

# Cash Flow Fund

South Dakota Investment Council

April 22, 2021

# Fund Background

- Serves as checking account for state and state agencies
  - Comprised of over 500 separately identified state account
- Fund size average \$2,549 mm, range \$2,168 mm to \$2,690 mm
  - Typical fund size pre-COVID was approximately \$1,335 mm
- Regular inflows and outflows fluctuate seasonally
  - Sales and franchise taxes, tuition and fees, salaries, road construction
- Irregular inflows and outflows can vary more significantly
  - Debt issues to fund construction, disbursements to pay for major construction, coronavirus relief funds
- Reserves for contingencies which may be remote or distant
  - Require reasonable availability in event needed
- Size fluctuates less than expected given significant flows in and out
  - Timing of inflows and outflows meshes well but unsure if will remain the case
  - Various state contingency reserves comprise part of fund helping stabilize overall size

# Cash Flow Fund Investment Objectives

- **Safety of Principal**

The Cash Flow Fund shall be managed by limiting investments to duration range, rating categories and sector weights defined in portfolio guidelines.

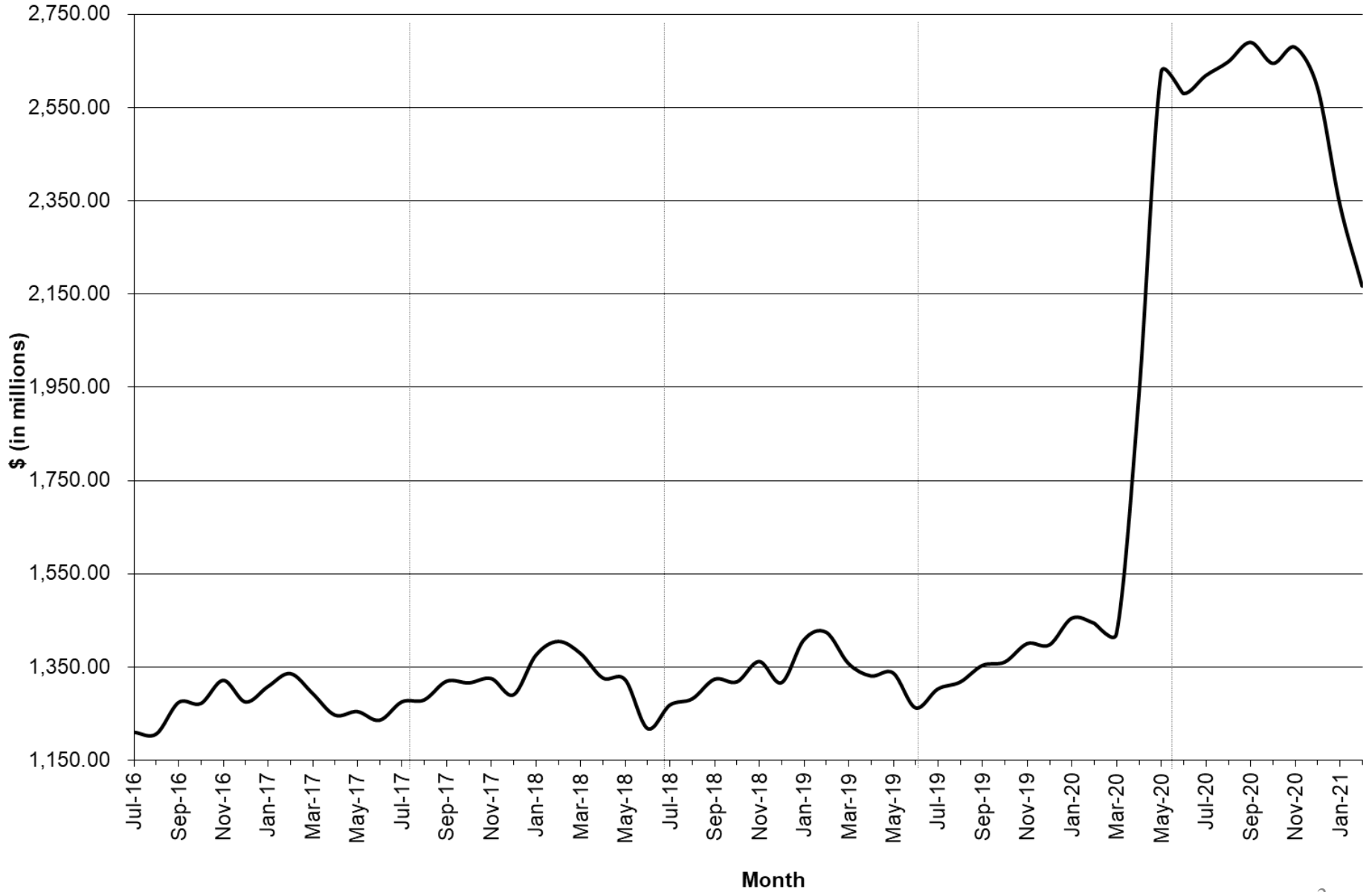
- **Return on Investments**

The Cash Flow Fund shall be managed to maximize return versus the benchmark portfolio, within the investment risk constraints and liquidity needs.

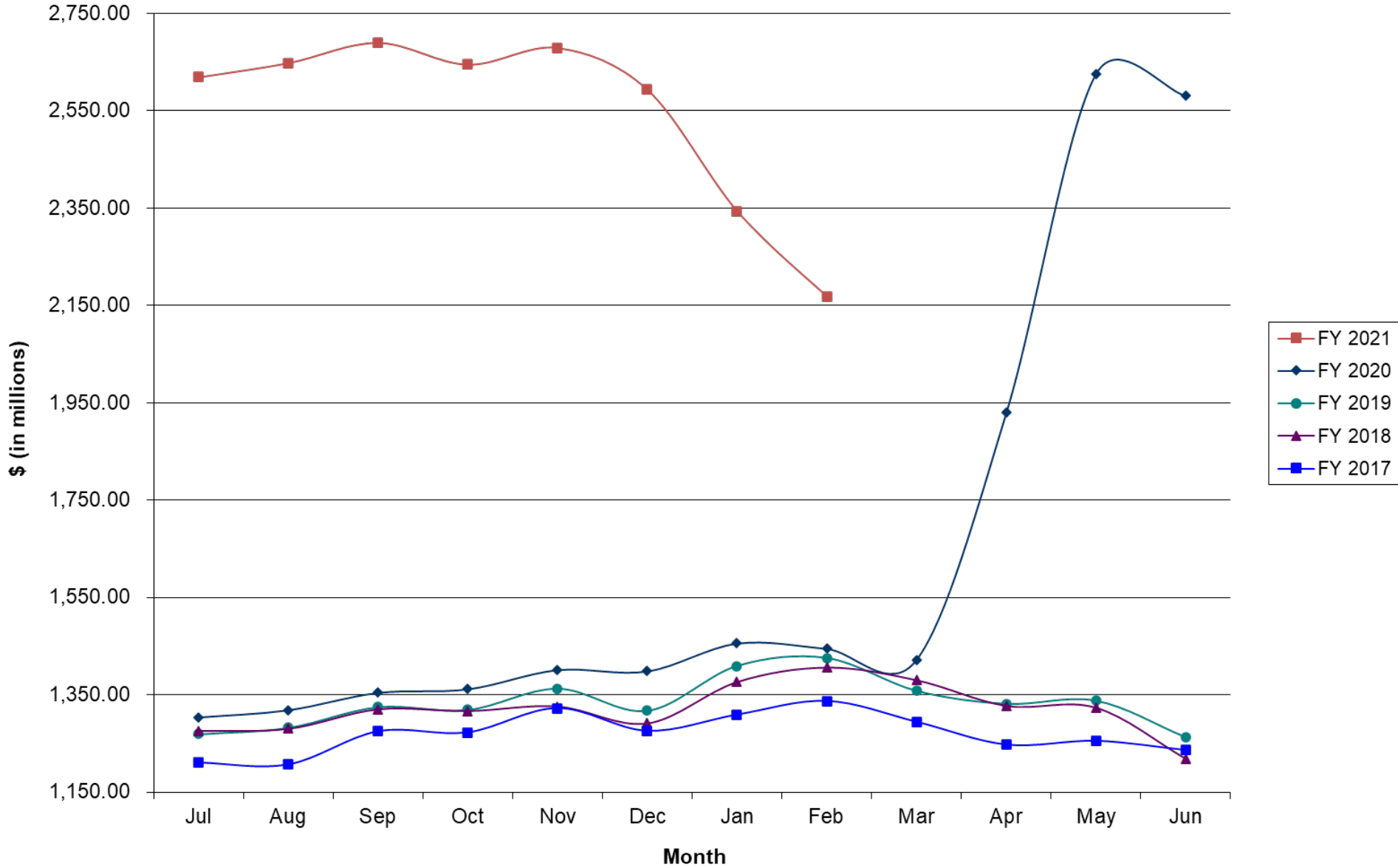
- **Liquidity**

The Cash Flow Fund will remain sufficiently liquid to enable the state to meet all cash requirements which might be reasonably anticipated.

### Cash Flow Fund Monthly Average Balance



### Seasonality of Monthly Average Balances



# Cash Flow Fund Classes of Investments Approved

4-5-26. Classes of investments approved. Money made available for investment may be invested in the following classes of securities and investments and, except as provided by § 3-12-117, chapter 3-13, chapter 13-63, the permanent trust fund containing the net proceeds from the sale of state cement enterprises, the health care trust fund as provided in S.D. Const., Art. XII, § 5, and the education enhancement trust fund as provided in S.D. Const., Art. XII, § 6, not otherwise:

- (1) Direct and indirect obligations of the United States government;
- (2) Agencies and instrumentalities of the United States government;
- (3) Direct obligations of the State of South Dakota and any of its political subdivisions;
- (4) Obligations consisting of notes, bonds, debentures, and certificates which are direct obligations of a solvent corporation or trust existing under the laws of the United States or any state thereof, if such investments are rated in the four highest classifications established by at least two standard rating services at the time of purchase;
- (5) Savings accounts, share accounts, certificates of deposit of banks, savings and loan associations, building and loan associations, and bankers' acceptances; or
- (6) In addition to the investments authorized by subdivisions (1) to (5) of this section, inclusive, the investment council may also allocate a sum certain of state public funds for investment in the accounts and certificates of South Dakota banks and associations. This sum shall initially be offered to South Dakota banks and associations, and if not initially fully subscribed, the investment officer shall immediately reoffer the unsubscribed sum to other qualified public depositories defined by subdivision 4-6A-1(7).

**Source:** SL 1971, ch 27, § 20; SL 1977, ch 36; SL 1986, ch 43; SL 1993, ch 49; SL 2000, ch 27, § 3; SL 2001, ch 24, § 1; SL 2001, ch 25, § 2; SL 2001, ch 26, § 2; SL 2002, ch 26, §§ 2, 4; SL 2015, ch 34, § 1.

# Short-Term Fixed Income Portfolio Guidelines

- **SD Financial Institution CD Program:**

- Amount and maturity set by Council
- Program governed by administrative rules

- **Money Market Portfolio:**

- Average maturity ~60 days
- Money market type securities Money market funds rated in the highest rating category by at least 2 standard rating services, Treasury bills, commercial paper, and other short-term cash instruments

- **Short-Term Fixed Income Portfolio**

- Position maturity limit 5.25 years
- Position size limits for corporates\* AAA/AA 4%, A 3%, BBB 1%, BBB- .5%
- Portfolio duration\*\* Range .5 to 2.88 years (~ 3 year maturity)
- Credit rating limits
  - BBB 15% of portfolio/20% with Inv. Officer permission
  - downgrades below BBB 5% of portfolio/10% with Inv. Officer permission
- Portfolio limits
 

	<u>Min</u>	<u>Benchmark***</u>	<u>Max</u>
Investment grade corporate	0%	70%	80%
Treasury / Agency	20%	30%	100%

# Short-Term Fixed Income Portfolio Guidelines

## \*Position Size Limits

Based on credit ratings at time of purchase.

Based on portfolio market value at beginning of month using prior month-end pricing. Will be repriced for significant cash transfers intra-month. Will not consider accrual changes due to immateriality and practicality.

Buffer of 1% of portfolio, however cannot purchase additional if over position limit .

Exception for new issue purchases if plan to offset the purchase by selling existing holdings of same within 3 days, with notification to State Investment Officer.

Holding for longer period requires permission of State Investment Officer.

\*\***Duration** is a measure of the weighted average life of all cash flows from a security including coupons.  
Current duration is ~2.24 years.

## \*\*\*Short-Term Fixed Income Portfolio benchmark

60%	FTSE 1-3 Year AAA-A Corporate Index
26.67%	FTSE 1-5 Year US Treasury Note Index
13.33%	FTSE 3-6 Month US Treasury Bill Index



# Intermediate-Term Fixed Income Portfolio Guidelines

- **Intermediate-Term Fixed Income Portfolio**

- Position maturity limit 30 years
- Portfolio duration\* Range 70% to 130% of FTSE BIG duration
- Position size limit for corporates 3%

– Portfolio limits	<u>Min</u>	<u>Benchmark**</u>	<u>Max</u>
Treasury	15%	37%	70%
Agency	0%	3%	50%
Investment Grade Corp	15%	33%	50%
Mortgages	15%	27%	50%
Cash	0%	0%	50%

\*Duration is a measure of the weighted average life of all cash flows from a security including coupons. The current duration for the Intermediate-Term Fixed Income Portfolio's benchmark is 6.54 years.

\*\*Current sector weightings of the FTSE Broad Investment Grade (BIG) Index serve as the benchmark for the Intermediate-Term Fixed Income Portfolio.

# Intermediate-Term Fixed Income Portfolio Implementation

- The intermediate term portfolio portion of the Cash Flow Fund is invested similarly to the South Dakota Retirement System (SDRS) investment grade fixed income portfolio.
- This portfolio participates with SDRS in the purchase and sale of fixed income securities like is currently done for the state trust funds.
- Per the Guidelines, investments are made in Treasury debt, Agency debt, GNMA Mortgage-Backed Securities, and US Investment Grade Corporate Bonds.
- The benchmark index is the FTSE Broad Investment Grade (BIG) Index.
- The portfolio was established with \$300 million in five tranches beginning with securities from the CFF short-term fixed income portfolio in order to reduce transaction costs.
- Over time, proceeds from the sale of these securities were used to purchase securities from dealers or from the existing investment grade portfolios until the portfolio was similar to SDRS and the four trust funds.
- The same process continued to be followed as the intermediate term portfolio increased in size. The default size and timing was \$50 million every 6 months until the portfolio reached \$300 million. The process concluded with the \$50 million tranche on June 1, 2018. The portfolio's fair value as of 2/28/21 was \$347.8 million.

# Annual Proration

- Proration process outlined in SDCL 4-5-30 “..Prorating of income---.. ..utilizing the facilities of the state budgetary accounting system...The state investment officer shall credit the gain or interest due as a result of investments made pursuant to 4-5-29 on a pro rata basis to the participating funds in the same ratio as the average daily cash balance of each fund bears to the total average cash balance of all funds.”
- The receipted (cash basis) income and gains for a fiscal year are allocated to the participating funds the following fiscal year.

# Proration Rate compared to Institutional Prime Money Market (IMM)

	<u>Proration Rate</u>	<u>IMM Rate</u>
FY 21	1.10% est.	.10%
FY 20	2.30%	1.51%
FY 19	2.08%	2.35%
FY 18	1.19%	1.47%
FY 17	1.25%	.73%
FY 16	1.35%	.26%
FY 15	1.25%	.06%
FY 14	.99%	.04%
FY 13	1.47%	.12%
FY 12	2.33%	.12%
FY 11	3.37%	.17%
FY 10	4.94%	.17%
FY 09	4.59%	1.63%
FY 08	5.07%	4.25%
FY 07	4.23%	5.19%
FY 06	3.07%	4.10%
FY 05	2.66%	2.08%
FY 04	2.95%	.94%
FY 03	4.22%	1.39%