STATE BOARD OF ADMINISTRATION

LOCAL GOVERNMENT INVESTMENT POOL

Background:

The State Board of Administration (SBA) is an investment management organization responsible for managing $187.5 billion in governmental funds, including Florida’s $138 billion pension fund and the Local Government Investment Pool.

The Local Government Investment Pool was created to promote, through state assistance, the maximization of net interest earnings on invested surplus funds of local units of government, thereby reducing the need for imposing additional taxes. (Florida Statutes §218.401). The fund has operated since 1982. As of October 31, the pool had 995 participants.

The objectives of the LGIP are as follows:

- Provide a short-term, very liquid, high quality investment vehicle to participating local governments
- Purchase securities consistent with Section 215.47, Florida Statutes
- Operate the pool as a “2a7-like” fund using the Securities and Exchange Commission investment requirements for 2a-7

Money Market Funds as guidance

- Follow all accounting and reporting requirements of Governmental Accounting Standards Board (GASB) Statement No. 31
- Provide liquidity to the participants on a daily basis; and
- Add incremental income by participating in the SBA securities lending program.

As a money market fund, the LGIP invests in short-term, high quality money market instruments issued by financial institutions, non-financial corporations, the U.S. government and federal agencies. Money market instruments must be of the highest applicable rating, while other eligible securities must be rated investment grade. All non-governmental securities must have a maturity of less than 13 months. The maturity of obligations of the U.S. Treasury and U.S. Agencies may not exceed two years. The weighted average maturity of the portfolio may not exceed 90 days.

UNF had invested with the Local Government Investment Pool, $50.7 million of University funds and $66.0 million of construction bond funds for the Financing

Corporation. The remaining monies for the University were invested within SPIA, another State operated fund (approximately $30 million) and Sawgrass Management Company ($25 million). The Financing Corporation also has funds invested within a Goldman Sacs AAA Rated fund.

Series of Events:

November 14: The SBA reported on an Update on Sub-Prime Mortgage Meltdown and State Board of Administration Investments dated November 9. This report indicated that SBA was well-positioned to sustain a disciplined long-term focus during periods of heightened financial market volatility and uncertainty due to their highly diversified investment portfolio. Reasons provided for why the SBA's assets had continued to perform well despite the heightened market uncertainty were:

1. Diversification
2. Proactively reviewed funds under management for direct or indirect exposures to sub-prime residential mortgages that indicated immaterial direct exposure to sub-prime residential mortgages
3. Vast majority of the assets were in actively managed strategies that prudently manage risk while pursuing their return objectives, and SBA reached out to is investment managers to assess the potential for sub-prime spillover effects to negatively impact SBA assets
4. Fixed asset income investments emphasized higher credit quality and under Florida law, the SBA could only directly invest in AAA-rated agency mortgage-backed securities
5. Short term portfolios were also selectively lowering exposures to asset-backed commercial paper and financial company securities in a prudent and orderly fashion.

The report stated that the SBA's bond and money market investments had continued to maintain high overall credit ratings. The only disappointment had been with isolated credit downgrades impacting several short-term portfolios and accounting for about 4.7% of par value. However, the SBA participated in restructuring negotiations with two asset-backed commercial paper issuers to ensure that collateral was held in trust to pay principal and interest due the SBA's clients. No client of the SBA had ever lost money in a short-term portfolio, and the SBA remained confident that their portfolios would continue to provide stable returns for clients with an emphasis on safety and liquidity of principal. The SBA continued to collect principal and interest on these restructured investments and had not experienced any loss.

Of the $2.2 billion of holdings downgraded below the initial purchase guidelines, three had been restructured, one was in the process of restructuring and two expected to mature as scheduled. The securities that restructured agreed to interest rate premiums.

The SBA began to re-invest asset-backed commercial paper maturities in other highly rated instruments. They intended to enhance the liquidity because client outflows had marginally increased given the heightened market uncertainty.

November 14: Bloomberg reported "Florida Holds $2.2 billion of Debt Cut to Junk Status." The downgrades affect 4% of funds. The article indicated that now that the participants had been notified of the downgrades, there was a danger of a run on the bank.

November 19: The State's Chief Financial Officer, Alex Sink, put out a press release reporting Subprime Risk to State Treasury was minimal. The release indicated that SBA reviewed its investments and reported the results at the Cabinet meeting on November 14th. The release restated that the State's pension fund was properly diversified and not at risk. There was no mention in the release of any concerns about the Local Government Investment Pool.

November 28: The SBA's press release announced that Executive Director recommended financial plan to protect the Local Government Investment Pool. It stated that the Pool will continue to provide safety of principal in the midst of an unprecedented absence of market liquidity. It referred to a November 28 Bloomberg article that erroneously stated that the Florida pool's $900 million of defaulted asset-backed commercial paper now amounted to almost 5 percent of its holdings. In fact, the release stated that certain pool investments that had been downgraded continued to pay principal and interest. It outlined recommendations that the SBA proposed to provide assurance to the Pool participants.

November 29: Florida officials suspended withdrawals from the Local Government Investment Pool after withdrawals from participants reduced the fund by 44% from $27 billion to $15 billion. These withdrawals were paid out at par as opposed to adjusting the investment value reflecting the current market value of the securities.

December 4: Governor Crist, CFO Sink and Attorney General McCollum met as the State Board of Administration, to discuss further actions regarding the SBA Local Government Investment Pool (LGIP). After a lengthy discussion, with a presentation by Black Rock, an international financial advising and management firm, the following actions were taken:

1. Black Rock named Interim Fund Manager
2. SBA would issue an RFP for a permanent fund manager
3. An update would be provided at each future Cabinet meeting
4. At the end of the meeting, Coleman Stipanovich, SBA Executive Director, stepped down.
5. Approved an operating plan

Highlights of the Operating Plan

1. LGIP will be broken into two funds, A and B: 86% is in Fund A – Triple AAA debt, all liquid by Dec. 2008 and 14% is in Fund B – Not Triple AAA.
2. Starting as soon as possible, aiming for December 6, withdrawals equal to the greater of $2,000,000 or 15% of the amount on deposit would be allowed.
3. The 15% cap would be increased over time.
4. Investors would be able to borrow against balance.
5. 2% penalty for withdrawal over 15%.
6. New deposits were encouraged, and 100% of these would be placed in Fund A. These deposits would not be subject to any withdrawal restrictions.
7. November interest allocation would go into Fund B, including those with deposits who have withdrawn their accounts.
8. There is a SBA advisory group, which was formed with representatives of the local government entities, who agreed to the Black Rock plan as an interim step with reservations.

FINANCIAL TIMEOUT

The University has taken the following actions:

1. Redeemed the allowable amount for the University of $6.5 million and for the Financing Corporation of $8.5 million.
2. Determined not to exercise the option to take the remaining dollars with the 2% penalty at this time. We believe this would exacerbate the fund's problems.
3. Withdrawn $29 million thus far from SPIA, the other State managed fund, leaving a balance of $2.0 million in the SPIA account due to concerns about SPIA.
4. Placed the funds returned in AAA short maturity funds managed by top tier banks and money managers.
5. Requested our independent money manager to review the Fund B portfolio. So far, he has not been able to access the portfolio in detail.

The following attachments have been provided for additional information:

1. Current Investment Portfolio
2. Comparison of attributes for SBA and SPIA
3. Interest Rates Trends for SBA and SPIA
4. SUS Participation in the Local Government Investment Pool as of 11/30