

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
April 12, 2018**

(Permanent School Fund Items)

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:03 a.m. on Thursday, April 12, 2018, in Room #1-104 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. Attendance was noted as follows:

Present: David Bradley, chair; Tom Maynard, vice chair; Lawrence A. Allen, Jr.; Patricia Hardy

Absent: Ken Mercer

Public Testimony

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

DISCUSSION ITEM

1. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-41)

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, 2017 through February 28, 2018 unless otherwise noted. Ms. Civileto reported on the current fair market value of the Fund, the asset allocation mix as of February 28, 2018, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period beginning September 1 through February 28, 2018, the activity in the securities lending program for the fiscal period beginning September 1 through February 28, 2018, 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 calendar year ending December 31, 2017 and the period beginning January 1, 2018 through February 28, 2018, fixed income rating changes for the fiscal period beginning September 1, 2017 through February 28, 2018, and short-term cash investments.

CONSENT ITEM

2. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of December 2017, January and February 2018
(Board agenda page III-1)
[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, that the State Board of Education ratify the purchases and sales for the months of December 2017 and January and February 2018 in the amount of \$1,328,402,454 and \$1,428,787,057 respectively (Attachment A).*

DISCUSSION ITEM

3. 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, 2017

(Board agenda page III-43)

Mr. Bradley introduced Hillary Eckford, audit manager, and Bill Hunter, managing senior auditor, from the State Auditor's Office (SAO), for the presentation of the annual audit of the Permanent School Fund for the year ending August 31, 2017, and presentation of results of the Certification of the Permanent School Fund's Bond Guarantee Program for fiscal year 2017.

Mr. Hunter 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. Hunter 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 FY2017 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

4. Adoption of an Annual Report on the Status of the Bond Guarantee Program

(Board agenda page III-3)

[Consent agenda item #(3)]

Holland Timmins, executive administrator and chief investment officer, 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, 2017.*

DISCUSSION ITEM

5. Fourth Quarter 2017 Permanent School Fund Performance Report

(Board agenda III-45)

Tom Heiner, BNY Mellon Global and Risk Solutions, presented the fourth quarter 2017 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 2017. He stated that the PSF returned 3.87% for the fourth quarter outperforming the target benchmark by 18 basis points.

Mr. Heiner reviewed fourth quarter 2017 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 one basis point. Mr. Heiner added that Small/Midcap Equity portfolio outperformed its benchmark by

eight basis points. He added that international equities returned 5.31% for the quarter, underperforming the benchmark by eight basis points. The fixed income portfolio returned 0.53% for quarter, exceeding its benchmark by 14 basis points. Mr. Heiner stated that the Absolute Return composite returned 2.08% for the quarter, beating its benchmark, the HFRI Fund of Funds Composite Index, by one basis point. Mr. Heiner added that the Real Estate composite returned 3.03% for the quarter, outperforming its benchmark by 100 basis points. Mr. Heiner added that Total Risk Parity Strategies returned 4.45% in the third fourth of 2017, outperforming the benchmark by 33 basis points. He further stated that the Real Return Asset class returned 2.98% for the quarter, performing in line with its benchmark. He added that Emerging Market Debt returned 0.81% for the quarter, underperforming its benchmark by one basis point. Mr. Heiner stated that private equity returned 4.11% for the quarter, coming above its benchmark by 46 basis points. Finally, he stated that the total emerging market equity composite returned 6.83% for the fourth quarter 2017, underperforming its benchmark by 63 basis points.

CONSENT ITEMS

6. Decision on Real Estate Investments

(Board agenda page III-5)

[Consent agenda item #(4)]

The PSF real estate consultant, Courtland Partners, was represented by Tom Hester, senior vice president, joined by John Grubenman, director of private markets, and Ali Houshmand, portfolio manager.

Mr. Hester introduced a real estate investment recommendation, Kayne Anderson Real Estate Partners V, L.P. offered by Kayne Anderson Real Estate Advisors, LLC. Mr. Hester, Mr. Grubenman, and Mr. Houshmand 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: *By unanimous consent, the committee recommended that the State Board of Education approve execution of agreement(s) with Kayne Anderson Real Estate Advisors, LLC, necessary to make an investment commitment of up to \$75 million in Kayne Anderson Real Estate Partners V, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

7. Approval of an Extension of the Standard Contract with NEPC, LLC and Authorization for Contract Execution by the Commissioner of Education

(Board agenda page III-7)

[Consent agenda item #(5)]

Mr. Timmins stated the purpose of the item was for the committee and board to extend the standard contract with NEPC, LLC and authorization for contract execution by the commissioner of education.

MOTION AND VOTE: *By unanimous consent, the committee recommended that the State Board of Education approve renewal of the standard contract with NEPC, LLC beginning September 1, 2018 and ending August 31, 2021, and authorize contract execution by the Commissioner of Education.*

ACTION ITEMS

8. **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, §33.5, Code of Ethics**

(Second Reading and Final Adoption)

(Board agenda page III-9)

[Official agenda item #14]

Mr. Timmins called on Chuck Campbell, partner, Jackson Walker LLP and fiduciary counsel, to address the item. Mr. Campbell stated that PSF staff went through a lengthy process and worked with several individuals to update certain portions of the Statement of Investment Objectives, Policies, and Guidelines of the PSF to improve and clarify how the rule applies to investments of the Permanent School Fund in investment funds, particularly private investment funds.

Since first reading of the proposed amendments, the PSF staff sought input from the State Auditor's Office and the Texas Ethics Commission regarding the proposed amendments to the Board rules on ethics. Neither the State Auditor's Office nor the Ethics Commission recommended any changes.

MOTION AND VOTE: *By unanimous consent, the committee recommended 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 the 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, §33.5, Code of Ethics, with an effective date of 20 days after filing as adopted with the Texas Register.*

9. **Proposed Amendments 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, §33.15, Objectives, and §33.20, Responsible Parties and Their Duties**

(Second Reading and Final Adoption)

(Board agenda page III-27)

[Official agenda item #15]

Mr. Maynard called on Mr. Campbell to address the item. Mr. Campbell discussed the amendments to the calculation of the benchmark and the process and responsibilities for benchmark recommendations.

MOTION AND VOTE: *By unanimous consent, the committee recommended 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 the proposed amendments 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, §33.15, Objectives, and §33.20, Responsible Parties and Their Duties, with an effective date of September 1, 2018.*

CONSENT ITEMS

10. Review of Permanent School Fund Benchmarks

(Board agenda page III-37)
[Consent agenda item #(6)]

Rhett Humphreys, partner, NEPC was called to give a presentation on benchmarks used by the Permanent School Fund. The presentation provided an overview of the various total plan and asset class specific benchmarks. The discussion also covered different benchmark vendors, characteristics and methodologies.

11. Consider a Process to Obtain a PSF Logo and Potential Solution for Donations

(Board agenda page III-39)
[Consent agenda item #(7)]

Mr. Maynard presented a proposal to the committee related to creating PSF brand identity through a logo/seal design competition open to public school students. The committee unanimously agreed to move forward with the concept of obtaining a PSF logo and potential solution for donations.

DISCUSSION ITEMS

12. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer

(Board agenda page III-47)

Mr. Timmins noted that the committee received a memo from Moody's Investors Service. The memo reaffirmed the PSF credit rating.

13. Discussion on SB 253 of the 85th Legislative Session

(Board agenda page III-49)

Mr. Campbell provided the committee an update on SB 253 related to restrictions on certain investments of public money.

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