

**Report and Recommendations
of the Governor's
Citizens Ad Hoc Evaluation Committee on
Lands/Endowment**

Committee Members

Don Curtis, Chair

Gary Christensen

John Cowden

Jerry Evans

Mike Everett

Bob Maynard

Sen. Marguerite McLaughlin

Presented to the Land Board

July 10, 2001

Memorandum

To: Land Board Members - Gov. Dirk Kempthorne, Attorney General
Al Lance, J.D. Williams, Pete Cenarrusa, Dr. Marilyn Howard

Pc: Phil Reberger, John McGee, Clive Strong, Gino White, Ben Ysursa, Don
Robertson, Dr. Nick Hallett, Committee Members

From: Don Curtis, Chair, Citizens Evaluation Committee-Lands/Endowment

Date: July 3, 2001 (Updated July 9, 2001)

Re: Preliminary Report

Our preliminary report to the Land Board is forwarded herewith for discussion/feedback

Background: The Citizen's Evaluation Committee (see appendix A) was formed in the late January/early February 2001 timeframe. By mid March, after extensive input from Land Board members, their deputies, Department of Lands acting director and others, we finalized our Charter Package as a working document (see appendix B). Thereafter, we focused our efforts through three committee work teams. The areas of work team focus are shown on the "working model" in the Charter package.

Report Content: Our recommendations to the Land Board consist of ten overall recommendations, which follow as attachments to this memo. Supplementary information is included in appendices A through G. Because each recommendation is relatively brief and basically self-contained, the only Executive Summary we have planned for this report is the following attachment listing. We hope that this will provide an easy way to read this report in an efficient manner and refer to portions of it in the future.

- Attachments Summary (Recommendations related)

- #0 Committee Recommendations Rollout Process
- #1 Recommendation #1: Formal Land Trust Investment Policy
- #2 Recommendation #2: Lands/Funds Investment Reporting Format
- #3 Recommendation #3: Permanent Department of Lands Director
- #4 Recommendation #4: Implementation Actions for Recommendations #1 and #2
- #5 Recommendation #5: "Endowment Investment" Paradigm shift (mindset)
- #6 Recommendation #6: Endowment Real Estate Manager Position
- #7 Recommendation #7: Land Board Executive Director/Secretary Position
- #8 Recommendation #8: Land Board Organizational Models-Long Term
- #9 Recommendation #9: Land Board Operational Governance Model
- #10 Recommendation #10: Land Board Processes Clarification – Land Bank

- Appendices Summary: (Related Recommendation #)
 - A. Citizens Evaluation Committee Membership Information
 - B. Charter Document (Including Working Model, Work team areas of focus)
 - C. Investment Policy Template/Model (Recommendation #1)
 - D. Standard/Common Three-page Reporting Format-sample numbers eliminated- (Recommendation #2)
 - E. Real Estate Investment and State Endowment Lands-White Paper (Recommendation #6)
 - F. Land Board Executive Director/Secretary position-Graphic (Recommendation #7)
 - G. Excerpt from State Trust Lands, Souder and S.K. Farifax. (Note: Hard copy forwarded under separate cover) (Recommendation #8)

- Committee Content Caveat: Despite some number of requests from a variety of constituencies to delve down into very specific policy and organizational areas, the committee avoided the tendency to do so. We have specifically attempted to keep all our recommendations to The Land Board at a higher overall management level and to leave any policy analysis/deliberation to the Land Board members and their deputies.

- Planned Report Distribution (Only): Copies of this report have been provided to only those listed at the top of this memo, which includes Land Board Members and their deputies, Winston Wiggins, Charles Saum, Dr. Nick Hallet, and committee members.
Note: Any distribution of this report beyond this level is left up to the discretion of the Land Board. However, if after our scheduled pre-reviews, we remain on the July 10 Land Board meeting agenda and present this preliminary report, we will have additional copies available at that time.

- Summary: We hope the these ten recommendation contain sufficient clarity and detail to be actionable by the Land Board, their deputies, the Department of Lands and other state agencies/organizations. We believe that all the recommendations are consistent with our established Charter.

We respectfully request that the Land Board, as soon as possible, consider each part of each recommendation with a “yes,” “no” or “yes, as modified,” decision along with the specific leadership (“owner”) assignment for action and planned follow up action review date by the Land Board.

To do so would not only honor our efforts, but would be the most significant thank you we could ever receive. We are grateful for the opportunity to serve on this ad hoc committee, and we hope we have made a worthwhile contribution.

With best regards,

Don Curtis, Chair
For the Committee

Memorandum

To: Land Board Members - Gov. Dirk Kempthorne, Attorney General
Al Lance, J.D. Williams, Pete Cenarrusa, Dr. Marilyn Howard

CC: Phil Reberger, John McGee, Clive Strong, Gino White, Ben Ysursa,
Don Robertson, Charlie Saums, Winston Wiggins; Dr. Nick Hallett

From: Don Curtis, Chair, Citizens' Evaluation Committee-Lands/Endowment

Date: May 29, 2001

Re: **Committee Recommendations Rollout Process**

Our committee began formation in February 2001 and has been meeting every few weeks for the past few months. Our initial effort, namely to decide upon a clear and meaningful charter based on broad/varied inputs, was completed in late February-early March. A copy of that material was then forwarded to you for feedback to us during the March timeframe. We incorporated recommended changes and have subsequently used this charter as a working document for our committee. An updated copy is attached for your information.

We have now completed sufficient interviews, working sessions with Lands/Endowment Fund players, and enough discussion time together as a committee to begin to offer recommendations--in draft form--for Land Board Members, their direct subordinates, and other Lands/Endowment Funds managers to begin the work of chewing on these recommendations and using them real-time in their Lands/Endowment work on a day to day basis. **Our stated intent has always been to be a strong, supportive, consultative team who does its work and makes real-time recommendations that have sufficient substance to be actionable.** Although implementation of decisions is not part of our charter, we are happy to consult with Land Board members, their deputies, and other Lands/Endowment managers on their implementation planning (and, have already done so in some instances). We believe that a serial rollout of recommendations, as we are ready to make them, will be supportive of this consulting process.

Our Committee's Decision: Rather than waiting for the end of committee work and submission of a final (executive summary format) report and recommendations document sometime this summer, submit/rollout committee recommendations serially to the Land Board as we are ready to make them. Send each recommendation via memorandum, to all Land Board members and their deputies. We will then follow up with personal explanations or discussions as requested or needed.

We hope that you will find this decision both acceptable and entirely in keeping with your (the Land Board's) initial requests to this citizens' committee. We have also attached our current committee roster with phone/fax numbers for your information and ease in contacting us as you wish. Since we are presuming your agreement with this decision, you should expect to see our initial committee recommendations follow within the next day or so.

Committee Members:

Gary Christensen
John Cowden
Don Curtis, Chair
Jerry Evans
Mike Everett
Kathy Killen, Management Assistant, Serving as Support to Committee
Bob Maynard
Marguerite McLaughlin

Appendix A - Committee Membership Contact Information

Appendix B - Committee Charter Package

Memorandum

To: Land Board Members - Gov. Dirk Kempthorne, Attorney General
Al Lance, J.D. Williams, Pete Cenarrusa, Dr. Marilyn Howard

CC: Phil Reberger, John McGee, Clive Strong, Gino White, Ben Ysursa, Don
Robertson, Charlie Saums, Winston Wiggins; Dr. Nick Hallett

From: Don Curtis, Chair, Citizens' Evaluation Committee-Lands/Endowment

Date: May 29, 2001

Re: **Recommendation #1-- Formal Land Trust Investment Policy**

BACKGROUND:

Up through the present, the Department of Lands has done an excellent job in their assigned critical lands management role. However, as a result of recent constitutional amendments, changes must now occur to move the handling of these endowment assets to a more integrated investment perspective. This goal requires the consideration and adoption of an Endowment Lands Investment Policy. As explained in more detail in the final paragraph of this memorandum, this policy must recognize and take into consideration the expected long-term value of investment in land assets.

COMMITTEE RECOMMENDATION # 1:

The Land Board should adopt a formal Land Trust Investment Policy that includes, among other standard items, the following three areas:

- **Statement of Investment Objectives**
- **Annual Investment Plan**
- **Commercial Real Estate Policies**

KEY EXPLANATION POINTS:

Enclosed is a template or model of an Investment Policy. This template sets out the items that need to be addressed by the Land Board in its deliberations on a desired investment policy. **THE COMMITTEE *DOES NOT NECESSARILY RECOMMEND* THE SUBSTANCE OF ANY OF THE PROVISIONS OF THE ATTACHED DRAFT.** (This caveat is due solely to our committee's somewhat limited experience and expertise in a number of these areas). However, we have thoroughly reviewed the document's provisions and believe its contents are worthy of careful consideration by the Land

Board. At the very least, this draft should dramatically shorten the process time spent by the Land Board when adopting an investment policy document, which meets their needs.

The attached draft (Appendix C) is composed of the following two general types of provisions:

- Existing written policies of the Land Board (regulations, operations memoranda, etc.) that relate to investment matters (these need to be reviewed to assure that the Land Board still believes these items are appropriate when considered from the investment perspective); or
- Where there was no written policy in essential areas, standard institutional investor or industry provisions were inserted as an example and starting point for the Land Board deliberations on necessary issues.

In particular, we would like to focus your attention on a few items of particular import as you consider your adoption of an investment policy. These items of focus are:

1. The overall target rate of return, or performance objective (page 4);
2. Policies for the Commercial Property program (pp 26-28);
3. The need for an annual investment plan (pp 7-9).

First, a key provision of an investment policy, and one that has extensive ramifications, is the *performance objective* of the Land Trust. This objective drives all investment and management decisions. Currently, there is no investment objective for the Land Trust.

As a starting point for your considerations, we have inserted a 6 % real return objective. This *target real rate of return* (the return after subtracting inflation) is the real rate of return objective for most pension fund real estate programs, and is also the target return for many timberland programs (for example, the extensive California Public Employee Retirement System – CalPERS – timberland program). It also happens to be a return number that is generally consistent with (or neutral to) the Endowment Fund Investment Board’s asset allocation expected real return, and would not set up any artificial bias in favor of placing assets in the financial trust.

THIS TARGET NUMBER HAS SIGNIFICANT AND MATERIAL IMPACTS. The reason it does is that, under standard appraisal practice (which the Land Board has already adopted as its standard), where there are no recent comparable sales, a discounted cash flow method (or “income capitalization”) approach is to be used. (A third method - the “cost” approach - is generally inapplicable to non-commercial lands). Since most of the lands in the trust have few, if any, recent comparable sales data, this is the method that will be generally used under standard industry practice and existing Land Board policy.

A discounted cash flow or income capitalization approach requires a discount rate – one that is consistent with the performance objective of the investment program. Thus, most valuations of the Land Trust will be driven by the selection of the performance

objective. And, of course, all investment and asset management decisions are driven by current and expected valuations and cash flows.

As an example of the impact of this decision, we have measured the performance of the Land Trust and the general resulting land valuations of the Trust using a 6% real rate of return. We have included these numbers in the **proposed format for a comprehensive summary performance report** that could be used by the Land Board in reviewing the Land Trust, the Financial Trust, and the entire endowment as a whole [Committee Recommendation # 2). These sample format reports have been previously distributed and reviewed with your assistants, the Department of Lands, and the Endowment Fund Investment Board staff.

Second, the Land Board has embarked on a program of purchasing and managing commercial real estate in urban areas. There are, however, **currently no investment policies or management guidelines for this activity**. This is a materially different activity than those customarily undertaken by the Department of Lands. It is also an activity that requires significant planning, due diligence, management, and monitoring activity. We have added some detail to the section on a proposed Commercial Property Investment Policy (see Section XIII) that is taken from standard pension fund practice. We will urge the Land Board to carefully consider whether it is willing to put the resources in this area to assure a successful and long-term program, and to consider carefully, in advance, its plans and procedures for entering this competitive arena, including where you want the management responsibility for this new venture to reside. This will be covered in more detail in Committee recommendation #4.

Third, a key component of an investment program in lands and real estate is an *Annual Investment Plan* that is presented to and reviewed by the Board. We have included a standard template of items that are usually contained in such investment plans. It is the annual generation of this report that will provide the forum and format for the integration of investment decisions into the Department's activity on a daily basis. As a result, careful consideration of the components of the report, and the ability to monitor the tracking of actual Department activity with the promises and plans set out in the report, are of crucial importance if the Land Board is to operate as an investment organization as well and a land management arm of the state.

Finally, throughout our committee's discussions there has been a concern that with these policies, reporting metrics, and investment plans there might be an implication that land assets failing to meet a targeted rate of return should be converted to the financial trust, which is another way of saying, "dispose of the land." However, disposition of any land asset under unconstitutionally imposed requirements and the likelihood, in most cases, of non-competitive sales at auction really necessitates a careful look at another viable option, namely, taking the steps necessary to realize the targeted rate of return on certain land assets. Clearly, these decisions will represent significant and very sensitive investment choices for the Land Board in the future.

Appendix C: Investment Policy Template/Model

Memorandum

To: Land Board Members - Gov. Dirk Kempthorne, Attorney General
Al Lance, J.D. Williams, Pete Cenarrusa, Dr. Marilyn Howard

CC: Phil Reberger, John McGee, Clive Strong, Gino White, Ben Ysursa,
Don Robertson, Charlie Saums, Winston Wiggins; Dr. Nick Hallett

From: Don Curtis, Chair, Citizens' Evaluation Committee-Lands/Endowment

Date: May 29, 2001

Re: **Recommendation #2-- Lands/Funds Investment Reporting Format**

Background:

One very specific request from each and every Land Board Member to the Citizens' Evaluation Committee was to come up with a standard or common format for reviewing lands and funds investments and performance on a periodic basis--both to evaluate performance and to aid in the Land Board's decision-making processes. No such common format exists to date.

Measurement is a critical aspect of the Land Board's operations and decisions, as well as decisions and actions at the Lands/Funds departments' level. "You tell me how I am measured and I'll tell you exactly how I am going to act," said William R. Hewlett, co-founder Hewlett-Packard Company, 1938.

Recommendation #2:

Implement a standard/common 3-page reporting format (previously distributed as a working document to the Department of Lands and Land Board members and their staff) for review of lands/funds investments and performance. Implement/utilize the sample report format provided, initially to begin to get experience/understanding with the reporting tool and its underlying assumptions and, then iterate/improve on this management tool as needed in the future. (Note: a tutorial in this tool and its effective use may be well advised for Board Members and their deputies.) Appendix D is the proposed reporting format with numbers deleted.

Key Explanation Points:

Bob Maynard (PERSI) has provided the point leadership within this citizens' committee on this work. He has worked closely with Charlie Saums and Winston Wiggins to develop this first draft as accurate as needed for use as a starting point. In addition, Bob has met with most of the deputies of Land Board Members to describe this format, as well as, the investment policy template/model of Recommendation #1. I am certain that Bob will make himself available for a tutorial on this new reporting format whenever the Land Board desires it.

Deputies of the Land Board Members have been briefed by Bob and have begun working with this new reporting format. Bob will follow up with any additional support/consulting needed by these deputies.

The committee recommends a strong **CAUTION** in the use or premature publication of this reporting format and the numbers contained therein because:

- The numbers in the previously distributed are **EXAMPLE** results of asset valuation and returns resulting from a 6% targeted real rate of return and the Discounted Cash Flow methodology used for asset valuation. (Note: a detailed discussion of this issue was included in Committee Recommendation #1 and the Investment Policy template.)
- **It will remain an action item for the Land Board to decide upon the targeted real rate of return for each of the various endowment lands asset categories.**

Appendix D: Standard/Common 3 page Reporting Format

Recommendations # 3: Permanent Department of Lands Director

The Land Board should immediately establish a formal process for selecting a permanent director for the Department of Lands with the goal of having that person in place within 90 days.

Steps to Consider:

1. **Position requirements:** With the help of the Administrator of the Division of Human Resources, Ann Heilman, adopt clear technical and behavioral skills and competency requirements for the Department of Lands director's position. Such skills and competencies might include, but not be limited to:
 - **Technical Knowledge & Experience with Natural Resources**
 - **Ethics, Trust and Integrity** – viewed as a highly credible and trustworthy person who demonstrates consistency between words and actions. Creates and instills strong values and ethics within the department.
 - **Managing Vision and Purpose** – creates and communicates a compelling vision of the future. Translates the vision into clear and meaningful strategies and specific priorities, which helps others focus their efforts.
 - **Interpersonal Communication and Political Savvy** – establishes and maintains productive relationships with appropriate people at all levels within and outside the department. Builds and effectively uses coalitions and partnering. Strong in communication skills.
 - **Change Agent** – inspires creativity and innovation inside department while demonstrating awareness to external factors.
 - **Team Building** – establishes a positive work climate through personal actions, policies, and consistent signals that nurtures enthusiasm and commitment to the team's mission.
 - **Action Oriented** – uses experience and knowledge to capitalize on opportunities and challenges.
 - **Command Skills** – takes charge in challenging, difficult and/or ambiguous situations.
 - **Motivating and Inspiring Others** – provides strong leadership and finds ways to get maximum results from others.
 - **Problem Solving and Decision Quality** – identifies both overt and underlying issues. Makes sound and timely decisions in accordance with the department's vision, mission, core purpose and strategic thrusts.
 - **Results Orientation** – drives execution of the department's strategies and goals to reach objectives. Produces results consistent with the department's vision and mission.
 - **Strategic Agility** – has broad knowledge and perspective and can anticipate and adapt to future consequences and trends accurately.
 - **Management Judgment** – demonstrated sound, clear judgment especially in the areas of strategy, business decisions, leadership and people.

2. **Hiring Decision:** Evaluate acting director for the position and make a long-term hiring decision and/or open the position to other applicants via a search process (Reason: Acting directors for longer than six months find it very difficult to be effective and efficient, with resultant impact on employee morale. Also, despite management's best efforts, many employees under an acting director may adopt a "wait and see" posture rather than aggressively helping to make change happen within the department.)
3. **Key Support:** Both now and once the permanent director is in place, a number of changes may need to be made in order for him/her to succeed:
 - a. Ensure that the director has the appropriate strength of assistance in Human Resources, Finance, and IT, who will be change agents to help with reorganization and department change process management.
 - b. Retain a temporary (1-2 year) strong, experienced human resource/change management agent as direct support to the director and his/her staff.
 - c. Follow through completely on Employee Survey consulting effort, which is currently under way.
 - Present a summary to the Land Board along with the director's plan on how to address the issues and concerns raised
 - Request a third-party review by the State Human Resources Director
 - of survey information, and action plans

Recommendation 4: Implementation Action for Recommendations 1 and 2

Adopt the following specific implementation actions for:

Recommendation 1 - Formal Land Trust Investment Policy

Recommendation 2 - Lands/Funds Investment Reporting Format

Recommended Steps to Follow:

1. Leveraging the Model/Template provided, complete the Formal Land Trust Investment Policy through Land Board review and approval.
 - Land Board should assign action to Department of Lands Director as lead plus two other Land Board members' deputies as team
 - Completion target September 1, 2001
2. Thereafter, ensure Department of Lands completion of an Annual Investment Plan
 - Initial completion target November 1, 2001
 - Land Board assign action to Department of Lands Director
 - Land Board review business/investment plans (Department of Lands; Endowment Funds) – Twice a year
3. Thereafter, Land Board hold a quarterly review of performance vs. plan commitments
4. Land Board consider establishment of a (3rd Party) performance audit/review process
 - Reporting format (Recommendation #2) utilized
 - Consultant (Independent, non-state entity) lead review for Land Board
 - Accomplishes objective assessment of Department of Lands, Endowment Fund Performance vs. Plan

Recommendation 5: “Endowment Investment” Paradigm Shift (Mindset)

At Land Board level, Department of Lands level and all levels below, establish a clear paradigm shift toward “Endowment Investment.” These two words must color all future analysis, decisions and actions.

From:

To:

“Lands Management”  “Endowment Lands Investment Management”

“State Lands”  “Endowment Lands Real Estate Assets”

Goal:

Cause all levels in organization to begin thinking, speaking and acting in an **Endowment Investment frame of mind**

Specific Recommended Action:

1. The Land Board should establish the “**Shift of Focus to Endowment Investment**” as a its #1 strategic priority, formally articulate this, and reflect it in all Land Board decisions and actions. Assign one member or deputy to “own” this plan and lead it.
2. Empower (and require) all investment opportunity decisions be consistently and professionally evaluated/calculated with this priority in mind for optimization of return to the endowment.

Recommendation 6: Endowment Real Estate Asset Manager Position

Establish an “Endowment Real Estate Asset Manager” (e.g. Assistant Director for Real Estate) position within the Department of Lands

Reason: Focuses Endowment Real Estate Asset management under a single manager. Frees professional Land/Forest/Mineral managers to focus on their own critical management roles.

1. Reports to Director, Department of Lands
2. Major Responsibilities include:
 - Evaluation of endowment estate assets, asset performance, annual investment plan formulation
 - Cottage sites management
 - Transition lands oversight
 - Land bank transaction mgmt
 - Analysis of investment opportunities
 - Basically, all/any commercial real estate management functions within Department of Lands

Note: Not intended to be responsible for administration/management of state owned commercial real estate (buildings). Recommend retention of this function in state administration organization, but remains accountable to the “owner” (of the endowment assets).

3. Key Role Competencies:
 - Commercial Real Estate experience
 - Real Estate investment management
 - Business focus (MBA preferred, solid experience/results base)
 - Strong partner
 - Strong communicator
 - Strong facilitator
 - Action oriented to drive decisions and implementation
4. Open position, conduct search, hire best possible candidate. Target date: November 1, 2001

See Appendix E: Real Estate Investment and State Endowment Lands White Paper (Important: Please read carefully to understand concept/role of this recommended management position to implement strategy/change.)

Recommendation 7: Land Board Executive Director/Secretary Position

Land Board establish the role/position of “Executive Director/Secretary to Land Board”

Background/Justification

The current organizational relationships and communications linkages and networks within and between the Land Board (members and deputies), Department of Lands (director and staff), Endowment Board, and various other state offices unavoidably creates an extremely complex organizational model which needs to be proactively managed and facilitated by a single key player. No one player currently has either available bandwidth or designated authority to do this role.

Note: This is not an additional level of management between the Land Board and the director of the Department of Lands. Rather, it is a facilitating/coordinating position in support of all players in the organizational model.

Position Specifications:

1. Role Concept:

- Reports to the Land Board with strong organizational linkage to the Governor, each Land Member, and the Land Board deputies. Key partner with the Director of the Department of Lands
- Strong coordination and communication/facilitation role.
- Key staff coach to the Governor, Land Board members and their deputies, and Director of the Department of Lands.
- Manage the Land Board “macro-agenda” and strategic priorities
- Chairs/facilitates Land Board pre meetings (w/Deputies, etc.), meeting preparation
- Coordinates Land Board meeting agenda
- Leads Land Board in their own ongoing internal organizational development work and processes improvement efforts

(Note: A graphical summary of this role/position is shown in Appendix F.)

2. Key Competencies/Skillset:
 - Strong business skills and natural resource knowledge (with an MBA or similar applicable experience)
 - Leadership + communications
 - Facilitation skills/coordination
 - Teamwork
 - Process focus
 - Facilitating management across complex org., “org. whitespace”
 - Desired: Organizational development experience/facilitation skills
 - Strong action orientation (drive decisions and implementation)

Specific Implementation Actions:

1. Assign Land Board team to work with Ann Heilman (Idaho State Human Resources Director) and Citizens Committee to define the Land Board executive director/secretary position, sourcing model/process and selection timeframe
2. Define key technical/behavioral competencies, skillsets required
3. Define clear preliminary position plan, objectives, measurement
4. Ensure person hired is able to meet strong coordinating role requirements (including conflict resolution)
5. Assign overall recruiting/selection leadership responsibility to one Land Board member (owner) with senior level selection team.
6. Target completion date: November 1, 2001

Recommendation 8: Land Board Organization Models-Long Term

Research the Utah (and other states') Land Board Organization Model(s) and recommend/decide on best overall long term Idaho Model (see Appendix G)

Action Steps Recommended:

1. Assign to team of Land Board deputies for staff action over the next six months with a report back date of January 2001.
2. Understand the dynamics/pressures, which caused organizational/structural changes to be enacted in respective states.
3. Understand how their system(s) work; specifically how they get the job done better?
4. Benchmark our Idaho Land Board operation vs. Utah's, others.
5. Evaluate pros/cons of models reviewed (including board officials)
6. Understand Idaho Constitutional implications of other models
- 7. Conduct Final review of staff analysis and recommendation/decision by Land Board in January 2002. Creation of implementation plans/timeline, as applicable by 1 March 2002.**

See Appendix G: State Trust Lands-History, Management and Sustainable Use, Jon A. Souder, Sally K. Fairfax pp 38-47.(Provided to Committee by Clive Strong, Deputy Attorney General) Hardcopy forwarded under separate cover.

Recommendation 9: Land Board Operational Governance Model

Reason: Based on our experience, the committee believes that current Land Board organizational effectiveness could be improved by implementation of some specific practices/procedures.

Specific Actions Recommended:

1. Increase the focus on Land Board Organizational Development and Process (es) Development/Management
 - Assign lead to Executive Director/Secretary (To be hired – Recommendation #7)
 - Consider external consultant services
 - To include: purpose, mission (3-5 year), strategies, objectives (1 year), defined specific roles/responsibilities for all players, keyboard processes (e.g. decision making, agenda, task/action assignment and tracking, etc.)
2. Annually re-establish the strategic priorities and direction of Land Board; re-visit mission and goals every 3 years.
3. Semi-annually, establish 6-12 month Land Board objectives (policies completion, task force completion, etc.)
4. Establish and maintain meeting plans and schedules 1 year in advance (Executive Director/Secretary responsibility)
5. Continue to strengthen content and processes for Land Board pre-meeting.
 - Delegate more of Land Board agenda for pre-meeting agreement, save agenda space for more strategic discussions and appeals process (only). (e.g. Land Board give themselves a “promotion” to deal with more strategic matters)
6. Due to the inherent organizational complexity, the Land Board needs to develop a workable system for annually reviewing and providing mentoring/coaching for the Department of Lands’ director (either Governor or other designated Land Board member)
 - Role/Responsibilities:
 - Management/Oversight
 - Direct, personal mentor/coach to the Director, Department of Lands
 - Facilitate communication with Land Board members when needed
 - Draft Annual performance evaluation and development plan for Director. Review and gain approval by entire Land Board (Note: Executive Director/Secretary to Land Board to be fully included in this process)

7. (Note: The committee did not take the time needed to reach full agreement on this recommendation, but the Chair believes it is an issue, which at least should be thought about and discussed by the Land Board at this time.)

The Land Board is not a traditional state agency. It has a fiduciary obligation to maximize the long-term return to the endowments, and as such, the Land Board is more akin to a Board of Directors of a corporation. In order for the Board to compete in a business environment, the Board must have the ability to develop an investment strategy exempt from Idaho's Public meeting law. The committee chair also believes that, for the Land Board to be a "high performance, highly functional work team," internal organizational development work must be meaningful and direct and, therefore, it must always take place in a non-public executive session of the board.

Recommendation 10: Land Board Processes Clarification

Reason: Although we (the committee members) admittedly have not done an in-depth review of the Land Bank policies, processes, and procedures, we believe that this kind of review may well be in order at this time due to their importance in overall effective portfolio management in the future.

Specific Actions Recommended:

1. Ensure Land Bank structure, processes, responsibilities and policies are fully articulated, clear and well understood by Land Board members, the Department of Lands employees, the Endowment Fund personnel, etc.
2. The Land Board should assign an individual or team to research and recommend policies for Land Bank, money movement/reinvestment, etc. Specifically, how do we direct the management of lands in the Land Bank and integrate the management of these assets to the best benefit of the overall portfolio?

Citizen's Evaluation Committee – Lands/Endowment

First Name	Last Name	Affiliation	Work	Fax	E-mail
Don	Curtis	HP Executive, retired		344-3699	doncurtissr@earthlink.net
Marguerite	McLaughlin	State Senator, retired	476-0273	476-3676	mpmclaughlin@valint.net
Jerry	Evans	School District Council	338-0427	345-1172	idahosdc@hostpro.net
John	Cowden	Boise Cascade Human Resources, retired			kjcowden@msn.com
Gary	Christensen	Developer	333-7007	333-7070	gfairfax@hostpro.net
Mike	Everett	Dept. of Agriculture, Deputy Director	332-8531	334-2170	meverett@agri.state.id.us
Bob	Maynard	Chief Investment Officer, PERSI	334-2239 ext. 232	334-3804	bmaynard@persi.state.id.us
Kathy	Killen	Dept. of Agriculture, Mangt. Assistant	332-8503	334-2170	kkillen@agri.state.id.us

Note: If needed, addresses and home phone numbers may be obtained from Kathy Killen.

Charter: Citizens' Ad Hoc Evaluation Committee Lands/Endowment

Purpose:

Recommend efficiency/effectiveness changes to the Land Board regarding Department of Lands, Endowment Funds Investment, Land Board and their interrelationships and management practices.

Overarching Value(s):

- Changes that will help maximize long-term return to the Endowment Funds, balanced with...
- Appropriate consideration of other statutory and regulatory requirements, as well as varied public interests

Mission:

The What: By Summer 2001, make specific recommendations to the Land Board regarding any of the following:

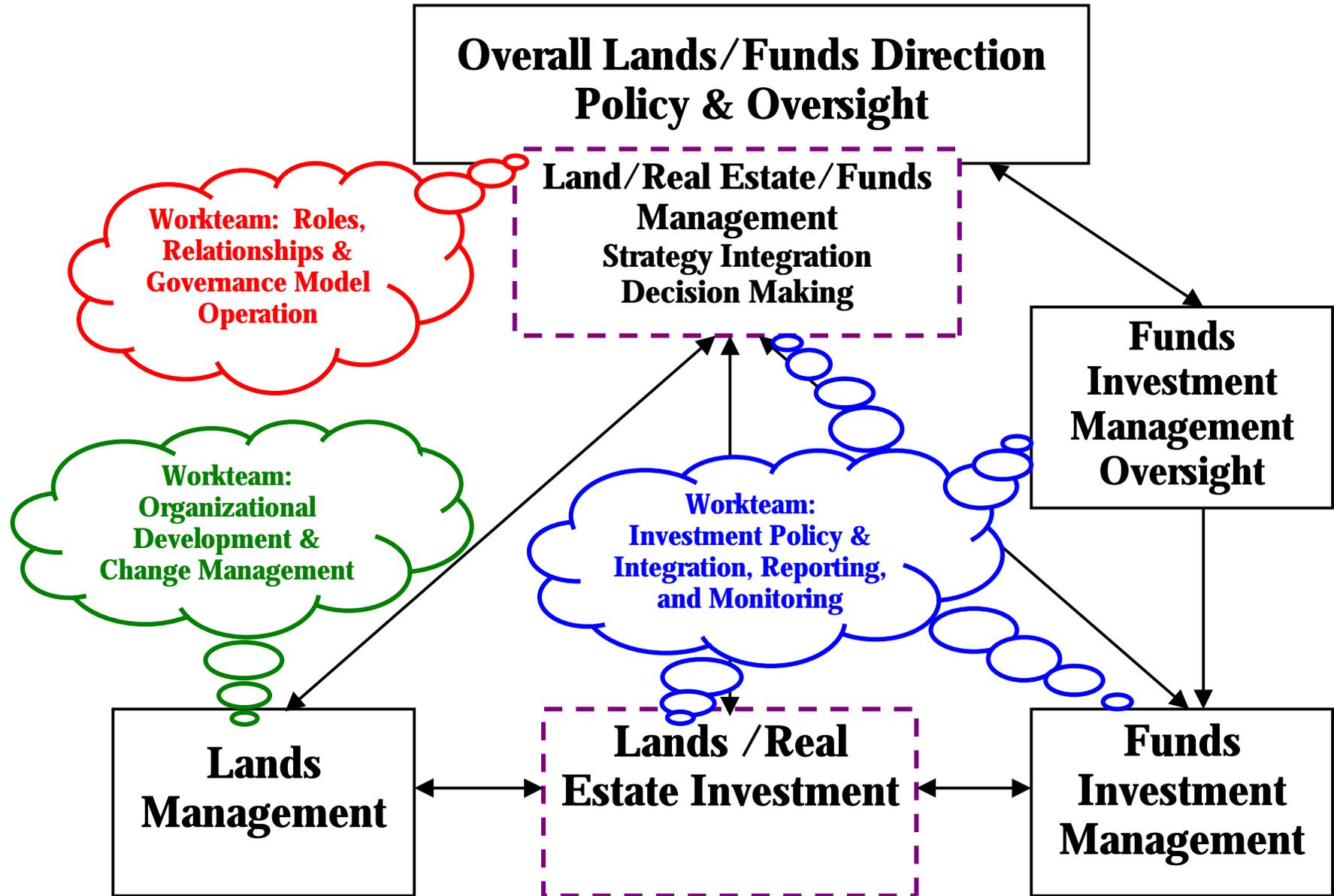
- Organization
- Processes and procedures
- Fiscal management
- Investment management & investment policy
- Board processes, organizational relationships, reporting processes
- Reporting metrics, report format, key oversight; monitoring indicators
- Strategic areas management (e.g. human resources management, change management, etc.)
- Framework for resolving conflicts (from varying interests)

The How: Wherever possible, provide specific implementation plans and formats for recommendations

What is Not in Our Charter:

- Being any sort of an "investigate probe"
- Personnel audit for any organization
- Evaluation/recommendations re: any specific personnel
- Implementation of recommendations
- To replace role/authority of Land Board in any area (e.g., policy, decision making)

Macro Roles and Relationships ~ Working Model



Workteam:
Investment Policy & Integration, Reporting, and Monitoring

Working with the Endowment Fund Investment Board and the Department of Lands staff:

- A. Develop the specific format for: **Lead: Bob**
1. the investment policies of the Department of Lands
 2. the Land Board investment policies for the overall, combined endowment
 3. the reports to the Land Board for monitoring the investment status and performance for the overall, combined endowment.
- B. Describe, in the recommended format: **Lead: Bob**
1. the existing, implied investment policies of the Department of Lands
 2. the existing investment policy of the combined endowment (i.e., combine the implied Lands policies with the EFIB policies in one document from the perspective of the Land Board)
 3. the current investment status and performance of the combined endowment
- C. Develop a means for ensuring the maximum long-term return from state lands as a real estate asset portfolio, including considering: **Lead: Gary**
1. utilizing independent investment advisors
 2. tying investment decisions to an investment advisory board vs. a single department
 3. establishing investment return expectations for various real estate assets in the portfolio

Team Members:

- Bob Maynard
- Gary Christensen

Key Inputs From:

- Charlie Saums
- Endowment Fund Investment Board
- Winston Wiggins

Workteam: Organizational Development and Change Management

Work closely with the Department of Land management team to assist/consult in:

1. Develop a Department Business plan that supports the overall mission, purpose, and strategy (clear & consistent) of the Land Board.
2. Develop a specific strategy for the Department of Lands to address:
 - a. Financial and/or regulatory targets for each subdivision
 - b. Organizational needs to meet targets for each subdivision
 - c. Reporting systems to measure the progress
3. Develop detailed plan for implementation of strategic plan which includes:
 - a. Specific sub department goals and timelines
 - b. Resources required and organization changes needed
 - c. Plan to inform and educate all levels of the organization
 - d. Individual performance plans – with training/development plan
 - e. Reports to monitor progress and gather feedback for improvements
4. Develop overall strategy to address perceived resistance to change
 - a. Recommend that management conduct some form of all employee opinion survey (mission, strategy, human resources, etc.)
 - b. Provide feedback/listening sessions involving all employees of organization
 - c. Promote process improvement changes in all organizations
 - d. Build reward systems around accomplishment of short-term and long-term goals

Success will require proactive support by the Land Board, and commitment by senior management of the various departments of Idaho Public Lands. This requires a substantial amount of time, and capable staff resources.

Team Members:

- John Cowden
- Mike Everett
- (Marguerite McLaughlin)

Key Inputs From:

- Winston Wiggins and Immediate Staff

Workteam: Roles, Relationships, and Governance Model Operation

Purpose:

Working closely with involved departments/players, make recommendations to the Land Board in support of its role and integration of the Land Trust and Financial Trust for the maximum benefit of the endowments. Focus on organization model/process, effectiveness and efficiency.

Workplan:

- Interview/discuss organization, processes and operations with key managers to gain their view of the governance model including issues and challenges. Understand “as is” model operation.
- Map these roles/relationships and issues/challenges on a simple to understand governance model. Identify significant opportunities for improvement.
- Identify organizational processes and opportunities that would orient and focus the Land Board on significant policy and strategy issues, freeing the Board from most appeals and minor administrative matters (work with advisors)
- Summarize recommendations to the Land Board

Team Members:

- Jerry Evans – Lead
- Don Curtis
- (Marguerite McLaughlin)

Key Inputs From:

- Land Board Members & Deputies
- Winston Wiggins
- Charlie Saums

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I. Introduction

The Land Board (“the Board”) hereby establishes its Statement of Policy for the investment management of the endowment trust lands in accord with the Idaho Constitution Article IX, Section 8 and Idaho Code Title 58.

II. General Requirements

The investment of the Trust Lands will be in accord with all applicable laws of the state of Idaho.

A. Sole Interest of Beneficiaries

Investment Management will be solely in the interest of the beneficiaries and for the exclusive purpose of providing benefits to the beneficiaries and defraying reasonable expenses of administration.

B. Prudent Investments

Investment decisions will be made with the judgment and care under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Investments will be diversified so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is prevented by law, impracticable under the circumstances, or clearly prudent not to do so.

C. Fiduciary Duties

The Board and its agents, including staff, consultants, and investment managers, will discharge their duties with respect to the trust lands solely in the interest of the beneficiaries, and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

D. Consideration of Additional State or Public Interests

Maximizing the long-term economic benefits to the Endowment is the primary objective in managing the trust lands. The management of trust lands shall incorporate sound environmental principles with consideration of impacts on wildlife, water and air quality, and soil conservation. Respecting the desire to maintain environmental quality, the Department of Lands shall strive to use the best and highest management standards commercially and economically feasible while meeting or exceeding the performance objective.

III. Investment Goals

A. General Objective

Trust lands will be managed to secure maximum long-term financial returns to the endowment without causing significant long-term adverse impacts to the land or related resources.

B. Performance Objectives

Trust lands will be managed with the objective of exceeding a minimum target real rate of return of 6.0% and exceeding the relevant National Council of Real Estate Investment Fiduciaries Index (“NCREIF Index”), if available, while maintaining an appropriate level of risk.

C. Investment Holding Period/Dispositions

The target holding period for assets shall generally be for long-term investment (10 years or more). However, disposition of individual tracts may be triggered by an opportunity to capture a return in excess of the targeted return, or by a revised investment strategy resulting from changes in markets or changes in the Endowment’s financial objectives.

D. Valuation of Lands and Returns

Land valuations and returns will be calculated under the methodology used by the NCREIF Index. This methodology is generally as follows:

1. For Timber, Grazing, and Mineral Lands

a. Income Return

$$\frac{I_t}{MV_{t-1} + 0.5(CI_t - PS_t + PP_t - I_t)}$$

b. Capital Return

$$\frac{MV_t - MV_{t-1} - CI_t + PS_t - I_t}{MV_{t-1} + 0.5(CI_t - PS_t + PP_t - I_t)}$$

2. For Commercial and Cottage Site Lands

a. Income Return

$$\frac{I_t}{MV_{t-1} + 0.5(CI_t - PS_t) - 0.33I_t}$$

b. Capital Return

$$\frac{MV_t - MV_{t-1} - CI_t + PS_t}{MV_{t-1} + 0.5(CI_t - PS_t) - 0.33I_t}$$

Where

I_t = net operating income obtained from land during quarter t

CI_t = capitalized expenditure on land during quarter t

PS_t = net proceeds from sales of land during quarter t

PP_t = gross costs of adding land during quarter t

MV_t = market value of land at end of quarter t

3. Determination of Market value

Market value will generally be determined using the principles set forth in the Real Estate Investment Standards and as set forth in the Uniform

Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation. That standard is often expressed as follows:

The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- 1. buyer and seller are typically motivated;*
- 2. both parties are well informed or well advised, and acting in what they consider their best interests;*
- 3. a reasonable time is allowed for exposure in the open market;*
- 4. payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and*
- 5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.*

These standards will generally be followed, except that

- The standards of the relevant industry in appraising land shall be followed where there are differences between the Standards and industry practices, and
- The Discounted Cash Flow method of appraisal should be favored where there are significant difficulties in determining a most probable price in an open and competitive market. The discount rate used should be consistent with the minimum target rate of return under the Performance Objectives for the land, unless there are demonstrably better alternatives under the circumstances.

4. Performance Reporting

The department will present a report showing the performance of the entire Land Trust and each of its components at least quarterly to the Land Board. Determinations of market value should be updated at least annually for purposes of performance reporting. These determinations of market value may be done informally, provided that a formal determination of market value is done at least once every five years for each type of property held by the Trust.

IV. Investment Management of Lands

A. Annual Investment Plans

The Department of Lands will annually prepare an Investment Plan for each type of land managed by the department and for the portfolio as a whole. These plans will be presented to the Land Board for their review and approval.

B. Contents of Investment Plans

The plan will contain at least the following items, both for the portfolio as a whole, and for each individual type.

- An Executive Summary of the contents of the plan.
- A description of the current and expected investment environment and outlook, including
 - a description of the major influences on the investment environment,
 - major dangers to achieving projected returns over the next year and longer, and
 - The competitive environment
- An analysis of past and current returns, including
 - An analysis of the previous periods' returns, identifying the main drivers of either over or under performance compared to the minimum performance objectives and compared to the NCREIF Index, where applicable
 - Plans to remedy underperformance, either for the entire portfolio or for particular properties in portfolio,
 - Progress in remedying previously identified underperformance from prior plans, and reasons for any lack of progress
 - An analysis of the current market value of the land

- A comparison of the current market value of the land with the previous period's market value, and describing the reasons for any significant change in market value.
- An analysis of future expected returns, including
 - A ten year projection of annual cash flows from the land,
 - A comparison of the latest projection of cash flows with previous projections, identifying significant differences and the reasons for those differences
- A description of the current characteristics of the portfolio, including
 - Regional diversification
 - Mix of types of assets
 - Quality of assets
 - Other distinguishing features
 - An explanation of any significant changes in the characteristics of the portfolio from previous annual plans,
- A discussion of the long-term objectives for the portfolio, including
 - A description of the long-term desired characteristics of the portfolio, and the reasons for the changes from the current characteristics
 - The long term plans for achieving the desired characteristics
 - A description of efforts to achieve those long-term desired characteristics over the upcoming year
 - A comparison of efforts over the past year to achieve those goals with the previous year's planned efforts, and reasons for any failure to achieve previous objectives.
- A discussion of the risks facing the portfolio, and plans to monitor and mitigate any risks, including
 - A description of the portfolio's exposure to major physical risks over the upcoming year, and plans to mitigate any significant risks, including the risk of
 - Natural disasters, including fire, wind, ice, and snow,
 - Pest infestation
 - Disease
 - Animal damage
 - Theft
 - A description of the portfolio's exposure to major economic and financial risks over the upcoming year, and plans to mitigate any significant risks, including the risk of
 - Price risk,
 - Supply risk, including productivity and environmental constraints

- Demand risk, including reduction related to usage (such as decline in housing starts for timber), substitution of other products (both raw and finished), and financial or economic constraints on potential bidders for land.
- A hold/sell analysis, which
 - Will include updated cash flows and a review of market conditions, costs, revenues, inventory, and regulations,
 - Identifies properties with projected internal rates of return (IRRs) below the targeted rate of return, or properties with substantially different IRRs relative to the prior year's IRRs, along with an analysis to identify factors contributing to changes in their IRR,
 - Evaluates of potential disposition of properties with IRRs that are below the targeted rate of return, isolated parcels that do not provide efficient property management opportunities, or parcels that would have higher or better uses, including the specific alternatives for use of disposition proceeds to achieve overall portfolio objectives.
- A review of this Investment Policy, including:
 - A statement demonstrating compliance with the provisions of this policy, and
 - The opinion of the department concerning whether the provisions of this policy are still appropriate, or suggested changes to the policy along with supporting rationale for those changes.

V. Consolidation of Forest and Grazing Tracts

It is an objective of the Land Board to consolidate forest and grazing tracts into logical management units thereby decreasing property boundary length and reducing the number of tracts. These consolidated tracts may vary in size and location due to local terrain and management goals and desires.

Priority should be given to the exchange and consolidation of small isolated tracts, which are most difficult and expensive to manage.

VI. Sale, Purchase or Exchange of Lands

A. Goals of Sales, Purchases, or Exchanges

To the extent allowed by law, the sale, purchase, or exchanges of endowment land on a similar value basis with the United States, local units of government, corporations, individual, or a combination thereof, may be entered into in order to accomplish one or more of the following objectives:

- To protect and provide efficient resource management of state property
- Enhance access to state property
- To increase the financial return
- Reduce administrative costs
- Assist with the diversification of the real estate portfolios

B. Considerations

Proposed or planned purchase, sale, or exchange of endowment lands will consider the following issues

- Will the action provide increased revenue for the endowment beneficiaries?
- Will the action provide the opportunity to diversify the real estate holdings?
- How does the property fit in the department's overall management objectives?
- Will the proposal form a logical management unit?
- What are the administrative benefits or problems that may arise out of the proposed action?
- Does the property have legal access?
- What are adjacent ownership and management objectives?
- Are there any existing improvements (e.g. springs, grass seedings, fences, buildings, plantations, etc.)?
- Are there potential restrictions to management or administration (threatened or endangered species, unauthorized dumps, wilderness study areas or scenic designations, critical wildlife habitat, known cultural resources, etc.)?

- How marketable is the property due to proximity to lumber mills, livestock markets, municipalities, access routes, and utilities?

C. Procedures

In addition to such other actions as may be required by law or as may be developed by the Department of Lands, the procedure for a particular sale, purchase, or exchange of endowment land will include the following:

- 1. Proposal.** A proposal for sale, purchase, or exchange of land will be either received from a proponent by the Idaho Department of Lands, or be proposed by the Idaho Department of Lands.
- 2. Proposal Review.** The IDL area and state office staff will review all proposals to determine if the proposal meets long-term management goals of the department as set forth in the annual investment plan, and will consider all applicable items described above. Property acquisitions which IDL staff believes are in the best interest of the state involving commercial and/or light industrial property will be presented to the Land Board in executive session for further review.
- 3. Agency and Lessee Notification.** The Department will notify the Idaho Department of Fish and Game of the proposed action to obtain input regarding the proposed action. Other agencies such as the Bureau of Land Management and the U.S. Forest Service will be notified for input if they border the property or if it may be important to their management. Lessee(s) will be notified of the proposed action.
- 4. Preliminary Value Estimate.** Staff will research and prepare a preliminary value estimate of the land or lands subject to the proposed action using the principles of valuation set forth in this Investment Policy. For land exchanges, staff will also analyze whether the exchange is for properties of similar value, or if more property needs to be added to the exchange proposal,
- 5. Staff Approval.** The Department will obtain area and state office staff approval of the proposed action.

- 6. Board Conceptual Approval.** Staff will then brief the Land Board on all proposed purchase, sale, or exchanges and obtain conceptual approval to proceed.
- 7. Public Hearing.** IDL will hold a public hearing to seek input regarding the action.
- 8. Mitigate Public Concerns.** IDL staff will work to resolve concerns which various public interests may voice during public hearings or otherwise.
- 9. Timber Cruise.** Actions involving commercial timberland will require the performance of a timber cruise to estimate the net harvestable volume. This will involve timber typing if necessary, method of cruise, number of plots, who will perform cruise, and who will check cruise.
- 10. Environmental Site Assessment.** Department staff will perform an Environmental Site Assessment on unimproved lands to verify if there are any environmental contamination problems on the properties. Improved lands, including commercial or industrial businesses, will require a Level 1 Site Assessment.
- 11. Architecture and Engineering Analysis.** Actions involving commercial office or light industrial properties will require and Architecture and Engineering (A&E) analysis. The A&E analysis will be contracted to vendors that have already been pre-qualified by the Division of Public Works. A&E contracts will be developed and administered by IDL staff.
- 12. Appraisal Request.** An appraisal will be performed on the properties. The Bureau of Real Estate will administer the appraisal contract of IDL, and will be performed in conformance with the valuation principles set forth in this policy.
- 13. Check Cruise.** Timber cruises will be checked to verify accuracy and acceptability. Typically a minimum of 10 percent of the original cruise plots will be checked. The check cruiser will verify the number of trees in the plot(s), species, height, diameter, and percent of defect.

14. Review Appraisal. All appraisals will be reviewed by IDL staff to determine acceptability and conformance with the Uniform Standards of Professional Appraisal Practice.

15. Final Agreement. IDL staff will reach a final agreement with all necessary parties. All final agreements must receive the approval of the Director and the Assistant Director(s). The final agreement will be subject to approval by the Land Board. Exchange agreements are to be signed by the Governor, Secretary of State, and the Director.

VII. Hazardous Waste on State Lands

Because of the potentially large amounts of money required to cleanup or remediate contaminated sites, it is imperative that the Department of Lands, as trustee of endowment and public trust lands, manage state lands in an environmentally responsible manner. Also, the Department of Lands should perform due diligence and establish the “innocent landowner defense” when possible.

Therefore, under procedures and guidelines developed and administered by the Department of Lands, the IDL will:

- Inventory state owned lands administered by the Department of Lands for possible hazardous waste contamination
- Identify and manage sites that are contaminated with hazardous waste in an environmentally sound manner
- Minimize the liability position of the State of Idaho as a landowner where possible when acquiring, disposing, and leasing lands;
- Provide basic guidelines for managing state lands in a manner to establish an “innocent landowner defense”; and
- Protect and provide for general public and state employee health and safety.

VIII. Additional Policies for Timberland

A. Prevention of Long-term Adverse Impacts to the Land or Related Resources

In avoiding significant long-term adverse impacts to the land or related resources, the department will implement forest management activities that

- Are designed to protect and maintain or enhance site productivity and air and water quality.
- Will maintain soil structure, fertility, and moisture-holding ability so as to sustain the site's functional capacity to support optimum regeneration and tree growth.
- Establish standards for forest practices that will maintain the productivity of the forest land and minimize soil and debris entering streams and protect wildlife and fish habitat.
- Provide for residual stocking and reforestation that will maintain a continuous growing and harvesting of forest tree species by describing the conditions under which reforestation will be required, and for sites not requiring reforestation, to maintain soil productivity and minimize erosion.
- Provide that trees left for future harvest will be of acceptable species and adequately protected from harvest damage to enhance their survival and growth.
- Set standards for slashing management that will provide for management of slashing and fire hazard resulting from harvesting, forest management, or improvement of forest tree species, or defoliation caused by chemical applications in that manner necessary to protect reproduction and residual stands, reduce risk from fire, insects and disease, or optimize the condition for future regeneration of rest tree species and to maintain air and water quality, fish and wildlife habitat.
- Encourage the reforestation of all cut-over and burned-over forest lands and to protect growing timber, thereby perpetuating the State's forest resources.
- Limit the size of clearcuts on state land to help guarantee long-term endowment returns and adequate consideration of other values by
 - Limiting the size;
 - Requiring, for each clearcut, a management statement that clearly explains the need for clearcutting and the economic

- benefits as related to harvesting systems, site preparation, and planting; and
- Considering for each clearcut
 - Whether it is justified silviculturally, with consideration for stand age, species composition, insect and disease problems, habitat type, and similar considerations
 - Whether the size and design conforms to the terrain considerations,
 - The impact of the clearcut on scenic and aesthetic values
 - Establish realistic and balanced stream protection standards through administration of the Forest Practices Act on endowment lands which will exceed the minimum standards in questionable or critical instances, recognizing that such additional protection will incur additional costs and expenditures, which are to be analyzed in light of the potential damage and the mitigation measures necessary to avert the damage

B. Classification of State Forest Lands

State Forest Lands will be classified into three categories: Primary Forest Lands, Secondary Forest Lands, and Nonforest Lands. Primary Forest Lands will be those forest lands that receive the primary timber management activities of the Department of Lands. Secondary Forest Lands will receive attention to the extent practicable given the resources available to the Department of Lands.

1. Primary Forest Lands

Primary forest lands are those forest lands that are capable of natural regeneration within 20 years and successive commercial timber production within 120 years. Typically, these lands have well-developed transportation systems, are near milling facilities, and respond to silvicultural treatments (precommercial thinning, fertilizations, plantings, etc.) with sufficient volume increases to ensure positive final economic return on the investment.

2. Secondary Forest Lands

Secondary forest lands are those forest lands which do not meet primary forest lands, and are not nonforest lands.

3. Nonforest Lands

Nonforest lands are those lands that have never supported forest growth or have been permanently developed for other uses (e.g., agriculture, utility rights –of-way, state highways, or industrial purposes).

C. Methods of sale

The department of land will sell timber either by direct sales, salvage sales, or timber sales

1. Timber sales

Timber sales are those sales that typically harvest mature stands of timber of sufficient value and volume to support normal development programs and the orderly harvest of state-owned timber. Timber sales accomplish stand improvement, minimize or capture mortality, provide for regeneration, prime access for the present and future, and produce maximum stumpage returns consistent with good management practices. Each timber sale must be approved by the Land Board. Timber sales must be used for all sales that either:

- exceed a net appraised value of \$150,000,
- are in excess of 1 million board feet, or
- are determined by the director to otherwise support a timber sale.

2. Salvage sales

Salvage sales typically harvest timber of insufficient quantity and/or quality to support a timber sale. Salvage sale objectives are generally similar to those for timber sales except that stand improvement may, under some conditions, be given prime consideration if it provides long-term gains to the state. The Forest Management Bureau must approve salvage sales prior to advertisement, but the Area Supervisor has the authority to execute the contract. Salvage sales are those sales that are not direct sales and

- Are less than a net appraised value of \$150,000 and
- Are under 1 million board feet.

3. Direct sales

Direct sales may be used to harvest isolated or bypassed parcels of timber of insufficient volume to justify a salvage sale. Area supervisors have the authority to approve and execute direct sales, which shall not exceed an initial period of six months with a provision of one six month extension.

Direct sales

- may not exceed \$15,000 in net appraised value,
- May not exceed 100,000 board feet
- May not be used if general inquiry indicates that there two or more interested bidders, and.

D. Investment Management of Timberlands

The Department of Lands will annually prepare an Annual Sales Plan and an Annual Investment Plan. These plans will be presented to the Land Board for their review and approval.

1. Annual Sales Plan

The Department will prepare an annual sales plan for each fiscal year to be approved by the Land Board. The annual plan will be based on recommended annual harvest volumes, and will consider:

- inventory reports
- local stand conditions
- special management problems
- economic factors

The annual sales plan may be altered either

- to respond to changing market conditions or
- to expedite the sale of damaged or insect-infested forest products

Each individual timber sale will be submitted to the Board for approval.

2. Annual Investment Plan

In addition to the items required for all investment plans, plans for timberland management will also contain the following items.

- The description of the current and expected timberland investment environment and outlook, will include a discussion of:
 - The prospects for timber prices, and
 - The prospects for future timber harvests
- The analysis of the previous periods' returns will also identify the main drivers of either over or under performance compared to the NCREIF Timberland Index
- The ten year projection of annual cash flows from timberland, will identify separately the expected yearly harvest and the expected prices for the timber
- The description of the current characteristics of the timber portfolio will include
 - Regional diversification
 - Species mix
 - Timberland quality (Primary and Secondary Forest Lands)
 - Age-class distribution
- The description of the long-term desired characteristics of the timberland portfolio, and the reasons for the changes from the current characteristics, will include desired
 - Regional diversification
 - Species mix
 - Timberland quality (Primary and Secondary Forest Lands)
 - Age-class distribution

IX. Additional Policies for Grazing and Cropland

A. Objectives, Purpose, and General Guidelines for Leasing of Cropland and Grazeland

A continuous income to the state endowments is generated by the leasing of endowment lands for various uses. The amount of money provided is a direct result of the department's leasing practices. Adequate attention must be given to this effort to ensure the maximum return consistent with appropriate long-term resource management.

The importance of proper resource planning and management cannot be overemphasized as an integral part of the department's leasing program. *It is the department's responsibility, as well as the lessees', to ensure that the resources of the endowment lands are protected and enhanced.*

Leasing of unleased lands, identified suitable for grazing or framing, should be encouraged to increase income to the endowment. However, it is not essential to lease all endowment land. In some cases, conflicts may arise with other uses or lease rentals may be too low to justify the administrative expense and the encumbrance.

Leases will be issued based on land capability and long-term benefits to the endowment. The designated use should be discontinued if subsequent reviews indicate improper use or a higher and better use. Special provision should be added to the lease to address any existing or anticipated management needs. Leases must be checked periodically to determine if lease requirements are being followed, and noncompliance with lease terms may result in lease cancellation.

B. Rental Determination

The Idaho Department of Lands, with the review and approval of the Land Board, will annually set the rental rates or procedures for determining the rental rates for grazing and cropland leases. Those rates or procedures will be set considering the following principles:

- The rental for grazing leases will be based on the number of AUMs available for livestock consumption
- The rental for cropland will be based on the average yield and value of the commodity produced
- The minimum rental on any grazing or cropland lease will be \$50.00
- Special use fees should be charged for authorized uses other than grazing or cropland (e.g., feed grounds, sheds, range rider facilities)
- Changes in lease rental or special use fees made at times other than lease renewal must be accomplished through a lease adjustment.

C. Additional Plans

In addition to the Annual Investment Plan, the IDL will prepare, maintain, and update as necessary, the following management plans for cropland and grazeland:

1. Range Management Planning

Overview

All land management activities, whether they occur on private, state, or federal land, are under increasing public scrutiny as a growing human population places greater demands on Idaho's natural resources. Activities on state rangelands, including livestock grazing, timber harvest, mining, recreation, and miscellaneous special uses, are no exception. Resource impacts that were acceptable in the past are no longer so today.

Current resource impacts can frequently be attributed to several activities and/or involve multiple landowners. As a result, improving management of one use or even eliminating that use may not effect a corresponding improvement or elimination of the resource problem. An assessment of all activities and their cumulative impacts is necessary to implement effective solution solutions to resource management problems.

Policy and Plans

The IDL will develop, maintain, and, as necessary, modify range management plans to guide activities on state rangelands to ensure protection and/or improvement of the associated resource to the endowments. These management plans will be developed so that they

- Ensure that all factors contributing to resource management problems or opportunities are identified and evaluated in developing a course of action.
- Provide for the selection of a course of action from several alternatives which best addresses the issues and concerns involved, while justifying the expenditure of funds and human resources for its implementation.
- Document the decision-making process which led to the selected course of action

- Document the commitment of all involved parties to proceed with the selected course of action
- Provide for an evaluation feedback loop to ensure that the objectives of the management plan are achieved.

Criteria for determining planning priorities

The Department will determine which lands will receive priority for development and review of planning activities. The department will use the following criteria for determining management planning priorities:

- Land where resource damage is occurring.
- Lands where high resource values (anadromous fisheries, timber, water quality, etc.) are potentially at risk due to poor management practices.
- Areas of consolidated state ownership.
- Lands where more intensive management will result in increased revenue to the endowments.
- Lands that involve lessees and/or other interest users or parties who are willing participants in management planning efforts.

These criteria should be used collectively to determine management planning priorities. For example, lands meeting all five criteria would have a higher priority than lands meeting only one or two.

In many low priority areas or where short-term solutions are needed for management before a management plan can be developed, lease adjustments and/or special lease provisions addressing seasons of use, livestock numbers, salting requirements, rider requirements, annual plan of use, reporting requirements, etc., may be used to effect changes in management.

Preparation and Review of Plans

The Department will prepare five-year management-planning schedules that identify planning area priorities. This schedule will be subject to annual review and revision.

2. Vegetation Management - Grazing

Overview

Idaho endowment lands include a diversity of land and vegetation types of varying income-producing capability. The Land Board seeks to ensure the health and/or enhancement of vegetation and related resources on these lands, consistent with achieving the goal of the maximum long-term return to the endowed institutions as required by the Idaho Constitution. The development of site specific vegetation management plans that take into consideration the current and desired condition of the vegetation resource will ensure the productivity of endowment lands and the maximum long-term return to the endowments.

Assessment and Plans

The Idaho Department of Lands, in coordination with other agencies, shall

- Assess the current condition of the vegetation and related resources on all endowment lands
- Determine the desired condition
- Propose specific management practices to achieve this condition.

Vegetation management plans will:

- Emphasize management of an entire endowment parcel (including riparian areas and associated uplands) rather than small discrete areas within the parcel
- Provide for the abatement and control of noxious and invasive weeds
- Provide for decreasing the probability, recurrence, and severity of wildfires
- Provide for the control of excessive erosion

The specified management practices developed by the Department of Lands shall require that the land be managed in a manner consistent with the achievement of the desired vegetative condition. The Department of Lands, in cooperation with the lessee and other agencies, shall monitor and evaluate the effectiveness of the specified management practices.

X. Additional Policies for Cottage Site Lands

A. Rental Rate

The rental rate for cottage site leases will be an annual rate of 2.5% of the value of the leased premises, with the value determined as though the premises were vacant and unimproved.

B. Valuation for Purposes of Determining Rental Rates

Cottage site leases will be valued each five years and updated annually by indexing based on market data. The valuation may be done either by a qualified employee of the Department, a county assessor's office, or by an independent licensed appraiser.

C. Use of Leased Premises

The premises and any improvements must be used solely for residential purposes unless otherwise approved either in the lease document or by prior written approval of the Department.

D. Inspection of Cottage Sites

To insure compliance with the applicable rules and regulations, state laws, and lease provisions, a current lease inspection record shall be completed for each cottage site lease. The Department will inspect each leased site every five years, at the time of a lease assignment, and at the time of improvement construction.

XI. Additional Policies for Transition Lands

Typically, state lands are managed for natural resource values such as timber harvesting or agricultural uses such as grazing and cropland leasing. For most state lands, the natural resource uses generate the highest revenue. As populations increase, the highest and best use changes on lands near urban centers and intensive public use areas. The change in highest and best use requires a change in management of these parcels to protect or enhance land values and increase revenue. A policy

and procedure for identifying and managing these transition parcels pending development is described.

A. Identification of Transition Lands

The Department of Lands will identify those parcels that may within next twenty years be suitable for development as commercial, or commercial recreational used.

Commercial land is land used principally for an industrial, retail, or wholesale business, multiple family residential, or similar intensive use. A commercial lease is characterized by high initial improvement costs and the transaction of business.

Some of the criteria to be used in identifying transition lands are

- An appraised value above the value normally indicative of natural resources
- New, nearby development
- Frontage on a major highway
- Proximity to a town or urban area.

Area managers shall revise existing management plans and land use plans to specifically identify transition type lands.

The criteria and identification of transition lands or parcels should be more, rather than less, inclusive.

B. Preparation of Transition Land List

The Department will prepare and maintain a list and a map of those lands identified as transitional. The land list shall be circulated for staff review.

C. Management of Transition Lands

The Department shall take at least the following measures with regard to transition lands:

- Area management proposals affecting listed lands should be reviewed before taking action that may affect other uses.
- Any new plans shall specifically identify transition type lands and their potential highest and best use.

- Before a lease, easement, or temporary permit is issued, or a timber sale is offered, the impacts on potential future development must be analyzed.
- If the transition lands are within a zoned county, the Department shall notify the germane zoning commission that a plan has been written which identifies the highest and best use on the transition lands.

XII. Additional Policies for Mineral Lands

XIII. Additional Policies for Commercial Real Estate

A. Property Types, Property Characteristics, and Investment Structures

The Department may consider the purchase of direct, wholly owned property investments in the state of Idaho of the following property types:

1. Office Properties
 - a. High-rise buildings
 - b. Mid-rise buildings
 - c. Office parks
2. Retail Properties
 - a. Super-regional malls and regional malls
 - b. Community centers
 - c. Power centers
 - d. Neighborhood centers
 - e. "Main Street" retail
3. Industrial Properties
 - a. Warehousing/distribution

- b. Flex space (allowing conversion to and from warehousing and office space)
 - c. Light industrial
 - d. Research and development facilities
- 4. Residential Properties
 - a. Rental housing -- high-rise, mid-rise and garden style
 - b. For sale housing (limited to small components of commingled or company investments)
- 5. Lodging
 - a. Full service hotels
 - b. Limited service hotels
- 6. Mixed-use Properties -- primarily urban and "edge-city" properties containing office/retail/residential/lodging use combinations

Preference will be given to investment in "seasoned" properties, i.e. those which have a trackable physical and financial operating history. Commercial property investments may be leveraged by mortgage debt (direct or securitized), but that debt shall: (i) provide positive leveraging (the realistic ability to achieve enhanced after-debt returns); (ii) have a modest (typically not in excess of 50%) loan-to-value ratio so that the debt does not create unwarranted risk; and, (iii) have the ability to retire or refinance the debt without unwarranted cost. It is the Board's preference to consummate equity real estate investments on an unleveraged basis, and it is anticipated that leveraged equity investment positions will be primarily occasioned by the acceptance of debt already in place when an investment is consummated.

Real estate investments should normally be occupied by a reasonable mix of national credit tenants, regional tenants and local tenants. Such tenants should generally be subject to leases reflecting current competitive rents and the ability to increase rents. Leases should ideally be staggered as to term to provide both the continuity of income and the ability to raise income.

Generally, it is not anticipated that any individual transaction size will be less than Five Million Dollars (\$5,000,000) nor exceed Twenty Million Dollars (\$20,000,000).

No commercial investment shall be consummated without assurance that all regulatory requirements have been satisfied.

Although not subject to unrelated business income tax, the Department should make reasonable efforts to avoid unrelated business taxable income since such investments are a rough guideline to what Treasury considers "aggressive" investing.

The Trust shall only make investments in assets which have received favorable environmental reports from a qualified environmental specialist, or for which an environmental hazard may be quantified to the extent of allowing adoption of an appropriate environmental management and remediation plan.

B. Asset Management Policies and Procedures

In addition to the requirements of the annual investment plan which apply generally to commercial property, each commercial property investment position will require an annual operating plan, which shall be modified, as appropriate, no less often than quarterly. The purpose of receipt of such plans is to allow the commercial property real estate investments and overall commercial property real estate portfolio to be properly monitored by Staff on an ongoing basis.

Annual operating plans should contain the following information:

1. Operating budgets
2. Property management and leasing plans
3. Physical property review
4. Market area review
5. Disposition plan

Operating budgets shall contain all appropriate line items of income, expense and capital expenditures. Requirements include monthly preparation of budgets and comparison of same on a monthly, quarterly and annual basis to operating budgets previously adopted. Capital expenditures and leasing commissions shall be clearly delineated budget categories, and shall distinguish between: (i) recurring and non-recurring items, (ii) such expenditures which are reimbursable by tenants, and (iii) a

breakdown of major capital expenditure items. Capital expenditure budget estimates will relate historical and probable future capital expenditure needs by category. Leasing commission budgeting shall be based on and justified by: (i) prevailing conditions in the marketplace, (ii) historical leasing commissions incurred, (iii) probable future leasing commissions due to lease expirations or other tenant rollover issues, and (iv) anticipated market rental rates.

Property management and leasing plans contained in the operating budgets shall include: (i) justification of the professionals currently employed, (ii) expectation for changes in property management or leasing agents, (iii) fees and costs, and (iv) adherence of fees and costs to current market conditions. Property management and leasing contracts should be generally cancelable upon thirty (30) days written notice.

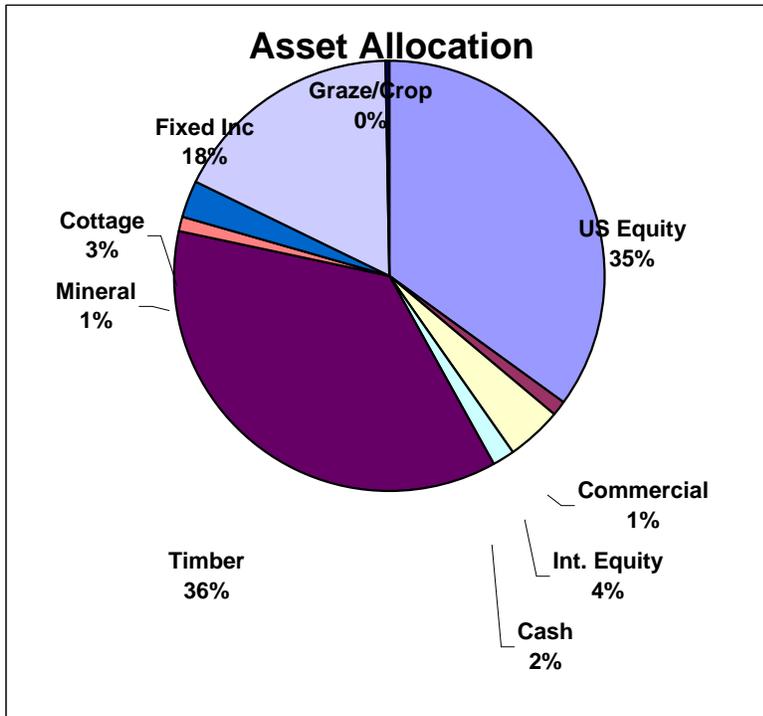
There shall be a physical property review stating: (i) the general condition of the property, (ii) expectation for capital and tenant improvement costs based on the property's condition and/or leasing status, (iii) physical property conditions which may change from market, political or economic impact, and (iv) hold/sell factors justified by the property's physical status.

There shall be provided a market area review generally describing: (i) occupancy of the subject property compared to its competition, (ii) a summary of the major economic, governmental and political factors affecting the market area, (iii) projected, near term market factors which could impact the value of the asset, and (iv) hold/sell considerations based on market area factors.

The annual operating plan shall include for each property a disposition plan. In addition to the aforementioned hold/sell considerations relating to physical property condition and market area conditions, the plan shall contain information on such strategies relating to economic performance and other financial factors that may indicate maximization of value to the investors. Specific recommendations shall be made for the hold, sale or other financial structuring of each asset.

ENDOWMENT TRUST INVESTMENT REPORT

			Total Trust	Endowment	Land Trust		
	BEGIN VALUE	NET CASH TRANSFERS					
	INVESTMENT GAIN/LOSS	END VALUE					
	QTD	FYTD	1 YEAR	2 YRS	3 YRS	4 YRS	5 YRS
TOTAL TRUST							
<i>Policy Benchmark</i>							
EFIB TRUST							
<i>Policy Benchmark</i>							
TOTAL LANDS							
<i>Policy Benchmark</i>							
TIMBERLAND							
MINERAL							
COTTAGE SITES							
GRAZING/CROP							
COMMERCIAL							



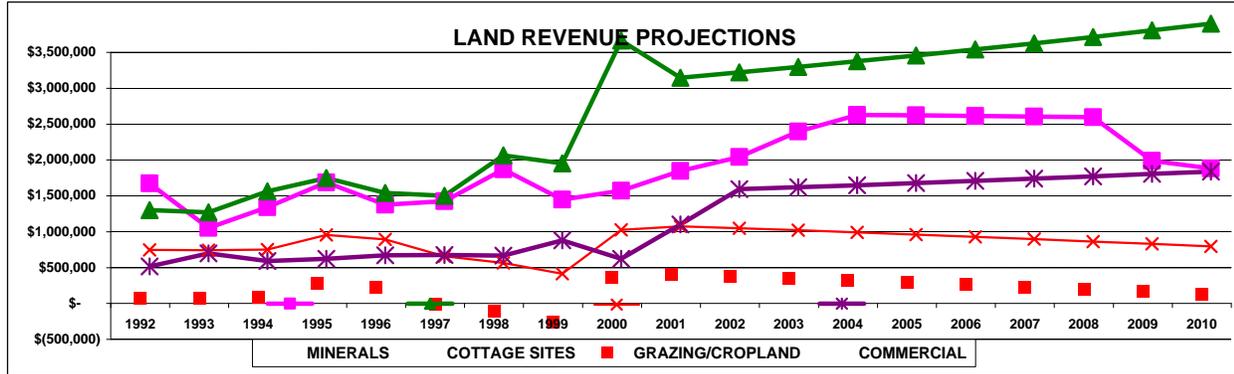
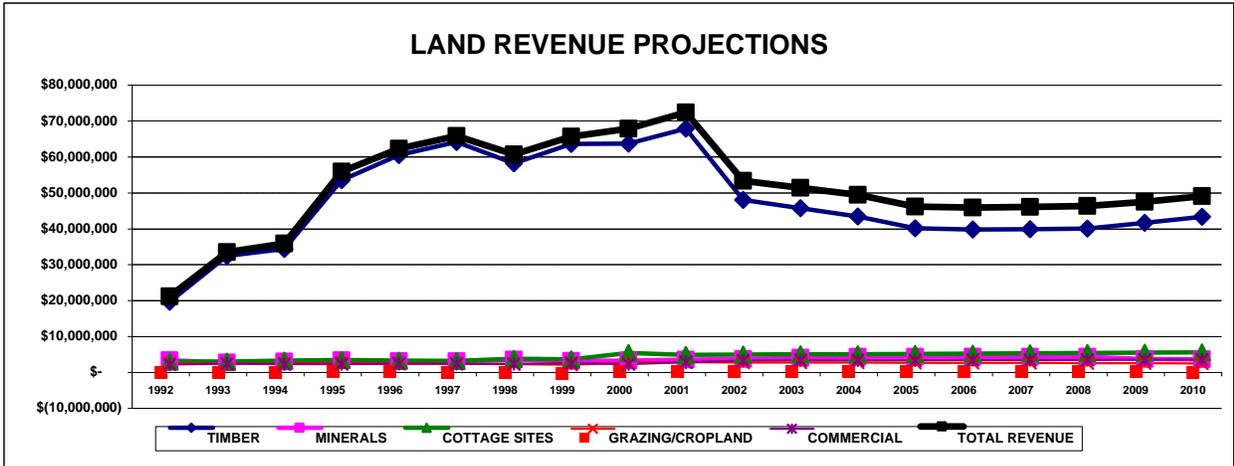
US Equity
 Int. Equity
 Fixed Inc
 Cash
 Timberland
 Mineral
 Cottage
 Graze/Crop
 Commercial
TOTAL

\$ Per Acre

Timberland
 Mineral
 Cottage
 Graze/Crop
 Commercial
Total

FINANCIAL ASSETS REPORT

		QTD		FYTD			
BEGIN VALUE							
NET CONTRIBUTIONS							
INVESTMENT GAIN/LOSS							
END VALUE							
	US Equity						
	Int. Equity						
	Fixed Inc						
	Cash						
	QTD	FYTD	1 YEAR	2 YRS	3 YRS	4 YRS	5 YRS
TOTAL FUND							
<i>Policy Benchmark</i>							
TOTAL EQUITY							
<i>Russell 3000</i>							
FIXED INCOME							
<i>US Bonds</i>							
CASH							
<i>US T-Bill</i>							
MANAGERS							
Key S&P 500							
<i>S&P 500</i>							
Trainer Wortham							
<i>R1000 Growth</i>							
Mastrapasqua							
<i>R1000 Growth</i>							
Capital Investors							
<i>R1000 Growth</i>							
Met West							
<i>R1000 Value</i>							
MFS							
<i>R Mid Cap Growth</i>							
Nicholas Applegate							
<i>R2000 Growth</i>							
Strong Capital							
<i>R2000 Value</i>							
Lazard							
<i>EAFE</i>							



EARNINGS RESERVE FUND PROJECTIONS

FYTD Estimate 4/1-6/30 Total

Beginning Balance

Inflows

New Lands Money

Timber

Minerals

Cottage Site

Crop/Grazeland

Commercial

Dividend/Interest

Realized G/L

Unrealized G/L

Total New Money

Outflows

To Beneficiaries

Operating Expenses

Transfers to Corpus

Total Outflows

Ending Balance

REAL ESTATE INVESTMENT AND STATE ENDOWMENT LANDS

June 20, 2001

The State Endowment Lands comprise a significant real estate portfolio consisting of:

1. Timbered Real Estate
2. Mineral and Grazing Real Estate
3. Cottage Site Real Estate, and
4. Commercial Real Estate

The purpose of this paper is to explain some real estate investment fundamentals and strategies, and show how they can be applied to the Real Estate Portfolio owned by the State Endowments.

THE REAL ESTATE INVESTMENT MODEL

In real estate investment, the overall intent is to (a) maximize financial return, (b) maintain the property in productive condition on a long-term basis, and (c) enhance the capital appreciation of the real estate that is owned.

In managing a real estate portfolio, there are three entities with distinct responsibilities: the Owner, the Asset Manager, and the Property Manager. In smaller portfolios, the same individual or team may perform all three functions. Sometimes, two functions will be performed by one of the teams. In large, diversified portfolios, broader experience and manpower is needed. It is critical that the owner receive expert assistance from qualified and experienced Asset and Property Managers to ensure the best financial performance from its real estate assets and the highest level of long term care for the properties.

The Owner

The Owner has the fee title to the properties in its portfolio. The Owner makes all major decisions that affect the real estate that it owns. The Owner has the right and obligation to set the goals, requirements and priorities for its real estate investments. The Owner is responsible for setting requirements for the financial return on their investment, the kinds of properties to comprise the portfolio, and the levels of maintenance that the properties will receive.

An extensive portfolio, real estate or otherwise, will be diversified. Different property types are affected by different factors at different times. By owning different property types, the Owner reduces its risk from any market conditions that may negatively affect one property type at any point in time.

The Owner of a real estate portfolio may have become the Owner by various means. They may have inherited it. They may have developed it from scratch. They may have taken funds that have been earned elsewhere and invested them in real estate for diversity. The Owner may be experienced in the many facets of real estate investment and be able to make the necessary decisions themselves. They may be rather naïve (or “inexperienced” or “more experienced in other arenas”) and require professional assistance.

The Owner will determine the investment horizon to be considered, based on their individual goals and needs. While the goals and needs of an individual owner will change every five to ten years, an institutional Owner will be looking at a time frame of 25 to 30 years. In the case of the State Endowments, that investment horizon will appropriately be 100 years or more.

The Asset Manager

The Asset Manager periodically analyzes the individual properties in the real estate portfolio. They suggest ways to increase the return on those investments by making capital improvements, or changing management tactics or procedures. They perform buy/sell analyses to identify those individual properties that are expensive to maintain and others that would better meet the Owner’s goals and objectives.

The Asset Manager generally performs the financial analysis and does the transactional work on behalf of the Owner. They proactively look for ways to enhance the financial return of individual properties. They will execute the will of the Owner in buying, selling or trading properties to enhance the yield, safety, balance, and growth potential for the portfolio.

The Property Manager

The Property Manager has the responsibility for managing the properties in the Owner’s portfolio on a day-to-day basis. They are experienced professionals that understand how the different types of properties in the real estate portfolio operate. They are responsible for the regular, ongoing operations and maintenance of the properties. They hire the contractors to make needed improvements, when necessary. They supervise the staff that provides regular maintenance on the properties. They handle the bookkeeping. All of the work “on the ground” is the responsibility of the Property Management team.

Hierarchy

Both the Asset Manager and the Property Manager work for the Owner. They are teammates, not opponents. Both Managers report to the Owner and take instructions from the Owner. The Property Manager does not report to the Asset Manager, nor does the Asset Manager report to the Property Manager. They work together to formulate plans and strategies to help the Owner reach their objectives.

THE REAL ESTATE INVESTMENT MODEL AND THE STATE ENDOWMENT LANDS

The Owner

The Owner of the major portion of the State Lands is the State Endowments for Education, _____, _____, and others. It is not the government of the State of Idaho nor is it the people of Idaho. It is not the Land Board. It is not the Department of Lands. Constitutionally, the State Endowments own approximately 95% of all State Lands.

Under the Idaho State Constitution, the Land Board represents the Endowments. Their fiduciary responsibility to the Endowments is to maximize the long-term financial return to the Endowments. That responsibility should guide each and every decision rendered by the Land Board, to maximize the long-term financial return to the Endowments.

The Land Board members all have demanding full time elected positions, and distinct political and social agendas. Sometimes these individual political and social agendas conflict with the interest of the Beneficiaries of the State Endowments, the school children of Idaho and others. Sometimes Land Board decisions have served to benefit the political persuasions and expediencies of the individual members of the Board, rather than the Beneficiaries of the State Endowments. While this is a political reality, it conflicts with their fiduciary responsibility to the Endowments.

At this time, there is no one in state government who is on call full time to insure that the Endowment is protected. When proposals are presented to the Land Board, there is no one to identify the financial cost to the Endowment of a decision being considered or call attention to other conflicts that may be present. When decisions are made by the Land Board that may benefit a political constituent or a favored interest group, there is no “ombudsman” to point out that fact and calculate cost of the long term subsidy that the school children of Idaho, and others are giving to that constituent or group.

Asset Management

At this time, the Department of Lands performs the dual role of Property Manager and Asset Manager for all of the Endowment Lands. Typically, their decisions, goals and objectives have to do with maintaining the health and long-term viability of the Endowment Lands (particularly timber lands). The mandate to maximize the financial return to the endowment is not first on their minds.

The Department of Lands is very well qualified to perform most of the Asset Management duties with respect to the Timbered Real Estate and the Grassland Real Estate sections of the Endowment’s Real Estate Investment Portfolio. However, they are lacking in expertise with respect to maximizing the return on the Cottage Site Real Estate and the Commercial Real Estate in the Portfolio.

The Department of Lands needs an Assistant Director (Manager?) to fill the role of Asset Manager for the Cottage Sites and the Commercial Real Estate. That person would supervise

the real estate personnel in the Department of Lands, and keep them focused on their responsibility to the Endowment, not to the Lands, and not to the State. They would negotiate and coordinate the sale of Cottage Sites and the purchase of Commercial Properties.

That individual could also help the other sections of the Department of Lands in providing additional financial analysis of the various plans that the Department is considering with regards to Timber and Grasslands. They could help the Department analyze specific properties owned by the Endowment to help them identify the most valuable parcels and the ones on which the Endowment is losing money. They could also perform the “ombudsman” responsibilities mentioned above, calculating the cost to the Endowments when actions are taken on leases or sales that reduce the financial return to the children of Idaho and the other beneficiaries of the Endowments.

The Assistant Director for Real Estate should have significant investment real estate experience. Some one with banking or appraisal experience may have both the financial and management skills necessary and be willing to perform this service for State wages. In the Department of Lands, the individuals that currently perform real estate functions would be part of their team.

Property Management

As stated the Department of Lands currently performs the both the Asset Management and Property Management functions for the Timbered Real Estate and the Grassland Real Estate in the Endowment’s Portfolio. They have strong and extensive expertise in these areas and are generally doing a very good job. They make sure that the properties are well maintained. They supervise the remedial work to improve yields, and use their professional expertise to ensure that the properties owned by the State Endowments are productive over the very long term.

The prevailing attitude in the Department, however is that they are “stewards of the Land.” Their first thought should be that they are responsible to the Endowment to obtain the “maximum long-term financial return.” To do that, they need to maintain the health and long-term viability of those properties so that they can provide a substantial financial return to the Endowments over the entire investment horizon.

This is a subtle semantic difference that can have a big effect on attitudes and outcomes. Instead of managing the Lands for the long-term health and benefit of the *lands*, they need to be managing the Lands for the long-term *financial return to the Endowments*. This will be an important, difficult, but necessary responsibility of the Director to shift the departmental mindset in this way.

COTTAGE SITES AND COMMERCIAL REAL ESTATE

There is a lot of emotion in discussions regarding both Cottage Sites and Commercial Real Estate. It can be easily shown that while the market value of the Cottage Sites has appreciated and will probably continue to increase, the financial return to the Endowments is significantly below the returns provided by other investments. Safe-haven investments such as government bonds currently provide a return that is nearly 300% of what Cottage Sites pay to the Endowments. The Timber portfolio produces a significantly higher return. Stocks and Mutual Funds historically provide returns 500% to 600% of what Cottage Sites pay.

Opponents to selling Cottage Sites argue that Idahoans will be denied access to Payette Lake and Priest Lake in favor of wealthy people from out of state. The fact is that Idahoans in general are denied access to these beautiful lakes over these lands now. The Cottage Sites are improved properties used by individuals and families. They are under long term agreements that are controlled by an elite group of generally wealthy people, many of which are from Idaho, and many of which are already from out of state.

Selling Cottage Sites and buying Commercial Real Estate can provide higher, safe returns to the Endowments while still keeping the investment in quality Idaho Real Estate. That portfolio could grow to be \$100,000,000 once all of the Cottage Sites are successfully sold. To successfully acquire and manage a portfolio of Commercial real estate and maximize the return on investment to the Endowments, the properties need to be carefully selected and properly managed.

At this time, we will not discuss whether all of the Cottage Sites should be sold or whether all of the proceeds from the sales of Cottage Sites should be reinvested in Commercial Real Estate. Investments in additional timbered properties should be considered. Investments in financial instruments should be considered. We do feel that a the majority if not all of the proceeds from the sale of Cottage Sites (good Idaho real estate) should be used to obtain office and industrial properties in communities around the State (which are also good Idaho real estate).

Commercial Real Estate Investment

Successful investors in commercial real estate are generally entrepreneurs who are willing to take some financial risk in order to earn a higher yield. Both “entrepreneur” and “financial risk” are inconsistent with the mission of State Government. Also, some investors and developers are going to cry foul, saying that the Endowments are unfairly competing against the private sector.

Risks in Commercial Real Estate Investment come from the uncertainty of maintaining rent paying tenants on a long-term basis. When a tenant moves out, significant work, hassle, and expense are incurred to find a new tenant and upgrade the building to meet their requirements. Motivated entrepreneurs can sometimes use turnover to enhance their investments, but turnover is generally very expensive for passive investors such as the Endowments would be.

If the Endowments are going to acquire Commercial Real Estate, those properties need to be managed in such a way as to remove the risk of tenant turnover and ensure a steady, reliable income stream over a long term.

One Strategy

One strategy would be to only invest in good quality, well-located office and industrial properties in Idaho communities that can be occupied by State Agencies. As the State is already empowered to own buildings for use by State Agencies, the private sector could not successfully argue unfair competition.

The Endowments would enter into leases with the State Agencies at an “adjusted market rent.” Market rent for the property could be determined by appraisal or market analysis, and then reduced by the cost of real estate taxes and management fees. With these adjustments, the adjusted market rent for the Endowment property would be less than the market rent the Department of Administration would pay for comparable private sector properties. The Endowment property could even compete with inferior private sector properties, as the adjusted market rent for the Endowment property would be comparable to the rent that inferior properties would offer.

The expense component of the rent would then be determined to compute a pure net (or triple net) rent that would be paid to the Endowments. The Department of Administration would then maintain and operate these properties as they do other State buildings.

With this strategy, the Endowments would have a reliable long-term tenant (the State of Idaho) for their Commercial buildings reducing the risk of turnover. (The risk would not be eliminated entirely as a building may become unsuitable for an Agency as their needs change over time, and another tenant/Agency would have to be sought.) The Endowments would be able to get the returns on investment they expected when they bought the Commercial properties.

The State of Idaho would also benefit by getting (a) a superior property at the market rent they would pay for inferior properties because of the property tax/management fee adjustment, or (b) a slightly lower rent than they would pay for buildings of comparable quality. In either case, the State Agencies would be treated fairly, if not favorably.

Inevitably there would be some wrangling between the Endowments/Department of Lands and the Department of Administration. The Assistant Director for Real Estate would have to be very thorough in:

- A. Analyzing the purchase of properties for the Endowments to ensure that they are not paying prices that are higher than market. If the properties are bought at higher than market prices, then the Endowment will have to get higher than market rents to justify the price they paid. This would put unrealistic expectations on the Endowment properties, and would result in lower than expected returns on Endowment investments when those premium rents cannot be obtained.

- B. Researching and documenting the market rents to demonstrate that the State Agencies (the State of Idaho) are not paying more than they have to for office and industrial space. Their proposals must be complete and conclusive to ensure that the State is being treated fairly.

The Governor would also have to take a strong position in favor of this arrangement. As Chairman of the Land Board responsible for maximizing the return on investment to the State Endowments, he would need to be committed to obtaining dependable long-term income streams on the Endowments' commercial properties at the lowest risk. This could be accomplished by leasing them to State Agencies. To accomplish that, he would have to use his authority as Chief Executive of the State of Idaho to require the State Agencies to cooperate with the Department of Lands to complete these transactions.

Another Strategy

The other strategy would be to invest in good quality, well-located commercial properties and then enter into long-term lease agreements with experienced individuals and firms for the maintenance and care of those properties. The Department of Lands and the Land Board are already comfortable with lease transactions, as they have been doing them for decades. These transactions would be distinct and unique and require some different expertise and strategies in putting them together.

Vacant commercial properties could be leased, in some cases, to competent developers who would construct buildings on them for their own portfolio. The State would not be obligated to lease space in the building or in any other way help the developers with their projects. The developers would assume all of the construction, marketing, and investment risk as they would on any other project. The difference would be that instead of buying the land, they would have a long-term, unsubordinated ground lease on the property.

This would not be a common transaction. Leases would have to be at least forty (40) years long and preferably from the developers' point of view, fifty (50) years or more. The amount paid could be adjusted to market at intervals, probably not less than every five years nor more than every ten years so that the Endowment would get the maximum (that is to say, fair market) return on their investments.

At the end of the term, the land and the buildings thereon would revert to the Endowments, and should be more valuable than they would have been if they had not been developed. The Endowments would maintain an unsubordinated lease position (with some provisions to protect lenders making long term mortgages on the properties) that would protect them in case the developer defaults for any reason.

Leases could run anywhere from five to twenty years, depending on the properties and the future uses the State have for them in the future (putting these properties back under the first strategy above). Leases would have to be carefully prepared and require certain levels of investment and maintenance on the part of the investor so the value of the properties increases over time. (Perhaps a deposit of 10% to 20% of the market value of the property should be required to make sure the investor has incentive to keep the property up.)

Similarly, in some cases office, retail, and industrial buildings owned by the Endowments could be master leased to competent investors. The Endowments would get a fixed rate of return, again adjusted over time, and the investors would assume all responsibility for maintenance, management and tenanting of the properties.

The Endowments probably would not get as high a return as they would by leasing to State Agencies in the first strategy, because the investor would be assuming all of the risk and cost for the maintenance and care of the improvements. There would have to be enough left in the deal for them to justify the work and expense involved. But the return to the Endowments should be higher than it would get on bonds, and would be significantly higher than the +/-1.5% it currently gets on Cottage Sites.

CONCLUSIONS

The State Endowment Lands actually comprise an extensive and varied Real Estate Investment Portfolio. These lands are owned by the State Endowments. They are not owned by the State of Idaho or its citizens. At this time, the returns to the Endowments and their Beneficiaries are significantly below the benchmark rates of return that can be obtained by other investments.

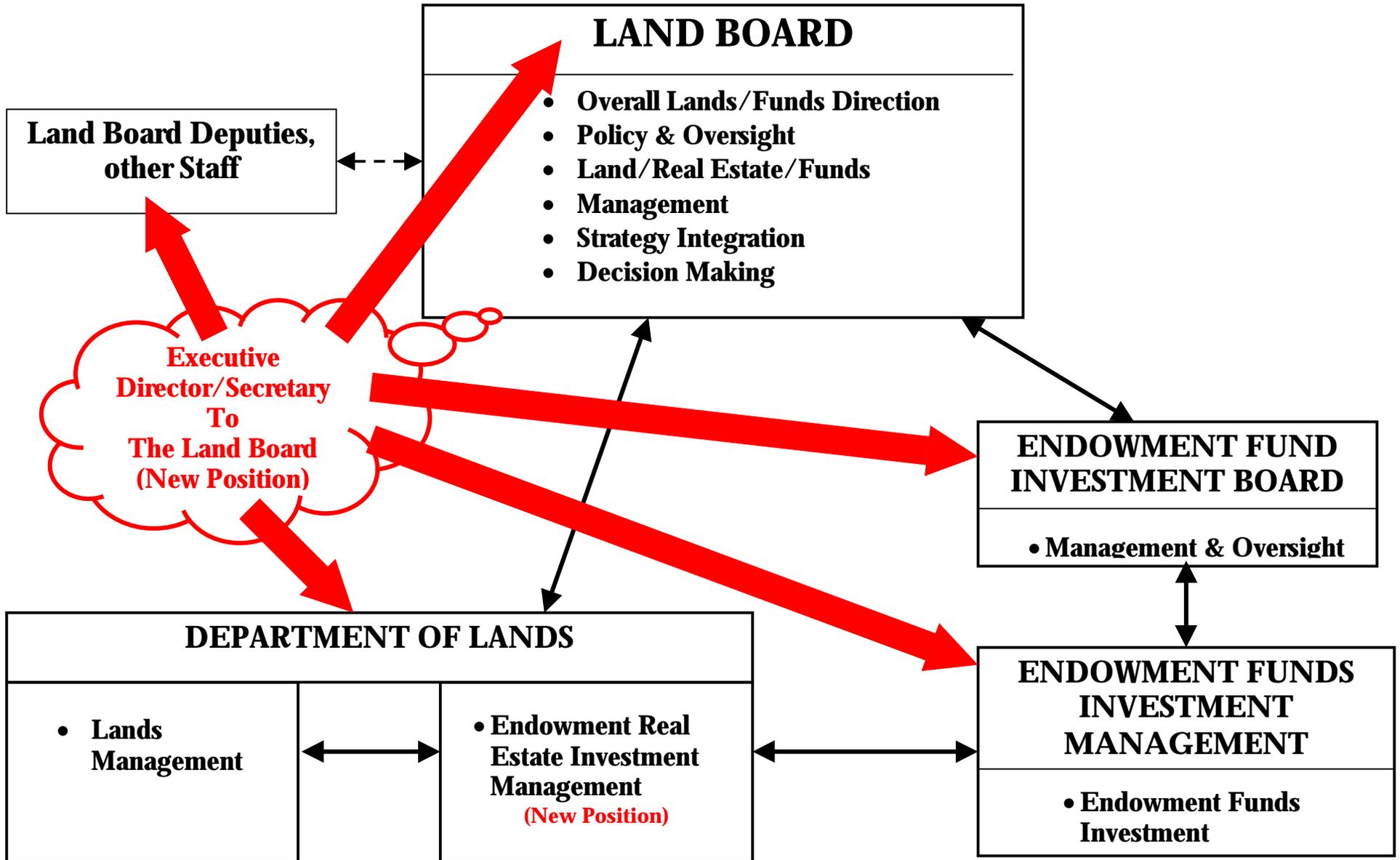
Part of this shortfall results from this shortfall results from the current mindset held by both the Land Board and the Department of Lands. They see these lands as the “crown jewels of Idaho” and should be protected and preserved for the benefit of the State and its Citizens. In actuality, the mindset needs to be shifted to see that these lands are valuable Real Estate Assets that need to be actively and intensively managed to provide the maximum possible financial return to the Endowments on a long-term basis.

While the Department of Lands has significant expertise in providing both the Asset Management and Property Management function for the Timbered Real Estate and Grassland Real Estate, they could be aided by an experience real estate manager on certain financial matters.

The Department of Lands lacks expertise in Commercial Real Estate and will create significant problems for itself and the Endowments if it continues its current course in Commercial Real Estate investment without a long term plan for keeping strong long term tenants and/or master lessees in place on those properties to provide the market rate income that the Endowments deserve.

With the proper personnel in place, and with a new vision on the mission of both the Land Board and the Department of Lands to recognize the lands they administer as financial assets of the State Endowments, the additional money that can be generated for the benefit of the schoolchildren of Idaho and the other beneficiaries of the Endowments will be significant and long-lasting.

Appendix F: Land Board Executive Director/Secretary Position Graphic



Appendix G is available as a separate download.