SSF RATE CALCULATION SCENARIOS

OFFICE OF THE TREASURER & CASH MANAGEMENT POLICY BOARD

MAY 2022

Jennifer Appel, CFA, Investment Director
Kevin M. Leonard, Partner
Brendan Heaney, CFA, Sr. Consulting Analyst

NEPC

SSF CALCULATION BACKGROUND

The Office of the State Treasurer ("OST") manages and invests the state's excess cash in two fixed income portfolios—a smaller, short-term "liquidity portfolio" and a larger, longer-term "reserve portfolio," collectively referred to at the state's "total portfolio." The total portfolio includes monies on deposit from the school districts and other sources that are accounted for in various special budgetary funds, referred to as School and Special Funds ("SSFs"). The Cash Management Policy Board ("CMPB") determines the interest rate which SSFs on deposit with OST are paid.

Currently, the CMPB calculates the SSF rate using the 12-month return (rolling average) on the state's liquidity portfolio. To protect SSF recipients and the State, the SSF rate has a "rate cap" and a "rate floor." If the liquidity rate is more than the combined rate for the total portfolio, the rate cap is applied, and OST pays the combined rate for the total portfolio. The liquidity rate is typically less than the rate of return for the total portfolio, so the SSF cap is not often applied. Conversely, the rate floor stipulates that the SSF rate cannot go below zero. This means that SSFs are guaranteed not to lose money, even when the rate of return for the total portfolio is negative. The CMPB views this as an equitable approach.

Fund balances range between $3M and $85M for public school districts, while charter schools range from $1M to $22M

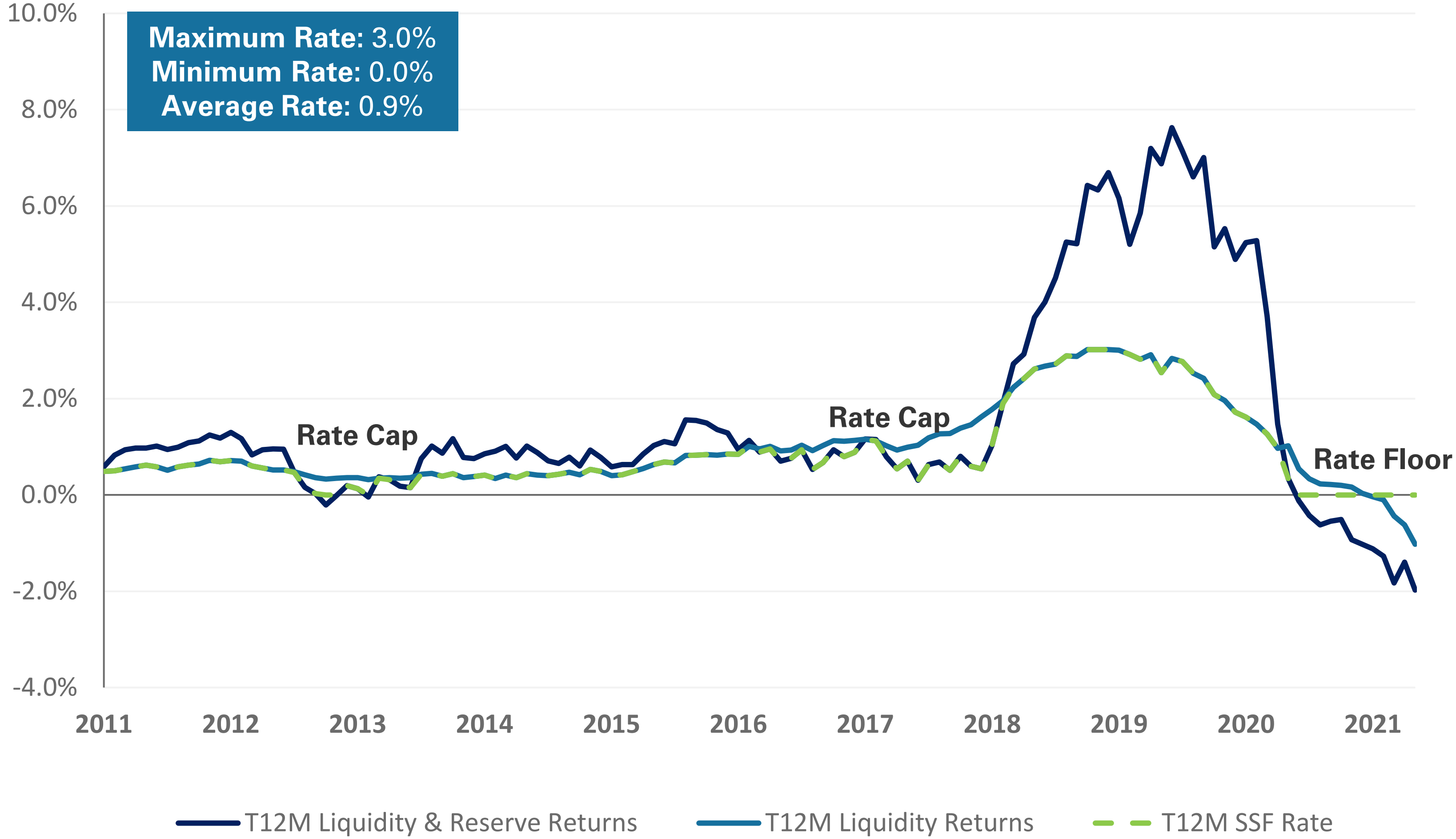
SSF CALCULATION METHODOLOGY

SSF Rate = 12-Month Rolling Average Return on the State's Liquidity Portfolio

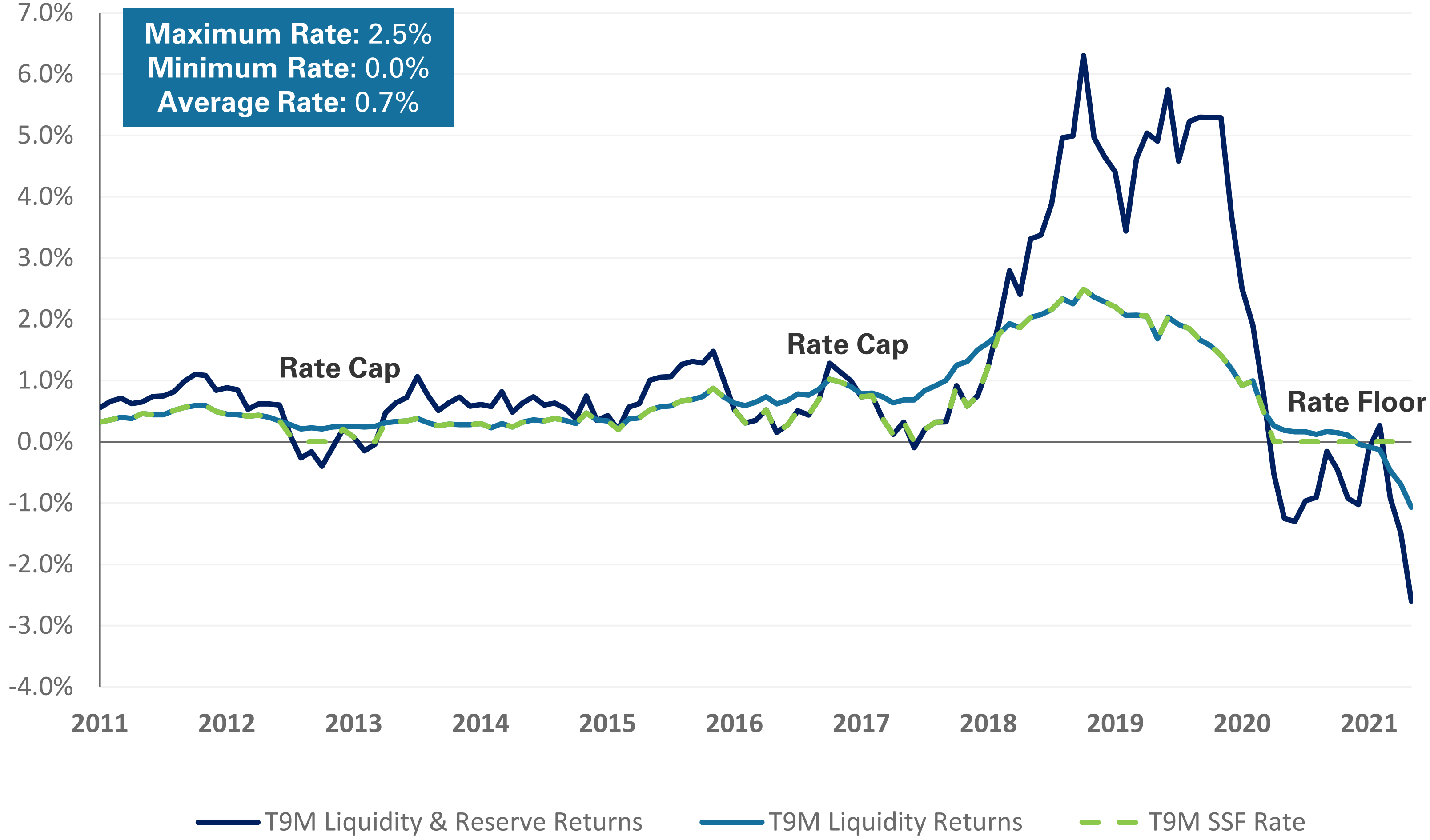
The "rate cap" is applied if the liquidity rate is greater than the total portfolio rate. OST will pay the combined rate for the portfolio.

The "rate floor" stipulates that the SSF rate cannot go below zero.

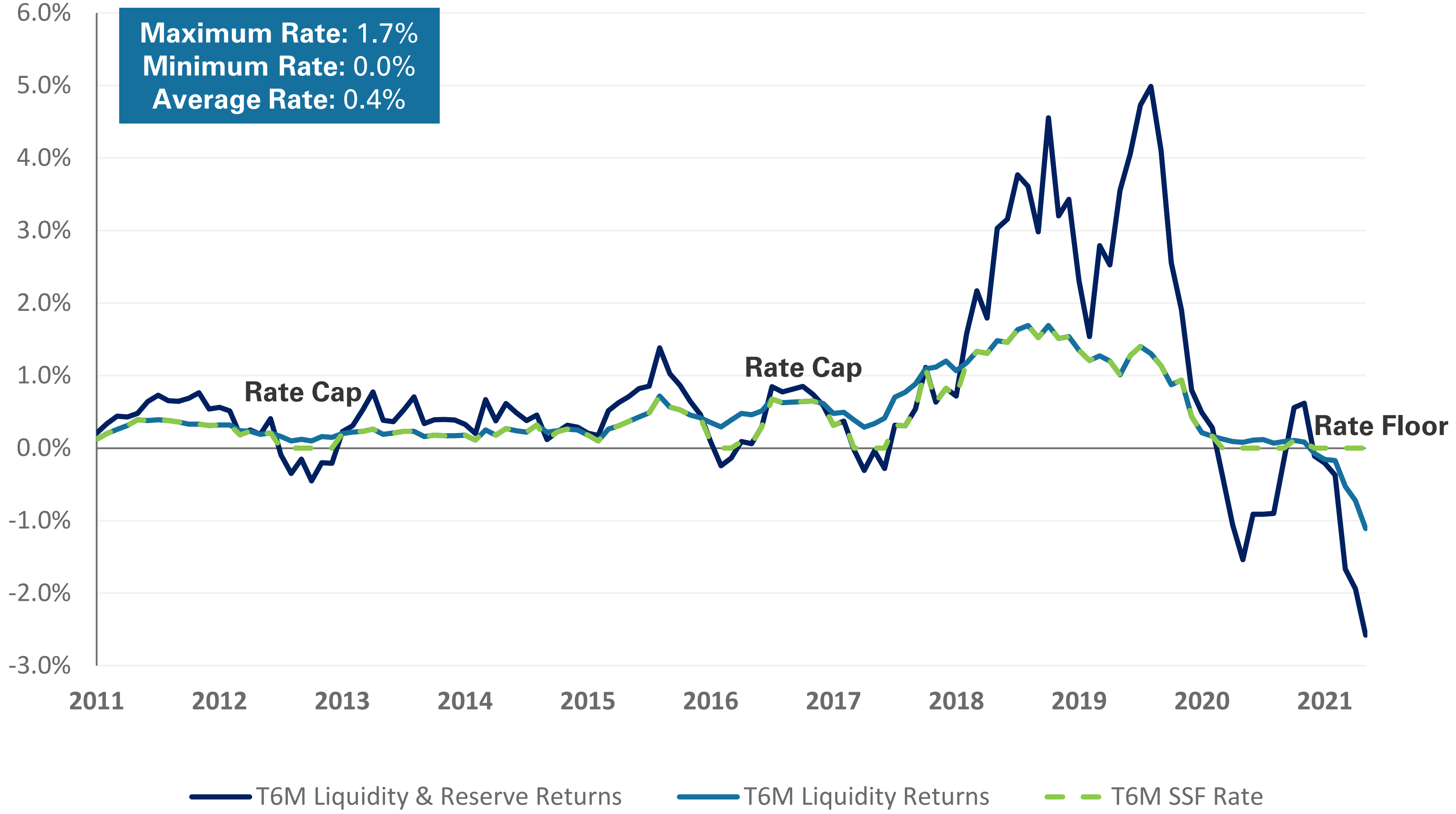
TRAILING 12 MONTHS – CURRENT METHODOLOGY



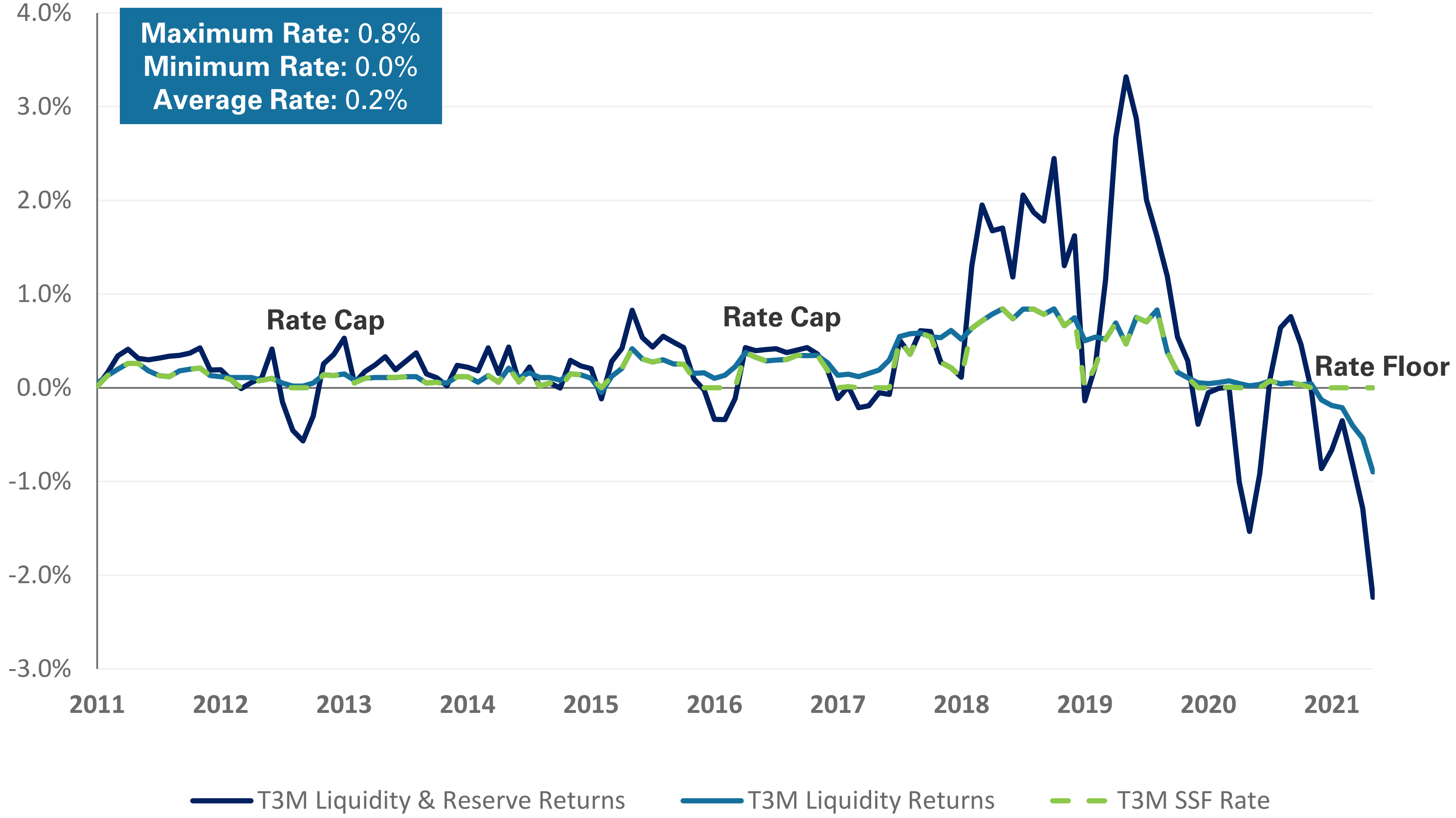
TRAILING 9 MONTHS



TRAILING 6 MONTHS

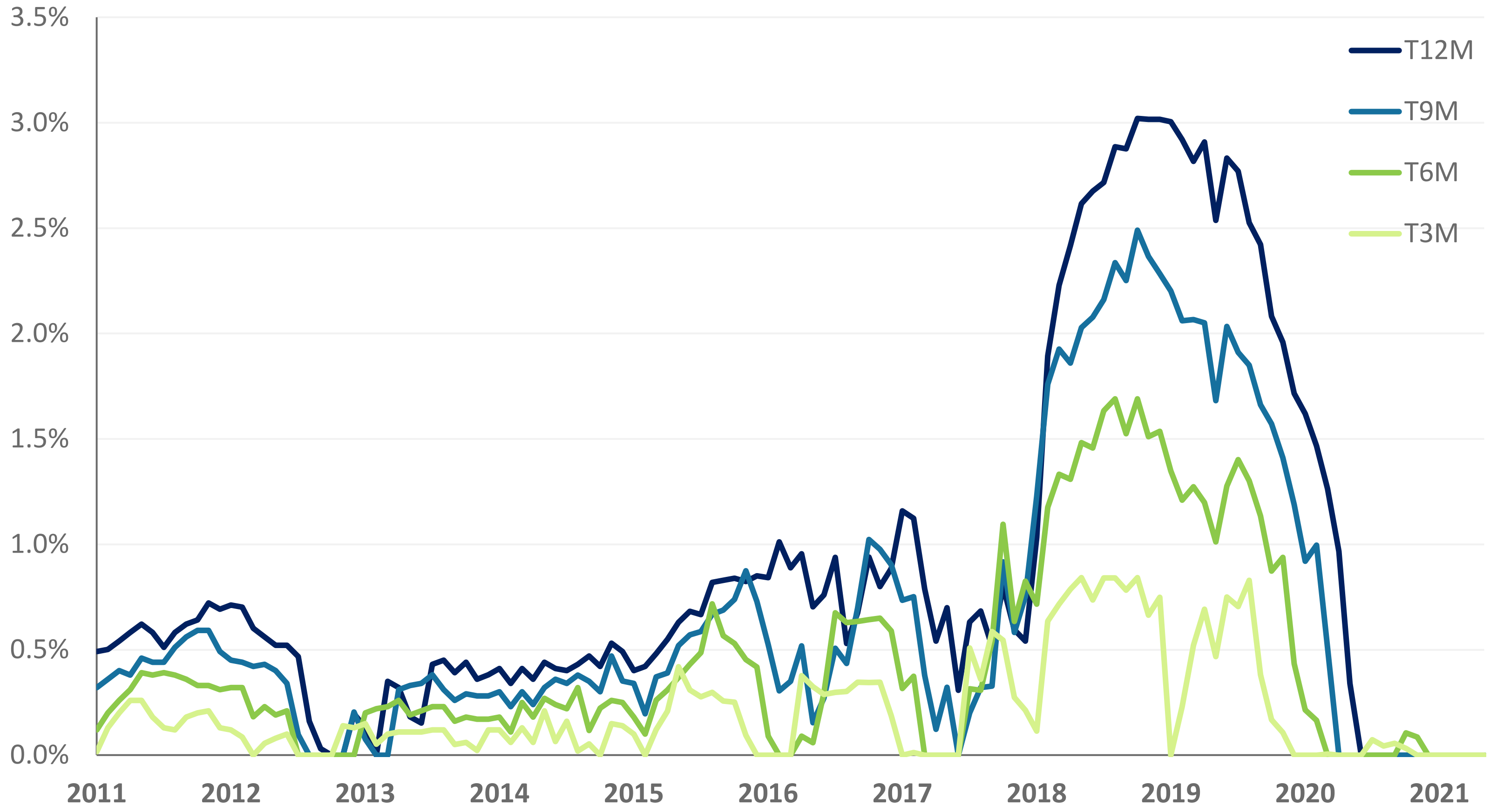


TRAILING 3 MONTHS



THE DIFFERENCE FOR THE SSF RATE IS TANGIBLE

COMPARING THE SSF RATE WITH DIFFERENT LAGS



CONCLUSIONS AND RECOMMENDATIONS

- **The current methodology (trailing 12 months) offers the highest SSF payout rate on average**
  - This methodology is beneficial in times of falling interest rates as the payout rate will be above current market levels
  - However, during times of rising interest rates, this methodology will lag shorter time lags as the payout rate will incorporate lower numbers relative to current market levels

- **Given the current market environment, NEPC recommends shifting to a 9 month calculation lag as this will be more reactive to the changing market environment**

- **In addition, we recommend OST revisit this calculation methodology on an annual basis in conjunction with NEPC and the school CFOs**

NEPC DISCLOSURES

Past performance is no guarantee of future results.

Information on market indices was provided by sources external to NEPC. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.

The goal of this report is to provide a basis for substantiating asset allocation recommendations. The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.