

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

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:02 a.m. on Thursday, September 19, 2013, in Room #1-100 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

Non-Committee Members Present: Mavis B. Knight, Sue Melton-Malone, Geraldine Miller

**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 #3. Information regarding the individual who presented public testimony is included in the discussion of that item.

**ACTION ITEMS**

**1. Per Capita Apportionment Rate for the 2013-2014 School Year**

(Board agenda page III-1)

[Official agenda item #8]

Lisa Dawn-Fisher, associate commissioner for school finance and chief school finance officer, presented this item. She asked the committee to recommend that the State Board of Education adopt a preliminary Available School Fund per capita apportionment rate of \$256.125 for the 2013-2014 school year based on an estimate of the amount available for expenditures from the fund (Attachment A).

**MOTION AND VOTE:** *It was moved by Mr. Allen, seconded by Mr. Mercer, and carried unanimously to recommend that the State Board of Education adopt a preliminary per capita apportionment rate of \$256.125 for the 2013-2014 school year and to place this item on the consent agenda of the State Board of Education meeting of September 20, 2013. (Mr. Bradley was absent for the vote.)*

2. **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**

(First Reading and Filing Authorization)

(Board agenda page III-3)

[Official agenda item #9]

Dr. Dawn-Fisher presented this item, a proposed amendment to 19 TAC §33.65, Bond Guarantee Program, for first reading and filing authorization. Dr. Dawn-Fisher explained that the proposed amendment would reorganize the rule for clarity and update the rule to refer to the recently implemented online application for the guarantee administered through the website of the Municipal Advisory Council (MAC) of Texas. She stated that another proposed change to the existing rule was a change in the application fee, specified in subsection (e)(1)(A) of the existing rule. Dr. Dawn-Fisher stated that agency staff recommended lowering the fee from the current amount of \$2,300 to \$1,500. She stated that the lower fee better aligns with the current cost of administering the Permanent School Fund (PSF) Bond Guarantee Program. Dr. Dawn-Fisher explained that program administration costs are lower than in the past mostly because lower interest rates have prompted more school districts to issue bonds and apply for the guarantee and partly because automating the application process through the agency's partnership with the MAC of Texas has reduced application processing costs. Dr. Dawn-Fisher responded to committee members' questions and provided the committee with an exhibit showing the current program cost and how it was determined (Attachment B).

**MOTION AND VOTE:** *It was moved by Mr. Bradley, seconded by Mr. Ratliff, 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, §33.65, Bond Guarantee Program, for first reading and filing authorization, with the application fee of \$1,500 in subsection (f)(1)(A), as follows:*

(f) Application process and application processing.

(1) Application submission and fee. A district must apply to the commissioner for the guarantee of eligible bonds or the credit enhancement of eligible bonds as authorized under §61.1038 of this title by submitting an application electronically through the website of the MAC of Texas or its successor. The district must submit the information required under the TEC, §45.055(b), and this section and any additional information the commissioner may require. The application and all additional information required by the commissioner must be received before the application will be processed. The district may not submit an application for a guarantee or credit enhancement before the successful passage of an authorizing proposition.

(A) The application fee is \$1,500 [~~\$~~—].

## DISCUSSION ITEMS

### **3. Discussion of 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**

(Board agenda page III-37)

Public testimony was provided by the following individual:

NAME: Denise Pierce  
AFFILIATION: Texas Charter Schools Association (TCSA)

Dr. Dawn-Fisher presented this item, proposed new 19 TAC §33.67, Bond Guarantee Program for Charter Schools, for discussion. The proposed new rule would implement provisions of the Texas Education Code (TEC), Chapter 12, Subchapter D, and Chapter 45, Subchapter C, which 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 PSF Bond Guarantee Program to allow for guarantee of bonds issued for the benefit of open-enrollment charter schools. The committee was provided draft text of the proposed new rule as a separate exhibit (Attachment C).

Dr. Dawn-Fisher explained that while the committee had discussed a longer timeline for implementing a charter school bond guarantee program at its last meeting, a recent decision by the Internal Revenue Service would allow the board to implement the program sooner. Dr. Dawn-Fisher stated that she intended to bring the proposed rule before the board for first reading and filing authorization at the November 2013 meeting and then for second reading and final adoption at the January 2014 meeting. She explained that that timeline would result in an approximate effective date for the rule of February 2014.

Dr. Dawn-Fisher explained that the draft text was developed with advice from stakeholders, including bond counsels, charter schools, and the TCSA. She summarized for committee members the provisions in the draft text of the proposed new rule, outlining the provisions subsection by subsection. Dr. Dawn-Fisher and David Anderson, general counsel, responded to questions from committee members about the proposed rule and its authorizing statutes. Denise Pierce, general counsel and vice president of member services for the TCSA, responded to committee members' questions about charter school bond issuance and how the proposed rule would affect charter schools. Dr. Dawn-Fisher emphasized that the rule text was draft text only and that policy decisions about how the program would operate were under the purview of the board.

Committee members asked Ms. Pierce to provide them with more information related to charter school debt and borrowing practices at the November 2013 committee meeting. Ms. Pierce said that the TCSA would provide that information at the meeting. Dr. Dawn-Fisher stated that she would provide the committee with detailed information on the PSF Bond Guarantee Program's capacity to guarantee school district and charter school bonds at that same meeting.

**4. Review of Permanent School Fund Securities Transactions and the Investment Portfolio**  
(Board agenda page III-47)

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 June 1, 2013 through July 31, 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 July 31, 2013, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2012 through July 31, 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 July 31, 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 June and July 2013**  
(Board agenda page III-21)  
[Consent agenda item #(1)]

**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 June and July 2013 in the amount of \$616,992,766 and \$592,957,868 respectively (Attachment D).*

**DISCUSSION ITEM**

**6. Second Quarter of 2013 Permanent School Fund Performance Report**  
(Board agenda page III-49)

Tom Heiner with BNY Mellon Asset Servicing, presented the second 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 second quarter 2013. He stated that the PSF returned -0.96% for the first quarter underperforming the target benchmark by sixty-four basis points. The Fund ranked in the 85th percentile or fourth quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending June 30, 2013.

Mr. Heiner reviewed second quarter 2013 performance of the Permanent School Fund by asset class, stating that the total domestic equity composite returned 2.70% for the quarter, outperforming its benchmark by two basis points. He stated that international equities returned -2.99% for the quarter, outperforming its benchmark by 12 basis points. He further stated that the fixed income portfolio returned -2.68% for quarter, underperforming its benchmark by 36 basis points. Mr. Heiner added that the Absolute Return composite returned 1.35% for the quarter, outperforming its benchmark, the HFRI Fund of Funds Composite Index, by 136 basis points. He further added that the Real Estate composite returned 3.59% for the quarter, outperforming its benchmark by 69 basis points. Mr. Heiner stated that Total Risk Parity Strategies returned -9.30% in the second quarter of 2013, underperforming its benchmark by 1,000 basis points or 10%. He further stated

that the Real Return Asset class returned -9.98% for the quarter underperforming its benchmark by 175 basis points during the quarter. He added that the main driver for underperformance in real return was in commodities as the internally managed TIPS portfolio outperformed its benchmark by 20 basis points. Finally Mr. Heiner stated that private equity returned 5.39% for the quarter.

Holland Timmins, executive administrator and chief investment officer, reported that there has been a substantial underperformance by three external managers. These three portfolios make up 8.5% of the Fund. The lagging performance cost the Fund 79 basis points during the second quarter and 130 basis points during the one-year period ending June 30, 2013.

Mr. Timmins informed the committee that both staff and NEPC are spending a great deal of time on the continued due diligence and assessment of the managers and portfolios since the magnitude of under performance is significant. He stated that all three managers will be making their annual presentations to the committee at the November meeting. He further stated that because of the Investment Procedure Manual guidelines, the committee may decide to place these managers on the watch list or shift assets among managers. Therefore, the items will be posted as action items.

The meeting recessed at 12:16 and reconvened at 1:19 p.m.

#### **ACTION ITEM**

**7. Proposed Amendment to 19 TAC Chapter 33, Statement of Investment Objectives, Policies, and Guidelines of the Texas Permanent School Fund, §33.25, Permissible and Restricted Investments and General Guidelines for Investment Managers**

(Second Reading and Final Adoption)

(Board agenda page III-23)

[Official agenda item #10]

Carlos Veintemillas, Deputy Chief Investment Officer, presented this item to the committee stating that this was the second reading and final adoption to revisions to 19 TAC Chapter 33, §33.25. He added that revisions to the guidelines were being made to align them with the Barclay's Aggregate Bond Index as it relates to credit ratings determination.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended 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, §33.25, Permissible and Restricted Investments and General Guidelines for Investment Managers for second reading and final adoption (Attachment E).*

#### **CONSENT ITEMS**

**8. Determination as to Whether Transfers May be Made from the Permanent School Fund to the Available School Fund**

(Board agenda page III-31)

[Consent agenda item #(2)]

Ms. Hardy called on Mr. Veintemillas to address the item. Mr. Veintemillas explained that the board needs to affirm that the distribution in fiscal year 2014 will meet the constitutional restrictions. He described the methodology and the calculations used to determine the distribution.

He stated that distribution rate set by the board last year for fiscal years 2014 and 2015 is 3.3%. Mr. Veintemillas further stated that all constitutional tests have been satisfied and recommended that the committee approve the distribution for fiscal year 2014.

Rhett Humphreys, partner and senior consultant with NEPC, agreed with the methodology and the calculations used by PSF staff to determine the distribution amount. Mr. Humphreys also agreed that, based on the constitutional restrictions, a distribution is allowed for fiscal year 2014.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended that the State Board of Education determine that a distribution of \$838.7 million for fiscal year 2014 is permitted under Texas Constitution Article VII, Subsection 5(a)(2).*

## **9. Decision on Real Estate Investments**

(Board agenda page III-35)  
[Consent agenda item #(3)]

The PSF real estate consultant, Courtland Partners, was represented by Ben Blakney, managing director, and Dan Moore, senior consultant, joined by Mr. Timmins. Mr. Timmins provided an introduction to a real estate investment recommendation.

Mr. Blakney and Mr. Moore presented the recommendation for the Morgan Stanley Prime Property Fund, LLC, and described the due diligence process conducted by both Courtland and PSF staff. Mr. Blakney 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.

**MOTION AND VOTE:** *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreements with Morgan Stanley Real Estate Adviser Inc. necessary to make an investment commitment of up to \$100 million in Prime Property Fund, LLC, subject to continued due diligence and negotiation of fund terms.*

## **DISCUSSION ITEMS**

### **10. Presentation by The Bank of New York Mellon on the Custody and Securities Lending Services Provided to the Permanent School Fund** (Board agenda page III-51)

The Bank of New York Mellon (BNY Mellon) was represented by Catherine Wargo, vice president, relationship executive, Tom Heiner, vice president, senior consultant, global risk solutions and Mike McDermott, managing director, head of securities lending client relationship management (PGH). Ms. Wargo reviewed BNY Mellon and Permanent School Fund (PSF) partnership milestones and accomplishments since being appointed as global custodian, reviewed the custodian services provided by BNY Mellon and also provided an overview of the BNY Mellon organization, including financial highlights and recent quality rankings.

Mr. Heiner reviewed services provided by the global risk solutions group which include performance measurement, compliance monitoring and reporting. Mr. McDermott presented an overview of the securities lending program.

**11. Discussion of the Permanent School Fund Bond Guarantee Program**  
(Board agenda page III-53)

Ms. Civileto presented an overview of the Permanent School Fund Bond Guarantee Program (BGP) in response to interest expressed by the committee at the July meeting. The presentation was based primarily on data provided by the Municipal Advisory Council of Texas (MAC) as of July 31, 2013 and highlighted BGP history, those districts which can participate in the Program, the types of school district debt the Program guarantees, and graphical presentations related to various BGP metrics. Ms. Civileto presented additional detail related to guaranteed Capital Appreciation Bonds, their use, and their fit into the overall guaranteed debt picture of the BGP.

**12. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer**  
(Board agenda page III-55)

Mr. Timmins informed the committee that one of the Fund's absolute return strategic relationship managers, Grosvenor Capital Management, is purchasing one of the private equity managers. This will be brought back to the committee in November as an action item to consent to the transaction.

**13. Texas Education Agency Administrative and Program Strategic Budget for 2014-2015 Biennium**  
(Board agenda page III-57)

Shirley Beaulieu, associate commissioner for finance and chief financial officer, presented for review and comment the agency administrative and program budget for the 2014-2015 biennium as per the appropriations set by the 83rd Texas Legislature in Senate Bill 1, Regular Session. Ms. Beaulieu provided committee members with an exhibit comparing the budget for the 2014-2015 biennium to the budget for the 2012-2013 biennium (Attachment F).

Ms. Beaulieu discussed the major components of the budget, including the Foundation School Program (FSP) and TEC, Chapter 46, facilities programs; programs funded by federal funds; programs funded by state general revenue; and the agency's administrative budget. Ms. Beaulieu answered questions from committee members regarding these budget components. She explained that the reductions in the adult-education budget item amounts from last biennium's budget to the current biennium's budget were attributable to the legislature's transferring responsibility for adult education from the Texas Education Agency to the Texas Workforce Commission. In response to a question from Mr. Mercer, she explained that the changes in the Temporary Assistance for Needy Families (TANF) budget item amounts were also attributable to that transfer of responsibilities, as the TANF items were related to adult education. Ms. Beaulieu explained how legislation passed in 2011 had changed the way school districts purchase their instructional materials and so had changed the associated budget item. She explained that the variance in that budget item from last biennium's budget to the current biennium's budget was mostly attributable to a surplus left over from the last biennium. In response to a question from Ms. Hardy, Ms. Beaulieu stated that the budget item labeled "Texas Advanced Placement Incentive" included both reimbursements of test fees to qualifying students and funds for teacher training. In response to a question from Mr. Bradley, Ms. Beaulieu stated that the agency did charge the PSF for services provided by the agency and explained how those charges were calculated. Mr. Bradley asked whether there had not been discussion at previous committee and board meetings of the feasibility of making the PSF and its support staff an entity separate from the agency. Mr. Anderson stated that there had but that it was his recollection that doing so would require legislative action.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 3:13 p.m.