



LGIP QUARTERLY MEETING & CONFERENCE CALL

11.6.2013

OFFICE OF THE ARIZONA STATE TREASURER



AGENDA

- **LGIP Performance**
- **Endowment Performance and Distributions**
- **State Cash Flow**
- **Guest Presentation:
State Budget Outlook from JLBC**
- **Q & A**



INVESTMENT PHILOSOPHY

SAFETY

before

LIQUIDITY

before

YIELD



EARNINGS FOR Q1 FY 2014

\$33,282,400



LOWER MANAGEMENT FEES

Starting August 1, 2013, all management fees are reduced 8.3% from 6 basis points to 5.5 basis points.





LGIP PERFORMANCE

Q1 FY2014



YIELDS: JULY 1, 2011 – OCT. 31, 2013

UST 2-Year Note



UST 3-Year Note



UST 5-Year Note



UST 10-Year Note



POOL 5

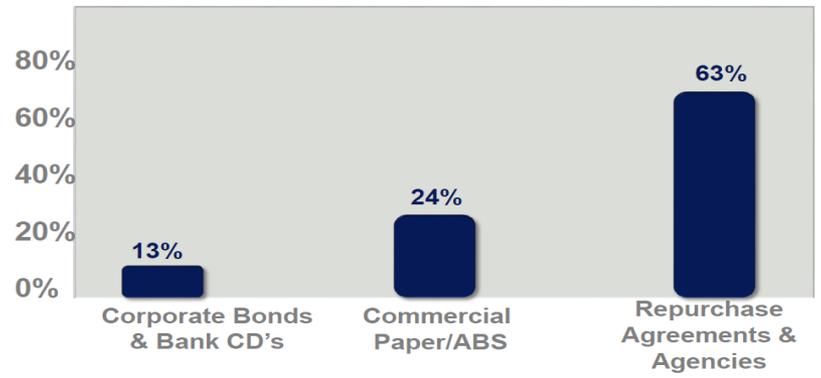
- \$1.19 Billion Assets as of 9/30/2013
- Net Asset Value - \$1.000 9/30/2013
- Diversified investments weighted to highly rated Commercial Paper, Repurchase Agreements, and Agency/Treasuries
- Overnight repo rates continue to be extremely low and as a result allocation to commercial paper has increased. Will continue to add more short corporate bonds and asset-backed securities.
- Keep daily liquidity in the 10-30% range
- Maintained the highest rating possible from S&P

Liquidity

Weighted Average Maturity: 35 days on 9/30/2013

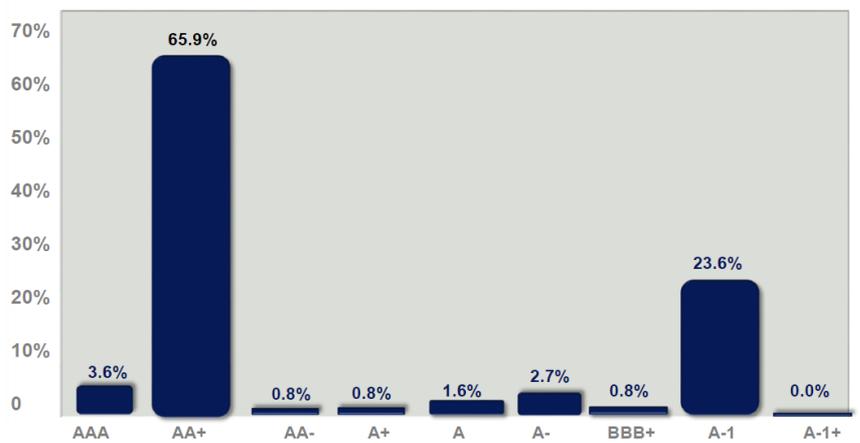
DURATION: 100% from 0-1 yrs

ASSET MIX:



Safety

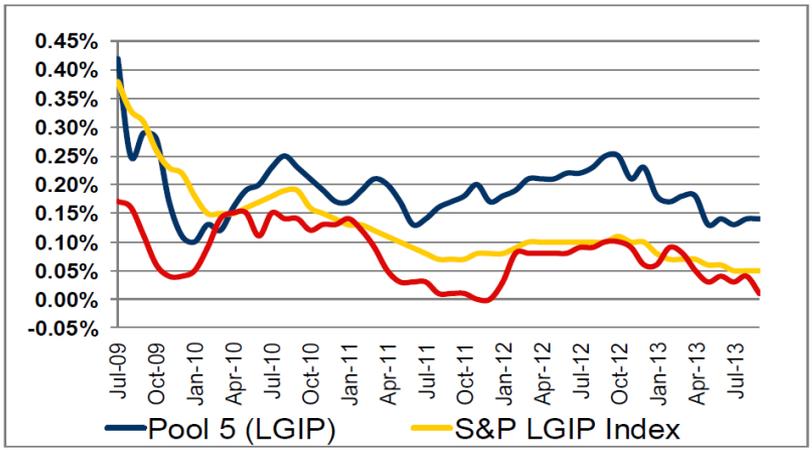
Continues to receive highest rating from Standard & Poor's: AAAf/S1+



Yield

.14% FYTD

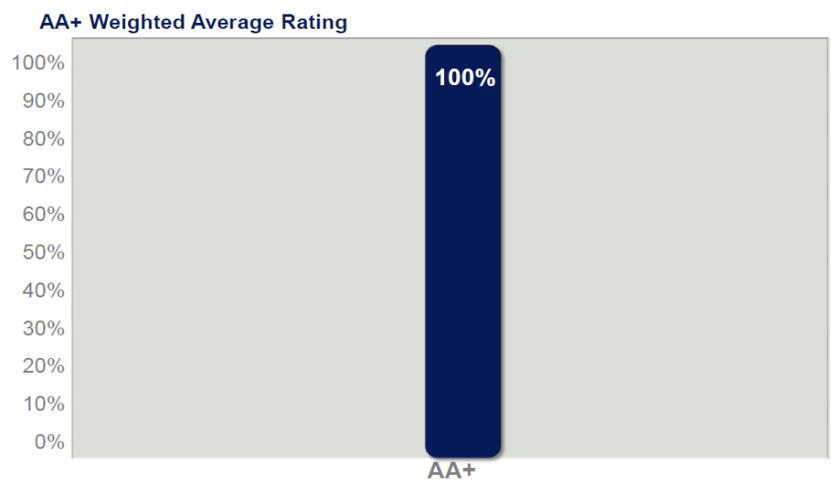
.05% FYTD (S&P LGIP Index)



POOL 7

- \$861 million Assets as of 9/30/2013
- Net Asset Value - \$ 1.000 9/30/2013
- Overnight repo rates have been very low this quarter.
- Looking to ladder treasuries/repo and other full faith and credit products up to 13 month horizon
- WAM will remain short and stay under 90 days to minimize interest rate risk.

Safety

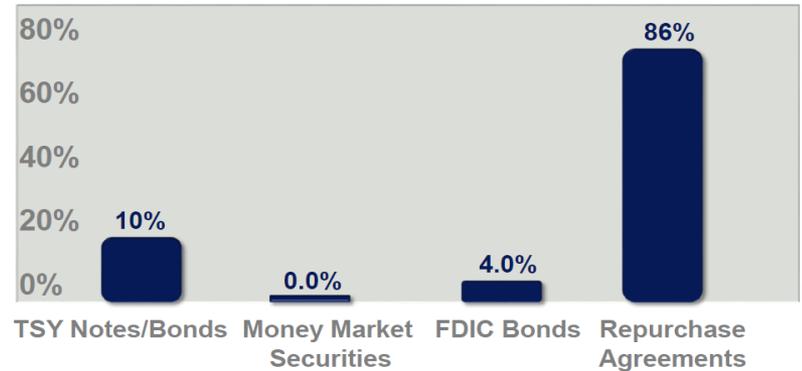


Liquidity

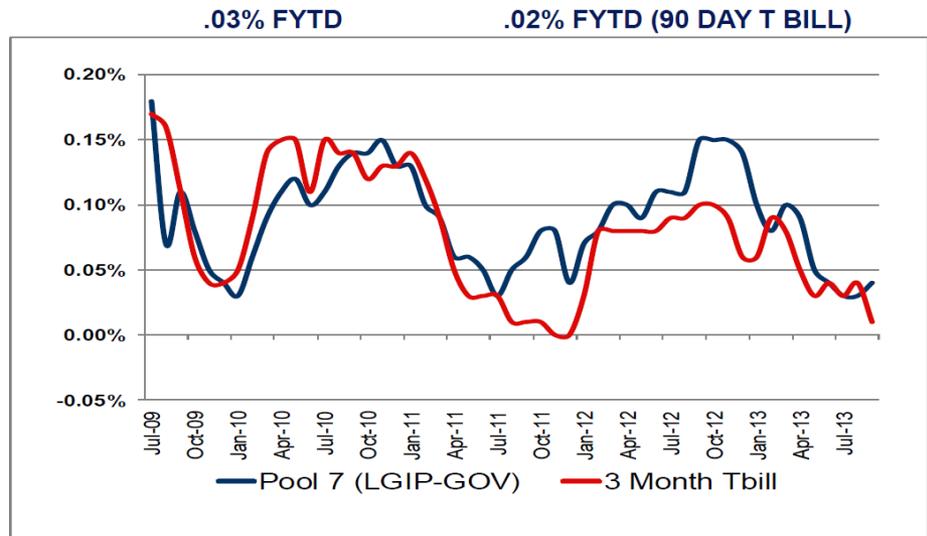
Weighted Average Maturity: 54 days on 9/30/2013

DURATION: 100% from 0-1 yrs

ASSET MIX:



Yield



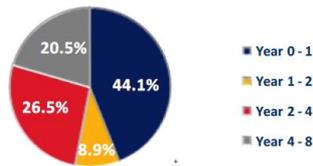
POOL 500

- \$285.3 million in assets as of 9/30/2013
- Floating Net Asset Value - \$1.034 9/30/2013
- Will continue to invest in assets that provide a prudent diversification that takes advantage of prevailing market opportunities
- Keep maximum exposure to any credit below 2.5%
- Continue to target duration at one year less than the benchmark with 10% to 30% of the fund in liquid short term securities

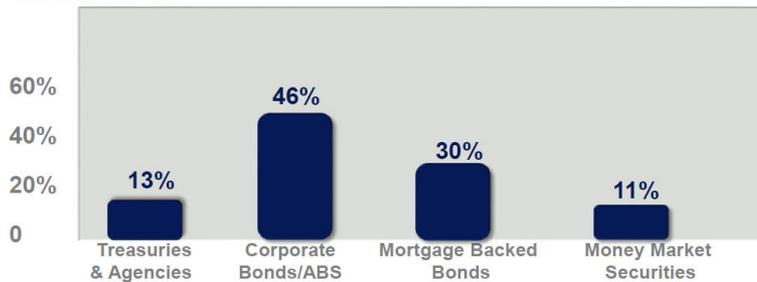
Liquidity

Effective Duration: 1.95 years on 9/30/2013

DURATION:

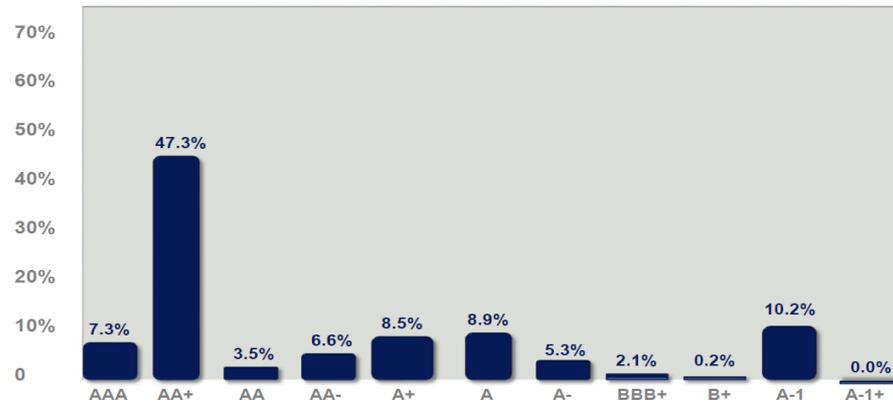


ASSET MIX:



Safety

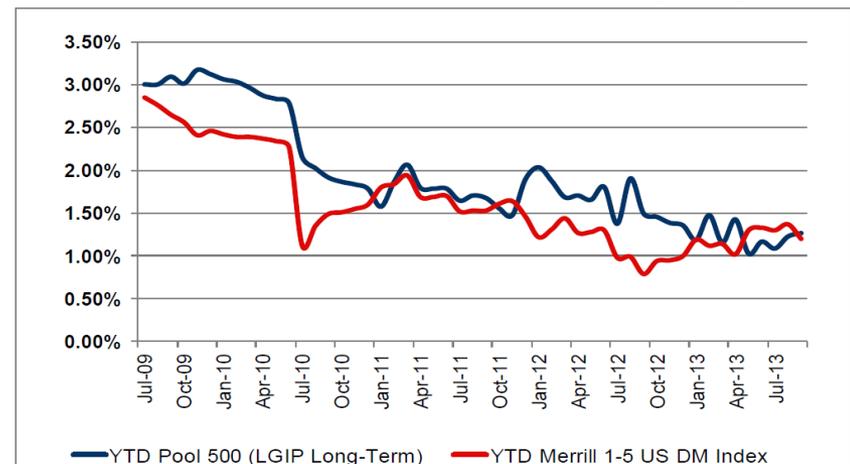
AA Weighted Average Rating



Yield

1.20% FYTD

1.29% FYTD (Index)



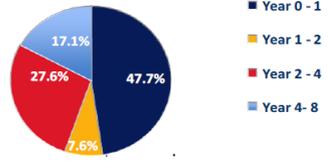
POOL 700

- \$235.4 million in assets as of 9/30/2013
- Floating Net Asset Value - \$ 1.0012 9/30/2013
- Strategy is to invest in a mix of 1-5 year US Treasuries, GNMA Mortgages and FDIC Paper
- All securities backed by US Government
- Continue to target duration at one year less than the benchmark and overweight GNMA mortgage back securities as there is not a lot of options for full faith and credit bonds

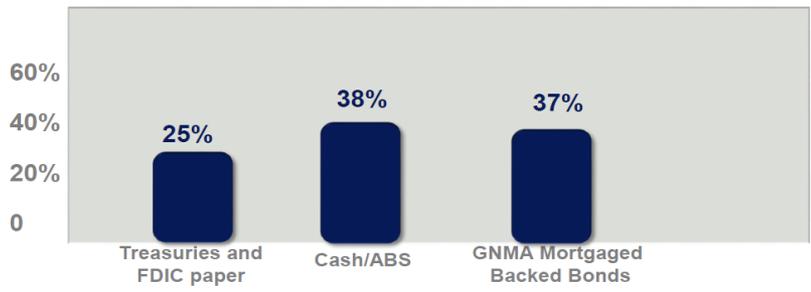
Liquidity

Effective Duration: 2.46 years on 9/30/2013

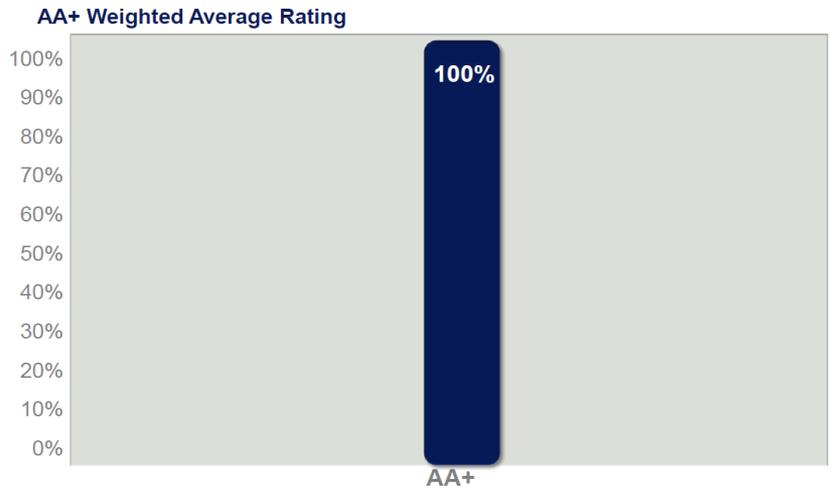
DURATION:



ASSET MIX:

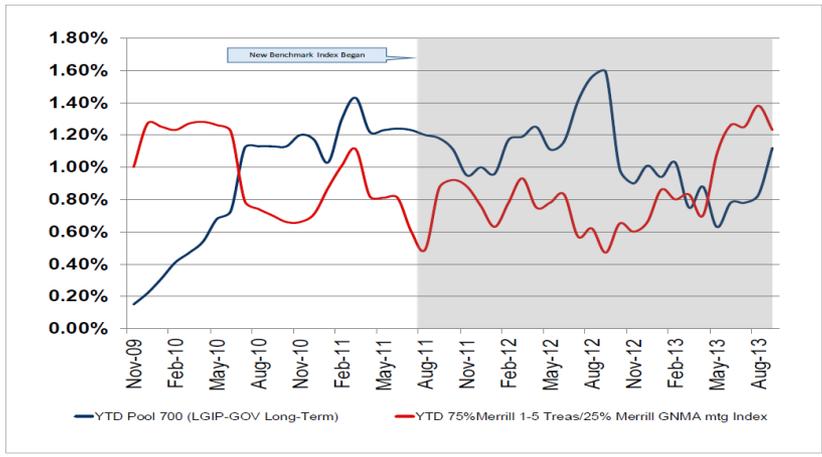


Safety



Yield

.91% FYTD 1.28% FYTD (Index)





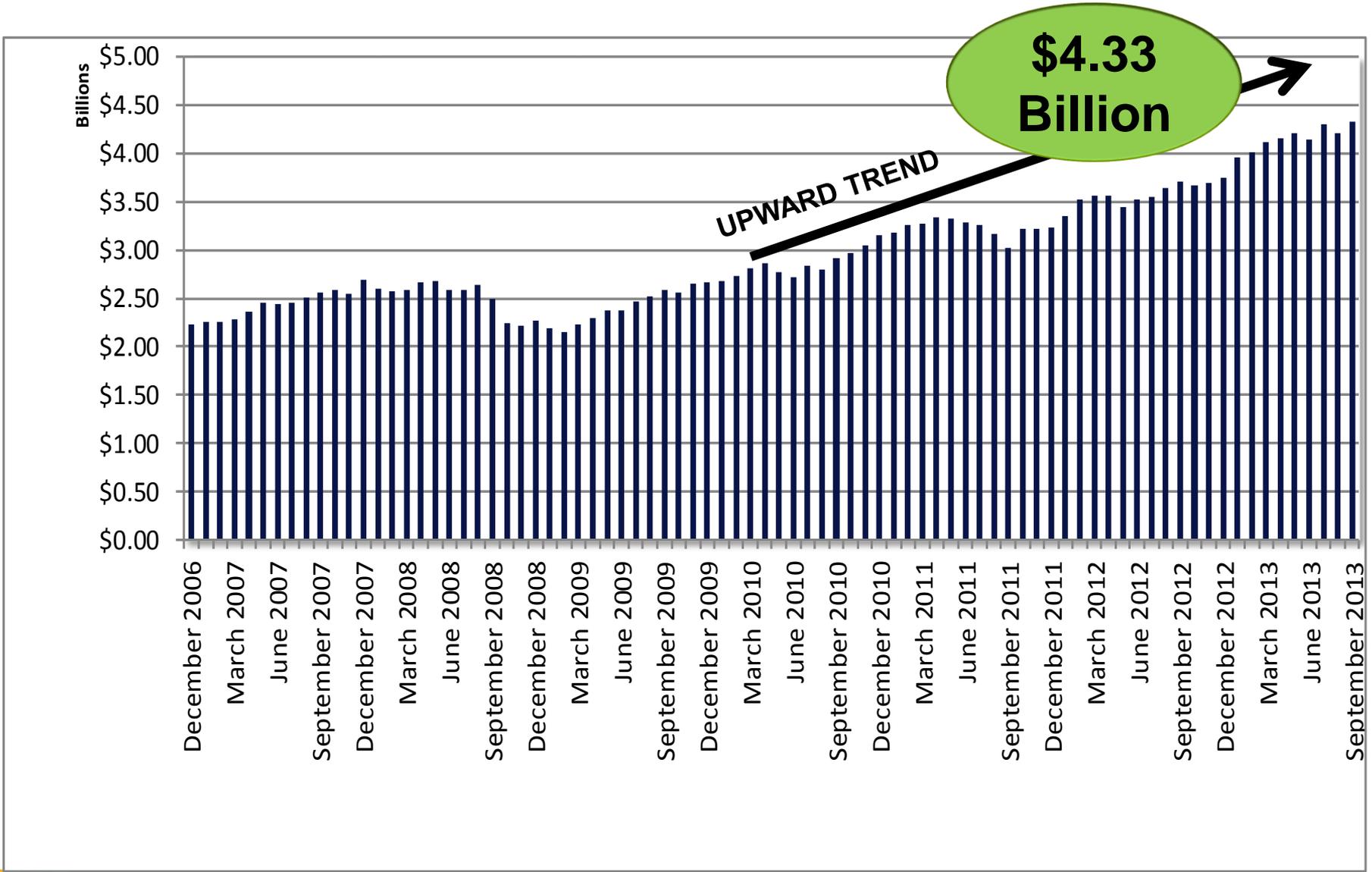
ENDOWMENT PERFORMANCE

Q1 FY2014

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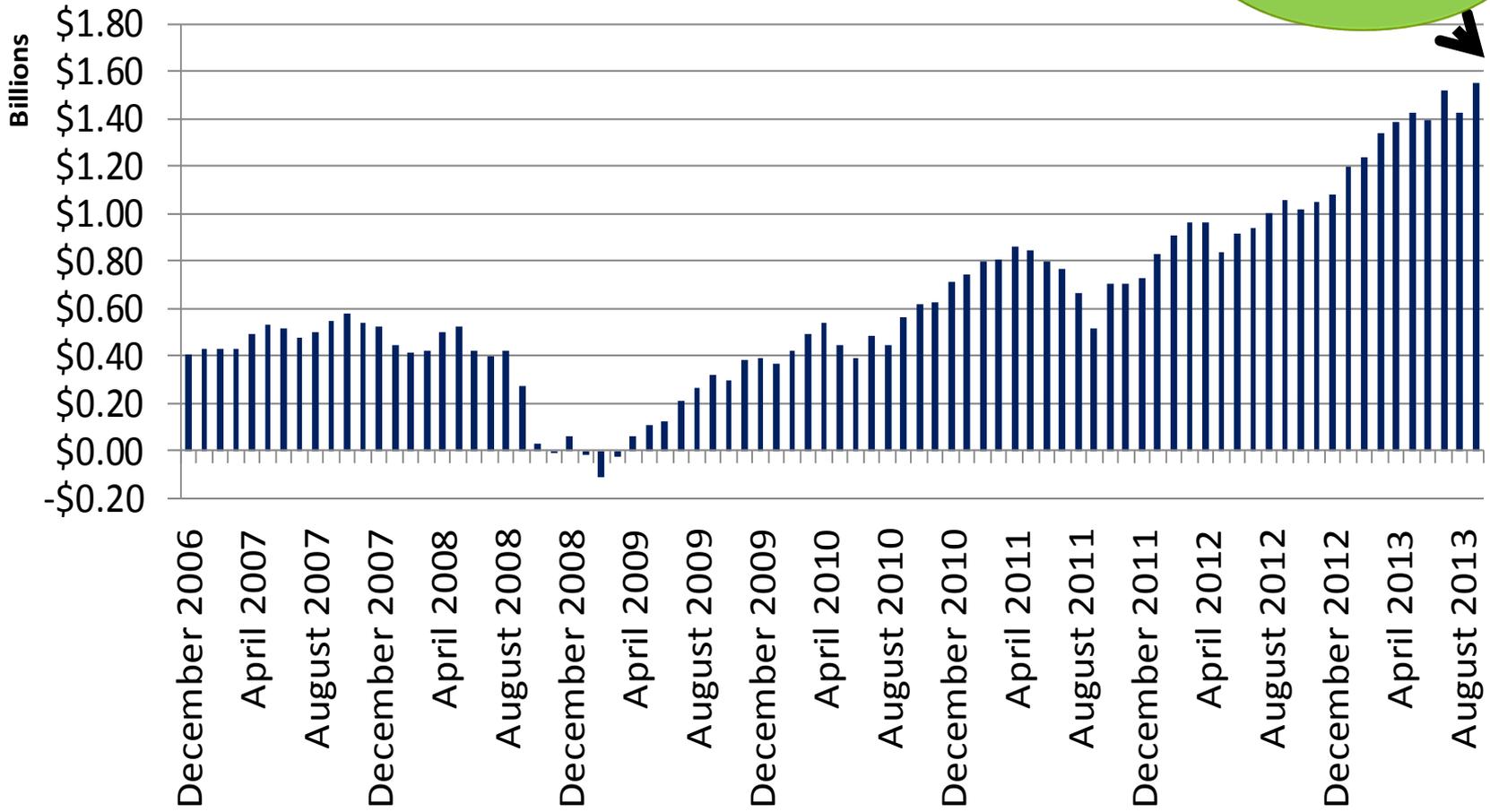
ENDOWMENT MARKET VALUE



ENDOWMENT UNREALIZED GAINS

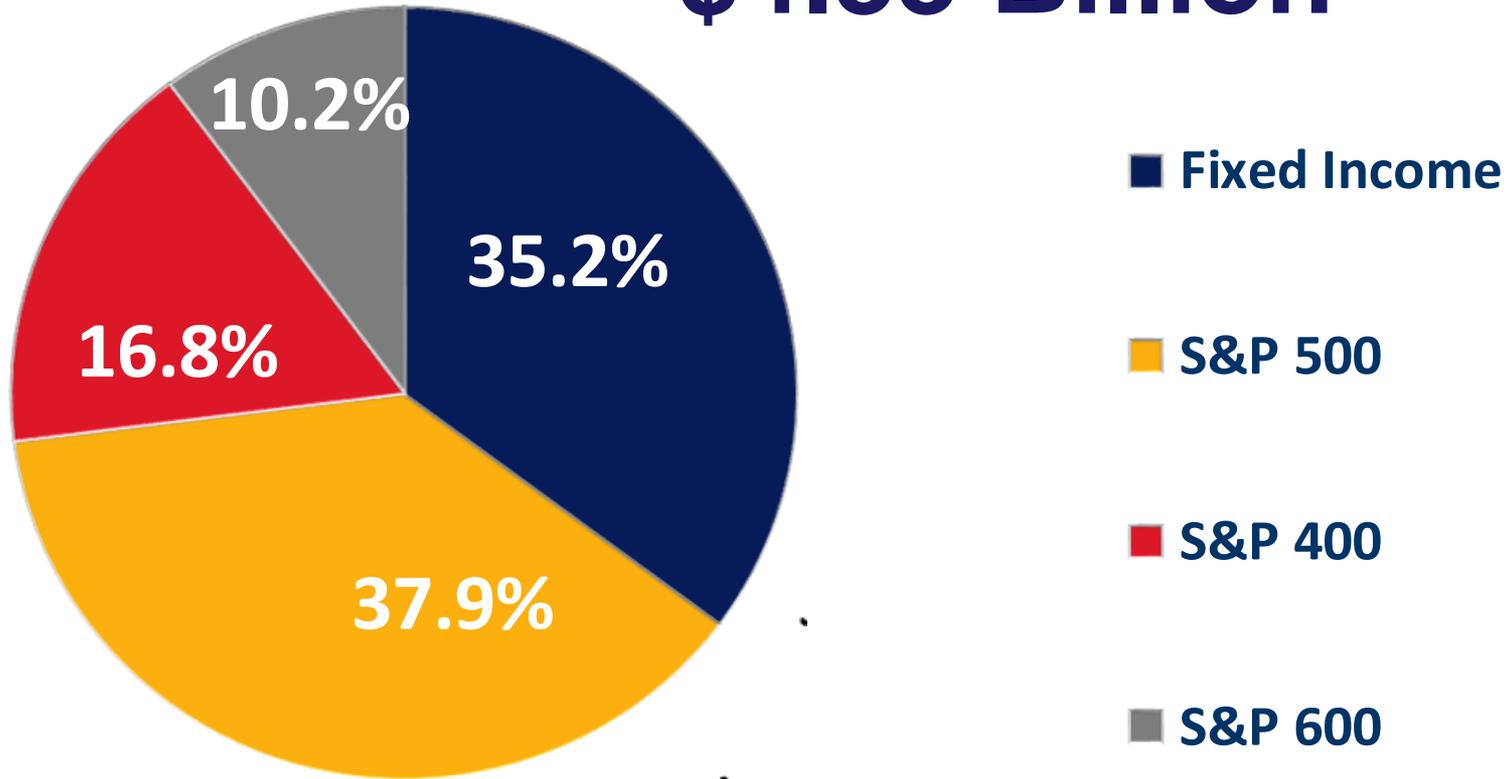
Total Endowment Unrealized gains/losses

**\$1.55
Billion**



ENDOWMENT ASSET ALLOCATION

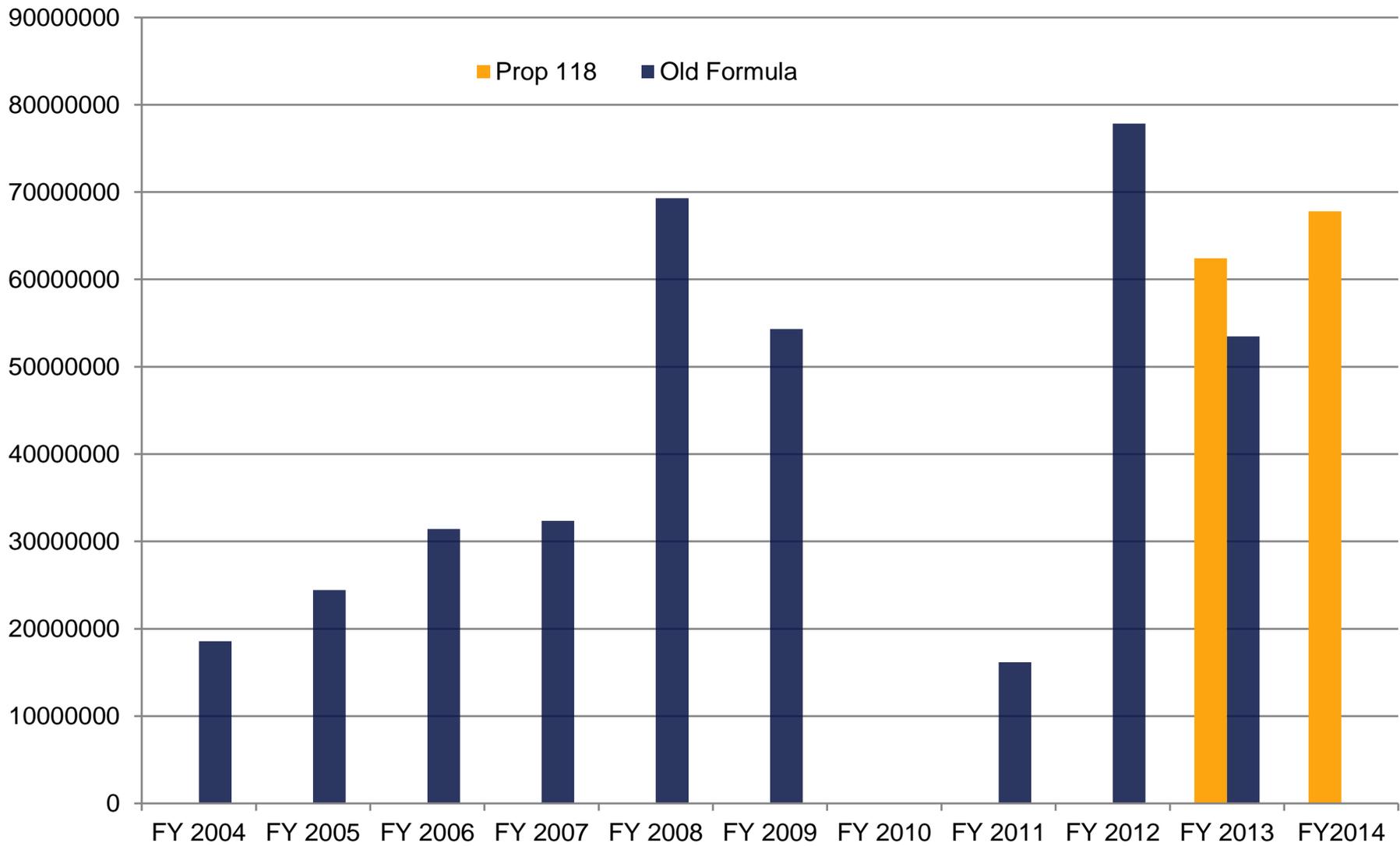
\$4.33 Billion



As of 9/30/2013



K-12 DISTRIBUTIONS





STATE CASH FLOW

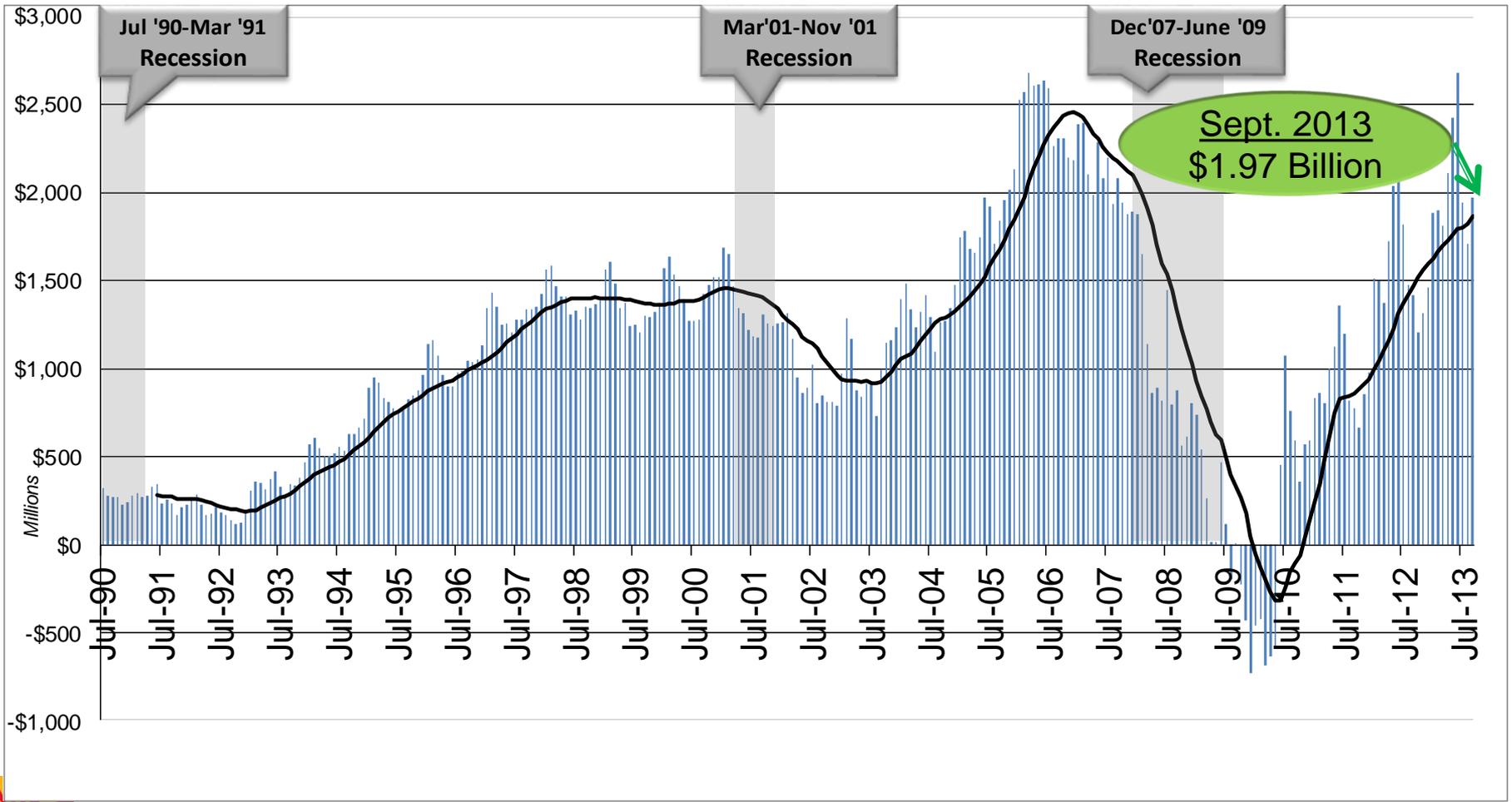
OFFICE OF THE ARIZONA STATE TREASURER



STATE CASH FLOW

TOTAL OPERATING ACCOUNT AVERAGE MONTHLY BALANCE

Up 21% in First 3 months YOY

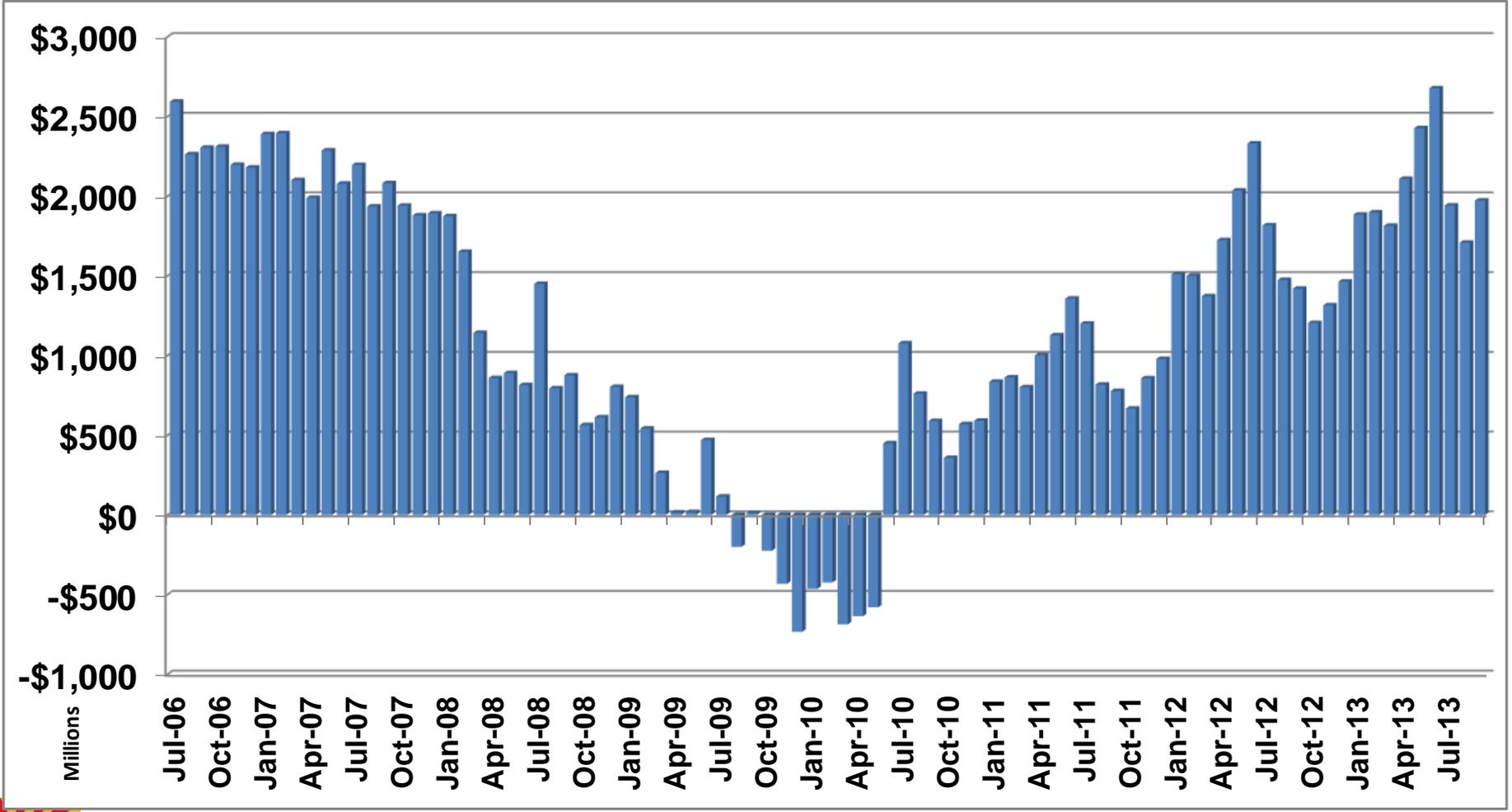


Sept. 2013
\$1.97 Billion



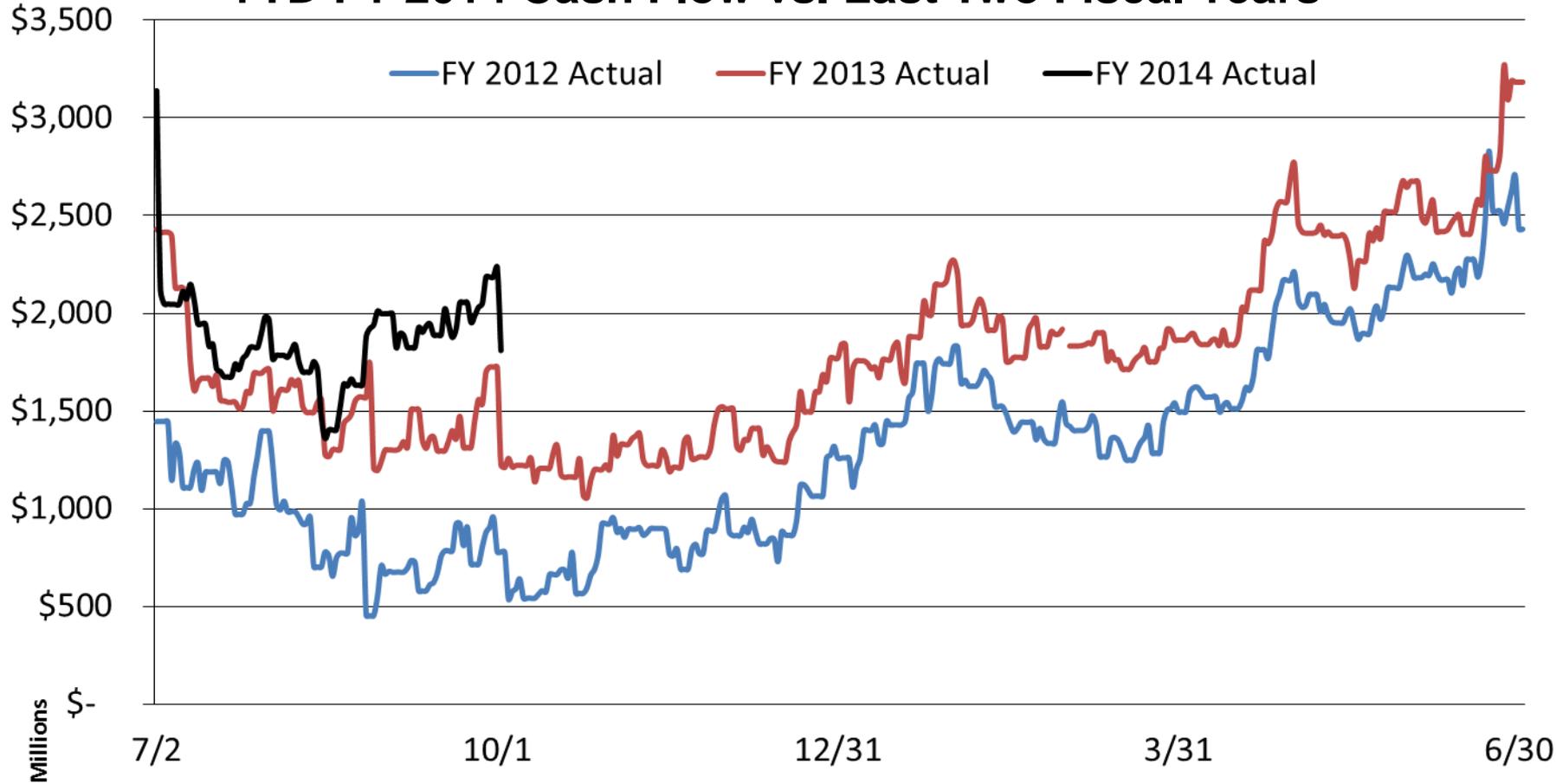
STATE CASH FLOW

State Operating Balance FY 2007 - FY 2014 YTD



STATE CASH FLOW

YTD FY 2014 Cash Flow vs. Last Two Fiscal Years





Special Presentation

Stefan Shepherd

Deputy Director

Joint Legislative Budget Committee

OFFICE OF THE ARIZONA STATE TREASURER



Treasurer Quarterly Meeting

Revenue and Budget Update

November 6, 2013

JLBC

Summary of Current Budget Status

- ❑ FY '13 ending balance was \$200 M more than expected
- ❑ Annual base revenue is projected to grow by only 3.5% in FY '14 due to a decline in capital gain taxes – will be reevaluated throughout the year
- ❑ FY '15 – FY '17 annual revenues would increase by over 5%
- ❑ On-going spending above projected revenues – carry forward keeps budget balanced in FY '14 and FY '15
- ❑ Projected annual shortfalls of \$(200) M in FY '16 and \$(300) M in FY '17

Revenue Overview

FY '13 Capital Gains Acceleration Pushed Overall Base Growth to 6.4%

| | <u>FY '13 Over FY '12</u> | |
|-------------------|---------------------------|---------------|
| | <u>Budgeted</u> | <u>Actual</u> |
| Sales * | 3.5% | 4.9% |
| Individual Income | 5.8% | 10.1% |
| Corporate Income | 1.4% | 2.8% |

* Includes 1-cent, and excludes impact of change in estimated payment threshold

1st Quarter FY '14 Growth Rate 3.8%

- \$(12.6) M Below Forecast

| | <u>% Change over Prior Year *</u> |
|----------------------------|---------------------------------------|
| Sales Tax (without 1-cent) | 7.0% |
| Individual Income Tax | 6.7% |
| Corporate Income Tax | (24.2)% |

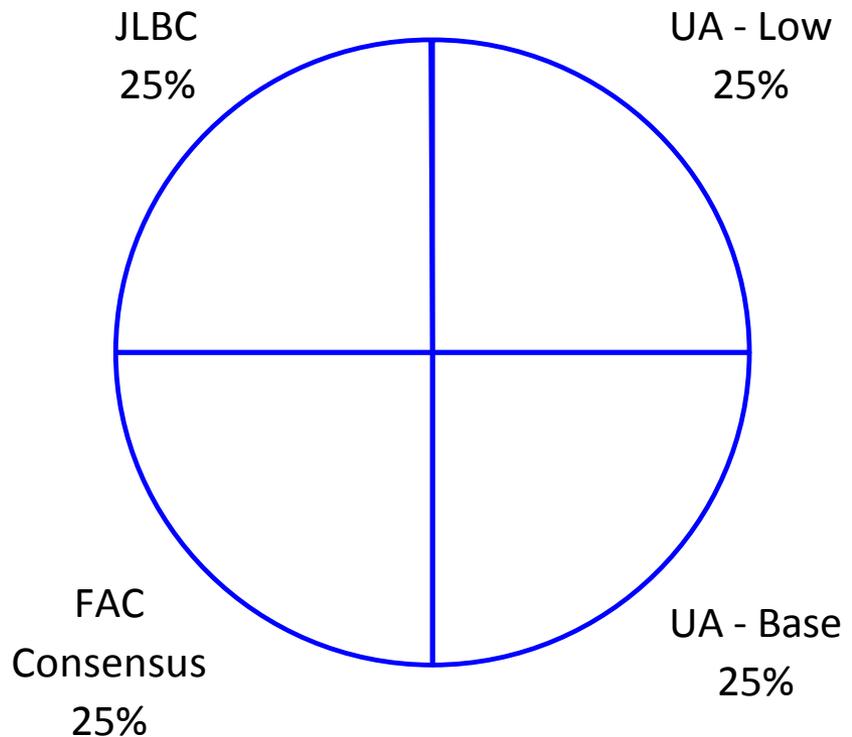
- First quarter growth (1.2)% below budgeted growth rate

Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

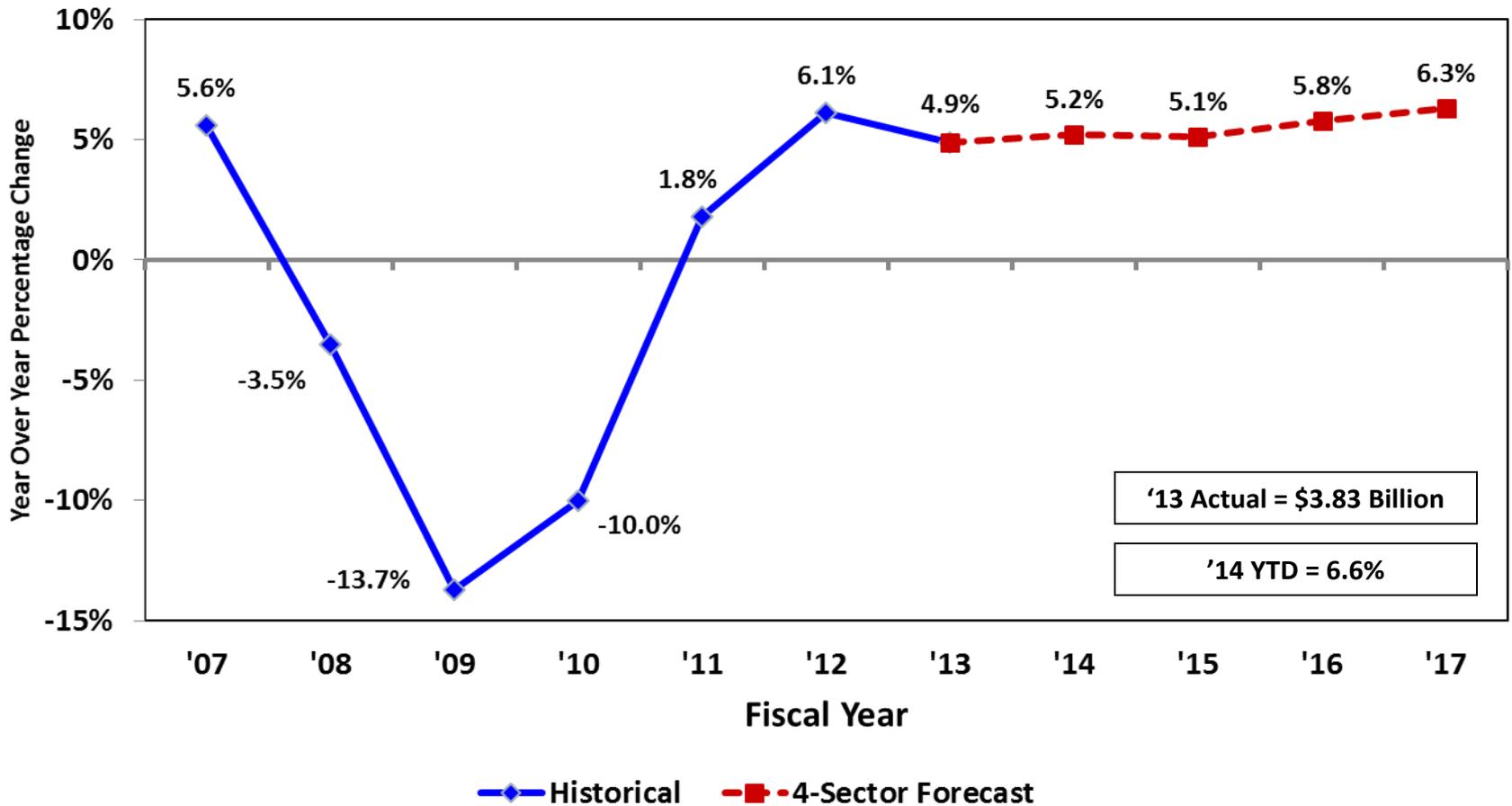
- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (10% of total) are staff forecast



* Includes Big 3 categories of sales tax, individual income and corporate income taxes

Sales Tax

- Projected Growth of 5.2% in FY '14 and 5.1% in FY '15



'13 Actual = \$3.83 Billion

'14 YTD = 6.6%

Percent Change in Base Revenue Excluding Tax Law Changes and 1-Cent Sales Tax

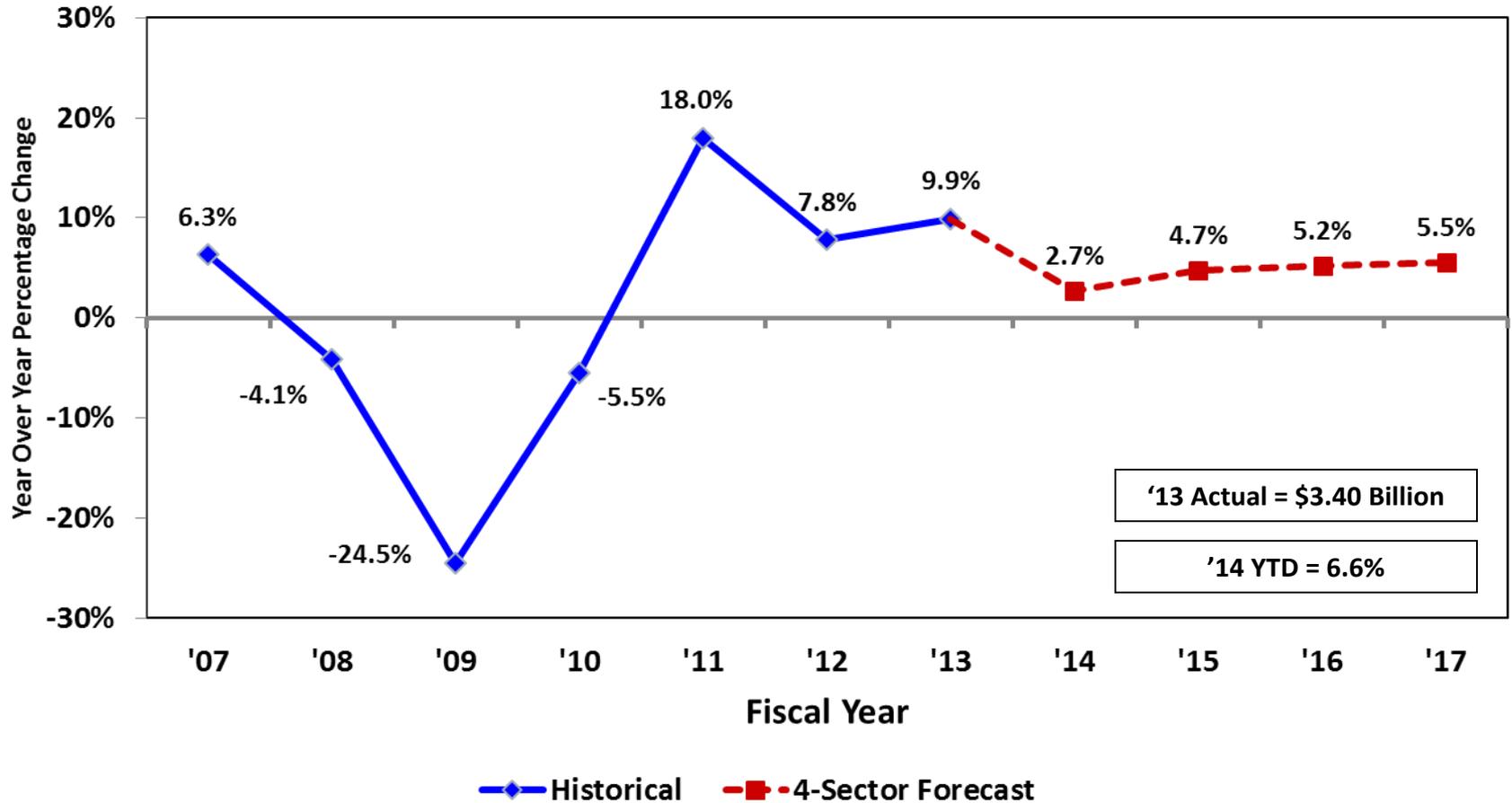
'14 YTD Sales Tax Growth Driven by 2 Categories

- Retail up by 8.5% - Contracting by 18.1%

- ❑ Auto sales are up by 13.2% (included in the retail category)
- ❑ Pent up demand and end of 1% sales tax may have boosted car sales
- ❑ Strong growth in contracting driven by both residential and nonresidential construction – up 20% and 27% respectively

Individual Income Tax

- Projected Growth of 2.7% in FY '14 and 4.7% in FY '15



'13 Actual = \$3.40 Billion

'14 YTD = 6.6%

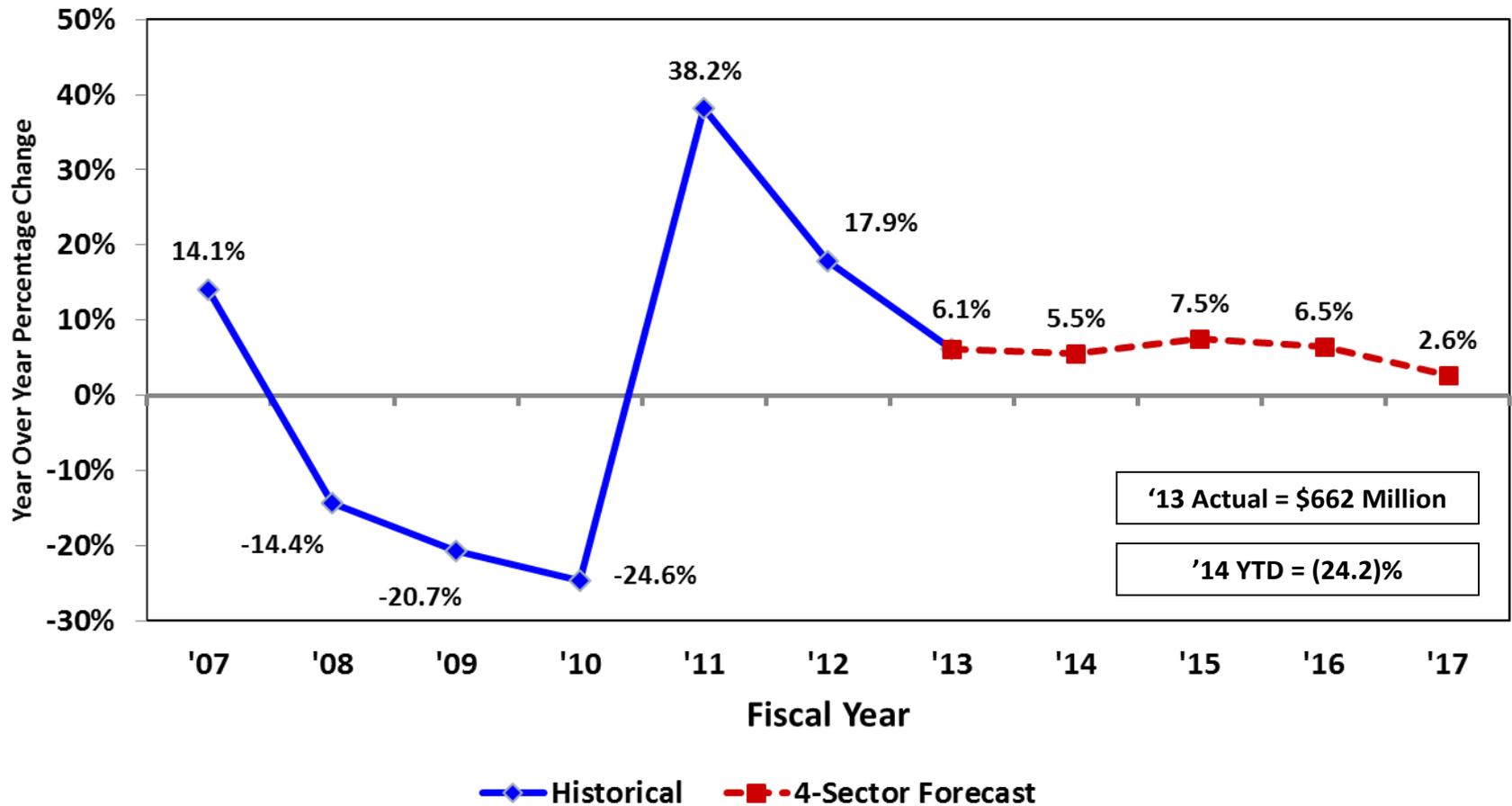
Percent Change in Base Revenue Excluding Tax Law Changes and One-Time Changes

FY '13 Tax Acceleration Likely One-Time

- ❑ Possible and actual federal policy changes incentivized companies to issue dividends and stockholders to take capital gains
- ❑ Collections were accelerated into FY '13, likely reducing collections in future years
- ❑ JLBC projections include a \$103 M acceleration of collections in FY '13 and a \$(103) M reduction in FY '14
- ❑ Strong stock market performance in TY '13 is projected to provide a \$42 M offset to the loss of one-time investment income

Corporate Income Tax

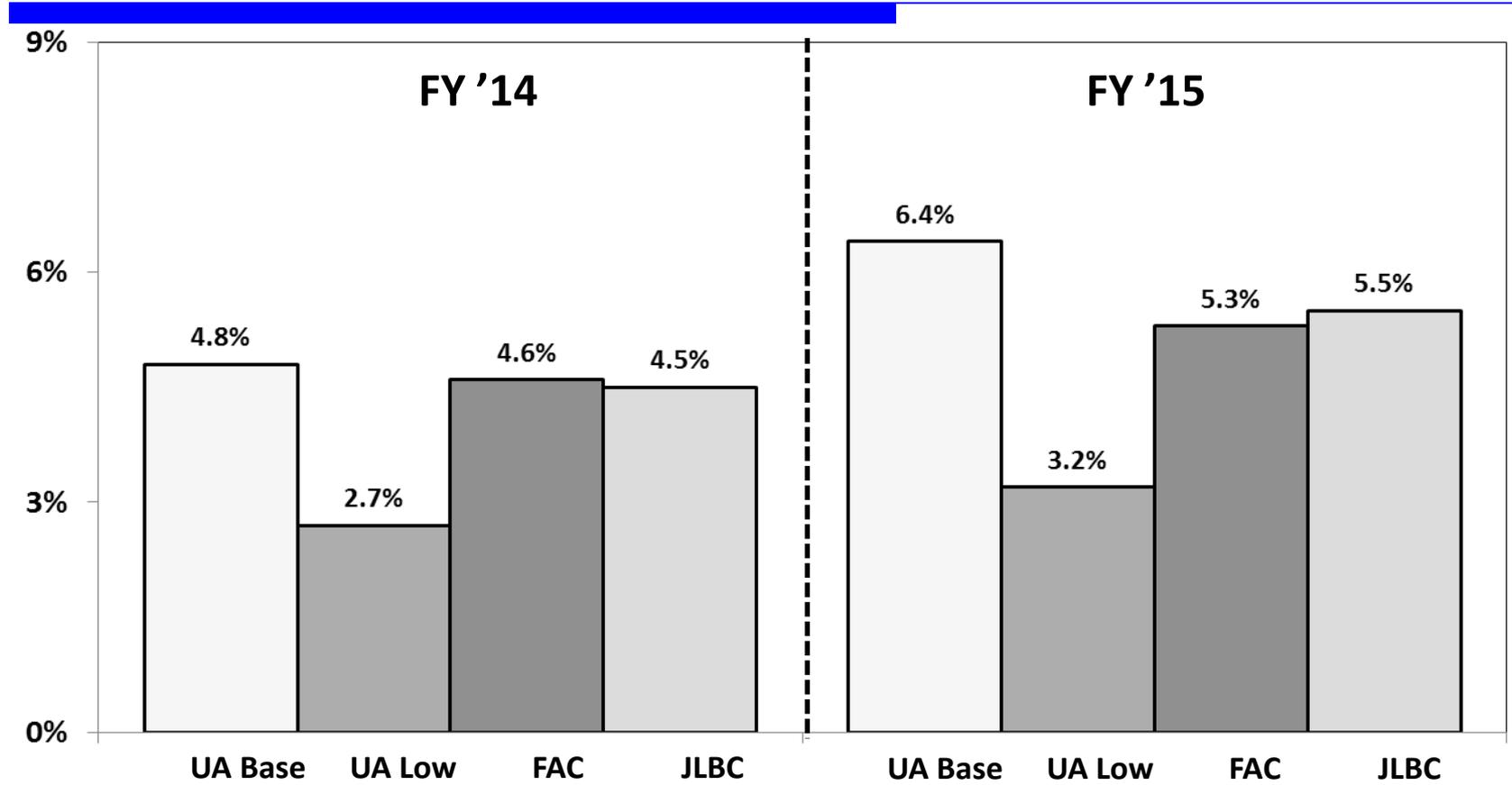
- Projected Growth of 5.5% in FY '14 and 7.5% in FY '15
- (24)% 1st Quarter Decline May Suggest Forecast is Too High



Percent Change in Base Revenue Excluding
Tax Law Changes and One-Time Changes

Consensus Predicts Base Growth Rate of 3.5% in FY '14 and 5.3% in FY '15*

- FY '14 Growth Rate Would Be 4.7% Absent Capital Gains Adjustment



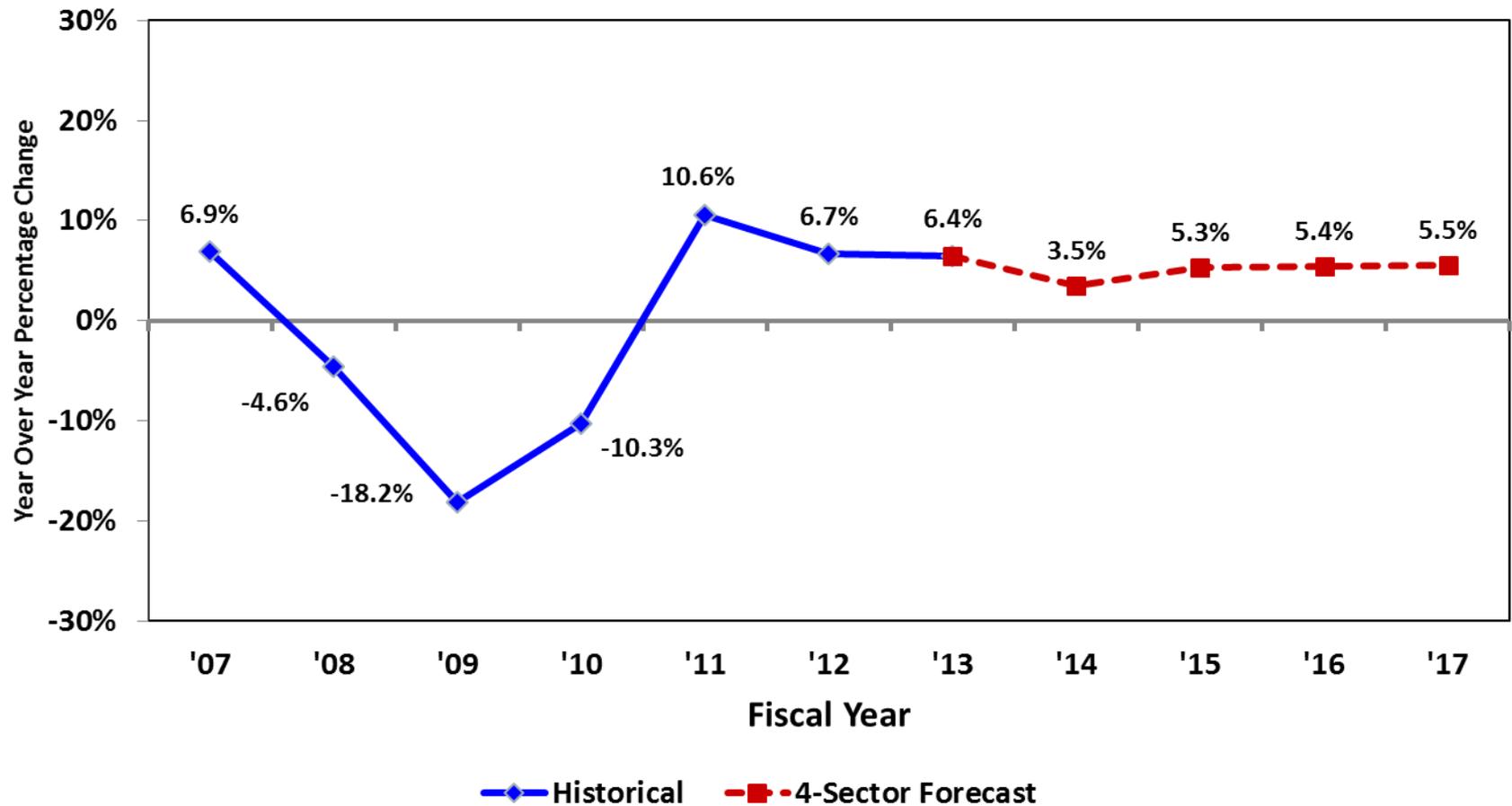
Details in Appendix A

* After adjusting for small tax categories, the base growth rate is 3.5% in FY '14 and 5.3% in FY '15

Arizona Impact of Partial Federal Shutdown

- ❑ Dynamics of shutdown constantly changing – hard to assess
- ❑ Tourism – Arizona’s National Parks
 - Average of 27,000 people visit daily
 - Visitors spend \$2.0 million per day
- ❑ Arizona employment
 - Arizona has 37,000 federal civilian employees – maybe 15,000 furloughed?

Consensus Forecasts Continuing Moderate Growth Rates Through FY '17



Percent Change in Base revenues excluding balance forward, tax law changes, one-time revenues, and urban revenue sharing

Spending Overview

FY '15 – FY '17 Projected Spending Changes

| | General Fund - \$ in Millions | | |
|----------------------------|-------------------------------|-----------------------------|-----------------------------|
| | <u>FY '15 Above '14</u> | <u>FY '16 Above '15</u> | <u>FY '17 Above '16</u> |
| K-12 Formula | 181 | 204 | 251 |
| Medicaid Formula | 6 | 88 | 86 |
| DES Caseload | 47 | 30 | 32 |
| Comm. Colleges Formula | (3) | 2 | 2 |
| Universities | 15 | 10 | 0 |
| ADC Operating | 28 | 10 | 3 |
| Capital | (50) | 0 | 0 |
| Other | 5 | (9) | (10) |
| Additional Spending | <u>229</u> | <u>335</u> | <u>364</u> |
| Total Spending | \$9,055 M | \$9,390 M | \$9,754 M |

Projected Ending Balance Estimates

Updated FY '14 – '17 Budget Projections

- October FAC Revenue Estimate With Updated Agency Caseload Estimates

| Baseline | <u>FY '14</u> | <u>FY '15</u> | <u>FY '16</u> | <u>FY '17</u> | |
|-----------------------|----------------|----------------|------------------|------------------|------------------|
| Balance Forward | \$895 M | \$570 M | \$163 M | \$0 | \$(202) M |
| Revenues | \$8.50 B | \$8.65 B | \$9.02 B | \$9.45 B | |
| Spending | \$8.83 B | \$9.05 B | \$9.39 B | \$9.75 B | |
| Ending Balance | \$570 M | \$163 M | \$(202) M | \$(303) M | \$(505) M |

- ❑ On-going spending above projected revenues – carry forward keeps budget balanced in FY '14 and FY '15
- ❑ \$450 M Rainy Day Fund available to offset shortfalls
- ❑ Does not include any impact of potential mandatory repayment of operating financing issued during FY 2010



QUESTIONS?

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