

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 4, 2019**

(School Finance Items)

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:08 a.m. on Thursday, April 4, 2019, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Lawrence A. Allen, Jr., vice chair; Donna Bahorich; Patricia Hardy; Ken Mercer

Public Testimony

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

ACTION ITEMS

1. **Adoption of Review of 19 TAC Chapter 129, Student Attendance, Subchapter A, Student Attendance Allowed, and Subchapter B, Student Attendance Accounting (Adoption of Review)**
(Board agenda page III-1)
[Official agenda item #14]

David Marx, director, financial compliance, explained that the item was a four-year rule review and suggested that the item be moved to the consent agenda. He explained that no changes were recommended to the rule and answered questions from Mr. Mercer and Ms. Hardy.

MOTION AND VOTE: *It was moved by Mr. Allen, seconded by Mrs. Bahorich, and carried unanimously to recommend that the State Board of Education adopt the review of 19 TAC Chapter 129, Student Attendance, Subchapter A, Student Attendance Allowed, and Subchapter B, Student Attendance Accounting, and placement of this item on the April 5, 2019, consent agenda.*

2. **Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide (First Reading and Filing Authorization)**
(Board agenda page III-6)
[Official agenda item #15]

Mr. Marx explained that the proposed amendment would update the *Financial Accountability System Resource Guide*. He also explained the guide's purpose.

MOTION AND VOTE: *It was moved by Mr. Allen, seconded by Mrs. Bahorich, and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization proposed amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter C, Adoptions By Reference, §109.41, Financial Accountability System Resource Guide, and placement of this item on the April 5, 2019, consent agenda.*

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 4, 2019**

(Permanent School Fund Items)

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:08 a.m. on Thursday, April 4, 2019, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: Tom Maynard, chair; Lawrence A. Allen, Jr., vice chair; Donna Bahorich; Patricia Hardy; Ken Mercer;

Public Testimony

The Committee on School Finance/Permanent School Fund received no presentations of public testimony.

DISCUSSION ITEM

3. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-12)

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 December 2018 and January 2019 unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund; the asset allocation mix as of January 31, 2019; PSF transactions occurring in the reporting period; revenues and expenditures for the fiscal period beginning September 1, 2018 through January 31, 2019; the activity in the securities lending program for the fiscal period beginning September 1, 2018 through January 31, 2019; the status of transfers from the General Land Office per the agreed to resolution 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, 2018 through December 31, 2018, and the month of January 2019; fixed income rating changes for the fiscal period beginning September 1, 2018 through January 31, 2019; 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 December 2018 and January 2019

(Board agenda page III-13)
[Consent agenda item #(5)]

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 that the State Board of Education ratify the purchases and sales for the months of December 2018 and January 2019 in the amounts of \$825,802,645 and \$898,234,583, respectively (Attachment A).*

DISCUSSION ITEM

- 5. Report by the State Auditor's Office on the Audit of the Permanent School Fund's Financial Statements and Certification of the Bond Guarantee Program for the Fiscal Year Ending August 31, 2018**
(Board agenda page III-14)

Mr. Maynard introduced Michael Clayton, audit manager, and Bill Hunter, managing senior auditor from the State Auditor's Office (SAO) for presentation of the annual audit of the Permanent School Fund for the year ending August 31, 2018, and for presentation of results of the Certification of the Permanent School Fund's Bond Guarantee Program for fiscal year 2018.

Mr. Clayton stated that the SAO issued an unqualified opinion on the financial statements audited for the period. He stated that the SAO also conducted a review of internal controls and identified no reportable internal control weakness at the Texas Education Agency.

Mr. Clayton then presented the results of the Certification of the Permanent School Fund's Bond Guarantee Program for the fiscal period. He stated that the amount of bonds guaranteed during FY 2018 was within all regulatory limits established by the Texas Education Code (Section 45.053(a) and (d), and §45.0531(a) and (b)), the Internal Revenue Service (Notice 2010-5 dated December 16, 2009), and the State Board of Education, and that the Fund had sufficient reserves to meet the State Board of Education's reserve requirements for the same period.

CONSENT ITEM

- 6. Adoption of an Annual Report on the Status of the Bond Guarantee Program**
(Board agenda page III-15)
[Consent agenda item #(6)]

Mr. Timmins presented the annual report of the Bond Guarantee Program as required by the Texas Education Code and requested that the committee adopt the report as presented.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education adopt the annual report on the status of the Bond Guarantee Program as of August 31, 2018.*

DISCUSSION ITEM

- 7. Fourth Quarter 2018 Permanent School Fund Performance Report**
(Board agenda page III-16)

Ms. Lori Roeller of BNY Mellon Global and Risk Solutions, presented the fourth quarter of 2018 Permanent School Fund performance report. Ms. Roeller began with an overview of the U.S. and foreign capital markets. Ms. Roeller then reviewed the performance of the Fund for the fourth quarter 2018. She stated that the PSF returned -5.25% for the fourth quarter underperforming the target benchmark by 29 basis points. Ms. Roeller attributed most of the underperformance to international and emerging market equities.

Ms. Roeller reviewed fourth quarter 2018 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite exceeded its benchmark for the quarter by eight basis points. Ms. Roeller added that Small/Midcap Equity portfolio outperformed its benchmark by nine basis points. She added that international equities returned -10.92% for the quarter, underperforming its benchmark by 16 basis points during the period. The fixed income portfolio returned 1.40% for the quarter, underperforming its benchmark by 24 basis points. Ms. Roeller stated that the Absolute Return composite returned -3.19% for the quarter, beating its benchmark, the HFRI Fund of Funds Composite Index, by 204 basis points. Ms. Roeller added that the Real Estate composite returned 2.2% for the quarter, outperforming its benchmark by 49 basis points. Ms. Roeller added that Total Risk Parity Strategies returned -4.96% in the fourth quarter of 2018, outperforming its benchmark by 260 basis points. She further stated that the Real Return Asset class returned -5.24% for the quarter, underperforming its benchmark by 28 basis points. She added that Emerging Market Debt returned 1.5% for the quarter, underperforming its benchmark by 60 basis points. Ms. Roeller stated that private equity returned 3.57% for the quarter, beating its benchmark by two basis points. Finally, she stated that the total emerging market equity composite returned -8.31% for the fourth quarter 2018, underperforming its benchmark by 23 basis points.

CONSENT ITEMS

8. Decision on Real Estate Investments

(Board agenda page III-17)
[Consent agenda item #(7)]

The PSF real estate consultant, Courtland Partners, a StepStone Company, was represented by Tom Hester, managing director, joined by John Grubenman, director of private markets, and Kathryn Gernert, portfolio manager, representing PSF. Mr. Grubenman provided a brief introduction of one real estate investment recommendation.

Mr. Hester introduced a real estate investment recommendation, in GreenOak Asia (USD) III, offered by GreenOak Asia GP III, LP. Mr. Hester and Ms. Gernert 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.

MOTION AND VOTE: *The committee recommended that the State Board of Education approve execution of agreement(s) with GreenOak Asia GP III, LP, necessary to make an investment commitment of up to \$75 million in GreenOak Asia (USD) III, LP, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

9. Review of the Permanent School Fund Real Estate Policy and Tactical Plan

(Board agenda page III-19)
[Consent agenda item #(8)]

Mr. Grubenman discussed options for recommended changes to select provisions in the *Real Estate Investment Policy Statement*. He explained that the recommended changes being presented by staff were made in consultation with Courtland. Mr. Hester stated that Courtland concurs with the proposed options and for the reasons discussed.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve proposed changes to the Real Estate Investment Policy Statement, as amended.*

Mr. Grubenman discussed updates presented in the *Annual Tactical Plan*. Mr. Hester stated that Courtland concurs with the suggested updates to the tactical plan.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve proposed changes to the Annual Tactical Plan, Appendix B of the Real Estate Investment Policy Statement, as presented.*

10. Review of the Permanent School Fund Emerging Market Debt Asset Class

(Board agenda page III-20)

[Consent agenda item #(9)]

Carlos Veintemillas, deputy chief investment officer and director of fixed income and real return, gave an update on the emerging market debt asset class structure and performance history. Keith Stronkowsky, senior consultant at NEPC, also provided an overview of the emerging market debt structure. Both staff and NEPC recommended that Stone Harbor Investment Partners be terminated, and the net assets be reallocated between the existing emerging market debt managers.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education terminate Stone Harbor Investment Partners and distribute the net assets between Ashmore Investment Group and Investec Asset Management Limited.*

11. Presentation on the Permanent School Fund Private Equity Program Structure

(Board agenda page III-21)

[Consent agenda item #(10)]

Mr. Grubenman introduced the item. Brien Smith, managing director, and Kaci Boyer, principal of Neuberger Berman, presented an update on the firm and the PSF private equity program. Mr. Smith described the proposal for the contract renewal. Mr. Grubenman stated that staff recommended approval of the contract renewal. Mr. Stronkowsky of NEPC stated that NEPC had reviewed the proposal and that NEPC was supportive of staff's recommendation to renew the contract.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with Neuberger Berman LLC necessary to renew their contract for private equity advisory services, as presented, and authorization for contract execution by the Commissioner of Education.*

DISCUSSION ITEM

12. Presentation on the Permanent School Fund Risk Parity Asset Class (Board agenda page III-22)

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.

AQR Capital Management, LLC

Iwan Djanali, Vice President, Investor Relations

Yao Hua Ooi, Principal, Portfolio Management and Research

Bridgewater Associates, LP

Alan Bowser, Senior Client Advisor

Patrick Dimick, Portfolio Strategist

CONSENT ITEM

13. Permanent School Fund Logo Contest Contribution (Board agenda page III-23) [Consent agenda item #(11)]

Debbie Ratcliffe, executive director, SBOE support, provided an update on the Permanent School Fund Logo and acceptance of a donation of \$187.38 to cover part of the cost to replicate the winning design.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve acceptance of a donation to cover part of the cost to replicate the winning design of the Permanent School Fund Logo.*

DISCUSSION ITEM

14. Report of the Permanent School Fund Administrator and Chief Investment Officer (Board agenda page III-24)

Mr. Timmins provided the committee an update on PSF-related legislation being considered by the 86th Texas Legislature, Regular Session.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 1:14 p.m.