

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
September 15, 2016**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:04 a.m. on Thursday, September 15, 2016, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. The following members of the committee were present:

Presiding: Pat Hardy, chair; Lawrence A. Allen, Jr., vice chair; David Bradley; Ken Mercer;

Absent: 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 received no presentations of public testimony.

CONSENT ITEM

1. Per Capita Apportionment Rate for the 2016-2017 School Year

(Board agenda page III-1)
[Consent agenda item #(3)]

Leo Lopez, chief school finance officer, presented this item. Mr. Lopez recommended that the State Board of Education adopt a preliminary Available School Fund per capita apportionment rate of \$390.186 for the 2016-2017 school year (Attachment A). Mr. Lopez answered questions from the committee regarding the per capita apportionment rate.

MOTION AND VOTE: *It was moved by Mr. Mercer, seconded by Mr. Bradley, and carried unanimously to recommend that the State Board of Education adopt a per capita apportionment rate of \$390.186 for the 2016-2017 school year.*

DISCUSSION ITEMS

- 2. Texas Education Agency Legislative Appropriation Comparison by Major Component FY 2016-2017 Compared to FY 2018-2019 Legislative Appropriation Request**
(Board agenda page III-17)

Commissioner Mike Morath presented a comparison of the FY 2016-2017 budget to the FY 2018-2019 Legislative Appropriation Request. The commissioner explained some of the large variances and answered several questions related to the variances.

Additionally, the commissioner presented a high-level overview of the agency's Exceptional Items requested in the Legislative Appropriation Request. The commissioner responded to several questions from committee members.

- 3. Review of Permanent School Fund Securities Transactions and the Investment Portfolio**
(Board agenda page III-19)

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 June 1, 2016 through July 31, 2016, unless otherwise noted. Ms. Civiletto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of July 31, 2016, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2015 through July 31, 2016, the activity on the securities lending program for the fiscal period September 1, 2015 through July 31, 2016, 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 for the fiscal period September 1, 2015 through July 31, 2016, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2016 through July 31, 2016, and short-term cash investments.

CONSENT ITEM

- 4. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of June and July 2016**
(Board agenda page III-3)
[Consent agenda item #(4)]

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 2016, in the amount of \$1,069,387,454 and \$1,041,145,213 respectively (Attachment B).*

DISCUSSION ITEM

5. Second Quarter 2016 Permanent School Fund Performance Report (Board agenda page III-21)

Tom Heiner of BNY Mellon Global and Risk Solutions, presented the second quarter of 2016 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 of 2016. He stated that the PSF returned 2.35% for the second quarter outperforming the target benchmark by 38 basis points. The Fund ranked in the 14th percentile or top quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending June 30, 2016.

Mr. Heiner reviewed second quarter 2016 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite outperformed its benchmark by two basis points for the quarter. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by 12 basis points. He added that international equities returned -0.39% for the quarter, having outperformed its benchmark by 25 basis points during the period. The fixed income portfolio returned 2.47% for quarter, exceeding its benchmark by 26 basis points. Mr. Heiner stated that the Absolute Return composite returned 1.40% for the quarter, outperforming its benchmark, the HFRI Fund of Funds Composite Index, by 77 basis points. Mr. Heiner added that the Real Estate composite returned 1.79% for the quarter, underperforming its benchmark by 31 basis points. Mr. Heiner added that Total Risk Parity Strategies returned 5.88% in the second quarter of 2016, outperforming its benchmark by 351 basis points. He further stated that the Real Return Asset class returned 6.90% for the quarter, falling short its benchmark by 29 basis points. He added that Emerging Market Debt returned 2.87% for the quarter, exceeding its benchmark by 16 basis points. Mr. Heiner stated that private equity returned 0.69% for the quarter, coming above its benchmark by 76 basis points. Finally, he stated that the total emerging market equity composite returned 1.43% for the second quarter 2016, outperforming its benchmark by 77 basis points.

CONSENT ITEMS

6. Determination as to Whether Transfers May be Made from the Permanent School Fund to the Available School Fund (Board agenda page III-5) [Consent agenda item #(5)]

Ms. Hardy called on Carlos Veintemillas, deputy chief investment officer/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 in fiscal year 2017. Mr. Veintemillas stated that NEPC, PSF general consultant, also did the same calculations as 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 2017 is permitted under Texas Constitution Article VII, Subsection 5(a)(2).*

7. Proposed Amendments to the Investment Procedures Manual

(Board agenda page III-9)

[Consent agenda item #(6)]

Mr. Veintemillas discussed the proposed amendments to the Investment Procedures Manual of the Permanent School Fund. The amendments reflect the changes to the asset allocation adopted by the board in July 2016, a new section regarding manager review/redemption, and additional clean up language.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education adoption of the amendments to the Investment Procedures Manual.*

8. Authorization to Issue a Request for Proposals for Passive International Equities Management Services for the Permanent School Fund

(Board agenda page III-11)

[Consent agenda item #(7)]

Holland Timmins, chief investment officer and executive administrator, presented the key points relevant to the issuance of this Request for Proposals for Passive International Equities Management Services for the Permanent School Fund.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to issue a Request for Proposals for Passive International Equities Management Services for the Permanent School Fund.*

9. Decision on Real Estate Investments

(Board agenda page III-13)

[Consent agenda item #(8)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal and Chief Operating Officer, and Tom Hester, Senior Vice President, and joined by John Grubenman, Director of Private Markets for PSF.

Mr. Grubenman provided an introduction to the first real estate investment recommendation, a non-discretionary, separate managed account with Metropolitan Real Estate Equity Management L.L.C. Mr. Novick and Mr. Hester described the due diligence process conducted by Courtland and PSF staff. Mr. Novick and Mr. Hester provided a brief overview including its objectives and strategy, and outlined the investment's merits and considerations.

Mr. Grubenman then provided an introduction to the second real estate investment recommendation, Longpoint Realty Fund I, L.P. offered by, Longpoint Realty Fund I GP, L.L.C. as General Partner. Mr. Novick and Mr. Hester described the due diligence process conducted by both Courtland and PSF staff. Mr. Novick and Mr. Hester 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 Metropolitan Real Estate Equity Management L.L.C. or affiliates thereof, necessary to make an investment commitment of up to \$100 million in a non-discretionary separate managed account, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with Longpoint Realty Fund I GP, L.L.C., necessary to make an investment commitment of up to \$75 million in Longpoint Realty Fund I, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

10. Overview of the Permanent School Fund Real Estate Policy

(Board agenda page III-15)
[Consent agenda item #(9)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal/Chief Operating Officer, and Tom Hester, Senior Vice President, joined by Mr. Grubenman.

Mr. Grubenman introduced the topic and discussed options for recommended changes to select provisions in the *Real Estate Investment Policy Statement*, *Real Estate Procedures Manual*, and the *Annual Tactical Plan*. He explained that the options presented were made in consultation with fiduciary counsel, as instructed at the previously scheduled committee meeting. Mr. Novick and Mr. Hester stated that Courtland concurs with the options proposed for a variety of reasons.

MOTION AND VOTE: *It was moved by Mr. Bradley, seconded by Mr. Allen, and carried unanimously to recommend that the State Board of Education 1) adopt the changes to the Real Estate Policy Statement, as discussed and amended and 2) adopt the changes to the Real Estate Procedures and Annual Tactical Plan.*

DISCUSSION ITEM

11. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-23)

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

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 12:00 p.m.