

FUTURE WATER SUPPLIES FOR TEXAS

2014 Biennial Report on the
State Water Implementation Fund for Texas

84th Legislative Session

Texas Water 
Development Board

2014 Biennial Report on the
State Water Implementation Fund for Texas

Future Water Supplies for Texas

Carlos Rubinstein, Chairman

Bech Bruun, Member

Kathleen Jackson, Member

Kevin Patteson, Executive Administrator

December 1, 2014

Texas Water Development Board



P.O. Box 13231, 1700 N. Congress Ave.
Austin, TX 78711-3231, www.twdb.texas.gov
Phone (512) 463-7847, Fax (512) 475-2053

December 1, 2014

To: The Honorable Rick Perry, Governor of Texas
The Honorable David Dewhurst, Lieutenant Governor of Texas
The Honorable Joe Straus, Speaker of the Texas House of Representatives

The Texas Water Development Board is pleased to present the first Biennial Report on the State Water Implementation Fund for Texas (SWIFT) submitted to you in compliance with Texas Water Code §15.440.

This report provides an update on TWDB's implementation of HB 4, 83rd Texas Legislative Session, including development of a new financial assistance program to implement the state water plan. Future reports will focus on how SWIFT funds are being used to develop new water supplies, including how the program is supporting rural and agricultural projects, water conservation, and reuse of wastewater.

On behalf of the citizens of Texas, the Texas Water Development Board respectfully submits this report to the Governor, the Lieutenant Governor, the Speaker of the House, and members of the 84th Texas Legislature.

Carlos Rubinstein
Chairman

Kevin Patteson
Executive Administrator

Our Mission : **Board Members**

To provide leadership, information, education, and support for planning, financial assistance, and outreach for the conservation and responsible development of water for Texas

: Carlos Rubinstein, Chairman | Bech Bruun, Member | Kathleen Jackson, Member
:
:
:
:
: Kevin Patteson, Executive Administrator

Contents

1. Overview.....	1
2. Implementation of HB 4 Governance Changes.....	1
3. Implementation of the State Water Plan Funding Program.....	2
Project Prioritization.....	3
Rule Development.....	4
Strategic Planning Model Development.....	5
Partnership with the Texas Treasury Safekeeping Trust Company.....	6
4. Oversight, Transparency, and Reporting.....	6
5. Outlook on First Round of Funding.....	7
6. Preview of Next Biennial Report.....	7

Attachment A

SWIFT Investment Report.....	9
------------------------------	---

Future Water Supplies for Texas:

2014 Biennial Report on the State Water Implementation Fund for Texas

84th Texas Legislative Session

1. Overview

In 2013, the 83rd Texas Legislature passed House Bill (HB) 4 and Senate Joint Resolution (SJR) 1 providing for the creation of the State Water Implementation Fund for Texas (SWIFT) and the State Water Implementation Revenue Fund for Texas (SWIRFT). In addition, HB 1025 authorized a one-time, \$2 billion supplemental appropriation from the state's Economic Stabilization Fund (also known as the Rainy Day Fund) to SWIFT, contingent on enactment of HB 4 and passage and adoption by an election of the voters of SJR 1. Proposition 6 passed on November 5, 2013, with more than 70 percent in favor. This investment is designed to support close to \$27 billion in state financial assistance identified in the 2012 State Water Plan for water supply projects over the next 50 years to ensure that Texas communities have adequate supplies of water during drought.

The purpose of this report is to provide an update on the Texas Water Development Board's (TWDB) implementation of this new financial assistance program. Future reports—due to the Governor, Lieutenant Governor, Speaker of the House, and Texas Legislature before each legislative session—will focus on how SWIFT funds are being used to develop new water supplies, including how the program is supporting rural and agricultural projects, water conservation, and reuse of wastewater. The first round of project

applications will be ranked by the TWDB in spring 2015.

In addition to the next biennial report due December 1, 2016, the TWDB will regularly post information on the agency's website regarding progress made in developing needed water supplies, along with a description and status of each project funded through the program.

2. Implementation of HB 4 Governance Changes

Along with the creation of SWIFT and SWIRFT, HB 4 included administrative changes to the TWDB—the state's water supply planning and financing agency—in Chapter 6 of the Texas Water Code. To ensure active management of the funds, it converted the agency's governing body from a six-member part-time board to a three-member full-time board. It also required the appointment of a new board and executive administrator. The new Board took office on September 1, 2013, and an Executive Administrator was hired shortly thereafter.

In light of these changes, the TWDB's new administration has placed a greater emphasis on outreach, transparency, and efficiency. Board members have committed themselves to promoting the TWDB's mission and to being more accessible to the agency's stakeholders. An Agricultural and Rural Texas Ombudsman position was created to help rural communities better participate in the

planning process and to get better acquainted with all of the TWDB's financial and technical assistance programs.

The new administration made a number of organizational changes to increase efficiency and to better serve customers. During fall 2013, the financial assistance project implementation staff was reorganized into six geographical teams.

Each team—composed of an attorney, financial analyst, engineer, environmental reviewer, and planner—is led by a manager that serves as the primary point of contact for existing and potential customers. This change in structure, single point of contact, and procedural and process efficiencies will help reduce the application review timeframe and expedite delivery of project funding.

Other efficiency and transparency initiatives include:

- Streamlining of the environmental review process for state-funded projects
- Development of an online financial assistance application that will be completed by the end of 2014
- Launch of the first stage of an interactive state water planning website that illustrates potential water shortages during drought
- Addition of a groundwater component to waterdatafortexas.org, an online repository of current and historical water level data

The new Board has also made a concerted effort to meet the goals of the statewide Historically Underutilized Business (HUB) program and is committed to providing

increased opportunities for HUB participation in all TWDB expenditures. In October 2013, the Board updated the agency's investment and debt management policies to reaffirm their commitment to making a good-faith effort in including HUB firm participation. The TWDB will strive to achieve its goal of at least 33 percent HUB participation in both investment activity and the establishment of a new underwriting team. The TWDB has already been successful in exceeding or improving HUB participation in three of the four applicable procurement categories where expenditures have occurred.

In addition to these new initiatives, the TWDB remains committed to the agency's longstanding priorities: coordinating long-range water supply planning, maintaining expertise in the study and science of Texas' water resources, and providing technical and financial assistance for the conservation and responsible development of water.

3. Implementation of the State Water Plan Funding Program

As specified in HB 4, SWIFT is intended to serve as a water infrastructure bank to enhance the financing capabilities of the TWDB by providing financial support for low-cost flexible financing options for projects in the state water plan.

Implementation of the state water plan is a multi-phased process as directed by the Texas Legislature. Water supply projects are conceived at the local level and then evaluated, recommended, and prioritized by the

16 regional water planning groups. Applications for financial assistance will be ranked according to criteria developed by the Legislature. Over the next 50 years, the \$2 billion investment will seek to achieve support for approximately \$27 billion in water supply projects, representing the amount of state financial assistance that water providers indicated would be needed to implement the 2012 State Water Plan. This assistance to political subdivisions will provide support for low-interest loans and longer repayment terms, incremental repurchase terms for projects in which the state owns an interest, and deferral of loan repayments.

Per HB 4, of the money disbursed from the fund during the five-year period between the adoption of a state water plan and the adoption of a new plan, the TWDB must undertake to apply not less than:

1. 10 percent to support projects for rural political subdivisions or agricultural water conservation
2. 20 percent to support projects that are designed for water conservation or reuse, including agricultural irrigation projects

The \$2 billion capitalization will primarily be leveraged through investment of funds in SWIFT and the issuance of revenue bonds through SWIRFT. The proceeds from SWIRFT will be used to fund state water plan projects. Money from SWIFT will be transferred to SWIRFT through a legal mechanism called a “bond enhancement agreement.” Funds transferred from SWIFT will be used to cover the difference between the actual interest rate on the TWDB-issued revenue bonds and the subsidized rates and deferral options provided

to borrowers in the program. Borrowers’ loan repayments, combined with the funds from SWIFT, will pay back the TWDB revenue bond debt. A portion of the borrowers’ loan repayments will also be used to pay back the funds transferred out of SWIFT.

Since funds are being transferred out of SWIFT, the balance of the fund will slowly decline over time; however, the balance will be replenished as investment income is realized and loans are repaid. Depending on the loan terms offered, it could take about 82 years to have the balance of SWIFT return to the full \$2 billion. The TWDB and the Texas Treasury Safekeeping Trust Company—the entity charged with managing and investing the fund—will work together to ensure that the program can provide financial assistance over the 50-year time frame and that the \$2 billion will ultimately be replenished. The program will also be overseen by a special legislative advisory committee composed of the Texas Comptroller or designee and three members each from the Texas Senate and Texas House of Representatives.

The following sections describe several of the activities necessary to implement the new funding program.

Project Prioritization

Water planning in Texas starts at the regional level with 16 regional water planning groups. The planning groups have members who represent at least 12 separate stakeholder groups as required by Texas statute. During each five-year planning cycle, planning groups identify water user groups that will not have enough water supplies during a repeat of the state’s drought of record, recommend

strategies that could be implemented to address shortages, and estimate the costs of these strategies, including the amount of state financial assistance needed. Once the planning groups adopt their regional water plans, they are sent to the TWDB for approval. The TWDB then compiles the state water plan, which serves as a guide to state water policy with information from the regional water plans and policy recommendations to the Legislature. The 2012 State Water Plan recommended strategies with a total capital cost of \$53 billion; water providers indicated a need for \$27 billion in state financial assistance to implement those strategies.

HB 4 put in place a process for prioritizing these projects, which will occur at both the regional and state level. At the regional level, the regional water planning groups prioritize projects in their regional water plans using uniform standards developed by a stakeholder committee composed of representatives of the planning groups. All planning groups met the statutory September 1, 2014, deadline for submitting their final prioritization of projects in their 2011 regional water plans. These projects will be eligible for the first round of state water plan funding in 2015; projects recommended and prioritized in the 2016 regional water plans will be eligible for funding once the TWDB adopts the 2017 State Water Plan.

At the state level, the TWDB's new administrative rules include a prioritization system for those projects applying for state water plan funding. This system includes factors required by HB 4 and the associated weighting of criteria such as how many people will be served by the project, whether the project will serve a diverse urban and rural

population, and the ranking by the regional water planning group. Other criteria include the local financial contribution, emergency needs for water, and the project's impact on conservation.

Rule Development

HB 4 directed the TWDB to adopt administrative rules providing for the use of money in SWIFT, including specifying the manner for prioritizing projects and establishing standards for determining whether projects meet the criteria for rural, conservation, and reuse projects as specified in Texas Water Code §15.434(b).

As an initial step to implement the program, the TWDB engaged in an extensive effort to solicit input from stakeholders. Each Board member made numerous presentations to a wide variety of groups, and the Board as a whole held work sessions in Conroe, Lubbock, Harlingen, and El Paso to solicit public input during development of the proposed rule. The Executive Administrator held three staff-led stakeholder meetings in Austin, receiving input on the prioritization system and definitions of agricultural water conservation, rural, and water conservation. The Board also solicited written comments via email and the TWDB website.

The proposed amendments to Title 31 of the Texas Administrative Code (TAC), Chapter 363, were published in the Texas Register on July 11, 2014; the extended public comment period closed on September 1, 2014. The proposed amendments included a new Subchapter M to Chapter 363, relating to SWIFT and SWIRFT, which included a prioritization system to score and rank projects

for which financial assistance is sought. The Board strived to develop rules that make the assignment of points clear and objective and to maximize flexibility so that the Board can actively manage SWIFT funds and protect the \$2 billion corpus, while still offering attractive financial terms for loans.

Also of central importance in the proposed rule was the determination of projects that qualify for the 10 percent funding for rural projects and agricultural water conservation and the 20 percent funding for water conservation and reuse. The Board understands that in undertaking to apply the percentages given in the statute, the percentages are intended as “a floor and not a ceiling,” meaning that the TWDB is not limited to funding only 10 percent of total project funds for rural and agricultural water conservation or only funding 20 percent of total project funds for water conservation and reuse.

In addition to oral comments received at public hearings in San Antonio, San Angelo, and Fort Worth, the TWDB received a total of 104 written comments plus 8,784 petitions, form letters, and collected electronic submissions on the proposed rule. Several changes were made as a result of these comments, and the Board adopted the final rule on November 6, 2014, four months ahead of the March 2015 statutory deadline. Immediately upon adopting the final rule, the TWDB launched an extensive public outreach campaign.

Strategic Planning Model Development

The TWDB has worked with financial and legal advisors to develop a strategic planning model to analyze multiple funding scenarios to achieve the legislative directive

of implementing the state water plan over the next 50 years. The model includes inputs such as interest rates and types of loan structures offered and outputs such as program capacity, fund balances, and forecasted cash flows. Minor changes to any one of many variables early in the program can have a significant impact on the program’s capacity because of the compounding effect over time.

Some of the primary variables that could impact the available funding capacity of the program include:

- Amount of project funding awarded in the early years of the program
- Loan structures with payment deferrals
- Longer loan terms (30-year versus 20-year amortizations)
- Amount of interest rate subsidy provided
- Timing between when the TWDB closes its bonds and when borrowers close their loans

While these are all variables over which the program has some discretion, there are others that the TWDB has no control over but must also be addressed in the model. Interest rates, for instance, are dynamic and subject to the effects of economic, national, and global events. The agency also does not have control over rating agency criteria, the fund earnings rate, or the management and investment of the funds by the Texas Treasury Safekeeping Trust Company.

Because of the 50-year planning horizon and the significance of the impact of the various variables, the program may need to evolve over time. Flexibility embedded into the structure of the program, as well as active

management by the full-time Board, will allow the TWDB to nimbly respond to the variables which are beyond the state's control.

Partnership with the Texas Treasury Safekeeping Trust Company

SWIFT is a special fund in the state treasury outside the general revenue fund. As specified in HB 4, SWIFT funds are held and invested in the name of the TWDB by the Texas Treasury Safekeeping Trust Company. The "Trust" is a special purpose entity created by the Legislature to manage, invest, and safeguard funds for the state and various political subdivisions of the state. The Texas Comptroller is the sole officer, director, and shareholder of the Trust and is charged with managing the company. The Comptroller has delegated management and investment-related duties to the chief executive officer of the Trust.

The Trust is required to adopt an investment policy appropriate for SWIFT, with the overall objective, as specified by HB 4, "to maintain sufficient liquidity to meet the needs of the fund while striving to preserve the purchasing power of the fund." The Trust must invest the fund in accordance with the prudent investor standard and will consider only those investments appropriate for SWIFT given its purpose and distribution requirements.

At least annually, the TWDB is required to formally adopt and provide to the Trust a long-term cash flow forecast for SWIFT, which will be the basis for the ultimate positioning of the investment portfolio between liquid and less liquid investment strategies. The TWDB will run updated cash-flow forecasts in conjunction with each funding round to

show impacts to capacity, SWIFT balance, and repayment amortization. These annual forecasts of needed cash flows and periodic updates will ensure that the Trust maintains sufficient liquidity to meet the needs of the fund while striving to preserve its purchasing power. Adjustments to the positioning of assets, and associated return expectations, will be made as needed to provide liquidity required by the TWDB for the program. As of September 30, 2014, assets in the SWIFT Investment Fund, including cumulative interest and investment income, have grown to \$2,017,206,009 (Appendix A).

The TWDB will direct the Trust regarding needed disbursements from SWIFT semi-annually, but not more than twice a year. The Trust will provide to both the SWIFT legislative advisory committee and the TWDB an annual report regarding the investment of the fund. The Trust is also responsible for conducting an independent, annual audit and reporting the findings.

4. Oversight, Transparency, and Reporting

HB 4 included a number of oversight, reporting, and transparency requirements, which include creation of the legislative advisory committee, requirements for this biennial report to the Legislature, and regular reporting on the TWDB's website. In addition to receiving and considering recommendations from the advisory committee, the TWDB is also required to report to the committee annually on the agency's compliance with statewide annual goals relating to HUBs and how they are participating in the program,

as reported by those political subdivisions that receive financial assistance. If the level of participation by HUBs does not meet state-wide annual goals, the advisory committee will make recommendations to the TWDB to improve the participation level.

Standing legislative committees and state regulatory entities also retain customary policy and agency oversight. These include: Senate Finance; House Appropriations; Senate Natural Resources; House Natural Resources; Governor's Office of Budget, Planning, and Policy; Legislative Budget Board; State Auditor's Office; and the Sunset Advisory Commission. Other financial regulatory oversight includes the U.S. Securities and Exchanges Commission, the Office of the Attorney General, Comptroller of Public Accounts, Bond Review Board, and Credit Rating Agency considerations. SJR 1 also directed the Legislative Budget Board to provide approval before each bond enhancement agreement or loan agreement is executed.

5. Outlook on First Round of Funding

The first round of abridged applications for state water plan funding was solicited on November 6, 2014. All abridged applications will be prioritized by the Executive Administrator according to 31 TAC §363.1303. The Board will then consider the prioritizations and establish the funds available by category, the structure of financing, and the terms of any subsidy, in spring 2015. All projects that receive priority for funding must submit a complete financial assistance application to the TWDB within 30 days after receiving

priority.

In a similar manner to the application process for the TWDB's longstanding financial assistance programs, agency staff will conduct a technical review of each application, including legal, engineering, environmental, planning, and water conservation reviews. After the technical review is complete, the applications will be presented to the TWDB's three-member Board for approval at a public meeting. Once a funding commitment has been made by the Board, financing agreements will be executed with the borrowers, the TWDB will issue the SWIRFT revenue bonds, bond enhancement agreements will be ratified, and then borrowers will close on loans.

6. Preview of Next Biennial Report

The next biennial report on use of SWIFT, due December 1, 2016, will include:

- An overview of applications received and the amount awarded each funding round, including loan terms and subsidies
- Progress toward meeting (1) the 10 percent funding for rural projects and agricultural water conservation and (2) the 20 percent funding for water conservation and reuse
- Summary of HUB participation

This page is intentionally blank

SWIFT

State Water Implementation Fund for Texas



TEXAS TRUST
TEXAS TREASURY SAFEKEEPING TRUST COMPANY
COMPTROLLER SUSAN COMBS, CHAIRMAN

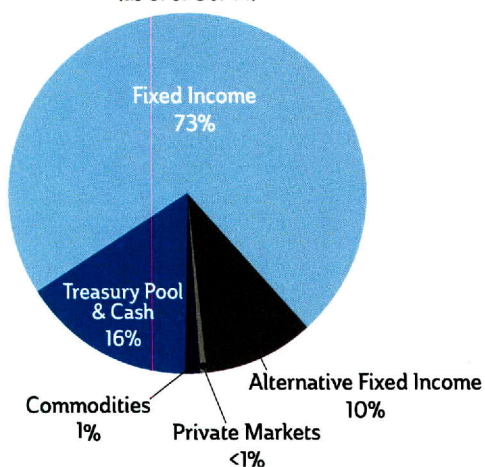
The State Water Implementation Fund for Texas (“SWIFT”) was created by the 83rd Texas Legislature, Regular Session, and became effective once the voters approved the constitutional amendment to fund the SWIFT with \$2 billion from the Economic Stabilization Fund. The creation of the SWIFT and its requirements are set forth in Chapter 15 of the Texas Water Code. The SWIFT is intended to serve as a water infrastructure bank whose objective is to enhance the financing capabilities of the

Texas Water Development Board (“TWDB”) and to provide a cash flow mechanism where money used for TWDB’s programs will ultimately flow back to the SWIFT. The purpose of the SWIFT is to provide financial support for revolving low-cost flexible financing options for water projects. The SWIFT will be used to help provide financing for projects in the State Water Plan overseen by the Texas Water Development Board.

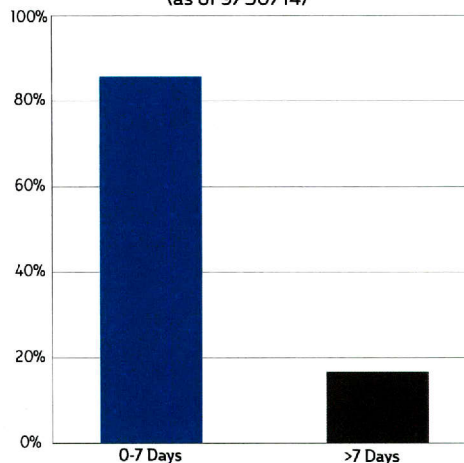
SWIFT Investment Fund (SIF)

Strategy	11/22/13	12/31/13	1Q2014	2Q2014	3Q2014
Treasury Pool/Cash	\$2,000,000,000	\$2,000,192,549	\$1,502,647,876	\$802,797,455	\$317,235,104
Fixed Income			\$454,699,752	\$1,014,876,716	\$1,461,985,929
Alt. Fixed Income			\$50,694,250	\$206,547,271	\$204,380,909
Private Markets					\$9,957,304
Commodities					\$23,646,761
TOTAL	\$2,000,000,000	\$2,000,192,549	\$2,008,041,878	\$2,024,221,442	\$2,017,206,009

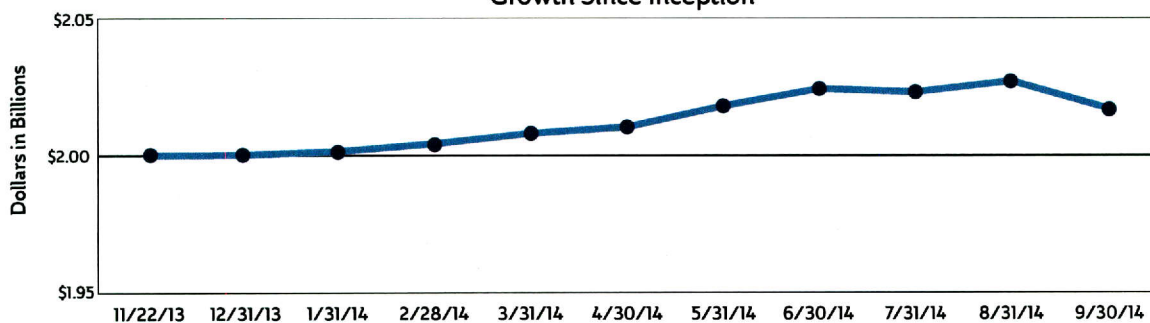
Asset Allocation by Strategy
(as of 9/30/14)



Liquidity
(as of 9/30/14)



Growth Since Inception



This page is intentionally blank



Texas Water Development Board
P.O. Box 13231, Capitol Station
Austin, Texas 78711-3231