



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

David Groeschl, Secretary to the Board

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*Be it remembered, that the following proceedings were had and done by the State Board of Land Commissioners of the State of Idaho, created by Section Seven (7) of Article Nine (IX) of the Constitution.*

Final Minutes  
State Board of Land Commissioners Regular Meeting  
July 17, 2018

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, July 17, 2018, in the Capitol, Lincoln Auditorium, Lower Level, West Wing, 700 W. Jefferson St., Boise, Idaho. The meeting began at 9:00 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.

Director Groeschl updated the Land Board on the completion of the Coeur d'Alene (CDA) staff office building expansion. Two years ago a decision unit was approved for a 12,800 square foot addition; the project cost was \$3.4 million. The building addition included integrating the Mica Supervisory Area Office and the CDA staff office into the same building, while keeping them distinct with separate entrances. On July 12th the combined offices held an open house with ribbon cutting event. Director Groeschl remarked that it was a pleasant surprise to have Attorney General Wasden attend; the Attorney General assisted Director Groeschl with the actual ribbon cutting. Director Groeschl expressed special recognition for the efforts of Frank Waterman and Kate Christensen in making the remodel and transition into the new space a very smooth process. Director Groeschl commented that the Department's IT staff also contributed to an easy transition process. Director Groeschl thanked Attorney General Wasden for his participation, and thanked the Land Board for its support in approving the decision unit. Attorney General Wasden noted that he was in Coeur d'Alene on other business and was able to incorporate the open house into his schedule. Attorney General Wasden commented that as he toured the remodeled facility it was evident that the expansion will greatly improve the efficiency and operation for employees at the CDA office.

## 1. Director's Report

### Endowment Transactions

#### A. Timber Sales – June 2018.

*DISCUSSION:* Controller Woolf said it was interesting reading in the first paragraph about sale TS414302 and the non-cedar sawlog selling for \$929/MBF. Controller Woolf asked if that is an anomaly or is that likely to be recurring in the future on sales that have a large quantity of cedar product. Director Groeschl replied that it is probably an anomaly. Director Groeschl elaborated that in this particular sale cedar makes up 84% of the volume; the non-sawlog volume that was bid up significantly is a very small portion of the overall sale volume. What happens at times is during the bidding process somebody bids up the non-cedar sawlogs in order to get the sale, because they only have to remove the non-sawlog trees—just enough volume to access those cedar pole trees.

#### B. Leases and Permits – June 2018

### Status Updates

#### C. Return on Asset (ROA) Review

*DISCUSSION:* Governor Otter asked how the measurement is based on return-on-investment and capital appreciation when most of the land was free<sup>1</sup>; why would it be based upon return on capital? Director Groeschl responded that the Department calculates value for timberland and rangeland based on land expectation value (LEV). The Department's timberland asset value is about \$1.18 billion and that LEV calculation is based on a discounted cash flow based on historical net revenue stream. That methodology is also used for rangeland whereas commercial real estate and residential real estate are all based on appraisals. Commercial and residential assets are saleable; they can be appraised and see what the change in market value is over time. The Department is statutorily prohibited from selling timberland; an appraisal really does not help. Governor Otter remarked that buying timberland is not prohibited; when timberland is added at today's prices—\$700-800/acre—as opposed to the starting corpus of \$1.18 billion, the index could be thrown off substantially. In the future it will look like it is not doing well compared to today, as more timberland is added. Director Groeschl referred to page 11; the timberland portfolio shows some additions called capital contributions. When the Department has acquired timberland, at the price acquired, it is then added to the value of the existing timberland based on that purchase price. The purchase price is calculated based on a discounted cash flow at a range of 3.5% net up to about 6% net. As Callan recommended the Department looks to acquire at 3.5% net or above. Acquisitions so far have been 4-5.5% net return; those are added in on top of the present value of existing timberland and then income return is calculated based off the income divided by that new land value, with that value added in. This year even though this land value was added to existing land base at those prices, final year-end numbers will be close to the 3-year average shown on the Callan report which was a 3.92% income return.

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<sup>1</sup> Approximately 3.6 million acres of endowment land was granted by Congress to Idaho at statehood.

Attorney General Wasden thanked the Director for the analysis of breaking out the return of vs. return on investment which was important to understand in terms of comparing apples-to-apples in the return on investment. Attorney General Wasden called attention to page 2, the asset distribution—about 80% of land assets are in timber which seems to be a large number in terms of the asset portfolio, the asset allocation. Attorney General Wasden noted that there is a distinction in that if the endowment is considered as a whole, including securities assets, that 80% number is going to go down and it actually constitutes somewhere in the 30% range of overall assets. Attorney General Wasden voiced interest in making certain the asset allocation across the entire portfolio is not too heavily weighted in one area, reducing risk. Director Groeschl mentioned that the reinvestment strategy agenda item will address that topic. Director Groeschl commented that timberland is 80-81% of the value of all land assets, timberland represents about 39-40% of the total asset of the whole trust, including financial assets and land assets. The range determined in Callan's original asset allocation study for timberland is 30-50% of the whole asset value. If all of the Land Bank proceeds are reinvested into timberland, it would only push the total timberland asset value up a few percentage points of the whole. Governor Otter wondered, more importantly, what is the contribution of that 80% timberland asset to net income. Director Groeschl noted that timber is roughly 80-85% of net income from land revenue.

D. Land Bank Fund

E. Fire Season

*DISCUSSION:* Director Groeschl reported on a fire not included in this report. The Mile Marker 21 fire started on Sunday, July 15th and is the largest fire within the Department's protection area, located near Lucky Peak Reservoir. It was roughly 700 acres and is now one hundred percent contained; the Department was assisted by Forest Service resources. The Department will be mopping up and patrolling that fire for a few weeks to make sure there are no hot spots. The fire is under investigation.

**2. Endowment Fund Investment Board Report – Presented by Chris Anton, EFIB Manager of Investments**

A. Manager's Report; and

B. Investment Report

*DISCUSSION:* Mr. Anton remarked that the endowment portfolio generated solid returns in fiscal year 2018. During the month of June the Fund was down 0.2% but ended the fiscal year up 9.8%. Mr. Anton commented that global equities had a strong fiscal year led by U.S. equities. Equities overall were up 13.9%; U.S. equities were up 17.3%. One U.S. equity manager, Sands Capital, that manages the large-cap growth sector of the portfolio was up more than 35%; a very good year. International developed and emerging market equities faltered a bit in the final quarter as there were indications that economic growth outside of the U.S. was slowing, concerns about a trade war and a strengthening dollar. The real estate portion of the portfolio provided modest returns both from income and appreciation; overall real estate provided about a 7.8% return for the year. The fixed income portion of the portfolio

struggled to break even, with rising interest rates and inflation beginning to tick up later in the year, but it did provide some stability to the portfolio. Generally 2018 was a very strong year. Mr. Anton stated that fiscal year 2019 is off to a good start; the Fund is up 1.6% through yesterday. Distributions for 2018 and 2019 are well-secured. Based on preliminary analysis, it will be possible to increase the reserves for Public School from five to six years. Charitable Institutions was approved to increase from five to seven years; it may not quite get to seven—six-and-a-half years is probable. All other endowments will be at seven years. Mr. Anton indicated there are no actions of the Investment Board to report. EFIB will present its beneficiary distribution request as well as transfer request at the August Land Board meeting. Distributions are anticipated to modestly increase. In fiscal year 2019 the distribution total is \$78 million; it will be closer to \$80 million for 2020. Even at the higher distribution level a little over \$50 million from reserves will move into the permanent fund. Mr. Anton mentioned EFIB is in the process of closing its books; the auditors will be on hand next week and the Land Board Audit Committee is scheduled to meet August 16th. The Audit Committee will present their report at the August Land Board meeting. The Investment Board is scheduled to meet on August 17th.

- **CONSENT (ACTION)**

- 3. Statement of Investment Policy Annual Review** – Staffed by Kari Kostka, Strategic Planning Manager

*RECOMMENDATION:* Callan, the Department, and EFIB recommend approval of the annual revision to the Statement of Investment Policy for the combined Endowment assets.

*DISCUSSION:* None.

- 4. Approval of Minutes** – June 19, 2018 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 (ACTION)**

- 5. Reinvestment of Land Bank Funds** – Presented by Kari Kostka, Strategic Planning Manager

*RECOMMENDATION:* Approve the Investment Subcommittee's recommendation to implement Option A from Callan's Asset Allocation and Distribution Study for the reinvestment of Land Bank funds.

*DISCUSSION:* Attorney General Wasden stated his understanding of the options available: Option C is to immediately transfer funds to the permanent fund which the Department does not recommend. Option B is to essentially transfer \$58 million immediately and save the rest in reserve for potential transactions. Option A is to pursue potential transactions—the Department has a few in the pipeline--and then transfer what is not needed. Ms. Kostka said that is correct. Attorney General Wasden asked for the Department's view of Option A; i.e., what it does and how

it will operate. Ms. Kostka responded that Option A most closely resembles what the Department is doing now. There is a joint effort with EFIB, analysis of numbers (revenue) coming into the Land Bank, and with the development of the acquisition business plan, the Department has confidence that it is moving forward with several beneficial, sound transactions. The Department, in coordination with EFIB, is also being realistic; if potential transactions will not utilize Land Bank funds before they expire, the Department will identify amounts that make sense to proactively transfer to the permanent fund. Ms. Kostka commented that the Department is not opposed to transferring funds but staff sees a few really good acquisition possibilities in the near term and does not want to limit opportunities just yet, so Option A is preferred. Ms. Kostka added that it is not necessarily ideal to reinvest in financial markets with markets being as high as they are right now. Attorney General Wasden noted that the hurdle rates listed in Option A are intended to make certain that the Department is seeking land investments that will add to the endowment portfolio—timberland is not being purchased just for the sake of buying timberland, it has to meet specific financial criteria. This is an important consideration to remember. Ms. Kostka agreed that hurdle rates are a big component of the option. Attorney General Wasden requested verification and assurance from the Department, from EFIB, and from Callan that the recommendation of Option A accomplishes two things simultaneously and that is—recognizing that the future cannot be predicted; there is no crystal ball—to the best of all parties' ability Option A is intended to accomplish reducing volatility in the endowments' overall investment portfolio at the same time as increasing returns, or the potential for reducing volatility and the potential for increasing returns. Ms. Kostka stated that is exactly the goal of the Department. Ms. Kostka mentioned another component intended to counter any volatility is the increase in reserve levels which was approved by the Board and is already being implemented.

Regarding the financial portfolio, Mr. Anton remarked that during the February meeting Callan presented their capital markets assumptions and indicated that over the next ten years they expect gross returns of about 6.3%, net returns of 4.05%. In their study Callan said timberland investment is a good diversifier. If the Department gets similar real returns, because timber has lower volatility, it helps reduce overall volatility. It also provides similar and potentially greater returns if the Department finds opportunities above that hurdle rate. EFIB's perspective is that the Board should preserve its flexibility during this five year period and allow the Department to find and identify opportunities as long as they meet or exceed the hurdle rate. Governor Otter wondered what the motivation was for even considering Options B and C. Mr. Anton commented that the recommendation for B and C is they could potentially get similar returns on the financial assets but would likely have more volatility. Neither of those are bad options, the financial assets have been performing well; however, the Department has this unique opportunity to reinvest the money in timberland and it makes sense to preserve flexibility and look for transactions that provide substantial returns. Governor Otter suggested a cautious eye would look at Options B and C and conclude they were only included to validate Option A. Mr. Anton noted that Callan believes investing Land Bank money in financial assets is not a bad decision either. Generating 6.3% gross returns, 4% real returns, is a good option. Right now there is another option and that is to look at timber opportunities. Mr. Anton said Callan and EFIB agree that the Department should have the opportunity to look for reinvestment opportunities in timber and agricultural land. If the Department finds opportunities that meet the hurdle rate it will reduce overall volatility and enhance returns for the beneficiaries.

Governor Otter commented that the Department has shown there is a margin of diminishing return of around \$8 million yet the earnings reserve levels are increasing. Governor Otter inquired how the Department and EFIB intend to add to the reserves when there is \$8 million less in diminishing returns on investment. Mr. Anton indicated that at the end of fiscal year 2018 all reserves will be at target levels with the exception of Charitable Institutions, which will be at six-and-a-half of its target seven years. Mr. Anton continued that investing in more timberland generates more revenue that comes directly into those reserves and keeps them replenished; it is a healthy thing if the right opportunities are found. Governor Otter asked if new timberland acquisitions are expected to provide an increase in land revenue. Director Groeschl remarked that the acquisition of timberlands does two things: one, it replaces or exceeds the revenue that was lost through the sale of commercial and residential properties, and two, it reduces volatility; it provides a very stable revenue stream that meets or exceeds revenue previously being generated.

Director Groeschl elaborated, explaining that there is a two-year lag between acquiring new timberland and generating revenue from it. In addition to providing a stable revenue source, new timberland will increase the Department's sustained yield—not only is there sustained yield off the land base that is acquired, it also then increases the sustained yield off the existing land base because now it is looking at entire ownership. For example, one area has a sustained yield calculation of roughly 85 million board feet (MMBF) a year; if 20,000 or 30,000 acres is acquired with 15 MMBF on those acres, add those numbers and the sustained yield is 100 MMBF. But in running the model again, a third time, the sustained yield is actually 115 MMBF because what it does is now look at the entire land base and age/size class distribution and it gives an uplift on sustained yield across the entire land base. However, returns for acquisitions are only calculated on that acquisition, on what that land can produce, so it is conservative. Director Groeschl stated that the existing timberland base from the southern border of Idaho to the northern border of Idaho is returning about 3.9% net revenue. The Department is looking to acquire timberland in the strongest wood basket areas—good transportation, strong markets, competition—the return expectations for those acquisitions are higher. Director Groeschl noted that Callan used 3.5% in their modeling. If the Department can acquire timberland that is in that 4-5% range then the return across the entire timberland portfolio is increased and that provides stability to that land revenue stream versus the volatility on revenue generated in the financial markets. Governor Otter asked if, relative to the timber report earlier in this meeting, the Department will concentrate on buying cedar. Director Groeschl replied the focus is more on where it is located within various wood basket areas and site productivity; the Department is not targeting a single species because even cedar prices can vary significantly. While cedar is high right now, other non-cedar prices are also very strong. Due to fluctuations, the Department uses an average in its analysis. Governor Otter commented it helps stumpage price when there is a 25% tax from Russia and beetle kill and pine bark kill in Canada.

Governor Otter mentioned that a couple of years ago the Department reported that Idaho imported sawlogs of about 200 MMBF, even with all of Idaho's private harvest, federal harvest in the state, before Good Neighbor Authority, and state harvest which was at that time around 230 MMBF. Governor Otter asked what is present usage of infrastructure (sawmills) and is more capital structure going to be needed. Director Groeschl responded that the Department just looked at the current percent of capacity being used right now in Idaho across the various sawmills; statewide the number is below 80%, around 74-75%. Mills like to run slightly above 90% capacity.

The mills can absorb 200-300 MMBF before they would reach that 90% capacity level. The mill infrastructure would not require any capital expenditures right now to absorb an additional 200-300 MMBF.

Secretary of State Denney inquired if the return on funds in the Land Bank is exceeding the target of 3.5%. Mr. Anton replied that the return in the Land Bank is about 2%; it is below target today because it is invested in short-term investment-grade fixed income. Statute does not allow any losses on those investments so it is invested very conservatively. Mr. Anton noted that is one of the downsides in providing time to reinvest Land Bank funds, that in the intermediate term there is some opportunity cost because the funds are earning a small amount.

Attorney General Wasden requested Callan's input on Option A. Ms. Haskins stated with regard to the options that were presented, and Option A in particular, Callan likes to lay out acceptable options; all the options that were laid out are acceptable and the Board can choose to do Option A or B or C at any time. Ms. Haskins commented that for the reasons previously mentioned, Callan is supportive of Option A and options B and C are also acceptable. Ms. Haskins complimented the Department and EFIB for all the work that has been done and noted that having this discussion about what to acquire, where to acquire it, and what it is going to look like, is meant to assure the Board. What does the transaction pipeline look like, will it meet the hurdle rates, and will the returns be accretive because that is what is needed. The 4.5% range is certainly competitive with EFIB at lower volatility. Ms. Haskins indicated the returns at the minimum hurdle rate for timber at 3.5% would also be fine but mentioned that for the next agenda item which will be discussed, Callan did a study and looked at a number of large institutional timber managers—what are they doing and what are their return requirements—the Department's target hurdle rates are consistent with those managers return requirements; from that perspective the Department is doing what others are doing. Ms. Haskins mentioned one thing she found interesting is that there are not a lot of institutional buyers playing in this market in Idaho, which should be good for the Department in terms of purchasing timber and potentially getting returns above the minimum hurdle rate of 3.5%. Ms. Haskins said it is a little bit different on farmland which is a reason to set the hurdle rate higher, but if farmland markets turn then there might be similar opportunities because people would rotate out and the Department would have more opportunity to acquire farmland.

Secretary of State Denney inquired if the Department, as it looks at purchasing timberland, is receiving any pushback from the county commissioners for taking that potential purchase off the tax rolls. Director Groeschl stated the Department has made two fairly small acquisitions to date; the Department spoke with the county commissioners, who were supportive of those acquisitions. As the Department considers some of these larger acquisitions, staff will be having conversations with those county commissioners. Director Groeschl shared that a little over a year-and-a-half ago before coming to the Land Board for approval of the reinvestment strategy, the Department met with eight or nine counties. All of those counties where potential timberland opportunities exist were either neutral or supportive of the Department's reinvestment strategy; they simply asked that they be informed prior to closing on an acquisition so that if there is a tax impact to their county they can determine how they might deal with it. Director Groeschl reiterated that Department staff, as a signed purchase sale agreement is in place for an acquisition, will start the outreach with the respective county commissioners.

Governor Otter asked if in some of these acquisitions the Department is entertaining maintaining a conservation easement that may have been sold or given at one time or another, and if so, how will that be treated. Director Groeschl stated the Department is looking at potential properties that have conservation easements on them. These easements typically were put in place to compensate the current landowner for the development rights but then to manage those in perpetuity as timberland using traditional forest management practices. The Department does not see an issue with the conservation easement impeding its ability to manage those lands or impeding the Board's ability in making decisions regarding the management of those lands related to the traditional use and management of forest management. Governor Otter wondered about the appreciation value for the portfolio. Director Groeschl explained that once the development rights have been taken off through a conservation easement, the land is valued as timberland without any higher and better use values associated with it. The increase in value would come just like existing endowment timberland. Since the Department is statutorily prohibited from selling timberlands the value comes in the revenue generated off that land; it would be calculated through land expectation value. The increase would be associated with the timberland value increase and not associated with other potential uses. Governor Otter reflected on capital revenues that have been flowing in; the money has to be spent someplace. Governor Otter wondered what if there had been conservation easements on all of the lake lots—is the Department giving up something for the lack of that appreciation value. Director Groeschl indicated that as the Department evaluates those timberlands that may have a conservation easement on them, the lands are not the small lands, for instance around a lake where a small private landowner has put a conservation easement on with a development envelope within there. The lands the Department would consider do not have development envelopes in them and are typically not associated with lake frontage. Governor Otter remarked that Idaho is the fastest growing state in the nation and observed the Department could be suffering an opportunity cost someday, especially with those conservation easements.

*BOARD ACTION:* A motion was made by Attorney General Wasden that the Board adopt the Department recommendation that is approve the Investment Subcommittee's recommendation to implement Option A from Callan's Asset Allocation and Distribution Study for the reinvestment of Land Bank funds. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

**6. Strategic Reinvestment Plan Annual Review** – Presented by Sally Haskins, Senior Vice President, Callan LLC

*RECOMMENDATION:* The Department recommends approval of the memo submitted by Callan on July 5, 2018, as the annual update to the Strategic Reinvestment Plan.

*DISCUSSION:* None.

*BOARD ACTION:* A motion was made by Attorney General Wasden that the Board adopt the Department recommendation that is approve the memo submitted by Callan on July 5, 2018 as the annual update to the Strategic Reinvestment Plan. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

For the record, Governor Otter left the meeting at 10:25 am and returned at 10:27 am and therefore did not vote on agenda item 6.

**7. Cottage Site 2024 Voluntary Auction for Ownership (VAFO) Plan** – Presented by Sid Anderson, Program Manager-Residential

*RECOMMENDATION:* Approve the Department's proposed Cottage Site Voluntary Auction for Ownership (VAFO) 2024 Plan, approve the auctioning of the new residential lots at Payette Lake, and approve the auctioning of future lots in locations appropriate for each site to include Ada, Bonner, Kootenai, or Valley Counties.

*DISCUSSION:* Controller Woolf expressed his appreciation for all the work done by the Department these past years. Controller Woolf asked for the Department's perspective on the 67 lots that may potentially remain after the VAFO process through 2024. Mr. Anderson responded it is a mixed bag; there are lessees that that would prefer to continue leasing. Some have expressed that since the beginning that they felt like the lease rate was fine and they would rather continue leasing than have to purchase the lease. There is also a percentage of lessees that just do not feel like they can afford to purchase; they can continue to lease but they cannot buy. The majority of those fall in one of those two categories. Controller Woolf wondered how valid it will be to hold auctions in those years indicated with a very small number of interested parties. Mr. Anderson commented that is why the Department is asking the Board to continue to allow VAFOs depending on interest. If there is one site in a year that is going to go to auction then an auction would not be held, with the exception of the last year of auctions. The Department is gauging interest, knowing this is going to fluctuate and change as people continue to assign; just in the last month two new sites assigned at Payette Lake that were not interested before but the new lessee is. The Department anticipates that after 2019 auctions would be held every other year.

*BOARD ACTION:* A motion was made by Attorney General Wasden that the Board adopt and approve the Department recommendation that is to approve the Department's proposed Cottage Site Voluntary Auction for Ownership 2024 Plan, and include the auctioning of new residential lots at Payette Lake, and approve the auctioning of future lots in locations appropriate for each site to include Ada, Bonner, Kootenai or Valley counties. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

• **INFORMATION**

NONE

At 10:40 a.m. a motion was made by Attorney General Wasden to resolve into Executive Session pursuant to Idaho Code § 74-206(1)(d) and § 74-206(1)(f) to consider records that are exempt from disclosure as provided in Chapter 1, Title 74, Idaho Code and to discuss the legal ramifications of and legal options for pending litigation or controversies not yet being litigated but imminently likely to be litigated. Attorney General Wasden requested that a roll call vote be taken and that the Secretary record the vote in the minutes of the meeting. Controller Woolf seconded the motion. *Roll Call Vote:* Aye: Denney, Wasden, Woolf, Ybarra, Otter; *Nay:* None; *Absent:* None.

