

The School Land Board & The Permanent School Fund

- Jerry Patterson, Commissioner of the Texas General Land Office, is also chairman of the School Land Board (SLB), which invests in real estate on behalf of the \$21.6 billion Permanent School Fund (PSF).
- The PSF is a single fund with bifurcated management. The State Board of Education oversees the equity portion of the fund. The SLB oversees the real estate portion of the fund. Returns from the real estate portion of the fund are transferred to the State Board of Education for investment in equities.
- The 77th Texas Legislature granted the SLB the authority to hold oil and gas earnings from PSF lands in escrow for no more than two years, and invest that money in real estate in Texas.
- Both the 78th and 79th Legislatures made changes to the School Land Board's investment capabilities.
 - The SLB may now invest in real estate outside of Texas and even the United States.
 - The SLB may now improve PSF real estate assets in order to enhance the value PSF real estate holdings.
 - The SLB may now work with private real estate investment firms to identify investments for the School Land Board's approval.
- The SLB has hired the Townsend Group as a fund advisor to assist in developing policies and procedures for investment in a diversified portfolio of institutional quality real estate and to identify potential real estate fund managers. (Attached)
- This course of action was recommended by the State Auditor's Office in June 2004.
- This move into real estate aims to offset predicted future declines in oil and gas production revenues and volatility in the stock market.
- The PSF now expects to be able to invest about \$300 million a year in real estate because of these changes over the next five years.
- The goals of the SLB are to diversify the equities-heavy PSF portfolio (from about 4-percent real estate to about 10-percent real estate) as well as increase the return to the school children of Texas.

A Change in Authority - Legislative Background

- During the 77th Legislative Session, the GLO's role in helping to manage the PSF changed. Historically, the role of the State Board of Education has been to invest in stocks and bonds and the SLB's role has been to handle the leases and revenue accounting on all state lands dedicated to the Permanent School Fund. HB 3558, authored by Rep. Robert Junell (D-San Angelo) and sponsored by Sen. Rodney Ellis (D-Houston), provided the SLB the authority to use the proceeds from future mineral leases and royalties available for the acquisition of additional real property and mineral interests on behalf of the PSF.
- During the 79th Legislative Session, HB 2217, authored by Rep. Brian McCall (R-Plano) and sponsored by Sen. Staples (R-Palestine), provided the SLB with more authority to manage real property allocated to the PSF. HB 2217 gives the SLB authority to contract with professional investment management services (external fund managers) to help manage and diversify PSF real estate fund investments.

Impact on School Finance

- The SLB has a fiduciary responsibility to diversify the PSF real estate portfolio beyond oil and gas. While earning record royalties today, at some point in the future depleting reserves will reduce the amount of income into the PSF. Investing in real estate is an excellent way to diversify PSF investments and protect the futures of schoolchildren across this state.

How the School Land Board exercises oversight of the External Fund Managers

- **The Hiring Process**
 - The managers will not be hired unless they have proven experience providing similar services, a successful performance history, and an established client base.
 - H.B. 2217 gives the School Land Board authority to specify any policies, requirements, or restrictions, including ethical standards and disclosure policies that it adopts for real estate investment managers of the PSF within their Investment Management Agreements with the PSF.
- **Compensating the Fund Managers**
 - The compensation structure will be created in a manner that aligns the interests of the managers with the Fund.
 - Compensation will be consistent with the standards of the industry and that paid by similarly situated institutional investors.
 - The PSF will seek to pay a manager a base fee intended to reimburse its costs with additional revenues payable contingent upon successful performance of investments.
 - Compensation will vary somewhat depending on the investment strategy to be executed.
 - The PSF may use performance-based compensation for Enhanced Return or High Return Investments.