thousand

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[7] The City's 2014-15 budget was adopted as Resolution No. 2014-245, and its 2015-16 budget was adopted as Resolution No. 2015-132.

City retirees (the "Mediation Parties"). Ultimately, each of the entities that participated in the mediation entered into settlements with the City – CalPERS, the official Retiree Committee, the unions representing the City's police officers and firefighters, and all of the City's bondholders. Judge Zive's proactive participation in the mediation was vital to the City's reaching agreements with its principal creditor constituencies.

D. <u>The City's Pension Plan and the CalPERS Settlement</u>

A CalPERS defined benefit pension is considered to be the industry standard for municipal employees in California. Over 97% of California cities contract with CalPERS for pension benefits, and more than 99% of California municipal employees are covered by CalPERS or another defined benefit pension plan. The City contracts with CalPERS to administer a pension plan for the City's employees and retirees. The City has no ready, feasible, and cost-effective alternative to the administration of its pension plan by CalPERS.

The City believes that its obligations to CalPERS constitute an "executory contract." Under bankruptcy law, a city may assume or reject an executory contract, or the parties may agree to modify the contract. CalPERS, however, took the position that the relationship between the City and CalPERS is not an executory contract that can be assumed or rejected in bankruptcy, and that California law does not provide CalPERS with any legal authority to negotiate changes to the pension plans to provide reduced benefits or different payment structures for the City, or make any other modification that would provide material financial relief to the City. CalPERS also asserted that if the City terminated its participation in CalPERS, current and future retirees would suffer a significant reduction in their pension benefits. According to CalPERS actuarial valuation reports for the Safety and Miscellaneous Plans as of June 30, 2014, if the City had terminated its participation in CalPERS as of June 30, 2014, the City would face an almost $2.5 billion hypothetical termination liability.

Under the Plan, the City is not terminating or rejecting its contract with CalPERS. Rather, pursuant to a settlement agreement entered into with CalPERS, the City will continue to participate in CalPERS, and the City's relationship with CalPERS will be unimpaired by the Bankruptcy Case or the Plan. A copy of the settlement, entitled Mediator's Order, is included in the Appendix as Exhibit 19.

As described in the Mediator's Order, the City owed CalPERS $13.52 million for the unpaid employer contributions to the City's pension plan for the period from August 1, 2012 through June 30, 2013 (the "Arrearage"). The Mediator's Order provides, among other things, that the City will: (i) will pay the Arrearage with interest; (ii) pay certain additional administrative costs of CalPERS; and (iii) ratify its relationship with CalPERS and not impair CalPERS under the Plan. On July 1, 2014, the City began repaying the Arrearage with interest in the amount of $602,580.00 monthly. As of March 1, 2016, the City has paid CalPERS $14.154 million. The City was expected to complete payment in full of the Arrearage on June 1, 2016.

Although the City will have paid the Arrearage in full (including with interest at a 7.5% interest rate) in the amount of $15,961,909.00 before confirmation of the Plan, and ratified its relationship with CalPERS and agreed not to impair CalPERS under the Plan, the settlement with CalPERS still required that the City pay a penalty to CalPERS in the amount of $2 million, paid out over five annual installments of $400,000 each, beginning upon confirmation of the Plan. Of that $2 million, $500,000 will be kept by CalPERS itself and the remaining $1,500,000 will be credited to the City's pension plans (which payment is in addition to the normal annual amount due).

The City agreed to the terms of the Mediator's Order because, after careful analysis, the City determined that it could not, as a practical matter, terminate its relationship with CalPERS. The City concluded that termination of the CalPERS relationship would lead to an exodus of City employees and impair the City's future recruitment of new employees due to the noncompetitive compensation package it would offer new hires. This would be a particularly acute problem in law enforcement where retention and recruitment of police offers is already a serious issue in California, and where a defined benefit pension program is virtually a universal benefit.

The departure of City employees upon the City's termination of its relationship with CalPERS could be massive and sudden. Under recently enacted California law, in order to preserve their pension benefit levels at a new employer, City employees would need to leave the City's employ and obtain employment with another public agency with a defined pension benefit plan administered by CalPERS or by the County Employees Retirement Act of 1937 within six months of a rejection of the City's contract with CalPERS. A sudden massive loss of trained and experienced employees would seriously jeopardize the City's ability to provide even the most basic essential services, including public safety services. Termination would also require the City to fund and operate an alternate pension plan providing market-level benefits in order to remain a competitive employer, because the City does not participate in the federal Social Security program and City employees receive no federal pension benefits from that source. As a result, the City could not terminate its relationship with CalPERS without incurring substantial additional financial obligations and jeopardizing its ability to recruit qualified employees.

The City believes that the changes made during the Bankruptcy Case requiring greater contributions by employees to their own pension plans, together with the changes in pension benefits for new hires after January 1, 2013, have moderated the City's pension costs. Since January 2013, City employees have been contributing the full statutory CalPERS employee rates and the City has eliminated the contractual Employer Paid Member Contribution (EPMC) benefit. The City is also reducing pension costs by contracting out to the private sector certain municipal services (including solid waste and recycling, sweeping and right-of way clean up), and is reducing pension costs related to City firefighting personnel by annexing into the County Fire District. While feasible contracting or regionalization opportunities for some municipal services (*e.g.* police protection) are not existent at this time and the City will have to employ public workers for core management and administrative functions, the City will continue to explore options for more efficient delivery of municipal services at a lower cost (including, in particular, lower pension costs).

E. <u>Settlement With Official Retiree Committee on Retiree Health Benefits</u>

In October 2013, with the support of the City, the Office of the United States Trustee (an arm of the U.S. Dept. of Justice) appointed nine retired City employees to serve as members of the Official Committee of Retired Employees ("Retiree Committee"). The Retiree Committee represents only the interests of City retirees, and does not represent current City employees or any other creditors. The Retiree Committee is represented by Bienert, Miller & Katzman, PLC.

The City and the Retiree Committee have reached a comprehensive settlement (the "Retiree Settlement Agreement"), a copy of which is included in the Appendix as Exhibit 27. The City began implementing the Retiree Settlement Agreement on January 1, 2015. Under the Retiree Settlement

Agreement, the City has agreed to continue to fund the pension benefits provided by CalPERS to the City's retirees, without impairment. **Retirees will continue to receive pension benefits from CalPERS unaffected by the filing of the City's Bankruptcy Case or the confirmation of the Plan**. In exchange, the retirees consent to the City's modifications to retiree health benefits that the City implemented in January 1, 2015. The City's agreement to continue funding the pension benefits unimpaired by the Plan is contingent therefore on the retirees voting to accept the Plan. The following summary describes the terms of the Retiree Settlement Agreement, but retirees are encouraged to read the entirety of the agreement, and any inconsistency between this description and the Retiree Settlement Agreement will resolved by reference to the Retiree Settlement Agreement.

Medicare Eligible Retirees Under the Age of 65

Retirees in this category include all Retirees under the age of 65 as of January 1, 2015 and: (i) who will become eligible for Medicare benefits once the Retiree reaches the age of 65; or (ii) whose spouse or partner will become eligible for Medicare benefits once this individual reaches the age of 65. All Retirees in this category will be eligible to participate in the City's healthcare plans until they reach the age of 65; however: (i) the City will no longer provide a subsidy of $112 per month; (ii) Retirees will no longer be allowed to participate in a "blended" benefit program with active City employees but will be placed in a Retiree-only healthcare plan; and (iii) in the event that a Retiree opts out of the City's healthcare plans for Retirees, that Retiree will not be eligible to participate in the City's health benefit programs in the future.

Medicare Eligible Retirees Who Are Age 65 and Over

Retirees in this category include Retirees who are age 65 or older as of January 1, 2015 and: (i) who are eligible for Medicare benefits; or (ii) whose spouse or partner is eligible for Medicare benefits or who will become eligible for Medicare benefits once this individual reaches the age of 65. For all Retirees in this category, the City will no longer provide a subsidy of $112 per month. Also, the City's sponsored healthcare coverage will terminate as of the date of the Retiree's 65th birthday or that Retiree's spouse/partner's 65th birthday (whichever individual is Medicare-eligible); if both the Retiree and the spouse/partner are Medicare eligible, the City's sponsored healthcare coverage will terminate on the earliest date that either reaches the age of 65. Upon termination of healthcare coverage, the City will provide information to the Retirees in this category concerning options to purchase Medicare Supplemental plans and/or managed care plans.

Medicare Ineligible Retirees Under the Age of 65

Retirees in this category include Retirees hired prior to April 1, 1986 who are under the age of 65 as of January 1, 2015, and who are not eligible for Medicare benefits. All Retirees in this category will be eligible to participate in the City's healthcare plans; however: (i) the City will no longer provide a subsidy of $112 per month; (ii) Retirees will no longer be allowed to participate in a "blended" benefit program with active City employees but will be placed in a Retiree-only healthcare plan; and (iii) in the event that a Retiree opts out of the City's healthcare plans for Retirees, that Retiree will not be eligible to participate in the City's health benefit programs in the future.

Medicare Ineligible Retirees Who are Age 65 and Over

Retirees in this category include Retirees: (i) hired prior to April 1, 1986; (ii) who are not eligible for Medicare benefits and provide proof to the City of non-eligibility; and (iii) who are age 65 or older as of January 1, 2015, or who reach the age of 65 after January 1, 2015 and who satisfy the two previous requirements of this paragraph. All Retirees in this category will be eligible to participate in the City's healthcare plans; however: (i) the Retirees will no longer be allowed to participate in a "blended" benefit program with active City employees, but will be placed in a City healthcare plan for Retirees only; and (ii) in the event that the Retiree opts out of the City's healthcare plans for Retirees, such Retiree will not be eligible to participate in the City's health benefit programs in the future. The City will provide to Retirees in this category a lifetime subsidy equivalent to the difference between the current and future premium for the lowest baseline unblended medical plan for 2014 ("Subsidy"). Any annual increases in the Subsidy shall be capped at two percent (2%) per calendar year. The Subsidy shall be available so long as the Retiree is not eligible to receive Medicare benefits. For calendar year 2015, the City contributed $112 per month towards the Subsidy.

In order to be eligible for any of the health plans or City Subsidies as defined in the Retiree Settlement Agreement, all Retirees are required to respond to all requests for information regarding eligibility for certain plans and/or City contributions toward the same. Retirees who fail to provide sufficient information in response to the City's request for eligibility information ("Affected Retirees") may be disqualified from participating in any plans or receiving City contributions. The City shall undertake reasonable efforts to contact Affected Retirees and provide them with a reasonable time and opportunity to respond to the City's request for information prior to any determination to disqualify an Affected Retiree from participating in any plans or received City contributions.

The City retains the discretion to modify, at any time, any of the City sponsored healthcare plans provided to any or all of the Retirees. Pursuant to Resolution No. 2014-369, employees hired on or after January 1, 2013, will not be eligible to receive City contributions, payments or subsidies for retiree health benefits or premiums.

F. Litigation, and then Settlement, with the POB Creditors

In 2005, the City issued pension obligation bonds ("POBs") and used the proceeds of the POBs to prepay a portion of its obligation to CalPERS in 2005. COMMERZBANK Finance & Covered Bond S.A., formerly known as Erste Europäische Pfandbrief-Und Kommunalkreditbank AG in Luxemburg ("Commerzbank") is the holder of the POBs, and Ambac Assurance Corporation ("Ambac, together with Commerzbank, the "POB Creditors") is the purported insurer of a portion of the POBs for the benefit of the bondholders. After the Petition Date, the City stopped making payments to the POB Creditors. Approximately $51 million in principal remained due on the POBs on the Petition Date.

In January 2015, the POB Creditors filed a complaint for declaratory relief (adversary proceeding 6:15-ap-01004-MJ). In the complaint, the POB Creditors asked the Bankruptcy Court to determine that whenever the City pays CalPERS, whether now or under the Plan, the POB Creditors are entitled to an equivalent payment. In March 2015, the City filed a motion to dismiss the complaint. In May 2015, the Bankruptcy Court entered its "Order Dismissing Complaint for Declaratory Judgment" wherein it dismissed the complaint in its entirety with prejudice and without leave to amend (the "Dismissal Order"). In June 2015, the POB Creditors filed a Notice of Appeal from the Dismissal Order. The appeal is currently pending before the Bankruptcy Appellate Panel for the Ninth Circuit. The City and the POB Creditors recently entered into a comprehensive settlement regarding the treatment of the POB Creditors' claims under the Plan (the "POB Settlement Agreement"). The settlement is contingent upon confirmation of the Plan, and the POB Creditors' appeal will be dismissed with prejudice once the Plan is confirmed and goes effective. A copy of the POB Settlement Agreement is included in the Appendix as Exhibit 26.

Pursuant to the POB Settlement Agreement, the POB Creditors' asserted $95.8 million claim against the City is reduced to $50.7 million, which is a $45.1 million reduction in one of the City's largest obligations. The City will make installment payments over a 30 year term at a discount rate of 5.628% beginning one year after the Effective Date of the City's Plan. The City will make payments of $1 to $2.5 million per fiscal year until 2046, instead of the $3.3 to $4.7 million per fiscal year due under the terms of the POBs. The present value of the settlement amount is $21.3 million, about a 60% reduction in the $52.7 million owed under the POBs.

The settlement with the POB Creditors saves the City what would have been significant litigation costs over the rights of the POB Creditors. The settlement also removes the risk that the POB Creditors might prevail on appeal on their priority of payment claims, and thereby force the City to pay the full amount of their claim, not just the 40% the parties have agreed on. **Were the City forced to pay the POB Creditors the full amount of their claim, the City would not have the funds to meet its other commitments under the Plan, including to continue fully funding retiree and current employee pension benefits.**

The settlement also ends enormously costly litigation with POB Creditors over confirmation of the Plan, as the settlement provides that the POB Creditors will now support confirmation of the Plan. As Judge Zive, the case mediator noted, the settlement is "a reasonable compromise of the various legal and financial issues."

G. <u>Litigation, and then Settlements, with the City's Labor Unions</u>

In January and February 2013, as part of the City's Pendency Plan, the City implemented certain changes to the terms and conditions of employment of City employees through bargaining with the seven labor organizations: 1) the police safety unit represented by the San Bernardino Police Officers Association (SBPOA); 2) the police management unit represented by the San Bernardino Police Management Association (PMA); 3) the fire safety employees represented by the San Bernardino City Professional Firefighters, Local 891 (SBCPF); 4) the general miscellaneous employees represented by the International Union of Operating Engineers (IUOE); 5) the fire management employees represented by the San Bernardino Fire Management Association; 6) the management/ confidential unit; and, 7) the mid-management employees formerly represented by the San Bernardino Public Employees Association (SBPEA) and currently represented by the Teamsters. While four of the City's seven unions agreed to the changes required by the Pendency Plan, three unions did not. In late February and early March of 2013, the SBCPF, the SBPOA and the SBPEA each moved the Bankruptcy Court for relief from the automatic stay of Bankruptcy Code Section 362 so they could file challenges to the modified terms and conditions of employment with the California Public Employees Relations Board and in the state courts. In March 2013, the City moved the Bankruptcy Court for authority to reject the collective bargaining agreements with those three unions.

The City has resolved all of the litigation with the SBPEA, SBPOA and SBCPF. In August 2013, the City and the SBPEA resolved their disputes and agreed on new terms and conditions of employment. On April 15, 2015, Bankruptcy Court entered an order authorizing rejection of the SBPOA collective bargaining agreement and the SBPOA's motion for relief from stay was denied. However, in August 2015, the City and the SBPOA reached agreement on the terms of a new collective bargaining agreement. A copy of the agreement is included in the Appendix as Exhibit 32. In October and November 2015, the City reached two-year settlement agreements with the Middle-Management, the IUOE, and the Management Confidential labor groups, and a five-year agreement with the PMA.

The litigation with the SBCPF was far more extensive. In July 2014, the SBCPF filed a second motion for relief from stay on an emergency basis seeking authorization to commence litigation against the City in other forums to challenge, among other things, planned operational changes in the City's Fire Department. The Bankruptcy Court denied that motion, the SBCPF appealed from the order, and the U.S. District Court affirmed the Bankruptcy Court's order in full. On September 19, 2014, the City's collective bargaining agreement with SBCPF members was rejected pursuant to the Bankruptcy Court's "Order Granting in Part and Denying in Part City Of San Bernardino's Motion Authorizing Rejection of Collective Bargaining Agreement with the San Bernardino City Professional Firefighters." The SBCPF appealed from the order, and the U.S. District Court affirmed the Bankruptcy Court order in full. The Bankruptcy Court also denied the SBCPF's motion seeking relief from stay to bring claims in the state court challenging the modifications made by the City to the terms and conditions of employment in February 2013. The SBCPF filed two appeals from that order, and the U.S. District Court affirmed the Bankruptcy Court order in full. After the Petition Date, the SBCPF also filed three charges with the California Public Employment Relations Board ("PERB") challenging the City's efforts to implement certain cost-saving measures.

In April 2015, the SBCPF filed two lawsuits in the Bankruptcy Court (adversary proceedings 6:15-ap-01116-MJ and 6:15-ap-01119-MJ) asserting claims related to, *inter alia*, the rejection of their collective bargaining agreement, the modified terms and conditions of employment imposed by the City, alleged violations of federal and state labor laws, purported violations of the City's Charter and civil rights, and the City's efforts to consider alternative methods of delivering fire and emergency medical services to the City's residents.

In adversary case 6:15-ap-01119 , the City filed a motion to dismiss an SBCPF claim that the City Charter and state law forbid the City from contracting out the work of City firefighters to another public agency or private contractor. After substantial briefing and a hearing, on July 16, 2015, the Bankruptcy Court entered an order granting the City's motion to dismiss the SBCPF's "no contracting out" claim. The SBCPF filed an appeal of that order to the U.S. District Court, and the District Court affirmed the Bankruptcy Court order. The SBCPF then appealed from the District Court's order to the Ninth Circuit Court of Appeals. Pursuant to a settlement between the City and the SBCPF, that appeal will be stayed and then will be dismissed when the City performs certain payment obligations under the settlement agreement discussed below.

In adversary case 6:15 ap-01116, the SBCPF challenged the validity of the City's April 2015 decision to issue a Request for Proposals ("RFP") for the contracting out of fire and emergency medical services ("Fire Services"), and moved the Bankruptcy Court to enjoin the City from contracting out Fire Services until the City met and conferred with the SBCPF on contracting out. The Bankruptcy Court (a) determined that the City was required to meet and confer with the SBCPF before contracting out Fire Services and ordered the City to do so, (b) prohibited the City from implementing contracting out of Fire Services until further order of the court, but (c) allowed the City to continue with its annexation application to the San Bernardino Local Area Formation Commission (discussed below) under which County Fire would take over providing Fire Services to City residents. The City and the SBCPF engaged in the meet and confer process required by the Bankruptcy Court, and ultimately reached a settlement dated February 8, 2016 (the "SBCPF Settlement Agreement"). A copy of the SBCPF Settlement Agreement is attached as Exhibit 22 in the Appendix.

The SBCPF Settlement Agreement resolves all of the lawsuits and PERB claims filed by the SBCPF prior to and after the Petition Date, and all of their proofs of claim and requests for payment filed during the Bankruptcy Case. The SBCPF Settlement Agreement was contingent on approval and implementation of the City's annexation into County Fire ("Annexation"), and the SBCPF agreed to fully support Annexation. The key financial terms of the SBCPF Settlement Agreement are: (a) two business days after the date that annexation into the County Fire District is implemented (the "Annexation Date"), the City will pay $1,562,187 in full settlement of all cost-sharing and other pension related claims of the SBCPF and its members, and the City will reduce the SBCPF's members' share of the normal cost of the CalPERS benefit to 9% (the City had raised it to 13.989% in February 2013) effective in January 2016; (b) on the later of December 31, 2016 or the Annexation Date, the City will pay $1,142,000 in settlement of all other post-petition litigation, including overtime claims under the Fair Labor Standards Act ("FLSA"); (c) two days after the Annexation Date, the City will make a "salary comparability" payment of $1,491,000, and will make a second payment in the same amount on the first anniversary of the Annexation Date, in full settlement of all claims of the SBCPF and its members arising from implementation of Annexation into the County Fire District, including claims that County Fire pay and benefits are not comparable to that currently provided by the City; (d) the City will make certain payments to the County Fire District so that transitioning firefighters will begin service with the County with sick leave and vacation time; and (e) all other claims of the SBCPF and its members will constitute a general unsecured claim of $14 million under the City's Plan ("Fire Union General Unsecured Claim"), and that claim will receive the same distribution payable to the class of General Unsecured Creditors in Class 13 General Unsecured Claims. The amount, treatment and distributions on the Fire Union General Unsecured Claim are conditioned on confirmation of the Plan.

Pursuant to the Plan, the City will not reject the SBCPF Settlement Agreement under Bankruptcy Code Section 365, and the City's payment obligations to the SBCPF under the SBCPF Settlement Agreement are excepted from discharge, and the Confirmation Order shall so provide.

H. Motions for Relief from Stay to Pursue or Commence Litigation

Pursuant to 11 U.S.C. §§ 362 and 922, the filing of the Bankruptcy Case imposed an automatic stay which, among other things, prohibits the commencement or continuation of actions against the City, its property and its officers. Approximately twenty-seven motions have been filed in the Bankruptcy Court seeking relief from the automatic stay so that litigation could commence or continue in the state and federal courts. The City has successfully opposed or favorably resolved almost all of these motions for relief from the automatic stay.

I. Status of the City's Audits

As of the Petition Date, the City had not completed its audit for the fiscal year 2011-12. During the Bankruptcy Case, the City completed its Comprehensive Annual Financial Report (CAFR) for the 2011-12 fiscal year.[8] The City's auditors also completed an audit of the City's financial statements for the fiscal year 2012-13.[9] The City's audit for the fiscal year ended June 30, 2014 is now targeted for completion in August 2016. Both the City's audit and the Single Audit for Federal Awards for fiscal year ended June 30, 2015 are targeted for completion in August 2016. The City's Single Audit for Federal Awards for fiscal years ended 2012, 2013 and 2014 have also been completed.[10] The audits of the City's Water Department are prepared separately and available on the City's Water Department website.[11]

J. Development of the City's Plan and Implementation of Measures to Increase Operational Efficiencies and Enhance Revenues

Throughout the Bankruptcy Case, the City worked to stabilize its dire fiscal condition and resolve major litigation with numerous creditors as part of the process of developing the Plan. The City

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[8] To locate the 2011-12 CAFR go to http://www.ci.san-bernardino.ca.us/civicax/filebank/blobdload.aspx?BlobID=17256. Alternatively, from the City's website, http://www.ci.san-bernardino.ca.us/ (1) click "City Hall"; (2) then click "Finance"; (3) then click "Financial Reports"; and (4) then click "Fiscal Year 2011-2012 Comprehensive Annual Financial Report."

[9] The 2012-13 fiscal year audited financial statements can be obtained at this link: http://www.sbcity.org/civicax/filebank/blobdload.aspx?blobid=19606

[10] The City's Single Audits can be obtained at: http://www.sbcity.org/cityhall/finance/financial_reports.asp.

[11] Financial and audit information for the City's Water Department is available at: http://www.sbcity.org/water/divisions/finance/financial_information.asp

also embarked on a community engagement and strategic planning process to further develop its Plan, move the City beyond bankruptcy and build a stronger community. This strategic planning process involved both citizens and community leaders through a number of public meetings held at local public schools throughout the City.

Through this process, the City worked to develop a strategic plan that met the following requirements: (1) resulted in a sustainable local government delivering a competitive mix of municipal services; (2) demonstrated financial stability over at least a ten-year period, with all costs of service covered and appropriate reserve levels maintained; (3) balanced competing needs in an equitable manner with priority placed on continued delivery of basic and satisfactory municipal services, including deferred maintenance while realigning expenditures with resources; (4) delivered services in an effective and efficient manner following industry best practices; (5) recognized the need for the City to be a viable employer for the types of employees it needs to recruit and retain; and (6) formed a system of governance that is proven to support satisfactory performance by other municipal corporations of comparable size and complexity.[12]

During the strategic planning process, the City also developed its Recovery Plan to restore service solvency to the City in a financially sustainable way in order to maintain cash solvency and budget solvency. As part of developing the Recovery Plan, the City evaluated the City's current methods of delivering municipal services and evaluated the feasibility of alternative methods of service delivery and analyzed areas of potential revenue enhancement that either required voter approval or could be achieved without voter approval.[13] During the Bankruptcy Case, the City has taken steps to effectuate greater efficiency in its operations in order to reduce costs while restoring service solvency. These steps are include: (1) contracting out municipal services such as park and grounds maintenance, solid waste, recycling, and street sweeping and right-of-way; (2) initiating and implementing the plan to annex the City into the County Fire District for Fire Services; and (3) evaluating options for alternative

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[12] Further information about the strategic planning process is located on the City's website at the following link under the "Strategic Plan" section: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp

[13] Further information regarding the Recovery Plan dated May 18, 2015, and an update to the Recovery Plan dated November 25, 2015, can be found on the City's website at the following link under the "Recovery Plan" section: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp.

service delivery providers for other municipal services including animal control, fleet maintenance, attorney services, inspection services, and maintenance for certain government use properties such as the Soccer Complex, the Shandin Hills Golf Course and the San Manuel Stadium. The City is taking steps to increase fees for municipal services that do not require voter approval, including approving a parcel tax fee for Fire Services, and increasing fees for water and sewer treatment. The City continues to evaluate additional revenue enhancement opportunities. The steps taken by the City to restore service solvency, streamline its operations and evaluate revenue enhancement measures are discussed below in Section V.C.5.

K. <u>Filing of the City's Plan and Disclosure Statement</u>

On May 30, 2015, the City filed its initial Disclosure Statement and Chapter 9 Plan of Adjustment (May 29, 2015). After considering objections to the initial Disclosure Statement at a hearing on October 8, 2015, the Bankruptcy Court ordered the City to file an amended Disclosure Statement on or before November 25, 2015, and continued the hearing on the adequacy of the Disclosure Statement to December 23, 2015. On November 25, 2015, the City filed its First Amended Disclosure Statement and First Amended Chapter 9 Plan of Adjustment (November 25, 2015). After considering objections to the First Amended Disclosure Statement at a hearing on December 23, 2015, the Bankruptcy Court ordered the City to file a further amended Disclosure Statement on or before February 10, 2016, and continued the hearing on the adequacy of the Disclosure Statement to March 9, 2016. Due to significant developments in the Bankruptcy Case that would materially affect the Disclosure Statement and Plan, the Bankruptcy Court set a status conference for February 4, 2016. On that date, the Bankruptcy Court continued the deadline to file a further amended Disclosure Statement to March 30, 2016, and continued the hearing on the adequacy of the Disclosure Statement to April 27, 2016. On April 27, 2016, the Bankruptcy Court continued the deadline to file a further amended Disclosure Statement to May 27, 2016, and continued the hearing on the adequacy of the Disclosure Statement to June 16, 2016. On July 7, 2016, the Bankruptcy Court entered an order approving the City's Third Amended Disclosure Statement.

IV. THE CITY'S LIABILITIES AND ASSETS

This section summarizes the proofs of claim filed in the Bankruptcy Case, and describes certain of the City's principal liabilities and assets not discussed in earlier sections of the Disclosure Statement.

A. Liabilities and Claims

The description of the transactions in this section is included for summary purposes only. The underlying agreements control in the event of any inconsistency between such descriptions and the agreements. The City reserves any and all rights, defenses and arguments as to whether any of the documents termed as "leases" are "leases" within the meaning of Bankruptcy Code section 365, and no implication may be drawn from or prejudice result from the description of any such "lease" as a lease.

1. Liabilities Listed by the City in Its List of Creditors

On August 9, 2012, the City filed a list of creditors holding the 20 largest unsecured claims against the City as required by the Bankruptcy Code. On November 8, 2013, the City filed the First Amended List of Creditors (the "Creditors' List") which provided a more comprehensive list of creditors and claims. The cover sheet to the Creditors' List disclosed as follows: "The List of Creditors represents obligations of the City's General Fund as well as obligations of the City's designated special use funds. Special use fund obligations are included on the List of Creditors for purposes of full disclosure, and the City maintains that applicable laws and procedures prohibit the use of such special use funds to pay General Fund obligations."[14]

2. Proofs of Claim

The Bankruptcy Court established two deadlines for the filing of proofs of claim against the City that arose on or before September 17, 2013. The first bar date of February 7, 2014 (the "General Bar Date") applied to all claims against the City except those specifically excluded by the order (the "Bar Date Order"). The excluded claims were primarily those relating to (i) claims of current employees of the City; (ii) claims of former employees of the City (and their spouses and dependents) who are receiving pensions or retiree health benefits based upon their former employment with the

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[14] The Amended List of Creditors is available at this link: http://www.omnimgt.com/sblite/templates/a/documentslist.aspx?clientid=CsgAAncz%2b6ZKJYniNraoaWaJM%2bqzpd6uwuSGCG13uwcvZKN5ZQTA3%2bteumuyt5waBBIEHibrRH4%3d&tagid=627

City; and (iii) claims of governmental units against the City. The second bar date of March 21, 2014 (the "Governmental Bar Date") was limited to the claims of governmental units.

Approximately 385 proofs of claim were filed on or prior to the General Bar Date or Governmental Bar Date. Though many of the proofs of claim did not specify, or did not specify correctly, their classification as general unsecured, priority, secured, etc., the City classified these claims based on a review of the proofs of claim filed and the best information available to the City. Based on the City's initial review, the City estimates that creditors filed or asserted 303 General Unsecured Claims, 17 Unsecured Priority Claims, and 42 Secured Claims filed or asserted against the City. Approximately 96 of the proofs of claim, rather than listing a specific amount being sought, were filed with amounts shown as "unknown," "to be determined," or "unliquidated." Those proofs of claim listing a specific amount aggregate to approximately $410.7 million, which are comprised of approximately $292.7 million of General Unsecured Claims as calculated by the filing entities, $557,518 of Unsecured Priority Claims, and $113.8 million of Secured Claims.

The Bar Date Order preserved the City's right to request that the Bankruptcy Court set a deadline for the filing of proofs of claims against the City for claims held by current employees of the City and retirees of the City. As a result of the settlements the City has entered into with CalPERS and each of the Consenting Unions, the City does not contemplate seeking a bar date order for current and former employees because all such current and former employee claims have been resolved by settlement with the Consenting Unions. Similarly, as a result of the settlement the City entered into with CalPERS and the Retiree Committee regarding the continued funding of pension benefits, and the settlement the City entered into with the Retiree Committee on restructuring retiree health benefits, the City also does not contemplate seeking a bar date order for retirees. The amount of the Class 11 Retiree Health Benefit Claim is a fixed number for each retiree, and the Ballots distributed to each retiree for voting on the Plan will provide notice of that fixed claim amount.

3. <u>General Unsecured Claims</u>

Approximately 303 General Unsecured Claims were filed or asserted against the City. Based on its analysis and calculations, the City believes that the allowed amount of General Unsecured Claims in Class 13 will ultimately be between approximately $200 million. This estimate is comprised primarily of General Unsecured Claims that will be discharged under the Plan for Retiree Health Benefits, Employee Wage and Benefit Claims, Consenting Union Claims, Contract Rejection Claims, Litigation Claims and Other Post-petition Claims. A number of proofs of claim were filed that greatly exceed the City's estimates and/or are inconsistent with the City's records.

4. Priority Unsecured Claims

The City believes that substantially all of the Claims which assert a priority unsecured claim against the City are claims properly characterized as General Unsecured Claims and treats them as such in the Plan. Because Chapter 9 incorporates only those administrative claims allowed under section 507(a)(2), the City submits that virtually all Claims filed as priority Claims are not entitled to priority status under Chapter 9. Accordingly, the City intends to object to the characterization of substantially all Claims filed as a priority Claim.

5. Secured Claims

The City has categorized a number of proofs of claim as Secured Claims. These claims are the claims of the California Infrastructure Economic Development Bank, Western Alliance in connection with the Police Station AC Financing Agreement, and Tim Burgess. Although a number of other proofs of claim were also filed as secured, the City does not believe that such claims are actually secured.

a. California Infrastructure Bank Claims

The California Infrastructure and Economic Development Bank ("CIEDB") issued bonds and loaned the proceeds of the bonds to the City so that the City could make the following capital improvements: (1) the "Harriman Place Street Extension Project – Phase I" (a $2 million project to extent the eastern end of Harriman Place to align with a nearby intersection, in order to facilitate the development of a regional commercial shopping center and the improvement of a local blighted area); (2) the "Verdemont Fire Station Project" (a $2.55 million project to finance the construction, acquisition and installation of the Verdemont Fire Station, located on real property owned by the City, as well as the purchase of two new fire engines); and (3) the "Pavement Reconstruction and Rehabilitation Project" (a $10 million project to finance the construction, acquisition and installation of pavement in or around the public streets throughout the City).

In each transaction listed above, the City leased certain real property to CIEDB, CIEDB leased the real property back to the City, and the City's obligations to pay rent under the leases secure the payment of principal and interest under the bonds. The Harriman Place Project involved a Site Lease between the City, as lessor, and CIEDB, as lessee, and a Facility Lease between CIEDB, as lessor, and the City, as lessee, both leases dated as of August 28, 2001 (the real property that is the subject of the leases includes the City's Rudy C. Hernandez Community). The Pavement Project involved a Site Lease between the City, as lessor, and CIEDB, as lessee, and a Facility Lease between CIEDB, as lessor, and the City, as lessee, both leases dated as of April 15, 2006. The Verdemont Fire Station Project involved a Site Lease between the City, as lessor, and CIEDB, as lessee, and a Facility Lease between CIEDB, as lessor, and the City, as lessee, both leases dated as of August 2, 2004 (the "2004 leases"). The amounts due under the Verdemont Fire Station leases will be paid in connection with implementation of the City's annexation into the County Fire District.

b. <u>Claims of Western Alliance</u>

(i) <u>Fire Alerting System</u>

In December 2009, the City and Bank of America, National Association ("Bank of America") entered into a Master Equipment Lease/Purchase Agreement (the "Fire Alerting System Financing Agreement") pursuant to which the City could lease and acquire certain fire alerting system equipment (the "Fire Alerting System") from the lessor. Payment on the Fire Alerting System Financing Agreement was secured by a security interest in the equipment leased and other assets of the City. Bank of America filed a UCC financing statement with respect to the equipment and other collateral. The equipment purchased under the Fire Alerting System Financing Agreement included fire station alerting systems for twelve of the City's fire stations and one dispatch center as set forth on the Schedule of Property No. 1 (related to the Fire Alerting System Financing Agreement). The City still uses the Fire Alerting System equipment. The City makes bi-annual principal and interest payments pursuant to the Fire Alerting System Financing Agreement which matures in December 2016. The City believes that the Fire Alerting System Financing Agreement was assigned by Bank of America to Western Alliance Equipment Finance, Inc. ("Western Alliance") in March 2012.

The amount due in connection with the Fire Alerting System Financing Agreement is approximately $85,000 and has been paid in connection with implementation of the City's annexation into the County Fire District.

(ii) <u>Police Station Air Conditioning Units Agreement</u>

In October 2004, the City and Koch Financial Corporation ("Koch") entered into a Master Equipment Lease/Purchase Agreement pursuant to which the City leased four air conditioners (the "Police Station ACs") for the City's police station headquarters (the "Police AC Financing Agreement"). Koch filed a UCC financing statement with respect to the Police Station ACs. The City believes that Koch assigned its rights and obligations under the Police AC Financing Agreement to Banc of America Public Capital Corp. in May 2010, which subsequently assigned its rights and obligations under the Police AC Financing Agreement to Western Alliance in March 2012. The obligations under the Police AC Financing Agreement were secured by a security interest in the Police Station ACs.

c. <u>The Burgess Claim</u>

In June 2009, the City acquired certain real property located at 120 South D Street in San Bernardino from Tim Burgess ("Burgess") for use as a Fire Department maintenance facility ("Fire Maintenance Facility"). The City's former Fire Department maintenance facility was acquired by Caltrans in connection with work to widen Interstate 215, and the property acquired from Burgess was intended to be used as a maintenance facility for firefighting equipment. The San Bernardino Joint Powers Financing Authority ("JPFA") entered into a Purchase and Sale Agreement to purchase the property from Burgess for $1.6 million and executed the San Bernardino City Fire Department Maintenance Facility Note in the original principal sum of $1,200,000 (the "Burgess Note"), an Indenture and Loan Agreement, and a Deed of Trust, Security Agreement, Assignment of Leases and Rents, and Financing Statement. In June 2009, the City as lessee and the JPFA entered into a Lease Agreement pursuant to which the City makes lease payments to the JPFA for use of the Fire Maintenance Facility. The lease payments secure the JPFA's obligations under the Burgess Note, which the City pays directly to Burgess (the "Burgess Obligations").

6. Restricted Revenue Bond and Note Payable Claims

The revenues that secure the City's Restricted Revenue Bond and Notes Payable Obligations, including the 1998 Refunding Certificates of Participation (Sewer) ("1998 Sewer COPS") and the CSWRCB Revenue Bond Claim, were not a part of or available to the General Fund, and the General Fund is not obligated to make any payment on the Restricted Revenue Bond and Notes Payable Obligations. Rather, Restricted Revenue Bond and Notes Payable Obligations are paid out of "restricted" or "special" funds, as such terms are defined in Bankruptcy Code section 902(2).

The Restricted Revenue Bond and Notes Payable Obligations include the 1998 Refunding Certificates of Participation (the "1998 Sewer COPs"). In order to finance infrastructure improvement projects related to the City's sewer system and wastewater treatment plant, the City and the San Bernardino Public Safety Authority (the "SBPSA") entered into a Trust Agreement dated July 1, 1998 with the 1998 Sewer COPs Trustee, pursuant to which $36.23 million of the 1998 Sewer COPS were issued. Pursuant to an Installment Purchase Agreement entered into between the City and the SBPSA dated July 1, 1998, the SBPSA sold the improvement projects to the City and the City agreed to pay the purchase price of such sale in installment payments (the "Sewer Installment Payments"). The City pledged certain income, rents, rates, fees, charges and other moneys derived from the operation of the City's sewer system (the "Special Revenues") to secure the Sewer Installment Payments, and the SBPSA assigned its right to receive the Special Revenues to the 1998 Sewer COPs Trustee, to fund interest and principal payments on the 1998 Sewer COPS. The 1998 Sewer COPS were scheduled to mature in February 2017. The 1998 Sewer COPS were defeased and paid off in April 2016, in the approximate amount of $3.4 million.

The Restricted Revenue Bond and Notes Payable Obligations also include the CSWRCB Revenue Bond Claim. The CSWRCB Revenue Bond is secured by dedicated Water Funds, which are Restricted Funds and "special revenues" as defined in Bankruptcy Code section 902(2). On or about April 12, 1994, the State Water Resources Control Board (the "SWRCB") and the Santa Ana Watershed Project Authority (the "Santa Ana Agency") entered into a State Revolving Fund Loan (the "Water Project Loan"), as subsequently amended, pursuant to which the SWRCB loaned $30,563,058 to the Santa Ana Agency for the construction of a Regional Tertiary Treatment System (the "Water

Project"). The Santa Ana Agency received the loan on behalf of the City (by and through its Board of Water Commissioners) and the city of Colton and the Santa Ana Agency completed the Water Project on April 1, 1996. On or about April 1, 2000, the Santa Ana Agency assigned its then-outstanding obligations for the Water Project Loan to the City, which assumed the obligation to repay 85% of the outstanding balance (the "CSWRCB Revenue Bond"), and the city of Colton (which assumed the obligation to repay the remaining 15% of the outstanding balance). By City Resolution No. 515, the Sewer Fund of the City was dedicated to repayment of the City's obligation under the CSWRCB Revenue Bond. In April 2016, the remaining $1.7 million outstanding on the CSWRCB Revenue Bond was repaid.

Under the Plan, the City will continue to apply restricted revenues to pay the Restricted Revenue Bond and Notes Payable Obligations in the ordinary course of business pursuant to the applicable documents (which will be assumed by the City on the Effective Date, with any defaults, to the extent any defaults exist as of the Effective Date, that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code cured, or adequate provision made for the prompt cure thereof).

7. Other Bond Claims

a. The 1996 Refunding Bonds and the City Hall and Parking Structure Lease

Pursuant to a 1996 Trust Indenture, the Joint Powers Financing Authority ("JPFA") issued the 1996 Refunding Bonds in the principal amount of $16,320,000 for the purpose of refunding prior certificates of participation, rehabilitating certain portions of City Hall, and funding other capital projects. In connection with the 1996 Refunding Bonds, the former Redevelopment Agency ("RDA") leased City Hall and an adjacent parking structure to the JPFA under a Site and Facility Lease, dated as of December 1, 1996, by and between the RDA, as lessor, and the JPFA, as lessee. In turn, the JPFA leased those buildings to the City.

The lease and lease back transaction is reflected in the following documents: (1) a Ground Lease between the City and the RDA, pursuant to which the City leased the City Hall building located at 300 North "D" Street and an adjacent five-story parking structure to the RDA ("City Hall Ground Lease"); (2) a Site and Facility Lease between the RDA as lessor and the JPFA as lessee pursuant to which the RDA leased City Hall and the related premises (with the RDA retaining fee title to City Hall and the parking structure) to the JPFA ("City Hall Site Lease"); and (3) the City Hall Lease, pursuant to which the JPFA leased City Hall and the parking structure back to the City. In connection with the issuance of the 1996 Refunding Bonds, the City also entered into a Continuing Disclosure Agreement with First Trust of California National Association, the predecessor to the 1996 Refunding Bonds Trustee. The City has continued to make lease payments required under the City Hall Lease during the Bankruptcy Case.

Pursuant to the City Hall Lease, the City agreed to pay the JPFA for use and occupancy of the premises, which lease payments were denominated in principal and interest components payable at the times and in the amounts necessary to allow the JPFA to make full and timely payments of principal and interest on the 1996 Refunding Bonds. Pursuant to the 1996 Trust Indenture, the JPFA transferred in trust and assigned to the 1996 Refunding Bonds Trustee, as security for the benefit of the holders of the 1996 Refunding Bonds, all of the "Revenues" (as defined in the 1996 Trust Indenture) and all of the rights and interest of the JPFA in the City Hall Lease payments, including the right to receive such payments from the City. As additional security for the 1996 Refunding Bonds, MBIA Insurance Corporation ("MBIA") issued its Financial Guaranty Insurance Policy No. 22731, dated December 18, 1996 ("FGI Policy"), pursuant to which MBIA insured the payment of the principal and interest on the 1996 Refunding Bonds when due, subject to the terms and conditions set forth in the FGI Policy. National has succeeded to the rights and obligations of MBIA under the FGI Policy, and U.S. Bank National Association currently is the 1996 Refunding Bonds Trustee.

The 1996 Refunding Bonds are treated in Class 1 of the Plan. Pursuant to the Plan and the terms of the 1996 Refunding Bonds Amendment, the 1996 Trust Indenture and the City Hall Lease will be amended on the Effective Date to permit the substitution of a surety bond issued by National in an amount equal to the "Reserve Requirement" (as such term is defined in the 1996 Trust Indenture) to replace the "Reserve Fund" (as such term is defined in the 1996 Trust Indenture). As of the date of this Disclosure Statement, approximately $5.67 million in principal amount of 1996 Refunding Bonds remains outstanding, and approximately $1.1 million was held in the Reserve Fund. Simultaneously with the substitution of the surety, the funds held in the Reserve Fund will be released to the City, to be used by the City for capital expenditure purposes in accordance with federal tax covenants. In addition, the Plan provides that the City will assume the 1996 Refunding Bond Agreements and cure, or provide adequate assurance for the prompt cure, of all defaults under the 1996 Refunding Bond Agreements that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code.

The effectiveness of the 1996 Refunding Bonds Amendment will also be subject to a number of terms and conditions set forth therein. These terms and conditions include receipt of an opinion of nationally recognized bond counsel to the City, in form and substance reasonably satisfactory to the 1996 Refunding Bonds Trustee, that interest on the 1996 Refunding Bonds will not be included in the gross income of the holders thereof for purposes of federal income taxation as a result of the 1996 Refunding Bonds Amendment; the occurrence of the Effective Date, and the satisfaction or waiver of the conditions to the effectiveness of the 1999 Refunding Certificates of Participation Amendment.

In exchange for the foregoing agreements by the City described in this Section IV.A.7.(a), National Public Guarantee Finance Corporation (“NPFG”), as the deemed holder of the Class 1 Claims, has advised the City that it supports the Plan and intends to vote to accept the Plan.

b. <u>The 1999 Refunding Certificates of Participation and the Police Station, 201 North E Street, and South Valle Leases</u>

Pursuant to the 1999 Trust Agreement, the JPFA issued the 1999 Refunding Certificates of Participation (“1999 COPS”) in the principal amount of $15,480,000 for the purpose of (1) refunding prior certificates of participation issued in 1995 for the cost of constructing and equipping the City’s Police Station; (2) refunding prior certificates of participation issued in 1987 to cover the cost of various public street improvements in the City’s South Valle Redevelopment Project Area; and (3) providing funds for RDA projects and capital improvements.

At the time the 1999 COPS were issued, the RDA owned the Police Station and a 201 North E Street Building located in the City (the “201 Building”), and the City owned the South Valle Improvements (as defined in the South Valle Lease). The lease and lease back transaction was documented by the following documents: (1) the 201 North E Street Site and Facility Lease Agreement between the RDA, as lessor, and the JPFA, as lessee, pursuant to which the RDA leased the 201 Building and the site on which it was located to the JPFA; (2) the 201 North E Street Lease Agreement between the JPFA, as lessor, and the City, as lessee, pursuant to which the JPFA leased to the City the improvements and real property referred to as the 201 North E Street Site (the "201 Lease"); (3) the Police Station Site and Facility Lease between the RDA, as lessor, and the JPFA, as lessee, pursuant to which the RDA leased the Police Station and the Police Station site to the JPFA; (4) the Police Station Lease, pursuant to which the JPFA leased to the City the improvements and real property referenced as the "Police Station Site," which include the City's Police Station; (5) the South Valle Site and Facility Lease between the City, as lessor, and the JPFA, as lessee, pursuant to which the City leased certain City-owned property known as the "South Valle Improvements" to the JPFA; and (6) the South Valle Lease Agreement between the JPFA, as lessor, and the City, as lessee, pursuant to which the JPFA leased back to the City the South Valle Improvements (the "South Valle Lease").

Payment of principal and interest under the 1999 COPS is secured by the lease payments made by the City to the JPFA under the 201 Lease, the Police Station Lease, and the South Valle Lease, and the right to receive such lease payments has been assigned to the 1999 Refunding Certificates of Participation Trustee pursuant to that certain Assignment Agreement, between the JPFA and the 1999 Refunding Certificates of Participation Trustee, dated as of September 1, 1999. In addition, the RDA secured payment of the 1999 COPS pursuant to a deed of trust from the RDA for the benefit of the 1999 Refunding Certificates of Participation Trustee on the real property located at 201 North E Street. During the Bankruptcy Case, the City has made the lease payments due under the 201 Lease, the Police Station Lease, and the South Valle Lease.

As additional security for the 1999 COPS, MBIA issued its Financial Guaranty Insurance Policy No. 30284, dated September 29, 1999 (the "FGI Policy"), pursuant to which MBIA insured the payment of the principal and interest on the 1999 COPS when due, subject to the terms and conditions set forth in such insurance policy. National has succeeded to the rights and obligations of MBIA under the FGI policy, and U.S. Bank National Association currently is the 1999 Refunding Certificates of Participation Trustee. In connection with the issuance of the 1999 COPS, the City also entered into a Continuing Disclosure Agreement with the 1999 Refunding Certificates of Participation Trustee. In addition, the City and the RDA entered into an Agency Agreement, as well as a Reimbursement

Agreement, pursuant to which the RDA promised to reimburse the City for the lease payments made under the 201 Lease and the South Valle Lease.

Subject to the terms and conditions of the 1999 Refunding Certificates of Participation Amendment, on the Effective Date, the 1999 Trust Agreement and the Police Station Lease will be amended and supplemented. Pursuant to the 1999 Refunding Certificates of Participation Amendment, on the Effective Date, funds from the "Reserve Fund" (in excess of the "Reserve Requirement") and the "Capital Reserve Fund" (as such terms are defined in the 1999 Trust Agreement) will be used to prepay in full all remaining lease payments due from the City under the Police Station Lease. As a result of these transactions, the City will be able to withdraw any remaining amounts in the Capital Reserve Fund in accordance with the terms and conditions of the 1999 Trust Agreement. Upon payment in full of the remaining lease payments under the Police Station Lease, the Police Station Lease will terminate and neither the JPFA, National nor the 1999 Refunding Certificates of Participation Trustee will have any interest in the Police Station or the Police Station Lease. The City expects that such prepayment will enable the City to use the Police Station as collateral for purposes of obtaining financing for capital expenditures. As of the date of this Disclosure Statement, approximately $7.9 million in principal amount of the 1999 COPS remains outstanding. In addition, the current balance of the Capital Reserve Fund is approximately $4 million, and the balance of the Reserve Fund (in excess of the Reserve Requirement) is approximately $500,000. The City expects to receive approximately $1 million in excess funds from the Reserve Fund and the Capital Reserve Fund following the optional redemption provided under the Plan.

In addition, pursuant to Section 10.02 of the Police Station Lease, the City will give notice of an optional redemption of the 1999 COPS in an amount equal to the amount of the Police Station Lease payments, with such redemption to occur at the earliest practicable date following the occurrence of the Effective Date. Such notice will specify the order of redemption of the 1999 COPS, which order will ensure that the remaining payments required to be made by the City under the 1999 COPS (Police Station/201 North E Street/South Valle) will be sufficient to pay the principal of and interest on the 1999 COPS when due, as certified by an independent financial consultant of the City reasonably acceptable to National and the Trustee. On the Effective Date, the City will deposit the proceeds of the payment in full of the Police Station Lease with the 1999 Refunding Certificates of Participation Trustee to hold in trust pursuant to the terms of the 1999 Trust Agreement pending the redemption of the 1999 COPS.

In connection with the 1999 Refunding Certificates of Participation Amendment, on the Effective Date, the City will also assume the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle), including the Police Station Lease, as amended by the 1999 Refunding Certificates of Participation Amendment, and will cure, or provide adequate assurance for the prompt cure of all defaults under the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle) that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code.

The effectiveness of the 1999 Refunding Certificates of Participation Amendment will also be subject to a number of terms and conditions. These terms and conditions include the occurrence of the Effective Date and the receipt of an opinion of nationally recognized bond counsel to the City, in form and substance reasonably satisfactory to the 1999 Refunding Certificates of Participation Trustee, that interest on the 1999 COPS will not be included in the gross income of the holders thereof for purposes of federal income taxation as a result of the 1999 Refunding Certificates of Participation Amendment.

In exchange for the foregoing agreements by the City described in this Section IV.A.7.(b), NPFG, as the deemed holder of the Class 2 Claims, has advised the City that it supports the Plan and intends to vote to accept the Plan.

8. Consenting Union Claims

The City has entered into settlements with each of the seven unions representing City employees. Certain of those unions’ and employees’ claims will be impaired, treated as Class 13 General Unsecured Claims and discharged under the Plan. A discussion of the Consenting Union Claims is found at Section V.A.2.j. below.

9. Litigation Claims

a. Pending Lawsuits

There are approximately 172 lawsuits currently pending against the City that seek, among other things, monetary damages. Approximately 94 lawsuits are pre-petition claims, and approximately 78 lawsuits are post-petition claims. The City has reviewed the allegations made in each case, its own files with respect to each case, and the settlements and verdicts in past cases with similar facts, and took into consideration that there has been a substantial recent increase in settlements and verdicts obtained by plaintiffs against public entities in the general geographic region that includes the City. Based upon that analysis, and solely for the purpose of estimating the amount of pending Litigation Claims so as not to delay Plan confirmation, and not for the purpose of allowing any particular claim:

(a) the City's estimated potential liability on the **prepetition** claims is up to $16 million; and if the City were forced to litigate the prepetition claims, the estimated cost of defense would be $5.2 million, in the aggregate; and

(b) the City's estimated potential liability on the **post-petition** claims is up to $6.72 million; and if the City were forced to litigate the post-petition claims, the estimated cost of defense would be $3.16 million, in the aggregate.

A chart listing the lawsuits which identifies the plaintiffs' names, provides a brief description of the causes of action and the date the lawsuit was served on the City and the alleged date of loss, is included in the Appendix as Exhibit 6.

b. <u>Personal/Bodily Injury Claims</u>

Approximately 119 of the 172 pending lawsuits seek damages from the City for personal injury and bodily injury based on alleged torts by the City and its police officers and other employees; 67 of the suits allege prepetition injuries and 52 allege post-petition injuries (the "Injury Claims"). The Injury Claims may be covered by the BICEP Agreement and the Reinsurance Policies (discussed below).

The Injury Claims implicate the City's obligations to defend and indemnify its employees because, under California Government Code §§ 825 and 995, the City is generally required to (a) defend and indemnify its employees in actions brought against such employees by third parties for acts or omissions occurring in the scope of employment, and (b) pay judgments against such employees in the action. *See e.g. Dionne Smith-Downs v. City of Stockton*, 2012 U.S. Dist. LEXIS 109181 (E.D. Cal. 2012) (City of Stockton must indemnify police officers for the amount of any judgment or settlement in civil rights violations action under Cal. Gov't Code §825(a)); *In re City of Stockton*, 484

B.R. 372, 379 (Bankr. E.D. Cal 2012) ("The City bears the financial risk of a judgment against the individual defendants. The City, having undertaken the defense of the City Manager and Deputy City Manager, is generally obliged to pay a judgment against them in the civil action. Cal. Gov't Code § 825.")

Based upon the City's analysis of the Injury Claims: (a) the City's estimated potential liability on the **prepetition** Injury Claims is up to $14.10 million; and if the City were forced to litigate the prepetition Injury Claims, the estimated cost of defense would be $4.24 million in the aggregate; and (b) the City's estimated potential liability on the **post-petition** Injury Claims is up to $5.59 million; and if the City were forced to litigate the post-petition Injury Claims, estimated cost of defense would be $2.43 million, in the aggregate. These estimates of liability for Injury Claims are a subset of the overall estimates of potential prepetition and post-petition liability discussed above.

The estimates described above do not reflect the likelihood that any particular plaintiff will prevail in any particular case, and the aggregate of outcomes in 172 lawsuits may yield significantly lower or higher results. The City is defending or intends to defend substantially all of these cases, and nothing contained in this Disclosure Statement can be used as an admission of fact in any cases.

c. BICEP Agreement and Reinsurance Policies

The City is self-insured under the BICEP Agreement for the first $1 million of defense costs, settlements and judgments per bodily injury or personal injury claim.[15] If the amount of judgment or settlement exceeds $1 million, the City, as a member of the BICEP, and pursuant to the BICEP Agreement, has purchased excess liability coverage that is backed by the Reinsurance Policies between BICEP and each of Great American Insurance Company, Wesco Insurance Company and Starr

[15] Under the BICEP Agreement, (1) bodily injury means physical injury, emotional distress, sickness, or disease sustained by a person, including death resulting from any of these at any time; and (2) personal injury means damages caused by or arising out of one or more of the following: (a) false arrest, detention or imprisonment, malicious prosecution or abuse of process; (b) wrongful entry or eviction; (c) publication or utterance of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services, or infringement of copyright, title or slogan, or oral or written publication of material that violates a person's right of privacy; (d) discrimination, other than employment practices, based upon race, religion, nationality, national origin, color, creed, sex, sexual orientation, handicap, disability, age or employment or violation of civil rights; and (e) assault and battery.

Indemnity & Liability Co. (and/or other companies that BICEP contracts with for reinsurance). The aggregate effect of the BICEP Agreement and the Reinsurance Policies is to provide annually up to $9 million of coverage per claim and an aggregate $26 million dollars of coverage for personal liability and bodily injury claims above the City's $1 million self-insured retention per claim, subject to the other terms, conditions and limitations of the BICEP Agreement and the Reinsurance Policies, copies of which are attached to the Appendix as Exhibit 5.

Under paragraphs 6.1 and 6.2 of Exhibit A to the BICEP Agreement, the City is obligated to provide BICEP with written notice of any claim or occurrence that the BICEP Agreement covers or potentially covers if, among other things, the claim involves paralysis, brain damage, dismemberment or death or otherwise has potential damages exposure of at least $500,000 (which potential damages exposure includes claimant's attorney's fees, costs and prejudgment interest). The City in the ordinary course provides notice to BICEP of such claims. Attached to the Appendix as Exhibit 6A is a list of claims as to which the City has provided such notice to BICEP (including claims that do not necessarily meet the criteria of Section 6.1 of Exhibit A to the BICEP Agreement).

Under the Plan, if necessary to preserve the City's and claimants' rights under the BICEP Agreement, and solely to the extent that Section 365 of the Bankruptcy Code is applicable to the BICEP Agreement, the City will assume the BICEP Agreement pursuant to Section 365. In that event, the Confirmation Order will contain findings regarding the approval of assumption and the satisfaction of the cure and adequate assurance requirements of Section 365(b) of the Bankruptcy Code.

d. <u>ADR Procedures</u>

Attached to the Appendix as Exhibit 4 are the ADR Procedures that shall be used to liquidate the claims of claimants holding Litigation Claims as part of the claims allowance procedures. The City designed the ADR Procedures to substantially reduce the cost to the City and the claimants of reaching an equitable resolution of the claims. The City intends to make concrete mediation settlement proposals once the Plan is confirmed and the ADR Procedures apply, and the City will pay for the costs of the mediators that are used in the ADR Procedures. The ADR Procedures also provide that, unless otherwise directed by the Bankruptcy Court, after the Effective Date of the Plan the City shall have the discretion to enter into settlements regarding the allowance and payment of Litigation Claims without further order of the Bankruptcy Court. The ADR Procedures also provide that BICEP will be a released party in any settlement entered into by the City in respect of any Litigation Claims.

In connection with solicitation of votes to approve the Plan, the City will provide a separate notice to the holders of Litigation Claims listed in Exhibit 6 to the Appendix that a discussion of the Litigation Claims, the BICEP Agreement, and the Reinsurance Policies is contained in this Section IV.A.9. of the Disclosure Statement, and that copies of the ADR Procedures, the BICEP Agreement and the Reinsurance Policies are attached as Exhibits 4 and 5 to the Appendix.

e. BICEP's Position Statement

BICEP requested that the City include the following in this Disclosure Statement, as the position of BICEP regarding the BICEP Agreement and certain of its provisions.

BICEP Position Statement

> The City is along, with several other cities, a member of the Big Independent Cities Excess Pool Joint Powers Authority ("BICEP") and a party to the BICEP Master Memorandum of Liability Coverage with BICEP ("the BICEP Agreement"). The BICEP Agreement is a risk sharing agreement among member cities of BICEP and is not an insurance policy. BICEP objects to any references in this Disclosure Statement or in the City's Plan to the BICEP Agreement as an insurance policy.
>
> As proposed by the City, the Plan and this Disclosure Statement provide that, if necessary to preserve the City's and claimants' rights under the BICEP Agreement, and solely to the extent that Section 365 of the Bankruptcy Code is applicable to the BICEP Agreement, the City will assume the BICEP Agreement pursuant to Section 365; and in that event, the Confirmation Order will contain findings regarding the approval of assumption and the satisfaction of the cure and adequate assurance requirements of Section 365(b) of the Bankruptcy Code. BICEP disagrees with the City's proposal and asserts that: (i) the BICEP Agreement is an executory contract that must be assumed or rejected by the City; and (ii) in the event the City assumes the BICEP Agreement:
>
> - the City must assume the BICEP Agreement without modification pursuant to Sections 365, 1123(b)(2) and 901of the Bankruptcy Code;

- the Plan and Confirmation Order must provide that they will not enlarge, abridge, or in any way, modify, impair, or alter any rights, obligations or interests of the City, BICEP or holders of Litigation Claims under the BICEP Agreement ("Assumption in Full"); and
- the Plan and Confirmation Order must contain findings regarding the approval of assumption and the satisfaction of the cure and adequate assurance requirements of Section 365(b) of the Bankruptcy Code.

Further, BICEP's agreement to the City's assumption of the BICEP Agreement is conditioned on Assumption in Full of the BICEP Agreement and the City's satisfaction of the cure and adequate assurance requirements of Section 365(b), among other things. For instance, BICEP does not believe the City has complied with the reserves requirement under the BICEP Agreement in that the City has not set aside the required reserves.

The BICEP Agreement provides: (i) at Section III, paragraph 1, that BICEP has the right but not the legal duty to defend any claim against a member city; (ii) at Section III, paragraph 2, that BICEP shall reimburse the member city only after the self-insured retention amount of $1 million (the "SIR") has been exhausted by payment of judgments, settlements and defense costs, subject to the terms and conditions of the BICEP Agreement; (iii) at Section VII, paragraph 9, that there are no third party beneficiaries to the BICEP Agreement; and (vi) at Section VII, paragraph 15, that the BICEP Agreement is not an insurance policy.

BICEP's position is that: (i) BICEP owes obligations only to the City, as the other party to the BICEP Agreement; (ii) the BICEP Agreement does not confer any coverage or benefits to any person or entity other than the City; (iii) no direct claims for coverage can be made by third parties such as holders of Litigation Claims; (iv) per the terms and conditions of the BICEP Agreement, the City must comply in full with all requirements as a condition precedent to making a claim for coverage including by complying with the requirement that the City pay 100% of the SIR; (v) the City, as a member of the risk sharing pool, has a duty to reduce risks in the pool including by paying 100% of the SIR (whether it be through expenditure of defense costs or payment of a judgment or settlement agreement) prior to making a claim for coverage;

(vi) the right of the City to make a claim for coverage under the BICEP Agreement is a right to make a claim for reimbursement only after 100% payment of the SIR; and (vii) what the City has under the BICEP Agreement is a property interest.

Further, in terms of how third party litigants will be paid under the Plan *in conjunction* with the BICEP Agreement, BICEP's position is that: (i) the legal effect of assumption, or Assumption in Full, of the BICEP Agreement is that the City must comply with all requirements as a condition precedent to making a claim for coverage including by complying with the requirement that the City pay 100% of the SIR; and (ii) under the terms and conditions of the BICEP Agreement as well as the Plan, holders of Litigation Claims have recourse only by making claims against the City and are barred from making claims directly against BICEP and the BICEP Agreement.

As proposed by the City, the Plan and this Disclosure Statement provide ADR Procedures that in turn provide that BICEP will be a released party in any settlement entered into by the City in respect of any Litigation Claims. BICEP disagrees with the City's proposal and asserts that in light of the terms and conditions of the BICEP Agreement, BICEP must be a released party in all settlements implicating the BICEP Agreement whether or not the settled claim is categorized as a Litigation Claim and whether or not the settlement is achieved through the ADR Procedures.

BICEP reserves any and all its rights on the aforementioned issues and on any and all other issues.

The foregoing indented section is the statement of position of BICEP, not the City, and the City does not share BICEP's views on the issues raised in the BICEP Position Statement.

f. <u>The Possible Effect of the City's Bankruptcy on the SIR in the BICEP Agreement</u>

BICEP has made clear its position that (a) it has no duty under any circumstances to defend claims against the City, and (b) litigation claimants may not make direct claims against BICEP – therefore, the City bears the entire burden of defending against all such claims. However, the question of whether California insurance law and federal bankruptcy policy apply in the circumstances of the

City's chapter 9 case to provide litigation claimants access to the BICEP Agreement and the Reinsurance Policies for the amount of a judgment in excess of the SIR, even if the City does not first pay the $1 million SIR in full in cash, is not a matter of settled law. The City's position is that the majority view in the published decisions is that the Bankruptcy Code requires an insurer to provide coverage for liability in excess of the deductible or SIR and up to the coverage limits regardless of whether an insolvent insured satisfies amounts owing under the deductible or SIR. That is particularly so, several cases hold, where, as in the BICEP Agreement (at Section VII.5., entitled Conditions; Bankruptcy and Insolvency), there is a provision that states that the bankruptcy or insolvency of the City shall not relieve BICEP of its obligations under the BICEP Agreement.[16] BICEP disagrees with the City's legal analysis and position.

Under the Plan, Litigation Claims are Class 13 General Unsecured Claims and will be paid the 1% distribution paid on all other allowed Cass 13 General Unsecured Claims. Thus, if a holder of a personal injury claim obtains a judgment against the City in excess of $1 million, and seeks payment of the judgment in excess of the $1 million SIR from BICEP or the reinsurers under the Reinsurance Policies, there is likely going to be a dispute over the effect of the SIR provisions on BICEP's and the reinsurers' payment obligations.

[16] *See e.g.* Richard L. Epling, Kelly A. Brennan & Brandon Johnson, *Intersections of Bankruptcy Law and Insurance Coverage Litigation*, 21 J. Bankr. L. & Prac. 2 (April 2012) (citing cases and other secondary sources at fn. 78); *Phillips v. Noetic Specialty Ins. Co.*, 919 F. Supp. 2d 1089 (S.D. Cal. 2013) ("Adopting Defendant's interpretation of the policy and requiring payment of the SIR to trigger coverage, even in the event of the insured's insolvency . . . would . . . conflict with public policy as reflected by California's direct action statute. While not controlling, this Court finds the underlying public policy persuasive in reaching the conclusion that failure to pay the SIR resulting from an insured's insolvency does not prevent coverage from being triggered."); *Gulf Underwriters Ins. Co. v. Burris*, 674 F.3d 999, 1005 (8th Cir. 2012) (holding that terms of insurance agreement limited amount of coverage in the event of non-payment of the retention, but not the availability of coverage; even if policy had unambiguously provided that non-compliance by the insured due to insolvency voided existing claims, the court would hold the provision void as against public policy); *Rosciti v. The Ins. Co. of the State of Penn.*, 659 F.3d 92 (1st Cir. 2011)(terms of insurance policy unambiguously providing that insurer was only liable after SIR was satisfied, even in the event of the insured's bankruptcy, are contrary to public policy); *Albany Ins. Co. v. Bengal Marine, Inc.*, 857 F.2d 250, 255 (5th Cir. 1988) (insurer should not be allowed to escape its obligations under the insurance policy simply because its insured is in bankruptcy); *Admiral Ins. Co. v. Grace Indus.*, 409 B.R. 275 (E.D.N.Y. 2009) (insurer may not withdraw from its obligations under the policy on theory that the SIR endorsement supersedes the bankruptcy clause required by state law).

Based upon the dispute between the City and BICEP over the effect of the City's bankruptcy on the rights of the City, BICEP and holders of Litigation Claims under the BICEP Agreement and the Reinsurance Policies, there can be no certainty that holders of Litigation Claims with allowed claims in excess of the $1 million SIR will be able to access the coverage provided under the BICEP Agreement and the Reinsurance Policies. In the event that such BICEP and reinsurance coverage is not available, the recoveries of Litigation Claimants will be limited to the 1% distribution that holders of allowed Class 13 General Unsecured Claims will receive under the Plan or the amounts achieved through settlement under the ADR Procedures.

10. <u>Employee Wage and Benefit Claims</u>

Employee Wage and Benefit Claims are defined under the Plan as "claims of current and former employees of the City and their collective bargaining representatives for unpaid wages and benefits, but not including Claims included in any other category of Claims." With the exception of unpaid leave claims of former employees, substantially all Employee Wage and Benefit Claims are subsumed into the PARS Claims, Retiree Health Benefit Claims, and the Consenting Union Claims. Therefore, the category of Employee Wage and Benefit Claims means, for all practical purposes, the accrued and unpaid leave claims of retirees and former (non-retiree) employees of the City. Under the Plan, Employee Wage and Benefit Claims are part of Class 13 General Unsecured Claims and will receive the same distribution as other holders of Class 13 General Unsecured Claims.

Retirees and former employees of the City will receive a Class 13 General Unsecured Claim distribution on account of their leave claims soon after the Effective Date. Current employees of the City will receive a distribution on account of prepetition accrued leave in the following manner. In accordance with the agreements entered into with the Consenting Unions, current employees of the City may utilize accrued pre-petition leave balances during the course of their employment only in the event that they have exhausted their post-petition leave balances. Upon separation from employment, employees will be cashed out for any post-petition leave balances in accordance with the provisions of the applicable collective bargaining agreements, and will also receive a Class 13 General Unsecured Claim distribution for any accrued but unused prepetition leave. The City's Effective Date distribution to current employees of their pro rata share of the Consenting Union claims will exclude a distribution on account of prepetition leave, such distribution to be made only upon separation from employment.

Former (non-retired) employees of the City hold $1.4 million of prepetition leave claims, retirees hold $2.8 million of such claims, and the City anticipates that current employees will be entitled to an allowed Employee Wage and Benefit Claim for accrued unpaid leave of approximately $2.4 million in the aggregate upon termination of employment.

11. Key Contractual Obligations

During the development of the City's fiscal year 2015-16 budget, the City conducted an analysis of the contracts it has outstanding. The City has slated for the current fiscal year an audit of its continuing contracts (including analyzing whether there is duplication in any of the City's current contractual relationships and whether the City might be able to renegotiate, or negotiate elsewhere, a better deal). The City is currently undergoing that review of its significant contracts.

a. New World Agreement

The City is party to a Standard Software License Subscription and Services Agreement dated as of January 12, 2011 (the "New World Agreement") between New World Systems Corporation ("New World") and the City. Pursuant to the New World Agreement, among other things, New World granted the City a license to install and operate two New World computer software systems: (1) the "AEGIS" system, pertaining to certain public safety products and services, including police dispatch services; and (2) the "LOGOS" system, pertaining to certain public administration products and services, including certain human resources and finance functions of the City. The New World Agreement also provides for certain training and other services that New World provides to the City in relation to the AEGIS and LOGOS systems. The City has proposed to New World that it will assume the New World Agreement, with certain modifications.

b. Kohl's Department Stores Agreement

The City is a party to a Business Operations and Covenant Agreement dated as of August 2, 2010 (the "Kohl's Covenant Agreement") between the City and Kohl's Department Stores, Inc. ("Kohl's"). Pursuant to the Kohl's Covenant Agreement, Kohl's agreed, among other things, to open and operate an internet sales fulfillment center/office within the City, to designate certain taxable sales transactions through the City and not to open another similar facility in California. In return, the City agreed to make certain covenant payments to Kohl's on a quarterly basis for a term of approximately 40 years in the amounts and upon the terms set forth in the Kohl's Covenant Agreement. The City intends to assume the Kohl's Covenant Agreement pursuant to the Plan.

c. Franchise Agreements

The City is party to a number of legacy franchise agreements which entitle the City to collect certain franchise taxes and related fees, and which grant to private entities, such as Southern California Edison Company, franchise rights to use City property for conducting operations (such as the provision of electricity, telephone services, etc.). The City intends to assume those Franchise Agreements that have not previously been reduced to ordinance.

12. Newmark Groundwater Contamination Consent Decree

The City is a party to the Newmark Groundwater Contamination Consent Decree ("Consent Decree") entitled the *City of San Bernardino Municipal Water Department v United States Army*; *State of California Department of Toxic Substances Control v United States*, Civil Action Nos. 96-5205, 8867 (C.D. Cal. approved March, 2005). Pursuant to the Consent Decree, the City has certain obligations that it funds through the Water Department. The City and the Water Department remain committed to carrying out their obligations under the Consent Decree, and do not intend to modify, amend or abridge any of the terms or conditions found in the Consent Decree, whether pursuant to the City's Plan or otherwise.

13. Environmental/Remediation Obligations

From 1950 until about 1960, the City operated a municipal landfill on the south bank of the Santa Ana River, just east of Waterman Avenue (the "Waterman Landfill"). The Waterman Landfill property (approximately 14.6 acres), has been under private ownership since the City ceased its landfill operations in or about 1960. In 1995 and 1996, as partially described in letters dated October 23, 1995 and April 17, 1996, the Santa Ana Regional Water Quality Control Board ("RWQCB") determined that the City was primarily responsible for the environmental monitoring of the Waterman Landfill, and the City was subsequently ordered to perform mitigation of (1) potential groundwater contamination, and (2) the release of methane gas (the "Initial Determination"). In response, the City installed a soil cover as well as gas extraction wells at the Waterman Landfill, and the City has since continued its monitoring and mitigation activities. In 2014, the RWQCB determined that the Waterman Landfill should be treated as a closed, abandoned or inactive landfill in the Santa Ana Region and issued Order No. R8-2013-0010 ("2014 Order"). Since that time, the City has complied with both the Initial Determination and the 2014 Order. Collectively, the Initial Determination and the 2014 Order are the "Waterman Landfill Obligations." The City remains committed to carrying out the Waterman Landfill Obligations as determined by the RWQCB, and the City does not intend to modify, amend or abridge any of the Waterman Landfill Obligations pursuant to the City's Plan. The Plan does not purport to affect the City's Waterman Landfill Obligations.

14. <u>Lease Obligations for Real Property</u>

a. <u>Rialto Property Lease</u>

On or about January 23, 2007, the City of San Bernardino Municipal Water Department ("Water Department"), acting by and through its Board of Water Commissioners, entered into a "Standard Industrial/Commercial Single-Tenant Lease-Net" as lessee for real property located at 444 W. Rialto Avenue in San Bernardino, California ("Rialto Property"), which is improved with an office building and a warehouse for use by the City's Water Department as an office building and warehouse. The lessor for the Rialto Property is Woo Sung Lim, who recently purchased the Rialto Property from Superior Homes. The City entered into a series of stipulations with Superior Homes extending the time period to assume or reject the lease for the Rialto Property until June 30, 2016, and recently entered into a stipulation with the new owner, Woo Sung Lim, to extend the time until December 31, 2016. The City will assume the Rialto Property Lease and reserves all of its rights with respect to any options to extend thereafter.

b. <u>The SBEDC Lease</u>

Between 1994 and 1996, the City and the former RDA caused the construction of a new baseball field, stadium and ancillary parking and related facilities (the "Stadium"). The RDA subsequently transferred its ownership interest in the Stadium to the San Bernardino Economic Development Corporation (the "SBEDC"). In 1996, pursuant to a lease agreement, the City leased the Stadium to the San Bernardino Stampede, Inc. for the purpose of conducting and carrying on a Class A professional baseball franchise (the "Stadium Lease"). The Stadium Lease has been amended from time to time. The Inland Empire 66ers Baseball Club of San Bernardino, Inc. currently is the lessee under the Stadium Lease. As part of the 2011 legislation that dissolved redevelopment agencies, the State ordered the SBEDC to transfer the Stadium to the City, in its capacity as the Successor Agency for the former RDA (the "Successor Agency"). The SBEDC thereafter quitclaimed its interest to the Successor Agency in December 2014, as ordered by the State of California. More information of the City's plans for the Stadium is found at Section IV.B.1. below entitled "City Owned Sports Facilities."

15. The PARS Claims

In January 2004, the City adopted the City of San Bernardino Public Agency Retirement System Retirement Enhancement Plan (the "PARS Enhancement Plan"), which was amended and restated effective July 1, 2007. The PARS Enhancement Plan provides 23 of the City's former police officers (with those participants of the PARS Excess Benefit Plan (as defined below), the "PARS Participants") with retirement benefits to supplement pension payments. The PARS Participants covered under the PARS Enhancement Plan were each required to be 50 years of age, have completed 20 years of service and have retired on or before December 31, 2008 in order to obtain benefits under the PARS Enhancement Plan.

Upon satisfying such criteria, the PARS Participants became eligible to receive supplemental benefit payments under the PARS Enhancement Plan, combined with the benefits they were entitled to receive under CalPERS. The supplement of the PARS Enhancement Plan allowed the PARS Participants covered by such plan to receive a 3% benefit upon retiring at age 50, which at the time was available under CalPERS only for participants of CalPERS who retired at age 55. Thus, the PARS Enhancement Plan permitted the PARS Participants to retire 5 years early, but still receive the benefits they would otherwise maintain upon retirement at age 55 under CalPERS. In addition, because two of the PARS Participants were subject to a benefit limitation under Section 415 of the Internal Revenue Code, in January 2008, the City also adopted the City of San Bernardino Excess Benefit Plan (the "PARS Excess Benefit Plan" (together with the PARS Enhancement Plan, the "PARS Plans")), which provided these employees with "gross ups" to compensate them for any loss in benefits because of the Section 415 limitation. Both PARS Plans are administered by an affiliate of the Public Agency

Retirement System (or "PARS") (while the Human Resources Director of the City acts as the penultimate plan administrator of the PARS Plans).

The benefits from both of the PARS Plans are paid out of two separate trusts. The PARS Enhancement Plan benefits are paid from a trust related to a multi-employer plan PARS Trust Agreement to which the City, along with other municipalities, is a party (the "PARS Trust"). The benefits from the PARS Excess Benefit Plan are paid out of a separate trust (the "415 Trust") established pursuant to the City of San Bernardino Excess Benefit Trust Agreement (the "415 Trust Agreement").

Prior to the Petition Date, the City made payments to the PARS Trust and the 415 Trust to fund the PARS Plans. After the Petition Date, the City made additional payments of approximately $240,000 to the PARS Plans. Currently, neither the 415 Trust nor the PARS Trust holds sufficient assets to pay all of the remaining obligations due under the respective PARS Plans. The 415 Trust maintains current assets (as of June 30, 2015) of approximately $56,000, and the PARS Trust holds current assets (as of June 30, 2015) of approximately $1.868 million, leaving both trusts (a) with total assets of approximately $1.924 million, and (b) collectively underfunded by approximately $2.974 million. These amounts are calculated assuming a 6% discount rate and 1983 Group Annuity Mortality table, one of the generally accepted actuarial standards for such calculations. Payments from the 415 Trust to the participants were halted on or about the Petition Date due to a provision in the 415 Trust Agreement requiring the trustee to cease payments upon the City's bankruptcy filing. Payments to PARS Participants from the PARS Trust assets have continued during the pendency of the Bankruptcy Case.

The City and the holders of the PARS Claims have entered into the PARS Settlement which was approved on May 5, 2016 as Resolution No. 2016-83, a copy of which is included in the Supplemental Appendix as Exhibit 34. In accordance with the PARS Settlement, the PARS Plans will be rejected, and the City will waive any and all claims to the funds held within the PARS Trust and the 415 Trust as of the date of termination of the PARS Plans, (ii) the amounts remaining in the PARS Trust and the 415 Trust will be distributed to the PARS Participants pursuant to agreed-upon allocations, and the City will endeavor to make each such distributions in a manner that will minimize adverse tax consequences for each PARS Participant, (iii) the City will make a distribution of $290,000.00 on the later of the Effective Date or July 5, 2017, and a distribution $290,000.00 on the later of the Effective Date or July 5, 2018, in each case to the PARS Participants pursuant to agreed-upon allocations, and (iv) the City will be discharged from any and all obligations to further fund any PARS Plan or to make any other distributions on account of the PARS Claims.

In exchange for the City's proposed treatment of the PARS Claims, the PARS Participants have agreed to vote their claims in favor of the Plan and to support confirmation of the Plan.

16. <u>Workers Compensation Liabilities</u>

Pursuant to the Plan, workers compensation claims will be processed and paid pursuant to the City's current practices in the ordinary course of the City's continued operations. Accordingly, no proofs of claim are or were required for holders of such claims.

17. <u>Capital Maintenance Obligations</u>

a. <u>Public Facilities Repair Needs</u>

The City has 169 public facilities which require on-going operational maintenance as well as required capital maintenance. The City's Building Maintenance & Costs Reports – Building Detail Report (the "City Properties Report") is included in the Appendix as Exhibit 8. For many years these facilities have not been maintained as necessary and many require immediate attention. As described in the City Properties Report, $63.6 million is required to meet this need (specifically, $12 million towards public facilities within the City's 44 parks and $51.6 million for other facilities such as City Hall, the Police Station, libraries, neighborhood community centers and senior centers).

b. <u>Street and Road Repair Backlog and Needs</u>

As set forth on the Street Repairs Report included in the Appendix as Exhibit 9, the City's right-of-way capital maintenance backlog exceeds $180 million. However, the historic funding allocated to finance the City's right-of-way infrastructure requirements continues to be significantly inadequate. In addition, other funding sources are unavailable to the City. For example, other federal funding is typically not available for capital maintenance, as most monies are earmarked for mobility or air quality improvements (*e.g.*, Federal Congestion Mitigation and Air Quality (CMAQ) Funds). In addition, the State of California's State Transportation Improvement Program (STIP) provides funding that could be used for local projects, but only where such projects are included in a Regional Transportation Improvement Plan (RTIP), and such RTIP funds are typically used solely for transportation improvements, not street and road maintenance. Thus, the City must supplement its funding needs through General Fund resources.

(i) Measure I Sales Tax

Measure I is a half-cent sales tax collected throughout San Bernardino County for transportation improvements and allocated to local agencies based on population. San Bernardino County voters first approved the measure in November 1989 and overwhelmingly approved the extension of the Measure I sales tax in 2004 to ensure that needed transportation projects were implemented countywide through 2040. The Measure I retail transactions and use tax is statutorily dedicated for transportation purposes only in San Bernardino County and cannot be used for other governmental purposes or programs. There are specific safeguards in the Ordinance to ensure that funding is used in accordance with the specified voter-approved transportation project improvements and programs.

The Measure I Ordinance contains maintenance-of-effort provisions that state that funds provided to government agencies by Measure I are to supplement, and not replace, existing local revenues being used for transportation purposes. In addition, Measure I revenues may not replace requirements for new development to provide for a municipalities own road needs. As a result, the City must continue to fund part of its street improvements needs with General Fund monies and not replace those funds with Measure I revenues.

San Bernardino Associated Governments ("SANBAG") is the council of governments and transportation planning agency for San Bernardino County. Among other things, SANBAG administers Measure I, the half-cent transportation sales tax approved by county voters in 1989. Pursuant to a letter agreement dated January 14, 2016, by and between the City and SANBAG (the "SANBAG Agreement"): (a) SANBAG is authorized to withhold, and has been withholding, certain Measure I funds until the City is in compliance with its obligations under Measure I and its requirements; and (b) such authorized withholding is without the need to seek relief under the Bankruptcy Code, among other things. The Plan and the confirmation of the Plan will not affect, impair or modify, in any way, SANBAG's rights under the SANBAG Agreement, including the power to continue to withhold funds until the City is in compliance with its obligations under Measure I and its requirements, and the Confirmation Order will so expressly provide.

(ii) <u>State Gas Tax</u>

The state collects a base excise tax of 18 cents per gallon of gasoline and a variable excise tax on gasoline of roughly 21.5 cents per gallon (the "Gas Taxes"). Annually, these taxes are estimated to generate $5 billion to $6 billion of which only a small portion of revenues are allocated to cities and counties for local streets and roads. State Gas Taxes have not been adjusted since 1995. As a result, local agencies are unable to keep up with inflationary costs related to right-of-way maintenance. Despite the inclusion of countywide sales taxes for transportation program including street maintenance (such as Measure I), funding to support the City's large right-of-way network is insufficient.

(iii) <u>The Need For Additional Non-Restricted Funding for Street and Road Repair</u>

Based on data provided through computations of State Controller and Department of Finance data, the City's per capita spending for street improvements is well below the statewide median average. In many years, the City's spending for street maintenance is only about 50% of the statewide median average. The lack of available non-restricted funds may explain, in part, the City's significant backlog of right-of-way maintenance projects. Without the inclusion of non-restricted funds, the City would be able to allocate only $95 million over 20 years to address a current need that exceeds $180 million, which equals only about 53% of the necessary funding. General Fund revenues will be required to help pay for such costs so that the City can begin to address the capital maintenance backlog at a level consistent with other cities statewide.

18. <u>Cash Balances of City Funds and Description of Restricted Funds</u>

As set forth in the Plan, the Plan does not propose to alter the obligations of those City funds that are restricted by grants, federal law or state law. Therefore, securities or claims payable solely from Restricted Funds are not impaired by the Plan and will be paid in the ordinary course. Without limiting the foregoing, those claims against the City/Water Department payable solely from Water Funds are unimpaired by the Plan and will be paid in the ordinary course. Included in the Appendix as Exhibit 17 is a "Cross Fund Report" listing different City funds and the estimated cash balance (including negative cash balances) of those fund as of February 29, 2016.[17] A chart which identifies restricted or committed funds and describes the basis for the restrictions on those funds is included in the Appendix as Exhibit 18.

19. Reservation of Rights on Allowance or Disallowance of Claims

While the City's review and analysis of Claims is ongoing, the City currently disputes a number of asserted Claims. Given the inherent uncertainty of litigation, no assurance can be given regarding the successful outcome of any litigation that may be initiated in objection to Claims or regarding the ultimate amount and priority, if any, of Claims that will be allowed against the City.

The Plan enables the City to file objections to claims and/or subject the claims to the ADR Procedures. The Plan also provides for the City to retain any and all defenses, offset and recoupment rights, and counterclaims that may exist with respect to any disputed Claim, whether under the Bankruptcy Code or otherwise. The City reserves all rights with respect to the allowance and disallowance of any and all Claims. In voting on the Plan, creditors may not rely on the absence of a reference in this Disclosure Statement or the Plan or the absence of an objection to their proof(s) of claim as any indication that the City will not object to the amount, priority, security, or allowance of their Claims.

Parties in interest may not rely on the absence of a reference in this Disclosure Statement or in the Plan as any indication that the City ultimately will not pursue any and all available claims, rights and causes of action of the City against such parties. All parties who previously dealt with the City are hereby on notice that the Plan preserves the City's rights, claims, causes of action, interests and defenses. The City expects that any and all meritorious claims will be pursued and litigated after the Effective Date.

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[17] The cash balances set forth in the Cross Fund Report are the most current available and, thus, unaudited. Some funds such as Successor Agency funds, trust and fiduciary funds, and the City's Water Department are not included in the Cross Fund Report, but financial and audit information for the City's Water Department is available at: http://www.sbcity.org/water/divisions/finance/financial_information.asp and information for the Successor Agency is available at: http://www.sbcity.org/cityhall/successor_agency_to_the_former_redevelopment_agency/default.asp

B. City Assets

1. City Owned Sports Facilities

The City owns, or will own, certain sports related real properties: the San Manuel Stadium Park (a baseball stadium), the Shandin Hills Public Golf Park ("Golf Park"), and the City Soccer Complex ("Soccer Complex"). The San Manuel Stadium is now an asset of the Successor Agency. In accordance with the Successor Agency's Property Management Plan submitted to the California Department of Finance (which is overseeing the dissolution of all municipal redevelopment agencies) discussed below, both assets are to be transferred to the City as "government use" properties. The Soccer Complex is already an asset of the City.

As discussed further in Section IV.B.3. below, on February 16, 2016, the Successor Agency adopted Resolution No. 2016-26 authorizing the transfer of certain real property to the City for government use, including San Manuel Stadium and the Golf Course. The transfer of San Manuel Stadium to the City is conditioned upon receiving authorization to do so from the California Department of Finance. A copy of Resolution No. 2016-26 is included in the Appendix as Exhibit 31.

a. San Manuel Stadium

The existing lease between the City and the Inland Empire 66ers Baseball Club of San Bernardino, Inc. ("IE66") has never produced significant revenue for the City. Over the past three fiscal years, the City has seen no revenue from the lease because of (1) cumulative deferred maintenance in the stadium that is an obligation of the City, but which IE66 has paid for, and (2) the dissolution of the City's redevelopment agency (the primary source of funding for stadium maintenance) that shifted more maintenance obligations to IE66. There are many studies and statistics demonstrating that municipally-owned or built minor league stadiums generally do not generate net revenue for their host cities, and most municipal stadiums require an ongoing subsidy for maintenance, repair, and replacement costs. Cities decide to bear the cost of a municipal stadium based on, among other things: (1) studies that indicate there is an overall economic benefit to the community and businesses from a municipal stadium and minor league franchise; and (2) the quality of life enhancement to the community from a stadium and minor league sports franchise that many cities believe is worth the cost of the subsidy.

The lease on the San Manuel Stadium will expire in the near future, and the City and IE66 will be negotiating a renewal of that lease without the benefit of redevelopment agency funding. The City's goal will be to internalize all stadium costs within the lease, thereby minimizing or eliminating any public contribution to the San Manuel Stadium costs. Therefore, it is not realistic to expect that the San Manuel Stadium can generate net revenue for the City. In fact, the City projects transfers of about $2.1 million from the General Fund to the Baseball Stadium Fund over the term of the Financial Model.

b. City Soccer Complex

The Soccer Complex has generated an average net positive cash flow of roughly $100,000 between fiscal years 2012 through 2014. However, the Soccer Complex was not maintained adequately and requires substantial repair. In around November 2015, the City entered into an agreement with the Elmore Sports Group to privatize the management of the Soccer Complex in an effort to save the Soccer Complex and its economic benefit to the community. Much like the San Manuel Stadium, the goal of the City in negotiating a management/operating agreement is to internalize the cost to rehabilitate and revitalize the Soccer Complex into the lease to avoid any significant support from the General Fund. Revenues from the Soccer Complex need to be utilized for critical repairs and replacement projects for the foreseeable future. The total cost of the rehabilitating the Soccer Complex over the next 3 to 4 years may also require a private capital contribution that would be repaid from future revenues. The City's goal is to return the Soccer Complex to a healthy and competitive condition and to ensure it is maintained at that level in order to reap the general economic benefits that flow from the thousands of club soccer teams that come to the facility annually. Given these circumstances, it is difficult to predict when or if the Soccer Complex will produce positive cash flow for the City in the future.

c. Shandin Hills Public Golf Park

The Shandin Hills Golf Park ("Golf Park"), was transferred to the City pursuant to Successor Agency Resolution No. 2016-26. However, because of significant deferred maintenance, competition from other local golf courses, and the cost of providing water to the facility, it may not yield comparable positive cash flow in the future.

2. <u>Other Real and Personal Property Assets</u>

The City also owns other properties. A Building Detail Report for each of those properties, which includes a picture of each property and an estimate of the replacement cost, is included in the Appendix as Exhibit 7. All of the properties listed as owned by the City on the Building Detail Report are public use properties (police stations, fire stations, kennels, picnic facilities, public restrooms, etc.). These properties are located primarily on public or governmental use land and are not established for commercial purposes. In addition, most of these properties have such a distressed value that they have little financial value other than as public use facilities.

A "List of City-Owned Equipment (Excluding Fire Dept. Equipment)" ("Equipment List") is included in the Appendix as Exhibit 16. The Equipment List identifies the City's machines and tools used to provide municipal services such as lathes, forklifts, back-hoes, chippers, trailers, air compressors, and reflects that most of the equipment has outlasted its useful life. A "List of City-Owned Personal Property (as of June 2013)" is included in the Appendix as Exhibit 14. This list has value and depreciation numbers associated with each item of personal property.

Because all of the properties and assets currently owned by the City are governmental use and/or distressed, the City is not contemplating any sales of such assets. Moreover, the City has determined that further appraisal of such assets would be cost-prohibitive and futile given the condition of these properties and assets.

3. <u>The Former RDA and the Successor Agency Assets</u>

a. <u>The Former RDA</u>

In 1945, the California legislature enacted the Community Redevelopment Act (the "Redevelopment Act") which gave cities and counties the ability to address urban blight. The Redevelopment Act was later codified as the Community Redevelopment Law in California Health and Safety Code §33000 and following, and amended to allow the use of part of the City's property tax revenues to finance redevelopment projects. Pursuant to the Redevelopment Act, the City established the Redevelopment Agency of the City of San Bernardino ("RDA") as its redevelopment agency. The former RDA was established to develop a number of projects within the City.

b. The Successor Agency and Its Long-Range Property Management Plan

Assembly Bill x1 26 (the "Initial Dissolution Bill"), effective on June 28, 2011, caused the dissolution of all redevelopment agencies in California, including the RDA, on February 1, 2012. Pursuant to the Initial Dissolution Bill, and as confirmed by Resolution of the Common Council, the Common Council elected to serve as the governing body of the Successor Agency. The Initial Dissolution Bill makes clear that the Successor Agency is a separate legal entity from the City, that the liabilities of the former RDA are not transferred to the City and that the assets of the former RDA will not become assets of the City by virtue of the Common Council's election to serve as the governing body of the Successor Agency. Pursuant to the Initial Dissolution Bill, the Successor Agency took ownership of former RDA real properties (excluding certain real properties that are subject to liens in favor of the United States Department of Housing and Urban Development) (the "RDA Properties"). The dissolution of the former RDA and winding down of the former RDA's affairs is discussed in more detail in the RDA Exhibit attached as Exhibit 12 to the Appendix.

The City believes that redevelopment and/or economic development of the RDA Properties is crucial to the future of the City. The Successor Agency refinanced certain long-term bond debt and note debt of the former RDA to generate debt service savings. This refinancing will benefit the various affected taxing agencies that receive property tax revenues from the former RDA's redevelopment project areas, including the City. On March 23, 2016, the Successor Agency's underwriter was authorized to sell the refinancing bonds to interested and eligible investors. The transaction closed in April 2016.

The Successor Agency prepared a Long-Range Property Management Plan ("Property Management Plan"), that was submitted to the California Department of Finance ("DOF") in 2015 and which has since been approved by the DOF. A copy of the Property Management Plan is included in the Appendix as Exhibit 13. The Property Management Plan will govern the disposition of the RDA Properties. In connection with the Property Management Plan, many Successor Agency properties will be marketed and sold, and the net proceeds of sale will be distributed to the various affected taxing agencies, including the City. The Property Management Plan may also authorize the City to retain certain properties for governmental use and/or future development.

On February 16, 2016, the Successor Agency adopted Resolution No. 2016-26 authorizing the transfer of certain former RDA Properties to the City for government use. These former RDA Properties include City Police Headquarters, the City Administration Campus (which includes City Hall and the former RDA building), the Local Agency Administration Building, the San Manuel Stadium, the Golf Park, portions of Secombe Lake Park, the California National Guard Armory, the U.S. Army Reserve building and various rights of way, parking lots and a water well site. These properties are designated as "government use properties" are not considered surplus or non-essential. The Property Management Plan includes a chapter on each government use property that provides a detailed history and overview of each property. It is anticipated that the Successor Agency will transfer these government use properties to the City toward the end of the City's current fiscal year in June 2016.

The City's new revenue projections include supplemental payments that are anticipated from either the County Auditor-Controller or the Successor Agency resulting from land sales by the Successor Agency pursuant to the Successor Agency's Property Management Plan. The Successor Agency's Property Management Plan includes 26 distinct grouping of parcels ("Sites") that have a combined estimated value of approximately $32 million. The Successor Agency anticipates the sale of the 26 Sites over an approximate five-year period beginning in 2016. If the estimated values are achieved, the City's share will be approximately 18% of net proceeds, which represents the City's approximate share of the 1% General Tax Levy ("GTL"). This 18% recovery is derived from the tax-increment financing provisions of the Redevelopment Act, under which certain property tax revenue dedicated to school districts and other public agencies was used for urban redevelopment purposes. Pursuant to the recent RDA dissolution statutes, the net proceeds from the sale of RDA assets are distributed to the local agencies in the same geographic area as the dissolved RDA. The City is entitled to 18% of the property taxes in its geographical area (the rest goes to the County, school districts, and other local agencies and special districts), hence the City will receive 18% of the net proceeds from the sale of the RDA assets. It is assumed that approximately 10% of gross proceeds from the sale of the 26 Sites will be allocated to costs of sale. Therefore, under these assumptions the City's share would be equal to 18% of approximately $28.8 million, or approximately $5.2 million. However, this amount is only a rough estimate of the City's potential recovery. The actual sales prices for the affected 26 Sites may vary from the estimated values and will affect the amount of land sales proceeds that will be paid to the City.

Currently there exist certain disputes and litigation between the City and the DOF that relate to actions taken in regard to the former RDA and/or taken by the Successor Agency all as more fully described in the RDA Exhibit. The parties are in discussions to resolve these disputes but no final resolution has been reached. As of the date of the Disclosure Statement, the City has no information that would lead the City to believe that the DOF will withhold any sales tax, use tax or property tax revenue payments otherwise due the City.

V. SUMMARY OF THE PLAN OF ADJUSTMENT

The summary and discussion of the Plan set forth below is qualified in its entirety by reference to actual terms of the Plan, which are controlling. Creditors and other interested parties are urged to, and should, read the Plan and the documents referred to in the Plan and this Disclosure Statement that are in included in the Appendix so that they may make an informed decision regarding the Plan. The Plan does not alter the obligations of those City funds that are restricted by grants, federal law or state law. Thus, obligations payable solely from restricted funds are not impaired by the Plan.

A. Classification and Treatment of Claims

1. Unclassified Claims

Section II of the Plan governs the treatment of certain claims that are not classified into Classes under the Plan.

a. Administrative Claims

Administrative Claims, as defined in the Plan, are dealt with in Section II.A. of the Plan. The Plan provides that, except to the extent that the holder of an Allowed Administrative Claim agrees to a different treatment, the City or its agent will pay to each holder of an Allowed Administrative Claim, in full satisfaction, release, and discharge of such Allowed Administrative Claim, Cash in an amount equal to such Allowed Administrative Claim on the later of (i) the Effective Date or (ii) the date on which such Claim becomes an Allowed Administrative Claim, or as soon thereafter as is practicable. In addition, the City's consent under the Plan to the Bankruptcy Court adjudicating Administrative Claim status is given without the City in any way consenting or agreeing that Claims for post-petition obligations of the City are or would be entitled to status as Administrative Claims as "the actual necessary costs and expenses of preserving the estate" under Bankruptcy Code section 503(b), and the City reserves its right to maintain that such Claims are Other Post-petition Claims under the Plan.

b. Deadline for the Filing and Assertion of Administrative Claims

Section II.B. of the Plan provides that all requests for approval of Administrative Expense Claims must be filed with the Bankruptcy Court and served upon the City no later than thirty (30) days after the date on which the Notice of Effective Date is served pursuant to the Plan.

Any proof of claim for payment of an Administrative Claim that is not timely filed by such date will be forever barred, and holders of such claims will be barred from asserting such claims in any manner against the City.

c. Professional Claims

Professional Claims are claims of professionals for unpaid services and costs during the Bankruptcy Case or incident to the Plan to be paid by the City. Bankruptcy Code section 943(b)(3) provides that, in order to confirm the Plan, all amounts to be paid by the City for services or expenses incurred in the Bankruptcy Case, or incident to the Plan, must be fully disclosed and must be reasonable. After the Effective Date, there will be paid to each holder of a Professional Claim, in full satisfaction, release, and discharge of such Claim, Cash in an amount equal to the amount the Bankruptcy Court determines is reasonable. The City, in the ordinary course of its business, and without the requirement for Bankruptcy Court approval, may pay for professional services that are rendered and costs that are incurred following the Effective Date.

2. Classified Claims

a. Class 1 Claims - 1996 Refunding Bonds Claims

Class 1 is comprised of Claims relating to the 1996 Refunding Bonds. Subject to the terms and conditions of the 1996 Refunding Bonds Amendment, on the Effective Date, the 1996 Trust Indenture and the City Hall Lease will be amended and supplemented. Pursuant to the 1996 Refunding Bonds Amendment, on the Effective Date, a surety bond will be issued by National in an amount equal to the

"Reserve Requirement" (as such term is defined in the 1996 Trust Indenture) to replace the "Reserve Fund" (as such term is defined in the 1996 Trust Indenture). Simultaneously with the substitution of the surety, the funds held in the Reserve Fund will be released to the City, to be used by the City for capital expenditure purposes in accordance with federal tax covenants. In addition, in connection with the 1996 Refunding Bonds Amendment, the City will assume the 1996 Refunding Bond Agreements (City Hall) and will cure, or provide adequate assurance for the prompt cure, of all defaults under the 1996 Refunding Bond Agreements (City Hall) that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code. The effectiveness of the 1996 Refunding Bonds Amendment will also be subject to a number of terms and conditions as set forth therein. Subject to the 1996 Refunding Bonds Amendment, the 1996 Refunding Bonds Trustee shall retain all of its rights, remedies, security interests and collateral under the 1996 Trust Indenture, as amended, and any bonds, notes, security agreements, or any other instruments or agreements executed in connection with the 1996 Refunding Bonds or otherwise providing, granting or perfecting a lien in connection with the 1996 Refunding Bonds. The form of the 1996 Refunding Bonds Amendment will be included in the Plan Supplement. A more complete description of the 1996 Refunding Bonds is set forth above in Section IV.A.8. The Class 1 Claims are Impaired and the holders of the Class 1 Claims are entitled to vote the Claims to accept or reject the Plan.

b. <u>Class 2 Claims - 1999 Refunding Certificates of Participation Claims</u>

Class 2 is comprised of Claims relating to the 1999 Refunding Certificates of Participation. Subject to the terms and conditions of the 1999 Refunding Certificates of Participation Amendment, on the Effective Date, the 1999 Trust Agreement and the Police Station Lease will be amended and supplemented. Pursuant to the 1999 Refunding Certificates of Participation Amendment, on the Effective Date, funds from the "Reserve Fund" (in excess of the "Reserve Requirement") and the "Capital Reserve Fund" (as such terms are defined in the 1999 Trust Agreement) will be used to prepay in full all remaining lease payments due from the City under the Police Station Lease. As a result of these transactions, the City will be able to withdraw any remaining amounts in the Capital Reserve Fund in accordance with the terms and conditions of the 1999 Trust Agreement. Upon the prepayment in full of the remaining lease payments under the Police Station Lease, the Police Station Lease will terminate, and neither the JPFA, National, nor the 1999 Refunding Certificates of Participation Trustee will have any interest in the Police Station or the Police Station Lease. The City expects that such prepayment will enable the City to use the Police Station as collateral for purposes of obtaining financing for additional capital expenditures.

In addition, pursuant to Section 10.02 of the Police Station Lease, the City will give notice of an optional redemption of the 1999 Refunding Certificates of Participation in an amount equal to the amount of the Police Station Lease payment hereunder, with such redemption to occur at the earliest practicable date following the occurrence of the Effective Date. Such notice will specify the order of redemption of the 1999 Refunding Certificates of Participation, which order will ensure that the remaining payments required to be made by the City under the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle) will be sufficient to pay the principal of and interest on the 1999 Refunding Certificates of Participation when due, as certified by an independent financial consultant of the City reasonably acceptable to National and the Trustee. On the Effective Date, the City will deposit the proceeds of the prepayment in full of the Police Station Lease with the 1999 Refunding Certificates of Participation Trustee to hold in trust pursuant to the terms of the 1999 Trust Agreement pending the redemption of the 1999 Refunding Certificates of Participation required hereunder.

In connection with the 1999 Refunding Certificates of Participation Amendment, the City will also assume the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle), including the Police Station Lease, as amended by the 1999 Refunding Certificates of Participation Amendment, and will cure, or provide adequate assurance for the prompt cure, of all defaults under the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle) that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code. The effectiveness of the 1999 Refunding Certificates of Participation Amendment will also be subject to a number of terms and conditions, as set forth therein. Subject to the 1999 Refunding Certificates of Participation Amendment, the 1999 Refunding Certificates of Participation Trustee shall retain all of its rights, remedies, security interests and collateral (other than with respect to the Police Station) under the 1999 Trust Agreement, as amended, and any bonds, notes, security agreements, or any other instruments or agreements executed in connection with the 1999 Refunding Certificates of Participation or otherwise providing, granting or perfecting a lien in connection with the 1999 Refunding Certificates of Participation. The form of the 1999 Refunding Certificates of Participation Amendment will be included in the Plan Supplement. A more complete description of the 1999 Refunding Certificates of Participation is set forth above in Section IV.A.8. The Class 2 Claims are Impaired and the holders of the Class 2 Claims are entitled to vote the Claims to accept or reject the Plan.

c. <u>Class 3 – Secured Claims: CIEDB Harriman Project Claims</u>

Class 3 is comprised of Claims held by CIEDB with respect to the Harriman Project. These Claims will be paid in accordance with those CIEDB Documents relating to the CIEDB's financing of the Harriman Project. The holder of Claims in this Class is not entitled to vote to accept or reject the Plan.

d. <u>Class 4 – Secured Claims: CIEDB Pavement Project Claims</u>

Class 4 is comprised of Claims held by CIEDB with respect to the Pavement Project. These Claims will be paid in accordance with those CIEDB Documents relating to the CIEDB's financing of the Pavement Project. The holder of Claims in this Class is not entitled to vote to accept or reject the Plan.

e. <u>Class 5 – Secured Claims: Police Station AC Financing Claims</u>

Class 5 is comprised of Claims of Western Alliance in relation to the Police Station AC Financing Agreement. Under the Plan, the collateral securing the Western Alliance Claim will be returned to Western Alliance and Western Alliance shall have a Class 13 General Unsecured Claim in the approximate amount of $475,000 which will receive a 1% distribution. Western Alliance may leave the Police Station ACs on City property (or property controlled by the City) without any liability to the City, and if so, the Police Station ACs shall be deemed abandoned to the City, without any City liability to Western Alliance. The Class 5 Claims are Impaired and the holders of the Class 5 Claims are entitled to vote the Claims to accept or reject the Plan.

f. <u>Class 6 – Secured Claims: Burgess Claims</u>

Class 6 is comprised of Claims held by Tim Burgess pursuant to the Burgess Documents. The maturity date with respect to the Burgess Documents is in 2019, at which time a large balloon payment is due to Burgess. Under the Plan, the Burgess Documents will be amended to extend the maturity date until 2022, and the balloon payment will be amortized over that 3-year period with interest continuing to accrue through the new maturity date on the unpaid principal balance at the current interest rate set forth in the Note (5%) which will be paid on January 1 and July 1 of each ear of the 3 year extend period. The Burgess Documents will also be amended to provide that Burgess has granted the City the option until April 30, 2017 to pay the principal amount due under the Note at a 10% discount (the "Discounted Payoff"), plus all accrued and unpaid interest at the rate set forth in the Note through the date that the Discounted Payoff payment is made. The City exercised its option to make the Discounted Payoff payment in June 2016, and then conveyed the Fire Maintenance Facility to the County Fire District in connection with annexation of the City into the County Fire District. The holder of the Claims in this Class is entitled to vote to accept or reject the Plan. The Class 6 Claims are Impaired and the holders of the Class 6 Claims are entitled to vote the Claims to accept or reject the Plan.

g. <u>Class 7 - Claims on Restricted Revenue Bond and Note Payable Obligations</u>

Class 7 is comprised of Claims on Restricted Revenue Bond and Note Payable Obligations. Such obligations are secured by a pledge of and lien on revenues of several of the City's systems and enterprises, which are restricted revenues and "special revenues" as defined in Bankruptcy Code section 902(2). The City will pay Restricted Revenue Bond and Notes Payable Obligations in the ordinary course of business pursuant to the applicable documents (which will be assumed by the City on the Effective Date, with any defaults, to the extent any defaults exist as of the Effective Date, that are required to be cured under section 365(b)(1)(A) of the Bankruptcy Code cured, or adequate provision made for the prompt cure thereof). The holders of Claims in this Class are not entitled to vote to accept or reject the Plan.

h. <u>Class 8 - CalPERS Claims</u>

Class 8 is comprised of the Claims of CalPERS arising under and related to the City's contract with CalPERS. The CalPERS Claims will be paid under the Plan in accordance with the Mediator's Order. Notwithstanding anything in the Plan to the contrary, nothing in the Plan is intended to or does impair or interfere with the rights of the City and CalPERS under the Mediator's Order. All terms of the Mediator's Order are deemed incorporated into the Plan and the Confirmation Order shall provide that the Mediator's Order is approved. The holders of Claims in this Class are not entitled to vote to accept or reject the Plan.

i. Class 9 - PARS Claims

Class 9 is comprised of the Claims of PARS Participants in respect of the PARS Trust and the 415 Trust.

In accordance with the PARS Settlement, the PARS Plans will be rejected, and the City will waive any and all claims to the funds held within the PARS Trust and the 415 Trust as of the date of termination of the PARS Plans, (ii) the amounts remaining in the PARS Trust and the 415 Trust will be distributed to the PARS Participants pursuant to agreed-upon allocations, and the City will endeavor to make each such distributions in a manner that will minimize adverse tax consequences for each PARS Participant, (iii) the City will make a distribution of $290,000.00 on the later of the Effective Date or July 5, 2017, and a distribution $290,000.00 on the later of the Effective Date or July 5, 2018, in each case to the PARS Participants pursuant to agreed-upon allocations, and (iv) the City will be discharged from any and all obligations to further fund any PARS Plan or to make any other distributions on account of the PARS Claims. The Class 9 Claims are Impaired and the holders of the Class 9 Claims are entitled to vote the Claims to accept or reject the Plan.

j. Class 10 – Consenting Union Claims

The City has entered into settlements with each of the unions representing its seven bargaining units. All of the fiscal impacts of the settlements with the labor unions representing the City's employees have been included in the Financial Model. The City and the Consenting Unions have agreed to stipulate to the amount of the Consenting Union Claims, which stipulated amounts shall be voted by each of the respective unions on behalf of their members in connection with voting on the Plan.

The Class 10 Consenting Union Claims are Impaired and the Consenting Unions are entitled to vote their Class 10 Claims to accept or reject the Plan. **The Class 10 Consenting Union Claims are General Unsecured Claims and shall be treated as part of Class 13 General Unsecured Claims for all purposes, including for voting on the Plan and payment on the claims**.

Each of the City's settlements with the Consenting Unions (other than the SBCPF and Fire Management) contains the following provisions:

- the MOU will become null and void and of no further effect if the Plan is not confirmed;
- the Confirmation Order (approving the Plan) shall provide for approval of the settlement and, where applicable, the modified or new Memorandum of Understanding ("MOU"); and
- all claims of the union and its members with respect to wages, pensions (including implementation of cost sharing and elimination of the employer paid member contribution ("EPMC") benefit, other benefits and other terms and conditions of employment that arose prior to the date of the confirmation of the Plan, including, without limitations, all claims arising from the City's changes to the terms and conditions of employment and/or rejection or the prior MOU (collectively the "union claims"), shall be treated as general unsecured claims under the Plan, and the City and its officers shall be discharged from such union claims upon confirmation of the Plan; provided, however, that any claims arising under the settlement or MOU after it is executed by the City and the union (*e.g.* grievances) shall not be discharged as long as (a) the union complies with the terms of the MOU, and (b) the Bankruptcy Court confirms the Plan; and
- the Union and the City shall agree on the amount of the union Claim and the union shall vote the union Claim in support of the Plan.

The Consenting Union Claims generally include claims arising from modifications to retirement benefits (cost sharing, EPMC, retiree health benefits) and reductions in accruals and cash out of leave time (vacation and sick leave), and also include specific modifications to terms and conditions of employment with respect each Consenting Union. The City has calculated the amounts of the Consenting Union Claims as follows:

SBCPF	$ 14.00 million
SBPOA	$ 74.14 million
Police Mgmt.	$ 5.98 million
General Unit	$ 20.90 million
Mgmt. Confi.	$ 8.58 million

Middle Mgmt.	$ 4.60 million
Fire Mgmt.	$ 1.62 million
Total	$129.82 million

(i) The Police Safety Settlement

The City and the San Bernardino Police Officers Association ("SBPOA") have entered into a new MOU covering the Police Safety Bargaining unit for the period of July 1, 2015 to June 30, 2020. A copy of the MOU is included in the Appendix as Exhibit 24. The SBPOA MOU provides for a minimum 3.5% salary increase per year and CalPERS member cost-sharing of 12% for the last three years of the agreement. These impacts have been included in the Financial Model.

(ii) The Police Management Settlement

Resolution 2015-255 adopted in November 2015 provides compensation and CalPERS cost-sharing obligations for the 13-member Police Management Association similar to that approved for the SBPOA. The Resolution is included in the Appendix as Exhibit 23.

(iii) The General Unit Settlement

The City's settlement with the International Union of Operating Engineers regarding the General Unit employees unit is contained in the Side Letter approved in October 2015 included in Resolution No. 2015-217, a copy of which is included in the Appendix as Exhibit 20. The Side Letter provides, among other things, that: it will be in effect from July 1, 2015 through June 30, 2017; and General Unit employees will receive 2% cost of living raises effective each of July 1, 2015 and July 1, 2016.

(iv) The Management/Confidential Unit Settlement

The City's settlement with the Management/Confidential unit is included in Resolution 2015-242 approved in November 2015, which is included in the Appendix as Exhibit 21. The settlement provides, among other things, that it will be in effect from July 1, 2015 through June 30, 2017 and Management/Confidential employees will receive 2% cost of living raises effective each of July 1, 2015 and July 1, 2016.

(v) The Middle Management Unit Settlement

The City's settlement with the Middle Management unit is included in Resolution No. 2015-261 approved in December 2015, which is included in the Appendix as Exhibit 25. The settlement provides, among other things, that it will be in effect from July 1, 2015 through June 30, 2017 and Middle Management employees will receive 2% cost of living raises effective each of July 1, 2015 and July 1, 2016. The stipulated Class 13 General Unsecured Claim of the Middle Management Unit will be determined and disclosed prior to commencement of balloting on the Plan.

(vi) <u>The Fire Management Unit Settlement</u>

The City's settlement with the Fire Management Unit is set forth in Resolution No. 2016-68 approved on April 4, 2016, which is included in the Appendix as Exhibit 33. The settlement provides, among other things, for the transition of members of the Fire Management Unit to the County Fire District and certain salary mitigation payments over the next five fiscal years in amounts not to exceed $300,000 in any fiscal year. These costs have been included in the Financial Model.

k. <u>Class 11 - Retiree Health Benefit Claims</u>

Class 11 is comprised of Retiree Health Benefit Claims of the City's retirees who are covered under the Retiree Settlement, which is included in the Appendix as Exhibit 27. Under the Plan, the holders of the Retiree Health Benefit Claims will receive the rights and benefits set forth in the Retiree Settlement, **including no modifications to their pension benefits**, but retiree health benefits will be modified, in accordance with the procedures implemented by the City on January 1, 2015 and as described in Section III.E above. The Class 11 Retire Health Benefit Claims are Impaired and the holders of the Class 11 Claims are entitled to vote the Claims to accept or reject the Plan. **The Class 11 Retiree Health Benefit Claims are General Unsecured Claims and shall be treated as part of Class 13 General Unsecured Claims for all purposes, including for voting on the Plan and payment on the claims**.

l. <u>Class 12 – POB Claims</u>

Class 12 is comprised of Claims held by the holders of the outstanding POBs issued by the City in 2005. Under the Plan, the POB Creditors will be paid in accordance with a settlement entered into between the City and the POB Creditors in March 2016. The terms of the settlement are deemed incorporated into the Plan and the Confirmation Order shall provide that the Settlement is approved. A copy of the settlement is included in the Appendix as Exhibit 26. Pursuant to the terms of that settlement, under the Plan, the City will make installment payments over a thirty-year term, starting one year after the City's chapter 9 plan is confirmed and goes effective. The City will make payments of $1 million to $2.5 million per fiscal year until 2046 instead of the $3.3 million to $4.7 million per fiscal year owed under the terms of the 2005 pension bond agreement. The settlement reduces their $95.8 million dollar claim against the City to $50.7 million, a $45.1 million reduction of its largest debt. The present value of the tentative settlement is $21.3 million instead of the $52.7 million owed under the pension bond agreement. The Class 12 Claims are Impaired and the holders of the Class 12 Claims are entitled to vote the Claims to accept or reject the Plan.

m. Class 13 - General Unsecured Claims

Class 13 is comprised of Claims of general unsecured creditors of the City and includes all claims except Administrative Claims, CalPERS Claims, POB Claims, Convenience Class Claims, those Claims payable from a Restricted Fund, and those Claims relating to the 1996 Refunding Bonds or the 1999 Refunding Certificates of Participation. This Class includes, without limitation, the Fire Union General Unsecured Claim, General Unsecured Claims, Employee Wage and Benefit Claims, Contract Rejection Claims, Litigation Claims, Other Post-petition Claims, all Claims of pre-petition vendors and service providers to the City, the unsecured and/or deficiency portion, if any, of the claims of the holders of the Claims in Classes 1 through 6, Retiree Health Benefits Claims, Consenting Union Claims, the unfunded liability portion of the PARS Claims, and any other Claims that by agreement and/or pursuant to the Plan, will be treated as Class 13 General Unsecured Claims and discharged under the Plan. **As a result of the settlements that the City has entered into with the official Retiree Committee and with each of the unions representing City employees, the Class 10 Consenting Unions Claims and Class 11 Retiree Health Benefit Claims are fully included in this Class 13 General Unsecured Claims for all purposes, including voting on the Plan and claim treatment under the Plan. When the Ballot tabulator reports on the results of the voting, Classes 10 and 11 shall be included in Class 13 for calculating the votes in Class 13 accepting and rejecting the Plan.**

Under the Plan, on the Effective Date, or as soon as reasonably practicable after the Effective Date, Holders of Allowed Class 13 Claims will receive a distribution equal to 1% of their Allowed

General Unsecured Claims. The holders of Claims in this Class are entitled to vote to accept or reject the Plan. The Class 13 Claims are Impaired and the holders of the Class 13 Claims are entitled to vote the Claims to accept or reject the Plan. Each of the Consenting Unions will vote the Consenting Union Claims for themselves and their members.

n. <u>Class 14 - Convenience Class Claims</u>

Class 14 is comprised of Convenience Class Claims, which are defined in the Plan as Allowed Claims that are (a) greater than zero but equal to or less than $100 in Allowed amount or (b) irrevocably reduced to $100 in Allowed amount at the election of the holder of an Allowed Claim as evidenced by the Ballot submitted by such holder; *provided, however*, that an Allowed Claim may not be subdivided into multiple Claims of $100 or less for purposes of receiving treatment as a Convenience Class Claim. Under the Plan, within 30 days after the Effective Date, each holder of an Allowed Convenience Class Claim will receive the lesser of the Allowed amount of the Claim or $100 at the election of the holder of the Allowed Convenience Class Claim. The Class 14 Claims are Impaired and the holders of the Class 14 Claims are entitled to vote the Claims to accept or reject the Plan.

B. <u>Treatment of Executory Contracts and Unexpired Leases</u>

1. <u>Executory Contracts Generally</u>

An "executory contract" is generally defined to mean a contract under which material performance other than the payment of money is due by the parties on either side of the agreement. An "unexpired lease" is a lease the term of which has not matured as of the date of the filing of the Bankruptcy Case. The Bankruptcy Code empowers debtors, subject to the approval of the Bankruptcy Court, to assume or reject their executory contracts and unexpired leases.

A debtor's assumption of an executory contract or unexpired lease means that it will and must continue to honor its obligations under such agreement. In other words, as to such agreement, it is business as usual. The caveat to this is that the debtor must also "cure" any existing defaults prior to assumption. On the other hand, rejection of an executory contract or unexpired lease constitutes a prepetition breach of such agreement, excusing the debtor's future performance but creating a claim for the breach.

The City will reject almost all of its executory contracts and unexpired leases except for a number of agreements and leases which it will assume – and which either are addressed specifically in the Plan or will be set forth in lists that will be Exhibits to the Appendix.

2. Assumption and Assignment of Executory Contracts

The City is a party to numerous executory contracts and unexpired leases, including numerous equipment and vehicle leases, agreements with contractors and vendors. Pursuant to the Plan, City will assume (a) all of the executory contracts and unexpired leases listed in the "List of Assumed Executory Contracts and Unexpired Leases" and in the "List of Assumed and Assigned Executory Contracts and Unexpired Leases," (which lists will be included in the Appendix prior to distribution of the Solicitation Packages), (b) those contracts and leases specifically provided for in the Plan as being assumed or assumed and assigned, including but not limited to Franchise Agreements that have not been reduced to ordinance, and the leases and contracts addressed in Classes 1, 2 and 7 of the Plan, and (c) all contracts and leases of the City's Water Department. The City shall be entitled to modify or supplement the List of Assumed Executory Contracts and Unexpired Leases and the List of Assumed and Assigned Executory Contracts and Unexpired Leases any time up to seven days prior to the Confirmation Hearing. The City will not assume those unexpired leases and executory contracts specified in Section VI.C. of the Plan to be rejected.

The City believes that it is current in its payments and other obligations under the executory contracts and unexpired leases that it will assume via the Plan. However, after the provision of notice and the opportunity for a hearing in relation to Plan confirmation, the Bankruptcy Court will resolve any and all disputes regarding: (i) the amount of any cure payment to be made in connection with the assumption of any contract or lease; (ii) the ability of the City to provide "adequate assurance of future performance" within the meaning of Bankruptcy Code section 365 under the contract or lease to be assumed; and (iii) any other matter pertaining to such assumption and assignment. Any party to an executory contract or unexpired lease that is to be assumed, or assumed and assigned, by the City that asserts that any payment or other performance is due as a condition to the proposed assumption must file with the Bankruptcy Court and serve upon the City a written statement and accompanying declaration in support thereof, specifying the basis for its Claim on the date that objections to confirmation of the Plan are due, September 2, 2016. The failure to timely file and serve such a statement in accordance with the Plan will be deemed to be a waiver of any and all objections to the proposed assumption and of any claim for cure amounts of the agreement at issue.

3. Rejection of Executory Contracts

Pursuant to the Plan, upon the Effective Date, without the need to file any motions, the following leases and contracts are rejected: (a) the contracts and leases listed in the "List of Rejected Executory Contracts and Unexpired Leases" (which list will be included in the Appendix prior to distribution of the Solicitation Packages), (b) any other contracts and leases expressly provided for under the terms of the Plan as rejected, (c) and all other contracts and leases not assumed pursuant to Section VI.A. of the Plan. For the avoidance of doubt, none of the following contracts and leases are rejected: (a) those contracts and leases related to the 1996 Refunding Bonds Agreements (City Hall), the 1999 Refunding Certificates of Participation Agreements (Police Station/201 North E Street/South Valle) (the assumption of which are addressed in Classes 1, 2 and 7 of the Plan); (b) the SBCPF Settlement Agreement; and (c) the contracts and leases of the City's Water Department.

The City will be entitled to modify or supplement the List of Rejected Executory Contracts and Unexpired Leases any time up to 7 days prior to the Confirmation Hearing.

4. Deadline for the Assertion of Rejection Damage Claims; Treatment of Rejection Damage Claims

Proofs of claim arising from the rejection of executory contracts or unexpired leases must be filed with the Bankruptcy Court and served on the City no later than 30 days after the Effective Date. Any Claim for rejection damages for which a proof of claim is not filed and served within such time will be forever barred and shall not be enforceable against the City or its assets, properties, or interests in property. All rejection damage claims will be treated as a Claim in Class 13 (General Unsecured Claims).

a. Modifications to Assumption, Assignment or Rejection of Contracts and Leases

Any time within 180 days after the Effective Date, the City may file a motion to add or remove contracts or leases to or from the List of Assumed and Assigned Executory Contracts and Unexpired

Leases and the List of Rejected Executory Contracts and Unexpired Leases or otherwise modify any decision to assume, assign or reject any executory contract or unexpired lease, upon notice to the counterparty. The Bankruptcy Court may grant such motion for cause shown, including that no opposition to the motion was filed.

C. Means for Execution and Implementation of the Plan

The implementation of the Plan will be accomplished by the City:

- implementing its settlements with CalPERS, the Retiree Committee, the SBCPF, the Consenting Unions and the POB Creditors;
- performing its Plan obligations to the other Creditors whose Claims are Impaired or Unimpaired under the Plan;
- complying with the contracts and memoranda of understanding that the City is entering in connection with the City's annexation into the County Fire District and the City's contracting out of certain municipal services including to Burrtec; and
- performing its obligations in good faith under the ADR Procedures to facilitate settlement of disputed claims.

Certain of the critical elements of Plan implementation are discussed in sections 1 through 6 below.

1. Alternative Methods of Delivering Municipal Services

A keystone of the Plan is contracting out and/or regionalization of certain municipal services currently provided by City employees. Municipalities have been contracting for virtually all municipal services since the 1950's. For a City such as San Bernardino, this approach can generate economies of scale savings and labor cost savings. Services can be provided by either private sector service providers or other public agencies, either through a contract or by regionalization.

The City has implemented annexation of the City into the County Fire District, and the County Fire District now provides Fire Services directly to the City's residents. The City also entered into a contract for solid waste disposal, recycling, sweeping and right-of-way clean-up services with Burrtec in January 2016. Burrtec began providing services on April 1, 2016.

In addition, the other services the City will be considering contracting out include fleet maintenance, business licensing, engineering, inspections, information technology, graffiti abatement, traffic signal maintenance, street maintenance, custodial maintenance, code enforcement and more. Such regionalization or outsourcing will allow the City to achieve both significant savings and receive additional revenues. While the City has done relatively little contracting in the past, it has had success with contracting out park maintenance functions in the last several years. The City believes that utilizing alternative methods to deliver municipal services will have significant economic and other benefits to the City and its residents.

a. City's Joint Application With the County of San Bernardino to Annex the City into the San Bernardino County Fire Protection District

In April 2015, the City issued a request for proposals to provide Fire Services to the City. The City received two proposals in response – one from the County Fire District for annexation and one from Centerra Group, LLC for private contracting of Fire Services. The City also received a proposal from the Interim Fire Chief for reorganization of the existing Fire Department. The City hired a consulting firm, Citygate Associates LLC ("Citygate"), to evaluate the proposals and make recommendations.

In August 2015, Citygate completed its evaluation and issued its report entitled "Evaluation of Fire Service Proposals" ("Citygate Evaluation"). On August 24, 2015, the former City Manager, Allen Parker, with the assistance of Andrew Belknap of Management Partners and Citygate, presented their evaluation and recommendations at a regularly noticed meeting of the City's Common Council. Both the Citygate Evaluation and the memorandum dated August 24, 2015 to the Mayor and Common Council from Mr. Parker and Mr. Belknap regarding Annexing to San Bernardino County Fire Protection District for Fire Service Delivery ("Staff Report") recommended that the City move forward with the County Fire District proposal.[18] After hearing and considering the presentations and public comments made at a five hour August 24, 2015 meeting, the Common Council approved Resolution No. 2015-195 which authorized: (1) City staff to negotiate with San Bernardino County and the County Fire District the terms and conditions of annexation and return to the Common Council for approval;

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[18] Further information and documents related to the City's evaluation of alternative methods of delivering fire and emergency services can be found on the City's website at this link under the "Fire Services" section: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp

and (2) the City Manager to negotiate an interim contract for the County Fire District to deliver Fire Services to the City until the annexation is completed and return to the Common Council for approval. Ultimately, the City and County Fire District decided not to enter into an interim contract, and proceed only with annexation of the City into the County Fire District.

The County Fire District is a proven and professional provider of the full range of fire and emergency medical services. The County Fire District currently operates 56 fire stations, serving unincorporated San Bernardino County and 7 incorporated cities (including the City of Fontana). It has a total of approximately 865 employees of which 642 are sworn firefighters. By annexing into the County Fire District, the City will be able to take advantage of two existing County Fire District stations to serve portions of the City and pool costs for a large number of administrative, support and specialized services such as management, dispatch, purchasing, fire prevention, EMS management, hazardous materials response, search and rescue and wildland fire response.

In accordance with Resolution No. 2015-195 and in furtherance of the City's Plan, the City submitted its certified application to the Local Agency Formation Commission of the County of San Bernardino (" LAFCO"), a local commission (separate and independent of the County of San Bernardino's government) empowered under the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 to ensure an orderly and efficient growth pattern and use of land resources and protect against overlapping governmental jurisdiction within San Bernardino County.

In September 2015, the San Bernardino County Board of Supervisors, acting as the governing body for the County Fire District, adopted a substantially similar resolution to the City's making the annexation application a joint request from the City and County Fire District. LAFCO subsequently opened two proposals for governmental reorganization, LAFCO 3198 – reorganization to include annexation into the County Fire District, its Valley Service Zone and Service Zone FP-5; and LAFCO 3197 – sphere of influence amendments (expansion) for the County Fire District. After LAFCO opened the two proposals, the City, as well as several County agencies (Assessor, Registrar of Voters and Surveyor) provided information necessary to support the reorganization proposal and the sphere amendment.

In October 2015, LAFCO held the Departmental Review Committee Meeting to review both proposals. Based on the meeting LAFCO issued a determinations letter on October 21 for both LAFCO 3197 and LAFCO 3198. In response to the determinations letter, the County Fire District filed a revised Plan of Service and Five Year Financial Forecast on October 28, 2015. The Five Year Financial Forecast showed a City General Fund property tax transfer revenue requirement starting at $20.4 million in FY 2016/17, increasing to $22.9 million in FY 2020/21. From an economic standpoint, this result is quite favorable to the City when measured against the financial projection prepared for the City by Urban Futures as part of the annexation analysis, which showed City costs for a stand-alone fire department for similar services and capital obligations to the County's proposal would have a General Fund revenue requirement of from $32.9 million to $36.7 million over the same five year period.

Under the County Fire District's Plan of Service, City residents will experience improved service from a dispatch system which has faster call processing time than is associated with the City dispatch system, as well as from direct responses from two County Fire stations which are closer to some sections of the City than City responding stations. County Fire also has more equipment for delivery of fire services such as water tenders, water rescue boats, heavy equipment for floods or earth moving, hand crews, ambulance response (in seven areas), additional hazardous materials response capabilities, and sophisticated urban search and rescue capabilities. Regionalization of fire services is considered an industry best practice in order to make service delivery more seamless and to take advantage of economies of scale. Many cities are currently served using an annexation model, and LAFCO has approved of several annexations into the County Fire District.

In January 2016, LAFCO held a public hearing to discuss LAFCO's staff recommendation to accept the joint City/County annexation application. The application, including County Fire's proposed service plan, was approved unanimously on January 27, 2016 as set forth in LAFCO Resolution No. 3211. In February 2016, the 30 day reconsideration period of LAFCO's decision ended and the Notice of Protest Hearing was issued. On April 21, 2016, LAFCO held the Protest Hearing and the number of protests received was below 5% for both property owners and registered voters. Accordingly, the

LAFCO Executive Director determined that annexation of the City into the County Fire District can proceed.[19]

On July 1, 2016, annexation of the City into the County Fire District was implemented, which was crucial to the City's reorganization efforts. It is the City's intention that disruptions to employment, compensation and benefits be kept to a minimum in connection with the County Fire District taking over the provision of Fire Services. Nonetheless, the City estimates that annual economic benefits from annexation will be between approximately $7.4 and $12 million.[20] The City's Financial Model shows that even including certain one-time transition costs associated with the annexation, the transfer of service responsibility will improve the City's fiscal position by in excess of $30 million, and considerably more if deferred maintenance costs are taken into consideration. Without annexation the projections show that the City would soon run an annual deficit of up to $12 million per year. Therefore, successful annexation is fundamental to restoring the City to solvency.

Under annexation, the City will remain responsible for certain "legacy" pension costs. These legacy pension costs are accounted for in the Financial Model under the line item entitled "Fire's Legacy CalPERS Pension Cost," and are estimated at approximately $3.3 million in fiscal year 2016-17 with annual increases up to $10 million annually in fiscal year 2033-34 for a total of approximately $131 million over the term of the Financial Model. The decision to annex into the County Fire District does not have an impact on these costs because they relate to and must be paid for the period when the City operated its own Fire Department. Even taking into consideration these estimated legacy pension costs, the City firmly believes that the increased savings and revenue improvements to the City from annexation on a net basis (particularly in contrast to the cost to the City of continuing to fund a stand-

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[19] Because the City's annexation into the County Fire District is a populated annexation, voters within the territory to be annexed had the right to petition LAFCO regarding the annexation decision. California's Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, as amended, Calif. Government Code §§ 56000 *et seq*., contains the notice procedures and timetables for resident and property owner input into the LAFCO decision-making process, including that LAFCO would (a) terminate the annexation approval process if 50% or more of the City's registered voters filed timely protests, or (b) place the annexation approval to a vote of the City's residents if more than 25% but less than 50% of registered voters filed timely protests.

[20] Detailed information that answers frequently asked questions about the annexation into the County Fire District can be found on the City's website at the following link: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/fire_annexation_faqs/default.asp

alone fire department) will be of significant benefit to the City and its residents and are critical to the success of the City's Plan.

b. <u>Contract for Solid Waste Disposal and Related Services</u>

California cities are increasingly contracting with the private sector for solid waste and recycling. Today the vast majority of cities in Southern California provide solid waste and recycling services under a franchise agreement with one or more private companies. The move to private contractors is justified by the economies of scale available to private companies which serve numerous jurisdictions. These economies are found in several areas including capital acquisition, fleet maintenance, workers compensation, employee recruitment, safety and training programs, customer service, billing, technology and management. Recent examples include Hemet which contracted its solid waste service to CR&R Waste and Recycling Services in 2011, and Newport Beach which contracted its residential solid waste services (commercial had already been contracted) to CR&R in 2013. Most cities in the Inland Empire provide these services through contracting with private companies.

With California recycling requirements that have been in place for over 25 years, refuse haulers gradually have expanded their businesses to include materials sorting, recycling, public education, and in some cases, street sweeping and other related services, working in partnership with individual cities and counties. In addition, the more sophisticated companies use specialized routing systems to reduce travel times and produce and closely monitor work measurements based on their experience. Given the expertise developed in multiple jurisdictions by these waste companies, and the economies of scale that larger operations can provide, it is likely that contracting these services to a private company will result in lower or similar costs to provide the service, plus increased franchise fees paid to the City's General Fund by the contractor, along with fees paid by the contractor to the City for an exclusive agreement.

In June 2015, the City sent out a request for proposals to contract three of its largest maintenance services – solid waste and recycling, street sweeping and right-of-way cleanup. These services are currently performed by approximately 100 employees in the City's Public Works Department. Four companies submitted proposals, all of which are active in solid waste collection and street sweeping in the Southern California area. An evaluation team of consultants with experience in contracting and solid waste evaluated the companies' financial statements, reviewed the technical, financial proposals and references, and provided a recommendation to the City Manager. In November 2015, a recommendation was made to the Common Council, the Common Council selected Burrtec and then directed staff to negotiate a ten-year agreement. In January 2016, the negotiations with Burrtec were completed and the Common Council has approved the contract between the City and Burrtec as Resolution No. 2016-10, a copy which is included as Exhibit 29 in the Appendix. A copy of the Burrtec Contract is included as Exhibit 30 in the Appendix. Burrtec began providing services on April 1, 2016. As a result, the City will be able to offer the same or better level of services than the City currently provides, with substantial economic benefit to the City.

In connection with the Burrtec Contract, the City expects to receive these benefits: (1) a one-time franchise fee payment of $5 million within 60 days of execution of an agreement; (2) franchise fees of $2.8 million per year above current levels and other franchise/host fee payments which the City estimates will net a cumulative annual revenue stream of approximately $5 million to $7.6 million per year over the 20-year term of the Financial Model as reflected in line item "New Waste Management Franchise" (which amounts to approximately $106.9 million in revenues); (3) an enhanced franchise fee of $500,000 annually; (4) a host fee of $325,000 annually; (5) recycle waste revenue of approximately $60,000 annually; and (6) an estimated $12.225 million from the sale of refuse vehicles, carts, bins, and containers (which is included in the Financial Model under the line item, "Proceeds from IW Vehicle Sale & CIP") that will be used to pay liabilities. In addition, Burrtec has agreed to reimburse the City for "wear and tear" costs on the City's streets over the course of the Financial Model (which are reflected in the line item "Proceeds from IW Vehicle Sale & CIP").[21]

c. Soccer Complex Maintenance

The City has implemented a contract to operate the Soccer Complex. The Elmore Sports Group ("ESG") took over operations in November of 2015. Under the agreement, the City expects a net gain of approximately $280,000 in base operations in fiscal year 2016-17 increasing to about $425,000 per

[21] Further information and documents related to the City's evaluation of alternative methods of delivering waste management services can be found on the City's website at this link under the "Refuse Services" section: http://www.sbcity.org/home_nav/chapter_9_bankruptcy/default.asp

year in fiscal year 2033-34 as reflected in the line item “Contract Soccer Complex Mgt & Admin” in the Financial Model. This will come from ESG’s participation in capital improvement costs and improved marketing of the facility, which will result in additional revenues for the City. Because of the City’s economic situation, basic maintenance and capital replacement funding had been inadequate which led to a decrease in utilization of the facility. Contracting with ESG creates a satisfactory maintenance and capital replacement platform which, along with proper marketing, will position the Soccer Complex for fiscal solvency.

d. Fleet Maintenance

The City has been financially unable to replace its vehicles and equipment in accordance with industry standards or provide an effective fleet maintenance operation. About 479 units, representing 56% of the City’s total fleet, are currently due or past due for replacement at an estimated cost of more than $41 million. The aging fleet has resulted in a significant burden on the understaffed fleet maintenance employees who must contend with an aging fleet and an inefficient fleet operation. Deferred fleet maintenance also puts the City at risk for compliance with state mandated equipment and vehicle inspections. The City is attempting to address this issue through the transfers of certain heavy equipment to Burrtec as part of its outsourcing efforts, and through resources directed via the Police Resources Plan (in the form of new fleet vehicles, which the City intends will alleviate some of the maintenance issues currently faced). The City also anticipates outsourcing fleet maintenance operations in 2017 to provide the City with increased resources and estimated annual savings of $400,000 beginning in fiscal year 2016-17 and increasing thereafter to about $600,000 as shown in the line item “Contract Fleet Maintenance” in the Financial Model.

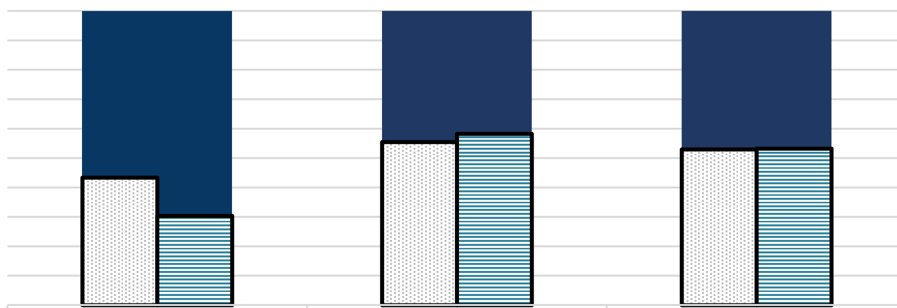
e. Other Contracting Options

There are other areas where the City likely will derive efficiencies from a contract approach. Efforts are underway to contract for business license administration, custodial services, graffiti abatement and some information technology functions which are anticipated to be completed in 2016 or 2017. Areas where savings have yet to be identified but might offer benefit include engineering, inspection, code enforcement and attorney services, and the City is preparing RFPs and implementing an analysis of each option.

2. Police Resources Plan

The primary municipal service provided by the City is for police services. Reducing the City's violent and other crime rates and addressing the City's perception as a "dangerous" city are the most pressing issues facing the City. As shown in the chart below, San Bernardino has more than double the violent crime rate as either the surrounding region or the state as a whole. For every three violent crimes per 1,000 residents in the region, there are ten such crimes in San Bernardino.

State and Regional Crime Rates Compared to San Bernardino in 2014



	Violent Crime per 1,000	Property Crime per 1,000	Part 1 Crime per 1,000
San Bernardino	100%	100%	100%
California	43%	55%	53%
Region Average	30%	58%	53%

Sources: 2015 California Department of Finance; 2014 Federal Bureau of Investigation Crime Reports
Notes: Region average includes large nearby cities: Fontana, Moreno Valley, Rancho Cucamonga, Ontario, Riverside, and Corona. Part 1 crimes include violent and property crimes as defined by the Federal Bureau of Investigation.

San Bernardino's crime rates are high even when compared to other high-crime cities in California. Of the 63 California cities with populations between 100,000 and 400,000, San Bernardino has the second highest Part 1 crime rate. The table below provides demographic and crime data for the 10 cities with the highest crime rates within this population range. Notably, San Bernardino also has a significantly lower median household income and a higher percentage of people in poverty than other cities with high rates of crime. People living in poverty are the victims of violent crime at more than twice the rate of high income populations according to a study by the Bureau of Justice Statistics between 2008 and 2014.

High-Crime Cities in California between 100,000 and 400,000 in population – Demographic Data

City	2015 Population	2014 Part 1 Crimes per 1,000 Residents*	2014 Violent Crimes per 1,000 Residents	2014 Percent Violent Crime of Part 1 Crimes	2013 Median Household Income	2013 Percent of All People in Poverty
Antioch	108,298	46.9	7.8	17%	$65,254	14.9
Bakersfield	369,505	45.0	4.5	10%	$56,204	20.4
Berkeley	118,780	46.7	3.6	8%	$63,312	18.7
Concord	126,069	45.0	3.7	8%	$65,798	12.1
Modesto	209,186	52.3	8.5	16%	$47,060	20.8
Richmond	107,346	48.0	7.9	16%	$54,589	18.5
San Bernardino	213,933	53.7	9.9	19%	$38,385	32.4
Stockton	306,999	56.1	13.0	23%	$46,831	24.3
Vallejo	119,683	49.8	8.6	17%	$58,371	17.5
Victorville	121,168	41.6	5.3	13%	$50,034	25.3
State	38,714,725	28.4*	4.0	14%	$61,094	15.9

Sources: 2015 California Department of Finance; 2014 Federal Bureau of Investigation Crime Reports; 2009-2013 American Community Survey Estimates
Note: Part 1 crimes include violent and property crimes as defined by the Federal Bureau of Investigation.

San Bernardino's rates of crime also top national averages. San Bernardino has 53.7 Part 1 crimes per 1,000 residents and 9.9 violent crimes per 1,000 residents, significantly higher than the respective national rates of 29.6 and 3.7, according to the 2014 Crime Reports by the Federal Bureau of Investigation.

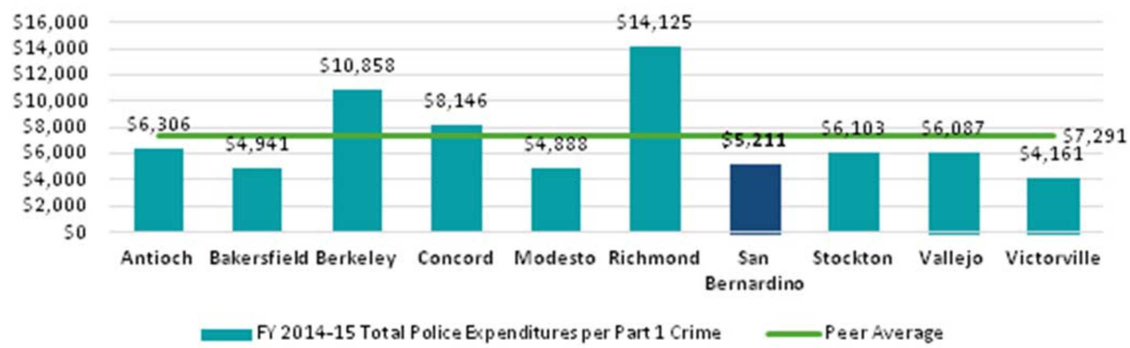
Yet, financial circumstances have forced the City to reduce the size of its Police Department. The Police Department's sworn staffing levels have been in decline steadily since 2009, while crime rates remain steady and response times rose to unacceptable levels. The general service impacts can be described as follows:

- Sworn staffing has been reduced from 356 full-time equivalent (FTE) employees in 2008 to 248 today (30% reduction),
- Patrol division sworn staffing has been reduced by 25% since 2008,
- Community policing teams have been scaled back by about 75%,
- Narcotics enforcement has been reduced by 50% since 2008,

- Traffic enforcement personnel were reduced by 58% since 2008,
- Priority 1 average response times increased 76% since 2008, and
- Almost 36% of patrol vehicles are overdue for replacement.

Unless residents, business owners and visitors feel safe in the City, efforts to attract economic development and new residents will be significantly hampered. Currently, funding for the Police Department falls well below the average compared with other similarly sized California cities with high rates of crime.

Similar Sized California Cities with Top Crime Rates – Police Expenditure per Part 1 Crime in FY 2014-15



Sources: FY 2014-15 Adopted City Budgets; 2014 Federal Bureau of Investigation Crime Reports
Note: Part 1 crimes include violent and property crimes as defined by the Federal Bureau of Investigation.

The City will have to dedicate significant resources to very specific and measurable elements to reduce crime.

To address these issues, the City developed a five-year plan intended to bolster the City's police resources and reduce the City's crime rates (the "Police Resources Plan") which was approved by the Common Council in November 2015. A staff report outlining the Police Resources Plan is included in the Appendix as Exhibit 11. The primary objective of the Police Resources Plan is to rebuild sworn staffing levels and provide the sworn staff with the tools (largely technology, equipment and vehicles) needed to do the job as follows:

- Increase staffing levels of the City's Police Department to enable the Police Department to reduce call response time sand be able to build deeper relationships in the community;

- Invest in the Police Department technology (to replace otherwise aging and deficient systems, to improve efficiency and effectiveness and to ensure business continuity and access to critical systems); and
- Fleet replacement (to replace the Police Department's largely aging fleet - with more than half of all police cars 10 years or older and roughly a fifth with more than 100,000 miles).

The Police Resources Plan also seeks to increase community engagement in strategies to reduce crime and increase economic development opportunities.

With respect to staffing, the table below provides a history of authorized sworn police staffing levels over the last 10 years. The City's sworn police staffing was at its peak of 356 positions in 2009. Since that time the number of sworn positions has decreased by almost 30%. Also, the number of actual positions (those filled) is at the lowest level in a decade.

History of Sworn Police Staffing Levels

Fiscal Year	Budgeted	Year-End Actual
FY 2005-06	312	311
FY 2006-07	330	323
FY 2007-08	346	346
FY 2008-09	356	324
FY 2009-10	350	326
FY 2010-11	350	348
FY 2011-12	305	292
FY 2012-13	281	272
FY 2013-14	260	234
FY 2014-15	248	229
FY 2015-16	248	214 (November)
Percent Change FY 2011 to 16	**-29%**	**-39%**

Source: San Bernardino Police Department

Ideally, the Police Resources Plan will result in 89 new positions, for an overall 29% increase in sworn positions. Although still below the peak staffing level of 356 in fiscal year 2009, this increase will enable the department to deliver its core service mission, reduce call response times, and provide the depth required to engage with the community on a path to improving the overall quality of life.

Increased staffing would also have a significant impact on the ability of the department to redeploy officers and other staff to address those critical community issues related to gangs, illegal narcotics, prostitution, and traffic enforcement. Increasing both sworn and civilian staffing levels will provide renewed capacity to the department to be able to reconstitute or expand some of the specialty units designed to address these issues and reduce associated crime.

The City will only be able to fund a fraction of the Police Resources Plan with existing revenues. To address the staffing and technology goals identified above, the City will spend approximately $17.6 million over the next five year period, with a total expenditure of $91 million over the 20 year term of the Financial Model as reflected in the "Police Services Master Plan" line item. Over the horizon of the Financial Model, the City projects it can afford only about 40% of what is necessary to fund the Police Resources Plan.

With respect to police fleet vehicles, more than half of the City's Police Department vehicles require replacement, as reflected in the List of City Non-Fire Vehicles included in the Appendix as Exhibit 15. The City's Financial Model allocates approximately $23.4 million over the 20 year term for new police vehicles as reflected in the Capital Investment-Fleet-Police line item to address the third goal of Police Resources Plan.

The Police Resources Plan addresses some of the most critical needs for the Police Department in its fight against rising crime rates. While the cost to the City of implementing the Police Resources Plan is not insignificant, research has shown that reductions in crime rates can lead to higher tax revenues and increased economic development. Thus, the City's plan to upgrade the Police Department's infrastructure (staffing, IT and fleet) will have long term economic benefits for the City.

3. <u>Necessary Reinvestment in City Infrastructure and Services</u>

a. <u>Public Facilities Repair and Maintenance</u>

The City has 169 public facilities which require on-going operational maintenance as well as required capital maintenance. However, due to the City's significant capital maintenance backlog and limited financial resources, only approximately 15% (or approximately $39.1 million) of the needed infrastructure maintenance is included in the City's Financial Model. This budgeted amount is reflected in the Financial Model at line item "Capital Investment – Buildings & Fixtures." The Financial Model also budgets approximately $1.8 million for park improvements as reflected in the line item "Capital Investment – Parks."

b. <u>Street and Road Repair</u>

As set forth on the Street Repairs Report included in the Appendix as Exhibit 9, the City's right-of-way capital maintenance backlog exceeds $180 million. To fund the much needed right-of-way maintenance needs, the City of San Bernardino will utilize both restricted funding sources (Measure I and State Gas Tax Funds) as well as General Fund resources. The City's Financial Model allocates only about $14.5 million over 20-years to address a current need exceeding $180 million. Even though the addition of General Fund monies increases the funding available over the next 20-years, the City will still be able to fund only a small fraction of the current need (as reflected at line "Capital Investment – Public Right-of-Way" of the Financial Model and in the Street Repairs Plan. While not sufficient to fully address all of the City's street repair and maintenance needs, the additional application of General Funds is at least anticipated to reduce the numbers of streets within the City that will require rehabilitation and/or full reconstruction. Because the City's costs for backlogged capital maintenance will continue to grow over the 20-year funding term, the funding percentage is anticipated to decline annually as costs for repairs go up. As a result, the City will need to find additional sources for funding in the coming years.

c. <u>Outdated Information Technology Systems Upgrade</u>

Since the early years of the Great Recession, the City eliminated funding for Information Technology (IT) capital requirements. In recent years, the City has allocated funds to replace only those systems which have failed, but continues to risk other failures due to lack of funding availability. The lack of funding availability for IT infrastructure has left the City with operational systems that are long past their useful life and are beyond manufacture support and/or warranty. More concerning is the lack of a back-up system if the City's network crashes and is unrecoverable. To address these basic service level issues, the City is allocating approximately $11.5 million over the term of the Financial Model as reflected in the line item Capital Investment – IT Infrastructure.

d. Reinvestment in City Corporate Support Functions

The City's administrative services have declined significantly over the last decade due to high turnover and other factors. The City has not been in a position over the past several years to invest in management, staffing levels, training and information systems or modern municipal policies and procedures in administrative functions such as finance, risk management and general government. For example, while the situation varies from division to division, the average vacancy rate is approximately 16% and the vacancy rate in management level positions is typically higher – as much as 46%. In addition, City information technology systems have not been updated and operations are struggling to provide even basic levels of service in some areas.

The City and its consultants have identified where critical needs exist for additional City staff and systems, and have a plan to improve City corporate support functions which it intends to implement in fiscal year 2016-17. The primary focus is to implement needed changes to the City's Information Technology, Human Resources and Finance departments. The cost of this plan is included in the line item "Organizational/Service Improvements" of the Financial Model.

e. Replacement of Aging Vehicles

Similar to other capital equipment and maintenance needs, the City's vehicle fleet has not received adequate funding for replacement vehicles for many years. Much of the City's fleet is well beyond it useful life and has become costly to maintain. Some of the City's fleet needs have been resolved through contracting of solid waste and other services and annexation into the County Fire District. The City will no longer need to fund vehicles associated with fire service and emergency medical services, and integrated waste, recycling, street sweeping, right-of-way clean-up and park maintenance fleet needs have been met through contracting out these municipal services. However, the City still must finance the replacement of essential vehicles necessary to provide basic services such as facility maintenance, public works, animal control, code enforcement, and planning and building inspection. The City has allocated $25.3 million for general purpose vehicles as reflected in the Capital Investment-Fleet-Other line item over the term of the Financial Model.

f. City Hall Seismic Retrofit

The City has considered seismic retrofitting of City Hall since 2002. The City Hall site is within 4 miles of the San Andreas Fault which is capable of producing a magnitude 8.0 earthquake. The next dominant fault is the San Jacinto at a distance of 2 miles capable of producing a magnitude 7.5 earthquake. These faults make the City of San Bernardino, including the location of City Hall, one of the most seismically hazardous locations in California. On any business day, more than 200 people on average occupy City Hall. The City Hall building is a 7-story structure with one subterranean level reinforced concrete structure designed in 1970. It is constructed with lightweight concrete slabs, beams and columns and to the 1968 UBC building code. However, the 1971 San Fernando earthquake demonstrated vulnerability of this type of construction to collapse. Starting with the 1973 Building Code, this type of construction was prohibited in areas with high and moderate seismic potential.

In 2002, IDS performed work on the seismic strengthening project of the City Hall parking structure. While performing this work, IDS reported to the City that the building had sustained structural damage which had occurred during the Landers earthquake of 2002. Subsequently, the City solicited proposals from earthquake engineering consultants to perform a seismic evaluation of the building, but due to funding constraints, the City did not proceed at that time with the evaluations. In 2007, URS Corporation was retained by the City to perform a seismic evaluation of City Hall. Based on the review and soil testing under City Hall, URS' review confirmed that the building needed seismic retrofitting.

In July 2015, the City developed and sent out a Request for Qualifications (RFQ) to architects and large contractors who have successfully completed large-scale seismic retrofits for municipalities, universities and other public entities while maintaining the design integrity of their buildings. The City received statements of qualifications and project estimates from five firms. Following a review of the proposals received, the IDS Group was selected to perform the work. The work requested consists of performing a detailed analysis to pinpoint the problem areas and to recommend a retrofit strategy for City Hall, identify additional professional assistance that will be required for implementation, and estimate associated construction costs and schedule. The options for continuity of City operations during the retrofitting process will also be considered because the seismic retrofit will require all of the employees as well as the furnishings, equipment and infrastructure necessary for those employees to perform their job duties to move to another building during the work required to complete the retrofit.

IDS Group's work was recently completed and the City Hall seismic retrofit is projected to cost $20 million. The Financial Model assumes a $20 million financing for the seismic retrofit costs, equal to an annual debt service of about $1.7 million, and these costs are included in the Financial Model in the Capital Investment – Buildings & Fixtures line item.

4. City Charter Reform

The City historically has experienced a wide range of operational and other problems that have adverse economic impacts due to the existing Charter structure. As one example, the Charter specifies that both primary and general elections for City officers are to be held at times other than the nominal November general election in numbered years. As a result, the City cannot consolidate its elections with most State and Federal elections. This costs the City at least $270,000 more per election cycle because costs cannot be shared. It also diminishes voter turnout.

The Mayor and Common Council established the Volunteer Citizen-Based Charter Committee ("Charter Committee") in March 2014. The Charter Committee identified the Charter as a barrier to efficient and effective government because it is overly complex, hard to understand, and contains elements that are inconsistent with best practices for modern municipal government. The Charter Committee worked to develop recommendations for a new or substantially revised charter that reflects the principles of good governance and meets the City's needs. The Charter Committee has met approximately twice per month since May 2015 with the goal of providing recommendations to the Mayor and Common Council by May 2016, and has sought public input and engaged in community outreach efforts through public forums.

On December 29, 2015 the Charter Committee completed its work on the charter skeleton. The charter skeleton is an outline of the key elements, ideas and principles to be addressed in the City's charter, including an overall governance structure. In order to recommend a charter that reflects best practices consistent with modern municipal governance, the Charter Committee decided to propose a completely new charter instead of recommending numerous amendments to the existing charter. The City intends to place a proposed new charter before the City's voters on the November 2016 ballot.

The Charter Committee's preliminary recommendations for the charter result in a governance structure that looks fundamentally different than the existing governance structure. It shows an organizational structure with greater clarity in roles, responsibilities and reporting relationships. Perhaps most importantly, the City Manager is unambiguously responsible for City operations and management. It removes administrative and management decisions from the Mayor and Common Council and focuses their role on establishing policies to be carried out by the City Manager and executive leadership.

This structure is consistent with best practices for council-manager forms of government, as well as the provisions of modern-era charters. Assuming this charter approach is approved by the voters, the City will have a governance and management structure which much more closely approximates the structure in other comparable California cities. This is of critical importance to the City and its residents because the governance approach taken by other cities leads to performance which is demonstrably better in terms of the delivery of municipal services and the maintenance of fiscal solvency than has been the case for the City under the current system of government. While awaiting Charter reform, the City is operating under the Operating Practices for Good Government protocol the City adopted which streamlines decision making, increases efficiency and provides for better accountability. The City expects that Charter reform will result in streamlined operations, increased efficiency and improved City government accountability. The City's Plan is not conditioned upon approval of any Charter reforms, and the City's Financial Model and feasibility analysis do not assume or require that any Charter reforms will be implemented.[22]

5. <u>Revenue Enhancement Measures</u>

While revenue enhancement is severely constrained under California law, there are a number of best practices which can be implemented to generate revenues. The City has evaluated approximately 14 additional revenue sources (many of which require voter approval) and the Financial Model contemplates implementation of various new fee adjustments. In 2015, the City implemented increases to the cost allocation structure for the water, sewer treatment and sewer collection enterprise funds.

[22] More information on the Charter reform efforts can be found at this link: http://www.sbcity.org/cityhall/city_clerk/volunteer_citizen_based_charter_committee_agendas.asp.

The City's fire service annexation application requested annexation into a service zone with an approximate $148 per parcel annual fee, which would generate new revenue of approximately $7.8 million for Fire Services. The City also negotiated a solid waste management franchise fee.

Many measures the City considered for purposes of raising revenues have been rejected because they would not be realistically feasible to implement. In light of the very low income levels among a substantial percentage of the City's residents, the City faces significant hurdles in pursuing voter approved tax measures. The City remains the poorest community of its size in California, and it has grown progressively poorer over the past decades. According to the latest U.S. Census Bureau data: the per capita income of City residents is $14,879, compared to a state average of $29,527; the median household income in the City is $38,385, compared to a state average of $61,094; and the percentage of City residents living below poverty level is 32.4%, compared to a state wide average of 15.9%. The median value of owner occupied housing units in the City is $152,800 compared to a state average of $366,400.[23]

Compounding the severe poverty is the City's relatively low population growth rate. Over the past 25 years, the City had a compound annual growth rate of 1%, and over the last five years the compound annual growth rate was 0.25%. The City's inability to provide a basic level of municipal services only exacerbates the slow growth rate. Until the City can restore a decent level of municipal services to attract new residents, new population growth is expected to continue to be in the poorer population sectors of the City where the demand for City services is even greater.

A summary of key potential revenue enhancement options the City considered is set forth below.

a. Measure Z Sales Tax Reauthorization

The City is working towards reauthorization of the Measure Z sales tax in 2021, which requires voter approval. The City projects that reauthorization of the Measure Z sales tax will lead to estimated revenues of between $8.7 million and $12.8 million each year between fiscal year 2021 through fiscal year 2034 for a total of approximately $134.7 million. Other than Measure Z, the City considered but

[23] *See* http://quickfacts.census.gov/qfd/states/06/0665000.html (comparing income and housing data for the City of San Bernardino to the average for California).

decided against further sales tax increases at this time. Sales tax in the City is already among the highest in the region, and an increase would only unduly burden the City's residents who are among the poorest in California. City officials reasonably determined that the residents are not financially capable at this time of carrying a heavier sales tax load in addition to the other revenue measures that will be implemented in connection with the Plan.

b. <u>Ground Emergency Medical Transport</u>

Legislation that would have provided some potential revenue to municipalities that provide emergency paramedic response in advance of ambulance arrival was passed in 2013-14 but vetoed by Governor Brown. Another similar piece of legislation (SB 534) is pending in Sacramento (which would allow revenue to flow to public agencies that provide ground transport of Medi-Cal eligible emergency patients). The City does not provide any such ground transport service at this time, and it would be both speculative and unsound to rely on any such potential revenue.

c. <u>Revenues from Contracting Out</u>

The City will realize significant additional savings and revenues from annexation of the City into the County Fire District for Fire Services, its contract with Burrtec for solid waste and recycling, sweeping and right-of-way cleanup, and from contracts for other municipal services with private or other government agency providers that the City is exploring.

d. <u>Cost Allocation Revisions for Enterprise Funds</u>

Following the City's plans to restructure its operations for service delivery efficiencies, it was necessary to create a new cost allocation strategy which allowed the City to recover costs associated with general administrative and public safety services. Such cost allocation provides the City an equitable return for services, while allowing the City to continue to receive cost allocation fees from the City's utilities throughout the term of the Financial Model. Implementing this strategy will ensure the City an increasing cost allocation return for services as the City's cost for general administration, public safety and right-of-way maintenance increase during the term of the Financial Model. Specifically, the Financial Model (at line items "Transfers In – Water Fund," Transfers In – Sewer Treatment" and "Transfers In – Sewer Collection") assumes transfers into the General Fund from the water, sewer treatment and sewer collection enterprise funds of a total of almost $4 million in Fiscal Year 2015-16, growing to almost $6.9 million in FY 2033-34, for a total of approximately $109 million over the term of the Financial Model.

e. Water/Sewer Utilities Rate Increases

The City is implementing new water/sewer utility rate increases in connection with an agreement adopted between the City and the City's Water Department which will provide the City with additional revenue.

f. Other Opportunities Considered

The City considered additional opportunities to improve revenues from existing sources and generate revenue from new sources such as implementing: (1) a raise in the existing Utility User Tax, or an application of the tax to additional utilities; (2) a higher Transient Occupancy Tax; (3) a higher Real Property Transfer Tax; (4) a higher Business License Fee; (5) a 911 Communication Fee; (6) a Paramedic Subscription Fee; (7) a higher Emergency Response Fee; and (8) a larger Electricity Franchise Fee. However, based on the City's assessment at this time, such sources are not likely to be successful at this time. This is due primarily to a poor residential community unlikely to vote for tax or fee increases. Implementing the above taxes and fees would also require significant time, as well as fundamental management and technology improvements which separately require a funding investment. As such, the City has determined that the above options are not financially feasible for the City at this time. In the interim, and as an alternative, the City is instead focused on seeking to realize additional potential revenue with updated fee and charges schedules implemented later in 2016, better collection on existing fees and charges, and resource management, together with the parcel tax being implemented for fire and EMS services as part of annexation into the County Fire District.

6. City's Continued Operations

Following the Effective Date, the City will continue to operate under its Charter (subject to any changes, repeal or amendments pursuant to voter action), the California Constitution, and other applicable laws. The City will continue to collect real property tax revenues, sales tax revenues, the user utility tax, and other taxes, fees, and revenues following the Effective Date, spending such revenues on municipal services. In accordance with existing policies and operational guidelines, the City will continue to pay ordinary course debt, including, without limitation, Workers' Compensation

Claims (the Uninsured Portion, where the Insured Portion is covered by insurance), trade and/or vendor claims, and amounts due federal agencies (e.g., HUD, and Environmental Protection Agency) that provide ongoing funding to the City. In addition, following the Effective Date, the City will continue to provide Indemnification in accordance with the City's pre-petition practices (as revised from time to time). The City reserves the right to provide or deny requests or demands for Indemnification in accordance with its practices.

7. <u>City's Retention of Rights of Action</u>

Except as otherwise set forth in the Plan, the Plan provides that the City will retain all of its Rights of Action after the Effective Date. The failure to list in the Plan or the Disclosure Statement, the Plan Supplement or any Plan Document any potential or existing Right of Action retained by the City is not intended to and will not limit the rights of the City to pursue any such Right of Action. Unless a Right of Action is expressly waived, relinquished, released, compromised, or settled in the Plan or otherwise, the City expressly reserves all Rights of Action for later adjudication and, as a result, no preclusion doctrine, including without limitation the doctrines of res judicata, collateral estoppel, issue preclusion, claim preclusion, estoppel (judicial, equitable, or otherwise), or laches, will apply to such Rights of Action upon confirmation or consummation of the Plan thereafter. Without limiting the foregoing, the City expressly reserves the right to pursue against any entity any claims alleged in any lawsuit in which the City is a defendant or an interested party.

D. <u>Provisions Regarding Distributions Under the Plan</u>

1. <u>Distribution Agent</u>

On and after the Effective Date, the City will act as the Distribution Agent under the Plan. The City may also retain one or more agents (including Rust Omni) to perform or assist it in performing the distributions to be made pursuant to the Plan, which agents may serve without bond. The City may provide reasonable compensation to any such agent(s) without further notice or Bankruptcy Court approval.

2. <u>Delivery of Distributions</u>

All distributions to be made pursuant to the Plan to any holder of an Allowed Claim will be made at the address of such holder as set forth in the books and records of the City or its agents, unless the City has been notified by such holder in a writing that contains an address for such holder different from the address reflected in the City's books and records that is mailed to Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367 at least two weeks prior to such distribution. All distributions to indenture trustees or similar entities will be made in accordance with the relevant indenture or agreement, as applicable.

3. Distributions of Cash

Any payment of Cash to be made by the City or its agent pursuant to the Plan will be made by check drawn on a domestic bank or by wire transfer, at the sole option of the City.

4. Timeliness of Payments

Any payments or distributions to be made pursuant to the Plan will be deemed to be timely made if made within 30 days after the dates specified in the Plan. Whenever any distribution to be made under the Plan will be due on a day that is not a Business Day, such distribution instead will be made, without interest on such distribution, on the immediately succeeding Business Day, but will be deemed to have been timely made on the date due.

5. Compliance with Tax, Withholding, and Reporting Requirements

The City will comply with all tax, withholding, reporting, and like requirements imposed on it by any government unit, and all distributions pursuant to the Plan will be subject to such withholding and reporting requirements. In connection with each distribution with respect to which the filing of an information return (such as Internal Revenue Service Forms W-2, 1099, or 1042) or withholding is required, the City will file such information return with the Internal Revenue Service and provide any required statements in connection therewith to the recipients of such distribution, or effect any such withholding and deposit all moneys so withheld to the extent required by law. With respect to any entity from whom a tax identification number, certified tax identification number, or other tax information that is required by law to avoid withholding has not been received by the City, the City at its sole option may withhold the amount required and distribute the balance to such entity or decline to make such distribution until the information is received.

6. Time Bar to Cash Payments

Checks issued by the City on account of Allowed Claims will be null and void if not negotiated within 91 days from and after the date of issuance thereof. Requests for reissuance of any check will be made directly to the City by the holder of the Allowed Claim with respect to which such check originally was issued. Any claim in respect of such a voided check must be made on or before the second anniversary of the Effective Date. After such date, all Claims in respect of voided checks will be discharged and forever barred and the City will retain all moneys related thereto.

7. No *De Minimis* Distributions

Notwithstanding any other provision of the Plan, no Cash payment of less than $10 will be made by the City on account of any Allowed Claim.

8. Distributions of Unclaimed Property

If any distribution to any holder of a Claim is returned to the City or its agent as undeliverable, no further distributions will be made to such holder unless and until the City is notified in writing of such holder's then-current address. Any unclaimed distributions will be set aside and maintained by the City. On the first business day after the first anniversary of the Effective Date and after each subsequent anniversary until all Plan distributions are completed, the City will post on its official website a list of unclaimed distributions, together with a schedule that identifies the name and last-known addresses of the holders of any unclaimed distributions. The City will not be required to make any further attempt to locate the holders of any unclaimed distributions. Any distribution under the Plan that remains unclaimed after 120 days following the date of the first posting on the website may be deemed by the City not to have been made and, together with any accrued interest or dividends earned thereon, may, at the City's sole discretion, be transferred to and vest in the City to be used by the City for any purpose. The City will not be obligated to make any further distributions on account of any Claim with respect to which an undeliverable distribution was made or was to be made, and such Claim will be treated as a Disallowed Claim. Nothing contained herein or in the Plan will affect the discharge of the Claim with respect to which such distribution was to be made, and the holder of such Claim will be forever barred from enforcing such Claim against the City or its assets, estate, properties, or interests in property.

9. No Distributions on Account of Disputed Claims

Notwithstanding anything to the contrary in the Plan, no distributions will be made on account of any part of any Disputed Claim until such Claim becomes Allowed (and then only to the extent so Allowed). Distributions made after the Effective Date in respect of Claims that were not Allowed as of the Effective Date (but which later became Allowed) will be deemed to have been made as of the Effective Date.

10. Certain Claims to be Expunged

Any Claim that has been or is hereafter listed in the List of Creditors as contingent, unliquidated or disputed, and for which no proof of Claim is or has been timely filed, is not considered to be an Allowed Claim and will be expunged without further action by the City and without further notice to any party or any action, approval or order of the Bankruptcy Court.

11. No Post-petition Accrual

Unless otherwise specifically provided in the Plan, in an executed Plan Document or otherwise required by order of the Bankruptcy Court, the City will not be required to pay to any holder of a Claim any interest, penalty, or late charge accrued or accruing with respect to such claim from the Petition Date through the date of distribution on such claim.

E. Disputed Claims

1. Claims Objection; ADR Procedures; Prosecution of Objections

The City will have the right to object to the allowance of Claims with respect to which liability or allowance is disputed in whole or in part and, prior to objection, and to subject any Disputed Claim to the ADR Procedures. The City will have until the later of 180 days after the Effective Date or 180 days after a Claim was filed or scheduled, to either (a) file and serve objections to Claims, or (b) give notice to the holder of a Disputed Claim that the City intends to try and resolve allowance of the Claim pursuant to the ADR Procedures (the “180 Day Deadline”). Upon the request of the City, the Bankruptcy Court will be authorized to extend the 180 Day Deadline. The City anticipates there will be additional Bar Dates for certain Claims classified under the Plan. The ADR Procedures are included in the Appendix as Exhibit C.

2. Payments and Distributions with Respect to Disputed Claims

After the Effective Date has occurred, at such time as a Disputed Claim becomes an Allowed Claim, in whole or in part, the City or its agent will distribute to the holder thereof the distribution(s), if any, to which such holder is then entitled under the Plan. Such distribution(s), if any, will be made as soon as practicable after the date that the order or judgment of the Bankruptcy Court allowing such Disputed Claim becomes a Final Order (or such other date as the Claim becomes an Allowed Claim). Unless otherwise specifically provided in the Plan, no interest will be paid on Disputed Claims that later become Allowed Claims.

F. Continuing Jurisdiction of the Bankruptcy Court

The Plan provides for the Bankruptcy Court to retain jurisdiction over a broad range of matters relating to the Bankruptcy Case, the Plan and other related items. Readers are encouraged to review the Plan carefully to ascertain the nature of the Bankruptcy Court's continuing post-Effective Date jurisdiction.

VI. CONFIRMATION AND EFFECTIVENESS OF THE PLAN

Because the law with respect to confirmation of a plan of adjustment is complex, creditors concerned with issues regarding confirmation of the Plan should consult with their own attorneys and financial advisors. The following discussion is intended solely for the purpose of providing basic information concerning certain confirmation issues. The City cannot and does not represent that the discussion contained below is a complete summary of the law on this topic.

Many requirements must be met before the Bankruptcy Court may confirm the Plan. Some of the requirements discussed in this Disclosure Statement include acceptance of the Plan by the requisite number of creditors, and the determination of whether the Plan is in the "best interests" of creditors. These requirements, however, are not the only requirements for confirmation, and the Bankruptcy Court will not confirm the Plan unless and until it determines that the Plan satisfies all applicable requirements, including requirements not referenced in this Disclosure Statement.

A. Voting on the Plan

1. Who May Vote to Accept or Reject the Plan?

A creditor generally has a right to vote for or against the Plan if its Claim is both allowed for purposes of voting and is classified in an Impaired Class. Generally, a Claim is deemed allowed if a proof of claim was timely filed; *provided, however*, that if an objection to a claim has been filed, the claimant cannot vote unless the Bankruptcy Court, after notice and hearing, either overrules the objection or allows the claim for voting purposes. Thus, the definition of "Allowed Claim" used in the Plan for purpose of determining whether creditors are entitled to receive distributions is different from that used by the Bankruptcy Court to determine whether a particular claim is "allowed" for purposes of voting. Holders of claims are advised to review the definitions of "Allowed," "Claim," and "Disputed Claim" in the Definitions section of the Plan to determine whether they may be entitled to vote on, and/or receive distributions under, the Plan. Under the Plan, a Class is an "Impaired Class" if the Plan alters the legal, equitable, or contractual rights of the members of that Class with respect to their claims or interests. Classes 1, 2, 5, 6, 9, 10, 11, 12, 13 and 14 are impaired under the Plan.

2. Who Is Not Entitled to Vote?

The holders of the following types of claims are not entitled to vote on the Plan: (i) Claims that have been disallowed; (ii) Claims that are subject to a pending objection and which have not been allowed for voting purposes; (iii) Claims that are not Impaired; and (iv) Administrative Expense Claims, since such Claims are not placed in Classes and are required to receive certain treatment specified by the Bankruptcy Code.

3. Vote Necessary to Confirm the Plan

The Bankruptcy Court cannot confirm the Plan unless, among other things, (i) at least one Impaired Class has accepted the Plan without counting the votes of any insiders within that Class; and (ii) either all Impaired Classes have voted to accept the Plan, or the Plan is eligible to be confirmed by "cramdown" with respect to any dissenting Impaired Class. A Class of claims is considered to have accepted the Plan when more than one-half in number and at least two-thirds in dollar amount of the claims that actually voted in that Class have voted in favor of the Plan.

B. The "Best Interests" Test

The Bankruptcy Court also must determine that the Plan is in the "best interests of creditors" pursuant to Bankruptcy Code section 943(b)(7), which in the Chapter 9 context means that treatment under the Plan must be better than the only alternative available, which is dismissal of the case. Dismissal permits every creditor to fend for itself in the race to the courthouse, since a municipality such as the City is not eligible under the Bankruptcy Code for a court-supervised liquidation under chapter 7. The City submits that the Plan is in the best interests of all creditors because the payments that will be made to holders of Allowed Claims in all Impaired Classes will be greater than those the creditors would receive were the Bankruptcy Case dismissed.

In contrast, if the Plan is not confirmed and the Bankruptcy Case is dismissed, the City's creditors would be left to "fend for themselves." Individual creditor collection actions likely would aggregate, through lawsuits, attempts at attachments, and writs of mandate, to make continued operation of the City untenable. Massive litigation costs would burden the City, its creditors, and all parties in interest, although creditors financially equipped to pursue litigation most quickly (and thus win "the race to the courthouse") would benefit disproportionately. And even the swiftest of creditors would likely find its ability to collect on a judgment stymied by the inability of the City to pay without violating provisions of California law by raiding Restricted Funds. In short, dismissal of the Bankruptcy Case likely would result in chaos, with few if any creditors emerging safely from the blizzard of inevitable litigation. The City, its residents and its creditors cannot afford to be left in such a circumstance. Confirmation of the Plan is in their best interest.

C. The Plan's Payment of 1% on General Unsecured Claims

Under the Plan, approximately $209.3 million in General Unsecured Claims will receive a distribution of 1% on the Allowed Claims, comprised of approximately:

a. Liquidated retiree claims of $46.7 million (which consists of $43.9 million of Retiree Health Benefit Claims[24] and $2.8 million of pre-petition accrued leave claims held by retirees);

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[24] The City has provided the Official Retiree Committee with the backup for the calculation of the $43.9 million amount.

b. $129.8 million of liquidated Consenting Union Claims;

c. $22.8 million of estimated Litigation Claims; and

d. $10 million of additional claims.

As demonstrated by this Disclosure Statement, in particular in the discussion of the City's Financial Model, the City does not now have, and is not projected to have the financial resources to fully fund its infrastructure repairs and necessary rebuilding of police and other municipal services, let alone pay anything more on these unsecured claims.

The City's financial crisis forced the City to severely cut municipal services, which process continued during the Bankruptcy Case, to the point of service insolvency, in addition to undisputed budgetary and cash insolvency. The depth of the crisis was demonstrated during the Bankruptcy Case by evidence showing that the City could not continue to fund the operations of its own Fire Department. Similarly, for all the reasons discussed in Section V.C.2. above regarding the City's Police Resources Plan, the City's underfunding of its Police Department also must be remedied. But like its other budgetary needs, the City will only be able to spend fraction of what it needs for the Police Resource Plan in the coming years. And even those limited amounts that the City can budget for in the coming years are based on the assumption that the City will be able to discharge the unsecured claims with a 1% distribution on Allowed Claims. If the City is required to pay more on general unsecured claims, it will have nothing left to fund its rehabilitation and service stabilization. If the City cannot provide adequate services, it will not be able to attract economic and become a community of choice for a diverse population with choices of where to live and raise a family. Instead, it will continue a cycle of decline that led to the City's Bankruptcy Case.

San Bernardino historically was a middle class community, and services have declined as the community became increasingly poorer. The extent of the cutbacks in municipal services have been dramatic due to the Great Recession and during the Bankruptcy Case.

<u>Police Services</u>

- Sworn staffing reduced from 349 full-time equivalent (FTE) employees in 2008 to approximately 248 today (29% reduction)
- Patrol division sworn staffing reduced by 25% since 2008

- Community policing teams discontinued
- Narcotics enforcement reduced by 50% since 2008
- Traffic enforcement personnel reduced by 58% since 2008
- Priority 1 average response times increased 76% since 2008
- Almost three-fourths (73%) of patrol vehicles are overdue for replacement
- Substantial increases in police response times to service calls ranging from a 75% increase in response time for Priority E life-threatening emergency calls to a 274% increase for Priority 2 calls.

<u>Fire Services</u>

- Total staffing (sworn and non-sworn) reduced 18% since FY 2011, 27% since 2008
- Number of units deployed reduced from 15 in 2008 to 13 in 2014
- One engine company eliminated
- One fire station closed in November 2014
- Substantial fleet replacement needed for fire vehicles

<u>Public Works</u>

- Public Works staff reduced by 50 (19%) since 2008
- Deferred street repairs and improvements estimated at $180 million, up from $88.4 million in 2008
- Deferred facility repairs and improvements estimated at $131 million
- Only 20% of sewer collection system has been video inspected; deferred sewer system improvements estimated at $23 million.
- Over 730 claims filed for damages to vehicles caused by potholes since 2003
- 1,200 locations identified for sidewalk and curb gutter repairs
- Vehicle and equipment replacement deferred (56% of fleet units due for replacement)

<u>Libraries</u>

- Central library hours reduced from 54 to 37 per week (30% reduction)
- Reduced library hours at the three branches from 54 to 20 hours per week (63% reduction)
- Library staff reduced by 68% from 31 in 2008 to 10 FTE
- All 60 public computers are 7 to 10 years old with no funds for replacement

- No book budget (all acquisitions rely on fundraising)

Parks and Recreation

- Significantly reduced recreation programs; primary information tool for advertising recreational programs eliminated
- Two pools closed to public (although maintenance costs continue)
- Two community centers closed; reduced hours at six other centers
- Youth sports programs eliminated

City Support Functions

- IT staffing reduced 30% since 2012
- Many computers more than 10 years old
- Internal service funds have not been funded, including workers compensation and litigation reserves
- Finance and accounting staff has been difficult to recruit and retain, and the City is running about an 11% vacancy rate due to the inability to afford market wages with staffing shortages particular acute in the Police Department and overall management positions.
- Overall municipal staffing has dropped from nearly 1,300 employees to about 900 employees since 2009, and the City is about to lose another 200 due to the annexation into the County Fire District and the contract with Burrtec for solid waste and recycling, sweeping, and right-of-way clean up services. Cutting the number of municipal employees nearly in half in about 6 years is unprecedented for a city the size of San Bernardino.

The amount of the City's deferral of spending on basic municipal infrastructure was just as dramatic. $180 million deferred for street repairs, $130 million deferred for facility repairs and improvements, the failure to inspect 80% of the sewer system – these and other basics of municipal services will not be fully funded during the course of the 20-year Financial Model; indeed some may not be funded at even 50% of requirement as discussed throughout the Disclosure Statement. Even that limited funding, to keep the City moving towards service solvency, is based upon the Financial Model's assumption that the City can discharge its $200 million of unsecured debt based upon a 1% distribution on Allowed Claims.

The City has a fundamental duty to its residents to provide them with basic municipal services. The principal purpose of a chapter 9 debt restructure is the continued provision of public services. *In re Mount Carbon Metro District*, 242 B.R. 18, 34 (Bankr. D. Colo. 1999). Unlike the other chapters of the Bankruptcy Code, Chapter 9 does not attempt to balance the rights of the debtor and its creditors, but rather, to meet the special needs of a municipal debtor. *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Cal. 1991). Rather, chapter 9 is designed to assist municipalities in providing vital government services by "providing the debtor with an array of bankruptcy powers to enable it to achieve financial rehabilitation with very few, if any, corresponding limitations and duties of the type to which a Chapter 11 debtor is subject." *Id.* at 224. Accordingly, courts assessing plans of adjustment in chapter 9 have emphasized the unique need to consider the general municipal welfare when addressing issues of plan confirmation. *See e.g., In re Corcoran Hosp. Dist*., 233 B.R. 449, 454 (Bankr. E.D. Cal. 1999) (describing the area's economic woes and noting that "[t]he hospital is very important to the community of Corcoran" and that it was "an essential element to the survival of Corcoran as a community"); *In re Barnwell Cnty. Hosp.*, 471 B.R. 849, 869 (Bankr. D. S.C. 2012) ("of particular importance to the Court is that the Plan preserves the availability of healthcare services to citizens and patients in the County").

The City's Plan and its proposed distribution to general unsecured creditors are well within the four corners of chapter 9 precedents. The Plan is a reasonable effort to adjust the City's debts to enable the City to dedicate its future limited resources to service, cash and budgetary solvency.

D. <u>Feasibility: The City's Financial Model and The Bankruptcy Fund</u>

To satisfy the requirement set forth in Bankruptcy Code section 943(b)(7) that the Plan be feasible, the City must demonstrate the ability to make the payments required under the Plan and still maintain its operations at the level that it deems necessary to the continued viability of the City. The City submits that the Plan is feasible. The financial underpinning of the Plan is the City's Financial Model included as Exhibit 3 in the Appendix. The Financial Model projects revenues and expenditures over a 20-year period and analyzes, among other things, the resulting unrestricted General Fund balance at the end of each fiscal year covered by the Financial Model. The Financial Model shows that the City will be able to maintain reserves above 15% of General Fund expenditures for 16 out of the 20 fiscal years reflected in the Financial Model assuming Plan confirmation.

It is essential that the City maintain adequate levels of fund balances to mitigate current and future risks (such as revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. General Fund balance levels are a crucial consideration in long-term municipal financial planning, and credit rating agencies monitor levels of a city's fund balances to evaluate a city's creditworthiness. Municipal finance best practices recommend the maintenance of reserves equal to at least two months of expenditures, and a city's particular situation may require a level of reserves significantly in excess of this recommended minimum level. Factors that may compel keeping reserves in excess of two months expenditures include increased capital needs and deficits in other funds, both of which are present in the City. The average reserve level for California cities with populations in excess of 50,000 is 23%. The level of reserves that the City's advisors have recommended and incorporated into the City's financial projections reflects the tension between taking actions to improve long term economic conditions for the City's residents and the City's creditworthiness, on the one hand, and the pressure from creditors who may view the reserves as excessive, on the other hand. The City is sensitive to that inevitable tension, and believes that the proposed level of reserves is consistent with the levels of risk still facing the City.

As discussed below, the Financial Model reflects three components leading to the City's financial recovery: (1) the baseline budget; (2) adjustments to the baseline budget through new revenues, service delivery restructuring and basic level service recovery; and (3) the restructuring components. It also explains the purpose of the "Bankruptcy Fund" which is being established to ensure that the City appropriately budgets and tracks the monies necessary to implement the Plan.

1. <u>The Baseline Budget</u>

The baseline budget is the first component of the Financial Model. It represents the City's projections of revenues and expenses based on prior year trends and current revenue sources, using estimates from the City's property and sales tax auditor. This forecast also takes into account assumed modest recessions every seven years beginning in calendar year 2017. Further, expenditure projections for the baseline budget are predicated on current budget levels of staffing. In essence, the baseline budget is the City's "status quo" and projects out assuming little to no change in the City's financial condition. If the City were to move forward in line with its baseline budget model alone, absent restructuring, the City would not be financially or service solvent. The Financial Model shows that the City will be able to make all contributions to CalPERS during the 20 year period based upon projected CalPERS rates. The forecast takes into consideration anticipated increases in CalPERS rates resulting from both a long-term investment return reduction and portfolio performance shortfalls since 2007 discussed in greater detail in Section VII.C. below.

2. <u>Adjustments to the Baseline Budget Through New Revenues, Service Delivery Efficiencies and Basic Level Service Recovery</u>

The second component to the Financial Model is the adjustments to the Baseline Budget resulting from fiscal and service stabilization shown in the Restructuring – New Revenues, Restructuring/Service Delivery, and Basic Level Service Recovery sections of the Financial Model. In the Restructuring – New Revenues section of the Financial Model, the City has identified the projected revenues from the new waste management franchise with Burrtec discussed in Section V.C.5 above, the adjustments to the rates charged to water and sewer utilities discussed in Section V.C.1 above, anticipated increases in revenues from street sweeping parking violations and transient occupancy tax audits, revisions to the City's master fees and charges, the renewal of Measure Z, proceeds from the disposition of former RDA properties, and proceeds from the integrated waste vehicle sale and CIP.

In the Restructuring/Service Delivery section of the Financial Model, the City has identified the economic components of restructuring the delivery of municipal services and other savings through, among other things, annexation of Fire Services, contracts with private entities for fleet maintenance, operation of the Soccer Complex, custodial maintenance, graffiti abatement, business license administration, and modifications to retiree health benefits.

In the Basic Level Service Recovery section, the City has projected the funds the City requires for deferred maintenance in buildings and fixtures, parks, public right-of-ways, information systems, fleet replacement and restoration of internal service fund reserves (including worker's compensation, general liability insurance reserves, and organizational and service improvements). Each of these components reflects aspects of critical City needs that have been deferred in light of the City's cash flow issues and the filing of its Bankruptcy Case. As discussed in Section V.C.3 above, the City's information technology and vehicles are far beyond their useful life, and there is a major backlog in infrastructure and public facility maintenance projects. Restoring basic levels of service and infrastructure repair and maintenance is essential to render the City service solvent so that it is capable of providing essential services to its residents.

3. The Debt Adjustment Component

In the Restructuring of Secured and Unsecured Obligations section of the Financial Model, the City has projected the savings from the impairment of certain major creditor claims and the implementation of the settlement agreements the City has entered into with its major creditor constituencies. All of these components are critical to the City's restructuring which the City could not have accomplished without the benefits afforded by Chapter 9. With the restructuring components to the City's Financial Model, as well as the fiscal and service stabilization components to the Financial Model, the City will become a viable entity and municipal service provider for its residents.

4. The Bankruptcy Fund

A "Bankruptcy Fund" is being established in fiscal year 2015-16 to track costs associated with the Bankruptcy Case, including legal fees, certain settlements, and claim payments. The Bankruptcy Fund will be used to maintain the separation of resources and costs of bankruptcy activities from other funds so that tracking of bankruptcy expenditures is more transparent.

The Bankruptcy Fund will be funded primarily with monies from the General Fund that the Common Council committed towards bankruptcy costs and settlements, and budgets approximately $33 million over the next five fiscal years. The Bankruptcy Fund is dedicated to implementing the Plan by allocating budgeted monies in the following fiscal years:

Fiscal Year 2015-16 Allocations

The Bankruptcy Fund budgets approximately $3.5 million towards certain costs associated with Annexation of Fire Services (such as transition leave for firefighters, debt owed to CIEDB secured by fire stations, a capital payment, a lease obligation for a fire alerting system and a note secured by the City's Fire Maintenance facility).

<u>Fiscal Year 2016-17 Allocations</u>

The Bankruptcy Fund budgets approximately $25 million towards the following anticipated obligations: (1) $15.33 million for settlements and general unsecured claims, as well as litigation defense costs and other costs related to creditor claims; (2) $5.93 million towards the settlement with the SBCPF; (3) $3.1 million towards delinquent property tax obligations for City government buildings including, the Police Station, the 201 Building and part of the City Hall complex which are secured by City issued bonded debt; (4) $300,000 towards the settlement with the Fire Management Unit; and (5) a $400,000 penalty payment to CalPERS.

<u>Fiscal Year 2017-18 Allocations</u>

The Bankruptcy Fund budgets approximately $2.48 million towards the following anticipated obligations: (1) $1.49 million towards the settlement with the SBCPF; (2) $300,000 towards the settlement with the Fire Management Unit; (3) a $400,000 penalty payment to CalPERS; and (4) a $290,000 payment under the PARS Settlement.

<u>Fiscal Year 2018-19 Allocations</u>

The Bankruptcy Fund budgets approximately $990,000 towards the following anticipated obligations: (1) $300,000 towards the settlement with the Fire Management Unit; (2) a $400,000 penalty payment to CalPERS; and (3) a $290,000 payment under the PARS Settlement.

<u>Fiscal Years 2019-20 and 2020-21 Allocations</u>

The Bankruptcy Fund budgets approximately $700,000 annually in fiscal years 2019-20 and 2020-21 towards the following anticipated obligations: (1) $300,000 towards the settlement with the Fire Management Unit; and (2) a $400,000 penalty payment to CalPERS.

E. <u>Cramdown</u>

The Bankruptcy Code provides that the Bankruptcy Court may confirm a plan of adjustment that is not accepted by all Impaired classes if at least one Impaired Class of claims accepts the Plan and the so-called “cramdown” provisions set forth in sections 1129(b)(1), (b)(2)(A) and (b)(2)(B) are satisfied. The Plan may be confirmed under the “cramdown” provisions if, in addition to satisfying the other requirements of section 943(b), it (i) is “fair and equitable,” and (ii) does not discriminate unfairly with respect to each Class of claims that is impaired under and has not accepted the Plan.

The "fair and equitable" standard, also known as the "absolute priority rule," requires, among other things, that unless a dissenting unsecured Class of claims receives payment in full for its allowed claims, no holder of allowed claims in any Class junior in priority to that Class may receive or retain any property on account of such claims. The "fair and equitable" standard also has been interpreted to prohibit any class senior to a dissenting class from receiving more than 100% of its allowed claims under a plan. The City believes that the Plan satisfies the "fair and equitable" standard because, among other things, no classes junior to the classes of unsecured claims are receiving or retaining any property under the Plan, and no Class of Claims is receiving more than 100%.

The requirement that the plan not "discriminate unfairly" means, among other things, that a dissenting Class must be treated substantially equally with respect to other Classes of equal rank. The City believes that the Plan does not unfairly discriminate against any Class that may not accept or consent to the Plan.

The City has reserved the right to request the Bankruptcy Court to confirm the Plan by "cramdown" in accordance with sections 1129(b)(1), (b)(2)(a) and (b)(2)(b) of the Bankruptcy Code. The City also has reserved the right to modify the Plan to the extent, if any, that confirmation of the Plan under Bankruptcy Code sections 943 and 1129(b) requires such modifications.

F. Effective Date

1. Conditions to the Occurrence of the Effective Date

The Plan will not become effective and operative unless and until the Effective Date occurs. Section XIII.B. of the Plan sets forth certain conditions to the occurrence of the Effective Date. The City may waive in whole or in part the condition regarding agreements and instruments contemplated by, or to be entered into pursuant to, the Plan. Any such waiver of a condition may be effected at any time, without notice or leave or order of the Bankruptcy Court and without any formal action, other than the filing of a notice of such waiver with the Bankruptcy Court. One of the conditions to the occurrence of the Effective Date is that the conditions to the effectiveness of the 1996 Refunding Bonds Amendment and the 1999 Refunding Certificates of Participation Amendment have been satisfied or waived. Any waiver of such condition requires the prior written consent of National, the 1996

Refunding Bonds Trustee, and the 1999 Refunding Certificates of Participation Trustee (which consents shall not be unreasonably withheld).

The Effective Date will occur on the first Business Day after which the conditions set forth in Section XIII.B. of the Plan are satisfied or waived. Because the Confirmation Hearing will not commence until October 14, 2016, the City estimates that the Effective Date will occur in the first quarter of 2017.

2. Non-Occurrence of Effective Date

The Plan provides that, if confirmation occurs but the Effective Date does not occur in a timely manner (unless waived), upon notification submitted by the City to the Bankruptcy Court: (i) the Confirmation Order will be vacated; (ii) no distributions under the Plan will be made; (iii) the City and all holders of Claims will be restored to the *status quo* as of the day immediately preceding the Confirmation Date as though the Confirmation Date never occurred; and (iv) all of the City's obligations with respect to the Claims will remain unchanged, and nothing contained herein or in the Plan will be deemed to constitute a waiver or release of any claims by or against the City or any other entity or to prejudice in any manner the rights of the City or any entity in any further proceedings involving the City. The failure of the Effective Date to occur, however, will not affect the validity of any order entered in the Bankruptcy Case other than the Confirmation Order.

G. Effect of Confirmation

Section XI of the Plan provides that confirmation of the Plan and the occurrence of the Effective Date will have a number of important and binding effects, some of which are summarized below. Readers are encouraged to review Section XI of the Plan carefully and in its entirety to assess the various consequences of confirmation of the Plan.

1. Discharge of the City

Pursuant to Bankruptcy Code section 944, upon the Effective Date, the City will be discharged from all debts (as defined in the Bankruptcy Code) of the City and Claims against the City as of the Confirmation Date, including without limitation all Pre-Confirmation Date Claims, other than (i) any debt specifically and expressly excepted from discharge by the Plan or the Confirmation Order, or

(ii) any debt owed to an entity that, before the Confirmation Date, had neither notice nor actual knowledge of the Bankruptcy Case.

The rights afforded in the Plan and the treatment of holders of Pre-Confirmation Date Claims, be they Claims Impaired or Unimpaired under the Plan, will be in exchange for and in complete satisfaction, discharge, and release of all Claims of any nature whatsoever arising on or before the Confirmation Date, known or unknown, including any interest accrued or expenses incurred thereon from and after the Petition Date, whether against the City or any of its properties, assets, or interests in property. Except as otherwise provided in the Plan, upon the Effective Date all Pre-Confirmation Date Claims will be and will be deemed to be satisfied, discharged, and released in full, be they Impaired or Unimpaired under the Plan.

Notwithstanding anything to the contrary in Section XI.A. of the Plan, the City's obligations under the SBCPF Settlement Agreement may not be discharged pursuant to the claims discharge provisions of the Bankruptcy Code.

2. <u>Release by Holders of Pre-Confirmation Date Claims</u>

Pursuant to Section XI.B. of the Plan, holders of Pre-Confirmation Date Claims provide the following release:

“**AS OF THE EFFECTIVE DATE, IN CONSIDERATION FOR THE OBLIGATIONS OF THE CITY UNDER THE PLAN, EACH HOLDER OF A PRE-CONFIRMATION DATE CLAIM IS DEEMED TO FOREVER RELEASE, WAIVE AND DISCHARGE ANY AND ALL CLAIMS, ACTIONS, CAUSES OF ACTION, DEBTS, OBLIGATIONS, RIGHTS, SUITS, DAMAGES, ACTIONS, REMEDIES, JUDGMENTS, AND LIABILITIES WHATSOEVER (INCLUDING WITHOUT LIMITATION THE AB 506 PROCESS AND THE ELIGIBILITY CONTEST) AGAINST THE CITY AND THE INDEMNIFIED PARTIES, WHETHER KNOWN OR UNKNOWN, FORESEEN OR UNFORESEEN, LIQUIDATED OR UNLIQUIDATED, FIXED OR CONTINGENT, MATURED OR UNMATURED, EXISTING AS OF THE EFFECTIVE DATE OR THEREAFTER ARISING, IN LAW OR AT EQUITY, WHETHER FOR TORT, CONTRACT, OR OTHERWISE, BASED IN WHOLE OR IN PART UPON ANY ACT OR OMISSION, TRANSACTION, EVENT OR OTHER OCCURRENCE OR**

CIRCUMSTANCES EXISTING OR TAKING PLACE PRIOR TO OR ON THE EFFECTIVE DATE ARISING FROM OR RELATED IN ANY WAY IN WHOLE OR IN PART TO THE CITY, THE INDEMNIFIED PARTIES AND THEIR ASSETS AND PROPERTY, THE BANKRUPTCY CASE, THE DISCLOSURE STATEMENT, THE PLAN OR THE SOLICITATION OF VOTES ON THE PLAN THAT SUCH HOLDER OF A PRE-CONFIRMATION DATE CLAIM WOULD HAVE BEEN LEGALLY ENTITLED TO ASSERT (WHETHER INDIVIDUALLY OR COLLECTIVELY) OR THAT ANY HOLDER OF A CLAIM OR OTHER ENTITY WOULD HAVE BEEN LEGALLY ENTITLED TO ASSERT FOR OR ON BEHALF OF SUCH HOLDER OF A PRE-CONFIRMATION DATE CLAIM (WHETHER DIRECTLY OR DERIVATIVELY); ***PROVIDED, HOWEVER,*** **THAT THIS SECTION XI.B. SHALL NOT OPERATE TO WAIVE, DISCHARGE OR RELEASE THE RIGHTS OF HOLDERS OF PRE-CONFIRMATION DATE CLAIMS TO ENFORCE THE PLAN AND THE CONTRACTS, INSTRUMENTS, RELEASES, AND OTHER AGREEMENTS OR DOCUMENTS DELIVERED UNDER THE PLAN OR ASSUMED PURSUANT TO THE PLAN OR ASSUMED PURSUANT TO FINAL ORDER OF THE BANKRUPTCY COURT.**”

3. <u>Injunction</u>

Section XI.C. of the Plan provides:

“**Except as otherwise expressly provided in the Plan, all Entities who have held, hold, or may hold Pre-Confirmation Date Claims will be permanently enjoined from and after the Confirmation Date, with respect to such Pre-Confirmation Date Claims, from: (i) commencing or continuing in any manner, directly or indirectly, any suit, action or other proceeding of any kind against the City or its property or any or all of the Indemnified Parties or any of their property; (ii) enforcing, levying, attaching, collecting, or recovering by any manner or means any judgment, award, decree, or order against the City or its property or any or all of the Indemnified Parties or any of their property; (iii) creating, perfecting, or enforcing any lien or encumbrance of any kind against the City or its property or any or all of the Indemnified Parties or any of their property; (iv) asserting any right of setoff, subrogation, or recoupment of any kind against any obligation due to the City or any or all of the Indemnified Parties, except as otherwise permitted by**

Bankruptcy Code section 553; (v) proceeding in any manner in any place whatsoever that does not conform to or comply with the provisions of the Plan or the settlements provided for in the Plan Documents; and (vi) taking any actions to interfere with implementation or consummation of the Plan."

4. <u>Term of Existing Injunctions and Stays</u>

Section XI.D. of the Plan provides:

"**Unless otherwise provided, all injunctions or stays provided for in the Bankruptcy Case pursuant to Bankruptcy Code sections 105, 362, or 922, or otherwise, and in existence immediately prior to the Confirmation Date, will remain in full force and effect until the Effective Date; and will continue in full force and effect after the Effective Date with respect to the ADR Procedures, determination of the City's liability (or lack thereof) on any Pre-Confirmation Date Claim and the allowance or disallowance thereof**."

5. <u>Exculpation</u>

Section XI.E. of the Plan provides:

"**Each of the following is an Exculpated Party under the Plan: (i) the City and each of the persons (including their staff) acting in the following capacities during the Bankruptcy Case: Mayor, City Attorney, City Manager, Deputy City Manager, member of the Common Council; and any employee of the City that submitted a declaration in support of any pleading filed by the City in the Bankruptcy Case; (ii) any of the City's financial advisors, attorneys, accountants, investment bankers or advisors, consultants, representatives and other professionals, including but not limited to the following: (A) Management Partners, Inc.; (B) Urban Futures, Inc.; (C) Stradling Yocca Carlson & Rauth, a Professional Corporation; (D) Law Office of Linda L. Daube, A Professional Corporation, and (E) Rust Omni; (iii) U.S. Bank National Association, in its capacities as indenture trustee; (iv) the members of the Retiree Committee, and (v) counsel for the Retiree Committee, Bienert Miller & Katzman, PLC. Except with respect to obligations specifically arising pursuant to or preserved in the Plan, no Exculpated Party will have or incur, any liability to any person or Entity for any act taken or omitted to be taken in connection with, relating to or arising out of the City's restructuring efforts and the Bankruptcy Case, including**

the authorization given to file the Bankruptcy Case, the formulation, preparation, negotiation, dissemination, consummation, implementation, confirmation or approval (as applicable) of the Plan, the solicitation of votes and acceptances for the Plan, the property to be distributed under the Plan, the settlements implemented under the Plan, the Exhibits, the Disclosure Statement, any contract, instrument, release or other agreement or document provided for or contemplated in connection with the consummation of the transactions set forth in the Plan or the management or operation of the City; *provided, however*, that nothing in Section XI.E. of the Plan will be deemed to release or exculpate any Exculpated Party for its willful misconduct or gross negligence. Each Exculpated Party will be entitled to reasonably rely upon the advice of counsel and financial advisors with respect to its duties and responsibilities under, or in connection with, the Bankruptcy Case, the administration thereof and the Plan."

6. <u>Comprehensive Settlement of Claims and Controversies</u>

Section XI.F. of the Plan provides:

"**In consideration for the distributions and other benefits provided under this Plan, the provisions of this Plan, including the exculpation and release provisions contained in this Section XI, constitute a good faith compromise and settlement of all Claims, causes of action or controversies relating to the rights that a holder of a Claim may have with respect to any Claim against the City and/or the Indemnified Parties, any distribution to be made pursuant to this Plan on account of any such Claim and any and all Claims or causes of action of any party arising out of or relating to the Eligibility Contest. The entry of the Confirmation Order constitutes the Bankruptcy Court's approval, as of the Effective Date, of the compromise or settlement of all such Claims or controversies and the Bankruptcy Court's finding that all such compromises and settlements are in the best interests of the City and the holders of Claims, and are fair, equitable, and reasonable.**"

7. <u>Injunction and Release Provisions of the Plan</u>

In exchange for the distributions under the Plan, the Plan releases, and enjoins the prosecution of, claims against the "Indemnified Parties," who are defined in the Plan as "the current and former officers and employees of the City who are entitled to Indemnification." Plan, § I.B.72.

"Indemnification" is defined as the "rights of indemnity . . . of current and former officers and employees of the City . . . in each case arising out of an act or omission occurring within the scope of such officer's or employee's employment as an employee of the City." Plan, § I.B.71.

Section XI.B of the Plan has the effect of relieving employees from personal liability on claims that arose within the scope of their employment. As courts in the Ninth Circuit have recognized, claims against officers and employees acting within the scope of their employment are brought against employees not to recover from the officers and employees (who are often judgment proof or close), but to access a city's assets via its obligation to indemnify the officers and employees. *See e.g. In re City of Stockton*, 484 B.R. 372, 376 (Bankr. E.D. Cal. 2012) (discussing the "strategy of suing a sovereign by falsely pretending to sue an officer"). While the officer or employee may procedurally be a necessary party for purportedly having committed the alleged harm, the real party in interest expected to satisfy the judgment, if any, is the municipality. The terms of the Plan simply recognize and maintain that *status quo*, and there is no justifiable reason for the realities of the non-bankruptcy litigation process to be upended as a result of the City's chapter 9 filing. Under the Plan, the plaintiffs will look to the City to satisfy their judgments, not to the individual officers or employees. Exposing officers and employees to liability for harms committed while at work would exposes officers and employees to often ruinous liability simply for doing their jobs.

Courts across the country have recognized that third-party releases are appropriate under certain circumstances. *See e.g., Securities and Exchange Commission v. Drexel Burnham Lambert Group, Inc.*, (*In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93 (2d Cir. 1988); *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136 (2d Cir. 2005); *Gilman v. Cont'l Airlines* (*In re Cont'l Airlines*), 203 F.3d 203, 213 (3d Cir. 2000); *Menard-Sanford v. Mabey (In re A.H. Robins Co.*), 880 F.2d 694, 701-02 (4th Cir. 1989); *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 348-50 (4th Cir. 2014); *In re Dow Corning Corp.*, 280 F.3d 648, 657-58 (6th Cir. 2002); *In re Airadign Commc'ns, Inc.*, 519 F.3d 640, 656 (7th Cir. 2008); *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015). While the formulation may be different from circuit to circuit and case to case, fundamentally courts look to circumstances where an identity of interest between the debtor and third-party is so strong that to permit claims against the third-party would significantly undermine the debtor's rehabilitation.

The circumstances of this case amply demonstrate a situation where a limited third party release is appropriate. The City is obligated by statute to indemnify its employees and officers for acts committed within the scope of employment. If the plaintiffs are permitted to pursue claims against the officers and employees, the City will be forced to pay such claims one hundred cents on the dollar, which the City cannot afford to do. The limited third-party injunction and release provisions of Article XI of the Plan are necessary and appropriate to preserve the benefit of the discharge for the City.

While a minority of circuit courts, including the Ninth Circuit (*see e.g., In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) and *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985)) have expressed reluctance to approve third-party releases and injunctions on the circumstances of the cases then before the courts, such reluctance is not a complete bar here. The holdings in those cases are based upon the courts' application of Bankruptcy Code Section 524(e), which provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." However, pursuant to Bankruptcy Code 901, Section 524(e) does not apply in chapter 9 cases. In contrast, Section 922(a) – expanding the scope of the automatic stay to apply to claims against officers and inhabitants of the chapter 9 debtor – shows that the statutory treatment of such claims against third parties is different in chapter 9 than it is in chapter 11. The chapter 11 cases on plan releases of third parties that rely on Section 524(e) as the legal basis for the analysis may not apply in chapter 9 cases.

8. <u>Agreements With the U.S.</u>

The City has agreed with the U.S. Dept. of Justice that that the Confirmation Order will provide that, notwithstanding any other provision of the Plan or Confirmation Order to the contrary:

(a) The City's obligations pursuant to its Contracts for Loan Guarantee Assistance Under Section 108 of the Housing and Community Development Act of 1974, as amended, 42 U.S.C. § 5308, with the United States Department of Housing and Urban Development shall remain extant and enforceable and not subject to discharge pursuant to 11 U.S.C. § 944;

provided, however, that the City retains all defenses to the enforceability of such obligations under applicable non-bankruptcy law.

(b) Nothing in the Plan or Confirmation Order shall adversely affect in any way the rights and remedies of the United States and the State of California under the consolidated actions styled as *City of San Bernardino v. United States and State of California, on behalf of Department of Toxic Substances Control v. United States*, Civil Action Nos. 96-8867 (MRP), 96-5205 (MRP) - Consolidated (C.D. Cal.), including without limitation, the Consent Decree therein and any amendment thereto ("C.D. Cal. Actions"), nor shall anything in the Plan or the Confirmation Order divest or limit the jurisdiction of the United States District Court for the Central District of California over the C.D. Cal. Actions. Upon the Effective Date of the Plan, the C.D. Cal. Actions shall survive the bankruptcy case and may be adjudicated and enforced in the United States District Court for the Central District of California, provided, however, that Bankruptcy Court approval must be obtained for any allowance of an administrative expense.

(c) As to the United States, its agencies, departments or agents, nothing in the Plan or Confirmation Order shall discharge, release, or otherwise preclude: (1) any liability of the City to the United States, its agencies, departments or agents arising on or after the Effective Date; (2) any liability to the United States, its agencies, departments or agents that is not a "claim" within the meaning of section 101(5) of the Bankruptcy Code; (3) any valid defense of setoff or recoupment with respect to a Claim of the United States, its agencies, departments or agents; (4) the continued validity of the City's obligations to the United States, its agencies, departments or agents under any grant or cooperative assistance agreement; (5) any liability of any entity under environmental law arising or springing anew after the Effective Date that any entity would be subject to as a post-Effective Date owner or operator of property; or (6) the United States from, subsequent to the Confirmation Date, pursuing any police or regulatory action against the City.

VII. CERTAIN RISK FACTORS TO BE CONSIDERED

Confirmation of the Plan and the occurrence of the Effective Date are not without risk to the City and its creditors in that the sources of revenue projected in the future years covering the City's

Financial Model could diminish sharply. The reality is that there are economic cycles over time that can negatively affect revenue growth, but the timing of these cycles is very difficult to predict. Thus, while the City devoted considerable time and effort in formulating the Financial Model that forms the basis of the City's Plan, there can be no guaranty that the predicted results will be achieved. For example, few California cities, if any, could have predicted the length and severity of the recent global financial crisis, its devastating effect upon the housing market in San Bernardino and the Inland Empire generally, and the reduction in sales tax revenues to state and local governments. Moreover, while the General Fund expenditures projected in the Financial Model are the City's best and most reasoned estimate of costs, factors such as higher inflation, state or federal law changes that increase of shift costs to local government, or a natural or human-caused disaster could and likely would cause costs to rise. These risk factors should not be regarded as constituting the only risks involved in connection with the Plan and its implementation. More specific risks to the Financial Model are described below.

A. <u>Failure of Voters to Reauthorize Measure Z in 2021</u>

Measure Z established a 0.25 percent district tax for 15 years in 2006. The substantial revenue from this tax will vanish unless voters reauthorize the sales tax in an election in 2021. The City projects that it will lose an estimated $134.4 million (an average of $11.2 million each year) from 2022 through 2034 if the tax is not reauthorized. If Measure Z is not reauthorized, the City's ability to make certain payments under the City's Plan may be compromised.

B. <u>If Annexation is Challenged and Reversed</u>

Although Annexation was approved by LAFCO and the County Board of Supervisors, supported by the firefighters' unions, and the statutory challenge period has expired, if for any reason Annexation could be subsequently challenged and reversed, the City would reap none of the critical economic benefits of Annexation and would be required to fund its own Fire Department, thereby imposing an additional burden on the General Fund of between $7 and $12 million annually.

C. <u>Future Increases in CalPERS Rates</u>

Based on independent forecasts provided CalPERS and the City's actuary, Bartel & Associates, it is projected that over the next eighteen years the cumulative retirement contributions from the General Fund will exceed $643.9 million with projected annual contributions starting at roughly $19 million in 2016-2017 increasing to a peak of roughly $44 million by 2030-2031. Both independent forecasts take into account $130.8 million in legacy costs associated with former fire employees transitioning to the County Fire District and shortfalls in the returns on CalPERS' investment portfolio since 2007 to the present. Additionally, both forecasts assumed full implementation of the recent CalPERS Board directive to lower the current actuarially assumed investment rates of return down from 7.5% to 6.5% over the next 20 years.[25] As a result of these two recent changes to the City's forecast of future pension costs, CalPERS pension cost rose by $78.6 million in the City's 20-Year Financial Model since the City's original Disclosure Statement was filed with the Bankruptcy Court and provided to the City's creditors.

In general, the increasing costs of pension benefits are attributable to an increase in the pension plans' unfunded liabilities. Because unfunded liabilities must be "amortized" over the remaining life of a retirement plan, the amount that must be contributed to pay off that liability must also increase. There are three major causes of this increase in annual retirement expense:

a. CalPERS' investment returns since 2007 which led to a failure to meet earnings expectations on plan assets (discussed above);

[25] CalPERS asked that the City include the following CalPERS comment regarding CalPERS' assumed rate of return on its investment portfolio:

> "The City's forecasts are based on a conservative projection that the discount rate will be reduced from 7.5% to 6.5% over a 20 year period. In November 2015, CalPERS adopted a funding risk mitigation policy intended to reduce over time the expected volatility of its investment portfolio. Under the policy, in years where investment returns outperform the then existing discount rate by more than 4%, the discount rate - or assumed rate of return - will be reduced and the portfolio reallocated to less volatile investments. For example, in a year where the discount rate is 7.5%, if investment returns exceed 11.5%, the discount rate will be lowered to between 7.25 and 7.45% depending on the actual investment return. Because the reduction in discount rate depends on investment returns in future years, it is not possible to predict with certainty what the discount rate will be in any specific year or how many years it will take for the discount rate to be reduced to a specific level. Because the discount rate is only reduced in years where the investment return exceeds the discount rate by at least 4%, a decrease in the discount rate of a full percentage point over 20 years would require multiple years with investment returns well in excess of the discount rate. For more information on CalPERS' funding risk mitigation policy, see the information available at the following two links: https://www.calpers.ca.gov/page/newsroom/calpers-news/2015/adopts-funding-risk-mitigation-policy and https://www.calpers.ca.gov/docs/funding-risk-mitigation-policy.pdf"

b. Actuarial changes in actuarial assumptions based on experience, including increased longevity and adjusting down the assumed investment rate of return down from 7.5% to 6.5%; and

c. An increase in the number of retirees and the size of their pensions.

These factors have combined to take the City's pension plans from being at or above full funding levels during the last decade to being underfunded now.

One of the variables responsible for the increase in annual contributions is the failure of the pension plans to achieve the annual earning assumptions on which they have been premised. Nationally, the trend for earnings assumptions has been downward reflecting: (a) the lower yields on bonds comprising 30-40% of pension portfolios, and (b) reduced expectations for equity (stock) investments given the global overhang of sovereign and consumer debt. Until 2002, CalPERS assumed earnings of 8.25% when it began phasing in a reduction of the earnings assumption to 7.75%. From 2000-2002 to 2008-2009, much of the new unfunded pension liabilities were caused by investment losses and adjustments. As anticipated by the City, the CalPERS Board has taken action to reduce the actuarially assumed investment rates of return below its current level of 7.5% to 6.5%, the Unfunded Actuarial Accrued Liability (UAAL) for the plans is expected to increase and as such the difference is reflected in increased annual contributions.

Another factor in the increase in pension costs is the rising number of retirees relative to active employees. In San Bernardino, as the number of active employees as a percentage of overall pension plan membership has decreased, the payments to retirees out of the plans have exceeded payments by active employees into the pension plans. The increasing ratio creates a risk of even higher future contribution rates, which have been factored into the City's forecast. This means that the annual cost to make payments related to the Unfunded Accrued Actuarial Liability is spread across fewer active employees.

Despite these increases, the Financial Model demonstrates the ability to remain cash, budget and service solvent, as basic operational services are funded, roughly $10 million annually is available to fund essential capital investments, including increased public safety services and infrastructure investments, and reserves are maintained at the Government Finance Officers Association (GFOA) recommended level of 15% of annual expenses.

D. Financial Projections

There can be no assurances that the City's finances in future years will be consistent with the financial projections set forth in the Financial Model, and creditors should review such financial projections with this caveat in mind.

VIII. INCOME TAX CONSEQUENCES

The implementation of the Plan may have federal, state, local and foreign tax consequences to the City and its creditors. No tax opinion has been sought or will be obtained with respect to any tax consequences of the Plan. However, because the City is a municipal corporation duly organized and existing under its Charter and the California Constitution, and is treated as a political subdivision of the State of California for federal income tax purposes, the City believes that it will not be subject to any federal income tax liability from implementation of the Plan. The City anticipates that, in conformity with past practice, it will not file any federal corporate income tax returns with respect to the periods in which the Plan is implemented nor report any income for federal income tax purposes as a result of implementing the Plan. The City may file certain tax documents associated with the restructuring of some of its tax-exempt bonds affected by the Plan, which documents may be required in order to maintain the exclusion from gross income of interest on the bonds for purposes of federal income taxes applicable to the holders thereof. The City may update this discussion and analysis of tax consequences based on developments and/or settlements occurring after the filing of this Disclosure Statement.

Because individual circumstances may differ, and the income tax consequences of a Bankruptcy Case are complex and uncertain, this summary does not address the income tax consequences that may be relevant to the creditors of the City as a result of the Plan. Accordingly, creditors should consult with their own tax advisors regarding the income tax consequences of the Plan to them, including the effect, if any, the Plan may have on prior outstanding obligations the interest components of which the creditors were treating as excludable from gross income for income tax purposes.

To ensure compliance with requirements imposed by the Internal Revenue Service, you are hereby notified that any discussion of tax matters contained herein (including any

attachments) is not intended or written to be used by any taxpayer, and cannot be used by any taxpayer, for the purpose of avoiding tax-related penalties that otherwise may be imposed under the Internal Revenue Code on the taxpayer. Such discussion of tax matters was written in connection with the solicitation of votes in favor of the Plan. Creditors should seek tax advice regarding the tax consequences to them of the Plan based on their particular circumstances from an independent tax advisor.

IX. RECOMMENDATION

The City urges all creditors that received Ballots to vote to accept the Plan by so indicating on their ballots and returning them as specified in this Disclosure Statement and on their ballots.

DATED: July 29, 2016

CITY OF SAN BERNARDINO, CALIFORNIA

By: _/s/ Mark Scott_
Mark Scott
City Manager

Submitted By:

STRADLING YOCCA CARLSON & RAUTH, P.C.

By: _/s/ Paul R. Glassman_
Paul R. Glassman
Fred Neufeld
Marianne S. Mortimer
Kathleen D. DeVaney

Attorneys for the City of San Bernardino

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:

100 Wilshire Blvd., 4th Floor, Santa Monica, CA 90401.

A true and correct copy of the foregoing document entitled THIRD AMENDED DISCLOSURE STATEMENT WITH RESPECT TO THE THIRD AMENDED PLAN FOR THE ADJUSTMENT OF DEBTS OF THE CITY OF SAN BERNARDINO, CALIFORNIA (JULY 29, 2016) will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner stated below:

1. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF)**: Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On July 29, 2016, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

The United States trustee will be served electronically by the court to:
United States Trustee (RS) ustpregion16.rs.ecf@usdoj.gov

ATTORNEYS FOR DEBTOR
Paul R. Glassman pglassman@sycr.com
Fred Neufeld fneufeld@sycr.com
Laura L. Buchanan lbuchanan@sycr.com

Franklin C Adams on behalf of Creditor San Bernardino Associated Governments
franklin.adams@bbklaw.com, arthur.johnston@bbklaw.com;lisa.spencer@bbklaw.com

Franklin C Adams on behalf of Creditor San Bernardino Local Agency Formation Commission
franklin.adams@bbklaw.com, arthur.johnston@bbklaw.com;lisa.spencer@bbklaw.com;

Franklin C Adams on behalf of Big Independent Cities Excess Pool Joint Powers Authority ("BICEP")
franklin.adams@bbklaw.com, arthur.johnston@bbklaw.com;lisa.spencer@bbklaw.com;

Andrew K Alper on behalf of Interested Party Courtesy NEF
aalper@frandzel.com, efiling@frandzel.com;ekidder@frandzel.com

Christian U Anyiam on behalf of Claimant Gustavo Arzola
anyiamlawfirminc@gmail.com, chrisanyiam4law@gmail.com

Thomas V Askounis on behalf of Interested Party Courtesy NEF
taskounis@askounisdarcy.com

Marjorie Barrios on behalf of Raymond Newberry, Patricia Mendoza, Maria Aboytia, Juana Pulido, Jesus Pulido, Jonathan Pulido, Richard Gonzalez Lozada, Melinda McNeal, Bertha Lozada, Mildred Lytwynec, Nicholas Lytwynec, Gloria Basua, and Others Similarly Situated
iecivillaw@gmail.com, mbarrios@mbarrios.com

Marjorie Barrios on behalf of The Estate of Fernando Melgoza
iecivillaw@gmail.com, mbarrios@mbarrios.com

Julie A Belezzuoli on behalf of Defendant California Department of Finance
julie.belezzuoli@kayescholer.com

Julie A Belezzuoli on behalf of Defendant Office of State Controller, State of California
julie.belezzuoli@kayescholer.com

Julie A Belezzuoli on behalf of Defendant Ana J Matosantos julie.belezzuoli@kayescholer.com

Julie A Belezzuoli on behalf of Defendant John Chiang
julie.belezzuoli@kayescholer.com

Anthony Bisconti on behalf of Creditor Certain Retired Employees of the City of San Bernardino
tbisconti@bmkattorneys.com, admin@bmkattorneys.com

Jeffrey E Bjork on behalf of Interested Party Courtesy NEF
jbjork@sidley.com

Michael D Boutell on behalf of Creditor Comerica Bank
mdbell@comerica.com

J Scott Bovitz on behalf of Creditor U.S. TelePacific Corp.
bovitz@bovitz-spitzer.com

John A Boyd on behalf of Interested Party Thompson & Colegate LLP
fednotice@tclaw.net

Jeffrey W Broker on behalf of Creditor The Glen Aire Mobilehome Park Corporation
jbroker@brokerlaw.biz

Laura L Buchanan on behalf of Debtor City of San Bernardino, California
lbuchanan@sycr.com

Michael J Bujold on behalf of U.S. Trustee United States Trustee (RS)
Michael.J.Bujold@usdoj.gov

Christopher Celentino on behalf of Party Erste Europaische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg S.A.
celentinoc@ballardspahr.com, burkec@ballardspahr.com

Lisa W Chao on behalf of California Infrastructure and Economic Development Bank
lisa.chao@doj.ca.gov

Shirley Cho on behalf of Interested Party National Public Finance Guarantee Corp.
scho@pszjlaw.com

Carol Chow on behalf of Interested Parties CMB INFRASTRUCTURE INVESTMENT GROUP III, LP, CMB INFRASTRUCTURE INVESTMENT GROUP V, LP AND CMB INFRASTRUCTURE INVESTMENT GROUP VI-C, LP
carol.chow@ffslaw.com

Alicia Clough on behalf of Defendant California Department of Finance
aclough@loeb.com, ladocket@loeb.com;klyles@loeb.com;mnielson@loeb.com

Alicia Clough on behalf of Defendant Office of State Controller, State of California
aclough@loeb.com, ladocket@loeb.com;klyles@loeb.com;mnielson@loeb.com

Alicia Clough on behalf of Defendant State of California
aclough@loeb.com, ladocket@loeb.com;klyles@loeb.com;mnielson@loeb.com

Alicia Clough on behalf of Defendant Ana J Matosantos
aclough@loeb.com, ladocket@loeb.com;klyles@loeb.com;mnielson@loeb.com

Alicia Clough on behalf of Defendant John Chiang
aclough@loeb.com, ladocket@loeb.com;klyles@loeb.com;mnielson@loeb.com

Marc S Cohen on behalf of Defendant California Department of Finance
mscohen@loeb.com, klyles@loeb.com;mnielson@loeb.com;ladocket@loeb.com

Marc S Cohen on behalf of Defendant Office of State Controller, State of California
mscohen@loeb.com, klyles@loeb.com;mnielson@loeb.com;ladocket@loeb.com

Marc S Cohen on behalf of Defendant State of California
mscohen@loeb.com, klyles@loeb.com;mnielson@loeb.com;ladocket@loeb.com

Marc S Cohen on behalf of Defendant Ana J Matosantos
mscohen@loeb.com, klyles@loeb.com;mnielson@loeb.com;ladocket@loeb.com

Marc S Cohen on behalf of Defendant John Chiang
mscohen@loeb.com, klyles@loeb.com;mnielson@loeb.com;ladocket@loeb.com

Christopher J Cox on behalf of Interested Party National Public Finance Guarantee Corp.
chris.cox@weil.com, janine.chong@weil.com

Christina M Craige on behalf of Interested Party Courtesy NEF
ccraige@sidley.com

Alex Darcy on behalf of Creditor Marquette Bank
adarcy@askounisdarcy.com, akapai@askounisdarcy.com

Susan S Davis on behalf of Interested Party Courtesy NEF
sdavis@coxcastle.com

Robert H Dewberry on behalf of Creditor Allison Mechanical, Inc.
robert.dewberry@dewlaw.net

Donn A Dimichele on behalf of Debtor City of San Bernardino
dimichele_do@sbcity.org, brigman_ch@sbcity.org

Todd J Dressel on behalf of Creditor Pinnacle Public Finance, Inc.
dressel@chapman.com, lillbyrd@chapman.com

Warren M Ellis on behalf of Claimant Jesus Castaneda
warren.m.ellis@gmail.com, ciprianturcu@presumeinnocence.com

Scott Ewing on behalf of Interested Party Rust Consulting/Omni Bankruptcy
contact@omnimgt.com, sewing@omnimgt.com;katie@omnimgt.com

John A Farmer on behalf of Creditor County of San Bernardino, California
jfarmer@orrick.com

John C Feely on behalf of Claimant Broadway Capital LLC
johnconrad85@gmail.com, john@lblegal.org

Lazaro E Fernandez on behalf of Creditor Lori Tillery, Michael Wade, Michael Anthony Rey, Terrel Markham, et al., Attornwy fo J.A. et al., Cedric may Sr., et al., Sheryl Jackson
lef17@pacbell.net, lef-karina@pacbell.net;lef-mari@pacbell.net;lefkarina@gmail.com

M Douglas Flahaut on behalf of Interested Party Wells Fargo Bank, N.A.
flahaut.douglas@arentfox.com

Dale K Galipo on behalf of Attorney Dale K Galipo
dalekgalipo@yahoo.com, mpartow@galipolaw.com;lcostanza@galipolaw.com;rvasquez@galipolaw.com

Dale K Galipo on behalf of Michael Wade, Michael Anthony Rey, Terrel Markham, et al., Attornwy fo J.A. et al., Cedric may Sr., et al., Sheryl Jackson
dalekgalipo@yahoo.com, mpartow@galipolaw.com;lcostanza@galipolaw.com;rvasquez@galipolaw.com

Victoria C Geary on behalf of Defendant California State Board Of Equalization
victoria.geary@boe.ca.gov

Victoria C Geary on behalf of Defendant Cynthia Bridges
victoria.geary@boe.ca.gov

Paul R. Glassman on behalf of Debtor City of San Bernardino, California
pglassman@sycr.com

Paul R. Glassman on behalf of Plaintiff City of San Bernardino, California
pglassman@sycr.com

Richard H Golubow on behalf of Glen Aire Mobilehome Park Corporation, Pacific Palms Mobilehome Park Corporation, Friendly Village Mobilehome Park Corporation, Orangewood Mobilehome Park Corporation and Affordable Community Living Corporation fka California Mobilehome Park Corporation fka San Bernardino Mobilehome Park Corporation
rgolubow@winthropcouchot.com, pj@winthropcouchot.com;vcorbin@winthropcouchot.com; mconour@winthropcouchot.com

David M Goodrich on behalf of Creditor San Bernardino City Professional Firefighters Local 891
dgoodrich@sulmeyerlaw.com, asokolowski@sulmeyerlaw.com, dgoodrich@ecf.inforuptcy.com, slee@sulmeyerlaw.com

Morton J Grabel on behalf of Claimant Lorrie Pauly
mortgrabel@aol.com, rowena@flatrocklegal.com

Christian Graham on behalf of Creditor Miramontes Const. Co., Inc.
cgraham23@dlblaw.net

Everett L Green on behalf of U.S. Trustee United States Trustee (RS)
everett.l.green@usdoj.gov

Asa S Hami on behalf of Creditor San Bernardino City Professional Firefighters Local 891
ahami@sulmeyerlaw.com,
agonzalez@sulmeyerlaw.com;agonzalez@ecf.inforuptcy.com;ahami@ecf.inforuptcy.com

James A Hayes on behalf of Interested Party Courtesy NEF
jhayes@jamesahayesaplc.com

Eric M Heller on behalf of Interested Party Internal Revenue Service
eric.m.heller@irscounsel.treas.gov

Richard P Herman on behalf of Creditor Javier Banuelos
rherman@richardphermanlaw.com

Jeffery D Hermann on behalf of Creditor and Defendant County of San Bernardino, California
jhermann@orrick.com

Whitman L Holt on behalf of Interested Party Courtesy NEF
wholt@ktbslaw.com

Michelle C Hribar on behalf of Interested Party San Bernardino Public Employees Association
mch@sdlaborlaw.com, sak@sdlaborlaw.com

Steven J Katzman on behalf of Creditor Certain Retired Employees of the City of San Bernardino
SKatzman@bmkattorneys.com, admin@bmkattorneys.com

Steven J Katzman on behalf of Official Committee Of Retired Employees
SKatzman@bmkattorneys.com, admin@bmkattorneys.com

Jane Kespradit on behalf of Interested Party Courtesy NEF
jane.kespradit@limruger.com, amy.lee@limruger.com

Mette H Kurth on behalf of Interested Party Courtesy NEF
kurth.mette@arentfox.com;pchlum@foxrothschild.com

Sandra W Lavigna on behalf of Interested Party U. S. Securities and Exchange Commission
lavignas@sec.gov

Michael B Lubic on behalf of Creditor California Public Employees' Retirement System
michael.lubic@klgates.com, jonathan.randolph@klgates.com

Michael B Lubic on behalf of Interested Party California Public Employees' Retirement System
michael.lubic@klgates.com, jonathan.randolph@klgates.com

Michael C Maddux on behalf of Creditor Asinia Johnson
1mcmnla@gmail.com, mikemadduxlaw@gmail.com

Vincent J Marriott on behalf of Erste Europäische Pfandbriefund Kommunalkreditbank AG in Luxemburg
Pearsonj@ballardspahr.com

Vincent J Marriott on behalf of Erste Europäische Pfandbriefund Kommunalkreditbank AG in Luxemburg
Marriott@ballardspahr.com, Pearsonj@ballardspahr.com

David J McCarty on behalf of Interested Party David J. McCarty
dmccarty@sheppardmullin.com, nparker@sheppardmullin.com

Reed M Mercado on behalf of Interested Party M. Reed Mercado
rmercado@sheppardmullin.com

Dawn A Messick on behalf of Interested Party Courtesy NEF
messickd@ballardspahr.com, chabota@ballardspahr.com

Fred Neufeld on behalf of Debtor City of San Bernardino, California
fneufeld@sycr.com

Aron M Oliner on behalf of Interested Party San Bernardino Police Officers Association
roliner@duanemorris.com

Scott H Olson on behalf of Creditor Kohl's Department Stores, Inc.
solson@vedderprice.com, ecfdocket@vedderprice.com,jcano@vedderprice.com, jparker@vedderprice.com

Allan S Ono on behalf of Interested Party Courtesy NEF
allan.ono@doj.ca.gov, beatriz.davalos@doj.ca.gov

James F Penman [former City Attorney of the City of San Bernardino]

Mark D Potter on behalf of Creditor Creditor Timothy Crowley
mark@potterhandy.com, rhondahandy@potterhandy.com;kevin@potterhandy.com

Dean G Rallis, Jr on behalf of Interested Party Courtesy NEF drallis@afrct.com;msinclair@afrct.com; AFRCTECF@afrct.com;mpham@afrct.com; yblum@afrct.com

Manoj D Ramia on behalf of Creditor California Public Employees' Retirement System
manoj.ramia@klgates.com, klgatesbankruptcy@klgates.com

Jason E Rios on behalf of Creditor California Public Employees' Retirement System
jrios@ffwplaw.com, lnlasley@ffwplaw.com

Esperanza Rojo on behalf of Interested Party Rust Consulting/Omni Bankruptcy
contact@omnimgt.com, sewing@omnimgt.com

Kenneth N Russak on behalf of Interested Party Courtesy NEF
krussak@frandzel.com, efiling@frandzel.com;dmoore@frandzel.com

Vicki I Sarmiento on behalf of Claimants X.J.G., as minor by and through guardian ad litem Angelina Saenz, C.A. as minor Gonzalez by and through guardian ad litem Rosalsela Avalos, Brunilda Gonzalez, Angelina Cesar, Zochilt Gutierrez, Sasha Gonzalez
vsarmiento@vis-law.com, jfregoso@vis-law.com

Mark C Schnitzer on behalf of Attorney Mark C. Schnitzer
mschnitzer@rhlaw.com, mcschnitzer@gmail.com

John R Setlich on behalf of Claimant Francisca Zina Gomez
John R Setlich jrsetlich@setlichlaw.com

Diane S Shaw on behalf of Interested Party Courtesy NEF
diane.shaw@doj.ca.gov

Ariella T Simonds on behalf of Interested Party Courtesy NEF
asimonds@sidley.com

Jason D Strabo on behalf of Creditor U.S. Bank National Association, not individually, but as Indenture Trustee
jstrabo@mwe.com, cgilbert@mwe.com

Cathy Ta on behalf of Big Independent Cities Excess Pool Joint Powers Authority ("BICEP")
cathy.ta@bbklaw.com, Arthur.Johnston@bbklaw.com;lisa.spencer@bbklaw.com

Mohammad Tehrani on behalf of U.S. Trustee United States Trustee (RS)
Mohammad.V.Tehrani@usdoj.gov

Sheila Totorp on behalf of Creditor Landmark American Insurance Company
stotorp@clausen.com, jbrzezinski@clausen.com

Benjamin R Trachtman on behalf of Interested Party Courtesy NEF
btrachtman@trachtmanlaw.com, sstraka@trachtmanlaw.com

Matthew J Troy on behalf of Creditor United States of America
matthew.troy@usdoj.gov

United States Trustee (RS)
ustpregion16.rs.ecf@usdoj.gov

Anne A Uyeda on behalf of Interested Party Courtesy NEF
auyeda@bmkattorneys.com

Annie Verdries on behalf of Interested Party Courtesy NEF
verdries@lbbslaw.com, Autodocket@lbbslaw.com

Delilah Vinzon on behalf of Interested Party Ambac Assurance Company
dvinzon@milbank.com

Brian D Wesley on behalf of Interested Party Courtesy NEF
brian.wesley@doj.ca.gov

Arnold H Wuhrman on behalf of Creditor Serenity Legal Services, P.C.
Wuhrman@serenitylls.com

Clarisse Young on behalf of Interested Party Courtesy NEF
youngshumaker@smcounsel.com, levern@smcounsel.com

☐ Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:
On July 29, 2016, I served [or will serve] the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

☐ Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on July 29, 2016, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

PRESIDING JUDGE'S COPY
Honorable Meredith A. Jury
U.S. Bankruptcy Court
3420 Twelfth Street, Suite 325
Riverside, CA 92501-3819
Via overnight delivery service with Golden State Overnight (www.gso.com) Delivery Tracking number: 532765457

UNITED STATES TRUSTEE
Office of the United States Trustee (Overnight Delivery Service)
3801 University Avenue, Suite 720
Riverside, CA 92501
Via overnight delivery service with Golden State Overnight (www.gso.com) Delivery Tracking number: 532764062

ATTORNEYS FOR UNITED PACIFIC RAILROAD COMPANY (Via Email)
Mary Ann Kilgore (Via Email)
MKILGORE@UP.COM
Jennie L. Anderson
JLANDERS01@UP.COM

☐ Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

July 29, 2016	Christine Pesis	*/s/ Christine Pesis*
Date	*Printed Name*	*Signature*