



## OFFICE OF THE TREASURER-TAX COLLECTOR

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May 15, 2009

TO: Board of Supervisors  
Thomas G. Mauk, County Executive Officer  
Treasury Oversight Committee  
Treasurer's Advisory Committee  
Participants

FROM: Chriss W. Street   
Treasurer-Tax Collector

SUBJECT: Treasurer's Management Report for April 30, 2009

Attached please find the Treasurer's Management Report for the County of Orange for the month ended April 30, 2009. The information provided herein, including all charts, tables, graphs and numerical representations, is provided to readers solely as a general overview of the economic and market conditions which the Treasurer utilizes in making investment decisions. In addition, a complete version of this report is also available for download at our website [www.ttc.ocgov.com](http://www.ttc.ocgov.com).

### TREASURER'S REPORT

In order to assist you in reading this report, please note that the current balances reflect the investments recorded in the portfolios for each particular fund for the period ending April 30th. Each money market fund has an average maturity of less than sixty days, with a net asset value (NAV) falling within the range of \$0.9950 and \$1.0050. The Extended Fund shall have a duration not to exceed a leading 1-3 Year index +25%. All investments are marked to the market at the end of the reporting period due to the narrow valuation range prescribed by the Pools' Investment Policy Statement.

The reports reflect the par value (face value), the cost and market value (the price of each security at the close of the market on the last trading day of the month). Market values are derived from the Bloomberg Professional Service, a premier provider of instant access to real-time and historical financial data. The difference between the market value and book value is the unrealized gain or (loss). The Detail Transaction Report Section is provided in compliance with California Government Code Section 53607, which requires that the Treasurer file such a report with the Board of Supervisors, from whom his investment authority has been delegated.

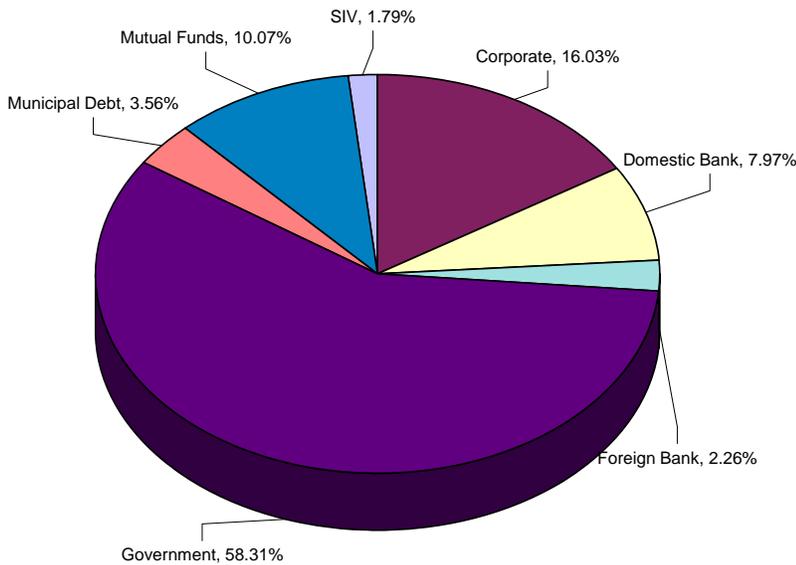
### APPORTIONMENT OF COMMINGLED POOL INTEREST EARNINGS

We have prepared a forecast for the timing of the County Investment Pool's February 2009, March 2009 and April 2009 interest apportionments. The February 2009 interest apportionment was posted to participants' cash accounts in the County general ledger on May 5, 2009. We anticipate posting the March 2009 and April 2009 interest apportionments to participants' cash accounts in the County general ledger by approximately June 9 and June 15, 2009 respectively.

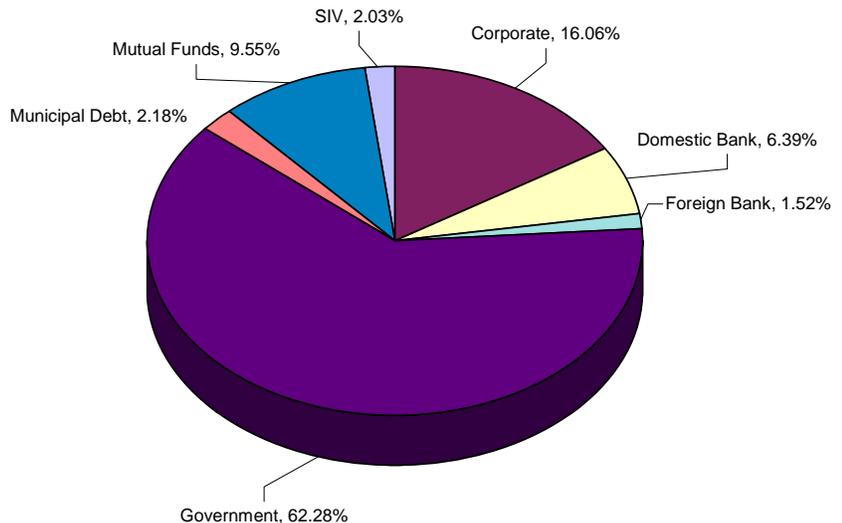
### PORTFOLIO COMPOSITION

The following graphs represent the County, School and John Wayne Airport investment pools' composition by issuer type. The County and School pools include their portion of the Extended Fund (Exhibit 1).

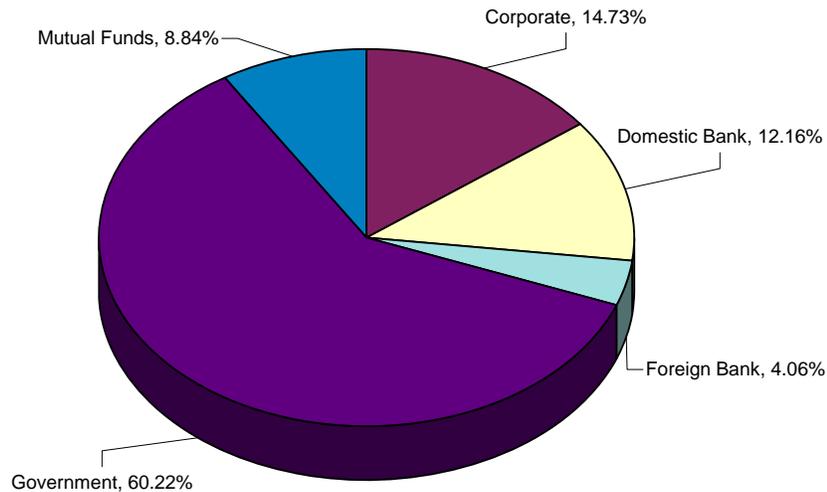
**Exhibit 1: County**



**Schools**



### John Wayne Airport



### MARKET OBSERVATIONS

The Orange County Treasurer's Office last month re-positioned the \$7 billion in portfolio assets we manage into a "neutral" strategy for interest rates. We had locked in attractive yields on both fixed rate government agency debt and FDIC backed corporate floating rate debt. During the month of April the press stories about the economy were horrendous; banks failed the stress test, California is broke, Chrysler filed for bankruptcy, mortgage defaults were up 80% and unemployment hit an all time record. We simply sighed, old news.

Investing is an art of setting rules and then having the discipline to follow those rules. The reason the Orange County Treasurer's portfolio has been in the "Top Ten" in national performance for the last two years is that we saw the credit crisis coming and went to the safety of US government securities. That strategy allowed us to achieve AAAM by Moody's Investor Service, their highest credit rating. We also earned \$521million while other funds suffered low or negative returns.

We continue to believe the recession will officially end in the Fourth Quarter of 2009 and then the gross domestic product (GDP) will only grow by approximately 1% for the next one to two years. Since the economy has historically needed 2.5% positive GDP growth

to absorb new entrants into the workforce, most Americans will continue to “feel” that the economy is in recession.

The world is experiencing a deep deflationary cycle as the prices of manufactured goods and wages continue falling. The US government is trying desperately to spend enough money to re-inflate credit growth. But they have not accepted the fact that the problem with the economy is not a lack of access to credit, but rather is the growing fear by the average citizen that they have too much debt!

Orange County Treasurer Chriss Street recently was officially invited by Congressman Campbell and Congressman Royce last month to speak in front of Chairman Barney Frank's House Financial Services Committee to oppose using US taxpayers funds being used to reimburse government investors in Lehman Brothers securities. Treasurer Street made the strong argument that Orange County did not ask US taxpayers to pay for their investment mistakes of 1994, so why should Orange County taxpayers bail out others' investment losses (Testimony Attached).

The markets clearly understand that bailouts will result in new taxes in the future. The unholy marriage of high taxes with slow growth would create an even bleaker economic outlook for our nation.

Americans are quickly unwinding the enormous level of private debt, but that progress is being offset by an unprecedented amount of government debt. As our nation's economy bottoms out, we all hope that the Federal Government will slow down its spending and prevent a permanent increase in tax burden from defeating the effort by individual Americans to “get solvent”. The sooner American families feel confident in the present, the sooner they will be willing to buy new cars and houses.

The neutral investment strategy of Orange County Treasurer's office will insure our pool participants continue to receive a competitive rate of return and stable portfolio values. The Treasurer's office appreciates your continued confidence as well as the opportunity to provide you exemplary portfolio and cash management services in the future.

The Treasurer's Office appreciates your continued confidence as well as the opportunity to provide you exemplary portfolio and cash management services in the future. Please call Orange County Treasurer, Chriss W. Street, at 714-834-7625 with any questions or to arrange a personal visit to see “Your Money”.

Honorable Chairman and Members of the Committee, Thank you for the opportunity to testify before you today.

Together, as we tackle the challenges that confront the nation, and navigate the financial sinkholes that have created uncertainty and instability, it is important to remember that each and every one of our actions will have consequences, both intended and unintended, anticipated and unforeseen. Whatever we do should be reasoned and rational.

I, more than most, understand what the local elected officials who are testifying here today are facing: angry constituents, an uncertain future and the paralyzing fear of facing a seemingly an insurmountable fiscal black hole.

Fifteen years ago, bad investments forced Orange County, California into bankruptcy. In one of the nation's most affluent counties, taxpayers remain on the hook for \$1 billion dollars of bankruptcy debt. I stood in the shoes of these local leaders.

But as a result of directly facing those challenges, Orange County came together to solve the problems and overcome the obstacles that financial collapse posed. Labor and management, conservatives and liberals, businesses and unions, the entire community pulled together and solved

our problems, without the government intervening to cover our investment losses.

Today, because of compromise and teamwork, Orange County holds the prestigious AAAM rating from Standard & Poor's ... the highest rating in the Nation and the only County in America to have achieved this recognition.

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The pleas that you hear today are heart wrenching, but the actions these good people are asking you to take ... are nonetheless wrong.

We, as state and locally elected officials, must live with the intended, and unintended, consequences of our decisions. If we do not live with the decisions and accept those consequences, we are shirking our responsibilities as leaders. We must not look to someone else to blame for our current condition ... or solve our current problems.

Bailouts will not instill the virtue of fiscal responsibility at the local level. A bailout simply masks the problem, and permits leaders to avoid the consequences of financial mismanagement. We must meet today's challenges today ... not push them down the road to our children.

And what are the known, and unknown, consequences if we cover municipal losses? Realistically, just how much more debts can the United States of America assume without threatening the AAA, Full Faith and Credit of our Nation? If the cost to the Federal Government for issuing debt increases dramatically due to a credit downgrade, all the assumptions upon which the anticipated recovery are based, will be rendered irrelevant and moot.

In the last few weeks the ten-year US Treasury Bond yields, despite billions of dollars of Federal purchases, have already climbed to 3.2 percent. That is a 25% increase in very short period of time!

Rising obligations reinforce the market's concerns about the solvency of the Debt of the United States of America. To add billions more in commitments...could be the tipping point that crushes the fragile and embryonic recovery.

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If we are going to shelter our local leaders from the consequences of their investments in Lehman Brothers, how can we stop there. Why not reimburse cities and counties for their mistaken investments in Chrysler, General Motors, AIG and Washington Mutual.

And why stop at government entities? Why shouldn't we cover the losses of our own citizens who have seen their 401k's decimated and retirement dreams destroyed by this economic tsunami? How do we determine which constituency merits a government bailout?

When we create laws, no matter how good our intentions that exempt individuals from the consequences of their actions, we eliminate responsibility and promote irresponsibility. Bailouts, no matter how lofty the original goal ... encourage bad behavior.

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Pain, however uncomfortable and difficult, is part of the healing process. From experience, I can say that living through and managing short-term pain, gave Orange County the resolve and fortitude to bring about financial rehabilitation and community healing.

I caution you as our National Leaders, to be deliberate in evaluating the legislation before you today and mindful of potentially unintended consequences. ... I urge you to vote no on this proposed legislation.



## **DANGER OF GUARANTEEING CALIFORNIA DEBT**

In the next two months, the State of California intends to bring \$15 billion in Tax & Revenue Anticipation Notes (TRANS) to the public marketplace. Due to the recent multiple downgrades of California's credit rating and deteriorating economic fundamentals, the State fears there may be no appetite to purchase new California debt. The purpose of this financing is to bridge the State's cash flow needs beyond July 2009. To enhance the offering's credit worthiness, the State is asking the US Congress to take the unprecedented step of backing the sovereign debt of the State of California with the Full Faith & Credit of the United States. There is a substantial risk that the AAA credit rating enjoyed by the United States would be cut if the US Government took this action.

### **EXTERNAL ECONOMIC ENVIRONMENT**

The United States is in the midst of a severe recession, which began in 2007 and is expected to run through the end of 2009. The sectors of the economy most severely impacted by the recession continue to be real estate and finance. Considering California was at the National forefront of both sectors for the last decade, it is logical that the current contraction will have a disproportionately negative impact on the State.

The large monetary and fiscal intervention by the US Federal Government has cushioned the initial shock of the contraction and created a favorable basis for a moderate recovery of GDP next year. Nonetheless, it will probably be at least another 5 years for the real estate and financial sector to become positive generators of growth. Absent any structural change to the California economy, the State should anticipate a slower recovery than the US in general.

### **INTERNAL ECONOMIC ENVIRONMENT**

For 35 years California has led the United States in GDP growth, job creation and standard of living. During these golden years, the State taxed, borrowed and spent itself into an increasingly uncompetitive economic position. Today California has the highest tax rates, second highest unemployment rate, highest total unemployed, lowest credit rating, highest fiscal deficit and least attractive business environment of any state in the Nation.

Although California leads the Country in net migration out of the State, it continues to enact new anti-business laws and environmental mandates. The increasingly negative business climate and punitive consumer tax structure contributes to the State's increasing deficits. Because the State has historically been able to borrow its way out of cash flow shortfalls, there has been no pressure to change this broken model.

### **PROPOSITION 13**

The State of California has historically relied on taxing real property and income to fund its operations. In 1978, a taxpayer revolt resulted in the passage of Proposition 13, which limited the increase on assessed valuations of existing properties to 2% annually. Consequently, the State increasingly relied on income tax, especially capital gains taxes, to fund budget growth.

The broad decline in real estate prices from 1990-97 predictably resulted in a significant drop in revenue for California. One of the biggest victims of the recession was the County of Orange. The County maintained its spending levels, even as revenue contracted, by increasing its reliance on speculative short-term investment earnings. Although the investments helped cover costs in the short run, the scheme ultimately proved to be a disaster and the County was forced into bankruptcy. When the County's efforts to raise sales taxes were rebuffed by voters, operations were restructured to be more efficient. In spite of a 20% revenue reduction, services continued largely uninterrupted and at a level which met all legal requirements.

### **CAPITAL GAINS FROM STOCKS AND REAL ESTATE**

From 1997-2001 Silicon Valley was the center of the universe. Capital gains taxes, a byproduct of soaring internet stock prices, filled California's coffers. The newly created wealth resulted in higher consumer spending, increased auto sales and record revenues for California. It also fueled a dramatic expansion of government programs.

When revenues fell off a cliff in fiscal year 2001-2002, the Governor and California Legislature sought to create new taxes to fill the budget short fall. Working together, they increased the marginal tax rates on high-income earners and tripled the vehicle license fee (VLF) for all car owners. The combination of progressive and regressive taxes, were wildly unpopular and led to another taxpayer revolt. The Governor was recalled, the VLF tax was rescinded and legislation was passed that permitted \$10 billion of long term borrowing to plug a current year deficit.

For the next 5 years, consumer spending and car sales accelerated, while real estate capital gains exploded. The spike in tax revenue allowed the State Legislature to increase spending at twice the compounded growth of the State GDP.

## **THE END OF CAPITAL GAINS**

Spurring the growth of the California budget was the State's phenomenally large capital gains tax base. The top one percent of earners generates 40% of the states revenues; 250,000 people have been doing the heavy lifting for a state with a population around 36 million.

From 1994 to 2007, this top-heavy tax system flourished as virtually every class of investment vehicle, including stocks, residential real estate, commercial real estate, commodities, art, collectibles, oil, gold and US Government bonds participated in a bull market. During this period of economic expansion, the state was collecting roughly \$25 billion in capital gains driven taxes.

Since the middle of 2008, most investments have declined precipitously in value. The losses associated with all investments have created tax-loss carry forwards that will offset about 80% of any capital gains tax liabilities for the next 5 years.

## **TAX AND SPEND**

In late 2008 the California State Controller's and Treasurer's offices began warning that worsening economy would inevitably result in significantly diminished revenues. The Legislature responded to this grim outlook by increasing regressive State taxes, expanding State employee head-count and passing new business restrictions. In order for the Legislature's budgetary house of cards to stand, voters must approve a series of new taxes when they go to the polls May 19. The Legislature's tax, borrow and spend initiatives will fail, according to all recent polling data.

## **STATE REVENUE CASH FLOW**

The State of California's cash flow balances rise and fall annually on a predictable cycle. Consumer sales and new model car sales generate very large sales tax and VLF revenue at the end of the calendar year. Tax revenues are paid to schools and other beneficiaries in January and reserves thus hit a low point in February.

Income and property tax collections begin in March and the State's reserves hit their annual high point in April. Reserves then decrease each month until they hit their annual low point in September.

To smooth cash flows availability, Federal Law permits the State to sell TRANS with maturities up to 210 days, or until sufficient revenue is collected to match spending activity. If the State does not have the resources to pay beneficiaries of State spending on a timely basis, the Legislature may delay the distribution of apportionments to beneficiaries.

## **WARRANTS AND RAWs**

If the State is unable to borrow money to meet their obligations, the State Controller can issue unsecured warrants, which are IOUs to vendors. The State can also sell Registered Anticipation Warrants (RAWs), which are promises to pay on a daily priority basis as cash flow is available. It is a felony for the State Controller to fail to pay RAWs as cash becomes available. RAWs would be extraordinarily attractive to investors because their priority is criminally protected against non-payment; default is not an option!

The RAWs that were issued in the last 30 years were met with strong ratings and exceptionally strong investor demand. The State has resisted issuing RAWs in the past, because RAWs require fiscal discipline; as revenue is collected cash must be immediately paid out to creditors.

Moody's and S&P have both assigned an A rating to the State of California. Given that TRANS are sold to money market funds that require a minimum rating of AA, there currently is no market for California TRANS. Issuing RAWs appears to be the only way for the State to meet its cash flow needs.

## **COMPROMISE TAX INCREASE**

In late February 2009, the California State Legislature signed a "compromise" State Budget that substantially increased taxes, and placed tax and borrowing measures on the May 19th ballot. Although the State is required to annually pass a balanced budget with a \$2 billion reserve, most State financial officers' estimate the budget will be billions in the red, even if all the initiatives passed.

Furthermore, the current budget curiously assumes that property taxes will continue to increase at 5%, while most County Treasurers forecast their collections to be flat or negative this year and down an additional 5% next year. The California Legislative Analyst March 2009 forecast is enclosed.

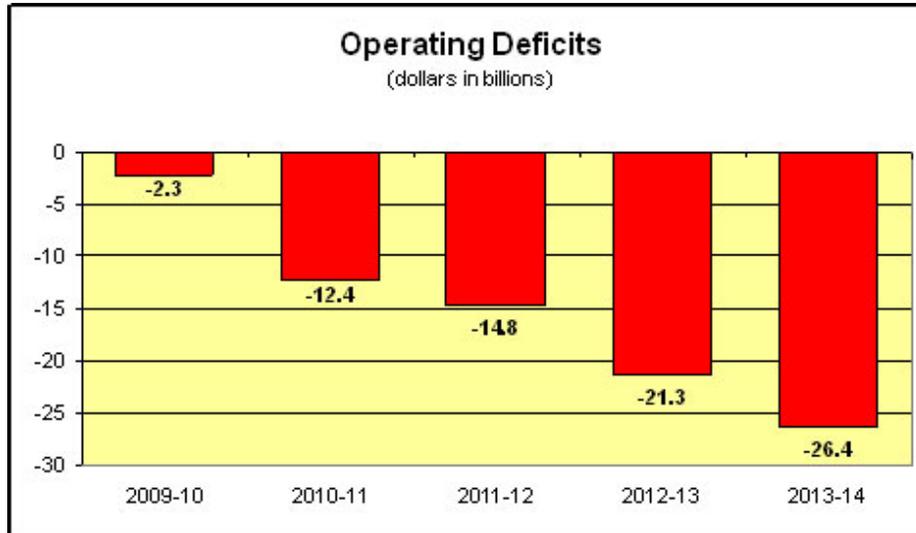
## **CALIFORNIA STATE DEBT ISSUANCE**

The Treasurer of the State of California has sold \$10 billion of bonds so far this year. Bonds issued at the beginning of the year yielded 4%, but this most recent offering saw rates with yields up to 6%; a 200 basis point increase in just a couple months!

California now has approximately \$60 billion of debt outstanding. The vast majority of the bond sales have been to individuals. Each sale of bonds included financial projections regarding the State budget that appear to have been incorrect, or unreasonably hopeful, at the time of issuance

Further borrowing by the State of California, will make higher taxes a necessity. If the Legislature fails to keep spending in line with State revenues, California risks defaulting on their bonds. The March 2009 pro forma published by the California State Legislative Analysts Office

(LAO) estimates that the State of California would face a new \$2 billion operating shortfall for Fiscal 2009-10 and a \$76 billion of annual deficits over the next 5 years (exhibit below).



These projections may be extraordinarily optimistic. The LOA's forecast assumes that all the revenue generating in initiatives on the May 19th ballot pass and that assessed property values continue to rise. As of today the ballot initiatives are trailing badly in the polls and property values continue to decline

### **ADDITIONAL BUDGET RISKS**

No commercial bank or insurance company is currently willing to provide credit enhancement to increase the rating of the State of California. The common response from lenders is that California appears to be heading for further downgrades. Lenders are concerned that exposure to California debt may drag down their own credit rating.

### **ISSUANCE OF RAWs**

There is a substantial pool of buyers for California State Revenue Anticipation Warrants. The interest rate cost to issue RAWs would be more favorable than that of recent debt offering. The only impediment is that the State Legislature fully understands issuing RAWs would legally require fiscal discipline.

## **US GOVERNMENT GUARANTEE OF CALIFORNIA DEBT**

Providing US Federal guarantees for the State of California substantially increases the RISK of the United States losing its AAA Sovereign Debt rating. Furthermore, US guarantees of California State debt would have a material adverse effect on the ability of all other municipality and state borrowers to fund, due to a “crowding out” effect; interest rates would soar for non-Federal-guaranteed debt. The United States government will inevitably become the lender of “last resort” for all government entities in California and across the United States as the contagion devastates other government issuers.

If the US government decides to aid California, it should buy RAWs, not guarantee the State’s debt. RAWs will insure that all investors get paid on time. Purchasing RAWs give the US government an avenue to aid California, without establishing a precedent that could destroy the US government’s credit worthiness.

**ORANGE COUNTY TREASURER-TAX COLLECTOR**

**EXECUTIVE SUMMARY**

**May 1, 2008 - April 30, 2009**

<b>PERIOD ENDING - MONTH / YEAR</b>	<b>MARKET VALUE</b>	<b>EARNINGS FOR MONTH</b>	<b>YIELD FOR MONTH</b>	<b>MONTH END WAM</b>
<i>Current Month - April 2009</i>				
County Pool - Money Market Fund	\$ 2,179,797,628	\$ 1,444,232	0.74%	51
Educational Pool - Money Market Fund	\$ 1,787,863,217	\$ 854,923	0.63%	50
Extended Fund	\$ 2,667,974,783	\$ 4,796,125	2.04%	417
OC Extended Fund B	\$ 52,200,929	\$ -	N/A	61
<i>March 2009</i>				
County Pool - Money Market Fund	\$ 2,029,134,964	\$ 1,400,404	0.81%	48
Educational Pool - Money Market Fund	\$ 1,338,411,552	\$ 1,109,701	0.88%	48
Extended Fund	\$ 2,645,713,854	\$ 5,538,166	2.57%	428
OC Extended Fund B	\$ 52,200,929	\$ -	N/A	91
<i>February 2009</i>				
County Pool - Money Market Fund	\$ 2,169,443,772	\$ 1,630,117	1.00%	53
Educational Pool - Money Market Fund	\$ 1,576,700,518	\$ 1,540,126	1.17%	59
Extended Fund	\$ 2,350,452,260	\$ 5,828,257	3.12%	387
OC Extended Fund B	\$ 52,200,929	\$ -	N/A	122
<i>January 2009</i>				
County Pool - Money Market Fund	\$ 2,014,879,118	\$ 1,827,150	0.99%	50
Educational Pool - Money Market Fund	\$ 1,856,648,856	\$ 1,820,578	1.13%	53
Extended Fund	\$ 2,533,665,548	\$ 7,079,923	3.32%	281
OC Extended Fund B	\$ 52,200,929	\$ -	N/A	150
<i>December 2008</i>				
County Pool - Money Market Fund	\$ 2,308,197,426	\$ 3,627,727	1.77%	58
Educational Pool - Money Market Fund	\$ 2,152,827,732	\$ 2,244,826	1.46%	55
Extended Fund	\$ 2,503,173,696	\$ 7,054,362	3.32%	325
OC Extended Fund B	\$ 52,200,929	\$ -	N/A	25
<i>November 2008</i>				
County Pool - Money Market Fund	\$ 1,923,820,987	\$ 3,212,472	2.18%	30
Educational Pool - Money Market Fund	\$ 1,591,357,027	\$ 2,695,568	2.01%	48
Extended Fund	\$ 2,337,562,301	\$ 6,880,107	3.45%	349
OC Extended Fund B	\$ 53,690,396	\$ -	N/A	56
<i>October 2008</i>				
County Pool - Money Market Fund	\$ 1,693,321,937	\$ 3,606,898	2.55%	36
Educational Pool - Money Market Fund	\$ 1,716,217,568	\$ 3,457,222	2.36%	43
Extended Fund	\$ 2,491,877,137	\$ 6,881,334	3.30%	345
OC Extended Fund B	\$ 53,690,395	\$ -	N/A	86
<i>September 2008</i>				
County Pool - Money Market Fund	\$ 1,633,383,931	\$ 3,733,815	2.64%	51
Educational Pool - Money Market Fund	\$ 1,707,114,565	\$ 3,660,952	2.52%	52
Extended Fund	\$ 2,333,839,343	\$ 3,483,307	1.84%	393
OC Extended Fund B	\$ 69,117,440	\$ -	N/A	117
<i>August 2008</i>				
County Pool - Money Market Fund	\$ 1,735,397,363	\$ 3,733,249	2.51%	47
Educational Pool - Money Market Fund	\$ 1,839,799,053	\$ 3,658,783	2.42%	45
Extended Fund	\$ 2,182,413,404	\$ 6,883,249	3.74%	477
OC Extended Fund B	\$ 69,117,440	\$ -	N/A	147
<i>July 2008</i>				
County Pool - Money Market Fund	\$ 1,787,284,123	\$ 3,899,411	2.41%	50
Educational Pool - Money Market Fund	\$ 1,797,691,062	\$ 3,698,983	2.38%	50
Extended Fund	\$ 2,104,561,539	\$ 7,010,329	3.73%	481
OC Extended Fund B	\$ 69,117,440	\$ -	N/A	178
<i>June 2008</i>				
County Pool - Money Market Fund	\$ 1,922,691,656	\$ 4,090,847	2.44%	33
Educational Pool - Money Market Fund	\$ 1,707,534,727	\$ 4,119,816	2.46%	33
Extended Fund	\$ 2,194,238,720	\$ 7,014,532	3.92%	503
OC Extended Fund B	\$ 69,117,440	\$ -	N/A	209
<i>May 2008</i>				
County Pool - Money Market Fund	\$ 2,052,055,391	\$ 4,328,189	2.42%	29
Educational Pool - Money Market Fund	\$ 2,208,622,434	\$ 4,646,915	2.45%	35
Extended Fund	\$ 2,188,235,769	\$ 7,248,040	3.81%	456
<b>May 1, 2008 - April 30, 2009</b>				
	<b>Annual Average</b>	<b>Total for Year</b>	<b>Annual Average</b>	<b>Annual Average</b>
County Pool - Money Market Fund	\$ 1,954,117,358	\$ 36,534,510	1.87%	45
Educational Pool - Money Market Fund	\$ 1,773,399,026	\$ 33,508,392	1.82%	48
Extended Fund	\$ 2,425,787,176	\$ 75,697,731	3.18%	403