

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 16, 2015**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9 a.m. on Thursday, April 16, 2015, 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://tea.texas.gov/About_TEA/Leadership/State_Board_of_Education/SBOE_Meetings/SBOE_Operating_Rules_Amended_2-11-15/ or in the information section (yellow pages) of the agenda.

The Committee on School Finance/Permanent School Fund heard public testimony on agenda item #3. Information regarding the individuals who presented public testimony is included in the discussion of that item.

DISCUSSION ITEMS

1. Attorney General Opinion on the Calculation of the PSF Bond Guarantee Limit for the Charter School Bond Guarantee Program

(Board agenda page III-7)

Von Byer, general counsel, presented this discussion item. Mr. Byer responded to questions that bond guarantee limit for the charter school Bond Guarantee Program (BGP) would be cumulative, rather than monthly.

2. Discussion of 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules, §33.65, Bond Guarantee Program for School Districts

(Board agenda page III-13)

Lisa Dawn-Fisher, associate commissioner for school finance and chief school finance officer, presented this discussion item. Dr. Dawn-Fisher explained that this discussion item relates to firms allowed to provide investment grade ratings for the BGP for school districts. Holland Timmins, executive administrator and chief investment officer of the Texas Permanent School Fund, spoke on a request for qualifications (RFQ) in progress to find qualified ratings firms to provide investment grade ratings.

Mr. Bradley requested that the discussion item be brought to the July State Board of Education Committee on School Finance/Permanent School Fund meeting for first reading with additional language and information from the RFQ on qualified rating firms.

3. Discussion of 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, Subchapter A, State Board of Education Rules, §33.67, Bond Guarantee Program for Charter Schools

(Board agenda page III-27)

The following individuals provided public testimony:

NAME: Tom Sage
AFFILIATION: Andrews Kurth LLP

NAME: Brent Wilson
AFFILIATION: Life School

NAME: Lindsay Gordon
AFFILIATION: Texas Charter School Association

NAME: Yalcin Akyildiz
AFFILIATION: Harmony Public Schools

NAME: James Montfort
AFFILIATION: A. W. Brown Fellowship Charter School

Dr. Dawn-Fisher presented this discussion item. She explained that this discussion item relates to firms allowed to provide investment grade ratings for the BGP for school districts. Dr. Dawn-Fisher responded to questions on financial accountability for charter schools and its implication on the issuance of bond guarantees, and the current capacity available for bond guarantees. Dr. Dawn-Fisher and Mr. Byer also responded to questions on the property of closed charter schools.

Mr. Ratliff and Mr. Allen requested language to amend the criteria related to the prioritization of bond guarantee awards.

Mr. Bradley requested that the discussion item be brought to the July State Board of Education Committee on School Finance/Permanent School Fund meeting for first reading with additional language and information from the RFQ on qualified rating firms.

4. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-41)

Catherine Civiletto, 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 January 1 through February 28, 2015 unless otherwise noted. Ms. Civiletto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of February 28, 2015, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period beginning September 1 through February 28, 2015 the activity on the securities lending

program for the fiscal period September 1, 2014 through February 28, 2015, 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, 2015 through February 28, 2015, 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 January and February 2015

(Board agenda page III-1)

[Consent agenda item #(3)]

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 January and February, 2015 in the amount of \$743,108,137 and \$670,433,524, respectively (Attachment A).*

DISCUSSION ITEM

6. Report by the State Auditor's Office on the Certification of the Bond Guarantee Program for Fiscal Year Ending August 31, 2014

(Board agenda page III-43)

Ms. Civileto introduced Brianna Lehman, audit manager, and Greg Adams, project manager, with the State Auditor's Office, to present the results of the Certification of the Permanent School Fund's Bond Guarantee Program for Fiscal Year 2014. Mr. Adams stated that the amount of bonds guaranteed during FY2014 was within all regulatory limits established by the Texas Education Code (Section 45.053(a) and (d)), 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. Mr. Adams also stated the approval process complied with all applicable laws and policies.

CONSENT ITEM

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

(Board agenda page III-3)

[Consent agenda item #(4)]

Mr. Timmins 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, 2014.*

DISCUSSION ITEM

8. Fourth Quarter 2014 Permanent School Fund Performance Report

(Board agenda page III-45)

Tom Heiner, vice president and senior investment analytics consultant, and Scott Barad, regional manager and investment analytics consultant, both with BNY Mellon Performance & Risk Analytics, presented the fourth quarter of 2014 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 2014. He stated that the PSF returned 0.81% for the fourth quarter underperforming the target benchmark by 22 basis points. The Fund ranked in the 80th percentile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending December 31, 2014.

Mr. Heiner reviewed fourth quarter 2014 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite outperformed its benchmark by six basis points for the quarter. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by two basis points. He added that international equities returned -3.79% for the quarter, outperforming its benchmark by eight basis points. The fixed income portfolio returned 1.66% for quarter, falling short of its benchmark by 13 basis points. Mr. Barad stated that the Absolute Return composite returned 0.83% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 12 basis points. Mr. Barad added that the Real Estate composite returned 3.00% for the quarter, outperforming its benchmark by 58 basis points. Mr. Barad added that Total Risk Parity Strategies returned -0.84% in the fourth quarter of 2014, falling short of its benchmark by 450 basis points. He further stated that the Real Return Asset class returned -5.84% for the quarter, coming in above its benchmark by 33 basis points. He added that Emerging Market Debt returned -6.24% for the quarter, underperforming its benchmark by 53 basis points. Finally, Mr. Barad stated that private equity returned 4.32% for the quarter ending December 31, 2014.

CONSENT ITEM

9. Decision on Real Estate Investments

(Board agenda page III-5)

[Consent agenda item #(5)]

The PSF real estate consultant, Courtland Partners, was represented by Michael Humphrey, Managing Principal, Steve Novick, Principal/Chief Operating Officer and Jarrod Rapalje, Senior Analyst, and joined by Mr. Grubenman, director of private markets for PSF. Mr. Novick provided an introduction to a real estate investment recommendation.

Mr. Rapalje presented a recommendation of the Rockpoint Real Estate Fund V offered by Rockpoint Group, as General Partner. Mr. Rapalje 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 authorize the commissioner of education to execute agreement(s) with Rockpoint Group, necessary to make an investment commitment of up to \$50 million in Rockpoint Real Estate Fund V, a U.S. dollar denominated fund, subject to continued due diligence and negotiation of fund terms.*

DISCUSSION ITEMS

10. Presentations on Investment Management Services Provided to the Permanent School Fund (Board agenda page III-47)

Representatives from Blackstone Alternatives Asset Management, Grosvenor Capital Management and Mesriow Advanced Strategies made presentations to the committee in which they discussed recent market conditions and provided the committee with updates on strategy and performance for the portfolios they manage for the benefit of the PSF and on the Strategic Partnership Structures managed jointly with PSF staff.

Blackstone Alternative Asset Management

Stephen Sullens, Head of Portfolio Management, Senior Managing Director
Emily Reycroft, Managing Director, Investor Relations
Brett Chalanick, Associate, IRBD

Grosvenor Capital Management

Stephen Brewster, Managing Director, Business Development
Brad Meyers, Managing Director, Head of Portfolio Management
Andy Preda, Vice President, Portfolio Management

Mesriow Advanced Strategies

Linda Jordan, Managing Director
Erik Barefield, Senior Managing Director
Tom Macina, CEO Mesriow Advanced Strategies

11. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer (Board agenda page III-49)

Mr. Timmins provided an update on the Request for Proposal (RFP) for PSF Investment Counsel. The RFP was issued and closed, with three (3) firms submitting proposals. The proposals are currently being evaluated and staff will bring recommendations to the committee in July.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:24 p.m.