

## **BILL ANALYSIS**

Senate Research Center  
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S.B. 1659  
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Education  
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As Filed

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

The \$44 billion Permanent School Fund (PSF)—the largest education endowment in the country—is jointly managed by the State Board of Education (SBOE) and the School Land Board (SLB). Their shared mission is to generate revenue for public education in perpetuity.

During the Sunset review of the SLB, it became evident that this dual-management structure has created a multitude of problems. The School Land Board Sunset legislation (S.B. 608) focuses on improving communication and coordination between the SLB and SBOE, however the bill does not address the investment issues of the dual-management structure.

The SLB's investment authority is limited to real estate, infrastructure, minerals and land, and it holds some of the cash to meet capital commitments for those investments. The \$4.2 billion in cash holdings—about 40 percent of its assets—far exceed the amount needed for capital commitments and generate only a nominal return in the State Treasury.

SBOE manages a diversified investment portfolio and makes many of the same kinds of investments as the SLB, but it has the cash management tools necessary to put more of the Permanent School Fund assets to work for their intended purpose.

Education Commissioner Mike Morath testified in Senate Finance that the net effect of the SLB's large cash holdings was a loss to public education of \$200 million per year, every year.

S.B. 1659 aims to improve management of the Permanent School Fund assets for the benefit of the schoolchildren of Texas.

As proposed, S.B. 1659 amends current law relating to the acquisition and management of certain real property assets by the School Land Board for the use and benefit of the permanent school fund and the transfer of certain permanent school fund assets from the control of the School Land Board to the State Board of Education.

### **RULEMAKING AUTHORITY**

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Section 51.011, Natural Resources Code, by amending Subsection (a) and adding Subsections (a-3) and (a-4), as follows:

- (a) Requires any land or mineral or royalty interest that is set apart to the permanent school fund under the constitution and laws of this state together with the mineral estate in riverbed, channels, and the tidelands, including islands, to be controlled, sold, and leased by, rather than requiring any land, mineral or royalty interest, real estate investment, or other interest, including revenue received from those sources, that is set apart to the permanent school fund under the constitution and laws of this state together with the mineral estate in riverbeds, channels, and the tidelands, including islands, to be subject to the sole and exclusive management and control of, the school land board (SLB)

and the commissioner of the Texas General Land Office (commissioner; GLO) under the provisions of this chapter (Land, Timber, and Surface Resources) and other applicable law.

(a-3) Requires all revenue received from mineral or royalty interests described by Subsection (a), including bonus payments, surface lease revenues, royalties, and any other type of revenue received from those interests, to be transferred each month to the State Board of Education (SBOE) for investment in the permanent school fund.

(a-4) Requires revenue received from land described by Subsection (a) that is not required to be transferred under Subsection (a-3) to remain with SLB.

SECTION 2. Amends Section 51.401, Natural Resources Code, by amending Subsection (a) and adding Subsections (c), (d), and (d-1), as follows:

(a) Authorizes SLB to designate money received from the sale of real property or mineral or royalty interests set apart to the permanent school fund under the constitution and laws of this state together with the mineral estate in riverbeds, channels, and the tidelands, including islands, for deposit in the real estate special fund account of the permanent school fund in the State Treasury to be used by SLB to acquire fee or lesser interests in real property, including mineral or royalty interests, for the use and benefit of the permanent school fund, as provided by Section 51.402 (Use of Designated Funds), rather than authorizing SLB to designate funds received from any land, mineral or royalty interest, real estate investment, or other interest, including revenue received from those sources, that is set apart to the permanent school fund under the constitution and laws of this state together with the mineral estate in riverbeds, channels, and the tidelands, including islands, for deposit in the real estate special fund account of the permanent school fund in the State Treasury to be used by SLB as provided by this subchapter (Acquisition of Public School Land).

(c) Requires money received from the sale of real property, including mineral or royalty interests, and designated under this subchapter for the acquisition of real property, including mineral or royalty interests, to be used by SLB not later than two years after the date of the sale from which the money is derived.

(d) Requires any money from a specific sale that remains in the real estate special fund account for longer than two years to be immediately deposited in the State Treasury to the credit of the SBOE for investment in the permanent school fund.

(d-1) Requires SLB, each quarter, to provide a cashflow report to SBOE that specifies the use of all funds designated under Subsection (a) and the amount of time that money from each specific sale has remained in the real estate special fund account.

SECTION 3. Amends Section 51.402, Natural Resources Code, by amending Subsections (a) and (b) and adding Subsection (a-1), as follows:

(a) Authorizes SLB to use the money designated under Section 51.401 for any of the following purposes:

(1)–(3) makes no changes to these subdivisions;

(4) to acquire mineral or royalty interests, rather than mineral and royalty interests, for the use and benefit of the permanent school fund; or

(5) to prudently manage any internally managed commercial real estate held of acquired by SLB on or before August 31, 2019, subject to Subsection (a-1). Removes Subdivisions (6)–(8) relating to acquiring interests in real estate, paying reasonable fees for professional services related to a permanent school fund investment, and acquiring, selling, leasing, trading, improving, maintaining, protecting, or using land, mineral and royalty interests, or real estate investments,

an investment or interest in public infrastructure, or other interests, at such prices and under such terms and conditions SLB determines to be in the best interest of the permanent school fund.

(a-1) Requires SLB, not later than September 1, 2023, to divest itself of all interests in assets described by Subsection (a)(5), except any asset for which divestment by that date would cause substantial loss to the permanent school fund. Requires SLB to divest itself of an asset described by Subsection (a)(5) that is not divested on or before September 1, 2023, as soon as prudently practicable, and to take direction from SBOE regarding the timing of the divestment of that asset with respect to the best interest of the permanent school fund.

(b) Requires SLB, before acquiring real property, including mineral or royalty interests, under Subsection (a), to determine, using the prudent investor standard, that the acquisition is in the best interest of the permanent school fund, rather than requiring SLB, before using funds under Subsection (a), to determine, using the prudent investor standard, that the use of the funds for the intended purpose is authorized by Subsection (a) and in the best interest of the permanent school fund. Deletes existing text providing that the determination by SLB on the use of funds under this section is conclusive unless the determination was made as a result of fraud or obvious error.

SECTION 4. Amends Sections 51.4021(a) and (b), Natural Resources Code, as follows:

(a) Authorizes SLB to appoint investment managers, consultants, or advisors to invest or assist SLB in investing the money designated under Section 51.401, to the extent the investment of the money is authorized under this chapter, by certain means.

(b) Authorizes money designated under Section 51.401 to only be invested to the extent SLB has the authority under this chapter to make the investment, and prohibits the money from being invested in a real estate investment trust, as defined by Section 200.001 (Definition), Business Organizations Code, or otherwise invested in a manner not authorized under this chapter.

SECTION 5. Amends Sections 51.408(a), (b), (d), and (e), Natural Resources Code, as follows:

(a) Requires SLB, in addition to any other requirements provided by law, to adopt and enforce an ethics policy that provides standards of conduct relating to the management and investment of the funds designated for that purpose under Section 51.401. Requires the ethics policy to include provisions that address certain issues as they apply to the management and investment of the funds and to persons responsible for acquiring or managing real property or mineral or royalty interests of the permanent school fund or investing the funds to the extent authorized by this chapter.

(b) Requires the ethics policy to include provisions applicable to:

(1)–(3) makes no changes to these subdivisions; and

(4) any person who provides services to SLB relating to the management of the funds designated under Section 51.401 of the investment of funds to the extent authorized by this chapter, rather than any person who provides services to SLB relating to the management or investment of funds designated under Section 51.401.

(d) Requires the provisions of the ethics policy that apply to a person who provides services to SLB relating to the management of the funds designated under Section 51.401 or the investment of those funds to the extent authorized by this chapter, rather than requiring the provisions of the ethics policy that apply to a person who provides services to SLB relating to the management or investment of the funds designated under Section 51.401, to be based on the Code of Ethics and the Standards of Professional Conduct

prescribed by the Association for Investment Management and Research or other ethics standards adopted by another appropriate professionally recognized entity.

(e) Requires SLB to ensure that applicable provisions of the ethics policy are included in any contract under which a person provides services to SLB relating to the management of the funds designated under Section 51.401 or the investment of those funds to the extent authorized by this chapter, rather than relating to the management or investment of the funds designated under Section 51.401.

SECTION 6. Amends Section 51.409(a), Natural Resources Code, as follows:

(a) Requires a member of SLB, the commissioner, an employee of SLB, or a person who provides services to SLB that relate to the management of the funds designated under Section 51.401 or the investment of those funds to the extent authorized under this chapter who has a business, commercial, or other relationship that could reasonably be expected to diminish the person's independence of judgment in the performance of the person's responsibilities relating to the management of public school lands or investment of the funds, rather than requiring a member of SLB, the commissioner, an employee of SLB, or a person who provides services to SLB that relate to the management or investment of the funds designated under Section 51.401 who has a business, commercial, or other relationship that could reasonably be expected to diminish the person's independence of judgment in the performance of the person's responsibilities relating to the management or investment of the funds, to disclose the relationship in writing to SLB.

SECTION 7. Amends Section 51.410, Natural Resources Code, as follows:

Sec. 51.410. REPORTS OF EXPENDITURES. Requires a consultant, advisor, broker, or other person providing services to SLB relating to the management of the funds designated under Section 51.401 or the investment of those funds to the extent authorized by this chapter, rather than requiring a consultant, advisor, broker, or other person providing services to SLB relating to the management and investment of the funds designated under Section 51.401, to file with SLB regularly, as determined by SLB, a report that describes in detail any expenditure of more than \$50 made by the person on behalf of certain individuals.

SECTION 8. Amends Section 51.412, Natural Resources Code, as follows:

Sec. 51.412. REPORTS TO LEGISLATURE. Deletes existing text prohibiting SLB from disclosing information under this section that is confidential under applicable state or federal law and requires SLB, not later than September 1 of each year, to submit to the legislature a report, rather than requires SLB, not later than September 1 of each even-numbered year, to submit to the legislature a report that, specifically and in detail, assesses the direct and indirect economic impact, as anticipated by SLB, of the investment of funds designated under Section 51.401 for deposit in the real estate special fund account of the permanent school fund, that includes the following information:

(1) the total amount of money received under this chapter and designated under Section 51.401 for deposit in the real estate special fund account of the permanent school fund that the board intends to use for a purpose authorized under that section, rather than the total amount of money designated by Section 51.401 for deposit in the real estate special fund account of the permanent school fund that the board intends to invest;

(2) deletes existing text of Subdivision (2) relating to the rate of return SLB expects to attain on the investment, redesignates Subdivisions (3), (4), and (6) as Subdivisions (2), (3), and (5), and includes the amount of money SLB expects to distribute to the available school fund or SBOE for investment in permanent school fund under Section 51.413 (Transfers From the Real Estate Special Fund Account to the Available School Fund

and the Permanent School Fund), rather than in the permanent school fund after making the investments;

(3) the distribution by county of real property interests, including mineral or royalty interests, and including the actual or expected revenues from the interests, that were acquired by SLB for the use and benefit of the permanent school fund since the most recently submitted report under this section, rather than the distribution of SLB's investments by county;

(4) the market value of all investments and assets managed by SLB and the total market value of the permanent school fund; and

(5) makes no further changes to this subdivision.

(b) Deletes Subsection (b) relating to the requirement that SLB, not later than January 1 of each odd-numbered year, submit to the legislature a report that assesses the return and economic impact of the investments reported to the legislature before the preceding regular legislative session.

SECTION 9. Amends Section 51.413(a), Natural Resources Code, as follows:

(a) Authorizes SLB, by a resolution adopted at a regular meeting, to release from the real estate special fund account funds previously designated under Section 51.401 or used under Section 51.402 to acquire real property, including mineral or royalty interests, rather than managed, used, or encumbered under Section 51.402 or Section 51.4021 (Appointment of Special Fund managers, Investment Consultants, or Advisors) to be deposited in the State Treasury to the credit of certain entities.

SECTION 10. Repealer: Section 51.011(a-1) (relating to authorizing SLB to acquire, sell, lease, trade, improve, maintain, protect, or otherwise manage, control of use land, real estate investments, or certain other interests that are set apart to the permanent school fund in any manner, at such prices, and under such terms and conditions as SLB finds to be in the best interest of the fund), Natural Resources Code.

Repealer: Section 51.011(a-2) (relating to requiring SLB to report to the Legislative Budget Board the sale of certain land), Natural Resources Code.

Repealer: Section 51.402(c) (relating to prohibiting the market value of certain investments on January 1 of each even-numbered year from exceeding a certain amount), Natural Resources Code.

SECTION 11. Requires SLB to:

(1) not later than September 30, 2019:

(A) provide SBOE with a list of every investment held by SLB that was acquired on or after September 1, 2001, other than sovereign lands, other state lands, mineral or royalty interests, and commercial real estate that is owned and internally managed by SLB, including information on unfunded commitments and funding obligations related to every investment;

(B) provide to SBOE a balance of the cash holdings as of the most recent month end; and

(C) provide notice of the enactment of this Act to the general partner or other managing entity of every investment described by Paragraph (A) of this subdivision;

(2) provide to SBOE, not later than November 30, 2019, all financial, contract, investment and related records and documents in the possession of SLB, GLO, or a

service provider to the SLB or GLO relating to an asset described by Subdivision (1)(A) of this section;

(3) not later than July 31, 2020, transfer, at the direction of SBOE:

(A) all assets described by Subdivision (1)(A) of this section, provided that if SBOE determines in its discretion that it cannot receive an asset, requires SLB to coordinate with SBOE concerning the appropriate timing of a transfer of the asset that is in the best interest of the permanent school fund; and

(B) all cash holdings related to or derived from permanent school fund assets, except for an amount necessary to make distributions to the available school fund in fiscal years 2020 and 2021, as directed by previously adopted SLB resolutions; and

(4) not later than September 1, 2020, submit to the legislature and SBOE a report accounting for every investment and all cash holdings transferred to SBOE or retained by SLB in accordance with this Act.

SECTION 12. Provides that an asset transferred in accordance with this Act to be managed by SBOE in accordance with applicable laws, and any investment agreement, contract, or similar document related to the asset is assigned to the Texas Education Agency as of the date of the transfer of the asset.

SECTION 13. Effective date: September 1, 2019.