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# LOCAL GOVERNMENT NEWS REPORT

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January 2010

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## INTEREST RATES

The average annualized yield for December was 0.6839%. The rates for December were as follows:

December 1 <sup>st</sup> – 21 <sup>st</sup>	0.70%
December 22 <sup>nd</sup> – 31 <sup>st</sup>	0.65%

## UPCOMING HOLIDAY

Due to the Martin Luther King Jr. holiday, the Office of the State Treasurer, Fed wire service and Oregon banks will be closed Monday, January 18<sup>th</sup>. Local government account statements will not be produced for January 18<sup>th</sup>, due to the closures. Any ACH transfers called prior to 1:00 p.m. on Friday, January 15<sup>th</sup>, will settle at your bank on Tuesday, January 19<sup>th</sup>. Any ACH transfers called between 1:00 p.m. Friday, January 15<sup>th</sup>, and 1:00 p.m. Tuesday, January 19<sup>th</sup>, will settle at your bank on Wednesday, January 20<sup>th</sup>.

## OREGON SHORT TERM FUND UPDATE: INCOME DISTRIBUTION & ALLOWANCE FOR IMPAIRED SECURITIES

As you are all aware, the credit crunch and associated financial market turmoil have been felt far and wide across our economy. While the use of diversification and credit quality standards have minimized our exposure, unfortunately, the Oregon Short Term Fund (“Fund”) has not been immune from these forces. The Fund was affected specifically as its \$191 million (par value) holdings in Lehman Brothers Senior Debt dropped significantly in value when the company entered Chapter 11 bankruptcy in September 2008. These holdings mature in January and May 2010. This article will describe what the Oregon State Treasury (OST) has done in response to this situation and what we’re planning to do going forward.

**Income Distribution/Allowance for Impaired Securities** Within a few days of the announcement of the Lehman bankruptcy, OST began building an allowance for impaired securities. Our assumptions then and now are that the bankruptcy will take several years to resolve; therefore, building the allowance is a multi-year project. In order to fund the allowance, income distributions have been reduced since September 2008 with the difference accumulating in the allowance account. This preserves the principal deposited in the Fund. As of December 31, 2009, the allowance has already reached 52% of the anticipated loss from the Lehman holdings and is growing on a daily basis. Fortunately, even with the allowance, the Fund has maintained one of the top yields in the TRACS Financial Institute of Public Investment Management Survey of government investment pools.

When the maturity dates of these investments arrive in January and May of 2010, we expect that the holdings will not mature, that is, we anticipate we will get nothing on maturity date. When the bankruptcy is resolved, which is expected to be one and one-half to three years from now, the loss will be recognized and partially or fully absorbed by the allowance account. **Please understand: we are building the allowance over time so that recognizing the loss will not be a material or surprising event.** If the allowance is inadequate at the time the bankruptcy is resolved, we will continue with reduced income distributions until the loss is fully covered. Similarly, if the allowance balance exceeds the Lehman loss, the excess will be used to fund a continuing allowance for impaired securities. The size of the allowance will be based on historical default rates for securities similar to those in the Fund. During periods in which the allowance is adequate, income distributions to participants will return to the full available amount.

**Fiscal Year-End Reporting** A number of questions have been raised concerning June 30, 2009 reporting. The annual report for the Fund is on the OST web site at this location:

<http://www.ost.state.or.us/About/OSTF/Statements/OSTF-6-30-2009.pdf>

In the notes to the statements, note 7 presents the fair value percentage, that is, the Fund's net assets divided by participant balances. As of June 30, 2009, this percentage was 99.11%. Because this dropped below 100%, OST staff has received questions asking if participants should use this factor and adjust balances accordingly for financial reporting purposes. OST's position is that whether or not to adjust is a decision that each entity will need to make in consultation with their auditors. We continue to watch the fair value factor, which has steadily been increasing.

**Looking Ahead...** In the coming months, we will continue to monitor the allowance and its progress toward funding the Lehman losses. We expect the current Lehman holdings will not mature as usual; therefore, we plan to reclassify the Lehman holdings to an "impaired securities" category. As described above, we will continue to build the allowance account to levels that will absorb the Lehman loss and beyond.

To sum up, OST has been taking steps to ensure preservation of principal for Fund participants, and we believe it remains a secure option for the investment of government funds. Fifty percent of the Fund is invested in US Treasuries, US Agencies, and FDIC-guaranteed corporate notes; and its weighted average credit quality is AA/Aa2 based on S&P/Moody's ratings, respectively. The Fund continues to provide full liquidity at an attractive, above-market rate. And finally, the Fund's expenses are less than four basis points per year. We hope this has addressed a few questions that have been raised; but if you have further questions about these topics, please contact the Fund staff at (503) 378-4155 or e-mail [lgip@mail.ost.state.or.us](mailto:lgip@mail.ost.state.or.us).

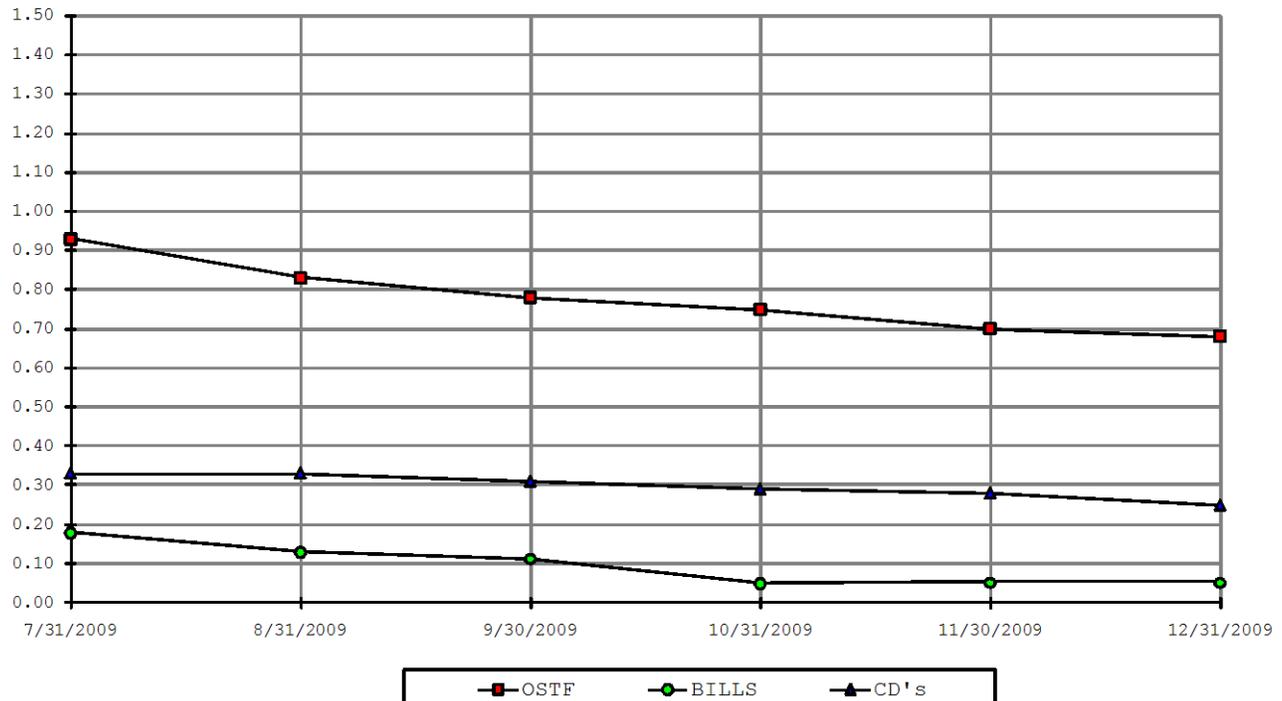
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Local Government News List: <http://www.webhost.osl.state.or.us/mailman/listinfo/local-gov-news>

**OREGON SHORT-TERM FUND ANALYSIS**



**Oregon Short-Term Fund Analysis as of December 31, 2009**

	7/31/2009	8/31/2009	9/30/2009	10/31/2009	11/30/2009	12/31/2009
<b>LGIP AV DOLLARS INVESTED (MM)</b>	4,082	4,152	3,979	3,766	5,119	5,505
<b>STATE AGENCY AV DOLLARS INVESTED (MM)</b>	5,760	6,051	6,422	6,081	5,791	5,628
<b>TOTAL OSIF AV DOLLARS INVESTED (MM)</b>	9,842	10,202	10,401	9,847	10,910	11,133
<b>OST ANNUAL YIELD (ACT/ACT)</b>	0.93	0.83	0.78	0.75	0.70	0.68
<b>3-MO UST BILLS (BOND EQ YLD)</b>	0.18	0.13	0.11	0.05	0.05	0.05
<b>3-MO JUMBO CDS (ACT/360)</b>	0.33	0.33	0.31	0.29	0.28	0.25

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to accountholders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from monthend. 3-MO JUMBO CDS is the highest posted rate received by the Treasury from Oregon banks as of monthend. Consequently, whereas the yield on UST Bills should normally be lower than CD rates, the fact that the quotes are up to a week different in time may result in an apparent reversal of this situation.

This material is available in alternative format and media upon request.