

Dept. of Lands

MAR 30 2020

Boise, Idaho

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March 27, 2020

Governor Brad Little
Attorney General Lawrence Wasden
Mr. Irving Littman
P.O. Box 83720
Boise, ID 83720

Re: Endowment Reinvestment Subcommittee
Sale of Public Lands/Cottage Sites and Commercial Property

Dear Members of the Endowment Reinvestment Subcommittee,

The recent deliberations and data reviewed by the Endowment Reinvestment Subcommittee (Committee) have been helpful in understanding the current status of the state endowment funds and related endowment land issues. The Committee has unearthed several important questions and is to be commended for its efforts. In fact, the discussions, questions, and dialogue among the Committee members have exceeded discussions and dialogue among the collective Land Board members during the entirety of the year. One of the most obvious outcomes from the Committee's efforts is that it is time to end the process of selling leased and unleased cottage sites. Doing so is a matter of fiduciary obligations and being a prudent investor. The Land Board should also reconsider the selling of commercial properties

I have had the opportunity to observe many of the deliberations of the Land Board and the Committee, at least those that have been public. Since the Committee is preparing to provide recommendations to the entire Land Board, it is particularly relevant at this stage to consider some of the more salient aspects of the Committee's deliberations. Committee members have made the following points:

1. Governor Little correctly noted the importance for periodic review of underlying facts, assumptions, and data when making investment decisions dealing with endowment lands. Annual review of the investment hurdle rate was one telling example.
2. Attorney General Wasden and Land Board counsel noted the Land Board is limited in some of the actions it can take such as the prohibition on selling timberlands, and that there are potential conflicts between statutory and constitutional obligations that would require the Land Board to resolve the conflicts as part of its decision making. For

example, redefining timberlands as cottage sites or another class so they could then be “sold” would certainly be unconstitutional, a breach of fiduciary obligations, and the Prudent Investor Rule. The Attorney General noted fiduciary obligations extend to present and future beneficiaries.

3. Governor Little, Attorney General Wasden, and Mr. Littman all emphasized the fiduciary obligations of the Land Board members, as well as the critical nature of the Prudent Investor Rule.
4. All three members acknowledged that political considerations can play no role in investment decisions. The endowment investment advisor agreed. Mr. Littman also pointed out questions regarding whether the Land Board could consider tax implications for counties. The unanimous response was “no”. The same principle applies to existing cottage site lessees. For example, on one leased cottage site in the Payette Lake area, a 2019 appraisal valued the lot at \$1,008,000.00. A second appraisal in 2020, 12 months later, valued it at only \$800,000.00 -- in a market that is supposed to be increasing. The effect is to shift at least \$208,000.00 of “value” to the lessee, thus benefitting the lessee at the expense of the endowment. Problems with the VAFO program are numerous and serious.

The above details of the Committee’s deliberations require that the sale of public lands such as leased and unleased cottage sites be ended. The sale of commercial properties likewise needs to be carefully considered. In other words, the Land Board needs to slow down, take a deep breath, and think about this before permanent mistakes are made. Business as usual will not do and will not meet Land Board fiduciary obligations. Each Land Board member needs to make an independent, individual assessment of this situation and their own obligations, in particular since some members were not on the Board in 2010.

The beginnings of the current cottage site sales program, as described in the 2010 Heartland LLC report, began around 2009. All Land Board members at the time recognized the program was designed largely as an ill-disguised effort to transfer ownership of state cottage sites at Payette Lake and Priest Lake to current lessees. The Heartland report uses statements, assumptions, and data from 2010 and prior years to justify its recommendations. It also references the political aspects of the decision to sell cottage sites. The Heartland report has never been revisited or updated. Continuing to make investment decisions using the outdated Heartland report only exacerbates the original concerns, including the political implications embedded in the report’s recommendations. The current Land Board is not bound by and should not be making investment decisions using outdated assumptions by some previous Land Board members.

Cottage sites and commercial properties represent individual asset classes that add critical balance and diversification to the endowment portfolio. These two asset classes provided, and have the potential to continue providing, the highest returns per acre of any asset class. Their rates of return are approximately three-to-five times that of other classes. For the past three years, cottage sites and commercial properties have appreciated approximately three-to-four times the rate of other asset classes. Selling off these public lands is an irretrievable

disposition of valuable endowment assets. The Land Board can buy stocks and bonds all day long – not so with cottage sites at Payette and Priest Lakes. Cottage sites, once sold, are likely gone forever, thus foreclosing significant revenues that out compete all other classes.

Governor Little pointed out in the March 12, 2020 meeting that approximately 80% of cottage sites and commercial properties have been disposed of since 2011. Over 342 cottage sites at Payette and Priest Lakes have been sold, the vast majority being sales at no more than the minimum appraised value to existing lessees holding potentially illegal leases. For most sales to existing lessees under the VAFO program, there is no competitive bidding at all, in part due to questionable auction procedures. These circumstances alone should alert a fiduciary/prudent investor and generate scrutiny and questions as to substance and process. That sales have continued for so many years with no review of underlying assumptions, data, and procedures should be a concern for the Land Board, with constitutional concerns at the fore. No fiduciary/ prudent investor would sell, through constitutionally suspect procedures, the most valuable, highest returning assets from their “Sacred Trust” portfolio in 2020 based on 2010 assumptions and data that have not been updated or reviewed.

The Committee has had an opportunity to examine many aspects of the endowment in much greater detail than the Land Board as a whole. The Committee needs to recommend, and the Land Board needs to take, immediate action to stop the sale of public land cottage sites and commercial properties. The Land Board needs to make certain its information is timely, and that its actions comply with constitutional and statutory obligations before even considering selling these lands. Each member of the Land Board needs to fully understand and grasp their individual obligations. As seen in the recent undertakings regarding Lease 500031 in McCall, mixing constitutional questions and political considerations creates a toxic brew. Constitutionally questionable sales pose a two-prong risk of devaluing the overall trust fund and jeopardizing previous sales agreements.

Sincerely,

Bruce M. Smith

cc: Superintendent of Public Instruction Ms. Sherri Ybarra
Secretary of State Mr. Lawrence Denney
State Controller Mr. Brandon Woolf

✓ Director Dustin Miller