

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 20, 2017**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9 a.m. on Thursday, April 20, 2017, 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: David Bradley, Chair; Lawrence A. Allen, Jr.; Patricia Hardy; Tom Maynard, Vice Chair; Ken Mercer

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_1-31-17/ or in the information section (yellow pages) of the agenda.

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

ACTION ITEM

1. **Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract, §109.51, Uniform Depository Bank Bid or Proposal Form**
(Second Reading and Final Adoption)
(Board agenda page III-1)
[Official agenda item #11]

This item presents an amendment that would update the bank bid and proposal forms. David Marx, director of financial compliance, presented this item and explained that this amendment would provide flexibility for school districts and banks and generate competition. Mr. Marx said he has received positive feedback from school districts on this amendment.

MOTION AND VOTE: *It was moved by Mr. Mercer, 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 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract, §109.51, Uniform Depository Bank Bid or Proposal Form, with an effective date of 20 days after filing as adopted with the Texas Register.*

CONSENT ITEM

2. Adoption of Review of 19 TAC Chapter 109, Budgeting, Accounting, and Auditing

(Adoption of Review)

(Board agenda page III-41)

[Consent agenda item #(4)]

Mr. Marx presented this item. Mr. Marx explained that the item is a four-year rule review and his division is currently performing all of the tasks required by the rule.

MOTION AND VOTE: *It was moved by Mr. Mercer and carried unanimously to recommend that the State Board of Education adopt the review of 19 TAC Chapter 109, Budgeting, Accounting, and Auditing.*

DISCUSSION ITEM

3. Review of Permanent School Fund Securities Transactions and the Investment Portfolio

(Board agenda page III-65)

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 December 1, 2016 through February 28, 2017 unless otherwise noted. Ms. Civileto's report included reporting on the current fair market value of the Fund, the asset allocation mix as of February 28, 2017, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2016 through February 28, 2017 and the fiscal period beginning September 1, 2016 through February 28, 2017 the historical activity on the securities lending program through the fiscal period September 1, 2016, through February 28, 2017, 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 bond guarantee program, internal fixed income ratings for the fiscal period from September 1, 2016 through February 28, 2017, broker commissions on both the internal and external equity portfolios for the calendar year ending December 31, 2016 and the period beginning January 1, 2017 through February 28, 2017, 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 2016, January and February 2017

(Board agenda page III-57)

[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 to ratify the purchases and sales for the months of December 2016, January and February 2017, in the amount of \$820,188,573 and \$897,691,986 respectively (Attachment A).*

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, 2016

(Board agenda page III-67)

Holland Timmins, executive administrator and chief investment officer, introduced from the State Auditor's Office (SAO) Michael Clayton, audit manager, and Greg Adams, managing senior auditor, for presentation of the annual audit of the Permanent School Fund for the year ending August 31, 2016, and for presentation of results of the Certification of the Permanent School Fund's Bond Guarantee Program for fiscal year 2016.

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

Mr. Adams 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 FY2016 was within all regulatory limits established by the Texas Education Code (Section 45.053(a) and (d), and 45.0531(a) and (a-1)), 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-59)

[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 to the State Board of Education adoption of the annual report on the status of the Bond Guarantee Program as of August 31, 2016.*

DISCUSSION ITEM

7. Fourth Quarter 2016 Permanent School Fund Performance Report

(Board agenda page III-69)

Tom Heiner of BNY Mellon Global and Risk Solutions, presented the fourth 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 fourth quarter of 2016. He stated that the PSF returned 0.57% for the fourth quarter outperforming the target benchmark by one basis points. The Fund ranked in the 57th percentile or top of the third quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending December 31, 2016.

Mr. Heiner reviewed fourth quarter 2016 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite outperformed its benchmark by one basis points for the quarter. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by six basis points. He added that international equities returned -1.28% for the quarter, having underperformed its benchmark by three basis points during the period. The fixed income portfolio returned -2.74% for quarter, exceeding its benchmark by 24 basis points. Mr. Heiner stated that the Absolute Return composite returned 2.43% for the quarter, outperforming its benchmark, the HFRI Fund of Funds Composite Index, by 123 basis points. Mr. Heiner added that the Real Estate composite returned 1.97% for the quarter, outperforming its benchmark by 26 basis points. Mr. Heiner added that Total Risk Parity Strategies returned -2.02% in the fourth quarter of 2016, underperforming its benchmark by 312 basis points. He further stated that the Real Return Asset class returned -0.25% for the quarter, falling short of its benchmark by 36 basis points. He added that Emerging Market Debt returned -5.72% for the quarter, exceeding its benchmark by 37 basis points. Mr. Heiner stated that private equity returned 3.35% for the quarter, coming above its benchmark by 45 basis points. Finally, he stated that the total emerging market equity composite returned -3.91% for the fourth quarter 2016, outperforming its benchmark by 25 basis points.

CONSENT ITEMS

8. Decision on Real Estate Investments

(Board agenda page III-61)
[Consent agenda item #(7)]

The PSF real estate consultant, Courtland Partners, was represented by Michael Murphy, Managing Director, and Andrew Mitro, Vice President, and was joined by John Grubenman, director of private markets for the Permanent School Fund.

Mr. Murphy provided an introduction to a real estate investment recommendation, Ares US Real Estate Fund IX, L.P. offered by Ares US Real Estate IX Advisors, L.P., as General Partner. Mr. Mitro 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 provided an update on a co-investment recently executed. He reported that the transaction is in compliance with standards set forth in the real estate investment policy.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreement(s) with Ares US Real Estate IX Advisors, L.P., as General Partner, necessary to make an investment commitment of up to \$75 million in Ares US Real Estate Fund IX, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

9. Approval of the Selection of a Firm to Provide Investment Management Services for Long-Only Passive International Developed and Emerging Market Equity for the Texas Permanent School Fund and Authorization for Contract Execution by the Commissioner of Education

(Board agenda page III-63)
[Consent agenda item #(8)]

Mr. Timmins presented an update related to the RFP for Investment Management Services for Long-Only Passive International Developed and Emerging Market Equity for the Permanent School Fund.

The PSF general consultant, NEPC was represented by Keith Stronkowsky, senior consultant and joined by Karim Hirani, director of equities for the Permanent School Fund. They presented information about the search process.

The following two finalist firms gave presentations:

Blackrock Investment Management, LLC:

Obie McKenzie, Managing Director, Institutional Client Business
Alan Mason, Managing Director, Head of Americas of ETF & Index Investment Group Portfolio Management
Tim Murray, Director, Senior Strategist, ETF & Index Investment Group
Matt Waldron, Director, Senior Portfolio Manager, ETF & Index Investment Group
Nadia Patel, CFA, Vice-President, Institutional Client Business

Northern Trust Investments, Inc.:

Jason J. Tyler, Executive Vice President, Head of Institutional Client Solutions, Asset Management
Matthew Peron, Executive Vice President, Head of Global Equity, Asset Management
Brendan E. Sullivan, CFA, Vice President, Senior Portfolio Manager – International Equities, Asset Management
Melissa Galla, CFA, Senior Vice President, Investment Relationship Manager, Asset Management

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve a contract with Blackrock Investment Management, LLC for Investment Management Services for Long-Only Passive International Developed and Emerging Market Equity for the Texas Permanent School Fund and Authorization for Contract Execution by the Commissioner of Education.*

DISCUSSION ITEMS

10. Review of the Fixed Income Asset Class

(Board agenda page III-71)

Mr. Bradley called on Carlos Veintemillas, deputy chief investment officer, director of fixed income to give a presentation on the internally managed fixed income and real return asset classes. Bill Glenn, portfolio manager also participated in the presentation. The presentation covered the fixed income team, investment process, objectives, strategy, current portfolio characteristics and sector allocations, and performance.

11. Review of the Permanent School Fund Administrative Budget

(Board agenda page III-73)

No discussion occurred on this item.

12. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-75)

Mr. Timmins provided a brief update on a resolution passed by the General Land Office regarding distribution of funds to the available school fund and PSF related legislation.

13. Discussion of Proposed Amendment to 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, §105.1, Rules for the Definition of Tax Levy and Tax Collection
(Board agenda page III-77)

This item presents an amendment that would update the definition of tax collections to comply with Texas Tax Code. Al McKenzie, director of state funding, presented this item. Mr. McKenzie explained that this item was proposed at the recommendation of state auditors to comply with Texas Tax Code. Mr. McKenzie answered questions from Mr. Bradley regarding the item.

DISCUSSION ITEM

14. Discussion of Pending Litigation
(Board agenda page I-277)

This item was discussed as a committee of full board item.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 12:21 p.m.