

**Report of the State Board of Education
Committee on School Finance/Permanent School Fund
March 25-26, 2009**

The State Board of Education Committee on School Finance/Permanent School Fund met at 9:07 a.m. on Wednesday, March 25, 2009, in Room #1-111 of the William B. Travis Building, 1701 N. Congress Avenue, Austin, Texas. All members of the committee were present, as follows:

Presiding: David Bradley, chair; Rick Agosto, vice chair; Cynthia Dunbar, Gail Lowe, Rene Nuñez

Non-Committee Members Present: Pat Hardy

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.

On Wednesday, March 25, the committee considered items in the following order: Items #4 through #8.

ACTION ITEMS

**1. 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-1)

[Official agenda item #9]

Belinda Dyer, director of forecasting and fiscal analysis, presented the item for second reading and final adoption.

MOTION AND VOTE: *By unanimous consent, the committee voted 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 the proposed amendments to 19 TAC Chapter 129, Student Attendance, Subchapter B, Student Attendance Accounting, §129.21, Requirements for Student Attendance Accounting for State Funding Purposes, with an effective date of 20 days after filing as adopted with the Texas Register.*

2. Proposed Amendment to 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts, §30.21, Historically Underutilized Business (HUB) Program

(Second Reading and Final Adoption)

(Board agenda page III-7)

[Official agenda item #10]

Shirley Beaulieu, associate commissioner for finance and chief financial officer, presented the item for second reading and final adoption.

MOTION AND VOTE: *By unanimous consent, the committee voted 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 the proposed amendments to 19 TAC Chapter 30, Administration, Subchapter B, State Board of Education: Purchasing and Contracts, §30.21, Historically Underutilized Business (HUB) Program, with an effective date of 20 days after filing as adopted with the Texas Register.*

3. Proposed Ratification of Increase in the Reserve for the Guarantee Program for School District Bonds

(Board agenda page III-11)

[Official agenda item #11]

Lisa Dawn-Fisher, deputy associate commissioner for school finance, presented the item for ratification of the increase in the reserve capacity of the Bond Guarantee Program from 5 percent to 8 percent.

MOTION AND VOTE: *It was moved by Mr. Agosto and carried unanimously to ratify the 8 percent reserve and to place this item on the consent agenda of the State Board of Education meeting of March 27, 2009.*

DISCUSSION ITEM

4. Report by Weaver & Tidwell on the Audit of the Permanent School Fund's Financial Statements for the Period Ending August 31, 2008

(Board agenda page III-25)

Mr. Bradley asked Holland Timmins, executive administrator and chief investment officer, for the reason an annual audit is required for the Permanent School Fund. Mr. Timmins noted there were two reasons: (1) the size of the Fund and (2) PSF is guarantor of school bonds through the Bond Guarantee Program and the buyers of the bonds require an independent annual audit.

Kevin Sanford, Audit Senior Manager, Weaver & Tidwell, L.L.P., presented the results of the annual audit of Permanent School Fund for the year ending August 31, 2008. Also present from Weaver & Tidwell were Bob Loritz, Partner and Laura Lambert, Senior. Mr. Sanford thanked the board for the opportunity and the Permanent School Fund staff for their cooperation during the audit process. Mr. Sanford informed the committee that Weaver and Tidwell issued an unqualified opinion on the financial statements of the Permanent School Fund for the fiscal year ended

August 31, 2008. In response to Mr. Bradley's question regarding what an unqualified opinion means, Mr. Sanford noted that no material misstatements were found during the audit and that the financial statements are materially correct. Mr. Sanford then briefly reviewed the Balance Sheet and the Statement of Revenues, Expenditures and Fund Balance, noting the value of the Fund at 8/31/08 and the change in value during the fiscal year. Mr. Sanford noted that the PSF real estate assets managed by the General Land Office are included in the annual report and valued at historical cost. Mr. Sanford further noted that a new standard issued by the Governmental Accounting Standards Board, GASB Statement 52, will require that these real estate assets be valued and reported at fair market value in next year's financial report.

ACTION ITEMS

5. Search for Outside Legal Counsel for the Permanent School Fund (Board agenda page III-13) [Official agenda item #12]

David Anderson, general counsel, and David Mattax, division chief, financial litigation, Office of the Attorney General, presented this item. Mr. Anderson introduced Mr. Mattax to the committee as being a knowledgeable representative from the Office of the Attorney General (OAG) who could answer questions about hiring outside counsel for securities litigation and the use of contingent fee payments when hiring such. Mr. Mattax explained the process, procedures, and statutes that govern both these matters and answered questions from the committee. He stated that the OAG has the authority to perform all legal work required by the SBOE, but can delegate to qualified outside law firms when the OAG lacks the expertise or resources necessary to perform the work. The OAG is required to approve all contracts with recommended outside counsel firms. In all instances, there must be Texas licensed attorneys working on the project who know and are familiar with Texas law and who possess the requisite expertise.

Mr. Mattax stated that for securities litigation, monitoring the marketplace and calculating potential losses for claims are services that both qualified law firms can provide, as well as certain investment industry vendors. These vendor services do not constitute legal advice and can only serve the purpose of providing analysis and spotting potential litigation opportunities. The board can consider hiring such outside vendors, outside counsel on an hourly fee basis, or possibly expanding the scope of the current fiduciary counsel contracts to obtain these monitoring services. In either instance of hiring outside counsel or expanding the scope of the existing contracts, the OAG would have a significant role in the approval process.

Mr. Mattax further stated that if the need arises to pursue litigation to protect the Fund's assets, each litigation case is authorized by the OAG on a case by case basis, with the OAG reserving the right to litigate on behalf of the Fund without hiring outside counsel. Additionally, contingency fee contracts may be authorized for specific litigation matters, but they must be approved by the Legislative Budget Board (LBB) and these are handled on a case by case basis. The LBB can establish the terms and conditions of the contingency; including setting upper limits on the amounts the outside counsel can get compensated.

Mr. Bradley concluded the discussion by requesting that the primary fiduciary counsel, Strasberger & Price, meet with the committee.

6. Decision on a Real Estate Policy Statement

(Board agenda page III-15)

[Official agenda item #13]

Mr. Bradley introduced this item and noted that this is an action item for the board. He invited representatives of R.V. Kuhns Associates, Inc., including Becky Gratsinger, CEO and senior consultant and Jim Voytko, president and COO, director of research and senior consultant, to participate in the discussion of the agenda item. Mr. Bradley then asked Steve Novick, principal/chief operating officer of Courtland Partners, Benjamin Blakney, managing director of Courtland Partners, and Dan Moore CFA, senior analyst, to begin their presentation.

Mr. Novick began by stating that Courtland's presentation would cover the Real Estate Investment Policy Statement (IPS), an Annual Tactical Recommendation, and a Real Estate Market Overview. He stated that Courtland had worked with staff in the preparation of each of the items and that R.V. Kuhns had also reviewed the IPS.

Mr. Novick reviewed the details of the IPS, which includes the purpose and amount of the real estate allocation of the fund, the objectives of the real estate program, investment guidelines, and requirements on diversification of the real estate investments in the program. Mr. Novick stated that Courtland's recommended strategic and tactical allocations provide for higher allocations to non-core real estate investments including value, opportunistic, and international investments, and therefore, for the purposes of the IPS, Courtland recommended that the benchmark of the program to be the NCREIF Property Index plus 100 basis points.

Mr. Novick stated that commercial real estate properties have experienced significant declines in value recently and that Courtland expected further declines in the upcoming quarters, which could present a favorable investment opportunity for the PSF. He additionally described that the value investments recommended by Courtland would primarily be "repositioning" opportunities of former "core" investments, not "redevelopment" or "development" opportunities.

Mr. Novick and Mr. Blakney stated that Courtland and staff had held discussions regarding procedures for the real estate program, including constraints related to the procurement of managers. Mr. Timmins distributed to the committee a memorandum from Jeff Armstrong, TEA legal counsel, which reviewed the draft procedures that had been prepared by Courtland. Mr. Bradley asked Mr. Anderson to further discuss statutory constraints regarding procurement of managers. There was lengthy discussion regarding potential approaches to the screening and selection of investment managers for the real estate program.

MOTION AND VOTE: *It was moved by Mr. Nuñez, seconded by Mr. Agosto, and carried unanimously to recommend to the State Board of Education approval of the Texas Permanent School Fund Real Estate Investment Policy Statement dated March 2009 and the placement of this item on the consent agenda of the State Board of Education meeting of March 27, 2009.*

DISCUSSION ITEM

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

(Board agenda page III-27)

Catherine Civileto, deputy executive administrator, provided a summary of the status of the Permanent School Fund portfolio. All reports presented to the Committee were for the reporting period December 1, 2008 through January 31, 2009, unless otherwise noted. This included the current fair market value of the Fund, the asset allocation mix as of January 31, 2009, PSF transactions summary, income and portfolio gains/losses and expenditures for the period September 1, 2008 through January 31, 2009, GLO managed real estate assets summary of revenues and contributions to the Fund for the period pre 1982 to January 2009, securities lending activity, Bond Guarantee Program Status Report, the proxy votes against management provided by the proxy vendor RiskMetrics Group, details of purchases and sales on all portfolios, including the absolute return assets, internal fixed income rating changes for the period September 1, 2008 through January 31, 2009, broker commissions cumulative for the period January 1, 2009 through January 31, 2009 and activity in the short term investment assets.

CONSENT ITEM

8. Ratification of the Purchases and Sales of the Investment Portfolio of the Permanent School Fund for the Months of December 2008 and January 2009

(Board agenda page III-17)

[Consent agenda item #(1)]

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 2008 and January 2009 in the amount of \$667,387,330 and \$658,796,495 respectively (Attachment A).*

The meeting recessed at 11:50 a.m. The Committee on School Finance/Permanent School Fund reconvened on Thursday, March 26, at 6:43 p.m. All members of the committee were present. The committee considered items in the following order: Items #1 through #3; and #9 through #13.

ACTION ITEMS

9. Authorization to Issue a Request for Proposals for Global Custody and Securities Lending Services for the Permanent School Fund

(Board agenda page III-19)

[Official agenda item #14]

Mr. Timmins presented the Request for Proposal for Global Custody and Securities Lending Services with the modifications requested by the committee at the February 20 meeting. Mr. Timmins and Mrs. Gratsinger responded to questions about the RFP. The proposals will include separate pricing for each service provided.

Mr. Timmins reviewed the timeline in the RFP. Selection is on the calendar for July 17, 2009.

MOTION AND VOTE: *It was moved by Mr. Agosto, seconded by Mrs. Dunbar, and carried unanimously to recommend to the State Board of Education approval to issue a Request for Proposals for Global Custody and Securities Lending Services for the Permanent School Fund and the placement of this item on the consent agenda of the State Board of Education meeting of March 27, 2009.*

10. Authorization to Issue a Request for Proposals for a Private Equity Discretionary Separate Account Manager

(Board agenda page III-21)

[Official agenda item #15]

Mr. Timmins presented the modified draft of RFP #701-09-021 for a Private Equity Discretionary Separate Account Manager. This draft RFP was developed at the direction of the board to replace the closed procurement process associated with RFP #701-08-053 for Private Equity Specialist Advisor and/or Fund-of-Funds Manager. Mr. Timmins stated that, at the direction of the committee, the draft was modified to revert to the minimum proposer qualifications from the original RFP.

In response to a question from Mr. Bradley, Mr. Timmins discussed the proposed schedule for review of the RFP responses and the subsequent selection of finalist candidates. Mr. Agosto proposed that the committee appoint a subcommittee to participate in the initial review process and in the selection of the firms that would participate in the Austin interviews. Mr. Bradley stated that staff would report to the committee following the conclusion of the RFP submission period and that the committee could discuss the need for a subcommittee at that time.

The committee directed staff to make minor technical changes to the RFP.

MOTION AND VOTE: *It was moved by Mr. Agosto, seconded by Mrs. Dunbar, and carried unanimously to recommend to the State Board of Education approval to issue a Request for Proposals for Private Equity Discretionary Separate Account Manager for the Permanent School Fund and the placement of this item on the consent agenda of the State Board of Education meeting of March 27, 2009.*

11. Authorization to Issue a Request for Proposals for Performance Measurement Services for the Permanent School Fund

(Board agenda page III-23)

[Official agenda item #16]

Mr. Timmins presented this item to the committee. Minor technical changes were proposed by committee members and incorporated into the final document.

MOTION AND VOTE: *It was moved by Mrs. Dunbar, seconded by Mr. Nuñez, and carried unanimously to recommend to the State Board of Education approval to issue a Request for Proposals for Performance Measurement Services for the Permanent School Fund and the placement of this item on the consent agenda of the State Board of Education meeting of March 27, 2009.*

DISCUSSION ITEMS

12. Discussion of the Real Return Asset Class

(Board agenda page III-29)

Mrs. Gratsinger introduced the item. The committee decided to postpone the presentation until the April committee meeting. The committee agreed to schedule the meeting for 10 a.m. on Friday, April 24, 2009, to continue the discussion on the real return asset class and other topics as determined.

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

(Board agenda page III-31)

Mr. Timmins reported that during the 4th quarter of 2008, there were no transactions between Permanent School Fund service providers that involved PSF assets.

The meeting of the Committee on School Finance/Permanent School Fund adjourned at 8:07 p.m.