

# COUNTY OF SAN MATEO



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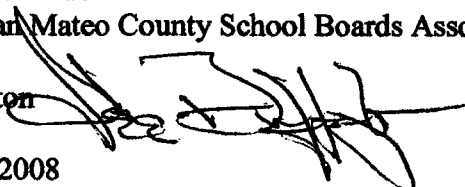
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TO: Dennis P. Mc Bride  
President, San Mateo County School Boards Association

FROM: Lee Buffington 

DATE: October 23, 2008

SUBJECT: San Mateo County Investment Pool issues

I am in receipt of your October 17, 2008 correspondence on behalf of the San Mateo County School Boards Association. I share the Association's concern regarding the significant financial loss to all pool participants resulting from the Lehman Brother's bankruptcy. As you may be aware, on November 4, 2008, I am giving a presentation to the Board of Supervisors addressing questions regarding the pool and its investments. I am hopeful that this presentation will be helpful not only to the pool participants but to the general public as well. In the meantime, I would like to take this opportunity to address the specific issues raised in your letter. If I have failed to address any of your concerns, please let me know.

**1. Are the Pool's investments consistent with the Pooled Fund Investment Policy's stated objectives?**

Yes. As stated in the Policy, and as you have noted in your letter, the primary objective of the Pool is preservation of principal with secondary objectives being liquidity in order to match maturities with capital expenditures and other planned outlays. State law specifies that the primary objective guiding any investments made with local agency funds is preservation of principal. In furtherance of that objective, State law limits allowable investment vehicles to those specified in Government Code §§ 53600 *et seq.*, such as, commercial paper, floating notes and corporate bonds. These types of investment vehicles are widely accepted in the financial community as being low risk, consistent with objective of preservation of principal. As such, each of the Pool's investments was purchased in accordance with not only the Policy but also the requirements set forth in California Government Code.

In your letter, you raised specific concerns regarding the Pool's holdings in Morgan Stanley, in "small regional banks," and in "financial institutions" generally in light of the current market. Please note that through a series of sales in October, the Pool's investment in Morgan Stanley went from \$160 million to a present \$105 million bringing the investment to an amount which is less than 5% of the Pool's portfolio. On September 21, 2008, the federal government allowed Morgan Stanley to become a bank, allowing it to take in deposits thus building capital. This action dramatically changes the basic structure of the company. On October 14, Mitsubishi purchased a 20% interest in Morgan Stanley and the U.S. Treasury Department purchased \$10 billion in Morgan Stanley preferred stock. Morgan Stanley's present long term ratings continue to be "Investment grade" ratings in accordance with the Government Code and its short term ratings remain investment grade as well.

With respect to the Pool's bank holdings, the Pool currently holds investments in strong A rated California Bank, owned by Mitsubishi Bank, Union Bank of California, Sun Trust and PNC all of which are large AA rated financial institutions. Finally, as you may be aware, our office is audited twice each year, one of which is conducted by the Grand Jury's outside auditor. The sole purpose of that audit is to ensure the Pool's investments fall within the guidelines set forth in the Policy. To date, please be assured this office has, without exception, always been found to have held its investments in accordance with the Policy guidelines and State law.

- 2. In light of the recent Lehman Brothers bankruptcy, what steps has the Treasurer's Office taken to address potential problems in the portfolio that could result in additional losses?**

Since the Lehman bankruptcy, our office has taken a number of steps to reduce our risk consistent with the Policy's guidelines and State law. First, we have instituted an internal operational investment limit of 5% per issuer pending consideration of changes to the County Investment Policy. This percentage decrease will ensure a broader diversification than the 10 % set forth in the Policy. Further, consistent with our past practice, we are continuing to evaluate each of the Pool's investments on a daily basis in light of current market conditions. We are not adding any financial paper to the fund with the exception of the highest rated commercial paper and CDs. This office will continue to evaluate each of its investments in light of any developments which may occur. Finally, as an on going process, I continue to work with my staff to determine additional steps that can be taken to address any potential problems in the portfolio.

- 3. What steps can be taken in order to insure more frequent reports from the County regarding Pool investments? Can more or different types of information be made available in such reports? Can the reports be made available online?**

The Treasurer's Office strongly values regular and thorough reporting with the goal of keeping all Pool participants informed of the status of pool investments. As set forth in the Policy, this office prepares a monthly report for all County pool participants stating the type of investment, name of the issuer, maturity date, rating, and par and dollar amount of each investment. For the total pooled investment fund, the report lists the average maturity and the market value, ratings, cost, accrued interest, etc. In addition, this office prepares a 15 month as well as current month cash flow report which sets forth projections for revenue inflows, and interest earnings as compared to the projections for the operating and capital outflows of depositors. The software we use to track the portfolio has a standard industry format (*i.e.* sorted by type of investment, rating, maturity, etc.) which is what you see in our reports. The software license does not allow us to make modifications; however, we would be happy to put any proposed format changes in our folder for next generation software.

At the present time, there are 76 different locations on the regular mailing list that receive these reports electronically. Reports for the schools have historically been sent to the County Office of Education for distribution. We honor all requests for this information and are constantly adding new names to the regular mailing list. Most of these reports and other current information can also be found on the Treasurer's web site.

**4. Will the Association have an opportunity to engage in a dialogue regarding the calculation and distribution of the losses resulting from the Lehman Brothers bankruptcy and other market conditions?**

Pursuant to the Policy, gains and losses are attributed to each depositor based on their average daily pool balance as reported by the County's Controller and are attributed to the fund balance of each depositor on a quarterly basis. This assures fairness to all Pool participants. As stated in my October 14, 2008 letter, this office has booked the Lehman Brothers investment losses as of September 30, 2008. I would like to reiterate my earlier offer to the school districts to review the possibility of charging the loss to a one or more of their specific accounts. Our office is open to such possibilities to the extent that they are within the parameters of the Policy, state law, and generally accepted accounting principles.

**5. What steps can be taken to improve communication between the Treasurer's Office and School Boards?**

This office places a premium on maintaining open and frequent communication with Pool participants; that being said, I understand that different school boards may have different expectations with regard to the frequency and type of information desired. Given the large number of Pool participants, it would be problematic to try to meet differing expectations with regard to provisions of information. I realize, however, we can improve upon the communication with the group. As noted above, this office sends regular reports to Pool participants and further posts relevant reporting information

online. Finally, we have the Investment Advisory Board, which reviews and advises the Treasurer on performance and investment decisions. This board, whose members are appointed by the Board of Supervisors, regularly meets on a quarterly basis pursuant to California Government Code §§ 27130 *et seq.* The appointees to this board are representatives of the major participants in the County Pool, including representatives of the County School Boards and the County Office of Education. Minutes of the Investment Advisory Board are also available. I am looking forward to further suggestions that could improve communications between the Treasurer's office and the school board.

cc: Adrienne Tissier  
Jean Holbrook  
John C. Beiers  
Ron Galatolo  
School District Governing Board Members