

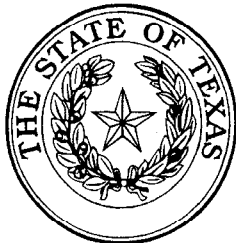
State Board of Education

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February 9, 2006

FILE # ML-44622-06

I.D. # 44622 RECEIVED

FEB 15 2006

OPEN RECORDS DIVISION

The Honorable Greg Abbott
Texas Attorney General
Post Office Box 12548
Austin, Texas 78711-2548

Re: Opinion Request

RQ-0448-GA

Dear General Abbott:

I am writing to request your opinion about the proper construction of Article VII, Section 5(a) of the Texas Constitution. As you know, that section was amended in 2003 to adopt a "total return" process by which a portion of the market value of the Permanent School Fund ("PSF") would be transferred to the Available School Fund ("ASF") for the support of public free schools¹. The State Board of Education is granted broad authority over the investment assets of the PSF, including the determination of the amount to be transferred to the ASF².

Section 5(a) defines the PSF and ASF, and requires a portion of the PSF to be transferred to the ASF during each two-year state budget cycle:

(a) The permanent school fund consists of all land appropriated for public schools by this constitution or the other laws of this state, other properties belonging to the permanent school fund, and all revenue derived from the land or other properties. The available school fund consists of the distributions made to it from the total

¹ Acts, 2003, 78th Leg., H.J.R. 68.

² Subsection 5(f) of Article VII provides as follows:

(f) Notwithstanding any other provision of this constitution, in managing the assets of the permanent school fund, the State Board of Education may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment, including investments in the Texas growth fund created by Article XVI, Section 70, of this constitution, that persons of ordinary prudence, discretion, and intelligence, exercising the judgment and care under the circumstances then prevailing, acquire or retain for their own account in the management of their affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

return on all investment assets of the permanent school fund, the taxes authorized by this constitution or general law to be part of the available school fund, and appropriations made to the available school fund by the legislature. The total amount distributed from the permanent school fund to the available school fund:

- (1) in each year of a state fiscal biennium must be an amount that is not more than six percent of the average of the market value of the permanent school fund, excluding real property belonging to the fund that is managed, sold, or acquired under Section 4 of this article, on the last day of each of the 16 state fiscal quarters preceding the regular session of the legislature that begins before that state fiscal biennium, in accordance with the rate adopted by:
 - (A) a vote of two-thirds of the total membership of the State Board of Education, taken before the regular session of the legislature convenes; or
 - (B) the legislature by general law or appropriation, if the State Board of Education does not adopt a rate as provided by Paragraph (A) of this subdivision; and
- (2) over the 10-year period consisting of the current state fiscal year and the nine preceding state fiscal years may not exceed the total return on all investment assets of the permanent school fund over the same 10-year period.

The initial description of the transfer process in subsection (a) describes the ASF as receiving a portion of the total return on "all investment assets" of the PSF. However, Subsection 5(a)(1) requires the use of a part of the "market value" of the PSF for purposes of calculating the transfer to the ASF for each state fiscal biennium. The limitation on the maximum transfer in subsection 5(a)(2) again uses the term "investment assets".

My questions involve the appropriate calculation of this market value amount. The State Auditor's Office has raised several questions regarding the accounting methodology used in the initial determination in the fall of 2004.

Section 5(a)(1) excludes from the market value calculation "real property belonging to the fund that is managed, sold, or acquired under Section 4 of this article". Real property subject to Section 4 is managed by the School Land Board and the Commissioner of the General Land Office (collectively "GLO") under the provisions of the Texas Natural Resources Code. Sections 51.401 and 51.402 of the Texas Natural Resources Code authorize the GLO to retain proceeds from the sale of PSF real property for up to two years for the purpose of acquiring other real property for the PSF. While held, those proceeds are required to be deposited into an interest-bearing account in the State Treasury³. While deposited in the Treasury, those funds do not lose their character as a

³ Section 51.401(b), Texas Natural Resources Code.

part of the PSF⁴. At any time, a large portion of these funds may be encumbered for the settlement of GLO real estate transactions at a future date.

The initial calculation made of the market value in 2004 excluded all PSF assets under management by the GLO, including funds held in the Treasury and dedicated to the purchase of additional real property under Sections 51.401 and 51.402 of the Natural Resources Code. This calculation followed the Board's understanding that the term "investment assets" was intended to differentiate between assets managed by the Board and those managed by the GLO. This reading of the Constitution appears to the Board to be consistent with the relative roles delegated to it and the GLO, as well as with the distinction made between assets managed under Article VII, Section 4 and all other PSF assets managed by the Board under Article VII, Section 5.

Section 5(a)(1) uses the term "market value" of the PSF to determine the amount transferred to the ASF, based on the last day of sixteen state fiscal quarters preceding the regular legislative session. The initial calculation made in 2004 used market values of the investment assets managed by the State Board as of those dates⁵. That calculation did not include accrued payables or receivables (including accrued but unpaid interest and dividends) that are accounted for in the total value of the PSF in its annual audited financial statements. The PSF financial statements are prepared on a modified accrual basis of accounting and thus reflect accrued but unpaid dividends, interest and expenses. The market value calculation does not include those accrued but unrealized assets and expenditures.

My questions are as follows:

1. May the State Board of Education administratively adopt the accounting methodology used to determine the "market value" of the PSF? If so, what limits (if any) exist on that discretion?
2. Does Article V, Section 5(a)(1) of the Texas Constitution require funds held by the GLO in the Treasury for the purchase of additional real property that will be managed, sold or acquired under Article VII, Section 4 to be included in the market value of the PSF for purposes of that section?
3. Does Article V, Section 5(a)(1) of the Texas Constitution require the market value of the PSF be determined in the same manner as the total value of the PSF in its audited financial statements?

Thank you for your consideration of this request. The State Board will be considering the amount to be transferred to the ASF for the 2008-2009 state fiscal biennium in the fall of 2006. We would greatly appreciate your guidance as to the calculation of the market

⁴ See, Attorney General's Opinion DM-316 (1995).

⁵ All assets currently managed by the State Board are publicly traded and were valued by the custodian as of close of business at the end of a state fiscal quarter in accordance with the GASB 31 governmental accounting statement.

value of the PSF under Article VII, Section 5 prior to that consideration. Should you have any questions, please contact David A. Anderson, Texas Education Agency General Counsel, at 463-9720.

Sincerely,

A handwritten signature in cursive script that reads "Geraldine Miller". The signature is written in black ink and is positioned above the printed name and title.

Geraldine ("Tincy") Miller, Chair
State Board of Education