Board Of Natural Resources Chair Report

Trust Lands
Performance Assessment
Update and Key Findings

December 1, 2020
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and
Kristen Ohlson-Kiehn, Projects and Planning Assistant Division Manager
Agenda

• Background
• Analyses and Findings
• Challenges and Opportunities
• Initial Recommendations
• Next Steps
Department of Natural Resources

Trust Manager

~2.9 million acres of State Trust Lands in Washington
As manager of state trust lands, DNR has legal fiduciary responsibilities to:

- Generate revenue and other benefits for each trust, in perpetuity
- Preserve the corpus of the trust
- Exercise reasonable care and skill
- Act prudently to reduce the risk of loss for the trusts
- Maintain undivided loyalty to beneficiaries
- Act impartially with respect to current and future beneficiaries
## Major Trusts

### Federally Granted

<table>
<thead>
<tr>
<th>Trust</th>
<th>Acres</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common School Trust</td>
<td>1,787,047</td>
<td>Construction of K-12 Schools</td>
</tr>
<tr>
<td>Capital Building Trust</td>
<td>109,510</td>
<td>State government office buildings</td>
</tr>
<tr>
<td>University Trust</td>
<td>89,051</td>
<td>University of Washington</td>
</tr>
<tr>
<td>Scientific School Trust</td>
<td>84,177</td>
<td>Washington State University</td>
</tr>
<tr>
<td>Charitable, Educational, Penal and Reformatory Institutions (CEP&amp;RI) Trust</td>
<td>71,624</td>
<td>Institutions such as Department of Social and Health Services, Department of Corrections, and University of Washington</td>
</tr>
<tr>
<td>Agricultural School Trust</td>
<td>71,148</td>
<td>Washington State University</td>
</tr>
<tr>
<td>Normal School Trust</td>
<td>66,786</td>
<td>Eastern Washington University, Central Washington University, Western Washington University, The Evergreen State College</td>
</tr>
</tbody>
</table>

### State Forest

<table>
<thead>
<tr>
<th>Trust</th>
<th>Acres</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Forest Transfer Lands</td>
<td>538,015</td>
<td>Acquired by 21 counties in the 1920s &amp; 1930s through tax foreclosures. Transferred to the state and placed in trust status</td>
</tr>
<tr>
<td>State Forest Purchase Lands</td>
<td>79,384</td>
<td>Purchased by the state, or acquired as a gift</td>
</tr>
</tbody>
</table>

~2.9 Million Acres of State Trust Lands
Trust Land Acres in each Asset Class

- **Timber**: ~2.06 million acres
- **Grazing**: ~750,000 acres
- **Other Resources**: ~530,000 acres
- **Agriculture**: ~238,000 acres
- **Mining**: ~5,900 acres
- **Commercial Real Estate**: ~1,000 acres
- **Communications**: ~100 acres

*Other Resources: Wind Energy, Special Uses, Special Forest Products, Rights-of-Way*

*Acres may overlap into more than one asset class.*
The Commissioner's Priorities

Modernize state trust lands

Reform and enhance revenue programs with promise for immediate growth (e.g.):

- *Renewable energy*
- *Commercial real estate*

Optimize near- and long-term performance for *current and future generations*
DNR partnered with the Legislature

(Proviso: ESSB 6095, Section 7105 in 2018)

Shared funding for a comprehensive assessment:

1. Asset valuation of trust lands
2. Estimate fair market value
3. Gross & net income by asset class
4. Value ecosystem services & recreation
5. Recommendations for improvement

Asset Classes

- Timber
- Agriculture
- Grazing
- Commercial Real Estate
- Mining
- Communication Sites
- Other Resources
  Includes wind energy, special forest products, rights-of-way, and special uses.
Trust Lands Assessment Products

1. Trust Portfolio Valuation
   An assessment of the asset classes

2. Non-Market Environmental Benefits & Values Assessment
   Valuation for ecosystem services, recreation, and carbon storage

3. DNR’s Legislative Report
   A summary of analyses, findings, challenges, opportunities and initial recommendations
Beneficiaries are the audience

Based on FY 2018 revenue

“Trust Value” identified and defined

Revenue is the preferred metric for performance
## Summary of 2018 Asset Class Income and Trust Value

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Gross Income</th>
<th>Net Operating Income</th>
<th>Trust Value</th>
<th>Net Operating Income/Trust Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timber</td>
<td>$171.7 million</td>
<td>$123.6 million</td>
<td>$2,136 million</td>
<td>5.79%</td>
</tr>
<tr>
<td>Agricultural Resources</td>
<td>$23.5 million</td>
<td>$16.7 million</td>
<td>$238.3 million</td>
<td>7.00%</td>
</tr>
<tr>
<td>Commercial Real Estate</td>
<td>$10.3 million</td>
<td>$7.2 million</td>
<td>$95.7 million</td>
<td>7.53%</td>
</tr>
<tr>
<td>Communication Resources</td>
<td>$4.8 million</td>
<td>$3.4 million</td>
<td>$41.2 million</td>
<td>8.16%</td>
</tr>
<tr>
<td>Other Resources</td>
<td>$3.2 million</td>
<td>$2.2 million</td>
<td>$20.3 million</td>
<td>11.03%</td>
</tr>
<tr>
<td>Mining Resources</td>
<td>$1.9 million</td>
<td>$1.3 million</td>
<td>$16.6 million</td>
<td>7.99%</td>
</tr>
<tr>
<td>Grazing Resources</td>
<td>$1 million</td>
<td>$0.7 million</td>
<td>$10.5 million</td>
<td>7.00%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$216.4 million</strong></td>
<td><strong>$155.1 million</strong></td>
<td><strong>$2,558.6 million</strong></td>
<td><strong>6.07%</strong></td>
</tr>
</tbody>
</table>

*See Deloitte’s report*
Deloitte Transactions and Business Analytics hired Earth Economics to fulfill a portion of the 2018 proviso direction.

“Estimates the value of ecosystem services and recreational benefits for asset classes that produce these benefits.”
## Annual Ecosystem Service Value and Social Cost of Carbon

### Averaged by Land Cover and Asset Class (2018)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Asset Acres</th>
<th>Annual Ecosystem Services Value</th>
<th>Social Cost of Carbon (One-Time Cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forested</td>
<td>2,170,070</td>
<td>$1,231.64 million</td>
<td>$16.56 billion</td>
</tr>
<tr>
<td>Cultivated</td>
<td>301,807</td>
<td>$84.55 million</td>
<td>$0.74 billion</td>
</tr>
<tr>
<td>Grazing</td>
<td>366,240</td>
<td>$46.20 million</td>
<td>$1.00 billion</td>
</tr>
<tr>
<td>Other</td>
<td>124,969</td>
<td>$37.68 million</td>
<td>$0.44 billion</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,963,086</strong></td>
<td><strong>$1,400.07 million</strong></td>
<td><strong>$18.74 billion</strong></td>
</tr>
</tbody>
</table>

### Economic Value of Outdoor Recreation on State Trust Lands (2018)

<table>
<thead>
<tr>
<th>Activities</th>
<th>Annual Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Recreational Activities</td>
<td>$990 million</td>
</tr>
</tbody>
</table>
DNR Analysis

Options to:

- Improve rates of return
- Increased revenue reliability & possible enhancement
- Present and explain factors that either:

Define | Constrict | Define & Constrict

the department's management practices and revenue production

Factors considered include:
- Statutory
- Constitutional
- Operational
- Social
## DNR Analysis

### Differences in Net Revenue Between 1995 and 2018

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Timber</td>
<td>$139.83 million</td>
<td>$224.34 million</td>
<td>$123.62 million</td>
<td>-45%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>$3.9 million</td>
<td>$6.3 million</td>
<td>$16.68 million</td>
<td>166%</td>
</tr>
<tr>
<td>Commercial Real Estate</td>
<td>$2.3 million</td>
<td>$3.6 million</td>
<td>$7.2 million</td>
<td>99%</td>
</tr>
<tr>
<td>Grazing</td>
<td>$386 thousand</td>
<td>$619 thousand</td>
<td>$735 thousand</td>
<td>19%</td>
</tr>
<tr>
<td>Communication Resources</td>
<td>$1.1 million</td>
<td>$1.8 million</td>
<td>$3.4 million</td>
<td>90%</td>
</tr>
<tr>
<td>Mining</td>
<td>$1.1 million</td>
<td>$1.7 million</td>
<td>$1.3 million</td>
<td>-23%</td>
</tr>
<tr>
<td>Other Resources</td>
<td>n/a</td>
<td>n/a</td>
<td>$2.2 million</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>$148.56 million</strong></td>
<td><strong>$238.36 million</strong></td>
<td><strong>$155.18 million</strong></td>
<td><strong>-35%</strong></td>
</tr>
</tbody>
</table>

**Challenge:** Decrease in Revenue

All numbers are rounded.
DNR Analysis - Timber Revenue

Stumpage prices for state trust lands

Sold and removed volume from state trust lands

WHY?
1. Decline in stumpage price
2. Decline in operating base
Total Net Revenue Generated from State Trust Lands FY 1995-2018

Challenge: Revenue reliability
Opportunities

Update Business Model
Increase Access to Capital
Greater Ability to Transact Lands
Expand Responses to Societal Expectations
Going Forward

Need
DNR needs to increase the amount and reliability of the revenue it generates through the assets it manages on state trust lands into perpetuity.

Purpose
DNR will modernize state trust land management:
1) Legislative proposals to increase amount and reliability of revenue
2) Changes to Board of Natural Resources policies to improve trust asset performance
3) Updated operational business practices to increase efficiency and effectiveness
Going Forward

Objectives

1. Increase amount and reliability of revenue
2. Sustain the natural resource lands, while seeking opportunities to diversify
3. Maintain or enhance the social, environmental, and cultural benefits of state trust lands consistent with revenue generating purposes of the land
4. Feasible solutions
Update Business Model

Incorporate for-profit-enterprise business practices

New operational funding models

Single investment manager

Reliability fund for beneficiaries
Increase Access to Capital

- Borrowing authority
- Smoothing revenue through loans
- Monetize ecosystem services
- Retaining earnings for capital investment
Greater Ability to Transact Lands

Public auction requirements

Parcel size limitations on federally granted lands

Plat requirements prior to sale

Land bank acreage limitations

Sale of State Forest Land

Updating asset management policies, specifically for transition lands
Expand Responses to Societal Expectations

Funding sources for recreation

Community Forest Trust

Trust Land Transfer

Trust Land Replacement Program
Outreach Strategy – Building Solutions

- 2021 Legislative Session: Initial proposals
- 2021 April → December: DNR works with legislature, beneficiaries, and stakeholders to jointly explore and build consensus solutions
- 2022 Legislative Session: Proposals for trust modernization
Questions?