

I hope everybody is doing well and you have survived the summer that never found its way to Western Washington. I am writing to discuss two topics: the first is to invite interested participants to an October 26, 2010 meeting in Olympia regarding a potential LGIP Extended Asset Pool that we are considering offering, and second, to notify you of updated LGIP forms that all participants will be required to fill out by December 31, 2010.

All interested LGIP participants are invited to a meeting in Olympia on Tuesday, October 26 at 1:00 pm. The meeting will be held in the Columbia Room in the Legislative building, which is the main "Capitol" building. Please contact us for directions. The purpose of the meeting is to bring you up to date regarding our plans for a longer-term LGIP option and assess the level of interest in such an option. Please RSVP by October 22nd if you plan to attend the meeting. You can email me at [Robbi.Stedman@tre.wa.gov](mailto:Robbi.Stedman@tre.wa.gov) or reach me by phone at 360-902-9013.

OST conducted a survey last fall in an attempt to assess the potential interest in a longer-term option for the LGIP in conjunction with the current short-term option. We did this in response to inquiries about the possibility of OST providing this type of pool. A fact sheet regarding the rationale for a longer-term option can be accessed on the OST web site through the following link:

[www.tre.wa.gov/lgip/index.shtml](http://www.tre.wa.gov/lgip/index.shtml)

While less than 30 percent of the LGIP participants responded to the survey, those that did respond indicated enough interest to warrant further exploration. Furthermore, 2ESB 6221, which was passed during the 2010 Legislative session, updates and expands the universe of potential LGIP participants, including state operating funds. The state can now provide a significant and stable core balance for the extended option, which would be critical during the initial phases of operation.

Two factors that caused OST to indicate that we would not be offering an extended option until interest rates had risen to a higher level were:

- Interest rates were at historically low levels, and
- Participants would be taking the interest rate risk in the extended asset option.

The only way to safely offer a longer pool and provide participants with liquidity is to operate with a variable share price, as opposed to the stable share price that the SEC allows the 2a-7 funds to utilize (which the current LGIP uses). Since the share price would drop in a rising rate environment the participants could experience a loss in principal if funds were withdrawn after a short time period.

Last spring we made a decision to proceed with planning for an extended option but not begin operation until rates had risen off of their historically low levels. At that point the economy was showing some signs of turning around and rates were expected to go higher by the end of 2010. However, the economy has continued to languish, rates have gone even lower and they are widely expected to remain at low levels for an extended period of time. Consequently, we have been exploring the feasibility of offering a pool longer than 2a-7 but shorter than what we had originally planned on offering. If we remain in an extended period of low rates this extended cash option should provide a pick-up in yield compared to the LGIP and a more stable share price than the longer-term option, which would prove advantageous once rates do start to rise. The intent would be to move to a longer duration target if/when interest rates return to a more normal range. We have examined how much additional yield we

might be able to provide our participants under varying levels of duration targets and the corresponding risk levels under different interest rate scenarios. While we believe we can offer an additional return over what the LGIP is currently providing there is a risk to participate in this if rates rise too soon or too quickly. The risks range from under-performing the 2a-7 like LGIP to a principal loss if rates rise too sharply and funds are withdrawn from the pool.

Since ultimately the enhanced returns of an extended option are a moot point if there is no participation, our goals for the October 26 meeting are to discuss available options, assess the level of interest in an extended cash option and the extent to which that interest translates into firm commitments. We will discuss our assessment at the November 9 LGIP Advisory Committee meeting.

We are currently working with PFM Asset Management, whom we retained to advise us on an extended option, and the OST IT and Accounting Divisions to determine the scope of the project and the anticipated timeline for development. We will need to develop the capability to operate the current LGIP on a variable share price basis to align with new SEC requirements for 2a-7 funds. Thus this development will proceed whether or not we offer the extended option. Additionally, even if there is sufficient firm interest in utilizing an extended option the actual decision to flip the "on" switch would be contingent on a suitable interest rate environment at the time the development is completed.

I hope you will be able to join us at the October 26 meeting in Olympia. We welcome your level of interest, as well as comments and concerns.

I mentioned in the first paragraph that we had updated our current LGIP forms. They received a badly needed facelift as they have remained largely unchanged for over 20 years. The updated forms are more formal to provide another layer of protection for the participants and OST. The forms will be on the website shortly. Again we will be requiring **ALL** participants to fill out all new paperwork by December 31, 2010. We will put reminders on the website and TM\$ but please get started ASAP and of course don't hesitate to call if you have any questions. See you in October!