

# Texas Permanent School Fund

Annual Report for the Fiscal Year Ending August 31, 2013



*Financing tomorrow's education with sound investments*



# **TEXAS PERMANENT SCHOOL FUND**

## **COMPREHENSIVE ANNUAL FINANCIAL REPORT**

**FISCAL YEAR ENDING  
AUGUST 31, 2013**

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Holdings – may be found at <http://www.tea.state.tx.us/psf>

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# SECTION ONE

## INTRODUCTION

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## **MESSAGE FROM THE COMMISSIONER OF EDUCATION**

December 2013

Please find attached the annual financial report of the Texas Permanent School Fund for the fiscal year ending August 31, 2013. The fund continued the tradition of improving its financial strength and providing valuable financial resources to fund public education in the State of Texas. This report is designed to provide an independently audited overview of the Fund's financial statements to the Fund owners, the people of Texas and to other interested parties. Since its inception in 1854 by Texas visionaries, the Fund continues to be a perpetual endowment instrumental in helping finance public schools in the State of Texas.

The Texas Education Agency is proud to work with the State Board of Education on the investments and administration of the Fund. I want to express my thanks to the Board members for their hard work and diligence in fulfilling their fiduciary duty to preserve and protect the Fund for future generations of Texas students. We look forward to working with the Board, and also with the state's legislative leadership, to assure the ongoing prudent management of the Fund, and to see that it is well positioned to continue the mission of financing Texas education in the years ahead.

Michael Williams  
Commissioner of Education

## MESSAGE FROM THE EXECUTIVE ADMINISTRATOR

The 159 year old Texas Permanent School Fund, managed by the State Board of Education (PSF (SBOE)) continued on a growth trajectory correlating with the global financial recovery and maintained the tradition of strong support for public education in Texas during fiscal year 2013. During the year, the Fund achieved a gross return of 10.16%, slightly underperforming its target policy by 0.25% for the year. The Fund continues to hold its ranking as the second largest educational endowment in the country.

The Fund serves Texans in two ways. First, a distribution is made every year from the Fund to pay a portion of educational costs in each school district within the state. During the current 2012-2013 biennium, the Fund distributed more than \$2 billion for education. Since 1960, the Fund has distributed over \$23 billion to help fund the education of Texas students.

Second, the Fund provides a guarantee for bonds issued by local school districts. Because of the PSF guarantee, qualified districts are able to pay lower interest rates when they issue debt since the debt carries the AAA rating by the three major rating agencies. At the end of the year, PSF assets guaranteed \$55.2 billion in school district bonds providing cost savings to 810 public school districts in the State.

At the end of fiscal 2013, the Fund balance was \$30.6 billion, an increase of \$1.8 billion from the prior year. During the year, the SBOE continued implementing the long term strategic asset allocation, diversifying the PSF(SBOE) to strengthen the Fund. The asset allocation is projected to increase returns over the long run while reducing risk and portfolio return volatility. The Permanent School Fund is invested in global markets and experiences volatility commensurate with the underlying indices. The Fund is broadly diversified and benefits from the low cost structure of its investment program. Changes are currently being implemented to bring that cost even lower.

I would like to thank the State Board of Education for its wise counsel and continued efforts to strengthen the Permanent School Fund. I would also like to thank Commissioner of Education Michael Williams and Chief Deputy Commissioner, Lizzette Gonzalez Reynolds, for their support and encouragement. Finally, I would like to thank the hard working and dedicated team of professionals within the PSF and in the other divisions at the Texas Education Agency. It is an honor to work with professionals such as these who embody such a high level of integrity and high standard of excellence.

Sincerely,

B. Holland Timmins, CFA  
Executive Administrator and Chief Investment Officer  
Texas Permanent School Fund

## **A SUMMARY OF THE TEXAS PERMANENT SCHOOL FUND**

The Texas Permanent School Fund (Fund) was created with a \$2,000,000 appropriation by the Legislature of 1854 expressly for the benefit of the public schools of Texas. These funds were available as a result of a \$10 million payment from the United States government in exchange for giving up claims to western lands claimed by the former Republic of Texas. In 1854–55, the Fund's first annual per capita distribution for public education was 62 cents. By 1861, the Fund was depleted by loan defaults by the railroads, collapse of the Confederate monetary system, and eventual loan of the Fund to the Civil War effort. The Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the Texas Permanent School Fund. Additional Acts later gave more public domain land and rights to the Fund.

In 1953, the U.S. Congress passed the Submerged Lands Acts that relinquished to coastal States all rights of the U.S. navigable waters within State boundaries. Submerged lands were defined to be those lands beneath and beyond three miles. If the State, by law, had set a larger boundary prior to or at the time of admission to the Union, or it had been approved by Congress, then the larger boundary applied. After three years of litigation (1957–1960), the U.S. Supreme Court on May 31, 1960, affirmed Texas' historic three marine leagues (10.35 miles) seaward boundary. Texas proved its submerged lands property rights to three leagues into the Gulf of Mexico by citing historic laws and treaties dating back to 1836. All lands lying within that limit belong to the Fund. The proceeds from the sale and the mineral related rental of these lands, including bonuses, delay rentals, and royalty payments, become the corpus of the Fund.

On November 8, 1983, the voters of the State approved a Constitutional Amendment, which provides for the guarantee of school district bonds by the Fund. On approval by the Commissioner of Education, bonds properly issued by a school district are fully guaranteed by the corpus of the Fund. The Texas Permanent School Fund has guaranteed \$112 billion in school bonds since the inception of the program, resulting in substantial savings to the taxpayers of the State through reduced issuance costs and lower borrowing costs.

Historically, only the income produced by the Fund was used to complement taxes in financing public education. As such, from 1854 through the 2003 fiscal year, all interest and dividends produced by Fund investments and certain land related income flowed into the Available School Fund (ASF). From the ASF, monies are distributed to the public schools based on average daily student attendance.

On September 13, 2003, the voters of the State of Texas (State) approved a Constitutional Amendment that changed the Fund distribution methodology from an income-based formula to a total return based formula (2003 Constitutional Amendment). With the approval of the 2003 Constitutional Amendment, interest and dividends produced by fund investments and certain land related revenues are additional revenue to the Fund. Beginning in September 2003, the Fund transfers on a monthly basis a total return amount to the ASF. Revenues earned by the Fund include gains realized on the sale of land and real estate owned by the Fund; lease payments, bonuses and royalty income received from oil, gas and mineral leases; commercial real estate lease revenues; surface lease and easement revenues; revenues from the resale of natural and liquid gas supplies; dividends, interest, and securities lending revenues; the net increase or decrease in the fair market value of the investment portfolio and externally managed real assets investment funds; and, other miscellaneous fees and income.

## **A SUMMARY OF THE TEXAS PERMANENT SCHOOL FUND**

Expenditures are now paid from the Fund and include operational costs, investment management fees, and costs incurred to manage the land endowment and real assets investments.

Investment assets managed by the State Board of Education (SBOE) are referred to throughout the Fund's annual report as the PSF(SBOE) assets. The SBOE is comprised of fifteen elected members. Administrative duties related to these assets reside with the PSF(SBOE) Investment Office, a division of the Texas Education Agency (TEA). The TEA is under the guidance of the Commissioner of Education, an appointee of the Governor. In making investments, the SBOE is charged with exercising the judgment and care under the circumstances then prevailing which men of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the expected income as well as the probable safety of their capital. The SBOE employs independent firms for advice on investment programs, asset allocation, and performance measurement to assist in the management of the PSF(SBOE) assets. The SBOE may appoint a Committee of Investment Advisors (CIA) to provide independent review of the Fund's investment policies, procedures, and nature of investments. The CIA advises the SBOE members on investment plans, strategies, and programs. Each member of the SBOE can appoint a single member to the CIA. The CIA members serve at the pleasure of the SBOE member that appointed them.

While many factors impact the decision-making process, the most important factor is the asset allocation strategy. In order to protect the purchasing power of the PSF(SBOE) assets from inflation while maintaining sufficient distribution to support the funding of education in Texas, the SBOE must determine the appropriate balance between expected risk and return as the portfolio is diversified.

The financial marketplace is very dynamic and continuously provides new potential investment opportunities. Working closely with investment staff and investment advisors, the SBOE approved an updated target asset allocation strategy at the July 2012 Board Meeting, which is expected to provide an increased total return at reduced risk. This asset allocation strategy affords the SBOE the opportunity to select from a broad range of investment opportunities, thus creating a more diversified portfolio while continuing to meet the Fund's financial objectives for risk, return, and income. The PSF(SBOE) target asset allocation includes Real Estate investments which are funded and managed separately from the PSF(SLB) Real Assets investments.

Texas law assigns control of the Fund's land and mineral rights to the three-member School Land Board (SLB), which includes the elected Commissioner of the General Land Office (GLO), an appointee of the Governor, and an appointee of the Attorney General. These assets are referred to throughout the Fund's annual report as the PSF(SLB) assets. Administrative duties related to the land and mineral rights reside with the GLO, which is under the guidance of the Commissioner of the GLO. The assets managed by GLO on behalf of the SLB generally fall into three broad categories: (1) discretionary real assets investments, (2) sovereign and other lands, and (3) mineral interests.

In 1985, the SLB, through the GLO, was authorized to use the proceeds of land sales to acquire other interests in real property. In the ensuing years, the SLB's investment authority has been

## **A SUMMARY OF THE TEXAS PERMANENT SCHOOL FUND**

modified and expanded several times. The current investment authority of the SLB is detailed in Section 51 of the Natural Resources Code (NRC). Additionally, Section 51.402 states that the market value of the investments in real estate on January 1 of each even-numbered year may not exceed an amount that is equal to 15 percent of the market value of the Fund on that date.

The 77<sup>th</sup> Legislature amended the NRC effective September 2001 to allow the SLB to deposit some or all of the proceeds of future mineral leases and royalties generated from existing and future active leases of the Fund's mineral interest into a special fund account at the State Treasury. The 79<sup>th</sup> Legislature further amended the NRC in 2005 to clarify the purposes for which the funds can be used, including adding three additional purposes. For the use and benefit of the Fund, the proceeds in the special fund account are to be used by the SLB to acquire, as public school land: land; interests in real property for biological, commercial, geological, cultural or recreational purposes; to acquire mineral and royalty interests; to protect, maintain, or enhance the value of public school lands; to acquire interests in real estate; or, to pay reasonable fees for professional services related to Fund investments.

In 2007, the 80th Legislature again amended Chapter 51 of the NRC with HB 3699, authorizing the SLB and the Land Commissioner to designate funds previously transferred to PSF(SBOE) for deposit into a real estate special fund account (RESFA) and to determine whether to release any funds from the RESFA to the PSF(SBOE) or to directly transfer funds to the ASF. HB 3699 also expanded the investment authority of PSF(SLB) to include the following: land; interests in real property for biological, commercial, geological, cultural or recreational purposes; to acquire mineral and royalty interests; to protect, maintain, or enhance the value of public school lands; to acquire interests in real estate; to pay reasonable fees for professional services related to Fund investments; or to acquire, sell, lease, trade, improve, maintain, protect, or use land, mineral royalty interests, or real estate investments, an investment or interest in public infrastructure, or other interests. The legislation became effective June 15, 2007, and was duly implemented by SLB resolution on September 1, 2007. On November 8, 2011, voters approved amendments to the State Constitution that included several non-substantive changes to clarify references to the Fund, but also included a change that increases the base amount used in calculating the distribution rate from the PSF(SBOE) to the Available School Fund (ASF). The amendments included an increase to the base used to calculate the distribution rate by adding to the calculation base certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, the SLB) that has responsibility for the management of land or other properties of the Fund to determine in its sole discretion whether to transfer each year from the PSF(SLB) assets to the ASF revenue derived from such land or properties, an amount not to exceed \$300 million.

The SLB's written real assets investment policy statement (Investment Policy) authorizes the investment of money in the RESFA, in externally managed commingled funds and separate accounts, as well as in direct investments that are sourced, executed, and managed internally by the GLO. The SLB is required to use the prudent investor standard in determining the suitability of the potential investments.

With regard to externally managed investments, the PSF(SLB) Investment Policy authorizes an investment advisory committee (IAC) to review potential investments and make recommendations to the SLB for the investment of money in the RESFA. The current IAC is comprised of five members, chaired by the Deputy Commissioner of Funds Management/Chief

## **A SUMMARY OF THE TEXAS PERMANENT SCHOOL FUND**

Investment Officer of the GLO. The IAC meets periodically to review potential investments and works in conjunction with the SLB's real assets investment advisor, currently The Townsend Group, to evaluate potential investments and make recommendations to the SLB for the investment of money in the RESFA. Following the formulation of recommendations by the IAC, the chairman of the IAC makes formal presentations and recommendations to the SLB for its consideration and approval.

Internally managed real estate investment acquisitions and dispositions are sourced and evaluated by GLO staff and are then formally presented to the SLB for consideration and approval.



**SECTION  
TWO**

**FINANCIAL  
STATEMENTS**

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## Independent Auditor's Report

Members of the State Board of Education  
Members of the School Land Board

### Report on the Financial Statements

We have audited the accompanying financial statements of the Texas Permanent School Fund (Fund), as of and for the year ended August 31, 2013, and the related notes to the financial statements.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Fund, as of August 31, 2013, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

## *Emphasis of Matters*

### *Fund Financial Statements*

As discussed in Note 1, the financial statements present only the Fund, a governmental permanent fund of the State of Texas, and do not purport to, and do not, present fairly the financial position of the State of Texas as of August 31, 2013, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Investments with Values that are not Readily Determined*

As discussed in Notes 2 and 3, the financial statements include investments valued at approximately \$9,098,085,680 as of August 31, 2013, whose fair values have been estimated by management in the absence of readily determinable fair values. Our opinion is not modified with respect to this matter.

## *Other Matters*

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The Introduction, Statistical Summary, Bond Guarantee Program, Supplemental Schedules, and Compliance Statement are presented for purposes of additional analysis and are not a required part of the financial statements.

The Introduction, Statistical Summary, Bond Guarantee Program, Supplemental Schedules, and Compliance Statement have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### *Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2013, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.



John Keel, CPA  
State Auditor

December 20, 2013

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## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This Management's Discussion and Analysis (MD&A) is required by the Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments (GASB 34)*. The purpose of the MD&A is to provide an objective and easy to read analysis of the Texas Permanent School Fund (Fund) financial activities based on currently known facts, decisions, and conditions. Please read the MD&A in conjunction with the transmittal letters from the Commissioner of Education, the Executive Administrator, and the Fund's financial statements.

The activity of the Fund directed by the State Board of Education (SBOE) shall be referred to throughout as the PSF(SBOE). The activity of the Fund managed by the School Land Board (SLB) shall be referred to throughout as the PSF(SLB). The SLB manages designated land, mineral interests, and real assets investments of the Fund as detailed in the notes to the financial statements. All other Fund assets are the management responsibility of the SBOE. The annual report of the Fund is divided into five sections: the introduction, the financial statements with accompanying notes preceded by this MD&A, statistical summaries and analyses, a summary of the Bond Guarantee program, and supplemental financial information for the PSF(SBOE).

### FINANCIAL HIGHLIGHTS

- The total fund balance of the Fund increased \$1.8 billion or 6.2% during fiscal year 2013.
- The Fund provided \$1.3 billion during the fiscal year toward the cost of public education in the State. The PSF(SBOE) provided \$1 billion, derived by using the total return based distribution method of the Texas Constitution, Article 7, Section 5(a). The PSF(SLB) provided \$300 million based on Section 51.413 of the Natural Resources Code.
- As of August 31, 2013, \$55.2 billion in school district bond issues were guaranteed by the Fund in support of public education in Texas. The amount outstanding increased 3.0% from the prior fiscal year end.

### Required Financial Statements

GASB 34 requires two financial statements for governmental funds: the balance sheet and the statement of revenues, expenditures, and changes in fund balance. These statements report financial information regarding the Fund's activities under U.S. Generally Accepted Accounting Principles.

The notes to the financial statements contain supplemental information that is essential for the fair presentation of the financial statements.

### **Balance Sheet**

The balance sheet reports the assets, liabilities, and fund balance of the Fund.

The assets of the Fund are categorized into current and non-current. Current assets include

cash and other assets that can generally be converted into cash within one year and are used primarily to settle the day-to-day security clearing activities/capital calls of the PSF(SBOE) assets and the purchase of real assets investments by the PSF(SLB). Securities lending cash collateral invested represents the largest category of current assets, other than cash and cash equivalents. The PSF(SBOE) engages in securities lending activity in order to earn incremental income. Please read the notes to the financial statements to get a detailed explanation of the securities lending program.

Non-current assets consist primarily of PSF(SBOE) investments, including public market equity, fixed income securities and alternative investments, such as absolute return, real estate, private equity, risk parity and real return investments. Also included in non-current assets are PSF(SLB) investments in land, mineral interests, and real assets investments.

Most assets are valued at their fair values based on quoted market prices, as of the date of the financial statements. Short-term securities which have maturities with less than one year at the time of purchase are valued at amortized cost, which approximates fair value. Investments in alternative investments are valued by the PSF(SBOE) at fair values as determined by management. Absolute return investment values are based on the net asset value (NAV) of each fund-of-funds, as communicated to management by the investment advisor of the funds. Values of the risk parity strategies are based on the NAV of the fund provided to management by the general partner or the investment advisor, as applicable, for each investment structure. Real estate and private equity investment fund fair values are estimated by management based on the latest capital account balance or latest valuation data, respectively. The latest capital account balance or valuations are adjusted for contributions and withdrawals subsequent to the latest reporting or valuation date as communicated to management by the investment manager or general partner. Commodity fair values are based on NAVs provided by the commodity funds general partners.

PSF(SLB) investments in real assets represent real property and ownership interests in externally managed real asset investment funds, separate accounts, and co-investment vehicles held for the benefit of the Fund, and are carried at fair value. Investments in sovereign lands and mineral interests are reported at cost.

The fair market value of the externally managed PSF(SLB) real assets investment portfolio is determined by using the valuations provided by the portfolio's investment managers at June 30, 2013, adjusted for any subsequent contributions or distributions that occurred through August 31, 2013.

The fair value of the Fund's land surface value is based on estimated appraisal values or values independently determined by the staff in the General Land Office (GLO) Appraisal Division. The GLO uses data from studies conducted by the Texas Chapter of the American Society of Farm Managers and Rural Appraisers, Multiple Listing Services throughout the State, and CoStar commercial sales data in certain metropolitan areas. The fair value of the Fund's interest in oil, gas, and hard minerals is based on an estimate of the present value of future royalty cash flows using a 10 percent discount rate. Future royalty cash flow projections from oil and gas are based on 12-month average prices preceding the valuation date and an estimate of future production from existing wells. The estimate of future production is based on Oil & Gas Industry submissions of such volumes for the 12-month period prior to valuation and reduced to account for estimated depletion. Hard mineral future cash flows are also estimated based on future royalty approximations and discounted. Nonproducing proven reserves of oil, gas, and hard



minerals are not included in the estimate.

Because of the inherent uncertainty of estimated valuations, the fair values of investments that are estimated by management may differ significantly from the value that would have been used had a ready market for these investments existed and such differences could be material to the financial statements. Actual results could differ from the estimates.

Liabilities represent claims against the Fund as of August 31, 2013. The payable for PSF(SBOE) securities lending cash collateral invested is the largest category of liabilities and represents the value of the cash collateral provided by the borrowers in accordance with the securities lending agreement. This collateral is returned to the borrowers when the securities are returned from loan.

The fund balance of the Fund has been classified in accordance with GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The corpus of the Fund is classified as nonspendable and is calculated based on the original source and type of revenue deposited to the Fund since inception. The balance of the Fund is classified as restricted based on the provisions in the Texas Constitution which limit the use of the Fund to support public free schools.

Table 1 below shows the values of the Fund's assets, liabilities, and fund balance as of August 31, 2013 and 2012. Total fund balance increased by 6.2% during the fiscal year. This increase was primarily attributable to the increase in the fair value of the PSF(SBOE) equities and alternative assets and the PSF(SLB) real assets investments. The increase in the fair value of the PSF(SBOE) and PSF(SLB) investments is consistent with the increase in value of the markets in which those investments were made.

TABLE 1  
Summarized Balance Sheet Accounts (in Millions)

	As of August 31, 2013	As of August 31, 2012	Amount of Increase (Decrease)	Percent Change
<b>ASSETS</b>				
Investments	\$ 29,191.1	\$ 27,369.3	\$ 1,821.8	6.7%
Securities Lending Cash Collateral Invested	138.9	370.5	(231.6)	-62.5%
Cash, Receivables, and Other Assets	1,615.8	1,656.9	(41.1)	-2.5%
<b>TOTAL ASSETS</b>	<b>\$ 30,945.8</b>	<b>\$ 29,396.7</b>	<b>\$ 1,549.1</b>	<b>5.3%</b>
<b>LIABILITIES</b>				
Payables for Investments Purchased	\$ 32.1	\$ 18.1	\$ 14.0	77.4%
Payables for Security Lending Cash Collateral Invested	205.5	470.2	(264.7)	-56.3%
Other Liabilities	106.7	105.5	1.2	1.1%
<b>TOTAL LIABILITIES</b>	<b>\$ 344.3</b>	<b>\$ 593.8</b>	<b>\$ (249.5)</b>	<b>-42.0%</b>
<b>TOTAL FUND BALANCE</b>	<b>\$ 30,601.5</b>	<b>\$ 28,802.9</b>	<b>\$ 1,798.6</b>	<b>6.2%</b>

Unless determined otherwise, the PSF(SLB) deposits all of the proceeds of mineral leases and royalties generated from existing and future leases of the Fund's mineral interests into a special fund

(Real Estate Special Fund Account or RESFA) at the State Treasury. These proceeds can be used by the SLB to acquire additional tracts of land; to acquire interests in real property for biological, commercial, geological, cultural, or recreational purposes; to acquire mineral and royalty interests; to acquire interests in real estate; to pay for reasonable fees for professional services related to these investments; or to acquire, sell, lease, trade, improve, maintain, protect, or use land, mineral royalty interests, or real assets investments, an investment or interest in public infrastructure, or other interests, all for the use and benefit of the Fund. Note 3 of the notes to the financial statements contain a summary of the historical cost of the land owned by the Fund. As of August 31, 2013 the estimated fair value of the land, real assets investments and mineral rights (excluding cash) was approximately \$4.8 billion and the historical cost was \$2.2 billion. Sovereign lands and minerals are reported at historical cost on the balance sheet and per GASB Statement No. 52 the remaining real assets are reported at fair value.

### Statement of Revenues, Expenditures, and Changes in Fund Balance

The statement of revenues, expenditures, and changes in fund balance represents the activity from the PSF(SBOE) investment portfolio and the PSF(SLB) real assets investment portfolio that occurred during the fiscal year.

TABLE 2  
Summarized Revenue and Expenditure Accounts (in Millions)

	Fiscal Year Ended August 31, 2013	Fiscal year Ended August 31, 2012	Amount of Increase (Decrease)	Percent Change
<b>REVENUES</b>				
Land Endowment Income	\$ 410.4	\$ 390.5	\$ 19.9	5.1%
Settlement of Claims	30.4	-	30.4	n/a
Dividends and Interest Income	635.5	598.8	36.7	6.1%
Securities Lending (net of rebates/fees)	8.8	6.3	2.5	39.7%
Gain on Sale of Sovereign Land	2.7	9.8	(7.1)	-72.4%
Net Increase in Fair Value of Investments	2,064.2	1,897.6	166.6	8.8%
Revenue from Sales of Purchased Gas	51.1	46.8	4.3	9.2%
Other Income	0.1	1.8	(1.7)	-94.4%
<b>TOTAL REVENUES</b>	<b>3,203.2</b>	<b>2,951.6</b>	<b>251.6</b>	<b>8.5%</b>
<b>EXPENDITURES</b>				
PSF(SBOE) Operational Costs	16.4	12.7	3.7	29.1%
PSF(SLB) Operational Costs	23.2	19.9	3.3	16.6%
SEMP Gas Supplies Purchased for Resale	44.1	42.4	1.7	4.0%
<b>TOTAL EXPENDITURES</b>	<b>83.7</b>	<b>75.0</b>	<b>8.7</b>	<b>11.6%</b>
<b>TOTAL NET TRANSFERS</b>	<b>(1,320.9)</b>	<b>(1,020.9)</b>	<b>(300.0)</b>	<b>29.4%</b>
<b>NET CHANGE IN FUND BALANCE</b>	<b>1,798.6</b>	<b>1,855.7</b>	<b>(57.1)</b>	<b>-3.1%</b>

In fiscal year 2013, revenues earned by the Fund included lease payments, bonuses and royalty income received from oil, gas and mineral leases; lease payments from commercial real estate; surface lease and easement revenues; revenues from the resale of natural and liquid gas supplies; dividends, interest, and securities lending revenues; changes in fair value of the investment portfolio, and other miscellaneous fees and income. Expenditures are paid from the Fund before distributions are made under the total return formula. Such expenditures include the costs incurred by the PSF(SLB) to manage the land endowment and operational costs of the PSF(SBOE), including certain external management fees. Management fees for alternative

investments are paid from the investment assets themselves.

For fiscal year 2013, total revenues were \$3.2 billion, an increase of \$251.6 million from the fiscal year 2012 amount of \$3.0 billion. This increase is reflective of the performance of the markets in which the Fund was invested in fiscal year 2013. Total operating expenditures, net of security lending rebates and fees, increased 11.6% from \$75.0 million for fiscal year ending August 31, 2012 to \$83.7 million for the fiscal year ending August 31, 2013. The increase for both PSF(SBOE) and PSF(SLB) is primarily attributable to the operational costs related to managing alternative investments due to diversification of the Fund. Overall, the fund balance increased by \$1.8 billion for fiscal year ending August 31, 2013.

## **INVESTMENT MANAGEMENT**

### **PSF(SBOE) Asset Allocation and Portfolio**

In July 2012, the SBOE approved a revised long term asset allocation policy to further diversify the PSF(SBOE) assets into alternative asset classes whose returns are not as correlated to traditional asset classes. It is expected that over time, this shift will provide incremental total return at reduced risk. It is anticipated that asset classes will be strategically added commensurate with the economic environment and the goals and objectives of the SBOE. Investments in absolute return were launched during fiscal year 2008 and real estate and private equity were launched during the later part of fiscal year 2010. Risk parity strategies and real return investments in Treasury Inflation Protected Securities (TIPS) were implemented in the later months of fiscal year 2011. Real return investments in commodities were funded in fiscal year 2013 and increased allocations were made to both real estate and private equity. The emerging market debt asset class will be added in 2014. The remaining asset class on the SBOE strategic allocation plan for the PSF(SBOE) assets is emerging international equity securities.

Table 3 indicates the strategic asset allocation of PSF(SBOE) approved by the SBOE in July 2012. The equity allocation is managed passively. Domestic equity is managed by internal staff while international equity is managed by an external manager. Fixed income and real return TIPS portfolios are actively managed by internal staff. The absolute return investments are held within seven (7) single member limited liability companies, each with an external investment manager. The Fund entered two (2) strategic partnerships with existing investment management firms within the absolute return asset class in November 2012. These two funds are jointly managed by the staff and these two investment management firms. Risk parity strategies are managed in one limited liability company and one limited partnership, each with an external manager. Real estate investments are executed direct with general partners utilizing limited partnership agreements. Private equity investments are managed in four (4) limited partnerships. The private equity partnerships launched in 2010 are managed by two external investment managers. In 2013, the Fund entered into two additional partnerships with one of the existing external managers. One of these is jointly managed by the staff and the investment manager. Actual allocations within the portfolios fluctuate as the markets shift and portfolio rebalancing takes place as needed to adhere to the strategic allocation guidelines. Commodities are also managed within two (2) limited partnerships utilizing external investment managers.

TABLE 3  
Strategic Asset Allocation – PSF(SBOE)  
Fiscal Years Ending August 31, 2013 and 2012

ASSET CLASS	2013	2012	Increase (Decrease)
<b>EQUITY</b>			
Domestic Small/Mid Cap	7.0%	7.0%	0.0%
Domestic Large Cap	18.0%	18.0%	0.0%
<b>Total Domestic Equity</b>	<b>25.0%</b>	<b>25.0%</b>	<b>0.0%</b>
International Developed and Emerging			
Large Cap	18.0%	18.0%	0.0%
International Small/Mid Cap	0.0%	0.0%	0.0%
Emerging International Equities	3.0%	3.0%	0.0%
<b>Total International Equity</b>	<b>21.0%</b>	<b>21.0%</b>	<b>0.0%</b>
<b>TOTAL PUBLIC MARKET EQUITY</b>	<b>46.0%</b>	<b>46.0%</b>	<b>0.0%</b>
<b>FIXED INCOME</b>			
Core Fixed Income	12.0%	12.0%	0.0%
Emerging Market Debt	5.0%	5.0%	0.0%
<b>TOTAL FIXED INCOME</b>	<b>17.0%</b>	<b>17.0%</b>	<b>0.0%</b>
<b>ALTERNATIVE INVESTMENTS</b>			
Absolute Return	10.0%	10.0%	0.0%
Real Estate	8.0%	8.0%	0.0%
Private Equity Investments	6.0%	6.0%	0.0%
Risk Parity	7.0%	7.0%	0.0%
Real Return	6.0%	6.0%	0.0%
<b>TOTAL ALTERNATIVE INVESTMENTS</b>	<b>37.0%</b>	<b>37.0%</b>	<b>0.0%</b>
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>

The market value of the PSF(SBOE) is directly impacted by the performance of the various financial markets in which the assets are invested. In addition, the PSF(SBOE) investments are exposed to various risks, such as interest rate, market, and credit risks. The most important factor affecting investment performance is the asset allocation decision made by the SBOE. The PSF(SBOE) investment in public equity securities experienced a return of 17.7% during the fiscal year. The absolute return investments yielded a return of 10.2% and real estate and private equity investments returned 11.9% and 26.9%, respectively. The investment in fixed income return was -2.0% for the fiscal year due to market reactions to the Federal Reserve decisions made during the year. Risk parity and real return portfolios returned -3.3% and -8.0%, respectively. Combined, all asset classes produced an investment return of 10.2% for the fiscal year ending August 31, 2013.

Table 4 summarizes the changes in the composition of the PSF(SBOE) investment portfolio, including cash, during the fiscal year and does not include real assets or cash under the management of the (PSF)SLB. The total fair value of the PSF(SBOE) investments increased by \$1.7 billion (6.5%) from the previous fiscal year. Unallocated Cash is on hand at fiscal year-end pending capital calls for alternative investments. At August 31, 2013, PSF(SBOE) unfunded commitments to real estate investments totaled \$513 million and unfunded commitments to the four private equity limited partnerships totaled \$1.58 billion.

**TABLE 4**  
**Comparative Investment Schedule – PSF(SBOE) (in millions)**  
**Fiscal Years Ending August 31, 2013 and 2012**

ASSET CLASS	Fiscal Year Ended August 31, 2013	Fiscal Year Ended August 31, 2012	Amount of Increase (Decrease)	Percent Change
<b>EQUITY</b>				
Domestic Small Cap	\$ 2,210.4	\$ 2,047.8	\$ 162.6	7.9%
Domestic Large Cap	7,421.9	7,495.5	(73.6)	-1.0%
Total Domestic Equity	9,632.3	9,543.3	89.0	0.9%
International Equity	4,822.9	4,311.9	511.0	11.9%
<b>TOTAL EQUITY</b>	<b>14,455.2</b>	<b>13,855.2</b>	<b>600.0</b>	<b>4.3%</b>
<b>CORE FIXED INCOME</b>	<b>4,933.0</b>	<b>5,439.6</b>	<b>(506.6)</b>	<b>-9.3%</b>
<b>ALTERNATIVE INVESTMENTS</b>				
Absolute Return	2,806.1	2,561.5	244.6	9.5%
Real Estate	858.1	624.6	233.5	37.4%
Private Equity Investments	724.5	435.4	289.1	66.4%
Risk Parity	1,754.3	1,818.9	(64.6)	-3.6%
Real Return	1,554.3	753.9	800.4	106.2%
<b>TOTAL ALTERNATIVE INVESTMENTS</b>	<b>7,697.3</b>	<b>6,194.3</b>	<b>1,503.0</b>	<b>24.3%</b>
<b>UNALLOCATED CASH</b>	<b>80.0</b>	<b>13.9</b>	<b>66.1</b>	<b>475.5%</b>
<b>TOTAL PSF(SBOE) INVESTMENTS</b>	<b>\$ 27,165.5</b>	<b>\$ 25,503.0</b>	<b>\$ 1,662.5</b>	<b>6.5%</b>

### **PSF(SLB) Portfolio**

The real assets investment portfolio managed by the PSF(SLB) is generally characterized by three broad categories: (1) discretionary real assets investments, (2) sovereign and other lands, and (3) mineral interests. Discretionary real assets investments consist of externally managed real estate, infrastructure, and energy/minerals investment funds, separate accounts, and co-investment vehicles; internally managed direct real estate investments, and cash that is associated with the RESFA. Sovereign and other lands consist primarily of the lands set aside to the Fund when it was created. Mineral interests consist of the minerals that are associated with Fund lands.

**TABLE 5**  
**Comparative Investment Schedule – PSF(SLB)**  
**Fiscal Years Ending August 31, 2013 and 2012**  
**(in Millions)**

Asset Class	As of August 31, 2013	As of August 31, 2012	Amount of Increase (Decrease)	Percent Change
Discretionary Real Assets Investments				
Externally Managed				
Real Assets Investments Funds*				
Energy/Minerals	\$ 204.1	\$ 226.5	\$ (22.4)	-9.9%
Infrastructure	378.5	299.5	79.0	26.4%
Real Estate	1,144.7	1,025.4	119.3	11.6%
Internally Managed Direct				
Real Estate Investments	348.9	313.4	35.5	11.3%
Total Discretionary Real Assets Investments	<u>2,076.2</u>	<u>1,864.8</u>	<u>211.4</u>	11.3%
Sovereign and Other Lands	366.2	360.5	5.7	1.6%
Mineral Interests	2,307.1	2,180.5	126.6	5.8%
Cash at State Treasury**	<u>1,216.0</u>	<u>1,376.0</u>	<u>(160.0)</u>	-11.6%
Total PSF(SLB) Investments	<u>\$ 5,965.5</u>	<u>\$ 5,781.8</u>	<u>\$ 183.7</u>	3.2%

\*The fair values of externally managed real assets investment funds, separate accounts, and co-investment vehicles are estimated by management using the most recent valuations available, adjusted for subsequent contributions and withdrawals.

\*\*Cash at State Treasury represents amounts that have been deposited in the State Treasury and temporarily invested in short-term investments until called for investment by the external real assets investment funds, separate accounts, and co-investment vehicles to which PSF(SLB) has made capital commitments. PSF(SLB) is required by statute to deposit cash designated by the SLB for investment in real assets in the State Treasury until it is drawn for investment.

### **Discretionary Real Assets Investments – External**

Approximately \$280.0 million of capital commitments to externally managed real assets investment funds, separate accounts, and co-investment vehicles were funded during Fiscal Year 2013. At August 31, 2013, approximately \$2.2 billion of total capital commitments had been funded, net of the original capital commitments associated with any investments that were subsequently sold or dissolved, and the fair value of the investments was approximately \$1.7 billion.

### **Discretionary Real Estate Investments – Internal**

At August 31, 2013, there were approximately 33 internally managed discretionary real estate investments with a fair value of approximately \$348.9 million.

## **Sovereign and Other Lands**

At August 31, 2013, the sovereign lands portfolio, which is primarily composed of approximately 427,000 acres of land-locked tracts in West Texas, had a fair value of approximately \$262.7 million. In addition to the sovereign lands portfolio, the PSF also owns approximately 843,000 acres of other lands with a fair value of approximately \$103.6 million.

## **Mineral Interests**

The PSF also owns approximately 12.6 million acres of various submerged, free royalty, mineral-reserved lands, and mineral interest with a fair value of approximately \$2.3 billion.

## **PSF(SLB) Portfolio Returns**

At August 31, 2013, discretionary real assets investments, including Cash at the State Treasury (most of which was associated with existing unfunded capital commitments to new real assets investments) were approximately \$3.3 billion, which was approximately 10.7% of the total Fund assets of approximately \$30.9 billion. Discretionary real assets investments, excluding Cash at the State Treasury, were approximately \$2.1 billion, which was approximately 6.8% of total Fund assets. Discretionary real assets investments within the RESFA managed by PSF(SLB) are currently limited by the Natural Resource Code (NRC) to no more than 15% of the market value of total Fund assets.

At June 30, 2013, the gross time-weighted returns and Internal Rate of Return (IRR) on the PSF(SLB) discretionary real assets investment portfolio were as follows:

	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>	<u>Inception</u>	<u>IRR</u>
Excluding Cash	12.67%	16.35%	1.75%	9.36%	4.96%
Including Cash	7.60%	9.56%	1.04%	4.90%	2.91%

### **Note:**

*PSF(SLB) is required to deposit cash designated by the SLB for investment in real assets into the State Treasury for investment in short-term investments until it is ultimately drawn for investment in real assets. It is typical for capital commitments to externally managed real assets investment funds to be drawn down over a two to three year investment period. This typical delay between commitment and funding can create a negative effect on returns (typically referred to as a "cash drag") until the committed cash is finally drawn.*

## **OTHER PROGRAMS**

### **Support Provided to the Public School System**

The Fund supports the State's public school system in two major ways, through distributions to the ASF and the guarantee of school district issued bonds. The Fund distributes a predetermined percentage of its asset value to the ASF. For fiscal year 2013 the PSF(SBOE) distribution to the ASF totaled \$1.0 billion, and the PSF(SLB) direct distribution to the ASF totaled \$300 million. The SBOE adopted new administrative rules in September 2009 based on Attorney General Opinion GA-0707 issued on April 13, 2009. These rules state the SBOE will determine each year whether a distribution to the ASF is permitted under the Texas Constitution, Article VII, §5(a)(2), and shall be made for the current fiscal year.

Through the Bond Guarantee Program (BGP), the Fund is pledged to guarantee bonds issued by Texas school districts thus enhancing their credit rating. Since its inception in 1983, the Fund has guaranteed 5,280 school district bond issues for a total of \$112.0 billion. During the past fiscal year, the number of outstanding issues increased by 155 (5.9%). The dollar amount of issues outstanding increased by approximately \$1.6 billion (3.0%). This program is designed for school districts with credit ratings lower than AAA. Bonds issued under the Bond Guarantee Program are rated AAA, thus allowing participating school districts to borrow at a lower cost.

TABLE 6  
Comparative Summary of the Bond Guarantee Program  
(in Millions except for Number of Issues)

	Fiscal Year Ending August 31, 2013	Fiscal Year Ending August 31, 2012	Amount of Increase (Decrease)	Percent Change
Number of Issues	2,789	2,634	155	5.9%
Issues Guaranteed During the Year	\$ 8,565.8	\$ 7,197.0	\$ 1,368.8	19.0%
Issues Refunded or Matured during the Fiscal Year	\$ 6,981.4	\$ 6,216.5	\$ 764.9	12.3%
Year End Balance	\$ 55,218.9	\$ 53,634.5	\$ 1,584.4	3.0%
Total Guarantee Capacity	\$ 76,797.9	\$ 75,486.0	\$ 1,311.9	1.7%

The capacity of the Fund to guarantee bonds under the BGP is limited in two ways: by State law (the "State Capacity Limit") and by the Internal Revenue Service (IRS) Notice 2010-5 (Notice) received by TEA on December 16, 2009. The State Capacity Limit is currently three (3) times the latest cost value of the Fund. IRS Notice 2010-5 changed the Internal Revenue Service Limit to a sum certain amount calculated on the date of the Notice, which totals \$117,318,653,038. Texas Education Code Section 45.053(d) provides that the SBOE may, by rule, increase the capacity of the Guarantee Program to an amount not to exceed five (5) times the cost value of the Fund, provided that the increased limit does not violate federal law and regulations and does not prevent bonds guaranteed by the Guarantee Program from receiving the highest available credit rating, as determined by the SBOE. SB 389 further provides that the SBOE shall at least annually consider whether to change the capacity of the Guarantee Program. Additionally, the 82<sup>nd</sup> Texas Legislature authorized the use of the PSF to guarantee revenue bonds issued by certain open enrollment charter school districts. It is anticipated that this process will not become effective until certain requirements are satisfied. For further discussion, please see Note 9 to the financial statements.



**TEXAS PERMANENT SCHOOL FUND  
BALANCE SHEET  
AUGUST 31, 2013**

**Assets**

Current Assets:

Cash and Cash Equivalents	
Cash in Bank	\$ 3,457,462
Cash in State Treasury	1,392,547,368
Cash Equivalents	60,974,112
Securities Lending Cash Collateral Invested	138,865,074
Receivables	
Interest and Dividends Receivable	64,877,559
Investments Sold	7,046,667
Land Endowment Revenue	84,908,053
Land Sale Notes	38,246
Due from Broker for Margin Collateral	1,879,000
Due From Other Funds	50,775
Prepaid Items	6,000
<b>Total Current Assets</b>	<b><u>\$ 1,754,650,316</u></b>

Non-Current Assets

Investments, at fair value	\$ 29,173,820,201
Investments in Sovereign Land and Minerals, at historical cost	13,890,356
Land Sale Notes	3,432,641
<b>Total Non-Current Assets</b>	<b><u>\$ 29,191,143,198</u></b>

**Total Assets**

**\$ 30,945,793,514**

**Liabilities And Fund Balances**

Current Liabilities:

Accounts Payable	\$ 14,512,215
Payroll Payable	3,308,161
Interest	197
Payable for Investments Purchased	32,145,590
Unearned Revenue	88,728,312
Due To Other Funds	101,844
Payable for Securities Lending Cash Collateral Invested	205,505,653
<b>Total Current Liabilities</b>	<b><u>\$ 344,301,972</u></b>

**TOTAL LIABILITIES**

**\$ 344,301,972**

**Fund Financial Statement-Fund Balances**

Nonspendable	\$ 12,279,926,457
Restricted for Public School Support	18,321,565,085
<b>Total Fund Balance</b>	<b><u>\$ 30,601,491,542</u></b>
<b>Total Liabilities And Fund Balance</b>	<b><u>\$ 30,945,793,514</u></b>

The accompanying notes are integral part of these financial statements

**TEXAS PERMANENT SCHOOL FUND**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE**  
**FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>Revenues</b>	
Interest, Dividends and Other Investment Income	\$ 635,529,257
Settlement of Claims	30,440,278
Securities Lending	10,329,594
Gain on Sale of Sovereign Land	2,686,641
Net Increase in Fair Value of Investments	2,064,157,564
Land Endowment Income	410,446,910
Revenue from Sales of Purchased Gas	51,120,948
Other	51,473
	<hr/>
<b>Total Revenues</b>	<b>\$ 3,204,762,665</b>
<b>Expenditures</b>	
Salaries and Wages	\$ 20,793,243
Payroll Related Costs	4,123,696
Professional Fees and Services	6,868,885
Travel	300,353
Materials and Supplies	664,765
Communication and Utilities	1,455,319
Gas Supplies Purchased for Resale	44,136,510
Repairs and Maintenance	1,067,922
Rentals and Leases	974,719
Printing and Reproduction	20,478
Claims and Judgments	220,000
Securities Lending Rebates and Fees	1,548,979
Other Expenditures	3,083,677
Capital Outlay	50,461
	<hr/>
<b>Total Expenditures</b>	<b>\$ 85,309,007</b>
	<hr/>
<b>Excess of Revenues Over Expenditures</b>	<b>\$ 3,119,453,658</b>
<b>Other Financing Sources/(Uses)</b>	
Transfers Out	<hr/> <b>\$ (1,320,886,919)</b>
	<hr/>
Total Other Financing Sources/(Uses)	<b>\$ (1,320,886,919)</b>
	<hr/>
Net Change in Fund Balance	1,798,566,739
<b>Fund Financial Statement-Fund Balance</b>	
Fund Balance-September 1, 2012	<hr/> 28,802,924,803
	<hr/>
Fund Balance-August 31, 2013	<b>\$ 30,601,491,542</b>
	<hr/> <hr/>

The accompanying notes are integral part of these financial statements

# **TEXAS PERMANENT SCHOOL FUND**

## **NOTES TO THE FINANCIAL STATEMENTS**

### **1. Summary of Significant Accounting Policies**

#### **A. The Reporting Entity**

The Texas Permanent School Fund (the Fund) was created with a \$2,000,000 appropriation by the Legislature of 1854 expressly for the benefit of funding public education for present and future generations. The Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the Fund. Additional Acts later gave more public domain land and rights to the Fund. In 1953, the U.S. Congress passed the Submerged Lands Acts that relinquished to coastal States all rights of the U.S. navigable waters within State boundaries. If the State, by law, had set a boundary larger than three miles prior to or at the time of admission to the U.S., or if the boundary had been approved by Congress, then the larger boundary applied. Concluding three years of litigation, the U. S. Supreme Court on May 31, 1960, affirmed Texas' historic three league (10.35 miles) seaward boundary. Texas proved its submerged lands property rights to three leagues into the Gulf of Mexico by citing historic laws and treaties dating back to 1836. All lands lying within that limit belong to the Fund. The Fund currently owns approximately 15 million total acres.

The State of Texas (State) Constitution describes the Fund as "permanent" and "perpetual" with proceeds produced by the Fund to be used to complement taxes in financing public education. Under an obligation to maintain trust principal, the Fund's assets are held in a trustee capacity for the benefit of public free schools. The annual distribution provided by the Fund is calculated using a total return methodology.

The Fund's financial assets are managed by the State Board of Education (SBOE). The SBOE is comprised of fifteen elected members. Administrative duties related to these assets reside with the Fund's Investment Office, a division of the Texas Education Agency (TEA), which is under the guidance of the Commissioner of Education, an appointee of the Governor. Investment Office operations are included in the TEA's financial report for inclusion in the State's Comprehensive Annual Financial Report (CAFR). The Fund's financial statements are reported as a governmental permanent fund in the State's CAFR. The portion of the Fund directed by the SBOE shall be referred to within these notes as the PSF(SBOE) assets.

Texas law assigns control of the Fund's land, mineral rights, and certain real assets investments to the three-member School Land Board (SLB), which includes the elected Commissioner of the General Land Office (GLO), an appointee of the Governor, and an appointee of the Attorney General. Administrative duties related to the land and mineral rights reside with the GLO, which is under the guidance of the Commissioner of the GLO. SLB land and real assets investment operations are included in the GLO's annual financial report for inclusion in the State's CAFR. The portion of the Fund managed by the SLB shall be referred to within these notes as the PSF(SLB) assets.

The 79th Legislature authorized the SLB to manage and operate the State Energy Marketing Program (SEMP) with land sale, lease, and royalty receipts of the Fund. This legislation allowed for certain portions of SEMP accounting to be consolidated into the Fund from a special revenue fund.

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

### **B. Basis of Presentation and Basis of Accounting**

The accompanying financial statements of the Fund were prepared to conform to U.S. Generally Accepted Accounting Principles (GAAP) as established by the Governmental Accounting Standards Board (GASB).

The Fund is classified as a governmental permanent fund. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. The Management's Discussion and Analysis is required as supplementary information preceding the financial statements.

Measurement focus refers to the definition of the resource flows measured and has to do with the types of transactions or events reported in the statement of revenues, expenditures, and changes in fund balance. Basis of accounting refers to the timing of the recognition of transactions or events. Under the modified accrual basis of accounting, amounts are recognized as revenues in the period in which they are available to finance expenditures of the current period and are measurable. The Fund considers revenues available if they are collected within 60 days of the end of the current period. Accruals whose receipt is due after the 60 day period are classified as unearned revenue. Amounts are considered measurable if they can be estimated or otherwise determined. Expenditures are recognized in the period in which the related fund liability is incurred, if measurable.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of income and expenditures during the reporting period. Alternative investments, including absolute return fund of funds, risk parity strategies, commodities (real return investments), private equity and real estate, are valued by the PSF(SBOE) at fair values as determined by management. The real assets investments are valued by the PSF(SLB) at fair values as determined by management.

The budget is prepared biennially and represents appropriations authorized by the Legislature and approved by the Governor of Texas (the General Appropriations Act). Encumbrance accounting is employed for budgetary control purposes. Unencumbered appropriations are generally subject to lapse 60 days after the end of the fiscal year for which they were appropriated.

### **C. Assets, Income, Expenditures, and Operating Transfers**

#### **Cash and Cash Equivalents**

Cash and cash equivalents consist of money market instruments, cash held at the State Treasury, cash held in a FDIC insured bank account, foreign currencies and other overnight funds. The PSF(SBOE) cash in bank balance represents the U.S. dollar equivalent of amounts held in foreign currencies for which trade settlement is pending and dividend payment is awaiting repatriation. The Fund's deposits with the State Treasury are available upon demand

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

and are therefore presented as cash. Cash equivalents on the balance sheet represent cash balances that are invested in the money market fund managed by the PSF(SBOE) custodian, The Bank of New York Mellon Corporation (Custodian). Cash held in the money market fund is primarily utilized to settle investment obligations. Cash and cash equivalents are an integral part of investment management of the Fund.

### **Receivables**

The PSF(SLB) reports receivables based on revenues earned during the fiscal year. The voluntary oil and gas royalty receivables are calculated from production reports or remittance advices; the payments and reporting of these royalties are not legally due until the second month after production occurs. The receivables for voluntary oil and gas royalties are established based on the information received in the remittance advices in September and October 2013 for the production months August 2013 and earlier.

The PSF(SBOE) reports receivables based on revenues earned but not collected during the fiscal year.

### **Investments**

Investment transactions are recorded on a trade date basis. Investments other than land endowment are reported at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. PSF(SBOE) investments, such as equities and fixed income securities with readily determinable fair values, are valued on the basis of market valuations provided by the Custodian. Short-term securities, which have maturities less than one year at the time of purchase, are valued at amortized cost, which approximates fair value.

Fair values of PSF(SBOE) absolute return fund of funds are based on the net asset value (NAV) provided to management by the investment advisors of the funds.

Fair values of PSF(SBOE) risk parity strategies are based on the NAV provided to management by the general partner or the investment advisor, as applicable for each investment structure.

Fair values of PSF(SBOE) real estate investments are estimated by management using the latest valuation provided by the general partners, adjusted for contributions and withdrawals subsequent to the latest available valuation reporting date.

Fair values of PSF(SBOE) private equity investment funds are estimated by management using the investment's capital account balance at the latest available reporting date, as communicated by the investment manager or general partner, adjusted for contributions and withdrawals subsequent to the latest available reporting date.

Fair values of PSF(SBOE) commodity investment funds, which are a component of the real return portfolio, are based on the NAV provided to management by the general partners of the funds.

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

Fair values of the externally managed PSF(SLB) real assets investments portfolio are estimated by management using the latest valuation provided by the general partner, adjusted for contributions and withdrawals subsequent to the latest available valuation reporting date.

Fair values of the internally managed PSF(SLB) real assets investments are based on estimated appraisal values or values independently determined by the staff in the Appraisal Division of the GLO. The GLO uses data from studies conducted by the Texas Chapter of the American Society of Farm Managers and Rural Appraisers, Multiple Listing Services throughout the state, and CoStar commercial sales data in certain metropolitan areas.

Because of the inherent uncertainty of valuations, the value of alternative investments estimated by management may differ significantly from the value that would have been used had a liquid market for these investments existed and such differences could be material to the financial statements. Actual results could differ from the estimates.

Investments are registered in the name of the Fund or are registered in the nominee name of the Custodian of the Fund, and are held in the name of the Fund by the Custodian. Certain physical securities are held in the name of the Fund. The absolute return investments are held within seven (7) single member limited liability companies, each with an external investment manager. The Fund's ownership interests in the two (2) risk parity strategies are through a limited liability company and a limited partnership, each with an external investment manager. Commodities are managed in two (2) limited partnerships, each with an investment manager. Private equity investments are managed in four (4) limited partnerships, each with an external investment manager. Real estate investments are executed direct with general partners utilizing limited partnership agreements.

### **Land Endowment and Other SLB Real Property Investments**

The land endowment is maintained on the Fund's behalf by the SLB, administered by the GLO and is generally held for the production of related income. Public domain appropriated to the Fund, including surface acres, submerged and offshore lands, and mineral rights, is stated at the State's basis in such holdings. In accordance with GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, real estate held as investments is reported at fair value with the exception of sovereign lands and minerals, which are reported at historical cost. Land acquired through trades is recorded at the fair value of the land traded to the other party with a gain or loss recognized on the exchange per GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. No basis is currently assigned to certain categories of public domain acreage. The acreage for public domain tracts that include surface acres and the underlying mineral rights is counted as both surface acres and mineral acres. However, the historical cost basis for this acreage is allocated between the value assigned to the surface and the value assigned to the mineral rights.

The 77th Legislature amended the Natural Resources Code (NRC) effective September 1, 2001, to allow the GLO to deposit some or all of the proceeds of future mineral leases and royalties generated from existing and future active leases of the Fund's mineral interest into a

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

special account, now called the Real Estate Special Fund Account (RESFA), to be used to acquire additional real assets investments. The 79th Legislature further amended the NRC in 2005 to clarify the purposes on which the funds can be spent, including adding three additional purposes. For the use and benefit of the Fund, the proceeds in the special account are to be used by the SLB to acquire, as public school land, interests in real property for biological, commercial, geological, cultural or recreational purposes; to acquire mineral and royalty interests; to protect, maintain, or enhance the value of public school lands; to acquire interests in real estate; and, to pay reasonable fees for professional services related to Fund investments.

The 80th Legislature passed HB 3699 which further expanded the SLB's authority to spend revenues generated by lands dedicated to the Fund for deposit into the RESFA. The RESFA is to be used to make prudent investments in real assets on behalf of the Fund.

### **Income, Expenditures, and Operating Transfers**

Land endowment income, derived from the real assets administered by the GLO, consists principally of mineral royalties, bonus and delay rental payments, commercial lease payments, operating lease payments and investment gain/loss. Investment income/loss derived from the PSF(SLB) investment assets consists of the net increase/(decrease) in the fair value of real assets investments, interest, and dividends.

Royalty income is recognized upon oil and gas production and the various types of lease income are recognized during the applicable lease period. SEMP revenues are generated from the sale of natural gas supplies and enhancements from the sale of generated electricity to school districts and other governmental entities.

Investment income/loss derived from the PSF(SBOE) investment assets consists of the net increase/(decrease) in the fair value of the investments and securities lending cash collateral, securities lending revenue, and interest and dividends.

Operating and investment management expenditures, less securities lending rebates and fees, totaled \$83,760,028 for fiscal year 2013. Under the direction of the GLO, \$23,192,459 was spent to manage the PSF(SLB) assets and \$16,431,059 was expended by the TEA to administer the PSF(SBOE) assets. SEMP expenditures of \$44,136,510 include the purchase of gas supplies in the open market and are reflected in the total expenditures for 2013.

During the Regular Session of the 82<sup>nd</sup> Legislature, which concluded on May 30, 2011, a joint resolution (HJR 109) was enacted proposing amendments to various sections of the Texas Constitution that pertain to the Fund. In accordance with HJR 109, a referendum was held in the State on November 8, 2011. At that referendum, voters of the State approved non-substantive changes to the Texas Constitution to clarify references to the Fund, and, in addition, approved an amendment that affects an increase to the base amount used in calculating the distribution rate from the PSF(SBOE) to the Available School Fund (ASF). The amendments included an increase to the base used to calculate the distribution rate by adding

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

to the calculation base certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, the SLB).

Article VII, Section 5 of the Texas Constitution has two constraints that affect the amount to be distributed. First, the SBOE is prevented from approving a distribution rate or making transfers to the ASF that exceed 6% of the average of the market value of the Fund, excluding real property, on the last day of each of the sixteen State fiscal quarters preceding the Regular Session of the Legislature that begins before that State fiscal biennium. Second, the total distributions to the ASF over the 10-year period as defined in subsection 5(a)(2) may not exceed the total return on all investment assets of the PSF(SBOE) over the same ten year period.

The constitutional amendments approved also provided authority to the SLB or other non-SBOE entity exercising responsibility for the management of land or other properties of the Fund to determine at its sole discretion whether to transfer annually up to \$300 million from PSF(SLB) assets resulting from revenue derived from such land or properties to the ASF.

The SBOE set the rate for the 2012-2013 biennium at 4.2% based on a commitment of the SLB to transfer \$500 million to the PSF(SBOE) during the biennium. The SLB transferred \$250 million to the PSF(SBOE) during the year ended August 31, 2013. Interfund transfers from the PSF(SBOE) to the Available School Fund (ASF) totaled \$1,020,886,919. The SLB also transferred an additional \$300 million to the ASF during the year ended August 31, 2013.

### **D. Fund Balance Classification**

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* requires that governmental fund balances be classified in the financial statements as nonspendable, restricted, committed, assigned and unassigned. The corpus of the Fund is classified as nonspendable and is calculated based on the original source and type of revenue deposited to the Fund since inception. The balance of the Fund is classified as restricted based on provisions in the Texas Constitution which limit the use of the Fund to the support of public free schools.

### **2. Deposit and Investments**

Deposits and investments of the Fund are exposed to risks that have the potential to result in losses. GASB Statement No. 40, *Deposit and Investment Risk Disclosures-An Amendment to GASB Statement No. 3* establishes and modifies disclosure requirements related to deposit and investment risks. Deposit risks include custodial credit and foreign currency risk. Investment risks include credit risk (custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. This statement applies to all state and local governments.

#### **Investment Policies**

The Texas Constitution and applicable statutes delegate to the SBOE the authority and responsibility for investment of the Fund's assets excluding investment of the land endowment,



## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

which is the responsibility of the School Land Board. In making these investments, the SBOE is charged with exercising the judgment and care under the circumstances then prevailing which persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income there from as well as the probable safety of their capital. The Fund is authorized to purchase, sell, and invest its funds and funds under its control in accordance with the Texas Administrative Code. The deposit policy of the Fund states that all residual cash must be invested on a daily basis. Permissible investments subject to Constitutional and SBOE imposed restrictions include the following:

- a) Equities listed on well recognized principal U.S. or foreign exchanges, including common or preferred stocks; futures; corporate bonds, debentures, and convertible preferred corporate stocks that may be converted into equities; and investment trusts.
- b) Fixed income securities, including U.S. or foreign treasury or government agency obligations, U.S. or foreign corporate bonds, asset or mortgage backed securities, taxable municipal obligations, Canadian bonds, Yankee bonds, supranational bonds denominated in U.S. dollars, and 144A securities. Fixed income securities must be rated at least BBB by Standard and Poor's (S&P), Baa3 by Moody's Investors Service (Moody's) and BBB by Fitch. Fixed income securities may not be purchased unless there is a stated par value amount due at maturity.
- c) Real estate, including investments in real properties, such as apartments, office buildings, retail centers, infrastructure, timberlands and industrial parks. It also includes investments in real estate related securities and real estate related debt.
- d) Private equity, including venture capital, buy-out investing, mezzanine financing and distressed debt.
- e) Absolute return investments which are a diversified bundle of primarily marketable investment strategies that seek positive returns, regardless of market direction.
- f) Real return investments which target a return that exceeds the rate of inflation, measured by the Consumer Price Index (CPI).
- g) Short-term U.S. Government or U.S. Government agency securities, money market funds, corporate discounted instruments, corporate-issued commercial paper, U.S. or foreign bank time deposits, bankers acceptances, and fully collateralized repurchase agreements. Short term money market instruments must be rated at least A-1 by S&P or P-1 by Moody's.
- h) Risk parity strategies.
- i) Any new form of investment or non publicly traded investment approved by the SBOE based on risk and return characteristics consistent with Fund's goals and objectives, and
- j) Currency hedging strategies, as approved by the SBOE, for the international portfolio.

Investments other than PSF(SLB) managed land endowment and other real property at fair value as of August 31, 2013 are as follows.

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<b>PSF(SBOE) Investments</b>	<b>Fair Value</b>
Absolute Return Investments	\$ 2,806,109,527
Real Estate Investments	861,477,909
Private Equity Investments	727,873,283
Risk Parity Strategies	1,754,251,092
Real Return - Commodities	768,637,879
Domestic Equity	9,595,967,573
International Equity - Foreign Currency Denominated	4,726,364,299
International Equity - USD Denominated (ADR/GDR)	87,594,881
Asset Backed Securities	68,492,896
Commercial Mortgage Backed Securities	297,941,907
Corporate Obligations	1,377,184,273
Yankee - Corporate Obligations	36,191,111
Non Agency Mortgage Backed Securities	20,275,581
Non U.S. Government Sovereign Debt	90,678,543
U.S. Government Agency Commercial Mortgage Backed Securities	77,580,362
U.S. Government Agency Mortgage Backed Securities	1,192,857,134
U.S. Government Agency Obligations	271,728,845
U.S. Taxable Municipal Bonds	63,598,558
U.S. Treasury Securities	1,194,222,375
U.S. Treasury TIPS	975,056,183
<b>Total Investments Other Than PSF(SLB)</b>	
<b>Managed Land Endowment and Real Property</b>	<b>\$ 26,994,084,211</b>

The Texas Constitution also establishes the authority of the GLO which is responsible for managing most state-owned lands and minerals and is responsible for protecting the economic future of the Texas Gulf Coast by preserving all vital assets and natural resources from erosion. The GLO also administers the land endowment and real assets investments under the direction of the SLB. Before using funds for prescribed purposes, the SLB must determine, using the prudent investor standard that the use of the funds for the intended purpose is in the best interest of the Fund. The PSF(SLB) real assets investments are diversified across three sectors: commercial real estate, infrastructure, and energy/minerals.

**Custodial Credit Risk for Deposits**

The custodial credit risk for deposits is the risk that in the event of bank failure, the Fund's deposits may not be recovered. Except for the requirement to invest cash daily, the State Constitution, applicable statutes, and the Fund's investment policies do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits. As of August, 31, 2013, there was \$3,346,755 of uninsured and uncollateralized cash in bank subject to custodial credit risk. This cash in bank balance represents the U.S. dollar equivalent of amounts held in foreign currencies and cash received but not yet invested. It is for trades for which settlement is pending and for dividend payments that are awaiting repatriation. The remaining cash in bank in the amount of \$110,707 cash is held in an FDIC insured account.

Most of the Fund's cash is deposited in the State Treasury in an external investment pool managed by the Comptroller of Public Accounts (CPA). The CPA invests in authorized

**TEXAS PERMANENT SCHOOL FUND  
NOTES TO THE FINANCIAL STATEMENTS**

investments consistent with applicable law and the CPA investment policy. The CPA pools funds for investment purposes and allocates investment earnings on pooled funds proportionately among the various state agencies whose funds are so pooled. Currently, most pooled funds are invested in the following instruments: repurchase agreements, reverse repurchase agreements, obligations of the United States and its agencies and instrumentalities, and fully collateralized deposits in authorized state depositories. All investments are marked to market daily, using an external pricing service. The State Treasury deposits are not subject to custodial risk because the State Treasury has an arrangement with financial institutions to collateralize state deposits in excess of depository insurance.

The cash attributable to the PSF(SLB) real assets investment portfolio is deposited in the State Treasury and invested as described in the preceding paragraph; therefore, those deposits are not exposed to custodial credit risk.

**Custodial Credit Risk for Investments**

The custodial credit risk for investments is the risk that in the event of a failure of the counterparty, the Fund will not be able to recover the value of the investment or securities held as collateral that are in the possession of an outside party. PSF(SBOE) investments are registered in the name of the Fund or are registered in the nominee name of The Bank of New York Mellon Corporation and held in the name of the Fund at The Bank of New York Mellon Corporation. PSF(SBOE) investments are not subject to custodial credit risk. However, the invested securities lending collateral detailed below as of August 31, 2013, is subject to custodial credit risk because the collateral is purchased and held by the counterparty, The Bank of New York Mellon Corporation, which is contracted to serve as both the custodian and the securities lending agent. The cost basis of invested securities lending collateral at August 31, 2013 was \$205,505,653 and the fair value was \$138,865,074, which is detailed below.

<b>Invested Securities Lending Collateral</b>	<b>Cost Basis</b>	<b>Fair Value</b>
Asset Backed Floating Rate Notes	\$ 3,122,459	\$ 3,112,420
Corporate Medium Term Notes	66,630,540	-
Repurchase Agreements	135,752,654	135,752,654
<b>Total Securities Lending Collateral</b>	<b>\$ 205,505,653</b>	<b>\$ 138,865,074</b>

The State Constitution, applicable statutes, and the PSF(SBOE) investment policies do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments, including securities lending collateral investments.

**Credit Risk for Debt Investments**

Credit risk is the risk that an issuer or other counterparty of an investment will not fulfill its obligation to pay interest and repay principal. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO).

## TEXAS PERMANENT SCHOOL FUND

### NOTES TO THE FINANCIAL STATEMENTS

The rated debt investments of the PSF(SBOE) as of August 31, 2013 are as follows. If ratings are comparable between all NRSROs, the S&P rating scale is used to rate the securities. On securities with split or different ratings between the NRSROs, the rating indicative of the greatest level of risk is disclosed.

Investment Type	Rating	Rating Service	Fair Value
Asset Backed Securities	Aaa	Moody's	\$ 5,456,878
Asset Backed Securities	AAA	S&P	63,036,018
Commercial Mortgage Backed Obligations	AAA	S&P	85,947,410
Commercial Mortgage Backed Obligations	Aaa	Moody's	79,380,384
Commercial Mortgage Backed Obligations	AA	S&P	70,031,600
Commercial Mortgage Backed Obligations	Aa	Moody's	33,155,868
Commercial Mortgage Backed Obligations	A	S&P	29,426,645
Corporate Obligations	AAA	S&P	94,719,520
Corporate Obligations	Aaa	Moody's	22,059,228
Corporate Obligations	AA	Fitch	12,458,350
Corporate Obligations	AA	S&P	10,535,240
Corporate Obligations	Aa	Moody's	15,307,680
Corporate Obligations	A	Moody's	375,979,892
Corporate Obligations	A	Fitch	14,420,625
Corporate Obligations	A	S&P	31,590,442
Corporate Obligations	BBB	S&P	114,557,471
Corporate Obligations	Baa	Moody's	563,423,211
Corporate Obligations	BBB	Fitch	91,586,214
Yankee – Corporate Obligations	Baa	Moody's	15,871,421
Yankee – Corporate Obligations	BBB	S&P	20,319,690
Non Agency Mortgage Backed Securities	Aaa	Moody's	8,692,296
Non-Agency Mortgage Backed Securities	CCC	S&P	11,583,285
Non-U.S. Sovereign Government Debt	AAA	S&P	13,606,500
Non-U.S. Sovereign Government Debt	AA	S&P	32,987,200
Non-U.S. Sovereign Government Debt	A	S&P	44,084,843
U.S. Government Agency Commercial Mortgage Backed Securities	AA	S&P	74,482,490
U.S. Government Agency Commercial Mortgage Backed Securities	A	Moody's	3,097,872
U.S. Government Agency Mortgage Backed Securities	AA	S&P	1,153,889,352
U.S. Government Agency Obligations	AA	S&P	271,728,845
U.S. Taxable Municipal Bonds	AAA	S&P	26,286,670
U.S. Taxable Municipal Bonds	Aa	Moody's	14,502,679
U.S. Taxable Municipal Bonds	A	Moody's	14,899,534
U.S. Taxable Municipal Bonds	A	S&P	7,909,675
U.S. Treasury Securities	AA	S&P	1,194,222,375
U.S. Treasury Inflation Protected Securities	AA	S&P	975,056,183
<b>Total Credit Risk Rated Debt Securities</b>			<b>\$ 5,596,293,586</b>
Corporate Obligations	Not Rated		30,546,100
Corporate Obligations	Withdrawn Rating	Moody's	300
U.S. Government Agency Mortgage Backed Securities	Not Rated		38,967,782
<b>Total Fixed Income</b>			<b>\$ 5,665,807,768</b>

**TEXAS PERMANENT SCHOOL FUND  
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**Credit Risk for Invested Securities Lending Collateral**

The following presents the rated investments of the cash collateral as of August 31, 2013. The investment policy of the PSF(SBOE) defines the various permissible collateral investments including required ratings, at the time of purchase. Negotiable certificates of deposit drawn on certain prescribed banks, commercial paper, asset backed commercial paper, and short term corporate debt other than commercial paper must carry a "Tier 1" rating, defined as the highest short-term rating category by S&P, Moody's or Fitch. Asset backed securities shall be rated Aaa or AAA by Moody's and S&P respectively. Reverse repurchase agreements must have a counterparty rated Tier 1 and the underlying collateral shall be Tier 1 if the security is a short term security and at least Aa2 Moody's/AA S&P or better if the collateral is corporate debt (other than commercial paper). Foreign sovereign debt issued by a foreign government rated Aa2 Moody's/AA S&P or better is permissible collateral.

<b>Investment Type</b>	<b>Rating</b>	<b>Rating Service</b>	<b>Fair Value</b>
Asset Backed Floating Rate Notes	AA	S&P	\$ 3,112,420
Repurchase Agreements	Not Rated		135,752,654
<b>Total Investments</b>			<b>\$ 138,865,074</b>

**Interest Rate Risk for Debt Investments**

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of the investment. Duration is a measure of the price sensitivity of a debt investment to changes arising from movements in interest rates.

Duration is the weighted average maturity of an instrument's cash flows, where the present value of the cash flows serves as the weights. The duration of an instrument can be calculated by first multiplying the time until receipt of cash flow by the ratio of the present value of that cash flow to the instrument's total present value. The sum of these weighted time periods is the duration of the instrument. Effective duration extends this analysis to incorporate an option adjusted measure of an instrument's sensitivity to changes in interest rates. The SBOE approved Investment Procedures Manual mandates the average duration of the core fixed income portfolio to be consistent with the Barclay's Capital U.S. Aggregate Bond Index (formerly Lehman Brothers Aggregate Index) duration and the duration of the real return (TIPS) portfolio be consistent with the Barclay's Capital U.S. TIPS Index. As of August 31, 2013 the Barclay's Aggregate index duration was 5.44 years and the Barclay's U.S. TIPS Index duration was 7.76 years.

Investments in fixed income securities by investment type, fair value, and the effective weighted duration rate as of August 31, 2013 are as follows for the core fixed income portfolio and real return portfolio.

**TEXAS PERMANENT SCHOOL FUND**  
**NOTES TO THE FINANCIAL STATEMENTS**

Investment Type	Fair Value	Effective Weighted Duration Years
Asset Backed Securities	\$ 68,492,896	1.4250
Commercial Mortgage Backed Securities	297,941,907	4.4784
Corporate Obligations	1,377,184,273	5.8739
Yankee - Corporate Obligations	36,191,111	9.7284
Non Agency Mortgage Backed Securities	20,275,581	7.5423
Non U.S. Government Sovereign Debt	90,678,543	7.0441
U. S. Government Agency Commercial Mortgage Backed Securities	77,580,362	4.5877
U. S. Government Agency Mortgage Backed Securities	1,192,857,134	4.7346
U. S. Government Agency Obligations	271,728,845	5.3953
U.S. Taxable Municipal Bonds	63,598,558	12.5975
U. S. Treasury Securities	1,194,222,375	5.9609
U. S. Treasury TIPS	195,309,735	4.4429
<b>Total Fixed Income Portfolio (Excluding Real Return TIPS)</b>	<b>4,886,061,320</b>	<b>5.5126</b>
Real Return - U. S. Treasury TIPS Portfolio	779,746,448	7.7968
<b>Total Fixed Income Investments</b>	<b>\$ 5,665,807,768</b>	<b>5.8257</b>

**Interest Rate Risk for Invested Securities Lending Collateral**

The following provides information about the interest rate risks and maturities associated with invested securities lending collateral by investment type. The PSF(SBOE) investment policy defines the maturities of all permissible securities lending collateral investments. The maximum maturity of invested securities lending collateral is 397 days on fixed rate and 3 years on floating rate securities, except for bank time deposits which is 60 days, bankers acceptances which is 45 days, and reverse repurchase agreements which is 180 days. The maximum weighted average maturity of the entire collateral portfolio must be 180 days or less. The maximum weighted average interest rate exposure of the entire collateral portfolio must be 60 days or less.

Investment Type	Fair Value	Investment Maturities Less Than One Year	Investment Maturities Greater Than One Year
Asset Backed Floating Rate Notes	\$ 3,112,420	\$ -	\$ 3,112,420
Repurchase Agreements	135,752,654	135,752,654	-
<b>Total</b>	<b>\$ 138,865,074</b>	<b>\$ 135,752,654</b>	<b>\$ 3,112,420</b>

**Concentration of Credit Risk**

Concentration of credit risk is the risk of loss due to the magnitude of the Fund's investment in a single issuer. The investment policies of the PSF(SBOE) preclude engaging in any purchase transaction after which the cumulative market value of equity securities, fixed income securities, or cash equivalent securities of a single corporation (excluding the U. S. government or its

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

agencies) exceeds 2.5% of the PSF(SBOE) total market value or 5.0% of the manager's total portfolio market value.

As of August 31, 2013, the PSF(SBOE) held \$689,157,846 in fixed income securities and mortgage backed obligations issued by the Federal National Mortgage Association (Fannie Mae) and \$528,152,625 in fixed income securities and mortgage backed obligations issued by the Federal Home Loan Mortgage Corporation (Freddie Mac). The investments in Fannie Mae securities represent a concentration of more than 2.5% of the PSF(SBOE) total market value. The investments in both Fannie Mae and Freddie Mac securities equal more than 5% of the fixed income total portfolio market value. These entities are government-sponsored enterprises chartered by Congress and, since September 2008, have been in conservatorship, operating under the direction of the Federal Housing Finance Agency. The U.S. Department of the Treasury has an agreement to provide required capital to correct net worth deficiencies; therefore, the credit risk is the same as holding U.S. Government securities.

### **Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes**

In accordance with PSF(SBOE) investment policies, the PSF(SBOE) may invest in asset backed and mortgage backed obligations. The PSF(SBOE) may also invest in investments that have floating rates with periodic changes in market rates, zero coupon bonds, and stripped U.S. Treasury and Agency securities created from coupon securities. As of August 31, 2013, the PSF(SBOE) held investments that are highly sensitive to interest rate changes.

Mortgage backed obligations are subject to early payment of principal in a period of declining interest rates. These securities also tend to increase in duration as interest rates rise. The resultant reduction or extension in expected cash flows will affect the fair value of these securities. As of August 31, 2013, these securities totaled \$1,588,654,984.

Asset backed obligations are backed by home equity loans, auto loans, equipment loans, and credit card receivables. Pre-payments by the obligees of the underlying assets in periods of declining interest rates could reduce or eliminate the stream of income that would have been received. Conversely, rising interest rates could extend the stream of income that would have been received. As of August 31, 2013, these securities totaled \$68,492,896.

### **Foreign Currency Risk for Deposits and Investments**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or an investment. The exposure to foreign currency risk as of August 31, 2013, is as follows:

**TEXAS PERMANENT SCHOOL FUND  
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<b>Deposits</b>	<b>Amount</b>
<b>Currency</b>	
Australian Dollar	\$ 366,861
Brazil Real	331,538
British Pound Sterling	36,371
Canadian Dollar	403,626
Egyptian Pound	656,849
Euro Currency Unit	229,983
Malaysian Ringgit	7,613
New Taiwan Dollar	1,073,980
New Turkish Lira	55
Peruvian Nuevo Sol	619
Polish Zloty	147
Russian Ruble	108,760
Swiss Franc	47,056
Various Other Currency Balances	13
<b>Total Deposits Subject to Foreign Currency Risk</b>	<b>\$ 3,263,471</b>



**TEXAS PERMANENT SCHOOL FUND**  
**NOTES TO THE FINANCIAL STATEMENTS**

<b>Securities</b>	<b>Amount</b>
<b>Currency</b>	
Australian Dollar	\$ 275,445,785
Brazil Real	112,473,045
British Pound Sterling	756,900,956
Canadian Dollar	351,842,000
Chilean Peso	17,362,002
Columbian Peso	12,941,552
Czech Koruna	2,446,166
Danish Krone	40,161,158
Egyptian Pound	1,804,609
Euro Currency Unit	998,883,294
Hong Kong Dollar	301,870,418
Hungarian Forint	2,372,797
Indonesian Rupiah	26,394,266
Israeli Shekel	9,646,936
Japanese Yen	738,929,332
Malaysian Ringgit	38,519,022
Mexican New Peso	54,208,914
Moroccan Dirham	924,835
New Taiwan Dollar	120,884,528
New Turkish Lira	16,697,841
New Zealand Dollar	4,366,213
Norwegian Krone	29,349,605
Philippines Peso	10,015,199
Polish Zloty	17,854,434
Russian Ruble	46,284,940
Singapore Dollar	52,672,473
South African Rand	75,515,016
South Korean Won	161,118,363
Swedish Krona	111,022,006
Swiss Franc	312,434,649
Thailand Baht	25,021,945
<b>Total Securities Subject to Foreign Currency Risk</b>	<b>\$ 4,726,364,299</b>

The investment policy of the PSF(SBOE) allows for international diversification to improve the risk and return characteristics of the PSF(SBOE). As such, the PSF(SBOE) investments are exposed to foreign currency risk. The investment policy of the PSF(SBOE) does not contain legal or policy requirements that limit the exposure to foreign currency risk. With SBOE approval, the Fund is permitted to hedge currency. Hedging currency is a way to limit exposure to foreign currency risk. Currently, however, foreign currency exchange forward contracts are only executed as part of normal trading of foreign denominated equity, real estate and private equity securities.

**TEXAS PERMANENT SCHOOL FUND**  
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**3. Investment in Land, Mineral Interests and Real Assets Investments**

The changes in land acreage, historical cost, and fair value of PSF(SLB) land, mineral interests, and real assets investments during the year ending August 31, 2013 are included in the following table. Please note that there can be permanent improvements included in the costs or fair values of the surface acres, although such improvements are not specifically identified. All acreage totals provided below are approximations.

Investment Type	Historical Cost	Fair Value
Investments in Real Assets		
Sovereign Lands <sup>(1)</sup>	\$ 495,953	\$ 262,670,589
Discretionary Internal Investments <sup>(3)</sup>	343,775,892	348,925,827
Other Lands	19,309,436	103,566,837
Minerals <sup>(1), (2)</sup>	13,394,403	2,307,102,037
Investments with External Managers <sup>(4)</sup>	1,779,934,021	1,727,243,326
<b>Total Investments <sup>(5)</sup></b>	<b>\$ 2,156,909,705</b>	<b>\$ 4,749,508,616</b>
Cash in State Treasury <sup>(6)</sup>	1,216,045,685	1,216,045,685
<b>Total Investments and Cash in State Treasury</b>	<b>\$ 3,372,955,390</b>	<b>\$ 5,965,554,301</b>
Consisting of the following:		
Noncurrent Investments	2,156,909,705	4,749,508,616
<b>Total Investments, as above</b>	<b>\$ 2,156,909,705</b>	<b>\$ 4,749,508,616</b>

(1) Sovereign Lands and Minerals are reported at historical cost on the balance sheet.

(2) Includes an estimated 1,000,000.00 acres in fresh water rivers.

(3) Includes commercial real estate investments only.

(4) Includes investments in commercial real estate, infrastructure, and energy/minerals.

(5) Includes an estimated 1,747,600.00 in excess acreage.

(6) Cash in State Treasury is managed by the Treasury Operations Division of the Comptroller of Public Accounts of the state of Texas.

The current surface real property portfolio of the Fund consists of 706,586.219 surface acres valued at \$669,067,920. Of this, 426,761.737 acres are sovereign lands with a fair value of \$262,670,589 located primarily in West Texas and representing 60 percent of the total acreage, but only 39 percent of the total value. Some of this property, though marginally suitable, has been leased for grazing and hunting purposes. The remainder, most of which is landlocked, has little value other than for adjacent landowners who wish to increase their holdings. Over time, these properties will likely be sold.

The September 1, 2012, beginning basis for the Fund's land surface portfolio value was \$341,097,434. From September 1, 2012, to August 31, 2013, four new discretionary internal real assets investments were acquired. Contributions of approximately \$4.9 million were made to ongoing development projects. The basis of the Fund's land surface portfolio at August 31, 2013, is \$363,581,282. In addition to the land surface portfolio, the Fund also owns 12,594,222.313 acres of Relinquishment Act, Submerged, Free Royalty, and Mineral Reserved Lands representing a basis of \$13,394,403.

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

Dispositions for the fiscal year ended August 31, 2013, equaled 2,471.447 acres sold, for net proceeds of approximately \$14.54 million.

Typically, the Fund does not convey its mineral interests when land is sold. No value is assigned to the estimated public domain acres. The fair value of the Fund's land surface value is based on the estimated appraisal values or independently determined by the staff in the Appraisal Division using the data from studies conducted by the Texas Chapter of the American Society of Farm Managers and Rural Appraisers, Multiple Listing Services throughout the state and CoStar commercial sales data in certain metropolitan areas.

The fair value of the Fund's interest in oil, gas and hard minerals is based on an estimate of the present value of future royalty cash flows using a 10 percent discount rate. Future royalty cash flow projections from oil and gas are based on 12-month average prices preceding the valuation date and estimate of future production from existing wells. The estimate of future production is based on Oil & Gas Industry submissions of such volumes for the 12-month period prior to valuation and reduced to account for estimated depletion. Hard mineral future cash flows are also estimated based on future royalty approximations and discounted. Nonproducing proven reserves of oil, gas, and hard minerals are not included in the estimate.

#### 4. Leases

The GLO manages several types of operating leases. The need for each specific lease category is based upon the type of action proposed (e.g., pier, dock, agriculture, recreational hunting, pipeline, etc.) and the statute under which it will be authorized. Lease categories managed by the GLO are summarized as follows:

Commercial Leases and Easements (LC) are issued for projects that produce revenue from the private use of state-owned property. LCs are issued pursuant to Chapters 33 and 51, Texas Natural Resources Code (TNRC), and fees are based on the published School Land Board rate schedule in effect at the time of contract issuance. The rate schedule allows calculation of fees based upon the amount of state land encumbered, and the appraised value of the adjacent littoral property. LCs cover activities and structures such as marinas, bait stands, fishing piers, mooring dolphins, fuel docks, dredging activity, restaurants, and navigation signs. Contracts for LCs grant the applicant exclusive use of the site for the purposes specified in the contract.

Coastal Easements (CE) are issued by the GLO pursuant to TNRC §33.103(a)(2), 33.111(a), and 33.103 authorizing owners of private property abutting submerged state-owned lands to place and maintain structures on coastal public land adjacent to their private property. CEs typically cover structures such as piers, decks, docks, rip-rap, pilings, bulkheads, and boat lifts. CEs can also be issued for activities such as dredging, filling, and material disposal. Contracts for CEs grant the applicant exclusive use of the structure, but not use of the public land around the structure.

Coastal Leases (CL) are issued by the GLO pursuant to TNRC §33.103(1) and 33.105. CLs are issued to public entities, tax-exempt organizations, or scientific or educational entities to authorize the use of state-owned land for public recreation, estuarine preserves, wildlife

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

preserves, or scientific research activities. CLs grant the applicant limited exclusive use of the property for the purposes stated within the contract. The GLO may issue other grants of interest for use of the same property, so long as it does not interfere with the current leaseholder's activities.

Surface Leases (SL) are issued by the GLO pursuant to TNRC §51.011, 51.121, and 51.292. Coastal SLs are issued for activities on submerged coastal public lands and are typically used to authorize activities not associated with littoral property ownership adjacent to state-owned submerged land, and for energy platforms in the Gulf of Mexico. Examples of activities covered by coastal SLs include, but are not limited to: drilling platforms outside an existing leased mineral tract, electrical substations, pumping stations, loading racks, tank farms, artificial reefs, and wildlife preserves. Upland SLs typically authorize activities such as hunting, grazing, agriculture, timber production, and other commercial activity (including commercial leases on investment property).

Miscellaneous Easements (ME) are issued on both coastal submerged lands and state-owned uplands for projects which require a right-of-way (ROW) on, across, under, or over state-owned lands, pursuant to TNRC §51.291. Fees are based upon a published rate schedule and are calculated based on the width and length of right-of-way, the region of the state, and the diameter of the pipeline, and the power wattage (if applicable). ME contracts cover activities such as oil and gas pipelines, power transmission lines, communication lines, roads, and certain other structures and uses. Contracts for MEs grant the applicant exclusive use of the ROW for the purposes specified in the contract.

Holders of the above leases and easements are required to maintain all structures in a safe condition and to comply with all terms of the contract. Violation of the contract terms or failure to pay the required land-use fees may result in delinquent penalties and/or termination of the contract, and removal of the structures at the expense of the property owner. Obtaining said leases and easements from the GLO does not exempt the applicant from complying with all other applicable local, state, and federal permitting requirements.

Special Documents (SD) are issued for projects on state-owned submerged land and state-owned uplands. The SLB has authorized the land commissioner to approve, by Special Document, erosion response projects administered by the GLO pursuant to the Coastal Erosion Planning and Response Act, codified as TNRC, Chapter 33, Subchapter H, and the regulations set forth in Texas Administrative Code, Title 31, Part 1, Chapter 15, Subchapter B. Special Documents are also issued for Highway Use Agreements under Chapter 203, Subchapter D, Texas Transportation Code for Texas Department of Transportation projects on land dedicated to the Fund. Special Documents may also be used for projects that do not explicitly fall into one of the other established categories.

The historical cost of all internally managed properties available for leasing activity is \$363,581,282. The fair value of the properties is \$715,163,254. Because the Fund is a permanent fund, real estate is held as an investment and is not depreciated.

**TEXAS PERMANENT SCHOOL FUND**  
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Contingent rental revenues in the amount of \$842,451 are reported for nineteen leases for the year ended August 31, 2013.

A schedule of estimated future lease payments by lease type is presented below in the aggregate and for each of the five succeeding years. The amounts include known lease escalation provisions.

Lease Categories	Fiscal Year 2014	Fiscal Year 2015	Fiscal Year 2016	Fiscal Year 2017	Fiscal Year 2018	Fiscal Years 2019 & Beyond
Coastal Easements	\$ 244,378	\$ 202,608	\$ 196,617	\$ 196,303	\$ 195,206	\$ 539,436
Coastal Leases	2,445	2,445	2,445	2,445	1,245	78,413
Commercial Leases and Easements	1,366,116	1,291,549	1,227,441	1,149,398	1,118,907	9,319,119
Miscellaneous Easements	352,791	301,452	254,171	271,154	254,456	1,779,258
Surface Leases	3,339,973	3,195,936	2,703,280	2,401,152	2,265,293	30,598,891
<b>Total Lease Payments</b>	<b>\$ 5,305,703</b>	<b>\$ 4,993,990</b>	<b>\$ 4,383,954</b>	<b>\$ 4,020,452</b>	<b>\$ 3,835,107</b>	<b>\$42,315,117</b>

**5. State Energy Marketing Program**

The State Energy Marketing Program (SEMP) of the SLB is designed to provide additional revenues, or enhancements, to the PSF(SLB) and to provide savings to public customers by offering utility services at a below-market rate. The 79<sup>th</sup> Legislature authorized the SLB to manage and operate the SEMP with land sale, lease, and royalty receipts of the Fund. Royalty payments due the State on certain leases are received in the form of mineral production instead of monetary royalty payments. The SEMP then sells the oil and gas to public retail customers. These customers include public school districts, state institutions of higher education, state agencies, and political subdivisions.

**6. Derivatives**

As a function of its normal business operations, the GLO manages the SEMP and enters into contracts for the purchase and sale of natural gas, the sale of oil, and the delivery of natural gas and electric energy to certain Public Retail Customers (PRCs). Some of these contracts are derivatives, as defined under GASB Statement No. 53, *Accounting and Reporting for Derivative Instruments* (GASB 53). As of August 31, 2013, all SEMP contracts identified as derivatives under GASB 53 also qualify for the normal purchases and normal sales exception described in Paragraph 14 of GASB 53. Therefore, all SEMP contracts identified as derivatives under GASB 53 are not subject to the requirements of GASB 53. The documentation required to support the determination of the normal purchases and normal sales exception with regard to all SEMP contracts identified as derivatives under GASB 53 is maintained by the GLO in the applicable SEMP contract files.

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The PSF(SBOE) enters into futures contracts to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes, and therefore classifies its futures contracts as investments. The SBOE approved Investment Procedure Manual defines the parameters for investing in futures contracts. The total amount of a portfolio's financial futures contract obligation should not exceed ten percent (10%) of the market value of the portfolio's total assets. The PSF(SBOE) may exceed the ten percent (10%) rule during a transition approved by the SBOE. In no instance will the total amount of the contracts be an amount greater than the market value of a portfolio's cash, receivables and short-term securities.

Upon entering into a futures contract, initial margin deposit requirements are satisfied by segregating specific securities or cash as collateral for the account of the Futures Commission Merchant (FCM) broker (the Fund's agent in acquiring the futures position). During the period the futures positions are open, the contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss is referred to as the daily variation margin which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The PSF(SBOE) executes such contracts on major exchanges through major financial institutions and minimizes market and credit risk associated with these contracts through the managers' various trading and credit monitoring techniques.

As of August 31, 2013, the PSF(SBOE) invested in S&P 500 Index Futures contracts and S&P 400 Index Futures contracts as detailed below with FCM Bank of America Merrill Lynch:

<b>Futures Contract</b>	<b>Maturity Date</b>	<b>Number of Contracts</b>	<b>Notional Value</b>	<b>FCM Margin Deposit</b>
S&P 500 e-mini	September 20, 2013	258	\$ 21,043,770	\$ 903,000
S&P-500 e-mini	December 20, 2013	113	9,178,990	395,500
S&P 400 e-mini	September 20, 2013	121	14,313,090	544,500
S&P 400 e-mini	December 20, 2013	8	943,680	36,000
<b>Total Futures</b>			<b>\$ 45,479,530</b>	<b>\$ 1,879,000</b>

The amount of net realized gains on the futures contracts for the period ended August 31, 2013 was \$3,626,310 and is included in the net change in fair value of investments on the Statement of Revenues, Expenditures and Changes in Fund Balance. The futures contracts themselves had no fair value at August 31, 2013. If Bank of America Merrill Lynch failed, the loss that would be recognized at August 31, 2013 would be \$1,566,600 which is the net of the FMC Margin Deposit of \$1,879,000 and the unpaid year-end variation margin loss of \$312,400.

Foreign currency balances are not maintained by the Fund except for transactions that occur as part of normal security transactions; buys, sales and income payment. Foreign currency exchange (FX) contracts are executed by the external investment manager on the same day as security transactions. The investment manager buys or sells the FX contract in the currency native to the security transaction. These foreign exchange contracts hedge against the risk of currency changes between trade and settlement dates. Risks associated with such contracts include movement in the value of the foreign currency related to the U.S. dollar and the ability of the counterparty to perform. For income payments received in other currencies, the custodian

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bank executes foreign exchange spot contracts to repatriate payments to U.S. dollars on actual income payment date.

### 7. Securities Lending

The PSF(SBOE) is authorized to conduct a securities lending program in accordance with Article 7, Section 5 of the Texas Constitution. The implementation policy for the program is further defined in Texas Administrative Code Title 19, Part 2, Chapter 33. The PSF(SBOE), through its securities lending agent The Bank of New York Mellon Corporation (Agent), lends securities to certain brokers in exchange for authorized collateral.

Authorized collateral includes cash, government securities, irrevocable letters of credit, and other assets specifically agreed to by the Agent and the SBOE. The PSF(SBOE) receives collateral against the loaned securities in an amount of 102% of the fair value plus accrued income for domestic corporate securities and 105% of the fair value plus accrued income for foreign securities; except in the case of foreign securities denominated and payable in U.S. Dollars, the required percentage is 102%. Collateral provided for Reverse Repurchase Agreements is maintained at various percentages depending on the type of security provided as collateral.

The Agent indemnifies the SBOE against losses as a result of the broker's failure to return loaned securities. Securities collateral cannot be pledged or sold unless the borrower defaults. All securities within the PSF(SBOE) portfolio are available to be loaned to brokers based on market demand. The contract does not restrict the total aggregate value of loaned securities outstanding at any one time and loans are made to a specific list of brokers. The PSF(SBOE) has the option to set a maximum aggregate loan limit for each broker.

As defined by the lending agreement, the length of maturities permitted for loans are clearly selected, defined, and approved by the lender. Loans made in this program can be terminated on demand by either party and are considered to have a one-day maturity, although cash collateral is invested in securities having longer maturities. As of August 31, 2013 the Fund invested cash collateral had a weighted average maturity of 3 days to reset date.

During the fiscal year ending August 31, 2013, the Agent did not experience any losses on securities lending activity as a result of borrower defaults. Since there were no losses in the fiscal year ending August 31, 2012 no losses were recovered in the fiscal year ending August 31, 2013.

Certain assets held in the invested cash collateral pool experienced a permanent impairment as of September 30, 2008. The original cost basis of these permanently impaired assets totaled \$104,953,800. A partial cash recovery was received from the receiver in November 2010 resulting in the cost basis of the assets being reduced to \$99,647,745. The Fund received a settlement amount of \$27,930,039 as the result of a class action suit settlement reached in October 2012, which reduced the amortized cost to \$71,717,706. Following the receipt of settlement proceeds in March 2013 and beginning in April 2013, all Fund earnings from the securities lending program have been directed to further reduce the amortized cost. At fiscal

**TEXAS PERMANENT SCHOOL FUND  
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year-end, these assets remain in the cash collateral pool at an amortized cost of \$66,630,540; however, the estimated market value is \$0 as of August 31, 2013.

As of August 31, 2013, the fair value of securities on loan to brokers equaled \$2,269,855,978 against non-cash collateral with a fair value of \$2,124,580,639 and invested cash collateral with a cost basis of \$205,505,653 and a fair value of \$138,865,074.

The non-cash collateral along with the cash collateral was used to secure outstanding security loans. At August 31, 2013 there was no credit risk to the PSF(SBOE) as the amount owed by the Fund to borrowers exceeded the amount the borrowers owed the Fund.

Income is earned in two ways from loaning securities. If the broker provides cash collateral, income is earned by investing the cash collateral, and the broker is compensated with a "rebate," an interest rate paid on the cash collateral given. If the investment of cash collateral fails to provide enough income to pay the rebate, the Fund and its Agent share the difference based on the agreed upon earnings split. During the year ended August 31, 2013, income generated from the investment of cash collateral was insufficient to compensate the lender due to the extreme low level of interest rates, so the securities lending agent and broker agreed to a "negative rebate" to borrow the securities in addition to providing the cash collateral. If the broker provides securities or letters of credit as collateral for the securities lent, it pays a negotiated lender fee. Additionally, in certain market situations, the broker may actually pay a fee or receive a negative rebate on cash collateral. Net income generated from securities lending transactions is then split between the Fund and its securities lending agent.

For fiscal year 2013, gross securities lending revenue totaled \$10,329,594, including negative rebates (brokers paid instead of receiving rebates) in the amount of \$5,102,763. Gross expenditures for bank fees and other adjustments totaled \$1,548,979. Net securities lending income totaled \$8,780,615.

**8. Fund Balance**

In accordance with the requirements of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the PSF fund balance has been classified on the face of the balance sheet as noted below:

Fund Balance Classification	Fund Balance Amount
Nonspendable Fund Balance	\$ 12,279,926,457
Restricted Fund Balance	18,321,565,085
<b>Total Fund Balance at August 31, 2013</b>	<b>\$ 30,601,491,542</b>

GASB Statement No 54 establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. Specifically, for permanent funds such as the PSF, the statement requires classification of the corpus (principal) portion of the fund balance as nonspendable if there is a legal or contractual requirement for it to be maintained intact. Permanent funds are defined in GASB 54, paragraph 35, as funds used to account for and report resources that are restricted to the extent that only earnings, and not



## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

principal, may be used for purposes that support the reporting government's programs. Article VII of the Texas Constitution describes the Fund as a perpetual school fund set apart for the support of public schools. The Fund's assets are held in a trustee capacity for the benefit of public free schools, with authority granted to the SBOE to establish, within the constitutional limits, a percentage that is transferred to the ASF each year. The corpus of the Fund is classified as nonspendable and is calculated based on the original source and type of revenue deposited to the Fund since inception. The balance of the Fund is classified as restricted based on the provisions in the Texas Constitution that state the ASF shall be applied annually to the support of the public free schools.

### **9. Contingencies**

#### Bond Guarantee Program

In 1983, the voters of the State approved a constitutional amendment which provides for the guarantee of school district bonds by the Fund. The Guarantee Program is administered by the Commissioner of Education (Commissioner). For eligible bonds, including refunding bonds, school districts submit an application for guarantee and a \$2,300 processing fee. The Commissioner may endorse bonds for guarantee only after investigating the accreditation and financial viability of the applying school district. If the district is considered viable and the bonds are approved by the State of Texas Attorney General, then the guarantee is endorsed at a zero premium charge to the district. In the event of a default by a school district, and upon proper notice to the Commissioner, the Fund will transfer to the Paying Agent/Registrar an amount necessary to pay the maturing or matured principal and/or interest. Upon receipt of funds for payment of such principal or interest, the Paying Agent/Registrar must pay the amount due and forward the canceled Bond or evidence of payment of the interest to the State Comptroller of Public Accounts (Comptroller). The Commissioner will instruct the Comptroller to withhold the amount paid, plus interest, from the first State money payable to the school district. The amount withheld will be deposited to the credit of the Fund. To date, no school district has ever defaulted on their guaranteed bonded indebtedness.

The Internal Revenue Service issued Notice 2010-5 on December 16, 2009 stating that it intended to propose regulations to replace the previous federal law limit on the Guarantee program capacity to be no more than five times the cost value of the Fund on that date. Section 4 of the Notice states that it may be relied on for bonds issued after December 16, 2009.

The 80<sup>th</sup> Texas Legislature adopted a change in the state law limit, amending Section 45.053 of the Texas Education Code to allow the SBOE to increase the guarantee capacity up to five times the cost value of the Fund, provided that the Board determines that any increase will still allow school district bonds to receive the highest rating. Effective July 1, 2010, the SBOE authorized capacity multiplier for the State Capacity Limit was increased to three (3) times the cost value of the Fund, including the portion managed by the SLB.

As of August 31, 2013, the capacity of the Guarantee Program is \$117,318,653,038 under Federal law and \$76,797,890,706 under State law. Outstanding bonds guaranteed by the Fund under this program total \$55,218,889,156 at August 31, 2013 and relate to 810 school districts. This balance represents the outstanding principal amount of the bonds issued. The balance

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does not reflect any subsequent accretions in value for the compound interest bonds (zero coupon bonds), nor does it include interest on current interest bonds or variable rate notes. The balance also excludes bonds that have been refunded and released from the Guarantee Program. The balance of bonds guaranteed under the program does not exceed the calculated capacity of the program as of August 31, 2013.

As of August 31, 2013, the total principal debt guaranteed on bond issues is \$55,218,889,156, the expected interest to be paid out over the remaining life of those bond issues is \$36,271,307,574, and the final maturity is scheduled to occur in the year 2051.

As of August 31, 2013, there is no financial liability to the Fund related to the Fund's obligation to stand ready to perform over the term of the guarantee. The guarantee functions as a liquidity facility and an intercept program that carries very little risk to the Fund. The guarantee is offered at nominal cost to a school district that properly applies, receives endorsement by the Commissioner, and has its bonds approved by the State of Texas Attorney General.

The 82nd Texas Legislature enacted Senate Bill 1 ("SB 1") authorizing the Charter School Guarantee Program. Among other provisions, SB 1 authorizes the use of the Fund to guarantee revenue bonds issued by certain open-enrollment charter schools that are designated as "charter districts" by the Commissioner. It is anticipated that the Charter School Guarantee Program will not become effective until certain contingent requirements are satisfied, including the establishment of regulations by the Commissioner for the administration of the program. It is also expected that the new program will not be implemented until the SBOE has received a response from the IRS with respect to certain federal tax law matters concerning the Charter School Guarantee Program that have been submitted to the IRS for review. As a result, the date of implementation and the ultimate structure of the Charter School Guarantee Program are presently unknown.

### Pending Litigation

The PSF(SBOE) has potential liability in two sets of defense class actions asserting fraudulent conveyance claims and seeking to recover moneys paid the PSF(SBOE) for the sale of publicly-traded securities in response to tender offers made in the context of leveraged buy-outs. While ultimately uncertain whether the PSF(SBOE) will have any liability for these matters, management believes that it is unlikely that these suits will result in any liability to the Fund during the twelve months subsequent to August 31, 2013 therefore, in accordance with GAAP, no accrual for these matters is currently reflected in the accompanying financial statements. The Attorney General's Office is representing the PSF(SBOE) in both matters and asserting sovereign immunity and other defenses.

- 1) In re: Lyondell Chemical Company, No. 09-10023; Edward S. Weisfelner, as Trustee of the LB Creditor Trust v. Morgan Stanley, Adv. Pro. No. 10-04609 (Bankr. S.D.N.Y.) and Edward S. Weisfelner, as Litigation Trustee of the LB Litigation Trust v. Holmes, Adv. Pro. No. 10-05525 (Bankr. S.D.N.Y). The PSF(SBOE) received approximately \$17.5 million for Lyondell stock.

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

- 2) In re: Tribune Company, No. 08-13141; The Official Committee of Unsecured Creditors of Tribune Company v. Fitzsimmons, Adv. Pro. No. 10-54010 (Bankr. D. Del); and Deutsche Bank v. Employees Retirement Fund of the City of Dallas, No. 3:11-CV-1167-F; (N. D. Tex. Dallas Div.) CONSOLIDATED in: In re: Tribune Company Fraudulent Conveyance Litigation; Nos. 11-MD-2296 and 12-MC-2296 (S. D. N. Y.). The PSF(SBOE) received approximately \$3.9 million for Tribune stock.

As of August 31, 2013, certain lawsuits were pending against the state and/or the commissioner of the GLO, which challenge the Fund's title to certain real property or past mineral income from that property. The following lawsuits are pending and may represent contingent liabilities:

*Porretto v. Commissioner Dewhurst and Texas General Land Office, et al.* The GLO is the defendant in this suit to determine the ownership of certain acreage subject to Texas General Land Office leases to the City of Galveston. The District Court dismissed the case on a plea to the jurisdiction. On appeal, the Court reversed the District Court's Decision and remanded the case for trial. At the trial in January of 2009, the jury found that there was a taking by the State. The jury awarded \$5,012,000 to the Plaintiff and against the State. This award included prejudgment interest from March 12, 2002, the date this suit was filed, until March 4, 2009, the date the judgment was executed. This awarded amount also included accrued post judgment interest at a rate of 5% compounding annually from the date the judgment was entered until the date the judgment is satisfied. The State appealed this judgment and the First Court of Appeals reversed and rendered judgment in the State's favor in August of 2011. This judgment also awarded the state appellate costs. The Plaintiff filed a motion for rehearing in August of 2011 and that was denied. The Plaintiff has subsequently filed bankruptcy and filed a petition for review before the Supreme Court of Texas where the case is currently pending. The probability of liability is reasonably possible. The possible amount of loss could be as high as \$5,012,000 plus pre and post judgment interest if upheld.

*State v. Riemer.* The GLO is involved in this suit to determine a takings claim regarding certain acreage along the Canadian River. The State filed suit against Riemer for unlawfully fencing the bed of the Canadian River below the Sanford Dam. Riemer filed multiple counterclaims against the State. The Trial Court denied the State's plea to the jurisdiction. The Appeals Court reversed the Trial Court's denial, and ordered the trial court to dismiss all claims against the State except Riemer's claim to the surface of the two tracts and also certain takings claims of other parties. The Plaintiffs sought class certification as to the takings claims. On December 30, 2009, the Trial Court denied class certification and Riemer appealed and the denial of class certification was affirmed in May of 2011. The Plaintiffs filed a petition for review with the Supreme Court of Texas where the Court found an abuse of discretion by the Trial Court. The matter of class certification has been remanded to the trial court where the case is currently pending. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

*Texaco v. State, et al.* The GLO is a defendant in this suit to determine the ownership of certain mineral interests located beneath a portion of Manahuilla Creek in Goliad County. Probability of liability is reasonably possible. The Plaintiff is seeking an unspecified amount of attorneys' fees.

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

The GLO is currently in settlement negotiations. The possible final amount of loss is undeterminable at this time.

*Fleming v. State & City of Corpus Christi.* The GLO is a defendant in this suit claiming title to lands owned by the Fund. The District Court dismissed the suit. Plaintiffs appealed and have filed a second lawsuit substantially similar to the first. The County Court at Law in the second case abated pending the outcome of the appeal pending in the District Court. The 13th Court of Appeals affirmed the District Court dismissal of the case on October 19, 2010. The second case in the County Court at Law is still pending. An adverse result is possible, but that possibility is remote. The possible final amount of the loss is undeterminable at this time.

*Jobe Materials, LP v. State.* The GLO is a defendant in this suit seeking a declaratory judgment that determines that "sand, gravel, rock, granite, aggregate and other stone materials" are a surface interest as opposed to a mineral interest pursuant under Texas Natural Resources Code §53.151 or that § 53.061, as amended, is unconstitutional. The Plaintiff also claims that the assertion of the ownership of the minerals by the State constitutes a taking. This case is currently pending in the 250th District Court in Travis County in light of related litigation. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

*Lone Oak Club, LLC v. Jerry Patterson, et al.* The claimant asserts ownership to certain property concerning the tidally influenced boundary in Chambers County. In a trespass to try title suit, the Plaintiff claims that the GLO, through ultra vires acts, wrongfully asserts jurisdiction, title and right to possession and control over watercourses or navigable streams on these properties. Plaintiff also asserts that the GLO has been encouraging members of the general public to commit trespass and to hunt without consent upon the properties and streambeds. Plaintiff finally claims that the GLO unreasonably interferes with Plaintiff's right to possession, use, control and quiet enjoyment of the streambeds and properties. Plaintiff seeks title and possession of disputed property, prejudgment and post-judgment interest and reasonable attorney fees. The case is currently in the discovery phase. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

*State & Jerry Patterson, Land Commissioner v. BP American Production Co./Vastar.* The claimant asserts ownership of certain property involved in a dispute concerning the boundary of the San Jacinto River in Harris County. The claim is that subsidence caused claimant's land to be submerged, and therefore title should not transfer to the State. The claimant seeks damages based on inverse condemnation. The Trial Court denied the State's plea to the jurisdiction. The Third Court of Appeals affirmed in part, dismissed in part, reversed and rendered in part. The State filed a petition for review by the Supreme Court of Texas and the Court denied the petition for review in August of 2011. The case was remanded to the Trial Court and is currently pending there. Royalties have been deposited with the Court Registry, pending outcome of the case. The probability of liability is reasonably possible. The possible final amount of the loss is undeterminable at this time.

*Brannan, et al. v. State of Texas, et al.* The GLO is a defendant in this suit seeking declaratory relief with respect to the rights of beachfront property owners and members of the general public

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

to beaches on the Gulf Coast of Texas at Surfside Beach. The Plaintiffs are also seeking a determination as to whether the imposition upon private property of a rolling easement for public use is a deprivation of use or a taking by the State. The Trial Court granted the State defendant's motion for summary judgment regarding Plaintiff's takings claims based on the rolling beach easement. A number of parties intervened at this point and carried on the lawsuit claiming that the GLO was taking their property by refusing to allow them to make repairs to their beachfront homes after a high tide. The Trial Court then issued the injunction ordering the removal of all of the houses on the easement. The First Court of Appeals affirmed the trial court's injunction and agreed that the Trial Court properly denied the owner's claims for damages due to a permanent taking and a regulatory taking. The plaintiff filed a motion for rehearing, and the Court of Appeals denied this motion and withdrew the opinion from August 2009 and issued a new opinion in February 2010. In April 2010, the Plaintiffs filed a petition for review in the Supreme Court of Texas. The case was remanded to the First Court of Appeals for further consideration in light of the *Severance* opinion. An extension was granted for the State and Village responses until November 15<sup>th</sup>. The probability of liability is reasonably possible. The possible final amount of the loss is undeterminable at this time.

*Severance v. Jerry Patterson, Greg Abbott, & Kirk Sistrunk*. The GLO is a defendant in this federal suit seeking declaratory and injunctive relief. The Plaintiff filed suit in Federal District Court to prevent the State from enforcing a public easement under the Texas Open Beaches Act on her beachfront properties in Galveston, Texas. The Plaintiff alleges that because the beach boundary of her beachfront property migrated landward after Hurricane Rita, taking in land not previously encumbered by a public access easement, the enforcement of the easement on her beachfront properties constitutes a seizure in violation of the Fourth Amendment and a taking without just compensation in violation of the Fifth Amendment. The Federal District Court dismissed the action because the Plaintiff did not present any ripe claims that would entitle her to the relief she was seeking. The Plaintiff appealed. The Federal Appellate Court affirmed the dismissal of the takings claim and certified state law issues to the Texas Supreme Court in regard to the claim of unreasonable seizure. The Texas Supreme Court ruled against the GLO in November 2010. In December 2010, the GLO filed a joint motion for rehearing that was granted in March 2011. The Texas Supreme Court heard oral argument in April 2011 and issued its opinion in March of 2012. The Federal Appellate Court issued its opinion in May of 2012 and reversed and remanded the case for further proceedings regarding Fourth Amendment claims. The parties have subsequently entered into a settlement agreement in July 2013, but the case is currently pending. The probability of liability is reasonably probable. The possible final amount of the loss is undeterminable at this time.

*Gulf Coast Rod, Reel and Gun Club Inc., et al. v. Patterson, et al.* The GLO is the defendant in a lawsuit where the plaintiffs' are seeking declaratory relief and allege that (1) the Commissioner and the GLO violated the Plaintiffs' due process rights under the 5th and 14th Amendments of the U.S. Constitution in applying for and obtaining a federal §10/§404 permit from the U.S. Army Corps of Engineers authorizing the closure of Rollover Pass; and (2) that the Commissioner and the GLO violated the Americans with Disabilities Act and Section 504 of the Rehabilitation Act by discriminating against individuals with mobility impairments who fish along Rollover Pass. The plaintiffs' complaint separately alleges several causes of action against the U.S. Army Corps of Engineers, asserting violations of the National Environmental Policy Act and the Clean

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

Water Act relating to the federal §10/§404 permit issued to the GLO for Rollover Pass. The primary relief sought by Plaintiffs is a declaration that the federal permit authorizing the closure of Rollover Pass is invalid, as well as an order from the district court revoking the permit. This case is currently in the discovery phase. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

In re: Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010. The BP Deep Water Horizon Oil Spill occurred in April 20 through July 15, 2010 off the Louisiana coast. As a result of the spill and the damage caused by the spill, the Department of Justice (DOJ) brought causes of actions against BP for Natural Resource Damages (NRD), Clean Water Act (CWA) violations and criminal violations. Although DOJ made an attempt to settle all NRD, CWA and criminal claims against BP related to the spill, that settlement dissolved. Recently, however, DOJ settled the criminal violations with BP for \$4 billion, with payments to be made over five years. Of the \$4 billion, \$2.394 billion will be dedicated to the National Fish and Wildlife Foundation (NFWF) for projects to remedy harm to resources resulting from the spill, and \$191.52 million will be for projects in Texas. BP has also agreed to pay \$1 billion for NRD early restoration projects and the states have been working through NRD assessments and presenting projects to BP and DOJ for approval. Trial in federal court related to liability and gross negligence for CWA violations is scheduled to begin in February 2013. Finally, another defendant, MOEX, agreed to pay the State of Texas \$3.25 million in civil penalties and attorneys' fees to settle its liability to the State related to the spill. A complaint has been filed by the GLO with respect to violations of the Texas Natural Resource Code and claims for economic damages under OPA, including the loss of tax and state park revenue. The stay was lifted on a Conditional Transfer order and the case has been transferred to a multi-district litigation court. The phase II trial commences on September 30, 2013 in the US District Court for the Eastern District of Louisiana. The likelihood of recovery is probable.

*Larry Mark Polsky Esq. v. Cameron County and Jerry Patterson.* The GLO is a defendant in this suit where the plaintiff filed a lawsuit related to ongoing litigation against the GLO seeking declaratory and injunctive relief and citing an unlawful and unconstitutional taking as the cause of action. The plaintiff has filed a second amended counterclaim adding selective enforcement, as an alternative remedy. The State has filed a special Exception to the plaintiff's takings and due process allegations and has also requested a Rule 91a Motion to Dismiss the plaintiff's selective enforcement claim. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

*State and GLO, et al. v EPA and Lisa Jackson.* The GLO and other interested entities filed a Petition for Review to obtain a partial stay of the United States Environmental Protection Agency's (EPA) rule, the Cross-State Air Pollution Rule requires states reduce power plant emissions that distribute ozone and/or fine particles to other states. The U.S. Court of Appeals for the D.C. Circuit vacated the CSAPR and the EPA filed for rehearing en banc that was denied. Pending the final settlement of CSAPR, the EPA's previous air-transport rule, the 2005 Clean Air Interstate Rule (CAIR), remains in effect. EPA has filed a Petition for Writ of Certiorari in the Supreme Court as have the Environmental Defense Fund and the American Lung Association. A brief for the state and local respondents in opposition and a brief in opposition of industry and labor respondents has been filed in The United States Supreme Court. The

## TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS

Supreme Court granted cert in June of 2013, and the EPA filed their opening merits brief in September of 2013 and the State's briefing will follow. On September 13, 2013 Texas joined North Dakota in suing the EPA for failure to meet deadlines to act for area designations. The suit seeks to force the EPA to designate areas within the states w/ respect to their attainment with National Ambient Air Quality Standard (NAAQS). Without a definite classification, there is uncertainty about which permit requirements apply. North Dakota is taking the lead in this counteraction. The probability of liability is reasonably possible. The possible final amount of the loss is undeterminable at this time.

*State v. Mark A. Ball.* The GLO is the plaintiff in seeking a recovery of funds owed to the State under a Land Award and Obligation. The defendant received a Land Award and Obligation from the Fund for the purchase of land in Reeves County, Texas. Mr. Ball defaulted and the GLO forfeited Mr. Ball's award and the property reverted to the state. Upon notifying the Reeves County Appraisal District of the reversion, the GLO was informed that Mr. Ball had sold parcels of the land on eBay as well as deeded at least one tract of land to multiple parties for sums in excess of \$33,000. The matter was referred by the OAG to the Williamson County District Attorney; however the OAG has taken up this matter again on the GLO's behalf. The case is currently in the discovery phase. An adverse result is possible, but that possibility is remote. The possible final amount of the loss is undeterminable at this time.

*Texas General Land Office v. Larry Mark Polsky.* The GLO is a plaintiff in this suit and is pursuing an injunction against the defendant to cease ongoing construction activities in Cameron County, Texas in violation of Section 63.091 of the Tex. Nat. Res. Code. A Temporary Restraining Order and Temporary Injunction have been granted in favor of the GLO. The defendant filed a motion to disqualify the GLO's lead counsel and the GLO filed a motion for sanctions claiming the motion to be frivolous. On September 20, 2013 the court granted the GLO's motion and fined the defendant in the amount of \$2,500. The case is currently in the discovery phase. The probability of liability is reasonably possible. The possible final amount of loss is undeterminable at this time.

*Wesley West Minerals, et al. v. SandRidge Energy and GLO et al.* The GLO is a defendant in this case seeking lost royalties. Plaintiff/Lessor Wesley West Minerals alleges that Defendant/Lessee Sandridge has failed to pay royalties. Defendant GLO has claimed sovereign immunity from the suit and has cross-claimed against defendant Sandridge. The GLO alleges that Sandridge has entered into an agreement with Oxy USA Inc., which deprives Cross-Plaintiff GLO of royalties from enormous monies from disposition of carbon dioxide (CO<sub>2</sub>). Under the Relinquishment Act, Sandridge is required to pay royalties to the GLO for CO<sub>2</sub> produced from the leased subject land. The District Court granted partial summary judgment for SandRidge regarding the proper interpretation of the Citation oil and gas lease. SandRidge's cross-motion for summary judgment against the GLO and Plaintiffs on the Relinquishment Act Leases was granted. Plaintiffs' motion for clarification of the summary judgment as it relates to SandRidge's royalty obligations has been denied. The parties have reached agreement on a motion and order for interlocutory appeal of the summary judgment ruling, and the GLO has filed a Notice of Agreed Interlocutory Appeal. The likelihood of recovery is reasonable possible.

## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

*Vastar v. State.* The claimant asserts ownership of certain property involved in a dispute concerning the boundary of the San Jacinto River in Harris County. The claim is that subsidence caused claimant's land to be submerged, and therefore title should not transfer to the State. The claimant seeks damages based on inverse condemnation. The trial court denied the State's plea to the jurisdiction. The Court of Appeals for the 3rd Circuit affirmed in part, dismissed in part, reversed and rendered in part. The State filed a Petition for Review to the Texas Supreme Court, which was denied. The Supreme Court remanded the case to the trial court and Plaintiff has proposed a settlement. Discussions are still currently ongoing as to an adequate settlement. Royalties have been deposited with the court registry pending outcome of the case. The likelihood of liability is unknown at this time.

There may be substantial legal obstacles to satisfaction of a judgment with Fund monies. The above lawsuits are referenced in this note as contingent liabilities in the interest of full disclosure. While ultimately uncertain whether the Fund will have any liability for these matters, management believes that it is unlikely that these suits will result in any liability to the Fund during the twelve months subsequent to August 31, 2013 therefore, in accordance with GAAP, no accrual for these matters is currently reflected in the accompanying financial statements. The possibility that payment will be required from the Fund is remote.

The GLO has potential lost revenue for the Fund due to two currently pending bankruptcy claims associated with mineral activity on state lands.

The GLO has filed a claim of \$57,042 against Heritage Standard. The recoverable amount has yet to be determined.

The GLO had a claim amount of \$4,702,727 for oil and gas sales transactions related to Enron Corporation, of which none was accrued as revenue in the year of the bankruptcy due to the unlikelihood of its collection. Revenues will be recognized in the years collections are received. The GLO received and recognized total revenues of \$2,755,258 through August 31, 2013.

### **10. Significant Commitments**

The PSF(SLB) makes investments in certain limited partnerships that legally commit it to possible future capital contributions. At August 31, 2013, the remaining commitments totaled approximately \$1.14 billion.

In July 2012, the SLB adopted a resolution that releases a total of \$280 million from the RESFA during the Fiscal Years 2014 and 2015 to the SBOE for investment in the PSF(SBOE). The funds will be released in four quarterly installments of \$32.5 million each in Fiscal Year 2014 and four quarterly installments of \$37.5 million each in Fiscal Year 2015.

The current land inventory includes approximately 2,000 acres of PSF property that is the remaining inventory of the Paseo Del Este development. This acreage is subject to a commitment to sell parcels of land over time as the development proceeds. The sales price of specific parcels are governed by the terms of a Purchase Contract effective June 1, 1998 and the four subsequent contract amendments, and are subject to an annual seven percent (7%)



## **TEXAS PERMANENT SCHOOL FUND NOTES TO THE FINANCIAL STATEMENTS**

increase compounded annually, but calculated on a per diem basis. This remaining acreage is reported in inventory at a fair value of \$25,961,679 as of August 31, 2013.

In November 2012, the SBOE set the distribution rate to the ASF for the 2014-2015 biennium at 3.3%, which is expected to produce an effective rate of 3.5%, after taking into account broadening of the calculation base for the Fund that was effected by a 2011 State Constitutional amendment; this amendment did not increase contributions from the PSF(SLB). The PSF(SBOE) expects to distribute approximately \$839 million annually for each year of the 2014-2015 biennium.

As of August 31, 2013 the SBOE has approved and the Fund made capital commitments to externally managed real estate investment funds in a total amount of \$1.25 billion and capital commitments to private equity limited partnerships for a total of \$2.2 billion, to be implemented over the next several years. Unfunded commitments at August 31, 2013 totaled \$513 million in real estate investments and \$1.58 billion in private equity investments.

### **11. Recent Accounting Pronouncements**

The Governmental Accounting Standards Board (GASB) has issued new accounting pronouncements which are not effective as of August 31, 2013. A discussion of these issued but not effective new standards which could have potential impact to the PSF is below.

The GASB has issued Statement No. 70, *Accounting and Financial Reporting for Non-Exchange Financial Guarantees*, which provides accounting and financial guidance to state and local governments that either offer or receive non-exchange financial guarantees. Statement No. 70 requires a government to recognize a liability when qualitative factors indicate that it is more likely than not that the government will be required to make a payment as a result of the guarantee agreement. The requirements for this statement are effective for periods beginning after June 15, 2013.

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**SECTION  
THREE**

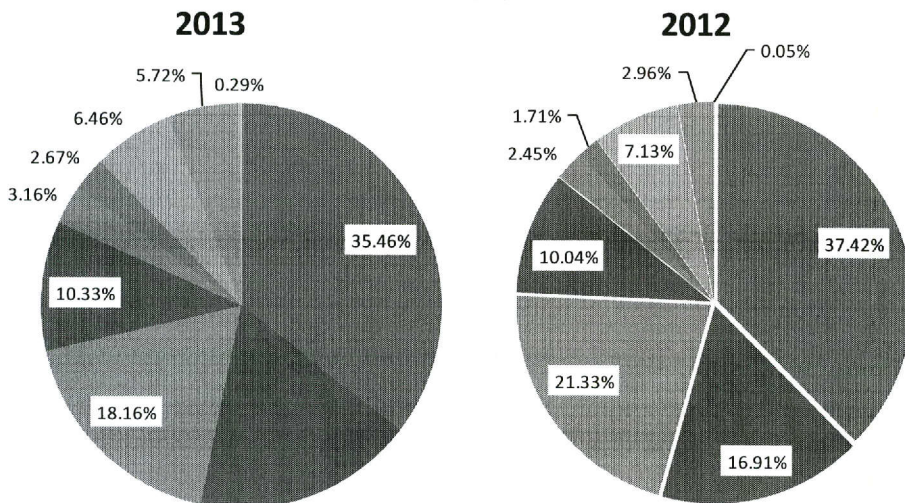
**STATISTICAL  
SUMMARY  
(UNAUDITED)**

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## AN OVERVIEW OF THE STRENGTH OF THE TEXAS PERMANENT SCHOOL FUND ASSETS MANAGED BY THE STATE BOARD OF EDUCATION (SBOE)

Founded in 1854, the SBOE Texas Permanent School Fund (PSF(SBOE)) has grown from its initial capitalization of \$2,000,000 to approximately \$27.17 billion as of August 31, 2013. The PSF(SBOE) investment assets consist of \$14.46 billion in equity securities (including domestic and international equity securities, and making up 53.21% of the total portfolio fair value), \$4.93 billion in fixed income securities (18.16%), \$2.81 billion in absolute return investments (10.33%), \$858.10 million in real estate investments (3.16%), \$724.50 million in private equity investments (2.67%), \$1.75 billion in risk parity strategies (6.46%), \$1.55 billion in real return investments (5.72%), and \$80.01 million in unallocated Cash (0.29%). This compares with the prior fiscal year's PSF(SBOE) fair value of \$25.50 billion when the PSF(SBOE) consisted of \$13.86 billion in equity securities (54.33% of the total portfolio fair value), \$5.44 billion in long-term fixed income securities (21.33%), \$2.56 billion in absolute return investments (10.04%), \$624.57 million in real estate investments (2.45%), \$435.40 million in private equity investments (1.71%), \$1.82 billion in risk parity strategies (7.13%), \$753.88 million in real return investments (2.96%), and \$13.89 million in unallocated Cash (0.05%).

**FIGURE 1**  
TEXAS PERMANENT SCHOOL FUND  
Portfolio Diversification  
Fair Value



Asset Class	August 31, 2013	Percent	August 31, 2012	Percent
Domestic Equity	\$ 9,632,323,310	35.46%	\$ 9,543,337,864	37.42%
International Equity	4,822,910,037	17.75%	4,311,865,365	16.91%
Domestic Fixed Income	4,932,984,581	18.16%	5,439,600,525	21.33%
Absolute Return	2,806,109,527	10.33%	2,561,523,071	10.04%
Real Estate	858,103,624	3.16%	624,565,708	2.45%
Private Equity	724,500,410	2.67%	435,395,447	1.71%
Risk Parity	1,754,251,092	6.46%	1,818,888,708	7.13%
Real Return	1,554,283,603	5.72%	753,884,939	2.96%
Unallocated Cash	80,008,055	0.29%	13,891,641	0.05%
<b>Net Investment Balance</b>	<b>\$ 27,165,474,239</b>	<b>100.00%</b>	<b>\$ 25,502,953,268</b>	<b>100.00%</b>

The asset classes include cash that has been allocated to the investment portfolios.

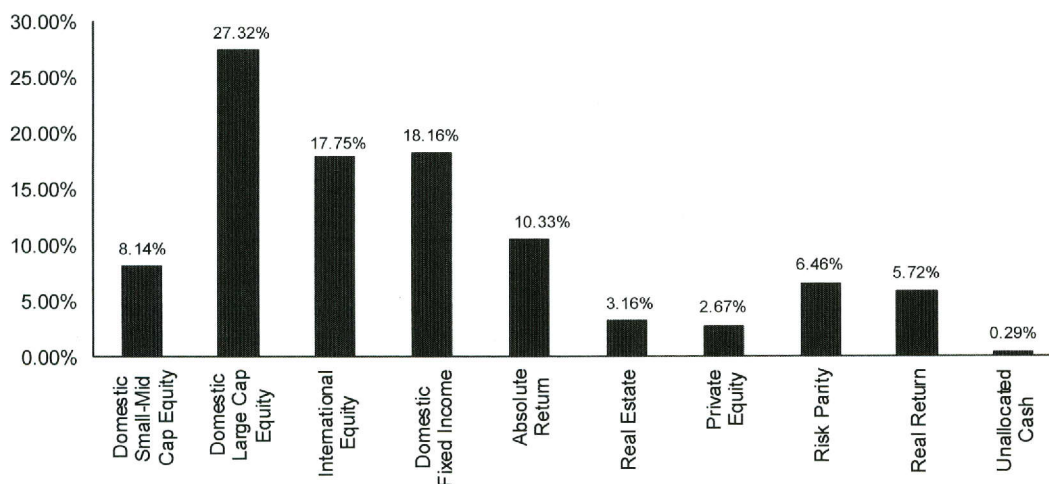
**TEXAS PERMANENT SCHOOL FUND  
ASSET ALLOCATION MIX - SBOE  
AS OF AUGUST 31, 2013**

<u>ASSET CLASS</u>	<u>Book Value</u>	<u>Mix</u>	<u>Fair Value</u>	<u>Mix</u>
<b>Equity</b>				
Public Market Equity				
Domestic Small-Mid Cap	\$ 1,467,132,413	6.60%	\$ 2,210,410,687	8.14%
Domestic Large Cap	4,642,439,606	20.89%	7,421,912,623	27.32%
Total Domestic Equity	6,109,572,019	27.49%	9,632,323,310	35.46%
Developed and Emerging Market				
International Equity	4,047,251,867	18.21%	4,822,910,037	17.75%
Total Public Market Equity	10,156,823,886	45.70%	14,455,233,347	53.21%
<b>Fixed Income</b>				
Domestic Fixed Income	4,913,112,013	22.11%	4,932,984,581	18.16%
Total Fixed Income	4,913,112,013	22.11%	4,932,984,581	18.16%
<b>Alternative Investments</b>				
Absolute Return	2,476,127,276	11.14%	2,806,109,527	10.33%
Real Estate	764,587,500	3.44%	858,103,624	3.16%
Private Equity	595,321,414	2.68%	724,500,410	2.67%
Risk Parity	1,561,455,040	7.03%	1,754,251,092	6.46%
Real Return	1,675,803,252	7.54%	1,554,283,603	5.72%
Total Alternative Investments	7,073,294,482	31.83%	7,697,248,256	28.34%
Unallocated Cash	80,008,055	0.36%	80,008,055	0.29%
<b>Fund Total</b>	<b>\$ 22,223,238,436</b>	<b>100.00%</b>	<b>\$ 27,165,474,239</b>	<b>100.00%</b>

**Notes:**

The PSF(SBOE) asset classes include cash that has been allocated to the investment portfolios. Income accruals are not reflected in this schedule.

FIGURE 2:  
TEXAS PERMANENT SCHOOL FUND  
ASSET ALLOCATION MIX  
As of August 31, 2013



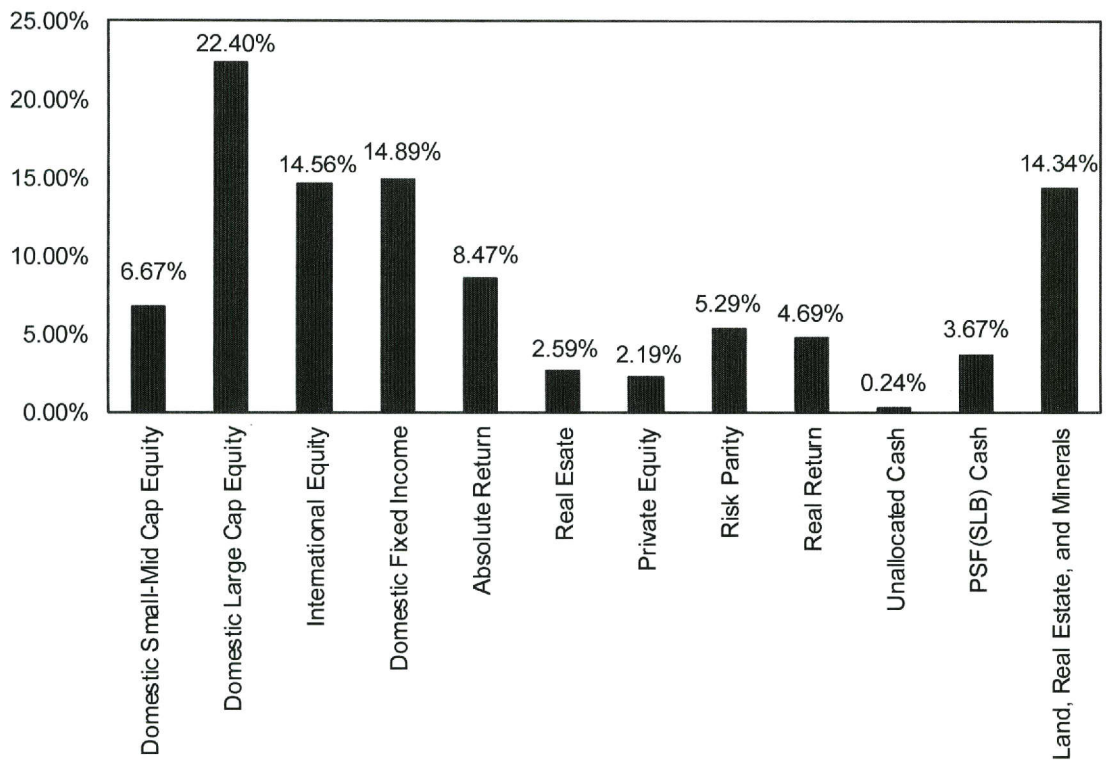
**TEXAS PERMANENT SCHOOL FUND**  
**ASSET ALLOCATION MIX INCLUDING ASSETS MANAGED BY THE SLB**  
**AS OF AUGUST 31, 2013**

<u>ASSET CLASS</u>	<u>Book Value</u>	<u>Fair Value</u>	<u>Mix</u>
<b>PSF(SBOE)</b>			
Equity			
Public Market Equity			
Domestic Small-Mid Cap Equity	\$ 1,467,132,413	\$ 2,210,410,687	6.67%
Domestic Large Cap Equity	4,642,439,606	7,421,912,623	22.40%
Total Domestic Equity	6,109,572,019	9,632,323,310	29.07%
International Equity	4,047,251,867	4,822,910,037	14.56%
Total Public Market Equity	10,156,823,886	14,455,233,347	43.63%
Fixed Income			
Domestic Fixed Income	4,913,112,013	4,932,984,581	14.89%
Total Fixed Income	4,913,112,013	4,932,984,581	14.89%
Alternative Investments			
Absolute Return	2,476,127,276	2,806,109,527	8.47%
Real Estate	764,587,500	858,103,624	2.59%
Private Equity	595,321,414	724,500,410	2.19%
Risk Parity	1,561,455,040	1,754,251,092	5.29%
Real Return	1,675,803,252	1,554,283,603	4.69%
Total Alternative Investments	7,073,294,482	7,697,248,256	23.23%
Unallocated Cash	80,008,055	80,008,055	0.24%
<b>PSF(SLB)</b>			
Cash	1,216,045,685	1,216,045,685	3.67%
Land, Real Asset Investments and Minerals			
Soveriegn/Other Lands and Discretionary			
Internal Investments	363,581,282	715,163,253	2.16%
Investments with External Managers	1,779,934,020	1,727,243,326	5.21%
Mineral Investments	13,394,403	2,307,102,037	6.97%
Total Land, Real Assets, and Minerals	2,156,909,705	4,749,508,616	14.34%
<b>FUND TOTAL</b>	<b>\$ 25,596,193,826</b>	<b>\$ 33,131,028,540</b>	<b>100.00%</b>

The PSF(SBOE) asset classes include cash that has been allocated to the investment portfolios. Income accruals are not reflected in this schedule.

**TEXAS PERMANENT SCHOOL FUND  
ASSET ALLOCATION MIX INCLUDING ASSETS MANAGED BY THE SLB  
AS OF AUGUST 31, 2013**

FIGURE 3:  
TEXAS PERMANENT SCHOOL FUND  
ASSET ALLOCATION MIX  
As of August 31, 2013





## **TOTAL PSF (SBOE) FUND RATE OF RETURN FOR FISCAL YEAR ENDED AUGUST 31, 2013**

The total market value of the PSF(SBOE) at August 31, 2013, was \$27.17 billion. The PSF(SBOE) annual rates of return for the one year, five year and ten year periods ending August 31, 2013, were 10.16%, 6.16% and 7.26%, respectively. The Fund returned 10.16% for the fiscal year, underperforming its target index by approximately 25 basis points.

The capital markets continued to see growth and post-recession recovery during the year with fixed income, domestic and international equities, absolute return, real estate, and private equity realizing impressive returns. The internally managed core fixed income portfolio outperformed its benchmark, the Barclays Capital U.S. Aggregate Bond Index, by 45 basis points. The internally managed domestic equity portfolios outperformed their benchmark with a performance of 20.13% while international equity, managed by Blackrock Investment Management LLC, outperformed its benchmark, the Morgan Stanley Capital All Country International World Ex-US, with a return of 13.10% for the fiscal year. Real estate outperformed its index by 133 basis points for the year, as did absolute return, which exceeded its benchmark by 429 basis points. Private equity realized a return of 26.89% for the period ending August 31, 2013.

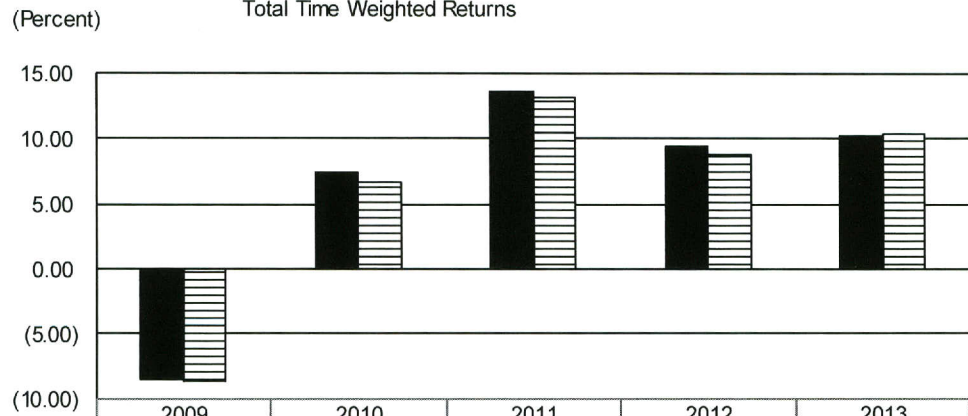
The underperformance of the PSF(SBOE) relative to its benchmark was the result of significant losses attributed to the risk parity and real return portfolios. Risk parity returned -3.28% for the year, underperforming its benchmark by 1312 basis points. The real return portfolio returned -7.99% for the year, underperforming its benchmark.

The diversification of asset classes mitigated the losses attributed by the risk parity and real return portfolios to the total PSF(SBOE) composite. The PSF(SBOE) strategic asset allocation reduces the Fund's risk profile while improving its expected return. The strategic asset allocation of the PSF(SBOE) includes a 25% allocation to domestic equities, 21% allocation to international equities including emerging markets, 17% allocation to core fixed income and a 37% allocation to alternative assets. Alternative assets include absolute return, real estate, risk parity, real return strategies (TIPS and commodities), and private equity.

Additional information about performance is included in the chart on the following page. The information shown is for fiscal year periods ending August 31 and includes comparisons to established benchmarks for the same time periods. Benchmark compositions are defined in the footnotes. Investment performance is calculated using a time weighted rate of return. Returns are calculated using standard industry practices. Total return takes into account the change in the fair value of the Fund during the year as well as all net income generated by PSF(SBOE) investments.

## TOTAL PSF (SBOE) TIME WEIGHTED RETURNS FOR FISCAL YEAR ENDED AUGUST 31, 2013

FIGURE 4:  
TEXAS PERMANENT SCHOOL FUND  
Total Time Weighted Returns



	2009	2010	2011	2012	2013
■ PSF(SBOE)	(8.47)	7.51	13.64	9.45	10.16
▨ Target Policy Benchmark	(8.64)	6.67	13.15	8.87	10.41

Fiscal Year Ending August 31

## TOTAL PSF (SBOE) TIME WEIGHTED RETURNS FOR FISCAL YEAR ENDED AUGUST 31, 2013

<b>Total PSF(SBOE) Portfolio <sup>1</sup></b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
PSF(SBOE)	(8.47)	7.51	13.64	9.45	10.16	11.07	6.16	7.26
Target Policy Benchmark <sup>2</sup>	(8.64)	6.67	13.15	8.87	10.41	10.79	5.79	7.00
<b>Domestic Equities</b>								
PSF(SBOE)	(18.00)	6.25	19.29	17.32	20.13	18.91	7.93	7.79
Domestic Equity Benchmark <sup>3</sup>	(18.33)	5.99	19.36	17.13	20.00	18.82	7.75	7.70
<b>International Equities</b>								
PSF(SBOE)	(13.95)	3.11	10.52	(1.59)	13.10	7.15	1.77	7.97
International Equity Benchmark <sup>4</sup>	(14.41)	2.85	10.34	(1.92)	12.98	6.93	1.48	8.09
<b>Fixed Income</b>								
PSF(SBOE)	10.20	11.29	4.58	6.57	(2.02)	2.98	6.02	5.32
Fixed Income Benchmark <sup>5</sup>	7.94	9.18	4.62	5.78	(2.47)	2.58	4.93	4.83
<b>Absolute Return</b>								
PSF(SBOE)	(4.86)	7.85	4.48	3.69	10.23	6.09	4.15	---
Absolute Return Benchmark <sup>6</sup>	3.97	6.60	5.36	0.14	5.94	3.78	4.38	---
<b>Real Estate</b>								
PSF(SBOE)		0.20	15.53	7.38	11.85	11.54	---	---
Real Estate Benchmark <sup>7</sup>		0.20	14.69	10.40	10.52	11.85	---	---
<b>Private Equity</b>								
PSF(SBOE)		3.74	20.32	5.43	26.89	17.19	---	---
Private Equity Benchmark <sup>8</sup>		3.74	20.32	5.43	26.89	17.19	---	---
<b>Risk Parity</b>								
PSF(SBOE) (inception to date)			3.51	13.11	(3.28)	---	---	---
Risk Parity Benchmark <sup>9</sup>			(4.48)	13.34	9.87	---	---	---
<b>Real Return</b>								
PSF(SBOE) (inception to date)			(0.76)	8.49	(7.99)	---	---	---
Real Return Benchmark <sup>10</sup>			(0.76)	8.29	(6.13)	---	---	---

<sup>1</sup> Time weighted rates of return adjusted for cash flows for the PSF(SBOE) investment assets. Does not include real estate assets managed by the GLO. Returns are gross of fees.

<sup>2</sup> As of 08/31/13, Total PSF Benchmark weights are fixed with the following: 27% S&P 500 Index, 8% S&P 1000 Index, 19% Barclays Capital Aggregate, 18% MSCI ACWI ex US Net, 3% Real Return Benchmark, 3% Real Estate Benchmark, 7% Risk Parity Benchmark, 10% Absolute Return Benchmark, 2% Private Equity Benchmark and 3% Commodities.

<sup>3</sup> As of 08/31/2013, 77.14% S&P 500, 22.86% S&P 1000

<sup>4</sup> As of 08/31/2013, 100% MSCI ACWI Ex-US Net Dividend.

<sup>5</sup> As of 08/31/2013, 100% Barclays Capital U.S. Aggregate Bond Index.

<sup>6</sup> As of 08/31/2013, HFRI Fund of Funds Composite Index.

<sup>7</sup> The benchmark is calculated by dynamically allocating market value of portfolios and applying the *NCREIF Property Index (1 quarter lag)* to each portfolio upon receipt of valuations.

<sup>8</sup> As of 08/31/2013, represents actual return of Private Equity investments.

<sup>9</sup> As of 08/31/2013, 60% S&P 500 and 40% Barclays Capital U.S. Aggregate Bond Index.

<sup>10</sup> As of 08/31/2013 weights are fixed with the following: 50% Barclays Capital U.S. Treasury: US TIPS Index and 50% Dow Jones UBS Commodities Total Return Index.

## **CONTRIBUTIONS TO THE TEXAS PERMANENT SCHOOL FUND ASSETS MANAGED BY THE SBOE**

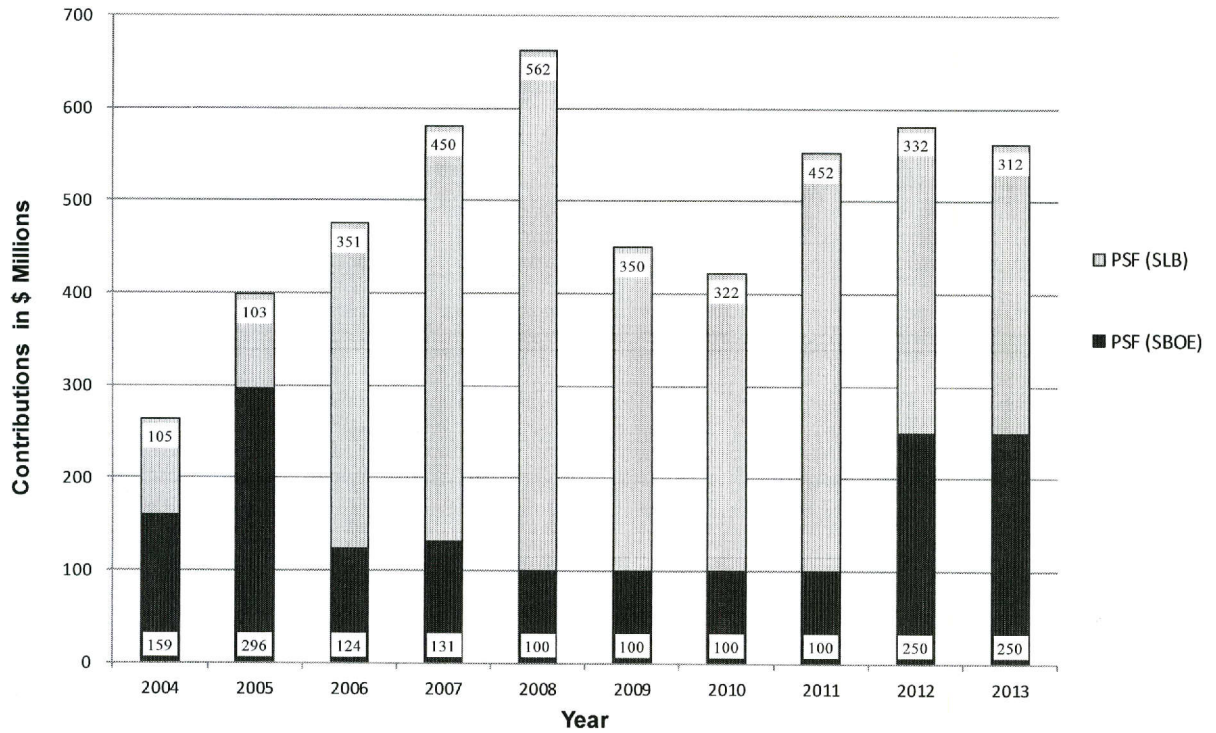
The School Land Board (SLB) makes contributions to the PSF(SBOE) from the revenue generated by royalties, lease payments, and other income derived from lands dedicated to the Fund. Legislative actions in the past ten (10) years have amended the Natural Resources Code (NRC) several times and have impacted the flow of contributions from the PSF(SLB) to the PSF(SBOE).

H.B. 3558 passed by the 77<sup>th</sup> Legislature and subsequent actions by the 79<sup>th</sup> and 80<sup>th</sup> Legislatures amended the NRC to grant the SLB authority to deposit some or all of the Fund's land and mineral interest proceeds previously transferred to the PSF(SBOE) into a special fund account at the State Treasury and to grant investment authority to the SLB for this Real Estate Special Fund Account (RESFA). The amount of proceeds retained by the SLB under this legislative authority continues to grow and has increased from \$151.6 million at August 31, 2002 to \$3.0 billion at August 31, 2013.

The 80<sup>th</sup> Legislature also authorized the SLB and the Land Commissioner to determine whether to release any funds from the RESFA to the PSF(SBOE). During the past year, the PSF(SBOE) received \$250 million in contributions from the SLB, which sourced from the SLB resolution adopted in January 2011 to release to the PSF(SBOE) a total of \$500 million from the RESFA - \$250 million in each year of the 2012-2013 biennium. The SLB also adopted a resolution to transfer \$300 million directly to the Available School Fund in fiscal year 2013, which is not reflected in Figure 5 below.

## CONTRIBUTIONS TO THE TEXAS PERMANENT SCHOOL FUND ASSETS MANAGED BY THE SBOE

FIGURE 5:  
Texas Permanent School Fund Contributions to  
PSF (SBOE) and PSF (SLB)  
(in millions)



## **DISTRIBUTIONS TO THE AVAILABLE SCHOOL FUND**

Since September 2003, the Fund has calculated its annual distribution to the Available School Fund using a total return methodology. Prior to that year, all interest and dividends earned from investments was paid immediately to the ASF. In fiscal year 2013, \$1.02 billion was distributed to the ASF by the PSF(SBOE). The amount transferred was determined by the SBOE under new administrative rules adopted in September 2009.

These rules state the SBOE will determine each year whether a distribution to the ASF is permitted under the Texas Constitution Article VII, §5(a)(2), and if a transfer shall be made for the current state fiscal year. The rule adoption was the result of Attorney General Opinion No. GA-0707, dated April 13, 2009, which clarified the proper application by the SBOE of Article VII, §5(a)(1) and §5(a)(2),

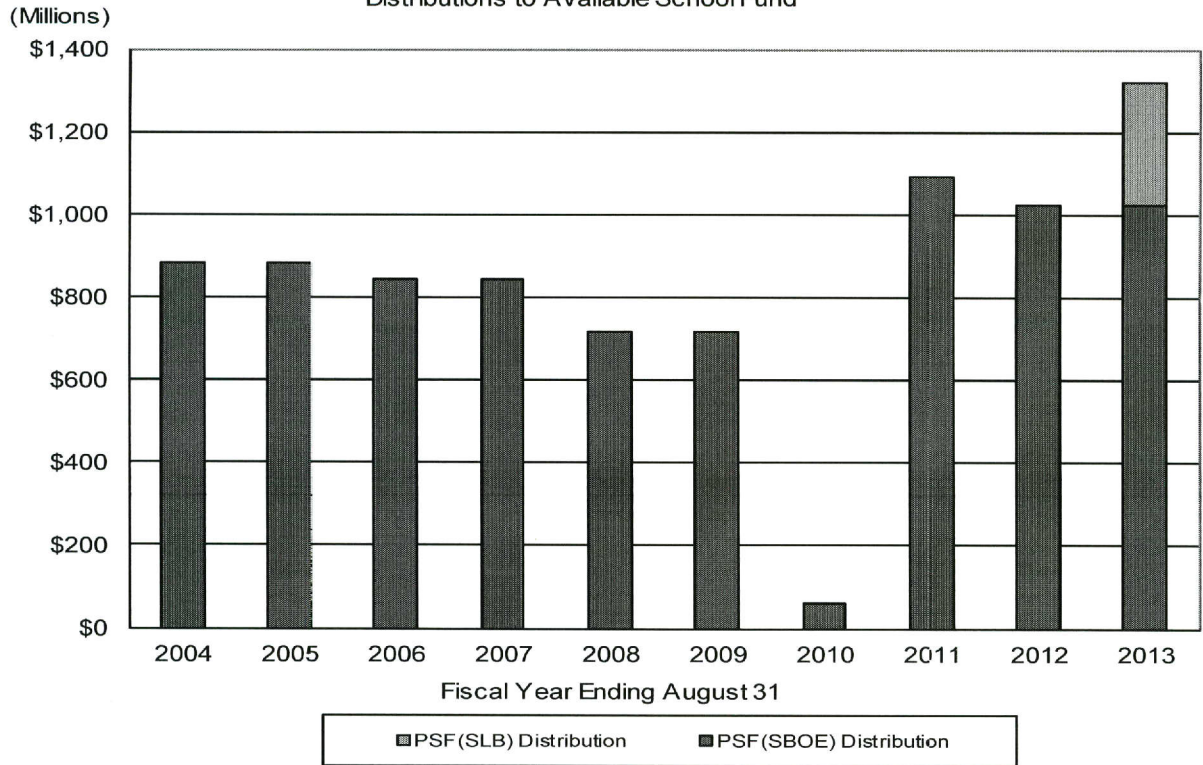
The ASF is distributed during the year to the school districts throughout the state based on their average daily attendance (ADA). For fiscal year 2013, the per capita income earned by the Fund and distributed to school districts was \$281.08, the second year in which charter schools were included in the ADA and the first year in which the PSF(SLB) made distributions directly to the ASF. In fiscal years 2011 and 2012, this amount was \$246.09 and \$221.04, respectively (Figure 6).

On November 8, 2011, Texas voters approved Proposition 6, a constitutional amendment which increases the base amount used in calculating the distribution rate from the PSF(SBOE) to the ASF by adding certain discretionary real assets and cash in the Fund that is managed by entities other than the SBOE (at present, by the SLB). While the amendment provided for an increase in the base for the calculation, no new resources were provided for deposit to the PSF(SBOE). The new calculation base is required to be used to determine all payments to the ASF from the PSF(SBOE) beginning with the 2012-13 biennium. The SBOE approved a distribution rate of 4.2% in November 2010 based on a commitment of the SLB to transfer \$500 million to the PSF(SBOE) during the biennium, \$250 million of which was received in each of the fiscal years 2012 and 2013.

The changes approved by the voters also provide authority to the SLB determine in its sole discretion whether to transfer each year from PSF(SLB) assets to the ASF an amount not to exceed \$300 million. During fiscal year 2013, the SLB transferred \$300 million to the ASF.

## DISTRIBUTIONS TO THE AVAILABLE SCHOOL FUND

FIGURE 6:  
Distributions to Available School Fund



Fiscal Year Ending	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
PSF(SBOE) Distribution	\$880	\$880	\$842	\$843	\$717	\$717	\$61	\$1,093	\$1,021	\$1,021
PSF(SLB) Distribution	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$300
Per Capita Distribution (dollars)	\$222	\$219	\$204	\$196	\$166	\$163	\$14	\$246	\$221	\$281

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SECTION  
FOUR

BOND GUARANTEE  
PROGRAM  
(UNAUDITED)

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## AN OVERVIEW OF THE BOND GUARANTEE PROGRAM

Since its inception in 1983, the Bond Guarantee Program has guaranteed 5,280 school district bond issues for a total of \$112.0 billion. At the end of fiscal year 2013, there were 2,789 issues outstanding with a balance of \$55.2 billion. This balance represents the principal amount of the bonds issued and does not reflect any subsequent accretions in value for compound interest bonds (zero coupon securities). The balance also excludes bonds that have been refunded and released from the Bond Guarantee Program. During the fiscal year, there were 155 additional school district issues guaranteed by the Fund. This increased the total amount outstanding by \$1.58 billion.

The guarantee capacity of the Fund is limited in two ways. The first limit is imposed by the "State Capacity Limit" limiting the amount guaranteed to 300% of the current historical cost of the assets in the Fund. The second limit is imposed by Internal Revenue Service Notice 2010-5 or the "Internal Revenue Service Limit." Notice 2010-5, issued by the Internal Revenue Service on December 16, 2009, changes the Internal Revenue Service Limit to 500% of the historical cost of the assets in the Fund on the date of the Notice (December 16, 2009). As of August 31, 2013, the ratio of guaranteed debt outstanding to the book value of the Fund was **2.16:1** and the ratio of guaranteed debt to the fair value of the Fund was **1.67:1**.

In order to be eligible for the bond guarantee program, school districts must be accredited by the State, have bond ratings below AAA, and have their applications approved by the Commissioner of Education. If a school district fails to make scheduled payments for any bond issues guaranteed by the Fund, the Fund will make the scheduled debt service payment for the defaulting school district. The Fund will not accelerate the total bond issue. Any State funds subsequently due to the district will instead be paid to the Fund until all monies due the Fund are repaid.

Figure 7 lists the school districts with the ten largest aggregate amounts of bonds outstanding, which are guaranteed under the program as of August 31, 2013.

**FIGURE 7:  
Bond Guarantee Program  
Ten Largest Total Debt Outstanding  
Guaranteed Under the Program  
At August 31, 2013**

School District Name	Balance
DALLAS ISD	\$ 2,453,110,000
HOUSTON ISD	1,829,198,577
NORTHSIDE ISD - BEXAR COUNTY	1,686,330,000
CYPRESS-FAIRBANKS ISD	1,518,044,377
NORHT EAST ISD	1,407,069,128
KATY ISD	1,232,844,928
FRISCO ISD	1,161,075,843
CONROE ISD	851,915,000
LEANDER ISD	784,423,156
PLANO ISD	691,305,871

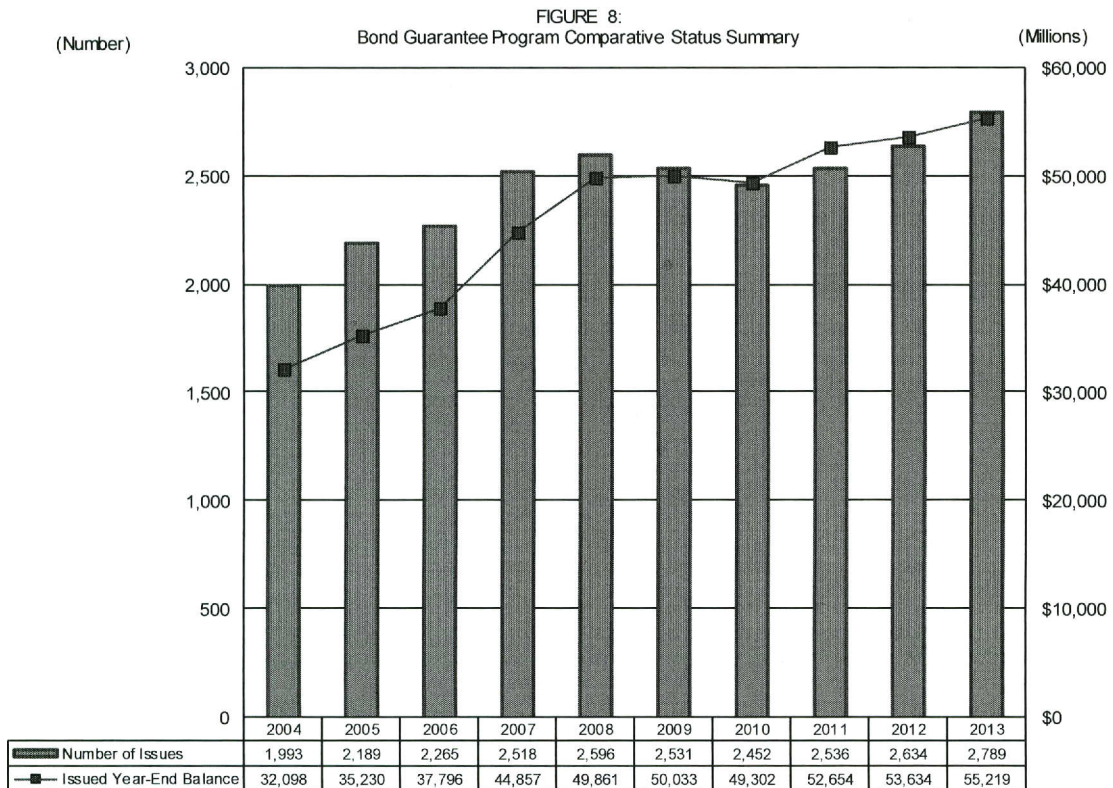
## BOND GUARANTEE PROGRAM COMPARATIVE STATUS SUMMARY FOR THE FISCAL YEAR ENDED AUGUST 31, 2013

### NUMBER OF ISSUES

Number of Issues as of September 1, 2012	2,634
Fiscal Year Activity:	
District Issues Guaranteed During Fiscal Year	345
District Issues Matured	(134)
District Issues Refunded	(56)
	2,789
Number of Issues as of August 31, 2012	2,789

### BALANCE

Balance as of September 1, 2012	\$ 53,634,455,141
Fiscal Year Activity:	
District Issues Guaranteed During Fiscal Year	8,565,825,610
District Issues Matured	(1,917,815,299)
District Issues Refunded	(5,105,754,130)
Adjustments	42,177,834
	42,177,834
Balance as of August 31, 2013	\$ 55,218,889,156



**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Abbott ISD	3,284,000	Bay City ISD	17,333,484
Abernathy ISD	17,360,000	Beaumont ISD	282,445,000
Abilene ISD	44,773,722	Beckville ISD	5,390,000
Academy ISD	5,184,998	Beeville ISD	19,479,686
Alamo Heights ISD	100,075,000	Bells ISD	9,997,419
Alba-Golden ISD	2,080,000	Bellville ISD	24,653,031
Aldine ISD	387,010,000	Belton ISD	134,359,996
Aledo ISD	143,001,258	Ben Bolt-Palito Blanco ISD	5,165,000
Alice ISD	35,619,998	Benavides ISD	7,145,000
Alief ISD	160,993,656	Big Sandy ISD	1,795,000
Allen ISD	313,730,936	Big Spring ISD	62,010,000
Alpine ISD	2,060,000	Birdville ISD	203,760,361
Alto ISD	5,075,000	Bishop CISD	9,930,512
Alvarado ISD	50,404,393	Blackwell CISD	5,965,000
Alvin ISD	304,620,000	Blanco ISD	12,365,000
Alvord ISD	9,220,000	Bland ISD	13,777,894
Amarillo ISD	154,603,633	Blanket ISD	1,089,999
Anahuac ISD	15,230,000	Blooming Grove ISD	1,744,503
Anderson-Shiro CISD	15,030,000	Bloomington ISD	2,985,000
Andrews ISD	12,996,408	Blue Ridge ISD	15,710,000
Angleton ISD	130,328,258	Bluff Dale ISD	265,000
Anna ISD	81,365,024	Blum ISD	2,695,000
Anson ISD	7,070,000	Boerne ISD	192,001,625
Anthony ISD	5,865,868	Boles ISD	5,357,300
Aquilla ISD	2,153,000	Bonham ISD	10,040,000
Aransas Co ISD	32,275,000	Booker ISD	505,000
Aransas Pass ISD	1,890,000	Borger ISD	35,619,336
Archer City ISD	650,000	Bosqueville ISD	8,557,270
Argyle ISD	47,321,839	Bowie ISD	26,855,000
Arlington ISD	398,489,719	Boyd ISD	23,600,000
Arp ISD	9,937,059	Brady ISD	17,959,995
Aspermont ISD	8,455,000	Brazos ISD	15,964,991
Athens ISD	15,027,542	Brazosport ISD	139,453,112
Atlanta ISD	13,370,500	Breckenridge ISD	6,480,000
Aubrey ISD	52,125,148	Brenham ISD	39,132,099
Austin ISD	338,868,405	Bridge City ISD	18,414,734
Austwell-Tivoli ISD	546,000	Bridgeport ISD	27,185,000
Avalon ISD	1,095,000	Brock ISD	31,868,484
Azle ISD	18,750,000	Brookesmith ISD	873,722
Balmorhea ISD	1,175,092	Brooks Co ISD	34,960,000
Bandera ISD	23,806,827	Brownfield ISD	10,735,000
Bangs ISD	7,516,744	Brownsboro ISD	31,031,710
Banquete ISD	11,194,508	Brownsville ISD	158,320,000
Barbers Hill ISD	135,023,771	Brownwood ISD	1,000,000
Bartlett ISD	1,350,000	Bruceville-Eddy ISD	6,805,000
Bastrop ISD	137,511,071	Bryan ISD	138,100,000

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Bryson ISD	16,621,036	Chireno ISD	1,085,000
Buckholts ISD	845,000	Chisum ISD	8,740,000
Buena Vista ISD	360,317	Christoval ISD	1,070,000
Buffalo ISD	16,800,000	City View ISD	3,761,350
Bullard ISD	36,160,986	Claude ISD	1,840,000
Buna ISD	7,395,000	Clear Creek ISD	435,725,000
Burkburnett ISD	6,410,000	Cleburne ISD	47,452,102
Burkeville ISD	1,975,000	Cleveland ISD	36,710,801
Burleson ISD	241,101,943	Clifton ISD	2,905,000
Burnet CISD	29,475,000	Clint ISD	117,819,458
Burton ISD	6,955,000	Clyde CISD	19,920,000
Bushland ISD	12,455,000	Coahoma ISD	13,350,000
Bynum ISD	1,035,000	Coldspring-Oakhurst CISD	2,000,000
Caddo Mills ISD	32,563,719	Coleman ISD	650,000
Calallen ISD	43,879,337	College Station ISD	175,085,000
Caldwell ISD	2,930,000	Collinsville ISD	1,023,000
Calhoun Co ISD	10,010,000	Colorado ISD	29,840,000
Callisburg ISD	19,604,998	Columbia-Brazoria ISD	39,069,984
Cameron ISD	17,117,900	Columbus ISD	13,209,988
Campbell ISD	241,006	Comal ISD	437,506,479
Canadian ISD	13,130,000	Comanche ISD	10,187,584
Canton ISD	38,063,692	Comfort ISD	19,423,800
Canutillo ISD	102,669,361	Commerce ISD	27,675,000
Canyon ISD	76,548,602	Community ISD	28,616,540
Carlisle ISD	10,235,000	Comstock ISD	2,700,000
Carrizo Springs CISD	49,475,000	Connally ISD	19,440,500
Carroll ISD	125,593,792	Conroe ISD	851,915,000
Carrollton-Farmers Branch ISD	298,035,000	Coolidge ISD	1,908,088
Carthage ISD	22,729,931	Cooper ISD	13,140,000
Castleberry ISD	47,599,997	Coppell ISD	97,813,212
Cedar Hill ISD	109,428,996	Copperas Cove ISD	30,071,286
Celeste ISD	7,875,000	Corpus Christi ISD	128,100,000
Celina ISD	54,851,695	Corrigan-Camden ISD	2,340,000
Center ISD	8,699,397	Corsicana ISD	57,724,092
Center Point ISD	1,440,000	Cotulla ISD	19,810,000
Central Heights ISD	2,700,000	Covington ISD	1,055,000
Central ISD	12,112,344	Crandall ISD	23,014,638
Channelview ISD	155,129,997	Crane ISD	3,005,000
Channing ISD	2,500,000	Crawford ISD	5,365,180
Chapel Hill ISD	3,645,000	Crockett ISD	13,194,999
Chapel Hill ISD	20,365,000	Crosby ISD	117,825,717
Charlotte ISD	2,846,645	Cross Plains ISD	165,000
Chester ISD	295,000	Cross Roads ISD	1,140,000
Chico ISD	18,146,409	Crowley ISD	282,109,360
Childress ISD	1,830,000	Crystal City ISD	20,034,999
China Spring ISD	46,340,000	Cuero ISD	11,278,592

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Culberson Co-Allamoreo ISD	735,000	Edinburg CISD	160,060,000
Cumby ISD	1,885,000	Edna ISD	21,335,000
Cypress-Fairbanks ISD	1,518,044,377	El Campo ISD	20,425,000
D'Hanis ISD	5,181,274	El Paso ISD	403,795,208
Daingerfield-Lone Star ISD	10,378,999	Electra ISD	900,000
Dalhart ISD	14,840,000	Elgin ISD	61,074,984
Dallas ISD	2,453,110,000	Elysian Fields ISD	10,830,000
Danbury ISD	2,973,742	Ennis ISD	142,341,847
Darrouzett ISD	3,590,000	Era ISD	1,892,371
Dawson ISD	3,492,673	Etoile ISD	2,515,000
Dayton ISD	15,920,000	Eula ISD	4,160,000
De Leon ISD	885,000	Eustace ISD	3,950,000
Decatur ISD	25,512,612	Evadale ISD	3,205,000
Deer Park ISD	207,845,000	Everman ISD	87,845,000
Del Valle ISD	155,559,999	Fabens ISD	24,455,000
Denison ISD	72,798,052	Fairfield ISD	5,880,000
Denton ISD	502,937,937	Falls City ISD	1,120,000
Denver City ISD	32,290,902	Fannindel ISD	1,315,000
DeSoto ISD	97,798,113	Farmersville ISD	13,451,027
Detroit ISD	6,315,000	Ferris ISD	31,363,077
Devers ISD	1,145,000	Flatonia ISD	4,800,000
Devine ISD	14,115,000	Florence ISD	7,054,998
Deweyville ISD	10,300,000	Floresville ISD	73,119,985
Diboll ISD	16,129,924	Flour Bluff ISD	3,880,000
Dickinson ISD	223,847,962	Floydada ISD	5,240,000
Dilley ISD	28,900,000	Follett ISD	1,595,000
Dimmitt ISD	15,055,000	Forestburg ISD	150,000
Dodd City ISD	1,150,000	Forney ISD	268,184,987
Donna ISD	100,215,000	Forsan ISD	25,290,000
Dripping Springs ISD	123,589,998	Fort Bend ISD	634,654,425
Driscoll ISD	1,750,000	Fort Elliott CISD	3,065,000
Dublin ISD	7,760,000	Fort Hancock ISD	1,505,000
Dumas ISD	22,950,000	Fort Stockton ISD	12,675,000
Duncanville ISD	146,497,100	Fort Worth ISD	378,584,995
Eagle Mountain-Saginaw ISD	550,652,951	Franklin ISD	6,390,000
Eagle Pass ISD	62,505,000	Frankston ISD	16,996,275
Eanes ISD	78,370,000	Fredericksburg ISD	15,760,000
Early ISD	19,773,358	Freer ISD	20,300,000
East Bernard ISD	2,735,000	Frenship ISD	148,169,472
East Central ISD	74,610,000	Friendswood ISD	105,125,000
East Chambers ISD	7,810,000	Friona ISD	3,815,000
Ector Co ISD	190,288,720	Frisco ISD	1,161,075,843
Ector ISD	2,085,000	Frost ISD	855,000
Edcouch-Elsa ISD	44,420,000	Fruitvale ISD	990,000
Edgewood ISD	85,090,000	Gainesville ISD	33,265,000
Edgewood ISD	5,240,000	Galena Park ISD	205,045,211

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Galveston ISD	62,774,998	Hamshire-Fannett ISD	9,235,000
Ganado ISD	4,126,778	Hardin ISD	1,595,000
Garland ISD	315,764,346	Hardin-Jefferson ISD	23,376,249
Garner ISD	1,815,000	Harlandale ISD	158,204,457
Garrison ISD	1,840,002	Harleton ISD	1,680,000
Gary ISD	9,435,000	Harlingen CISD	148,965,000
Gatesville ISD	243,887	Harmony ISD	1,849,000
George West ISD	16,230,000	Hartley ISD	50,000
Georgetown ISD	180,335,000	Haskell CISD	667,000
Giddings ISD	37,375,000	Hawkins ISD	12,260,000
Gilmer ISD	15,330,000	Hawley ISD	7,565,000
Glasscock Co ISD	4,555,000	Hays CISD	281,400,000
Glen Rose ISD	26,190,000	Hearne ISD	11,550,000
Godley ISD	33,176,396	Hedley ISD	255,000
Goldthwaite ISD	7,600,000	Hempstead ISD	17,094,480
Goliad ISD	13,165,000	Henderson ISD	23,625,254
Gonzales ISD	2,645,000	Henrietta ISD	11,177,482
Goose Creek CISD	392,145,000	Hermleigh ISD	4,050,000
Gordon ISD	458,000	Hico ISD	3,825,000
Gorman ISD	4,429,552	Hidalgo ISD	41,685,000
Grady ISD	7,065,000	Higgins ISD	2,000,000
Graford ISD	2,844,999	High Island ISD	1,345,000
Graham ISD	30,940,000	Highland ISD	4,365,940
Granbury ISD	42,394,250	Highland Park ISD	2,520,000
Grand Prairie ISD	365,846,495	Hillsboro ISD	15,680,413
Grand Saline ISD	9,895,000	Hitchcock ISD	33,754,410
Grandview ISD	16,310,000	Holland ISD	5,736,044
Grandview-Hopkins ISD	820,000	Holliday ISD	14,665,000
Granger ISD	855,000	Hondo ISD	7,069,998
Grape Creek ISD	4,495,000	Honey Grove ISD	9,968,961
Grapeland ISD	4,150,000	Hooks ISD	8,605,000
Grapevine-Colleyville ISD	258,395,467	Houston ISD	1,829,198,577
Greenville ISD	20,010,000	Howe ISD	8,194,767
Greenwood ISD	62,440,988	Hubbard ISD	9,965,000
Gregory-Portland ISD	44,270,000	Hudson ISD	18,391,093
Groesbeck ISD	10,792,000	Huffman ISD	42,804,997
Groom ISD	1,610,000	Hull-Daisetta ISD	2,300,000
Gruver ISD	2,200,000	Humble ISD	357,270,000
Gunter ISD	15,150,000	Huntington ISD	18,678,951
Gustine ISD	1,165,000	Huntsville ISD	28,356,845
Guthrie CSD	2,505,000	Hurst-Eules-Bedford ISD	198,167,934
Hale Center ISD	6,414,986	Hutto ISD	148,856,004
Hallettsville ISD	12,505,000	Idalou ISD	14,540,000
Hallsville ISD	84,640,000	Industrial ISD	2,030,000
Hamilton ISD	1,955,000	Ingleside ISD	7,835,000
Hamlin ISD	4,079,998	Ingram ISD	2,975,000



**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Iowa Park CISD	16,605,000	La Pryor ISD	2,443,595
Iraan-Sheffield ISD	11,259,996	La Vega ISD	43,315,717
Iredell ISD	300,000	La Vernia ISD	42,539,516
Irving ISD	473,652,376	La Villa ISD	5,530,000
Italy ISD	1,275,000	Lago Vista ISD	42,463,999
Itasca ISD	7,835,000	Lake Dallas ISD	83,342,581
Jacksboro ISD	21,865,000	Lake Travis ISD	290,317,804
Jacksonville ISD	53,674,631	Lake Worth ISD	64,202,149
Jarrell ISD	38,399,999	Lamar CISD	515,590,000
Jasper ISD	10,985,000	Lampasas ISD	41,974,982
Jefferson ISD	7,510,000	Lancaster ISD	28,830,000
Jim Hogg Co ISD	435,000	Laredo ISD	166,169,325
Jim Ned CISD	940,000	Lasara ISD	6,910,000
Joaquin ISD	5,285,000	Latexo ISD	1,809,996
Johnson City ISD	7,965,000	Leander ISD	784,423,156
Joshua ISD	65,323,390	Lefors ISD	530,000
Judson ISD	358,015,908	Leon ISD	12,475,000
Karnes City ISD	3,055,000	Leonard ISD	1,260,000
Katy ISD	1,232,844,928	Levelland ISD	18,559,992
Kaufman ISD	20,732,397	Lewisville ISD	601,832,577
Keene ISD	14,000,000	Lexington ISD	2,880,000
Keller ISD	518,976,973	Liberty Hill ISD	112,579,926
Kelton ISD	1,690,000	Liberty ISD	12,354,995
Kemp ISD	25,759,025	Liberty-Eylau ISD	6,050,000
Kenedy County-Wide CSD	1,860,000	Lindale ISD	60,045,650
Kenedy ISD	2,165,000	Lindsay ISD	1,000,000
Kennedale ISD	44,931,049	Lingleville ISD	1,145,000
Kerens ISD	2,000,000	Lipan ISD	4,186,835
Kermit ISD	29,135,000	Little Cypress-Mauriceville CISD	8,685,285
Kerrville ISD	27,310,000	Little Elm ISD	137,544,407
Kilgore ISD	57,860,000	Livingston ISD	61,790,000
Killeen ISD	86,685,000	Llano ISD	15,940,000
Kingsville ISD	76,264,993	Lockhart ISD	19,179,988
Kirbyville CISD	14,535,000	Lohn ISD	1,155,000
Klein ISD	646,315,000	London ISD	8,919,620
Klondike ISD	7,960,000	Lone Oak ISD	10,925,000
Knippa ISD	4,095,000	Longview ISD	181,250,308
Knox City-O'Brien CISD	335,000	Loop ISD	3,270,000
Kopperl ISD	115,000	Loraine ISD	11,325,000
Kountze ISD	11,020,000	Lorena ISD	32,319,998
Krum ISD	38,585,532	Los Fresnos CISD	41,585,000
La Feria ISD	31,015,000	Louise ISD	730,000
La Joya ISD	281,941,118	Lovejoy ISD	135,435,471
La Marque ISD	21,716,272	Lubbock ISD	205,915,000
La Porte ISD	29,675,000	Lubbock-Cooper ISD	43,154,996
La Poynor ISD	680,000	Lueders-Avoca ISD	1,225,000

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Lufkin ISD	52,142,969	Millsap ISD	19,338,508
Luling ISD	3,295,000	Mineral Wells ISD	33,615,000
Lumberton ISD	9,525,000	Mission CISD	143,480,222
Lyford CISD	3,929,997	Monahans-Wickett-Pyote ISD	21,999,145
Lytle ISD	19,460,000	Monte Alto ISD	14,860,000
Mabank ISD	37,923,656	Montgomery ISD	127,239,690
Madisonville CISD	8,005,000	Moody ISD	10,953,540
Magnolia ISD	75,960,000	Moulton ISD	85,000
Malakoff ISD	21,850,000	Mount Calm ISD	1,500,000
Malone ISD	1,095,000	Mount Enterprise ISD	2,885,771
Malta ISD	955,000	Mount Pleasant ISD	34,820,407
Manor ISD	187,204,999	Muenster ISD	17,319,331
Mansfield ISD	660,009,963	Muleshoe ISD	20,845,000
Marble Falls ISD	59,495,441	Nacogdoches ISD	40,040,000
Marfa ISD	6,600,234	Natalia ISD	1,715,000
Marion ISD	10,115,000	Navarro ISD	20,005,490
Marlin ISD	1,670,000	Navasota ISD	11,860,000
Mart ISD	2,540,000	Nazareth ISD	824,380
Martins Mill ISD	765,000	Neches ISD	4,865,000
Martinsville ISD	4,210,000	Nederland ISD	23,020,000
Mason ISD	1,945,000	Needville ISD	46,935,000
Matagorda ISD	4,925,000	New Boston ISD	15,923,112
Mathis ISD	15,494,999	New Braunfels ISD	119,566,673
Maud ISD	835,000	New Caney ISD	237,359,358
May ISD	3,125,000	New Diana ISD	3,500,000
Maypearl ISD	14,208,394	New Home ISD	490,000
McAllen ISD	97,645,000	New Waverly ISD	7,040,000
McDade ISD	999,961	Newcastle ISD	4,500,000
McGregor ISD	24,064,464	Newton ISD	6,810,000
McKinney ISD	419,445,000	Nixon-Smiley CISD	12,984,000
McLean ISD	2,185,000	Nordheim ISD	4,429,000
McMullen Co ISD	7,950,000	Normangee ISD	7,626,982
Meadow ISD	1,155,000	North East ISD	1,407,069,128
Medina Valley ISD	56,721,713	North Hopkins ISD	265,000
Melissa ISD	52,265,000	North Lamar ISD	2,740,000
Mercedes ISD	47,969,693	North Zulch ISD	5,371,000
Meridian ISD	7,505,000	Northside ISD	1,645,000
Merkel ISD	285,000	Northside ISD	1,686,330,000
Mesquite ISD	345,687,822	Northwest ISD	561,304,468
Mexia ISD	1,310,000	Nursery ISD	3,020,000
Midland ISD	163,196,365	Oakwood ISD	3,683,000
Midlothian ISD	228,992,167	Odem-Edroy ISD	4,904,997
Midway ISD	86,590,848	Oglesby ISD	415,000
Mildred ISD	14,152,759	Offen ISD	1,070,000
Miles ISD	910,000	Olney ISD	4,855,000
Miller Grove ISD	2,090,000	Olton ISD	825,000

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Onalaska ISD	4,330,127	Presidio ISD	6,350,704
Orange Grove ISD	14,230,000	Priddy ISD	260,000
Orangefield ISD	9,494,998	Princeton ISD	79,455,420
Ore City ISD	9,855,000	Pringle-Morse CISD	1,800,000
Overton ISD	3,715,000	Progreso ISD	29,465,000
Paint Rock ISD	2,410,000	Prosper ISD	233,531,557
Palacios ISD	3,365,000	Queen City ISD	3,340,000
Palmer ISD	4,301,179	Quinlan ISD	19,232,830
Palo Pinto ISD	3,370,000	Quitman ISD	4,785,000
Pampa ISD	47,580,000	Rains ISD	5,965,000
Panhandle ISD	23,260,000	Rankin ISD	7,970,000
Panther Creek CISD	950,000	Raymondville ISD	21,180,000
Paradise ISD	8,980,000	Reagan Co ISD	10,620,000
Paris ISD	47,375,000	Red Lick ISD	5,385,000
Pasadena ISD	510,185,000	Red Oak ISD	90,677,143
Pawnee ISD	6,525,000	Redwater ISD	1,460,000
Pearland ISD	300,627,047	Refugio ISD	1,965,000
Pearsall ISD	16,606,059	Rice CISD	14,570,000
Peaster ISD	13,354,998	Rice ISD	11,944,592
Pecos-Barstow-Toyah ISD	24,630,000	Richardson ISD	353,124,988
Perrin-Whitt CISD	6,495,000	Riesel ISD	26,384,831
Perryton ISD	21,570,000	Rio Grande City CISD	103,840,000
Petrolia ISD	3,920,526	Rio Hondo ISD	20,368,888
Pewitt CISD	1,770,000	Rio Vista ISD	4,570,000
Pflugerville ISD	306,575,000	River Road ISD	13,692,617
Pharr-San Juan-Alamo ISD	358,390,000	Rivercrest ISD	6,630,866
Pilot Point ISD	18,003,268	Robert Lee ISD	10,381,578
Pine Tree ISD	58,105,000	Robinson ISD	8,626,804
Pittsburg ISD	11,895,000	Robstown ISD	58,133,031
Plains ISD	27,555,000	Roby CISD	225,000
Plano ISD	691,305,871	Rockdale ISD	26,954,998
Pleasant Grove ISD	33,513,431	Rocksprings ISD	2,500,000
Pleasanton ISD	16,635,000	Rockwall ISD	347,903,257
Plemons-Stinnett-Phillips CISD	32,300,000	Rogers ISD	9,116,079
Point Isabel ISD	20,786,260	Roma ISD	65,355,000
Ponder ISD	26,120,000	Roosevelt ISD	10,910,000
Poolville ISD	4,480,000	Ropes ISD	4,999,986
Port Aransas ISD	10,054,998	Roscoe Collegiate ISD	820,000
Port Arthur ISD	8,000,000	Rotan ISD	210,000
Port Neches-Groves ISD	76,993,539	Round Rock ISD	324,945,000
Post ISD	27,560,000	Round Top-Carmine ISD	1,035,000
Poteet ISD	29,679,996	Roxton ISD	531,000
Poth ISD	1,455,000	Royal ISD	69,520,493
Pottsboro ISD	5,981,983	Royse City ISD	97,497,673
Prairiland ISD	8,180,000	Rusk ISD	3,545,000
Premont ISD	2,030,000	S & S CISD	6,550,091

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Sabinal ISD	1,230,000	Slidell ISD	1,930,000
Sabine ISD	19,650,000	Smithville ISD	10,939,991
Sabine Pass ISD	13,104,485	Smyer ISD	1,160,000
Saint Jo ISD	350,000	Snook ISD	8,975,000
Salado ISD	20,735,000	Socorro ISD	555,501,504
Sam Rayburn ISD	95,000	Somerset ISD	33,809,991
San Angelo ISD	9,450,000	Somerville ISD	2,045,000
San Antonio ISD	616,939,988	Sonora ISD	1,090,000
San Augustine ISD	14,000,000	South San Antonio ISD	184,264,677
San Benito CISD	90,470,000	Southside ISD	52,235,000
San Diego ISD	26,140,000	Southwest ISD	194,365,161
San Elizario ISD	1,836,000	Spearman ISD	9,360,000
San Felipe Del Rio CISD	47,899,993	Splendora ISD	53,880,000
San Isidro ISD	1,267,000	Spring Branch ISD	592,365,000
San Marcos CISD	164,934,959	Spring Hill ISD	37,275,000
San Perlita ISD	3,955,000	Spring ISD	468,505,000
San Saba ISD	6,829,000	Springtown ISD	64,260,000
Sands CISD	2,435,000	Spur ISD	6,265,000
Sanford-Fritch ISD	410,863	Spurger ISD	2,640,000
Sanger ISD	25,206,111	Stafford MSD	58,045,000
Santa Anna ISD	1,228,688	Stamford ISD	2,180,000
Santa Fe ISD	47,830,000	Stanton ISD	6,600,000
Santa Gertrudis ISD	5,725,000	Stephenville ISD	29,790,000
Santa Maria ISD	4,130,000	Sterling City ISD	7,500,000
Santa Rosa ISD	12,880,000	Stockdale ISD	9,605,000
Santo ISD	1,530,000	Stratford ISD	430,000
Savoy ISD	2,210,000	Sudan ISD	1,235,000
Schertz-Cibolo-Universal City	295,895,515	Sulphur Bluff ISD	881,000
Schulenburg ISD	5,764,994	Sulphur Springs ISD	8,535,000
Scurry-Rosser ISD	7,219,980	Sunnyvale ISD	58,071,802
Seagraves ISD	11,115,000	Sunray ISD	8,870,000
Sealy ISD	23,514,053	Sweeny ISD	12,060,000
Seguin ISD	70,739,491	Sweetwater ISD	9,426,041
Seminole ISD	70,420,000	Taft ISD	30,011,458
Shallowater ISD	30,868,740	Tarkington ISD	11,330,000
Sharyland ISD	123,462,559	Tatum ISD	25,305,000
Shelbyville ISD	1,550,000	Taylor ISD	11,555,000
Sheldon ISD	165,533,248	Teague ISD	32,555,000
Shepherd ISD	20,395,000	Temple ISD	88,335,000
Sherman ISD	86,810,000	Tenaha ISD	3,540,000
Sidney ISD	1,430,000	Terrell ISD	28,268,448
Silsbee ISD	6,620,000	Texarkana ISD	37,489,462
Simms ISD	1,512,957	Texas City ISD	87,050,000
Sinton ISD	21,915,000	Thorndale ISD	820,000
Skidmore-Tynan ISD	11,523,337	Thrall ISD	1,245,000
Slaton ISD	3,690,000	Three Rivers ISD	26,195,000

**BOND GUARANTEE PROGRAM --- ISSUED AND GUARANTEED  
FOR THE FISCAL YEAR ENDED AUGUST 31, 2013**

<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>	<b>SCHOOL DISTRICT NAME</b>	<b>BALANCE</b>
Tidehaven ISD	49,630,000	West Sabine ISD	8,805,000
Tioga ISD	6,875,193	Wharton ISD	23,071,693
Tolar ISD	11,106,464	Wheeler ISD	7,080,000
Tom Bean ISD	6,200,000	White Oak ISD	2,905,000
Tomball ISD	243,160,000	White Settlement ISD	165,653,198
Tornillo ISD	10,990,080	Whiteface CISD	9,300,000
Trent ISD	3,590,000	Whitehouse ISD	30,962,228
Trenton ISD	7,580,000	Whitesboro ISD	13,056,381
Trinidad ISD	1,475,000	Whitewright ISD	7,704,338
Trinity ISD	4,525,000	Whitney ISD	28,335,000
Troup ISD	7,215,000	Wichita Falls ISD	48,470,426
Troy ISD	19,270,011	Willis ISD	71,423,956
Tuloso-Midway ISD	62,389,999	Wills Point ISD	3,715,000
Tyler ISD	183,210,000	Wimberley ISD	57,584,169
Union Grove ISD	4,225,000	Windthorst ISD	2,064,999
United ISD	199,017,865	Wink-Loving ISD	13,830,000
Uvalde CISD	21,819,996	Winona ISD	15,189,541
Valley Mills ISD	8,000,000	Woden ISD	1,710,000
Valley View ISD	1,675,000	Wolfe City ISD	2,395,000
Valley View ISD	50,669,764	Woodsboro ISD	8,335,000
Van Alstyne ISD	31,918,488	Wortham ISD	6,425,000
Van ISD	35,070,000	Wylie ISD	231,081,055
Vega ISD	3,200,000	Yantis ISD	1,310,000
Venus ISD	10,159,132	Yoakum ISD	10,230,000
Veribest ISD	1,385,000	Yorktown ISD	5,770,000
Vernon ISD	2,812,037	Ysleta ISD	195,395,000
Victoria ISD	165,995,000	Zavalla ISD	5,239,000
Vidor ISD	18,633,415	Zephyr ISD	2,930,000
Waco ISD	142,330,000		
Waelder ISD	3,332,884	<b>TOTAL AMOUNT</b>	
Wall ISD	1,600,000	<b>OUTSTANDING</b>	<b>\$55,218,889,156</b>
Waller ISD	80,930,000		
Warren ISD	14,807,161		
Water Valley ISD	3,110,796		
Waxahachie ISD	116,749,295		
Weatherford ISD	69,349,007		
Webb CISD	1,937,310		
Weimar ISD	8,885,177		
Wellman-Union CISD	18,997,299		
Wells ISD	3,585,000		
Weslaco ISD	65,205,000		
West Hardin Co CISD	2,955,000		
West ISD	3,488,416		
West Orange-Cove CISD	50,812,201		
West Oso ISD	23,264,994		
West Rusk Co CISD	14,890,000		

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**SECTION  
FIVE**

**SUPPLEMENTAL  
SCHEDULES  
(UNAUDITED)**

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**TEXAS PERMANENT SCHOOL FUND  
SCHEDULE OF HISTORICAL EARNED INCOME – PSF(SBOE)  
ASSIGNED TO THE AVAILABLE SCHOOL FUND**

Year	Total Investment Fund <sup>1</sup>	Increase Over Previous Year <sup>2</sup>	Net income From Investments <sup>3</sup>	Other Income <sup>4</sup>	Total Income From Operations	Distributions <sup>5</sup>
1854	\$ 2,000,000	\$ -	\$ -	\$ -	\$ -	\$ -
1900	9,102,873	682,284	337,437	445,705	783,142	-
1910	16,752,407	712,842	628,669	1,341,858	1,970,527	-
1920	25,698,282	2,832,785	899,946	1,988,609	2,888,555	-
1930	38,718,106	2,349,227	1,668,949	1,100,598	2,769,547	-
1940	68,299,082	5,119,511	2,353,046	978,828	3,331,874	-
1950	161,179,979	10,891,509	3,586,117	399,857	3,985,974	-
1961	454,391,643	28,570,043	13,474,481	291,955	13,766,436	4,593,565
1970	842,217,721	43,557,978	34,114,113	648,842	34,762,955	-
1980	2,464,579,397	401,868,617	158,079,171	8,396,255	166,475,426	-
1990	8,930,703,666	(160,746,667)	671,049,192	3,585,802	674,634,994	-
2000	22,275,586,452	2,659,856,111	694,916,560	3,570,745	698,487,305	-
2001	19,021,750,040	(3,253,836,412)	779,903,603	14,380,628	794,284,231	-
2002	17,047,245,212	(1,974,504,828)	753,785,910	10,768,657	764,554,567	-
2003	18,037,320,374	990,075,162	890,116,742	6,694,173	896,810,915	-
2004	19,261,799,285	1,224,478,911	51,076,130	3,846,180	54,922,310	825,059,655
2005	21,354,333,727	2,092,534,442	-	-	-	879,981,967
2006	22,802,708,177	1,448,374,450	-	-	-	841,878,709
2007	25,311,835,346	2,509,127,169	-	-	-	843,136,949
2008	23,142,393,002	(2,169,442,344)	-	-	-	716,534,543
2009	20,545,271,679	(2,597,121,323)	-	-	-	716,533,764
2010	22,107,795,468	1,562,523,789	-	-	-	60,700,000
2011	24,091,592,601	1,983,797,133	-	-	-	1,092,809,024
2012	25,502,953,268	1,411,360,667	-	-	-	1,020,886,917
2013	27,165,474,239	1,662,520,971	-	-	-	1,020,886,919

<sup>1</sup> Includes cash, stocks at cost, and bonds at par (1854-1986). Beginning in 1987 and thereafter, the total investment fund is reported using fair values.

<sup>2</sup> Includes revenue from GLO, gains and losses on security transactions, and increases/decreases in the fair value of the portfolios.

<sup>3</sup> For 2004, income from investments includes interest and dividends on debt and equity securities respectively, interest on funds in the State Treasury, and securities lending proceeds. Due to the change to the total return methodology, the net income from investments is through September 29, 2003 only.

For 2003, income from investments includes interest and dividends on debt and equity securities respectively, interest on funds in the State Treasury, securities lending proceeds, and a one-time payment of \$126,716,305 made to the ASF to change to the accrual basis of accounting.

For the years 1994-2002, income from investments includes interest and dividends on debt and equity securities respectively, interest on funds in the State Treasury, and securities lending proceeds.

For the years 1987-1993, income from investments includes interest and dividends on debt and equity securities, respectively and interest on funds in the State Treasury.

For the years 1854-1986, income from investments includes interest and dividends on debt and equity securities, respectively.

<sup>4</sup> For the years 1987-2004, other income includes interest on land notes and interest payments and surface rental income from land owned by the Fund. (Surface rental income included beginning with fiscal year 1979).

For the years 1854-1986, other income includes interest on funds in the State Treasury, interest on land notes, and interest payments and surface rental income from land owned by the Fund. (Surface rental income included beginning with fiscal year 1979).

<sup>5</sup> One percent, or \$4,593,565 and \$4,625,982 was transferred to the ASF in 1961 and 1962 respectively (Sec. 5, S.B. 1, 57th Legislature, 2nd Called Session). Beginning in fiscal year 2004, the ASF received a total return transfer amount in lieu of actual revenue.

**TEXAS PERMANENT SCHOOL FUND**  
**SCHEDULE OF ADMINISTRATIVE EXPENSES – PSF(SBOE) (IN MILLIONS)**

The Texas Permanent School Fund is required by the General Appropriations Act to publish the costs of administering the Fund for the current year and projections for the following three years. The schedule below reflects the current year's costs. Projected amounts are based on the current operating structure and full implementation of the long-term allocation plan adopted by the State Board of Education.

Actual-Fiscal Year 2013	\$16.4
Projected-Fiscal Year 2014	\$30.0
Projected-Fiscal Year 2015	\$30.0
Projected-Fiscal Year 2016	\$30.0

## COMPLIANCE STATEMENT

### **TITLE VI, CIVIL RIGHTS ACT OF 1964; THE MODIFIED COURT ORDER, CIVIL ACTION 5281, FEDERAL DISTRICT COURT, EASTERN DISTRICT OF TEXAS, TYLER DIVISION**

Reviews of local education agencies pertaining to compliance with Title VI Civil Rights Act of 1964 and with specific requirements of the Modified Court Order, Civil Action No. 5281, Federal District Court, Eastern District of Texas, Tyler Division are conducted periodically by staff representatives of the Texas Education Agency. These reviews cover at least the following policies and practices:

- (1) Acceptance policies on student transfers from other school districts;
- (2) Operation of school bus routes or runs on a non-segregated basis;
- (3) Nondiscrimination in extracurricular activities and the use of school facilities;
- (4) Nondiscriminatory practices in the hiring, assigning, promoting, paying, demoting, reassigning, or dismissing of faculty and staff members who work with children;
- (5) Enrollment and assignment of students without discrimination on the basis of race, color, or national origin;
- (6) Nondiscriminatory practices relating to the use of a student's first language; and
- (7) Evidence of published procedures for hearing complaints and grievances.

In addition to conducting reviews, the Texas Education Agency staff representatives check complaints of discrimination made by a citizen or citizens residing in a school district where it is alleged discriminatory practices have occurred or are occurring.

Where a violation of Title VI of the Civil Rights Act is found, the findings are reported to the Office for Civil Rights, U.S. Department of Education.

If there is a direct violation of the Court Order in Civil Action No. 5281 that cannot be cleared through negotiation, the sanctions required by the Court Order are applied.

### **TITLE VII, CIVIL RIGHTS ACT OF 1964 AS AMENDED BY THE EQUAL EMPLOYMENT OPPORTUNITY ACT OF 1972; EXECUTIVE ORDERS 11246 AND 11375; EQUAL PAY ACT OF 1964; TITLE IX, EDUCATION AMENDMENTS; REHABILITATION ACT OF 1973 AS AMENDED; 1974 AMENDMENTS TO THE WAGE-HOUR LAW EXPANDING THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967; VIETNAM ERA VETERANS READJUSTMENT ASSISTANCE ACT OF 1972 AS AMENDED; IMMIGRATION REFORM AND CONTROL ACT OF 1986; AMERICANS WITH DISABILITIES ACT OF 1990; AND THE CIVIL RIGHTS ACT OF 1991.**

The Texas Education Agency shall comply fully with the nondiscrimination provisions of all federal and state laws, rules, and regulations by assuring that no person shall be excluded from consideration for recruitment, selection, appointment, training, promotion, retention, or any other personnel action, or be denied any benefits or participation in any educational programs or activities which it operates on the grounds of race, religion, color, national origin, sex, disability, age, or veteran status (except where age, sex, or disability constitutes a bona fide occupational qualification necessary to proper and efficient administration). The Texas Education Agency is an Equal Employment Opportunity/Affirmative Action employer.

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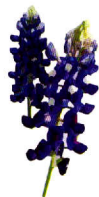
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