



**ILLINOIS METROPOLITAN INVESTMENT FUND**

Annual Financial Report

September 30, 2004

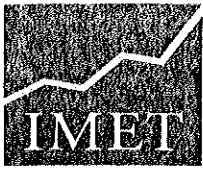
(With Independent Auditors' Report Thereon)

# ILLINOIS METROPOLITAN INVESTMENT FUND

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**INTRODUCTORY SECTION**



# Illinois Metropolitan Investment Fund

Investing together for  
our communities

Scott Bordui  
Finance Director  
Village of Flossmoor  
*Chairman*

Gary Holmes  
Village Administrator  
Village of Lemont  
*Vice Chairman*

Robert Nowak  
Finance Director  
Village of Skokie  
*Treasurer*

William Brimm  
Assistant Village Manager  
and Finance Director  
Village of Buffalo Grove  
*Secretary*

John Crois  
Village Manager  
Village of Westchester  
*Trustee*

Leonard Flood  
Finance Director  
Village of Lombard  
*Trustee*

Christy Powell  
Finance Director  
Village of Riverside  
*Trustee*

Laura Vesecky  
Director of Financial Services  
and Administration  
Intergovernmental Risk  
Management Agency  
*Trustee*

Michelle Saddler  
*Executive Director*

Dear Fellow IMET Participants:

I am pleased to submit to you the eighth Annual Financial Report of the Illinois Metropolitan Investment Fund (IMET) which covers the fiscal year of October 1, 2003 through September 30, 2004. The 2003-2004 fiscal year was one of success and progress, as IMET consistently continued to meet its investment objective and as the Board and staff brought further refinements to IMET as a membership organization. The year brought further success, as IMET effectively faced both marketing and operational challenges brought on by rising interest rates and mergers in the banking industry.

First and foremost, IMET continued to meet its investment objective of meeting or exceeding the performance on the Lehman 1-3 year government bond index. We are pleased that this objective was accomplished for the all multi-year periods as well as since inception of the fund. Gross of fees, IMET provided a return of 1.24 percent for the fiscal year ended September 30<sup>th</sup> versus the benchmark return of 1.17 percent. Net of fees, IMET provided a .98 percent return to participants for the fiscal year.

In June of 2004, the Federal Open Markets Committee finally met market expectations by beginning a long-awaited series of moves to increase short-term interest rates. The expectation of ongoing tightening caused volatility in the 1-3 year government bond market, and caused shorter-term, money market instruments to show greater strength in certain months and for the fiscal year end.

In anticipation of rising interest rates, IMET was pleased to begin the fiscal year with the introduction of the new IMET Convenience Fund. The Convenience Fund provides a high yielding, liquid investment alternative for IMET investors with lower risk tolerance and near-term liquidity needs. IMET members are able to make tactical adjustments, shifting positions slightly into the IMET Convenience Fund while keeping 1-3 year designated funds invested with IMET. The introduction of this new fund, together with dissemination of numerous capital markets studies, enabled IMET to end the year with relatively minor adjustments to IMET's total asset base.

IMET is proud of its other accomplishments during the fiscal year:

- Six public entities joined the IMET fund during the 2004 fiscal year, bringing the total membership to 160 municipalities and other public agencies. This increase in membership underscores the confidence that public agencies have in IMET and the value of diversification throughout market cycles.
- During the 2004 fiscal year, The Nominating Committee completed its review of the Declaration of Trust and recommended amendments to promote involvement and participation by the membership on the IMET Board of Trustees. In addition to modifying the nomination and election process, the Board also extended an invitation for IMET members to serve

on various standing committees, including the Audit, Personnel, New Products Committee, and – on an ad hoc basis – the Vendor Selection Committee.

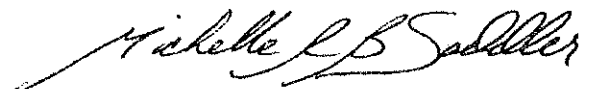
- IMET in FY2004 codified many of its policies and procedures. Most notably, responsibilities of board and committee members were formalized, a personnel policy was drafted and finalized, and all governing documents were gathered into a handbook of policies and procedures.
- IMET made a successful transition in leadership, as we thanked and bid farewell to Grace Turi, who served as IMET's chairman for five years from 1999 until 2004. After serving on the Board for six years and chairing the New Products Committee, I became the new IMET Chair, and Riverside Finance Director Christy Powell joined the Board as the new representative from the West Central Municipal Conference.
- With the able assistance of Smith Barney, IMET this year began to track the long-term benefit of diversification into 1-3 year investments. Numerous 10, 15, and 25-year studies highlight the fact that, over market cycles, the one-to-three year area is an optimal horizon in which to diversify a core investment portfolio. As we update and monitor these studies to inform the IMET membership, the studies continually show that the greatest marginal increase in yield - with the smallest downside during rising rate environments - is gained by extending maturities to the one-to-three year horizon.
- Significantly, this year IMET successfully weathered mergers experienced by two of our key banking partners. In the merger between Bank One and JPMorgan/Chase, IMET's portfolio management team remained fully intact. Further, in an acquisition of Fifth Third's corporate trust business by the Bank of New York, IMET was able to remain with Fifth Third and avoid an ill-timed, involuntary conversion to a new custodial bank.

Last but certainly not least, we are proud that IMET continues to receive the **Aaa/MR1** ratings, the highest ratings available from Moody's Investors Service for both credit risk and market risk. Together with the IMET Board and staff, I look forward to our ongoing work with both new and longstanding IMET participants for the long-term success of the IMET fund.

In service with you,



Scott Bordui  
IMET Chair



Michelle R.B. Saddler  
IMET Executive Director

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Board of Trustees

September 30, 2004

**ILLINOIS METROPOLITAN INVESTMENT FUND**

1616 E. Golf Road  
Des Plaines, IL 60016  
Telephone: (847) 296-9200, ext. 38  
Facsimile: (847) 296-9207

**BOARD OF TRUSTEES**

Chairman: Scott Bordui  
Village of Flossmoor

Vice Chairman: Gary Holmes  
Village of Lemont

Treasurer: Robert Nowak  
Village of Skokie

Secretary: William Brimm  
Village of Buffalo Grove

Trustee: John Crois  
Village of Westchester

Trustee: Leonard Flood  
Village of Lombard

Trustee: Christy Powell  
Village of Riverside

Trustee: Laura Vesecky  
Intergovernmental Risk Management Agency

Executive Director: Michelle R.B. Saddler

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Supporting Chicago Area Councils of Government

External Advisors

September 30, 2004

**SUPPORTING CHICAGO AREA COUNCILS OF GOVERNMENT**

**DUPAGE MAYORS AND MANAGERS CONFERENCE**

Mark Baloga  
Executive Director

**NORTHWEST MUNICIPAL CONFERENCE**

Mark Fowler  
Executive Director

**SOUTH SUBURBAN MAYORS AND MANAGERS ASSOCIATION**

Ed Paesel  
Executive Director

**WEST CENTRAL MUNICIPAL CONFERENCE**

Donald Storino  
Executive Director

**WILL COUNTY GOVERNMENTAL LEAGUE**

Steven Quigley  
Executive Director

**EXTERNAL ADVISORS**

**INVESTMENT ADVISOR**

Banc One Investment Advisors  
Chicago, Illinois  
Columbus, Ohio

**FUND ACCOUNTANT AND CUSTODIAN**

Fifth Third Bancorp  
Rolling Meadows, Illinois

**INDEPENDENT AUDITORS**

KPMG LLP  
Chicago, Illinois

**EXTERNAL PERFORMANCE MONITORING**

The Consulting Group of  
Salomon Smith Barney

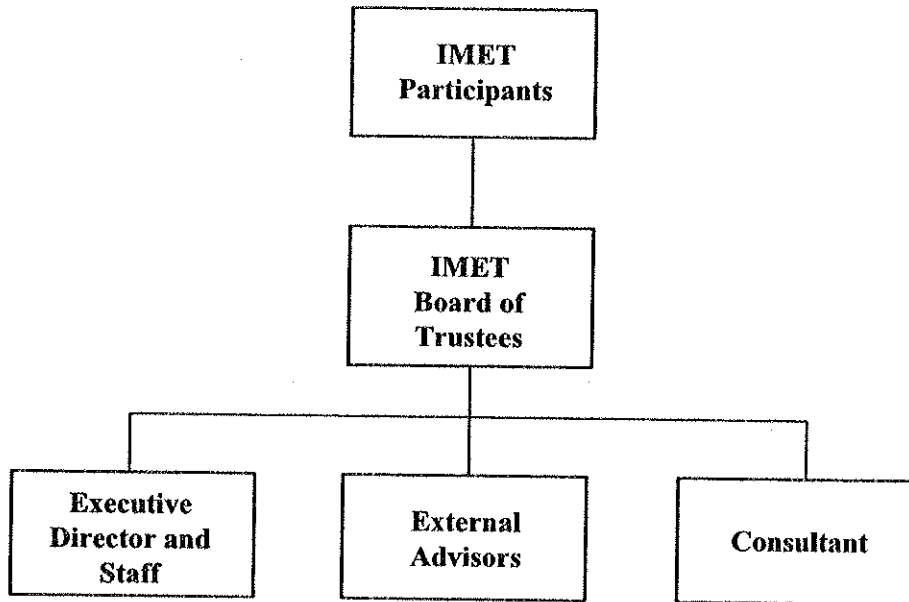
**LEGAL COUNSEL**

Chapman & Cutler  
Chicago, Illinois

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Organizational Chart

September 30, 2004





**FINANCIAL SECTION**



**KPMG LLP**  
303 East Wacker Drive  
Chicago, IL 60601-5212

## **Independent Auditors' Report**

The Board of Trustees  
Illinois Metropolitan Investment Fund:

We have audited the accompanying combining statement of net assets of the Illinois Metropolitan Investment Fund (IMET) as of September 30, 2004, and the related combining statement of changes in net assets for the year then ended. These financial statements are the responsibility of the Board of Trustees. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the board of trustees, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 2(g), the reporting entity of IMET was changed to include the IMET Convenience Series during the year ended September 30, 2004.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Illinois Metropolitan Investment Fund as of September 30, 2004, and the changes in its net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 9 through 11 and the schedule of funding progress on page 20 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Investments as of September 30, 2004 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The introductory and statistical sections have not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on them.

**KPMG LLP**

January 8, 2005

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Management Discussion and Analysis

Year ended September 30, 2004

Management is pleased to provide this overview and analysis of the financial activities of the Illinois Metropolitan Investment Fund (IMET) for the year ended September 30, 2004. This information is intended to supplement the financial statements, which begin on Page 13 of the report. We encourage readers to consider additional information in the Fund's *First Amended and Restated Declaration of Trust*, as amended and approved on March 22, 2002.

#### Financial Highlights

During fiscal year 2004, total assets of IMET (including IMET 1-3 Year Series and IMET Convenience Series) decreased by \$8,350,017 to a balance of \$298,907,656 as of September 30, 2004. Total assets of the IMET 1-3 Year Series decreased by \$19,234,458 to a balance of \$286,573,215, while total assets of the IMET Convenience Series increased by \$10,884,441 to a balance of \$12,334,441 as of September 30, 2004.

Participant's equity in IMET was \$297,435,624 (\$285,110,546 in the IMET 1-3 Year Series and \$12,325,078 in the IMET Convenience Series) as of September 30, 2004 and \$301,896,900 (\$300,446,900 in the IMET 1-3 Year Series and \$1,450,000 in the IMET Convenience Series) as of September 30, 2003.

During fiscal year 2004, the IMET 1-3 Year Series achieved its investment objective of meeting or exceeding the return on the Lehman Index on a gross basis. The IMET 1-3 Year Series ended the fiscal year with a gross one-year return of 1.24% versus a one-year return of 1.17% for the Lehman Index. The Federal Reserve's policymaking Open Market Committee (FOMC) tightened monetary policy three times during the 2004 fiscal year. The FOMC increased the fed funds target rate by 25 basis points in each respective month of June, August and September of 2004. The consecutive rate increases resulted in the shorter-term three-month Treasury bill index outperforming the IMET 1-3 Year Series' net return for the 2004 fiscal year. Net of fees, the IMET 1-3 Year Series provided a net 12-month performance of .98% in 2004 versus the net one-year return of 1.10% for 90-day Treasury bills. During fiscal year 2004, the first full year of the IMET Convenience Series, the one-year return was 1.00%. The IMET Convenience Series returns are pegged to the Fed Funds target rate less 10 basis points. The positive performance of the IMET 1-3 Year Series, on an absolute basis, continues to be driven by the Investment Advisor's bottom-up identification of undervalued securities and sectors across U.S. Treasuries, U.S. Agencies, and Mortgage-backed markets. The positive performance of the IMET Convenience Series continues to be driven by the strength of IMET's beneficial arrangement with JP Morgan Chase to pay interest earnings based on the fed funds target rate less 10 basis points.

#### Overview of the Financial Statements

The two basic financial statements of IMET are the *Combining Statement of Net Assets* and the *Combining Statement of Changes in Net Assets*. The statements are prepared in conformity with accounting principles generally accepted in the United States.

The *Combining Statement of Net Assets* is a measure of IMET's assets and liabilities at the close of the fiscal year. Total assets less liabilities equal net assets held in trust for IMET participants.

The *Combining Statement of Changes in Net Assets* shows purchases to and redemptions (withdrawals) from IMET, as well as additions and deductions due to operations during the fiscal year. The net increase (or decrease) is the change in net assets owned by participants since the end of the previous fiscal year.

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Management Discussion and Analysis

Year ended September 30, 2004

The *Notes to Financial Statements* are a fundamental part of the financial statements and provide important information to augment the figures in the financial statements. The notes describe accounting policies and other financial information.

A *Schedule of Investments* is included to detail the types and amount of investment instruments held by the IMET 1-3 Year Series.

### Financial Statement Analysis

#### *Net Assets*

Net assets of IMET increased \$18,128,528 (6.39%) during the fiscal year ended September 30, 2003. In part, this increase was the result of \$10,455,139 in net additions (versus redemptions) from IMET participants. The increase was also the result of \$7,673,389 in net addition from operations in the IMET 1-3 Year Series (interest earned on the IMET portfolio less unrealized depreciation and operating expenses). At September 30, 2003, 98% of IMET's net assets consisted of investments in securities. Other assets consisted of cash and short-term investments, interest receivable, and receivables for investments sold. Liabilities consisted of accrued management, consulting, and administrative fees, as well as payables for investments purchased but not settled.

During the year ended September 30, 2004, net assets of IMET decreased by \$4,461,276. In part, this decrease was the result of \$52,969,168 in total redemptions by IMET participants that exceeded participant's new additions of \$45,634,699. Redemptions from the IMET 1-3 Year Series totaled \$43,292,389, while the IMET Convenience Series redemptions totaled \$9,676,779. Much of the redemption activity was due to the withdrawal of bond proceeds to meet the payment drawdowns on various construction projects. Fiscal 2004 additions (versus redemptions) from IMET participants consisted of \$25,179,747 in the IMET 1-3 Year Series and \$20,454,952 in the IMET Convenience Series. At September 30, 2004, 95% of IMET's net assets consisted of investments in securities. Other assets consisted of cash and short-term investments (including amounts invested by the IMET Convenience Series), interest receivable, and receivables for paydowns from investments. Liabilities consisted of accrued management and administrative fees, as well as a one-day cash overdraft. The overdraft resulted from a portfolio management error; a security purchase was made at year-end, one day prior to funds being available for settlement.

#### *Operations*

For fiscal 2004, IMET 1-3 Year Series produced a gross return of 1.24% versus the Lehman 1-3 Year Government Bond Index return of 1.17%, and a net return of 0.98% to IMET 1-3 Year Series participants. The IMET Convenience Series produced a total annualized return of 1.00% for fiscal 2004, the first year of the Convenience Series.

For comparative purposes, in fiscal 2003 investment operations resulted in a gross total return of 2.89% and a net return of 2.59% to participants in the IMET 1-3 Year Series. During the same fiscal year, the Lehman 1-3 Government Bond Index, IMET's performance benchmark, provided a total return of 2.80%.

For additional information regarding performance returns of IMET 1-3 Year Series and asset allocation please refer to the Statistical Section on page 24 of this report.

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Management Discussion and Analysis

Year ended September 30, 2004

During the current fiscal year ended September 30, 2004, total additions from operations consisted of \$8,771,551 in interest income offset by net depreciation in fair value of investments of \$5,133,777. These amounts may be compared with \$10,953,334 of interest income and \$2,442,396 net depreciation in fair value of investments during the prior fiscal year, for total additions of \$2,873,193 in FY 2004 compared to \$7,673,389 in FY03. Interest income decreased primarily as a result of a lower interest rate environment during fiscal year 2004.

Operating expenses of the IMET 1-3 Year Series and the IMET Convenience Series were \$755,218 and \$9,363, respectively, for a combined total of \$764,581 for the current fiscal year compared with \$837,549 for the prior fiscal year. The primary reasons for the decrease in operating expenses were lower consulting fees as well as lower management and administrative services fees. As described in note 4(b) to the financial statements, IMET 1-3 Year Series did not incur a consulting fee for the 2004 fiscal year. Lower management fee expense in 2004 coincided with a decrease in average net assets for IMET 1-3 Year Series during the year.

#### Summary of IMET Operations

Past IMET Chairman Grace Turi resigned from the Board of Trustees effective February 20, 2004. Grace had served as the chair since 1999 and was one of the founding members of the IMET Board. Grace's departure from the board left a vacancy in the chairman's seat as well as a vacancy for a delegate from the West Central Municipal Conference (WCMC). Scott Bordui, Director of Finance for the Village of Flossmoor and IMET's delegate from the South Suburban Mayors & Managers Association, was elected to the chairmanship following Grace's resignation, while Christy Powell, Director of Finance for the Village of Riverside, was appointed to the Board of Trustees to represent the West Central Municipal Conference.

During fiscal year 2004, Fifth Third Bank's Trust Services were purchased by the Bank of New York. Fifth Third Bank provides IMET's fund accounting, transfer agency and custodial services. Through negotiations with the Bank of New York, Fifth Third was able to retain the IMET account and continues to provide custodial services for IMET.

Another bank merger in 2004 affecting IMET was the purchase of Bank One by JP Morgan Chase. Banc One Investment Advisors Corporation (BOIA), the investment advisory arm of Bank One Corporation, provides IMET's portfolio investment management services. As a result of the merger, there were some changes in key personnel working with and representing IMET. Steve Eitel, the most recent IMET relationship manager, resigned. Steve's position has been filled by Danielle Cassidy, who will be taking over the IMET relationship. There were no changes, however, to the Bank One portfolio management team and there are no foreseeable changes planned.

#### *Requests for Information*

Questions about any information provided in this report should be addressed to:

The Illinois Metropolitan Investment Fund (IMET)  
ATTN: Executive Director  
1616 East Golf Road  
Des Plaines, IL 60016

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Combining Statement of Net Assets

September 30, 2004

Assets	IMET 1-3 Year Series	IMET Convenience Series	Total
Cash and short-term investments	\$ 158,059	12,331,331	12,489,390
Interest receivable	3,091,232	3,110	3,094,342
Receivable for investment paydowns	15,707	—	15,707
Investments at fair value:			
U.S. Treasury obligations	177,974,505	—	177,974,505
U.S. Government agency obligations	98,279,105	—	98,279,105
Mortgage backed securities	5,284,347	—	5,284,347
Money market mutual funds	1,770,260	—	1,770,260
Total investments	283,308,217	—	283,308,217
Total assets	286,573,215	12,334,441	298,907,656
Liabilities			
Payables:			
Cash overdraft	1,397,195	—	1,397,195
Management fee	27,974	—	27,974
Administrative and other	37,500	9,363	46,863
Total liabilities	1,462,669	9,363	1,472,032
Net Assets			
Net assets held in trust for participants (units outstanding: 18,743,658 and 12,325,078 at September 30, 2004 for IMET 1-3 Year Series and IMET Convenience Series, respectively; equivalent to \$15.21 and \$1.00 per unit outstanding at September 30, 2004 for IMET 1-3 Year Series and IMET Convenience Series, respectively)	\$ 285,110,546	12,325,078	297,435,624

See accompanying notes to financial statements.

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Combining Statement of Changes in Net Assets

Year ended September 30, 2004

	<u>IMET 1-3 Year Series</u>	<u>IMET Convenience Series</u>	<u>Total</u>
<b>Additions from operations:</b>			
Investment income:			
Interest	\$ 8,665,283	106,268	8,771,551
Net appreciation (depreciation) in fair value of investments	(5,133,777)	—	(5,133,777)
Total additions from operations	<u>3,531,506</u>	<u>106,268</u>	<u>3,637,774</u>
<b>Deductions from operations:</b>			
Operating expenses:			
Management and administrative services	474,154	3,745	477,899
Compensation and related expenses	190,126	—	190,126
Professional services	22,704	—	22,704
Insurance	31,613	—	31,613
Audit	17,500	5,618	23,118
Marketing	7,816	—	7,816
Administrative and other	11,305	—	11,305
Total operating expenses	<u>755,218</u>	<u>9,363</u>	<u>764,581</u>
Net additions from operations	<u>2,776,288</u>	<u>96,905</u>	<u>2,873,193</u>
<b>Distributions:</b>			
Distributions of income to participants	—	(96,905)	(96,905)
Total distributions	<u>—</u>	<u>(96,905)</u>	<u>(96,905)</u>
<b>Capital share and individual account transactions:</b>			
Proceeds from sale of units to participants	25,179,747	20,454,952	45,634,699
Distributions reinvested by participants	—	96,905	96,905
Cost of units redeemed by participants	(43,292,389)	(9,676,779)	(52,969,168)
Net additions from capital shares and individual account transactions	<u>(18,112,642)</u>	<u>10,875,078</u>	<u>(7,237,564)</u>
Net increase (decrease)	<u>(15,336,354)</u>	<u>10,875,078</u>	<u>(4,461,276)</u>
<b>Net assets held in trust for participants:</b>			
Beginning of year	<u>300,446,900</u>	<u>1,450,000</u>	<u>301,896,900</u>
End of year	<u>\$ 285,110,546</u>	<u>12,325,078</u>	<u>297,435,624</u>

See accompanying notes to financial statements.

# ILLINOIS METROPOLITAN INVESTMENT FUND

## Notes to Financial Statements

September 30, 2004

### (1) General Information

The Illinois Metropolitan Investment Fund (IMET), which was formed on July 17, 1996, actively manages two investment funds for municipal treasurers, official custodians of municipal funds, and other public agencies in the state of Illinois. These funds are the IMET 1-3 Year Series and the IMET Convenience Series.

The IMET 1-3 Year Series is designed as an investment vehicle for funds not required for immediate expenditure and which are available for investment in securities with average maturities and returns generally greater than those for money market instruments.

The objectives of the IMET 1-3 Year Series are to provide a high current yield while maintaining safety and liquidity and to offer participation in a diversified portfolio of high-quality fixed income instruments permitted for investment under the Public Funds Investment Act of the State of Illinois. The IMET 1-3 Year Series seeks to ensure the preservation of capital with the objective of obtaining an appropriate market rate of return in relation to the prevailing monetary environment as measured by the Lehman Brothers 1-3 year Government Bond Index.

The IMET Convenience Series was established on September 2, 2003 as an investment alternative exclusively for IMET participants. All IMET participants have immediate access to an IMET Convenience Series account; no additional application is needed. The IMET Convenience Series is a fully collateralized, short-term money market instrument with one-day liquidity. It currently provides a return that is pegged to the fed funds target interest rate less ten basis points. It is intended for use as a short-term investment for funds that may or may not be needed for near-term disbursement.

The objective of the IMET Convenience Series is to provide a high current return while maintaining the safety and liquidity of public funds. The IMET Convenience Series serves as a companion vehicle to the IMET 1-3 Year Series and Arbitrage Rebate Calculation service. It provides a money market vehicle for the convenient investment of bond proceeds, for the temporary investment of longer-term intermediate funds, and/or for cash management and liquidity purposes.

### (2) Significant Accounting Policies

#### (a) Reporting Entity

As defined by generally accepted accounting principles established by the Governmental Accounting Standards Board (GASB), the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either a) the ability to impose will by the primary government, or b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

Based upon the required criteria, IMET has no component units and is not a component unit of any other entity.



## ILLINOIS METROPOLITAN INVESTMENT FUND

### Notes to Financial Statements

September 30, 2004

**(b) *Cash and Short-term Investments***

At September 30, 2004, the IMET 1-3 Year Series had \$158,059 segregated for administrative costs. These funds are invested in money market funds and included as cash and short-term investments on the statement of net assets.

The IMET Convenience Series' assets are invested in a time deposit account at Bank One, and included in cash and short-term investments on the statement of net assets. The interest rate on the account was 1.65% at September 30, 2004.

**(c) *Security Valuation***

Investments of the IMET 1-3 Year Series are reported at fair value based on market quotations obtained from a third-party provider. Securities for which quotations are not available are stated at fair value determined by the board of trustees.

The IMET Convenience Series' investment is reported at cost, which approximates fair value based on the nature of the investment.

**(d) *Security Transactions and Income***

Security transactions are accounted for no later than one business day after the securities are purchased or sold. Gains and losses on investments are realized at the time of the sale and the cost of securities sold is determined on the first in, first out basis. Interest income from fixed income and money market investments is accrued on a daily basis. Discounts and premiums on all fixed income securities are amortized or accreted on a constant yield basis.

**(e) *Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of changes in net assets held in trust for participants during the reporting period. Actual results could differ from those estimates.

**(f) *Subscriptions and Redemptions***

Participants may subscribe to either of the funds on any business day. Purchase instruction received by the Funds before 12:00 noon is credited to accounts at the net asset value as of the close of business that day. Participants may redeem shares of the IMET 1-3 Year Series with five days notice at the net asset value as of the close of business on the third business day following the day of notification. Participants may redeem from the IMET Convenience Series with one day notice at the net asset value as of the day following notification.

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Notes to Financial Statements

September 30, 2004

**(g) Change in Accounting**

Prior to fiscal year 2004, the activities reported for the Illinois Metropolitan Investment Fund consisted solely of the IMET 1-3 Year Series. Effective October 1, 2003, the financial statements of the Illinois Metropolitan Investment Fund also include the IMET Convenience Series, which was established on September 2, 2003. The Series are presented in separate columns in the combining statement of net assets and the combining statement of changes in net assets.

**(3) Deposits and Investments**

At September 30, 2004, the bank balance and carrying amount of the IMET 1-3 Year Series' deposits were \$(1,188,108) and \$(1,237,136), representing the balance of cash and short-term investments, net of the cash overdraft balance. The deposits of the IMET 1-3 Year Series are insured, registered, or collateralized by securities recorded in the IMET 1-3 Year Series' name and held by the IMET 1-3 Year Series' agent.

At September 30, 2004, the bank balance and carrying amount of the IMET Convenience Series' deposits was \$12,331,331. The deposits of the IMET Convenience Series are insured, registered, or collateralized by securities recorded in the IMET Convenience Series' name and held by the IMET Convenience Series' agent.

The following table presents a summarization of the fair values and duration of the IMET 1-3 Year Series investments at September 30, 2004.

	Fair value	Duration (in years)
U.S. Treasury obligations	\$ 177,974,505	1.81
U.S. Government agency obligations	98,279,105	1.54
Mortgage backed securities	5,284,347	1.24
Money market mutual funds	1,770,260	—
Total investments	\$ 283,308,217	1.71

**(a) Interest Rate Risk**

Through its investment policy, IMET manages its exposure to fair value losses of the IMET 1-3 Year Series arising from increasing interest rates by limiting the duration of its investment portfolio to within 25% of that of the Lehman Brothers 1-3 Year Government Bond Index under normal conditions. The duration for total investments represents the weighted average of the durations for the respective categories of investments. The duration for the Lehman Brothers 1-3 Year Government Bond Index was 1.76 years as of September 30, 2004.

**(b) Credit Risk**

The investments in U.S. Treasury and agency obligations carry the explicit guarantee of the United States Government. The investments in mortgage-backed securities are rated in the top rating category issued by nationally recognized statistical rating organizations. The investment in the Fifth Third U.S. Treasury Money Market Fund was unrated.

# ILLINOIS METROPOLITAN INVESTMENT FUND

## Notes to Financial Statements

September 30, 2004

**(c) Concentration of Credit Risk**

IMET's investment policy for the IMET 1-3 Year Series does not restrict the allowable concentration of total assets invested in the securities of the United States Government or its agencies. As of September 30, 2004, IMET was in compliance with its investment policy requirements with respect to diversification and concentration of credit risk.

**(4) Fund Expenses – IMET 1-3 Year Series**

The total expenses, including any consulting fees, for the IMET 1-3 Year Series are not expected to exceed 0.28% of the average daily net assets. The average daily net assets of the IMET 1-3 Year Series were approximately \$296.2 million for the year ended September 30, 2004. The contractually obligated expenses are described below.

**(a) Fund Management**

IMET pays a management fee to Banc One Investment Advisors, which acts as the investment advisor.

In accordance with the amended advisory agreement effective May 1, 2002, the management fee is calculated each day and paid monthly based upon the average daily net assets of the fund as follows:

	<u>Fee rate</u>
Average daily net assets:	
Until Fund reaches \$300 million	0.13%
Thereafter:	
\$0 – \$300 million	0.12%
\$300 – 350 million	0.11%
\$350 – 400 million	0.10%
\$400 – 500 million	0.09%
over \$500 million	0.08%

Effective May 1, 2002, the IMET also entered into an agreement with Fifth Third Bancorp to provide administrative services including fund accounting, transfer agent, and custody services. Effective April 1, 2003, the fee associated with these services is calculated at an annual rate of 0.04% of average daily net assets.

For the year ended September 30, 2004, the IMET 1-3 Year Series incurred expenses of \$355,591 for services provided by Bank One. For the year ended September 30, 2004, the IMET 1-3 Series incurred expenses of \$118,563 for services provided by Fifth Third Bancorp.

**(b) Consultant**

The DuPage Mayors and Managers Conference, Northwest Municipal Conference, South Suburban Mayors and Managers Association, West Central Municipal Conference, and the Will County Governmental League act collectively as the IMET 1-3 Year Series' Consultant. Services provided by the Consultant typically include identification and solicitation of potential investors. The IMET 1-3 Year Series pays the Consultant an annual fee in arrears equal to 0.02% of the IMET 1-3

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Notes to Financial Statements

September 30, 2004

Year Series' average daily net assets for each fiscal year, not to exceed \$125,000 in any fiscal year. No annual fee shall be payable for any fiscal year unless the assets of the IMET 1-3 Year Series exceed \$100 million for at least 31 consecutive calendar days during such fiscal year and the total return to fund participants for such fiscal year equals or exceeds the average 90-day treasury bill rate during such fiscal year. For fiscal year 2004, the IMET 1-3 Year Series' return did not exceed the average 90-day Treasury bill rate. Accordingly, the IMET 1-3 Year Series did not incur consulting fees expense for the year ended September 30, 2004.

**(c) Administrative and Other Expenses**

In accordance with the various agreements, the IMET 1-3 Year Series calculates a daily accrual, at contractual rates equivalent to 0.12%, applied to the Series' net assets. The amounts accrued are deposited monthly in a money market fund and are withdrawn as needed to cover actual administrative expenses incurred to operate and market the IMET 1-3 Year Series, including the cost of the Executive Director and staff of the Illinois Metropolitan Investment Fund. To the extent that the accrued amounts exceed the actual expenses in any period, the IMET 1-3 Year Series may use these amounts to pay future expenses. Amounts remaining in the money market fund are included in net assets.

**(5) Fund Expenses – IMET Convenience Series**

The IMET Convenience Series calculates a daily accrual, at contractual rates equivalent to 0.10%, applied to the IMET Convenience Series' net assets. The amounts accrued are to be deposited periodically in a separate account and withdrawn as needed to cover administrative expenses incurred by the Board of Trustees and Fifth Third to operate and market the IMET Convenience Series. To the extent that the accrued amounts exceed the actual expenses in any period, the IMET Convenience Series may use these amounts to pay future expenses. For the year ended September 30, 2004, the IMET Convenience Series incurred expenses of \$5,618 and \$3,745 for audit services and services provided by Fifth Third, respectively.

**(6) Unit Transactions**

A summary of participants' unit transactions for the year ended September 30, 2004 were as follows:

	IMET 1-3 Year Series	IMET Convenience Series
Unit transactions:		
Issued	1,660,478	20,454,952
Distributions reinvested	—	96,905
Redeemed	(2,861,573)	(9,676,779)
Change in units	(1,201,095)	10,875,078
Units outstanding:		
Beginning of year	19,944,753	1,450,000
End of year	18,743,658	12,325,078

## ILLINOIS METROPOLITAN INVESTMENT FUND

Notes to Financial Statements

September 30, 2004

### (7) Retirement Fund Commitments – Illinois Municipal Retirement Fund

IMET's defined benefit pension plan, Illinois Municipal Retirement Fund (IMRF), provides retirement, disability, annual cost of living adjustments and death benefits to plan members and beneficiaries. IMRF is an agent-multiple employer public employee retirement system that acts as a common investment and administrative agent for local governments and school districts in Illinois. The Illinois Pension Code establishes the benefit provisions of the plan that can only be amended by the Illinois General Assembly.

IMRF issues a financial report that includes financial statements and required supplementary information. The report may be obtained at [www.imrf.org/pubs/pubs\\_homepage.htm](http://www.imrf.org/pubs/pubs_homepage.htm) or by writing to the Illinois Municipal Retirement Fund, 2211 York Road, Suite 500, Oak Brook, Illinois 60523.

Employees participating in IMRF are required to contribute 4.5% of their annual covered salary. The member rate is established by state statute. IMET is required to contribute at an actuarially determined rate. The employer rate for calendar year 2003 was 12.83% of payroll. The employer contribution requirements are established and may be amended by the IMRF Board of Trustees. IMRF's unfunded actuarial liability is being amortized as a level percentage of projected payroll on a closed basis (overfunded liability amortized on open basis). The amortization period at December 31, 2003 was 10 years.

For December 31, 2003, IMET's annual pension cost of \$8,082 was equal to IMET's required and actual contributions. The required contribution was determined as part of the December 31, 2001 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) 7.50% investment rate of return (net of administrative expenses), (b) projected salary increases of 4.00% a year, attributable to inflation, (c) additional projected salary increases ranging from 0.4% to 11.6% per year depending on age and service, attributable to seniority/merit, and (d) post-retirement benefit increases of 3% annually. The actuarial value of IMRF assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The assumptions used for the 2003 valuation were based on the 1999-2001 experience study.

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Illinois Municipal Retirement Fund

Required Supplementary Information (unaudited) --  
Schedule of Funding Progress

<u>Actuarial valuation date</u>	<u>Actuarial value of assets (a)</u>	<u>Actuarial accrued liability (AAL) Entry Age (b)</u>	<u>Unfunded (assets in excess of) AAL (UAAL) (b-a)</u>	<u>Funded ratio (a/b)</u>	<u>Covered payroll (c)</u>	<u>Percentage of covered payroll ((b-a)/c)</u>
12/31/2003	\$ 12,072	57,025	44,953	21.17 %	\$ 62,993	71.36 %

IMET began participating in the Illinois Municipal Retirement Fund during the calendar year ended December 31, 2003. Accordingly, there is only one year of information included in the schedule of funding progress.

See accompanying independent auditors' report.

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Schedule of Investments – IMET 1-3 Year Series

September 30, 2004

Units/ par value	Description	Market value
U.S. Treasury Obligations: 62.8%		
2,500,000.00	U.S. Treasury Bond, 10.000%, Due 5/15/10	\$ 2,620,998
12,000,000.00	U.S. Treasury Bond, 12.750%, Due 11/15/10	13,378,596
10,000,000.00	U.S. Treasury Note, 1.625%, Due 10/31/05	9,940,630
10,000,000.00	U.S. Treasury Note, 5.570%, Due 11/15/05	10,389,070
10,000,000.00	U.S. Treasury Note, 1.875%, Due 12/31/05	9,951,960
5,000,000.00	U.S. Treasury Note, 1.625%, Due 2/28/06	4,950,590
10,000,000.00	U.S. Treasury Note, 6.875%, Due 5/15/06	10,704,690
10,000,000.00	U.S. Treasury Note, 7.000%, Due 7/15/06	10,781,260
5,000,000.00	U.S. Treasury Note, 2.375%, Due 8/15/06	4,985,550
5,000,000.00	U.S. Treasury Note, 2.500%, Due 9/30/06	4,986,933
13,000,000.00	U.S. Treasury Note, 6.500%, Due 10/15/06	13,999,895
5,000,000.00	U.S. Treasury Note, 2.625%, Due 11/15/06	4,999,805
8,500,000.00	U.S. Treasury Note, 3.500%, Due 11/15/06	8,649,082
1,793,250.00	U.S. Treasury Note, 3.375% (Inflation Indexed), Due 1/15/07	1,916,466
5,000,000.00	U.S. Treasury Note, 6.250%, Due 2/15/07	5,403,515
15,000,000.00	U.S. Treasury Note, 4.375%, Due 5/15/07	15,602,940
3,000,000.00	U.S. Treasury Note, 2.750%, Due 8/15/07	2,991,798
10,000,000.00	U.S. Treasury Note, 6.125%, Due 8/15/07	10,899,610
10,000,000.00	U.S. Treasury Note, 5.500%, Due 2/15/08	10,803,910
6,000,000.00	U.S. Treasury Note, (Stripped), Due 2/15/06	5,813,058
5,000,000.00	U.S. Treasury Note, (Stripped), Due 2/15/07	4,689,605
2,500,000.00	U.S. Treasury Note, (Stripped), Due 8/15/07	2,301,577
7,500,000.00	U.S. Treasury Note, (Stripped), Due 5/15/06	7,212,967
		<u>177,974,505</u>
U.S. Government Agency Obligations: 34.7%		
5,000,000	Federal Home Loan Bank, 6.875%, Due 8/15/05	5,201,580
5,000,000	Federal Home Loan Bank, 2.500%, Due 12/15/05	5,006,830
1,150,000	Federal Home Loan Bank, 5.375%, Due 2/15/06	1,193,799
10,000,000	Federal Home Loan Bank, 5.125%, Due 3/6/06	10,363,850
10,000,000	Federal Home Loan Bank, 2.375%, Due 2/15/06	9,974,920
5,000,000	Federal Home Loan Bank, 1.875%, Due 6/15/06	4,936,720
5,000,000	Federal Home Loan Bank, 2.875%, Due 9/15/06	5,011,425
5,000,000	Federal Home Loan Bank, 2.75%, Due 11/15/06	4,985,870
3,000,000	Federal Home Loan Bank, 4.125%, Due 11/15/06	3,075,819
5,000,000	Federal Home Loan Bank, 3.125%, Due 8/15/07	4,998,400
8,000,000	Federal Home Loan Mortgage Co., 2.875%, Due 9/15/05	8,042,048
10,000,000	Federal Home Loan Mortgage Co., 5.250%, Due 1/15/06	10,349,460
5,000,000	Federal Home Loan Mortgage Co., 2.375%, Due 4/15/06	4,983,590
5,000,000	Federal Home Loan Mortgage Co., 5.500%, Due 7/15/06	5,241,495
5,000,000	Federal Home Loan Mortgage Co., 2.750%, Due 8/15/06	4,997,290
5,000,000	Federal Home Loan Mortgage Co., 2.375%, Due 2/15/07	4,934,180
3,000,000	Federal Home Loan Mortgage Co., 2.700%, Due 3/16/07	2,979,057
2,000,000	Federal Home Loan Mortgage Co., 4.000%, Due 10/29/07	2,002,772
		<u>98,279,105</u>

**ILLINOIS METROPOLITAN INVESTMENT FUND**

Schedule of Investments -- IMET 1-3 Year Series

September 30, 2004

Units/ par value	Description	Market value
<b>Mortgage Backed Securities: 1.9%</b>		
477	Federal Home Loan Mortgage Co. Pool 140140 7.750%, Due 3/1/09	\$ 483
592,418	Federal Home Loan Mortgage Co. Pool 846774 6.500%, Due 12/1/27	616,419
598,605	Federal Home Loan Mortgage Co. Pool 645242 6.977%*, Due 1/1/30	616,919
272,506	Federal Home Loan Mortgage Co. (Gold) Pool E77591, 6.500%, Due 7/1/2014	288,645
109,939	Federal Home Loan Mortgage Co. (Gold) Pool E82002, 7.500%, Due 11/1/2011	116,996
263,249	Federal Home Loan Mortgage Co. (Gold) Pool E62448, 7.500%, Due 9/01/10	279,756
367,107	Federal Home Loan Mortgage Co. (Gold) Pool G10740, 7.500%, Due 8/1/09	390,126
978,074	Federal Home Loan Mortgage Co. (Gold) Pool P60089, 7.000%, Due 12/1/2014	1,030,646
912,056	Federal Home Loan Mortgage Co. (Gold) Pool P60090, 7.000%, Due 3/1/2016	961,079
458,584	Federal Home Loan Mortgage Co. (Gold) Pool E00667, 5.000%, Due 4/1/14	468,621
4,318	Government National Mortgage Association Pool 9547, 7.500%, Due 12/15/05	4,404
6,028	Government National Mortgage Association Pool 12229, 7.500%, Due 6/15/06	6,229
101,135	Government National Mortgage Association Pool 780831, 9.500%, Due 12/15/24	114,903
104,327	Government National Mortgage Association Pool 2006, 8.500%, Due 5/20/25	114,615
34,557	Government National Mortgage Association Pool 2324, 8.000%, Due 11/20/26	37,740
146,126	Government National Mortgage Association Pool 2512, 8.000%, Due 11/20/27	159,061
13,134	Government National Mortgage Association Pool 2566, 8.000%, Due 3/20/28	14,285
13,727	Government National Mortgage Association Pool 2633, 8.000%, Due 8/20/28	14,929
23,091	Government National Mortgage Association Pool 2647, 8.000%, Due 9/20/28	25,113
21,496	Government National Mortgage Association Pool 2677, 8.000%, Due 11/20/28	23,378
		<u>5,284,347</u>
<b>Mutual Funds: 0.6%</b>		
1,770,260	Fifth Third U.S. Treasury Money Market Fund	1,770,260
		<u>\$ 283,308,217</u>

\* Variable rate security. The rate listed is as of September 30, 2004.

See accompanying independent auditors' report.



**STATISTICAL SECTION**

**ILLINOIS METROPOLITAN INVESTMENT FUND**  
 Selective Comparative Data (unaudited) – IMET 1-3 Year Series  
 September 30, 2004

Total returns for period ended September 30, 2004

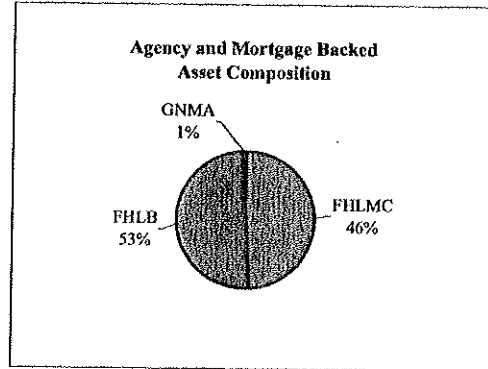
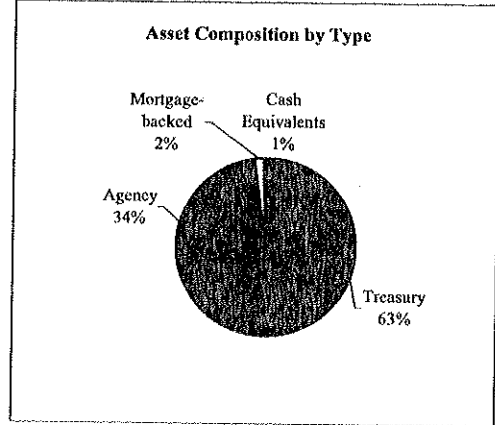
	One year *	Three year *	Since inception July 17, 1996
IMET 1-3 Year Series Net Return	0.98%	3.00%	5.24%
IMET 1-3 Year Series Gross Return **	1.24%	3.30%	5.63%
Lehman Brothers 1-3 Year Government Bond Index	1.17%	3.25%	5.56%
Merrill Lynch 3-Month Treasury Bill Index	1.10%	1.47%	3.91%

\* Annualized return  
 \*\* Returns exclude expenses of the fund

	Fund profile	Index profile
Fund size	\$	-----
Gross yield to maturity	2.60	2.63
Duration	1.71	1.76
Average maturity	1.83	1.87

Sectors	Fund profile	Index profile
Treasury	63%	64%
Agency	34%	36%
Mortgage backed	2%	
Cash equivalents	1%	

Quality	Fund profile	Index profile
AAA	100%	100%



See accompanying independent auditors' report.

**INVESTMENT POLICY**

# ILLINOIS METROPOLITAN INVESTMENT FUND

## Investment Policy

September 30, 2004

The Illinois Metropolitan Investment Fund ("*IMET*" or "*Fund*") is an actively managed investment fund for Illinois local governments.

### 1.0 Policy

It is the policy of IMET to invest public funds of Illinois governments in a manner which seeks to provide the best return while pursuing the preservation of capital. IMET is designed as an investment vehicle for funds not required to be spent immediately and available for investment in securities with maturities and returns generally greater than those for money market instruments. IMET will conform to Illinois state statutes governing the investment of public funds.

### 2.0 Funds

Monies invested in this Fund will be those of participating Illinois governments whose treasurers become members of the Fund. Any funds that an Illinois government can invest in under Illinois statutes are eligible for investment in IMET. This is an intermediate investment fund, however, and short-term cash monies which are needed for immediate liquidity demands will not be encouraged to be invested in this Fund.

### 3.0 Prudence

The standard of prudence to be used for all investment activities shall be the following "prudent person" standards, as stated below, and shall be applied while conducting all investment transactions.

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable preservation of their capital as well as the probable income to be derived.

### 4.0 Objective

This actively managed portfolio will be invested in certain fixed income securities and cash equivalents. In summary, the investment objectives of IMET are:

- A. **Preservation of Principal:** Preservation of principal is the foremost objective of IMET. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.
- B. **Liquidity:** IMET will seek to remain sufficiently liquid to allow for withdrawals by Fund members with five business days notice of that withdrawal to the Fund, and will otherwise remain sufficiently liquid in accordance with prudent fund management.
- C. **Return on Investment:** IMET's assets will be invested with the objective of obtaining an appropriate market rate of return in relation to the prevailing monetary environment. See also "Performance Standards" herein.

## ILLINOIS METROPOLITAN INVESTMENT FUND

Investment Policy

September 30, 2004

### 5.0 Delegation of Authority

The Board of Trustees of IMET (the "Board") seeks to employ an investment advisor who possesses superior capabilities in the management of assets of the Council of Governments' governmental bodies. The Board further requires the investment advisor selected and working on its behalf to meet the following set of conditions.

- A. To take in its discretion actions which in its best professional judgment are in the best interests of IMET, in accordance with this Investment Policy and the Investment Circular distributed by the Fund, to meet IMET investment objectives. Such actions include but are not limited to (A) the allocation of funds among alternative types of investments; (B) specific investment opportunities regarding the acquisition, retention or disposition of investments; and (C) the recommendation of the addition, deletion or modification of authorized investments.
- B. To execute all investment transactions on behalf of the Fund at the best net price, utilizing such brokers and dealers as they deem appropriate to obtain the best execution capabilities and/or valuable information with respect to the economy and the affairs of corporations at the lowest cost to the Fund.
- C. Additional responsibilities as detailed in each investment advisor's agreement with the Board.

### 6.0 Ethics and Conflicts of Interest

Officers and employees of the Fund involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the IMET chairperson any material financial interests in financial institutions that conduct business with IMET, and they shall further disclose any large personal financial/investment positions that could be related to the performance of IMET, particularly with regard to the time of purchases and sales.

### 7.0 Authorized Financial Dealers and Institutions

The Board will maintain a list of financial institutions authorized to provide investment advisor, administrative, and distributive investment services. The advisor will make investments only in those investments specifically authorized in the Public Investment Act of the State of Illinois (30 ILCS 235/1) (the "Investment Act"). The administrator shall perform its duties in conformance with the Declaration of Trust, By-Laws, and Investment Circular of the Fund. The distributor shall be competent and fully qualified under federal and state securities laws and the rules and regulations of the Comptroller of the Currency or the National Association of Securities Dealers, as applicable, to engage in marketing and sales efforts.

A current audited financial statement is required to be on file for each financial institution which provides the above mentioned services.

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Investment Policy

September 30, 2004

#### 8.0 Authorized and Suitable Investments

All investments shall be made in compliance with the Investment Act, including, without limitation, the definition of "agency" contained therein. In seeking to achieve its investment objective, the Fund intends to invest under normal market conditions at least fifty percent (50%) in (i) obligations issued or secured by the U.S. Government and/or its agencies and/or (ii) money market mutual funds that are permitted investments under the Investment Act. In extraordinary circumstances, such as when the investment advisor believes that market conditions indicate that the Fund should adopt a temporary defensive position, the Fund may invest up to one hundred percent (100%) in cash and/or such money market mutual funds.

The Fund portfolio is restricted to a maximum dollar weighted average maturity of five years or less, under normal conditions. The net asset value will fluctuate on a daily basis according to the change in market value of its underlying portfolio obligations.

The following are additional investment restrictions:

- (i) All fixed income securities (other than obligations of the U.S. or its agencies) at the time of purchase shall be rated at the highest rating classification established by at least two standard rating services (without regard to any refinement or gradation of rating category by numerical modifier or otherwise). However, issues that are reclassified after purchase so that they are no longer at the highest classifications established by at least two standard rating services may be sold by the advisor to the Fund after the date of the security's reclassification or held to maturity, in either case based on the investment advisor's discretion.
- (ii) Mortgage pass-through securities must be issued by an agency of the United States government. There are three major types of such agency pass-throughs, guaranteed by three organizations: Government National Mortgage Association ("Ginnie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac"), and Federal National Mortgage Association ("Fannie Mae"). Pass-through securities or collateralized mortgage obligations of Fannie Mae are not permitted investments under Illinois law. In addition, privately structured and issued mortgage pass-through securities or collateralized mortgage obligations are not permitted investments.
- (iii) All investments are required to be made in compliance with the Investment Act, including, without limitation, the definition of "agency" contained therein.

The following transactions are prohibited in the portfolio managed by the investment advisor.

1. Reverse repurchase agreements.
2. Common or preferred stocks.
3. Futures and options.
4. Margin purchases or intentional use of leverage.
5. Private or direct placements.

## ILLINOIS METROPOLITAN INVESTMENT FUND

### Investment Policy

September 30, 2004

6. Commodities.
7. Direct ownership of real estate or mortgages.
8. Non-U.S. dollar denominated securities.
9. Stripped mortgage backed securities (i.e. interest-only (IO) and principal-only (PO) securities).
10. Convertible notes or bonds.
11. Purchases, participation, or other direct interest in gas, oil, or other mineral exploration or development programs.
12. Collateralized mortgage obligations.
13. Lending of Fund securities.
14. Structured notes -- however, the Portfolio may invest in Federal government agency securities whose coupon rates are scheduled to "step up" (i.e. increase) one or more times before they mature.
15. Investments not allowed under the Investment Act.

The advisor shall indemnify and make whole the Fund and its shareholders for any losses incurred by the Fund as a result of the advisor's own or any Sub-advisor's gross negligence or its failure to comply with the provisions of the Investment Act as those provisions are communicated to the investment advisor in writing by IMET or by IMET's Legal counsel.

#### **9.0 Safekeeping and Custody**

Securities purchased for IMET, as well as collateral for repurchase agreements, shall be delivered against payment and held in a custodial safekeeping account with the trust department of a bank acting as custodian. The bank will be designated by the Board and all transactions will be evidenced by safekeeping receipts or confirmations.

#### **10.0 Diversification**

Fixed income securities in the Fund will have the following characteristics::

- A. United States Treasury, agency and agency mortgage pass-through securities may be used without limitation and under normal market conditions such obligations, along with money market mutual funds that are permitted investments under the Investment Act, will constitute at least 50% of the portfolio.
- B. Commercial paper investment, pursuant to Illinois law, must mature within 180 days from date of purchase and cannot exceed 10% of the corporation's total commercial paper. The Fund will have no more than one-third of its monies invested in commercial paper.

# ILLINOIS METROPOLITAN INVESTMENT FUND

## Investment Policy

September 30, 2004

- C. At no time may the portfolio own more than 5% of the outstanding amount of any one fixed income issue (other than securities of the United States Government or its agencies) or have more than 7% of its total assets invested in the securities (including cash equivalents) of any permissible fixed income issuer (other than securities of the United States government or its agencies) without prior notification and approval of the Board.

### 11.0 Maturities

Portfolio duration is to be maintained within 25% of that of the Lehman Brothers 1-3 Year Government Bond index under normal conditions; provided, however, that the portfolio's dollar weighted average maturity will not exceed five years under normal conditions. Individual securities may have remaining maturities of greater than five years, but in any event not greater than ten years from the date of the Series' purchase thereof. The remaining life of any agency mortgage pass-through security will be determined based on the weighted average life of the security.

### 12.0 Internal Control

The advisor shall establish a system of internal controls, which shall be documented in writing. The control shall be annually reviewed by their auditor and shall be designed to prevent losses of public funds arising from failure to comply with the provisions of the Investment Act, fraud, employee error, misrepresentation by third parties or imprudent actions by employees and officers of the firm. The advisor shall at all times have in place a fidelity bond or bonds covering the actions of its employees and officers relating to fraud, theft, dishonesty, and other willful acts which may result in the loss of Fund assets. Such bond or bonds shall be maintained in amounts not less than \$5,000,000 per occurrence and \$10,000,000 in the annual aggregate, covering its duties. The advisor will also maintain a fidelity bond against employee theft, dishonesty, and related risks, and covering its duties in an amount not less than \$10,000,000 in the annual aggregate.

### 13.0 Performance Standards

IMET's investment strategy is targeted active management. The performance objective for this portfolio is to meet or exceed the Lehman Brothers 1-3 Year Government Bond Index (the benchmark) prior to payment of Fund expenses.

### 14.0 Reporting

The advisor shall report to the Board at least quarterly on:

- A. Performance as compared to the benchmark.
- B. Asset allocation and duration as compared to the benchmark.
- C. Any deviation from the guidelines herein established.
- D. Significant changes in the portfolio under their management during the quarter.
- E. Economic and investment outlook for the near and long term.
- F. Monthly purchase and sale transactions.
- G. Any change in key personnel.

### 15.0 Investment Policy Adoption

IMET's investment policy shall be adopted by resolution of the Board. The policy shall be reviewed annually by the Board and any modifications made thereto must be approved by the Board.