

Staying Vigilant: Local Government Investment Pools Remain Wary Into 2010

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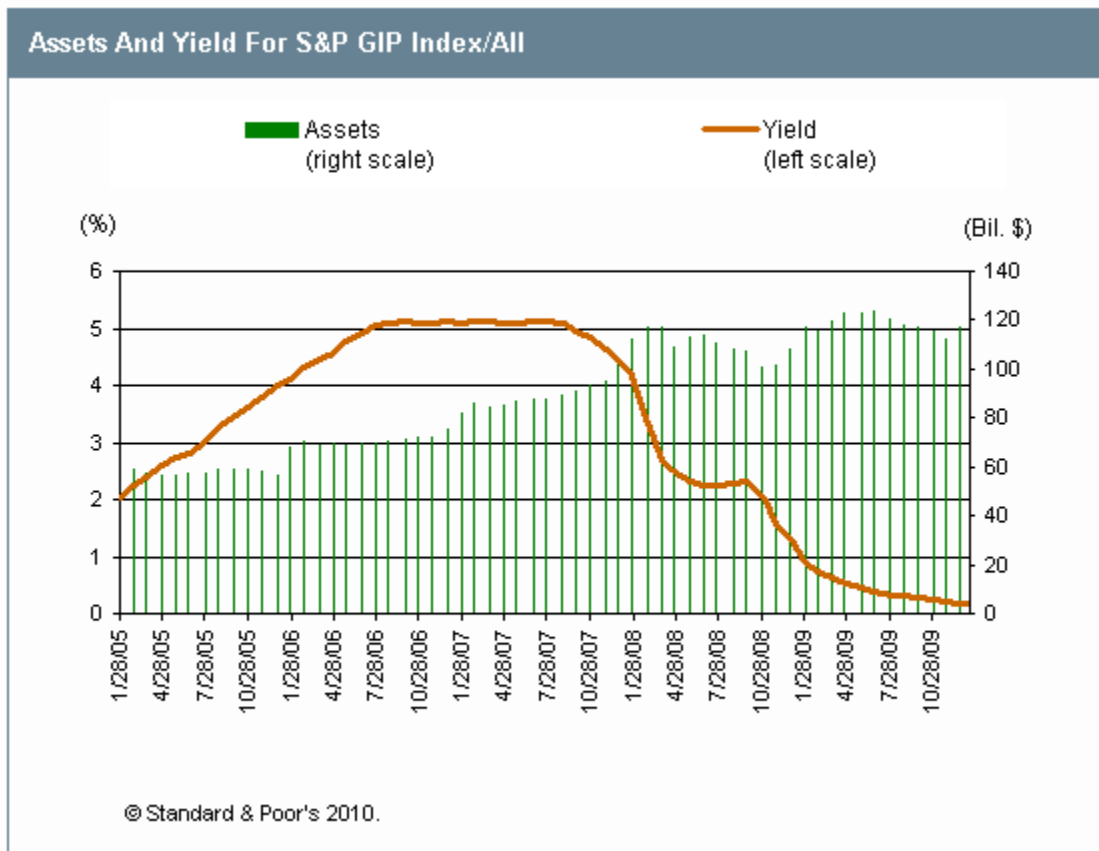
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Staying Vigilant: Local Government Investment Pools Remain Wary Into 2010

The credit events of the past two years have introduced a new awareness for local governments managing money on behalf of their constituents. Managers have been dealing with unprecedented and varied challenges ranging from credit deterioration to extraordinary yield pressure. Government investment pools (GIPs) have been fairly resilient to these challenges, with assets (in the Standard & Poor's-rated LGIP Index) remaining near all-time highs in the face of depressed yields (see chart 1). To provide enhanced oversight, states and public investor associations have requested and received Standard & Poor's Ratings Services' ratings on these portfolios since 1992.

Chart 1

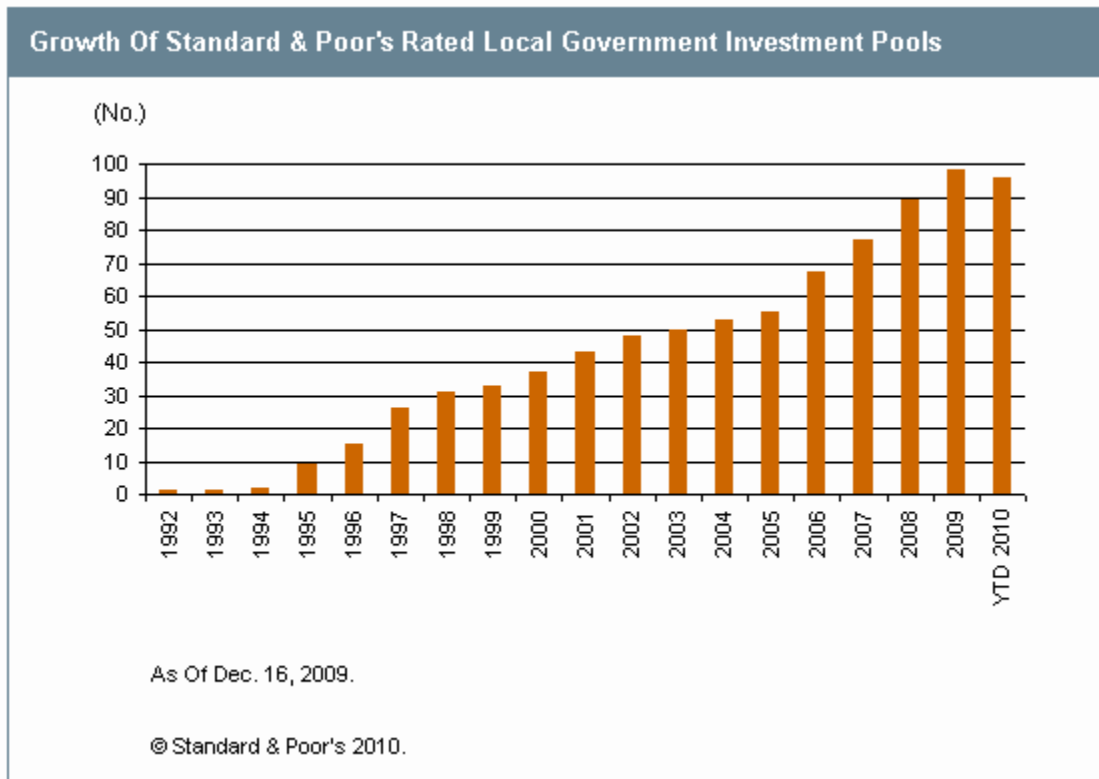


GIPs' primary objective is the prudent management of public funds on behalf of state and local governments. GIPs are established to offer cost-effective pooled investment vehicles in which municipalities and public entities pool their idle cash and operating funds while earning a competitive rate of return, with safety and liquidity as their primary concern. State-level pools are generally run by treasurers who are either elected or appointed by state officials. Many municipalities invest in state-run GIPs because they are cost-effective investment vehicles.

GIPs can differ in their level of risk taking, internal oversight, participant services, and external reporting. For the 60 rated GIPs designed to maintain a stable net asset value (NAV) of \$1.00 per share, we include a lowercase "m" modifier in our principal stability fund ratings because we rate these GIPs on their ability to maintain principal

value. The NAV can fluctuate on the remaining 38 rated pools, making them more like short-term bond funds. Our fund ratings on these include a lowercase "f" (see chart 2), and most have a volatility rating (indicated by "S" for sensitivity). Stable-NAV pools are run like money-market funds, limiting maturity and keeping relatively high credit quality. GIPs that pay out a variable NAV tend to have securities with longer maturities and higher duration than the stable-NAV portfolios. Our fund credit ratings reflect the ongoing analysis of a pool's overall credit quality. The volatility ratings address the degree to which the pool is exposed to factors that ultimately lead to return volatility.

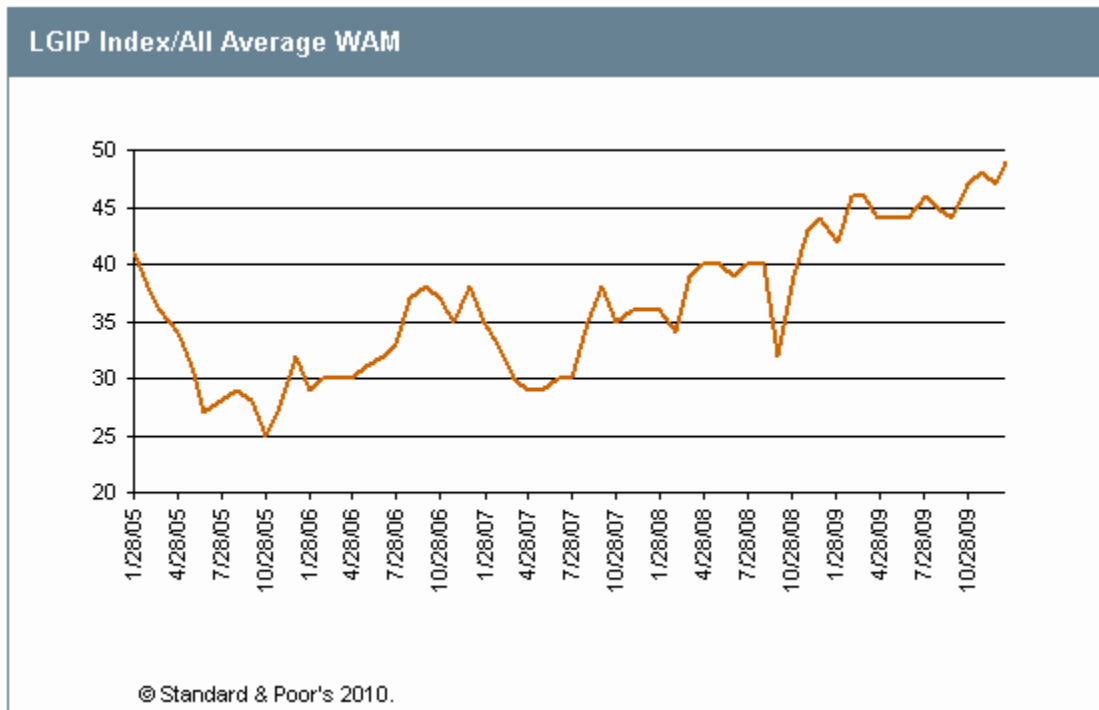
Chart 2



How The Landscape Has Changed During The Past Two Years

The onset of the credit crisis caused a strategy change in the maturity and asset concentrations of all pools. Stable-NAV GIPs have, on average, increased the maturity of their portfolios in an attempt to return any yield to their participants. These pools still have a very short maturity profile of approximately 49 days, but that is considerably longer than it was at the time of Lehman's failure in September 2008, when it was as short as 32 days (see chart 3).

Chart 3



The pools' asset concentrations have also shifted, with stable-NAV pools reducing exposure to repurchase agreements (repos) and commercial paper (CP). Pools have moved away from these asset classes because of depressed yields (repos) and an effort to make their portfolios simpler (CP). These pools have generally increased their exposure to Agency product, bank deposits, and to a lesser extent Treasuries. Charts 4 and 5 show the changes in the relative weights of the asset types in the S&P LGIP Index/All from about two-and-a-half years earlier, approximately at the onset of the stress for ultra short funds.

Chart 4

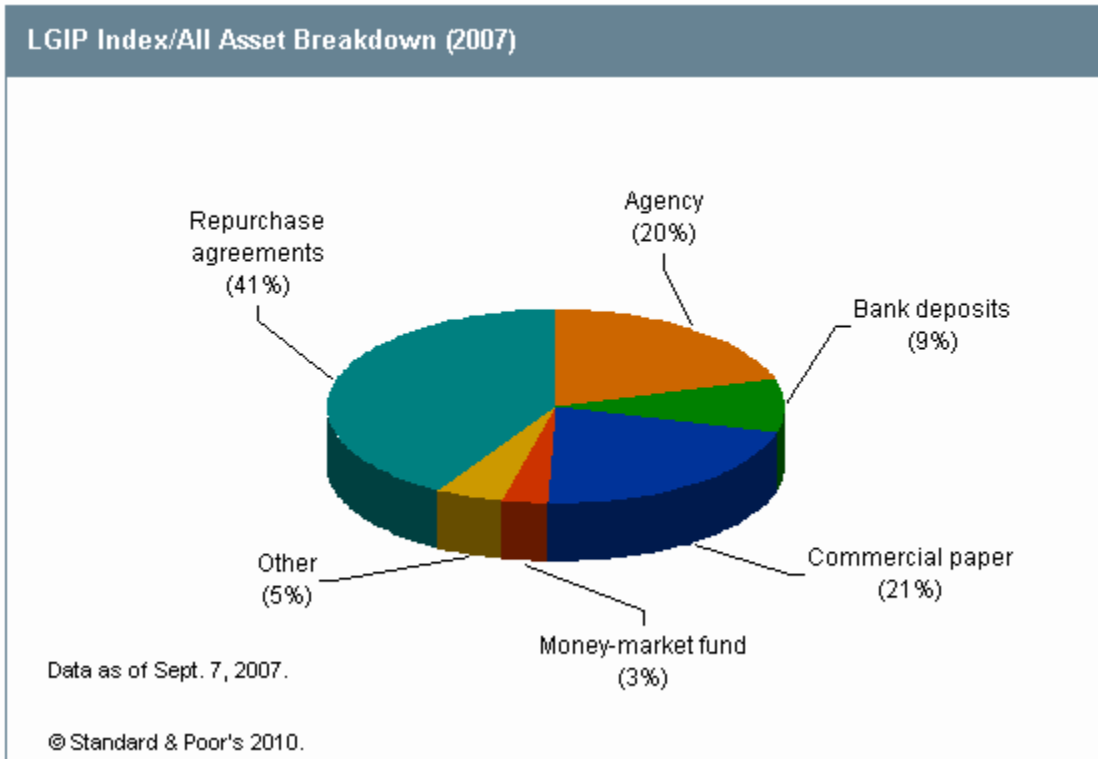
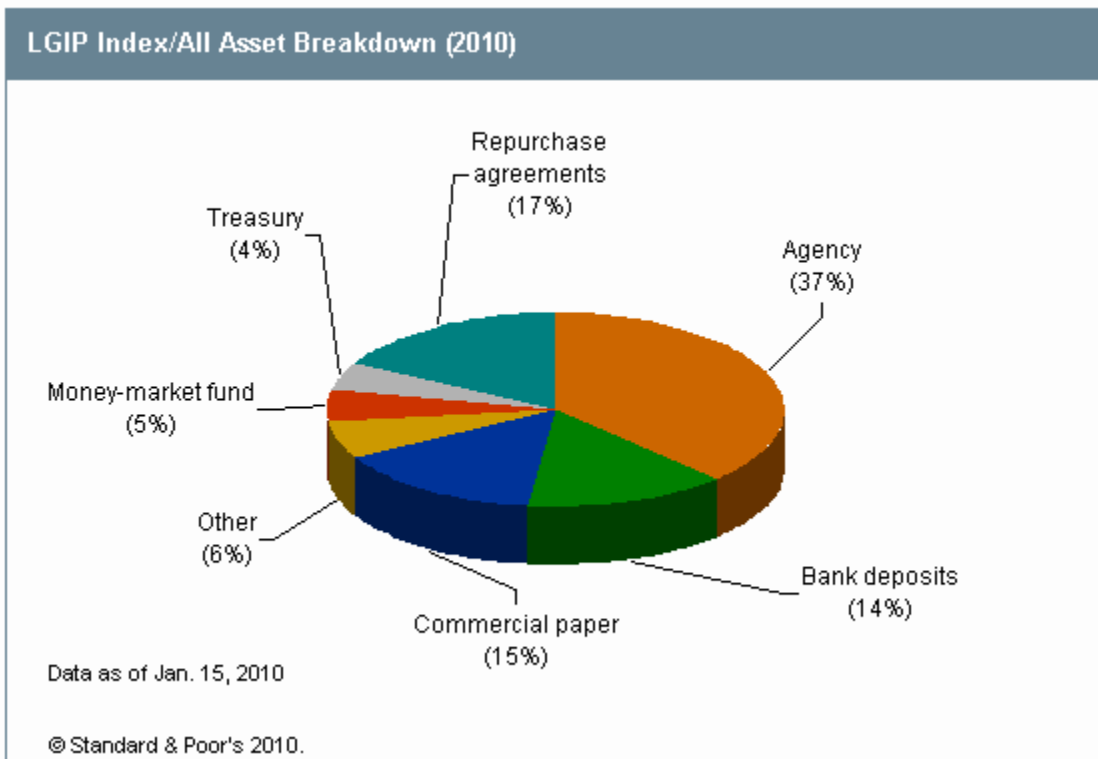
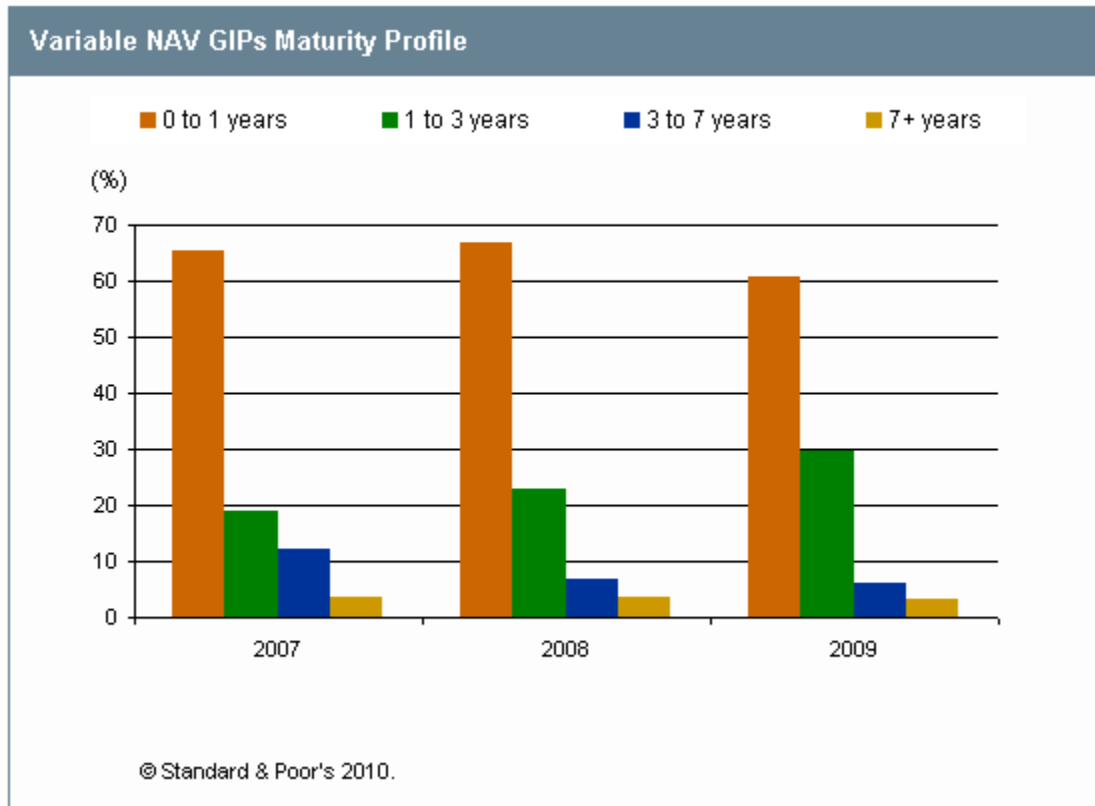


Chart 5



Variable-NAV pools have generally shortened their maturity, keeping less of their pools maturing within one year, but larger amounts maturing within three years. These GIPs are not attempting to enhance their returns by going farther out on the yield curve. Their maturity profiles could have a number of explanations. Among them could be a still-wary attitude toward putting additional incremental risk on their portfolios. Also, if interest rates rise, having an increased duration would diminish their portfolios' value (see chart 6).

Chart 6



Variable-NAV pools have shown portfolio composition transitions similar to those of the stable-NAV pools. These pools are concentrating on plain-vanilla products and not showing an interest in the esoteric products that led to problems in 2007 and 2008. Charts 7 and 8 demonstrate that CP, and private mortgage-backed securities have been largely replaced by agencies in fund credit-rated GIPs. The migration of asset types takes much longer in variable-NAV pools because of these pools' longer duration.

Chart 7

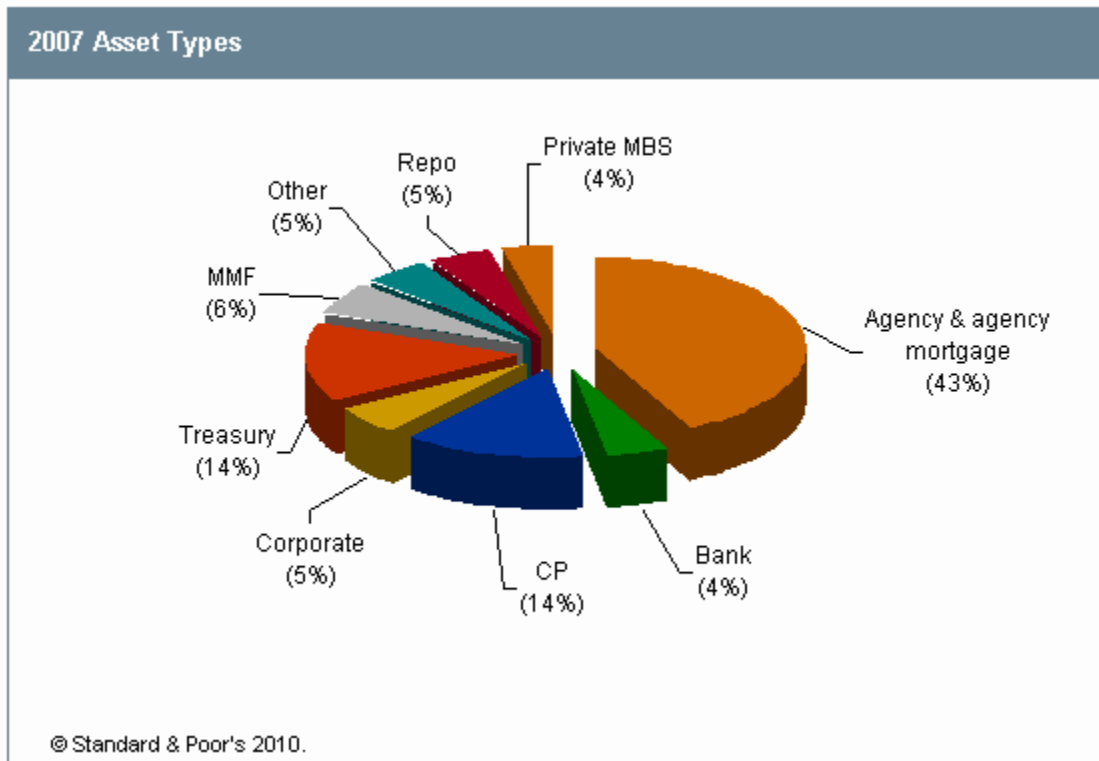
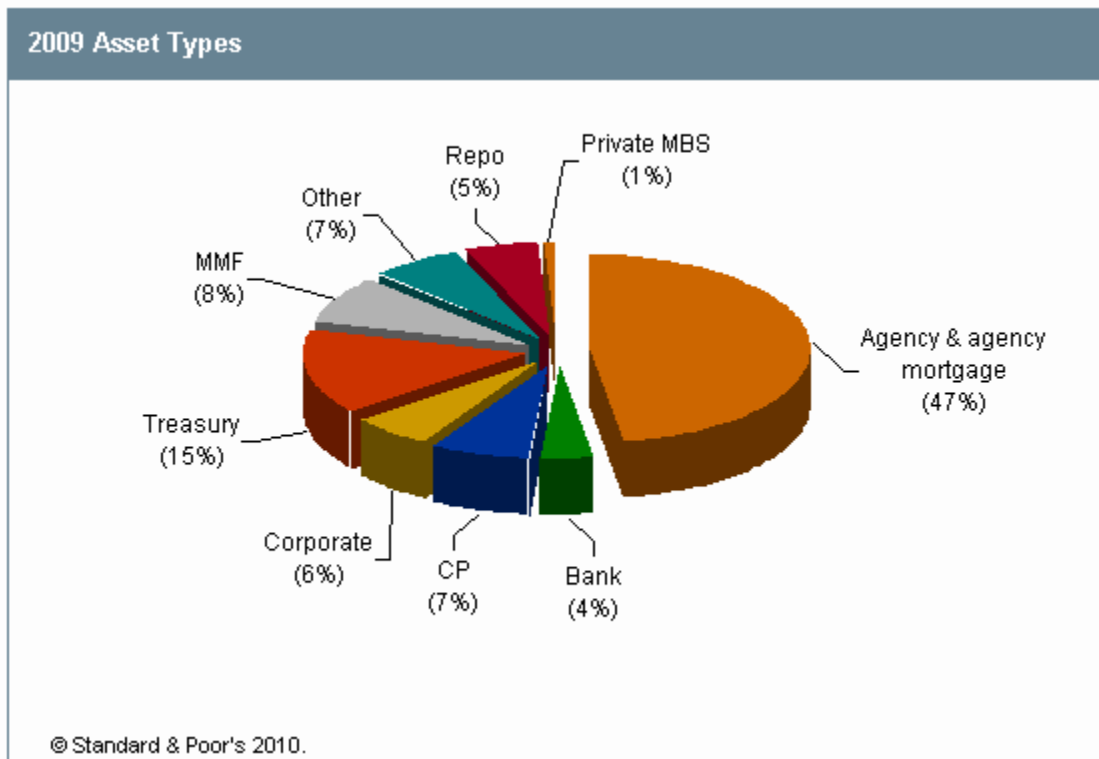


Chart 8



Unconventional Thinking: New Methods Of Confronting Issues

Local governments are trying to meet a host of new challenges because of the current depressed yield environment. They are exploring ways to enhance efficiency and save money. The Louisiana Asset Management Pool transitioned to one external sponsor from three to reduce costs. This change had the added bonus of simplifying day-to-day processes. Also, the yield environment has made many managers extremely cautious and conscious not to overreach for return. As one pool put it, managers are currently more concerned with the "return of money, not return on money."

Nevertheless, we have seen several LGIPs turn to other investment alternatives in their search for yield. Two such investment options are FDIC NOW accounts (related to the temporary liquidity guarantee program [TLGP]) and the Certificate of Deposit Account Registry Service (CDARS) program. With FDIC NOW accounts, banks can issue CDs covered under the TLGP. Banks will typically pay 50 basis points or less to the depositor. The depositor should verify that the issuing bank's NOW account meets all statutory requirements for FDIC NOW accounts. With the CDARS program, financial institutions can offer CDARS because they are members of a network in which the bank or other financial institution can place the depositor's investment in CDs issued by banks in their network, allocated only up to \$250,000 per bank for them to qualify for FDIC protection (in increments of less than the standard FDIC insurance maximum so that both principal and interest are eligible for full FDIC insurance). Of course, like other nonmarketable securities, these are not considered liquid investments for rated principal stability funds and may impose fees for early withdrawal.

Securities lending, employed by a very small part of the rated universe, has come under increased scrutiny during the past two years. For many funds, this was an unknown risk that participants are paying more attention to than before this segment of the financial world showed extreme stress. Several funds were under the impression that they would be indemnified against losses on their reinvestment portfolio by the reinvestment manager. A few experienced losses in portfolios that they thought were very safely invested. For this reason, we have seen considerably less securities-lending activity from rated GIPs.

Government pools that we rate had trended during the previous few years toward "f" rated pools. In 2009, the ratings were more evenly distributed, with 11 pools receiving "m" ratings and eight receiving "f" ratings (see tables 1 and 2).

Table 1

Standard & Poor's Variable NAV LGIP Ratings*				
Pool Name	Rating	Rating date	Run by	State
Arizona LGIP Pool 5	AAAf/S1+	11/10/2008	state/county	AZ
Broward County Investment Portfolio	AAAf/S1+	7/23/2007	state/county	FL
CalTRUST Short Term Fund	AAf/S1+	10/10/2006	subadviser	CA
City of Anaheim Treasurer Investment Pool	AAAf/S1	7/7/2008	state/county	CA
City of Houston General Investment Pool	AAAf/S1	6/10/2003	state/county	TX
City of Long Beach California Investment Pool	AAAf/S1	11/14/2000	state/county	CA
City of Los Angeles General Pool	AAAf/S1	5/20/2002	state/county	CA
Contra Costa County Investment Pool	AAAf/S1+	11/19/2007	state/county	CA
Corporate Overnight Plus Fund	AAAf/S1+	5/20/1999	subadviser	TX
Florida Local Government Investment Trust	AAAf/S1	11/10/1994	subadviser	FL

Table 1

Standard & Poor's Variable NAV LGIP Ratings* (cont.)				
FMIVT 0-2 Year High Quality Bond Fund	AAAf/S1	1/11/2008	subadviser	FL
Georgia Extended Asset Pool	AAAf/S1	11/9/2000	state/county	GA
Hillsborough County Investment Pool	AAAf/S1	3/31/2008	county/subadviser	FL
IMET 1-3 Year Fund	AAAf/S1	6/1/2006	subadviser	IL
Kansas Pooled Money Investment Portfolio	AAAf/S1+	3/15/2004	state/county	KS
Manatee County Investment Portfolio	AAAf/S1+	8/6/2008	subadviser	FL
Miami-Dade County Investment Portfolio	AAAf/S1	6/24/2009	state/county	FL
Michigan Liquid Asset Fund Plus Term, Series H - 0310	AAAf	4/3/2009	subadviser	MI
Michigan Liquid Asset Fund Plus Term, Series I - 0910	AAAf	8/13/2009	subadviser	MI
Michigan Liquid Asset Fund Plus Term, Series I - 0910	AAAf	7/31/2009	subadviser	MI
Missouri Securities Investment Program Term, Series H-0210	AAAf	1/12/2009	subadviser	MO
Missouri Securities Investment Program Term, Series I - 0810	AAAf	8/13/2009	subadviser	MO
Palm Beach County Investment Portfolio	AAAf/S1	9/30/2008	state/county	FL
San Bernardino County Investment Pool	AAAf/S1+	9/1/2005	state/county	CA
San Diego County Treasurer's Pooled Money Fund	AAAf/S1	5/16/2001	state/county	CA
San Mateo County Investment Portfolio	AAAf/S1	7/15/2009	state/county	CA
Solano County Treasurer's Investment Pool	AAAf/S1	2/22/2007	state/county	CA
St. Lucie County Investment Portfolio	AAAf/S1	10/15/2008	subadviser	FL
State of Texas Treasury Pool	AAAf/S1	4/29/2002	state/county	TX
Texas Term, Local Government Investment Pool, Series R - 0610	AAAf	2/20/2009	subadviser	TX
Ventura County Treasury Portfolio	AAAf	6/5/1996	state/county	CA

*As Of Jan. 25, 2010.

Table 2

Standard & Poor's Stable NAV LGIP Ratings*				
Pool Name	Rating	Rating date	Run by	State
Alaska Municipal League Investment Pool	AAAm	5/6/2009	subadviser	AK
California Asset Management Trust/Cash Reserve Portfolio	AAAm	8/21/2001	subadviser	CA
Colorado Local Government Liquid Asset Trust (COLOTRUST PLUS+)	AAAm	4/24/1996	subadviser	CO
Colorado Local Government Liquid Asset Trust (COLOTRUST PRIME)	AAAm	11/16/1992	subadviser	CO
Colorado Surplus Asset Fund Trust (CSAFE)	AAAm	11/13/1995	private	CO
Connecticut Cooperative Liquid Assets Securities System Plus	AAAm	4/3/2009	subadviser	CT
Connecticut State Treasurer's Short-Term Investment Fund	AAAm	1/2/1996	state/county	CT
Corporate Overnight Fund	AAAm	8/21/1995	subadviser	TX
Florida PRIME	AAAm	12/21/2007	subadviser	FL
Florida Surplus Asset Fund Trust	AAAm	2/7/2008	private	FL
Florida Trust Day to Day Fund	AAAm	1/20/2009	subadviser	FL
Georgia Fund 1	AAAm	6/19/1995	state/county	GA
Government Overnight Fund	AAAm	3/2/2009	subadviser	TX
Illinois Funds - Money Market Fund (The)	AAAm	10/9/1996	state/county	IL
Illinois Institutional Investors Trust	AAAm	10/30/2002	subadviser	IL
Illinois Park District Liquid Asset Fund Plus	AAAm	11/13/1997	subadviser	IL

Table 2

Standard & Poor's Stable NAV LGIP Ratings* (cont.)					
Illinois School District Liquid Asset Fund Plus - Liquid Class	AAAm	11/13/1997	subadviser	IL	
Illinois School District Liquid Asset Fund Plus - Max Class	AAAm	11/13/1997	subadviser	IL	
Local Government Investment Cooperative	AAAm	2/8/2006	subadviser	TX	
Louisiana Asset Management Pool	AAAm	4/11/1995	subadviser	LS	
Maryland Local Government Investment Pool	AAAm	4/18/2000	subadviser	MD	
Massachusetts Health & Educational Facilities Authority- Short Term Asset Reserve Fund	AAAm	12/8/1998	subadviser	MA	
Michigan Cooperative Liquid Assets Securities System	AAAm	4/3/2009	subadviser	MI	
Michigan Liquid Asset Fund Plus	AAAm	11/13/1997	subadviser	MI	
Minnesota School District Liquid Asset Fund	AAAm	4/20/2001	subadviser	MN	
Missouri Securities Investment Program - Money Market Series	AAAm	11/13/1997	subadviser	MO	
Nebraska Liquid Asset Fund	AAAm	11/13/1997	subadviser	NE	
New Jersey Asset & Rebate Management Program/Joint Account	AAAm	7/11/1997	subadviser	NJ	
New Jersey Cooperative Liquid Assets Securities System	AAAm	4/3/2009	subadviser	NJ	
New MexiGROW Local Government Investment Pool	AAAm	3/5/2009	state/county	NM	
New York Cooperative Liquid Assets Securities System	AAAm	4/3/2009	subadviser	NY	
New York Liquid Asset Fund - Liquid Portfolio	AAAm	5/4/1998	subadviser	NY	
New York Liquid Asset Fund - MAX Portfolio	AAAm	5/4/1998	subadviser	NY	
North Carolina Capital Management Trust - Cash Portfolio	AAAm	10/21/1998	subadviser	NC	
Orange County Educational Money Market Fund	AAAm	12/1/2008	state/county	CA	
Orange County Money Market Fund	AAAm	12/1/2008	state/county	CA	
Pennsylvania INVEST Community Pool	AAAm	8/26/1999	state/county	PA	
Pennsylvania INVEST Daily	AAAm	2/8/1996	state/county	PA	
Pennsylvania Local Government Investment Trust/PLGIT Portfolio	AAAm	11/21/1997	subadviser	PA	
Pennsylvania Local Government Investment Trust/PLGIT/ARM Portfolio	AAAm	11/21/1997	subadviser	PA	
Pennsylvania School District Liquid Asset Fund - Liquid Series	AAAm	11/13/1997	subadviser	PA	
Pennsylvania School District Liquid Asset Fund - Max Series	AAAm	11/13/1997	subadviser	PA	
PFM Funds Prime Series-SNAP Class	AAAm	10/1/2008	subadviser	VA	
Puerto Rico Government Investment Trust Fund	AAAm	6/10/1996	subadviser	PR	
State Treasury Asset Reserve of Ohio (STAR OHIO)	AAAm	7/10/1995	state/county	OH	
Texas Cooperative Liquid Assets Securities System	AAAm	4/3/2009	subadviser	TX	
Texas Local Government Investment Pool	AAAm	3/28/1995	subadviser	TX	
Texas Short Term Asset Reserve (TexSTAR) Cash Reserve Fund	AAAm	4/8/2002	subadviser	TX	
TexasDAILY	AAAm	9/20/2001	subadviser	TX	
TexPool Prime	AAAm	12/9/2002	subadviser	TX	
Virginia Local Government Investment Pool	AAAm	6/15/2005	state/county	VA	
West Virginia Government Money Market Pool	AAAm	8/9/2007	subadviser	WV	
West Virginia Money Market Pool	AAAm	8/9/2007	subadviser	WV	
Wisconsin Cooperative Liquid Assets Securities System	AAAm	4/3/2009	subadviser	WI	
Wisconsin Investment Series Cooperative-Cash Management Series	AAAm	12/16/2008	subadviser	WI	
Wisconsin Investment Series Cooperative-Investment Series	AAAm	12/16/2008	subadviser	WI	
Wyoming Government Investment Fund Liquid Asset Series	AAAm	3/15/2007	subadviser	WY	

*As Of Jan. 25, 2010.

Benchmarking--A Critical Tool

A good way for local governments to gauge the characteristics of their pools is to use a benchmark. The S&P Rated GIP Indices are performance indicators of rated GIPs that attempt to maintain a stable NAV. We report three indices--the S&P Rated GIP Index/All, the S&P Rated GIP Index/Government, and the S&P Rated GIP Index/General Purpose Taxable.

These indices provide a simple average of seven-day and 30-day net and gross yields, average days to maturity, as well as the total assets of all pools that we publicly rate 'AAAm' (see table 3). Average asset exposure was a recent addition to the publication of the indices (see table 4). We publish gross yields, net yields, and asset allocation to enable pool managers and investors to compare investment-management performance.

Table 3

S&P Rated GIP Indices (Week Ended Jan. 15, 2010)						
	7-day net yield (%)	30-day net yield (%)	7-day gross yield (%)	30-day gross yield (%)	Avg. maturity (days)	Total assets (Bil. \$)
S&P Rated GIP Index/All	0.16	0.17	0.31	0.33	49	122
S&P Rated GIP Index/Government	0.12	0.14	0.28	0.30	47	40.1
S&P Rated GIP Index/General Purpose Taxable	0.17	0.19	0.32	0.35	50	81.8

Table 4

S&P Rated GIP Indices Breakdown (Week Ended Jan. 15, 2010)									
(% of total)	Agency	Asset-backed securities	Bank deposits	Commercial paper	Corporate	Money-market fund	Municipal debt	Treasury	Repurchase agreements
S&P Rated GIP Index/All	37.37	2.96	14.46	15.22	2.02	5.41	0.97	4.47	17.06
S&P Rated GIP Index/Government	45.53	0	17.02	0	0	0.65	0	3.93	32.87
S&P Rated GIP Index/General Purpose Taxable	34.72	3.92	13.63	20.18	2.68	6.96	1.29	4.64	11.91

The S&P Rated GIP Index/All is a composite of all rated stable-NAV pools. The S&P Rated GIP Index/Government is comprised of pools that invest in U.S. government securities, U.S. Treasury securities, repos collateralized by U.S. government and treasury securities, or any combination of these. The S&P Rated GIP Index/General Purpose Taxable consists of pools that invest in an array of securities other than just U.S. government and treasury securities, which may include CP, corporate notes, bankers acceptances, and certificates of deposit. The LGIP Index Quartile Rankings are released quarterly, providing a reference for relative rankings in the GIP universe (see table 5).

Table 5

Standard & Poor's LGIP Index Quartile Rankings				
(As of Dec. 25, 2009)				
(%)	--Seven-day--		--30-day--	
	Top yield	Low yield	Top yield	Low yield
Gross yields				
Top quartile	0.72	0.45	0.75	0.47

Table 5

Standard & Poor's LGIP Index Quartile Rankings (cont.)				
Second quartile	0.45	0.34	0.47	0.36
Third quartile	0.34	0.26	0.36	0.27
Fourth quartile	0.26	0.16	0.27	0.20
Net yields				
Top quartile	0.42	0.25	0.43	0.26
Second quartile	0.25	0.20	0.26	0.21
Third quartile	0.20	0.14	0.21	0.16
Fourth quartile	0.14	0.00	0.16	0.07

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