

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
September 10, 2015**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:04 a.m. on Thursday, September 10, 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 4-17-15/](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 heard public testimony on agenda item #3. Information regarding the individual who presented public testimony is included in the discussion of that item.

DISCUSSION ITEM

- 1. Texas Education Agency Legislative Appropriations by Program for the 2016-2017 Biennium Compared to the 2014-2015 Biennium**
(Board agenda page III-47)

Shirley Beaulieu, associate commissioner for finance and chief financial officer, presented the agency administrative and program budget for the 2016-2017 biennium. Ms. Beaulieu provided committee members with an exhibit comparing the budget for the 2014-2015 biennium to the appropriated budget for the 2016-2017 biennium (Attachment A).

Ms. Beaulieu presented an overview of the major components of the budget, and answered questions from committee members regarding these budget components.

CONSENT ITEM

- 2. Per Capita Apportionment Rate for the 2015-2016 School Year**
(Board agenda page III-1)
[Consent agenda item #(1)]

Amanda Brownson, director of state funding, presented this item. Dr. Brownson asked the committee to recommend that the State Board of Education adopt a preliminary Available School Fund per capita apportionment rate of \$176.437 for the 2015-2016 school year based on an estimate

of the amount available for expenditures from the fund (Attachment B). Dr. Brownson responded to questions regarding the per capita apportionment rate.

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Allen, and carried unanimously to recommend that the State Board of Education adopt a per capita apportionment rate of \$176.437 for the 2015-2016 school year.*

ACTION ITEMS

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, §33.65, Bond Guarantee Program for School Districts**
(Second Reading and Final Adoption)
(Board agenda page III-3)
[Official agenda item #10]

The following individual provided public testimony:

NAME: David Welch
AFFILIATION: Franklin, Parlapiano, Turner & Welch LLC

Dr. Brownson presented this action item. Dr. Brownson presented proposed amendments to eliminate the proposed prohibition on providing the guarantee for bonds used to construct teacher housing. Mr. Ratliff expressed a need to add requirements for using BGP funds for teacher housing. Mr. Ratliff requested amendments be brought to the general meeting on September 11, 2015.

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

4. **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-19)
[Official agenda item #11]

Dr. Brownson presented this action item. Dr. Brownson answered the committee's questions regarding the calculation of capacity, the limitation on the guarantee of charter bonds, and the charter school bond guarantee reserve fund.

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Allen, and carried to amend 19 TAC §33.67(e)(2)(A)(vii), as follows:*

(vii) *not have materially violated a covenant relating to debt [~~a financial~~] obligation in the immediately preceding three years.*

MOTION AND VOTE: *It was moved by Mr. Ratliff, seconded by Mr. Allen, 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 for second reading and final adoption 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, with an effective date of 20 days after filing as adopted with the Texas Register.*

DISCUSSION ITEM

5. Review of Permanent School Fund Securities Transactions and the Investment Portfolio (Board agenda page III-49)

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 June 1 through July 31, 2015, 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, 2015, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2014 through July 31, 2015, the activity on the securities lending program for the fiscal period September 1, 2014 through July 31, 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, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2015 through July 31, 2015, and short-term cash investments.

CONSENT ITEM

6. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of June and July 2015 (Board agenda page III-37) [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 June and July 2015 in the amount of \$1,279,404,264 and \$1,289,786,472, respectively (Attachment C).*

DISCUSSION ITEM

7. Second Quarter 2015 Permanent School Fund Performance Report (Board agenda page III-51)

Tom Heiner, vice president and senior analytics consultant with BNY Mellon performance and Risk Analytics, presented the second quarter of 2015 Permanent School Fund performance report. Mr. Heiner began by giving an overview of the U.S. and foreign capital markets. Mr. Heiner then reviewed the performance of the Fund for the second quarter 2015. He stated that the PSF returned 0.09% for the second quarter outperforming the target benchmark by one basis point. The Fund ranked in the 62nd percentile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending June 30, 2015.

Mr. Heiner reviewed second quarter 2015 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 seven basis points. He added that international equity returned 0.66% for the quarter, having outperformed its benchmark during the period by 13 basis points. The fixed income portfolio returned -1.67% for quarter, exceeding its benchmark by one basis point. Mr. Heiner stated that the Absolute Return composite returned 0.22% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 12 basis points. Mr. Heiner added that the Real Estate composite returned 3.99% for the quarter, outperforming its benchmark by 228 basis points. Mr. Heiner added that Total Risk Parity Strategies returned -2.87% in the second quarter of 2015, underperforming its benchmark by 338 basis points. He further stated that the Real Return Asset class returned 1.28% for the quarter, coming in below its benchmark by 52 basis points. He added that Emerging Market Debt returned -0.86% for the quarter, exceeding its benchmark by 10 basis points. Finally Mr. Heiner stated that private equity returned 2.04% for the quarter, outperforming its benchmark by 81 basis points for the quarter ending June 30, 2015.

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-39) [Consent agenda item #(3)]

Ms. Hardy called on Mr. Carlos Veintemillas, deputy chief investment officer and director of fixed income, to address the item. Mr. Veintemillas gave a presentation describing the two constitutional limits on distributions from the Permanent School Fund. The two limits require that an annual distribution cannot be greater than six percent of the value of the Fund assets and the total amount of distributions from the current and previous nine state fiscal years cannot exceed the total return on the Fund assets over the same time period. Mr. Veintemillas stated that both tests were satisfied, allowing for a distribution from the PSF to the Available School Fund for fiscal year 2016. Rhett Humphreys, partner with NEPC, stated that NEPC reviewed the methodology used by PSF staff and agreed that both tests were satisfied and a distribution would be permitted.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education determine that a distribution of \$1.056 billion for fiscal year 2016 is permitted under Texas Constitution, Article VII, Subsection 5(a)(2).*

9. Decision on Real Estate Investments

(Board agenda page III-43)
[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, principal/chief operating officer, and Jarrod Rapalje, senior analyst, and joined by John Grubenman, director of private markets of PSF.

Mr. Novick provided an introduction to a real estate investment recommendation. The GreenOak Asia (USD) II, L.P. offered by GreenOak Asia GP II, L.P., as General Partner. Mr. Rapalje described the due diligence process conducted by both Courtland and PSF staff, provided a brief overview of the investment including its objectives and strategy, and outlined the merits and considerations. Mr. Grubenman stated that the board would need to review and approve the manager's relationship with a placement agent.

MOTION AND VOTE: *By unanimous consent, the committee recommends to the State Board of Education approval to execute agreement(s) with GreenOak Asia GP II, L.P., necessary to make an investment commitment of up to \$50 million in GreenOak Asia (USD) II, L.P., a U.S. dollar-denominated fund, subject to continued due diligence and negotiation of fund terms, and also, to approve the relationship between GreenOak and Hodes Weill Securities, LLC after determining it meets the standards of 19 TAC Chapter 33, Section (9)(j)(5), which has been disclosed in writing, and authorization for contract execution by the Commissioner of Education.*

Mr. Grubenman provided an introduction to a potential real estate co-investment opportunity with an existing investment manager and asked that the board approve a one-time waiver of the PSF Real Estate Investment Policy Statement for an increased commitment amount.

MOTION AND VOTE: *By unanimous consent, the committee recommends to the State Board of Education to approve a one-time waiver of the PSF Real Estate Investment Policy Statement and authorize an amount of up to \$50 million, excluding reserves (whether for follow-up investments, expenses, or otherwise) for a potential real estate co-investment with an existing PSF investment manager.*

DISCUSSION ITEM

10. Review 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

(Board agenda page III-53)

Holland Timmins, executive administrator and chief investment officer, presented this item. Mr. Timmins stated that the Texas Government Code establishes that rules should be reviewed every four years. He stated that the last time the board reviewed Chapter 33 under this context was 2011 and that the need for the rules still exist. Mr. Timmins added that staff will bring the item back to the board at the November board meeting to adopt the rule review.

CONSENT ITEM

11. Permanent School Fund Private Equity Program Structure

(Board agenda page III-45)
[Consent agenda item #(5)]

Mr. Humphreys, joined by Mr. Grubenman, gave a presentation on the private equity program history and structure. NEPC recommended to proceed with Neuberger Berman LLC for Phase III of the private equity program, commencing in July 2016. NEPC also recommended a staff/non-discretionary advisor structure for primary fund investments and continuing the discretionary separate account for co-investments and secondaries.

John Buser, managing director, and Kaci Boyer, vice president, Neuberger Berman LLC, commented on the Neuberger Berman LLC proposal.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education to select the non-discretionary advisory model as presented by NEPC for phase III of the private equity program.*

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education to contract with Neuberger Berman LLC for (i) a discretionary separate account to invest in private equity co-investments and secondaries, and (ii) non-discretionary advisory services for primary private equity investments for phase III of the private equity program.*

DISCUSSION ITEMS

12. 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-115)

The Bank of New York Mellon (BNY Mellon) was represented by Catherine Wargo, vice president, relationship executive, Mr. Heiner, and Mike McDermott, vice president, manager, client services/global securities lending. 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.

13. Presentation on the Commodities Discretionary Investment Management Services Provided to the Permanent School Fund
(Board agenda page III-117)

Mr. Allen called on Mr. Timmins to introduce the item to the committee.

The following firms then gave presentations from their respective representatives:

PIMCO

Brent Holden, Managing Director

Bransby Whitton, Executive Vice President and Real Return Product Manager

Credit Suisse Asset Management, LLC

Nelson Louie, Global Head of Commodities

Charlie Shaffer, Managing Director and Global Head of Distribution

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

14. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-119)

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

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:35 p.m.