

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

Minutes
September 26, 2001

William Sherwood, acting as Chairperson for State Treasurer Philip Angelides, called the Local Investment Advisory Board (LIAB) meeting to order at 3:55 p.m., Wednesday, September 26, 2001.

AGENDA ITEM 1: Roll Call

LIAB Members present were Patricia Elliott, Leslie Wells, Robert Torrez, and William Sherwood representing State Treasurer Philip Angelides. Board Member Byron Scordelis was unable to attend. A quorum was present. State Treasurer's Office staff present were Dan Dowell, Eileen Park, Amy Pawloski, and Kim Lee.

AGENDA ITEM 2: Approval of the Minutes

The minutes of the June 6, 2001, meeting were approved as submitted with a motion by Ms. Elliott and seconded by Mr. Wells.

AGENDA ITEM 3: 2001 Annual LAIF Conference/LAIF Deposit Limit

A. 2001 Annual LAIF Conference

Ms. Park provided general information about the 2001 LAIF Annual Conference, which afforded Board Members an opportunity to ask questions about the conference. Ms. Park stated approximately 130 participants were registered to attend the conference and a maximum of 30 participants were registered for each of the two post-conference tour sessions. Ms. Park provided Board Members with a conference timetable, an agenda, and a map of the convention center. Ms. Park further stated that the conference attendance reflected the local agencies' participation in LAIF (60% from special districts and 40% from counties and cities).

Mr. Torrez asked how many LAIF participants attended the conference last year.

Ms. Park replied approximately 100 LAIF participants attended the 2000 Annual Conference. She reported that there have been a few cancellations due to traveling concerns after the September 11th terrorist attacks, but additional cancellations were not expected.

B. LAIF Deposit Limits

Ms. Park stated that the agenda includes a staff report, which was requested by the Board when it last met on June 6, 2001. As background, staff provided a table which detailed the history of LAIF deposit and transaction limits.

Ms. Park reported that during the first few years of the LAIF Program, between January 1977 to April 1981, the State Treasurer had no limit on the total amount on deposit per agency or the number of transactions processed per month per agency. In April 1981, the LAIF program implemented the first limit on deposit balance and the number of transactions to control the volatility in the dollar volume and workload, which adversely effected the State's portfolio and investment operations. Since then, the LIAB has periodically advised the State Treasurer on the policies affecting the acquisition, retention, management and disposition of LAIF dollars that are held in trust by the State Treasury, including assessing the need to increase total dollars deposited by an agency or monthly transaction limits. The last time the Treasurer increased the LAIF deposit limits was on July 1, 1998 (as requested by the LIAB). The deposit limit was raised from \$20 million per account to its current level of \$30 million.

Ms. Park stated that the data indicates about 200 accounts (9% of the active regular accounts) may increase their deposits if the policy is changed to allow for deposits in excess of the current \$30 million limit. As of August 31, 2001, there were 67 accounts at the \$30 million balance limit. There were also 133 accounts with balances between \$25 million and \$29.99 million. When Mr. Sherwood and Ms. Park participated on a panel at the California Municipal Treasurers Association Annual Conference in April 2001, many local officials asked if the State Treasurer's Office would consider a deposit limit increase. Similar requests have also come from other local government officials whenever the Investment Division staff participated in local and regional government meetings. Ms. Park asked the Board Members if they had received any requests from participants about increasing the LAIF deposit limit.

Mr. Wells stated that he had polled some of his contacts regarding this issue. About one-half of the agencies he polled felt an increase in the LAIF deposit limit was not needed while the other half (with \$25 million to \$30 million in balances) felt they would like to see the deposit limit increased. He explained that since Orange County's bankruptcy in December 1994, local agencies' investment policies have been revised to place limits on exposures to all securities, including LAIF deposits. Mr. Wells further stated that many of the counties felt the state was pulling money from county pools when deposit limits were increased. Mr. Wells asked about the impact to LAIF and PMIA operations if the deposit limit were increased. As he recalled for other Board members, the reason for implementing limits for LAIF is due to the fact that the LAIF monies are *hot monies*, which means these voluntary monies can leave the Fund on demand.

Mr. Dowell stated that there would be no significant impact to the LAIF or to PMIA operations. He said that even if all 200 agencies were to increase their deposits by \$5 to \$10 million, that would only increase the Pool by \$1.0 to \$2.0 billion. The current rate declining interest rate environment provides the impetus for local agencies to ask the State Treasurer's Office for the policy change, since the Pool is about 150 basis points over other investment alternatives due to the structure of the Pool. When interest rates start to increase, it is expected that LAIF will lose some dollars to other investment alternatives. As such, the potential increases and decreases to the LAIF, and to the Pool, are manageable. To address the counties' concerns as raised by Mr. Wells, Mr. Dowell suggested that any action to increase the deposit limit should also include a sufficient lead-time so that the change in LAIF policy would not be a detriment to other pools. This accommodation should address some of the concerns about the funds being withdrawn from county pools.

Mr. Sherwood stated a commitment was made to local agencies to give prior notice about policy changes for the LAIF Program after the limit was increased in 1998. Mr. Sherwood further stated, if this Board decides to recommend an increase to the LAIF deposit limit to the State Treasurer - how many days notice should be given to the other portfolios in preparation for a deposit limit increase. LAIF will communicate to counties, cities and other entities through their associations and provide as much notice as possible. Mr. Sherwood explained that once the Board Members recommend an increase to the deposit limit, the State Treasurer would consider the recommendation.

Staff supports the policy change.

Mr. Dowell stated that the State Treasurer's Office is considering the increase to the deposit limit as requested by the LAIF participants and this Board. Advance notice will be provided to local agencies so that those affected by the deposit limit increase can prepare portfolios for liquidity.

Board members discussed the amount for the deposit limit increase. Mr. Torrez suggested increasing the deposit limit by \$10 million to \$40 million and all other Board Members agreed.

Ms. Elliott stated that she was in support of the policy change. She said that the Eastern Municipal Water District would increase their balance to the new limit, if recommended and implemented. Ms. Elliott suggested giving counties at least a 30-day notice on any policy change.

Mr. Sherwood stated that notice of the policy change would be released as soon as the Treasurer approves the action. Staff will work with the city treasurers, county treasurers, municipal finance officers, and special districts associations to get this information out to their constituents.

Mr. Dowell suggested that the policy change be effective at the end of an accounting period so that the change would not interfere with local agencies' earnings and reporting systems that have already been forecasted for the end of the quarter.

Mr. Torrez and Mr. Wells agreed that January 1, 2002 would be the appropriate day to make the deposit limit increase effective. Discussion ensued regarding the amount of the recommended increase \$5 million or \$10 million.

A recommendation was approved by Board Members to increase the LAIF deposit limit on regular accounts beginning January 2, 2002, (the first working day of the year) to \$40 million, as motioned by Ms. Elliott and seconded by Mr. Wells. LIAB's recommendation will be forwarded to the State Treasurer for his consideration.

AGENDA ITEM 4: Overview LAIF Operations & PMIA Performance

LAIF Operations

Ms. Park provided a brief report with graphics on LAIF Operations. Ms. Park also reported on LAIF functions affected by the terrorist attacks on September 11, 2001. The LAIF window was closed about 10 minutes early, at approximately at 9:50 a.m., as requested by the State Controller's Office and the banks. LAIF provided emergency liquidity to several agencies that had monies in New York institutions and that were not able to access their funds due to the crisis. These agencies also re-deposited these same funds the next day or when funds became available from their New York institutions. Prior to evacuating the office on September 11th, staff recorded on the voice mail service that the office was closed due to the emergency and the LAIF cell phone numbers were provided for further contact.

Mr. Sherwood stated that there is a long-term emergency plan in place for both Investment and LAIF operations. The Investment Division has off-site emergency capabilities and the LAIF database is downloaded everyday. The Investment Division has access to backup computer systems for its investment and LAIF programs. However, if the entire system were to go down, LAIF would have to process the transactions manually. The ability to execute investment and LAIF transactions also depends on the operations of the State Controller, the depository banks, the Fed wire system, and others. Mr. Sherwood reported that the SCO committed to allowing LAIF to send money without a warrant - a tremendous act of cooperation during this emergency situation on September 11.

Mr. Dowell stated that the LAIF process was discontinued early because the channels that required the SCO's and the depository banks' operations were narrowing. Mr. Dowell felt it was important to clear the LAIF transactions already processed to meet the needs of local agency clients. All LAIF claims were prepared and cleared by 10:10 a.m. Once the office was closed down, staff was able to run Investments and LAIF off-site within 20 minutes.

Ms. Elliott asked if this emergency process would be discussed at the conference. She commended the staff for keeping the Board members informed during the emergency and stated that how staff dealt with the emergency should be shared with the LAIF participants.

Mr. Wells and Mr. Torrez also commended the Investment Division staff's preparedness for the emergency and for keeping the Board members informed during the crisis.

Mr. Sherwood said that both Mr. Dowell and he would discuss Investment's and LAIF's emergency plans and the liquidity of the Fund at the conference.

Mr. Dowell reiterated that while the State Treasurer's Office could not provide guarantees for the program since the State Treasurer Office does not control outside departments or the banking system; LAIF participants should receive their requested funds as long as these systems are in operation. He stated that the State Treasurer's Office would do everything in its control to make sure that local agencies have access to their funds.

Ms. Park reported that one of the State's depository banks closed early on September 11th because the facility was in the downtown corridor, which was evacuated for safety reasons. About six local agencies with corresponding banking relationships with that bank did not receive their funds. Since September 11th, the staff asked the depository banks to review their emergency plans and identify alternative sites for operation should their offices be closed in the future. The State Treasurer's Office is taking a proactive approach in working with the banks and the other parts of the system to address the weaknesses that were fleshed out during the emergency.

Ms. Park announced that the emergency cell phone numbers would be posted permanently on the State Treasurer's LAIF website.

PMIA Performance

Mr. Dowell provided a brief report on the PMIA Performance. Fed Funds are at 3% and will probably decline further. Mr. Dowell estimated a 50-basis point cut at the next Fed meeting. The PMIA portfolio is approximately \$51.5 billion and the daily earnings rate is currently 4.13%. The Pool is earning about \$5.8 million daily. The estimated apportionment rate for the LAIF participants will be about 4.48% to 4.50% for the quarter ending September 30, 2001. *Based on the current rates and market environment*, estimated apportionment rates for the quarter ending December 31, 2001 about 3.75% to 3.80%, for the March 31, 2002 quarter about 3.25% to 3.30%, and for the quarter ending June 30, 2002 about 3.00%. The September 11th attacks probably pushed back any economic recovery by about three months.

The average life of the portfolio is about 157 days. Mr. Dowell explained that with a shorter average life, it would not take as long for the portfolio to react, if and when, interest rates start to rise.

On the *Double Bottom Line* issues, the next delivery of agency mortgages for under-served areas is expected to settle at the end of October. These agencies are about \$200 million, with a five-year average life, yielding about 6.02% for the portfolio. These securities were priced up-front when the mortgages were being gathered and the note was being structured. The current 5-year Treasury note is trading at about 3.8%.

AGENDA ITEM 5: Public Comment

There was no public comment for this meeting.

AGENDA ITEM 6: Other Business

Mr. Wells suggested looking at an alternative means to communicate with more of the LAIF participants via teleconference or other mediums. He indicated that the California Municipal Treasurers Association is looking at this issue to try to get more information out to their constituents. Mr. Wells and Ms. Elliott suggested polling the LAIF participants to see if they are interested in receiving LAIF conference and training information in other formats.

Mr. Sherwood directed Ms. Park to look into technology that would make it possible for more participants to receive information from meetings as they happen.

Board Members agreed to meet in late January or early February. LAIF staff will communicate with Board members to schedule the meeting.

AGENDA ITEM 7: Adjournment

There being no further business, the meeting was adjourned at 4:50 p.m.