

MINUTES
SENATE RESOURCES & ENVIRONMENT COMMITTEE

DATE: Wednesday, March 14, 2012

TIME: 1:30 P.M.

PLACE: Room WW55

MEMBERS PRESENT: Chairman Pearce, Vice Chairman Bair, Senators Cameron, Siddoway, Brackett, Heider, Tippetts, Werk, and Stennett

ABSENT/ EXCUSED: None

NOTE: The sign-in sheet, testimonies, and other related materials will be retained with the minutes in the committee's office until the end of the session and will then be located on file with the minutes in the Legislative Services Library.

CALLED TO ORDER: **Chairman Pearce** called the meeting to order at 1:32 p.m. He directed the secretary to take a silent roll call.

APPROVAL OF MINUTES: **Senator Brackett** made a motion, **seconded** by **Vice Chairman Bair**, to approve the minutes of March 5, 2012. The motion **passed** by a **voice vote**.
Senator Siddoway made a motion, **seconded** by **Vice Chairman Bair**, to approve the minutes of March 7, 2012. The motion **passed** by a **voice vote**.
Senator Werk made a motion, **seconded** by **Senator Tippetts**, to approve the minutes of March 2, 2012. The motion **passed** by **voice vote**.

H 495: Continuation of Hearing Relating to State Endowment Lands.

TESTIMONY: **Rachel Gilbert**, Tax Accountability Committee, testified in support of H 495. She cited the prior testimony of **Representative Burgoyne** and urged the Committee to pass the bill. A copy of her testimony is attached.

TESTIMONY: The following people testified and asked the bill H 495 **be held in Committee**. **Robin Nettinga**, Executive Director of the Idaho Education Association, expressed two concerns: 1) The bill would significantly shorten the time lines for the Land Board to make decisions regarding the acquisition and disposal of lands in the best interest of the beneficiaries; and 2) This bill limits the landlord's ability to diversify investments and maximize returns through the acquisition of business entities. She said at the same time, other sections of government would continue to operate businesses that could be construed as competing with the private sector.

TESTIMONY: **Karen Echeverria**, Executive Director of the Idaho School Boards' Association, said she was there to present ISBA's opposition to H 495; and **Rich Garber**, Director of Industry and Government Relations for the cause of agriculture and life sciences at the University of Idaho, who spoke about a proposal to create a livestock and research center in southern Idaho. He spoke about the impact H 495 may have on the ability to move forward with the facility.

Senator Tippetts asked **Mr. Garber** if he could give the Committee a little more information about the language in the bill that gave him concerns. **Senator Tippetts** referred to page 2 of the bill, Section 58-104A, number 1 and asked if the language having to do with "provided however, that except where the state endowment lands is used by a public entity for a public purpose" not give the comfort level that WAS needed and if not, why? **Mr. Garber** said the intent was not to impede the development of the research facility, but the legal counsel felt the statement was not definitive and if the 501C3 was to operate the business as a business, then they were in competition with private enterprise. He stated he didn't think the impact was clear.

Chairman Pearce said he would ask a similar question of **Mr. Garber**. If the Committee would fix the wording so he was comfortable and would specify **Mr. Garber** would like to develop a dairy, did he feel this was good legislation? **Mr. Garber** said if there was a fix, they would welcome and support that, but at this point, he didn't know if the fix would be in this current piece of legislation.

TESTIMONY: **Erik Makrush**, Idaho Freedom Foundation, testified and asked the bill H 495 be sent to the amending order .

TESTIMONY: **Tom Schultz**, Director, Department of Lands, said he found himself in a difficult position, on a different side of the issue with the **Chairman**. He said he appreciated the opportunity to speak before the Committee. A copy of talking points for his testimony is attached to the minutes. He said the Land Board took action on this bill and voted 3:1 to oppose the bill. **Mr. Schultz** said he was there representing the majority of the Land Board. The opposition felt very passionate about this bill and he understood their concerns. He said this had been bantered back-and-forth for the last 18 months. He said there was a discussion as to who had the decision-making authority over some of the issues. Is it the role of the legislature or is it the role of the landlord? The landlord has expressed concerns. Specifically, they were concerned about the fact that this infringed upon their authority and impinged on their constitutional rights. This was one of the key arguments of this bill. He said the role of the legislature was to provide some structure, some rules within which to operate. The decision-making of the Board on business decisions that fall in the realm of the landlord, and he said he understood members of the Committee and others disagreeing with the decision made by the Board. **Mr. Schultz** questioned how this would be any different than any decision that would be made with a spouse or anything else. He stated when one disagreed with someone, how did one respond and what dialogue would they enter into and he said he realized this was an avenue to go. He said the Board had tried to pursue the issue and there had been a lot of mention made about the Asset Management Plan. He said there was actual language put in the Asset Management Plan that specifically addressed the concerns.

Mr. Schultz talked about the infringement upon authority and he felt that was what had the Board mostly concerned. He responded to some of the comments made over the last couple of days. He said the staff indicated they had no ulterior motive. They were trying to carry out their constitutional responsibilities by getting the maximum return for the beneficiaries over the long term. He said the return on the investment had outpaced anything they have done. He talked about the Land Bank Fund and gave a brief history of the time line. He said the Department felt that six months was not sufficient enough time to turn around transactions. He said the six month requirement would force poor decisions and make unintended consequences. He said if they had more time, they could make better decisions in the marketplace and be more transparent.

He addressed the comment about the Endowment Trust losing money on commercial investments. He said during fiscal year 2010 to 2011, they invested over \$5 million in their commercial assets in terms of renovating those buildings, bringing them up to code. That was money the Department of Lands had to get appropriated from the legislature. The returns had been 1.3% over the last couple of years overall from all of their commercial buildings. Going forward, he said, in fiscal year 2013, they were anticipating a 6% to 8% return from their commercial portfolio. There are costs in doing business and part of owning commercial real estate is to invest in those assets insuring their long-term viability.

Another issue came up about how they account for their costs. Per state law, the Department of Lands has to do a cash-on-cash basis in terms of how they account. **Mr. Schultz** stated that in fiscal year 2012, they were going to look at accrual based accounting, just as a comparison.

Mr. Schultz talked about risky investments and the fact that the state was liable if they perform poorly. He said the constitution was pretty clear in Article IX, Section 3, that the Public School Permanent Endowment Fund of the state shall remain forever inviolate and intact. The permanent fund grew from land sales on the royalties generated from minerals that were developed over time. Most of the earnings from the permanent fund were fed back to the permanent fund and these funds were guaranteed based against loss.

Mr. Schultz addressed the comment that had been made about their expertise in managing commercial properties, in particular, self-storage units. He said he made it clear they don't directly run the businesses. They pay for professional services to manage their commercial assets.

He indicated another issue had to do with taxes. On average, taxes foregone for the 2.6 million acres that the state owns and manages was between \$5 to \$7 million and if it was sold tomorrow and put back into the private sector, that would be how much tax would be generated. He said they generated profits, by having those lands in state ownership and employing people. Direct contributions of about \$46 to \$50 million a year net of expenses were being directly put into the school system. In addition to that, there were indirect benefits of jobs, such as, equipment that was purchased to manage the lands and gasoline. There were about \$133 million on an annual basis, between direct and indirect benefits, that were generated from the management of state trust lands, compared to \$5 to \$7 million statewide annually, using average numbers that would be put back on the tax rolls. From a very gross scale, the management of these lands, under the current management scheme, is far in excess of the property taxes that would be generated using average tax numbers.

Mr. Schultz said another comment that was made was about decisions of investments made for the Endowment Fund investments or past investing in emphasizing diversity and looking at what were the FID returns over a ten-year period. The Endowment Fund, over the last ten years, made a 5.9% return with their benchmark being 4.6%. The average returns averaged from 2% and 4% in a given year. On the commercial side, he said, looking forward, they were looking at 6% to 8%. He enumerated the various properties and different classes of land and said they have different terms. He said the Committee needed to keep in mind the volatility of the stock market. The notion that putting money in the permanent fund was risk-free was not necessarily correct. He said timber was their primary revenue-generator. There are always issues with being openly-dependent on the timber base. He said the commercial portfolio was less than 1% of the total assets. He said he felt they were not at high risk for commercial and that it would actually help over the long-term to reduce their risk from being overly-dependent on timber returns.

Mr. Schultz said a lot of questions were raised about the authority of the landlord to let his land and what constitutes land. He cited the Supreme Court case in 1935 in Reynard vs. the City of Caldwell, and the term "land" was actually defined in the case. Land includes all physical things on the earth, such as buildings, fixtures and any state or interest in lands including easements. The question was whether or not the Land Board had the authority to manage land. That had not been in dispute and one would have to define and interpret what that means and the court, in 1935, did that.

Senator Siddoway asked **Mr. Schultz** if he understood on page 2, 58-104A, Section 1, line 24 where it said that "provided, however, that except where the state endowment land is used by a public entity for a public purpose". **Senator Siddoway** said he took it to mean that if one were talking about a school or perhaps even a research center, that would allow an out. **Mr. Schultz** said that looking at the history and evolution of this bill in the earlier draft, it initially talked about having to sell, not sell or lease, all of the improvements and that was an adjustment made between H 188 and this version of the bill. Part of the reason was that state entities, like the Department of Lands, actually rents from the trust's beneficiaries an office building. So, his understanding was initially that was an attempt to get the sponsors to address issues where public buildings were owned by the beneficiaries that were then leased to the Department of Lands.

Senator Siddoway spoke about the same section of the bill where "all non-agricultural improvements on said land shall be leased or sold to private person" and his question really lies within this sentence. If there was a building like the one **Mr. Schultz** mentioned and this forces that to either be sold or leased, if that is so, then he thought the next sentence on line 29, "that it shall be sold to private persons", then did that set the state up with lands, with buildings that are owned by other entities or other people and the land is owned by the state, did that set us up again with the cottage site situation just like Payette Lake?

Mr. Schultz said the best way to get the maximum return was to own the improvements and the bare land. The state could own a building and the bare land based on the wording in the bill. The disposition of the structure was not forced, but it forced the disposition of the business entity and he thought that was the way it was portrayed by the sponsors.

Senator Tippets said that when he saw the Asset Management Plan he was surprised and he thought it was a pretty aggressive plan for getting into and expanding in the commercial market. He felt it had been represented to the Committee today that the state was looking to get involved in hotels, restaurants, shopping malls, and so forth, which he was not entirely comfortable with. He said it appeared there had been an increased sensitivity on the Land Board to these kinds of businesses being owned by the state because a concern had been expressed to purchase storage buildings. He asked **Mr. Schultz** whether or not there was an increased sensitivity to getting those kinds of businesses and did the state have intentions to own hotels, restaurants, shopping malls and or to operate those kinds of businesses?

Mr. Schultz referred to his prior testimony regarding how the entities would be managed and he said they would not be managed with state employees. They would be third parties, professionals and the state would contract with to carry out those operations. He also said there had not been anything that had been plucked out saying they were going to go buy a hotel. The process was such that they didn't go tell people what to buy for them, rather, they brought the Department of Lands potential transactions. He said they were not out there in the marketplace pointing to all of these different things. However, for example, the state did have a ski hill on endowment lands. There was a recognition that some of these things do exist. The state had not made any ventures into owning or acquiring a hotel or any of those things. There was a list of things for consideration and there was a study done as to how the state could diversify.

TESTIMONY:

Lynn E. Thomas, Attorney, said he was not there to advocate one way or the other for the bill. He said he was hired with another attorney, **Mr. Dave Leroy**, to do an independent, outside legal analysis of the bill from the perspective of whether or not the legislature had the authority that was set in constitutional power to enact legislation. In the process, they received an opinion from the Attorney General and opinions and analyses were opinions or predictions about what the courts might do with a particular piece of legislation, given all of the varying circumstances, such as the language, the legislative history and the constitutional background. They used a different approach as to whether this was a valid piece of legislation. He said the Attorney General's opinion appeared to be based on pieces of language taken from factually different circumstances. He said they seemed to reason from the bottom up, namely, focusing on the premise that the Board had very broad discretionary authority. On the other hand, **Mr. Leroy** and he had begun the constitutional language and have reasoned down from there. The important piece of language that appeared in the Constitution spoke of the duties of the Board which were to be exercised subject to such regulations as may be prescribed by law, as may be prescribed by legislation. The legislature, in all of the cases they examined, the Board's power as they saw it, emanated from the legislative authority and the regulations prescribed by law. One thing that was seen in all of the cases is continuous judicial deference to legislative enactments and this is one of the strongest principles in interpretation. **Mr. Thomas** said the legislature has the power to make policy judgements and the judiciary defers to those judgements in every case where it is not plain.

When the business manager was being described on the plans, essentially one was dealing with a subordinate authority. Who is the Board of Directors? The Board of Lands is the business manager and it is the state legislature and that seems to be the sense of these opinions. The duties of the board are to be exercised subject to such regulations as prescribed by law. According to **Mr. Thomas**, the conclusion, as a result of these things, was that the legislature has legal authority to enact.

TESTIMONY:

John L. Runpt, Attorney in Boise, volunteered to assist the Taxpayer's Accountability Committee. He reaffirmed **Mr. Thomas's** exposition on the constitutionality of the bill and said he agreed and came to the same conclusions. He discussed the diversity of the investment brought up by **Senator Heider**. Diversity of investments is prudent. He said the Land Board, in the handling of the land and the Permanent Endowment Fund, the principle of the prudent investment standard must at least be followed. He said there were cases that also talked about this trust being a sacred trust and there must be an unconditional guarantee. He suggested to the Committee that the prudent investment standard was a commercial standard and this standard for handling these funds, that is the Endowment Funds on one hand and the Lands on the other, is an inviolate trust.

The idea of professional management could be handled by the professional managers in New York. The landlord has the capacity to direct the investment facilities in New York. If they felt there should be a push to give more attention to commercial development, they could instruct the New York managers to do just that, to invest more in commercial real estate. He asked the Committee why they had to beef up the Department of Lands in Idaho to replicate this investment function. **Mr. Runpt** stated it was a very sophisticated process with appraisers, actuarial experts, investment people so why would we want to duplicate this investment function here beyond what the Department of Lands does very well in the timber area. He suggested to the Committee that the limitations to this bill could foster that direction and to prevent the Land Board from exercising the idea of going into commercial investments and directing and owning businesses. He said he felt it was a terrible direction to go.

Mr. Runpt pointed out that in the Heartland Study in Seattle, sponsored by the Department of Lands, there was a recommendation to get rid of the auction process.

He summarized, stating that the bill did not prohibit land exchanges, investing in commercial real estate, owning any land or the improvements. It only prohibited operating businesses and that was one of the objectives of the bill.

Mr. Runpt said he wanted to add one more thing about agriculture and whether agriculture covered timber and he said, yes, the intent of the drafters was that the use of the word "agriculture" did cover the timber business.

Senator Heider said to **Mr. Runpt** that knowing our land values have dropped that have been held for investment, how does one square that with the mandate to maximize the return on our investment. There seems as though there is a contradiction. How are we going to maximize that if all we own is bare land or land for timber or agricultural uses.

Mr. Runpt said it was to maximize long-term financial returns and it was the long term issue that fostered the language by the Supreme Court. Land values have gone down, but so did the market in New York and it is a constant variable type of investment portfolio that has to be established with some diversity to take care of those ups and downs. Comments have been made, such as, why don't we sell all of the public lands and he said he did not feel comfortable with that idea. The land is always going to be there and there is the investment portfolio on the other hand. The landlord can direct the New York managers to favor certain investments. He suggested that is where the diversity needed to be and would be proper.

Senator Heider said that **Mr. Runpt** was suggesting the state does not have the ability to invest in enterprises in Idaho and that we should turn our money over to a New York investor to manage it better than the state can and was that his intention.

Mr. Runpt said he was not suggesting the lack of ability as much as he would the requirements that it would take to develop the facility in the Land Department to do it competently to build a true investment.

TESTIMONY: **Jason Hancock**, from the Superintendent of Public Instruction office, said he was asked to testify about the reason **Superintendent Luna** wouldn't have voted against the motion to oppose three bills, although the large part of his reason for voting against that motion was for his support of bill H 495. He said he agreed with some of the things **Mr. Schultz** said about the commercial property and the cash accounting versus accrual accounting and was part of the reason that appeared to be a low return in that area. Both **Superintendent Luna** and he fully support the activities of the Department of Lands staff. He said they were doing a good job for the endowments. He said the reason for **Superintendent Luna's** opposition to that motion that supported this bill was really philosophical and simply that the government should not be in the role of actively running or have a profit interest in the operation of businesses. He said their only consideration in looking at what kind of assets they should own in the endowments was how much money they could make and there was no limit as to what they might take on. He gave an example of owning a McDonald's, a meat packing plant, or a law office. He said maybe we should sell all of our lands because the return was less than what one could get in the market over a long period of time. When we own a storage business, that puts the state in the position of having a profit or loss and a vested interest in who wins or loses in that particular business sector. We want the storage business to win because it accrues to our benefit if they do. This bill would not actually require the board to sell even their storage property. We would, however, have to at least lease out the whole business so we would no longer have a profit interest and whether or not this particular business was successful. We see this bill as being fairly modest in scope and he thought we could own any kind of land asset under this legislation, but we could not own the business that operates it.

TESTIMONY: **Representative Vander Woude** did a summary. He said commercial and residential was to diversify in the right markets. The first point, he said, was that the diversity argument was not constitutional nor were they practicing diversity by trying to get rid of residential lots. The second point was the University said they could not have their research dairy or their facility they want to build there. He believed that argument was bogus and he said the bill said for public entity for a public purpose and the University was a public entity and the research dairy was for the public purpose and he said he thought this was definitely excluded from this bill.

The rate of return from the Permanent Endowment Fund over the same 10 year period was 5.83%. He pointed out that the \$2.7 million was turned into the Permanent Endowment Fund at the same time they bought the storage units. He said that the Permanent Endowment Fund made 15.8% one year and 24.6% the next year, so that was a lot more income than the 6% or 7% that they were talking about. He said he was baffled that the School Board and the Parent-Teacher's Association said they didn't want to hinder where the return was. Everyone heard that the Permanent Endowment Fund lost a considerable amount of money prior to those years, but so did the commercial. But, he said, look at the same time frame and look at the same numbers. If that money would have been invested there, we would have had a substantially better return than what we have now.

Representative Vander Woude said he did not want the Permanent Endowment Fund or the Endowment Fund to get rid of their land. The purchase of land, to him, was what classified it as a long-term perspective on investments and the long-term return, if one keeps it in land. This bill is philosophical as to what is the proper role of government and what is the proper role of the legislature. He said it was the proper role of the legislature to give some guidance to the Land Board on how they invest the money and he also thought it was the proper role of government to stay out of the private sector competing with businesses. He said he wanted to yield his time to the co-sponsor, **Representative Burgoyne**.

TESTIMONY: **Representative Burgoyne** said he would articulate the choices for the Committee. He said he was very confident that: 1) the bill is constitutional; and 2) in technical terms, it does what we say we want it to do. The issue then falls to the Committee to decide if the policy choice that has been presented is the policy choice they choose to make. He said he didn't think there was a technical or a constitutional issue. He said we want the endowments to be healthy and to provide a permanent long-term benefit to the beneficiaries which are school children and others of this state benefit. The policy choice is not complicated and he could understand others have different views about that policy choice.

Representative Burgoyne said that when it comes to a question about affordable storage, it is not where the investment is, it is the nature of the investment. He said that land that was sold and rather than putting it back into just lands, some of that money went into a tangible asset. He queried, do we want to sell off land and use some of the money from that land to buy blue sky? He said for him, the answer was no, that was too risky. He said even if a professional manager was hired, what was our expertise to do that. He said he thought these types of investments were best made through a broad portfolio with many different kinds of businesses, stocks, bonds and other investments. Money from land, that in his opinion, should have gone back into land, went for blue sky. Let us get that blue sky through that passive, diversified endowment fund investment, which he views as sacred and would probably provide a greater return.

Chairman Pearce said to the Committee that the H 495 bill was before them. There was **no response**. He reminded the Committee there were only three minutes left. **Chairman Pearce** said he guessed the bill would be held in Committee as there was **no motion**.

ADJOURNMENT: **Chairman Pearce** adjourned the meeting at 2:56 p.m.

Senator Pearce
Chairman

Linda Kambeitz
Secretary