

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 31, 2019**

(School Finance Items)

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:03 a.m. on Thursday, January 31, 2019, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Lawrence A. Allen, Jr., vice chair; Donna Bahorich; Patricia Hardy; Ken Mercer

Public Testimony

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

ACTION ITEM

- 1. Election of Chair**
(Board agenda page III-1)

MOTION AND VOTE: *It was moved by Ms. Hardy and carried unanimously to elect Mr. Maynard as chair of the Committee on School Finance/Permanent School Fund.*

Mr. Maynard appointed Mr. Allen to serve as vice chair.

DISCUSSION ITEMS

- 2. Review of 19 TAC Chapter 129, Student Attendance, Subchapter A, Student Attendance Allowed, and Subchapter B, Student Attendance Accounting**
(Board agenda page III-2)

David Marx, director, financial compliance, explained that the rules in these subchapters must be reviewed once every four years per Texas Government Code, §2001.039. There are no anticipated revisions to the rules in 19 TAC Chapter 129, Subchapters A and B.

3. **Discussion of Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide**

(Board agenda page III-7)

The committee discussed a proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide. The proposed amendment would reference the updated *Financial Accountability System Resource Guide* (FASRG) and remove language relating to the commissioner's role in amending the FASRG.

Mr. Marx presented the item and answered questions about the proposed amendment. Von Byer, general counsel, legal services, clarified the rule language in the proposed amendment.

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 31, 2019**

(Permanent School Fund Items)

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:04 a.m. on Thursday, January 31, 2019, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Lawrence A. Allen, Jr., vice-chair; Donna Bahorich; Patricia Hardy; Ken Mercer

Public Testimony

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

DISCUSSION ITEM

4. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-2)

Catherine Civileto, deputy executive administrator, provided a summary on the status of the Permanent School Fund portfolio. Reports presented to the committee were for the reporting period October and November 2018 unless otherwise noted. Ms. Civileto's report included current fair market value of the Fund, the asset allocation mix as of November 30, 2018, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period beginning September 1 through November 30, 2018, the activity in the securities lending program for the fiscal period beginning September 1 through November 30, 2018, the status of transfers from the General Land Office as per the agreed upon resolution for the current fiscal year, current status of the Bond Guarantee Program and the available capacity in the program, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2018 through November 30, 2018, fixed income rating changes for the fiscal period beginning September 1, 2018 through November 30, 2018, and short-term cash investments.

CONSENT ITEM

5. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2018

(Board agenda page III-7)
[Consent agenda item #(2)]

MOTION AND VOTE: *Based on the information provided by staff and the recommendation of the executive administrator and chief investment officer and the commissioner of education, the committee by unanimous consent recommended that the State Board of Education ratify the purchases and sales for the months of October and November 2018, in the amount of \$869,799,322 and \$874,849,738, respectively (Attachment A).*

DISCUSSION ITEMS

6. Annual Reporting of the Internally Managed Permanent School Fund Investment Portfolio (Board agenda page III-13)

Holland Timmins, executive administrator and chief investment officer, provided the required attestation regarding compliance with 19 TAC Chapter 33 of the internally managed investment portfolios in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

7. Third Quarter 2018 Permanent School Fund Performance Report (Board agenda page III-14)

Tom Heiner, BNY Mellon Global and Risk Solutions, presented the third quarter of 2018 Permanent School Fund performance report. Mr. Heiner announced that he was leaving BNY Mellon and that this was his last formal presentation to the committee. Mr. Heiner began with an overview of the U.S. and foreign capital markets. Mr. Heiner then reviewed the performance of the Fund for the third quarter of 2018. He stated that the PSF returned 1.99% for the fourth quarter underperforming the target benchmark by 12 basis points. Mr. Heiner attributed most of the underperformance to Risk Parity.

Mr. Heiner reviewed third quarter 2018 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite exceeded its benchmark for the quarter by six basis points. Mr. Heiner added that the Small/Midcap Equity portfolio outperformed its benchmark by five basis points. He added that international equities returned 0.58% for the quarter, outperforming its benchmark by 19 basis points during the period. The fixed income portfolio returned 0.19% for quarter, outperforming its benchmark by 17 basis points. Mr. Heiner stated that the Absolute Return composite returned 1.19% for the quarter, beating its benchmark, the HFRI Fund of Funds Composite Index, by 80 basis points. Mr. Heiner added that the Real Estate composite returned 1.96% for the quarter, outperforming its benchmark by 65 basis points. Mr. Heiner added that Total Risk Parity Strategies returned 0.03% in the third quarter of 2018, underperforming its benchmark by 456 basis points. He further stated that the Real Return Asset class returned -1.32% for the quarter, outperforming its benchmark by eight basis points. He added that Emerging Market Debt returned -2.36% for the quarter, underperforming its benchmark by 53 basis points. Mr. Heiner stated that private equity returned 3.63% for the quarter, beating its benchmark by 39 basis points. Finally, he stated that the total emerging market equity composite returned -0.97% for the third quarter 2018, outperforming its benchmark by 12 basis points.

CONSENT ITEMS

8. Proposed Amendments to the Investment Procedures Manual (Board agenda page III-15) [Consent agenda item #(3)]

Mr. Timmins provided an overview of the amendments made to the investment procedures manual related to SEC amended rule changes for the Bond Guarantee Program disclosure (SEC Rule 15c2-12).

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve the amendments to the Investment Procedures Manual as presented by staff.*

9. Decision on Real Estate Investments

(Board agenda page III-16)

[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners of Stepstone Group Real Estate, was represented by Tom Hester, managing director, and Andrew Mitro, principal, joined by John Grubenman, director of private markets, Nick Tramontana and Ali Houshmand, portfolio managers. Mr. Grubenman provided a brief introduction of four real estate investment recommendations.

Mr. Mitro introduced a real estate investment recommendation in Blackstone Real Estate Partners IX L.P., offered by Blackstone Real Estate Advisors IX L.P. Mr. Mitro and Mr. Grubenman described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview including its objectives and strategy, and outlined the merits and considerations.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with Blackstone Real Estate Advisors IX L.P., necessary to make an investment commitment of up to \$75 million in Blackstone Real Estate Partners IX L.P. subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

Mr. Mitro introduced a real estate investment recommendation in KKR Asia Real Estate Partners SCSp offered by KKR Associates RE Asia SCSp. Mr. Mitro and Mr. Grubenman described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview including its objectives and strategy, and outlined the merits and considerations.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with KKR Associates RE Asia SCSp necessary to make an investment commitment of up to \$75 million in KKR Asia Real Estate Partners SCSp, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

Mr. Hester introduced a real estate investment recommendation in PAG Special Situations Fund III L.P., offered by PAG Special Situations GP III Limited. Mr. Hester and Mr. Grubenman described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview including its objectives and strategy, and outlined the merits and considerations.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with PAG Special Situations GP III Limited. necessary to make an investment commitment of up to \$75 million in PAG Special Situations Fund III L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

Mr. Hester introduced a real estate investment recommendation in Rockpoint Real Estate Fund VI, L.P., offered by Rockpoint Real Estate Fund VI GP, L.L.C. Mr. Hester and Mr. Grubenman described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview including its objectives and strategy, and outlined the merits and considerations.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with Rockpoint Real Estate Fund VI GP, L.L.C. necessary to make an investment commitment of up to \$75 million in Rockpoint Real Estate Fund VI, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

DISCUSSION ITEMS

10. Presentation on the Risk Parity Asset Class for the Permanent School Fund

(Board agenda page III-18)

Rhett Humphreys, partner, NEPC, gave a presentation on the externally managed risk parity strategy. The presentation provided an overview of the strategy including a discussion on benchmarking, managers and the strategy's forward-looking outlook. Mr. Timmins called on Carlos Castro, director of global risk control strategies, to give a presentation on the risk parity strategy. The presentation provided a review of the strategy, a discussion on manager implementation processes, allocation policies, and performance of the strategy since inception.

11. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer

(Board agenda page III-19)

Mr. Timmins provided an update on the Charter District Reserve Fund. He reported that at this time no legislation has been filed related to the PSF. Mr. Timmins also noted that the agency received an attorney general opinion on whether and to what extent the Permanent School Fund should be classified as nonspendable in annual financial reporting.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 12:21 p.m.

**TEXAS PERMANENT SCHOOL FUND
SUMMARY OF TRANSACTIONS FOR APPROVAL
(Including External Manager's Trades)
For October 1, 2018 through November 30, 2018**

Purchases/Capital Calls:

Long Term Fixed Income	\$ 166,283,338
Public Market Equities	236,139,190
Alternative Investments	<u>467,376,794</u>
 TOTAL	 <u><u>\$ 869,799,322</u></u>

Sales/Distributions:

Long Term Fixed Income	\$ 110,259,439
Public Market Equities	459,492,395
Alternative Investments	<u>305,097,904</u>
 TOTAL	 <u><u>\$ 874,849,738</u></u>

General Land Office Contributions:

FY 2018 Cumulative November 2017	FY 2019 Cumulative November 2018
\$58,750,000	\$63,750,000

Based on the above information provided by staff including a report that deposits to the Permanent School Fund from the General Land Office were \$63,750,000 through November 2018 for fiscal year 2019 versus \$58,750,000 through November 2017 for fiscal year 2018, and the recommendation of the Executive Administrator and Chief Investment Officer and the Commissioner of Education; it is moved by unanimous consent that the Committee on School Finance/Permanent School Fund ratify for the months of October and November 2018, Permanent School Fund portfolio purchases of \$869,799,322 and sales of \$874,849,738.