


September 18, 2006

Cynthia A. Thornton  
State Board of Education, District 10  
Chair, School Finance/Permanent School Fund Committee  
P. O. Box 321  
Round Top, Texas 78954  


**Madam Chair and Members of the Texas Senate Education Committee:**

Thank you for allowing me to speak to you today. I would like to present four (4) issues in relationship to the Texas Permanent School Fund.

The issues are as follows:

- 1. Changes for the PSF and Background Issues.**
- 2. PSF Bond Guarantee Program**
- 3. General Land Office Contributions**
- 4. PSF Distribution Rate for Fiscal 2008-2009.**

### **Changes for the Fund**

Active management for the fund as been changed to internal TEA staff management except for International Equities with Merrill Lynch. In November of 2005 the SBOE chose to extend a new contract to RVKuhns & Associates as our new investment consultants. RVKuhns & Associates have been in the investment business for over 20 years and headquarters are located in Portland, Oregon. The Board along with RV Kuhns is presently looking into diversifying the present asset allocation in order to raise the expected rate of return while also reducing risk on investments for the future of the fund. In July the SBOE approved an asset allocation which is projected to increase the funds return and reduce the risk. During the SBOE September 2006 meeting a Request For Proposal (RFP) was approved to retain outside counsel for legal advice concerning fiduciary duties for the Permanent School Fund. The Board is accepting proposals until November 10, 2006 at 3:00 p.m., Central Time.

### **PSF Background Issues**

The Fund value on August 31, 2006 was \$22.9 Billion.

The Fund is distributing \$842 million per year to the ASF in 2006 and 2007.

The Fund's returns have been good.

Over the past year ending August 31, 2006 the Fund return of 10.44% exceeded the benchmark by over ½ %.

Over the past three (3) years, the Fund return of 11.72 % also exceeded the benchmark.

**PSF Bond Guarantee Program**

2.

This bond program is an extremely important service for the independent school districts in the State of Texas. Because of the AAA rating of the bond program the districts save on the interest rate for their loans and do not need to purchase outside insurance for their loans.

The PSF bonds have a AAA rating.

The Bond Guarantee Program limit is calculated at 2.5 times the lower of cost or market which is a very conservative methodology. This rate was established through the H.B. No.1295 effective September 1, 2003.

Available capacity is currently \$48 Billion as of August 31, 2006 (8/31/06)

The Fund currently guarantees \$38 Billion as of August 31, 2006 (8/31/06)

TEA projects that the excess capacity will be used within 2-3 years.

Moody's Investors Services is currently evaluating the funds triple A rating at different multipliers. Our current multiplier of 2 ½ times is very conservative, and I believe this rate should be higher in order to serve the districts in the near future.

**General Land Office Contributions** (See Attachment 1)

Since 2002 the General Land Office has statutorily retained money and managing a real estate portfolio for the Permanent School Fund.

For the fiscal year ending August 31, 2006:

Total Available Deposits of GLO	513,828,563.02
Total Amount Received by PSF (Include \$43M cash from leases + \$78M (6 ½M a month) voluntary amounts)	121,722,456.75
<b>Percentage Received</b>	<b>23.69%</b>
GLO Land & Mineral Value (FYE 05)	4,383,236,551.00
GLO Cash Balance (FYE 05)	<u>256,909,749.79</u>
GLO Total Asset Values	4,640,146,300.79
<b>Distribution as a Percent of Asset Value</b>	<b>2.62%</b>

**The amount received by the PSF was \$121.7 million which was an effective payout of 2.6% of the assets under management.**

Distribution at 6% of GLO Total Assets Value Should Be 278,408,778.05

**If the GLO distributed 6% of total assets, they would have sent \$278 million per year to the PSF.**

**The SBOE has been told by the General Land Office the amount that will be received by the PSF in fiscal 2008-2009 will be \$100 million. This is lower than before. Therefore, the percent (%) received by the PSF will be lower than 2.6 % of the assets under management by the General Land Office.**

#### **PSF Distribution Rate for the Fiscal Year 2008-2009**

The SBOE set the PSF distribution rate for the fiscal year 2008-2009 during the September meeting. The distribution rate of 3.5 % was based upon the Spending Rate Model that our consultants, RVKuhns, prepared for the SBOE.

The inputs to the Spending Rate Model are:

1. Expected Total Return will be lower.
2. Consumer Price Index will be high
3. Growth in Student Population will be higher
4. General Land Office Inflow will be lower
5. Administration Expenses will be higher if the new asset allocation is funded.

At this time I would like to introduce the following representatives of RV Kuhns & Associates:

Russ Kuhns, CEO and Senior Consultant

Becky Gratsinger, President and Senior Consultant

**Texas Permanent School Fund  
GLO Income and Contribution  
Fiscal Year 2006**

Description	FY'06
Total Available Deposits on GLO Assets	\$ 513,828,563.02
Total Amount Received by PSF	\$ 121,722,456.75
Percentage Received	23.69%
GLO Land and Mineral Value (FYE 05)	\$ 4,383,236,551.00
GLO Cash Balances (FYE 05)	\$ 256,909,749.79
GLO Total Asset Values	<u>\$ 4,640,146,300.79</u>
Distribution as a Percent of Asset Value	2.62%
<b>Distribution at 6% of GLO Total Assets Value</b>	<b>\$ 278,408,778.05</b>



# Spending Rate Model

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- The Texas Permanent School Fund Spending Model Depends on Various Inputs:
  1. Expected Total Return – Lower than 2004
  2. Consumer Price Index – Higher than 2004
  3. Growth in Student Population - Higher
  4. General Land Office Inflows - Lower
  5. Administrative Expenses