



STATE BOARD OF LAND COMMISSIONERS

Dirk Kempthorne, Governor and President of the Board

Ben Ysursa, Secretary of State

Lawrence G. Wasden, Attorney General

Keith L. Johnson, State Controller

Marilyn Howard, Superintendent of Public Instruction

Winston A Wiggins, Secretary to the Board

Final Minutes
Regular Land Board Meeting
February 14, 2006

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, February 14, 2006 in Boise, Idaho. The meeting began at 9:02 a.m. in the second floor courtroom of the Borah Post Office building. The Honorable Dirk Kempthorne presided. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence G. Wasden
Honorable State Controller Keith L. Johnson
Honorable Superintendent of Public Instruction Marilyn Howard

Secretary to the Board Winston A Wiggins

Before beginning the Consent Agenda, Director Wiggins informed the Board that Jeff Youtz was unable to attend today's meeting due to a scheduling conflict. Ray Houston attended in his stead representing the Joint Finance and Appropriations Committee. Mr. Houston advised the Board that Mr. Larry Johnson of the Endowment Fund Investment Board provided a presentation to JFAC recently and informed them of the proposals and distributions. JFAC is in agreement with the endowment spending policy for the current fiscal year and is not recommending changes.

• **CONSENT**

Director Wiggins provided background information on the Consent Agenda items.

A motion was made by Attorney General Wasden to approve the Consent Agenda in its entirety. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 5-0.

1. Director's Report – approved

- A. Interest Rate on Department Transactions – December 2005; January 2006
- B. Bureau of Real Estate, Land Sale Section, Official Transactions – November, December 2005
- C. Bureau of Real Estate, Easement Section, Official Transactions – November, December 2005
- D. Bureau of Surface and Mineral Resources, Official Transactions – November, December 2005
- E. Timber Sale Official Transactions – November 26, 2005 through January 20, 2006
- F. Timber Sale Activity Report – December 2005; January 2006
- G. Legal Matter Summary

2. Timber Sales – Staffed by Roger Jansson, Operations Chief-North and George Bacon, Operations Chief-South – approved

A. Mutiny OSR	CR-21-3010	1,660	MBF	Boundary
B. Divide Saddle	CR-40-0773	7,240	MBF	Clearwater
C. North Cedar	CR-40-0778	4,715	MBF	Clearwater
D. N. Lewis	CR-40-0783	5,570	MBF	Clearwater
E. Silver Chicken	CR-40-0784	1,565	MBF	Clearwater
F. Elk Slough	CR-41-0010	3,040	MBF	Latah
G. Robinson OSR	CR-41-0012	1,845	MBF	Clearwater
H. Jericho-Fisher OSR	CR-41-0024	3,265	MBF	Clearwater
I. West Crane Ridge	CR-42-5009	4,275	MBF	Clearwater
J. Wilson Suttler Divide Pulp	CR-42-5011	4,395	MBF	Idaho
K. Burcham Commercial	CR-42-5015	2,130	MBF	Clearwater
L. Bo Tyee	CR-50-0131	4,961	MBF	Valley
M. Leftover Johnson	CR-50-0132	5,278	MBF	Washington

DISCUSSION: Attorney General Wasden noted that timber sales E, I and J contain clearcuts. He asked if those clearcuts are silviculturally justified and do they meet the requirements of the Land Board rules and regulations. Director Wiggins responded the clearcuts are silviculturally justified and do meet the requirements of the Board.

3. Qualified Bidders List, Timber Sales – Staffed by Bob Helmer, Chief, Bureau of Forest Management – approved

A. Potlatch Forest Products Corporation, 805 Mill Road, Post Office Box 1388, Lewiston ID 83501

4. Approval Request for Disclaimer of Interest to Carey and Sandra Hawkins for Accretion Land Adjacent to the Boise River in Canyon County – Staffed by Perry Whittaker, Chief Bureau of Real Estate – approved

DEPARTMENT RECOMMENDATION: Direct the Department to issue a disclaimer of interest for one parcel totaling 26.02 acres of the former bed of the Boise River and to require Carey and Sandra Hawkins to pay a fee of \$600.00 to the Department of Lands for this transaction.

BOARD ACTION: Approved.

5. Conceptual Approval for a Land Exchange between the State of Idaho and Wood River Land Trust – Staffed by Perry Whittaker, Chief Bureau of Real Estate – approved

DEPARTMENT RECOMMENDATION: Direct the Department to initiate the exchange process with the WRLT by completing an *Agreement to Initiate the Exchange* and performing the necessary appraisals to finalize the exchange. A final exchange proposal will be presented to the Land Board for final approval.

BOARD ACTION: Approved.

6. Kootenai County Board of Commissioners Request to Spend Waterways Fund Dollars for Public Access Projects on Lake CDA – Presented by Denise Mills, Assistant Director, Lands, Minerals, Range – approved

DEPARTMENT RECOMMENDATION: Authorize the Kootenai County Board of Commissioners to expend \$12,000 for the Harrison Public Dock project and \$45,000 for the Third Street Breakwater project from the Kootenai County Waterways Fund.

BOARD ACTION: Approved.

7. Minutes – approved

A. Regular Land Board Meeting – December 20, 2005

- **REGULAR**

8. Endowment Fund Investment Board Manager's Report – *Presented by Larry Johnson, Manager of Investments, EFIB*

A. EFIB Manager's Report

Mr. Johnson stated that January was a good month with a gain of 3.5% for a fiscal year-to-date return of 11.3%. All of the active managers beat their benchmarks fiscal year-to-date. At the end of January, the current value of the Fund was \$952 million.

No action was taken on this agenda item.

B. Draft Legislation Recommended by the Endowment Reform Review Task Force and the EFIB

Mr. Johnson reviewed legislation making technical corrections to the statutes governing Endowment Fund operations. The legislation was developed by the Reform Review Task Force and the Task Force is seeking the endorsement of the Land Board for these changes. The legislation does not change the intent of the existing statutes, but reduces ambiguity and simplifies administration.

- House Bill 591

In 2004, the Legislature passed Senate Bill 1306 to change the definition of earnings for the permanent endowment funds to incorporate dividends and interest into the annual gain calculation for each fund. Currently, cash returns (interest and dividends) and capital gains are handled differently in administering the endowment fund, but this change incorporates both into the year-end calculation of gain based on the overall market value of the permanent fund. Under SB1306, the effective date of the change is as of the first day of the fiscal year following the year in which the public school permanent endowment fund first exceeds its gain benchmark (i.e., June 2000 value adjusted for inflation and certain deposits.)

This bill establishes a triggering event for the change in the definition of earnings on an individual endowment fund basis rather than tying each endowment to the public school endowment. It also allows for one legislative session to occur between the time the triggering event occurs and the new definition of earnings takes effect. This will provide adequate time for the Endowment Fund Investment Board and the Board of Land Commissioners, as trustees of the endowments, to review whether an adjustment to the beneficiary's distributions is appropriate once the triggering event has occurred, and will also allow the Legislature to take any such adjustment into account in the appropriations process for the beneficiary.

- House Bill 592

This legislation clarifies the calculation of gains and losses to the State's endowment funds and the mechanism for recovery of losses to the Public School Permanent Endowment.

DISCUSSION: Attorney General Wasden noted an emergency clause in HB592 retroactive to June 30, 2000. He asked if this change will require recalculation of the gain and loss benchmarks. Mr. Johnson stated it will require recalculation, but the figures come to almost exactly the same amount (within a hundred thousand dollars) as of June 20, 2005.

Superintendent Howard asked if the new calculations change the odds that the Legislature will have to make up any deficits in the Public School Endowment Fund. Mr. Johnson stated this legislation does not change those odds. It only clarifies how the process of making up a deficit would work. Historically over ten-year cycles, the odds of a loss have been close to zero. Superintendent Howard asked if the number of years has always been ten. Mr. Johnson stated it has not. It was a shorter period, but when the Fund started investing in equities, the decision was made that, given the volatility of the equity markets, a longer period should be used.

BOARD ACTION: A motion was made by Secretary of State Ysursa that the Board go on record in support of House Bill 591, House Bill 592 and the process. Attorney General Wasden seconded the motion. The motion carried on a vote of 4-0, with Governor Kempthorne recused for this vote.

- JFAC Presentation Overview (February 7, 2006)

Mr. Johnson provided an overview of his February 7, 2006 JFAC presentation. He noted that the goal of most endowments is to provide a perpetual stream of income with main three objectives: maximize total return over time at an acceptable level of risk; provide equitably for future generations and hold distributions relatively stable. He discussed the organizational interaction between the Land Board, the Department of Lands and the Endowment Fund Investment Board. He described the three types of funds: permanent assets, available reserve and spendable funds. Permanent assets include land assets and the permanent fund. The available reserve (stabilization fund) includes the earnings reserve fund. The spendable funds (appropriation) includes the distribution to the beneficiaries, which is set by the Land Board annually.

Mr. Johnson reviewed the considerations in setting distributions: spendable funds can only come from earnings from the land or returns from stocks and bonds; the earnings reserve fund must absorb volatility in interest rates and stock market returns and revenues from state lands. Every time distributions are made, it is a balancing act. Every dollar in current year distributions increases the likelihood of a decrease in future distributions.

Mr. Johnson summarized a presentation presented by Richelle Sugiyama in August 2005. In that presentation, Ms. Sugiyama forecast a \$77 million earnings reserve balance in 2007 and how much could be spent in advance of that date. In measuring the risk of shortfalls, Ms. Sugiyama looked at the balance in the reserves, divided by the annual distribution, to determine how much coverage would be available for future distributions.

As a January 2006 update, Mr. Johnson stated with the new forecast of Lands, at the end of 2007 it is believed that the earnings reserve fund balance will be \$35 million higher than the August 2005 forecast. That increase is attributable to Lands revenue being about \$2 million higher than expected. The beginning balance is \$8 million higher due to final audit adjustments and shifting between the permanent and earnings reserve funds, which was completed about a week and a half after Ms. Sugiyama's August 2005 presentation. Interest and dividends were forecast higher because some conservatism was built into the forecast in case interest rates fell. Instead, interest rates rose so the conservatism was removed from the forecast. That change added about \$16 million. Also, the Department of Lands identified some dedicated funds that are legally under the purview of the endowment fund. The Department has requested authority from the Legislature to transfer those funds and that transfer will add an additional \$9 million. Based on this information, it has been concluded that there is no risk of a shortfall in either 2006 or 2007 distributions.

DISCUSSION: Superintendent Howard expressed concern that, in discussions about downturns in the State's economy, the endowment fund should not be looked to as the salvation for the State's general fund. She believes the same respect should be given to the endowment fund as is given to the general fund. Each year brings new stresses and issues for the Legislature to face. She suggested that the Land Board, the Department of Lands and the Endowment Fund Investment Board need to be the voices in support of the endowment fund and be continually watchful and questioning of the intent of words, actions and attitudes.

Controller Johnson asked where the \$9 million in funds transfer originated. Director Wiggins responded that the three funds are road maintenance, scaling of logs that are harvested from state lands and that portion of the Hazard Management Fund that is generated from endowment lands. The Hazard Management Fund is used to clean up slash after logging. The first two funds are completely endowment-generated dollars and their only place of expenditure is on endowment lands. The third fund, that portion that is endowment, is the same way. The revenue was generated by the endowment land management, and it is expended only for those purposes. The Department proposes to move roughly \$9 million. This movement of funds accomplishes several things: it simplifies accounting; it simplifies billing for timber sale purchasers; and it increases investment revenue to the earnings reserve.

No action was taken on this agenda item.

9. Cancellation of Auctions for Grazing Leases G-4051, G-4052, G-4055, G-4057 and G-4608 – Presented by Denise Mills, Assistant Director, Lands, Minerals, Range

DEPARTMENT RECOMMENDATION:

BOARD OPTIONS:

The Board has several options to consider with regard to future auctions, the appeal process and the requests made by Lazy Y Ranch and each of the former lessees:

Option 1:

- Declare the August 24, 2005 auctions invalid for leases G4051, G4052, G4055, G4057 and G4608.
- Direct the Department to reschedule auctions for these leases at the earliest possible date so that auction results can be presented for review and lease award at the April Board meeting.
- Direct the Department to conduct an auction for lease G4008, for which improvement values have been agreed on by the parties, on the same timeframe as for the above leases.
- Forego existing Department appeal procedures (those not in Idaho Code or Administrative Rule) to ensure that appeals filed are available for review and lease award by the Board at the April meeting.
- Work to establish the value for the creditable improvements for leases G4054 and G4056, for which auctions have not been held, so that the auction results can be presented to the Board for review and lease award at the May meeting. If improvement credits cannot be resolved by that date, issue a one-year permit to the current lessee for grazing during the 2006 calendar year.

Under this option the leases would be awarded at the April Land Board meeting. Turnout on the affected allotments is approximately June 1.

Option 2:

- Declare the August 24, 2005 auctions invalid for leases G4051, G4052, G4055, G4057 and G4608.
- Direct the Department to reschedule auctions for these leases at the earliest possible date and present them for lease award when all Department procedures are followed.
- Direct the Department to conduct an auction for lease G4008, for which improvement values have been agreed on by the parties, on the same timeframe as for the above leases.
- Direct the Department to work to resolve the value for the creditable improvements for leases G4054 and G4056 with the understanding that the auctions will be scheduled as soon as possible after the resolution of the improvement values.
- Direct the Department to follow all statutes, rules and procedures before bringing the auction results to the Board for review.
- If leases cannot be awarded prior to turnout, issue temporary permits to the former lessees so that livestock grazing can continue through the 2006 season.

Assuming that the results of the auctions are appealed, and Department procedures followed, leases would not be ready for award until at least the May Land Board meeting. Turnout on the affected allotments is approximately June 1.

Option 3:

- Declare the August 24, 2005 auctions invalid for leases G4051, G4052, G4055, G4057 and G4608.
- Direct the Department to resolve the value for the creditable improvements for leases G4054 and G4056.
- Direct the Department to schedule auctions for all leases conflicted by Lazy Y Ranch at a time convenient to all participants, but no later than July 1, 2006.
- Direct the Department to issue Temporary Permits authorizing the former grazing lessees to continue their grazing management of the subject leases for the 2006 grazing season.

Temporary permits could be issued by the Department by February 20, 2006.

DISCUSSION: Transcript available upon written request to Susan Terry, Idaho Department of Lands, 954 West Jefferson, Post Office Box 83720, Boise, ID 83720-0050.

BOARD ACTION: A motion was made by Controller Johnson to accept option 3. Controller Johnson stated this option allows for current year revenue generation, which is important to the Board and fulfills its obligation. It also allows adequate time to hold an auction that is legitimate for all interested parties. He noted that experience with the former grazing lessees shows they have a credible record. They have met their management obligations in the past and have a clean record for doing what the Board and the Department have asked of them. Controller Johnson stated he comes down on the side of what Option 3 recommends, which is to declare the August 24th, 2005 auctions invalid for those leases and direct the Department to issue temporary permits to the former grazing lessees for the 2006 grazing season. With that, Controller Johnson offered his motion for the Board's consideration. Superintendent Howard seconded the motion. The motion carried on a vote of 5-0.

10. Leasing Additional Cottage Sites at Priest Lake – Presented by Denise Mills, Assistant Director, Lands, Minerals, Range

DEPARTMENT RECOMMENDATION: Authorize the Department to proceed with the auction of Lots 37A and 37B. Subsequent to analyzing the results of these auctions, the Department shall provide the Board with a plan for leasing additional cottage sites at Priest Lake.

DISCUSSION: Governor Kempthorne asked what the term of the lease would be, if issued. Mr. Murphy stated cottage site leases are ten-year terms, and they all rotate on the same cycle. They expire in 2010. The Department is proposing that the two cottage sites be auctioned and that the leases extend from the current date until the same 2010 lease-end period, wherein the two leases would be included in the regular lease cycle.

Governor Kempthorne asked what the renewal process is for the current leaseholders. Mr. Murphy stated by law, as long as the lessees are in good standing, there is no timing issue. They need to file an application at that time.

Superintendent Howard stated the issue then is on renewing leases and resulting land values. She asked if the properties are reassessed at that time. Mr. Murphy stated appraisals are currently used to assess the values of those properties. Once the properties are auctioned, or in conjunction with the auction, the Department would conduct appraisals of the two parcels to determine their value and then multiply them by the same 2.5%. Superintendent Howard stated actually she is addressing the ones that would be already leased and then would come up for being renewed. She asked if they are then reevaluated on the basis of current land costs. Mr. Murphy stated a five-year cycle is currently used for addressing the value. During the years when the Department does not actually appraise them, an index is used in the process to revalue them.

Secretary of State Ysursa noted that under Section 58-310a, the code section dealing with cottage sites, when leases expire, they are non-conflicted provided current market value is being received. He stated that is the key point.

Attorney General Wasden commented his understanding of the recommendation is that we proceed with auctions for lots 37A and 37B, and thereafter examine the rest of the lots and make an overall plan. However, he would feel more comfortable if he knew what the process is before leasing these areas. He would like to have a whole plan in place and understand the implications of that plan before proceeding. Director Wiggins stated the reason the Department is considering leasing two lots to begin with is those leases would give an indication of the market and what could be expected. That information would help form the basis of a plan for the remainder of the lots.

Controller Johnson asked if feedback has been received in response to the Department's letter of December 1 to Bonner County Commissioners and Bonner County Planning and Zoning. Mr. Murphy stated as of this date we have not received any feedback.

Superintendent Howard asked if the lessees are required to connect to the main sewer lines on these lots. On the map she noted a main sewer line close to the lots, along with the proximity to telephone and electric utilities. The assumption would be that whoever would lease those lots would be responsible for improvements. She wonders if there are requirements associated with any of those improvements. Mr. Murphy stated the lessees would be required to address any kinds of waste generation at the site and would be required to be in compliance. He is not aware of any obligation to provide electricity to the site, but he assumes the lessees would want to do that. Regulations would require connection to either the sanitary sewer or an approved drainfield.

Governor Kempthorne stated based on that, it is important when this item is brought back to the Board that the issue be further defined. If, in fact, the main sewer line is close by, but it may cost more to connect to the sewer line than to put in their own drainage field. Governor Kempthorne suggested the emphasis should be to connect to the sewer and that it not be an option.

Controller Johnson asked if these lots are limited to single family dwellings, summer cabin kinds of homes and if there is any anticipation that someone could lease one of these for condominiums or multiple-family units. Mr. Murphy stated they are single-family residences.

Governor Kempthorne asked if an enterprise or corporation could acquire more than one lot. Mr. Murphy responded the law states that the cottage sites can be leased only by an individual, a couple or a family trust. By law, corporations are not allowed to lease cottage sites.

Governor Kempthorne asked if an individual, a couple or a family trust, could acquire more than one lot. Mr. Murphy stated an individual or a couple could each have one lot as individuals, but beyond that, they can only have one.

Superintendent Howard suggested making clear the kinds of expectations placed upon the people who bid on these leases in association with the occupancy and how they plan to handle waste, et cetera. She suggested checking if those requirements should be made tighter going forward, especially if higher occupancy results along a specific area.

Governor Kempthorne agreed with Superintendent Howard. He suggested looking at it almost like homeowner association covenants.

BOARD ACTION: A motion was made by Secretary of State Ysursa to accept the Department's recommendation. Controller Johnson seconded the motion. The motion carried on a vote of 5-0.

