MINUTES
Approved by the Committee
Endowment Asset Issues Interim Committee
Tuesday, September 30, 2014
9:00 A.M.
WW02 - Lincoln Auditorium - State Capitol - Boise, Idaho
Boise, Idaho

Co-chair Representative John Vander Woude called the meeting to order at 9:05 a.m. and requested a silent roll call. Members present were: Co-chairs Representative John Vander Woude and Senator Cliff Bayer; Senators Shawn Keough, Jeff Siddoway, Bert Brackett, and 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, Elizabeth Bowen and Charmi Arregui.

Others in attendance included the following ten panel members: Dr. Peter Crabb, Northwest Nazarene University; Mr. Tim Hurst, Idaho Chief Deputy, Idaho Secretary of State's Office; Larry Johnson, Endowment Fund Investment Board (EFIB); Jeff Lord, Lord Ranch; Mr. Scott Phillips, Deputy Controller, Office of the Idaho State Controller; Jim Riley, President, Riley & Associates; Director Tom Schultz, Idaho Department of Lands (IDL); Clive Strong, Office of the Attorney General; Lynn Thomas, Former Idaho Solicitor General; Mr. David New, Growing Excellence, Inc. Others in attendance were: Robert Forrey; Rachel Gilbert; Ronalee Linsenman; Heidi Knittel; Wayne Hoffman; Araminta Self; Todd Hatfield; Darryl Ford; John Foster, Kestrel West; Andrew Jacobs, Pilgrim Cove; Joshua Whitworth, State Controller's Office; Emily Patchin, Risch Pisca; Ronald Harriman and John L. Runft, Tax Accountability Committee; Jan Sylvester; and Laurie Boeckle, PTA.

Co-chair Vander Woude welcomed everyone to the committee and **Co-chair Bayer** extended his welcome and appreciation to everyone participating in this meeting. He pointed out that the legislative website contains handouts and detailed information, and will also include most public testimony given. He expressed hope that making all this information broadly available will promote dialogue and an exchange of information before the final meeting to be held on November 14, 2014. At that time, the committee will take under consideration any proposals in the form of legislative recommendations.

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

Co-chair Vander Woude asked for approval of the August 28, 2014 minutes and **Senator Siddoway** moved for approval, seconded by **Senator Bayer**. The motion passed unanimously by voice vote.

Co-chair Vander Woude introduced the above ten panel members and he invited committee members to address questions to those panel members. **Representative Burgoyne** asked about the current management program and a chart (posted on LSO's website) entitled "Idaho Land Grant Endowments - A Report to the Citizens - 2014" from EFIB and IDL which showed that assets are going up rather dramatically and distributions to beneficiaries have recently either been flat or indicate some modest decline. There is concern among some legislators about seeing assets rise at a time when schools have gone to four-day weeks in 40 districts. It raises the question as to whether or not the current beneficiaries are being deprived of what they need from the trust in the name of future generations. How do we reconcile the obligations to future generations versus obligations to current beneficiaries? **Mr. Larry Johnson** responded that this gets to the distribution policy that the Land Board has established. Distributions are rising, he said, and the chart and the panel show two separate bars, one for public schools (which has been flat) and one for "other" (which has dramatically increased). Total distributions are rising with several factors in play. First, there is a time lapse between when assets are deposited to the trust and when those eventually

result in higher distributions, partly due to the state's budgeting process since distribution levels are established in August to start the following July due to the way the fiscal year works. Rising assets that occurred in 2014 start to effect distributions in 2016, which is why the Land Board recently approved an increase in distributions of 8% for 2016. They anticipate those will continue to rise in 2017 and 2018 as a result of the numbers shown. Also, during the downturn in assets from 2000 to 2003, there was a concerted effort on the part of the Land Board to hold distributions at a higher level than the fund at that time was earning, so during that time the reserves and the corpus of the fund for future generations were somewhat depleted and neglected to try to maintain distributions to the current beneficiaries. Today's beneficiaries are paying for the additional support given in the 2003-2005 period. Distributions will start rising significantly in the range of 10-15% over the next few years, at a minimum, reflecting this rise in assets noticed on the chart. **Representative Burgoyne** requested to ask a follow-up question of **Mr. Thomas** and that question was: "Do you have a view as to how we balance the rights of future generations against the current generation? There is a fiduciary obligation to all the beneficiaries, and is this a matter of discretion for the Land Board or a matter that the Legislature can legitimately intervene and set down some policy?" **Mr. Thomas** answered that the Land Board has been empowered to exercise its business judgment about how to manage the endowment assets, but it has always been the position of the courts, based on the law that the Legislature effectively has plenary power, to adjust matters of this kind to set the basic policy and leave to the Land Board the day-to-day management of business operations. He thinks the Legislature does have the power; beyond that, he hesitated to say whether it was a good idea or not, since that was a matter of legislative policy. He thinks the Legislature has very broad powers to deal with issues of this kind.

Representative Burgoyne asked **Mr. Strong** the same question as he'd asked of **Mr. Thomas** and **Mr. Strong's** response was that he agreed with **Mr. Thomas** to the extent that the Legislature has a role with regard to management of endowment lands, but he said he did not agree with him on the line that he had drawn. The court decisions, in his opinion, are very clear that the business judgment rests with the Land Board and that the Legislature's powers are with respect to the ability to establish procedure for the Board to conduct its business. **Representative Burgoyne** asked if there was a distinction between the business judgment in managing lands and the EFIB assets and the judgment, the legal requirements, with respect to future generations versus current generations. **Mr. Strong** said that what we are dealing with here is a private trust and there are specific principles that deal with private trusts and what we operate under is called the Prudent Investor Rule as set forth in Idaho Code. Under that rule, the Land Board has a fiduciary duty to manage these assets for both the benefit of current and future generations; within that judgment, the Land Board certainly has discretion about how to allocate those funds, but there has to be a balanced representation and the future cannot be favored over the present or vice versa.

Representative Gannon said that currently the policy requires that we have a five to seven-year profit reserve for investments, approximately $345 million in profit that is sitting in reserve untouched and unused. It is his understanding that the reason for that reserve is that investments are volatile and not stable; he wondered if that would indicate that different places to invest shouldn't be looked at, such as the $200 million invested in foreign currency or some of the merging market investments. Do you think we should look at investments in a different area so that we don't have to have $345 million in profit just sitting. **Mr. Johnson** said that this is an issue that EFIB takes very seriously with regard to what the mix of assets should be for the endowment fund and certainly is an issue that IDL looks at in terms of managing the land base and diversifying that. Generally, the more consistent the return, the lower the expected future return. Ten-year government bonds today pay 2.5%, barely the rate of inflation, so that would not leave much room for distribution of any sizable amount if the whole endowment were invested in bonds, for example. There is a need to take risk in the portfolio to generate a return higher than inflation, over time; the offset to that is that we need to carry a reserve of undistributed earnings so that we can fulfill the desire of the beneficiaries to never reduce their distributions. That is always a trade-off and is a subjective business and investment judgment.

The Land Board has commissioned an investment consultant to look at the overall asset base, both the land and the fund, to see if the mix is right. That preliminary report will be presented at the end of this week, he said, adding that this is a very difficult issue. EFIB has about 4-5% of the fund in emerging market stocks; they do have exposure to foreign currencies, both in the companies they own in the stocks and in the fact that some of the companies they own are domiciled outside of the U.S. and their stocks are priced and in foreign currencies. EFIB believes that about 20% of the fund is in international exposure which they believe is an appropriate degree of diversification. That is a matter of business and investment judgment, and this is taken very seriously and examined frequently knowing that a consistent stream of income is desirable given the fact that beneficiaries desire consistent payouts. EFIB believes in the long term (10-20 years out) that those will be higher return assets and having to return some income as a reserve is a prudent way to balance that issue. **Representative Gannon** has come around to the viewpoint that one of our best assets, for example, would be these cottage site leases because they get a certain percentage annually, even though this issue is a very difficult one. It seems that with an asset like cottage sites, then we wouldn't have to put $345 million in profit in reserve; instead that money could be distributed each year, with a more minimal reserve. Maybe it's a wiser policy to look at investment land in Idaho and that might be a better way to go than getting into higher risk, more exotic investments, which require more oversight by EFIB. If EFIB has a $1.7 billion fund, and $345 million of profit is kept in reserve, it seems to him that the focus might need to be shifted to look at Idaho land, rather than volatile investments. He asked **Mr. Johnson** what he thought about that, and **Mr. Johnson** replied that this is all part of the mix that IDL looks at. IDL's ability to adjust their portfolio over time is limited, but certainly EFIB is always interested in investments that pay a steady rate of return at a high level. That is the mission of IDL, to do that with Idaho land to the degree that we should increase or decrease the mix of certain assets; he said that IDL is more of an expert on that.

Director Schultz referred to a handout on our LSO website at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_johnson.pdf The income history shown on that handout had fluctuated from a minus 18% in 2009 to a 24.6% return in 2011 in the endowment income, so the question is: "What is the best mechanism by which to generate the maximum overall return?" To put it in perspective, he said that on timber ground this past year, a cash return of about 4% was realized. When you look at appreciation, the long-term average on appreciation would be between 3-4%, so on timber this year, IDL made a total return of between 7-8%, which is pretty good for land. At the same time in 2014, the permanent fund made an 18.8% return; there is volatility and swings, but **Director Schultz** said that they were not experts at IDL to make those kinds of decisions. Callan Associates is reviewing a study and their charge is to look at lands and the cash to make a recommendation to the Land Board as to how best to allocate resources over time. In light of the land base we have, how should this impact the investment portfolio and how should that impact the land base over the long term. The task now is to look at both these things. Outside experts have been hired to advise IDL and EFIB to inform them about whether to reinvest cottage site proceeds into timber, farm land or into the permanent fund.

Co-chair Vander Woude complimented IDL on the rate of return on the endowment fund, adding that everyone would be happy with an 18% return, realizing that cannot be realized on a continual basis. It was his understanding that it was the Land Board that decides what money gets disbursed, and that is not up to IDL. Is there a cap or a certain amount of money in the permanent endowment fund that once an amount is reached, that becomes the cap adjusted to inflation, and anything above that amount gets disbursed. He asked if **Director Schultz** would be happy with that type of policy or is that a risky policy. **Mr. Johnson** answered that he took his current job nine years ago today and he was immediately appointed to a task force to look at distribution policy for the Land Board, and that was examined for three years, after the 2005 declines in distributions and earnings. The process by which a desired level is set for the fund and everything above that is distributed, the problem with that is that the strong feedback from beneficiaries and the Vice Chair of JFAC was that beneficiaries want consistent distributions. EFIB works hard to establish a policy to ensure that

the chance of a reduction in distributions was very low; that naturally meant that they would be hesitant to raise the distribution, and is part of what is being seen now. We have had three years of good land and fund income and the distributions have been slow in rising, partly due to the budget lag and partly associated with the natural hesitancy to raise distributions that cannot be sustained long-term. If we have variations in distributions, the question arises about giving bonus distributions, but feedback from beneficiaries is that this would not help them very much. In fact, what they would do is put the bonus in the bank because they can't depend on that the next year, so if the beneficiaries bank that excess, then EFIB may as well bank it and hold it. That is the major policy principle that has directed the distribution policy.

Representative Anderson asked for clarification on the statement made that when the market increases, distributions don't immediately follow. If there was a market decline, would distributions immediately react in a negative way to that under EFIB's current policy? **Mr. Johnson** replied: "Absolutely not. Distributions would not fall and that was certainly demonstrated in 2009-2010 when there were very negative returns in the endowments. IDL set a record for low land income in one of those years, but distributions were able to be maintained because of the reserves. It is true that it is slow on the upside and very slow on the downside." **Representative Anderson** said that a comment was made about distributing money over and above inflation; he thinks that inflation is used when computations are made, but another factor is used also and that is population, and he asked for an explanation on why that is considered and how. **Mr. Johnson** said that enshrined in state statute is an objective that the endowments grow with the rate of inflation, so that is a principle enshrined by the Legislature. On top of that, the Land Board has established a softer, more discretionary target of also growing the funds at the rate of population growth. That is harder to measure and harder to control to, but the idea is that fifty years from now, the per capita distribution, per school child in real dollars, would be the same as it is today or higher. **Representative Anderson** asked about the $345 million that had been said "was just sitting" and he wondered if that was true; also, he heard reference to high risk, more exotic investments, asking if EFIB has those in the endowment fund and do they differ materially from other funds such as PERSI or 401ks at major companies around the world. **Mr. Johnson** pointed out that funds were not just sitting, but were invested in the same 70/30 asset mix that is expected to earn 6-7% over the next ten years for the beneficiaries. With regard to the endowments, relative to other institutional investments such as pension funds, etc., people would say that the portfolio asset mix is a little less exotic, more transparent, conservative and simpler than most, including the PERSI portfolio.

Representative Burgoyne asked about the resolution of the potential conflict between current and future generations, in terms of earnings and assets, and how much principal should the endowments have. He said the view could be taken that current and future generations are entitled to have in value what was given by the federal government in 1890 plus inflation. Other views could extend to other extremes. He had two questions: (1) Are we, in terms of the distribution policy, looking to find out what the school kids need today and what we think they'll need tomorrow, in order to be competitive in the world? (2) What questions do we need to be asking, and is anybody asking them to arrive at the answer? **Mr. Johnson** replied that he did not have the perfect answers to those questions. He thought that, in theory, the endowments should have, ideally on a per capita basis, the objective to have as much fifty years from now as we do today. Because of the policy decision it is very disruptive to beneficiaries to lower a distribution, that tends to make distributions more conservative and, as a result, over time the natural result is that a little more is reinvested in the fund than if all income was distributed every year. He thinks that the policy will actually result in moving future generations to better prosperity, (he said the cadillac) but that is not necessarily the objective. The primary objective is to ensure that distributions never drop. The practical implication of that is the accumulation of assets over time, due to fear of not being able to make a distribution that cannot be sustained. With regard to looking at what beneficiaries need, **Mr. Johnson** said that EFIB advises the Land Board on distributions, but they are not in a position to evaluate what beneficiaries need. It is within fiduciary and trust law to allow for a fiduciary to look at what beneficiaries need;

however, the little EFIB has looked at that, caused EFIB to conclude that beneficiaries are most dependent upon non-endowment revenues, primarily tax revenues, which make up most of the budgets. The endowment itself cannot fully fund a beneficiary, so EFIB does not need to make a decision about whether they have enough or not. EFIB knows that beneficiaries do not have enough with just the endowment. Constitutionally, the Legislature is empowered by the people to make those kinds of decisions as to how much is enough and how much should be gathered from tax revenues, etc. EFIB knows that beneficiaries need a lot more than the endowments can provide.

Dr. Crabb informed the committee that any views he expressed here were his own views and not those of Northwest Nazarene University. He responded to **Representative Burgoyne's** second question by reiterating what **Mr. Johnson** said -- investment policies don't look at how the money is being spent by beneficiaries. It is probably not the responsibility of either the Land Board or EFIB to look at what those needs are. In answer to the first question, he thought that could be approached by economic theory, as well as economic history. The gift given by the federal government in 1890 to the state of Idaho is very similar to other means of economic development at that time. What would the federal government do today, if they wanted to support schools or any other community service, they would give cash or give loan guarantees, probably not land. (Using that logic, he used the Buick comparison.) This is what was given, this is what it would earn, and that is what the payout from the trust should be. He agreed with regard to the beneficiaries asking for more stable distributions; they are interested in receiving a more stable payout and to do so, a portfolio must be diversified, much as EFIB has done. This is consistent with all financial theory and long-term practice. Diversification is a good thing; however, the trade-off is maximum long-term (he said long-run) returns. Given the way the Constitution is read, a financial advisor should take very specific and perhaps very risky investment approaches today. **Representative Burgoyne** admitted that he comes at this with a bias; it's hard to fashion a distribution policy without any reference as to what the beneficiary needs. It strikes him that the lands were granted for a purpose and the endowments were established for a purpose with respect to education and that over succeeding generations it would allow the state of Idaho to more easily provide for the educational needs of its children. That is something that probably increases over time and does not remain static; it seems to him that distribution policy ought to be looking at what those needs are. He asked that those responsible for distribution policy reexamine their position. He wondered if **Mr. Strong** had anything to say about this.

Mr. Strong said that **Mr. Burgoyne** was absolutely right; the purpose of the endowment should be looked at as set forth in Article IX, Section 8 of the Idaho Constitution, which is to maximize the long-term financial return to the endowment. It is not to look at the specific needs of the endowment beneficiaries, but rather to ensure a return that can help fund education for the children. Ultimately, the duty of funding education for the children constitutionally lies with the Legislature and the amount of money contributed to the endowments helps to offset that. Policy choices about how and what type of education are legislative determinations, not endowment determinations (which are financial in nature).

Representative Gannon asked **Mr. Strong** if the Legislature could make a decision to spend the retained earnings, that $345 million profit, or does the Land Board have to make a decision first. **Mr. Strong** said, in his opinion, the decision on how to achieve the maximum long-term return to the endowment is vested in the Land Board constitutionally. There is separation there for a specific reason because they want to make sure that the objective is not served by legislative expediency. In his opinion, the Legislature would not have the authority to make that determination.

Senator Siddoway commented on the chart that showed 2013 income on rangeland amounted to about $700,000; the total land endowment was about 2.4 million acres (1.4 million in rangeland). He suggested that if so little income is being received on rangeland, it seemed to him that is a nonperforming asset that should be looked at for sale and taking those funds to be better invested (which could have a negative impact on the ranching business). Even an investment earning 2% would amount to $2 million, ten times more than the current income. Wouldn't that be more

prudent? **Director Schultz** replied that a consultant is looking at this currently and will advise the Land Board. One issue is the struggle to use the tools available to IDL to divest of lands; the Constitution limits direct sale at public auction to 320 acres to any individual over that person's lifetime, so with regard to wholesale divestiture through the auction process, that tool does not currently exist. IDL cannot sell an individual more than 320 acres at public auction. Exchange is another option, and these have become more complex. In the days when a rancher had a large ranch (20,000-30,000 acres) there are limited opportunities for trading parcels on the periphery for interior parcels, this may not be the most prudent decision to pick up more rangeland. With regard to the premise that some lands could be sold, there are limited opportunities for public auction right now, given constitutional restraints. The land exchange process is something that has some utility. Some exchanges with BLM are being examined currently, but that is the tool to wholesale divestiture, and that tool may not be adequate.

Director Schultz cautioned that lands have future potential for minerals, for instance, and policy is currently in code that if there are producing minerals, the state should not divest of minerals at all. If it is commercial property, minerals could be sold, but short of that, you retain minerals. Having surface ownership may make sense to help facilitate development of minerals which could far eclipse any surface rental envisioned short-term. Grazing lands, in general, are being evaluated, and that is done about every 5-10 years. How lands are valued can vary; the value of $250 per acre had been mentioned. When these lands were granted to the state, initially there were provisions that lands could not be sold for less than $10 per acre, which is the default value placed on these lands. Over time, what would be the value if land could be sold at public auction? Some lands could be sold for $200-$1000 per acre for rangeland, so that number fluctuates. **Director Schultz** said he would argue that a comparable sales approach (looking at what private rangelands are selling for) is probably not an appropriate way to measure performance for lands granted to the state, since there was very little opportunity to influence that selection process. The state was granted primarily 16s and 36s at statehood and have been managed as such; he added that there are other ways to measure performance, looking at what a reasonable rate of return would be on rangelands, or even private lands. Using an approach like that, as was advocated in Dr. O'Laughlin's report, suggests that those returns are probably more in the 2-3% return range than if a comparable sales approach was used. First, IDL would need more tools in the toolbox to more actively divest of those lands, and he cautioned that it makes sense to maintain some rangelands for purposes not even envisioned today. There was recently a proposal for a solar plant near Hailey. The Snake River Canyon jump paid the state $1 million in a bonus payment, so wholesale divestiture may not always be the most prudent decision. The founding fathers tried to reflect that caution in limitations the state does have. The 320 acre limitation does suggest that with the debate over retaining or selling lands, there was a desire to retain a portion. **Mr. Johnson** said that he did not have much to add, but opined that if you have a $300 million asset that is only returning $700,000, options need to be examined to improve that return or hold it for future options, as mentioned. **Senator Siddoway** said it sounded like the state is limited constitutionally as to how much land can be moved; he thinks maybe a constitutional amendment is needed to change that, asking if that was correct. **Director Schultz** replied that the Land Board could not direct that; it would need a constitutional change. **Senator Siddoway** asked when there was a proposal for an exchange for an auction to buy land, is an assessment taken of the assets that are currently on that land. Twenty-five years ago they tested for oil and gas and came up with a pessimistic outlook. **Senator Siddoway** said that in a desert where there is no water or access, he didn't know why the state would want to hold on to those lands. Would anyone on the panel make that assessment, and what do we do with it when that assessment has been made? **Director Schultz** said that assessing mineral potential is very difficult but the technology has improved with 3D seismic; however, IDL does not usually get access to that information, since it is proprietary and kept by companies who shoot the seismic. He knows there is production potential just south of Nevada and east of the border in Wyoming, so there is some hope that Idaho has future reserves. Tools to divest of nonperforming assets are not conducive to that

right now. A portion of timber assets are highly productive, and a portion is less productive. There is a primary and secondary timber base. IDL is looking at a similar type of classification for rangelands. IDL is not averse to disposing of lands, and those issues are being examined, but the limitation currently is the limited available tools. **Senator Siddoway** asked how we codify that with the Prudent Investor Rule? If we take the best information available today and do the best job we can for future endowment, but are restricted by the Constitution or by biases either within IDL or the Land Board by those not wanting to sell assets and reinvest that money, due to political will, how does that coincide with the Prudent Investor Rule? **Mr. Johnson** answered that he hoped members of the Land Board want to do the right thing and there are no great biases against creating value where there is opportunity. He believes that the consultant's report will reflect what current conditions are and also ideal conditions, since there are limitations under current conditions in the Constitution as to what can be sold. He believes that framers of the Constitution put limitations there for a reason; however, those reasons may have been based on the economy and the governance structure that existed back then. Whatever changes are made, there needs to be a prudent governance structure to ensure that when land is sold, it is sold at the appropriate price.

Co-chair Vander Woude steered the committee to the topic of exchanges, leases and other disposal of endowment assets, along with the land exchange process. **Senator Brackett** said that in the past there had been three-party trades, believing that to be a helpful, important tool available to IDL, but IDL has moved away from that. What would it take to get that back as a tool? **Director Schultz** gave a history on land exchanges done on pieces of land that had similar values on a per-acre basis, done always with someone who owned the land. IDL has been counseled that there is risk when someone does not own property with whom a trade is being done, so IDL has been cautious in the past two years pursuing land exchange transactions. IRS laws with regard to ownership and what the ultimate intent is presents potential problems about whether someone is trying to skirt the auction requirement in the Constitution or do a traditional land exchange. This is the question, and there is legal risk, which has happened in other states. This gives IDL pause; the intent going into a transaction is to dispose of land through an exchange solely to avoid the auction requirement, and that is going to be fact specific in that determination. If an exchange is done with something we own for something that somebody else owns that we have a desire to acquire, there is no problem with that. The problem arises when a third party is involved, since there could be the appearance of avoiding the constitutional requirement. **Mr. Strong** commented that there was a March 3, 2014 letter issued by the Office of the AG to **Representative Mike Moyle** that he made available to the committee, and it describes the issues being dealt with in an exchange. This letter is on our LSO website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_strack.pdf
It is similar to when the Land Board was looking at exchanging cottage sites for commercial property. The parties were interested in an outcome that would work for everyone, but not everyone sees a transaction in the same way. There was litigation risk and the question was raised by the Land Board; the AG's office was asked to opine as to the implications. He pointed out that the current statute provided that lands had to be exchanged for similar lands, and the conclusion was that cottage sites for commercial property was not similar land, and there was a statutory limitation. We did not originally have exchange authority, he said, under the Constitution, but it came in the 1930s. In the 1980s the authority to exchange was expanded beyond that to allow private exchanges, but the dilemma encountered with regard to endowment lands is not only the similar lands issue but what was the motivating purpose for this exchange. The real issue isn't that exchanges can't be done, but what is the motivation for the exchanges and are you meeting your fiduciary duty or are you doing this in order to achieve some other private interest that is adverse to the beneficiaries?

Senator Brackett said he was not advocating wholesale disposal of rangelands, for example, but his question was: "What would it take to get that three-way trade possibility back in the tool box for use by the Land Board?" **Mr. Strong** suggested that tool is in the tool box, but in a much more limited nature than was envisioned under some prior exchanges. It is more a question of

the type of transaction than the absence of the transaction. **Senator Brackett** said that IDL has been very cautious, except in limited cases, and he doesn't see the tool as being readily available and he wanted further ideas as to what this committee could recommend or what could be done to get that to be a more practical tool. **Mr. Strong** said that there is tension between the public auction requirement, which is constitutionally based, and the exchange provisions, which are also constitutionally based, and absent some resolution of that tension between them, he suspects there is always going to be limitation on three-way exchanges. In order to get a broader set of exchanges, a constitutional amendment would be necessary; however, one concern that will be encountered with endowment lands is that what is in the interest of one interest may not be in the interest of others. This becomes a very political process. In summary, he said that for a broader set of exchanges, some modification would have to be made to the public auction requirement or some expansion of the exchange provisions in the Constitution.

Senator Keough expressed curiosity as to the assessment of what impact, if any, SB 1277 had with regard to the issues being discussed, particularly the striking of the word "similar" since that legislation went into effect on July 1, 2014. **Mr. Strong** said it certainly removed the one barrier which was the "similar" lands language, but he suggested that if there are forestry lands, for example, that have value to the endowments and there is a way to do a three-way exchange to establish that outcome, there is not that "similar" lands prohibition. There are also indirect actions that come through as you try to make those exchanges, such as county tax issues, local interests in how the lands have been managed, and extraneous influences which are difficult to avoid.

Representative Burgoyne requested that the co-chairs include in the record for this meeting the opinion that was received from **Mr. Thomas** and **Mr. Leroy** and that is on LSO's website at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_leroy.pdf
Mr. Thomas commented that this opinion simply suggested that the legislation was constitutional. He underscored one point with regard to a whole host of hidden problems. The Constitution provides in rather broad language that management of endowment lands is entrusted to the Land Board subject to provisions of law which means, as the Supreme Court has held, that legislation provides the legal principles upon which the Land Board may act. So, he disagreed with **Mr. Strong's** basic premise that there are things that the Land Board can do, and only the Land Board, with respect to management of endowment lands including exchanges, distribution and regulation of funds. The broad language of the Constitution, to him, suggests that there is almost nothing that is within the exclusive authority of the Land Board to the exclusion of the Legislature. The Legislature, he thinks, can make appropriate adjustments to management policies.

Mr. Riley stated that he was with the private sector, not a government employee, and his clients uniquely own forest land in Idaho and others own and invest in sawmills and manufacturing that utilize to some extent the endowment timber sales. He referred to the handout "Idaho Land Grant Endowments" showing that most of the timberland is north of the Salmon River which is distinctly different than grazing land, and those differences are important. Many intermingled lands are private and others would likely be owned by his clients or other private timberland/forestland businesses in Idaho who manage that land for investors or shareholders. What goes on routinely are land exchanges between private parties to block up the ownership and facilitate mutually beneficial consolidated ownership of the forestland asset. He said he was an advocate to maintaining land exchange authority for the private sector and from the state. There are opportunities for both to better meet their objectives. **Mr. Riley** emphasized that whatever is done, it should be done in a way such that there is great satisfaction among the Legislature that when the state does engage in a land exchange that there are fair values arrived at and there is fair opportunity for the public to inspect so that it is truly a value-for-value exchange. There is opportunity to improve that. With regard to third-party exchanges, this becomes more complicated. If something was done privately, there would not be the fair opportunity for access to bid, and that does undercut an investment. There should be a properly functioning land exchange process for the state and should not cross

the line of disguised sales; that could be done and at the same time look at the improvements suggested and what to do about appraisals and public involvement in the exchange process. On the private side, there is no obligation to get the public involved in exchanges, and private deals are done often, and there is reason for some confidentiality. At the same time, with the state involved, there need to be assurances that the public values are protected. Maintaining land exchange authority is extremely important; what is needed today are clear rules so people who start down the path with the state to engage in an exchange know what they can count on and what they can't count on in terms of how the process goes forward. What is not fair is to entice the private sector to begin a land exchange process and at the end of the game say that even though everything was done as asked, it didn't come together for some reason that wasn't disclosed at the beginning. This is going to take more work by the experts. **Co-chair Vander Woude** asked if it was safe to say that exchange of cottage sites for forest land is a win/win for both IDL and the cottage site owners. **Mr. Riley** said that each land exchange was unique in terms of parcels involved and cottage sites for timberland becomes complex in lots of ways because they are not similar parcels. When the state looks to see if an exchange maximizes return to the endowment and did they live by their constitutional requirement for not having disguised sales, he understands those complexities. The problem is that it has had a chilling effect across all land exchanges that we need to now come out the other side of. He admitted he was not an expert on cottage sites.

Representative Gannon asked about exchanging leases as an alternative to exchanging ownership; is there any potential there? **Mr. Riley** said that in the world of forestry sometimes land is exchanged, but the stumpage rights or the trees are a separate part of a transaction that might be held by another party. There are opportunities for all of those things. From the state's perspective, if we maintain the focus on blocking up and consolidating ownership for mutual efficiencies of the parties, just on timberlands, that makes great sense. Once you get into more complex issues about leases or other things, that becomes more complicated, and suspicions arise due to that complexity.

Mr. Jeff Lord said that, as a rancher, he spent 27 years as a CPA specializing in taxes and trusts. With regard to the IRS issue that was brought up, he clarified that this had been an extremely litigated issue and he didn't know what that had to do with the state. The endowment isn't going to pay income taxes, so tax treatment to the other party in a trade really shouldn't be a factor; it is a tool for the Land Board to take advantage of, and there can be a taxable exchange. Whatever the IRS issues are, they should not be a part of this discussion, in his opinion. He asked about the word "intent" and whether it is the intent of the Land Board or is it the intent of all parties doing the exchange. **Mr. Strong** responded that the tax issue has no relevance to the exchange. The real issue is looking at what the real purpose is of the exchange; you are equating the property to a value, changing it into a cash value, trying to get equal values for the purpose of flipping properties. That is the intent issue. With regard to cottage sites, the issue wasn't that the Land Board desired this particular property, but rather that cottage site owners desired to avoid the public auction requirement and did so by consolidating their ownerships in a way that got to a value and then found a property that was of equal value and tried to do a three-way exchange expressly for the purpose of avoiding the public auction requirement. **Co-chair Vander Woude** emphasized that the IRS issue didn't involve the state at all, but the people doing the exchange and **Mr. Strong** confirmed that to be true. **Mr. Lord** wondered how to reach into the mind of anyone involved in an exchange to determine intent, rather than what the Land Board's intent is. **Mr. Strong** said that was not what he was saying. When a transaction is looked at from a risk exposure standpoint, the court is going to look at the overall purpose of the exchange. It was his assessment that the risk of those types of exchanges are such that they would be viewed by a court, when looking at facts objectively, that the desire or intent was to avoid the public auction requirement through an exchange process.

Representative Burgoyne recalled testimony on SB 1277 in the House committee, **Mr. Leroy** was very emphatic, in support of the bill, that exchanges are not subject to the public auction requirement and he said that he shares that view. It seemed to him that the intent of any private

sector actors entering into a land exchange that involves endowment lands is probably not the long-term return for the beneficiaries of the endowment. Their intent is profit for themselves, some social or economic advantage for themselves, and he did not agree with the emphasis being given to the private actors' intent. What really matters, he believes, is the intent of the Land Board and the actions of the Land Board. Do their actions in entering into an exchange promote the long-term interests or return for the beneficiaries? Multiple endowments of this size cannot be managed without confronting legal risk. Fear of risk does not promote the long-term best interest of beneficiaries. Senate Bill 1277 was a direct reaction to the Land Board's decision to put a moratorium on all land exchanges because of one problem with one completed land exchange involving property in Idaho Falls and University of Idaho property in McCall. That seemed to him an incredible overreaction and one of the reasons SB 1277 was passed. **Mr. Lord** commented that he believed that the "intent" should be of the Land Board. It was the intent of the Land Board to circumvent the auction process, not whether it was the intent of cottage site owners, and that is the action that would be challenged. Once you look at like kind for like kind, are you truly disposing of endowment assets or are you simply exchanging for similar real estate? That seems to be the issue before this committee. If you want to pursue exchanges, that is where the focus needs to be and it shouldn't be because it is difficult or not transparent; it should be transparent. It is the Land Board's duty to conduct business, which is sometimes difficult. **Mr. Strong** disavowed that the intent of the cottage site lessees was being looked at. What is being done is boiling the issue down to one simple issue and saying that the Land Board refused to do the exchange solely for that reason. Risks are entered into constantly, he said, and the Land Board does that on an informed basis. When the cottage site transactions were looked at, there was more to this than simply the risk of a disguised sale; there was the risk with regard to how the property was valued, risk associated with whether a commercial property should be invested in, was that a good investment and a number of legislators think that was a poor decision. It's not fair to look at this from a single perspective; all risks are considered and attorneys advise clients based on the entirety of those risks before a decision is made. There is not a moratorium on exchanges, but there is a decision being made by the Land Board to be more cautious in the approach because they took a position that invoked a large reaction. The Land Board wants to make sure they act prudently, consistent with their fiduciary obligation, and that is all anyone should ask of the Land Board, and all they ask of themselves.

The committee recessed at 11:32 and reconvened at 11:45 for public testimony.

Co-chair Vander Woude announced that public testimony would now be heard by the committee.

ROBERT FORREY

Robert Forrey said he was representing the Tax Accountability Committee and he lives in southwest Ada County. He opined that the Idaho Land Board members had struggled for years at their attempt to manage public schools and other endowment lands granted by the U.S. Congress. Lawsuits and legal actions involving the Land Board have become commonplace in recent years, partly because the Land Board refuses to honor mandates set down in the Idaho Constitution. **Mr. Forrey** suggested amendments to Idaho Code in reference to the words "land" and "real estate or real property." He asked this committee to take the steps necessary to make very major changes in the Idaho Land Board's Asset Management Plan. He believes that a land use permit is another way to circumvent the auction process. He objects to the Land Board dealing in speculative investments, especially those that go sour, since endowments are dealing with money for school children. He thinks that some investment projects are in direct competition with the private sector. **Mr. Forrey's** testimony and handouts are posted on LSO's website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_forrey.pdf

Representative Burgoyne disclosed that he used to do legal work for Tamarack Resort when it was a going concern.

RACHEL GILBERT

Former Senator Rachel Gilbert lives in Boise and said that she had been deeply involved in the Tax Accountability Committee for the last four years. She believes that issues with regard to the Idaho Land Board have been ongoing for years and that the Land Board is gaining more power and she thinks it's time for the Legislature to step up and stop some things being done by the Land Board. She believes that leases in the 1920s started violating the Constitution when the leases were not put out for public auction. Years of trust ended when the Land Board changed leases on Priest and Payette Lakes. Article IX gives the Land Board power, but only according to laws passed by the Legislature. She reminded the legislative members of their power and she asked them to put controls on the Land Board since they have an obligation to do so under Article IX. She objects to a lease the Land Board did with 10 Barrell Brewing Company in Boise, and she thinks that many would have bid on that if it had gone to public auction. She believes the Constitution is being violated constantly by the Land Board and they can't be stopped, if nothing is done. She asked this committee to create an oversight committee for the Land Board. The Constitution is the bedrock of our legal system, and she believes the Land Board breaks the law and the Legislature is allowing them to get by with it. She asked the committee members to read Article IX of the Constitution.

RONALEE LINSENMANN (read by Barbara Forrey)

Ronalee Linsenmann thinks that the Land Board has devised a scheme to circumvent the constitutional requirement for disposal of school endowment lands to be done by holding an auction. She objects to the land use permits being offered by the Land Board for cottage site lessees who choose not to renew their leases. This is essentially a disposal of school endowment land to a selected party without holding an auction. She believes that the Land Board has no idea whether or not the maximum financial return is being received on endowment land and is why the Idaho Supreme Court ruled that " ... and for this reason competitive bidding is made mandatory." Her written testimony that was read is on LSO's website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_linsenmann.pdf

HEIDI KNITTEL

Heidi Knittel said she was representing herself and is the program director of a mental health agency in Nampa. She is also running for the Idaho Senate in District 12 as a Democrat in Canyon County. She was present to ask the members and the Legislature to designate the entire $10 million endowment fund to State Hospital South. When you speak of a fiduciary duty to current and future generations, she felt obligated to share that 54,000 adults in Idaho live with a serious mental illness and 27% are incarcerated with an annual cost to taxpayers of $41,748,120. Prisons may now be the largest mental health providers in the U.S. State Hospital South serves over 800 patients. Better funding could potentially save the state millions of dollars in recidivism and in other ways.

WAYNE HOFFMAN

Wayne Hoffman is the President of the Idaho Freedom Foundation which is a nonprofit, nonpartisan public policy research organization in Boise. In a past committee, he said that IDL was not able to clearly articulate what kinds of assets it would or would not invest in and this has been a source of trouble for many. When inquiries are made, different answers are given. He believes that commercial or residential real estate are very concerning types of assets to be involved in. If the state will not undercut the commercial real estate market with its rental rates because IDL must charge market-driven rates, like state endowment-owned forests that compete with privately owned lands and for the sale of timber, IDL must charge a market price for the use of the asset, anyone who is in business knows this is just not true. If you're in a storage unit business, a hotel or brewery business, one is not comforted by the idea that your competition is charging the same rate as you because that means that he gets to work with them instead of his business. He sees this as a real problem. He asked how much the state has to make off of competition with the private sector in order for it to be okay. How many businesses need to be undercut, competed against, or injured before it becomes an okay investment in the private sector? How many businesses will be

comforted, after they go under, because the endowment made some profit or that the beneficiaries got the maximum return? He thinks the 2015 session would be a good time to put some parameters on the types of investments the state should and should not invest in, and he volunteered to help in that role, not only to help endowments in future years, but also in the very important work of protecting the free market system in the state of Idaho.

Representative Gannon talked about the state renting office space in Boise for $10.5 million annually; he asked if **Mr. Hoffman** would feel comfortable if the endowment fund was invested in building that leased only to the state of Idaho, thereby saving the state money and also providing a firm rate of return to the fund. **Mr. Hoffman** said he appreciated the comments about the reserve fund, which is a huge issue that should be examined. With regard to rental property, for private sector use, this is a huge concern and could be something to look into. However, he said the biggest issue is the fact that people in Idaho are renting property from the state instead of doing business with the private sector.

Representative Burgoyne asked for **Mr. Hoffman's** views on what he regards as the biggest issues being grappled with which is whether there is the appropriate governance model for the endowments with the Land Board or whether it should be modified; should there be a new model for management of the endowment assets? **Mr. Hoffman** replied that right now the Land Board is antiquated; he believes that the Legislature could play a larger role in the oversight of the Land Board and the endowment. He also thinks there is an issue with the Attorney General being on the Land Board.

RONALD HARRIMAN

Ronald Harriman is the Chairman of the Tax Accountability Committee and he presented examples to the committee as to what the effect is when the state of Idaho comes into competition with private business. He is a retired certified residential appraiser and an ex-contractor. When the Land Board proposed trading privately owned commercial property located in Nampa for state land on Payette Lake, they claimed that income would increase by $63,000 annually. However, the end result would have been that the building in Nampa would have become tax exempt and it would have taken $57,000 away from Nampa's property taxes and taxpayers of Nampa would have actually had to subsidize the IDL and levy rates would be raised in Nampa. He gave several examples of proposed actions by IDL. He asked this committee to guide the Land Board away from commercial investments. His handout is on LSO's website at: http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_harriman.pdf

Co-chair Vander Woude recessed the committee for lunch at 12:03 p.m. and they reconvened at 1:30 p.m.

Co-chair Vander Woude welcomed everyone back to the committee and reopened the panel discussion. **Representative Burgoyne** expressed concern about the idea that the bid, whether on cottage sites or other lands, is for a predetermined rent and the idea that the Land Board has the asserted authority to go out and make some sort of appraisal to arrive at a predetermined rent and then bidders come in for the right to pay that rent, basically bidding a premium. It is his view that this it not what the public auction provision of the Constitution is expecting; we should be testing estimates given by appraisers in the real market, which is who will show up and how much will they bid. He asked for views about this and whether this drives or doesn't drive the market. **Mr. Thomas** said he was once asked to offer a judgment about whether the Constitution required that public auctions begin at a zero base, rather than at a predetermined reserve; he thinks that is a legislative question, not a constitutional question. Regarding cottage sites, this is an area where there are lots of hidden inequities and there is currently litigation going on and potential for a good deal more. There are claims that people who have relied on cottage site leases and past law have put up expensive homes (from $100,000 to $3 million) on endowment lands and may be in jeopardy of losing them, particularly those who cannot afford the current rent structure. The law provides

that if a person walks away from the lease, the state gets your property; this issue is particularly appropriate for legislative adjustment and consideration. Appraisals used by the Land Board have been challenged and it has been alleged that values were inflated, causing higher rents. **Director Schultz** added that with regard to bidding, it is pretty standard in the industry that there is a fixed rental which tends to be between $1-2 per acre, and you bid a bonus. Grazing leases have two ways for bidding; you can bid on a rate or on a bonus and Idaho has done it both ways. IDL's leases for grazing are between 5-20 years, a much longer term than in the private sector which are between 1-3 years. With regard to cottage sites, he didn't think it would be prudent to bid a rate; the problem is that there is a captured market, in a sense, and there is very little bidding on cottage sites. Social consequences are often suffered in bidding against neighbors. The more valuable the improvements, that must be factored into the bid, in order to compensate the lessee, in addition to paying that premium bid. The system does not lend itself well to competitively bidding rates on cottage sites, so the Land Board has set a minimum rate (basically 4% of the appraised value). The Constitution does require appraisals for disposition; less than appraised value cannot be accepted. Market rate studies are done through IDL and there has been much research done on cottage sites and appropriate rent (4-8%). An informed decision needs to be made on how to set up a process conducive to bidding.

Senator Keough asked about the land use permit offered for two years to those cottage site lessees who didn't want to renew their 2014 leases. **Director Schultz** replied that not every instrument is a disposition; that is the fundamental difference. What is in a lease, what rights you convey, that makes it a disposition. Selling something is a disposition. A lease where you allow someone to sign that, there is a guaranteed term, you have certain rights, that is considered a disposition, and there are other instruments (i.e., a permit) and permits are not new. IDL has been issuing permits for over 20 years, and they are short in duration. The permits in question refer to lessees at Priest Lake and there are concerns by people who are looking for an exit strategy from the lake and IDL worked with the lessee association to develop this concept for people who could not assign (not offered full rights) giving them two years so they can actively market their improvements with the goal of selling improvements and assigning their lease to another party during that two-year period. The difference between a lease and a permit comes down to what are the legal rights being granted in that instrument, and not everything is considered a disposition (such as an easement). **Mr. Strong** reiterated that Article IX, Section 8, provides that any disposal of land shall be at public auction; the operative question becomes what constitutes disposal. That requires going back to the 1890 laws and you look to see if somebody has a legally enforceable right of possession to the property for a time certain and that becomes the operative question and becomes a disposal. With a lease, once a lease expires, the property reverts back to the state, surrendering a portion of that interest in property to a present interest to a lessee. For that reason, it has been characterized as a disposition, and that was the conclusion that came out of Wasden v. Idaho State Board of Land Commissioners. **Mr. Strong** clarified that it is not the label put on a transaction, but rather what the effect of the transaction is and if the Land Board, entering into the transaction, is surrendering some legal right of possession and control of the property, that is when it becomes a disposition of land as opposed to just granting a right of use. It is easy to state, but harder to define, in application.

Senator Brackett asked for comment on how access was dealt with in appraisals on cottage sites, as well as rangeland. **Director Schultz** said that the state owns property around cottage sites, so there is full access to the sites, and the lessees who have acquired property have been issued easements to demonstrate they do have full access, so when appraised, they are appraised as though they have full access to the lots. Grazing leases have to do with selling grass, not property, so they are not as concerned about access when an AUM rate is set, so if grazing land was sold, the value would be with access. Typically, if there is no legal access, sometimes there is a discount put on land and that can vary from 20%-80%. **Senator Brackett** commented that particularly on rangeland, financing would require insured legal access; therefore, a discount would be appropriate. **Director Schultz** affirmed that access was key.

Mr. Strong was asked by **Co-chair Vander Woude** what the differences and restrictions were between a land use permit (looking to him like a short-term lease) and a long-term lease. **Mr. Strong** said that the Idaho Supreme Court has held that a cottage site lease is a disposition, subject to Article IX, Section 8, and the disposal requirement. The dilemma is that has to be undone. Ownership has been split between improvements and the property itself. Some people want to go forward with leases and some don't; there are arguments about appraisals that may be appropriately decided by courts. A land use permit does not grant exclusive possession; in fact, possession is being surrendered for the purpose of allowing marketing of that property. A land use permit is simply a transition document being used solely for the purpose of giving lessees an opportunity to remove improvements so that there can be a long-term lease on that property and subject to disposal through a public auction. **Co-chair Vander Woude** asked if the lessee would still have the option to go through the auction process and buy this lot when it comes on the market. **Mr. Strong** responded that a land use permit would indicate that the person had made a determination they are not going forward, so the land use permit is a transition document and that person would not be bidding on that particular property. **Co-chair Vander Woude** asked if that person would be allowed to bid on it and **Mr. Strong** said his recollection was that they are not allowed to bid. The reason was that there is not an easy way to go directly to a lease if there is somebody that does not want to continue with a property; that property has to get back into a marketable condition. **Co-chair Vander Woude** asked if a person made improvements on that property with a land use permit, are they allowed to take the improvements off that property. **Mr. Strong** affirmed that improvements are considered personal property and can be removed if the lessee desires to do so. **Director Schultz** said that with regard to whether a person could still bid at auction, he said he would verify that and get the response back to the committee.

Senator Bayer asked if it was fair to say that part of the justification for the consideration of the land use permit is to change the time line on the auction process. It was referred to as transitional, and he asked if that was a fair statement. **Mr. Strong** said it was not just a transitional document because when the Wasden decision came down, the leases were sorted out by IDL into various lengths of leases in order to stagger that lease term. The land use permit only came up in the context when there were lessees indicating a desire to get out of the leasing process, and that was how that document was developed. **Senator Bayer** wondered if the auction process has led to advocates of the land use permit. **Mr. Strong** said that was a fair assessment; what happened was that once a site was put up for public auction, then individuals responded that they were not in the position they wanted, going forward. **Senator Bayer** gave a hypothetical situation about a site with no improvements and someone was part of a very short-term land use permit, would it be logistically feasible to put improvements on that land. **Mr. Strong** explained that a party does not have the right to add improvements on the land with a land use permit. It is only for the purpose of removal of what is there.

Representative Burgoyne asked how long does a land use permit (LUP) last and is there rent for an LUP. **Director Schultz** responded that nobody had signed up for an LUP. If issued, the term was up to two years. The rent would remain exactly the same. Statute allows IDL to defer up to two years any increases in rent. As rentals went up, some people had difficulty paying that, so the idea was that an increase could be deferred for up to two years, while marketing improvements during that time. At the end of the two-year permit, full rental would be due, the difference of rent during that time period, plus interest on that amount. **Representative Burgoyne** wondered what restrictions there are on the lessee's use during use of an LUP; can they rent it or live there. **Director Schultz** reiterated that nobody had actually applied for an LUP; what was envisioned is that a lessee could have full use of that property for that two-year period, but there is no assignment provision. Leases are assignable. A permittee (of an LUP) is not allowed to bid on their own lot, but they could bid on another lot; an LUP is an exit strategy. **Mr. Strong** commented that the objective is that there are two choices: If somebody doesn't want to continue with the property, you have them vacate the property and then the problem arises about how to manage, control and protect

that property for future sale. The judgment call was made that it was better to have a lessee there caretaking than to leave the property vacant.

Senator Keough asked about cottage sites at Payette Lake that the Land Board was considering for a hotel, dormitory or some private enterprise. **Director Schultz** explained that in 2010 when the Land Board approved the cottage site plan, they were looking to unify the estate and there were two options: (1) sell the land, or (2) acquire the improvements. In most cases, selling the land is preferred; in some cases people want to donate improvements, others have removed improvements, and some want to sell improvements. All of those are options to unify the estate. There was an instance where two improvements were acquired ($120,000 for one, and $50,000 for another) and some were acquired through litigation where people walked away. Until those lots could be sold, they were leased on short-term rentals, and they were homes listed with a broker in the McCall area and were leased on a rental basis. There is no intention of renewing that contract and one will be sold at the auction in December with 30 other lots, 6 vacant. IDL's goal is to unify the estate in an orderly fashion preferably through disposition of the lots. **Senator Keough** asked if there was a proposal approved by the Land Board that would call for going into a hotel or dormitory-style building. **Director Schultz** assured her that the Land Board has approved nothing regarding going into hotels; the Land Board did approve the acquisition of those two improvements he mentioned, one on a daily/weekly rental and the other had a one-year lease, but both contracts ended and both properties will be sold within a year.

Co-chair Vander Woude opined that appraisals were highly subjective with regard to cottage sites and exchanges, so he asked how appraisals can become a less volatile issue. How can this conflict be resolved when the Land Board is deciding the value of improvements as compared to the owner? **Director Schultz** replied that any time there is a land deal, an appraisal is called into question. He accepts that as a fundamental, controversial issue. The code currently requires in a land exchange that there be a second review process or appraisal, which is one way the Legislature tried to help this situation. With regard to current cottage sites, IDL is involved in a challenge process; at Priest Lake there are 128 lessees out of 354 originally who are challenging the value of the lot, not the improvements. IDL expects those review appraisals to come back by the second week in November, 2014, and if those appraisals are greater than 10% or less than 10% of the original number, there is a built-in process to have yet a third look at those values from yet another appraiser. IDL does hire appraisers who are MAIs and the code requires that if there is a land exchange, an MAI appraiser will look at those properties. The code is prescriptive in terms of expectations, but there will always be differences of opinions between professionals. Fifty-nine lessees acquired their lots at Priest Lake in August; they paid to get appraisals done on improvements and auctions were voluntary. If a lessee thinks the value by the state on improvements is unacceptable, that lessee can withdraw from the process, so there is an out. At Payette Lake, 59 lessees (out of 60) acquired their lots.

Mr. Strong suggested dividing this into two separate issues. He believed that cottage sites are unique in that you have a split estate and this will always cause an argument between the owner of the improvements and the owner of the land and which is more valuable, the land or improvements. That is the issue. He said he'd been working on this issue since 1985 and in every year where an appraisal was done on either setting rent or on a sale, there has been this continued conflict over the correct value. Ultimately, the process is going to get us to that point because an appraisal is an estimation of the value, not the actual value. By having the public auction, there is an opportunity for public bid, then that will get to the true value for that property. Until that split state is resolved, what you have is a problem of rent-seeking behavior, and a small group of people trying to influence that. The result of that, over years, was that the return on cottage site endowments was about 1.7%, before the Wasden court case; after Wasden, the rental rate moved up to 4%.

Director Schultz announced that as of today 34 lots at Payette Lake had been sold (36 more will be sold in December), and at Priest Lake 59 lots were sold. IDL started with 534 lots, so by the end of the calendar year, 25% of the cottage sites will have been sold and over the next 3 years, IDL

envisions selling another 200 lots, approximately 60% of the lots. This process is moving forward, and the auction process is a path. IDL sees the transition from state ownership to private ownership of cottage sites as a positive, and money has been transferred out of the land bank fund into the permanent fund. The Land Board will make the decision as to future funds coming into the land bank.

Representative Gannon commented that he thought the Payette Lake lots were very reliable with regard to generating ongoing income and steadily increasing in value; what steps are being taken to find comparable properties or investments other than putting them in stocks, bonds and foreign currency? **Director Schultz** replied that Callan Associates is currently looking at this issue and will advise the Land Board on asset allocation, and that draft report will be available within several weeks. IDL will rely on outside experts to advise the Land Board.

Co-chair Vander Woude said there had been much discussion and consternation about a previous study where the Land Board was going heavily into commercial investments, which was put on hold. He asked if that study was dead or not. **Director Schultz** assured the committee that the consultant did visit with Land Board members to understand their perspectives and actions. **Director Schultz** did not envision any surprises that would generate a lot of controversy.

Representative Burgoyne referred to a report received from Mr. Maynard (members received this in preparation for the August 28 meeting), which indicated that EFIB can hold cash and buy land (out of state and out of the U.S.), and he asked if we need a land bank for management by IDL. It begs the question as to why we have a land bank and why do we need one. Would laws about public bidding and caps on amount of land that can be sold or provisions in the Constitution follow endowment acquisitions out of state and into foreign countries? **Mr. Tim Hurst** responded that with regard to diversity, this had been discussed, allowing others to do what PERSI has done to purchase land, and that is why a consultant was hired. He said that many do not have the expertise currently to make that call. **Mr. Crabb** responded that his views were his own, not his employer's, and said that from an economic standpoint, he didn't think that a land bank was necessary and did not need to be incurring expenses either for financial assets or for the process of appraisal in order to meet objectives. Administrative and management fees on the permanent fund are about 40 basis points; you can get roughly the same return for lower basis points in an index fund. Yes, there are choices, but the question remains as to the intent. If land is purchased outside, it would be subject to the laws of those lands, and conflicts would obviously result. In finance, he believes that fees would go up and expenses would rise. Investing in a U.S. index fund today, about 8-10 basis points would be paid annually on fees; in contrast, investments in an international fund would cost 20-30 basis points in terms of fees. **Director Schultz** thinks that we do need a land bank; if all the money is moved into the permanent fund and EFIB hires fund investors to invest that money, chances are that investment would not be in land. The idea of the land bank was to retain some moneys to reinvest in land; if you want the opportunity to reinvest in land in Idaho, then a land bank is needed. The question is what to invest in and what information is utilized to make those decisions. If there is not a land bank, then that money would all flow into the permanent fund; it would be very unlikely, for instance, for EFIB to buy timber in Idaho for IDL to manage. **Mr. Riley** thought that the broadest question was whether it was reasonable to think about scenarios where EFIB or the Land Board, or perhaps with the Legislature involved, might decide it to be a worthy objective for the state or the endowment to increase or decrease the amount of forest land, or land in its portfolio. He referred to the income history on the "Idaho Land Grant Endowments" handout, pointing out that discussion had taken place whether the endowment ought to sell all forest land assets due to poor performance in relationship to the equity market at one time. Because the state has inherited this land base, particularly the forest land, there have been substantial investments in business entities that intersect what happens with the timber sale program; history cannot be unwound without significantly changing the status quo for stakeholders substantially invested in communities. Going forward, he thinks that a land bank is needed to do small transactions that make sense. On the flip side, if the state wanted to expand investments, other businesses will

be actively seeking those markets and there is a question as to why the state would want to compete with the private sector. Over time, IDL has evolved in expertise in management of lands, second to none probably anywhere in the world, capturing value for the asset while protecting the environment and providing sustainable benefits to the public.

Representative Gannon commented that the million acres Idaho had in 1890 (having been sold and no longer in the endowment fund) would now be worth about $5 billion; in terms of the future, he speculated that if lands are not sold, what the potential value of the 2.4 million acres might be 100 years from now. Doesn't it seem wiser to keep land long-term, especially with population growth? **Mr. Riley** replied that we know the population of the globe will double within 10-15 years; the amount of forest land on the globe will stay exactly the same. **Director Schultz** added that a lot of the million acres sold was agricultural land, and $5,000-$8,000 per acre is not an unheard of value in the Magic Valley, so it adds up quickly. Whether land is retained or sold, that is the odd question, and is really a policy call informed by experts. The Land Board is trying to form that discussion using experts who make recommendations. In code, timberland cannot be sold, so there is very much a hold policy from the Legislature. The Constitution limits direct sales, so he suggested that roughly what we have now is what we will have in ten years, in terms of land base.

Co-chair Vander Woude asked about preservation and performance of endowment assets and if the consultant report will be accepted or will there be a chance for input or modification. How can performance be increased while maintaining the land base, and will decisions strictly be made by the Land Board?

Representative Gannon asked about IDL not looking now at any land acquisitions to replace lots at Payette Lake and he wondered what would be needed in order to do that. Does IDL need more staff or what? **Director Schultz** said that when the Land Board voted to move forward with the consultant review, they basically gave direction to IDL that until the study is complete that money will be on hold until the experts make recommendations. **Director Schultz** assured that the Land Board seeks public input and whatever they adopt won't be done until December at a public meeting. There will be a briefing in October from the consultants to the Land Board, and that meeting will also be open to the public and the report will be available for comment. **Mr. Hurst** added that this discussion had taken place between the Land Board and Secretary Ysursa about whether the consultant report will simply be accepted or not; the answer to that from Secretary Ysursa is "no." They hired the experts for advice to make rational decisions and there is a reason, he believes, that the founding fathers put the five most political people in the state of Idaho on the Land Board. That is to somewhat temper the responsibility of looking out for and being trustees for the endowments and looking out for what is best for the state of Idaho. If the report makes sense to them, that advice may be followed, but it could go either way. **Co-chair Vander Woude** expressed his concern after what happened on the Heartland report, which caused heartache when it was accepted as presented. **Mr. Hurst** stated that the Heartland report was not accepted by everybody. **Director Schultz** assured the committee that the consultants doing the report are willing to brief members and visit about any issues in their findings. **Co-chair Vander Woude** announced that another meeting of this committee would be on November 14th, and the report will be out by then, so there will be a chance by then to discuss findings. He hoped that everyone will work together on the findings in this report.

Representative Gannon commented on the reserve fund of $345 million and payout of only $52 million; his concern was that the reserve is invested in the same manner and place as the fund itself, so if the fund goes down, the reserve also goes down, presenting a need to replenish the reserve, he assumed, under present rules. Is it possible that there may never be a return or a significant payout from all this profit being made with endowments? **Mr. Johnson** responded that there will be a payout; conservative projections were made in the next few years, and for 2016 the Land Board has approved a payout of around $56 million; in 2017 that should rise to $65 million, and in 2018 close to $70 million. The $345 million in reserve fund on October 1st will be slightly

lower because some of those reserves will be converted into permanent principal. The current asset mix, over time, will earn over 6.5%.

Mr. Strong said the question had been asked earlier today about the Legislature's authority to appropriate out of the earnings reserve fund. At lunch, he looked at Article IX, Section 3; he said that it provides that funds shall not be appropriated by the Legislature from the public school earnings reserve fund except as follows: The Legislature may appropriate from the public school earnings reserve fund administrative costs incurred in managing the assets of the public school endowment including, but not limited to, real property and monetary assets. **Representative Gannon** commented that is for the public school portion of the endowment, a little over half, and asked about the other seven beneficiaries. **Mr. Strong** said this does deal specifically with the public school funds; he was not aware of other statutory provisions dealing with the other earnings reserve funds. **Co-chair Vander Woude** asked if the money from the endowment fund goes through the appropriation process and if it increased from $30 million to $60 million, then the endowment doesn't necessarily benefit the schools, it benefits the general public if it is considered part of the operating budget of the schools. How does the endowment fund actually end up at the schools and not just less money appropriated from the general fund to the schools? **Mr. Strong** said it comes back to the Legislature's responsibility to fund an adequate school system for the school children. If the public school responsibility is not met, then that is a constitutional issue, and there has been public school litigation on that issue. **Co-chair Vander Woude** asked if it was possible to set policy that says $30 million from the endowment fund goes to the appropriation of the schools and any other greater disbursement than that cannot be considered part of the budget. Would that be a policy of the Land Board, the Legislature, or arbitrarily set by whomever controls the endowment funds? **Mr. Strong** replied that the authority of the Land Board rests with maximizing long-term return of the endowments, and how much is appropriate to come out of the earnings reserve fund for the annual distribution. With regard to whether the Legislature wants to use that money coming out of the endowment fund as off budget, that is a policy choice from the Legislature. **Mr. Johnson** added that does occur in some states, where a portion of the public school fund does flow through a different appropriation process than the Legislature, so that is a policy choice. **Co-chair Vander Woude** asked if that decision would be similar to the tobacco money received by the state and allocated; would the state or the Land Board control that? **Mr. Johnson** did not think the Land Board would control that. **Co-chair Vander Woude** used the example of capping at $30 million and anything above that disbursement to the public schools was above budget, who would make the decision where the amount above the cap or normal distribution gets spent? **Mr. Strong** said that would be a legislative determination. **Representative Gannon** said that although it might be a legislative decision, couldn't it be a joint decision where the Land Board and legislators agreed that money released would be for a specific purpose? **Mr. Strong** said that the system before us now has a necessary intention between it; on one side in order to protect the trust and assets in the trust, that authority has been vested in the Land Board to generate that revenue, but once generated, the obligation of appropriation of that money rests with the Legislature. There is a fiduciary obligation not to divert those funds to anything other than the benefit of the beneficiaries. This cannot be a substitute for general funds somewhere else in the budget. To the extent once those moneys are appropriated, and you want to determine how they are allocated to the beneficiaries, that can be a shared responsibility, once that amount is determined. **Representative Gannon** asked about the excess money in the profit reserve fund, the $38 million above and beyond the 5-7 year reserve required for beneficiaries. That money was put back into the permanent fund; was that necessary based on population growth and inflation because of the $345 increase in the fund this year? **Mr. Johnson** said that it varies by endowment; certain endowments were behind their target for population and inflation growth, so transfers allowed them to catch up with that target. Two funds will have distributions that will be greater in the future per capita than in the past. The structure of the process is to protect the current distribution; when there is extra income, it creates that additional corpus. The distribution policy has been structured to balance needs of the current and

future beneficiaries. For every endowment that has a transfer, it results in an automatic increase in their distribution reflecting there is a permanent increase in the capital that supports those distributions into the future. **Representative Gannon** asked if the money isn't necessary for future beneficiary increase based on population and inflation, then would it be a legitimate concern that the money should have been used for the present beneficiaries? **Mr. Johnson** said that was a difficult philosophical question. If there is a windfall profit one year, should that windfall be spent immediately? Maybe one generation of beneficiaries would enjoy that, but no other generation would. Given the way the state budget process works, and how the money is used by beneficiaries who do not like one-time distributions, that makes it a difficult decision. Creating more corpus to create higher distributions in the future is the best way to serve beneficiaries.

Co-chair Vander Woude asked if anyone on the panel would like to address the issue of getting involved in an exchange; how much information should be out there prior to the close of the transaction? How is transparency increased? **Mr. Riley** explained that the current process is that you engage in a land exchange and appraisals are done on the property of both parties and once the deal is done, then those appraisals are released to the public. Part of the question that surfaced is whether appraisals could be released before the deal is consummated. He thinks that if a prior-to-closing state valuation could be available to the public, with time for comments, that might be enough additional transparency. He thought this idea would be very good, and he credited **Representative Burgoyne** for this idea. **Co-chair Vander Woude** asked **Mr. Lord** if there would be issues or concerns with regard to appraisals and public information. **Mr. Lord** said that when a business deal is negotiated, too many cooks ruin the stew, but he does believe there needs to be oversight. Oversight has had its impact, referring to total curtailment of commercial real estate trades at present. Sometimes when interests are protected, then the result becomes limiting the ability of IDL or the Land Board to conduct business. How much leeway should be given, and when does there need to be oversight? If every transaction is reviewed, then essentially exchanges won't be done. He cautioned about taking oversight into management; a landowner wanting to do business with the endowment doesn't want too much red tape and regulation. Auctions seem like a very democratic process, but the bottom line is that auctions restrict the ability of the endowment to make a return. We want more money to be available, but we make it more difficult for IDL and the Land Board to achieve that. We need to start talking about net income, which is relevant, and not gross income.

Co-chair Vander Woude recessed the committee at 3:30 and reconvened at 3:45. He opened the meeting up for more public testimony.

ARAMINTA SELF

Araminta Self said she was representing Community Support Center in Boise, a nonprofit facility that works with individuals with mental illness and is also a taxpaying citizen and homeowner. With regard to the $10.7 million being returned to the general fund, originally earmarked for the State Hospital South, she asked that this $10.7 million be returned to the beneficiary to benefit the mental health field. She works with mentally ill patients, has a mentally ill son, and she thinks these funds should go toward treating mental illness. Lost earnings due to mental illness annually amount to $193.2 billion, combined with the $80 billion cost of the prison system annually. Proactively serving the mentally ill could save the state and citizens a great deal of money. One in four Americans experience mental illness in a given year. Seventy percent of youths in the juvenile justice system have at least one mental health condition and 20% of adult prisoners have a recent mental health condition. It costs $500 daily to house an individual in the Ada County jail compared to $55 daily for mental health services. The military is drastically underserved with regard to mental health and veterans represent 20% of suicides nationally on a daily basis. She asked the committee to please consider the $10.7 million be redistributed to the beneficiary so they can possibly give that back to the mental health system.

Senator Keough asked for clarity on the $10.7 million. **Mr. Johnson** assured everyone that this money was being held for the beneficiary and will be reinvested for the beneficiary. State Hospital

South's distribution will rise 25% in 2016, partly due to this $10.7 million transfer that will raise their distribution by about $750,000. Seven percent of the State Hospital South's fund is distributed. The $10.7 million is part of a total transfer of excess income from the reserve fund back to the permanent fund. Enough reserve must be kept there to assure a steady distribution. This $10.7 million is not lost and remains within the endowment. **Senator Siddoway** asked if this was dedicated money that would go only to State Hospital South and **Mr. Johnson** said that was correct.

JOHN RUNFT

John Runft stated that he was present on behalf of the Tax Accountability Committee. He handed out materials which can be found on LSO's website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_runft2.pdf
Mr. Runft stated that his handout addressed why it would be wise to retain land (as opposed to real estate) when the maximum long-term financial return would appear to be best achieved by so doing. He wanted the committee to consider his synopsis as to the fundamental direction he thought they needed to go and the direction the Legislature needs to give to the Land Board, which is purely a legislative function. Some land always has immutable value in and of itself. **Mr. Runft** submitted a proposal for a joint resolution for the committee which is available on LSO's website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_runft.pdf

TODD HATFIELD

Todd Hatfield addressed issues of transparency with IDL and EFIB. He suggested that the committee read the proceedings and debates of Idaho's Constitution or, at least, read *Idaho's Constitution: The Tie that Binds* written by Dennis Colson. He believes that how endowments are to be managed is set forth clearly in this publication. He does not believe that endowments should be invested in commercial properties. He thinks today it's more about the game than about children and the endowments. The vision statement of IDL has changed from being a leader for Idaho to being one of the premier organizations in the northwest U.S. He believes that IDL and the EFIB have engaged in deceptive practices to portray a favorable image of their assets. **Mr. Hatfield** referred to a handout on LSO's website at:
http://www.legislature.idaho.gov/sessioninfo/2014/interim/endowment0930_hatfield.pdf
He said that this supposedly shows revenues and expenses, but pointed out that it shows only revenues. It also refers to two five-year periods which he believes is very misleading, showing just what the endowments have made in the last five years. He referred to a figure of 22.56% return on assets on the commercial portfolio which he said was completely false. He said the actual return on the investment was 1.29%. He believes that IDL should hire an outside, independent auditor for the endowment timber assets because in the last 10-15 years, the harvest amounts have fluctuated a lot. He thinks that IDL's responses should be authenticated by hard fact. For EFIB, **Mr. Hatfield** recommended a complete review of the investment strategy and putting some parameters on stock market investments. He also suggested putting receipts for the timber market into the earnings reserve to be a cushion to smooth out distributions. He believes that endowments have missed out on $73.5 million in the last 10 years. He believes that transparency is very lacking and that IDL and EFIB reveal only what they want to be seen.

DARRYL FORD

Darryl Ford said he represented himself, a citizen of Idaho. He addressed the Land Board's cultural change and said that the board had injected themselves into the competitive free market and in direct competition with private enterprise. With the purchase of the 414 unit storage businesses and the remodel of a building for a new brew pub, the state now owns 16 other commercial business properties in the Boise area. When buildings are bought and leased out, that takes money off property tax rolls for counties. Expanding the portfolio to include more commercial properties to compete with private businesses in the free market means, to him, that it is time to elect new leadership. Idahoans should object to this type of cultural change.

Co-chair Vander Woude announced that there would be time for more public testimony at 9:00 a.m. on October 1, 2014, the second day of this meeting.

Co-chair Bayer said that there will be no cutoff for public testimony on October 1st, and that the committee would have further dialogue with the panel members. He said that resources available to committee members would be discussed, inside and outside of the legislative branch.

Co-chair Vander Woude thanked the people who testified and the panel. He adjourned the meeting at 4:29 p.m., but reminded everyone that the second day of this meeting would convene at 9:00 a.m. on October 1, 2014.