

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 30, 2014**

The State Board of Education Committee on School Finance/Permanent School Fund met at 10:45 a.m. on Thursday, January 30, 2014, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. All members of the committee were present, as follows:

Presiding: Pat Hardy, chair; Lawrence A. Allen, Jr., vice chair; David Bradley; Ken Mercer; Thomas Ratliff

Public Testimony

This item provides an opportunity for the public to present testimony at the time the related item comes up for committee discussion or action. The procedures for registering and taking public testimony at State Board of Education committee meetings and general board meetings are provided at <http://www.tea.state.tx.us/index4.aspx?id=25769804094> or in the information section (yellow pages) of the agenda.

The Committee on School Finance/Permanent School Fund heard public testimony on agenda item #1. Information regarding the individuals who presented public testimony is included in the discussion of that item.

ACTION ITEMS

- 1. Proposed New 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.67, Bond Guarantee Program for Charter Schools**
(Second Reading and Final Adoption)
(Board agenda page III-1)
[Official agenda item #11]

The following individuals provided public testimony:

NAME: Janet Vaughan Robertson
AFFILIATION: Haynes and Boone LLP

NAME: Tracy Young
AFFILIATION: Texas Charter Schools Association (TCSA)

Lisa Dawn-Fisher, chief school finance officer and associate commissioner for school finance, presented this item. The proposed new rule would implement provisions of the Texas Education Code (TEC), Chapter 12, Subchapter D, and Chapter 45, Subchapter C, that were added by Senate Bill 1, Article 59, 82nd Texas Legislature, First Called Session, 2011, and amended by

House Bill 885, 83rd Texas Legislature, Regular Session, 2013. These provisions expand the Permanent School Fund (PSF) Bond Guarantee Program to allow for the guarantee of bonds issued for the benefit of open-enrollment charter schools.

Dr. Dawn-Fisher presented the committee with a summary of the public comments that had been received since the rule was published in the *Texas Register* and proposed substitute rule text that included amendments based on those comments. Dr. Dawn-Fisher reviewed with the committee each change shown in the substitute rule text.

Several committee members asked whether the revised definition of "educational facility" in subsection (b)(11) of the substitute rule text would include athletic facilities. Ms. Robertson was invited to speak to the question. Ms. Robertson asked Dr. Dawn-Fisher if the definition largely matched a similar definition in the TEC, Chapter 53, which provides for the issuance of bonds for the benefit of certain charter schools. Dr. Dawn-Fisher confirmed that it did. Ms. Robertson said that, given that, some charter schools likely had already used proceeds from Chapter 53 revenue bonds for athletic facilities. Dr. Dawn-Fisher stated that bond proceeds could be used for athletic facilities under the Bond Guarantee Program for school districts. She also stated that athletic facilities were not ineligible facilities under the state Instructional Facilities Allotment program, which provides state assistance to school districts for debt service payments related to instructional facilities.

While the committee was reviewing proposed revisions to subsection (e)(2), Ms. Young was invited to speak about an amendment to that section that the TCSA had proposed in its public comments. Ms. Young stated that the TCSA recommended striking proposed subsection (e)(2)(A)(iv), which requires that a charter holder not be considered a high-risk grantee by the agency in order to be eligible for charter district status and have its application for the guarantee considered. She stated that the TCSA recommended that a charter holder's status as a high-risk grantee instead be made one of the factors considered in the commissioner's decision of whether to grant approval for the guarantee, which are listed under proposed subsection (f)(3)(A). Ms. Young stated that the current placement of the high-risk-grantee provision in subsection (e)(2) barred a high-risk grantee from even being considered for the guarantee. She stated that moving the provision to appear under (f)(3)(A) would allow the commissioner to review a high-risk grantee's circumstances and decide whether the high-risk-grantee status was relevant to approval for the guarantee. Ms. Hardy asked Ms. Young for an example of a circumstance in which a high-risk grantee should not be barred from the program. Ms. Young explained that when the TCSA first recommended this change to the rule, the TCSA did not know how many charter schools were considered high-risk grantees. She stated that the TCSA had since found out through public information requests that the number of charter schools considered high-risk grantees was relatively small. Dr. Dawn-Fisher stated that until this fall, the agency's practice had been to consider all new charter schools to be high-risk grantees but that that was no longer the agency's practice. Mr. Bradley asked if having the benefit of the guarantee might act as a cure to the circumstances that had caused a charter school to be considered a high-risk grantee. David Anderson, general counsel, explained that the term "high-risk grantee" referred to an entity's being considered at high risk for mismanaging funds received through a grant, not to being at high risk for insolvency. Several committee members asked whether it was accurate that the current placement of the high-risk-grantee provision would bar a high-risk grantee from even being considered for the guarantee. Dr. Dawn-Fisher said that it would. Several committee members said that they agreed that the provision should be moved as the TCSA had recommended.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Ratliff, and carried unanimously to amend the substitute rule text by striking proposed subsection (e)(2)(A)(iv) and inserting a provision related to evaluation of high-risk-grantee status under proposed subsection (f)(3)(A), as shown in Attachment A.*

Dr. Dawn-Fisher and Ms. Robertson responded to questions regarding revisions to the following proposed subsections: subsection (e)(3)(A), related to how program capacity is allocated when capacity is insufficient to cover the total value of all applicants' bonds; subsection (f)(3)(B), related to a charter district's debt service coverage ratio; and subsection (f)(5), related to responsibilities of the charter district on receipt of approval.

Ms. Young was invited to speak about an amendment to subsection (q) that the TCSA had proposed in its public comments. She explained that the amendment would change the proposed subsection to specify that failure to comply with applicable statutory or rule requirements *may* constitute a material violation of a charter holder's charter and that knowingly or intentionally misrepresenting information in an application for charter district status and the guarantee does constitute a material violation of the charter. Ms. Young explained that the existing language was a concern because it was unclear whether a minor or accidental error could constitute a material violation. Committee members asked Mr. Anderson's opinion on the proposed amendment. Mr. Anderson stated that he thought the subsection should remain as is, as making the change would affect any litigation under the subsection. He stated that proving intention could be difficult. Mr. Anderson stated that perhaps the TCSA's concern could be addressed by revising the subsection to refer to "any material misrepresentations" instead of "any misrepresentations."

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Allen, and carried unanimously to amend subsection (q) of the substitute rule text by inserting the word "material" before the word "misrepresentations," as shown in Attachment A.*

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Ratliff, and carried unanimously to recommend that the SBOE, by an affirmative vote of two-thirds of the members of the board, approve for second reading and final adoption the substitute rule text for proposed new 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.67, Bond Guarantee Program for Charter Schools, as amended, as shown in Attachment A.*

2. **Proposed Amendments 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract**
(First Reading and Filing Authorization)
(Board agenda page III-23)
[Official agenda item #12]

David Marx, director of financial compliance, presented this item. Mr. Marx explained that the proposed amendments would reduce paperwork and streamline the process by which a school district selects a depository bank.

Mr. Marx also presented substitute documents for page 2 of Figure: 19 TAC §109.51(d), the uniform proposal form, and page 1 of Figure: 19 TAC §109.52(b), the uniform depository contract form. Mr. Marx explained that the substitute forms were slightly revised from the forms that were published in the agenda.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Allen, and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization the proposed amendments to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract, §109.51, Uniform Depository Bank Bid or Proposal Form, and §109.52, Uniform Depository Bank Contract and Surety Bond Forms, with the following revisions: replacement of the word "proposal" with the word "bid" in Option A on page 2 of Figure: 19 TAC §109.51(d) and replacement of the last sentence on page 1 of Figure: 19 TAC §109.52(b) with the following: "The District and the Depository execute this contract and each retain a copy, both of which are considered to be originals, and file the contract with the TEA electronically as specified in Article IV, item C, above." (Mr. Bradley was absent for the vote.) (See Attachments B and C.)*

CONSENT ITEM

3. Review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds

(Adoption of Review)

(Board agenda page III-69)

[Consent agenda item #(1)]

The Texas Government Code, §2001.039, establishes a four-year rule review cycle for all state agency rules, including SBOE rules. As part of the four-year rule review process, Amanda Brownson, director of state funding, presented this item, a review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds, for adoption. The review is intended to ensure that the need for the rules still exists and to determine whether any amendments are necessary. Ms. Brownson stated that no public comments on the review had been received and that her division recommended no amendments to the subchapters.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Allen, and carried unanimously to recommend that the SBOE adopt the review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds. (Mr. Bradley was absent for the vote.)*

DISCUSSION ITEM

4. Review of Permanent School Fund Securities Transactions and the Investment Portfolio

(Board agenda page III-79)

Catherine Civileto, deputy executive administrator, provided a summary of the status of the Permanent School Fund portfolio. Reports presented to the committee were for the reporting period October 1, 2013 through November 30, 2013 unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of November 30, 2013, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2013 through November 30, 2013, the status of transfers from the General Land Office as per the resolution they agreed to for the current fiscal year, current status of the Bond Guarantee Program and the available capacity in the program, proxy votes against

management, details of purchases and sales on all portfolios, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2013 through November 30, 2013, 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 2013

(Board agenda page III-77)

[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 recommended by unanimous consent to ratify the purchases and sales for the months of October and November 2013 in the amount of \$606,514,190 and \$1,086,675,145 respectively (Attachment D).*

DISCUSSION ITEMS

6. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio

(Board agenda page III-81)

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

The meeting recessed at 11:50 a.m. and reconvened at 1:05 p.m.

7. Presentation by BlackRock Investment Management, LLC on Investment Management Services Provided to the Permanent School Fund

(Board agenda page III-83)

Mr. Timmins introduced Obie McKenzie, managing director, and Sara Shores, head of Americas Index Strategy, both of BlackRock. Mr. McKenzie gave a brief business update and reported on indexing trends at BlackRock. Ms. Shores provided a review of and reported on the performance of the international equities portfolio managed by BlackRock.

8. Presentation by Private Equity Managers on Investment Management Services Provided to the Permanent School Fund
(Board agenda page III-85)

The following two firms gave presentations by their respective representatives:

Customized Fund Investment Group (CFIG)

Kelly Williams, President of GCM CFIG

Bernard Yancovich, Managing Director

Neuberger Berman

John Buser, Managing Director

Doug Manor, Vice President

Nan Wang, Associate

9. Discussion of the Implementation of the Emerging Market Equities Allocation of the Permanent School Fund
(Board agenda page III-87)

Karim Hirani, director of equities, and Keith Stronkowsky, NEPC's senior consultant, gave presentations on the proposed emerging market equity procurement and implementation. Mr. Hirani's presentation included emerging market long term performance and various options to implement emerging market equities. Mr. Stronkowsky covered emerging market equity characteristics and active fund manager performance.

Mr. Stronkowsky recommended that TPSF issue a broad RFP to include a variety of active and passive strategies and stated that NEPC is willing to work with staff to help develop the RFP document.

10. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-89)

Mr. Timmins reported that the PSF total return for fiscal year 2013 was 10.16%. As a result of this return, the PSF had the highest return of any major state of Texas investment fund. It was the second year in a row that the PSF was the top performing major State investment fund. He stated that the Fund reached a new record high of \$29 billion at the end of 2013. For the calendar year ending December 31, 2013, the PSF return was 14.88%. Over the last three years, the Fund's return was 9.29%.

Mr. Timmins reported that Mohamed El-Erian, the CEO and Co-CIO for PIMCO, one of the Fund's commodities managers, had announced his resignation. As a result of the resignation, PIMCO is reorganizing senior management. He indicated that both staff and NEPC are closely monitoring the changes.

Mr. Timmins provided a chart showing absolute return performance since the strategic relationships were funded. The strategic relationships have been highly productive and have provided strong returns.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:45 p.m.