

- SUBJECT:** Replacing SBOE as managers of the Permanent School Fund
- COMMITTEE:** Public Education — committee substitute recommended
- VOTE:** 9 ayes — Eissler, Hochberg, Aycock, Farias, Jackson, Olivo, Patrick, Shelton, Weber
- 0 nays
- 2 absent — Allen, Dutton
- WITNESSES:** For — (*Registered, but did not testify:* Nan Clayton, League of Women Voters-TX; James De Garavilla; Bill Grusendorf, Texas Association of Rural Schools; Chuck Hempstead, Texas Association of College Teachers; Kathy Miller, Texas Freedom Network; Don Rogers, Texas Rural Education Association)
- Against — Don McLeroy; (*Registered, but did not testify:* Merrylynn Gerstenschlager, Texas Eagle Forum)
- On — David Anderson, Texas Education Agency
- BACKGROUND:** The Permanent School Fund is a perpetual endowment for Texas public schools established by the Legislature in 1854, which includes more than 46.5 million acres of Texas land, including the mineral rights of 7.1 million acres, and all income generated from its assets. Returns earned through investments are constitutionally dedicated to the Available School Fund to be appropriated by the Legislature to school districts to purchase instructional materials. The fund may guarantee bonds issued by school districts to purchase, construct, or maintain instructional facilities.
- Tex. Const., Art. 7 grants the State Board of Education (SBOE) authority to manage any financial investment made by the fund. The Constitution requires the SBOE to exercise prudence and discretion without regard to speculation, but with regard to the permanent disposition of the fund, considering the probable income and safety of the capital to be invested. Education Code, sec. 43.005 permits the SBOE to contract with private professional investment managers to assist the board in making investment decisions, and the board may delegate investment powers or duties to a

committee, officer, employee, or other agent of the board. Education Code, sec. 43.0051 permits the board to transfer money from the Permanent School Fund to a sub-fund, the real estate special fund account, controlled by the General Land Office (GLO).

The SBOE controls investment management of cash assets, and the Texas Education Agency (TEA) carries out the administrative duties necessary to implement policies established by the SBOE regarding the fund. TEA holds hiring authority for the chief investment officer of the Permanent School Fund.

The GLO is responsible for the real property assets of the fund. Lease sales and other transactions are approved by the School Land Board chaired by the land commissioner. The governor and the attorney general each appoint an individual to the School Land Board. The board may acquire, sell, lease, trade, improve, maintain, protect, or otherwise manage, control, or use land owned by the fund. The SBOE may invest in real estate without the consent or knowledge of the land commissioner.

The comptroller must report the condition of the Permanent School Fund to the governor before any legislative session, and must provide any report requested by the State Board of Education.

The SBOE by a two-thirds vote decides the distribution rate from the Permanent School Fund to the Available School Fund before each regular session of the Legislature. If the SBOE fails to adopt a distribution rate, the Legislature adopts the rate.

DIGEST:

CSHJR 77 would amend Art. 7 of the Texas Constitution by adding sec. 5a to require the Legislature to provide by law for a Permanent School Fund Management Council to manage the Permanent School Fund. The council members would have to have substantial institutional investment expertise or institutional financial management experience. Council members would be appointed or elected as provided by the Legislature for terms determined by the Legislature. The council would perform the duties prescribed by law. References to management of the fund by the SBOE would be replaced with references to the new council.

CSHJR 77 also would amend Art. 7, sec. 5(a) to require that the distribution rate for the amount distributed from the Permanent School fund to the Available School Fund in each year of a state fiscal biennium

be adopted by a two-thirds vote of the total membership of the Permanent School Fund Management Council, with approval by a majority vote of the total membership of the State Board of Education (SBOE). The Legislature would adopt a rate if the council did not adopt one or if the SBOE did not approve one.

The proposal also would change various references to the “Public Free School Fund” to the “Permanent School Fund.”

The proposal would be presented to the voters at an election on Tuesday, November 3, 2009. The ballot proposal would read: “The constitutional amendment to create the Permanent School Fund Management Council, composed of members with substantial institutional investment expertise or institutional financial management experience, to assume the duty of the State Board of Education to manage the permanent school fund.”

**SUPPORTERS
SAY:**

CSHJR 77 and its enabling legislation, HB 2037 by D. Howard, would allow for management of the Permanent School Fund (PSF) by one entity composed of individuals with expertise in financial matters. The framers of the Constitution did not intend for the fund to be run by ordinary individuals because in 1876, the Constitution mandated that the governor, the comptroller of public accounts, and the superintendent of schools make up the State Board of Education (SBOE). These individuals would have had the expertise necessary to manage the fund. In 1928, the SBOE became a nine-member body appointed by the governor, each of whom would have the necessary expertise. The SBOE became an elected body in 1949, returned to an appointed body in 1984, and again became an elected body in 1989. The original intent for the SBOE was for it to be a body of prudent and careful people who would make safe investments in stocks and bonds, and CSHJR 77 would restore that original intent through creation of the PSF management council.

The SBOE in its current form has not managed the fund successfully. In a report to the 77th Legislature in 2000, the Texas House General Investigating Committee recommended that the Constitution be amended to create an appointed Permanent School Fund Investment Board, separate from the State Board of Education, with the jurisdiction of the State Board of Education limited to education policy. In 2003, an independent report contracted through the State Auditor’s Office and requested by the State Board of Education said that “by constitutional amendment a governing board for a state-sponsored, quasi-independent investment management

organization [should be] created to administer the Permanent School Fund.”

The Permanent School Fund Management Council would improve the effectiveness of fund management. The SBOE does not provide adequate management for the fund because it lacks expertise. While most members are qualified for education policy-making, they are not qualified in investment fund management. Their lack of knowledge has resulted in each member appointing a personal advisor, none of whom are professional money managers.

This constitutional amendment would enable a comprehensive investment strategy and adequate management, which would increase the money available to the public school finance system. The SBOE has duplicated work and employed an ineffective and non-comprehensive investment strategy. For example, the SBOE is able to invest in real estate without consulting the General Land Office, resulting in chaotic and ill-informed investments. The SBOE’s duplication of GLO actions has resulted in double expenses to the fund. This constitutional amendment would allow enabling legislation to require the new management council to consult the GLO before making real estate investments and would eliminate double expenses to the fund, increasing the money available to the public school finance system.

OPPONENTS
SAY:

CSHJR 77 would undermine the intent of the framers of the Constitution, who did not intend to place the Permanent School Fund in the hands of financial experts but to have it overseen by those accountable to the people. The SBOE has successfully managed the fund for more than 125 years. The SBOE has survived all the ups and downs in the state’s history and provides checks and balances to ensure that the fund produces as much money as possible. Any dysfunction of the SBOE is a result of piecemeal changes made by Legislature to the duties of the SBOE. The Legislature demanded increased returns, so SBOE investments became riskier, which necessitated personal advisors for members of the board.

The SBOE plays an important role in maintaining the permanency of the fund and preserving intergenerational equity, both of which require conservative spending policies. The SBOE is charged with maintaining equity between generations of children, taking into account inflation and the cost of education, so SBOE membership has resisted efforts to overspend the fund. The SBOE, as a separately elected independent body

accountable to the voters of the state, is not required to guarantee a fixed disbursement each biennium, but to protect the long-term financial soundness of the Permanent School Fund.

The state does not need to create an entire new governmental entity because the SBOE can correct itself within the existing structure. The SBOE is diverse in beliefs and ideas, which is a strength, not a weakness.

OTHER
OPPONENTS
SAY:

The Constitution should not be amended to change the management and investment of the Permanent School Fund until the state examines the policies and procedures of successfully managed funds such as the University of Texas Investment Management Company (UTIMCO), the Teacher Retirement System (TRS), and the Employees Retirement System (ERS). From this research, the state would determine what best practices suit the PSF.

The SBOE should not have approval of the distribution rate adopted by the council. This responsibility should be transferred wholly to the new council. To ensure intergenerational equity, spending and investment policy decisions should be consistent with one another.

NOTES:

The enabling legislation, HB 2037 by D. Howard, on today's General State Calendar.

The committee substitute differs from the joint resolution as filed by requiring State Board of Education approval of the rate adopted by the Permanent School Fund Management Council for use in determining the amount to be distributed from the Permanent School Fund to the Available School Fund; providing for the Legislature to adopt a distribution rate if either the council did not adopt a rate or the State Board of Education did not approve one; and requiring members of the council to have substantial institutional investment expertise or institutional financial management experience.