

STATE BOARD OF LAND COMMISSIONERS
Special Meeting – February 10, 2010
Regular Agenda

SUBJECT

Discussion Regarding Public School Distribution from the Endowment Fund

BOARD ACTION

MOTION

A motion was made by Superintendent Luna that the Board approve a one-time distribution of \$52.8 million from the Public Schools Earnings Reserve Fund to the Public Schools Income Fund for Fiscal Year 2011. This distribution would be in addition to the distribution previously authorized by the Board.

- The motion failed for lack of a second.

SUBSTITUTE MOTION 1

A substitute motion was offered by Secretary of State Yursa that the Board allow a one-time distribution of \$22 million, which represents a 200% coverage ratio in the Public School Earnings Reserve Fund.

- Governor Otter seconded Substitute Motion 1.

SUBSTITUTE MOTION 2

A second substitute motion was offered by Superintendent Luna that the Board approve a one-time distribution of \$42,323,900 from the Public Schools Earnings Reserve Fund to the Public School Income Fund for Fiscal Year 2011. This distribution would be in addition to the distribution previously authorized by the Board.

- Substitute Motion 2 failed for lack of a second.

SUBSTITUTE MOTION 3

Attorney General Wasden moved that the Idaho Board of Land Commissioners defer action on the proposal to make a one-time distribution from the Earnings Reserve Fund and direct that the Endowment Fund Investment Board and the Department of Lands provide a written analysis of the effects of such a distribution on the Board's current investment strategy.

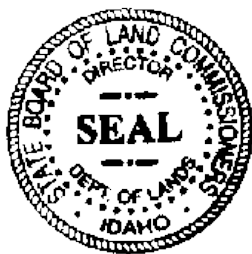
In particular, Attorney General Wasden requested an analysis of the effect of such a distribution: one, on the Board's ability to continue distribution in accordance with its distribution policy; in other words, would there be a sufficient "shock absorber" to sustain the current pay out and, if so, for what period; number two, on whether the current asset allocations would have to be changed to account for the lack of coverage for the volatility associated with the current asset allocation; three, what impact would such a distribution have on a long-term rate of return for the endowment; four, what effect will such a distribution have on the equitable distribution of assets between current and future beneficiaries; five, what effect, if any, will such a distribution have on other endowments; six, will such a distribution require the development of different distribution formulas for each endowment; seven, whether such a distribution is prudent given the general economic conditions; and eight, such other factors the Board is required to consider under Idaho Code Section 68-502, or in other words, the Idaho Prudent Investor Rule.

- Controller Jones seconded Substitute Motion 3.
- *ROLL CALL VOTE:* Governor Otter: nay; Secretary of State Ysursa: nay; Attorney General Wasden: aye; Controller Jones: aye; Superintendent Luna: nay. Vote Tally: 2 ayes (Wasden, Jones); 3 nays (Otter, Ysursa, Luna)
- Substitute Motion 3 failed.

CLARIFICATION OF SUBSTITUTE MOTION 1

Secretary of State Ysursa offered a clarification to his substitute motion (Substitute Motion 1). He stated this is a one-time distribution. It is Public School Earnings Reserve. It is not the other endowments that have reserves. It is for \$22 million, which represents about two percent of the \$1,048,000,000 currently invested. Governor Otter concurred with Secretary of State Ysursa's clarification of his substitute motion.

- *ROLL CALL VOTE:* Governor Otter: aye; Secretary of State Ysursa: aye; Attorney General Wasden: nay; Controller Jones: nay; Superintendent Luna: aye. Vote Tally: 3 ayes (Otter, Ysursa, Luna); 2 nays (Wasden, Jones)
- Motion carried.



State Board of Land Commissioners



Tom Luna

Superintendent of Public Instruction

www.sde.idaho.gov

About Idaho Public Schools

- 711 schools
- 115 school districts
- 36 public charter schools
- 275,000 students

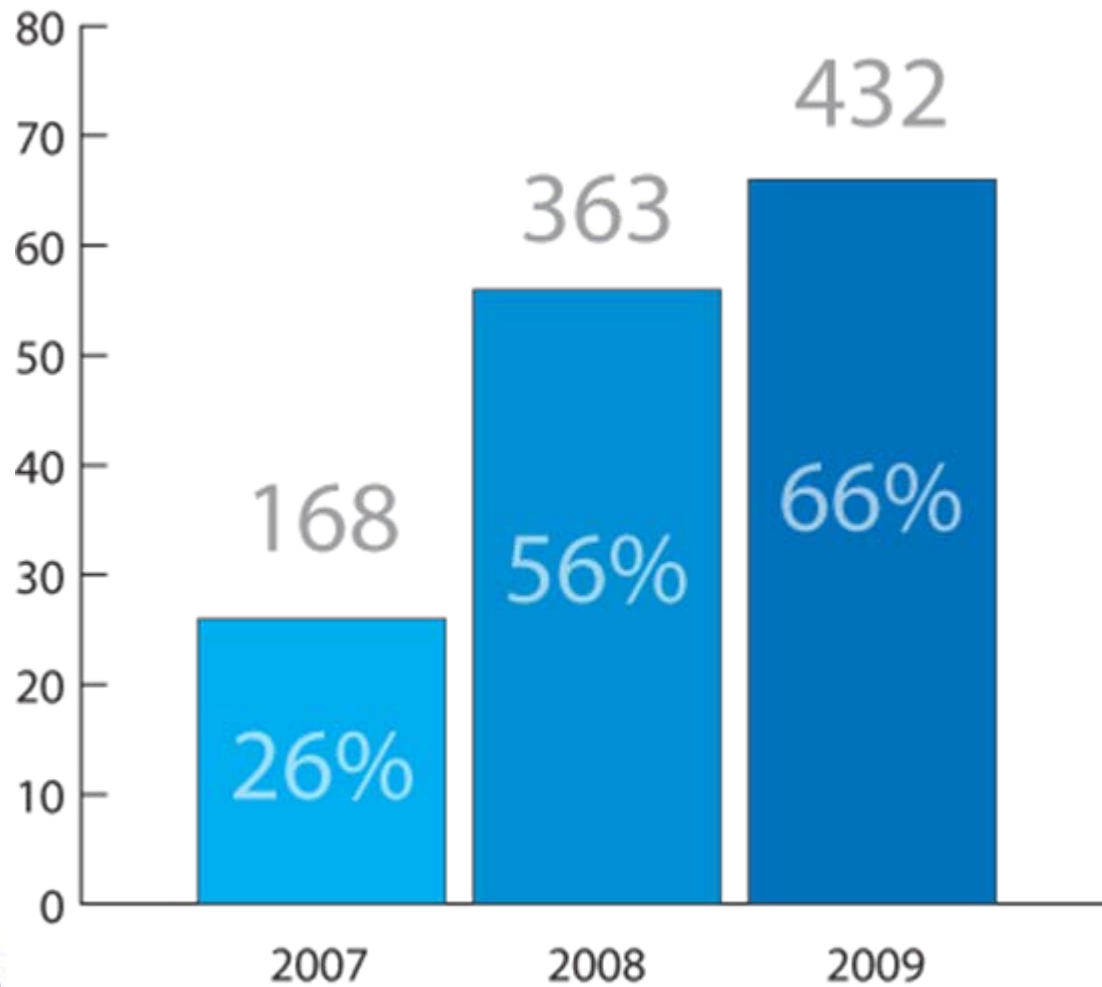


About Idaho Public Schools

- 89.7% graduation rate
- 88.15% students on grade level or above in reading
- 81.57% students on grade level or above in math

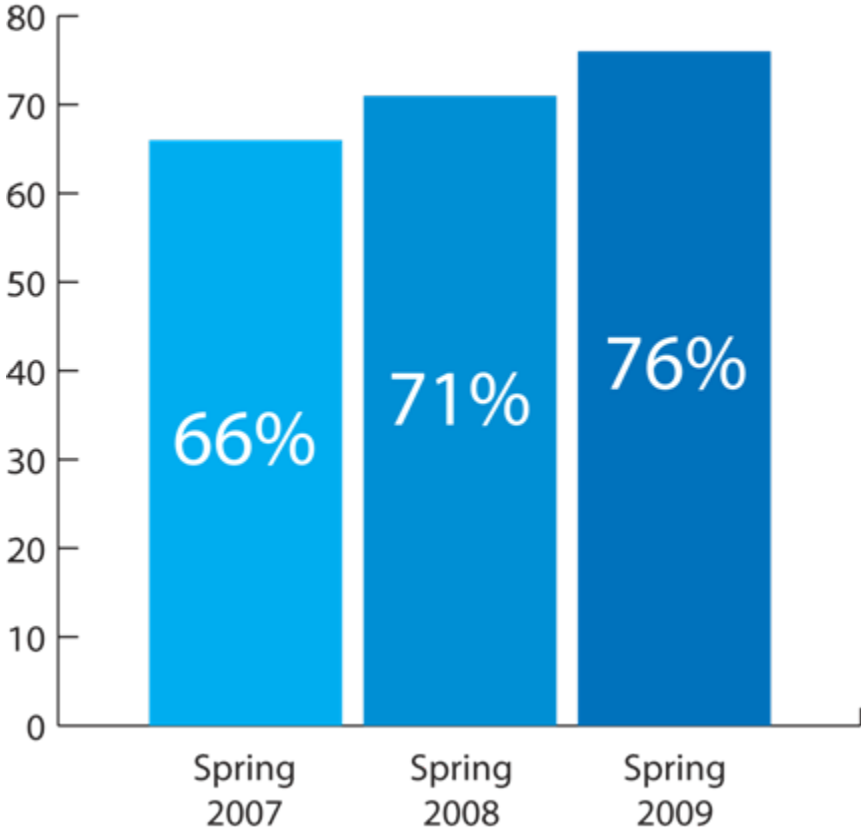


Schools Making AYP



Idaho Reading Initiative (IRI)

IRI scores in 3rd Grade



Nation's Report Card in Math

- Idaho is one of only a few states to show improvement in math.
- In 2007, 75% of students performed at grade level. In 2009, 78% of students are now performing at grade level.



Role of Trustees

- The Trustees (the Land Board) can and often should consider what is happening with the other income sources of the beneficiary (public schools) in determining the amount to distribute.



Cuts to Public Education

- \$68 million cut to public schools in FY2010
- In FY2011, facing shortfalls in revenues of between \$135 million and \$160 million
- Even with the one-time distribution, public schools will still face cuts



One-Time Distribution

- Prudent, responsible approach
- The request is for \$52.8 million in one-time distribution of earnings
- Request leaves cushion of \$31.3 million in earnings at the end of FY2011
- Based on the low-revenue scenario presented by experts in January



Constitutional Duties

- Maintain a “general, uniform and thorough system of public education”
- Balance the budget



Why \$52.8 Million?

- What \$52.8 million means for students
 - 1,000 teaching jobs
 - 10 school days
 - 70 hours of student-teacher contact time



Questions?

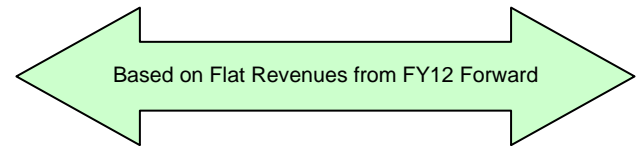
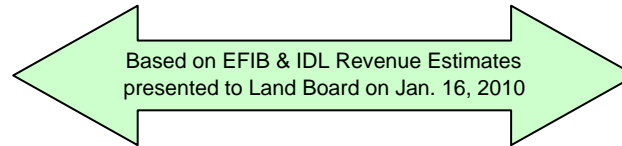


Visit

www.sde.idaho.gov

for more information

Public Schools Earnings Reserve Fund



	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>
1. Beginning Balance	\$87,666,634	\$90,424,669	\$31,305,311	\$31,406,658	\$31,508,005	\$31,609,352
2. IDL Earnings	\$21,871,668	\$31,016,871	\$37,207,968	\$37,207,968	\$37,207,968	\$37,207,968
3. IDL Expenses	<u>(\$13,951,318)</u>	<u>(\$15,783,000)</u>	<u>(\$15,783,000)</u>	<u>(\$15,783,000)</u>	<u>(\$15,783,000)</u>	<u>(\$15,783,000)</u>
4. Net IDL Revenue	\$7,920,350	\$15,233,871	\$21,424,968	\$21,424,968	\$21,424,968	\$21,424,968
5. EFIB Earnings	\$12,623,691	\$12,081,171	\$12,380,779	\$12,380,779	\$12,380,779	\$12,380,779
6. ERF Capital Gain/(Loss) to Date	\$15,779,994	\$0	\$0	\$0	\$0	\$0
7. EFIB Expenses	<u>(\$2,273,600)</u>	<u>(\$2,342,000)</u>	<u>(\$2,412,000)</u>	<u>(\$2,412,000)</u>	<u>(\$2,412,000)</u>	<u>(\$2,412,000)</u>
8. Net EFIB Revenue	\$26,130,085	\$9,739,171	\$9,968,779	\$9,968,779	\$9,968,779	\$9,968,779
9. Regular Distribution to Beneficiaries	(\$31,292,400)	(\$31,292,400)	(\$31,292,400)	(\$31,292,400)	(\$31,292,400)	(\$31,292,400)
10. One-time Distribution to Beneficiaries	\$0	(\$52,800,000)	\$0	\$0	\$0	\$0
11. Ending Balance (1+4+8+9+10)	\$90,424,669	\$31,305,311	\$31,406,658	\$31,508,005	\$31,609,352	\$31,710,699

Endowment Fund Policy Implications of One Time Distributions

Land Board
February 10, 2010



Estimated Cash Flow and Reserves FY2011 Approved, Proposed, & Alternative

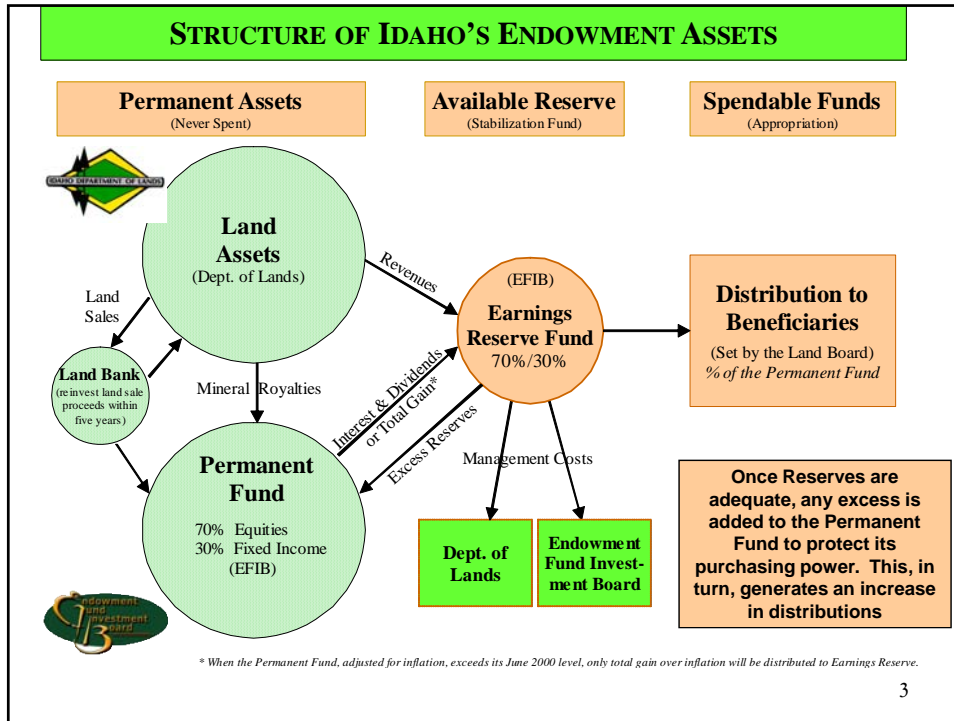
	<u>Current Approved Distribution</u>	<u>Proposed Additional One-Time Distribution</u>	<u>With Additional One-Time Distribution</u>	<u>Alternative One-Time Distrib. ***</u>	<u>With Alternative Distribution</u>
(millions of dollars)					
Beginning Balance	91		91		91
Distributions	<u>(31)</u>	(53)	<u>(84)</u>	(22)	<u>(53)</u>
Estimated Cash Revenues <i>(net of management cost)</i>					
From the land *	15		15		15
From the fund **	<u>10</u>		<u>10</u>		<u>10</u>
Total	25		25		25
Assumed Gain(Loss)	<u>-</u>		<u>-</u>		<u>-</u>
Net Cash Flow	<u>(6)</u>		<u>(59)</u>		<u>(28)</u>
Year End Reserves	<u>85</u>		<u>32</u>		<u>63</u>

* Cash earnings from timber sales, leases, etc, less the management expenses of the Dept. of Lands

** Interest and dividend income less the management expenses of the EFIB

*** Some Land Board members asked for a scenario where reserves are at two years at the end of FY2011

Source: Superintendent's proposal, EFIB analysis. Amounts may not precisely match other sources due to rounding.



Implications of special distributions

Special distributions from earnings reserves:

- Conflict with some fundamental objectives and priorities in place for decades; significantly affect the policies debated, developed, and refined over the past 15 years by the Land Board, the EFIB and special task forces
- Fundamentally change the intent of the Earnings Reserve Fund
 - Reserves cease being only “shock absorbers”, no longer serving exclusively as a stabilizer of the distributions and a conduit to retain earnings for future generations, offsetting inflation and population growth
- Require reassessment of distribution and investment policies
 - Current investment and distribution policies are interdependent and were created assuming that one-time distributions were not possible – the full implications of this new practice, especially on future generations, have not been fully vetted

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Mission of Idaho Endowments: Provide a perpetual stream of income by:

- ❖ Maximizing total return over time at a prudent level of risk
- ❖ Protecting future generations' purchasing power
- ❖ Providing a relatively stable and predictable payout

One-time distributions are contrary to the fundamental objectives of stable payout and protection of future generations

Source: Land Board Asset Management Plan, EFIB comments

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Current Priorities for Allocation of Endowment Income

- 1) **Avoid reductions** in total endowment distributions.
- 2) Maintain **adequate Earnings Reserves** to protect distributions from temporary income shortfalls.
- 3) **Grow distributions and permanent corpus** faster than inflation and population growth.

A one-time distribution fundamentally changes priorities

Source: Land Board Asset Management Plan, EFIB comments

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Fundamental Change in the Intent of the Earnings Reserve Fund

“Shock Absorber” versus “Rainy Day Fund”

- “Shock absorber” has two purposes:
 1. “To provide a means for stabilizing cash flows
 2. To provide a mechanism for expressly addressing the division of benefits between present and future generations”

Report and Recommendations of the Governor’s Committee on Endowment Fund Investment Reform (12/15/96, page 6)

- “ ‘Rainy day’ funds allow states to set aside excess revenue for use in times of unexpected revenue shortfall or budget deficit.”

The Tax Policy Center (Urban Institute and Brookings Institution)

Once the change is made, hard to go back 7

Retention of Earnings Assures Balanced Treatment

- Current policy: When reserves are deemed adequate, **additional income is transferred to the permanent fund**, resulting in **both**:
 - **Higher distributions** to current beneficiaries (5% of the transfer)
 - **More funds locked away** to protect future generations’ purchasing power
- Policy helps **assure balanced treatment** of current and future recipients
 - Objective: **both** distributions and permanent corpus grow at inflation + population growth

This balance cannot be achieved if one-time distributions impair retention of earnings and eventual reinvestment in the permanent fund

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Distribution of Endowment Earnings FY2001-FY2011(est)

	<u>Current Approved Distribution</u>	<u>With One-Time Distribution</u>
<small>(millions of dollars)</small>		
Balance FY2000	555	555
Net Income 2001-2011		
Lands	268	268
Fund	212	212
Total	<u>480</u>	<u>480</u>
Distributions	<u>(350)</u>	<u>(403)</u>
Balance FY2011 (est)*	<u>685</u>	<u>632</u>
% Income Distributed	73%	84%

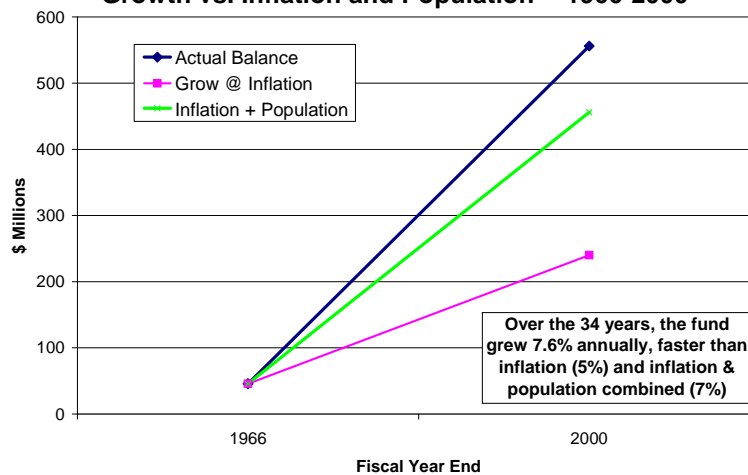
* Based on "Low" income forecast for FY2010-'11. Permanent Fund balance is \$600 million -- remainder is Earnings Reserve

Current policy assumes roughly 50/50 split of long-term earnings between current and future beneficiaries. Over the last 11 years, 73% of earnings have gone to current beneficiaries. Proposal would boost this to 84%.

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From 1966 to 2000, fund kept up with inflation & population growth

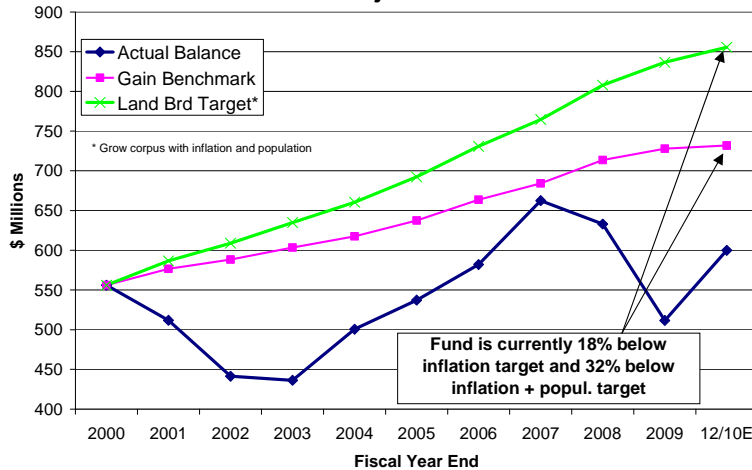
**Public School Endowment Fund
Growth vs. Inflation and Population -- 1966-2000**



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Since 2000, the perm. fund has not kept up with long-term objectives

Public School Permanent Endowment Fund
Actual Balance vs. Objective - 2000 to 2010YTD

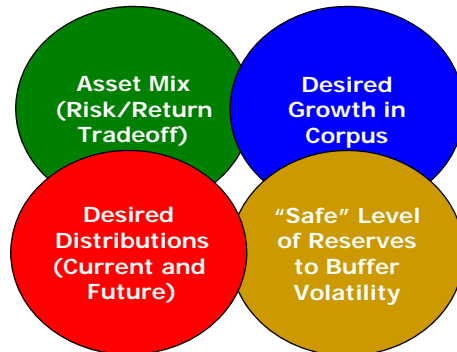


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Endowment policies are interdependent, require Trustees evaluate tradeoffs

Evaluate the interaction of four policy drivers

- Higher long-term return means more potential short-term volatility
- How much downside variation can the fund endure?



- How fast should the fund grow over time? With inflation? Faster than inflation?
- How much risk of a failure to meet planned distributions should beneficiaries take on?

- Minimum required distribution given level of asset volatility
- Spend a lot, save a little or spend little now and more later

A major policy change in one driver requires that all be reevaluated for consistency

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Key Policies – Current Land Board Asset Management Plan

- 1) Mission statement for the endowments
- 2) Fund investment policy (70%/30%)
- 3) Criteria for determining distributions
- 4) Priorities for endowment distributions
- 5) Rate of annual distributions (5%)
- 6) Desired level of reserves (5 years)

EFIB recommendation: Each of these should be reexamined before committing to one-time distributions

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Conclusion

- Special distributions will likely impede the fund from growing fast enough to protect future purchasing power
 - A fundamental change in mission
- Existing objectives and management policies have been carefully crafted over the last 15 years, assuming special payments were not possible
- It would be premature to consider a special distribution until objectives and operating structure have been comprehensively reevaluated and appropriate policy revisions adopted

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Appendix

Rationale for independent trustees

Why does a grantor place trust assets under the control of an independent trustee? It is often because the creator of the trust (in this case the U.S. Congress and the drafters of the Idaho Constitution*), has **concerns that the beneficiary will spend funds too quickly and neglect long-term needs**. Rather than hand control over to the beneficiary, the creator entrusts the assets to an independent fiduciary, who can **make decisions from an arms-length**; a trustee who has a sacred duty (and a personal legal liability) to **consider both current and future recipients**.

Trust and endowment beneficiaries seldom have enough current income to satisfy their desires. Therefore, the **current recipient is conflicted** in representing the needs of the future recipient. That is the reason individuals or entities create trusts – to have an independent third party be the **impartial gatekeeper** who can manage the funds to protect the interests of both current and future beneficiaries.

*Constitutional structure confirmed by Idaho Citizens in 1999 election

Must consider multiple factors

A prudent trustee must consider both investment policy and distribution policy. Bringing investment and distribution duties together requires taking a **multifaceted, integrated view**:

- Investing in markets that provide **growth** over many years
- Maintaining **liquidity** to make annual distributions
- Establishing a reasonable **current distribution rate**
- **Retaining sufficient income** to grow future distributions as the beneficiary's needs grow.

Before making a change in one factor, a prudent fiduciary should consider the **long-term impact on all other aspects** of their responsibilities, consistent with their role as in **impartial, third-party gatekeeper**.

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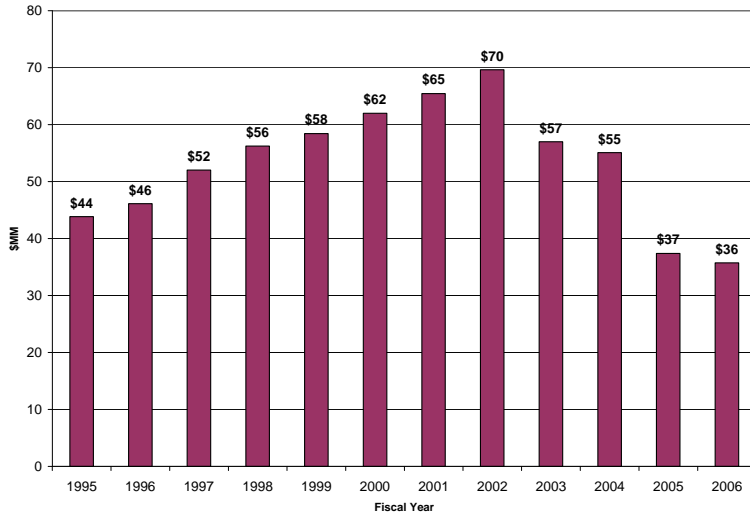
Chronology: Development of Current Endowment Fund Policies

- FY1997: Committee on Endowment Reform recommends restructuring of endowment governance, asset mix
- FY1998: New statutes, Constitutional amendments drafted
- FY 2000: Endowment fund trust structure implemented
- FY 2002-2006: Endowment distributions drop by half; three of eight endowments deplete reserves, payments temporarily interrupted
- FY2004: Pub School Fund threatens to hit three years of losses, statute rewritten to extend time to make up losses and protect permanent fund from losses and inflation
- FY 2005-2008: Land Board forms Special Task Force; reviews investment and distribution policies, rewrites statutes
- FY 2007-2008: EFIB and Investment Consultant review/refine investment and distribution policy
- FY 2009: Land Board formally adopts investment and distribution policies as part of its Asset Management Plan

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Total Endowment Distributions To Beneficiaries 1996 to 2006

(Net of General Fund Contribution in 2006 of \$4.6MM)



— Total endowment distributions dropped 54% from 2002 to 2006 due to a sharp drop in timber revenues and equity markets in 2001-2003.

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Instability of Distribution Policy

	Public Schools	Ag College	Charitable Institutions	Normal School	Penitentiary	School of Science	State Hospital South	University
Spending Rate as a % of the Permanent Fund								
2001	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
2002	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
2003	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
2004	6.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
2005	5.0%	3.0%	3.1%	7.5%	9.9%	7.0%	9.4%	9.1%
2006	5.0%	0.0%	0.0%	8.1%	16.2%	6.4%	26.9%	10.2%
2007	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
2008	5.0%	5.0%	5.0%	5.0%	4.1%	4.1%	5.0%	5.0%
2009	5.0%	5.0%	5.0%	5.0%	4.1%	4.1%	5.0%	5.0%
2010	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
2011	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

- No change in rate from previous year
- Rate changed from previous year
- Reserve too low to allow appropriated distribution to be made

In FY2006, after frequent shifts in distribution policy and catastrophic failures in three endowments, the Land Board initiated a comprehensive review of Distribution Policy.²⁰

Land Board's Approved Criteria for Determining Distributions

In setting distributions, policy requires that the following criteria be considered:

1. Actual and **expected return** on the fund and income from the land.
2. Expected **volatility** of fund and land income.
3. The **adequacy of reserves** to compensate for volatility of income.
4. The beneficiary's **ability to tolerate declines** in distributions.
5. Need for inflation and **purchasing power protection** for future beneficiaries.
6. **Legal restrictions** on spending principal.

Source: Land Board Asset Management Plan

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Missing from the approved criteria

Past policy work considered, but **rejected**, the state's **general fund revenue situation** as a criteria that would drive distributions:

- Injects **additional uncertainty** into determining asset mix, setting reserve levels, growing permanent corpus
- Puts the Land Board into the **appropriation process** – is that tenable long term?
 - **General Fund becomes driver** of trust management
 - **No assurance** incremental funds will reach the beneficiary

Current integrated policies were crafted assuming one-time distributions were not possible

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Implications of a one-time distribution on income allocation priorities

A one-time, special distribution:

- Is **unsustainable** in the next year, violating the first objective of avoiding a reduction
- Reduces the reserve, increasing the chances of a **future reduction or interruption** of even “normal” payments*
- **Diverts funds** from sustainable long-term growth of distributions and corpus

*Especially after a fund crosses the gain benchmark. See later slide.

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Earnings Reserves

- Purpose of Earnings Reserves
 - Serve as a **shock absorber** to allocate income between current and future beneficiaries
 - Directly **tie** the level of the **distribution** and **growth of assets** with overall **investment policy**
- 5 years of reserves deemed adequate
- Reserve levels are particularly important when the fund eventually exceeds its “Gain Benchmark”
Significantly **increases the volatility** of income, requiring **higher reserve levels** to buffer volatility
 - We have **little control** over when a fund will achieve its gain benchmark – driven primarily by the market
 - We have **no experience** managing the fund under these new conditions – unexpected problems could arise

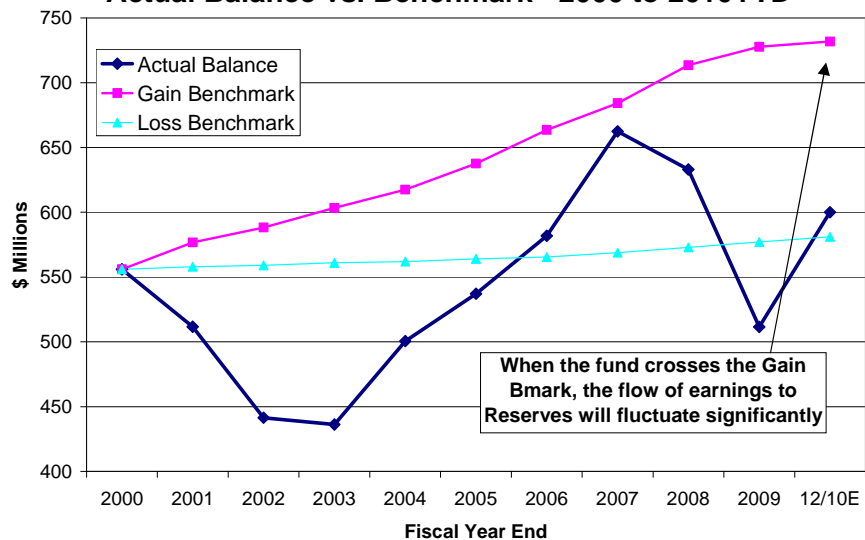
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Crossing the Gain Benchmark

- Pub School fund loss must be made up after 10 years
- In 2003, a statute was enacted to further **protect the permanent fund from losses**
- When the permanent fund catches up to its June 2000 level (adjusted for inflation) interest and dividends no longer flow automatically to reserves each year
 - Instead, the total gain above inflation goes to the reserves
 - In loss years, any **cash income is retained by the permanent fund** to boost/protect long-term corpus
- Once every 25 years, we can expect **cumulative losses to extend for 5 years or more**
 - **No investment income** to reserves for 5 years
 - Requires a larger reserve
 - If a fund crosses the benchmark with only one year of reserves, the **chances of a catastrophic failure rise significantly**

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**Public School Permanent Endowment Fund
Actual Balance vs. Benchmark - 2000 to 2010YTD**



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Fund Investment Policy

- With a **perpetual time horizon**, the funds can invest heavily in equities (70%), which have a higher (but more volatile) long-term expected return than fixed income
 - Target: 4% or more annual real return
- Land income provides significant annual cash flow to meet distribution needs
 - Allows reserve funds to have a perpetual investment horizon (70% equity)

If one-time distributions far in excess of land revenues are possible, this may require a change in asset mix for the reserves, reducing long-term returns and increasing management complexity

Source: Land Board Asset Management Plan, EFIB comments

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Assumptions and Trends in Land Based Revenue to Public School Endowment

2010 - 2013

1



Original FY2010 Projection All Revenue, All Asset Types

Net Income by Program

Forest Land	\$	13,846,010
Minerals	\$	3,791,922
All Other Asset Types	\$	<u>5,184,917</u>
Net Income	\$	<u>22,822,849</u>

2



Original FY2010 Projection All Revenue, All Asset Types

Net Income by Program

Forest Land	\$	13,846,010
Minerals	\$	3,791,922
All Other Asset Types	\$	5,184,917
Net Income	\$	<u>19,030,927</u>

Mineral royalty is deposited to the permanent fund and is not available for distribution.

3



Original FY2010 Projection Public Schools

Net Income by Program

Forest Land	\$	7,585,434
All Other Asset Types	\$	3,407,978
Net Income	\$	<u>10,993,412</u>

Forecast Assumptions – Low End of Expected Range:

- Estimated harvest based on volume under contract, following past trends
- Gradual improvement in market conditions i.e. stumpage rates and volume purchased (however, current trends are flat)

4



FY2011 Projection Public Schools

Net Income by Program

Forest Land	\$ 12,857,949
All Other Asset Types	<u>\$ 3,407,978</u>
Net Income	<u>\$ 16,265,927</u>

Forecast Assumptions – Low End of Expected Range:

- Estimated harvest based on volume under contract, following past trends
- Gradual improvement in market conditions i.e. stumpage rates and volume purchased (however, current trends are flat)
- Stable revenue for all other asset types

5



FY2011 Default Scenario Public Schools

Net Income by Program

Forest Land	\$ (9,313,323)
All Other Asset Types	<u>\$ 3,407,978</u>
Net Income	<u>\$ (5,905,345)</u>

Forecast Assumptions:

- All timber contracts default and no new timber is purchased
- Stable revenue for all other asset types
- Management costs incurred

6



FY2011 Delayed Revenue Scenario - Public Schools

Net Income by Program

Forest Land	\$	1,643,528
All Other Asset Types	\$	<u>3,407,978</u>
Net Income	\$	<u>5,051,506</u>

Forecast Assumptions:

- Timber markets remain at 20 year low and older, higher priced contracts are not completed
- Average stumpage \$100/MBF and can only sell 200 MMBF (120 MMBF for Public Schools)
- Stable revenue for all other asset types

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FY2011 Flat Price Scenario Public Schools

Net Income by Program

Forest Land	\$	5,368,857
All Other Asset Types	\$	<u>3,407,978</u>
Net Income	\$	<u>8,776,835</u>

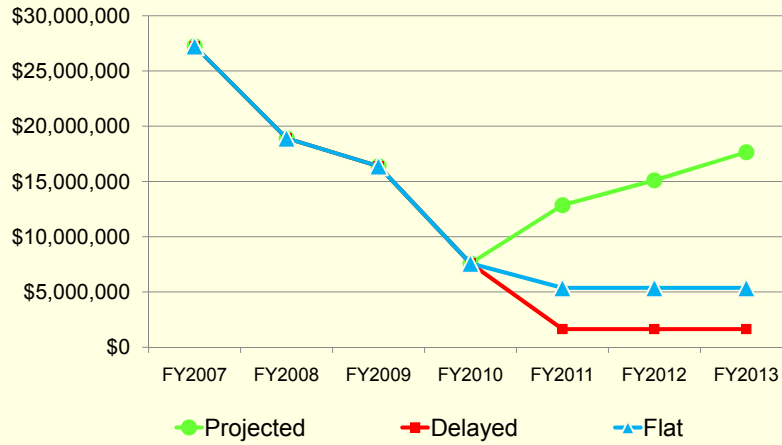
Forecast Assumptions:

- Timber markets remain at current demand
- Average stumpage \$134/MBF and can only sell 200 MMBF (120 MMBF for Public Schools)
- Stable revenue for all other asset types

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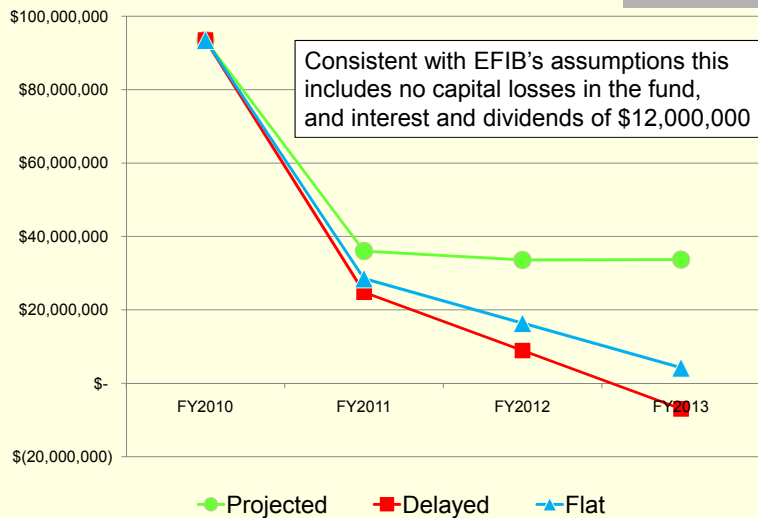
Public School Net Timber Revenue Trend and Forecasts



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Lands Revenue - Projected Impact to Public School Earnings Reserve



10

QUESTIONS



Station Bulletin 96
January 2010

Idaho Forest, Wildlife and
Range Experiment Station
Moscow, Idaho

Director
William J. McLaughlin

University of Idaho

Idaho's Forest Products Industry: Current Conditions and Forecast 2010

.....
Produced by

The Inland Northwest Forest Products Research Consortium,
a research cooperative centered at the Forest Products Department
at the University of Idaho, the Bureau of Business and Economic
Research at the University of Montana-Missoula, and the Wood Materials
and Engineering Laboratory at Washington State University.

.....

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Idaho's Forest Products Industry: Current Conditions and Forecast, 2010

Operating Conditions

The collapse of the U.S. housing industry and the related global financial crisis had a substantial negative impact on Idaho's forest products industry in 2009. Annual U.S. housing starts peaked in 2005 at just over 2 million and by 2009 had fallen to 550,000 units. With continued weak demand, lumber prices have fallen 13 percent in the last year and approximately 43 percent since 2005 (Figure 1).

Idaho Industry Sales, Employment, and Production for 2009

The University of Montana's Bureau of Business and Economic Research (BBER), in co-operation with the Forest Products Department at the University of Idaho, conducted a survey of Idaho's wood products manufacturers in late November and early December of 2009. The survey had a response rate of just over 70 percent and secured responses from 65 of Idaho's largest wood processing facilities as well as numerous smaller facilities. Results of the survey indicate that major wood products manufacturers in Idaho experienced a substantially poorer year in 2009 versus the already weak operating situation of 2008.

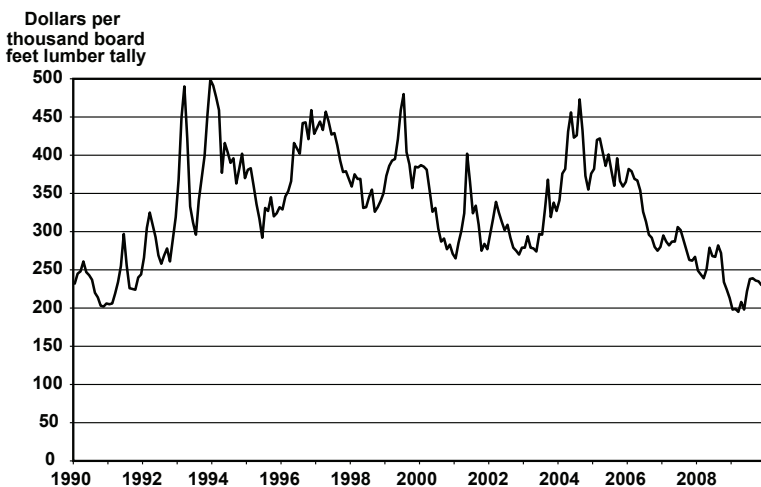
Eighty percent of responding wood and paper product manufacturers indicated a decrease in profits for 2009

relative to 2008, while only 6 percent indicated an increase. Nearly 60 percent of the facilities curtailed production in 2009, and over 80 percent reduced employment. Eighty-two percent of responding manufacturers indicated a decrease in sales, and 83 percent indicated a decrease in production. Furthermore, the number of facilities that reported making major capital expenditures declined to 19 percent in 2009 from 29 percent in 2008.

The estimated sales value of Idaho's primary wood and paper products manufacturers for 2009 was just over \$1.4 billion, down approximately \$120 million (approximately 8 percent) from the revised 2008 sales value of \$1.5 billion (Figure 2). The number of forest industry workers (including the self-employed) was estimated at 10,800 in 2009, down by about 14 percent or 1,800 workers from 2008 (Figure 3). Production of lumber, the largest component of Idaho's forest products industry, fell to an estimated 1.1 billion board feet in 2009 from just over 1.3 billion board feet in 2008 (Figure 4).

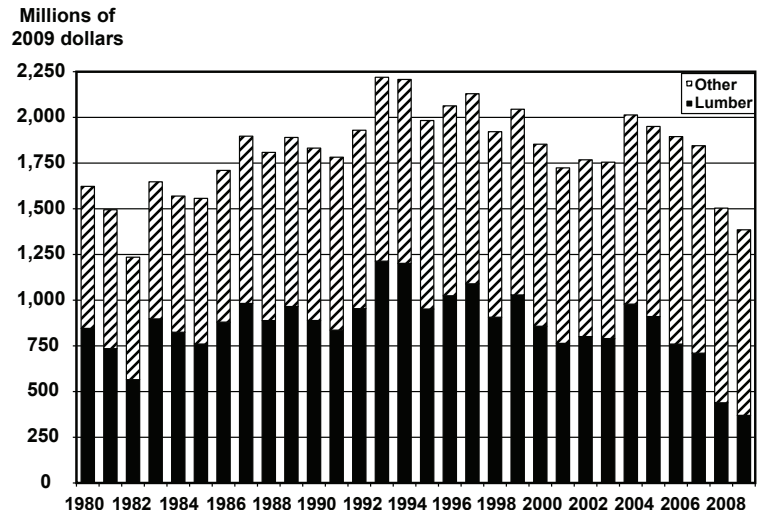
Timber harvest declines were seen across the timber ownership classes (Figures 4 and 5) with lower prices offered by mills being a major factor. Idaho's estimated timber harvest volume during 2009 was just under 800 million board feet, down nearly 15 percent from 900 million board feet in 2008 (Figures 4 and 5). Private land harvest, including industry and non-industrial private lands, was about 20

Figure 1
Nationwide Composite Lumber Prices
Monthly, 1990-2009



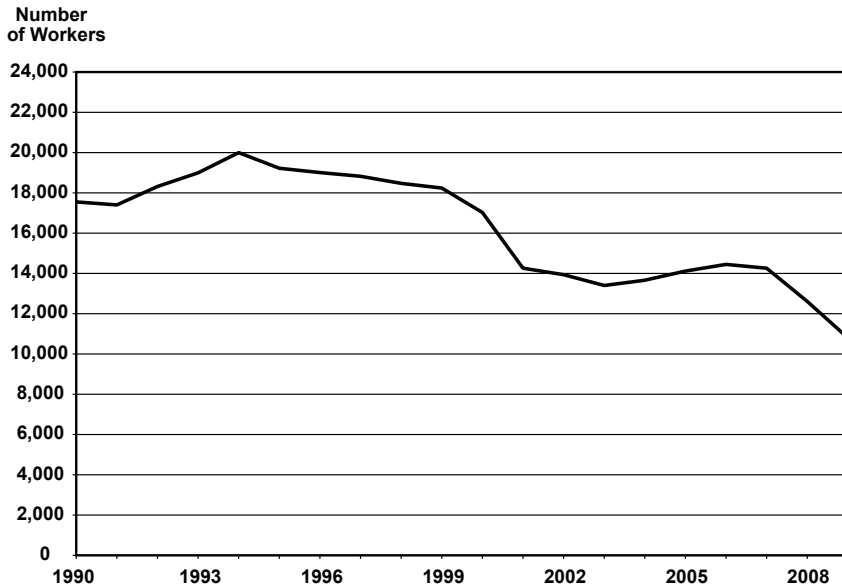
Source: Random Length 1990-2009

Figure 2
Sales Value of Idaho's Primary Wood Products
1980-2009



Source: Bureau of Business and Economic Research, The University of Montana-Missoula; Western Wood Products Association

**Figure 3
Employment in Idaho's Forest Products Industry
1969-2009**



Source: U.S. Department of Commerce, Bureau of Economic Analysis. Regional accounts data; Bureau of Business and Economic Research, The University of Montana-Missoula.

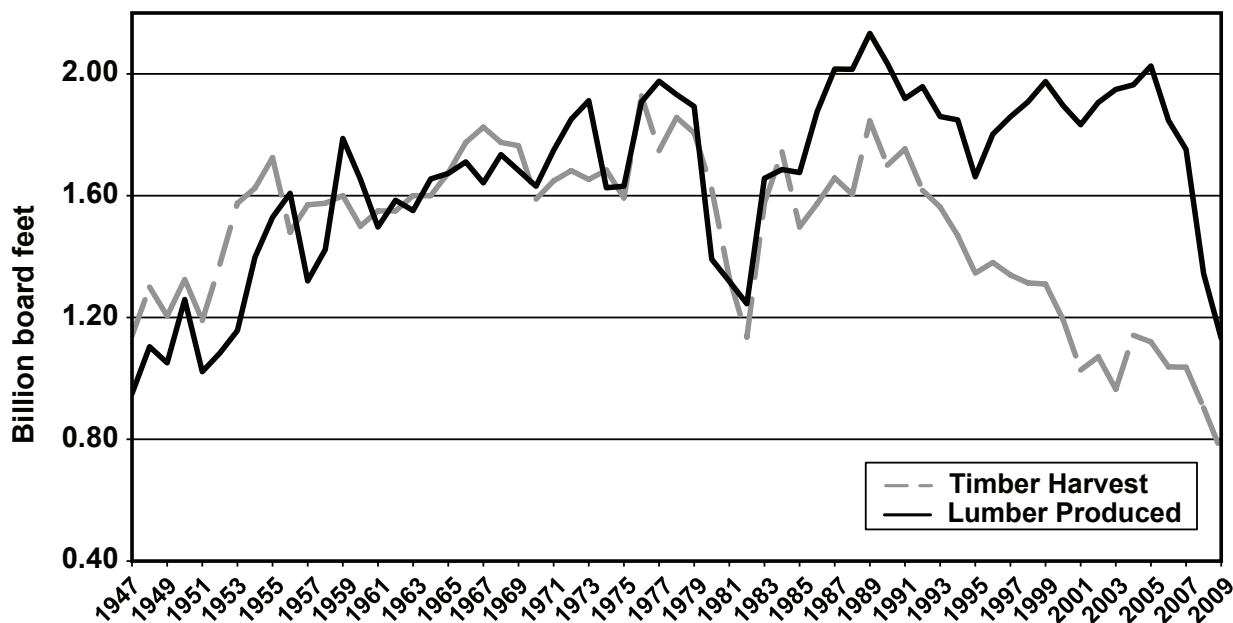
percent lower than during 2008. The harvest from federal lands was down about 5 percent bringing federal harvest levels near their lowest level since World War II (Figure 5). Harvest from state lands was down about 7 percent from 2008.

Outlook for 2010

National forecasts call for a modest increase in the U.S. economy, housing starts, and consumption of wood and paper products in 2010. Idaho wood products manufacturers have expressed more optimism entering 2010 with 36 percent of the survey respondents expecting operating conditions to get better. However, 52 percent expect 2010 conditions to be about the same as the very poor market conditions experienced in 2009, and 12 percent expect worsening conditions (Figure 6). Twenty-three percent of respondents indicated they expected to increase their number of employees during 2010, and only 17 percent expected to decrease employment.

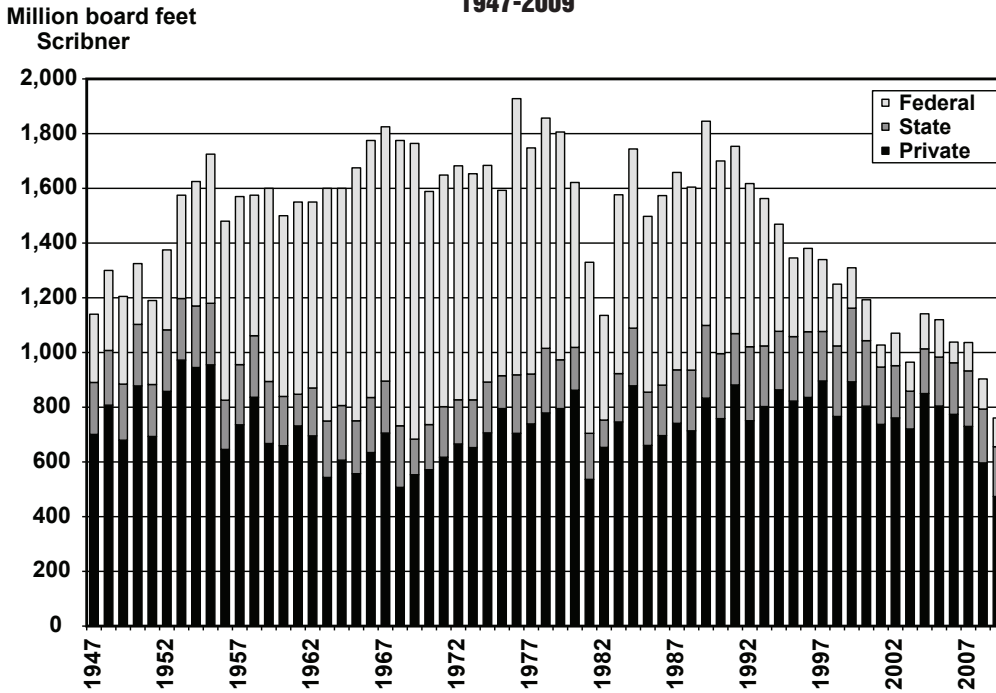
Forty-five percent of the wood products manufacturers stated they expect profits to

**Figure 4
Idaho Timber Harvest and Lumber Production
1947-2009**



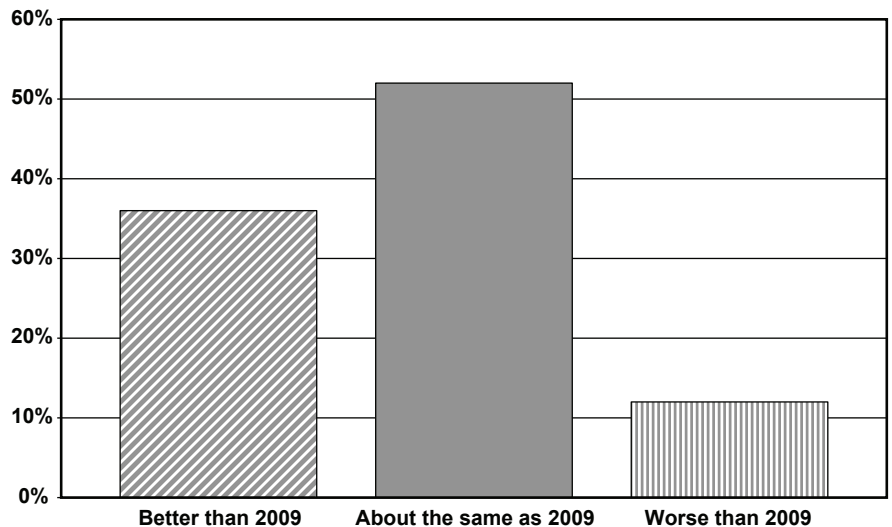
Source: Bureau of Business and Economic Research, The University of Montana-Missoula; USDA Forest Service Region One, Missoula, Montana; Western Wood Products Association.

Figure 5
Idaho Timber Harvest by Ownership
1947-2009



Source: Bureau of Business and Economic Research, The University of Montana-Missoula; USDA Forest Service Region One, Missoula, Montana.

Figure 6
Idaho's Wood and Paper Product Producers Overall Outlook for CY 2010



Source: Bureau of Business and Economic Research, The University of Montana-Missoula.

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increase from 2009 to 2010, while only 14 percent said they expect to see profits decrease. Over 80 percent of the facilities surveyed anticipate production to increase or stay about the same, and 43 percent expect to experience greater sales in 2010. Furthermore, 20 percent stated that they expect to see a price increase on their products, while 60 percent of the respondents expected prices to stay about the same as those in 2009.

Nearly all of the producers mentioned general market conditions and the overall economic condition as the major issues that will affect their operations in 2010. Idaho's wood products producers also mentioned raw material availability and increases in transportation and energy costs as major issues that will continue to impact their operations in 2010.