

**SUBJECT:** Managing public school land and the permanent school fund.

**COMMITTEE:** Land and Resource Management — committee substitute recommended

**VOTE:** 8 ayes — Mowery, Harper-Brown, Blake, Cook, Escobar, Leibowitz, Miller, Orr

0 nays

1 absent — Pickett

**WITNESSES:** For — Jerry Patterson, Texas General Land Office; Roger Ferris, State Auditor's Office; Bo Tanner, General Land Office; (*Registered, but did not testify*: Ellis Pickett)

Against — None

**BACKGROUND:** The General Land Office (GLO) and the School Land Board (SLB) oversee state-owned real property dedicated to the Permanent School Fund (PSF). The 77th Legislature, with HB 3558 by Junell, authorized SLB to use funds from the sale and management of PSF real property and proceeds of future mineral leases and royalties from PSF mineral interests to buy additional real property for the PSF. Proceeds from the special fund account may be used to acquire mineral and royalty interests for the PSF. Before HB 3558, the Board bought real estate only with proceeds from the sale of other PSF land, and the PSF mineral income was invested by the State Board of Education.

Since enactment of HB 3558 in 2001, funds available for investments significantly have expanded. Available investment funds previously averaged \$2 million per year. Now the annual average is \$200 million.

The GLO makes property transactions based on values determined by an appraiser. Based on these appraisals, the GLO cannot buy land for more than market value or sell land for less than market value. It may not make improvements on real property and manages its real estate portfolio without outside expertise.

**DIGEST:**

CSHB 2217 would allow GLO to make improvements on real property. Sale and purchase prices of land would not have to be based exclusively on appraisal values.

The bill also would lift restrictions on GLO's purchasing land for more than fair market value and selling land for less than market value, repealing two sections of the Natural Resources Code. "Market value" would have meaning as prescribed in sec. 1.04, which states that property may transfer for cash or its equivalent under prevailing market conditions.

Designated funds could be used in the best interest of the PSF, using a prudent investor standard, to protect, maintain, or enhance the value of public school land; to acquire interest in real property; and to pay reasonable fees for professional consulting services related to PSF investment.

The board could contract for professional investment management services with eligible organizations in that business.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2005.

**SUPPORTERS  
SAY:**

CSHB 2217 would implement recommendations made by the State Auditor Office in June 2004. The bill would clarify GLO's authority to manage its real estate investments. GLO is tasked with maximizing returns on the 750,000 acres of surface land that it manages. With the increased authority permitted in 2001 with HB 3558 to receive income from oil and gas royalties, the GLO must update its real estate investment portfolio to achieve the appropriate financial management.

The bill would allow GLO to make routine or essential improvements to land, such as building sewer lines or providing electricity. Resale values increase when improvements are made to land. Under current regulations, GLO has to execute a land lease with a third party to make improvements and share the resulting proceeds. This bill would add value to PSF real estate, which is the GLO's fiduciary responsibility.

The bill would require GLO still to consider appraisal values before selling land but would not force the appraisal value exclusively to govern the transaction. This flexibility would extend to the sale of land to

adjacent land owners, which currently is regulated by preferential rights. Preferential rights requires GLO first to offer the sale of the land to an adjacent land owner. This practice has proved to be impractical. In the past, GLO mostly managed scattered tracts of land in the western portion of the state that had little income potential. With HB 3558 in 2001, sales of these low-value assets were supplemented with other revenue and used to buy higher-valued state agency properties or other land. Now, for example, GLO holds valuable commercial property. When the GLO is forced to wait up to 90 days for an appraisal to be filed on commercial property and adjacent sales, it loses market opportunities.

The bill would allow GLO to hire a fund advisor to devise the real estate portfolio strategy, building in safeguards for investments. This fee-based consultant would act as an agent of GLO and would not be authorized to craft a strategy contrary to the agency's fiduciary responsibilities. GLO would entrust a fund manager with carrying out the investments under the fund advisor's direction. The fund manager would be required to report to the SLB as well. To ensure the integrity of these provisions, GLO would adopt the "prudent investor standard" described in Article VII, Section 11b, of the Texas Constitution and used by other state agencies entrusted with such fiduciary responsibilities.

The adverse impact of GLO's inability to maximize returns on real estate investments has been a financial loss to the PSF, especially considering that oil and gas production is decreasing. Gas production has flattened out, and oil peaked in the 1970s. It is critical for GLO to diversify its investments and for its financial management practices to keep pace and secure the PSF through the most competent means possible.

**OPPONENTS  
SAY:**

CSHB 2217 would grant excessive discretionary authority to make financial decisions, potentially compromising the stability of the PSF. Government agencies should not rest their financial viability on real estate investments, which is very risk prone. GLO should not delve any deeper into commercial real estate investments or land development.

Hiring outside expertise to oversee investments would distance the agency from critical investment decisions. It also does not specify the qualifications on which GLO should base the hiring of fund advisors and fund managers.

Certified appraisers are trained on the Uniform Standards of Professional Appraisal Practice, and appraisals are the accepted standard on which to base the value of land. Through training and continuing education from the comptroller, appraisal professionals practice a standard method of evaluating property at fair market value. CSHB 2217 would de-emphasize the importance of basing appraisals on a more acceptable standard.

NOTES:

The substitute changed the definition of "market value" to mean the price at which a property would transfer for cash or its equivalent under prevailing market conditions as defined by the Tax Code, chapter 1.04. Otherwise, the substitute made non-substantive, technical changes.