

Metropolitan Government of Nashville & Davidson County
Cash Benchmark Study



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Executive Summary

PFM Asset Management LLC (“PFM”) was engaged to conduct an investment review for the Metropolitan Government of Nashville & Davidson County (“Metro”) and prepare a Cash Benchmark Study (“Study”) based on our findings of this review. In preparation for the Study, PFM reviewed Metro’s Investment Policy including Appendix A, and quarterly reports prepared by Metro’s Office of the Treasurer.

The Scope of the engagement includes PFM’s review and evaluation of the investment manager’s implementation of Metro’s Letter of Instructions signed March 14, 2002 (Appendix A of the Investment Policy), review of the Office of the Treasurer’s policies in identifying investment dollars for each of the three components of the Metropolitan Investment Pool (“MIP”); review and discuss the appropriateness of the benchmarks for the components of the MIP and the Water and Sewer Extension and Replacement Fund (“WSE Fund”) and provide benchmark recommendations if necessary and determine why investment portfolio performance has been lower than the benchmarks.

This Study focuses on the assets within the MIP Long Pool #2803 (“Long Pool”), the MIP Short Pool #2806 (“Short Pool”) and the WSE Fund which are managed by Payden and Rygel. Information is based on quarterly reports for the periods Quarter End March 31, 2004 through Quarter End March 31, 2005.

Background

The Scope of the Investment Policy governs the overall administration and investment management of Short Term Investment Portfolio which is defined in this report as the MIP Consolidated Portfolio. The Investment Policy applies to all of Metro’s financial assets exclusive of funds for the Knowles Trust Fund and the retirement system portfolio. Metro’s investment objectives as stated in the Investment Policy are to first and foremost Preserve Principal, secondly, to Provide Liquidity to meet Metro’s cash flow needs and then to Maximize Return. Metro’s Charter states that with the Mayor’s approval, the Director of Finance shall instruct the Treasurer to invest Metro’s funds and the Treasurer shall be responsible for the investment process and carry out day-to-day operational requirements, and shall maintain written administrative procedures for the operation of the investment program that are consistent with the Investment Policy.

Metro’s Office of the Treasurer in the Department of Finance has oversight of short term investments and Payden & Rygel provide investment management for the MIP, WSE Fund and other project related investment portfolios. The MIP is comprised of the MIP Long Pool #2803 (“Long Pool”), the MIP Short Pool #2806 (“Short Pool”), and the Tennessee Local Government Investment Pool (“TN LGIP”). The WSE Fund assets are managed in a separate portfolio with slightly different maturity requirements.

A review of Metro’s Investment Policy and Appendix A (combined “Investment Policy”) and Metro’s quarterly investment reports prepared by Metro’s Office of the Treasurer found that the investments held in the MIP and WSE Fund portfolios have been in compliance with the Investment Policy. Specifically, the MIP Portfolio consists of U.S. Treasuries (50%), Federal Agencies (28%), Commercial Paper (3%) and the TN LGIP (18%). The Investment Policy allows for up to 100% allocation to U.S. Treasuries, Federal Agencies and the TN LGIP and 30% to Commercial Paper. Also, the securities within the MIP portfolio appear to be within the 2 year maturity limit. The WSE Fund portfolio also appears to meet the permitted investment and maturity requirements, with investment allocations of 86% to U.S. Treasuries and 14% to Federal Agencies. The securities in the WSE Fund have maturities of 3 years and less.

Review and Evaluation of Implementation of Letter of Instructions

Metro signed a Letter of Instructions (“LOI”) on March 14, 2002 which is attached as Appendix A to Metro’s Investment Policy. This LOI identifies Payden and Rygel Investment Counsel as Metro’s Investment Manager and presents investment restrictions in addition to the Investment Policy. The LOI provides requirements with regard to specific areas of investment. The paragraphs that follow identify the additional instructions and whether the Investment Manager has met the requirements.

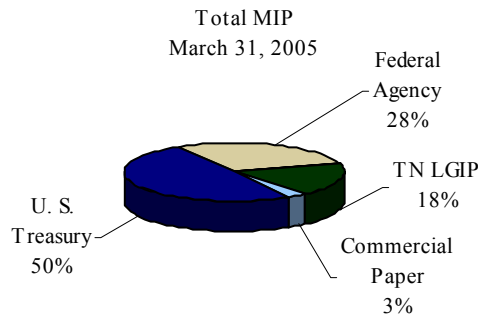
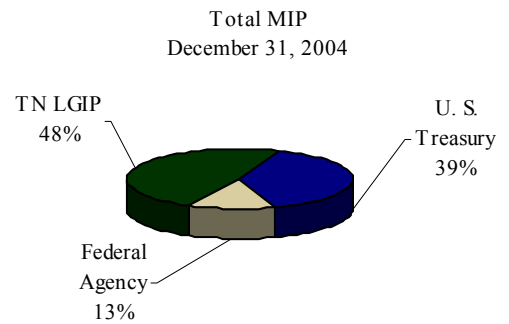
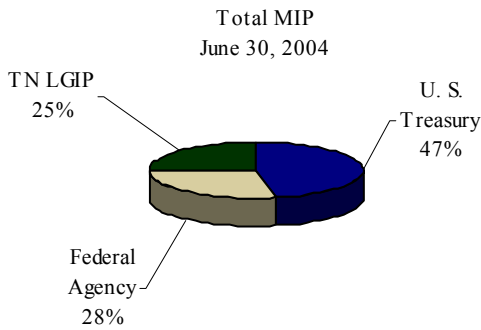
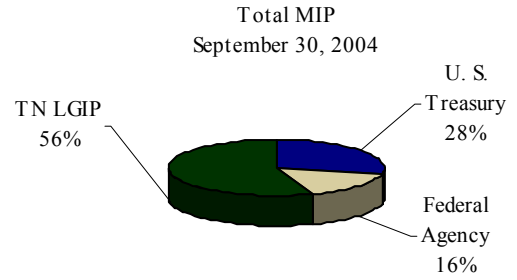
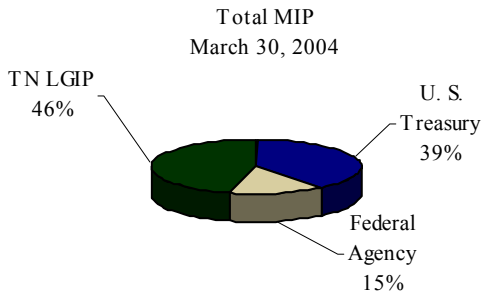
Diversification

The table below lists the permitted investment and each investment type’s maximum allocation. The allocations charts presented on the following page are presented as of Quarter End March 31, 2004 through March 31, 2005. The LOI requires a 10% per issuer allocation with the exception of U.S. Treasuries and Federal Agency securities. The pie charts illustrate the portfolio investment allocation for each quarter. It appears that the Investment Manager maintained diversification compliance with the LOI. The MIP investments consisted of U.S. Treasuries, Federal Agencies and the TN LGIP. All three investment types allow a maximum investment of 100%. The diversification charts as presented in the quarterly reports prepared by the Investment Manager appear to be unchanged during the five quarters with 26% allocated to the TN LGIP, 55% to U.S. Treasuries and 19% Federal Agencies. Given the considerable changes in balances for each component of the MIP during this period, we would typically expect the allocation to change to some degree. PFM reviewed the month-end statements for each quarter end and determined the asset allocation chart in the quarterly reports appear to be incorrect since December 31, 2003. The charts on the following page provide the correct asset allocation as of quarter end based on balance information provided in the quarterly reports prepared by the Office of the Treasurer. Detailed portfolio holding information should be provided to Metro in each quarterly report to confirm compliance.

Investment Type	Allocation
U.S. Treasury	100%
Federal Agency	100%
Repurchase Agreements*	20%
Insured/Collateralized Certificates of Deposit*	15%
Commercial Paper*	30%
Bankers' Acceptances*	20%
Corporate Obligations (CP plus BAs)*	30%
Tennessee LGIP	100%

*10% allocation per issuer

The pie charts below present the restated allocation of the MIP for the quarters ended March 31, 2004 through March 31, 2005. The charts are based on the information provided in the quarterly reports prepared by the Office of the Treasurer.

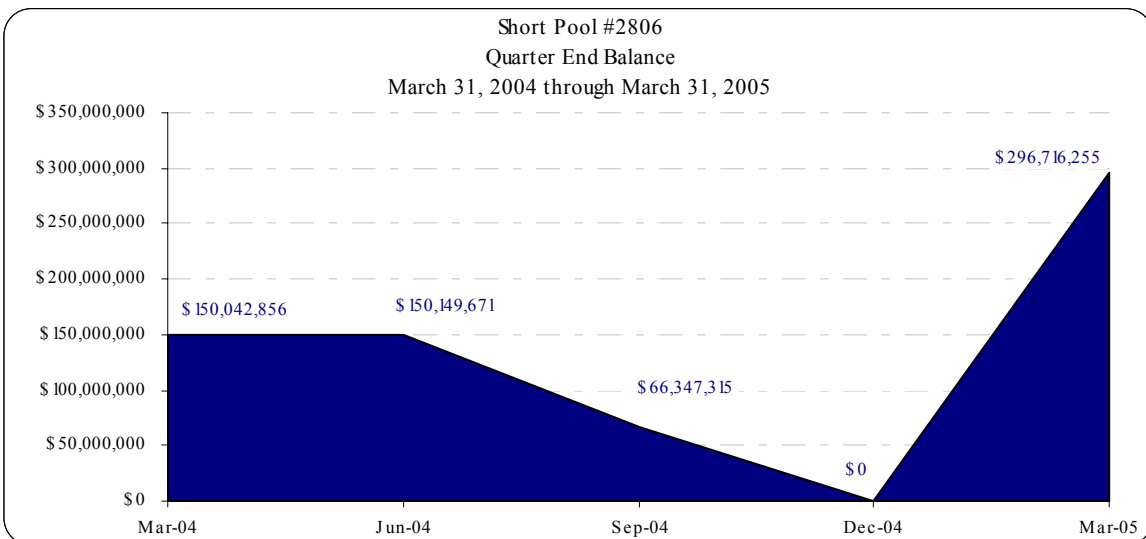
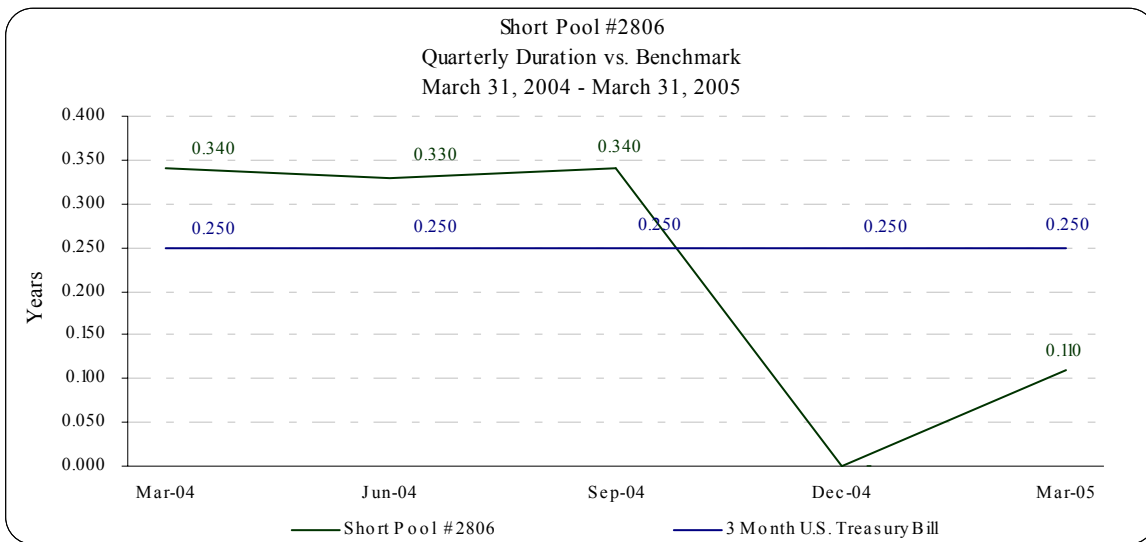


Maturity Limitations

The LOI states that no funds, other than bond proceeds, are to be invested in securities that have a maturity greater than two years without the approval of the State Director of Local Finance. The WSE Fund may have maturities up to four years. There were no maturities within the MIP portfolios or the WSE Fund that appeared to violate the maximum maturity requirement.

Short Pool Portfolio #2806 (“Short Pool”)

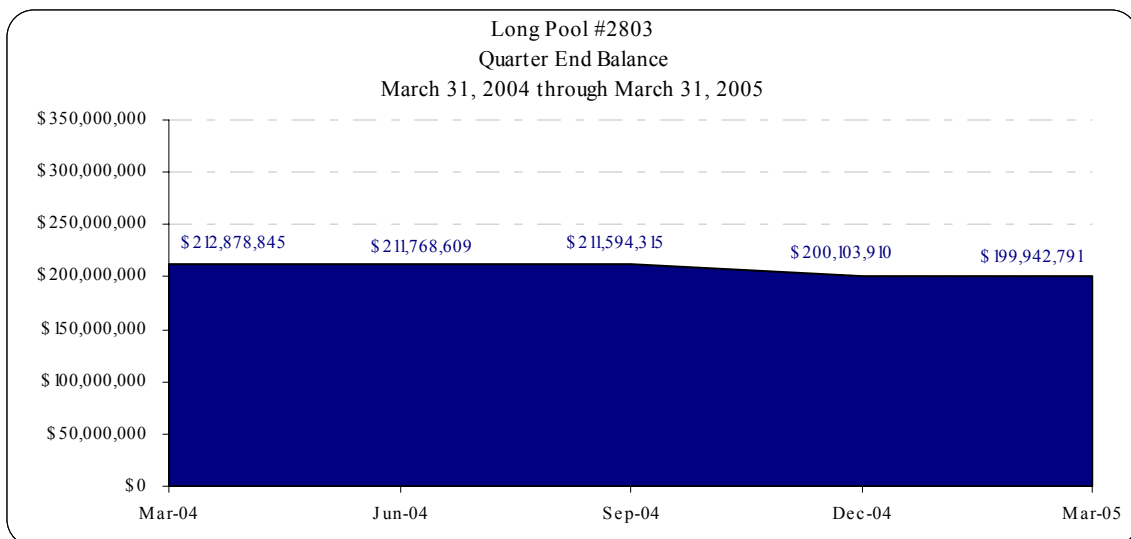
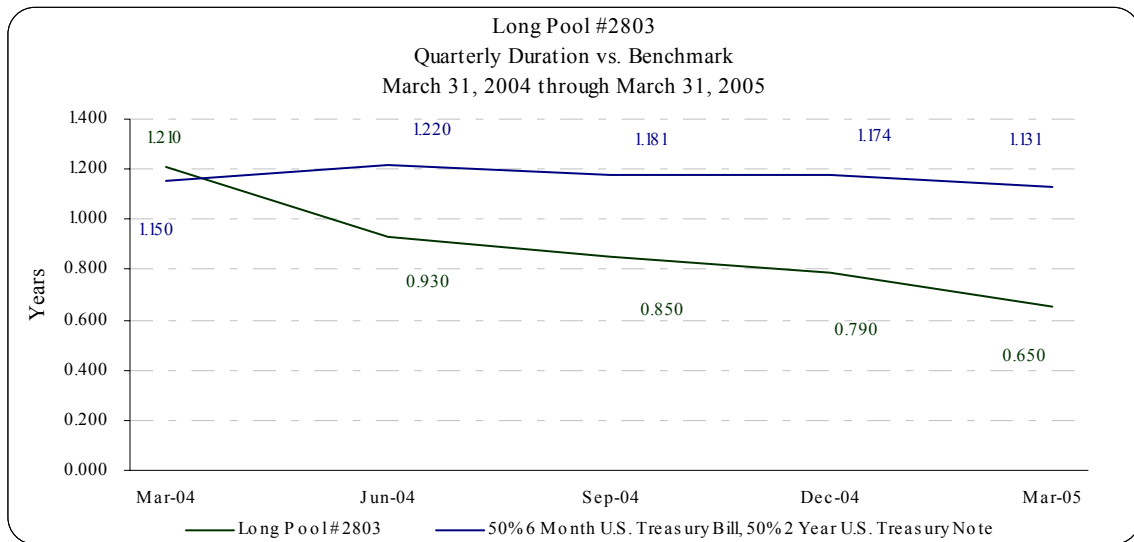
The Short Pool was created on January 1, 2002 with the Three Month U.S. Treasury Bill as the established benchmark. The duration of the benchmark remains constant at 0.25 years (91 days). The LOI states that the Short Pool will have an average term to maturity of no greater than 180 days. For the quarters ended March 31, 2004 through September 30, 2004 the duration of the portfolio was 0.34 years (124 days) which is 136% of the benchmark but still short of the maximum average maturity of 180 days. The Short Pool had a zero balance as of December 31, 2004. The Short Pool duration was low compared to the benchmark as of March 31, 2005 at .11 years (44% of the benchmark).



Long Pool Portfolio #2803 (“Long Pool”)

The Long Pool was created on June 1, 2002 with a benchmark that is made up of 50% of the Six Month U.S. Treasury Bill and 50% of the Two Year U.S. Treasury Note. The duration of the benchmark varies during the five quarters as a result of the Two Year U.S. Treasury Note duration fluctuation while the duration of the Six Month U.S. Treasury remains constant at .5 years (182 days). The LOI states that the Long Pool will have a duration target of 1 year.

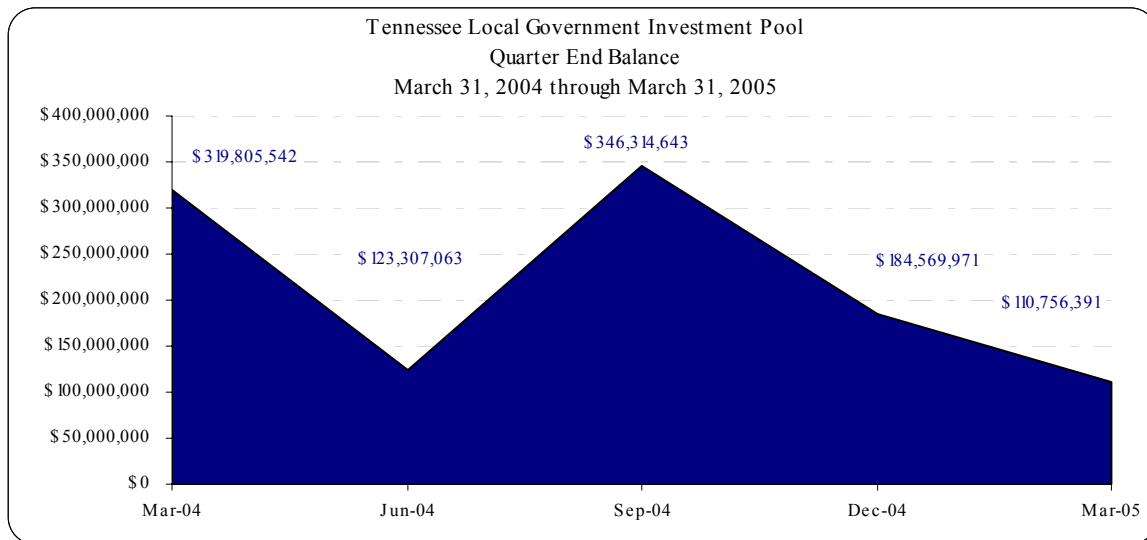
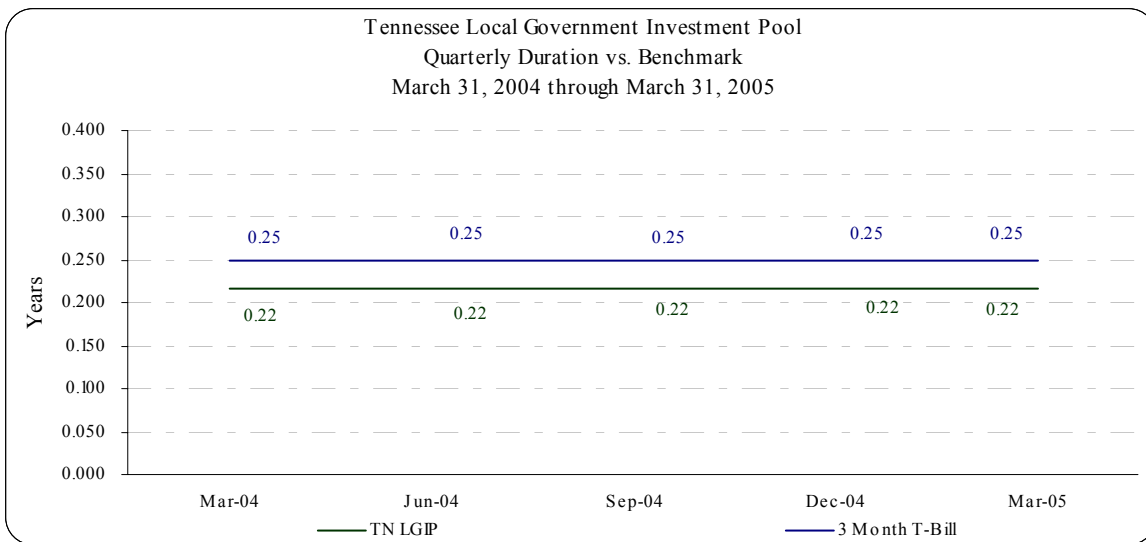
For the quarters ended March 31, 2004 through September 30, 2004 the duration of the Long Pool was as high as 1.21 years on March 31, 2004 (105% of the target) and as low as .65 years on March 31, 2005 (57% of the target). The LOI also states a target average maturity of 1.3 to 1.5 years. The Office of the Treasurer provides MIP maturity distribution in three month ranges within the quarterly report, but this does not provide the detail necessary to determine the average maturity. Detailed portfolio holdings should be included in the quarterly report which would provide the information necessary to determine the average maturity of each portfolio. In addition, the Investment Manager should include both the duration and the average maturity in the quarterly report to confirm compliance with the Investment Policy and LOI.



Tennessee Local Government Investment Pool (“TN LGIP”)

The shortest maturity investment of the MIP is invested in the TN LGIP with the Three Month U.S. Treasury Bill as the benchmark. The duration of the benchmark is fixed since the Three Month U.S. Treasury Bill has a constant duration of 0.25 (91 days). The duration of the TN LGIP varies, but based on the most recent annual report the average days to maturity was 79 days. The TN LGIP is limited to a dollar weighted average maturity of 90 days or less in accordance with the Security and Exchange Commission Rule 2a-7 of the Investment Advisers Act of 1940.

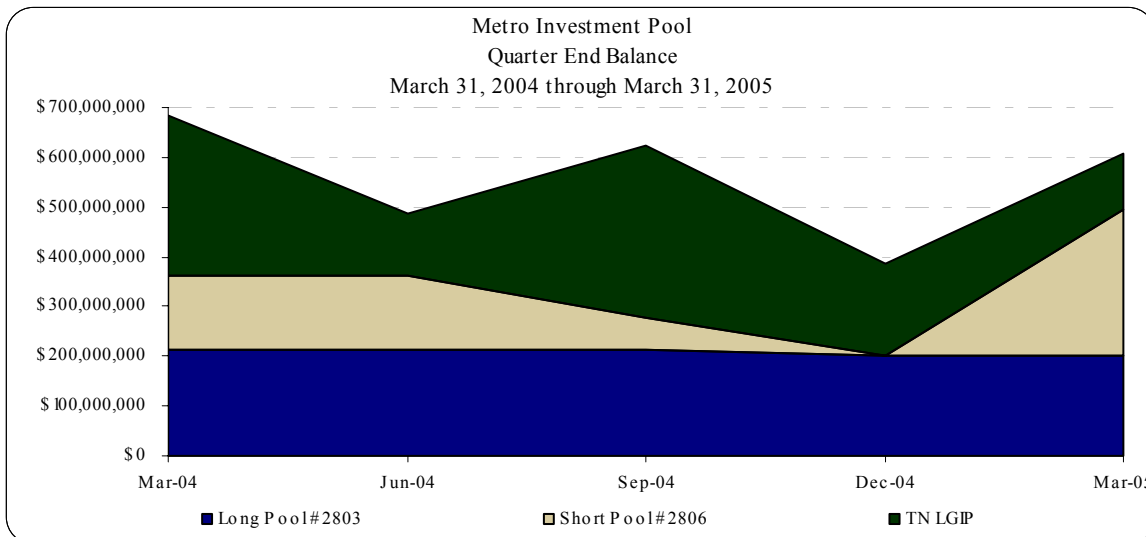
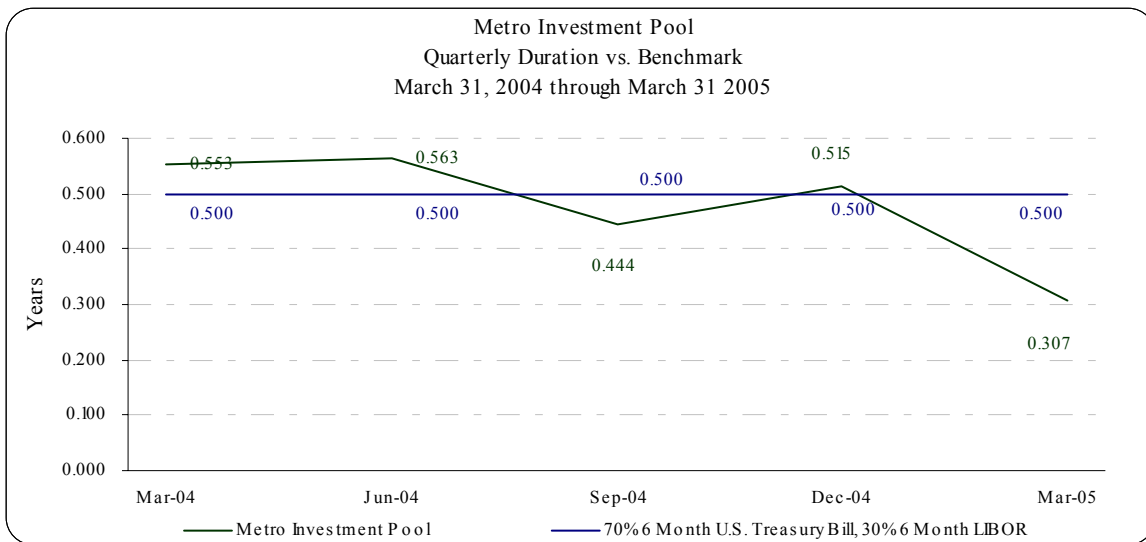
The TN LGIP provides Metro overnight liquidity and is a useful investment option for funds needed for short term requirements including operations such as payroll. The charts below illustrate the duration of the benchmark versus the duration of the TN LGIP, and the quarter end balances for the quarters ended March 31, 2004 through March 31, 2005.



MIP Consolidated Pool (“MIP”)

MIP Consolidated Pool is made up of three portfolios discussed in the previous pages, the Short Pool, the Long Pool, and the TN LGIP. The benchmark for the MIP is 70% Six Month U.S. Treasury Bill and 30% of the Six Month LIBOR. The duration of the benchmark is fixed since the Six Month U.S. Treasury Bill and the Six Month LIBOR have constant durations of 0.50 years (180 days).

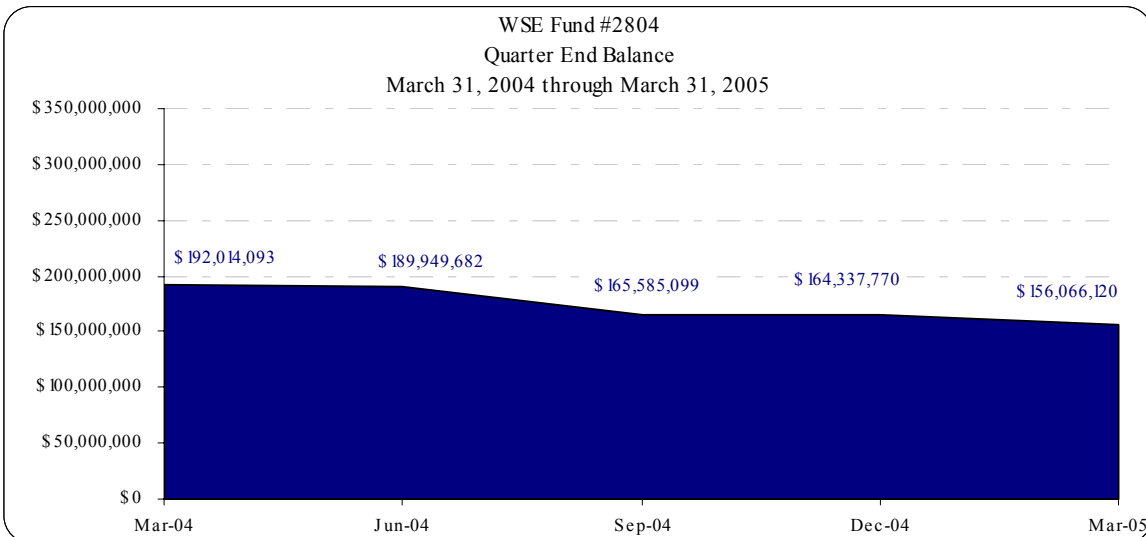
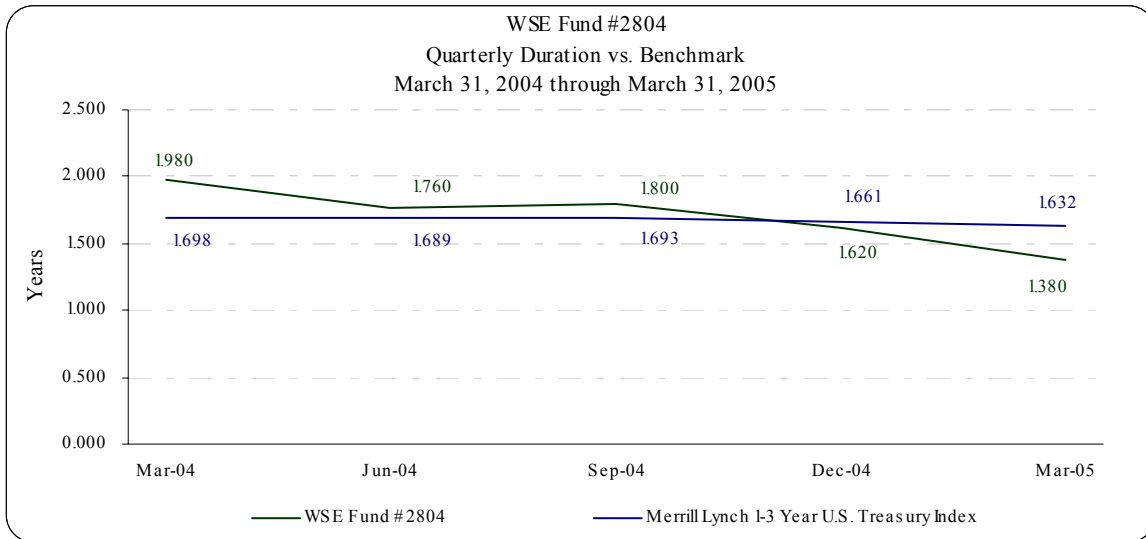
For the quarters ended March 31, 2004 through September 30, 2004 the duration of the portfolio fluctuated around the benchmark and was as high as 0.553 years on June 30, 2004 (110% of the target) and as low as 0.30 years on March 31, 2005 (61.4% of the target). Seventy percent of the MIP was invested in securities which had maturities of 3 month or less (as shown on page 6 of the Fiscal Year Ended September 30, 2005 report) which contributed to the considerable decrease in the duration of the MIP. Detailed portfolio holdings should be included in the quarterly report which would provide the information necessary to determine the average maturity of each portfolio. In addition, the Investment Manager should include both the duration and the average maturity in the quarterly report to confirm compliance with the Investment Policy and LOI.



Water and Sewer Extension and Replacement Fund #2804 (“WSE Fund”)

The WSE Fund was created on January 1, 2002. The WSE Fund benchmark is the Merrill Lynch 1-3 Year U.S. Treasury Index (“Index”) and has a maximum maturity of four years. The duration of the benchmark varies slightly during the five quarters as a result of the rebalancing of the Index.

For the quarters ended March 31, 2004 through September 30, 2004 the duration of the portfolio was at the highest level of 1.98 years at quarter ended March 31, 2004 (117% of the benchmark duration) and trended downward to a low of 1.38 years on March 31, 2005 (84.6% of the benchmark duration). The balance of the WSE Fund has declined during the last five quarters from \$192 million to \$156 million. The a WSE Fund maturity distribution chart is included in the quarterly report. The distribution table provides an allocation between the WSE and securities with maturities between 1-2 years and securities with maturities between 2-3 years. Detailed portfolio holdings should be included in the quarterly report which would provide the information necessary to determine whether the average maturity of the portfolio is below, meets or exceeds the two year target average duration as stated in the LOI. In addition, the Investment Manager should include both the duration and the average maturity in the quarterly report to confirm compliance with the Investment Policy and LOI.



The following paragraphs detail the requirements and conditions related to the additional permitted investments within the LOI and whether each of the investments were included in any of Metro's portfolios.

Repurchase Agreements

The LOI provides requirements regarding the purchase of obligations of the United States or its Agencies under a repurchase agreement provided that the conditions listed in the LOI are met. Conditions include a master repurchase agreement, collateral of at least 102% by obligations of the United States or Agencies and prospective counter parties must have a short-term credit rating of at least A-1/P-1. Metro is not currently entered into any repurchase agreements.

Commercial Paper

The LOI provides term and conditions for commercial paper including an A-1 rating, a 3% or \$15 million limit, whichever is less per issuer, and a limit of 30% total allocation to commercial paper. As of March 31, 2005, Metro has \$17.6 million commercial paper investments, 3% of the total portfolio.

Bankers' Acceptances

Only prime Bankers' Acceptances are permitted which are eligible for purchase by the federal reserve system, and must be issued by domestic banks with a minimum long term debt rating of "AA" or foreign banks which are rated "AAA". Bankers' Acceptances shall not exceed 20% of the portfolio's book value upon acquisition. The amount purchased from any one commercial bank cannot exceed 3% or \$15 million, whichever is less. There are currently no Bankers' Acceptances within Metro's portfolio.

Variable Rate Notes

Variable Rate Notes are not permitted investments for the Metro portfolio as stated in the LOI.

Certificates of Deposit

The LOI provides term and conditions for certificates of deposit (CD's), including all CD's and other evidence of deposit only from Tennessee State chartered bank and savings and loan associations and federally chartered banks and savings and loan associations. The LOI also details the deposit security requirements. There are currently no Certificates of Deposit within Metro's portfolio.

Reporting Requirements

The LOI states that the Investment Manager will provide Metro with monthly reports which contain a listing of the existing portfolios in terms of investment securities, amortized book value, maturities, return and other features deemed relevant, the total investment earnings for the period and a listing of all transactions which occurred during the month. Our review of the month-end statements provided by the Investment Manager appears to contain the required reporting information. This information should also be included in the quarterly report.

Review of Benchmarks and Performance

Metro's LOI identifies individual benchmarks for the MIP, the Long Pool and the Short Pool and the WSE Fund. The benchmarks appear to have been selected based on the maturity requirements, permitted investments and expected cash flow needs for each portfolio.

Determining the appropriate benchmark for each portfolio depends on several factors including sources and uses of funds in the portfolio and risk tolerances. While longer duration portfolios may provide higher returns over the long periods, as shown in the risk/return chart below, longer duration portfolios also incur considerably more quarters in which the total return is negative. For portfolios which consist of funds needed for short term uses such as operational needs, market volatility is an important consideration. For portfolios that consist of core assets, those assets which will not be needed in the short run, a longer duration portfolio may be appropriate to take advantage of higher yields offered in the longer indexes.

The chart below provides quarterly returns for benchmarks from the Three Month U.S. Treasury Bill Index to the Seven to Ten Year U.S. Treasury Index for the period March 31, 2004 through March 31, 2005.

Quarter Ended	3-Month Treasury Bill	6-Month Treasury Bill	1 Year Treasury Index	1-3 Year Treasury Index	1-5 Year Treasury Index	3-5 Year Treasury Index	5-7 Year Treasury Index	7-10 Year Treasury Index
3/31/2004	0.24%	0.28%	0.45%	1.00%	1.53%	2.62%	2.98%	4.01%
6/30/2004	0.24%	0.14%	(0.30%)	(1.06%)	(1.67%)	(2.89%)	(3.29%)	(4.24%)
9/30/2004	0.37%	0.43%	0.49%	0.97%	1.50%	2.53%	3.08%	4.42%
12/31/2004	0.48%	0.37%	0.18%	0.02%	(0.01%)	(0.06%)	0.09%	0.32%
3/31/2005	0.57%	0.54%	0.22%	(0.26%)	(0.60%)	(1.22%)	(1.11%)	(1.10%)

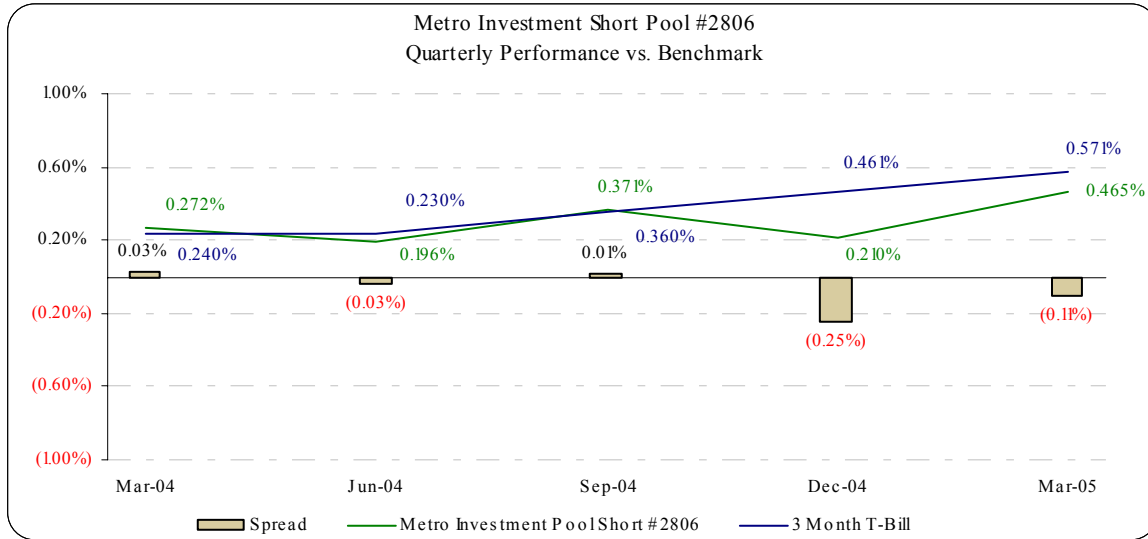
The risk return chart below illustrates the overall return for various Merrill Lynch U.S. Treasury indexes for ten years ended June 30, 2005. As the chart indicates, while portfolios managed against longer duration indexes may provide a higher return over long investment horizons, longer duration portfolios will typically experience additional quarters of negative returns. The Merrill Lynch 1-3 Year U.S. Treasury Index provides 83% of the return of the Merrill Lynch 7-10 Year U.S. Treasury Index while experiencing two quarters of negative returns compared with 14 quarters of negative returns of the longer index.

Risk/Return of Various Benchmarks 10 Years Ended 6/30/05				
Merrill Lynch Index	Duration	Overall Return	% of Value of 7-10 Year Index	Quarters With Negative Returns
3-Month Treasury Bill	0.15 Years	3.96%	75%	0 of 40
6-Month Treasury Bill	0.40 Years	4.17%	76%	0 of 40
1 Year Treasury Index	0.90 Years	4.55%	79%	1 of 40
1-3 Year Treasury Index	1.67 Years	5.12%	83%	2 of 40
1-5 Year Treasury Index	2.32 Years	5.46%	86%	6 of 40
3-5 Year Treasury Index	3.62 Years	6.18%	92%	13 of 40
5-7 Year Treasury Index	4.56 Years	6.70%	97%	13 of 40
7-10 Year Treasury Index	6.51 Years	7.04%	100%	14 of 40

Source: Bloomberg--Merrill Lynch Indices

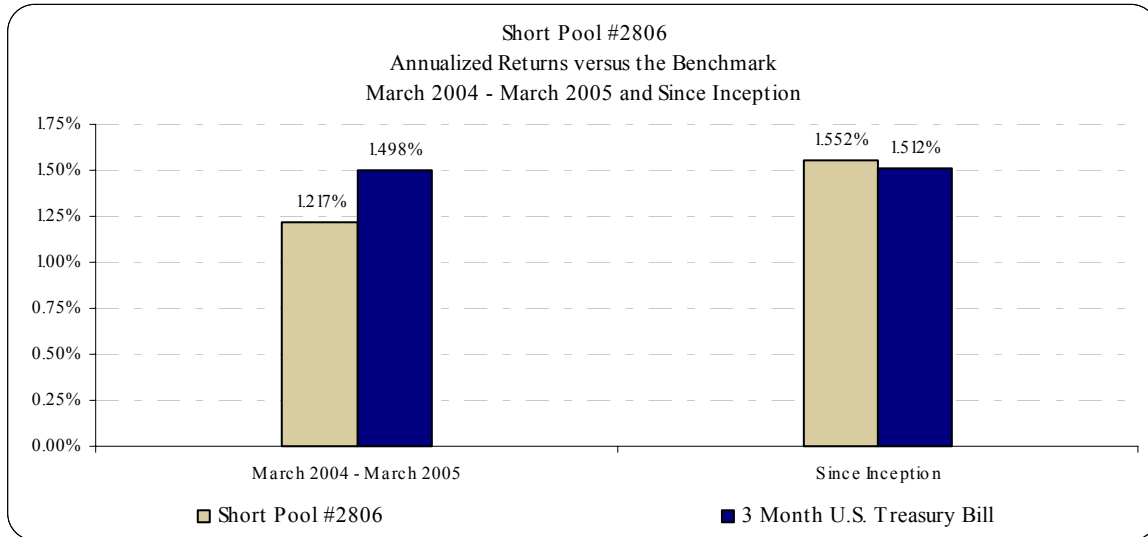
Short Pool Portfolio #2806 (“Short Pool”)

The Short Pool’s benchmark is the Three Month U.S. Treasury Index. For the quarters ended March 31, 2004 through September 30, 2004 the quarterly return of the Short Pool was in-line with the benchmark with +3 basis points, -3 basis points and +1 basis point versus the benchmark, respectively. The assets within the Short Pool were withdrawn during the quarter ended December 31, 2004 and were reinvested during the following quarter ended March 31, 2005 which may have affected the returns of the portfolio versus the benchmark for those two quarters. The chart below illustrates the performance of the Short Pool versus the benchmark as of each quarter end.



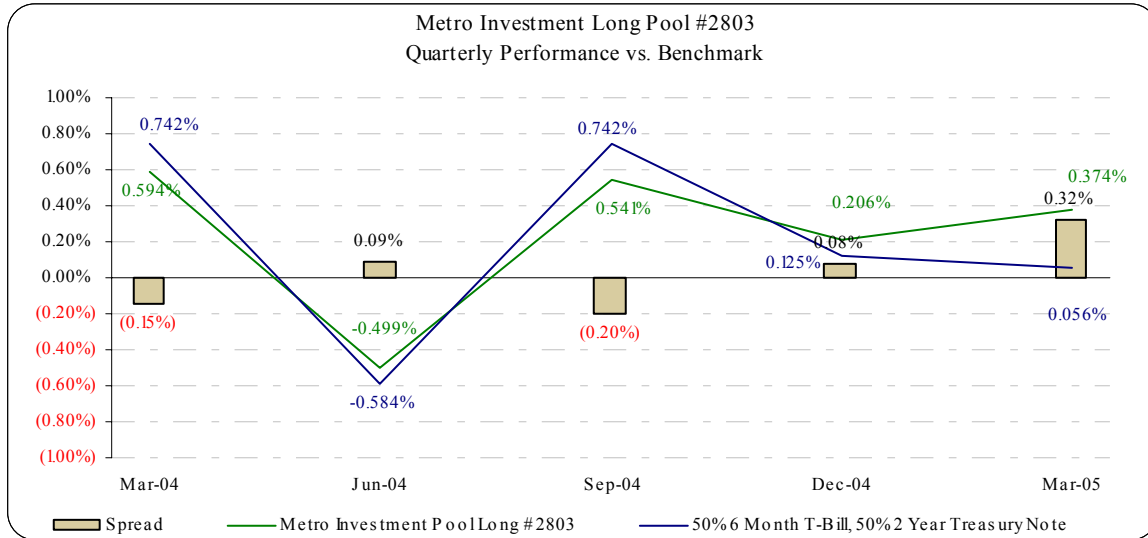
As the chart above indicates during the March 31, 2004, June 30, 2004 and December 31, 2004 quarters the Short Pool slightly outperformed the benchmark and also had a duration which was 0.35 years versus the benchmark of 0.25 years. The March 31, 2005 quarter experienced the largest level of underperformance with a return of 0.21%, 25 basis points less than the benchmark. This underperformance may be the result of the portfolio being depleted in during the quarter ended December 31, 2004 (the December 31, 2004 balance was zero) and reinvested during the March 31, 2005 quarter. The duration of the short pool of .11 years was considerably lower than the Three Month U.S. Treasury Bill duration of 0.25 years.

The Short Pool annualized return of 1.217% for the period March 31, 2004 through March 31, 2005 was 28 basis points lower than the benchmark Three Month U.S. Treasury Bill return of 1.498%. As of March 31, 2005 the Short Pool's since inception return of 1.55% was 4 basis points higher than the benchmark return of 1.51%.



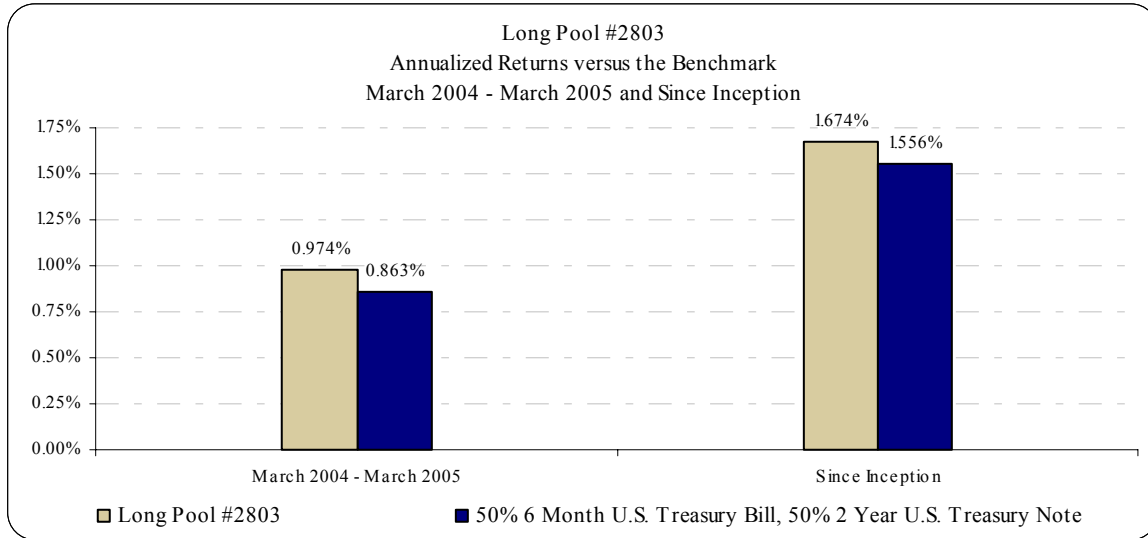
Long Pool Portfolio #2803 (“Long Pool”)

The Long Pool benchmark consists of 50% of the Six Month U.S. Treasury Bill and 50% of the Two Year U.S. Treasury Note. The duration of the benchmark varies during the five quarters but floats between 1.10 years and 1.20 years.



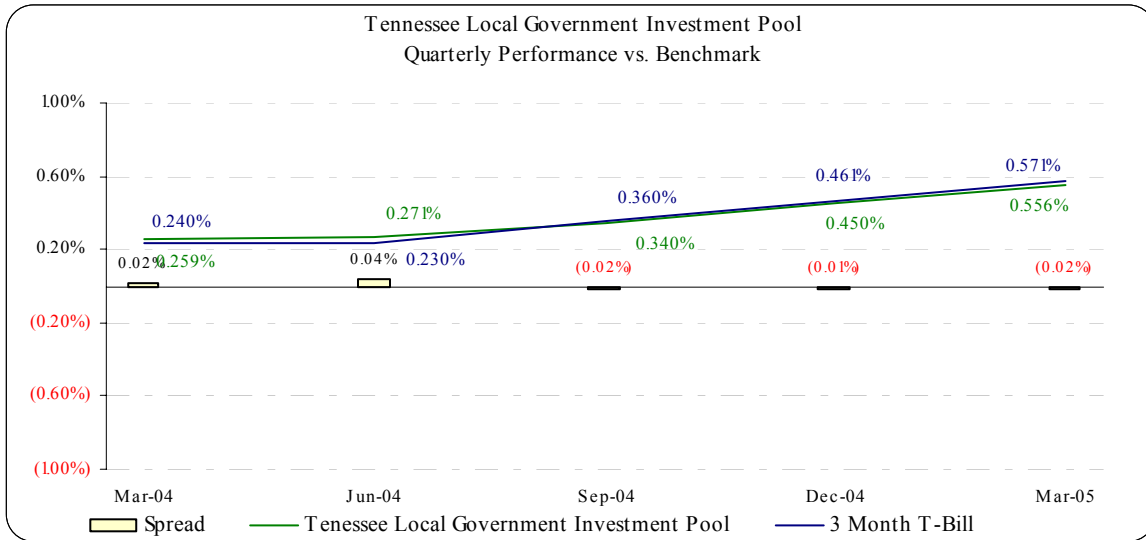
The chart above illustrates the Long Pool’s return between March 31, 2004 and March 31, 2005, the portfolio’s performance versus the benchmark fluctuated widely, underperforming the benchmark by 20 basis points for the quarter ended June 30, 2004 and outperforming the benchmark by 32 basis points in the quarter ended March 31, 2005. The duration of the Long Pool declines considerably from 1.21 years in March 31, 2004 to 0.65 years as of quarter ended March 31, 2005.

The Long Pool annualized return of 0.974% for the period March 31, 2004 through March 31, 2005 was 11 basis points higher than the benchmark Six Month U.S. Treasury Bill and 50% of the Two Year U.S. Treasury Note return of 0.863%. As of March 31, 2005 the Long Pool's since inception return of 1.674% was 12 basis points higher than the benchmark return of 1.556%.



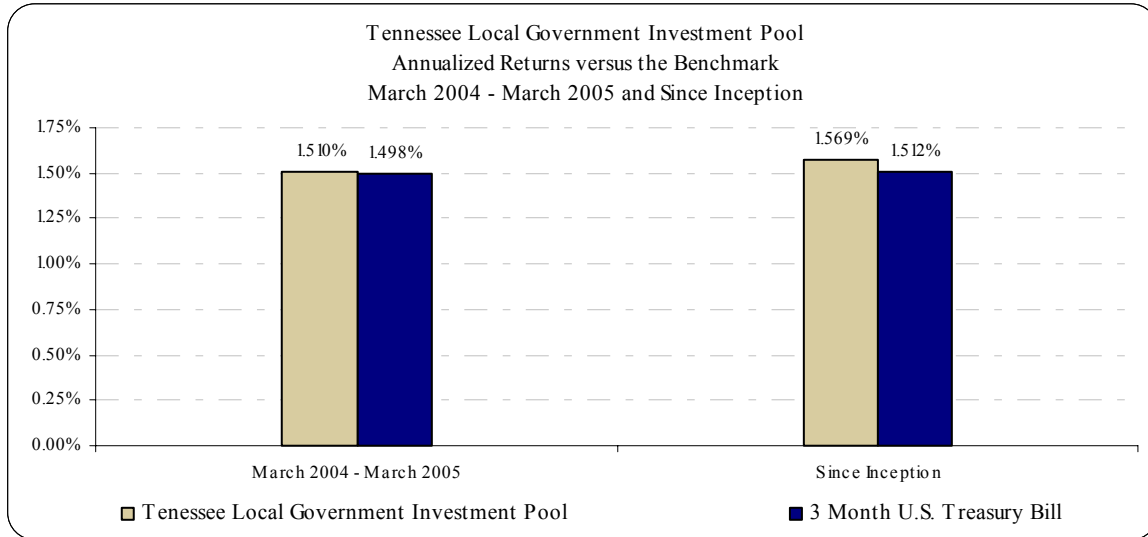
Tennessee Local Government Investment Pool (“TN LGIP”)

A portion of the MIP is invested in the TN LGIP which varied between 28% and 55% during the period March 31, 2004 and March 31, 2005. The benchmark of the TN LGIP is the Three Month U.S. Treasury Bill. The since inception return of the portfolio was 1.569% versus the benchmark return of 1.512%. The duration of the TN LGIP is limited to 90 days (0.25 years) which is in-line with the Three Month U.S. Treasury Bill duration.



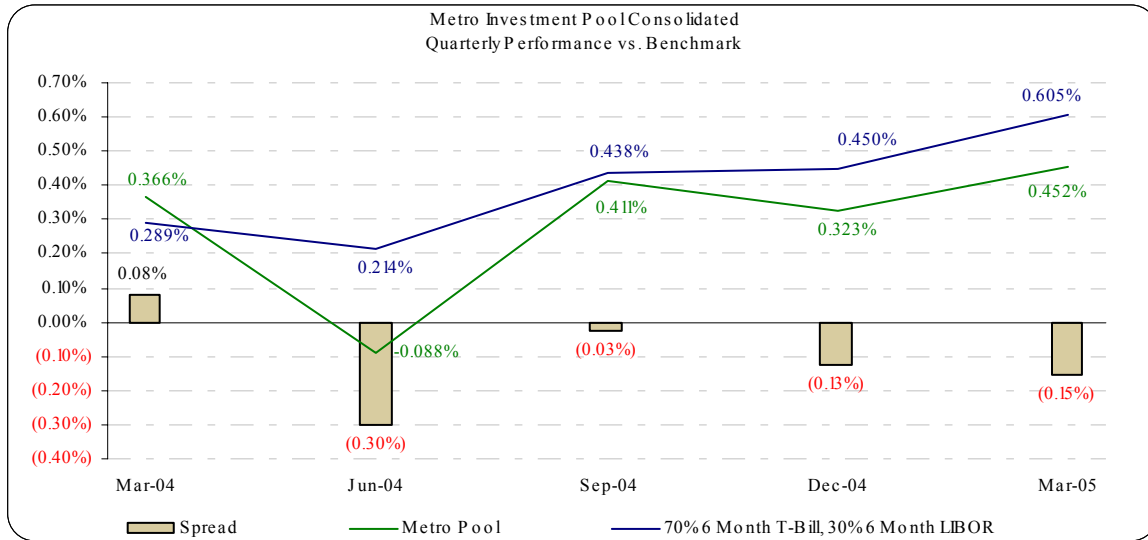
As the chart indicates the TN LGIP portfolio performs in-line with the benchmark in each quarter. The TN LGIP provides Metro with the liquidity and is utilized for short term investment strategies in certain market conditions. The TN LGIP is managed by the State of Tennessee’s Treasurer’s Office and the Investment Manager does not make investment decisions regarding the pool, but does make decisions regarding the level of investment of Metro’s assets which affects the return of the consolidated portfolio.

The TN LGIP annualized return of 1.510% for the period March 31, 2004 through March 31, 2005 was 1 basis point higher than the Three Month U.S. Treasury Bill benchmark return of 1.498%. As of March 31, 2005, the TN LGIP since inception return of 1.569% was 5 basis points higher than the benchmark return of 1.512%.



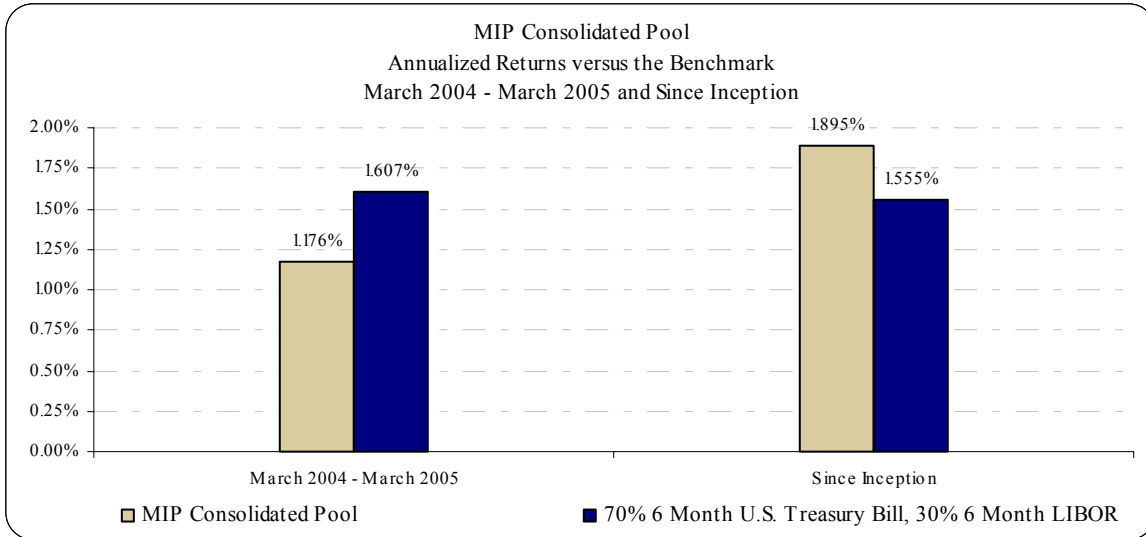
MIP Consolidated Pool (“MIP”)

The MIP Consolidated Pool is comprised of the Short Pool, the Long Pool, and the TN LGIP. The benchmark for the MIP is 70% Six Month U.S. Treasury and 30% of the Six Month LIBOR. The duration of the benchmark is fixed since the Six Month U.S. Treasury Bill and the Six Month LIBOR have constant durations of 0.50 years (180 days). The since inception return of the MIP Consolidated Pool is 1.895%, which is 34 basis points higher than the benchmark return of 1.555%.



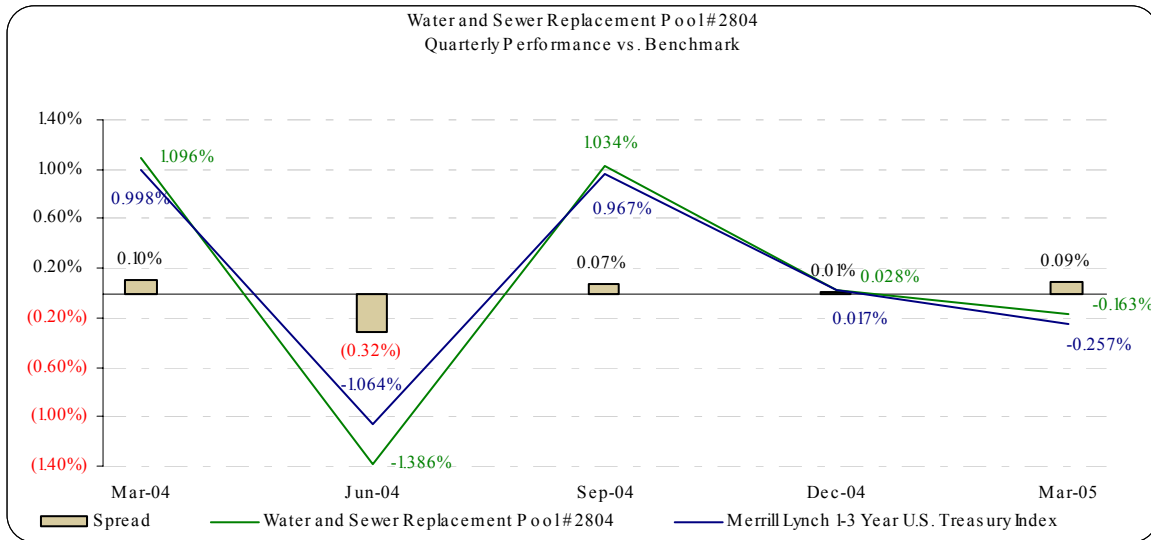
While the portfolio has performed well versus the benchmark since inception, for the quarters ended March 31, 2004 through March 31, 2005 the portfolio has underperformed the benchmark in four of the last five quarters. Some consideration of this underperformance should be given to the declining duration of the portfolio from 1.21 years on March 31, 2004 to 0.65 years on March 31, 2005.

The MIP Consolidated Pool annualized return of 1.176% for the period March 31, 2004 through March 31, 2005 was 43 basis points lower than the benchmark 70% Six Month U.S. Treasury and 30% of the Six Month LIBOR return of 1.607%. As of March 31, 2005, the MIP Consolidated Pool since inception return of 1.895% was 34 basis points higher than the benchmark return of 1.555%.



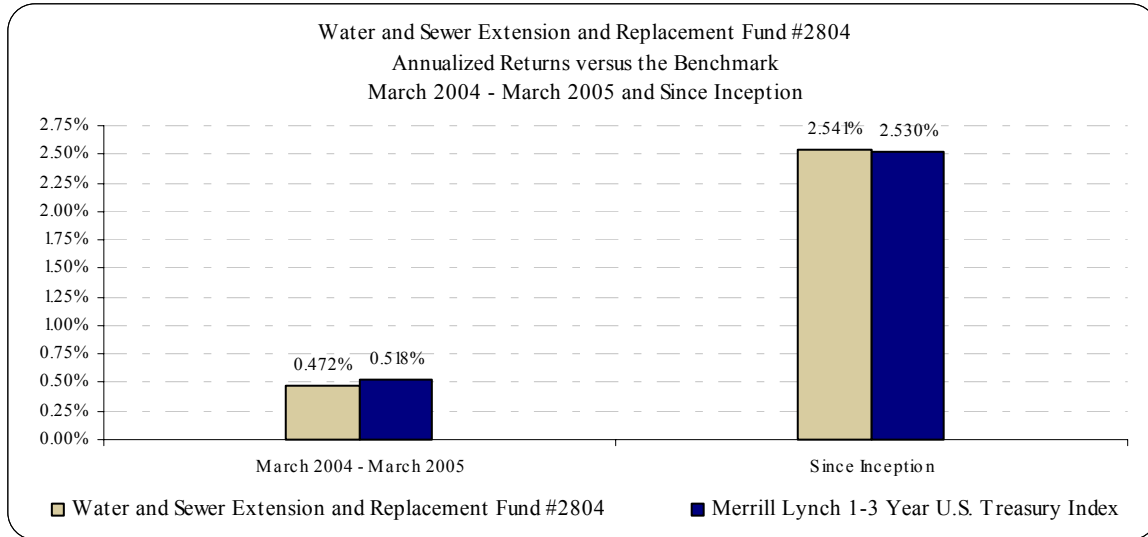
Water and Sewer Extension and Replacement Fund #2804 (“WSE Fund”)

The Water and Sewer Extension and Replacement Fund #2804 (“WSE Fund”) benchmark is the Merrill Lynch 1-3 Year U.S. Treasury Index. The duration of the benchmark varies slightly during the last five quarters as a result of the rebalancing of the benchmark. The WSE Fund duration declined slightly during the last five quarters, which may be a contributing factor to the return versus the benchmark. The since inception return of the WSE Pool is 2.541% versus the benchmark return of 2.53%.



While the portfolio has performed well versus the benchmark since inception, there were variations in performance from period to period for the quarters ended March 31, 2004 through March 31, 2005. The portfolio underperformed the benchmark by 9 and 32 basis points for the quarters ended March 31, 2004 and September 30, 2004, respectively. The portfolio outperformed the benchmark by 10, 7 and 1 basis points for the June 30, 2004, December 30, 2004 and March 31, 2005 quarters respectively.

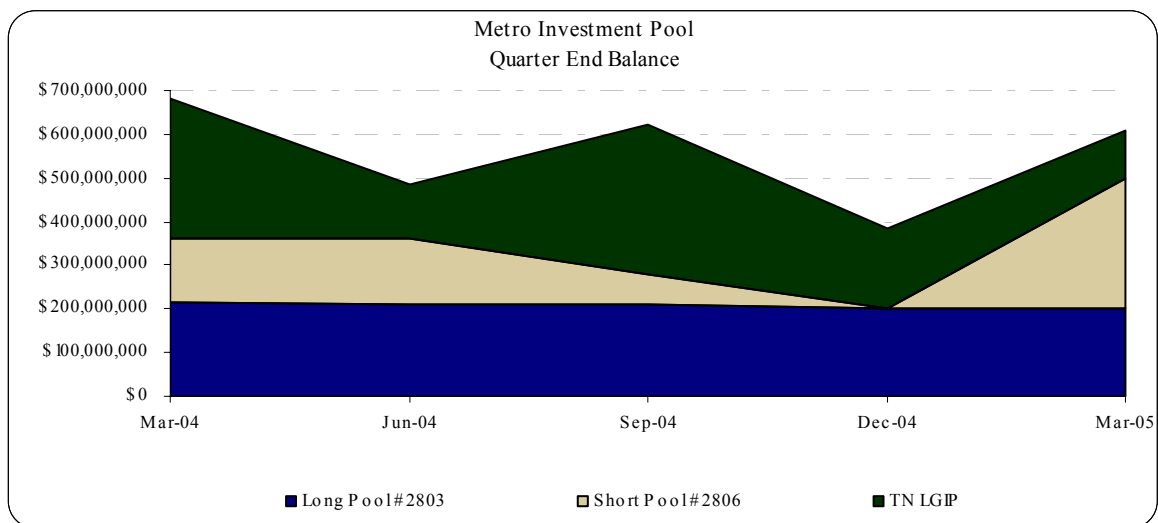
The WSE Fund annualized return of 0.472% for the period March 31, 2004 through March 31, 2005 was 4 basis points lower than the benchmark Merrill Lynch 1-3 Year U.S. Treasury Index return of 0.518%. As of March 31, 2005, the WSE Fund since inception return of 2.541% was 1 basis point higher than the benchmark return of 1.530%.



Review of Identifying Investment Dollars

Metro’s current investment strategy is maintaining separate portfolios with assets invested in an overnight investment vehicle, the TN LGIP, a short term portfolio (Short Pool) with an average maturity target of 180 days and a Longer Term Portfolio (Long Pool) with a target average maturity of 1.3 to 1.5 years and a duration target of 1 year. The WSE Fund is appropriately managed separately with an assumed duration target of 1.5 to 1.7 years given the selected Merrill Lynch 1-3 Year U.S. Treasury Index.

The chart below illustrates the portfolio balances within the MIP as of quarter end for March 31, 2004 through March 31, 2005. As the chart indicates, the Long Pool balance remains steady while the balances in the TN LGIP and Short Pool portfolios fluctuate from quarter to quarter.



To accurately identify the appropriate levels for each portfolio, a detailed fund by fund cash flow analysis should be created which will calculate short term and long term allocations for Metro’s overall investment program.

Developing a Customized Cash Flow Analysis

Once assets are identified, a cash flow analysis that is tailored for Metro should be developed to determine the appropriate level core and short term balances. In addition, the cash flow analysis should be customized to separate assets dedicated to specific functions such as bond proceeds for construction projects or one-time grant funds. The charts on the following page provide samples of results of the cash flow analysis.

The important element of the cash flow analysis is the determination of the “core” cash balance, which serves as one of the building blocks in the pursuit of improving an investment program. The “core” balance represents the minimum balance of funds maintained during a defined historical period. Fundamentally, the Cash Flow analysis attempts to calculate an approximate amount of “core” funds, which may be invested more strategically than funds that are needed on a short-term basis, such as operational funds. This balance often represents funds that could be invested more aggressively to potentially enhance rate of return on the investments. In addition, the “core” balance should be actively managed to out-perform an appropriate benchmark based on the cash flow needs and risk tolerance of the entity pursuant to the investment policy. It is important to note that the Cash Flow analysis is based on historical data and therefore is only estimated. Finally, the cash flow analysis is only part of the process of building an investment strategy.

This cash flow analysis is based on monthly cash balances by fund. For the long term portfolio the funds are considered appropriate for possible longer-term investment strategies. In addition, separate cash flow analyses should be created based on the sources of revenues and timing of expenditures, such as capital project funds.

The cash flow analysis serves as both an audit tool and a planning tool for determining the appropriate level of the core and short term portfolios. The cash flow analysis should be updated at least annually. The results of the Cash Flow analysis helps answer the following questions:

- How predictable are the cash flows?
- Is there a statistically significant seasonal pattern?
- Is there a growth trend?
- What will the portfolio balance be during any month?
- How much is available for longer-term investment?
- How much money should remain in overnight or other highly liquid investments?
- How much money can be invested out 30, 60, 90 or 120 days?

Calculation of the Short-Term and Core Portfolios

Short-Term Portfolio Calculation

If a positive net cash flow is anticipated, the short-term portfolio equals the cushion percentage.

Step 1. If a positive net cash flow is anticipated, the short-term portfolio equals the cushion percentage.

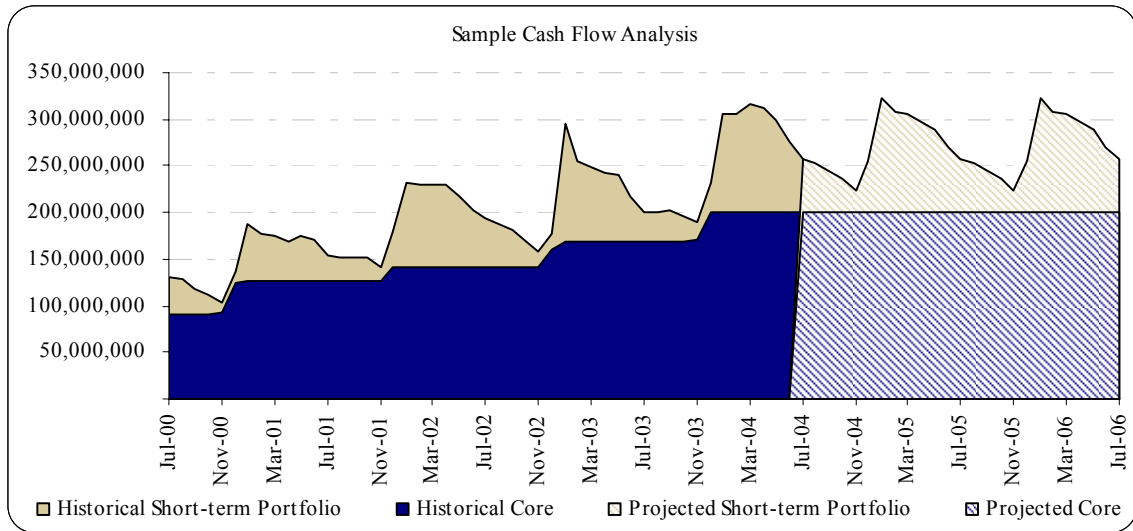
Step 2. If a negative net cash flow is anticipated, the short-term portfolio equals the projected negative net cash flow plus the cushion percentage.

Core Portfolio Calculation

The core is computed in two steps, as follows:

Step 1. Subtract the short-term portfolio allocation from the total portfolio balance. This is the "monthly core."

Step 2. Compute the minimum monthly core for the next 12 months. This is the actual core. The core is always a rolling 12-month average of the minimum monthly core.



Sample Cash Flow Analysis Report Illustration

The analytical information presented in the sample cash flow analysis below illustrates a cash flow analysis for a fiscal year end June 30, 2004 with a portfolio duration target of 1.5 years. As the sample analysis shows, based on the historical fund balances, the sample core portfolio is approximately \$214.9 million with a short term allocation of \$61.3 million.

SAMPLE CASH FLOW ANALYSIS

Maximum Maturity Range of Short-term Portfolio:	12 Months	
As of (month-end date):	June 30, 2004	
Maximum Weighted Average Maturity - Short Term Portfolio	365	
Maximum Weighted Average Maturity - Short Term Portfolio	365	
Combined Portfolio Weighted Average Maturity Requirement (Y/N)	Y	
If Yes (fill in the following)		
	Days	Years
Combined Portfolio Target Weighted Average Maturity:	548	1.500
Core Target Average Maturity:	548	1.500
Maximum Short-Term Portfolio:	548	1.500
Short-Term Allocation:	61,379,580	
Core Allocation:	214,882,891	
Total Portfolio:	276,262,471	

Projecting Portfolio Growth

In addition to calculating short-term and core balances based on historical month-end information, a cash flow analysis should be able to project the growth of the portfolios based on certain assumptions and the seasonality of revenues and expenditures. The analysis below illustrates how the portfolios growth may be projected using various growth options.

Project Growth? (Yes or No)	Yes
Growth Rate (Enter 1, 2, or 3):	1
Option 1=Historical Period Growth (annual rate):	19.2%
<i>Average Monthly Change:</i>	3,159,275
Option 2=Growth rate during a specific period:	19.2%
<i>Average Monthly Change:</i>	3,159,275
<i>Month End - Begin Date</i>	7/31/2000
<i>Month End - End Date</i>	6/30/2004
Option 3=Your Choice (Annual Growth Rate)	5.0%
<i>Average Monthly Change:</i>	1,054,571
Short-Term Portfolio Cushion:	10.0%
Compensating Balance Requirement:	0.00
Core Date:	June 30, 2006
Core Balance:	283,123,232

Summary of Findings and Recommendations

PFM's review of the performance and benchmarks of Metro's portfolios for the quarters ended March 31, 2004 through March 31, 2005, and since inception, indicates that Metro's portfolios have mixed results with regard to performance. The annualized returns for the MIP Consolidated Pool, Short Pool and WSE Fund portfolios underperformed the benchmark for the period March 31, 2004 through March 31, 2005 and the Long Pool and TN LGIP portfolios outperformed the benchmark by 11 basis points and 1 basis point, respectively. The since inception performance of the MIP Consolidated portfolio was 34 basis points over the benchmark and the since inception performance of the individual portfolios was between +1 basis point and +11 basis points.

Portfolio vs. Benchmark Return	March 2004 - March 2005	Since Inception
MIP Consolidated Pool	1.176%	1.895%
70% 6 Month T-Bill, 30% 6 Month LIBOR	1.607%	1.555%
Spread	(0.43%)	0.340%
Short Pool #2806	1.217%	1.552%
3 Month T-Bill	1.498%	1.512%
Spread	(0.28%)	0.040%
Long Pool #2803	0.974%	1.674%
50% 6 Month T-Bill, 50% 2 Year Treasury Note	0.863%	1.556%
Spread	0.11%	0.118%
Tennessee Local Government Investment Pool	1.510%	1.569%
3 Month T-Bill	1.498%	1.512%
Spread	0.01%	0.057%
Water and Sewer Extension and Replacement Fund #2804	0.472%	2.541%
Merrill Lynch 1-3 Year U.S. Treasury Index	0.518%	2.530%
Spread	(0.05%)	0.011%

PFM also found that the duration of the portfolios compared to the benchmarks, with exception to the WSE Fund portfolio, decreased over time. Short durations typically protect the market value of a portfolio in an increasing interest rate environment, but the considerably short durations of Metro's MIP portfolios may have contributed to the performance of the portfolios. Also, Metro's cash flow needs more than likely contributed to the total return of the MIP and the Short Pool in particular. The Short Pool balance decreased to zero as of December 31, 2004 and then re-funded during the quarter ended March 31, 2005 which has possibly affected the total return.

PFM recommends constructing a detailed cash flow analysis based on historical balances of each fund within the general ledger. A cash flow analysis will identify long term and short term assets and will factor in the seasonality of the inflow of revenues and the outflow of expenditures. The analysis should be conducted on a fiscal year basis to account for the full revenue/expenditure cycle.

PFM recommends changing the benchmark for the Long Pool to an index such as the Merrill Lynch 1-3 Year U.S. Treasury Index or similar index. PFM also recommends increasing the maximum maturity for individual securities within the Long Pool portfolio to 5 years and a portfolio duration of 2 years. This will increase the target duration of the Long Pool portfolio to 1.5 to 1.7 years, inline with the duration of a Merrill Lynch 1-3 Year U.S. Treasury index. Once long term assets are identified using

the cash flow analysis, these assets should be managed separately and performance measured against the selected benchmark.

The Short Pool's Three month U.S. Treasury Bill benchmark appears appropriate given the average term to maturity of no greater than 180 days. The Short Pool balance fluctuated widely between March 31, 2004 and March 31, 2005 with a high of \$296,716,255 and a low of zero. This considerable change in balance from quarter to quarter will affect the return of the portfolio which should be considered when compared to a benchmark with a stable duration.

The TN LGIP's benchmark of Three month U.S. Treasury Bill also appears appropriate given the TN LGIP's 79 average days to maturity and maximum average maturity of 90 days. It is important to note that the TN LGIP is a 2a-7 like fund and does not have a fluctuating Net Asset Value, and therefore, while the total return of the Three Month U.S. Treasury Bill Index may experience a negative total return for a quarter, the TN LGIP will likely not experience a yield (return) that is less than zero. The Investment Manager does not control the investments of the TN LGIP, but should provide Metro with insight regarding the level of non-core assets that should be invested in the TN LGIP versus other short-term investments such as discount notes and commercial paper. The balance in the TN LGIP was wide-ranging for the period March 31, 2004 through March 31, 2005 with a high of \$346.3 million for quarter ended September 30, 2004 and a low of \$110.7 million as of March 31, 2005.

PFM recommends the elimination of the 70% 6 Month U.S. Treasury Bill/30% 6 Month LIBOR benchmark for the MIP and maintain separate performance benchmarks for each portfolio within the MIP. Each portfolio should be managed separately and should be structured based on the results of a detailed cash flow analysis. The performance of each portfolio within the MIP should be measured individually as is currently presented in the quarterly report, but the MIP Consolidated performance should not be included.

The WSE Fund portfolio's Merrill Lynch 1-3 Year U.S. Treasury Index benchmark is appropriate as long as the balance in this fund is expected to remain somewhat stable. For the period March 31, 2004 through March 31, 2005 the balance in the portfolio decreased 19% from \$192 million to \$156 million. If this trend is expected to continue the benchmark should be reconsidered to reflect the short term nature of the portfolio.

PFM's Recommendations Based On Our Cash Benchmark Study

- Eliminate the MIP Consolidated benchmark for performance measurement;
- Metro should utilize a composite return for the MIP which is a weighted average for the Long Pool, the Short Pool and the TN LGIP;
- Detailed portfolio holding information should be provided to Metro in each quarterly report to confirm compliance;
- Create a cash flow analysis that identifies assets available for short term and long term investments;
- Increase the maturity limit for individual securities to five years and a portfolio duration of two years;
- Utilize the Merrill Lynch 1-3 Year U.S. Treasury Index or similar index for the Long Pool;
- Establish per issuer limits for Federal Agencies of 40%;
- Include Month-end statements with quarterly performance reports; and
- Include duration and weighted average maturity information in the quarterly reports.