



STATE BOARD OF LAND COMMISSIONERS

C. L. "Butch" Otter, Governor and President of the Board
Lawrence E. Denney, Secretary of State
Lawrence G. Wasden, Attorney General
Brandon D. Woolf, State Controller
Sherri Ybarra, Superintendent of Public Instruction

Tom Schultz, Secretary to the Board

Final Minutes
State Board of Land Commissioners Regular Meeting
May 19, 2015

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, May 19, 2015 in the State Capitol, Lincoln Auditorium WW02, at 700 West Jefferson Street, Boise, Idaho. The meeting began at 9:01 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Lawrence Denney
Honorable Attorney General Lawrence Wasden
Honorable State Controller Brandon Woolf
Honorable Superintendent of Public Instruction Sherri Ybarra

For the record, Governor Otter recognized the presence of all Board members.

1. Director's Report

A. Interest Rate on Department Transactions and Information Report – May 2015

B. Timber Sale Transactions – April 2015

DISCUSSION: Governor Otter inquired what percentage a successful bidder is required to put down. State Forester Groeschl replied that a 10% cash initial deposit is required at the time of the bid; purchasers are also required to put down a 25% performance bond. Governor Otter asked if the chart reflected the 10% down and where the Department accounts for the reserve. Mr. Groeschl said the harvest receipts do not reflect the 10% down. Those funds are held in a reserve account until purchasers complete the sale. At the end of the sale, on the last invoice or two, purchasers can use that initial deposit to pay their invoice if they so elect. Otherwise, once all the invoices are paid for the timber that is harvested, the Department returns that 10% initial deposit. Director Schultz pointed out that interest is paid on the money.

C. Division of Lands and Waterways Activity and Information Report – April 2015

D. Legal Matter Summary – April 2015

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

Chairman Dean Buffington stated the Endowment Fund Investment Board will make its semi-annual report to the Land Board and then depart to conduct its own quarterly board meeting. Chairman Buffington introduced Investment Board members, all in attendance: Vice Chair Gavin Gee, Representative Neil Anderson, Senator Chuck Winder, Richelle Sugiyama, Sue Simmons, Gary Mahn, Warren Bakes, and Tom Kealey. Chairman Buffington also noted staff in attendance: Larry Johnson, Chris Halvorson, Laurel Fritz and Judy Shock. Chairman Buffington indicated that Mr. Johnson would present the Investment Board report.

A. Manager's Report

DISCUSSION: Mr. Johnson stated reserves are well secured given the land revenues reported. There have been no significant actions or compliance issues to report. Mr. Johnson commented that Governor Otter reappointed three Investment Board members for four-year appointments: Dean Buffington, Representative Neil Anderson, and Senator Chuck Winder. Mr. Johnson mentioned that following their presentation to the Land Board, the Investment Board will conduct their annual review of the Endowment distribution policy and consider an implementation plan to invest up to \$150 million in diversified U.S. commercial real estate funds later this year.

Mr. Johnson introduced Paul Black and Duff Daniels of WCM Investment Management who were in town for the Investment Board meeting.

B. Investment Report

DISCUSSION: Mr. Johnson noted the Fund was up 1.0% for the month of April. Thus far into May, the Fund has gained about half a percent and fiscal year to date is slightly above 4.3%.

C. Semi-Annual Report

DISCUSSION: Mr. Johnson stated that the Endowment Fund Investment Board's mission is to provide professional management services to stakeholders. As of the end of the calendar year, assets overseen by the Investment Board totaled about \$2.5 billion; the largest are the State Land-grant Endowment Funds. The Investment Board also manages the reserves and surplus for the State Insurance Fund, the newly established Bunker Hill Water Treatment Endowment for the Department of Environmental Quality, two endowments for the Department of Fish and Game and two for the Department of Parks and Recreation.

Looking at results through the end of March, the total Fund balance increased \$95 million or 5%. Cottage site proceeds accounted for \$44 million; earnings reserves increased about \$17 million or 6%. Earnings reserves receipts for endowment lands for the first nine months of the fiscal year were \$65 million. Total investment return for the nine months was 3.3% and 10.6% annualized for the last five years; that is 90 basis points ahead of benchmark.

Referring to the chart on page 8 of the report showing data previously requested, Attorney General Wasden stated it is important to recognize that the Fund was about \$500 million in 1994 and is now nearing the \$2 billion range. Attorney General Wasden commented that is a significant action by the Land Board and a great deal of gratitude is owed to the Endowment Fund Investment Board. Attorney General Wasden stated it is a remarkable achievement and thanked the Investment Board, staff and investment managers for all the efforts put forward in that achievement. Mr. Johnson commented the whole investment governance structure put in place by the Legislature and managed by the Land Board also contributed to the success. Mr. Johnson added that the overall governance structure in the state of Idaho is very strong and works effectively, and this achievement is a testament to that.

Mr. Johnson stated that each of the endowments has five years of reserves in place for coverage in the event of weak returns and revenue. The reserves are calculated conservatively because they do not take into account any potential capital gains that might accrue from the permanent funds. Returns in excess of inflation turn into capital gains at the end of the fiscal year. Returns are up around 5% so far, and inflation has been running a little less than 1%; that will crystallize into capital gains of around 3% or 4% of the funds at the end of this fiscal year. Those capital gains would transfer to the reserves. Governor Otter asked for clarification that capital gains transfer into the reserves. Mr. Johnson replied that at the end of the fiscal year, capital gains are recognized as income. There are severe principal restrictions in the management of the endowments. Principal may not be given away but principal is defined as the original investment; capital gains may be distributed. Per statute, inflation is deducted from capital gains and the remaining amount transfers to the reserves.

Governor Otter remarked that several years ago the Land Board approved an additional distribution of \$22 million to public schools and, in his recollection, dropped the coverage ratio to 3.8 years. Governor Otter asked if the endowment was managed to meet expected coverage ratio of 5 years as quickly as anticipated. Mr. Johnson responded that reaching 5 plus years in reserves was achieved more quickly than anticipated due to excellent fund returns and terrific land returns. Mr. Johnson added that during that time it was necessary to constrain growth of Public School distribution; fiscal year 2016 is the first year to see an increase in Public School distribution since 2003 or 2004. Due to the growth in reserves, a healthy increase is anticipated in FY2017 and FY2018.

Attorney General Wasden pointed out that as a result of the Land Board's decision, the Fund was exposed to risk it would not otherwise have been. There was a potential for not being able to meet obligations; fortunately that risk did not develop.

Mr. Johnson commented that the performance report on page 10 showed the Endowment Fund versus other endowments. In all the annual periods shown the Endowment Fund return is above the average. Mr. Johnson stated at the last meeting, Attorney General Wasden asked about 10-year returns; those are also shown on this chart. Over the last ten years the Endowment Fund has earned 8.03% which is about 120 basis points ahead of the benchmark. The benchmark is what that similar asset mix would have earned if it had only been invested in index funds.

Mr. Johnson explained the purpose of the School Bond Credit Enhancement Program is to boost the credit rating of voter approved school bonds to triple A, above the state's double A+ rating. Triple A rating currently lowers the issuers' interest rate about five basis points annually, which is material savings on multi-million dollar bond issues. The credit insurance is backed by a \$200 million commitment of assets from the Public School Endowment Fund. Currently EFIB guarantees \$470 million on bonds and those bonds have payments associated with them annually of \$58 million dollars. The EFIB does charge a fee to compensate the Fund for its non-cancellable guarantee; that fee generated income of \$22,000 to the Fund over the last 10 ½ months. The estimated total savings to the eight issuers and their local taxpayers over the life of the bonds averages about 15 times the cost of that fee.

Mr. Johnson noted this is a form of insurance and touched on the likelihood of the Fund paying a claim. The Fund would suffer a loss if a district was permanently unable to make its bond payments. The EFIB believes that the fiscal management of school districts in Idaho is such that the Fund will never permanently lose money on the guarantee, and that is one reason why the insurance premium is so low. Mr. Johnson remarked that it is unlikely Idaho would have to make payments but noted a natural disaster like Hurricane Katrina is an example of a situation that would cause a school district to need assistance from this risk guarantee program. Mr. Johnson concluded by recognizing two investment bankers at today's meeting who are involved in this process of helping schools issue school bonds: Eric Heringer and Michael Keith with Piper Jaffray.

Controller Woolf asked if school districts are aware of the credit program and whether EFIB educates the districts about the program. Mr. Johnson responded that EFIB does advertise the program to the districts and that nearly half of the state's districts have debt guaranteed by the Investment Board. Governor Otter asked if the program was for capital bonds or operating bonds. Mr. Johnson replied that it is for capital bonds. Governor Otter noted that the state picks up the interest on new school buildings construction through a diversion of lottery funds. Mr. Johnson offered his understanding that only certain districts qualify for that money and it is usually only a portion of their bond payment. Governor Otter commented that those interest payments are not included in the savings from the School Bond Credit Enhancement Program as stated above, and wondered what the savings would be if the interest payments made for the districts was included in the amount. Mr. Johnson indicated he would find the information following the meeting and report it to the Board.

- **CONSENT**

- 3. **Release Idaho Department of Fish and Game** – *Staffed by Gregg Servheen, Wildlife Program Coordinator, Idaho Department of Fish and Game*

RECOMMENDATION: Authorize and direct the Idaho Department of Fish and Game to release, abandon and disclaim these properties.

DISCUSSION: None.

4. Approval to Dispose of Fish and Game Surplus Property-Ashton Fish Hatchery – Staffed by Gregg Servheen, Wildlife Program Coordinator, Idaho Department of Fish and Game

RECOMMENDATION: Direct the Idaho Department of Fish and Game to solicit interest in purchase of the property from other state agencies and if none are interested, then to advertise the property for sale and conduct a public auction to dispose of this surplus property.

DISCUSSION: Governor Otter noted that Fish and Game would need to get authorization from the Legislature to reinvest those funds from sale of the property. Director Schultz acknowledged that Fish and Game would need to get spending authority for those funds.

5. Approve Timber Sale – Staffed by Eric Besaw, Regional Operations Chief-North

<u>NORTH OPERATIONS</u>				<u>COUNTY</u>	<u>AREA OFFICE</u>
A. Flyout	CR-10-0437	2,100	MBF	Bonner	Priest Lake (Coolin)

DISCUSSION: Director Schultz remarked this sale is unique in that it borders Priest Lake and the Priest River at Outlet Dam. The sale is within a plan that was adopted back in 1990 called the Seen Area; there are certain areas of endowment land that can be seen from the lake. The Department tried to ensure additional leaf trees to buffer the harvest from visuals. Harvest operations will be limited to Monday through Friday, 8 am – 8 pm, during the summer period.

Attorney General Wasden commented on the issue of a water intake affected by the sale; there is no water right associated with the intake and the intake is likely a trespass on endowment land. Attorney General Wasden noted that the Department first notified the individual using the intake in 1990, and sufficient time has been allowed to resolve this issue. Attorney General Wasden encouraged the Department to take more assertive action to remove the impediment. Director Schultz agreed the Department will take more forceful action and will obtain assistance as needed from the Attorney General's office.

6. State Participation as a Member of Clearwater-Potlatch Timber Protective Association (CPTPA) and Southern Idaho Timber Protective Association (SITPA) – Staffed by David Groeschl, State Forester and Deputy Director-Forestry and Fire

RECOMMENDATION: The Department recommends that the State continue to participate as a member of the Clearwater-Potlatch Timber Protective Association and Southern Idaho Timber Protective Association.

DISCUSSION: Controller Woolf asked how much the Department pays in user fees to these associations. Director Schultz stated the Department pays around \$600,000 statewide in assessment. About 500,000 acres are protected by CPTPA and 200,000-250,000 acres are protected by SITPA. State Forester Groeschl confirmed that approximately \$300,000 combined is paid to the two TPAs with the largest portion going to CPTPA.

7. Authorization for Issuance of Deficiency Warrants to pay Fire Suppression Costs in FY 2016 –
Staffed by David Groeschl, State Forester and Deputy Director-Forestry and Fire

RECOMMENDATION: Authorize the Department to issue deficiency warrants necessary to pay the fire suppression costs beyond the \$151,600 appropriation for fiscal year 2016.

DISCUSSION: None.

8. Approval of Minutes – April 21, 2015 Regular Meeting (Boise)

CONSENT AGENDA BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt and approve the Consent Agenda. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

- **REGULAR**

NONE

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

- **INFORMATION**

9. Grazing Program Business Plan – Presented by Diane French, Program Manager-Grazing, Ag, Conservation

DISCUSSION: Wyatt Prescott, executive vice president of the Idaho Cattle Association (ICA), testified the Idaho Cattle Association has reviewed the most recent version of the grazing business plan; ICA had some concerns with the original business plan but after working with Department staff most of those concerns have been addressed. ICA fully supports this grazing business plan moving forward. Governor Otter asked Mr. Prescott if he had any comment on the process. Mr. Prescott replied it worked very well after ICA had an opportunity to sit down and work through concerns and issues. Mr. Prescott added ICA is not completely certain how the Tier 1 and Tier 2 structures will work but understands that has yet to be all worked out.

10. Grazing Rate Methodology Review – Presented by Mike Murphy, Bureau Chief-Endowment Leasing

DISCUSSION: Director Schultz pointed out that next year the rate will go up to over \$8/AUM based on the current formula. The Department AUM rate has been hovering somewhere between \$5.50 and \$6.50 for the last ten years. The price of beef has gone up and that does factor into the current methodology. There is a lag; as price of beef hit a high point, about a year ago, Department prices were still lower per AUM. Now the price of beef has come down and the Department AUM rate is increasing. The review would consider this timing issue. Governor Otter asked where the AUM would be for sheep. Diane French stated there is an adjustment within the formula if sheep prices fell below 70% of cattle prices. This has not happened; in fact, sheep prices are trending above cattle prices, currently 105% above beef.

- EXECUTIVE SESSION**

NONE

There being no further business before the Board, at 9:54 a.m. a motion to adjourn was made by Attorney General Wasden. Controller Woolf seconded the motion. The motion carried on a vote of 5-0. Meeting adjourned.

IDAHO STATE BOARD OF LAND COMMISSIONERS

/s/ C. L. "Butch" Otter

C. L. "Butch" Otter
President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/ Lawrence E. Denney

Lawrence E. Denney
Secretary of State

/s/ Thomas M. Schultz, Jr.

Thomas M. Schultz, Jr.
Director

The above-listed final minutes were approved by the State Board of Land
Commissioners at the June 16, 2015 regular Land Board meeting.