POOLED MONEY INVESTMENT BOARD
DECEMBER 17, 2008
Staff Report – Agenda Item 7

INTRODUCTION

Prior to considering Item 8 (AB 55 Loan Applications) at the November 19, 2008 Pooled Money Investment Board ("Board") meeting, the Chair made the following statement:

> *In the event the Legislature and Governor do not enact budgetary and cash solutions in the special session that will improve the State's cash situation and enable the Treasurer's Office to resume issuing General Obligation bonds, the Chair is directing staff to provide a recommendation as soon as possible prior to the December 17th PMIB meeting regarding the approval of future AB 55 loans.*
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> *The recommendation should be based on an analysis of projected cash needs versus available cash resources. At this point, it appears likely that such a recommendation may include the identification of a point in time when PMIB should stop approving any loan increases or new loans until the State's budget situation has improved.*

Following a discussion regarding the funding of AB 55 loans, the Board voted to hold over all AB 55 loan requests until its December meeting so that the loan requests could be considered in light of the requested staff analysis. This staff report responds to the Chair's requested analysis.

AB 55 LOAN PROGRAM BACKGROUND

The Federal Tax Reform Act of 1986 imposed rebate requirements that severely limited the issuance of tax-exempt bonds. In response, the Legislature enacted Assembly Bill 55, Chapter 6, Statutes of 1987 ("AB 55"). The law established a loan program ("AB 55 Loan Program") to simplify rebate compliance and allow the orderly continuation of the State's bond programs. The AB 55 Loan Program has been very successful. Since 1987, the Board has provided tens of billions of short-term loans for State bond programs, primarily General Obligation ("GO") bond programs and the State Public Works Board Lease Revenue Bond ("LRB") program. The loans have greatly simplified compliance with federal tax laws, and provided additional, important benefits. Specifically, the AB 55 Loan Program has given departments quick access to funds by eliminating the wait for bond sales, which has increased flexibility in project planning and delivery. The loans also have provided the State Treasurer's Office greater flexibility in scheduling bond sales, and they have been solid investments for the State's investment pool.

AB 55 authorized the Pooled Money Investment Account ("PMIA") to make loans for two purposes: for State bond programs; or to prepay or replace existing financing. Since the inception of the AB 55 Loan Program, virtually all of the loans have been short-term loans for State bond programs. Loan amounts disbursed for eligible project expenditures of these bond programs are repaid from the proceeds of either a long-term State bond issue or the issuance of commercial paper notes ("CP Notes"). If CP Notes are issued, those notes are in turn paid down by the proceeds of a long-term bond issue (CP Notes can only be issued for the GO bond program). The ability of the State to access the market to sell bonds forms the basis for making AB 55 loans. The Board does not approve loans unless it determines that access exists.

Historically, the State has issued GO bonds about 6 times per year, issued GO CP Notes 3-4 times per month, and issued LRBs 5 times per year. However, due to the delayed enactment of the 2008-09 State Budget and the State's current fiscal crisis, the STO has been unable to issue GO bonds or LRBs since June. The STO also has not issued any new-money CP Notes since September 10th. The credit rating of one of the banks that provides liquidity support for the CP Program was downgraded, which has required the State to pay high interest rates for its CP. As a result of these factors, as of December 8, 2008, the amount of unreimbursed AB 55 loan expenditures had risen to an all-time high of about $5.1 billion. If departments spend AB 55 loan funds for GO and LRB programs at a $664 million per month pace for the remainder of the 2008-09 fiscal year, and if the State is unable to issue GO bonds and LRBs for the remainder of the fiscal year, the amount of AB 55 loan expenditures would reach about $9.5 billion by June.

As of December 8, 2008, $6.5 billion provided under previously-approved AB 55 loans remained unspent. The loan requests on the December 17th agenda would increase that amount by $1.7 billion to 8.2 billion.

ANALYSIS OF STATE RESOURCES AVAILABLE TO FUND AB 55 LOANS

The PMIA also provides cash-flow loans to the General Fund. On December 10, 2008, the Department of Finance ("DOF") released updated cash flow projections showing that the State would run out of money in February 2009 absent corrective actions by the Legislature and Governor. The DOF numbers do not include expenditures from the AB 55 loan accounts. That is because DOF only projects General Fund expenditures. Additionally, the DOF numbers assume– which always has been true until just recently – that the State can issue bonds to repay the loans and, therefore, AB 55 loans should not reduce the net availability of cash for General Fund operations. As discussed above, however, the State currently has no access to the bond markets, and will not until a budget solution is reached. As a result, the AB 55 loans now are competing for the same shrinking PMIA pot of money that the General Fund is using for State operations.

In addition to General Fund operations, the California Constitution and statute require the State to maintain cash sufficient to meet the day-to-day operating needs of agencies funded by special funds. Sometime before March, the General Fund will have used all of the resources that the Controller has determined that the special-fund agencies do not need for daily operations (i.e. the borrowable resources). Staff's analysis of the State's assets and cash flows convinced staff of the State Treasurer's Office that we cannot continue to fund the undisbursed amounts of already authorized loans or make new AB 55 loans without jeopardizing the special funds (see Exhibit A). The combined cash demands of the General Fund, the special funds and AB 55 loans cannot be met absent a resolution to the budget and restoration of State's ability to access the bond market. Staff believes these factors compel the Board to conserve cash in order to make payments that have a higher priority, such as for schools, debt service, special funds and others.

RECOMMENDATION

Staff recommends that the Board take the following actions:

1. Authorize the Treasurer, on behalf of the Board, to request the Governor to promptly issue an Executive Order directing all State agencies and departments with AB 55 loans to: (1) immediately cease entering into any new construction, grant, loan or other agreements that commit the expenditure of funds pursuant to AB 55 loans; (2) immediately instruct all grant or loan recipients of GO bond funds to cease from entering into any new construction or other agreements or contracts that would be funded from GO bond funds.
2. Convene a Board meeting in the first week of January 2009.
3. Approve all AB 55 loan renewals on the December 17, 2008 agenda for the amount of the existing loan amount without any increases (unless a small increase is needed to fund accrued interest and necessary administrative costs such as State employee salaries). These loans as well as all other outstanding AB 55 loans may be reduced as a result of the recommendation arising from Recommendation #5 below.
4. Delay consideration of the two new AB 55 loans on the December 17, 2008 agenda (Item 8.m for the Air Resources Board and Item 8.o. for the California Housing Finance Agency) until the meeting to be held in the first week of January, 2009 when they can be considered along with all outstanding AB 55 loans.
5. Request staff of the Department of Finance's Capital Outlay Unit and the State Treasurer's Public Finance Division to consult with the administrators of all outstanding AB 55 loans and present a recommendation at the meeting to be held in the first week of January 2009 for winding down each loan in a manner that will reduce future loan expenditures to the greatest extent possible without subjecting the State to unacceptable penalties or legal action. The cumulative future disbursements after December 17, 2008 should not exceed $500 million in order to keep the available Pool balance from going negative by June 2009.
6. Freeze disbursements, with the exception of accrued interest and necessary administrative costs (such as State employee salaries), of all existing AB 55 loans pending the recommendation of staff and action taken by the Board at the meeting in the first week of January 2009, and request staff of the State Treasurer's Public Finance Division to notify agencies and departments with AB 55 loans of the freeze.

EXHIBIT A

Projected Pooled Money Investment Account Balances
Dec 2008 - June 2009

		DEC	JAN	FEB	MAR	APR	MAY	JUN
Beginning Pool Balance - All State Liquid Assets	(1)	$ 18,100	$ 18,283	$ 15,085	$ 10,745	$ 5,512	$ 9,151	$ 3,049
Receipts	(2)	$ 23,302	$ 21,150	$ 17,936	$ 18,896	$ 33,404	$ 18,819	$ 24,333
Disbursements excluding Expenditures from AB 55 Loans	(2)	$ 22,917	$ 23,612	$ 21,568	$ 23,785	$ 28,991	$ 24,624	$ 26,225
DOF Forecast Changes in Dec	(3)	$ (201)	$ (737)	$ (708)	$ (344)	$ (775)	$ (296)	$ (306)
Ending Balance - All State Funds without AB55 Loan Expenditures		$ 18,283	$ 15,085	$ 10,745	$ 5,512	$ 9,151	$ 3,049	$ 851
Cumulative Estimated AB55 Loan Expenditures		$ 664	$ 1,328	$ 1,992	$ 2,656	$ 3,320	$ 3,984	$ 4,648
Ending Pool Balance - All State Liquid Assets with AB 55 expenditures	(4)	$17,619	$13,757	$8,753	$2,856	$5,831	-$935	-$3,797
Cushion equal to 1 week of non-GF disbursements	(5)	$4,900	$4,900	$4,900	$4,900	$4,900	$4,900	$4,900
Balance Remaining after applying 1 week cushion	(5)	$12,719.5	$ 8,857	$ 3,853	$ (2,044)	$ 931	$ (5,835)	$ (8,697)

(1)Calculation of State Pool Total Assets

Total Portfolio at 12/1/08	$62.7
Minus LAIF	-$21.0
Minus Unexpended AB55 Loan Approvals	-$6.9
Total State Assets	$34.8
Minus Loan to (receivable from) GF (based on DOF cash flows)	-$11.8
Minus AB55 Loan Expenditures (receivable)	-$4.9
Total Liquid State Assets	$18.1

(2) Source: STO Cash Management projections November 2008

(3) STO's November 2008 projections are reduced by DOF's December estimate of further revenue losses

(4) All General Fund Borrowables are exhausted from February thru June. All assets in the Pool belong to Special Funds.

(5) An amount equal to one week of non General Fund Disbursements is shown as a cushion for comparison purposes.

STO has not determined that a one week cushion is adequate.