

# Texas Local Government Investment Pool

Basic Financial Report  
August 31, 2017 and 2016

## Texas Local Government Investment Pool

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RSM US LLP

## Independent Auditor's Report

To the Honorable Glenn Hegar  
Comptroller of Public Accounts of the State of Texas  
Texas Local Government Investment Pool

### Report on the Financial Statements

We have audited the accompanying financial statements of the Texas Local Government Investment Pool (TexPool), an investment trust fund of the State of Texas, as of and for the year ended August 31, 2017, and the related notes to the financial statements, which collectively comprise TexPool's basic financial statements.

### 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 Texas Local Government Investment Pool investment trust fund as of August 31, 2017, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As described in Note 1 to the financial statements, these financial statements present only the TexPool investment trust fund and do not purport to, and do not, present fairly the financial position of the State of Texas as of August 31, 2017, and the changes in its financial position for the year 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 Matters*****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 Matter***

The financial statements of Texas Local Government Investment Pool as of and for the year ended August 31, 2016, were audited by other auditors, whose report dated October 26, 2016, expressed an unmodified opinion on those statements with emphasis of matter paragraphs to alert the users that the entity is an investment trust fund of the State of Texas and that the entity adopted Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*, and Statement No. 79, *Certain External Investment Pools and Pool Participants*.

*RSM US LLP*

Austin, Texas  
November 3, 2017

## Texas Local Government Investment Pool

### Management's Discussion and Analysis Years Ended August 31, 2017 and 2016

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The Texas Local Government Investment Pool's (TexPool) management's discussion and analysis is designed to assist the reader in focusing on significant financial issues and provide a performance overview of TexPool's operations for the years ended August 31, 2017 and 2016.

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

This annual financial report consists of two parts:

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

The Statement of Pool Net Position presents the financial position of TexPool at the end of the fiscal year and includes all assets and liabilities of TexPool. The difference between total assets and total liabilities—net position—equals the sum of all participants' interest in TexPool. At August 31, net position was calculated as follows:

	2017	2016	2015
Total assets	\$ 16,039,703,208	\$ 13,334,747,174	\$ 12,527,285,952
Total liabilities	(15,444,514)	(5,291,868)	(1,214,141)
Net position held in trust for pool participants	<u>\$ 16,024,258,694</u>	<u>\$ 13,329,455,306</u>	<u>\$ 12,526,071,811</u>

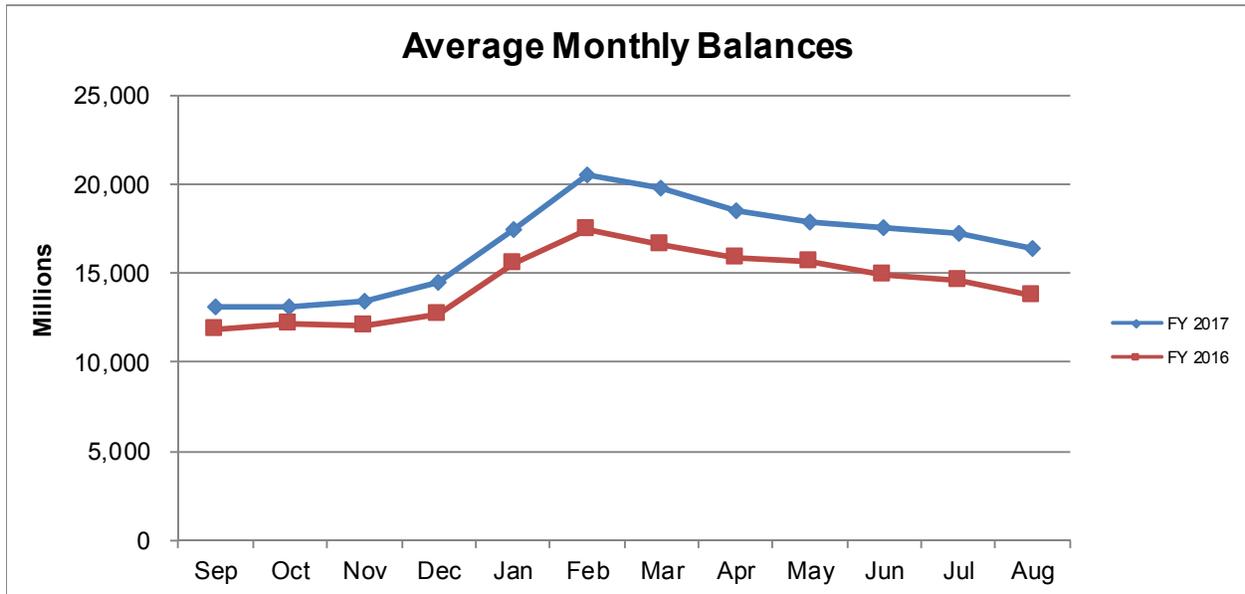
The Statement of Changes in Pool Net Position presents the activity within the net position balance for the year ended. Significant activity accounts include net investment income, earnings distributions and net contributions/withdrawals by participants. The changes in net position for the years ended August 31, 2017, 2016 and 2015 were as follows:

	2017	2016	2015
Net investment income	\$ 108,936,430	\$ 39,454,888	\$ 6,442,921
Earnings paid to investors from net investment income	(108,982,506)	(39,503,266)	(6,488,223)
Expense paid from management fees reserved for operating expenses	46,076	48,378	45,302
Net increase (decrease) in participant investments	<u>2,694,803,388</u>	<u>803,383,495</u>	<u>(87,374,685)</u>
Net increase (decrease) in net position	<u>\$ 2,694,803,388</u>	<u>\$ 803,383,495</u>	<u>\$ (87,374,685)</u>

## Texas Local Government Investment Pool

### Management's Discussion and Analysis Years Ended August 31, 2017 and 2016

The average monthly balance in TexPool grew to \$20.5 billion in February 2017, up from \$13.1 billion in September 2016, in what is a typical seasonal pattern for the pool. The average monthly balance as of August 31, 2017, was \$16.4 billion.



Management and administrative fees to operate TexPool are set at 4.73 basis points (0.0473%). During both fiscal years 2017 and 2016, management fees were rebated on various occasions. During fiscal year 2017, the average monthly fee ranged from a high of 4.66 basis points (0.0466%) to a low of 4.26 basis points (0.0426%). During fiscal year 2016, the average monthly fee ranged from a high of 4.73 basis points (0.0473%) to a low of 3.91 basis points (0.0391%).

The notes to the financial statements provide narrative explanations of accounting policies and additional data needed for full disclosure as required by accounting principles generally accepted in the United States of America.

#### Fiscal Year 2017 Performance

The 12-month reporting period ended August 31, 2017, was characterized by gradual improvement of the United States (U.S.) economy on the one hand and political, geopolitical and environmental volatility on the other. Throughout it all, the U.S. Federal Reserve (the Fed) retained a steadfast reliance on data. That led it to raise rates several times and to begin the process of paring its balance sheet, built up in response to the financial crisis. These moves amounted to a vote of confidence by the Fed in the economy even though a key metric—inflation—remained below the Fed's target. In the past, inflation has tended to rise as the labor market improved. But this has not occurred despite solid employment figures.

## **Texas Local Government Investment Pool**

### **Management's Discussion and Analysis Years Ended August 31, 2017 and 2016**

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Money market reform was the biggest impact to the cash market. The changes implemented in October 2016 altered the money market fund industry and landscape. Local government investment pools such as TexPool are not regulated by the Securities and Exchange Commission (SEC) and as such were not required to adopt the regulatory changes.

Buoyed by optimism over the prospect of a pro-business agenda from President Trump and a Republican Congress and another Fed rate hike in December 2016, the risk markets rallied early in 2017. As the year marched on, the labor market strengthened, manufacturing accelerated, consumer confidence rose and the housing market firmed, the latter lifted by a warmer-than-usual winter. These all factored into the Fed's decision to lift the target federal funds target range by 25 basis points again in March. When some economic data softened in the months that followed, including a slowdown in job growth and retail sales, the central bank was not deterred from hiking rates yet again in June. These three policy tightenings brought the Fed funds target range from 0.25% to 0.50% at the beginning of the reporting period to a 1.00% to 1.25% range by the end of the period on August 31, 2017. The reporting period ended with the expectation that the Fed would announce the timetable for the implementation of plans to reduce the size of its balance sheet at the September 2017 Federal Open Market Committee meeting.

During the 12-month reporting period, short-term Treasury yields increased in response to the policy actions by the Fed: 1-month rose 70 basis points, from 0.26% to 0.96%, 3-month rose 68 basis points, from 0.34% to 1.02% and 6-month rose 64 basis points, from 0.48% to 1.12%. Overnight, Treasury and mortgage-backed repo rates jumped from 0.32% and 0.34% to 1.06% and 1.07%, respectively. TexPool's average maturity decreased from 42 to 30 days, assets under management increased from \$13.3 billion to \$16.0 billion, and the average monthly yield rose from 0.37% to 1.00%.

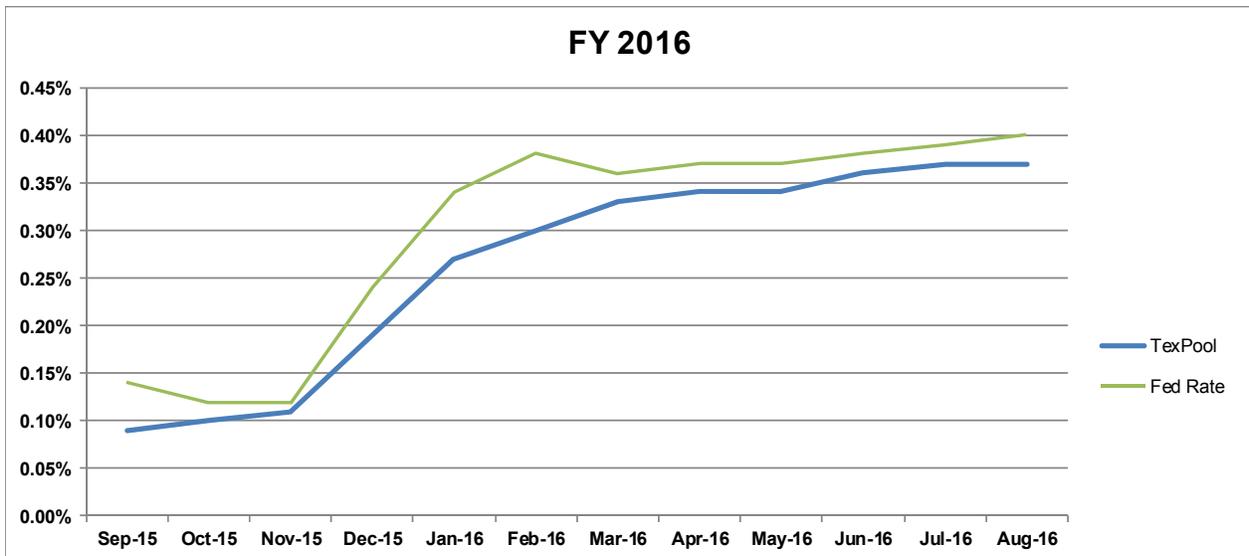
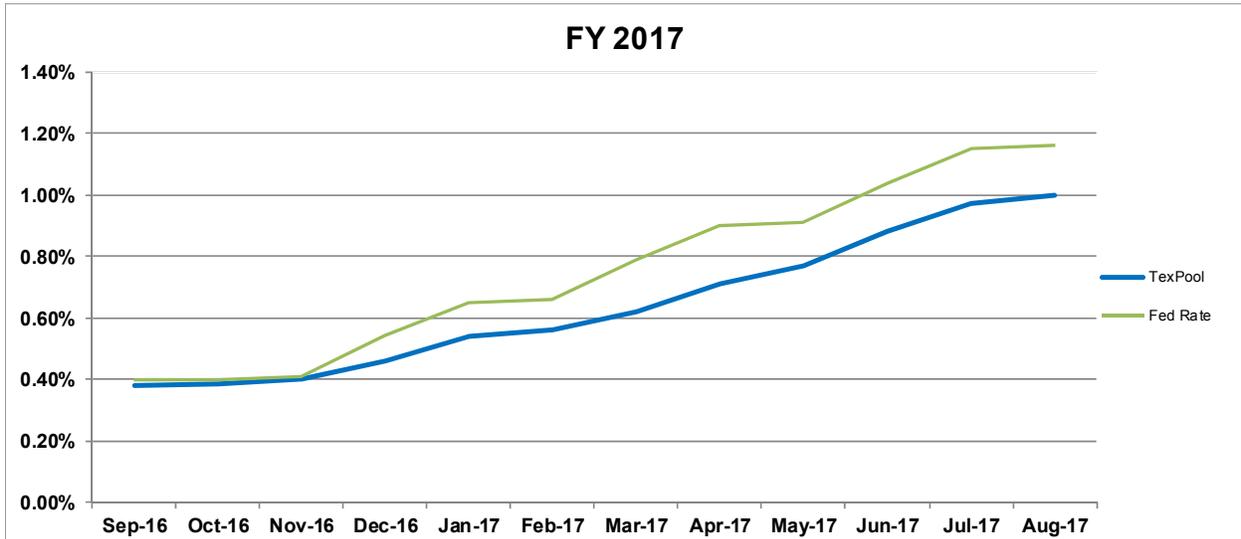
## Texas Local Government Investment Pool

### Management's Discussion and Analysis Years Ended August 31, 2017 and 2016

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#### TexPool vs. Fed Funds Rate

The following charts graphically depict the TexPool yield and the Fed rate for 2017 and 2016.



**Texas Local Government Investment Pool**

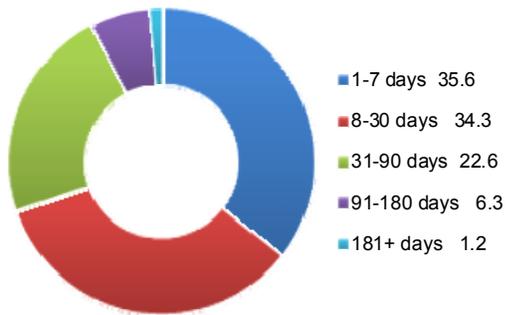
**Management’s Discussion and Analysis  
Years Ended August 31, 2017 and 2016**

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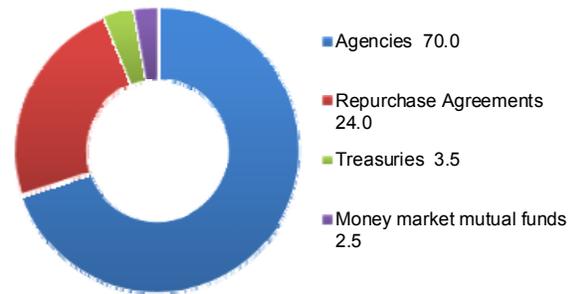
**TexPool Information as of August 31, 2017**

Additional information on the TexPool portfolio is reflected in the following graphics, which are available at [www.texpool.com](http://www.texpool.com) :

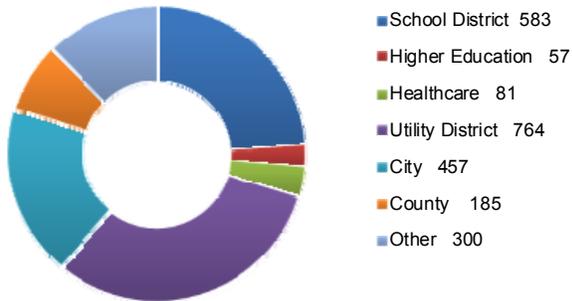
**Portfolio by Maturity (%)**



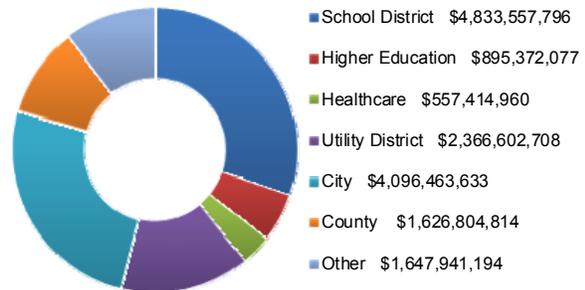
**Portfolio by Type of Investment (%)**



**Number of Participants by Account Type**



**Participant Balances by Account Type**



## Texas Local Government Investment Pool

### Management's Discussion and Analysis Years Ended August 31, 2017 and 2016

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#### Fiscal Year 2016 Performance

The U.S. experienced several economic developments during the one-year reporting period. The most significant came in December, when the Fed raised interest rates from near zero for the first time since late 2008. Policymakers had previously declined to raise rates due to an assortment of reasons, including concerns about continued low inflation and a labor market that, while improving, failed to produce the expected wage pressure. The increase to the target range of 0.25% to 0.50% pushed up yields for money markets.

As the reporting period progressed, policymakers identified volatile oil prices, a strong dollar and lower global demand as significant factors influencing business investment, manufacturing and exports, which kept them from implementing an additional increase in the target rate. Other global concerns also weighed on Fed decision-making, such as potential financial crises in emerging markets, especially China, multiple acts of terror and the surprise decision by United Kingdom voters to leave the European Union (referred to as Brexit). Tailwinds came in the form of the firming of housing market sales and prices, improving retail sales and growing consumer confidence, and the tightening of the labor market, with record lows in initial jobless claims. While the Fed's long view of the U.S. economy is one of steady, if slow, improvement, it did not see enough evidence of growth in the short term to raise rates again in the reporting period. Market expectation was that another small hike would occur before the end of 2016.

These events affected TexPool in so far as they influenced Fed decision-making. But a more pertinent influence came from another regulator, the SEC. While the SEC's reforms to money markets do not directly affect TexPool because Local Government Investment Pools (LGIPs), such as TexPool, are not money market mutual funds, TexPool was able to benefit from the steady rise of the London interbank offered rate (LIBOR) over the reporting period, and TexPool ended the fiscal year with a 30 basis-point increase in yield.

The Federal Reserve modestly tightened monetary policy over the 2016 fiscal year, raising the Fed funds target rate by 25 basis points at the December 2015 Federal Open Market Committee meeting. At August 31, 2016, the Fed funds target rate stood in the range on 25-50 basis points. As a result, TexPool experienced an increase in yield, moving from 7 basis points on August 31, 2015, to 37 basis points on August 31, 2016. The graph on page 6 reflects the average monthly rate in fiscal year 2016, and demonstrates that, on a net basis, TexPool closely tracked the Fed funds target rate during fiscal year 2016.

During the one-year reporting period, the LIBOR rose across the spectrum. One-month LIBOR rose from 20 basis points to 51 basis points, 3-month from 33 basis points to 81 basis points and 6-month from 53 basis points to 120 basis points, respectively.

Short-term Treasury bills rose over the period, with 1-month rising from 5 basis points to 26 basis points, 3-month from 10 basis points to 34 basis points and 6 month from 27 basis points to 48 basis points. Overnight Treasury and mortgage-backed repo rates jumped from 8 and 10 basis points to 32 and 34 basis points, respectively.

The average maturity of the pool was 41 days at the beginning of the reporting period and 42 days at the end of August 2016. Assets under management increased from \$12.5 billion to \$13.3 billion, and the average monthly yield rose from 0.07% to 0.37%.

**Texas Local Government Investment Pool**

**Statements of Pool Net Position  
August 31, 2017 and 2016**

	2017	2016
<b>Assets:</b>		
Investments, at amortized cost		
Securities purchased under agreement to resell	\$ 3,840,513,919	\$ 2,691,004,003
Money market mutual funds	415,022,104	770,022,104
United States government agency securities	11,222,763,767	8,220,314,231
United States government treasury securities	555,205,856	1,643,816,555
	<u>16,033,505,646</u>	<u>13,325,156,893</u>
Accrued interest receivable	6,197,562	9,038,832
Cash	-	551,449
<b>Total assets</b>	<u><b>16,039,703,208</b></u>	<u>13,334,747,174</u>
<b>Liabilities:</b>		
Accounts payable	1,239,177	-
Amounts payable to participants	13,852,434	4,344,220
Accrued expenses	19,976	568,645
Management fees reserved for operating expenses	332,927	379,003
<b>Total liabilities</b>	<u><b>15,444,514</b></u>	<u>5,291,868</u>
<b>Net position held in trust for pool participants</b>	<u><b>\$ 16,024,258,694</b></u>	<u>\$ 13,329,455,306</u>

See notes to financial statements.

**Texas Local Government Investment Pool**

**Statements of Changes in Pool Net Position  
Years Ended August 31, 2017 and 2016**

	2017	2016
Additions:		
Investment income:		
Interest income	\$ 116,512,789	\$ 45,953,374
Expenses:		
Management fees and expenses	<u>(7,576,359)</u>	<u>(6,498,486)</u>
<b>Net investment income</b>	<b>108,936,430</b>	<b>39,454,888</b>
Earnings paid to investors from net investment income	(108,982,506)	(39,503,266)
Expense paid from management fees reserved for operating expenses	46,076	48,378
Net increase in participant investments	<u>2,694,803,388</u>	<u>803,383,495</u>
<b>Net increase in net position</b>	<b>2,694,803,388</b>	<b>803,383,495</b>
Net position at beginning of year	<u>13,329,455,306</u>	12,526,071,811
Net position at end of year	<u><b>\$ 16,024,258,694</b></u>	<u>\$ 13,329,455,306</u>

See notes to financial statements.

## Texas Local Government Investment Pool

### Notes to Financial Statements

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#### Note 1. Summary of Significant Accounting Policies

**Background and reporting entity:** On September 1, 1989, local government investment pools became authorized investments for the majority of public entities in Texas. The Interlocal Cooperation Act was amended by the 71st Texas Legislature to facilitate the creation of local government investment pools in Texas. This act permits the creation of investment pools to which any political subdivision (local government) in Texas may delegate, by contract, the authority to make investments purchased with local investment funds and to hold legal title as custodian of the investment securities.

The Texas Legislature authorized the State Treasurer to incorporate a special-purpose trust corporation in 1986 called the Texas Treasury Safekeeping Trust Company (Texas Trust). The Texas Trust has direct access to the services of the Federal Reserve Bank and performs other activities. It is specifically authorized to manage, disburse, transfer, safekeep and invest public funds and securities.

The Texas Trust created the Texas Local Government Investment Pool (TexPool) as a public funds investment pool. Eligible participants include, but may not be limited to, incorporated cities, counties, villages, certain types of water districts, school districts, junior college districts, community college districts and certain other special districts in the State of Texas. TexPool began operations on December 6, 1989. On September 1, 1996, the operations of the State Treasury, including the Texas Trust and TexPool, were merged with the State Comptroller of Public Accounts (State Comptroller).

The administrative and investment services to TexPool are provided by Federated Investors, Inc. (Federated) under an agreement with the Texas Trust effective April 8, 2002. The current contract was executed on September 1, 2012, effective through August 31, 2015. The contract was renewed on September 1, 2015, effective through August 31, 2016, and is renewable annually one year at a time for two years ending August 31, 2018.

Federated is the investment manager and State Street Bank and Trust is the custodian for TexPool. Federated provides fund accounting and transfer agency services to TexPool. Effective July 1, 2004, Federated outsourced the transfer agent function to Boston Financial Data Services. Federated is the administrator for the TexPool program providing Participant Services and Marketing functions to TexPool participants. Federated is the participant contact point for account maintenance, assistance with transactions and other administrative information.

TexPool is established as an investment trust fund with the Texas Trust as trustee, segregated from all other trustors, investments and activities of the Texas Trust. Only local governments having contracted to participate in TexPool (Participants) have an undivided beneficial interest in its pool of assets. TexPool is not registered with the Securities and Exchange Commission (SEC) as an investment company.

These financial statements include only the operations of TexPool. The State Comptroller has established an eight member TexPool Advisory Board (Advisory Board) composed equally of Participants in the TexPool portfolios (TexPool and TexPool Prime) and other persons who do not have a business relationship with TexPool. Advisory Board members review TexPool's investment policy and management fee structure.

The State Comptroller exercises oversight responsibility over all other aspects of TexPool, including investment and accounting activity, development plans, etc. Oversight responsibility is demonstrated by financial interdependency, ability to significantly influence operations, designation of management and accountability for fiscal matters. As a result, the financial statements of TexPool are included in the financial statements of the Texas Trust as an investment trust fund, which are ultimately included in the financial statements of the State of Texas.

## Texas Local Government Investment Pool

### Notes to Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

**Basis of accounting:** The accounting and reporting policies of TexPool relating to the accompanying financial statements conform to accounting principles generally accepted in the United States of America applicable to state and local governments. Accounting principles generally accepted in the United States of America for state and local governments include those principles prescribed by the Governmental Accounting Standards Board (GASB) in its publication *Codification of Governmental Accounting and Financial Reporting Standards* (the Codification).

The financial statements of TexPool are presented as a fiduciary fund type investment trust fund using the economic resources measurement focus and accrual basis of accounting. Investment income is recorded when earned and expenses are recorded when incurred. Net investment income is allocated to Participant accounts monthly on a pro-rata basis. All gains and losses from the sale of securities are distributed among Participants, and will be amortized over the remaining term to maturity of the liquidated securities. Participants may redeem their accounts at any time based on the previous day's balance of their account. Unrealized gains or losses are not allocated to Participant accounts.

Investments are carried at amortized cost, which approximates fair value, as provided for by the Codification. Investments are priced daily and compared to TexPool's carrying value. If the ratio of the fair value of the portfolio of investments to the carrying value of investments is less than 0.995 or greater than 1.005, TexPool will sell investment securities, as required, to maintain the ratio at a point between 0.995 and 1.005.

**Expenses:** Expenses applicable to all Participants, paid in the form of a management fee to Federated, were allocated between all Participants as an adjustment to the daily investment yield so that only net investment income is credited to Participants accounts. The Advisory Board has the responsibility under the provisions of the TexPool Participation Agreement to approve any modifications or other amendments of the management fee structure.

**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 fund net position at the date of the financial statements. Actual results could differ from those estimates.

#### Note 2. Management Fees and Other Transactions With Affiliates

The Texas Trust, in order to recover its costs of operating TexPool, established a management fee for basic services provided to the Participants. As of August 31, 2017 and 2016, the fee was 4.73 basis points. Federated earns 4.23 basis points (0.0423%) as its management fee and the Texas Trust earns one-half basis point (0.0050%) as its management fee.

Under the current contract with Federated, the management fee may not be raised for the duration of the contract, which was renewed on September 1, 2015, and effective through August 31, 2016. The current contract is renewable annually one year at a time for two years ending August 31, 2018.

During fiscal year 2017 and 2016, the fees were reduced from the maximum allowed under the contract on various occasions. Fees are rebated when TexPool is invested in an affiliated money market product. During fiscal year 2017, the average monthly fee ranged from a high of 4.66 basis points (0.0466%) to a low of 4.26 basis points (0.0426%). During fiscal year 2016, the average monthly fee ranged from a high of 4.73 basis points (0.0473%) to a low of 3.91 basis points (0.0391%).

## Texas Local Government Investment Pool

### Notes to Financial Statements

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#### Note 3. Investments

Investments of TexPool are only those authorized by the Texas Public Funds Investment Act governing pools for local governments, which was in effect as of and prior to August 31, 2017 and 2016, respectively. The portfolio may include the following:

1. Obligations of the United States or its agencies and instrumentalities;
2. Direct obligations of the State of Texas or its agencies and instrumentalities;
3. 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;
4. Other obligations, for which the principal and interest are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or its agencies and instrumentalities;
5. Obligations of states, agencies, counties, cities and other political subdivisions of any state having been rated as to investment quality by nationally recognized investment rating firms and having received a rating of not less than "A" or its equivalent;
6. Bonds issued, assigned or guaranteed by the State of Israel;
7. Certificates of deposit issued by state and national banks domiciled in the State of Texas, a savings bank domiciled in the State of Texas or a state or federal credit union domiciled in the State of Texas that are:
  - a. Guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor;
  - b. Secured by obligations as described in items 1-4 above, which are intended to include all direct federal agency or instrumentality issued mortgage-backed securities that have a market value of not less than the principal amount of the certificates, but excluding mortgage-backed securities described by Section 2256.009(b) of the Texas Public Funds Investment Act; and
  - c. Secured in any other manner and amount provided by law for deposits of the investing entity.
8. Fully collateralized direct repurchase agreements having a defined termination date, secured by obligations described by item 1 above, pledged with a third party selected or approved by TexPool, and placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in the State of Texas; and
9. Such other investments as may be authorized by the Texas Public Funds Investment Act, Chapter 2256.

The above investments are the legally permitted investments; however, the TexPool Advisory Board has ratified an investment policy which further limits TexPool's portfolio to certain of the investments listed above. The investment policy does not allow for derivative securities, commercial paper or certificates of deposit.

## Texas Local Government Investment Pool

### Notes to Financial Statements

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#### Note 3. Investments (Continued)

The State Comptroller approved the current TexPool investment policy effective August 2016, which has been reviewed by the TexPool Advisory Board. Under this investment policy, the following are authorized investments:

- Obligations of the United States, its agencies or instrumentalities, except for:
  - Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;
  - Obligations whose payments represent the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;
  - Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and,
  - Collateralized mortgage obligations, the interest rate of which, is determined by an index that adjusts opposite to the changes in a market index.
- Fully collateralized repurchase and reverse repurchase agreements having a defined termination date, secured by any obligation of the United States, its agencies or its instrumentalities, to include certain mortgage-backed securities of the United States. The repurchase and reverse repurchase agreements are placed only with a primary government securities dealers, or a state or national bank doing business in the State of Texas;
- Money market mutual funds which are no-load, registered with and regulated by the SEC provide a prospectus and other information required by the Securities and Exchange Act of 1934 or the Investment Company Act of 1940, maintain a dollar-weighted average stated maturity of 90 days or fewer, and which include in its investment objectives the maintenance of a stable net asset value (NAV) of \$1.00 for each share.

TexPool is designed to be highly liquid in order to give Participants immediate access to their account balance. Therefore, the weighted average maturity of the investments (calculated using the reset date for variable rate notes) of TexPool cannot exceed sixty days. At August 31, 2017 and 2016, the approximate weighted average maturity of the portfolio was 30 days and 42 days, respectively.

Securities transactions are recorded on a trade date basis. Interest income, adjusted for amortization of premiums and accretion of discounts on investments, is accrued daily. Income to Participants is accrued daily and distributions or reinvestment of the income is made monthly.

Securities purchased under agreements to resell (repurchase agreements) are treated as investments, are collateralized by negotiable and eligible government securities and are carried at the amounts at which the securities were purchased as specified in the respective agreements.

Collateral on repurchase agreements is maintained in a segregated account by a third-party custodian upon entering into the repurchase agreement. The collateral is marked to market daily to ensure its market value as being at least equal to 100% of the resale price of the repurchase agreement. The August 2016 investment policy states that collateral on repurchase agreements will be equal to at least 102% of the total market value of the repurchase agreements, including accrued interest.

## Texas Local Government Investment Pool

### Notes to Financial Statements

#### Note 3. Investments (Continued)

TexPool 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. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Levels 1, 2 and 3 (lowest priority level) of the fair value hierarchy are defined as follows.

**Level 1:** Inputs using unadjusted quoted prices in active markets or exchanges in 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 should be categorized based on the lowest priority level input that is significant to the valuation. TexPool'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 NAV per share (or equivalent) as a practical expedient to fair value are not classified in the fair value hierarchy.

TexPool has the following recurring fair value measurements as of August 31, 2017 and 2016:

2017	Principal Value	Carrying Value	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)
Investments by fair value level:						
Debt securities:						
Securities purchased under agreement to resell	\$ 3,840,513,919	\$ 3,840,513,919	\$ 3,840,513,919	\$ -	\$ 3,840,513,919	\$ -
United States government agency securities	11,228,898,000	11,222,763,767	11,223,305,199	-	11,223,305,199	-
United States treasuries	555,000,000	555,205,856	555,137,915	-	555,137,915	-
Total debt securities	15,624,411,919	15,618,483,542	15,618,957,033	-	15,618,957,033	-
Total investments by fair value level	\$ 15,624,411,919	\$ 15,618,483,542	\$ 15,618,957,033	\$ -	\$ 15,618,957,033	\$ -
Investments measured at NAV:						
Money market mutual funds	\$ 415,022,104	\$ 415,022,104				
Total investments at NAV	415,022,104	415,022,104				
Total investments	\$ 16,039,434,023	\$ 16,033,505,646				

## Texas Local Government Investment Pool

### Notes to Financial Statements

#### Note 3. Investments (Continued)

2016	Principal Value	Carrying Value	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)
Investments by fair value level:						
Debt securities:						
Securities purchased under agreement to resell	\$ 2,691,004,003	\$ 2,691,004,003	\$ 2,691,004,003	\$ -	\$ 2,691,004,003	\$ -
United States government agency securities	8,222,988,000	8,220,314,231	8,222,888,646	-	8,222,888,646	-
United States treasuries	1,640,000,000	1,643,816,555	1,644,063,580	-	1,644,063,580	-
Total debt securities	12,553,992,003	12,555,134,789	12,557,956,229	-	12,557,956,229	-
Total investments by fair value level	\$ 12,553,992,003	\$ 12,555,134,789	\$ 12,557,956,229	\$ -	\$ 12,557,956,229	\$ -
Investments measured at NAV:						
Money market mutual funds	\$ 770,022,104	\$ 770,022,104				
Total investments at NAV	770,022,104	770,022,104				
Total investments	\$ 13,324,014,107	\$ 13,325,156,893				

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants. Debt securities and repurchase agreements classified as Level 2 of the fair value hierarchy are valued using other observable significant inputs, including but not limited to, quoted prices for similar securities, interest rates and a fixed-income pricing model.

The following table provides additional information about TexPool's investment portfolio as of August 31, 2017 and 2016:

	August 31, 2017	
	Ranges of	
	Interest Rates	Maturity Dates
Securities purchased under agreement to resell	1.020% to 1.070%	09/01/2017 - 09/07/2017
United States government agency securities	0.010% to 4.500%	09/01/2017 - 08/24/2018
United States treasuries	0.010% to 2.380%	10/19/2017 - 05/31/2018
Money market mutual funds	0.910%	09/07/2017
	August 31, 2016	
	Ranges of	
	Interest Rates	Maturity Dates
Securities purchased under agreement to resell	0.280% to 0.330%	09/01/2016 - 09/06/2016
United States government agency securities	0.260% to 5.000%	09/02/2016 - 05/05/2017
United States treasuries	0.388% to 3.130%	09/07/2016 - 01/31/2017
Money market mutual funds	0.340%	09/01/2016

## Texas Local Government Investment Pool

### Notes to Financial Statements

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#### Note 3. Investments (Continued)

**Custodial credit risk:** For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, TexPool would not be able to recover the loss of its investments or collateral securities that are in possession of an outside entity. As of August 31, 2017 and 2016, all of TexPool's investments are held by the Federal Reserve or the custodian in TexPool's name. TexPool's bank balances are fully collateralized by Federal depository insurance. The amounts that exceed the Federal depository insurance coverage are collateralized by the institution holding the funds. At August 31, 2017 and 2016, TexPool had a cash balance of \$-0- and \$551,449, respectively.

**Credit risk:** The TexPool portfolio is designed and managed to ensure that it maintains its AAAM rating (or the equivalent) by a nationally recognized statistical rating organization (NRSRO). As of August 31, 2017 and 2016, TexPool investments in U.S. government securities and the underlying securities of the Repurchase Agreements were rated A-1+ by Standard & Poor's, P1 by Moody's and F-1+ by Fitch. Money market mutual funds were rated AAAM by Standard & Poor's, Aaa-mf by Moody's and AAAMmf by Fitch as of August 31, 2017 and 2016.

**Concentration of credit risk:** Up to 100.0% of TexPool assets may be invested in government obligations of the United States, its agencies or instrumentalities. However, no more than 60.0% of the portfolio may be invested in variable rate notes. Up to 100.0% of TexPool assets may be invested in direct repurchase agreements. TexPool may enter into reverse repurchase agreements for up to one third (1/3) of the value of the TexPool assets. Up to 15.0% of TexPool assets may be invested in approved money markets mutual funds. No more than 10.0% of the TexPool assets may be invested in a single money market fund. The money market mutual fund must be rated AAA or its equivalent by at least one NRSRO. TexPool's investment policy has no limit on the amount it may invest in any single Governmental Sponsored Enterprise (GSE). As of August 31, 2017, TexPool had more than 5.0% of the pool's investments in the following GSEs: 39.2% with the Federal Home Loan Bank, 11.0% with the Federal Farm Credit Bank and 13.6% with the Federal Home Loan Mortgage Corporation. As of August 31, 2016, TexPool had more than 5.0% of the pool's investments in the following GSEs: 34.8% with the Federal Home Loan Bank, 13.5% with the Federal Farm Credit Bank and 6.0% with Federal National Mortgage Association.

**Interest rate risk:** The weighted-average maturity of the portfolio is limited to 60 days calculated using the reset date for variable rate notes (VRNs) and 90 days or fewer using the final maturity date for VRNs, with the maximum maturity for any individual security in the portfolio not exceeding 397 days for fixed rate securities and 24 months for VRNs. The following schedule reflects the weighted-average maturity by investment type and TexPool's portfolio as a whole:

Investment type:	Weighted-Average Maturity (Days)	
	2017	2016
Securities purchased under agreement to resell	2	2
United States government agency securities	38	50
United States treasuries	83	96
Money market mutual funds	1	2
TexPool's weighted-average maturity	30	42

