

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
June 22, 2017**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:05 a.m. on Thursday, June 22, 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; Tom Maynard, Vice Chair; Lawrence A. Allen, Jr.; Patricia Hardy

Absent: 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.

CONSENT ITEM

1. 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

(First Reading and Filing Authorization)

(Board agenda page III-1)

[Consent agenda item #(2)]

Leo Lopez, chief school finance officer, presented this item. This item would amend the definition of tax collections to comply with Texas Tax Code. Mr. Lopez answered questions from Mr. Bradley regarding the amendment.

MOTION AND VOTE: *It was moved by Mr. Bradley and carried unanimously to recommend that the State Board of Education approve for first reading and filing authorization the 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.*

DISCUSSION ITEM

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

(Board agenda page III-17)

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 March 1, 2017 through April 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 April 30, 2017, PSF transactions occurring in the reporting period, revenues and expenditures for the fiscal period September 1, 2016 through April 30, 2017, the historical activity on the securities lending program for the fiscal period September 1, 2016, through April 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 bond guarantee program, broker commissions on both the internal and external equity portfolios for the period beginning January 1, 2017 through April 30, 2017, internal fixed income ratings for the fiscal period from September 1, 2016 through April 30, 2017 and short-term cash investments for March and April 2017.

CONSENT ITEM

3. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of March and April 2017

(Board agenda page III-5)

[Consent agenda item #(3)]

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 March and April 2017, in the amount of \$709,522,829 and \$706,821,627 respectively (Attachment A).*

DISCUSSION ITEM

4. First Quarter 2017 Permanent School Fund Performance Report

(Board agenda page III-19)

Tom Heiner of BNY Mellon Global and Risk Solutions, presented the first quarter of 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 first quarter of 2017. He stated that the PSF returned 4.51% for the first quarter outperforming the target benchmark by 31 basis points. The Fund ranked in the 32nd percentile or top of the second quartile of the Mellon Universe of Public Funds greater than \$1.0 billion for the 3-month period ending March 31, 2017.

Mr. Heiner reviewed first quarter 2017 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 four basis points. He added that international equities returned 8.49% for the quarter, exceeding its benchmark by seven basis points during the period. The fixed income portfolio returned 1.24% for quarter, exceeding its benchmark by 42 basis points. Mr. Heiner stated that the Absolute Return composite returned 1.92% for the quarter, underperforming its benchmark, the HFRI Fund of Funds Composite Index, by 26 basis points. Mr. Heiner added that the Real Estate composite returned 2.09% for the quarter, outperforming its benchmark by 42 basis points. Mr. Heiner added that Total Risk Parity Strategies returned 3.85% in the first quarter of 2017, underperforming its benchmark by ten basis points. He further stated that the Real Return Asset class returned -0.23% for the quarter, beating its benchmark by 31 basis points. He added that Emerging Market Debt returned -7.47% for the quarter, exceeding its benchmark by 97 basis points.

Mr. Heiner stated that private equity returned 4.81% for the quarter, coming above its benchmark by 198 basis points. Finally, he stated that the total emerging market equity composite returned 11.92% for the first quarter 2017, outperforming its benchmark by 48 basis points.

CONSENT ITEMS

5. Update on Permanent School Fund Related Legislation

(Board agenda page III-7)

[Consent agenda item #(4)]

Mr. Bradley called on Holland Timmins, chief investment officer and executive administrator to address the item. Mr. Timmins began with House Bill 89, 85th Regular Session, and summarized the provisions of the bill. Chuck Campbell, fiduciary counsel, commented on HB 89 and the concept of social investing in light of fiduciary duty. Mr. Campbell stated that the bill does contain a provision that would not subject the Permanent School Fund to the bill's requirements if the State Board of Education determined that such action would be inconsistent with its fiduciary duty.

Mr. Timmins then summarized the provisions of Senate Bill 253, 85th Regular Session. Mr. Campbell stated that since the bill applies to entities subject to the Texas Public Funds Investment Act (PFIA) and the PSF has historically not been treated as being subject to the PFIA, then the bill most likely did not apply to the PSF.

Mr. Timmins summarized the provisions of Senate Bill 1480, 85th Regular Session. Mr. Bradley asked questions about future actions based on the bill.

The committee did not take any action with regard to any of the legislation.

6. Decision on Real Estate Investments

(Board agenda page III-9)

[Consent agenda item #(5)]

The PSF real estate consultant, Courtland Partners, was represented by Steve Novick (via teleconference), principal/chief operating officer and Andrew Mitro, senior vice president/principal, joined by John Grubenman, director of private markets for Permanent School Fund. Mr. Grubenman introduced two real estate investment recommendations.

Mr. Mitro presented a series of recommendations with respect to PSF's Core real estate portfolio as follows: 1) a full redemption of UBS (US) Trumbull Property Fund LP managed by Trumbull Property Fund G.P., LLC, 2) a recommendation to commit additional capital to Prime Property Fund, LLC, managed by Morgan Stanley Real Estate Inc, and 3) a recommendation to commit additional capital to Invesco Core Real Estate – U.S.A., L.P., managed by IRI Core I, L.P. 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. Mitro presented a recommendation of the Prologis Targeted U.S. Logistics Holdings II, L.P., a U.S. dollar denominated fund offered by Prologis, L.P., a U.S. based, Delaware limited partnership. 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 stated that the board would need to approve a waiver of the requirement for service providers to be registered with the Securities and Exchange Commission.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval to execute agreements:*

- *with Trumbull Property Fund G.P., LLC, to effect a 100% redemption of interests in the UBS (US) Trumbull Property Fund LP, and authorization for contract execution by the Commissioner of Education; and,*
- *with Morgan Stanley Real Estate Advisor Inc., as manager, necessary to make an investment commitment of up to \$225 million in Prime Property Fund, LLC, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education; and,*
- *with IRI Core I, L.P., as general partner, necessary to make an investment commitment of up to \$75 million in Invesco Core Real Estate – U.S.A., L.P., 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 Prologis, L.P., as General Partner, necessary to make an investment commitment of up to \$100 million in Prologis Targeted U.S. Logistics Holdings II, L.P., a U.S. dollar denominated fund, subject to continued due diligence and negotiation of fund terms, and authorization for contract execution by the Commissioner of Education, and to approve a waiver of the PSF Real Estate Investment Policy Statement requirement for the investment manager to be registered as an investment advisor.*

7. Review of the Permanent School Fund Private Market Policies and Real Estate Tactical Plan
(Board agenda page III-11)
[Consent agenda item #(6)]

Mr. Mitro, Mr. Novick, and Mr. Grubenman presented the item. Mr. Grubenman discussed a proposed clarifying language change to one provision in the *Real Estate Investment Policy Statement*. Additionally, as required per the *Real Estate Investment Policy Statement*, Mr. Grubenman, Mr. Novick and Mr. Mitro provided an annual update of the *Real Estate Tactical Plan*.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education to approve the proposed change to the Real Estate Investment Policy Statement and to approve the Real Estate Annual Tactical Plan.*

Mr. Grubenman discussed a proposed change to the *Private Equity Investment Policy and Guidelines*.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education to approve the proposed change to the Private Equity Investment Policy and Guidelines.*

8. Proposed Amendments to the Investment Procedures Manual

(Board agenda page III-13)

[Consent agenda item #(7)]

Carlos Veintemillas, deputy chief investment officer, director of fixed income provided an overview of the amendments made to the investment procedures manual.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education approval of the amendments to the Investment Procedures Manual as presented by staff.*

9. Selection of Qualified Respondents to the Request for Qualifications (RFQ) for Fiduciary Counsel, Alternative Assets Portfolio/Contracting and Tax Counsel for the Permanent School Fund

(Board agenda page III-15)

[Consent agenda item #(8)]

Ms. Civiletto presented this item to the committee. She explained the RFQ process to the committee and presented the list of all qualified law firms who were evaluated to provide fiduciary counsel, investment contracting counsel, real estate counsel, tax counsel and disclosure counsel. Ms. Civiletto presented the list of qualified respondents and recommended that the list be accepted by the committee for all services.

The two firms who applied for fiduciary counsel services made presentations for the purpose of the committee making a selection for the fiduciary category. The firms were:

Jackson Walker, L.L.P.

Squire Patton Boggs U.S. L.L.P.

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education, approve the list of qualified respondents for the categories of fiduciary counsel, investment contracting, real estate, tax and disclosure counsel.*

MOTION AND VOTE: *By unanimous consent, the committee recommended to the State Board of Education, to approve a contract with Jackson Walker L.L.P. for fiduciary counsel services and authorization for contract execution by the Commissioner of Education.*

DISCUSSION ITEMS

10. Review of the Public Market Equities Asset Classes

(Board agenda page III-21)

Karim Hirani, director of equities gave a presentation on the internally and externally managed public equities asset classes. The presentation covered the equity team, investment process, objectives, strategy, current portfolio characteristics, and performance.

11. Review of the Permanent School Fund Administrative Budget

(Board agenda page III-23)

Ms. Civiletto introduced the item providing the committee an overview of the Permanent School Fund's budget. Additionally, Patricia Molina, budget analyst, TEA budget, and planning discussed the administrative expenditures as they apply to TEA's agency overhead.

12. Presentation of the Permanent School Fund's Current Asset Allocation

(Board agenda page III-25)

Rhett Humphreys, partner at NEPC, gave a presentation on the 2017 Asset Allocation Review. He discussed shorter-term and longer-term risk and return forecasts for the different asset classes.

Mr. Timmins presented a review of the Permanent School Fund asset allocation. He also discussed net performance and value add for each asset class.

13. Review of the Request for Proposal (RFP) Process

(Board agenda page III-27)

Ms. Civiletto presented this item to the committee. She explained the procurement processes the SBOE has authority over pursuant to 19 TAC Chapter 33. The presentation included brief overviews of the types of procurement; the steps taken by the SBOE, Committee, and PSF Staff in developing a competitive solicitation; critical dates for solicitation; an example of qualifications and selection criteria; and information regarding a sample upcoming SBOE procurement.

Mr. Humphreys provided further detail as to the procurement process with regard to interviews and recommendations of qualified respondents to the competitive solicitations.

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

(Board agenda page III-29)

Mr. Timmins had no report for the committee.

CONSENT ITEM

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

(Board agenda page III-16A)

[Consent agenda item #(9)]

Mr. Lopez presented this item. This item proposed an update to the preliminary per capita apportionment rate from \$390.186 to \$390.300. Mr. Lopez answered questions from Mr. Bradley regarding the per capita apportionment rate.

MOTION AND VOTE: *It was moved by Mr. Bradley and carried unanimously to recommend that the State Board of Education adopt a per capita rate of \$390.300 for the 2016-2017 school year.*

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 2:55 p.m.