T H E   C A B I N E T

S T A T E   O F   F L O R I D A

Representing:

DEPARTMENT OF BOND FINANCE
DEPARTMENT OF REVENUE
DEPARTMENT OF HIGHWAY SAFETY AND MOTOR VEHICLES
BOARD OF TRUSTEES
STATE BOARD OF ADMINISTRATION

The above agencies came to be heard before THE FLORIDA CABINET, Honorable Governor Bush presiding, in the Cabinet Meeting Room, LL-03, The Capitol, Tallahassee, Florida, on Tuesday, December 13, 2005, commencing at approximately 9:25 a.m.

Reported by:

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Representing the Florida Cabinet:

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Governor

CHARLES H. BRONSON
Commissioner of Agriculture

CHARLIE CRIST
Attorney General

TOM GALLAGHER
Chief Financial Officer

* * *

I N D E X

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BOARD OF TRUSTEES, INTERNAL IMPROVEMENT TRUST FUND
(Presented by Colleen Castille)

STATE BOARD OF ADMINISTRATION
(Presented by Coleman Stipanovich)

P R O C E E D I N G S

GOVERNOR BUSH: Division of Bond Finance.

CFO GALLAGHER: Motion on the minutes.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, Item 1 passes.

MR. WATKINS: Item Number 2 is a resolution authorizing the negotiated sale of up to $100 million of --

GOVERNOR BUSH: Let's wait for the Tax Watch folks to leave here.

Thank you.

CFO GALLAGHER: It's so much quieter.

GOVERNOR BUSH: Item 2.

MR. WATKINS: Item 2 is a resolution authorizing the negotiated sale of up to $100 million of Everglades restoration revenue bonds.

CFO GALLAGHER: Motion on 2.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. WATKINS: Item Number 3 is a resolution authorizing the negotiated sale of up to $11.2 million of taxable revenue bonds for a dining facility at Florida State University.

CFO GALLAGHER: Motion on 3.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

CFO GALLAGHER: And we have received fiscal sufficiency from SBA; right?

MR. WATKINS: Yes, sir.

GOVERNOR BUSH: Item 4.

MR. WATKINS: Item 4 is a resolution authorizing the issuance of up to $70 million of university system improvement revenue bonds.

CFO GALLAGHER: Motion on 4.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. WATKINS: Item number 5 is a report of award on the competitive sale of $200 million in PECO bonds. The bonds were awarded to the low bidder at a true interest cost of 4.60 percent.

CFO GALLAGHER: Motion on 2.

GOVERNOR BUSH: Is there a second?

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: Motion and a second. Without objection, Item 5 passes.

MR. WATKINS: Item 6 is a report of award on the competitive sale of $11,270,000 of parking facility revenue bonds for Florida State University.

CFO GALLAGHER: Motion on 6.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: Motion and a second. Without objection, the item passes.

MR. WATKINS: Item Number 7 is a report of award on the competitive sale of $142,420,000 of Florida Forever revenue bonds.

CFO GALLAGHER: Motion on 7.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. WATKINS: And Item Number 8 is the presentation of the 2005 debt affordability report. Gentlemen, if I may --

ATTORNEY GENERAL CRIST: We've got it.

MR. WATKINS: A new version, new and improved version.

By way of background, the debt affordability analysis originally done back in 1999 was a methodology adopted by this board as policy to govern the issuance of state debt. The analysis was subsequently formalized by the Legislature including this policy in statute in 215.98, which designates a benchmark debt ratio of debt service to revenues and establishes a target of 6 percent and a cap of 7 percent and requires that this information be updated and provided annually to the legislative leadership, to the President of the Senate, Speaker of the House, and the chairs of the specific Appropriations Committees. So the purpose of this presentation is simply to summarize and provide highlights of the information that will be included in the debt affordability analysis that will be delivered to the Legislature tomorrow.

The purpose of the exercise is to provide a framework for --

COMMISSIONER BRONSON: Ben, I had a question. On these figures that you're showing here over the next few years projected out to 2015, what would cause us to go over, and what potential would there be for us to go over that 7 percent from a finance standpoint?

MR. WATKINS: The biggest issue, the biggest uncertainty is with respect to economic climate. The one factor that affects the analysis and our debt position in addition to the debt burden that we have -- because once we have it, it's there. It's embedded. It's a recurring requirement for appropriation over the long term. So there's two inputs. One is the amount of debt and the attendant debt service requirements, and then the other are the revenues we have available to pay, and that's what moves that ratio more than anything.

But the biggest issue, and we're going to talk about this, from a finance standpoint is funding class size.

COMMISSIONER BRONSON: So -- but I guess my point was, we go into supposedly -- hit an inflationary period where everybody's revenues are going to be affected. Could this put us in a pretty bad position down the road? Say around the 2008, 2011 area, could we go over that because of those economic indicators?

MR. WATKINS: We could. I don't foresee that, and that's the purpose of the fluid nature of the analysis, is to update it every year based on the most current information we have so that we can look out and see those problems and address them in a meaningful way rather than inadvertently doing something, that we're going to do this in an informed and educated way.

GOVERNOR BUSH: If we took advantage of every debt-creating opportunity, which is Florida Forever, Everglades, class size, and the other debt obligations that we do on an annual basis, and there is a Revenue Estimating Conference that shows a decrease in the increase in general revenue, then you could see the numbers -- we've had really good improvement on this. You could see that go away.

So, for example, I'm hopeful that the Legislature will pay all cash for Florida Forever, for -- I'm not going to say this. Never mind. I won't bring it up. I'll save it for a later date. But, you know, there are things that you can pay all cash for.

CFO GALLAGHER: Big purchases.

GOVERNOR BUSH: Big purchases. I'm looking at Eva.

CFO GALLAGHER: Real big.

GOVERNOR BUSH: Everglades. And you total it up, and it can be $600 million that's cash that doesn't require debt service.

CFO GALLAGHER: And that saves about 400 and -- let's see. I think it was 250 to $300 million a year in debt service if we were to pay cash for the things you just mentioned.

GOVERNOR BUSH: But class size is something we don't have the luxury of paying cash for.

MR. WATKINS: Class size is the 10,000-pound elephant in the room that nobody wants to talk about.

GOVERNOR BUSH: I do.

MR. WATKINS: But it will get --

GOVERNOR BUSH: No one wants to listen. That's the difference. Okay.

MR. WATKINS: Legislatively.

So the purpose of the exercise is to provide a framework for measuring, monitoring, and managing the State's debt position by integrating the function of this board, which is actually executing the spending plan that's formulated at the legislative level. So what we're trying to do is integrate those two functions by providing information to the Legislature to enable them to make an informed decision about the long-term financial consequences of borrowing decisions that they make.

And most fundamentally, this financial model is used to calculate bonding capacity based on two variables. One is the amount of debt that we have outstanding and our annual debt service requirements associated with that debt, and secondly are the revenues that we have available to make those payments with.

So the process for evaluating -- for updating the debt affordability analysis, which you're familiar with and is included in this information that we will walk through, involves calculating total state debt, evaluating how much debt has increased over the past year and how much annual debt service payments have increased over the last year, to update the projected benchmark debt ratio for annual debt service to revenues available to pay by using the most current information we have available, the two factors being the expected debt issuance over the next 10 years and the most recent Revenue Estimating Conference forecast of revenues that we'll have available to make those payments with.

So we take that information, and we evaluate what the impact of that debt issuance is going to be over the long term based on the debt service that we -- the debt that we have outstanding currently plus the debt that we plan on issuing over the next 10 years.

Also, what I would like to do, because they're particularly relevant issues this year, is to evaluate the level of our reserves and also to review our credit ratings, because these two particular issues are important this year.

GOVERNOR BUSH: What is our credit rating, pray tell?

MR. WATKINS: You know, I have a hard time remembering, Governor. AAA.

GOVERNOR BUSH: Just checking.

CFO GALLAGHER: AAA.

MR. WATKINS: As good as it gets.

GOVERNOR BUSH: I've been reading about that in the paper recently.

ATTORNEY GENERAL CRIST: Does any state have it that high?

GOVERNOR BUSH: We do.

CFO GALLAGHER: Quite a few.

ATTORNEY GENERAL CRIST: Any other states?

MR. WATKINS: There are six other states with AAA ratings. But it's a relatively exclusive group, and it is -- those states tend not to be growth states.

GOVERNOR BUSH: Georgia, Georgia --

MR. WATKINS: Georgia, for example.

GOVERNOR BUSH: -- is a good state.

MR. WATKINS: And North Carolina lost their AAA rating this year.

GOVERNOR BUSH: Sorry to hear it.

MR. WATKINS: They didn't do the things that we did in terms of managing the state financially. They chose to do more debt to address some of their budgetary issues and some of their challenges, and so the level of debt that they had outstanding impacted the rating agencies' view of how much they could afford and how they were being managed financially.

Total state debt outstanding is now $22-1/2 billion, and this graphic on page 4 is just simply to show that over 55 percent of the debt that the State has outstanding has been used to fund education facilities.

The next thing we evaluate in our debt position is to look at a trend over a period of years. So what we do is look at the 10-year history. And you all are familiar with this chart in terms of the amount by which debt has increased. Debt has increased for the State by $12.3 billion over the last 10 years from

10.2 billion to 22-1/2 billion, so that's a 2.2 times increase over that 10-year period.

But this year we've also had a shift in the complexion of what made up that increase in debt. And what I mean by that is, although we had a $1.3 billion increase in total debt that was outstanding, the most meaningful measure, because it's what we use to calculate the benchmark debt ratio, is tax-supported debt, which is different from self-supported debt, things like toll roads, dormitories, parking garages, where it's a self-liquidating enterprise and the revenues used to secure the debt are generated from user fees associated with that facility. While we include those in total state debt, that's not what we calculate the benchmark debt ratio off of. We calculate the benchmark debt ratio off of tax-supported debt.

This year, tax-supported debt only increased 600 million, which is significantly less than prior year increases. And you're going to see momentarily what that means for the State from a financial management standpoint.

The next and most -- the next consideration in terms of evaluating the State's debt position is to look and see what our annual debt service requirements are on an annual basis to repay the debt that we borrowed to date. And you can see that now the State devotes $1.6 billion on a recurring basis to pay debt service on debt that has previously been issued, which is about a 2.4 times increase, which mirrors the increase in the debt that we just saw on the preceding slide.

However, for this fiscal year, 2005, the increase in the annual debt service requirements is less than what you would have -- than what we would have expected and has increased by only $32 million, and that's because of a couple of significant factors.

One is, I just mentioned there has been less tax-supported debt issued during 2005, and that's because of the initiative to use cash in lieu of bonding. So now we see the effect of the prudent financial decisions we made over the last three years of using cash rather than borrowing the money, which means less debt has been issued, and that then therefore affects our overall debt requirements, and then that is reflected in our benchmark debt ratio.

The other thing that is significant that has an impact on the low growth in our annual debt service requirements is significant refinancing activity that we've undertaken over the last -- or during 2005 to refinance debt at lower interest rates to lower our annual debt service requirements. So we -- over the fiscal year 2005, we executed $1.8 billion in refinancings, which is significant, and the gross savings over time resulting from that is about $225 million.

So the combined impact of those two variables really serve to minimize the increase in annual debt service requirements that is significantly different from prior years, where our increases are usually $100 million to $150 million on a recurring basis to support the debt that we normally issue.

Now we start -- that's the look-back part, and now we start the process of looking forward and looking at the amount of debt that we expect to issue under the programs that are currently authorized in statute. And this is a 10-year look on all of the programs that are currently authorized. And what we see is that our expected debt issuance over the next 10 years is $9.55 billion.

And again, the expected borrowing has not increased. It's virtually the same as it was last year. There's only a $52 million increase in our expected debt issuance over the next 10 years, and that's because there have been no new programs authorized.

So even though we have had increases embedded within this schedule showing the different programs and how much we expect to issue, we've increased PECO bonding by $765 million based on the November Revenue Estimating Conference numbers, the PECO revenue estimates. So we've increased PECO, but we've had decreases in programs that were limited by dollar amount. And so what I mean is, we issued bonds last year for lottery, for class size. We issued bonds last year for right-of-way. So those come off of the schedule, and we didn't increase it in any way. So we issued debt we expected to issue, and then that serves to reduce the amount or mitigate the impact of the increases in expected funding for PECO. So it's basically flat.

GOVERNOR BUSH: You don't have the class size on this.

MR. WATKINS: Do not have the class size on that, biggest caveat.

GOVERNOR BUSH: It's huge.

MR. WATKINS: So this doesn't include any new financing programs, although there has been talk about a new financing program for transportation, for growth management, and there's talk about funding Babcock with debt rather than using cash. And then the biggest issue that's mandatory, not optional, is class size reduction and how to pay for that.

But the plan is, as those proposals get floated legislatively, we'll run the numbers to evaluate the financial impact so that the Legislature has that information and they can establish priorities with an eye towards what impact it has on -- what long-term financial consequences it has with respect to approving debt today.

COMMISSIONER BRONSON: Governor, we've heard the molasses part of the good work that we're doing to improve Florida's financial security, but the sulfur part of this also needs to be said, and that is that for agencies such as the one that I'm responsible for, where we're trying to be as frugal as we can be, and we're raising money through trust funds that we pull in by doing our work, and the Legislature decides to move trust fund money over to use as cash to pay for some of these very good programs, that also the agencies that have been very frugal and doing a good job at getting that trust fund money up because of fines owed and so forth -- and I hear this within my own division heads too, that it seems like the better job we do and the more efficient we are, the more we get taken to replenish things that we need in our department to pay for these.

Now, I'm not -- you know, that's a philosophical thing that the Legislature is going to do from time to time, or every year it seems now, to help pay for some of these programs. But I just want to go on record as being known to say I can see the efficiencies of this type of program, what it's doing to the Department of Agriculture and Consumer Services and some of the work we have to do as regulators.

And so I just want to make sure that everybody knows that there are some people paying for this, and some of it is coming directly from the agencies that are doing a good job, and I think that's something that ought to be said here. And we're not the only one out there.

GOVERNOR BUSH: Treasurer?

CFO GALLAGHER: Ben, I don't understand. On page 7 --

GOVERNOR BUSH: He's got a long script.

CFO GALLAGHER: Yes. No, that's page 6. I may be getting out ahead of you.

MR. WATKINS: That's all right.

CFO GALLAGHER: You're running about 4 percent increases in revenue, somewhere, 3.6, 3.7, 4.1. And then all of a sudden 2012 hits, and it goes to 9.23. What do you know that the rest of us don't know?

MR. WATKINS: That is -- there's a financial program being added called GARV bonds that has been statutorily authorized for several years but has never been deployed. It's going to be a -- it's a program to leverage federal revenue sharing for highways. Okay? So the way the model works, if you bring a financing program on, you also bring the revenue stream that's going to secure that program into the analysis. So there's a new program that's planned to be implemented in --

CFO GALLAGHER: In 2012? 2012 is when it's going to be implemented?

MR. WATKINS: Let's see.

CFO GALLAGHER: That's when the kick-up is.

GOVERNOR BUSH: See right there? See the GARV on the chart?

CFO GALLAGHER: On this chart?

MR. WATKINS: The GARV -- back up one, and look at the GARV, which is sort of in the middle of the page, 300 million and 225 million.

CFO GALLAGHER: Yes, I see it.

MR. WATKINS: Commences in 2012.

CFO GALLAGHER: There it is.

MR. WATKINS: Okay. So we've got --

GOVERNOR BUSH: I think what we've done is, we have advanced revenues that we're going to receive with the commitment to bond, use these GARV bonds at that date, so the money has been expended to accelerate construction projects for roads. I believe that's -- so we made the commitment now, and --

CFO GALLAGHER: Build the roads now?

GOVERNOR BUSH: We're building -- we've just accelerated our work plan by doing this. And we're one of the last states to begin to participate in the GARV bond process that's allowed by law.

CFO GALLAGHER: Right. But, see, that's $500 million out of 3.6 billion, and the year before that it's 1.5 billion. So even if we took the 500 million out, you would still be, you know, over 8 percent.

MR. WATKINS: But it's the revenue side.

GOVERNOR BUSH: It's the revenue side that's brought into the equation, and the revenue side is probably significantly greater.

MR. WATKINS: Over a billion dollars. So we're bringing more revenues in calculating that debt ratio, Treasurer. We're bringing on a billion or so dollars in revenues, but we're only bringing in a very small percentage -- the debt service requirements on 300 million, let's call it 30 million a year. So you see, you're bringing on a lot more revenues in terms of revenues available to pay and only a small part of debt service because of the amount of borrowing that's being done.

So it has the impact of, for lack of a better term, artificially depressing the benchmark debt ratio until you get it leveraged up to a 5 or 6 percent, and then it starts working against you.

CFO GALLAGHER: So what you're doing is, this actually shows us having more revenue available for debt.

MR. WATKINS: Correct.

CFO GALLAGHER: Because you're getting the revenue, but the debt stays low.

MR. WATKINS: Starting in 2012, yes, sir, that's exactly right. It's one of the anomalies of the model.

CFO GALLAGHER: The tail is wagging the dog here is what's happening.

MR. WATKINS: Yes, sir, the mechanics of that. But one thing I would like to --

GOVERNOR BUSH: Except now we're accelerating construction that will be far more costly, you know, later.

CFO GALLAGHER: It's a winner for us to do it today instead of down the road, there's no doubt.

GOVERNOR BUSH: Within limits. I mean, I think you could get so leveraged up that it creates problems.

MR. WATKINS: I think the statutory

limitations, Governor, if my recollection serves me correctly, is no more than 10 percent of federal revenues, and the duration of the debt can't exceed 10 years. So it's really intended to be a cash flow kind of borrowing, because the way DOT programs work, they do it over a 10-year period. And so this GARV is intended to plug shortfalls in those out years so that you can go ahead and get things started and get it in the work program to accelerate work.

One thing that I would like to point out that's another reflection of sort of conservative financial management that the rating agencies have taken note of, this program was authorized four or five years ago, but we haven't needed to use it, for two reasons: We're getting more revenues than we thought, but more importantly, the growth management legislation.

I mean, there are significant resources being dedicated to transportation spending that allows the acceleration. So, in effect, we're delaying the deployment of a financing mechanism that has been in place statutorily for several years, and it's because we're using cash until we really need to use the debt several years out.

So we're both accelerating things, accelerating construction to get more work product under way. We're using cash in the early years, dedicating it towards that, and then filling the gaps in the late years with debt.

GOVERNOR BUSH: Onward.

MR. WATKINS: Onward.

GOVERNOR BUSH: We briefly went into the weeds, but now we're out.

MR. WATKINS: The change in the revenue forecast, the reason I put this in there, you're all familiar with the Revenue Estimating Conference adding about $3.2 billion in revenues, really reflecting the strength and resiliency of the State's economy. The booming real estate market, $600 million has been added in documentary stamp taxes, sales taxes because of population growth, reconstruction activity, and increased business investment, and also $350 million in corporate income taxes because of increased profitability on the change in business cycle.

Now, we take all these factors, and this is the projection of the benchmark debt ratio. And using the debt service on the existing debt plus the expected debt service on the 9.55 billion expected over the next 10 years, and using the current Revenue Estimating Conference forecast, we calculate the projected benchmark debt ratio, and this is the result.

So we showed the historical trend line and then projected -- we've had an improvement, and that improvement continues in the out years, and the improvement in the debt ratio over the last two years from 6.12 percent in 2003 to 5.36 percent at the end of 2005. So the benchmark debt ratio has improved significantly over the last two years due to higher revenue estimates, less projected debt issuance, and refinancing activities to take advantage of lower interest rates.

And the important thing to note here is, not only have we changed the trend line from a historical perspective, but also changed the fundamental direction of the benchmark debt ratio. So for really the first time over this projection period, we have shown a significant improvement in the benchmark debt ratio.

Again, the thing that this thing doesn't include, class size.

The next thing we do is calculate debt capacity available within the 6 percent target, and what we find is that we've got capacity of $23.6 billion within the 6 percent target, less the expected debt issuance of 9.55 billion leaves $16.7 billion in available capacity. This is a $4.8 billion increase from the estimate of 11.9 billion in available capacity last year.

And again, the reasons are the same reasons that we previously talked about, higher revenue estimates, using cash in lieu of debt, which reflects upon our future debt issuance, refinancings to lower interest rates, and lower our debt service requirements. And one additional factor is the final maturity of the P2000 bonds in 2013, when we will have amortized the entire program in 2013, which then generates significant capacity in the out years.

Then we calculate the available capacity within the 7 percent cap. And again, going through the same methodology, what we find is that we have a significant increase in debt capacity within the confines of the 7 percent cap.

But my cautionary word here is, we've seen how changes in the economic climate can affect the debt capacity both on the downside when we went through the '01-03 recession and were actually cutting revenue estimates, and we've seen it on the upside through the economic recovery post recession, where we're adding capacity because we have higher revenues.

So the bottom line is that the benchmark debt ratio is sensitive to economic cycles, so that layer between 6 and 7 percent really should be used and viewed as a cushion against changes in economic outlook and not used simply because the model indicates that it's available.

Now what we've done is to -- for illustration purposes only, and really not intended to be an accurate projection of what implementation of class size reduction could mean, because one of the difficulties we have is getting hard estimates --

GOVERNOR BUSH: Well, I can assure you --

MR. WATKINS: -- on the cost.

GOVERNOR BUSH: -- the 1.8 billion is --

CFO GALLAGHER: Too low.

GOVERNOR BUSH: That's ridiculously low. If you're assuming that we're using debt to finance the capital outlay for class size, that's not even -- I've never seen that estimate. That's an estimate of wishful thinking.

MR. WATKINS: Right. On the low side, the 1.8 billion --

GOVERNOR BUSH: 4.2, by the way, that's not the high estimate.

CFO GALLAGHER: 6.2.

GOVERNOR BUSH: The high estimate would be higher, because the estimates haven't factored in any increase in construction costs, which have gone up about 40 percent in the last few years.

CFO GALLAGHER: 6.2 is what it was.

GOVERNOR BUSH: So, you know -- but go ahead and make your point. I'm sorry.

MR. WATKINS: That's okay. This shows the projected impact. We've run three different scenarios. The bottom line, the blue line, is the base case scenario. That's what -- on the prior projections, that's what you see with our existing borrowing plans. We simply added $1.8 billion as a low estimate, and that's the green line, and then we've added $4.2 billion as the high estimate. That's based on DOE current policy, which doesn't include any inflationary impacts on construction cost.

And so what you see is that if the cost is around 1.8 billion, that we slightly exceed our target in 2009. But if you have the -- but if the cost of implementation comes in at the high end, then you move significantly towards the cap, which is not a desirable thing.

GOVERNOR BUSH: All right.

MR. WATKINS: Levels of reserves. That completes the debt affordability analysis, and the last two things I would like to comment on, Governor, is talk about reserves and credit ratings.

The single most important tangible measure of financial strength are the level of reserves. In general, fund reserves have grown substantially over the last 10 years, both in absolute dollars and as a percentage of general revenues. We ended 2005 with $4.6 billion in our reserves from the Budget Stabilization Fund and our General and Working Capital Fund, so not including our trust funds, 4.6 billion.

GOVERNOR BUSH: How much in trust funds? About another 800 million?

MR. WATKINS: Governor, if we just look the

Lawton Chiles Endowment Fund --

CFO GALLAGHER: You can't count those.

MR. WATKINS: If you want to get a rise --

CFO GALLAGHER: Can't count those.

GOVERNOR BUSH: And then the Chiles Endowment is not counted either.

MR. WATKINS: That's 1.8 billion in Chiles Endowment.

GOVERNOR BUSH: So in terms of real cash reserves in a crisis, even if you exempted Treasurer Gallagher's and Commissioner Bronson's trust funds, gave them a special secret squirrel exemption --

CFO GALLAGHER: They're not ours. They're the people's.

GOVERNOR BUSH: Yeah, yeah. We have probably an additional $2-1/2 billion of cash over and above this. Just to put it in perspective, we're liquid.

MR. WATKINS: Right. And that obviously has been recognized by the rating agencies. It was cited in all the rating agency reports and the upgrades, substantial reserve levels. And the measure that the industry uses is reserves as a percentage of general revenues. Florida's at the end of 2005 was 18.3, a phenomenal 18.3 percent.

We have statistics for every state, so just to put it into perspective, if you look at our 10-state peer group, which is the 10 largest states, the statistics we have are from the end of '04, not the end of '05. However, what it indicates is four of those states, growth states, were in deficit positions. So California, Texas, New York, and Illinois were all under water in terms of their general fund balances and had to use budget --

GOVERNOR BUSH: How can they be in deficit?

CFO GALLAGHER: They're allowed to, are they not?

GOVERNOR BUSH: No, they don't have a --

CFO GALLAGHER: Their constitution lets them be in deficit.

MR. WATKINS: Normally, from a budgetary perspective, Governor, they can play games in terms of when they pay bills and when they --

GOVERNOR BUSH: How come no one told me that when I was here?

CFO GALLAGHER: You can't do it here.

MR. WATKINS: I don't think it would have met with a receptive audience.

GOVERNOR BUSH: I agree. I agree.
MR. WATKINS: That's the reason they probably didn't tell you that.
GOVERNOR BUSH: It's a bad thing.
MR. WATKINS: So four states were in deficit positions. The six states who had positive positions, three of them were virtually zero. And the other two, relative to us, were from 3.9 percent to 4.75 percent on a reserve basis.
So, you know, in terms of the level of our reserves, we are at levels that are just not comparable to other states, which really reflects -- the reserve levels are a product of the conservative financial management practices and how the State has been extraordinarily well managed over the last several years.
GOVERNOR BUSH: I think we need to pause and recognize the Florida Legislature for its efforts, because this last year -- I imagine the Legislatures of the states you mentioned may not have the discipline that the Florida Legislature showed this last year by reserving a significant slug of cash that could have been spent. You know, Tom Lee and Allan Bense and their appropriators deserve a lot of credit for this.

MR. WATKINS: The other thing, Governor, which you've already mentioned is that from a liquidity standpoint, it puts us in a position to effectively deal with the unexpected, and that is -- for Florida, that means hurricanes and storms. So really, having these reserves for the truly unexpected put us in the best possible position we could be in to deal with the cost of recovery.

GOVERNOR BUSH: I'll give you an example. We've spent -- maybe it's state and local governments in Florida, but I think a majority of it has been state. We've spent $150 million in Mississippi. Did we not have the liquidity to do it, we would not have been able to do it. We would not have been the first responders to our neighbor. Now, we'll get reimbursed fully on that, but it takes a while for all that paperwork to be processed through Jackson, Mississippi, up to Washington and back. So, you know, the reserves do matter.

MR. WATKINS: And then lastly, the State's credit rating being upgraded by the three rating agencies, so we're now AAA by Standard & Poor's, AA+ by Fitch, and AA1 by Moody's. And this is the first time the State has ever obtained a AAA rating and the first time Moody's has ever upgraded the State's general obligation bond rating. So this has been extraordinary. And it's obviously important because of the impact on borrowing costs and the perception of the credit markets on how the State has been managed financially.

And I would also like to point out some of the highlights, Governor, in terms of what precipitated the rating upgrades. Not only have we been fortunate from an economic standpoint, and our economy has been durable through the recession and has been very resilient, but we've also helped ourselves, that is, the Legislature and the leadership, from a credit perspective by the way the State has been managed financially. And we have -- the rating upgrades recognize the State's demonstrated fiscal discipline and conservative financial management practices.

The State has done many things right from a financial management perspective, like balancing the budget by cutting spending in the '01-03 recession, using cash in lieu of bonding, and really paying attention to the structural balance between recurring and nonrecurring and using nonrecurring revenues to fund nonrecurring expenditures, funding growth management with cash, building substantial reserves, a fully funded pension plan, which is unprecedented among states, and the leadership on major policy initiatives like high speed mail and Medicaid reform, and lastly, an emphasis on debt management.

So if I may just give you some of the things that the rating agencies, the bullet points that they have articulated as the reason for the State's upgrades in their latest credit reports. The State's strong and conservative financial and budget management practices; strong revenue performance in the past several years, setting Florida apart from most other states; budget pressures that have been effectively managed as the State continues funding various constitutional amendments and service demands of a growing population; service-based economy with growth continuing to outpace the national economy; solid economic growth prospects in the long term with a strong and competitive position in the Southeast; and moderate debt burden that will remain stable due to legal guidelines regarding debt affordability.

So from a debt management perspective, this is as good as it gets. And I would like to thank you for the support you guys have provided that really made my job easy. All I had to do was sort of tell the story that the Governor made it a priority. I had tremendous help from his staff in terms of putting together the information to tell Florida's story, and the rating upgrades are the product of that.

GOVERNOR BUSH: Treasurer?

CFO GALLAGHER: Move to accept the report.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion to accept and a second. Without objection, we gratefully accept the report. Thank you, Ben, for your service. Thank you for that five-minute presentation too, by the way. But you deserve it. You know, you deserve to give us the full loaf of bread, because you've done an incredible job.

MR. WATKINS: Thank you, sir. It's the danger of giving me an open mind.

GOVERNOR BUSH: Department of Revenue.

CFO GALLAGHER: Motion on the minutes.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: Dr. Zingale has a role to play in all this as well. One of the reasons why we're in a better fiscal situation is that we have a nonpoliticized revenue estimating process, and it's very professional, and Dr. Z has been a part of that, and we appreciate your service as well.

DR. ZINGALE: Thank you very much. One item beyond the one that you just adopted, five rules dealing with ad valorem tax --

CFO GALLAGHER: Motion on 1.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion on Item 1 and a second. Without objection, the item passes.

DR. ZINGALE: Item Number 2 are five rules that deal with ad valorem taxes. Three of them are simply implementing legislative changes that were made last session. One of them is a forms update, and one of them is an administrative change dealing with the digital submission of data to the property appraisers. Request approval.

CFO GALLAGHER: Motion on 2.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

DR. ZINGALE: On behalf of the Department of Revenue, we all -- the family of the Department of Revenue wishes you a Merry Christmas and another great year coming up. Thank you.

GOVERNOR BUSH: Thank you, Jim.

GOVERNOR BUSH: Department of Highway Safety and Motor Vehicles.

CFO GALLAGHER: Motion on the minutes.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. DICKINSON: Item Number 2 is the quarterly report for the fall quarter. Everything looks good there, Governor, but it should. That's compared to last year, and we all know what we were fighting.

CFO GALLAGHER: Motion to accept the report.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item is approved.

MR. DICKINSON: Item Number 3 is a request for approval to enter into a five-year contract on our motor vehicle side with the tax collectors.

CFO GALLAGHER: How much money are we saving on that?

MR. DICKINSON: We're saving about 2 million over the cost of the last five years. But we have expanded so much with the tax collectors, that's probably where most of that growth was eaten up. It should have been more with the lowering of the cost, but we got a good deal.

CFO GALLAGHER: Motion on 3.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. DICKINSON: Happy holidays to all.

GOVERNOR BUSH: Thank you.

GOVERNOR BUSH: Board of Trustees.

MS. CASTILLE: Good morning, Governor and members of the Cabinet.

GOVERNOR BUSH: Good morning.

MS. CASTILLE: I'm just so glad that Babcock is through this board.

CFO GALLAGHER: No, we're not finished yet. We have to figure out how to pay for it.

MS. CASTILLE: Oh, we have a long way to go.

GOVERNOR BUSH: Don't you have to bring it back? Didn't we have a modification of the interlocal agreement or something we need to approve now?

CFO GALLAGHER: I think as long as they didn't change what we approved and they had the two local agreements, I think --

MS. CASTILLE: But they want to approve the management plan, which --

GOVERNOR BUSH: There was no change by Lee County?

MS. CASTILLE: That was a change for a management plan.

CFO GALLAGHER: Which we agreed with.

MS. CASTILLE: Right. They want to be a signatory, and approval of the management plan.

GOVERNOR BUSH: Okay.

MS. CASTILLE: And so ultimately -- we'll just have to see. We want to wait and see what the funding does, and if there's something else we have to bring back to you, then we'll bring it back.

GOVERNOR BUSH: All right.

MS. CASTILLE: Okay. Item -- oh, I want to take a moment to introduce you to our new district director in the Northeast Florida District, Jacksonville. His name is Greg Strong. Here he is.

GOVERNOR BUSH: Hey, Greg.

MS. CASTILLE: Greg comes to us from Connecticut from a company by the name of Veeder-Root, and they manufacture monitoring equipment for the oil and gas industry. But his heart is in Florida, and he's back with his family.

Do you want to say hello, Greg?

MR. STRONG: Good morning. It's a pleasure to be here and to come back to Florida. I spent four very good years at Florida State just down the road, and I'm looking forward to working on some of the challenges in the Northeast District.

GOVERNOR BUSH: Great.

CFO GALLAGHER: Welcome.

GOVERNOR BUSH: Welcome aboard.

MS. CASTILLE: I wanted to give him a little immersion in Cabinet for today.

Item 1. This is the Huckins Yacht Corporation recommended consolidated intent for a five-year sovereignty submerged lands lease. Governor and members of the Cabinet, these are very good actors. They have a clean marina and a clean boat yard designation as well, so we --

CFO GALLAGHER: Motion on 1.

COMMISSIONER BRONSON: Second.

MS. CASTILLE: -- recommend it.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MS. CASTILLE: Item 2. This is the City of Punta Gorda recommended consolidated intent. This is a request by the City of Punta Gorda to modify an existing 10-year sovereignty submerged lands lease by converting a mixed use docking facility to a public municipal marina open on a first-come, first-served basis.

CFO GALLAGHER: Congratulations. Motion on 2.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: This is undoing something we did; right?

MS. CASTILLE: It is.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MS. CASTILLE: The mayor is here. Do you want to say thank you, Mayor?

GOVERNOR BUSH: Where's the mayor? Bring up the mayor. Let me -- you know, I'm going to have a hug.

MR. FABIAN: He always makes me cry.

Governor Bush, Cabinet members --

GOVERNOR BUSH: That's a great city.

MR. STRONG: The citizens of Punta Gorda thank you not only for what you just did now, but for what you and your staff and all the state did for us in the aftermath of Charley. You know, some people think a football game with a coin toss is nothing important, but what it meant to our city was fantastic, and thank you again for that.

You know, this project is going to be the jewel of our city, and we're looking forward to it. And again, thank you, and we appreciate all of your staff's help on this.

GOVERNOR BUSH: What is the project? Describe it a little better. We've already approved it, so you can't --

MR. FABIAN: It will be a marina, and also the uplands will be a city park. We have a group that is even talking about carving a carousel for us to put in this park. It's going to be beautiful.

GOVERNOR BUSH: You have three or four, maybe five city blocks on the waterfront there that are not developed or could be redeveloped.

MR. FABIAN: I'll tell you, the City is -- our citizens are not only spirited, but tenacious, and we are coming back. We have a lot to go, but it's coming back every day. We have -- the county auditorium is on the water there where we're building the marina. There's a big marketplace right in the center of town. It's just coming along. And in three to five years, we're going to see things that usually would have taken 15 to 20 years. So Charley really hasn't been too bad to us.

Thank you very much.

GOVERNOR BUSH: Thank you. Merry Christmas to you.

CFO GALLAGHER: I move Item 3 deferred to 1/31/06.

COMMISSIONER BRONSON: Second.

CFO GALLAGHER: Exciting year.

GOVERNOR BUSH: There's a motion and a second to defer Item 3 to January 31st, 2006, and a second. Without objection, the item is deferred.

MS. CASTILLE: Item 4 is a Flagler County lease agreement. This is the consideration of a request by Flagler County for a 99-year lease agreement to use the property as a public park for Flagler County fairgrounds, softball, and baseball fields.

CFO GALLAGHER: I'll move a 99-year lease for Item 4.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: There's a motion to approve the 99-year lease and a second. Without objection, the motion is approved.

MS. CASTILLE: Item 5 is the City of Jacksonville option agreement for Pumpkin Hill Creek Florida Forever project. This is the consideration of an option agreement to acquire

184 acres within the Pumpkin Hill Creek Florida Forever project from the City of Jacksonville, who has preacquired it for us.

CFO GALLAGHER: Motion on 5.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MS. CASTILLE: Item 6 is the City of Jacksonville option agreement for the Northeast Florida Timberlands and Watershed Reserve Florida Forever project.

CFO GALLAGHER: Motion on 6.

COMMISSIONER BRONSON: Second.

GOVERNOR BUSH: This is a great encroachment property as well.

MS. CASTILLE: Yes, it is.

GOVERNOR BUSH: Because Whitehouse Field still continues to be used, I think, for touchdowns and training.

There's a motion and a second. Without objection, the item passes.

MS. CASTILLE: That concludes our agenda.

GOVERNOR BUSH: Thank you, Colleen.

MS. CASTILLE: Thank you. Happy holidays.

GOVERNOR BUSH: Happy holidays.

CFO GALLAGHER: Merry Christmas.

GOVERNOR BUSH: Merry Christmas.

GOVERNOR BUSH: State Board of Administration.

CFO GALLAGHER: Motion on the minutes.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

Coleman, good morning.

MR. STIPANOVICH: Good morning, members.

GOVERNOR BUSH: Item 2.

MR. STIPANOVICH: Is a request for approval of fiscal sufficiency of an amount not --

GOVERNOR BUSH: Are you sick?

MR. STIPANOVICH: Yes, I am.

GOVERNOR BUSH: Sorry to hear it.

MR. STIPANOVICH: Me too.

CFO GALLAGHER: Stay over there.

MR. STIPANOVICH: Request for approval of fiscal sufficiency of an amount not exceeding 100 million State of Florida Department of Environmental Protection Everglades restoration revenue bonds.

ATTORNEY GENERAL CRIST: Motion on 2.

CFO GALLAGHER: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

MR. STIPANOVICH: Item 3 is a request for approval of fiscal sufficiency of an amount --

CFO GALLAGHER: Motion on 3.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion and a second. Without objection, the item passes.

Item 4.

MR. STIPANOVICH: Item 4 is a request for approval to move forward with our legislative proposal. In that, there is a defined contribution proposal as well as a defined benefit proposal. The legislative proposal for the defined contribution plan consists mostly of technical changes that clarifies and makes the administration of the FRS investment plan easier and less costly. I would be happy to answer any questions regarding that proposed piece of legislation.

ATTORNEY GENERAL CRIST: Motion on 4.

GOVERNOR BUSH: There's a motion.

CFO GALLAGHER: Second.

GOVERNOR BUSH: And a second. Any discussion? Without objection, the item passes.

CFO GALLAGHER: That includes the one you didn't discuss.

MR. STIPANOVICH: Sir?

CFO GALLAGHER: I said that includes the one you did not discuss.

MR. STIPANOVICH: That's correct.

And the last one, Treasurer and members and Governor, is the defined benefit plan. The defined benefit plan proposes seven housekeeping amendments to the current legislation that mainly clarifies and improves our ability to meet the requirements of 215.47 and defines our legal list and our compliance with such.

There are two other amendments that do two things. One increases our ability to manage international investments and gain international exposure across other asset classes and be in compliance with the pension fund investment policy which you all approved. And the second enables us to implement value-added investment strategies that allow investment managers to enhance returns with stocks when they go up or down.

CFO GALLAGHER: Coleman, we already approved all that. We're on 5.

MR. STIPANOVICH: Oh, you did? I'm sorry.

CFO GALLAGHER: That's what I said,

including the ones you didn't talk about. We're on 5.

MR. STIPANOVICH: I thought you were talking about the other one.

GOVERNOR BUSH: What other one?

CFO GALLAGHER: That's it. We're on 5.

GOVERNOR BUSH: Item 5.

MR. STIPANOVICH: The annual report on corporate governance. The 2005 corporate governance report data has to do with proxy voting and governance activities of the SBA during the year.

CFO GALLAGHER: Motion to accept the report.

ATTORNEY GENERAL CRIST: Second.

GOVERNOR BUSH: There's a motion to accept the report and a second.

I would like to just add that I have read the report, and I think that -- I appreciate the fact that we're poised to take a more aggressive, active leadership role in this area. Given our scale and size, it's important, I think.

The couple of issues that are particularly -- there are two issues that I think are particularly important. One, the one that angers me the most, I guess, is the lack of tying executive compensation to results. And if we could take the lead on that, I would be very grateful and would like to participate. It's just outrageous, some of the salaries or the bonuses or the compensation that executives get for poor results, and we should not have any tolerance of that.

And then we've looked at in the past outside directors and their fiduciary responsibility and how they perform in that regard. I know based on this recommendation or this report, there are some things that we could probably do as well. So I look forward to maybe coming back after Christmas to give us a report on what your recommendations are and how we can be more aggressive in this area. I would appreciate it.

CFO GALLAGHER: Well, the good news is that the SEC made some changes a couple of years back that allow the pension funds to work with each other on proxy votes. Before, they couldn't really get together and do anything. And now through the Council of Institutional Investors, which Coleman is a leader in, they can basically discuss corporate governance and things they think are important with individual companies, which really couldn't be done before.

And so as a group, when you look at the pension funds, probably 30 to 40 percent of corporate America is owned by all the pensioners in the major pension funds, states and corporate and union pension funds, and so they can now get together and really put forward an agenda on corporate governance, which is what you're talking about here. And I know Coleman is a leader on that, so he can let us know what they're working on.

MR. STIPANOVICH: Yes, sir.

GOVERNOR BUSH: You know, there's just no -- there's not a focus on long-term economic performance in corporate America now, and partially it's because of all these hedge funds that are driving the quarterly stock prices up, and their expectations, their windows of expectations are very short. But I think from a governance point of view, you can help. I think they can withstand -- successful businesses can withstand that if they have in place strategies that compensate fairly, but based on performance. I mean, it's just -- we need it.

MR. STIPANOVICH: Well, Governor, we're

certainly -- and staff, we're on the same page. If you look at the report and turn to page 76, you'll see 17 pages -- excuse me, page 39, you'll see 17 pages devoted to the issue of executive compensation.

There are two issues that are our top priorities for the year, and it's executive compensation and majority voting. Those are the two issues that we'll be focused on this year in great length. And we've already done some things that I report on as well as some things that we're planning to do on corporate governance and the majority voting.

Majority voting is another important issue, and it kind of addresses your question about the board of directors. The issue is on majority voting, if we had majority voting, it addresses, you know, bad behavior on corporate boards and the appointment of members of corporate boards, because right now it's plurality voting, so they put up one member, and literally with one vote, the management and board's nominee can get elected without any opposition.

So majority voting would at least require that if more than 50 percent of the shareholders

-- and the SEC is coming out with a rule, by the way, on executive compensation that we'll be reviewing sometime in late December or early January. They haven't done anything on majority voting because they're trying to ascertain what's the appropriate law, it is 50 percent withhold votes, or is it 35 percent.

But if somehow or another the shareholders could have a voice in majority voting, they could have a lot to do with the composition of boards. And if you get the boards right and good behaving people on the boards, you'll get executive compensation --

GOVERNOR BUSH: That's right. Well, again, this was a great report.

MR. STIPANOVICH: Thank you, sir. Well, I want to commend my staff. Michael McCauley and Tracy --

GOVERNOR BUSH: Where are they? Where are they so we can commend them? We commend you.

CFO GALLAGHER: It's an awesome report.

GOVERNOR BUSH: It's a great report.

MR. STIPANOVICH: We have had probably four to five states contact us, big states on the West Coast as well, who are very active, very much activists in corporate governance, as well as some of the national investment advisor services wanting copies of this report so that they can see how basically -- you know, the content, the layout. When I started reading it, I couldn't stop. I went from front to back without stopping.

GOVERNOR BUSH: It's a little dry. I mean, the subject matter is not the most exciting or riveting, but for a guy like me that has ADD, it's well --

CFO GALLAGHER: It's good stuff.

GOVERNOR BUSH: There's a lot of meat to it. But it's also put together well.

MR. STIPANOVICH: They put a tremendous amount of time into. And Tracy is a new addition to the board as well.

CFO GALLAGHER: And, Coleman, you've done a great job in leading this place considering that you haven't been working there for two years.

MR. STIPANOVICH: That's right. That's the next agenda item, Treasurer.

CFO GALLAGHER: I noticed that. We have a statute, Governor, that says that the executive director is to be rehired every two -- every year, annually, and we sort of forgot to do that the last couple of years. So I guess we're going to move it. You have to be to the prevailing side, Governor, to move this. I would like to make the motion that we retroactively approve Coleman for '04 and '05.

ATTORNEY GENERAL CRIST: Second.

CFO GALLAGHER: And in January of '06, you'll be up again.

GOVERNOR BUSH: There's a motion and a second. Without objection, the motion passes. Merry Christmas.

CFO GALLAGHER: And I think that lets you qualify for your bonus. I'm not sure. We'll have to check on that.

MR. STIPANOVICH: Thank you so much. You all have a great Christmas.

(Proceedings concluded at 10:27 a.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA:
COUNTY OF LEON:

I, MARY ALLEN NEEL, Registered Professional Reporter, do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter translated under my supervision; and the foregoing pages numbered 1 through 60 are a true and correct record of the aforesaid proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

DATED THIS 21st day of December, 2005.

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