

Solano County

675 Texas Street Fairfield, California 94533 www.solanocounty.com

Agenda Submittal

Agenda #: 7 Status: Received and Filed

Type: Report Department: Treasurer-Tax Collector-County Clerk

File #: 11-0516 **Contact:** Charles Lomeli - 784-3419

Agenda date: 10/25/2011 **Final action**: 10/25/2011

Title: Accept the Solano County Treasurer's Quarterly Report for the period of July 1, 2011 through

September 30, 2011

Governing body: Board of Supervisors

District: All

Attachments: A - Letter to the Board, B - Statement of Compliance, C - Maturity Report, D - Charts, E - Greek

Default, Minute Order.pdf

DateVer.Action ByActionResult10/25/20111Board of SupervisorsAccepted

Published Notice Required ? Yes _____ No _X Public Hearing Required ? Yes _____ No _X

DEPARTMENTAL RECOMMENDATION:

It is recommended that the Board accept the County Treasurer's Quarterly Report for the period of July 1, 2011 through September 30, 2011.

SUMMARY/DISCUSSION:

Submitted herein is the Treasurer's FY2011/12 First Quarter Report, which contains the Treasurer's Statement of Compliance.

This report is provided for informational purposes only. All information contained in this report pertains to all county, district, agency and school district funds. This report is also available on the Treasurer's web site at www.solanocounty.com http://www.solanocounty.com.

FINANCIAL IMPACT:

There is no financial impact in accepting this report; all costs associated with producing the report are realized in the Treasurer's budget.

ALTERNATIVES:

The Board could elect not to accept this report at this time or request a change in content or format.

OTHER AGENCY INVOLVEMENT:

This report will be promulgated to the distribution list on the Statement of Compliance and published on the Treasurer's website.

File #: 11-0516, Version: 1

CAO RECOMMENDATION:

APPROVE DEPARTMENT RECOMMENDATION



Treasurer-Tax Collector-County Clerk CHARLES LOMELI

October 6, 2011

The Honorable Members of the Board of Supervisors County of Solano County 675 Texas Street, Suite 6500 Fairfield CA 94533

Honorable Members of the Board:

It is my pleasure to present the Treasurer's report for the first quarter of 2011/2012.

The State of the Treasury:

As of September 30, 2011, Total Pool assets are \$553.2 million, with a yield of 0.81 % and a total return of 0.81 %. It is anticipated that the total assets of the Treasury Pool will increase in the coming quarter as a consequence of cyclical property tax collections. In keeping with tenets of a conservative approach to portfolio management, the duration of the portfolio is not expected to increase dramatically as a result of the net new purchases. The duration of the portfolio will continue to target an expectation that, due to the nature of economy, Treasury Pool participants will draw down most available cash during the remainder of the current fiscal year.

Projections of future Treasury Pool earnings remain depressed in reflection of current low interest rates and the Federal Reserve Bank indicated desire that the low levels remain in effect until at least the second quarter of 2013. For perspective on how this impacts the Treasury Pool, three years ago the Treasury Pool invested \$16.6 million in a State private placement bond yielding 3.18%. This bond generated \$527,000 in income annually for distribution to the Treasury Pool participants. With the impending maturity of the bond, the same \$16.6 million will need to be reinvested. Under current market conditions, a similar security to the one maturing will yield approximately 1%, thereby generating income of \$116,000 annually. The net effect is a \$411,000 annual decline in the amount of funds available to the Treasury Pool participants. In addition to this specific example, the previously reported challenging economic conditions continue to dictate a prudent bias toward the maintaining of higher liquidity and a shorter duration position. This bias necessitates buying shorter term, lower yielding securities than we might otherwise.

As a quantitative measure of the Treasury Pool's conservative management bias, Standard &Poor's (S&P) continues to rate it Treasury Pool AA. Discussions with S&P have indicated that the AA rating of the Treasury Pool is based primarily on their assignment of an AA credit rating on US Government debt, which by statute the Treasury Pool is heavily invested in. The rating on the United States is not likely to change in the near future; therefore, the pool rating is unlikely to change as well unless the California Government Code regarding allowable investments is adjusted. The chief credit officer at S&P, Mr. Mark Adelson, has revamped the firms rating process following the financial crisis of 2008. It is reported that he believes a AAA rating should be very difficult to attain and should be for stellar credits following a thorough testing process. The sovereign rating is based on politics, economics, fiscal, monetary and external elements. Based on this stated criteria, I will not be surprised if further downgrades of US Government debt are forthcoming.

Economy:

The economy continues to deteriorate, with consumer confidence slumping last week to the second-lowest level on record as Americans grow more concerned with their financial situation. According to the Bureau of Labor Statistics, unemployment remains stubbornly high at 12.0 % in California and 9.1% nationally. As reported previously, it is my belief that the economy cannot recover without a substantive improvement in employment. In September, employers announced the most anticipated job cuts in two years. Announced firings jumped 212% from a year ago according to a Bloomberg report citing Challenger, Gray & Christmas. The majority of the cuts were in the western part of the country.

US banks continue to face strong headwinds in the fight for profitability. As a result of the Federal Reserve Banks "operation twist", the yield curve has flattened, making for a more challenging lending environment. The result of these headwinds continues to be stringent lending requirements and stagnant loan demand. Without access by businesses to ready borrowing, it will be extremely challenging to grow the economy.

The financial crisis embroiling the European Union, and a possible default by Greece, is causing turmoil and volatility in all of our markets. For a more detailed explanation of this crisis, please see my white paper titled "Greece" attached as Attachment E.

In testimony before the Congressional Joint Economic Committee, Federal Reserve Chairman Ben Bernanke stated the US economy is "close to faltering". He cited poor job growth and the European financial crisis as contributors. Factory goods orders fell in August and September suggesting companies are not attracting new business. On the positive side, US companies are sitting on two trillion dollars of cash which should help insulate them should another recession take hold. But with diminishing growth prospects in the economy, most companies are only spending on essential requirements and not investing. As a result, many shareholders are now demanding that a portion of the cash on corporate balance sheets be allocated them in the form of dividend payments. These dividend payments reduce capital available for future investment should prospects brighten; thereby dampening the strength of any potential recovery. So far many of the companies have resisted raising dividends, not in anticipation of future growth, but in concern over a repeat of the credit crisis of 2008 and 2009. During that period of time, companies experienced difficulty raising cash and many failed as a result.

One exception to the withholding of corporate capital is AB InBev, the parent company of Anheuser Busch, which is planning to invest \$1 billion in its U.S. breweries. A portion of this investment may benefit Solano County as one of their facilities is located here.

Unfortunately, there is little good news to report with regard to housing. Interest rates are at an all-time low, with the 30 year fixed mortgage below 4%, but more importantly loan applications and home prices are also declining. According to the Mortgage Bankers Association most recent report, mortgage applications fell 4.3% in the month of September. In addition, Notices of default (NOD) filed in the Solano County Recorder's office had averaged 420 filings a month for the first seven months of the calendar year; but jumped to 609 in August and 497 in September, indicating a continuing decline in the county housing market. Some of the decline in mortgage applications may be attributed to borrower fatigue. With so many homes financially underwater, mortgage applications for refinancing fall into two broad categories, those with a chance of success and those without. Given the steep decline in mortgage rates, successful borrowers have likely already refinanced once if not more often and may see minimal benefit to repeating the process again. Borrowers with less chances of success have likely already been rejected for a refinancing and may also be reluctant to repeat the process.

Respectfully Submitted,

CHARLES LOMELI Treasurer – Tax Collector – County Clerk

Letter to the Board 1st Quarter 2011/12

Attachment A



Treasurer-Tax Collector-County Clerk CHARLES LOMELI

STATEMENT OF COMPLIANCE

September 30, 2011

Liquidity:

The Treasury has a cash and cash equivalent position (securities maturing within 6 months) of \$296 million dollars as of September 30, 2011. Based on historical trend analysis and projections by the various school districts, it is estimated that this cash position is adequate to meet projected liquidity requirements of the pool participants for the next six months.

Should the treasury experience unusual demands on cash, the liquidity position will be adjusted accordingly.

Investments:

The investment portfolio has been reviewed by the Treasurer-Tax Collector-County Clerk at September 30, 2011 and found to be in compliance with the Investment Policy.

Reporting and Distribution:

In accordance with the Government Code this report is submitted to:

County Administrator
Auditor-Controller
Board of Supervisors
Investment Oversight Committee
California Debt & Investment Advisory Commission

This report is also made available to the Superintendent of Schools, the business managers of each district, many pool participants and the public at large via the Internet.

Respectfully Submitted,

CHARLES LOMELI Treasurer-Tax Collector-County Clerk

Solano County Treasury Detailed Investment Holdings

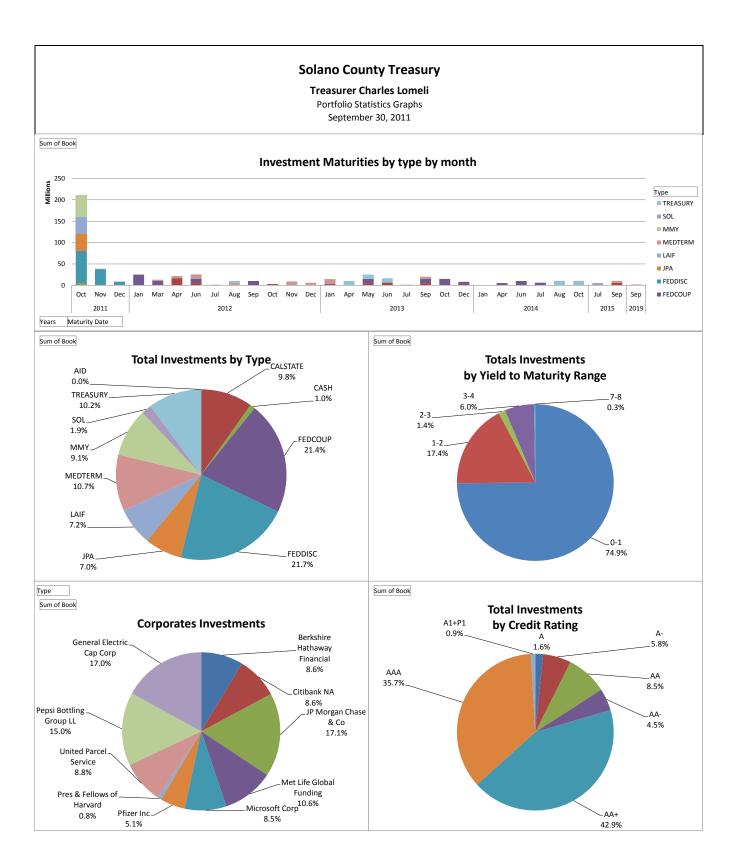
	Values		
Row Labels	Sum of Par	Sum of Book	Sum of Market
2011	Can Ci i ai	Cum of Book	Jam Ji marnet
Oct	210,730,992	210,730,788	210,929,688
AID	16,634	16,634	
Republic of Honduras	16,634	16,634	
438180AD3	16,634	16,634	
CASH	5,304,203	5,304,203	
Cash on Hand	5,304,203	5,304,203	
CASH	5,304,203	5,304,203	
FEDDISC FHLB	76,000,000 31,000,000	75,999,796 30,999,898	
313384NF2	31,000,000	30,999,898	
Freddie Mac	15,000,000	14,999,990	
313396NK5	15,000,000	14,999,990	
Fannie Mae	30,000,000	29,999,908	
313588MM4	5,000,000	4,999,978	
313588NL5	10,000,000	9,999,931	9,999,870
313588MP7	15,000,000	15,000,000	14,999,985
JPA	38,943,368	38,943,368	39,142,699
Caltrust Medium	7,066,832	7,066,832	
CALTMED	7,066,832	7,066,832	
Caltrust Short	31,876,536	31,876,536	
CALTSHORT	31,876,536	31,876,536	
LAIF	39,863,925	39,863,925	
Local Agency Investment Fund	39,863,925	39,863,925	
LAIF MMY	39,863,925	39,863,925	
Bank of America Money Market	50,602,862 1,784,657	50,602,862 1,784,657	
BANK AMERICA MMY	1,784,657	1,784,657	
Union Bank Money Market	245,203	245,203	
UNION BANK MMY	245,203	245,203	
Wells Fargo Bank Money Market	4,076,329	4,076,329	
WELLS MMY	4,076,329	4,076,329	
Camp Money Market	11,077,325	11,077,325	11,077,325
CAMP MMY	11,077,325	11,077,325	
Cal Trust Money Market	33,419,348	33,419,348	
CAL TRUST MMY	33,419,348	33,419,348	
Nov	38,845,000	38,849,553	
FEDDISC	37,000,000	36,999,642	
Freddie Mac	10,000,000	9,999,908	9,999,830
313396NU3 Fannie Mae	10,000,000 27,000,000	9,999,908 26,999,733	
313588PX7	7,000,000	6,999,755	
313588PA7	20,000,000	19,999,978	
SOL	1,845,000	1,849,912	
Solano County COPS	1,845,000	1,849,912	
834131GM0	1,845,000	1,849,912	
Dec	8,550,000	8,553,282	
FEDDISC	7,000,000	6,999,557	
FHLB	7,000,000	6,999,557	6,999,713
313384QP7	7,000,000	6,999,557	6,999,713
CALSTATE	1,550,000	1,553,726	
Riverside COPS	1,550,000	1,553,726	
768901SN1	1,550,000	1,553,726	1,554,185
2012	05 000 000	OF 000 To 1	05.070.000
Jan	25,000,000	25,023,731	25,042,685
FEDCOUP	25,000,000	25,023,731	25,042,685
FFCB	5,000,000	5,023,731	5,027,285

31331GKY4	5,000,000	5,023,731	5,027,285
FHLB	20,000,000	20,000,000	20,015,400
313372AQ7	20,000,000	20,000,000	20,015,400
Mar	13,000,000	13,103,689	13,141,808
FEDCOUP	10,000,000	10,087,521	10,090,580
Freddie Mac	10,000,000	10,087,521	10,090,580
3137EABY4	10,000,000	10,087,521	10,090,580
MEDTERM	3,000,000	3,016,167	3,051,228
Pfizer Inc	3,000,000	3,016,167	3,051,228
717081CZ4	3,000,000	3,016,167	3,051,228
Apr	21,600,000	21,688,389	21,689,785
MEDTERM	5,000,000	5,088,389	5,089,785
Berkshire Hathaway Financial	5,000,000	5,088,389	5,089,785
084664BJ9	5,000,000	5,088,389	5,089,785
CALSTATE	16,600,000	16,600,000	16,600,000
CA State Private Placement	16,600,000	16,600,000	16,600,000
13063A5L4	16,600,000	16,600,000	16,600,000
un	25,000,000	25,380,398	25,425,010
FEDCOUP	10,000,000	10,209,293	10,230,020
FHLB	10,000,000	10,209,293	10,230,020
3133XR5T3	10,000,000	10,209,293	10,230,020
MEDTERM	10,000,000	10,112,369	10,135,240
JP Morgan Chase & Co	10,000,000	10,112,369	10,135,240
481247AE4	10,000,000	10,112,369	10,135,240
CALSTATE	5,000,000	5,058,735	5,059,750
CA State RANS Series A2	5,000,000	5,058,735	5,059,750
13063BLK6	5,000,000	5,058,735	5,059,750
ul	1,250,000	1,250,000	1,250,000
SOL	1,250,000	1,250,000	1,250,000
SOLANO-TXB-RF-PE	1,250,000	1,250,000	1,250,000
834127BT8	1,250,000	1,250,000	1,250,000
lug	10,000,000	10,096,413	10,178,360
MEDTERM	5,000,000	5,062,324	5,110,390
General Electric Cap Corp	5,000,000	5,062,324	5,110,390
36962G4E1	5,000,000	5,062,324	5,110,390
TREASURY	5,000,000	5,034,089	5,067,970
US Treasury	5,000,000	5,034,089	5,067,970
912828LH1	5,000,000	5,034,089	5,067,970
Sep	10,000,000 10,000,000	10,000,000	9,975,690
FEDCOUP		10,000,000	9,975,690
Fannie Mae	10,000,000 10,000,000	10,000,000	9,975,690
3135G0DE0		10,000,000	9,975,690
Oct AID	3,025,000 25,000	3,034,578	3,055,990
Jamaica Aid	25,000	25,000 25,000	25,000 25,000
470172AA5	25,000 25,000	25,000 25,000	25,000
CALSTATE	3,000,000	3,009,578	3,030,990
AZ COPS Series A	3,000,000 3,000,000	3,009,578	3,030,990 3,030,990
040588XE0	3,000,000	3,009,578	
040366AE0 Nov	8,510,000	8,864,251	3,030,990 8,890,610
MEDTERM	8,510,000	8,864,251	8,890,610
Pepsi Bottling Group LL	8,510,000 8,510,000	8,864,251	8,890,610
10138MAB1	8,510,000	8,864,251	8,890,610
_			
Dec MEDTERM	6,000,000 5,000,000	6,060,551 5,060,551	6,095,195 5,086,865
Citibank NA	5,000,000	5,060,551 5,060,551	5,086,865
17314JAT0	5,000,000	5,060,551 5,060,551	5,086,865
CALSTATE	1,000,000	1,000,000	1,008,330
Sacramento Municipal Utilities	1,000,000 1,000,000	1,000,000 1,000,000	1,008,330
786134SQ0	1,000,000	1,000,000	1,008,330
7661345Q0 913	1,000,000	1,000,000	1,000,330
/ L-J			
Jan	14,140,000	14,408,579	14,460,019

Attachment C

FEDCOUP	3,000,000	3,000,000	3,003,261
FFCB	3,000,000	3,000,000	3,003,261
31331J7E7	3,000,000	3,000,000	3,003,261
MEDTERM	11,140,000	11,408,579	11,456,758
United Parcel Service	5,000,000	5,171,951	5,251,490
911312AG1	5,000,000	5,171,951	5,251,490
Met Life Global Funding	6,140,000	6,236,628	6,205,268
59217GAA7	6,140,000	6,236,628	6,205,268
Apr	10,000,000	10,180,217	10,227,700
TREASURY	10,000,000	10,180,217	10,227,700
US Treasury	10,000,000	10,180,217	10,227,700
912828MX5	10,000,000	10,180,217	10,227,700
May	25,000,000	25,096,001	25,267,340
FEDCOUP	10,000,000	9,968,495	10,003,340
Freddie Mac	10,000,000	9,968,495	10,003,340
3134G1ZC1	10,000,000	9,968,495	10,003,340
TREASURY	10,000,000	10,127,507	10,177,700
US Treasury	10,000,000	10,127,507	10,177,700
912828NC0	10,000,000	10,127,507	10,177,700
CALSTATE	5,000,000	5,000,000	5,086,300
University of CA Revs-BAB	5,000,000	5,000,000	5,086,300
91412GEV3	5,000,000	5,000,000	5,086,300
Jun	16,195,000	16,363,095	16,669,415
TREASURY	10,000,000	10,087,505	10,144,100
US Treasury	10,000,000	10,087,505	10,144,100
912828NH9	10,000,000	10,087,505	10,144,100
CALSTATE	6,195,000	6,275,590	6,525,315
Pacifica CA POB	1,195,000	1,195,000	1,227,815
69511AAC8	1,195,000	1,195,000	1,227,815
CA Statewide Communities	5,000,000	5,080,590	5,297,500
130795R66	5,000,000	5,080,590	5,297,500
Jul	1,555,000	1,567,288	1,567,410
SOL	1,250,000	1,250,000	1,250,000
SOLANO-TXB-RF-PE	1,250,000	1,250,000	1,250,000
834127BU5	1,250,000	1,250,000	1,250,000
CALSTATE	305,000	317,288	317,410
South Coast CA Water District	305,000	317,288	317,410
837433CW9	305,000	317,288	317,410
Sep	20,100,000	20,163,866	20,164,971
FEDCOUP	10,000,000	10,000,000	10,005,735
FFCB	5,000,000	5,000,000	4,996,445
31331KXD7	5,000,000	5,000,000	4,996,445
FHLB	5,000,000	5,000,000	5,009,290
3133747F1	5,000,000 5,000,000	5,000,000	5,009,290
MEDTERM Microsoft Corp	5,000,000	5,016,523 5,016,523	5,032,510 5,032,510
594918AF1	5,000,000	5,016,523	5,032,510
CALSTATE	5,100,000	5,147,343	5,126,726
La Quinta Redevelopment	1 00,000	100,043	100,476
50420AAX2	100,000	100,043	100,476
CA State Taxable	5,000,000	5,047,301	5,026,250
13063BNN8	5,000,000	5,047,301	5,026,250
Oct	15,000,000	14,945,312	15,003,995
FEDCOUP	15,000,000	14,945,312	15,003,995
FHLB	10,000,000	9,953,875	10,003,520
313371F27	10,000,000	9,953,875	10,003,520
Freddie Mac	5,000,000	4,991,437	5,000,475
3134G1VH4	5,000,000	4,991,437	5,000,475
Dec	8,000,000	8,000,000	8,070,135
FEDCOUP	5,000,000	5,000,000	5,005,875
Freddie Mac	5,000,000	5,000,000	5,005,875
3134G2HU9	5,000,000	5,000,000	5,005,875
0.0.0200	3,300,000	5,550,550	5,500,010

CALSTATE	3,000,000	3,000,000	3,064,260
Sacramento Municipal Utilities	3,000,000	3,000,000	3,064,260
786134SR8	3,000,000	3,000,000	3,064,260
2014			
Jan	421,000	451,995	462,839
MEDTERM	421,000	451,995	462,839
Pres & Fellows of Harvard	421,000	451,995	462,839
740816AF0	421,000	451,995	462,839
Apr	5,000,000	4,997,701	5,006,805
FEDCOUP	5,000,000	4,997,701	5,006,805
Freddie Mac	5,000,000	4,997,701	5,006,805
3134G2QB1	5,000,000	4,997,701	5,006,805
Jun	10,000,000	9,999,089	10,037,075
FEDCOUP	10,000,000	9,999,089	10,037,075
Fannie Mae	10,000,000	9,999,089	10,037,075
3136FRTS2	5,000,000	5,000,000	5,020,905
3135G0BN2	5,000,000	4,999,089	5,016,170
Jul	6,695,000	6,724,095	6,727,847
FEDCOUP	5,000,000	5,000,000	5,002,405
Freddie Mac	5,000,000	5,000,000	5,002,405
3134G2RG9	5,000,000	5,000,000	5,002,405
SOL	1,250,000	1,250,000	1,250,000
SOLANO-TXB-RF-PE	1,250,000	1,250,000	1,250,000
834127BV3	1,250,000	1,250,000	1,250,000
CALSTATE	445,000	474,095	475,442
South Coast CA Water District	445,000	474,095	475,442
837433CX7	445,000	474,095	475,442
Aug	10,000,000	10,404,118	10,561,719
TREASURY	10,000,000	10,404,118	10,561,719
US Treasury	10,000,000	10,404,118	10,561,719
912828LK4	10,000,000	10,404,118	10,561,719
Oct	10,000,000	10,409,465	10,585,160
TREASURY	10,000,000	10,409,465	10,585,160
US Treasury	10,000,000	10,409,465	10,585,160
912828LS7	10,000,000	10,409,465	10,585,160
2015		-	-
Jul	5,000,000	5,000,000	5,000,000
SOL	5,000,000	5,000,000	5,000,000
SOLANO-TXB-RF-PE	5,000,000	5,000,000	5,000,000
834127BW1	5,000,000	5,000,000	5,000,000
Sep	10,000,000	10,340,046	10,281,490
MEDTERM	5,000,000	4,992,807	4,976,540
General Electric Cap Corp	5,000,000	4,992,807	4,976,540
36962G4S0	5,000,000	4,992,807	4,976,540
CALSTATE	5,000,000	5,347,240	5,304,950
CA State Variable Purpose	5,000,000	5,347,240	5,304,950
13063BLM2	5,000,000	5,347,240	5,304,950
2019	4 500 000	4 500 000	4 050 005
Sep	1,500,000	1,500,000	1,952,025
CALSTATE	1,500,000	1,500,000	1,952,025
San Luis Obispo County	1,500,000	1,500,000	1,952,025
798703BD5	1,500,000	1,500,000	1,952,025
Grand Total	550,116,992	553,186,492	555,124,293



Greek Default

An analysis of the potential ramifications for Solano County

October 6, 2011 Charles Lomeli: Treasurer – Tax Collector – County Clerk

Overview

The European Union (EU) is in a financial crisis that has steadily worsened over the past two years. It is becoming more certain every day that at least some of the EU member nations face a high likelihood of default on their sovereign debts. These potential defaults are testing the very viability of their multinational economic system. Weaker countries such as Portugal, Italy, Ireland, Greece, and Spain (PIIGS) are being pushed to the brink of insolvency. Attempts by stronger countries such as Germany, France, and Norway to help support the weaker ones are facing strong political resistance at home.

In the aftermath of the 2008/2009 financial crisis, many countries around the globe found themselves deficit spending at an unsustainable rates to try and maintain economic growth. Some of these countries were already deeply in debt going into the crisis and quickly reached their functional borrowing limits. For most countries facing this dilemma the solution is to print money and monetize the outstanding debt. The PIIGS however, because of their affiliation to the European Union (EU), were constrained in their response to the crisis because they share a common currency and individual member nations cannot print more. Absent this tool, the remaining options available to become financially stable involved reducing debt loads and reducing deficits. Put another way, taking away services and imposing austerity measures on the population. These actions have resulted in civil disorder in multiple countries, thereby endangering the political stability of them.

The most immediate crisis encompasses the solvency of the Greek state. Despite several rounds of bailouts, and the imposition of multiple rounds of austerity measures, the crisis continues to deepen. It appears that Greece will not have the resources to meet debt obligations, and a default is likely. Members of the European Union have combined to aid Greece in the past, and would like to continue to help, but financial institutions and citizens in the respective countries are becoming less willing provide additional assistance and assume additional risks. The citizens of Germany and France are exerting enormous pressure on their respective political leaders to end additional aid. Banking and financial institutions, primarily in France and Germany, have significant exposure to Greek debt, which is endangering the financial stability of the entire continent.

As the EU struggles to stabilize Greece through financial aid packages, other fiscally challenged PIIGS countries are watching closely, as they could

require financial assistance in the near future. The challenge is that aid terms deemed too easy on Greece may encourage the others to seek additional costly bailouts; while aid terms deemed too harsh may result in bailout avoidance in favor of a default by one of them, Adding to the challenge, Moody's recently downgraded the credit rating of Italy by three notches following a downgrade by Standard & Poor's. A destabilizing event like the default of Greece could make the financial conditions of these countries much more uncertain.

Given the unstable state of affairs in the EU, US markets have experienced significant volatility driven by investor uncertainty over the degree to which various financial institutions would be impacted by a sovereign default in the EU. As the 2008/2009 financial crisis showed, financial institutions around the globe have become interwoven with one another as they invest capital and borrow from each other. As a result, determining the specific exposure of a specific financial entity to a specific event can be nearly impossible. The entity may face direct exposure, indirect exposure, and some of the indirect exposure can be completely unknowable until it is revealed.

A default by Greece would immediately impact the Greek banks, making many of them insolvent. Banks in France and Germany would suffer serious losses; it is estimated that among them they hold 55% of Europe's total exposure. In some cases the survival of large multinational financial institutions could be threatened. It is likely that countries may have to bail out their own banks in the case of a Greek default.

Indirect exposure will then befall any financial institution with contracts or obligations to those institutions and banks that hold direct obligations of Greece. It is primarily this indirect exposure to banks and institutions that are causing uncertainty in our markets, as money markets mutual funds and large U.S. banks are heavily invested in EU banking institutions.

The Chairman of the Federal Reserve, Ben Bernanke, in testimony this summer said that a default by Greece would have little impact on our Banks. He has asked our banks to conduct a stress test to gage the exposure to an EU credit event and based his assessment on that basis. Money market mutual funds do not have a large direct exposure to Greece and peripheral counties, but have substantial exposure to EU banks in the core countries of France and Germany. Half of our mutual funds hold European bank commercial paper and will be exposed to large losses. In addition, it is likely that corporations in the U.S. also hold direct debt obligations of Greece.

A default could cause panic among financial institutions, triggering a Lehman style domino effect where EU banks stop lending to each other, and a deadly credit freeze takes hold.

Alan Greenspan, former Chairman of the Federal Reserve, has said that a Greek default is almost certain and may trigger a recession in the U.S.

Potential Default Scenario

If a default occurs, here's one potential scenario of how it would transpire:

- 1. The Greek government is unable or unwilling to meet a fiscal obligation.
- 2. Greek banks are nationalized, likely over a weekend.
- 3. European banks, primarily in the UK, France, and Germany, are then embroiled in a credit crisis.
- 4. Credit default swaps cause a credit event and insurance company's become stressed or insolvent.
- 5. The domino's fall and a global credit crisis ensues as banks stop lending to one another because exposure is unknown and collateral requirements are increased.
- 6. Other EU countries begin to ponder default to avoid austerity measures, why should they be forced to pay if others do not. The EU Central bank is exposed to several state defaults and becomes insolvent and a political crisis ensues across Europe.
- 7. U.S. Companies hoard additional cash choking off growth.
- 8. 8. Global protectionism takes hold, the U.S. and Europe fall into recession and growth in China slows dramatically.
- 9. What has been a slow recovery becomes a recession and hopes of a recovery are put off for years.

Conclusion

The above described scenario, or a version of it, has our markets on edge. This has been evident by large swings in the equity markets, and to a lesser extent in the bond markets. A default of any EU member is a dangerous scenario with significant risk to world markets and investors around the globe. The good news is – our leaders have time to gage the associated risks and take measures now to prevent an all-out panic. Let's hope they are prepared, and can minimize any shock to the system and prevent the above

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scenario carried to the end. If they fail, citizens around the globe will suffer more than they already have for years to come.

How could this impact Solano County? PERS rates that the county pays will increase to compensate for another stock market plunge. The economic recovery for the country and the state will be further delayed following another recession. Housing and the corresponding property tax base will continue to deteriorate. The structural deficit we are attempting to close will expand and further cost reduction plans will be necessary. It would be prudent for the CAO and Board to close the current deficit and be prepared for further reductions in the years to come.



Solano County

Board of Supervisors

Minute Order

October 25, 2011

File Reference No. 11-0516

RE:

Accept the Solano County Treasurer's Quarterly Report for the period of July 1, 2011

through September 30, 2011

Accepted