MINUTES
Approved by the Committee
Endowment Asset Issues Interim Committee
Thursday, August 28, 2014
8:30 A.M.
EW 42 - Capitol Bldg.
Boise, Idaho

Co-chair Senator Cliff Bayer called the meeting to order at 8:34 a.m. and requested a silent roll call. Members present were: Co-chairs Senator Cliff Bayer and Representative John Vander Woude; Senators Shawn Keough, Jeff Siddoway, Bert Brackett, Janie Ward-Engelking; Representatives Neil Anderson, Jason Monks, Rick Youngblood, John Gannon and Grant Burgoyne (ad hoc). Legislative Services Offices (LSO) staff members present were Katharine Gerrity, Ray Houston and Charmi Arregui.

Others in attendance included: Larry Johnson and Judy Shock, Endowment Fund Investment Board (EFIB); Fred Birnbaum, Idaho Freedom Foundation; Director Tom Schultz and Donna Caldwell, Idaho Department of Lands (IDL); Robin Nettinga, Idaho Education Association (IEA); Jane Wittmeyer, Wittmeyer & Associates; Brent Olmstead, Milk Producers of Idaho; Julie Hart, Juniper Resources; Dan Goicoechea, Office of the State Controller; Dr. Jay O'Laughlin, University of Idaho; David Leroy, Esq., Leroy Law Office; and Clive Strong, Office of the Attorney General.

NOTE: Copies of most presentations, handouts, and reference materials can be found at: www.legislature.idaho.gov and are also on file at the Legislative Services Office.

Co-chair Bayer welcomed everyone in attendance and thanked all committee members and Representative Burgoyne for his wealth of knowledge on the subject matter. He thanked the presenters at this meeting for participating in this effort and for providing a comprehensive background on the issues before this committee relating to HCR 58. He said that at the end of this meeting there would be discussion on how to facilitate additional dialogue.

Co-chair Vander Woude commented that the committee had before them a vast amount of information and he thanked the presenters and the committee for coming together for the purpose of finding solutions. He said that the committee would be dealing with land exchanges, cottage sites and investments. The purpose of this committee is to come up with real solutions that work for the endowments, the Land Board and the Legislature. He welcomed everyone.

Senator Brackett disclosed a potential conflict of interest since he has ownership interest in state land grazing leases. **Senator Siddoway** also disclosed that he has state leases, as did **Representative Anderson**. **Co-chair Bayer** confirmed that these potential conflicts would be duly recorded in these minutes.

The first presenter was **Mr. Ray Houston**, Principal Budget and Policy Analyst, LSO, and his PowerPoint presentation entitled "Endowment Management History Flow Chart" is online at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_houston.pdf
Mr. Houston outlined the following for the committee:

- Endowment Management History Flow Chart from 1890-1969; 1969-2000; 2000-2014;
- Endowment History by the Numbers, acres in millions and distributions in millions;
- Eight Selected Lawsuits over Management of Land Grant Endowments; and
- Endowment Distribution to Beneficiaries Comparison to General Fund Support.

Mr. Houston noted that by the end of 2013 the Permanent Fund, including both public schools and the other land endowments, had reached $1.2 billion and the Earnings Reserve Funds were up to $249.6 million, having started out with zero in the fund in 2000. The total endowment in FY 2013 was $1,460,700,000. The value of the total endowment and distributions during FY 2013 were

$47.51 million. In 2014 the permanent fund was up to $1,399,800,000 and the earnings reserve at $345 million for a total of $1,744,800,000; distributions were $48.84 million. He said there is a lag with the distributions. Essentially, Permanent Fund values are taken for the prior three years, which are averaged, and the 5% distribution rule is used for public schools, for example. That is then used to determine the FY 2016 distribution. **Mr. Houston** said there is always a two-year lag between the time the dollar values of the Permanent Funds and the Earnings Reserve Funds are known and the time the resulting distribution numbers will be used in the budgets.

Mr. Houston said that FY 2015 distributions to beneficiaries were $51,978,200 and the FY 2015 General Fund Budget to beneficiaries was $1,762,218,200, the percentage being 2.9% compared to the General Fund.

Senator Brackett asked about the words "the court ruled" in **Mr. Houston's** presentation, and he asked if there were any examples where the board relied on an AG opinion, as opposed to a court ruling. **Mr. Houston** replied that the cases referred to were all Supreme Court cases and that is what was reflected in his presentation. In terms of management by the Idaho Department of Lands (IDL) or the Endowment Fund Investment Board (EFIB), he said they both rely on their staff attorneys to provide guidance to interpret statutes. **Senator Brackett** asked if ultimately the cases mentioned went to the Supreme Court for the final decision, and **Mr. Houston** confirmed that. He added that when a state agency or elected official sued another state agency, some cases were over principle, a friendly lawsuit to prove that an agency can use permanent funds to back the local bonds.

Co-chair Vander Woude asked about the graphs in the presentation where it said "the Legislature appropriates" and said he wondered if the Legislature has the authority to appropriate any amount they want out of those funds or is it dependent upon the Land Board what can be pulled out of those funds. **Mr. Houston** explained that the Legislature is basically constrained to the amount that the Land Board makes available for distribution. However, he said they could appropriate something less and those dollars would remain in the income funds. There are two other sets of appropriations, he said, one being the IDL budget itself, and also the EFIB has a component of dedicated funds reserved for administrative costs. He added that those are also appropriated by JFAC and the Legislature. In terms of distributions, he said the Legislature has restrained itself to appropriating only the income funds.

Representative Burgoyne asked about a chart in the presentation showing acres in millions and the distributions in millions. During 1969-1970 there was $4.86 million distributed to public schools and in 2013-2014 roughly $31.29 million was appropriated. His question was if these were inflation-adjusted dollars or raw dollars. **Mr. Houston** answered that his figures were not adjusted for inflation and were current year dollars. **Representative Burgoyne** wondered about how, in terms of inflation, his general view was that this is less than a 10% increase over roughly 44 years, adding that this didn't look to him like the inflationary increase was met with the distribution. **Mr. Houston** said that he did look at the consumer price index (CPI) between 1970 and 2000 and it seemed to him that it came in about seven times, so he thought the CPI was lower than what was distributed in 2000. Up to 2000, there were two parts to include in the appropriation. There was an income stream coming from the Permanent Fund and an income stream from IDL. He said it was difficult for the Legislature to anticipate how much they were going to get since there were two separate revenue streams that would fluctuate rather wildly. He noted that one of the ideas of endowment reform was to provide a more dependable, steadily increasing, predictable flow of revenue to the beneficiaries. He added that the jury was still out on how successful that has been. From an analyst standpoint, he said this is a better model than the one between 1969 and 2000. **Representative Burgoyne** asked if it was correct that there are some factors that depress the early years in this 44 year time period that were at least partially corrected with the reforms in 1996-2000. **Mr. Houston** replied that he didn't have the data in front of him, but he said that the distributions since 2000 have actually declined. He said it was incumbent upon the EFIB to reduce those distributions to a

more sustainable level and there has been a shift in paying the current beneficiaries into more of a future beneficiary approach. He added that building up reserves was necessary.

Senator Siddoway asked about the earnings reserve in the presentation, wondering if there was a sale of an asset, would the money go there and be held for a time certain and whether it could be utilized to purchase other assets. **Mr. Houston** replied that the Land Bank allows for the Land Board to sell land and to put revenues from that land into a separate fund called the Land Bank Fund. He said they have up to five years to either reinvest the money into land or, if not, it will go into the Permanent Fund. He noted that there is money in that Land Bank now and they are talking about how to proceed. As cottage sites sell, he said that money goes into the Land Bank as well and it takes Land Board action to decide where that money goes or if it is reinvested back into the land trust. **Senator Siddoway** asked if it was possible for money in the reserve to be accessed for distribution by the Land Board or whether that would be considered part of the body of assets, or corpus, and held tightly and not distributed. **Mr. Houston** explained that the Earnings Reserve Fund is the one that holds the earnings from the Permanent Fund and also the distribution of timber sales. He said that is what the Land Board's responsibility is, to decide how much is to be distributed to the income fund, how much should be put back into the Permanent Fund, and how much should be reinvested in the land trust. He noted that If improvements are made to properties, there is a decision that must be made. A request is made to JFAC, that request is appropriated, and earnings reserves are spent improving that property. He stated that it is the responsibility of the Land Board to decide what to do with that earnings reserve.

Dr. Jay O'Laughlin was the next presenter. He is an author and professor at the University of Idaho. His presentation was entitled "Idaho's Endowment Lands and Other Assets" and can be accessed online at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_olaughlin.pdf

Dr. O'Laughlin explained that legislators created the Policy Analysis Group (PAG) in 1989 and, through the University of Idaho, the PAG has provided timely scientific and objective data and analysis of resource and land use questions of general interest to the people of Idaho. Enabling legislation is found in Section 38-714, Idaho Code, and the PAG is a unit of the College of Natural Resources Experiment Station. He distributed a report entitled: "Idaho's Endowment Lands: A Matter of Sacred Trust (Second Edition)" which may be accessed online at: http://www.idl.idaho.gov/land-board/lb/documents-long-term/olaughlin-endowment-lands-2011.pdf

Dr. O'Laughlin stated that the PAG's enabling legislation created a standing advisory committee and assigned it specific functions. He said that the committee's main charge is to review current issues and suggest topics for analysis. He noted that the first topic chosen was that of endowment lands because there was a misunderstanding about the purpose of the lands and how they are to be administered. He added that twenty years later they were asked to update the earlier report, which was the report he distributed to committee members. He thanked the legislators for creating the PAG and giving him a very interesting twenty-five years of working for the citizens of Idaho to answer difficult questions about resources and land use issues in Idaho. **Dr. O'Laughlin** said he was not appearing as an advocate of anything, but was there to provide objective information. He emphasized that in 1969, IDL was called the Idaho Department of *Public* Lands and in a letter to Idaho's Governor, a troublesome problem the agency faced in managing the state's endowment lands was described as follows:

> Evidence strongly suggests a lack of public knowledge and understanding of the term "state lands." These lands are, at times, referred to as "public lands," "grant lands," "school lands," "endowment lands," etc. Regardless of the term used to describe them, there appears to be a general misconception as to how they were acquired, their purpose and dedication, and their disposition.

Dr. O'Laughlin said that these points do need clarification, and that is what he was asked to address for the members. He said that Idaho is a public lands state with the federal government being responsible for the administration of more than 63% of the land in the state. He noted that State lands that IDL manages are different and have a different mission and purpose. He said that there is a body of assets that consists of almost 2.5 million acres of land. He added that there is the Permanent Fund and an Earnings Reserve Fund. **Dr. O'Laughlin** pointed out that prior to Idaho statehood in 1890, the federal government granted land to the Idaho Territory for the explicit purpose of providing financial support for the state's public schools. He said that the school land grant was confirmed at statehood, at which time other specifically designated public institutions also received land grants for a total of 9 beneficiary institutions. He went on to say that the financial assets in the endowment trusts today were derived from the sale and leasing of the 3.6 million acres of original land grants. He said that proceeds from land sales, leases, and sales of severable assets (e.g., timber and minerals) become financial assets in the trust funds. The Land Board, he noted, plays a key role as it fulfills its constitutional assignment to oversee endowment trust operations on behalf of the endowment trust's beneficiary institutions to ensure they receive "maximum long-term financial return" from the trust assets. **Dr. O'Laughlin** said that he assumed that is why this committee was meeting, to see if that is actually being done. He said that he would be happy to assist the committee in any way he can.

Dr. O'Laughlin told the committee that state endowment land in Idaho totals 2,449,255 acres (2010). Endowment trust land assets include: forest land; agriculture land; rangeland; commercial real estate; cottage sites; minerals conservation; and recreation (non-commercial). He said that there are about a million acres of timberlands and about 1.4 million acres of rangelands. He went on to say that data from 1998-2000 showed that return on assets from timberland is about 6% per year and the return on assets for rangeland is less than 1.5% per year. He stated that the return on asset value is the manner of evaluation. **Dr. O'Laughlin** told the committee that they might go about determining the value of rangeland assets by consulting a chapter in the publication entitled "Endowment Fund Reform and Idaho's State Lands: Evaluating Financial Performance of Forest and Rangeland Assets" that he co-authored with Philip S. Cook. He noted that the comparable sales approach is the best, but if you don't have comparable sales you have to use another method. Although the state of Idaho has hired an appraiser to do comparable sales, **Dr. O'Laughlin** suggested asking if these were really comparable to our state lands; he thinks that answer will be interesting.

Dr. O'Laughlin stated that another publication entitled "Analysis of Procedures for Residential Real Estate (Cottage Site) Leases on Idaho's Endowment Lands" tells how to go about setting lease rates for cottage sites. He said that the conclusion reached was that the matter is a political issue. He added that there are social aspects that must be balanced with everything else.

Dr. O'Laughlin said that as of now, the $1.7 billion in assets is managed by the EFIB and that Director Schultz estimates the assets managed by IDL are worth about $2.5 billion.

Dr. O'Laughlin told the committee that prior to Idaho statehood in 1890, the federal government granted land to the Idaho Territory for the explicit purpose of providing financial support for the state's public schools. He said the school land grant was confirmed at statehood, at which time other specifically designated public institutions also received land grants. He noted that the mission statement for Idaho's endowment lands as expressed in the Constitution of the State of Idaho is quite specific. The mission statement requires the Idaho State Board of Land Commissioners, as trustee, to manage endowment land" ... in such manner as will secure the maximum long-term financial return to the institution to which granted ..." He said that people often shorten this language to "maximum revenue" but revenue is only one part of financial return, since costs are also part of the return. He added that the productive capability of lands must be sustained and this is not always done in the timber or rangeland business.

With regard to restrictions, **Dr. O'Laughlin** emphasized that the Idaho Supreme Court has repeatedly stated, the Land Board "must find authority in the Constitution and statute for its acts." Both the Land Board and the Legislature not only have constitutive authority to use the land to produce financial returns for the public institutions designated as beneficiaries, they have an affirmative duty to do so.

Dr. O'Laughlin told the committee that all states have endowment lands. He recommended a website:statetrustlands.org

Dr. O'Laughlin went on to say that with regard to limitations, the state, by statute, can sell only 100 sections per year, a section being 640 acres, so 64,000 acres per year. He said the land can be held and benefits will result by leasing the land and selling severable assets, like timber and minerals. The dilemmas, he added, like many political issues, are resolved through compromise. He concluded by stating that proceeds are deposited into the permanent endowment fund, and according to the Constitution "shall forever remain inviolate and intact."

Representative Anderson asked about the 3.6 million acres referenced at statehood, and he wondered how that number was determined. **Dr. O'Laughlin** replied that a section of land is comprised of 36 units, each one "x" number of acres, and it was section 16 and 36 in each township that the state received. **Representative Anderson** also inquired about beneficiaries today that are not necessarily public school related and how they got their block of assets. **Dr. O'Laughlin** answered that was covered in the Idaho Admission Act, adding that he did not know what the rationale was, other than they were public institutions that were deemed to be worthy of financial support, even though not public schools. **Representative Anderson** asked if all this dated back to 1890, and **Dr. O'Laughlin** affirmed that to be correct.

Representative Gannon asked if there was any data on the value of the one million acres we no longer have, in present-day dollars. **Dr. O'Laughlin** replied that he could not answer that question and that it would be a huge undertaking, just to identify where those parcels are and to then assign a value. He said that as far as he knows, that information does not exist.

Senator Keough thanked **Dr. O'Laughlin** for his service on the PAG and the work he has done personally which has been of great value to Idaho and its citizens.

Representative Burgoyne asked about endowment governance issues, and whether **Dr. O'Laughlin** had any thoughts about the Land Board and alternatives to a Land Board form of governance. **Dr. O'Laughlin** said that he has not had anyone ask him that before, and he had not given it thought. He said that if he were asked to come back to this committee to comment on a set of questions, he would be willing to tackle that, but he pointed out that he had a mandate, created by the Legislature, to be objective and that any response as to the structure of the Land Board may fall outside that objective purview. **Representative Burgoyne** said that with regard to figures relating to return on asset value for timberland at roughly 6% and rangeland at less than 1.5%, he had two questions. He asked whether those were net of taxation figures or is taxation ignored and what the implications and ramifications of those numbers are. He asked if it is true or a misperception that we obviously should be getting rid of rangeland and move into timber or something else. **Dr. O'Laughlin** replied that these are state lands and not subject to taxation so that was not considered in the analysis published in 2001. With regard to under-performing assets, he suggested changing the management, sell them, have more competition for timber sales and grazing leases which raise rates.

Co-chair Vander Woude asked about Priest Lake and Payette Lake with regard to cottage sites and whether the land that became part of endowment land is just lake-front lots or lots adjacent to a lake or does that land go considerably beyond the boundary of what we now call cottage sites. **Dr. O'Laughlin** said he did not have the answer to that question, suggesting that IDL could better answer that question.

Representative Gannon asked about returns, given the goal of financial return to beneficiaries. He added that we have about $38 million in excess retained earnings for several beneficiaries that

apparently they did not use. He asked if the goal is to distribute excess retained earnings to the beneficiaries or should excess retained earnings be returned to the corpus. **Dr. O'Laughlin** said he was not familiar with surplus earnings.

Co-chair Bayer asked for a clarification on one of **Dr. O'Laughlin's** pie charts and asked if the term "real estate" was being used synonymous with "land." He said he was looking for consistency with regard to terms and asked for clarification. He said he thought that with regard to cottage sites, that the reference should be to "land." **Dr. O'Laughlin** responded that terminology is very important in the business of policy analysis. Being a forest economist, he said that forests are real property; real estate is land on which trees grow, and while trees are attached to the land, they are considered real estate as well. He said that this becomes an important issue with regard to cottage sites because the state administers the land on which there are assets that lessees have constructed and this is a sensitive issue. **Co-chair Bayer** said as he looks through historical information, he sees the word "lands" referenced countless times, but he has a hard time finding the term "real estate," which creates an opportunity for a dialogue on clarity.

Co-chair Bayer recessed the committee at 10:02 a.m. and the committee reconvened at 10:15 a.m.

Mr. David Leroy was the next presenter and said he served four years on the Land Board and that the constitutional lodestar for management of lands considered today was maximum long-term financial return, an idea he elaborated on by speaking of the "Cenarrusa Doctrine," a group of ideas formed in the 1970s and 80s by long-term Land Board member and sheep man, Pete Cenarrusa, that were influential with regards to public land management. The doctrine stated that long-term maximum revenue for beneficiaries required long-term, stable, symbiotic and predictable relationships between those beneficiaries and the state.

Mr. Leroy acknowledged the many changes in public land management since the 1980s, mentioning Article IX of the Idaho Constitution. He said that every section dealing with endowment lands has been amended at least once, though not always substantively. He specified Section 3 (amended in 1998), Section 4 (amended in 1998 and again in 2000) and Section 8, which in 1998 amended the very provision dealing with the location and disposition of public lands. **Mr. Leroy** pointed out that the Idaho Legislature had indeed attempted, in the early 1980s and 1990s, to codify the Cenarrusa Doctrine by suggesting that public land leases would be most beneficial in the long-term, and in the maximization of revenue, if there could be ingrafted into that concept the term "qualified lessees" that looked out for long-term, stable, profitable and predictable leasing partners.

Mr. Leroy emphasized the doctrine's establishment of long-term relationships by citing the Idaho Supreme Court's 1999 decision in The Idaho Watershed Project (IWP) vs. the State Board of Land Commissioners, a case where a nonprofit conservation group alleged that overgrazing of public lands was damaging to the conservation aspects of those lands, and that on those grounds, the IWP should be allowed to apply for and participate in public grazing lease auctions, an activity denied them by the State Board of Land Commissioners, in favor of long-term lessees. He added that the Idaho Supreme Court considered Section 58-310B, Idaho Code, a statute which had attempted to embrace again some of the aspects of the Cenarrusa Doctrine, and had termed "leases" as preferred or available at public auction to qualified lessees who had some of these characteristics. However, he said that this statute, according to the Supreme Court, was in conflict with the Idaho Constitution, from which **Mr. Leroy** then quoted, in part, as follows: Article IX, Section 8 of the Idaho Constitution provides that the objective of sales and leases of endowment lands is to "secure the maximum long-term return to the institution to which granted or to the state if not specifically granted ... "

Mr. Leroy went on to say that prior to the enactment of Section 58-310B, Idaho Code, hearings in the Senate Resources and Environment Committee disclosed that the Idaho livestock industry contributed somewhere between $1.2 and $3.8 billion to the Idaho economy as compared to only $78,000 from conflict bids for public grazing lands. He stated that aside from the strict financial gain to the state, supporters of Section 58-310B, Idaho Code, urged the committee to consider several

other factors, all financially related, including the stability of the livestock industry, the effect of the overall economy of ranchers going out of business, jobs and additional tax funds generated by the livestock industry and the effect on those who supply the livestock industry. As a result of those factors, he noted that proponents argued that if the livestock industry were weakened, the moneys to be obtained from bidding auctions would also be weakened, since there would be fewer participants in the livestock industry to place bids. The court went on to say that the board had indicated that it needed to consider sales, income, and property taxes from businesses conducted on leased lands in determining maximum long-term financial return. He added that the board also stated that in the previous year, $22.4 million had been earned from rents on school endowment lands, which moneys were funneled directly to the schools of Idaho, while an additional $800 million had been collected in various taxes that were of benefit to the state as a whole. According to **Mr. Leroy** the factors considered by the board in this case mirror the factors presented to the Senate and discussed prior to the enactment of the statute. He stated that the holding of the Supreme Court was as follows: rather than seeking to provide income to the schools and to the state in general, Article IX, Section 8, requires that the state consider only the maximum long-term financial return to the schools in the leasing of school endowment public grazing lands. Article IX, Section 8 requires the Legislature to provide by law that the land from Congress carefully be preserved, held in trust, subject to disposal at public auction for the use and benefit of the respective object. He said that by attempting to promote funding for the schools and the state through the leasing of endowment lands, Section 58-310B, Idaho Code, violates the requirements of Article IX, Section 8. He went on to say that the board applied the considerations contained in the statute, and by those considerations, IWP was denied the opportunity to participate in auctions. The court said that while it acknowledged that the board is granted broad discretion in determining what constitutes maximum long-term financial return to the states, the statute removed much of the discretion of the board by impermissibly directing the board to focus on the schools, the state, and the livestock industry in assessing lease applications, all to the detriment of other potential bidders.

Mr. Leroy summed up his view with regards to the IWP litigation as a case of the state having taken the kinds of things being talked about in the Cenarrusa Doctrine (and which had previously been adopted by the Idaho Legislature as statute), and seeing therein an example of the collaborative effort between the Land Board and the Legislature in trying to take a broad look at how to maximize financial value, and pointing out that the auction requirement of the Constitution as narrowly construed, does not permit the consideration and the promotion of long-term partnerships by lease terms, and that broad statutory definitions do not focus solely on even participation in public leases.

Mr. Leroy said that what he was suggesting in terms of what it used to be and what it might one day become is that this may be the time to revisit some portions of the Cenarrusa Doctrine in some lawful, constitutional form and hopefully do so in a way that is consistent with the Idaho Supreme Court's decision, and that recognizes that in 1998 the voters of Idaho ratified a constitutional amendment that required the term "disposal" in the Constitution to apply only to sales and not to leases. He asked that the committee recognize the decision in the *Wasden (State Attorney General) v. State Board of Land Commissioners* decision that said that leases in Idaho under our Constitution are by them interpreted to continue to be included in the term "disposal" although the supreme courts of several other states have actually determined that leases are not disposals under similar constitutional language. He said that one cannot rewrite that history or ignore that history, but did urge that there may well be some room for an effort to recognize the Cenarrusa Doctrine even in today's modern landscape, even though many things have changed. He directed the committee's attention to discerning what may remain of the Cenarrusa Doctrine, even under these legal decisions, and what could or should become the policy of the state. He then directed several points to the committee's attention as follows:

(1) There is a great need in working with public lands and the income from public lands for predictability, that, for the board, helps avoid conflict and public problems with the electorate,

and that, for the lessees, is essential in making intelligent bidding decisions, and which, for the public schools, helps to predict incomes.

(2) There is a need to consider the mandate of "long-term" in the constitutional language. There is a time component to the money goal in the language pertaining to maximization, and a legitimate question to be asked of practices today concerning whether those practices are only helpful for today, or whether they also maximize benefits for tomorrow's beneficiaries.

Mr. Leroy opined that a better concept and perhaps some legislative encouragement about how we mandate, maximize and define "long-term," was needed, more perhaps than we have had in the past. According to **Mr. Leroy,** the whole central proposition and touchstone for someone who sits on the Land Board, and for staff and the Director of IDL, is the prudent investor rule, which addresses how we prudently invest these moneys so as to maximize for the long term. He stated that the prudent investor rule, as distinguished from the prudent investor statute, a far more organized, orchestrated and calibrated federal law, is actually a fairly simplistic notion, that simply says to a member of the Land Board, or to a legislator interacting with members of the Land Board, that you must invest trust assets as if they were your own funds, basing your decisions on available knowledge at the time the investment is made. **Mr. Leroy** mentioned that the board has adopted guidelines, plans and strategies that consider the needs of beneficiaries, the provision of regular income, the preservation of trust assets and the avoidance of excessive risk.

Mr. Leroy finds nothing in the prudent investor rule that would bar consideration of the kinds of components found in the Cenarrusa Doctrine, and he thinks that a number of the distinguishing features found in the federal prudent investor act do not necessarily apply to Idaho's Land Board. In the difficult proposition wherein our state lands are one set of assets, and our state endowment finances are another asset, he said one could pose the question of whether we should sell all of our state lands in pursuit of a higher rate of return in New York-based investment markets. He added that is a significant rub for the prudent investor, and nicely focuses the question as to whether there remains anything, or should remain anything, of the Cenarrusa Doctrine in such a consideration.

Mr. Leroy then stated that a fundamental decision needs to be made. He commented that at one time Idaho had 100% of the value of the state endowment funds, assets and moneys held in lands. He asked whether we should hold 80%, or 60% in lands, and if so, which lands – forest land, mining land, grazing land, or commercial land. He added that the rate of return is part of the prudent investor's decision, but it seemed to him that in looking at the history of the state, the Cenarrusa Doctrine, and the management of our State Board of Land Commissioners, historic and current, all have recognized the long-term immutable value of land, and that it must be a mix. **Mr. Leroy** asked to what extent should the trust be bound to an 1890 mix of land, whether it must all be undeveloped and non-improved, whether there is any room for commercial and developed property with a higher rate of both appreciation and risk, and how to handle the competition with the private sector issue all need to be considered. He said that it seemed to him, without supplying answers to these issues, that the committee has five tools to use as it pursues answers:

(1) There should be more legislative collaboration with IDL. **Mr. Leroy** said that his experience with IDL is that it has an extremely capable staff on board at this time, and that Director Schultz is able and accessible and meets personally with people to discuss problems, even when a person brings an attorney into the room. **Mr. Leroy** said that he believes that to be a great rarity, and trusts that Director Schultz will be willing to share that same access with members of the Legislature, particularly a member with a good idea, and that more legislative collaboration with IDL would mean that all good ideas and all potential statutes would be vetted and refined, prior to the session, through interaction with IDL and staff.

(2) The Legislature should seek, and the Attorney General should issue, more frequent opinions on critical questions related to public lands. **Mr. Leroy** stated that he is very respectful of the Attorney General's Office, but there was one issue last year that shows and illustrates what he means. He said that In his day they issued a whole book of Attorney General's opinions and

over the years they have become fewer and fewer, with more informal guidelines. He said that the use of actual Attorney Generals' opinions is a very valuable tool in predicting outcomes for both the courts and Legislature, and should be utilized more. He added that in the process of passing Senate Bill 1277 last year, just ten minutes before a bill was called to the committee for final action, an Attorney General's opinion of several pages was presented to participants, including panel members, without time to digest the same. He went on to say that of even greater consequence was the fact that the Attorney General's opinion related to Senate Bill 1277, and was presented just ten minutes before the House committee met, after the Senate had already passed the bill. He said that kind of timing is problematic for the Legislature and for the Attorney General.

(3) The Legislature should continue to promote and urge fundamental decision making by the Land Board. The commissioners are well-intentioned, popularly-elected public officials who carry the burden of education funding on their backs along with the mantle of forever, perpetuity, and posterity as a part of the maximization, a task they assume.

(4) This particular Land Board courageously made a decision that no prior Land Board has ever countenanced: the disposing of cottage site inventory. This board has demonstrated that it is willing to make fundamental decisions and recognizes that dialogue and interaction with the Legislature is a very useful tool. In part, by legislative action and interaction, the board issued a press release on February 18, 2014, saying that the Land Board suspends commercial property acquisitions. **Mr. Leroy** asked that this committee encourage and shepherd that to the extent they can. **Mr. Leroy** once again asked that the committee remember and move toward the Cenarrusa Doctrine.

(5) The legislature should remember and move toward the Cenarrusa Doctrine. Long-term, predictable, symbiotic relationships, in his view, do indeed maximize income over the long term. He said that state forest land income requires a state forest industry from which these incomes would be derived. The same can be said of grazing, mining, and agriculture. **Mr. Leroy** said those same lumberjacks, mills, mining communities and lessees, as the Supreme Court considered and dismissed in the IWP case, do indeed pay property taxes and sales taxes and in many other ways improve the quality of life in communities and support the government of the state. He noted that this is the way things were, and the way things should become.

Co-chair Vander Woude asked how one describes long term with regard to an investment, sometimes ignoring immediate needs thinking that something is being saved for the long term. He asked how far out we look with regard to long-term needs. **Mr. Leroy** said there was no easy answer to that question and that it needs to be on a case-by-case basis. He suggested there is some value in fundamental decisions and having a concept that includes an immutable mix of land and there is value in looking at short-term as well. He said he didn't have an answer as to how to balance that, but he thinks the Land Board can give sufficient guidance. He thinks we need to have a concept of how immediate needs will trend toward a long-term result. **Co-chair Vander Woude** said that opinions had been sought regarding legislation dealing with the Land Board that differ from an AG opinion on legislation. He asked how is that issue resolved when two well-known attorneys differ. He went on to ask what legislative authority is there with regard to the Land Board and endowments. **Mr. Leroy** answered that it is important to remember that there is only one Attorney General and Mr. Wasden's office has extremely competent lawyers who act in the best interest of the people. He said that there are, however, always differences of opinion. He added that when he is honored with an opportunity to provide his view of such an opinion, he always starts with the likelihood that he will agree with the Attorney General. However, he said, on matters of broad constitutional policy, the possibility of differing opinions always arises. He noted there are certain features of the public land law, such as texts dealing with exchanges, where the Legislature, in his view, has an upper hand. He said that the only devise by which Land Board judgments, bad or good, can be modified is either by public persuasion or judicial review. He added that If the Legislature wishes to get into litigation, it certainly may, but the opportunity to clarify, further refine or have

dialogue with a majority of Land Board members who may or may not agree with an AG opinion, is open to legislative members as well. He suggested a great deal of dialogue between the Legislature and interested bill sponsors at the department staff level so that perhaps legislative appearances before the Land Board could resolve some of these questions and make litigation unnecessary.

Senator Siddoway said that one thing that has been plaguing him has been non-performing assets that lay within the endowment. He said that as a rancher, what he is willing to pay for utilizing land assets are pretty minimal on a per-acre basis. He said it seems to him that over the years land values have always appreciated, but he wondered if the state wouldn't be better off to sell some of those lands. He added that when liquidated and moved out of a portfolio, it only makes sense that it is done on a private treaty basis, an auction basis. He said some ranches have endowment lands inside their operations that have no access for people from the outside, and it doesn't make sense to put that up in a bid, in his opinion, if nobody is going to show up. He asked **Mr. Leroy** to speak to those problems and what kind of resolution he would advise.

Mr. Leroy replied that the issue of non-performing assets is a perfectly useful device to examine the prudent investor rule and what the state should prudently do. He said that there are those that hold that all lands are valuable and others see a pragmatic result in taking grazing land and turning it into a commercial building that performs by paying rent twelve months a year at a very high rate, for example. He believes that exchanges are a very good way to go and he thinks it is exciting that the Legislature has the opportunity to interact with the Land Board, with IDL and on an almost equal basis in terms of the constitutional language. He said the current problem with exchanges is that they have been throttled by this thread of predictability or unpredictability which he identified. Therefore, to address the issue he suggested that one of the functions of this committee ought to be to engage in how to make exchanges predictable, how to make them palatable to the AG and members of the Land Board and how to use exchanges to move toward whatever fundamental policies this board will adopt about an asset mix. He went on to say that there could be an asset that is non-performing today that could have some new extremely valuable mineral yet to be discovered under it. He said we cannot predict those far future events, but we can make intelligent choices and exchanges today.

Senator Siddoway asked about an auction versus a private treaty, which is not allowed now, but is that something that should be examined and would a constitutional change be required. **Mr. Leroy** replied that public auctions are not particularly defined in the Idaho Constitution and what constituted a public auction in a pioneer community is a far cry from the endeavors gone through for months today to auction a single parcel of state land. He stated that whether minimum bids can be set and whether appraisals are appropriate to suggest value to bidders, all of these questions swirl around public auctions, although public auctions are clearly spoken to under constitutional language as a principal device for disposal, and our Supreme Court has suggested disposal includes leases. He said he wasn't sure what the Legislature could do to make sure a private treaty qualifies as an exchange under constitutional language. **Senator Siddoway** clarified that he was referring to selling, like the rest of the world does business. He said if there is a parcel of land with an evaluation of value, why can't a real estate team be sent with that valuation and try to negotiate a deal with a rancher that has an interest in that land, without going through an exchange or a bid process. **Mr. Leroy** answered that he thought that would clearly require a constitutional amendment; he said that he assumes the AG has so opined.

The next presenter was **Mr. Clive Strong**, Division Chief, Natural Resources Division, Office of the Attorney General. His PowerPoint presentation is online at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_strong.pdf
Mr. Strong addressed the role of the Attorney General and noted that when opinions are issued they are trying to predict what a court will say and they are not looking at something from the perspective of the Land Board or the Legislature. He reiterated that It is a prediction, and not a conclusive decision which can only come from a court, the ultimate arbiter of language. He said that, unfortunately, the office is not always in control of the timing of an opinion. He noted that they are

respectful of the Legislature's authority and traditionally do not engage with the legislature, unless requested to do so. He added that there are strongly held views on various pieces of legislation and the AG's office is often used as a foil for the purpose of either advancing or defeating a bill. He went on to say that it is easier to do a better job when they receive a request for an opinion earlier, rather than later, and to vet the information. He said a more active dialogue on issues prior to introduction of legislation would be very helpful and added that when legislation is thoroughly vetted through the committee process for review, fewer conflicts result and there is a better outcome for everyone. **Mr. Strong** said that his presentation involves how he would analyze both the legal authority of the Land Board and the legal authority of the legislature and that he was not taking a client perspective or a policy perspective. He said the most important tool they use when constitutional interpretation questions arise is to go back to constitutional debates, particularly on this issue of endowment lands. He referred to a handout which is online entitled "Idaho Endowment Lands and the Idaho Constitution" compiled by Dennis C. Colson, University of Idaho College of Law: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_strong3.pdf
Mr. Strong stated that there was a heated debate referred to in the publication, similar to what is going on today, about whether to sell or keep the lands. He said some lands were sold, most were retained, and limitations were imposed on the disposal of lands.

Mr. Strong pointed out another handout entitled the "Idaho Admission Bill" which is online at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_strong4.pdf
Mr. Strong said it's important to remember that endowment lands are lands granted to the state as part of statehood. He said endowment lands are those lands granted to the state for support of public schools, universities, and certain other public beneficiaries. The Idaho Admission Bill has limitations on how these lands can be managed. He said that a trust consists of three elements: (1) trust property; (2) trustee; and (3) beneficiary. He added that the Land Board is "to provide for the protection, sale or rental" of endowment lands and lands are to be managed "in such manner as will secure the maximum possible amount therefor." He said lands are to be "carefully preserved and held in trust" and that lands are "subject to disposal at public auction." He responded to an earlier question by **Senator Siddoway**, reponding that to enter into a private sale would be contrary to the constitutional limitation and it would have to go through a public auction or an exchange. The Legislature is to provide for the sale of lands and for the sale of timber. The Legislature is to "provide for the faithful application" of all proceeds for the benefit of beneficiaries. He went on to say that the Land Board has been the trustee of lands since 1914 and this is indisputable. He also addressed the prudent investor rule and stated that the members of the Land Board are, as it were, the trustees or business managers for the state in handling these lands, and on matters of policy, expediency and the business interest of the state, they are the sole and exclusive judges so long as they do not run counter to the provisions of the Constitution or statute, as found in **Pike v. State Bd. of Land Commissioners,** 19 Idaho 268 (1911).

Mr. Strong said that there has been consternation about whether the Land Board should be engaged in competition. He submitted that the Land Board has been engaged in competition from the day the trust was created in terms of timber sales, land sales, grazing leases, and the debate is really what *type* of business the Land Board should be engaged in. He went on to say that questions arise around what is property and what is real estate; this is particularly difficult with regard to cottage site leases because the Land Board holds in trust those lands for the benefit of beneficiaries. He stated that pursuant to leases that were executed, individuals built structures on the property and the question becomes who owns the land. We have a split state where the state owns the land, and structures created on that land are personal property owned by individuals. He commented that this fact does not preclude the Land Board from owning fixtures and that those improvements become part of the real estate itself. **Mr. Strong** went over the legislative role and limitations on legislative authority. He said that, contrary to a suggestion made earlier in the meeting, the board is not of the opinion that the Legislature does not have a role in the process. He stated that the Land Board is subject to properly and duly enacted legislative principles and the question is what those are. He added that

both the board and the legislature have a fiduciary role to act in the interest of the beneficiaries. The dividing line, from a legal perspective, becomes whether legislation tries to direct an outcome.

Mr. Strong concluded by providing the committee with the some principles he believes are well established:

> Endowment lands are held in a sacred trust. Both the Land Board and the legislature have the fiduciary duty to manage the lands for the benefit of beneficiaries. Legislation is explicitly cabined by the constitutional requirement that endowment lands must be preserved and held in trust and disposed of for the use and benefit of the respective object for which said grants of land remain. Land management decisions cannot be influenced by personal or political motivation and endowment lands cannot be managed to benefit lessees, particular industries or the state in general. **Mr. Strong** commented that **Mr. Leroy's** suggestion of taking into account the Cenarrusa Doctrine would certainly be a policy choice of this committee, but in order to do so, that would require a constitutional amendment. **Mr. Strong** said he was simply describing what he thinks the law is today. He doesn't think simply by statute that constitutional authorities can be changed. Endowment land must adhere to the principle of trust law.
>
> The legislature may regulate the Land Board's exercise of its business judgment and discretion but cannot deprive the board of its constitutionally vested discretion or substitute its discretion for that of the board.

Mr. Strong commented as an aside that the exchange authority is different than the other three authorities of the Legislature and the reason for that is, it was added by a constitutional amendment. It was clear, in that context, the Legislature has the ability to define the methods and procedures for exchange. The Land Board understands that proposition. During the last session, the Legislature changed that process to remove the requirement for similar lands, so that has removed a barrier that was in place before. Now the Land Board has the ability to exchange lands for lands of a similar nature, but that provision doesn't resolve all issues because there is still the business judgment about whether an exchange should go forward. **Mr. Strong** stated that he did not agree with **Mr. Leroy** on the proposition that the Legislature would have the authority to direct an exchange. He believes that is within the business judgment of the Land Board, but there is more latitude in the scope of what the legislature can do under the exchange authority, as opposed to other authorities. He again emphasized that he was not here as a policy maker; he was here to give the committee his best legal judgment on what he thought the court would do in terms of sorting out respective authorities of the Legislature and the Land Board.

Representative Anderson noted that recently the Land Board reversed a decision it had made previously with regard to buying commercial property, and asked if the board decided it was not a sound business principle or that it would not maximize revenues in the long run, or were there other conditions germane to that decision. **Mr. Strong** replied that the decision of the board was based upon whether it was a sound business judgment to proceed in that particular forum. He stated that everything the board deals in is commercial, but he clarified that what was being talked about was the idea of actually owning structures and then trying to manage those through land management companies. Prior boards initially went forward with the idea of trying to acquire those lands, viewing them as an opportunity to address a diversification problem with cottage sites, trying to move out of an asset that had become difficult to manage and to find one more manageable. He said the outcome was that constitutional amendments were proposed to try to free up some business judgment decisions under which there are limitations, such as the requirement that property be disposed of at public auction. It became apparent to the board that if commercial buildings were going to be owned and disposed of, one must be more "fleet of foot" than we can under our constitutional provisions. The idea of offering a building for public auction is not commercially reasonable. The board also looked at the political consternation that it caused and there was a multiplicity of factors. He went on to say that a time-out was taken to determine if that was a prudent business decision, and the board is in the process now of hiring an outside consultant to look at legal constraints on their ability to manage those lands and to look at

opportunities for being effective managers of those lands. He said that ultimately, a decision will come from the board to address concerns raised.

Representative Burgoyne said that it struck him that there are some traditional reasons why public auctions are popular devices when it comes to government and he wondered if **Mr. Strong** agreed about what some of those traditional reasons are. He went on to comment that public auctions inhibit corruption; they give everyone an equal opportunity to purchase or lease; they better assure that sales prices and rents equal fair market value than do estimates given by real estate agents and appraisers; and they promote transparency and greater public understanding and confidence in government. He asked whether Mr. Strong believed those are reasons that traditionally have underlied the reasons that governments institute public auctions. **Mr. Strong** replied that he does agree.

Co-chair Vander Woude said that **Mr. Strong** had stated that the job of the AG's office is to offer legal opinions that are not necessarily based on what a client may want to have. He wondered how that is separated when the client sits on the Land Board and that client is asking for a legal opinion on legislation, trying to separate that legal opinion from the client when the client is you. **Mr. Strong** replied that in government service, we all serve in multiple capacities and we all have potentially conflicting roles. He said that we all have integrity within our office; when he serves in the capacity of issuing an opinion, all other roles must be set aside to offer an opinion based upon the best interpretation of what that law is. He said all clients cannot be satisfied, and the chips must fall where they may. **Co-chair Vander Woude** said that if all the endowments must benefit the beneficiaries, how do you get conservation and recreational land in your endowment lands that benefit solely the public schools or a university when you have lands in those categories. **Mr. Strong** replied that it is not the *use* of the land that is being looked at, but rather the return that land is getting. If a conservation lease yields a higher return than some other use, then that is consistent with fiduciary duty. If not, then the fiduciary duty has been violated, and that is not an appropriate transaction.

Senator Brackett asked about exchanges and wondered if **Mr. Strong** could prepare a slide or two on exchange authority consistent with the rest of his handout to distribute to the committee members, and **Mr. Strong** agreed to do so.

Director Tom Schultz Idaho Department of Lands, Secretary to the Land Board, was the next presenter and his PowerPoint presentation is online at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_schultz.pdf
Director Schultz said that he came to IDL three years ago from Montana. He explained that a township has 36 sections, each section is 1 mile by 1 mile, roughly 640 acres, but not all sections are 640 acres. He said that in 1890, Idaho came in under the Idaho Admission Bill and each state received two sections, about 6%, so state lands total about 6%. He stated that those lands had to be surveyed, after which the federal government relinquished control of those lands to the states in order for the state to take ownership of that property.

Director Schultz told the committee that last year the state made $72 million from forested trust lands. He encouraged debate and discussion about accountability and performance, but he assured the committee that timberlands are managed in premier fashion. He said that he thinks IDL has been unduly beaten up over management of grazing and rangelands and he thinks that IDL has fermented that discussion. He stated that they have tried to look at comparable sales as a way to value rangelands, which is inappropriate and doesn't work. He noted the lands that we have are largely illiquid and we cannot divest of them. He added that the sale of timberland is precluded and rangeland can only be sold to a person in the amount of 320 acres per lifetime. The founders were trying to balance what to keep and what to divest of, but there are significant limitations. He went on to say that valuing land is very difficult since appraisals based upon comparable sales vary between $500 to $2000 per acre, but a mass appraisal was done that said that rangeland is worth

$775 per acre. He said that if rangeland was to be sold that was probably a reasonable value, but asked when was the last time anyone saw rangeland sold. He continued that no more than 320 acres are sold at one time, and the transaction costs can far eclipse the value of the exchange. This has to be considered with appraisal methodology and he championed **Dr. O'Laughlin's** work on this issue, looking at land expectation value and not relying on comparable sales as a way to measure performance of rangeland assets. **Director Schultz** said he could use a comparable sales approach and give you a value of $1.1 billion; when you talk about how much money is being returned from state trust lands in Idaho and you're told that we have $4.2 billion in assets and $1.1 billion is rangeland, he believes this to be an erroneous figure. **Dr. O'Laughlin** suggested the value in 2001 was $26 million and **Director Schultz** said he would argue fundamentally that value has not substantively changed today. He said that using that $26 million value for the rangeland asset based on methodology advocated, we returned a 3% return from rangeland asset this year, netting $775,000. He told the committee that IDL is meeting with lessees around the state getting input and feedback on these very issues. He said it is not that the rangeland asset is being neglected, and it's not that it is significantly under-performing, asking how do you measure performance. He went on to say that a one-size fits all approach is inappropriate. **Director Schultz** said he has been frustrated by cottage sites, and he shared that 85% of his time last year was spent on the issue of disposition of cottage sites. He said this is a critical concern and issue for so many people including legislators, lessees, and the endowment and they are focused on disposition of those assets. He said there was an auction on the day of this meeting to sell 60 lots on Priest Lake.

Director Schultz read IDL's mission statement: "To professionally and prudently manage Idaho's endowment assets to maximize long-term financial returns to public schools and other trust beneficiaries and to provide professional assistance to the citizens of Idaho to use, protect and sustain their natural resources." He said he spends as much time managing endowment lands as on regulatory programs. IDL protects over 6.2 million acres in Idaho from wildfires, they regulate oil and gas in the state and forest practices, as well as surface mining, dredge and placer mining, and they issue dock permits at navigable lakes. He noted that the State Board of Land Commissioners includes the following elected officials: the Governor, Secretary of State, Attorney General, State Controller, and Superintendent of Public Instruction. He added that authorities include the Idaho Admission Bill, the Idaho Constitution, and Title 58 of the Idaho Code.

Director Schultz emphasized the authority of the Land Board in the Idaho Constitution, Article IX, Section 8: "It shall be the charge of the State Board of Land Commissioners to ... manage the endowment lands in such manner as shall secure the maximum long-term financial return to the institution to which granted"; "...not to exceed one hundred sections of state lands shall be sold in any one year, and to be sold in subdivisions of not to exceed three hundred and twenty acres of land to any one individual, company, or corporation." He said this is a real key piece and a fundamental game changer; these lands are largely illiquid because of that provision. He said the limitations are not in statute, but are in the Constitution. There have been attempts and discussion about amending this again.

Director Schultz was asked to compare similar agencies in other states, how they are structured, and he shared various land board models with the committee.

Co-chair Bayer recessed the committee for lunch at 12:05 p.m. and they reconvened at 1:33 p.m.

Director Schultz discussed the evolution of the Department of Public Lands (created in 1919) and noted that the name changed to the Idaho Department of Lands (IDL) in 1974. He explained that there are sovereign lands, endowment lands, state lands and all of those are public lands. The Constitution refers broadly to public lands, so when you talk about the authorities of the board, they have authority over not just endowment lands, but also state lands, sovereign (or public trust) lands, as well as all state lands. IDL is charged with the responsibility of managing those lands. He pointed out that the Land Board meets monthly, each member designates one or more staff persons

to be focused on Land Board issues, and IDL stays engaged with Land Board members and staff throughout the month. **Director Schultz** said that he works for all five members of the Land Board and he keeps them all apprised of issues; he also reports to the Oil & Gas Conservation Commission, and is Chairman of the Idaho Board of Scaling Practices. He explained IDL's agency structure, diversity of duties, endowment functions (how they make the money), and regulatory and service functions. He thinks that IDL is doing what they are supposed to be doing with regard to revenues, and this year was a record year. He told the committee that IDL generated more money in FY 2014 then ever before, almost $102,000,000, including almost $12,000,000 in land sales. Timber sales comprised a record harvest of $72,735,914 and IDL has 6% of the forest land in the state and 33% of the harvest comes from state lands. Going forward, looking at revenue projections, as IDL disposes of cottage sites over the next 10-20 years, he said there will be a reduction in revenue on the land side because that asset generates a 4% return. As land is disposed of and that money is put into the Permanent Fund, the Permanent Fund will grow, but the income generated from the land will decrease, and he emphasized that everyone needs to remember that. One of **Director Schultz's** top goals is to reduce commercial real estate (revenue from cottage sites) down to zero from $5.2 million for FY 2014 and convert that into the Permanent Fund to be invested with a target return of 6%. This calendar year alone, he predicted that IDL will have generated over $50 million solely in cottage site sales. He had talked earlier about the value of cottage sites being $200 million, so about 25% of that value will have been disposed of by the end of this calendar year.

Director Schultz pointed out the many regulatory functions of IDL and he explained that IDL works with the federal government in forestry programs. Federal land issues are being examined including what the role of the state is, and IDL has been part of those discussions, but he said the Land Board has not advocated a position of divestiture by any means. However, they are looking at the Farm Bill provisions that allow the state to help the federal government manage lands through contract administration and other things. He said the role of the state needs to be clarified before too long on these issues.

Director Schultz went on to tell the committee that IDL is the administrative arm of the Oil and Gas Conservation Commission, a five-member citizen commission appointed by the Governor and confirmed by the Senate. **Director Schultz** next mentioned acquisitions and dispositions as being a hot topic over the last several years. Section 5 of the Idaho Admission Bill authorizes sale of endowment land and exchange of endowment land for other public or private land. Sale auctions are authorized by Article IX, Section 8 and Section 58-101, Idaho Code. Sale proceeds can be deposited into the land bank fund and used to acquire land for the same endowment within five years of the sale." ... not to exceed one hundred sections of state lands shall be sold in any one year, and to be sold in subdivisions of not to exceed three hundred and twenty acres of land to any one individual, company or corporation." He said that the 320 acres used to be 16, in the original constitution, so it's already been amended once. He added that land exchanges are authorized by Sections 58-105.8, 58-133 and 58-138, Idaho Code. He stated that there was an amendment last year to Section 58-138, Idaho Code, to require review appraisals for properties in land exchanges. There were concerns over some of the exchanges proposed over valuation, and he pointed out that the piece that is usually questioned on a land exchange is the appraisal. The amendment was an effort to bolster confidence in the appraisal process.

Director Schultz was asked to address due diligence in relation to acquisitions, what IDL does before exchanges or sales, and he gave the committee a very long list of that complex process, adding that evaluation is the critical piece. He said that auctions for ownership were previously covered and the Constitution requires there be open, public auctions, and anyone can participate if they meet qualifications of auction participation. IDL cannot sell to someone who is not a U.S. citizen, and that is in the Idaho Code. He mentioned that, in case there were fears of Canadians buying cottage sites at Priest Lake. With regard to conflict lease auctions, this pertains to everything that IDL leases and they advertise on IDL's website and on other commercial websites for a minimum of 14 days, and

sometimes 30-60 days. He noted that just because land is advertised as a conflict lease auction does not mean that it's going to have a conflict. A conflict is basically a competitive bid, he said. All expiring leases for endowment trust lands and applications for "new" uses are subject to the public auction requirement if multiple lease applications are received for the same site. Expiring leases are advertised. IDL knows two years in advance when grazing leases will be expiring and those are advertised on IDL's website. He went on to say that after the advertisement period, if more than one person applies to lease the same land, the lease is auctioned to the applicants at a conflict auction. A bidder bids not on the value of the lease rate, but rather the bid is on a bonus payment.

Director Schultz addressed oversight by saying that there is a Land Board subcommittee on endowment investment governance established by the Land Board in December 2013 and he handed out a Land Board memo and Maynard Report, all available online. He said the purpose was to review investment decisions and recommend to the full Land Board a governance structure for those decisions, especially those that may warrant outside expert review, consistent with the prudent expert approach. He added that Callan Associates was hired to act as a third-party independent reviewer and consultant for comprehensive strategy review. In October 2014 that subcommittee will present recommendations to the full Land Board.
Representative Anderson asked for elaboration on mineral rights and what the policy is dealing with buying and selling property. **Director Schultz** replied that at statehood we received about 3.6 million surface and subsurface acres and the minerals are broken into different types such as coal, phosphate, oil and gas. Statute currently in Idaho precludes the sale of minerals, which he believes is a good thing. However, there is an exception in code that changed in the last ten years which says if there is a commercial property on the surface, that we could then dispose of the minerals. He stated that the general policy of the state is to retain minerals and to not sell them due to the unknown value in future years. **Director Schultz** said that the only producing oil and gas well in the entire state right now is on state minerals near New Plymouth and the surface is not owned by the state, since it has been previously sold.

Representative Burgoyne said he was intrigued about what the director said about owning property out of state because that seemed to be what Mr. Maynard was driving at in his report. He wondered if the director or Mr. Strong could tell him if the EFIB were to acquire land in another state or another country, would it be subject to our constitutional and statutory requirements and limitations on things such as the amount of land that can be sold in a year, and does that count against that limit, the public auction requirement, proceeds going to the land bank. If you can only sell Canadian land to U.S. citizens, it may really impact marketability of the property. **Director Schultz** deferred that question to **Mr. Strong** who replied that typically when EFIB invests, it doesn't invest in property but rather in real estate trusts, so it is a liquid form of investment and that EFIB has not invested in lands outside the state of Idaho. **Representative Burgoyne** said he had been troubled about the constitutionality of bidding on the bonus rate to pay a predetermined rate of rent which happens in leasing cottages and rangelands, but it seems that it adds a layer between what he regards as a true public auction and using appraisals or estimates to get to a rate for rent which may drive people to or away from an auction. **Mr. Strong** answered one could bid on the rate, adding that nothing in Idaho would preclude us from doing that, or you could do the bonus bidding process because that is money up front. He said that the question raised was a good one because if all the money must be available up front, what kind of chilling effect might that have on somebody's willingness to come in to bid versus bidding on a rate being paid over time. This could be evaluated under the prudent investor rule.

Representative Gannon asked for more information relating to $5 billion in assets having been disposed of since 1890. **Director Schultz** stated that about a million acres had been disposed of since statehood, so it depends upon the value per acre of that land. A lot of the land disposed of was agricultural property and was consistent with what was going on with the Homestead Act at the time. Today, agricultural land in Idaho is worth between $1,000 and $5,000 per acre. **Representative**

Gannon asked about the Payette Lake cabin lots and selling that property now versus what it may be worth in fifty years. **Director Schultz** said typically a very conservation number is 4% appreciation per year, adding that cottage sites might be closer to 6% appreciation. The Land Board made a determination that a better investment could be made and this was a policy decision, although there has been much debate about divesting cottage sites. The Land Board was unanimous on this decision in 2010 and the will of the board is being executed in the sale of cottage sites. He stated that this is a very contentious and tenuous proposition and the amount of effort it takes to generate that $5 million can be better spent in increasing our timber portfolio, finding better ways to look differently at oil and gas, or investing in croplands. He added that by far, over the last 5-50 years, there is an inordinate amount of time spent on cottage site issues as compared to other issues that IDL manages.

Co-chair Vander Woude asked about the Snake River jump and where that $1 million of income was accounted for by IDL. **Director Schultz** said that was probably accounted for in commercial since it was a one-time bonus. **Co-chair Vander Woude** said that would probably explain the higher commercial income than what he thought there was. He then asked about the Land Board approving a land use permit for cottage site owners and he wondered how that falls under the constitutional guidelines with regard to lessees. **Director Schultz** responded that approval was done about a year ago. There is a requirement under the Constitution to have an oral auction for dispositions, and a lease is considered a disposition. A permit, something that guarantees less rights, cannot be assigned and has a limited duration and a lease and a permit are different instruments. Permits don't necessarily require an auction, but does not preclude IDL from going to auction, but that requirement is not there because a permit is not considered a disposal. A lease is considered a disposal under the Constitution, so therefore, it requires a public, oral auction. **Mr. Strong** yielded and said that the difference is this: under the Constitution it is very clear that when you are disposing of a piece of property, that it is subject to the public auction requirement. A disposal is considered any instance in which you surrender control of the exclusive use of the property. When you enter into a lease with a cottage site lessee, they are getting exclusive use of that property for the period of the lease. Under a permit, you don't have that interest in the property. You only have a revokable right to use and it is not subject to the disposal process because the state retains all ownership of the property. **Co-chair Vander Woude** said that to him a permit is just a short-term lease, so he didn't see the distinction between the permit and the lease since it allows the same access, same use and same rights as if being leased, but just a shorter term. He asked why this is not a short-term lease rather than a long-term lease of 10-20 years. **Mr. Strong** answered that it is not the same and the two do not carry the same rights of entitlement. If we lease to an individual, they have a right to the use of that property, an interest in that property for that ten-year period which cannot be taken away from them, unless compensation is paid. Under a permit, that can be revoked at any time and there is no right of compensation. There is a real difference between these two documents. **Co-chair Vander Woude** asked if IDL can revoke a permit at any given time. **Mr. Strong** said that IDL can revoke a permit at any time, but a time certain is put on it because there was a highly contested situation about the value of the land and clear direction from the Supreme Court that if the property is leased, it is subject to public auction. Not having the ability to set the base value on the land, there had to be some kind of transitional document that would allow sufficient time to get the appraisals worked out to go through the conflict auction process. They looked for a vehicle consistent with the constitutional provisions but didn't commit the state to a long-term lease of a particular property.

Representative Burgoyne expressed confusion about calling it a permit instead of a lease but the public auction requirement of the constitution seems to rise and fall on the terms of the contract, whatever that may be. Leases in the commercial sector are not assignable and for a short period of time. Is this an issue that would benefit the state of Idaho to test in a friendly lawsuit before the Supreme Court to get parameters. **Mr. Strong** replied that this has already been contested in some instances. For example, there is established case law that says an easement is not a disposal of land but is a right of use of the land for some time certain or for perpetuity because the state retains ownership of it. It is important what the terms of that document look like because you cannot put a

name of a permit on top of a document and thereby avoid the constitutional requirement of public auction. The court would look past that title and call it what it is, a lease. **Representative Burgoyne** asked if it would impinge on the rights of the Land Board for the Legislature to enter this area and define what the permissible scope is. It is his position that the court has fully defined the permissible scope here. **Mr. Strong** said he thought the principles have been defined by the court. What documents fit within that can be subject to debate. He doesn't see that the Legislature has the authority to change that line, but they certainly have the authority to help define the process for defining that line.

Senator Siddoway asked **Director Schultz** if the same provisions apply to the lands leased for grazing and timber. Once leased to a person, that person has the stability of the terms of that lease for the time-line (10-20 years). He asked whether the same provisions prevail in the leasing of commercial property. He provided an example of a situation where there is an office building in town and a floor has been leased to a business for ten years, could you sell the building, or are you restricted to the ten-year lease time with that lessee? **Director Schultz** said that with lessees in general, there is always an out clause if IDL disposes of the property, whether for sale or exchange. There is a right reserved in every contract for the Land Board to decide whether to sell or exchange that property. There is also a provision in code that a lessee can protest that, and that could be a constitutional issue if litigated.

Mr. Larry Johnson, Manager of Investments, Endowment Fund Investment Board (EFIB), presented next and his PowerPoint presentation and two handouts are online at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0828_johnson.pdf
Mr. Johnson read the mission of EFIB as follows: "Provide professional investment management services to our stakeholders consistent with our constitutional and statutory mandates." The objective of EFIB is to act like a professional investment advisor to four main clients: the State Land Board; the State Insurance Fund; the Department of Environmental Quality; and the Parks & Recreation Endowments. In June, EFIB had $2.4 billion under investment in total, and he noted that PERSI took responsibility for the $75.1 million Judges' Retirement Fund on July 1, 2014, and that EFIB began management of Bunker Hill Water Treatment on July 11, 2014.
Mr. Johnson went over EFIB's responsibilities and structure. He said that EFIB is made up of nine members, appointed by the Governor, confirmed by the Senate who meet at least quarterly and have a full-time staff of four. EFIB's goals for client service is to provide good investment advice and the tools for implementing that advice. **Mr. Johnson** shared endowment fund assets by quarter from June 1994 through June 2014 showing that they are volatile but profitable over time. He gave a history of the EFIB strategy and said there have been no substantial changes from the original 70/30 mix (70% equities and 30% fixed income) since 2000. EFIB's philosophy includes viewing themselves as long-term investors, holding a diversified portfolio, using index funds for bonds and small allocations to equity. He shared elements of fund diversification and asset diversification maps. He added that the last ten years have been great; this past year yielded an 18% return and over the last five years the return has been 14.6%. The purpose of the endowment fund is to provide a perpetual stream of income, so determining distributions is always the issue talked about, since it's the very heart and purpose of an endowment fund. He went on to say that the EFIB assists the Land Board in establishing a distribution policy which recognizes that they balance three conflicting objectives: (1) Maximize total return over time at a prudent level of risk; (2) Protect future generations' purchasing power; and (3) Provide a relatively stable and increasing payout. The structure of Idaho's endowment assets include: permanent assets (never spent); available reserve (stabilization fund); and spendable funds (appropriation). EFIB can never make a distribution by selling land; those proceeds can never be used to make a distribution. He shared principles of distribution policy management which include distributing expected long-term sustainable income every year and reinvesting sufficient income back into principle so that distributions and permanent corpus grow at least as fast as inflation and population. There are fiduciary tradeoffs that make defining and managing distribution policy challenging. Beneficiaries clearly prefer that distributions be based on conservative income

expectations. A reduction in distributions is much more difficult for them to adjust to than it is for them to temporarily forego an increase. He shared objectives for determining distributions.

Mr. Johnson showed a chart of land and fund income history showing volatility that EFIB is trying to buffer with reserves, trying to keep distributions sustainable. He said that over the last ten years, the land income has about $44 million annually and varies by plus or minus 50% from that number. Over the last ten years, the average endowment income has been $93 million annually and that varies plus or minus 200% or almost $200 million in swings, up and down from the average. That is the type of volatility that EFIB tries to offset. He showed Idaho endowment land log auction price trends from 1989-2014. He showed major flows of income from the Permanent Fund and endowment land flowing into earnings reserve for distributions. To determine annual distributions, there are two main steps: (1) start with a policy calculation; (2) if necessary, adjust the policy calculation up or down to reflect the status of reserves, the previous year's distribution level and any other relevant factor. **Mr. Johnson** shared a FY 2015 endowment distribution summary to beneficiaries totaling almost $52 million, up 6.4% over last year. He showed endowment distributions to beneficiaries from 1995-2016 actual and estimated, the net of general funds, nominal and inflation-adjusted. He said that strong reserves permit distribution growth, and he expects within the next two years that, barring some major downturn in the equity market, that a distribution of $70 million annually will be reached, another significant increase. The reason for that is that reserves have been rebuilt. He predicted, absent some dramatic reduction in land revenues or fall in equity prices, that the public school distribution will rise from its current $32 million to $40 million or higher by 2018. Current low interest rates and recent strong equity returns have dampened the outlook for fund returns over the next ten years. Also, due to natural variations in the market, there is a 25% chance returns could be less than 3.2% per year over the next 7 years. Returns are before investment management and EFIB oversight fees of approximately 0.4% and assume no gain or loss from active management versus the index. He added that private wealth management typically charge about 1% and most equity mutual funds would charge between 80 and 100 basis points, so EFIB believes they offer a good value for the management provided.

Mr. Johnson gave a state comparison with regard to who oversees land grant endowment funds. He showed public school endowment assets by state for FY 2013; Idaho's balance ranks about median. He noted that the largest funds have oil and gas revenues. He showed asset mix - public school endowment funds for various states in FY 2013; Idaho and Oregon have the highest allocation to publicly traded equities. Public school endowments in FY 2013 stocks outperformed bonds, so funds with fewer bonds generally performed better. In summary, he said that Idaho's endowment funds have performed well; the governance structure is stable, robust, and cost-effective; the outlook for fund returns is muted, but with reserves having been built, distributions will continue to grow, barring a prolonged meltdown in equity markets or log prices.

Co-chair Bayer recessed the committee at 3:18 p.m. The committee reconvened at 3:25 p.m.

Mr. Johnson said that the Land Board had instituted a comprehensive strategy review, and Mr. Bob Maynard's conclusions were that the Land Board needs to include more independent review of the investment process associated with endowment land (called the prudent expert approach) and place an increased emphasis on managing the land and fund components as one portfolio. In response to his recommendation, he said the Land Board decided to conduct a comprehensive strategy review with the assistance of an investment consultant and voted to establish a temporary Governance Subcommittee. The Land Board clarified that it would not be buying any commercial property, agreed upon back in December 2013. The scope of the consultant's work is to:

- Conduct an asset allocation analysis of the land and financial assets of the endowment trust;
- Identify asset types that are generating returns below market expectations and provide recommendations for improvement;

- Review processes for valuing land assets and whether they are appropriate for the Land Board's purposes;
- Review land revenue forecasting process;
- Review the Governance Subcommittee's recommendations;
- Propose a periodic performance and monitoring report format to summarize results for the land and the land and fund combined;
- Review existing investment policies and procedures; and
- Identify any other issues that may impede investment management effectiveness.

Mr. Johnson said that delivery of the final report is due in early November 2014. The scope of work by the Governance Subcommittee is to determine when independent consultants or advisors should be used to advise the Land Board on land-related investment decisions and to recommend delegation of authority for investment decisions. Governance is a system that empowers the appropriate people to implement an appropriate decision. He said that Idaho endowment governance objectives are to enhance long-term value of the trust; provide a structure for the Land Board to make informed decisions; ensure the Land Board can delegate technical investment judgments to accountable specialists; build trust with stakeholders, enhance reputation as a prudent investor; align expertise, authority, accountability and responsibility; push decisions to the lowest possible level; and create processes that will endure turnover in elected officials, EFIB members and IDL/EFIB staff.

With regard to the consultant selection process, he said that an RFP was issued in March and widely circulated and Callan Associates responded at a price of $125,000. EFIB believes this firm to be highly competent to conduct this assessment. The time line for completion of this assessment is a draft report will be issued on October 1st and the final report will be issued between November 5-10, 2014. Presentation of final report to the Land Board will be on November 18 and the Land Board will take action on the strategy review items on December 16th. He said that interaction with this interim committee can be arranged with Callan Associates and draft and final reports will be provided to the committee. Callan will be available to present to the committee, if desired, after October 28, 2014.

Mr. Johnson said that by December, he hoped that the Land Board will have a better road map for establishing priorities for, and evaluating, acquisitions and divestitures of land assets; adjusting fund portfolio to diversify land income; improving performance measurement; and prioritizing which legal and policy changes produce the largest improvements in investment return.

Representative Anderson stated that he was a member of the EFIB and he wanted to point that out to all committee members; this was duly recorded.

Co-chair Vander Woude said that he understands that the corpus cannot be spent, but asked what the corpus value was at this present time. **Mr. Johnson** said he believed that about $1.35 billion is corpus and $350 million is reserves. **Co-chair Vander Woude** asked if there was a target goal of how big EFIB wants the corpus to be. **Mr. Johnson** said there was not a goal in that regard, but it is the goal to grow as fast as inflation and population grow and therefore grow distributions at that rate. The reserves range between five and seven years of distributions depending on the endowment, but as that grows it generates a higher distribution, so it is a difficult question to answer.

Representative Gannon said he was impressed with the fiduciary check and balance system that EFIB has in place. He asked about the excess reserve profit issue, whether the fund has doubled in the last 10-12 years and inflation and population goals were met, and whether it would not be necessary to take the excess profits from the five or six beneficiaries and put them in that fund in order to meet those goals. **Mr. Johnson** clarified that the public school fund only this year met its objective of keeping up with inflation, and it has not kept up with population growth, but most of the other endowment funds have, since their distributions have been lower. The idea is to create a sustainable distribution that will never be cut. When there is income greater than expected, they call a portion of that permanent corpus that can never be spent. With that

money, the beneficiary is promised that they will get a 5-7% of that investment into perpetuity. So, distributions recommended consist of taking 5% times the three-year average of the fund, plus 5% of any transfer made. **Representative Gannon** asked: "With the increase in profit of roughly $102 million in the land fund and about $300 million plus in the endowment fund, it's not necessary to meet any population or inflation goal and it's not necessary to transfer that $38 million into the corpus, would that be right?" **Mr. Johnson** said that would have to be looked at endowment by endowment. Most of that $300 million in profit was generated by the public school fund which has started barely to meet its reserve levels and corpus goal; certainly some endowments have exceeded inflation and population, so for some of them it would not be necessary to meet that goal.

Co-chair Vander Woude asked about ongoing distribution and why the corpus is being grown; is there anything in the policy that prevents one-time distributions to public schools, for example, in a downturn year that would not affect their corpus or their normal distribution. **Mr. Johnson** explained that the policy would not permit that, but the policy is established by the Land Board and they can change that policy on a whim, which they did, in essence, for the $22 million public school distribution.

Representative Burgoyne said that even though EFIB doesn't make the policy about this $38 million going to corpus, he asked what the reasons were. **Mr. Johnson** answered that the reason for that is to build the corpus over time to increase distributions. **Representative Burgoyne** said he suspected that these decisions were somewhat situational, either a report comes in that says due to a change in projections, inflation or population growth, it is time to make an adjustment and he wondered about what was behind the decision. **Mr. Johnson** replied that several things are looked at such as the expected long-term return of the endowments, both the land and the fund. Ideally, a conservative estimate of what that number is would be distributed. They hold in reserve the amount necessary to protect for volatility. Every 25 years there is a 5 year period where there is no income for five years, and that is why reserves are set between 5 to 7 years in order to survive those downturns. There are subjective judgments that go into this as to what is the expected long-term sustainable amount of income given our current asset base, how volatile will things be, and how much needs to be protected. These are fiduciary judgments that the Land Board makes, and EFIB advises the Land Board. **Representative Burgoyne** said that there are about 40 school districts in the state that are on four-day weeks and to him that is like EFIB being a trustee for an elderly person and the amount given allows them to eat six days a week, but not on the seventh. He asked, In terms of trust administration, whether the calculus changes about how EFIB protects out generations versus how it protects the current beneficiary and whether that suggests that if there is $38 million that **Representative Gannon** was talking about, that you take more of those available funds and pay them out now. **Mr. Johnson** answered that the $38 million mentioned is for six endowments, other than public schools, so it doesn't address the needs we have in public education currently. That is a one-time event and beneficiaries don't like one-time money, they like guarantees of continuous money. He added that it is a difficult issue. Back in 2003, EFIB recommended some cuts in distributions and the Land Board accepted all of those recommendations with the exception of the public school distribution which was kept higher than EFIB recommended. He said that the good news about that decision is that from that time on, there was no catastrophic failure and they were able to meet distributions at the higher level. The bad news is that it's taken them a lot longer to build their reserves and they are still paying for that decision made back in 2003-2004 while some of the other endowments took their cuts and have since recovered strongly. He said that public schools are the biggest and it drives the total number. He added that this is probably the reason the Land Board accepted cuts in all the other beneficiaries, except public schools, is that it is really tough to force that kind of change on public school funding, particularly when things were already in crisis.

Co-chair Bayer asked the committee about future meetings and expectations of the members. He announced that the next two meetings for this committee will be held on September 30 and October 1, 2014. The September 30 and October 1 meetings will have blocks of time for public

testimony in order to optimize availability for citizens traveling from around the state. He wanted to accommodate everyone and their travel needs. There will also be an extended effort for notification of the two meetings allowing public testimony, since there are areas of the state very interested in this issue in order to gather as much input as possible. Written submissions and oral testimony will be accepted. Another scheduled meeting on November 14 will be devoted in large part to discussion of proposed language. He encouraged committee members to work with one another and with staff, using the many resources available, between now and then, and also to facilitate communication between committee members for better committee decisions. All presentations and official documents will continue to be posted on the legislative website for public use and for the committee. Draft legislation and language should be routed through the co-chairs of this committee, since this is more of a political process for developing any language. He encouraged going back to the charge of the committee, even though not limited by those items.

Co-chair Vander Woude said that agendas had not been firmed up for future meetings, and he invited input to the co-chairs as soon as possible regarding suggestions. Any questions or concerns can be directed to the co-chairs and LSO staff.

Co-chair Bayer adjourned the meeting at 3:55 p.m.