

HEADWATERS GROUNDWATER CONSERVATION DISTRICT
PUBLIC FUNDS INVESTMENT POLICY

Revised July 26, 2023

I. POLICY

It is the policy of the Headwaters Groundwater Conservation District (District), through the District's Board of Directors (Board), that after allowing for the anticipated cash flow requirements of the District and giving due consideration to the safety and risk of all deposits and investments, all available funds shall be deposited and invested in conformance with these legal and administrative guidelines seeking to optimize safety and preservation of principal.

Effective cash management is recognized as essential to good fiscal management. Investment interest is a source of revenue to District funds. The District's investment portfolio shall be designed and managed in a manner designed to be responsive to safety, liquidity, public trust, optimization of interest revenue and to be in compliance with legal requirements and limitations.

Investments shall be prioritized in the following order:

1. Safety and preservation of principal;
2. Maintenance of sufficient liquidity to meet operating needs;
3. Public trust from prudent investment activities; and
4. Optimization of interest earnings on the portfolio.

II. PURPOSE

The purpose of this investment policy is to comply with Chapter 36, Water Code, and Chapters 2256 and 2257, Government Code, ("Public Funds Investment Act" and "Public Funds Collateral Act," respectively), which requires each District to adopt a written investment policy regarding the deposit/investment of its funds and funds under its control. The Investment Policy addresses the methods, procedures and practices that must be exercised to ensure effective and judicious fiscal management of the District funds.

III. SCOPE

This Investment Policy shall govern the deposits and investments of all financial assets of the District. These funds are accounted for in the District's Comprehensive Annual Financial Report (CAFR) and include:

General Fund

- Operating Account in the District's selected depository bank
- Reserve funds (Cash/CD's)
- Any new fund created by the District, unless specifically exempted from this Policy by the Board or by law.

Investment income will be allocated to the various funds based on their respective participation.

This Investment Policy shall apply to all transactions involving the financial assets and related activity for all the foregoing funds. This policy does not apply to the assets administered for the benefit of the District by outside agencies under deferred compensation programs.

IV. INVESTMENT OBJECTIVES

The District shall manage and invest its cash with four primary objectives, listed in order of priority: (1) safety, (2) liquidity, (3) public trust, and (4) yield, expressed as optimization of interest earnings. The safety of the principal invested always remains the primary objective. All deposits and investments shall be designed and managed in a manner responsive to the public trust and consistent with state and local law.

The District shall maintain a comprehensive cash management program, which includes collection of account receivables, vendor payments in accordance with invoice terms, and prudent deposits and investment of available cash. Cash management is defined as the process of managing monies in order to ensure maximum safety, cash availability, public trust, and optimized earnings of idle cash.

Safety

Safety of principal is the foremost objective of the investment program. Deposits and Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit and interest rate risk.

Credit Risk and Concentration of Credit Risk – The District will minimize credit risk, the risk of loss due to the failure of the issuer or backer of the investment, and concentration of credit risk, the risk of loss attributed to the magnitude of investment in a single issuer, by:

- Limiting investments to the safest types of investments;
- Pre-qualifying the financial institutions and broker or dealers with which the District will do business; and
- Diversifying the investment portfolio so that potential losses on individual investments will be minimized.

Interest Rate Risk – the District will manage the risk that the interest earnings and the market value of investments in the portfolio will fall due to changes in general interest rates by limiting the maximum weighted average maturity of the investment portfolio to 365 days. The District will, in addition:

- Structure the investment portfolio so that investments mature to meet cash requirements for ongoing operations, thereby avoiding the need to liquidate investments prior to maturity.
- Invest operating funds primarily in certificates of deposit.

- Diversify maturities and staggering purchase dates to minimize the impact of market movements over time.

Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that investments mature concurrent with cash needs to meet anticipated demands. Because all possible cash demands cannot be anticipated, the portfolio will be deposited in the District's selected depository bank in an operating account. Reserves may be placed in Certificates of Deposit.

Public Trust

All participants in the District's investment process shall seek to act responsibly as custodians of the public trust. Investment officers must avoid any transaction that might impair public confidence in the District's ability to govern effectively.

Yield (Optimization of Interest Earnings)

The investment portfolio shall be designed 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. Return on investment is of secondary importance compared to the safety and liquidity objectives described above.

V. RESPONSIBILITY AND CONTROL

Delegation of Authority

In accordance with Chapter 36.1561, Water Code, and the Public Funds Investment Act, the District Board designates the *General Manager* as the Public Funds Investment Officer. The Public Funds Investment Officer is authorized to execute investment transactions on behalf of the District. All investment transactions shall require two signatures that of the Public Funds Investment Officer and a Director that is an authorized signer. No person may engage in an investment transaction or the management of District funds except as provided under the terms of this Investment Policy as approved by the Board. The investment authority granted to the investing officer is effective until rescinded by the Board or immediately upon the Investment Officer's employment termination.

Quality and Capability of Investment Management

The District shall provide periodic training in investments for the designated Public Funds Investment Officer through courses and seminars offered by professional organizations,

associations, and other independent sources in order to ensure the quality and capability of investment management in compliance with the Public Funds Investment Act.

Training Requirement

The Investment Officer of the District shall attend a training session of at least six hours of instruction relating to investment responsibilities under Chapter 2256, Government Code, not later than the first anniversary of the date the officer takes office or assumes the officer's duties. The Investment Officer shall attend at least four hours of additional investment training within each two-year period after the first year. The investment training session shall be provided by an independent source approved by the Board. For purposes of this policy, an "independent source" from which investment training shall be obtained shall include a professional organization, an institution of higher education or any other sponsor other than a business organization with whom the District may engage in an investment transaction. The following organizations are specifically authorized as independent sources for training:

- Texas Alliance of Groundwater Districts
- Texas Water Conservation Association
- Association of Water Board Directors
- University of North Texas, Center for Public Management
- William P. Hobby Center for Public Service at Texas State University

Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with Chapters 2256 and 2257, Government Code.

Internal Controls

The General Manager is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the District's General Manager shall establish a process for annual independent review by an external auditor performed according to the generally accepted government auditing standards adopted by the American institute of Certified Public Accountants, to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion.
- Separation of transactions authority from accounting and record keeping.
- Custodial safekeeping.
- Avoid physical delivery of securities.
- Clear delegation of authority to subordinate staff members.

Prudence

The standard of prudence to be applied by the Public Funds Investment Officer shall be the “prudent investor” rule:

“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 safety of their capital as well as the probable income to be derived.”

In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

- The investment of all funds, or funds under the District’s control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and
- Whether the investment decision was consistent with the written approved investment policy of the District.

Indemnification

The Public Funds Investment Officer may not be held personally responsible for a specific investment’s credit risk or market price changes as long as the officer acted in accordance with written procedures and exercised due diligence, provided that the officer reports these deviations immediately and the appropriate action is taken to control adverse developments.

Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with the proper execution and management of the investment program, or that would impair their ability to make impartial decisions. Employees and Investment Officers shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial or investment positions that could be related to the performance of the investment portfolio. Employees and officers are prohibited from undertaking personal investment transactions with the same person with whom business is conducted on behalf of the District.

An Investment Officer of the District who has a personal business relationship with an organization seeking to sell an investment to the District shall file a statement disclosing that personal business interest. An Investment Officer who is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the

District shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the District Board.

An Investment Officer has a personal business relationship with a business organization if:

- 1. 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;*
- 2. 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*
- 3. 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.*

VI. SUITABLE AND AUTHORIZED INVESTMENTS

Portfolio Management

The District has a “buy and hold” portfolio strategy. Maturity dates are matched with cash flow requirements and investments are purchased with the intent to be held until maturity. However, investments may be liquidated prior to maturity for the following reasons:

- An investment with declining credit may be liquidated early to minimize loss of principal.
- Cash flow needs of the District require that the investment be liquidated.

Authorized Investments

District funds governed by this policy may be invested in the instruments described below, all of which are authorized by Chapter 2256 of the Government Code (Public Funds Investment Act). Investment of District funds in any instrument or security not authorized for investment under the Act is prohibited.

1. Depository Bank Operating Account – General Fund
2. Certificates of Deposit issued by a depository institution that has its main office or a branch office in Kerr County, Texas. The certificate of deposit must be guaranteed or insured by the Federal Deposit Insurance Corporation. Any funds held in excess of the amount insured shall be secured by obligations in a manner and amount as provided by law and the District's collateral policy.

All prudent measures will be taken to liquidate an investment that is downgraded to less than the required minimum rating. The Public Funds Investment Officer shall, at least monthly, review the credit quality rating of instruments in the District's portfolio using published resources from at least one nationally recognized rating service.

Prohibited Investments

The following are prohibited investments:

1. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
2. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
3. Collateralized mortgage obligations that have a final stated maturity date of greater than 10 years;
4. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index;
5. Investments in companies engaged in business with the governments of Sudan and Iran or with a foreign terrorist organization designated as such by the United States Secretary of State (the District may rely on a company's response to a notice or communication made under this paragraph without conducting any further investigation, research, or inquiry);
6. Securities of a business identified by the state comptroller as a “scrutinized business” on a list provided at least annually to the District unless acquired pursuant to an exception under Chapter 2270, Government Code; and
7. Any investment that does not meet a required minimum rating under this policy for the duration the investment does not have the minimum rating.

Action and Reports on Prohibited Investments:

An entity shall take all prudent measures that are consistent with its investment policy to liquidate an investment that does not have the minimum rating. Except as provided by Chapter 2270, Government Code, relating to the prohibition on certain investments, the District is not required to liquidate investments that were authorized investments at the time of purchase.

Not later than the 30th day after the date the District receives the list of scrutinized businesses from the state comptroller, the District shall notify the comptroller of the listed companies in which the District owns direct or indirect holdings, if any.

Not later than December 31 of each year, the District shall:

1. file a publicly available report regarding its investments with the presiding officer of each house of the legislature and the attorney general in compliance with Section 2270.0252(1), Government Code; and

2. file a report with the United States presidential special envoy to Sudan in compliance with Section 2270.0252(2), Government Code.

VII. INVESTMENT PARAMETERS

Maximum Maturities

It is the District's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risk caused by changes in interest rates.

The District attempts to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the District will not directly invest in securities maturing more than one (1) years from the date of purchase; however, the above-described obligations, certificates, or agreements may be collateralized using longer dated investments.

The composite portfolio will have a weighted average maturity of 180 days or less. This dollar-weighted average maturity will be calculated using the stated final maturity dates of each security.

Diversification

The District 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:

- Limiting investments to avoid over concentration in investments from a specific issuer or business sector;
- When investing in two or more Certificates of Deposit have varying maturities; and

The following maximum limits, by instrument, are established for the District's total portfolio:

1. Selected Depository Bank Operating Account 100%
2. Certificates of Deposit 100%

VIII. SELECTION OF BANKS AND DEALERS

Depository (Water Code 36.155)

At least every five (5) years the Public Funds Investment Officer shall select a Depository through the District's procurement process which shall include a formal request for proposal (RFP). This subsection does not limit the power of the board to place a portion of the District's funds on time deposit or to purchase certificates of deposit. To the extent that funds in the Depository are not insured by the Federal Deposit Insurance corporation, they shall be secured in the manner provided by law for the security of funds by the Public Funds Collateral Act, Chapter 2257 Government Code. The selection of a Depository will be determined by competitive bid and evaluation of bids will be based on the following selection criteria:

- The ability to qualify as a Depository for public funds in accordance with the HGCD Public Funds Investment Policy.
- Sign a certification acknowledging that the organization has received and reviewed the District's investment policy and that reasonable procedures and controls have been implemented to preclude investment transactions that are not authorized by the District's policy.
- The ability to provide requested information or financial statements for the periods specified.
- The ability to provide an appropriate level of service.
- The credit worthiness and financial stability of the bank.
- That the firm does not boycott Israel and will not boycott Israel during the term of the contract.

Authorized Brokers/Dealers

If the District has securities transactions, the District's Public Funds Investment Officer, shall annually review, revise, and adopt a list of qualified brokers or dealers and financial institutions authorized to engage in securities transactions with the District. Those firms that request to become qualified bidders for securities transactions will be required to provide: 1) a completed broker or dealer questionnaire that provides information regarding creditworthiness, experience and reputation; and 2) a certification stating the firm received, read and understood the District's investment policy and agrees to comply with that policy. 3) a statement that the firm does not boycott Israel and will not boycott Israel during the term of the contract. Authorized firms may include primary dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule), and qualified depositories. All investment providers, including financial institutions, banks, money market mutual funds, and local government investment pools, must sign a certification acknowledging that the organization has received and reviewed the District's investment policy and that reasonable procedures and controls have been implemented to preclude investment transactions that are not authorized by the District's policy, and that the firm does not boycott Israel and will not boycott Israel during the term of the contract.

Competitive Bids

It is the policy of the District to require competitive bidding for all individual security purchases and sales except for: 1) transactions with money market mutual funds and local government investment pools; and 2) treasury and agency securities purchased at issue through an approved broker or dealer or financial institution. The Public Funds Investment Officer shall develop and maintain procedures for ensuring competition in the investment of the Entity's funds.

Delivery vs. Payment

Securities shall be purchased using the "delivery vs. payment" method with the exception of investment pools and mutual funds. Funds will be released after notification that the purchased security has been received.

IX. CUSTODIAL CREDIT RISK MANAGEMENT

Safekeeping and Custodian Agreements

The District shall contract with a bank or banks for the safekeeping of securities either owned by the District as part of its investment portfolio or held as collateral to secure demand or time deposits. Securities owned by the District shall be held in the District's name 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 District and pledged to the District 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 the depository bank's trust department, a Federal Reserve Bank or branch of a Federal Reserve Bank, a Federal Home Loan Bank, or a third-party bank approved by the District. A Custodian, other than a government agency or department thereof, shall provide the District with a statement that the firm does not boycott Israel and will not boycott Israel during the term of the contract.

Collateral Policy

Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the District to require full collateralization of all District investments and funds on deposit with a depository bank, other than investments, which are obligations of the U.S. government and its agencies and instrumentalities. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of market value of principal and accrued interest on the deposits or investments less an amount insured by the FDIC. At its discretion, the District may require a higher level of collateralization for certain investment securities. Securities pledged as collateral shall be held by an independent third party with whom the District has a current custodial agreement or the depository bank's trust department. The General Manager is responsible for entering into collateralization agreements with third party custodians in compliance with this Policy. The agreements are to specify the acceptable investment securities for collateral, including

provisions relating to possession of the collateral, the substitution or release of investment securities, ownership of securities, and the method of valuation of securities. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the District and retained. Collateral shall be reviewed at least monthly to assure that the market value of the pledged securities is adequate.

Collateral Defined

The District shall accept only the following types of collateral:

- Obligations of the United States or its agencies and instrumentalities.
- Direct obligations of the State of Texas or its agencies and instrumentalities.
- 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.
- 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.
- A surety bond issued by an insurance company rated as to investment quality by a nationally recognized rating firm not less than A.
- A letter of credit issued to the District by the Federal Home Loan Bank.

Subject to Audit

All collateral shall be subject to inspection and audit by the General Manager or the District's independent auditors.

X. PERFORMANCE

Performance Standards

The District's investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio shall be designed with the objective of obtaining a rate of return through budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow requirements of the District.

XI. REPORTING

Methods

The Investment Officer shall prepare an investment report at least on a Quarterly basis that summarizes investment strategies employed in the most recent reporting period and describes the portfolio in terms of investment securities, maturities, and shall explain the total investment return for the reporting period.

The monthly deposit/ investment report shall include a summary statement of deposit/investment activity prepared in compliance with generally accepted accounting principles. This summary will be prepared in a manner that will allow the District to ascertain whether deposit/investment activities during the reporting period have conformed to the Investment Policy. The report will be provided to the Board. The report will include the following:

- Listing of investments by maturity date.
- Fully accrued interest for the reporting period
- The percentage of the total portfolio that each type of investment represents.
- Statement of compliance of the District's investment portfolio with state law and the investment strategy and policy approved by the Board.
- Monthly Balance Sheet
- Monthly Revenue & Expenditures Report (including check register)
- (WAM) Weighted Average Maturity of investments.

An independent auditor will perform a formal annual review of the investment reports with the results reported to the Board.

Review of Certain Investments

The District and any entity investing on behalf of the District may not acquire securities of a company that is identified on a list of companies with scrutinized active business operations in Sudan or Iran, or with business ties to Foreign Terrorist Organizations. The Investment Officer shall review the Texas Comptroller's list of Companies that Boycott Israel, Scrutinized Companies with ties to Sudan, Scrutinized Companies with ties to Iran, Designated Foreign Terrorist Organizations to ensure compliance with this Investment Policy.

XII. INVESTMENT POLICY ADOPTION

The District's investment policy shall be adopted by resolution of the Board. It is the District's intent to comply with state laws and regulations. The District's investments policies shall be subject to revisions consistent with changing laws, regulations, and needs of the District. The Board shall review the policy annually and approve any changes or modifications.