

GOVERNANCE AND FUNDING METHODOLOGY

Permanent School Fund financial assets are managed by the elected 15-member State Board of Education (SBOE). The Fund's real property holdings and mineral rights are managed by the five-member School Land Board (SLB). Starting fiscal year 2020, SBOE began managing the Liquid Account as established by the Legislature, which is intended to be a diversified portfolio of liquid assets upon full implementation. The Liquid Account had value of approximately \$4.0 billion at August 31, 2020.

From 1854 through fiscal year 2003, all interest and dividends produced by the Fund's investments and certain land related income flowed into the ASF, through which funds were distributed to Texas schools. In 2003, voters approved to change the Fund distribution methodology from an income-based formula to a total return-based formula. This amendment allows interest and dividends as well as capital gains to flow into the ASF. This methodology is designed to produce stable funding benefits to Texas schools, while preserving the Fund's value after adjusting for inflation and student population growth.

BOND GUARANTEE PROGRAM

The Bond Guarantee Program (BGP) was created through a Constitutional amendment approved by voters in 1983. This amendment provides for the guarantee of school district bonds by the Texas Permanent School Fund. In 2014, the BGP was expanded to include the guarantee of

qualified charter district bonds. Through the BGP, the principal and income of the fund are used to guarantee locally-issued bonds in the event of a default. The BGP provides participating school bonds the highest rating available in the bond market, AAA. This high rating allows schools to issue bonds at a lower interest rate than they otherwise could based on their underlying rating. This in turn currently saves school districts and local taxpayers an estimated \$225 million annually in funding costs.

Since its inception in 1983, the BGP has guaranteed 7,789 school district and charter district issues totaling about \$202.1 billion. At the end of fiscal year 2020, there were 3,296 school district guaranteed bond issues outstanding and 64 charter district guaranteed bond issues outstanding. The outstanding guaranteed principal balance totaled \$87.8 billion for school district guarantees and \$2.5 billion for charter district guarantees.

BOND GUARANTEE PROGRAM

Ten Largest Total Debt Outstanding Guaranteed Under the Program At August 31, 2020

Cypress-Fairbanks ISD.....	\$2,971,210,000
Dallas ISD.....	2,902,695,000
Houston ISD	2,228,810,000
Northside ISD (Bexar).....	2,038,845,000
Frisco ISD	1,951,558,118
Katy ISD.....	1,888,706,959
North East ISD.....	1,366,550,000
Fort Bend CISD	1,297,633,767
Conroe ISD	1,251,730,000
Lamar CISD	1,138,945,000



Texas Permanent School Fund

A PERMANENT FUND OF
THE STATE OF TEXAS

For the Fiscal Year Ending
AUGUST 31, 2020

The Texas Permanent School Fund

FUNDING TEXAS EDUCATION

The Texas Permanent School Fund endowment (PSF or Fund) continued on its path of growth and financial strength in a challenging environment and ended the 2020 fiscal year with an overall value of \$46.7 billion, an increase of \$0.2 billion from the prior year.

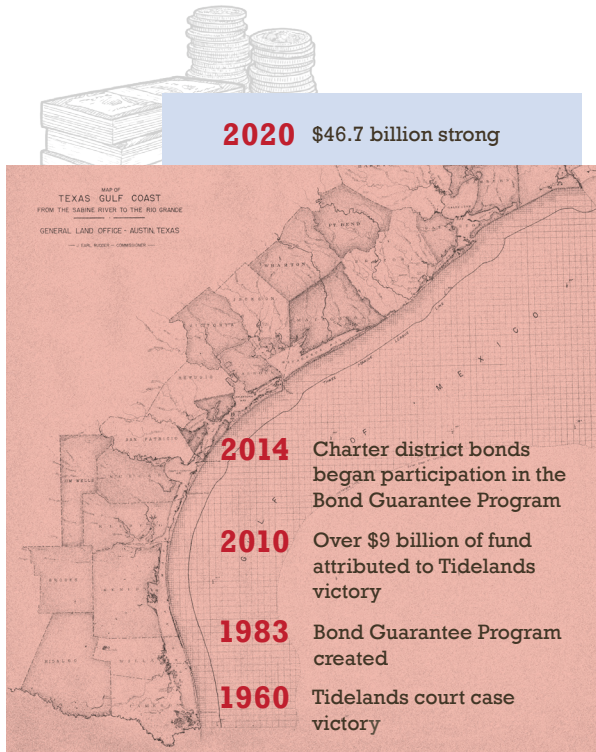
At 175 years old and counting, the Fund serves Texas citizens in two primary ways. First, it helps pay a share of the cost of educating Texas school children by financing the purchase of instructional materials through the State Textbook Fund. During the 2020 fiscal year, the Fund distributed approximately \$1.7 billion to fund education, which translates to about \$347 per student. This per student allotment guarantees funding to every public school student in the state regardless of school district wealth. Since 1960, the Fund has distributed approximately \$31.2 billion in support of Texas public education. The Fund is prudently managed to ensure that it funds education for current and future generations of Texas school children.

Second, the Fund serves Texas citizens through the Bond Guarantee Program. Through this program, the PSF provides participating Texas school districts and charter districts bond issues with the Fund's AAA credit rating, resulting in substantial savings to the taxpayers of Texas through reduced borrowing costs. Without this guarantee, public school districts and charter districts would otherwise need to purchase private bond insurance or pay higher interest rates on the bonds they issue.

SERVING ALL TEXANS

The Texas Permanent School Fund

HISTORY



In 1845 Texas became the 28th state, and the new State Constitution established a perpetual fund to which ten percent of all tax revenue would be devoted. However, the new state had no tax base, so the fund failed to accumulate any significant deposits. The PSF's initial significant funding was the result of a \$2 million 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 western lands claimed by the former Republic of Texas. By 1861, the Fund was depleted by railroad loan defaults, collapse of the Confederate monetary system, and eventual loan of the Fund to the Civil War effort. The Texas Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the PSF. Additional Acts later gave more public domain land and rights to the Fund. These Constitutional provisions and additional Acts have served as the seeds from which the current value of the Fund has grown.

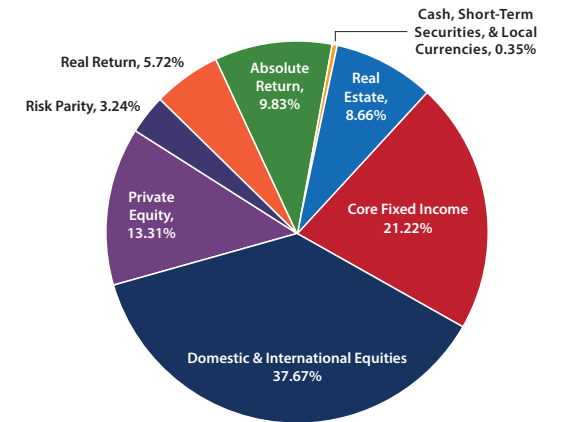
The Fund land ownership expanded in 1960, when the State prevailed in litigation regarding ownership rights of submerged coastal lands in the Gulf of Mexico. This ownership provided the Fund with a large inflow of royalties related to oil and gas extraction that resulted in a significant increase in its corpus during the latter part of the 20th century.

ASSET ALLOCATION

The Fund's financial assets are managed by the State Board of Education (SBOE), which sets the Fund's asset allocation. This allocation decision is the most important factor affecting overall investment performance of the Fund. In July 2020, the SBOE updated the long-term asset allocation to continue diversifying PSF's assets into alternative asset classes whose returns are less correlated with traditional asset classes.

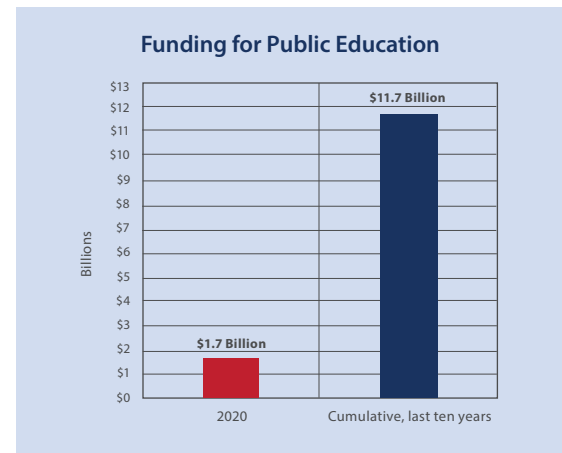
The PSF continues to implement its strategic asset allocation plan with the goal of improving the risk/return profile of the Fund. The strategic asset allocation of the PSF is comprised of private equity, real return, risk parity, absolute return, real estate, and emerging market debt in addition to traditional allocations to developed and emerging market equities, and fixed income. As of the end of fiscal year 2020, the Fund held \$7.6 billion in fixed income, \$13.5 billion in domestic and international equities, \$3.5 billion in absolute return investments, \$3.1 billion in real estate

Texas Permanent School Fund
Portfolio Diversification
at August 31, 2020



investments, \$4.8 billion in private equity investments, \$1.2 billion in risk parity strategies, \$2.0 billion in real return investments, and \$122.9 million in unallocated cash, short-term securities, and local currencies.

FUNDING FOR PUBLIC EDUCATION



The Fund distributes a SBOE-approved percentage of its asset value to the Available School Fund (ASF) to fund public education using a total return methodology that allows for intergenerational equity by preserving the real value of the PSF. Additionally, the SLB may contribute up to \$600 million per year directly to the ASF. Over the last ten years, the Fund has contributed more than \$11.7 billion to the ASF for distribution to school districts.