

The State Land Board met in regular session on April 13, 2004 in the Land Board Room of the State Lands Building, 775 Summer Street NE, Salem, Oregon 97301-1279.

Present were:

Theodore R. Kulongoski	Governor
Bill Bradbury	Secretary of State
Randall Edwards	State Treasurer

<u>Assistants</u>	<u>Staff</u>	<u>Dept. of Justice</u>
Jim Brown	Ann Hanus	Lore Bensel
Jesse Cornett	John Lilly	
Inga Deckert	Steve Purchase	
	Jeannette Holman	
	Gail Lowry	

The Governor called the meeting to order at 9:03 am. The topics discussed and the results of those discussions are listed as follows. Further details of the discussions may be obtained in the written transcript of the meeting available at the Department of State Lands, 775 Summer Street NE, Suite 100, Salem, Oregon 97301-1279, (phone: (503) 378-3805, ext. 224).

Director Hanus reviewed the following six items on the Consent Agenda:

- 1. a. Request by Columbia County for authority to change a limited-term easement to a permanent easement for the Westport Slough Bridge across state-owned submerged and submersible lands of the Westport Slough located in Columbia County.**
- b. Request by the Oregon Department of Environmental Quality to acquire a permanent easement over and upon state-owned submerged and submersible lands located in the Willamette River, Multnomah County to encapsulate 22 acres and allow the clean up of the McCormick Baxter site and adjacent lands to proceed.**

- c. Request for authorization to submit 10 legislative concepts to the Department of Administrative Services.**
- d. Request to approve the adoption of amendments to the administrative rules governing Freshwater Wetland Mitigation Banking. These rules are a result of House Bill 2899 (2003 Legislative Session).**
- e. Request for authority to initiate rulemaking to amend the rules governing the use of state-owned property.**
- f. Request for approval of February 10, 2004 State Land Board minutes.**

Secretary of State Bradbury moved the Consent Agenda be approved. Treasurer Edwards seconded the motion and the approval was unanimous.

Informational Items

2. Annual briefing on Common School Fund Investment Policy and Performance.

Mike Mueller, Assistant Director of Investments at the Oregon State Treasury, reviewed the Oregon Investment Council's investment policy for the Common School Fund, explained how the fund is invested and discussed the great performance of the Common School Fund over the previous year.

He suggested the Board may want to consider revising its distribution policy based on a rolling three year average, then distributing four or five percent per year, based on that three year average.

Treasurer Edwards said the PERS Fund uses this indexing and this provides a bit more return, though there is more risk. He recommended considering the idea for the Common School Fund.

Secretary of State Bradbury asked about risk involved in this proposal. Mueller explained that the tracking error would be no more than two percent, up or down, which he said is within the comfort range.

Governor Kulongoski asked whether there is a different investment philosophy because of the nature of the Common School Fund opposed to other funds. Mueller replied that there is a difference. For the pension fund, he said the liability is in meeting the eight percent actuarial rate of return. For the Common School Fund, he said you must balance the need for growing the corpus of the fund and distributions to schools.

3. Annual review of Common School Fund Distribution Policy.

Jeannette Holman, Assistant Director for Finance and Administration, announced that the distribution for this biennium would be almost double what was previously anticipated (\$26.4 million more) if the current distribution policy is followed.

Holman commented that the distributions have fluctuated a lot over the recent years, as Mueller had indicated, showing that a three or five year running average could be helpful in leveling them out.

Hanus added that a change in the distribution policy would require that there be enough earnings to be able to meet that distribution policy. She said there is a problem with trying to smooth the distributions, especially if there are major swings in the stock market.

Lore Bensel, Assistant Attorney General, said there is a Constitutional provision that requires distributions be made out of earnings. Hanus added that this is a constraint other endowments do not have.

Holman said we face this issue even with the current distribution policy. She said some investments might need to be sold to cover the increased distribution.

Holman explained how the current distribution policy works. She said it ranges from the minimum distribution of two percent up to the maximum distribution of five percent.

She said due to the economy, the agency was distributing the minimum amount to schools at a time when they needed the money the most.

Holman said the agency is exploring ways to be able to set aside a portion of the earnings in a good year to supplement on years when the market is down, to make a more even distribution to schools. She said when the 2002 Legislature took an extra \$17.7 million in additional distribution, it essentially depleted the corpus of the fund of its 50-year accumulation of statutory monies, which are the funds that are more flexible than the constitutional portion of the fund. These funds had previously provided a cushion to draw on if it was needed to make the distribution. She said that is no longer an option.

The other current issue Holman reported on is as the value of the fund increases there must be enough money in investment earnings to make the distribution. Hanus noted this is more of a challenge, especially where stocks are rising rapidly, but bonds have relatively low interest rates, so the cash generated from bonds and dividends is low.

Governor Kulongoski commented on the lack of a mechanism in the current policy to set aside money in good years to supplement the distribution. He asked whether that had been a policy choice of the Board, or whether it is a constitutional issue. Holman replied that the Department of Justice advises that once these monies are captured in the corpus of the Fund, if they are not distributed that year, they become part of the corpus. Holman said the agency should work closely with the Department of Justice to determine whether there might be a way to develop a reserve fund.

Bensel said there is a proposal to take the funds that would be left at the end of each biennium from the account out of which the expenses are paid and transfer them to a new account, like a rainy day fund. Normally these are transferred to the corpus of the Fund. She said the Board may need to consider a statutory change in order to do this. She recommended the Board request a written statement from the Department of Justice on this issue, if they decide to go forward with it.

Hanus commented that by setting monies aside in this fund, there would be less to distribute now but would allow distributions to smooth out later. She said one concern was whether this fund might

be used as a reserve, or if there would be pressure to capture it during one particular year. There had been some previous proposals by some legislators to use on using the Common School Fund in its entirety as a rainy day fund.

Treasurer Edwards said the market has seen historic highs and a historic low, so it seems to be feast or famine. He encouraged the Board to find a way of smoothing the distributions over a three- or five-year average.

Director Hanus added that with the desire to maximize earnings over the long term, the fund is invested at 75 percent in equities, making it more susceptible to swings in the market. She said a 50/50 percent split would give a more predictable flow of earnings, but an analysis done by Frank Russell Company strongly recommended the fund continue at the 75 percent allocation to stocks for maximization of the growth of the fund, over more stable distributions.

Treasurer Edwards noted that if a rainy day fund is established, it could be diverted by the Legislature.

Governor Kulongoski said, since he was not present when the policy was adopted, he would like to better understand the historical context of why the current policy was adopted and what the alternatives would be. Director Hanus briefly reviewed what happened during the 1990s that encouraged the Board to revise their policy to make the distribution a percentage of the growth of the fund. Governor Kulongoski asked that this issue be made a separate item on the agenda for a future meeting.

Victoria Guillabeau, school trust lands committee chair for Oregon PTA, thanked the Board for its excellent stewardship of the Common School Fund. She said Director Hanus and the Department of State Lands are a shining example of how agencies should work.

4. Status report on the process to revise the Elliott State Forest Management Plan and Habitat Conservation Plan.

Marvin Brown, Director of the Department of Forestry, introduced Jim Young, Coos Bay District Forester, and Ross Holloway, State Forest Program Director.

Holloway provided a power point presentation showing how the forest is managed today and detailing the issues driving the revision of the management plan and the habitat conservation plan.

He said the management plan was developed for the Elliott in the early 1990s. A habitat conservation plan (HCP) was approved in 1995 with two species covered. A 60-year incidental take permit (ITP) was received for the northern spotted owl and a six-year ITP for the marbled murrelet. The ITP for the murrelet was short, since very little was known about the species, and the HCP would need adjusted. The owl ITP is still in effect, but the murrelet ITP expired in October 2001, so the new HCP process has been initiated.

Since the expiration of the murrelet ITP, Forestry has reinitiated surveys for murrelet on proposed timber sales two years ahead of the actual sales. In addition, they are applying the 100-foot no harvest buffer on fish bearing streams; 50 feet on perennial non-fish bearing streams; and the forest practices standard on the other types of streams on the forest.

Holloway said the agency's Asset Management Plan describes how the forest is to be managed primarily to produce a sustainable, even-flow harvest of timber, subject to economic, environmental and regulatory considerations.

Holloway reported sales of approximately 27 million board feet per year on the Elliott since 1996, bringing in about \$15 million per year.

Treasurer Edwards asked what the harvest levels were before the owls and murrelet were found. Holloway responded that harvest levels had been in the 45-50 million board feet range. After the owls were found, over the period of about 5-6 years, he said those levels fell to about 7-8 million board feet per year prior to the HCP.

Holloway said currently there is murrelet occupancy on about 25 percent of the proposed sales, causing these areas to be dropped from the potential sales. He said about 2,600 total acres have been set aside around these occupied areas for marbled murrelet management areas. With the overlap of other existing reserves,

riparian areas, owl conservation areas on the Elliott, the net acreage impacted is about 1,300 acres. At a question by Governor Kulongoski, Holloway confirmed that a review process is currently underway covering whether the murrelet should not have been listed. He added that since the HCP, the coho salmon were listed, affecting the Elliott.

Holloway discussed the many differences in the Elliott Management Plan and the HCP. He summarized by saying the HCP is a much narrower document, focusing on the species for which you are trying to obtain an ITP. He said it constitutes a contract with the federal government. The Elliott Management Plan is the policy direction of the Land Board.

Governor Kulongoski asked about the current population of owls on the Elliott. Jim Young said a density study done last year showed 12 or 13 sites with about 26 owls—approximately the same number as were present in 1996.

Young talked about the planning approach taken with the Elliott to meet the mandates and trust obligations for the Common School Fund lands on the forest. He summarized their efforts to balance the economic, social and environmental values there; actively manage the forest, consistent with different resource values on the forest; provide a dependable, sustainable timber harvest and revenues; and maintain scientific stakeholder and public support of those strategies.

He said they are recommending a multi-species HCP approach to cover a broad range of listed species so an annual survey will not be necessary.

Young reported that early in the process some initial modeling was done with Dr. John Sessions at OSU. Out of this effort three key strategy concepts were developed to be used in the planning process: 1) maintain conservation areas to protect the most important habitat; 2) develop riparian strategies to provide for aquatic habitat in alignment with the Oregon Plan for Salmon; and 3) define habitat in the forest by structural characteristics of the forest, rather than by using the age of the forest.

Young described the landscape of the Elliott, saying it serves as a link between the younger forests to the south and the older successional reserves and federal forests to the north.

He discussed the draft strategy their team is developing, explaining that the forest is divided into 13 management basins, based on watershed boundaries. Each basin has a target for the amount of advanced structure that it will have outside the threatened and endangered core areas. The total combined advanced structure equals 50 percent of the forest, which is needed to maintain the owl population as it is today.

Young reviewed seven alternative modeling scenarios currently being reviewed for the Elliott—Take Avoidance ODF Policies; 50 percent Conservation; Owl HCP (no change from the current); Integrated Landscape Strategy; Integrated Landscape Strategy with FPA RMA; Pre-1990 Management (no threatened and endangered species); and Wood Emphasis. Young then detailed the projected percent of conservation areas, advanced structure, early structure, and the harvest volume that could be anticipated in each of these models over one hundred years.

Secretary Bradbury expressed his frustration that not all of these models are choices the Board could actually make for the forest. Young agreed with this. He explained that showing all the modeling scenarios helps with understanding the potential economic return that may be lost due to our requirements for complying with the Endangered Species Act.

Young said they have the strategies drafted. He reported they are close to being finished on reconciling the first scientific peer review. A draft of the strategies will be distributed in May, and then public meetings held in June for input. A second scientific peer review will be held later this year with another set of public hearings. Young expects the Forest Management Plan will be ready for the Land Board's approval in April 2005.

He said the HCP is being developed concurrently with the Forest Management Plan. He anticipates development of the environmental impact statement to begin the second half of 2004 and the ITP to be issued around June 2006. Sometime during the fall of 2005 the Department of Forestry will request Land Board approval to submit the HCP to the Federal Services.

Holloway detailed some of the key issues they must consider as they move forward with the process, which he said boils down to the cost and benefits of the various choices.

A matrix showing the pros and cons of the different modeling scenarios was provided to the Board.

5. Navigability status report.

Director Hanus said a letter was sent to citizens along the river letting them know a request was received by the Board from the district attorney to conduct a navigability study of the Rogue River. She said the agency would return to the Board in June for a decision on whether to proceed with that study.

A public notice will be issued early May on the draft John Day River study.

In addition, Hanus said a request was received from the Klamath County sheriff to consider a navigability study for the Klamath River from Lake Ewana to Keno and one for Crooked Creek, which drains in the north end of Agency Lake in Klamath County.

6. Rangeland audit update.

Director Hanus reported that the Secretary of State's Audits Division conducted an audit of the management of our rangelands. She reviewed the specific recommendations of the audit and reviewed the agency's plan to address those audit recommendations.

7. Update on Removal-Fill Program and Statewide Programmatic General Permit.

Hanus reported the agency had hoped they would have received the draft biological opinion from the USFWS, but they are still waiting. She said a streamlined process for recreational placer mining is being explored, with changes in part coming from the passage of House Bill 2899. Another issue for consideration is the streamlining process for ODOT bridge projects.

Laurie Bleckman spoke to the Board regarding plans she has for building a recreational facility near Rockaway Beach to host bicyclists who travel Highway 101.

8. Other.

Bob Bailey reviewed the Report of the U.S. Commission on Ocean Policy giving background on the Commission, explaining how the report came about, what the Commission will recommend, how the report affects the Land Board and when the Governor's response to the report will be due.

Bailey said the Board has an interest in this because of its stewardship of the 1,200 miles of territorial sea along the Oregon coast, and the submerged and submersible lands in the estuaries.

He is currently working with agencies and experts at Oregon State University to review this report. He said this could provide a great advantage to the State of Oregon, the coastal program and the Land Board by providing resources to do a better job of managing our marine and ocean resources.

Hanus reported that the Sustainability Board approved DSL's Sustainability Plan.

Director Hanus thanked the Board for their letter regarding Larry Potter, a DSL employee who passed away last week. Hanus said Larry epitomized the employee who took the "can do" approach to solving problems. She reviewed some of his achievements at DSL, such as working on issues relating to the sale of property near Rainier for the U.S. Gypsum Plant that brought jobs to Oregonians; managing leases at Tongue Point and working closely with the Clatsop Economic Development Department and the Clatsop County Council Fisheries project to grow salmon smolts, which is boosting sport and commercial fishing on the north coast by more than half a million dollars per year. She called Potter one of our star property managers. Hanus read the letter signed by the Land Board at his funeral last Friday.

The meeting was adjourned at 11:35 am.

Theodore R. Kulongoski, Governor

Ann Hanus, Director