State of Idaho – Governance of Land Trust Assets

Brief History of Endowment Reform

In 1996, Governor Batt appointed the "Governor's Committee on Endowment Fund Investment Reform." The Committee report contained the following recommendations:

- 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.
- 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 is poor years; and (2) to provide a mechanism for expressly addressing the division of benefits between present and future generations.
- Investment policies should be changed to eliminate artificial restrictions which have led to both underperformance and to a portfolio structure that exposes the endowment to unnecessary risk.
- 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 those assets, and develop a means for implementing those plans.
- There was recognition of the need to examine the land endowment to ensure assets were managed in a way that maximized the long-term return to the endowment.
- 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.
- Develop procedures and report for identifying, monitoring and addressing the performance of the assets of the Trust.

In 1998., constitutional and statutory amendments were enacted to implement the recommendations from the Governor's Committee on Endowment Fund Reform.

In 1999, there were recommendations that the Land Board do the following:

- Establish a distribution and spending policy for the endowments.
- Set forth its investment policies for the investment and use of the assets and income from the trust.
- 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.

In 2001, 2005, 2007, 2009, 2010, 2011 the Committee issued reports and made refinements to policies.

In 2014, Robert Maynard delivered the Endowment Fund Reform Progress Report. He recommended:

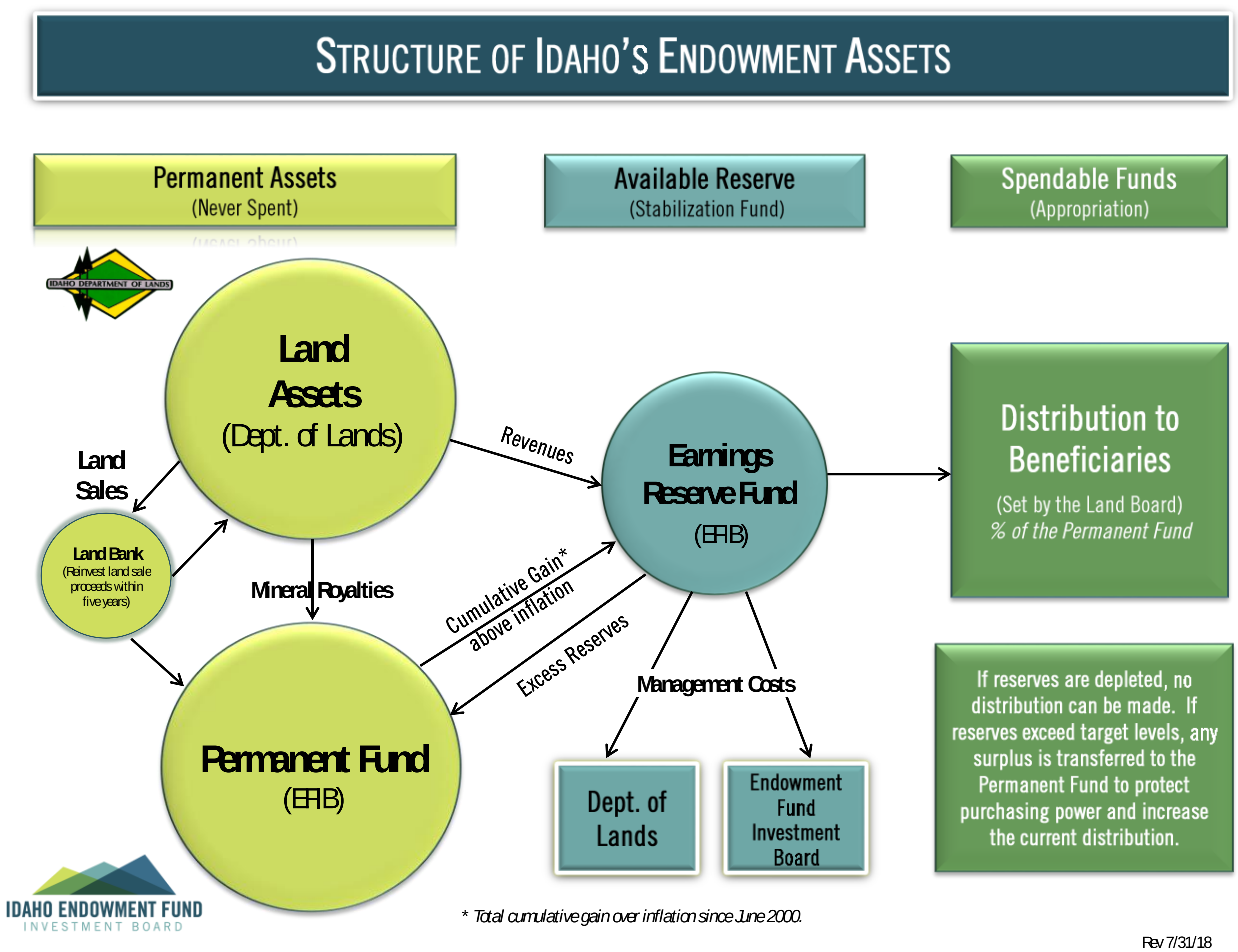
- Independent verification of land investment decisions.
- Consolidated trust asset report reviewed or produced by a consultant or other independent investment organization.

- Involve the Investment Board in any recommendation for the use of Land Bank proceeds for potential acquisitions.
- Develop and independent annual valuation of the real assets of the Land Trust.

In 2014, Callan issued an Asset Allocation and Governance Review Report.

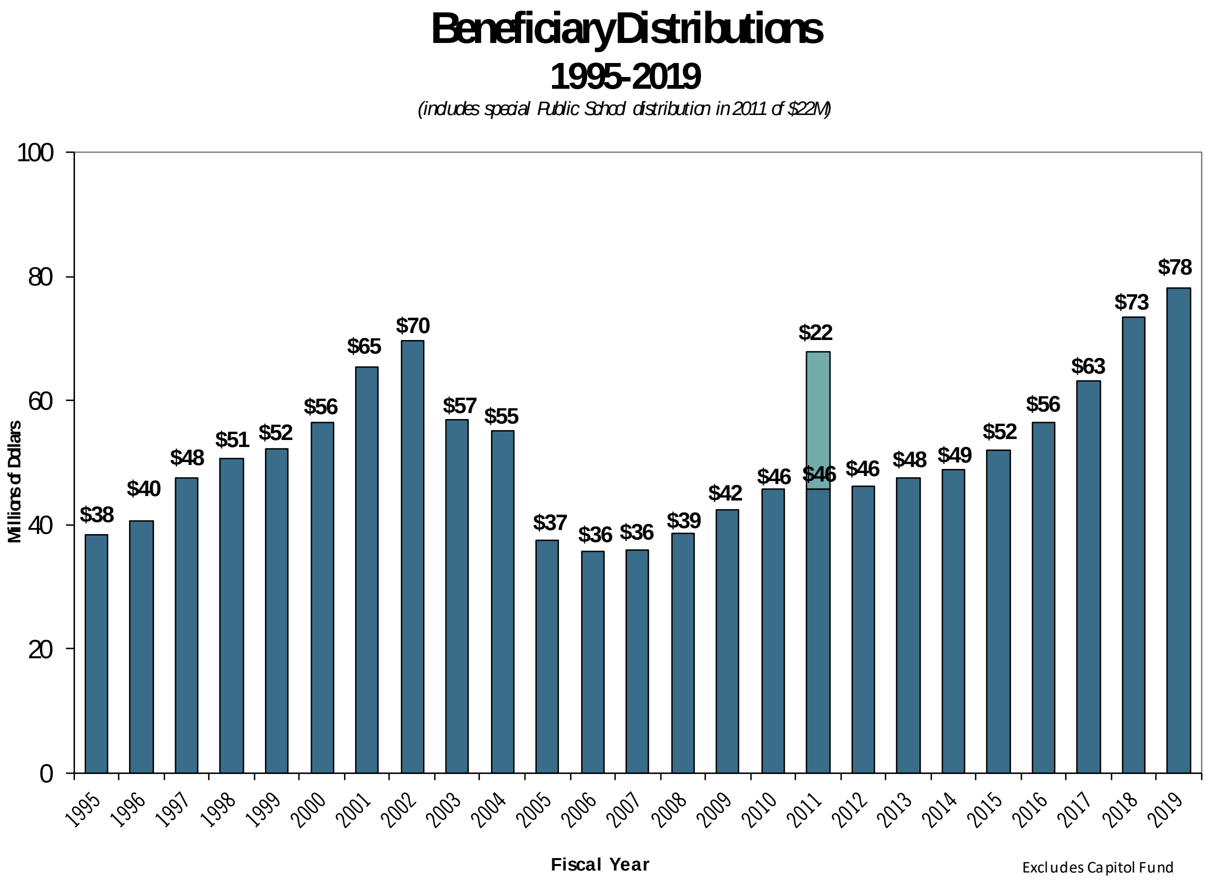
Structure of the Endowment Fund:

- The endowment for each beneficiary includes both a permanent fund and earnings reserve fund. Each fund is invested with the same strategy. The permanent and earnings reserve funds are set-up as separate accounts with our investment custodian.
- The permanent fund grows through land sales, mineral royalties, investment gains equivalent to annual inflation and annual transfers from the earnings reserve fund if the earnings reserve fund balances exceed target reserve levels at fiscal year-end. Our policy is to maintain target earnings reserves equivalent to seven years of annual beneficiary distributions.
- The earnings reserve fund grows through revenue generated by endowment land (timber sales, grazing royalties, land leases, etc.) and annual investment gains in excess of inflation on the permanent funds. The earnings reserve fund declines due to beneficiary distributions, management costs related to investments, administrative costs related to the management of endowment lands and possible investment losses.



Our Goals:

- Make consistent and sustainable annual distributions to beneficiaries.
- Maintain earnings reserves sufficient to protect beneficiary distributions from temporary income shortfalls and investment volatility.
- Grow the permanent corpus at a rate equal to or greater than inflation and population growth.



Beneficiary Distributions / Investment Strategy:

- Our policy is to distribute annually 5% of the three-year average of each beneficiary's permanent fund balance.
- In order to support the beneficiary distribution policy, we need an investment strategy that generates an average annual return of close to 7% (5% beneficiary distribution plus ~2% inflationary growth of the permanent fund). A portion of the beneficiary distributions are funded by revenue generated from endowment land, so our average annual investment return needs to be closer to 6%.
- What asset allocation will provide the necessary long-term investment return at a prudent level of risk? Our asset allocation is 66% equities, 26% fixed income and 8% real estate. Based on

our consultant's capital market assumptions, this allocation should provide an average annual return of approximately 6.3%.

Annualized (gross of fees, ending June 30, 2018)					
	FY 2018	3 Years	5 Years	7 Years	10 Years
Total Fund	9.9%	7.4%	8.7%	8.3%	7.6%
Benchmark (38% Russell 3000, 19% ACWI ex-US, 9% ACWI, 8% ODCE, 26% BBC Aggregate)	*8.5%*	*7.3%*	*8.5%*	*8.0%*	*7.0%*
Total Equity	13.9%	9.6%	11.1%	10.4%	8.5%
Domestic Equity	17.2%	11.8%	13.5%	13.3%	11.1%
Large Cap.	16.7%	12.0%	13.9%	13.7%	11.2%
Mid Cap.	16.4%	10.3%	12.0%	11.7%	9.5%
Small Cap.	21.5%	12.8%	13.8%	13.1%	13.6%
International Equity	9.2%	5.7%	6.8%	4.1%	2.7%
Global Equity	8.8%	6.1%	7.0%	6.5%	----
MSCI ACWI Index	*11.3%*	*8.8%*	*10.0%*	*8.5%*	*6.4%*
Real Estate (net of fees)	7.2%				
NCREIF ODCE Index	*8.1%*				
Fixed Income	0.0%	1.8%	2.2%	2.5%	3.7%
Benchmark (85% BBC U.S. Aggregate, 15% BBC U.S. TIPS)	*0.0%*	*1.8%*	*2.2%*	*2.5%*	*3.6%*

Financing for Public Schools:

- On July 1, 2002, the State of Idaho's Credit Enhancement Program for school district bond financing was established. This program, in accordance with Idaho Code Section 57-728 and in conjunction with Idaho Code Chapter 53, Title 33, requires the Public School Endowment Fund to purchase up to $300 million in notes of the State that may be issued to avoid default on school district bonds. This credit enhancement allows eligible voter-approved school bonds to be issued with AAA ratings, which is above the State's AA+ rating. The enhanced credit rating results in lower borrowing costs for Idaho school districts.
- This program allows us to help public schools reduce borrowing costs and preserve an independent investment strategy that maximizes returns for our beneficiaries.