F I S C A L   I M P A C T   R E P O R T

SPONSOR:	Burpo	DATE TYPED:	03/16/01	HB	171/aSFC
SHORT TITLE:	Investment of Short-term Investment Fund			SB	
				ANALYST:	Eaton

REVENUE

Estimated Revenue		**Subsequent Years Impact**	**Recurring or Non-Rec**	**Fund Affected**
FY01	**FY02**			
	$ (325.0)		Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files
State Treasurer's Office (STO)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment returns the local preference language for local funds to be invested with local banking institutions at the rate established by the State Treasurer to a policy adopted by the state Board of Finance.

Synopsis of Original Bill

This bill removes language that is duplicated in another section. The language is the requirement that local government bodies give first consideration to local financial institutions when the rate charged by local financial institutions is equal to (or presumably less than) the rate established by the state treasurer when investing public monies in the Treasurer's Short Term Investment Fund (STIF).

This bill adds language that limits the types of investments the STIF have to maturities no greater than 397 days, (reiterating current Board of Finance Policy governing STIF investments).

This bill also strikes language setting the fee charged to local governments (5 basis points) and adds language that would charge all reasonable and applicable expenses associated with management of the fund, against interest income. Presumably, this frees the office of the State Treasurer to contract with an outside entity to manage this fund.

Significant Issues

The short term investment fund (STIF), also known as the local government investment pool (LGIP) has been cited for instances of noncompliance with investment policy and inaccurate reconciliations in past audits.

FISCAL IMPLICATIONS

The Office of the State Treasurer charges five basis points (.05 percent) to local governments. For investment fees. This amount would no longer be collected and credited to the state general fund. The estimated negative impact in FY02 on the general fund is 325.0, based on average balances of $650 million in the Short Term Investment Fund (STIF).

If one assumes that the fund will be managed via an outside contractor, operating costs at the state treasurer may be reduced, offsetting some or all of the negative impact from not receiving the 5 basis point fee on the general fund (99 percent of all operating revenue for the State Treasurer comes from the general fund).

TECHNICAL ISSUES

Board of Finance policy governing the STIF permits variable rate investments that have a maturity longer than 397 days. This bill, if passed, would supercede this current investment policy.

OTHER SUBSTANTIVE ISSUES

The office of the State Treasurer's FY98 and FY99 audits as well as the LFC FY00, FY01 & FY02 (*page 272*) budget documents identify instances of noncompliance with investment policy and inaccurate reconciliations in the local government investment pool (LGIP), named in statute as the short-term investment fund (STIF).

In March, April and July of 1999, the office of the State Treasurer purchased $210 million of five-year bonds for the LGIP. The investment policy for the office of the State Treasurer, approved by the Board of Finance, limits the maturity of fixed-rate LGIP investments to 397 days (this bill repeats this policy). By April 30, 2000, the LGIP portfolio had a paper loss of $8 million, or approximately 1 percent of assets. The investment policy requires selling bonds and charging the losses against income when the market value of assets falls more than 0.5 percent below book value.

To resolve the non-compliance with investment policy the office of the State Treasurer (on May 8, 2000) swapped the bonds worth $202 million for general fund assets worth $210 million. The FY00 audit of the general fund should reflect this "swap" as a net loss to the state general fund as General Accounting Standards Board (GASB) Statement No. 31 requires such transactions be made and valued at market rates.

The Legislative Finance Committee is concerned the swap set a bad precedent for the general fund by assuming market risk and losses to the benefit of other funds and their participants. In addition, the swap might not comply with the prudent investor rule, because the general fund assumed additional risk and assets worth less than the assets swapped.

The Office of the State Treasurer might consider using outside contractors to manage this program fund, presumably to deal with the incidences of non-compliance as well as the issues raised in the financial audits with respect to the LGIP.

POSSIBLE AMENDMENTS

It is suggested that if the Office of the State Treasurer elects to contract with outside management that the selection of manager be contingent upon approval of the Board of Finance.

POSSIBLE QUESTIONS

1. Has a Request for Proposal been issued to manage the fund by outside managers?

2. What has been the range of bids received (in basis points)?

3. What are the estimated costs (to the agency budget) of administering the STIF program?

4. How does that compare to the revenue generated by charging five basis points?

JBE/ar