

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Washington State Treasurer's Office provides the Management's Discussion and Analysis of the Local Government Investment Pool's (LGIP) Comprehensive Annual Financial Report (CAFR) for readers of the financial statements. This overview and analysis of the LGIP's financial activity is for the fiscal year ended June 30, 2006. Please read this analysis in conjunction with the letter of transmittal and the financial statements that follow.

Financial Highlights

- The LGIP reported net assets as of June 30, 2006, in the amount of \$5.3 billion.
- The LGIP distributed \$199 million to pool participants as a result of investment activity during the year. This was an increase of \$99 million from the previous year.

Overview of the Financial Statements

The LGIP is operated in a manner consistent with Rule 2a-7 money market funds, as recognized by the Securities and Exchange Commission. Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities in order to minimize both market and credit risk. Investments are reported on a trade date basis in accordance with generally accepted accounting principles (GAAP). This is based on the assumption that governments face custodial risk in connection with sold investments up to the date of settlement and face no custodial risk in association with purchases recorded on the balance sheet prior to the settlement date. This report consists of the Statement of Net Assets, Statement of Changes in Net Assets, Notes to the Financial Statements, Schedule of Investments and Certificates of Deposit and the Schedule of Reconciliation of Assets. In addition, this CAFR also contains supplementary and statistical information to aid the reader in further understanding the financial position of the LGIP and the results of its operation for the fiscal year ended June 30, 2006. The following is a description of the basic financial statements:

Statement of Net Assets - The Statement of Net Assets presents all of the LGIP's assets and liabilities, with the difference between the two reported as net assets. It also provides information on the types of investments held by the LGIP.

Statement of Changes in Net Assets – The Statement of Changes in Net Assets presents information on how the net assets changed during the fiscal year. Additions consist of the net increase in net assets resulting from operations and the purchase of units. Deductions consist of redemption of units.

Notes to the Financial Statements - The Notes to the Financial Statements serve to describe the LGIP as a reporting entity and to further clarify its financial activity as reported in the financial statements.

Financial Analysis

To gain an understanding of the financial position of the LGIP, the reader should examine the financial statements as a whole, rather than in isolation from one another. This will provide a more comprehensive picture of the activity.

A summary of the LGIP's net assets is presented below:

Table 1
Net Assets
(expressed in millions)

	2006	2005	Dollar Change	Percent Change
Pooled cash and investments	\$5,278.4	\$5,002.0	\$276.4	5.5%
Receivables	13.0	9.1	3.9	42.9
Securities lending investments	44.8	80.9	(36.1)	(44.6)
Total Assets	5,336.2	5,092.0	244.2	4.8
Liabilities	45.2	125.0	(79.8)	(63.8)
Net Assets	\$5,291.0	\$4,967.0	\$324.0	6.5%

As the table shows, the LGIP experienced an increase in net assets of \$324.0 million in 2006. Total assets were higher while liabilities were lower, compared to last year. Liabilities are primarily comprised of securities lending obligations and, in 2005, included securities purchased but not yet settled, both of which have offsetting asset entries. Accordingly, the LGIP's Net Asset total is a function of several parameters, some of which are independent of the performance of the LGIP. The resulting change in net assets can best be explained simply by changes in deposits and withdrawals of the participants in the fund. Since the LGIP is a 100% voluntary investment option for local governments, participants may use the LGIP at their discretion. The percentage of total funds that individual participants have available for investment in the LGIP changes over time and can vary from near zero to 100%.

Table 2
Changes in Net Assets
(expressed in millions)

	2006	2005	Dollar Change	Percent Change
Purchase of units	\$12,891.2	\$11,537.1	\$1,354.1	11.7%
Redemption of units	12,766.2	11,617.4	1,148.8	9.9
Net income	199.0	99.8	99.2	99.4
Net increase in net assets	\$324.0	\$19.5	\$304.5	1,561.5%

Net income for the LGIP was up by nearly one hundred percent over the previous year. This increase was due, in large part, to the increase in portfolio yield, as shown in Table 3. Purchases and redemptions both experienced increases over the prior year. Due to the discretionary nature of the LGIP as an investment option, it is difficult to ascertain the reasons behind the changes in net assets, as discussed in the previous paragraph.

Table 3
Average Monthly Portfolio Yield (360-Day Basis)

	2002	2003	2004	2005	2006
Portfolio Yield	2.58%	1.46%	1.05%	2.13%	4.14%
iMoneyNet Inc.	2.02%	1.05%	0.61%	1.71%	3.68%

The Monthly Portfolio yield represents the percent return of LGIP investments based on the average invested balance for the month. Table 3 shows an average of the monthly portfolio yields for each of the last five fiscal years. The average monthly portfolio yield showed a significant increase in Fiscal Year 2006 from what was experienced in Fiscal Year 2005. The changes in LGIP yield can be explained by the changes in the targeted Fed Funds rate, which is the interest rate that banks charge each other for the use of funds. LGIP yields closely follow the targeted Fed Funds rate and this rate went from a high of 6.50% in the first half of Fiscal Year 2001, to a low of 1.00% in June 2003, where it remained until the end of Fiscal Year 2004. The June 2004 Federal Open Market Committee (FOMC) meeting began the first of 17 consecutive 25 basis point (bp) increases in the targeted Fed Funds rate, bringing the target to 5.25% at the June 2006 FOMC meeting. The August 2006 FOMC meeting marked the first time in over two years that the fed funds rate was not increased.

The best measure of the LGIP's performance is not the change in the yield of the portfolio over time, but rather a comparison of the LGIP yield to the yield of its benchmark, iMoneyNet Inc., Government Only/Institutional Only Money Market Funds (formerly IBC Donoghue). This benchmark is comprised of privately managed money market funds similar in composition and guidelines to the LGIP. The LGIP net yield during Fiscal Year 2006 was 46 basis points higher than that of the benchmark. The LGIP continues to be a sound investment option for local governments, obtaining a competitive yield while preserving principal and liquidity.