



Local Government

News Report

APRIL 2018

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HOLIDAY

No holiday in April

GASB TACKLES FINANCIAL REPORTING OF BANK LOANS, PRIVATE PLACEMENTS

The Governmental Accounting Standards Board has published a new financial reporting standard for state and local governments designed to enhance debt-related disclosures for direct borrowings and private placements in the notes to financial statements.

The new standard, contained in [Statement 88](#), takes effect for the reporting period beginning after June 15, 2018 and applies to annual reports for fiscal years ending June 30, 2019 and afterward.

“We found governments are entering into more direct borrowing, where they go to a bank or do a private placement rather than a public offering of debt,” GASB Chairman David Vaudt told The Bond Buyer.

“Concern was raised by user groups about the adequacy of the disclosures surrounding that debt,” he said.

Local governments in some cases weren’t disclosing repayment covenants with a bank that might include a priority for repayment.

Statement 88 requires the disclosure of amounts of unused lines of credit and assets pledged as collateral for debt. It also requires disclosure of terms specified in debt agreements related to significant: events of default with finance-related consequences; termination events with finance-related consequences; and subjective acceleration clauses.

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LGIP INVESTOR MEETING

The Oregon State Treasury will be holding its first Local Government Investment Pool Investor Meeting on August 30, 2018, in Tigard. The meeting would be an opportunity for local government finance staff to hear from State Treasurer Tobias Read, Treasury’s Chief Investment Officer John Skjervem, and fellow local governments about investment-related topics. Treasury staff also would be present to discuss the Oregon Short Term Fund, answer questions, and gather feedback on how we can continue to best serve you—our customers.

You can help our planning of this event by taking a brief [online survey](#). Thank you for your input!

INTEREST RATES

Average Annualized Yield

March
1.9226 percent

Interest Rates

March 1–22
1.85 percent

March 23–31
2.10 percent

GASB TACKLES FINANCIAL REPORTING OF BANK LOANS, PRIVATE PLACEMENTS

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GASB standards are not binding on state and local governments but they must be adhered to in order for governments to receive clean opinions on audits of their financial statements.

GASB has been working on the new standard since August 2016.

The Government Finance Officers Association offered comments in September of last year in general support with some advice for technical changes.

Emily Swenson Brock, director of GFOA's federal liaison center, described bank loans and direct placements as "a cost-effective tool that may be utilized to create infrastructure by many issuers across the country."

"Local governments use bank loans, in general, it's because they are simpler than a bond issue that is marketed to the public market, with fewer issuance costs and ongoing compliance requirements," Brock said. "Additionally, bank loans can often be structured in a manner that more closely conforms to specific project or repayment considerations than is the case with bond issues."

GFOA also offers [best practice advice](#) to local governments on the use of bank loans.

Statement 88 also provides a uniform definition of what constitutes debt for financial statement reporting purposes.

"There was some confusion by preparers and auditors of which long-term liabilities were debt and were subject to the debt disclosure requirements, so we added some clarity," Vaudt said.

For instance, pension obligations are not covered by this standard nor are compensated absences.

The new GASB statement requires footnotes for direct borrowings to be listed separately from those for other debt.

GASB issues about four or five statements annually to provide reporting and accounting standards for state and local governments.

Statement 88 is the first guidance issued this year. GASB is working mostly on implementation guides, but also has a project involving capitalization of interest costs that's expected to be published in the second quarter and another planned for the third quarter on equity interest ownership that primarily impacts tribal governments, according to a GASB spokesman.

This article, by Brian Tumulty, originally appeared in The Bond Buyer on April 3, 2018, and is reprinted with permission.

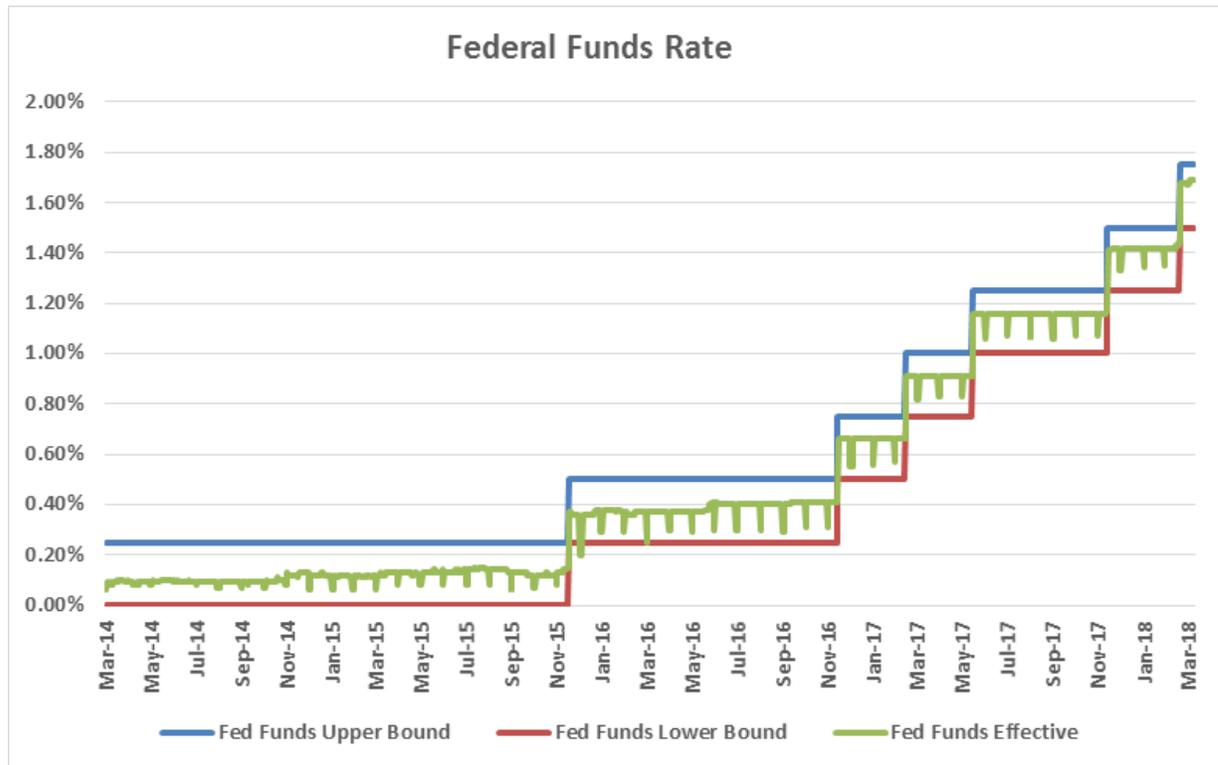
CREDIT MARKET REVIEW

The first quarter of 2018 was a rocky ride for markets. January felt like a continuation of 2017, with stocks climbing to new all-time highs and credit spreads continuing their gradual move tighter. Once February came along, all that changed as the market was met with higher interest rates and increased inflation expectations that pushed investors to re-price risk assets such as stocks and corporate debt. The Standard and Poor's 500 stock index closed at an all-time high of 2,873 on January 26 and quickly shed more than 10 percent to close at 2,581 on February 8. Adding to the market pressure was a re-shuffle of President Trump's cabinet as Gary Cohn resigned from his post as the Chief Economic Adviser and Secretary of State Rex Tillerson was relieved of his duties. On top of these key departures, trade protectionist action and rhetoric picked up as the administration announced several minor tariffs and put pressure on China in an effort to reduce the trade deficit with the exporting powerhouse.

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CREDIT MARKET REVIEW

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The Federal Reserve stuck to its forecast as the Federal Open Market Committee (FOMC) increased the Federal Funds target rate at the conclusion of its March meeting. This action moved the target range for the rate from between 1.25 percent and 1.50 percent to between 1.50 percent and 1.75 percent. The committee also released a fresh set of economic and monetary policy projections, which contained revealing insights given that the recent tax package was passed by Congress after the release of the FOMC’s last set of projections from its December meeting. The FOMC shifted its 2018 growth projection from 2.5 percent to 2.7 percent, and its 2019 growth projection from 2.1 percent to 2.4 percent, but left its 2020 and “longer run” projections unchanged at 2.0 percent and 1.8 percent respectively. Also of note was the very mild increase in personal consumption expenditures (PCE) inflation expectations. The FOMC left its outlook for 2018 and 2019 inflation expectations unchanged at 1.9 percent and 2.0 percent respectively and moved its 2020 expectation from 2.0 percent to 2.1 percent. Given the Congressional Budget Office expects the tax package to add \$1.9 trillion to the nation’s deficit over the next 10 years, the uptick in growth and inflation expectations from the FOMC felt underwhelming. On the policy front, the FOMC expects to increase the Federal Funds rate another two times this year and three times in 2019.

Economic growth appears to be slowing thus far in 2018 after enjoying above-trend growth in late 2017 as the economy grew at an annualized pace of 3.2 percent in the third quarter and 2.9 percent in the fourth quarter. The late 2017 level of growth was meaningfully higher than the 2.24 percent average growth rate we have observed since the economy emerged from the crisis in late 2009. Much of the strong growth in late 2017 came from a boost in consumer spending as retail sales growth accelerated in the fourth quarter to an annualized rate north of

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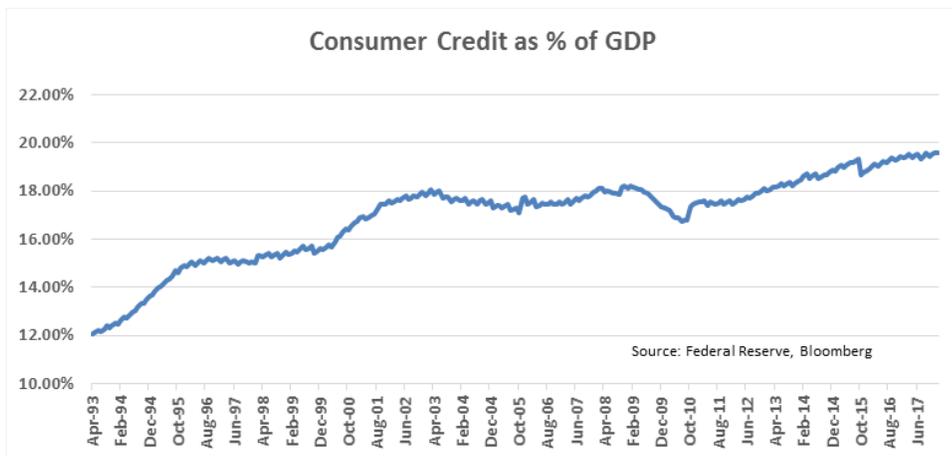
CREDIT MARKET REVIEW

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five percent. At this pace, the growth in consumer spending far outpaced wage growth that has been stuck below three percent for much of this post-crisis cycle. It is clear from the graph below that consumers have eagerly stepped up to the cash register during the last two holiday seasons.



However, much of the recent acceleration in consumer spending that has fueled above-trend growth has come from increased use of consumer credit and a dip into savings accounts, neither of which bode well for continued strong consumption out of the U.S. consumer absent increases in wages. Looking at the below graph, we note that consumer credit outstanding is now equal to 19.5 percent of U.S. gross domestic product. This level of consumer debt is at an all-time high. On top of that, the Bureau of Economic Analysis reported a savings rate of 2.4 percent at the end of 2017—a post-crisis low.



We note these trends in consumer spending, wages, debt, and savings as consumption makes up nearly 68 percent of the U.S. economy. Much of the growth in consumer spending and debt has been masked by low

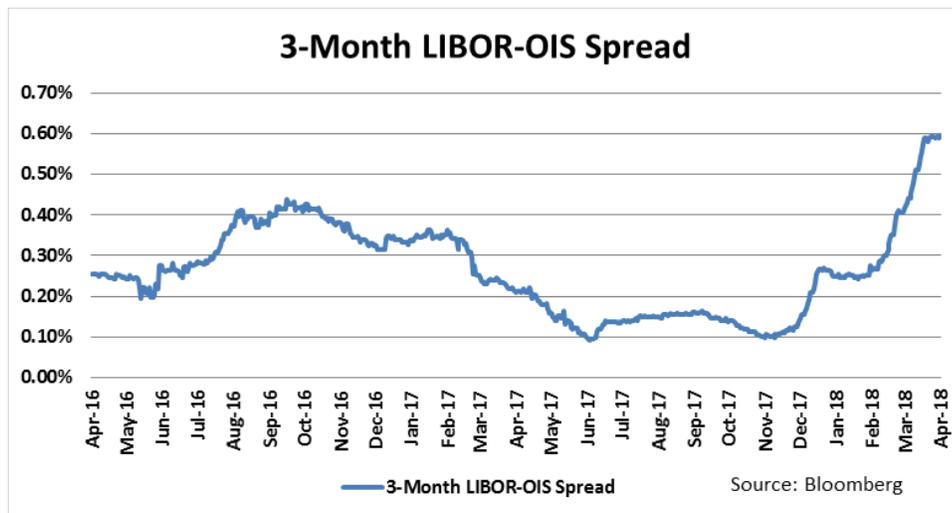
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CREDIT MARKET REVIEW

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interest rates that have allowed borrowers to comfortably add cheap debt. As rates start to move higher, we are keen to keep an eye on the consumer's balance sheet and spending habits in order to gauge the potential for the economy to continue the above trend growth witnessed in the back half of 2017.

One of the more interesting developments in markets during the first quarter was the rapid rise in the London Inter-bank Offered Rate (LIBOR), an interest rate that reflects what banks charge to lend to each other. In particular, three-month LIBOR surged 0.60 percent higher during the quarter. Some of this move can be explained by the steady increase in interest rates from the FOMC, but much of it cannot. A popular gauge for measuring risk is the spread between three-month LIBOR and the three-month market contract on the Federal Funds rate (referred to as the Overnight Indexed Swap rate or "OIS"). By subtracting the market's three-month interest rate expectations, or the three-month OIS, from the three-month LIBOR, you are left with a gauge that is used to assess the risk of lending to banks. Given the names of the two referenced rates, this spread is referred to as "LOIS." Since bottoming out at 0.10 percent in November 2017, LOIS has surged to 0.60 percent, which represents a post-crisis high. To be clear, we are nowhere near the crisis-era high of 3.64 percent that occurred in October 2008, shortly after the failure of Lehman Brothers.



Typically such a high reading for this risk gauge represents heightened credit risk in the banking system. This time around, it appears we have a few different reasons for the uptick. First and foremost, regulation around the world has led to a large deleveraging and de-risking of the banking system, which has led to safer financial institutions from a credit perspective. It is also worth pointing out that continued stable economic growth, gradually rising rates, and tame inflation have provided banks with a profitable environment. So if not for rising credit risks, what can help explain such a rapid rise in LOIS? For the most part, the rise can be attributed to two main causes. First is the massive issuance of Treasury Bills to help finance the recently enacted tax cuts and expanded federal government budget. In the first quarter of 2018, the U.S. Treasury issued an additional \$336 billion of Treasury Bills, which provided banks and investors with a compelling investment alternative compared to wholesale bank funding. This is the classical "crowding out" theory that is prevalent in economics. Second, was the element of the recent tax change that led to the repatriation of overseas earnings of large U.S.-based multinational corporations. It is estimated that these companies had more than \$2 trillion of overseas dollars that was investing in high-quality and short-duration investment products such as the wholesale bank funding markets. The tax changes appear to have profoundly altered their investing behavior as this cash is now unlocked to engage more interesting opportunities than three-month bank funding or Treasury Bills.

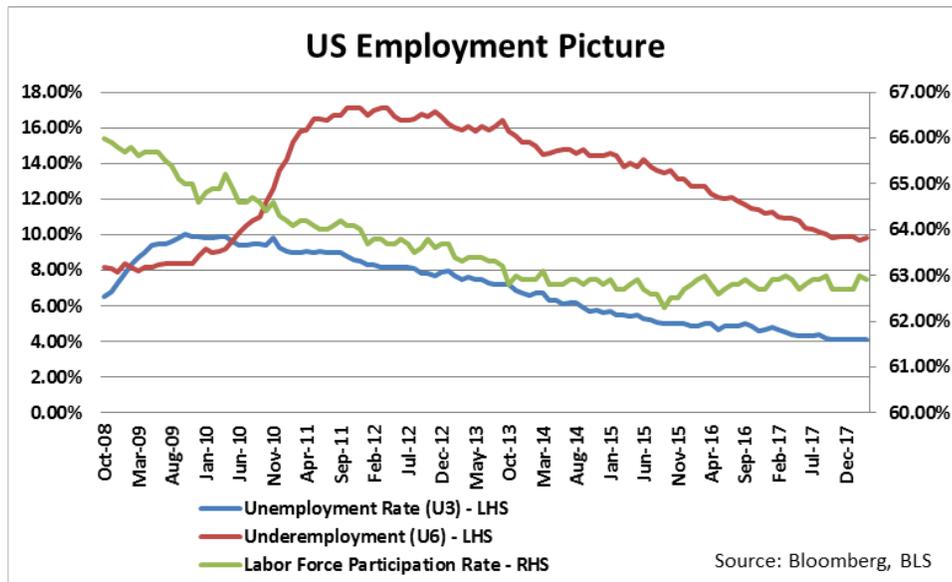
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CREDIT MARKET REVIEW

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Additionally, we can look ahead into the markets and assess the future expectations for the LOIS spread by gauging longer-dated Federal Funds futures contracts and comparing them to the pricing on future three-month LIBOR settings. What we see when we look one year ahead is that the markets are indicating the LOIS spread should gradually decline and settle in at a more modest level around 0.35 percent in one year's time. Therefore, while the LOIS spread always bears monitoring for those navigating front-end markets, we see less reason to be alarmed at this point in time.

The U.S. labor market continues to rumble along with strong job gains and tepid wage growth. During the first quarter, the economy added 605,000 non-farm jobs. Despite the strong job gains, the unemployment rate held steady at 4.1 percent over the quarter as the labor force participation rate and the labor force both increased. The underemployment rate, a more encompassing measure of labor market slack than the traditional unemployment rate, remains elevated when compared to pre-crisis readings. Wages remain tepid, growing at 2.7 percent year over year.



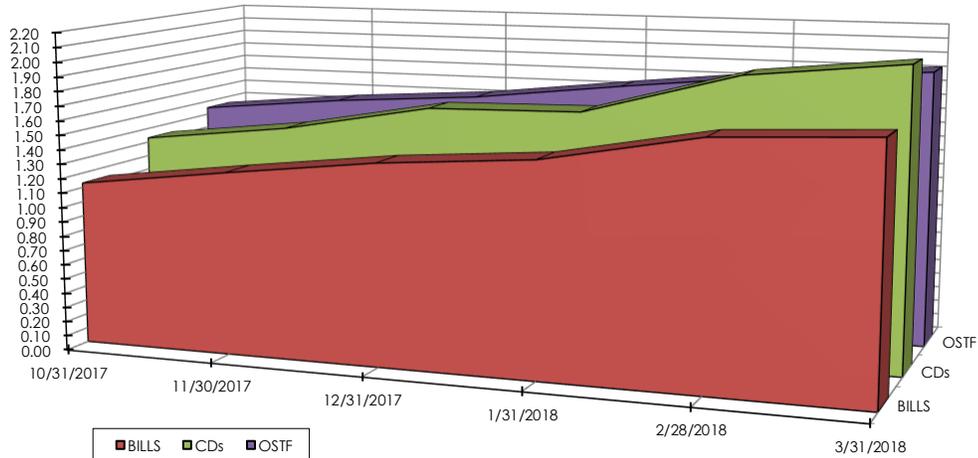
Front-end interest rates and credit markets had a lively quarter as inflation expectations shifted higher, the FOMC hiked rates in March, the U.S. Treasury flooded the market with more than \$325 billion in new Treasury Bill supply, and LIBOR spiked higher. On top of all the moves in rates, credit spreads faced their worst three-month stretch since the beginning of 2016 as credit spreads widened 20 basis points from the start of the year.

CYBERSECURITY AWARENESS

April 23, 2018, is Oregon Cyber Security Day. While the day is highlighted by a [conference](#) at the University of Oregon, sponsored in part by the [Oregon Cybersecurity Advisory Council](#), the day also serves as a reminder of the council's vision that cybersecurity is a shared responsibility across individuals, private entities, and governments.

Given their breadth of functions and extensive interaction with the public, governments must be especially vigilant in protecting against cyber-attacks. A recent article from the law firm Orrick cited a survey of local governments that indicated 44 percent of local governments reported daily cyber-attacks. Governments often face limited resources and aging technology when developing strategies to counter cyber-attacks, but there are still basic steps that governments can take to lessen risk. For more information about common cyber-attacks and strategies to combat them, read Orrick's "[Ransomware Attacks for Local Governments and Public Agencies: A Primer.](#)"

OREGON SHORT TERM FUND ANALYSIS AS OF 3-31-18



| | 10/31/2017 | 11/30/2017 | 12/31/2017 | 1/31/2018 | 2/28/2018 | 3/31/2018 |
|---------------------------------------|------------|------------|------------|-----------|-----------|-----------|
| LGIP AV DOLLARS INVESTED (MM) | 6,255 | 8,926 | 9,100 | 8,509 | 8,257 | 8,085 |
| STATE AGENCY AV DOLLARS INVESTED (MM) | 10,898 | 10,526 | 10,418 | 10,589 | 10,451 | 10,667 |
| TOTAL OSTF AV DOLLARS INVESTED (MM) | 17,153 | 19,452 | 19,518 | 19,098 | 18,708 | 18,752 |
| OST ANNUAL YIELD (ACT/ACT) | 1.45 | 1.55 | 1.62 | 1.74 | 1.85 | 1.92 |
| 3-MO UST BILLS (BOND EQ YLD) | 1.13 | 1.26 | 1.38 | 1.46 | 1.66 | 1.71 |
| 3-MO US CD (ACT/360)* | 1.33 | 1.45 | 1.64 | 1.66 | 1.95 | 2.06 |

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to account holders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectively) bank certificates of deposit and are quoted on a CD equivalent yield basis.

This material is available in alternative format and media upon request.

MARKET DATA TABLE

| | 3/31/2018 | 1 Month | 3 Months | 12 Months | | 3/31/2018 | 1 Month | 3 Months | 12 Months |
|---|-----------|---------|----------|-----------|--|-----------|---------|----------|-----------|
| 7-Day Agency Discount Note** | 1.57 | 1.29 | 1.00 | 0.59 | Bloomberg Barclays 1-3 Year Corporate YTW* | 2.88 | 2.75 | 2.30 | 1.92 |
| 30-Day Agy Nt Disc** | 1.62 | 1.43 | 1.16 | 0.69 | Bloomberg Barclays 1-3 Year Corporate OAS* | 0.67 | 0.59 | 0.47 | 0.70 |
| 90-Day Agy Nt Disc** | 1.70 | 1.63 | 1.33 | 0.79 | Bloomberg Barclays 1-3 Year Corporate Modified Duration* | 1.95 | 1.98 | 1.88 | 1.92 |
| 180-Day Agy Nt Disc** | 1.86 | 1.75 | 1.40 | 0.83 | | | | | |
| 360-Day Agy Nt Disc** | 2.00 | 1.99 | 1.65 | 0.97 | 7-Day Muni VRDN Yield** | 1.58 | 1.09 | 1.71 | 0.91 |
| | | | | | O/N GGC Repo Yield** | 2.10 | 1.69 | 2.00 | 0.86 |
| 30-Day Treasury Bill** | 1.54 | 1.45 | 1.19 | 0.73 | | | | | |
| 60-Day Treasury Bill** | 1.64 | 1.52 | 1.26 | 0.71 | US 1 Year Inflation Break-Even** | 2.24 | 2.40 | 0.85 | 2.01 |
| 90-Day Treasury Bill** | 1.71 | 1.60 | 1.32 | 0.74 | US 2 Year Inflation Break-Even** | 1.98 | 2.10 | 1.56 | 1.80 |
| 6-Month Treasury Yield** | 1.92 | 1.84 | 1.53 | 0.90 | US 3 Year Inflation Break-Even** | 2.00 | 2.03 | 1.71 | 1.87 |
| 1-Year Treasury Yield** | 2.09 | 2.04 | 1.74 | 1.03 | | | | | |
| 2-Year Treasury Yield** | 2.27 | 2.21 | 1.89 | 1.28 | 1-Day CP (A1/P1)** | 2.40 | 1.43 | 1.46 | 0.93 |
| 3-Year Treasury Yield** | 2.38 | 2.36 | 1.97 | 1.53 | 7-Day CP (A1/P1)** | 2.26 | 1.48 | 1.49 | 0.95 |
| | | | | | 30-Day CP (A1/P1)** | 1.96 | 1.63 | 1.57 | 1.01 |
| 1-Month LIBOR** | 1.88 | 1.69 | 1.56 | 0.98 | | | | | |
| 3-Month LIBOR** | 2.31 | 2.02 | 1.69 | 1.15 | 30-Day CD (A1/P1)** | 1.65 | 1.63 | 1.53 | 0.87 |
| 6-Month LIBOR** | 2.45 | 2.22 | 1.84 | 1.42 | 90-Day CD (A1/P1)** | 2.06 | 1.98 | 1.68 | 1.11 |
| 12-Month LIBOR** | 2.66 | 2.51 | 2.11 | 1.79 | 6-Month CD (A1/P1)** | 2.37 | 2.19 | 1.79 | 1.30 |
| Sources: *Bloomberg Index Services, **Bloomberg | | | | | 1-Year CD (A1/P1)** | 2.59 | 2.43 | 2.02 | 1.26 |

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