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February 16, 2006

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

FROM: John M. W. Moorlach, C.P.A., CFP® 
Treasurer-Tax Collector

SUBJECT: Treasurer's Management Report for January 31, 2006

Attached please find the Treasurer's Management Report for the County of Orange for the month end January 31, 2006. 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.ocgov.com/treas/.

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 January 31. Each money market fund has an average maturity of less than ninety days, with a net asset value (NAV) falling within the range of \$0.9950 and \$1.0050. The extended fund will have an average maturity of up to 549 days and a fluctuating NAV. 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 book value (cost to the County of the investment) 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 Pool's December 2005 and January 2006 interest apportionments. We anticipate posting the December 2005 and January 2006 interest apportionments to participants' cash accounts in the County general ledger by approximately February 21, 2006 and March 15, 2006, respectively.

CREDIT WATCH NEGATIVE AND APPROVED ELIGIBILITY LIST

In the month of January, there was one change to the Treasurer's approved eligibility list:

The following was removed from the CP/ MTN Eligibility list:

- 1) **First Data Corp.**

Please see the attached report detailing the reasons the above action was taken by the Treasurer.

STAFFING UPDATE

Our Assistant Treasurer-Tax Collector Gary Cowan has announced that he will retire on March 16. Mr. Cowan has served the County of Orange with distinction for thirty-three years and we are sorry to watch him walk off into the proverbial sunset.

Mr. Chriss Street has been recruited to replace Mr. Cowan as the Assistant Treasurer-Tax Collector. Mr. Street is the owner and president of Street Asset Management, headquartered in Corona del Mar. Most long-time county residents would remember Mr. Street for his efforts to prevent the County's filing for bankruptcy in 1994 and his continued assistance to address the fiscal issues once Mr. Citron's investment schemes were fully appreciated. Mr. Street is also a former Board member of the Orange County Employees Retirement System.

Ms. Emily Lin left our department in January to work for the City of Anaheim. Ms. Lin was our Treasury Accounting Manager. She was able to get a similar management position with her new employer with a very substantial raise in salary, as well as a comparable retirement benefit package. Ms. Lin was an outstanding technician and assisted us during a very critical Treasury Work Station installation and will be greatly missed. We are pursuing a recruitment to fill this position.

Ms. Judy Jacobson continues to be out on medical leave. Mr. Paul Cocking, our Assistant Investment Officer has been covering our trading desk, assisted by Mr. John Byerly.

With the departure of Ms. Julia Xue several months ago as our Financial Analyst, we promoted Mr. John Byerly, our Assistant Financial Analyst, to her position. We have

been evaluating whether Mr. Byerly could cover both positions, thus pursuing more trimming of staff. However, we have recently decided that it would be most helpful to fill the vacant Assistant Financial Analyst position and will be pursuing a recruitment soon.

With the enhanced retirement benefits we will also see more retirements in the month of March. We will be losing a key manager, Vickie Pazanti, Deputy Treasurer-Tax Collector, Administration, who serves as the department's human and administrative services manager. Gloria Martinez, Supervisor of our Taxpayer Services division, is retiring. Darlene Kataoka and Mai Branch are also retiring. We are also losing staff members to other departments who are recruiting for vacancies resulting from retirements, watching two long-term staff members going to promotions in the Auditor-Controller's Department. This is truly an amazing and demanding year of transition.

PENSION OBLIGATION NOTE

“Orange County, Calif., Is Buying Own Note to Save on Pensions”

This was the January 28 “The Wall Street Journal” headline for an article written by Stan Rosenberg of Dow Jones Newswires (page B4). It explained one of the new pieces in our County's Money Market Investment Pool as follows:

If you are a municipal government looking to save money on your pension costs, you might want to have a look at Orange County, Calif., bonds.

The county, which in 1994 filed for the largest municipal bankruptcy ever, on Friday priced a \$117 million private placement of taxable notes.

The buyer was Orange County's treasury, which is purchasing the notes for its own investment pool.

The deal resulted from an agreement with the Orange County Employees' Retirement System, which offered the county a 7.5% discount for advance payment of half its fiscal 2007 annual pension contribution, county treasurer John M.W. Moorlach said.

"Basically, it's a prepayment opportunity," that will save the county about \$4 million, which is money it can use to address other cost issues, he said.

The notes will mature in 2007, on June 30, the end of the fiscal year, but will contain a feature allowing them to be sold back to the county in 13 months, Mr.

Moorlach said. In that case, the county's liability would be about \$50 million, but "it would have available reserves to honor that," he said.

The securities would pay only the unfunded liability portion of the county's annual contribution to the pension fund. They wouldn't fund current-year contributions. "The portion that's normal cost, the county will find funds to pay for that," Mr. Moorlach said.

A summary of the finance plan circulated by the county indicated it had explored other options for financing the prepayment. It said, however, that the use of cash reserves "would reduce liquidity below comfortable levels" and that interfund borrowing would have to be repaid within the same year.

Initial thinking estimated the notes might be priced at 0.20 to 0.35 percentage point above the one-month London interbank offered rate, but they were priced Friday at 0.15 percentage point over Libor, based on a recommendation by financial adviser Kelling, Northcross & Nobriga, based in Oakland, Calif.

Friday, one-month Libor was roughly 4.57%, producing an initial rate of about 4.72%. That rate will be reset monthly.

Because the deal is strictly an internal transaction, no underwriter was required, Mr. Moorlach said, adding that his costs are being held to a financial adviser, bond counsel and the price of ratings.

The notes will be funded Monday, and the entire amount turned over to the retirement system immediately instead of making payroll period payments every two weeks.

The notes received Moody's highest rating for a taxable short-term security, P1. Standard & Poor's assigned its highest short-term rating of SP-1-plus and a commercial paper rating of A1, reflecting the Feb 28, 2007 put feature.

INVESTMENT POLICY STATEMENT

The Board of Supervisors approved our 2006 Investment Policy Statement (IPS) on December 13, 2005. Including some minor grammatical changes, we modified when the "credit watch-negative" would apply toward dropping issuers from our "approved list" and removed a redundant paragraph regarding a specific broker/dealer.

On January 31 we made a special request of the Board of Supervisors to add the highest short-term ratings for taxable municipal bonds.

The updated IPS is on our website at <http://tax.ocgov.com/treas/>

ECONOMIC OBSERVATIONS

The Federal Open market Committee (FOMC) raised interest rates by 25 basis points for the fourteenth straight meeting on January 31, raising their rate to 4.5%.

Last month's Economic Observations posed the question, "How will the economy continue to grow in the future?" At this point it appears to be a continuation of very strong consumer demand. Sales at stores open at least a year climbed 5.1% in January. Confidence remains at or near five month highs as job growth continues and mild weather helps to contain higher heating costs. The unemployment rate declined from 4.9% in December to 4.7% last month.

An end to the housing boom could still jeopardize growth, as new home sales and sales of existing homes have dropped nearly 30 percent since the middle of last year.

Last month the market was speculating this could be the last rate increase in the current rate cycle. However, the market consensus is now forecasting an additional rate increase on March 28.

Please call with any questions.