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State Treasurer

State of Washington
Office of the Treasurer
Local Government Investment

October 21, 2013

The Honorable Jay Inslee, Governor
The Honorable Troy Kelley, State Auditor
Members of the State Finance Committee
Members of the Joint Legislative Audit and Review Committee
Participants in the Local Government Investment Pool

I am pleased to submit this Comprehensive Annual Financial Report (CAFR) of the state of Washington Local Government Investment Pool (LGIP) for the fiscal year ended June 30, 2013. This report has been prepared by the Office of the State Treasurer (OST) pursuant to Revised Code of Washington (RCW) 43.250.080. It includes only activity of the LGIP and does not include data or information related to other state agencies or funds.

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with OST management. A framework of internal controls has been established by management for this purpose, as well as to ensure information reported in the investment section is reliable. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

To the best of our knowledge, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and changes in net position of the LGIP in conformance with generally accepted accounting principles (GAAP). All disclosures necessary to enable the reader to gain an understanding of the LGIP's financial activities have been included. Data presented in the investment section is prepared on a basis consistent with other sections of the report.

The LGIP's financial statements have been audited by Peterson Sullivan LLP, a firm of licensed certified public accountants. The independent auditor concluded the enclosed financial statements are presented fairly in conformance with GAAP. The independent auditors' report is included in the financial section of this report.

Management's Discussion and Analysis (MD&A), immediately following the independent auditors' report, provides a narrative introduction, overview and analysis of the basic financial statements. The MD&A complements this letter and should be read in conjunction with it.

LGIP Profile

The LGIP, created by the Washington State Legislature in 1986, is managed and operated by OST on behalf of participants. The State Finance Committee administers the statute that created the pool and adopts administrative rules and procedures. In 1995, the State Treasurer established the LGIP Advisory Committee to provide advice on the pool's operation. The advisory committee includes 12 members selected from active pool participants. Eight members are appointed by participant associations, and four are appointed by the State Treasurer.

The LGIP is operated as a business enterprise within the framework of state laws and regulations. The LGIP serves as an investment tool for eligible governmental entities. At their option, such entities may invest temporary cash surpluses to take advantage of the volume and management expertise of the state's investment program to earn a competitive rate of return while maintaining security and liquidity.

Investment Policies and Practices

The LGIP is considered extremely low risk. Funds are invested in a portfolio of securities in a manner generally consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940 as it currently stands. The portfolio is made up of high-quality, highly liquid securities, with relatively short average maturities to reduce the pool's price sensitivity to market interest rate fluctuations and credit risk. The LGIP also has a strong degree of asset diversification to minimize risk and maintain adequate rates of return.

The investment activity is guided by an investment policy, approved by the State Treasurer and follows the standard of the prudent investor. The objectives of the investment practices, in priority order, are safety, liquidity and return on investment. OST invests cash in excess of the daily liquidity requirements of LGIP participants. Investments authorized by statute include: U.S. Treasury and Agency securities, banker's acceptances, repurchase agreements, reverse repurchase agreements, commercial paper, and deposits with qualified public depositories.

The LGIP is managed diligently by professional treasury personnel to protect against losses from market and credit changes. However, the pool is not insured or guaranteed by any government. Therefore, the maintenance of principal is not fully assured.

Financial and Economic Information

The economic condition of the LGIP is based primarily upon investment earnings. Due to the short-term nature of the portfolio, and the types of investments utilized, yields closely follow the targeted federal funds rate. With \$10.6 billion in net assets as of June 30, 2013, the LGIP produced an average monthly portfolio yield of .17 percent. The LGIP exceeded its benchmark by 16 basis points, resulting in \$15 million in additional interest income for participants.

Fiscal year 2013 was marked by sustained monetary policy by the Federal Open Market Committee (FOMC). The FOMC did not change its target for the federal funds rate from July 2012 through June 2013 stating that inflation has been below its objective, although longer-term inflation expectations have remained stable. The targeted federal funds rate began and ended the fiscal year at 0 to 1/4 percent.

During the period, the FOMC remarked that economic activity expanded at a moderate pace; labor market conditions showed some improvement; the unemployment rate remained elevated; household spending and business fixed investment advanced; and, the housing sector strengthened further, albeit from depressed levels. Furthermore, the FOMC sees the downside risks to the economic outlook and labor market as having diminished since last fall.

Consistent with its statutory mandate, the FOMC seeks to foster maximum employment and price stability. To support a stronger economic recovery and help ensure that inflation is at the rate most consistent with its mandate, the FOMC purchased agency mortgage-backed securities and longer-term Treasury securities monthly to maintain downward pressure on interest rates and make broader financial conditions more accommodative.

During the first quarter of fiscal year 2014, the FOMC maintained its target for the federal funds rate at 0 to 1/4 percent anticipating that this exceptionally low range will be appropriate as long as the unemployment rate remains above 6.5 percent and longer-term inflation expectations continue to be well anchored.

Major Initiatives

OST began calculating earnings and expenses for LGIP participants daily rather than monthly in March 2013. The daily expense factor is based on estimated annual expenses adjusted throughout the fiscal year for changes in those estimates. The daily earnings factor reflects accrued and accreted income, as well as capital gains and losses, less expenses. Amounts continue to be credited to participant accounts monthly.

OST is exploring the feasibility of offering a longer-term investment fund option to LGIP participants, similar to an intermediate bond fund, to complement the current 2a-7 like money market fund option. PFM Asset Management has been retained to provide oversight and guidance for the development and launch of this extended asset fund, as well as, assist in the education and outreach to participants. Upon completion of a prospectus and administrative rules, OST expects to begin operation when market conditions, such as the interest rate environment, are conducive.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the LGIP for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2012. This was the sixteenth consecutive year the LGIP achieved this prestigious award. To be awarded a Certificate of Achievement, OST had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. OST believes this CAFR continues to meet the Certificate of Achievement Program's requirements and will submit it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

The preparation of this report was accomplished with the professionalism and dedicated services of personnel in OST's Accounting and Fiscal Services Unit and its Investment Division. This CAFR reflects the State Treasurer's commitment to pool participants and citizens of the state of Washington to operate the LGIP in a responsible manner and to maintain financial statements in conformance with the highest standards of financial accountability.

Additional Information

A section of the State Treasurer's website is dedicated to the LGIP, and features information related to performance measures, historical rates, and portfolio holdings. This CAFR, plus additional information for participants and interested parties, may be accessed on the internet at: <http://www.tre.wa.gov/>.

Sincerely,



Shad Pruitt
Deputy State Treasurer