

# **State Water Implementation Fund for Texas**

Annual Financial Report  
August 31, 2021 and 2020

## Contents

Independent auditor's report	1-2
Management's discussion and analysis	3-6
Basic financial statements	
Statements of fiduciary net position	7
Statements of changes in fiduciary net position	8
Notes to financial statements	9-16
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	17-18

## **Independent Auditor's Report**

Honorable Glenn Hegar  
Comptroller of Public Accounts of the State of Texas  
State Water Implementation Fund for Texas

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the State Water Implementation Fund for Texas (the Fund), a custodial fund of the Texas Treasury Safekeeping Trust Company (Texas Trust), as of and for the years ended August 31, 2021 and 2020, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of August 31, 2021 and 2020, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matters**

As described in Note 1 to the financial statements, these financial statements present only the financial statements of the Fund and do not purport to, and do not, present fairly the financial position of Texas Trust as of August 31, 2021 and 2020, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

**Other Matter—Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2021, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

*RSM US LLP*

Austin, Texas  
December 10, 2021

## **State Water Implementation Fund for Texas**

### **Management's Discussion and Analysis August 31, 2021 and 2020**

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The State Water Implementation Fund for Texas' (SWIFT or the Fund) management's discussion and analysis is designed to assist the reader in focusing on significant financial issues and provide a performance overview of the Fund's operations for the years ended August 31, 2021 and 2020. Please read this analysis in conjunction with the financial statements which follow this section. The Texas Treasury Safekeeping Trust Company (Texas Trust) administers and manages the assets of the Fund.

#### **Financial Highlights**

- The total net position of the Fund is \$1.8 billion at August 31, 2021, and \$1.7 billion at August 31, 2020.
- The Fund earned \$194.5 million from investing activities during fiscal year 2021 and earned \$15.0 million from investing activities during fiscal year 2020.

#### **Overview of the Financial Statements and Condensed Financial Information**

The management's discussion and analysis is an introduction to the Fund's basic financial statements.

The Fund was created by the 83rd Texas Legislature, Regular Session, and became effective once the voters approved the constitutional amendment to fund the SWIFT with \$2.0 billion from the Economic Stabilization Fund on November 22, 2013.

The Statements of Fiduciary Net Position provide information about the nature and amounts of the Fund's cash, investments and receivables (assets), and its management fees (liabilities). The Statements of Changes in Fiduciary Net Position report the additions to, deductions from, and net increases or decreases in net position.

This annual financial report consists of two parts:

- Management's discussion and analysis
- Basic financial statements
  - Statements of Fiduciary Net Position
  - Statements of Changes in Fiduciary Net Position
  - Notes to the Financial Statements

## State Water Implementation Fund for Texas

### Management's Discussion and Analysis August 31, 2021 and 2020

The Statements of Net Position present the financial position of the Fund at the end of each fiscal year and include all assets and liabilities of the Fund. The difference between total assets and total liabilities equals the Fund's net position. At August 31, net position was calculated as follows:

	2021	2020	2019
Investment in State Treasury Pool	\$ 135,633,226	\$ 175,604,464	\$ 191,820,961
Other assets	27,523	95,278	555,941
Investments	1,677,482,921	1,503,507,855	1,565,377,153
Total assets	1,813,143,670	1,679,207,597	1,757,754,055
Total liabilities	567,951	508,404	532,354
Net position	\$ 1,812,575,719	\$ 1,678,699,193	\$ 1,757,221,701

From August 31, 2020 to August 31, 2021, assets increased by \$133.9 million due to higher net investment income as well as smaller distributions out of the Fund, as compared to the prior year. Total liabilities increased by \$0.06 million.

From August 31, 2019 to August 31, 2020, assets decreased by \$78.5 million due to \$93.4 million in distributions out of the Fund, partially offset by net investment income. Total liabilities decreased by \$0.02 million.

The Statements of Changes in Fiduciary Net Position present the activity within the net position balance for the period ended. Significant activity accounts include net investment income and allowable distributions. The Fund distributed \$60.6 million during the fiscal year ended August 31, 2021. The change in net position for the years ended August 31 was as follows:

	2021	2020	2019
Net investment income	\$ 194,512,172	\$ 14,901,631	\$ 81,566,127
Distributions	(60,635,646)	(93,424,139)	(213,478,638)
Net increase (decrease) in net position	133,876,526	(78,522,508)	(131,912,511)
Net position at beginning of year	1,678,699,193	1,757,221,701	1,889,134,212
Net position at end of year	\$ 1,812,575,719	\$ 1,678,699,193	\$ 1,757,221,701

Net investment income was \$194.5 million for the fiscal year ended August 31, 2021. The total rate of return for the fiscal year ended August 31, 2021, was 12.22%. The total Fund outperformed its policy benchmark by 2.46% for the year ended August 31, 2021.

Net investment income was \$15.0 million for the fiscal year ended August 31, 2020. The total rate of return for the fiscal year ended August 31, 2020, was 1.06%. The total Fund underperformed its policy benchmark by 4.67% for the year ended August 31, 2020.

The Texas Trust disburses money from the Fund as directed by the Texas Water Development Board (TWDB). The TWDB directs disbursements from the Fund based on its needs for projects on a semiannual schedule specified by the TWDB and not more frequently than twice in any state fiscal year. Disbursement amounts vary based on project needs.

## State Water Implementation Fund for Texas

### Management's Discussion and Analysis August 31, 2021 and 2020

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#### Asset Allocation

The current SWIFT asset allocation as of August 31, 2021, is shown in the chart below:

Asset Class	Current Market Value	Weight	Policy Range
Cash and cash equivalents	\$ 246,032,073	13.57%	0-40%
Fixed income	171,075,730	9.44%	5-40%
Alternative fixed income	257,740,527	14.22%	5-40%
Private debt	278,451,933	15.36%	0-30%
Directional equity	454,023,523	25.05%	0-10%
Hedged equity	80,661,765	4.45%	5-40%
Real assets	211,637,902	11.68%	0-25%
All asset strategies	112,952,266	6.23%	0-10%
Total portfolio	<u>\$ 1,812,575,719</u>	<u>100.00%</u>	

The SWIFT asset allocation as of August 31, 2020, is shown in the chart below:

Asset Class	Current Market Value	Weight	Policy Range
Cash and cash equivalents	\$ 243,528,365	14.51%	0-40%
Fixed income	170,873,864	10.18%	5-40%
Alternative fixed income	194,281,898	11.57%	5-40%
Private debt	285,858,156	17.03%	0-30%
Directional equity	97,972,811	5.84%	0-10%
Hedged equity	357,402,859	21.29%	5-40%
Real assets	234,269,313	13.96%	0-25%
All asset strategies	94,511,927	5.63%	0-10%
Total portfolio	<u>\$ 1,678,699,193</u>	<u>100.00%</u>	

The current asset allocation represents the ongoing effort by the Texas Trust to achieve its investment objective to preserve the Fund's purchasing power and achieve the return and liquidity requirements of the SWIFT as determined by the TWDB. The TWDB sets forth the liquidity requirements of the SWIFT, and works with the Texas Trust to establish the asset allocation to meet the liquidity and rate of return requirements of the SWIFT.

Fixed Income strategies are expected to generate relatively consistent positive returns with lower correlation to the public markets. Strategies selected are intended to provide positive returns during most economic and capital market environments.

Alternative Fixed Income strategies are intended to preserve investment capital by achieving consistent positive real returns and maximizing long-term total returns, within prudent levels of risk, through the use of diversified portfolios of complementary strategies.

## **State Water Implementation Fund for Texas**

### **Management's Discussion and Analysis**

**August 31, 2021 and 2020**

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Private Debt strategies will be primarily focused on debt and credit oriented strategies ranging from senior secured credit to distressed credit, but at times may include exposures across the entire corporate capital structure. Private debt strategies are intended to take advantage of illiquidity premiums available in the debt markets. Portfolios may take an extended period to be realized.

Equity strategies include public and private equities and asset classes that are correlated to global equity markets. Historically, global equity investments have provided returns in excess of the total fund return objective. The equity portfolio consists of traditional long-only, hedged and private strategies whose portfolios are predominantly invested in the equity of corporations.

Real Asset strategies are intended to serve primarily as inflation hedges and provide diversification benefits of low correlation with other investment strategies. A significant majority of the portfolio is exposed to real assets such as high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock and grains.

All Asset strategies include exposures across equity, fixed income and real asset classes. The all asset portfolio may consist of long-only, hedged and private strategies whose portfolios are diversified across a broad range of asset types.

### **Unfunded Commitments**

As of August 31, 2021 and 2020, the Fund's outstanding unfunded commitments totaled \$266,442,972 and \$254,490,224, respectively.

### **Contacting Texas Trust's Financial Management**

This financial report is designed to provide the Fund's beneficiaries, business partners and creditors with a general overview of its finances. Questions about this report can be directed to Texas Trust's Chief Financial Officer at (512) 463-4300.



## **Basic Financial Statements**

**State Water Implementation Fund for Texas**

**Statements of Fiduciary Net Position  
August 31, 2021 and 2020**

	<u>2021</u>	<u>2020</u>
Assets:		
Cash in State Treasury	\$ 135,633,226	\$ 175,604,464
Interest and other receivables	27,523	95,278
Investments	<u>1,677,482,921</u>	<u>1,503,507,855</u>
<b>Total assets</b>	<u><b>1,813,143,670</b></u>	<u><b>1,679,207,597</b></u>
Liabilities:		
Accounts payable	<u>567,951</u>	<u>508,404</u>
<b>Total liabilities</b>	<u><b>567,951</b></u>	<u><b>508,404</b></u>
Net position		
<b>Net position</b>	<u><b>\$ 1,812,575,719</b></u>	<u><b>\$ 1,678,699,193</b></u>

See notes to financial statements.

**State Water Implementation Fund for Texas**

**Statements of Changes in Fiduciary Net Position  
Years Ended August 31, 2021 and 2020**

	<u>2021</u>	<u>2020</u>
Additions		
Investment income:		
Net increase (decrease) in fair value of investments	\$ 171,162,220	\$ (13,838,161)
Interest and investment income	<u>26,525,072</u>	<u>31,823,768</u>
Expenses:		
Professional fees and services	<u>(3,175,120)</u>	<u>(3,083,976)</u>
<b>Net investment income</b>	<u>194,512,172</u>	<u>14,901,631</u>
<b>Total additions</b>	<u>194,512,172</u>	<u>14,901,631</u>
Deductions:		
Distributions	<u>60,635,646</u>	<u>93,424,139</u>
<b>Total deductions</b>	<u>60,635,646</u>	<u>93,424,139</u>
<b>Change in net position</b>	<u>133,876,526</u>	<u>(78,522,508)</u>
Net position at beginning of year	<u>1,678,699,193</u>	<u>1,757,221,701</u>
Net position at end of year	<u><u>\$ 1,812,575,719</u></u>	<u><u>\$ 1,678,699,193</u></u>

See notes to financial statements.

## State Water Implementation Fund for Texas

### Notes to Financial Statements

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#### Note 1. Reporting Entity

The State Water Implementation Fund for Texas (SWIFT or the Fund) was created by the 83rd Texas Legislature, Regular Session, and became effective once the voters approved the constitutional amendment to fund the SWIFT with \$2 billion from the Economic Stabilization Fund on November 22, 2013. The creation of SWIFT and its requirements are set forth in Chapter 15 of the Texas Water Code, pursuant to House Bill 4. The SWIFT is a special revenue fund in the state treasury outside the general revenue fund to be used by the Texas Water Development Board (TWDB), without further legislative appropriation, for the purpose of implementing the state water plan as provided by subchapter G of the Texas Water Code, Chapter 15.

The Texas Treasury Safekeeping Trust Company (Texas Trust) holds and invests the SWIFT for TWDB. The Texas Trust adopts an investment policy appropriate for SWIFT and presents it to the state of Texas Comptroller's Investment Advisory Board (CIAB). In accordance with Section 15.433(f) of the Water Code and CIAB procedures, the Texas Trust submits the investment policy to the CIAB and the Comptroller.

The Comptroller is the sole officer, director and shareholder of the Texas Trust and charged with managing the entity. The Comptroller has delegated management and investment related duties to the chief executive officer of the Texas Trust.

The Texas Trust Investment Committee (Investment Committee) is responsible for oversight of Texas Trust investment portfolios including: reviewing and recommending investment policies; approving certain investments; establishing strategic and tactical investment plans; evaluating and recommending the selection or dismissal of investment managers; reviewing quarterly portfolio performance; and reviewing and approving portfolio rebalancing and tactical asset allocation.

These financial statements include only the operations of the Fund and do not purport to, and do not, present the financial position of Texas Trust as of August 31, 2021 and 2020, and the changes in its financial position for the years the ended.

#### Note 2. Summary of Significant Accounting Policies

**Measurement focus, basis of accounting and financial statement presentation:** During the year ended August 31, 2020, the Fund adopted new accounting guidance by implementing the provisions of Governmental Accounting Standards Board (GASB) Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying and reporting fiduciary activities. The implementation of this statement did not result in changing the presentation of the financial statements of the Fund.

Texas Trust reports the Fund as a custodial fund in its financial statements. Custodial funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flows.

**Management and investment of the Fund:** Section 15.433 of the Water Code (the Act) establishes the overall objective for investing the SWIFT "to maintain sufficient liquidity to meet the needs of the fund while striving to preserve the purchasing power of the fund." The Texas Trust shall invest the Fund in accordance with the prudent investor standard. It will consider only those investments appropriate for the SWIFT given its purpose and distribution requirements.

## State Water Implementation Fund for Texas

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

The Texas Trust has any power necessary to accomplish the purposes of managing and investing the assets of the Fund. The Texas Trust will manage and invest the assets of the Fund, through procedures, and subject to restrictions the Texas Trust considers appropriate. The Texas Trust may acquire, exchange, sell, supervise, manage or retain any kind of investment that a prudent investor, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements and other circumstances of the fund then prevailing, taking into consideration the investment of all assets of the Fund rather than a single investment.

**Investments:** Investments are reported at fair value. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Investments are reported at fair value based upon quoted market prices, or when quoted market prices are not readily determinable, other observable significant inputs including, but not limited to, quoted prices for similar securities, interest rates, net asset values of underlying securities, and fixed income pricing models.

According to the Act, the Texas Trust is to administer and manage the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy.

The following table reflects the Fund's asset class target allocation and the tolerance range per the Fund's Investment Policy as of August 31, 2021 and 2020:

Asset Class	Strategy Description	Typical Liquidity	Benchmark(s) Strategy Range	Allocation Range
Cash	Stable Value, AAA rated	Daily	90 Day T-Bill	0-40%
Fixed Income	Unconstrained, Rates & credit	Daily/ Monthly	Bloomberg Barclays US Universal Bond Index	5-40%
Alternative Fixed Income	Long/Short Relative Value & Multi-Strategy	Monthly/ Quarterly	HFRI FoF Conservative	5-40%
Private Debt	Private Credit	Illiquid	50% U.S. Credit Suisse Leveraged Loan Index & 50% Bloomberg Barclays U.S. Corporate High Yield Bond Index, plus a premium of 1% per annum	0-30%
Equity	Directional	Daily/ Monthly	MSCI ACWI IMI Net Index	0-10%
	Hedged Equity	Monthly/ Quarterly	HFRI FoF Strategic Index	5-40%
Real Assets	Core Real Estate	Illiquid	NCREIF NFI - ODCE	0-25%
All Asset Strategies	Risk Parity, Tactical Asset Allocation, Multi-Strategy	Monthly/ Quarterly	Total SWIFT Benchmark	0-10%

## State Water Implementation Fund for Texas

### Notes to Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

**Custodian:** The Fund contracts services to a custodian to discharge certain of its responsibilities. The custodian performs the duties involving the acquisition, sale and holding of fixed income and equity investments in the Fund's name.

**Income tax:** The Fund is exempt from federal income tax on its operations in accordance with Internal Revenue Code Section 115.

**Distributions:** The Texas Trust disburses money from the Fund as directed by the TWDB. The TWDB directs disbursements from the Fund on a semi-annual schedule specified by the TWDB and not more frequently than twice in any state fiscal year.

**Use of estimates:** 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 revenues and expenses during the reporting period. Accordingly, actual results could differ significantly from these estimates.

#### Note 3. Investments

The Fund reports investments at fair value in the Statements of Fiduciary Net Position, and all investment income, including changes in the fair value of investments, is reported in the Statements of Changes in Fiduciary Net Position.

The Texas Trust administers and manages the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy.

The Fund categorizes its fair value measurement disclosures within the fair value hierarchy established by generally accepted accounting principles. The hierarchy prioritizes valuation inputs used to measure the fair value of the asset or liability in three broad categories. Levels 1, 2 and 3 (lowest priority level) of the fair value hierarchy are defined as follow:

**Level 1:** Inputs using unadjusted quoted prices in active markets or exchanges for identical assets or liabilities.

**Level 2:** Significant other observable inputs, which may include, quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in non-active markets; and inputs other than quoted prices that are observable for the assets or liabilities, either directly or indirectly.

**Level 3:** Valuations for which one or more significant inputs are unobservable and may include situations where there is minimal, if any market activity for the asset or liability.

If the fair value is measured using inputs from different levels in the fair value hierarchy, the measurement is categorized based on the lowest priority level input that is significant to the valuation. The Fund's assessment of significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment. Investments measured at fair value using net asset value (NAV) per share (or equivalent) as a practical expedient to fair value are not classified in the fair value hierarchy.

## State Water Implementation Fund for Texas

### Notes to Financial Statements

#### Note 3. Investments (Continued)

The Fund's investments as of August 31, 2021, are as follows:

Investments at Fair Value Level		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments at Fair Value Level	Fair Value			
Money market funds	\$ 110,939,275	\$ 110,939,275	\$ -	\$ -
Mutual funds—global fixed income	171,075,730	171,075,730	-	-
Mutual funds—global equities	104,183,938	104,183,938	-	-
Total investments at fair value level	<u>\$ 386,198,943</u>	<u>\$ 386,198,943</u>	<u>\$ -</u>	<u>\$ -</u>

  

Investments Measured at NAV	Investment Strategy	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Hedge funds—fund of funds	Equity	\$ 77,999,796	N/A	Monthly, Quarterly	26 - 95 days
Hedge funds—direct funds— fixed income	Alternative fixed income	257,740,527	N/A	Daily, Monthly, Quarterly	2 - 65 days
Hedge funds—direct funds—equities	Equity	349,839,585	N/A	Monthly, Quarterly, Semi- Annually, Anniversary	30 - 120 days
Hedge funds—direct funds—all asset	All asset	112,952,266	N/A	Annually	45 days
Domestic alternative—private debt	Private debt	278,451,933	\$ 168,186,485	N/A	N/A
Domestic alternative—private equity	Equity	2,661,969	79,479,480	N/A	N/A
Domestic alternative—real assets	Real asset	211,637,902	18,777,007	N/A	N/A
Total investments at NAV		<u>\$ 1,291,283,978</u>	<u>\$ 266,442,972</u>		
Total investments		<u>\$ 1,677,482,921</u>			

## State Water Implementation Fund for Texas

### Notes to Financial Statements

#### Note 3. Investments (Continued)

The Fund's investments as of August 31, 2020, are as follows:

Investments at Fair Value Level	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$ 68,337,027	\$ 68,337,027	\$ -	\$ -
Mutual funds—global fixed income	170,873,864	170,873,864	-	-
Mutual funds—global equities	95,213,070	95,213,070	-	-
Total investments at fair value level	<u>\$ 334,423,961</u>	<u>\$ 34,423,961</u>	<u>\$ -</u>	<u>\$ -</u>

Investments Measured at NAV	Investment Strategy	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Hedge funds—fund of funds	Equity	\$ 64,886,188	N/A	Monthly, Quarterly	26 - 95 days
Hedge funds—direct funds—fixed income	Alternative fixed income	194,281,898	N/A	Daily, Monthly, Quarterly	2 - 65 days
Hedge funds—direct funds—equities	Equity	292,516,671	N/A	Monthly, Quarterly, Semi-Annually, Anniversary	30 - 120 days
Hedge funds—direct funds—all asset	All asset	94,511,927	N/A	Annually	45 days
Domestic alternative—private debt	Private debt	285,858,156	\$ 155,396,642	N/A	N/A
Domestic alternative—private equity	Equity	2,759,741	79,659,480	N/A	N/A
Domestic alternative—real assets	Real asset	234,269,313	19,434,102	N/A	N/A
Total investments at NAV		<u>\$ 1,169,083,894</u>	<u>\$ 254,490,224</u>		
Total investments		<u>\$ 1,503,507,855</u>			

Mutual funds are valued daily or monthly, as appropriate, at fair value as noted in the table above. Hedge Funds are valued monthly at NAV using the current monthly account statements from the funds. If a current monthly account statement is unavailable, the value is calculated by the custodian using the estimated monthly return from the fund. Once a statement is received, the value is adjusted to reflect the NAV from the statement adjusted for cash flows that occur after the statement date. Domestic alternative investments are valued monthly at NAV using the latest account statements from the funds. NAV is adjusted for cash flows that occur after the date of the statements through the month-end date.

Equity strategies include public and private equities and asset classes that are correlated to global equity markets. Historically, global equity investments have provided returns in excess of the total fund return objective. The equity portfolio consists of traditional long-only, hedged and private strategies whose portfolios are predominantly invested in the equity of corporations.

Alternative fixed income strategies are intended to preserve investment capital by achieving consistent positive real returns and maximizing long-term total returns, within prudent levels of risk, through the use of diversified portfolios of complementary strategies.



## State Water Implementation Fund for Texas

### Notes to Financial Statements

#### Note 3. Investments (Continued)

All asset strategies include exposures across equity, fixed income and real asset classes. The all asset portfolio may consist of long-only, hedged and private strategies whose portfolios are diversified across a broad range of asset types.

Private debt strategies will be primarily focused on debt and credit oriented strategies ranging from senior secured credit to distressed credit, but at times may include exposures across the entire corporate capital structure. Private debt strategies are intended to take advantage of illiquidity premiums available in the debt markets. Portfolios may take an extended period to be realized.

Real asset strategies are intended to serve primarily as inflation hedges and provide diversification benefits of low correlation with other investment strategies. A significant majority of the portfolio is exposed to real assets such as high quality real estate, timber, infrastructure assets, industrial and precious metals, energy, livestock and grains.

**Credit risk:** Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Fund's investment policy does not limit credit risk. The following schedule lists Standard & Poor's credit rating by investment type for those investments subject to credit risk.

Standard & Poor's Credit Rating	August 31			
	2021		2020	
	Mutual Funds— Global Fixed Income	Money Market Funds	Mutual Funds— Global Fixed Income	Money Market Funds
AAA	\$ -	\$ 110,939,275	\$ -	\$ 68,337,027
Not Rated	171,075,730	-	170,873,864	-
Total	<u>\$ 171,075,730</u>	<u>\$ 110,939,275</u>	<u>\$ 170,873,864</u>	<u>\$ 68,337,027</u>

**Custodial credit risk:** For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Fund would not be able to recover the loss of its investments or collateral securities that are in possession of an outside entity. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not held in the name of the Texas Trust and are held by the counterparty, its trust or agent, but not in the name of the Texas Trust. The Fund's investments are not exposed to custodial credit risk since they are insured or registered or the securities are held by the Texas Trust or its agent in the Texas Trust's name.

**Concentration risk:** Concentration of credit risk is the risk of loss attributable to the magnitude of the investment in a single issuer. Excluding passive strategies, exposure to any investment firm will generally be limited to no more than 25% of Fund assets. Fund investments will generally not exceed more than 25% of any firms' total assets under management. As of August 31, 2021 and 2020, no more than 5.0% of the portfolio was invested in securities of one issuer.

## State Water Implementation Fund for Texas

### Notes to Financial Statements

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#### Note 3. Investments (Continued)

**Interest rate risk:** Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund's investment policy does not limit investment maturities. The following schedule reflects the average effective duration of the funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

Investment Type	Effective Duration	
	August 31	
	2021	2020
Mutual funds—global fixed income	4.48 years	4.51 years
	Weighted-Average Maturity	
	August 31	
	2021	2020
Money market mutual funds	23 days	40 days

**Treasury pool:** The Fund participates in the Treasury Pool, which is an internal investment pool of the state of Texas. The state of Texas Comptroller maintains oversight responsibility for the Treasury Pool. This responsibility includes the ability to influence operations, designation of management, and accountability for fiscal matters. The Treasury Pool operates in accordance with the Comptroller's Investment Policy. The Fund may make withdrawals at any time and has no commitment to add additional funds to the Treasury Pool. The Fund receives allocated earnings based on its percentage share of the Treasury Pool, but its overall value remains the same as the initial deposit, at cost, into the Treasury Pool plus accrued income. The Fund's balance in the Treasury Pool as of August 31, 2021, was \$135,633,226 plus accrued interest for August of \$25,420. The Fund's balance in the Treasury Pool as of August 31, 2020, was \$175,604,464 plus accrued interest for August of \$91,461.

#### Note 4. Related Parties

The contract and agreement between the Comptroller and the Texas Trust allows the Texas Trust to charge a fee of up to 30 basis points to recover all costs associated with the management of the Fund. The fee for the fiscal years ended August 31, 2021 and 2020, was 20 basis points. The Fund was charged \$3,175,120 for the year ended August 31, 2021, and \$3,083,976 for the year ended August 31, 2020.

During the fiscal year ended August 31, 2021, the Fund entered into a series of related-party transactions with the Endowment Pool and the Texas Economic Stabilization Investment Fund of Texas (TESTIF), both of which are portfolios managed by the Texas Trust, whereby certain interests in limited partnership investments were transferred in exchange for cash. These transactions enabled the Fund to generate sufficient liquidity to meet its annual cash distribution, while allowing the Endowment Pool and the TESTIF to meet strategic and tactical allocation targets. The transactions involved transferring the limited partnership shares from the Fund to the Endowment Pool and the TESTIF at the current net asset value. No gain or loss on the exchange was recognized by the Fund as a result of the transactions. The total amount of partnership interests exchanged was approximately \$69.5 million with the Endowment Pool and approximately \$26.5 million with the TESTIF.

## **State Water Implementation Fund for Texas**

### **Notes to Financial Statements**

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#### **Note 5. Impact of COVID-19**

On January 30, 2020, the World Health Organization declared the coronavirus outbreak a “Public Health Emergency of International Concern” and on March 11, 2020, declared it to be a pandemic. Actions taken around the world to help mitigate the spread of the coronavirus include restrictions on travel, quarantines in certain areas, and forced closures for certain types of public places and businesses. The coronavirus and actions taken to mitigate the spread of it have had, and are expected to continue to have, an adverse impact on the economies and financial markets of many countries, including the geographical area in which the Fund operates. On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act was enacted to, amongst other provisions, provide emergency assistance for individuals, families and businesses affected by the coronavirus pandemic.

It is unknown how long the adverse conditions associated with the coronavirus will last and what the complete financial effect will be. To date, the Fund has not experienced any significant changes in the fair value of assets or liabilities as a result of the pandemic.

**Report on Internal Control Over Financial Reporting and on  
Compliance and Other Matters Based on an Audit of  
Financial Statements Performed in Accordance With  
*Government Auditing Standards***

**Independent Auditor's Report**

Honorable Glenn Hegar  
Comptroller of Public Accounts of the State of Texas  
State Water Implementation Fund for Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State Water Implementation Fund for Texas (the Fund), a custodial fund of the Texas Treasury Safekeeping Trust Company, as of and for the year ended August 31, 2021, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated December 10, 2021.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Fund's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*RSM US LLP*

Austin, Texas  
December 10, 2021