

MONTANA

BOARD OF INVESTMENTS

SHORT TERM INVESTMENT POOL FINANCIAL STATEMENTS

(UNAUDITED)
FOR THE FISCAL YEAR ENDING JUNE 30, 2021

*PREPARED BY THE STAFF AND MANAGEMENT OF
THE MONTANA BOARD OF INVESTMENTS*

*As contained within the Audited Unified Investment Program Financial Statements
www.investmentmt.com*

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SHORT TERM INVESTMENT POOL
STATEMENT OF FIDUCIARY NET POSITION
AS OF FISCAL YEAR ENDED JUNE 30, 2021
(in thousands)

Assets

Investments

Cash and cash equivalents held at custodial bank	\$ 3,234,299
Investments at fair value	<u>3,082,075</u>
Total investments	<u>6,316,374</u>
Dividend and interest receivable	<u>945</u>
 Total assets	 <u>6,317,319</u>

Liabilities

Income due participants	<u>507</u>
Total liabilities	<u>507</u>
 Net position held in trust	 <u><u>\$ 6,316,812</u></u>

The accompanying notes are an integral part of these financial statements.

SHORT TERM INVESTMENT POOL
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
FOR FISCAL YEAR ENDING JUNE 30, 2021
(in thousands)

Additions

Purchases by participants	\$ 11,736,759
Net investment earnings	
Investment earnings	
Net increase (decrease) on fair value of investments	5,704
Dividend/interest income	5,731
Other investment income	<u>856</u>
Investment earnings	<u>12,291</u>
Investment costs	<u>(854)</u>
Net investment income	<u>11,437</u>
 Total additions	 <u>11,748,196</u>

Deductions

Sales by participants	9,955,241
Income distributions to participants	<u>11,018</u>
Total deductions	<u>9,966,259</u>
Change in net position	<u>1,781,937</u>
Net position held in trust - beginning of year	<u>4,534,875</u>
Net position held in trust - end of year	<u><u>\$ 6,316,812</u></u>

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED JUNE 30, 2021

These financial statements present only the activity of the Short Term Investment Pool (STIP) as managed by the Board of Investments (the Board). STIP financial statements are included in the Board's Unified Investment Program (UIP) financial statements, which are audited by the Montana Legislative Auditor. These stand-alone STIP financial statements are for informational purposes only and are not separately audited. The Board's audited annual financial information is available from the Board at 2401 Colonial Drive 3rd Floor, PO Box 200126, Helena, MT 59620-0126 or by calling 406-444-0001. The Board's information can also be found on the Board's website at www.investmentmt.com.

1. DESCRIPTION OF FUNDS AND SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF FUNDS

STIP is comprised of state agencies with accounts that retain their own interest earnings which are legally required to invest in STIP, and local governments entities that by statute can voluntarily participate in STIP.

BASIS OF ACCOUNTING

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting and have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as established by the Governmental Accounting Standards Board (GASB).

CASH AND CASH EQUIVALENTS HELD WITHIN POOLS

Cash and cash equivalents generally are short-term, highly liquid investments with maturities of three months or less at time of purchase. STIP holds cash and cash equivalents that are measured at cost.

VALUATION OF INVESTMENTS

Investments reported at fair value are on a trade date basis. Quoted market prices, when available, have been used to value investments. The fair values for securities that have no quoted market price represent estimated fair value. Fair value measurements are reviewed monthly, and third-party valuations are reviewed for reasonableness and compliance with approved price source authorization policy. Refer to Note 4 - Fair Value Measurement for further detail.

REVENUE RECOGNITION

Unrealized gains and losses are included as a component of investment income in the Statement of Changes in Fiduciary Net Position. Unrealized gains and losses are computed based on changes in the fair value of investments held from the beginning of the year, but unsold at the fiscal

year-end. The net change in fair value of investments also consists of the realized gains or losses. Interest income is recognized when earned. Dividend income is recorded on the ex-dividend date.

INVESTMENT COSTS

The State Legislature sets management fees the Board charges. The maximum fee is set at the aggregate level at the beginning of each fiscal year. Custodial bank fees are paid by a statutory appropriation from the State's General Fund. The Board allocates custodial bank fees across UIP, including STIP. During the fiscal year, STIP was allocated \$574 thousand in Board fees and \$280 thousand in custodial bank fees, for a total of \$854 thousand in fees. The STIP investment fee ratio was 0.01%.

PURCHASES AND SALES BY PARTICIPANTS AND INCOME DISTRIBUTIONS

Purchases and sales by participants are recorded when received or paid. STIP participants receive monthly income distributions. STIP distributable income is total net investment earnings less the net increase (decrease) on the fair value of investments not attributable to amortization.

USE OF ESTIMATES

In conformity with GAAP, management may make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from estimated amounts.

REGULATORY OVERSIGHT

The Board was created by the State Legislature to manage the UIP established by the State Constitution. The Board is not registered with the U.S. Securities and Exchange Commission as an investment company.

POOL PARTICIPANT UNITS

Pool units are purchased and sold in the same manner as individuals investing in mutual funds. The STIP participants purchase and sell units at \$1 per unit, at the participant's discretion. Individual investments in the pools are not specifically identified to the respective participants. Refer to Note 6 – STIP Reserve for further detail.

2. INVESTMENT RISK DISCLOSURES

CUSTODIAL CREDIT RISK (CASH AND CASH EQUIVALENTS AND INVESTMENTS HELD AT CUSTODIAL BANK)

Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Board will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Per policy, the Board's custodial bank must be rated at a minimum at the 6th highest investment grade rating by at least two Nationally Recognized Statistical

Rating Organizations (NRSROs) on an annual basis.

As of June 30th, all the public securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. Commingled fund investments are registered in the name of the Montana Board of Investments. Therefore, the Board is not subject to custodial credit risk.

CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributable to the magnitude of any single investment per issuer name. Investments explicitly guaranteed by the U.S. Government are excluded from the concentration of credit risk requirement. Concentration of credit risk is addressed within the Investment Policy Statement (IPS) as set by the Board. Refer to Note 3 – Summary of Investment Policy – Legal and Contractual Provisions for further detail.

CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Except for U.S. Government securities, STIP fixed income instruments have credit risk as measured by NRSRO ratings. Credit risk is contemplated for each individual portfolio in the IPS. Credit risk is managed by constraining portfolio purchases around investment grade NRSRO ratings as appropriate. The U.S. Government guarantees its securities directly or indirectly. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit risk. Refer to Note 3 – Summary of Investment Policy – Legal and Contractual Provisions for further detail.

As a matter of STIP investment policy, the Board's fixed income investment staff can only purchase securities from a pre-approved "Approved Issuer" list. By STIP policy, permitted money market investments include only SEC registered 2a-7 Institutional Money Market Funds that are considered "US Treasury" or "US Government" money market mutual funds according to the SEC regulations or short-term investment vehicle available through the custodial bank. As of June 30th, all the STIP money market investments were in US Governmental Money Markets and \$166 million was held on deposit in a short-term investment vehicle available through the custodial bank. NRSRO provides the credit ratings presented in the following table.

STIP CASH EQUIVALENT CREDIT QUALITY RATINGS AS OF JUNE 30, 2021
(in thousands)

<u>Cash Equivalent Investment Type</u>	<u>Total Cash Equivalents</u>	<u>Credit Quality Rating</u>
Agency or Government Related	\$ 182,211	A-1+
Asset Backed Commercial Paper	2,303,761	A-1+
Corporate:		
Commercial Paper	531,325	A-1+
Certificates of Deposit	51,002	A-1+
Interest Bearing Demand Deposit Account (IBDDA)	166,000	NR
Total Cash Equivalents Held at Custodial Bank	<u>\$ 3,234,299</u>	

INTEREST RATE RISK

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board uses effective duration as a measure of interest rate risk for all fixed income portfolios. Refer to Note 3 – Summary of Investment Policy – Legal and Contractual Provisions for further detail.

STIP investments at fair value are categorized to disclose credit risk and weighted average maturity (WAM). Credit risk reflects the weighted security quality rating by investment type as of the June 30th report date. Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated. STIP interest rate risk is determined using the WAM method. The WAM measure expresses investment time horizons – the time when investments are due or reset and payable in days, months, or years – weighted to reflect the dollar size of the individual investments within an investment type. Inclusive of cash and cash equivalents, the WAM averages 115 days for the portfolio.

**STIP CREDIT QUALITY RATINGS AND WEIGHTED AVERAGE MATURITY AS OF JUNE 30, 2021
(in thousands)**

<u>Security Investment Type</u>	<u>Total Fixed Income Investments at Fair Value</u>	<u>Credit Quality Rating</u>	<u>WAM (Days)</u>
Treasuries	\$ 789,021	A-1+	99
Agency or Government Related	724,008	A-1+	87
Corporate:			
Commercial Paper	913,481	A-1+	153
Notes	250,494	A-1	111
Certificates of Deposit	405,071	A-1	142
Total STIP Fixed Income Investments at Fair Value	<u>\$ 3,082,075</u>		

Based on their short weighted average maturity and the relative immaterial difference from their cost to fair value as of June 30th, the Board deemed the cash equivalents to have little discernible interest rate risk.

3. SUMMARY OF INVESTMENT POLICY – LEGAL AND CONTRACTUAL PROVISIONS

The Board manages the Investment Program pursuant to the “Prudent Expert Principle” mandated by state law, which requires an investment manager to:

- (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims;
- (b) diversify the holdings of each fund within the UIP to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and
- (c) discharge the duties solely in the interest of and for the benefit of the funds forming the UIP.

ALLOWED INVESTMENTS

The Board approves all IPSs. The IPSs also reflects the Board approved asset allocation ranges.

The STIP IPS limits concentration of credit risk exposure by limiting portfolio investment types to 3% in any issuer except for U.S. Treasury and U.S. Agency securities as well as any repurchase agreements with a financial institution.

STIP invests primarily in short-term, high quality, fixed income securities with a maximum maturity of 397 days or less. Variable securities shall have a maximum maturity of 2 years. STIP shall maintain a dollar-weighted average portfolio maturity of 120 days or less. STIP is managed to preserve principal while providing 24-hour liquidity for state agency and local government participants.

Per the STIP IPS, “The STIP portfolio will minimize interest rate risk by:

- 1) structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations thereby normally avoiding the need to sell securities on the open market prior to maturity;
- 2) maintaining a WAM of 120 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities); and
- 3) STIP will maintain a reserve account.”

OTHER POLICY CONSIDERATIONS

STIP may hold fixed and variable rate securities. Interest payments on variable securities are based on an underlying reference rate, for example, Secured Overnight Financing Rate (SOFR).

4. FAIR VALUE MEASUREMENT

The Board categorizes its fair value measurements within the fair value hierarchy established by GAAP as follows:

Level 1 - Quoted prices for identical assets or liabilities in active markets that the Board can access as of June 30th.

Level 2 - Prices are determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly. These inputs can include quoted prices for similar assets or liabilities in active or inactive markets, or market-corroborated inputs.

Level 3 - Prices are determined using unobservable inputs, which generally results in the Board using the best information available and may include the Board’s own data.

Fair Value Level

Fixed income and equity investments classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Fixed income investments classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities’ relationship to benchmark quoted prices. Investments measured at cost are included to account for all investments. These assets represent cash equivalents.

STIP has the following value measurements as of June 30th:

INVESTMENTS MEASURED AT FAIR VALUE (in thousands)		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
	June 30, 2021			
<u>Investments by fair value level</u>				
Fixed income investments:				
Treasuries	\$ 789,021	\$ 789,021	\$ -	\$ -
Agency or government related	724,008	-	724,008	-
Corporate:				
Commercial paper	913,481	-	913,481	-
Commercial notes	250,494	-	250,494	-
Certificates of deposit	405,071	-	405,071	-
Total STIP Fixed Income Investments at Fair Value	3,082,075	\$ 789,021	\$ 2,293,054	\$ -
<u>Investments at cost</u>				
Cash and cash equivalents held at custodial bank	3,234,299			
Total investments	\$ 6,316,374			

5. BOND AND LOAN GUARANTEES

As of June 30th, the Board had provided loan guarantees from STIP, Trust Fund Investment Pool (TFIP), the Coal Severance Tax Trust Fund, and the Treasurer's Cash Fund to the Enterprise Fund for exposure to INTERCAP bond issues amounting to approximately \$90.6 million and to the Montana Facility Finance Authority (MFFA) amounting to approximately \$100.2 million. The Board has not had to perform on any bond and loan guarantee in the past.

STIP and TFIP are external investment pools managed by the Board. Both the Coal Severance Tax Trust Fund and the Enterprise Fund are part of the primary government for the State of Montana. The Board manages the Treasurer's Cash Fund which consists of fund balances of all the funds for the State whose investment earnings are permitted by law to flow to the State's General Fund. The Board has irrevocably pledged to make loans to cure INTERCAP reserve account deficiencies and to purchase tendered bonds not redeemed or remarketed. The outstanding bonds have final maturities of March 1, 2028 – March 1, 2042. The Board has not had to perform on any loan guarantee in the past. The amounts are merely commitments of the Board.

By statute, the Board is authorized to credit enhance the INTERCAP bonds and allows the Board to charge a fee for this service. There is an annual fee of up to 15 basis points on outstanding INTERCAP bonds. If the Board was called on to purchase tendered bonds not redeemed or remarketed, INTERCAP's governing bond indenture requires the Board to be paid a fee equal to 25 basis points of the principal amount of tendered bonds purchased. The credit enhancement fee was waived in fiscal year 2021 to reduce the INTERCAP loan rate from 2.50% to 1.00% until August 15, 2020 providing COVID-19 pandemic relief in the form of debt obligation interest savings. No credit enhancement fees were received during the fiscal year. Refer to Note 6 – STIP Reserve for further detail.

MFFA is a discretely presented component unit of the State of Montana. MFFA guarantee requests are submitted to the Board for review and approval. The Board's participation, either duration or any other consideration, to either purchase bonds or loans or to lend money for deposit into MFFA's statutorily allowed capital reserve account is explicitly limited by statute which requires the Board to act prudently. The guarantee requests from MFFA pertain to bonds issued by MFFA with a term of up to 40 years. The Board receives a credit enhancement fee at MFFA bond closing based on the term of the financing, the type of bond, the rating of the borrower, and the type of reserve fund. The Board and MFFA have entered into an agreement detailing repayment to the Board. The credit enhancement fee received during the fiscal year was \$385 thousand.

The following schedule summarizes the guarantee activity during the fiscal year:

Bond and Loan Guarantee Activity as of June 30, 2021				
(in thousands)				
	<u>Beginning</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
	<u>Balance</u>			
INTERCAP	\$ 90,670	\$ -	\$ 70	\$ 90,600
MFFA	88,346	33,465	21,563	100,248

6. STIP RESERVE

The reserve account may be used to offset losses within the STIP portfolio. Refer to Note 5 – Bond and Loan Guarantees for more detail. The following table details STIP Reserve activity for the fiscal year ended June 30, 2021:

STIP RESERVE ACTIVITY	
(in thousands)	
Beginning STIP Reserve	\$ 52,564
Additions	
Investment earnings:	
Net increase (decrease) on fair value of investments	21
Interest income	12
Transfer of daily STIP income	760
Recoveries from write offs	855
Credit enhancement fees	-
Total investment earnings	<u>1,648</u>
Total STIP Reserve activity	<u>1,648</u>
Ending STIP Reserve	<u>\$ 54,212</u>

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