

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
January 20, 2011**

The State Board of Education Committee on School Finance/Permanent School Fund met at 2:33 p.m. on Thursday, January 20, 2011, in Room #1-100 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. All members of the committee were present, as follows:

Presiding: Pat Hardy, chair; Lawrence A. Allen, Jr., David Bradley, Bob Craig, Thomas Ratliff

Non-Committee Members Present: Mavis B. Knight, Gail Lowe, 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://www.tea.state.tx.us/index4.aspx?id=3958> 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. Election of Chair
(No agenda exhibit)

Mr. Bradley, acting as temporary chair, brought the meeting to order and asked for nominations for the position of committee chair.

MOTION AND VOTE: *It was moved by Mr. Craig and carried unanimously to elect Ms. Hardy as chair of the Committee on School Finance/Permanent School Fund.*

Mr. Ratliff stated for the record that he was submitting the names of publicly traded companies that he represents before the legislature. They are as follows: (1) AIG (2) El Paso Electric Company (3) Microsoft (4) Orchid CellMark (5) T-Mobile and (6) Reed Elsevir.

DISCUSSION ITEM

2. Review of Permanent School Fund Securities Transactions and the Investment Portfolio
(Board agenda page III-7)

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

October 1, 2010 through November 30, 2010 unless otherwise noted. Ms. Civiletto reported on the current fair market value of the Fund, the asset allocation of the Fund, PSF transactions occurring in the reporting period, revenues and expenditures of the Fund fiscal year to date through November 30, 2010, historical summary of revenues and contributions of General Land Office managed real estate assets through November 30, 2010, cumulative activity for the fiscal year in the securities lending program, current status of the Bond Guarantee Program and the available capacity in the program, proxy votes against management, details of purchases and sales on all portfolios, and broker commissions for internal equity portfolios cumulative for the period January 1, 2010 through November 30, 2010 and the same for the international equity program, and short term cash management activity

CONSENT ITEM

- 3. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of October and November 2010**
(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 to ratify the purchases and sales for the months of October and November 2010 in the amount of \$879,252,026 and \$809,892,535 respectively (Attachment A). Mr. Ratliff recused himself from the vote.*

DISCUSSION ITEMS

- 4. Annual Reporting Requirement of the Internally Managed Permanent School Fund Investment Portfolio**
(Board agenda page III-9)

Mr. Timmins provided the required certification regarding the compliance with 19 TAC Chapter 33 of the internally managed investment portfolio in the matters of permissible and restricted investments, trading and brokerage policy, and proxy voting policy.

- 5. Presentation by BlackRock Investment Management, LLC on Investment Management Services Provided to the Permanent School Fund**
(Board agenda page III-11)

Obie McKenzie, Managing Director of BlackRock Investment introduced his colleagues Christopher Bliss, Managing Director and Sara Shores, Director. Mr. McKenzie gave the committee a brief overview and update of BlackRock. Mr. Bliss and Ms. Shores provided the committee an update on the portfolio.

ACTION ITEMS

6. **Decision on Real Estate Investments**

(Board agenda page III-3)

[Official agenda item #9]

Ms. Hardy introduced the item. Mr. Steve Novick, principal/chief operating officer of Courtland Partners, Dan Moore, senior analyst of Courtland Partners, and John Grubenman, director of private market investments of the PSF, joined the discussion. Mr. Novick provided a brief history and updated the status of the real estate program. Mr. Novick explained to the committee that the investments approved at the September board meeting, managed by Angelo Gordon, had experienced a material event. Mr. Novick and Mr. Grubenman stated that Courtland and PSF staff would continue to review information provided by the manager and would complete due diligence prior to executing the commitments previously approved by the board.

Mr. Novick reported to the committee that the real estate program may benefit if the qualified pool of real estate opportunities were refreshed. He stated that Courtland and PSF staff recommended that RFQ 701-09-027 be reopened. The committee directed that the item be placed on the agenda at the next scheduled board meeting.

Mr. Moore presented two proposed investments to the committee, including the evaluation and due diligence activities of Courtland and PSF staff. He first introduced *Cornerstone Real Estate Fund VIII, L.P.* Next, Mr. Moore introduced *L&B Core Income Partners, L.P.* For each, Mr. Moore explained the objectives and constraints, terms and fees, and benefits and concerns of the fund. Mr. Moore and Mr. Grubenman described the in-depth due diligence activities conducted by both Courtland and PSF staff, including on-site visits and reference calls.

MOTION AND VOTE: *It was moved by Mr. Craig, seconded by Mr. Ratliff, and carried unanimously to recommend to the State Board of Education approval to execute agreement(s) with Cornerstone Real Estate Advisers LLC, necessary to make an investment commitment of up to \$50 million in Cornerstone Real Estate Fund VIII, L.P. and with L&B Realty Advisors LLP, necessary to make an investment commitment of up to \$75 million in L&B Core Income Partners, L.P., subject to continued due diligence and negotiation of fund terms.*

7. **Decision on Absolute Return Investments**

(Board agenda page III-5)

[Official agenda item #10]

Ms. Hardy introduced the item. Mr. Timmins invited Keith Stronkowsky, consultant at NEPC, to join him. Mr. Timmins walked through the absolute return strategy presentation. Mr. Timmins concluded the presentation by making the following recommendations:

- (1) Place K2 Advisors on the Watch List as per Section F(6) in the Investment Procedures Manual.
- (2) Execute contract with GAM.
- (3) Terminate Goldman Sachs once a new contract with GAM is in place.
- (4) Rebalance the absolute return strategy weighting up to 10% of the Permanent School Fund.
- (5) Equalize allocations to Mesirov and GAM with each managing at least \$300 million.

Mr. Stronkowsky expressed that these actions would move the global macro allocation within the range recommended by NEPC.

MOTION AND VOTE: *It was moved by Mr. Craig and carried unanimously to recommend to the State Board of Education approval of the recommendations made by Mr. Timmins.*

DISCUSSION ITEM

8. Report of the Permanent School Fund Executive Administrator and Chief Investment Officer
(Board agenda page III-13)

Mr. Timmins updated the committee on three items. He informed the committee that the School Land Board approved a resolution on January 5, 2011 to provide \$500 million during the 2012-2013 fiscal years. He also informed the committee about the compliance reports related to transactions between service providers. All required respondents filed the forms and there were no reports indicating transactions between service providers related to PSF assets. Mr. Timmins also provided a copy of a letter from NEPC which gives an update on the firm.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 4:40 p.m.