

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 7, 2016**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:01 a.m. on Thursday, April 7, 2016, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. The following members of the committee were present:

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

Absent: 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://tea.texas.gov/About_TEA/Leadership/State_Board_of_Education/SBOE_Meetings/SBOE_Operating_Rules_Amended_4-17-15/ or in the information section (yellow pages) of the agenda.

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

ACTION ITEMS

- 1. Adoption of Review of 19 TAC Chapter 129, Student Attendance, Subchapter A, Student Attendance Allowed, and Subchapter B, Student Attendance Accounting**
(Adoption of Review)
(Board agenda page III-1)
[Official agenda item #15]

Lisa Dawn-Fisher, associate commissioner of school finance and chief school finance officer, presented this item. Dr. Dawn-Fisher explained that this rule did not receive any applicable comments while open for public comment and that reasons for adoption continue to exist.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Bradley, and carried unanimously to recommend the State Board of Education adopt the review of 19 TAC Chapter 129, Student Attendance, Subchapter A, Student Attendance Allowed, and Subchapter B, Student Attendance Accounting, and the placement of this item on the consent agenda for the State Board of Education meeting of April 8, 2016.*

2. **Proposed Amendment to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes**

(First Reading and Filing Authorization)

(Board agenda page III-9)

[Official agenda item #16]

Dr. Dawn-Fisher presented this item. Dr. Dawn-Fisher explained that the proposed amendment would allow paraprofessionals to take attendance for funding purposes when accompanying students to off-campus activities.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Mercer, and carried unanimously to suspend the board operating procedures in accordance with §5.2(a) to allow consideration at first reading and filing authorization.*

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization the proposed amendment to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes.*

DISCUSSION ITEM

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

(Board agenda page III-57)

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 December 1, 2015 through February 29, 2016, unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of February 29, 2016, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2015 through February 29, 2016, the activity on the securities lending program for the fiscal period September 1, 2015 through February 29, 2016, 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, internal fixed income credit rating changes, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2016 through February 29, 2016, and short-term cash investments.

CONSENT ITEM

4. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of December 2015, January and February 2016

(Board agenda page III-15)
[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 December 2015, January and February 2016 in the amount of \$1,178,405,824 and \$1,245,473,723 respectively (Attachment A).*

DISCUSSION ITEM

5. Report by the State Auditor's Office on the Audit of the Permanent School Fund's Financial Statements and Certification of the Bond Guarantee Program for Fiscal Year Ending August 31, 2015

(Board agenda page III-59)

Ms. Hardy introduced from the State Auditor's Office (SAO) Angelica Ramirez, audit manager, and Hillary Eckford, project manager, for presentation of the annual audit of the Permanent School Fund for the year ending August 31, 2015, and for presentation of results of the Certification of the Permanent School Fund's Bond Guarantee Program for fiscal year 2015.

Ms. Eckford stated that the SAO issued an unqualified opinion on the financial statements audited for the period. She also stated that the SAO also conducted a review of internal controls and identified no reportable internal control weakness at the Texas Education Agency.

Ms. Eckford then presented the results of the Certification of the Permanent School Fund's Bond Guarantee Program for the fiscal period. She stated that the amount of bonds guaranteed during FY2015 was within all regulatory limits established by the Texas Education Code (Section 45.053(a) and (d), and 45.0531(a) and (a-1)), the Internal Revenue Service (Notice 2010-5 dated December 16, 2009), and the State Board of Education, and that the Fund had sufficient reserves to meet the State Board of Education's reserve requirements for the same period.

CONSENT ITEM

6. Adoption of an Annual Report on the Status of the Bond Guarantee Program

(Board agenda page III-17)
[Consent agenda item #(3)]

Holland Timmins, executive administrator and chief investment officer, presented the annual report of the Bond Guarantee Program as required by the Texas Education Code and requested that the committee adopt the report as presented.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education adoption of the annual report on the status of the Bond Guarantee Program as of August 31, 2015.*

DISCUSSION ITEM

7. Fourth Quarter 2015 Permanent School Fund Performance Report

(Board agenda page III-61)

Tom Heiner and Scott Barad of BNY Mellon Global and Risk Solutions, presented the fourth quarter of 2015 Permanent School Fund performance report. 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 fourth quarter of 2015. He stated that the PSF returned 1.93% for the fourth quarter underperforming the target benchmark by 49 basis points.

Mr. Heiner reviewed fourth quarter 2015 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite outperformed its benchmark by four basis points for the quarter. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by three basis points. He added that international equities returned 3.27% for the quarter, having outperformed its benchmark by three basis points during the period. The fixed income portfolio returned -1.21% for quarter, falling behind its benchmark by 64 basis points. Mr. Barad stated that the Absolute Return composite returned -0.06% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 77 basis points. Mr. Barad added that the Real Estate composite returned 3.35% for the quarter, outperforming its benchmark by 100 basis points. Mr. Barad added that Total Risk Parity Strategies returned -1.90% in the fourth quarter of 2015, underperforming its benchmark by 591 basis points. He further stated that the Real Return Asset class returned -4.88% for the quarter, coming in above its benchmark by 75 basis points. He added that Emerging Market Debt returned -0.39% for the quarter, falling short its benchmark by 38 basis points. Mr. Barad stated that private equity returned 2.09% for the quarter, coming above its benchmark by 227 basis points. Finally, he stated that the total emerging market equity composite returned -1.84% for the fourth quarter 2015, falling short of its benchmark by 250 basis points.

CONSENT ITEMS

8. Decision on Real Estate Investments

(Board agenda page III-19)

[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal/Chief Operating Officer, and Tom Hester, Senior Vice President. They were joined by John Grubenman, director of private markets. Mr. Grubenman informed the committee that staff had two items to present.

Mr. Grubenman provided an introduction to a real estate investment recommendation, PAG Enhanced Credit Fund, L.P., offered by PAG Enhanced Credit Management Limited, as General Partner. Messrs. Novick and Hester 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 to the State Board of Education approval to execute agreement(s) with PAG Enhanced Credit Management Limited, necessary to make an investment commitment of up to \$70 million in PAG Enhanced Credit Fund L.P., a U.S. dollar denominated fund, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education, and to approve a waiver of the PSF Real Estate Investment Policy Statement requirement for the investment manager to be a registered investment advisor with the Securities Exchange Commission.*

Mr. Grubenman then provided an introduction to a second real estate investment recommendation, Kildare European Partners II, L.P. offered by Kildare GenPar II, L.P. as General Partner. Messrs. Novick and Hester 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 to the State Board of Education approval to execute agreement(s) with Kildare GenPar II, L.P., necessary to make an investment commitment of up to \$75 million in Kildare European Partners II, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

9. Overview of the Private Equity Asset Class

(Board agenda page III-21)
[Consent agenda item #(5)]

Mr. Grubenman and Brien Smith, Managing Director at Neuberger Berman, presented the Private Equity Investment Policy and Guidelines, including objectives and investment guidelines for the program.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval of the Private Equity Investment Policy and Guidelines.*

10. Authorization to Issue a Request for Proposals for Global Custody and Securities Lending Services for the Texas Permanent School Fund

(Board agenda page III-23)
[Consent agenda item #(6)]

Mr. Timmins presented the Request for Proposal for Global Custody and Securities Lending Services (RFP) document and responded to questions regarding the RFP. Mr. Timmins reviewed the timeline in the RFP. Selection is on the calendar for January, 2017.

MOTION AND VOTE: *By unanimous consent, the committee moved to recommend to the State Board of Education approval to issue a Request for Proposal for Global Custody and Securities Lending Services for the Permanent School Fund.*

ACTION ITEM

11. Proposed Amendments to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules

(First Reading and Filing Authorization)

(Board agenda page III-25)

[Official agenda item #17]

Ms. Hardy called on Mr. Timmins to address the item. Mr. Timmins stated that PSF staff went through a lengthy process and worked with several individuals to update certain portions of the Statement of Investment Objectives, Policies, and Guidelines of the PSF to better reflect the Fund's asset allocation and to consolidate provisions to eliminate repetition, among other items.

Chuck Campbell, partner with Jackson & Walker and fiduciary counsel, stated that the proposed amendments to ethics policies are for clarifying purposes. Carlos Veintemillas, deputy chief investment officer/director of fixed income stated the changes to the investment policies are designed to remove repetitive provisions and reorganize items for clarity.

MOTION AND VOTE: *By unanimous consent, the committee approved for first reading and filing authorization proposed amendments to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules, and the placement of this item on the consent agenda for the State Board of Education meeting of April 8, 2016.*

DISCUSSION ITEM

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

(Board agenda page III-63)

Mr. Timmins did not have an update for the committee.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 10:55 a.m.