

**LOCAL INVESTMENT ADVISORY BOARD**  
**915 Capitol Mall, Room 110**  
**Sacramento, CA 95814**

**Minutes**  
**June 6, 2002**

William Sherwood, acting as Chairperson for State Treasurer Philip Angelides, called the Local Investment Advisory Board (LIAB) meeting to order at 1:08 p.m., Thursday, June 6, 2002.

**AGENDA ITEM 1: Roll Call**

LIAB Members present were Patricia Elliott, Leslie Wells, Byron Scordelis, and William Sherwood representing State Treasurer Philip Angelides. A quorum was present. State Treasurer's Office staff present were LIAB Executive Secretary Theodore Eliopoulos, Dan Dowell, Eileen Park, Marian Yee, and Kim Lee.

**AGENDA ITEM 2: Approval of the Minutes**

The minutes of the January 31, 2002, meeting were approved as submitted with a motion by Mr. Wells and seconded by Mr. Scordelis.

**AGENDA ITEM 3**

**Planning the 2002 LAIF Annual Conference**

Ms. Park reported that the 2002 Annual LAIF Conference would be the LAIF's 25<sup>th</sup> Anniversary. The LAIF Conference has been scheduled for Thursday, September 12, 2002, at the Sacramento Convention Center from 9:00 a.m. to 3:30 p.m. The post-conference tour will commence Friday, September 13, 2002, at the Treasurer's Office in the Investment Division. The next Board meeting is scheduled for September 11, 2002, at 1:30 p.m.—the afternoon before the conference.

The 2001 post-conference tour had two sessions and was well received by LAIF participants. Just like last year, the 7:00 a.m. session will observe the trading process live, while the 9:00 a.m. session will be an explanation of the trading process. Due to space restrictions, the number of participants able to attend each session will be limited. The LAIF staff will continue to advertise the conference on the State Treasurer's website and will contact local government associations, such as California Municipal Treasurer Association (CMTA), California Association of County Treasurer's & Tax Collectors (CACTTC), California Society of Municipal Finance Officers (CSMFO), California

Special Districts Association (CSDA) and others, to advertise the LAIF Conference. The conference brochure will be released by the beginning of July.

Ms. Park provided Board Members with a worksheet for the conference agenda with proposals for potential topics. As she detailed the proposed sessions, Ms. Park asked the Board Members for their comments and suggestions.

Ms. Park stated that Maury Harris, Ph.D., Managing Director and Chief Economist for the Americas with UBS Warburg, has agreed to speak for the economist session. Mr. Harris was scheduled to speak at the 2001 LAIF Conference but was unable to attend due to a religious holiday. The proposed title of the session is *Economic Recovery, Are We There Yet?* Mr. Harris can also address the Californian economy. Ms. Park asked the Board Members to provide additional suggestions or topics to assist Mr. Harris with focusing his presentation for the LAIF Conference.

Mr. Sherwood said that Mr. Harris should be asked to provide economic information for the world, the United States and the State of California.

Ms. Park explained that the next session was an overview of the Pooled Money Investment Account (PMIA) and LAIF programs by Mr. Sherwood and Mr. Dowell. This session was moved to the beginning of the 2001 LAIF Conference program. The attendees preferred this program change because the investment managers provided basic information and set the stage for the following sessions. Ms. Park asked Board Members for specific issues that Mr. Sherwood and Mr. Dowell could address during this session.

Mr. Scordelis asked if the questions and answers regarding the LAIF deposit balance increase raised during the Board's meeting on January 31, 2002, were communicated to the LAIF participants.

Mr. Dowell stated that the questions and answers regarding the LAIF deposit balance increase were read into the minutes. The reason the responses were read into the minutes was to allow LAIF participants to access the State Treasurer's website to download information as needed. Mr. Dowell further stated that there have been no additional questions or correspondence about the LAIF deposit balance increase.

Ms. Park stated that the minutes from the LIAB January 31, 2002, meeting would be posted to the Treasurer's website after the Board adopted them at today's meeting.

Ms. Park announced that Mr. Michael Reynolds, City of Redlands Treasurer and CMTA Legislative Committee Chair has committed to speak at the conference. His session will provide participants with legislative updates.

For the remaining conference sessions, Ms. Park proposed the following sessions and ideas for Board consideration:

- A status report on the AB943 investment reporting requirements from the California Debt and Investment Advisory Commission (CDIAC) staff.
- An overview of the State's financial condition and the impact to local governments, including a discussion of the State's budget deficit, debt issuance plans, and what to expect in future budget years for the State.
- A briefing on credit quality issues affecting the market. What should be on the local agency's target screen while monitoring credit? Are there other issues that local agencies should be watching, such as accounting and conflict of interest issues?
- A one-half hour open forum or roundtable at the end of the conference to allow LAIF participants to get individual assistance for questions.

Ms. Elliott stated that the participants would benefit from information about the State's procedures on how issuers are evaluated and how a company's creditability is determined. LAIF participants should be aware of the State's credit procedures for evaluating issuers and the broker/dealers that do business with the State.

Mr. Dowell stated that most of the calls he receives from local governments are regarding credit issues. Local agencies want to know how the State approves a new dealer, how the State evaluates corporate bonds, or the steps to authorizing new issuer names for certain types of securities. Mr. Dowell agreed that a session on credit issues was a good idea.

Mr. Sherwood suggested that a fifteen-minute update for CDIAC reporting requirements would be sufficient.

Mr. Wells stated that prior to the 2001 Conference participants, treasurers and finance officers expressed an interest in hearing from CDIAC on the information collected pursuant to AB943 and how CDIAC planned to use the information. He further stated that he attended two meetings with CDIAC in the last quarter. CDIAC staff reported basic statistics for counties and cities. The city and county data was broken down by portfolio and population size. City and county officials at the two CDIAC events did not have any questions about the data. Since there was minimal new information from CDIAC on the AB943 investment reporting requirements, a full session for CDIAC may not be warranted. If the Board decides to include a CDIAC session, Mr. Wells suggested that a roundtable might be better suited for the program since there are more pressing issues that should be covered.

The Board members discussed a number of ideas and methods for determining the informational needs of the LAIF Conference attendees. This included surveys, contacts by telephone and e-mail, and interaction with local government associations' leadership. Ms. Park committed to using as many methods as possible to gather information from the LAIF constituents to help focus the subject matter for the conference speakers.

The Board Members agreed to include the budget and credit sessions to the conference program, and that the AB943 session will not be need at this time.

Ms. Elliott asked if there would be a discussion on the *Jarvis v. Connell* Court of Appeal decision at the conference.

Mr. Sherwood stated that the case would be discussed at the conference during the overview of the PMIA and LAIF sessions.

Since the recent Enron accounting issues have come to the surface, Mr. Scordelis asked if a session on the risks involved with using a single firm to perform consulting, public reporting, and accounting services would be of interest to LAIF participants. He stated that in light of the Enron scandal, most Fortune 500 companies are now splitting the external accounting, consulting and internal auditing duties among two or more firms. Previously most companies had one firm providing all three services. He asked if local agencies would benefit from a discussion on the external accounting and consulting issue and looking at how the private sector is changing the way they contract for these services.

Ms. Park stated she has been working with analysts at Fitch Ratings on the credit panel. She stated she has approached them with developing an idea on how the agency reviews and analyzes the accounting practices, financial reports, and auditing practices of the firms they rate. She stated that she would continue to work with the rating agencies and others to develop a topical session on credit, accounting-auditing-consulting, and other topical issues.

Mr. Sherwood stated that this was a very good idea and would be of interest to the LAIF participants. The issues are of widespread interest to everyone in the market due to the recent Enron developments.

Mr. Eliopoulos stated that the California Public Employees' Retirement System (CalPERS) and California State Teachers' Retirement System (CalSTRS) have adopted a policy to split outside accounting and consulting. Both retirement systems are in the process of implementing these policies, realizing that the corporate governance criteria in use to evaluate firms the systems invest with were also good and solid business practices for the systems.

Ms. Park stated that she would gather the information from Mr. Eliopoulos and others to develop this topic further.

Mr. Scordelis asked, in the event of an emergency such as a major disruption in the financial markets operations from the September 11<sup>th</sup> attacks, what are the business recovery procedures for the State to function financially? What is the status of the PMIA and LAIF mainframes in the event of an emergency? Mr. Scordelis asked whether these questions would be good topics for the conference?

Mr. Sherwood stated the disaster recovery issue has been addressed for the PMIA and the LAIF programs in previous conferences. He will also cover the issue briefly during his presentation at this conference. The State Treasurer's Office has off-site capabilities in several locations inside and outside of California. He further stated that disaster recovery needs became issues during the San Francisco earthquake in the mid 1990s, during the Year 2000 computer concerns, and during the September 11, 2001 terrorist attacks. During these occasions, the disaster recovery plans were implemented, as needed, and have worked effectively. However, the State Treasurer's Office evaluates its operations and the performance of staff during operational disruptions and implements improvements to the disaster recovery plans as needed. Since the September 11<sup>th</sup> disaster, the Treasurer's Office has negotiated an agreement with the CalSTRS for short-term operational back-up needs. CalSTRS has agreed to provide the Treasurer's Office access to their investment operations facilities during a crisis.

Mr. Sherwood stated that the Enron situation and the September 11<sup>th</sup> attacks provide the impetus for change and reevaluation. These events are like the Orange County bankruptcy, in that the events spur state and local government policy makers, lawmakers, governing boards and staff to review their policies and procedures, enact legislation or engage in other actions to ensure that their business operations are compliant with current issues and situations.

Mr. Scordelis noted that another topical issue for the LAIF participants is a discussion of the securities business, where regulators are looking at strengthening the rules related to how independent a securities analyst is in making buy/sell recommendations on securities underwritten by the investment banking side of the same firm.

Ms. Elliott stated that her agency recently selected new auditors. In discussions with the competing firms, the big accounting firms are trying to absorb the business that is leaving Arthur Andersen. She noted that her district has not given her any instructions for splitting the accounting and consulting relationships. However, she thought that a discussion of this issue might be informative to local agencies.

Mr. Sherwood directed staff to develop a session to include all the elements noted by the Board members in a panel session on credit, accounting and consulting, and securities analysts and investment banking issues.

Ms. Park stated that she would work on the conference agenda and incorporate the Board's input into program. She said that the conference program should be finalized and the speakers confirmed before the end of June. Upon completion, staff will transmit the final program to the Board members.

## **AGENDA ITEM 4: Overview LAIF Operations and PMIA Participation**

### **PMIA Performance**

Mr. Dowell reported that the PMIA is currently at \$48 billion. The Pool is expected to add \$7.5 billion on June 24, 2002, which are the proceeds from the sale of the revenue anticipation warrants (RAW). The first installment for repayment of the RAW is \$1.5 billion in late October 2002, followed by a \$3 billion repayment in late November 2002, and \$3 billion in late January 2003. The RAWs also have a call option for the January payment to be paid back with the November payment. The RAW will be called in November, if the revenue anticipation notes (RAN) are sold after the budget is passed. Investment managers have considered how the increased cash flow from the RAWs and RANs, will impact the Pool and the investment options for such a sizeable pot of money.

In estimating the performance of the Pool for local agencies, the Investment Division managers assumed that the earliest the Federal Open Market Committee (FOMC) may take action to increase interest rates is during their August 2002 meeting. However, that assumption may no longer be valid, as there is continuing weakness in the economy. Mr. Dowell stated that many local governments ask him to forecast performance rates for the Pool. Based on the different variables and assumptions for the year, the Investment Division has provided a blend of two scenarios. The first scenario assumes there is no tightening of rates, resulting in projected rates of 2.95% for March 31, 2002 and 2.75% for June 30, 2002. If the FED does not intervene by August 2002 and with the current daily rate at 2.70% to 2.72%, the PMIA could be yielding about 2.70% to 2.65% if the rates continue to drop for the September quarter end. He stated based on those assumptions, the projections were on target and he anticipated that this might be the lowest the rates will go for the Pool.

Mr. Dowell announced that the Investment Division is continuing to work on the *Double Bottom Line* program. A couple of small business lenders have been added to the list of authorized dealers, who have done very well. This month a pool of \$23 million in California-only loans, with a specific emphasis on low- to moderate-income borrowers, have been added to the portfolio. The Pool also added \$156 million of teacher-assistance mortgages at 6.30% rate of return and 3.77 year average life. These teacher mortgages are "95 to 5" mortgages that allow teachers to buy more for their mortgage dollar than a conventional mortgage loan, based on meeting a number of funding criteria. The investment managers are also working with JP Morgan to develop a \$200 million Community Reinvestment Act (CRA) only mortgage for October.

Mr. Scordelis asked what is the prepayment risk on these mortgages?

Mr. Dowell stated that these mortgages are easier to assume on the prepayment speeds because the properties do not change ownership as often as conventional mortgages.

Mr. Dowell said that the investment managers have been meeting with Countrywide to discuss specific programs and to get some ideas about the trends in the mortgage industry. Countrywide is one of the largest loan originators in California and the information they share may help with the development of more mortgage types that could be packaged for the *Double Bottom Line* program. So that local agencies have a perspective of the total amount of mortgage securities in the portfolio, he provided the following information. Structured securities (which include structured mortgages, SBAs, CRA mortgages, GNMAAs, FHLMCs, and floating rate securities) are less than 3.7% of the total portfolio.

Mr. Dowell reported that the demand for funds in Time Deposit Program seems to have leveled out. There is a continuing demand for new or increased time deposits, but these are offset by other banks returning time deposit monies due to diminishing loan demand. The Time Deposit Program is approximately 10% of the portfolio.

Mr. Sherwood asked Mr. Dowell if he would be addressing the *Jarvis v. Connell* court decision.

Mr. Dowell stated that Ms. Park would address this issue. However, he did note for the Board that the PMIA has plenty of liquidity for local agencies that would want to withdraw funds at the end of the fiscal year, if they felt any uncertainty about the decision.

Mr. Scordelis asked if the \$200 million from JP Morgan is residential?

Mr. Dowell stated that the program is single family mortgages from their JP Morgan Chase mortgage operations in California. He also stated that the institution was asked to make a concerted effort (with results) to address predatory lending in California. JP Morgan Chase presented a package with checklists and contact sheets for borrowers, slide show for presentations at borrowers' seminars, workshops throughout the state, and a list of dates and shows in Spanish and English for the benefit of the borrower. The information from this package will help to educate the California borrowers, which is a different approach from other institutions that focus on educating the lending institutions on the predatory lending issues.

### **LAIF Operations**

Ms. Park provided a routine status report on LAIF operations. Board Members were provided with graphic illustrations for the quarter ending March 2002 on LAIF operations. As of the date of the Board meeting, LAIF deposits total about \$20.2 billion, which is about 39% of the PMIA.

Ms. Park stated she has been working closely with Mr. Eliopoulos, Mr. Sherwood, and Mr. Dowell for the past two weeks informing the LAIF participants about the *Jarvis v. Connell* issue. The April 2002 *LAIF News* issue was released to inform LAIF participants that the court heard the *Jarvis v. Connell* case and a decision was expected within 90 days

of the hearing date. The court issued the decision on May 29, 2002. Staff worked with the State Treasurer's Office legal staff and the Attorney General's Office on the interpretation of the decision and what the decision meant for Central Treasury operations. Most important to the LAIF program, the Attorney General's Office said that based on the decision—LAIF funds might be distributed back to the local agencies on demand, with or without, a state budget. A special edition of *LAIF News* was immediately released, informing LAIF participants of the court decision. The newsletter was posted on the Treasurer's website, as well as mailed to each LAIF participant with the May account statement.

Ms. Park stated she has spent a significant amount time answering questions for LAIF participants about the decision since its release. On occasion Ms. Park transmitted pages of the court decision to participants. Ms. Park provided Board Members with the complete copy of the court decision, comprised of 52 pages of text. Ms. Park further stated that the PMIA has the liquidity to provide funds on demand if LAIF participants continue to be concerned about the availability of the LAIF funds and wish to withdraw funds over the fiscal year-end.

Mr. Sherwood stated that some of the initial concern from local officials came from the news releases on the decision in the popular press. The headlines and stories related to this case gave the public the impression that the State lost the case. He explained that there were two parts to the *Jarvis v. Connell* case. They were 1) the ability of the State to pay employees as of July 1, 2002 without a State budget, and 2) the ability of the State to pay continuous appropriations when there was no budget as of the beginning of the fiscal year on July 1<sup>st</sup>. Regarding the payroll issue, the court decision ruled that the State was only able to pay its employees the federal minimum wage. This point was the focus of the news stories on the court decision and why some believed that the State lost its case. This payroll issue will likely be pursued by to a higher level by others in the State government structure.

However, the second part of the case related to continuous appropriations was ruled in favor of the State. The court decision said that the Controller may disburse funds during a budget impasse when state and federal law properly authorizes or requires their payment, despite the absence of a budget act or emergency appropriation. This decision gave the State Treasurer's Office a clear ruling for operational issues for LAIF, for investment operations, for debt service payments and other programs. For LAIF, this means that the Controller may make disbursements from LAIF, with or without a State budget, because the program is authorized in State law and is a continuously appropriated program. The attorneys of the State Controller's Office, the State Treasurer's Office, Attorney General's Office and the Department of Finance were in agreement with the interpretation of the court decision.

Mr. Scordelis asked if the State Controller would be precluded from issuing warrants for payroll.



Mr. Sherwood stated that as it stands right now, the courts say that warrants could be issued for payroll, but up to the federal minimum wage standard. However, the labor unions and others will be quick to challenge the decision. The Legislature also has the option of passing an emergency appropriation to deal with some of these issues until the budget is passed.

Ms. Park stated that it was fortunate that the release of the court decision was about five weeks before the end of the fiscal year. With the release of the court decision, this gave staff ample time to get information out to the LAIF participants. Some participants indicated that they were considering major withdrawals from LAIF if the State budget negotiations looked like the Legislature was not going to meet the July 1<sup>st</sup> deadline. Since the release of the court decision information, local agencies have reconsidered their cash flow options, have canceled scheduled withdrawals, or have redeposited funds based on information supplied to them on the decision – via the website, hardcopy, or fax.

Mr. Wells asked Ms. Park if there are any numbers on the number of LAIF withdrawals executed in anticipation of having no budget on July 1st.

Ms. Park stated that there are substantial deposits and withdrawals daily and unless a participant informs LAIF of the reason for withdrawal—staff has no way of knowing. She said that there was one agency that scheduled a withdrawal of \$20 million, but the agency cancelled that order based on the court decision. The agency was satisfied with the decision that they would be able to get funds on July 1. The agency did not want to lose out on the earnings in the LAIF.

Mr. Wells stated that during that last couple of months he had been fielding some questions from local agencies about the *Jarvis v. Connell* case. Local government officials' concerns are elevated as we approach the fiscal year end, especially if they expect State budget negotiations will be difficult. He stated that he addressed their concerns about the availability of funds on or after July 1<sup>st</sup> if there was not budget, but also referred many of the calls to the LAIF Administrator.

Mr. Sherwood stated that there were some misunderstandings and misinformation disseminated by Board members on the outcome of the court decision. He said that Ms. Park, Mr. Dowell and he have been working with all concerned local officials to ensure that they understood the court decision and what it meant to LAIF operations. He noted that it is important as representatives of the LAIF program, that Board members and staff have the most accurate and up-to-date information when speaking about these issues.

Mr. Sherwood stated that Ms. Park and he would be attending the California Association of County Treasurers and Tax Collectors Annual Conference. Mr. Sherwood stated that he had spoken to many county treasurers from the larger counties and they have stated the budget impasse was not an issue of concern for them because county funds were diversified.

Ms. Park informed the Board that there is legislation to address LAIF as continuing appropriation. SB68 is sponsored by the City of Palm Desert and the author is Senator Battin. Municipal Treasurer Thomas Jeffery is pursuing this legislation to fully clarify the continuous appropriation issue and that the LAIF funds are held in trust. The amendments to the LAIF law includes a provision that clearly states that LAIF monies will not be withheld if there is no budget. Ms. Park informed the Board that the bill is scheduled for hearing on June 10, 2002, in the Assembly Banking and Finance Committee. LAIF is working with the author, the sponsor, and the CMTA in an effort to support this issue.

#### **AGENDA ITEM 5: Public Comment**

There was no public comment for this meeting.

#### **AGENDA ITEM 6: Other Business**

Mr. Wells advised the Board members that he represented LAIF when he met the City of Claremont. He also met with the City of Irvine Investment Committee as well on the behalf of LAIF. Mr. Wells thanked Ms. Park for providing him with the LAIF Answer Books. Both cities were pleased with the information and presentation. Several have been involved with LAIF for years but lacked understanding about how the program is run. Mr. Wells explained that the program is a hands on program and that the Investment/LAIF staff, as well as member of the LIAB, are willing to visit with them and that they are available at many of the conferences.

Mr. Sherwood thanked Mr. Wells for his contribution and dedication to the LAIF program.

Ms. Park announced that the next LIAB meeting is scheduled for be September 11, 2002, at 1:30 p.m., the day prior the 2002 LAIF Annual Conference.

#### **AGENDA ITEM 7: Adjournment**

There being no further business, the meeting was adjourned at 2:15 P.M.