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Texas Permanent School Fund Credit Update

Texas Permanent School Fund (PSF) Bond Guarantee Program

	Ratings	Outlooks
Moody's	Aaa	Stable
Standard & Poor's	AAA	Stable
Fitch	AAA	Stable

The Texas Permanent School Fund (PSF) is a perpetual endowment established by the state in 1854 for the purpose of supporting Texas schools. In 1983, Texas voters approved a constitutional amendment allowing the PSF to guarantee the debt of local school districts. As a result, local school district bonds that are guaranteed by the PSF get the same Aaa/AAA/AAA ratings.

The PSF bond guarantee program provides very strong security for Texas school district bonds. The credit characteristics of the PSF program support the highest credit ratings: high asset levels, low leverage, a strong and diverse pool of guaranteed bond issues and strong management and oversight. Because the PSF is essentially a public trust, its credit ratings depend on the specific characteristics of the trust. Thus, while the State of Texas (Aaa/AA+/AAA, outlooks stable) is also highly rated, the credit quality of the PSF is independent of the State. Should the State's credit ratings change in the future, that would not have any direct impact on the credit quality of PSF's bond guarantee going forward.

Additionally, PSF bonds often offer yields that are higher than comparably-rated bonds from other states. In some cases, PSF bonds can offer yields that are equal or greater than the after-tax equivalent yields available to municipal investors in other states, making them potentially an attractive tax-exempt investment option for conservative investors nationwide. ***For these reasons, we believe Texas PSF bonds can be an attractive investment option for tax-exempt investors not only in Texas, but for residents of most states.***

The PSF was initially established with a \$2 million state contribution in 1854. Subsequently, the state has added more than 40 million acres of land to the PSF, as well as mineral rights to millions of acres in the state as well as "submerged and offshore" land rights on the Gulf Coast. As of Oct. 31, 2012, the market value of PSF assets was \$31.7 billion, with the portfolio comprised of approximately 55% equities, 22% fixed income and 23%

alternative investments (including real estate, private equity and other asset classes). The primary income streams for the PSF are oil and gas royalties, lease revenues from PSF land holdings, dividends and interest income and earnings on investments.

The PSF benefits Texas public school in two ways. First, the PSF makes a distribution each year to local school districts to support educational costs. Funds are distributed on a per-pupil basis and typically total between \$700 million and \$900 million per year. Second, the PSF provides the bond guarantee program to enhance local school district bond credit quality. By providing credit enhancement at triple-A levels, the PSF guarantee program offers local school districts improved market access and lower borrowing costs.

The PSF Bond Guarantee Program

The PSF guarantee program permits the state to enhance voter-approved local school district bond issues by wrapping them with the PSF payment guarantee. Federal law allows the PSF to guarantee a maximum allowable par value of five times the book value of the fund. However, the Texas State Board of Education takes a more conservative approach, currently capping the PSF leverage ratio of three-to-one. As a result, the PSF had a maximum allowable guarantee capacity of \$76.1 billion as of Oct. 31, 2012 (the most recent figures released by the state). As the table below outlines, the actual amount of PSF-guaranteed bonds outstanding as of Oct. 31, 2012 was \$53.9 billion, creating an actual leverage of 2.12-to-one. By comparison, at the height of their market penetration in 2006 and 2007, the triple-A municipal bond insurers (MBIA, Ambac, FSA, AGM, etc.) had leverage ratios ranging from 25:1 to as high as 175:1.

Texas Permanent School Fund

Bond Guarantee Program Summary (Figures as of Oct. 31, 2012)

PSF Book Value	\$25,367,403,418
Maximum Allowable Guarantee Under Federal Law	\$117,318,653,038
Maximum Allowable Guarantee Under State Law	\$76,102,210,254
Lower of State or Federal Maximum Allowable Guarantee	\$76,102,210,254
Less: Net Amount Guaranteed as of 10/31/12	(\$53,876,577,586)
Less: Reserve of 5% of the Maximum Allowable for Guarantee	(\$3,805,110,513)
Amount Available for Guarantee as of 10/31/12	\$18,420,522,155
Less: New Money Issues Approved or In Process	(\$359,105,000)
Net Amount Available	\$18,061,417,155
Number of Issues Guaranteed	
Outstanding as of 9/1/12	2,634
District Issues Guaranteed During Fiscal Year	35
District Issues Refunded or Matured	(6)
Number of Issues as of 10/31/12	2,663

Source: *The Texas Permanent School Fund*

The PSF currently guarantees 2,663 outstanding local school bond issues. Most of the underlying school districts have credit quality in the A or AA rating categories, making the guarantee pool very high quality on aggregate. The top 10 local school districts guaranteed by the PSF account for approximately 24% of all enhanced bonds by par amount. While this level of concentration could create some concern, the high credit quality of the largest borrowing districts mitigates the concentration risk in the guarantee portfolio. According to Fitch, no Texas school district has defaulted on its debt since the Great Depression.

Texas Permanent School Fund
Bond Guarantee Program Largest Total Debt Outstanding
 (Figures as Fiscal Year Ended Aug. 31, 2011)

School District	Current Rating	Guaranteed Balance Outstanding
Dallas ISD	AA-	\$2,543,680,000
Houston ISD	AA+	\$1,587,588,577
Northside ISD (Bexar County)	AA	\$1,578,740,000
Cypress-Fairbanks ISD	AA-	\$1,541,485,000
North East ISD	AA-	\$1,187,822,690
Katy ISD	AA	\$1,077,256,064
Frisco ISD	AA+	\$1,043,983,099
Leander ISD	AA-	\$824,774,863
Conroe ISD	AA	\$777,935,000
Fort Bend ISD	AA	\$691,504,425

Source: *The Texas Permanent School Fund; S&P*



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