

Lane County, Oregon

Annual Investment Report

For the Calendar Year Ending
December 31, 2007

Prepared by the
Financial Services Division
Department of Management Services

Lane County, Oregon Annual Investment Report Calendar Year Ending December 31, 2007

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Introduction

Each year the Financial Services Division of the Department of Management Services aggregates and analyzes information regarding the previous year's investment activity. This Annual Investment Report for the calendar year ending December 31, 2007 captures that information and is used by the Investment Advisory Committee to form a conclusion about whether or not management has met the legal and administrative parameters set forth in the Oregon Revised Statutes, Lane Manual, and Lane County's Administrative Procedures Manual.

Portfolio Examination

This Annual Investment Report is organized to examine the general investing objectives of the portfolio. The general objectives of the investment activities, in priority order, are:

General Objectives

- **Safety** – Seek to ensure preservation of principal in the overall portfolio by mitigating credit risk and interest rate risk.
 - Credit Risk - Risk of loss due to failure of the security issuer or backer.
 - Interest Rate Risk - Risk that the market value of securities in the portfolio will fall due to changes in market interest rates.
- **Liquidity** – Seek to ensure portfolio remains sufficiently liquid to meet daily operating requirements.
- **Yield** – Seek to attain a rate of return that is typical of market conditions for similar portfolios with comparable safety and liquidity needs.

Although ranked, these objectives represent factors that interrelate and should be considered together when managing the investment portfolio. No objective supercedes another but all three objectives should receive adequate consideration, as prioritized, before making investment decisions.

Executive Summary

Compliance

Lane County's investment portfolio is in full compliance with Oregon Revised Statutes (ORS), the Lane Manual (LM), and Lane County's Administrative Procedures Manual (APM).

Safety

Credit Risk – Lane County's investment portfolio has not been subjected to unreasonable risk of loss.

- All securities held are either backed by the US Government or meet minimum ratings set by either Standard and Poor's or Moody's Investor Service.
- No one financial institution or broker/dealer can account for more than 18% of the County's investment purchases.
- Investments are well diversified with no one investment vehicle accounting for more than 28% of the portfolio.

Interest Rate Risk – Lane County's investment portfolio has minimized the risk that the market value of securities will fluctuate when market interest rates change.

- The portfolio has limited the term of all securities to three years or less, and the portfolio complies with the minimum investment percent per maturity term as established in the APM.

Liquidity

The investment portfolio is sufficiently liquid to meet all operating requirements. No securities were required to be sold short to meet cash flow needs.

Yield

The County, City of Eugene (Eugene), and the State Local Government Investment Pool (LGIP) yields are all virtually identical at the end of the year. Our strategy of investing in longer-terms has finally recovered from the recent cycle of rate increases. Regardless, over the last six years the County's investment yield continues to outperform Eugene and LGIP.

Custodial Banking Fees

Fees to Union of Bank of California, the County's security safe-keeper, remain low and continue to be reasonable.

Long-term Rates Analysis

Long-term interest rates continue to show improvement in comparison to current short-term rates. However, one year rates are still exceeding two year rates. Although investing beyond three years is beginning to make some sense, we still do not believe it is appropriate at this time. We will continue to monitor the spread.

Investment Authority

State Authority

Oregon Revised Statutes 294 and 295 governs the investment of public funds for Oregon municipalities.

<http://www.leg.state.or.us/ors/294.html>

<http://www.leg.state.or.us/ors/295.html>

Local Authority

Lane Manual 4.015 to 4.020 states the policies to be followed by the Director of Management Services in administering the investment program.

http://www.lanecounty.org/LaneManual/documents/ManualChapter04_July24_07.pdf

Procedures

Administrative Procedures chapter 2, section 20, provides specific direction to the Director of Management of Services in administering the investment program.

http://insidelane/Documents/portal_001/module_0188/Ch2Sec20.pdf

Investment Advisory Committee

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Portfolio Examination

Safety Considerations

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of principal in the overall portfolio. The objective is to mitigate credit risk and interest rate risk.

Credit Risk

Lane County mitigates credit risk by performing the following:

1. Security analysis
2. Financial partners analysis
3. Diversification analysis

Security Analysis

Oregon Statute and the APM limit the types of investments that the County can hold. During the calendar year ending December 31, 2007, the County held the following types of securities:

- US Treasuries:
 - Financing Corp (FICO Strips)
- US Agencies:
 - Federal Farm Credit Bank
 - Federal Home Loan Bank
 - Federal Home Loan Mortgage Corporation
 - Federal National Mortgage Association
- Corporate:
 - Promissory Notes:
 - US Bank
 - Bank One
 - HSBC Finance Corp
 - Citigroup Funding
 - Credit Suisse New York
 - General Electric Capital Corp
 - MBIA Global Funding
 - Norwest Financial
 - Bank of America
 - Commercial Paper:
 - Merrill Lynch
 - Co-op Association Tractor Broker/Dealer

- State of Oregon:
 - Local Government Investment Pool (LGIP)
- Money Markets:
 - US Bank
 - Umpqua Bank
- Certificates of Deposit:
 - US Bank
 - Umpqua Bank

In addition, Oregon statute and the APM require minimum ratings from either one of the following rating agencies for each of the following security types.

	<u>S&P</u>	<u>Moody's</u>
• Oregon municipalities	A	A
• Corporate indebtedness:		
○ Promissory notes		
• Non-Oregon	AA	Aa
• Oregon	A	A
○ Commercial paper		
• Non-Oregon	P-1	A-1
• Oregon	P-2	A-2

For the calendar year ending December 31, 2007, the County fully complied with the ORS and APM limitations regarding types of securities and minimum ratings.

Financial Partners Analysis

The APM requires the County to pre-qualify the use of any depository, financial institution, or broker/dealer.

Depositories

US Bank is the County's main banking partner. The current contract with US Bank runs through June 30, 2007 and is in the process of being extended to June 30, 2009. Other banks used by the County include:

- Umpqua Bank (for Certificates of Deposit and Money Market accounts)
- Siuslaw Bank (for Florence and Oakridge Justice Courts and Public Works sites in Florence)

Other Financial Institutions

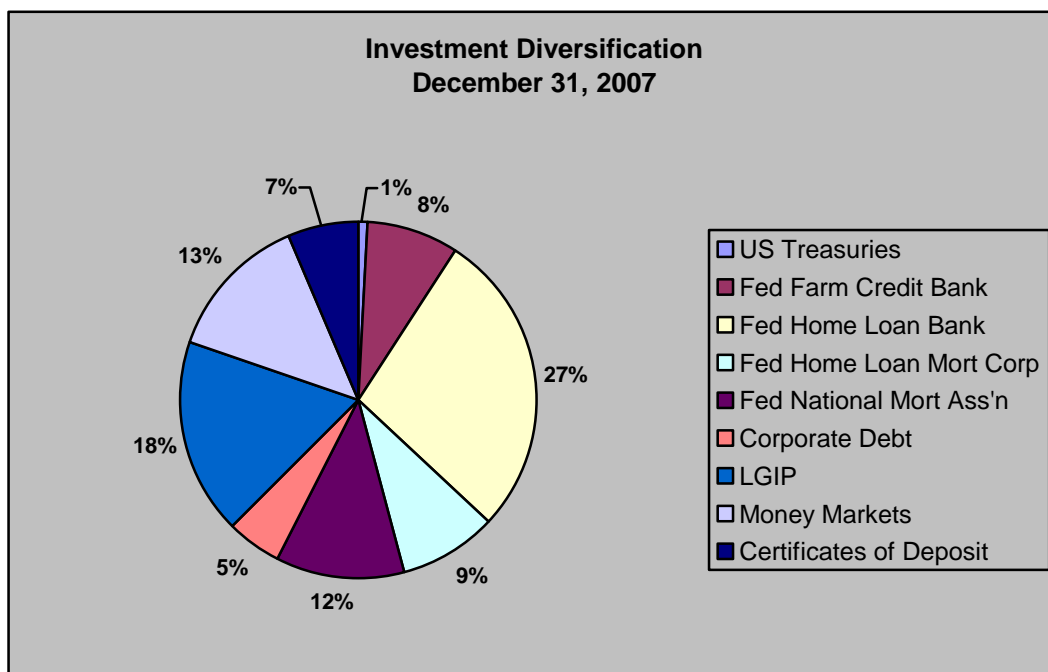
The Bank of California is the County's third-party custodian of all the County securities. Lane County has used Bank of California for the past 11 years.

Broker/dealers

Lane County works through various broker/dealers when purchasing securities. The following is a list of broker/dealers used by the County and their percent of our December 31, 2007 portfolio:

	<u>Percent</u>
Bank of America	2.6
BB&T Capital Markets	2.0
Financial Northeastern	11.1
Multi-Bank Securities, Inc.	4.6
Oppenheimer & Co.	12.9
RBC Dain Rauscher	3.3
Seattle-Northwest Securities	4.6
State of Oregon (LGIP)	17.8
Sterling Financial	1.3
Sterne, Agee, & Leach	14.2
UBS Financial Services	2.0
Umpqua Bank	9.2
US Bank	10.5
Vining Sparks	1.3
Wells Fargo	2.6

Diversification Analysis



The APM states that investments are not allowed to exceed the following as a percent of all monies available for investment:

- 33% - United States or any one of its agencies
- 25% - Bankers Acceptances
- 35% - Corporate Indebtedness, or 5% in any one single corporate issuer

As is evidenced above, the County investments are well diversified.

Interest Rate Risk

Interest rate risk is addressed as follows:

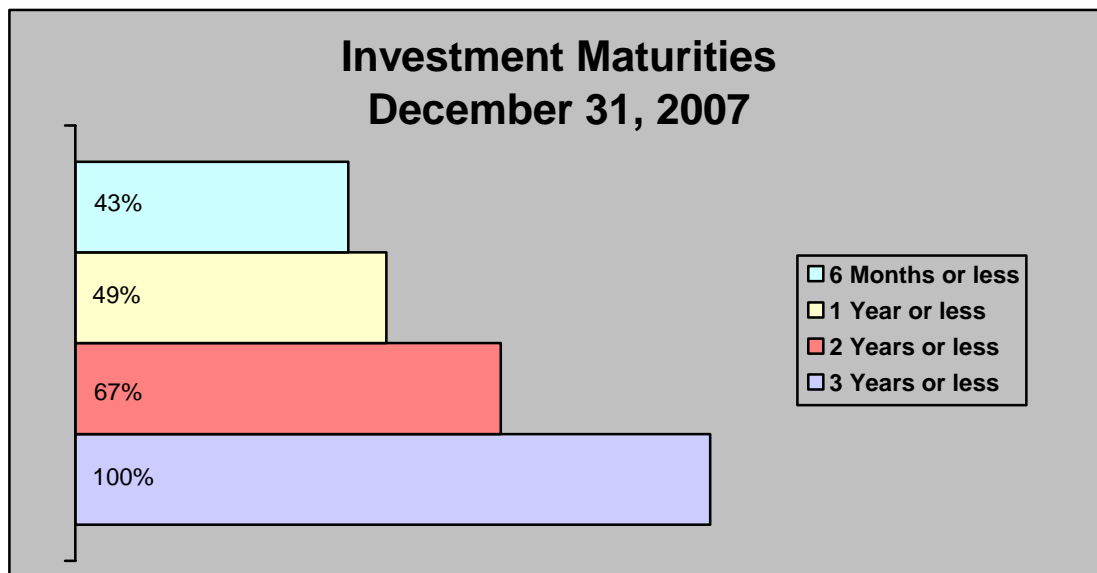
Portfolio Structure

Lane County structures the maturities of its investments so that securities mature to meet cash flow requirements for ongoing operations. During the calendar year ending December 31, 2007, no securities were required to be sold short to meet cash flow requirements. Please see the discussion on Liquidity for more information.

Maturity Analysis

The APM requires that the County not invest in securities whose maturity is more than three years from the date of purchase unless matched to a specific cash flow and approved by the Board of Commissioners. At this time, no County investments exceed three years, nor has the Board of Commissioners granted specific authorization for any investment to exceed three years.

The maturities of the County investment portfolio at fair value, without consideration of calls, were as follows as of December 31, 2007:



The APM requires the following minimum investment percent per maturity term:

- 20% of the portfolio must mature within 6 months
- 30% of the portfolio must mature within 1 year
- 50% of the portfolio must mature within 2 years
- 100% of the portfolio must mature within 3 years

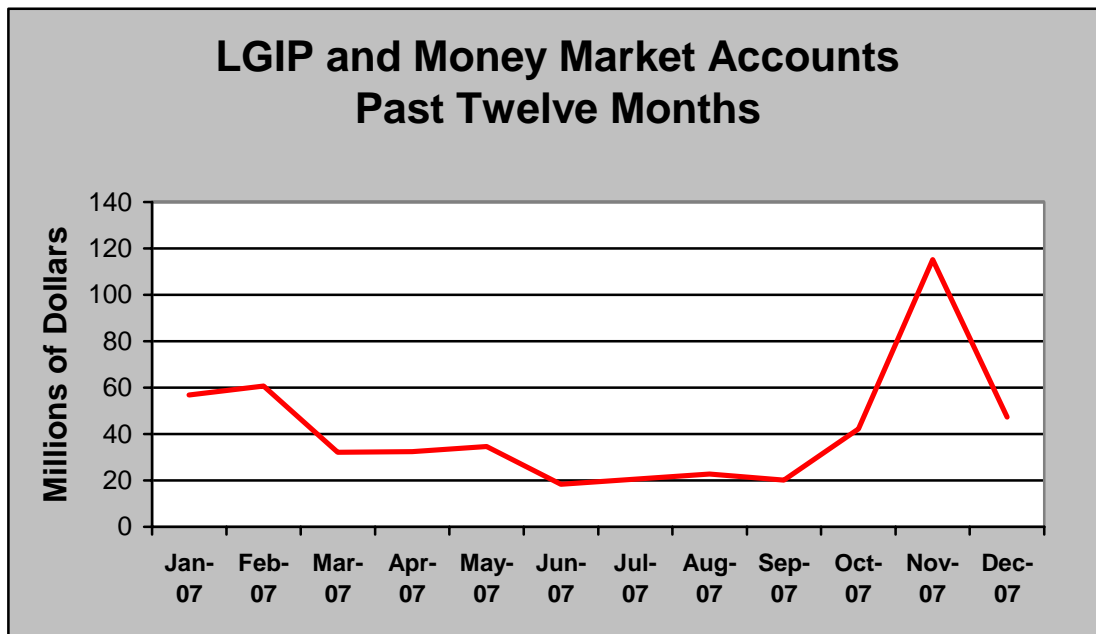
As can be seen, the investment portfolio is in compliance with this requirement as of December 31, 2007.

Liquidity Considerations

The investment portfolio needs to remain sufficiently liquid to meet the daily operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands.

Lane County expends approximately \$20 million per month. In order to keep cash in our checking account low and still pay our bills on time, the County invests with the LGIP and commercial money market accounts that offer same day liquidity.

Over the past twelve months, the combined LGIP and money market account balances at month-end are as follows:

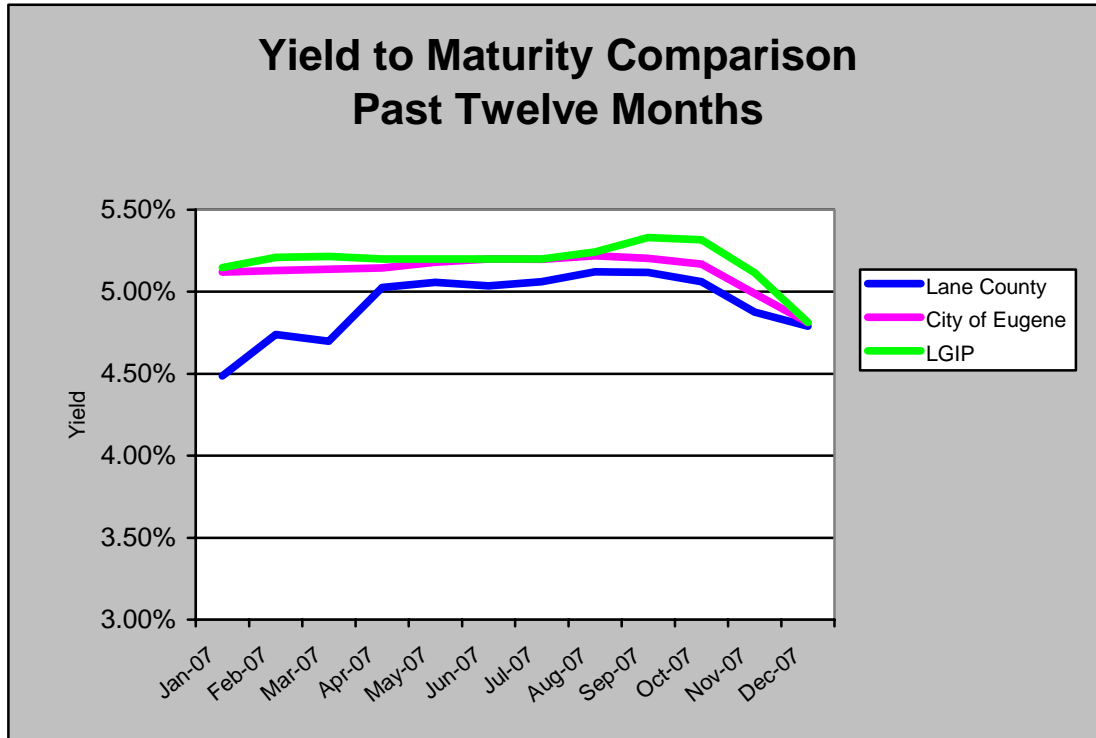


The spikes in November, and small bumps in February, and May are the result of the temporary investment of property tax receipts with the LGIP. The bump in January is due to receipt of federal forest monies. Most of these receipts are reinvested into securities within one month. No securities were required to be sold short to meet cash flow requirements the past twelve months.

Yield Considerations

The investment portfolio is designed with the objective of attaining a rate of return throughout budgetary and economic cycles that is typical of market conditions for similar portfolios, taking into account the investment risk constraints and liquidity needs of the County. However, return on investment is of secondary importance compared to the safety and liquidity objectives previously discussed.

Lane County benchmarks its actual investment yield for the portfolio overall to the State's LGIP and Eugene's internal investment pool.

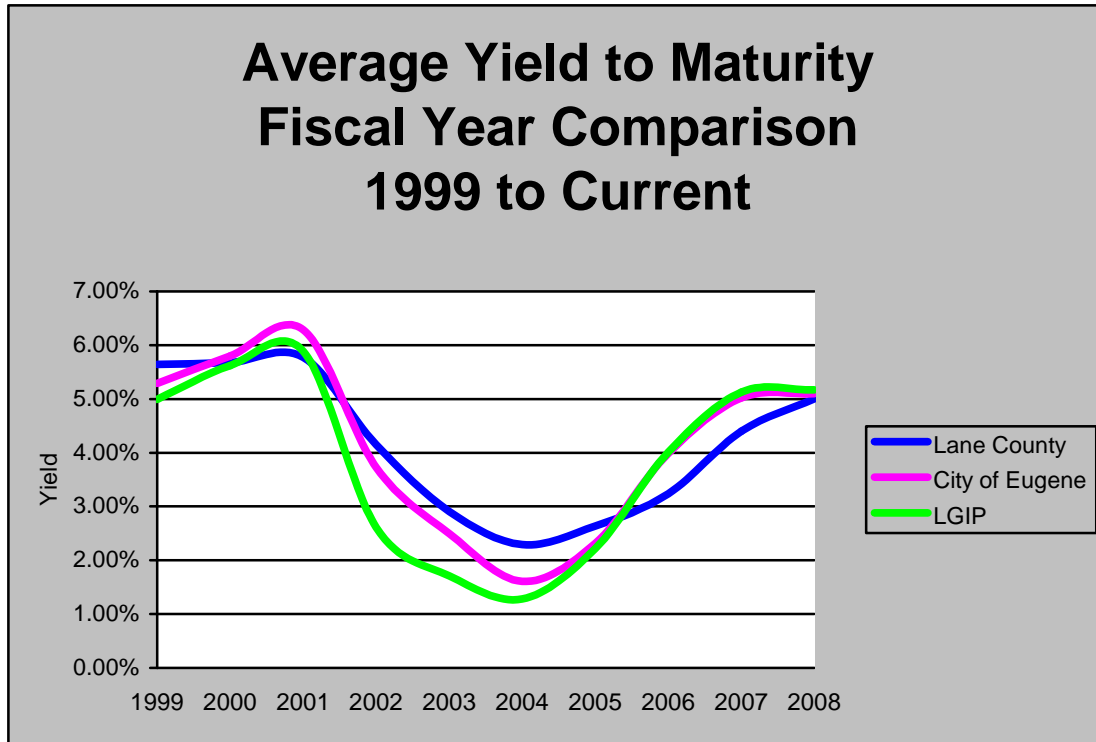


Since May, 2005 Lane County's portfolio yield under-performed in comparison to Eugene and LGIP. This is because the County's investment policy allows us to invest in securities for longer durations than does Eugene or LGIP, and when interest rates rise, it takes us longer to liquidate our lower yielding investments and invest in more productive securities. Conversely, when interest rates are on the decline, the County's portfolio yield outperforms Eugene and LGIP.

As can be seen in the above graph, Lane County's yield has finally caught up with Eugene and LGIP - the combined result of 1) all our lower yielding investments maturing, and 2) the shortening up of our average maturities in response to the lack of yield spread between one, two, and three year securities (see Average Investment Duration Comparison chart that follows).

Beginning in January 2007, short-term rates began to slide some so the County began to increase its average investment term again to lock in longer-term interest rates. We anticipate the County's yield will outperform the benchmarks within the next year.

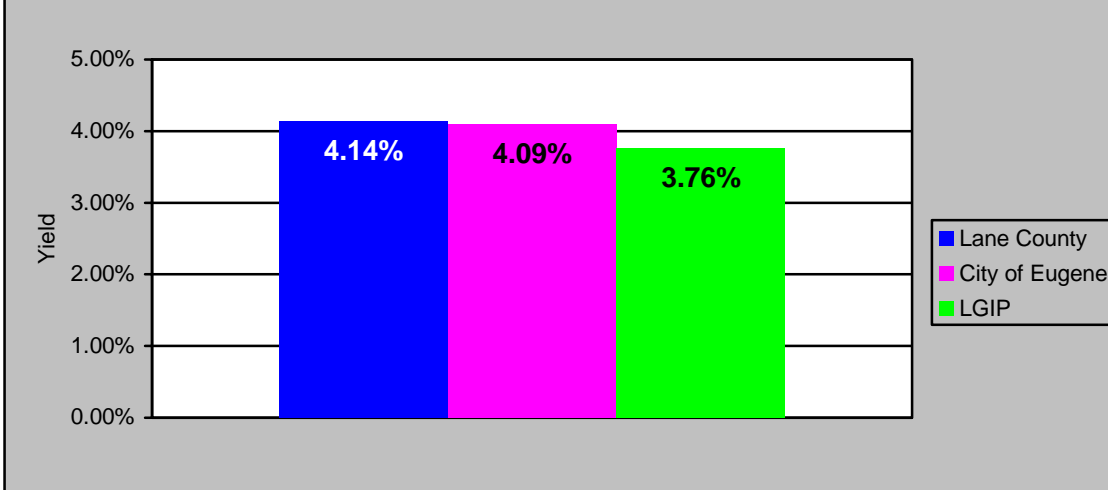
Over the long-run, the County's investment strategy to hold longer term investments has been very successful as can be evidenced in the following chart.



As can be seen, in periods when interest rates decline the County outperforms Eugene and LGIP. In periods when interest rates rise, the County lags behind. Furthermore, it can be noted that Lane County's policy of investing longer term helps smooth earnings over multiple years, providing more resource stability than those portfolios with shorter-term investment strategies.

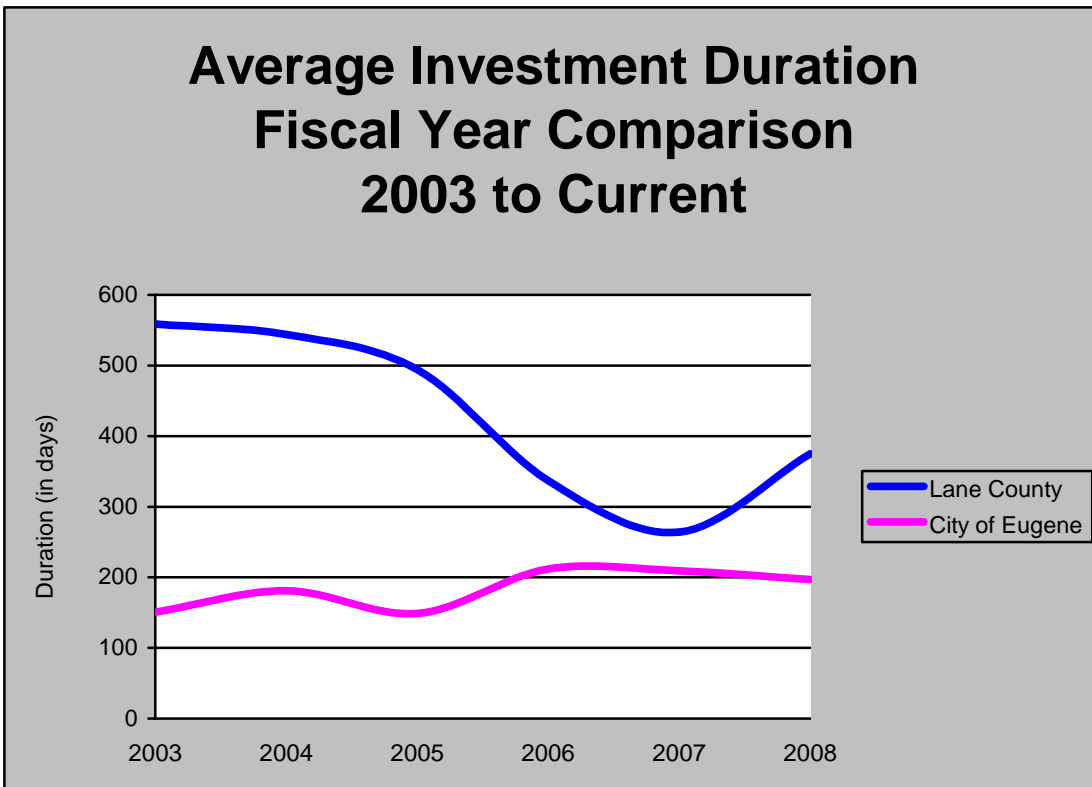
As evidenced in the following graph, the County's average yield performance has outpaced Eugene and LGIP over the past nine years.

Average Yield to Maturity Comparison 1999 to Current



Beginning in 2005, Lane County began focusing its efforts on reducing its portfolio of two and three year maturities due to the fact that short-term investments were yielding more than long-term investments. As the following graph displays, the County's average investment duration has declined rapidly between 2005 and 2007. However, Lane County has begun to buy long-term again in response to the decline in short-term rates.

Average Investment Duration Fiscal Year Comparison 2003 to Current



Custodial Banking Fees

Union Bank of California is the County's third-party safekeeping bank for all of its securities. Union Bank receives securities we purchase and relinquishes securities we sell. All of the securities are held in Lane County's name. Fees to Union Bank are a sum of the following quarterly charges:

1. \$150 base fee
2. \$3 holding fee per eligible security
3. \$12 holding fee per ineligible security
4. \$15 transaction fee per transaction
5. \$10 disbursement fee per disbursement
6. \$625 minimum fee per quarter

Fees paid for the past five calendar years are as follows:

2007	\$6,308
2006	2,852
2005	2,680
2004	4,412
2003	4,320

Fees to Union Bank are a reflection of investment turnover during the year. When interest rates decline, higher yielding investments are called by the lenders. When interest rates increase, investment calls are not as frequent. The decline in fees in 2005 and 2006 is a direct result in interest rate increases that decreased investment calls and turnover. The rise in fees in 2007 is a direct result in interest rate decreases that increased investment calls and turnover.

Union Bank has not increased their fee schedule to the County in the eleven years we have been with them.

Long-Term Rate Analysis

The APM allows the County to invest in securities whose maturity is more than three years when matched to a specific cash flow and approved by the Board of Commissioners.

New issue rates for US Treasuries are considered indicative of the market for longer-term investments. On January 8, 2008, new Treasury issues were as follows:

1 - Year	2.93%
2 - Year	2.78%
5 - Year	3.18%
10 - Year	3.86%
30 - Year	4.36%

As can be seen, the yield for new one year Treasuries is outperforming two year issues while the spread between one year and five year durations is positive but small. The spread between two year and thirty year issues continues to improve and is currently 1.43%. If this trend continues and long-term rates increase, investing outside the current three-year window may be appropriate.