



September 22, 2010

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City of Surprise
Investment Guidelines and Objectives
Month Ended August 31, 2010

Investment Objectives: In accordance with the City's Investment Policy, the City's primary objectives in order of priority are:

- A. Safety** – Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to prudently mitigate credit risk and interest rate risk. It is understood by the City that no investment is completely free of risk.
- B. Liquidity** – The investment portfolio shall remain sufficiently liquid to meet anticipated cash flow requirements. This is to be accomplished by structuring the portfolio so that securities mature concurrent with anticipated cash flow needs (static liquidity). Furthermore, because all possible cash demands cannot be anticipated, the portfolio should consist of securities for which there are active secondary markets (dynamic liquidity).
- C. Optimal Yield** – Return on investment is of lesser importance compared to the safety and liquidity objectives described above. The investment portfolio shall be designed to optimize the yield the City obtains from the portfolio taking into account the criteria of the investment policy, the dynamic liquidity needs of the City, and the current interest rate outlook/economic condition.

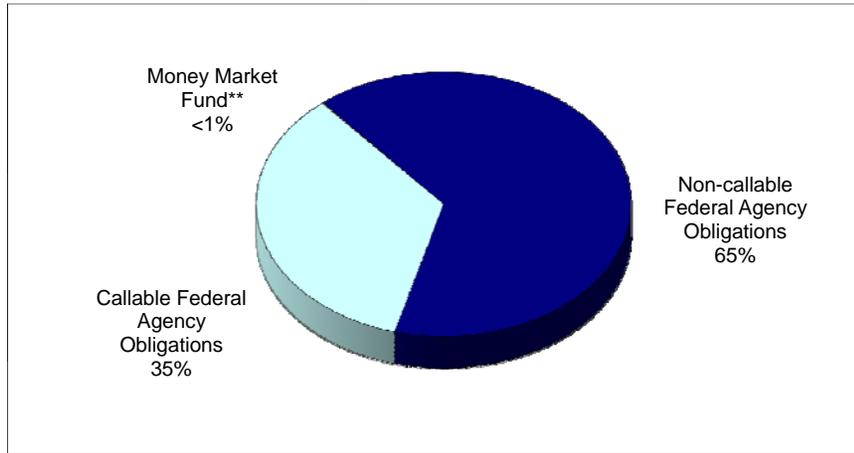
Investment Guidelines: In relation to the investment portfolio, the City's investment strategy focuses on the following:

- Permitted Investments. The City will invest in permitted securities consistent with A.R.S.§35-323. Additionally, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments outlined in the Investment Policy.
- Transactions prior to maturity – Securities shall generally be held to maturity with the following exceptions:
 - A security with a declining credit may be sold early to minimize loss of principal.
 - Liquidity needs of the portfolio require that the security be sold.
 - Securities may be sold to better position the portfolio in accordance with better market opportunities. The City will approve all of these transactions but only after PFM Asset Management LLC, the City's investment advisor, provides detailed information about the transaction, including the qualitative and quantitative impacts on the portfolio, and will be cognizant of trades that will result in large material realized losses.

City of Surprise Portfolio Summary and Characteristics
Month Ended August 31, 2010

<u>Security Type</u>	<u>Current Holdings*</u>	<u>Current Month % of Portfolio</u>	<u>Previous Month % of Portfolio</u>
U.S. Treasury	\$0.00	0%	0%
Federal Agency	\$20,278,207.00	100%	100%
Discount Federal Agency	\$0.00	0%	0%
Callable Federal Agency	\$7,021,387.00	35%	13%
Non-callable Federal Agency	\$13,256,820.00	65%	87%
FDIC Guaranteed Corporate	\$0.00	0%	0%
Wells Fargo MMF	\$17,920.39	<1%	<1%
Total Market Value	\$20,296,127.39	100%	100%

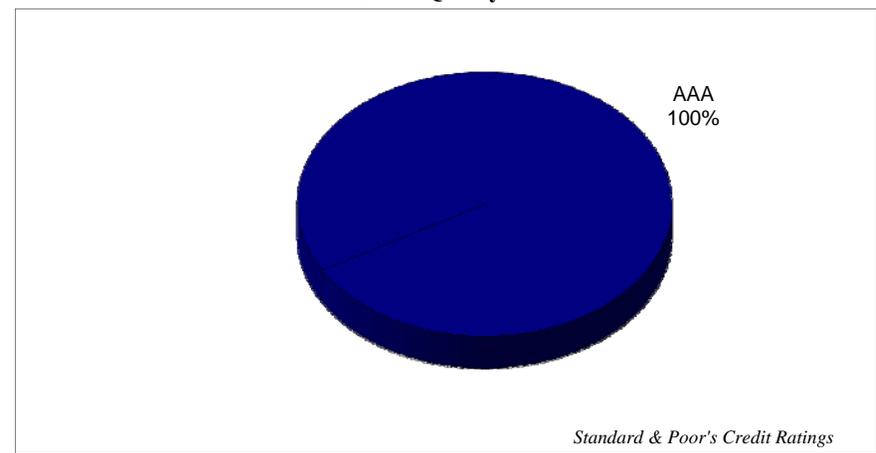
Sector Distribution



The City's portfolio continues to comply with the investment policy and the Arizona Revised Statutes.

*Security market values excluding accrued interest as of settlement date. Note that PFM monthly statements reflect holdings as of trade date.

Credit Quality Distribution



The A-1+ rating is the highest credit rating for short-term investments assigned by Standard & Poor's

**Assumed AAA rating.

City of Surprise Maturity Summary and Key Portfolio Statistics
Month Ended August 31, 2010

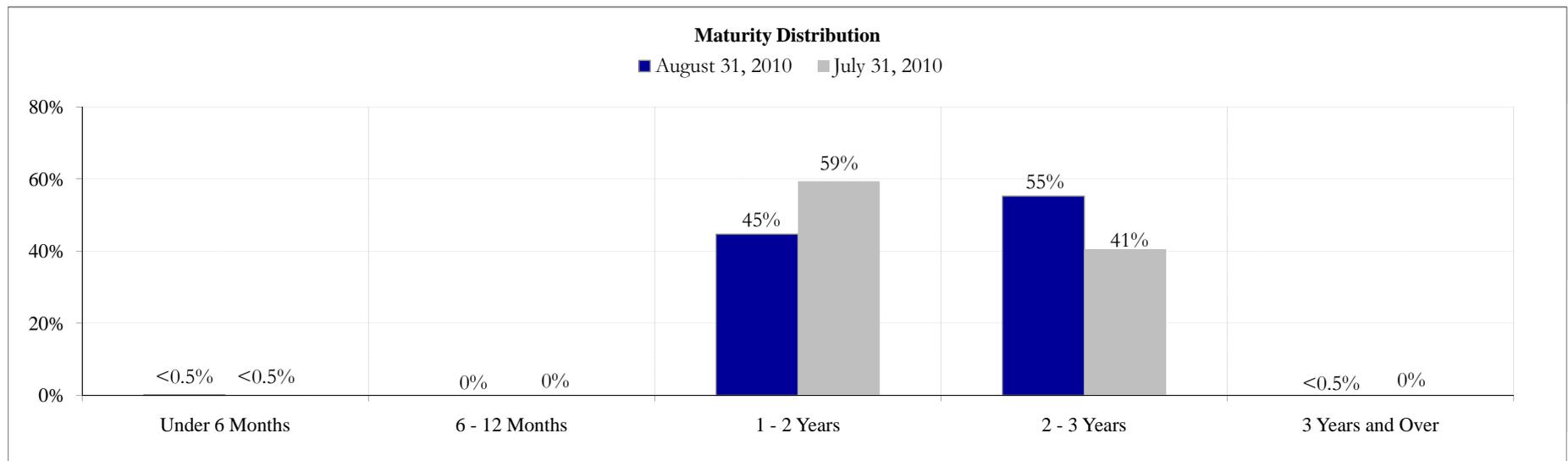
Maturity Distribution Summary		
<u>Maturity Class</u>	<u>Fair Value*</u>	<u>% of Portfolio</u>
Under 6 Months	\$17,920.39	<0.5%
6 - 12 Months	\$0.00	0%
1 - 2 Years	\$9,069,378.00	45%
2 - 3 Years	\$11,208,829.00	55%
3 Years and Over	\$0.00	<0.5%
Total Market Value	\$20,296,127.39	100%

*Security market values excluding accrued interest as of settlement date. Note that PFM monthly statements reflect holdings as of trade date.

Key Portfolio Statistics	
Duration	1.37 years
Benchmark Duration	1.78 years
Yield at Cost	1.03%

Please note that the percentages on this page are rounded and may not add up to 100% due to the rounding.

The City's benchmark is the Merrill Lynch 1-3 year U.S. Treasury Index.

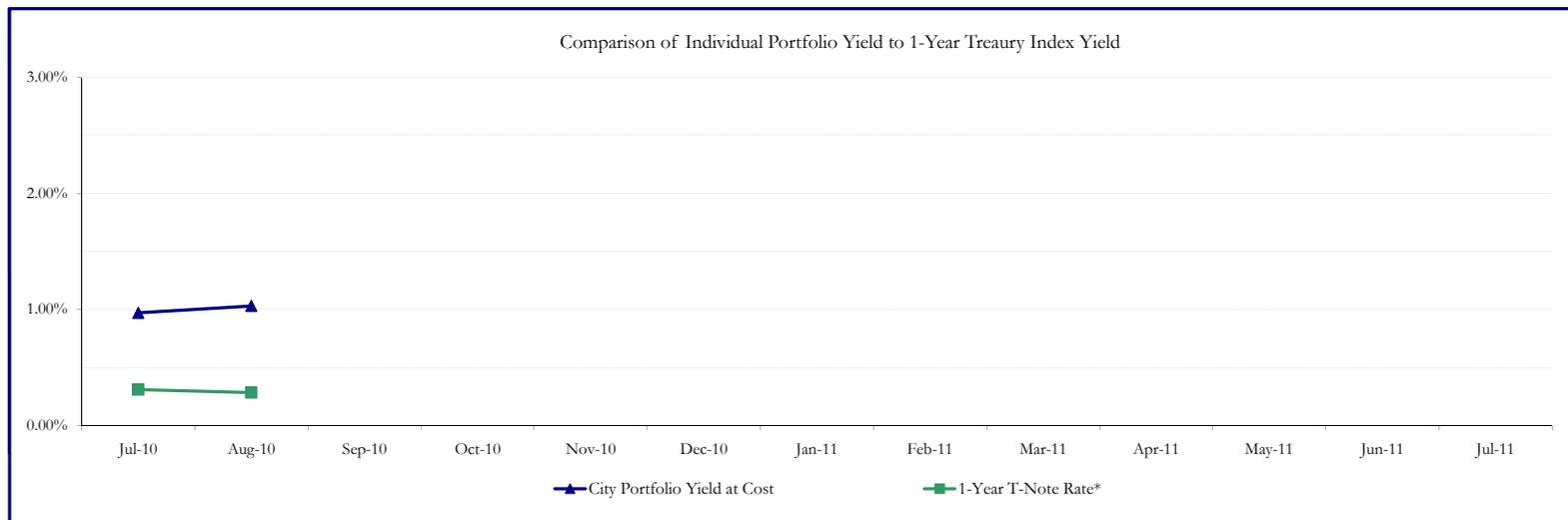


City of Surprise Individual Portfolio Yield Summary Fiscal Year 2010-2011

Date	Month-End Market Value ¹	Duration	Portfolio YTM at Cost	1-Year T-Note Index Rate ²
Jul-10	\$15,279,792	1.75	0.97%	0.31%
Aug-10	\$20,296,127	1.37	1.03%	0.28%

¹ Excludes accrued interest and includes balance in the custody account MMF.

² Rate represents the Merrill Lynch 1-Year U.S. Treasury Note Index month-end yield (GC03). Source Bloomberg

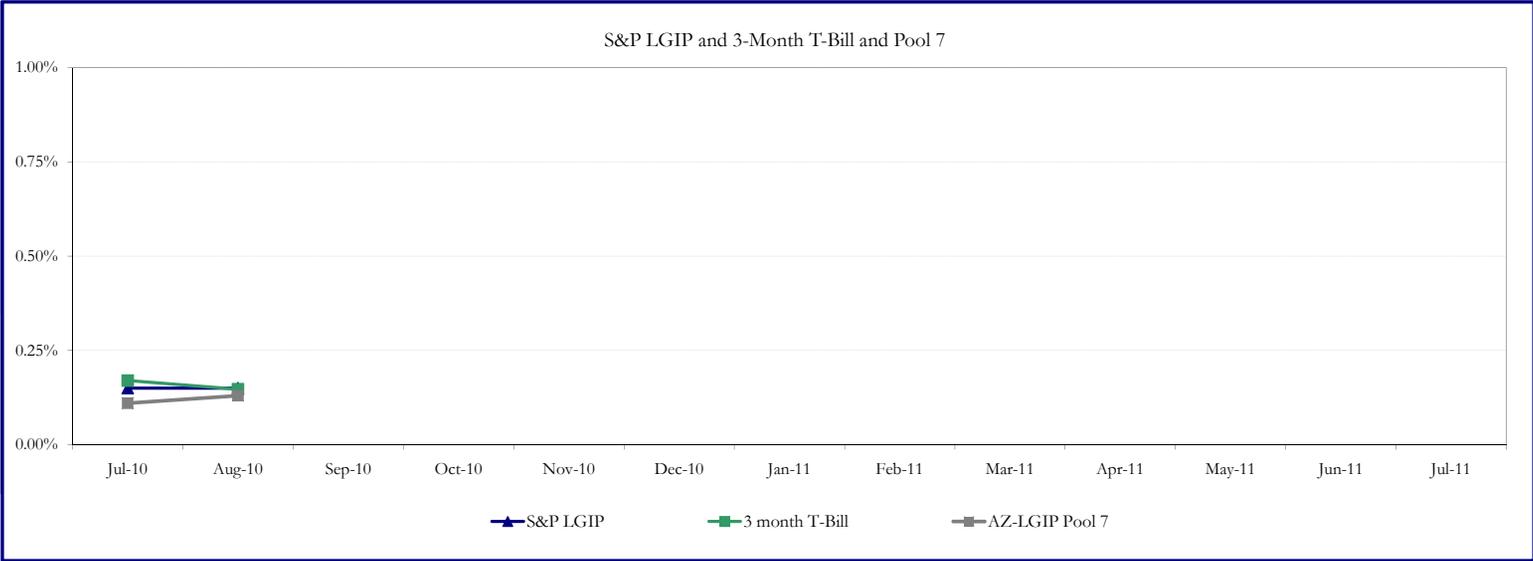


**City of Surprise Short-Term Benchmark Comparisons
Fiscal Year 2010-2011**

Date	S&P LGIP	AZ-LGIP Pool 7 ¹	3 month Treasury Bill ²
Jul-10	0.15%	0.11%	0.17%
Aug-10	0.15%	0.13%	0.15%

¹ Monthly Apportionment Yields. Source: Office of the Arizona State Treasurer

² Rate represents the Merrill Lynch 3-Month U.S. Treasury Bill Index month-end yield (GOO1). Source: Bloomberg



City of Surprise Holdings
Month Ended August 31, 2010

Operating Funds Investment Inventory by Maturity Date

Issuer	Maturity	Years to Maturity	Fair Value	Yield to Maturity	Next Call Date	Frequency
Wells Fargo MMF	8/31/2010	0.00	\$17,920	0.07%		
FHLB	12/28/2011	1.33	\$3,021,747	0.62%		
FHLB	1/9/2012	1.36	\$3,006,609	0.65%		
FHLB	6/8/2012	1.77	\$3,041,022	0.97%		
FHLMC	12/21/2012	2.31	\$2,152,252	1.09%		
FNMA	6/26/2013	2.82	\$2,035,190	1.41%		
FNMA	7/19/2013	2.89	\$2,010,132	1.39%	7/19/11	One-time
FNMA	8/16/2013	2.96	\$5,011,255	1.23%	2/16/11	One-time
Total Market Value			\$ 20,296,127			



Managed Account Detail of Securities Held

For the Month Ending **August 31, 2010**

CITY OF SURPRISE OPERATING FUND

Security Type/Description Dated Date/Coupon/Maturity	CUSIP	Par	S&P Rating	Moody's Rating	Trade Date	Settle Date	Original Cost	YTM at Cost	Accrued Interest	Amortized Cost	Market Value
Federal Agency Bond / Note											
FHLB GLOBAL BONDS DTD 11/16/2009 1.000% 12/28/2011	3133XVRS2	3,000,000.00	AAA	Aaa	06/23/10	06/24/10	3,016,950.00	0.62	5,250.00	3,014,869.47	3,021,747.00
FHLB NOTES DTD 07/09/2010 0.625% 01/09/2012	3133703Y2	3,000,000.00	AAA	Aaa	07/13/10	07/14/10	2,998,740.00	0.65	2,708.33	2,998,850.40	3,006,609.00
FHLB TAP BONDS DTD 01/07/2010 1.375% 06/08/2012	3133XWKU2	3,000,000.00	AAA	Aaa	06/16/10	06/17/10	3,024,000.00	0.97	9,510.42	3,021,520.89	3,041,022.00
FHLMC GLOBAL REFERENCE NOTES DTD 12/17/2007 4.125% 12/21/2012	3137EABE8	2,000,000.00	AAA	Aaa	06/23/10	06/24/10	2,148,600.00	1.09	16,041.67	2,137,621.88	2,152,252.00
FNMA GLOBAL NOTES DTD 05/21/2010 1.500% 06/26/2013	31398AT44	2,000,000.00	AAA	Aaa	06/16/10	06/17/10	2,005,560.00	1.41	5,416.67	2,005,187.26	2,035,190.00
FANNIE MAE (CALLABLE) GLOBAL NOTES DTD 07/19/2010 1.375% 07/19/2013	31398AW32	2,000,000.00	AAA	Aaa	07/13/10	07/19/10	1,999,280.00	1.39	3,208.33	1,999,307.52	2,010,132.00
FNMA NOTES (CALLABLE) DTD 08/16/2010 1.250% 08/16/2013	31398A2L5	5,000,000.00	AAA	Aaa	08/05/10	08/16/10	5,003,000.00	1.23	2,604.17	5,002,750.00	5,011,255.00
Security Type Sub-Total		20,000,000.00					20,196,130.00	1.03	44,739.59	20,180,107.42	20,278,207.00
Managed Account Sub-Total		20,000,000.00					20,196,130.00	1.03	44,739.59	20,180,107.42	20,278,207.00
Securities Sub-Total		\$20,000,000.00					\$20,196,130.00	1.03%	\$44,739.59	\$20,180,107.42	\$20,278,207.00
Accrued Interest											\$44,739.59
Total Investments											\$20,322,946.59

Market Update

Interest Rates Remain Near Historic Lows

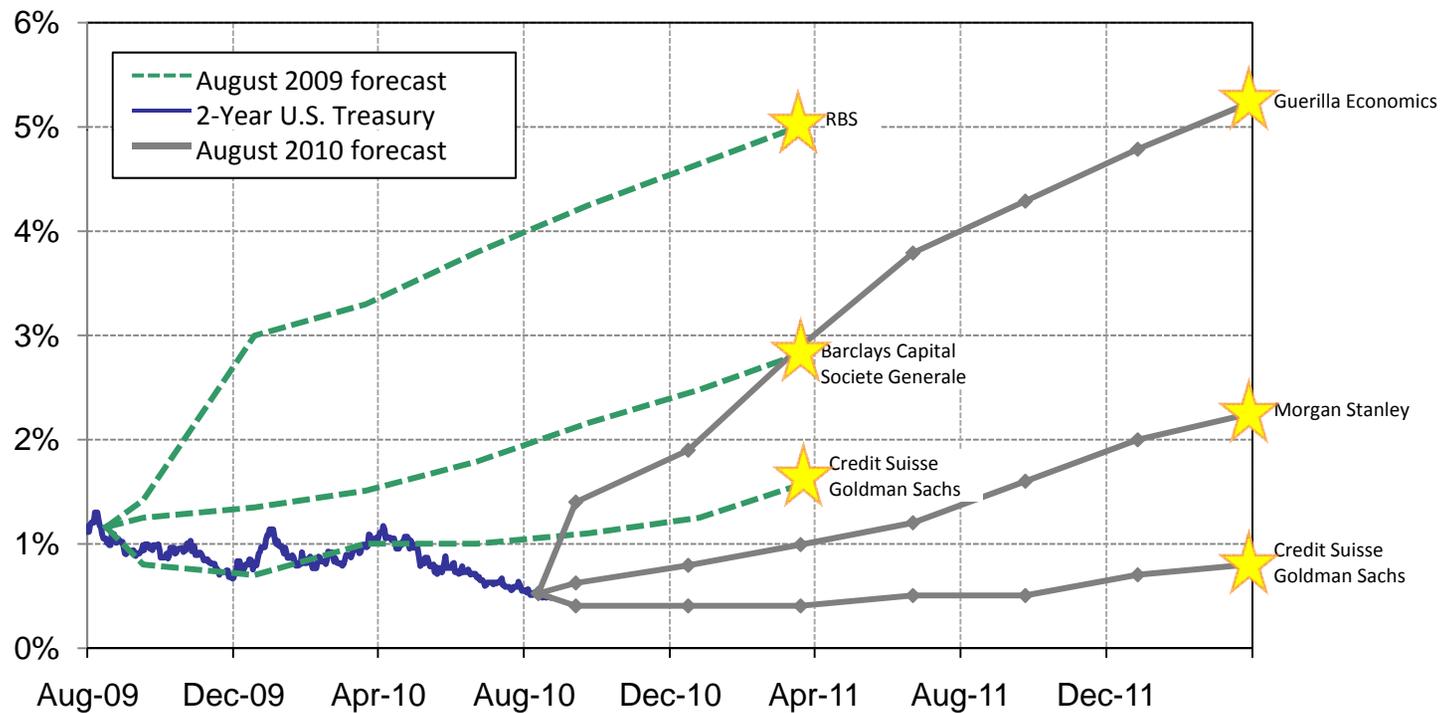
- During the current year, yields have plunged to historic lows, recently falling as far as 0.47%.
 - Since January, yields have fluctuated between 1.18% and 0.47%.



Source: Bloomberg

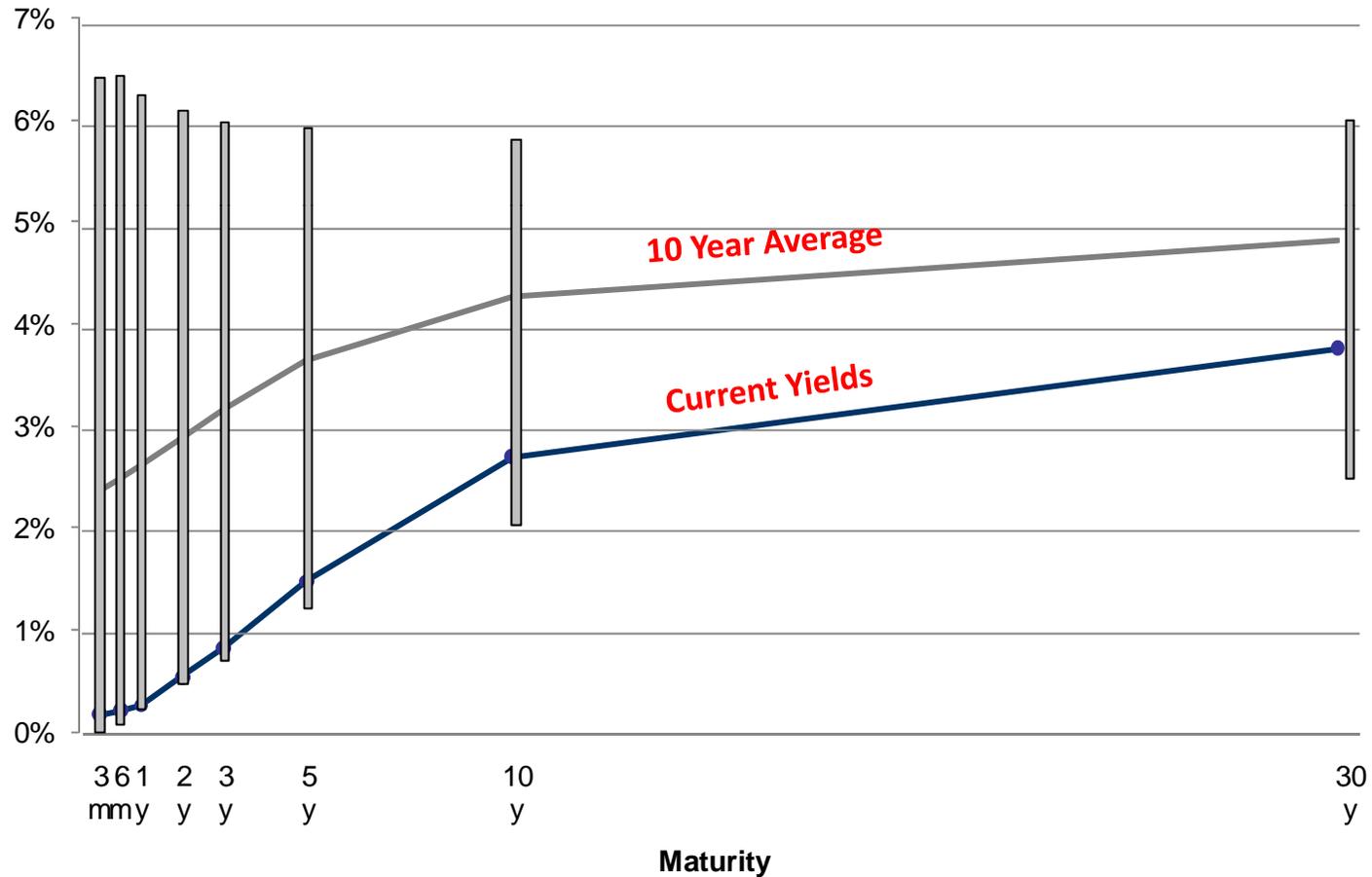
Interest Rate Forecasts Vary Widely

Two-Year U.S. Treasury Note Yield and Forecasts
August 2009 – March 2012



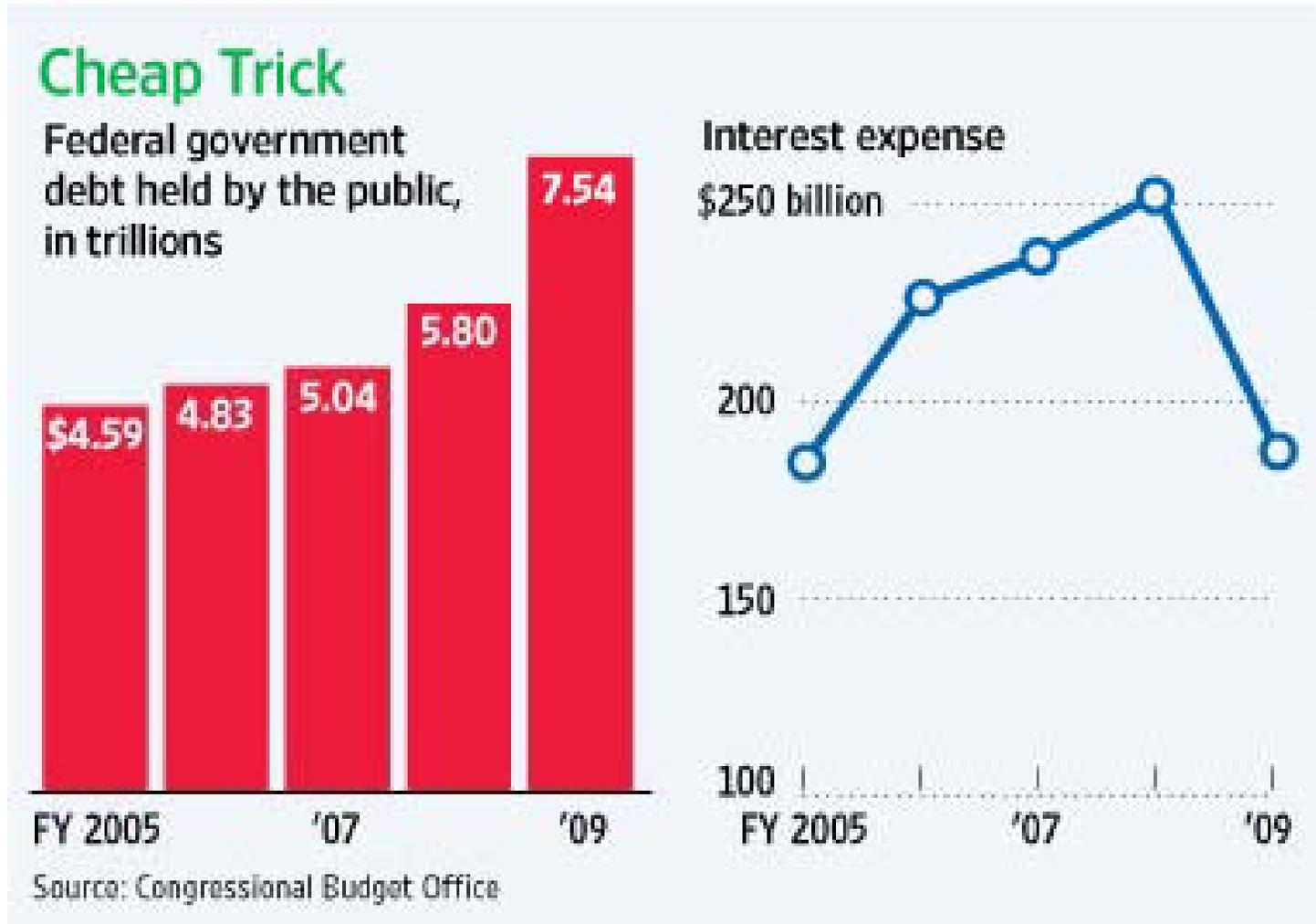
Treasury Yields Near All-Time Lows; Best Relative Value in Intermediate-Term Maturities

U.S. Treasury Yield Curve
 High, Low, Average & Current
 September 8, 2000 – September 8, 2010



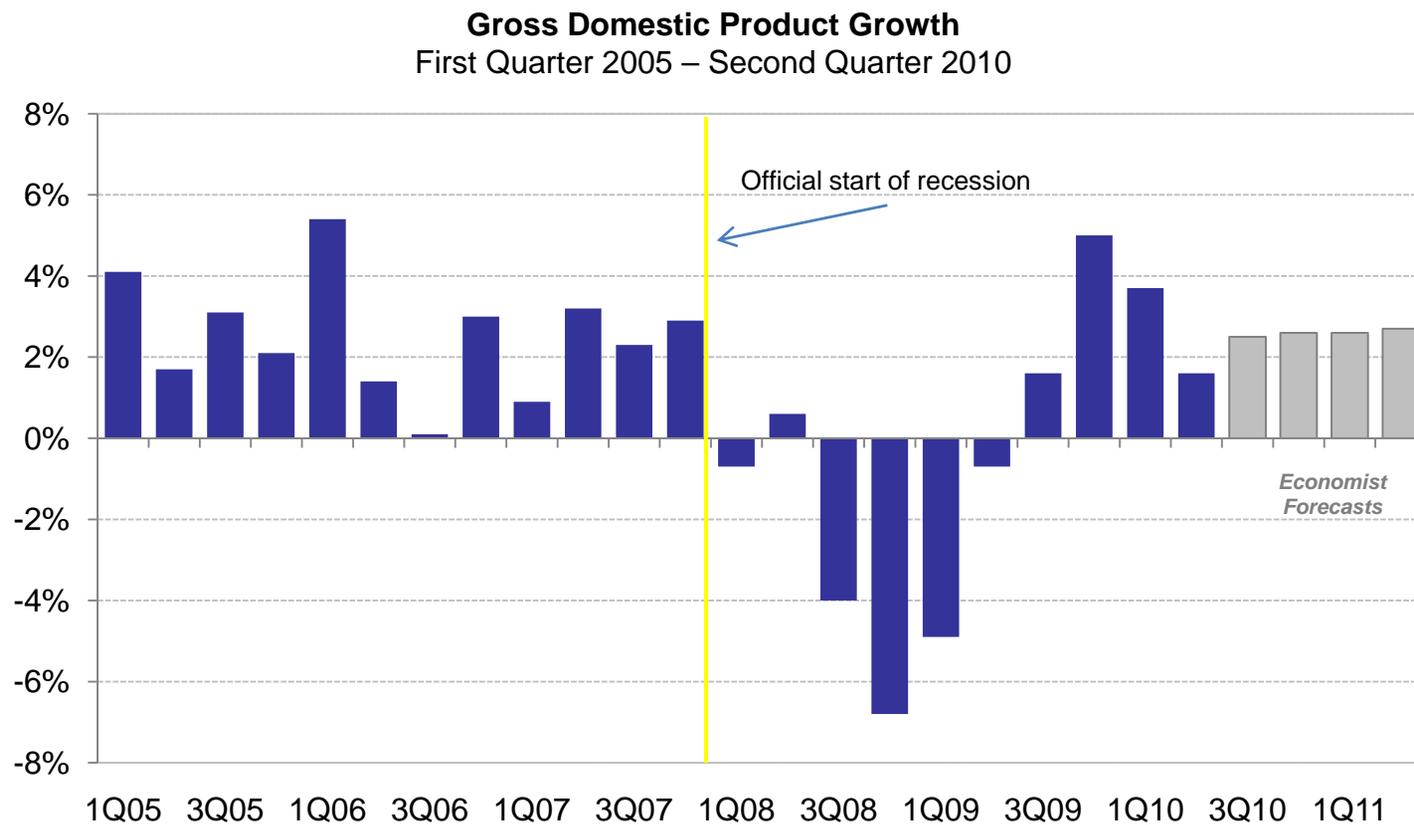
Source: Bloomberg

Silver Lining of Low Rates



Economic Growth Sluggish

- Second quarter GDP was revised downward to a 1.6% annualized rate from prior estimate of 2.4%. Revision was primarily due to wider trade deficit and smaller gain in inventories. Business investment and consumer spending remained level.

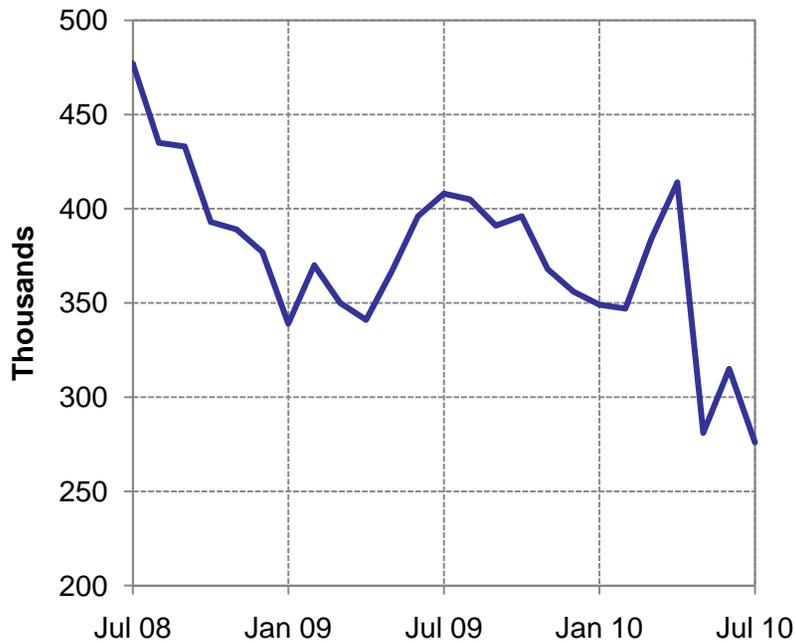


Source: U.S. Department of Commerce – Bureau of Economic Analysis and Bloomberg Survey of Economists median forecasts

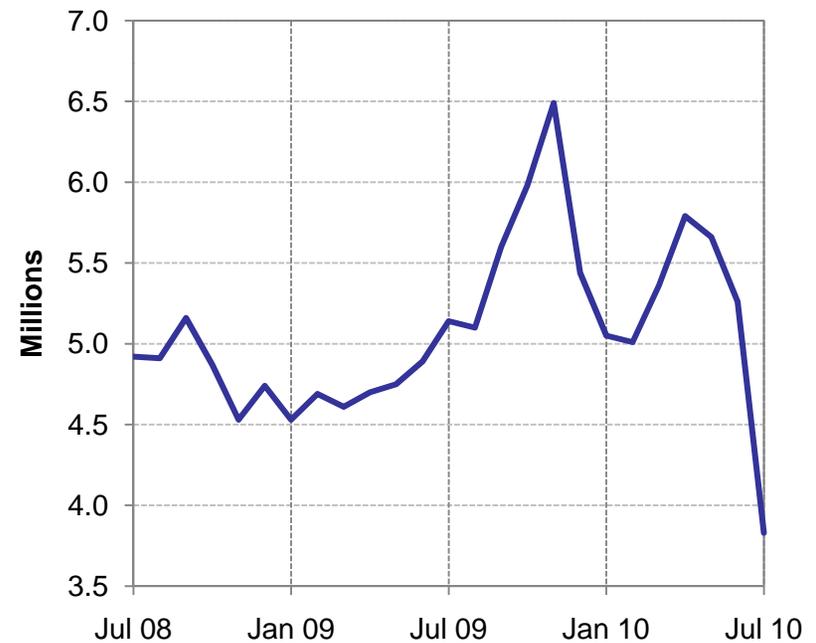
Housing Sector Slide

- Sales of existing houses plunged by a record 27 % in July as the effects of a government tax credit waned, showing a lack of jobs threatens to undermine the U.S. economic recovery. Purchases plummeted to a 3.83 million annual pace, the lowest in a decade of record keeping .

U.S. New Home Sales
July 31, 2008 – July 31, 2010



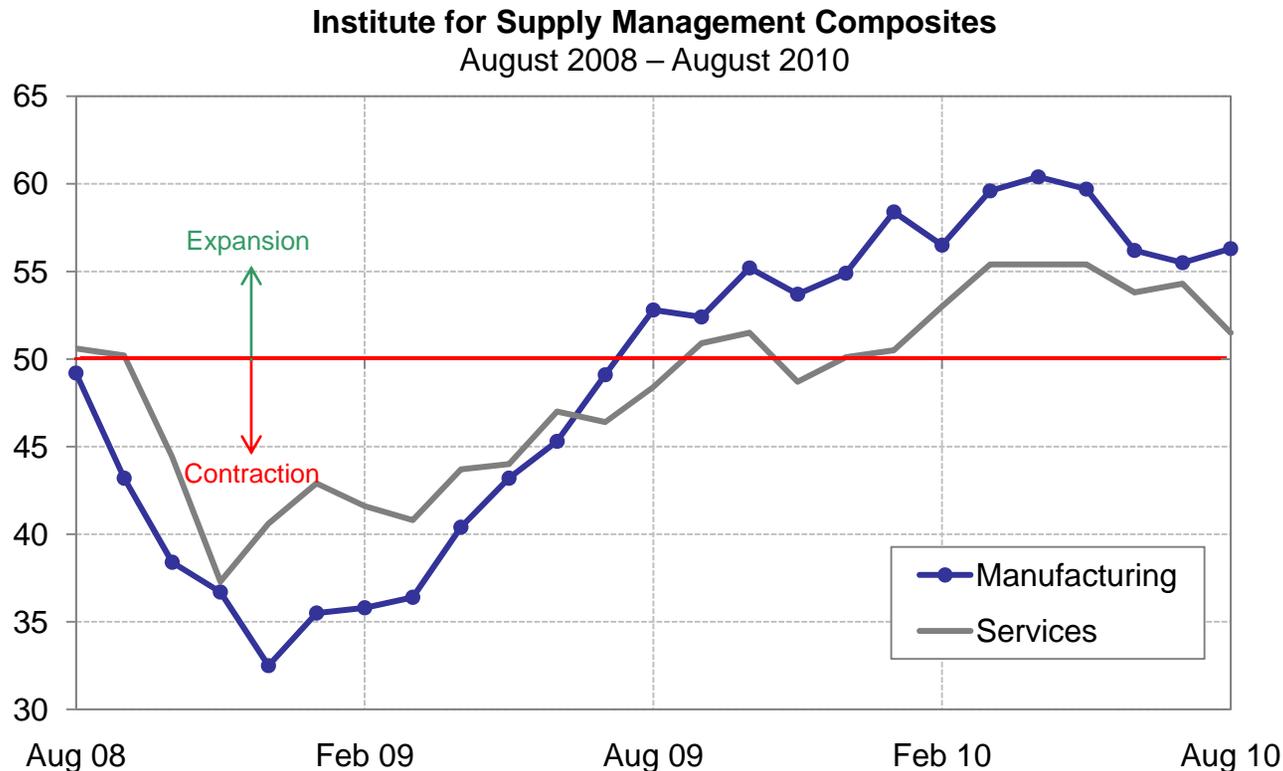
U.S. Existing Home Sales
July 31, 2008 – July 31, 2010



Source: Bloomberg

Recent Manufacturing and Services Data Signal Economic Weakness

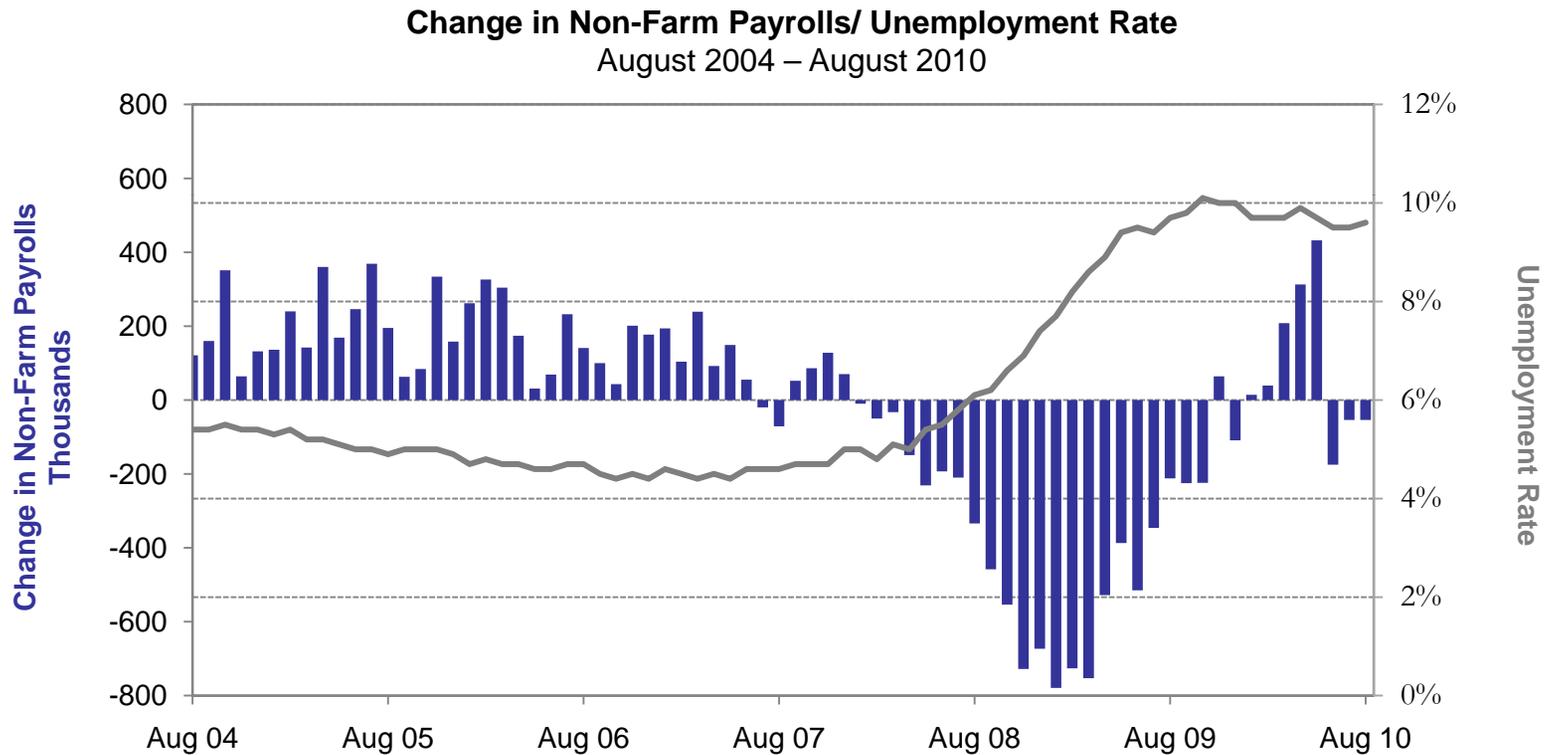
- While the ISM Manufacturing index rose from 55.5 in July to 56.3 in August, all the gains came in lagging indicators – production, employment, and inventories – whereas, leading indicators still point to slowing growth, the new orders component falling from 53.5 to 53.1, the lowest reading since May of 2009.
- Service industries expanded at the weakest pace in seven months, indicating the U.S. economy may be slow to strengthen in the second half of the year.



Source: Institute for Supply Management

Non-Farm Payrolls Decline, But Exceed Expectations

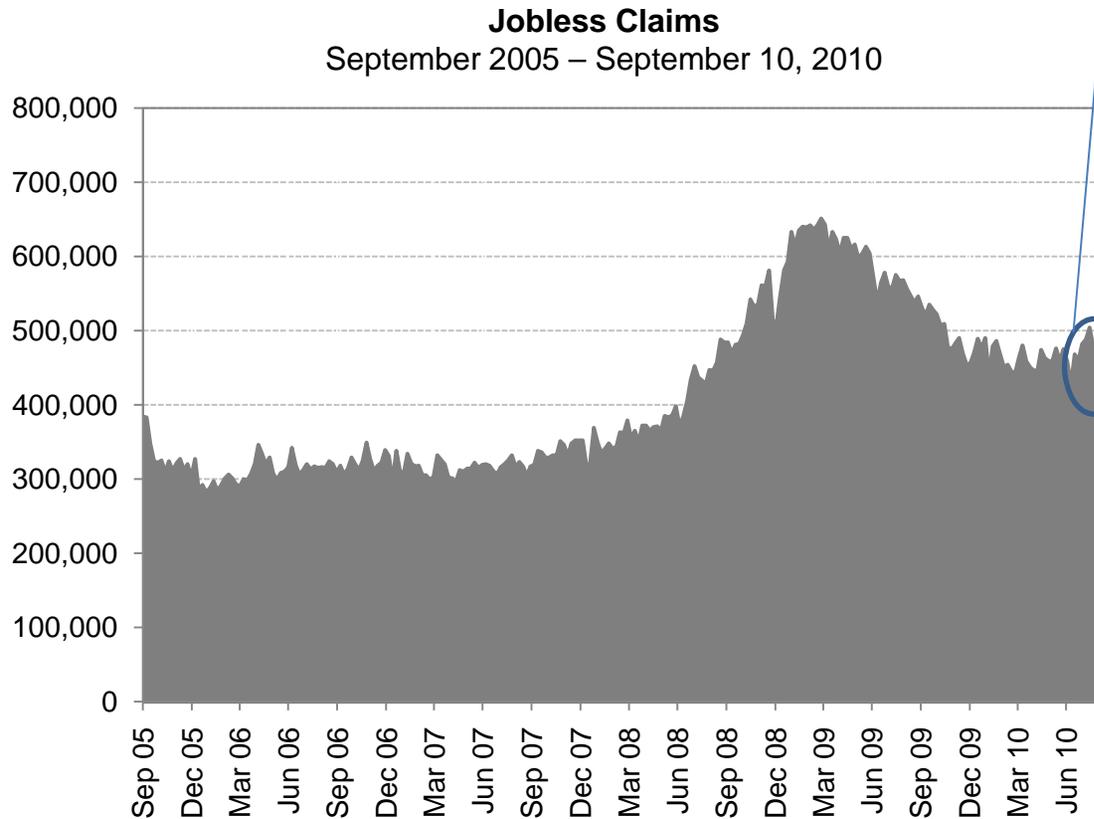
- Nonfarm payrolls dropped by 54,000, exceeding expectations for a 90,000 decrease. Private payrolls were a positive surprise as well, jumping up 67,000 instead of the anticipated 40,000.



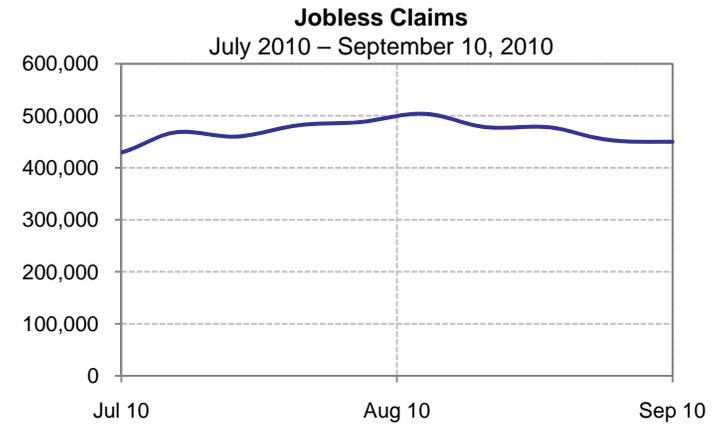
Source: Bloomberg

Jobless Claims Decline, But Still Remain High

- According to the Labor Department, initial jobless claims declined to 450,000 for the week ending September 10. However, in a healthy economy jobless claims are usually below 400,000.



Source: Bloomberg



Retail Sales Show Consumers Are Spending

- Advanced retail sales increased August for a second consecutive month. Sales likely benefitted from back-to-school sales and tax-free holidays in many states.

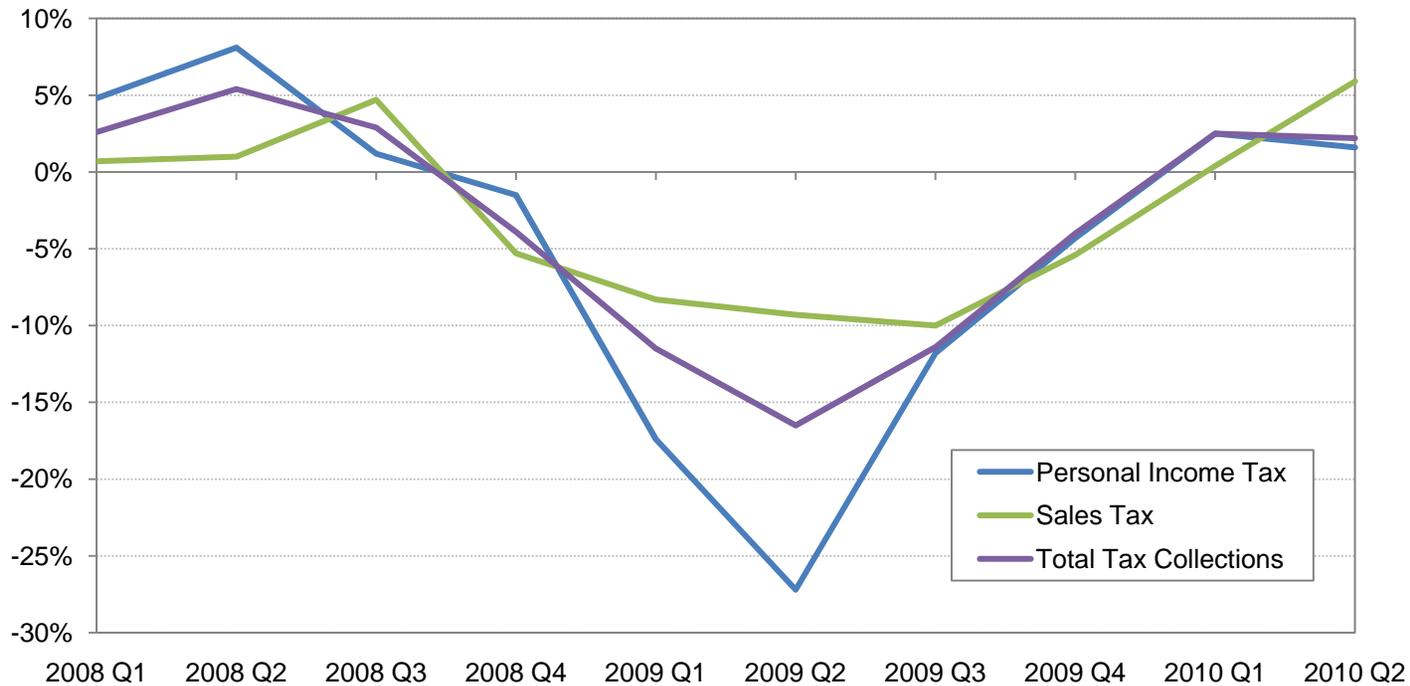


Source: US Commerce Department

State Tax Collection Slowly Rebounding in the Second Quarter of 2010

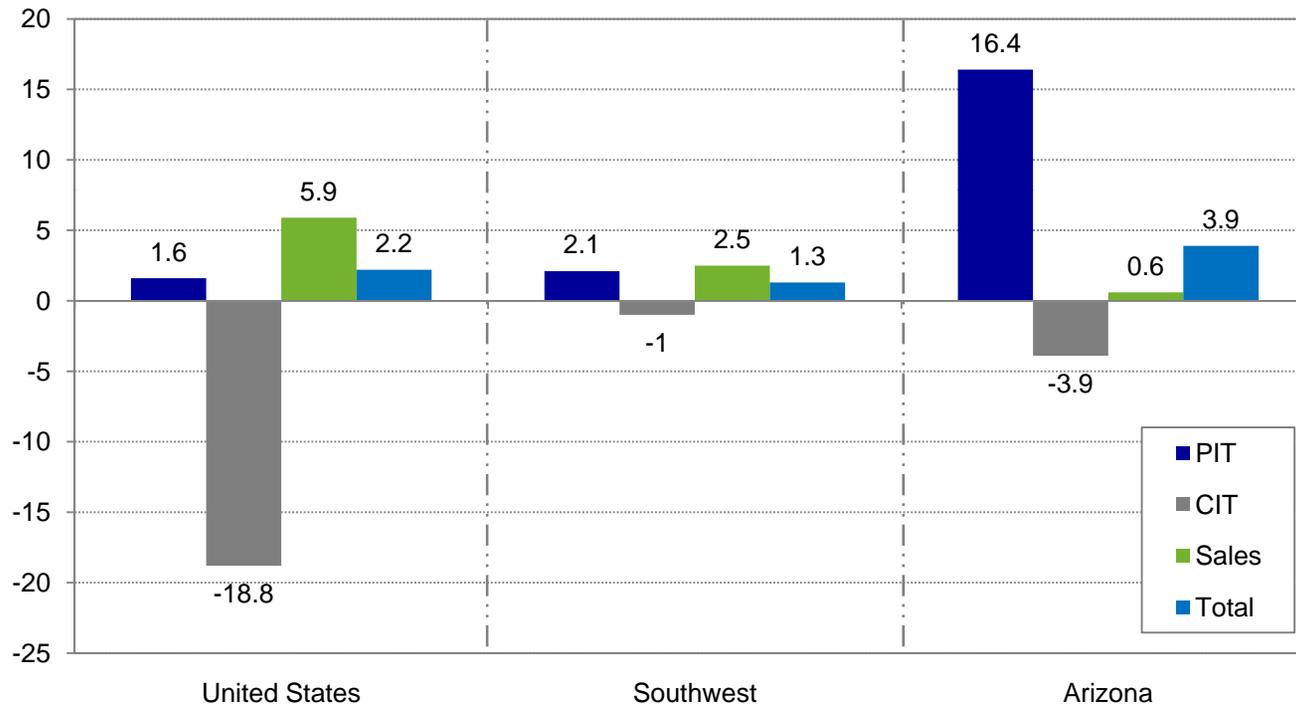
- Preliminary tax collection data for the second quarter of 2010 show improvement in overall state tax collections as well as for personal income tax and sales tax revenue. Overall, revenue collections remain significantly below peak levels and are still weak in a number of states.

Change in State Tax Collections (YoY)
First Quarter 2008 – Second Quarter 2010



The Southwest and Arizona Show Positive Tax Revenue Growth

National vs. Regional vs. Arizona State Tax Collections
April 2009 – June 2010



Source: The Nelson A. Rockefeller Institute of Government

Senate Passes Small Business Bill

- Bill is aimed at boosting access to capital and tax credits to provide temporary financial relief. Some measures include:
 - \$30 billion lending facility that would direct taxpayer money to regional banks on the condition they lend it to small businesses, banks would volunteer to participate.
 - \$12 billion in tax breaks, including an immediate write-off of 50% of new equipment purchases in 2010 for small and large businesses.
- The House must still vote to approve the bill before it is sent to President Obama to sign into law.

PFM's Commitment to Safety

- Global Finance magazine has released its annual list of the world's 50 safest banks.
- Banks were selected through a comparison of the long-term credit ratings and total assets of the 500 largest banks around the world. Ratings from Moody's, Standard & Poor's and Fitch were used.

Approved PFM Issuer as of 8/13/10

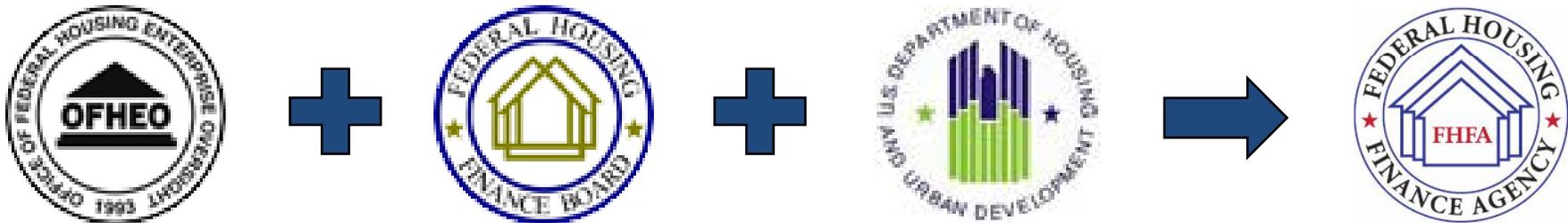
1. KfW	26. Credit Suisse
2. Caisse des Depots et Consignations (CDC)	27. Nordea
3. Bank Nederlandse Gemeenten	28. Caja de Ahorros y Pensiones de Barcelona
4. Zuercher Kantonalbank	29. Svenska Handelsbanken
5. Landwirtschaftliche Rentenbank	30. BNY Mellon
6. Rabobank Group	31. Oversea-Chinese Banking Corporation
7. Landeskreditbank Baden-Wuerttemberg - Foerderbank	32. United Overseas Bank
8. Nederlandse Waterschapsbank	33. Pohjola Bank
9. NRW.Bank	34. Barclays Bank
10. Royal Bank of Canada	35. Intesa Sanpaolo
11. National Australia Bank	36. Bank of Montreal
12. Westpac Banking Corporation	37. CIBC
13. Commonwealth Bank of Australia	38. National Bank Of Kuwait
14. Banco Santander	39. Deutsche Bank
15. Toronto-Dominion Bank	40. JPMorgan Chase
16. Australia and New Zealand Banking Group	41. Société Générale
17. ASB Bank	42. Wells Fargo
18. BNP Paribas	43. Banque Federative du Credit Mutuel
19. HSBC Holdings	44. Landesbank Baden-Wuerttemberg
20. Credit Agricole	45. Credit Industriel et Commercial (CIC)
21. Banco Bilbao Vizcaya Argentaria (BBVA)	46. Nationwide Building Society
22. Scotiabank	47. U.S. Bancorp
23. DBS Bank	48. Shizuoka Bank
24. Banco Espanol de Credito S.A. (Banesto)	49. Northern Trust
25. Caisse centrale Desjardins	50. National Bank of Abu Dhabi

Update on Fannie Mae & Freddie Mac

The Housing and Economic Recovery Act of 2008

July 2008:

- As part of the reform of GSE regulation, the act created a new regulator, the Federal Housing Finance Agency (FHFA), by combining three government agencies.



- Powers granted to the FHFA:
 - Safety and soundness mandate
 - Mission oversight responsibilities for the housing GSEs
 - Certain conservatorship powers, which they would use within a few months.

Conservatorship

September 2008:

- FHFA placed FNMA and FHLMC into conservatorship.
- Goal of conservatorship:
 - Conserve the enterprises' assets
 - Mitigating systematic risk.
- FHFA assumed the power of the board and management.
 - Reconstituted the boards and executive management
 - Eliminated common and preferred dividends (saving \$2B/yr)
 - Halted all political and lobbying activities
 - Implemented enterprise risk oversight system, including:
 - Governance
 - Solvency
 - Earnings
 - Credit/market/operational risk.
- Note: FHFA cannot dissolve the enterprises. This can only be done by an act of Congress.

U.S. Treasury Support

- September 2008
 - Treasury agrees to commit up to \$100 billion to FNMA and FHLMC
- February 2009
 - Raised to \$200B each
- December 2009
 - Raised once again in December 2009 to unlimited amount for next 3 years

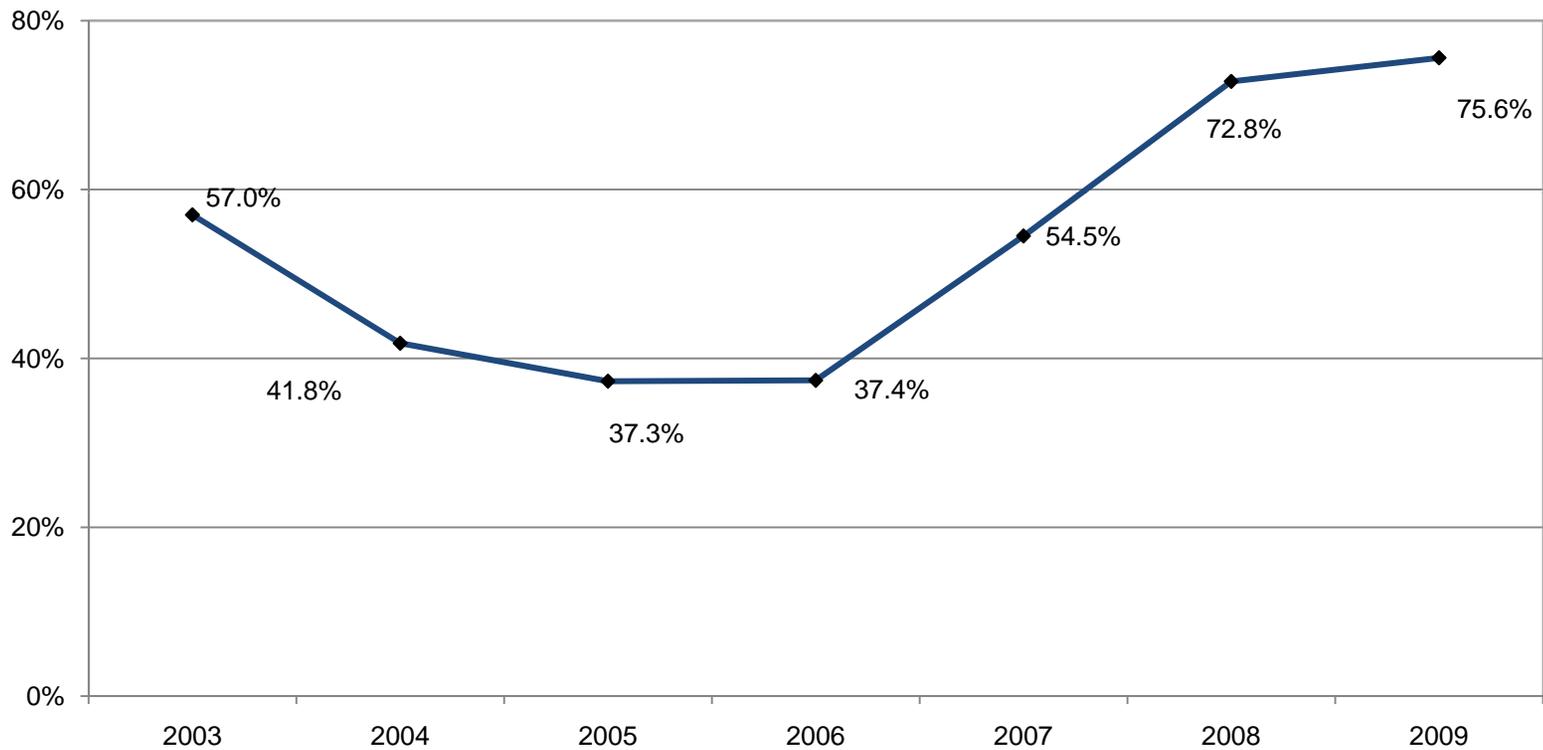
Cumulative Draws of Treasury Senior Preferred Stock by Fannie Mae and Freddie Mac (in billions)
Sep 2008 – June 2010

	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
Fannie Mae	0.0	15.2	34.2	44.9	59.9	75.2	83.6	85.1
Freddie Mac	13.8	44.8	50.7	50.7	50.7	50.7	61.3	63.1
Total	13.8	60.0	84.9	95.6	110.6	125.9	144.9	148.2

Source: FHFA: Quarterly Draws on Treasury Commitments to Fannie Mae and Freddie Mac per the Senior Preferred Stock Purchase Agreements

FNMA and FHLMC Remain Dominant Players

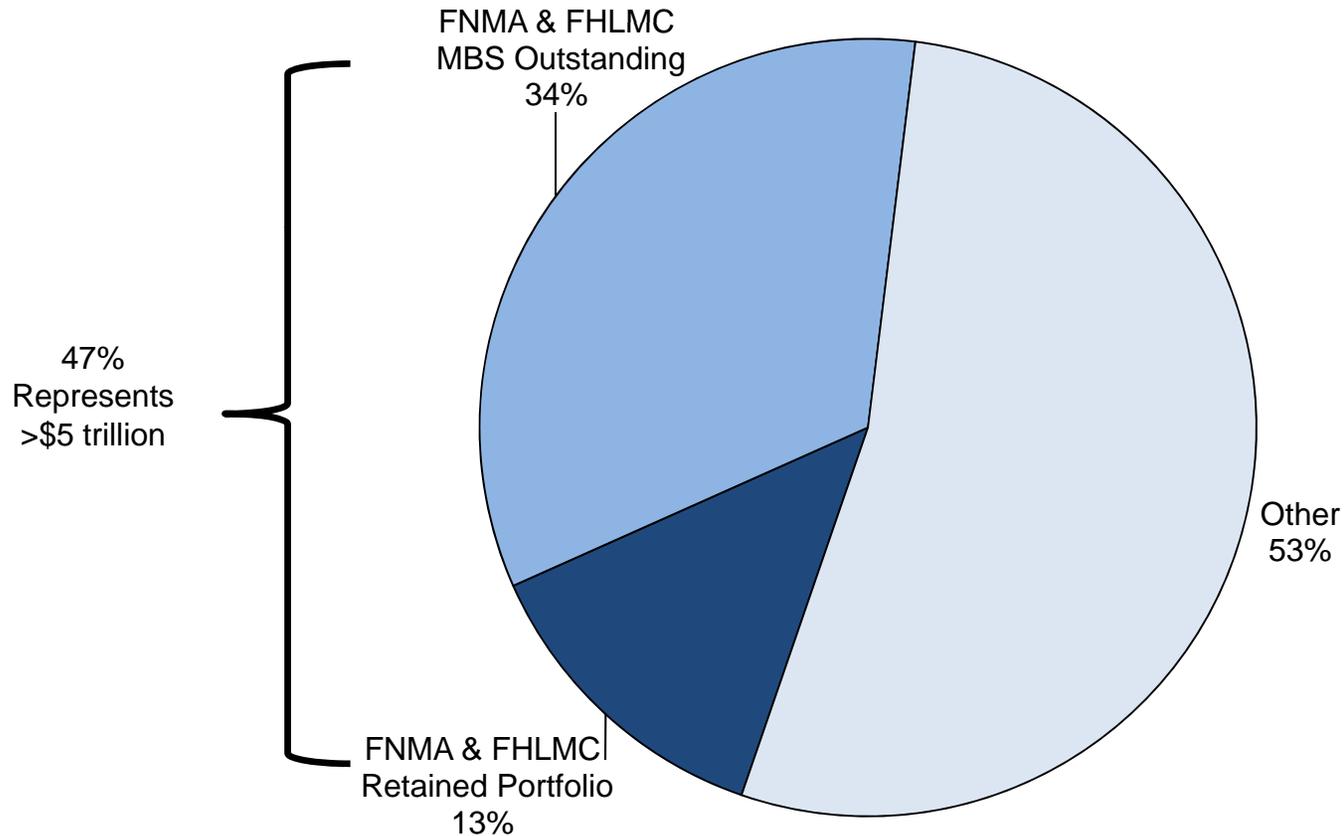
Fannie Mae and Freddie Mac's New Business as Share of Originations



Source: Financial Crisis Inquiry Commission: Preliminary Staff Report on Government Sponsored Enterprises and the Financial Crisis

Market Share of Outstanding Mortgage Debt

Enterprise Share of Residential Mortgage Debt Outstanding
As of 2009



Improved Underwriting

- Loan losses concentrated in 2006 and 2007 vintages.
- Beginning in 2009, significantly tightened underwriting standards.

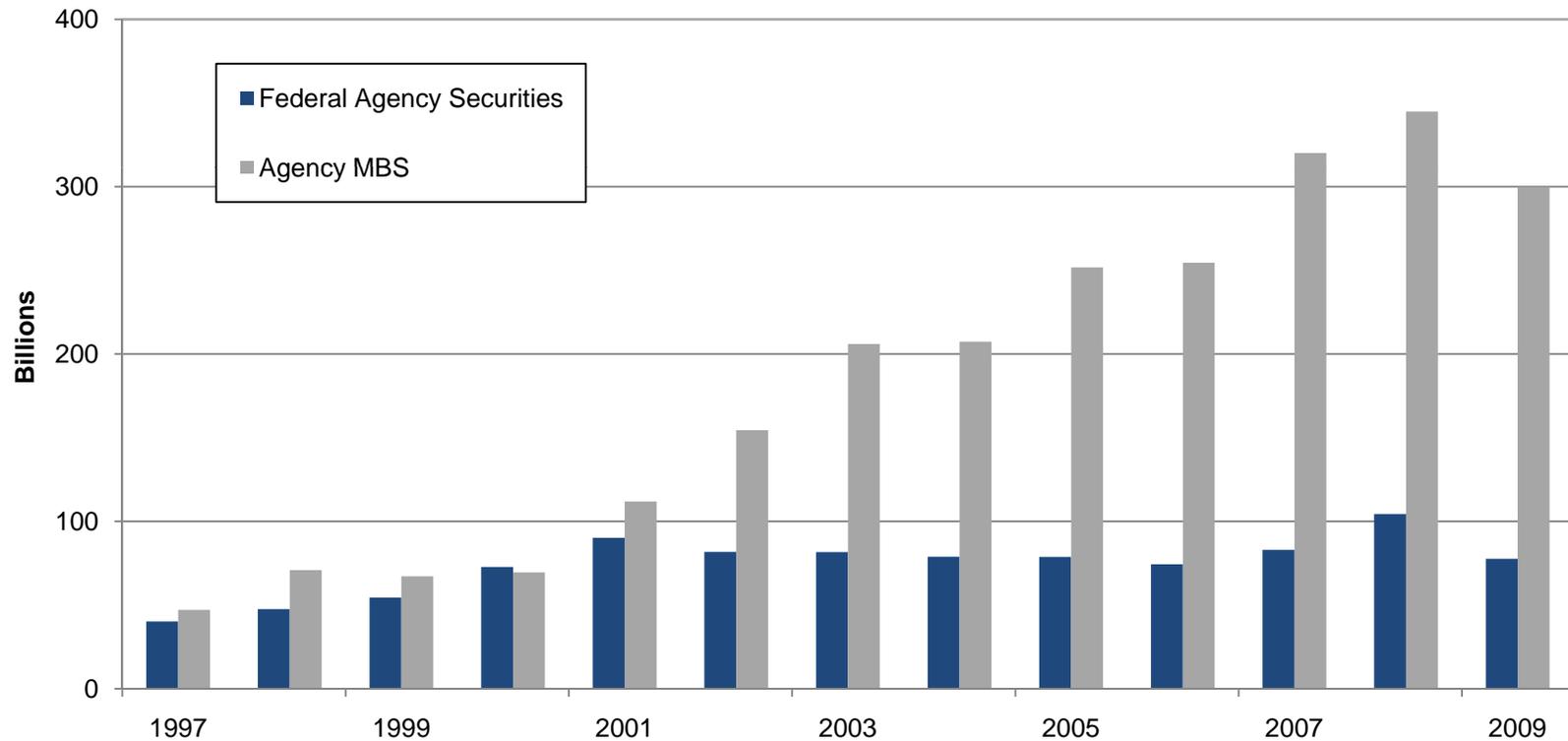
Fannie Mae and Freddie Mac New Commitment Statistics
2007-2009

	2007	2008	2009
LTV< 80%	76%	78%	89%
FICO>720	55%	68%	85%

- Programs to lower default rates and avoid foreclosures:
 - February 2009: **Making Homes Affordable Program (MHA)**. MHA gives homeowners opportunities to modify or refinance their mortgage to make their payments more affordable.
 - **Home Affordable Modification Program (HAMP)**, a component of MHA, is a loan modification process that provides eligible borrowers with monthly mortgage payments equal to 31 percent of their gross monthly income.

Agency Market Remains Active

Federal Agency Average Daily Trading Volume
1997 - 2009

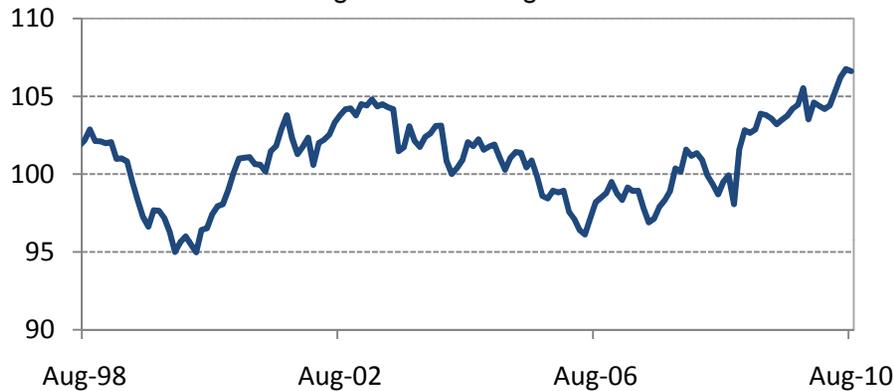


Source: SIFMA US Bond Markets Average Daily Trading Volume

Housing GSEs Retain Market Acceptance

- MBS prices are at record highs, and MBS spreads hit all-time record lows.

Mortgage Master Index Par Weighted Price
August 1998 - August 2010

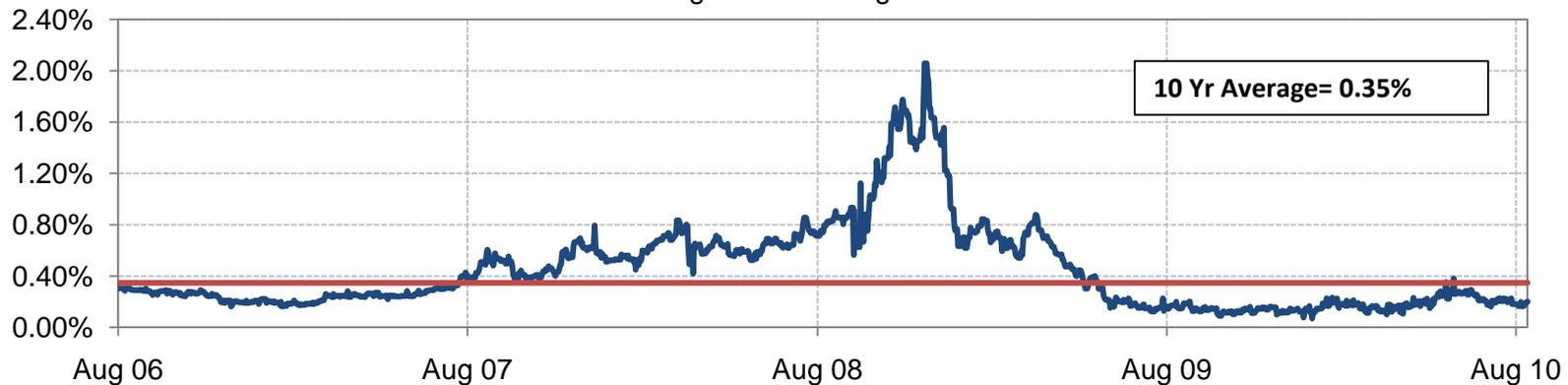


Spread of 30-yr FNMA Current Coupon to 10-yr Treasury
August 1998 - August 2010



- Agency bullet spreads are at narrow levels vs. historical averages

2-yr Treasury - Agency Spread
August 2006 - August 2010



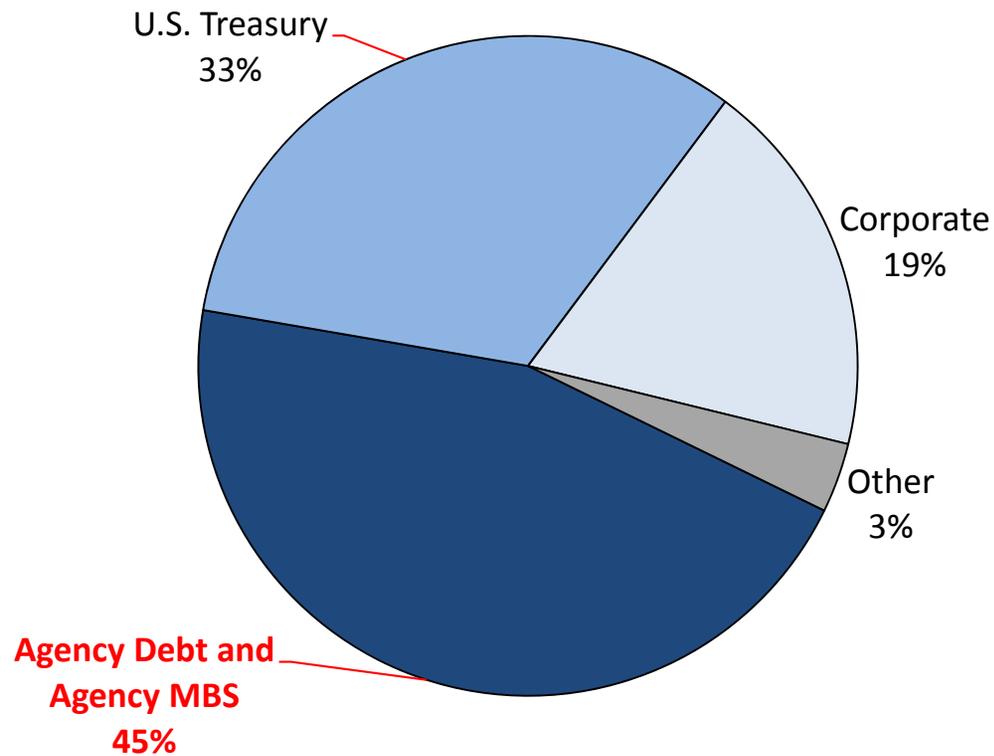
Sr. Debt Credit Ratings Remain “AAA”

Issuer	Type of Debt	S&P	Moody's	Fitch
Fannie Mae	Short Term Debt	A-1+	P-1	F1+
	Long Term Debt	AAA	Aaa	AAA
Freddie Mac	Short Term Debt	A-1+	P-1	F1+
	Long Term Debt	AAA	Aaa	AAA

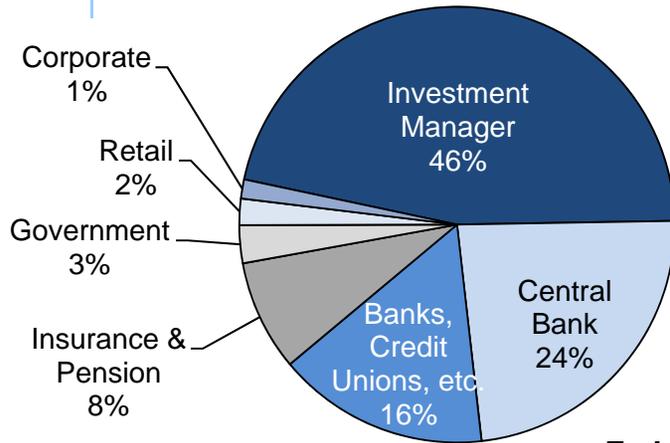
Source: Credit Ratings from Fannie Mae and Freddie Mac Second Quarter 10-Q as of July 30, 2010;
 Fannie Mae 10-K from 2006-2010; Freddie Mac Annual Information Statement from 2002-2008; Freddie Mac 10-K from 2009-2010

Agency Debt Is a Major Asset Class

Barclays Aggregate US Bond Index Composition

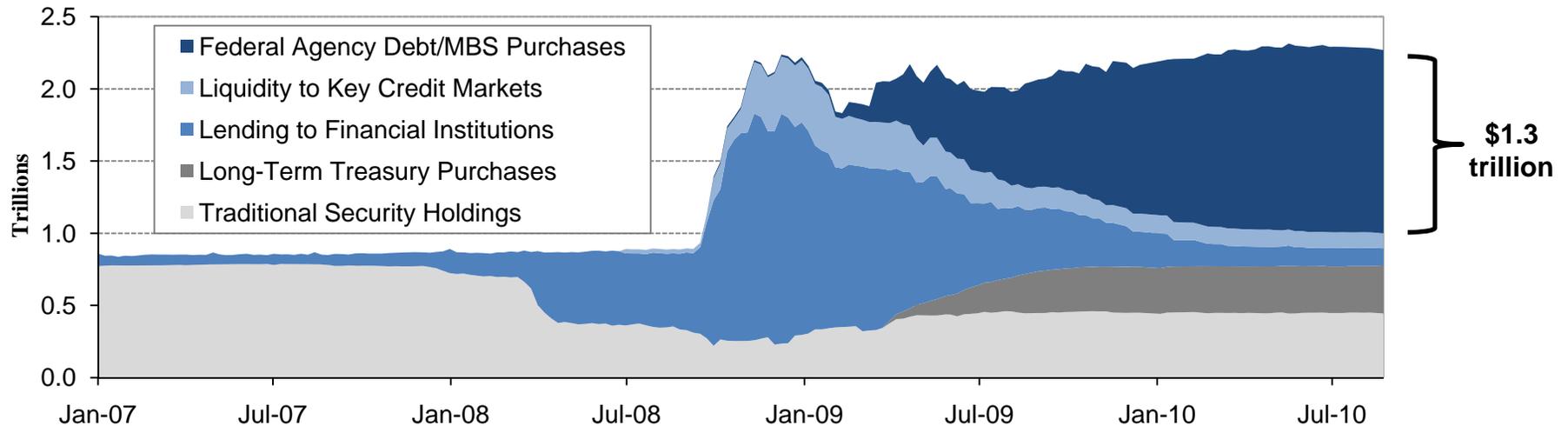


Agency Debt Is Widely Held



Freddie Mac Debt Holders Distribution

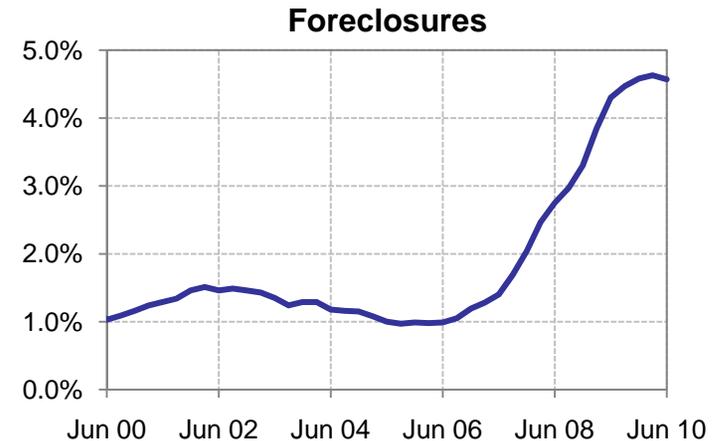
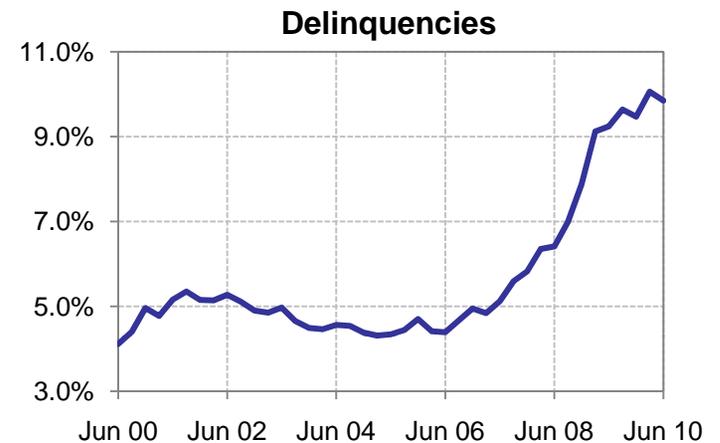
Federal Reserve Balance Sheet Holdings
January 2007 – August 2010



Source: http://www.clevelandfed.org/research/data/credit_easing/index.cfm -- Cleveland Federal Reserve: Credit Easing Policy Tools
 Fed Balance sheet as of August 25th 2010 on slide 12
 Freddie Mac Debt Holders Distribution

Challenges Remain

- Housing market remains weak, but may be bottoming. Serious problems remain in certain geographic regions (NV, CA, AZ, FL).
 - Delinquencies and foreclosures remain at troubling levels, the highest in recent history.
 - REO: collectively they own over 100K properties.
- High unemployment and slow recovery pose significant headwinds.
- Their huge retained portfolios expose them to a huge amount of market risk, should rates move up sharply.
- Continued reliance on front loaded short-term funding.
- Staffing: attracting and retaining high quality staff.
- Ultimate future: to be determined by Congress. For the foreseeable future, there is no alternative. The private-label securitization market is virtually dead, and will never return in its prior form.



Future

3 basic options for the future of FNMA and FHLMC:

- 1) True government agency, essentially nationalization.
- 2) GSE, built upon the new framework and regulatory structure put in place. Would require continuing US Treasury support.
- 3) Fully private firms, which raises currently insurmountable transition issues.

Summary

- Fannie Mae & Freddie Mac remain critical to mortgage finance in the U.S.
- U.S. Treasury providing unlimited support
- Agency debt is widely held
- Agency market remains liquid and widely accepted
- Business conditions are improving
- Default is unthinkable

Disclaimer

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