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Executive Summary

The State Board of Administration ("SBA") has engaged BlackRock to undertake an assessment of the current status of the investments of the Local Government Investment Pool ("LGIP")

- This assessment is intended to address the investment exposures currently in the portfolio, and to make recommendations about a way forward to optimize fund value and liquidity

Using the portfolio information provided by SBA, BlackRock has analyzed the portfolio with regards to credit characteristics and maturity structure

Depending upon the needs of investors, two primary options are considered in this presentation:

- "Run-off" Option – In this option, the LGIP would become a liquidating trust with projected cash distributions over time
- "Operating" Option – In this option, SBA would create two pools. One would be run as a cash vehicle for investors. The other pool would contain the distressed assets.

Other options that have been considered include:

- Potential for State or SBA to provide "guarantees" or to invest in LGIP
  - Within statutory, fiduciary and available cash limitations
- Liquidate the portfolio immediately albeit at a "distressed" price
- More complex structures in which distressed assets might be treated as "warrants"

LGIP Faces Two Inter-related Challenges

Credit risk

- This is the risk that some securities will not pay out as promised
- When a security defaults there is a real economic loss to the holder
- The LGIP currently has securities with face amounts equal to about 6% of the fund that are currently in default, have defaulted or extended
- The actual recovery amount and timing is currently unknown

Liquidity issues

- This is the cost of selling large quantities of a security into the market or of selling illiquid securities – prices that can be achieved will be lowered resulting in additional loss
- This risk exists even for securities that will pay fully and on time
- In that case, it may be better to hold the security to maturity rather than sell it
- There are some embedded losses in the fund at this point. If the SBA were to sell substantial assets now, losses would increase due to market illiquidity

Options going forward must try to balance two competing needs of shareholders

- The desire to maximize economic value
- The need for liquidity

Evaluation of Local Government Investment Pool ("LGIP")

BlackRock received from the SBA information regarding the investment holdings of the LGIP

These holdings were uploaded to BlackRock's proprietary risk systems for evaluation

A team of senior liquidity portfolio management and credit research professionals undertook to evaluate each individual position

Initial observations on the portfolio:

- $14 billion face amount
- Market value today is less than book value
- $867 million face amount (~6% of fund) is held in securities that are in default, have defaulted or extended, which adds uncertainty to timing and amount of payments
- $1.2 billion face amount (~8% of fund) is held in securities that are under stress due to credit issues
- $12.0 billion face amount (~86% of fund) are high quality money market instruments
- Of the high quality assets, the securities have maturities ranging between December 2007 and December 2008

Note that while much is known about this portfolio, many uncertainties exist, especially as market conditions change

Run-off Option

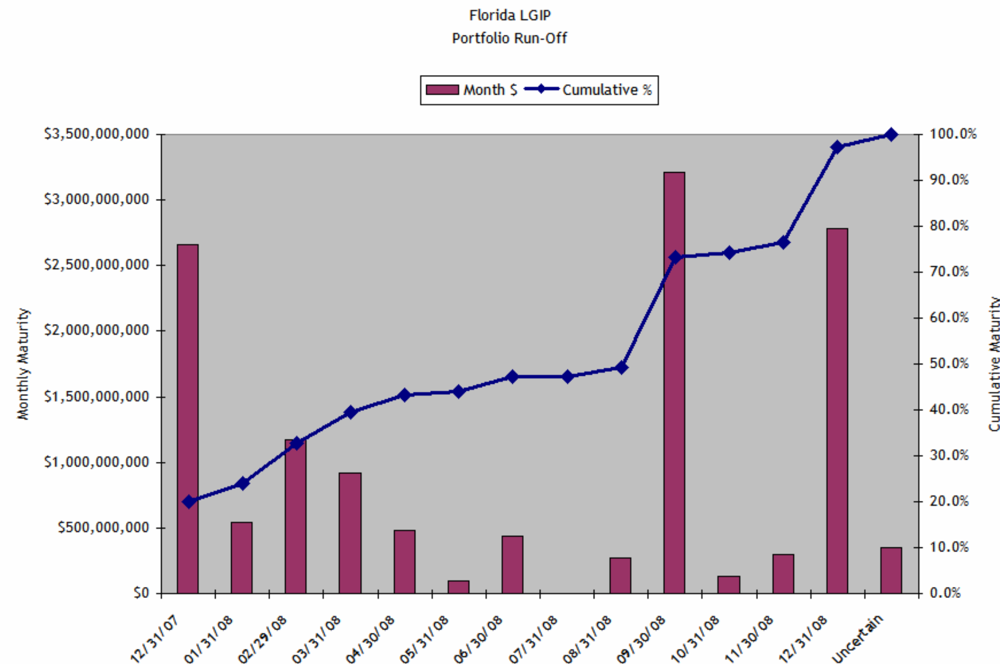
The LGIP would continue to be managed as one fund

Investors would receive distributions as income and principal is received by LGIP

The chart below shows the expected maturity schedule of LGIP assets. Assuming no changes occur, investors would receive the majority of their funds between December 2007 and December 2008

The maturity dates of approximately 6% of the holdings are considered “uncertain” today as these issuers have defaulted or extended, and a workout is needed

It is possible that additional securities could default



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Run-off Option: Pros and Cons

Pros

- Every investor in LGIP will be treated the same
- Minimizes economic losses
- Enhances probability of investors receiving their money back as measured by total payout vs. current capital balance

Cons

- Liquidity limited to cashflows from underlying securities
- Investors have no other access to cash from the pool
- LGIP becomes a liquidating trust

Operating Option

In this scenario, LGIP would be divided into two parts

“FUND A”

- Would contain all money-market appropriate assets
- ~$12 billion or ~86% of current LGIP

“FUND B”

- Would consist of assets in default, impaired or having significant credit risk
- ~$2 billion or ~14% of current LGIP

Operating Option – Overview of "FUND A"

Fund A is a managed cash vehicle, offering money market yields

There are several ways to address liquidity for shareholders in Fund A. Note that solutions are in part dependent upon withdrawal requests versus deposits.

1. Need to ascertain which investors are willing to commit to stay in the pool and/or make new investments in the pool
2. Need to verify amount of liquidity available "today". Currently estimating $2 billion available to meet near-term redemption requests
3. Currently shareholders will be allowed to redeem (with no fees) *the greater of*:
   a) Up to 15% of their holdings, or
   b) $2 million

   This amount is based on fund balances today and is expected to increase over time. New amounts will be posted based on continuous evaluation of the fund
4. Arrange a public-private partnership to allow shareholders to borrow cash against their shares
   - Shareholders would pledge shares in Fund A as collateral
   - Shareholders would pay interest on loan and would receive income on fund shares
5. <u>For shareholders who need additional funds and are not able to make use of the credit facility</u>, they can redeem shares, however, subject to redemption fees
   a) This fee will *not* apply to redemptions described in #3 above
   b) Transfers between shareholders will *not* be treated as redemptions
   c) New deposits will *not* be subject to redemption fees
   d) The redemption fee will decline over time as the liquidity structure of the fund improves
   e) The redemption fee schedule needs to be determined prior to re-opening the fund
   f) All redemption fees collected will be retained in Fund A reserve account for benefit of remaining shareholders

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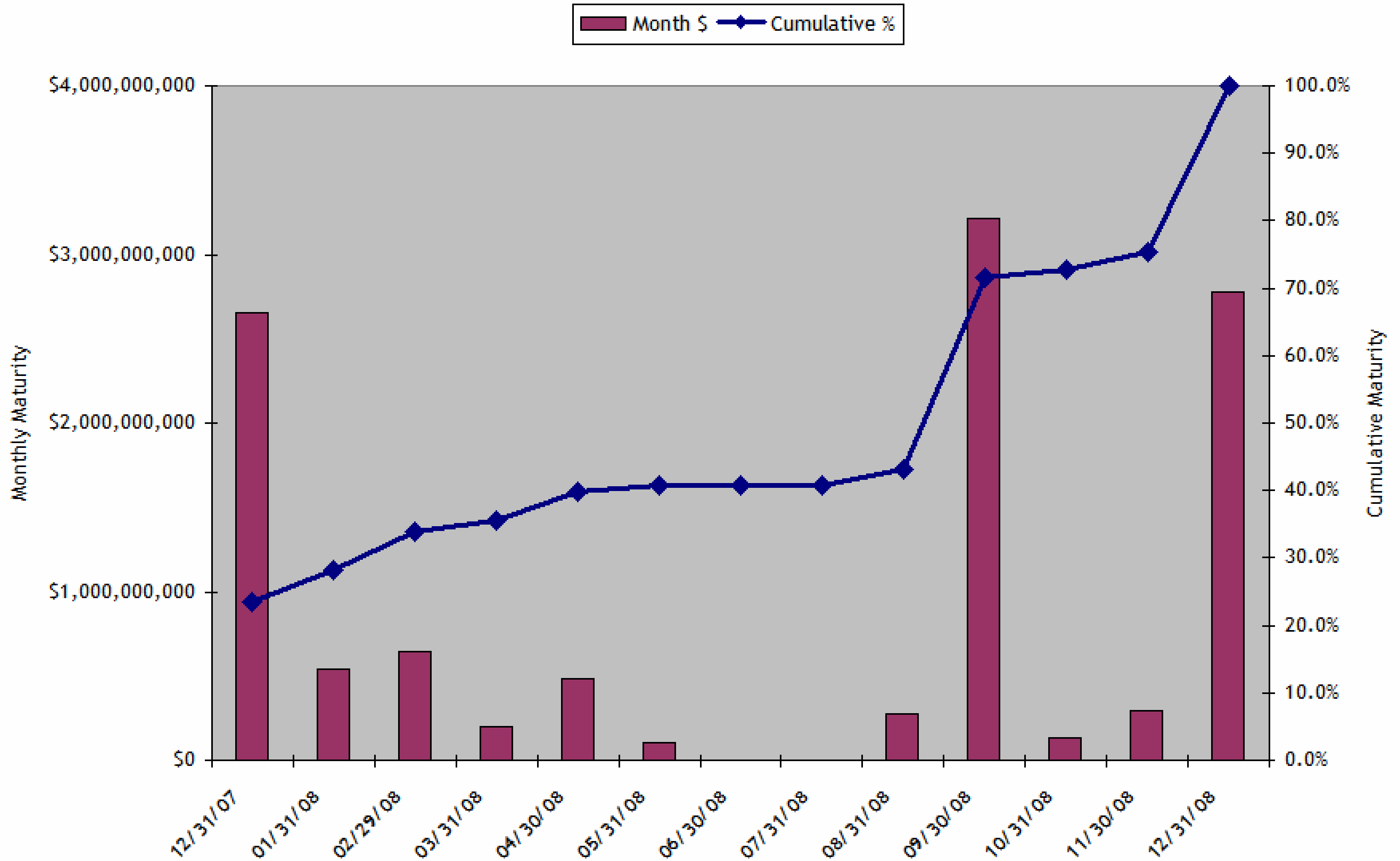
Operating Option - Expected Maturities for "FUND A"



Operating Option – Overview of "FUND B"

This new pool would be comprised of assets in default or currently considered at-risk

The November LGIP income plus the loss reserve account will be added to Fund B

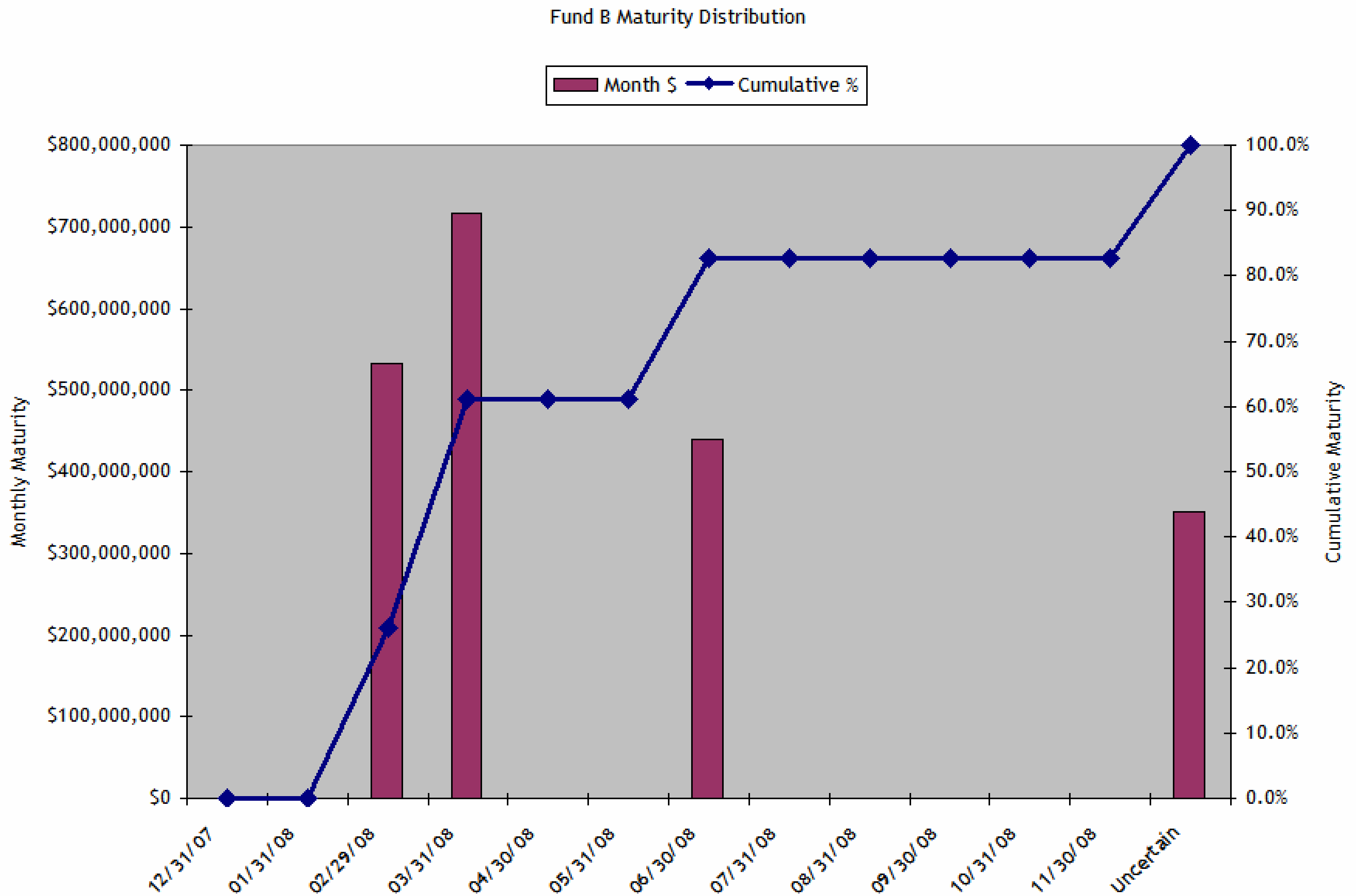
- Goal is to offset some of the lost value

Fund B's shares will be illiquid and are not tradable

Distribution policy needs to be determined

- Payouts need to balance the desire of participants to get cash sooner with the desire to have a full return of capital

Operating Option - Expected Maturities for "FUND B"



What does this mean for a shareholder?

Example 1:	Current LGIP Ownership:	$10 million
	Fund A Shares:	$8.6 million face amount
	Fund B Shares:	$1.4 million face amount
	Near term liquidity from Fund A:	$2 million (as this is greater of 15% or $2 million)
	Additional liquidity from credit facility:	Loan terms to be negotiated. Anticipate $5.3 to $5.9 million can be borrowed*.
Example 2:	Current LGIP Ownership:	$100 million
	Fund A Shares:	$86 million face amount
	Fund B Shares:	$14 million face amount
	Near term liquidity from Fund A:	$12.9 million (15%)
	Additional liquidity from credit facility:	Loan terms to be negotiated. Anticipate $58.5 to $65.8 million can be borrowed*.

* This represents 80-90% of the value.

Operating Option – Pros and Cons

Pros

- Creates greater freedom for shareholders in managing their own liquidity needs
- Problem assets are identified and segregated
- Chance of emerging with a viable ongoing entity

Cons

- Current investors must weigh tradeoffs of immediate liquidity versus redemption fee or cost of credit line
- May increase economic loss in meeting liquidity needs

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Steps to Enhance Investors' Confidence

Move rapidly to make decisions

Ensure complete transparency in the underlying securities

Get a AAA rating on Fund A

- Process takes time
- Rating agencies need familiarity with the manager

Bring in new assets to Fund A as soon as possible to increase liquidity

Determine manager characteristics that will inspire confidence

Key Steps to Move Forward

Meet with LGIP Advisory Committee to further discuss and refine the recommendation

Select the fund manager

- Abbreviated search in consultation with LGIP Advisory Committee, or
- Issue RFP to potential liquidity managers, or
- Hire interim manager for next 90 days

Determine immediate liquidity needs for Fund A

Confirm operational approach and prepare for launch

- Accounting and recordkeeping
- Call center / Order placement by shareholders
- Imposition of redemption fees

Create Fund B and transfer identified assets immediately

Approach investors for potential investments in Fund A

Negotiate terms of credit facility with one or more banks

Initiate conversations with ratings agencies to obtain a AAA rating on Fund A

Prepare shareholder communications

- Immediate transparency on Fund A portfolio – ratings, maturities, etc.
- Near-term transparency on Fund B portfolio