

POOLED MONEY INVESTMENT BOARD
JANUARY 16, 2009
Staff Report – Agenda Item 7

BACKGROUND

At the December 17, 2008 meeting of the Pooled Money Investment Board (“Board”), the Board unanimously adopted a resolution that:

- Authorized a meeting to be held in January 2009 prior to the regularly scheduled January 21st meeting.
- Approved the AB 55 loan renewals on the agenda for the amount of the existing loans without any increases (unless a small increase was needed to fund accrued interest and necessary administrative costs such as State employee salaries).
- Delayed consideration of two new AB 55 loans on the agenda (Item 8.m for the Air Resources Board and Item 8.o. for the California Housing Finance Agency) until the January meeting, when they could be considered along with all outstanding AB 55 loans.
- Requested staff of the Capital Outlay Unit of the Department of Finance (“DOF”) and the Public Finance Division of State Treasurer’s Office (“STO”) to consult with the administrators of all outstanding AB 55 loans and present a recommendation at the January meeting 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 prevent the available Pooled Money Investment Account balance from going negative by June 2009.
- Froze AB 55 loan 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 subsequent action by the Board at the January meeting.

Staff also recommended that the Board authorize the Treasurer, on behalf of the Board, to request that the Governor 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 committing the expenditure of AB 55 loan funds; (2) immediately instruct all grant or loan recipients of General Obligation (“GO”) bond funds to cease entering into any new construction or other agreements that would be funded from GO bond funds. In lieu of including this recommendation in the resolution, the Director of Finance committed to accomplish this goal through other effective means.

The staff report cited the following as the basis for the Board's actions:

The STO has been unable to issue GO bonds or Lease Revenue Bonds ("LRBs") since June 2008 due to the delayed enactment of the 2008-09 State Budget and the State's current fiscal crisis. [STO also has cited weak market conditions as a reason the State has not been able to sell bonds.] The STO has not been able to issue any new-money commercial paper notes since September 10, 2008. As a result of not being able to sell bonds to reimburse AB 55 loan expenditures for GO bond and LRB funded programs, the amount of unreimbursed AB 55 loan disbursements had risen to an all-time high of about \$5.1 billion as of December 8, 2008. If departments spend AB 55 loan funds at an assumed pace of \$664 million per month for the remainder of the 2008-09 fiscal year, and if the State is unable to issue GO bonds or LRBs for the remainder of the fiscal year, the amount of unreimbursed AB 55 loan disbursements would reach approximately \$9.5 billion by June.

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 State statutes 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 expended all resources that the Controller has determined 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 flow convinced STO staff that the State cannot continue to disburse unspent funds under already-authorized loans, or make new AB 55 loans, without jeopardizing the special funds. The combined cash demands of the General Fund, the special funds and AB 55 loans cannot be met absent a solution to the budget crisis and restoration of the State's ability to access the bond market.

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.

DEPARTMENT OF FINANCE ANALYSIS OF PROJECT FUNDING NEEDS

On December 18, 2008, DOF issued a Budget Letter to all State agencies and departments with AB 55 loans to inform them of the Board's December 17 actions. The Budget Letter instructed the agencies and departments to: (1) immediately cease authorizing any new grants or obligations for bond projects, including new phases for existing projects; (2) suspend all projects, excluding those for which DOF authorizes an exemption, unless the contracting entity can continue with non-state funding sources (private, local or federal funds); and (3) notify all grant or loan recipients not to enter into any new construction or other agreements that would be funded from AB 55 loans. DOF also instructed the agencies and departments to immediately report information on any project which, if suspended, would subject the State to unacceptable legal liability, fines or penalties.

Shortly after issuing the Budget Letter, DOF's Capital Outlay Unit began collecting additional project information from agencies and departments with AB 55 loans. DOF has determined that approximately 5,600 individual projects/programs will be impacted if no more AB 55/GO bond or LRB funds become available in Fiscal 2008-09. These projects are in various stages of development – in the design phase, ready to break ground, or under construction. Approximately 5,300 of those projects/programs have been stopped or will not be proceeding forward as planned until additional funding is available. Below is an overview of certain costs obtained by DOF (see Exhibit A for a breakdown of the costs by department).

- An estimated \$149 million is needed over the next six months to cover bond-funded State administrative costs, including wages.
- An estimated \$499 million is needed to pay for work already performed under State contracts.
- An estimated \$2.6 billion is needed to pay for work already performed under grants to non-state entities, including K-12 school districts and nonprofit entities. STO staff understands that the \$2.6 billion also includes costs associated with work still to be performed under existing grants.
- An estimated \$610 million would be needed to shutdown all projects.

DOF proposes that 276 of the 5,600 projects be considered for exemption from the loan disbursement freeze. The criteria used by DOF to identify the projects proposed to be exempted included, but was not limited to: the cost to shut down the project versus continuing the project; for nearly completed projects, the cost of completing the project versus legal and shutdown costs; court orders; public safety; adverse legal ramifications; and alternative funding sources. DOF estimates \$1.129 billion would be needed over the next six months to fund these projects.

BUDGET AND CASH UPDATE

The Legislature and Governor have not enacted any budget solutions since the December 17, 2008 meeting, and the STO has remained unable to issue any GO bonds or LRBs. Thus, the underlying reasons for the Board's actions at the last meeting have not changed.

POTENTIAL BOND SALES

At the time of the last PMIB meeting, inaction on the State's budget crisis and a weak market for municipal bonds created conditions under which the STO could not expect to issue GO bonds or LRBs. While the budget crisis continues, the municipal bond market has improved. Interest rates have steadily declined for four weeks, indicating increased investor demand not being met by new supply.¹ The state last week was able to complete a bond sale for the Department of Water Resources that last November had been reduced in size by two-thirds due to a lack of buyers. Some mutual funds are beginning to see net inflows providing them with funds they must invest. Given these conditions, several investment banks the STO works with now believe the State could sell GO bonds, though how long these favorable market conditions will last is unknown. In addition, there may be some investors who do not typically buy municipal bonds who may be interested in making a short-term loan to the state to enable it to continue project spending.

Accordingly, the STO is aggressively pursuing options for issuing GO bonds as quickly as possible in order to provide project funding for GO bond and LRB programs. It is premature, however, to assume a sale will be successful.

RECOMMENDATIONS

Staff recommends that the Board take the following actions:

1. **Loan Renewals.** Approve items 7.a, 7.b, 7.e, 7.f and 7.g for the amount requested (or adjusted loan amount requested if applicable). These amounts are either the amount of the current loan or are reductions from the current loan amount (the reductions are at the department's request). Approve items 7.c and 7.d for the amount of the current loan without the requested increases. Approve item 7.e.1 as requested, which includes an approximately \$3.4 million increase that is necessary for the Resources Agency to pay bond funded State staff costs for the months of December 2008 and January 2009.
2. **New Loans.** Postpone consideration of the new loans on the agenda (Items 7.h, 7.i. and 7.j.) until the next Board meeting.
3. **Outstanding Loans.** Do not decrease the loan amount for all other outstanding loans (Items 7.k – 7.ed) at this time. Staff may provide a recommendation for reducing authorized loan amounts at a subsequent meeting.
4. **Disbursement Freeze.** Continue the freeze except for a total of \$500 million of disbursements. The \$500 million should be distributed based on a determination to be made by DOF of which disbursements have the highest priority and are in

¹ The Bond Buyer 20 Bond GO Index declined from 5.85% at the time of the last Board meeting to 5.02% as of January 13, 2009.

the State's best interests. Given the lack of a budget solution to improve the State's cash position, and the lack of GO bond or LRB issuances, staff has concluded this is the maximum amount that can be expended between now and the end of the fiscal year and still provide reasonable protection against the Pool's depletion.

DOF is requested to report back at the next meeting regarding how the \$500 million has, or will be, distributed.

5. **Implementation of Disbursement Freeze.** DOF and the State Controller's Office are requested to establish a mutually agreeable disbursement approval or certification process to ensure that only the disbursements authorized in Recommendation No. 4 are made.
6. **Early February Meeting.** Staff will schedule a Board meeting in early February. The STO will provide a report at the meeting regarding the status of any completed or planned GO bond sales and whether any additional funds are available (or are expected to be available). Staff of DOF's Capital Outlay Unit and the STO's Public Finance Division will provide a recommendation for prioritizing disbursement of such funds, if available.

EXHIBIT A

Summary of PMIB Costs
(amounts in thousands)

Compiled by
Dept of Finance
As of 1/14/2009

Org Code	Organization	Bond-funded Administrative Costs (Jan-Jun 2009)	Unpaid Bills for Work Already Performed--State Contracts	Unpaid Bills for Work Already Performed--Grants	Total Unpaid Bills	Total Additional Shutdown Costs
0250	Judicial	-	2,374	-	2,374	1,083
0540	Resources Agency	5,107	1,991	13,740	15,731	80
0690	Cal EMA	800	-	4,500	4,500	-
0890	Secretary of State	-	-	-	-	-
0950	State Treasurer's Office	2,500	-	-	-	-
0977	CA Health Fin Authority	150	-	20,157	20,157	-
1760	DGS	-	93,725	-	93,725	123,485
1760	Office of Public School Construction	6,390	-	1,222,967	1,222,967	-
2240	Housing and Comm Devlpmt (1)	3,600	-	851,814	851,814	-
2260	Cal Housing Finance Agency	-	-	250,000	250,000	-
2680	CALTRANS	51,333	102,934	-	102,934	-
2685	High Speed Rail	-	4,157	-	4,157	-
3125	Tahoe Conservancy	1,399	2,082	4,848	6,730	-
3340	Conservation Corps	240	68	22	90	525
3340	Conservation Corps CO	-	3,125	-	3,125	-
3480	Conservation	948	10	902	912	-
3540	Cal Fire CO	-	2,371	-	2,371	-
3540	Cal Fire	1,244	35	610	645	-
3600	Fish and Game	10,403	6,259	1,855	8,114	-
3640	Wildlife Conservation Board	1,579	192	5,394	5,566	600
3760	State Coastal Conservancy	2,487	805	4,940	5,745	18,246
3790	Parks	10,810	2,991	8,244	11,235	7,664
3800	Various Conservancies	785	89	4,289	4,378	3,507
3860	DWR	35,729	41,582	41,436	83,018	19,109
3900	Air Board	2,000	490	41,749	42,239	507
3940	Water Board	6,756	1,429	12,461	13,890	39,130
4265	Public Health	2,975	-	52,986	52,988	-
4300	DDS	-	11,702	-	11,702	-
4440	DMH	-	7,046	-	7,046	-
5225	CDCR	-	25,894	-	25,894	19,855
5225	Office of the Receiver	-	11,950	-	11,950	10,878
6110	CDE	-	11,510	-	11,510	15,479
6120	State Library	295	110	500	610	-
6440	UC	-	31,697	-	31,697	-
6445	Cal Inst Regenerative Medicine (2)	(3,195)	-	-	-	-
6600	Hastings	-	-	-	-	-
6610	CSU	-	69,363	-	69,363	-
6670	Community Colleges	940	-	-	83,870	326,740
8860	Department of Finance	363	-	-	-	-
8950	Veteran's Affairs	-	63,343	-	63,343	23,750
TOTALS		\$ 148,953	\$ 499,324	\$ 2,627,094	\$ 3,126,408	\$ 610,618

(1) Recommended amount of \$81 million for HCD is to fund three months of cash flow for HCD loan commitments.

(2) CIRM has balance of bond proceeds available to cover these costs.