

OVERVIEW OF LAND BOARD ENDOWMENT REFORM

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1. In 1996, Governor Batt appointed the “Governor’s Committee on Endowment Fund Investment Reform.” *Memorandum from Governor Batt to Land Board Members* dated September 24, 1996. The genesis for the formation of the Committee was a discussion among the Land Board members at its July 29, 1996 meeting regarding the underperformance of the cottage site leasing program. *Minutes of the July 29, 1996 Land Board Meeting at 6*. Governor Batt stated, in his memorandum, that the purpose of the Committee was to:

[I]nvestigate methods of improving the Board of Land Commissioners (sic) ability to manage the state’s asset base for an appropriate return to the endowment fund. In addition, the Governor’s Committee will examine the investment policy of the Endowment Fund Board to see if higher rates of return can be achieved. This will include an investigation into the overall management of all endowment assets to provide an appropriate return in light of the objectives of the fund.

Memorandum at 2. Governor Batt also identified the premise for the formation of the committee.

The Board of Land Commissioners must have a long term strategic plan to manage the state’s asset base, while at the same time provide the highest rates of return to the state endowment fund. The ability of the Board of Land Commissioners to diversify the state’s base needs to be streamlined. At the same time, the Endowment Fund Board needs to adopt a method of investment that will allow for an increase in the amount of money generated by the fund, if appropriate. Both government boards need to coordinate their efforts toward this end.

Id. Finally, the Governor directed that the Committee “consist of individuals who are familiar with investment options, the state endowment fund, and the economics of long term investments for continued rates of return.” *Id.*

2. *1996 Report and Recommendations of the Governor's Committee on Endowment Fund Investment Reform.*

- a. The Committee members were: Douglas Dorn, private investment consultant; Representative William Deal; Robert L. Montgomery, Chairman of the Endowment Fund; Dr. Thomas Stitzel, Professor of Economics at Boise State University; and Robert Maynard, Chief Investment Officer for PERSI. Ex officio members of the Committee were: State Controller J.D. Williams; Department of Financial Management Administrator Michael Brassey; Deputy Attorney General Clive Strong; and State Economist Michael Ferguson. Douglas Dorn chaired the Committee.
- b. The Committee's report concluded that: "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." *1996 Report at 2.*
- c. The Committee report contains 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."
 - 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."
 - 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."
 2. "The [Endowment Fund 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."
 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.”

1996 Report at 3-8.

- d. The *Report* observed that the endowment structure and practices in 1996 reflected “momentum from the past rather than a focus on the present.” *Id. at 21.* The land portfolio was the product of chance rather than selection for optimum return for the endowment beneficiaries. When the federal land grants were made in the 19th century there was a general belief that land ownership was the safe way of preserving wealth. The notion that inflation would become a central concern of investment policy and that preservation of purchasing power would become intimately tied to the concept of preservation of principal, were notions that did not exist at the time of the creation of the trust. Moreover, the idea that land ownership, with its illiquidity and development risk, could become a riskier form of preserving long-term wealth was not foreseen.
 - e. The *1996 Report* concluded that times have changed radically since the 19th century and the objective of the initial endowment reform committee was to respond to this change. There was recognition of the need to examine the land endowment and to ensure these assets were managed in a way that maximized the long-term return to the endowment. *Id. 21-24.*
 - f. The Committee identified the purpose of the endowment as “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.” *Id. at 21.*
 - g. One of the key recommendations of the Endowment Fund Investment Reform Committee was for the Land Board to develop procedures and reports for identifying, monitoring, and addressing the performance of the assets of the Trust. *Id. at 56.*
3. ***1998 Constitutional and Statutory Amendments Enacted to Implement the Recommendations of the 1996 Governor’s Committee on Endowment Fund Reform.***
 - a. In 1997, the Idaho Legislature authorized the Legislative Council to appoint “a Committee to study the report and recommendations of the Governor’s Endowment Fund Investment Reform Committee” and “in conjunction with the State Board of Land Commissioners and the Idaho Endowment Fund Investment Board [to] submit recommendations and proposed legislation, if any, for endowment investment reform as deemed appropriate to the Second Regular Session of the Fifty-fourth Idaho Legislature.” *H.C.R. 21, 1997 Idaho Sess. Laws at 1340.*

- b. The Legislative Endowment Fund Investment Reform Committee recommended and secured passage of the following legislation:
1. [Chapter 256, 1998 Idaho Sess. Laws](#) established endowment and earnings reserve funds for each of the endowments, placed the Endowment Fund Board under the direction of the Land Board, provided that the Endowment Fund Board's investments were governed by the provisions of the uniform investor act, and created the land bank.
 2. [H.J.R. 6](#) proposed to amend Article IX, § 4 of the Idaho Constitution to allow the deposit of proceeds from the sale of public school lands into a land bank fund, and to amend Article IX, § 8 to change the word "disposal" to "sale" to clarify that leases are not subject to disposal at public auction. *Legislative Council Statement of Meaning and Purpose HJR6*. The Idaho Supreme Court barred implementation of the ballot measure, however, on the grounds that the amendment violated the constitutional requirement that an amendment be limited to a single subject. *Idaho Watersheds Project v. State Board of Land Commissioners*, 133 Idaho 64, 982 P.2d 367 (1999). Article IX, § 4 was subsequently amended to provide for the land bank by ratification of [H.J.R. 1](#) at the 2000 general election. [2000 Idaho Sess. L. 1669](#).
 3. [H.J.R. 8](#), as ratified at the 1998 general election, amended [Article IX, § 3](#): 1) to change the name of the "Public School Fund" to the "Public School Permanent Endowment Fund"; 2) to allow earnings to be deposited into the Public School Earnings Reserve Fund; 3) to provide that no part of the Public School Permanent Endowment Fund principal shall ever be transferred, used or appropriated to any other fund; 4) to provide for legislative appropriation from the earnings reserve fund for administrative costs incurred in managing the assets of the public school endowment. [H.J.R. 8](#) also amended [Article IX, § 11](#) to allow the permanent fund to be invested in financial instruments that a private trustee is authorized to invest in pursuant to state law.
 4. [H.J.M. 9](#) requested that Congress amend Section 5 of the Idaho Admissions Bill to allow the deposit of proceeds from the sale of school endowment lands in a land bank fund, to allow for deposit of school funds in an earnings reserve fund, and to allow for the leasing of the school endowment lands under such laws as prescribed by the legislature, provided any such lease secures the maximum long-term financial return to the endowment. On October 27, 1998, Congress amended [Section 5](#) of the Idaho

Admissions Bill in accordance with the H.J.M. 9. P.L. 105-296, 112 Stat. 2822.

4. ***1999 Recommendations on Endowment Trust Reform Implementation.***
 - a. The *1999 Recommendations* were a follow-up to the *1996 Report and Recommendations of the Governor’s Committee on Endowment Fund Investment Reform*, prepared by Robert M. Maynard, Chief Investment Officer for PERSI, and Douglas Dorn, private investment consultant.
 - b. The *1999 Recommendations* suggested that the Land Board should do the following:
 1. Establish a distribution and spending policy for the endowments;
 2. Set forth its investment policies for the investment and use of the assets and income from the trust;
 3. Develop procedures and reports for identifying, monitoring, and addressing the performance of the assets of the trust; and
 4. Overhaul the management of and rules for operation of the endowment as a whole, including implementing a risk management system for all of the assets of the trust.

Recommendations at 1.

- c. The proposed process included a recommendation to establish target rates of return for each asset and a process for identifying and addressing underperforming assets. *Background Paper for Recommendations on Endowment Trust Reform Implementation at 28-32.*
- d. The *Background Paper* stated that: “The most important investment principle is that a portfolio must be designed to generate returns that will meet its liabilities with the appropriate amount of risk. One general misconception is that an investment program should be designed solely to capture the highest returns. While returns are important, all attempts to generate higher returns will also include more risk.” *Id. at 16-17.*
- e. The *Background Paper* concluded that “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.” *Id.* at 22.

5. *2001 Report and Recommendations of the Governor’s Citizen Ad Hoc Evaluation Committee on Lands/Endowment.*

- a. Governor Kempthorne created the Governor’s Citizen Ad Hoc Evaluation Committee on Lands/Endowment. The membership of the 2001 Committee included the following individuals: Don Curtis, retired HP executive; Gary Christensen, private developer; John Cowden, retired Boise Cascade executive; Jerry Evans, retired Superintendent of Public Instruction; Mike Everett, Deputy Director of the Idaho Department of Agriculture; Bob Maynard, Chief Investment Officer PERSI; and Senator Marguerite McLaughlin. Don Curtis chaired the committee.
- b. The purpose of the Citizen’s Ad Hoc Evaluation Committee Lands/Endowment was to “recommend efficiency/effectiveness changes to the Land Board regarding Department of Lands, Endowment Funds Investment, Land Board and their interrelationships and management practices.” *2001 Report, Appendix B.*
- c. The Committee made the following recommendations:
 1. The Land Board should adopt a formal Land Trust Investment Policy that includes, among other standard items, the following three areas: statement of investment objectives; annual investment plan; and commercial real estate policies.
 2. Implement a standard/common 3-page reporting format for review of lands/funds investments and performance.
 3. At Land Board level, Department of Lands level, and all levels below, establish a clear paradigm shift toward “Endowment Investment.” These two words must color all future analysis, decisions, and actions.
 4. Establish an “Endowment Real Estate Asset Manager” position within the Department of Lands.
 5. Implement organization changes to improve Land Board operational effectiveness.
- d. *Appendix C* to the *2001 Report* set forth a “Statement of Investment Policy for Endowment Lands.” The investment objective as stated in the policy is to manage trust lands “to secure maximum long-term financial returns to the endowment without causing significant long-term adverse

impacts to the land or related resources.” *2001 Report, Appendix C at 4.* The performance objective is to exceed “a minimum target real rate of return of 6.0%” and to exceed the “relevant National Council of Real Estate Investment Fiduciaries Index . . . , if available, while maintaining an appropriate level of risk.” *Id.*

6. ***2005 Endowment Fund Reform Review Task Force***

- a. On August 9, 2005, the Land Board requested that Governor Kempthorne appoint a task force to “review the implementation of the endowment reform and to provide the Land Board and the Endowment Fund Investment Board with their findings and recommendations.” *Minutes of the August 9, 2005 Land Board Meeting at 2-3.*
- b. Governor Kempthorne appointed the following members of the Task Force: Larry Johnson Manager of Investments, Endowment Fund Investment Board; Representative William Deal; Representative Darrell Bolz; Deputy Attorney General Clive Strong, Kathy Opp, Division Administrator for Support Services for the Department of Lands; Chuck Goodenough, Secretary of State’s Office; Larry Schlicht, Department of Financial Management, and Steve Allison, Controller’s Office. Ex officio members of the Committee were: Legislative Budget Analyst Ray Houston; Deputy Attorney General Kent Nelson; and Deputy Attorney General Julie Weaver. The Task Force was chaired by Larry Johnson.
- c. This Task Force never issued an official report; however, it assisted with the drafting and passage of technical amendments to *Idaho Code §§ 57-724 and 57-724A* during the 2006 Legislative session. The Task Force also examined the objectives and structure of the distribution policy for the endowments, which served as a basis for an expanded policy adopted by the Idaho Land Board in July, 2008.

7. ***2009 Report and Recommendations for the State Board of Land Commissioners.***

- a. The Idaho Land Board directed the Department of Lands “to formulate an *Endowment Land Transaction Advisory Committee* (“ELTAC”) for the express purpose of reviewing constitutional and the Admissions Act language for consistency with modern business practices.” *Minutes of March 17, 2009, Land Board Meeting at 4.*
- b. The members of ELTAC were: Bryant Forrester, Homeland Realty; Kurt R. Gustavel, President, Idaho Independent Bank; Jack Harty, President, Harty Capital; George Kirk, The Kirk Group; Al Marino, Partner, Thorton-Oliver-Keller; Robert Phillips, President, Hawkins Companies; and Robert Follett, Deputy Attorney General.

- c. The purpose of the Committee was to conduct “an impartial review of the Idaho State Constitution and the Admission Act to identify any impediments to conducting real estate transactions in the 21st century.” *2009 Report at 4.*
 - d. The Committee recommended changes to Article IX, § 8 that would allow endowment lands “to be managed and disposed of in any reasonable manner to secure the maximum long term financial return.” *2009 Report at 11.* The Report also recommended that the 320 acre constitutional limitation on the sale of state lands to an individual be removed. *2009 Report at 14.* A conforming change was also recommended to Article IX, § 10. *2009 Report at 15.* No action has been taken on these proposed changes.
8. Under the direction of the Land Board, the staff of the Department of Lands has been moving forward to implement the recommendations of the endowment investment committees.
- a. In 2007 the Land Board adopted an overarching asset management plan to ensure the long-term preservation of the purchasing power of the assets as a whole while providing a steady stream of increasing income to the endowment beneficiaries. *Minutes of December 20, 2007, Land Board Meeting at 6.* A section on management of financial assets of the endowments was added in July, 2008. *Minutes of the July 2008 Land Board Meeting at 5.*
 - b. The Department of Lands is developing an asset business plan for each of the revenue centers. The Land Board has approved the outline of this plan, and the Department is moving forward with the actual drafting of the plans. The business plans will:
 - 1. Describe the current and future influences on plan implementation and asset performance;
 - 2. Set forth an acceptable range of return for each asset classification;
 - 3. Define appropriate valuation methods by asset classification; and
 - 4. Detail opportunities and challenges the asset faces and specify plans for capitalizing on opportunities and dealing with challenges.
 - c. While the Asset Management Plan provides the framework for land asset management, additional effort to move forward with endowment reform endowment reform that have been implemented or are being implemented include:

1. Pursuing exchanges that block state land ownership or reposition the land holdings to achieve a more favorable rate of return;
 2. Exploring options for reducing the cost of management or increasing the revenue from underperforming assets;
 3. Completion of a mass appraisal to facilitate the evaluation of the performance of the assets;
 4. Streamlined endowment land asset disposition processes for small, isolated and underperforming assets to facilitate more timely repositioning of the beneficiary portfolio; and
 5. Developing a strategy to consolidate land holdings of the eight small endowments into a common ownership, which would reduce variability of income and management expense.
- d. The underlying objective of endowment reform is to ensure that endowment management decisions are consistent with the Board's constitutional duty to achieve the "maximum long term financial return" for the endowment beneficiaries.