



The Texas Permanent School Fund

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The \$24.4 billion Texas Permanent School Fund (PSF) started as a \$2 million legislative appropriation in 1854 in order to benefit the public schools of the state. After the fund's coffers were drained by railroad loan defaults and the Civil War, the Constitution of 1876 granted the fund certain state lands and all proceeds from the sale of these lands. Over the years more public domain land and rights have been given to the fund. The PSF is a major source of education revenues for school districts in Texas - in some districts accounting for one fourth of revenues for public education. In 1983, voters approved a state constitutional amendment that allowed the PSF to guarantee public school district bonds. Since the passage of this amendment \$88.9 billion in school bonds have been guaranteed under the PSF program.

The PSF is administered by two state agencies: the General Land Office (GLO) and the Texas Education Agency (TEA). The GLO has historically been responsible for the real property assets of the fund, including land, minerals, and oil and gas royalties. The TEA is responsible for the investment management of the cash assets of the PSF. The TEA, acting through the state board of education, appoints a committee of investment advisers to oversee the conservative investment programs and asset allocation of the PSF's cash holdings.

The real property holdings of the PSF are substantial. The fund owns 15 million acres of surface and mineral acres in Texas. Upland acres, mostly west of the Pecos River, comprise 719,000 acres of the PSF's land. In addition, the fund owns 12.5 million mineral acres, including 4 million acres of submerged coastal lands. One million riverbed acres are held by the fund, and the revenue received from all mineral extraction in these areas goes directly to the PSF. The PSF also accepts oil and gas in lieu of cash royalty payments, which it then sells at discounted prices to public entities such as schools and cities, earning the fund more than cash royalties would provide.

The PSF bond guarantee works much like traditional monoline municipal bond insurers with a few significant differences that make it a much more conservative and strong backer of school district debt. The PSF's strong capital position is enhanced by strict leveraging guidelines as to how much debt may be guaranteed. Current guidelines state that the PSF may not guarantee a par value of debt exceeding two and a half times the book value of the fund.

Compare this to monoline municipal issuers who may leverage themselves almost 90 times the par amount insured. Another source of strength is the type of debt insured by the PSF. Most school districts secure their debt with an unlimited general obligation tax pledge.

In order to take part in the PSF guarantee program, a borrower must submit a formal application and audited financial statements to the PSF. There is no cost to take part in the PSF guarantee program aside from a nominal application fee. The school district must be state accredited, and the bonds to be guaranteed must have the approval of voters in the school district. After a review of the application is completed and approved, borrowers must submit audited financial statements for review on an annual basis. Should an issuer fail to make a debt service payment, it must notify the PSF in advance. In this case, the payments will be made from the corpus of the PSF and state aid payments would then be intercepted from the district to recoup payment, plus interest, to repay the debt servicing made by the PSF.

It should be clear that the Permanent School Fund is unmatched in its financial stability. The PSF enjoys a AAA credit rating from all three major credit rating agencies. There has never been a default on a school district general obligation bond in Texas where the PSF has a 97% market share. With investors questioning the stability of monoline municipal bond insurers such as Ambac and MBIA, PSF municipal bonds look all the more attractive. For current PSF guaranteed municipal bond offerings, contact your Coastal Securities representative.

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