MEMORANDUM

OFFICE OF THE ATTORNEY GENERAL

To: Idaho State Board of Land Commissioners

From: Lawrence Wasden, Attorney General

cc: Irving Littman, Reinvestment Subcommittee Member

Date: Monday, May 11, 2020

Re: Minority Report of Attorney General Wasden, Member, Land Board Reinvestment Subcommittee

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The following Minority Report is prepared to summarize the history of the Board's decisions concerning investment policy and the discussions of the Reinvestment Subcommittee; analyze the recommendation of the Majority Report and make an alternative recommendation and motion to the Idaho State Board of Land Commissioners. This is a lengthy report because I have attempted to coalesce the testimony presented to the Board and the Subcommittee in one place. Accordingly, I will begin with a summary of the report and my alternative recommendation.

SUMMARY AND RECOMMENDATION

The purpose of the Reinvestment Subcommittee was to examine whether the analysis and recommendations of the 2016 Strategic Reinvestment Plan as reaffirmed by the Land Board at its July 2018 meeting remained valid, or whether changes in market conditions required a different reinvestment strategy. During the course of five separate meetings of the Reinvestment Subcommittee over the course of eleven months, no testimony from Callan & Associates (Callan), EFIB director Chris Anton, or any other expert, reflected any change in the underlying rationales or analysis that supported the 2016 or 2018 decisions of the Land Board. Indeed at the March 12, 2020 meeting both Callan and EFIB Director Anton reaffirmed that the analysis and recommendations of 2016 and 2018 remained valid.

Despite the lack of any expert testimony or information to suggest a change in the investment strategy, a majority of the Reinvestment Subcommittee voted on April 10, 2020 to recommend to the Land Board that $50,000,000.00 of the funds currently held in the Land Bank be invested in the Permanent Fund. Notably, at no time did any expert recommend this to the Subcommittee either as to the amount, nor as to whether doing so was in the best long term financial interests of the endowments as compared to purchasing land assets. In fact, the only testimony presented during these proceeding concerning the future performance of the permanent fund was that Callan's market expectations were either lower for the permanent fund than in past years or would remain unchanged.

> **Ms. Becker-Wold**: Right. And as I mentioned earlier, and I think this is an important thing for us to consider, is that we do an asset allocation update for the Endowment Fund Investment Board annually, to sort of re-benchmark what our current forward ten-year look is. So that is probably up for adjustment, because as the capital markets have outperformed so dramatically, <u>our expectation now going forward is going to be lower for the endowment fund, which means that the hurdle rates should also be adjusted at some point as well.</u> We haven't done that work, and we haven't even completed our expectations for this year yet, but I'm thinking that given the fact that the capital markets have done so well, the equity returns could come down a little bit. We try to do that every year on the endowment fund, so we can make adjustments if we need to. We don't generally make big adjustments, but that's possible, yes.

Minutes of October 10, 2019, Reinvestment Subcommittee Meeting at pg. 11 (emphasis supplied). (TAB 1); See also Minutes of March 12, 2020, Reinvestment Subcommittee Meeting at pg. 7. (TAB 2).

No testimony or analysis presented over the course of the meetings supports the Majority Recommendation. And, indeed, the Majority Recommendation is actually counter to the testimony of Chris Anton to the Reinvestment Subcommittee.

> **Mr. Anton**: As I look at the Callan study that was published in 2018, it really provided the Land Board with a framework to evaluate land acquisition opportunities that were presented from the Department of Lands. Essentially it said that if the opportunity presents a real return of less than 3.5%, it makes sense to put it in the financial assets. If it presented a return between 3.5 and 4.5%, it is somewhat indifferent, although it recommended that if we increased our reserves, as you're closer to the 3.5% end of that range, the financial assets are probably preferable; because we have higher reserves we can withstand a little more volatility. As you move out closer to 4.5%, or above 4.5%, the study recommended considering timberland investments. Again, looking at it from a whole trust perspective, the idea is that if we have opportunities that provide solid returns that are more stable from timber that makes sense from a whole trust perspective. I think the analysis that they did still makes a lot of sense, that we have to be disciplined, that the Land Board would evaluate any opportunities that were brought forward; we would also have to look at any synergies. I look at us as a strategic buyer. We're in the timber business. We have substantial holdings that if a land acquisition also enhances the returns from our other property it can provide other benefits. <u>We feel at EFIB that we should give the Department of Lands that opportunity that the Land Bank provides to look at opportunities.</u> I think there was always an understanding that if the Department of Lands said there weren't opportunities, or there weren't complete opportunities that spend all of that money, we could certainly transfer the money sooner into the financial portfolio. I think that the model Callan developed, from my perspective, made a lot of sense.

Minutes of March 12, 2020, Reinvestment Subcommittee Meeting at pg. 3 (emphasis added).

The Majority Recommendation thus ignores a fundamental premise of endowment fund reform and the policy of the Land Board to seek out and rely upon expert opinion rather than ad hoc decisions by elected officials. In these uncertain times, it is more important than ever that we adhere to this principal. As our world faces a global pandemic which as of May 7, 2020 has killed approximately 263,268 people worldwide and wreaked havoc on the world economy, we should be ever more cautious about how we make investment decisions.

At the April 10, 2020 meeting, I made and continue to support, an alternative recommendation to the Land Board which comports with Land Board policy to seek out and rely upon the expert advice of professional advisors. To wit:

> At its July 2018 meeting, the Land Board adopted what is known as Option A. Essentially, Option A provided that the Board, consistent with the reinvestment plan, identify transactions that meet the established hurdle rates and set aside sufficient funds over an appropriate time horizon, and in fulfillment of the scope and purpose of this subcommittee to examine that decision and make recommendations to the full Board, I make a four-part motion:
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> > 1) That the full Board stay the course on Option A in order to maintain the Board's flexibility in applying funds to either land or financial investments;
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> > 2) The full Board request Callan to review the efficacy of the hurdle rates;
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> > 3) Recognizing that our normal processes for investment require our seeking advice from our retained experts, that the full Board also request Callan and EFIB to review current market conditions and report to the full Board at its next monthly meeting and make any recommendations concerning investments in current financial markets;
> >
> > 4) That the Department of Lands prepare a letter of transmittal to the full Board outlining the subcommittee's recommendations, and I offer Darrell Early to assist the Department in preparing that letter .

See Meeting Minutes of April 10, 2020 Reinvestment Subcommittee (TAB 3).

This recommendation adheres to the adopted decisions of the Land Board as recommended and supported by our retained consultants in 2016 and 2018 because there has been no change in the information or analysis which supported those decisions. Importantly, however, it does not rule out the possibility of transferring Land Bank funds to the Permanent Fund, but instead allows for IDL to retain the flexibility to acquire land assets that will meet or exceed the established and validated hurdle rates <u>or</u> to transfer money to the permanent fund if our expert consultants identify that it will be in the long term best financial interests of the endowments. Until such a decision is endorsed by our investment advisors, however, the funds should remain available for land acquisition.

I encourage my fellow Land Board members to consider this minority report and recommendation.

DISCUSSION OF CONSTITUTIONAL & LEGAL OBLIGATIONS OF THE LAND BOARD

At the October 10, 2019 and November 13, 2019 meetings of the Reinvestment Subcommittee, the Office of the Attorney General submitted testimony concerning the fiduciary responsibility of the Land Board and other legal constraints upon the Board's actions. (TABS 4 & 5).

The Land Board is the "epitomic public trustee" bound by a fiduciary duty to fulfill the constitutional purpose of the trust to maximize long term returns to the beneficiaries. The fiduciary duty of the Board consists of two principals: Undivided loyalty and prudent business judgment.

Undivided loyalty requires the Board to reject any considerations other than those of the stated purposes of the trust which is the maximum long term return to the endowments. This principal is embodied both in the general law of trusteeship and reflected in the *Idaho Watersheds* decisions.

Prudent business judgment requires the Board to exercise the degree of skill and care that an ordinary prudent investor would in the course of their private affairs. A concomitant feature of this rule, as reflected in Land Board policy is, that in making decisions, the Board should seek out and rely upon the advice of experts. Known as the "prudent expert rule" the policy requires:

> This additional step would engage outside consultants and experts hired directly by the Land Board with the assistance of the Endowment Fund Investment Board to provide an independent review and confirmation of information and recommendations to the Land Board prior to any major investment decisions. These additional agents would also be responsible for measuring, monitoring, and reporting on those IDL investment activities to assure progress toward the investment goals and maintenance of procedures and standards at the expert level in investment management.

See R. Maynard, Endowment Fund Reform Progress Report, December 6, 2013 at 2-3 (TAB 6); Minutes of the December 17, 2013, Land Board Meeting at 4-5 (TAB 7).

CHRONOLOGY OF REINVESTMENT DECISIONS AND DOCUMENTS:[1]

Decisions concerning investments are, first and foremost, governed by the Board's adopted "Statement of Investment Policy" which states that the goals of investment are:

- 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.

July 17, 2018, Statement of Investment Policy pg. 3. (TAB 8)

In 2014 Callan was retained by the Land Board to (among other things) conduct an asset allocation study incorporating the IDL-managed land assets with the financial assets. *Minutes of May 22, 2014, Land Board Meeting at 5 (TAB 9).*

The report was submitted to and approved by the Land Board in November 2014. *Minutes of November 18, 2014, Land Board Meeting at 4 (TAB 10).*

As part of the Asset Allocation study, Callan recommended a range of investment split between the financial assets and the land assets. Callan recommended a range for timber between 30% and 50%. At the time in 2014, timber was approximately 39% of the total portfolio. *2014 Asset Allocation and Governance Review: Pg. 27 (TAB 11).*

Callan concluded in 2014 that investment in timberland could be increased if IDL could obtain parcels that performed at least as well as the existing inventory.

> Timberland is a desirable investment across the range of asset mixes reviewed. Timberland has an attractive forecast return for the anticipated level of risk and diversifies other asset classes well. Consequently, the unconstrained computer model specified an allocation to timberland at or above its current level for all asset mixes evaluated. The model suggest that timberland investment could be expanded if the acquired properties are expect to perform at least as well as the existing timberland.

2014 Asset Allocation and Governance Review: Pg. 4

> In all asset mixes IDL timberland has an allocation at least as large as its existing allocation. Consequently, we would not recommend reducing the overall timber portfolio. Unconstrained, allocations to timberland are higher suggesting the allocation could be expanded. It is important to recognize that this is only the case if new investments are expected to perform at least as well as the existing

[1] This chronology starts in 2014, but the issue of managing the land assets as part of a "whole trust" concept started long prior. For a detailed chronology of this, see "Overview of Land Board Endowment Reform" by Clive Strong.

timberland. Expanding timberland for the sole purpose of meeting an unconstrained allocation is not recommended.

2014 Asset Allocation and Governance Review: Pg. 31

At the December 15, 2014 Land Board meeting the Board voted to establish an Investment Subcommittee. The members of the subcommittee are one EFIB Board Member, the EFIB Manager, and the Director of the Idaho Department of Lands. *Minutes of December 15, 2014, Land Board Meeting* at 6. The subcommittee was directed to "to develop a draft policy (consistent with Idaho Code Section 58-1333) regarding proceeds from the disposal of assets (e.g. cabin sites, commercial real estate, grazing land) utilizing the Land Bank Fund to hold a portion of the proceeds to be used for land acquisition (excluding commercial buildings), and to purchase access to currently owned endowment lands and to block up ownership of endowment lands." *Id*.

The Investment Subcommittee met several times and at the May, 2016 Land Board meeting IDL recommended adoption of the "Strategic Reinvestment Plan" that had been developed by Callan and the Investment Subcommittee: *Minutes of May, 17, 2016 Land Board Meeting at pg. 7 (TAB 12).*

At the time of the 2016 Strategic Reinvestment Plan, Timberland remained at 39% of the total endowment portfolio. The Strategic Reinvestment Plan had the following conclusions.

- Callan recommends pursuing additional investment in timberland in Idaho provided investment can be sourced with appropriate net returns.
- Additional investment is supported by the asset allocation study which indicates portfolio risk/return will be maintained with additional investment in timberland provided new investments have a net projected returns at or above the returns of the existing portfolio with a similar level of risk. In Callan's study, the existing timberland portfolio had an expected net 10 year composed return of 5.70 (3.45% net real return). The recommend Hurdle Rate for Timberland is a minimum net real return of 3.5% which equates to 5.75% net nominal return, assuming 2.25% inflation. The risk profile of each transaction and market dynamics will dictate the return that will be require, such that some transaction may have returns above the hurdle Rate.
- Callan does not recommend setting a hard target for the amount of dollars to be invested, but rather allowing the investment decision to be driven by the opportunities. The range for timberland is 30-50% of the total endowment portfolio if attractive opportunities are found, all of the projected proceeds in the Land could be invested in timberland and timberland would remain in the target 30-50% range, assuming the total portfolio remains at or above the current value.
- Investment in additional timberland is a way to replace lost income from the sales of cabin sites and commercial real estate.
- Market dynamics in the Timberland industry included increasing transaction flow. There have been several large intuitional portfolios of timberland brought to the market in the U.S. Several closed–end commingled funds are nearing their expiration, which will result

in timberland for sale. Additional multiple timberland investment organizations are undergoing changes which could result in additional deal flow from manager disruption and terminated vehicles. The environment with substantial availability of properties for sale and projected to be for sale may help to moderate pricing. The availability of transactions is in marked contrast to prior years and the Land Board should take advantage of the increased transaction flow.

- This is an unusual time for the Endowment due to the amount of disposition activity taking place. Based on the current Asset Management Plan, it does not appear that after FY 2020, there will again be the level of proceeds to invest in land. Therefore, the Land Board should consider using Land Bank proceeds to invest in Timberland and Farmland, provide the targeted Hurdle Rates can be met or exceeded and an institutional investment process is used.

Strategic Investment Plan p.g 6-7 (TAB 13). Callan further recommend that a detailed business plan be developed for the acquisition strategy. The Land Board approved and adopted the Strategic Reinvestment Plan. *Minutes of May 17, 2016 Land Board Meeting at pg. 6.*

In the summer of 2017 the Land Board directed Callan to further analyze the reinvestment of Land Bank funds as related to the smaller endowments based on a concern that perhaps the smaller endowments should be treated differently than the public school endowment. *See Minutes of July 5, 2017 Land Board Meeting at pg. 4-5 (TAB 14).*

In April 2018 Callan submitted its analysis which also included a review of the overall strategic reinvestment plan. By this time Timberland was approximately 34% of the Endowment Assett mix by class due to the growth of the financial investment. See *April 17, 2018 Asset Allocation and Distribution Study pg. 4 (TAB 15).* The 2018 study looked at several factors including the level of funding retained in Earnings Reserve and the reinvestment of land sale proceeds. The study recommended increasing Earnings Reserve to protect against financial market volatility due in part to the sale of residential cottage sites and commercial properties.

> "Focusing on cumulative real distributions, a financial investment results in greater distributions in the expected and better-case outcomes while land reinvestment protects in poor capital market environments. Land reinvestment generally provides equal or better protection relative to the financial assets in terms of preventing declines in distributions."

April 17, 2018 Asset Allocation and Distribution Study pg. 6.

The summary findings concluded:

- Depositing land sale proceeds into the financial asset portfolio is preferable under <u>recommended</u> (i.e. increased) reserve levels.
- Reinvesting land sale proceeds back into the lands is preferable <u>at current</u> earnings reserve levels.

The study further noted the "important role in dampening the volatility of the total Endowment over long time periods. *See April 17, 2018 Asset Allocation and Distribution Study pg. 30.*

If, however, the expected return on land investments increased toward 4.5% net real, land reinvestment becomes more compelling relative to the financial assets. *Id. at 31.*

At the May 2018 Land Board meeting, the Land Board approved the recommendation of the EFIB Board to increase earnings reserve levels for the endowments.

> Attorney General Wasden stated his understanding that the basis for this recommendation is two-fold: an analysis of the market by Callan, and the new asset mix that is a result of cottage site auction sales. Attorney General Wasden commented that the Board is contemplating potential risks and the ability to maintain constant payout to the beneficiaries. Mr. Anton agreed; given the expected decline in revenue from both investments and lands, in order to keep the same level of confidence in distributions it is appropriate to have larger reserve levels. Attorney General Wasden noted that the purpose of maintaining constancy in terms of distributions is to best serve the beneficiaries; they can count on that money rather than having some level of volatility which would cause them difficulty. Mr. Anton concurred; the beneficiaries rely on the annual distributions as a significant portion of their budgets, and the Land Board and Investment Board take seriously their roles in keeping distributions stable each year, if not increasing modestly.

See Minutes of May 15, 2018 Land Board Meeting pg. 6-7 (TAB 16).

At the July 2018 Land Board Meeting Callan and the IDL presented the final results of the Strategic Reinvestment Plan Update and the recommendation of the Investment Subcommittee. Consistent with the April Study, the Department and Callan presented three (3) options to the Land Board.

A. Option A "Consistent with the Reinvestment Plan, identify transactions that meet established hurdle rates and set aside sufficient funds over an appropriate time horizon (immediately move money that will either mature prior to the transaction or exceeds what is required).
B. Option B – Move land sale proceeds that are set to expire in calendar years 2020-2021 (approximately $58 million) into the Permanent Fund with the remainder contingent on IDL identifying land acquisitions consistent with the Strategic Reinvestment Plan.
C. Option C – Immediately transfer all Land Bank funds to the financial asset portfolio.

Minutes of July 17, 2018 Land Board Meeting pg. 3 (TAB 17).

Following presentation of the options, there was a robust discussion of the issue by members of the Land Board.

> 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. <u>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.</u> 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.

Minutes of July 17, 2018 Land Board Meeting pg. 5 (emphasis added). There was further discussion by Acting Director Groeschl concerning the effects on sustained yield for the total timber portfolio of additional timberland acquisitions.

> 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.

Id. at 6. The Land Board voted unanimously to approve Option A. *Id. at 8.*

PROCEEDINGS OF THE REINVESMENT SUBCOMMITTEE:

The concept of the "Reinvestment Subcommittee" first came up at the April 2019 Land Board meeting after a presentation by Stimson Lumber regarding its concerns about the Strategic Reinvestment Plan and the "Packers 1" (Molpus) acquisition. Governor Little raised it as follows:

> For the record, Governor Little commented that he was not a member of the Land Board at the time the policy was put in place and proposed that a subcommittee of the Land Board review the current situation. Governor Little noted that EFIB reported earlier in the meeting that a request for proposal for an investment consultant is being advertised, and also noted that $200 million is a large sum of cash to be spending in a significant manner. Governor Little asked for volunteers to serve on a subcommittee of the Land Board to review the asset management plan [strategic reinvestment] going forward. Attorney General Wasden and Secretary of State Denney volunteered to serve on the subcommittee; Governor Little so ordered.

Minutes of April 16, 2019, Land Board Meeting at 8 (TAB 18).

The Committee was formally created at the May 2019 Land Board meeting:

> Land Board Subcommittee: Study of Reinvestment Strategy Discussion: Governor Little reported that following the last Land Board meeting, Attorney General Wasden and EFIB board member Irv Littman agreed to join the subcommittee to look at the current asset investment. Governor Little stated that given the magnitude of $240 million to reinvest, there is a need for absolute certainty in the plan going forward: that the net-net to beneficiaries is what the Board wants it to be in the long term, and that the Board complies with its obligation to maximize returns to the endowments in the long-term. Governor Little mentioned that Mr. Littman was a former chief financial officer of Boise Cascade who knows about timberland investment and is very capable in the securities and investment field.
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> Attorney General Wasden commented that he is pleased to serve on this subcommittee and that it will be beneficial to the entire Land Board. Attorney General Wasden shared some ideas to consider in terms of how the subcommittee's discussion is focused: what

are the Constitutional provisions and the legal aspects; what is the history–how did the Board arrive at its current strategic reinvestment plan; and what are the options going forward. Governor Little duly noted the Attorney General's suggestions.

Minutes of May 21, 2019, Land Board Meeting at 7 (TAB 19).

JULY 10, 2019 MEETING: In July 2019, the Reinvestment subcommittee held its first meeting which was largely formative in nature. No testimony was taken. Governor Little explained his purpose in asking for the Committee is "to have a higher comfort level in the strategy the Land Board is using to reinvest the enormous sum of money that will be available in the coming years, and what the Land Board is doing with that sacred trust." The Governor further indicated that his view was that perhaps "things have changed since the asset allocation study done by Callan in 2014: standards for investment have changed; opportunities for investment have changed; the Endowment Fund did not have a real estate portfolio at that time; 2 1/4% was the acknowledged standard for inflation then." The Committee agreed to meet again where it would hear from legal counsel and its retained experts, Callan and EFIB on these and other issues.

Minutes of July 19, 2019, Reinvestment Subcommittee Meeting (TAB 20).

OCTOBER 10, 2019 MEETING: At its next meeting in October the Subcommittee heard testimony on the following topics:

1. Legal framework governing the Land Board's reinvestment decisions by Darrell Early, Deputy Attorney General. (See TAB 4)
2. A summary of Callan's work in 2014, 2016 and 2018 concerning investment strategy by Janet Becker-Wold. (TAB 21)
3. A summary of performance of the Endowment Fund from Chris Anton (TAB 22)
4. A summary of the land acquisition process and acquisitions to date from former Deputy Director David Groeschl. IDL also provided written answers to questions raised during the July meeting (TAB 23).

Key take-aways from Callan's presentation at the October meeting were as follows:

- Callan is comfortable with the current target asset allocation

- Lands and financial assets fall within the prescribed bands, while cash is clearly over its 1% target

- We recognize that as the financial assets have outperformed lands, they have grown in percent relative to the lands portfolio

- The 2018 study re-visited the asset allocation and concluded that preference for financial assets versus land assets differs based on the assumed return from lands,

the earnings reserve levels and primary objectives (e.g., growing real distributions; protection against a decline in distributions)

- The study concluded that moving to a more or less aggressive asset allocation has very little impact on the prevention of a decline in distributions

- Focusing on cumulative real distributions, a financial investment results in greater distributions in the expected and better-case outcomes while land reinvestment protects in poor capital market environments

- Land reinvestment generally provides equal or better protection relative to the financial assets in terms of preventing a decline in distributions

Minutes of October 10, 2019, Reinvestment Subcommittee Meeting (See TAB 1); Powerpoint presentation of Janet Becker-Wold (see TAB 21).

During questioning Ms. Becker-Wold further explained how the timber asset portfolio works to dampen volatility in the Endowment portfolio because even while it moves in response to economic conditions its movements are delayed. *Minutes of October 10, 2019, Reinvestment Subcommittee Meeting at pg. 5 and 9-10.*

In discussing the 3.5% hurdle rate Ms. Becker-Wold explained these were set to assure that any land asset purchase was "accretive" to the over-all endowment. In other words a purchase would add equal or greater value to the endowment than would purchasing a financial asset. She next explained how the hurdle rates were revisited annually or anytime there was a significant change in market conditions. Importantly, Ms. Becker-Wold, explained that in light of how well the equity markets had performed in recent years, it was likely that the return on investment expectations for the financial assets going forward would be lower, and thus the hurdle rate adjusted downward.

> **Mr. Littman**: That says that given the capital market assumptions that Callan was using for us and other clients, that 3.5%, given the perceived risk and the alternatives, that's kind of a point of indifference.
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> **Ms. Becker-Wold**: Right. And as I mentioned earlier, and I think this is an important thing for us to consider, is that <u>we do an asset allocation update for the Endowment Fund Investment Board annually, to sort of re-benchmark what our current forward ten-year look is. So that is probably up for adjustment, because as the capital markets have outperformed so dramatically, our expectation now going forward is going to be lower for the endowment fund, which means that the hurdle rates should also be adjusted at some point as well.</u> We haven't done that work, and we haven't even completed our expectations for this year yet, but I'm thinking that given the fact that the capital markets have done so well, the equity returns could come down a little bit. We try to do that every year on the endowment fund, so we can make adjustments if we need to. We don't generally make big adjustments, but that's possible, yes.

Minutes of October 10, 2019, Reinvestment Subcommittee Meeting at pg. 11 (emphasis added).

Mr. Anton, then explained the view of EFIB on how timberland assets help to balance the financial portfolio and allow for more aggressive investment in the financial markets by providing a stream of income for payment of distributions. The synergy created by this has allowed Idaho's permanent fund grow and outperform other similar funds in the U.S.

> **Mr. Anton**: Governor, Mr. Attorney General, yes, I think our structure is very well thought out, and I say that in a couple respects. First of all, as we've looked at other land grant structures, the thought that went in during endowment reform of setting up this structure is pretty remarkable. And I say that for a couple of reasons: first, each year we have to grow the permanent fund at least at the rate of inflation. If we have years when that doesn't happen, we make it up. We then move earnings above inflation into the reserve funds to make sure we have adequate and sufficient reserves to manage volatility and keep distributions to beneficiaries consistent. And if the levels in the reserve funds exceed those target reserve levels, we move that money back into the permanent fund, and that's allowed the permanent fund to grow not only at the rate of inflation and population growth, we've exceeded both of those numbers historically as a result of these. In terms of the integration of lands and the endowment fund, it works very effectively because the revenue from lands allows us to pay some of those beneficiary distributions. If you look at the ratios at the bottom of that schedule, you see that in many years, the revenue generated by lands covered all of the distributions, which allowed us to preserve our investment returns, grow the fund, grow distributions. So they all work together cohesively as a nice systematic cycle. So, since we have those reserves, since we have the extra revenue coming in from lands, to your question, we are able to invest fairly aggressively. We have looked at the asset allocation of other land grant institutions and we are on the more aggressive side with 68% equities, so we are going to have more volatility, we are going to have down years, but what we've seen is it's allowed us to generate greater returns than most of our competitors, other land grant institutions. In fact, we've been in the top 10% when compared to all of those institutions, and it's because we have those reserves, because we have money coming in from lands, that we're allowed to invest more aggressively. I don't know if that answers your question.

Minutes of October 10, 2019, Reinvestment Subcommittee Meeting at pg. 15

Finally, Deputy Director Groeschl explained the process used for making timberland acquisitions including how the Discounted Cash Flow analysis is performed and evaluated by third party experts to assure that the established hurdle rates are met or exceeded. With respect to acquisitions made recently, he explained those transactions exceeded the hurdle rates without accounting for increases in the Forest Asset Management Plan sustained yield.

> **Mr. Groeschl**: . . . So with that, the expected return rate well-exceeded … it was in that 4-6% range that I mentioned earlier. The other thing, the immediate benefit of that property as well … we don't look just because of the adjacency, we look at the market conditions of where that property is located. That property also resulted in an increase in

our forest asset on our sustained yield, on our existing land base, of about 10 million board feet a year because of the sustained yield effect by bringing 32,000 acres of young growing stock into the model and into our existing land base. It allowed us to address the large older size classes quicker because we had that younger growing stock in place. That bumped our sustained yield by 10 million board feet, which should generate an addition $3 million a year just from that increase or that sustained yield effect – so that is an immediate benefit of bringing that property into the portfolio.

* * *

Mr. Groeschl: The 3.5% net real is the hurdle rate that we are expected to meet and when we do those evaluations and models, then those models are evaluated by outside experts. They actually develop the models and we have them review each other's models to see if they make sense, as well as internally, but they have to stand alone to meet the 3.5%. When I say that those investments all are expected to yield 4-6%, those were as stand-alone properties, but they will likely yield more than that because of the additional benefit that they provide to the existing endowment land base.

Minutes of October 10, 2019, Reinvestment Subcommittee Meeting at pg. 18-19.

NOVEMBER 13, 2019 MEETING: At the next meeting of the Reinvestment Subcommittee in November, 2019 the Subcommittee asked additional questions of Callan concerning the way hurdle rates were established and the validity of the 2018 recommendations. Ms. Haskins explained that hurdle rates are set so that any land acquisition is "accretive" to the over-all portfolio.

Ms. Haskins: Well, if you remember from our 2018 report, part of what you decide to do depends on where you want to be with regard to the downside scenario, in the worst worse case scenarios – if you want to protect against that, and it was clear that you want to do that, was where land really came into account. So I think part of it is where you want to be on that risk spectrum. I have maintained all along that this is … if you can find transactions … I come at it from more of a bottom up perspective, if you can find transactions that are truly accretive to what you already have; and it sounds like the last couple that have been done not only stood on their own, but have made the rest of the portfolio better, then that's the way to go about it. I think that's what we've tried to stress too.

Mr. Littman: Sally, correct me if I misspeak here. I think what Sally is saying is that's where the hurdle rate comes in. That as you consider adding individual investments, they have to be accretive, they have to be better than what you've got. That is why the hurdle rate was designed. Sally describes that the hurdle rate … this is a criteria, a threshold, she's saying it has to be done in such a way to include all costs including the fire costs and projected inflation. So if the investment is good enough and high enough, then it adds to the overall return and health of the portfolio. If it's marginal or below the hurdle rate, then it will hurt the portfolio and we should not do it. So the question really becomes of

the $150 million, how much is there within the time that we have prescribed that we can execute transactions that are individually accretive and I would ask, not barely accretive, but have enough cushion so that you know you're really adding to the portfolio. Did I say that right?
Ms. Haskins: Way better than I could ever say it, thank you.

Minutes of November 13, 2019 Reinvestment Subcommittee at pg. 7-8 (TAB 24).

Attorney General Wasden then clarified earlier remarks addressing how changes to the overall endowment risk portfolio were addressed by acquiring lands.

Attorney General Wasden: Sally this is Lawrence Wasden. We step back for a moment in time: the state owned a number of parcels of land, they happen to be around Priest Lake and Payette Lake. We've sold land, and that's actually the genesis of that $150 million is that our land portfolio went down. As a consequence of that, our risk factors went up. To accommodate for those risk factors, we increased the size of our reserves. By doing that we were leveling the playing field. The question now is what do we do with this $150 million and in order for us to maintain that balance, we need to do something. That is, we can purchase securities, but that is more volatile marketplace than is the land which is the whole issue I was trying to raise earlier. That it's the working of the entire portfolio together so if we were to acquire land, it may be that we could reduce the size of our reserves based upon what the relative risks were. Isn't it the entire workings of that together that we're trying to accomplish the maximum long-term return?

Ms. Haskins: That's correct, and you point out that there are trade-offs to anything that you do.

Minutes of November 13, 2019 Reinvestment Subcommittee at pg. 8-9.

Governor Little then asked EFIB Director Anton a hypothetical about whether the endowments would have been better off if land bank money had been invested in the equity markets and if issues of risk could be better addressed through reserve levels.

Governor Little: The most widely scribed to index is the Vanguard index, what, 8 basis points?

Mr. Anton: The S& P 500 is 3 basis points now.

Governor Little: I just looked this afternoon. Three, five and ten years it's almost 300 basis point premium over the incredible work that you've done. But it's in a different area. So if you take $2.3 billion times 3%, that's $60 million bucks a year; we would have an additional return if we would have just plowed it all in there. I am not, just like the Towne Square Mall, I am not advocating for that; but what I am saying are there a number of years of earnings reserve that we could put aside to compensate for just plowing it all into the SPDR, the Vanguard SPDR.

Mr. Anton: Governor, members of the subcommittee, we do have a substantial portion of the portfolio of the S&P 500 index. But we don't have it all invested in that because we believe diversification of non-correlated or partially correlated assets reduces the overall risk. To your point, yes if we happen to be all in the US equity market, we would have earned more over the last 10 years. But if you look at the prior 10 years we would have earned less because the S&P 500 was flat for 10 years.

Governor Little: Vanguard's 11% over the life of the programs.

Mr. Anton: Okay, different assets perform well different periods and that's why we're diversified.

Governor Little: But my question is can you make up for that diversity just by having more earnings reserve.

Mr. Anton: If you compare our portfolio to other land grant institutions, we're fairly equity intensive with 66% and we're able to do that because we have the earnings reserves. We're able to take more equity risk in the portfolio and still meet our objective of stable distributions for the beneficiaries because we have 6 or 7 years of reserves and because we have revenue coming into the reserves from the Department of Lands through timber sales. That structure is well thought out and it allows us to be fairly aggressive. Many of our peers are investing in other non-equity related investments to try to reduce volatility. They are investing in other alternatives, infrastructure and other things. So to your question to Sally, yes, we could consider other types of investments that have low risks, but we're able to take a fair amount of risk to try to maximize the returns for the beneficiaries given our structure.

Minutes of November 13, 2019 Reinvestment Subcommittee at pg. 8-9.

<u>MARCH 12, 2020 MEETING</u>: The next meeting of the Committee occurred on March 12, 2020 at that meeting, the Subcommittee once again heard from its experts.

Attorney General Wasden: I'd like to read some minutes of our May 15, 2018 Land Board meeting. It's a fairly lengthy paragraph, but I'd like to read it because it sets out part of our discussion. Callan made a presentation, and then it was actually your discussion. The minutes reflect:

> 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 that they 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 … 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 to the beneficiaries.

Here's my question, do you still feel the same way based upon changes that have taken place in the marketplace, that having the flexibility with these monies while we have this unique opportunity is a recommended option. We chose option A and I am asking you are we still there?

Mr. Anton: As I look at the Callan study that was published in 2018, it really provided the Land Board with a framework to evaluate land acquisition opportunities that were presented from the Department of Lands. Essentially it said that if the opportunity presents a real return of less than 3.5%, it makes sense to put it in the financial assets. If it presented a return between 3.5 and 4.5%, it is somewhat indifferent, although it recommended that if we increased our reserves, as you're closer to the 3.5% end of that range, the financial assets are probably preferable; because we have higher reserves we can withstand a little more volatility. As you move out closer to 4.5%, or above 4.5%, the study recommended considering timberland investments. <u>Again, looking at it from a whole trust perspective, the idea is that if we have opportunities that provide solid returns that are more stable from timber, that makes sense from a whole trust perspective. I think the analysis that they did still makes a lot of sense, that we have to be disciplined, that the Land Board would evaluate any opportunities that were brought forward; we would also have to look at any synergies. I look at us as a strategic buyer. We're in the timber business. We have substantial holdings that if a land acquisition also enhances the returns from our other property it can provide other benefits. We feel at EFIB that we should give the Department of Lands that opportunity that the Land Bank provides to look at opportunities.</u> I think there was always an understanding that if the Department of Lands said there weren't opportunities, or there weren't complete opportunities that spend all of that money, we could certainly transfer the money sooner into the financial portfolio. I think that the model Callan developed, from my perspective, made a lot of sense.

Minutes of March 12, 2020 Reinvestment Subcommittee at pg. 2-3 (emphasis added) (See TAB 2).

Mr. Anton later explained the effects of land revenue on earnings reserve and distributions.

Mr. Anton: One thing that I think is important to highlight as well, is that the revenue generated from the Department of Lands goes into the earnings reserve fund. For many

> years, that level of revenue was enough to basically make the beneficiary payment so that all of the growth and financial assets allowed the fund to grow more rapidly. Over time as the financial assets have grown and the land revenue has come down somewhat, that revenue coming from the lands generates only about 50-60% of the annual distribution. That's another type of volatility or risk that we have, that we're less able to look to that steady source of revenue, and why under certain scenarios having more land revenue is beneficial because it does come into that reserve. It helps make some of those beneficiary distributions.

Minutes of March 12, 2020 Reinvestment Subcommittee at pg. 4. The committee then further discussed how hurdle rates were established and whether they should be annually reviewed.

This was the conclusion of the substantive discussions and testimony to the Reinvestment Subcommittee.

CONCLUSION:

In 2016 and again in 2018, the State Board of Land Commissioners heard from its experts concerning how to reinvest the proceeds held in the land bank resulting from the sale of cottage and commercial properties. While investment in financial assets was always an option, the Board's experts advised that investment in timberland that met or exceeded a specific hurdle rate was also a prudent decision because it provided protection against the risks of down markets and cash revenue to the earnings reserve that in some years paid for distributions and in others allowed for more aggressive investment by the EFIB. Similarly, because of the delayed response of timber prices, it dampened volatility. This Board made an informed decision to be conservative in its investment strategy to protect distributions against market volatility and replace the lost cash revenue by allowing IDL to look for land acquisitions that would be accretive to the endowments and also create additional value to the endowments in the form of increased sustained yield.

During the entire course of proceedings before the Reinvestment Subcommittee not a single expert offered a different view. Despite lengthy questions, both Callan and EFIB have said that nothing has changed between the decisions in 2016, 2018 and today and that the same risk balancing reasons for investing in timberland present in 2016 and 2018 remain true. Both Callan and EFIB continue to support their prior work and recommendations to the Board.

While a worthwhile effort, the proceedings of the Reinvestment Subcommittee have offered no new information that should change the course this Board previously charted for IDL. And, most importantly, no experts have advised that investing in the financial markets today is a better course than continuing to look for timber investment. I encourage my fellow land board members to listen to our experts and affirm the actions already taken by this Board to stay the course as outlined in my alternative motion. IDL should be directed to proceed with the approved strategy from the July 2018 Land Board meeting keeping in mind that as new information, or new ideas for investment of Land Bank monies come forward, those ideas should be evaluated as potential "strategic" investments. Likewise, the IDL should continue to monitor

the Land Bank aging report and look at the “pipeline” of possible investments making sure to consult with EFIB and expeditiously move money into the Permanent Fund that will not be useable for acquisitions.

In an uncertain world, it is more imperative than ever that this Board choose wisely and rely upon its investment advisors when it comes to making investment decisions. Taking action to invest tens of millions of dollars in the financial markets when neither of our investment consultants have recommended such course reflects a lack of prudence that should be avoided.

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Final Minutes
Reinvestment Subcommittee
October 10, 2019

The Land Board Reinvestment Subcommittee meeting was held on Thursday, October 10, 2019, in the State Capitol, Hearing Room EW40, Lower Level, East Wing, 700 W. Jefferson St., Boise, Idaho. The meeting began at 8:33 a.m. Governor Brad Little presided. The following members were in attendance:

Attorney General Lawrence Wasden
Mr. Irving Littman

For the record, all subcommittee members were present.

Governor Little: The Land Board Strategic Reinvestment Subcommittee will come to order. For the most part, I think everybody knows why we're here, and for me, as the new guy, I think that the policy of the Land Board on what to do, I guess it's a $150 million dollar question now. It was a $250 million dollar, but part of that's been put in the permanent fund and part of it's been put in the Land Bank; that to me is the big question. I'm the new one and I know the Board spent a lot of time over the past few years studying it; I know that the EFIB, they've been a part of that, and I just think it's prudent for us at this juncture, you know different things have happened in the market, different things have happened in the value of timberland, and I just think it's good to make everybody have a higher comfort level with the policy that is going forward. I know we'll hear it from Darrell in a minute, but the ultimate question, which in Land Board in the state of Idaho, is should the current plan be revised, changed, or the no action alternative. It's all about getting that maximum long-term return to the beneficiaries which I think everybody in Idaho agrees with. With that, General.

Attorney General Wasden: Governor, I would just note that all members of the subcommittee are present; just wanted to make sure that is on the record.

Governor Little: Roll call will show after a lengthy discussion that we're all here.

Mr. Littman: And to that, I think we ought to acknowledge the tenacity and patience of Renée Miller in working with everybody's calendar in making it happen. And I gather she's not done, so thanks.

Governor Little: And if I have a regret, it's the fact that it's taken this long. And at the end of the meeting, when we wrap up, we'll hopefully get our arms around, because we did make a commitment to have the public comment; we'll definitely do that at the next meeting. But, I'd like to shorten this rather than lengthen it. We'll listen intently to all the presenters that we have this morning and go forward. Anything else?

Attorney General Wasden: Governor, short is good.

Governor Little: Absolutely. I'm all in. All right, Darrell.

Mr. Darrell Early: Governor, members of the committee, for the record my name is Darrell Early, Deputy Attorney General with the Natural Resources Division of the Office of the Attorney General. At your request I'm here today to provide a hopefully short presentation on the statutory and constitutional boundaries that govern the actions of the Land Board with respect to its investment of resources. I have a few slides up here I'm going to try to move through quickly and give you time to ask any questions. So with that, I'll start.

[Editor's Note: Minutes do not capture Mr. Early's presentation of each slide, just questions from the subcommittee members after the presentation concluded.]

Mr. Early: With that, my formal presentation is over. Among the materials that I've provided to you in your notebooks is a summary that was prepared in 2014 by my predecessor, Clive Strong, of basically the history of endowment reform up to that point in time. I think now that I've had more time to read it, my office is going to endeavor to bring that forward to 2020, and some of the more recent decisions that have come out of the Board over the last four or five years to do that. For your benefit, that document is printed in your binder, but it's actually a hyperlinked document, so everything that's in blue in that material, there is a hyperlink on the electronic document. Unfortunately the electronic document is so large I can't email it to anybody, so I have burned it onto thumb drives and I will provide each of you a copy of it. I've already provided one to the Attorney General. Governor, I've given one to your attorney, Mr. Wonderlich, and Mr. Littman I will provide one to you, so that as you read that, you can, if you're interested, click on the document that's linked and it will take you directly to that reference in there. I offered that to you because it does provide a significant amount of context to the discussion that you're having in this committee, and I think it will be very helpful for you all to take a look at that and take a look at some of those references along the way. With that, I'll stand for questions.

Governor Little: Thank you. General.

Attorney General Wasden: I don't have anything, Governor.

Governor Little: I've got a couple. We amended the constitution in the 80s and inserted the words "long-term." As I read some of those citations, they were pre-constitutional amendment, and I get Western Watersheds being kind of one of the sideboards, you know, the court was pretty plain that it says...and it actually was talking to the legislature about what kind of broad discretion. The Watersheds is one side of it, but some of those cases that you cited, when you do your re-drill down on Clive's work, for the decision we have here today, it isn't a big deal, but I think it is for the Land Board and for the legislature going forward. Part of the problem that the Land Board had in the 70s and 80s was the fact that it was being determined by just the return and not the maximum long-term, and when the public and the legislature amended the constitution, that would be helpful for me. And then something peaked my interest right at the end when you talked about 68-502(1), you said the word "taxes." Would that ever be considered as taxes, ad valorem taxes, that go to the counties? I was surprised the word "taxes" was in there because obviously we don't pay taxes.

Mr. Early: Governor, members of the board, the Uniform Investor Act is applicable to all trustees, not just to this body, and so a trustee in management of an asset, if an exchange or a decision by that trustee is going to have adverse tax consequences on the trust, that's what that provision is typically interpreted to apply to, not necessarily to adverse tax consequences on other people outside. Again,

the duty of undivided loyalty to the beneficiaries means that you cannot look to somebody that's not the beneficiary and say is this going to have an adverse impact on them; you have to look at it, is it going to have an adverse impact on the trust and the endowment.

Governor Little: I'm all in, but if the beneficiary is the Benewah County School District, is our undivided loyalty only to the trust, what's in that box, or do we go a little broader and go to the beneficiary, which is public schools, and the tax consequences has a negative impact there; where's that line?

Mr. Early: That raises the question of who is the beneficiary, and off the top of my head I know there's a case that talks about this; I will get you the answer on this issue.

Governor Little: Perfect.

Mr. Early: But the question of the duty of loyalty, and again this goes back to an individual school district is not the only beneficiary of this, so you have to look at all of the school districts, and all of the endowments, and the ability of the endowments as a whole to meet their obligations to every school district across the state.

Governor Little: I get it. When we get to the end of the ditch, I think that's what the conclusion will be.

Mr. Early: My recollection is there's a case out there that talks about who is the beneficiary, and off the top of my head I can't recall the case exactly, but I will get that and I will provide that to your counsel and to everybody for their benefits.

Governor Little: All right. Irv.

Mr. Littman: This was very helpful; thank you. And thanks for the Strong memo as well; good background. So, are there additional statutes and so forth that impose constraints on the freedom of action of either the EFIB or the Land Board, in terms of managing the assets – selling the land?

Mr. Early: There are certain statutes; for example, there is the statute that prohibits the sale of timberland that has been passed by the Idaho legislature. The constitutionality of those kinds of statutes have not necessarily been, to my knowledge, challenged. There's always a question about how far the legislature can go in cabining. Now the constitution does say in Section 8 – Article IX, Section 8 – that the legislature does have a role in this, and so what that role is, and how far the legislature can go in cabining the discretion of this Board has always been a tension. For example, in the Watersheds case, the court found no, this goes too far because the legislature is directing the Board, by statute, to violate its fiduciary duty, its duty of loyalty. So, it's always going to come down to those kinds of tests. I believe there are several different statutes out there that talk about how lands are to be leased, or how lands are to be sold along the way. But, for the most part, the Board has broad discretion in terms of selling land, with the exception of timberland, and again it's to do so with the best interests of the endowments in mind, under the prudent investor rule.

Mr. Littman: But the existing statute is specific to timberland?

Mr. Early: That's my recollection, yes.

Attorney General Wasden: Governor and Darrell, also, and you've mentioned it, but the requirement of disposal at public auction also has an impact on our ability to transact because it lengthens the time.

We can't just simply sell a piece; you have to go through a process for an auction in order to dispose of that, and that includes leases as we've found out.

Mr. Early: Yes. That's in the constitution itself to start with...

Attorney General Wasden: It's not a statute.

Mr. Early: ...and that's been litigated on several occasions over the years as to what that means. The Barber Lumber case raised that question; because of the way it was awarded, there was question, and in fact one of the dissenting opinions notes that the land was offered for public auction under basically a cash offer, and this bidder brought additional terms and additional consideration to the table that wasn't cash, and the other bidder never got noticed that that was even something they should be thinking about. There was a question about whether or not in that case, and the dissenting opinion pointed out that this probably violated the public auction requirement, because it changed the terms of the auction. The Barber Lumber case is actually probably questionable in many ways as a precedent today, because of the Watersheds case. One of the factors the Barber Lumber Company case focused on was the idea that this other bidder, the Barber Lumber Company, had brought the notion that they were going to build this short line railroad up into the endowment lands, and the Board took that into account and said, that's going to increase the long-term returns because it's going to make more endowment land accessible; we'll be able to harvest more timber off of these other lands, and that was what they took into account. But, interestingly enough, they also took into account things like taxes, and the local public interest, and things like that, and again, the dissent in that case points out you're not supposed to look at any of that stuff. We should only be looking at what's in front of us today, not these other things. And in light of the Watersheds case, the Barber Lumber Company case could be looked at in an entirely new light, in the modern era, and might not come out the same way. There is still the argument that this increase in value to the other endowment lands might be a relevant consideration because of its long-term value to the endowments.

Governor Little: And long-term wasn't in the constitution when Barber was discussed.

Mr. Early: No, it wasn't, but there's a lot of criticism of Barber Lumber that basically that was, in some respects, a political vote at the time, and the entity, if you read the facts of the case, the entity that came forward was from out of state, and was using out-of-state banks, and there was a whole bunch of discussion about that kind of stuff by the Board, as to, at the time, as to why they didn't like this bidder, and there's a flavor to that case that in light of the modern era and the modern case law, I doubt would come out the same way, if it were to come before the Idaho Supreme Court in this modern era.

Governor Little: Other questions. Mr. Early, thank you very much, as always. Janet, are you giving your next...we're just almost right on schedule.

Ms. Janet Becker-Wold: Yes, sir, I think I am next. Thank you very much. For the record, Janet Becker-Wold from Callan. Thank you for having us here and giving us an opportunity to clarify some of the questions that were asked of us. I put together a very brief presentation, and the focus of this brief presentation was specifically to address the questions that we received from Nate Fisher on behalf of the committee. I'm sure there are many other issues that you might want to discuss; I brought everything we've ever done for the Land Board with me, in case you have additional questions. But that's kind of how this presentation is laid out.

[Editor's Note: Minutes do not capture Ms. Becker-Wold's presentation of each slide, just questions from the subcommittee members after the presentation concluded.]

Attorney General Wasden: I hate to interrupt you, but it's on that point...the fact that the timber market is moving slower is actually to our advantage because we're able to sort of stabilize the risk factors in the equity markets. I want to make sure I understand what you're saying.

Ms. Becker-Wold: And that is more due to the private nature of it, right, that's it's not been marked to market, exactly. And the corollary inside the financial assets would be the commercial real estate portfolio that the Endowment Fund Investment Board (EFIB) invests in, because that's commercial real estate. It is buildings, and apartments, and that sort of thing. And they get appraised by third party appraisers once a year, and they get appraised by the organizations themselves every quarter, so you can see the steps; you know, every quarter there's an adjustment up or down, but it's every quarter. When you look at the equity market, it's every minute of every day, so the fact that you have an asset that is not being priced daily just dampens the volatility of the entire trust, absolutely. It's more due to the private nature of it.

Governor Little: Questions.

Mr. Littman: Janet, could you elaborate a little bit on the distinction in hurdle rates, looking back at the memo from last summer, to 2018, timberland versus other lands. Other lands had a higher hurdle rate.

Ms. Becker-Wold: Because the risk was higher, so we assigned a little bit higher hurdle rate to ag. And those are the only two we even evaluated was timber and agriculture, because those were the two categories that Department of Lands had said they may have some interesting transactions in.

Mr. Littman: It's relative to the perceived volatility.

Ms. Becker-Wold: Right, because the timber we felt was a little more of a...it was an area that the Department of Lands had a lot of expertise in, it's something where we could kind of quantify the income on, and the ag was a little bit more of an unknown, so we assigned a little bit higher return to accommodate the little bit higher risk that we perceived to be there.

Mr. Littman: When you looked at the total asset allocation going back a couple years, you constrained it by the amount of ownership in the total trust.

Ms. Becker-Wold: I'm sorry, Irv, I'm not understanding your question.

Mr. Littman: Well, if you look at other institutional clients that may choose to invest in timberland, how do you help them get at the right decision in terms of what percentage that ought to play, either in an endowment or pension fund?

Ms. Becker-Wold: I want to make sure I caveat that by saying that is not relevant here. Because this was given to you, this is part of who you are as a state, it's an important part of the trust. So we wouldn't sit back and say to any other institutional client you should have fifty percent of your assets in timber, because their objectives are different; this is a constraint on the management of the trust. Attorney General Wasden's staff basically said, you can't sell this, so you have it, you can only manage it as best you can to meet your fiduciary obligations. But you have the financial assets that you can change. And now I will answer your question.

Mr. Littman: I understand that.

Ms. Becker-Wold: Okay, I just wanted to make sure, because what we would do for them is not particularly connected here.

Mr. Littman: It would be helpful if we understood how an institutional investor would look at timberland.

Ms. Becker-Wold: Right. So, if you take an institutional pool of money, let's say a pension fund, because I think that's an easy example and something that everybody can relate to. If you look at that pool of assets, their objective is to pay their benefit obligations. Their liabilities are pension payments for everyone that is in the plan. And it's going to go on into perpetuity, so it's a long-dated trust. But their liabilities are very different from yours. Your liabilities are not set in stone, per se, they are related to what you can afford to pay, because you're paying distributions from a trust. There, like the name says, it's a defined-benefit plan, meaning the benefits are committed and they're in stone, and they have to be paid. They have a very defined liability stream, so that's different. Their time horizon is very similar: very long/very long. But their liabilities are very different. So what you would do in that situation as a pension, you would say my actuary tells me that in order for me to be able to pay those obligations, I have to earn 7%. And then you go to your assets and you say, how do I squeeze this pool of assets hard enough to earn 7%, and then you design your asset allocation with that objective. But, the risk also comes into it, because as you know, if you put all your money in private equity and public equities, when you lose money, you can lose a lot of money, and it takes almost two times the return to get it back. So there's a real concept of winning by not losing that is a very easy way to think about cutting off what we call the left tail of risk, the really bad scenarios. The market goes down like 2008, 40%; we don't want that to happen. So we build an asset allocation for a pool like a public pension fund to say, we need to grow because we've got to pay this 7%, but we can't afford to take a 40% down year, so you add asset classes that balance each other out, sort of like what we've done in the endowment pool. You have some equities that provide your growth. Private equity: growth. Bonds: stability. Real estate: stability. And then you balance that out and you do the best you can. Because where we are now of course is that the capital markets expectations for a pension fund that's invested approximately 65/35 or 70/30 equities and fixed income, the expected return on that portfolio right now is closer to 6.3%. And while they may want to get to 7%, the risk that you would have to take to get there is more than anybody could sleep at night. So, it's a compromise; it's always a compromise. But where timber would come in would be in a role of a real asset category that would go with real estate, TIPS,[1] and other kind of hard assets in infrastructure. And we would create that as a pool to diversify the equity risk and to provide an inflation hedge, where they may not have one imbedded in it like you do with timber.

Mr. Littman: But it's used in terms of construction of the total portfolio to look at risk and return, and...

Ms. Becker-Wold: Yes, but all of it is in relationship to...

Mr. Littman: ...and diversification, in terms of bonds, and...

[1] Treasury Inflation-Protected Security

Ms. Becker-Wold: Right, diversification, reasonable amount of risk in a return that can at least get you as far as you can go with the risk you can tolerate.

Governor Little: General.

Attorney General Wasden: Governor. Thanks, Janet. In the 2014 study, as that unfolded, there was a great controversy concerning commercial property and there was some comments, I'd like to get your view on them. One comment made to me was, well you Land Board don't need to invest in the marketplace because there's lots of other places you can make money. And I was quite shocked at that, because I'd certainly like to know what that place was, because that's the place I'd like to put my money.

Ms. Becker-Wold: Talking about the lands portfolio, just for clarification?

Attorney General Wasden: I'm just talking about...

Ms. Becker-Wold: In general.

Attorney General Wasden: ...in general. So, no matter where we are, in the lands portfolio, or in the equities portfolio, we're in a marketplace, and there's no other place for us to fulfill our constitutional duty to obtain the maximum long-term financial return. So my question to you is, am I correct in that view?

Ms. Becker-Wold: I think so, if I understand your question, which is, yes, you're limited to the investments that are available.

Attorney General Wasden: Yes, limited to those investments that are available. There was also a concept of, well, you shouldn't be in competition. And, so, as I responded to that, it doesn't matter which marketplace we're in, we're in competition. When we're in commercial real estate marketplace, we're competing with people in the commercial real estate marketplace. When we're in timberlands, we're competing with people who are in timberlands. When we're in ag lands, we're competing with people who are in ag lands. When we're in the equities market, we're actually competing with other people in the equities market. We can't avoid this concept of competition, because it's how a marketplace is made, and it's how we get a return. Do you agree with that?

Ms. Becker-Wold: Yes, but I have to just add one point for historical perspective, which is that we didn't formally opine on the competition aspect of it. That was a political aspect of it that the Land Board was acutely aware of at the time. Our logic...

Attorney General Wasden: Well, I want to do a follow-up on that question.

Ms. Becker-Wold: But our logic behind the commercial real estate was primarily two-fold. One was the determination of whether or not IDL [Idaho Department of Lands] had the appropriate expertise to maintain and grow the commercial real estate portfolio; that was a question that the Land Board had. And the other one was, does it make sense from a risk return perspective to have only Idaho commercial real estate, or did it make sense to have it implemented in a different way that could provide a similar return with lower risk, which was to put it in the Endowment Fund Investment Board portfolio and get more diversified. Those were Callan's issues.

Attorney General Wasden: And in that regard, again the competition issue, it doesn't matter whether you're investing in commercial real estate some other location, or you're doing it by REITs,[2] or whatever way in which you do it, you're still competing with other elements in the marketplace.

Ms. Becker-Wold: Absolutely. Because your commercial real estate portfolio, they're out buying properties, they're bidding against other funds, of course.

Attorney General Wasden: Exactly. And in the same way if you buy a share of Shell Oil, you're competing with other people wanting to purchase Shell Oil stock, too, in the very same way. And so there's no way to avoid that competition element, because that's actually the process by which you get a return is the whole concept of that competition. And so, in the 2014 study, and I remember this very clearly, there's a statement that says your asset allocation, your investment portfolio, really likes timber. And my recollection of that is that it's because we had some volatility in the marketplace and what the land assets did was ameliorated that level of risk. It's the very thing you were talking about and that is that it allowed us to not experience the downside loss in the short term, and we were able to then stabilize that income stream. Is that your recollection?

Ms. Becker-Wold: That is absolutely the case and still is the case.

Attorney General Wasden: Okay, and that was my follow-up question, is that still the case. And...

Ms. Becker-Wold: And that's why we're not trying to make a suggestion that you make some sort of reduction in lands. What we're just saying is the incremental dollar that goes in needs to be accretive. That's the only thing we're thinking of, and the risk. The overall risk.

Attorney General Wasden: And thus the hurdle rates that say, okay, if you're going to invest in here, you've got to have lands that actually produce the money that create the effect that we're trying to achieve.

Ms. Becker-Wold: Exactly. And again on the risk side, though, is that we did mitigate some of the risk that the lands could have taken on in some more significant role by increasing the reserves. Because remember you've got a number of things you can do as a Board that can manage the risk, and the reserves is a very powerful way of doing that.

Attorney General Wasden: So, one more question, and maybe this is better directed to Darrell than you, but I'm interested in your thoughts. If we were to make a choice to invest, based upon what the politics are, as opposed to the financial impacts, would we be violating our fiduciary duty?

Ms. Becker-Wold: I think you know the answer to that question.

Attorney General Wasden: I do. I do know the answer to that question.

Ms. Becker-Wold: You just want me to go on record and say yes.

Attorney General Wasden: Yes, I do; thank you.

Ms. Becker-Wold: Politics can't be involved.

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[2] Real Estate Investment Trusts

Attorney General Wasden: Okay, thank you.

Ms. Becker-Wold: But how you define that, as your office has pointed out, can be interpreted differently under different circumstances.

Attorney General Wasden: Right. Exactly.

Ms. Becker-Wold: That was the consultant's answer.

Mr. Littman: This might be a better question for Department of Lands, but it seems that to really understand the impact on what lands does to impact the total ability to make distributions, and recognizing that we are not going to sell timberland, that we're looking at the cash flow that's going to come off the management of that timberland, from stumpage sales and so forth. So, have we ever looked at what's the stream of that, what's the volatility of that cash flow?

Ms. Becker-Wold: Yes. That was an important component of the study in 2018, is Julia looked at the volatility in 2014 of those land revenues compared to the volatility of the revenues now; the Department of Lands provided us with a significant amount of data on that so we could do an evaluation of that volatility.

Mr. Littman: And that was included in your analysis of the reserves?

Ms. Becker-Wold: Yes, it was. It was included throughout.

Governor Little: Have we hit the reserve levels?

Ms. Becker-Wold: Yes, you are at all the recommended reserve levels. We've had great returns in the markets, and you were able to do that and increase distributions this year. Just want that to go on the record.

Governor Little: If I look back at your work before, that even at a 3.5% hurdle rate, Callan's recommendations were if we met those reserve levels, to invest the Land Bank money in the financial assets. Do I have that correct?

Ms. Becker-Wold: That's what we had in the study, yes. We also did make comment in there as well that there was a role for lands on the worse case scenarios for the ability to not lower reserves. I just want to make sure that also gets stated.

Governor Little: And of course I go back and forth about this, but, if we're in the back of our mind thinking about the worst case scenario, you know, 300 basis point increase in interest rates, which would darn sure have an impact on housing and the price of lumber and it would have a big impact on the market, that balance coefficient, counter-cyclical, at some point in time, when everything goes to hell, everything goes to hell. Do I have that right?

Attorney General Wasden: I'm not going.

Ms. Becker-Wold: Governor Little, they go to hell in a different time; they go at different times. They don't all go at the same time, which is what we hope. You know, we're in kind of a unique situation, and I'm not trying to dodge your question, but we're in a unique situation right now where equities are very highly valued, bonds are extremely highly valued, and real estate is arguably pretty valued, too. So, there's risk across the system right now and I think that the economy is starting to feel it. We have

the trade and tariff wars, we have a lot of stuff going on, slow growth in Europe, etc., so we could be entering this period now where you have a risk across. So there are periods of time when equities have been highly valuated but bond rates are higher, which means that they can go lower. You know, the ten-year treasury, I don't know where it is today, but it's been bouncing around about 150, which is low, which means the Federal Reserve has very little room to move rates down to stimulate the economy at this point, so they may have to go to fiscal policy, and then if they do, that could be very good for the timber portfolio because if there's construction – I don't know how much timber is involved in government infrastructure projects – but there's a number of things that we can't anticipate that could happen, so we just try to position the portfolio to not get too highly impacted by any one of those potential scenarios: high inflation, rising rates, falling equities. We've tried to balance everything and that's why we did this whole trust view is to take into account the key role that lands plays in all of that, which is this more steady income. And it will respond differently to the markets at different times than the equity market will, or the bond market, so the idea is to spread things out. Don't put your eggs all in one basket, so to speak. We've tried our best overall, over many years, to do that and it's been pretty effective. If you look at the overall returns of the trust, they've been very good. You are the model for other states. I work with two other states and one right now is trying very hard to implement your model, and they are having some troubles because of their constitution, but you're held up as the model for land trusts in terms of how you balance these risks out.

Governor Little: Well, we want to stay in that category.

Ms. Becker-Wold: I can't imagine that you would not.

Governor Little: So, you stated in 2018 that TIMOs[3] are basically a little reluctant because they think, and of course a TIMO has a different role than we do, but the bottom line is if they're going to spend a dollar in timberland, Idaho's not their preferred target state. Is that correct?

Ms. Becker-Wold: I believe...and again, this was Sally's thing, so I will try to channel her right now, but in our conversation with her, they did it as part of the preface, the update memo that was presented to the Land Board in conjunction with the strategic reinvestment plan, and she did do a survey on that, and they did say that. But her conclusion from that is that gives you an advantage.

Governor Little: No competition.

Ms. Becker-Wold: Because they're not here, they're somewhere else. And if they don't want the type of timber that Idaho produces, they'll get it in Georgia or wherever they want, but that gives you less competition, which means maybe you can charge higher prices. I don't know how that plays through, that would clearly be a question for the Department of Lands, but I think that was her general conclusion from that, is that gives you an advantage. A window, maybe.

Governor Little: For the most part, we're price takers, we're not price makers. Even though we'd like to be.

Ms. Becker-Wold: I'm sorry, I'm not a timber expert. I won't even try to go there.

[3] Timber Investment Management Organizations

Mr. Littman: Janet, if I could come back to the hurdle rate; maybe this is a question for Sally. This is last summer – the 3.5% hurdle rate is viewed as that minimum threshold for a timberland acquisition to be accretive, or to not be dilutive.

Ms. Becker-Wold: And that's on a real basis.

Mr. Littman: On a real basis. And that's exactly what I'm asking. So, in the memo, it describes 3.5% which equates to 6.75% gross nominal return, and 2.25% inflation. Is the rest of that...that doesn't add, so there's a piece missing. Is that the student population adjustment?

Ms. Becker-Wold: That's possible. I'm going to try to find that right now in the document. I assume that's what she did, that she probably put in a 0.2 or 0.3% for student population growth, or it might have even been higher.

Mr. Littman: It looks like it's about a percent.

Ms. Becker-Wold: Can I have Sally get back to you on this, Irv?

Mr. Littman: Yes, an email, to help us understand that, because that's kind of at the heart of...[*unintelligible*]

Ms. Becker-Wold: Absolutely, I'm happy to have her get back to the committee.

Mr. Littman: That says that given the capital market assumptions that Callan was using for us and other clients, that 3.5%, given the perceived risk and the alternatives, that's kind of a point of indifference.

Ms. Becker-Wold: Right. And as I mentioned earlier, and I think this is an important thing for us to consider, is that we do an asset allocation update for the Endowment Fund Investment Board annually, to sort of re-benchmark what our current forward ten-year look is. So that is probably up for adjustment, because as the capital markets have outperformed so dramatically, our expectation now going forward is going to be lower for the endowment fund, which means that the hurdle rates should also be adjusted at some point as well. We haven't done that work, and we haven't even completed our expectations for this year yet, but I'm thinking that given the fact that the capital markets have done so well, the equity returns could come down a little bit. We try to do that every year on the endowment fund, so we can make adjustments if we need to. We don't generally make big adjustments, but that's possible, yes.

Mr. Littman: And as the Governor pointed out, the only data you had that was scrubbed at all was based on the total U.S. market that includes all regions and timberlands.

Ms. Becker-Wold: We did try to do adjustments where we could on the risk and return, and that's all outlined in great detail in the 2014 study, exactly how we came up with all those assumptions, the proxies we used, all the numbers that we evaluated, the standard deviations, everything, is all outlined in a huge amount of detail.

Mr. Littman: Okay, but important for us to understand that there's huge variations in the characteristics of commercial timberland by region, and within a region, so to some extent, that's the one area where we don't have as extensive of data as we do on all the other asset classes.

Ms. Becker-Wold: Exactly. And so we had to use the national index as a proxy, and then we made adjustments to try to accommodate a single market, which is a riskier market, actually, because it's less diversified. But all of that is in there and we outlined it very clearly, exactly what all the adjustments were and why.

Mr. Littman: Thank you.

Governor Little: Janet, if we're going to go back and look at that, I would suggest, or I guess I would ask if it was your recommendation...when you buy an asset type you can't sell, statutorily, is different than everything else that's over at the EFIB; every asset there: TIPS, REITs, any global whatever it is, the board can make the recommendation, you or one of your advisors makes a recommendation, they can do that. It's hard to buy an asset type that you can't sell, and so when you're comparing it, is there a way to milk that out of the decision to buy an asset type that you can't sell?

Ms. Becker-Wold: That's a very unique situation that you're in. Yes, there is an illiquidity component to that; that creates additional risk because you can't change it. I would defer much of this to IDL; I think that's the way they look at it, is that we won't buy it unless it will add some value to what we already have. In other words, if it's a right-of-way, or a continuous property, or you're consolidating a piece, or whatever you're doing, and again this is not my area...I'm sure that's fore in their mind, in addition to the potential return that they have to consider by virtue of their obligation as fiduciaries, and yours, to do that. And I'm sure that when they calculate everything out – and they also have advisors that work with them on acquisitions – they have to be considering this, because that's part of the overall cost and management of lands. But I don't know how you quantify it, except to do what we kind of did, which was in the 2018 study try to look at what we could in terms of knowing that once it goes into lands, it's there forever.

Governor Little: But I would argue that there's a certain class, that's right adjacent to you, that there's great margins in when you purchase it, but as I've known a few large landowners and all they ever wanted to do was buy what was next to them, and where do you draw that line. If you buy what's next to you that adds great value to what you already have, that's one thing, but if you just have a policy I'm going to buy whatever's next to me, there's a big difference in that.

Ms. Becker-Wold: Governor Little, that's a conversation with IDL. We have no opinion or no transparency into that issue.

Governor Little: But this goes to the greater question, what do we do with $150 million?

Ms. Becker-Wold: Well, we tried to give you our best thoughts in the 2018 study.

Governor Little: Anything else.

Attorney General Wasden: Just a thank you.

Governor Little: Thanks, Janet.

Ms. Becker-Wold: Thank you.

Governor Little: Chris.

Mr. Littman: Can I ask a follow-up question to Mr. Early? Does the prohibition against sale of timberland, statutory prohibition, does that apply to after-acquired timberland?

Mr. Early: It's my understanding it does.

Mr. Littman: As well as the original.

Mr. Early: Right. There's no constitutional provision in either the Admissions Act or in the Idaho Constitution that prohibits the sale of timberland, and in fact there probably were transactions back in the day where some of that timberland was conveyed away. I don't recall exactly when that statutory prohibition went into effect, off the top of my head. I can get that information to you. And we certainly sell other types of land, ag land, and grazing.

Mr. Littman: It's just timberland, and it doesn't matter whether it's to be acquired or in the portfolio.

Governor Little: Ag lands not included in that, is it?

Mr. Early: Not to my knowledge.

Governor Little: It's just timberland.

Mr. Early: Just timberland.

Attorney General Wasden: Darrell, recognizing that the statutory provision exists, and the potential that it poses to interfere with the fiduciary duty of the Land Board, if the disposal of a parcel of timberland was in the best interest of the beneficiaries, that statutory provision would have to give way to the constitutional fiduciary duty; do you agree?

Mr. Early: I believe there's case law that would support that; some of the cases that are referenced in there talk about the ability of the legislature to control and cabin. Balanced against that, though, we have to remember that there is language in the constitution that gives the legislature a role in this, and so where the court is going to draw that line and say this is interfering with and causing a violation of the fiduciary duty, as they did in the Watersheds case, versus were they properly exercising their role to judiciously locate and provide for the disposition of those lands. And that's the language in Article IX, Section 8 that will be the focal point of that. And I would defer opining on what the Idaho Supreme Court might do in that circumstance.

Attorney General Wasden: Thank you.

Governor Little: Chris.

Mr. Chris Anton: Governor, members of the Strategic Reinvestment Committee, good morning, my name is Chris Anton, I am the Manager of Investments for the Endowment Fund Investment Board. I was asked to respond to two questions, and their schedule is hopefully in your materials; I know the print is a little small. So I'll provide an overview and certainly respond to any questions you may have.

The first question was to outline the diversification, or the investment strategy, for the Endowment Fund portfolio, often referred to today as the financial assets. The first page shows what we call our Asset Allocation; this is included both in the EFIB and the Land Board investment policy. And as you can see in this schedule, we currently have an allocation of 66% to equities, 8% to real estate, and 25% to fixed income. The equity allocation can be broken down further into 38% for domestic or U.S. equities, 19% for international, and 9% for global. So again we have a bias toward U.S. stocks. And then we have a breakdown of the U.S. piece into large, mid and small, and we have a slight bias relative to the market toward mid- and small-cap companies. So that's a breakdown. I can get into more detail; we

have about 19 different managers that help us implement this strategy that specialize in each of the areas in that allocation.

The second question I was asked to respond to is to provide an overview of ten years of financial history for EFIB. These numbers are a simple summary of our audited financials. They reflect revenue coming into EFIB from the Department of Lands, the investment gains or losses that we've realized, the distributions to beneficiaries, and then ultimately what the balance of the endowment portfolio is. The first section of the schedule are additions to the earnings reserve funds. The vast majority of revenue generated by the Department of Lands goes into the earnings reserve funds for each of the beneficiaries. And those revenues include such things as timber revenue, grazing lease revenue, other ground leases such as the cabin site revenue from leases; those all go into the earnings reserve funds. You can see the trends; the revenue grew from about $44.4 million in 2010 and peaked in 2014 at $87.9 million, and for the fiscal year that just ended June 30th was $69.3 million. We also pay out of the earnings reserve funds expenses, both the Department of Lands expenses and EFIB expenses, so you can see the expenses incurred by the Department of Lands to manage those land assets and to generate those revenues. The net land revenue going into the earnings reserve has grown from about $21.4 million in 2010, peaked in 2014 at $64.1 million and in the year that just ended, 2019, was around $40 million. The decline can be spoken to more specifically by the Department of Lands but is primarily the result of the sale of commercial real estate that generated consistent revenue, and the sale of the cabin sites, which also was a strong source of revenue for the beneficiaries. The second category are additions to the permanent fund. If the Department of Lands sells land, or generates revenue that is a depletion of the value of the land, so from natural gas or mineral royalties as an example, those are added to the permanent fund so they retain and become part of the whole trust. Those numbers typically run, as you can see, about $2-3 million a year with the exception of 2015 when some of the revenue that was generated from the sale of commercial sites was moved from the Land Bank into the permanent fund. The next section of the report highlights our investment performance. As Janet indicated earlier, it's been a very strong ten-year period. You can see every year, with the exception of 2016 where we had a very modest loss, we had gains on our investments, and then you can see EFIB's expenses to manage the investment process. Currently those expenses are running about $9 million a year. Of that total, around $700,000 is the cost related to the EFIB team. Most of those expenses are to pay the managers who are helping us manage the fund, to pay the custodian, and to pay our consulting expenses. Finally, you can see the distributions out to the beneficiaries, and they've grown consistently during this entire period from about $45.9 million to $78.4 million in 2019. And as you know, I think we approved a little over $84 million for 2021. There was one year in fiscal 2011 where a special $22 million distribution was approved for public schools. The results are pretty impressive of what you and the team have done. The endowment fund balance was $920 million at the beginning of fiscal 2010, which would have been July 1, 2009. And we closed on June 30, 2019 with a balance of $2.3 billion.

So the growth again is the result of outstanding efforts by the Department of Lands to bring in revenue, that's added and helped us make many of our beneficiary payments, and very strong financial markets that have allowed the portfolio to grow. As that grows, our distributions to beneficiaries continue to grow each year. That's a high level overview of our results and what we've experienced the last ten year. With that, I'll stand for any questions you may have.

Attorney General Wasden: This is an oversimplification, I understand, but because we have a fiduciary duty that is an ongoing duty, so we have a duty to the current beneficiaries and we also have a duty to

future beneficiaries, I'm thinking about the asset mix that we have, with the Endowment Fund Investment Board portfolio, as well as the land assets. Based upon that, it's within the parameters of meeting that fiduciary duty to the current beneficiary, as well as to the future beneficiary, and it accounts for inflation and increase in school student population. So, is it your recommendation and your view, and I realize you only have half this puzzle, but do those two components work together in your view?

Mr. Anton: Governor, Mr. Attorney General, yes, I think our structure is very well thought out, and I say that in a couple respects. First of all, as we've looked at other land grant structures, the thought that went in during endowment reform of setting up this structure is pretty remarkable. And I say that for a couple of reasons: first, each year we have to grow the permanent fund at least at the rate of inflation. If we have years when that doesn't happen, we make it up. We then move earnings above inflation into the reserve funds to make sure we have adequate and sufficient reserves to manage volatility and keep distributions to beneficiaries consistent. And if the levels in the reserve funds exceed those target reserve levels, we move that money back into the permanent fund, and that's allowed the permanent fund to grow not only at the rate of inflation and population growth, we've exceeded both of those numbers historically as a result of these. In terms of the integration of lands and the endowment fund, it works very effectively because the revenue from lands allows us to pay some of those beneficiary distributions. If you look at the ratios at the bottom of that schedule, you see that in many years, the revenue generated by lands covered all of the distributions, which allowed us to preserve our investment returns, grow the fund, grow distributions. So they all work together cohesively as a nice systematic cycle. So, since we have those reserves, since we have the extra revenue coming in from lands, to your question, we are able to invest fairly aggressively. We have looked at the asset allocation of other land grant institutions and we are on the more aggressive side with 68% equities, so we are going to have more volatility, we are going to have down years, but what we've seen is it's allowed us to generate greater returns than most of our competitors, other land grant institutions. In fact, we've been in the top 10% when compared to all of those institutions, and it's because we have those reserves, because we have money coming in from lands, that we're allowed to invest more aggressively. I don't know if that answers your question.

Attorney General Wasden: Absolutely; thank you.

Governor Little: Chris, from an accounting standpoint, if you look at land receipts from a gap basis, and Mr. Littman can correct me if I get out on a limb here, but when you sell assets, wouldn't it be prudent to say this is normal operating income, you know, commercial leases, timber, on a sustained basis, versus when we sell, as it showed up here...we've probably sold eighty percent of our cabin sites, and eighty percent of our commercial property. Shouldn't that be on a different line, because it skews a statistical analysis given the fact that you're selling.

Mr. Anton: Governor, members of the committee, so at EFIB, we recognize revenue when it comes to us, and it comes to us when it's transferred, currently monthly, from the Treasurer's office. So, as the cabin sites have been sold, we haven't recognized any of that revenue; it's currently in the Treasurer's office. I think the balance, you'll see in the Land Board meeting on Tuesday, is around $115 million. We only recognize that revenue when a decision is made by the Land Board to move it over, and that's what happened in 2015, and it is accounted for separately as a transfer directly into the permanent for those beneficiaries. Keep in mind that each beneficiary has both a permanent fund and an earnings reserve fund, and if there is sale of assets, or depletion of assets, on their land, it goes directly into the permanent fund and is accounted for separately.

Governor Little: Other questions. Thank you.

Mr. Anton: Thank you.

Governor Little: Mr. Miller, or David. There's the winner.

Mr. David Groeschl: Governor, members of the subcommittee, for the record, my name is David Groeschl, Deputy Director for the Department of Lands. I will attempt to keep my comments brief and then stand for any questions.

Governor Little: You've got about five minutes, so if you can do it in three, that would be perfect.

Mr. Groeschl: To date there have been four acquisitions, all timberland acquisition, 36,000 acres, roughly $50 million in acquisitions. As Chris mentioned, $46 million has already been transferred into the permanent fund. We have evaluated a number of transactions over the last three to four years, roughly. A number of those did not meet certain criteria, whether it was the return threshold, or other factors that we were looking at. It is a very disciplined process like any investor would make, and I would like to clear up a couple of misconceptions. TIMOs as has been referenced here, timber investment management organizations, are not fleeing Idaho because this is not a good place to invest. In fact, I have spoken to those TIMOs, and I have also spoken to other investors, and they see Idaho as an attractive place to invest. That is why, as you understand from previously, one company expressed great concern about competition, us buying timberland in Idaho, because this is a desirable place to invest, both from the markets, the political environment, the tax environment here in Idaho; this is a valuable place to invest for these investment groups. The reason some of these TIMOs are disposing of their property is because of investment cycles. Their investments have come mature; their clients have indicated to them how long they want to hold that investment. Those investments are five to fifteen years in length; when they hit maturity, those TIMOs look to divest of that for that client, and then reinvest for that client somewhere else. There are other investors, then, who look at acquiring those lands when they're looking at divesting of it. Years ago we were asked to look at the lands that have been purchased by DF Development down in southern Idaho; we did not purchase or even attempt to make an offer on those because they did not meet our investment goals, as far as the return rate, the markets, and other issues associated with those properties. The lands that we have purchased thus far, the four properties, have all been focused in strong market areas, good transportation, more competition, and good milling infrastructure if you will. So that's where our focus has been, and that's where other investors are also looking at investing. That's why the TIMOs and REITs are looking at their cores being in those same areas that we are looking at. There's been a number of questions asked when the LEV calculation was done, land expectation value that Janet mentioned. There are a few things that have come up. One is the fire expenses. Fire was part of the valuation process, both in determining the original value of the timberland and the different assets. So on fire, we pay a fire assessment of 60 cents an acre, like all private land owners; we pay the FPA assessment now of 13 cents an acre; and any negligent fires that started on IDL on the endowment ground we pay those expenses as well. No private entity pays for suppression costs other than when it is a negligent fire, same as IDL. So we treat the endowments like private lands when it comes to paying the assessments and paying for negligent fires. Those costs are all reflected in the LEV calculation as well as in the timberland valuation when we're looking at acquisitions. Another piece of this is when we look at making an acquisition and we do a discounted cash flow analysis. The question of the ability to sell or not sell the property is taken into account when we make an acquisition decision and we do the discounted cash flow. For example, if it were timberland that we could sell, we would build in

incremental land sale values into the cash flow model like the private sector does. They put incremental land sales in theirs, they peel off higher and better use properties that they can capture additional value on. IDL cannot, so that is not factored into our discounted cash flow, and that is conservative on our part because we can't sell it. They actually have a competitive advantage when it comes to buying timberland because of their ability to not only manage it and derive stumpage revenue. That is all we can derive off of the property basically is stumpage revenue, versus incremental land sales that they build into their cash flow model. So it is taken into consideration when we do the discounted cash flows and we do a range of discount rates from 3.5% to 6%. The four properties that we purchased will yield expected returns from 4 to 6%. The goal was to not only meet the hurdle rate, but to exceed it so that we got an uplift in the entire portfolio and it's based solely on stumpage revenue. When the LEV calculation was done, it also included about nine percent other revenue from layered revenue on our timberlands. So we have stumpage revenue, that's about 91% of our revenue from timberlands, then we have communication sites, we have grazing leases and permits, we have recreational revenue coming in, commercial recreation revenue. That's about 9%. That was not factored into the discounted cash flow models that were developed for the four acquisitions. So again, those expected returns are conservative because we did not build in the 9% additional revenue that we may earn off those properties. In addition, those models were developed by two outside, independent experts – timberland experts that do business not only in Idaho but in the Pacific Northwest. Those discounted cash flow models and the assumptions that went into them were rigorously debated and developed independent with the two advisors to evaluate those properties. Again those are the four properties that met the criteria, those were the acquisitions that were made; there were many that did not, both timberland and farmland. In addition to the statutory prohibition on selling timberlands, another complicating factor that we do take into account is the constitutional acreage limitations to any one entity. It is 320 acres for most of the endowments, and I believe it is 160 acres for University of Idaho endowment. When we evaluated farmland properties, those farmland properties could not meet or exceed the 4.5% net return because many of those farmland properties when they are larger – 1,000-, 2,000-, 3,000-, 4,000-acre properties – are basically operated as a unit. The complicating factor is you would have to do a discounted cash flow with a terminal value in it, meaning you would sell that asset in 10-20 years in order to capture the appreciated value of that property, in order to meet that 4.5% net real. We could not meet the hurdle rate based just on management revenue like we can on timberland. That's why we've made no farmland purchases to date, plus we knew to sell a three- or four-thousand acre operation like that we would bump up against the constitutional acreage limitations which made it very difficult then. You're busting up a whole farm operation in order to meet the constitutional acreage limitations; that is part of the complicating factor. So I wanted to conclude by basically saying this is a complex situation. I could talk about the impacts to counties, and talk about the school distributions, and the ad valorem tax rate versus the distribution to the school districts within each of those counties, and some of the other economic direct, indirect, and induced that are generated from endowment land management. But suffice it to say that IDL has been focused on implementing the Land Board's approved reinvestment strategy and looking for those opportunities to invest in timberland and farmland as directed in that reinvestment strategy and our focus has been on our fiduciary obligation to the endowments for the long term. While we take all of those secondary pieces into account, our focus has been to meet that long-term return to the endowments. With that, I will stand for any questions.

Governor Little: Questions. David, on Packers 1, it's different than our legacy land portfolio; have we done an analysis given the fact that some of that Packers 1 timber was pledged to the seller versus the state? Have all of those hurdles that you talked about in the 9% that's over there...as we look forward

of what we do with this $150 million that's burning a hole in our pocket, have we done a post-Packers 1 analysis on what we think the cash flow is going to be?

Mr. Groeschl: Governor, members of the subcommittee, yes that was all part of the discounted cash flow looking at the timber reservation by the three clients there. So those timber reservation...that value was actually zeroed out in the discounted cash flow, and the remaining timber volume and the growth that was occurring was all part of the discounted cash flow. So with that, the expected return rate well-exceeded...it was in that 4-6% range that I mentioned earlier. The other thing, the immediate benefit of that property as well...we don't look just because of the adjacency, we look at the market conditions of where that property is located. That property also resulted in an increase in our forest asset on our sustained yield, on our existing land base, of about 10 million board feet a year because of the sustained yield effect by bringing 32,000 acres of young growing stock into the model and into our existing land base. It allowed us to address the large older size classes quicker because we had that younger growing stock in place. That bumped our sustained yield by 10 million board feet, which should generate an addition $3 million a year just from that increase or that sustained yield effect – so that is an immediate benefit of bringing that property into the portfolio.

Governor Little: That was all pre-sale, have we done anything post-sale on Packers?

Mr. Groeschl: Governor, members of the subcommittee, the wood stock modeling was done after the acquisition was done. We had no idea what the uplift to our existing land base would be in our existing sustained yield when we purchased the property. When we make an acquisition decision it is solely based on meeting the return expectations for that property, not the uplift or additional value that we achieve by bringing it into our existing land base.

Governor Little: So the analysis that is taking place now, the $135,000 that the Land Board either talked about or didn't talk about at the last Land Board meeting, that will not do some of the analysis that you're talking about you did after. I guess explain to me, when we go out and assess a piece of ground to purchase, I just assumed that we factored all of those items into there. But now you're saying that after Packers 1 you did some of the analysis as how it affected your entire sustainable production afterwards...so I'm a little confused on this.

Mr. Groeschl: Governor, members of the subcommittee, when we evaluate a particular property we have to value that property on its merits, so the due diligence that's done on that property looks at the existing merchantable volume on that timber and looks at the age/size class distribution of the timber across that property – looks at access, looks at if there's any environmental issues there – and then we develop a discounted cash flow model with different discount rates to look at, what's the potential range of that property. We have to make an investment decision solely based on whether or not that property will yield the kind of return that we're looking for; Callan has given us as a minimum hurdle rate which is 3.5% net real. We evaluate the property on its own merits. There's many times when we get additional value that we then model separately, if you will, from the evaluation of that property. So if that property unlocks value to our existing timberland by providing access, or it allows us to address some of our inventory imbalance on our existing land base, the older to larger size class and address that quicker, all of those are evaluated separately and taken into consideration, but it does not influence the decision of whether or not we buy that piece of property. That's why when we make an acquisition, the benefit derived to the endowments is usually greater than just that property as a stand-alone analysis or evaluation. There are added benefits to the endowments that have occurred.

Governor Little: That's new to me. I thought the 3.5% hurdle rate included everything, but you're saying it does not.

Mr. Groeschl: The 3.5% net real is the hurdle rate that we are expected to meet and when we do those evaluations and models, then those models are evaluated by outside experts. They actually develop the models and we have them review each other's models to see if they make sense, as well as internally, but they have to stand alone to meet the 3.5%. When I say that those investments all are expected to yield 4-6%, those were as stand-alone properties, but they will likely yield more than that because of the additional benefit that they provide to the existing endowment land base.

Governor Little: Okay. Mr. Littman.

Mr. Littman: I may take more time than allowed. David, when you talk about the 4-6% return for these, is that real return?

Mr. Groeschl: Governor, Mr. Littman, members of the subcommittee yes, those are net real returns.

Mr. Littman: So you've adjusted it for your inflation expectations and have you included this factor that we're going to talk about later of the growth in school population. When we talk about real return it has to be after inflation and after accommodating the student population growth. Are those numbers you've incorporated in the calculations?

Mr. Groeschl: Governor, Mr. Littman, members of the subcommittee, they are adjusted for inflation. Inflation is already taken into account, those are net real. The overall distributions and the growth of the entire corpus, the permanent fund, has to take into account inflation and growth of student population. The discounted cash flow analysis that we do, and the decision criteria that goes into making an acquisition, does not take into account student growth.

Mr. Littman: The Land Bank has about $120 million now, is that correct?

Mr. Groeschl: About $115 million currently.

Mr. Littman: As sales occur it'll grow. Can you provide us some data on the scope of the issue we're talking about relative to the acreage, timberland acreage owned today; using reasonable expectations, what would be the growth if all of that were reinvested in timberland? How much more timberland would we grow as a percentage of existing land base?

Mr. Groeschl: Governor, Mr. Littman, members of the subcommittee, if all of the expected Land Bank funds, the $115 million and what's expected to go in over the next three to four year...if it were in the $150 million range, the additional land that could be acquired from that, again, it would depend on the value of the land that we're purchasing. But if it is in the same ballpark of what we've been purchasing, and it's in that $1,300 to $1,400 range, you would be looking at anywhere from 100,000 to 130,000 acres, depending on values of those properties. Stepping back, when we look at what the endowments were originally given at statehood, it was 3.65 million; 1.2 million has been sold, 400 million of that was agricultural lands, the remaining roughly 800,000 acres was timberland and rangeland combination. So when you look at it in the scope of everything, it puts maybe ten percent back into the endowment portfolio. One of the goals that Callan had given us as they looked at the asset allocation, as Janet mentioned, was where we're currently at versus what the goal would be to keep the range of timberland within thirty to fifty percent of the total asset value of the permanent fund. That would require an investment of this magnitude because over time as the permanent fund grows,

the land asset value becomes a smaller and smaller portion of that. So in order to keep it in that range, and to create the ballast to the volatility of the financial assets as Janet mentioned, we also have to find a mechanism to grow the land asset side. There are only about three ways to do that. One is to gain access to locked lands to increase the value of that land; another way is to layer revenue streams off that land; and the other way is to buy land and to add that asset if it meets or exceeds the hurdle rates. Those are the three ways to build the value of those land assets.

Mr. Littman: It could conceivably add about ten percent to the acreage of timberland. Spending the full amount of cash available, and expected to be in the near term, could add ten percent to the timberland acreage, using some reasonable assumptions of price. You talked about that you haven't invested in farmland and rangeland and explained some of the issues there; is that still in your plan – to what extent have you focused resources on farmland and rangeland?

Mr. Groeschl: Governor and Mr. Littman, members of the subcommittee, we continue to evaluate farmland opportunities and timberland opportunities. The rangeland has never been a component of it because it has never been considered an institutional grade type of investments. There's several issues with rangeland in doing that. But farmland and timberland have been considered institutional grade investments that the endowments should look at. So that's where our focus has been. Those are the two asset types we continue to evaluate.

Mr. Littman: So to simplify the analysis, rangeland is basically off the table. Farmland is on the table, but hasn't been executed.

Mr. Groeschl: That's correct.

Mr. Littman: You mentioned the experts you draw on, could you name some of the consultants.

Mr. Groeschl: Governor, Mr. Littman, members of the subcommittee, when we were looking at governance structure and looking at reinvestment, Callan put out an RFP[4] for timberland advisors and farmland advisors. We currently have two timberland advisors that we have worked with. One is Mason, Bruce, and Girard; the other one is Northwest Management, and their real estate arm is Northwest Rural Properties. Those are the two timberland advisors that we've been working with. There are others that we have used as subcontractors to assist in doing some of the due diligence work. On the farmland side we're also using one of the advisors to evaluate farmland properties for us. I do not have the name of that advisor off the top of my head.

Governor Little: General.

Attorney General Wasden: Nothing.

Governor Little: Thanks, David. Closing thoughts, comments.

Attorney General Wasden: Governor.

Governor Little: General.

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[44] Request for Proposal

Attorney General Wasden: I noticed that we do have some draft minutes; we have not adopted those. There's not an item on the agenda to do so. I suggest that we hold that over to our next meeting to adopt the draft minutes.

Governor Little: Okay. Further comments. With the committee's permission, let's try within the next three or four days to set a time for our next meeting so we don't have the delay that we did. The next meeting, I think that I already talked about having a public comment period. We will just use the same protocol that we use at Land Board meetings as far as public comment. People will need to sign up and dependent upon how many people sign up will determine what the length of time is. Anything else? Are there any action items that the committee wants us to address? I think, Darrell, a couple of those legal analyses, particularly what of those founding documents and court cases would have been altered by the insertion of the word long-term into the constitution? From my standpoint, I think I get it. I don't see anything that we're going do that's going to get us outside of our constitutional side boards. If there's anything else...

Mr. Littman: I would appreciate just a short memo on what are the statutory constraints including this 320-acre...the auction process that get in the way. I'm not sure I've got all that.

Attorney General Wasden: We will make certain that that is provided. Actually, Darrell will make certain that that is provided.

Governor Little: Because we do have both statutory and constitutional constraints.

There being no further business, at 10:52 am a motion was made by Attorney General Wasden that the subcommittee adjourn. Mr. Littman seconded the motion. The motion carried on a vote of 3-0.

Idaho State Board of Land Commissioners
Strategic Reinvestment Subcommittee

/s/ Brad Little

Brad Little
Chairman, Strategic Reinvestment Subcommittee and
President, State Board of Land Commissioners and
Governor of the State of Idaho

The above-listed final minutes were approved by the Land Board's Reinvestment Subcommittee at its November 13, 2019 meeting.

Final Minutes
Reinvestment Subcommittee
March 12, 2020

The Land Board Reinvestment Subcommittee meeting was held on Thursday, March 12, 2020, at the Idaho Department of Lands Office, Garnet Conference Room, 300 N. 6th St., Suite 103, Boise, Idaho. The meeting began at 1:41 p.m. Governor Brad Little presided. The following members were in attendance:

Attorney General Lawrence Wasden
Mr. Irving Littman

For the record, all subcommittee members were present.

Governor Little: The Land Board Strategic Reinvestment Subcommittee will come to order. We have the consent agenda.

Attorney General Wasden: I move adoption and approval of the consent agenda.

Mr. Littman: I approve.

Governor Little: It's been moved and seconded. All in favor say aye.

All: Aye.

Governor Little: Consent agenda has been adopted. Information section. Chris, have you got a list of questions? You didn't have any you were supposed to bring?

Mr. Chris Anton: Not that I am aware of.

Governor Little: Okay. General, Irv have you got questions for EFIB?

Attorney General Wasden: I do have a couple of questions. Mr. Anton...

Governor Little: Callan is on the phone, who else is on the phone?

Ms. Renee Jacobsen: Just Sally and Janet from Callan.

Governor Little: Okay.

Attorney General Wasden: There's a couple of questions that I am trying to work my way through. One of them is the status of our reserves. I know that many years we've had a level set of reserves and we've made some increases...if you could help me remember the process by which we determined that, what those are for, what we're looking for in the future, I would greatly appreciate that.

Mr. Anton: If you recall back in the spring of 2018 when Callan conducted their last study, one of the things they evaluated was the level of reserves. Part of what prompted that analysis was the fact that

as we sold cabin sites, we reduced the revenue coming in from the Department of Lands into the reserves, which also resulted in increase in the volatility of the revenue from Lands. In addition to that, Callan's capital markets assumptions had come down for the endowment fund as the result of equity valuations and lower yields on the bond part of the portfolio. So Callan looked at that and they recommended that we increase modestly the reserves, for about four of the beneficiaries. For public schools we went from 5 years to 6 years; and we made permanent all the others at 7 years. There were a couple that were temporarily at 7 years and then one or two that we had to increase up to 7 years. The Land Board approved that around August 2018, and we implemented that. Until probably the last few weeks here, those reserves were fully funded; I think we're a little under that at this point.

Attorney General Wasden: My understanding of where we are is that any change we make in our financial portfolio or in our land portfolio ultimately is a measure of relative risks in those arenas and our reserves will have to be modified to reflect any changes that we may make in either of those arenas. Am I misunderstanding that?

Mr. Anton: Yes, your understanding is correct. One of our ultimate goals is to maintain the stability of distributions to the beneficiaries because they rely on those distributions for their operations. To the extent there's a change in our view of our financial performance, or the revenue coming from Lands, it is prudent to look at our reserves and make sure they're adequate and adjust accordingly.

Attorney General Wasden: The reserves, again I am just trying to make sure I understand, the reserves as they now exist reflect what we see as the current level of risk, not something that may come to us as we change our asset mixture in the future, correct?

Mr. Anton: Yes, that's correct.

Attorney General Wasden: I'd like to read some minutes of our May 15, 2018[1] Land Board meeting. It's a fairly lengthy paragraph, but I'd like to read it because it sets out part of our discussion. Callan made a presentation, and then it was actually your discussion. The minutes reflect:

> 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 that they 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....
>
> ...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 to the beneficiaries.

[1] Editor's correction: The referenced excerpt is from page 5 of the July 17, 2018 Land Board meeting minutes.

Here's my question, do you still feel the same way based upon changes that have taken place in the marketplace, that having the flexibility with these monies while we have this unique opportunity is a recommended option. We chose option A and I am asking you are we still there?

Mr. Anton: As I look at the Callan study that was published in 2018, it really provided the Land Board with a framework to evaluate land acquisition opportunities that were presented from the Department of Lands. Essentially it said that if the opportunity presents a real return of less than 3.5%, it makes sense to put it in the financial assets. If it presented a return between 3.5 and 4.5%, it is somewhat indifferent, although it recommended that if we increased our reserves, as you're closer to the 3.5% end of that range, the financial assets are probably preferable; because we have higher reserves we can withstand a little more volatility. As you move out closer to 4.5%, or above 4.5%, the study recommended considering timberland investments. Again, looking at it from a whole trust perspective, the idea is that if we have opportunities that provide solid returns that are more stable from timber, that makes sense from a whole trust perspective. I think the analysis that they did still makes a lot of sense, that we have to be disciplined, that the Land Board would evaluate any opportunities that were brought forward; we would also have to look at any synergies. I look at us as a strategic buyer. We're in the timber business. We have substantial holdings that if a land acquisition also enhances the returns from our other property it can provide other benefits. We feel at EFIB that we should give the Department of Lands that opportunity that the Land Bank provides to look at opportunities. I think there was always an understanding that if the Department of Lands said there weren't opportunities, or there weren't complete opportunities that spend all of that money, we could certainly transfer the money sooner into the financial portfolio. I think that the model Callan developed, from my perspective, made a lot of sense.

Attorney General Wasden: It's my understanding that when we selected option A, it wasn't that we go out necessarily and buy timberland or agricultural land, it was that we examine the marketplace and determine if there were opportunities in those arenas; they had to meet the hurdle rate, and that's what we're talking about, in order for us to invest in that. It wasn't really a directive to invest in those lands, nor was it a directive to put the money in the securities market, in the financials, it was let's take this unique opportunity, see what's out there and then we'll eventually make that decision one way or the other. It is based upon the numbers that we're going to generate rather than a preconceived notion of where we are going to go. Am I understanding that correctly?

Mr. Anton: Yes, that's exactly correct. I think there was an understanding that having that money held at the Treasurer's Office, there's an opportunity cost because it isn't earning much money while it's there, but if the Department of Lands would work quickly to look at opportunities of what's out there, and we can make decisions hopefully before five years either to make investments or to move the money over to EFIB.

Governor Little: When we increase the earnings reserve, that was mainly for comfort level. What's happened the last two weeks, compared to other trusts that don't have those kinds of earnings reserve, they're at risk of their payout. Is there a scenario to where we increase the earnings reserve that if the theory was correct about having a bigger earnings reserve to take care of volatility, then if you're going to take on a higher risk portfolio, long term – higher risk and higher return – wouldn't earnings reserve take care of part of that issue?

Mr. Anton: So when Callan modeled the years of reserve, I think they looked at the 95th percentile from a statistical perspective and the volatility of the market, and said under those conditions that level of reserve and given our asset allocation should allow us still to continue to provide stable returns

to the beneficiaries. It is important to keep in mind that both the permanent fund and the earnings reserve fund are invested the same so that when we have these volatilities, the earnings reserve fund is going down significantly as well, but with 6 – 7 years it could maybe withstand a fairly large impact. To your question, if I understood it correctly, could we have an even more aggressive allocation; we could but it may suggest that to stay within that 95-percentile band we would want to increase the reserves further.

Governor Little: You could also, in the financial assets, look at your asset mix there to lower the risk.

Mr. Anton: Yes, that is correct. One of the things we did model was should we consider having the earnings reserve invested primarily in fixed income, but if we wanted the same overall allocation for the portfolio it would say the permanent fund would be almost 100% in equities which would make that extremely risky. As you know there are rules and statutes around the permanent fund growing at inflation and having to make up that inflation deficit over time, and so the analysis suggested that keeping them both invested the same made the most sense.

Governor Little: Of course, you could purchase timber REITS in the financial.

Mr. Anton: That's correct.

Mr. Littman: Not to be fussy, but I think we need to be more precise with terms. We're sometimes mixing up return and distribution. Return is what the total invested funds provide in terms of annual yield. As Chris appropriately pointed out, the reserves and the permanent fund are vested in one big pot. The idea of the reserves is to enable us to maintain consistency of distribution under a variety of return scenarios, including those which we are currently experiencing.

Mr. Anton: One thing that I think is important to highlight as well, is that the revenue generated from the Department of Lands goes into the earnings reserve fund. For many years, that level of revenue was enough to basically make the beneficiary payment so that all of the growth and financial assets allowed the fund to grow more rapidly. Over time as the financial assets have grown and the land revenue has come down somewhat, that revenue coming from the lands generates only about 50-60% of the annual distribution. That's another type of volatility or risk that we have, that we're less able to look to that steady source of revenue, and why under certain scenarios having more land revenue is beneficial because it does come into that reserve. It helps make some of those beneficiary distributions.

Governor Little: I agree. Callan you have been listening to this. Is there anything that we missed in that line of questioning and comments?

Ms. Janet Becker-Wold: No, I think Chris Anton laid out the case exactly how we presented it in the study.

Governor Little: When the assets were valued, and I am the new guy and that's one of the reasons that I appreciate both the Attorney General and Irv helping me...the valuation on the land was predicated on the fact that we would never sell it and that the primary source would be the sale of standing timber, versus a competing interest that might look at other ways to monetize that investment.

Ms. Sally Haskins: This is Sally; that's correct, because you can only, you only take income, you can't sell.

Governor Little: Isn't there some logic to the fact that when you compete against for instance a TIMO, that they're looking at other revenue streams on that valuation of that property when you're in the buying mode.

Ms. Haskins: They would have a different holding period also than you. That is completely different underwriting standard because of what they can do.

Ms. Becker-Wold: I believe at the subcommittee meeting that was held in the fall we discussed this a little bit as well which was, would you want to double down on the timber allocation by putting it in the financial assets portfolio when you already have a significant exposure to it in the total endowment; we suggested that maybe there were other real assets that could function as a stabilizer with income that might be a better complement to both the financial assets and the timber portfolio.

Governor Little: I am aware of that. I am not advocating for it, but I am saying we could. Just like we got out of our commercial real estate within a block of where we're sitting here, and then endowment went out and bought real estate to compensate, to put that into the...I am not saying that we double down, but I am saying that is an option. That was the option that the Board employed when they got out of the commercial real estate right here where we're sitting. Does silence mean you agree with me?

Mr. Anton: Janet, I think that question is for you.

Ms. Becker-Wold: Sorry...

Governor Little: You're the one that made the recommendation Janet, I just want to make sure you haven't changed your mind.

Ms. Becker-Wold: The decision on the real estate had different factors based on skill sets within the Department of Lands I don't think exist on the timber side. I mean you have a lot of expertise there on the lands side. I think you probably have a better return with the lands investment in timber than you would in a commercial timber investment within the financial assets. Sally would you agree, you're the expert on this not me.

Ms. Haskins: Yeah, absolutely. That's why we felt comfortable talking about additional reinvestments in timber, because of the expertise that exists. If you look at a common theme all the way back to commercial real estate, timber investment, and farmland investment, one of our big themes is always that you have to have the expertise to find acquisitions and then manage them afterwards. That was a bit of an issue in commercial real estate, doesn't exist in timberland, and farmland is probably somewhere in between. We're always more cautious on farmland in terms of deploying that money and I think saw that timber was the real strong area in terms of expertise.

Governor Little: I think this is for Janet, when do you reassess the hurdle rate? As economic conditions change, is that hurdle rate carved in stone; or does it change over a period of time for whatever reason?

Ms. Becker-Wold: That is a Sally question.

Governor Little: Okay.

Ms. Haskins: It is. So that is meant to be a long-term realistic expectation. It is not necessarily a year-to-year thing. We could look at it periodically. I was revisiting it before the call and I still feel comfortable with it based on what's going on. Again, it's pegged around your existing portfolio as well, to just circle back to what Chris was saying – you want to be doing things that are enhancing your

portfolio. This was meant to make sure that you were really doing accretive acquisitions, if that makes sense.

Governor Little: I agree, but just like the endowment fund has in the last week, rebalanced predicated on what's happening, those are the short-term things you do. The long-term is as your asset mixes or other things change, don't you...I know that PERSI does, I know that EFIB does, that you do a periodic long-term reassessment of your investment mix. Even if it just reaffirms what you have.

Ms. Haskins: Yeah, absolutely.

Governor Little: Otherwise we wouldn't need to pay you.

Ms. Haskins: And we do want to continue to get paid very much, I want to confirm that. Janet, that could be a question for you, or you could affirm that as well. The other thing to keep in mind here is that that's the hurdle rate, but when you are going out into the market acquiring property, that is either affirming or not affirming that rate. It's meant to be a minimum. You should always be acquiring kind of at the market price, too; what you're acquiring could be above that hurdle rate. You're not just underwriting the [unintelligible] because that wouldn't make any sense necessarily.

Governor Little: Well, don't we always want to be over the hurdle rate?

Ms. Haskins: You could be at it or over it. You're not going to be under it, because that is not allowed really. You want to cut the best deal that you can is what I am saying.

Governor Little: I agree. But the hurdle rate is on a set of suppositions – what's your administration costs, what's your investment costs, if Bernie Sanders gets elected and they're going to put a big transaction fee in...I mean all of these decisions have to be dynamic relative to what your costs are of investing, of administrating, because it is all about the net, net, net over the long term back to the beneficiaries.

Ms. Haskins: I don't have a Bernie factor currently in my...

Governor Little: But if there was a new transaction fee, and of course the fact that one of the biggest transaction fees that everybody else has is taxes, which we don't have, it makes a difference. If hypothetically Congress said now we're going to tax everybody's investments...but the issue is when do we reassess. I think the issue is you reassess your suppositions predicated on the reality that is out there.

Ms. Haskins: Yes, I agree.

Mr. Littman: A question for...I put my EFIB hat on for a moment...so annually, for EFIB and your other investment clients, Callan presents an expectation model for planning purposes of expected returns, risks, and correlations for all the financial assets. I am thinking ahead; for example this year in January 2020, there were very modest changes to that grid, and other firms in your space do similar work and so forth as well as some of the investment banking firms; but it seems as an administrator process after the distribution of that it would be useful to go back and say is there a reason to revisit. What did we learn from that to revisit the assumptions we're making on hurdle rates. We may say there's no change, as I suspect we do this year, but hopefully there will be a time where we'll look at higher returns than we're seeing today.

Governor Little: It wouldn't take much.

Ms. Becker-Wold: Is that directed toward us, Irv...

Mr. Littman: That was a general comment, although feel free to add to it.

Ms. Becker-Wold: I think you got it right. We do this exercise for our clients every year to sort of repeg it. It doesn't generally result in any big changes because our capital markets expectations don't change that much year-to-year. They're meant to just reflect a change in the market environment and generally the market environment doesn't change significantly year-to-year because we're looking out ten. These hurdle rates shouldn't be modified real often; however, if we have a very significant change in the way we're viewing the capital markets on the public market side, that should be reflected in that hurdle rate. When Sally looked at that, and this is where she might step back in because this crosses back over into her territory, they're not always pegged against a liquid market alternative; but they're relative to what you should expect over a long term relative to inflation. Sally, do you have anything to add or did I misspeak.

Ms. Haskins: No, that was brilliant, Janet.

Mr. Littman: What I've suggested is that perhaps in using the cycle of the last few years if in February of each year we had a short conversation with you and Sally and representatives of the Department of Lands. Is there any reason we ought to embark on a more substantive review of the hurdle rate or could we allow the one that we've been using to continue?

Ms. Becker-Wold: I think that's a very reasonable thing to do. I don't think it will change much, but the fact that we look at it and confirm it, I think it is also a powerful thing to do and document that.

Mr. Littman: I think that's a constructive administrative discipline.

Governor Little: I think as I un-delicately talked about earlier, you look at suppositions from the last hurdle rate and then you ground truth them to what's really happening and what you think is going to happen in the future, because your administration costs, your friction costs, your transaction costs, those are all based on a set of suppositions and you need to ground truth your suppositions.

Chris, do you think that there's any reason that your board and your advisors would think there's any reason to adjust the earnings reserve fund given the new...you look at the volatility that's in the market now, particularly in some areas, I hope you're not real long airline stocks and cruise stocks, but do you think there's any reason to readjust the earnings reserves?

Mr. Anton: I think the policy is sound. This is the type of situation it's intended to test. I think at this point the reserve policy is appropriate.

Governor Little: At the number it is?

Mr. Anton: I think so, I mean you can always ask for greater reserves and maybe have almost too much of a cushion; but that comes at the jeopardy of distributions to the beneficiaries because you're holding more in reserves. I think it is a reasonable balance at this point in time. I don't see a reason to change it.

Ms. Becker-Wold: In the study that we did in 2018, we actually tested some very specific dire scenarios at different reserve levels. The reserve level that we recommended, which was an increase in a couple of the reserves, was meant to deal with a pretty severe market decline and still be able to make distributions at least at the current level. We actually tested that through this study and that was why we recommended the increase in a couple of them that were specifically impacted by the removal of the cabin site revenues. Their income became more volatile; we added on, we said these two are potentially going to have issues so let's increase them. That was specifically contemplated.

Mr. Anton: One thing I might add, certainly we want to continue to monitor not just the financial portfolio but also the revenue from the Department of Lands. As you've seen, timber prices have come off about 30% from a couple of years ago. Right now, lumber yards are pretty full, we're not having any auctions this month. We're assuming that is a temporary situation but to the extent we had a long drought in revenue from lands combined with challenges in the financial portfolio, we may consider it at some point, but I think for now let's test the policy and see how it works.

Governor Little: Well, neither asset type is doing great this week.

Mr. Anton: Right.

Governor Little: Irv, have you got anything else.

Mr. Littman: Nope.

Governor Little: Well I think the question, and I'll defer to my fellow Land Board member, the question is the recommendation that this committee will make to the Board about what we do going forward. We know we've got the money in the Land Bank fund. From my standpoint, the asset mix that we have now – you can roll the dice about which way it's going to go. I am inclined to think that given the valuation...the fact that when the land was valued, it was valued at a lower value because we didn't say this is the real market value; this is the value that it is to us with restrictions we've got. That you can't sell over 160 acres, that you can't sell timberland, which is a set of handcuffs that is in code and in the constitution that the Land Board has to deal with. When you're looking at the asset mix, you have to take that into account. Without going out and going parcel-by-parcel and say what's the real market value of it, which at some point we might want to do that, look at what are values are relative to the fair market value, but if you're not going to sell it, it really doesn't matter. The question is if you're going to buy new, that's where I am. We've got this wonderful portfolio, these great endowment lands. This land is really up to a better management level and, particularly with the new policy, we're going to have a bigger cut off those lands. I think for me that we should look at putting part of the assets into the financial markets and part of them into timber assets. As far as those timber assets, I think they ought to be on timber where we increase the wood basket. Do I take a highly productive, well-managed piece of private timber that fits right in, take it and really not create any more wood basket, or do we do like we're talking about doing in some of these things where we're taking other lands that haven't been productive...I see that as much more accretive to the goal of the Land Board and the state. Particularly if you're not taking it off the tax rolls of these local communities. After we had that last sale, I know those of us on the Land Board got tapped on the shoulder a few times about the net effect of reducing the real property. That's where I am coming from. All the work that the committee's done, that the staff, Callan, and EFIB have done...that's kind of what I was thinking when I got into this process and what I am thinking going forward. We know that our lowest cost asset to manage is the financial assets. I know we pay for all the fire, but we have to account for the fire...those big issues. Paying the dues to the protective associations is one thing, we do that out of one pot money; then we come over to the other pot of money and take away money from the general fund to pay for these fires...and that brings me back more to my thought process that it ought to be ground that maybe isn't managed that well that we can have better forest health on it. That's where I am, and I'll let my other two committee members tell me where they are.

Mr. Littman: One of the things I got exposed to is the discussion of the 10 most northern counties and the impact on property taxes. That was a very compelling and enlightening issue, even before the intense discussion on property taxes we've seen statewide more recently. I know we're not necessarily directed to deal with this, but I find that is kind of an interesting issue and a special issue that came up.

I'd encourage the Land Board to look at what can we do to make the presence, not just of prospective future purchases, but existing purchases to be good citizens within the respective counties; and it's clearly within a handful of counties that it's the most issue. Having said that, I am comfortable with your thoughts. Callan's recommendation was if there are investments in timberland or, they were a little bit broader originally, in other lands that are accretive to the return, and looking at where to get the maximum return over time. I think that we are advantaged by having the founders and the writers of the constitution gave us something that's turned out to be helpful and I would like to see some of these funds go to preserving...I phrase it a little bit differently than perhaps you would...recognizing we've got about 800,000 acres in the prime wood basket, that's an important asset and we ought to make sure we're preserving the value and preserving the future cash flow. One of the interesting things, as we've met and as the participants from the Department of Lands have talked, and the review of certain statutory and constitutional things, I find investment in other forms of land, particularly farmland, to be less compelling. I hear the Department of Lands saying that's not something they're particularly interested in so I think it would be useful for our recommendation, let's make that clear – we're not going to do that. That it's got low value. That's recognizing your own roots in the farm and rangeland business, don't take this personally. I think if we're going to go and invest in land, let's focus a little bit more; I think it ought to have a very rigorous hurdle rate that we ought to be absolutely sure that it's accretive and is supportive of what we're doing. All of that, and I am saying that I am sympathetic with the issues of the counties, but I see the Department of Lands being competitive; most of the holders of industrial timberland are positioned similarly, TIMOs on behalf of their clients are not paying income taxes. The REITs are deferring or not paying income taxes, so in many ways...but they are paying county property taxes. I think that is an issue that I am sympathetic to. I would narrow the focus on lands, and I think that a recommendation to do that which would include an accretive hurdle rate, and some to the financial assets. Recognizing that the structure is to the extent that really attractive opportunities to invest in land don't occur, the funds do roll into the financial assets the way it is set up. So I think the notion, someone used the phrase earlier, it's sitting in the Land Bank while we look to see if there's something constructive. The only option in the end, to the extent that attractive investments aren't there, is to fall to the financial assets.

Governor Little: As far as the property tax issue, we can't take that into account. Of course, mysteriously quiet from the complaining were Valley and Bonner County where they had a huge spike. They were mysteriously quiet when I went to the Association of Counties; I do have a little holding on the lake at McCall and I noticed that my property taxes went way down but they were very quiet about that.

Mr. Littman: Well it is a very prescribed issue...

Governor Little: And that's the unfortunate thing is one county's gain is another county's, maybe, material loss. We can't take that into account, but to me it colors the issue. We have to invest for the long term return, but they're on the line; the courts...and I know I am practicing law and I will get chastised here in a minute...the court will default if we're doing it for good reason to the judgement of Land Board.

Attorney General Wasden: First of all, I note on the agenda that it doesn't have an action item, so we actually can't make a decision today. We will have to reconvene to make a decision about what to do.

Governor Little: Nothing changes in the state of Idaho, nothing changes in law...let me ask my good counsel, can we make a recommendation, I mean nothing changes? In the Land Board if we act, as the Land Board, that has the effect of change in policy and change of rules. But as an advisory committee

making a recommendation, and we can have another meeting I don't have a problem with that, but that's my question to my legal counsel.

Attorney General Wasden: I think that this is really an open meeting question, and that is can we take an action without having on the agenda notice that it is an action item. The statute requires that we identify it as an action item and that was a statute passed a couple of years ago. All I am saying is that as the person who has the responsibility of enforcing the open meeting law against state entities, I would just as soon not violate the statute. [laughter]

Governor Little: Okay, and we appreciate that.

Attorney General Wasden: I don't want to assess myself a fine. [laughter] That's a technical matter that I wanted to raise, that we will have to have an opportunity to make a formal...

Governor Little: Never have enough meetings...

Attorney General Wasden: ...action. Well, I didn't see the agenda until I walked in here. Let me address my thoughts. My thoughts on this are that we had a fairly broad discussion on this matter in front of the Land Board. Callan prepared a 2016 analysis, they did another in 2018. We selected among the various options. We chose option A because option A provided the greatest flexibility for us to place this money where it was going to do the best good; it was going to get us the long-term return. So, that may be to put that money in the financials. It may be to buy land. Timberland was one of the things suggested and strongly so because of the dampening effect in terms of the volatility. But it wasn't to run right out and buy that timberland, it was let's go look and see what's out there. Let's go see if we can meet the hurdle rates. If we can, then we make a decision, a sound financial decision at that time. We have a time limit here, and that time limit here is how long can these funds stay in this Land Bank, and that time is closing on us fairly soon. By default, we may end up putting those monies in the permanent fund. My view is maintaining where we are right now, maintaining that flexibility to continue to see are there opportunities. Maybe there are, maybe there aren't. Maintaining the course of where we are now actually provides us the greatest opportunity to see if there are financial investments we can make, either in land or in securities, so maintaining the course where we are is actually a relatively short time period for us to do that. My view is stay the course until we have better financial data and it may be that these monies go to the financial investments anyway.

Governor Little: Is that a motion to not have another meeting?

Attorney General Wasden: Well....

Governor Little: We can't make that motion.

Attorney General Wasden: We cannot make that motion as it was not provided on the agenda. The only thing we could do is amend the agenda, but in order to amend the agenda, we have to have a valid reason for amending the agenda and we don't have a valid reason.

Governor Little: But the no action alternative is always an action.

Attorney General Wasden: It is...

Mr. Littman: I am glad to say that I can take entire guidance from you.

Attorney General Wasden: Thanks a lot, Irv.

Mr. Littman: And not weigh in.

Attorney General Wasden: We can simply adjourn the Reinvestment Subcommittee...

Governor Little: Motion to adjourn is always in order...

Attorney General Wasden: ...and if we took no more action, then there would be no recommendation made to the Board, it would simply be we've ended our function as the subcommittee.

Mr. Littman: So the existing policy...

Attorney General Wasden: The existing policy is option A. I've described the existing policy.

Governor Little: I think in all fairness, we delay a pathway by the Department that was going forward...

Attorney General Wasden: ...for about a year.

Governor Little: ...predicated on some action by this committee and that's why I feel an obligation, rather than leave it up in the air, to do something. We can reconvene and take action.

Attorney General Wasden: Well, I've given my thoughts. Without making a motion, you would be at least put on notice that that's the kind of motion I would be interested in making. I am not making a motion and I am not requesting a second – I am taking no action.

Mr. Littman: If we meet, I think it would be helpful to refresh all of ourselves on the status of the Land Bank, prospective additions to the Land Bank, and to recognize the issue...there are important dates to describe to various layers of the Land Bank....

Governor Little: I think I've got all of that.

Mr. Littman: Okay.

Governor Little: Jeremy, do you want to say something?

Mr. Jeremy Chou: I am so sorry for interrupting, but I do feel compelled just to state that I don't believe that you are subject to the open meeting laws. You are members of the Land Board, but this is a subcommittee; you don't have a quorum and you have the ability to make those motions and decisions within this group. Now, I apologize; Mr. Early is here and Mr. Wonderlich and Brian, we all know each other. I think I am correct here that you can make those decisions; whether you choose to or not is up to you.

Governor Little: I am fine with waiting. It does go back to what I was saying before. We need to do it...I've been just a little busy the last few days. We can notice up and do this. When's our next Land Board meeting, Dustin?

Director Dustin Miller: It's on Tuesday, the 17th.

Governor Little: That might be a little hasty.

Attorney General Wasden: What the open meeting law says is that any sub-agency of an agency is bound by the open meeting law.

Governor Little: I will let you guys wrestle with that. I do what I am told.

Attorney General Wasden: We're just safer if we just comply with this.

Mr. Littman: It looks like Renée has to set up another meeting.

Attorney General Wasden: Yes, that would be my recommendation.

Governor Little: And she does such a good job. Director Miller, have we got...is there anything on the agenda at the next meeting that wants us to have action from this committee...is there anything on the

other pending land sale that's hanging out there, or can we wait until after that to have our next meeting.

Director Miller: There's no item on the next agenda at the Land Board meeting.

Governor Little: All right, we'll get together and figure out a time. Anything else?

Attorney General Wasden: Motion to adjourn.

Governor Little: Always in order.

Mr. Littman: Second.

Governor Little: Seconded, all in favor say aye.

All: Aye.

Governor Little: We are adjourned.

There being no further business, at 2:36 pm a motion was made by Attorney General Wasden that the subcommittee adjourn. Mr. Littman seconded the motion. The motion carried on a vote of 3-0.

Idaho State Board of Land Commissioners
Strategic Reinvestment Subcommittee

/s/ Brad Little

Brad Little
Chairman, Strategic Reinvestment Subcommittee and
President, State Board of Land Commissioners and
Governor of the State of Idaho

The above-listed final minutes were approved by the Land Board's Reinvestment Subcommittee at its April 10, 2020 meeting.

Draft Minutes
Reinvestment Subcommittee
April 10, 2020

The Land Board Reinvestment Subcommittee meeting was held on Friday, April 10, 2020, via teleconference only.[1] The meeting began at 1:32 p.m. Governor Brad Little presided. The following members were in attendance:

Attorney General Lawrence Wasden
Mr. Irving Littman

For the record, all subcommittee members were present.

Governor Little: Okay, Brad Little here. General Wasden are you on?

Irv, are you on?

Mr. Littman: I am, Governor.

Governor Little: All right. You might have to get closer to your speaker phone. Dustin, are you on?

Director Miller: Yes, I am here, Governor.

Governor Little: Okay, I will try General Wasden again?

Well, I guess we've got a quorum, but I am hesitant to start without Lawrence on the line. I assume he's within a minute. There's two of us, and I saw that Irv, you submitted a minor change in the minutes – they looked okay to me. If you'll make a motion, we'll approve the minutes while we wait for Lawrence.

Attorney General Wasden: I'm on, Governor; I didn't have the code.

Governor Little: There we go. Okay we're all on, Lawrence, Irv and I, and Director Miller are on. We're at the approval of the minutes.

Mr. Littman: I move approval of the minutes of the March 12th meeting.

Attorney General Wasden: Second.

Governor Little: It's been moved and seconded. All in favor say aye.

[1] Pursuant to Governor's proclamation, March 18, 2020.

All: Aye.

Governor Little: The minutes have been approved.

We are at a point in time where I am hopeful that we'll be able to make a recommendation to the Land Board at this point in time about what the policy should be going of the Board going forward. We are nothing but an advisory committee to the Land Board; I recognize that. There are several things that have been brought out during our deliberations. Of course, we've had a very dynamic change in all of the markets from the beginning of our first meeting to the consummation of our last. It's been a rodeo in the asset management business, as it has been in the land management business. The issue, the way I see it, and I want to hear from my two fellow subcommittee members about what we do going forward; where the market is; our recommendations we've had historically from Callan about what we do in assets. I appreciate everybody's good work and we've got some good options. As I talked to my fellow governors in other states, we're pretty blessed here in Idaho given what we have. It's a tough time for everybody in Idaho right now, but our central goal is the very, very long-term obligation that the Land Board members have to the beneficiaries. All of the input we've had has been to maintain our fiduciary obligations but to also realize that things change over time. Any good trustee basically has to be adaptive to the times they're in. I believe that our deliberations have pointed that out. Our asset mix, how we analyze and value those assets, it's a little different for a portfolio that's got different classes of assets and how you value those compared to just...financial assets can be marked day to day to the market, and that's where we are here in Idaho. We've got some other issues in Idaho about our current laws and some of the things we do that we have to recognize. I think everyone's goal is to continue to maximize that long-term return as our constitution says. At the last meeting, Chris [Anton] talked about how dynamic it was over at EFIB as far as the reinvestments. I think our very capable EFIB staff and [Investment] Board, which Irv sits on, has done a very good job, and following best practices the people of Idaho, and more importantly the beneficiaries in years to come, have been well served. Under these policies we did acquire the Packer 1 acquisition in late 2018 so that's been part of what we've done. We've sold a lot of the liquid, both commercial and cabin sites, and put those in the land Bank per the policy of the State of Idaho. The issue to me is what do we do going forward. Again, I appreciate the work of the committee, everybody that participated, as we look at the financial landscape as we go forward. Timber has averaged around $75 million over the last 5 years and the Board adopted a new policy which we think will increase that return going forward. We still have some things that are...if we knew everything, which nobody does, anybody that anticipated this would have been a rocket scientist...but if you use good policy, you're well protected. Where we were at the last meeting, we were going to make a recommendation. We made the decision then to delay it until this meeting. We were anticipating we would be able to meet in person, but good policy dictates we're not able to do that. Everybody knows where I was and the recommendation that I intended to make as we go forward. I think that my recommendation was that we determine going forward what percent of the Land Bank fund goes into the procurement of real estate assets and what percent goes into financial assets. With that, I will stop for a minute and let my two other members talk about where they think we are today.

Attorney General Wasden: Governor, I am prepared to make a motion; I'm certainly interested in listening to Mr. Littman, but I'm prepared to make a motion.

Governor Little: Irv?

Mr. Littman: I guess we all are. Who goes first?

Attorney General Wasden: I guess I will, Governor.

Governor Little: Okay.

Attorney General Wasden: At its July 2018 meeting, the Land Board adopted what is known as Option A. Essentially, Option A provides that the Board, consistent with the reinvestment plan, identify transactions that meet established hurdle rates and set aside sufficient funds over an appropriate time horizon, and in fulfillment of the scope and purpose of this subcommittee to examine that decision and make recommendations to the full Board, I make a four-part motion:

1) That the full Board stay the course on Option A in order to maintain the Board's flexibility in applying funds to either land or financial investments;

2) That, pursuant to the suggestion of Mr. Irv Littman, the full Board request Callan to review the efficacy of the hurdle rates;

3) Recognizing that our normal processes for investment require our seeking advice from our retained experts, that the full Board also request Callan and EFIB review current market conditions and report to the full Board at its next monthly meeting to make any recommendations concerning investments in current financial markets;

4) That the Department of Lands prepare a letter of transmittal to the full Board outlining the subcommittee's recommendations, and I offer Darrell Early to assist the Department in preparing that letter.

That's my motion.

Governor Little: It's a little hard for me to analyze the width and breadth of it. I guess I have a question for you, General. Do you think that this committee, because we're not the full Land Board, do we have the authority to do all of those things?

Attorney General Wasden: What we're doing is recommending to the full committee...

Governor Little: Recommending to the Land Board.

Attorney General Wasden: Yes. We're recommending to the Land Board four things: 1) that we stay the course on Option A, that's our recommendation; 2) that we have Callan review the hurdle rates to make sure that they're appropriate; 3) that we also ask Callan and EFIB to examine the current financial market conditions and give us a recommendation of what we ought to be doing concerning the financial markets; the fourth element is that we transmit that to the full Land Board by a letter.

Governor Little: Okay, I got the first part. But we're making a recommendation to the Land Board. If we're making a recommendation to the Land Board that they do 2, 3, and 4, is that correct?

Attorney General Wasden: Yes.

Governor Little: Or are we asking for the study and as a subcommittee...is it all encompassed 1, 2, 3, and 4 under the heading of we make a recommendation to the Land Board to do 1, 2, 3, and 4? I guess the question is, as a subcommittee and not a functioning...we're not a quorum of the Board...do we have the authority to do all of that other than just pass questions?

Attorney General Wasden: Governor, my motion is that we make these 1, 2, 3, and 4 as recommendations to the Board. All we can do is recommend that the full Board take an action. So here's what I am recommending: I recommend that the full Board stay the course on Option A; we recommend that the full Board request Callan to review the efficacy of the hurdle rates; we recommend that the full Board ask Callan and EFIB to give us an analysis of current market conditions; and four, my motion is really for us, that we transmit that to the full Board via letter. We're making three recommendations to the Board.

Governor Little: For my simple mind, the multiple part of this...and I can't remember exactly what Option A was, I don't have it in front of me; I thought that would be the status quo. In essence, and please correct me if I am wrong, the recommendation is to maintain the status quo and study some stuff, is that right?

Attorney General Wasden: Basically, yes.

Mr. Littman: Governor.

Governor Little: Irv.

Mr. Littman: If we're following parliamentary procedure, do we need a second in order to discuss the motion...but I think our discussion at the last meeting, with Callan on the phone, that they reaffirmed their view on capital market expectations which they published in January, and that the hurdle rates made sense in the current environment. We discussed a process to revisit that annually.

Attorney General Wasden: I am certainly willing to remove that; I was just trying to accommodate your comments, Mr. Littman. If you are satisfied that we are doing that, which we are, then I am most happy to remove that portion. In view of that, let me restate a new motion, and that is a three-part motion:

1) That the full Board stay the course on Option A in order to maintain the Board's flexibility in applying funds to either land or financial investments;

2) Recognizing that our normal processes for investment require our seeking advice from our retained experts, that the full Board also request Callan and EFIB review current market conditions and report to the full Board at its next monthly meeting to make any recommendations concerning investments in current financial markets;

3) The Department prepare a letter of transmittal to the full Board outlining the subcommittee's recommendations, and again I offer Darrell Early to assist the Department in preparing that letter.

Governor Little: My inclination is, given the width and the breadth of the motion is, perhaps we could, instead of taking this as an encompassing motion, General, if we could take them one at a time is my...of course, all of them are recommendations to the Board anyway.

Attorney General Wasden: Right. So let me make this motion, Governor, since I don't yet have a second: it's a two-part motion: 1) that the full Board stay the course on Option A in order to maintain the Board's flexibility in applying funds to either lands or financial investments; and 2) that the Department of Lands prepare a letter of transmittal to the full Board outlining the subcommittee's

recommendations; again I offer Darrell Early to assist the Department in preparing that letter. My motion is stay the course on Option A and tell the full Board in a letter.

Governor Little: Okay, if I can clarify for my mind the motion basically says maintain the status quo and prepare a letter to that effect to send to the Board. Is that fair?

Attorney General Wasden: That's my motion, yes.

Governor Little: Okay. Irv, have you got any comments about that? If not, I've got an alternative motion which would have the second part, which would be that the committee draft a letter with the three of us to basically to look at that letter. I kind of understand having the Department do it, but this is really not a letter from the Department, it is a letter from the committee. The staff can participate in it, but it really ought to be a letter from the three of us. But, in my substitute motion, it's that we put 50% of the current Land Bank fund in the financial assets, which is different than Option A. That's an alternative motion.

Mr. Littman: I am comfortable with Option A, and the General's proposed motion, because it does say that the funds will go to financial assets unless very attractive and accretive investments are found within specific time periods which roll off. I note from the Land Bank aging report, in a little over a year-and-a-half about $33 million will flow naturally if they're not properly invested. This does get us to the residual all following into that. But I understand your point, Governor, and I would be comfortable with...I would probably pick a lower number like $50 million rather than 50% and move that into financial assets, recognizing that the markets have been disruptive and that may provide a constructive opportunity to put that money to work after it's fallen some.

Governor Little: Is that it, Irv? I don't want to cut you off. It's hard to tell without seeing you. I am comfortable with allowing your suggestion to be an amendment to my motion to instead of 50% of the assets to be $50 million. Let me rephrase my motion: that out of the current land Bank fund, we move $50 million into the financial assets and prepare a letter that encompasses some of General Wasden's comments in the first part of it, prepare a draft letter, circulate it between the three of us, and submit it to the Land Board. I am comfortable with that; I guess you could say I amended my motion.

Mr. Littman: Okay, and Governor, the inference then is that with the remaining funds you're comfortable reinforcing the existing strategy.

Governor Little: Yes, and, of course I think General Wasden's comments about hurdle rates and analysis of everything that we've been doing. This is a new reality, Irv, you know this you serve on the EFIB board and all of the other board's you've served on; every investment committee in the United States is looking at their hole card about what they've done, and it would be prudent for the State of Idaho to do the same.

Mr. Littman: Agreed. A small practical question, as I look at the Land Bank aging report, I see there are four different funds within the overall endowment with different aging; I can easily get confused about how a subset of that would be taken and reallocated directly to financial assets. I assume that Director Miller and Chris Anton from EFIB are best qualified to look at that and make specific allocations of where that $50 million were to come from, out of the existing $123 million in the Land Bank plus interest.

Governor Little: I would just assume it would be, from an aging standpoint, it would be the most current. I can pretty well guess what their recommendation would be.

Mr. Littman: That would end up with a different distribution in terms of among the different sub things; I would defer to that. I don't have anything to add other than question the mechanical process.

Governor Little: I go back to the latter part of the motion is that...if the motion that I spoke to is passed, then we take that, put it in draft form and circulate it, and then some of these unknowns we can put in there. In essence all we're doing is making a recommendation to the full Board anyway.

Mr. Littman: If I understand, you've amended your motion, I would second it.

Governor Little: We've got a motion in front of the subcommittee. Further discussion?

Attorney General Wasden: Yes, Governor. I will be voting no on this motion, because inherent in this motion is the fact that we've avoided seeking the advice of our experts in selecting a number. That's why my motion included that element. Instead of us just choosing a number out of the air, that we actually go to our experts – EFIB and Callan – and ask them what we ought to do with regard to the current marketplace. The motion that we have now before the subcommittee is to recommend that we just select a number; we don't know if that's the right number. I am going to be voting no on this motion, and I ask for the opportunity to write a minority report.

Governor Little: As a constitutionally elected member of the Land Board, you don't need to seek permission from the two of us to write a minority report. If you're insinuating that you're writing a minority report, does that mean you'd be included in drafting the letter from the majority?

Attorney General Wasden: No, I will be writing my own.

Governor Little: Okay. We have a motion in front of us. All in favor say aye.

Governor Little: Aye.

Mr. Littman: Aye.

Governor Little: All opposed.

Attorney General Wasden: Nay.

Governor Little: Okay. I'm somewhat disappointed that we didn't come to a better...we'll work through this as we go forward. What about, is there consensus, which would be my preference, that we review the hurdle rate.

Mr. Littman: Sure.

Attorney General Wasden: My understanding was that we do that anyway, that we do a review of that and that was a part of the discussion; that's why I included that in my original motion. But we do a review of that. I don't have a problem if we examine the hurdle rate, or actually that we recommend to the full Board that we do an examination of the hurdle rate.

Governor Little: We have consensus; we're making progress.

Mr. Littman: Governor, I wonder if there's a way to qualify your motion, maybe we can amend it to incorporate a validation review that would make General Wasden a little more comfortable with it.

Governor Little: Again, I will re-emphasize, we're just making a recommendation to the full Board. We'll circulate something between the three of us about how to review the hurdle rate and hopefully there'd be some consensus; that would be my recommendation. We've got reams of material about the hurdle rate, how do we value the assets, and so I think it is just prudent to review that.

Mr. Littman: Okay.

Governor Little: We passed the first motion. Is there any disagreement with just a motion that we ask the Board to review the hurdle rate? Whether it is embedded into the process now or not, I think that's good policy. I think just a general motion that the Board work with both Department of Lands and Callan to review the hurdle rate.

Mr. Littman: Agreed.

Governor Little: All in favor.

Mr. Littman: Aye.

Governor Little: Aye.

Attorney General Wasden: Aye.

Governor Little: I think I heard you say 'agreed,' Irv, so I'm going to consider that a second.

Mr. Littman: Yes, I did.

Governor Little: One of the other recommendations, and I'll make this motion...as I digested all of the information that we got from staff, when we looked at the totality of our return off of our timber assets...that the subcommittee make a recommendation that, as we look at assets to purchase, we look at increasing active production in Idaho. There are different classes of assets. If we've got two assets that are exactly alike and one of them increases active production in Idaho, and I don't believe that is part of any of the proposals, but it is some of the things we've heard, that we ask that the...of course this is not in deciding whether it's financial, this is in timberland management...that if all things being equal, we look at increasing active production in Idaho, because that helps everybody. It will help the return and it will add...our customers, the people that buy our product off of the land, that sends a signal to them that there's going to continue to be a wood basket for them to make capital investments to where they can actively compete for timber. The goal is to increase bidding for the endowment lands which I think is in everybody's best interest. Given the silence, I will make a motion that we make that recommendation to the Board.

Mr. Littman: I assume that's consistent with good forest management practices; we ought to seek the highest sustainable yield.

Governor Little: As I said, all things being equal, if it's ground that's currently being actively managed...we've got $100 to spend and the $100 can either go to ground that's already maximizing bidders for our product, and we have a choice of spending $100 on a piece of ground that's going to increase the sustainability of the wood basket, that means we're going to have more bidders which is

really a long-term, it complies with the long-term part of our obligation. We want more bidders out there to maximize opportunities for us to sell future wood products off of our lands.

Attorney General Wasden: Governor.

Governor Little: General.

Attorney General Wasden: I guess I am confused by the motion. I don't know what it accomplishes. I've listened, but I am just not sure that I understand. The guiding principle here ought to be our fiduciary responsibility to the beneficiaries. If what you're proposing is consistent with that, great. But I can't really tell. Can you help me out?

Governor Little: Okay. You've got a million dollars and you can buy a million dollars' worth of land that hasn't been producing any timber, that hasn't been sustaining the saw mill, that hasn't been sustaining the logging industry, or you can take the million dollars and buy a piece of ground that is already producing opportunity. The long-term benefit is the fact that if one more mill is established at some point in time, that can bid on our logs, we're going to have more competition out there to get higher eventual returns for the entire endowment; that's the issue. If you don't do that, then you don't have as many bidders, and the more bidders you have the higher the eventual returns. In the short-term basis, you probably wouldn't, but this is really a long-term decision to maximize the amount of healthy bidders that we have for our product.

Attorney General Wasden: As a follow up question then, Governor, what are we recommending to the full Board?

Governor Little: This recommendation, if adopted by this committee and submitted to the Board, would be if we have two pieces of property, all things being equal, but one of them is going to increase the totality of production, that's going to be good because it might mean either: a) one new sawmill or, b) perhaps more importantly, not the loss of a sawmill somewhere, to we have multiple bidders and that's the goal of this.

Attorney General Wasden: Can I make a friendly amendment to your motion, Governor, that we include the language 'consistent with our fiduciary duty?'

Governor Little: Sure. That's as friendly as they get.

Attorney General Wasden: With that, has there been a second of this motion?

Governor Little: Nope.

Attorney General Wasden: With that friendly amendment, I will second your motion.

Governor Little: Very good. It's been moved and seconded that the subcommittee make a recommendation to the Land Board that they focus on acquisitions that increase total amount of working forests in Idaho consistent with our fiduciary duty. All in favor.

All: Aye.

Governor Little: None opposed. Unanimous. Are there any further motions?

Attorney General Wasden: I move that we adjourn and consider the subcommittee having fulfilled its obligation.

Mr. Littman: Second.

Governor Little: It's been moved and seconded that we adjourn. The motion to adjourn is non-debatable, but I will take the chairman's prerogative and thank you in particular, Irv, for all of your good work on this, and thank all of the members of the staff, EFIB and Callan for all of their good information. I was going to say we'll beg leave to sit again, but we're not even doing that. With that, all in favor say aye.

All: Aye.

Governor Little: Opposed nay. The ayes have it and we are adjourned. Thank you everyone.

Mr. Littman: Thanks, everyone, for the help; it's been fun.

Attorney General Wasden: Thanks, Governor.

There being no further business, at 2:10 pm a motion was made by Attorney General Wasden that the subcommittee adjourn, and that the subcommittee has fulfilled its obligation. Mr. Littman seconded the motion. The motion carried on a vote of 3-0.

Constitutional and Statutory Duties of Endowment Trustees

Prepared by

Darrell G. Early

Deputy Attorney General

Idaho Admissions Act, 26 Stat 215-219 (July 3, 1890)

- Section 4: "That sections numbered sixteen and thirty six in every township of said State, and where such sections, or any parts thereof have been sold or otherwise disposed of by or under the authority of any act of Congress other lands equivalent thereto, in legal subdivisions of not less than one quarter section, and as contiguous as may be to the section in lieu of which the same is taken are hereby granted to said State for the support of common schools, such indemnity lands to be selected within said State in such manner as the legislature may provide, with the approval of the Secretary of the Interior.

Idaho Admissions Act, 26 Stat 215-219 (July 3, 1890)

- Section 5: That all lands herein granted for education purposes shall be disposed of only at public sale, the proceeds to constitute a permanent school fund, the interest of which only shall be expended in the support of said schools. But said lands may, under such regulations as the legislature shall prescribe, be leased for periods of not more than five years, and such lands shall not be subject to pre-emption, homestead entry, or any other entry under the land laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes.

Article IX – Education and School Lands

- Section 4. PUBLIC SCHOOL FUND DEFINED. The public school fund of the state shall consist of the proceeds of such lands as have heretofore been granted, or may hereafter be granted, to the state by the general government, known as school lands, and those granted in lieu of such; lands acquired by gift or grant from any person or corporation under any law or grant of the general government; and of all other grants of land or money made to the state from the general government for general educational purposes, or where no other special purpose is indicated in such grant; all estates or distributive shares of estates that may escheat to the state; all unclaimed shares and dividends of any corporation incorporated under the laws of the state; all other grants, gifts, devises, or bequests made to the state for general educational purposes

Endowment Reform

Idaho Admission Bill Amendments
1998 Pub. L. 105-296

The Act of July 3, 1890 (commonly known as the 'Idaho Admission Act') (26 Stat. 215, chapter 656), is amended by striking section 5 and inserting the following:

'SEC. 5. SALE, LEASE, OR EXCHANGE OF SCHOOL LAND.

'(a) SALE-

'(1) IN GENERAL- Except as provided in subsection (c), all land granted under this Act for educational purposes shall be sold only at public sale.

'(2) USE OF PROCEEDS-

'(A) IN GENERAL- Proceeds of the sale of school land--

'(i) except as provided in clause (ii), shall be deposited in the public school permanent endowment fund and expended only for the support of public schools; and

'(ii)(I) may be deposited in a land bank fund to be used to acquire, in accordance with State law, other land in the State for the benefit of the beneficiaries of the public school permanent endowment fund; or

'(II) if the proceeds are not used to acquire other land in the State within a period specified by State law, shall be transferred to the public school permanent endowment fund.

'(B) EARNINGS RESERVE FUND- Earnings on amounts in the public school permanent endowment fund shall be deposited in an earnings reserve fund to be used for the support of public schools of the State in accordance with State law.

* * *

Article IX – Education and School Lands

- Section 4. PUBLIC SCHOOL PERMANENT ENDOWMENT FUND DEFINED. The public school permanent endowment fund of the state shall consist of the proceeds from the sale of such lands as have heretofore been granted, or may hereafter be granted, to the state by the general government, known as school lands, and those granted in lieu of such; lands acquired by gift or grant from any person or corporation under any law or grant of the general government; and of all other grants of land or money made to the state from the general government for general educational purposes, or where no other special purpose is indicated in such grant; all estates or distributive shares of estates that may escheat to the state; all unclaimed shares and dividends of any corporation incorporated under the laws of the state; all other grants, gifts, devises, or bequests made to the state for general educational purposes; and amounts allocated from the public school earnings reserve fund. Provided however, that proceeds from the sale of school lands may be deposited into a land bank fund to be used to acquire other lands within the state for the benefit of endowment beneficiaries. If those proceeds are not used to acquire other lands within a time provided by the legislature, the proceeds shall be deposited into the public school permanent endowment fund along with any earnings on the proceeds.

Creation of the Trust

Article IX – Education and School Lands

- Section 8. LOCATION AND DISPOSITION OF PUBLIC LANDS. **It shall be the duty of the state board of land commissioners to provide for the location, protection, sale or rental of all the lands heretofore, or which may hereafter be granted to or acquired by the state by or from the general government, under such regulations as may be prescribed by law, and in such manner as will secure the maximum long term financial return to the institution to which granted** or to the state if not specifically granted; provided, that no state lands shall be sold for less than the appraised price. No law shall ever be passed by the legislature granting any privileges to persons who may have settled upon any such public lands, subsequent to the survey thereof by the general government, by which the amount to be derived by the sale, or other disposition of such lands, shall be diminished, directly or indirectly. The legislature shall, at the earliest practicable period, provide by law that **the general grants of land made by congress to the state shall be judiciously located and carefully preserved and held in trust, subject to disposal at public auction for the use and benefit of the respective object for which said grants of land were made, and the legislature shall provide for the sale of said lands from time to time and for the sale of timber on all state lands and for the faithful application of the proceeds thereof in accordance with the terms of said grants**; provided, that not to exceed one hundred sections of state lands shall be sold in any one year, and to be sold in subdivisions of not to exceed three hundred and twenty acres of land to any one individual, company or corporation. The legislature shall have power to authorize the state board of land commissioners to exchange granted or acquired lands of the state on an equal value basis for other lands under agreement with the United States, local units of government, corporations, companies, individuals, or combinations thereof.

Article IX – Education and School Lands

- Section 7. STATE BOARD OF LAND COMMISSIONERS. 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.

Cooper v. Roberts, 59 U.S. 173, 181-2 (1855)

"The trusts created by these compacts relate to a subject certainly of universal interest, but of municipal concern, over which the power of the State is plenary and exclusive. In the present instance, the grant is to the State directly, without limitation of its power, though there is a sacred obligation imposed on its public faith."

Barber Lumber v. Gifford, 25 Idaho 654, 139 P. 557 (1914)

"The grant of lands for the various purposes by the federal government to the state constitutes a trust, and the State Board of Land Commissioners is the instrumentality created to administer that trust, and is bound upon principles that are elementary to so administer it as to secure the greatest measure of advantage to the beneficiary of it. To that end, and of necessity, the board must have a large discretionary power over the subject of the trust."

Wasden v. State Bd. Of Land Com'rs, 153 Idaho 190, 280 P.3d 693 (2012)

- The State's endowment lands are part of a sacred trust reserved for the benefit of Idaho's public schools and public institutions. The Board, which manages those endowment lands, is the epitomic public trustee.

Pike v. State Board of Land Com'rs, 19 Idaho 269, 113 P. 447 (1911)

- "…the Constitution vests the control, management and disposition of state lands in the State Board of Land Commissioners. Section 8, art. 9. They are, as it were, the trustees or business managers for the state in handling these lands, and on matters of policy, expediency and the business interest of the state, they are the sole and exclusive judges so long as they do not run counter to the provisions of the Constitution or statute.

Allen v. Smylie, 92 Idaho 846, 452 P.2d 343 (1969)

- The Idaho Constitution, Art. IX, Sec. 8, provides that, 'It shall be the duty of the state board * * * to provide for * * * rental of all the lands * * * under such regulations as may be prescribed by law, and in such manner as will secure the maximum possible amount therefor.' <u>This enjoins a duty upon the Board to lease for maximum return</u> under procedural regulation of the legislature. The constitutional duty of the board is self-executing. Therefore, if the legislature has not specified the procedure the Board may adopt appropriate procedures to carry out its constitutional duties.

Moon v. State Board of Land Commrs., 111 Idaho 389, 724 P.2d 125 (1986)

"The State of Idaho manages two separate trusts *for the benefit of public schools.* The Public School Fund is the res of the first trust, which is invested by the Investment Board. I.C. § 57–715 et seq. The State's constitutional responsibilities regarding this trust and the protection of the money corpus are found in ID. CONST. art. 9, § 3. The second trust consists of school endowment lands managed by the Land Board. The endowment lands themselves form the res of this trust and the State's constitutional duties regarding this trust and protection of the land corpus is found in ID. CONST. ART. 9, § 8."

Tobey v. Bridgewood,
22 Idaho 566, 127 P. 178 (1912)

"The question of policy and business expediency which may have been pursued by the state board in the past, and which might be pursued in the future, should not control or guide this court in upholding and sustaining a policy, where such policy is *absolutely prohibited by the provisions of the constitution and the laws of this state.* The constitution and laws of the state should at all times be followed and upheld and sustained by the courts, and should not be ignored by public officers in the administration of public affairs of the state."

East Side Blaine Co. Livestock Ass'n v. State Board of Land Com'rs., 34 Idaho 807, 198 760 (1921)

- Board violated obligation to hold public auction and award lease to highest bidder, when it refused to hold an auction and awarded land to adjoining landowner.
- "The provisions of the Constitution and statutes above referred to made it the duty of the State Board of Land Commissioners, under the facts and circumstances of this case, to offer the lease of said lands at auction to the highest bidder, and the Board, in refusing to do so, failed in the performance of an act which the law enjoins as a duty resulting from its official position. In refusing to do so, its action ran counter to the provisions of the Constitution and statutes."

TRUST CONCEPTS

- A trust consists of three elements
  - Trust Property – assets held for the benefit of another
  - Trustee – person who holds title to trust property for the benefit of another
  - Beneficiary – person for whom the trustee holds title

- Fiduciary duty – a duty owed by the trustee to the beneficiary
  - Loyalty
  - Prudence

Undivided Loyalty

- A trustee must act with undivided loyalty to the trust beneficiaries, to the exclusion of all other interests. G. Bogert, *Trusts and Trustees* § 543, at 197–98 (2d ed. 1978). In the context of this case this means that when the state transfers trust assets such as contract rights it must seek full value for the assets. Const. art. 16, § 1. It may not sacrifice this goal to pursue other objectives, no matter how laudable those objectives may be.
- *County of Skamania v. State*, 685 P.2d 576 (Wa. 1984).

CHECKS AND BALANCES

- Delegates to the Idaho Constitutional Convention were particularly concerned that endowment lands not be used to further political agendas.

"[L]et us put this property in these lands in a condition that neither democrat nor republican can take it . . . the question before the convention now is how and in what manner we are going to best perpetuate the funds of the schools of this territory."

[Remarks of Alexander Mayhew, Vol. I, P. 656].

Idaho Watersheds Project v. State Bd. Of Land Comm'rs., 133 Idaho 64, 982 367 (1999)

- Provision of Idaho Code directing the Board to consider factors other than the maximum long term financial return to endowments held unconstitutional.
- "We acknowledge that "[t]he Board is granted broad discretion in determining what constitutes the maximum long term financial return for the schools." (citation omitted) Section 58–310B removes much of the Board's broad discretion, however, by impermissibly directing the Board to focus on the schools, the state, and the Idaho livestock industry in assessing lease applications, all to the detriment of other potential bidders like IWP, which might provide "maximum long term financial return" to the schools, but not to the state and the Idaho livestock industry."

FIDUCIARY DUTY

Prudent Investor Rule – "[A] trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule . . . ." Idaho Code § 68-501.

"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." Idaho Code § 68-502(1).

CONSTITUTIONAL DEBATE OVER TRUST

- The delegates contemplated that lands would be managed on sound business principles to maximize revenues. Delegates referred to land management decisions as "business transactions" and "business proposition[s]." [Remarks of William J. McConnell, Vol. I, pp. 661, 735, 737].
- The delegates recognized that "sound practical business judgment" would be needed "to get the most we possibly can from our school lands." [Remarks of Orlando Batten, Vol. I, p. 666].
- Lands were to be managed for "profit." [Remarks of William Claggett, Vol. I, p. 740].

ATTORNEY CLIENT COMMUNICATION – PRIVILEGED AND CONFIDENTIAL

Memo

To: State Board of Land Commissioners – Reinvestment Subcommittee: Honorable Brad Little, Governor; Honorable Lawrence Wasden, Attorney General; Irving Littman,

From: Darrell G. Early, Deputy Attorney General

cc:

Date: Wednesday, November 13, 2019

Re:
1. Constitutional and Statutory Restrictions on Disposition of State Land;
2. Effect of 1982 Amendment to add "maximum long term financial return."

At the conclusion of the last reinvestment Subcommittee meeting on October 10, 2019, the OAG was asked to provide additional analysis on two points. First, what are the restrictions and limitations upon the Boards' ability to dispose of endowment land? Second, whether the 1982 Amendment to Art. IX, section 8 of the Idaho Constitution effects, or would change the analysis, regarding the case law and interpretation of the Board's fiduciary duty? This memo covers both topics.

SUMMARY OF LAND DISPOSAL RESTRICTIONS:

Article IX, Section 8 Limitations:

1. State Board of Land Commissioners (Board) to provide for the sale or rental of all the lands:

a. Under such regulations as may be prescribed by law[1].
b. Sales must "secure the maximum long term financial return to the institution to which granted."
c. State lands cannot be sold for less than the appraised price.
d. May only be sold at public auction.
e. The State cannot sell more than one hundred sections of state lands (64,000 acres) in any one year,
f. State cannot sell more than three hundred and twenty acres of land to any one individual, company or corporation.
g. Exchanges of State land must be for equal value.

Statutory Limitations:

1. Idaho Code 58-313

    a. State cannot sell lands to anyone other than a citizen of the United States or a those who have declared an intent to become such.
    b. Must be advertised for 4 weeks in a weekly newspaper;
    c. Advertisement must state the minimum price below which no bid shall be accepted

2. Idaho Code 58-313A –

    a. Must provide notice to County Commissioners
    b. 60 days for County to object
    c. Reconsideration by the Board
    d. Judicial review of Board's decision by any person "aggrieved"
        i. Standard of Review: "arbitrary, erroneous or capricious."

3. Idaho Code 58-133(1): all state-owned lands classified as chiefly valuable for forestry, reforestation, recreation and watershed protection are hereby reserved from sale and set aside as state forests.

4. Idaho Code 58-138 – Exchanges of State land

    a. Must be for equal value
    b. For the purpose of consolidating state lands or to aid in the state control and management and use of state lands
    c. Must give notice to Lessees

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[1] Provisions regarding "under such regulation as may be prescribed by law" are probably limited to procedural regulation and cannot alter substantive terms of State Land Board's duties. See *Idaho Power Co. v State*, 104 Idaho 570, 661 P.2d 736 (1983); State v. State Board of Education, 33 Idaho 415, 427, 196 P. 201, 204 (1921); Idaho Attorney General Opinion 91-3; Utah Attorney General Opinion 87-44.

AFFECT OF 1982 CONSTITUTIONAL AMENDMENT

Textual and Case Analysis:

As originally adopted and up to the 1982 Amendment, Art. IX, Section 8 provided in relevant part:

> It shall be the duty of the state board of land commissioners to provide for the location, protection, sale or rental of all the lands heretofore, or which may hereafter be granted to the state by the general government, under such regulations as may be prescribed by law, and in such manner as will secure the maximum possible amount therefore;

Idaho Const. Art. IX, Sec. 8. (Emphasis added).

The 1982 Amendment proposed by HJR 18 (1982 Idaho Sess. L. pg. 935) and adopted by the voters at the general election that same year altered this language to provide:

> It shall be the duty of the state board of land commissioners to provide for the location, protection, sale or rental of all the lands heretofore, or which may hereafter be granted to or acquired by the state by or from the general government, under such regulations as may be prescribed by law, and in such manner as will secure the maximum long term financial return to the institution to which granted or to the state if not specifically granted;

Idaho Const. Art. IX, Sec. 8. as amended by 1982 Idaho Sess. L. pg. 936 (emphasis added).

On its face this language change would appear to shift the focus from getting the maximum single purchase value and allow the Board to consider other factors that address a longer term horizon of financial benefit. Indeed, as explained later, that was one motivating factors for the proposed change. However, as applied prior to the amendment, the Board appears to have had the discretion to consider more long term factors and on at least one occasion did so.

There is no Idaho case law directly interpreting the relevant phrase from either the original provision or as it was amended. The closest case addressing this issue as a matter of application appears to be Barber Lumber Co. v. Gifford, 25 Idaho 654, 139 P. 557 (1914). In that case the Board had auctioned a timber sale but did not award the sale to the person offering the most money at the time of sale (a bid of $101,000). Instead the Board awarded the sale to the next lowest bidder who had bid $100,000 but also included in their proposed bid additional consideration including the building of a short line railroad to the area of the timber sale. Without addressing the specific language of the Constitution, the Idaho Supreme Court upheld the Board's decision stating:

> [I]t is clear that the state board has acted in this matter only as a man of good business sense and judgment would act in regard to his own affairs. The board had two bidders at said auction sale for said timber, the state retaining the land on which said timber was situated, and it had much other land in the vicinity of said timber, and the state's land, no doubt, would be greatly enhanced in value by the construction of a railroad into the other timber lands of the state. And, too, the construction of a railroad not only will greatly enhance

> the value of other state lands in the neighborhood of such railroad, but will also add greatly to the value of the taxable property of the state, and if this were a private transaction, upon that state of facts, how would any business man of good sense and judgment, occupying the position of the state, do otherwise than accept said bid of $100,000 for said timber, when evidently such bid would result greatly more to the financial benefit of the state than $1,000? The value of the other state lands in that region of country would be increased ***562** many thousands of dollars by reason of the construction of the railroad, and the value of said railroad for taxable purposes, when completed, would amount in a single year to a great deal more than said $1,000.

139 P. at 561-62 (emphasis added). This decision implicitly recognizes the authority of the Board to look at the longer term interests of the endowments even prior to the changed language in 1982.[2]

Accordingly, it can be stated that the change to the Idaho Constitution did not likely change how the Board had historically looked at the issue, nor the Court's application of the provision.

Legislative History Analysis:

The 1982 Amendment to Art. IX, Section 8 of the Idaho Constitution was born out of what is commonly referred to as the "Sagebrush Rebellion." In this context the Idaho Legislature established a Public Lands Committee. S. Con. Res. 144, 45th Leg. (1980). The committee was assigned the task of "gathering accurate information to assist the Idaho Legislature in properly addressing the issue of the management and control of the unappropriated public lands in the state of Idaho." Id. The 1982 amendment came about, in part, because of the committee's work and was based, in part, on the committee's report to the legislature.

The first appearance in the committee's minutes of a proposed constitutional amendment was at its October 27, 1980 meeting when Vern Ravenscroft representing a group referred to as "Carey Act Settlers" proposed an amendment offering the following explanation:

> Mr. Ravenscroft stated that a constitutional amendment proposed by his organization would do the following: (1) It would bring in the concept of acquired lands over and above those granted to the state. (2) It would bring in the requirement that all lands in the state should be managed for the greatest public benefit - this would make it possible to manage fish and game lands without a concept of a profit motive and it would provide that endowment lands would still be managed for the maximum return for support of the particular institution for which it is dedicated. (3) It would require and place in the constitution the restriction that forestry land, reforestation land, watershed land and recreational land cannot be sold and that it must be retained and managed for the multiple use it would provide. (4) It would clarify the 320 acre situation so that no one can ever acquire more than 320 acres of state land from any sale or combination

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[2] As I mentioned in my presentation on 10/10/2019 it is likely that certain aspects of the Barber Lumber decision (i.e. its reference to the tax benefits and other considerations) would not be upheld today in light of the Court's holding in Idaho Watershed's Project v State Board of Land Comm'rs., 133 Idaho 64, 982 P.3d 367 (1999). It is also pertinent to note that the Idaho Watershed case postdates the amendments in 1982 and therefore was already governed by the new language.

of sales. (5) It would clarify the common practice to make it possible to exchange properties with more than just the federal government. Mr. Ravenscroft stated that these clarifications need to be made in the constitution whether or not the Sagebrush Rebellion is successful. A copy of the proposed constitutional amendment is attached as Appendix B.

Minutes of Legislative Council Committee on Public Lands, October 27, 1980.

The Proposed Amendment provided as follows (additions/deletions reflected in underline/strikeout):

> Section 8. LOCATION AND DISPOSITION OF PUBLIC LANDS. It shall be the duty of the state board of land commissioners to provide for the location, protection, sale or rental of all the lands heretofore, or which may hereafter be granted to or acquired by the state ~~by~~ from the general government, under such regulations as may be prescribed by law, and in such manner as will secure the maximum possible ~~amount~~ public benefit thereforom long; provided, that no ~~school~~ state lands shall be sold for less than the appraised price and never less than ~~ten~~ fifty dollars ($~~10~~50) per acre, and provided also that all endowment lands shall be manage to secure the maximum support for the intuitions to which they are dedicated. No law shall ever be passed by the legislature granting any privileges to persons who may have settled upon any such public lands, subsequent to the survey thereof by the general government, by which the amount to be derived by the sale, or other disposition of such lands, shall be diminished, directly or indirectly. The legislature shall, at the earliest practicable period, provide by law that the general grants of land made by congress to the state shall be judiciously located and carefully preserved and held in trust, subject to disposal at public auction for the use and benefit of the respective object for which said grants of land were made, except that no state lands classified as forestry, reforestation, recreational, or watershed lands shall ever be so sold. ~~and t~~The legislature shall provide for the ~~sale of said lands from time to time and for the~~ sale of timber on all state lands and for the faithful application of the proceeds thereof in accordance with the terms of said grants; provided, that not to exceed one hundred sections of ~~school~~ state lands shall be sold in any one year, and ~~to be sold in subdivisions of not to exceed three hundred and twenty acres of land to any one individual, company or corporation~~ no individual, corporation, company, or combination thereof may ever purchase more than three hundred and twenty (320) acres of state land by any sale or combination of sales. The legislature shall have power to authorize the state board of land commissioners to exchange granted or acquired lands of the state on an equal value basis for other lands under agreement with the United States, corporations, companies, individuals, or combinations thereof.

Minutes of Legislative Council Committee on Public Lands, October 27, 1980 (Appendix B).

These entries reflect an intention on the part of at least some participants to clarify that lands acquired from the federal government potentially as part of the Sagebrush Revolution would be managed under a different standard than typical endowment lands, but that endowment lands would continue to be manage for the financial benefit of the endowments.

However, the Committee on Public Lands took no position nor made any recommendation regarding the proposed amendment. See Final Report of Legislative Council Committee on

Public Lands, Nov. 26, 1980 pg. 15.

From this point forward the legislative history of the amendments to Art. IX, Sec. 8 become murky as I was unable to locate any additional documents discussing the amendment prior to its adoption by the legislature. However, after it was adopted and as it was presented to the voters additional information becomes available.

The Legislative Council issued a statement regarding the Effect of Adoption of the amendment, which stated:

> If this amendment is adopted, the constitutional standard for managing endowment and other lands granted to or acquired by the State of Idaho from the federal government will change. At present, endowment lands are managed to "secure the maximum possible amount therefor." This amendment will change that standard and require management to secure the "maximum long term financial return." This amendment will also add a constitutional standard for sales and exchanges of state lands.

Legislative Council's Statement of Effect of Adoption of H.J.R. No. 18, pub. by Secretary of State (1982).

In addition to the above-referenced materials, the voters were provided the following Statements FOR Proposed Amendment:

> 1. This amendment will formally spell out in the State Constitution a management practice that the State Board of Land Commissioners uses in managing the State's endowment lands. The State Board of Land Commissioners manages the endowment lands to receive the maximum long-term financial return instead of the short-term benefit.
>
> 2. The maximum long-term financial return to the State of Idaho from the management of state-owned lands could be significantly different than the maximum possible amount received from the lands. Requiring that the State Board of Land Commissioners manage lands to receive the maximum amount of return over a period of years will promote efficient, cost-effective far-sighted management practices, and allow the State of Idaho to realize the maximum financial return possible from the sale or rental of state lands.

Legislative Council's Statements FOR Proposed Amendment, pub. by Secretary of State (1982).

Finally, the following Statements AGAINST the Proposed Amendment were provided to the voters:

> 1. This proposed amendment is unnecessary as the State Board of Land Commissioners now administers the State's endowment lands in a manner that will secure the maximum long-term financial return to the institution for which they are granted. It is provided by statute that the State Board of Land Commissioners shall not sell state lands under bid for less than the minimum price set by the board. This has traditionally been for at least the appraised price. It is statutorily provided that the State Board of Land Commissioners may exchange state lands on an equal basis with private and governmental entities.

2. While it is not the intent of the amendment, wording in this amendment may preclude the State of Idaho from acquiring land from the federal government and devoting it to a purpose that would not secure the maximum long-term financial return to the State. This could prevent the State of Idaho from acquiring land from the federal government and converting that land into a state park or a fish and game preserve if that use does not secure the maximum long-term financial return to the State of Idaho.

3. This amendment substitutes the phrase "maximum long-term financial return" for a phrase that has been interpreted by the courts. This substitution may eliminate nearly a century of case law regarding the State's endowment lands. Also, the phrase "maximum long-term financial return" is highly ambiguous.

4. While not the intent of the amendment, the wording of this proposed amendment could possibly endanger certain existing state parks and wildlife refuges which had been granted to the State of Idaho by the United States government. Lands containing certain state parks and wildlife refuges were granted to the State of Idaho by the United States specifically for use as parks or wildlife refuges. If a court were to find that the use of these lands as state parks or wildlife refuges is not securing the maximum long-term financial return to the State and hence in violation of the State Constitution, title to the lands could revert to the United States Government.

Legislative Council's Statements AGAINST the Proposed Amendment, pub. by Secretary of State (1982).

While the statement of effect suggests that the constitutional standard "will change," the statements for and against indicate that perhaps both the proponents and those against the amendment believed that the standard already being used by the Board was to "secure the maximum long term financial return" to the endowments and that this amendment likely just codified the existing practice. This is consistent with the Board's application as affirmed by the Court in the Barber Lumber case.

CONCLUSION:

It is my opinion that the 1982 Amendment to Art. IX, Sec. 8 of the Idaho Constitution does not likely change the outcome of the single relevant case precedent in Barber Lumber. It would appear that the amendment simply codified a practice that the Court had already tacitly approved when it affirmed the Board's exercise of discretion to award a timber sale to a person who was not the highest "cash" bidder at an auction.

ENDOWMENT FUND REFORM PROGRESS REPORT

By Robert Maynard

Member, Governor's Committee on Endowment Fund Investment Reform (1996)

December 6, 2013

INTRODUCTION AND SUMMARY

Endowment Fund reform began seventeen years ago with the report and recommendations of the Governor's Committee on Endowment Fund Investment Reform. The ultimate goal was clearly laid out in the initial paragraph of the Committee report in December of 1996:

> The state needs to shift its current policy from management of individual parts (the land trust separately from the financial assets) to management of the entire endowment. The entire integrated endowment needs to have its rules of overall operation clarified, reorganized, and reoriented towards providing a predictable and increasing stream of revenue to the beneficiaries while at least maintaining the purchasing power of the assets of the endowment. The endowment also needs to specifically set out its goals and investment policies, including the rules for setting the distribution and level of benefits to both the current beneficiaries and those of future generations.

Most of endowment fund reform has been accomplished to the great benefit of the state and the beneficiaries of the Trust. Some steps, however, remain. The next major step is to introduce more of the "prudent expert rule" mode of thinking and decision making when the Land Board considers Idaho Department of Land (IDL) issues that have substantial investment components. This would essentially require "Trust, but Verify" type procedures when considering issues such as land exchanges, disposition of Land Bank assets, and commercial property transactions.

Currently, for example, IDL staff is responsible for making substantive recommendations, often using outside resources. This report assumes they are expert. But modern public fund investment practice always double checks expert recommendations by additional, independent expert opinions and reviews, and independently monitors performance and maintenance of qualifications. In practice, then, the prudent expert approach requires two separate actions: first, that all investment decisions are done either by experts or upon the recommendations of experts; and second, that independent monitoring systems are in place to assure that the experts making the decisions or recommending the decisions are, in fact, maintaining their expertise and that the decisions (or recommendations) meet institutional investment expert standards. Current Land Board procedures do not contain the second of these two steps – that of independent verification.

This additional step would engage outside consultants and experts hired directly by the Land Board with the assistance of the Endowment Fund Investment Board to provide an independent review and confirmation of information and recommendations to the Land Board prior to any major investment decisions. These additional agents would also be responsible for measuring, monitoring, and reporting on those IDL investment activities to assure progress toward the investment goals and maintenance of procedures and standards at the expert level in investment management. If desired, outside agents could also be responsible for portions of the actual management of investment activities with oversight by the Land Board through IDL staff and other consultants. These outside experts could also assist the Land Board, with the involvement of both the EFIB and the IDL, in developing an asset allocation policy

from an investment perspective that would include all Land Trust assets, both lands and the financial assets.

The Land Board should request the EFIB to supervise the recommendation of consultants and other experts to independently review, oversee and as necessary opine on the investment activities of the IDL, and present recommended consultants and other experts for approval by the Land Board. The EFIB should subsequently assist the Land Board in monitoring those agents and review any recommendations for conformance with institutional investment practice prior to presentation to the Land Board. The EFIB should not, however, make any independent judgments about the substance of the recommendations and reports (either by IDL staff or the reviewing experts).

RECOMMENDATION FOR INDEPENDENT VERIFICATION IS PROCEDURAL, NOT SUBSTANTIVE

This recommendation for a procedural addition to IDL and Land Board practices makes no judgment on any past or current investments or policies, and no review has been made of those investments, practices, procedures or policies. It could be that an independent review or a contemporaneous outside due diligence opinion would have verified those recommendations, but without that additional independent review one could not be comfortable with any final conclusion under modern investment practice.

Thus, for example, this recommendation does not address the current debate over whether the Land Board should invest in commercial property. It simply notes that under current procedures, one cannot tell if commercial property is an appropriate investment since no asset allocation study reviewed or produced by an independent consultant of the entire Trust assets has been performed. Until such a study has been done from an investment perspective in conjunction with independent experts and has been adopted by the Land Board, the desirability (if any) of commercial property (not to mention the issue of whether that property should be local or national) cannot be confidently asserted under a "prudent expert" framework.

Nor does this recommendation comment on the reasonableness of any particular land swap or any particular purchase of a commercial property proposed or entered into by the IDL. This recommendation assumes that the Idaho Department of Lands is an expert in commercial property management and valuation of land exchanges, and that all of its recommendations are expert recommendations. But the "prudent expert" rule has two parts: first, hire an expert, but second, independently monitor the activities of that expert to assure that that delegated trust is warranted and is maintained. Investment practice recognizes that experts can be wrong or can make mistakes. It is the second part of the requirement to verify decisions or recommendations that is lacking in current Land Board procedures,

Those independent verifications are now standard practices under the "prudent expert" rule used by large institutional portfolios (including the EFIB). Land Board investment decisions involving Idaho lands, however, currently primarily follow procedures developed for land management and regulatory frameworks: namely, the Land Board directly makes a substantive decision on the underlying merits of a proposed action acting solely on the recommendation and analysis of the IDL. Modern investment

practice, however, would ask for more procedural assurance and reduce the Land Board's need to make their own substantive judgment.

With this relatively small procedural addition, endowment fund reform will be very close to achieving all of the aims of an effort that began almost a generation ago.

BACKGROUND AND PROGRESS TO DATE

The primary concept of endowment reform was that the state is managing one entire Land Trust, which for historic and some management reasons had been split into two entirely separate parts: state lands managed by the Department of Lands, and financial assets managed by an Endowment Fund Investment Board who could only invest in certain types of bonds. The central goal was to not only merge the two types of assets in overall policy, but also integrate the different disciplines of land management on the one hand, and modern investment practice on the other.

The main change of endowment reform was to merge what were then entirely separate state entities into one organization under the Land Board with modern investment capabilities. The Land Board became both the land manager and the investment manager of all of the Land Trust. Second, the investment and management options were updated to reflect the changes in investment and fiduciary management that had occurred since the original grants in the late 1800s (such as the recognition that a diversified portfolio of assets across many types could lead to higher returns with less risk or volatility than a portfolio of solely land assets and investment grade bonds).

The Land Board became the ultimate policy maker for both land management and for investment management. The Endowment Fund Investment Board became the tactical arm under the Land Board for the financial assets, with the ability to invest in a wide range of financial assets beyond simply bonds. The Idaho Department of Lands remained as the tactical arm for land management.

Since then, major advances have been made to reach the goals of the reform effort – advances that have rebounded to the clear benefit of the citizens of the state of Idaho. These advances include:

1. The expansion of the investments of the financial assets of the endowment to a professionally managed fully diversified portfolio that is one of the very top performing billion dollar plus investment organizations in the world. For example, in the last ten years (ending with the most recent fiscal year), through some of the most turbulent financial markets in a century, the EFIB has ranked in the top 5% of all public funds (Callan Plan Sponsor Data Base). Over the past 5 years (starting with the Great Collapse of 2008) it has ranked in the top 10% of all endowments and foundations (Bank of New York Mellon database, 191 funds reporting), handily outperforming such well known endowments as Harvard and Yale, and sovereign wealth funds such as Norway and the Alaska Permanent Fund.
2. The Department of Lands has shifted its orientation from a focus on biological management to one that incorporates return considerations in the management of timber and other lands. These return considerations take into account changes in milling technology and preferences for smaller, less defective timber; risk factors such as loss of timber due to fire, insect and disease;

local, national and global market conditions; alternative energy goals and other pecuniary and non-pecuniary factors. Since 1996, annual sustained timber yields have increased approximately 50%. The benefits of this shift include avoiding many of the predictions of precipitous and dwindling timber revenues that were common at the end of the 1990s.

3. Distributions and payments of revenues from the Trust are now largely in the hands of policymakers who can respond to ongoing circumstances (such as the financial crises of 2001-2003 and 2008-2009) rather than left solely to the vagaries of outmoded statutes that acted as a "dead hand" in the distribution of revenue from solely bond interest and interest on timber sales, and which automatically deposited all timber sale revenue in the "lockbox" of the permanent fund (then being managed by an entirely separate Endowment Fund Investment Board). Currently policy makers from the Land Board, the Endowment Fund Investment Board, and even the Legislature can be involved in setting the rules for current distribution and the fair division of assets between future and current generations.
4. The Land Board has adopted an Asset Management Plan, a written investment policy which codifies the principles and procedures by which the Trust operates. This has added significant transparency and consistency to the governance of Trust assets. It has also promoted dialogue between policy makers when reviewing matters such as distribution policy. [The recommendation of this report would have simply added an outside review or involvement by a qualified expert investment consultant both prior to adoption as well as periodically since].

These and other benefits (including focusing on the needs of the individual beneficiaries, rationalizing the management of other land based assets of the endowment, providing for guarantees for school bond issuances, formal reviews of distribution policies, the creation of a Land Bank to provide flexibility in the disposition and management of state lands, increasing the cash flows to beneficiaries, etc.) attest to the dedication of the entire state system, from legislatures through constitutional officers, including citizen appointed boards, and staff members of the Department of Lands, the Endowment Fund Investment Board, and the Office of the Attorney General. While the participants and the public might emotionally feel that on a day to day basis there is slippage, when one looks over the decade and a half of efforts, the change for the better has been most impressive.

REMAINING ISSUE AND CHALLENGES

While great strides have been made, the full benefits of complete integration of the management of the land trust are yet to be achieved. If a football analogy can be used, the ball has been advanced from one's own goal line to around the opponents' 15 or 20 yard line. The "red zone" has been reached, but there is yardage still to be gained.

The problems still remaining now lay in the "grey area" between financial assets and land assets: namely, decisions involving land assets that have substantial investment considerations. These areas include decisions involving the investment and deployment of the Land Bank funds, procedures and considerations involving land swaps, the purchase and management of in-state commercial property, decisions concerning asset allocation and distribution policies that do not expressly include all Land Trust assets and cash flows in the same framework as the financial assets, and the lack of a performance

measurement and monitoring system that includes all of the Land Trust assets using currently well-established institutional investment principles.

Currently there are still areas where the options and institutions being considered by the Land Board are artificially constrained by structures, procedures, and approaches that result in "siloed" management of parts of the land trust from parts of the financial trust. Small changes can materially advance the goals of the reform, and might lead to the Land Board being able to consider a wider range of options for the management of the land and financial assets, assure that the best decisions are being made for the Trust as a whole, and potentially avoid some of the controversies that have arisen in the management and disposition of the assets and in the setting of the policies for the distribution of those assets.

For example, there is one clear attitude from the current structure that infects the Trust: that the physical assets of the Department of Lands are seen and treated as a separate "pool" of assets from the financial assets of the Endowment Fund Investment Board. Both parts of the Trust see themselves as separate entities only marginally connected. Further, each entity manages its portion of the Trust with a different mentality: the EFIB from an institutional investor with a "prudent expert" frame of mind, and the Department of Lands as a state land manager and regulator with a primarily operational frame of mind. Each looks at their particular assets from their own different perspectives, and has different values (and valuations) because of that difference. And, at least impliedly, each views "their" assets as being lost if, for some reason, those assets would go to other parts of the Trust.

It is true that there are parts of each section of the Trust that requires those different points of view. The EFIB has no need to be expert on how to manage a timber sale, while the IDL has no need for help in evaluating a potential emerging market investment or whether a stock manager is picking the right stocks. But, there are major points of intersection between the two divisions. When there is investment overlap, the attitude of "separate but equal" managements might cause distortions in policy recommendations and a relative narrow view of the range of potential policy choices.

At the moment there are four issues causing policy and other concerns that demonstrate that further integration of the Trust is needed – that if the goal line of complete integration is still some way away, it does not mean the ball shouldn't be advanced another ten yards.

These issues are:

1. The interim investment and ultimate destination of Land Bank funds
2. The valuation and implementation of land-swaps (particularly involving cabin sites)
3. The role and management of in-state commercial real estate
4. The determination of distribution policy

The first example is in decisions on Land Bank investments and purchases. The Land Bank is the temporary depository for proceeds from the sales of state lands – otherwise, the monies would be deposited in the Permanent Fund that is managed by the Endowment Fund Investment Board. That deposit of Land Bank monies in the Permanent Fund is delayed for five years to allow for the efficient

management of Trust lands (for example, isolated parcels of grazing land could be more easily consolidated through a Land Bank mechanism).

But, because of the siloed practices, Land Bank proceeds are (or are currently expected to be) kept on deposit in Treasury (in increasingly non-productive cash). Further, because there is an implied view of "use it or lose it", there is an artificial motivation to invest the monies in in-state commercial real estate because of the perceived need to stabilize land revenues and reduce sing industry risk (timber) only within that "silo". There is an implied view that once monies go to the EFIB and the Permanent Fund, that they can never come back into Idaho, and that the jewel of the state land base will eventually be wasted away.

But investment practices require more. Modern investment practice would have an overall plan, developed in conjunction with and reviewed by independent investment experts, for all of the assets of the Land Trust, and decisions about the destination of Land Bank proceeds would be made in the context of that overall plan (or asset allocation). It may be that in-state commercial real estate is an allowable use of that money, either for return purposes or for long-term policy reasons. However, it is impossible to tell without some overall plan for the entire Trust – one that looks at not only the land assets in IDL, but also the financial assets managed by the EFIB. The Land Bank sits "between" these two components. In-state commercial property should not be the only option under consideration simply because of the tendency to see the entire Trust as consisting of completely separate pools of assets that are not parts of a larger whole.

The second example is land-swaps, particularly concerning cabin sites. For various reasons, land exchanges are used instead of straight sales and purchases. Without commenting on the use of that particular procedure, one problem that remains is that these swaps are now solely for other in-state lands. This is, in large measure, an Admission Act and statutory result of thinking solely from the traditional IDL viewpoint – IDL only has authority to manage in-state properties. And, in-state properties managed by the IDL can only be subsequently disposed of by auction or by another land-swap. Further, while the land swap may put the existing state property on the tax rolls, the new property would be taken off the tax rolls, with a differential between in-state taxing jurisdictions (particularly counties and school districts). These considerations severely constrained the market for land swaps, and therefore the value that might be achieved through land swaps of existing state properties (including cabin sites).

This approach made sense before Endowment Reform, because at that point the Endowment Fund Investment Board was entirely separate from the Land Board and the Idaho Department of Lands. Department of Land properties had to be managed by IDL. But with Endowment Fund reform the Land Board became the responsible party for the management of those endowment assets, and the EFIB became the entity charged with tactical implementation of investments. The EFIB, under prudent diversification standards now available after Reform, can purchase and manage out of state properties and other financial assets without the disposal and other restrictions that exist on in-state properties held by the state of Idaho.

Thus, the valuation options being considered in land swaps are artificially constrained to only properties within the state of Idaho. And, the swap is constructed to be for properties that will be managed in the longer term by the IDL, and not with an eye to being able immediately sell the acquired property at auction for proceeds that would (or could) go to the Permanent Fund for investment by the EFIB. The investment options are much broader than simply in-state commercial property that will be held long term by the IDL, and those options can provide a broader perspective when investment values are part of the ultimate decision. There may be very valid policy reasons for only swapping for in-state land (maintaining the Land Trust's in-state land base, etc.), but the issue of the value of the swap should look at broader considerations. That comparison at least widens the range of possibilities and potentially increases the values of current in-state properties.

The third example is the current management of commercial real estate and cabin sites in the Idaho Department of Lands. These assets are comprised entirely of in-state real estate managed by in-house IDL staff (who make the purchase or sale recommendation and other major property decisions, and implement those decisions through outside property managers, using outside appraisers, etc.). The tradition and orientation of the IDL is to manage assets primarily in-house – the requirements of disposal of state lands (with auction and other standard public protection statutes) and the local nature of the interests to be managed made management by in-house staff the universally preferred alternative.

There are two issues at stake: (1) whether acquiring only in-state commercial property makes sense in the context of the overall assets of the Land Trust; and (2) using solely in-house (IDL) staff for the acquisition and management of the properties without outside independent expert review and monitoring. As noted previously, both occur, in large part, because of the view that the land assets are a separate and siloed part of the Land Trust and should be managed consistent with the land management and regulatory tradition of the Idaho Department of Lands. And, because of that tradition, there is no independent, outside expert review of the investment activities or procedures of the IDL or an independent performance measurement and monitoring system with regular reports to the Land Board.

This is consistent with both the traditional land management and also regulatory activities of the IDL. After all, for example, having an outside expert in the area independently approve a state regulatory decision is nonsensical. But when investment activities are involved, very different considerations and frameworks are involved.

Almost all billion dollar or greater investment funds (such as the Land Trust) have private commercial real estate portfolios. That is also an option for the Land Board when looking at the portfolio of the entire Trust. If part of a reasonable and considered overall asset allocation of the entire assets of the Trust, commercial real estate, whether within or without the state, can be a very legitimate investment. But, most programs make comparisons of real estate purchases on a national (if not international) comparison. There is no reason to restrict the decisions on commercial real estate to solely in-state investments, or constrain the consideration of the merits of a decision to only in-state factors.

Similarly, there is no reason to artificially restrict the management of real estate to solely in-house staff because of historical practice for other IDL activities. The decision on the structuring and oversight of a commercial real estate program should not be artificially restricted or constrained because of a "separate and siloed" mentality. There are a number of options available. There are a number of professional, national firms with the needed expertise to not only assist in the management of the in-state properties, but also to make reasonable comparisons to the decisions and procedures for in-state properties.

In-house management is, of course, an option – larger investment operations (particularly in Canada) often use in-house management because of cost savings. In-house management, for example, is clearly preferred for the Trust's timberland assets. That is still an option, in whole or in part, for the Trust's commercial real estate operations. But, here an investment mentality would require an independent review of the in-house management and a separate and independent performance and monitoring system to assure the Land Board that it has hired an "expert" when it has hired itself as the manager.

The fourth example issue is the determination of distribution policy and the scope and review of the asset allocation policy of the entire Land Trust.

Great strides have been made in the determination of the distribution policy of the Land Trust. It is no longer mechanically determined by statutes and regulations laid out separately for the land assets and the financial assets that were set out decades ago in completely different financial and market circumstances. Nor is the division of benefits mechanistically allocated between current and future generations. The EFIB now recommends an annual distribution to the Land Board in accordance with a detailed policy following general principles set out by the Land Board. This policy takes into account expected market environments, projected cash flows from the Department of Lands, and a number of other articulated factors. That recommendation is reviewed and expressly adopted or modified by the Land Board annually.

This largely completes the vision of the original endowment reform that distribution policy should take into account current and future needs of the beneficiaries in a manner that recognizes the changing market and other environments, and should be ultimately in the hands of the elected constitutional officers that comprise the Land Board. Recent debates about alterations to recommended distributions show that those officers are cognizant of those ultimate responsibilities, and that a wide range of considerations are applied.

The only step remaining on the distribution policy is one more of form, and probably not substance. Currently the EFIB proposes a distribution policy that is expressed solely in reference to the financial assets of the Trust, although the development of that policy considers the cash flow projections of the IDL.

Similarly, and requiring more effort, the asset allocation policy is developed solely in terms of the financial assets, with the IDL having its own, and separate, asset allocation policy for the lands – one with a much different cast, focus, and basis. Finally, each part of the Trust has its own performance measurement, again with different formats, concepts, bases, and valuation measures.

All of these activities should be merged for a presentation to the Land Board into one common format, language, and objectives, that is, in turn, reviewed and (if needed) produced by a consultant or other independent investment organization. The measurement and inclusion of "real" assets, including timberland, agricultural land, and mineral lands, in an investment performance report by independent sources is now a common occurrence in the global investment community, and similar standards should apply to the entire Land Trust under the direction and supervision of the Land Board.

Indeed, it is difficult to see any ultimate resolution of the place and desired size of commercial property in the overall Land Trust until there is an express asset allocation that looks at all Land Trust assets on the same footing, which, in turn, would require an investment valuation of the land assets to be comparable to the financial assets. Then there would be an investment basis for allocating some proportion of overall assets (if any) to commercial property. After a decision about the size and benefits of commercial real estate, then there would be a framework for the subsequent determination of the merits on in-state properties as opposed to commercial properties located out of state. But this "top-down" resolution is difficult, if not impossible, as long as the two parts of the Trust are seen (and measured) as separate pools of assets.

ADDITION OF INDEPENDENT OUTSIDE REVIEWS – THE PRUDENT EXPERT RULE

Land Board decisions involving land transactions and programs with substantial investment components currently rely only on IDL staff recommendations and require the Land Board to make the substantive investment decisions directly. But in the world of investment management and the "prudent expert" rule, other approaches become as feasible (and, in most instances, preferable).

In the investment world, the rules are different – if one directly makes a decision, then one is held to the standards of an expert in the field. But there is another alternative – particularly for investment Boards with "lay" Board members. That is that a Board can hire an outside expert, and then the responsibility is delegated to that outside expert to either make that decision, or present an investment recommendation for action. If the Board makes a different decision than recommended, and it is not for overriding non-investment policy concerns, then that different decision is subject to higher scrutiny. But, if the expert makes the decision, or if the Board follows the recommendations of the expert, then the Board or hiring authority is then only responsible for independently verifying that expertise: namely, that that agent was reasonably considered an expert, and the performance is monitored to assure the expertise is maintained. In other words, the decisions or recommendations of the delegated expert, itself, needs to be independently reviewed and monitored by some other organization independent from that delegated expert.

The Land Board has delegated decision and recommendation authority to IDL staff, and considers IDL the delegated expert. It needs to add independent oversight of the IDL to separately monitor and report to the Land Board on the delegated activities.

Currently, then, Land Board decisions involving land assets with substantial investment considerations do not contain a standard component of most modern institutional investment processes – the inclusion of an independent expert review opinion of the proposed decision, and the regular independent expert

review and monitoring of the investment components of a program. Instead, the Land Board relies on the recommendation and analysis only from the perspective of IDL, who have performed the analysis in-house (although the staff does use outside sources of information, such as appraisals and broker opinions). Even granting that the IDL staff is expert in the area, this is not enough. Standard practice in the investment world requires more.

As an example from the purely institutional investment world, most large funds hire expert stock managers to manage their domestic, international, or global stock portfolios. Those expert stock managers then pick individual stocks, and those managers also use many outside sources of information. Even granted their expertise, relying only on those managers is not enough, There are independent, and often daily, reviews of performance by other outside experts or sources of information (custodial reports, monthly or quarterly consultant reports, separate staff monitoring and reports, to name a few). Outside consultant and independent staff reviews (including on-site reviews) are regularly performed and reported to the usually lay Boards. Comparisons of performance with similar managers as well as against benchmarks are routine. Qualitative judgments of processes and continued expertise of the manager, as well, are a normal part of the information received by the Board. All of these independent, outside reviews are done in addition to receiving the reports of the expert managers themselves on their own stock-picking activities.

Here the role of the expert stock manager in the context of the in-state commercial real estate is performed by the expert IDL staff for real estate and land-swap valuation. Simply relying on their reports of their activities and their recommendations is only a part of the information that needs to be presented to the Land Board if they are to act as an institutional investor under modern standards. Independent confirmations of expertise and continued maintenance of that expertise similar to that performed on hired stock managers needs to be added.

For example, independent outside opinions from an investment perspective of recommendations or options need to be included in the presentations to the Land Board when decisions are made on purchase of in-state commercial properties (including land swaps) or when the management and performance of those properties are reviewed. The Land Board has hired itself (IDL) as the manager of the properties. If it had hired an outside professional real estate manager, then there would be certain reviews by independent consultants and certain performance monitoring reports required under investment industry standards. No less is required when the Land Board essentially has hired itself instead of an outside professional.

These outside reviews might also uncover options or considerations not advanced in the underlying recommendations. These outside opinions might also suggest different or additional procedures or processes that enhance the program. At the very least, these outside reviews will assure a "lay" Land Board and other outside stakeholders that any recommendations are consistent with current institutional practice and meet prudent fiduciary standards.

Therefore the next step in the integration of the two parts of the Trust is to at least partially "meld" the investment approach, procedures, and safeguards common to institutional investing with the IDL land

management and regulatory mentality in those areas where investment issues are a significant consideration. While it is impractical to suggest that that melding of attitudes can be accomplished in one step, some major strides could currently be taken in that direction.

There are various options. But all would require some involvement of one silo with the other in either joint decision making, or independent outside oversight of investment actions involving land assets.

An example for discussion purposes would be if the current structure of IDL primary management is kept. If so, then the EFIB should be responsible for supporting the Land Board's hiring of independent consultants or outside professionals to review, report, and monitor investment related activities and decisions by the IDL. Outside reviewers' mandates would include activities such as quarterly performance reports on all land asset types along with annual reviews of the commercial real estate and other investment related operations and procedures by outside, nationally recognized real estate investment professionals – including recommendations for any changes in procedures or operations, and reviews of annual business plans for the real estate portfolio. Those reports would be presented for initial vetting by the EFIB, and then presented to the Land Board for their consideration, including decisions on any recommendations for changes in operations.

Similarly, an outside expert review of any land exchanges could be achieved by the Land Board through the hiring, with the assistance of the EFIB, of an independent, nationally recognized firm for an opinion of fairness or reasonableness (often called a "due diligence" opinion). Again, the report would be vetted by the EFIB and then passed on to the Land Board for its considerations when it makes the final decision.

One of the first tasks of an independent review would be to determine which IDL activities have substantial enough investment considerations to warrant independent review and monitoring, and perhaps setting some order of priority. Clearly the commercial property operations, the land-swap determinations, allocation of Land Bank monies, and overall Land Trust allocations would fall into "investment related activities" that would be at the head of any list. At the other extreme, the regulatory activities of the IDL, such as regulation of surface mining, forest practices, lake protection, and similar activities would not. These are regulatory activities, not investment activities, and are on the other side of the line between "investment" and "other" activities. Nor does this recommendation mean that all pieces of this puzzle have to be solved at once – the Land Board with the assistance of outside experts, the EFIB, and the IDL would probably need to set some order of priority.

These are just a few of the investment activities that would be involved if the current structure is maintained. Other activities would also be included under this approach.

The EFIB should be formally involved (although not solely responsible) in any recommendation for the use of Land Bank proceeds for potential acquisitions, either as a major actor in making recommendations, or as a formal commentator on any plan to use that money (unless, perhaps, if the Land Bank is being used for its original purpose of consolidating current holdings of state lands). This should be done in the context of an overall asset allocation policy for the entire trust developed in accordance with modern investment practice. In any event, the EFIB should be given its original

intended role of investing Land Bank proceeds, rather than leaving it within the purview of the IDL, whose only investment option is to deposit it as cash in Treasury.

Further, the Land Board with the assistance of the EFIB should formally contract with a nationally recognized firm to develop an independent valuation of the "real" assets of the Land Trust according to institutional investment standards on at least an annual basis and include those valuations and performance in a performance report on the entire Land Trust to be reported to the Land Board. That valuation would, of necessity, project expected cash flows and make some judgment on their riskiness (through the use of a discount rate). That valuation would serve three purposes. The first would be to allow a complete view of the Trust assets in setting distribution policy. The second would allow an annual performance review of the Land Trust assets. Third, that valuation would allow the development of an overall Land Trust asset allocation policy based on the same investment principles and valuations.

It should be emphasized that in this structure the EFIB would not be responsible for the management of the assets of the Land Trust, nor would they even be in the lead position for determining, in the first instance, the preferred policy. Instead, they would be supporting the Land Board in retaining and monitoring independent experts to review potential decisions or actions by the IDL when the IDL is engaged in investment activities. The EFIB would initially review the independent conclusions of outside experts for reasonableness and clarity, and then pass on those reviews to the Land Board prior to any decision being reached.

Another option under the prudent expert rule is to delegate some of the IDL investment activities to an outside nationally recognized organization with real asset expertise, and have IDL and EFIB jointly exercise supervisory and monitoring authority over that outside firm (which would include, as with stock managers, other outside independent reviews of that activity). That firm could be responsible for making recommendations or managing commercial properties or land exchanges, and the joint EFIB/IDL oversight would be responsible for assuring that any decision by the Land Board or report to the Land Board based on that outside group's recommendation was reasonable and expert. That joint oversight by the IDL and EFIB could also be responsible for overseeing other investment related activities that involve delegation to outside experts.

Again, this recommendation to "verify" IDL activities and recommendations does not, in any way, imply any judgments about current procedures, structures, practices or recommendations of the Idaho Department of Lands. There has been no review here of any of those operations or any of the transactions of the Idaho Department of Lands. It could very well be that an independent review and monitoring would have supported all of the recommendations, or verified all of the practices of the IDL.

But that is not the point of the recommendation. This recommendation is simply an observation that the IDL is performing analyses and making investment recommendations to the Land Board with no independent oversight, review, or monitoring. Independent review and monitoring of experts by other experts is standard practice in the institutional investment industry. The Land Board needs to include such independent verifications of the decisions of the investment expert who has delegated authority

(currently the IDL) and independently monitor the activities of the expert to assure expertise is maintained.

As a side note, once these independent verification procedures are set up, the Land Board might consider delegating the actual substantive decisions down to either IDL staff or another delegated expert. The EFIB board members do not pick individual stocks, and public pensions with commercial property portfolios usually do not have their Board members decide on individual properties. Because, under the prudent expert rule, if a lay Board member makes a specific investment decision, that decision is reviewed under the standards of an expert in the area – and most lay Board members do not meet that criteria. Once the Land Board is convinced of the expertise of its delegated agent (currently the IDL staff) and that expertise is continually confirmed by outside professionals both in general (such as by performance monitoring and structural reviews) and specifically (independent due diligence on major property decisions), it can choose to delegate the investment decision itself (such as whether a land swap is reasonable investment) and only retain approval authority for particular non-investment policy reasons.

In summary, this recommendation assumes that the Department of Lands is an expert. But there are two parts of the "prudent expert" rule. One is to hire an expert. The second is to independently monitor and verify the activities of that expert to assure that the judgment of expertise is warranted and maintained. It is the second of these two requirements – the oversight of the expert – that is lacking in the current procedures and should be added.

In either case, the EFIB is the appropriate entity to assist the Land Board in retaining outside experts, supervise the independent reviews, and monitor the agents to generate those reviews. First, the EFIB is the part of the overall Land Trust operation that is familiar with modern institutional investment practice, and the frame of mind that is needed to implement those practices. Second, the EFIB's stellar investment record over the past decade is at least proof that it is a professional and well-qualified entity whose judgment and skill have withstood some of the most difficult financial markets in generations. Third, the entity reviewed (here the IDL staff) should not be the ones helping determine who watches them, and who recommends the hiring or firing of those reviewers. That should be the EFIB.

The suggestions set out in this report are only examples of possible approaches. The actual options and recommended courses of actions should be part of the process of the outside reviews facilitated by the EFIB. The EFIB should consult with and recommend to the Land Board, in the first instance, which types of consultants and tasks should be undertaken. For example, there are a number of fiduciary and governance consultants who do reviews of large investment programs and recommend structures and steps to achieve those structures. That may very well be the first type of expert to be hired by the Land Board with the assistance of the EFIB, and the recommendations of that review could set the template for future actions.

In any event, the EFIB should be tasked by the Land Board to

- arrange for the review of IDL activities by an outside expert(s) to be hired by and to report to the Land Board to
    - determine which activities need additional investment oversight
    - recommend experts to be hired by the Land Board to independently review those areas
    - report to the Land Board on options for oversight, review, and monitoring of the investment activities of the IDL
- help implement the preferred option(s) by arranging for the hiring of the experts by the Land Board
- review any reports or recommendations prepared by outside experts for completeness prior to presentation to the Land Board.

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

Tom Schultz, Secretary to the Board

Final Minutes
State Board of Land Commissioners' Regular Meeting
December 17, 2013

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, December 17, 2013 in the State Capitol, Senate Hearing Room WW55, 700 West Jefferson, Boise, Idaho. The meeting began at 9:02 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence Wasden
Honorable State Controller Brandon Woolf
Honorable Superintendent of Public Instruction Tom Luna

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

DEPARTMENT OF LANDS YEAR IN REVIEW

Department of Lands' staff presented a video of 2013 Year in Review accomplishments.

1. Director's Report

A. Interest Rate on Department Transactions – December 2013
DISCUSSION: Director Schultz noted the interest rate on Department transactions is 4.25% for December.

B. Timber Sale Activity and Information Report – November 2013
DISCUSSION: Director Schultz reported the Department had two timber sales in November with a 73% upbid over advertised value. The Department currently has 472 MMBF under contract, worth slightly more than $103 million. Director Schultz remarked the Department had over $9 million in harvest receipts for the month and close to $6 million projected for December. The Department has had a phenomenal year for both harvest to date as well as revenue to date from the timber sales. The Department has reached approximately 70% of its fiscal year target for sawlog sales and about 30% of its target for cedar pole sales. Director Schultz noted cumulative harvest receipts are nearly $43 million for the year, which is 152% of the 5 year average, and harvest volume is at 200 MMBF, far eclipsing historical averages on both revenue and volume harvested this first half of the year. Director Schultz commented that stumpage prices have moderated back to about $250/MBF from a high of $300/MBF earlier in the year.

C. Division of Lands and Waterways Activity and Information Report – November 2013
DISCUSSION: Director Schultz mentioned the Department had a number of new transactions in November, primarily grazing leases. Director Schultz also pointed out a few residential cottage site leases were signed and provided an update by lake: at Payette Lake there are 118 leases signed and 9 one year extensions signed, with a total of 19 lessees choosing the reappraisal option that was approved by the Land Board in October. At Priest Lake there are 58 leases signed and 35 one year extensions signed. Director Schultz noted that some individuals at Priest Lake who had signed a lease were participants in an exchange and may now choose the one year lease extension and the reappraisal option, so those numbers may change somewhat.

D. Legal Matter Summary – November 2013
DISCUSSION: Director Schultz gave a brief update on the Tamarack issue. The Department signed forbearance documents with Tamarack Resort LLC and Tamarack Municipal Association so the ski resort could open for the season, which it did on Saturday, December 14th. The lease payment is due by January 2nd. Governor Otter asked how much is the lease payment, and how much have they already paid. Director Schultz replied the lease amount is $277,000 and has not been paid yet, but there is a commitment from Credit Suisse to pay by January 2nd.

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

A. Manager's Report
B. Investment Report
C. Analysis of Required Years of Reserves (Preliminary Results)

DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

- **CONSENT**

3. **Approval of Minutes** – November 12, 2013 Special Meeting (Boise)

4. **Approval of Minutes** – November 19, 2013 Regular Meeting (Boise)

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

- **INFORMATION**

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

5. **Proposal for Auctions at Payette and Priest Lakes** – *Presented by Brian Rallens and Mark Bottles, Mark Bottles Real Estate Services, and Kent Corbett, Corbett Bottles Real Estate Marketing*

6. **Endowment Fund Reform Progress Report** – *Presented by Bob Maynard, Chief Investment Officer, Public Employee Retirement System of Idaho (PERSI)*

A verbatim transcript is available for the above information items by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

At 11:01 a.m. a motion was made by Attorney General Wasden to resolve into Executive Session pursuant to Idaho Code § 67-2345(1) subsections (d) and (f) to consider records that are exempt from disclosure as provided in chapter 3, title 9, Idaho Code, and to communicate with legal counsel regarding 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. Secretary of State Ysursa seconded the motion. Roll Call Vote: Aye: Ysursa, Wasden, Woolf, Luna, Otter; Nay: None; Absent: None.

- **EXECUTIVE SESSION**

A. Idaho Code 67-2345(1)(d)(f) - to consider records that are exempt from disclosure as provided in chapter 3, title 9, Idaho Code, and to communicate with legal counsel for the public agency to discuss the legal ramifications of and legal options for pending litigation, or controversies not yet being litigated but imminently likely to be litigated. [TOPICS: Ownership of Grays Lake; Voluntary Auctions]

For the record, at 12:01 p.m. Governor Otter excused himself from the Land Board meeting to attend another commitment. Secretary of State Ysursa presided for the remainder of the meeting.

At 12:24 p.m. the Board resolved out of Executive Session by unanimous consent. No action was taken by the Board during the Executive Session.

- **REGULAR**

7. **Payette Lake Voluntary Cottage Site Auction for Former Land Exchange Participants** – *Presented by Kathy Opp, Deputy Director-Lands and Waterways*

DEPARTMENT RECOMMENDATION: The Department recommends that the Land Board direct the Department to offer the voluntary auction opportunity to the lessees of the twenty-one (21) Payette lots listed on Attachments 1A – 1C, as shown in the former proposed land exchange memorandums, and subject to the seven (7) criteria outlined above.

DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the Department's recommendation as outlined on page 2 of 2, Tab 7 that is that the Land Board direct the Department to offer the voluntary auction opportunity to the lessees of the twenty-one (21) Payette lots listed on Attachments 1A through 1C as shown in the former proposed land exchange memorandums and subject to the seven (7) criteria outlined above on page 2 of 2, Tab 7. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

8. **Priest Lake Voluntary Cottage Site Auction for Former Land Exchange Participants** – *Presented by Kathy Opp, Deputy Director-Lands and Waterways*

DEPARTMENT RECOMMENDATION: The Department recommends that the Land Board direct the Department to offer the voluntary auction opportunity to the lessees of the seventy-four (74) Priest Lake lots listed in Attachments 1A and 1B, subject to the nine (9) criteria outlined above.

DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation that is that the Land Board direct the Department to offer the voluntary auction opportunity to the lessees of the seventy-four (74) Priest Lake lots listed in Attachments 1A and 1B and subject to the nine (9) criteria outlined on page 2 of 2, Tab 8 in the current Board book. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

9. **Recommendations from Endowment Fund Reform Progress Report** – *Presented by Larry Johnson, EFIB Manager of Investments, and Tom Schultz, Director*

DEPARTMENT RECOMMENDATION:

1. Direct the EFIB, with support from the Department of Lands and Land Board staff, to recommend consultants to perform a comprehensive strategy review of endowment assets, policies, procedures and studies, and 1) consult with subcommittee in item 2 to determine what constitutes a significant investment for the Trust that should be reviewed by third party experts, 2) recommend strategic priorities for acquisition/divestiture of Idaho endowment land, 3) recommend adjustments to the fund portfolio to reflect the cash earnings of the land, 4) recommend operating framework to best meet prudent investor standards, and 5) evaluate the long term investment outlook for Idaho timber land. Final selection of any consultant would be made by the Land Board.

2. Establish a Land Board Subcommittee on Endowment Fund Investment Governance Strategy that would be comprised of two Land Board members or staff, one EFIB Board member, EFIB Manager of Investments, IDL Director, and one Deputy Attorney General. The purpose of the Subcommittee would be to review investment decisions and recommend to the full Land Board a governance structure for those decisions that warrant outside expert review, consistent with the prudent expert approach.

3. Direct the Department of Lands, pending completion of the overall asset allocation review to discontinue consideration of any property acquisitions other than for the purposes of 1) obtaining access for currently owned endowment lands, and 2) blocking up of ownership of endowment lands

4. Direct the EFIB and the Department of Lands to jointly report, in May and November of each year, on the status of implementing the recommendations and observations of the Reform Progress Report, including:

    - Basing asset allocation on all trust assets
    - Basing distribution policy on all trust assets
    - Obtaining independent verification of investments by the Department of Lands
    - Enhancement of governance policies and procedures
    - Enhancing performance measurement and reporting to summarize all trust assets – total trust performance/returns
    - Investment of idle funds while held in the Land Bank.

5. Direct the EFIB to consult with the State Treasurer on the optimal investment of endowment assets while they are held in the Land Bank and present a recommendation to the Land Board.

DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

BOARD ACTION: A motion was made by Controller Woolf that the Board adopt, with the correction to the subcommittee name in recommendation number 2, that the word "Fund" is removed, that the Board accept recommendation number 1, 2, 3, 4 and 5 as stated on page 2 of 2, Tab 9. Attorney General Wasden seconded the motion. The motion carried on a vote of 4-0.

There being no further business before the Board, at 1:09 p.m. a motion was made by Attorney General Wasden to adjourn. Controller Woolf seconded the motion. The motion carried on a vote of 4-0. 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/ Ben Ysursa

Ben Ysursa
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 January 21, 2014 regular Land Board meeting.

Statement of Investment Policy

Idaho Land Grant Endowments

As overseen by the:

Idaho Board of Land Commissioners

IDAHO ENDOWMENT FUND
INVESTMENT BOARD

INCLUDES FUNDS MANAGED BY THE ENDOWMENT FUND INVESTMENT BOARD

IDAHO DEPARTMENT OF LANDS

INCLUDES LAND MANAGED BY THE IDAHO DEPARTMENT OF LANDS

July 17~~8~~, 2018~~7~~

This Statement of Investment Policy was initially published May 17, 2016, and is updated annually. The policy superseded the State Trust Lands Asset Management Plan dated December 20, 2011.

ATTACHMENT 1

Table of Contents

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 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, minerals, and oil and gas (collectively, Land Assets) located in Idaho.

II. Purpose

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

- 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: "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 (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.

The 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
- A maximum of 100 sections (64,000 acres) of state lands may be sold in any year
- A 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 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 in Idaho for the benefit of the endowment beneficiaries. Funds in the Land Bank, 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.

E. Other Constitutional Requirements and Statutes

Additional constitutional articles and state statutes are described throughout this Statement. 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 the following:

- Constitutional and statutory requirements as noted previously. Constitutional restrictions are considered permanent given the process required to amend the Constitution (approval by a two-thirds 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 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. Asset Class Diversification 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 volatility of earnings of the Endowment Assets, shall be managed primarily through diversification. Subject to land disposal restrictions and the statutory prohibition on selling timberland, the Endowment Assets will be diversified both by asset class and within asset classes to the extent practical. 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 the Endowment Assets' expected long-term returns will meet expected long-term obligations with a prudent level of risk. Approximately every eight years, the Land Board will evaluate the asset allocation mix and conduct an asset allocation study (last completed in 2014) to determine the long-term strategic allocations to meet risk/return objectives.

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 the target asset mix of the Financial Assets be adjusted due to 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.

EFIB will review the Distribution Policy annually. When key assumptions in the Distribution Policy, such as expected earnings and volatility change, EFIB 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 summarizes the major conclusions of the asset allocation portion of the Callan Report. The purpose of the asset allocation study was to evaluate current and potential asset allocation mixes incorporating Land Assets with Financial Assets to evaluate expected return and volatility of the portfolio.

The Land Board commissioned a second Callan study in 2017 to provide further analysis and refinement on the asset allocation work completed in 2014. The primary goal of the follow-up study was to determine for each endowment the best and highest use of assets in the Land Bank—reinvestment into traditional land assets (timberland or farmland) or transfer to the financial asset portfolio. The Land Board accepted the results from the study and elected to pursue Option A from Callan's Options to Consider (page 33 of the report), which reads:

> Option A: Consistent with the Reinvestment Plan, identify potential transactions that meet established hurdle rates and set aside sufficient funds over appropriate time horizon (immediately move money that will either "mature" prior to the transaction or exceeds what is required).
>
> - Recognizes the importance of land in the total Endowment and attempts to maintain land's target allocation (41%)

The Land Board approved the asset mix from the Callan Report presented in Exhibit 1 below:

Exhibit 1: Strategic Asset Allocation

Asset Class	Target Asset Allocation	Range	Actual Allocation June 30, 2017	Expected 10 Year Compounded Return[1,2]	Implied Real Net Return[3]
Financial Assets	58%	50-65%	59.2%	6.3%	4.05%
IDL Timberland	39%	30-50%	33.2%	5.70%	3.45%
IDL Grazing Land	2%	0-5%	1.7%	3.00%	0.75%
Cash Equivalents –Land Bank	1%	0-5%	2.1%	2.00%	-0.25%
Residential Real Estate	0%	N/A	2.6%	N/A	

[1] Based on Callan's 2014 Asset Allocation and Governance Review and 2018 capital market expectations.

[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%.

Asset Class	Target Asset Allocation	Range	Actual Allocation June 30, 2017	Expected 10 Year Compounded Return	Implied Real Net Return
Idaho Commercial Real Estate	0%	N/A	0.5%	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 Asset Allocation percentages were established in December 2014 with the following exceptions:
  - A Diversified US Real Estate (Commercial Property) target allocation was adopted by EFIB in October 2015 and implemented in 2016 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.
  - The asset allocation study did not include commercial real estate given its limited size and low likelihood that it should be expanded due to the following:
    - Difficulty 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 Land Board adopted a plan in February 2016 to divest most commercial real estate managed by IDL and has implemented a substantial portion of that plan.

- 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 rebalance 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' 2018 capital market assumptions for each asset class and the total Endowment using the target asset allocations. Over a 10-year period, Callan indicates the target asset allocation should generate a nominal return in excess of 6.3% net of fees. Using an inflation assumption of 2.25% results in an expected real net return of 4.05%. 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 the actual 10-year return can deviate significantly from this expectation—both positively and negatively.

The Land Board acknowledges the link between the Target Asset Allocation and the Distribution Policy. If an asset allocation mix is selected that deviates from the risk and return in the current Target Asset Allocation, the Land Board, in consultation with 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, as measured by volatility of income, will impact the desired level of reserves.

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 EFIB as the manager of the Financial Assets, established the appropriations process for the payment of trust management expenses, and created 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 EFIB and IDL, the Land Board may 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 role and responsibilities regarding investments include, but are not limited to the following:

- Direct and oversee the conduct and operations of EFIB and IDL.
- Appoint and consult with expert advisors (including EFIB and 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 on 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.
- Periodically review this master investment policy and any sub-policies.
- Monitor the compliance of EFIB and IDL with the investment policies and strategy determined by the Land 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 consideration by the governor and legislature (including review of appropriation requests to 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 Fund 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 that exceed the authority delegated to the IDL director.
- Approve rulemaking and legislation for IDL.
- 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 member (selected by the EFIB chair), 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 the following:

- Administer the contract for the general consultant and other consultants, as assigned by the Land Board.
- Work with the general consultant to identify the Land Board's advisor(s) and consultants, including the Land Investment Advisor(s), Land Acquisition Advisor(s), Commercial Real Estate Broker, and the Land Board's Commercial Real Estate Investment Advisor.
- Work with the general consultant and 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). This may include deposit in the Permanent Fund or holding of proceeds in the Land Bank Fund to acquire additional endowment land assets in Idaho (excluding commercial buildings), access to currently owned endowment lands, or to block-up ownership of endowment lands.

3. Use of Outside Experts

The Land Board employs outside advisors and consulting firms to provide specialized expertise, assist IDL with transactions, and verify or review IDL's and 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 may use a commercial real estate advisor to advise on the Idaho commercial property portfolio or transition properties. The commercial real estate advisor will provide analysis and management expertise on the retention, leasing, disposition, and management of the 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 Acquisition Advisors

The Land Board may use land acquisition advisors to source land acquisitions, facilitate completion of due diligence work, and make recommendations. Due diligence services may include appraisals, review appraisals, timber cruise and check cruise, financial evaluation, mineral and water right identification, encumbrance review, survey, and title review. Land acquisition advisors will be fiduciaries with respect to the services provided and act in a non-discretionary capacity with no decision-making authority.

d) Land Investment Advisor

The Land Board may use a land investment advisor(s) to independently review certain land investment decisions proposed by IDL (land disposal, land acquisition, exchange, and new tenant improvements) that are over $100,000. The land investment advisor will review the post-audit completed by 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.

e) Auditor

Idaho Code § 57-720 requires 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 EFIB, appointed by its Chair.

B. Investment Governance and Investment Policy for the Financial Assets

Idaho Code § 57-718 created EFIB 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 Idaho Code § 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 EFIB

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

2. Structure of EFIB

Per Idaho Code § 57-718, 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 EFIB and Agents

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

- 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 Reserves for consideration by legislative appropriation.
- Overseeing a credit enhancement process to reduce interest rates on Idaho school bonds through the pledge of certain assets of the Public School Endowment Fund.
- Maintaining a reporting system that provides a clear picture of the status of the Financial Assets.

4. Professional Staff

EFIB will maintain a staff with investment expertise, including a Manager of Investments (MOI) who is a fiduciary to 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. 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

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 EFIB.

C. Investment Governance for Land Assets

Idaho Code § 58-101 created IDL 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, and oil and gas (collectively "Land Assets") located in Idaho.

1. Mission of IDL

The mission of 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. IDL also has various regulatory, technical assistance, and resource protection roles.

2. Structure of IDL

IDL operates under the direction of the Land Board and is the administrative arm of the Idaho Oil and Gas Conservation Commission. 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 (State Forester), a division administrator for Forestry and Fire, a division administrator for Lands and Waterways, a division administrator for Oil and Gas, a division administrator of Operations (Chief Operations Officer), a division administrator for Support Services, and a human resources officer—collectively, the executive staff. Each of the positions identified above supervises various professional, technical, and administrative support staff.

3. General Roles and Responsibilities

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 on the following investment-related activities:

- 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.
- Developing a land and resource management expense budget from Earnings Reserves for Land Board approval and consideration for legislative appropriation. Earnings Reserves is only a portion of the IDL budget.
- Monitoring and reporting progress toward strategic goals, including preparing an annual income statement following agreed upon procedures and calculating annual returns for major asset classes and all asset classes combined.

Decision-making authority for endowment land asset management resides with the Land Board except as delegated to the IDL director. Program management resides with the director's staff and their subordinates. IDL establishes policies and procedures for routine programmatic activities at the bureau and program levels.

IDL has delegated authority to approve the following:

- 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 or financial management are fiduciaries.

5. Use of Outside Experts

IDL may use outside experts at its discretion and the Land Board's discretion. IDL may use the Land Board's expert advisors when in need of the special expertise provided by the advisors and when the 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 including the Commercial Real Estate Investment Advisor, Commercial Real Estate Broker, Land Acquisition Advisor(s), and the Land Investment Advisor(s). 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 the following:

- Enacting laws to establish the methodology for restoring losses to the Public School and Agricultural College funds.
- Appropriating Earnings Reserve Funds for operation of IDL and 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.

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) compared to other asset classes. Investment objectives also consider the existing base of land holdings along with management constraints, notably sales restrictions, acreage limitations, and the rent-setting and leasing processes. 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 and fees, net of internal management costs (e.g., the cost of IDL management), net of all fees and costs of program management (e.g., 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 IDL and, except in unusual circumstances, no external managers are used. Active management includes the following primary activities:

- Maximize net income while protecting and enhancing the long-term value and productivity of the Land Assets. (IDL shall produce a quarterly income statement which allows for evaluation of income versus management and operating expenses by trust beneficiary, program, and 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 Statement 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 Statement.
- 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 (IDL is the sole manager), or vintage year since most Land Assets were acquired at statehood. Diversification of income source shall be pursued by encouraging multiple bidders for timber sales. There is limited opportunity to actively diversify the tenant base in rangeland, commercial real estate, residential real estate, farmland, and other land types that are leased as leases are simply awarded to the highest bidder.

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. Offering a variety of timber sale sizes, types, and locations across the state also helps to maintain a diverse customer base. Geographic diversity of the land base over the state provides protection against catastrophic fire, disease, and insect outbreak.

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 and fees, net of internal management costs (e.g., the cost of IDL

management), and net of all fees and costs of program management (e.g., 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, intermediate silvicultural treatments, road construction, and maintenance projects are allowed, as are investments in easements or other means of achieving cost-effective access to productive timberlands.

New timberland acquisitions shall be subject to a thorough due diligence process (by IDL or a land advisor, consistent with the established governance structure) to determine the following:

- 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, including an analysis of the transaction in terms of long-term financial return and risk to the Endowment;
- Whether the transaction would facilitate improved management or improve the overall Endowment land ownership pattern in the area;
- 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 Reinvestment Plan.

New investments in timberland must be owned 100% by the endowment. Joint ventures are not allowed. Acquisition of land with a conservation easement in place is allowed provided the Land Board has full decision-making authority regarding implementation of land management practices.

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 that annual timber sale plans be published and public comment opportunities be made available. Small sales (less than 1,000,000 board feet or less than $150,000 in value) and salvage sales are exempt from the policy.

5. Management

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

- 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 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 or other commercially acceptable methods approved by the Land Board shall be used for the valuation of the timberland asset class. The timberland asset class shall be valued using the LEV method every three years 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.

7. Monitoring Standards

IDL will report cash flows for the timberland asset class to the general consultant 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 and fees, net of internal management costs (e.g., the cost of IDL management), net of all fees

and costs of program management (e.g., 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 IDL or a land advisor, consistent with the established governance structure) to determine the following:

- If the expected financial return generated by income exceeds the minimum hurdle rate of a 3.5% real net return;
- Whether the return profile is sufficient relative to the risk taken, including an analysis of the transaction for long-term financial return and risk to the Endowment;
- Whether the transaction would facilitate improved management or improve the overall Endowment land ownership pattern in the area;
- 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 Reinvestment 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 acreage limitations—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 its size 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 of 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 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 timberland uses. The presence of minerals such as sand and gravel can enhance the net return from rangeland. Management objectives for rangeland include the following:

- 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 every three years by an independent expert. MAI appraisals must be used for individual parcels in the event of an exchange or sale.

7. Monitoring Standards

IDL will report cash flows for the rangeland asset class to the general consultant 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 are vacant endowment land where lessees are authorized to construct and own improvements, typically cabins and single-family homes.

2. Overall Financial Objective and Benchmark

Leases shall be at least 4% of the appraised value until sold at auction. 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.

3. Allowable Investments

The Land Board and 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 IDL and reviewed by the Land Board as the current disposal process is completed.

5. Management

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

- Execute the approved Cottage Site Plan to unify the estate in a business savvy manner to maximize return to the endowments.
- 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 endowments.
- 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 prior to sale. Until reappraisal, existing appraisal data will be used for valuation of the asset class.

7. Monitoring Standards

IDL will report cash flows for the residential real estate asset class to the general consultant 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 farmland 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 and fees, net of internal management costs (e.g., the cost of IDL management), net of all fees and costs of program management (e.g., 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

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

New investments shall be subject to a thorough due diligence process (by 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 and whether the return profile is sufficient relative to the risk taken. The due diligence process includes an analysis of to analyze the transaction in terms of long-term financial return and risk to the Endowment and determines 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 Rei~~-~~nvestment Plan.

Investments in farmland must be owned 100% by the Endowment. Joint ventures are not allowed. Acquisition of land with a conservation easement in place is allowed provided the Land Board has full decision-making authority regarding implementation of land management practices.

4. Considerations

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

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 the following:

- Achieve return consistent with policy objective.
- Identify and acquire additional farmland.
- 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 the Asset Management Plan for Endowment Assets (and any related plans developed) and the Farmland Program Business Plan.

6. Valuation

Properties will be valued internally by IDL using NASS Farmland Data. This is appropriate as farmland holdings only represent approximately 1.7% ($25 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 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, retail, and other properties located in Idaho.

2. Overall Financial Objective and Benchmark

The majority of the Idaho Commercial Real Estate portfolio was sold as recommended by the Commercial Real Estate Advisor and approved by the Land Board in February 2016. Of the properties identified in the 2016 sales plan that did not sell, IDL will continue to pursue prudent disposition as recommended. Certain properties may be retained by the Land Board for strategic purposes.

3. Allowable Investments

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

4. Management

The portfolio is overseen by 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. The Commercial Real Estate Advisor may be used to assist in advising, hiring, and managing property managers.

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 and evaluation purposes.

6. Monitoring Standards

IDL will report cash flows for the commercial real estate asset class to the general consultant 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 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, Idaho Surface Mining Act, Oil and Gas Conservation Act, and Idaho Dredge and Placer Mining Protection Act. Management objectives include the following:

- Manage the mineral asset prudently, efficiently, and with accountability to the endowments.
- 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.
- Seek opportunities to unify the mineral estate.
- 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 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 potential transition lands 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. Once the land is transitioned, it will be identified under the predominant revenue producing asset class.

3. Allowable Investments

Lands suited for transition are those currently owned by the endowments. Lands should not be acquired where the primary reason for acquisition is transition. In select cases, improvements such as obtaining zoning and other entitlements may be pursued for ground leasing purposes, to maximize value, or to ready the parcel for sale.

Investment in improvements shall be subject to a thorough due diligence process (by IDL or a land advisor, consistent with the established governance structure) to determine 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; 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

Transitional activities will focus first on 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, 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 be valued based on the traditional asset class to which they belong or as transitioned. Properties will be valued by appraisal prior to sale or on a predetermined schedule pursuant to the terms of the lease or other approved plan.

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 for performance reporting purposes. Lands with potential for transition currently classified as rangeland will be monitored and reported as part of the rangeland asset class. 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. The Land Bank is invested by the State Treasurer under a financial objective or benchmark 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 Fund of the appropriate endowment unless the five-year time limit is extended by the legislature.

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

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

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 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 of the financial statements for 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 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.
- Adequacy of distributable reserves to compensate for volatility of income.
- Each 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 at 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 Reserves, transfers to the Permanent Fund, and other factors.
- The levels of Earnings Reserves deemed adequate for future distributions are:
    - ~~5~~6 years – Public School~~s, Charitable Institutions, and State Hospital South~~
    - ~~6 years – Normal School~~
    - 7 years – All other endowments (Agricultural College, Charitable Institutions, Normal School, Penitentiary, School of Science, State Hospital South, and University of Idaho)
- 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 interpretation of nuances. EFIB has documented most of these in the Distribution Principles included in Appendix G. The principles are used by 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 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 IDL and EFIB (and by extension the EFIB's 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 instances.

C. Financial Assets

1. Reporting at EFIB Level[4]

The EFIB Investment Policy requires that performance reports be generated by the investment consultant 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 following to the Land Board:

- 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 EFIB.
- Any compliance/legal issues, areas of concern, or upcoming events.

Part-way through the fiscal year, typically at the May meeting, 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, EFIB shall provide the Land Board with the following:

- A financial summary for the recently completed fiscal year.

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

- The report of the Land Board Audit Committee regarding control deficiencies identified by the independent auditor.
- An update on 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.

Each program administered by IDL is managed by a bureau chief and a program manager. Policies and procedures governing daily activities are in place at the bureau 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 (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:

- Timber sale activity and information.
- Lands and Waterways Division 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.

IDL also reports the Land Bank Fund balance to the Land Board quarterly.

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

Each month, IDL brings matters forward for Land Board review and approval. Items are discussed first with senior Land Board staff members then placed on the consent agenda, where routine items may be

approved without discussion, or the regular agenda, which addresses policy and programmatic items 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.

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 an Asset Management Plan 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:

- 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	General Consultant and EFIB Staff	Monthly and Quarterly
Performance Review Total Endowment	General Consultant, IDL Staff, and EFIB Staff	~~Semi-annually~~Annually
Statement of Investment Policy	General Consultant, IDL Staff, and EFIB Staff *Reviewed by Investment Sub-Committee*	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 Reinvestment Plan	General Consultant *Reviewed by Investment Sub-Committee*	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	Annually
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**

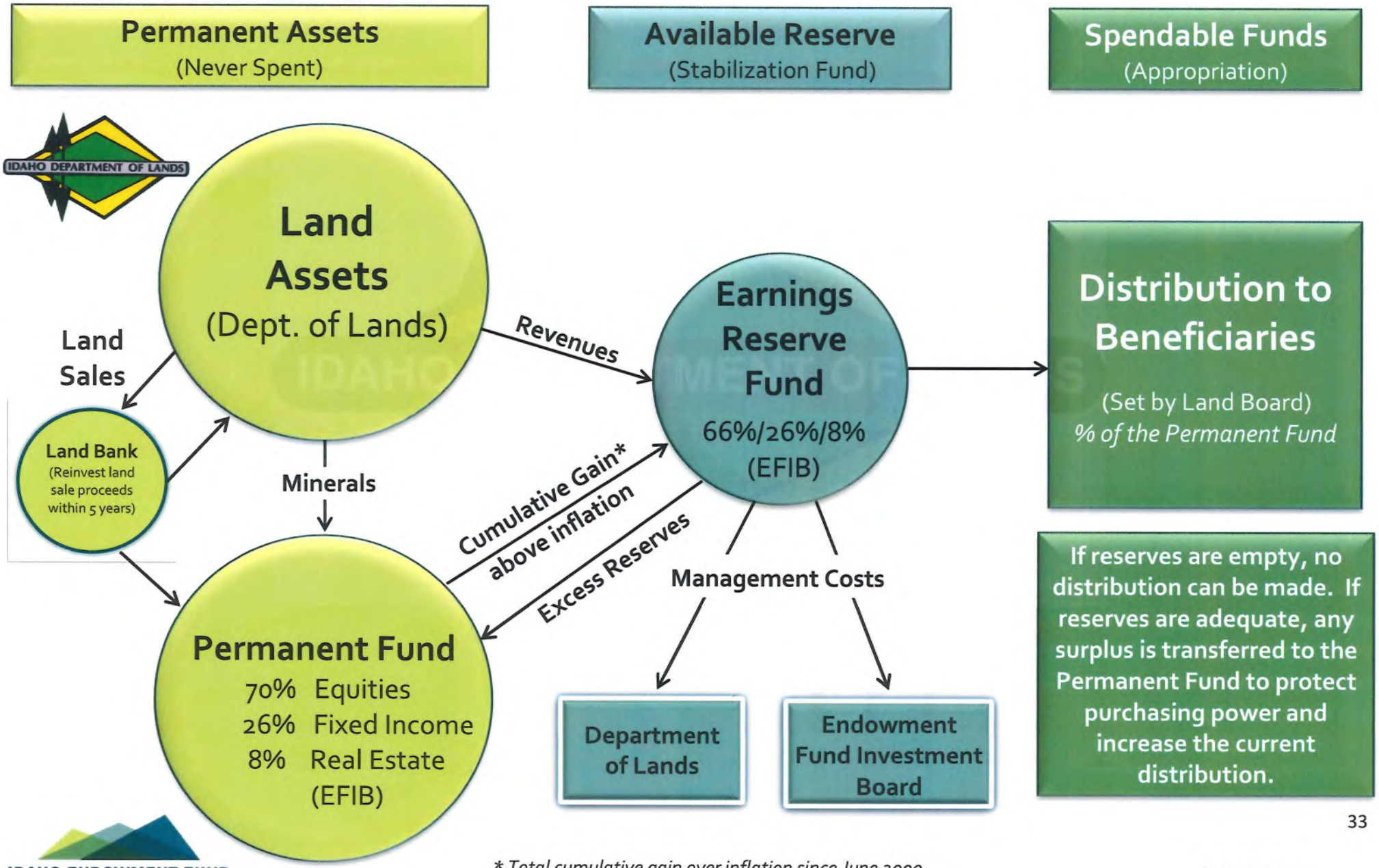
D. **Use of External Advisors**

E. **Decision-Making Structure Chart**

F. **Real Estate Acquisition Flow Chart**

G. **EFIB's Distribution Principles**

STRUCTURE OF IDAHO'S ENDOWMENT ASSETS



IDAHO ENDOWMENT FUND

** Total cumulative gain over inflation since June 2000.*

Rev 2/9/17

B. Constitution and State Statutes

Constitution of the State of Idaho

ARTICLE IX EDUCATION AND SCHOOL LANDS

- SECTION 3 PUBLIC SCHOOL PERMANENT 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 LANDS
- CHAPTER 2 INDEMNITY LIEU LAND SELECTIONS
- CHAPTER 3 APRRAISEMENT, 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

C. EFIB Investment Policy

ENDOWMENT FUND INVESTMENT BOARD
Comingled Pool Investment Policy

Date Established: **2000**
Last Reviewed: **February 2018**
Last Revised: **February 2018**

This Statement of Investment Policy is applicable to:

Public School Permanent Fund and Earnings Reserve Fund
Agricultural College Permanent Fund and Earnings Reserve Fund
Charitable Permanent Fund and Earnings Reserve Fund
Normal School Permanent Fund and Earnings Reserve Fund
Penitentiary Permanent Fund and Earnings Reserve Fund
School of Science Permanent Fund and Earnings Reserve Fund
State Hospital South Permanent Fund and Earnings Reserve Fund
University Permanent Fund and Earnings Reserve Fund
Capitol Permanent Fund and Maintenance Reserve Fund
Department of Environmental Quality Bunker Hill Endowment Fund Trust
Department of Fish & Game Southern Idaho Mitigation Endowment Trust
Department of Fish & Game Craig Mountain Wildlife Mitigation Trust
Department of Fish & Game Blackfoot Wildlife Mitigation Trust
Department of Parks & Recreation Ritter Island Endowment Fund
Department of Parks & Recreation Trail of the Coeur d'Alene's Endowment Fund

Statement of Philosophy

This statement of investment policy is set forth by the Endowment Fund Investment Board (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 objectives, 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 are:

- 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; and
- Maintain sufficient liquidity for anticipated expenditures.

General Investment Principles
- Investments shall be made solely in the interest of 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.
- The EFIB will employ one or more investment managers of varying styles and philosophies to support the Funds' objectives;
- Cash is to be employed productively at all times, by investment in short-term cash equivalents to provide safety, liquidity, 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.

Assignment of Responsibility
- Responsibility of the Manager of Investments ("MOI") – The MOI serves as a fiduciary and 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 shall be hired by the EFIB. The consultant serves as a non-discretionary advisor to the EFIB that confers with staff. 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, performance of the investment managers, and designing objectives and guidelines ;
    - Supporting portfolio optimization and other investment techniques to optimize the 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 achieving 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.

Delegation of Authority

The MOI is a fiduciary to the EFIB and 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 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 hired by the EFIB 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 with approval by the EFIB to assist in meeting its responsibilities and obligations to administer Fund assets prudently.

The MOI will not have 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.

Marketability of Assets
Based on the Fund's long-term liquidity requirements, the EFIB desires securities with readily ascertainable market values that trade in liquid markets but recognizes that some allowable assets are valued less frequently by industry established appraisal methods, and may be reported on a lagged basis.

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 Bloomberg Barclays U.S. TIPS Index or Bloomberg Barclays 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.

Real Estate	Domestic, private, open-end, core commingled funds, REITS
ETF's, Mutual or Collective Funds:	ETF's, Mutual Funds, and Collective Funds which invest in securities as allowed in this statement are also permitted. Investment managers will advise the MOI of their intent to utilize ETFs prior to their purchase, what specific ETFs they intend to use and the purposes they serve.
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. For example, S&P 500 and 10-Year Treasury futures are used to equitize idle cash and to passively rebalance the portfolio. 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;
- 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% 33%-43%	66.0% 38.0%	+-3% +-5%	MSCI All Country World Index Russell 3000 Index
Large Cap Growth Core Value	21%-31% 3%-7% 9%-13% 8%-12%	26.2% 5.0% 11.3% 9.9%	+/-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%	7.6% 3.8% 3.8%	+/-4%	Russell Mid Cap Index Russell Mid Cap Growth Russell Mid Cap Value
Small Cap Growth Value	3%-7% 1%-3% 1%-3%	4.2% 2.1% 2.1%	+/-2%	Russell 2000 Index Russell 2000 Growth Index Russell 2000 Value Index
International Equities Developed Growth Developed Value Developed Markets Index Fund	15%-23% 4%-10% 4%-10% 1%-3%	19.0% 8.5% 8.5% 2.0%	+/-4%	MSCI ACWI EX US (ND) Index MSCI EAFE Growth (ND) Index MSCI EAFE Value (ND) Index MSCI EAFE Index
Global Equity	5%-13%	9.0%	+/-4%	MSCI All Country World Index
Real Estate	4%-12%	8.0%	+/-4%	NCREIF ODCE Index
Fixed Income Aggregate Bond US Tips	23%-29% 20%-24% 3%-5%	26.0% 22.0% 4.0%	+/-3%	BB Aggregate Bond Index BB Aggregate Bond Index BB US TIPS Index
Cash and Equivalents	0-5%	0%		3-month Treasury Bill Index

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-/BBB- or higher) using the middle rating of Moody's, S&P and Fitch; when a rating from only two agencies is available, the lower is used; when only one agency rates a bond, that rating is used.
- 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 Fixed Income benchmark 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.

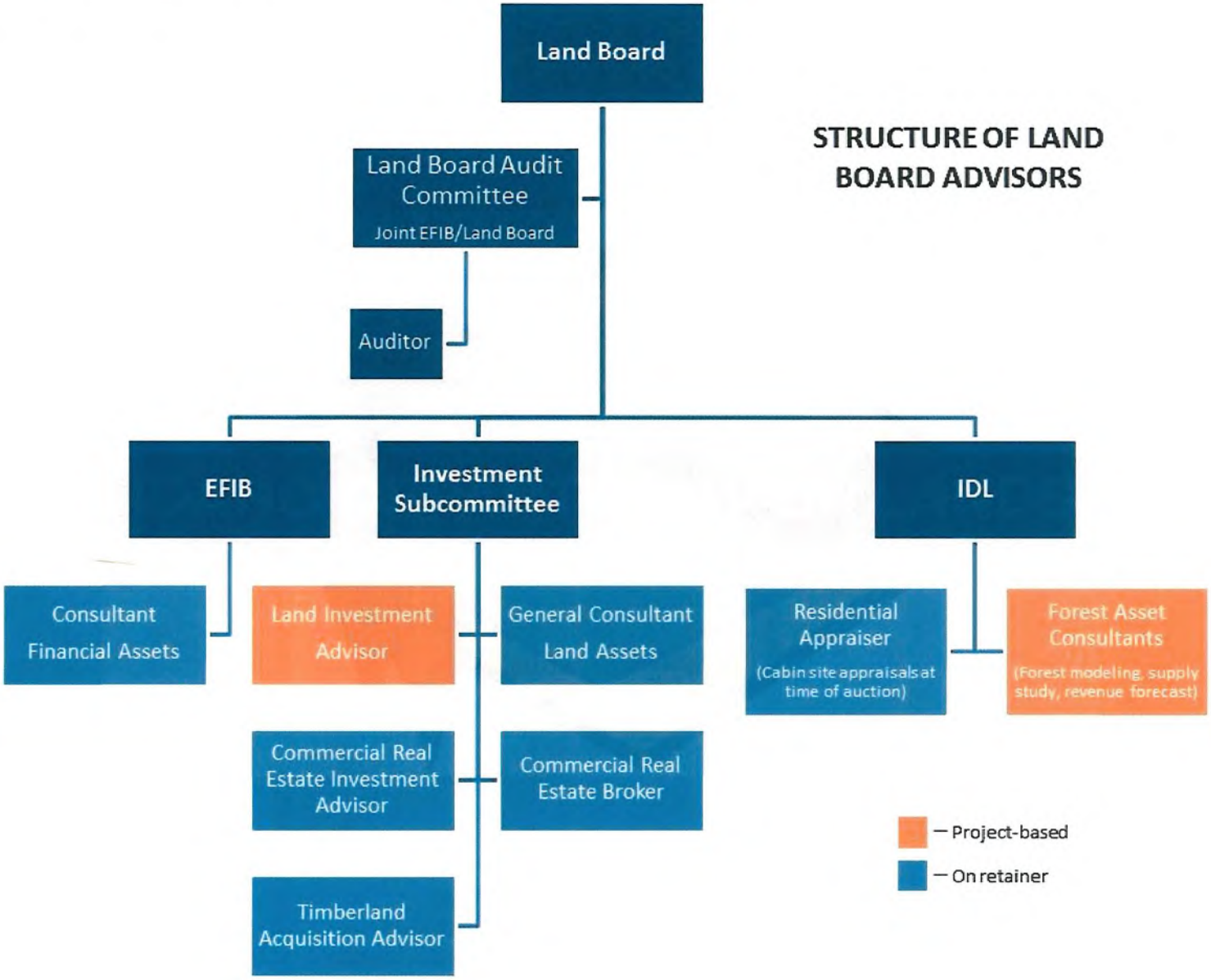
- Interest Rate Risk: The risk that changes interest rates will adversely affect the fair value of an investment. Interest rate risk to the EFIB's fixed income portfolio is monitored using the effective duration methodology. Effective duration measures the volatility of the price of a bond given a change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

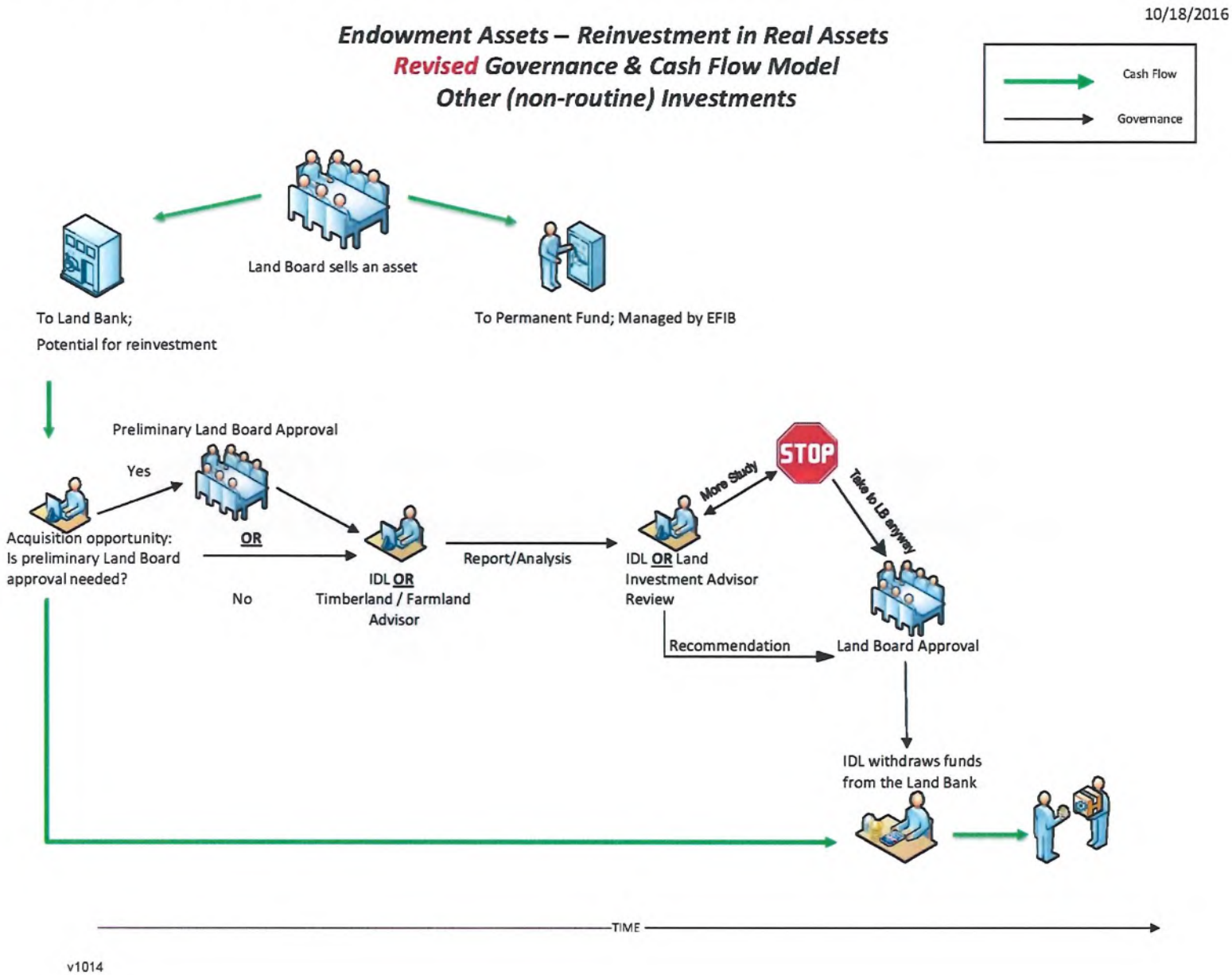
- Foreign Currency Risk: The risk that changes exchange rates will adversely impact the fair value of an investment. The EFIB's currency risk exposures, or exchange rate risk, primarily reside within the international equity investment holdings.

  Policy: The EFIB permits investing up to 30% 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.

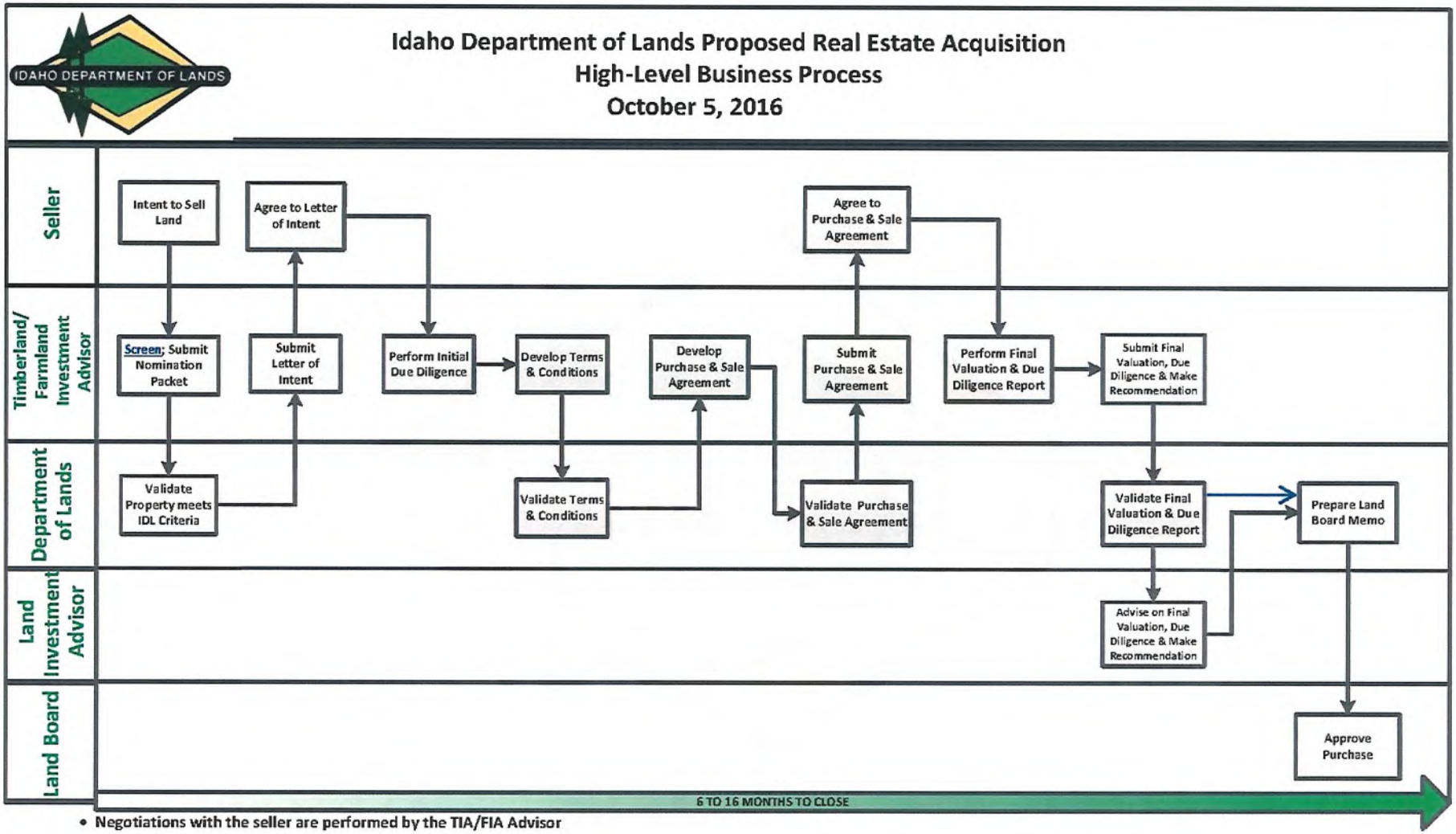
D. Use of External Advisors



E. Decision-Making Structure Chart



F. Real Estate Acquisition Flow Chart



- Negotiations with the seller are performed by the TIA/FIA Advisor
- Purchase denials will be tracked for reporting
- Purchase approval pipeline process will be tracked for reporting

v1014

G. EFIB's Distribution Principles

Summary of Idaho Endowment Fund Distribution Principles, Policy and Background

By the Endowment Fund Investment Board – Updated July 17, 2018

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

- 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[iii]
- Land Board policy objective: Requires that principal grow faster than the rate of inflation and population growth[iv]

Determining Annual Distributions[v]
Distributions are initially calculated as a percent (the policy distribution rate[vi]), multiplied by the Permanent Fund balance[vii] (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[viii].

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

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:[xi]

- 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. Buffer against volatility in land income and fund return – a bank for unusually high earnings to be used to maintain distributions in lean times
2. Benchmark 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[xii] 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

[i] 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

[ii] 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.

[iii] 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).

[iv] The Land Board policy objective of keeping up with population growth:

- Makes real per capital distributions equivalent, current vs. future
- 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.

[v] 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.

[vi] 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.

[vii] 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.~~

[viii] 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).

[ix] 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

[x] 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.

[xi] 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.

[xii] 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.

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

Tom Schultz, Secretary to the Board

Final Minutes
State Board of Land Commissioners' Regular Meeting
May 22, 2014

The regular meeting of the Idaho State Board of Land Commissioners was held on Thursday, May 22, 2014 in the State Capitol Lincoln Auditorium (Room WW02) at 700 West Jefferson, Boise, Idaho. The meeting began at 9:02 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence Wasden
Honorable State Controller Brandon Woolf
Honorable Superintendent of Public Instruction Tom Luna *(via teleconference)*

For the record, Governor Otter recognized the presence of all Board members, with Superintendent Luna joining the meeting via conference phone at 9:02 a.m.

1. Director's Report

A. Interest Rate on Department Transactions – May 2014

B. Timber Sale Activity and Information Report – April 2014
DISCUSSION: Governor Otter asked if the increase in price per MBF is a result of increased retail user activity or a result of reduced harvest. Director Schultz replied there is typically a good correlation between lumber price and stumpage price. Lumber mills may be paying a bit more right now as they are trying to increase their supply.

C. Division of Lands and Waterways Activity and Information Report – April 2014
DISCUSSION: Director Schultz provided an update of the Cottage Site Program fiscal year to date. At Priest Lake of 354 leased lots: 348 have executed leases, 1 pending lease, 3 pending assignments and 2 non-renewals. At Payette Lake of 151 leased lots: 114 have executed leases, 31 lots have sold at auction, 1 pending assignment and 5 non-renewals.

Moving forward to the lease effective for 2015: at Priest Lake, 269 applications were mailed; 258 were received back (96% of what was mailed out). 251 applications were received on time, 7 were received after the deadline, and will be re-advertised for the potential for a conflict lease application process. Of those received, 113 accepted the appraised value (44%); 145 decided to challenge the appraisal process (56%).

Lessees may choose one of two appraisers to perform the challenge appraisal and must pay the $750 price of the appraisal. Of those 258 applications received, 70 also returned signed leases for 2015. At Payette Lake 16 applications were mailed for this year going forward. Everybody prior to these 16 had already signed a long term lease. All 16 have accepted their value and all 16 of those have already returned their 2015 lease.

Governor Otter inquired if the Department still pays for the first appraisal if the challenge appraisal shows a major correction. Director Schultz replied that the first appraisals are paid for and considered final. Governor Otter asked if the first appraisals also cost $750 each. Director Schultz indicated they were between $300 and $500 apiece. If the second appraisals come back with a significant discrepancy – if they are within 10% then the Department will average those numbers, if they are outside of 10% then yet a third appraiser may be hired to look at those first two numbers. If a third appraisal is done, the cost will be split between the Department and the lessee.

Attorney General Wasden requested an update on the status of the voluntary auctions, both at Priest Lake and Payette Lake. Director Schultz responded the Priest Lake auction is scheduled for August 28th in Coeur d'Alene. 62 lessees are currently continuing in that process. Director Schultz commented that average values for many of those lots are in the $400,000 - $500,000 range which would mean approximately $30 million in revenue to start with at auction. Director Schultz stated post cards were mailed to Payette Lake lessees on Friday, May 16 soliciting interest in an auction. The Department will accept up to 30 applications for participation in this next auction, which would be the 2nd auction this calendar year at Payette Lake. The Department will bring a proposal to the Board in July or August with a recommended mix of lakefront and second tier lots.

Director Schultz then mentioned lease conflicts in programs other than cottage sites. A total of 8 out of 130 grazing leases were conflicted, which is about 6% of those that were available. There was 1 out of 4 cropland leases also conflicted. Those conflict processes will occur over the summer and results will come to the Board this fall for approval.

D. Legal Matter Summary – April 2014

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

A. Manager's Report
DISCUSSION: Mr. Johnson stated distributions are well secured with the reserves in place. There are no compliance or legal issues to mention. Mr. Johnson noted the Investment Board met on May 21st to interview the finalist for the asset allocation and governance consulting study; there will be more discussion on that later in this meeting.

The EFIB expects to bring a request for permission to manage the $50 million Bunker Hill Endowment Treatment Fund at the next Land Board meeting.

B. Investment Report
DISCUSSION: Mr. Johnson reported the Fund more or less broke even for the month of April. Fiscal year to date through the end of April was 14.6%. In May the Fund has gained half a percentage point thus far, to 15.1%. All investment managers are performing as expected.

C. Semi-Annual Report
DISCUSSION: Mr. Johnson stated the Land Board Asset Management Plan calls for the Investment Board to make two reports yearly to the Land Board. EFIB presents a semi-annual report in May with the full annual report in November. Mr. Johnson reviewed the report as printed in the Board materials.

Attorney General Wasden referred to the graph on slide 9 showing coverage ratios in earnings reserves as of March 31, 2014 and commented that finally all reserves are at 5 years or more. Attorney General Wasden asked if the Investment Board is considering whether some of those funds should be moved into the permanent funds while maintaining that 5 year time coverage. Mr. Johnson responded that the Investment Board did have a conversation about that at its meeting yesterday and that information will be shared with the Land Board at its June meeting. Mr. Johnson noted that at this point numbers are preliminary; the guidelines in statute specify that final calculations will be done at the end of June. In general terms, EFIB is expecting between a 5 and 6% in the total distribution next year if balances at the end of June are the same as the end of March.

Attorney General Wasden commented that recently there has been some discussion about the Fund losing a considerable amount of money in the 2008 period but Fund numbers now are quite favorable. Attorney General asked what efforts EFIB can undertake or has undertaken to communicate with the public the success in the Endowment Fund. Mr. Johnson replied the EFIB has published its financial statements and he has made presentations to several groups. Mr. Johnson thought a press release had been issued as well. Attorney General Wasden asked Mr. Johnson to confirm the press release and to consider additional public outreach regarding the success of the Fund. Mr. Johnson stated he would do so.

- **CONSENT**

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

NORTH OPERATIONS				COUNTY	AREA OFFICE
A. Lucky Again	CR-10-0416	1,130	MBF	Bonner	Priest Lake (Coolin)
B. Junta OSR	CR-10-0423	1,800	MBF	Bonner	Priest Lake (Coolin)
C. Lookout Below	CR-10-0431	1,160	MBF	Boundary	Priest Lake (Coolin)
D. Molar Ton	CR-20-0319	5,756	Tons	Boundary	Pend Oreille (Sandpoint)
E. Sand Mountain OSR	CR-21-3028	2,775	MBF	Boundary	Pend Oreille (Sandpoint)
F. Merry Pole	CR-30-0621	650	MBF	Shoshone	St. Joe (St. Maries)
		2,279	Poles		
G. Fry Creek	CR-41-0085	7,040	MBF	Latah	Ponderosa (Deary)

SOUTH OPERATIONS				COUNTY	AREA OFFICE
H. Expulsion	CR-42-5084	990	MBF	Idaho	Maggie Creek (Kamiah)
I. Island North Ton	CR-50-0169	10,913	Tons	Adams	Payette Lakes (McCall)
J. Horse Fir Ton	CR-50-0174	6,287	Tons	Adams	Payette Lakes (McCall)
K. Grizzly Creek Ton	CR-80-0112	49,912	Tons	Caribou	Eastern (Idaho Falls)

4. **Results of April 17, 2014 Oil and Gas Auction** – *Staffed by Sid Anderson, Program Manager-Commercial Energy and Minerals*

   DEPARTMENT RECOMMENDATION: Approve the results of the April 17, 2014 oil and gas lease auctions and direct the Department to issue the identified 136 oil and gas leases to the successful bidder/applicant AM Idaho, LLC.

   DISCUSSION: Governor Otter inquired about the minimum price for a lease. Director Schultz responded the minimum price is a dollar per acre. Bidders are bidding a bonus on top of that, so if only one person shows up the tract will be leased with no bonus and one dollar per acre. Governor Otter than asked aside from the right to go in and explore does the Department maintain a working interest? Director Schultz replied the Department earns a 12.5% royalty on the state tracts that are being leased. There is also a severance tax in the state; the severance tax would accrue to the State and the royalty goes to the endowment beneficiary. Governor Otter asked what is the amount of the severance tax. Director Schultz stated it is 2.5%.

5. **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*

   DEPARTMENT 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: None.

6. **Authorization for Issuance of Deficiency Warrants to Pay Fire Suppression Costs in FY 2015** – *Staffed by David Groeschl, State Forester and Deputy Director-Forestry and Fire*

   DEPARTMENT RECOMMENDATION: Authorize the Department to issue deficiency warrants necessary to pay the fire suppression costs beyond the $151,600 appropriation for fiscal year 2015.

   DISCUSSION: None.

7. **Approval of Minutes** – April 15, 2014 Regular Meeting (Boise)

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

- **REGULAR**

8. **Endowment Governance Subcommittee Consultant** – *Presented by Larry Johnson, EFIB Manager of Investments*

   RECOMMENDATION: The EFIB is scheduled to meet May 21, 2014 to finalize its recommendation to the Land Board. EFIB staff has recommended to the Investment Board that Callan be retained for the mandate.

   DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

   BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the recommendation that is that the Board select Callan to be retained for the mandate. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

For the record, Superintendent Luna excused himself from the meeting at 10:25 a.m. to attend another commitment.

Secretary of State Ysursa asked for State Forester Groeschl to provide a quick update of the recent action by the U.S. Secretary of Agriculture Vilsack regarding the Farm Bill. Attorney General Wasden stated it was not on the agenda and is not an action item. Secretary of State Ysursa noted it was referenced in the April 15, 2014 draft minutes approved in today's Consent Agenda. The Board concurred a brief update would be allowed.

Mr. Groeschl reported the Department worked with several collaboratives and forest supervisors throughout the State of Idaho and identified 50 proposed treatment areas totaling a little over 1.8 million acres that met the criteria of the Farm Bill. These proposed treatment areas were submitted by the Governor on March 31st to Secretary Vilsack as authorized under the Farm Bill. Earlier this week Secretary Vilsack approved all 50 proposed treatment areas with a slight modification to 1 of the proposed treatment areas. The Department does not have the details yet as to why the modification but is checking into that. Mr. Groeschl mentioned that at this time there are no new appropriated dollars for these designations as provided for under the Farm Bill however, it is the Department's understanding that the Forest Service will be prioritizing their current funding levels over the next several years to focus on conducting treatments within these proposed treatment areas.

Governor Otter inquired when the Board could expect the executive white paper previously requested explaining what was submitted and action going forward. Mr. Groeschl apologized to the Board for the delayed response and stated within the next 2 weeks the Board will receive electronically an executive summary of the Farm Bill, what was submitted and the designations by the Secretary of Agriculture as well as a matrix table of how the management varies on state trust lands vs. federal lands. Governor Otter expressed his compliments to Mr. Groeschl, the collaborative and the team. Idaho was the first to submit its plan; it has been used as a pro forma by the Western Governors Association and 11 states have commented what a great product it is. Secretary of State Ysursa also thanked Mr. Groeschl.

9. **Approval to Auction Lots on East Watertower Street, Meridian ID** – *Presented by Roger Titmus, Strategic Business Analyst*

   DEPARTMENT RECOMMENDATION: Direct the Department to market the above referenced property and conduct an auction for Lots 5, 6, and 7, which will be auctioned only as a unit at the total appraised value for all three lots of $394,500.00. Lot 4 will be auctioned only if lots 5, 6, and 7 sell at auction. Lot 4 will be auctioned, if at all, at the appraised value of $131,000.00.

   DISCUSSION: A verbatim transcript is available by request to the Department of Lands, Attn: Land Board Recording Secretary, PO Box 83720, Boise, Idaho 83720-0050 or by email to public_records_request@idl.idaho.gov.

   BOARD ACTION: A motion was made by Attorney General Wasden that the Board approve the Department recommendation with the modification that each lot be offered individually. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 4-0.

10. **Negotiated Rulemaking, IDAPA 20.03.16, Oil and Gas Leasing** – *Presented by Mike Murphy, Bureau Chief-Endowment Leasing*

    DEPARTMENT RECOMMENDATION: Authorize the Department to enter into negotiated rulemaking for IDAPA 20.03.16 - *Oil and Gas Leasing on Idaho State Lands*.

    DISCUSSION: Controller Woolf asked if the Department at some point would move the legal authority to create these IDAPA rules to the newly established Oil and Gas Conservation Commission. Director Schultz clarified that these rules are regarding leasing of endowment lands; the Department would not envision these actions going under the Commission. The Commission's role is strictly regulatory; the Land Board retains all leasing oversight, no differently than if this was a grazing piece of land or selling a cottage site. This is within the discretion and responsibility of the Board.

    BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation and authorize the Department to enter into negotiated rulemaking concerning oil and gas leasing on Idaho state lands. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

- **INFORMATION**

  NONE

- **EXECUTIVE SESSION**

  NONE

There being no further business before the Board, at 10:41 a.m. a motion was made by Attorney General Wasden to adjourn. Controller Woolf seconded the motion. The motion carried on a vote of 4-0. 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/ Ben Ysursa
Ben Ysursa
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 17, 2014 regular Land Board meeting.

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

Tom Schultz, Secretary to the Board

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

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, November 18, 2014 in the State Capitol Lincoln Auditorium (Room WW02) at 700 West Jefferson, Boise, Idaho. The meeting began at 9:00 a.m. The Honorable Governor C. L. "Butch" Otter was attending to official duties out of state; the Honorable Governor Brad Little presided in his place. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence Wasden *(via teleconference)*
Honorable State Controller Brandon Woolf
Honorable Superintendent of Public Instruction Tom Luna

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

1. Director's Report

A. Interest Rate on Department Transactions – November 2014
DISCUSSION: None.

B. Timber Sale Activity and Information Report – October 2014
DISCUSSION: None.

C. Division of Lands and Waterways Activity and Information Report – October 2014
DISCUSSION: Director Schultz referred to page 2 of the report, residential leases, and provided some background in terms of the number of residential assignments processed this year versus prior years. In 2011 the Department had a total of 18 assignments, 6 of those were arms length (i.e., not a family transfer); in 2012 there were 16 assignments, 10 were arms length; in 2013 there were 18 assignments, 9 were arms length. Already in 2014 the Department has had 27 assignments, 18 have been arms lengths, roughly double from the prior three years. Director Schultz pointed out an interesting detail that in 2011 average leasehold value (the amount lessees were being paid for the value of the lease when it was transferred) was averaging about $153,000; in 2014 that average has been about $32,000. As would be expected, as prices go up, the difference between what a buyer is willing to pay to simply acquire the lease goes down substantially.

D. Legal Matter Summary – October 2014
DISCUSSION: None.

2. **Endowment Fund Investment Board Manager's Report** – *Presented by Dean Buffington, EFIB Chairman, Larry Johnson, EFIB Manager of Investments, and Tom Kealey, EFIB Audit Committee Chair*

   A. Manager's Report
   B. Investment Report
   C. EFIB Annual Report

   DISCUSSION: Chairman Buffington congratulated each of the Board members who were re-elected to their offices, and wished good tidings to Secretary of State Ysursa and Superintendent Luna as they move on to the next chapters in their lives. Chairman Buffington remarked the Endowment Fund Investment Board (Investment Board) traditionally meets with the Land Board in May and November of each year to update the Board on Investment Board activities. Chairman Buffington introduced other members of the Investment Board: Gavin Gee, Vice-Chair; Representative Neil Anderson; Warren Bakes; Tom Kealey, Audit Committee Chair; Gary Mahn; Richelle Sugiyama; Senator Chuck Winder; Sue Simmons. Chairman Buffington also introduced Investment Board staff and several consultants: Larry Johnson, Manager of Investments; Chris Halvorson, Investment Officer; Laurel Fritz, Sr. Financial Specialist; Judy Shock, Administrative Assistant; Julie Weaver, Deputy Attorney General; Janet Becker-Wold, Callan Associates; and Scott Klitsch, CliftonLarsonAllen LLP. Governor Little thanked Chairman Buffington for his continued fine work in the Investment Board's well performing organization.

   Mr. Johnson reviewed the Manager's Report and Investment Report, reporting no compliance issues or other significant actions to report. Mr. Johnson called attention to the chart on page 2 of the Manager's Report, a comparison of the Endowment Fund's performance against peers. The Endowment Fund ranks in the 4th percentile for the past ten year period; a low number is desired. Mr. Johnson explained much of the high performance may be attributed to the asset mix of the Fund. The Endowment Fund has 49% of its assets in U.S. equity funds; the average public fund as only 38% and the average foundation and endowment fund only 37% in U.S. equities. Relative to other asset classes such as fixed income and particularly real estate hedge funds and other alternatives, the U.S. equity has performed better over this time period. Mr. Johnson mentioned there will likely be periods in the future in which U.S. equities perform worse than international equities and that will affect Endowment Fund peer ranking.

   Mr. Johnson reported October was a good month for the Fund, following a tough September; the Fund ended 1.6% in the positive for October, with a fiscal year to date return of 0.5%. Mr. Johnson stated investment managers are performing as expected in this market environment.

   Mr. Johnson went through the EFIB Annual Report, commenting that the Land Board's Asset Management Plan has specific requirements for the Investment Board to report every year. The Investment Board tracked compliance with investment policy during Fiscal Year 2014 and thus far into Fiscal Year 2015; there were no material violations of policy and governance compliance guidelines. The Investment Board reviewed the investment policy in detail in February. Mr. Johnson noted the Investment Board held four regular meetings and three special meetings; average attendance was 89% for the seven meetings, which speaks highly of the dedication and commitment of the Investment Board members. In fact, four members had perfect attendance at all seven meetings. Mr. Johnson mentioned the report contained excerpts from the

Endowment Funds' strategic plan: its mission, goals and objectives and also performance against some specific measures in the strategic plan regarding returns, balances and distributions.

Mr. Kealey reviewed the Fiscal Year 2014 Financial Statement Summary and associated Audit Summary. Mr. Kealey commended Mr. Johnson and the EFIB staff for their fair and accurate presentation of the statements. Mr. Kealey mentioned the EFIB has a new audit firm, CliftonLarsonAllen, LLP. Scott Klitsch is the manager of the Boise office. Mr. Kealey repeated Mr. Johnson's report of a good year for the Endowment Fund. Total fund balances were $1.7 billion in the year ending June 30, 2014, up roughly $284 million from the prior year or a 19% increase. Earnings Reserve was also up to $345 million; receipts to the reserves from land were $88 million up 18% from the prior year and distributions to beneficiaries were up to $49 million. The Fund did very well against benchmark for this last year, and for the last three, five, seven, and ten years. With respect to the audit, Mr. Kealey stated the independent auditor report gave the Fund an unqualified opinion, which is the best that can be given. There is appropriate accounting for all the assets in the Fund. The independent auditor found no items to report on compliance and internal controls. There were no instances of non-compliance with laws and regulations, no material weaknesses or significant deficiencies in internal controls. The independent auditor also did an examination of the account processes between the Department of Lands and the Endowment Fund for transfers, etc.; they sampled different revenue and expense transactions and found no items to report. Controller Woolf expressed appreciation to Mr. Kealey and the Audit Committee for timely submission of the EFIB FY2014 Financial Statement to the Controller's Office in August for inclusion in the state's financial reports. Mr. Kealey concluded his presentation by thanking Superintendent Luna and Secretary of State Ysursa for their service and the opportunity to work with them these past years.

- **CONSENT**

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

NORTH OPERATIONS				COUNTY	AREA OFFICE
A. Long Spur Pole	CR-41-0090	3,650	MBF	Clearwater	Ponderosa (Deary)
		575,350	LF		

SOUTH OPERATIONS	COUNTY	AREA OFFICE
NONE		

4. **October 15, 2014 Oil and Gas Lease Auctions** – *Staffed by Sid Anderson, Program Manager-Minerals and Commercial Leasing*

   RECOMMENDATION: Approve the results of the October 15, 2014 oil and gas lease auctions and direct the Department to issue the identified 11 oil and gas leases to the successful bidders.

5. **Approval of Minutes** – October 28, 2014 Regular Meeting (Boise)

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

- **REGULAR**

6. **Callan Associates Asset Allocation and Governance Review Final Report** – *Presented by Janet Becker-Wold, Senior Vice President, Sally Haskins, Senior Vice President and James Van Heuit, Senior Vice President, Callan Associates*

RECOMMENDATION: Accept Callan Associates final report as completion of contract.

DISCUSSION: Ms. Becker-Wold stated there were no significant changes to the report since Callan Associates' presentation in October, other than a few charts that needed minor updates, and some typographical errors. Ms. Becker-Wold noted the report was presented to the legislative Endowment Asset Issues Interim Committee on Friday, November 14 and seemed to be well received. Callan Associates received no substantial feedback or comment from the Land Board or the Interim Committee since those presentations.

Controller Woolf thanked Ms. Becker-Wold and her associates for the report and for correction of the few minor errors. Governor Little remarked the report was a much improved product from his initial reading of the first draft. Ms. Becker-Wold indicated a corrected, final report would be issued to the Board within a week.

Secretary of State Ysursa thanked Ms. Becker-Wold and Callan Associates for their work to date, and noted Callan Associates may be providing additional consultation as the Land Board's Subcommittee on Endowment Investment Governance Strategy (Subcommittee) reviews the report and comes to the Board in December with recommendations, implementation plans and timeframes based on the report.

Governor Little asked Director Schultz what action is expected from the Board today. Director Schultz explained this contract was let under the authority of the Land Board. Today the Board is accepting this as the final report for completion of the contract. Director Schultz added to Secretary Ysursa's comments; the Subcommittee's intention is to come back at the December Land Board meeting, bringing an implementation schedule with people, timeframes, and expectations for taking these ideas and implementing them over time. The Subcommittee will also look at the cost of implementation. With good recommendations comes a price tag and it will be important to understand and have an acceptance of common expectations.

Attorney General Wasden thanked Ms. Becker-Wold and Callan Associates for their fine work. This report has been needed in order to help the Board fulfill its fiduciary duty. Callan Associates took the assignment very seriously and the Board could not ask for a better recommendation. Attorney General Wasden remarked the report gives the Board a record that it can use and sustain its decision-making.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation and approve fulfillment of the contract and receipt of Callan Associates final report. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 5-0.

- **INFORMATION**

  NONE

- **EXECUTIVE SESSION**

  NONE

There being no further business before the Board, at 9:24 a.m. Governor Little declared the 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/ Ben Ysursa
Ben Ysursa
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 December 15, 2014 regular Land Board meeting.

Asset Allocation and Governance Review
Idaho Board of Land Commissioners

Janet Becker-Wold, CFA
Sally Haskins
James Van Heuit

November 24, 2014

EXECUTIVE SUMMARY

I. Introduction and Background

Callan was retained by the Idaho Board of Land Commissioners (Land Board) in May 2014 to review the findings and recommendations of the Subcommittee on Endowment Governance and identify shortcomings and make recommendations for improvement; review the internal policies and procedures of the Idaho Department of Lands (IDL) regarding valuation and forecasting methodologies; and conduct an asset allocation study incorporating the IDL-managed land assets with the financial assets overseen by the Endowment Fund Investment Board (EFIB).

II. Governance Summary and Conclusions

In order to gain a better understanding of the issues and the opinions of those close to the process, Callan reviewed relevant current and historical documents and interviewed members of the Land Board, Land Board staff, the IDL director and staff and the Manager of Investments for the EFIB. As a result of our review, a number of issues were identified as weaknesses in the governance structure based on current best practices. Our recommended improvements to the governance structure are designed to mitigate the concerns as well as address the weaknesses. We prioritized the recommended governance improvements as follows:

Priority 1: Clearly Established Objectives

The mission statement as expressed in the Idaho Constitution is to manage the endowment lands "in such manner as will secure the maximum long term financial return to the institution to which granted"; however, there is little context around this objective. The Land Board must operate within the framework of Constitutional and statutory conditions which impact the current stated objective. Callan notes that these constitutional conditions may temper the objective of maximizing financial returns. The Land Board needs to determine what position, over the long-term, endowment lands play in the portfolio given legal constraints and authority.

A comprehensive Investment Policy Statement should be developed for the combined Trust that identifies the investment objectives, risk management processes, risk tolerance (including connecting the risk taken in the asset allocation with that expressed in the distribution policy), the adopted asset allocation and rebalancing ranges, decision-making and the roles of each party involved in the investment process, how performance will be monitored and measured for each asset type, and the establishment of appropriate metrics and peer groups where relevant for both the land and financial assets. Elements of this policy have been set forth in various documents already including in the State Trusts Lands Asset Management Plan and the EFIB Investment Policy Statement.

The Investment Policy Statement should be a separate document distinct from the State Trust Lands Asset Management Plan. The Asset Management Plan should be re-oriented to be a strategic plan which covers the combined Trust and focuses on the long-term implementation of the Policy. This strategic plan should be supplemented by an annual plan.

Priority 2 - Align Expertise, Authority and Responsibility

The role of the Land Board should be one of strategic planning and policy setting. To fulfill its duty as a fiduciary, the Board should retain outside expertise to assist in the setting of policy and strategy as well as provide review of transactions. Additionally, the Land Board should re-examine current delegation of decisions to IDL to ensure they align with their expertise. An expert should be utilized to assist the Land

Board in areas where it lacks expertise. All recommendations provided by this expert should be reviewed independently for adherence to institutional processes and procedures.

Priority 3 – Independent Verification

Checks and balances exist in the management of the financial assets with the use of an independent board (EFIB) and use of outside expertise (consultant). Outside expertise and independent verification is lacking in some of the work that IDL conducts. IDL has been identified as an operational expert for timberland, rangeland, and agriculture. Under the trust but verify principle, IDL's operational recommendations and procedures should be reviewed and verified by an independent expert, who reports to the Land Board and not IDL. The addition of an outside expert advisor with knowledge of those issues faced by the Land Board, including review, reporting and monitoring of IDL investment activities, would help to create a fiduciary structure similar to that in place for the financial assets. The addition of an outside expert advisor with knowledge of those issues faced by the Land Board, including review, reporting and monitoring of IDL investment activities, would help to create a fiduciary structure similar to that in place for the financial assets.

A comprehensive independent outside financial audit is not conducted on the land asset portfolio as is done for the financial assets. An independent audit is an important check and safeguard on an expert's internal financial controls and accounting procedures. Currently, the independent auditor of the financial assets performs a limited review and testing of IDL accounting procedures annually, but does not express an opinion on endowment land financials as a whole. The Legislative Auditor also performs an examination every three years, but their emphasis is on compliance and not disclosure.

Priority 4 - Transparency

Further developing the supporting documentation and infrastructure consistent with modern institutional investment practice for land-related investments will improve transparency. Policies should be reviewed to ensure they clearly document the process by which investment decisions are made and be codified in an Investment Policy Statement. The policies should be logical, defensible and clear to stakeholders and other interested parties and lay out a road map for achieving long term objectives. The policies should define the roles of all parties and the criteria used to make decisions.

Priority 5 - Accountability

Institute a process to fairly measure IDL progress towards the achievement of goals and objectives established by the Land Board. After further clarifying the role of Idaho commercial real estate[1] in the portfolio, a revised and approved strategic plan should clearly describe appropriate measurement methodologies and reasonable performance objectives by asset class. The current Asset Management Plan lays out expected peer returns on assets by land asset class but there is no comparable information for the financial assets in the Investment Policy Statement for the fund. Periodic reporting to the Land Board should measure current performance and progress towards achieving long-term objectives as stated in the Investment Policy and consistent with the Asset Management/Strategic Plan.

The Land Board and the IDL should expand their view of the appropriate peer set for governance and operations. The peer set goes beyond regulatory requirements and other state land trusts and includes institutional investors such as endowments and state pension plans. This would provide a way to measure whether IDL is achieving its stated vision of being a "premier organization for trust management".

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[1] Commercial real estate here refers to ownership of offices, retail properties, operating business etc.

Review of Sub-Committee Proposed Governance Structures

A number of recommendations were proposed by the Sub-Committee on Endowment Investment Governance in regard to governance issues including the modification of the level of decision making authority on timber sales contracts, land investment decisions deemed to be routine and special land investment decisions. There were also recommendations for cash flow which included a proposed 90%/10% rule for splitting proceeds from land disposal between the Permanent Fund and the Land Bank. Callan's conclusions on the Endowment Investment Governance Sub-Committee's recommendations include:

> **Conclusion:** Callan supports the delegation of authority to make decisions to IDL and the Director where appropriate. We defer to the Sub-Committee and Land Board on what the applicable levels for each should be.
>
> **Conclusion:** Callan believes the 90%/10% rule of splitting proceeds from land disposals is too rigid and premature. The Land Board needs to determine whether maintaining and/or growing the land base is a priority given the objective of maximizing returns of the total trust at an appropriate level of risk. There may be strategic considerations that are difficult to quantify in a formula. Land Bank monies could be allocated periodically consistent with the long term strategic and annual plans, as they are developed, rather than according to prescribed rule.

III. Revenue Forecasting Conclusions

The revenue forecasting methodology could be improved for all asset types except forestland and residential cabin sites. In particular, the revenue forecast for land types that are subject to leases should be based on the amounts that will be generated under the terms of the lease in the forecast years. The documentation of the process and verification of the forecasts could be augmented and improved across the board.

IV. Land Asset Valuation Policy Conclusions

The current practice of having a complete mass land appraisal using a sales comparable approach for forestland, rangeland, and agriculture should be discontinued. This valuation method does not provide an independent valuation of the entire asset (e.g. land and resource growing on the land) nor does it contain information that could be used by the IDL for performance measurement, or to improve its management or valuation practices, and it does not consider the particular constraints on the sale of land. It is also inconsistent with best practices.

Independent values will need to be established for the commercial portfolio by an expert as there are no recent independent, third party opinions of value. Callan believes external valuations are important to develop a baseline until the direction of the portfolio is more fully developed and for performance measurement purposes. Additionally, if a specialist real estate investment manager/consultant is hired to provide assistance on the portfolio, they will need current values to give appropriate advice on the properties.

The Land Board will need to determine a valuation approach for forestland and rangeland. The report identifies various options that could be taken by the Land Board for forestland and rangeland. Callan supports a process that incorporates an independent expert opinion and a discounted cash flow/income approach. There is little benefit to be gained from valuing smaller components of the portfolio such as agriculture for ongoing performance measurement given the de minimis holdings.

The valuation policy should be updated if the Land Board makes any changes to the current methodology.

V. Performance Reporting Conclusions

Callan proposes a summary report similar to that currently produced for the Endowment Fund Investment Board that would include the addition of market values for the IDL portfolio to reflect the asset allocation of the total endowment fund. We would rely on IDL to provide the monthly cash flows for their portfolio. A return would be calculated quarterly which would reflect cashflows in/out of the portfolio but hold the market value constant. Once a year a new valuation for the IDL portfolio could be calculated based on the valuation policy and methodology approved by the Land Board.

VI. Asset Allocation Results

The asset allocation study did not include an assessment of the impact of differing asset allocations on the current distribution policy. Dollar distributions to beneficiaries are calculated as a percent of the rolling three-year average of the individual endowment permanent funds. The earnings reserves are set by evaluating the volatility of the returns of the financial assets and land revenues. If an asset allocation mix is selected that deviates from the risk and return in the current mix, the Land Board will need to assess the impact on the distribution policy and make changes as necessary.

Four sets of potential allocations were constructed:

1. Allocations with only the existing investment types (stocks, bonds and Idaho lands) assuming that Idaho timberland and grazing land could be bought and sold to reach the desired allocations;
2. Allocations with only the existing investment types assuming that timberland and grazing land would be maintained at their current allocations;
3. The same assumptions as set 1 but with possible allocations to US real estate and private equity; and,
4. The same assumptions as set 2 but with possible allocations to US real estate and private equity

Sets 1 and 3 assume that any lands acquired would have investment characteristics similar to existing lands and an expected return of at least that of the existing assets.

The study developed a value for grazing land at $61 million and timberland of $1.15 billion. The total portfolio, IDL lands and financial assets, has a value of approximately $3 billion. The expected long-term compound return of the existing combined portfolio is projected to be 6.7% nominal, or 4.45% real after adjusting for a projected inflation of 2.25%.

The study reached several important conclusions:

- The current total endowment allocation is reasonable and efficient.
- Timberland is a desirable investment across the range of asset mixes reviewed. Timberland has an attractive forecast return for the anticipated level of risk and diversifies other asset classes well. Consequently, the unconstrained computer model specified an allocation to timberland at or above its current level for all asset mixes evaluated. The model suggests that timberland investment could be expanded if the acquired properties are expected to perform at least as well as the existing timberland.
- Grazing land was included by the computer model in more conservative (lower risk) asset mixes. The return for grazing land provides reasonable compensation for its risk and diversifies bonds well. However both a lower return and less attractive equity diversification relative to timberland reduce its allocation to zero in higher return and risk mixes. If the asset mix chosen results in a reduction or elimination of the allocation to grazing land, potential sales or exchanges should be prioritized according to their expected contributions to returns with transactions executed as limitations permit. It would be counterproductive to dispose of grazing land quickly at a discount for the sole purpose of bringing the actual allocation in line with the target.

- The model shows investments in U.S. diversified, institutional real estate to be modestly attractive and private equity to be only marginally attractive. As a general rule, an allocation below 5% to an asset class does not contribute enough return to make it a worthwhile investment. This is especially true for investments such as real estate and private equity which are more complex investments than stocks and bonds. The computer model allocated less than 5% to private equity in all asset mixes evaluated. U.S. real estate could be an attractive investment for mixes with rates of return at or above those currently forecast for the EFIB portfolio.
- The model finds that the combination of Idaho timberland and grazing land with the EFIB investments at their current levels has a similar expected return but a volatility that is anticipated to be materially lower than that of the existing allocation containing financial assets alone. While there is no compelling reason to adjust the current EFIB asset allocation, other allocations could be considered. Increasing the public equity allocation as a percentage of public assets from the current 70% to 85% would boost the return by almost 0.4% annually at the expense of increasing the expected risk from 9.41% to 10.77%. Conversely, decreasing the public equity component to just under 60% would reduce the return by the approximately the same 0.4% annually while decreasing the risk to 8.12%.

The decision to maintain the existing mix or move to one of the alternatives should be done in conjunction with an evaluation of the impact on the distribution policy.

VII. Idaho Commercial Real Estate Portfolio

Callan has been asked to specifically address the role of Idaho Commercial Real Estate in the portfolio Most of the stakeholders with whom we spoke were hesitant, for a variety of reasons, to grow the current Idaho commercial property portfolio, unless there was a compelling investment reason to do so. In Callan's opinion, there is not. The asset allocation work implies an allocation to a broadly diversified portfolio of U.S. real estate could, at best, play only a modest role in improving the diversification of the portfolio and there is no investment reason for an allocation to consist primarily of a concentrated position in Idaho properties. Further, Callan does not recommend ownership of single properties for the endowment.

Currently, appropriate decision-making and oversight is not in place for the ongoing management, analysis, or prudent divestiture of the existing Idaho commercial portfolio. Our report details recommendations designed to put in place a decision-making framework, including the hiring of a specialist real estate manager/consultant, reporting to the board, to provide the analysis and management expertise on the retention, disposition and management of commercial properties.

The decision-making and management framework to properly oversee the current commercial portfolio will also prove useful as a model for the evaluation and management of other non-routine land investment decisions. For example, consideration of whether to execute a ground lease with a tenant on a vacant parcel of land or purchasing more timberland or farmland.

Table of Contents

I. Governance

A. Introduction

The mission of the Endowment is to prudently manage Idaho's endowment assets to maximize the long-term financial returns to the beneficiary institutions.

Callan was retained by the Idaho Board of Land Commissioners (Land Board) in May 2014 to review the findings and recommendations of the Subcommittee on Endowment Governance and identify shortcomings and make recommendations for improvement; review the internal policies and procedures of the Idaho Department of Lands (IDL) regarding valuation and forecasting methodologies; and conduct an asset allocation study incorporating the IDL-managed land assets with the financial assets.

B. Governance Environment

Management of the endowment trust lands is entrusted to the State Board of Land Commissioners who serves as the sole fiduciary of both the land and financial assets. Per the Idaho Constitution, the Land Board is charged with managing the Endowment in such a manner as will secure the maximum long-term financial return to the beneficiary institutions. The Board must invest trust assets in compliance with the Idaho Prudent Investor Act which requires decisions to be made in the sole interest of trust beneficiaries and "manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust."[1] 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.

The Endowment Fund Investment Board (EFIB) was formed to provide expertise and professional oversight to the investment of the revenues from lands. The IDL administers the management of the land assets.

C. Governance Structure

Governance is a framework of policies and procedures by which an organization ensures fairness, accountability and transparency. The framework consists of an understanding of expectations between the organization and its stakeholders; processes that minimize conflicts of interest; procedures that provide supervision and serve as checks and balances; and continuous monitoring.

Priorities of a good governance structure include:

- Clearly established mission with supporting reasonable objectives
- Alignment of expertise, authority and responsibility
- Independent verification
- Transparency
- Accountability – Monitoring process including metrics for assessing achievement or progress towards agreed upon objectives

D. Information Gathering

In order to gain a better understanding of the issues as well as the thoughts and opinions of those close to the process, Callan reviewed current and historical documents and interviewed members of the Land Board, their respective staffs, the Manager of Investments for the EFIB, and the Director of the Department of Lands during July and August. Some common themes emerged from our conversations:

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[1] Idaho Statutes, Title 68, Chapter 5, Section 68-502

- Monies currently in the Land Bank, as well as those to be received from the sale of cabin sites, should be deployed quickly given the current low level of return in the Treasurer's pool.
- IDL and the EFIB have been operating in separate silos.
- Interviewees generally agreed that if commercial real estate is determined to be an appropriate asset class for investment, it is best implemented in a national or globally-diversified manner through the EFIB.
- Many felt that the Land Board should have a policy level decision-making role and should not be approving every individual transaction proposed by IDL.
- There was consensus that the IDL is not an expert in commercial real estate. The lack of expertise was noted both for acquisition analysis and asset management including establishing a longer term plan, renovation, change of use, deciding when to sell, and executing dispositions.
- All expressed their satisfaction with the governance structure surrounding the management and monitoring of the financial assets – professional staff, independent board, use of outside expertise (consultant) and performance reporting and monitoring.
- There is a general sense of dissatisfaction with the current State Trust Lands Asset Management Plan especially in regards to commercial real estate and an immediate need to address the ongoing issue of deployment of proceeds generated by the sale of cabin sites.
- Looking at recent press, there appears to be a general misunderstanding of the performance objectives of IDL compared to the financial assets as well as a generally negative view of the Endowment owning operating businesses that compete with the private sector and remove property from tax rolls.

E. Weaknesses in the Current Governance Structure

Callan has identified the following weaknesses in the current governance structure:

- Insufficient context around the constitutionally defined Land Board objective of maximizing return.
- The current State Trust Lands Asset Management Plan is a combination of investment policy and strategic plan.
- There are meaningful differences in the structure of decision making, performance expectation setting, use of outside experts and reporting for the financial assets compared to the land assets.
  - In the management of the financial assets, both internal (EFIB staff) and external (consultant) expertise is used. Checks and balances exist in the form of oversight by a multi-member professional board and external as well as internal preparation and review of performance.
  - IDL is making some investment decisions with implications to the Trust without any independent verification. The Land Board often relies on the recommendation and analysis of IDL without the use of outside sources of information or expertise.
- An elected Board may be influenced by politics, have short-term motives and incentives, and lack expertise, all of which may present conflicts to its fiduciary duty to act in the sole interest of the beneficiaries of the Trust. Incorporating additional expertise and policies and procedures to provide checks and balances will help to mitigate any potential conflicts of interest.
- The Land Board should be focused on the setting of policy and strategy. Much of the Land Board's time is spent reviewing individual transactions.
- IDL performance measurement and reporting could be improved.

F. Recommended Improvements to Governance Structure

Priority #1 – Clearly Established Objectives

The mission statement as expressed in the Idaho Constitution is to manage the endowment lands "in such manner as will secure the maximum long term financial return to the institution to which granted". As noted previously, there is little context around this objective. The Land Board must operate within a framework of Constitutional and statutory considerations:

- Requirement that asset sales are conducted exclusively through an oral auction process with a minimum price set at appraised value.
- Condition specifying maximum sales of 320 acres per person over their lifetime

Callan notes that these constitutional conditions may temper the objective of maximizing financial returns. The Land Board needs to determine the role, over the long-term, that endowment lands play in the portfolio given current legal constraints and authority.

A comprehensive Investment Policy Statement should be developed for the combined Trust that identifies the following:

- Investment objectives – clearly state investment objectives in the context of the desired distribution policy.
- Risk tolerance – connecting the risk taken in the asset allocation with that expressed in the distribution policy.
- Appropriate asset classes – real estate, agriculture, other?
- Target mix and rebalancing ranges where appropriate
- How investment decisions will be made (including decisions about how revenues from lands are reinvested).
- How performance will be monitored, establishing appropriate metrics and peer groups where relevant – land and financial assets.
- Elements of this policy have already been set forth in various documents including in the State Trusts Lands Asset Management Plan and the EFIB Investment Policy Statement.
- The Investment Policy Statement should be a separate document distinct from the State Trust Lands Asset Management Plan. The Asset Management Plan should be re-oriented to be a strategic plan which covers the combined Trust and focuses on the long-term implementation of the Policy. This strategic plan should be supplemented by an annual plan.

Priority #2 - Align Expertise, Authority and Responsibility

The role of the Land Board should be one of strategic planning and policy setting. To fulfill its duty as a fiduciary, the Board should retain outside expertise to assist in the setting of policy and strategy as well as provide review of transactions. A re-examination and determination should be made by the Land Board regarding the appropriate delegation of decisions to IDL that aligns with their expertise.

An expert should be utilized to assist the Land Board in areas where it lacks expertise. All recommendations provided by this expert should be reviewed independently for adherence to institutional processes and procedures. Retaining a specialist real estate manager/consultant for the commercial properties will solve a number of concerns identified elsewhere in this report including appraisal, management, maximizing value, producing what if scenarios, and revenue forecasting. IDL is the recognized operational expert for timberland, rangeland, and agriculture and a different set of decision-making delegations will apply to ensure the Land Board retains policy-setting responsibilities.

Priority #3 – Independent Verification

Checks and balances exist in the management of the financial assets with the use of an independent board (EFIB) and use of outside expertise (consultant). Outside expertise and independent verification is lacking in some of the work that IDL conducts. IDL has been identified as an operational expert for timberland, rangeland, and agriculture, and has established comprehensive internal review processes for many routine investments (e.g. road construction and reforestation) and employs outside expertise in many of those activities. Under the trust but verify principle, IDL's operational recommendations and procedures should be reviewed and verified by an independent expert who ultimately reports to the Land Board and not IDL. This is not a new idea. "An investment mentality would require an independent review

of the in-house management and a separate and independent performance and monitoring system to assure the Land Board that is has hired an "expert" when it has hired itself as the manager."[2] The addition of an outside expert advisor with knowledge of those issues faced by the Land Board, including review, reporting and monitoring of IDL investment activities, would help to create a fiduciary structure similar to that in place for the financial assets.

Unlike the financial asset portfolio, a comprehensive independent outside financial audit is not conducted on the land portfolio. An independent audit is an important check and safeguard on an expert's internal financial controls and accounting procedures. Currently, the independent auditor of the financial assets performs a limited review and testing of IDL accounting procedures, but does not express an opinion on endowment land financials as a whole. The Legislative Auditor also performs an examination every three years, but their emphasis is on compliance and not disclosure.

Priority #4 - Transparency

Develop the supporting documentation and infrastructure consistent with modern institutional investment practice for land-related investments. Policies should be established that document the process by which investment decisions are made and be codified in an Investment Policy Statement. The policies should be logical, defensible and clear to stakeholders and other interested parties and lay out a road map for achieving long term objectives. The policies should define the roles of all parties and the criteria used to make decisions.

An example of a decision making process that is transparent is the current EFIB Distribution Policy. The policy was established by the Land Board recognizing the importance of balancing the needs of current and future beneficiaries of the Trust. Those affected by the policy may not always agree with the results but the process is transparent and defensible.

Priority #5 - Accountability

Institute a process to fairly measure IDL progress towards the achievement of goals and objectives established by the Land Board.

The EFIB has established investment objectives for the management of the financial assets: maintain the purchasing power of the Fund, maximize total return over time at an acceptable level of risk and provide relatively smooth and predictable distributions to beneficiaries.[3] There is also a clearly established performance review process requiring monthly performance; evaluation of the sufficiency of earnings reserves; summary of significant actions taken by the EFIB; and any compliance issues or areas of concern.[4]

A revised (after further investment consideration of commercial real estate[5]) and approved strategic plan should clearly describe appropriate measurement methodologies and reasonable performance objectives by asset class. The current Asset Management Plan lays out expected peer returns on assets by land asset class but there is no comparable information for the financial assets. Periodic reporting to the Land Board should measure current performance and progress towards achieving long-term objectives as stated in the Investment Policy and consistent with the Asset Management or Strategic Plan.

The Land Board and the IDL should expand their view of the appropriate peer set for governance and operations. The peer set goes beyond regulatory requirements and other state land trusts and includes

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[2] Endowment Fund Reform Progress Report, Robert Maynard, December 6, 2013

[3] Endowment Fund Investment Board Investment Policy Statement, February 2014.

[4] Idaho State Board of Land Commissioners, State Trust Lands Asset Management Plan, (December 20, 2011).

[5] Commercial real estate here refers to ownership of offices, retail properties, operating business etc.

institutional investors such as endowments and state pension plans. This would provide a way to measure whether IDL is achieving its stated vision of being a "premier organization for trust management".

G. Sub-Committee Proposed Governance Structures

The recommendations of the Land Board Sub-Committee on Endowment Investment Governance Strategy were forwarded to Callan Associates on September 19.

A number of recommendations were proposed in regards to governance issues: the modification of the level of decision making authority on timber sales contracts, land investment decisions deemed to be routine and special land investment decisions.

> *Callan opinion: Callan supports the delegation of authority to make decisions to IDL and the Director where appropriate. We defer to the Sub-Committee and Land Board on what the applicable levels for each should be.*

A number of recommendations were proposed by the Sub-Committee in regards to cash flow:

- Land Bank to only be used to facilitate consolidation of lands, acquire access or acquire land for Public Schools
- 90% of the proceeds from land disposals go to the Permanent Fund managed by the EFIB, other 10% stays in the Land Bank for potential reinvestment in lands
- Non-Public School land proceeds flow to the Permanent Fund managed by EFIB unless there is an identified need to acquire access
- Land Board conducts biennial review of the Land Bank to determine if funds should be retained or transferred to the permanent Fund

> *Callan opinion: We feel that the 90%/10% rule of splitting proceeds from land disposals is potentially too rigid and premature. The Land Board needs to determine whether increasing the land base is desirable from an investment perspective. If the Land Board were to engage an outside expert to assist in the development of a long term strategic as well as an annual plan, land bank monies could be allocated on a periodic basis consistent with the plans.*

II. Revenue Forecasting

Callan has reviewed IDL's revenue forecasts and processes. The current revenue forecasts are completed by the IDL and given to the EFIB for use in evaluating the appropriate distribution rates and levels of earnings reserves. The forecast is presented in a spreadsheet with very limited back up. The spreadsheet has forecast numbers for each class of land. It includes information on the process used to derive the forecast for the non-timber assets with some accompanying notes that are included as comments for certain cells in the Excel worksheet. The timber forecast is provided as "clean sheet" numbers with no comments or explanation; however, the IDL has background data and information supporting the forecast numbers. It has not historically been provided to the EFIB.

A. Revenue Forecasting Method

The revenue and expense forecasting methodology for commercial real estate, grazing land, agriculture, recreation, conservation, oil and gas, and minerals is as follows:

- Revenues are forecast using a rolling average of the prior five years adjusted for significant events
- Expenses are forecast using a rolling average of the prior three years adjusted for significant events

In the FY 2015 forecast, the only adjustments made to the rolling average calculations for revenue were for oil and gas revenue which was reduced 50% relative to FY 2014. Direct program expenses for grazing were adjusted by $150,000 (i.e. rolling three year average plus $150,000 for FY 2015).

Institutional best practice for properties and land that are encumbered by leases is to use software and accounting programs which allow input of lease terms (rent, rental escalations, landlord's expenses, expense recoveries from tenants, etc.). The software allows projections into future years for income and expenses that are based on the actual contractual lease terms, not a historical look back. These programs also interface with valuation software to produce pro forma projections and allow scenario modeling including re-leasing assumptions, the costs of re-tenanting, and ongoing capital improvements.

The IDL believes that using a historical average is a quicker and easier way to develop projections than pulling information from its Instrument Management System which has lease information but was not developed with a reporting or forecasting capability. According to IDL (email from Patrick Hodges on 9/19), "this system could be used to pull the information based on leases, but it is not a simple task and would not yield significantly better information than what has happened in the prior five-year period. The amount of revenue and volatility compared with timber has been relatively small, and largely driven by one or two larger, one-time events (like a $1M bid to jump the Snake River Canyon or a large premium bid on a grazing lease). Other things can impact revenue like shorter term leases/permits and non-use on grazing leases, but in the grand scheme of things these do not greatly impact the total."

B. Residential Real Estate Revenue

Residential real estate revenue is based on the forecasts in the appraisal for the first year and in subsequent years, revenue is assumed to be 93% of the prior year. The revenue reduction takes into account the planned sales of cottage sites.

C. Timberland Revenue

The timberland program revenue and expense is based on the annual and 10 year sales plans. The basis for the annual and 10 year sales plan is established in the Forest Asset Management Plan (FAMP), a comprehensive and well documented strategy completed every five years. IDL uses forest planning modeling software to run scenario analysis and produce an optimized Net Present Value with an associated harvest schedule that achieves defined management objectives while considering management constraints. In the past, a program named SPECTRUM was used but it is being replaced

with Woodstock for the next FAMP update. The result of the analysis and the go forward sales and management plan, is set forth in the comprehensive FAMP. An external natural resource and timberland consultant, Mason, Bruce, and Girard, Inc., was used alongside the IDL when the April 2009 FAMP was approved by the Land Board. The IDL anticipates one or more outside consulting experts will be utilized in future FAMP work.

The timber revenue forecast includes sales currently under contract at actual sales prices which are allocated to each endowment over the contract period. The forecast also includes proposed sales from the 10 year sales plan and ten year average stumpage prices that are adjusted up or down depending on the IDL's assessment of future market conditions. For example, going into the downturn, the stumpage prices used in the forecast were adjusted downward by 30% for three years. The revenue forecast is updated every six months with timber sales contract information. The IDL indicated that the forecasts are reasonably accurate for three years because of the contracts in place but after three years, the forecast becomes more subjective as it involves more forecasting than contractual revenue. Pricing, timing of execution on the contracts, pests, and fire are all variables impacting the forecast.

Callan discussed the approach with large timberland investment management organizations (TIMOs) and verified that their process used for revenue forecasting is similar. In fact, many use the Woodstock modeling software. TIMO revenue forecasting is done at the acquisition of a property and then yearly as part of an annual asset management plan. TIMOs also consider information from third party appraisals which include a pro forma revenue model that is reviewed alongside their internally generated forecasts.

D. Recommendations and Prioritizations

Recommendation 1: Callan does not recommend any changes to the revenue forecasting methodology utilized for forestland or residential cabin sites.

Recommendation 2: Develop an asset management plan for each commercial property and projected cash flow models. Use these cash flow models as the foundation for the revenue forecast. Complete in FY 2015. For all other land that is subject to leases, the forecasts should be based on the amounts that will be generated under the terms of the lease in the forecast years. Over time, develop the capabilities to forecast grazing and agricultural revenue using a forward-looking analysis based on leases.

Recommendation 3: The revenue forecast provided to EFIB should include a summary of the process used along with the major assumptions and data inputs. This is most important for forestland given it is the primary driver of the revenue forecast. The IDL should provide its existing documentation of methodology, inputs and assumptions to the EFIB to provide context for the timber revenue forecast. Complete for the FY 2015 forecast.

Recommendation 4: Callan believes the addition of a third party to verify the forecasts is particularly important and part of the "trust but verify" concept discussed earlier. The Land Board may want to consider having the forecasts reviewed periodically by a timberland consultant and in the interim, continue to have the EFIB verify the IDL's forecasts. Complete for the FY 2016 forecast.

Recommendation 5: The revenue forecasts should be accompanied by a reconciliation of the prior year's forecast versus actual results as a way to illustrate where the variances were, as a tool to understand the accuracy of the forecasting model, and to identify areas of improvement. Complete at the end of FY 2015.

III. Land Asset Valuation Policy

IDL's valuation policy is summarized in Table 1. The purpose of obtaining valuations is for performance measurement, to compare performance with peers (western states managing similar land trusts, private trusts or investment firms in similar market sectors), to optimize trust management performance, and as a tool to identify underperforming assets.[6]

Valuations are not used in the IDL Annual Report to present a total asset value for lands. The only asset value that is included in the IDL Annual Report is the commercial real estate value that is used to compute a return on asset.[7] Valuations are also done by an external third party at the time an asset is sold to establish the minimum price that can be accepted at auction.

Table 1 – Valuation Policy for Lands[8]

Type of Land	Valuation Method	Frequency
Commercial Real Estate	Independent or Internal Appraisal – Management Recommendation	Annual Index, 5 Year Mass Appraisal
Forestland	Stumpage price indices Independent or Internal Appraisal – Management Recommendation	Annual Index, 5 Year Mass Appraisal
Rangeland	Independent or Internal Appraisal	Annual Index, 5 Year Mass Appraisal
Agricultural Land	Independent or Internal Appraisal	Annual Index, 5 Year Mass Appraisal
Residential	Independent or Internal Appraisal – Management Recommendation	Annual Index, 5 Year Mass Appraisal
Minerals	Unproven Site – Bare Land Value Proven, Unopened Site – Bare Land Value only or NPV of future earnings less development cost Producing Sites – NPV of earnings Close/Abandoned Site – Reversion value, possible liability to reclaim	Dictated by changing stages of property characteristics and uses
Conservation	Western States Survey	Annual
Rights of Way	Western States Survey	Annual

A. Summary of Methods Used to Establish 2013 Valuations

Callan has reviewed the current valuations of timber and non-timber assets. Valuation information was provided by EFIB staff and IDL staff. The 2013 values were determined using a variety of methodologies and valuations were established by external third parties and IDL staff as summarized in Table 2.

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[6] Idaho State Board of Land Commissioners, State Trust Lands Asset Management Plan, (December 20, 2011), 19-20.
[7] Idaho Department of Lands, 2013 Annual Report, 32.
[8] State Trust Lands Asset Management Plan, 19-20.

Table 2 - Valuation Methods Used in 2013

Type of Land	2013 Valuation Method
Commercial Real Estate	Internal IDL solicited a local brokerage firm to provide a Broker's Price Opinion ("BPO") in 2012. For 2013, IDL used publications from local real estate brokers to determine price changes and applied these changes to the 2012 BPO values to establish 2013 values.
Forestland	Third party appraisal of bare land using mass appraisal sales comparison approach plus Internal valuation by IDL of standing timber based on discounted cash flow Internal valuation by IDL also informed by recent timberland sales
Rangeland	Third party appraisal of bare land using mass appraisal sales comparison approach Only land value assessed
Agricultural Land	Third party appraisal of bare land using mass appraisal sales comparison approach Only land value assessed
Residential	Third party appraisal for the purpose of establishing new rental rates
Other Commercial Right of Ways Conservation Minerals	No valuation in 2013 for any of these categories of land

Going forward, the valuation policy adopted by the Land Board will need to, at a minimum, continue to comply with legal and audit requirements. Additional factors influencing the adoption of the valuation policy will depend on the Land Board's consideration of the following: type of land, requirements or constraints surrounding the land ownership, best practices, cost, and use of the valuation (valuations are typically used for reporting investment performance, asset allocation, investment research, formulating investment and divestment strategies, performance measurement of staff or external adviser, and determining fees paid if using external advisers).

Developing and using consistent valuation standards over time will help to ensure that changes in value over time reflect changes in the land being valued and changes in the markets and are not driven by changes in valuers or methodologies.[9]

There have been attempts to standardize reporting across state land trust entities and develop common performance reporting and valuation methodology. In particular the Western States Land Commissioners Association (WSLCA) in July 2008 set forth a series of recommendations in "The Case for Uniform Land Asset Reporting." Representatives of IDL participated in developing these recommendations and the valuation policies in place are modeled based on these standards. The recommendations and initiatives started by the WSLCA for valuation have not been widely adopted by the WSLCA membership.

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[9] Paraphrased from Hancock Timber Resource Group. Timberland Appraisal Policy, (Revised May 28, 2014), 3.

The entity that develops and sets reporting and valuation standards for institutional investors in real estate, timberland, and farmland is the National Council of Real Estate Investment Fiduciaries ("NCREIF"). NCREIF also produces benchmarks and operational data that are widely used by investors for performance measurement and benchmarking purposes. NCREIF does not collect data on the assets held within state land trusts unless they are invested and managed by a third party manager.

In the following paragraphs, the valuation of each type of land, both current and prospective, including a summary of practices used by institutional investors (non-state land trusts) and suggestions for changes to the current valuation policies and practices are discussed.

B. Commercial Real Estate

Current best practices for commercial real estate owned by institutions are annual valuations completed by a third party Member of Appraisal Institute ("MAI") appraiser or a combination of a third party and internal valuations by the owner or owner's advisor. In the latter case, there is an independent third party valuation every three years which is updated in the interim years by the owner, owner's advisor, original appraiser, or a valuation consultant.

Comprehensive appraisals are conducted to provide an accurate estimate of fair market value of the subject property, and are supported by thorough documentation of assumptions, methodologies, and comparable sales. Appraisals conform to the Uniform Standards of Professional Appraisal Practice ("USPAP") as defined by the Appraisal Standards Board of The Appraisal Foundation. Broker opinions of value are not used as a valuation approach or relied upon by institutional investors.

The major benchmarks for U.S. commercial real estate include properties and funds that are subject to annual and quarterly valuations. There is a trend to quarterly independent valuations and to full outsourcing of the appraisal contracting and update function to a valuation consultant for institutionally managed real estate portfolios in the U.S.

Recommendation 1: The Land Board should require annual valuations for the current portfolio of Idaho commercial properties. This would include an independent third party valuation completed by an external MAI appraiser not less frequently than every three years with annual updates.

If a Separate Account Advisor/Oversight Consultant is retained to manage the commercial portfolio, that advisor would complete the annual update valuations every year (as part of the asset management planning process which would include a hold versus sell analysis). Separate Account Advisors/Oversight Consultants complete an income based valuation alongside the third party MAI appraiser even in the years when the MAI appraiser is hired as a check and balance mechanism.

Although the asset value of the Idaho commercial portfolio is relatively small compared to other land types, Callan believes a valuation process consistent with institutional practices is preferable because there are no acreage restrictions on the sale of commercial property (unlike some of the other land assets), the information will provide input and benchmarking for portfolio management and hold/sell decisions, valuation is a part of sound asset planning, and will provide transparency. It will also help satisfy one of the concerns voiced by Land Board members regarding the lack of a plan or end game for the commercial properties as it can be used in decision-making in a hold/sell analysis.

The requirement for valuations should be addressed over time as the portfolio becomes an even smaller part of the land portfolio (and the total portfolio), but at this point in time, Callan believes external valuations are important to develop a baseline and until the direction of the portfolio is more fully developed.

C. Forestland

Institutional owners of forestland have similar valuation policies to commercial real estate. Comprehensive appraisals are conducted every three years by an external MAI appraiser. Appraisal

updates are conducted during the interim years or quarters between comprehensive appraisals. Updates may be conducted by the original appraisal firm or the timberland advisor on behalf of the owner. Valuation changes made in the update are typically driven by actual changes in annual growth, harvests and prices as well as assumptions. Valuations are used for reporting investment performance, asset allocation, investment research, formulating investment and divestment strategies, performance measuring/benchmarking of staff or external adviser, and determining fees paid if using an external adviser.

To be included in the NCREIF Timberland Property Index, the only benchmark for institutional timberland investment, properties must be valued quarterly. Valuations may be internal or external except that there must be an independent external appraisal performed in accordance with USPAP at least once a year.

Timberland appraisals are comprehensive and cover land and timber. A timberland appraisal may consider one or all three approaches to value (cost, sales comparison and income capitalization) depending on how buyers are pricing similar properties. The valuation approaches are summarized below and included in this document to provide context for the analysis used by the IDL.

- Cost Approach: the cost approach sums the value of the bare land plus the value of the existing merchantable timber plus the value of pre merchantable stock which is derived in various ways. The value of the land is segmented by type such that a per-acre value is determined for each type of land that may exist in the subject property. The theory behind the approach is that an option for a purchaser of the property, instead of buying a piece of timberland with trees and land, would be to buy the components separately.
- Sales Comparison Approach: the sales comparison approach is based on prices paid for similar properties in an open market. The prices are adjusted based on differences between the subject and the comparables.
- Income Capitalization Approach: the income capitalization approach converts projected future cash flows of the subject into a present value.

The most recent valuation conducted by the external appraiser and the IDL most closely mirrors the cost approach in that the IDL takes the third party appraiser's bare land value and adds to it their estimate of the value of the standing timber. The recommended value provided by IDL was also based on a discounted cash flow and a limited number of sales comparables with high level information so it had elements of the income capitalization and sales comparison approach.

An institutional process would not have the appraiser only do a land value with the owner providing the timber value and elements of the other two approaches. The appraiser would do the entire cost approach and, most likely, a sales comparison and income approach to determine fair market value. Institutional timberland appraisals are completed by third party firms with specialized expertise in comprehensive timberland appraisal. Value Logic, who completed the most recent mass appraisal of the land value that is used as one component of the current timberland value, is not one of those firms.

Recommendation 2: The current practice of having an appraiser complete mass land appraisals is not useful because it does not provide an independent valuation of the entire asset (e.g. land and timber) nor does it contain any information that could be used by the IDL to improve its management or valuation practices for forestland. This valuation approach should be discontinued.

Valuation Options For Forestland

Primary considerations for the valuation approach adopted by the Land Board for the purpose of performance measurement and monitoring for forestland include the sales constraints which make it impossible to convert unrealized appreciation to realized gains, the cash flow orientation of the asset with cash flow as the primary driver of return, and the fact that timberland is the largest holding in the portfolio.

Alternative valuation approaches are presented in Table 3 below.

Table 3 Alternative Valuation Approaches

Valuation Approach	Strengths	Issues
Do not value forestland	No time or cost required Complies with GASB	No value conclusion Difficult to produce performance reporting or asset allocation without periodic values Not consistent with best institutional practices No external market information
Discounted cash flow completed by internal staff annually	Minimal cost	Lack of an independent opinion Valuation assumptions and facts would not be checked by an independent party Potential conflict of interest if the valuation impacts the person doing the value No external market information
Discounted cash flow completed by independent expert	Independent opinion Provides valuation information for performance reporting and asset allocation Tailored to Land Board's purposes and situation Depending on scope, could be a cross check on internal numbers	Moderate cost Market information would be more limited Limits ability to compare performance results to the NCREIF Timberland Index if this is a priority
External appraisals every three years; Internal staff or appraiser provides updates in the interim years	Independent opinion of value Provides valuation information for performance reporting and asset allocation Consistency with best practices of TIMOs and institutional owners Provides basis for comparison to other peer groups and a benchmark Cross check on internal numbers Source of external market information, including sales that could potentially be useful to the IDL and the Land Board	Most expensive option External appraisal value would assume the forestland could be sold and value conclusion would include values that cannot be realized by the Land Board

D. Rangeland

The valuation approach for rangeland is complicated considering (1) the absence of rangeland ownership by institutional owners beyond state land trusts; (2) the lack of institutional benchmarks and valuation standards; (3) the formulaic approach to setting rents used by the Land Board versus a free market approach for setting rents; and (4) the value drivers of rangeland beyond the pure economic value of the forage which have been well documented in prior studies for the Land Board and in the literature.[10] Stated another way by O'Laughlin and Cook, "Valuing the bare land component of rangelands involves accounting for ranch quality of life values beyond their value for livestock production." Doye and Brorsen point out a number of factors impacting value for rangeland including agricultural uses, recreational uses and residential uses. Because of the land sales constraints and the nature of the ownership, the other factors beyond the pure rental stream are of little value or cannot be captured at all by the Land Board.

The most recent appraisal used only a sales comparable approach to establish a bare land value. The purpose of the appraisal was to "estimate the market value of the subject land by the land classifications as identified by our client. This appraisal does not consider the value of the resource growing or improvements constructed on the subject parcels."[11]

Callan reviewed the rangeland appraisal and noticed that the comparables used for the rangeland had very few adjustments even though there was a significant range of land types and amenities. For example, some included significant improvements (homes and buildings), others had timberland that could be sold or water rights or access to water, and some had utilities and wells and differing access.

The appraisal also assumed that the Land Board could sell the properties being appraised. Finally, as noted previously, the values in those comparables inherently include a variety of non-financial factors, such as quality of life, that drive the land value.

Recommendation 3: The current practice of having an appraiser complete mass land appraisals is not useful for the reasons included in the paragraph above. This valuation approach should be discontinued.

Valuation Options For Rangeland

The valuation options available to the Land Board are similar to those outlined under forestland. Callan concludes that should the Land Board decide that valuations are a priority, the most appropriate valuation approach is an income based approach modeled after that set forth in the O'Laughlin and Cook study on page 78. A value derived by using the income stream may be conservative in the sense that it will not capture the value of small parcels that may be sold opportunistically. But we believe this is far better than a sales comparison approach that does not consider the constraints. Should the sales constraints be lifted, the valuation approach could be modified. A third party appraisal that includes an income capitalization and sales comparison approach could be used as a decision-making tool for specific sales but not for the overall portfolio as a whole at this time.

E. Agriculture Land

Institutional owners of farmland use appraisers with a specialty in agricultural properties and have policies similar to timberland (i.e. three year externals with annual or more frequent updates). Farmland appraisals are comprehensive in that they come to a conclusion for the entire property which considers the crop

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[10] Jay O'Laughlin and Philip S. Cook, "Endowment Fund Reform and Idaho's State Lands: Evaluating Financial Performance of Forest and Rangeland Assets", Idaho Forest, Wildlife and Range Policy Analysis Group, Report No. 21, (December 2001); Damona Doye and B. Wade Brorsen, "Pasture Land Values: A "Green Acres" Effect", in *Choices Magazine a publication of the Agricultural and Applied Economics Association*, (2nd Quarter 2011), www.choicesmagazine.com.

[11] Value Logic, "Idaho Department of Lands-Contract #13-104 Gross Land Appraisal Services, Summary Format, Appraisal of Zone 1 Thru 12 RANGE LAND, As of June 13, 2013", (December 13, 2013), 4.

growing on the land and the leases in place. This is in contrast to the land value only approach in the most recent appraisal.

Recommendation 4: Discontinue the current appraisal practice for agriculture.

Recommendation 5: There is little benefit to be gained from valuing this part of the portfolio in the future for ongoing performance measurement given the de minimis holdings.

Summary of Valuation Priorities:

- Callan has developed timberland and rangeland values for purposes of the asset allocation study using a discounted cash flow approach.
- Independent, third party valuations need to be established for the commercial real estate portfolio. If management is transferred from the IDL to a specialist real estate investment manager/consultant, current values will need to be established and updated periodically for performance measurement purposes.
- Determine a valuation approach for timberland and rangeland to be used for performance measurement purposes. Callan recommends an approach that incorporates an independent expert opinion and a discounted cash flow/income approach.
- Update the lands valuation policy in FY 2015. Information addressed in such policy would include frequency, methodology, guidelines, roles and responsibilities and program administration, valuer qualifications, interaction with valuer, conflicts of interest, and documentation.
- Contract for third party valuation work for FY 2016.
- The Governance Sub-Committee recommended that Callan evaluate the options for valuation and determine the best approach for measuring performance. The above recommendations are responsive to that request; however, there are performance metrics in addition to those derived from valuations that could be developed and measured.

IV. Performance Reporting

Callan would propose a summary report similar to that currently produced for the Endowment Fund Investment Board that would include the addition of market values for the IDL portfolio to reflect the asset allocation of the total endowment fund. We would rely on IDL to provide the monthly cash flows for their portfolio. A return would be calculated quarterly which would reflect cashflows in/out of the portfolio but hold the value constant. Once a year a new valuation for the IDL portfolio could be calculated based on the valuation policy and methodology approved by the Land Board.

A total return is calculated by aggregating the market values and cashflows of the financial assets and IDL assets. Once there is a long enough history, statistics such as standard deviation could be added to the report.

V. Asset Allocation Study

A. Introduction

The purpose of the asset allocation study is to evaluate the current and potential asset allocation mixes incorporating the IDL lands portfolio with the EFIB financial assets. In order to accomplish this objective, values were established for the Idaho timber and grazing lands. In addition, risk, return and correlation assumptions were developed for the Idaho-specific assets. Return expectations were formulated using existing and forecast data provided by IDL as well as supplemental data from outside sources. These were integrated with existing Callan forecasts for both publicly and privately-traded institutional asset classes. The asset allocation exercise was conducted to address the following issues:

- The appropriate levels of investment for Idaho timberland and grazing land
- Other asset classes not currently considered that should be added
- The process for liquidating assets, if appropriate

The asset allocation study did not include an assessment of the impact of differing asset allocations on the current distribution policy. Dollar distributions to beneficiaries are calculated as a percentage of the rolling three-year average values of the individual endowment permanent funds. The earnings reserves are set by evaluating the volatility of the returns of the financial assets and land revenues. If an asset allocation mix is selected that deviates from the risk and return in the current mix, the Land Board will need to assess the impact on the distribution policy and make changes as necessary.

B. Land Asset Valuations

Forecasting returns, risks and diversification potential (correlations) for timber and grazing lands is challenging. Although historical and projected net income streams are available for both asset classes, the returns these income streams generate are dependent on the value of the underlying land. Land valuation under any circumstances involves art as well as science but art plays a particularly large role for Idaho timberland and grazing land due to both the size of the holding and State constitutional considerations. Appraisals based on comparable sales do not account for a number of factors including location, accessibility, improvements and the tremendous increase in supply that would result from a significant land sale (assuming that there were no restrictions on sales).

For the purposes of our asset allocation analysis, it is useful to value the lands by discounting expected future cash flows for a variety of reasons. First, cash flows for these lands have been projected and using them makes the value of the land consistent with these forecasts. Second, the duration and frequency of the projections allows better estimation of standard deviations and correlations than appraisals which are conducted several years apart. Finally, stocks and bonds are generally valued based on discounted cash flows so there is consistency in the forecasting methods across asset classes.

The approach we used to value both the timberlands and the grazing lands in this analysis is the land expectation value method (LEV). LEV is based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow is discounted by a constant discount rate. The formula for LEV is:

LEV = Constant Real Annual Cash Flow / Real Annual Discount Rate

It is important to recognize what the land expectation value represents. The LEV is not an appraisal of the fair market value for all or any portion of the land. It does not attempt to value individual tracks of land based on their specific characteristics. It does not take into account the revenues that might be generated from other potential uses. Unlike an appraisal, it is not intended to facilitate a transaction.

The LEV is a general estimate of the overall land value. It is constructed from the expected revenues reflecting current operations. Its purpose is to provide a necessary input to forecast returns for use in the asset allocation analysis and to determine the percentage weight of the lands in the existing asset allocation.

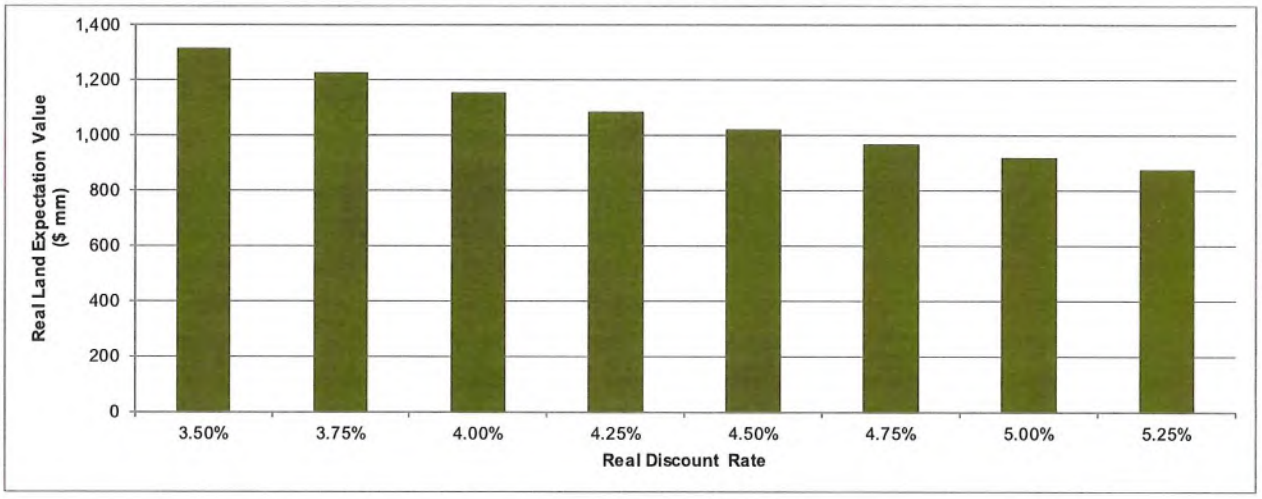
C. Timberland Forecast

For timberland, the forecast cash flow is based on the volume of timber harvested, the price paid for the timber and non-timber income. For our purposes, we assume that the long-term sustainable yield (LTSY) for timber is 240 mmbf on an annual basis. We assume the stumpage price is $240 per mbf. Historically, non-timber income has run about 9% of total income. Direct program expense and managerial overhead assumptions are taken from the Endowment Lands Income Statement. Combining these values provides the estimated real dollar value of the LTSY.

The selection of the discount rate is somewhat subjective. The figure below shows the impact of the real discount rate on the LEV given the cash flow assumptions described above.

Figure 1

Land Expectation Values for Timberland Based on a Range of Discount Rates



For our purposes, we have chosen to discount the cash flows at a rate consistent with the expected return on institutionally-managed timber. Currently, institutional managers are forecasting 4% to 6% real returns. IDL manages its timber on the conservative end of the institutional range so a 4% real discount rate is appropriate. The selection of this discount rate is also consistent with the dividend and earnings yields of timber REITs. Using a 4% real discount rate translates into a real LEV for $1.15 billion for the timber assets. Dividing the $1.15 billion LEV by the timberland holdings of 980,764 acres, results in an estimated value of $1,174 per acre.

The real return on assets (real ROA) is calculated by dividing the real net cash flow by the real LEV. The result for timberland is 4% which is the same as the real discount rate of 4%. The nominal return on assets is the real return on assets plus the assumed rate of appreciation in the cash flows. We assume the growth in timber revenues will be equal to inflation which Callan currently forecasts to be 2.25%. Summing the inflation expectation and the real ROA gives a nominal expected rate of return of 6.25%.

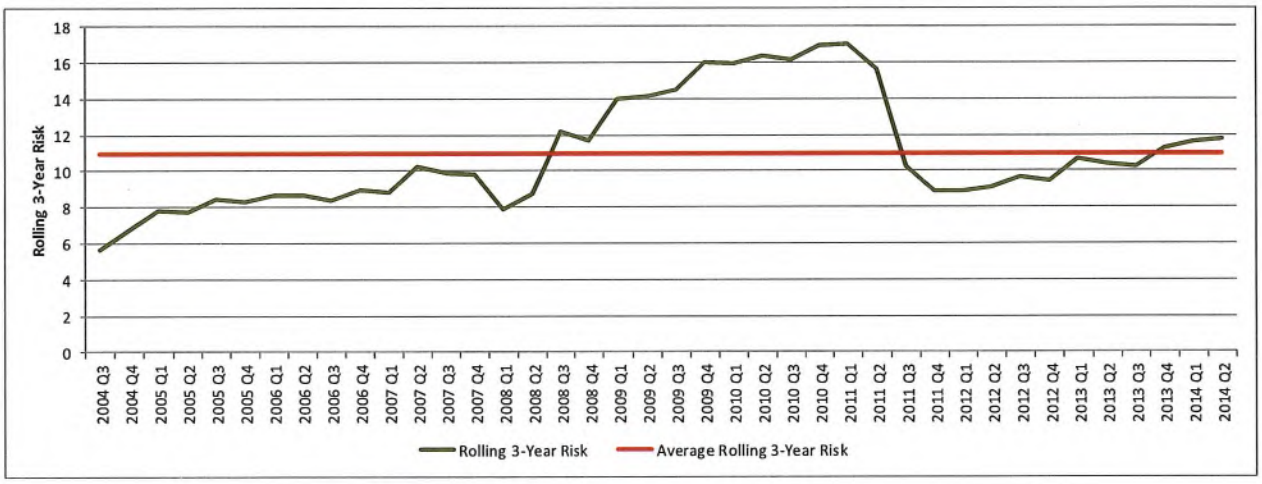
In addition to return, risk (as measured by standard deviation) and diversification with other asset classes (as measured by correlation) have to be estimated. Both of these parameters require frequent

observations of returns. For publicly-traded asset classes we estimate risks and correlations using quarterly returns usually over 3 to 5-year timeframes. This can't be done using Idaho timberland directly because, while cash flows are available frequently, land values are not. Consequently we used proxies for measuring the risk and diversification.

The volatility of timber has both price and volume components. To evaluate the price component we chose the logging sector of the producer price index (PPI). For the volume component we used changes in the number of U.S. housing starts. Due to autocorrelation in the pricing data, we applied a 40% weight to it and a 60% weight to housing starts. This combination has an average standard deviation of about 11% as shown in the following figure.

Figure 2

Historical Risk for the Timber Proxy



For the purposes of our forecasts we added an additional 1% to the standard deviation to account for the risks associated with fire, insects and disease for a total forecast standard deviation of 12%. Historically timber revenues have been less volatile than the EFIB portfolio of financial assets. Table 5 later in this analysis shows the EFIB allocation of 70% equity and 30% fixed income has a projected standard deviation of 13.4% so the timber forecast volatility relative to financial assets is consistent with history.

The forecast correlations are -0.01 for US stocks, -0.01 for non-US stocks, 0.02 for EFIB bonds (85% broad market bonds, 15% TIPS), 0.02 for real estate and 0.00 for private equity based on the historical values shown in the following figures.

Figure 3

Correlation Between U.S. Equity and the Timber Proxy

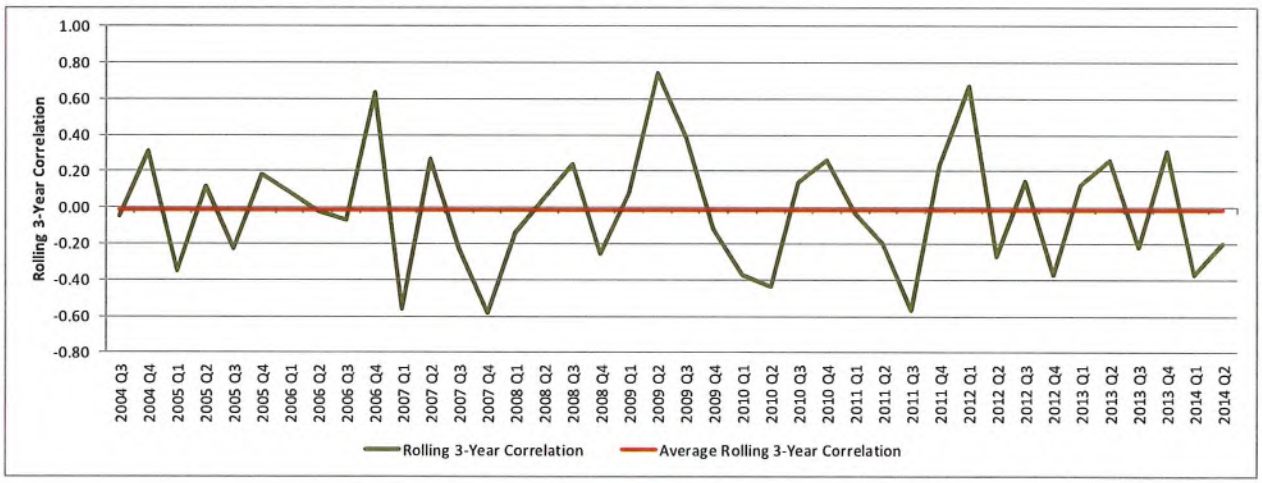


Figure 4

Correlation Between Non-U.S. Equity and the Timber Proxy

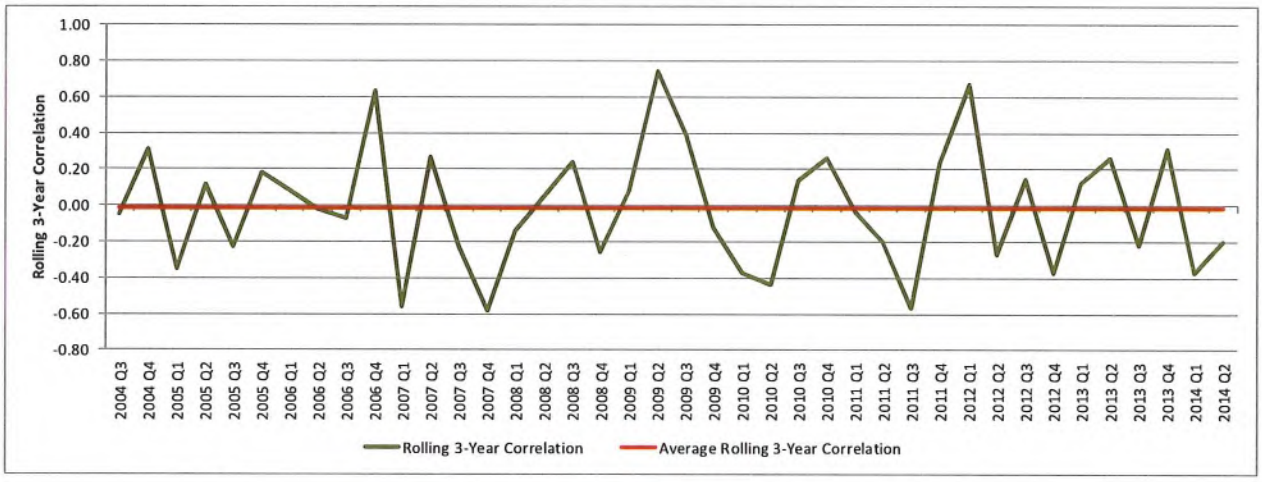


Figure 5

Correlation Between EFIB Bonds and the Timber Proxy

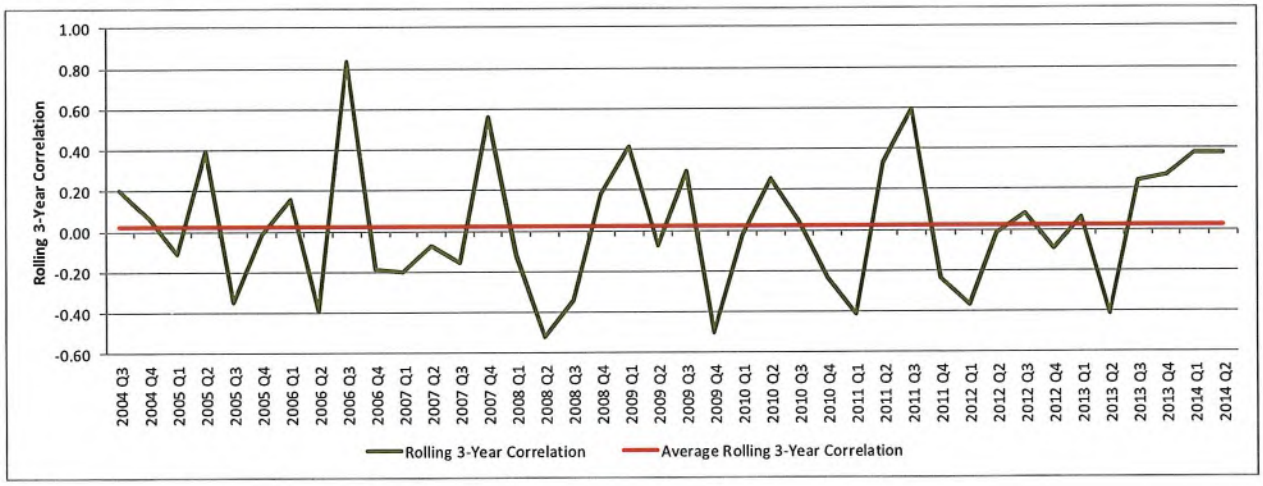


Figure 6

Correlation Between Real Estate and the Timber Proxy

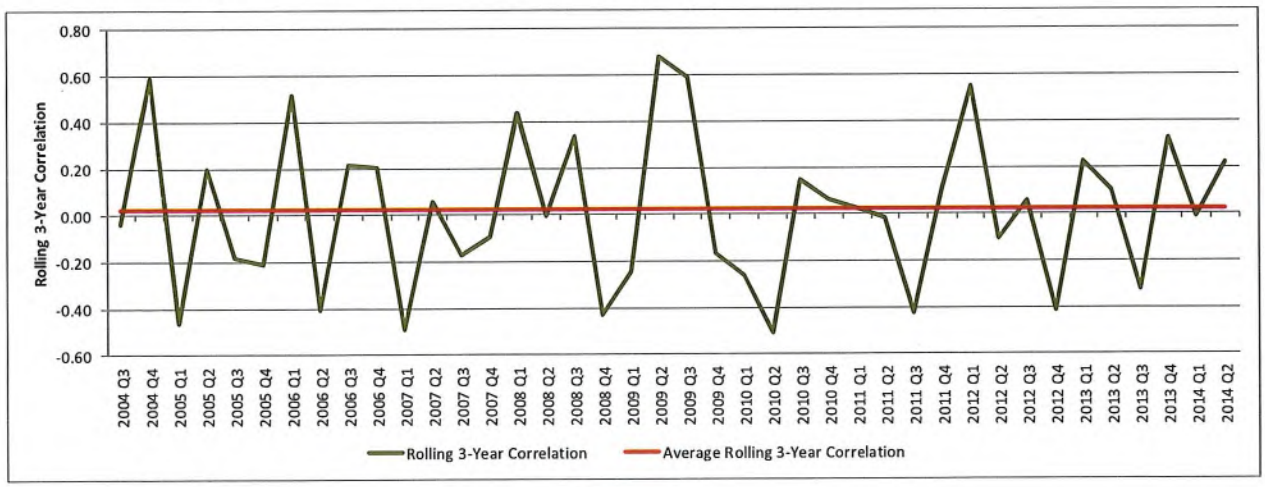
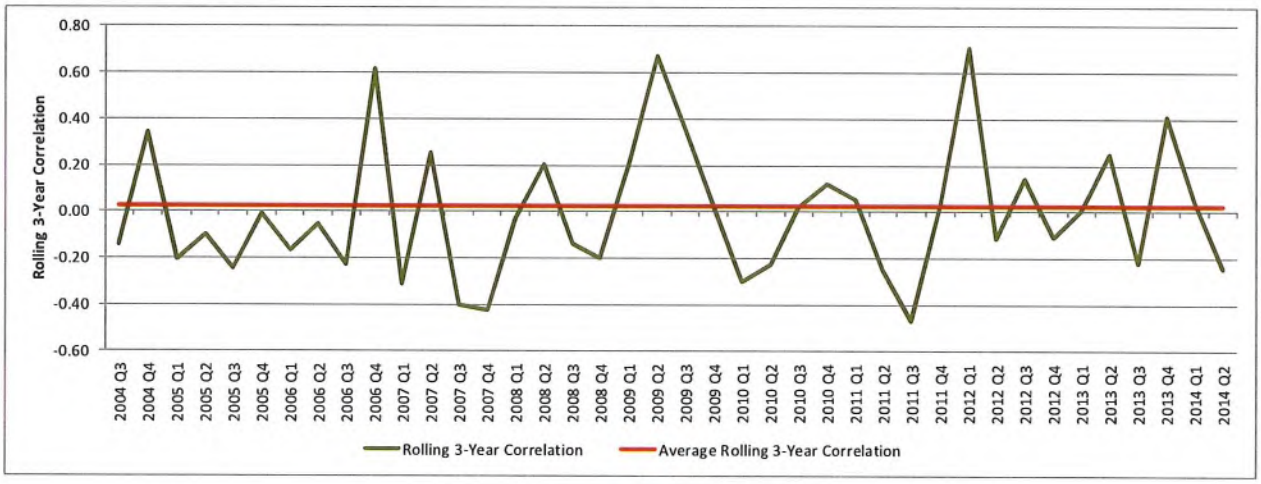


Figure 7

Correlation Between Private Equity and the Timber Proxy



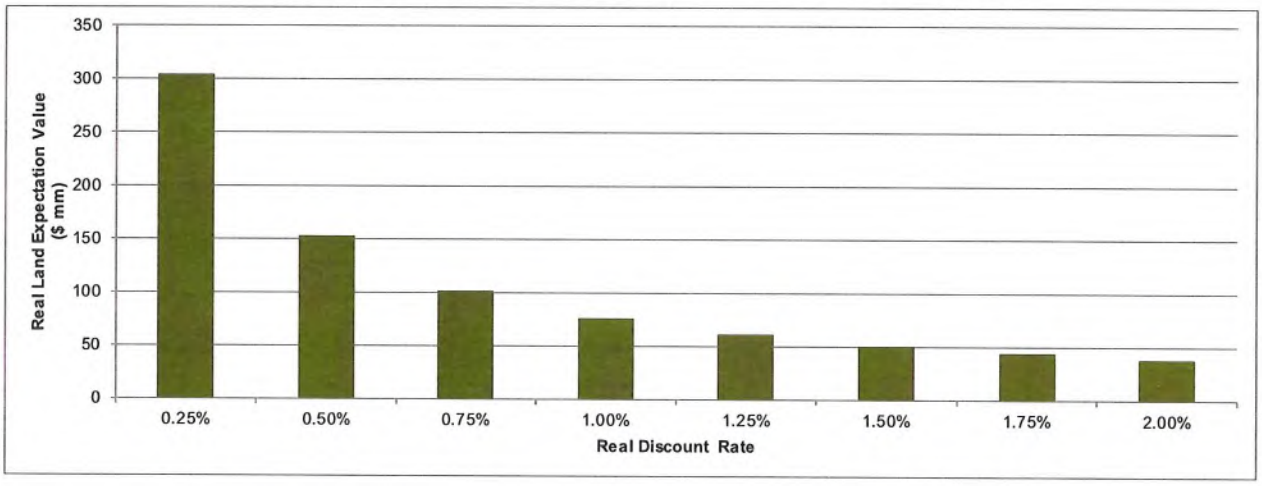
D. Grazing Land Forecasts

Grazing land cash flows are forecast based on anticipated values for Animal Unit Months (AUMs) and the AUM grazing rate. We used the estimate of 285,000 AUMs from the March 2014 State Grazing Rate Review and kept it constant throughout the forecast period. We used the $6.77 / AUM Grazing Lease Rate for Calendar Year 2015. As was the case in the timberland forecasts, direct program expense and managerial overhead assumptions are from the Endowment Lands Income Statement discounted for inflation so that they are consistent with the real revenue forecasts.

Once again the selection of the discount rate is somewhat subjective. Figure 8 below shows the impact of the real discount rate on the LEV given the cash flow assumptions described above.

Figure 8

Land Expectation Values for Grazing Land Based on a Range of Discount Rates



The 10-year bond equivalent yield for funding costs provided by the Farm Credit System Bank was used to estimate the discount rate. The 10 and 5-year averages for this rate are approximately 4% and 3%, respectively. We averaged these to get a nominal discount rate of 3.5%. The forecast real discount rate was determined by subtracting our inflation assumption of 2.25% from the nominal discount rate resulting in a forecast real discount rate of 1.25%. This real discount rate leads to a $61 million land expectation value for grazing land. This translates to $43/acre ($61 million value/1.4 million acres). The real return on assets (real ROA) for the combination of forage and land is the real cash flow divided by the real LEV. The result is the real discount rate of 1.25%. The nominal return on assets is the real return on assets plus the assumed rate of inflation so the nominal expected rate of return is 3.5%.

For the purposes of calculating risk, we assumed the forecast AUMs are a constant 285,000, the same assumption made to forecast revenue. Consequently, volatility only comes from variations in grazing fees. The AUM rate is calculated by:

AUM Rate = $IDFVI_{t+2}/100 \times 1.70$

where $IDFVI_{t+2}$ is calculated as:

$IDFVI_{t+2} = -6.92 + (0.13 \times FVI_t) + (0.60 \times BCPI_t) - (0.33 \times PPI_t) + (0.74 \times IDFVI_t)$

The variables are defined as:

$IDFVI_{t+2}$ is the predicted value of the Idaho Forage Value Index two years in the future

FVI_t is the most recent published Forage Value Index for the 11 western states

$BCPI_t$ is the most recent published Beef Cattle Price Index for the 11 western states

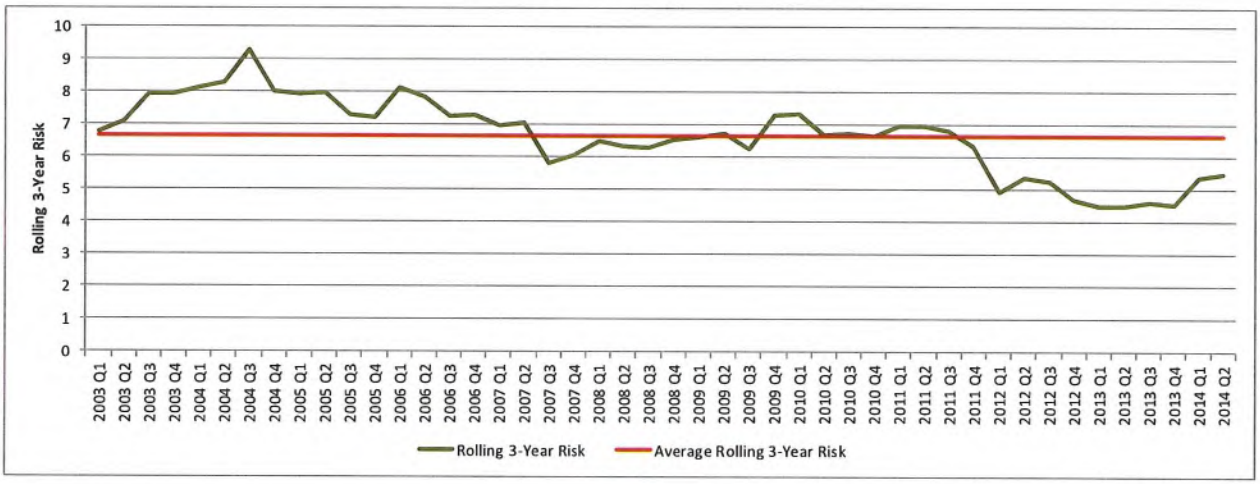
PPI_t is the most recent published Prices Paid Index for the 11 western states

$IDFVI_t$ is the most recent published value for the Forage Value Index for Idaho

The coefficient for the AUM Rate and the first term in the formula for $IDFVI_{t+2}$ are both constant so contribute nothing to volatility. Further, both FVI_t and $IDFVI_t$ have not historically been very volatile. This is particularly true for $IDFVI_t$ since the 0.74 coefficient creates a high degree of autocorrelation. Consequently, the vast majority of volatility in the AUM rate comes from $BCPI_t$ and PPI_t. Unfortunately, these data are only available annually which is inconsistent with the quarterly data frequency that we use to measure risks and correlations for financial assets. As a result, we used historical proxies for these values. For the BCPI and PPI we used the Index of Prices Received for Livestock and Products and the Index of Prices Paid for Production Items, respectively, from the USDA National Agricultural Statistics Service. Both indices are national rather than specific to Idaho or western states and neither is specific to cattle grazing. Having said this, our goal is to get a sense of the degree and timing of the changes in the income and costs associated with raising livestock relative to the return patterns of other asset classes. These indices serve as good proxies as long as there are not substantial differences between the Idaho and national data sets. The historical risks and correlations are estimated with these factors weighted according to the coefficients in the IDFVI formula.

Figure 9

Historical Risk for the Grazing Lease Rate Proxy



This analysis results in an expected standard deviation of 6.75%.

The correlations using the same proxies are forecast to be 0.36 with U.S. equity, 0.32 with non-U.S. equity, -0.18 with EFIB Bonds, 0.19 with real estate, 0.34 with private equity, and -0.20 with IDL timber.

Figure 10

Correlation Between US. Equity and the Grazing Lease Rate Proxy

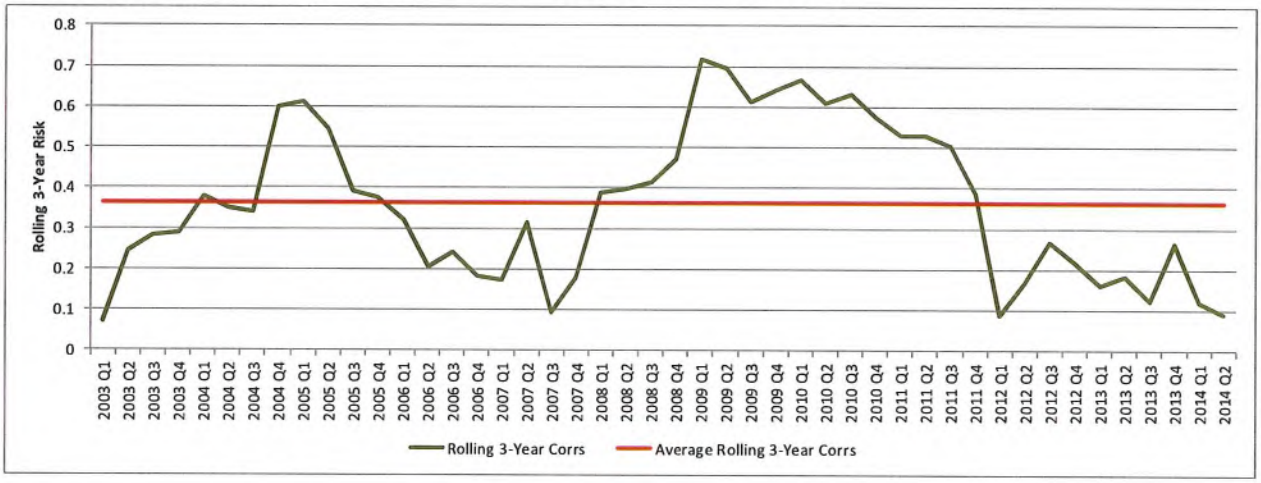


Figure 11

Correlation Between Non-US Equity and the Grazing Lease Rate Proxy

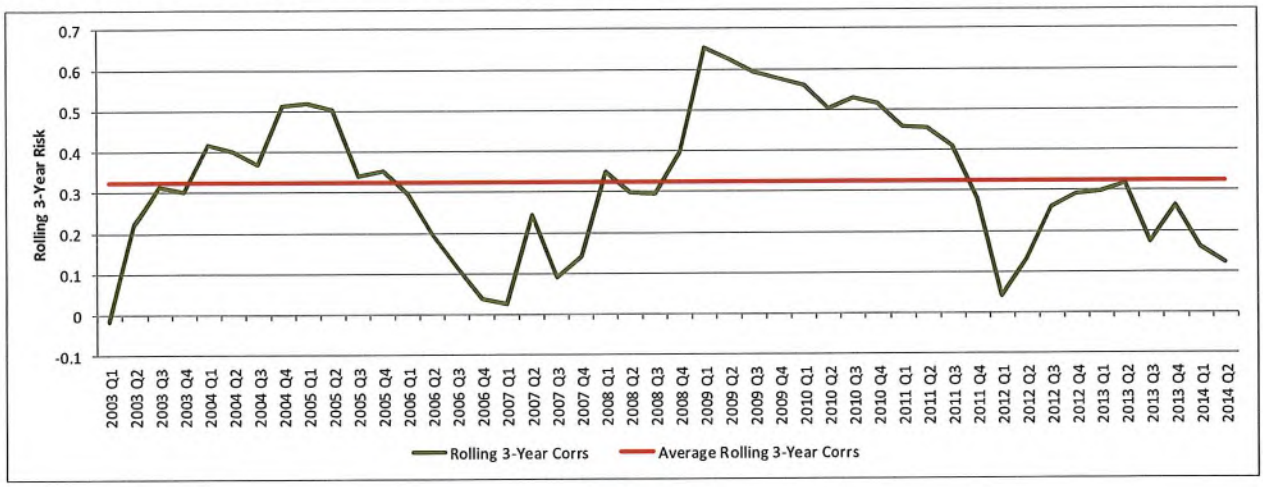


Figure 12

Correlation Between EFIB Bonds and the Grazing Lease Rate Proxy

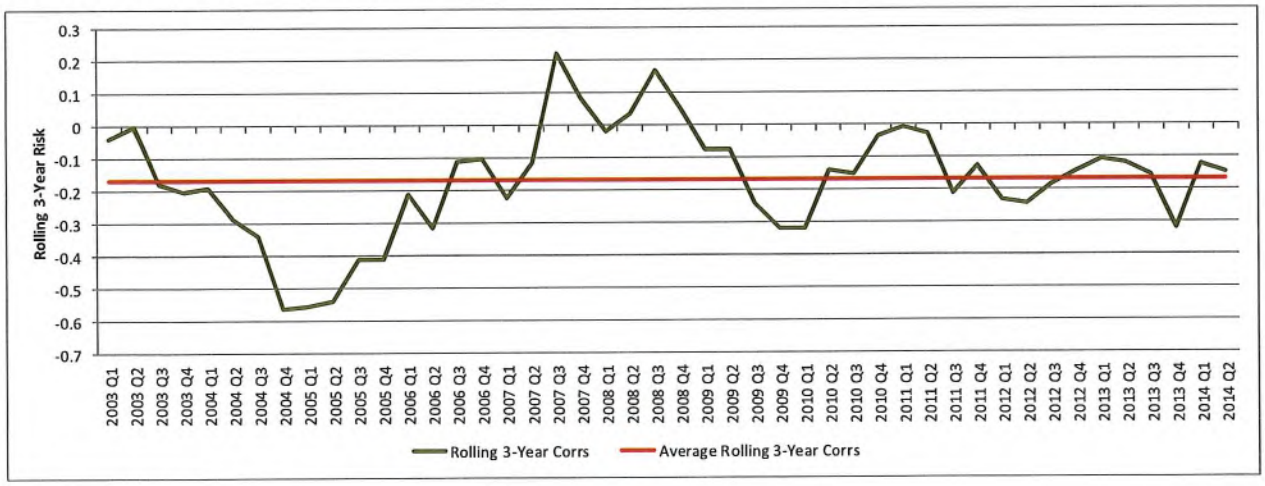


Figure 13

Correlation Between Real Estate and the Grazing Lease Rate Proxy

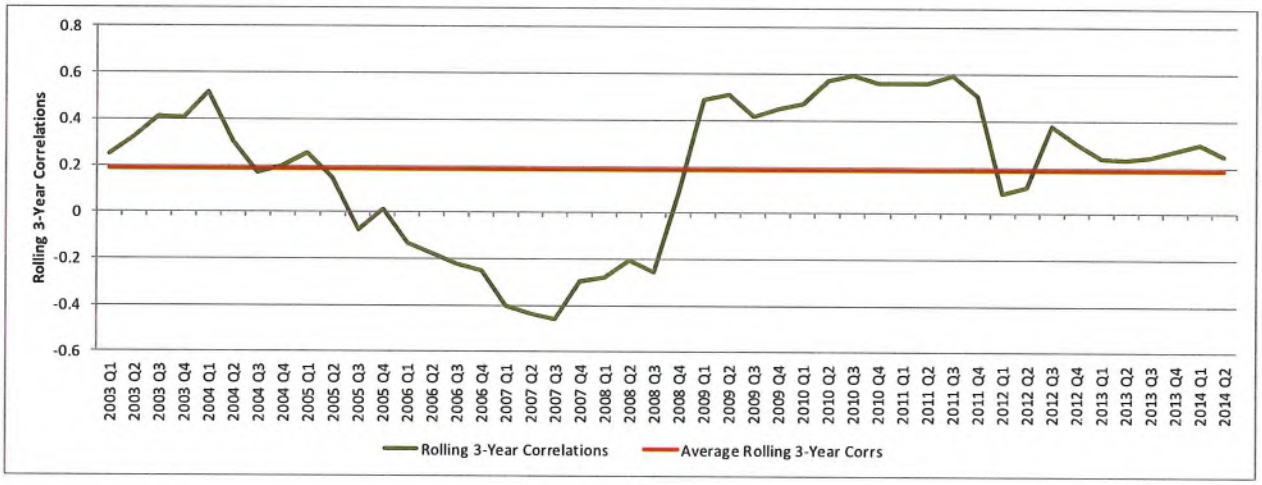


Figure 14

Correlation Between Private Equity and the Grazing Lease Rate Proxy

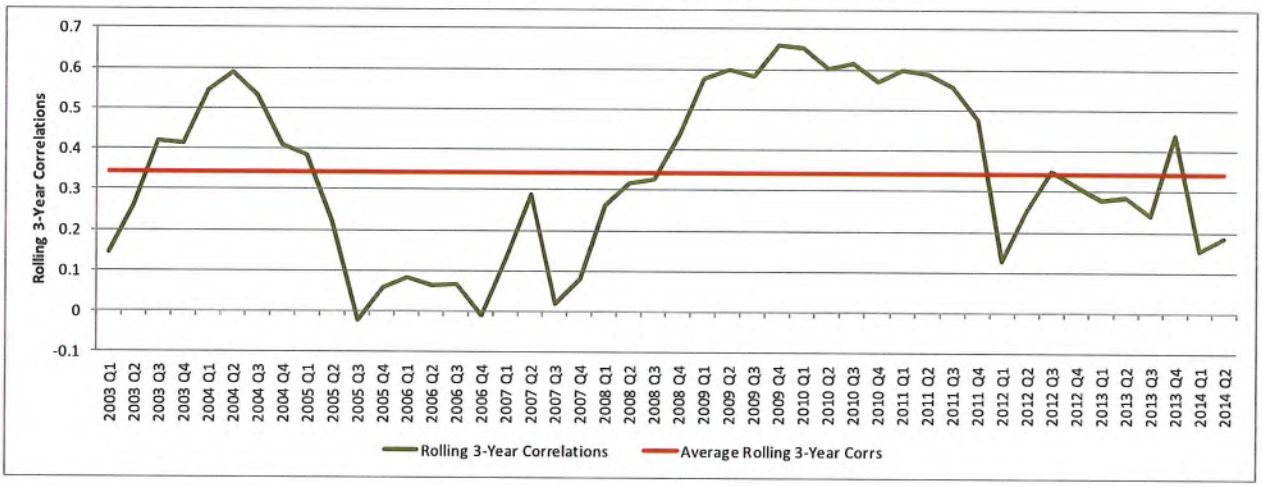
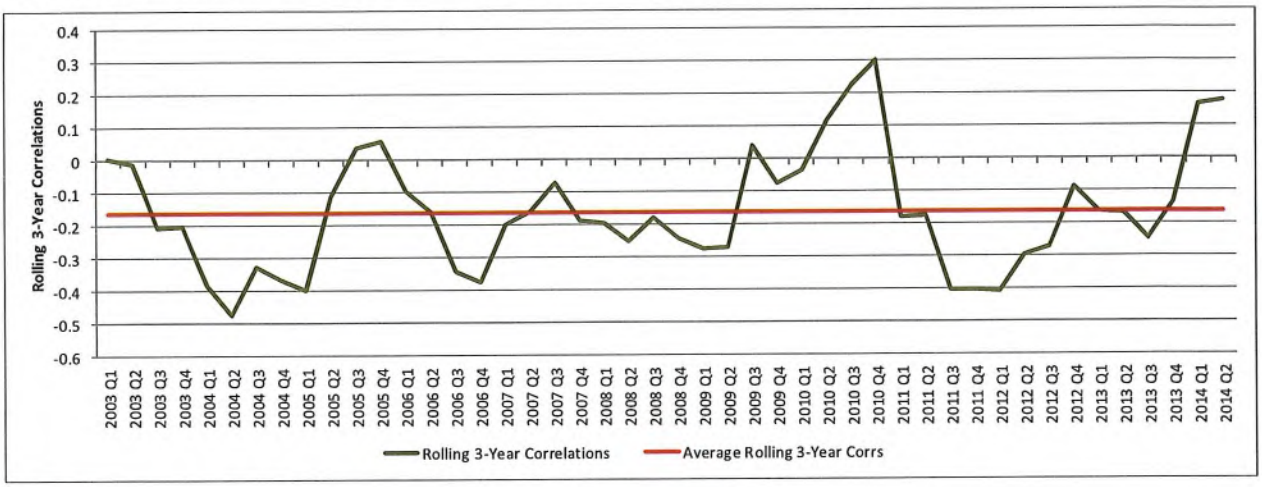


Figure 15

Correlation between IDL Timberland and the Grazing Lease Rate Proxy



E. Capital Market Projections

The projections for all asset classes are consolidated in the following tables. Uncompounded returns are the forecast for any given year. Compound returns are measured over longer time periods (~10 years) and reflect the reduction in return that comes from variations around the average return ("volatility drag"). Risks are measured by standard deviations.

Table 1

Projected Returns and Risks

Asset Classes	Uncompounded Return	Compounded Return	Standard Deviation
Broad US	9.15	7.60	19.02
Global Ex-US	9.80	7.80	21.46
EFIB Bonds	3.06	3.00	3.71
Real Estate	7.35	6.20	16.50
Private Equity	13.55	8.50	33.05
IDL Timberland	6.25	5.70	12.00
IDL Grazing Land	3.50	3.30	6.75
Cash Equivalents	2.00	2.00	0.90
Inflation	2.25	2.25	1.50

Correlations measure the amount of diversification between two asset classes. A correlation of 1 indicates no diversification. A correlation of -1 indicates perfect diversification. Very few investments have correlations much less than zero.

Table 2

Projected Correlations

	Broad US	Global Ex-US	Domestic Fixed	TIPS	EFIB Bonds	Real Estate	Private Equity	IDL Timberland	IDL Grazing Land	Cash Equivalents	Inflation
Broad US	1.00	0.88	-0.11	-0.05	-0.10	0.74	0.94	-0.01	0.36	-0.04	0.00
Global Ex-US	0.88	1.00	-0.12	-0.05	-0.11	0.67	0.93	-0.01	0.32	-0.04	0.00
Domestic Fixed	-0.11	-0.12	1.00	0.58	0.98	-0.02	-0.18	0.02	-0.17	0.10	-0.35
TIPS	-0.05	-0.05	0.58	1.00	0.71	0.01	-0.09	0.02	-0.17	0.07	0.11
EFIB Bonds	-0.10	-0.11	0.98	0.71	1.00	-0.02	-0.17	0.02	-0.18	0.10	-0.28
Real Estate	0.74	0.67	-0.02	0.01	-0.02	1.00	0.72	0.02	0.19	-0.06	0.20
Private Equity	0.94	0.93	-0.18	-0.09	-0.17	0.72	1.00	0.00	0.34	0.00	0.19
IDL Timberland	-0.01	-0.01	0.02	0.02	0.02	0.02	0.00	1.00	-0.20	0.00	0.10
IDL Grazing Land	0.36	0.32	-0.17	-0.17	-0.18	0.19	0.34	-0.20	1.00	0.00	0.00
Cash Equivalents	-0.04	-0.04	0.10	0.07	0.10	-0.06	0.00	0.00	0.00	1.00	0.05
Inflation	0.00	0.00	-0.35	0.11	-0.28	0.20	0.19	0.10	0.00	0.05	1.00

Existing Asset Allocations

As of June 30, 2014, the EFIB had the following asset allocation (percentage allocations don't add to 100% due to rounding):

Table 3

EFIB Asset Allocation (Financial Assets Only)

6/30/2014

Asset Class	Allocation ($ mm)	Allocation (%)
Domestic Equity	820	47
International Equity	267	15
Global Equity	163	9
EFIB Fixed	469	27
Cash	17	1
Total	1,736	100

Given the timberland $1.15 billion LEV and the grazing land $61 million LEV, the total Endowment asset allocation is:

Table 4

Endowment Asset Allocation (Financial and IDL)

6/30/2014

Asset Class	Allocation ($ mm)	Allocation (%)
Domestic Equity	902	30
International Equity	349	12
EFIB Fixed	469	16
IDL Timberland	1,152	39
IDL Grazing Land	61	2
Cash	17	1
Total	2,949	100

Note that in Table 4, the EFIB global equity allocation is split equally between U.S. and non-U.S. equity.

F. Alternative Asset Allocations

Given the asset class forecasts and current allocations, a number of alternative mixes were evaluated. All asset allocation mixes represent the minimum amount of risk for the targeted rate of return. The tables below show unconstrained and constrained mixes using existing asset classes (Tables 5 and 6) and unconstrained and constrained mixes adding diversified real estate and private equity (Tables 7 and 8).

Unconstrained mixes assume that IDL timberland and grazing land can be bought and sold like a public security. We acknowledge that constitutional considerations limit the sales of assets but our objective was to assess the attractiveness of the IDL lands from a purely investment prospective.

The first set of asset allocations shown in Table 5 are unconstrained and use only the existing asset classes.

Table 5

Unconstrained Allocations with Existing Asset Classes

Asset Class	Endow-ment	EFIB	Min	Max	Mix 1	Mix 2	Mix 3	Mix 4	Mix 5
Broad US	30	49	0	100	19	21	23	24	25
Global Ex-US	12	21	0	100	13	14	15	16	17
EFIB Bonds	16	30	0	100	21	17	13	8	3
IDL Timberland	39	0	0	100	43	46	49	52	55
IDL Grazing Land	2	0	0	100	4	2	0	0	0
Cash Equivalents	1	0	0	100	0	0	0	0	0
Totals	100	100			100	100	100	100	100
Uncompounded Return	6.94	7.46			6.50	6.75	7.00	7.25	7.50
10-Year Compounded Return	6.69	6.76			6.34	6.55	6.76	6.97	7.17
Risk (Standard Deviation)	9.28	13.39			8.10	8.69	9.28	9.87	10.47
Public Equity	42	70			32	35	38	40	42
Public Equity % of Public Assets	72	70			60	67	75	83	93
IDL Lands	41	0			47	48	49	52	55
Alternatives	0	0			0	0	0	0	0

Unconstrained optimizations with only existing asset classes contain more timber than the current portfolio. There are also positive allocations to grazing land in more conservative asset mixes although they tend to be small. Mix 3 earns a 10-year compound rate of return equal to the forecast EFIB financial asset portfolio but does so at a lower level of risk (standard deviation) due to the large 49% allocation to timberland. Allocations to public equity as a whole and as a percentage of public assets are reasonably consistent with the existing Endowment allocation.

The second set of asset allocation mixes shown in Table 6 use the existing asset classes but limits allocations to timber land and grazing land to their existing levels recognizing the challenges associated with significantly increasing or decreasing the allocations.

Table 6

Constrained Allocations with Existing Asset Classes

Asset Class	Endow-ment	EFIB	Min	Max	Mix 1	Mix 2	Mix 3	Mix 4	Mix 5
Broad US	30	49	0	100	21	23	25	27	30
Global Ex-US	12	21	0	100	14	15	17	19	20
EFIB Bonds	16	30	0	100	24	21	17	13	9
IDL Timberland	39	0	39	39	39	39	39	39	39
IDL Grazing Land	2	0	2	2	2	2	2	2	2
Cash Equivalents	1	0	0	100	0	0	0	0	0
Totals	100	100			100	100	100	100	100
Uncompounded Return	6.94	7.46			6.50	6.75	7.00	7.25	7.50
10-Year Compounded Return	6.69	6.76			6.33	6.54	6.75	6.94	7.14
Risk (Standard Deviation)	9.28	13.39			8.12	8.75	9.41	10.08	10.77
Public Equity	42	70			35	38	42	46	50
Public Equity % of Public Assets	72	70			59	64	71	78	85
IDL Lands	41	0			41	41	41	41	41
Alternatives	0	0			0	0	0	0	0

Mix 3 looks like the existing overall Endowment allocation as it has 42% in equity and 17% in EFIB bonds. International equity makes up about 40% of total public equity in mix 3 compared with about 30% in the Endowment. The projected 10-year compound return is slightly higher as is the risk. The mix 5 fixed income allocation is reduced to only 9% indicating that a significant amount of diversification is sacrificed to earn a compound return in excess of 7%.

The next set of asset allocations expands the analysis to include diversified U.S. commercial real estate and private equity. Table 7 below shows the resulting mixes when the allocations to timberland and grazing land are unconstrained.

Table 7

Unconstrained Allocations with New Asset Classes

Asset Class	Endow-ment	EFIB	Min	Max	Mix 1	Mix 2	Mix 3	Mix 4	Mix 5
Broad US	30	49	0	100	16	18	19	21	22
Global Ex-US	12	21	0	100	12	13	14	15	16
EFIB Bonds	16	30	0	100	20	16	12	8	2
Real Estate	0	0	0	100	3	3	4	4	4
Private Equity	0	0	0	100	1	1	1	1	1
IDL Timberland	39	0	0	100	43	46	49	51	55
IDL Grazing Land	2	0	0	100	5	3	1	0	0
Cash Equivalents	1	0	0	100	0	0	0	0	0
Totals	100	100			100	100	100	100	100
Uncompounded Return	6.94	7.46			6.50	6.75	7.00	7.25	7.50
10-Year Compounded Return	6.69	6.76			6.34	6.55	6.76	6.97	7.17
Risk (Standard Deviation)	9.28	13.39			8.09	8.68	9.27	9.86	10.46
Public Equity	42	70			28	31	33	36	38
Public Equity % of Public Assets	72	70			58	66	73	82	95
IDL Lands	41	0			48	49	50	51	55
Alternatives	0	0			4	4	5	5	5

In the unconstrained scenario, allocations to the IDL asset classes and fixed income are very similar to those without the new asset classes. This indicates that real estate and private equity are sourced primarily from public equity. The allocations to real estate and private equity are less than 5%, a level that is often considered the minimum threshold allocation for having a meaningful impact on portfolio returns. Note that in mix 3, IDL timberland is at a similar level to mix 3 with existing asset classes only.

The final set of mixes evaluates the impact of adding real estate and private equity when the IDL asset classes are constrained to their current allocations. Table 8 now shows that the lowest allocation to real estate is 4% in mix 1 while it is 5% or more in mixes 2 through 5. The largest private equity allocation is only 3% across all mixes.

Table 8

Constrained Allocations with New Asset Classes

Asset Class	Endow-ment	EFIB	Min	Max	Mix 1	Mix 2	Mix 3	Mix 4	Mix 5
Broad US	30	49	0	100	17	19	21	22	23
Global Ex-US	12	21	0	100	13	14	15	17	18
EFIB Bonds	16	30	0	100	24	20	16	13	9
Real Estate	0	0	0	100	4	4	5	5	6
Private Equity	0	0	0	100	1	2	2	2	3
IDL Timberland	39	0	39	39	39	39	39	39	39
IDL Grazing Land	2	0	2	2	2	2	2	2	2
Cash Equivalents	1	0	0	100	0	0	0	0	0
Totals	100	100			100	100	100	100	100
Uncompounded Return	6.94	7.46			6.50	6.75	7.00	7.25	7.50
10-Year Compounded Return	6.69	6.76			6.34	6.55	6.75	6.95	7.14
Risk (Standard Deviation)	9.28	13.39			8.11	8.74	9.39	10.06	10.75
Public Equity	42	70			30	33	36	39	41
Public Equity % of Public Assets	72	70			56	62	69	75	82
IDL Lands	41	0			41	41	41	41	41
Alternatives	0	0			5	6	7	7	9

G. Summary of the Analysis and Recommended Actions

The results of the asset allocation study rely on the forecast of expected returns, risks and correlations of the underlying asset classes. For the IDL assets, the historical cash flow generated can be easily observed, the performance and therefore the attractiveness of these investments depend on the valuation of the underlying land. Given the large volume of land and the constitutional considerations involved in liquidating these lands, valuations were based on their current uses and therefore reflect the current and forecast cash flows.

The total values for timberland and grazing lands were determined by discounting their future cash flows. The modeled cash flows are consistent with historical values and reasonable assumptions for future values. The rates used to discount the future cash flows are consistent with institutional rates of return or applicable financing rates. The projected rates of return reflect the cash flows, discount rates and their associated land values.

Given the illiquid nature of timberland and grazing land, proxies were necessary to estimate the risks of these asset classes as well as the diversification they provide. These proxies are consistent with the underlying revenues and costs associated with the lands. While the forecast volatility would be generally higher than that observed in practice, it is reflective of the risk of loss associated with these investments.

The low correlations exhibited by the liquid proxies are consistent with the realized correlations for the associated illiquid investments.

In all asset mixes IDL timberland has an allocation at least as large as its existing allocation. Consequently, we would not recommend reducing the overall timber portfolio. Unconstrained, allocations to timberland are higher suggesting the allocation could be expanded. It is important to recognize that this is only the case if new investments are expected to perform at least as well as the existing timberland. Expanding timberland for the sole purpose of meeting an unconstrained allocation is not recommended.

The case for grazing land is more ambiguous. In the unconstrained allocations (both with and without new asset classes), there are positive allocations to grazing land similar in magnitude to the existing allocation in the more conservative (lower return, lower risk) mixes but not the more aggressive (higher return, higher risk) mixes. Although the grazing land return is expected to compensate for its risk, more aggressive asset mixes require larger allocations to higher returning asset classes which are better diversified by publicly-traded fixed income (EFIB Bonds).

The absence of grazing lands in more aggressive allocations is based on the existing leasing formula. If leasing arrangements can be made more favorable to the Endowment, the attractiveness of grazing lands may increase to the point that there would be positive allocations in more aggressive mixes and larger allocations in more conservative mixes. Employing grazing land in a "higher and better use" is not evaluated here but could also improve returns although potentially at the expense of more risk.

We do not recommend selling grazing land at a discount for the sole purpose of realigning the target and actual asset allocations. Grazing land is only unattractive in more aggressive mixes because it has a relatively low return. In terms of a standalone investment, grazing land is forecast to provide a return consistent with the level of risk taken.

The illiquidity of much of the land assets may require that the target asset mix evolve over time. Possible reasons for the evolution of the target are changes in the land allocation due to potential land sales in the absence of other attractive land investments or the appreciation of the financial assets at a faster or slower rate than the appreciation of the land assets.

Since the asset mix is independent of endowment size, there is no reason for smaller endowments to implement different asset mixes due to their sizes.

In the process of creating alternative asset allocations we have only considered asset classes that would be suitable for institutional investors. In the course of this analysis, we have not evaluated Idaho-specific investments in commercial real estate or agricultural land. It is our general belief that the expanded opportunity set (a greater number of potential investments to choose from) and diversification possibilities (more types of investments) available on a national or international level is consistent with prudence, cost-effectiveness and the scale required to have a meaningful impact on the portfolio return. There may, however, be exceptions worthy of review on a case-by-case basis consistent with proper institutional investment governance.

VI. Idaho Commercial Real Estate Portfolio

Callan has been asked to specifically address the role of Idaho Commercial Real Estate in the portfolio. Most of the stakeholders with whom we spoke were hesitant, for a variety of reasons, to grow the current Idaho commercial property portfolio unless there was a compelling investment reason to do so. In Callan's opinion, there is not. The asset allocation work suggests an allocation to a broadly diversified portfolio of U.S. real estate could, at best, play only a modest role in improving the diversification of the portfolio and there is no investment reason for an allocation to consist primarily of a concentrated position in Idaho properties. Further, Callan does not recommend ownership of single properties for the endowment. Callan believes at least two conditions must be met before single property ownership is considered: (1) there must be a real estate allocation of at least $500 million which is the baseline to assemble a diversified US portfolio and (2) there must be qualified resources (typically a combination of staff and an external manager(s)) to analyze and manage the properties. Neither of these conditions is satisfied in the case of the current real estate portfolio.

Currently, decision-making and oversight is not in place for the ongoing management, analysis, or prudent divestiture of the existing Idaho commercial portfolio. This report details recommendations designed to put in place a framework for these decisions to be made, including the hiring of a specialist real estate manager/consultant, reporting to the board, to provide the analysis and management expertise on the retention, disposition and management of commercial properties.

The decision-making and management framework to properly oversee the current commercial portfolio will also prove useful as a model for the evaluation and management of other non-routine investment decisions. For example, consideration of whether to execute a ground lease with a tenant on a vacant parcel of land or purchasing more timberland or farmland. These types of decisions could be analyzed as follows:

- Is the investment consistent with the overall asset allocation and objectives of the total portfolio as set forth in the Investment Policy Statement and in the Strategic and Annual Plans?
- Does it make a difference and move the needle from an overall portfolio perspective?
- Completion of a full underwriting of the potential investment including upside, base case, and downside scenarios with identification of assumptions and risks alongside of the returns (both the return gross of fees and net of all fees and costs).
- Detailed outline of the business plan for the investment and the plan for execution including consideration of the internal and external resources required to execute the plan and associated costs.
- Comparison of the risk adjusted return and the net return relative to other choices (e.g. stocks, bonds, other land types). In other words, what are the other choices for investment?

OVERVIEW OF LAND BOARD ENDOWMENT REFORM

Prepared by

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1. In 1996, Governor Batt appointed the "Governor's Committee on Endowment Fund Investment Reform." *Memorandum from Governor Batt to Land Board Members* dated September 24, 1996. The genesis for the formation of the Committee was a discussion among the Land Board members at its July 29, 1996 meeting regarding the underperformance of the cottage site leasing program. *Minutes of the July 29, 1996 Land Board Meeting* at 6. Governor Batt stated, in his memorandum, that the purpose of the Committee was to:

> [I]nvestigate methods of improving the Board of Land Commissioners (sic) ability to manage the state's asset base for an appropriate return to the endowment fund. In addition, the Governor's Committee will examine the investment policy of the Endowment Fund Board to see if higher rates of return can be achieved. This will include an investigation into the overall management of all endowment assets to provide an appropriate return in light of the objectives of the fund.

Memorandum at 2. Governor Batt also identified the premise for the formation of the committee.

> The Board of Land Commissioners must have a long term strategic plan to manage the state's asset base, while at the same time provide the highest rates of return to the state endowment fund. The ability of the Board of Land Commissioners to diversify the state's base needs to be streamlined. At the same time, the Endowment Fund Board needs to adopt a method of investment that will allow for an increase in the amount of money generated by the fund, if appropriate. Both government boards need to coordinate their efforts toward this end.

Id. Finally, the Governor directed that the Committee "consist of individuals who are familiar with investment options, the state endowment fund, and the economics of long term investments for continued rates of return." *Id*.

2. ***1996 Report and Recommendations of the Governor's Committee on Endowment Fund Investment Reform***.

a. The Committee members were: Douglas Dorn, private investment consultant; Representative William Deal; Robert L. Montgomery, Chairman of the Endowment Fund; Dr. Thomas Stitzel, Professor of Economics at Boise State University; and Robert Maynard, Chief Investment Officer for PERSI. Ex officio members of the Committee were: State Controller J.D. Williams; Department of Financial Management Administrator Michael Brassey; Deputy Attorney General Clive Strong; and State Economist Michael Ferguson. Douglas Dorn chaired the Committee.

b. The Committee's report concluded that: "The entire integrated endowment needs to have its rules of overall operation clarified, reorganized, and reoriented towards providing a predictable and increasing stream of revenue to the beneficiaries while at least maintaining the purchasing power of the assets of the endowment." *1996 Report* at 2.

c. The Committee report contains the following recommendations:

1. "The currently separate parts of the endowment – the land trust and the financial trust – should be organized, invested, administered, and managed as a whole."

   A. "A governing body must be created or identified to oversee all of the assets of the endowment, set its goals, and monitor its progress in achieving those goals."

   B. "The trust should be invested and administered as a whole, with the rules for distributing annual cash flows altered to treat the endowment as a unit and (1) to provide a means for stabilizing cash flows by reserving excess cash flow in good years and supplementing distributions in poor years; and (2) to provide a mechanism for expressly addressing the division of benefits between present and future generations."

2. "The [Endowment Fund Board's] investment authority and policies should be changed to eliminate the artificial restrictions which have led both to underperformance and to a portfolio structure that exposes the endowment to unnecessary risk."

3. "The endowment managers must develop a formal reporting mechanism designed to identify underperforming assets, develop

plans either to improve the returns from those assets or to dispose of those assets, and develop a means for implementing those plans." *1996 Report* at 3-8.

d. The *Report* observed that the endowment structure and practices in 1996 reflected "momentum from the past rather than a focus on the present." *Id.* at 21. The land portfolio was the product of chance rather than selection for optimum return for the endowment beneficiaries. When the federal land grants were made in the 19th century there was a general belief that land ownership was the safe way of preserving wealth. The notion that inflation would become a central concern of investment policy and that preservation of purchasing power would become intimately tied to the concept of preservation of principal, were notions that did not exist at the time of the creation of the trust. Moreover, the idea that land ownership, with its illiquidity and development risk, could become a riskier form of preserving long-term wealth was not foreseen.

e. The *1996 Report* concluded that times have changed radically since the 19th century and the objective of the initial endowment reform committee was to respond to this change. There was recognition of the need to examine the land endowment and to ensure these assets were managed in a way that maximized the long-term return to the endowment. *Id.* at 21-24.

f. The Committee identified the purpose of the endowment as "the long-term preservation of the purchasing power of the assets while providing a steady stream of increasing income to the public schools and other beneficiaries." *Id.* at 21.

g. One of the key recommendations of the Endowment Fund Investment Reform Committee was for the Land Board to develop procedures and reports for identifying, monitoring, and addressing the performance of the assets of the Trust. *Id.* at 56.

3. ***1998 Constitutional and Statutory Amendments Enacted to Implement the Recommendations of the 1996 Governor's Committee on Endowment Fund Reform.***

a. In 1997, the Idaho Legislature authorized the Legislative Council to appoint "a Committee to study the report and recommendations of the Governor's Endowment Fund Investment Reform Committee" and "in conjunction with the State Board of Land Commissioners and the Idaho Endowment Fund Investment Board [to] submit recommendations and proposed legislation, if any, for endowment investment reform as deemed appropriate to the Second Regular Session of the Fifty-fourth Idaho Legislature." H.C.R. 21, 1997 Idaho Sess. Laws at 1340.

b. The Legislative Endowment Fund Investment Reform Committee recommended and secured passage of the following legislation:

1. Chapter 256, 1998 Idaho Sess. Laws established endowment and earnings reserve funds for each of the endowments, placed the Endowment Fund Board under the direction of the Land Board, provided that the Endowment Fund Board's investments were governed by the provisions of the uniform investor act, and created the land bank.

2. H.J.R. 6 proposed to amend Article IX, § 4 of the Idaho Constitution to allow the deposit of proceeds from the sale of public school lands into a land bank fund, and to amend Article IX, § 8 to change the word "disposal" to "sale" to clarify that leases are not subject to disposal at public auction. *Legislative Council Statement of Meaning and Purpose HJR6.* The Idaho Supreme Court barred implementation of the ballot measure, however, on the grounds that the amendment violated the constitutional requirement that an amendment be limited to a single subject. *Idaho Watersheds Project v. State Board of Land Commissioners*, 133 Idaho 64, 982 P.2d 367 (1999). Article IX, § 4 was subsequently amended to provide for the land bank by ratification of H.J.R. 1 at the 2000 general election. 2000 Idaho Sess. L. 1669.

3. H.J.R. 8, as ratified at the 1998 general election, amended Article IX, § 3: 1) to change the name of the "Public School Fund" to the "Public School Permanent Endowment Fund"; 2) to allow earnings to be deposited into the Public School Earnings Reserve Fund; 3) to provide that no part of the Public School Permanent Endowment Fund principal shall ever be transferred, used or appropriated to any other fund; 4) to provide for legislative appropriation from the earnings reserve fund for administrative costs incurred in managing the assets of the public school endowment. H.J.R. 8 also amended Article IX, § 11 to allow the permanent fund to be invested in financial instruments that a private trustee is authorized to invest in pursuant to state law.

4. H.J.M. 9 requested that Congress amend Section 5 of the Idaho Admissions Bill to allow the deposit of proceeds from the sale of school endowment lands in a land bank fund, to allow for deposit of school funds in an earnings reserve fund, and to allow for the leasing of the school endowment lands under such laws as prescribed by the legislature, provided any such lease secures the maximum long-term financial return to the endowment. On October 27, 1998, Congress amended Section 5 of the Idaho

Admissions Bill in accordance with the H.J.M. 9. P.L. 105-296, 112 Stat. 2822.

4. ***1999 Recommendations on Endowment Trust Reform Implementation.***

a. The *1999 Recommendations* were a follow-up to the *1996 Report and Recommendations of the Governor's Committee on Endowment Fund Investment Reform*, prepared by Robert M. Maynard, Chief Investment Officer for PERSI, and Douglas Dorn, private investment consultant.

b. The *1999 Recommendations* suggested that the Land Board should do the following:

1. Establish a distribution and spending policy for the endowments;

2. Set forth its investment policies for the investment and use of the assets and income from the trust;

3. Develop procedures and reports for identifying, monitoring, and addressing the performance of the assets of the trust; and

4. Overhaul the management of and rules for operation of the endowment as a whole, including implementing a risk management system for all of the assets of the trust.

Recommendations at 1.

c. The proposed process included a recommendation to establish target rates of return for each asset and a process for identifying and addressing underperforming assets. *Background Paper for Recommendations on Endowment Trust Reform Implementation* at 28-32.

d. The *Background Paper* stated that: "The most important investment principle is that a portfolio must be designed to generate returns that will meet its liabilities with the appropriate amount of risk. One general misconception is that an investment program should be designed solely to capture the highest returns. While returns are important, all attempts to generate higher returns will also include more risk." *Id.* at 16-17.

e. The *Background Paper* concluded that "in judging the efficiency or characteristics of investments in a portfolio, one needs to look at the combined impact of all of the investments, and not the investments on an individual basis. Further, it is total portfolio volatility and return, and not

individual asset investment risk or performance, that is central, and diversification among a number of asset types is beneficial." *Id.* at 22.

5. ***2001 Report and Recommendations of the Governor's Citizen Ad Hoc Evaluation Committee on Lands/Endowment.***

a. Governor Kempthorne created the Governor's Citizen Ad Hoc Evaluation Committee on Lands/Endowment. The membership of the 2001 Committee included the following individuals: Don Curtis, retired HP executive; Gary Christensen, private developer; John Cowden, retired Boise Cascade executive; Jerry Evans, retired Superintendent of Public Instruction; Mike Everett, Deputy Director of the Idaho Department of Agriculture; Bob Maynard, Chief Investment Officer PERSI; and Senator Marguerite McLaughlin. Don Curtis chaired the committee.

b. The purpose of the Citizen's Ad Hoc Evaluation Committee Lands/Endowment was to "recommend efficiency/effectiveness changes to the Land Board regarding Department of Lands, Endowment Funds Investment, Land Board and their interrelationships and management practices." *2001 Report*, Appendix B.

c. The Committee made the following recommendations:

1. The Land Board should adopt a formal Land Trust Investment Policy that includes, among other standard items, the following three areas: statement of investment objectives; annual investment plan; and commercial real estate policies.

2. Implement a standard/common 3-page reporting format for review of lands/funds investments and performance.

3. At Land Board level, Department of Lands level, and all levels below, establish a clear paradigm shift toward "Endowment Investment." These two words must color all future analysis, decisions, and actions.

4. Establish an "Endowment Real Estate Asset Manager" position within the Department of Lands.

5. Implement organization changes to improve Land Board operational effectiveness.

d. Appendix C to the *2001 Report* set forth a "Statement of Investment Policy for Endowment Lands." The investment objective as stated in the policy is to manage trust lands "to secure maximum long-term financial returns to the endowment without causing significant long-term adverse

impacts to the land or related resources." *2001 Report*, Appendix C at 4. The performance objective is to exceed "a minimum target real rate of return of 6.0%" and to exceed the "relevant National Council of Real Estate Investment Fiduciaries Index . . ., if available, while maintaining an appropriate level of risk." *Id.*

6. ***2005 Endowment Fund Reform Review Task Force***

a. On August 9, 2005, the Land Board requested that Governor Kempthorne appoint a task force to "review the implementation of the endowment reform and to provide the Land Board and the Endowment Fund Investment Board with their findings and recommendations." *Minutes of the August 9, 2005 Land Board Meeting* at 2-3.

b. Governor Kempthorne appointed the following members of the Task Force: Larry Johnson Manager of Investments, Endowment Fund Investment Board; Representative William Deal; Representative Darrell Bolz; Deputy Attorney General Clive Strong, Kathy Opp, Division Administrator for Support Services for the Department of Lands; Chuck Goodenough, Secretary of State's Office; Larry Schlicht, Department of Financial Management, and Steve Allison, Controller's Office. Ex officio members of the Committee were: Legislative Budget Analyst Ray Houston; Deputy Attorney General Kent Nelson; and Deputy Attorney General Julie Weaver. The Task Force was chaired by Larry Johnson.

c. This Task Force never issued an official report; however, it assisted with the drafting and passage of technical amendments to Idaho Code §§ 57-724 and 57-724A during the 2006 Legislative session. The Task Force also examined the objectives and structure of the distribution policy for the endowments, which served as a basis for an expanded policy adopted by the Idaho Land Board in July, 2008.

7. **2007 State Trust Lands Asset Management Plan.**

a. The Land Board adopted a trust lands asset management plan to ensure the long-term preservation of the purchasing power of the assets as a whole while providing a steady stream of increasing income to the endowment beneficiaries. *Minutes of December 20, 2007, Land Board Meeting* at 6. A section on management of financial assets of the endowments was added in July, 2008. *Minutes of the July 2008 Land Board Meeting* at 5. The Asset Management Plan was updated in December 2011.

b. On February 18, 2014, the Idaho Board of Land Commissioners voted to "1) suspend the portions of the Asset Management Plan related to property acquisitions, including commercial property; and 2) continue to consider property acquisitions for the purposes of obtaining access for currently

owned endowment lands, and blocking up of ownership of endowment lands. *Minutes of the February 2014 Land Board Meeting* **at 5.**

c. As part of the implementation of the Asset Management Plan, the Department of Lands developed asset business plans for the timber and grazing programs. The business plans include:

1. Describe the current and future influences on plan implementation and asset performance;

2. Set forth an acceptable range of return for each asset classification;

3. Define appropriate valuation methods by asset classification; and

4. Detail opportunities and challenges the asset faces and specify plans for capitalizing on opportunities and dealing with challenges.

8. **2009 Report and Recommendations for the State Board of Land Commissioners.**

a. The Idaho Land Board directed the Department of Lands "to formulate an *Endowment Land Transaction Advisory Committee* ("ELTAC") for the express purpose of reviewing constitutional and the Admissions Act language for consistency with modern business practices." *Minutes of March 17, 2009, Land Board Meeting* at 4.

b. The members of ELTAC were: Bryant Forrester, Homeland Realty; Kurt R. Gustavel, President, Idaho Independent Bank; Jack Harty, President, Harty Capital; George Kirk, The Kirk Group; Al Marino, Partner, Thorton-Oliver-Keller; Robert Phillips, President, Hawkins Companies; and Robert Follett, Deputy Attorney General.

c. The Committee was to conduct "an impartial review of the Idaho State Constitution and the Admission Act to identify any impediments to conducting real estate transactions in the 21st century." *2009 Report* at 4.

d. The Committee recommended changes to Article IX, § 8 that would allow endowment lands "to be managed and disposed of in any reasonable manner to secure the maximum long term financial return." *2009 Report* at 11. The Report also recommended that the 320 acre constitutional limitation on the sale of state lands to an individual be removed. *2009 Report* at 14. A conforming change was also recommended to Article IX, § 10. *2009 Report* at 15. No action was taken on these proposed changes.

9. 2010 S.J.R. 102

a. S.J.R. 102 sought to amend Article IX, § 8 of the Idaho Constitution to remove the restriction on disposal of endowment lands at public auction and to allow disposal "through such other means a prudent investor would use while considering the purposes and terms of the trust and while exercising reasonable care, skill and caution." The amendment also would have removed the three hundred and twenty acre lifetime limitation on the sale of endowment lands "to any one individual, company or corporation."

b. S.J.R. 102 sought to implement some of the recommendations of ELTAC. S.J.R. 102 passed the Senate was killed in the House.

10. 2011 Idaho Legislature Natural Resources Interim Committee

a. The Natural Resources Interim Committee conducted a two day hearing for the purpose of reviewing endowment reform.

b. The hearing was held, in part, to address growing Legislative concerns regarding the Board of Land Commissioners' investment in "commercial property."

11. 2014 Endowment Fund Reform Progress Report

a. The Idaho Board of Land Commissioners asked Robert Maynard to conduct a review of endowment reform.

b. At the December 2013 Land Board meeting, Robert Maynard delivered his Endowment Fund Reform Progress Report. The Report concluded that while much progress had been made on endowment reform some steps still remain. "The next major step is to introduce more of the 'prudent expert rule' mode of thinking and decision making when the Land Board considers Idaho Department of Land (IDL) issues that have substantial investment components. This would essentially require "Trust, but Verify type of procedures when considering issues such as land exchanges, disposition of Land Bank assets, and commercial property transactions." Recommendations were:

1. Independent verification of land investment decisions. *Id.* at 9;

2. Consolidated trust asset report "reviewed and (if needed) produced by a consultant or other independent investment organization", *Id.* at 10;

3. Involve EFIB "in any recommendation for the use of Land Bank proceeds for potential acquisitions, either as a major actor in

making recommendations, or as a formal commentator on any plan to use that money. . . ." *Id.* at 12; and

4. "Develop an independent valuation of the 'real' assets of the Land Trust according to institutional investment standards on at least and annual basis and include those valuations and performance in a performance report on the entire Land Trust." *Id.* at 13.

12. 2013 Land Board Subcommittee on Endowment Investment Governance Strategy

a. The Idaho Board of Land Commissioners established a subcommittee comprised of Secretary of State Ben Ysursa, Controller Brandon Woolf, EFIB Manager Larry Johnson, EFIB Member Thomas Kealey, Director Tom Schultz and Deputy Attorney General Clive Strong. The purpose of the subcommittee was "to review investment decisions and recommend to the full Land Board a governance structure for those decisions that warrant outside expert review, consistent with the prudent expert approach. *Minutes of December 17, 2013, Land Board Meeting* at 4.

b. The Board of Land Commissioners adopted the Subcommittee's recommendation that the Board "1) suspend the portions of the Asset Management Plan and the Mid-term Strategy related to property acquisitions, including commercial property; and 2) continue to consider property acquisitions for the purposes of obtaining access for currently owned endowment lands, and blocking up of ownership of endowment lands." *Minutes of February 18, 2014, Land Board Meeting* at 5.

c. The Board of Land Commissioners accepted the Subcommittee's recommendation that the $12.5 million in the Land Bank be transferred to the respective Permanent Funds and to revisit the Land Bank fund policy in December 2014. *Minutes of August 14, 2014, Land Board Meeting* at 6. At the December 2014 Land Board meeting the Board adopted the Subcommittee recommendation that all but $5 million in Land Bank be transferred to the appropriate Permanent Endowment Funds. *Minutes of December 15, 2014, Land Board* at 5.

d. The Land Board adopted the following governance recommendations of the Subcommittee:

1. With regard to Timber Sale Contracts

A) The Land Board approves the annual timber sale plan and delegates authority to the Director to approve individual timber sales that fall within established Land Board

policies. Direct timber sales and salvage sales of less than 1 MMBF do not require Land Board approval.

B) The Land Board approves only those individual sales that fall outside of established Land Board policies such as: A) sales with clear cut harvest units over 100 acres; B) sales with development credits that exceed 50% of net appraised sale value (33% of the gross); or C) sales where there are written citizen concerns.

C) A table is added to the Director's Monthly Timber Sale Activity Report showing the proposed sales for the next month.

2. With regard to Routine Land Investment Decisions

A) Transactions <$500,000 the IDL Director may authorize;

B) Transactions >$500,000 require Land Board approval; and

C) An audit of IDL procedures shall be conducted every 3-5 years.

3. With regard to Other Land Investment Decisions

A) Transactions >$100,000 require Land Board approval and may require review by the Land Board's Land Investment Advisor at the Board's discretion;

B) 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

C) Transactions <$100,000 the IDL Director may authorize; however, those that are complex or controversial may be vetted by the Land Investment Advisor.

4. The outlined governance structure superseded all previous policy, operations memorandum and procedures that pertain to these governance issues. The governance recommendations are to be reviewed by the Board at its December 2015 meeting. *Minutes of the December 15, 2014, Land Board Meeting* at 5 – 6.

e. The Subcommittee was dissolved on December 15, 2014. *Id.* at 6.

13. 2014 Idaho Legislative Endowment Asset Issues Interim Committee

a. H.C.R. 58 created an interim committee "to undertake and complete a study of endowment asset issues of importance to the State of Idaho."

b. Issues of concern included "the structure and makeup of the Idaho Board of Land Commissioners, the endowment land exchange process, endowment land conflict auctions and other auctions, lakeside cottage sites, the management, operation, exchange, lease and other disposal of endowment assets, the preservation and performance of endowment assets, increasing returns to the endowment beneficiaries, improving transparency with respect to endowment assets and actions taken with respect to assets."

c. The Interim Committee endorsed the Callan Report. *November 14, 2014 Minutes of Endowment Asset Issues Interim Committee* at 8.

14. 2014 Callan Asset Allocation and Governance Review Report

a. Board of Land Commissioners directed EFIB to recommend consultants "to perform a comprehensive strategy review of endowment assets, policies, procedures and studies." *Minutes of December 17, 2013, Land Board Meeting* at 4. Draft RFP was approved by the Board of Land Commissioners on March 18, 2014. *Minutes of March 18, 2014, Land Board Meeting* at 4 - 6.

b. "Callan was retained by the Idaho Board of Land Commissioners (Land Board) in May 2014 to review the findings and recommendations of the Subcommittee on Endowment Governance and identify shortcomings and make recommendations for improvement; review the internal policies and procedures of the Idaho Department of Lands (IDL) regarding valuation and forecasting methodologies; and conduct and asset allocation study incorporating the IDL-managed land assets with the financial assets overseen by the Endowment Fund Investment Board (EFIB)." *Id.* at 1; *Minutes of May 22, 2014, Land Board Meeting* at 5.

c. The Board of Land Commissioners accepted the Callan final report in November 2014. *Minutes of November 18, 2014, Land Board Meeting* at 4.

d. Governance Recommendations:

1. "A comprehensive Investment Policy Statement should be developed for the combined Trust that identifies the investment objectives, risk management processes, risk tolerance (including connecting the risk taken in the asset allocation with that expressed in the distribution policy), the adopted asset allocation and

rebalancing ranges, decision-making and the roles of each party involved in the investment process, how performance will be monitored and measured for each asset type, and the establishment of appropriate metrics and peer groups where relevant for both the land and financial assets." *Id.*

2. "The role of the Land Board should be one of strategic planning and policy setting. To fulfill its duty as a fiduciary, the Board should retain outside expertise to assist in the setting of policy and strategy as well as provide review of transactions." *Id.*

3. "IDL's operational recommendations and procedures should be reviewed and verified by an independent expert, who reports to the Land Board and not IDL." *Id.* at 2. And, an independent financial audit of the financial assets should be performed on the land asset portfolio. *Id.*

4. "Policies should be reviewed to ensure they clearly document the process by which investment decisions are made and be codified in an Investment Policy Statement." *Id.*

5. A process should be instituted "to fairly measure IDL progress towards the achievement of goals and objectives established by the Land Board. After further clarifying the role of Idaho commercial real estate in the portfolio, a revised and approved strategic plan should clearly describe appropriate measurement methodologies and reasonable performance objectives by asset class." *Id.*

e. Callan made the following recommends on asset management:

1. Improve revenue forecasting for all asset types, except forestland and residential cabin sites. *Id.* at 3.

2. "The current practice of having a complete mass land appraisal using a sales comparable approach for forestland, rangeland, and agriculture should be discontinued. The valuation method does not provide an independent valuation of the entire asset (e.g. land resource growing on the land) nor does it contain information that could be used by the IDL for performance measurement, or to improve its management or valuation practices, and it does not consider the particular constraints on the sale of land. It is also inconsistent with best practices." *Id.*

3. A summary financial asset report similar to that currently produced for the Endowment Fund Investment Board should be developed for the land assets. *Id.* at 4.

f. Callan conducted an asset allocation study for the endowment portfolio as a whole that contained the following conclusions:

1. "The current total endowment allocation is reasonably efficient."

2. "Timberland is a desirable investment across the range of asset mixes reviewed."

3. While grazing land "provides reasonable compensation for its risk and diversifies bonds well", "potential sales or exchanges should be prioritized according to their expected contributions to returns with transactions executed as limitations permit."

4. Investment in U.S. diversified, institutional real estate is "modestly attractive and private equity to be only marginally attractive."

5. "The combination of Idaho timberland and grazing land with the EFIB investments at their current levels has a similar expected return but a volatility that is anticipated to be materially lower than that of the existing allocation containing financial assets alone."

6. Direct investment in commercial property was not recommended. *Id.* at 4-5.

g. The Board of Land Commissioners adopted the following policies at its December 2014 meeting:

1. The Department was directed to discontinue the practice of having an appraiser complete mass land appraisals on timberland, rangeland and agricultural land.

2. The Department was directed to utilize the land expectation value (LEV) method approach for the valuation of timberland and rangeland.

3. Staff was directed to develop a draft Investment Policy Statement and to revise the Asset Management Plan "with the following general concepts driving the long term strategy: A) discontinue the policy of acquiring Idaho commercial buildings; B) manage or dispose of existing Idaho commercial property in a prudent manner consistent with the recommendation from the Commercial Real Estate Investment Advisor; C) manage or dispose of lowest return grazing land as opportunities arise consistent with the recommendations from the Land Investment Advisor; and D) increase timber investment (or other land investments with similar risk and return ratios) as attractive opportunities emerge with meet

or exceed predicted statewide average return. *Minutes of December 15, 2014, Land Board Meeting* at 7.

f. The Board of Land Commissioners directed implementation of the Callan recommendations with a timeline for adoption of the Investment Policy and the revision of the Asset Management Plan by mid-November 2015. *Id.* at 8.

15. Investment Subcommittee

a. The Board of Land Commissioners established an Investment Subcommittee at its December 15, 2014 meeting. The members of the subcommittee are one EFIB Board Member, the EFIB Manager, and the Director of the Idaho Department of Lands. *Minutes of December 15, 2014, Land Board Meeting* at 6.

b. The purpose of the subcommittee is to:

1. Administer the contract for the General Consultant;

2. Work with the General Consultant to identify the Land Board's Land Investment Advisor and the Land Board's Commercial Real Estate Investment Advisor and to administer the associated consulting contracts;

3. Work with the General Consultant to vet the Investment Policy Statement and Asset Management Plan and make recommendations to the Land Board with regard to those documents; and

4. Coordinate consideration of investment issues that cross both the endowment fund and endowment lands. *Id.*

c. The Subcommittee is directed to develop a draft policy regarding implementation of land exchanges on endowment lands. *Id.*

d. The Subcommittee is directed "to develop a draft policy (consistent with Idaho Code Section 58-1333) regarding proceeds from the disposal of assets (e.g. cabin sites, commercial real estate, grazing land) utilizing the Land Bank Fund to hold a portion of the proceeds to be used for land acquisition (excluding commercial buildings), and to purchase access to currently owned endowment lands and to block up ownership of endowment lands." *Id.*

16. Land Board Audit Committee

a. The Board of Land Commissioners created a five-member committee to review and advise on EFIB and IDL joint audit results.

b. The Audit Committee is comprised of three EFIB board members, the State Controller or designee and the Attorney General or designee. *Id.* at 7.

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
May 17, 2016

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, May 17, 2016, in the State Capitol, Lincoln Auditorium, Lower Level, West Wing, 700 W Jefferson St., Boise, Idaho. The meeting began at 9:02 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Lawerence 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 – May 2016

B. Timber Sale Activity and Information Report – April 2016

C. Division of Lands and Waterways Activity and Information Report – April 2016

D. Cottage Site Auctions Update
DISCUSSION: Controller Woolf asked if any unleased lots will be included in the June (Priest Lake) and August (Payette Lake) auctions. Director Schultz replied that one unleased lot at Payette Lake has been nominated and there may be several as well. Governor Otter asked for clarification of the $26,000,000 estimated revenue for the upcoming auctions; that is the total of the appraised values. Director Schultz said that is correct and added that if there is competitive bidding, the total may be above that. Governor Otter stated the Department may not accept less than the appraised value for a lot; Director Schultz affirmed that statement.

2. **Endowment Fund Investment Board Manager's Report** – *Presented by Dean Buffington, EFIB Chairman, and Larry Johnson, EFIB Manager of Investments*

DISCUSSION: Chairman Buffington stated that today is one of two regularly scheduled meetings of the Investment Board with the Land Board. Chairman Buffington introduced Investment Board members in attendance: Representative Neil Anderson, Warren Bakes, Tom Kealey, Gary Mahn, Sue Simmons, Richelle Sugiyama, and Senator Chuck Winder. Gavin Gee was not able to join due to other business needs. Chairman Buffington then introduced Larry Johnson. Attorney General Wasden expressed his appreciation to Chairman Buffington and all the Investment Board members for their dedicated service to the state of Idaho. Attorney General Wasden wanted to acknowledge the level of expertise the Investment Board brings to managing the Endowment Fund.

A. Manager's Report
DISCUSSION: Mr. Johnson first introduced representatives from Callan Associates: Janet Becker-Wold, Gene Podkaminer and Bill Howard. Other representatives present were John Harloe and Melodie Hunt from Barrow Hanley; and Ryan Hulbert with Clearwater Advisors. EFIB staff was all in attendance as well: Chris Halvorson, Michelle Watts and Judy Shock.

Mr. Johnson reported that Endowment Fund reserves are good; the Fund has had modestly weak returns but land revenues have been adequate. Mr. Johnson stated there are no issues to report.

B. Investment Report
DISCUSSION: Mr. Johnson remarked that the Fund in April was up almost 1%, primarily because of a rising stock market both offshore and domestically, making the fiscal year-to-date return -1.1%. Through the month of May the Fund has lost about 60 basis points, and year-to-date through yesterday now stands at -1.7%.

C. Semi-Annual Report
DISCUSSION: Mr. Johnson stated that the Endowment Fund is at approximately $1.8 billion, the largest of the funds that EFIB manages. The Fund balance compared to end of June last year is down about 3% due to generally weak equity markets in the last nine months. Reserves are down just 7% at $322 million but still relatively strong. Revenue receipts from endowment lands are down about 9% from the prior year, which was a very good year, so this year's earnings receipts are average; May and June are estimated to be above average. Mr. Johnson commented that investment returns for the first nine months was -2.0%; total assets for the endowments remain near the record level of a year ago. All of the endowments are very close to their maximum years of reserves required and distributions are secured. Mr. Johnson reported that the Endowment Fund performance versus peers – public plans – is above average in all periods longer than two years.

Mr. Johnson mentioned the School Bond Enhancement Program which boosts the credit rating of eligible voter approved school bonds to triple A, the highest possible rating. With that high rating districts receive about five basis points of additional savings. The rating of

the program was recently reviewed by Standard & Poor's which confirmed the triple A rating and informally commented that the Idaho School Bond Guaranty Program was one of the strongest in the nation.

- **CONSENT**

3. **Emerald Creek Garnet P300350 Placer Mining Permit** – *Staffed by Todd Drage, Program Manager-Minerals*

   RECOMMENDATION: Approve issuance of the permit subject to the plan submitted in the application, submission of the required $18,000 bond and compliance with the Rules and Regulations Governing Dredge and Placer Mining Operations in Idaho.

   DISCUSSION: None.

4. **Idaho Fish and Game Surplus Property – Lawman Parcel** – *Staffed by Ryan Lay, Right of Way Agent-South Operations*

   RECOMMENDATION: Direct the Department to execute a State Deed returning title of the remaining 204.09 acres of the Lawman Ranch Sites to Idaho Department of Fish and Game.

   DISCUSSION: Governor Otter inquired if the Department knows what Fish and Game intends to do with the parcel. Director Schultz replied he has not specifically discussed it with Director Moore but believes it will be managed as it was prior to the proposed sale.

5. **Approval of Minutes** – April 19, 2016 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**

6. **Negotiated Rulemaking IDAPA 20.03.16, Rules Governing Oil and Gas Leasing on Idaho State Lands** – *Presented by Mike Murphy, Bureau Chief-Endowment Leasing*

   RECOMMENDATION: Direct the Department to initiate Negotiated Rulemaking for IDAPA 20.03.16 – *Oil and Gas Leasing on Idaho State Lands*.

   DISCUSSION: None.

   BOARD ACTION: A motion was made by Attorney General Wasden that the Board approve the Department recommendation that is direct the Department to initiate Negotiated Rulemaking for IDAPA 20.03.16 – Oil and Gas Leasing on Idaho State Lands. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

7. **Investment Policy Statement** – *Presented by Bill Haagenson, Strategic Planning Manager, and Sally Haskins, Senior Vice President-Real Assets Consulting, Callan Associates*

RECOMMENDATION: The Department recommends approval of the Investment Policy Statement for the combined Endowment assets.

DISCUSSION: None.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt and approve the Department recommendation that is approval of the Investment Policy Statement for the combined Endowment assets. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

8. **Asset Management Plan** – *Presented by Bill Haagenson, Strategic Planning Manager*

RECOMMENDATION: The Department recommends approval of the Asset Management Plan for Endowment lands.

DISCUSSION: Attorney General Wasden noted that the memo mentions that there has been a change in direction in regard to commercial properties; Attorney General Wasden recollected that this change took place based upon a recommendation by Callan Associates as they examined the Endowment Fund's asset mix. The recommendation said certain kinds of property enhance the asset mix versus what is currently held and that is the basis upon which the Board made a change of direction. Mr. Haagenson stated that Attorney General Wasden's recollection is accurate. Controller Woolf asked how frequently the Asset Management Plan will be reviewed. Mr. Haagenson replied it is on a five-year review, but if conditions change a review may take place sooner.

BOARD ACTION: A motion was made by Controller Woolf that the Board adopt the Department's recommendation and approve the Asset Management Plan for the Endowment lands. Attorney General Wasden seconded the motion. The motion carried on a vote of 5-0.

9. **Strategic Reinvestment Plan** – *Presented by Bill Haagenson, Strategic Planning Manager, and Sally Haskins, Senior Vice President-Real Assets Consulting, Callan Associates*

RECOMMENDATION: The Department recommends approval of the Strategic Reinvestment Plan written by Callan Associates. The Department recommends that the Land Board authorize the Department to establish a pipeline of transactions for acquisition of timberland and opportunistic acquisition of farmland. The Department shall implement a diligent investment process including financial analysis of each potential transaction and report quarterly to the Land Board regarding progress towards reinvestment.

DISCUSSION: Attorney General Wasden remarked that it appears this plan is intended to leverage the stability of land assets against the volatility of market-based assets, increasing the types of returns and still giving the Land Board options. It is leveraging the best use of endowment assets. Ms. Haskins replied that is correct, and it also is about managing risk in the

portfolio by maintaining investments that create stable cash flow and also have low to negative correlations with the financial assets.

Attorney General Wasden mentioned that he reviewed the comments in opposition to this plan, and based on the Board's constitutional and fiduciary duty, which is its guiding principle, does the Department feel that any of the statements in opposition are consistent with the Board's fiduciary responsibilities outlined in the Constitution. Mr. Haagenson responded that his assessment is the comments represent the viewpoints of the individuals who submitted them rather than the constitutional obligation that the Board serves.

Governor Otter commented on the five-year limitation of the Land Bank Fund, wondering if that is adequate time to build sufficient capital in order to make acquisitions. Mr. Haagenson replied that the Department has discussed that and has some concerns; more time would be better, but the Department will operate under the five-year law and will do its best during that time period. Governor Otter noted that on a first-in, first-out rule, the available cash in the Land Bank for some of these acquisitions could start depleting after five years, and asked if the Department has suggestions on what length of time would be better. Mr. Haagenson said he did not have a suggestion on how much more time would be needed, but anything longer than five years would be helpful in terms of reinvestment.

Director Schultz commented that in Montana, their Land Bank has a ten-year stay before funds transfer. Director Schultz also mentioned that in Idaho the term first started at two years then went to five years, and several years ago there was a push to go from five to one; there may be risk in opening up this issue.

Director Schultz stated the Department's goal is to comply with the recommendation to create a pipeline; if there are not adequate sales on the marketplace then by default the money will transfer to the Permanent Fund, or the Board may take action to transfer it sooner. Director Schultz is optimistic the Department will fill a pipeline in the first year; beyond the first year is unknown. Director Schultz noted that revenue into the Land Bank will be staggered, as cottage sites are sold over the next several years. The Department also anticipates having input from brokers who will bring properties forward for evaluation that would go into the pipeline; to the extent that the Board gives affirmative direction to the Department that this is something they would consider, it is likely that marketplace representatives will bring transactions forward.

Attorney General Wasden wanted to make clear that Article IX, Section 4 of the Idaho Constitution provides for the establishment of the Land Bank but then it provides that the Legislature makes the determination as to the time; that limitation is imposed by statute so to change that it has to be done by statute. Governor Otter stated it is for that reason the subject should be investigated because implementation of these plans considerably changes the environment and activities within the Land Bank. Governor Otter did not recall a time when the Land Bank had as much money as now. Governor Otter commented that there is a real potential to suffer an opportunity cost here; for instance if the Department is short $20 million in the Land Bank of making a timberland acquisition, which seems to be the best return on investment. Perhaps the limit could be a total of not more than $50 million rather than a five-year limit. It is something that needs to be considered. Director Schultz indicated that the Department will have

more discussions over the next several months and if the Board gives such direction, the Department would work to draft appropriate legislation for the next session.

Controller Woolf asked if the Department has staff capacity to handle the type of workload that will be coming forward. Director Schultz replied that the Department has employed temporary staff and is looking at repurposing permanent staff to assist with the anticipated workload.

Secretary of State Denney mentioned an article he read which stated that since 2000 the Department has sold 100,000 acres. Secretary Denney could not remember any large sales and asked the Director to comment on that. Director Schultz asked the Board to refer to Tab 8 in their binders, Attachment 1, page 7 of the Asset Management Plan which shows endowment asset ownership through time in terms of acreage, between 1890 and 2015. In 1890 the state was granted 3.65 million acres. These acres can be traced back to the Admissions Bill. That is the original land grant. Through 1940 there was disposition of about 700,000 acres. Between 1911 and 1920 there was a total of 200,000 acres sold, mostly farmland.

Director Schultz indicated that the Department received a public records request and in response supplied information in a database that was raw data. Transactions in that database, it is difficult to differentiate between trades, land exchanges, and actual sales; acres were double counted through that public records request and a statement was made that the Department had sold one hundred thousand acres in the last 15 years. In fact, there were 60,000 acres sold between 1950 and 1960 but the Board held the note on those properties. It used to be the Department of Lands and Investments; it was not uncommon for the Land Board to hold the note when land was sold and in many cases those were 40-year mortgages. In 2000 those notes were finally paid off, but the 60,000 acres were sold 40 years before. The Department had additional acreages that were traded during the last 15 years but there has not been wholesale divestiture of land in the last 15 years.

Controller Woolf inquired if the reporter had verified with the Department after reviewing the raw data to confirm it. Director Schultz replied that an entity took the information received from the public records request and wrote a report and then a reporter based stories off of that report. The Department did not directly provide information for that report and did not see nor review the report. The Department intends to reach out to the entities to clarify the data used and the conclusions stated in that report. Governor Otter remarked that he would be interested in the facts stated by the Department.

BOARD ACTION: A motion was made by Controller Woolf that the Board adopt the Department's recommendation to approve the Strategic Reinvestment Plan written by Callan Associates and authorize the Department to establish a pipeline of transactions for acquisition of timberland and opportunistic acquisition of farmland. The Department shall also implement a diligent investment process including financial analysis of each potential transaction and report quarterly to the Land Board regarding progress towards reinvestment. Attorney General Wasden seconded the motion. The motion carried on a vote of 5-0.

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

- **INFORMATION**

10. Farm Bill and Good Neighbor Authority Update – *Presented by David Groeschl, Deputy Director-Forestry and Fire, Leanne Marten, Regional Forester-Northern Region, U.S. Forest Service, and Nora Rasure, Regional Forester-Intermountain Region, U.S. Forest Service*

- **EXECUTIVE SESSION**

NONE

There being no further business before the Board, at 10:33 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/ Lawerence E. Denney
Lawerence 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 21, 2016 regular Land Board meeting.

Callan

May 2016

Idaho Board of Land Commissioners

Strategic Re-Investment Plan

The following investment strategy was compiled by Callan Associates Inc. from information provided by the Idaho Board of Land Commissioners and other sources believed to be reliable. All written comments in this report are objectively stated and are based on facts gathered in good faith.

This report is for informational purposes only and should not be construed as legal or tax advice on any matter. Any decision you make on the basis of the content is your sole responsibility. You should consult with legal and tax advisers before applying any of this information to your particular situation. Reference to or inclusion in this report of any product, service or entity should not be construed as a recommendation, approval, affiliation, or endorsement of such product, service or entity by Callan.

ATTACHMENT 1

Table of Contents

Idaho Board of Land Commissioners Strategic Re-Investment Plan

Purpose and Background

The purpose of this Strategic Investment Plan ("Plan") is to assess options to guide the Land Board's decision-making regarding prudent investment of money in the Land Bank.

As background, the total Endowment Portfolio is valued at approximately $3,277 million and the Land Portfolio, excluding the Land Bank, comprises approximately 43% of the total portfolio as shown in Table 1. The current Endowment portfolio is consistent with the Target Asset Allocation from the Callan asset allocation study ("Callan Report").

Table 1: Current Portfolio Compared to Target Asset Allocation

Asset Class	Target Asset Allocation	Range	Existing %	$s Currently Invested $ Millions[(a)]
Financial Assets	58%	50-65%	55.9%	$1,833
Timberland	39%	30-50%	35.8%	$1,174
Rangeland	2%	0-5%	1.9%	$61
Idaho Commercial Real Estate	0%	N/A	1.0%	$32
Residential Real Estate (Cottage Sites)	0%	N/A	3.8%	$123
Farmland	N/A	N/A	0.7%	$22
Cash Equivalents (Land Bank)	1%	0-5%	1.0%	$32
Total Endowment Portfolio	100%		**100%**	**$3,277**

(a) As of 12/31/2015 for the Financial Assets. As of June 30, 2015 for Timberland, Rangeland, and Farmland. As of 12/31/2015 for Idaho Commercial Real Estate based on valuation from Century Pacific. Residential Real Estate is a current estimate.
Source: Idaho Department of Lands for Land and Callan for Financial Assets.

The Land portfolio is undergoing changes due to the strategic sale of cottage sites and the commercial real estate portfolio which will result in deposits into the Land Bank as properties are sold. The balance in the Land Bank is currently $31.85 million and it is projected to end FY2016 at that level. Disposition of cottage sites and Idaho commercial real estate is projected to produce additional sales proceeds of $130.75 million in FY2017 through FY2020. The estimated total proceeds that could be re-invested in Land or transferred to the Permanent Fund is $162.60 million ($31.85 million plus $130.75 million). Since the cottage site sales program began, approximately $46.70 million has been transferred to the Permanent Fund.

As land and commercial property is sold, gross income from the sold properties will be lost. IDL estimates that the gross income reduction due to sales is approximately $6.83 million.[1] Table 2 shows the projected additions to the

[1] Land Bank balance, estimated sales proceeds, gross income reduction, and timing of sales proceeds were provided to Callan by Idaho Department of Lands ("IDL").

Land Bank by year, the corresponding Land Bank balance if no investments are made, and the annual and cumulative reduction in gross income.

Table 2: Projected Additions to the Land Bank and Reduction in Gross Income Due to Sales

	Prior Periods	FY2016 $MM	FY2017 $MM	FY2018 $MM	FY2019 $MM	FY2020 $MM
Additions to Land Bank	$51.7	$26.85	$53.15	$34.85	$30.15	$12.60
Transfers to Permanent Fund	$46.7	$0	$0	$0	$0	$5.00
Land Bank Balance[2]	$5.00	$31.85	$85.00	$119.85	$150.00	$157.60
Reduction in Gross Income[3] from Sales	N/A	$1.82	$3.42	$1.09	$0.50	$0
Cumulative Reduction in Gross Income	N/A	$1.82	$5.24	$6.33	$6.83	$6.83

Using the Land Bank Balance on Table 2 and holding the value of the total portfolio constant, the Land Bank Balance, as a percentage of the total portfolio, rises from 1% currently to 2.6% at the end of FY2017 to just under 5% by the end of FY2020 which is in the recommended range of 0-5%.

Comparison of Investment Options

The Callan report suggested a framework for making investment decisions for timberland and farmland (Items 1-5 below). These and other relevant decision-making factors (Items 6-8 below) are applicable to establishing priorities for investment of the Land Bank.

1. Is the investment consistent with the overall asset allocation and objectives of the total portfolio as set forth in the Investment Policy Statement and in the Strategic and Annual Plans?
2. Comparison of the risk adjusted return and the net return relative to other choices (e.g. stocks, bonds, other land types). In other words, what are the other choices for investment?
3. Does it make a difference and move the needle from an overall portfolio perspective?
4. Completion of a full underwriting of the potential investment including upside, base case, and downside scenarios with identification of assumptions and risks alongside of the returns (both the return gross of fees and net of all fees and costs);
5. Detailed outline of the business plan for the investment and the plan for execution including consideration of the internal and external resources required to execute the plan and associated costs;
6. Market fundamentals;
7. Availability of transactions; and
8. Institutional investment trends, processes, and implementation for timberland and farmland.

Callan believes there are three investment options for the Land Bank proceeds: Financial Assets (Permament Fund), Idaho Farmland, and Idaho Timberland. Table 3 summarizes the investment options with commentary on each option following the table.

[2] Assumes no acquisitions are completed and transfers to the Permanent Fund occur after 5 years.
[3] Gross income is before deduction of IDL management expenses

Table 3: Summary of Investment Options for Land Bank Proceeds

	Financial Assets Permanent Fund	Idaho Farmland	Idaho Timberland
Consistent with Investment Policy and Objectives	Yes	Yes	Yes
Long Term Policy Return Objective (Net)[4]	4.0% Real 6.25% Nominal	4.0% Real 6.25% Nominal	3.0% Real 5.25% Nominal
Minimum Hurdle Rate for New Investments (Net)	N/A	4.5% Real	3.5% Real
Potential to Replace Income	Yes	Yes	Yes
Strategic Asset Class in Asset Allocation	Yes	No	Yes
Market Fundamentals	Continued Volatility	Weakening in Short Term Strong Long Term	Choppy in Short Term Strong Long Term
Expected Availability of Transactions	High	Medium	High
Internal Expertise	High	Medium	High
Implementation Complexity Implementation Costs	Simple Low	Complex High	Complex High

Commentary

Financial Assets

- If all of the projected proceeds were invested in Land or if all of the money was transferred to the Permanent Fund, the total Endowment would still be within the asset allocation target ranges. The default option would seem to be to transfer the money to the Financial Assets as there is no compelling asset allocation reason *currently* to invest in Land, investing in the Financial Assets is the easiest and most cost efficient option, and it has sufficient long term risk/adjusted returns. However, this is an unusual time with the amount of disposition activity taking place, and it is unclear when there will be this level of proceeds to invest in Land again.

Farmland

- Investment in farmland totals 17,000 acres with an approximate value of $22 million which is 0.7% of the total Endowment. Farmland is not currently a part of the Endowment's Strategic Asset Allocation. Callan's asset allocation study did not model Idaho farmland as a separate asset class due to the small investment held by the Endowment and the fact that a concentrated portfolio of Idaho farmland is not considered an institutional investment class. Investment in Idaho farmland is allowed under the Draft Statement of Investment Policy in Section V (D) which states:

[4] Long Term Policy Return Objectives will be continually evaluated and refined as performance data is collected and based on results from implementation of the Business Plan for each Land Type. The Long Term Policy Objective is a portfolio level return target. It is different from the hurdle rate which is the rate of return required for new investments. The hurdle rate will be reviewed and updated annually.

"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 and the impact on the Distribution Policy."

- As noted previously, we have not modeled the investment characteristics of Idaho farmland. For Idaho farmland, we have considered the short return series of the Idaho farmland properties reported to the National Council of Real Estate Investment Fiduciaries (NCREIF). These are all row crop properties which is what we assume would be the target of any additional investment in farmland by the Land Board.

  Our broader view of the farmland sector and its investment characteristics considers the historical returns and correlations of the NCREIF farmland index (both row crops and permanent crops), a survey of farmland investment managers to gauge go forward expectations of returns for diversified U.S. farmland, our experience developing farmland investment programs and farmland investment policies for other investors, and underwriting farmland investment opportunities.

  Callan's recommended policy target for U.S. core diversified farmland includes the following components: Nominal cash yield of 3% to 5%, appreciation of 3% to 4%, and total return of 6.00% to 8.00% net nominal. The corresponding net real return would be 3.75% to 5.75%. The characteristics of this Core portfolio would be diversified row crops with a high focus on current income and current cash yield through the acquisition of farmland with sufficient in place water resources. It assumes a cash lease structure is used to avoid direct connection to production and price risk.

  A diversified portfolio of institutionally owned U.S. Farmland has low to negative correlation characteristics with publicly traded equities and bonds which makes it a good diversifier in an overall portfolio. This is similar to institutionally owned diversified U.S. commercial real estate and institutionally owned diversified U.S. timberland as shown on the chart below:

Table 4: Correlation for Ten Years Ended December 31, 2015

	NCREIF Farmland	NCREIF Timberland	NCREIF Property	S&P 500	Barclays Agg Index
NCREIF Farmland Index	1.00	0.61	0.09	0.10	(0.10)
NCREIF Timberland Index	0.61	1.00	0.25	(0.16)	0.10
NCREIF Property Index	0.09	0.25	1.00	0.26	(0.20)
Equities – S&P 500	0.10	(0.16)	0.26	1.00	(0.27)
Bonds – Barclays Aggregate Index	(0.10)	0.10	(0.20)	(0.27)	1.00

- From a market perspective, pricing in the sector is adjusting as the commodities markets continue to experience turmoil; however, there is ample capital for investment from other institutions and individuals that is supporting pricing above that which is justified by the fundamentals. Pricing was mentioned as a significant risk by every one of the institutional buyers and managers of farmland that Callan surveyed, which suggests careful underwriting is of particular importance currently. Access to water is another risk that is being more closely considered and control over water resources is a requirement for institutional buyers. Evaluation of a potential tenants' credit and financial strength has taken on heightened importance as commodity prices and credit has tightened. Callan understands that the conflict auction leasing process used by the Land Board does not allow for evaluation of tenant financial strength and credit of the high bidder. IDL noted that if an applicant is 18 years old and not in default with the state and were the high bidder, the bid would be accepted and there would not be an opportunity to evaluate the financial position.

- The long term fundamentals for farmland are compelling. Strong demand for farmland is expected to continue to meet the increasing global demand for food, fiber,and energy, as well as to satisfy institutional investor demand for diversifying, inflation-hedging assets. The relatively fixed supply of land capable of supporting agriculture is another favorable factor supporting the investment case for farmland.

- The availability of transactions in farmland is expected to be less than timberland and the pace of investment is slower than timberland due to the the limited pool of investment transactions every year. There is not a pool of closed end funds that are reaching maturity and selling assets like in timberland. Investors tend to buy and hold, the asset class is popular with significant competition for transactions, and operators/farmers have had strong balance sheets for acquiring farmland, with limited financial pressure/incentive to sell. Access to transaction deal flow via relationships with institutional and local owner/operators is critical to building a portfolio.

- Implementation is characterized as complex because it involves sourcing transactions, completing due diligence, and hiring third party advisors. Costs of implementation are relatively high due to costs of external land advisors, transaction costs including brokers, legal fees, title work, environmental, etc., the costs of internal staff time, and the opportunity cost of holding money in the Land Bank versus investing in the Financial assets (which could be positive or negative depending on the returns of the IDLE pool versus the Financial Assets over the timeframe in which proceeds are in the Land Bank).

- Institutional ownership of farmland in Idaho (as reported to NCREIF) totals $280 million in 32 properties with total acreage of 57,086 acres. This equates to an average investment per property of $8.75 million and an average per acre value of $4,904. All properties are annual row crops.

  These owners represent potential competition to IDL for larger transactions ($5 million+) but not for smaller transactions which IDL may want to consider in its acquisition strategy. On the disposition side, should the Land Board wish to sell farmland, the institutional owners would likely not be buyers as the transaction size would be too small for those buyers if they could only purchase 320 acres. The ability to achieve liquidity would depend on local buyers.

- We find no compelling reason that the net returns the Land Board should accept from additional investment in Idaho farmland (annual row crops) should be less than those of a diversified U.S. core farmland portfolio. The non-diversified nature of the Idaho only investment is a reason to require higher returns.

  Callan recommends that additional investment in Farmland be pursued if Core investments can be found such that the *minimum* net returns are competitive with both the Long Term Policy Return Objective for the Financial Asset portfolio and the Farmland Portfolio, as well as, noted above, diversified U.S. core farmland. The recommended Hurdle Rate is a *minimum* net real return of 4.5% which equates to a 6.75% net nominal return, assuming inflation of 2.25%. Of course, the risk profile of each transaction and market dynamics will dictate the return that will be required, such that some transactions may have returns above the Hurdle Rate.

  Setting the Hurdle Rate above the Long Term Policy Returns for both the Financial Asset Portfolio and the Farmland Portfolio, will keep the focus on finding transactions that are accretive.

  The expected return of a farmland investment should include both income and appreciation with a focus on income to provide income replacement for the portfolio; however, for the returns to be competitive, investments will need to also have appreciation and the plan for managing each investment should have a strategy for realizing the appreciation.

  The lease structure will be an important mechanism to insure the income and inflation hedging characteristics of farmland and the total returns are achieved.

- Callan does not recommend setting a hard target for the amount of dollars to be invested in Farmland, but rather allowing the investment decision to be driven by the opportunities.

- Investment in a diversified portfolio of U.S. farmland may be another way to enhance the risk/return of the Endowment portfolio. In the next asset allocation study, the impact on the Endowment of investment in diversified U.S. farmland could be studied as a complement to the existing Idaho farmland portfolio. Diversification geographically as well as by row and permanent crops could be considered. The external and internal resources and investment vehicles that would be required to implement a diversified allocation efficiently would also be examined.

Timberland

- Callan recommends pursuing additional investment in timberland in Idaho provided investments can be sourced with appropriate net returns.

  Additional investment is supported by the asset allocation study which indicates portfolio risk/return will be maintained with additional investment in timberland provided new investments have a net projected return at or above the returns of the existing portfolio with a similar level of risk. In Callan's study, the existing timberland portfolio had an expected net 10 year compounded return of 5.70% (3.45% net real return). The recommended Hurdle Rate for Timberland is a *minimum* net real return of 3.5% which equates to a

5.75% net nominal return, assuming 2.25% inflation. The risk profile of each transaction and market dynamics will dictate the return that will be required, such that some transactions may have returns above the Hurdle Rate.

- Callan does not recommend setting a hard target for the amount of dollars to be invested, but rather allowing the investment decision to be driven by the opportunities. The range for timberland is 30-50% of the total Endowment portfolio. If attractive opportunities are found, all of the projected proceeds in the Land could be invested in timberland and timberland would remain in the target 30-50% range, assuming the total portfolio remains at or above the current value.

- Investment in additional timberland is a way to replace lost income from the sales of cabin sites and commercial real estate.

- Market dynamics in the timberland industry include increasing transaction flow. There have been several large institutional portfolios of timberland brought to the market in the U.S. Several closed-end commingled funds are nearing their expirations, which will result in timberland for sale. Additionally, multiple timberland investment organizations are undergoing changes which could result in additional deal flow from manager disruption and terminated vehicles. The environment with substantial availability of properties for sale and projected to be for sale may help to moderate pricing. The availability of transactions is in marked contrast to prior years and the Land Board should take advantage of the increased transaction flow.

- Similar to Farmland, implementation is characterized as complex.

- Callan believes that the Land Board has a competitive advantage in timberland investing compared to other institutional investors and owners of timberland given its experienced Staff, existing portfolio, long term investment horizon, and cost of capital.

- IDL has a management structure and monitoring resources in place to execute the business plan for the assets.

Conclusions and Next Steps

This is an unusual time for the Endowment due to the amount of disposition activity taking place. Based on the current Asset Management Plan, it does not appear that after FY 2020, there will again be the level of proceeds to invest in Land. Therefore, the Land Board should consider using Land Bank proceeds to invest in Timberland and Farmland, provided the targeted Hurdle Rates can be met or exceeded and an institutional investment process is used.

To be credible in the market with potential sellers, IDL needs to be able to represent to sellers that it has money to fund transactions (subject to the Land Board due diligence, underwriting, and approval process) which will require money to remain in the Land Bank while transactions are found.

Investment in Land transactions requires time to identify and execute. A logical next step is to have IDL establish a pipeline of transactions to substantiate their investment thesis that attractive transactions can be found in Timberland and Farmland. The pipeline should be documented via a pipeline report/deal log which is updated and discussed with the Land Board each quarter to track progress. A pipeline report/deal log is a standard tool that is used by third party investment managers.

The Land Bank money will be available over time, in increments. This means IDL will need to source and execute transactions according to the timing and amount of proceeds for each underlying endowment. It is currently IDL's intention to purchase properties such that the underlying endowment would own an undivided interest. Money will not be commingled from endowments to make purchases whereby each endowment would own its pro rata share of the property, either by acreage or by a share of the economics.

Priorities should be set in terms of the size of transactions and the number that IDL can reasonably expect to diligence and close given current resourcing. Pursuing a fewer number of large transactions for each endowment will be more efficient both in terms of staff time and transaction costs. If high priority, larger transactions are expected then money should be earmarked to insure it is available to match the transaction timeframe.

A formal transaction allocation process should be established and documented to insure that transactions are allocated fairly to each endowment. This may involve suitability screens such as transaction size. IDL has proposed a transaction allocation process that would allocate a deal to the endowment with money that has been waiting the longest in the Land Bank.

Underwriting should include upside, base case, and downside scenarios with identification of assumptions and risks alongside of the returns. The underwriting should include an evaluation of income, appreciation, and total return on a gross of fees and net of fees basis, calculated in accordance with industry standards.

A detailed outline of the business plan for the investment should be completed as part of the underwriting including consideration of the internal and external resources required to execute the plan and associated costs, to insure there is a plan for producing the returns that are projected.

If IDL does not have the inhouse capabilities to implement an institutional investment process, external investment management advisory expertise will be required.

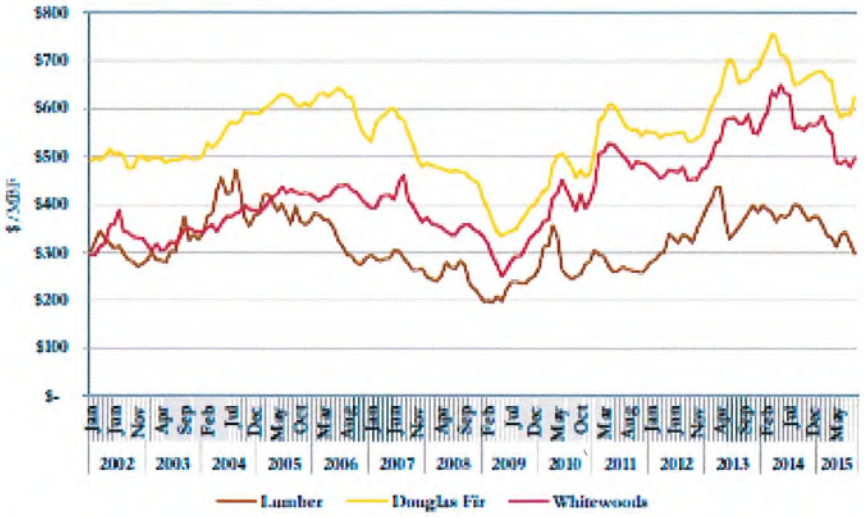
Appendices

Timberland Market Overview

Timberland Supply and Demand Dynamics

There are several macro supply factors affecting today's timberland markets. First, the globe's largest supply of timberland by country is Russia. Russia has implemented tariffs of 25% on timberland exports, which has impacted other countries' desire to import from the region. Second, the mountain pine beetle has destroyed a significant portion of the Canadian timber supply. The damage has been done primarily in Western Canada, in British Columbia. Nearly all of Canada's timberland is sovereign owned. Timberland managers have indicated that the damage from the mountain pine beetle was exacerbated by inadequate road access to timberland which impacted the government's ability to contain the issue. Nonetheless, the mountain pine beetle damage will result in an estimated 9 million acres[5] of timberland removed from the supply chain. It is estimated that this will result in a 20% reduction in the average annual log harvest in British Columbia. The reduction in supply is expected to have an impact through 2030. Because this supply is located in the Western North American region, it positively impacts the Pacific Northwest region of the United States, as much of this supply was expected to be utilized for Asian, specifically Chinese, timber demand. However, due to slowing growth in China and Korea, log exports to Asia have underperformed in 2015 compared to 2014, resulting in timber pricing that has been fairly flat over much of 2015 and increasing inventories in mills in the Pacific Northwest. Even though Chinese demand was flat in the fourth quarter of 2015, it is expected to decrease in the first half of 2016. As seen in the chart below, the price of Douglas Fir and Whitewoods has declined significantly since it peaked in 2014.

Random Lengths Framing Lumber Composite Prices and Pacific Northwest Log Prices, January 2002 through September 2015

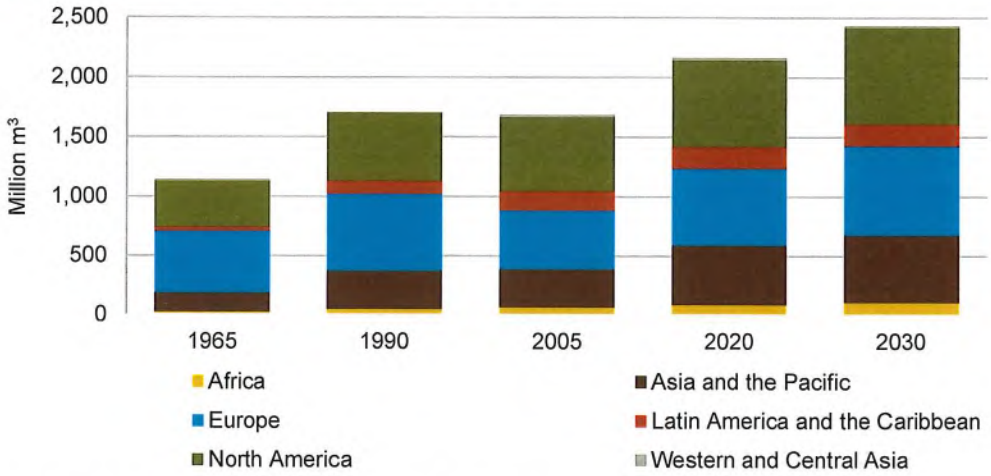


Source: Prudential Agricultural Investments.

[5] Figure quoted from Campbell Global presentation, February 2015.

A positive factor in the timber supply and demand dynamics is the expected growth in demand for wood products both domestically and abroad. The chart below highlights the expected consumption in wood across various regions.and illustrates that the expected consumption is increasing. The demand is also driven by the growing middle class population in emerging countries.

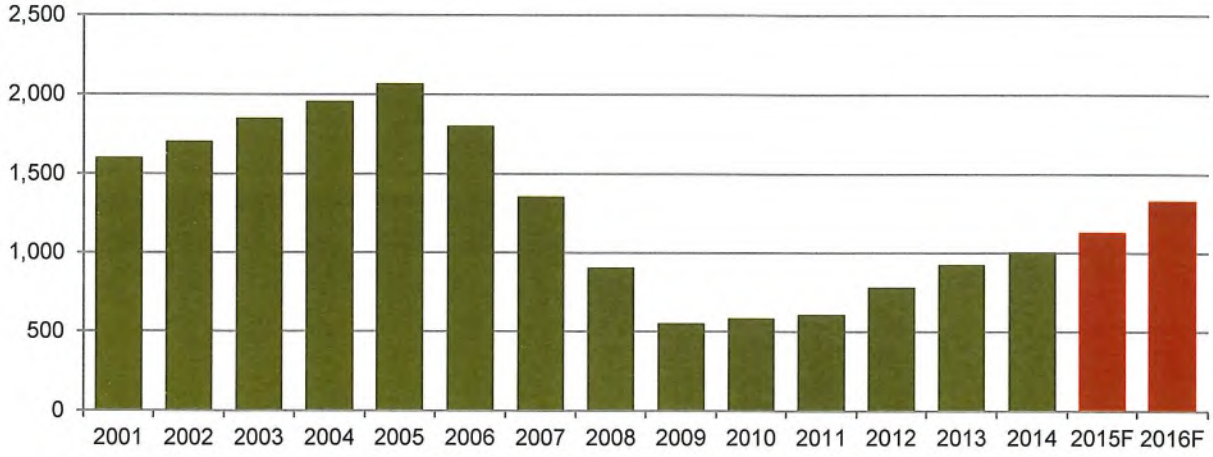
Global Consumption of Industrial Roundwood



Source: Campbell Global and Food & Agriculture Organization.

U.S. demand is anticipated to increase driven by construction of new residential and commercial buildings and existing building renovations. The following chart highlights historical housing starts, as measured by the U.S. Census Bureau's data. Incorporated into the chart are Freddie Mac's 2015 and 2016 estimates of housing starts. The decline in housing starts following the Global Financial Crisis ("GFC") is significant followed by a gradual increase with levels in 2016 still not projected to reach the pre GFC peak in 2005.

Housing Starts



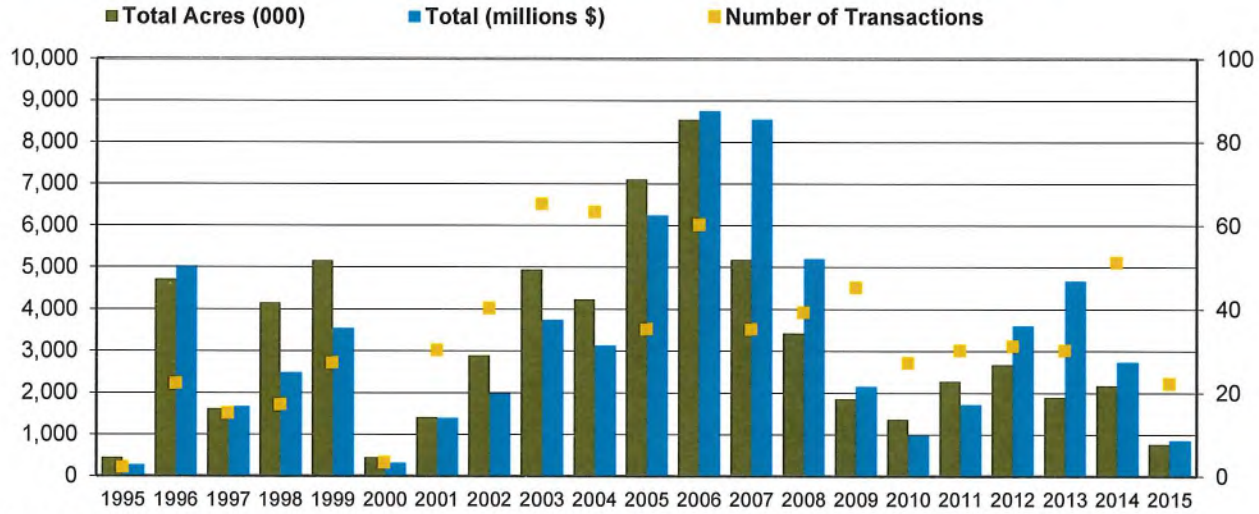
Source: US Census Bureau, Freddie Mac

A negative supply driver is the decline in the use of paper and pulp products due to electronic media and increased recycling. International Woodland Corporation estimates that the U.S. pulp production will remain relatively flat, but that production of pulpwood for oriented strand board (used for residential construction) and wood pellets will increase through 2020. Demand for biomass, pulpwood products used for energy purposes, is expected to increase given environmental regulations adopted in Europe and expected initiatives elsewhere globally. Pulpwood dynamics are not expected to negatively impact timberland investment meaningfully in the coming years.

Timberland Capital Market Flows and Transaction Data

Market dynamics in the timberland industry include increasing transaction flow, especially in the U.S. There have been several large institutional portfolios of timberland brought to the market in the U.S. Several closed-end commingled funds are nearing their expirations, which will result in timberland for sale and should decrease the pressure on pricing. Additionally, multiple timberland investment organizations are undergoing changes. As a result of ownership changes or shifts in assets under management, there has been some account and professional turnover, which is expected to continue going forward. This activity could result in additional deal flow from manager disruption and terminated vehicles. Transactional history in the United States has been varied, and levels have not yet recovered to those pre-Global Financial Crisis. The following chart illustrates domestic timberland transaction history:

Major US Timberland Transactions Since 1995 (# transactions – right scale)



Source: GMO

In the early 2000's there was a high level of commitment activity to U.S. focused timberland funds. Many of these funds have reached the end of their legal life and still have remaining timberland assets to be sold. Given the challenges in the recent market cycle and the long term nature of the timberland asset class and timber lifecycle, the ten year life has proved an insufficient time frame to roundtrip a strategy and exit all assets. As a result there are many groups of fund investors determining extension provisions for their funds and a certain level of dissatisfaction or frustration with the lack of disposition activity to date. This has been evidenced in the California Public Employees' Retirement System's ("CalPERS") decision to require a sale of the TimberSouth portfolio fund

managed by Campbell Global. It was announced that 300,000 acres of the fund would be taken to market and the sale is being driven by CalPERS. Based on information from a recent timberland request for information, Callan estimates that there is $9.5 billion in timberland commingled fund holdings that are currently within two years or beyond the legal fund term life. The expiring funds may result in a fair amount of investment opportunities coming to market. If these timberland holdings are sold and in 2016 and 2017, this would represent a significant increase from transaction levels in 2014 which were at lower levels than years prior. At the end of 2015, a number of transactions occurred between TIMOs, including Molpus Woodlands Group purchasing a subset of Campbell Global's Louisiana portfolio, the Conservation Forestry Partners Fund purchasing a Northeast portfolio from The Forestland Group and Hancock Timber selling three different Pacific Northwest portfolios to Campbell Global, Olympic Resource Management and Molpus. These fourth quarter transactions account for over 370,000 acres of timberland changing hands, with more coming in 2016 including the potential for another 160,000 acres of Campbell Global-owned Pacific Northwest timberland.[6]

There may also be acquisition opportunities from REITS. The universe of timber REITs is very small, and has undergone a recent shift. In November 2015, the largest and second largest public timber companies, Weyerhaeuser and Plum Creek Timber, merged, creating a company with a combined market capitalization of over $20 billion. Plum Creek's timber holdings are diversified over a number of states, however Weyerhauser's timber holdings are concentrated in the Pacific Northwest. Weyerhaeuser is expected to shift its business focus entirely to timberland and wood-product operations and exit its cellulose-fiber business. The REIT will continue to pay its dividend and likely increase it and is expected to cut $100 million in corporate overhead. After the merger, there are now four publically traded timber REITs in the United States, the merged entity will operate under the Weyerhaeuser name and the remaining three are Rayonier, Inc., Potlatch Corporation, and CatchMark Timber Trust, Inc. CatchMark Timber Trust is the newest addition to the group as it started operations in 2006 as a non-traded REIT and was converted to a company listed on the New York Stock Exchange in December 2013. Timber REITs have been exhibited poor performance in 2015, as they are the second worst performing sector after Lodging REITs as of October 31, 2015, returning -12.2%. Rayonier has been the worst performing, returning -19.41%. Poor performance can be attributed to a lack of available and harvestable timberland as well as the sale of higher-and-better-use (HBU) lands to meet REIT dividend requirements. As there is a finite amount of HBU land to sell, the timber REITs will eventually run out of such land.

There have been some organizationally driven industry shifts, as well, that may result in acquisitions coming to market, including the SEC determination that Timbervest committed Investor Act violations.

Timberland Historical Performance

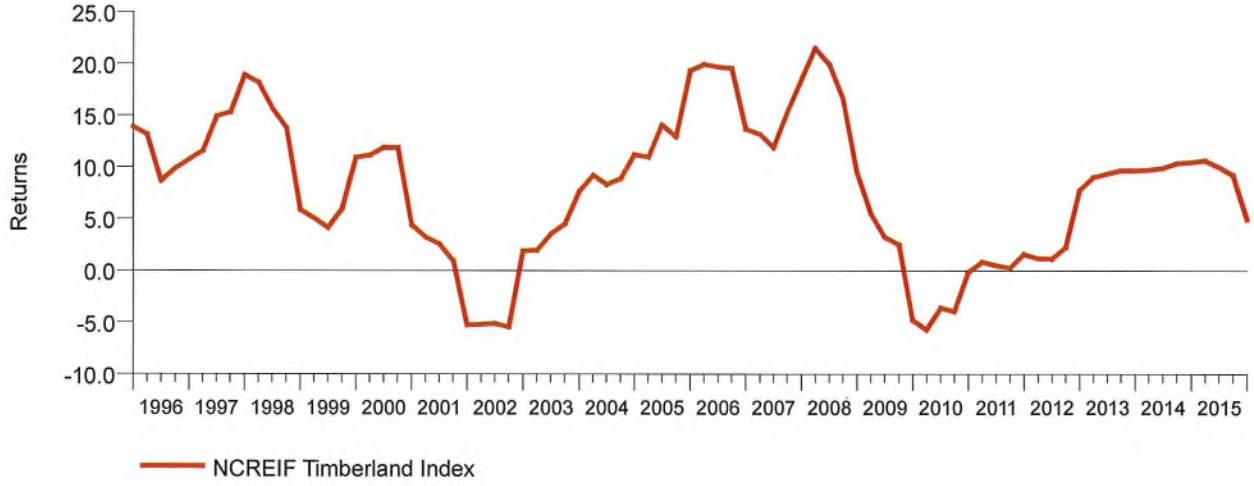
Private, institutional timberland performance is best measured by the NCREIF Timberland Index, a time-weighted, unlevered property level index that reports performance results quarterly. The index constituents are properties owned wholly and in joint ventures by voting members of NCREIF, and the inception date is 1987. The Index is available both gross and net of management fees. It is important to note that, while the Index is the industry standard, it represents only a sample size of the total United States timberland market. As of December 31, 2015, The NCREIF Timberland Index is made up of 454 properties representing 13.3 million acres and a market value of $24.3 billion. The NCREIF Timberland Index has four sub indices created by region, South, Northwest,

[6] Forest Investment Associates

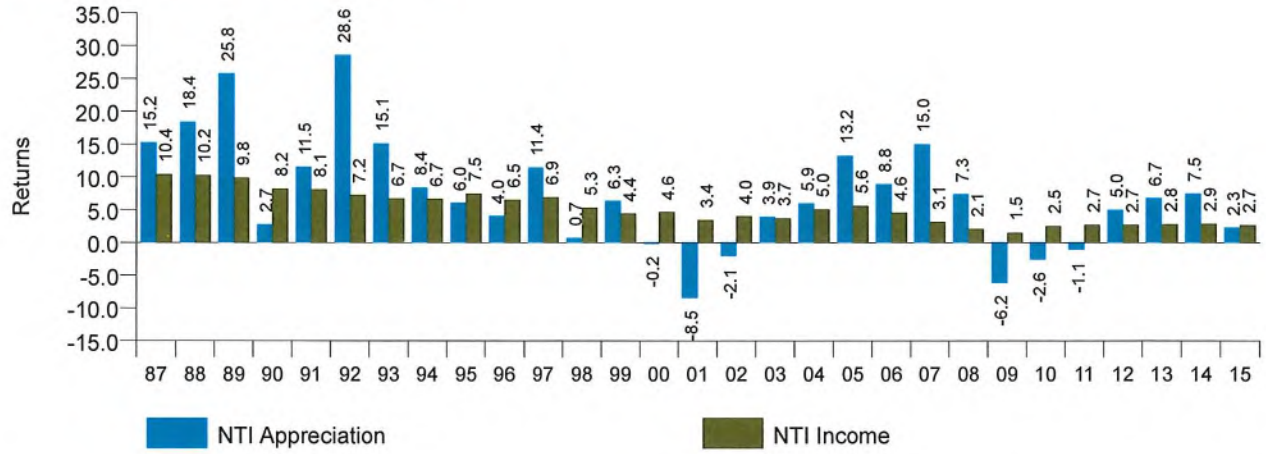
Northeast and Lake States. The South region is the largest region across all categories, property number, acreage and market value. Idaho is in the Northwest region of the NCREIF Timberland Index along with California, Oregon and Washington. As of December 31, 2015, the Northwest Index consists of 83 properties made up of 2.80 million acres, representing $5.3 billion in market value. Per acre, the Northwest region has the most value in its timber properties. Five properties in the Northwest region are located in Idaho representing approximately 145,401 acres and a market value of $155 million.

Timberland experienced peak pricing prior to the Global Financial Crisis ("GFC") as liquidity from investors drove prices upwards. Following the GFC, the appraisal lag, particularly in properties that were only appraised every three years, resulted in a delayed mark down in asset values. In 2012, NCREIF required that all properties contributing to the Index be appraised quarterly. The table below highlights the historical timberland performance for the NCREIF Timberland Index. The first chart highlights the rolling four quarter return history of the NCREIF Timberland Index over the last 20 years. The second chart highlights the income and appreciation returns of the Index. Income returns have waned given weaker wood demand coming out of the GFC. Appreciation returns have been positive in recent years but have not been at levels seen pre-GFC.

Rolling 4 Quarter Gross of Fee Returns for 20 Years Ended December 31, 2015

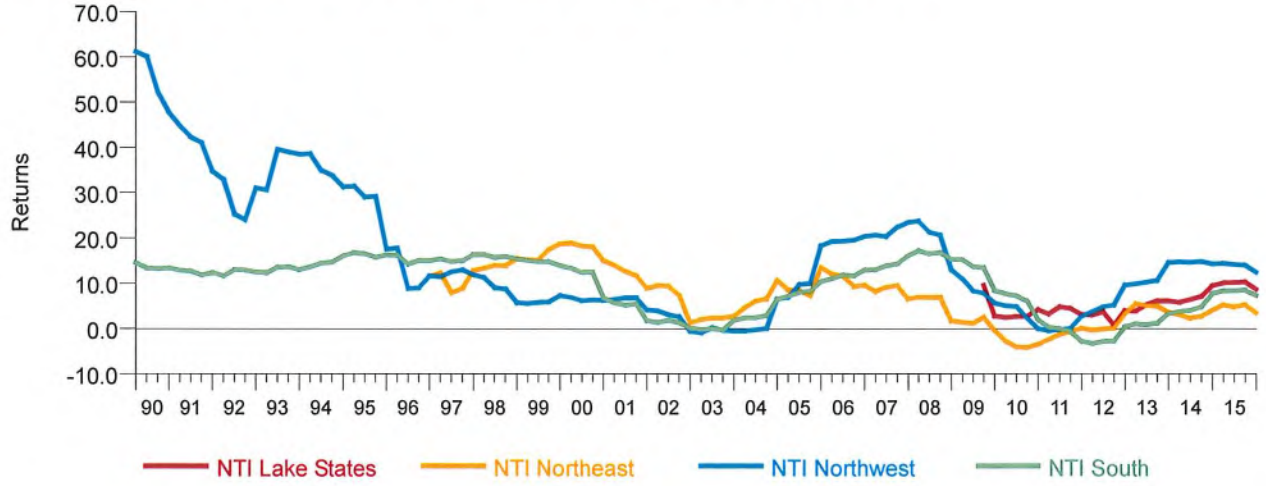


NCREIF Timberland Income and Appreciation Gross Returns for 29 Years Ended December 31, 2015



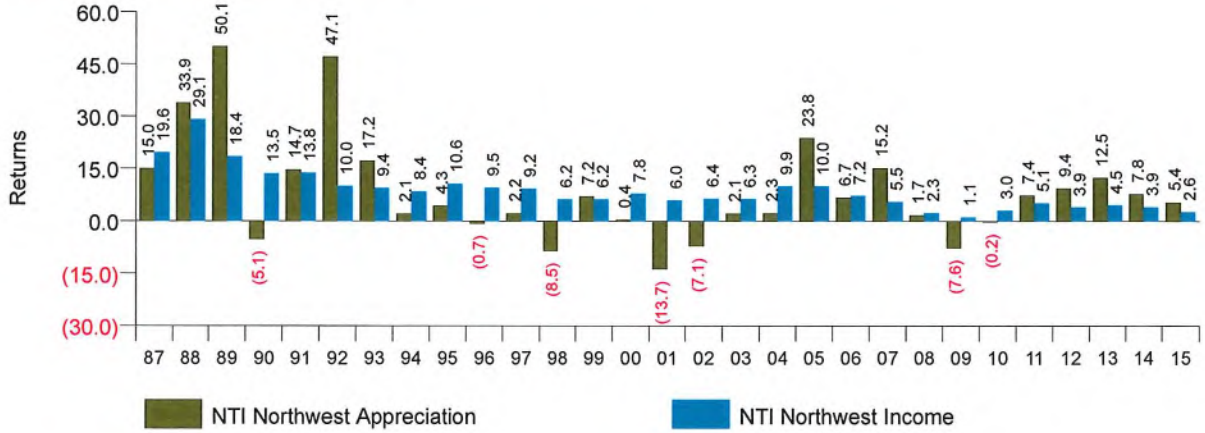
The next chart highlights the annual rolling regional performance. The regional performance diverges and in recent periods, the Northwest region has outperformed the other U.S. regions. The diverging performance is a primary reason many investors seek to build diversified regional exposure to timberland.

Rolling 12 Quarter Gross Returns for 25 3/4 Years Ended December 31, 2015



The following chart breaks out the NTI Northwest Index further into the income and appreciation returns generated by timberland in the same region where IDL timber is located. In recent years, both income and appreciation outpace the broader index. The performance of the Idaho properties in the NCREIF Timberland Index cannot be shown as NCREIF does not release data if the sample size is under a certain number of properties.

NCREIF Northwest Region Timberland Index Income and Appreciation Gross Returns for 29 Years Ended December 31, 2015



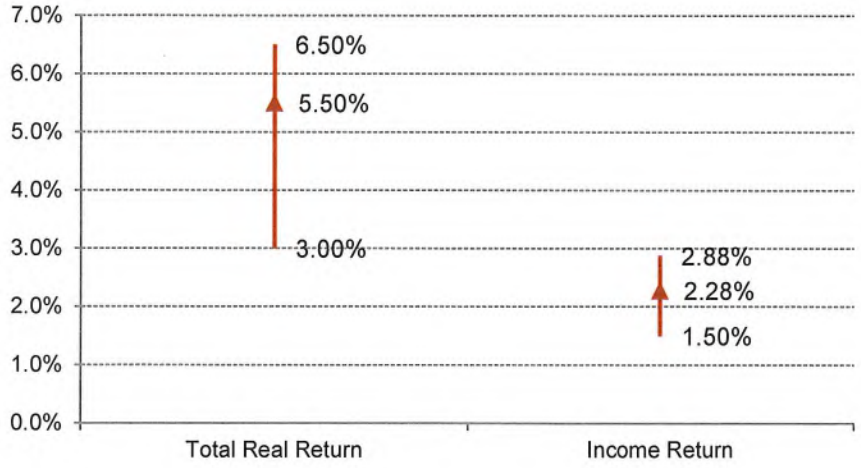
Gross Returns for Periods Ended December 31, 2015

	Last Year	Last 5 Years	Last 10 Years	Last 15 Years	Last 25 Years
NCREIF:Timberland Index	4.97	6.84	6.92	6.83	10.28
NTI Appreciation	2.25	4.02	4.10	3.47	5.61
NTI Income	2.67	2.75	2.75	3.28	4.51
NTI Northwest	8.15	12.74	9.69	9.28	12.42
NTI Northwest Appreciation	5.40	8.46	5.64	3.97	5.45
NTI Northwest Income	2.64	4.02	3.90	5.16	6.72

Expected Returns

Callan surveyed the timberland investment manager universe. We received responses from 12 managers with $33.75 billion of timber assets under management. The timber investment manager universe has a widely varying set of expectations for domestic timberland returns over the next five to ten years as is shown on the chart below. Real return expectations range from approximately 3% to 6.5% on an unleveraged basis. Most managers expect returns to be around 5.5% real with income generating 40-50% of that return. Expectations for income ranged from 25% of the total return to 60% of the total return, resulting in an expected income range of 1.5% to 2.88%.

Domestic Timberland Return Expectations



Source: Callan Associates

It is important to note that there are differences in regional expectations, and a consensus of managers noted that the Northeast and Lake States would likely return 50 to 100 basis points less than the total domestic expected returns. Managers did not have a consensus view on the Southeast or Pacfic Northwest. While the income returns are roughly in line with what timber investments have historically generated, most managers are expecting a slight downward shift in the real return of the asset class over the next five to ten years.

IDL, as a manager and acquirer of timberland, may compete directly with timberland investment management organizations for acquisitions.

Farmland Market Overview

Farmland Supply and Demand Dynamics

The current outlook for farmland is based on long term positive supply and demand dynamics that support appreciation of both agricultural commodities and farmland. The primary factors supporting the positive long term outlook are increasing global population, a growing middle class in developing economies who demand better diets and more meat, and a relatively fixed supply of farmland around the world. According to projections by the UN FAO under their baseline scenario, between 2005-07 and 2050, world food production needs to increase by 60% to meet increasing demand from population growth. While some additional land has (and may continue to) come into production, rising population has translated to arable land and permanent cropland available for cultivation to decline steadily on a per capital basis.[7] Increases in food production will need to come from increases in productivity, not increases in arable land. Productivity gains are no longer outpacing population growth, instead demand growth is outstripping productivity increases which makes the supply of land more valuable.

In the near term, macro risks are contributing to decelerating fundamentals and declining prices in some regions of the country. Weaker economic growth, particularly in China and Europe which are key export markets, is contributing to commodity price weakness and reduced demand. Additionally in China, higher currency devaluation and cost cutting at state owned enterprises in response to the government crackdown on corruption is further negatively impacting the demand for many agricultural products. Globally, supplies of commodity crops are at near record levels. There is downward pressure on cash rents in the central region of the United States due to the negative commodity price outlook. Corn, soybean, cotton, rice, and wheat are being adversely affected by low commodity prices putting pressure on rents and values.

Nut prices have generally remained stable to strong due to consumer demand which has kept farm profitability and farmland values strong in California. Continually rising nut prices, now in the fourth year, combined with drought conditions in California may point to higher levels of risk for California properties.[8] Statewide, properties with that are irrigated have continued to see strong pricing. There are predictions of softening in the market for certain types of nuts including pecans and pistachios due both to supply and demand factors. Almond prices have already declined precipitously due to a drop in overseas demand and a bumper crop domestically.

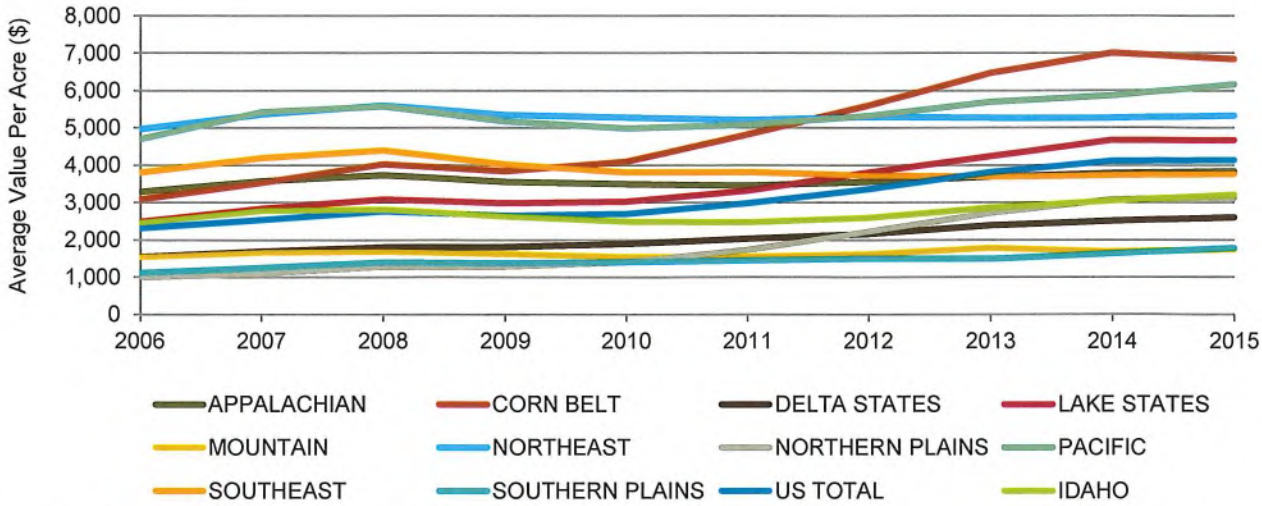
Rising interest rates will increase costs for farm operators and could negatively influence farmland values. Lenders are pulling back on credit particularly in the Corn Belt, creating pressure on farmers. A prolonged strengthening of the dollar could negatively impact exports. Water availability and regulatory risk associated with water resources has moved to the forefront of investors' minds.

Beginning in 2011, cropland values started to show significant per acre value increases before beginning to moderate in the past year, although there are still substantial disparities by region as shown on the next two

[7] GMO, "A Farmland Investment Primer," July 2014
[8] Mesirow Financial Agriculture Management 3Q2015 Summary

charts. The USDA Land Values report for 2015 showed an overall 0.7% increase for US cropland values from 2014. Cropland values were down in the Corn Belt by -2.3% from 2014. In the Delta, cropland values were up by 3.6% over 2014. Northern Plains' cropland showed an average increase of 1.3% compared to 2014. Idaho showed one of the higher increases at 5.3%.

Cropland Values Per Acre



Source: US Department of Agriculture National Agriculture Statistics Service

Cropland Values Per Acre

Year	Corn Belt	Delta	Pacific	Idaho	U.S.
2006	3,090	1,540	4,690	2,450	2,300
2007	3,530	1,690	5,420	2,770	2,530
2008	4,030	1,800	5,570	2,800	2,760
2009	3,840	1,810	5,160	2,610	2,640
2010	4,090	1,890	4,980	2,480	2,700
2011	4,810	2,020	5,070	2,470	2,980
2012	5,600	2,160	5,310	2,580	3,350
2013	6,470	2,380	5,690	2,850	3,810
2014	7,000	2,510	5,860	3,040	4,100
2015	6,840	2,600	6,160	3,200	4,130

Source: US Department of Agriculture National Agriculture Statistics Service

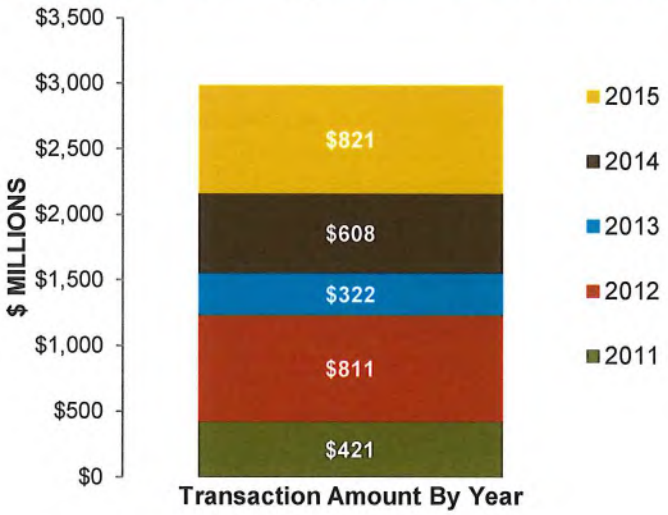
Farmland Capital Market Flows and Transaction Data

Farmland has received increased investment and interest from institutional investors and individuals in recent years, along with the interest in other types of real assets due to its return profile, inflation hedging characteristics, low correlations with financial assets, ability to diversify a broader investment portfolio, strong long term return

drivers, and recent performance. Institutional ownership of farmland continues to steadily grow but is still only a very small part of the overall farmland universe with owner operators dominating ownership of the asset class.

Callan surveyed the farmland investment manager universe which included nine managers with $7.3 billion of farmland assets under management. The participants included the largest farmland investment managers. These managers made $3 billion in farmland investments over the past five years in the U.S. as shown on the bar chart. The managers report approximately $4 billion in uninvested capital that has been allocated to them for new investments which will be invested as suitable investments are found. There continues to be strong interest among institutional managers and investors for both U.S. and international farmland opportunities.

Farmland Investments by Institutional Farmland Managers



Source: Callan

Farmland Historical Performance

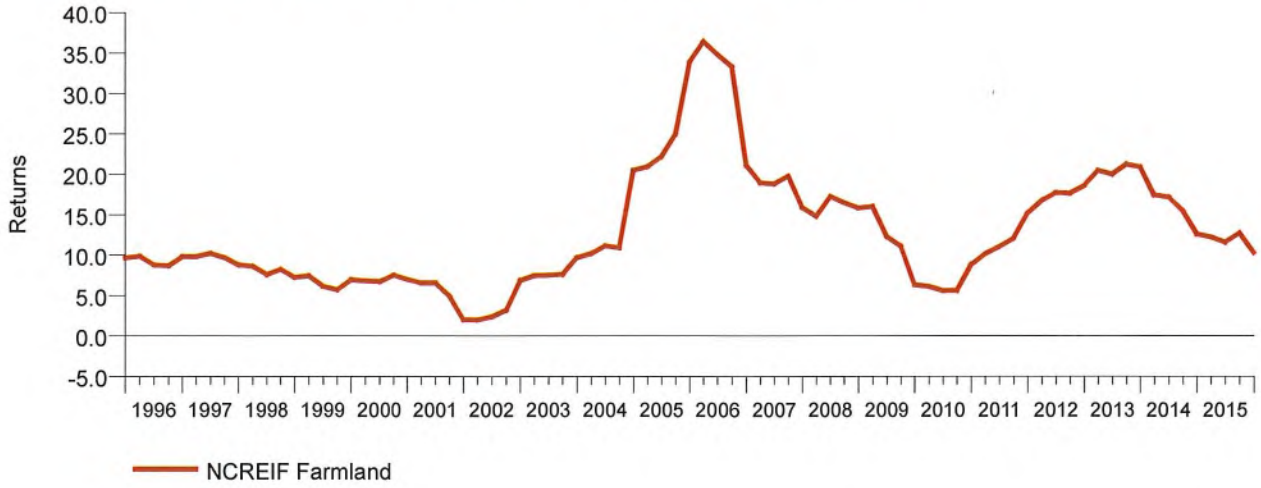
Private, institutional farmland performance is best measured by the NCREIF Farmland Index, a time-weighted, unlevered property level index that reports performance results quarterly. The index constituents are properties owned wholly and in joint ventures by voting members of NCREIF, and the inception date is 1991. Properties in the index have been acquired in the private market for investment purposes only on behalf of tax-exempt institutional investors. As such, all properties are held in a fiduciary environment.

Data is reported by the managers of the NCREIF members' farmland investments, and both income and market value data is reported to NCREIF each quarter. Returns are reported on an all-cash, unleveraged basis before fees. Each property's market value is determined by real estate appraisal methodology, consistently applied. It is important to note that, while the Index is the industry standard, it represents only a small sample size of the total United States farmland market. As of December 31, 2015, The NCREIF Farmland Index is made up of 667 properties with a market value of $6.727 billion. The NCREIF Farmland Index has two property type sub-indices – Annual Cropland and Permanent Cropland. There are twelve regional sub indices which align with the USDA Economic Regions except that Pacific is split into two regions and NCREIF has an Other region. The NCREIF

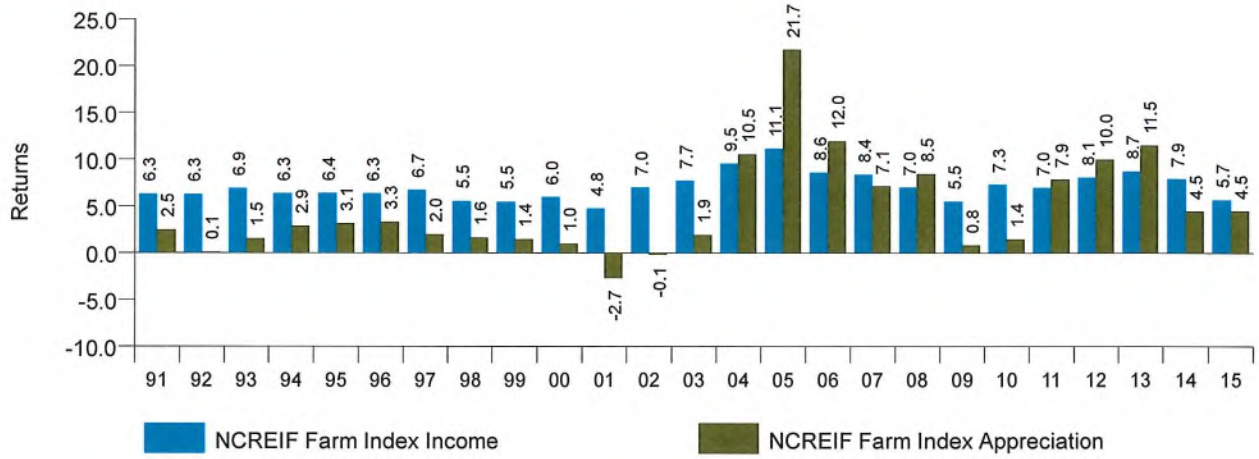
Farmland Regions include: Pacific West, Pacific Northwest, Mountain, Corn Belt, Lake States, Southeast, Delta States, Appalachian, Northern Plains, Southern Plains, Northeast, and Other. Annual Cropland comprises 423 properties and $3.610 billion of market value and Permanent Cropland comprises 244 properties and $3.118 billion. Idaho is in the Mountain region of the NCREIF Farmland Index along with Arizona, Colorado, Montana, Nevada, New Mexico, Utah, and Wyoming. As of December 31, 2015, the Mountain Region consists of 48 Annual Cropland properties representing $428.9 million in market value and no Permanent Cropland. Thirty-two properties in the Mountain region are located in Idaho with a market value of $280 million.

Farmland returns have been strong but have begun to moderate moving toward historical long term averages. The table below highlights the historical performance for the NCREIF Farmland Index. The first chart highlights the rolling four quarter return history of the NCREIF Farmland Index over the last 20 years. The second chart highlights the income and appreciation returns of the Index.

Rolling 4 Quarter Gross of Fee Returns for 20 Years Ended December 31, 2015



NCREIF Farmland Income and Appreciation Gross Returns for 25 Years Ended December 31, 2015

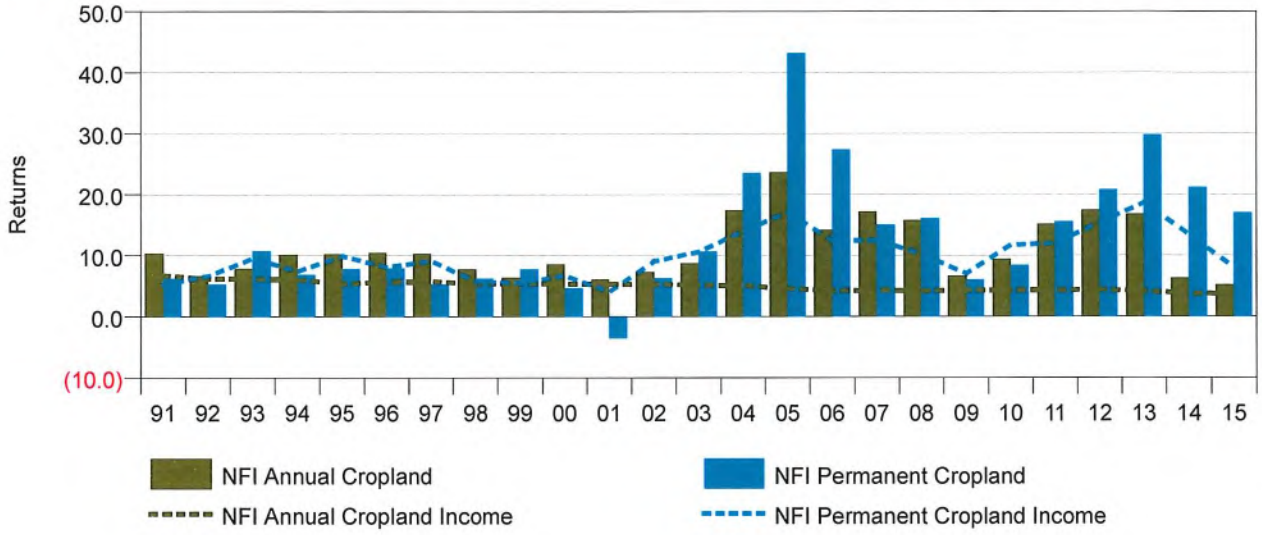


Gross Returns for Periods Ended December 31, 2015

	Last Year	Last 5 Years	Last 10 Years	Last 15 Years	Last 25 Years
NCREIF:Farm Idx	10.35	15.47	14.47	14.33	11.85
NCREIF Farm Index Appreciation	4.48	7.63	6.74	6.46	4.63
NCREIF Farm Index Income	5.69	7.47	7.41	7.61	7.05
NFI Annual Cropland	5.18	12.02	12.27	12.32	10.91
NFI Annual Cropland Appreciation	1.42	7.73	7.87	7.61	5.71
NCREIF Farm Index Income	5.69	7.47	7.41	7.61	7.05

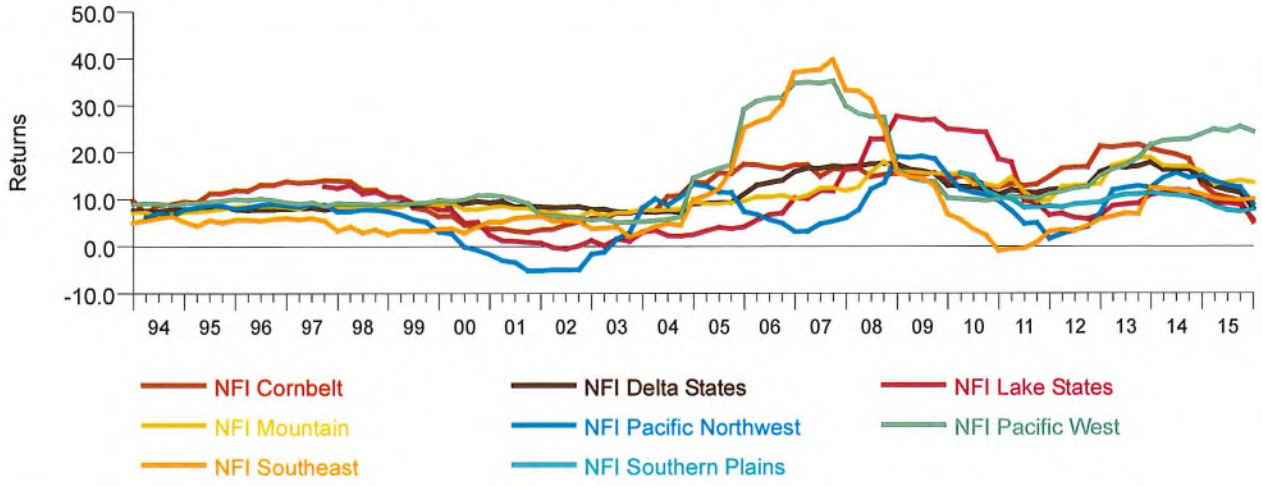
The returns of Annual Cropland compared to Permanent Cropland are shown on the chart below. Permanent crops, led by nut crops, have outpaced annual crop investments in recent years both in total return as well as income return. The annualized total return for permanent crops over the past ten years has been 17.50% versus the 12.27% annualized ten year return for row crops.

US Farmland Gross Returns, Row Crops and Permanent Crops for 25 Years Ended December 31, 2015



The rolling return by region is shown on the chart below. The difference in returns between Annual Cropland and Permanent Cropland as well as the regional performance differences are a primary reason many investors seek to build diversified regional exposure to farmland

Rolling 12 Quarter Gross Returns for 22 Years Ended December 31, 2015

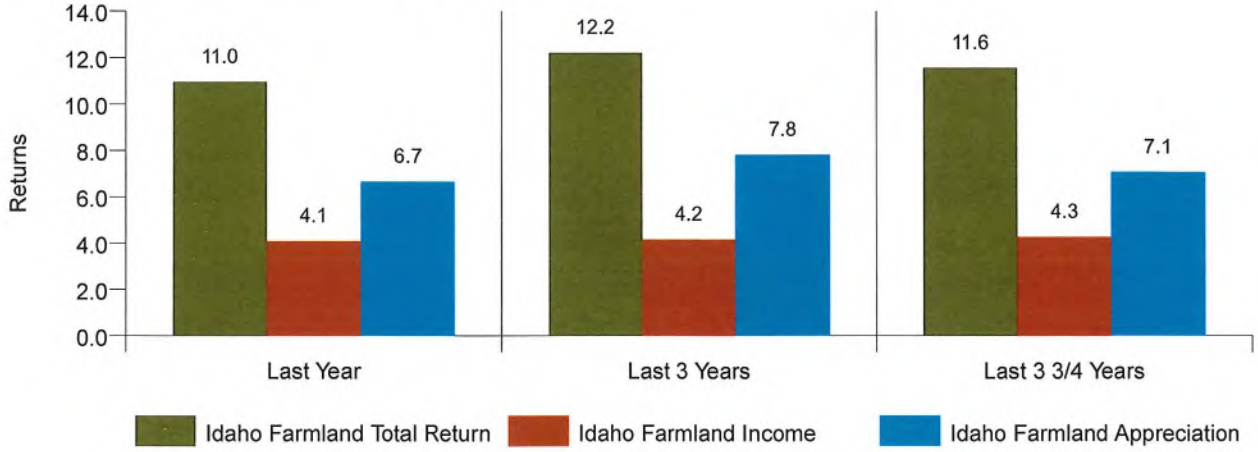


Idaho farmland in the NCREIF Farmland Index is comprised soley of annual cropland. The data series is relatively short and is shown on the chart following:

Gross Returns for Calendar Years
3 Years Ended December 31, 2015

	2015	2014	2013
Idaho Farmland Total Return	10.95	4.51	21.85
Idaho Farmland Appreciation	6.66	0.51	16.91
Idaho Farmland Income	4.09	4.00	4.41

Gross Returns for Various Periods
Current Quarter Ending December 31, 2015



Expected Returns

Callan surveyed the farmland investment manager universe. We received responses from eight managers with $5.3 billion of farmland assets under management. The farmland investment manager universe has a widely varying set of expectations for domestic farmland returns over the next five to ten years and there are substantial differences in expectations for row crops versus permanent crops. Operated permanent crops have higher return expectations and higher income expectations. Permanent crops are forecast to have a 9.0%-13.5% total nominal return with an 8-10% income return whereas Leased Row Crops are in the range of 6.5%-11.0% total nominal return with a 3.5%-6.0% income return. We find investment manager surveys are usually on the optimistic side; however, investment managers do expect a downward shift in the real return of the asset class over the next five to ten years.

In the search for higher returns, managers are pursuing strategies that combine farmland with private equity type investing (e.g investing in farmland infrastructure or fully integrated agribusiness operations, distribution, ag tech, processing) which are projected to generate 10% and higher total returns, but include higher risk as well. International strategies are also a mechanism some managers are using to generate higher returns.

Ways to Invest in Farmland

Institutional investors invest in farmland primarily through the use of a specialist farmland investment managers. Making farmland investments and managing them directly using in house staff, like IDL, is not typical due to the complexity, specialist knowledge of farmland, time required to assemble a diversified portfolio of farmland, and to retain, on staff, the expertise to properly oversee and manage those investments. Investing via a farmland investment manager provides diversification, experience, scale, and confidence that best in class farm management practices are being implemented.

Investment programs are implemented through pooled investment vehicles, including open end and closed end funds, or separately managed accounts. There is one institutionally recognized farmland open end fund and a few other open end funds focused on individual investors. The institutional open end fund is broadly diversified across the U.S. farmland sector by permanent and row crops as well as geography and has a long track record. Closed end funds may pursue higher risk strategies that may use leverage and combine farmland with private equity type investing discussed earlier or international strategies.

Separate accounts require a larger amount of capital than fund investments, typically at least $50 million. Investment management fees range from 50 to 100 basis points on the net asset value of the account. Separate accounts provide a higher level of control to the investor and are customizable according to investor needs. Typically the farmland investment manager operates within pre-set guidelines established at the inception of the account and approved annually by the investor. Acquisitions and dispositions in an account are approved by the investment committee of the investment manager provided they are within the established guidelines. Some investors require the manager to obtain approval for all transactions from the investor's investment committee or similar decision-making board; however this process may put the investor at a disadvantage due to the uncertainty it creates and additional time required to close a transaction. In a separate account, an investor has the ability to to terminate the advisor at any time and move the assets to another manager, which fosters greater manager accountability.

Investors can also access farmland through public REITs. The universe of farmland REITs is very small and very new. There are three farmland REITs including: Gladstone Land Corp. (LAND), with an inception date of 2013, Farmland Partners Inc. (FPI), with an inception date of 2014, and American Farmland Co. (AFCO), which held its initial public offering in 2015. The lack of track record, size of each company, and amount of leverage represent significant risks making implementation via the public markets unattractive for now.

A major consideration in developing a farmland investment strategy is risk tolerance and where an investor wants to be in the value chain. The basic building blocks to any portfolio are permanent plantings and row crops. Because of the significant investment in living improvements, permanent plantings are generally direct operated with the investor bearing all the volatility and risk of crop yield and commodity price. This is contrasted to row crops where the norm is cash leasing to an operator who bears the production and commodity price risk.

The chart below provides an overview of different risk scenarios and provides a context for evaluating an investor's risk tolerance and relative risk in an existing portfolio of farmland.

Investor Risk Preference or Portfolio Characteristics

Portfolio Diversification Factors	Low	Medium	High
Geography	Broadly Dispersed	Moderately Dispersed	Narrowly Dispersed
Commodity	Large Assortment	Medium Assortment	Small Assortment
Crop Type	100% Row 0% Permanent	50% Row 50% Permanent	0% Row 100% Permanent
Management Style	100% Leased 0% Operated	50% Leased 50% Operated	0% Leased 100% Operated
Leasing Arrangement	100% Fixed Rent 0% Flexed Rent	50% Fixed Rent 50% Flexed Rent	0% Fixed Rent 100% Flexed Rent
Operating Arrangement	100% Custom Farm 0% Directly Operate	50% Custom Farm 50% Directly Operate	0% Custom Farm 100% Directly Operate

Source: Callan 2015 Farmland Investment Survey and Hancock Agricultural Investment Group

Conclusions and Implications for Investment

Strong demand for farmland is expected to continue to meet the increasing global demand for food, fiber,and energy, as well as to satisfy institutional investor demand for diversifying, inflation-hedging assets. The relatively fixed supply of land capable of supporting agriculture is another favorable factor supporting the investment case for farmland. With less leverage and increasing technological efficiencies, the farm sector is better positioned for weak prices compared to the decline of 1980s. [9] Additionally, operators and investors have adjusted their return expectations downward. Moderating farmland prices may represent an attractive entry point if transactions are carefully underwritten over the next several years.

Primary risks of investing in farmland include the risks of crop destruction due to fire, disease, pests, natural weather events, and changing demand for agricultural products. These risks are primarily mitigated by investing in a diversified farmland portfolio. Additionally, today valuations may exceed current fundamentals with appraised values lagging the decline in pricing given weakening fundamentals of some commodities. There is a risk in potentially overpaying. Tenant credit default is more of a risk today highlighting the need to conduct extensive due diligence on a tenant's financial status, require a letter of credit and rental pre payments, and invest in areas with deep pools of tenants to replace a tenant/operator in the event of a default. An exhaustive descripton of risks is included in the Appendix.

9 Hancock Agricultural Investment Group, "Farmland Investor," Voume 22, Number 2.

The pace of investment in farmland is typically slower than timberland or commercial real estate due to the the limited pool of investment transactions every year. There is not a pool of closed end funds that are reaching maturity and selling assets like in timberland. Investors tend to buy and hold, the asset class is popular with significant competition for transactions, and operators/farmers have had strong balance sheets for acquiring farmland, with limited incentive to sell. There is an expectation by farmland managers that current relatively weak fundamentals may be a catalyst for weaker, marginal farmers/owners to sell their land. Some expect that stronger farmers may stay on the sidelines with regard to new acquisitions, again due to the state of the market. Access to transaction deal flow via relationships with institutional and local owner/operators is critical to building a portfolio. Investors must have an appropriately long term time frame to acquire a diversified portfolio of farmland, typically at least five years. The timeframe is similar for direct acquisitions in a separate account as well as investing via the open end fund. Investment horizons for closed end fund investments span from 10 to 15 years.

NASS Cropland Per Acre Prices and Percentage Change

	Appalachian	Y/Y%	Corn Belt	Y/Y%	Delta States	Y/Y%	Lake States	Y/Y%	Mountain	Y/Y%	Northeast	Y/Y%	Northern Plains	Y/Y%	Pacific	Y/Y%	Southeast	Y/Y%	Southern Plains	Y/Y%	Idaho	Y/Y%	US Total	Y/Y%
2006	$3,290		$3,090		$1,540		$2,480		$1,520		$4,970		$985		$4,690		$3,790		$1,110		$2,450		$2,300	
2007	$3,570	8.51%	$3,530	14.24%	$1,690	9.74%	$2,830	14.11%	$1,640	7.89%	$5,350	7.65%	$1,090	10.66%	$5,420	15.57%	$4,180	10.29%	$1,250	12.61%	$2,770	13.06%	$2,530	10.00%
2008	$3,730	4.48%	$4,030	14.16%	$1,800	6.51%	$3,080	8.83%	$1,670	1.83%	$5,590	4.49%	$1,280	17.43%	$5,570	2.77%	$4,380	4.78%	$1,390	11.20%	$2,800	1.08%	$2,760	9.09%
2009	$3,550	-4.83%	$3,840	-4.71%	$1,810	0.56%	$2,970	-3.57%	$1,600	-4.19%	$5,340	-4.47%	$1,280	0.00%	$5,160	-7.36%	$4,010	-8.45%	$1,370	-1.44%	$2,610	-6.79%	$2,640	-4.35%
2010	$3,490	-1.69%	$4,090	6.51%	$1,890	4.42%	$3,010	1.35%	$1,520	-5.00%	$5,270	-1.31%	$1,410	10.16%	$4,980	-3.49%	$3,800	-5.24%	$1,400	2.19%	$2,480	-4.98%	$2,700	2.27%
2011	$3,440	-1.43%	$4,810	17.60%	$2,020	6.88%	$3,310	9.97%	$1,540	1.32%	$5,200	-1.33%	$1,730	22.70%	$5,070	1.81%	$3,810	0.26%	$1,450	3.57%	$2,470	-0.40%	$2,980	10.37%
2012	$3,550	3.20%	$5,600	16.42%	$2,160	6.93%	$3,790	14.50%	$1,600	3.90%	$5,280	1.54%	$2,210	27.75%	$5,310	4.73%	$3,710	-2.62%	$1,500	3.45%	$2,580	4.45%	$3,350	12.42%
2013	$3,690	3.94%	$6,470	15.54%	$2,380	10.19%	$4,240	11.87%	$1,780	11.25%	$5,260	-0.38%	$2,720	23.08%	$5,690	7.16%	$3,690	-0.54%	$1,480	-1.33%	$2,850	10.47%	$3,810	13.73%
2014	$3,780	2.44%	$7,000	8.19%	$2,510	5.46%	$4,670	10.14%	$1,690	-5.06%	$5,260	0.00%	$3,090	13.60%	$5,860	2.99%	$3,730	1.08%	$1,630	10.14%	$3,040	6.67%	$4,100	7.61%
2015	$3,830	1.32%	$6,840	-2.29%	$2,600	3.59%	$4,670	0.00%	$1,740	2.96%	$5,330	1.33%	$3,130	1.29%	$6,160	5.12%	$3,770	1.07%	$1,780	9.20%	$3,200	5.26%	$4,130	0.73%

Idaho Farmland Information

The following information on Idaho farmland price, volatility and return trends was provided by Resource Dimensions to IDL as an update to the March 2010 Agriculture Market Rent Study.

Real Cash Rents Plus Land Appreciation Returns for Idaho Cropland 2003-2015

Year	Land Value ($/Acre)	Change in Land Value ($/Acre)	Appreciation Rate	Cash Rent ($/Acre)	Rent-to-Value Ratio	Appreciation + Cash Rent ($/Acre)	Total Rate of Return
Irrigated							
2003	2,834			149	5.3%		
2004	2,924	90	3.2%	148	5.1%	238	8.4%
2005	3,398	475	16.2%	150	4.4%	625	21.4%
2006	4,585	1,187	34.9%	150	3.3%	1,338	39.4%
2007	4,973	387	8.4%	149	3.0%	536	11.7%
2008	4,954	-19	-0.4%	160	3.2%	141	2.8%
2009	4,419	-535	-10.8%	177	4.0%	-358	-7.2%
2010	3,631	-788	-17.8%	153	4.2%	-636	-14.4%
2011	4,025	394	10.9%	177	4.4%	571	15.7%
2012	4,171	146	3.6%	187	4.5%	332	8.3%
2013	4,314	143	3.4%	180	4.2%	323	7.8%
2014	4,605	292	6.8%	197	4.3%	489	11.3%
2015	4,830	225	4.9%	205	4.2%	430	9.3%
Average	4,128	166	4.5%	168	4.1%	336	8.6%
Standard Deviation	728	495	13.1%	20	0.7%	494	13.4%
Non Irrigated							
2003	1,005			66	6.5%		
2004	1,004	-1	-0.1%	67	6.6%	66	6.5%
2005	1,032	28	2.8%	67	6.5%	95	9.4%
2006	1,234	203	19.7%	68	5.5%	271	26.3%
2007	1,406	172	13.9%	66	4.7%	238	19.3%
2008	1,497	91	6.5%	61	4.0%	152	10.8%
2009	1,436	-61	-4.1%	63	4.4%	2	0.1%
2010	1,166	-271	-18.8%	57	4.9%	-213	-14.9%
2011	1,275	109	9.4%	58	4.5%	167	14.4%
2012	1,249	-26	-2.0%	54	4.3%	28	2.2%
2013	1,333	84	6.7%	57	4.3%	141	11.3%
2014	1,322	-11	-0.8%	61	4.6%	50	3.7%
2015	1,400	78	5.9%	65	4.6%	143	10.9%
Average	1,258	33	2.8%	62	4.9%	95	7.7%
Standard. Deviation	166	124	9.8%	5	0.9%	126	10.3%

Farmland Risks

Potential risks associated with investing in U.S. Farmland include, but are not limited to the following:

a. **Environmental Risks**. Investment returns may be impacted by environmental issues, events and risks including but not limited to the following:
   - Drought
   - Flood
   - Water use (overexploitation/depletion and deteroriation of groundwater)
   - Soil type and drainage
   - Soil erosion/deletion
   - Pollution from agrochemicals
   - Biodiversity impacts, deforestation
   - Greenhouse gas (GHG) emissions
   - Endangered species
   - Issues related to intensive production, monocultures (use of land for growing only one type of crop), genetically modified organisms (GMO) use
   - Storage tank contamination
   - Groundwater or soil contamination from on or off-site sources
   - Weather
   - Pests
   - Climate change

b. **Social Risks**.
   - Risks related to food price volatility
   - Human/labor rights issues. Farmland investments may have an impact on labor groups and public sector employment opportunities.
   - Impact of on small farmers and local/regional food security
   - Impacts of intensive land use on communities
   - Occupational health and safety

c. **Commodity Price Volatility.** Given the uncertain and volatile nature of commodity prices, return in any one year may be impacted, both on the income and appreciation side. This risk is heightened if lands are being leased and part of the rent is dependent on production or price levels.

d. **Productivity Risk**. External operators or lessees may poorly manage farmland operations, use inappropriate agricultural techniques, or the original land selection may not produce as expected.

e. **Financing Risks**. Changes and volatility in the credit and equity markets may impact financing efforts and the capital structures of underlying agriculture investments or the lessee.

f. **Tenant Risk**. Tenant default and failure to pay rent may occur.

g. **Leverage Risk.** Farmland investments may utilize significant leverage which may increase financial and refinancing risks. This is not a risk for the Land Board currently as no leverage is used to acquire properties.

h. **Liquidity Risk.** As farmland investments may have long durations, they often are illiquid. Secondary markets for agriculture or farmland partnership investments may not be fully established or may provide limited opportunities.
i. **Market Risk**. The farmland market is a developing market globally and investment opportunities may be impacted by market supply and demand.
j. **Political and Headline Risks**. Agriculture or Farmland investments may involve political activities and may introduce headline risk to investors. Politics may impact the global trade of agriculture commodities. Politics may influence returns through adjustments to subsidies and bio-fuel mandates. Politics and regulations may impact water rights and water usage.
k. **Regulatory Risk.** Changes in regulatory mandates may impact investment returns and strategies.
l. **Management**. The investment manager universe for farmland investment is limited. Few institutional options are available which could impact manager diversification and manager substitution, if the need were to arise. The Land Board has chosen to use IDL as the internal manager and is dependent on one entity for management.

There are additional risks associated with investing in non-U.S. farmland that are not included in this document.

Historical Returns and Correlations for Farmland, Timberland, and Commercial Real Estate with Major Stock and Bond Indices

Gross of Fee Returns for Periods Ended December 31, 2015

	Last Year	Last 5 Years	Last 10 Years	Last 15 Years	Last 25 Years
NCREIF Timberland	4.97	6.84	6.92	6.83	10.28
NCREIF Farmland	10.35	15.47	14.47	14.33	11.85
NCREIF Property Index	13.33	12.18	7.76	8.96	8.05
S&P 500	1.38	12.57	7.31	5.00	9.82
Barclays Aggregate	0.55	3.25	4.51	4.97	6.15

Gross of Fee Correlation for 10 Years Ended December 31, 2015

	NCREIF Timberland	NCREIF Farmland	NCREIF Property	S&P 500	Barclays Aggregate
NCREIF Timberland	1.00	0.61	0.25	(0.16)	0.10
NCREIF Farmland	0.61	1.00	0.09	0.10	(0.10)
NCREIF Property Index	0.25	0.09	1.00	0.26	(0.20)
S&P 500	(0.16)	0.10	0.26	1.00	(0.27)
Barclays Aggregate	0.10	(0.10)	(0.20)	(0.27)	1.00

Glossary of Terms

Appraisal – An estimate or opinion of market value.

Appreciation – The percentage change in the market value of a property or portfolio over the period of analysis.

Asset Management – The various disciplines involved with managing real property assets from the time of investment through the time of disposition. Proper asset management plans and policies include: requirements for operating and capital budgets, property management, leasing, physical property analysis, operational and financial reporting, appraisal, audits, accounting policies and asset disposition plans (hold/sell analyses).

Benchmark – An index derived from database information that allows for comparative performance evaluation within an asset class.

Capital Improvements – Expenditures that cure or arrest deterioration of assets or add new improvements to prolong their lives.

Core Investment – Typical Core portfolio investments shall be mature, brownfield/existing assets that produce steady and predictable cash flows. These assets should be difficult to replicate and will be long life assets. The assets shall be located in well established markets.

Commingled Fund – A term applied to all open-ended and closed-ended pooled investment vehicles designed for institutional tax-exempt investors. A commingled fund may be organized as a group trust, partnership, corporation, insurance company separate account, private real estate investment trust or other multiple ownership entity.

- **Open-ended Fund** – A commingled fund with no finite life, which allows continuous entry and exit of investors and typically engages in ongoing investment purchase and sale activities.
- **Closed-ended Fund** – A commingled fund with a stated termination date, with few or no additional investors after the initial formation of the fund. Closed-ended funds typically purchase a portfolio of properties to hold for the duration of the fund and, as sales occur, typically do not reinvest the sales proceeds.

Compound Return: Compounded Returns are measured over long time periods (10 years) and reflect the reduction in return that comes from variations around the average return ("volatility drag").

Correlation: Correlations measure the amount of diversification between two asset classes. A correlation of 1 indicates no diversification. A correlation of -1 indicates perfect diversification. Very few investments have correlations much less than zero.

Dairy – A dairy is a business enterprise established for the harvesting of animal milk. A dairy farm produces milk and a dairy factory processes it into a variety of dairy products.

Discretion – The level of authority given to an investment manager over the investment and management of a client's capital once that capital is allocated to the investment manager.

Direct Investment – An investment in which an investor has a direct ownership interest in underlying agriculture projects and/or assets. This is compared to investment in a commingled fund structure where the investor has in interest in the commingled fund and the fund owns the underlying assets.

Diversification – Investing in a wide range of assets/projects or asset classes in order to reduce financial risk.

Due Diligence – The process of investigating, evaluating and analyzing a potential investment's characteristics, investment philosophy and terms and conditions.

Fair Market Value – The highest price a property would bring if exposed for sale in the open market by a willing seller to a willing buyer with both parties being fully informed of all the uses and purposes to which the property is reasonably adaptable and available.

General Partner – Managing partner of a limited partnership responsible for performing the day-to-day administrative operations of the partnership and acting as investment advisor to the partnership.

Income – The component of return derived from property or portfolio operations during the period of analysis.

Inflation – The general upward price movement of goods and services in an economy over a period of time.

Inflation-Link – Investments that allow inflation risk to be mitigated contractually through inflation-adjusted pricing agreements such as water utilities where the user fees are linked to Consumer Price Index (CPI).

Internal Rate of Return (IRR) – The discount rate at which the present value of future cash flows of an investment equals the cost of the investment. It is determined when the net present value of the cash outflows (the cost of the investment) and the cash inflows (returns on the investment) equal zero, the rate of discount being used is the IRR.

Investment Manager – A company that, by contractual agreement, provides farmland or timberland investment opportunities and/or property asset management services.

Joint Venture – A structure wherein an investor and a partner form a partnership to purchase and/or operate an investment or investments.

Leverage – The use of borrowed funds to increase purchasing power and, ideally, to increase the profitability of an investment.

Limited Partnership – A partnership with both general and limited partners in which the general partner manages the business and assumes full liability for the partnership obligations with the liability of the limited partners generally restricted to their capital contributions.

NCREIF Farmland Index – A quarterly time series composite return measure of investment performance of a large pool of individual agricultural properties acquired in the private market for investment purposes only. All properties in the Farmland Index have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment. The Index tracks U.S. properties exclusively.

NCREIF Property Index – A quarterly time series composite return measure of investment performance of a large pool of individual commercial real estate properties acquired in the private market for investment purposes only. All properties in the Property Index have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment. The Index tracks U.S. properties exclusively.

NCREIF Timberland Index – A quarterly time series composite return measure of investment performance of a large pool of individual timberland properties acquired in the private market for investment purposes only. All properties in the Timberland Index have been acquired, at least in part, on behalf of tax-exempt institutional investors - the great majority being pension funds. As such, all properties are held in a fiduciary environment. The Index tracks U.S. properties exclusively.

Net Asset Value (Nav) – Represents total assets at fair market value minus liabilities.

Net Operating Income (NOI) – Rental and other income of a property, less operating expenses, but before the deduction of capital expenditures and debt service.

Nominal Rate of Return: Rate of return before adjusting for inflation

Opportunistic – A phrase characterizing an investment in underperforming and/or undermanaged assets/projects typically purchased from distressed sellers, utilizing high levels of leverage at times with the expectation of near-term increases in cash flow and value.

Pastoral Farming – is the branch of agriculture concerned with the raising of livestock. It is animal husbandry: the care, tending and use of animals such as cattle and sheep.

Permanent Crop – A crop that grows on a tree or vine. Permanent crops are typically categorized as citrus fruits, fruits and nuts. Examples include oranges, wine grapes, apples, almonds, walnuts, etc.

Property Management – The various functions that are performed at the property level in order to assure timely collection of rents, payment of expenses and supervision of on-site activities.

Real Rate of Return – Rate of return after adjusting for inflation (typically determined by the Consumer Price Index).

Row Crop – A crop that requires annual planting. These can be categorized as commodities and vegetables. Examples include corn, cotton, grains, soy, oilseeds, potatoes, etc.

Specialty Crop – A non-traditional crop that requires specialized expertise in its growth, harvesting or transportation. Many fresh fruits and produce are considered specialty crops. Examples include lettuce, strawberries, mangos, broccoli, etc.

Total Return – The sum of the income and appreciation returns.

Value-Added – A phrase commonly used by investment managers to describe a management approach to an asset or project with the connotation that their skills will add value, which otherwise would not be realized.

Vintage Year – The year of formation for a fund or investment program and its first takedown of capital. By placing a fund/investment program into a particular vintage year, the investor can compare the performance of a given fund with all other similar type funds formed in that particular vintage year. In addition, that vintage year return can then be compared to an industry benchmark which is provided by a leading publication source.

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 18, 2017

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, July 18, 2017, 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 Secretary of State Lawerence Denney presided in place of the Honorable Governor C.L. "Butch" Otter. The following members were present:

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

For the record, Secretary of State Denney recognized the presence of Attorney General Wasden, Controller Woolf and Superintendent Ybarra. Secretary of State Denney also noted the presence of a quorum.

1. Director's Report

A. Interest Rate on Department Transactions – July 2017

B. Timber Sale Activity and Information Report – June 2017
DISCUSSION: Attorney General Wasden noted cumulative harvest receipts are 101% of the five-year average, but commented that the five-year average spanned over 10 years is probably a lot higher. Director Schultz asked if Attorney General Wasden was referring to the revenue over five years, such as what the number would look like in a 10-year average. Attorney General Wasden confirmed this, stating that the harvest rate has increased, and harvest receipts are 101% of the five-year average, but that five-year rate would seem longer than five years if cuts were increased, so those numbers are going to look similar on a graph. Director Schultz affirmed that they are. Attorney General Wasden asked if the increased rate of harvest is still occurring. Director Schultz stated that it is and explained that 10 years ago, the volume being harvested was 212 MBF, which resulted in lower revenues and lower harvest volumes. The harvest was increased around 2009, so from 2009 to 2017 the range is higher.

Secretary of State Denney inquired if the countervailing duties coming down will raise the stumpage prices. Director Schultz explained that the Department typically tracks pretty closely, so if there is a slight dip in lumber price, there will be a slight dip in stumpage. Director Schultz stated that cedar prices currently average about $600 per thousand higher than they were a year ago, and that when those cedar sales are complete there will be more revenue. The average price is $1,800 per thousand. Director Schultz continued to say that he thinks there could be a little bump, but he will wait to see how the summer progresses and what is in the next quarterly report.

C. Division of Lands and Waterways Activity and Information Report – June 2017

D. Cottage Site Update

E. Fire Season Update

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

A. Manager's Report
DISCUSSION: Mr. Johnson reported that the distributions for 2018 are well-secured, reserves as of the end of the fiscal year averaged about seven years and every Endowment exceeded their desired maximum. Mr. Johnson stated that the Investment Board held a meeting on June 22, where it agreed to submit a legislative idea to the Governor's office that would increase board member per diem compensation. Mr. Johnson noted that the Board will be presented with a recommendation for distributions for FY2019 and that the Investment Board will debate what recommendation they send the Board at their August 11 meeting. The Land Board Audit Committee will also meet on August 11 to review the independent auditor's report and approve the Endowment Fund's FY2017 financial statements.

B. Investment Report
DISCUSSION: Mr. Johnson remarked that the month of June was mildly positive for the Fund, which is up 60 basis points. The Fund finished the year at 12.8%, and after additional adjustments from a custodian for some accrued income, it rounded up to 12.9%. Mr. Johnson stated that inflation averaged 1.8%, so the Fund had an 11% return above inflation. He described that one of the Endowment Fund Investment Board's key measures is to outperform inflation over time. At the end of the previous year, the Endowment Fund Investment Board was approximately half a percentage point away from that number, so it made up the cumulative deficit from last year and now has real income in excess of 10% that will flow to the earnings reserve funds.

Controller Woolf questioned how the Endowment Fund Investment Board's return compared to that of the Public Employee Retirement System of Idaho for the year. Mr. Johnson stated that the Endowment Fund Investment Board barely beat them, as the Public Employee Retirement System of Idaho's return came in at about 12.7%.

- **CONSENT**

3. **Disclaimer of Interest in Former Bed of the Snake River, Elmore County, Idaho** – *Presented by Eric Wilson, Lands Bureau Chief, RPA*

   RECOMMENDATION: Direct the Department to issue a disclaimer of interest for the parcel totaling 0.97 acres of the former bed of the Snake River, and to require Elmore County to pay the remaining processing fee of $300 or actual cost, whichever is greater, to the Department of Lands for this transaction.

   DISCUSSION: Attorney General Wasden noted that there is a public right-of-way easement as well. Director Schultz affirmed that is correct, explaining that when handling a disclaimer of interest, the policy of the Board and the state has been to retain a 25-foot public right-of-way. This would allow the public legal access.

   Controller Woolf, referring to the map included as Attachment 1, asked if block 34 and block 33 have been disclaimed and if Director Schultz knew anything about the neighboring lots. Director Schultz responded that as far as he knew, they have not been disclaimed and that disclaimers of interest are typically an applicant-driven process. Director Schultz commented that it is typical to receive another application soon after one neighbor finds out another neighbor has done it.

4. **Approval of Minutes** – June 20, 2017 Regular Meeting (Boise)

CONSENT AGENDA BOARD ACTION: A motion was made by Attorney General Wasden to adopt and approve the consent agenda. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

- **REGULAR**

5. **Annual Review of Statement of Investment Policy** – *Presented by Sally Haskins, Senior Vice President, Callan Associates, Larry Johnson, EFIB Manager of Investments and Kari Kostka, Strategic Planning Manager*

   RECOMMENDATION: The Department and the EFIB recommend approval of the revised Statement of Investment Policy for the combined Endowment assets.

   DISCUSSION: None.

   BOARD ACTION: A motion was made by Attorney General Wasden that the Land Board adopt the Department and the EFIB's recommendation to approve the revised Statement of Investment Policy for the combined Endowment assets. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

6. **Annual Review of Strategic Reinvestment Plan** – *Presented by Sally Haskins, Senior Vice President, Callan Associates and Kari Kostka, Strategic Planning Manager*

RECOMMENDATION: The Department recommends approval of the updated Strategic Reinvestment Plan recommendations submitted by Callan Associates in their memo dated July 5, 2017. The Department will continue to establish a pipeline of transactions for acquisition of timberland and farmland for the Public Schools Endowment. The Department will continue to implement a diligent investment process, which includes financial analysis of each potential transaction, and will report progress toward reinvestment to the Land Board quarterly. The Department will not invest any non-Public Schools Endowment Land Bank funds until the asset allocation/spending study is completed and any new recommendations are approved by the Land Board.

DISCUSSION: Attorney General Wasden stated it makes sense to take a pause on non-public schools until the Board gets some additional information and that he wants to concentrate on the investment in timberland or farmland for public schools. Attorney General Wasden described how Callan recommended investment in timberland and farmland, based on the specific asset mix and the risks the Board was attempting to address, because it helped the Board's overall portfolio. Attorney General Wasden said he wanted to make certain that was still the case. Ms. Kostka responded it is definitely still the case, as it will be a benefit to invest the funds into timberland and farmland for public schools, which helps balance the risk of the overall portfolio. Ms. Kostka stated that the Board still wants to be investing in lands, but the same ratio or proportion that is appropriate for Public Schools might not be appropriate for the smaller Endowments. She continued to say that per Callan and the analysis the Department has done so far, it is appropriate to continue to invest for Public Schools due to their overall land asset and the size of their portfolio.

Attorney General Wasden remarked that he would like to hear from Ms. Haskins. Ms. Haskins said the important part of the original recommendation stated that if there are investments to be made, they need to be made at or above hurdle rates that are accretive to the existing land investment returns. Ms. Haskins explained that hurdle rates were set to be appropriate over the longer term. The language is to invest 'at or above' the hurdle rate, so if something changes in the environment and investments can be found that are above the hurdle rate, those investments should be selected at the appropriate risk. Ms. Haskins stated that she hoped her explanation answered Attorney General Wasden's question. Attorney General Wasden confirmed that it did and asked if it was Ms. Haskins' recommendation that the Land Board do this. Ms. Haskins responded that it absolutely was.

Controller Woolf verified that the hurdle rates haven't changed, asking if they are still 3.5% for timber or 4.5% for ag land or farmland. Ms. Haskins confirmed that those numbers are correct.

BOARD ACTION: A motion was made by Controller Woolf that the Board adopt the Department recommendation to approve the updated Strategic Reinvestment Plan recommendations submitted by Callan Associates in their memo dated July 5, 2017. The Department will continue to establish a pipeline of transactions for acquisition of timberland and farmland for the Public Schools Endowment. The Department will continue to implement a diligent investment process, which includes financial analysis of each potential transaction, and will report progress toward

reinvestment to the Land Board quarterly. The Department will not invest any non-Public Schools Endowment Land Bank funds until the asset allocation/spending study is completed and any new recommendations are approved by the Land Board. Attorney General Wasden seconded the motion. The motion carried on a vote of 4-0.

- **INFORMATION**

NONE

At 9:30 a.m. a motion was made by Attorney General Wasden to resolve into Executive Session pursuant to Idaho Code § 74-206(1)(b) to consider the evaluation of a public official. 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; *Nay*: None; *Absent:* Otter.

- **EXECUTIVE SESSION**

A. Idaho Code 74-206(1)(b) – to consider the evaluation, dismissal or disciplining of, or to hear complaints or charges brought against, a public officer, employee, staff member or individual agent, or public school student. [TOPIC: Performance Evaluation – Director, Department of Lands]

At 9:41 a.m. the Board resolved out of Executive Session by unanimous consent. No action was taken by the Board during the Executive Session.

- **REGULAR**

7. Personnel Matter – *No Board Materials*

DISCUSSION: Attorney General Wasden reported that the Board discussed the quality of work Director Schultz performs and the tremendous effort he puts forward. Attorney General Wasden noted that Superintendent Ybarra specifically mentioned Director Schultz's effort to keep the Board informed and the many steps he takes to be available to answer questions. Attorney General Wasden continued to say that the Board genuinely appreciates the leadership Director Schultz demonstrates for the Department and the fact that he is willing to sit down, examine difficult issues, and find solutions. Attorney General Wasden said that he has watched Director Schultz include his staff in determining those solutions as well and stated that presentations to the Board are of great quality. Attorney General Wasden remarked that the Board believes it is past time they consider compensation issues and then thanked Director Schultz for his leadership and the congenial way he deals with difficult issues. The Board noticed the confidence Director Schulz had in dealing with fractious parties in front of the Legislature, and Attorney General Wasden stated he appreciates it. Controller Woolf echoed the comments of Attorney General Wasden. Secretary of State Denney stated that Attorney General Wasden covered all the points the Board discussed and that the Board wants Director Schultz to know how much they appreciate what he does for them. Superintendent Ybarra conveyed deep gratitude from herself as well as her staff,

as they feel well-prepared in attending Land Board meetings and appreciate Director Schultz keeping them informed.

BOARD ACTION: A motion was made by Attorney General Wasden to increase the Director's salary by 5%; Attorney General Wasden further recommended a short-term commendable of $2,000 with the effective date of July 2, 2017, and pay date July 28, 2017. Controller Woolf seconded the motion. The motion carried on a vote of 4-0.

There being no further business before the Board, at 9:45 a.m. a motion to adjourn was made by Attorney General Wasden. Controller Woolf seconded the motion. The motion carried on a vote of 4-0. 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/ Lawerence E. Denney
Lawerence 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 August 15, 2017 regular Land Board meeting.

Callan

April 17, 2018

Idaho State Board of Land Commissioners

Asset Allocation and Distribution Study

Janet Becker-Wold, CFA
Fund Sponsor Consulting

Julia Moriarty, CFA
Capital Markets Research

Sally Haskins
Real Assets Consulting

Introduction

- Callan conducted a study on behalf of the Idaho State Board of Land Commissioners in 2014 to evaluate the governance structure, review the Land Board's Asset Management Plan and conduct an asset allocation analysis of the total endowment
- The Endowment Fund, the Department of Lands holdings, and Callan's forward-looking expectations for the capital markets have changed with the passage of time
- The goals of this update to the 2014 analysis include:
  - Assess the impact of cabin or cottage site sales on the level and volatility of income for the three endowments (Public Schools, Normal Schools, and State Hospital South) where it represents a meaningful percent of historical cash inflows *(pages 9, 10 and 12)*
  - Determine appropriate earnings reserve levels for each of the eight endowments and for the seven smaller combined *(pages 14-16)*
  - Determine whether the asset allocation, reserves, or distribution policy of the eight individual endowments should be changed *(pages 18-21)*
  - Determine the best use of land sale proceeds for each of the eight endowments and for the seven smaller combined *(pages 23-33)*

Idaho Land Grant Endowments – Investment Policy

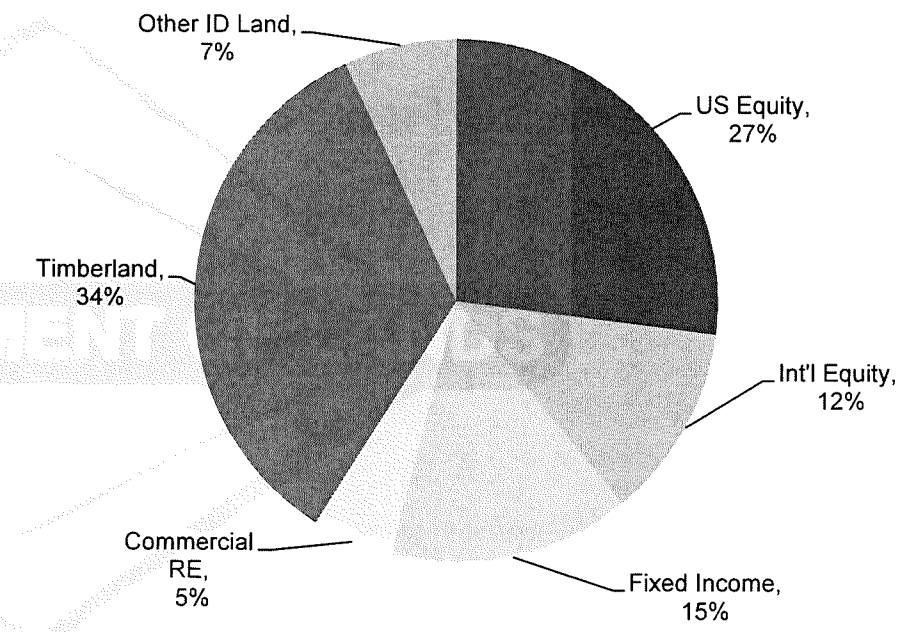
- Overseen by Idaho Board of Land Commissioners
- Investment goals
  - Maximize long-term financial return at a prudent level of risk
  - Provide relatively stable and predictable distributions to beneficiaries
  - Constrain distributions to protect future generations' purchasing power
  - Maintain sufficient liquidity
- Investment return objective
  - Per State Constitution and Statue, the Endowment as a perpetual time horizon
  - Return objective is to earn, over a long period, an annualized real return (net of fees, expenses and costs) above spending and inflation as well as population growth.
- Investment risk
  - Risk, as it relates to stability of distributions, shall be managed primarily by holding reserves of undistributed income
  - Risk as it relates to the volatility of earnings of the Endowment Assets, shall be managed primarily through diversification

Current Position

Total Endowment Asset Allocation

- As of June 30, 2017, the total Endowment was valued at $3.5 billion
  - Financial assets ($2.1 billion) represent approximately 60% of the Fund
  - Land assets ($1.4 billion) represent approximately 40% of the Fund
- $113 million (3.2% of the total Endowment value) resided at the Land Bank at December 31, 2017*
  - Funds may remain in the Land Bank for 5 years after deposit date
  - Next "maturity" is $21.5 million in 4Q 2020
- There are $118 million in forecasted land sales over the next 10 years
  - $69 million from FY18 through FY20
  - $7 million annually thereafter

Total Endowment Asset Allocation



Green = IDL allocations
Blue = Financial assets

*$47 million was transferred from the Land Bank to the Permanent Fund prior to the development of the Strategic Reinvestment Plan in 2016

Fiscal Year End 2018 Asset Allocation vs. Target

Total Endowment Asset Allocation: Current versus Target

Asset Class	June 30, 2017 (Millions)	June 30, 2017 (%)	Target Asset Allocation*	Range
Financial Assets	$2,108	59%	58%	50-65%
Timberland	$1,190	34%	39%	30-50%
Other Idaho Lands	$245	7%	2%	0-5%

*Excludes 1% Land Bank cash allocation

- Financial and Timberland allocations are within their specified ranges while Other Idaho Lands is outside its range
  - Current Financial Assets are close to target
  - Timberland is below target and Other Idaho Lands is above target as of June 30, 2017
- Land Bank deposits currently total $113 million or 3.2% of the total Endowment as of June 30, 2017

Summary Observations

- Relative to the 2014 study
  - The expected return on the financial assets is 50 basis points lower (6.3% versus 6.8%)
  - Projected net land revenues have generally declined for most endowments
  - Projected land revenue volatility is higher for seven of the eight endowments
- Reserve levels
  - Reserve levels need to rise for two of the eight endowments in order to obtain the same level of comfort that distributions will not decline (10 year projection) at the 95th percentile
    - *Public Schools needs to increase from 500% to 600% and Charitable Institutions from 500% to 700%*
    - *Temporary increases to 700% for State Hospital South and Normal Schools should be made permanent*
    - *The EFIB voted at a special board meeting on March 12th to recommend the above changes in earnings reserve levels to the Land Board*
- Distribution rates
  - Lowering the distribution rate results in marginal improvement in preventing a decline in distributions
- Asset allocation
  - Moving to a more or less aggressive asset allocation has very little impact on the prevention of a decline in distributions

Summary Observations

- Preference for financial assets versus land reinvestment for Land Bank assets differs based on the assumed return from lands, earnings reserve level, time period, and primary objective
  - A focus on real ending market values indicates land reinvestment is preferable
    - *Note that the portion of the real ending market value that represents land does not impact distributions nor is it expected to be sold*
  - Focusing on cumulative real distributions, a financial investment results in greater distributions in the expected and better-case outcomes while land reinvestment protects in poor capital market environments
  - Land reinvestment generally provides equal or better protection relative to the financial assets in terms of preventing a decline in distributions

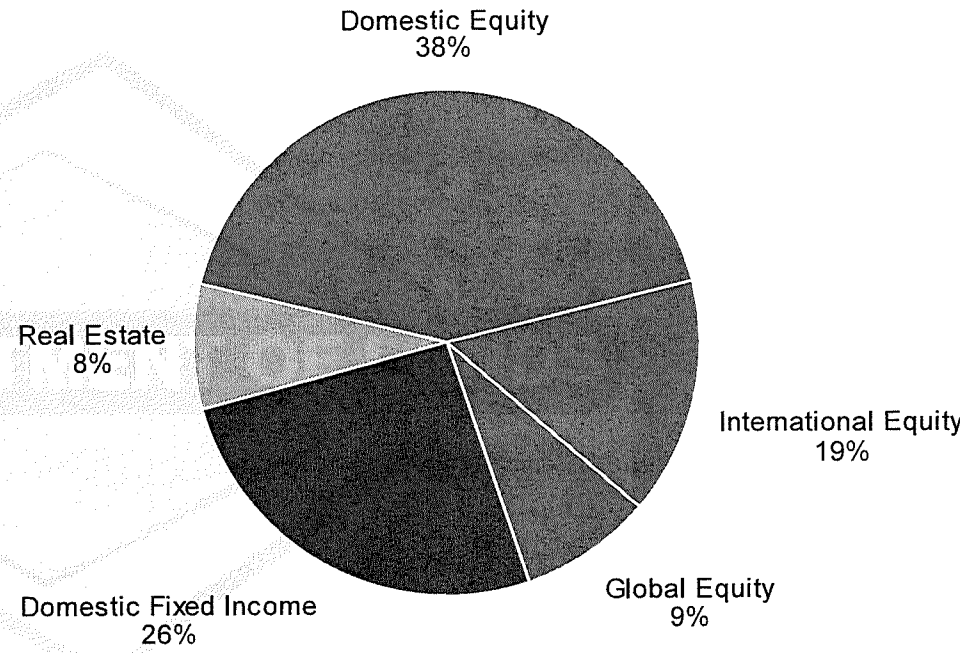
1 What's Changed?

Expected Return on Assets

2017-2018 Study versus 2014 Study

- The current Target allocation is shown in the pie chart to the right
- Using Callan's 2018 capital market expectations the current Target is expected to earn 6.3% over the next 10 years on an annualized basis
- The 2014 study employed a different Target allocation (70% public equity and 30% fixed income) which was projected to earn 6.8% or a 50 basis point premium over the 2018 return expectation

Target Asset Allocation



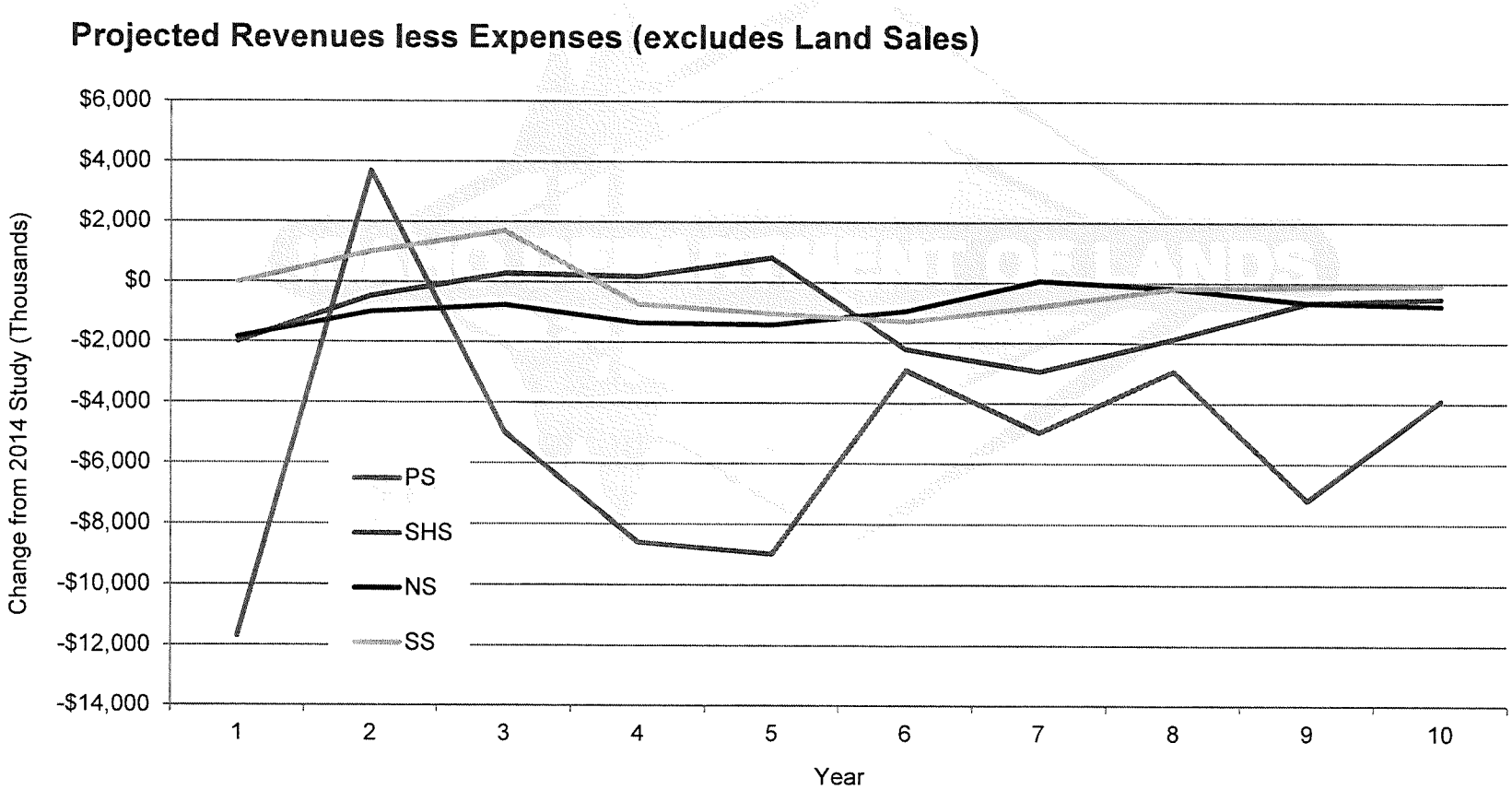
2017-2018 Expected Return: 6.3%
2014 Expected Return: 6.8%*

*Based on a 70% public equity and 30% fixed income target allocation

Projected Revenues less Expenses (excludes Land Sales)

2017-2018 Study versus 2014 Study

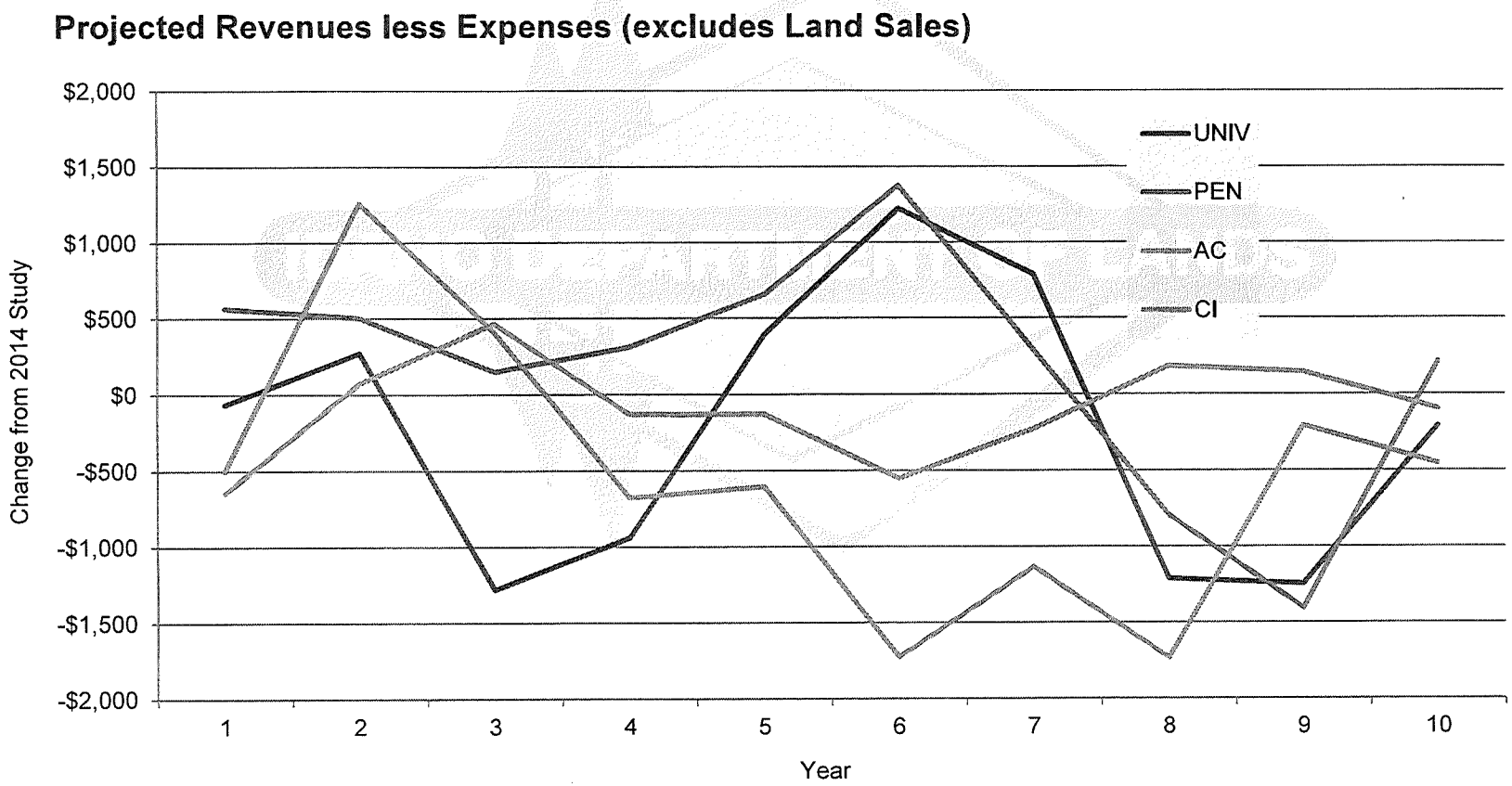
- Projected net revenues (excluding land sales) have generally declined from their 2014 levels



Projected Revenues less Expenses (excludes Land Sales)

2017-2018 Study versus 2014 Study

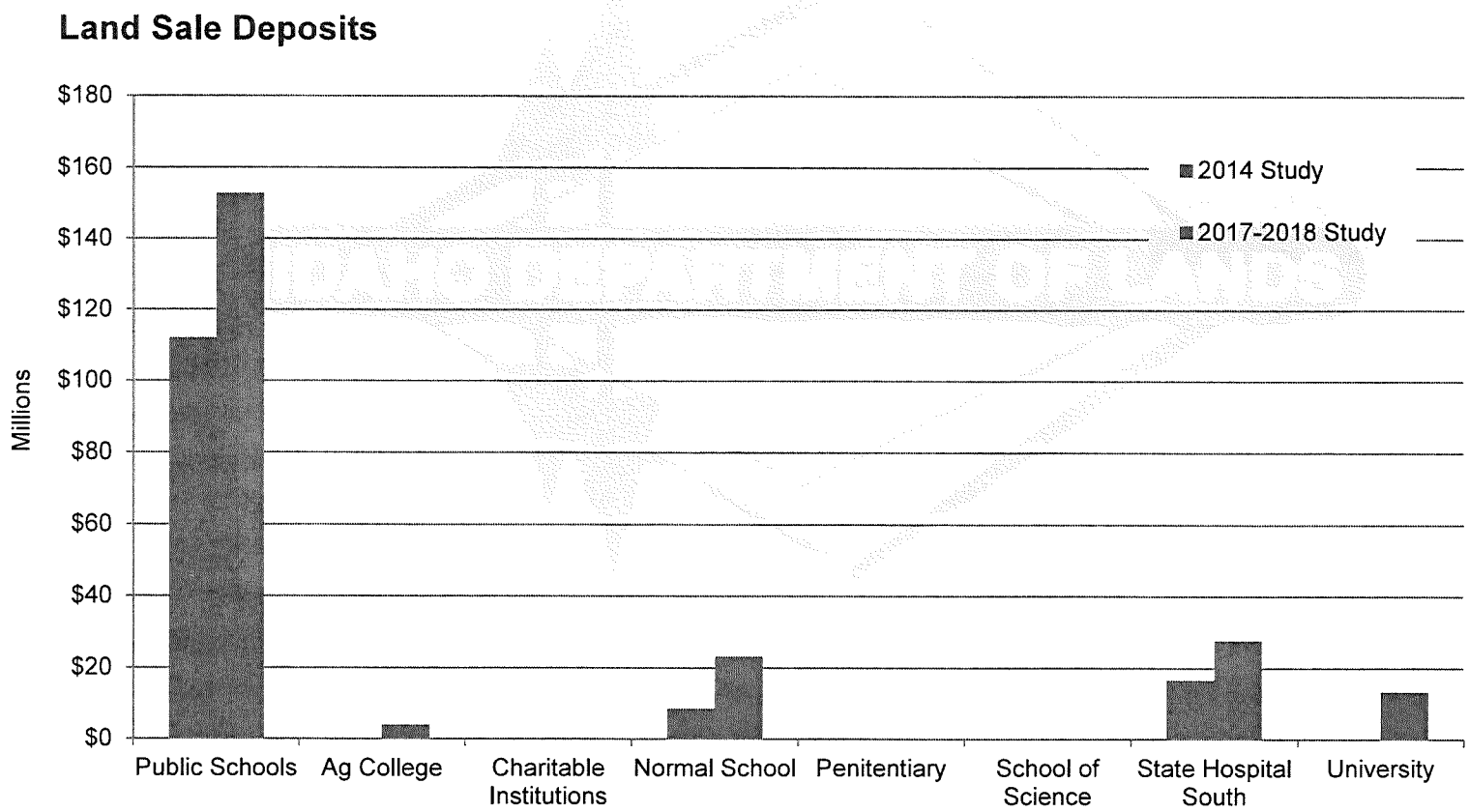
- Projected net revenues (excluding land sales) have generally declined from their 2014 levels over most years, with Penitentiary being the most notable exception



Land Sale Deposits

2017-2018 Study versus 2014 Study

- While land revenues are generally down relative to the 2014 study, deposits from land sales are up for the five endowments with meaningful sales
  - Public Schools, Ag College, Normal School, State Hospital South, University

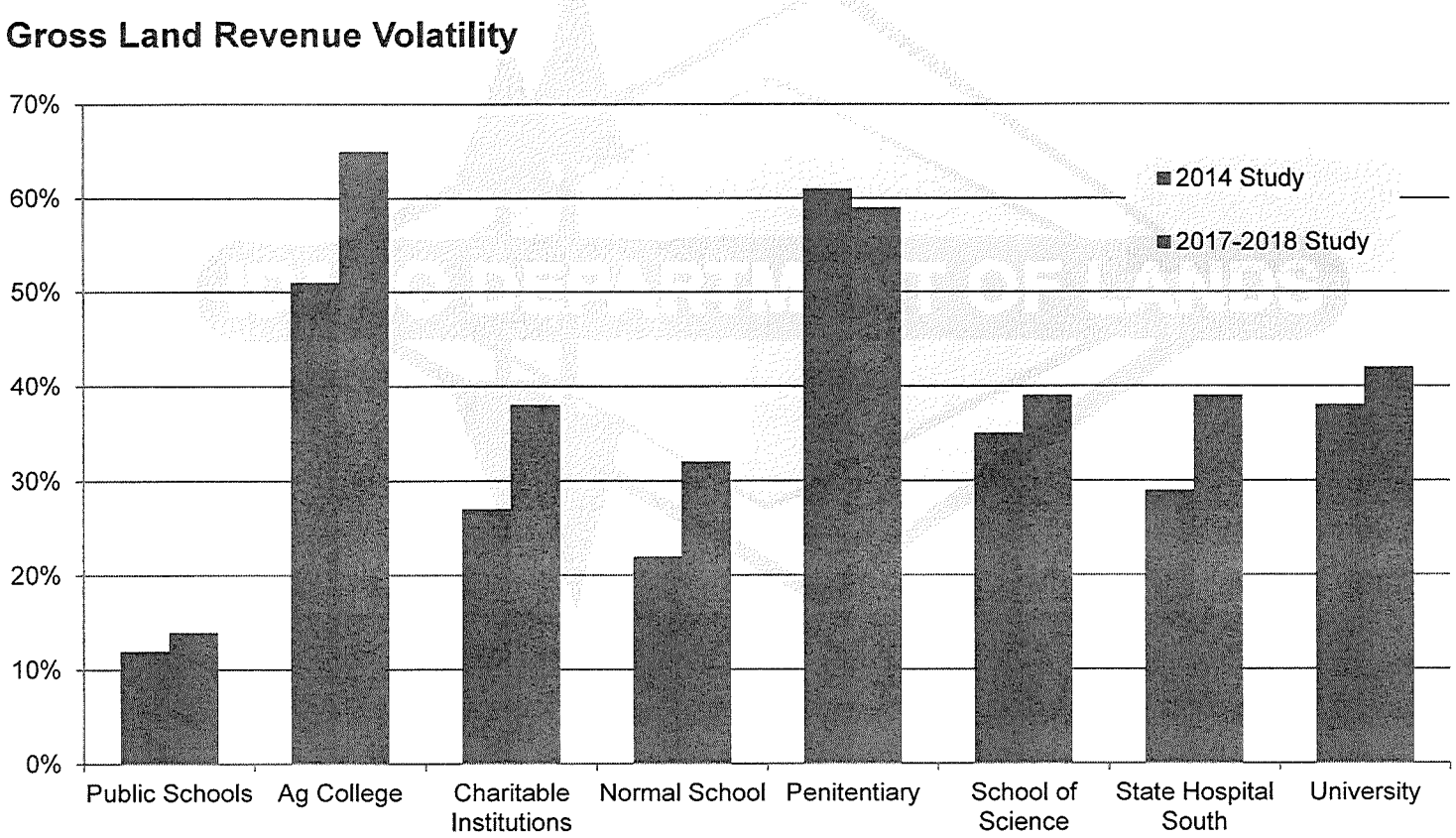


Notes: 2017-2018 amounts include the cash at the Land Bank (PS = $73, NS = $18, SHS = 22$); Land sale proceeds are assumed to be deposited into the PFs two years after the sale while earning interest at the Land Bank in the interim; $7 million in annual sales is assumed to occur beyond FY20 and are allocated pro-rata based on current land holdings

Gross Land Revenue Volatility

2017-2018 Study versus 2014 Study

- Gross land revenue volatility rose for all endowments from the 2014 study to today with the exception of Penitentiary
- Future land investments should be equal or less volatile than the existing portfolio



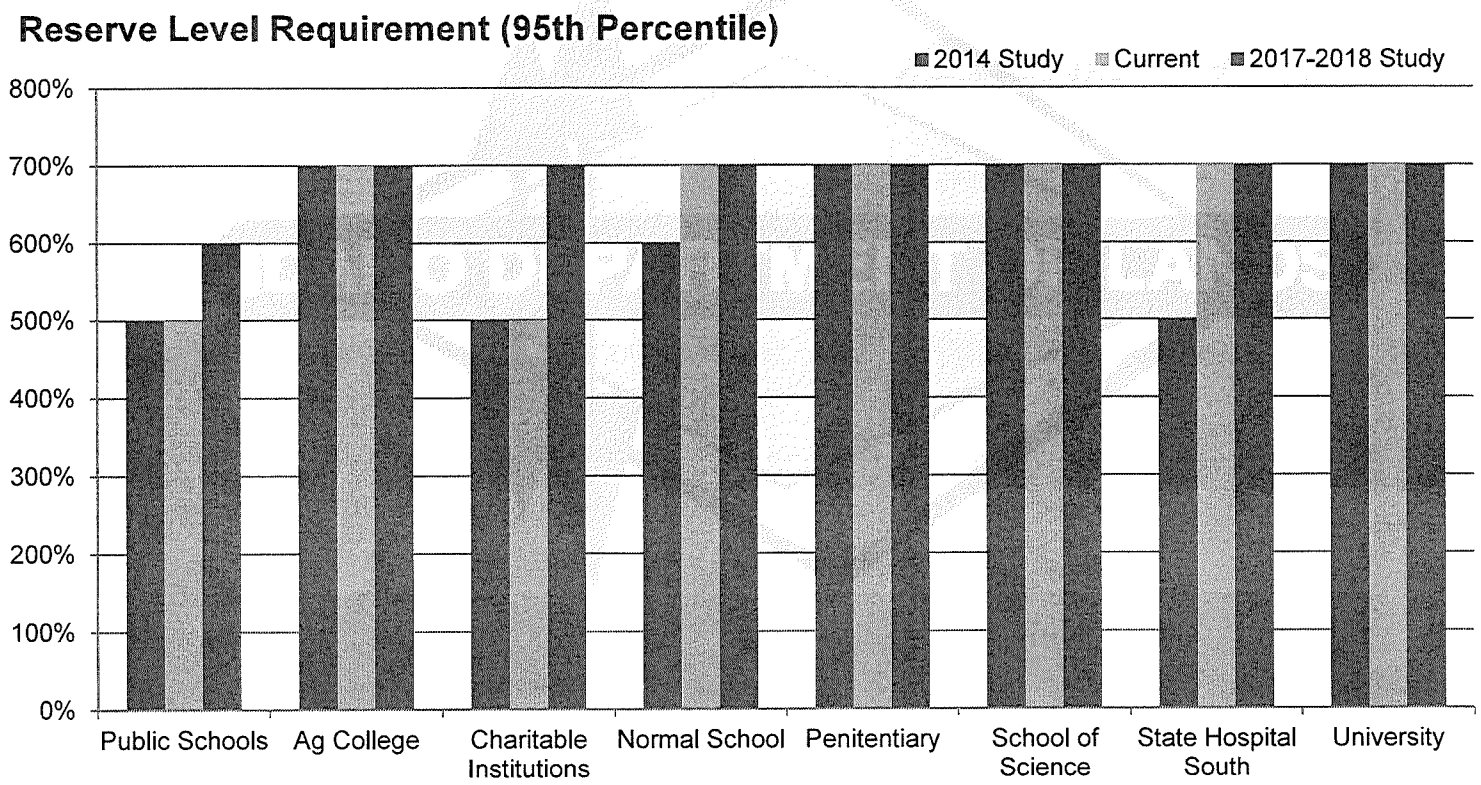
Notes: Volatility levels calculated as a % of 10 year projected gross land revenues; 2017-2018 models assume land sale proceeds are deposited in the Permanent Fund; 2014 volatility figures are based on actual and projected gross land revenues (1998-2024); 2017-2018 volatility figures are based on actual gross land revenues (1998-2017)

11 Reserve Levels

Reserve Level Requirements

10 Year Projection

- The chart below compares the level of reserves which prevents a decline in distributions at the 95th percentile outcome under the 2014 study (green bars) to the current study (blue bars)
- Reserve levels which are currently being employed are also shown (yellow bars)



Notes: Minimum reserves are 100% for all endowments with the exception of Public Schools (50%); Distribution rates are 5% for all endowments with the exception of State Hospital South (7%); Land sales are assumed to be deposited into the Permanent Fund after two years

Reserve Level Requirements

10 Year Projection

- Recommended reserve levels increase by approximately 70% (absolute) on average from those required in 2014 study
- Increased reserve levels are the result of a number of factors
  - The expected return on the investments is 50 bps lower
  - Projected net revenues are lower, although this is offset to a certain degree by increased land sale projections
  - Projected land revenues are more volatile
  - Year 1 and 2 distributions are greater as a percentage of the beginning market value
- Reserve levels need to rise for two of the eight endowments in order to obtain the same level of comfort that distributions will not decline
  - Public Schools needs to increase from 500% to 600% and Charitable Institutions from 500% to 700%

Reserve Level Requirements

10 and 20 Year Projections

- The table below indicates that reserve levels which prevent a decline in distributions over 10 years are not sufficient over 20 years

Level of Reserves Which Prevents a Decline in Distributions over 10 Years & # of Failures over 20 Years

Fiscal Years 2018-2027 & 2018-2037	Public Schools		Ag College		Charitable Institutions		Normal School	
	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years
90th Percentile	600%	2	700%	2	600%	3	700%	3
95th Percentile	600%	3	700%	3	700%	3	700%	3
97.5th Percentile	700%	3	800%	3	700%	3	800%	3

Fiscal Years 2018-2027 & 2018-2037	Penitentiary		School of Science		State Hospital South		University	
	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years	10 Year Reserve Level Requirement	# Yrs Failure over 20 Years
90th Percentile	600%	3	700%	3	600%	3	600%	3
95th Percentile	700%	3	700%	3	700%	3	700%	3
97.5th Percentile	700%	3	800%	3	700%	3	700%	3

Note: Minimum reserves are 100% for all endowments with the exception of Public Schools (50%); Distribution rates are 5% for all endowments with the exception of State Hospital South (7%)

11 Distribution Rates

Public Schools Testing Example

10 Year Projection

- Public Schools results for various distribution and reserve levels

Levels of Reserves Which Prevent a Decline in Distributions

Fiscal Years 2018 to 2027	5% Distribution; 500% Reserve Level; 50% Min. Reserve Level	4% Distribution; 500% Reserve Level; 50% Min. Reserve Level	4% Distribution; 500% Reserve Level; 50% Min. Reserve Level; Adjust Yr 0 Distribution	3% Distribution; 500% Reserve Level; 50% Min. Reserve Level; Adjust Yr 0 Distribution	4.75% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution	4.5% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution	4.25% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution	4% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution	3.75% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution	3.5% Distribution; 500% Reserve Level - ADJ; 50% Min. Reserve Level; Adjust Yr 0 Distribution
Percentile w/ No Decline	80th	80th	85th	95th	85th	90th	95th	97.5th	97.5th	97.5th
90th Percentile Failure	1/10	1/10	1/10	0/10	1/10	0/10	0/10	0/10	0/10	0/10
95th Percentile Failure	2/10	2/10	1/10	0/10	1/10	1/10	0/10	0/10	0/10	0/10
97.5th Percentile Failure	2/10	2/10	2/10	1/10	2/10	1/10	1/10	0/10	0/10	0/10

Marginal improvement

- Results indicate a 4.25% distribution rate combined with a 500% reserve level applied to a fictional 5% distribution prevents a decline in distributions at the 95th percentile
  - 4.5% distribution rate prevents a decline in distributions at the 90th percentile
  - 4.0% distribution rate prevents a decline in distributions at the 97.5th percentile

Public Schools Testing Example

10 Year Projection

- Several things contribute to the marginal improvement when lowering the distribution rate
- Earnings and net inflows from lands exceed distributions as a percentage of assets
- Distributions as a percentage of earnings reserve are higher under a 4% distribution rate in the first four years and higher under a 3% distribution rate over the first eight years
- Even when lowering the year 0 distribution and removing the fixed distribution amounts in years 1 and 2, there is only marginal improvement because distributions and earnings reserve decline ~proportionally given the size of the earnings reserve is a function of the size of the distribution
  - Distributions as a percentage of beginning earnings reserve in later years go from 4.9% under a 5% distribution rate to 4.8% under a 4% distribution rate to 4.7% under a 3% distribution rate

1 Asset Allocation

Public Schools Testing Example

10 and 20 Year Projections

PS	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous		
10 Years	Less Aggr.	Target	More Aggr.	Less Aggr.	Target	More Aggr.	Less Aggr.	Target	More Aggr.
2.5%	3,207,615	3,612,566	4,080,500	771,221	825,405	880,220	0%	0%	0%
5.0%	2,892,782	3,233,952	3,631,338	734,278	779,062	829,289	0%	0%	0%
10.0%	2,549,218	2,816,074	3,107,627	693,079	735,164	778,670	0%	0%	0%
25.0%	2,076,646	2,223,197	2,378,405	616,691	640,573	664,301	0%	0%	0%
50.0%	1,615,500	1,669,080	1,723,638	551,309	564,039	576,583	0%	0%	0%
75.0%	1,233,679	1,239,142	1,230,643	479,154	482,454	484,293	0%	0%	0%
90.0%	1,026,434	997,416	974,266	429,129	427,602	425,135	10%	10%	10%
95.0%	931,659	886,739	845,748	407,925	403,020	396,584	10%	20%	20%
97.5%	822,661	779,783	735,497	381,908	373,612	366,338	20%	20%	20%

PS	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous		
20 Years	Less Aggr.	Target	More Aggr.	Less Aggr.	Target	More Aggr.	Less Aggr.	Target	More Aggr.
2.5%	5,149,542	6,225,612	7,736,981	2,165,774	2,430,282	2,754,525	0%	0%	0%
5.0%	4,266,892	5,036,634	6,013,630	1,955,012	2,161,372	2,389,189	0%	0%	0%
10.0%	3,490,847	4,028,542	4,684,853	1,751,582	1,909,310	2,082,776	0%	0%	0%
25.0%	2,611,421	2,907,467	3,212,128	1,424,923	1,508,331	1,596,884	0%	0%	0%
50.0%	1,950,794	2,054,991	2,176,079	1,123,662	1,157,367	1,197,035	5%	5%	5%
75.0%	1,416,031	1,434,329	1,441,580	801,142	803,807	808,426	10%	10%	10%
90.0%	1,118,572	1,097,961	1,044,180	607,599	603,289	600,809	15%	15%	15%
95.0%	1,006,154	968,644	911,734	545,925	544,888	541,133	15%	15%	15%
97.5%	873,667	803,945	743,519	483,373	481,983	478,688	15%	15%	15%

Notes: Dollar amounts shown in thousands; Less Aggressive moves 10% from equity to fixed income while More Aggressive moves 10% from fixed income to equity

- Moving to a more or less aggressive asset allocation has very little impact on the prevention of a decline in distributions
- A less aggressive asset allocation results in lower real ending market values and cumulative real distributions in the expected and better-case scenarios but higher values in worse-case outcomes relative to the Target
- A more aggressive asset allocation results in higher real ending market values and cumulative real distributions in the expected and better-case scenarios but lower values in worse-case outcomes relative to the Target

11 Land Sale Proceeds

Land Bank Cash and Future Land Sales Testing

- The pages that follow illustrate real ending market values, cumulative real distributions, and distribution failures (defined as a decline in distributions) assuming the proceeds from land sales are put into the financial asset portfolio ("Fin'l") or reinvested in land ("Land")
- Five endowments currently have cash at the Land Bank and/or meaningful projected land sales
  - Public Schools, Normal School, State Hospital South, University, and Ag College
- Land sale proceeds are assumed to be held at the Land Bank for two years (earning interest) before being deposited into the financial asset portfolio or reinvested in land
- Land investments (timber and farmland) are expected to produce a 3.5% real yield that grows by price inflation (2.25%) and has the same volatility as current projected land revenues
- Nominal land values grow by price inflation and are factored into the real ending market value regardless of whether they can or will be sold
- While 10 and 20 year projections are shown, Callan believes the focus should be on the 10-year forecast as earnings reserve levels are based on the 10-year projection period and Callan and Department of Lands forecasts become less reliable over longer periods

Land Bank Cash and Future Land Sales: Public Schools

5% Distribution and 600% Earnings Reserve

10 Year Projection

3.50% PS: 600% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	3,644,287	3,554,469	89,819	800,658	771,068	29,591	0%	0%
5.0%	3,267,632	3,201,720	65,911	754,886	724,776	30,109	0%	0%
10.0%	2,842,608	2,796,951	45,657	715,780	688,198	27,582	0%	0%
25.0%	2,245,293	2,233,161	12,133	624,307	603,749	20,557	0%	0%
50.0%	1,683,543	1,691,310	-7,767	552,830	538,316	14,514	0%	0%
75.0%	1,233,714	1,274,505	-40,792	483,563	478,357	5,206	0%	0%
90.0%	985,604	1,021,081	-35,477	440,759	444,050	-3,291	0%	0%
95.0%	866,919	915,505	-48,586	424,672	430,032	-5,360	0%	0%
97.5%	755,734	807,768	-52,034	405,552	416,920	-11,368	10%	0%

20 Year Projection

3.50% PS: 600% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	6,378,375	6,232,993	145,382	2,408,482	2,285,526	122,956	0%	0%
5.0%	5,066,560	5,001,723	64,836	2,119,360	2,021,997	97,363	0%	0%
10.0%	4,075,610	4,014,388	61,222	1,880,210	1,787,190	93,020	0%	0%
25.0%	2,909,400	2,888,859	20,541	1,505,323	1,443,572	61,751	0%	0%
50.0%	2,033,894	2,045,060	-11,165	1,183,708	1,155,482	28,227	0%	0%
75.0%	1,405,479	1,436,641	-31,162	837,874	866,274	-28,400	10%	10%
90.0%	1,060,567	1,104,227	-43,660	630,255	680,644	-50,389	10%	10%
95.0%	938,450	987,798	-49,348	567,872	621,605	-53,733	15%	15%
97.5%	781,103	844,658	-63,556	508,462	565,257	-56,795	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Public Schools

5% Distribution and 500% Earnings Reserve

10 Year Projection

3.50% PS: 500% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	3,612,566	3,518,566	94,000	825,405	794,134	31,271	0%	0%
5.0%	3,233,952	3,169,914	64,038	779,062	748,129	30,933	0%	0%
10.0%	2,816,074	2,768,604	47,470	735,164	707,705	27,459	0%	0%
25.0%	2,223,197	2,210,431	12,767	640,573	620,397	20,175	0%	0%
50.0%	1,669,080	1,675,051	-5,971	564,039	549,623	14,416	0%	0%
75.0%	1,239,142	1,265,670	-26,528	482,454	484,023	-1,568	0%	0%
90.0%	997,416	1,031,876	-34,460	427,602	441,555	-13,953	10%	0%
95.0%	886,739	933,015	-46,276	403,020	425,743	-22,722	20%	10%
97.5%	779,783	821,202	-41,419	373,612	407,256	-33,644	20%	10%

20 Year Projection

3.50% PS: 500% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	6,225,612	6,079,762	145,850	2,430,282	2,324,820	105,462	0%	0%
5.0%	5,036,634	4,890,103	146,531	2,161,372	2,056,367	105,005	0%	0%
10.0%	4,028,542	3,939,635	88,907	1,909,310	1,814,697	94,613	0%	0%
25.0%	2,907,467	2,880,417	27,050	1,508,331	1,446,873	61,458	0%	0%
50.0%	2,054,991	2,068,339	-13,348	1,157,367	1,138,192	19,175	5%	5%
75.0%	1,434,329	1,466,474	-32,146	803,807	829,620	-25,812	10%	10%
90.0%	1,097,961	1,135,426	-37,465	603,289	646,855	-43,565	15%	10%
95.0%	968,644	1,019,818	-51,174	544,888	592,527	-47,639	15%	15%
97.5%	803,945	875,096	-71,151	481,983	537,543	-55,559	15%	15%

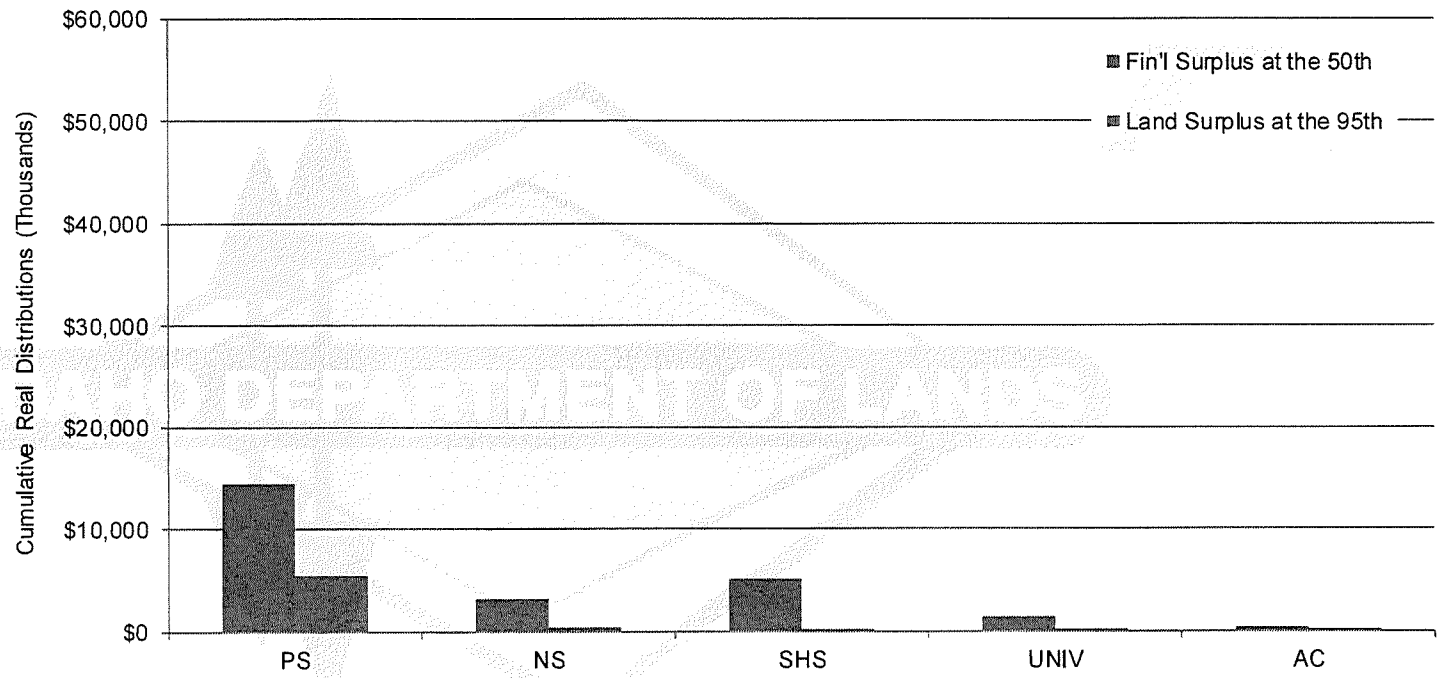
Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Findings

10 Year Projection, Recommended Reserve Levels, and 3.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but marginally lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), a land reinvestment is preferable at the 97.5th percentile for three of the endowments at recommended reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	-	-	-	-
90th	-	-	-	-	-
95th	-	-	-	-	-
97.5th	Land	Land	-	-	Land

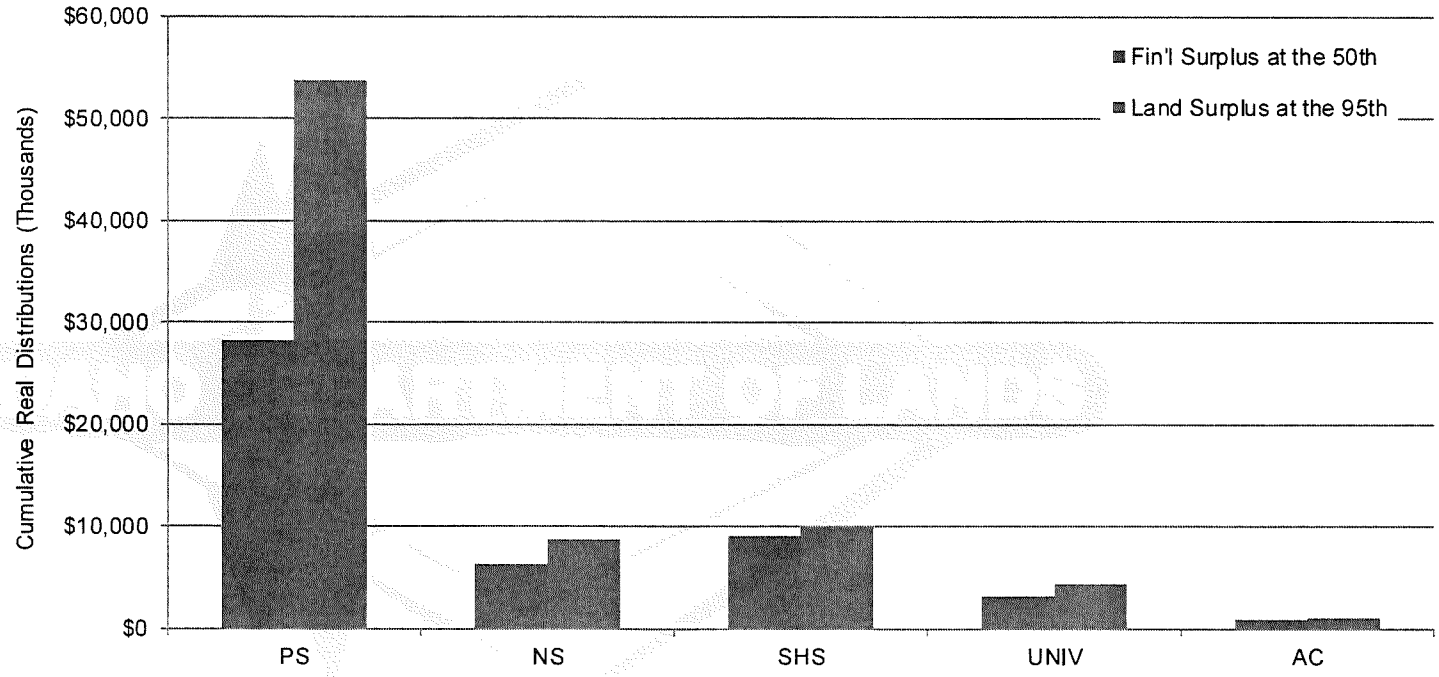
Reserve Levels: PS 600%, NS 700%, SHS 700%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

20 Year Projection, Recommended Reserve Levels, and 3.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), neither method is preferable at recommended reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	-	Land	-	-
90th	-	-	-	Fin'l	-
95th	-	-	-	-	-
97.5th	-	-	-	-	-

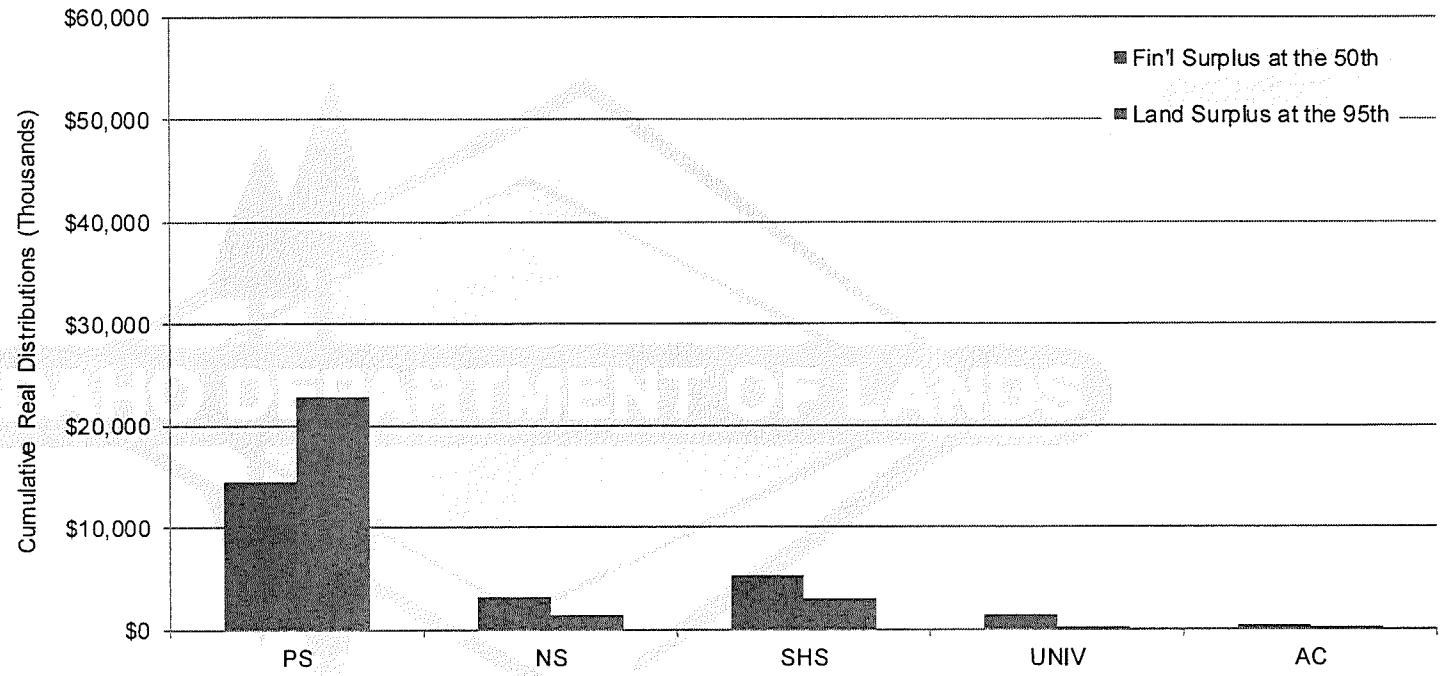
Reserve Levels: PS 600%, NS 700%, SHS 700%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

10 Year Projection, Current Reserve Levels, and 3.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), the case for land reinvestment is fairly compelling at current reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	-	-	-	-
90th	Land	Land	Land	-	-
95th	Land	Land	Land	-	-
97.5th	Land	Land	Land	-	Land

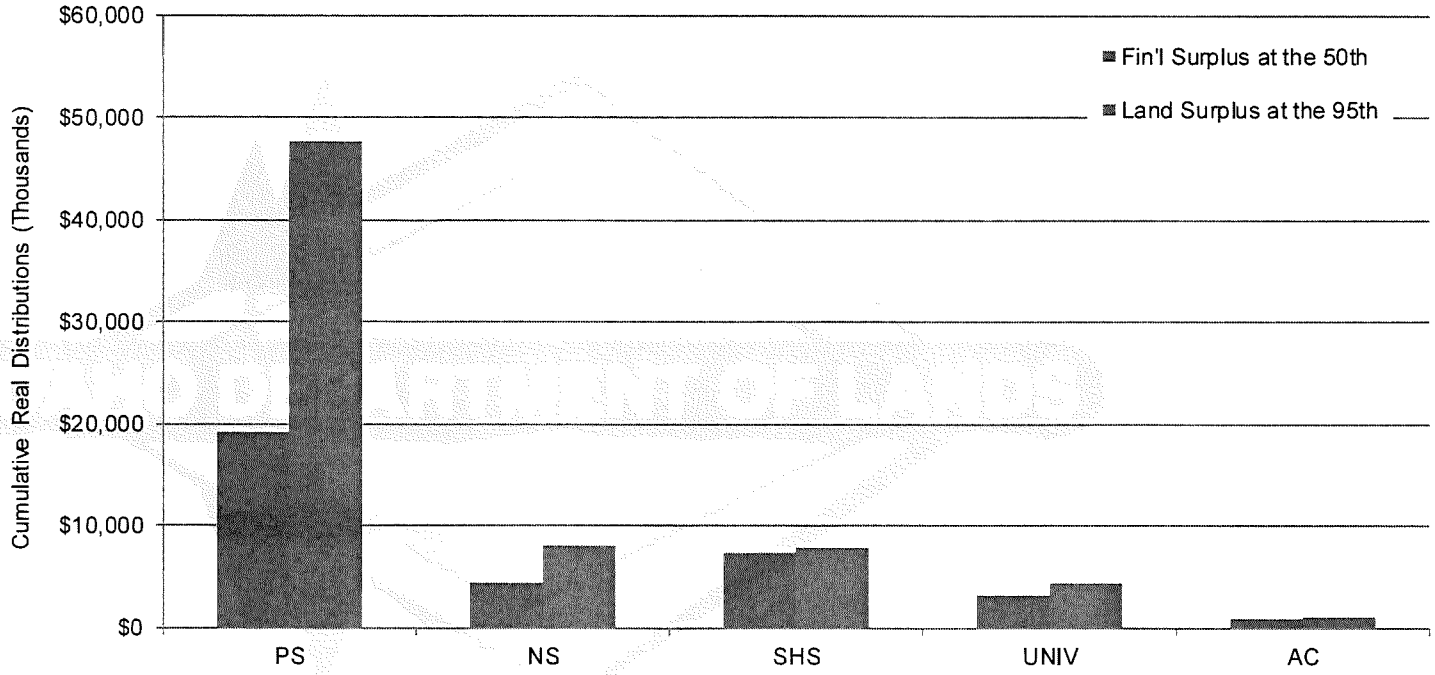
Reserve Levels: PS 500%, NS 600%, SHS 500%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

20 Year Projection, Current Reserve Levels, and 3.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but much lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), the case for land reinvestment is a bit more compelling at current reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	Land	Land	-	-
75th	-	-	-	-	-
90th	Land	-	-	Fin'l	-
95th	-	-	-	-	-
97.5th	-	-	Land	-	-

Reserve Levels: PS 500%, NS 600%, SHS 500%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Summary Findings

- 3.5% land yield assumption
  - Depositing land sale proceeds into the financial asset portfolio is preferable under recommended reserve levels
  - Reinvesting land sale proceeds back into lands is preferable at current earnings reserve levels
  - Assets can be deployed easily and cheaply into the financial asset portfolio while land transactions require a lot of time and due diligence to complete
- Lands provide an important role in dampening the volatility of the total Endowment over long time periods
  - Expected returns must be considered in addition to the risk mitigation role
  - The Strategic Reinvestment Plan set minimum return thresholds to explicitly address return objectives vis-à-vis the financial asset opportunity
- The findings from this study are consistent with the Strategic Reinvestment Plan from 2016
  - Investment of Land Bank proceeds should consider the following factors:
    - *Comparison of risk adjusted returns and the net returns across asset types – timber, agriculture, stocks, bonds, and diversified commercial real estate (in financial asset portfolio)*
    - *Will the investment move the needle from a total portfolio perspective?*
    - *New investments should meet or exceed a real return hurdle rate of 3.5% for timberlands and 4.5% for farmland (new investments must be accretive)*

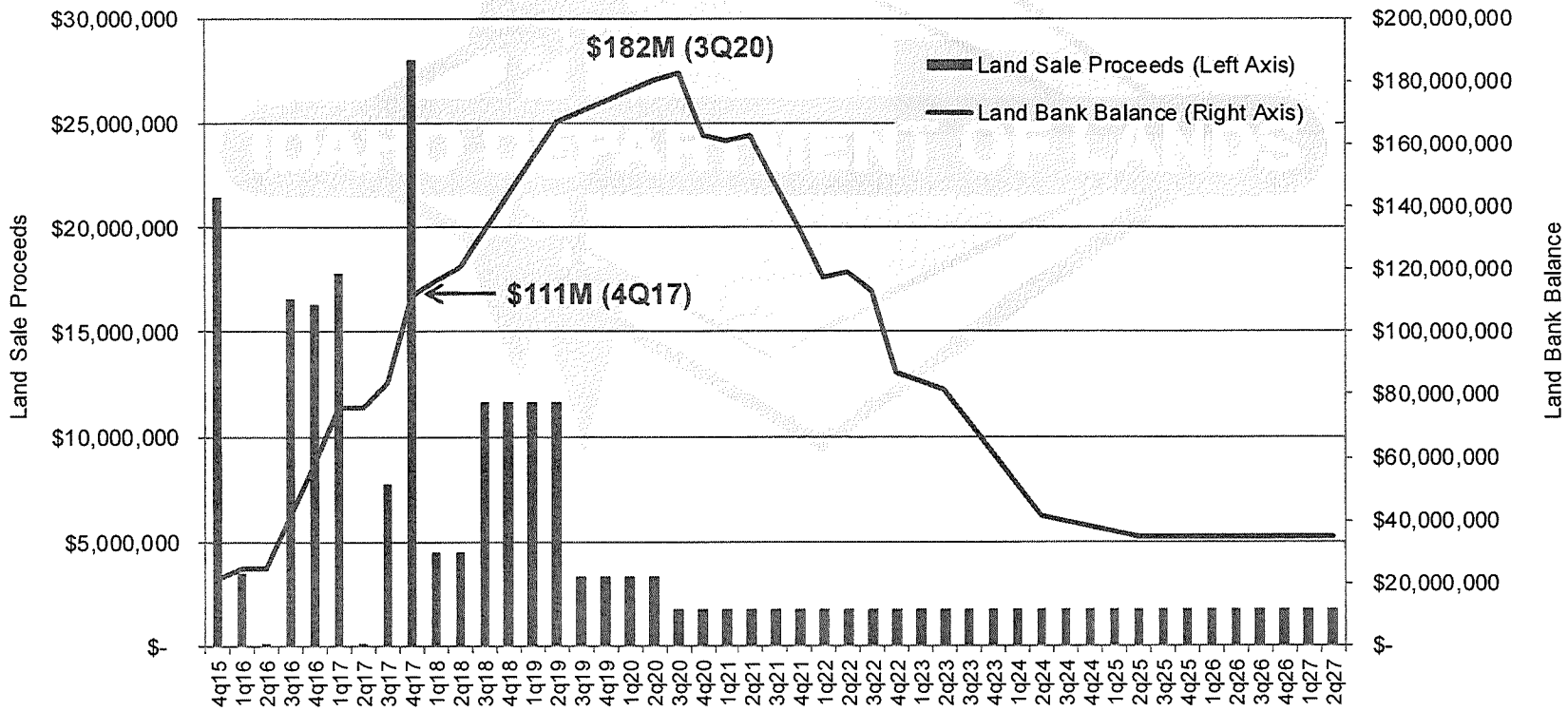
Outstanding Issues

- IDL has stated that there is a long lead time on large, potentially higher returning acquisitions and is concerned that moving assets too quickly from the Land Bank will make it challenging to secure these transactions
- IDL also sees the current Land Bank funds as a rare opportunity to redeploy capital into larger transactions than would normally be feasible
  - Reinvestment in lands helps to maintain the targeted allocation given growth in the financial asset portfolio
- Could Land Bank funds be outsourced to the EFIB and managed in a modestly more aggressive fashion to mitigate the cost of carry relative to what they are currently earning?
  - Funds are invested with an outside advisor under the authority of the State Treasurer and currently yield ~2%
- As expected land yields move toward 4.5%, land reinvestment becomes more compelling relative to the financial assets
  - From a cumulative distribution perspective with assumed land yields between 3.5% and 4.5%, there is a preference for financial assets if higher earnings reserve levels are implemented
  - Finding land investments in this yield range has proved challenging

Land Sale Proceeds and Land Bank Balances

- The below chart illustrates past and projected land sales and their impact on the level of funds residing at the Land Bank (excludes earned interest)
- Land sale proceeds are assumed to be transferred out of the Land Bank to the Permanent Fund after five years in compliance with the current policy

Land Sale Proceeds and Land Bank Balances (CY)



Land Board Options to Consider

- Option A: Consistent with Reinvestment Plan, identify potential transactions that meet established hurdle rates and set aside sufficient funds over appropriate time horizon (immediately move money that will either "mature" prior to the transaction or exceeds what is required)
  - Recognizes the importance of land in the total Endowment and attempts to maintain land's target allocation (41%)
  - If possible, move Endowment monies currently invested in the IDLE fund under the EFIB and modestly increase the risk to mitigate the cost of carry while waiting for IDL to identify attractive investments
    - *Portfolio is under the authority of the STO with management of the pool outsourced to FTN Financial*
    - *Current portfolio real yield ~0% (2.2% yield is about even with inflation)*
    - *Introducing volatility could result in short-term returns below cash*
- Option B: Move land sale proceeds that are set to expire in calendar years 2020-2021 (approximately $58 million) into the Permanent Fund with the remainder contingent on IDL identifying land acquisitions consistent with the Strategic Reinvestment Plan
  - Attempts to strike a balance between the benefits of investing the money in the Permanent Fund (greater expected distributions) versus reinvesting in land (downside protection)
  - If no other transfers, Land Bank balance will be approximately $86 million by end of calendar year 2018 given projections
- Option C: Immediately transfer all Land Bank funds to the financial asset portfolio
  - Assets can be deployed easily and cheaply into the financial asset portfolio while land transactions require a lot of time and due diligence to complete
  - Depositing land sale proceeds into the financial asset portfolio is preferable under recommended reserve levels

Appendix

Callan's 2018 Capital Market Projections

Return and Risk

- Most capital market expectations represent passive exposure (beta only); however, return expectations for private market investments reflect active management premiums
- Return expectations are net of fees

Summary of Callan's Long-Term Capital Market Projections (2018 - 2027)

Asset Class	Index	Projected Return*	Projected Risk
Equities			
Broad Domestic Equity	Russell 3000	6.85%	18.25%
Large Cap	S&P 500	6.75%	17.40%
Small/Mid Cap	Russell 2500	7.00%	22.60%
Global ex-US Equity	MSCI ACWI ex USA	7.00%	21.00%
International Equity	MSCI World ex USA	6.75%	19.70%
Emerging Markets Equity	MSCI Emerging Markets	7.00%	27.45%
Fixed Income			
Short Duration	Bloomberg Barclays 1-3 Yr G/C	2.60%	2.10%
Domestic Fixed	Bloomberg Barclays Aggregate	3.00%	3.75%
Long Duration	Bloomberg Barclays Long G/C	3.00%	10.95%
TIPS	Bloomberg Barclays TIPS	3.00%	5.25%
High Yield	Bloomberg Barclays High Yield	4.75%	10.35%
Non-US Fixed	Bloomberg Barclays Glbl Agg xUSD	1.40%	9.20%
Emerging Market Debt	EMBI Global Diversified	4.50%	9.60%
Other			
Real Estate	Callan Real Estate Database	5.75%	16.35%
Private Equity	TR Post Venture Capital	7.35%	32.90%
Hedge Funds	Callan Hedge FoF Database	5.05%	9.15%
Commodities	Bloomberg Commodity	2.65%	18.30%
Cash Equivalents	90-Day T-Bill	2.25%	0.90%
Inflation	CPI-U	2.25%	1.50%

** Geometric returns are derived from arithmetic returns and the associated risk (standard deviation).*

Callan's 2018 Capital Market Projections

Correlation

2018 Correlation Matrix

	Broad	Lg Cap	Sm/Mid	GlobxUS	Int'l Eq	Emerge	Sht Dur	Dom Fix	Long D	TIPS	Hi Yield	NUS Fix	EMD	Real Est	Pvt Eqt	Hedge Fd	Comm	Cash Eq	Inflation
Broad Domestic Equity	1.000																		
Large Cap	0.996	1.000																	
Small/Mid Cap	0.966	0.940	1.000																
Global ex-US Equity	0.874	0.872	0.839	1.000															
International Equity	0.840	0.840	0.800	0.987	1.000														
Emerging Markets Equity	0.866	0.860	0.845	0.936	0.865	1.000													
Short Duration	-0.250	-0.240	-0.270	-0.271	-0.250	-0.290	1.000												
Domestic Fixed	-0.110	-0.100	-0.135	-0.130	-0.110	-0.160	0.870	1.000											
Long Duration	0.109	0.112	0.096	0.080	0.094	0.043	0.739	0.930	1.000										
TIPS	-0.054	-0.045	-0.080	-0.049	-0.030	-0.085	0.525	0.600	0.532	1.000									
High Yield	0.636	0.635	0.610	0.627	0.605	0.615	-0.140	0.020	0.190	0.060	1.000								
Non-US Fixed	0.013	0.050	-0.100	0.013	0.060	-0.090	0.480	0.510	0.539	0.340	0.120	1.000							
EMD	0.573	0.570	0.555	0.577	0.550	0.580	-0.040	0.100	0.143	0.180	0.600	0.010	1.000						
Real Estate	0.732	0.730	0.705	0.677	0.660	0.650	-0.165	-0.030	0.168	0.000	0.560	-0.050	0.440	1.000					
Private Equity	0.948	0.945	0.915	0.927	0.895	0.910	-0.260	-0.200	-0.005	-0.110	0.640	-0.060	0.570	0.715	1.000				
Hedge Funds	0.802	0.800	0.770	0.761	0.730	0.755	-0.130	0.080	0.287	0.075	0.570	-0.080	0.540	0.605	0.780	1.000			
Commodities	0.152	0.150	0.150	0.161	0.155	0.160	-0.220	-0.100	-0.041	0.120	0.100	0.050	0.190	0.200	0.180	0.210	1.000		
Cash Equivalents	-0.043	-0.030	-0.080	-0.040	-0.010	-0.100	0.300	0.100	-0.041	0.070	-0.110	-0.090	-0.070	-0.060	0.000	-0.070	0.070	1.000	
Inflation	-0.010	-0.020	0.020	0.010	0.000	0.030	-0.200	-0.280	-0.288	0.180	0.070	-0.150	0.000	0.100	0.060	0.200	0.400	0.000	1.000

- Relationships between asset classes are as important, or more important, than the levels of individual asset class assumptions
- These relationships will have a large impact on the generation of efficient asset mixes using mean-variance optimization

Projected Revenues less Expenses

2017-2018 Study versus 2014 Study

- Projected net revenues as a percentage of assets generally declined in the first year and rose over the next couple of years before falling thereafter relative to their 2014 levels

Gross Land Revenues + Land Sales - DOL Expenses - EFIB Expenses

	PS						SHS						NS						SS					
Year	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change
1	62,663	36,567	(26,096)	5.8%	2.9%	-2.9%	14,316	8,311	(6,005)	16.1%	6.7%	-9.4%	6,000	2,581	(3,420)	5.8%	2.0%	-3.8%	2,880	2,857	(23)	2.4%	2.2%	-0.3%
2	37,675	56,967	19,292	3.1%	4.1%	1.0%	5,124	15,291	10,166	4.8%	10.9%	6.0%	4,583	16,411	11,828	4.0%	11.6%	7.5%	2,908	3,906	997	2.3%	2.7%	0.4%
3	36,880	51,107	14,227	2.9%	3.5%	0.6%	4,612	9,630	5,018	4.0%	6.0%	2.0%	3,665	7,585	3,920	3.0%	4.6%	1.7%	2,034	3,720	1,686	1.5%	2.4%	0.9%
4	36,114	51,064	14,950	2.6%	3.2%	0.6%	4,143	6,993	2,851	3.4%	4.0%	0.7%	3,178	3,223	45	2.4%	1.8%	-0.6%	2,107	1,371	(737)	1.5%	0.9%	-0.6%
5	33,889	29,369	(4,520)	2.3%	1.8%	-0.6%	2,921	3,458	537	2.2%	1.9%	-0.4%	3,243	1,132	(2,111)	2.3%	0.6%	-1.7%	1,980	927	(1,054)	1.3%	0.6%	-0.8%
6	29,229	23,888	(5,341)	1.9%	1.4%	-0.5%	5,014	2,157	(2,858)	3.7%	1.1%	-2.5%	3,099	1,679	(1,420)	2.1%	0.9%	-1.2%	2,142	832	(1,310)	1.4%	0.5%	-0.9%
7	29,363	22,447	(6,916)	1.8%	1.2%	-0.6%	5,071	1,537	(3,534)	3.5%	0.8%	-2.7%	1,973	1,594	(379)	1.3%	0.8%	-0.5%	1,646	853	(794)	1.0%	0.5%	-0.5%
8	27,287	22,852	(4,435)	1.6%	1.2%	-0.4%	4,216	1,818	(2,398)	2.7%	0.9%	-1.8%	2,151	1,564	(587)	1.3%	0.7%	-0.6%	957	769	(188)	0.6%	0.4%	-0.1%
9	28,228	19,916	(8,312)	1.5%	1.0%	-0.5%	2,967	1,815	(1,153)	1.8%	0.9%	-0.9%	2,460	1,428	(1,032)	1.4%	0.7%	-0.8%	934	815	(119)	0.5%	0.4%	-0.1%
10	29,215	24,560	(4,654)	1.5%	1.2%	-0.3%	3,785	2,804	(981)	2.2%	1.3%	-0.9%	2,870	1,764	(1,106)	1.6%	0.8%	-0.8%	1,948	1,838	(110)	1.0%	0.9%	-0.1%

	PEN						UNIV						AC						CI					
Year	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change
1	673	1,236	564	1.3%	2.1%	0.7%	1,879	1,798	(81)	1.8%	1.6%	-0.2%	647	(3)	(651)	1.8%	0.0%	-1.9%	3,801	3,284	(517)	3.1%	2.3%	-0.8%
2	1,104	1,605	501	2.1%	2.4%	0.3%	2,668	2,925	257	2.4%	2.3%	-0.1%	499	572	73	1.3%	1.4%	0.0%	4,201	5,446	1,245	3.2%	3.4%	0.3%
3	811	961	150	1.4%	1.4%	-0.1%	2,713	7,299	4,586	2.3%	5.5%	3.2%	348	811	463	0.9%	1.8%	1.0%	3,165	3,561	396	2.2%	2.1%	-0.1%
4	490	801	312	0.8%	1.1%	0.3%	2,059	7,765	5,706	1.6%	5.3%	3.7%	956	4,341	3,385	2.3%	9.4%	7.1%	3,566	2,876	(690)	2.4%	1.6%	-0.7%
5	492	1,147	656	0.8%	1.5%	0.7%	1,534	1,910	376	1.1%	1.2%	0.1%	732	600	(132)	1.7%	1.2%	-0.5%	3,575	2,958	(617)	2.2%	1.6%	-0.6%
6	119	1,493	1,373	0.2%	1.8%	1.7%	836	2,211	1,374	0.6%	1.3%	0.7%	994	541	(454)	2.2%	1.0%	-1.2%	3,801	2,060	(1,741)	2.2%	1.1%	-1.2%
7	772	1,063	292	1.1%	1.3%	0.1%	1,125	2,068	943	0.8%	1.2%	0.4%	689	561	(128)	1.4%	1.0%	-0.4%	2,821	1,673	(1,148)	1.6%	0.8%	-0.7%
8	1,380	585	(795)	1.9%	0.7%	-1.3%	2,305	1,244	(1,062)	1.5%	0.7%	-0.8%	210	493	283	0.4%	0.8%	0.4%	2,893	1,144	(1,749)	1.5%	0.5%	-1.0%
9	1,824	417	(1,407)	2.4%	0.4%	-2.0%	2,389	1,296	(1,094)	1.5%	0.7%	-0.8%	123	369	245	0.2%	0.6%	0.4%	1,432	1,212	(220)	0.7%	0.6%	-0.2%
10	851	1,063	212	1.1%	1.1%	0.0%	1,932	1,876	(56)	1.1%	0.9%	-0.2%	575	578	3	1.0%	0.9%	-0.1%	3,266	2,796	(471)	1.6%	1.2%	-0.3%

Notes: Dollar amounts shown in thousands; Land sale proceeds are assumed to be deposited into the PFs two years after the sale while earning interest at the Land Bank in the interim; $7 million in annual sales is assumed to occur beyond FY20 and are allocated pro-rata based on current land holdings

Projected Revenues less Expenses (excludes Land Sales)

2017-2018 Study versus 2014 Study

- Projected net revenues (excluding land sales) have generally declined from their 2014 levels for most endowments over most years as a percentage of assets, with Penitentiary being the most notable exception

Gross Land Revenues - DOL Expenses - EFIB Expenses

	PS						SHS						NS						SS					
Year	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change
1	30,077	18,377	(11,700)	2.8%	1.5%	-1.3%	4,308	2,311	(1,996)	4.9%	1.9%	-3.0%	3,359	1,524	(1,835)	3.2%	1.2%	-2.1%	2,871	2,857	(13)	2.4%	2.2%	-0.2%
2	26,685	30,380	3,695	2.2%	2.2%	0.0%	4,149	3,683	(467)	3.9%	2.6%	-1.3%	3,763	2,767	(996)	3.3%	2.0%	-1.3%	2,899	3,906	1,007	2.3%	2.7%	0.5%
3	26,625	21,666	(4,959)	2.1%	1.5%	-0.6%	3,704	3,983	279	3.2%	2.5%	-0.7%	2,876	2,115	(761)	2.3%	1.3%	-1.0%	2,024	3,720	1,696	1.5%	2.5%	1.0%
4	26,515	17,919	(8,596)	1.9%	1.2%	-0.8%	3,298	3,483	185	2.7%	2.0%	-0.6%	2,442	1,080	(1,362)	1.9%	0.6%	-1.2%	2,098	1,371	(727)	1.5%	0.9%	-0.6%
5	24,716	15,741	(8,975)	1.7%	1.0%	-0.7%	2,135	2,949	814	1.6%	1.6%	0.0%	2,549	1,132	(1,417)	1.8%	0.6%	-1.2%	1,971	927	(1,044)	1.3%	0.6%	-0.8%
6	20,473	17,559	(2,914)	1.3%	1.0%	-0.3%	4,283	2,061	(2,222)	3.1%	1.1%	-2.0%	2,441	1,498	(944)	1.6%	0.8%	-0.9%	2,133	832	(1,301)	1.4%	0.5%	-0.9%
7	21,059	16,094	(4,965)	1.3%	0.9%	-0.4%	4,390	1,441	(2,949)	3.0%	0.7%	-2.3%	1,353	1,412	59	0.9%	0.7%	-0.2%	1,637	853	(784)	1.0%	0.5%	-0.5%
8	19,419	16,481	(2,938)	1.1%	0.9%	-0.3%	3,582	1,722	(1,860)	2.3%	0.8%	-1.5%	1,564	1,382	(183)	0.9%	0.7%	-0.3%	947	769	(179)	0.6%	0.4%	-0.1%
9	20,743	13,533	(7,210)	1.1%	0.7%	-0.5%	2,377	1,718	(659)	1.4%	0.8%	-0.6%	1,904	1,245	(659)	1.1%	0.6%	-0.5%	924	815	(110)	0.5%	0.4%	-0.1%
10	22,064	18,168	(3,896)	1.1%	0.9%	-0.3%	3,236	2,708	(528)	1.9%	1.3%	-0.6%	2,344	1,581	(763)	1.3%	0.7%	-0.6%	1,939	1,838	(101)	1.0%	0.9%	-0.1%

	PEN						UNIV						AC						CI					
Year	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change	2014	2017-2018	Change	2014 / Assets	2017-2018 / Assets	Change
1	672	1,236	565	1.3%	2.1%	0.7%	1,864	1,798	(66)	1.8%	1.6%	-0.2%	645	(3)	(648)	1.8%	0.0%	-1.8%	3,786	3,284	(502)	3.1%	2.3%	-0.8%
2	1,103	1,605	503	2.1%	2.4%	0.4%	2,650	2,925	274	2.4%	2.3%	0.0%	496	572	76	1.3%	1.4%	0.0%	4,187	5,446	1,258	3.1%	3.5%	0.3%
3	809	961	151	1.4%	1.4%	0.0%	2,697	1,416	(1,281)	2.2%	1.1%	-1.2%	345	811	467	0.9%	1.9%	1.0%	3,151	3,561	410	2.2%	2.1%	-0.1%
4	488	801	313	0.8%	1.1%	0.3%	2,043	1,102	(941)	1.6%	0.8%	-0.8%	952	821	(131)	2.3%	1.8%	-0.5%	3,552	2,876	(676)	2.4%	1.6%	-0.7%
5	491	1,147	657	0.8%	1.5%	0.7%	1,518	1,910	393	1.1%	1.2%	0.1%	729	600	(129)	1.7%	1.2%	-0.5%	3,561	2,958	(603)	2.2%	1.6%	-0.6%
6	118	1,493	1,375	0.2%	1.9%	1.7%	820	2,043	1,223	0.6%	1.2%	0.7%	991	439	(552)	2.2%	0.8%	-1.3%	3,787	2,060	(1,727)	2.2%	1.1%	-1.2%
7	770	1,063	293	1.1%	1.3%	0.1%	1,109	1,899	790	0.8%	1.1%	0.3%	686	458	(227)	1.4%	0.8%	-0.6%	2,807	1,673	(1,134)	1.6%	0.8%	-0.7%
8	1,379	585	(794)	1.9%	0.7%	-1.3%	2,289	1,075	(1,214)	1.5%	0.6%	-0.9%	206	390	184	0.4%	0.7%	0.3%	2,879	1,144	(1,735)	1.5%	0.5%	-1.0%
9	1,822	417	(1,406)	2.4%	0.5%	-2.0%	2,373	1,127	(1,247)	1.5%	0.6%	-0.9%	120	266	146	0.2%	0.4%	0.2%	1,418	1,212	(206)	0.7%	0.6%	-0.1%
10	850	1,063	213	1.1%	1.1%	0.1%	1,916	1,706	(209)	1.1%	0.9%	-0.3%	571	475	(96)	1.0%	0.7%	-0.3%	3,252	2,796	(457)	1.5%	1.2%	-0.3%

Note: Dollar amounts shown in thousands

Reserve Level Requirements

10 Year Projection

- The table below indicates the level of reserves [2017-2018 (2014)] which prevents a decline in distributions at the 90th, 95th and 97.5th percentile outcomes for each of the eight endowments
  - Land sales are assumed to be deposited into the Permanent Fund after two years

Level of Reserves Which Prevents a Decline in Distributions: 2017-2018 Study (2014 Study)

Fiscal Years 2018 to 2027	Public Schools	# Yrs Failure at 2014 Reserve Levels	Ag College	# Yrs Failure at 2014 Reserve Levels	Charitable Institutions	# Yrs Failure at 2014 Reserve Levels	Normal School	# Yrs Failure at 2014 Reserve Levels
90th Percentile	600% (500%)	1/10	700% (600%)	1/10	600% (500%)	1/10	700% (500%)	2/10
95th Percentile	600% (500%)	2/10	700% (700%)	0/10	700% (500%)	2/10	700% (600%)	1/10
97.5th Percentile	700% (600%)	1/10	800% (700%)	1/10	700% (600%)	1/10	800% (700%)	1/10

Fiscal Years 2018 to 2027	Penitentiary	# Yrs Failure at 2014 Reserve Levels	School of Science	# Yrs Failure at 2014 Reserve Levels	State Hospital South	# Yrs Failure at 2014 Reserve Levels	University	# Yrs Failure at 2014 Reserve Levels
90th Percentile	600% (700%)	0/10	700% (600%)	1/10	600% (500%)	1/10	600% (600%)	0/10
95th Percentile	700% (700%)	0/10	700% (700%)	0/10	700% (500%)	2/10	700% (700%)	0/10
97.5th Percentile	700% (800%)	0/10	800% (800%)	0/10	700% (500%)	2/10	700% (700%)	0/10

Note: Minimum reserves are 100% for all endowments with the exception of Public Schools (50%); Distribution rates are 5% for all endowments with the exception of State Hospital South (7%)

Land Bank Cash and Future Land Sales: Normal School

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% NS: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	400,713	381,326	19,387	81,974	76,425	5,549	0%	0%
5.0%	358,303	344,452	13,851	77,580	71,855	5,725	0%	0%
10.0%	310,398	301,630	8,768	73,474	68,080	5,394	0%	0%
25.0%	244,893	243,118	1,775	63,686	59,390	4,296	0%	0%
50.0%	183,530	185,111	-1,581	55,793	52,718	3,074	0%	0%
75.0%	134,151	141,456	-7,305	47,735	46,365	1,370	0%	0%
90.0%	106,229	115,305	-9,076	42,145	41,895	250	0%	0%
95.0%	92,650	102,627	-9,976	39,848	40,232	-384	0%	0%
97.5%	79,935	91,666	-11,731	37,622	38,558	-936	10%	0%

20 Year Projection

3.50% NS: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	700,168	671,990	28,178	252,490	231,853	20,637	0%	0%
5.0%	555,409	537,381	18,027	222,703	204,592	18,112	0%	0%
10.0%	440,369	432,530	7,839	195,530	181,323	14,207	0%	0%
25.0%	310,957	311,299	-342	157,617	146,191	11,426	0%	0%
50.0%	214,389	219,016	-4,627	123,740	117,394	6,346	0%	0%
75.0%	144,806	151,940	-7,134	85,626	88,201	-2,574	10%	10%
90.0%	108,618	116,981	-8,363	62,852	70,649	-7,797	15%	15%
95.0%	95,426	104,339	-8,913	55,862	64,618	-8,756	15%	15%
97.5%	78,545	90,416	-11,871	48,587	59,121	-10,535	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Normal School

5% Distribution and 600% Earnings Reserve

10 Year Projection

3.50% NS: 600% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	396,939	377,796	19,143	84,696	78,851	5,845	0%	0%
5.0%	354,508	341,360	13,149	79,979	74,122	5,858	0%	0%
10.0%	307,082	298,757	8,325	75,668	70,133	5,535	0%	0%
25.0%	242,373	240,765	1,608	65,437	61,211	4,226	0%	0%
50.0%	181,509	183,328	-1,820	57,347	54,225	3,122	0%	0%
75.0%	132,442	139,939	-7,497	48,425	47,685	739	0%	0%
90.0%	106,730	114,212	-7,481	42,538	43,157	-619	10%	0%
95.0%	93,719	102,778	-9,060	40,126	41,453	-1,327	10%	0%
97.5%	81,839	91,351	-9,512	37,447	39,529	-2,082	20%	10%

20 Year Projection

3.50% NS: 600% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	684,086	656,864	27,223	257,576	237,505	20,071	0%	0%
5.0%	542,412	524,915	17,496	227,107	209,804	17,303	0%	0%
10.0%	431,292	424,206	7,086	199,524	184,415	15,109	0%	0%
25.0%	307,240	305,311	1,929	159,257	148,411	10,846	0%	0%
50.0%	214,726	217,615	-2,889	122,312	117,996	4,315	5%	0%
75.0%	147,449	153,680	-6,230	83,573	87,142	-3,569	10%	10%
90.0%	111,665	119,080	-7,415	60,794	67,945	-7,150	15%	15%
95.0%	98,047	106,566	-8,519	54,032	62,041	-8,009	15%	15%
97.5%	80,403	92,797	-12,395	46,735	56,736	-10,001	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: State Hospital South

7% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% SHS: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	391,807	369,918	21,889	102,029	92,937	9,091	0%	0%
5.0%	347,579	334,214	13,365	96,269	87,510	8,759	0%	0%
10.0%	302,551	293,672	8,879	91,203	82,575	8,628	0%	0%
25.0%	238,230	237,121	1,109	78,791	71,836	6,955	0%	0%
50.0%	178,440	183,241	-4,802	68,526	63,496	5,030	0%	0%
75.0%	129,746	139,693	-9,947	57,838	55,473	2,365	0%	0%
90.0%	101,868	115,041	-13,172	50,164	49,401	763	0%	0%
95.0%	88,477	102,216	-13,740	46,421	46,514	-93	0%	0%
97.5%	75,850	92,519	-16,669	43,869	44,153	-284	0%	0%

20 Year Projection

3.50% SHS: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	627,164	601,862	25,302	304,315	274,813	29,503	0%	0%
5.0%	502,483	477,513	24,970	270,113	243,240	26,873	0%	0%
10.0%	394,265	390,002	4,263	238,527	215,676	22,850	0%	0%
25.0%	274,753	279,926	-5,173	191,541	174,797	16,744	0%	0%
50.0%	191,317	199,460	-8,143	149,708	140,599	9,109	0%	0%
75.0%	130,776	140,934	-10,158	104,419	105,708	-1,289	10%	5%
90.0%	99,181	109,955	-10,773	77,370	85,792	-8,422	10%	10%
95.0%	86,458	98,703	-12,245	69,809	79,685	-9,876	15%	15%
97.5%	73,012	85,757	-12,745	60,548	74,018	-13,471	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: State Hospital South

7% Distribution and 500% Earnings Reserve

10 Year Projection

3.50% SHS: 500% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	376,923	357,869	19,055	110,674	100,531	10,144	0%	0%
5.0%	336,389	323,401	12,988	104,319	94,730	9,589	0%	0%
10.0%	292,017	283,722	8,295	98,511	89,100	9,412	0%	0%
25.0%	228,946	228,942	5	84,475	77,581	6,894	0%	0%
50.0%	171,085	176,204	-5,119	73,711	68,433	5,277	0%	0%
75.0%	125,930	134,252	-8,322	60,753	59,912	841	0%	0%
90.0%	102,158	111,450	-9,292	52,929	54,557	-1,627	10%	0%
95.0%	90,231	100,827	-10,597	49,266	52,152	-2,885	20%	10%
97.5%	79,981	90,182	-10,201	46,247	49,736	-3,490	20%	10%

20 Year Projection

3.50% SHS: 500% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	582,767	559,260	23,506	316,679	285,957	30,722	0%	0%
5.0%	463,738	445,293	18,445	281,353	255,251	26,102	0%	0%
10.0%	372,615	369,018	3,597	246,830	224,892	21,938	0%	0%
25.0%	267,591	270,654	-3,063	193,771	178,818	14,952	0%	0%
50.0%	192,518	198,857	-6,339	146,724	139,440	7,284	10%	5%
75.0%	135,017	144,342	-9,325	99,072	101,412	-2,340	10%	10%
90.0%	104,085	114,942	-10,857	73,210	80,461	-7,251	15%	15%
95.0%	91,550	103,378	-11,828	66,248	74,163	-7,915	15%	15%
97.5%	75,936	90,806	-14,870	58,059	67,967	-9,907	20%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: University

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% UNIV: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	344,991	336,954	8,037	71,804	69,444	2,360	0%	0%
5.0%	308,545	302,727	5,818	67,638	65,369	2,269	0%	0%
10.0%	268,101	264,075	4,026	63,811	61,648	2,163	0%	0%
25.0%	211,632	210,393	1,240	55,664	53,930	1,734	0%	0%
50.0%	158,049	158,079	-30	49,213	47,865	1,348	0%	0%
75.0%	114,888	118,599	-3,710	42,769	42,275	494	0%	0%
90.0%	90,397	94,089	-3,692	38,763	38,922	-159	0%	0%
95.0%	78,756	83,449	-4,693	37,452	37,665	-213	0%	0%
97.5%	68,799	73,672	-4,873	35,966	36,315	-349	0%	0%

20 Year Projection

3.50% UNIV: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	613,839	597,589	16,250	219,932	209,493	10,439	0%	0%
5.0%	483,516	474,361	9,155	193,203	184,334	8,869	0%	0%
10.0%	383,688	379,597	4,091	171,243	163,191	8,052	0%	0%
25.0%	269,651	270,097	-446	137,811	131,835	5,976	0%	0%
50.0%	186,323	187,276	-953	108,715	105,582	3,133	0%	0%
75.0%	125,371	128,193	-2,823	77,930	79,330	-1,400	10%	10%
90.0%	93,530	97,732	-4,203	58,718	62,434	-3,716	10%	15%
95.0%	82,355	86,190	-3,835	52,525	56,897	-4,372	15%	15%
97.5%	67,540	73,254	-5,714	46,112	51,743	-5,630	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Ag College

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% AC: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	113,721	111,279	2,442	23,707	23,115	592	0%	0%
5.0%	101,813	100,103	1,710	22,334	21,764	571	0%	0%
10.0%	88,426	87,118	1,309	21,110	20,586	524	0%	0%
25.0%	69,529	69,233	295	18,396	17,961	435	0%	0%
50.0%	51,781	51,707	73	16,250	15,944	306	0%	0%
75.0%	37,525	38,408	-882	14,167	14,085	82	0%	0%
90.0%	29,542	30,441	-898	12,904	12,922	-17	0%	0%
95.0%	25,758	26,755	-996	12,380	12,466	-87	0%	0%
97.5%	22,500	23,740	-1,240	11,755	11,951	-196	10%	0%

20 Year Projection

3.50% AC: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	202,695	196,417	6,277	72,537	69,495	3,043	0%	0%
5.0%	159,199	156,154	3,046	63,567	61,032	2,535	0%	0%
10.0%	125,715	124,292	1,422	56,305	54,005	2,301	0%	0%
25.0%	88,486	88,156	331	45,135	43,446	1,689	0%	0%
50.0%	61,152	61,358	-206	35,523	34,562	961	0%	0%
75.0%	41,082	42,026	-943	24,842	25,353	-511	10%	10%
90.0%	30,866	31,808	-942	18,491	19,471	-980	10%	10%
95.0%	26,988	28,416	-1,428	16,641	17,768	-1,127	15%	15%
97.5%	22,079	24,143	-2,064	14,545	15,846	-1,300	15%	15%

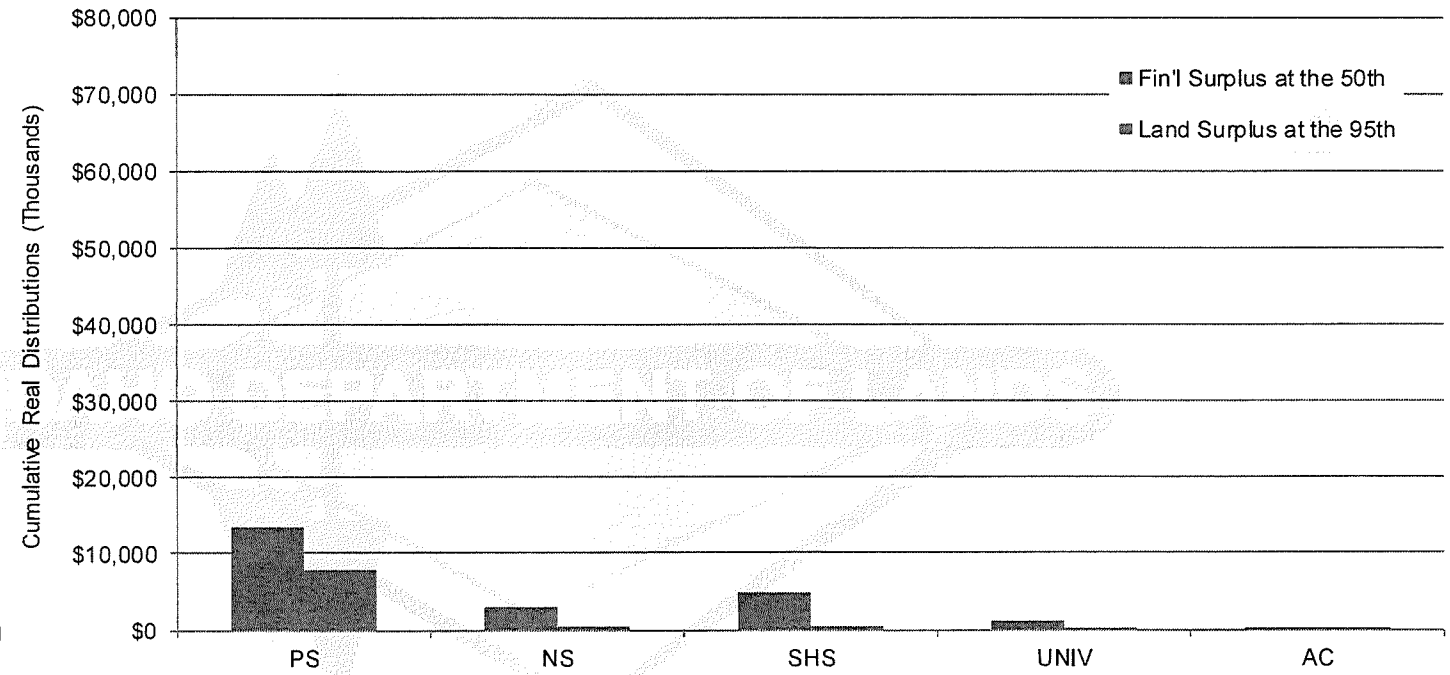
Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Findings

10 Year Projection, Recommended Reserve Levels, and 4.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in modest improvement in the expected (50th percentile) distributions but marginally lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on preventing a decline in distributions (bottom chart), land reinvestment is preferable at the 97.5th percentile for three endowments at recommended reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	-	-	-	-
90th	-	-	-	-	-
95th	-	-	-	-	-
97.5th	Land	Land	-	-	Land

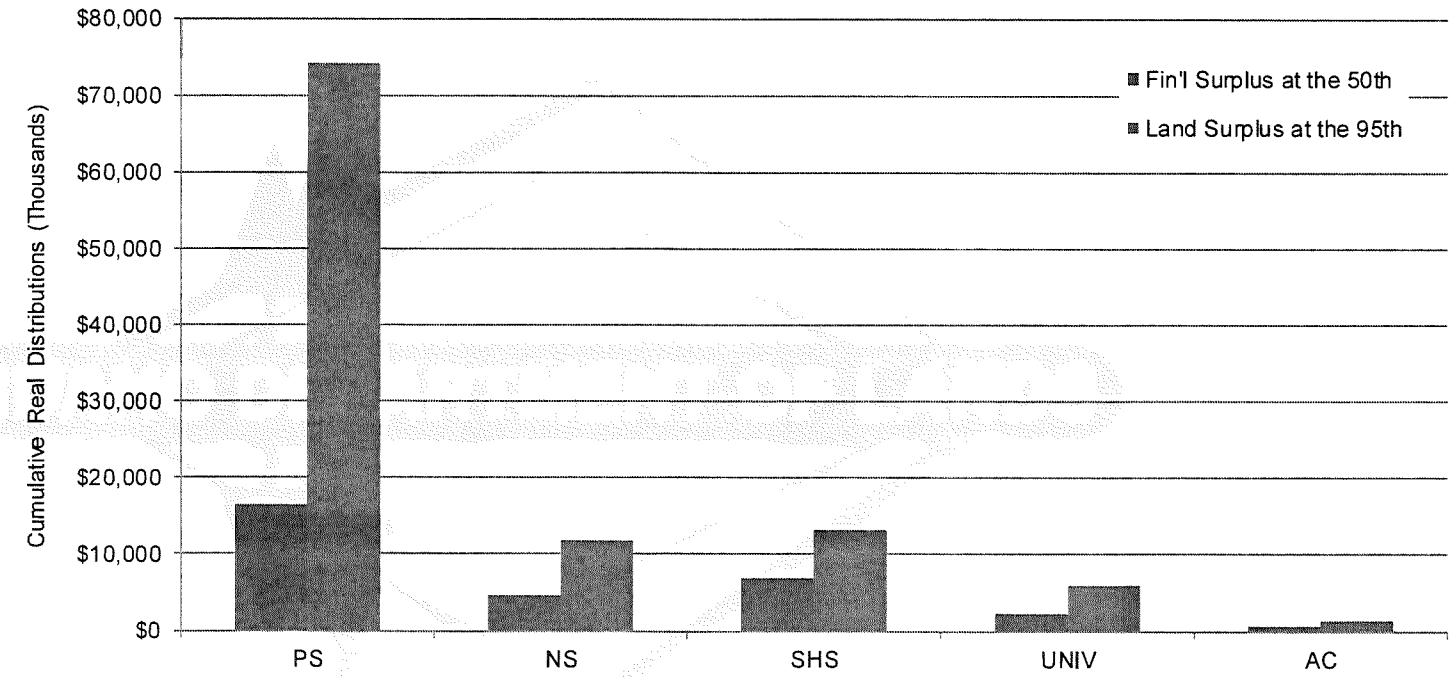
Reserve Levels: PS 600%, NS 700%, SHS 700%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

20 Year Projection, Recommended Reserve Levels, and 4.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but much lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), neither method is really preferable at recommended reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	Land	Land	-	-
90th	-	-	-	Fin'l	-
95th	-	-	-	-	-
97.5th	-	-	-	-	-

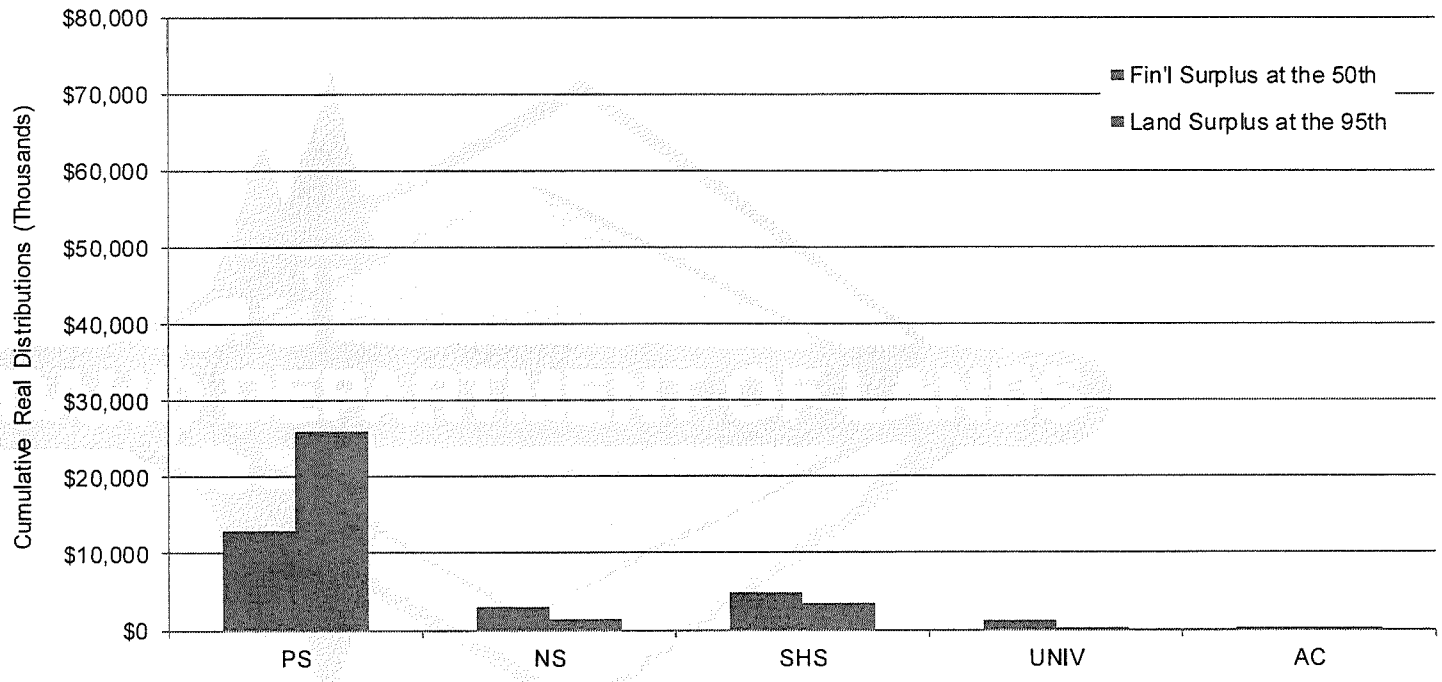
Reserve Levels: PS 600%, NS 700%, SHS 700%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

10 Year Projection, Current Reserve Levels, and 4.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in greater expected (50th percentile) distributions but marginally lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), the case for land reinvestment is fairly compelling at current reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	-	-	-	-	-
75th	-	-	-	-	-
90th	Land	Land	Land	-	-
95th	Land	Land	Land	-	-
97.5th	Land	Land	Land	-	Land

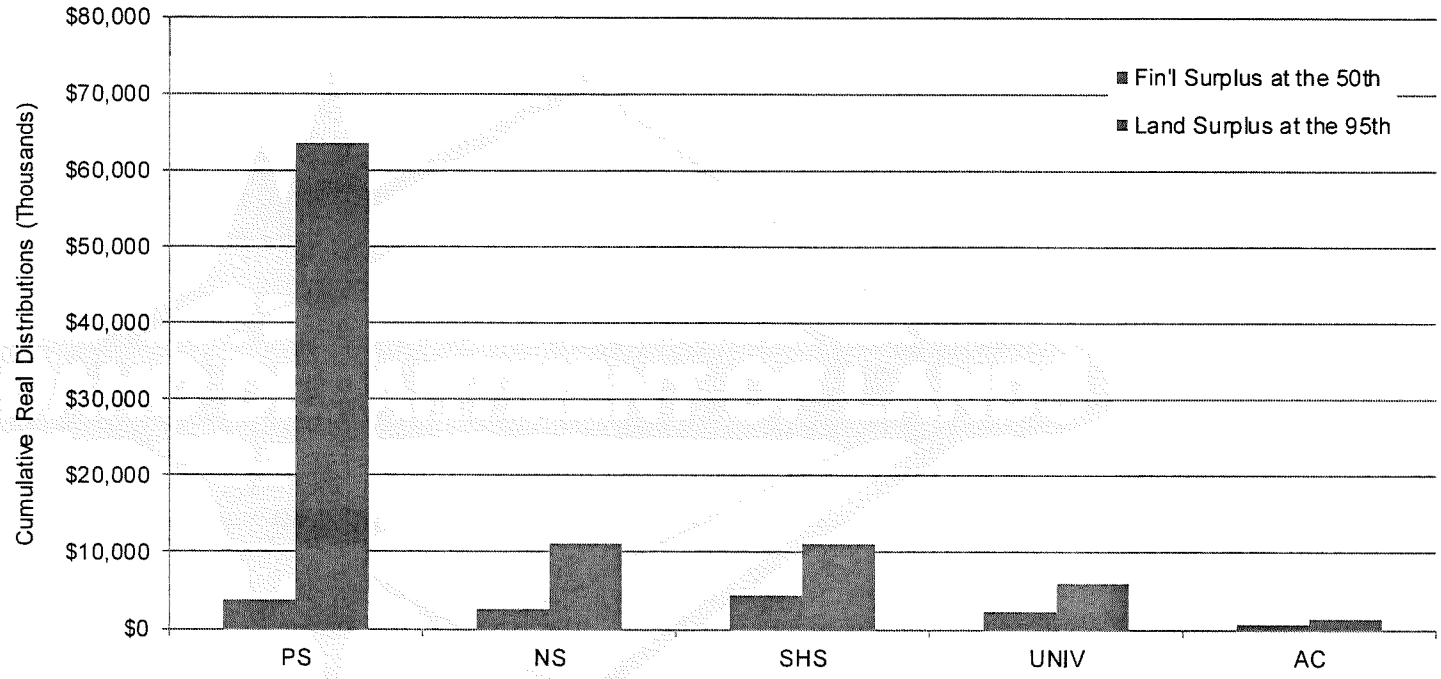
Reserve Levels: PS 500%, NS 600%, SHS 500%, UNIV 700%, AC 700%

Land Bank Cash and Future Land Sales: Findings

20 Year Projection, Current Reserve Levels, and 4.5% Land Yield

- Depositing land sale proceeds into the financial portfolio results in marginally greater expected (50th percentile) distributions but much lower worse-case (95th percentile) distributions relative to a land reinvestment (top chart)
- Focusing on the prevention of a decline in distributions (bottom chart), the case for land reinvestment is a bit more compelling at current reserve levels

Difference in Cumulative Real Distributions



Preventing a Decline in Distributions Favors

Precentile	PS	NS	SHS	UNIV	AC
50th	Land	Land	Land	-	-
75th	-	-	-	-	-
90th	Land	-	-	Fin'l	-
95th	-	-	-	-	-
97.5th	-	-	Land	-	-

Reserve Levels: PS 500%, NS 600%, SHS 500%, UNIV 700%, AC 700%

7 Smaller Endowments Combined

5% Distribution and 700% Earnings Reserve

- Combining the seven smaller endowments modestly lowers required reserve levels (*top table*)
- The results from land sale proceeds testing follow the same pattern as for the individual endowments (*bottom tables*), namely a land investment protects distributions on the downside at the cost of lower expected distributions

Level of Reserves Which Prevents a Decline in Distributions

Fiscal Years 2018 to 2027	Average of the 7 Individual Endowments	7 Combined
90th Percentile	643%	600%
95th Percentile	700%	700%
97.5th Percentile	743%	700%

10 Year Projection

3.50% 7: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	2,192,444	2,144,526	47,918	463,333	447,136	16,197	0%	0%
5.0%	1,966,599	1,929,918	36,682	437,474	420,524	16,950	0%	0%
10.0%	1,704,302	1,680,496	23,806	413,776	399,198	14,578	0%	0%
25.0%	1,343,667	1,339,441	4,226	360,729	349,266	11,463	0%	0%
50.0%	1,000,705	1,005,182	-4,477	319,581	310,767	8,814	0%	0%
75.0%	727,660	752,023	-24,363	279,390	274,260	5,131	0%	0%
90.0%	571,111	596,389	-25,279	253,677	253,576	102	0%	0%
95.0%	497,960	526,295	-28,335	245,279	244,873	406	0%	0%
97.5%	431,971	463,529	-31,558	236,331	237,655	-1,324	0%	0%

20 Year Projection

3.50% 7: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	3,845,775	3,754,219	91,556	1,403,520	1,338,022	65,498	0%	0%
5.0%	3,039,418	2,980,227	59,191	1,231,429	1,184,868	46,561	0%	0%
10.0%	2,409,161	2,383,399	25,762	1,090,032	1,045,037	44,995	0%	0%
25.0%	1,683,390	1,693,917	-10,527	876,786	845,205	31,581	0%	0%
50.0%	1,163,370	1,171,331	-7,961	691,950	677,017	14,933	0%	0%
75.0%	781,378	798,578	-17,200	495,326	503,560	-8,234	10%	10%
90.0%	582,068	604,629	-22,560	375,834	394,649	-18,815	15%	15%
95.0%	510,349	533,913	-23,563	337,179	360,423	-23,244	15%	15%
97.5%	413,888	452,093	-38,205	301,025	329,558	-28,533	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Charitable Institutions

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50%								
CI: 700% ER	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
10 Years	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	411,476	410,264	1,212	88,886	88,555	332	0%	0%
5.0%	368,906	368,154	753	83,654	83,403	251	0%	0%
10.0%	318,795	318,150	645	79,199	78,866	333	0%	0%
25.0%	251,002	250,566	437	69,226	69,046	180	0%	0%
50.0%	184,585	184,758	-173	61,539	61,380	159	0%	0%
75.0%	133,904	134,454	-550	54,321	54,232	89	0%	0%
90.0%	103,400	104,019	-619	50,068	50,016	51	0%	0%
95.0%	90,044	90,758	-714	48,504	48,542	-38	0%	0%
97.5%	77,865	78,326	-461	47,050	47,070	-19	0%	0%

20 Year Projection

3.50%								
CI: 700% ER	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
20 Years	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	718,019	716,722	1,297	264,278	262,599	1,679	0%	0%
5.0%	569,314	567,579	1,736	233,506	231,893	1,613	0%	0%
10.0%	451,190	449,994	1,196	205,726	204,325	1,402	0%	0%
25.0%	313,553	313,359	194	165,237	164,289	948	0%	0%
50.0%	213,959	213,999	-40	130,453	129,910	543	0%	0%
75.0%	143,803	144,335	-532	93,536	93,830	-294	10%	10%
90.0%	106,394	107,599	-1,205	71,864	72,398	-534	15%	15%
95.0%	92,607	92,868	-261	65,211	65,880	-670	15%	15%
97.5%	75,587	76,723	-1,136	58,948	59,526	-578	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: Penitentiary

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% PEN: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	173,159	172,701	459	36,779	36,672	107	0%	0%
5.0%	154,762	154,458	304	34,635	34,536	99	0%	0%
10.0%	134,094	133,944	150	32,612	32,551	61	0%	0%
25.0%	105,098	105,090	8	28,432	28,357	75	0%	0%
50.0%	77,134	77,196	-62	25,165	25,100	65	0%	0%
75.0%	55,657	55,858	-201	22,111	22,079	31	0%	0%
90.0%	42,773	42,912	-139	20,212	20,219	-7	0%	0%
95.0%	37,550	37,836	-286	19,442	19,430	12	0%	0%
97.5%	32,437	32,652	-215	18,754	18,748	7	0%	0%

20 Year Projection

3.50% PEN: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	307,711	307,198	513	111,123	110,314	809	0%	0%
5.0%	244,140	243,432	709	97,574	96,990	583	0%	0%
10.0%	192,346	191,796	550	86,430	85,926	504	0%	0%
25.0%	134,757	134,561	196	69,356	68,891	465	0%	0%
50.0%	91,473	91,561	-88	54,846	54,659	187	0%	0%
75.0%	61,332	61,199	133	39,828	40,002	-173	10%	10%
90.0%	45,148	45,122	26	30,505	30,650	-146	10%	10%
95.0%	39,261	39,381	-121	27,687	27,854	-167	15%	15%
97.5%	31,875	32,269	-394	24,660	24,913	-254	15%	15%

Note: Dollar amounts shown in thousands

Land Bank Cash and Future Land Sales: School of Science

5% Distribution and 700% Earnings Reserve

10 Year Projection

3.50% SS: 700% ER 10 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	362,287	361,096	1,191	79,030	78,778	252	0%	0%
5.0%	324,196	323,491	705	74,430	74,220	210	0%	0%
10.0%	279,518	278,872	646	70,261	69,980	282	0%	0%
25.0%	219,373	219,179	193	61,429	61,216	213	0%	0%
50.0%	161,606	161,923	-317	54,471	54,337	134	0%	0%
75.0%	116,997	117,290	-293	47,873	47,854	19	0%	0%
90.0%	90,253	90,955	-702	43,858	43,873	-15	0%	0%
95.0%	79,763	80,398	-635	42,037	42,051	-14	0%	0%
97.5%	68,728	69,250	-522	39,991	40,184	-193	10%	10%

20 Year Projection

3.50% SS: 700% ER 20 Years	Real Ending Market Value			Cumulative Real Distributions			% of Yrs Distribution < Previous	
	Fin'l	Land	Fin'l-Land	Fin'l	Land	Fin'l-Land	Fin'l	Land
2.5%	624,549	623,272	1,277	232,309	230,658	1,652	0%	0%
5.0%	497,109	496,904	205	204,713	203,134	1,580	0%	0%
10.0%	391,320	390,231	1,089	180,462	179,768	694	0%	0%
25.0%	270,702	270,378	324	144,543	143,577	965	0%	0%
50.0%	186,490	186,331	159	112,829	112,558	271	0%	0%
75.0%	126,078	126,699	-621	78,402	78,893	-491	10%	10%
90.0%	93,953	94,718	-766	58,621	59,085	-464	15%	15%
95.0%	81,817	82,485	-668	52,738	53,340	-602	15%	15%
97.5%	66,526	67,576	-1,051	46,880	47,600	-719	15%	15%

Note: Dollar amounts shown in thousands

Idaho IDLE Fund

- The State of Idaho Idle Pool (IDLE) is an involuntary internal pool for state agencies
- Benchmark
  - A blended index made up of 80% Bank of America Merrill Lynch 0-1 Year U.S. Treasury (G0QA Index) and 20% Bank of America Merrill Lynch U.S. Corporate & Government 1-10 Years A rated and above (B510 Index)
- Maturities
  - Investment maturities for operating funds (short-term funds) will be scheduled to coincide with cash flow needs, taking into account routine expenditures as well as anticipated revenue
  - Investments will not exceed a maximum maturity of 10 years on approved investments, with the exception of SBA Loans, mortgage-backed securities and commercial mortgage-backed securities which have up to a maximum maturity of 30 years
  - IDLE funds not needed for short-term cash flows within one year may be invested in the intermediate portion of the portfolio and will not exceed 30% of the total par value of the portfolio at the time of purchase
  - IDLE funds invested with a longer investment horizon are for the purpose of improving returns over extended periods
  - The IDLE portfolio's effective duration will be within 50% to 150% of the target effective duration of 2 years at the time of purchase

Disclaimers

This report is for informational purposes only and should not be construed as legal or tax advice on any matter. Any decision you make on the basis of this content is your sole responsibility. You should consult with legal and tax advisers before applying any of this information to your particular situation.

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The statements made herein may include forward-looking statements regarding future results. The forward-looking statements herein: (i) are best estimations consistent with the information available as of the date hereof and (ii) involve known and unknown risks and uncertainties such that actual results may differ materially from these statements. There is no obligation to update or alter any forward-looking statement, whether as a result of new information, future events or otherwise. Undue reliance should not be placed on forward-looking statements.

STATE BOARD OF LAND COMMISSIONERS
C. L. "Butch" Otter, Governor and President of the Board
Lawerence 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

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
May 15, 2018

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, May 15, 2018, in the Capitol, Lincoln Auditorium, Lower Level, West Wing, 700 W. Jefferson St., Boise, Idaho. The meeting began at 9:02 a.m. The Honorable Governor C. L. "Butch" Otter presided. The following members were present:

Honorable Secretary of State Lawerence 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. Timber Sale Activity and Information Report – April 2018
B. Division of Lands and Waterways Activity and Information Report – April 2018

- **CONSENT (ACTION)**

2. Gooding Hospital Surplus Property – *Staffed by Sid Anderson, Program Manager-Residential*

RECOMMENDATION: Declare the Land to be surplus and direct the Department to offer the former Gooding County Hospital District property for surplus property disposition in Ada County or Gooding County, in accordance with Idaho Code § 58-331 *et seq.*

DISCUSSION: Controller Woolf asked for verification that this property has no ties, and there is no relation, to the School for the Deaf and Blind. Deputy Attorney General Robert Follett affirmed that the deed does not identify any restriction for any purpose of the School for the Deaf and Blind. Mr. Follett noted that the property is located adjacent to other property owned by and for the benefit of the School for the Deaf and Blind but this surplus property appears to have been acquired as a separate parcel of property and not directly connected to the School for the Deaf

and Blind. Superintendent Ybarra mentioned that she is Chairman on the School for the Deaf and Blind's Board; Superintendent Ybarra stated their Board was briefed by their attorney with this information and understands that no ties or relation exist between the property and School for the Deaf and Blind.

3. **Bonners Ferry Armory Surplus Property (Idaho Military Division)** – *Staffed by Josh Purkiss, Program Manager-Real Estate*

   RECOMMENDATION: Direct the Department to offer the Bonners Ferry Readiness Center for surplus property disposition in Ada County or Boundary County, in accordance with Idaho Code § 58-331 *et seq*.

   DISCUSSION: None.

4. **Application for Dredge/Placer Permit No. P310335, Curtis Matteson** – *Staffed by Todd Drage, Program Manager-Minerals*

   RECOMMENDATION: Approve issuance of the attached permit subject to the plan submitted in the application and submission of the required Bond Assurance Fund fee to cover 10 acres of disturbance.

   DISCUSSION: None.

5. **Approval of Minutes** – April 17, 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)**

6. **Endowment Fund Investment Board Manager's Report** – *Presented by Dean Buffington, EFIB Chairman and Chris Anton, EFIB Manager of Investments*

   DISCUSSION: Chairman Buffington remarked that the Investment Board is pleased to attend this joint meeting today to present EFIB's semi-annual report to the Land Board. Chairman Buffington mentioned that following the Land Board meeting, the Investment Board will adjourn to EFIB offices and convene its regularly scheduled meeting. Chairman Buffington announced Investment Board members in attendance included Senator Chuck Winder, Representative Neil Anderson, Director of Finance Gavin Gee, Gary Mahn, Warren Bakes, Irv Littman and Jerry Aldape. Chairman Buffington shared the absence of Richelle Sugiyama due to the death of her father.

   Attorney General Wasden requested by unanimous consent that the Land Board members join the Investment Board members in sending a letter to Richelle with their condolences at the passing of her father. Governor Otter so ordered. Chairman Buffington noted that it would be done. Chairman Buffington then introduced Chris Anton to present the reports.

A. Manager's Report; and
B. Investment Report

DISCUSSION: Mr. Anton thanked Chairman Buffington and the Investment Board members for their participation today. Mr. Anton introduced EFIB staff: Chris Halvorson, Investment Officer, Michelle Watts, Fiscal Officer, and Liz Wieneke, Office Manager. Mr. Anton welcomed several guests in attendance: Janet Becker-Wold, Senior Vice President, Callan LLC, and Josie Lewis and Michael Raab, investment managers for Sands Capital. Mr. Anton stated that the market has been increasingly volatile since January but despite that volatility, strong corporate earnings and a strong economy overall have allowed EFIB to have a solid performance.

Mr. Anton reported that for the month of April the Endowment Fund was up 0.2% and fiscal year-to-date is up 8.6%. Mr. Anton added that as of close of business yesterday, the Fund is up 10.5%. The Investment Board feels good about investment results; the economy remains strong with inflation and interest rates at historically low levels although modest increases are starting to occur. Mr. Anton said that distributions from earnings reserves are well-secured for FY2018 and FY2019. At the end of March, the endowments had at least five times their annual distributions in place.

Mr. Anton noted that the Investment Board is holding a regular meeting today, as mentioned by Chairman Buffington, and the first Land Board Audit Committee meeting will be held next week as part of fiscal year-end planning. Mr. Anton commented that he feels very fortunate to work with the dedicated and thoughtful members of the Investment Board and is enjoying the experience. Mr. Anton referred to the Investment Report, stating that 11 of 13 investment managers are performing ahead of their benchmarks year to date. Mr. Anton drew attention to page 2 of the report, remarking that Sands Capital has exceeded their benchmark by 8.3% through March, and they are up 31.4% fiscal year-to-date, having a terrific year.

C. Semi-Annual Report

DISCUSSION: Mr. Anton observed that the Investment Board attends the Land Board meetings in May and November each year to provide its semi-annual update. In the report, Mr. Anton referenced EFIB's mission statement and pointed out total assets overseen by EFIB which are slightly over $3 billion, including $2.2 billion in Land Grant Endowments, $739 million in State Insurance Fund, $65.6 million for DEQ Bunker Hill Water Treatment, $24 million for Idaho Fish and Game Endowments, and $4 million for Idaho Parks and Recreation Endowments. Mr. Anton stated that the Land Grant Endowments Fund increased $142 million, or 7%, and explained that although investments were up over 8%, several variables affect the overall balance: investment gains, revenue from the endowment lands, expenses for IDL and EFIB, and distributions made to the beneficiaries. Earnings reserves decreased from $570 million to $458 million, primarily due to a transfer of $128 million to the permanent fund early in the fiscal year. Mr. Anton reported that net earnings reserve receipts from endowment lands revenue were $37.5 million and investment returns were 8.3% for fiscal year-to-date. Land Grant Endowment Fund assets growth is very impressive over the past 20 years; assets have nearly quadrupled from $600 million in 2003 to $2.2 billion in 2018.

Mr. Anton commented that earnings reserves for all endowments are at their recommended levels with the exception of Ag College, which is slightly under; reserve levels will bourgeon as fiscal year-end draws closer. Mr. Anton stated that the graphic on page 10 shows Endowment Fund performance over various periods of time; the Endowment Fund ranks above average for all periods, and is in the 9th percentile for the last 10-year period and 6th percentile for the last 15-year period. Mr. Anton conveyed that it is a testament to the continuity in Land Board and Investment Board management in achieving those results, being consistent and steadfast with asset allocation, being patient during difficult times, keeping costs low, hiring good managers and avoiding exotic strategies and mistakes. Mr. Anton expressed that the Land Board, Investment Board, and staff should be very pleased with results over the last 10-15 years.

Mr. Anton highlighted the School Bond Credit Enhancement Program administered by EFIB on behalf of Idaho schools. This program offers a credit enhancement that allows bond issuers to increase the bond rating from the state's AA+ rating to AAA. EFIB will provide up to $1.2 billion in credit enhancement, with a $40 million per school district limit; the enhancement is backed by $300 million in Public School Endowment Fund assets. Mr. Anton explained the increased rating has the effect of reducing the interest rate by about 0.05%, which may not seem like much but with approximately $756 million under guarantee, times 0.05%, it is about $380,000 a year. That is rather significant and meaningful for the state and public schools. This year EFIB has provided $50.5 million in new bond guarantees; eight different school districts have applied and two more are in process. Mr. Anton said EFIB charges a one-time application fee of $500 and a guarantee fee of 0.02% – that is a one-time guarantee fee in the first year only and schools have the benefit of that higher credit rating going forward. Total revenue EFIB has generated is about $19,400.

D. Earnings Reserve Levels

RECOMMENDATION: Modify the Land Board Distribution Policy to adopt the recommended new reserve levels.

DISCUSSION: Mr. Anton recalled that Callan LLC presented an update to the Land Board's Asset Allocation and Distribution Study at the April meeting. Included in the update were several recommendations, one of which EFIB suggests implementing today because it affects the fiscal year-end close process, and that is increasing reserve levels. Mr. Anton explained that the analysis and modeling done as part of Callan's study indicates the need to adjust the reserve level for Public School from five to six years and the reserve level for Charitable Institutions from five to seven years. In addition, a temporary boost in reserve levels to seven years for State Hospital South and Normal School was made in August 2017; that temporary increase should be made permanent. Mr. Anton summarized that these changes would result in Public School having six years of reserves and all other endowments having seven years of reserves. Mr. Anton remarked that the Investment Board believes these changes to be prudent. Controller Woolf asked, if this recommendation is implemented, will future distributions remain level or perhaps grow. Mr. Anton replied that this is a great time to consider change because of strong market performance; reserve levels can be enlarged and distributions will remain the same with perhaps modest enhancement.

Attorney General Wasden stated his understanding that the basis for this recommendation is two-fold: an analysis of the market by Callan, and the new asset mix that is a result of cottage site auction sales. Attorney General Wasden commented that the Board is contemplating potential risks and the ability to maintain constant payout to the beneficiaries. Mr. Anton agreed; given the expected decline in revenue from both investments and lands, in order to keep the same level of confidence in distributions it is appropriate to have larger reserve levels. Attorney General Wasden noted that the purpose of maintaining constancy in terms of distributions is to best serve the beneficiaries; they can count on that money rather than having some level of volatility which would cause them difficulty. Mr. Anton concurred; the beneficiaries rely on the annual distributions as a significant portion of their budgets, and the Land Board and Investment Board take seriously their roles in keeping distributions stable each year, if not increasing modestly.

Governor Otter recollected that annual disbursements from the Public School Fund have been in the $32 million range, with an exception in 2010 of an additional $22 million, and inquired if there has ever been a year that the distribution was reduced. Mr. Anton replied that to the best of his knowledge there was a period when the market was very volatile and distributions declined modestly; some years were held flat but for the most part there has been an increase every year.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board modify the Land Board Distribution Policy to adopt the recommended new reserve levels. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

7. **Extension of Recruiting Process for Department of Lands' Director** – *Presented by Andrea Ryan, Human Resource Officer*

RECOMMENDATION: The Department recommends extending the open, competitive recruitment for the Director of the Idaho Department of Lands using the following timeline. All candidates that applied during the first recruitment period shall be considered and do not need to re-apply.

Recruiting Timeline:

Action	Dates
Recruiting Extension Approved	May 15
Open Recruitment	May 16 – June 16
Applicant Screening	June 18 – July 6
Schedule Interviews/Reference Checks	July 6 – July 27
Interviews	August 3

DISCUSSION: Governor Otter noted that there were 57 applicants in the first recruitment period and inquired if they will be asked if they want to continue under consideration. Ms. Ryan responded that all applicants will be contacted and asked if they want to remain in the pool given the extended date. Attorney General Wasden stated he has no objection to the extension but wondered if it will provide ample time to gather additional applications. Ms. Ryan indicated that extending the recruitment process through the recommended date will be sufficient.

Governor Otter wondered why the hiring review group felt that 57 applicants was not adequate. Ms. Ryan noted that some individuals conveyed to Land Board staff that they were unable or unwilling to apply given extenuating circumstances. Governor Otter surmised that the primary elections were the hindrance.

BOARD ACTION: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation to extend the recruitment period. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

- **INFORMATION**

  NONE

- **EXECUTIVE SESSION**

  NONE

There being no further business before the Board, at 9:40 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/ Lawerence E. Denney
Lawerence E. Denney
Secretary of State

/s/ David Groeschl
David Groeschl
Director

The above-listed final minutes were approved by the State Board of Land Commissioners at the June 19, 2018 regular Land Board meeting.

STATE BOARD OF LAND COMMISSIONERS
C. L. "Butch" Otter, Governor and President of the Board
Lawerence 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

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 Lawerence 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[1]; 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.

[1] 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.

- **EXECUTIVE SESSION**

A. Idaho Code § 74-206(1)(f) - to communicate with legal counsel for the public agency to discuss the legal ramifications of and legal options for pending litigation, or controversies not yet being litigated but imminently likely to be litigated. [TOPIC: Sharlie-Grouse Petition]

At 10:52 a.m. the Board resolved out of Executive Session by unanimous consent. No action was taken by the Board during the Executive Session.

- **REGULAR (ACTION)**

8. Appointment of Hearing Officer

BOARD ACTION: A motion was made by Attorney General Wasden that the Board grant authority for the Idaho Department of Lands' Director to appoint a hearing officer to conduct the matter under the APA in regards to the Sharlie-Grouse Neighborhood Association Petition for Declaratory Ruling and that the hearing officer provide a recommended order to the Board. Controller Woolf seconded the motion. Governor Otter clarified that APA is the Administrative Procedures Act. The motion carried on a vote of 5-0.

There being no further business before the Board, at 10:53 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/ Lawerence E. Denney
Lawerence E. Denney
Secretary of State

/s/ David Groeschl
David Groeschl
Director

The above-listed final minutes were approved by the State Board of Land Commissioners at the August 21, 2018 regular Land Board meeting.

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
April 16, 2019

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, April 16, 2019, in the Boise City Council Chambers, Boise City Hall, 3rd Floor, 150 N. Capitol Blvd., Boise, Idaho. The meeting began at 9:00 a.m. The Honorable Governor Brad Little presided. The following members were in attendance:

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

For the record, all Board members were present.

1. **Department Report** – *Presented by Dustin Miller, Director*

Endowment Transactions
A. Timber Sales – March 2019
B. Leases and Permits – March 2019

Status Updates
C. Land Bank Fund
D. Legislative Summary – Final

Discussion: None.

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 reported that the endowment portfolio was up 1% for the month of March and was up 3.3% fiscal year-to-date, through March 31st. Over the last two weeks it gained another 2%; through April 15th it was up 5.3%. Mr. Anton added that the portfolio gained 10.1% during the first quarter of 2019, offsetting some of the losses experienced late in calendar year 2018—a nice rebound.

Mr. Anton stated that the global economy is slowing, but there seems to be optimism in the financial markets that it is temporary and there will be a recovery in the second half of the calendar year, primarily due to support from the Federal Reserve. The Federal Reserve indicated there will be no further increase in interest rates this year. After the announcement, interest rates came down, and home construction and auto sales—very interest rate sensitive sectors—picked up again. Mr. Anton remarked that growth in Europe is very soft right now; there is concern about Brexit and what will happen in terms of Brexit. The trade negotiations in China are still ongoing, but investors seem to be patient. There will be positive outcomes from those negotiations. The financial markets are largely moving sideways until there is positive growth in the second half of the year, and until there is resolution to negotiations with China.

Mr. Anton indicated that distributions for fiscal years 2019 and 2020 are well secured. The estimated reserves as of February 28th are 5.8 years for Public School, and 6.3 to 8 years for the other endowments. Mr. Anton referenced the chart provided in the Board materials; it shows the level of earnings reserves for each of the endowments expressed in years of reserves. Earnings reserves move not just based on investments. They also change based on revenue coming in from the Department of Lands, and expenses going out for EFIB, or the Department of Lands, and for the beneficiaries. Overall the reserves are very solid.

Mr. Anton mentioned that the Investment Board had a special meeting on March 25th and approved the hiring of Sycamore Capitol as a mid-cap value manager in place of Systematic Financial; that transition was completed at the end of last week. Mr. Anton thanked Governor Little for the appointment of Tom Wilford to the Investment Board, replacing Gavin Gee, who was probably the longest-serving member. The Investment Board is excited to have Mr. Wilford. Mr. Wilford was the CEO for the J.A. and Kathryn Albertson Foundation for many years and he will add some strong experience to the Investment Board.

Mr. Anton noted that EFIB has been working on an investment consultant request for proposal (RFP). EFIB's policy is to issue an investment consultant RFP every 10 years. At this point, the scope of work includes investment consulting for EFIB and the State Insurance Fund, and includes a scope of services for the Idaho Department of Lands. The RFP is constructed so that those are three very distinct scopes of service. EFIB intends to distribute the RFP broadly, and interested companies can respond to all three pieces, or to individual pieces. There is not a need to select one consultant for all three entities, but there may be economies in doing so. EFIB has consulted with the State Insurance Fund and the Department of Lands. Both agencies reviewed the scope of services that are needed from an investment consultant. The RFP will be issued by the end of this week.

Consent—Action Item(s)

3. **Transfer Old Penitentiary Parcel (Non-Endowment Land) to Idaho Department of Agriculture** – *Presented by Ryan Montoya, Bureau Chief-Real Estate Services; Dan Salmi, Bureau Chief, Bureau of Laboratories, ISDA; and Kelly Nielsen, Administration Administrator, ISDA*

   Recommendation: Approve the transfer of control of the two acres, identified herein, of Penitentiary Reserve Lands to ISDA for the construction of a new laboratory.

   Discussion: Superintendent Ybarra inquired if the City of Boise has been notified, given the proximity to the city park. Mr. Salmi replied that the City Parks Department was contacted and

staff concern was for a main water line at the back of the property, that caution be used so summer irrigation is not cut off. Governor Little asked if Department of Agriculture will be fixing roads to the facility. Mr. Salmi said yes, that project is now out for bid and will be contracted in the next couple of months. Controller Woolf mentioned that Department of Corrections had tended a garden plot on that parcel and asked about coordination with that agency. Mr. Salmi indicated that Department of Corrections had not yet been contacted, but he believed that garden was actually maintained by Department of Agriculture staff who then donated the produce to the food bank.

4. **Approval of Minutes** – March 19, 2019 Regular Meeting (Boise)

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

Regular—Action Item(s)

5. **FY2020 Timber Sales Plan** – *Presented by Jim Elbin, Bureau Chief-Forest Management*

Recommendation: Direct the Department to proceed with implementation of the FY20 Timber Sales Plan.

Discussion: Controller Woolf noticed that the recommendation for Maggie Creek's annual sale volume was significantly lower in FY20 than FY13. Mr. Elbin explained the difference was due to the Maggie Creek Pulp Plan, a ten-year plan which entailed harvesting high volumes of diseased trees and then replanting with healthy, productive tree species.

Governor Little asked how the 100-year sustained harvest forecast works, with different species and different silvicultural needs. Mr. Elbin responded that the Department models for each individual supervisory area, using either continuous forest inventory or stand-based inventory. Using forest modeling, the Department looks at growth projections for the future and standing inventory, and tries to determine how much volume, over what is growing, will be cut to bring the standing inventory down. At the same time, past management efforts result in more growth so there is a kind of push-pull relationship going on. The goal is to attain the balance where growth matches what is cut.

Attorney General Wasden recalled the Board made this decision to increase the cut rate because of aging timber that was beginning to exceed the sizes that were acceptable to the mills. Attorney General Wasden noted that what this evidence shows is the right decision was made. The Department is cutting timber at an increasing rate and yet growth rate is more than compensating for what is harvested. Mr. Elbin said that is correct. The Department is converting old stands that have reached a point in their growth where they are actually declining or very slowly growing, and is replacing old stands with super-fast growing stands. Mr. Elbin commented that it is a good problem to have.

Controller Woolf inquired if Department staff has a percentage of what is the growth of the cut rate, over the next 5-10 years. Mr. Elbin indicated it would be just a projection and estimated that annual harvest volume would be over 300 MMBF in the next five years.

Governor Little remarked that with programs like Good Neighbor Authority, there will be timber coming off grounds that have not been logged before, or not logged in a great number of years, and asked if the Department takes into account perpetuation of mills that have carriages for bigger logs. Mr. Elbin replied that the Department will likely never be able to accelerate harvest fast enough to get rid of all oversized timber; there will always be some segment of endowment forestland that is in that size class. Governor Little commented that having some oversized timber keeps those large carriage mills in business; those mills are essential in getting a return on the timber product from forest health projects such as Good Neighbor Authority.

Board Action: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation and direct the Department to proceed with the implementation of the FY20 Timber Sales Plan. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

6. **Negotiated Rulemaking IDAPA 20.03.04, Rules for the Regulation of Beds, Waters, and Airspace Over Navigable Lakes in the State of Idaho** – *Presented by Andrew Smyth, Program Manager-Public Trust*

Recommendation: Authorize the Department to initiate negotiated rulemaking for IDAPA 20.03.04 *Rules for the Regulation of Beds, Waters, and Airspace Over Navigable Lakes in the State of Idaho*.

Discussion: Attorney General Wasden pointed out the discussion on page 2 of the memo about whether the fee schedule would remain in the rules or be moved to allow fees to be set by the Land Board. Attorney General Wasden acknowledged Idaho Code § 58-127; however, the Attorney General is not yet convinced that the fee setting can be removed from the rules, despite the current controversy concerning rules. Attorney General Wasden wondered if the Department had discussed with the Office of the Attorney General the legality, the legal structure properly required, concerning the setting of those fees. Mr. Smyth responded that the Department is working with the Attorney General's staff on the legality. Attorney General Wasden noted that discussing it is one thing, proposing it is another, and asked the Department to make certain to fit the legal requirements in the rulemaking process.

Controller Woolf inquired when was the last time the fees listed at the bottom of page 1 were adjusted or changed, and if the change was up or down. Mr. Smyth replied the last time was 2008 and said the water intake line permit fee was actually adjusted down from $1,000 to $300.

Board Action: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation and authorize the Department to initiate negotiated rulemaking for IDAPA 20.03.04 Rules for the Regulation of Beds, Waterways, and Airspace Over Navigable Lakes in the State of Idaho. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

7. **Negotiated Rulemaking IDAPA 20.03.03, Rules Governing Administration of the Reclamation Fund** – *Presented by Todd Drage, Program Manager-Minerals*

Recommendation: Authorize the Department to initiate negotiated rulemaking for IDAPA 20.03.03 *Rules Governing Administration of the Reclamation Fund*.

Discussion: Attorney General Wasden reiterated his concern about the fee issue and advised the Department to make certain to meet statutory requirements when addressing the fees. Mr. Drage assured the Attorney General that the Department would coordinate with his office.

Board Action: A motion was made by Controller Woolf that the Board authorize the Department to initiate negotiated rulemaking for IDAPA 20.03.03 Rules Governing Administration of the Reclamation Fund. Attorney General Wasden seconded the motion. The motion carried on a vote of 5-0.

8. **Cancellation of Reclamation Plan S01020 and Use of the Bond Assurance Fund for Reclamation** – *Presented by Todd Drage, Program Manager-Minerals*

Recommendation: Authorize the Department to cancel Reclamation Plan S01020, and authorize the Department to expend up to $126,997 from the Reclamation Fund to reclaim the entire site.

Discussion: Attorney General Wasden questioned how the operator ended up mining 20 acres outside of the mine site. Mr. Drage surmised that is where the good sand and gravel was so the operator ignored the rules and went after it.

Superintendent Ybarra asked if the Department exhausted all possibilities of recovering money from Prime Earth, Inc. and its principals, to pay for this site's reclamation. Mr. Drage said the Department did look into it and his understanding is the company has been defunct for quite a while. Director Miller added that the Department worked with the Attorney General's office to try and collect from Prime Earth, Inc.; the company has disbanded and has no assets.

Governor Little observed that somebody has purchased this piece of ground and wants to develop it and asked if the Department is sure that after it pays to place dirt in the hole as part of the reclamation, it will not then be dug right back out again. Governor Little asked if the Department has given any consideration to speaking with the new owner, acknowledging the state's liability while working out a way to minimize the cost of site rehabilitation to the Department and still accommodate the owner's plans for the ground. Mr. Drage indicated that there has been no discussion with the new owner, but the Department could do so. Presently, the Department has developed a scope of work to reclaim per the reclamation plan, which is to smooth out the area, add top soil and then seed it. Governor Little speculated that the Department would add top soil and the developer would scrape it off.

Board Action: A motion was made by Attorney General Wasden that the Board adopt the Department recommendation and authorize the Department to cancel Reclamation Plan S01020, and authorize the Department to spend up to $126,997 from the Reclamation Fund to claim the entire site. Controller Woolf seconded the motion. The motion carried on a vote of 4-1; Governor Little cast the opposing vote.

Information

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

9. **Strategic Reinvestment and Central Idaho Land Exchange** – *Presented by David Groeschl, Deputy Director and State Forester*

   Discussion: Superintendent Ybarra thanked Mr. Groeschl for the overview, saying it was very thorough, and wondered if the Department has an anticipated date for bringing the exchange back to the Board for approval, as mentioned in the presentation. Mr. Groeschl stated the Department's preference would be the next 2-3 months, to bring this forward to the Land Board for an action item. There is support needed still from key groups; if the Department does not feel that it can get that support, then the Land Board would be advised that staff is discontinuing efforts on this exchange.

   Controller Woolf referred to page 3 of the memo, the last sentence in the summary says some groups have expressed support to move forward with a more formal land exchange process while others are outright opposed, and Attachment 7 is referenced. Attachment 7 is from Idaho County Commissioners who seem to be in the middle. Controller Woolf asked for clarification that Idaho County is not opposed right now, just in the middle. Controller Woolf also asked if there are others in support. Mr. Groeschl replied that Idaho County is interested simply in seeing the process move forward in a more formal process and is willing to continue engagement with the Department and others in that process. Mr. Groeschl said two groups have expressed outright opposition—Friends of the Clearwater, and Friends of the Palouse. Those organizations are opposed to any exchange proposal, regardless of the parties involved, and do not want to see any federal lands leave federal estate.

   Controller Woolf commented that Attachment 5, which describes the exchange concept, identifies Idaho County as potentially receiving funds equal to five years' worth of property taxes, approximately $500,000-$600,000. Controller Woolf inquired if Clearwater County has tried to negotiate anything along that line. Mr. Groeschl stated that only about 1,800 acres of Western Pacific Lands in the Upper Lochsa are in Clearwater County and there was not a request to consider some sort of compensation. Idaho County made the request because of the significant amount of acreage coming off its tax roll.

   Governor Little invited public comments from interested persons. Comments were received from the following:

   Phil Lambert, Benewah County Commissioner: Mr. Lambert expressed concern about the Board's strategic reinvestment policy. Mr. Lambert said the plan is good but that it causes problems for counties. In the last two years, approximately 15,000 acres have come off tax rolls in Benewah County, which is detrimental to county health in the short term. Five northern counties affected by this exchange feel the same. The short-term effect is budgetary restriction and long-term it requires a tax shift. A tax shift dramatically increases taxes without an appropriate increase in services. Mr. Lampert noted that there is about 66,500 acres of state-owned land in Benewah County; taxes on that acreage would be approximately $300,000. Public schools receive $199,000 from endowments; the county is losing more than it is gaining. There is other land in the county not taxed—federal lands, tribal lands, Idaho Fish and Game land—the county receives payments in lieu of taxes for

those. Mr. Lampert indicated that if the state purchased another 20,000 acres, that would be about 20% of acres in Benewah County that are not taxed. Funds go to public schools and other entities, but very little comes to the county. If Benewah County Commissioners could have that land, according to Department of Lands' annual report, at $46/acre net profit for timberland, that would be $3 million into county coffers. As it stands, the county gets $200,000; it is not fair to taxpayers. Mr. Lampert stated that Benewah County was not contacted prior to the last land purchase; commissioners were notified a month ago that Department of Lands purchased 12,500 acres and suddenly $58,000 came off the tax rolls. The Land Board needs to consider ways to make counties whole.

10. Stimson Request for Audience – *Presented by Keith Williams, Vice President-Resources, Stimson Lumber Company*

Discussion: Mr. Williams, on behalf of Stimson Lumber Company, communicated concerns regarding the Department of Lands' policy of purchasing private timberlands as part of its reinvestment strategy. Stimson Lumber Company provided a letter with these concerns and additional information; the letter was included in the Board materials. Mr. Williams stated that Stimson Lumber Company is opposed to the scale of the reinvestment strategy as it places the state in direct competition with private investment and enterprise.

Governor Little invited public comments from interested persons. Comments were received from the following:

John Robison, Idaho Conservation League: Mr. Robison testified on behalf of Idaho Conservation League in support of the Department of Lands' purchase of 32,000 acres of private timberlands in north Idaho in December 2018. Idaho Conservation League supports the goals of the Central Idaho Land Exchange and wants to see the process move forward. Mr. Robison remarked that Idaho was granted 3.6 million acres of land at statehood to generate revenue for beneficiaries, including Idaho public schools; approximately 2.4 million acres remain today. In the last several decades, the Department of Lands has disposed of 167,000 acres in Benewah, Bonner, Boundary, Latah and Shoshone counties. It is reasonable for the Department of Lands to acquire private timberlands in those areas from a willing seller. Mr. Robison encouraged the Land Board to continue to work with affected counties to address concerns about tax shifts. Mr. Robison recognized that endowment lands are managed to maximize long-term financial returns, and not for the same multiple purposes as national forests, but said sustainably managed state timberlands can provide greater benefits for wildlife and recreationists than private properties that are developed. Mr. Robison referenced the Land Board's recreation policy that allows continued public recreation access on state endowment lands. Many private timberlands also allow public access, which is appreciated, but this privilege can be revoked at any time and has been in other areas. Mr. Robison noted that the Department of Lands has increased the capacity for forest restoration across forest boundaries by investing significantly in the Good Neighbor Authority and providing leadership in Idaho in the shared stewardship agreement with Regions 1 and Regions 4 of the Forest Service. Mr. Robison thanked Governor Little for his role in the upcoming Idaho Forest Restoration Partnership conference. The conference brings together members of local forest restoration collaboratives, from across the state, to learn how to work better with the Forest Service, and the Idaho Department of Lands, on increasing the pace and scale of forest and watershed restoration.

For the record, Governor Little commented that he was not a member of the Land Board at the time the policy was put in place and proposed that a subcommittee of the Land Board review the current situation. Governor Little noted that EFIB reported earlier in the meeting that a request for proposal for an investment consultant is being advertised, and also noted that $200 million is a large sum of cash to be spending in a significant manner. Governor Little asked for volunteers to serve on a subcommittee of the Land Board to review the asset management plan [strategic reinvestment] going forward. Attorney General Wasden and Secretary of State Denney volunteered to serve on the subcommittee; Governor Little so ordered.

At 10:32 a.m. a motion was made by Attorney General Wasden to resolve into Executive Session pursuant to Idaho Code § 74-206(1)(f) to communicate with legal counsel for the Land Board 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, Little; *Nay:* None; *Absent:* None.

Governor Little called for a short break before the Board convened in Executive Session.

Executive Session

A. Idaho Code § 74-206(1)(f) - to communicate with legal counsel for the public agency to discuss the legal ramifications of and legal options for pending litigation, or controversies not yet being litigated but imminently likely to be litigated. The mere presence of legal counsel at an executive session does not satisfy this requirement. [**Topic**: Lease M500031]

At 11:09 a.m. the Board resolved out of Executive Session by unanimous consent. No action was taken by the Board during the Executive Session.

Regular—Action Item(s)

11. Lease M500031 – *Presented by Darrell Early, Deputy Attorney General, Chief-Natural Resources Division, Office of the Attorney General*

Board Action: A motion was made by Attorney General Wasden that the Land Board, one, rescind Lease M500031 on the basis that the Idaho Department of Lands failed to comply with constitutionally and legally required processes in issuing the lease. Two, direct the Idaho Department of Lands to prepare, market, and offer for lease at public auction the parcel of land subject to Lease M500031 in accordance with Idaho constitutionally, legally, and financially required processes. And, three, that the Department, with the assistance of the Office of the Attorney General, negotiate a mutually acceptable settlement with the current leaseholder to compensate the leaseholder for costs and expenses incurred by the leaseholder associated with the lease which were not otherwise addressed during the leasing process. Attorney General Wasden asked for the opportunity to address his motion, upon receiving a second. Controller Woolf seconded the motion.

Attorney General Wasden remarked that in the Board's review of this lease, the Board has to acknowledge that there were some mistakes made in the processes employed. The best thing for the Board to do is to rescind the lease and then to engage in proper processes that meet the

financial, legal, and constitutional requirements to offer this property at lease, which will give the greatest opportunity for all of the parties involved to address that lease. Attorney General Wasden noted that also of importance is that the persons who were the lessees under this lease, in a sense were led down the primrose path, and the Board has an obligation to make them whole within the confines of the law. Attorney General Wasden stated that this provides an opportunity to address the lessees, and to see that they are legally made whole.

The motion carried on a vote of 5-0.

There being no further business before the Board, at 11:14 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/ Brad Little
Brad Little
President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/ Lawerence E. Denney
Lawerence E. Denney
Secretary of State

/s/ Dustin T. Miller
Dustin T. Miller
Director

The above-listed final minutes were approved by the State Board of Land Commissioners at the May 21, 2019 regular Land Board meeting.

Idaho State Board of Land Commissioners
Brad Little, Governor and President of the Board
Lawerence E. Denney, Secretary of State
Lawrence G. Wasden, Attorney General
Brandon D Woolf, State Controller
Sherri Ybarra, Superintendent of Public Instruction

Dustin T. Miller, Director and Secretary to the Board

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
May 21, 2019

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, May 21, 2019, in the State Capitol, Lincoln Auditorium (WW02), 700 W Jefferson Street, Boise, Idaho. The meeting began at 9:00 a.m. The Honorable Governor Brad Little presided. The following members were in attendance:

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

For the record, all Board members were present.

1. **Department Report** – *Presented by Dustin Miller, Director*

Endowment Transactions

A. Timber Sales – April 2019

Discussion: Controller Woolf asked if the Department expects to reach 100% of its FY2019 target for pole sales by the end of the fiscal year. State Forester David Groeschl replied that the Department will reach the target, and will likely be slightly over that target, by fiscal year-end.

B. Leases and Permits – April 2019

Discussion: Governor Little referred to the Real Estate Services figure in the table on page 3, and asked if that is earnings or expense. Director Miller explained that the figure shown is income; it is the result of a buyer's premium that is paid at closing, for disposition of commercial and residential properties.

Status Updates

C. Cottage Sites Auction – Payette Lake ULA

Discussion: None.

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

   A. Manager's Report; and
   B. Investment Report

   Discussion: Chairman Buffington remarked that the Investment Board is pleased to attend this joint meeting to present EFIB's semi-annual report to the Land Board. Chairman Buffington announced Investment Board members in attendance: Senator Chuck Winder, Gary Mahn, Warren Bakes, Irv Littman, Jerry Aldape, and Richelle Sugiyama. Representative Neil Anderson was on business out of state, and Tom Wilford, the newest board member, planned to join the group shortly. Chairman Buffington indicated that following the Land Board meeting, the Investment Board will adjourn to EFIB offices and convene its regularly scheduled meeting. Attorney General Wasden thanked Chairman Buffington and all the members of the Investment Board for the tremendous effort put forward on behalf of the people of Idaho. Attorney General Wasden noted that the report is always well done—the Investment Board's work is well done. Attorney General Wasden stated that the investments made by EFIB make a great difference for the beneficiaries in Idaho.

   Mr. Anton also thanked the Investment Board for their attendance and introduced several individuals that play important roles in the success of EFIB's program: Janet Becker-Wold, Callan; Julie Weaver, Attorney General's office; Michael Ray, investment manager for TimesSquare Capital Management; and Rhet Hulbert, investment manager for Clearwater Advisors. Mr. Anton acknowledged EFIB staff as well: Liz Wieneke, office manager; Kathy Van Vactor, fiscal officer; and Chris Halvorson, investment officer.

   Mr. Anton reported that the portfolio continued to have a strong recovery from the December sell-off. The fund was up 2.8% for the month of April and 13.2% calendar year-to-date; the fund is up 6.2% fiscal year-to-date at the end of April. Mr. Anton mentioned that the global economy started to slow late in 2018 and the market sold off; fortunately the Federal Reserve indicated it would hold interest rates fixed, and central banks around the world put in place efforts to stimulate their economies, particularly in Europe and China. As investors gained confidence, a recovery in the global economy was anticipated late in 2019 and the market really took off. It has been a strong start to calendar year 2019. Mr. Anton commented that over the last couple of weeks, however, the market caught its breath–challenges to finalize the trade agreements with China resulted in a slight sell-off and the market was down a little bit. As of the close of the markets on May 20th, the fund was up 4% fiscal year-to-date—a couple of percentage points down from the end of April. Mr. Anton observed that fundamentally the U.S. economy still remains very strong: housing starts picked up, gross domestic product (GDP) was up 3.2% in the first quarter, unemployment was at a 50-year low at 3.6%, and inflation was very modest; all are good conditions for strong financial markets. Mr. Anton indicated that reserves are in a strong position with 5.8 years of reserves for public schools and between 6.3 and 8.1 years of reserves for the other endowment funds. Mr. Anton thanked Governor Little for his reappointments of Chairman Buffington and Senator Winder to the Investment Board and noted that their experience, and the continuity of their service, is really important to the Investment Board and investment fund; it is important to have continuity for consistency in terms of management approach. Mr. Anton informed the Land Board that EFIB sent out the investment consultant request for proposal; responses are due the end of May.

C. Semi-Annual Report

Discussion: Mr. Anton highlighted portions of the semi-annual report. As of the end of March EFIB had nearly $3.2 billion under management, which included about $2.25 billion in the Land Grant Endowment, $810 million for the State Insurance Fund, $68.5 million for the Department of Environmental Quality (DEQ), $32.8 million for the Fish and Game Department, and $4.5 million for the Department of Parks and Recreation. Following the end of March, EFIB received an additional $25 million for two new funds for DEQ, and received $400,000 from the Department of Lands for the new forest legacy funds. Mr. Anton remarked that for the first nine months of the fiscal year, the total Land Grant Endowment Fund balance had increased $48 million, or 2.2%. Earnings reserves were down modestly from $570 million to $513 million; that was primarily due the transfer of $50 million at the beginning of the year from earnings reserves to the permanent fund; reserves are still in very good shape. Net earnings reserves, after expenses from the Department of Lands, totaled $49.2 million—a very solid year—and the investment return for the first nine months was 3.3%. Mr. Anton pointed out the graph on page 8 that demonstrates how the fund balance has changed. In the last ten years, it has grown from less than $900 million to over $2.2 billion, which is fairly impressive. Mr. Anton commented that part of that growth is the result of EFIB's investment performance and referred to the chart on page 10 that shows the 10-year numbers and 15-year numbers; the fund grew at an average annual rate of almost 11% over the last ten years and ranked in the 7th percentile during that period. Those results are in large part due to the Investment Board and efforts from EFIB's consultants.

Mr. Anton mentioned that EFIB continues to provide school bond credit enhancement for public schools. It allows public schools to issue financing for new construction and increase the debt rating from AA+ to AAA, which saves schools approximately 5 basis points on interest rates. EFIB provides that enhancement on up to $1.2 billion in bonds, with a limit of $40 million per school district, and it is backed by $300 million of the Public School Endowment Fund assets. Mr. Anton shared that as of the end of March, EFIB had guarantees on $615 million in outstanding school bonds, and EFIB has nearly completed another three bond issues that will add $46 million to that total. Governor Little observed that EFIB is using about half of its capacity on bond guarantees. Mr. Anton said that is correct. Governor Little clarified that the AAA rating lowers interest rates around 0.05%, not 0.05% points. Mr. Anton agreed and acknowledged the error in the report.

Attorney General Wasden called attention to page 9 which displays years of reserves and targets for each endowment fund. Attorney General Wasden stated it appears that all of the reserves are pretty close to target levels and there is a degree of confidence in the Land Board's ability to continue to make payments to the beneficiaries. Attorney General Wasden asked if EFIB has any concerns; are the levels within a reasonable margin of error for the number of years reserves in the funds. Mr. Anton explained that as EFIB closes the fiscal year, it first ensures that the permanent fund grows at inflation; any earnings above that move into the earnings reserves. As long as the fund stays at the numbers as of today, at 4%, there will be additional money moved from the permanent fund into the earnings reserves, which for most of the funds will top them off. Mr. Anton noted that Charitable may not quite reach its target level—that endowment has moved from a target of 5 years to 7 years—but overall levels will be at, or very close to, target reserves at the end of the fiscal year.

Consent—Action Item(s)

3. **Land Transfer for Idaho Division of Veterans Services** – *Presented by Ryan Montoya, Bureau Chief-Real Estate Services; and Tracy Schaner, Deputy Chief Administrator, IDVS*

   Recommendation: As land trustee, approve the land transfer on behalf of the Idaho Division of Veterans Services.

   Discussion: Attorney General Wasden commented that there is a reversionary clause associated with this deed that requires providing services not later than May 1, 2027, and inquired if Idaho Division of Veterans Services (IDVS) anticipates any problems getting things on line before that date. Also, regarding the 25-year requirements of the reversionary clause, is there any expectation that this property would cease to be used as a veterans' home during that 25-year period. Ms. Schaner responded that IDVS does not see any concerns as far as the year 2027 date. IDVS has lined that out by timeline to make sure that it will be providing services prior to that date. Ms. Schaner said there is also no concerns that IDVS would not be providing services within that 25 year span. IDVS had to indicate that it will be providing services for at least 20 years to receive a grant from the Veterans Administration (VA). IDVS would not be moving forward with a grant opportunity if it was not able to meet that requirement. Ms. Schaner added that studies and research by IDVS have supported the viability of that.

   Secretary of State Denney asked what the demand is for services; is there already a waiting list of veterans who want to move into this facility. Ms. Schaner replied that there is a high demand in that area. There are more than 17,000 veterans in northern Idaho; IDVS also accepts spouses. Within that catchment area, the closest other veterans' home is Spokane; it is an older home with double occupancy in each of the rooms. There is a desire to have single bedrooms–private rooms–and a new veterans' home in the area. Ms. Schaner noted that IDVS does have waiting lists for veterans' homes and does struggle with staffing—that is a nationwide concern—IDVS is working through those issues. Secretary of State Denney remarked that phase 2 would be an additional 64 rooms, and inquired how soon IDVS thinks that will be on the agenda. Ms. Schaner indicated that IDVS wanted to make sure it planned for future growth, and an expansion is very likely within 20 years, but future growth depends on the state's growth. IDVS planned ahead to avoid a similar circumstance as in Boise where IDVS is landlocked and cannot expand its veterans' facility. Governor Little remarked that this is a great project and noted that the Jacklin brothers would like to be there for the ribbon cutting. Governor Little suggested that IDVS make hay while the sun shines and get this home built.

4. **Disclaimer of Interest Request DI600288-Diamond S Farms, Boise River** – *Presented by Eric Wilson, Bureau Chief-Resource Protection and Assistance*

   Recommendation: Direct the Department to issue a disclaimer of interest for one parcel totaling 12.81 acres of the former bed of the Boise River to Diamond S Farms, LLC following their payment to the Department of the remaining processing fee of $300 or actual cost, whichever is greater.

   Discussion: Governor Little asked if the Department knows what the actual costs are going to be; how close is it to $300. Mr. Wilson responded that most of the field work takes place by area staff. The Department has a base fee of $600: a $300 application fee for an on-site inspection, and then either the remaining $300, or the total sum of Department staff time, whichever is greater.

5. **Approval of Minutes** – April 16, 2019 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.

Following the vote, Superintendent Ybarra suggested that it would be appropriate for the Department to send a thank you letter to Jacklin Land Company for their donation of land to Idaho Division of Veterans Services for the veterans' home project in Post Falls. Superintendent Ybarra noted the new veterans' home is an extremely important effort. Attorney General Wasden seconded the recommendation and Governor Little so ordered.

Regular—Action Item(s)

6. **Approve Timber Sales** – *Presented by Bill Haagenson, Division Administrator-Operations*

Sale Name	Volume	County	Area Office	Region
A. North Town	7,690 MBF	Clearwater	Clearwater	South Ops
B. Deer Meadow	3,820 MBF	Clearwater	Clearwater	South Ops

Recommendation: Approve the North Town and Deer Meadow timber sales.

Discussion: None.

Board Action: Attorney General Wasden, noting that these sales are economically and silviculturally justified, made a motion that the Board approve the Department recommendation, that is approve the North Town and Deer Meadow timber sales. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

7. **Omnibus Temporary and Proposed Rulemaking** – *Presented by Kari Kostka, Strategic Planning Manager*

Recommendation: Approve the Notices of Omnibus Rulemaking and authorize the Department to proceed with omnibus temporary and proposed rulemaking through executive administrative action to ensure administrative rules remain in effect after July 1, 2019.

Discussion: Attorney General Wasden thanked the Department for the excellent work staff has done and recognized that Ms. Kostka, as the rules officer, put in a lot of time and effort. Attorney General Wasden commended and conveyed thanks to Governor Little. The legislature provided a unique opportunity and challenge; Attorney General Wasden expressed appreciation for the leadership shown by Governor Little in helping the Department of Lands and many other agencies through this process. Governor Little acknowledged that it was a golden opportunity and affirmed that a great many dedicated people all over the state have been doing a lot of work on a very constrained time period. Governor Little seconded the Attorney General's compliments to everyone that worked on this project.

Board Action: A motion was made by Attorney General Wasden that the Board approve the Department recommendation, that is approve the Notices of Omnibus Rulemaking and authorize the Department to proceed with omnibus temporary and proposed rulemaking through executive administrative action to ensure administrative rules remain in effect after July 1, 2019. Controller Woolf seconded the motion. The motion carried on a vote of 5-0.

For the record, Governor Little requested that item 8 on the agenda be moved from the regular agenda to the information agenda and that a decision on the topic be postponed until the next meeting. Controller Woolf so moved. Attorney General Wasden seconded the motion, and indicated that prior to taking a vote, the Board needs to state on record the reason for the change. Governor Little recalled that he was Acting Chairman when the previous phase of this organizational structure was approved. Governor Little remarked this is a big structure change; the Board needs to be comfortable that it will make the Department more effective going forward. There is no need for hurry and the Board can simply have a conversation about it today. Governor Little said the structure change has been reviewed internally by the Department, and perhaps an outside organizational expert should also take a look; it is prudent for the Board to be careful moving forward. Attorney General Wasden noted that because it is prudency the Governor is pursuing, and there is not a time requirement for the Board to make a decision today, it is appropriate for the Board to postpone action on this item and allow more time for consideration. Governor Little added that there were additional changes made to the proposed structure just in the last day or two and he wants the Board to be comfortable with it. Controller Woolf's motion carried on a vote of 5-0.

Information

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

8. Department of Lands Organizational Restructure – *Presented by Dustin Miller, Director*

Discussion: Controller Woolf mentioned the current schematic has the Operations structure remaining as-is, but in previous examples of the organizational chart, it showed a new central operations chief with a few of the areas shifting in reporting structure. Controller Woolf asked why the change. Director Miller said the Department's leadership team, which includes bureau chiefs and area managers, has been deliberating on how to align the operations components better. One of the ideas was to create a central operations region to provide additional coverage and support for area offices within the north central part of the state. The Department has also discussed potential reporting structure changes between areas and bureaus, for example fire wardens and private forestry specialists are stationed at the area offices and currently report to area managers. There has been discussion about the pros and cons, instead, of having the fire wardens report to the fire bureau and the forestry specialists report to the timber bureau. The Department needs to engage in additional discussions with the full leadership team on that particular structure proposal. There is a likelihood that the operations reporting structure would remain the same. The Department believes at the division structure level, having the endowment mission and regulatory and assistance functions split out will create more efficiencies.

Governor Little inquired if the Department anticipates any savings with the new organization. Director Miller said it is too early to tell, but indicated it will help the Department with budgetary lopsidedness that is has now. As an example, in the Forestry and Fire Division, there are 223 FTEs.[1] The division budget is $41.7 million. In the Lands and Waterways Division, there is a total of 46 FTEs and a budget of $9.4 million. The Forestry and Fire Division holds five bureaus, which creates a significant management workload for the division administrator. Moving the timber

[1] FTE = full-time equivalent

program into the new Trust Lands Division, currently the Lands and Waterways Division, addresses some of that unevenness. The proposed structure would better align the budgets based on the mission and programs, and would provide efficiencies in program delivery.

Superintendent Ybarra requested confirmation that although the Department cannot anticipate any cost savings, there will be no additional cost to implement this potential reorganization. Director Miller confirmed that the Department is not seeking additional FTEs or an additional appropriation for this organizational structure. The Department has the necessary resources to make this shift happen under its existing budget and FTE structure.

Governor Little expressed appreciation for the Board members support in moving this item to the information agenda. Governor Little remarked that there seems to be more questions than answers in certain areas of the proposed reorganization and asserted that the Board ought to have a list of those questions and proposed answers. Governor Little observed that he has not been in an organization that changed simply because one part of it was bigger than the other part. An organization puts functions in places where they get done in the most efficacious manner, not to have balance between supervisors. Governor Little asked that the Department work to address the questions prior to putting the organization restructure on a future agenda for action. Governor Little requested that the Department also retain an outside party to look at it from an effectiveness standpoint. Governor Little noted that the final answer could be just exactly as what is proposed; however, he requires more comfort with the questions that are unanswered at this point in time.

9. Land Board Subcommittee: Study of Reinvestment Strategy

Discussion: Governor Little reported that following the last Land Board meeting, Attorney General Wasden and EFIB board member Irv Littman agreed to join the subcommittee to look at the current asset investment. Governor Little stated that given the magnitude of $240 million to reinvest, there is a need for absolute certainty in the plan going forward: that the net-net to beneficiaries is what the Board wants it to be in the long term, and that the Board complies with its obligation to maximize returns to the endowments in the long-term. Governor Little mentioned that Mr. Littman was a former chief financial officer of Boise Cascade who knows about timberland investment and is very capable in the securities and investment field.

Attorney General Wasden commented that he is pleased to serve on this subcommittee and that it will be beneficial to the entire Land Board. Attorney General Wasden shared some ideas to consider in terms of how the subcommittee's discussion is focused: what are the Constitutional provisions and the legal aspects; what is the history–how did the Board arrive at its current strategic reinvestment plan; and what are the options going forward. Governor Little duly noted the Attorney General's suggestions.

Executive Session

None

There being no further business before the Board, at 10:02 a.m. a motion to adjourn was made by Attorney General Wasden. Controller Woolf seconded the motion.

Prior to the vote, Secretary Denney asked for a moment of personal privilege and shared that this is the last Land Board meeting for his Chief Deputy, Tim Hurst, who is retiring. Secretary Denney explained that Mr. Hurst has worked in state and county government for 44 years and recognized Mr. Hurst for the work he has done for the State and counties of Idaho these many years. Governor Little observed that Mr. Hurst has a lot of history, not only in the Secretary of State's office, but with the Land Board and the people of Idaho. Governor Little offered his congratulations to Mr. Hurst, and remarked that the electorate of Idaho, and the beneficiaries of the Land Board, all owe Mr. Hurst a debt of gratitude for his years of service.

Attorney General Wasden's motion carried on a vote of 5-0. Meeting adjourned.

Idaho State Board of Land Commissioners

/s/ Brad Little
Brad Little
President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/ Lawerence E. Denney
Lawerence E. Denney
Secretary of State

/s/ Dustin T. Miller
Dustin T. Miller
Director

The above-listed final minutes were approved by the State Board of Land Commissioners at the June 18, 2019 regular Land Board meeting.

Final Minutes
Reinvestment Subcommittee
July 19, 2019

The Land Board Reinvestment Subcommittee meeting was held on Friday, July 19, 2019, in the State Capitol, Hearing Room WW54, Lower Level, West Wing, 700 W. Jefferson St., Boise, Idaho. The meeting began at 9:00 a.m. Governor Brad Little presided. The following members were in attendance:

Attorney General Lawrence Wasden
Mr. Irving Littman

For the record, all subcommittee members were present.

Governor Little thanked Attorney General Wasden for serving on this subcommittee, and thanked all the members of the Land Board for the opportunity to have the Reinvestment Subcommittee revisit reinvestment, and asset allocation methodology. Governor Little's goal is to have a higher comfort level in the strategy the Land Board is using to reinvest the enormous sum of money that will be available in the coming years, and what the Land Board is doing with that sacred trust. Governor Little introduced Mr. Irving Littman, the third member of this subcommittee. Mr. Littman also serves on the Endowment Fund Investment Board, and was treasurer for Boise Cascade. Governor Little noted that he and Mr. Littman served on the Community Foundation Investment Committee for a number of years, and Governor Little expressed confidence in Mr. Littman's advice and counsel on timber issues and financial investment issues.

Attorney General Wasden commented on behalf of the Land Board members that this is a welcome opportunity for the subcommittee to review, have discussions, and make recommendations to the full Land Board. Attorney General Wasden said that taking time to look at the history of reinvestment is a valuable endeavor.

Mr. Littman stated that he looks forward to learning more about the issues.

Governor Little mentioned that many things have changed since the asset allocation study done by Callan in 2014: standards for investment have changed; opportunities for investment have changed; the Endowment Fund did not have a real estate portfolio at that time; 2 1/4% was the acknowledged standard for inflation then. Governor Little remarked that the Endowment Fund Investment Board—Mr. Littman, Chairman Dean Buffington, and the other members—have done an incredible job, as has the Department of Lands. Governor Little noted that the Department has constraints, some are adverse, and some are beneficial. It would be helpful to have a deeper understanding of both.

Governor Little commented that Callan's 2018 report stated that investing in land is preferable because it generally provides equal and better protection. Governor Little said he found that

interesting given the fact that timber management organizations (TMOs) view Idaho forestland as an asset to divest rather than invest, and he wondered about Callan's recommendation that the Land Board reinvest in timberland. Governor Little mentioned he would like to know how real estate is valued—is it the income approach; is it fair market value; is it fair market value as determined by comparable sales. Governor Little also stated his interest in learning what standard was given to Department staff and the consultants on how to value the assets, and what instructions were given to the appraisers. Governor Little referred to Callan's 2014 report which stated that 'U.S. real estate could at best play only a modest role in improving the diversification of the portfolio, and there is no investment reason for an allocation primarily consisting or concentrated on a portion in Idaho properties.' Governor Little concurred with that statement, but recalled that at that time the focus was commercial property, and now the focus is on timberland properties. Governor Little questioned that if the lack of diversification for commercial properties was a problem, why is doubling-down in investment in timber properties the right thing. Governor Little commented that another area with uncertainty is cottage sites. Cottage site sales to date have been those lots that people wanted to buy and wanted to sell, more-or-less the low-hanging fruit; some of the cottage sites left are going to be a little bit harder to sell. Thought needs to be given to what happens with administrative costs when only a few cottage sites remain.

Attorney General Wasden remarked that it is essential to identify questions, as the Governor is doing. In answering those questions, it will be important to do several things. The subcommittee needs to look at Land Board and Department reinvestment history, look at the legal structure that brought the Land Board and Department to where they are now, and have Callan explain the very things that the Governor has mentioned, and why Callan made the recommendations they did. Attorney General Wasden said those steps will provide many answers, and Mr. Littman can provide much of the financial analytical structure; he has more expertise to offer in that arena. Attorney General Wasden noted that Department staff needs to have direction, sooner rather than later; the subcommittee cannot drag this out a long period of time. If the subcommittee can move this along, everyone is better served, because the Land Board has a limited amount of time to use funds in the Land Bank. If the Land Board is going to make purchases, or if the Land Board is not going to make purchases, the Department needs to know that.

Governor Little mentioned that timing is important in investment strategy, not only picking the right asset type, but buying at the right time. Governor Little commented that the problem the Land Board had competing in the commercial realm is almost exacerbated in the ag land area. Callan pointed out that the expertise the Department has in ag land is much different than their expertise in timberland; investing in ag land is a timing issue as with most asset types. Governor Little said he would like to know where the Department is on purchasing ag land going forward, and he is dubious about the Department's ability to be competitive in ag land, similar to commercial property.

Mr. Littman remarked that one of the key issues he would like to understand is the Constitutional and statutory structure that the Department and Land Board need to operate in: what restraints come from that and what opportunities. Mr. Littman also wants to understand the management objectives. Mr. Littman observed that the financial Endowment has been very well managed and generated an important return. Timberland provides a good diversification and long-term stability.

Governor Little noted the issue is does the Land Board continue with ag land and timberland; that is the current strategy, and whether overtly or covertly, the decision has been mainly to buy timberland. The next decision is does the Land Board put all of the Land Bank funds into timberland; Governor Little said that seems to be the intent. Or, does the Land Board split the funds and allow some to ladder into the different asset types the Endowment Fund manages, and put some of the funds in timber.

Mr. Littman indicated that he would also like a review with Callan; there are some issues of the source and consistency of data in a financial context for non-financial assets, and how they are integrated into the analysis and asset allocation process as they are for financial assets. The subcommittee needs to hear from Callan and know if there are specific resources that the Board's consultant or the subcommittee ought to seek on that subject for further understanding. A well thought-out strategic opportunity can increase the asset return, over a long period of time of a non-financial asset, or dilute it. Understanding what the potential is there has a lot to do with the market.

Governor Little mentioned that isolated timber parcels are an issue. Per Idaho Code, the Board cannot sell timberland. But what is a block of timberland worth where there are no mills around. Governor Little wondered how endowment timberland matches up with the head rig capacity of Idaho mills, because having timberland is only beneficial if there is someplace to sell it. Governor Little expressed pleasure with the Department's work on the Good Neighbor Authority; the Good Neighbor Authority is increasing the supply, which is competing with the fair market value of endowment timber. At the same time, however, as the Land Board takes state resources and does what needs to be done to get more revenue off of federal lands, how does that impact the bottom line net of endowment timberlands. The Land Board needs to be aware of that.

Attorney General Wasden said the scope of what the subcommittee is trying to accomplish is to make recommendations to the full Land Board about reinvestment. Subcategories under that scope are the specific questions that have been voiced here today. Attorney General Wasden outlined three steps. First will be to talk about the history and the legal structure; the office of the Attorney General will be prepared to do that. Second is to have Callan come and provide a thorough review of their reports, with opportunities for the subcommittee to ask them questions. There are a few questions that can only be addressed by our experts; it will be helpful to have Callan explain their recommendations to us. The third step is that the subcommittee will need some time to talk about all the information it is assimilating, and identify where the Board should go in the future. Attorney General Wasden suggested that one additional step in the process is to have an opportunity for the public to provide comment to the subcommittee.

Governor Little proposed that the subcommittee try to meet again with the next three weeks for its second meeting, and anticipated one more meeting after that, to be timed to make a recommendation to the Land Board.

Attorney General Wasden indicated his staff will be prepared to make the historical and legal background review at the next subcommittee meeting.

There being no further business, at 9:28 am a motion was made by Attorney General Wasden that the subcommittee adjourn. Mr. Littman seconded the motion. The motion carried on a vote of 3-0.

Idaho State Board of Land Commissioners
Strategic Reinvestment Subcommittee

/s/ Brad Little

Brad Little
Chairman, Strategic Reinvestment Subcommittee and
President, State Board of Land Commissioners and
Governor of the State of Idaho

The above-listed final minutes were approved by the Land Board's Reinvestment Subcommittee at its November 13, 2019 meeting.

Callan

October 10, 2019

Idaho State Board of Land Commissioners

Strategic Reinvestment Subcommittee Meeting

Janet Becker-Wold, CFA
Denver Consulting

Callan's Role

- Endowment Fund Investment Board – Janet Becker-Wold
  - Professional review and analysis on investment policy and procedures
  - Review and analysis on proposed investment initiatives for consistency with EFIB policies
  - Periodic performance reporting
  - Manager review and selection
  - Educate the EFIB and staff on current investment trends, issues and regulatory changes

- Land Board – Sally Haskins
  - Review and analysis of investment policies, strategies and annual plans
  - Review and analysis of proposed investment initiatives for consistency with Land Board Investment Policies and Strategies
  - Evaluation of performance of endowment assets and the combined trust of land and fund assets
  - Support the Land Board in hiring and monitoring project consultants
  - Assist the EFIB and Land Board (named fiduciaries) in obtaining the level of expertise they need to prudently fulfill their responsibilities as fiduciaries

History of Work for the Land Board

- Asset Allocation and Governance Review – November 2014
  - Perform an asset allocation analysis of the Total Land Grant Endowment
  - Review IDL valuation and revenue forecasting process
  - Review governance structure and provide recommendations
  - Review and develop investment policies and procedures

- Refinement of 2014 Asset Allocation – April 2018
  - Confirm for Public Schools, Agriculture College, Charitable Institutions, Normal School Penitentiary, School of Science, State Hospital South and University the criteria to be used to evaluate the best and highest use of monetary assets in the Land Bank
  - Confirmed for combined smaller endowments (all except Public Schools) the criteria to evaluate the best and highest use of Lank Bank assets
  - Assess the impact of cabin or cottage site sales for Public Schools, Normal Schools and State Hospital South
  - Determine whether the asset allocation, reserves or distribution policies of the eight individual endowments should be changed
  - Update the Endowment Asset Allocation in light of 2017 Capital Market Expectations

Endowment Distribution Policy Objectives

Excerpt from Statement of Investment Policy – Land Grant Endowment, July 2018

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

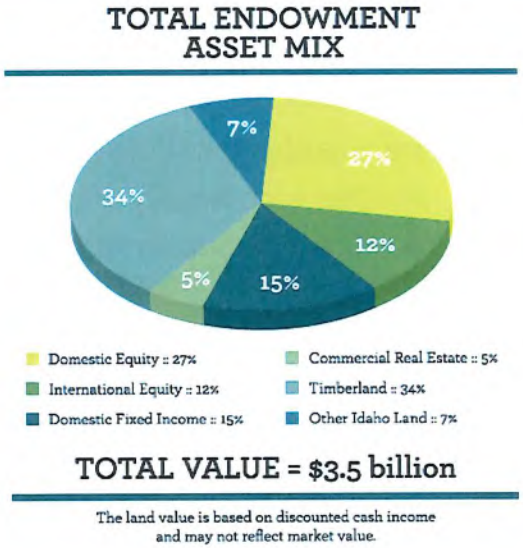
- Avoid reductions in total endowment distributions
- Maintain adequate Earnings Reserves to protect distributions from income shortfalls
- Grow distributions at least commensurate with inflation and student population growth

Subcommittee Questions – Asset Allocation

Asset Class	June 30, 2017 (Millions)	June 30, 2017 (%)	Target Asset Allocation*	Range
Financial Assets	$2,108	59%	58%	50-65%
Timberland	$1,190	34%	39%	30-50%
Other Idaho Lands	$245	7%	2%	0-5%

*Excludes 1% Land Bank cash allocation

Note that the revised Investment Policy Statement, dated July 17, 2018, shows a 2% target to Grazing Land and 1% to cash. Although IDL did not identify what was included in Other Idaho Lands (7%), we assume that Land Bank assets of $113 million (or 3.2%) is included.



- How were land values developed on this page? What valuation method was used?
  - The valuations shown were taken directly from the Idaho Land Grant Endowments – A Report to Citizens 2017
  - Pie chart (shown above) was utilized to calculate component market values
  - Values shown were derived by multiplying percent per asset class times the total value of $3.5 billion
  - Footnote in the Report to Citizens states that the land value is based on discounted cash income and may not reflect market value

Subcommittee Questions – Asset Allocation (continued)

- How was the asset allocation developed?
  - The asset allocation was determined by the original 2014 asset allocation study
  - The asset allocation reflects the estimated value of various land components for asset allocation purposes only
    - *A value is necessary to calculate a return*
    - *A value is necessary to determine the sizes of the land investments relative to the financial investments [these 2 sub-bullets contrast with the bullets below which say what the LEV is not]*
  - Risk, return and correlation assumptions were developed for each component
    - *The return assumption for timber land was 5.7% (risk =12%), grazing land was 3.3% (risk=6.8%)*
  - Unconstrained mixes suggested an additional investment in timberland could be considered if it can earn at least 5.7% (return assumption)
  - Land Board adopted the 2014 actual mix as the target: 58% financial assets; 39% timberland; 3% other (grazing land and cash equivalents)

  - Estimates of land valuations were determined using a land expectation value methodology (LEV)
    - *It is not an appraisal of the fair market value*
    - *It does not attempt to value individual tracks of land based on their specific characteristics*
    - *It is not intended to facilitate a transaction*
    - *LEV=Constant Real Annual Cash Flow / Real Annual Discount Rate*
  - For timberland
    - *The forecast cash flow is based on the volume of timber harvested, the price paid and non-timber income.*
    - *The discount rate is set consistent with the expected return on institutionally-managed timber*
  - For grazing land
    - *Cash flows were based on anticipated values for Animal Unit Months (AUMs) and the AUM grazing rate*

Subcommittee Questions – Asset Allocation (continued)

- How is the asset allocation designed to be used?
  - The asset allocation reflects the preferred financial assets allocation given the characteristics and amount of existing illiquid land assets (based on 2014 assumptions)
  - Used as a guide to the allocation of incremental assets
    - *Callan does not recommend setting a hard target for the amount of dollars invested, rather allowing opportunities to drive the decision (page 7, Strategic Reinvestment Plan, 2016)*
  - Sets objectives for return and risk
    - *Risk, return and correlation assumptions were developed for each component*
  - Ranges were established around each segment to recognize the difficulty managing to the established asset allocation
    - *The appropriate relative allocations of different financial assets depends in part on the allocation to illiquid land assets*

Subcommittee Questions – Asset Allocation (continued)

- Is the asset allocation what Callan recommends?
  - Callan is comfortable with the current target asset allocation given the future prudent deployment of Land Bank funds to get cash allocation down to 1% or so.
  - Lands and financial assets fall within the prescribed bands, while cash (Land Bank) is clearly over its 1% target
  - We recognize that as the financial assets have outperformed lands, they have grown in percent relative to the lands portfolio
- The 2018 study focused a decision making framework for deploying Land Bank Funds
  - The distribution policy objectives provided the guideposts for the 2018 study (see page 3)
  - The 2018 study re-visited the asset allocation and concluded that preference for financial assets versus land assets differs based on the assumed return from lands, the earnings reserve levels and primary objectives (e.g., growing real distributions; protection against a decline in distributions)
  - Focusing on cumulative real distributions, investment in the financial assets results in greater distributions in the expected and better-case outcomes while land reinvestment protects in poor capital market environments
  - Land reinvestment generally provides equal or better protection relative to the financial assets in terms of preventing a decline in distributions
  - Using a 3.5% net real hurdle rate, the study also concluded that deployment of Land Bank funds to the financial asset was preferable if the Land Board approved higher earnings reserves for Public Schools (500% to 600%) and Charitable Institutions (500% to 700%)
  - Study recognized the important role Lands play in dampening the volatility of the total Endowment
    - *Expected returns must be considered in addition to the risk mitigating role (meeting established hurdle rates)*

Subcommittee Questions – Reserves

Summary Conclusions from 2018 Study

- Relative to the 2014 study
  - The expected return on the financial assets is 50 basis points lower (6.3% versus 6.8%)
  - Projected net land revenues have generally declined for most endowments
  - Projected land revenue volatility is higher for seven of the eight endowments
- Reserve levels
  - Reserve levels need to rise for two of the eight endowments in order to obtain the same level of comfort that distributions will not decline (10 year projection) at the 95th percentile
    - *Public Schools needs to increase from 500% to 600% and Charitable Institutions from 500% to 700%*
    - *Temporary increases to 700% for State Hospital South and Normal Schools should be made permanent*
    - *The EFIB voted at a special board meeting on March 12, 2018 to recommend the above changes in earnings reserve levels to the Land Board*
- The stability of the distributions is determined by several interconnected factors
  - The size of the reserves
  - The expected return and volatility of the financial assets
  - The financial assets allocations
  - The expected return and volatility of the land assets
  - The land assets allocations

Subcommittee Questions

Relationship Between Timber and Financial Assets

- Timberland performance is linked to the underlying derived demand for wood products in the U.S.
  - In the U.S., positive timberland performance (and rising prices) requires the demand for lumber (lumber consumption), which is made up from not just housing starts (~33%) , but also residential improvement (~38%), industrial uses (~24%) and nonresidential (~5%)
- While there is a low correlation between timber and financial assets (0.11 to the S&P 500 and 0.06 to the Bloomberg Aggregate*) there is a broad economic relationship
  - No correlation to financial markets implies a neutral relationship, a negative correlation would indicate counter cyclicality
  - If the U.S. economy slows, unemployment may rise, salaries fall, demand for housing may fall, new construction declines, resulting in lower demand for timber

* 15 years ended June 30, 2019

Subcommittee Questions

- How was the hurdle rate developed and set?
  - The hurdle rate is the rate of return required for new investments. It is different from the Long Term Policy Target which is a portfolio return target set in the Investment Policy Statement. (see footnote 4 on page 3 of the May 2016 Reinvestment Plan).
  - Callan views reinvestment as a capital allocation question – not as a mechanism to fill certain buckets or asset allocation targets
    - *What is the best use of the marginal dollar for the total portfolio (the marginal dollar is the land bank proceeds)?*
    - *The hurdle rates are established based on the underlying premise that the acquisition needs to be accretive*
  - The hurdle rate is just a starting point – the risk profile of each transaction and market dynamics will dictate the return that will be required such that some transaction may have returns above the hurdle rate (page 7, May 2016 Reinvestment Plan)

The Callan report suggested a framework for making investment decisions for timberland and farmland (Items 1-5 below). These and other relevant decision-making factors (6-8 below) are applicable to establishing priorities for investment of the Land Bank.*

1. *Is the investment consistent with the overall asset allocation and objectives of the total portfolio as set forth in the Investment Policy Statement and in the Strategic and Annual Plans?*
2. *Comparison of the risk adjusted return and the net return relative to other choices (e.g. stocks, bonds, other land types). In other words, what are the other choices for investment?*
3. *Does it make a difference and move the needle from an overall portfolio perspective?*
4. *Completion of a full underwriting of the potential investment including upside, base case, and downside scenarios with identification of assumptions and risks alongside of the returns (both the return gross of fees and net of all fees and costs);*
5. *Detailed outline of the business plan for the investment and the plan for execution including consideration of the internal and external resources required to execute the plan and associated costs;*
6. *Market fundamentals;*
7. *Availability of transactions; and*
8. *Institutional investment trends, processes, and implementation for timberland and farmland.*

*Strategic Re-Investment Plan, May 2016, page 2

Subcommittee Questions

Hurdle Rates

- What impact did the state's prohibition on selling timberland have on setting the rate?
  - It was not considered
- Were timberland fire costs to the general fund considered?
  - They were not considered
- Under what circumstances should the hurdle rate be reconsidered?
  - Annually as noted in the footnote 4, page 3, May 2016 Reinvestment Plan
  - Changes to long term projected returns for land assets and financial assets
  - Changes to market conditions could influence it – e.g., trigger a move upward

Endowment Fund Investment Board

Summary of Historical Financial Results

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Additions to Earnings Reserves										
Lands Receipts	44,432,471	64,641,777	62,615,429	74,419,147	87,868,817	83,092,538	78,181,606	70,667,488	73,490,591	69,352,297
Less: Lands Expenses	(22,982,584)	(23,740,021)	(22,673,106)	(26,001,715)	(23,721,424)	(27,692,642)	(25,328,075)	(29,237,693)	(27,654,885)	(29,399,699)
Net Lands Revenue	21,449,887	40,901,756	39,942,323	48,417,432	64,147,393	55,399,896	52,853,531	41,429,795	45,835,706	39,952,598
Additions to Permanent Fund *	3,591,476	4,656,220	2,935,528	2,899,700	2,366,453	49,136,323	2,079,637	1,945,956	2,645,986	2,701,162
Investment Gains (Lossses)	145,863,194	254,510,718	21,630,019	182,551,328	273,751,323	53,167,558	(2,837,635)	233,805,878	200,007,135	167,392,206
Less: EFIB Expenses	(4,523,590)	(5,328,938)	(5,407,160)	(6,165,409)	(7,274,894)	(7,654,577)	(7,585,753)	(7,832,316)	(9,125,954)	(9,083,032)
Net Investment Gains (Losses)	141,339,604	249,181,780	16,222,859	176,385,919	266,476,429	45,512,981	(10,423,388)	225,973,562	190,881,181	158,309,174
Distributions to Beneficiaries **	(45,955,200)	(67,786,600)	(46,425,000)	(47,508,600)	(48,894,800)	(52,078,200)	(56,873,200)	(63,658,400)	(73,879,200)	(78,456,400)
Change in Endowment Balance	120,425,767	226,953,156	12,675,710	180,194,451	284,095,475	97,971,000	(12,363,420)	205,690,913	165,483,673	122,506,534
Endowment Fund Balance - BEG	920,423,853									
Endowment Fund Balance - END	1,040,849,620	1,267,802,776	1,280,478,486	1,460,672,937	1,744,768,412	1,842,739,412	1,830,375,992	2,036,066,905	2,201,550,578	2,324,057,112
Net Lands Rev/Beneficiary Distr.	47%	89%	86%	102%	131%	106%	93%	65%	62%	51%

Notes:

* In Fiscal 2015, revenue generated by the sale of commercial real estate was deposited in the Permanent Fund.

** In Fiscal 2011, there was a special one time distribution of $22,000,000 for Public Schools.

IDAHO ENDOWMENT FUND
INVESTMENT BOARD

Asset Allocation Guidelines

Asset Class	Range	Target	Rebalance Point	Benchmark
Equities	63.0%-69.0%	66.0%	+/-3%	MSCI All Country World Index
Domestic Equities	33.0%-43.0%	38.0%	+/-5%	Russell 3000 Index
Large Cap	21.2%-31.2%	26.2%	+/-5%	Russell 1000 Index
Growth	3.0%-7.0%	5.0%	+/-2%	Russell 1000 Growth Index
Core	9.3%-13.3%	11.3%	+/-2%	S&P 500 Index
Value	8.9%-10.9%	9.9%	+/-1%	Russell 1000 Value Index
Mid Cap	3.6%-11.6%	7.6%	+/-4%	Russell Mid Cap Index
Growth	1.8%-5.8%	3.8%	+/-2%	Russell Mid Cap Growth
Value	1.8%-5.8%	3.8%	+/-2%	Russell Mid Cap Value
Small Cap	2.2%-6.2%	4.2%	+/-2%	Russell 2000 Index
Growth	1.1%-3.1%	2.1%	+/-1%	Russell 2000 Growth Index
Value	1.1%-3.1%	2.1%	+/-1%	Russell 2000 Value Index
International Equities	15.0%-23.0%	19.0%	+/-4%	MSCI ACWI EX US (ND) Index
Developed Growth	7.0%-10.0%	8.5%	+/-1.5%	MSCI EAFE Growth (ND) Index
Developed Value	7.0%-10.0%	8.5%	+/-1.5%	MSCI EAFE Value (ND) Index
Developed Markets Index Fund	1.0%-3.0%	2.0%	+/-1%	MSCI EAFE Index
Global Equity	5.0%-13.0%	9.0%	+/-4%	MSCI All Country World Index
Real Estate	4.0%-12.0%	8.0%	+/-4%	NCREIF ODCE Index
Fixed Income	23.0%-29.0%	26.0%	+/-3%	BB Aggregate Bond Index
Core Plus Bond Active	10.0%-12.0%	11.0%	+/-1%	BB Aggregate Bond Index
Aggregate Bond Index	10.0%-12.0%	11.0%	+/-1%	BB Aggregate Bond Index
US Tips Index	3.0%-5.0%	4.0%	+/-1%	BB US TIPS Index
Cash and Equivalents	0.0-5.0%	0.0%		3-month Treasury Bill Index

Responses to Governor Little's Questions Regarding Reinvestment of Land Bank Funds

(Questions are from notes and meeting minutes from the 7/19/19 reinvestment subcommittee meeting)

1. **It's interesting that TIMOs are divesting from Idaho rather investing.**

TIMOs and REITs operate very differently from endowment timberland ownership and management. Basically, their strategy is to liquidate the timber asset and then sell the real estate. Much of the land available for sale retains very little merchantable timber, thereby making the land less valuable for acquisition for TIMOs and REITs. Conversely, the endowments can utilize the acreage with sub-merchantable trees to fill inventory gaps, making this timberland excellent for acquisition by the endowments who already hold billions of board feet of large trees.

The Strategic Reinvestment Plan developed by Callan in 2016 addressed availability of potential transactions due to changes in the timberland sector as follows:

> Market dynamics in the timberland industry include increasing transaction flow. There have been several large institutional portfolios of timberland brought to the market in the U.S. Several closed-end commingled funds are nearing their expirations, which will result in timberland for sale. Additionally, multiple timberland investment organizations are undergoing changes which could result in additional deal flow from manager disruption and terminated vehicles. The environment with substantial availability of properties for sale and projected to be for sale may help to moderate pricing. The availability of transactions is in marked contrast to prior years and the Land Board should take advantage of the increased transaction flow.
>
> In the early 2000's there was a high level of commitment activity to U.S. focused timberland funds. Many of these funds have reached the end of their legal life and still have remaining timberland assets to be sold. Given the challenges in the recent market cycle and the long term nature of the timberland asset class and timber lifecycle, the ten year life has proved an insufficient time frame to roundtrip a strategy and exit all assets. As a result there are many groups of fund investors determining extension provisions for their funds and a certain level of dissatisfaction or frustration with the lack of disposition activity to date.
>
> Based on information from a recent timberland request for information, Callan estimates that there is $9.5 billion in timberland commingled fund holdings that are currently within two years or beyond the legal fund term life. The expiring funds may result in a fair amount of investment opportunities coming to market.

2. Why is concentration in Idaho timberland a good thing?

The Strategic Reinvestment Plan described the advantages that the Land Board has related to timberland investment and the rationale supporting additional investment in timberland:

> Callan believes that the Land Board has a competitive advantage in timberland investing compared to other institutional investors and owners of timberland given its experienced Staff, existing portfolio, long term investment horizon, and cost of capital. (IDL note: The endowments also have an inventory advantage that makes acquisition of acreage primarily consisting of sub-merchantable trees desirable.)
>
> Investment in additional timberland is a way to replace lost income from the sales of cabin sites and commercial real estate.
>
> Additional investment is supported by the asset allocation study which indicates portfolio risk/return will be maintained with additional investment in timberland provided new investments have a net projected return at or above the returns of the existing portfolio with a similar level of risk. In Callan's study, the existing timberland portfolio had an expected net 10 year compounded return of 5.70% (3.45% net real return). The recommended Hurdle Rate for Timberland is a minimum net real return of 3.5% which equates to a 5.75% net nominal return, assuming 2.25% inflation. The risk profile of each transaction and market dynamics will dictate the return that will be required, such that some transactions may have returns above the Hurdle Rate.
>
> Callan does not recommend setting a hard target for the amount of dollars to be invested, but rather allowing the investment decision to be driven by the opportunities. The range for timberland is 30-50% of the total Endowment portfolio. If attractive opportunities are found, all of the projected proceeds in the Land could be invested in timberland and timberland would remain in the target 30-50% range, assuming the total portfolio remains at or above the current value.
>
> This is an unusual time for the Endowment due to the amount of disposition activity taking place. Based on the current Asset Management Plan, it does not appear that after FY 2020, there will again be the level of proceeds to invest in Land. Therefore, the Land Board should consider using Land Bank proceeds to invest in Timberland and Farmland, provided the targeted Hurdle Rates can be met or exceeded and an institutional investment process is used.

The following excerpts are from a Callan research publication entitled "*The Triple Play – Adding Timberland, Farmland, and Infrastructure to Portfolios*":

> Adding timberland, farmland, and infrastructure is beneficial for the portfolio mix of many investors. Real assets such as these provide diversification, stable income, and inflation protection, and they pair well with an established real estate portfolio.

Timber, farmland, and infrastructure assets differ in many regards, of course. But as investments they share some common features:

Low correlations to traditional asset classes contribute to diversification potential

- Stable and predictable income factors prominently into returns
- Inflation hedge
- Expanding global investment opportunity set
- Strong long-term demand drivers in both developed and emerging markets

These assets generally show low correlations to traditional asset classes (i.e., equities and fixed income), as well as to public and private real estate (**Exhibit 1**). This makes them powerful diversifiers for the total portfolio and within a real assets-only portfolio.

Exhibit 1

The Big Picture on Correlation

(periods ended 3/31/17)

5-Year Correlations / 10-Year Correlations

	U.S. Private Real Estate	Private Farmland	Private Timberland	U.S. REITs	Commod.	Listed Infra.	U.S. Stocks	U.S. Fixed Income	Inflation
U.S. Private Real Estate	1.00	0.04	0.20	0.23	0.21	0.20	0.24	-0.19	0.27
Private Farmland	0.16	1.00	0.58	-0.13	-0.13	-0.04	0.05	-0.10	-0.46
Private Timberland	0.20	0.91	1.00	-0.24	-0.16	-0.21	-0.20	0.12	-0.22
U.S. Public Real Estate (REITs)	0.17	0.23	0.28	1.00	0.39	0.70	0.76	0.02	0.25
Commodities	-0.39	-0.25	-0.29	-0.10	1.00	0.65	0.55	-0.11	0.63
Listed Infrastructure	-0.34	0.05	0.04	0.37	0.54	1.00	0.84	0.08	0.36
U.S. Stocks	-0.28	0.32	0.27	0.14	0.29	0.53	1.00	-0.30	0.30
U.S. Fixed Income	0.07	-0.14	-0.05	0.60	0.14	0.54	-0.19	1.00	-0.23
Inflation	-0.19	-0.60	-0.66	-0.07	0.70	0.46	0.13	0.15	1.00

Indices Used: U.S. Private Real Estate (NCREIF Property Index); Private Farmland (NCREIF Farmland Index); Private Timberland (NCREIF Timberland Index); U.S. Public Real Estate REITs (FTSE NAREIT Equity REITs Index); Commodities (Bloomberg Commodities Index-Total Return); Listed Infrastructure (Dow Jones Brookfield Global Infrastructure Index); U.S. Stocks (Russell 3000 Index); U.S. Fixed Income (Bloomberg Barclays US Aggregate Bond Index); Inflation (CPI-U).

Sources: Bloomberg, Bloomberg Barclays, Bureau of Labor Statistics, FTSE Russell, NCREIF, Russell, S&P Dow Jones.

IDL operates an efficient timber program on behalf of the endowments. Over the last five fiscal years, the average net income from timberland was $43.98 million on gross revenue of $65.98 million, resulting in an average net income ratio of 66.7%. The Department has established a goal of improving the overall net income ratio for all land assets to at least 67% (five year rolling average) by 2025. The current five year average net income ratio for all land assets is 63.5%.

With the disposal of commercial real estate and cottage sites, which were significant revenue sources, the timberland asset class is under increasing pressure to improve performance in order for the Department to meet the net income ratio goal. In effect, timberland must over-perform to offset poorer performance from other asset classes.

Because the productivity of endowment timberlands will allow it, the Department is recommending a 32.8% increase in annual timber sale volume from the existing land base. The recommendation is made in the long term best interest of the endowments and the endowment timberlands. Assuming stable prices and markets, based on five year average gross income, the endowments could expect an increase of about $21.6 million in gross income from the timberland asset. The increased revenue will not have a proportional spending increase. Once

the annual sale volume is fully implemented, timberland is expected to exceed the net income ratio goal, demonstrating increasing efficiency.

The timber program is scalable and can efficiently manage additional acreage. With additional reinvestment, the Department would not expect an increase in administrative staff, although addition of a small number of field staff could be needed. The Department believes that additional acreage would further improve the financial efficiency of the endowment timber program.

Endowment timberlands provide long-term benefits for public recreation, increased local school distributions, stability of ownership, and support for local jobs. In contrast, potential acquisitions by non-timber producing landowners may produce different outcomes in terms of development, land use restrictions, recreational access, stability, and economic outputs.

Endowment ownership provides economic stability and provides benefit to the public through typically open access for public recreation. Timberland acquisition is consistent with the constitutional mandate to maximize long-term revenue for the endowment beneficiaries.

3. How does our timberland ownership (and acquisitions) line up with mill infrastructure?

The evaluation of potential timberland acquisition includes a review of the proximity to timber markets and mill infrastructure. The interest in acquisition is limited to areas where markets are expected to remain strong (as a very general description - north of the Salmon River). Exceptions may be considered if the acquisition would help resolve another issue, such as access to a significant block of endowment land which may make an acquisition outside of the preferred area economically viable.

The Department has established basic evaluation criteria for potential land acquisitions. The criteria are a means of screening transactions so that staff time and resources can be utilized on the most promising potential acquisitions. The criteria include:

- Strong market areas and proximity to mill(s)
- No known political or regulatory issues
- Expected to exceed the required financial hurdle rate
- No/minimal T&E species concerns
- Manageable forest health, no known regeneration issues
- Operability – prefer all season, limited to one season is a concern
- No known environmental or boundary issues
- Minimal Highest and Best Use (HBU) values (not in the path of immediate development)
- Desirable aspect/elevation range
- Lawful permanent access
- Proximity to good transportation system
- Sufficient size
- Proximity to endowment land

Potential acquisitions that pass the initial screening are analyzed rigorously, including financial analysis, to determine suitability for purchase by the endowments.

The endowments own some of the most productive timberlands in the inland northwest. Factors including quality of soils, precipitation and variety of tree species contribute to the high quality, productivity, and resilience of endowment timberlands. Endowment lands produce about 25% of the volume harvested in Idaho despite being only 2.6% of the timberland. The current endowment timberland portfolio is mostly positioned well relative to markets/mill infrastructure. Most of the major mill infrastructure is located within a two hour haul distance of endowment timberlands in north and central Idaho. Timber sale auctions often include competitive bidding. Under the 2019 Forest Asset Management Plan, over 60% of the annual sale volume comes from the Department's North Operations region in central and north Idaho. However, timber sales in Southern Operations continue to sell and are rarely in a no-bid situation.

4. **Where are we on ag land moving forward?**

   The Department has evaluated several potential farmland acquisitions. To date, the Department has not been able to pursue farmland acquisition because transaction level analysis did not show that the acquisition would exceed the required 4.5% net real return on investment without including the disposition value in 10-20 years.

5. **Acquisition of isolated parcels might not make sense.**

   The Department's acquisition criteria prioritize parcels that are adjacent to existing endowment lands. Alternatively, stand-alone parcels of sufficient size with legal access may be suitable for acquisition. Also, an isolated parcel that would secure access to endowment lands may be appropriate for acquisition if the financial analysis provides justification.

6. **Timing for asset investment is key.**

   This is true for any investment whether in real assets or financial assets. Timing any market effectively is difficult. The five year Land Bank period provides some flexibility to allow for opportunistic acquisitions although there may be opportunity cost associated with delay as well.

   The Department analyzes any potential acquisition based on the economic factors at that time, including current timber prices. The Department, on behalf of the endowments, will not always be the high bidder for a potential acquisition. If the potential acquisition does not meet the established hurdle rates, or if the price is too high, the Department will not proceed with the acquisition. This occurred with a potential large acquisition in North Idaho where the Department could not compete with other bidders.

7. **Good neighbor is a good thing but also a concern in terms of additional fiber on the market and potential impact on endowment timber prices.**

Idaho is currently a net importer of timber to supply the existing mill infrastructure. There is room in the market for additional federal timber without impacting the market for endowment timber. There are likely to be short-term market related issues that will decrease endowment stumpage prices at times. Short-term market issues may not be indicative of competition from federal sales. Increased Federal management will also help maintain intermixed cooperatively managed transportation infrastructure which will ultimately decrease expenses for the endowments.

The vast majority of endowment lands share a boundary or are in close proximity to federal lands. Increased active management on federal lands will have long term forest health benefits for endowment lands. It could also help sustain the forest products industry in Idaho, which has clear long term benefits to the endowments. If the federal supply became sufficient and reliable, perhaps investment in mill infrastructure could occur in some locations.

8. **Should we put it all into timberland or split and put some into the financial side?**

During their presentation (September 2019) as a candidate for investment consultant for the Endowment Fund Investment Board (also for the Land Board/Department of Lands and the State Insurance Fund), the firm RVK provided analysis of the EFIB financial portfolio based on their capital markets assumptions using Monte Carlo simulation. The analysis showed, over a ten year period, a 54% chance of achieving at least 3.0% real return, a 43% of achieving at least 4.0% real return, and a 34% chance of achieving at least 5.0% real return from the financial portfolio.

Timberland acquisition using a hurdle rate (minimum net real return) of 3.5% would provide returns comparable to the expected performance of the financial assets over time.

The excerpts below are from the July, 2018, Land Board approval of its Investment Subcommittee's recommendation regarding reinvestment of land bank funds:

> In August 2017, as directed by the Idaho State Board of Land Commissioners (Land Board), the Secretary of the Land Board entered into a contract amendment with Callan Associates (Callan) to conduct an Asset Allocation and Distribution Study (Study). The Study was intended to provide further analysis and refinement on previous asset allocation work completed by Callan in 2014. One primary goal of the Study was to determine for each endowment the best and highest use of assets in the Land Bank—reinvestment into traditional land assets (timberland or farmland) or transfer to the financial asset portfolio.
>
> The Land Board's Investment Subcommittee (Subcommittee) was tasked with reviewing the final Study results related to Land Bank proceeds, including the options outlined for

Land Board consideration, before making a formal recommendation to the Land Board in July. This timeline coincides with the annual update to the Statement of Investment Policy and Strategic Reinvestment Plan.

The "Land Board Options to Consider" outlined on page 33 (Attachment 1) of the Callan Study read:

- Option A – Consistent with the Reinvestment Plan, identify potential transactions that meet established hurdle rates and set aside sufficient funds over appropriate time horizon (immediately move money that will either "mature" prior to the transaction or exceeds what is required).

- Option B – Move land sale proceeds that are set to expire in calendar years 2020-2021 (approximately $58 million) into the Permanent Fund with the remainder contingent on IDL identifying land acquisitions consistent with the Strategic Reinvestment Plan.

- Option C – Immediately transfer all Land Bank funds to the financial asset portfolio.

The Subcommittee thoroughly vetted the Study results, options outlined, and associated plans and voted on June 12, 2018, to accept the Study as completion of the general consultant contract amendment and to recommend the Land Board pursue Option A for the following reasons:

- 2017-2018 Study results are consistent with the 2014 Callan Study and the 2016 Strategic Reinvestment Plan (Attachment 2), which confirms Department activities are properly aligned with established goals and governance;

- Land Bank reinvestment is the only mechanism for recovering land assets and associated revenue (lost as result of cottage site and commercial property sales), which is necessary to reduce risk in the land base, balance risk in the overall endowment portfolio, and help grow revenue with inflation and population growth;

- A pipeline of potential land acquisitions has been developed by the Department with several acquisitions slated for close as early as calendar year 2018;

- Callan's model was based on the minimum hurdle rate of 3.5% return on asset but potential acquisitions under review by the Department are likely to bring higher levels of return and lower levels of volatility, which makes land acquisition more favorable than investment in the financial portfolio;

• The Department and EFIB are already closely monitoring Land Bank funds and intend to proactively initiate Land Bank transfers to the Permanent Fund when necessary; and

• The Department's Acquisition Business Plan, initiated after Land Board approval of the Strategic Reinvestment Plan in 2016, aligns with implementation of Option A as well as Land Board-approved governance documents, including the Statement of Investment Policy, Asset Management Plan, and Strategic Reinvestment Plan.

Also in July, 2018, the Strategic Reinvestment Plan was reviewed by the Land Board. The following are excerpts from the approved memo:

> Callan, the Idaho Department of Lands (Department), and Endowment Fund Investment Board (EFIB) completed the asset allocation/spending study over the past year. Results presented by Callan in April indicated findings are consistent with previous studies and the Strategic Reinvestment Plan approved in 2016. Callan concluded investment of Land Bank proceeds in timberland or farmland is appropriate for all endowments provided acquisitions meet or exceed established hurdle rates.
>
> For the 2018 update of the Strategic Reinvestment Plan, Callan issued a memo to the Land Board dated July 5, 2018 ..., which acknowledges the results of the asset allocation/distribution study, provides updated discussion on the hurdle rates for timberland and farmland acquisitions, and recommends continued implementation of the Strategic Reinvestment Plan approved in 2016. The memo specifically states:
>
>> The findings from the Asset Allocation and Distribution Study completed by Callan in 2018 are consistent with the conclusions and next steps outlined in the Strategic Reinvestment Plan approved by the Land Board in 2016. Assuming the Land Board adopts the recommendation of the Investment Sub-committee to proceed with Option A1 of the Asset Allocation and Distribution study, Callan recommends that all future investments in timberland and farmland are made at or exceed the established hurdle rates. This applies to all endowments.

9. What happens at the end of the road for cottage sites? The easy ones have been sold.

The current leases expire at the end of 2024. The Department intends to work with the Land Board to determine a path forward for Land Board approval in advance of the lease expiration date.

10. What is the basis for the real estate values established by IDL? Has the Land Board provided a standard for land valuation for the Department?

The Land Board accepted the Callan report in 2014, thereby providing guidance to the Department regarding certain land valuations. In the report, Callan supports a discounted cash flow/income approach for rangeland and timberland using an independent advisor.

The asset allocation study valued timberland at $1.14 billion and rangeland at $61 million in 2014 (analysis completed in 2013). The study did not value farmland, which it termed "de minimis holdings." The valuations for rangeland and timberland have not been updated.

The Department does not dictate how an appraiser defines market value to value a property. All appraisals must adhere to Idaho appraisal rules and laws (eg. I.C. § 54-4101 *et seq.*). At times, the Department will meet with the appraiser and address issues that may need to be resolved through appropriate appraisal methods, such as hypothetical conditions or extraordinary conditions. In many cases, an appraisal review and third party pre-qualified expert review is completed as part of the process.

Valuations vary based on the transaction type. For example, grazing leases are based on the Land Board established grazing rate. However, the valuation for the sale of grazing land would be based on the appraised value of the land. The following is a brief outline of appraisal and valuation methods used by the Department:

- Rules and Statutes:
  - 47-704 Leases of Mineral Rights in State Land
  - 54-4101 Idaho Real Estate Appraisers Act.
  - 58-133 Acquisition, Sale, Lease, Exchange or Donation of Public Lands – Creation and Operation of Land Bank Fund.
  - 58-138 Exchange of State Land.
  - 58-301 Appraisement – Fee – Reappraisement – Appropriation for Appraisement.
  - 58-304 Leases.
  - 58-313 Sale of State Land.
  - IDAPA 20.03.08 Easements on State Owned Lands
  - IDAPA 20.03.13 Administration of Cottage Site Leases on State Lands
  - IDAPA 20.03.14 Rules Governing Grazing, Farming, Conservation, Noncommercial recreation, and Communication Site Leases
  - 20.03.15 Rules Governing Geothermal leasing on Idaho State Lands
  - 20.03.16 Rules Governing Oil and Gas Leasing on Idaho State Lands

- Transaction types:
  - **Rights of Way (easements)**: IDAPA 20.03.08.021.02 compensation is based on the encumbrance. The valuation method is based on use and damages to the property. An appraisal may be required if the easement value exceeds the minimum compensation fee of $500. The appraisal will be performed by qualified department staff or a licensed Idaho appraiser. IDAPA provides compensation valuation based on certain easements.

- **Dispositions**: Article IX, Section 8 of the Idaho Constitution: "provided, that no state lands shall be sold for less than the appraised price."
    - Cottage sites are valued by appraisal using a comparable sales approach.
    - Commercial buildings are valued by appraisal using an income approach and/or comparable sales data.
    - Rangeland is valued by appraisal using a comparable sales approach.
    - Timberland is restricted from sale, see I.C. § 58-133.

- **Acquisitions**: Callan recommended return hurdle rates must meet or exceed 3.5% net real for timberland and 4.5% net real for farmland. Again, the Department has not purchased any farmland with Land Bank funds. All acquisitions are reviewed prior to closing by an independent third-party expert.

- **Asset Valuation**:
    - Farmland - Valued using National Agriculture Statistics Service data for dry farmland and is updated annually. Farmland acquisition valuation involves both comparable sales and income approach.
    - Timberland – The last valuation of timberland (2013) utilized the land expectation value method (LEV). LEV is based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow was discounted by a constant discount rate (4%).
    - Rangeland - The last valuation of rangeland (2013) also utilized the land expectation value method based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow was discounted by a constant discount rate (1.25%).

- **Land Exchanges** – Idaho Code § 58-138: an appraisal and review appraisal is conducted of the lands proposed for exchange. All such appraisals and review appraisals are performed by appraisers who are licensed or certificated to perform such work in accordance with chapter 41, title 54, Idaho Code, and are designated as members of the appraisal institute (MAI). All appraisals and review appraisals shall conform to the uniform standards of professional appraisal practice (USPAP) standards.

- **Leases**:
    - Commercial office / retail: local market rate
    - Commercial ground: percentage of appraised value
    - Grazing: Land Board approved grazing rate. IDAPA 20.03.14.040 - the methodology used to calculate rental rates shall be determined by the Board.
    - Telecommunications: Land Board approved usage type rate. IDAPA 20.03.14.040 - the methodology used to calculate rental rates shall be determined by the Board.

- Cottage sites: IDAPA 20.03.13.025 – Annual rental shall be set by the Board. The current yearly rental rate is a percentage (4%) of appraised value. Appraisals are performed every five years.
- Mineral Leases: 47-704 – the LB may lease state lands for such annual rental, not less than one dollar ($1.00) per acre per year, except in the case of state oil and gas leases wherein the royalty to the state shall be not less than twelve and one-half per cent (12 1/2%), and provided that the minimum royalty shall not be less than two and one-half per cent (2 1/2%).
- Oil and Gas: IDAPA 20.03.16 – The lessee shall pay to the state annual rental for each lease three dollars per acre with a minimum of $250 per lease.
- Geothermal: IDAPA 20.03.15.035 – Annual rentals will be set by the Board through competitive bidding, negotiation, fixed amounts, formulas, or some other method of valuation which a prudent investor might reasonably apply to establish such rental amounts.

Idaho State Board of Land Commissioners
Reinvestment Subcommittee
Brad Little, Governor and Chair
Lawrence G. Wasden, Attorney General
Irving Littman

Final Minutes
Reinvestment Subcommittee
November 13, 2019

The Land Board Reinvestment Subcommittee meeting was held on Wednesday, November 13, 2019, in the State Capitol, Hearing Room EW40, Lower Level, East Wing, 700 W. Jefferson St., Boise, Idaho. The meeting began at 3:00 p.m. Governor Brad Little presided. The following members were in attendance:

Attorney General Lawrence Wasden
Mr. Irving Littman

For the record, all subcommittee members were present.

Governor Little: There's a sign-up sheet at the back of the room; for the most part, we're going to have public testimony at the end. I do have one legislator that I think is going to be here; Representative Boyle asked if she could speak early, and we said okay. With that, the Reinvestment Subcommittee will come to order. We have the consent agenda. The two items on the consent agenda are the approval of the minutes of July 19, 2019 and October 10, 2019.

Attorney General Wasden: Governor, I move adoption and approval of the consent agenda.

Mr. Littman: Second.

Governor Little: It's been moved and seconded that we approve the consent agenda. All in favor say aye.

All: Aye.

Governor Little: Opposed nay. The ayes have it. The consent agenda has been adopted. That will be the only vote we will make but we did a really good job on that one [laughter]. The next item is a discussion from the Attorney General's Office. Mr. Early.

Mr. Darrell Early: Governor Little, members of the committee, my name is Darrell Early, Division Chief of the Natural Resources Division of the Office of the Attorney General. At the conclusion of our meeting in October, you had left me with two tasks. I wanted to start by addressing those two issues and then open it up for any further questions you may have of me. The first issue was a request by Mr. Littman for an explanation of the restrictions upon the Board's ability to dispose of land. I've prepared a memo and in that memo I've outlined and cited to the relevant authorities. Just briefly to summarize, obviously there's the public auction requirement that is applicable. Sales must be for the long-term financial return to the institution. It cannot be sold for less than appraised price. There is a 100-sections per year limit on how many acres of land can be disposed of; that equates to about 64,000 acres per year. They cannot be sold more than 320 acres to any one individual company or corporation. If the state is going to exchange land, it must be for equal value. So those are all

embodied in the constitution. There are a couple of other provisions out there in code that are applicable. There's a provision that says you cannot sell lands to anyone other than a citizen of the United States, or those who have declared an intent to become such. There's procedural restrictions on how they're sold. They must be advertised for four weeks in a weekly newspaper stating the minimum price below which no bid will be accepted. There's a procedural provision in 58-313(a) that requires that any time there's going to be a sale of lands there must be notice provided to the county commissioners. The county commissioners have 60 days to object, at which point if there's an objection filed, there's procedure in front of the Board to reconsider the sale. The sale is subject to judicial review. If the objection is brought forward, they can petition for judicial review. The standard review is arbitrary, erroneous, or capricious. Now interestingly enough, there are a number of cases dating back on the issue of the judicial review of the Land Board's land management activities. There's pretty strong authority out there from the Idaho Supreme Court that decisions the Land Board regarding the disposition of its land are not reviewable. The fact that the legislature has made this provision in the code may not necessarily mean that there's any meaningful review by the Idaho Supreme Court because they basically said the constitution vests these decisions with the Land Board and they're not really subject to judicial review. There's a little bit of a conflict in that. There is the restriction on forest lands in Idaho Code § 58-133 which provides that lands chiefly valuable for forestry, reforestation, recreation, watershed protection are reserved from sale and set aside as state forests. There's provisions relating again to the exchanges the state has.

Attorney General Wasden: Darrell, regarding Idaho Code § 58-133(1), it would appear to me that if it was in the best interest of the beneficiaries to sell forest land, that it was obtaining them in the process of obtaining the maximum long-term financial return that that provision would violate the fiduciary responsibility of the Land Board to obtain the maximum long-term return. I guess there's a question in my mind about whether that code section would be sustained on a constitutional basis. I am just interested in your thoughts on that.

Mr. Early: In the memorandum, there's a footnote specifically pointing out that there's a provision in the constitution that says under such...the legislature can promulgate regulations for the disposition of land, and it says under such regulation as maybe prescribed by law. There are a couple of cases in Idaho that have interpreted similar language to say basically that the legislature can promulgate procedural regulations and procedural requirements that govern the constitutional duties of, for instance, the Land Board or the State Board of Education, but they cannot alter the substantive and change the substantive obligations. There's case law, at least, that would suggest that the legislature cannot by law require the Land Board to violate its fiduciary obligation or otherwise violate the requirements that the constitution imposes. It is an unresolved question in this state, as it relates to that particular provision and until a court tests that, and until a court gives an opinion on that, it is an unanswered question whether or not that particular code provision would or would not violate the Idaho Constitutional requirements and whether the court would interpret this language in Article IX Section 8, under such regulation as maybe prescribed by law, to be limited solely to the procedural regulation of the Board's activities as opposed to substantive regulation of the Board's activities. Again, it is cited as a footnote, there's authority in the footnote to that effect.

Attorney General Wasden: A follow up question to that, just pointing out, in Idaho Code § 58-313(1) in statutory limitations, (b) says must be advertised for 4 weeks in a weekly newspaper. It seems to me that that would be a procedural matter that would clearly fit within the confines of what the legislature could do, but then there are the other extreme, it's sort of a continuum here, another extreme where in fact placing limitations may violate the fiduciary responsibility.

Mr. Early: And in fact, the Idaho legislature has put provisions on the Land Board's activities, as you well know, that the Idaho Supreme court has ruled are violation of the constitution. They have not, in that process, really directly addressed that question of how far can you go and what, but for example the preferential right of renewal on leasing was deemed to be a violation of the constitutional public auction requirements. There's certainly precedent even in the context of the Land Board to say that the legislature cannot modify certain constitutional issues.

Governor Little: Darrell, you brought this up, can the Land Board entertain an exchange for 65,000 acres of forest ground?

Mr. Early: I believe they could. The constitution specifically allows for exchanges of land so long as they are of equal value. In that case, the limitation on disposition may not apply because it's not a loss of lands. That limitation appears to be governed at the sale of lands not necessarily on exchange of lands. Again, that would be something that we would have to evaluate a little bit more closely. I hadn't really thought of whether that would apply.

Governor Little: Boise Towne Square Mall for 65,000 acres of forest ground.

Mr. Early: If you want to get in the mall business...

Governor Little: No, I don't...strike that from the record.

Mr. Early: Yes, the constitution clearly envisions exchanges of land. When it was originally enacted, the constitution only allowed for exchanges between the state and the general government in the United States. It was subsequently amended in 1982 to allow for exchanges with corporations, companies and individuals; because an exchange doesn't represent necessarily a net loss of land, per se, it might not be considered subject to the 64,000-acre limit. We will look at that if that ever comes up.

Attorney General Wasden: I just want to make sure the record reflects that I did not make any reference to the Towne Square Mall, I just wanted to make sure you knew that.

Governor Little: Okay.

Mr. Early: Moving on to the other question that you've specifically asked, Governor, whether or not the 1982 constitutional amendment to Article IX, Section 8 where the legislature and the people of the state of Idaho added the language about secure the maximum long-term financial return, whether that changed any of the analysis that I had presented to you about older case law, etc.

So in the memo, I tried to address that in two ways. First, just from a textual and case law present a fact, the language clearly changes. Prior to the amendment, the language read "to secure the maximum possible amount therefore." After the amendment, the language clearly changed and said, "to secure the maximum long-term financial return." So just on a purely textual basis, it clearly purports to change the standard that was applicable. Indeed, the constitutional amendment based upon what I've been able to discern from legislative history I can find, there was some desire to make that change so that there would be a difference in how the Land Board exercised its discretion. However, it's also clear that even prior to the change in the constitution, the Land Board in certain cases, had exercised its discretion to award bids potentially for a lower value if they saw a long-term benefit to the rest of the endowment. Specifically, the Barber Lumber case, that comes out in 1914 and is cited in the memo. That was a case where it was a timber sale. The bidder who bid the most, bid $101,000. The second bidder bid $100,000, but he also offered to build a short line railroad up to the lands that were going to be logged. The Board awarded, in part, the timber sale to the lower bidder, in the sense of lower cash bid, because of the increased value to the rest of the endowment lands that

the short-line railroad was going to bring, in addition to other factors, like tax, etc. which as I mentioned in my presentation last time under the Watershed cases today probably wouldn't be allowed to consider that. But they did at the time. So in any event, it appears that even back in the day under the prior language of the constitution, there were instances where the Board exercised its discretion in the management of it and the court affirmed a standard that was perhaps different than that immediate cash value in hand. So the question comes up, does it really change it or did it really just clarify the law in a way. When I looked more into the legislative history, when the amendment was proposed to the people of the state, the statements both for and against suggest perhaps that it was really just codifying the already existing practice of the Land Board. So for example, the statements for the proposed amendment says this amendment will formally spell out in the state constitution a management practice that the State Board of Land Commissioners uses in managing the state's endowment lands – suggesting perhaps that this was just indicating codifying or making formal what was already the practice of the Land Board. The legislative statements against said this proposed amendment is unnecessary as the State Board of Land Commissioners now administers the state endowment lands in a manner that will secure the maximum long-term financial return to the institution. So again, both the for and the con people were saying we don't need this necessarily, it's just going to maybe clarify the law. The upshot of this is that in answer to your question, which is does the amendment really change the case law or the analysis, my assessment is no, it does not. The Board has always had the ability to look at and has indeed, in the past, looked at the long-term financial returns to the endowments as it looks at potential dispositions of property.

Governor Little: I don't disagree. I was there when we drafted that amendment and I think a lot of the reason they put it in there was because some things wouldn't get across the hurdle of the Department as a proposal because of that language. The long-term was inserted in there to where there were more options because some of the options...at that point in time, I was very involved with livestock grazing industry and we were right there at the get go at inserting this because some of the things that were trying to get done, they were the literal $1 more today, the Barber case is a good example, we're saying you can't do that because you amended to put long-term in there we can get there. I know that Burt Ravenscroft was very involved, but I was there when that amendment was put in the constitution.

Mr. Early: I don't have the benefit of your personal knowledge and if you would have given me a chance to take your deposition, I would have but [laughter]...I don't disagree that it certainly clarifies the law, but it doesn't really change. I guess ultimately the question was does it change the sideboards that the case law reflect are out there and it doesn't really from that standpoint.

Governor Little: My interpretation is it allowed more flexibility. It wasn't quite as black and white and the language in the court case was prudent business...what would be a prudent business which is part of the fundamental underpinnings of the trust doctrine...

Mr. Early: ...which has not changed at all as a result of that amendment or anything. All this has really done is it's given the Board the ability to focus on things clearly in the law that perhaps weren't expressly clear in the constitutional provision before, even though they perhaps had always done it that way, at least at some level. Again, to answer the question which you asked was there a change in the legal standards? Not really as it was borne out by the case law.

Governor Little: All right, thank you.

Attorney General Wasden: Governor...I just wanted to make certain that you knew I wasn't a participant in the drafting of the language in 1982, I was in law school [laughter].

Mr. Early: It was an interesting exercise in looking back at how that came to be and also how hard it is to find legislative history in Idaho sometimes. There was an interim committee in 1980, there was a final report and then it sort of went dark for two years. Then it sort of came back to life again in 1982. I really didn't have a lot of in between.

Governor Little: There was a little election in 1980 that changed some things.

Mr. Early: Yes and so there's a lot of stuff you sometimes want to know the answer to, but you can't find in Idaho legislative history. It's getting better.

Governor Little: Any further questions? Thanks, Darrell, I really appreciate it.

Governor Little: Is Callan?

Ms. Renée Miller: Sally is on the phone.

Governor Little: Were you going to make a specific presentation, or were you just going to answer questions?

Ms. Sally Haskins: Governor and members of the reinvestment subcommittee, this is Sally Haskins from Callan for the record. I did not have any specific remarks, I think that there were some questions from the past time when Janet was there and I apologize for not being at your meeting last time, and not being able to be there in person. Fire away, so to speak.

Mr. Littman: Sally and I had the opportunity for some conversations. She provided me with some correlation data of timberland and the financial assets showing broadly a very small negative correlation. Essentially demonstrating that there is no correlation between the returns of timberland and the principal financial assets – bonds and US equities.

Governor Little: Irv, is that correlation or counter-cyclical?

Mr. Littman: It is correlation. They tend not to move...there's no relationship between their movements. Sally, would you like to comment on that for the benefit of the group?

Ms. Haskins: I think it just confirms the position of timberland and the asset allocation from the fact that it does provide a ballast. This is the reason we do it, because the returns move differently than the financial assets.

Mr. Littman: The other issue we talked about, asked about in your absence at the last meeting, and have talked about since then is the process and the intent, the content in your work on the hurdle rate. Help us understand what that means.

Ms. Haskins: The process for setting the hurdle rates?

Mr. Littman: Yes, and how should we interpret the hurdle rate?

Ms. Haskins: Yes. So the process for setting the hurdle rate is...first of all we do it annually. We look at our capital markets assumptions, we also look at the long term projected returns for financial assets, and then land assets including timberland; we look at the market conditions at that point in time; we consult with IDL to see what they're seeing on the ground and that's really the process for setting the hurdle rate. The hurdle rate, I want to make clear, is different from the long-term policy target. The long-term policy target is what you would expect the portfolio to return over the long term. For

example, timberland; in your investment policy statement timber has a 3% net real long-term policy objective. Now the hurdle rate, on the other hand, is the rate of return that is required for new investments.

Governor Little: Just real quick, it is 3.5 isn't it?

Ms. Haskins: Yes, that's correct 3.5. I can't tell who was speaking, I apologize...

Governor Little: This is Governor Little, but today's hurdle rate is 3.5.

Ms. Haskins: Correct. The hurdle rate today for timberland is 3.5 percent net real. So we like to look at everything after inflation and after all fees and costs have been factored in. You can think about that as sort of the take home pay, the take home projected investment return.

Governor Little: And we're using the standard of 2.25 for inflation and 100 basis points for all costs, is that correct?

Ms. Haskins: Well, if you want to convert it to a nominal, you could use the 2.25 inflation and then you can tack on 1%, but that's not really...I like to look at the net real. That's the take home and that is what IDL has been looking at as well. Reading through some of Mr. Groeschl's comments from the last time in how the underwriting has been done. That's what they're trying to meet and that's what they've been underwriting to, so that's appropriate. We're coming up on the time when we do our capital markets assumptions, we're in the process of setting those now and then we discuss those with clients and figure how it impacts the long-term projected returns for their portfolio. So in the first quarter we would looking again at the long-term policy objectives and the hurdle rates as well.

Governor Little: Does that 3.5% hurdle rate consider all the fire costs and the prohibition on selling timberland?

Ms. Haskins: Yes, it does.

Governor Little: I would argue with that but go ahead.

Ms. Haskins: To the extent that you have to pay for...on the first or second question about the prohibition on selling, it's been my understanding in setting the hurdle rate that for timberland the entire return basically comes from income. You don't factor in any appreciation...

Governor Little: I would agree there. That's using what we're calling the land expectation value methodology not fair market value, is that...

Ms. Haskins: Correct.

Governor Little: Okay.

Ms. Haskins: On the suppression costs, I don't know how those get factored in, but I guess my overall point is if you have to pay for that, and if it is a cost of management, then it should be factored into the return calculation or deducted. I don't know whether it has or not because I have not audited or done anything to actually look at how that's been factored in.

Governor Little: There's two different...there's the 60 cents an acre that private landowner or the state pays to the timber protective association, or whoever it is; but then there's the overarching fire costs which are actually a policy of the state legislature where...that applies to everything. But this year we were very blessed that we had a low cost, but some years we're not quite as fortunate. The question is do you tie that on to the cost of owning the land and that's a very high-level policy decision. If you don't pay for it for state timber, then what do you do about everything else? We've cooperative

agreements with the Forest Service and the BLM. Until this year, given the escalation there, I still think that from a policy standpoint, the fire costs ought to be looked at.

One other thing that I had was...in Callan's previous...they basically said that if you moved the reserves for public schools to 600% and charitable to 700% that would be enough buffer that the rest of the...in the 2018 Callan report that then you would put all of the money in financial assets, were you part of that report, Sally?

Ms. Haskins: Yes.

Governor Little: Has anything changed?

Ms. Haskins: Well, I think that when we did that report, we laid out various scenarios. The other subcommittee adopted option A, which is why we're continuing to think about investing in timberland and other asset types. But nothing has changed with regard to the assumptions that went into that study and our work.

Governor Little: Okay, other questions.

Attorney General Wasden: Thank you Sally, this is Lawrence Wasden. As I recall, Callan's assignment was to look at the endowment as a whole, not just the security assets but the land assets as well; to do an analysis of the entire portfolio and as a consequence made the recommendations that you did. My understanding of those recommendations, both in 2014 and 2018 reflected that whole approach; that is, that the land assets actually produced a steady level of income which allowed greater flexibility and more aggressive investing in the financial portfolio. I am wondering if that is your understanding, if that's still the case.

Ms. Haskins: Yes, absolutely. All of the land assets and financial assets have the same characteristics as they've had from 2014 until now; the land assets provide that ballast and that steadiness. That's why, and to your point, we do look at it on a whole trust basis. You've done well.

Attorney General Wasden: As a follow up Governor...if we altered the land assets, that would have an effect on the securities aspects. We would have to accommodate or account for increased risk that happens in the marketplace, correct?

Ms. Haskins: Correct. You can't do one thing without thinking about the whole trust and then maintaining your focus on wanting to have stable distributions, right?

Attorney General Wasden: Correct.

Ms. Haskins: Which is an objective.

Attorney General Wasden: So if we tinker with one part, it's going to affect something else is what you're saying, in layman's terms.

Ms. Haskins: Correct.

Attorney General Wasden: Thank you, that's all I have Governor.

Governor Little: I have the exact same question from a different angle. We're not talking about selling any state lands. The question is do we add $150 million more in land to the corpus. The current balance that exists between timberlands and the financial assets is what it is, the question is that at this point in time, and this goes back to my reference to the last report – one of the things we've done is move the earnings reserve levels up to a much higher level. The question is at this junction, at this fork in the road, what do we do with the $150 million that we've got in the land bank; and if that's

what we are and we're perfect, well you said we're good, wouldn't we want to put half in each? And that would be the right thing to do?

Ms. Haskins: Well, if you remember from our 2018 report, part of what you decide to do depends on where you want to be with regard to the downside scenario, in the worst worse case scenarios – if you want to protect against that, and it was clear that you want to do that, was where land really came into account. So I think part of it is where you want to be on that risk spectrum. I have maintained all along that this is...if you can find transactions...I come at it from more of a bottom up perspective, if you can find transactions that are truly accretive to what you already have; and it sounds like the last couple that have been done not only stood on their own, but have made the rest of the portfolio better, then that's the way to go about it. I think that's what we've tried to stress too.

Mr. Littman: Sally, correct me if I misspeak here. I think what Sally is saying is that's where the hurdle rate comes in. That as you consider adding individual investments, they have to be accretive, they have to be better than what you've got. That is why the hurdle rate was designed. Sally describes that the hurdle rate...this is a criteria, a threshold, she's saying it has to be done in such a way to include all costs including the fire costs and projected inflation. So if the investment is good enough and high enough, then it adds to the overall return and health of the portfolio. If it's marginal or below the hurdle rate, then it will hurt the portfolio and we should not do it. So the question really becomes of the $150 million, how much is there within the time that we have prescribed that we can execute transactions that are individually accretive and I would ask, not barely accretive, but have enough cushion so that you know you're really adding to the portfolio. Did I say that right?

Ms. Haskins: Way better than I could ever say it, thank you.

Governor Little: Sally, this is Governor Little again. You referenced in your prior dialogue about a down market. I know Chris, under Callan's guidance, they've got tips and bonds, this is not a one-off situation. There are other asset types, timberland in Georgia...and the endowment fund is investing in real estate in other areas. Are we at a point where we have only one decision and that's the current mix that the Endowment Fund Investment Board manages and timberland, or are there other options we should look at?

Ms. Haskins: Well, we've set forth a hurdle rate for farmland that is relatively high. Theoretically you could consider farmland or actually if you could hit the hurdle rate, but the reason we set that relatively high is that you have less expertise there, you have a smaller portfolio in Idaho and we wanted to set it competitive with farmland returns throughout the United States because we didn't see any reason why you should take a lower return in Idaho when you could potentially be investing outside of Idaho in a nationally diversified portfolio farmland. Having said that, even if you put all of the money in farmland, it's not going to do for you because it's just not a big enough chunk of money relative to the overall pool, what I think you could achieve in timberland in Idaho. I think that aside from timberland I think it would be difficult to do farmland, it would have to be something pretty dang special to even move the needle in farmland – returns in farmland I am not convinced you would do what you could do in timberland.

Attorney General Wasden: Sally this is Lawrence Wasden. We step back for a moment in time: the state owned a number of parcels of land, they happen to be around Priest Lake and Payette Lake. We've sold land, and that's actually the genesis of that $150 million is that our land portfolio went down. As a consequence of that, our risk factors went up. To accommodate for those risk factors, we increased the size of our reserves. By doing that we were leveling the playing field. The question now is what do we do with this $150 million and in order for us to maintain that balance, we need to do

something. That is, we can purchase securities, but that is more volatile marketplace than is the land which is the whole issue I was trying to raise earlier. That it's the working of the entire portfolio together so if we were to acquire land, it may be that we could reduce the size of our reserves based upon what the relative risks were. Isn't it the entire workings of that together that we're trying to accomplish the maximum long-term return?

Ms. Haskins: That's correct, and you point out that there are trade-offs to anything that you do.

Attorney General Wasden: Correct.

Ms. Haskins: It's kind of all about those trade-offs and where you want to position yourself with regard to risk and downside protection. The land provides income, a very strong consistent source of income. That's kind of the beauty of it.

Governor Little: So the 2018 report where you said you'd get a higher return if increase your earnings reserve and left it in financial, Callan has a different opinion than they did in 2018. Did I get that right?

Ms. Haskins: No, I don't think we have a different opinion. I think that is still true. I am just trying to point out that we did have...in the 97th percentile from a downside perspective that if you wanted to think about that. That was where additional investment in land came in.

Mr. Littman: Yes, they said that here under option c; but they also said there is an option A and B and they're all legitimate options.

Governor Little: Okay any other questions. Thank you Sally. I have a question for Chris. I found out the earnings reserve is invested in the exact same pool as everything else.

Mr. Chris Anton: Governor, members of the subcommittee, yes that is correct, both the permanent fund and the earnings reserve are invested with the same investment strategy.

Governor Little: And literally the only difference between the dollar permanent and the dollar earnings reserve is the permanent can never be touched; and the earnings reserve you could take it out to do distributions, or do something else with...in essence the portfolio that you, Callan and your board put together is all that money's basically managed the same.

Mr. Anton: Yes, that is correct Governor. We did consider as part of this study whether we should invest the permanent fund differently than the earnings reserve fund. That's theoretically possible. But it was determined that keeping it invested consistently made the most sense. I can get into the details of that, but that's part of what drives having six to seven years of reserves is that the earnings reserve portfolio can be fairly volatile as well.

Governor Little: Let me ask a hypothetical.

Mr. Anton: Okay.

Governor Little: The most widely scribed to index is the Vanguard index, what, 8 basis points?

Mr. Anton: The S& P 500 is 3 basis points now.

Governor Little: I just looked this afternoon. Three, five and ten years it's almost 300 basis point premium over the incredible work that you've done. But it's in a different area. So if you take $2.3 billion times 3%, that's $60 million bucks a year; we would have an additional return if we would have just plowed it all in there. I am not, just like the Towne Square Mall, I am not advocating for that; but what I am saying are there a number of years of earnings reserve that we could put aside to compensate for just plowing it all into the SPDR, the Vanguard SPDR.

Mr. Anton: Governor, members of the subcommittee, we do have a substantial portion of the portfolio of the S&P 500 index. But we don't have it all invested in that because we believe diversification of non-correlated or partially correlated assets reduces the overall risk. To your point, yes if we happen to be all in the US equity market, we would have earned more over the last 10 years. But if you look at the prior 10 years we would have earned less because the S&P 500 was flat for 10 years.

Governor Little: Vanguard's 11% over the life of the programs.

Mr. Anton: Okay, different assets perform well different periods and that's why we're diversified.

Governor Little: But my question is can you make up for that diversity just by having more earnings reserve.

Mr. Anton: If you compare our portfolio to other land grant institutions, we're fairly equity intensive with 66% and we're able to do that because we have the earnings reserves. We're able to take more equity risk in the portfolio and still meet our objective of stable distributions for the beneficiaries because we have 6 or 7 years of reserves and because we have revenue coming into the reserves from the Department of Lands through timber sales. That structure is well thought out and it allows us to be fairly aggressive. Many of our peers are investing in other non-equity related investments to try to reduce volatility. They are investing in other alternatives, infrastructure and other things. So to your question to Sally, yes, we could consider other types of investments that have low risks, but we're able to take a fair amount of risk to try to maximize the returns for the beneficiaries given our structure.

Governor Little: Any other questions.

Mr. Anton: Thank you.

Governor Little: Dustin, are we doing the forest asset management plan now?

Director Dustin Miller: Governor, members of the subcommittee, Dustin Miller, Director, Idaho Department of Lands. I've also got Ryan Montoya with me who is our Real Estate Services Bureau Chief. For purposes of this meeting, much like Ms. Haskins, we were just prepared to answer questions, what questions the subcommittee might have over the lands piece, our management, our implementation of the current reinvestment strategy. So, if that's okay we can stand for questions.

Governor Little: Director, what's the cost per acre to administer forest land, that's all land – general fund, earnings reserve, forest ground – what's the administrative cost?

Director Miller: Governor, I cannot answer that right off the top of my head. I am certain we have that information; I wasn't prepared for that question – we will get that for you.

Governor Little: You heard me talk a little about fire. Do I have this right that state pays into a pool, into the Clearwater, Southern Idaho Timber Protective Association, 60 cents an acre; but then we also have an overarching fire cost, but this year we didn't have any fires we still have $10-11 million. Does every state do that, where the state just picks up the fire costs?

Director Miller: Governor and subcommittee members, you are correct that 60 cents an acre is what the Department assesses on private timberland as well as our endowment lands and that goes into our prevention and pre-suppression funding; preparedness funding. On the suppression side, once we are engaged in initial attack, that's when the funding from the legislature kicks in through deficiency warrants. It's that $20 million cap, so two different pots of money. One for pre-suppression and one for the suppression. I am not familiar, certainly most other states in the west, state land management

agencies do have their own fire programs. They are similar in ways, certainly different in others. I would have to dig in a little more to tell you with a high degree of certainty how different they are. But I know each state has a different approach.

Governor Little: Further questions.

Mr. Littman: Director, so you've heard the discussion and I assume that you've read ad nauseam the discussion of hurdle rates. Are you comfortable that the hurdle rate for a prospective timberland investment is calculated and analyzed in a manner consistent with what Sally describes her expectations for hurdle rate are; that is, nominal net after all costs - administrative and fire suppression, of the Governor's point?

Director Miller: Yes, Governor and Mr. Littman I do believe Ms. Haskins captured that accurately on how that hurdle rate is derived for our timberland assets and all the factors that go into that particular model, that particular formula.

Mr. Littman: And that when someone is putting a proposal together, they're doing it that way. The numbers actually reflect all of those costs.

Director Miller: Mr. Littman to my knowledge, yes. All of that is taken into account when understanding the hurdle rates, what return we're trying to make on our timber ground and other assets. It's a complicated formula as you well know. I believe Ms. Haskins really captured the details there.

Mr. Littman: My question really is everybody using the same yard stick? Sally with her hurdle rate and you and your colleagues running through the complexities of putting together a particular proposal.

Director Miller: Governor and Mr. Littman, that's another question I think is better addressed by others in the Department. Unfortunately, our state forester couldn't be here today and as you know he has a long history of timberland acquisitions and understands the process and these formulas in and out. Mr. Littman, we would be happy to get back to you with answers to those questions.

Governor Little: Director Miller, I think Dave talked about this last time; Packer 1 - are we hitting a 6 1/2% right now out of Packer 1? Are we hitting that on Packer 1 right now?

Director Miller: If it's all right, I might defer if Mr. Montoya can answer that question. That's a brand-new acquisition and because of that 32,000 acres that was purchased about a year ago, our sustained yield has been increased in other areas. Certainly, the harvest is going up. Mr. Montoya can answer that question better.

Mr. Ryan Montoya: Thank you Governor, members of the committee. I am going to go back to one of your earlier questions, Mr. Littman. That was the evaluations that we do on the timber purchases. One of the requirements when we were working with Callan initially was that the standards were commercially acceptable. What we're doing is based on what the industry has done and like the Director said, David has been in the industry for a number of times and has been extremely helpful in making sure we're following commercial standards, but also as part of the process we do provide a third party evaluation on these acquisitions to confirm that we are adhering to commercial standards and that is by hiring outside experts to review and also to help prepare these acquisitions and to do evaluation of whether or not the due diligence has been appropriately vetted. In terms of whether or not we're using appropriate methods in the industry, I would answer yes. The other question regarding the hurdle rate is that if we look at the acquisitions that we've currently completed right now, we have a range of returns for the hurdle rate of 3.98 to 5.5%. There's a weighted average, based on the

acquired acres, of 4.3% and the simple average of 4.71%. So in terms of where we align with the Packers 1 acquisition the net real return on that is really, if you've looked at the size of the purchase, around that 4.38% return.

Governor Little: Ryan, you don't take inflation out. You operate on – here I've invested $100, I get $6.5 out of it, you don't take the inflation out…do you?

Mr. Montoya: So we're not including inflation in the evaluation. It's the net return and that is 4.3%, that would be the net. Then we have the 2.25% inflation that you would add on top of that. So if you were to add inflation on top of that you're looking at anywhere between 6% to over a 7% return.

Governor Little: Okay, so your real hurdle rate is 4.5?

Mr. Montoya: That's what our purchases have been at, yes.

Governor Little: And below that, it was stated by Sally, it was stated by the Department there were inquiries from Board members about farm ground and they said that they couldn't find anything that would hit the hurdle rate. So in essence, if it is below 4.5…is that correct that you won't look at it?

Mr. Montoya: Governor, for the timberland we have the hurdle rate at 3.5% and then for farmland it's 4.5%. So when we're doing an evaluation of timberland we're looking to make sure that it exceeds that 3.5%, which they have. Now when we looked at the farmland, for example, we haven't had any opportunities to purchase farmland that have been able to exceed the 4.5%.

Governor Little: So the hurdle rate is sacred.

Mr. Montoya: Yes.

Governor Little: Other questions. All right, thank you. Have you got anything else, General?

Attorney General Wasden: No.

Governor Little: Irv? I guess have we got a list of people that want to testify? Jerry Deckard.

Mr. Jerry Deckard: Pass.

Governor Little: Is Phil here? Are you on the phone from St. Maries?

Commissioner Phil Lampert: Yes, Phil Lampert from St. Maries.

Governor Little: You've got about…how long do you think you need Phil?

Commissioner Lampert: Just a few minutes.

Governor Little: A few in Emmett is three [laughter]; I don't know what it is in St. Maries.

Commissioner Lampert: Well, actually I live in Plummer not St. Maries. Anyway, I was listening to your sharing today, from your committee. I didn't hear anybody talk about the negative effects of purchasing land that comes down to the county level. Right now, the Land Board has 67,421 acres in Benewah County and that costs us in taxes roughly $325,000 per year that we don't get. If you purchase more land, then that comes off…the first thing we get from IDL is to take that off our tax rolls so that puts a shift in taxes from the land that is no longer taxable to the homeowners and other landowners. These rural counties already have a much higher tax rate than say Ada County or Kootenai County. We're running about 0.50%. The more metropolitan counties are running at about 0.30%. Your land acquisition if you want to purchase land, buy it in Washington, Alabama, or Georgia but stay away from land in Idaho, especially the five northern counties. I figured out we probably contribute to the

endowment fund a minimum every year of about $3 million plus and our schools only get back roughly $240,000. To me it was very frustrating listening to this whole meeting today and not one mention was made as to how negatively it affects local taxing districts, local schools especially if you buy a large...it just happened to St. Maries School District. IDL bought 13,000 acres all in one school district and now they had to run an override, so it seems like maybe the Land Board has forgotten that we don't operate in a vacuum and their actions can have some very adverse...what is very positive for you folks can have some very adverse reactions in these rural counties. You take Bonner, Boundary, Benewah, Shoshone and Clearwater and that accounts for 643,000 acres that supplies about $28 million worth of net revenue to you folks and they only get back $1.8 million to their schools. Going forward you need to figure out if you want to buy timberland in these rural counties, you need to factor in road maintenance, the cost of schools, and what it takes to keep those counties whole and not just take it off our tax roll. That's what I am concerned about is you folks coming into Benewah County and buying part of our county up and our taxes going through the roof to where we can't even approach levy limits and we as county commissioners cannot...we don't have enough funds to properly run the county. Thank you, Mr. Governor.

Governor Little: Well, Commissioner Lampert, thank you. We didn't bring it up, but the Land Board is fully aware of it. I think when I talked to you last time, I said you ought to call those guys in Bonner and Valley County that had all those cabin sites go on, those guys were mysteriously quiet in Bonner and Valley County because they had way more put on their tax roll than you had taken off, but for some reason they don't want to share with you; I am sorry about that. But we, the Land Board, I may be speaking for General Wasden, we're keenly aware of this fact. We appreciate you reminding us of it one more time.

Attorney General Wasden: Thank you, Governor and we are acutely aware of it.

Commissioner Lampert: That's the question. How are we going to remedy this?

Governor Little: Well, we're studying this. We haven't made a decision yet. There was that first tranche, Packer 1 and the issue is what do we do going forward. That's what we're studying. That's the recommendation this subcommittee is going to make to the Land Board.

Commissioner Lampert: One of your gentlemen today talked about getting the county commissioners blessings on land sales, but nobody comes and talks to us about getting blessings on land purchases in our county. That's a lot more detrimental than land sales. It's something that I picked up in listening to conversations. Anyway, thank you for letting me talk to you over the phone.

Governor Little: You're welcome; thanks Commissioner.

Commissioner Lampert: Okay, bye now.

Governor Little: Tim Hubbard. Is this going to be ditto?

Mr. Tim Hubbard: Pretty much. Thank you, Governor, members of the subcommittee for the opportunity to come to comment today. This will be a bit of a repeat from what you just heard from Commissioner Lampert, but I do want to drudge up some of this again.

Governor Little: Did you state that you represent the Idaho Association of Counties?

Mr. Hubbard: I did not, but I will. I am Tim Hubbard and I represent the Idaho Association of Counties, thank you Governor. This is going to be a little bit of a repeat of what you just heard, but I do want to come at it with a little bit of a different angle. A lot of numbers have been thrown around today and

when I hear these big numbers my eyes kind of gloss over. So I want to go over a simple example. When the Land Board does purchase private land in Idaho, it does have a negative financial impact on Idaho property taxpayers, especially in those rural counties that have large amounts of tax-exempt land and few taxpayers. Because Idaho has a budget driven system, when that taxable land is removed from the tax rolls, it creates a tax shift on the remaining property taxpayers. For example, if you have a county with a budget of $100 and 5 property taxpayers, each property taxpayer is responsible for $20 of that budget. For example, when the federal government purchases a parcel of land, they will provide PILT moneys to offset that loss in taxes. So the property tax dollars of those remaining property taxpayers doesn't necessarily have to increase. But when the Land Board purchases lands, they're constitutionally mandated that they are not able to provide some offset to help the property taxpayers. Now there are four property taxpayers remaining in that county and those property taxpayers' portion of that $100 budget goes from $20 to $25 each. So that's the issue that counties are having, it's further compounded in those rural counties that have negative population growth. So if you look at the sheet that I just handed out to you that's in front of you, you can see this is clear. In Clearwater County, Shoshone, and Benewah are the counties that are having significant population growth. They also have very small populations. The percent of public lands in their counties is very high. One thing I would note here, is that in Benewah County the percent of public land here does not include tribal lands. Benewah County has a lot of tribal lands so this number looks lower than it should be. These counties are very heavily impacted with population decreasing naturally and then with the State Land Board purchasing land, it is also decreasing artificially. For this purpose, the Idaho Association of Counties has a policy position that the State Land Board invests the land bank funds into the permanent fund rather than for the purchase of replacement endowment lands. Furthermore, as Commissioner Lampert did mention, they would like the Land Board to come in and talk to them to discuss any purchases that the Land Board would like to purchase in their county. This is merely a courtesy that the Land Board would be making to the commissioners that would go a long way in increasing the cooperation and transparency with the counties. With that, I would stand for any questions.

Governor Little: Questions. All right, thank you. Braden Jensen.

Mr. Jensen: Thank you, Governor Little and members of the subcommittee, my name is Braden Jensen on behalf of the Idaho Farm Bureau Federation. On behalf of our 81,000 member families, I would just like to stand and reiterate our opposition to the Land Board purchasing additional farmland and timberland. I think many of the points that I plan to make have already been discussed thus far. But I would like to restate some of those through my comments. First of all, the Idaho Farm Bureau does have a policy that supports a no net loss of private property. Our members are anxious to protect private property, particularly since it represents only about 30% of the land mass in the state. Farm Bureau does not believe that it's in the best interest of our economy and our citizens to further erode the small amount of private property that exists in the state. The proceeds from the sale from the cottage sites and other property should be placed in the permanent fund as was expected since the inception of our state. I would refer you to the comments that have been submitted earlier this year in March to the Land Board for more of those specifics. Our members do not believe that it is wise to take the money from this one land sale to reinvest back into the land for the following reasons, many of which have already been discussed. The constitutional requirements, we believe that these are restrictions that land assets make it extremely difficult to sell when and if necessary. Second, the loss of private property as it has been discussed. Obviously taking those lands off the tax rolls is of significant concern. Also, I think we've addressed this a little bit today as far as the need of additional

investment and the resources to land resources in comparison to financial funds such as stocks, bonds, and other investment opportunities. Also, Governor Little, I think you are very wise to bring up the fact that wildfire is a risk and it is something we should definitely consider. We would urge the subcommittee to consider and the full Land Board. I think it is well documented that catastrophic fire risk does exist by both our federal and state agencies. They've recognized this. In fact, the state legislature in February of this year, held a joint resources committee meeting to talk about this fact. Of course, many of these national forests to border state and private land and of course any land that would be considered to be purchased. One other aspect that we would like to address is that while we do oppose the purchasing of any private property we would be supportive of any consideration of purchase of federal lands. I know that many might say that this might be difficult, maybe impossible. I do not disagree that it would be more difficult. I would refer you to the lands package Senate Bill 47 that was recently passed by Congress and in those first couple pages it does list out a number of land conveyances. We do recognize that many of those were for easements and trades and things like that. All we are saying is that we would love to see that investigated and our members would be much more supportive of that as well. In summary, we do believe that for the benefit of our economy and the prosperity of our citizens, we would oppose the loss of private property in the state of Idaho and ask the Board to invest the proceeds of the land sales into suitable financial instruments. Thank you very much for your time and consideration of these comments.

Governor Little: Thank you Braden. Questions. Jonathan Oppenheimer.

Mr. Jonathan Oppenheimer: Thank you Mr. Governor, members of the strategic reinvestment subcommittee. I appreciate the opportunity to testify today. My name is Jonathan Oppenheimer and I serve as the External Relations Director for the Idaho Conservation League. Since 1973 the Idaho Conservation League has worked to protect the air we breathe, the water we drink, and the lands we love; and that includes state lands managed by the Idaho Department of Lands. I would say certainly to recognize the impact of land purchases on counties and taxable lands as an important issue and one that I know that you have wrestled with and will continue to wrestle with. I know it is at the forefront of the minds of the fine folks that work at the Idaho Department of Lands. I will just say from our perspective, we see a lot of benefit in terms of acquiring lands for the benefit of Idaho taxpayers and Idaho citizens because of the important values that they provide and would point out in particular, I think you are familiar with the Packers 1 acquisition and some of the concern that that has brought up. One of the things that we did was to evaluate what were the actual acres that were acquired in those counties and what has been the amount of land that has been sold in those counties since the time of statehood. Obviously at the time of statehood there was an express deal that was made that the State of Idaho and the people of Idaho would be in the land-owning business. I think it is important to recognize that and that there were a number of lands, about 3 million acres plus across the state that were held by the people of Idaho for the beneficiaries named in the constitution and that it is important to recognize that historical precedent. About a million of those acres have been sold since the time of statehood and now as we're dealing with some of the repositioning of lands, obviously some have increased in value, in particular those residential and cabin sites creating some revenue to be used for the acquisition of lands. Obviously, the Land Board and your subcommittee will be wrestling with the issues of how to balance that between the endowment and purchases of land. But I do think it is important to recognize that there have actually been a lot more acres sold in those 5 counties in north Idaho than were acquired through that Packers 1 acquisition. Just by way of comparison, in Benewah County there were about 10,000 acres that were acquired through the Packers 1 acquisition where since the time of statehood over 27,000 have been sold. I just think it is

important to look at how those lands have been distributed across the state at the time of statehood, how they've been sold off and what is now effectively being reacquired on behalf of the beneficiaries and the citizens of the state. So again, recognize that I am sure that there will be a balance of some lands that are purchased and some dollars that go into the endowment. But I do think it's important to recognize the long-lasting value of holding lands for the trust for the people of Idaho and that they provide many other values than just that dollar value.

Governor Little: Thank you. Questions. Jeremy Chou.

Ms. Miller: Governor, sorry. Mr. Chou has a presentation and it will take just a minute to get it ready.

Governor Little: Okay, I am excited.

Mr. Jeremy Chou: Governor and members of the subcommittee, my name is Jeremy Chou; I am an attorney at Givens Pursley. I represent Stimson Lumber Company. I wanted to go through, very quickly, a PowerPoint presentation. As she is loading it, we can talk about a couple of the slides initially as it loads. My coverage will talk a little bit about your standard, your fiduciary duty and really kind of dive into a little bit more questions and analysis of the Callan studies more than anything else. With everything, we start with the Idaho Constitution, Article IX, Section 7 does say that the State Board of Land Commissioners who shall have the direction, control and disposition of the public lands of the state under such regulations that may be prescribed by law. That's your authority. Under Article IX, Section 8 – it does say to secure the maximum long-term financial return of the institution. I am going to defer to Governor Little when he was there, and drafted this language, but to me it means it's a balance, that there's flexibility, and balance. The guidance really is to paraphrase it really the most money for the longest period of time, if that makes sense. A little bit about the fiduciary duty, apologize if I am repeating what Mr. Early had already discussed, but he is correct. This fiduciary duty is subject to a clear abuse of discretion standard. What that means to me is that there is absolutely no real one answer to get to the solution. If you have a reasonable basis, or even a non-arbitrary capricious basis for your decision then you're within your fiduciary duty. I cite the same case that Mr. Early cited, Barber Lumber. In fact, when they talk about a clear abuse of discretion standard, I've heard it described as even if you're reasonably wrong, the court is not going to look into it. So that is the standard that you make, that you have with respect to these decisions. So one of the things that kind of struck me during the last presentation was Governor Little's question. During that last meeting, Governor Little asked was it Callan's recommendation that if the reserves were met the land bank money should go to permanent fund. I thought that the answer was yes. So, I actually went and looked it up. This is a copy of the Callan April 17, 2018 report. Sure enough, the document says depositing land sale proceeds into the financial asset portfolio is preferable under recommended reserve levels. Just to back up, they did recommend some increase of reserve levels and if you met that reserve level, then those proceeds, they recommend should go into financial assets. In fact, later on it says, and I am just quoting here, if you stick funds in the asset portfolio, it's easier and cheaper and compared to land transactions it, quote, requires a lot of time and due diligence to complete. That kinds of makes sense if, I am not a financial whiz, my understanding is that there's about 40% of land investments or endowment investments that's currently in land assets. In most portfolios, those lands and tangible assets about 20% and I think Mr. Littman can correct me if I am wrong, so your 40% means that you're being very conservative with respect to your holdings. The next slide really talks with respect to outstanding issues, as expected land yields move toward 4.5, land reinvestment becomes more compelling relative to the assets from a cumulative distribution perspective with assumed land yields between 3.5 and 3.4, there is a preference for financial assets if higher earnings reserve levels were

implemented. Sure enough, your higher reserves were approved on May 15, 2018. Section D says the Land Board approves the higher reserves and that's just a copy of the minutes. If you turn to the current document, October 10, 2019 that you received, I really want to focus on two points with respect to the top page that you can barely see, and I apologize for the PowerPoint, but there are documents in front of you. It does say, using a net...well there's really two points. First it says we recognize that as the financial assets have out-performed lands have grown in percent relatives to the land portfolio. It begs the question by how much. In your April 2018 report, Callan says the financial projections from 2014-2018 went down from 6.8 to 6.3%, or 50 basis points. I mean it still went up, but not as much as you would have projected in 2014. Then it said, lands income went down further, but there were more deposits because there were more sales of land. So it just begged the question how much more did your income go down with respect to your timberland within that period of time? What I did was, I went to the annual report from 2014 and if you go down to the last column, it will say in 2014 your forest land income was $53,500,000; that's 2014. In 2018, your land income went to $43 million. That's almost a 10% reduction. Despite the fact that if you take a look at it, in 2018 your timberland holdings, the actual acres, increased. It increased by 25,610 acres, more timberland less money. That's what happened from 2014 to 2018. With respect to Mr. Littman's comments, based on that snapshot, you are not adding to the portfolio. You're losing your money on the portfolio and you're not moving the needle on timber income. The second point that I would like to make here is that the October 2019 report, back on page 7, recognizes that using a 4.5 net real hurdle rate the study also concluded that deployment of land bank funds to the financial assets was preferable if the Land Board approved higher earnings reserve and we already know that you approved a higher earning reserve and that they would bump this higher earnings reserve. I believe it does say that if you have higher earning reserves, then the floor should be moved to about 4.5%, well that was in May, right of 2018. But in 2018 you made a significant land purchase and that land purchase was about 3% of the total land forest land holdings in terms of acres. But instead of using your 4.5 net hurdle rate, the due diligence reports indicate that you used a 3.5 net hurdle rate, despite the fact that your reserves were increased. That is just a copy of the due diligence report, one of the sales, Jackson Timberland, and you'll see in the background that it does say you've used a 3.5 hurdle rate. So those are things that kind of struck me when I went through these reports. Timberland is a good asset when it comes to market crashes. I think Callan has done a wonderful job discussing the worse of the worst-case scenario with respect to the risk spectrum when it comes to the market, they did an excellent job on that. But they didn't consider any of the worse of the worst scenarios when it comes to buying timberland. It's not in any of these reports. There are three things that really struck me as I read this: fire, the prohibition of selling timberlands once it's purchased and how that affects the hurdle rate, and what happens when there's no private industry participating in public auctions? So, what did I do? I went online, I took a look at the US Forest Service and they had a discussion about the Great Fire of 1910. It's unlikely that it's going to happen again. I think with respect to land endowment management, they've done an incredible job with fire suppression and management. With that said, that state forest land is surrounded by federal forest land. They don't do as good a job as the state does. Here's the map. In 1910, that red mark west of St. Maries, a lot of that is endowment land. A quote from the website – the Great Fire of 1910 burned 3 million acres, killed enough timber to fill a freight train 2,400 miles long, merchantable timber destroyed was estimated to be 8 billion board feet, or enough wood to build 800,000 homes; 20 million acres were burned across the entire northwest. Now, is this unlikely? Absolutely it is unlikely. The same response that you would get if you were to ask me if a Great Depression were to happen again, unlikely. And yet we still need to prepare for these risks. The second point was – you can't sell that land after you buy it. Why isn't that factored into the

analysis? There's been a lot of discussion about whether or not that statute that prevents you from selling that land is constitutional and I agree with Mr. Early. A string of cases Commissioners v. Blaine County, I believe, have stated that...or the argument has been made that really the language here under such regulations that may be prescribed by law is procedural, it's not substantive. But the point is, it is going to be a matter of first impression. Do we really want the state suing the state again, to figure out whether or not a law is constitutional or not? That's the first issue. The second point is that is the state of the law as it exists today. You can't sell that land. You should be considering how much that impacts your value. The last point, just because it goes to the fiduciary duty discussion about taking testimony and comments – should be listening to private industry? I am representing Stimson and the question for Stimson is we have integrated business model – that means that you buy timber from endowment for their sawmills, we buy timberland so we can have our own timber supply for sawmills and sometimes we actually sell timber to other companies for our sawmills. The state doesn't have sawmills. Private industries have sawmills. A lot of the timberlands that they own are close to their sawmills. It is just more cost effective if your supply is close to your manufacturing. In this particular case, the state does have deep pockets, they have lower hurdle rates, they don't have to pay county taxes. Those are...that's not a set for a level playing field when you're talking about these discussions and if we're not going to have timber real estate around our sawmills there's more propensity for us to be looking somewhere else. In fact that's why they left California, that's why they reduced operations in Oregon, and that's why they left Montana because of overburden and unfair treatment of regulations. In 2018, 55 of 65 Idaho timber sales yielded just one or two bids. Stimson bid on 25 of those, we didn't win a lot. But what they did do is add $4.44 million to the endowment because they participated in those bids. That's the impact. That's why you should consider this type of testimony and with that I will stand for questions.

Governor Little: Mr. Chou, and actually Braden brought it up, what is your client's opinion of using the land bank money to facilitate some of these federal lands, the state buying some of these federal lands because obviously your client would probably have a hard time getting any federal land. What do you think their attitude would be about that?

Mr. Chou: Governor, I am sure that our client would be very supportive, in fact they have supported efforts in the past, with respect of the Department of Lands to purchase federal lands. That is, I am almost positive, our client's position. Putting on my legal hat, you really have to consider the long-term maximum return for the financial assets.

Governor Little: General.

Attorney General Wasden: I don't have anything.

Governor Little: Irv.

Mr. Littman: Mr. Chou, help me understand this last chart a little bit. Do you know what Stimson's self-sufficiency is from their own timberlands on average?

Mr. Chou: I apologize sir, I don't know the...

Mr. Littman: The portion that...of the purchases they've made recently, the last 5 years, have they purchased timberland from REITs?

Mr. Chou: Governor, Mr. Littman, again I apologize....

Mr. Littman: Pardon me, purchased stumpage from REITs or TIMOs?

Mr. Chou: Governor, Mr. Littman – I am speculating here. They're in the business, I am sure they have, but I can't dispositively represent that without asking them that question.

Mr. Littman: I apologize for not knowing. I am assuming that Stimson is neither a REIT nor a TIMO.

Mr. Chou: Governor, Mr. Littman that is correct.

Mr. Littman: It's a conventional corporate form, own your timberland in fee.

Mr. Chou: Governor, Mr. Littman my understanding is it's actually a family held, closely held business company. Yes, the answer is yes.

Governor Little: Mr. Chou, something that Deputy Director Groeschl said last time, talked about TIMOs have a policy of just owning this land for 10 or 20 years and, I apologize I should have followed up on that, is that your experience that the TIMOs are in it for...of course TIMOs and REITs are frankly new, they're not that old, they haven't been around that long because they're a creature of the tax laws. Is that your experience that the TIMOs, which we've had testimony in front of this committee, that the TIMOs are not looking at Idaho to purchase, but that they are in the business for just being in the business a while and then getting out and going somewhere else?

Mr. Chou: Governor, the short answer is yes. It is my understanding that with respect to one of the Callan reports it does say that TIMOs are looking to get out of Idaho and they actually characterize it as a benefit of purchasing the land here. I think that with respect to why they're doing that, you're speculating as to...I would think that it depends on who owns I guess the assets and those TIMOs. My understanding it if it's an endowment or a pension plan, then sometimes they have to plan on employees retiring and they just take out the money without regard to the market. I am just trying to be fair here. Sometimes, there are other things that they consider. Those things are all speculative and it really depends on the individual that is holding that asset and the TIMOs.

Governor Little: Okay. Mr. Littman.

Mr. Littman: Excuse me, I am still a little confused. I am still trying to understand how to read this. The headline says that Stimson is no longer participating in auctions, but then says that you did bid on 25 sales and generated $4.4 million in purchase.

Mr. Chou: That's right.

Mr. Littman: Are you in the market and buying timber stumpage that you don't own, or not?

Mr. Chou: Governor and Mr. Littman I apologize, that actually is my typo. I was sticking some notes in there and that is not correct. Thank you for catching that for me. They are in the market, they are still bidding, and they will, as far as I know, will still continue to bid as long as they have a presence here in Idaho.

Governor Little: Thank you Irv and Jeremy. I think the last time when you testified the issue wasn't not in the timber auctions but in the land auctions. That Stimson thinks that because of the unfair participation by the state, that that's one of their big issues here, is they think because the state doesn't pay taxes, the state has some other advantages that they wanted to expand their portfolio in Idaho and because they think that the state is an unfair...when I read that, that's my interpretation, did I miss something the last time Stimson testified?

Mr. Chou: No Governor, that is precisely the issue.

Governor Little: Okay. Anything else. All right, thanks Jeremy. Carolyn, Representative Troy. I think your house burnt down in that last slide we saw.

Representative Troy: Thank you Mr. Governor and committee members. For the record, I am Representative Carolyn Troy from Latah and Benewah Counties, and since Benewah County's been such a topic of the conversation today, I felt like I wanted to jump in a little bit. First of all, Governor, thank you for your thoughtful review of this policy, because as you understand, this impacts much more than our school systems and those other beneficiaries of our trust funds. I think it is important to remember the history of how endowment lands came to be. That they were primarily set up to benefit citizens of the state to enable their continuation and their education. As we're looking at this policy moving forward, let's not lose sight of that history and let's ensure that that history continues to impact our citizens the way the forefathers believed it to work. As I was preparing for today, I looked up the trust in fiduciaries uniform prudent investor act which I am sure you are very aware of. One of the statements in this code really struck home with me. A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of a trust portfolio as a whole and is a part of an overall investment strategy having both risk and return objectives reasonably suited to the trust. I believe that a lot of the conversations that have been taking place today talk a lot about what the impact of these decisions are making on these small rural counties and their ability to provide an education to their citizens. I would like to use for an example, the Fernwood School District in Benewah County, which is very isolated. It's a grade school about 30 miles from St. Maries so there's quite a bus ride for those kids and they're unable to eat their lunches without having the ceiling drop into their lunch meals because it was sprayed on newspaper in order to provide for some insulation in the ceilings. When we're talking about Benewah County that's what we're talking about. There's been a tax shift and as you know on the educational front, that is putting more and more burden on those taxpayers who have property in those counties. They are paying for things that benefit the endowment lands. Those counties are paying for roads, they're paying for emergency services, and they're paying for things important to you to be able to manage these endowment lands. But unlike the Idaho Department of Lands and unlike the Idaho Fish and Game Department, they are not getting any reimbursement, any consideration on your 3.5% hurdle rate threshold. They are paying for that out of their taxpayer dollars from their property taxes, in order to ensure that your lands can be managed appropriately and have emergency services provided. I guess a final point I would like to make is there's lots of ways to manage risk. Cornell was established as a land grant and they chose to take all of their land grant acres outside of their state. It's all in Wisconsin and they've sold most of it off. Idaho has taken a unique approach and we've done a great job managing these properties. But I think we need to continue to remember the history, what the benefit was intended to be was for those citizens seeking an education, seeking to better their lives – we can't lose sight of that. We need to make sure we're not setting up winners and losers between these counties and the Governor knows I've tried to figure out a way that would fall within the constitution to do that. I haven't been very successful yet; I am very concerned about winners and losers in our counties and especially in these small counties where these properties are located and how to ensure that there's some way to take care of their ability to provide roads, emergency services, and their public schools. I stand for any questions.

Governor Little: Thank you, Representative. This is very abnormal of me to come to the aid of the Fish and Game, but the Fish and Game when they buy land they do pay...if they buy private land...different than what we can do on the Land Board is the Fish and Game if they purchase land they pay I don't know if it is commensurate with PILT, they pay back to the counties in their acquisitions which the state, obviously Commissioner Lampert reminds us that every time I see him, that we don't.

Representative Troy: Governor, I know that it is deeply appreciated by the counties; however, I had lunch with the Director of the Fish and Game last week and he said that they are paying $0.25 per acre to the endowment lands in order to have access and the endowment is paying $0.09 to provide services, police services on the endowment lands.

Governor Little: What's the nine cents?

Representative Troy: Nine cents is being reimbursed per acre to Fish and Game to provide...

Governor Little: ...oh, okay, okay. I am talking about the purchase of land. I am saying when Fish and Game purchases land they pay what was commensurate to what the property taxes were. You're talking about specifically about the policy of the Land Board to make sure that these lands are all open to sportsmen and so that's what that...

Representative Troy: Paying for services.

Governor Little: Yeah, well it's also our constitutional obligation to maximize that recreational opportunity that's out there, so A, it's a benefit to the people and B, it's part of our duty to maximize that...I would suggest...I don't know many landowners that would sell all of their recreation rights for $0.25, but that's for a different day, so.

Representative Troy: Thank you, Mr. Governor, but my point was that the roads and emergency services are not being reimbursed to the counties.

Governor Little: And I am keenly aware of that. Any questions. Thank you. That's everyone we had signed up to testify. Thank you all for being prompt and at this point in time, Mr. Littman or General Wasden, have you got any closing comments?

Attorney General Wasden: I am prepared to make a motion to adjourn.

Governor Little: Well, before you do that, that's a non-debatable motion...

Attorney General Wasden: That was my closing comment [laughter].

Governor Little: For the three of us, is there any further...and we don't have to come up with it right now. But is there any further information that the subcommittee might need before we go forward? We've got a meeting scheduled on December 18, 2019. That's our next meeting. If there's any further research that either Callan or the Endowment Fund Investment Board, or the Department or obviously our very gracious Attorney General's Office can do – we'll have that dialogue, I think it is the goal of the three of us that we may have a recommendation at the December 18. Anything else? Your motion is in order, General.

There being no further business, at 4:50 pm a motion was made by Attorney General Wasden that the subcommittee adjourn. Mr. Littman seconded the motion. The motion carried on a vote of 3-0.

Idaho State Board of Land Commissioners
Strategic Reinvestment Subcommittee

/s/ Brad Little

Brad Little
Chairman, Strategic Reinvestment Subcommittee and
President, State Board of Land Commissioners and
Governor of the State of Idaho

The above-listed final minutes were approved by the Land Board's Reinvestment Subcommittee at its March 12, 2020 meeting.

Asset Allocation:

- **How were land values developed? What valuation methods were used?**

Assumption: Given the heading "Asset Allocation" the questions above are related to valuation of the land assets at the time of the asset allocation study.

Timberland: The last valuation of timberland (2013) used the land expectation value method (LEV). LEV is based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow was discounted by a constant discount rate (4%).

Rangeland - The last valuation of rangeland (2013) also used the land expectation value method based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow was discounted by a constant discount rate (1.25%).

Farmland – Callan did not place a value on farmland which was deemed "de minimis holdings." The value is currently estimated using National Agriculture Statistics Service data for dry farmland in Idaho.

Commercial Real Estate – Callan did not place a value on commercial real estate. Callan did recommend annual valuations of the assets. With the ongoing disposition of the portfolio, the Department has valued the assets via appraisal using an income approach and/or comparable sales data.

Residential Real Estate – Callan did not place a value on residential real estate. These properties are valued via appraisal using comparable sales data.

End of FY 2019 estimated value by asset class:

Timberland: $1.22 billion

Rangeland: $61 million

Farmland: $25.3 million

Residential Real Estate: $54 million

Commercial Real Estate: $14.6 million

Callan Methodology (2014)
Forecasting returns, risks and diversification potential (correlations) for timber and grazing lands is challenging. Although historical and projected net income streams are available for both asset classes, the returns these income streams generate are dependent on the value of the underlying land. Land valuation under any circumstances involves art as well as science but art plays a particularly large role for Idaho timberland and grazing land due to both the size of the holding and State constitutional considerations. Appraisals based on comparable sales do not account for a number of factors including location, accessibility, improvements and the tremendous increase in supply that would result from a significant land sale (assuming that there were no restrictions on sales).

For the purposes of our asset allocation analysis it is useful to value the lands by discounting expected future cash flows for a variety of reasons. First, cash flows for these lands have been projected and using them makes the value of the land consistent with these forecasts. Second, the duration and frequency of the projections allows better estimation of standard deviations and correlations than appraisals which are conducted several years apart. Finally, stocks and bonds are generally valued based on discounted cash flows so there is consistency in the forecasting methods across asset classes.

The approach we used to value both the timberlands and the grazing lands in this analysis is the land expectation value method (LEV). LEV is based on a forecast sustainable real cash flow that will exist into perpetuity. This cash flow is discounted by a constant discount rate. The formula for LEV is:

LEV = Constant Real Annual Cash Flow / Real Annual Discount Rate

It is important to recognize what the land expectation value represents. The LEV is not an appraisal of the fair market value for all or any portion of the land. It does not attempt value individual tracts of land based on their specific characteristics. It does not take into account the revenues that might be generated from other potential uses. Unlike an appraisal, it is not intended to facilitate a transaction.

The LEV is a general estimate of the overall land value. It is constructed from the expected revenues reflecting current operations. Its purpose is to provide a necessary input to forecast returns for use in the asset allocation analysis and to determine the percentage weight of the lands in the existing asset allocation.

For timberland, the forecast cash flow is based on the volume of timber harvested, the price paid for the timber and non-timber income. For our purposes, we assume that the long-term sustainable yield (LTSY) for timber is 240 mmbf on an annual basis. We assume the stumpage price is $240 per mbf. Historically, non-timber income has run about 9% of total income. Direct program expense and managerial overhead assumptions are taken from the Endowment Lands Income Statement. Combining these values provides the estimated real dollar value of the LTSY.

The selection of the discount rate is somewhat subjective...For our purposes, we have chosen to discount the cash flows at a rate consistent with the expected return on institutionally-managed timber funds. Currently, institutional managers are forecasting 4% to 6% real returns. IDL manages its timber on the conservative end of the institutional range so a 4% real discount rate is appropriate. The selection of this discount rate is also consistent with the dividend and earnings yields of timber REITs. Using a 4% real discount rate translates into a real LEV for $1.17 billion for the timber assets. Dividing timberland holdings of 980,764 acres by the $1.17 LEV results in an estimated value of $1,174 per acre.

Grazing land (now rangeland) cash flows are forecast based on anticipated values for Animal Unit Months (AUMs) and the AUM grazing rate. We used the estimate of

285,000 AUMs from the March 2014 State Grazing Rate Review and kept it constant throughout the forecast period. We used the $6.77 / AUM Grazing Lease Rate for Calendar Year 2015. As was the case in the timberland forecasts, direct program expense and managerial overhead assumptions are from the Endowment Lands Income Statement discounted for inflation so that they are consistent with the real revenue forecasts.

Once again the selection of the discount rate is somewhat subjective...To estimate the discount rate we used the historical average of the 10-year bond equivalent yield for funding costs provided by the Farm Credit System Bank. The 10-year average for this rate is approximately 4% while the 5-year average is about 3%. We averaged these to get a nominal discount rate of 3.5%. Subtracting our inflation assumption of 2.25%, results in a forecast real discount rate of 1.25%. This real discount rate leads to a $61 million land expectation value for grazing land. This translates to $43/acre ($61 million value/1.4 million acres).

- **Was the inability to sell timberland and/or recreation income factored into the valuations?**

  The valuation for timberland was based on income from timber management (and an estimated 9% from other sources, based on historic data). Revenue from potential sale of timberland was not a consideration when establishing value. Additionally, appreciation is not included in the valuation due to the statutory prohibition on timberland sales. This aligns with the valuation of timberland for acquisition where a 3.5% net real hurdle rate is required for consideration.

  Recreation income, such as from commercial recreation use, would be part of the assumed 9% from other sources.

Lands Income:

- **Rate of return on all lands other than commercial and residential for each of the last 10 years.**

  Beginning in FY 2016, the Department has worked with Callan to calculate returns for the endowment land asset classes. FY 19 returns will be calculated by about November 1, 2019. The returns from the report produced at FY 2018 year-end are in the table immediately below. Please note that the returns shown in this table include appreciation for Farmland, Commercial Real Estate, and Residential Real Estate. Commercial and Residential have shown significant appreciation due to market-related increases over the past few years, which skews returns in their favor because we have not accounted for appreciation of timberland, for example.

Returns for Periods Ended June 30, 2018

	FY 18	Last 2 Years	Last 3 Years
Farmland	6.1%	4.01%	5.42%
Farmland (net)	5.23%	3.25%	4.66%
Commercial RE	30.91%	29.77%	22.03%
Commercial RE (net)	22.32%	23.40%	16.49%
Rangeland	4.95%	4.96%	4.97%
Rangeland (net)	2.19%	1.90%	1.94%
Residential RE	37.20%	20.77%	14.88%
Residential RE (net)	34.68%	18.88%	13.12%
Timberland	5.75%	5.70%	5.63%
Timberland (net)	3.75%	3.63%	3.66%
Total Land – no land bank	7.84%	6.90%	6.41%
Total Land – no land bank (net)	5.74%	4.77%	4.37%
Total Land Portfolio (Gross)	7.43%	6.60%	6.18%
Total Land Portfolio (Net Nominal)	5.48%	4.58%	4.23%
Total Land Portfolio (Net Real Return)	2.55%	2.29%	2.36%
Consumer Price Index (All Urban Cons)	2.87%	2.25%	1.83%

The next chart shows returns as income, appreciation, and total. This information provides a clearer picture regarding the income returns from the endowment land asset classes.

Income, Appreciation, and Total Returns for Periods Ended June 30, 2018

	FY 18 Income (%)	FY 18 Appreciation (%)	FY 18 Total (%)	Last 3 Yrs Income (%)	Last 3 Yrs Appreciation (%)	Last 3 Yrs Total (%)
Farmland (Net)	0.9	4.28	5.23	1.2	3.42	4.66
Commercial RE (Net)	2.25	20.78	23.32	3.49	12.67	16.49
Rangeland (Net)	2.19	**0**	2.19	1.94	**0**	1.94
Residential RE (Net)	1.38	32.85	34.68	2.41	10.48	13.12
Timberland (Net)	3.75	**0**	3.75	3.66	**0**	3.66
Total Land – No Land Bank (Net)	3.47	2.23	5.74	3.43	0.91	4.37
Total Land Portfolio (Net Nominal)	3.34	2.09	5.48	3.35	0.86	4.23

- **Same for timber if it can be calculated.**
  Note that timber returns are shown in the table above along with the other asset classes.

- **Lost land income from divestiture.**

  It is important to clearly state that beginning with FY 16 the Department began tracking financial performance, income, and expenses by asset class rather than by activity. This provides a clearer picture regarding financial performance of each asset class.

  Gross income from Residential Real Estate reached its maximum of $7.225 million in FY 15. In FY 19, gross income had decreased to $1.978 million, a total decrease to date of $5.274 million. Residential Real Estate gross income is forecast to decline to $1.042 million in FY 26 for an expected additional decrease of $0.936 million. Ongoing future revenues are dependent upon the future of cottage site leasing, an issue that has not been presented to or addressed by the Land Board.

  Gross income from Commercial Real Estate reached its maximum of $5.244 million in FY 14. In FY 19, gross income had decreased to $1.015 million, a decrease to date of $4.229 million. Commercial Real Estate gross income is forecast to decline to $0.964 million in FY 20 for an expected additional decrease of $0.051 million. From that time forward the forecast shows relative stability and other commercial leasing opportunities may improve the forecast over time.

Combined, gross income from Commercial Real Estate and Residential Real Estate has declined from a peak of $11.563 million in FY 15 to $2.994 million in FY 19, for a total decrease to date of $8.569 million. Please note that gross revenue for each asset class reached its peak in a different fiscal year, thus there is a difference in the total decline depending on how it is viewed.

Net income for the two asset classes combined has declined from a peak of $8.0 million in FY 14 to $1.6 million in FY 18 for a total decline of $6.4 million.

- **Anticipated increase in income from the FAMP.**

  The previous Forest Asset Management Plan (FAMP) established an annual sale volume of 247 million board feet (mmbf). The FAMP revision has established an annual sale volume of 328 mmbf which is a 32.8% increase (approximately). Considering that as simply a statewide increase, without specific area by area analysis, gross income would be expected to increase by approximately the same ratio.

  Using five year average timberland receipts of $65.89 million, the new annual sale volume would be expected to increase gross income by about $21.6 million annually. The five year average net income ratio for timberland is 66.6%, resulting in average net income of $43.88 million. The Department has emphasized financial efficiency in the FAMP revision. As a result, of the increased gross income, it is expected that over 90% of the gross income increase from the FAMP revision will be realized as net income (based on five year average stumpage prices). Recent land acquisitions are responsible for about 10 mmbf of the increase in the annual sale volume.

  Under a more pessimistic ("worst case") scenario, if timber prices were to decline over an extended period by 30% (arbitrary assumption), gross income would decline to around $46.1 million annually. In that case, the FAMP increase would result in about $15 million in additional annual gross income.

Anticipated costs and overhead to administer the cottage site program going forward.

Administration of cottage site leases requires staff time from both bureau and area office staff. The future scale of the program is yet to be determined. The Department expects to present information to the Land Board in the future, including a recommendation regarding continued cottage site leasing.

After completion of the voluntary auction for ownership (VAFO) process, the Department's revenue forecast predicts Residential Real Estate (cottage site leasing) will generate about $1.0 million in gross income annually. Ongoing direct expenses and overhead are expected to be about $0.3 million annually, resulting in net income of about $0.7 million. The numbers are subject to change based on how many lessees participate in the VAFO process.

IDL efforts to identify and acquire farmland and timberland.

The primary objective for endowment land assets is to generate maximum long-term returns at prudent levels of risk using traditional land grant asset types. The acquisition of endowment assets aligns with the guidance provided and approved by the Land Board. With the recognition of a reinvestment opportunity, the Land Board approved Strategic Plans to provide guidelines for acquisitions in timberland and farmland with specific requirements to meet or exceed the hurdle rate for each asset type.

When timberland and/or farmland has been identified for acquisition, the asset must possess legal, transferable ownership; pose no significant risk; and meet the minimum return threshold. The overarching criteria that the land must meet is the asset class minimum return threshold for investment decisions. Again, timberland has a minimum return of 3.5% and farmland has a minimum return of 4.5%. In addition, the following criteria and considerations apply to all assets along with each asset being subjected to its own criteria:

- Whether the investment is in the approved asset class
- Income or potential income achieves or exceeds the target hurdle rate for the asset
- Whether the return revenue profile is sufficient relative to the risk taken
- Long-term financial return and risk to the endowment
- Low to moderate levels of risk, including consideration of the following:
  - Supply and demand of the property being considered (e.g., crop, location to market, uniqueness, value in the market place)
  - IDL's expertise in managing a particular asset type or the cost of outsourcing for the expertise needed
  - Market stability of the market sector to be served
  - Constraints or management issues related to environmental concerns
- Legal access to the asset
- No known environmental issues
- Clear and marketable title
- Asset management costs commensurate to industry standards
- Compliance with state and federal environmental requirements

To source potential acquisitions, the Department has used outreach including the Department website, direct mail, posted flyers, and communication with real estate professionals, other state agencies, and NGO's. The Department has a Land Board approved timberland acquisition advisor under contract (Northwest Management/Northwest Rural Properties) to assist with acquisition. The Department has also used the Land Board's approved land advisors for third party expert analysis of potential acquisitions.

The Department has established evaluation criteria for potential land acquisitions. The criteria are a means of screening transactions so that staff time and resources can be used on the most promising potential acquisitions. The criteria include:

- Strong market areas and proximity to mill(s)
- No known political or regulatory issues
- Expected to exceed the required financial hurdle rate
- No/minimal T&E species concerns

- Manageable forest health, no known regeneration issues
- Operability – prefer all season, limited to one season is a concern
- No known environmental or boundary issues
- Minimal Highest and Best Use (HBU) values (not in the path of immediate development)
- Desirable aspect/elevation range
- Lawful permanent access
- Proximity to good transportation system
- Sufficient size
- Proximity to endowment land

Potential acquisitions that pass the initial screening are analyzed rigorously, including financial analysis, to determine suitability for purchase by the endowments. All timberland acquisitions are analyzed by two independent third party experts using different modeling techniques to confirm the results.

The Department has evaluated several potential farmland acquisitions. To date, the Department has not been able to pursue farmland acquisition because transaction level analysis did not show that the acquisition would exceed the required 4.5% net real return on investment without including the disposition value in 10-20 years.

Packers 1: hurdle rate analysis (pre-sale) and post-sale assessment.

The acquisition was modeled and analyzed by two separate third-party experts to ensure that the potential acquisition would meet or exceed the established 3.5% net real hurdle rate for timberland. The two experts independently achieved very similar results which, indicated that the returns will comfortably exceed the hurdle rate.

The lands have been in endowment ownership for less than one year. Department staff are assessing the lands and planning/implementing projects such as planting or timber stand improvement as needed. In terms of actual measured returns, there is not yet data to analyze. However, the Department does know that the preliminary impact on the annual sale volume from the FAMP was about 10 mmbf, which will result in about $2.5 – 3.0 million in annual gross income.

Fire costs:

- **Annual cost to the general fund for fire suppression for each of the last 10 years.**

Fiscal Year	General Fund Expenditures (millions)
2019	$27.3
2018	$37.9
2017	$24.4
2016	$37.4
2015	$18.7
2014	$24.1
2013	$15.1
Total	$185.7
Average	$26.5

Data is readily available back to FY 13. Additional years would require additional time to compile the data.

NOTE: The amounts above are the fiscal year end total cash disbursements for expenses charged to the deficiency fund. These numbers do not represent or reflect the cost of firefighting in that particular year and will not align with the annual "Fire Season Cost" that we document in our annual reports for several reasons:

- When IDL fire staff members (and IDL equipment) are mobilized to fight fire, they will be paid from the deficiency fund regardless of who will ultimately be responsible for paying for that fire. Therefore, if IDL staff is fighting fire on USFS protection, we pay for some of the costs upfront and get reimbursed later.

- Similarly, when non-IDL staff and resources are used to suppress fire on land that is in IDL's protection boundaries, we will eventually be billed for those costs.

- In any given year, the expenses represented by the figures above may include: (1.) expenses incurred and owed for that year, (2.) expenses that were incurred but will be reimbursed later, and (3.) expenses that are owed but are being paid for previous years' fires.

- **Amount of fire costs attributable to IDL-managed timberland for each of the last 10 years, including FPA assessments and share of fire costs.**

The endowments pay for fire suppression on timberland in the same way that private landowners pay – an annual assessment of $0.60 per acre per year. Endowment timberland ownership is just over 1 million acres, resulting in an annual payment of over $600,000.

Landowners who pay the annual assessment do not pay suppression expenses unless the fire cause is determined to be negligence on their part. In a few instances, the endowments have been billed for fire suppression expenses when an investigation found negligence.

Determining the share of fire expenses applicable to endowment lands is a significant challenge with existing data. Fires may start on adjacent lands and burn onto endowment lands, or vice-versa. The Department protects more than 6 million acres despite endowment ownership of only about 1 million acres of timberland. The Department protects other ownership and in some instances other entities protect endowment lands. Fire suppression is a cooperative effort by necessity. Changes to cooperative fire protection funding would likely necessitate changes to the structure and priorities of fire protection organizations.

The endowments pay FPA assessments for their timberland ownership at the rate of $0.13 per acre, the same as private timberland owners. This assessment is for administration of the Forest Practices Act and is not related to fire suppression.

Impact on competition at IDL timber sales (i.e. mills, buyers, bidders) if IDL increases its share of the total non-federal timberland in Idaho.

The endowment timber program provides a consistent source of timber which helps support the forest products industry in Idaho. Endowment timberland is only 2.6% of the timberland in Idaho but produces about 25% of the timber for harvest. During the significant economic downturn around 2010 the Department continued to offer timber for harvest when other landowners did not. This was an important factor in retaining forest products industry infrastructure in Idaho and therefore has had long term benefits for the endowments. Endowment timber sales provide certainty and stability of supply that is important to the forest products industry.

Representatives of the forest products industry have informally expressed their support for the increased annual sale volume under the revised FAMP. Acquisition of additional lands would increase the annual sale volume further. Idaho still imports timber from neighboring states to supply existing mills. Additional timberland investment would give the endowments more available timber in closer proximity to existing mills, likely placing the endowments at an advantage over timber from other states.

The endowments would acquire lands that are already productive timberland. There is no increase in the timberland acreage in the state, but IDL management would provide stability, productivity, and certainty that could be lacking under a different potential owner.

Fully successful reinvestment into timberland would increase endowment timberland ownership by 10-15% with a corresponding increase in sustained yield of forest products. There are many factors that influence mills, buyers, and bidders for endowment timber sales. It seems unlikely that a 10-15% increase in annual sale volume due to acquisition of timberland would outweigh national and global economic factors.