

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
November 19, 2013**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:02 a.m. on Tuesday, November 19, 2013, 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 #2. Information regarding the individuals who presented public testimony is included in the discussion of that item.

ACTION ITEMS

1. **Proposed Amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.65, Bond Guarantee Program**
(Second Reading and Final Adoption)
(Board agenda page III-1)
[Official agenda item #11]

Lisa Dawn-Fisher, chief school finance officer and associate commissioner for school finance, presented this item. The proposed amendment would update the rule to refer to the recently implemented online application for the guarantee, lower the program's application fee, and add language explaining how the commissioner determines and applies the limitation on approval for the guarantee related to districts' annual debt service per student in average daily attendance. The proposed amendment would also modify the rule's financial exigency provisions to align with those in 19 TAC §109.2001, Financial Exigency, and reorganize the rule for clarity.

Dr. Dawn-Fisher presented the committee with a summary of public comments received about the proposed rule amendment, and she presented proposed substitute rule text with amendments based on those comments. Dr. Dawn-Fisher also told the committee that an additional public comment had been received since the summary was prepared. She explained that the comment recommended revising proposed subsection (f)(2) to allow the commissioner to announce the results of the monthly prioritization of applications before the 15th of the month. Committee members did not object to this recommended revision.

Mr. Ratliff proposed that subsection (d)(4) be revised to require, rather than allow, the commissioner to revoke approval for the guarantee if the commissioner determined that an applicant deliberately misrepresented information to secure the guarantee. No committee members objected to this revision.

Mr. Ratliff and Mr. Bradley proposed that subsection (g)(4)(A) be revised to permit the commissioner to extend the specified 180-day period on the request of the attorney general or the school district. Ms. Hardy directed staff to draft revised language for subsection (g)(4)(A) for the board's consideration at Friday's meeting.

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education, by an affirmative vote of two-thirds of the members of the board, approve the substitute text presented to the committee for proposed amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.65, Bond Guarantee Program, as amended as shown in Attachment A, for second reading and final adoption.*

2. 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

(First Reading and Filing Authorization)

(Board agenda page III-19)

[Official agenda item #12]

The following individuals provided public testimony as a single group:

NAME: David Dunn, Executive Director, Texas Charter Schools Association (TCSA)
AFFILIATION: TCSA

NAME: Teresa Elliott, Chief Operations Officer, Wayside Schools
AFFILIATION: TCSA

NAME: Mike Feinberg, Cofounder, KIPP Inc.
AFFILIATION: KIPP Inc.

NAME: Robert McBurnett, Chief Financial Officer, YES Prep Public Schools Inc.
AFFILIATION: YES Prep Public Schools Inc.

NAME: William J. Mays, Chief Financial Officer, Uplift Education
AFFILIATION: Uplift Education

NAME: Wyatt Truscheit, Chief Financial Officer, IDEA Public Schools
AFFILIATION: IDEA Public Schools

NAME: Drew Masterson, Managing Director, First Southwest
AFFILIATION: None

NAME: Tom Sage, Partner, Andrews Kurth LLP
AFFILIATION: TCSA

Dr. Dawn Fisher 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 guarantee of bonds issued for the benefit of open-enrollment charter schools.

Dr. Dawn-Fisher presented the committee with proposed substitute rule text, which included amendments that were proposed since the first reading version of the rule text was published in the November 2013 meeting agenda.

The committee asked Dr. Dawn-Fisher to first discuss the changes made to the rule text between when it was presented to the committee for discussion and when it was published in the November 2013 meeting agenda, as shown in the document labeled "Exhibit Showing Differences between Draft Rule Text Presented for Discussion and Rule Text Presented for First Reading." Dr. Dawn-Fisher discussed these changes with committee members.

Mr. Ratliff proposed that subsection (c)(4) be revised to require, rather than allow, the commissioner to revoke approval for the guarantee if the commissioner determined that an applicant deliberately misrepresented information to secure the guarantee. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (e) be revised to clarify that the commissioner's designation of a charter holder as a charter district would be only for purposes of this section. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (e)(2)(A)(i) be revised to specify that the charter holder not only have operated a charter school for three years but also have had students enrolled at the charter school for that time period. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (e)(2)(A)(iii) be revised to refer to all entities under common control of the charter holder and not only tax-exempt entities. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (e)(2)(A)(v) be revised to specify that the commissioner would determine whether steps taken by a charter holder to resolve a corrective action were appropriate. No committee members objected to this revision.

Mr. Bradley proposed striking subsection (e)(2)(A)(vii), which requires that a charter holder not have been required to submit a financial plan under financial solvency rules in the last three years in order to be designated a charter district. He proposed adding under subsection (f)(3)(A) a criterion related to commissioner review of whether a charter holder had been required to submit a plan under financial solvency rules in the last three years. No committee members objected to these revisions.

Mr. Ratliff proposed that subsection (e)(6) be revised to clarify whether a charter holder would be required to pay a fee for reapplication. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (f)(4)(D) be revised to clarify that email and facsimile were not the only means by which a charter district could provide the specified notification. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (f)(5)(A) be revised to permit the commissioner to extend the specified 180-day period on the request of the attorney general or the charter district. No committee members objected to this revision.

Mr. Ratliff proposed that subsection (l)(1) be revised to cite the specific statute or rule establishing the Charter District Bond Guarantee Reserve Fund. No committee members objected to this revision.

Mr. Ratliff proposed that the sentence in subsection (l)(6) specifying when interest accrual begins be made consistent with the statute the subsection references. No committee members objected to this revision.

Mr. Bradley and Ms. Hardy proposed that subsection (o) be revised to state that the commissioner may, rather than will, take action under the TEC, §45.062, if a charter district fails to make two or more bond payments. No committee members objected to this revision.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Ratliff, and carried unanimously to incorporate the discussed revisions to the document labeled "Exhibit Showing Differences between Draft Rule Text Presented for Discussion and Rule Text Presented for First Reading" into the rule text to be presented to the State Board of Education for approval for first reading and filing authorization (Attachment B).*

The committee recessed at 10:31 a.m. and reconvened at 10:41 a.m.

Ms. Hardy invited the individuals that were registered to testify to provide their testimony as a group. Mr. Dunn stated that the group's recommendations represented the consensus opinions of the charter school community and the financial professionals that serve that community. Several group members stated that the proposed rules would greatly reduce borrowing costs for charter schools and allow them to direct more money to the classroom. Mr. Masterson gave a brief presentation on Texas charter schools' borrowing costs and the savings the guarantee will provide.

Dr. Dawn-Fisher asked Mr. Sage to present the substitute rule text. She explained that the substitute rule text included amendments, in highlighted, boldfaced print, that were proposed since the first reading version of the rule text was published in the November 2013 meeting agenda. Dr. Dawn-Fisher also explained that the substitute rule text was developed with extensive input from the TCSA and charter school financial advisors.

Mr. Sage presented the substitute rule text, describing each highlighted provision showing a change from the rule text published in the agenda.

When Mr. Sage discussed (e)(2)(A)(vi), which refers to "unmodified" auditor opinions, he stated that the group now recommended referring to "unqualified or unmodified" opinions. He stated that

accounting standards now use the term "unmodified," but that the rule should use both terms as entities are still transitioning to using the new term. No committee members objected to this revision.

After Mr. Sage discussed the pro rata provisions in subsection (e)(3), David Anderson, general counsel, asked whether it was necessary to add a provision specifying a minimum allocation amount. The group and the committee discussed the subject, but no revised subsection text was proposed.

In discussing subsection (f)(5)(F), Mr. Sage stated that the group now recommended replacing the term "real property" with "educational facility," since "educational facility" is the term that the TEC, Chapter 53, uses. Dr. Dawn-Fisher stated that the agency agreed with that proposal and recommended adding a definition of the term "educational facility" to subsection (b). No committee members objected to these revisions.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Mercer, and carried unanimously to recommend that the State Board of Education approve the substitute text presented to the committee for proposed amendment to 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, amended as discussed, as shown in Attachment B, for first reading and filing authorization.*

Mr. Sage then presented the committee with four additional TCSA recommendations for amending the proposed rule text, shown in a document distributed to committee members.

Mr. Sage presented the first recommendation, an amendment to subsection (c)(2) that would allow a charter holder to receive the guarantee for refunding bonds that had a maturity date later than the maturity date of the bonds being refunded if the refunding bonds were not previously guaranteed by the Bond Guarantee Program.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Ratliff, and carried unanimously to incorporate the discussed amendment into the rule text to be presented to the State Board of Education for approval for first reading and filing authorization, as shown in Attachment B.*

Mr. Sage presented the second recommendation, an amendment to subsection (e)(2)(A)(iv), which is related to whether a charter holder is a high-risk grantee. The amendment would add to the subsection the phrase "according to standards published on the TEA website." After discussing the proposed amendment, committee members agreed that no change should be made and that the committee would reevaluate the subsection in January after reviewing public comments on the rule.

Mr. Sage stated that the TCSA withdrew what had been its third recommendation, as shown in the document distributed to committee members.

Mr. Sage then presented the fourth TCSA recommendation, an amendment to subsection (q) of the substitute rule text. That subsection provides that a charter holder's failure to comply with the TEC, Chapter 45, Subchapter C, or with 19 TAC §33.67 constitutes a material violation of the open-enrollment charter holder's charter. The amendment would remove the reference to complying with statute and would replace "constitutes" with "may constitute." After discussing the proposed

amendment, committee members agreed that no change should be made and that the committee would reevaluate the subsection in January after reviewing public comments on the rule.

Mr. Sage presented one additional TCSA recommendation that was not shown in the document distributed to committee members.

The recommendation was an amendment to change subsection (d)(2) to read, "Up to half of the total capacity of the PSF to guarantee bonds that were not previously guaranteed for charter districts may be used to guarantee charter district refunding bonds; provided that refundings of previously guaranteed bonds shall not count against such limitation." After discussing the proposed amendment, committee members agreed that no change should be made and that the committee would reevaluate the subsection in January after reviewing public comments on the rule.

Mr. Sage stated that the TCSA thought that improvements could be made to subsection (m) but that the group would introduce any proposed changes to that subsection through the public comments process.

DISCUSSION ITEMS

3. Discussion of Proposed Amendments to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract (Board agenda page III-55)

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

4. Review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds (Board agenda page III-101)

The Texas Government Code, §2001.039, establishes a four-year rule review cycle for all state agency rules, including State Board of Education (SBOE) rules. 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, as part of the four-year rule review process. 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 she did not anticipate any amendments to the rules as a result of the review.

CONSENT ITEM

5. Approval of Costs of Administering the 2013-2014 State of Texas Assessments of Academic Readiness (STAAR™) and the Exit-Level Texas Assessment of Knowledge and Skills (TAKS) to Private School Students

(Board agenda page III-39)

[Consent agenda item #(1)]

Gloria Zyskowski, director for student assessment, presented for approval the per-student assessment costs for the 2013-2014 school year as shown in the attachment on pages III-43 and III-44 of the SBOE agenda. The item is presented annually based on TEC, §39.033, which charges the SBOE with approving the costs for the administration of state-developed assessments to private school students. During the 2013 spring administration, 22 private schools participated in the state assessment program.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Allen, and carried unanimously to recommend approval of the per-student costs for administering the STAAR and TAKS tests to private school students in the 2013-2014 school year as reflected in the attachment on pages III-43 and III-44 of the SBOE agenda. (Mr. Ratliff was absent for the vote.)*

DISCUSSION ITEM

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

(Board agenda page III-109)

Catherine Civiletto, 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 August 1, 2013 through September 30, 2013 unless otherwise noted. Ms. Civiletto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of September 30, 2013, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2012 through September 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 September 30, 2013, and short-term cash investments.

CONSENT ITEMS

7. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of August and September 2013

(Board agenda page III-45)

[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 August and September 2013 in the amount of \$1,162,479,031 and \$1,111,582,786 respectively (Attachment C).*

8. Review of the Consent Form Related to the Sale of Credit Suisse Private Equity Customized Fund Investment Group (CFIG)

(Board agenda page III-47)

[Consent agenda item #(3)]

John Grubenman, director of private markets, presented an update on the sale of Credit Suisse's Customized Fund Investment Group to Grosvenor and reviewed the relevant terms of the transaction evaluated by PSF investment and legal staff. Mr. Grubenman indicated that staff requested that the committee recommend approval of the transfer.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval, subject to continued due diligence by Permanent School Fund staff of appropriate documentation, with respect to the Columbia CS Fund L.P., to consent to the change of control of the general partner and the investment manager from Credit Suisse controlled entities to Grosvenor controlled entities and the transfer of the financial obligation from Credit Suisse (USA) to Grosvenor Capital Management, L.P.*

DISCUSSION ITEM

9. Third Quarter 2013 Permanent School Fund Performance Report

(Board agenda page III-111)

Tom Heiner and Scott Berard with BNY Mellon Asset Servicing, presented the third quarter of 2013 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 third quarter 2013. He stated that the PSF returned 4.79% for the first quarter outperforming the target benchmark by six basis points. The Fund ranked in the 54th percentile or top of the third quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending September 30, 2013.

Mr. Heiner reviewed third quarter 2013 performance of the Permanent School Fund by asset class, stating that the total domestic equity composite returned 6.01% for the quarter, performing in line with its benchmark. He added that international equities returned 10.04% for the quarter, underperforming its benchmark by five basis points. The fixed income portfolio returned 0.53% for quarter, falling short of its benchmark by four basis points. Mr. Berard stated that the Absolute Return composite returned 2.16% for the quarter, outperforming its benchmark, the HFRI Fund of

Funds Composite Index, by 37 basis points. Mr. Berard added that the Real Estate composite returned 3.29% for the quarter, outperforming its benchmark by 28 basis points. Mr. Berard added that Total Risk Parity Strategies returned 2.93% in the third quarter of 2013, underperforming its benchmark by 46 basis points. He further stated that the Real Return Asset class returned 1.73% for the quarter underperforming its benchmark by 26 basis points. Finally Mr. Berard stated that private equity returned 5.52% for the quarter ending September 30, 2013.

CONSENT ITEMS

10. Decision on Real Estate Investments

(Board agenda page III-49)
[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, principal/chief operating officer and Dan Moore, senior consultant, joined by Mr. Grubenman. Mr. Grubenman provided an introduction to three real estate investment items.

Mr. Novick and Mr. Moore presented a recommendation for the Blackstone Real Estate Partners Europe IV, L.P. Mr. Novick and Mr. Moore described the due diligence process conducted by both Courtland and PSF staff. Mr. Moore provided a brief overview of how the fund fits into the current real estate program and that it is in compliance with the PSF real estate investment policy. Mr. Moore explained the objectives, constraints, terms, fees, benefits and concerns of the investment.

Mr. Novick and Mr. Moore also presented a recommendation of the European Property Investors Special Opportunities 3, L.P., offered by Tristan Capital Partners LLP, an English limited liability partnership. Mr. Novick and Mr. Moore described the due diligence process conducted by both Courtland and PSF staff. Mr. Moore provided a brief overview of how the fund fits into the current real estate program and that it is in compliance with the real estate investment policy. Mr. Moore explained the objectives, constraints, terms, fees, benefits and concerns of the investment. Mr. Grubenman stated that the board would need to approve a waiver of the requirement for service providers to be registered with the Securities and Exchange Commission and also review and approve the manager's relationship with a placement agent.

Mr. Grubenman provided a report on the real estate co-investment program, including an update on the recent transaction activity. He reported that the transaction is in compliance with standards set forth in the real estate investment policy and explained that a report from staff is required following the close of each real estate co-investment.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreements with Blackstone Real Estate Advisors L.P. necessary to make an investment commitment of up to \$75 million in Blackstone Real Estate Partners Europe IV, L.P. subject to continued due diligence and negotiation of fund terms.*

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with Tristan Capital Partners LLP, necessary to make an investment commitment of up to €60 million in European Property Investors Special Opportunities 3, L.P., a euro denominated fund, subject to continued due diligence and negotiation of fund terms, to approve the relationship between Tristan and LAZARD FRÈRES & CO., LLC & Co., LLC, after determining it meets the standards of 19 TAC Chapter 33, Section(j)(5), which has been disclosed in writing, and also, to approve a waiver of the PSF Real Estate Investment Policy Statement requirement for the investment manager (Tristan) to be a registered investment advisor with the Securities Exchange Commission.*

The committee recessed at 12:50 p.m. and reconvened at 2:06 p.m.

11. Presentation on the Commodities Discretionary Investment Management Services Provided to the Permanent School Fund

(Board agenda page III-51)

[Consent agenda item #5]

The following two firms gave presentations by their respective representatives:

Credit Suisse Asset Management, LLC

Nelson Louie, Global Head of CSAM Commodities

Charlie Shaffer, Head of CSAM AI Distribution

PIMCO

Mihir P. Worah, Managing Director, Head Real Return Portfolio Management

Brent Holden, Managing Director, Head Institutional Client Facing

Richard Fulford, Executive Vice President, Head Institutional Public Channel

Representatives from Credit Suisse and PIMCO discussed recent market conditions and provided the committee with updates on the portfolio strategy and performance.

No action was taken on this item.

12. Presentation on the Global Risk Control Strategies Management Services Provided to the Permanent School Fund

(Board agenda page III-53)

[Consent agenda item #(6)]

Mr. Timmins informed the committee that AQR is being placed on the watch list according to policy since they have lagged the benchmark for three consecutive quarters.

The following three firms gave presentations by their respective representatives:

AQR Capital Management, LLC

Joey Lee, Vice President

Michael Mendelson, Partner, Risk Parity Portfolio Manager

Bridgewater Associates, LP

Alan Bowser, Senior Client Adviser

Paul Podolsky, Senior Portfolio Strategist

The committee recessed at 4:26 p.m. and reconvened at 4:35 p.m.

Mesirow Advanced Strategies, Inc.

Marty Kaplan, Senior Managing Director, CEO of Mesirow Advanced Strategies
Linda Jordan, Managing Director, Mesirow Investment Management

Rhett Humphreys, partner and Alex Kamunya, senior research consultant with NEPC, gave a presentation on the current state and performance characteristics of the Hedge Fund Portfolio.

No action was taken on this item.

DISCUSSION ITEM

13. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-113)

Mr. Timmins had no report.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 5:18 p.m.