



STATE BOARD OF LAND COMMISSIONERS

C. L. "Butch" Otter, Governor and President of the Board
Ben Yursa, Secretary of State
Lawrence G. Wasden, Attorney General
Brandon D. Woolf, State Controller
Tom Luna, Superintendent of Public Instruction

Tom Schultz, Secretary to the Board

Final Minutes
State Board of Land Commissioners' Regular Meeting
March 18, 2014

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, March 18, 2014 in the second floor courtroom of the Borah Building, 304 North 8th Street, Boise. The meeting began at 9:09 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Ben Yursa
Honorable Attorney General Lawrence Wasden
Honorable State Controller Brandon Woolf

For the record, Governor Otter recognized the presence of four Board members and the absence of Superintendent Luna.

1. Director's Report

A. Interest Rate on Department Transactions – March 2014

B. Timber Sale Activity and Information Report – February 2014

DISCUSSION: Governor Otter asked if the Department has received receipts from the Prairie Fire salvage sales, recalling a \$2/ton price reduction. Director Schultz replied approximately 50% of the timber on those sales has been harvested, and affirmed that the contract modifications resulted in the sale price being \$2 less per ton.

C. Division of Lands and Waterways Activity and Information Report – February 2014

DISCUSSION: Director Schultz provided an update on the status of the residential leases. At Payette Lake, the Department has 151 leased lots. Ten were sold at auction last October, 135 have executed leases, five leases were not renewed, and one has an assignment in process. At Priest Lake, the Department has 354 leased lots. 341 now have executed leases, three were not renewed, three are in assignment, and seven are pending receipt of insurance documentation. Director Schultz also reported on the status of the voluntary auction cycle at Priest Lake. There were 74 potential lots; 64 lessees have scheduled pre-application meetings, eight have chosen to continue leasing and Department staff is still working to contact two lessees to schedule pre-application meetings.

Secretary of State Ysursa asked for an update on the appraisal appeals. Director Schultz stated that the Department has received 159 requests for copies of draft appraisals, and 170 reports of factual errors, some of which may be duplicates due to submittal by both email and mail. The factual errors are primarily related to topographical ratings.

D. Legal Matter Summary – February 2014

E. Legislative Update

DISCUSSION: Governor Otter asked for the amount of the entire 2013 fire suppression expenses. Director Schultz responded that fire suppression is unique because the fire season typically crosses fiscal years. For calendar year 2013 the total amount was approximately \$14 million. The Department's deficiency warrant request for fiscal year 2014 was about \$10.4 million. Governor Otter commented that he attended a meeting on March 17 with Secretary of the Interior Sally Jewell and Forest Service representatives, among others, and there was agreement that good management is prevention; if forests and wild lands are managed correctly, it has a preventive effect on fire, which will lessen suppression needs. Governor Otter advised that the Department will be asked to give input on its management practices and successes.

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

A. Manager's Report

DISCUSSION: Mr. Johnson reported that reserves are in great shape due to strong Fund returns and excellent land revenues. The Investment Board held a special meeting on March 4 to review the RFP that will be discussed at this meeting momentarily.

B. Investment Report

DISCUSSION: Mr. Johnson stated that February was an exceptional month for the Fund. In one month the Fund gained 3.8%, pushing fiscal year to date returns to 14.6%, which is 1.5% above benchmark. Mr. Johnson mentioned the last low in the markets was February 2009. The Endowment Fund has since had outstanding returns, with an average annual return of 18%. All investment managers are performing as expected.

Governor Otter reflected that there seems to be a swell in aggravated exaggerations from many sources regarding how sound the Land Board is in its Endowment responsibilities and management of its responsibilities. Governor Otter asked for assistance from the Investment Board and the Department in providing Board members with factual information when misleading claims are published or pronounced, and asked other Board members their thoughts.

Attorney General Wasden agreed that Board members need to have appropriate information to reference in discussions with people. Attorney General Wasden commented that much of the issue centers on educating the public, the press, participants and non-participants alike because there is a great deal of misunderstanding about this Board's authority, obligations and its Constitutional responsibility. It is very challenging to communicate that out in the public. There have been many claims about legal issues and factual issues that are just not accurate. Attorney General Wasden added that having the professionals at the Investment Board and the

Department provide the Land Board with exact background and precise information is very helpful as Board members try and educate folks and themselves in this process.

Secretary of State Ysursa concurred with Attorney General Wasden's remarks and agreed that having factual talking points on current Endowment issues would be helpful. Secretary of State Ysursa added that factual information about the Board's past decisions and future direction is essential to constructive dialogue.

Controller Woolf acknowledged that education is a key component for all involved and indicated another crucial element is making sure the facts are truly set and clearly expressed and understood.

Mr. Johnson noted that transparency is a key principal in Investment Board operations and offered to provide true and accurate information to the Board to allow members to respond and correct any errors that may arise. Director Schultz advised the Department will do the same.

- **CONSENT**

3. Timber Sales for Approval – Staffed by Eric Besaw, Regional Operations Chief-North, and Kurt Houston, Regional Operations Chief-South

<u>NORTH OPERATIONS</u>				<u>COUNTY</u>	<u>AREA OFFICE</u>
A. Catamount	CR-10-0425	4,100	MBF	Bonner/ Boundary	Priest Lake (Coolin)
B. OBC Poles	CR-20-0304	600 4,720	MBF Poles	Bonner	Pend Oreille (Sandpoint)
C. Port Hill	CR-21-3029	1,500	MBF	Boundary	Pend Oreille (Sandpoint)
D. Gleason	CR-30-0599	2,990	MBF	Clearwater	St. Joe (St. Maries)
<u>SOUTH OPERATIONS</u>				<u>COUNTY</u>	<u>AREA OFFICE</u>
E. Johnny Slide	CR-40-1138	10,340	MBF	Clearwater	Clearwater (Orofino)
F. Last Divide OSR	CR-40-1142	3,275	MBF	Clearwater	Clearwater (Orofino)
G. Tie Canyon	CR-40-1152	3,705	MBF	Clearwater	Clearwater (Orofino)
H. Four Corners	CR-42-5069	6,680	MBF	Idaho	Maggie Creek (Kamiah)

4. Timber License Plate Fee Recommendations – Staffed by Betty Munis, Director, Idaho Forest Products Commission

RECOMMENDATION: Direct the Department to proceed with the recommended educational projects listed in Attachment 1 and developed jointly with the Idaho Forest Products Commission.

DISCUSSION: Governor Otter asked if the Department receives feedback on these expenses; is there a report identifying expectations, accomplishments and successes for these expenditures. Director Schultz replied that Ms. Munis solicits feedback from teachers following the forest tour, which is generally very positive. Director Schultz noted that the Forest Products Commission makes worthwhile use of the funds for developing materials, educating students and teachers

and then bringing a general awareness to the forest products industry overall. During the Arbor Day campaign each year, the Forest Products Commission passes out free seedlings at Home Depot and other locations to educate the general public on the importance of reforestation. Ms. Munis works with a firm that conducts marketing and solicits data in terms of public trends and understanding. In Idaho there is a very high proportion of the public that supports active forest management, reforestation, much higher than national levels overall. Governor Otter remarked that total project estimated costs are \$325,000 and observed it would be good to know that expectations for spending \$325,000 have been met. Governor Otter suggested having a teacher who has participated in the forest tour give a 5 minute talk on the success of the experience. Director Schultz indicated that could be arranged. Director Schultz added that the remainder of the Forest Products Commission funding is from landowner assessments and grants.

5. **Approval of Minutes** – February 18, 2014 Regular Meeting (Boise)

6. **Approval of Minutes** – February 26, 2014 Special Meeting (Boise)

CONSENT AGENDA BOARD ACTION: A motion was made by Attorney General Wasden that the Board approve the Consent Agenda. Secretary of State Yursa seconded the motion. The motion carried on a vote of 4-0.

- **REGULAR**

7. **Request for Proposal for Strategy Review Consultants** – *Presented by Larry Johnson, EFIB Manager of Investments*

RECOMMENDATION: Approve the draft RFP.

DISCUSSION: Secretary of State Yursa expressed his compliments to Mr. Johnson for his hard work, vetting this RFP to various sources and getting the final product in front of the Board. Attorney General Wasden commented this is a crucial project for the Board to undertake, to have advice from professionals on the proper asset mix and to make decisions going forward. Attorney General Wasden anticipates and appreciates input from the Investment Board in this endeavor and welcomed any comments from Director Schultz and the Department. Governor Otter also asked for comments from the Director, specifically if he had undergone a similar process with the endowments during his time in Montana. Director Schultz replied no, Montana did not do anything like this. Montana has the Board of Investments and they are limited by the constitution to investing in bonds, much as was the case in Idaho prior to endowment reform. Every dollar that is generated in Montana is distributed and permanent dispositions of land or minerals goes into a permanent fund. The majority of interest from the permanent fund, 95%, is distributed, 5% goes back into the permanent fund. The Board of Investments has no discretion in terms of how to invest; it is just the land side reinvesting in land. Montana has tried to amend their constitutional structure three times and has failed each time.

Governor Otter remarked that mostly western states would engage in this type of review and asked if the Department knows of other states who have completed a similar process and where will potential consultants be found. Director Schultz responded that Oklahoma may have done

some sort of review, but Oklahoma has integrated management whereas Idaho has the Land Board overlooking both the financial side and the land side and is making a decision based on the whole trust concept. Director Schultz deferred to Mr. Johnson regarding the financial aspect. Mr. Johnson indicated there are quite a few firms that do such financial analysis but one challenge is many of them are not familiar with timberland assets. There certainly are consultants who advise institutional investors on how to invest money both in financial assets and in real estate assets; almost all large asset consulting firms would have some expertise in real estate in general. These would be the people who advise public pension funds, who advise corporate pension plans and who advise university endowment funds.

Director Schultz added one especially critical element in this RFP is the consultant needs to understand the legal framework within which the Land Board, and the Department, operate, particularly when it comes to the land side. A consultant may come in with the idea to just wholesale the best lands and go from a 3.5% return to a 15% return by liquidating the lands. They need to be educated on that process. In code the Board is precluded from selling timberland. In the Constitution, an individual can only acquire 320 acres over their lifetime. Land exchanges, as we have seen, are hampered in terms of the Board's ability to nimbly execute those, so there are constraints imposed by the legal framework. A consultant will have to understand such constraints before they make recommendations to this Board on how to both improve returns and in what assets to reinvest. For instance, to suggest the Board should divest of all the rangeland and expect to do that in a matter of years is not a realistic scenario.

Governor Otter commented if the Board could have, it would have divested of cabin sites a long time ago. Governor Otter wondered if the Board could consult with a land management company. As an example, Clearwater Paper stock has soared as a result of their management practices. In this global scheme of strategy, would this advisor tell the Board that the 320 acre limitation needs to change. In other words, would the consultant review include a strategy that advises the Board to change the Constitution in order to achieve maximum return. Mr. Johnson stated the consultant would be able to make that observation and include that in their recommendations.

Director Schultz reminded the Board that in 2009, the Endowment Land Transaction Advisory Committee (ELTAC), performed a study and made many of those same recommendations. In 2010, the Department tried to implement some of those changes before the Legislature and was unsuccessful. In the current Legislative session there were two bills to change the Constitution to modify some of those provisions that would allow for greater discretion – would not require public auctions and would raise the limitation on acreages. The hurdle is what the Legislature and the public will ultimately support in constitutional changes. Governor Otter noted that before the Board would make a recommendation, it would want to have a good solid reason for making any recommendation. The Board needs to be fully apprised. Governor Otter reasoned that any investment manager conducting a portfolio review would assess statutory and constitutional constraints before a recommendation is made on an overall conjunctive strategy between hard assets and liquid assets management.

Controller Woolf thanked Mr. Johnson, the Investment Board and EFIB staff for their work on the consultant RFP recommendation. Controller Woolf recognized and expressed appreciation for their continued work going forward, and thanked Secretary Ysursa for his lead as chairman of the

Governance Subcommittee. Attorney General Wasden also expressed his thanks to Secretary Ysursa and the subcommittee.

BOARD ACTION: A motion was made by Secretary of State Ysursa that the Board approve the draft RFP as presented by Mr. Johnson. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

Background information was provided by the presenter indicated below. No Land Board action is required on the Information Agenda.

- **INFORMATION**

8. Grazing Lease Rate for Calendar Year 2015 – Presented by Diane French, Program Manager-Grazing, Agriculture, Conservation

DISCUSSION: Controller Woolf asked if the rates presented are nominal or adjusted for inflation. Director Schultz replied they are nominal. Governor Otter noted that his ranch used to buy a lot of grass, on a gain; it was \$0.25/pound gain. How does the Department convert that to an AUM when comparing rates with private entities. Governor Otter did not recall every paying by the AUM for private grass. Ms. French acknowledged that across the western states, price is on a per head basis per month as opposed to AUM. Secretary of State Ysursa asked Director Schultz if there are discussions planned with grazing stakeholders later this summer. Director Schultz stated the Department has had discussions with the Cattle Association, with the Farm Bureau, and the Department intends to form a group this summer to get input from stakeholders and to work through these issues. It is not just a rate issue, but also lease term, as well as the issue of what is the land base. Director Schultz used timberland as an example: there is a primary and a secondary base of timber. Primary is the highly productive timber ground that the Department wants to retain. Secondary base is higher elevation, lower productivity, lands that do not contribute significantly to the revenue generation component. A similar type exercise could be done on rangelands. Are there primary rangelands that add to core revenue from range, ones with good access; are there other rangelands that are intermingled with federal lands that prevent effective management. In this discussion the Department would look at not just rents and rates for rents but term of leases. Is it a 5 year lease, a 10 year, a 20 year. The Board has discretion to go up to 20 years. Is there one rate structure, or two rate structures. If it is rangeland in the middle of the Owyhees in a federal allotment where the Department does not have any effect on management, does that warrant a different rate, maybe a lesser rate than for pasture that is close to town with good access and maybe also has a shorter term lease. The Department wants to engage stakeholders in a broader discussion; what is the vision for managing rangelands in the long term. Is it wholesale disposal of everything; is it to identify a core asset. Director Schultz explained the Department will engage stakeholders to get their feedback in this process and ideally bring the Board a decision this calendar year that has looked at these issues, incorporated the market rent study, incorporated the feedback and try to move forward in a way that makes sense. Director Schultz remarked that currently the rents are set far in advance. The rate that Ms. French presented of \$6.77 is for 2015. The Department is setting rents into the future right now given the required 180-day notification to lessees.

Director Schultz mentioned the Cattle Association is closely watching this issue; they are very interested and concerned with any changes that might be proposed by the Department over the status quo. The Department needs to really listen to them, get their feedback as well as other stakeholders. The Western Watersheds group has watched this closely and the Department typically gets a monthly call. The Attorney General's office gets periodic inquiries regarding the market rent study. The Department intends to undertake discussions this coming year, engage in a robust discussion with affected people and ultimately bring the Board a recommendation that weighs all these factors, including what is in the beneficiaries' best interest.

Attorney General Wasden recalled the Board created a grazing subcommittee in the past, and suggested at some point the Board will likely reactivate it to help review and engage in discussion and dialogue, perhaps after the preliminary conversations between the Department and stakeholders. It would be not only the Department's activity but the subcommittee itself coming back and making recommendations. Governor Otter endorsed that idea, with Attorney General Wasden in the role of chairman, but recused himself from serving when the subcommittee is reactivated as the Governor is now a grazing lessee.

Governor Otter had another question about how the Department factors the price of beef. If the calves come off federal, and state, allotments in the fall, around October 15th typically, the calves are still a long way from finish. Is the price set at weaned weight, approximately 550 pounds, or the kill weight, which is considerably higher. The calves come in off of forage and get hot feed; they probably have 4 pounds a day gain instead of a pound and a half out on the desert. Director Schultz responded that the Department rates a tract of land. For instance, on a 640 acre tract, one of the Department's resource specialists will visit that tract and assess there are this many AUM's on this tract. Then the bill that the lessee receives is tied to the amount of forage that is available. The Department is not necessarily looking at gains and losses in weight and when the cattle are turned in and turned out. The Department looks at how much forage can that tract produce. For example, there is 20 AUMs on this tract and the lessee will then run cattle consistent with that rating. Governor Otter asked if the Department includes water. Director Schultz replied that water is one factor considered when the carrying capacity for a tract is set.

Secretary of State Ysursa remarked that the grazing subcommittee relied heavily on the input of Dr. Neil Rimbey, with the University of Idaho, and advised that Dr. Rimbey should be involved in upcoming discussions as well. Secretary Ysursa also commented that one positive aspect in grazing issues is the plethora of statistics available, but one difficulty is the Department having to set grazing rates on essentially 2-year old data, due to publication timing of indices used in the formula and 6 month notice requirements to lessees.

Governor Otter had a final observation, bearing in mind the conversation earlier that fire suppression costs were \$14 million in 2013, the Board needs to be careful not to raise grazing rates to a point that lessees decide it is more cost effective to feed cattle Timothy hay for \$165/ton instead of grazing. The result being more fuel out there to burn and more the Department and federal agencies have to defend.

