CITY OF STOCKTON BANKRUPTCY COMMENTARY June 27, 2012

On June 27, 2012, the City Council of Stockton, California voted 6 -1 to adopt a spending plan for operating under bankruptcy protection. As a result, the city of nearly 300,000 residents with over $700 million total in debt outstanding is expected to seek bankruptcy protection under Chapter 9 in the next few days. Although Stockton may become the largest U.S. city to seek court protections from its creditors, the announcement has had very little impact on the overall municipal market because the city's financial struggles have been well known by investors and other market participants.

The city of Stockton's expected filing for bankruptcy was the result of systemic high costs of very extensive retirement benefit plans and substantial amounts of debt that it incurred during the housing boom. When the housing market collapsed, Stockton was left with fewer tax dollars to pay debt service and to pay the costs of increasing retiree health-care costs. Over time and after many declared fiscal emergencies and possible debt restructuring attempts had failed, City Council felt that they had no choice but to seek bankruptcy protection in order to maintain basic level of services. The city now must demonstrate to a federal judge they are unable to pay their bills and come up with a plan for meeting their obligations. Positively, municipalities have more leeway with creditors under Chapter 9 when compared to corporate filings under Chapter 11. For example, creditors are unable to seize or sell off city assets and the court cannot assign a trustee to take over city operations.

APA has not purchased any bonds issued by Stockton due to underlying credit weaknesses. Stockton has always had above average to high unemployment rates, low wealth levels with high poverty rates, weak financial operations, high debt levels and substantial retiree health care costs. For example, recent data shows the Stockton had an unemployment rate of 15.4% in April 2012 (almost double the national average) and has had double digit unemployment rates going back to November 2007. Poverty rates have never been below 15% since 2005, which are high when considering the national average in that time frame was 13.4%. In addition, 1 in every 195 homes in Stockton's metropolitan area received a foreclosure filing in May 2012, the fifth-highest rate in the nation, according to RealityTrac, Inc.

With regards to debt, APA's own analysis has total debt outstanding of over $700 million, which calculates to a very high $2,406 debt per capita. Merritt Research data shows that a BBB-rated city's debt per capita would be approximately $1,600. Extensive retirement benefit plans were also a problem. The Wall Street Journal cites statistics that the city has $800 million in unfunded liability for pensions and retiree health benefits. As a result, the city was forced to lay off 25% of its police officers to help pay for these generous benefits plans, the results of which have led to Stockton having the second highest violent crime rate in the state. The city also laid off 30% of its firefighters and 43% of its general city staff. Officials had no other choice but to file for bankruptcy protection.

Disclosures:
Past performance is not indicative of future results. This material is not financial advice or an offer to sell any product. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account, if any; and (iii) market exigencies at the time of investment. Asset Preservation Advisors, Inc. reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed may not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

APA is a registered investment advisor. More information about the advisor including its investment strategies and objectives can be obtained by visiting www.assetpreservationadvisors.com.   A copy of APA's disclosure statement (Part 2 of Form ADV) is available without charge upon request. Our Form ADV contains information regarding our Firm's business practices and the backgrounds of our key personnel. Please contact APA at 404-261-1333 if you would like to receive this information. APA-12-130