

Mark H. Finley
Oral remarks to Endowment Asset Interim Committee
October 1, 2014

Thank you for giving me the opportunity to speak to the committee today.

My name is Mark Finley. Several members of my family -- both past and current -- have been lessees at Priest Lake since the inception of the State's cottage site leasing program in the 1920s.

I have come today to give the committee members a brief status update on the Residential Leasing Program at Priest Lake and to humbly offer some potential win-win style recommendations.

Since my remarks were previously provided to all committee members in written form, I intend to go just a bit "off script" in an attempt to address some of the testimony I was able to see both yesterday and on the initial August 28th presentations.

First, the three items relating to yesterdays and the original 8/28 meeting:

1) IDL is looking through the wrong end of the telescope – focusing on increasing rents rather than preventing abandonments. The State is ignoring the very real potential for possible massive fallout later this year and failing to recognize that despite all of the energy spent on the cottage site issues, the rents that are generated from those lots total only \$4 million dollars per year in annual rental income.

2) But the Collateral Damage from bad policies is significant. In a nutshell, the State's market reputation with respect to personal property rights is at stake.

How do you put a price on "Trust?"

Is creating mistrust of the state or its agencies on ANY level worth as little value as \$4 million per year?

3) The State's AG's office trots out a standard....which is a "blame the victim" defense - as primary justification for the new -above market - rents.

The state, in looking through the wrong end of the telescope, has intentionally created a massive and very misleading magnifying glass.

For argument's sake, assume the state's assigned asset value for the cottage site asset class of \$200 million is accurate --\$160m for Priest and \$40m for

Payette. Using the State's rent formula of 4% per year, in simple math generates \$8 million per year yield from this asset class ...put that \$8 million into the context of the State's total annual budget of \$1.7 billion for education, this \$8 million in cottage site rents amounts to one single statewide 'snow day'.

However, whether the correct fair-market value is really only \$4.5 million per year --- or as the state wants to claim \$8 million -- matters greatly to the 500 cottage site lessees paying these above market rents.

However, when the IDL "spin-doctors" get going on this topic, they use the reverse telescope's magnification, to create the false impression that cottage site lessees and the rents we are charged represent the difference to the students of Idaho between a rich educational environment vs. one where children are being cheated out of vital educational opportunities.

Collateral damage from raising rents 154% in three year period.

The recent and unprecedented 154% rent increase is NOT a scalpel with surgical precision to extract the perceived excess 'fat' from cottage site lessees wallets.....it is more like a chain saw or hand grenade.

Quick anecdotal story demonstrates my point: Yesterday, while dropping off my boat for winterizing, the business owner tells me he lost 16 regular boat storage clients this year. If next year is comparable - or worse (which it VERY likely will be) he says he will be out of business.

Treatment of investments in cottage sites by lessees is trivialized.

In an effort to enhance returns in the grazing land asset class, consultants to IDL are drawing a focus to the worst of the scabby, dry lands and recommending oil and gas drilling, mineral rights leases, also alternate energy leases for wind, solar, geothermal...ALL of which require massive upfront commitment of capital and long term contractual obligations.

I'd ask the committee to create a realistic "report card" and make it focus on how well the "capital" invested by the cottage site lessees has been treated?

But before you assign your grade - I have another anecdotal story to demonstrate my point:

...
This June a Priest Lake lessee - who has been trying to sell his improvements for over 2 years finally closed his sale. He sold his home, a 4,000 sf, 6-bedroom, 5-bathroom year round home, exactly the type of home the State's "Right of

Continuation" was designed to encourage lessees to construct, appraised at over \$800,000 dollars for only \$100,000, booking a loss in excess of \$700,000.

IDL shows this loss in its monthly lease assignment report, at ONLY negative \$159,000 - why? Because they choose to use the Bonner County tax assessed value rather than appraised values (which is a truer number to illustrate the loss in value to the lessee).

If appraised values were to be used for this report - which was the convention previous to the recent inflated appraisals - every single sale since last June would show that the sellers are being forced, by the above market rents, to provide a 4 to 6 year 'pre-paid' rent subsidy to the new owner in order to offset the new above market rents.

Finally we see the use of 'blame the victim' defense of the new above market rates.

Deputy Attorney General Strack put forth just this flavor of argument in court to Bonner County Judge Barbara Buchanan in as the State's way of justifying the recent, unprecedented rent increases.

Essentially his argument claims that it is really about "optics"... the reason the rent APPEARS to be going up by such a large percentage, is because the starting figure was simply way too low..... The lessees were getting too good a deal, for too long, and now the State is forced to make up for prior undercharges.

Really?

So, this argument really begs a much broader policy question, it is RIGHT to expect that today's renters be charged now for the State's alleged systematic underpricing of rents, which allegedly occurred during the 70's and 80's? This kind of argue by the AG's office sounds like a wealth transfer via government mandate...NOT the hallmark of a state with a rich Republican/ Conservative tradition.

So is there a win-win solution available? Is there a way forward which helps to alleviate this uncertainty at Priest Lake?

I outlined here three potential remedies to the current crisis at Priest Lake.

I believe that enacting these recommendations will not only stabilize the residential leasing crisis at Priest Lake but will also ensure that the State maximizes the LONG TERM return to the Endowment beneficiaries.

It is requested that any revision of legislation regarding Land Board and IDL's management of the State's Endowment Lands include provisions requiring:

1. All appraisals of endowment lands shall be in compliance with USPAP standards, conducted by MAI appraisers. Such appraisals shall attribute the value of all improvements paid for by lessees, both on-site and off-site, to the lessee, not to the land itself.
2. The minimum bid at any voluntary auction of cottage site Endowment lands shall not be greater than the appraisal-based valuation used to set rents for the year of the auction, which is deemed the appraised value of the land.
3. If a lessee does not renew the lease of a state endowment land cottage site because of an increase in rent, the state shall pay to the lessee the value of the improvements to such Endowment lands, both on-site and off-site, paid for by lessees or their predecessors in interest.
4. If the lessee of a cottage sites on endowment lands requests the exchange or sale at voluntary auction of such lands, such exchange or sale shall take place within the term of the then-existing lease. The appraised value of the land used for the exchange or to set the minimum auction bid shall be the appraisal-based valuation used to set the current rent of the lease. If the exchange or sale is not completed within one (1) year of the request, all rents paid for the period after that date shall be credited to lessee's account against the ultimate exchange or sale price.

Thank you once again for the opportunity to speak before this honorable committee.

I have included my contact information for any committee members who wish to discuss further these recommendations.

Mark H. Finley
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Post Hearing comments:

As a follow up to questions posed to me by the committee today, I offer the following clarifications:

Regarding Senator Siddoway's question regarding Recommendation #3. Does purchasing the improvements from lessees represent the State becoming more involved in private sector real estate?

I would like to add that NO we are NOT interested in the state getting into the property rental business, but rather to provide an opportunity for the lessees to recover Fair Market Value for their improvements. Once the state owns the assets, what they want to do with them, including reselling or destroying them, is rightfully up to them.

Regarding Co-committee Chair Mr. Vander Woude's question regarding current appraisal process used to set minimum bids for voluntary auction participants (Recommendation #2).

We feel that the State's current practice of NOT allowing lessees to appeal their appraisals BEFORE entering a voluntary auction has led to inflated minimum bids for the August 2014 VAFO's. Based on our independent appraisals, the appraised values for the 2014 VAFO's were 30-40% above fair market value.

2014 VAFO participants were given two options: 1) accept the State's inflated appraised value or 2) be kicked out of the VAFO. Therefore, under duress (and because of their need to protect their considerable improvements), the 2014 VAFO's participants paid more than the fair market value for the land and inadvertently have established new and inflated sales comps for the next round of VAFO's.

If IDL is allowed to require new appraisals for the 2015 VAFOs based on the inflated 2014 VAFO sales comps, the integrity of the State's minimum bid process will be in jeopardy.

Statement from Mark H. Finley

Natural Resource Committee

October 1, 2014

Thank you for giving me the opportunity to speak to the committee today.

My name is Mark Finley. Several members of my family -- both past and current -- have been lessees at Priest Lake since the inception of the State's cottage site leasing program in the 1920s.

I have come today to give the committee members a brief status update on the Residential Leasing Program at Priest Lake and to offer some recommendations.

If you were wondering if the situation at Priest is as bleak as reports you are hearing, here is your proof:

Rental rates for cottage sites:

- Lessees at Priest Lake have been dealt a 154% rent increase in just the last three year period.
- Based on the State's Hall-Widdoss appraisals, the average annual rent of \$9,000 in 2011 will jump to \$18,000 or more per year in 2015. Some lessees will see their annual rent rise to \$25,000 per year starting next year. This increase follows on the heels of an increase in the rent multiplier from 2-4% in 2011.
- 120 independent appraisals conducted on behalf of lessees by two highly regarded North Idaho based appraisers found that the State's Hall-Widdoss appraisals are 30-40% above fair market values (for the same lots during the same time period).

Impact on "leasehold values" at Priest Lake:

- As a result of the inflated rents, dozens of lessees have been attempting to sell their improvements this summer. Few have had success.
- In order to entice buyers to take over the exorbitant 2015 rental rates/leases, lessees are selling their improvements at greatly reduced prices. Some lessees have begun offering their cabins for FREE to anyone willing to take over their lease (thus saving the lessee from a tear down later this year)

Anticipated abandonments this year:

- According to IDL, the State anticipates that 10-30% of lots will be abandoned this year due to the rent increases. In actual numbers, that means 35-106 lots will be abandoned by December 31st.
- IDL Director Schultz has stated that the State can absorb 46% abandonments and still make money.

Five Poor Options for lessees:

- 1) Sign a long-term lease at rents based on the Hall-Widdoss appraisals that are 80% to 126% over their current rent and hope that the State's new appeal process (with its undefined rules) will result in a reduction next year.
- 2) Attempt to sell their improvements (cabins, docks, etc) at prices well below the county assessed values or free to any buyer willing to take over lease.
- 3) Tear down and remove their improvements before December 31st at a cost of \$25-30,000 for a modest-sized cabin or face legal action from the State.
- 4) Purchase a six month permit to extend the time allowed to teardown improvements at a cost of \$500-1,500.
- 5) Or "donate" their improvements to the State (essentially allowing the State to nationalize millions of dollars' worth of private property).

Result from State's first Voluntary Auctions "VAFO" at Priest Lake:

- Land Board approved 74 lots for voluntary auctions in August (two months ago).
- 14 lessees were forced to drop out of the VAFO based on the appraised value (minimum bid) established by the State's appraiser Hall-Widdoss.
- 60 lessees participated in the VAFO. There was competitive bidding on only two lots. 57 other lots were purchased by the current improvement owner. One lot received no bids.
- These sales occurred, not because the price to own was fair market, but because of the massive investments the current lessees already had in their improvements, cabins and lots.
- The August 2014 VAFO's generated total additional income to the Endowment of \$135,000 over the minimum bid price but cost the State \$1.5 million in fees paid to the auctioneers. (The VAFO's were considered a replacement for two land exchanges that were cancelled in 2013 by the Land Board).

So what is the answer to all of this chaos and uncertainty at Priest Lake?

I have outlined three recommended remedies to the current crisis at Priest Lake. I believe that enacting these recommendations today will not only stabilize the residential leasing crisis at Priest Lake but will also ensure that the State maximizes the LONG TERM return to the Endowment beneficiaries.

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