DORN, HELLIESEN & COTTLE INC.

INVESTMENT CONSULTING

December 15, 1996

The Honorable Philip E. Batt
Governor of Idaho
Statehouse
Boise, Idaho 83720

Dear Governor Batt:

The Governor's Committee on Endowment Fund Investment Reform has concluded its work and submits the attached report on our findings and recommendations. Full implementation of the Committee's recommendations require statutory, constitutional and federal (Admissions Act) changes. Deputy Attorney General Clive Strong is drafting recommended legislation which should be considered as part of this report.

The critical recommendation of the Committee is that the real properties in the Land Trust, the financial assets in the Endowment Fund, and the cash flow from both be managed as a single portfolio under the supervision of a single body guided by a "strategic" plan for the management of the assets.

Subjects for consideration in a strategic plan would include asset allocation, policy for distribution to beneficiaries, and monitoring procedures. At your pleasure, members of the Committee will be available to assist in preparing strategic plan recommendations for consideration, if desired.

Concurrent with, and in concert with the development of a strategic plan, a "tactical" plan should be developed for each asset type, (i.e., timber, cottage sites, financial assets, etc.) This tactical plan should include target rates of return for the asset, a method and timetable for achieving such a return, or a plan for disposition of the asset if it is deemed that the asset should be liquidated and the proceeds reinvested.

Many of the Committee's recommendations appear to be implementable without legislative change, as they are a matter of policy rather than law. These changes are discussed beginning on page 14 of the report. The most significant is the

redirection of cash flows and the creation of the "Land Trust Earnings Reserve" to serve as a buffer which allows for the smoothing of distributions to the beneficiaries.

On behalf of the members of the Committee, I want to thank you for giving us this very rewarding opportunity for public service. And, we are prepared to continue to serve as resources to assist in the implementation of any of the recommendations we have submitted. If you need additional information, I may be reached locally at 344-9200.

Respectfully submitted,

THE GOVERNOR'S COMMITTEE ON ENDOWMENT FUND INVESTMENT REFORM

Douglas Dorn, Chairman
Rep. William Deal
Robert L. Montgomery
Dr. Thomas Stitzel
Robert Maynard

Ex Officio
J.D. Williams
Michael Brassey
Clive Strong
Michael Ferguson

REPORT AND RECOMMENDATIONS OF THE GOVERNOR'S COMMITTEE ON ENDOWMENT FUND INVESTMENT REFORM

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SUMMARY OF FINDINGS AND RECOMMENDATIONS

The Committee has identified a number of necessary changes to the management of the state's endowment. The state needs to shift its current policy from management of individual parts (the land trust separately from the financial assets) to management of the entire endowment. The entire integrated endowment needs to have its rules of overall operation clarified, reorganized, and reoriented towards providing a predictable and increasing stream of revenue to the beneficiaries while at least maintaining the purchasing power of the assets of the endowment. The endowment also needs to specifically set out its goals and investment policies, including the rules for setting the distribution and level of benefits to both the current beneficiaries and those of future generations.

As currently constituted with two separate parts – the land trust and the financial trust -- the endowment:

1) is not focused on the performance of the endowment as a whole;

2) is not structured so that the interests of the beneficiaries can be met in an efficient and predictable manner;

3) contains a number of underperforming assets that, because of a lack of overall focus, are not clearly identified or addressed;

4) because of a sole concentration on individual components of the trust, has investment policies for the financial assets that lead to a noticeable underperformance;

5) is concentrated in too few types of assets and, as a result, has a substantially riskier posture than is necessary;

6) both because of that underdiversification and because of the current rules for distributing cash flows, carries a significant and unnecessary risk of substantial uncertainty in the stability and the amount of future distributions to the beneficiaries; and

7) leaves to tradition what should otherwise be an ongoing policy decision concerning the division of the benefits of the trust between present and future generations.

Generally, the Committee recommends that actions be taken in the following three areas;

1) overhaul the management of and rules of operation for the endowment as a whole;

2) enhance the ability to prudently invest the financial assets of the endowment to allow greater safety through diversification and, if desired, achieve higher returns; and

3) implement a mechanism for identifying and addressing underperforming assets.

Specifically, the Committee makes the following recommendations:

1. **The currently separate parts of the endowment – the land trust and the financial trust – should be organized, invested, administered, and managed as a whole.** This requires at least two types of reorganization:

    a. **A governing body must be created or identified to oversee all of the assets of the endowment, set its goals, and monitor its progress in achieving those goals.** The management of the endowment should be concentrated on the endowment as a whole, and not on its individual components in isolation. This will require some governing body. This governing body can either be an existing entity, a new entity, or a joint committee of existing institutions. Whatever its form, however, this entity must: (1) be focused on the overall goals and performance of all of the assets of the endowment; (2) set the policies and rules for the distribution and management of the endowment assets; and (3) be able to identify underperforming assets in light of the goals of the overall endowment (namely, providing a stable and increasing stream of revenue to the beneficiaries while preserving the purchasing power of the assets of the trust). As part of this coordinated approach, the governing body should:

(i) develop investment policy statements that set out, at least, the long term goals of the plan, the principles and rules for distributing the benefits of the endowment between current and future generations, the specific return and risk objectives of the plan (including the strategic asset allocation), policies for each of the asset types that will be used to accomplish that goal (including the objective of that asset type, the allowable investments, the benchmarks to judge success or failure, etc.), the rules and procedures for distributing the cash flows of the endowment, and the investment structure of the trust; and

(ii) review the asset allocation of the entire trust on a regular basis. This would include reassessing the near and long-term needs of the beneficiaries, reviewing the expected performance of the current mix of assets, and making adjustments to that allocation (particularly among the financial assets) if necessary.

b. **The trust should be invested and administered as a whole, with the rules for distributing annual cash flows altered to treat the endowment as a unit and (1) to provide a means for stabilizing cash flows by reserving excess cash flow in good years and supplementing distributions in poor years; and (2) to provide a mechanism for expressly addressing the division of benefits between present and future generations.** Except for actual sales of land, which should continue to be added to the principal of the financial trust, all cash flows should be treated in a combined and coordinated manner so as to provide for a smooth, predictable, and increasing distribution to the beneficiaries over time. In particular, two rules need to be adopted:

(1) that *revenue from renewable resources such as timber sales be made available for distribution as well as for additions to the balance of the endowment fund*; and

(2) that *not all cash generated in every year must be distributed, and instead can be "reserved" in good years in anticipation of less advantageous times.*

In particular, the endowment should use the cash flows from the timber sales in a manner that creates a "shock absorber" between the volatility of the stream of revenues from the land trust (and its overwhelming dependence on timber) ***and the endowment fund*** (and its primary dependence on the fixed income market)***, on the one hand, and the level of annual distributions to the beneficiaries, on the other.*** The cash flow from the timber sales are larger than all other cash flows from non-timber sources combined, and could easily serve as the means to provide stability in distributions for the next several decades.

Currently, the land trust, for reasons of past practice and not constitutional or statutory law, sends all of this cash to the endowment fund. **The Committee recommends that, instead, the endowment first use this cash flow to guarantee a smooth and increasing cash flow to the beneficiaries according to some determined rule** (such as increasing the distribution at the rate of inflation plus 2%), **with any amounts left over either used to increase the endowment fund, or be reserved for potential poor investment or timber years in the future, or both.**

This approach would also provide an express mechanism (by the adoption of a spending rule) for addressing the intergenerational distribution of the benefits of the trust between current beneficiaries (through annual cash distributions) and future generations of beneficiaries (through using part of the current return to add to the balance of the endowment). This division of benefits is currently left to a tradition in handling cash flows for purposes now forgotten, and recently has resulted in the endowment fund growing at a rate substantially greater than the cash flows to the beneficiaries. While this may be the desired policy, it has not been directly addressed by policy makers.

2. **The endowment board's investment authority and policies should be changed to eliminate the artificial restrictions which have led both to underperformance and to a portfolio structure that exposes**

the endowment to unnecessary risk. In this regard, the committee recommends that:

a. a general "prudent expert" rule replace the legal list currently in the statutes (subject only to any constitutional or Admissions Act restrictions);

b. the portfolio be diversified to include other instruments, thereby to reducing the risk (or volatility) of annual returns to the financial assets. Here, the Committee recommends that, as a minimum necessary first step, the endowment expand its investments in equity-linked debt beyond convertibles; and

c. if the "shock absorber" structure set out above is put in place, then the committee recommends two additional actions:

   i. the elimination of current endowment board investment policies that require certain increasing cash returns in each and every year from the financial assets alone, since such policies have reduced returns by around .5% to 1% a year ($3 to $6 million annually) from what they would otherwise have been; and

   ii. the endowment consider actions to increase returns to the financial assets to the extent prudent and to the extent that the generation of predictable and increasing distributions to the beneficiaries is not put in any jeopardy.

3. **The endowment managers must develop a formal reporting mechanism designed to identify underperforming assets, develop plans either to improve the returns from those assets or to dispose of those assets, and develop a means for implementing those plans.** Specifically, the endowment managers must address:

   a. The development of a monitoring system for tracking performance of the trust as a whole and identifying underperforming assets. In this regard, a high priority should be given to developing a regular evaluation of general current market values of lands in the land trust;

b. Setting performance standards for each type of asset in the trust, such as expecting an overall rate of return of at least 10% for each asset in the land trust and, for those lands which are not expected to increase in value at a rate greater than inflation, achieving an annual cash yield of at least 6% of current market values;

c. Developing plans for addressing underperforming assets – such as the enhancement of the current underperforming assets of the cottage sites and the crop and grazelands. In particular, the Committee believes that the cottage sites are underperforming assets that have very little potential for improvement in returns and require too much management time and attention. The Committee recommends that the endowment develop a plan for disposing of the cottage sites and replacing those assets with either land or financial assets that can generate a competitive, market rate of return to the endowment.

d. Developing means for implementing either the improvement of current yields from underperforming assets, or trading or disposing of those assets in favor or other, better performing assets. In this regard, the Committee recommends that a "Land Bank" be authorized in order to provide flexibility so that, for example, the proceeds of any lands sold are not automatically added to the principal of the endowment fund, but instead can be reinvested in other land with greater return or yield potential.

The Committee believes that if the above recommendations are implemented, they will:

1. Increase the annual cash flows to the public schools and other beneficiaries of the trust;

2. Eliminate (for all practical purposes) the risk of fluctuations in the annual cash flows to the public schools and other beneficiaries of the trust;

3. Increase the rate of return to the financial assets while decreasing risk;

4. Allow policymakers to directly address the division of benefits of the endowment between current beneficiaries and future generations.

5. Provide a means for identifying and improving or replacing underperforming assets in the endowment.

6. Provide a means for further increasing returns to the endowment and distributions to the beneficiaries without jeopardizing the safety of the assets or the stability of the distributions.

SPECIFIC RECOMMENDATIONS ON ORGANIZATIONAL STRUCTURE AND DISTRIBUTION OF CASH FLOW

While there are many potential organizations and distribution rules that could accomplish the preceding goals, the Committee felt that it would be useful to suggest specific organizations and structures. First, a specific structure could be used as a starting (or final) point for proposed legislation or changes in policy. Second, a specific structure would illustrate the principles set out in the preceding recommendations.

This sections sets out two separate specific recommendations. One is the recommended structure and distribution rules that would apply if the constitution and current statutes are changed. A second recommended structure sets out changes that could be made under current law, without any statutory or constitutional change.

Proposed Structure With Changes in Constitution and Statute

Distribution of Cash Flow

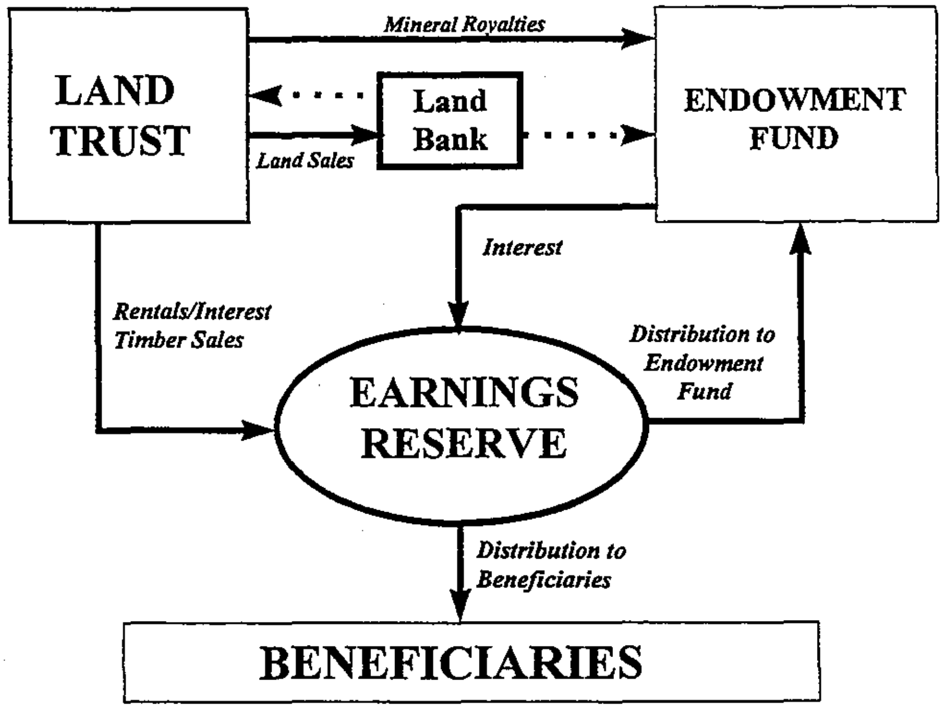
The Committee proposes the following structure to:

1. Consolidate all annual cash flow into one place (here a fund called the "earnings reserve");

2. Provide a place to retain excess cash flow in good years (again, in the "earnings reserve"); and

3. Provide for a "bank" to temporarily hold funds from land sales for purchase of more productive or more easily managed lands.

STATE ENDOWMENT CASH FLOW STRUCTURE WITH CONSTITUTIONAL AND STATUTORY CHANGES



Under this structure, all cash flow except for proceeds from the sale of land or non-renewable resources are deposited into an "earnings reserve" fund. The proceeds from the sale of land would go into a "land bank" where they could be used to purchase other land to replenish the land trust. If other land is not available within a reasonable time, then the money could be deposited into the endowment.

Under this structure, policymakers can directly decide on the appropriate short and long-term split of assets between present beneficiaries and future generations by the rules adopted for distributions out of the earnings reserve. And, the appropriate policymakers can determine how much should be kept in the earnings reserve for future poor years to assure a predictable stream of rising income to the beneficiaries.

For example, a long-term policy that would provide equality between the present and the future generations could be to distribute the cash flow according to the following rules:

1. Inflation-proof the distribution to the beneficiaries by increasing the previous year's distribution by the amount of last year's inflation;

2. Inflation-proof the endowment by adding back to the balance of the endowment an amount equal to the inflation rate times the balance of the endowment;

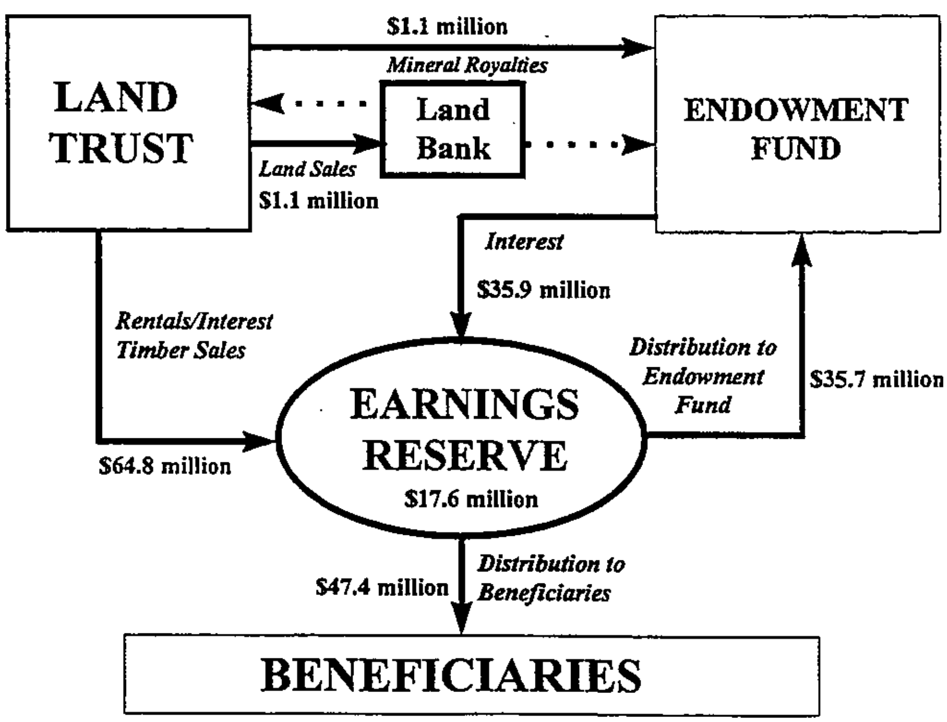
3. Increase the amount distributed to the beneficiaries by some "real" (over and above inflation) amount;

4. Increase the balance of the endowment by a proportionately equal real amount.

5. Keep any remaining amount in the earnings reserve as a cushion for potential future poor years.

Under these rules, and using "inflation plus 4%" as the spending rule for increasing the distributions to the beneficiaries and also for increasing the size of the endowment, fiscal year's 1996 cash flow would have been as follows:

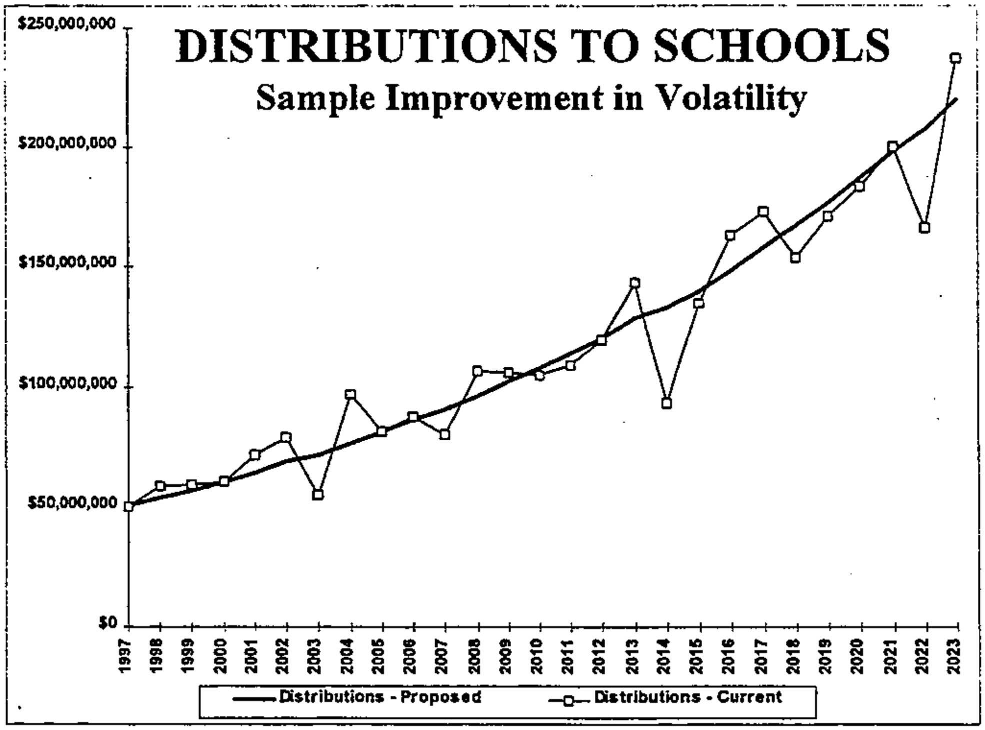
EXAMPLE OF CASH FLOWS UNDER PROPOSED STRUCTURE FY1996



The $47.4 million was the amount actually distributed in FY 1996 to the beneficiaries. $17.6 million was left over in the earnings reserve after equally increasing the distributions to the current beneficiaries (the present generation) and to the endowment balance (future generations). This $17.6 million could then either be retained in anticipation of future poor times, or distributed in similar proportions between the endowment fund and the beneficiaries (such as by raising the distribution to inflation plus 6% or some other formula). Further, the "Land Bank" would have $1.1 million that could be used for the purchase of additional land for the land trust, rather than having that amount automatically deposited into the endowment fund.

Thus the earnings reserve serves both as a "shock absorber", as a means for policy makers to directly address the equitable distribution of the benefits of the endowment between current and future beneficiaries, and as a means of directly tying the level of the distribution and growth of assets with overall investment policy. The pattern of distributions to beneficiaries can be smoothed because of the relatively large dollar amount of timber sales that annually become available for potential distribution, and by the amounts retained in the earnings reserve to "cushion" swings in market returns.

Compared to the current structure, and assuming no difference in investment policy, the proposed structure eliminates all of the volatility in distributions to the beneficiaries over time:



[Assumptions: Inflation at 3.75% with a standard deviation of 1% (in sample, ranged between 1.7% and 6%); Timber price increases at inflation plus 1.5%, with the actual receipts based on a four year price average, and harvest based on DOL projections; non-timberlands yield 0.9%; endowment yield under current law at interest rate of inflation plus 3%, changes in endowment corpus value under current law assume a modified duration of 5, spending rule under proposed rules at inflation plus 2%].

The above chart compares the distributions under the current structure and the distribution pattern under the proposed structure (in order to equalize the total distributions over time, a spending rule of inflation plus 2% was used for the proposed structure, since this approximates the amount that will be paid out over time if no changes are made). Under all reasonable and most unreasonable assumptions about the behavior of the capital and timber markets, the stability of an increasing cash flow to the beneficiaries of at least inflation plus 2% could be assured.

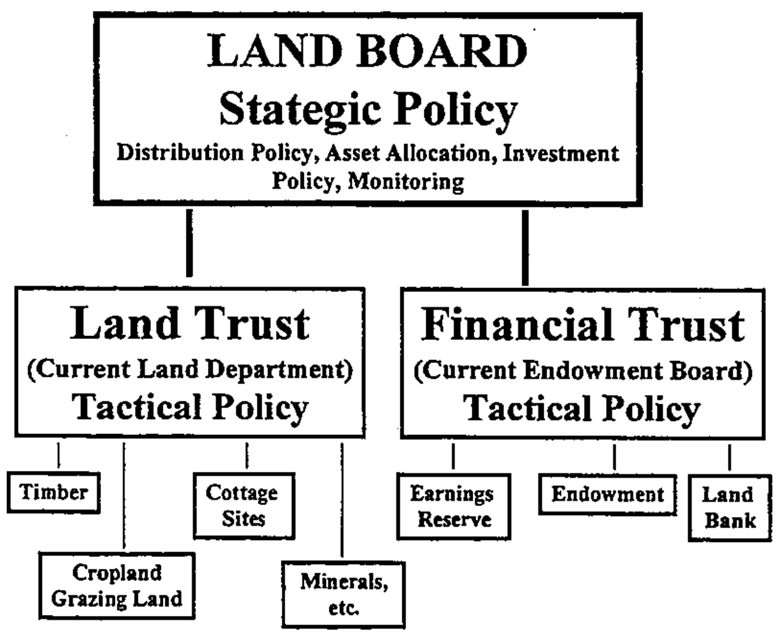
Therefore, the proposed structure would assure the beneficiaries of a smooth, predictable, and increasing cash flow to the beneficiaries, while directly addressing the equitable distribution of assets between current and future beneficiaries.

Organization

The Committee believes that the elected constitutional officers comprising the current Land Board are the most appropriate body for addressing the central policy issues concerning the division of benefits between current and future generations and for balancing the questions of risk and return for the entire endowment. Further, the Land Trust contains the bulk of the more difficult investment issues, and the Land Board has the history and expertise to deal with those complications on the policy level. And, the division between land issues that are investment related and those are not investment related is not a clear, bright line.

Therefore, the Land Board should be ultimately in charge of overall endowment policy. There are a number of potential structures that would accomplish this purpose. One structure would simply have both the Financial Trust (the current endowment, the land bank, and the earnings reserve) under the current Endowment Board and the Land Trust under the current Department of Lands both report directly to the Land Board. This structure would look as follows:

PROPOSED ORGANIZATIONAL STRUCTURE WITH CONSTITUTIONAL AND STATUTORY CHANGES



The Land Board could decide to administer both Trusts directly, through a separate staff, through a merged department, or through some other administrative structure, as may be desired. The key concept, however, is that the Land Board be ultimately responsible for all of the endowment policies, and provide a focal point for monitoring and reporting on the behavior of the entire endowment.

The Endowment Board or its staff (for the Financial Trust) and the Department of Lands (for the Land Trust) would be responsible for developing and implementing tactical policies in accord with the strategic policies adopted by the Investment Board. For example, the Land Board could adopt a strategic asset allocation of 70% -80% fixed income and 20%-30% equity, set a target real return goal of 3.5% for the financial assets, and perhaps set ranges of allowable exposures to certain types of securities (no more than 10% non-investment grade fixed income, 5% - 10% in small capitalization equity interests, etc.). Then the Endowment Board would be responsible for the actual investment of the financial assets within those parameters. Or, the Land Board could set a policy of, within a ten year period, either selling the cottage sites or raising the yield to 5% on those sites not sold, and the Department of Land would be responsible for developing a general plan and procedures for meeting those goals, having the general plan approved by the Investment Board, and then implement the details of that plan.

The Endowment Board would be responsible for the investment of all of the financial assets of the trust, which would be the current endowment fund, amounts that may be left over in the earnings reserve, and amounts in the land bank. The Department of Lands would be responsible for the management of the land assets. Non-investment issues relating to land in the trust (such as questions of access, recreation values, environmental issues, etc.) as well as non-endowment land issues would continue to be directly heard by the Land Board itself.

The creation of a governing entity will bring a focus and a consistency to the management of the entire endowment that has heretofore been lacking. The committee believes that the above structures will address and resolve the organizational issues raised in this report.

Proposed Structure Without Changes in Current Law

The recommended distribution of cash flow and organizational structure outlined above requires some changes in statutory and constitutional law. In particular, there are four parts of current law that are an impediment to the above structure:

1. Current law prevents the creation of a "land bank" as a temporary depository for proceeds of land sales – currently they are required to be deposited immediately in the endowment fund;

2. Under current law, once funds are deposited in the endowment, the only withdrawal can be of interest, and can only be used for direct payments to the beneficiaries. Consequently, the interest earned on the endowment funds cannot be commingled with other cash generated in a single "earnings reserve account" and potentially added back to the principal of the endowment;

3. Current statutes require that all interest earned on the endowment be paid to the beneficiaries, without any reservation for future poor years; and

4. Under current statutes the endowment board is not required to follow the directions of any other body, including the Land Board.

On the other hand, a large part of the recommended structure, and most of its benefits, can be accomplished by changes in policy alone – without any constitutional or statutory change. Current law allows much greater flexibility in the treatment of all of the cash flows from the land trust, besides land sales and mineral royalties, than that allowed for moneys earned in the endowment fund. Cash receipts from timber sales, interest from timber and land sales, and rentals do not come under specific restrictions set out in constitution or statute. Instead, general trust doctrines are all that restrict the use and distribution of cash from these sources.

In particular, cash receipts from timber sales, interest from timber and land sales, and rentals from land can be either:

1. Paid to beneficiaries that year;

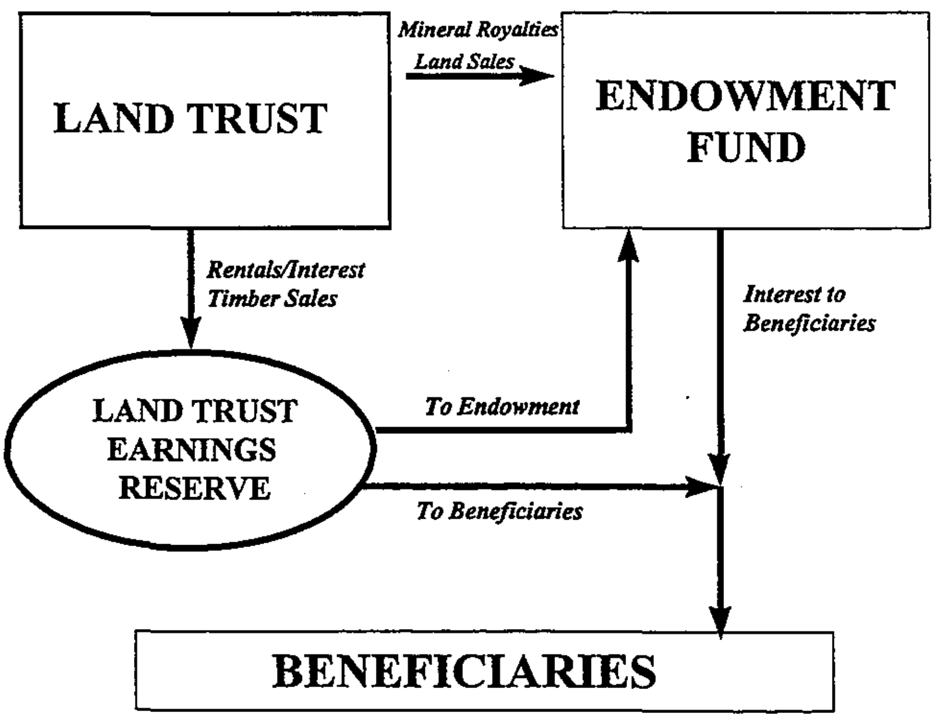
2. Added directly to endowment principal that year; or

3. Reserved for future distribution to either beneficiaries or the endowment fund.

Therefore, a "Land Trust Earnings Reserve" can be set up from the free cash generated from the land trust. Since this cash represents almost two-thirds of the cash generated by the endowment as a whole (in FY 1996, $64.8 million of the $100.8 million in total), this cash flow is more than sufficient to provide all of the "shock absorber" or buffering features needed. The annual cash flow from the timber sales and interest alone will be sufficient to assure a smooth, predictable, and increasing distribution to the beneficiaries for years to come.

This distribution scheme would look as follows:

**PROPOSED CASH FLOW STRUCTURE
WITHOUT CONSTITUTIONAL OR STATUTORY CHANGES**

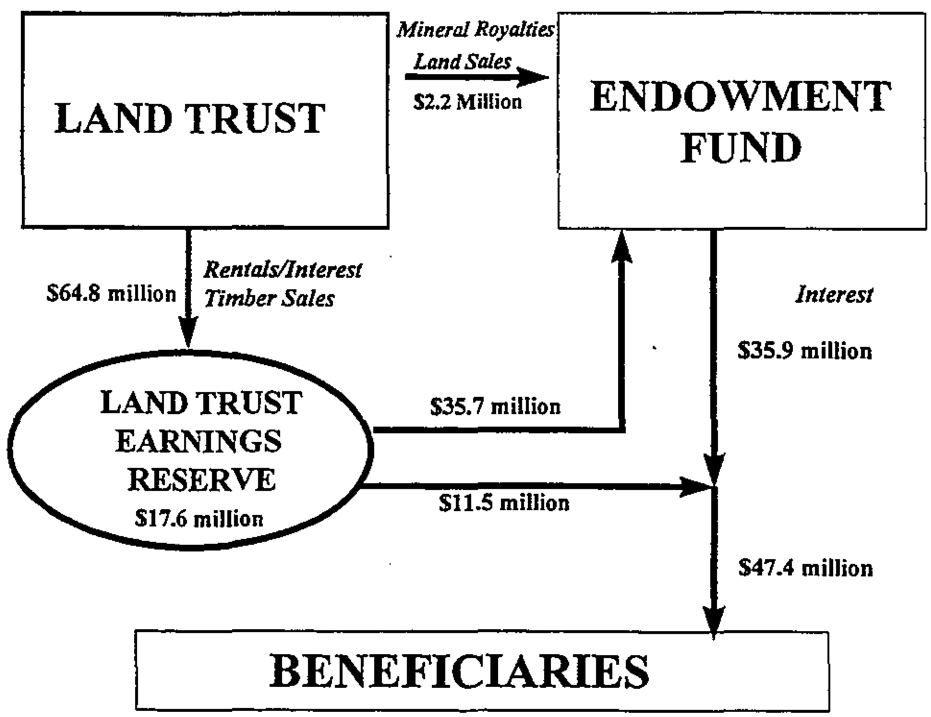


The changes in the cash flow stream from that proposed previously are the elimination of the Land Bank and the retention of the current direct distribution of income from the endowment fund to the beneficiaries. The earnings reserve is now a "land trust earnings reserve," composed only of cash generated from the land trust, and it is that amount which is used to even out the distributions to the endowment and the beneficiaries.

The only change in procedure would be for the Land Board to determine the amount distributed to the beneficiaries ***after*** receiving the projections from the endowment fund. In other words, the Land Board would still set an overall distribution rule, and would send enough cash from the land trust earnings reserve that, in combination with the expected distribution from the endowment fund for that year, would add up to the total set by that spending rule.

Using the same assumptions on the distributions of FY1996 cashflows as were set forth in the previous section, last year's cash flows would have looked as follows:

EXAMPLE OF CASH FLOWS UNDER PROPOSED STRUCTURE WITHOUT CONSTITUTIONAL OR STATUTORY CHANGES FY1996

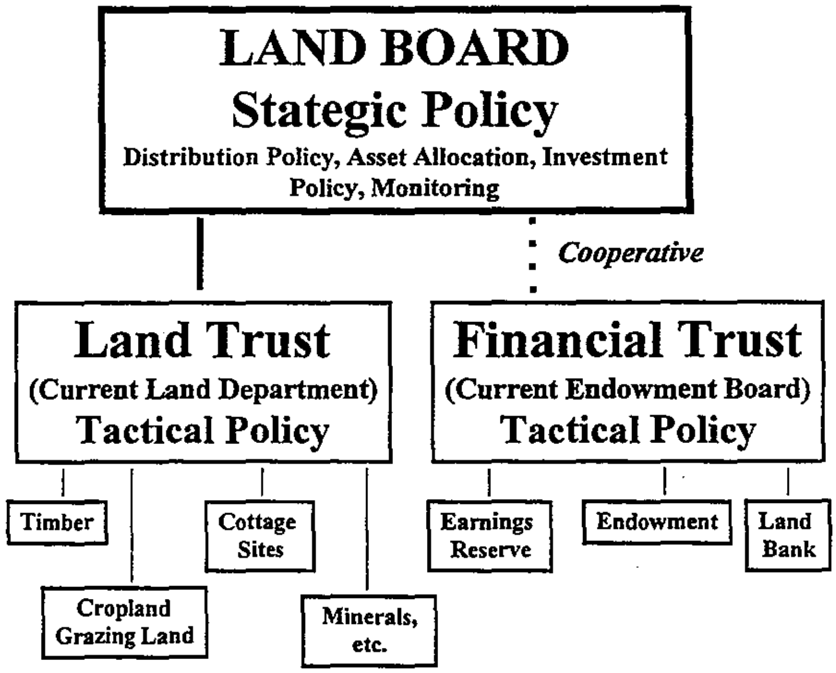


The same result occurs under the modified structure as previously occurred. Since last year's actual distribution represented an increase of inflation plus 4%, the Land Board would have received the projection of a $35.9 million distribution from the endowment fund, and determined that $11.5 million was needed to meet that spending rule. The Land Board would then send an equal percentage gain to the endowment fund to preserve equity between current and future generations. And, after treating the endowment fund (future generations) and the beneficiaries (present generation) equally, there would have been $17.6 million left over that could either be distributed equitably, or reserved for future use.

The organizational structure would have to be modified to allow for a cooperative relationship between the Land Board and the Endowment Board. The Committee believes that the Land Board could still develop overall strategic policy, but the Endowment Board could not be required to follow the investment policies set by the Investment Board. Compliance with the investment policies of the Investment Board by the Endowment Board would be cooperative rather than legally required.

The organizational structure, then, would be identical to that set out previously, with only a change in the nature of the relationship (cooperative rather than legally required) between the Land Board or the Investment Board and the Endowment Board:

PROPOSED ORGANIZATIONAL STRUCTURE WITHOUT CONSTITUTIONAL OR STATUTORY CHANGES



And, the management of the land trust earnings reserve and the land bank would have to be expressly delegated to the endowment board or be the subject of a management contract.

The Committee believes that these changes without statutory or constitutional change would accomplish over 80% of the ideal structure set out earlier. This is particularly the case over the next number of years, when the amount of the cash from timber sales will continue to dominate all other cash inflows and outflows from the entire endowment. Flexibility in the treatment of the cash generated by timber sales and the interest on timber sales alone can, over the near term, single-handedly assure a predictable and increasing distribution to the beneficiaries under any reasonable spending rules.

DISCUSSION

Overview of Current Endowment

The current structure and practices of the endowment as a whole reflect momentum from the past rather than a focus on the present. The endowment is split into two separate organizations and holdings: the land trust administered by the Land Board, and the financial assets administered by the Endowment Board. There is currently little coordination between these two entities. Further, each part of the trust is concentrated in a particular type of asset: the land trust is dominated by timber, and the financial assets are dominated by traditional, high grade U.S. fixed income. This structure and investment posture is not conducive to achieving the long-term goals of the endowment.

The Committee believes that the goal of the endowment is the long-term preservation of the purchasing power of the assets while providing a steady stream of increasing income to the public schools and other beneficiaries. The Committee also believes that this was the underlying purpose of the original grant, although the concept of maintaining purchasing power as an essential ingredient of preserving principal did not arise until the phenomenon of consistent and rising inflation appeared in the second half of the twentieth century.

With this as the goal, the endowment – if it were initially set up today – would be managed as a whole, and would be dominated by a diversified mix of equity assets, with smaller proportions of fixed income and real estate to provide diversification. This is the almost overwhelming practice and posture of all modern endowments with similar objectives as the state endowment. But the current mix is exactly the opposite – an endowment exclusively invested in raw land (timbered and otherwise) and traditional fixed income, with a total exclusion of stocks and diversified equity interests. The roots of this structure, and the primary reasons for its presence, are almost certainly historical.

The school trust was set up in the late 1800s, and the granting language uses investment concepts and language from the economic and investment environment that was dominant at the time of the original grant.

The notions that inflation would become a central concern of investment policy, and that the preservation of purchasing power would become intimately tied to the concept of preservation of principal, were notions that did not occur to the framers, since those concepts did not come to the forefront until the last three decades.

Further, a well-developed, extensive, regulated, and liquid equity market was also not a feature of the investment landscape until the mid-twentieth century. At the time of the grant, most of the stable corporations and companies were privately held, and the liquid or traded equity markets were speculative, were a relatively small part of the investment landscape, and were generally unregulated and subject to manipulation and ruses.

As a result, the granting language of the trust, the constitution and much of the existing statutory framework, although clearly oriented toward the long-term preservation of the assets and a steady stream of income to the schools, uses the terms and concepts of the limited and prevailing investment environment of the day. At that time, the dominant means of preserving long-term wealth was land (which was also the asset held by the federal government that was available to distribute to the endowments). And, the only means of reliably providing a steady stream of income was fixed income.

But times have changed radically. What were formerly the best means of preserving principal and providing a steady stream of income have, in fact, become the worst. The fact that bonds, with their guaranteed repayment of a nominal principal amount and a fixed nominal interest would become the ***worst*** means of preserving principal and providing income during the inflationary second half of the twentieth century never entered the framers' minds. And, the idea that land ownership, with its illiquidity and development risk, would become a riskier form of preserving long-term wealth than the public share ownership of large corporations, was a development that was not foreseen.

As a result, the granting language simply assumed that the existing investment climate of the late 1800s would continue forever, and has resulted in the existing investment posture of the endowment trust: land and fixed income instruments. Again, as the overwhelming practice of all university and other unfettered endowments now show, if the trust were set up today so as to provide a long-term income stream while preserving the actual purchasing power of the principal, the preferred investment vehicles would be liquid equity investments (U.S. and international stocks), with land and fixed income only secondary holdings to provide minimum diversification.

It is this conflict between 19^{th} century assumptions and the current investment landscape that presented the central investment dilemma for this Committee. Given a goal of preserving the purchasing power of the assets and providing a reliable stream of inflation-adjusted income to the public schools, current investment practice would look askance upon a portfolio that was relied only on raw and forested land for its equity interests, and relied only on a traditional fixed income portfolio for its provision of a long-term income stream to the beneficiaries. Such a portfolio is dangerously subject to inflationary pressures and is woefully under-diversified.

And, the separate and uncoordinated management of those two portfolios only exacerbates the efficient structuring of the assets to provide the best diversification and a stable real (inflation adjusted) income stream. There is currently no management of the distributions of overall cash flow – those distributions and their size are left solely to the vagaries of the timber and fixed income markets. Further, the current structure results in investment policy and practices that are excessively short-term in orientation – to the detriment of the long-term goal of the trust to produce returns that would maintain the purchasing power of both the distributions and the assets of the trust. Combined with non-investment considerations (such as public access, recreation values, etc.) that may drive many of the policies of the land trust, these impediments to modern endowment investment practice become the primary hurdle to be addressed.

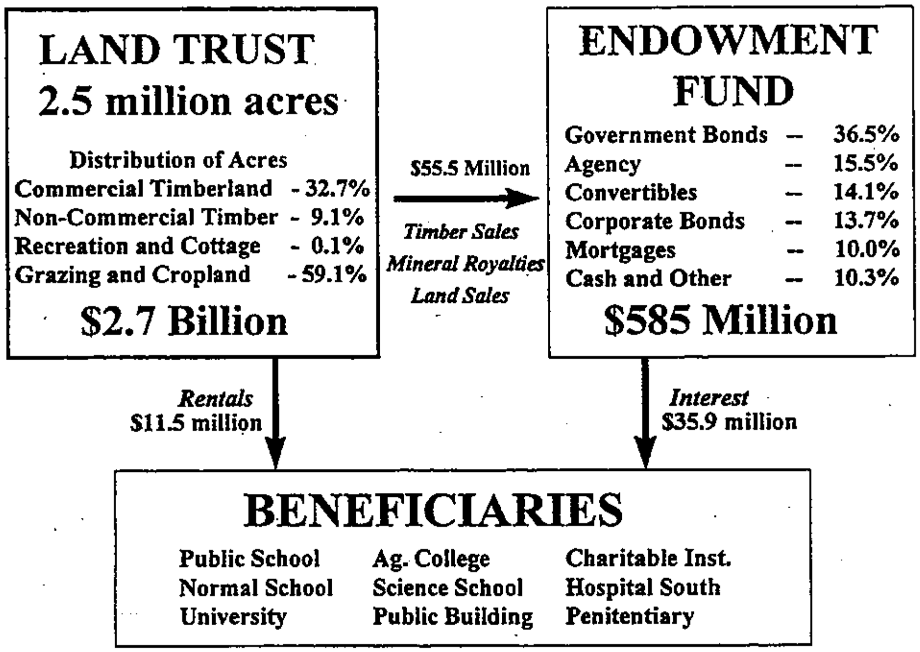
Given the constraints imposed by the Admissions Act, the constitution, and the current dominance of the timberland in the overall endowment, as well as the widespread interests that have developed in the current extensive state lands, a near-term radical change in the make-up of the overall endowment is impracticable. A redistribution of the assets to a balanced diversified portfolio in the modern sense is a goal that, as a practical matter, will require decades to fulfill.

Instead, the Committee has concentrated on the moderation or elimination of the near-term dangers that are likely to flow from an underdiversified portfolio that is overly exposed to the risks of inflation. These dangers are those of potential volatility in the income streams to the beneficiaries and material underperformance of many of the assets in the portfolio.

Consequently, this Committee's recommendations are oriented toward providing the structure and tools to the endowment that would allow policymakers the flexibility to use current investment practices to best meet the goals of the endowment in the most efficient manner in the short and long term. The structure recommended – such as the identification of a central entity to oversee the whole trust and an earnings reserve to centralize the cash flows of the trust -- provides for an organization that looks at the endowment as a whole, rather than solely in its individual parts, and allows the management of all of the cash flow from the endowment to be used in an efficient manner to smooth the distributions to the beneficiaries and preserve the purchasing power of both the distributions and the underlying assets. The tools recommended -- such as allowing the use of equity-linked assets, the ability to hold back extra earnings in good years in anticipation of poor years, and the creation of a Land Bank – allow the endowment to move its focus exclusively from the short-term, year-to year management of the assets, to a long-term orientation without jeopardizing the short term goals involved.

Current Structure of the Endowment

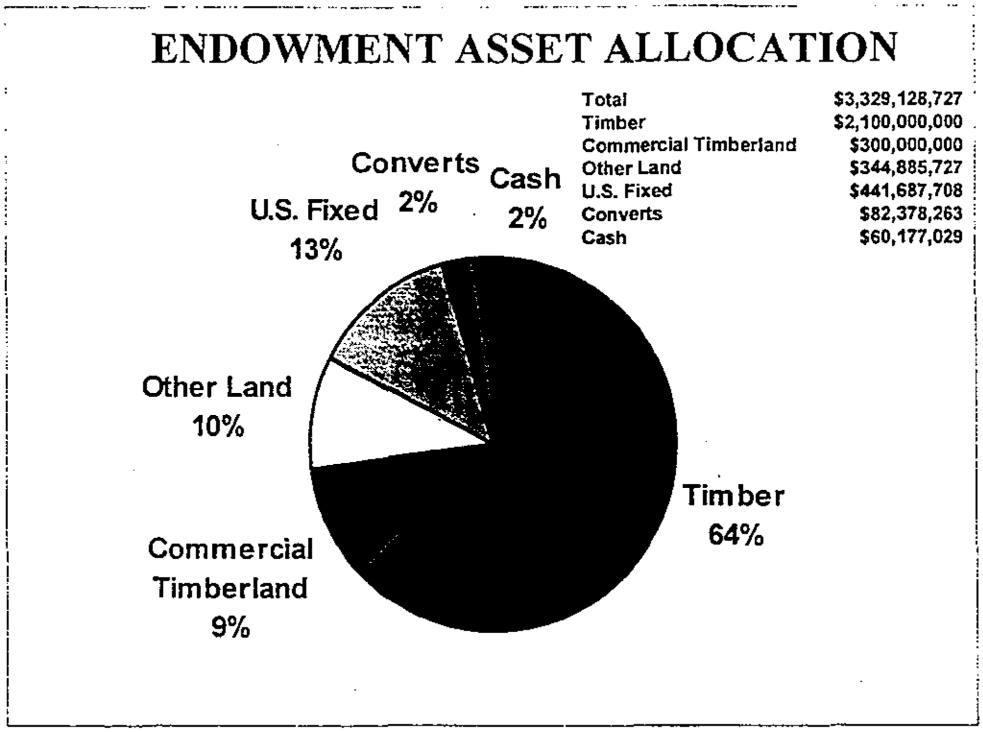
The current structure of the endowment is split into two separate and generally non-communicating bodies: the land trust, administered by the Land Board and the Department of Lands, and the financial trust, administered by Endowment Board and the staff of the Endowment Fund. The parts of the trust and the current cash flows (using FY1996 amounts) are as follows:



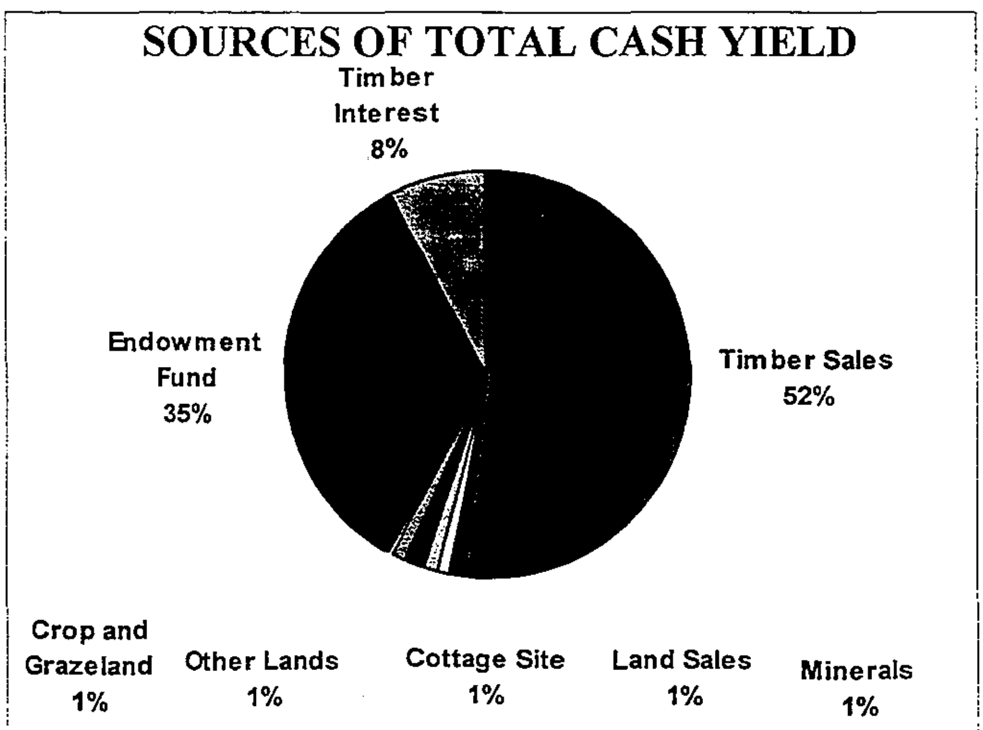
TOTAL VALUE - $3.3 Billion **TOTAL DISTRIBUTED - $47.4 Million**

This separation of the trust into uncoordinated compartments is a central problem that must be addressed. This compartmentalization jeopardizes the stable and increasing payment of income to the beneficiaries, hampers the diversification of the trust, and imposes practical restraints on the investment ability of the endowment that has led to money lost because of underperformance due to those constraints.

This separation is particularly dangerous because of the current dependence of the endowment on only two types of assets: timber and U.S. fixed income. Taking the endowment as a whole, the allocation of the market value of the overall assets is as follows:



And, the annual revenue from the endowment as a whole is also almost totally dependent on the annual returns from timber and U.S. fixed income (the primary investment of the endowment fund):

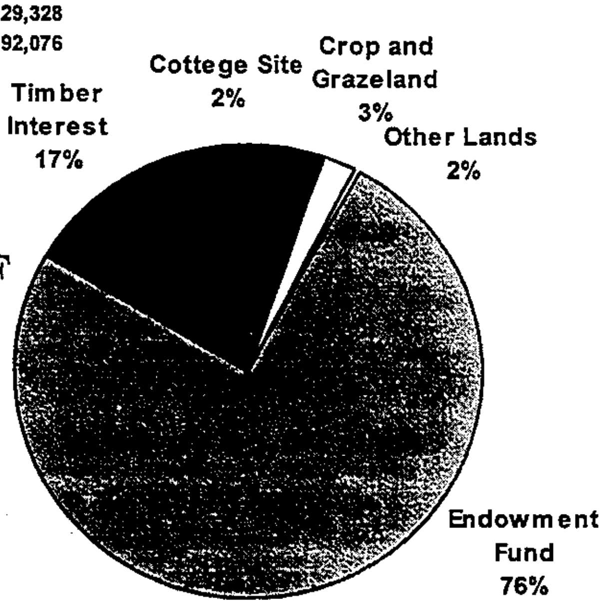


SOURCES OF TOTAL CASH YIELD

	FY 1996 Yield
Timber Sales	**$53,286,669**
Land Sales	**$1,123,232**
Minerals	**$1,107,381**
Cottege Site	**$1,186,576**
Crop and Grazeland	**$1,446,575**
Other Lands	**$1,000,412**
Endowment Fund	**$35,929,185**
Timber Interest	**$7,929,328**
Total Yield	**$103,009,358**

Since the timber sales currently go to the endowment fund, and not to the beneficiaries, the annual distribution to the beneficiaries relies on interest earned from the endowment (76%) and interest on timber sales (17%) for the vast bulk of the annual distributions:

	FY 1996 Yield
Crop and Grazeland	$1,446,575
Other Lands	$1,000,412
Endowment Fund	$35,929,185
Timber Interest	$7,929,328
Cash to Schools	$47,492,076



SOURCES OF CASH TO SCHOOLS

Under current practice, all cash from these sources is distributed each year, without any provision for reserving for future "bad years".

Organizational Structure

A crucial deficiency in the current structure is the divided and uncoordinated management of the two parts of the overall trust. Each organization – the Land Board and the Endowment Board – currently pursue policies and management of their assets with only scant reference to the other. Whatever the appropriate policies for the endowment as a whole, it is essential that some means be devised by which any desired policy can be developed, implemented, monitored, and, as is always the case over time, appropriately adjusted as the investment climate moves away from the circumstances that gave rise a particular original posture.

A key ingredient for investment success is maintaining the investment focus of an organization through changing times. While there are many appropriate investment postures for organizations and many successful structures, a common denominator is a structure that develops a long-term plan, monitors that plan over time, recognizes problems as they develop, and makes adjustments in particular postures so that the underlying reasons for the plan are maintained.

On the other hand, investment disasters regularly occur because of the lack of a mechanism to maintain the overall investment focus and the lack of an ability to monitor the ongoing success or failure of particular investment postures in achieving the long-term plan. In the short term these deficiencies often show up as a failure to maintain a consistent investment approach through an entire investment cycle -- where strategies are abandoned after a poor period just at the point they are about to become successful, and recently successful strategies are implemented just as they are about to become underperformers.

In the longer term, these deficiencies show up in the opposite way – in an excessive rigidity to an investment posture that does not recognize a change in the investment climate, and which pursues investments that actually work against the underlying goals that led to the original posture in the first place. The classic example of this failure was the havoc wrecked on many long-term trusts during the 1970s and early 1980s by inflation because either the trust documents or the trust management were unable to react to the high inflation and its devastation of fixed income investments. As the needs of the beneficiaries rose because of higher prices, the investments themselves not only did not keep pace with those needs, but actually were reduced in value because of the increased interest rates. The behavior of the assets chosen and kept by those trusts behaved in a manner exactly opposite to the purpose of the trust in that changed environment.

And, if there is a serious problem with the current endowment, this would be the root cause. For here a rigidity was initially introduced by the restrictive language and nature of the original grants. This rigidity has been perpetuated and enhanced by the dividing the organization and management of the endowment into the land trust and the endowment fund, without any mechanism for coordination of the two. Gradual changes over time have resulted in an investment climate that made the original investment posture of solely land and fixed income one that carries great dangers of actually working against the purpose of the original grant – to maintain the actual worth (including purchasing power) of the assets while providing a useful (again in terms of purchasing power) stream of income to the beneficiaries.

The means by which to avoid these problems in the future is a central body to perform three primary functions:

1. Establish and regularly review the long-term investment plan with an emphasis on matching the expected behavior of the assets to be chosen and the expected behavior of the needs of the beneficiaries;

2. Consistently monitor the actual behavior of the investments and the needs of the beneficiaries to assess whether that actual behavior comports with the assumptions and investment climate that led to the adoption of that particular plan; and,

3. Adopt and regularly review an investment policy for the endowment as a whole that will serve as a guide or road map to each of the respective management authorities (the Land Board and the Endowment Board) in the management of their respective assets.

Almost all pension funds, for example, perform asset allocation (or asset/liability) studies on an annual or every other year basis. These studies (1) use the latest projections of the actuaries concerning the expected cash flow needs to fund the retirement of existing retirees and current active members many years into the future; (2) project the then current expected general behavior of the various asset types in the capital markets (expected returns, expected volatility, and how those assets may move not only in relation to each other, but also in relation to the expected obligations); and then (3) fit the mixture of asset types to best meet the expected behavior of the liabilities (or needs of the beneficiaries). Such an exercise not only gives a fund a good chance of performing in the expected manner, but it also prevents the fund from wandering too far afield of its underlying purpose – to have enough cash available at appropriate times to fund the retirement obligations promised to the beneficiaries. Similarly, most endowment funds of any size regularly perform asset allocations to assure that then expected general behavior of the assets will, in all likelihood, provide the real returns needed to meet the spending goals of the endowment.

Second, most endowment and pension funds of any size have a means of monitoring and reporting of the ongoing success of the investments and investment posture in actually meeting the goals of the fund. At the very least, quarterly performance and annual performance reviews are provided that report such overall progress in a relatively easily understood manner. And, for example, pension funds regularly review the actuarial balance between the state of the assets and the state of the expected obligations to make sure that all is on track (through annual actuarial audits). Although temporary deviations from the expected long-term progress is to be expected because of the natural volatility of the markets, these reports will catch ongoing problems and, if they last for any appreciable length of time, trigger a review and, if necessary, adjustments. This aspect of centralized management of a trust will be discussed in greater detail later.

Third, all investment organizations have investment policy statements that set out, at least, the long term goals of the plan, the specific return and risk objectives of the plan (including the strategic asset allocation), policies for each of the asset types that will be used to accomplish that goal (including the objective of that asset type, the allowable investments, the benchmarks to judge success or failure, etc.), the distribution policies for the returns of the trust, and the investment structure of the trust. The creation and regular review of an investment policy assures that the managing authorities of the plan will at least occasionally focus on the overall direction of the plan, and provide a mechanism for review if changing circumstances require a change in direction.

The endowment does not have any one body to perform any of these functions on behalf of the overall trust. Without this centralized authority, any appropriate posture for the overall endowment has a high likelihood of eventually wandering into inappropriate stances or actions as either the investment climates change or the needs of the beneficiaries (the public schools and others) shift.

This governing body can either be an existing entity, a new entity, or a joint committee of existing institutions. Whatever its form, however, this entity must be focused on the overall goals and performance of all of the assets of the endowment, and must be able to identify underperforming or mis-performing assets in light of the goals of the overall endowment (providing a stable and increasing stream of revenue to the beneficiaries while preserving the purchasing power of the assets of the trust).

Compartmentalization and under-diversification of current endowment

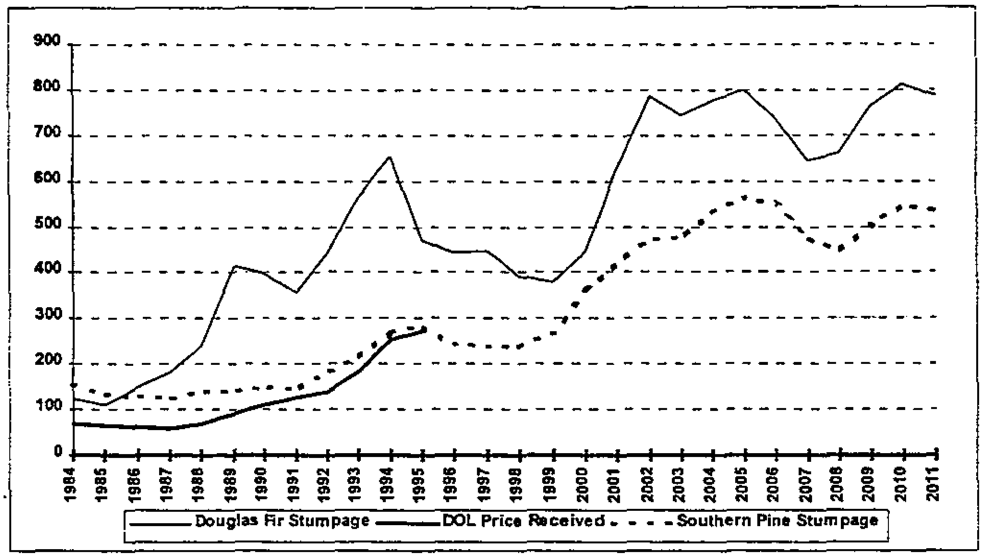
Another major danger in the current structure is the compartmentalization of the management and distribution of cash flows. Each source of cash flows (the land trust through rentals and interest on timber sales, and the financial trust through interest on fixed income instruments) has been managed separately, and thus each source of cash flows is subject to its own volatility and separate risk.

This structure exposes the overall trust to unnecessary future unstable cash flows to the beneficiaries. The interest rate on bonds has been steadily declining over time, and has grown more volatile in recent years. This one type of asset, and its behavior over time, directly impacts over three quarters of the current annual distribution to the beneficiaries. And, the behavior of timber prices, and the decisions of the timber companies to either cut timber earlier or later, directly impacts the level of interest on timber sales. If the cash yield from either or both of these two types of assets behave erratically in the future (as is arguably likely – see below), then the distribution pattern to the beneficiaries will likewise be erratic.

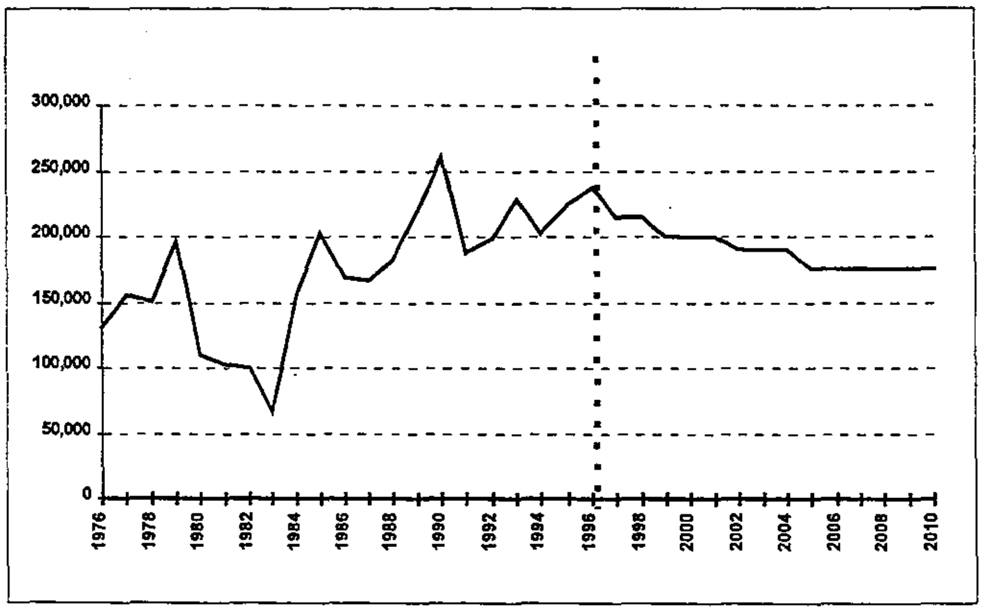
This problem has been hidden until now since the recent past has seen both a booming timber market at a time of historically high yields from the endowment's timberlands, and one of the best U.S. bond markets in history. These good times are expected to end.

First, with regard to timber, the endowment faces both declining or, at least, moderating timber prices and a reduction in the amount of the harvest.

TIMBER PRICES
ACTUAL 1984-1995 PROJECTED 1995 To 2011
Prudential Timber Investments, Inc. and Department of Lands

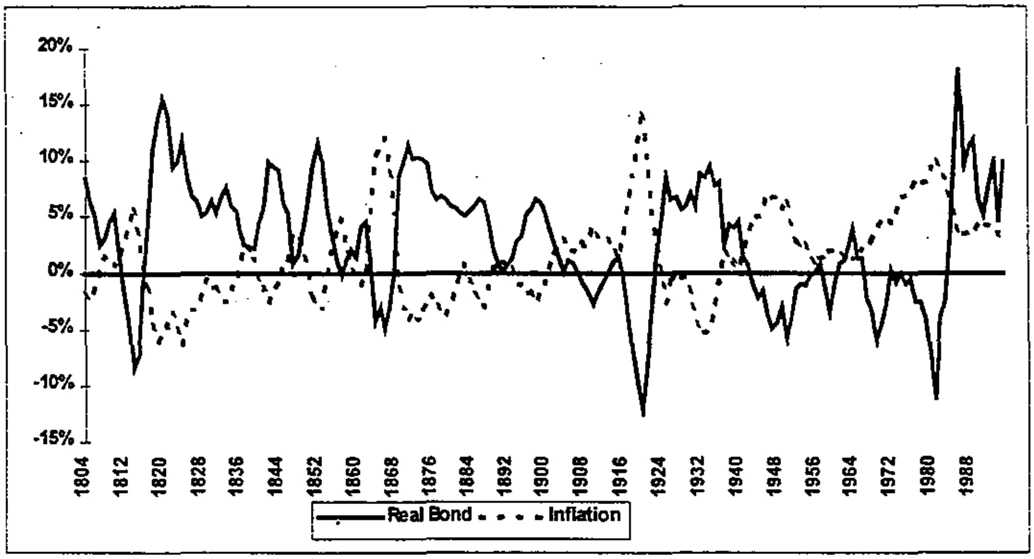


TIMBER HARVEST - ACTUAL AND PROJECTED
Thousands of Board Feet



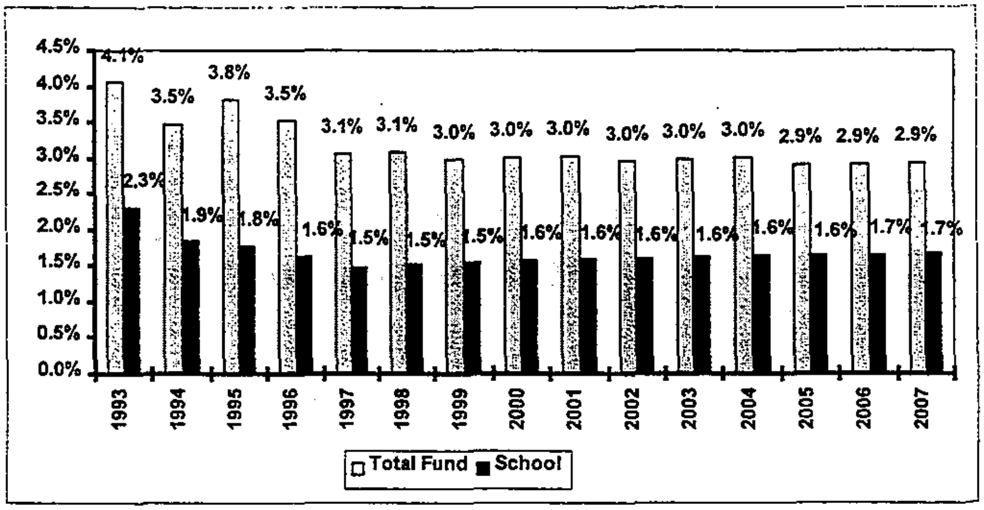
And, the historically high real (inflation adjusted) returns achieved in the bond market has been directly linked with the declining inflation over the past decade and a half, a trend that is not likely to continue:

REAL BOND RETURNS AND INFLATION
FIVE YEAR ROLLING ANNUALIZED
1804-1995



As a result, the endowment as currently constituted is likely to experience significant uncertainty in the distributions to the beneficiaries as the individual components of that distribution – timber sale interest and US fixed income returns – see a return to more "normal" markets. While the overall increase in the distributions will generally keep pace with the growth of the past, the pattern of those distributions will likely be more volatile, and the level of the distributions as a percentage of overall assets will decline:

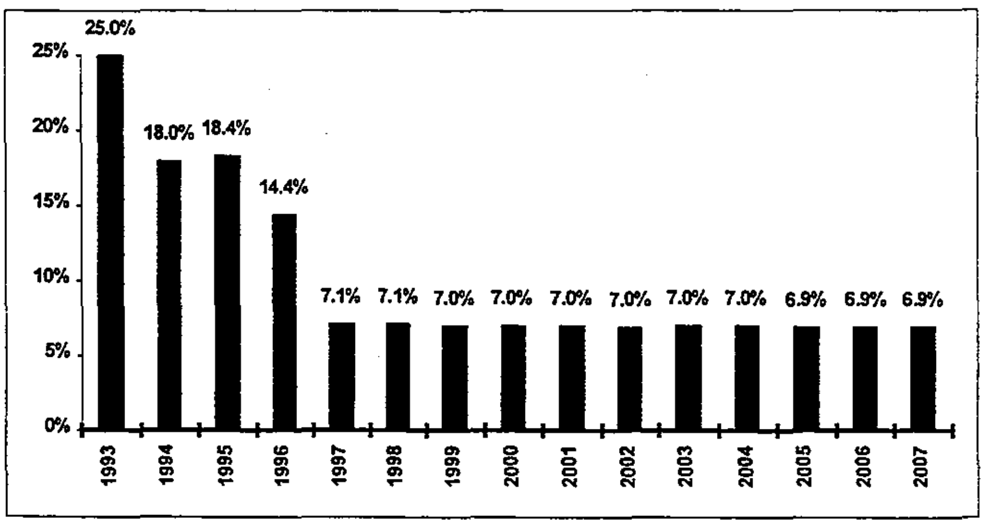
RECENT AND PROJECTED CASH YIELDS



Inflation 3.75%; Real Timber - 1.5%; Real Endowment Fund - 3%; Non-Timber Yield - 0.9%; Non-timber, non- endowment fund assets and cash flow rise by inflation

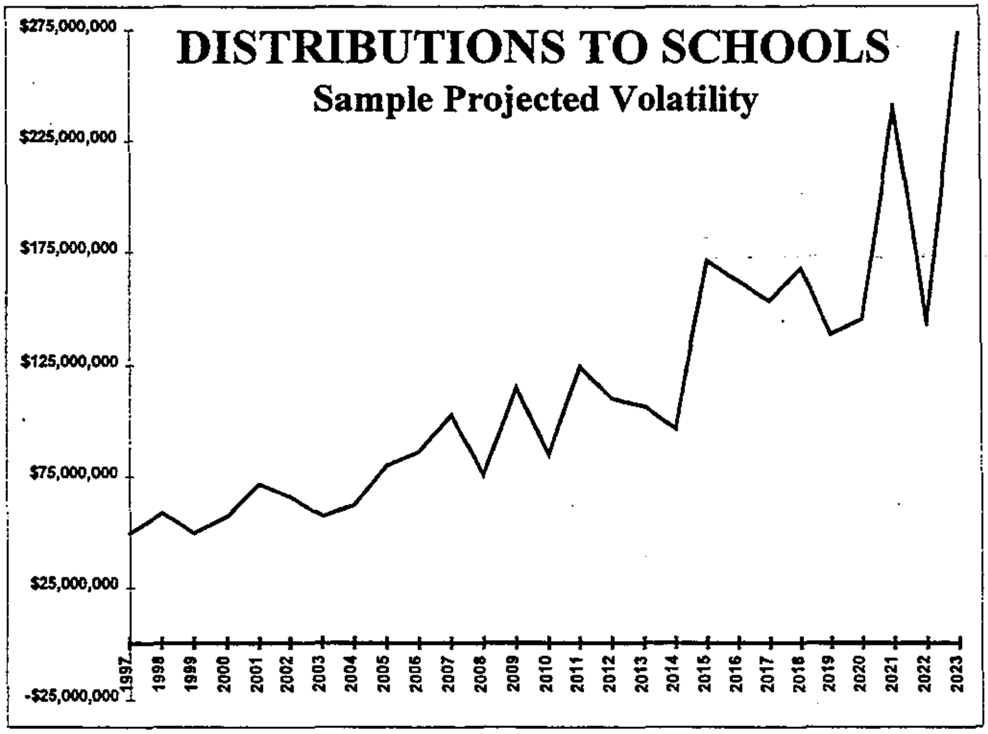
Further, the total returns to the overall endowment are likely to decrease substantially from the levels of the recent past:

RECENT AND PROJECTED TOTAL RETURNS



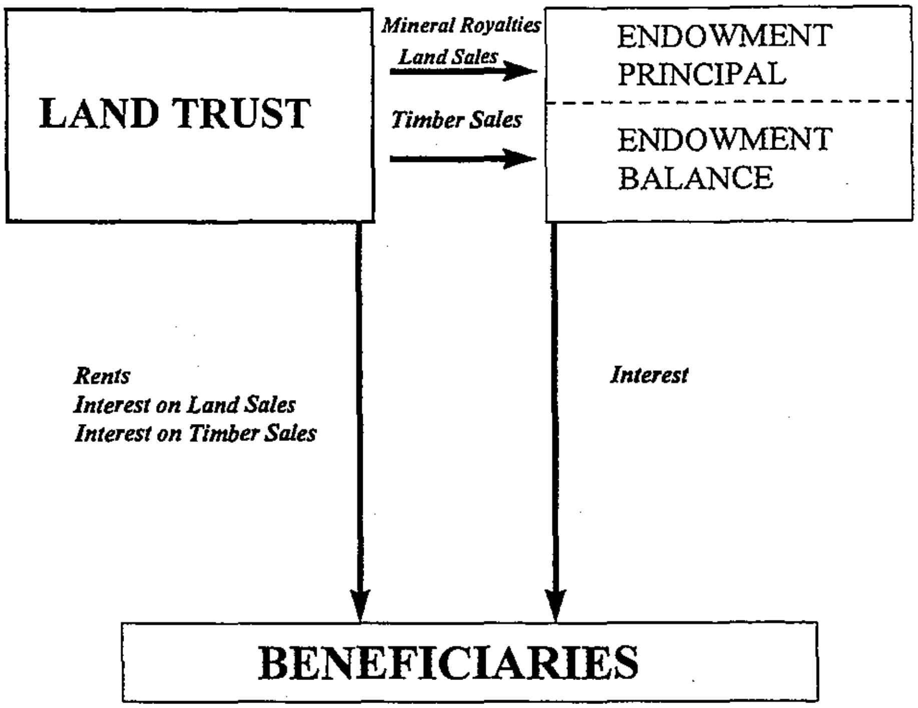
Inflation 3.75%; Real Timber - 1.5%; Real Endowment Fund - 3%; Non-Timber Yield - 0.9%; Non-timber, non- endowment fund assets and cash flow rise by inflation

The current structure and asset holdings, then, are essentially concentrated in only two types of assets whose near-term prospects are problematic, and are held in a structure than magnifies, rather than dampens, the potential volatility of the distribution to the shareholders. The return to more "normal" markets for timber and fixed income is likely to result in substantial volatility in the pattern of cash flows to the beneficiaries:



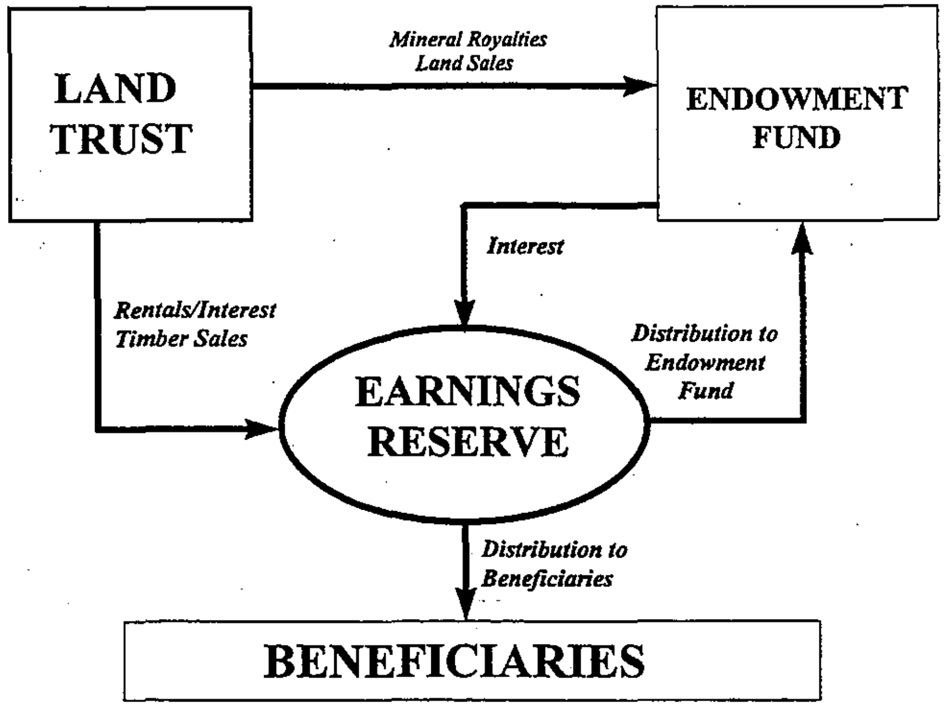
[Assumptions: Inflation at 3.75% with a standard deviation of 1% (in sample, ranged between 1.7% and 6%); Timber price increases at inflation plus 1.5%, with the actual receipts based on a four year price average, and harvest based on DOL projections; non-timberlands yield 0.9%; endowment yield, and payment to beneficiaries is equal to interest rate at inflation plus 3%, corpus value changes assume a modified duration of 5].

This volatility is unnecessary, and derives from the current rules for distributing cash flow. As currently set up, the cash flow from the various portions of the endowment mechanically go to different places, as follows:



Except for the deposit of proceeds from land sales directly into endowment principal, *all other rules for distributing land trust cash flow have grown out of practice, not constitutional or statutory law.* In particular, the major source of cash flow each year – the proceeds from timber sales – is deposited into endowment fund principal. This practice is at odds with the practices of many other states, where proceeds from the sale of renewable resources (like timber) are considered available for distribution. Because of the size of these proceeds ($53 million in FY 1996), this has resulted in the endowment fund growing at a rate greater than the distributions to the beneficiaries. This favors future generations over present generations -- an essential policy call that has been left to tradition rather than structured decisions. Further, the current practice of distributing all land trust cash flow, without reserving any for future poor years, also has grown up out of practice, rather than law.

Changing these two practices would have extensive and far-reaching benefits to the endowment. By consolidating all cash flow into one place (such as in a fund called "earnings reserve"), and by retaining any excess cash flow in good years for use in future poor years, the volatility of the distribution to the beneficiaries can be eliminated. The Committee proposes the following structure to implement these principles:



Under this structure, all cash flow except for proceeds from the sale of land or non-renewable resources are deposited into an "earnings reserve" fund. Then, policymakers can directly decide on the appropriate short and long-term split of assets between present beneficiaries and future generations. And, the appropriate policymakers can determine how much should be reserved for future poor years to assure a stable stream of rising income to the beneficiaries..

For example, a long-term policy that would provide equality between the present and the future generations could be to distribute the cash flow according to the following rules:

1. Inflation-proof the distribution to the beneficiaries by increasing the previous year's distribution by the amount of last year's inflation;

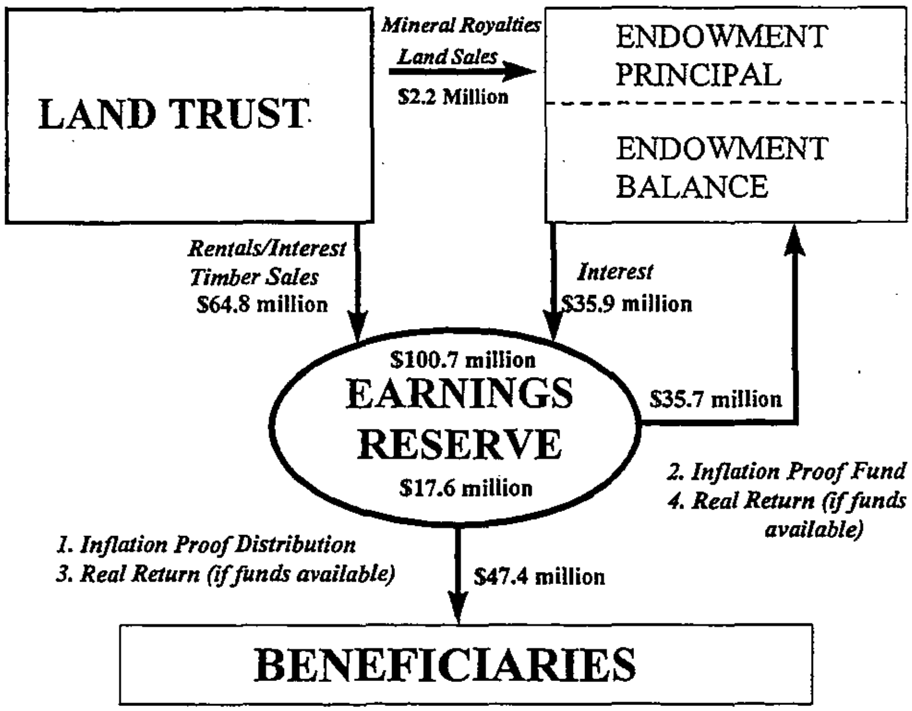
2. Inflation-proof the endowment by adding back to the balance of the endowment an amount equal to the inflation rate times the balance of the endowment;

3. Increase the amount distributed to the beneficiaries by some "real" (over and above inflation) amount;

4. Increase the balance of the endowment by an equal real amount.

5. Keep any remaining amount in the earnings reserve as a cushion for potential future poor years.

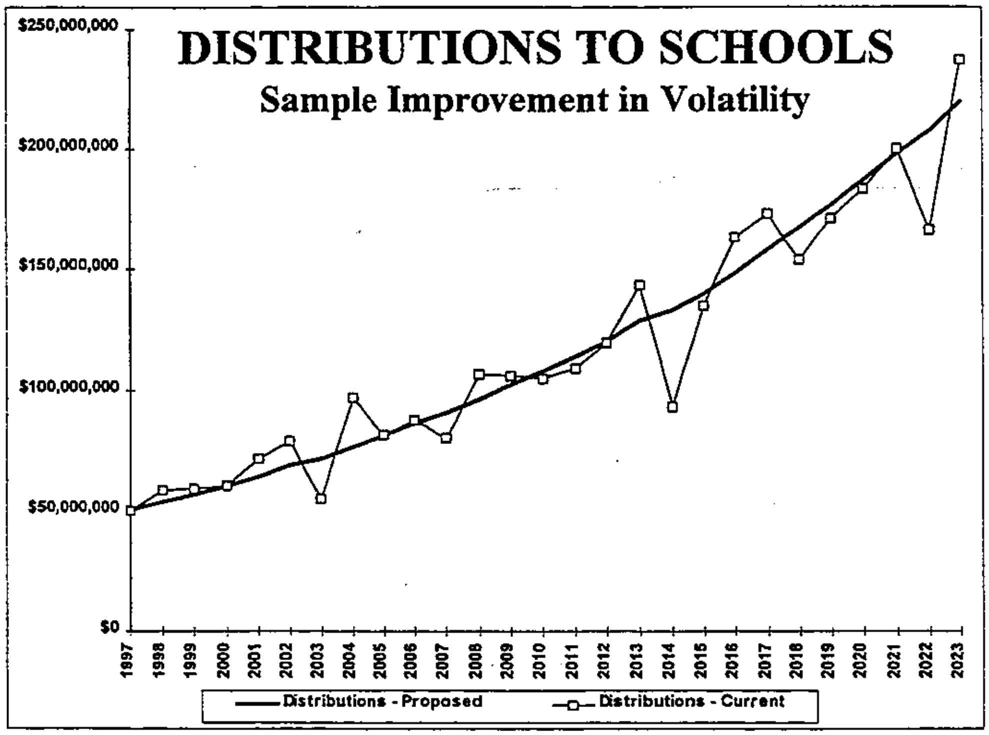
For example, if this structure were in place last year, and the decision were to split the benefits of the endowment evenly between the current beneficiaries and the future generations, then the cash flows would have been as follows (the increase from FY 1996 distributions over FY1995 was around 4% real, or inflation plus 4%):



The total amount of cash available for distribution during the year was $100.7 million. The distribution of $47.4 million to the beneficiaries during FY1996 represented an increase of inflation plus around 4% over the FY 1995 distribution (which was $44.4 million). An increase in the size of the endowment fund of inflation plus 4% would have required a $35.7 million addition to the endowment fund balance. This would have left $17.6 million in the earnings reserve to earn interest, and be added to the next year's cash flow.

Thus the earnings reserve serves both as a "shock absorber", as a means for policy makers to directly address the equitable distribution of the benefits of the endowment between current and future beneficiaries, and as a means of directly tying the level of the distribution and growth of assets with overall investment policy. The pattern of distributions to beneficiaries can be smoothed because of the relatively large dollar amount of timber sales that become available for potential distribution, and by the amounts retained in the earnings reserve to "cushion" swings in market returns.

Compared to the current structure, and assuming no difference in investment policy, the proposed structure eliminates all of the volatility in distributions to the beneficiaries over time:



The above chart compares the distributions under the current structure under the assumptions previously set forth, and the distribution pattern under the proposed structure under those same assumptions (in order to equalize the expected distribution under the current approach over time, a spending rule of inflation plus 2% was used for the proposed structure). Under all reasonable and most unreasonable assumptions about the behavior of the capital and timber markets, the stability of an increasing cash flow to the beneficiaries of at least inflation plus 2% could be practically guaranteed.

Therefore, one clear benefit of the proposed structure would be to assure the beneficiaries of a stable and increasing cash flow to the beneficiaries, while directly addressing the equitable distribution of assets between current and future beneficiaries.

Improving the investment focus of the endowment

Finally, because the endowment board concentrates only on its assets to the exclusion of the income generated from the land trust, it has adopted policies that concentrate on generating ever-increasing amounts of cash income to the beneficiaries, while also attempting to increase some of the principal in the endowment from investment returns alone.

The rules for distributing yearly cash flow result in over three-quarters of the cash to the beneficiaries coming from the endowment fund. Consequently, any volatility in interest received by the endowment fund during that year directly impacts that years' cash distributions to the schools and other beneficiaries.

The response has been for the endowment fund to play its investments "close to the chest". One such policy is to invest so that there is an ever-increasing cash flow from the investments of the endowment, and also so that there are no capital losses in a year. This leads to (1) an artificial preference for high-coupon bonds; (2) an artificial tendency to avoid discount or zero coupon bonds; (3) the purchasing of bonds that have cash payments of their interest at only certain times of the year (such as immediately before, not after, the close of a particular fiscal year); (4) a tendency not to sell some bonds when market conditions change solely because a "capital loss" may result, and other artificial practices.

These policies, for various reasons, have resulted in investment practices that prevented the endowment from achieving the market returns available for even high-grade, traditional U.S. fixed income. This underperformance costs the endowment millions of dollars annually. For example, in the past five years the endowment fund has generally underperformed both the general market and other active fixed income programs (such as PERSI's fixed income investments) by around .5% - 1% annually:

	1 Year	2 Years	3 Years	4 Year	5 Year
Endowment Fund	5.6%	7.8%	5.1%	6.8%	8.0%
PERSI Fixed Income	7.6%	9.7%	5.7%	7.4%	8.9%
Index	5.0%	8.7%	5.4%	7.0%	8.4%

This underperformance translates to around $3 - $6 million annually at current endowment fund levels. And, this underperformance has come during a period of generally declining interest rates. If interest rates rise, then these policies will likely harm the returns even more.

The practical need for the current endowment to be invested in this manner derives solely from the direct impact any volatility in annual returns have on the annual distribution to the beneficiaries. But if that direct connection is broken through the use of the "shock absorber" of the earnings reserve and the ability to use proceeds from timber sales to smooth the distributions, then the endowment fund can look to the longer-term and the best policies to position the endowment to meet future, as well as current, needs. No longer will the endowment fund feel the pressure to be responsible for smoothing the cash flows to the beneficiaries. With that smoothing being guaranteed by the timber sales and the earnings reserve, the Endowment Fund can look to investment issues solely in determining their investment practices.

Diversifying and lowering the risk of the endowment

The statutes basically limit the investments of the endowment to traditional, high grade U.S. bonds. This limitation has materially hurt the endowment fund in a number of ways.

First, by limiting the investments to only a portion of the capital markets, the statutes actually have increased the danger to the safe investment of the financial assets rather than reduced it. Second, by limiting the investment only to traditional fixed income returns, the statutes have put the assets of the trust in the most dangerous long-term investment for preserving the purchasing power of the assets and the distributions to the beneficiaries. Finally, this structure and practice, by requiring a very short term focus, gives away much higher long-term gains that would accrue to a more long-term oriented investment policy.

Need for additional diversification to reduce the level of current risk and increase returns

The current restrictions to high-grade bonds reflects a common misconception about investment management. This is that one should concentrate on the individual safety of each isolated investment or asset and, in addition, that having no "risky" investments (such as stocks, emerging markets assets, "junk bonds", etc.) is better than having some exposure to those assets.

This is false. Exposure to a wide range of asset types, including some individually risky investments, are better *for the total portfolio* than having a few individually "safe" assets. This is a central discovery of modern finance: that there are great benefits to **diversification** -- the spreading out the money among different assets so as to reduce the exposure to any particular asset or investment. The impact of diversification is that some exposure to all types of individual investments, whether considered risky individually or not, actually reduces the volatility of the overall portfolio than when those individual types of investments are excluded. Diversification works because asset values do not rise and fall at exactly the same time or at the same rate. These offsetting movements of values, when combined, dampen the "swings" of total portfolio returns, and thus provides a safer or less volatile stream of earnings to the entire portfolio.

Because this concept is usually the most counter-intuitive to non-investment professionals, and is one of the central problems of the current management of the endowment, two examples of the benefits of diversification will be given.

Example #1 - The benefit of many investments over the few

For example, first consider an "investment" in a coin flip. One coin flip can be bought for $45,000. If the coin comes up "heads" then $100,000 is paid. If the flip comes up "tails" then $0 will be paid. The "investment" has an expected return of $50,000 (a 50/50 chance of winning $100,000), or 11% on the original $45,000 invested. Clearly, however, this is a very risky investment – one either hits it big or loses everything.

This investment can be made safer, however, by simply adding additional similarly risky investments to the investment portfolio – here, more coin flips. If, instead, the investor purchases 100,000 coin flips for 45 cents each, with $1 being paid for each heads, and $0 for each tail, the investment is still $45,000. And, the expected return is still $50,000, or 11%.

But the risk in entering into the investment is now much, much less. In fact, with 100,000 coin flips, the investor is practically assured of receiving very close to the expected $50,000. And, there is almost no possibility of losing all the money (or, at the other extreme, winning $100,000).

All of the primary reasons for the benefits of diversification come to the fore in the coin flip example. The basic benefit is the reduction or elimination of the extreme results – both bad and good – and the enhancement of the likelihood of the expected or middle results. By diversification, the investor trades away the chance for a large loss (or a big gain) for an increased likelihood of the more normal or average result. The risk of a big loss, or a big gain, is reduced, and the safety of the middle is enhanced.

Another example shows the potential impact of dissimilarity of movement in returns, and how the investment in an individually riskier and lower returning asset can both enhance return and reduce risk for the total portfolio.

Example - Riskier and Lower Returning Assets can actually increase return and reduce risk : the impact of opposite movements

You own Suntan Lotion, Inc. If it is sunny, your company makes 30%; however, if it rains, you lose 10%. There is a 50-50 chance of it raining or shining. The "swing" in possible return is 40% (either up 30% or down 10%). You have $100,000 invested in Suntan, and if you get one period of sun and one period of rain, you would have $130,000 after the sunny period, and then lose 10% of that when it rained, to end up with $117,000, or 17% return through the weather cycle.

	Sun	Rain	Cycle
Sun-Tan, Inc.	30%	-10%	17%

You have the opportunity to buy Galoshes, Inc. This is a riskier investment, for if it rains you can make 40%, but if it is sunny you will lose 20%. The "swing" in possible returns is 60% -- clearly a riskier investment. It also has a lower return over a cycle. For with an investment of $100,000 through the same weather cycle, you would first lose 20%, to $80,000, and then gain 40% of that for a profit of $32,000, for an end amount of $112,000. The two period return, therefore, is 12%.

	Sun	Rain	Cycle
Galoshes, Inc.	-20%	40%	12%

Thus the riskier asset, Galoshes, Inc., not only has greater volatility or risk, but it also leads to lower long-term (or full cycle) returns. But by investing half of your Suntan money in Galoshes, Inc., which is an individually riskier and lower returning asset, you will actually improve your overall returns and reduce your overall risk though a complete weather cycle. The return pattern would be as follows:

RETURN

	Sun	Rain	Cycle
Galoshes, Inc.	-20%	40%	12%
Sun-Tan, Inc.	30%	-10%	17%
Combined	5%	15%	20.75%

If there is sunny weather, the portfolio's return would be 5%, since the Galoshes stock would lose 20%, but the Suntan Lotion stock would gain 30%. Thus a $50,000 investment in each would end up with $105,000 after the sunny period ($40,000 for the Galoshes investment plus $65,000 for the Suntan stock). If there is rainy weather, the Suntan lotion company would lose 10%, but the Galoshes company would gain 40%, for a total portfolio return of 15%. There would therefore be a 20.75% return after the weather cycle, with only a swing in the portfolio of 10%.

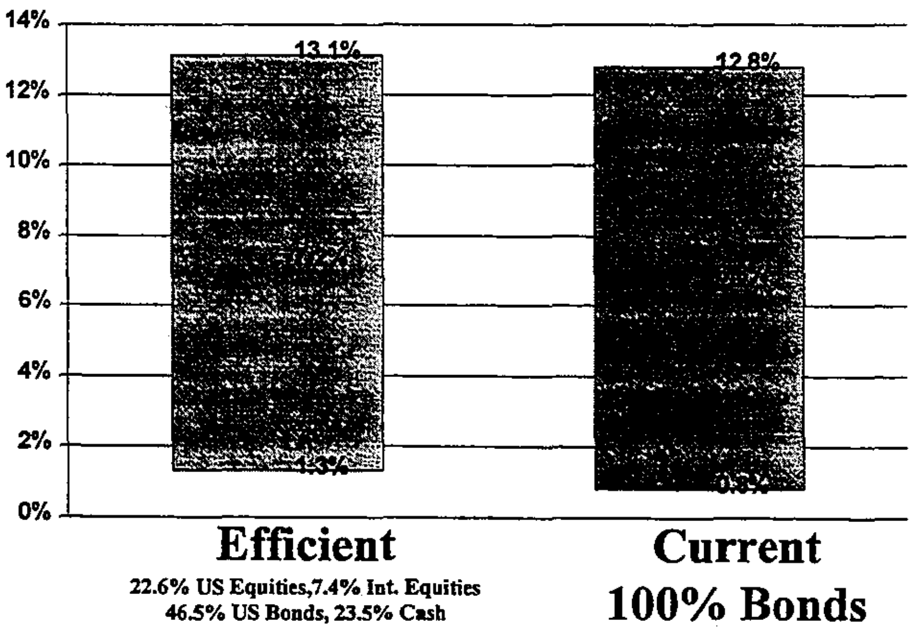
The $100,000 would grow to $105,000 after the sunny weather, and then grow an additional 15% during the rainy weather to reach $120,750. This compares to the $117,000 that would have been made by investing in Suntan Lotion, alone, or the $112,000 that would have been made in Galoshes, Inc. by itself.

Thus, by adding a riskier and lower returning investment to the portfolio, and by maintaining the investment discipline through rebalancing after each period, the Suntan Lotion shareholder actually increases the return and reduces the volatility or risk of his investment portfolio by diversifying to Galoshes, Inc.

Therefore, ***in judging the efficiency or characteristics of investments in a portfolio, one needs to look at the combined impact of all of the investments, and not the investments on an individual basis. Further, it is total portfolio volatility and return, and not individual asset investment risk or performance, that is central, and diversification among a number of asset types is beneficial.***

As a result, although each individual investment held by the endowment may be perceived to be, in isolation, "safe", this concentration in high-grade traditional US Bonds actually makes the whole portfolio riskier (more volatile) than a portfolio that held some US and international equities. In fact, adding some US and international equities to and all fixed income portfolio would actually increase the return while ***reducing***, not increasing, overall risk.

EXPECTED RISKS/RETURNS



The above chart shows the characteristics of an all bond portfolio compared with an "efficient" (highest return for each level of risk) portfolio containing US and international equities. The bars show the volatility of the portfolio, expressed by the extent of one standard deviation. Approximately two-thirds of annual returns will be within one standard deviation of the expected return. For an all bond portfolio, the expected return is 6.8%, with a standard deviation of 6%. Thus two-thirds of all annual returns for an all bond portfolio will be somewhere between 0.8% and 12.8%. A more efficient portfolio will have only 46.5% bonds, with around 41% in US and international equities, and the rest in cash. This portfolio will have a higher expected return – 7.2% vs. 6.8% -- and less risk. The standard deviation of this portfolio is 5.9%, less than the 6% expected for an all bond portfolio, with two-thirds of the returns expected to be between 1.3% and 13.1% (compared to 0.8% and 12.8%).

Thus adding a substantial equity exposure not only reduces the risk of the endowment's investments, but it also increases the expected return. Thus by adding the ability of the endowment to invest in equity returns, the endowment's investments not only become safer, they also become more productive.

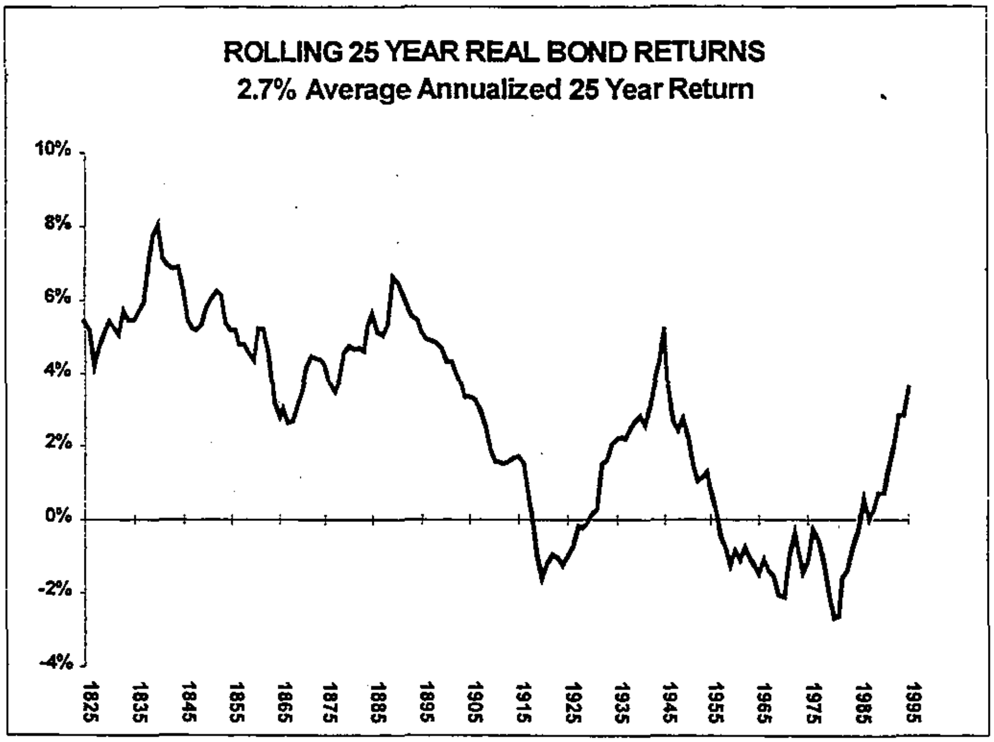
Traditional fixed Income is the riskiest asset for meeting the endowment's long-term needs

Second, the limitation to fixed income returns also makes the endowment fund a dangerous long term investment given that an important goal is keeping the endowment and its distributions whole in terms of purchasing power. The limitation to fixed income, or bond, investments for purposes of "safety" is the result of another common misconception.

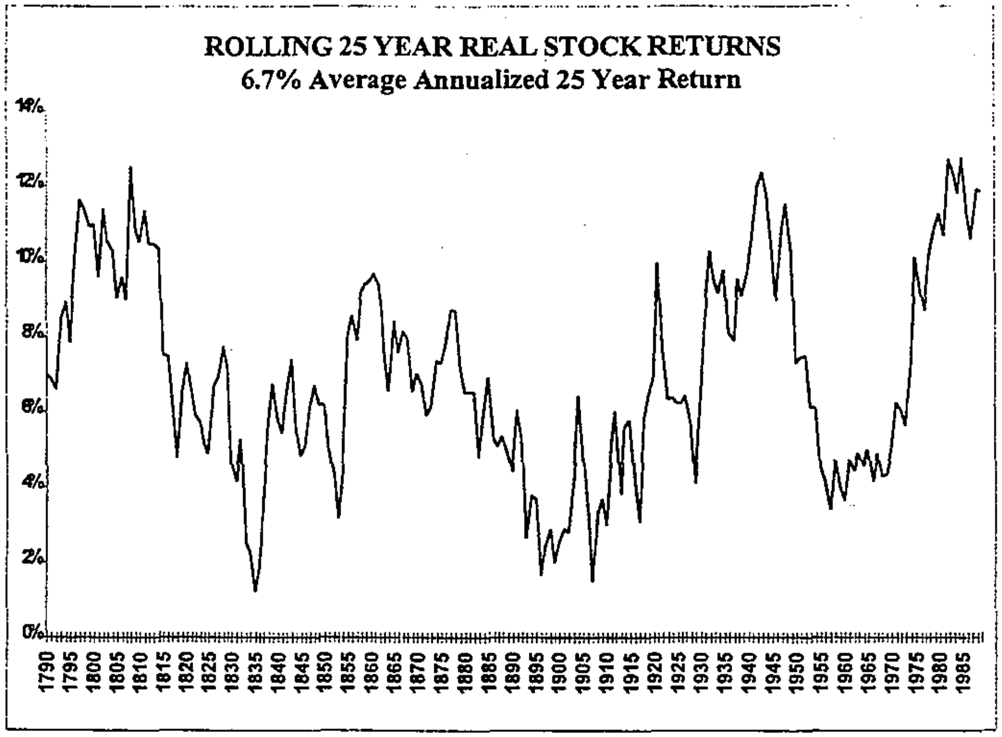
Many believe that bonds are safer than stocks. But, bonds are safer than stocks only in certain circumstances and for funding certain types of obligations. While bonds are good investments for persons with obligations that come due in a few years and are fixed in amount, stocks are safer than bonds to the extent that the obligations to be funded are sensitive to inflation and come due longer than 5 years in the future. ***For the endowment, stocks are a much safer long-term investment than traditional bonds.***

The reason is that the purposes of the endowment stretch far beyond the obligations of the next few years, and the needs of the beneficiaries are not fixed in amount, but grow with changes in inflation and the growth of the population. In that longer-term and inflation-sensitive environment, bonds are one of the worst and most dangerous types of investments.

Bonds will not match any movement in the level of the obligations or changes in spending needs – the return is fixed no matter what the behavior of inflation. As a result, over long periods of time, bonds often do not compensate for inflation. Using 25 year rolling returns (the returns that an investor would have received if they had bought bonds in, say, 1926, and held them for 25 years, then had bought bonds in 1927 and held them for 25 years, etc.) since 1800, bonds have averaged 2.7% annualized real returns; however, since 1926 bonds have not even kept pace with inflation, and have averaged -.02% over rolling 25 year periods.

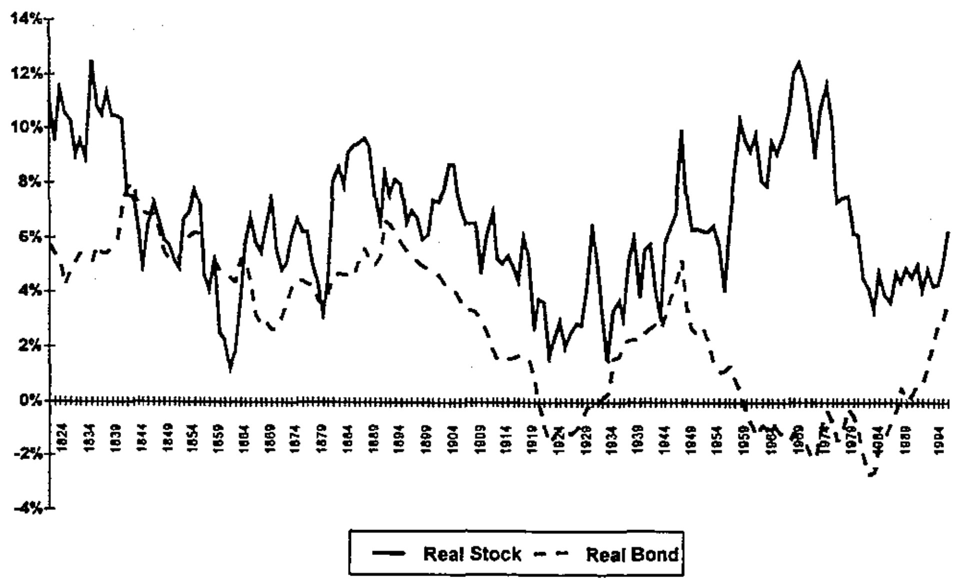


Stocks, on the other hand, over rolling 25 year periods have averaged an annualized real return of 7.5%, and in the history of the republic, through Civil Wars, Depressions, World Wars, and major economic shifts, have never returned less than an a 1.5% real return over any 25 year period:



And, compared to bonds over 25 year periods, there has not been a period since the mid 1800's when the real returns of bonds have been higher than the real returns of stocks:

ROLLING 25 YEAR REAL STOCK AND BOND RETURNS
SINCE 1800



This 7.5% long term real return for equities is one of the most solid historical numbers in the capital markets (U.K. stocks have had similar experiences). For time periods greater than 20 years, the real returns of equities have demonstrated less absolute volatility than bonds:

COMPARISON OF REAL STOCK AND REAL BOND RETURNS AND RISK OVER ROLLING PERIODS

	Stocks		Bonds	
	Return	Risk	Return	Risk
1 YR	9.0%	18.9%	3.9%	8.9%
3 YR	8.7%	9.2%	3.9%	5.9%
5 YR	8.5%	6.5%	3.9%	4.6%
10 YR	8.1%	3.9%	3.9%	3.3%
15 YR	7.9%	2.9%	3.9%	2.7%
20 YR	7.7%	2.3%	3.9%	2.3%
25 YR	7.5%	1.8%	3.9%	2.1%

Returns are annualized, arithmetic returns

Combining return and risk, stocks are clearly safer than bonds for real return needs stretching ten years and beyond, and there is a preference (although not as dominant) towards stock for real return needs for periods as short as five years (i.e., stocks will be safer than bonds around 75% of the time).

Therefore, the type of assets that should dominate the portfolio depend on whether the obligations to be funded are sensitive to inflation, and whether the time frame for achieving investment returns is near (0-5 years) or far. If the horizon is near term and the obligations are in nominal terms, bonds are the preferred vehicle (assuming the returns from bonds meet the target returns). If the horizon is longer term and the obligations to be funded are subject to inflation, then the preferred vehicle is stocks:

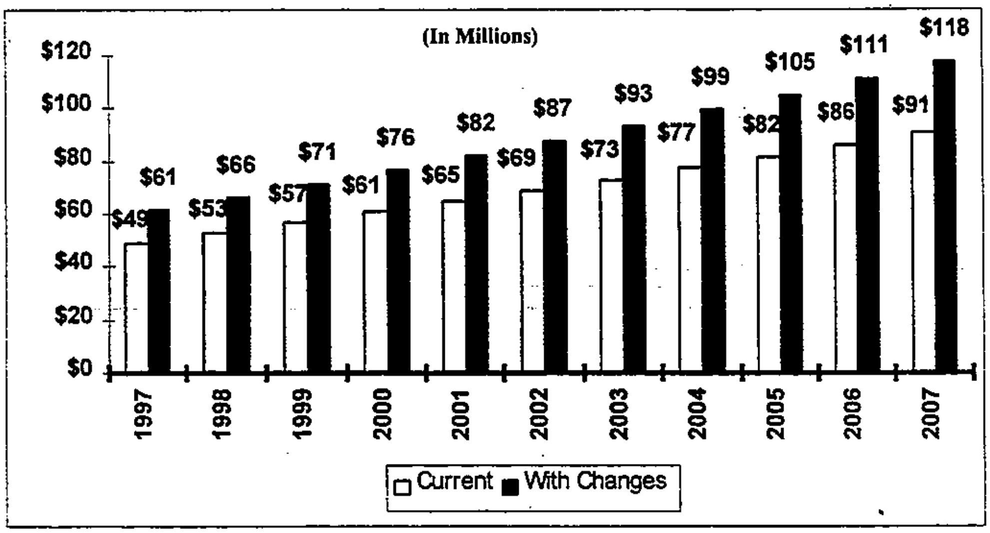
TIME HORIZON	REAL RETURN	NOMINAL (FIXED) RETURN
SHORT (0-5 YEARS)	?	BONDS
MEDIUM (5-10 YRS)	? STOCKS OVER BONDS	? BONDS OVER STOCKS
LONG (10+ YRS)	STOCKS	?

Clearly, the long-term needs of the beneficiaries (the schools in particular) are subject to inflation and growth in the population. As a result, the investment policy of the endowment should be oriented towards investments that provide a long-term real (inflation adjusted) return, and not a short-term fixed or nominal return. The current investment policies of the Endowment Fund are oriented toward short-term, nominal returns by their concentration on high grade fixed income instruments -- exactly opposite of the long-term needs of the endowment and those of the beneficiaries. Allowing a greater orientation toward equities, or equity type returns, is an essential move.

Increasing Returns From the Endowment Fund

A long term focus also allows the Endowment Fund to reach for substantial additional return than it currently expects. A fixed income portfolio can, at best, expect a real return of around 3% - 3.5% (inflation plus 3% to 3.5%). But by adding equity returns to the portfolio, the endowment fund can materially increase that expected return. If, for example, the Endowment Fund invested in a portfolio that would generate expected real returns of 5%, then substantially more cash could be distributed to the beneficiaries. Assuming no other changes in the current structure of the endowment, this change alone could add $10 - $30 million annually to the distributions to the beneficiaries:

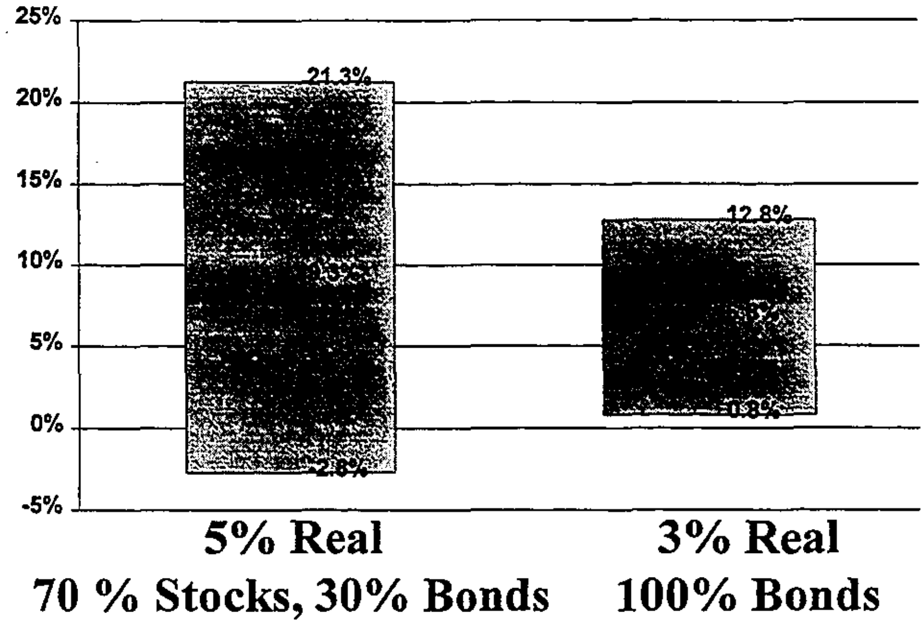
PROJECTED SCHOOL DISTRIBUTIONS ENDOWMENT FUND AT 5% REAL



Inflation 3.75%; Real Timber - 1.5%; Real Endowment Fund - 3%; Non-Timber Yield - 0.9%; Non-timber, non- endowment fund assets and cash flow rise by inflation

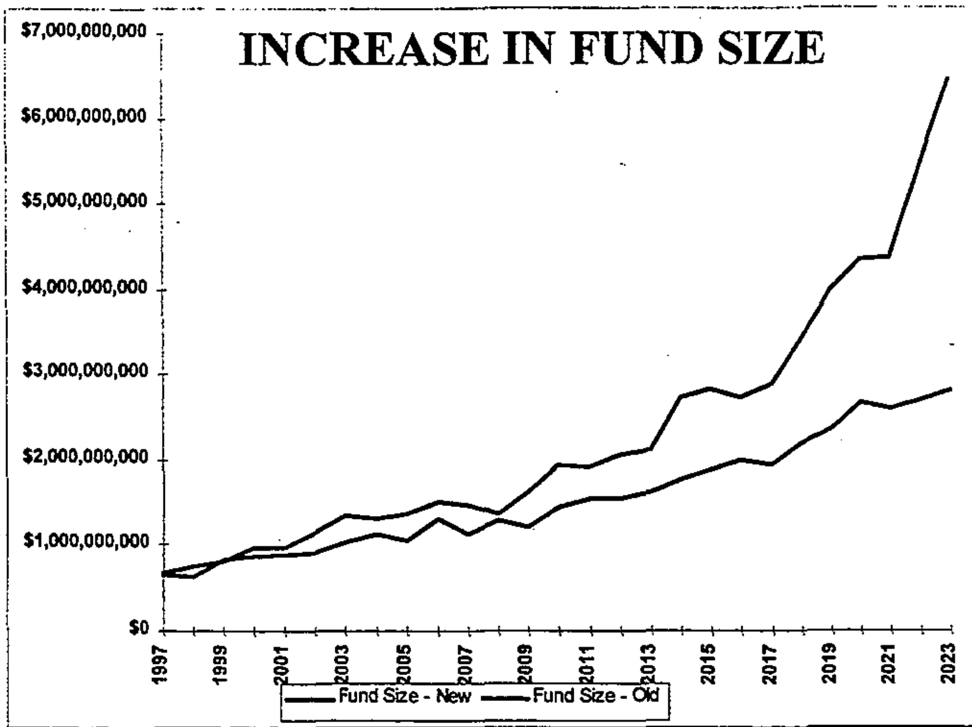
This increase in expected return, however, would also likely increase the annual volatility of the returns. This increase in expected return would come through the addition of equity-linked returns to the endowment fund portfolio. For example, a 5% expected real return – such as that used by PERSI -- would require approximately 70% equities in the portfolio, with an expected real return of 5% and a standard deviation of 12%. While equity is safer than fixed income over longer periods of time, on an annual basis those returns would become much more volatile.

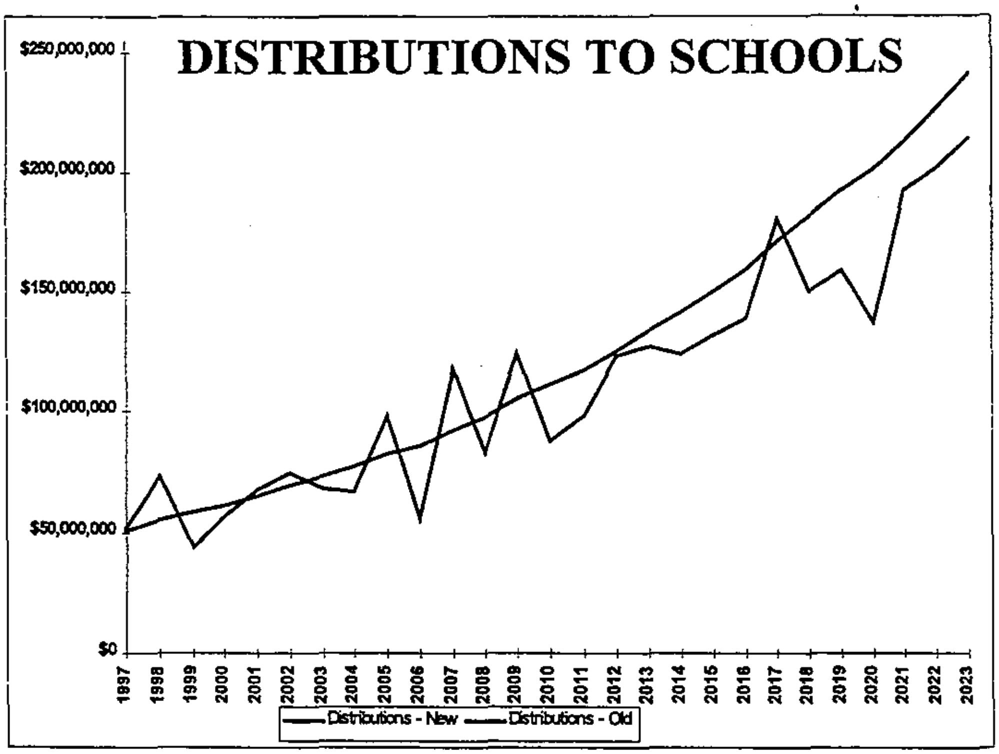
EXPECTED RISKS/RETURNS



Here, however, the shock absorber feature of the restructuring (creating an earnings reserve and redirecting the proceeds from land sales) would prevent that additional volatility from impacting the distributions to the beneficiaries. The pattern of distributions would still be very smooth, and greater than would otherwise have been the case with a more conservative investment policy.

Compared to the current structure, an increase in the expected return with a "shock absorber" structure in place would not only increase total payments under most market conditions, but it would also still decrease volatility:





The above charts uses the same assumptions as the previous comparative charts. Under most reasonable and many unreasonable market conditions, the move to a higher expected return policy increases the size of the fund materially over time yet does not impact (and in fact improves) the stability and amount of the distribution to the beneficiaries.

Therefore, if a structure was put in place that would act as buffer between annual investment results and the distributions to the beneficiaries, the Endowment Fund could (and, in the Committee's opinion, should) entertain changes in the investments of the Fund to increase the expected return to the extent that it does not jeopardize the desired distributions to the beneficiaries over time.

Equity Returns do not require investments in equities

The endowment must gain exposure to equity returns. Current statutes and the constitution limits the endowment, however, to fixed income. While it would be preferable for those restrictions to be lifted, the Committee believes the endowment can gain exposure to equity returns under current law.

The statutes and constitution denominate only the forms of allowable investments, not their behavior or the characteristics of their return patterns. Thus, the endowment fund restrictions require that the form of the investment vehicle be basically that of the traditional fixed income instrument -- securities that carry an unconditional promise of the repayment of principal and a separately identified income stream denominated as "interest".

This concentration on the form of the investment rather than the substance of the return is widespread, and represents another common misconception concerning investment. Modern investment practice gives an investor the choice among many forms of investment for achieving identical returns. For example, there are at least eleven ways that one can achieve the returns of the stocks in the S&P 500, only one of which involves the ownership of stocks, and only two others which even indirectly involves the stocks at all. They are:

1. The ownership of each share of stock;
2. Buying a share in an S&P index fund;
3. Purchase a share in a unit investment trust that holds the S&P 500;
4. Purchasing a futures contract on the S&P 500;
5. Purchasing an over-the-counter forward contract on the S&P 500;

6. Enter into a swap contract to receive the total return of the S&P 500 (for LIBOR or a similar standard interest rate);
7. Purchase exchange traded calls on the S&P 500;
8. Purchase over-the-counter calls on the S&P 500;
9. Purchase a variable rate annuity contract that has its return linked to the return of the S&P 500;
10. Purchase an equity-linked fixed income note that guarantees the return of principal and pays interest based on the return of the S&P 500;
11. Purchase a bank certificate of deposit whose payments are linked to the return of the S&P 500.

The focus, therefore, should be on the nature of the return rather than the form of the investment, and it is the total return of a portfolio that measures its real performance and characteristics, not the particular type of securities that generated the returns.

Since the restrictions on the endowment fund involve only the form of the instruments or interests that may be held, they are not necessarily restrictions on the types of returns that the endowment may achieve. For example, the last two examples of achieving S&P 500 equity returns would clearly fit within the current fixed income constraints of the endowment fund, and swap or annuity contracts could be structured to meet the forms required by the constitution.

Generally, there are many providers of fixed income instruments with sterling credit who would provide investment grade bonds with a guaranteed repayment of principal, and with the interest or coupon linked to returns not only of the U.S. equity market, but also any type of investment return desired (international equities, commodities, foreign debt, etc.). And, the instruments can be structured so that the principal repayment includes some form of inflation-proofing or index-linked increases. Such instruments would cleanly fit into the language of the statutes, constitution, and original grant. And, the use of such investment vehicles may very well fit the purpose of the underlying grant and endowment as a whole better than many of the existing investments.

The Endowment Board has gone part of the way down this path already with its use of convertible debt. These instruments usually behave more in line with equity returns than debt returns. The Committee believes that additional steps in this direction should be seriously considered.

The Committee recognizes that the existing restrictions on the forms of the investments that may be used by the endowment restricts flexibility, and that it would be advantageous – as a general matter -- to recommend legislation to broaden the forms of the securities that may be used, and particularly allowing the direct purchase of stocks. While this would be advantageous, the Committee does not believe that the endowment fund should wait until constitutional restrictions are removed before investing in securities that provide equity returns.

Although the Committee believes that existing statutory language would allow the purchase of certain types of equity-linked debt, the Committee recognizes that the Endowment Board may wish to have express legislative blessing before investing in those instruments. In any event, however, the Committee believes that gaining increased exposure to equity returns should be given the highest priority in the endowment fund's considerations – at least to the extent necessary to reduce the risk to the overall endowment.

Development of a Planning, Reporting, Monitoring, and Implementation System

As the third major area to be addressed, the endowment must develop a formal reporting mechanism designed to identify underperforming assets, develop plans either to improve the returns from those assets or to dispose of those assets, and must have a means for implementing those plans. Specifically, the endowment must address:

(1) Developing a monitoring system for tracking performance of the trust as a whole and identifying underperforming assets;

(2) Setting performance standards for each type of asset in the trust;

(3) Developing plans for addressing underperforming assets; and

(4) Developing means for implementing either the improvement of current yields from underperforming assets, or trading or disposing of those assets in favor or other, better performing assets.

Develop a monitoring system

Currently, there is no reporting which regularly looks at the endowment as a whole. Reporting on the ongoing performance of the endowment is a central and necessary function that serves as a key foundation for monitoring and improving the endowment over time.

One major problem with the current system is that the values of the land assets are seldom assessed, even in the roughest manner. Following the behavior of the current market values of the trust assets is a central feature of any reporting system. The Committee recommends that a high priority should be given to developing a regular evaluation of general current market values of lands in the land trust.

This reporting of land values does not have to be exact or precise. Nor does it have to occur in each and every year. A general in-house survey such as was done in 1992 could suffice if done on a once every two years basis, with the interim values calculated by increases in local inflation (for lands) or by increases in stumpage price (for valuing standing timber).

From this basis of value, reports could be generated on cash yields, total returns, and comparative changes in values for each of the assets of the trust. Also, those values could be tracked over time so as to identify underperforming assets, or developments that were unexpected when the near and long-term plans for the endowment as a whole were created.

As an example, a set of figures for the current endowment using the 1992 internal valuations of the Department of Lands, the market values of the endowment fund, the 1996 rough valuations of the timber lands developed by the Department of Lands, and with other values increased or decreased at the rate of the Consumer Price Index, would be as follows:

	Commercial Timber	Timber	Non-Com Timber	Rec and Cottage Site	Grazing and Cropland	Total Land	Endowment Fund	TOTA ENDOWN
Acres	782,256		225,309	3,217	1,455,385	2,466,167		
1985	91,281,504	697,356,764	20,959,796	58,552,477	156,946,204	1,025,096,746		
1986	92,891,382	709,655,634	21,329,452	59,585,133	159,714,171	1,043,175,773	**299,367,625**	1,342,54
1987	96,460,496	736,922,338	22,148,982	61,874,539	165,850,780	1,083,257,135	**308,398,980**	1,391,65
1988	100,279,826	766,100,596	23,025,965	64,324,446	172,417,601	1,126,148,434	**314,656,094**	1,440,80
1989	105,373,839	805,016,962	24,195,638	67,591,999	181,176,068	1,183,354,505	**338,127,252**	1,521,48
1990	110,382,873	843,284,122	25,345,798	70,805,041	189,788,425	1,239,606,258	**355,738,484**	1,595,34
1991	115,476,886	882,200,488	26,515,470	74,072,594	198,546,891	1,296,812,330	**381,081,474**	1,677,89
1992	**119,046,000**	**909,467,192**	**27,335,000**	**76,362,000**	**204,683,500**	**1,336,893,692**	**423,341,657**	**1,760,23**
1993	164,284,500	1,207,100,394	28,153,446	78,648,378	210,811,992	1,688,998,709	**470,297,328**	2,159,29
1994	209,523,000	1,504,733,596	28,875,412	80,665,236	216,218,052	2,040,015,296	**468,059,023**	2,508,07
1995	254,761,500	1,802,366,798	29,732,883	83,060,634	222,638,763	2,392,560,577	**532,316,600**	2,924,87
1996	300,000,000	**2,100,000,000**	30,570,841	85,401,521	228,913,364	2,744,885,727	**584,243,000**	3,329,12

The cash flows from these assets were as follows. First, the amounts and sources of the funds distributed to schools and other beneficiaries were:

	Timber Interest	Sale interest	Grazing	Cropland	Cottage	Commercial	Minerals	Misc.	Endowment	Total to
1992	2,187,312	1,140,000	1,071,270	202,050	1,040,040	0	221,600	111,690	31,530,155	37
1993	4,652,179	879,805	1,011,502	200,736	1,011,730	0	102,335	167,801	32,445,019	4(
1994	3,974,697	804,236	970,292	248,402	1,024,503	164,310	84,134	41,542	32,694,696	4(
1995	6,505,565	622,242	1,192,893	187,149	1,202,652	176,695	87,099	55,799	34,330,914	44
1996	7,929,328	539,495	1,171,909	274,666	1,186,576	254,427	146,640	59,850	35,929,185	47

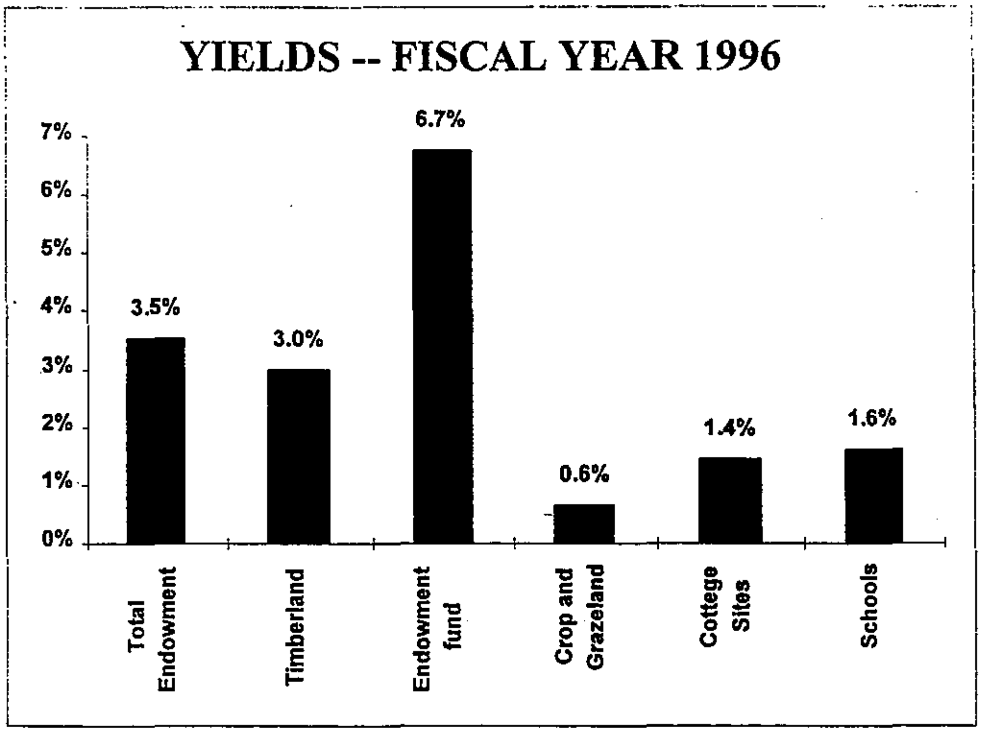
The amounts and sources of funds transferred to the endowment fund from the land trust were:

	Timber Sales	*Minerals*	*Real Estate*	*Cottage Sites*	Total to Fund
1992	**20,257,973**	**1,129,300**	**1,974,800**		23,362,073
1993	28,718,521	651,012	1,633,395		31,002,928
1994	32,182,947	969,141	1,813,124	163,000	35,128,212
1995	48,271,237	1,379,242	1,354,317	138,500	51,143,296
1996	53,286,669	1,107,381	1,123,232		55,517,282

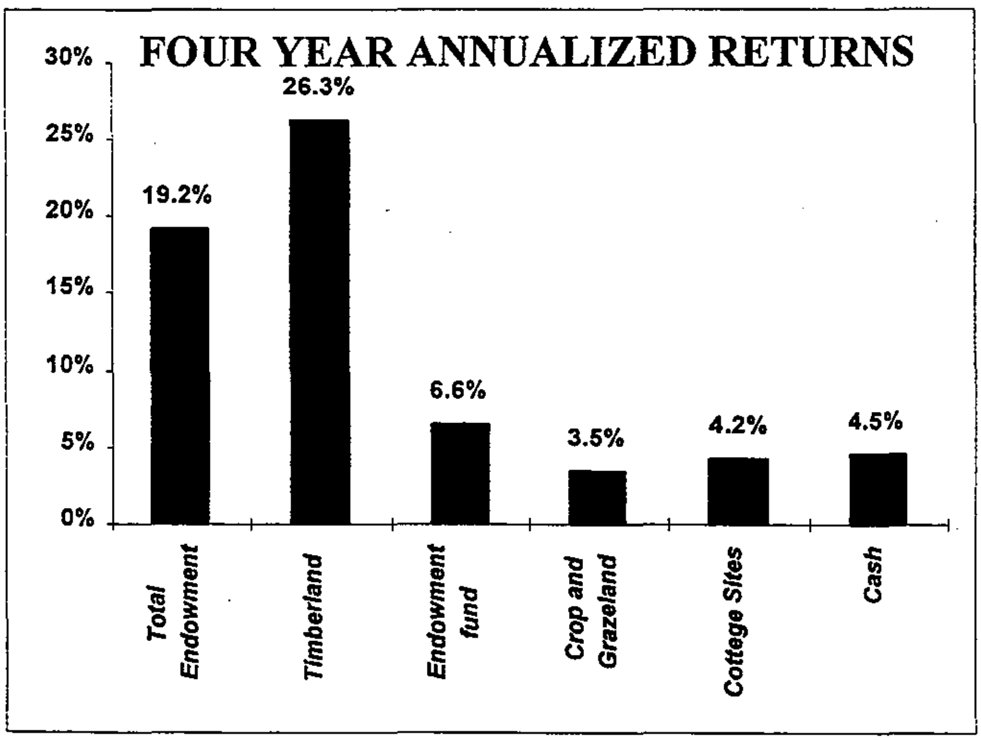
Collectively, total cash flows were as follows:

	Total to Schools	Total to Fund	Total
1992	37,504,117	23,362,073	60,866,190
1993	40,471,107	31,002,928	71,474,035
1994	40,006,812	35,128,212	75,135,024
1995	44,361,008	51,143,296	95,504,304
1996	47,492,076	55,517,282	103,009,358

From this type of data, overall performance and attribution of that performance can be calculated. For example, cash yields from various parts of the endowment can then be easily calculated, such as the following:



As can be seen, the cropland, grazeland, and cottage sites are all significant underperformers. And, when looking at total returns their relative status does not improve:



As can be seen, the cropland, grazeland, and cottage sites are underperforming cash, and these returns assume that the land values have been appreciating at the rate of inflation (which may be an optimistic assumption). And, it becomes clear that the dominant influence on the returns of the endowment as a whole is that of the timberland and timber itself. A chart summarizing the above graphs would look as follows:

RETURNS AND CASH YIELDS

	Four Year Returns	*1996 Yield*
Total Endowment	**19.2%**	**3.5%**
Timberland	**26.3%**	**3.0%**
Endowment fund	**6.6%**	**6.7%**
Crop and Grazeland	**3.5%**	**0.6%**
Cottage Sites	**4.2%**	**1.4%**
Cash	**4.5%**	**4.5%**

PERSI - 12%; US Equity - 16.6%; International Equity 12.8%; US Fixed - 6.9%

Returns are Annualized

Performance reporting along the above lines is an essential first step in monitoring the endowment as a whole. It is only by such reporting that the entity overseeing the trust can identify underperforming assets, understand the magnitude of any underperformance, and receive a feel for the interrelation of the various parts of the trust. These understandings are essential for any long-term management of the trust, and focus the efforts of the managers in making any needed changes.

Set performance standards for each type of asset in the trust

Each asset held in the trust should have performance standards or expectations that are understood by the managers of the trust, and against which the ongoing performance can be measured. Without these benchmarks, monitoring efforts would be without a foundation to judge performance and the relative magnitude of any problems that may develop.

These standards must recognize the two separate components of return: appreciation and cash yield. It is the total return to the trust that is important, and an asset that appreciates in value at a high rate does not need to generate as much current yield (and vice versa). For example, in the past few years the timberland has generated a cash yield of only 3%, below that of the endowment fund. But the value of the standing timber has increased at a rate of over 23% per year in the past few years because of the increase in timber prices. Thus, the total return to the trust from timber has been over 26% per year – excellent performance by any standards.

These standards must also include some adjustment for relative risk and liquidity (or lack thereof). For example, U.S. government bonds give relatively low returns when compared to stock and many private investments, but they are also extremely safe investments on a year to year basis, and they can easily be sold. Consequently, an investor will accept a lower rate of return from this type of safe and liquid investment and, on the other side, would need to be additionally compensated for other types of investments that are more volatile in returns and are less liquid. Thus timberland needs to have a higher return than government bonds to compensate for the volatility of timber prices, the greater difficulty in selling these private assets, and the additional management problems that come from overseeing those assets.

Each type of asset in the endowment must generate a competitive rate of return – namely, a rate of return that justifies keeping that asset rather than selling it for its market value and placing the proceeds in an asset that gives a better return, adjusted for any difference in risk, liquidity, or other difficulties. For example, the land in the land trust must return enough to be competitive with the returns available from financial assets – otherwise, it would be better to sell the land assets and place the proceeds in the endowment fund to be invested in financial assets.

To put the matter in a stark contrast, suppose that the projections for the income off of the public lands from cropland, grazing, and cabin leases, over the next 30 years is, at best, 1% of the value of lands themselves (which is their current yield). And also suppose (as is reasonable) that over three decades it is unlikely that the value of the lands will appreciate at a rate any higher than inflation. Now suppose that the inflation indexed bonds that the U.S Government intends to issue result in a 10 year bond where the principal rises with inflation, and the coupon is 3.5% (as many expect).

In that event, the clear investment choice for the benefit of the schools is to sell all of the public lands and put the moneys into those bonds. The income will be guaranteed to be three and a half times the income of the land trust well into the next millennium, and the market value of the principal is guaranteed to rise at the expected rate of the value of the lands themselves. Thus, if the state, at the end of those ten years, still wanted the lands, they could be repurchased (or their equivalent could be repurchased) from private hands when the inflation-adjusted principal is returned from the bonds.

Setting expectations for the financial assets is a relatively easy matter – there are many sources for information on assets traded in the public market. The difficulty is in setting expectations for real estate and other assets that are not traded on the public markets. The land trust, therefore, presents the greatest difficulty in this regard.

Although the specific expectations for each type of asset need to be developed by the entity responsible for the overall trust, the Committee believes that the endowment should expect an overall rate of return of at least 10% for each asset in the land trust, or around 6% - 6.5% real (inflation adjusted). The land held by the trust is an equity asset. Compared to the equity opportunities with comparable risk in the public markets, and adjusting for the additional management difficulties and illiquidity of the land assets themselves, 10% return (or 6% real) in each year is a minimum goal for these types of assets.

For lands that are not expected to rise at a rate greater than inflation, then, the minimum cash yield should be in the 6% to 6.5% range. For assets that may appreciate at a rate greater than inflation (like the recent timber rise) the cash yield can be lower to the extent that the appreciation is greater than inflation.

Develop plans for addressing underperforming assets

Where monitoring identifies underperforming assets, the endowment must develop plans for dealing with that underperformance. Currently, there are three clearly underperforming assets – the cropland, grazelands, and cottage sites. In particular, the Committee believes that the cottage sites are underperforming assets that have very little potential for improvement in returns and require too much management time and attention. The Committee recommends that the endowment develop a plan for disposing of the cottage sites and replacing those assets with either land or financial assets that can generate a competitive, market rate of return to the endowment.

Develop means for improvement of underperforming assets

In this regard, the Committee recommends that a "Land Bank" be authorized by the legislature so that the proceeds of any lands sold are not automatically added to the principal of the endowment fund, but instead can be reinvested in other land with greater return or yield potential. Currently, the efficient structuring of the Land Trust is hampered by the requirement that either land be exchanged, or that sales proceeds immediately be placed in the endowment fund (where they may not be withdrawn to purchase other land). For example, these rules substantially hamper the Land Board from consolidating land holdings since a contemporaneous exchange may not be available.

The Committee recommends that constitutional authorization be sought to allow the Land Board to deposit proceeds of the land sales in a "Land Bank" that could be used to purchase other, more productive lands. An at least temporary repository prior to placement of proceeds in the endowment fund would give desirable flexibility to the management of the Land Trust.