

MONTANA BOARD OF INVESTMENTS
ZORTMAN/LANDUSKY LONG TERM WATER (MU30) (FUND 02540)
INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of an investment policy statement is to give the investment manager guidance in developing an investment program to achieve the objectives agreed upon and enable the client, the Department of Environmental Quality (DEQ), to monitor the progress of the plan.

OBJECTIVES

Return Requirement: To purchase securities will have a value of \$15 million by 2017.

Risk Tolerance: Credit risk and reinvestment rate risk should be avoided on the \$15 million piece to insure that it is available by the year 2017. U.S. Treasury/Agency STRIPS are the best investment choice to eliminate credit risk and reinvestment rate risk. Excess funds could be invested in the Trust Funds Bond Pool.

CONSTRAINTS

Liquidity: None until the year 2017.

Time Horizon: The fund is considered a long-term fund that has a time horizon beyond one year.

Tax Considerations: This fund is tax exempt; therefore, tax advantaged investments will not be used.

Legal Considerations: This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge its 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 unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is solely prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Montana Constitution does not allow equity type investments in non-retirement funds.

Unique Circumstances:

Client Preference: None

ADMINISTRATIVE

Securities Lending: Section 17-1-113, MCA, authorizes the Board to lend securities held by the state. The Board may lend its publicly traded securities held in the investment pools, through an agent, to other market participants in return for compensation. Currently, through an explicit contract, State Street Bank and Trust, the state's custodial bank, manages the state's securities lending program. The Board seeks to assess the risks, such as counterparty and reinvestment risk, associated with each aspect of its securities lending program. The Board requires borrowers to

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maintain collateral at 102 percent for domestic securities and 105 percent for international securities. To ensure that the collateral ratio is maintained, securities on loan are marked to market daily and the borrower must provide additional collateral if the value of the securities on loan increases. In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor. From time to time, Staff or the investment manager may restrict a security from the loan program upon notification to State Street Bank. Staff will monitor the securities lending program, and the CIO will periodically report to the Board on the status of the program.

Cash Investments

Cash investments held at the pool level, any managed account within it, or any separate account entail an element of credit risk. Thus, only approved cash investment vehicles are permitted. These include the custodian's STIF vehicle, STIP, or any SEC-registered money market fund, all of which specifically address credit risk in their respective investment guidelines.

BACKGROUND INFORMATION

Zortman Mining Inc. provided a Financial Guaranty Bond to DEQ on October 25, 1996. National Fire Insurance Company of Hartford is the surety. Securities having a maturity value of \$15 million in 2017 are required to be deposited with the trustee, The First National Bank of Chicago, according to the following schedule:

- (1) On or before December 1, 1996, permitted securities with stated value at maturity of not less than \$3.3 million;
- (2) On or before December 1, 1997, permitted securities with stated value at maturity of not less than \$3.2 million;
- (3) On or before December 1, 1998, permitted securities with stated value at maturity of not less than \$3.0 million;
- (4) On or before December 1, 1999, permitted securities with stated value at maturity of not less than \$2.8 million;
- (5) On or before December 1, 2000, permitted securities with stated value at maturity of not less than \$2.7 million.

Zortman delivered the first two installments to the trustee. Zortman then filed for bankruptcy protection and did not deliver the December 1, 1998 requirement. DEQ filed a surety claim for the December 1, 1998 requirement and received \$1 million. DEQ also received \$800,000 from the surety for the December 1, 1999 installment.

June 1999 DEQ requested that BOI take delivery of first two installments from the trustee and buy additional securities with the surety payments.

August 1999 BOI purchased \$3.0 million par of FNMA STRIP 2017 for \$891,000 at a yield of 6.928%.

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September 1999 BOI purchased \$2.8 million par of same issue for \$837,648 at a yield of 6.94%.

October 1999 BOI received \$6.5 million par of U.S. Treasury STRIPS from the trustee and then swapped them for same FNMA issue to pickup yield and take out cash of \$70,952. The sale yield was 6.76% and the purchase yield was 7.116%.

May 2001 BOI purchased \$0.4 million par of same issue for \$143,624 at a yield of 6.48%. The par amount is now \$12.7 million or \$2.3 million short of the DEQ goal.

**ASSET ALLOCATION
(at market)**

FIXED INCOME

	<u>6/00</u>	<u>6/01</u>	<u>6/02</u>	<u>Ranges</u>
U.S. Government/Agency Securities	96.2%	99.5%	99.4%	90-100%
Trust Funds Bond Pool (TFBP)	0.0	0.0	0.0	0-10
Short-Term Investment Pool (STIP)	<u>3.8</u>	<u>0.5</u>	<u>0.6</u>	<u>0-10</u>
Total Fixed-Income	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>