

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
February 1, 2018**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:15 a.m. on Thursday, February 1, 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; Ken Mercer

Public Testimony

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

ACTION ITEMS

1. Proposed Amendment to 19 TAC Chapter 109, Budgeting, Accounting, and Auditing, Subchapter D, Uniform Bank Bid or Request for Proposal and Depository Contract, §109.52, Uniform Depository Bank Contract and Surety Bond Forms

(Second Reading and Final Adoption)

(Board agenda page III-1)

[Official agenda item #10]

David Marx, director of financial compliance, presented this item. Mr. Marx explained that the proposed amendment would update the depository contract adopted in rule to reflect changes made by Senate bill SB 754. No changes are recommended since approved for first reading.

MOTION AND VOTE: *It was moved by Mr. Maynard, 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, §109.52, Uniform Depository Bank Contract and Surety Bond Forms.*

2. Proposed Amendment to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes

(Second Reading and Final Adoption)

(Board agenda page III-11)

[Official agenda item #11]

Mr. Marx explained that the proposed amendment would update the rule to reflect changes made by Senate Bill SB 1152, 85th Texas Legislature, Regular Session, 2017. No changes are recommended since approved for first reading.

MOTION AND VOTE: *It was moved by Mr. Maynard, 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 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes.

CONSENT ITEM

- 3. Adoption of Review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds**
(Adoption of Review)
(Board agenda page III-19)
[Consent agenda item #(1)]

Al McKenzie, director of state funding, presented this item. Mr. McKenzie explained that the rules being reviewed provide for the use of Foundation School Program (FSP) funds.

MOTION AND VOTE: *It was moved by Mr. Maynard and carried unanimously to recommend that the State Board of Education adopt the review of 19 TAC Chapter 105, Foundation School Program, Subchapter A, Definitions, and Subchapter B, Use of State Funds.*

DISCUSSION ITEM

- 4. Review of Permanent School Fund Securities Transactions and the Investment Portfolio**
(Board agenda page III-89)

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 October 1, 2017 through November 30, 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 November 30, 2017, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period beginning September 1 through November 30, 2017, the activity in the securities lending program for the fiscal period beginning September 1 through November 30, 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 program, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2017 through November 30, 2017, fixed income rating changes for the fiscal period beginning September 1, 2017 through November 30, 2017, and short-term cash investments.

CONSENT ITEM

- 5. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2017**
(Board agenda page III-27)
[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 October and November 2017, in the amount of \$994,491,789 and \$1,045,014,658 respectively (Attachment A).*

DISCUSSION ITEMS

6. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio

(Board agenda page III-91)

Holland Timmins, executive administrator and chief investment officer, provided the required attestation regarding the compliance with 19 TAC Chapter 33 of the internally managed investment portfolios in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

7. Third Quarter 2017 Permanent School Fund Performance Report

(Board agenda page III-95)

Michael Burke of BNY Mellon Global and Risk Solutions, presented the third quarter of 2017 Permanent School Fund performance report. Mr. Burke began with an overview of the U.S and foreign capital markets. Mr. Burke then reviewed the performance of the Fund for the third quarter of 2017. He stated that the PSF returned 3.72% for the third quarter outperforming the target benchmark by 12 basis points. The Fund ranked in the 42nd percentile or second quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending September 30, 2017.

Mr. Burke reviewed third quarter 2017 performance of the Permanent School Fund by asset class, stating that the total domestic large cap equity composite performed in line with its benchmark for the quarter. Mr. Burke added that Small/Midcap Equity portfolio outperformed its benchmark by two basis points. He added that international equities returned 6.47% for the quarter, exceeding its benchmark by three basis points during the period. The fixed income portfolio returned 0.93% for quarter, exceeding its benchmark by eight basis points. Mr. Burke stated that the Absolute Return composite returned 1.83% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 76 basis points. Mr. Burke added that the Real Estate composite returned 2.47% for the quarter, outperforming its benchmark by 19 basis points. Mr. Burke added that Total Risk Parity Strategies returned 4.02% in the third quarter of 2017, outperforming its benchmark by 100 basis points. He further stated that the Real Return Asset class returned 1.81% for the quarter, beating its benchmark by 12 basis points. He added that Emerging Market Debt returned 4.14% for the quarter, outperforming its benchmark by 59 basis points. Mr. Burke stated that private equity returned 3.74% for the quarter, coming above its benchmark by 33 basis points. Finally, he stated that the total emerging market equity composite returned 7.74% for the third quarter 2017, underperforming its benchmark by 15 basis points.

CONSENT ITEMS

8. Decision on Real Estate Investments

(Board agenda page III-29)

[Consent agenda item #(3)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick, Principal/Chief Operating Officer and Tom Hester, Senior Vice President. Mr. Novick provided an update on the firm. He described the acquisition of the Courtland Partners, Ltd. by StepStone Group Real Estate L.P. Mr. Novick explained that the transaction was announced on January 9, 2018 and further explained that the transaction was expected to close by the end of March 2018, subject to customary closing conditions.

Mr. Novick, joined by John Grubenman, director of private markets and Ali Houshmand, portfolio manager introduced a real estate investment recommendation, AG Europe Realty Fund II, LP offered by AGR Europe II, 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: *The committee recommended to the State Board of Education approval to execute agreement(s) with AGR Europe II, L.L.C., necessary to make an investment commitment of up to \$75 million in AG Europe Realty Fund II, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

Mr. Hester, Mr. Grubenman, and Kathryn Gernert, portfolio manager introduced a real estate investment recommendation, Invesco Strategic Opportunities III, LP offered by Invesco Strategic Opportunities III GP, LLC. Mr. Hester, Mr. Grubenman, 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 to the State Board of Education approval to execute agreement(s) with Invesco Strategic Opportunities III G.P., L.L.C., necessary to make an investment commitment of up to \$75 million in Invesco Strategic Opportunities III, L.P., subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education.*

Mr. Grubenman provided a report on the real estate co-investment program, including an update on the recent transaction activity. He reported that the transaction is in compliance with standards set forth in the real estate investment policy.

9. Presentation on the Commodities Asset Class for the Permanent School Fund

(Board agenda page III-31)

[Consent agenda item #(4)]

Carlos Veintemillas, deputy chief investment officer, director of fixed income gave an update on the commodities asset class structure and the capabilities needed to manage a commodities strategy internally. Rhett Humphreys, partner at NEPC, introduced Erin Faccone, Operational Due Diligence Consultant with NEPC. Ms. Faccone discussed the findings from her operational due diligence review and concluded with NEPC's recommendation that a portion of the real return allocation to Commodities could be managed internally by PSF staff.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval of a \$175 million allocation to Commodities to be managed by internal staff.*

10. 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

(First Reading and Filing Authorization)

(Board agenda page III-33)

[Consent agenda item #(5)]

Mr. Bradley called on Chuck Campbell, partner with Jackson & Walker 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.

MOTION AND VOTE: *By unanimous consent, the committee approved for first reading and filing authorization 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, §33.5, Code of Ethics.*

ACTION ITEMS

11. 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, §33.65, Bond Guarantee Program for School Districts, and §33.67, Bond Guarantee Program for Charter Schools

(Second Reading and Final Adoption)

(Board agenda page III-51)

[Official agenda item #12]

Mr. Bradley called on Mr. Timmins to address the item. Mr. Timmins introduced the individuals who were invited for testimony.

Invited Testimony:

Annette Folmar, Chief Financial Officer, Hays CISD

Chris Scott, Executive Director of Business Services, Eanes ISD

Tom Sage, Andrews Kruth

Mr. Timmins noted that no changes were recommended since the approval of first reading.

MOTION AND VOTE: *By unanimous consent by affirmative vote of two-thirds of the members of the board, approve for second reading and final adoption 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 §33.65, Bond Guarantee Program for School Districts, and §33.67, Bond Guarantee Program for Charter Schools, with an effective date of 20 days after filing as adopted with the Texas Register .*

12. 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

(First Reading and Filing Authorization)

(Board agenda page III-77)

[Official agenda item #13]

Mr. Campbell introduced the item. He stated the purpose of the amendments was to update the rate of return objective of the PSF and provide clarifying language. Mr. Campbell provided an overview of the process that occurred to develop the rule amendments.

MOTION AND VOTE: *By unanimous consent, the committee recommended the board suspend the board operating procedures in accordance with §5.2(a) to allow consideration for first reading and filing authorization; and approve for first reading and filing authorization 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.

CONSENT ITEM

13. Review of Permanent School Fund Benchmarks

(Board agenda page III-87)

[Consent agenda item #(6)]

Discussion on this item was tabled until the April 2018 board meeting.

DISCUSSION ITEM

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

(Board agenda page III-97)

Mr. Timmins updated the committee that there were no disclosures submitted for the 2017 third quarter reporting period that involved PSF assets.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 12:55 p.m.