



APPLETON *PARTNERS*, INC.

State of California

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- Governor Schwarzenegger proposed a budget for the State that addresses a 2-year, \$19 billion combined budget gap for this fiscal year which ended June 30th and the fiscal year which began July 1st. There was an \$8 bln gap to close for FY10, and an \$11 billion hole for the 2011 fiscal year. The proposal relied heavily on spending reductions, mainly the complete elimination of key social welfare programs, with no tax increases included.
- Schwarzenegger did propose some measures aimed at budget and pension reform. The Governor called for spending limits and the building up of a rainy day fund to help with year-to-year revenue volatility, as well as reducing retiree benefits for newly hired public workers.
- The proposal tackled the deficit and planned to leave the State with a \$1.2 billion reserve. Solutions included \$12.4 billion of spending reductions, \$3.4 billion of federal funds, \$1.3 billion of “alternative funding” and \$2.1 billion of fund shifts and other revenues. While no new taxes were a part of the proposal, Schwarzenegger’s plan did include fee increases in both the California State University and University of California systems. Many of the proposals were carried forward from the January budget proposal.
- The formal budget announcement in May from the Governor set the foundation on which the legislature is to negotiate and debate. Democratic majorities in both houses do not meet the two-thirds votes it takes to adopt a final budget, so the expectation is that this will be a prolonged budget balancing process with headline risk throughout the summer.
- The State began the 2010-2011 fiscal year on July 1st with no budget in place, the 19th time in the last 25 years this has occurred. Given the magnitude of the gap and the difficult steps that will have to be taken to address the deficit, a budget is not likely to be passed until late in the summer.

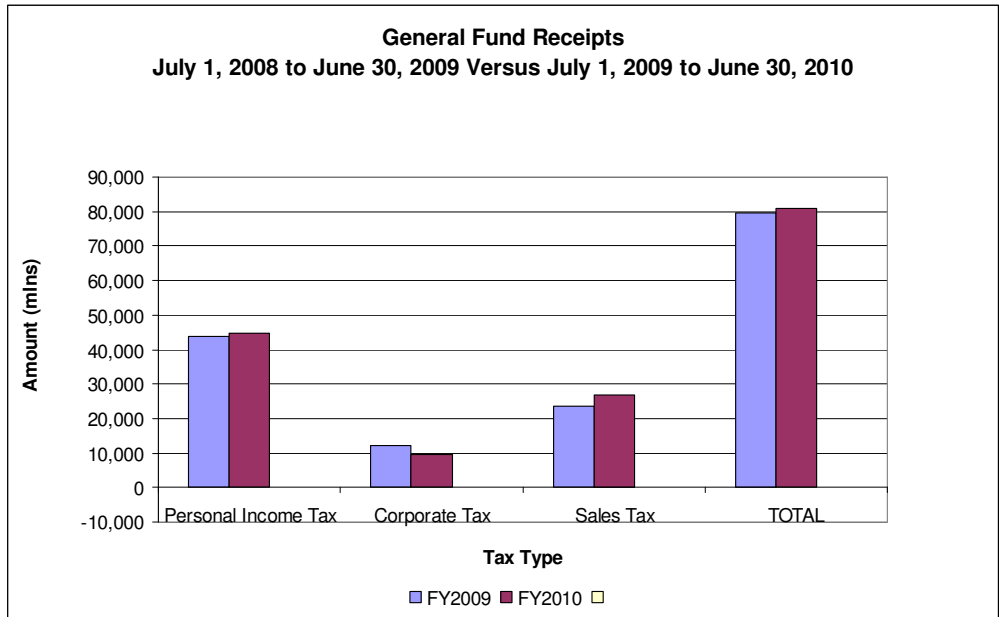


- California has been out of the municipal debt market since early in the spring with general obligation (GO) bond issuance. We expect that the State will await a final budget before the next financing will come to market. The last GO bonds were sold in March when the State issued \$6 billion in tax-exempt and taxable GO bonds in two sales. The sales were marked by strong demand as investors looked beyond California's low credit rating and its estimated \$19 billion, 2-year budget gap and focused on its guarantee of debt-service payment and attractive yields.
- With the State being out of the markets for such a long period of time, and the market anticipation of an April or May financing that never materialized, demand for CA paper has remained strong, helping to drive in spreads on state paper.

We continue to like the credit worthiness of the State of California general obligation bonds, and we look to find value in the market for state paper for client accounts when appropriate.



- We've seen significant revenue declines throughout the recession on top of upward pressure on expenditures (Medicaid, unemployment benefits, other social services).
- Modest revenue growth is beginning to materialize in 2010.
- When looking at fiscal year 2009 versus fiscal year 2010:
 - Personal income tax revenue is up 2%
 - Sales tax collections were up about 12%
 - Total tax revenue collections were up marginally about 1%



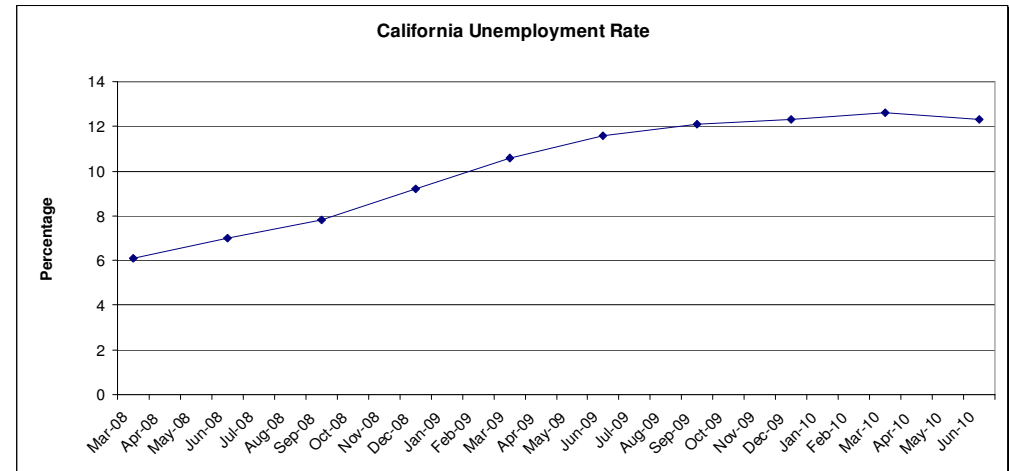
Source: CA State Controller

Summary of Cash Position as of June 30, 2010

- Through June, the State had total receipts of \$88.7 billion, \$417 million above the May estimate and disbursements of \$86.7 billion, \$1.3 billion below the May estimate.
- The State's operating cash deficit stands at \$9.9 billion, and is being covered with internal borrowing.
- Of the largest expenditures, \$60.6 billion went to local assistance and \$23.5 billion went to State operations.
- Local assistance payments were \$1.3 billion lower (-2.1%) than the 2010-11 May estimates and State operations were \$193 million above (0.8%) projections.



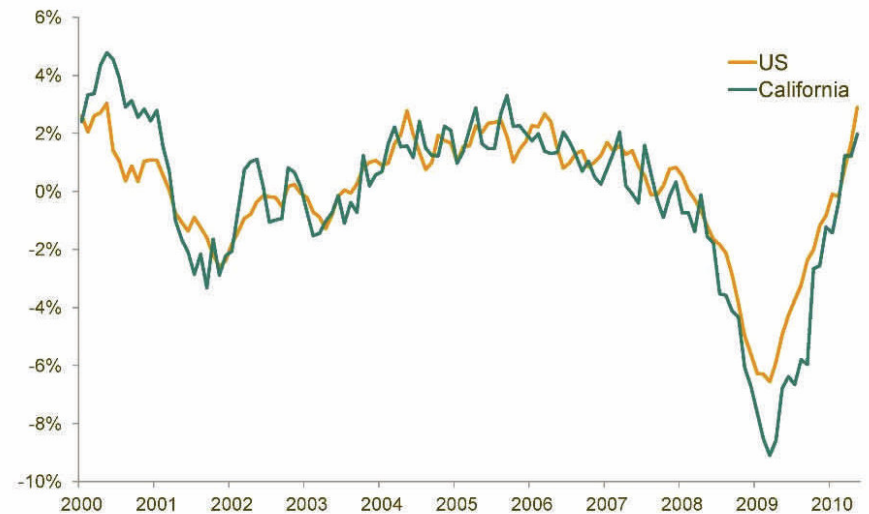
- Unemployment numbers suggest that the worst may likely be over.
- Job losses subsided in June with the unemployment rate dipping slightly in June 2010, for the first time since the recession began.
- While early to report a trend, unemployment in the State has been bouncing around the bottom for almost a year with this recent slight dip.
- California fared worse than the nation overall throughout the recession.
- Housing prices fell more in California, especially inland areas, than in most of the country, and state unemployment remains more than two points above the national level.
- However, the medium-term and long-term view shows that California's economic performance, through booms and busts, largely tracks or outpaces the U.S. overall.
- The vast majority of jobs created or lost are due to the formation, expansion, contraction, or closure of businesses, not relocation.



Source: Bureau of Labor Statistics

California Job Growth Tracks U.S.

Annualized quarterly employment change, monthly to May 2010



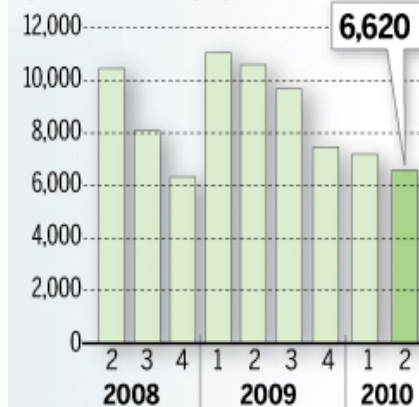
Source: Public Policy Institute of California



- The home mortgage crisis appears to be moderating.
- Mortgage defaults, a precursor to foreclosure, have dropped to their lowest level in 3 years and in the Sacramento area, they have dropped 38% in the past year.
- Statewide, lenders issued 70,051 default notices in the 2nd quarter, down 44% from a year ago. This is the lowest number since almost 3 years ago.
- Median home price of a single family home increased from \$230,000 in May 2009 to \$278,000 in May 2010.
- Single family home sales also increased from 39,051 in May 2009 to 40,965 in May 2010, a 5% increase.
- Newly permitted residential units (seasonally adjusted annual rate) 32,903 in May 2009 to 34,520 in May 2010.

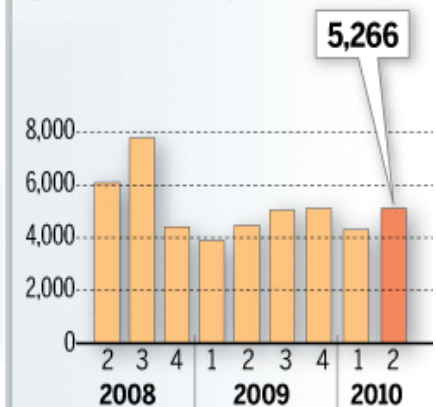
NOTICES OF DEFAULT*

CAPITAL REGION**

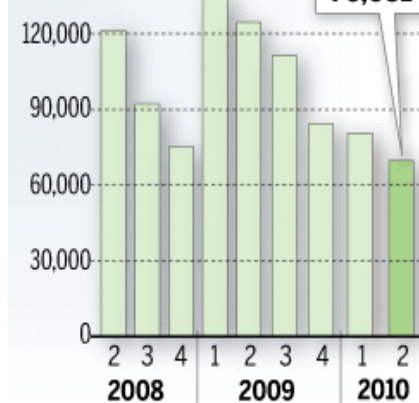


FORECLOSURES

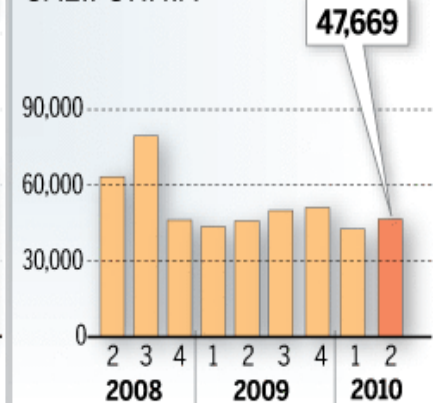
CAPITAL REGION**



CALIFORNIA



CALIFORNIA



*Notices of default are early foreclosure warnings issued by lenders when borrowers miss three or more monthly payments.

**Amador, El Dorado, Nevada, Placer, Sacramento, Sutter, Yolo and Yuba counties

Source: MDA DataQuick



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