

**Report of the State Board of Education  
Committee on School Finance/Permanent School Fund  
November 20, 2014**

The State Board of Education Committee on School Finance/Permanent School Fund met at 10:05 a.m. on Thursday, November 20, 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://tea.texas.gov/index4.aspx?id=25769804094&menuid=25769804716> or in the information section (yellow pages) of the agenda.

The Committee on School Finance/Permanent School Fund heard public testimony on agenda items #3 and #4. 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 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes**  
(Second Reading and Final Adoption)  
(Board agenda page III-1)  
[Official agenda item #11]

Lisa Dawn-Fisher, associate commissioner for school finance and chief school finance officer, presented this 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, for second reading and final adoption. The proposed amendment would update statutory references in the rule text to reflect changes from the 83rd Texas Legislature, Regular Session, 2013. No comments were received, and no changes are recommended since approved for first reading.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education approve 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, for second reading and final adoption, with an effective date of 20 days after filing as adopted with the Texas Register.*

2. **Proposed Amendment 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, §33.65, Bond Guarantee Program for School Districts**

(Second Reading and Final Adoption)

(Board agenda page III-9)

[Official agenda item #12]

Dr. Dawn-Fisher presented this item, which would add a definition of *bond* to the rule to define more precisely the types of debt that are eligible for guarantee. The proposed amendment would also modify the rule to require that *each issuance* of bonds approved for the guarantee be approved by the attorney general. In addition, the proposed amendment would add a definition of *nationally recognized investment rating firm* to provide consistency with the charter school bond guarantee rules. Mr. Ratliff proposed to amend §33.65(b)(9) by adding the sentence “This paragraph expires September 1, 2015” to the end of the paragraph.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Mercer, and carried unanimously to amend the proposed amendment 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, §33.65, Bond Guarantee Program for School Districts, for second reading and final adoption with added wording as follows:*

- 9) Nationally recognized investment rating firm--An investment rating firm that is, or is part of, Standard & Poor's, Moody's, or Fitch and is designated by the United States Securities and Exchange Commission as a nationally recognized statistical rating organization. This paragraph expires September 1, 2015.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Mercer, and carried unanimously to recommend that the State Board of Education approve the proposed amendment 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, §33.65, Bond Guarantee Program for School Districts, as amended, for second reading and final adoption, with an effective date of 20 days after filing as adopted with the Texas Register.*

3. **Proposed Amendment 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, §33.67, Bond Guarantee Program for Charter Schools**

(Second Reading and Final Adoption)

(Board agenda page III-23)

[Official agenda item #13]

The following individuals provided public testimony:

NAME: Jim Butera  
AFFILIATION: Legal Counsel for HR Ratings

NAME: Denise Pierce  
AFFILIATION: Texas Charter Schools Association

NAME: Tom Sage  
AFFILIATION: Andrews & Kurth

Dr. Dawn-Fisher presented this item, which would add a definition of *bond* to the rule to define more precisely the types of debt that are eligible for guarantee. The proposed amendment would also add a definition of nationally *recognized investment rating firm*. In addition, the proposed amendment would modify the rule to require that *each issuance* of bonds approved for the guarantee be approved by the attorney general. Finally, the proposed amendment would clarify language regarding the treatment of charter schools that apply for the guarantee within 12 months of the date that their charter is due to expire.

The public testimony provided by Mr. Butera urged the committee to include other firms in addition to the three named in the rule definition for *nationally recognized investment rating firm* to increase competition. He urged the committee to consider firms based on the firms' record on quality of ratings. The public testimony of Mr. Sage also addressed the need to increase competition for rating firms. Mr. Sage also noted that the bond guarantee program saved a charter school \$10.8 million in a recent bond issue.

Mr. Butera responded to questions from the committee about which ratings firms are currently providing ratings for charter schools.

Mr. Ratliff proposed to amend §33.67(b)(16) by adding the sentence "This paragraph expires September 1, 2015" to the end of the paragraph.

Mr. Bradley directed the staff to work with stakeholders to develop criteria that could be used to develop an RFQ system. The RFQ system would identify rating firms that school districts and charter schools could use to apply for the bond guarantee program.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to amend the proposed amendment 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, §33.67, Bond Guarantee Program for Charter Schools, for second reading and final adoption with added wording as follows:*

- (16) Nationally recognized investment rating firm--An investment rating firm that is, or is part of, Standard & Poor's, Moody's, or Fitch and is designated by the United States Securities and Exchange Commission as a nationally recognized statistical rating organization. This paragraph expires September 1, 2015.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Mercer, and carried unanimously to recommend that the State Board of Education approve the proposed amendment 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, §33.67, Bond Guarantee Program for Charter Schools, as amended, for second reading and final adoption, with an effective date of 20 days after filing as adopted with the Texas Register.*

4. **Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures**

(First Reading and Filing Authorization)

(Board agenda page III-39)

[Official agenda item #14]

The following individuals provided public testimony:

NAME: Robert Owen  
AFFILIATION: Texas Society of Certified Public Accountants

NAME: Angie Marsh  
AFFILIATION: Round Rock Independent School District

The proposed amendment was brought at the request of a State Board of Education (SBOE) member and would address provisions relating to a school district or other educational entity hiring an independent auditor, including the length of time the same auditor may be retained. The proposed amendment would also add and clarify other administrative provisions and make technical edits.

The discussion of the amendment began with public testimony by two commenters. The first commenter opposed the proposed auditor rotation requirement as being ineffective and costly for the districts. A committee member suggested removing the five-year rotation requirement and keeping the provision that allows the TEA to require a district to change auditors if deficiencies are found; the commenter agreed with that suggestion. The second commenter read a prepared statement requesting two changes to the proposed amendments. The first was to remove the requirement for an RFQ and substitute “competitive procurement process” to give districts more options in hiring an auditor. The second requested that the text be changed to give districts credit for having recently gone through the process to procure a new auditor.

The committee members agreed to amend the text of the proposed amendments as follows and directed the staff to renumber the remaining text as needed (See Attachment A).

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to amend the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, by deleting paragraph (d)(2).*

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to amend the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, by deleting subsection (e).*

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to amend the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, by deleting subsection (f).*

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to amend the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, by deleting the following text: “in the RFQ” and “through the RFQ process.”*

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education approve the proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter B, Texas Education Agency Audit Functions, §109.23, School District Independent Audits and Agreed-Upon Procedures, for first reading and filing authorization, as amended and renumbered.*

## **CONSENT ITEM**

### **5. Approval of Costs of Administering the 2014-2015 State of Texas Assessments of Academic Readiness (STAAR) and the Texas English Language Proficiency Assessment System (TELPAS) Assessments to Private School Students**

(Board agenda page III-47)

[Consent agenda item #(1)]

Gloria Zyskowski, director for student assessment, presented for approval the per-student assessment costs for the 2014-2015 school year as shown in the attachment on pages III-51 and III-52 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 2014 spring administration, 25 private schools participated in the state assessment program.

**MOTION AND VOTE:** *It was moved by Mr. Ratliff, seconded by Mr. Bradley, and carried unanimously to recommend approval of the per-student costs for administering the STAAR and TELPAS tests to private school students in the 2014-2015 school year as reflected in the attachment on pages III-51 and III-52 of the SBOE agenda.*

## **DISCUSSION ITEM**

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

(Board agenda page III-61)

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 August 1, 2014 through September 30, 2014 unless otherwise noted. Ms. Civileto’s report included reporting on the current fair market value of the Fund, the asset allocation mix as of September 30, 2014, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September through August 31, 2014 and the fiscal period beginning September 1 through September 30, 2014, the activity on the securities lending program for the fiscal period September 1, 2013 through August 31, 2014, as well as the month of September 2014, 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, 2014 through September 30, 2014, and short-term cash investments.

## CONSENT ITEM

### **7. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of August and September 2014**

(Board agenda page III-53)  
[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 2014 in the amount of \$1,352,935,918 and \$1,395,842,030, respectively (Attachment B).*

## DISCUSSION ITEM

### **8. Third Quarter 2014 Permanent School Fund Performance Report**

(Board agenda page III-63)

Tom Heiner with BNY Mellon Asset Servicing, presented the third 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 third quarter 2014. He stated that the PSF returned -1.70% for the third quarter, underperforming the target benchmark by 14 basis points. The Fund ranked in the 76th percentile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending September 30, 2014.

Mr. Heiner reviewed third quarter 2014 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite outperformed its benchmark by three basis points for the quarter. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by five basis points. He added that international equities returned -5.22% for the quarter, outperforming its benchmark by five basis points. The fixed income portfolio returned 0.03% for quarter, falling short of its benchmark by 14 basis points. Mr. Heiner stated that the Absolute Return composite returned 0.53% for the quarter, outperforming its benchmark, the HFRI Fund of Funds Composite Index, by 42 basis points. Mr. Heiner added that the Real Estate composite returned 2.77% for the quarter, which was even with its benchmark. Mr. Heiner added that Total Risk Parity Strategies returned -2.70% in the third quarter of 2014, falling short of its benchmark by 345 basis points. He further stated that the Real Return Asset class returned -6.93% for the quarter, underperforming its benchmark by eight basis points. He added that Emerging Market Debt returned -6.05% for the quarter, underperforming its benchmark by 39 basis points. Finally Mr. Heiner stated that private equity returned 5.23% for the quarter ending September 30, 2014.

## CONSENT ITEMS

**9. Approval of an Extension of the Investment Management Services Agreement with BlackRock Investment Management, LLC and Authorization for Contract Execution by the Commissioner of Education**

(Board agenda page III-55)

[Consent agenda item #(3)]

Holland Timmins, executive administrator and chief investment officer, explained that the international index fund contract with BlackRock Investment Management, LLC, expires on August 31, 2015. Mr. Timmins further explained the contract is eligible for a two year renewal and is associated with RFP#701-09-003 Investment Management Services for International Index Fund.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended to the State Board of Education approval of an extension of investment management services for international index fund contract for the Permanent School Fund with BlackRock Investment Management, LLC authorizing a two year extension as allowed by the contract and authorizing the commissioner of education to execute the contract. The extension period shall be from September 1, 2015 through August 31, 2017.*

**10. Approval of an Extension of the Real Estate Consultant Services Agreement with Courtland Partners and Authorization for Contract Execution by the Commissioner of Education**

(Board agenda page III-57)

[Consent agenda item #(4)]

Mr. Timmins explained that the real estate investment counsel services contract with Courtland Partners, Ltd. expires on August 31, 2015. Mr. Timmins further explained the contract is eligible for a four year renewal and is associated with RFP#701-13-015 for Real Estate Investment Counsel Services.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended to the State Board of Education approval of an extension of the real estate investment counsel services for the Permanent School Fund with Courtland Partners, Ltd. authorizing a four year extension as allowed by the contract and authorizing the commissioner of education to execute the contract. The extension period shall be from September 1, 2015 through August 31, 2019.*

**11. Decision on Real Estate Investments**

(Board agenda page III-59)

[Consent agenda item #(5)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal/Chief Operating Officer and Dan Moore, Senior Consultant, joined by John Grubenman, Director of Private Markets for the PSF. Mr. Grubenman provided an introduction to two real estate investment recommendations.

Mr. Moore presented a recommendation of the Fudo Capital III L.P., offered by CLSA Capital Partners, Ltd., a Hong Kong limited liability partnership. Mr. Moore 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. Mr. Grubenman stated that the

board would need to approve a waiver of the requirement for service provider to be registered with the Securities and Exchange Commission and also review and approve the manager's relationship with a placement agent.

Mr. Novick presented a recommendation for the AG Core Plus Realty Fund IV, L.P. Mr. Novick 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 of the investment.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with CLSA Capital Partners, Ltd., necessary to make an investment commitment of up to \$50 million in Fudo Capital III L.P., a U.S. dollar denominated fund, subject to continued due diligence and negotiation of fund terms, to approve the relationship between CLSA Capital Partners and Greenhill & 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 (CLSA Capital Partners) to be a registered investment advisor with the Securities Exchange Commission.*

**MOTION AND VOTE:** *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with Angelo Gordon & Co., necessary to make an investment commitment of up to \$100 million in AG Core Plus Realty Fund IV, L.P. subject to continued due diligence and negotiation of fund terms.*

## **DISCUSSION ITEMS**

### **12. Presentations on the Global Risk Control Strategies and Emerging Market Debt Management Services Provided to the Permanent School Fund** (Board agenda page III-65)

Ms. Hardy called on Mr. Timmins to introduce the item to the committee.

Representatives from the following firms 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.

#### **Emerging Market Debt:**

##### *Investec Asset Management*

Peter Eerdmans, Co-Head of Emerging Markets Fixed Income  
Doug Doucette, Head of Client Management

##### *Stone Harbor Investment Partners*

Stuart Sclater Booth, Portfolio Manager  
Christopher Mitrovich, Client Relationship Manager

##### *Ashmore Investment Management*

Jan Dehn, Global Head of Research  
Mark Weiler, Global Head of Consultant Relations



Global Risk Control Strategies

*AQR Capital Management, LLC*

Mike Mendelson, Principal and Portfolio Manager of Risk Parity Strategies

Joey Lee, Vice President, Investor Relations

*Bridgewater Associates, LP*

Alan Bowser, Senior Client Advisor

Seth M. Birnbaum CFA, Portfolio Strategist

*Mesirow Advanced Strategies, Inc.*

Tom Macina, CEO, Mesirow Advanced Strategies

Linda Jordan, Managing Director, Mesirow Financial Holdings, Inc.

**13. Review of Compliance Reporting**

(Board agenda page III-67)

Mr. Timmins presented a summary of the Texas Administrative Code Chapter 33.5 and Investment Procedures Manual compliance reporting requirements for the State Board of Education members.

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

(Board agenda page III-69)

Mr. Timmins reported the recent departure of Bill Gross from PIMCO. Mr. Gross was the founder of the firm and Mr. Timmins stated that both PSF staff and NEPC are closely monitoring the situation. Mr. Timmins stated that Mr. Gross was not involved with the portfolio management of the PSF commodities portfolio and that the investment team had been strengthened since he left.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 3:33 p.m.