

## ARTICLE X            INVESTMENT    POLICY    AND    INVESTMENT    STRATEGY STATEMENT

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### 10.01 Introduction and Scope

The Edwards Aquifer Authority (the “Authority”) has developed this Investment Policy (the “Policy”) to satisfy the statutory requirements of Sections 49.157, and 49.199, Texas Water Code and the Texas Public Funds Investment Act, Chapter 2256, Texas Government Code and the Public Funds Collateral Act, Chapter 2257, Texas Government Code requiring local governments to define and adopt a formal written investment policy and written investment strategies for each fund under its control. This Policy applies to all financial assets of the following funds:

- General Fund
- Abandoned Well Closure Assistance Fund
- Conservation/Aquifer Protection Fund
- Habitat Conservation Plan Program Fund
- Other funds established from time to time

Except for cash in certain restricted and special funds, the Authority may consolidate cash and investment balances to ease cash management operations and maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

(a) It is the policy of the Edwards Aquifer Authority’s Board that all available funds are to be invested to the maximum extent possible with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs at the time of the investment in conformance with the legal and administrative guidelines outlined herein for each of the Authority’s funds.

(b) The Board shall review its Investment Policy and investment strategies not less than

annually. In conjunction with its annual financial audit, the Authority shall also perform a compliance audit of management controls on investments and adherence to this Policy. If the Authority invests in other than money market mutual funds, investment pools or accounts offered by its depository banks in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the Investment Officers shall also be formally reviewed, and the result of the review shall be reported to the Board by the auditor.

(c) A written copy of this Policy shall be presented to any person offering to engage in an investment transaction with the Authority or to an investment management firm under contract with the Authority to invest or manage the Authority's investment portfolio.

(d) A business organization, as defined by Section 2256.005(k), Texas Government Code, to include a local government investment pool and a discretionary investment management firm under contract with the Authority shall execute a Certification by Business Organization form confirming the business organization has:

(1) received and reviewed the Authority's Investment Policy; and

(2) acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Authority and the organization that are not authorized by the Authority's Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the entire portfolio or requires an interpretation of subjective investment standards or relates to investment transactions of the Authority that are not made through accounts or other contractual arrangements over which the business organization has accepted discretionary investment authority.

## **10.02 Objectives**

The Authority recognizes that an effective Investment Policy is an essential element of sound fiscal management. To achieve this goal, the Authority states that its primary investment objectives, in the order of priority, are the preservation and safety of the principal, liquidity, investment diversification, reasonable yield, appropriate maturity dates, and the enhanced quality and capability of investment management.

(a) The Authority's Board and staff shall strive to ensure the preservation of principal in each investment transaction, achieve and maintain liquidity by matching investment maturities with forecasted cash flow requirements, and optimize return on the Authority's investment portfolio through sound investment management.

(b) In addition to achieving the stated objectives, all participants in the Authority's investment process shall act responsibly as custodians of the public trust. Investment Officers shall avoid any transaction that might impair public confidence in the Authority's ability to govern effectively.

### 10.03 Investment Strategy

For all investments, the Authority will stagger maturity dates in accordance with cash flow expectations and analysis to meet liquidity and operation requirements. To determine portfolio performance, this Policy establishes the “weighted average yield to maturity” as the standard performance measurement.

In accordance with the Public Funds Investment Act, the Authority maintains general guidelines for their various fund types regarding Suitability, Safety of Principal, Liquidity, Marketability, Diversification and Yield. Each specific fund will stipulate the maximum maturity for that particular fund.

**Suitability:** Any investment eligible in the Investment Policy is suitable for all fund types.

**Safety of Principal:** All investments shall be of high quality with no perceived default risk. Market price fluctuations will occur, however by managing the weighted average days to maturity for all fund types, except for the Habitat Conservation Plan Program Fund, to a maximum allowable maturity of two years for any investment type, the price volatility of the overall portfolio will be minimized. The Habitat Conservation Plan Program Fund shall be allowed to have a maximum maturity of five years for any investment type.

**Liquidity:** All fund types require short-term liquidity. Short-term investment pools, bank deposits, and eligible money market mutual funds shall provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.

**Marketability:** Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash requirement. Historical market “spreads” between the bid and offer prices of a particular security-type of less than ten basis points shall define an efficient secondary market.

**Diversification:** Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of the Authority. Market cycle risk will be reduced by diversifying the appropriate maturity structure out over two years.

**Yield:** Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of a rolling three-month Treasury bill portfolio shall be the minimum yield objective.

The Authority’s Funds Include:

- General Fund
- Abandoned Well Closure Assistance Fund
- Conservation/Aquifer Protection Fund
- Habitat Conservation Plan Program Fund

Specific Objectives of each fund and unique objectives of that fund are as follows:

- (a) General Fund:

The General Fund comprises the basic operating functions of the Authority and accounts

for all financial resources for which a separate fund has not been established. Investment revenue from this fund shall supplement existing revenues. On General Fund investments, the Authority will limit the investment to short term (two years or less). Intermediate term (more than two years) investments are not appropriate to the Authority's objectives because of their inability to supplement current year operations. Within the General Fund, the Authority administers a General Fund Contingency Fund, which is not set up as an actual separate bank account but is simply delineated as a fund for budget purposes only.

(b) Abandoned Well Closure Assistance Fund:

The Abandoned Well Closure Assistance Fund was established to provide financial assistance to low-income well owners to help resolve abandoned well closure matters. Abandoned Well Closure Assistance Fund investment revenue shall provide financial assistance to future well owners in need of assistance. Therefore, the Authority will limit all investment to short term (two years or less).

(c) Conservation/Aquifer Protection Fund:

The purpose of the Conservation/Aquifer Protection Fund shall be to hold funds, and the earnings therefrom, to be expended by the Authority for various projects related to the conservation and protection of the Aquifer. These funds come from payments by violators of the Authority's rules and from leases of Authority-controlled groundwater permits. Conservation/Aquifer Protection Fund investment revenue shall provide for the funding of future and/or on-going projects and programs related to this fund. Therefore, the Authority will limit all investment to short term (two years or less).

(d) Habitat Conservation Plan Program Fund:

The purpose of the Habitat Conservation Plan Program Fund shall be to hold funds, and the earnings therefrom, to be expended by the Authority for various projects detailed in the "Implementing Agreement" between the Authority, various parties and the United States Fish and Wildlife Service. The primary source of revenue to implement the Habitat Conservation Plan is an annually determined Program Aquifer Management Fee assessed against municipal and industrial permit holders and contributions from various parties subject to a "Joint Funding Agreement" for the implementation of the Habitat Conservation Plan. The Authority's objectives under the Habitat Conservation Plan Program involve accumulation of funds in excess of annual operational needs to cover costs during irregular periods for certain programs over the life of the Habitat Conservation Plan. Therefore, the Authority will limit all investment to short and intermediate term (five years or less).

#### **10.04 Investment Officers**

(a) The Authority's Board designates the Executive Director - Administration and Financial Services and the Controller as the Investment Officers. The Board delegates to the Investment Officers of the Authority, the authority and responsibility to manage the Authority's investment program subject to all applicable laws, the Authority's written Investment Policy,

including all amendments, and directions, policies and resolutions from time to time adopted by the Board.

(1) It is understood that implicit in this delegation of authority is authorization for the Executive Director - Administration and Financial Services to direct duties as are appropriate and necessary to satisfy the Authority's investment responsibilities.

(2) All investments shall be made with judgment and care under circumstances then prevailing that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived.

(3) The Authority's Board retains ultimate responsibility as a fiduciary of the Authority's assets. Each Investment Officer, and their designees, acting in accordance with this Policy and written strategies, and exercising due diligence shall be relieved of personal responsibility and liability in the management of the portfolio, provided that deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse market effects.

(4) Each Investment Officer, if he/she has a personal business relationship with an entity seeking to sell an investment to the Authority, shall file a statement disclosing that personal business relationship with the Texas Ethics Commission and the Board of the Authority. A personal business relationship will exist if:

(A) the Investment Officer owns 10 percent or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;

(B) funds received by the Investment Officer from the business organization exceed 10 percent of the Investment Officer's gross income for the previous year; or

(C) the Investment Officer has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the Investment Officer.

(5) Each Investment Officer, if he/she is related to an individual seeking to sell an investment to the Authority within the second degree of affinity or consanguinity as determined under chapter 573 of the Texas Government Code, shall file a statement disclosing the relationship with the Texas Ethics Commission and the Board of the Authority.

#### **10.05 Authorized Investments**

The Authority shall require a competitive environment for all individual security purchases and sales, financial institution time deposit placements and financial institution transaction accounts, and money market mutual fund and local government investment pool selections. The Executive Director - Administration and Financial Services shall develop and maintain procedures

for ensuring a competitive environment in the investment of the Authority's funds.

The Authority may invest in the following investments as authorized by the Public Funds Investment Act, Texas Government Code Chapter 2256.

(a) Obligations of the United States or its agencies and instrumentalities, including the Federal Home Loan Banks and letters of credit,

(b) Direct obligations of the State of Texas or its agencies and instrumentalities,

(c) Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of the State of Texas, the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States,

(d) Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than "A" or its equivalent,

(e) Financial Institution Deposits issued by a state or national bank, savings bank, or credit union in compliance with the Public Funds Investment Act that are insured by the Federal Deposit Insurance Corporation (FDIC) or its successor, or the National Credit Union Share Insurance Fund (NCUSIF) or its successor or collateralized in compliance with the Public Funds Investment Act, the Public Funds Collateral Act and this Policy. Quotes for certificates of deposit may be solicited orally, in writing, electronically, or in any combination of those methods.

(f) Fully collateralized repurchase agreement(s) if the repurchase agreement:

(1) has a defined termination date;

(2) is secured by a combination of cash and obligations described by Section 2256.009(a)(1) of the Texas Government Code;

(3) requires the cash or securities being purchased by the Authority to be pledged to the Authority, either directly or through a joint account (maintained by a custodian bank and established on behalf of two or more parties to engage in aggregate repurchase agreement transactions) approved by the Authority, held in the Authority's name, either directly or through a joint account (maintained by a custodian bank and established on behalf of two or more parties to engage in aggregate repurchase agreement transactions) approved by the Authority, and deposited at the time the investment is made with the Authority or with a third party selected and approved by the Authority; and

(4) is placed through a primary governmental securities dealer, as defined by the Federal Reserve, or a financial institution doing business in Texas.

(5) A repurchase agreement made by the Authority under this section may be submitted for clearing and settlement to a covered clearing agency, as defined by the Securities and Exchange Commission in 17 C.F.R. Section 240.17Ad-22.

(g) No-load money market mutual fund(s) if the mutual fund:

(1) is registered with and regulated by the Securities and Exchange Commission;

(2) includes in its investment objectives the maintenance of a stable net asset value of \$1.0000 for each share;

(3) invests funds in a manner consistent with a “government” money market mutual fund;

(4) maintains a AAA-m, or equivalent rating from at least one nationally recognized rating agency; and

(5) provides the Authority with a prospectus and other information required by the Securities Exchange Act of 1934 or the Investment Company Act of 1940.

(h) A guaranteed investment contract for bond proceeds if the guaranteed investments contract:

(1) has a defined termination date;

(2) is secured by obligations described by Section 2256.009(a)(1) of the Texas Government Code, excluding those obligations described by Section 2256.009(b) of the Texas Government Code, in an amount at least equal to the amount of bond proceeds invested under the contract;

(3) is pledged to the Authority and deposited with the Authority or with a third party selected and approved by the Authority;

(4) is specifically authorized as an eligible investment in the order, ordinance or resolution authorizing the issuance of bonds;

(5) provides for the receipt of bids from at least three separate providers with no material financial interest in the bonds from which proceeds are received;

(6) is purchased at the highest yield for which a qualifying bid is received;

(7) provides that the price accounts for the reasonably expected drawdown schedule for the bond proceeds to be invested; and

(8) stipulates that the provider certifies the administrative costs reasonably

expected to be paid to third parties in connection with the guaranteed investment contract.

(9) Bond proceeds, other than bond proceeds representing reserves and funds maintained for debt service purposes, may not be invested under Section 2256.015 of the Texas Government Code, in a guaranteed investment contract with a term of longer than five years from the date of issuance of the bonds.

(i) An eligible investment pool as provided in Section 2256.016 and 2256.019 of the Public Funds Investment Act. Among other requirements, the investment pool must furnish to the Authority's Investment Officer an offering circular or other similar disclosure that contains the maximum average dollar-weighted maturity allowed, based on the stated maturity date for the portfolio.

The Authority is not required to liquidate investments that were authorized investments at the time of purchase but no longer meet one or more requirements of this Policy. An investment that requires a minimum rating does not qualify as an authorized investment during the period that the investment does not have the minimum rating. The Authority shall monitor the rating of each issuer, as applicable, at least quarterly, and take all prudent measures that are consistent with this Policy to liquidate an investment that does not have the minimum rating.

#### **10.06 Investment Restrictions**

The Authority may not:

(a) invest an amount that exceeds 10 percent of the total assets of any one money market mutual fund;

(b) invest in obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;

(c) invest in obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;

(d) invest in collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and

(e) invest in collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

#### **10.07 Risk and Diversification**

The Authority recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Risk is controlled through portfolio diversification that shall be achieved by the following general guidelines:



(a) Credit Risk – The Authority will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

- (1) Limiting investments to the safest types of securities,
- (2) Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with whom the Authority will do business, and
- (3) Diversifying the investment portfolio so that potential losses on individual investments will be minimized.

(b) Interest Rate Risk – The Authority will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates by:

- (1) Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and
- (2) Investing shorter-term operating funds primarily in liquid financial institution deposits, shorter-term securities, money market mutual funds or similar investment pools.

All investment funds shall be placed directly with authorized investment providers. The Authority will not deposit or invest funds through third parties or money brokers.

#### **10.08 Investment Advisors**

By resolution, the Board may contract with an investment management firm to provide management advice and assist the Authority in the investment and management of the Authority's public funds and other funds under its control. The investment management firm shall be registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board. No such contract shall be for a term longer than two years, and a renewal or extension of such contract must be made by resolution of the Board. The Authority may not authorize an investment management firm to invest the Authority's public funds or other funds under the Authority's control in repurchase agreements using a joint account.

To be eligible for consideration, an investment advisor shall demonstrate knowledge of and experience in the management of public funds within the state of Texas. An appointed investment advisor shall act within the guidelines of this Investment Policy while transacting business on behalf of the Authority.

#### **10.09 Selection of Authorized Brokers**

The Authority Board shall, at least annually, review, revise and adopt a list of qualified brokers that are authorized to engage in investment transactions with the Authority. The current list of approved Broker/Dealers is:

FHN Financial  
Frost Bank  
Multi-Bank Securities  
Rice Financial Products Co.  
Raymond James & Associates, Inc.  
Wells Fargo Securities

## **10.10 Safekeeping and Custodial Agreements**

The Authority shall contract with a bank or banks for the safekeeping of securities either owned by the Authority as part of its investment portfolio, or held as collateral to secure demand or time deposits. Securities owned by the Authority shall be held in the Authority's account as evidenced by safekeeping receipts of the institution holding the securities.

Collateral for deposits will be held by a third-party custodian designated by the Authority and pledged to the Authority as evidenced by safekeeping receipts of the institution with which the collateral is deposited. Original safekeeping receipts shall be obtained. Collateral may be held by a Federal Reserve Bank or branch of a Federal Reserve Bank, a Federal Home Loan Bank, or a third-party bank approved by the Authority.

Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the Authority to require full collateralization of all Authority funds on deposit with a depository bank. To anticipate market changes and provide a level of security for all funds, with the exception of deposits secured with irrevocable letters of credit at 100% of the deposit amount plus anticipated interest, all deposits with financial institutions shall be secured by pledged collateral with a market value equal to or greater than 102% of total value of principal and accrued interest of the deposits, less any amount insured by the FDIC or NCUSIF. At its discretion, the Authority reserves the right to accept or reject any specific pledged security as collateral, or to require a higher level of collateralization for certain pledged securities.

Securities pledged as collateral shall be held by an independent third-party with which the Authority has a current custodial agreement, a Federal Home Loan Bank, or a Federal Reserve Bank. The Investment Officer is responsible for entering into collateralization agreements with third-party custodians in compliance with this Policy. The agreements are to specify the acceptable securities for collateral, including provisions relating to possession of the collateral, the substitution or release of pledged securities, control of securities, and the method of valuation of securities. A clearly marked evidence of pledge (collateral receipt) must be supplied to the Authority and retained. Collateral shall be reviewed at least monthly to assure that the market value of the pledged securities is adequate. The result of such valuations shall be reported to the Authority's Finance/Administrative Committee at least semi-annually.

The Authority shall accept only the following types of collateral:

- (a) Obligations of the United States or its agencies and instrumentalities;

- (b) Direct obligations of the state of Texas or its agencies and instrumentalities;
- (c) Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States;
- (d) Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized rating firm not less than A or its equivalent with a remaining maturity of ten (10) years or less;
- (e) A surety bond issued by an insurance company rated as to investment quality by a nationally recognized rating firm not less than A; and
- (f) A letter of credit issued to the Authority by the Federal Home Loan Bank.

All collateral shall be subject to inspection and audit by the Investment Officer or the Authority's independent auditors. A monthly report listing the collateral must be provided to the Authority.

Financial institutions serving as depositories will be required to sign a written depository contract with the Authority, when applicable. The collateralized deposit portion of the contract shall define the Authority's rights to the collateral in case of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with federal and state regulations. Additionally, the contract must be executed by the depository and Authority contemporaneously with the acquisition of the asset, approved by the Board of Directors or designated committee of the depository and a copy of the meeting minutes or adopted resolution must be delivered to the Authority, and the agreement must be a part of the depository's "official record" continuously from its execution.

### **10.11 Payment for Investment**

Payment shall be made by the Authority for investment securities authorized by this Policy upon delivery thereof to the Authority or to a custodial bank, or in the case of a book-entry transactions shall be done on a delivery versus payment basis and shall be credited to the custodial bank's Federal Reserve System account held in favor of the Authority. All transactions shall be confirmed in writing to the Authority.

### **10.12 Investment Reporting**

The Investment Officers shall provide a quarterly report to the General Manager and Board regarding the total investments for the quarter and a detailed listing for each investment. The report must:

- (a) Describe in detail the investment position of the Authority on the date of the report.
- (b) Be signed by each Investment Officer of the Authority.

- (c) Contain a summary statement of a pooled fund group that states the:
  - (1) beginning market value for the reporting period;
  - (2) ending market value for the period; and
  - (3) fully accrued interest for the period.
- (d) State the book value and market value of each separately invested asset at the end of the reporting period by type of asset and fund type invested.
- (e) State the maturity date of each separately invested asset that has a maturity date.
- (f) State the account or fund or pooled group fund in the state agency or local government for which each individual investment was acquired.
- (g) State the compliance of the investment portfolio of the Authority as it relates to the investment strategy expressed in the Authority's Investment Policy and relevant provisions of the Public Funds Investment Act.

### **10.13 Investment Training**

Not later than the first anniversary of the date of the Investment Officers taking office or assuming the Officer's duties, each Investment Officer shall attend a training session of at least six hours of instruction relating to investment responsibilities under the Public Funds Investment Act and attend at least four hours of additional investment training within each two-year period after the first year. In accordance with the Public Funds Investment Act, the two-year period will align with the Authority's fiscal years. Training must be from an independent source approved by the Board, and shall include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with the Public Funds Investment Act. The current approved list of independent training sources is:

- Government Finance Officers Association of Texas
- Government Treasurers' Organization of Texas
- American Institute of Certified Public Accountants (AICPA)
- Texas Society of Certified Public Accountants (TSCPA)
- Council of Governments
- University of North Texas Center for Public Management