



# Monterey County Office of Education

*Leadership, Support, and Service to Prepare All Students for Success*

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*Dr. Nancy Kotowski  
County Superintendent of Schools*

November 19, 2008

TO: Monterey County Chief Business Officials  
FROM: Garry P. Bousum, Associate Superintendent  
Administration and Business Services  
SUBJECT: Quarterly Treasurer's Report

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Enclosed is a copy of the Monterey County Treasurer's investment report for the quarter ending September 30, 2008. This report has been submitted to the Monterey County Board of Supervisors, reviewed by the Monterey County Treasury Oversight Committee, and distributed to all agencies participating in the Treasurer's investment pool.

This report should be helpful to districts in complying with Government Code 53646, requiring that District Chief Fiscal Officers render a quarterly report to their Boards of Education.

If you need further information regarding this report, please feel free to contact either Lou Solton (755-5015) or me (755-0307) for assistance.

GPB:cd

Enclosure



## MONTEREY COUNTY BOARD OF SUPERVISORS

<b>MEETING:</b> November 4, 2008 – 1:30	<b>AGENDA NO:</b>
<b>SUBJECT:</b> Approve amendments to the Treasurer's Investment Policy re-establishing the Monterey County Treasury Oversight Committee and making certain technical corrections; and receive and accept the Treasurer's Report of Investments for the quarter ending September 30, 2008.	
<b>DEPARTMENT:</b> Treasurer-Tax Collector	

### **RECOMMENDATION:**

It is recommended that the Board of Supervisors:

1. Approve Amendments to the Treasurer's Investment Policy re-establishing the Monterey County Treasury Oversight Committee and making certain technical corrections; and
2. Receive and accept the Treasurer's Report of Investments for the quarter ending September 30, 2008.

### **SUMMARY:**

Upon recommendation of the Treasurer, the Board of Supervisors dissolved the Treasury Oversight Committee on August 15, 2005. The Treasurer is requesting the Treasury Oversight Committee be re-established to provide further transparency to the investment oversight process.

Government Code Section 53646 (b) requires the Treasurer submit a quarterly report of investments. The attached Exhibit B describes the investment portfolio position by maturity range as of September 30, 2008 along with a narrative review of portfolio activity for the quarter. Exhibit C is an independent review of the investment portfolio by the firm of PFM Asset Management, LLC.

### **DISCUSSION:**

The proposed Investment Policy re-establishes the Treasury Oversight Committee and makes certain other technical amendments (Exhibit A). During the period from 1995 to 2005 the Monterey County Treasurer coordinated the statutorily mandated County Treasury Oversight Committee. In 2005, legislation was enacted that removed the mandate for Treasury Oversight Committees. Subsequently, and by a unanimous vote of Committee members, the Committee was dissolved following Board approval. The current financial climate supports the re-establishment of the Treasury Oversight Committee. The Treasurer is seeking Board approval through amendments to the Treasurer's Investment Policy establishing a member committee of finance executives from school and special districts and the County of Monterey. The Treasurer will return to the Board with final recommendations on membership and Committee Charter within the next 60 days.

Other proposed technical amendments to the Treasurer's Investment Policy reflect current State statutory and economic conditions.

During the first quarter of FY 2008-09, the investment portfolio suffered a default on two securities totaling \$30 million. Their impact and mitigation actions are described in the attached Exhibit B. On September 30, 2008, the Monterey County investment portfolio contained an amortized cost basis of \$902,431,613 spread among 49 separate investments. The market value as

of September 30, 2008 (\$865,091,886) equals 95.8%. The portfolio's weighted average yield on September 30, 2008 was 2.618% and earned income for the quarter was \$6,205,882.71, which represents a Net Portfolio Yield (365 day basis) of 2.607%. The weighted average maturity of the portfolio was .35 years (127.5 days). The Treasurer's investment portfolio is in compliance with all provisions of the adopted Investment Policy and with applicable provisions of State statutes. The sources of market values and prices were Bloomberg LLP., Union Bank of California, and certain securities dealers. The Treasurer's report includes a securities listing by maturity range (Exhibit B)

Exhibit B also contains an analysis of the current market turmoil that has resulted in the default of two securities totaling \$30 million for Monterey County during the quarter. The at-risk assets include a \$10 million Lehman Brothers Holding Company medium term note and a \$20 million Washington Mutual Bank medium term note. The Treasurer, along with other County Officials, is aggressively pursuing a maximum possible recovery of the defaulted securities.

In order to provide transparency, the Treasurer solicited an independent analysis of the investment portfolio. That analysis concludes the portfolio is strong in its credit quality and liquidity. The report was prepared by PFM Asset Management, LLC and is attached as Exhibit C.

**OTHER AGENCY INVOLVEMENT:**

A copy of this report will be distributed to all agencies participating in the Treasurer's investment pool. County Counsel has approved the amendments to the Treasurer's Investment Policy. The firm of PFM Asset Management, LLC has prepared a securities analysis of County investments (Exhibit C).

**FINANCING:**

Adoption of the recommendations pertaining to the re-establishment of the Treasury Oversight Committee will not have any fiscal impact on the General Fund.

The investment portfolio contains sufficient liquidity to meet all projected expenditures over the next six months. Budgeted interest income for FY 2008-09 is \$1.25 million. Depending on the outcome of mitigation pertaining to the at-risk securities, there may be a loss of revenue to the General Fund. A final determination of any investment losses and their impact on the General Fund will be presented when all recovery efforts are concluded.

Prepared by:

Approved by:

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Richard N. Smith  
Revenue Manager  
Treasurer-Tax Collector Department  
October 30, 2008

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Lou Solton  
Treasurer-Tax Collector  
October 30, 2008

cc: County Administrative Office  
County Counsel  
Auditor-Controller – Internal Audit Section  
All depositors

**Attachments:**

Exhibit A – Proposed Investment Policy – FY 2008-09  
Exhibit B – Investment Portfolio by Maturity Range – 9/30/08  
Exhibit C – Independent Review of Investment Portfolio by PFM Asset Management, LLC  
Exhibit D - Investment Policy FY 2008-09 strikethrough version

## Exhibit A

### TREASURER-TAX COLLECTOR County of Monterey Investment Policy

#### 1.0 Policy.

It is the policy of the Treasurer-Tax Collector of Monterey County to invest public funds in a manner which provides for the safety of the funds on deposit, the cash flow demands, or liquidity needs of the treasury pool participants, and the highest possible yield after first considering the first two objectives of safety and liquidity. In addition, it is the Treasurer-Tax Collector's policy to invest all funds in strict conformance with all state statutes governing the investment of public monies.

#### 2.0 Scope.

This investment policy applies to all financial assets of the treasury pool participants. These funds are accounted for in the annual Financial Reports of the County and each of the treasury pool's participating agencies.

**2.1 Participating Agencies.** Participants in the Treasurer's investment pool shall be limited to the County of Monterey, school districts within Monterey County and those special districts, which, by statute, maintain depository authority with the County Treasurer.

**2.2 Outside Agency Participation.** It is the Treasurer's policy to prohibit any voluntary agency participation in the treasury pool.

#### 3.0 Prudence.

The county treasurer is a trustee and therefore a fiduciary subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, the county treasurer shall act with care, skill, prudence and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the county and the other depositors. Within the limitations of this section and considering individual investments as part of an overall investment strategy, a trustee is authorized to acquire investments as authorized by law. Nothing in this Chapter is intended to grant investment authority to any person or governing body except as provided in Sections 53601, 53608, and 53635, of the Government Code.

#### 4.0 Objectives.

The primary objectives, in priority order, of the County of Monterey's investment activities shall be:

**4.1 Safety.** Safety of principal. Investments of the County shall be undertaken in a manner that seeks to ensure preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses do not exceed the income generated from the remainder of the portfolio.

**4.2 Liquidity.** The investment portfolio shall remain sufficiently liquid to enable all depositors to meet all expenditure requirements that might be reasonably anticipated. A minimum of 30% of the invested assets, including cash held in commercial bank accounts, shall be kept in

overnight liquid assets. In the event that unforeseen cash-flow fluctuations temporarily cause the ratio of overnight liquid assets to decline below 30% of the portfolio balance, no new investments will be made until the minimum ratio is restored.

**4.3 Return on Investment.** The County's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the County's investment risk constraints and the cash flow characteristics of the portfolio.

#### **5.0 Delegation of Authority.**

Authority of the Treasurer-Tax Collector to manage the investment program is derived from Section 53608 and 53635 of the Government Code of the State of California. The Treasurer- Tax Collector shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include reference to: safekeeping, master repurchase agreements, funds transfer agreements, collateral/ depository agreements and banking service contracts. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Treasurer-Tax Collector. The Treasurer-Tax Collector shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

#### **6.0 Conflict of Interest.**

Pursuant to Article 2 (commencing with Section 87200) of Chapter 7 of Title 9 of the Government Code and the regulations of the Fair Political Practices Commission enacted pursuant thereto, the Treasurer-Tax Collector shall disclose his investments, interests in real properties, and any income received during the immediately preceding 12 months. Such disclosure shall be in writing, and shall be filed with the officer designated by law within the time periods specified by law.

**6.1 Acceptance of Gifts.** The Treasurer-Tax Collector and all deputized departmental staff are prohibited from accepting any monetary or in-kind gift from any broker, dealer, or firm doing business or seeking to do business with the Monterey County Treasurer.

#### **7.0 Authorized Dealers and Institutions.**

The Treasurer-Tax Collector will maintain a list of broker/dealers and institutions authorized to provide investment services. Repurchase agreements and reverse repurchase agreements shall only be made with primary dealers designated by the Federal Reserve Bank. The Treasurer-Tax Collector may impose additional qualifications of brokers and their firms in order to ensure professionalism and suitability. At a minimum, all broker/dealers and/or financial institutions authorized to provide investment services to Monterey County shall meet the following criteria:

- 1 For commercial banks and saving institutions, must be authorized as insured with the FDIC, SIPC, or NCUA (credit unions), as applicable.
- 2 Must hold an active corporate registered status with the Secretary of State (California), or an out-of-state counterpart agency.
- 3 For commercial banks and savings institutions, must be nationally or state chartered, or be a state licensed branch of a foreign bank.
- 4 Must be an active member of the National Association of Security Dealers.

**7.1 Limitations on Political Contributions.** Pursuant to Government Code Section 27133 (c), the

Treasurer-Tax Collector shall not select for business any broker, brokerage, dealer, or securities firm that has, within any consecutive 48-month period following January 1, 1996, made a political contribution in an amount exceeding the limitations contained in Rule G-37 of the Municipal Securities Rulemaking Board, to the county treasurer, any member of the Monterey County Board of Supervisors, or any candidate for those offices.

## **8.0 Authorized and Suitable Investments.**

The Treasurer-Tax Collector of Monterey County may invest in any security within the limits authorized by Section 53635 of the Government Code of the State of California, and within the limits of any other Government Code Statute that permits public agency investment in various securities or participation in investment trading techniques or strategies. Permissible investments are detailed in Appendix A.

**8.1 Limitations.** The Treasurer shall not invest in any security not previously purchased prior to January 1, 1995, which, by its structure, term or other characteristics, has the possibility of returning a zero or negative yield or could be subject to a loss of principal at the time such security has attained its maturity date. Investments shall not be made in inverse floaters, range notes, and interest-only strips.

**8.2 Reverse Repurchase Agreements.** Any reverse repurchase agreement where securities were not purchased previous to January 1, 1995, shall have a maximum maturity of 92 days, and the proceeds shall not be invested beyond the expiration of the reverse repurchase agreement. The maximum amount of Reverse Repurchase Agreements shall be limited to 20% of the portfolio's book value on the date of the transaction.

**8.3 Securities Lending.** The Treasurer may engage in securities lending programs through nationally recognized counter parties, with a 20% restriction based on the portfolio's book value on the date of the transaction. Instruments involved in a securities lending program are restricted to those securities provided in Government Code Section 53635 and the County Investment Policy.

**8.4 Maximum Credit Exposure.** The Treasurer shall limit the investments in any single issuer, regardless of the combination of asset class, to no more than 10% of the portfolio's twelve month projected minimum size. Obligations of the United States Treasury and its Agencies are exempted from this restriction.

## **9.0 Safekeeping and Custody.**

All security transactions, including collateral for repurchase agreements, shall be conducted on a delivery-versus-payment basis. Securities shall be held by a third-party custodian designated by the Treasurer-Tax Collector and evidenced by safekeeping receipts and tri-party master repurchase agreements. Securities acquired through reverse repurchase agreement transactions may be held as collateral by primary dealers acting as counter-parties.

## **10.0 Criteria for Withdrawal of Funds from the Treasury Investment Pool – Section 27136 and Section 27133 (h) - Government Code.**

The County Treasurer is defined by statute (Government Code Sec. 27000.3) as a fiduciary subject to the prudent investor standard. The Treasurer shall have exclusive authority to approve any withdrawal request predicated on the impact such withdrawal may have on other depositors and other criteria incorporated in the Treasurer's Investment Policy.

An agency having funds on deposit in the county treasury investment pool, and where such agency possesses specific statutory authority to separately invest funds on deposit in the county treasury, may make application to the Treasurer for the withdrawal of funds. All such applications must be in writing and be received by the County Treasurer at least

30 days in advance of the first anticipated date of withdrawal. All application for withdrawal requests must include the following:

1. A resolution of the governing body of the requesting agency declaring a surplus of funds targeted for separate investment. The resolution must state the specific purpose for the withdrawal of funds and incorporate all of the following elements:
  - a) an investment plan specifying the first target date of withdrawal,
  - b) complete details of how, where, and by whom the targeted funds would be managed,
  - c) a statement of compliance assuring that all targeted funds would be managed in full accordance with all laws pertaining to the investment of public funds,
  - d) complete explanation of how the targeted investment funds would interface with the agency's operating account including the account reconciliation process, the specific source of all audits of the investment funds, and an explanation of how the agency plans to coordinate and balance externally invested funds with the agency's general ledger;

1 An investment policy adopted by the governing board of the requesting agency. Such policy must conform in all respects to all sections of the Government Code of California pertaining to the investment of public funds;

3. A contractual safekeeping agreement with a recognized bank or safekeeping institution providing for third party custody of invested public funds. The safekeeping agent must provide at least quarterly statements of all account activity and provide copies to the County Treasurer. The safekeeping agent must provide full delivery versus payment capability, and separate statements or other documents defining the GASB 3 investment categories encumbering invested funds. All agency deposits must conform to category 1 of GASB 3;

2 A detailed cash flow projection reflecting at least a 25% liquidity cushion where invested funds may be immediately withdrawn without the necessity to sell or liquidate other securities that are separately invested. The liquidity cushion must extend over a projected 12-month time horizon;

3 A statement of justification for withdrawal of funds. The statement must describe how the withdrawn funds would sustain their safety and liquidity on a basis comparable at least to the funds on deposit in the county treasury investment pool.

Before any withdrawal of funds is approved by the Treasurer, the requesting agency must first meet with the Treasurer to determine whether a mutually acceptable investment plan can be arranged within the county investment pool. In the absence of such a plan, and if all conditions for withdrawal (1) through (5) are satisfied, the Treasurer shall evaluate the proposal for withdrawal. In no instance will the Treasurer approve a withdrawal request where yield enhancement is the justified purpose for the withdrawal. A written decision of the Treasurer shall be delivered to the requesting agency no later than 15 days prior to the target date for first withdrawal. All decisions of the Treasurer are final. The value of the withdrawing participants' interest in the pooled portfolio will reflect its most recent quarterly valuation.

#### **11.0 Maximum Maturities.**

Any non-marketable investments, such as time deposits, should not exceed a two-year maturity. In addition, no specific investment shall have a term remaining to maturity in excess of five years except under the following circumstances, and subject to specific approval of the Board of Supervisors:

**Bond proceeds** where the maturity term is not integral to short term cash flow needs.

**Other special purpose investments** where the maturity term is not integral to short term cash flow needs.

**11.1 Weighted Average Maturity.** The weighted average maturity of the overall portfolio shall not exceed two years.

**11.2 Money Market Pool.** The maximum maturity of investments in a money market pool shall not exceed 397 days, and the weighted average maturity of the pool shall not exceed 90 days. A Money Market Pool shall not comprise more than 10% of the portfolio's book value on the date investments are made; maximum investment in all Money Market Pools shall not exceed 20% of the portfolio's book value on the date that investments are made.

## **12.0 Audits.**

The Monterey County investment portfolio shall be subject to a process of independent review by the Auditor-Controller's internal auditor. The County's external auditors shall review the investment portfolio in connection with the annual county audit and requirements of the Governmental Accounting Standards Board.

1 **Compliance Audit** Pursuant to Government Code Section 27134, the County Treasury Oversight Committee shall cause an annual audit to be conducted to determine the County Treasurer's compliance with Article 6, Chapter 5 of Division 2 of Title 3 of the Government Code.

2 **Performance Standards.**

The investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account the County's investment risk constraints and cash flow needs.

## **14.0 Investment Policy Adoption.**

The Treasurer-Tax Collector of Monterey County shall submit the Investment Policy to the Board of Supervisors for adoption at least annually.

**14.1 Policy Amendments.** As the California Government Code pertaining to investments is amended, this policy shall likewise become amended and adopted by the Board of Supervisors. Other amendments may be recommended periodically by the Treasurer-Tax Collector.

## **15.0 Reporting.**

Pursuant to Government Code Section 53686 (b) the Treasurer-Tax Collector shall provide quarterly investment reports to the Board of Supervisors, Treasury Oversight Committee, and all pool participants. The report shall include a listing of all securities held in the portfolio. Such listing shall include investment description, maturity date, par, amortized book value and market values, and a risk measurement standard such as duration, along with a certification concerning the portfolio's available liquidity to meet expenditure requirements for the next succeeding reporting period, and disclosure of the method used to apportion investment interest. Each second and fourth calendar quarter investment report and the current investment policy shall be provided to the State Treasurer's California Debt and Investment Advisory Committee as required by Sections 8855 and 53646 of the Government Code.

**16.0 Allocation of Investment Cost.**

The costs of investing, banking, and cash management as budgeted annually and applied quarterly shall be assessed to depositing agencies at the time of quarterly interest apportionment by the County Auditor-Controller, and in accordance with Government Code statutes. Depositing agencies will receive net revenue after pro rata application of costs that correspond to a basis point reduction to earned interest rates.

**17.0 Treasury Oversight Committee** A Treasury Oversight Committee nominated by the County Treasurer and confirmed by the Board of Supervisors shall provide oversight through periodic review of the Investment Policy and compliance with such policy. The Treasury Oversight Committee, pursuant to Government Code Section 27130 et seq; shall consist of 5 members including: the Treasurer-Tax Collector, the County Administrative Officer or his/her designee: the County Superintendent of Schools, or his/her designee, a representative of the governing bodies of county school districts, and a representative of the legislative bodies of county special districts that are authorized depositors in the county treasury. The committee shall meet at least quarterly, or as needed, and shall review investment policy and report on compliance with such policy.

17.1 Treasury Oversight Committee. Pursuant to Section 27130 et seq; of the Government Code, the Monterey County Treasury Oversight Committee is established. The committee shall be subject to the provisions of the Political Reform Act of 1974, as amended (Government Code Sections 8100 et seq).

17.2 Pursuant to Government Code Section 27132.4, Committee meetings shall be open to the public and subject to the Ralph M. Brown Act (Chapter 9 (commencing with Section 54950) of part 1 of Division 2 of Title 5).

**17.3 Membership Prohibitions**

Pursuant to Government Code Section 27132.2, No member of the committee shall directly or indirectly raise money for a candidate for local treasurer or a member of the governing board of any local agency that has deposited funds in the county treasury while a member of the committee.

Pursuant to Government Code Section 27132.3, a member of the Treasury Oversight Committee may not secure employment with, or be employed by, bond underwriters, bond covered security brokers or dealers or financial services firms, with whom the Treasurer is doing business during the period that the person is a member of the Committee or for one year after leaving the Committee.

ADOPTED 11/04/2008

APPENDIX A  
Authorized Investments County General Pool

Instrument	Maximum Maturity	County Restriction	Max %/ Dollar Limit
California State Treasurer's Local Agency Investment Fund	N/A	N/A	\$40,000,000

Bonds, including revenue bonds, issued by The County, its Agencies, or authorities	5 years	N/A	10% limit/ issuer (*)
U.S. Treasury notes, bonds, bills, or Certificates of indebtedness bearing a full faith and credit pledge	5 years	N/A	N/A
Registered warrants, notes, and bonds, including revenue bonds, of the State of California and all other 49 States	5 years	N/A	10%limit/ issuer (*)
Bonds, notes, warrants, and other evidences of indebtedness issued by any local agency within California, including revenue bonds	5 years	N/A	10%limit/ issuer (*)
Obligations of federal agencies and United States government-sponsored enterprises	5 years	N/A	N/A
Bankers acceptances	180 days	N/A	40% (*)
Prime commercial paper of domestic issuers with assets in excess of \$500 million	270 days	N/A	40% (*)
Negotiable certificates of deposit issued by domestic banks, associations, and state- chartered branches of foreign banks.	5 years	N/A	30% (*)
Reverse repurchase agreements and Securities Lending	92 days matched maturities	N/A 20%	N/A
Repurchase agreements	1 year	20%	N/A
Medium term notes issued by domestic corporations and depository institutions rated "A" or better	5 years	No inverse floating rate instruments	30% (*)
Money market mutual funds Collateralized deposits and investment contracts	N/A 5 years	N/A N/A	20% Total all funds 10% any one fund 10% limit/ issuer (*)
Securitized pass through instruments rated at least "A"	5 years	N/A	20% (*)
Overall portfolio weighted average maturity			2 years(*)

*Total exposure of all asset classes to any single issuer shall not exceed 10% of the 12-mo projected minimum size of the portfolio. (\*\*) Collateralized at 102% or greater with Treasury/Government Agency assets*

## Exhibit B - Narrative

### MARKET IMPACT ON COUNTY INVESTMENTS

Over the past 6 months, all sectors of the financial markets reached critical points of volatility and correction – in most cases more than at any time since the Great Depression. Some examples include:

- Freezing of credit where banks would not lend to other banks or to commercial markets
- Housing foreclosure rates and unsold inventories reaching all-time highs
- Equity losses averaging over 30% year over year (expressed in trillions of dollars)
- Commodity prices falling over 50%
- Personal and corporate bankruptcies reaching record levels

#### **Background – Investment Portfolio**

The County investment portfolio represents assets of mandatory depositors including schools and special districts as well as all county funds. The funds are held on a relatively short term basis (average maturity all assets is 98 days) pending their use for operational expenses. Some funds are held in special investments for infrastructure needs or to match short term borrowing with investments aligned to repayment dates (e.g. TRAN proceeds). As noted in the Board adopted investment policy, all assets are invested first to preserve their safety; second, to align maturities to support liquidity needs and, as a third priority, to achieve a market rate of return.

In connection with the first priority of safety, the Treasurer invests exclusively in fixed income securities pursuant to Government Code restrictions and limits. To achieve a level of diversity, the investments include U.S. Treasuries, Government Sponsored Enterprises, corporate bonds and a substantial position in a variety of liquid (immediately available) funds. Investments in corporate bonds have ranged between 15 to 20 percent of the total portfolio assets. They are selected based on asset quality as determined by statutorily required investment grade credit ratings and are primarily investments in bonds issued by the largest and most established U.S. banks.

#### **Background – Financial Institutions**

The recent market turmoil, resulting in large part from investments in poor quality mortgages, has caused substantial stress to the entire banking community – particularly to the largest banks that generate the major source of market liquidity. As liquidity began to seize, equity holders sold their positions which drove stock prices to record low levels. This in turn prompted credit rating agencies to lower ratings on several of the largest

banks. Ultimately, this resulted in either governmental intervention, corporate mergers or bankruptcy. At the same time, investors worldwide became fearful of a total collapse of the financial infrastructure of the U.S. banking system. Most of these events have occurred within the past 90 days. Finally, in early October, following a lengthy political engagement, a financial rescue plan was signed into law known as the Emergency Economic Stabilization Act of 2008. This legislation initiated the recovery process of the core banking system participants.

### **Impact on Investment Portfolio**

As of September 30, 2008 the County investment portfolio contained 17.5% of assets in corporate bonds of the largest U.S. banks. The bonds were purchased in conformance with Government Code requirements, the adopted Investment Policy and in recognition of the required investment grade credit ratings. When market conditions deteriorated, corporate bonds of financial institutions lost their liquidity resulting in the loss of market access to the sale of those securities. Thus, the corporate bond sector of the county investment portfolio was at risk of default. In fact, two of the County's assets (Lehman Brothers Holding and Washington Mutual Bank) did default and entered into Chapter 11 bankruptcy thereby creating a potential loss of up to \$30 million.

The Economic Stabilization legislation was designed in part to prevent any further defaults to the major U.S. banks. The county investment portfolio contains the corporate bonds of most of the banks that are under specific protection against default. Therefore, it is unlikely that any other county investments are at risk of loss.

### **Recovery Efforts**

The County has retained a specialized law firm to represent its interests in securing an optimal recovery of assets encumbered in the bankruptcy. In addition, the County has joined with San Mateo County in the bankruptcy recovery effort. It is unclear at this time what the amount of or the timeframe for recovery might be.

In a separate venue, a consortium of at least 25 other California public agencies that are similarly impacted by the bankruptcies of Lehman and Washington Mutual are working together in the recovery effort. To that end, Monterey and San Mateo counties were successful in securing mitigation language that is now contained in the Emergency Economic Stabilization Act of 2008. That language is found in Section 103 of the Act and directs the Secretary of the Treasury to consider the financial stability of public instrumentalities such as cities and counties that have suffered losses in the market. In that context, the above noted 25 public agencies are in the process of submitting a joint claim for recovery of their lost assets in connection with Section 103 of the Act. Again, it is unclear at this time what the outcome of this effort may be.

Exhibit B

County of Monterey  
Treasurer's Investment Pool  
as of September 30, 2008

All Pooled Funds - Listing by Maturity

Investment Number	Description	CUSIP	Fund #	Maturity Date	Purchase Date	Coupon	Yield	Par Value	Amortized Cost Basis	9/30/2008 Valuation	9/30/2008 Market Value
<b>OVERNIGHT LIQUIDITY</b>											
11361	State Treasurers Fund LAIF	NA	1	10/01/08	01/18/08	3.054	3.054	40,000,000	40,000,000	100.0000%	40,000,000
11422	State Treasurers Fund LAIF-MPC	NA	37	10/01/08	04/03/08	4.180	4.180	40,000,000	40,000,000	100.0000%	40,000,000
10379	Calif. Asset Mgmt Fund CAMP	NA	1	10/01/08	06/26/03	2.530	2.530	76,250,000	76,250,000	100.0000%	76,250,000
11457	Calif. Asset Mgmt Fund CAMP-MPC	NA	37	10/01/08	02/21/08	2.527	2.527	883,499	883,499	100.0000%	883,499
11154	Credit Suisse Money Mkt Fund	NA	45	10/01/08	07/01/08	2.527	2.527	31,008,473	31,008,473	100.0000%	31,008,473
11471	Credit Suisse Money Mkt Fnd-SVWP	NA	44	10/01/08	12/14/06	2.688	2.688	78,995,000	78,995,000	100.0000%	78,995,000
10884	UBS Money Mkt Fnd-Santalucia Res	NA	40	10/01/08	08/01/08	2.785	2.785	3,006,640	3,006,640	100.0000%	3,006,640
11386	Canter Fitz Repurchase Agrmt	NA	1	10/01/08	07/11/05	2.508	2.508	1,006,403	1,006,403	100.0000%	1,006,403
11360	ING Repurchase Agrmt	NA	1	10/01/08	02/29/08	1.000	1.000	49,304,589	49,304,589	100.0000%	49,304,589
SUBTOTAL	OVERNIGHT LIQUIDITY	44%			01/18/08	2.000	2.000	80,005,651	80,005,651	100.0000%	80,005,651
							*Average Yield =	400,250,255	400,250,255	100.0000%	400,250,255
<b>2 DAYS TO 3 MONTHS</b>											
11470	CalTrust Medium Term Fund	NA	1	10/30/08	08/01/08	3.367	3.367	34,834,587.53	34,834,587.53	100.0000%	34,834,588
11445	Fed Home Loan Mortg Assn FHLMC	313398M67	1	10/30/08	04/25/08	-	2.134	10,000,000.00	9,883,002.76	98.760%	9,976,000
11454	US Treasury Bill	912795H46	1	10/30/08	05/01/08	-	1.705	20,000,000.00	19,972,772.22	98.937%	19,987,340
11450	US Treasury Note	812828FV7	1	10/31/08	04/25/08	4.875	4.875	10,000,000.00	10,026,538	100.344%	10,034,375
11456	Fed Home Loan Mortg Assn FHLMC	313398Q30	1	11/20/08	05/09/08	-	2.083	20,000,000.00	19,843,333	99.667%	19,933,380
11463	Federal Home Loan Bank FHLB	313384Q44	1	11/21/08	05/28/08	-	2.255	10,000,000.00	9,868,408	98.682%	9,966,200
11464	US Treasury Bill	912795H87	1	11/28/08	06/02/08	-	1.595	10,000,000.00	9,988,181	99.867%	9,986,720
11451	US Treasury Note	912828FZ8	1	11/30/08	04/25/08	4.625	4.625	10,000,000.00	10,050,514	100.641%	10,084,063
11332	Federal Home Loan Bank FHLB	313398HG7	1	12/01/08	12/03/07	2.580	2.580	20,000,000.00	19,899,330	99.875%	19,875,000
11482	Fed Home Loan Mortg Assn FHLMC	3133XNHG7	1	12/23/08	05/29/08	-	2.218	10,000,000.00	9,949,508	99.330%	9,832,950
11468	Union Bank of Calif CD	90531CUB6	1	01/12/09	07/14/08	3.050	3.050	10,000,000.00	10,000,000.00	100.0000%	10,000,000
10602	Federal Home Loan Bank FHLB	3133XAV81	1	01/23/09	03/09/04	5.320	5.320	20,000,000.00	19,888,400	99.588%	19,891,600
11202	Morgan Stanley Medium Term Note	617446ZAO	1	02/09/09	03/30/07	2.913	2.828	20,000,000.00	20,005,451	85.0000%	17,000,000
11475	US Treasury Bill	912795K59	1	02/26/09	08/29/08	1.945	1.918	10,000,000.00	9,921,889	99.512%	9,951,180
11335	Citigroup Medium Term Note	173070DW6	1	03/02/09	12/04/07	2.981	4.149	20,000,000.00	19,961,598	98.0000%	19,600,000
11476	US Treas Bill-Pebble Beach CSD	912795K83	32	03/16/09	08/18/08	-	0.823	7,000,000.00	6,973,054	99.585%	6,970,978
11478	US Treasury Bill	912795K91	1	03/26/09	09/25/08	-	1.476	20,000,000.00	19,856,758	99.348%	19,069,220
11479	US Treasury Bill	912795K91	1	03/26/09	09/30/08	-	1.410	10,000,000.00	9,931,556	99.346%	9,934,610
SUBTOTAL	- 2 DAYS TO 3 MONTHS	30%			09/30/08			271,834,588	271,344,857	98.879%	268,008,163
							*Average Yield =	271,834,588	271,344,857	98.879%	268,008,163
<b>3 TO 12 MONTHS</b>											
11287	Lehman Bros Medium Term Note	52517FG21	1	04/03/09	10/01/07	2.878	4.265	10,000,000.00	9,945,400	11.000%	1,100,000
11467	Union Bank of Calif CD	90531CUC4	1	04/09/09	07/14/08	3.070	3.070	10,000,000.00	10,000,000.00	100.0000%	10,000,000
11477	US Treasury Note	912828G99	1	04/30/09	09/25/08	4.500	1.675	10,000,000.00	10,162,565	101.656%	10,165,625
11258	Washington Mutual Med Term Note	93933VAZ1	1	05/01/09	07/12/07	2.891	3.033	20,000,000.00	19,983,180	27.000%	5,400,000
11472	Union Bank of Calif CD-SVWP	90531CUX8	44	06/24/09	08/04/08	3.000	3.000	2,000,000.00	2,000,000.00	100.0000%	2,000,000
11455	US Treasury Note	912828G96	1	06/30/09	04/28/08	4.875	2.147	10,000,000.00	10,199,591	102.250%	10,225,000
11212	Student Loan Marketing Assn SLMA	78442FDQ8	1	07/27/08	04/18/07	2.840	3.613	20,000,000.00	19,952,146	88.000%	17,600,000
11338	Merrill Lynch Medium Term Note	59018YD07	1	08/14/09	12/11/07	2.894	5.257	20,000,000.00	19,760,800	84.000%	16,800,000
11474	US Treasury Bill	912795S28	1	08/27/09	08/29/08	2.164	2.146	10,000,000.00	9,807,464	98.428%	9,842,780
11435	US Treasury Note	912828HD5	1	09/30/09	04/24/08	4.000	2.118	10,000,000.00	10,183,704	102.047%	10,204,688
SUBTOTAL	3 TO 12 MONTHS	13%			04/24/08			122,004,849	122,004,849	81.438%	93,338,093
							*Average Yield =	122,004,849	122,004,849	81.438%	93,338,093

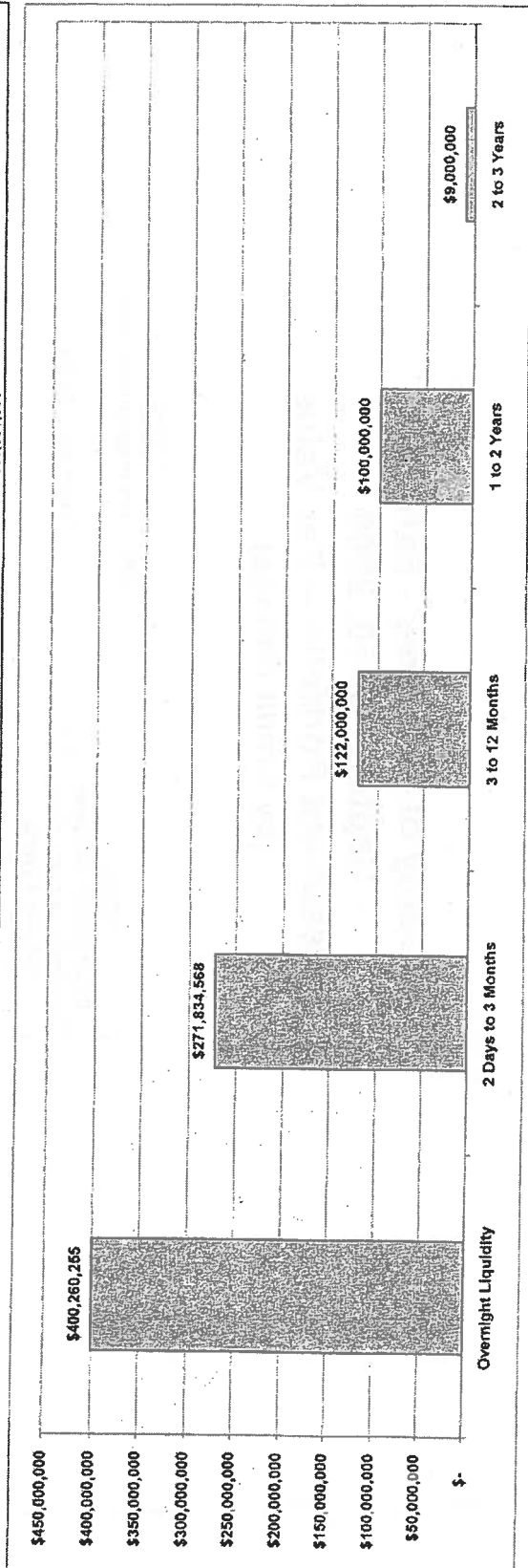
Exhibit B

County of Monterey  
Treasurer's Investment Pool  
as of September 30, 2008

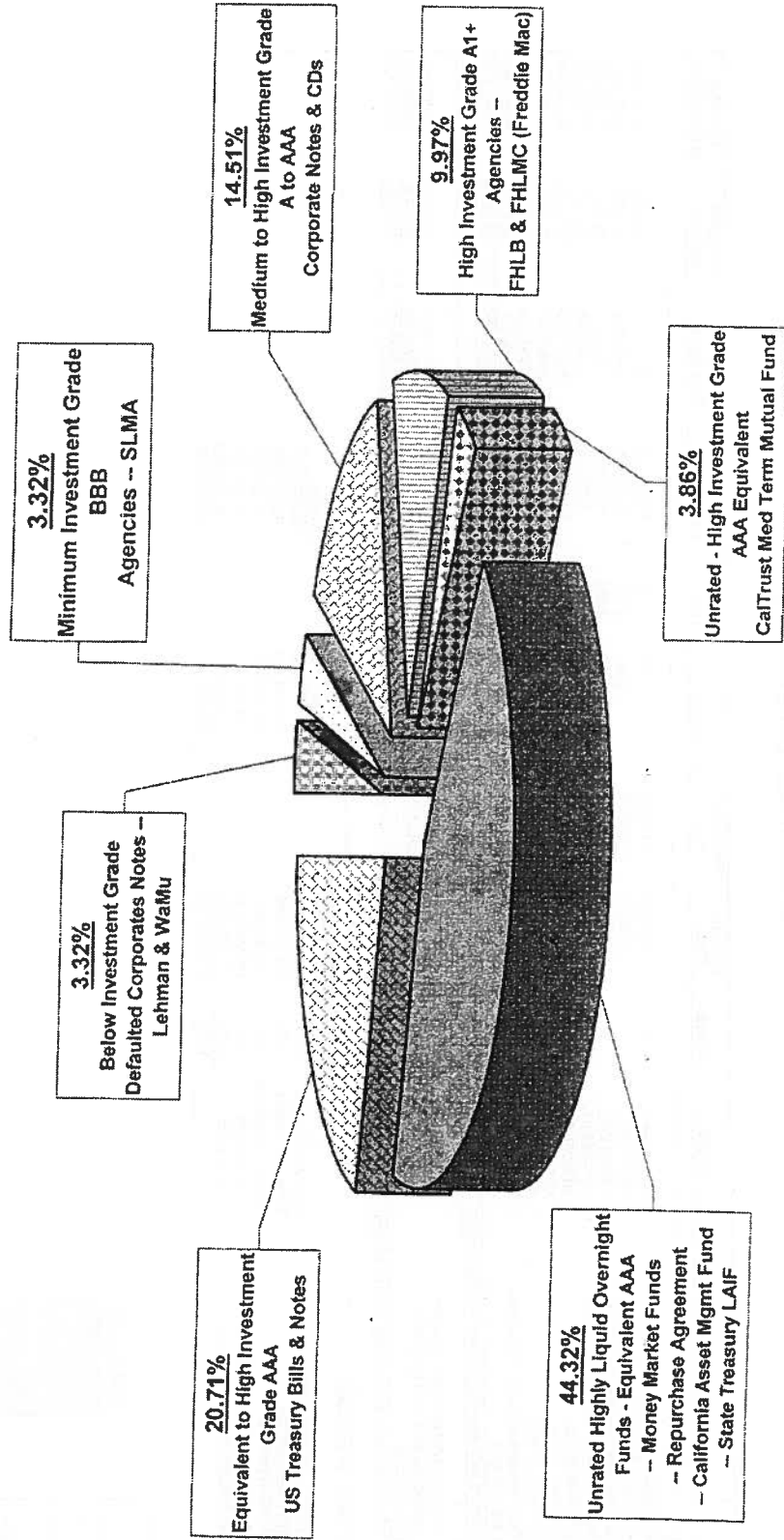
All Pooled Funds - Listing by Maturity

Investment Number	Description	CUSIP	Fund #	Maturity Date	Purchase Date	Coupon	Yield	Par Value	Amortized Cost Basis	9/30/2008 Valuation	9/30/2008 Market Value
<b>1 to 2 YEARS</b>											
11434	US Treasury Note	912828HF0	1	10/31/09	04/22/08	3.825	2.110	10,000,000	10,160,114	101.875%	10,187,500
11340	Goldman Sachs Medium Term Note	38141GET7	1	11/16/09	12/18/07	2.887	4.147	20,000,000	19,820,312	92.530%	18,506,000
11100	Student Loan Marketing Assn SLMA	78442FDA3	1	12/15/09	09/25/06	3.319	3.606	10,000,000	9,886,916	91.250%	9,125,000
11336	Morgan Stanley Medium Term Note	61746SBB4	1	01/15/10	12/10/07	3.071	4.233	10,000,000	9,886,405	74.000%	7,400,000
11432	US Treasury Note	912828HS2	1	02/28/10	04/16/08	2.000	1.820	15,000,000	15,037,112	100.109%	15,016,408
11431	US Treasury Note	912828HU7	1	03/31/10	04/16/08	1.750	1.838	15,000,000	14,981,181	99.797%	14,969,531
11453	US Treasury Note	912828HX1	1	04/30/10	04/30/08	2.125	2.423	10,000,000	9,954,384	100.484%	10,048,438
11473	Bank of America Medium Term Note	06050TLF7	1	05/12/10	05/21/08	3.404	3.286	10,000,000	10,016,311	98.000%	9,800,000
SUBTOTAL 1 TO 2 YEARS									99,852,735	94.756%	95,052,875
<b>2 To 3 YEARS</b>											
* Simple (not weighted) average yield by section											
11461	JP Morgan Medium Term Note-MPC	46625HGH7	37	05/16/11	05/22/08	2.917	3.518	4,000,000	3,944,812	89.500%	3,580,000
11420	Gen Electric Med Term Note-MPC	36982GX82	37	08/22/11	04/04/08	5.720	5.310	5,000,000	5,024,104	97.050%	4,852,500
SUBTOTAL 2 TO 3 YEARS									8,968,916	93.275%	8,432,500
* Simple (not weighted) average yield by section											

Period	Earned Income Yield = 2.671%	Weighted Average Yield = 2.618%	Weighted Average Market Valuation = 95.79%	Weighted Average Maturity = 0.35 Years
Overnight Liquidity	44%	400,260,255	400,260,255	400,260,255
2 days - 3 months	30%	271,834,568	271,344,857	268,008,163
3 months - 12 months	13%	122,004,649	122,004,649	93,338,093
1 - 2 years	11%	99,852,735	99,852,735	95,052,875
2 - 3 years	1.0%	6,968,916	6,968,916	8,432,500
<b>TOTAL PORTFOLIO - as of 9/30/08</b>	<b>100%</b>	<b>903,094,823</b>	<b>902,431,613</b>	<b>865,091,868</b>



**County of Monterey - Exhibit B**  
**September 30, 2008**  
**Investment Portfolio -- Par Value**  
**(by Credit Ratings)**



## EXHIBIT 'C'

In order to provide transparency, the Treasurer solicited an independent professional analysis of the September 30, 2008 investment portfolio. Accordingly, the financial advisory firm of Public Financial Management, Inc. (PFM) performed a detailed analysis of all assets contained in the portfolio, exempting Washington Mutual and Lehman Brothers bonds. The Treasurer has separately reported on those assets and their status in US Bankruptcy Court along with their associated recovery efforts.

In summary, PFM found the portfolio to be well diversified by sector and by issuer. In addition, PFM reported the investment sector of corporate assets is well diversified and that the assets are at or above minimum investment grade credit ratings. PFM found all assets to be in compliance with adopted investment policy and all applicable statutes of the California Government Code. In addition, PFM stated the overall credit quality of the portfolio is strong and there is sufficient liquidity to meet cash flow needs. PFM also noted the assets invested in Student Loan Marketing Association Corporation (SLM), originally, purchased at an 'A' level credit rating have reduced to minimal investment grade due to slowing economic conditions; see discussion on page 5 of PFM report. In its third quarter report, SLM stated the corporation was profitable, earning \$117 million in the quarter, or 19 cents per share. Moreover, SLM maintains \$11 billion in liquidity and excess cash flow over the next 15 months that exceeds its maturing debt by \$600 million. More importantly, SLM is largely insulated from the financial crisis because the corporation's loan portfolio is 82 percent government guaranteed. The U.S. Department of Education will fund all SLM loans through July 2010. The Monterey County SLM assets mature in 2009.

Overall, PFM has reported the Monterey County investment portfolio is safe and highly liquid with 47% of assets held in overnight maturities.



**The PFM Group**  
Public Financial Management, Inc.  
PFM Asset Management LLC  
PFM Advisors

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Suite 2300  
San Francisco, CA 94111

415-982-5544  
415-982-4513 fax  
www.pfm.com

October 22, 2008

## Memorandum

**To:** Lou Solton, Treasurer/Tax Collector  
County of Monterey

**From:** Nancy Jones, Managing Director  
Ken Schiebel, CFA, Managing Director  
Sarah Meacham, Consultant  
PFM Asset Management LLC

**Re:** Review of County Pool as of September 30, 2008

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In response to the recent turmoil in the financial markets, the County has requested that PFM Asset Management provide a review of the Monterey County Treasurer's Investment Pool. Our review is based on the County's portfolio as of September 30, 2008. The County is already aware of the issues associated with its investments in Lehman Brothers and Washington Mutual; therefore, we have excluded these securities from our review.

As with many public entities, the County's investment objectives, in order of priority, are safety, liquidity, and return on investment. In the current market environment, safety and liquidity are even more paramount, even if that means a lower yield for participants. For that reason, this memorandum will only address the safety and liquidity characteristics of the County Pool. Excluding the investments issued by Lehman Brothers, Washington Mutual, and SLM Corp (Sallie Mae), which we will discuss later, the securities in the County Pool are safe. The majority of the County's Pool is allocated to U.S. Treasuries, Government Sponsored Enterprises, investments backed by government securities, and securities in S&P's top two rating categories. 9% of the portfolio is invested in LAIF, the State of California's investment pool for local agencies, which is not rated.

The County has determined that 30% of the portfolio needs to be liquid at all times to ensure that the County can meet its cash flow needs and pool withdrawals. The portfolio currently has more than 30% of its funds in overnight investments. In addition, 21% of the Pool is allocated to highly liquid U.S. Treasuries.

### **Investment Objective: Safety**

Portfolio safety is a function of two primary elements: (1) the safety of each investment in the portfolio, and (2) diversification of the portfolio to avoid overconcentration in any one sector or issuer.

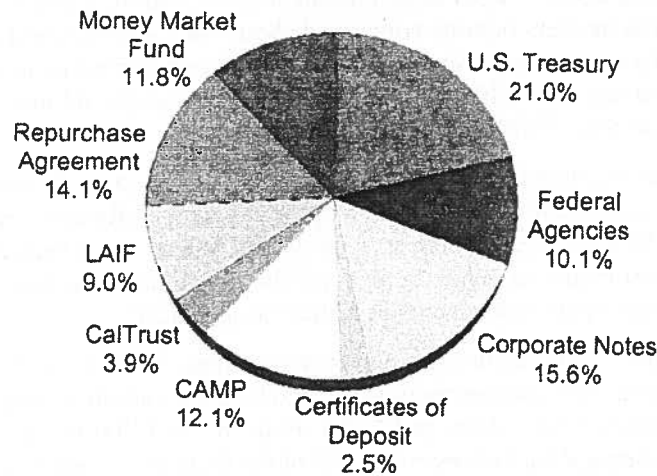
### **Diversification**

Diversification is a key element of safety. Investing in a variety of different sectors and issuers reduces the likelihood that a market disruption or credit event, such as in the current market, would



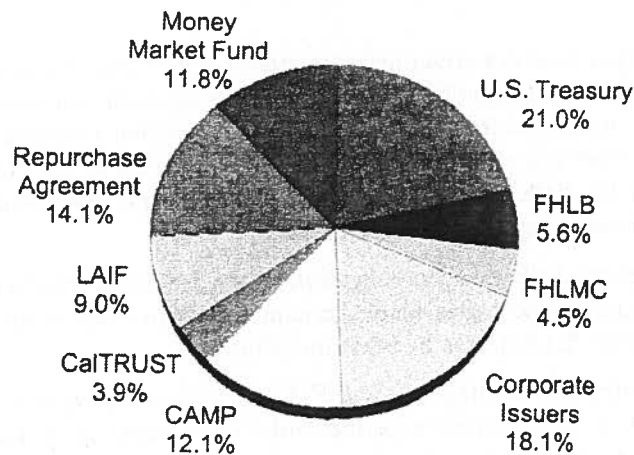
catastrophically affect the entire portfolio. The County's portfolio is well diversified by sector, as shown in the chart below.

**Distribution by Sector**  
as of September 30, 2008



The following chart shows that the Pool is also well diversified by issuer.

**Distribution by Issuer**  
as of September 30, 2008



*U.S. Treasuries*

21.0% of the County Pool is allocated to Treasuries, which are considered the safest and most liquid fixed-income investment sector, as they are backed by the full faith and credit of the U.S. Government.



#### *Government Sponsored Enterprises*

10.1% of the portfolio is invested in Government Sponsored Enterprises (GSEs)—FHLB and FHLMC.

FHLB, FHLMC, and FNMA are GSEs that were established primarily to support the housing markets. When the housing market began to deteriorate in 2006, causing a rise in mortgage delinquencies, the financial markets became concerned about the losses incurred by these GSEs. The market was especially concerned about the impact the continued housing downturn would have on the long-term financial stability of FHLMC and FNMA. The County did not, as of September 30, hold any securities issued by FNMA.

In response to the market's concerns, the Federal Government enacted the Housing and Economic Recovery Act of 2008 to support the GSEs. The Act gave the Federal Reserve the authority to lend directly to FNMA, FHLMC, and FHLB, increased the GSEs' line of credit from the Treasury, created a new, independent regulator called the Federal Housing Finance Agency, and authorized the Treasury to make direct equity investments in FNMA and FHLMC.

In September, the Treasury did in fact use this new power to place FNMA and FHLMC into conservatorship, taking over 80% ownership of these two GSEs. In addition, the Treasury made an explicit commitment to protect the holders of FNMA, FHLMC, and FHLB's senior and subordinated debt and mortgage-backed securities. All of the County's investments in FHLB and FHLMC are senior debt, and therefore, benefit from this Federal Government support and are considered safe investments.

#### *Overnight Investments*

47% of the County Pool is invested in securities with overnight liquidity, including Credit Suisse and UBS money market funds, repurchase agreements with ING and Cantor Fitzgerald, LAIF, and CAMP.

The Credit Suisse money market fund is a government portfolio, which was invested in FHLB, FHLMC and a tri-party repo with Deutsche Bank collateralized by government securities as of September 30. The Fund has opted into the Treasury's guarantee program for money market funds. Under the program, "the Treasury will guarantee the share price of shares of the Fund held by shareholders as of September 19, 2008 at \$1.00 per share if the Fund's net asset value per share falls below \$0.995 (a "Guarantee Event") and the Fund liquidates."<sup>1</sup>

In addition to Agency and Agency-collateralized obligations, the UBS money market fund invests in certificates of deposit, commercial paper, asset-backed commercial paper, and corporate notes. The UBS money market fund is rated AAAM/Aaa by S&P and Moody's.

The repurchase agreements with Cantor Fitzgerald and ING are both required to be collateralized at 102% of the repo value with U.S. Government securities only. The County's exposure to these financial institutions is therefore mitigated by the inherent structure of a repo and by the government-only collateral.

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<sup>1</sup> Source: Supplement to Prospectus available at <http://us.csam.com>



LAIF is the State of California's investment pool for local agencies. LAIF is not rated. As of September 30, LAIF's investment portfolio contained 21% loans, 21% Federal Agencies, 20% certificates of deposits and bank notes, 14% time deposits, 14% commercial paper, 8% Treasuries, 2% mortgages, 1% corporate notes, and -1% reverse repos.

CAMP is a statewide JPA that was established, and is managed, by Treasurers and Finance Directors of California local agencies. Portfolio management is provided by PFM Asset Management LLC. The Pool is rated AAAM by S&P. The CAMP Pool's permitted investments are limited to U.S. Treasuries, Federal Agencies, repurchase agreements with only U.S. Treasuries and Federal Agencies as collateral, certificates of deposit, commercial paper, and bankers' acceptances with sector and issuer limits consistent with the California Government Code. CAMP's weighted average maturity was 41 days as of September 30.

*Variable Share Price Bond Fund*

CalTrust is another statewide JPA. CalTrust's Medium Term Fund is not rated. As of September 30, the CalTrust Medium Term Fund was invested in 39% Agencies, 23% corporate notes, 15% commercial paper, 10% money market funds, 6% mortgage-backed and asset-backed securities, 5% certificates of deposit, 2% Treasuries, and 1% repo. The Fund does not maintain a stable share price/net asset value (NAV). As of September 30, the Fund's NAV was \$9.80 for every \$10 of deposits. The duration of the Fund was 1.04 years as of September 30.

*Corporate Issuers*

The County's corporate exposure is well diversified. The table below provides details about the County's corporate issuer diversification and credit ratings.

**Details of Corporate Issuers**

Security Type Corporate Issuer	% of Portfolio	S&P	Credit Ratings	
			Moody's	Fitch
<b>Corporate Notes</b>				
Morgan Stanley	3.4%	A+	A1	A
Sallie Mae	3.4%	BBB-	Baa2	BBB
Citigroup	2.2%	AA-	Aa3	AA-
Goldman Sachs	2.2%	AA-	Aa3	AA-
Merrill Lynch	2.2%	A	A2	A+
Bank of America	1.1%	AA+	Aaa	A+
General Electric	0.6%	AAA	Aaa	not rated
JP Morgan Chase	0.4%	AA-	Aa2	AA-
<b>Certificates of Deposit</b>				
Union Bank of CA	2.5%	A-1	P-1	F1

The County's holdings of corporate notes are in compliance with the maximum 30% allocation stipulated in the County's investment policy. Excluding Lehman Brothers and Washington Mutual, 15.6% of the portfolio is allocated to corporate notes. The County has additional corporate exposure with the 2.5% allocation to Union Bank of California certificates of deposit, which are also



in compliance with the County's investment policy. The total allocation to any one issuer is less than 5%, as mandated by the investment policy.

In response to the severe market disruptions causing major financial firms to experience default, insolvency, and problems accessing credit, the Federal Government passed the Economic Stabilization Act of 2008 in September. The Act provides \$700 billion for the Treasury and Federal Reserve to use to provide liquidity to the cash starved financial markets. Several corporate issuers held in the portfolio—Citigroup, JP Morgan Chase, Bank of America/Merrill Lynch, Morgan Stanley, and Goldman Sachs—were part of an initial \$125 billion capital injection made to nine large financial institutions through the purchase of senior preferred shares. The direct purchase of equity stakes will immediately enhance each firm's capital position. Numerous other banks will receive a portion of the remaining \$125 billion by the end of the year. The government initiatives also included a 30-day guarantee of newly issued commercial paper and senior debt for all FDIC insured bank and bank holding companies. Additionally, the government will guarantee newly issued debt through June 30, 2012 from financial institution that opt into the program and pay a fee. This guarantee does not apply to debt issued before its inception, but does imply a higher level of ongoing financial support from the Federal Government, which will strengthen the financial condition of the firms involved.

The Economic Stabilization Act of 2008 increased the FDIC insurance for accounts held at depository institutions to \$250,000 per account holder. Accordingly, only \$250,000 of the \$30 million of Union Bank of California CDs owned by the County is directly insured by the FDIC.

The corporate issuers held in the County's Pool that are not assisted by the government's initiatives were the non-bank corporations, General Electric and SLM Corp. General Electric is a highly regarded industrial issuer, which is rated AAA/Aaa by S&P and Moody's, and is therefore a mainstay for many public investors.

Sallie Mae, the largest provider of student loans in the United States, was a Government Sponsored Enterprise until 2004 when it became a private corporation, SLM Corp. Along with the rest of the financial markets, the student loan market is in disarray, with many securities backed by student loans now in trouble, and many financial institutions refusing to offer new loans. Due to the slowing economy and the rising delinquency rates for all types of loans, SLM Corp has experienced financial difficulties, which have affected the credit quality of its debt. SLM Corp's corporate obligations now carry a BBB-/Baa2/BBB from S&P, Moody's, and Fitch, respectively, which is below the minimum credit quality allowed by the California Government Code for purchase. The credit is also on negative watch by Moody's. However, at the time of purchase, the SLM Corp investments were rated A/A2/A+, within both the limitations of the California Government Code and the County's investment policy. SLM Corp's third quarter earnings are scheduled to be released today and may provide a clearer picture for SLM Corp continued viability.

#### **Credit Quality**

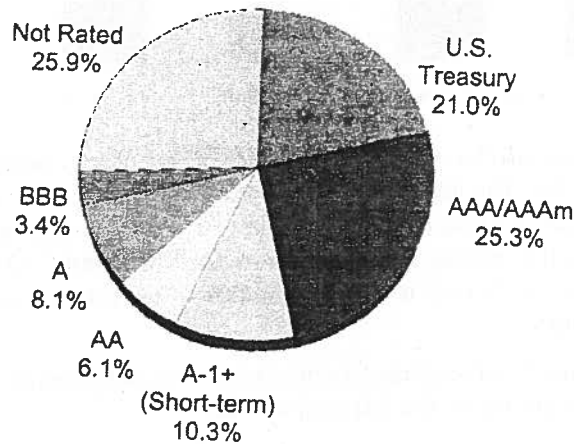
The overall credit quality of the County Pool is strong. 86.0% of the Pool is invested in U.S. Treasuries, investments in or backed by U.S. Government securities, or securities in S&P's top two rating categories (AAA/A-1+ and AA). Excluding Lehman Brothers, Washington Mutual, and SLM Corp, the corporate holdings are rated at least A, which is the minimum rating allowed by the



California Government Code. The chart below shows the breakdown of the Pool's holdings by credit quality. All ratings shown in the chart are by Standard & Poor's. The 25.9% of the portfolio that is not rated consists of the 9.0% allocation to LAIF, 3.9% in the CalTrust Medium Term Fund, 14.1% in government collateralized overnight repo, and 9.2% in a government money market fund.

The UBS money market funds and CAMP are rated AAAm by Standard & Poor's. The "m" simply denotes that the rating is for a money market fund or an investment pool with a stable net asset value (NAV). S&P's definition for a AAAm rating is that the fund's "safety is excellent [and the] fund provides superior capacity to maintain principal value and limit exposure to loss."<sup>2</sup>

**Distribution by Credit Quality**  
as of September 30, 2008



**Investment Objective: Liquidity**

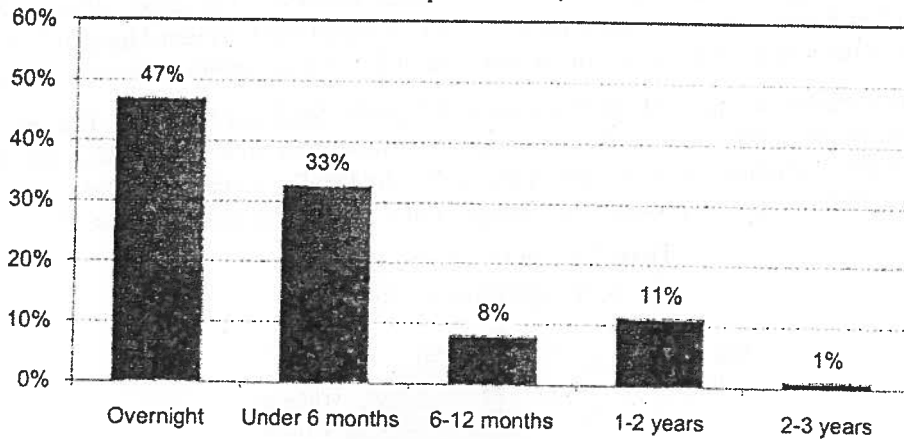
We used two criteria to determine the liquidity of the County Pool. The first and most common measurement for short-term pooled investments is the weighted average maturity (WAM) of the portfolio. The WAM viewed alongside the portfolio's maturity distribution provides a good indication of the portfolio's liquidity.

The weighted average maturity of the Pool was 0.31 years as of September 30, 2008, which is relatively short. The WAM of 0.31 years indicates that securities in the portfolio will turnover on average every 4 months. The County's exposure to interest rate movements is mitigated by the shortness of the portfolio. The chart on the next page shows that the Pool had 47% invested in securities with overnight liquidity, which is well beyond the 30% stipulated in the County's investment policy.

<sup>2</sup> Source: Standard & Poor's Fund Services, *Government Investment Pools*, Winter 2004, page 5.



Distribution by Maturity  
as of September 30, 2008



The portfolio's liquidity may also be measured by analyzing the relative liquidity of the individual securities within the portfolio. The liquidity of the portfolio is significantly enhanced by the 21% allocation to U.S. Treasuries, as Treasuries are considered the most liquid fixed-income sector. Overnight investments, such as money market funds, repo, LAIF, and CAMP, provide excellent liquidity because they allow the County to withdraw funds whenever necessary without, in general, incurring any loss of principal.

The CalTrust Medium Term Fund requires five days notice for withdrawals, and withdrawals are only allowed only once per month on the last business day.

Federal Agencies and corporate notes are less liquid than Treasuries and overnight investments. Historically, Federal Agencies were nearly as liquid as Treasuries, but in the current market, increased demand for "risk-free" Treasuries has diminished the demand for Agency debt. This has caused Agency yield spreads to widen to record levels, while bid/ask spreads (another indication of liquidity) have also widened sharply. Concerns about the financial markets and slowdown in the economy have impaired the liquidity of corporate obligations. The prices of these securities in the current market reflect a number of factors including: (1) lesser investor demand, (2) reduced earnings prospects in a slowing economy, (3) currently frozen funding markets, and (4) significant market illiquidity.

In the event that the County requires funds to meet a large volume of withdrawals, the funds maintained in overnight investments and Treasuries should provide sufficient liquidity to meet cash flow needs. Selling Agencies and corporate obligations to meet these withdrawals is not advisable in the current market.

If you would like to discuss this analysis further or have any questions, please contact Nancy Jones at (415) 982-5544.