Statement of Investment Policy

Idaho Land Grant Endowments

As overseen by the:

Idaho Board of Land Commissioners

Includes funds managed by the Endowment Fund Investment Board

Includes land managed by the Idaho Department of Lands

May 17, 2016

This Statement of Investment Policy supersedes the State Trust Lands Asset Management Plan dated December 20, 2011.

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I. Introduction

The State Board of Land Commissioners ("Land Board") hereby establishes this Statement of Investment Policy ("Statement") for the investment and management of the land grant endowment assets ("Endowment Assets" or "Endowment") of the State of Idaho. The Endowment Assets were created by The Idaho Admissions Act in 1889, which granted the new state approximately 3,600,000 acres of land for the sole purpose of funding fourteen specified beneficiaries including nine different trusts or endowments.

This investment policy statement provides policies for the investment and management of financial and land assets, which together comprise the Endowment Assets. Financial Assets consist primarily of the invested revenues from the endowment lands (collectively, "Financial Assets"). Land Assets include timberland, rangeland, farmland, commercial real estate, residential (cabin sites) real estate, and minerals/oil and gas (collectively, "Land Assets") located in Idaho.

II. Purpose

This Statement of Investment Policy is set forth by the Land Board to:

- Establish a clear understanding for all involved parties regarding the management and investment goals and objectives for the Endowment Assets.
- Offer guidance and limitations to all involved parties regarding the management and investment of Endowment Assets.
- Define and assign the responsibilities of participants involved in the investment process.
- Establish a basis for evaluating investment and management results.
- Manage Endowment Assets according to prudent standards as established in the Idaho Constitution and trust law.
- Establish the relevant investment horizon for which the Endowment Assets will be managed.

III. Constitutional and Statutory Requirements

The investment and management of the Endowment Assets will be in accordance with the Idaho Constitution, all applicable laws of the State of Idaho and other pertinent legal restrictions. In the event this Statement is inconsistent with Constitutional or Statutory Requirements ("Requirements"), those Requirements will control.

A. Land Board

Article IX Section 7 of the Constitution establishes the Land Board and states, "The governor, superintendent of public instruction, secretary of state, attorney general and state controller shall constitute the state board of land commissioners, who shall have the direction, control and disposition of the public lands of the state, under such regulations as may be prescribed by law."

B. Sole Interest of the Beneficiaries

All Endowment Assets of the State of Idaho must be managed "in such manner as will secure the maximum long-term financial return" to the trust beneficiaries.

C. Prudent Investments and Fiduciary Duties

The Land Board and its agents, including staff, the Idaho Department of Lands ("IDL"), the Endowment Fund Investment Board ("EFIB"), consultants, advisors, and investment managers shall exercise the judgment and care of a prudent investor as required under the prudent investor rule set forth in the Uniform Prudent Investor Act, Idaho Code § 68-501 to 68-514.

Endowment Assets shall be invested and managed with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent expert acting in like capacity and familiar with such matters would use in the investment and management of assets of like character with like aims.

This Act states, in part, that: "A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution;" and, "A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust."

The duty of prudence requires trustees to bring the appropriate level of expertise to the administration of the trust. An implied duty of trustees is also to preserve and protect the assets with a long-term perspective sensitive to the needs of both current and future beneficiaries.

D. Sales, Exchanges, and the Land Bank

Article IX Section 8 of the Idaho Constitution includes the following restrictions regarding the sale of lands:

- All land must be disposed of via public auction
- Maximum of 100 sections (64,000 acres) of state lands may be sold in any year
- Maximum of 320 acres may be sold to any one individual, company, or corporation
- No state lands may be sold for less than the appraised price
- Granted or acquired lands may be exchanged on an equal value basis with other lands subject to certain restrictions
- Forest and certain other land may not be sold per Idaho Code § 58-133, which states "All state owned lands classified as chiefly valuable for forestry, reforestation, recreation, and watershed protection are reserved from sale and set aside as state forests."

Article IX Section 4 of the Idaho Constitution provides for the deposit of the proceeds from the sale of school lands into a land bank fund to be used to acquire other lands within the state for the benefit of endowment beneficiaries, subject to a time limit to be established by the legislature.

Idaho Code § 58-133 provides conditions for use of the "Land Bank Fund." In summary, the Land Bank Fund exists to hold the proceeds from the sale of state endowment land pending the purchase of other land for the benefit of the endowment beneficiaries. Funds deposited in the Land Bank Fund, including earnings, are continually appropriated to the Land Board. If the funds have not been utilized for land acquisition within five years, they are transferred to the permanent endowment fund of the respective endowment, unless the five year time limit is extended by the legislature.

E. Other Constitutional Requirements and Statutes

Additional constitutional articles and state statutes are described throughout this Policy. Appendix A includes the entirety of the constitutional articles and statutes that apply to the investment and management of Endowment Assets.

IV. Investment Goals

A. General Objective

The stated mission for Endowment Assets is to provide a perpetual stream of income to the beneficiaries by managing assets with the following objectives:

- Maximize long-term financial return at a prudent level of risk.
- Provide relatively stable and predictable distributions to the beneficiaries.
- Constrain distributions to protect future generations' purchasing power.
- Maintain sufficient liquidity for anticipated expenditures.

B. Considerations

Primary considerations impacting the fulfillment of the investment mission and objectives include:

- Constitutional and statutory requirements as noted previously.
    - The constitutional restrictions are considered permanent given the process required to amend the Constitution. Amending the Idaho Constitution requires legislative approval (2/3 majority in the House of Representatives and Senate) followed by ratification by the citizens of Idaho via a general election ballot or a Constitutional convention.
- Managing revenue and profit generating activities within a government agency.
- Each trust holds its Financial Assets in a commingled pool (with shares owned by several trusts) but its Land Assets in specific and unique tracts.

C. Investment Return Objective

As perpetual assets, per State Constitution and Statute, the Endowment has a perpetual investment horizon. The investment return objective for the Endowment Assets is to earn, over a long period, an annualized real return, net of fees, expenses, and costs, above spending and inflation (per Idaho Code § 57-724) as well as population growth (per Land Board policy). Given the current financial and land asset mix, the Endowment is expected to earn a real net return of 3.5% annually over the long term.

D. Distribution Policy

The Distribution Policy adopted by the Land Board (further described in Section VIII) sets annual distributions to beneficiaries. The interaction of Investment and Distribution Policies should balance the needs of current and future beneficiaries. The Land Board's policy is to distribute a conservative estimate of long-term sustainable income and hold sufficient reserves of undistributed income to absorb predictable down cycles in endowment earnings. It is a priority to avoid reductions in distributions because most beneficiaries depend on endowment distributions to fund ongoing operations.

V. Investment Risk and Strategic Asset Allocation

A. Diversification Among Asset Classes

Risk, as it relates to stability of distributions, shall be managed primarily by holding reserves of undistributed income. Risk, as it relates to the earnings of the Endowment Assets, shall be managed primarily through diversification. Subject to the land disposal restrictions and the corresponding significant and statutorily permanent allocation to timberland, the Endowment Assets will be diversified both by asset class and within asset classes to the extent possible. The purpose of diversification is to provide reasonable assurance that no single asset class will have a disproportionate impact on the Endowment. Both quantitative measures and qualitative judgment will be used in assessing and managing risk.

B. Review of Asset Classes and Asset Allocation

In setting strategic asset allocations, the Land Board will focus on ensuring that the Endowment Assets' expected long-term returns will meet expected long-term obligations with a prudent level of risk. The Land Board will, approximately every eight years, evaluate the asset allocation mix and conduct an asset allocation study to determine the long-term strategic allocations so as to meet long-term return objectives with the appropriate level of risk.

Significant changes in capital market assumptions, portfolio characteristics, timber income expectations, or the Distribution Policy may cause the Land Board to accelerate the timing of an asset allocation study. For example, the illiquidity of much of the Land Assets may require that the target asset mix of the Financial Assets be adjusted over time due such events as significant land sales or acquisitions or the appreciation of the Financial Assets at a faster or slower rate than the appreciation of the Land Assets.

The EFIB will review the Distribution Policy annually. When key assumptions in the Distribution Policy, such as expected earnings and volatility change, the EFIB, in consultation with the Land Board, will recalculate the risk of shortfalls in future distributions and provide recommendations on policy adjustments to the Land Board.

C. Strategic Asset Allocation

The Land Board commissioned a governance and asset allocation study in 2014 and accepted the recommendations included in the Callan Asset Allocation and Governance Report ("Callan Report"). This section of the Policy summarizes the major conclusions of the asset allocation portion of the Callan

Report. The purpose of the asset allocation study was to evaluate the current and potential asset allocation mixes incorporating the Land Assets with the Financial Assets to evaluate the expected return and volatility of the portfolio.

The Land Board confirmed the asset mix presented in Exhibit 1 below:

Exhibit 1: Strategic Asset Allocation

Asset Class	Target Asset Allocation	Range	Actual Allocation June 30, 2015	Expected 10-Year Compounded Return and Risk[1,2]	Implied Real Net Return[3]
Financial Assets	58%	50-65%	55.8%	6.76%	4.51%
IDL Timberland	39%	30-50%	35.5%	5.70%	3.45%
IDL Grazing Land	2%	0-5%	1.8%	3.00%	0.75%
Cash Equivalents – Land Bank	1%	0-5%	0.9%	2.00%	-0.25%
Residential Real Estate	0%	N/A	4.5%	N/A	
Idaho Commercial Real Estate	0%	N/A	0.8%	N/A	
Other Land	N/A	N/A	0.7%	N/A	
Total	100%			6.69%	4.44%
Expected Risk (Standard Deviation)				9.28%	
Inflation Assumption				2.25%	

- The Target Allocation percentages were effective as of December 2014 with the following exceptions:
    - A Diversified U.S. Real Estate (Commercial Property) target allocation was adopted by the EFIB in October 2015 and is targeted to be implemented in 2016 and 2017 in the Financial Assets portfolio.
    - The asset allocation study did not include Residential Real Estate because of an approved disposition plan adopted by the Land Board.

[1] Based on Callan's 2014 Asset Allocation and Governance Review.

[2] Compounded returns are measured over long time periods and reflect the reduction in return that comes from variations around the average return ("volatility drag"). It is stated on a nominal basis before inflation but after all fees and costs associated with managing the investment(s) have been deducted from the return.

[3] Real net return is the nominal net rate of return after deduction of inflation. The inflation assumption is 2.25%.

- Idaho Commercial Real Estate was not included in the asset allocation study given its limited size and low likelihood that it should be expanded due to:
  - Difficulty in profitably managing the asset given certain constitutional and statutory constraints
  - Lack of a compelling investment rationale for a concentrated position in Idaho commercial properties considering other alternatives available, including increasing investment in timberland or the Financial Assets.

- The ranges for land investments reflect the inherent illiquidity in these land types combined with an inconsistent supply of land for purchase and restrictions on sales, all of which impact the ability to re-balance land investments.

- Although it is not an institutional asset class, grazing land was included in the asset allocation study due to its large absolute number of acres and its illiquidity.

The Expected 10-Year Compounded Return and Risk, as specified in Exhibit 1 above, are based on Callan Associates' 2014 capital market assumptions for each asset class and the total Endowment using the target allocations. Over a 10-year period, Callan indicates the target asset allocation should generate a nominal return in excess of 6.69% net of fees. Using an inflation assumption of 2.25% results in an expected real net return of 4.44%. The volatility level (standard deviation) associated with this asset mix is approximately 9.28%. The Expected 10-Year Compounded Return and Risk was developed with reference to the observed long-term relationships among major institutional asset classes.

The Land Board recognizes that the actual ten-year return can deviate significantly from this expectation – both positively and negatively.

The Land Board acknowledges that the Strategic Asset Allocation and the Distribution Policy are linked. If an asset allocation mix is selected in the future that deviates from the risk and return in the current Strategic Asset Allocation, the Land Board, in consultation with the EFIB, will assess the impact on the Distribution Policy and change the Distribution Policy as necessary. In broad terms, changes in long-term expected income will impact the estimated level of sustainable distributions while changes in risk will impact the desired level of reserves.

The EFIB will review the asset allocation for the Financial Assets per the EFIB Investment Policy and present it to the Land Board as an informational item.

D. Strategic Policies

In addition to asset allocation, the Land Board may, from time to time, authorize or adopt strategic policies. "Strategic Policies" are actions by the Land Board to allow investment in asset types that have not been singled out as "asset classes" in the asset allocation process, to overweight a particular sector within an asset class, or to employ particular strategies in the investment of the Endowment Assets. The purposes of these actions are either to increase the return above the expected return or to reduce risk. Any such policy would include consideration of the change in risk, the change in return, and the impact on the Distribution Policy.

VI. Investment Governance Structure

The Idaho Constitution provides that the Endowment funds are held in trust and administered by the Land Board as trustees. The Constitution further provides that the Idaho Legislature may establish a statutory structure for administration that is consistent with the nature of the trusts. Accordingly, the Idaho Legislature created a structure that established the EFIB as the manager of the Financial Assets, established the appropriations process for the payment of trust management expenses, and created the IDL to serve as the manager of the Idaho Land Assets of each trust. The constitutional and statutory provisions, together with Land Board policy, establish the governance structure for Endowment Assets.

A. Land Board Responsibility

Management of the Endowment Assets is entrusted to the Land Board, which serves as the sole fiduciary of both the Land Assets and Financial Assets. The Land Board is ultimately responsible for all management and investment activities. The powers and duties of the Land Board are fully described in Idaho Code § 58-104.

In exercising this responsibility, in addition to utilizing the EFIB and the IDL, the Land Board will hire personnel and agents and delegate investment functions to those personnel and agents consistent with constitutional and statutory provisions. Where the Land Board does not or cannot delegate investment powers or duties, the Land Board will either satisfy itself that it is familiar with such matters, or will retain persons who are familiar with such matters to consult or assist the Land Board in the exercise of those responsibilities. Where the Land Board delegates a responsibility, it will be delegated to a person who is familiar with such matters, and the Land Board will monitor and review the actions of those to whom responsibilities are delegated.

1. General Roles and Responsibilities

The Land Board's general roles and responsibilities regarding investments include, but are not limited to:

- Direct and oversee the conduct and operations of the EFIB and the IDL.
- Appoint and consult with expert advisors (including the EFIB and the IDL) for each critical function for which the Land Board has responsibility. In this context, the term "expert advisor" shall mean a person engaged in the business for which he holds himself out to be an expert and who is experienced in that field.
- Plan and establish strategic policies to coordinate the management of state endowment lands with the management of the Endowment funds.
- Provide reports of the status and performance of state Endowment lands and the respective Endowment funds to the State Affairs Committees of the Senate and the House of Representatives within fourteen days after a regular session of the Legislature convenes.
- Make strategic decisions, primarily concerning asset allocation, and establish and/or approve Endowment land asset investment and management policies and strategies.
- Periodic review of this master investment policy and any sub-policies.
- Monitor the compliance of EFIB and IDL with the investment policies and strategy determined by the Board and the execution of the strategy.

- Hire agents in addition to IDL and EFIB to assist the Land Board in the implementation of strategy or investment policies.
- Approve the IDL annual budget request for submission to the Division of Financial Management and the Legislative Services Office and for consideration by the Legislature (including reviewing appropriation requests of IDL from Earnings Reserves).
- Approve allocation of Earnings Reserve Funds as provided in Idaho Code § 57-723A (Distribution Policy), specifically how much is:
    - Distributed annually to beneficiaries ;
    - Retained for future distribution; and,
    - Transferred to the Permanent Funds to build corpus.
- Approve the annual timber sale plan and certain timber sales that fall outside of the IDL Director's authority.
- Review the IDL Director's monthly timber sale activity report showing the proposed sales for the next month.
- Approve large routine land investment decisions that exceed the authority of the IDL Director.
- Approve certain other land investment decisions which exceed the authority delegated to the IDL Director.
- Approve rule making.
- Review decisions of the IDL Director upon appeal in contested matters.

2. Land Board Investment Subcommittee

a) Structure of the Investment Subcommittee

The Land Board established and authorized the Subcommittee in December 2014. The current composition of the Subcommittee is one EFIB Board member, the EFIB Manager of Investments, and the IDL Director.

b) General Roles and Responsibilities of the Investment Subcommittee

The Investment Subcommittee provides review and advice to the Land Board. The primary purpose of the Investment Subcommittee is to coordinate consideration of investment issues that cross both the Land Assets and the Financial Assets, including:

- Administer the contract for the General Consultant and other consultants, as assigned by the Land Board.
- Working with General Consultant, identify the Land Board's Land Investment Advisor(s) and the Land Board's Commercial Real Estate Investment Advisor and administer the associated consulting contracts.
- Working with the General Consultant, recommend the Statement of Investment Policy and Asset Management Plan to the Land Board.
- Recommend policy regarding implementation of land exchanges on Endowment lands.
- Recommend policy (consistent with Idaho Code § 58-133) regarding the use of proceeds from the disposal of assets (e.g. cabin sites, commercial real estate, grazing lands), including deposit

in the Permanent Fund or holding proceeds in the Land Bank Fund to be used for Idaho Endowment land acquisition (excluding commercial buildings), and to purchase access to currently owned Endowment lands and block up ownership of Endowment lands.

3. Use of Outside Experts

The Land Board employs outside advisors and consulting firms to provide specialized expertise and to verify or review IDL's and the EFIB's investment and operational activities and procedures.

a) Non-Discretionary Investment Consultants

The Land Board may hire a qualified independent consultant or consultants (including a General Consultant) for strategic and annual plan reviews, review of new investment initiatives, investment policy development and review, asset allocation, advisor selection and monitoring, and performance measurement. Investment consultants will be fiduciaries with respect to the services provided and will act in a non-discretionary capacity with no decision-making authority.

b) Commercial Real Estate Advisor

The Land Board will use a Commercial Real Estate Advisor to advise on the Idaho commercial property portfolio. The Commercial Real Estate Advisor will provide analysis and management expertise on the retention, disposition, and management of the commercial properties. The Commercial Real Estate Advisor will be a fiduciary with respect to the services provided and act in a non-discretionary capacity with no decision-making authority.

c) Land Investment Advisor

The Land Board may utilize a Land Investment Advisor(s) to independently review certain land investment decisions proposed by the IDL (land disposal, land acquisition, and new tenant improvements) that are over $100,000. The Land Investment Advisor will review the post-audit completed by the IDL for transactions over $1,000,000. The Land Investment Advisor may be used for independent review of IDL procedures. The Land Investment Advisor will be a fiduciary with respect to the services provided and act in a non-discretionary capacity with no decision-making authority.

d) Auditor

Idaho Code § 57-720 requires that the Financial Assets of the Endowment be reviewed by an independent auditor. To oversee this process, and any other audits it deems prudent, the Land Board has established the Land Board Audit Committee, consisting of the Attorney General (or designee), the State Controller (or designee), and three members of the EFIB, appointed by its Chair.

B. Investment Governance and Investment Policy for the Financial Assets

Idaho Code § 57-718 created the Endowment Fund Investment Board which formulates policy for, and manages the investment of, the Financial Assets, which consists primarily of the invested revenues from the Endowment lands. As permitted in I C § 57-720, the fund assets of all nine endowments, both Permanent Funds and Earnings Reserve Funds, may be combined in a single investment pool.

1. Mission of the EFIB

The mission of the EFIB is to provide professional investment management services to its stakeholders consistent with its constitutional and statutory mandates.

2. Structure of the EFIB

Per Idaho Code § 57-718, the EFIB consists of nine members appointed by the Governor and confirmed by the Senate. These members are one state senator, one state representative, one professional educator, and six members of the public familiar with financial matters.

3. General Roles and Responsibilities of the EFIB and Agents

With a citizen board and small staff, the EFIB will make strategic allocations and generally avoid making tactical calls. The Board and staff will concentrate their activities on:

- Making strategic decisions, primarily concerning asset allocation.
- Establishing investment policy for the funds.
- Recommending Distribution Policy and transfers of Earnings Reserves to the Land Board.
- Establishing Distribution Policy for the Capitol Permanent Fund.
- Selecting, monitoring, and terminating investment managers, consultants, and custodians.
- Selecting and directing staff.
- Approving an investment management expense budget from Earnings Reserve for consideration by legislative appropriation.
- Maintaining a reporting system that provides a clear picture of the status of the Financial Assets.

4. Professional Staff

The EFIB will maintain a staff with investment expertise, including a Manager of Investments ("MOI") who is a fiduciary to the EFIB. The MOI is responsible for directing and monitoring the investment management of the Financial Assets.

5. Use of Outside Experts

The Financial Assets will be invested by professional investment firms. No funds will be managed internally. The EFIB will also employ one or more outside consulting firms to provide specialized expertise and assist in, among other things, asset allocation, manager selection and monitoring, and performance measurement.

6. Investment Policy Statement for Financial Assets

The EFIB will maintain a detailed Investment Policy that pertains specifically to the management and investment of the Financial Assets (Appendix C). The Land Board is not required to approve this investment policy as this duty is delegated to the EFIB.

C. Investment Governance for Land Assets

Idaho Code § 58-101 created the Idaho Department of Lands to serve as the internal investment and asset manager of the Land Assets of each trust. This role includes authorization to make certain investment decisions consistent with the established governance structure and includes day-to-day operating responsibilities for the Land Assets. This is in contrast to the EFIB structure where implementation and day- to-day decision making is delegated to external investment managers subject to approved guidelines and contracts.

The Land Assets include timberland, rangeland, farmland, commercial real estate, residential (cabin sites) real estate, minerals, transitional land, conservation land, rights of way, and recreation (collectively "Land Assets") located in Idaho. Transitional land, conservation land, rights of way, and recreation are not asset classes, but are subsets of, or things that occur on, the traditional asset classes.

1. Mission of the IDL

The mission of the IDL is to professionally and prudently manage Idaho's Land Assets to maximize long-term financial returns to public schools and other trust beneficiaries and to provide professional assistance to the citizens of Idaho to use, protect and sustain their natural resources.

The IDL's mission is not entirely focused on management of Land Assets. The IDL also has various regulatory, technical assistance, and resource protection roles.

2. Structure of the IDL

The IDL operates under the direction of the Land Board and is the administrative arm of the Idaho Oil and Gas Conservation Commission. The IDL is led by a Director who is employed by and is directed by the Land Board. The Director's staff includes a Deputy Director for Forestry & Fire (State Forester), a Deputy Director for Lands & Waterways, a Chief Operations Officer, a Support Services Division Administrator, a Human Resources Officer – collectively, the executive staff – and various support staff. Each of the positions identified above supervises various professional, technical, and administrative staff.

3. General Roles and Responsibilities

The IDL manages more than 2.4 million acres of Idaho Land Assets (and additional acreage of retained mineral rights) under a constitutional mandate to maximize long-term financial returns for the sole benefit of public schools and certain other State institutions enumerated in statute.

The Director and staff will concentrate their investment-related activities on:

- Serving as the instrumentality of the Land Board.
- Implementing the strategic direction established by the Land Board concerning Land Assets.
- Making strategic decisions (where authorized) and providing recommendations to the Land Board concerning management of Land Assets.
- Establishing policies and procedures for IDL programs.
- Selecting and directing staff.
- Approving a land and resource management expense budget from Earnings Reserve for Land Board approval and consideration for legislative appropriation. Earnings Reserve is only a portion of the IDL budget.

- Monitoring and reporting progress towards strategic goals, including preparing an annual income statement following agreed upon procedures and calculating semi-annual returns for major asset classes and in total.

Decision-making authority for Endowment land asset management resides with the Land Board except as delegated to the Director. Program management resides with the Director's staff and their subordinates. The IDL establishes policies and procedures for routine programmatic activities at the bureau and/or program level.

The IDL has delegated authority to approve:

- Normal timber sales that fall within established Land Board policies and salvage sales.
    - Exceptions include sales with clear-cut harvests over 100 acres; sales with development credits exceeding 50% of the net appraised value or 33% of the gross appraised value; and, sales with written citizen concerns.
- Approval of certain routine land investment decisions. Routine land investment decisions include access acquisition, forest and range improvements, reforestation, and building maintenance.
    - Transactions <$500,000 the IDL Director may authorize.
    - Transactions >$500,000 require Land Board approval.
- Approval of certain other land investment decisions. Other land investment decisions include land disposal, land acquisition, and new tenant improvements.
    - Transactions <$100,000 the IDL Director may authorize.
    - Transactions >$100,000 require Land Board approval.

4. Professional Staff

IDL staff consists of trained professionals and technical experts in various fields, such as forestry, range, real estate, minerals/oil & gas, fire, accounting, finance, procurement, GIS, IT, and other specialties. IDL staff members who are involved with management of Endowment Assets or related accounting/financial management are fiduciaries.

5. Use of Outside Experts

The IDL will use outside experts at their discretion and the Land Board's discretion. IDL may utilize the Land Board's expert advisors when the IDL is in need of the special expertise provided by the advisors and when their use of a specific advisor will not conflict with the Land Board's use of the advisor. IDL may review information and recommendations provided to the Land Board by outside experts, the Commercial Real Estate Investment Advisor, and the Land Investment Advisor. The chart in Appendix E below depicts the relationship between the Land Board, IDL, and outside experts.

D. Role of the Legislature

The Idaho Legislature is responsible for:

- Legislating the methodology for restoring losses to the Public School and Agricultural College funds.

- Appropriating Earnings Reserve Funds for operation of the IDL and the EFIB.
- Considering approved endowment distributions in setting beneficiary appropriations.
- Establishing the statutory structure for administration of endowment assets that is consistent with the nature of the trusts and the constitutional duties of the Land Board.

VII. Asset Class Policies for Land Assets

A. Investment Objective for the Land Assets

The primary objective for the Land Assets is the generation of maximum long term return at a prudent level of risk using traditional land grant asset types. The Land Assets diversify the Financial Assets given the low correlations of timberland and rangeland to public capital markets. The Land Assets also lower the volatility of the total investment portfolio considering timberland and rangeland returns have historically exhibited lower volatility than equity asset classes. During periods of negative financial returns, Land Assets can provide a positive revenue stream to help maintain Earnings Reserves and stable Endowment distributions.

The Investment Objectives are long-term return objectives. The Investment Objective for the Land portfolio recognizes that timberland is a primary driver of the overall return for Land and that income from timberland and, to a lesser degree, all other lands are the primary generator of investment returns. The individual investment objectives for timberland, rangeland, and farmland reflect the long-term investment characteristics (return, correlation, and volatility) of timberland, rangeland, and farmland compared to other asset classes. Investment Objectives also consider the existing base of land holdings along with management constraints, notably sales restrictions, acreage limitation, and the rent setting and leasing process. The return objectives should not be viewed in isolation but in relationship to one another.

The Land Assets are managed to achieve a real net return target of at least 3% over a long-term holding period (Land Assets Return Objective). The Land Assets Return Objective includes both income and appreciation, is net of all asset level expenses/fees, net of internal management costs (i.e. the cost of IDL management), net of all fees and costs of program management (such as legal and audit) and net of inflation as measured by the Consumer Price Index. While the Land Assets Return Objective includes both income and appreciation, the return is expected to be generated primarily from income.

Specific investment objectives and guidelines for each land category are summarized below. The Land Board shall review, periodically, its expectations for the land categories and assess how the updated expectations affect the probability that the Endowment will achieve the established investment objectives.

B. Key Elements of the Land Strategy

1. Active and Profitable Management

Land Assets are actively managed based on profitability, which means that some parcels will be managed more intensively than others. The portfolio is managed by the IDL and, except in unusual circumstances, no external managers are used. Active management includes the following primary activities:

- Maximizing net income while protecting and enhancing the long-term value and productivity of the Land Assets. IDL shall produce an annual income statement that allows for evaluation of income versus management and operating expenses by trust beneficiary/program/asset class as a way to evaluate returns and profitability.
- Acquire, through purchase or trade, land whose expected risk adjusted return meets or exceeds the return objectives outlined in this Policy and whose uses are aligned with IDL's management expertise.
- Dispose, through sale or trade, land whose expected long-term return does not meet the return objectives outlined in this Policy.
- Make incremental investments to enhance the value of existing assets when the expected risk adjusted return is favorable.

2. Leverage is Prohibited

Debt is not used in acquisition of Land Assets. All assets are unencumbered by debt.

3. Diversification

There is limited ability to diversify the Land Assets by geography land type, investment style, investment manager (the IDL is the sole manager), or vintage year, since most of the Land Assets were acquired at statehood. Diversification of income source shall be pursued by encouraging multiple bidders for timber sales. Because leases are awarded to the highest bidder there is no opportunity to actively diversify the tenant base in rangeland, commercial real estate, residential real estate, farmland, and other land types that are leased.

Timberland shall be managed to produce age class and species diversity across the timberland asset to maximize long-term returns. An individual timber stand may have trees of similar age, but other timber stands represent other age classes, ensuring a relatively even flow of forest products over time. An even flow of various forest products is considered a priority to maintain a vibrant and diverse customer base to maximize the sale prices of timber over time and resulting income distributions.

4. Illiquidity and Rebalancing

Land Assets represent a large part of the total Endowment portfolio and are illiquid compared to publicly traded equities. Strategic rebalancing to maintain the total Endowment portfolio within the desired asset allocation ranges will be actively pursued where possible through sales, exchanges, and acquisitions. However, constitutional and statutory requirements regarding land sales and exchanges limit the ability to rebalance the Land Asset portion of the portfolio.

C. Timberland

1. Definition

Timberland is defined as land capable of growing successive crops of commercial forest products for harvest.

2. Overall Financial Objective and Benchmark

The return on timberland comes from biological growth, upward product class movement, timber price appreciation and land price appreciation. The overall objective of timberland investments is to attain a real net income return of at least 3% over a long-term holding period. The net income return target is net of all asset level expenses/fees, net of internal management costs (i.e. the cost of IDL management), and net of all fees and costs of program management (such as legal and audit). Timberland (and real net income) is expected to appreciate over time at the rate of inflation, as measured by the Consumer Price Index. An appreciation target is not as relevant as the income return target, since timberland cannot be sold and the appreciation component cannot be realized.

3. Allowable Investments

Timberland in Idaho and investments in timberland improvements, including but not limited to planting seedlings, spraying, pre-commercial thinning, fertilization, and intermediate silvicultural treatments are allowed, as are investments in easements or other means of achieving cost-effective access to productive timberlands.

New investments shall be subject to a thorough due diligence process (by the IDL or a land advisor, consistent with the established governance structure) to determine if the expected financial return generated by income exceeds the minimum hurdle rate of 3.5% real net, whether the return profile is sufficient relative to the risk taken, to analyze the transaction in terms of long-term financial return and risk to the Endowment, whether the transaction would facilitate improved management, whether the transaction would improve the overall Endowment land ownership pattern in the area, and the existence of any potential risks, including but not limited to environmental or title-related issues. Parcels posing any significant risk, as described in the due diligence analysis, and those not meeting the minimum hurdle rate shall be avoided. The presence of minerals including sand and gravel can enhance the net return from timberland. Land Bank funds used for acquisition can only to be used on behalf of the endowment from which the funds originated. The minimum return requirement for new investments will be reviewed and updated as necessary based on the Strategic Re-Investment Plan.

New investments in timberland must be owned 100% by the Endowment. Joint ventures are not allowed.

4. Considerations

Idaho Code § 58-133 requires that all state owned lands classified as chiefly valuable for forestry, reforestation, recreation, and watershed protection be reserved from sale and set aside as state forests. Timberland can be exchanged, but only for other timberland.

IDL has an established public involvement process, approved by the Land Board, which requires annual timber sale plans be published and public comment opportunities be made available. Small sales (less than 1,000,000 board feet, less than $150,000 in value) and salvage sales are exempt from the policy.

5. Management

Timberland is directly managed by the IDL. Management shall comply with all applicable laws, such as the Idaho Forest Practices Act. Management objectives include:

- Manage the timberland asset prudently, efficiently, and with accountability to the beneficiaries.
- Reduce risk and increase prospects for sustainable annual income.
- Achieve a rate of return consistent with policy objectives.
- Produce forest products that meet market demands.
- Identify and acquire additional timberlands that maintain or enhance the value of the timberland asset class.
- Identify and dispose of or transition underperforming timberland assets to increase economic performance and improve land asset diversity.
- Achieve financial and forest health objectives identified in the Asset Management Plan, Forest Business Plan (and any related annual plans that are developed), and the Forest Asset Management Plan.

6. Valuation

The land expectation value (LEV) method (constant real annual cash flow/real annual discount rate) approach shall be used for the valuation of the timberland asset class. The timberland asset class shall be valued using the LEV method once a year by an independent expert for the purpose of calculating program returns, not for the purpose of acquisition or disposition of specific timberland parcels. MAI appraisals must be used for valuation of individual parcels in the event of an exchange or acquisition.

7. Monitoring Standards

The IDL will report cash flows for the timberland asset class to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation (based on LEV) and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. The most recent independent valuation will be adjusted for capital expenditures, sales, and acquisitions during the reporting period.

D. Rangeland

1. Definition

Rangeland is defined as lands supporting natural vegetation – generally grasses, forbs and small brush, suitable for grazing by domestic livestock and wildlife.

2. Overall Financial Objective and Benchmark

The overall objective of rangeland investments is to attain a real net return of 0.3% over a long-term holding period. The 0.3% real net rate of return includes primarily income and is net of all asset level expenses/fees, net of internal management costs (i.e. the cost of IDL management), net of all fees and costs of program management (such as legal and audit) and net of inflation as measured by the Consumer Price Index. Given its low expected return, rangeland is not an institutional asset class.

3. Allowable Investments

Selective investment in Idaho rangeland is allowed, subject to the desired asset allocation and the recommendations of the Callan Report. Additional investment may take the form of investments in rangeland improvements and easements or other means of access to improve productivity. Rangeland improvements refers to actions that improve the manageability and productivity of the asset including but not limited to fencing, weed control, access improvement, and water development.

New investments shall be subject to a thorough due diligence process (by the IDL or a land advisor, consistent with the established governance structure) to determine if the expected financial return generated by income exceeds the minimum hurdle rate of a 3.5% real net return, to analyze the transaction in terms of the long-term financial return and risk to the Endowment, whether the return profile is sufficient relative to the risk taken, whether the transaction would facilitate improved management, whether the transaction would improve the overall Endowment land ownership pattern in the area, and the existence of any potential risks, including but not limited to environmental or title related issues. Parcels posing any significant risk, as described in the due diligence analysis and those not meeting the minimum hurdle rate shall be avoided. Land Bank funds used for acquisition can only to be used on behalf of the Endowment from which the funds originated. The minimum return requirement for new investments will be reviewed and updated as necessary based on the Strategic Re-Investment Plan.

4. Considerations

Idaho Code § 58-138 requires that the written agreement of a lessee be obtained prior to entering into an exchange involving leased lands.

Rangeland may be sold or exchanged subject to the acreage limitations of a lifetime maximum of 320 acres may be sold to any one individual, company, or corporation. For rangeland, this limitation is a significant barrier to repositioning or reducing the size of the rangeland portfolio given the size of the rangeland portfolio at over 1.4 million acres. Any disposal of rangeland should consider its optionality for future conversion to a higher and better use, including reclassification and potential mineral extraction. Some endowments are restricted to a lifetime maximum 160 acres sold to any one individual, company, or corporation. Article IX of the Idaho Constitution describes the limitations on the sale of Endowment land.

5. Management

Rangeland is directly administered by the IDL. Livestock forage productivity and availability varies significantly across the state due to factors such as climate, vegetation types, topography and access to water. Some Endowment parcels are of sufficient size and productivity to stand alone as a grazing unit; however, most are managed in a manner consistent with adjoining federal and private lands because of normal livestock and grazing management practices. Some Rangeland parcels are leased in combination with forestland uses. The presence of minerals including sand and gravel can enhance the net return from rangeland. Management objectives for rangeland include:

- Manage the rangeland asset prudently, efficiently, and with accountability to the beneficiaries.

- Develop and manage long-term grazing leases that achieve a rate of return consistent with Policy objectives and market rates.
- Identify and dispose of or transition underperforming rangeland assets to increase economic performance and improve land asset diversity.
- Minimize contractual and environmental risks.
- Identify programmatic or statutory changes that maximize income.
- Achieve objectives identified in the Asset Management Plan and the Grazing Program Business Plan.

6. Valuation

The land expectation value (LEV) method (constant real annual cash flow/real annual discount rate) approach shall be used for the valuation of rangeland. Rangeland shall be valued using the LEV method once a year by an independent expert. MAI appraisals must be used for individual parcels in the event of an exchange or sale.

7. Monitoring Standards

The IDL will report cash flows for the rangeland asset class to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. The most recent independent value will be adjusted for capital expenditures, sales, and acquisitions during the reporting period.

E. Residential Real Estate (AKA "Cottage Sites")

1. Definition

Idaho has leased residential sites since 1932. These properties consist of vacant Endowment land and single-family homes where the lessee is authorized to construct and own cabins and single-family homes.

2. Overall Financial Objective and Benchmark

The overall objective of residential real estate investments is to attain, for each sale, net distributions to the Endowment that are at or above appraised value and cover all costs of the sale and internal management costs. Leases shall be at least 4% of the appraised value.

3. Allowable Investments

The Land Board and the IDL are implementing a disposition strategy for the residential portfolio subject to a long-term plan that was approved in December 2010, and subsequently revised in 2016. Future investment in cottage sites is not allowed with the exception that current land may be transitioned to cottage site lots and sold.

4. Considerations

While the Land Board has directed a disposition strategy for the residential portfolio, complete disposition is unlikely in the next five years. The viability of an ongoing lease program, with consideration of ongoing related expenses, shall be evaluated by the IDL and reviewed by the Land Board as the current disposal process is completed.

5. Management

Cottage sites are directly managed by the IDL. Management objectives include:

- Execute the approved Cottage Site Plan to unify the estate in a business savvy manner to maximize return to the trust beneficiaries.
- For the duration of the cottage site leasing program, develop and manage residential leases that appropriately compensate the endowments.
- Identify additional high value (undeveloped) residential sites for potential auction to maximize return to the trust beneficiaries.
- Identify and transition residential sites that may return more value to the trust if transitioned to a higher and better use.

6. Valuation

All properties will be appraised to establish lease rates and/or prior to sale. Until reappraisal, existing appraisal data will be utilized for valuation of the asset class.

7. Monitoring Standards

The IDL will report cash flows for the residential real estate asset class to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. The most recent independent value will be adjusted for capital expenditures, sales, and acquisitions during the reporting period.

F. Farmland

1. Definition

Farmland is defined as land under cultivation or capable of being cultivated. The agriculture asset includes lands used for cultivating grains, vegetables, and hay, as well as vineyards and orchards.

2. Overall Financial Objective and Benchmark

The overall objective of farmland investments is to attain a real net return of 4% over a long-term holding period. The rate of return includes both income and appreciation, is net of all asset level expenses/fees, net of internal management costs (i.e. the cost of IDL management), net of all fees and costs of program management (such as legal and audit) and net of inflation as measured by the Consumer Price Index. The farmland asset class net-of-fees performance shall be benchmarked against the NCREIF Farmland Index reconstituted to the farmland target weights for permanent and row crops established in the Program Business Plan.

3. Allowable Investments

Idaho farmland, investments in farmland improvements, such as irrigation or structures, and investments in easements or other means of access to productive farmlands are allowed.

New investments shall be subject to thorough due diligence process (by the IDL or a land advisor, consistent with the established governance structure) to determine if the expected financial return from income and appreciation exceeds the minimum hurdle rate of 4.5% real net, whether the return profile is sufficient relative to the risk taken, to analyze the transaction in terms of long-term financial return and risk to the Endowment, and the existence of any potential risks, including but not limited to environmental or title-related issues. Parcels posing any significant risk, as described in the due diligence analysis, and those not meeting the minimum hurdle rate shall be avoided. Land Bank funds used for acquisition can only to be used on behalf of the Endowment from which the funds originated. The minimum return requirement for new investments will be reviewed and updated as necessary based on the Strategic Re-Investment Plan.

Investments in farmland must be owned 100% by the Endowment. Joint ventures are not allowed.

4. Considerations

Farmland may be sold or exchanged subject to the acreage limitations of a lifetime maximum of 320 acres that may be sold to any one individual, company, or corporation. Some endowments are restricted to 160 acres to any one individual, company, or corporation.

5. Management

The asset class is directly managed by IDL through agriculture leases which may be cash, crop share, or flex with adjustment based on yield or price. Some agriculture parcels are leased in combination with grazing uses**.** Management objectives include:

- Achieve return consistent with policy objective.
- Identify and acquire additional agriculture lands.
- The portfolio will have a high focus on income and current cash yield through the management of existing properties and the acquisition of additional farmland. Cash lease structure will be preferred.
- Enroll Endowment lands in federal agricultural programs, when appropriate.
- Achieve objectives identified in Asset Management Plan for Endowment Assets (and any related plans that are developed) and the Farmland Program Business Plan.

6. Valuation

Properties will be valued internally by the IDL using NASS Farmland Data. This is appropriate because the farmland holdings represent approximately 0.7% ($22 million) of Endowment Assets. All properties shall be valued by an MAI appraiser prior to sale.

7. Monitoring Standards

IDL will report cash flows for the farmland asset class to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. The most recent independent value will be used adjusted for capital expenditures, sales, and acquisitions during the reporting period.

G. Idaho Commercial Real Estate

1. Definition

Idaho Commercial Real Estate is a discrete portfolio of office buildings, parking lots, self-storage, retail, and other properties located in Idaho.

2. Overall Financial Objective and Benchmark

The Idaho Commercial Real Estate portfolio will be prudently sold over time as recommended by the Commercial Real Estate Advisor and approved by the Land Board in February 2016. The performance objective will be to execute the adopted sales plan. Certain properties may be retained by the Land Board for strategic purposes.

3. Allowable Investments

Effective December 2014, no new Idaho Commercial Real Estate Investments may be made. There may be expenditures to maintain or re-position existing properties in preparation for sale. Leasing of existing endowment lands for commercial and industrial purposes will continue.

4. Management

The portfolio is overseen by the IDL and managed primarily through outside agents, including hiring and oversight of property managers and leasing agents, approving leases and budgets, approving capital expenditures and executing capital plans. In February 2016, the Land Board approved the selection of a Commercial Real Estate Advisor to manage the sales process and ready the properties for sale pursuant to the recommendations included in the business plans developed by the Commercial Real Estate Advisor. Agents may be hired to implement the sales auction process.

5. Valuation

All properties will be valued by appraisal prior to sale. In the interim, the value established by the Commercial Real Estate Advisor will be used for performance measurement purposes.

6. Monitoring Standards

IDL will report cash flows for the commercial real estate asset class to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. Property will be valued using a combination of MAI appraised values and values established by the Commercial Real Estate Advisor. The most recent independent value will be adjusted for capital expenditures, sales, and acquisitions during the reporting period.

H. Minerals/Oil & Gas

1. Definition

Mineral resources are concentrations of materials that are of economic interest in or on the crust of the Earth. Oil and gas reserves and resources are defined as volumes that will be commercially recovered in the future.

2. Overall Financial Objective and Benchmark

The asset class will be managed prudently to maximize financial return while complying with all applicable laws and regulations. Royalty payments are transferred to the Permanent Fund while other payments, such as lease or bonus payments, go to the Earnings Reserve Fund.

3. Allowable Investments

Acquisition of mineral rights together with, or independent of, surface rights is allowed. Acquisition of mineral rights together with surface rights is preferred to avoid a split estate. Acquisition of mineral rights is expected to occur primarily through land exchanges.

4. Management

The asset class is directly managed by IDL and management shall comply with all applicable federal and state statutes, such as the Federal Clean Water Act, the Idaho Surface Mining Act, Oil and Gas Conservation Act, and the Idaho Dredge and Placer Mining Protection Act. Management Objectives include:

- Manage the mineral asset prudently, efficiently, and with accountability to the beneficiaries.
- Minimize contractual and environmental risks associated with extractive industries.
- Lease lands for potential mineral products that capitalize on market demands.
- Retain mineral rights when land parcels are disposed.
- Identify programmatic or statutory changes that maximize income from mineral assets.

5. Valuation

There is no known, effective way of accurately valuing the Endowment's mineral assets.

6. Monitoring Standards

IDL will report cash flows for the minerals asset class to the General Consultant to be used for performance reporting purposes. All net income calculations will be net of all fees and expenses of managing the asset class. Because receipts from minerals extracted flow directly to the Permanent Fund they are not included in IDL's report of return on assets. The receipts are reported in IDL's annual report.

I. Transition of Lands

1. Definition

Lands within traditional asset classes, already owned by the Endowment, may become suitable for a higher and better use than the current asset classification. Often these properties exhibit high property values and low annual revenues (underperforming), and may be encroached upon by urban development. The major sources used to identify lands suitable for transition may include:

- Appraised values above the value normally indicative of the current use.
- Regional land use planning studies.
- Resource trends and demographic changes.

2. Overall Financial Objective and Benchmark

The objective for lands identified as transition candidates will be to lease the parcels, typically for commercial and/or industrial uses, or sell the parcels. Evaluation of the options for lease or sale will be completed on a case-by-case basis.

3. Allowable Investments

Lands possibly suited for transition are lands that the endowments already own. Lands will not be acquired where the primary reason for acquisition is because the land is suitable for transition. New development will not be undertaken by IDL on parcels suitable for transition. In select cases, improvements such as obtaining zoning and other entitlements may be pursued to maximize value and ready the parcel for the next owner.

Investment in improvements shall be subject to a thorough due diligence process (by the IDL or a land advisor, consistent with the established governance structure) to analyze the transaction in terms of long-term financial return and risk to the Endowment, whether the return profile is sufficient relative to the risk taken, whether the transaction would facilitate improved management, and the existence of any potential risks, including but not limited to environmental or title-related issues. Investments in improvements posing any significant risk, as described in the due diligence analysis, shall be avoided.

4. Management

Management activities will focus first on potential transition land at the high end of market values (best markets), and then on land possessing best market potential within the next five-to-ten years (emerging markets). Transition plans will identify land holdings in the best markets and identify emerging markets and, to the extent practical, parcels held in these markets. Land holdings in the best markets will also include a plan for achieving value potential. Timely disposition of parcels suitable for transition will be a management objective to increase asset value and, where the parcels are not income producing, reduce their "drag" on performance.

Underperforming assets may also present transition opportunities. IDL will identify and analyze such lands to determine the best solution to resolving the underperformance. Such analysis will consider:

- Whether management costs can be minimized;
- Whether the lands can be managed differently to increase performance;
- Whether the parcel has the potential for a higher and better use; and
- Who is the best long-term owner of the asset.

5. Valuation

Properties suitable for transition will continue to be valued with the traditional asset class to which they belong. Properties will be valued by appraisal prior to sale.

6. Monitoring Standards

IDL will report cash flows for the lands suitable for transition, together with the asset class in which the lands currently exist, to the General Consultant to be used for performance reporting purposes. For example, lands with potential for transition that are currently classified as rangeland will be monitored and reported together with rangeland. The reporting will follow institutional reporting standards and conventions. Income, appreciation and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. The most recent independent value will be used adjusted for capital expenditures, sales, and acquisitions during the reporting period.

J. Land Bank

1. Definition

The Land Bank Fund (Land Bank) exists to hold the proceeds from the sale of state endowment land pending the purchase of other land or to transfer to the Financial Assets for the benefit of the endowment beneficiaries, per Idaho Code § 58-133 .

2. Overall Financial Objective and Benchmark

The Land Board does not control the investment of the Land Bank as it is invested by the State Treasurer; the financial objective or benchmark is established by the Treasurer.

3. Considerations

Funds deposited in the Land Bank, including interest, are continually appropriated to the Land Board. If the funds have not been utilized for land acquisition within five years, they are transferred to the Permanent Endowment Fund of the appropriate endowment, unless the five-year time limit is extended by the legislature. Uninvested funds generally represent a performance drag on the Endowment.

Land Bank funds may be used to acquire lands within traditional asset classes. Land Bank funds may also be used to secure access to Endowment lands through purchase of easements or parcels of land. When purchasing a parcel of land in order to obtain access, the acquired parcel may, in some cases, produce minimal financial return. An easement may represent an expense without any resulting income directly related to the acquisition. In those cases, the evaluation of the acquisition and the projected returns would consider the additional net income that can be attributed to the access secured, rather than the financial return of only the access parcel.

4. Allowable Investments

The Land Bank funds are invested by the State Treasurer in the IDLE pool. IDLE funds are invested according to the IDLE Investment Policy.

5. Management

The IDL, in its capacity as the administrative arm of the Land Board, manages deposits to and withdrawals from the Land Bank. Fees for investment management are deducted by the Treasurer.

6. Valuation

The Land Bank is valued by the State Treasurer.

7. Monitoring Standards

IDL will report balances and cash flows for the Land Bank to the General Consultant to be used for performance reporting purposes. The reporting will follow institutional reporting standards and conventions. Income, appreciation, and total return shall be calculated by the General Consultant. All return calculations will be net of all fees and expenses of managing the asset class. Transaction history will be used to account for expenditures and deposits into the Land Bank. For purposes of transparency, the balance in the Land Bank shall be reported as a contingent asset in the notes to the financial statements of the Financial Assets.

VIII. Distribution Policy

A. Objectives

The ultimate purpose of Idaho's land grant endowments is to provide a perpetual stream of income to the beneficiaries. To guide the determination of future distributions for Idaho endowments, the following objectives, in priority order are established by the Land Board:

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

B. Considerations

In determining distributions, the Land Board, with assistance from the EFIB, considers the following for each endowment:

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

C. Policy Description

Based on the above objectives and considerations and the expected returns of the entire portfolio (lands and funds), the Land Board establishes the following Distribution Policy:

- Distributions are determined individually for each endowment (currently 5% for all endowments except State Hospital South which is 7%).
- Distributions are calculated as a percent of the three-year rolling average permanent fund balance for the most recently completed three fiscal years. The Land Board may adjust this amount, depending on the amount in the Earnings Reserve, transfers to the Permanent Fund, and other factors.
- The levels of Earnings Reserves deemed adequate for future distributions are:
    - 5 years – Public School, Charitable and State Hospital South
    - 6 years – Normal School
    - 7 years – Agricultural College, Penitentiary, School of Science and University

- The Land Board may transfer any balance in an Earnings Reserve Fund in excess of an adequate level to the corresponding Permanent Fund and designate whether the transfer will or will not increase the Gain Benchmark.
- The principal of the Permanent Endowment Funds, adjusted for inflation, will never be distributed, to protect the future purchasing power of the beneficiaries.

The Distribution Policy was developed based on many analyses, assumptions and constraints and its administration requires many interpretations of nuances. The EFIB has documented most of these in the Distribution Principles included in the Appendix. The principles are used by the EFIB as a basis for making its recommendations to the Land Board, but not all have been reviewed and approved by the Land Board.

IX. Monitoring and Reporting

A. Philosophy

The Land Board and its agents shall use a variety of compliance, verification, and performance measurement tools to monitor, measure, and evaluate how well the Endowment Assets are being managed. Monitoring, reporting, and evaluation frequencies shall range from live real time performance to daily, weekly, monthly, quarterly, semi-annual, and annualized performance.

The Land Board seeks to answer three fundamental fiduciary questions through the performance monitoring and reporting system:

- Are the assets being prudently managed? More specifically, are assets being managed in accordance with established laws, policies, and procedures, and are the IDL and the EFIB (and by extension the EFIB investment managers) in compliance with established policies and their mandates.
- How have the assets performed relative to Land Board approved investment objectives?
- Are the assets being profitably managed? More specifically, has performance affected distributions positively and advanced security of the corpus?

B. Deviation from Policies

If there is a deviation from Land Board investment policies, the IDL and EFIB staff are required to provide the Land Board with a report explaining how the deviation was discovered, the reasons for the deviation, and the impact on Endowment performance, if any, and steps taken to mitigate future circumstances.

C. Financial Assets

1. Reporting at EFIB Level[4]

The EFIB Investment Policy requires that performance reports generated by the investment consultant shall be compiled at least quarterly and communicated to EFIB Staff and the EFIB Board. The investment performance of the total Financial Assets, as well as asset class components, will be measured against commonly accepted performance benchmarks as outlined in the EFIB Investment Policy. Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals, and guidelines as set forth in this statement.

Investment managers shall be reviewed regularly, by EFIB staff and the general fund consultant, regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

2. EFIB Reporting to the Land Board

Each month, EFIB staff will provide the Land Board with:

- Investment performance, both absolute and relative to benchmark.
- An evaluation of the sufficiency of Earnings Reserve balances (measured by coverage ratio: reserve balance divided by the distribution).
- A summary of any significant actions by the EFIB.
- Any compliance/legal issues, areas of concern, or upcoming events.

Partway through the fiscal year, typically at the May meeting, the EFIB shall provide the Land Board with a brief financial summary of fiscal year-to-date activity.

After the end of the fiscal year, typically at the November meeting, the EFIB shall provide the Land Board with:

- A financial summary for the recently completed fiscal year.
- The report of the Land Board Audit Committee regarding control deficiencies identified by the independent auditor.
- An update on the EFIB's Strategic Plan.
- Investment performance for the Fund versus strategic (longer-term) measures.
- A report on EFIB meetings; including number of meetings and attendance.

D. Land Assets

1. IDL Internal Processes

IDL staff shall report to the Director using the standard reports, as described below,that are provided to the Land Board. All of the information is reviewed by the Director prior to submission to the Land Board.

[4] EFIB Investment Policy (see Appendix C). Management and approval of this policy is a duty delegated to the EFIB.

Each program administered by the IDL is managed by a bureau chief and a program manager. Policies and procedures governing daily activities are in place at the bureau and/or program level but are generally implemented by operations staff.

Decisions related to routine investment and management decisions are typically made at the area office level (and/or program level) with review by both the operations chiefs and bureau chiefs, subject to the established governance structure.

In the case of more complex investment and management decisions, staff involvement typically includes area office staff, operations chiefs, bureau chiefs, and executive staff to assure adequate due diligence and independent review. More than one member of the executive staff is likely to be involved in the analysis of the information and the final decision. Where necessary, the Director retains final decision-making authority as delegated by the Land Board and described in the established governance structure.

2. IDL Reporting to the Land Board

Each month, IDL reports the following:

- Interest rate on department transactions.
- Timber sale activity and information.
- Division of Lands and Waterways activity and information.
- Updates for ongoing special projects as needed.
- Legal and compliance issues and their status.
- Information necessary for Land Board review and approval of specific items.

As previously described, the IDL functions under the authority of the Land Board, with the Land Board having final approval of many of IDL policies, management decisions, up to and including review and approval of the IDL budget request prior to submission.

Each month, the IDL brings matters forward for Land Board review and approval. Items are discussed first with senior Land Board staff members, and then either placed on the consent agenda, where routine items may be approved without discussion, or the regular agenda, which addresses policy and programmatic items that the Land Board may wish to discuss prior to making a decision.

Certain confidential matters may be presented for the Land Board in executive session at the discretion of the Land Board, pursuant to Idaho Code § 74-206.

The IDL also produces an annual report to the Land Board, the State Affairs Committees of the Legislature, as well as the public. IDL's overall strategic plan is updated annually and presented to the Land Board prior to submission to the Division of Financial Management.

The Land Board requires IDL staff to prepare and deliver a business unit Strategic Plan every five years, an Asset Management Plan periodically, and Business Plans for each land type that explain how the Land

Assets will be managed to achieve the Land Board approved investment objectives. This provides the Land Board a focused opportunity to:

- Question and comment on IDL staff's investment and management plans.
- Request additional information and support about IDL staff's investment and management intentions.
- Express its confidence and approval in the Strategic Plan, Asset Management Plan, and Business Plans.

The Land Board requires certain IDL procedures to be audited every 3-5 years:

- Other Land Transactions >$1,000,000 shall be subject to a post-audit every three (3) years, and the Land Board's Land Investment Advisor shall review such post-audit and provide a report to the Land Board.

E. Total Endowment

Performance reports generated by the General Consultant shall be compiled semi-annually for review by the Land Board. The investment performance of the Endowment as well as asset class components, will be measured against performance benchmarks outlined in this Statement of Investment Policy and the EFIB Investment Policy.

X. Key Documents

To assist the Land Board, EFIB Staff, and IDL Staff, the following key documents will be produced or reviewed according to the schedule in Exhibit 2.

Exhibit 2: Key Documents

Document Name	Document Source	Review Schedule
Performance Review of Fund	Callan and EFIB Staff	Quarterly and monthly
Performance Review Total Endowment	Callan, IDL Staff, and EFIB Staff	Semi-annually
Statement of Investment Policy	Callan, EFIB Staff and IDL Reviewed by Investment Subcommittee	Annually
IDL Program Business Plans	IDL Staff	1-5 Years as specified in each plan
IDL Asset Management Plan	IDL Staff	Every 5 Years
Strategic Re-Investment Plan	Callan Reviewed by Investment Subcommittee	Annually
IDL Strategic Plan	IDL Staff	Annually
Asset Allocation	General Consultant	Every 8 years
Monthly Timber Sale Activity Report	IDL Staff	Monthly
Annual Timber Sale Plan	IDL Staff	Annually
Ten Year Forecast of Land Income	IDL Staff	July and December
IDL Annual Budget	IDL Staff	Annually
EFIB Strategic Plan	EFIB Staff	Annually
EFIB Meeting Report	EFIB Staff	Annually
Audit Committee Report	Audit Committee	Annually

XI. Appendices

A. **Structure of the Endowment**

B. **Constitution and State Statutes**

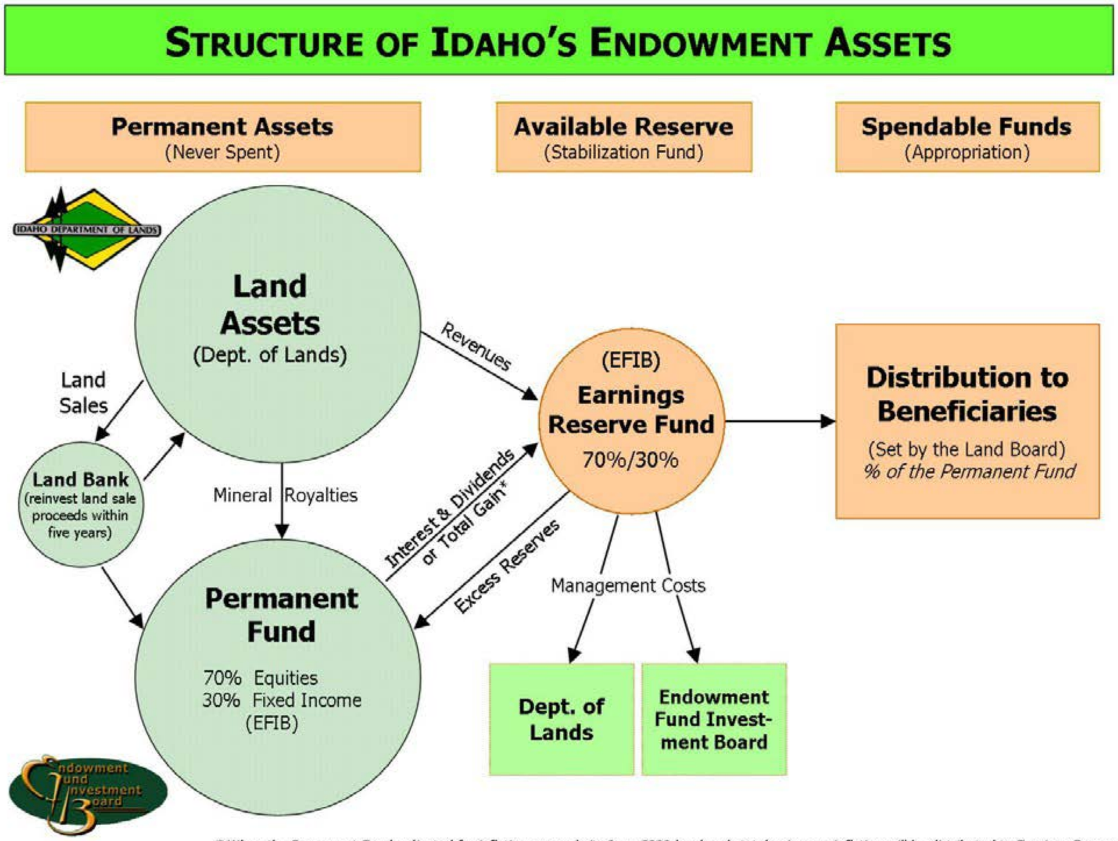
C. **EFIB Investment Policy**

D. **Decision-Making Structure Chart**

E. **Use of External Advisors**

F. **EFIB's Distribution Principles**

APPENDIX A



* When the Permanent Fund, adjusted for inflation, exceeds its June 2000 level, only total gain over inflation will be distributed to Earnings Reserve.

Appendix B

CONSTITUTION OF THE STATE OF IDAHO

ARTICLE IX EDUCATION AND SCHOOL LANDS

SECTION 3 PUBLIC SCHOOL ENDOWMENT FUND TO REMAIN INTACT.

SECTION 4 PUBLIC SCHOOL PERMANENT ENDOWMENT FUND DEFINED

SECTION 7 STATE BOARD OF LAND COMMISSIONERS.

SECTION 8 LOCATION AND DISPOSITION OF PUBLIC LANDS.

SECTION 10 STATE UNIVERSITY -- LOCATION, REGENTS, TUITION, FEES AND LANDS.

SECTION 11 INVESTING PERMANENT ENDOWMENT FUNDS.

IDAHO STATUTES

TITLE 57 PUBLIC FUNDS IN GENERAL

CHAPTER 7 INVESTMENT OF PERMANENT ENDOWMENT AND EARNINGS RESERVE FUNDS

TITLE 58 PUBLIC LANDS

CHAPTER 1 DEPARTMENT OF LANDSCHAPTER

CHAPTER 2 INDEMNITY LIEU LAND SELECTIONS

CHAPTER 3 APPRAISEMENT, LEASE, AND SALE OF LANDS

CHAPTER 4 SALE OF TIMBER ON STATE LANDS

CHAPTER 5 STATE PARKS AND STATE FORESTS

CHAPTER 6 RIGHTS OF WAY OVER STATE LANDS

CHAPTER 12 PUBLIC TRUST DOCTRINE

CHAPTER 13 NAVIGATIONAL ENCROACHMENTS

APPENDIX C
ENDOWMENT FUND INVESTMENT BOARD
Investment Policy

Date Established: **2000**
Last Reviewed: **February 2015**
Last Revised: **February 2016**

Background and Purpose

Statement of Philosophy
This statement of investment policy is set forth by the EFIB to:
- Define and assign the responsibilities of all involved parties;
- Establish a clear understanding for all involved parties of the investment goals and objectives of Fund assets;
- Offer guidance and limitations to all involved parties regarding the investment of Fund assets;
- Establish a basis for evaluating investment results;
- Manage Fund assets according to prudent standards as established in common trust law; and,
- Establish the relevant investment horizon for which the Fund assets will be managed.

Investment Objectives
In order to meet its needs, the investment strategy of the EFIB is to emphasize total return; that is, the aggregate return from capital appreciation, dividend and interest income. The primary objectives in the investment management for Endowment Fund assets shall be:

- *To maintain the purchasing power of the Fund* – In order to maintain fair and equitable inter-generational funding, state statute has mandated that the real value of the corpus be protected from inflation;
- *To maximize total return over time at an acceptable level of risk;*
- *To provide relatively smooth and predictable distributions to the beneficiaries*

General Investment Principles

- Investments shall be made solely in the interest of and for the beneficiaries of the Funds;
- The Funds shall be invested with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent expert acting in like capacity and familiar with such matters would use in the investment of a fund of like character and with like aims;

- Investment of the Funds shall be diversified as to minimize the risk of large permanent losses, unless under the circumstances it is clearly prudent not to do so;
- The EFIB will employ one or more investment managers of varying styles and philosophies to attain the Funds' objectives;
- Cash is to be employed productively at all times, by investment in short-term cash equivalents to provide safety, liquidity, and return; and,
- The investment manager(s) should, at all times, be guided by the principles of "best price and execution" and that the Funds' best interests are the primary consideration.

Delegation of Authority

The Manager of Investments ("MOI") is a fiduciary to the EFIB. The MOI is responsible for directing and monitoring the investment management of Funds' assets. As such, the MOI is authorized to delegate certain responsibilities to professional experts in various fields. These include, but are not limited to:

- *Investment Consultant*. The consultant will assist MOI and the EFIB in: 1) establishing investment policy; 2) designing objectives and guidelines; 3) selecting investment managers; 4) reviewing such managers over time; 5) measuring and evaluating investment performance; and, 6) other tasks as deemed appropriate. It is expected that the consultant will serve as a fiduciary with respect to the services it provides and will have the proper insurance to cover exposure to risk.
- *Investment Manager*. An investment manager hired by the EFIB must be registered with the Securities and Exchange Commission under the Investment Act of 1940, unless inapplicable, or in the case of a banking organization with the Office of the Comptroller of the Currency. The investment manager has discretion to purchase, sell, or hold the specific securities that will be used to meet the Funds' investment objectives. This includes mutual fund or any collective fund portfolio managers.
- *Custodian*. Any custodian will maintain possession of securities owned by the Fund, collect dividend and interest payments, and redeem maturing securities, and effect receipt and delivery following purchases and sales. Any custodian will also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the Fund accounts. Any custodian will provide at a minimum monthly reporting of assets and transactions to the MOI and provide the MOI with any additional data requests.
- Additional specialists may be employed by the MOI to assist in meeting its responsibilities and obligations to administer Fund assets prudently.

The MOI will not reserve any control over investment decisions, with the exception of specific limitations described in these statements. Managers will be held responsible and accountable to achieve the objectives outlined in their specific guidelines. While it is not believed that the limitations will hamper investment manager decisions, each manager should request in writing any modifications that they deem appropriate.

Any deemed fiduciaries must acknowledge such in writing. All expenses for such experts must be customary and reasonable, and will be borne by the Funds as deemed appropriate and necessary.

Assignment of Responsibility
Responsibility of the MOI
The MOI is empowered by the Board to make certain decisions and take appropriate action regarding investment of the Funds' assets. The responsibilities of the MOI include:

- Developing sound and consistent investment policy guidelines;
- Establishing reasonable investment objectives;
- Selecting qualified investment managers after consultation with the EFIB executive committee;
- Communicating the investment policy guidelines and objectives to the investment managers;
- Monitoring and evaluating performance results to assure that the policy guidelines are being met;
- Selecting and appointing custodian(s);
- Discharging investment managers after consultation with the EFIB executive committee; and,
- Taking any other appropriate actions.

Responsibility of the Investment Consultant(s)
The investment consultant's role is that of a non-discretionary advisor to the EFIB. The consultant will offer investment advice concerning the investment management of the Funds' assets. The investment consultant will act as a fiduciary with respect to the services it provides. The advice will be consistent with the investment objectives, policies, guidelines and constraints as established in this statement. Specific responsibilities of the investment consultant include:

- Assisting in the development and on-going review of the investment policy, asset allocation strategy and performance of the investment managers;
- Supporting portfolio optimization and other investment techniques to maximize return/risk characteristics of the Funds;
- Conducting investment manager searches when requested by the MOI;
- Monitoring the performance of the investment manager(s) to provide both the MOI and the Board with the ability to determine the progress toward the investment objectives;
- Communicating matters of policy, manager research, and manager performance to the MOI and the Board;

- Reviewing the Funds' investment history, historical capital markets performance and the contents of this investment policy statement with any newly appointed members of the Board.

Responsibility of the Investment Manager(s)

As a signed fiduciary, each investment manager will have full discretion to make all investment decisions for the assets placed under its jurisdiction, while observing and operating within all policies, guidelines, constraints, and philosophies as outlined in this statement and in their specific Manager Guidelines.

Marketability of Assets

Based on the Fund's long-term liquidity requirement, the EFIB has determined that all securities purchased for the Endowment Fund shall have readily ascertainable market values and shall be easily marketable.

Investment Guidelines

Allowable Assets

Cash Equivalents:	Treasury bills; money market funds; STIF funds; commercial paper; banker's acceptances; repurchase agreements; certificates of deposit.
Fixed Income:	US government and agency securities; corporate notes and bonds; mortgage backed bonds; fixed income securities of foreign governments and corporations; planned amortization class collateralized mortgage obligations; or other "early tranche" CMO's; asset backed securities; or any other fixed income security eligible for inclusion in the Barclays U.S. TIPS Index or Barclays Capital Aggregate Bond Index.
Equities:	Common stocks; convertible notes and bonds; convertible preferred stocks; preferred stocks; American depository receipts (ADR's); stocks of non-US companies (ordinary shares); non-investment grade bonds.
ETF's, Mutual or Collective Funds:	ETF's, Mutual Funds, Collective Funds may be used for the purposes of equitizing transactional cash. ETF's, Mutual Funds, Collective Funds which invest in securities as allowed in this statement are also permitted.
Futures and Options:	As described in Futures and Options" section below.

Futures and Options
The EFIB may approve the use of financial index futures and options in order to adjust the overall effective asset allocation of the entire portfolio and for use as hedges. For example, covered call options may be used to mitigate an expected decline in securities prices. However, futures and options positions are not to be used for speculation, and the EFIB must specifically approve the program for each type of use. No long or short futures or option positions may be established, unless the portfolio has sufficient cash reserves to either fund purchase or deliver securities under the contract.

Derivative Investments
Derivative securities are defined as synthetic securities whose price and cash flow characteristics are based on the cash flows and price movements of other underlying securities. Most derivative securities are derived from equity or fixed income securities and are packaged in the form of options, futures, CMOs (PAC bonds, IOs, POs, residual bonds, etc.), and interest rate swaps, among others. The EFIB will take a conservative posture on derivative securities in order to maintain its risk adverse nature. Since it is anticipated that new derivative products will be created each year, it is not the intention of this document to list specific derivatives that are prohibited from investment, rather it will form a general policy on derivatives. Unless a specific type of derivative security is allowed in the Investment Manager Guidelines, the Investment Manager(s) must seek written permission from the EFIB to include derivative investments in the Fund's portfolio. The Investment Manager(s) must present detailed written information as to the expected return and risk characteristics of such investment vehicles.

Prohibited Assets
Prohibited investments include, but are not limited to the following:

- Commodities and Futures Contracts except as described in previous section "Futures and Options";
- Naked Options;
- Interest-Only (IO), Principal-Only (PO), and Residual Tranche CMOs; and
- Purchases of securities on margin and short-sale transactions are prohibited.

Asset Allocation Guidelines
Investment management of the assets of the Endowment Fund shall be in accordance with the following asset allocation guidelines:

- Aggregate Fund Asset Allocation Guidelines (at market value)

Asset Class	Range	Target	Rebalance Point	Benchmark
Equities Domestic Equities	63%-69% 37%-47%	66.00% 42.25%	+-3% +-5%	MSCI All Country World Index Russell 3000 Index
Large Cap Growth Core Value	24%-34% 7%-11% 7%-11% 7%-11%	29.00% 9.65% 9.70% 9.65%	+/-5%	Russell 1000 Index Russell 1000 Growth Index S&P 500 Index Russell 1000 Value Index
Mid Cap Growth Value	4%-12% 2%-6% 2%-6%	8.48% 4.24% 4.24%	+/-4%	Russell Mid Cap Index Russell Mid Cap Growth Russell Mid Cap Value
Small Cap Growth Value	3%-7% 1.5%-3.5% 1.5%-3.5%	4.70% 2.35% 2.35%	+/-2%	Russell 2000 Index Russell 2000 Growth Index Russell 2000 Value Index
International Equities Developed Growth Developed Value Emerging Markets	11%-19% 5%-8% 5%-8% 1%-3%	15.20% 6.60% 6.60% 2.00%	+/-4%	MSCI ACWI EX US (ND) Index MSCI EAFE Growth (ND) Index MSCI EAFE Value (ND) Index MSCI Emerging Markets Index
Global Equity	5%-13%	8.55%	+/-4%	MSCI All Country World Index
Real Estate	5%-12%	8.0%	+/-4%	NCREIF ODCE Index
Fixed Income Aggregate Bond US Tips	23%-29% 20%-24% 3%-5%	26.00% 22.1% 3.9%	+/-3%	Barclays Aggregate Bond Index Barclays Aggregate Bond Index Barclays US TIPS Index
Cash and Equivalents	0-5%	0%		3-month Treasury Bill Index

- The EFIB may employ investment managers whose investment disciplines require investment outside the established asset allocation guidelines. However, taken as a component of the aggregate Fund, such disciplines must fit within the overall asset allocation guidelines established in this statement. Such investment managers will receive written direction from the EFIB regarding specific objectives and guidelines.

- In the event that the above aggregate asset allocation guidelines are violated, for reasons including but not limited to market price fluctuations, the MOI will instruct the investment manager(s) to bring the portfolio(s) into compliance with these guidelines as promptly and prudently as possible. In the event that any individual investment manager's portfolio is in violation with its specific guidelines, for reasons including but not limited to market price fluctuations, the EFIB expects that the investment manager will bring the portfolio into compliance with these guidelines as promptly and prudently as possible without instruction from the Board's Investment Committee.

Rebalancing of Fund Assets

Understanding that different asset classes will perform at different rates, the MOI and the investment consultant will closely monitor the asset allocation shifts caused by performance. Therefore:

- The MOI will review the relative market values of the asset classes whenever there is to be a net contribution to the Fund and will generally place the new monies under investment in the category(ies) which are furthest below the target allocation in this policy; and,

- The MOI and investment consultant will review the asset allocation quarterly and during periods of severe market change to assure that the target allocation is maintained. If an asset class is outside the allowable range, the MOI, with input from the investment consultant, will take appropriate action to redeploy assets taking into account timing, costs and other investment factors.

Guidelines for Fixed Income Investments and Cash Equivalents

- Securities must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine rating.
- Fund assets may be invested only in commercial paper rated A1 (or equivalent) or better.
- The fixed income weighted average portfolio maturity may not exceed that of the BC Aggregate Index by more than .5 years.
- Money Market Funds selected shall contain securities whose credit rating at the absolute minimum would be rated investment grade by Standard and Poor's, and/or Moody's.

Investment Performance Review and Evaluation

Performance reports generated by the investment consultant shall be compiled at least quarterly and communicated to the EFIB for review. The investment performance of the total Fund, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals, and guidelines as set forth in this statement. The EFIB intends to evaluate the manager over at least a three-year period, but reserves the right to terminate a manager for any reason.

Each manager shall maintain a portfolio consistent with characteristics similar to those of the composite utilized for their retention. Investment performance will be measured on a total return basis, which is defined as dividend and interest income plus realized and unrealized capital gains. Each manager will be evaluated in part by regular comparison to a peer group of other managers employing statistically similar investment style characteristics. It is expected that each manager will perform above the peer group median and the appropriate index over rolling three-year periods with respect to both return and risk.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

Investment Policy Review

To assure continued relevance of the guidelines, objectives, financial status and capital market expectations as established in this statement of investment policy, the EFIB will review the policy annually.

GASB 40 Reporting Requirements

Purpose: The Governmental Accounting Standards Board has identified that state and local governments have deposits and investments which are exposed to risks that may result in losses. GASB Statement number 40 (GASB 40) is intended to inform users of the financial statements about the risks that could affect the ability of a government entity to meet its obligations. GASB 40 has identified general deposit and investment risks as credit risk, including concentration of credit risk and custodial credit risk, interest rate risk, and foreign currency risk and requires disclosures of these risks and of policies related to these risks. This portion of the Investment Policy addresses the monitoring and reporting of those risks.

In general, the risks identified in GASB 40, while present, are diminished when the entire portfolio is viewed as a whole. Specifically, the risks identified and the measurements required is poorly transferable, if at all, to portfolios like the EFIB, which is dominated by equity exposure.

It is the policy of the EFIB that the risks addressed in GASB 40 are to be monitored and addressed primarily through the guidelines agreed to by those managers, and by regular disclosures in reports by managers of levels of risks that may exceed expected limits for those portfolios.

- Credit Risk: The risk that an issuer or other counterparty to an investment will not fulfill its obligations to the EFIB. GASB 40 requires disclosure of credit quality ratings of investments in debt securities as described by nationally recognized statistical rating organizations.

  Policy: The Investment Guidelines section of this Investment Policy provides credit quality and maturity guidelines for fixed income and cash equivalent investments. Managers are required to comply with the Investment Policies set forth by the EFIB.

- Custodial Credit Risk: The risk that in the event of a financial institution or bank failure, the Fund would not be able to recover the value of their deposits and investments that are in the possession of an outside party.

  Policy: The EFIB minimizes exposure to custodial credit risk by requiring that investments, to the extent possible, be clearly marked as to the EFIB ownership and further to the extent possible, be held in the Fund' name.

- Concentration of Credit Risk: The risk of loss that may be attributed to the magnitude of a government's investment in a single issue.

  Policy: Managers will provide the EFIB with expected concentration of credit risk exposures in their portfolio guidelines. If the concentration of credit risk exceeds expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board. For the portfolio as a whole, staff will report to the Board at a regular Board meeting if the exposure to a non-US government guaranteed credit exceeds 5% of the total EFIB portfolio.

- Interest Rate Risk: The risk that changes interest rates will adversely affect the fair value of an investment. Interest rate risk to the EFIB's fixed income portfolio is monitored using the effective duration methodology. Effective duration measures the volatility of the price of a bond given a change in interest rates, taking into account the optional underlying bond.

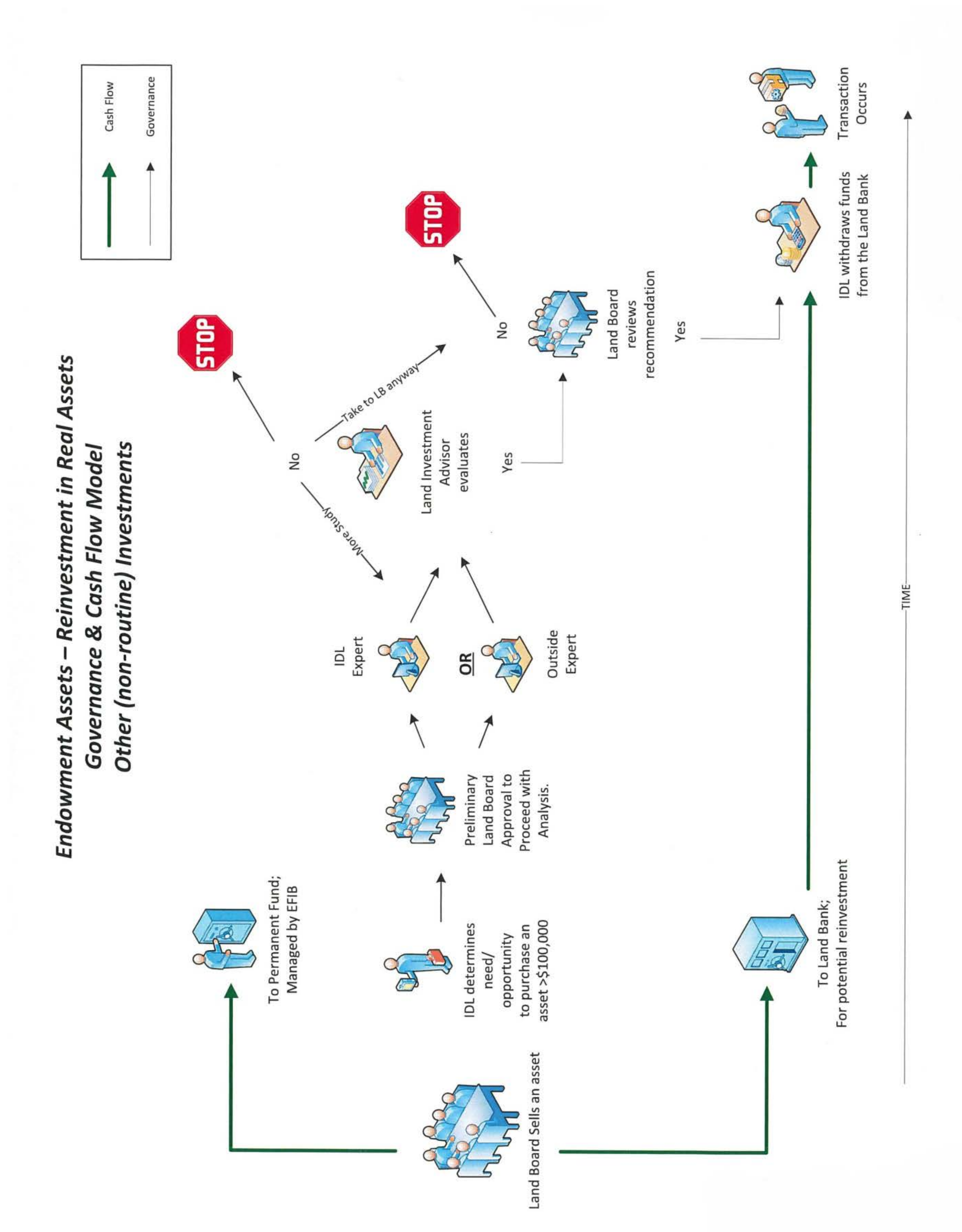
  Policy: Managers will provide the EFIB with the expected portfolio duration in their portfolio guidelines. If the duration of the portfolio differs from expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board.

- Foreign Currency Risk: The risk that changes exchange rates will adversely impact the fair value of an investment. The EFIB's currency risk exposures, or exchange rate risk, primarily reside within the international equity investment holdings.

  Policy: The EFIB permits investing up to 20% of total investments in international equities. No foreign fixed income securities are permitted except currency. The EFIB recognizes that international investments (equity or fixed income) will have a component of currency risk associated with it. The individual manager guidelines will outline the expected currency exposures (either specifically or through ranges of security exposures to particular currency areas) of the underlying portfolio and if the actual currency exposure differs from the expected, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board.

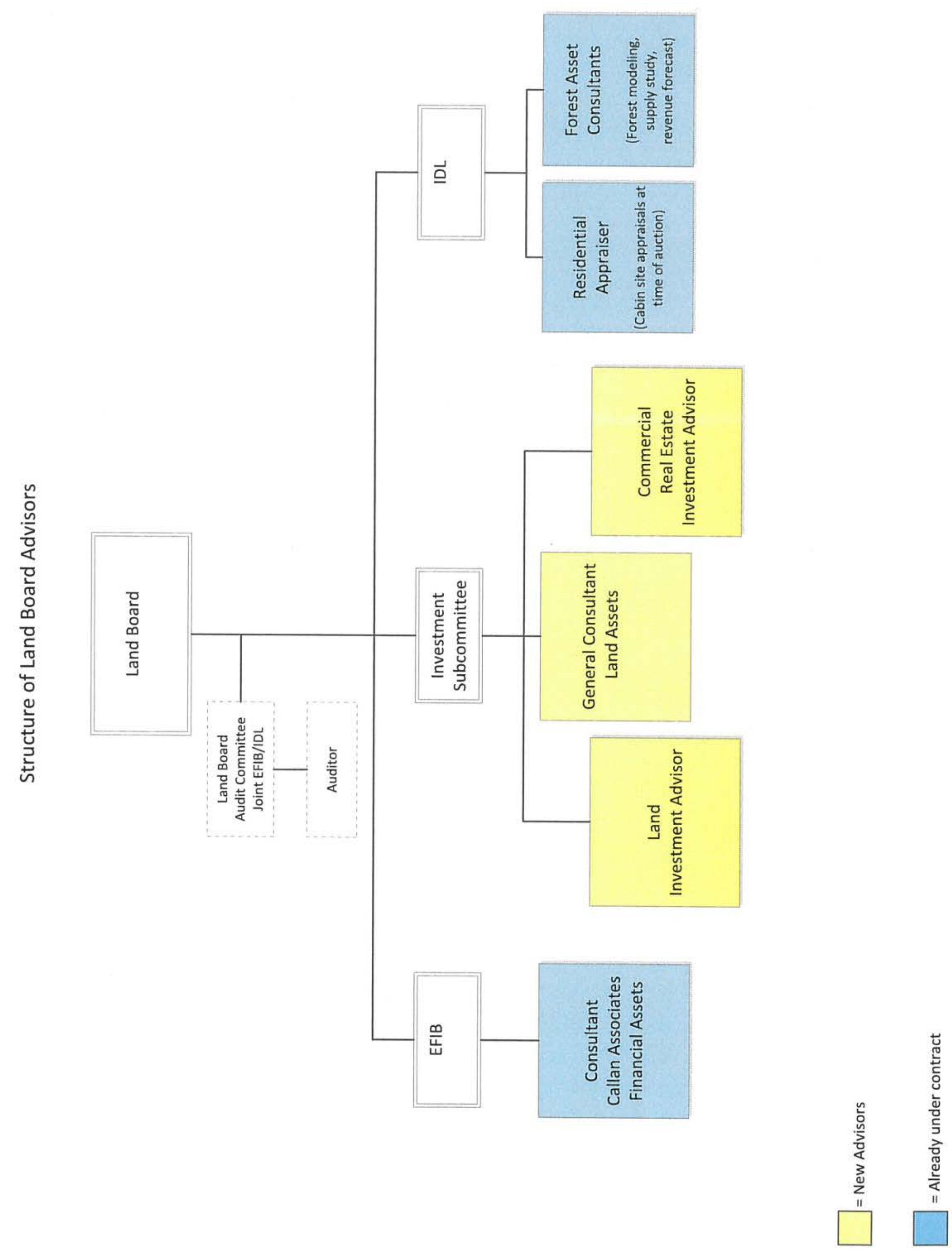
Appendix D

Decision Making Structure Chart for Non Routine Land Investment Decisions



Appendix E

Use of External Advisors



Appendix F
Summary of Idaho Endowment Fund Distribution Principles and Policy

By the Endowment Fund Investment Board – Updated February 25, 2016

Mission of Idaho Endowments: Provide a Perpetual Stream of Income[1]

To achieve this mission, Distribution Policy must balance four conflicting objectives:
- Maximize total return over time at a prudent level of risk
- Provide relatively stable and predictable distributions
- Constrain distributions to protect future generations' purchasing power
- Maintain sufficient liquidity for anticipated expenditures

Priorities for Allocating Income

To balance the interests of current and future beneficiaries, the Land Board established the following priorities for allocating endowment revenues and gains:
- First Priority: Avoid reductions in total endowment distributions
- Second Priority: Maintain adequate Earnings Reserves to protect the current level of distributions from temporary income shortfalls
- Last Priority: Increase both distributions and Permanent Fund corpus faster than inflation and population growth

Distribution Policy Management Principles
- Distribute a conservative estimate of long-term sustainable income every year
- Maintain distributions when income temporarily falls below long-term expectations by saving up income in a reserve when it exceeds expectations
- Grow both distributions and permanent corpus proportionately, more than offsetting losses from inflation and dilution from population growth by reinvesting sufficient income back into principal

Constraints on Wasting Principal (Corpus Growth Objectives)

A major risk any endowment faces is that assets will be depleted to satisfy the beneficiary's current needs at the expense of long-term needs. Many states have succumbed to pressure to spend down their endowment funds. Idaho has several protections in place to mitigate this pressure: [2]
- Federal law and state Constitution: Prohibits spending original principal, including the proceeds of land sales
- State statute: Requires that principal grow at least at the rate of inflation before any market appreciation of the Permanent Fund can be considered distributable income[3]
- Land Board policy objective: Requires that principal grow faster than the rate of inflation and population growth[4]

Determining Annual Distributions[5]

Distributions are initially calculated as a percent (the policy distribution rate[6]), multiplied by the Permanent Fund balance[7] (three-year-average to partly smooth variation in the equity markets)
- Current policy distribution rates are 5% for all endowments except State Hospital South (7%)

Distributions may be further adjusted, up or down, to reflect the reserve balance (and any other relevant factors):

- If reserves are adequate, distributions are maintained even when the Permanent Fund shrinks (actual rate > policy rate)
- If reserves are not fully sufficient (not at target), distributions are maintained even when the Permanent Fund rises (actual rate < policy rate)
- If reserves are unusually low, distributions may be reduced (actual rate < policy rate)

Honoring Beneficiaries' Strong Preference for Sustainable Distributions
Beneficiaries and legislators clearly indicate that a reduction in distributions (if actual income turns out to be low) is much more difficult for them to adjust to than it is to temporarily forego an increase if actual income turns out higher than a conservative expectation. Therefore, it is prudent to base the both the policy distribution rate and the annual distribution on a conservative expectation of fund and land earnings[8].

Determining Transfers to the Permanent Fund[9]
Excess income is converted to (transferred to) Permanent Fund corpus when reserves are deemed fully sufficient: i.e. exceed targeted years[10] of the planned distribution (five years for Public School and State Hospital, six years for Normal School, and seven years for Agricultural College, Penitentiary, School of Science and University).

Measuring the Balance of Current and Future Beneficiaries' Interests
Over time, balance is achieved when all (and only all) "real" income is distributed. Balance is specifically measured by the following relationship:[11]

- Actual distributions *plus* growth in reserves

equals

- Actual income (land & fund), *minus* income converted to principal

Earnings Reserves Serve Two Roles
The Earnings Reserve is not a "rainy day" fund to be drawn down when other state revenues falter. Its purpose is to be a:

1. <u>Buffer</u> against volatility in land income and fund return – a bank for unusually high earnings to be used to maintain distributions in lean times
2. <u>Benchmark</u> to determine when spendable reserves are fully sufficient so that any additional earnings can be reinvested in permanent principal (to maintain purchasing power and sustainably increase distributions)

Investment of the Earnings Reserve Fund
Because the fund intends to hold an adequate level of reserves into perpetuity, this long investment horizon allows reserves to be invested in the same risk/return portfolio mix as the Permanent Fund

- In extreme cases, low reserves may require moving the reserves to a more conservative asset mix (which may lock in losses)

Role of Endowment Distributions in the Overall Appropriation Process
Endowment distributions only satisfy a small portion of each beneficiary's annual spending needs, so those needs are essentially irrelevant in determining distributions. The EFIB recommends the Legislature address total beneficiary needs and short-term variations in tax receipts[12] so that distributions can be stable and growing, based solely on the long-term earning capacity of the endowment. A consistent, high-returning asset mix cannot be maintained if distributions vary based on tax revenues.

Endnotes

[1] The Mission can also be restated in a more measurable form:
The Idaho Endowments will maximize the prudent distribution if they:
- Earn strong real income in the fund and from the land
- Maintain adequate reserves to prevent reductions in distributions
- Reinvest income to protect future purchasing power

[2] To ensure these strict legal protections of the future beneficiary do not overrule the interests of the current beneficiary, Land Board policy requires that distributions grow proportionately with principal over the long term.

[3] The statutory method for achieving inflation protection is measured by the "Gain Benchmark" (June 2000 original principal, adjusted for deposits and inflation). The cumulative total appreciation below inflation must be retained in the Permanent Fund, but any excess (measured at fiscal year-end) flows to Earnings Reserve as income, generally in September (this can be a large amount in one year or zero for several years).

[4] The Land Board policy objective of keeping up with population growth:
- o Makes real per capital distributions equivalent, current vs. future
- o Is achieved by transferring (reinvesting) sufficient excess retained income from Reserves to Permanent Fund principal so it can never be spent

The current assumed population growth is 1.8% per year, except for Public School which is assumed to be 1.0% per year.

[5] Distributions can be changed at any time, but, to facilitate the budget process, are usually determined annually at the August Land Board meeting for the following fiscal year.

[6] The policy distribution rate is based primarily on a conservative estimate of expected total income. When expected long-term earnings change significantly, the policy distribution rate should change (see note 10). However, to protect the corpus, the policy rate should not be raised (i.e. distributions constrained) if Permanent Fund balance objectives have not been achieved.

[7] Calculating distributions as a percentage of the Permanent Fund is both a mechanism and an incentive to balance the interests of current and future beneficiaries. This structure ensures that:
- In normal conditions, distributions to current beneficiaries increase proportionately with the permanent fund balance
- Increases in distributions are sustainable (supported by sufficient permanent assets)
- Holding excess reserves is discouraged

Transfers from Earnings Reserve, both historical and approved but not completed, are added to the annual amounts used in calculating the three-year average Permanent Fund balance. As a result, a dollar transferred to the Permanent Fund immediately increases distributions by the current rate (5% or 7%). Cumulative proceeds from the sale of cabin sites is deducted from the balance, pending an update of the distribution models to reflect the impact of the dispositions on the ratio of total expected income to the Permanent Fund balance.

[8] To reflect the desired conservative bias in setting policy distribution rates:
- Policy distribution rates should be increased only based on a conservative "downside" forecast of long-term income: e.g. 25th percentile fund earnings and 20th percentile land revenue forecasts

- Policy distribution rates should be reduced if the current rate can only be justified with optimistic earnings and revenue forecasts. Ideally, the reduction in the rate would be accomplished by holding the distribution (in dollars) constant for a long period. However, an immediate cut in the absolute dollars would be required if reserves are low.

To reflect a conservative bias in setting annual distributions, the viability of a proposed distribution is tested by forecasting the coverage ratio over the next three years based on a "low" forecast of timber earnings and a 2% fund return.

It is impossible to eliminate the possibility of a reduction in distributions, but the policy is designed to allow at least two years warning of a potential reduction, consistent with the time lags inherent in the state budgeting process. If a fund is unable to make an appropriated distribution, that would be considered a catastrophic failure of the process. In the past, three endowments have experienced catastrophic failures (i.e. had insufficient reserves to pay promised distributions): Public School (2003), Ag College (2005) and Charitable Institutions (2005).

[9] Transfers of excess reserves to the Permanent Fund are generally approved annually at the August Land Board meeting, based on balances as of the previous year end and approved distributions for the next fiscal year, but actually done in September

Requiring that reserves which exceed a sufficient or target level be converted to corpus (i.e. transferred to the Permanent Fund) reduces the temptation to:

- Make large, one-time distributions of accumulated income to the detriment of future beneficiaries
- Hoard income to avoid an increase in distributions that would automatically result from a conversion

[10] The determination of how many years of reserves are sufficient was based on the combined volatility of fund returns and net land revenues, which is heavily influenced by the fact that in a severe equity downturn (once every 25 years), no distributable income would be available from the Permanent Fund for about five years because the Permanent Fund would retain all of its income to rebuild the corpus. A temporary increase in the years of reserve, above the targeted level, may be called for if there is a temporary reduction in expected income (e.g. timber harvest is predicted to be unusually low). Reserves for the three endowments with cabin site dispositions will be allowed to rise up to a year above target, pending an update of the distribution models to reflect the impact of the dispositions on the desired reserve levels.

[11] There will always be temporary deviations from this balance because actual income after inflation will vary from the expectations used to establish the distribution rate.

[12] The Land Board has the legal authority to consider a beneficiaries' other sources of revenue in setting distributions and therefore could attempt to adjust distributions in response to changes in tax receipts or fund income. However, only the Legislature has the Constitutional responsibility and authority to balance a beneficiary's total spending in excess of endowment distributions with tax revenues. When endowment distributions decline, the Legislature can choose to provide tax revenues to maintain the total level of spending they believe is appropriate. When endowment distributions rise, the Legislature can choose to reduce tax revenues to maintain the level of total spending they believe is optimal. The Land Board has no control over tax revenues and would be unable, without the Legislature's consent, to adjust distributions in response to changes in tax receipts. Also, the Legislature is in a better position than the Land Board to balance a beneficiary's unfunded needs with all other expenditure requests and options to increase or decrease tax revenues.