State Lands

Trust Lands Performance Assessment

Maximizing Opportunities

Legislative Update | December 2019

WASHINGTON STATE DEPARTMENT OF NATURAL RESOURCES

Office of the Commissioner of Public Lands, Hilary Franz
Deputy Supervisor for State Uplands, Angus Brodie

Acknowledgements and Primary DNR Contacts

Board of Natural Resources

- The Honorable Hilary Franz, Commissioner of Public Lands
- Jim Cahill, Representative for Governor Jay Inslee
- The Honorable Chris Reykdal, Superintendent of Public Instruction
- The Honorable Bill Peach, Clallam County Commissioner
- Dr. Andre-Denis G. Wright, Dean, College of Agriculture, Human, and Natural Resource Sciences, Washington State University
- Dr. Dan Brown, Director School of Environmental and Forest Sciences, College of the Environment, University of Washington

Executive Advisory Group

- Angus Brodie, Deputy Supervisor for State Uplands
- Josh Wilund, Department Supervisor
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- Brule Burkhart, Chief Financial Officer
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- Andrew Hayes, Forest Resources Division Manager
- Brock Milliern, Conservation, Recreation, and Transactions Division Manager

Project Team

- David Bergvall, Project Manager
- Hilary Browning, Data and Technical lead
- David Gordon, Assistant Division Manager for Transactions
- Bob Greene, Chief Appraiser
- David Chertudi, Chief Economist
- Candace Montoya, State Lands Budget Manager
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Deloitte Transactions and Business Analytics

- Dan Provencio, Principle, MAI, CRE, ASA
- Eric Dicus, Senior Manager, Real Estate Consulting
- Timothy R. Lowe, MAI, CRE
- Jake Kumferman, Data and Technical lead, Consultant, Real Estate Consulting
- Tiffany Trinh, GIS lead, Deloitte Advisory

A special thank you to all of the stakeholders who contributed ideas, gave feedback, and support the sustainable management of state trust lands.

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Acronyms

ASA	American Society of Appraisers
CLT	Cross-laminated timber
CRE	The Counselors of Real Estate
DNR	Washington State Department of Natural Resources
DTBA	Deloitte Transactions and Business Analytics
EE	Earth Economics
ESV	Ecosystem services valuation
FDA	Forest Development Account
FDF	Forest Development Fund
FSC	Forest Stewardship Council
FTE	Full-time equivalent
FY	Fiscal year
HCP	*State Trust Lands Habitat Conservation Plan*
MAI	Member, Appraisal Institute
NCREIF	National Council of Real Estate Investment Fiduciaries
NGO	Non-governmental organization
PILT	Payment in lieu of taxes
RCW	Revised Code of Washington
RMCA	Resource Management Cost Account
RFP	Request for proposal

Executive Summary

What Has Changed Since the Last Interim Report?

- Deloitte Transactions and Business Analytics (DTBA) was selected in January 2019 as the primary contractor for the valuation and performance assessment.
- Earth Economics (EE), as a sub-contractor to DTBA, was selected and is conducting the ecosystem services and recreation valuation (these services are collectively referred to as "ecosystem services valuation" [ESV]).
- Valuation methods proposed by DTBA have been certified by DNR and the valuation of all asset classes is under way, with draft results expected by winter of 2019/2020.
- The Washington State Department of Natural Resources (DNR) hosted a three-day Board of Natural Resources (Board) field tour to discuss operational and policy challenges and opportunities for the assets that DNR manages. Many business partners, beneficiaries, and stakeholders accompanied the Board.
- DTBA and DNR conducted interviews with five western states (Minnesota, Montana, Oregon, Idaho, and Arizona) that manage state trust lands in their states, one county (Grays Harbor) that manages state trust lands in Washington, two private land managers on the west coast (medium and large), and the British Columbia Ministry of Forests. These interviews were intended to asses comparable metrics (such as full time equivalents [FTEs] per 10,000 acres and funding mechanisms) to develop insight into potential performance and business development opportunities.

The recommendations from this Trust Land Performance Assessment will help guide DNR for many years to come. We look forward to the management and performance recommendations from DTBA, in combination with the other strategies proposed by the beneficiaries, stakeholders, the Board, and DNR staff. We thank the Washington State Legislature (Legislature) in advance for the work that will begin this session (2020) and be carried into the next (2021) to modernize the management of state trust lands and grow the financial endowment of the trust portfolio for generations to come. Thank you for your attention to this important work.

Data, facts, and figures in this report are sourced from DNR unless noted otherwise. DNR uses the utmost care in assembling information from the most updated sources. The complexity of the data may create rounding or other differences in comparison to other reports or planning documents.

Introduction

The Commissioner of Public Lands and DNR's State Lands program are leading the Trust Land Performance Assessment project associated with the management of DNR's trust portfolio. This work was partially funded by the Legislature in a 2018 capital budget proviso (ESSB 6095.PL, refer to Appendix A) that provides timeline and content expectations for DNR. The State Lands program, trust beneficiaries, stakeholders, and Washington legislators have a high level of interest in the outcomes of this review.

In This Report

This report focuses on project updates, methods, and potential strategies. As the majority of the valuation and data work wraps up in calendar year 2019, we are poised to move into performance analysis and recommendations to modernize the management of state trust lands. A brief description of the asset classes and valuation methods is provided as a primer to the final report by DTBA. Lastly, a snapshot of recommendations and ideas from stakeholders is included (Appendix C).

Vision

Optimize DNR trust asset management such that the corpus of the trusts are maintained or increase, and revenue to trust beneficiaries grows, consistent with a robust return on investment.

Part of DNR's duty is to provide the highest value to trust beneficiaries and manage state trust lands sustainably (RCW 43.30.215, Washington State Constitution Article IX and XVI, Enabling act Section 10 and 11). As part of this commitment, DNR's State Lands program is conducting this Trust Land Performance Assessment project.

Goal

Continuously improve the revenue performance of trust assets through forward-looking planning, identification of future opportunities and challenges, state-of-the-art business practices, and clear communication with trust beneficiaries, the Legislature, and stakeholders.

As part of this project, DNR will develop the information necessary to make informed choices regarding near-term and long-term investments. We also will explore potential new business lines across a variety of applications and programs.

Description of the Authorizing Environment

The federally granted lands and state forest lands, (collectively referred to as state trust lands) are held in trust by the State of Washington (refer to Appendix B). These are real and enforceable fiduciary trusts with specific intention, direction, and named beneficiaries. Just like a private trust held for the benefit of a family member or university, state trust lands must be managed prudently and endure over time. Each actor in the trust relationship has a responsibility to ensure the intent and obligations of the trust assets are carried out for this generation and every generation that follows.

Trustee	The Legislature is the trustee for the trusts, which include land holdings and permanent fund(s)
Trust manager	DNR is the trust manager for the land assets and revenue generated from said lands
Beneficiaries	The named beneficiaries* of the trusts
Permanent Fund Manager	The State Investment Board manages and invests the permanent funds

*The named beneficiaries include the following: Common School, Agricultural School, Scientific School, Normal School, University, CEPRI (Charitable, Education, Penal, and Reformatory Institutions), Capital Building, rural timber counties through State Forest Lands, Community College and Forest Reserve, King County Pollution Control Division

Each role in the trust relationship is specific and secures a collection of checks and standards to ensure compliance with the intent of the original trust grant.

Establishes and sets authorizing environment per its duties as the trustee	**Legislature**
Establishes and sets policy direction following its duty as the trust manager governing body	**Board of Natural Resources**
Implements direction from the Legislature and the Board to administer and manage the land assets of the trust(s)	**DNR**
Establishes and sets investment policy and distribution of the trust(s) permanent funds, as desired by the trust(s)	**State Investment Board**

Contracting for Services and Request for Proposals

The proviso provided limited funding for this project, and DNR reduced spending in other areas to pay for a full contract using DNR management funds (refer to Table 1). We welcomed the assistance of outside resources to complete the valuation and performance assessment. A request for proposals (RFP) for a contractor to assist with the assessment was released in October 2018. The contractor procurement process was completed in the beginning of 2019. Table 2 shows project funding per fiscal year (FY).

Table 1. Project Funding per FY

Item	FY 2019	FY 2020
Staff (fully loaded)*	$224,400	$271,918
Contracting **	$430,000	$770,000
Sum	$654,000 (A)	$1,041,918 (B)
Allocated (C)	$550,000	TBA
Total project need (D)	$1,696,300 (A+B)	TBA
Funds provided by management accounts to finish the work	**$1,146,300 (D-C)**	TBA

* DNR project staff: project manager 100%, data analyst 25%, Chief Appraiser 10%
** Contract estimated based off proposal that has been accepted under RFP 19-26
*** Expenditure timing estimated

Progress to Date

Progress is summarized in Table 2.

Table 2. Progress to Date

Task	Start Date	Completed
Contractor (DTBA) selected for valuation	January 2019	✓
Kick off meetings with contractor and subcontractors	January 2019	✓
Asset classes and data requirements certified by DNR	February 2019	✓
Proposed valuation methods certified by DNR	March 2019	✓
Ongoing stakeholder engagement	Continuous	✓
Board of Natural Resources tour	June 2019	✓
Final data and revenue packages transferred to DTBA	June 2019	✓
Legislative progress report	December 2019	✓

Benchmarks

DNR has invested in National Council of Real Estate Investment Fiduciaries (NCREIF) for use as an initial benchmarking tool. NCREIF is a national index with data for many of the asset classes that DNR manages. DNR will contribute data and information to NCREIF and receive quarterly reports for both forest and agriculture lands, starting in the first quarter of 2020. Meanwhile, we have access to the NCREIF index results and are working to put our data results (public sector) on a commensurate basis with the private sector index, so that we can complete an apples-to-apples comparison. The following quotes regarding the indices were taken from the NCREIF website:

> "The NCREIF Property Index promotes and reflects the growth of institutional investment in private commercial real estate." (Mary Ludgin, Managing Director of Global Research at Heitman, LLC)
>
> "The NCREIF Timberland Property Index is the industry source for performance measures of institution quality timberland investment in the United States." (Mary Ellen Aronow, Hancock Natural Resources Group)
>
> "The NCREIF Farmland Index is the trusted data source of institutional investors for US farmland income and appreciation." (Bill Frisbie, Gladstone Land Corporation)

DNR and DTBA also are looking at industry-specific benchmark services and surveys. Further, DTBA is offering an additional recommendation based on the caliber of third-party services and the unique nature of state trust lands.

Asset Classes and Valuation Methods

A description of each asset class and the certified valuation method is provided below. The uniqueness of law and policy placed on state trust lands creates a challenging valuation assignment. When results are verified and released, a full complement of explanatory information will be prepared, which will accompany the final report.

Forests

- Timber and log sales
- Special forest products

Agriculture

- Irrigated
- Dryland
- Grazing

Commercial

- Corporate retail
- Small family businesses
- Wind power

Communication

- Typically mountain top sites
- Diverse group of lessees

Mineral

- Aggregate
- Sand
- Basalt

Valuation Methods by Asset Class

Table 3 summarizes the valuation methods for each asset class.

Table 3. Valuation Methods

	Income	Direct Sales Comparison
Forests		
	Direct capitalization. Revenue based on analysis of prior 10 years of revenue and volume. Volume x rate = revenue. Expense based on analysis of prior 10 years. Direct capitalization of net income to an indication of value. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates. Timber volumes will be adjusted to reflect regulatory mandates.	Land value plus retail timber value less adjustments for legal limitations and other attributes. Analysis will segregate the acreage by geography (east/west), soil class, and topography type. Corresponding timber will be allocated by species and age. Stand size and/or valuation unit size to be determined.

	Income	Direct Sales Comparison
Agricultural resources		
Irrigated perennials (orchards/vineyards)	Direct capitalization based on existing contract base (share cropping group vs. term lease group). Revenue based on analysis of prior 10 years of revenue. Existing leases plus adjustments = revenue. Expense based on analysis of prior 10 years.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from agricultural production, regulatory mandates, and other relevant factors.
Irrigated annual crops (row crops)	Direct capitalization based on existing contract base (share cropping group vs. term lease group). Revenue based on analysis of prior 10 years of revenue. Existing leases plus adjustments = revenue. Expense based on analysis of prior 10 years.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from agricultural production, regulatory mandates, and other relevant factors.
Dryland agriculture	Direct capitalization based on existing contract base (share cropping group vs. term lease group). Revenue based on analysis of prior 10 years of revenue. Existing leases plus adjustments = revenue. Expense based on analysis of prior 10 years.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from agricultural production, regulatory mandates, and other relevant factors.
Non-productive land	Approach not used.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from agricultural production, regulatory mandates, and other relevant factors.
Open range and grazing permits (Note: Grazing occurs in open canopy, forested landscapes)	Direct capitalization. Revenue based on analysis of prior 10 years of revenue. Existing leases plus adjustments = revenue. Expense based on analysis of prior 10 years. Capitalization rate used will be an important issue to resolve.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from agricultural production, regulatory mandates, and other relevant factors.

	Income	Direct Sales Comparison
Commercial real estate		
Leased land	Direct capitalization based on existing contract. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates.	Land value based on comparable data less adjustments, including adjustments for differences in net income, regulatory mandates, and other relevant factors.
Leased land and buildings	Direct capitalization based on existing contract. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates.	Land value based on comparable data less adjustments, including adjustments for differences in net income, regulatory mandates, and other relevant factors.
Undeveloped urban enhanced, unimproved, and transition land	Approach not used.	Land value based on comparable data less adjustments, including adjustments for differences in net income, regulatory mandates, and other relevant factors.
Mining and aggregate		
	Direct capitalization based on existing income streams. Expense based on analysis of prior 10 years. Direct capitalization of net income to an indication of value. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates.	Analysis will stratify the acreage by factors that can be identified and then compared/valued in bulk. Land value based on comparable data less adjustments, including adjustments for differences in net income from mineral production, regulatory mandates, and other relevant factors.
Communication sites		
	Direct capitalization based on existing income streams. Expense based on analysis of prior 10 years. Direct capitalization of net income to an indication of value. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates.	Land value based on comparable data less adjustments, including adjustments for differences in net income, regulatory mandates, and other relevant factors.
Green energy (wind, solar)		
	Direct capitalization based on existing income streams. Expense based on analysis of prior 10 years. Direct capitalization of net income to an indication of value. Capitalization rate used will be adjusted to reflect appropriate regulatory mandates.	Land value based on comparable data less adjustments, including adjustments for differences in net income, regulatory mandates, and other relevant factors.

What Is Next?

Outreach and Stakeholder Ideas

DNR received numerous ideas from beneficiaries, DNR staff, and external stakeholders (refer to Appendix C). The suggestions ranged from procedural updates to entirely new ways of thinking about revenue. We are analyzing each suggestion to determine its potential contribution to modernizing and optimizing state trust lands management.

Preliminary Thinking on Revenue Reliability

A paramount duty of trust land management is to generate intergenerational revenue for the specific beneficiary of each trust. Trust beneficiaries have emphasized that the reliability of the revenue stream is as important as quantity for local services and school construction. DNR is actively pursuing improvements to the reliability of the revenue stream, which is challenging due to increases in cost of living, fuel, rent, labor, and other cost centers, and fluctuating market conditions. Following are some preliminary ideas and case examples of how these ideas have worked for other organizations.

- **Investigate how to create earnings reserve accounts for each trust with a goal of five years of reserve**

  Case example: The state of Idaho is well ahead of Washington in endowment/trust management modernization. Through their State Board of Land Commissioners and Endowment Fund Investment Board, the pooled asset value of the land and permeant funds have created five-year reserves for each trust beneficiary.

- **Investigate how the permanent fund and land base can work together to increase the value and yield to beneficiaries over time**

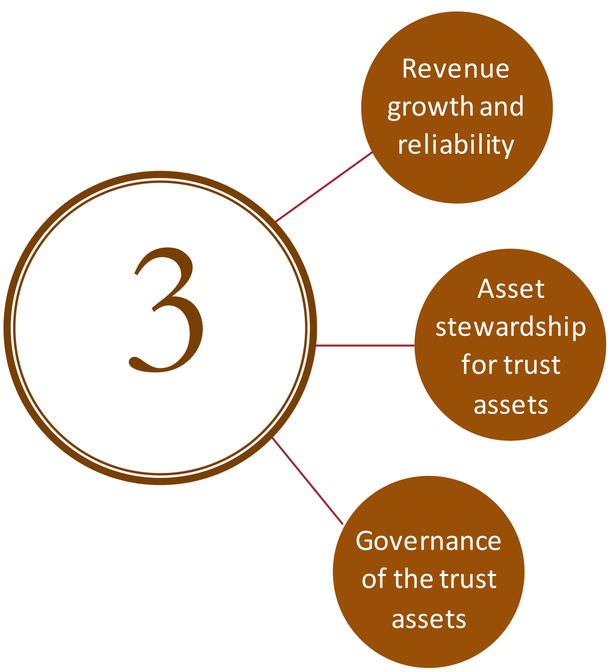
  Case example: Through the endowment reform process in Idaho, the pooled assets of revenue and land have grown the value of the endowment from $300 million in 2006 to more than $3 billion in 2018.

Ensure land management and investment strategies are adequately funded in the near and long term

Case example: Through the interviews conducted by DTBA and DNR, we identified that many land managers (public and private) are not constrained by a set management rate like Washington state trust lands. Fixed and variable costs are covered through a development process of actual need, potential return on investment analysis, and near-term forecast for cost increases.

Three Key Areas

DTBA's assessment and external feedback are bringing into focus three key areas for final project outcomes (refer to figure below). We look forward to collaborating with beneficiaries and stakeholders on the "three key areas" direction. Per our early analysis, these focus areas may lead to substantial growth and resiliency of the trust portfolio over time.



- Funding and revenue model changes
- Earnings reserves for beneficiaries

- All asset investment strategy
- Prioritization of acquisition and divestitures

- External advisors such as the State Investment Board
- Board policy updates

Modernization Packages

DTBA valuation and recommendations are just the start of the modernization work for DNR and the beneficiaries, as we collectively evaluate appropriate next steps for moving into implementation. There are many barriers that restrict the ability of trust land assets to be agile in the modern age. Over time, some barriers have served as appropriate governors; for example, the constitutional limitation on sale of state trust lands has kept the corpus of trusts intact. Other barriers have limited our ability to capture market space. In concert with the vision and goal of this work, we anticipate significant modernization of policy (governed by the Board) and statutory laws (governed by the Legislature). DNR will be working with the beneficiaries and the Legislature to prioritize elements of modernization to form a range of reform packages.

The goal for the 2021 legislative session is to have a series of scalable packages assembled by DNR, beneficiaries, and the Legislature. These packages will be scalable in the sense that recommendations may focus on small tweaks versus a comprehensive overhaul.

Why Wait?

The proviso language directs DNR to identify constraints that impact its ability to generate revenue (refer to Appendix A). We define constraints as laws, policies, and cultural business practices that restrict our ability to increase the revenue and value of state trust lands.

As state previously, DNR received feedback, ideas, and suggestions from a variety of sources, including the third-party work conducted by DTBA. Recommendations that could be implemented under current authorities are under way. We did not hesitate to implement recommended changes for business improvement areas, in line with the proviso direction and market conditions, when those changes were in the best interest of the trusts. The following efforts are under way.

■ Emerging markets and business development

Several sources recommended increasing capacity to explore emerging markets, with the end goal of participating in these markets to generate increased cash flow, when such participation is in the best interest of the trusts.

Key Result: Increased revenue via ground leases for clean energy, contribution to carbon reduction goals, and increasing commodity price

Accomplishments

1.) **Investment and new leases:** DNR hired a dedicated clean energy program manager and signed two solar leases. Five more leases are in negotiation. Results are higher returns for low-value state trust land parcels and a contribution to carbon reduction goals for DNR and the state.

2.) **Cross-laminated timber (CLT):** DNR executive leadership strongly supports milling and manufacturing capacity in rural economies. DNR continues to publicly support the addition of CLT manufacturing, and two new CLT manufacturing facilities (in Colville and Spokane Valley) are in production. These facilities will consume small-diameter timber from state trust lands, which should increase market competiveness and therefore price for raw logs.

Commercial real estate

In the 1990s, the DNR commercial real-estate and transition lands program (now collectively referred to as Commercial Lands) was staffed with sixteen FTEs. We reduced this program to two FTEs during the economic downturn of 2008. The program returns strong and consistent revenue set against very little expenditures and shows great promise for increasing sustainable and reliable revenue.

Key Result: Increased revenue via new ground leases for commercial real estate and meeting of sustainable growth goals of the region

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Accomplishments

1.) **Investment:** DNR is actively pursuing a mechanism (for example, revolving account or treasury financing) for investment capital (funds). This mechanism will allow for direct investment in current commercial properties (such as tenant improvements) and appropriate urban properties for new development. The end result will be increased, reliable revenue after an approved payback period.

2.) **Advisory:** Per the advice of other western states that manage state trust lands and DTBA, the Commissioner of Public Lands and the Board are considering an external advisory group to assist in rapid redevelopment of the Commercial Lands program.

3.) **Inventory**: The Commercial Lands program is updating DNR's inventory of transition lands. Transition and urban lands are defined in RCW and DNR policy as parcel(s) that have transitioned from resources lands to lands with a higher and better use. Reasons for transition include the proximity to, or inclusion in, urban growth areas, and nearness to municipalities. The updated inventory will assist DNR in divesting from, or developing, these parcels for greater revenue, consistent with regional planning goals.

LEAN timber sale process

Bringing a timber sale to market, which includes a final appraisal of the commodities to be sold before auction, takes tremendous care and effort.

Key Result: Decreased cost and carbon output and increased market awareness, resulting in better pricing

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Accomplishments

1.) **Alignment of market conditions and price**: Through a Lean Management System review, the appraisal-to-auction process was reduced from 83 to 46 days. This reduction will allow DNR to set a realistic minimum bid price during rapid market corrections. In declining markets, it will reduce the number of no bids and therefore reduce the cost to reappraise and remarket the sale. In increasing price markets, DNR will be able to capture more value because price and minimum bid will be aligned with market growth.
2.) **On-demand printing**: DNR prints monthly auction books that are sent to regional offices for distribution to local purchasers. The program has moved to on-demand printing at each region office, which will save approximately $25,000 per year while reducing the carbon impact of shipping printed booklets to each regional office.

■ Ecosystem services market participation pilot

Several stakeholders recommended investigating ecosystem service payments as a way to offset long return periods on forest investments (periods between expenditures for treatments and revenue from commercial timber harvest). DNR will receive ecosystem service values from DTBA and EE.

Key Result: Market awareness and potential partnerships for ecosystems services, in addition to the provisioning (timber and food) resources already provided

Accomplishment

Pilot project: To move towards monetization of the ecosystem values, DNR has partnered with EE and The Bullitt Foundation to pioneer actionable market opportunities for DNR's evaluation.

Appendix A, Authorizing Proviso ESSB 6095.PL

(1) The Department of Natural Resources must conduct an asset valuation of state lands and state forestlands held in trust and managed by the Department. The analysis required in subsections (3) and (4) of this section may be provided through contracted services.

(2) The Department must describe all trust lands, by trust, including timber lands, agricultural lands, commercial lands, and other lands, and identify revenues from leases or other sources for those lands. The Department must briefly describe the income from these trust lands, and potential enhancements to income, including intergenerational income, from the asset bases of these trusts.

(3) The analysis must estimate the current fair market value of these lands for each trust beneficiary, including the separate beneficiaries of state lands as defined in RCW 79.02.010, and the beneficiaries of state forestlands as specified in chapter 79.22 RCW. The estimation of current fair market values must specify the values by the various asset classes including, but not limited to, the following asset classes: timber lands; irrigated agriculture; dryland agriculture, including grazing lands; commercial real estate; mining; and other income production. The analysis must also estimate the value of ecosystem services and recreation benefits for asset classes that produce these benefits. The Legislature encourages the Department and its contractors to develop methods and tools to allow tracking of the estimated fair market values over time.

(4) For each of the different asset classes and for each of the various trusts, the analysis must calculate the average annual gross and net income as a percentage of estimated current asset value.

(5) The Department must provide a progress report to the Legislature by December 1, 2018. A follow-up progress report is expected to be provided by December 1, 2019, and may include any initial recommendations. The final report is expected to be submitted by June 30, 2020, and must include options to:

(a) Improve the net rates of return on different classes of assets;

(b) Increase the reliability of, and enhance if possible, revenue for trust beneficiaries; and

(c) Present and explain factors that either (i) define, (ii) constrict, or (iii) define and constrict the department's management practices and revenue production. The factors to be considered include, but are not limited to, statutory, constitutional, operational, and social factors.

Appendix B, History of State Trust Lands Management

Establishment of State Trust Lands

State trust lands are lands held as fiduciary trusts to provide revenue to specific trust beneficiaries. There are two types of state trust lands: federally granted lands, and State Forest Lands.

Federally granted lands

Just prior to Washington becoming a state in 1889, Congress passed the Omnibus Enabling Act of 1889, which granted the new state more than 3 million acres of land to support various schools and public institutions. This act set aside two square miles of every 36-square mile township across the state (public survey sections 16 and 36). Referred to as "federally granted lands," these lands support seven specific trusts:

- Common School, which supports the construction of kindergarten through twelfth grade public schools;
- Agricultural School, which supports construction at Washington State University;
- Charitable, Educational, Penal, and Reformatory Institutions, which supports establishment and maintenance of institutions managed by the Washington State departments of Corrections and Social and Health Services;
- University, which supports construction at the University of Washington;
- Normal School, which supports construction at Western Washington University, Central Washington University, Eastern Washington University, and The Evergreen State College;
- Scientific School, which supports construction at Washington State University; and
- Capitol Building, which supports construction of state office buildings on the capitol campus in Olympia.

In 1889, the delegates to the state's constitutional convention accepted the land grants and all the terms and conditions under which they were conveyed on behalf of the people of Washington. These terms and conditions are articulated in Article XVI of the state Constitution. For example, land grants cannot be disposed of except at public sale and for a minimum price of $10 per acre. The proceeds from the sale or permanent disposal of the education land grants (Common, Normal and Scientific School, University, and Agricultural School) are to be placed in permanent funds, the corpus of which cannot be diminished, and the interest from the permanent funds can be used only to support the named beneficiary. Federally granted lands may be leased and timber sold separately from the land, but only if authorized by the Washington State Legislature (Legislature).[1]

Unlike most states, Washington has retained most of its federally granted lands. Of the original 2.8 million acres of educational land grants, the state has retained 2.0 million acres, or more than 71 percent. Of the original 432,000 acres of institutional land grants (Capitol Buildings; Charitable, Educational, Penal, and Reformatory Institutions), the state has retained more than 262,000 acres, or 61 percent.

After statehood and mostly prior to 1930, an additional 931,000 acres were sold. Since 1930, the state has had a policy of retaining its federally granted lands rather than disposing of them.

For the federally granted trusts, the grantor is the federal government. The primary terms of the trust are contained in the Enabling Act. The trustee is the State of Washington, with the Legislature identified as having specific responsibilities under those terms, and the beneficiaries are those named in the Enabling Act. While the terms in the Enabling Act and state Constitution give considerable discretion to the state, the courts have ruled on numerous occasions that where the terms of the federally granted trusts are silent, certain common law duties apply.

Approximately 1.5 million acres of the federally granted lands are forested.

■ State Forest Lands

The other major category of state trust lands administered by the Washington Department of Natural Resources (DNR) is State Forest Lands,[2] which total about 626,000 acres. All State Forest Lands are to be used primarily for forestry, forever reserved from sale. Commodities such as the timber can be sold and lands leased in the same way and for the same purposes as the federally granted trusts.

There are two types of State Forest Lands, State Forest Purchase and State Forest Transfer. As the nomenclature implies, these lands are distinguished by how they were acquired.

State Forest Transfer Lands

Among the first environmental and social problems that faced the new state was what to do with the deforested lands that were being created by the rapid development of the forest products industry.[3] Many landowners did not pay the taxes on forestland, resulting in tax foreclosure.

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[1] 1889 Enabling Act, ch. 17.
[2] Formerly known as Forest Board Lands.
[3] Refer to Appendix 2, Forest Board Transfer Lands, Joint Legislative Audit and Review committee Report 96-5, December 16, 1996

The 1935 Legislature passed legislation requiring the counties to transfer tax-delinquent land suitable for forestry uses to the state for creation of a state forest. These lands are called State Forest Transfer Lands.

The Legislature created this trust in statute (RCW 76.22.010).[4] The Legislature directed that these lands be held in trust, forever reserved from sale, and managed for long-term timber supply on a sustained-yield basis.

The grantor of the State Forest Transfer trust is the State of Washington, and the primary terms of the trust are contained in statute. The trustee is the State of Washington, and the fiduciary beneficiaries are the junior taxing districts. Because the state is both the grantor and trustee, the state has considerable flexibility to change the terms of the trust through statutory direction.

The Legislature has directed that the State Forest Lands are to be managed in the same way and purposes as the federally granted lands. The courts have ruled that unless the Legislature has specifically directed otherwise, common law trust responsibilities apply.[5]

State Forest Purchase Lands

The State Forest Purchase Lands were acquired under the 1923 Reforestation Act. Under the act, the State Forest Board was given the power to acquire any lands that were chiefly valuable for developing and growing timber, and to designate these lands as State Forest Lands. Other State Forest Purchase Lands were acquired by the state as gifts.

These trusts were created by the state Legislature and the trust terms are contained in state statute. Similar to the State Forest Transfer Lands, the state is both the grantor and the trustee.

The forested, federally granted lands and State Forest Lands together total 2.1 million forested acres.

Other state trust lands

Community College Forest Reserve

In addition to the federally granted lands and State Forest Lands, DNR also manages more than 3,200 acres of forestlands for community colleges. The Community College Forest Reserve was established by the Legislature in 1990. Monies for DNR to purchase the properties were first appropriated that year. The properties are managed for sustained timber production, but special consideration is given to aesthetics, watershed protection,

[4] Hence these State Forest Lands are referred to as “statutory trusts”.

[5] Skamania102Wn.2d at 129; see also State ex rel. Hellar v. Young, 21 Wash. 391,392,58p.220 (1899)

and wildlife habitat. Revenues go to a special fund for building and capital improvements on community college campuses.

King County Water Pollution Control Division

DNR manages more than 4,300 acres for the benefit of King County and its Wastewater Treatment Division. These lands were transferred to DNR for management through an agreement with King County in June 1995. The agreement is part of a unique program to protect and enhance forests and wildlife habitat along the scenic I-90 corridor east of Seattle. These lands are managed for long-term forestry.

Governance of State Trust Lands

Legal construction of the trust

DNR's legal duties regarding state trust lands differ from the obligations of most federal and state land management agencies.

Each state's Enabling Act, constitution, state statutes, and resulting case law illustrate a common core for trust land management. Chief among these commonalities are the following:[6]

- ✓ The trusts are managed to provide financial support for specific, named beneficiaries,
- ✓ The trusts are perpetual,
- ✓ The trusts are managed by public entities, and
- ✓ The trusts are subject to the same federal and state laws as private lands.

In addition to the laws of general applicability, the trusts are subject to specific state law governing the management of the trusts.[7]

Management funds

Prior to the 1957 creation of DNR, all funds to manage federally granted lands were appropriated out of the state's general fund. Reforestation and silvicultural investments had to compete with other needs.

To address the need for funding in what was perhaps the most important innovation of the new department, the Legislature created the Resource Management Cost Account (RMCA) as a

[6] The Federally Granted Trusts: What Makes Them Unique, January 5, 1999. Prepared by DNR for the Western States Land Commissioners Association http://www.wslca.org/contents/Association_Information/Federally_Granted_Trusts.htm

[7] For example, the Washington State Constitution specified that the lands are held in trust for all the people of the state. In the area of forest resources, RCW 79.15.010 provides that "the best interest of the state" must be considered before timber or fallen timber is to be sold. RCW 79.11.175 further requires that the state find "that the best interests of the state may be served" before a confirmation of a timber sale is entered.

dedicated fund for the management of the federally granted lands. The Legislature directed that a percentage of the gross receipts from the federally granted lands (originally a maximum of 20 percent and increased to 25 percent in 1971) be placed in the RMCA to be used for "defraying the costs and expenses necessarily incurred in managing and administering all of the trust lands …"[8] RMCA funds are dedicated to the management and administration of the state trust lands from which they were derived, are considered a trust asset, and cannot be used for any other purpose unless the trust is compensated.

The Legislature also created the Forest Development Fund (FDF), which later became the Forest Development Account (FDA), to manage State Forest Lands. Beginning in the 1960s, funds in the FDA were not adequate to meet the management needs of the State Forest Lands, while RMCA funds were in excess of those needed to manage federally granted lands. The Legislature authorized DNR to spend the two funds on the management of all state trust lands. RMCA funds spent on State Forest Lands were to be considered a debt against the FDA, and FDA funds spent against the RMCA were considered a reduction in that debt. This debt, together with interest, has been repaid to the federally granted trusts.

While both the RMCA and FDA expenditures must be appropriated, the availability of dedicated management funds gives DNR somewhat greater independence in establishing long-range management programs for these lands because the Legislature is not being asked to fund management of these lands out of general fund state revenues. Tables B-1 and B-2 show how the FDA and the RMCA, respectively, have changed over time.

Table B-1. Changes to the FDA Over Time

Year	FDA	Rate Deducted From Revenue (Legislatively Authorized)
1923	First version of the account created	Expenses for reforestation and interest payments on bonds
1927	Account updated for State Forest Transfer Lands	10%
1951	Account changed to a revolving account	20%
1955	Rate established for State Forest Purchase Lands	50%
1971	Rate increased for State Forest Transfer Lands	25%
1986	County representative added to the Board	25%
2015	Rate set by the Board for temporary increase	27%
2017	Temporary increase reauthorized	27%

[8] RCW 79.64.030

Table B2. RMCA Changes Over Time

Year	RMCS	Rate Deducted From Revenue (Legislatively Authorized)
1961	First version of the account created	20%
1971	Rate increased and set	25%
1999	Statutory update: "Provided that no deduction shall be made from the proceeds from agricultural college lands."	25%
2003	Contract harvest deductions from net revenues	25%
2005	Rate set by Board for temporary increase	30%
2007	Temporary increase reauthorized	30%
2009	Temporary increase reauthorized	30%
2011	Temporary increase reauthorized	30%
2017	Temporary increase authorized for biennium	32%

Management Changes Over Time

State trust lands management in the State of Washington has changed dramatically since 1889. Support for the beneficiaries of the federally granted lands now comes not from the sale of these lands, but largely from timber sales, with some additional income increasingly coming from agricultural and grazing uses, mineral development, commercial leasing, and the Trust Land Transfer program.[9] State Forest Lands, virtually stripped of trees when originally obtained, are producing valuable harvests of timber once again, providing revenues to the counties in which they are located. The creation of DNR in 1957 consolidated previously scattered state trust lands management responsibilities into a single agency.

[9] For more information on the Trust Land Transfer program, refer to the 2003 Report to the Legislature available on the department's website at: http://www.dnr.wa.gov/htdocs/obe/reporttoleg/reportleghome.htm

Appendix C, Stakeholder Suggestions

The following suggestions were collected from a series of stakeholder meetings. Staff used the utmost care in listening to suggestions and capturing them in this document; however, some interpretation may have occurred.

- Divest from state trust lands and put the funds into alternative investment(s).
- Express the harvest target as a monetary target, rather than translating it to timber volume.
- Update the Riparian Forest Restoration Strategy to increase riparian harvest.
- Update the *State Trust Lands Habitat Conservation Plan* (HCP) to have specific blocks that are managed to Forest Practices standards (industry), and blocks that have a conservation objective.
- Hire a person to explore and develop ideas for new and non-traditional revenue. The position should be temporary and can be let go if monetary performance is not improved.
- Analyze climate change impacts for site productivity across the asset classes (forest and agriculture). Adjust current plans and forecasts.
- Lease forest lands and management responsibility to others (private or public), either for harvest or other purposes.
- Partner with organizations like PCC Farmland Trust to purchase at-risk farmland where the Washington State Department of Natural Resources (DNR) holds the title (either through sale or transfer from a non-governmental organization [NGO]) and seek family farmers to become the lessee. This suggestion may be particularly applicable for western Washington.
- Analyze ecosystem services, specifically water filtration from watersheds. Work with municipalities to receive payment for those services.
- Increase contract harvest sales as a way to increase short-term revenue and cash flow. Additionally, consider having DNR manage log yards, especially with high-value or Forest Stewardship Council (FSC)-certified products.
- Analyze what other states with trust lands are doing and explore what ideas may be transferred to Washington.
- Identify private investment opportunities; for example, corporations need carbon offsets.

- Increase advocating for Trust Land Transfer as a way to replace controversial lands with productive replacement lands.
- Partner with NGOs on land transactions: create a new form of land replacement account (NGOs buy forest land and put it in the replacement pool; state trust lands with conservation objectives are traded for the newly purchased lands).
- Work with beneficiaries to educate constituents on the importance of stable state trust lands revenue, in comparison to forest industry boom and bust.
- Increase (number of properties and funding) the Commercial Lands program.
- Create a story about the impact of trust lands and the good work they do for a community — tell the DNR story!
- Use DNR road systems and state trust lands for emergency response, pre-planning where DNR would be compensated for providing emergency access.
- Is there revenue from training contract fire crews or fire districts? Is there revenue from DNR employees doing prescribed fire for landowners?
- Create a pilot project around the unified/unitary trust concept for State Forest trusts.
- Give State Forest trusts choices in portfolio management; for example, what asset class the county wants to invest in, if it had the monetary equivalent to the timber land's worth.
- Evaluate the qualifications of DNR staff managing the portfolio to answer the question, do we have people with the right skills managing the portfolio and the assets?
- Instead of harvesting the arrearage, create a cash-out payment that could seed investment portfolios managed by county trust representatives.
- Consider commercial and transition (highest and best use) land program expansion, where DNR shares in the site development and infrastructure.
- Create a business development division at DNR.
- Create payment in lieu of taxes (PILT)-like payment (to counties) for working state trust lands when they are transferred to conservation status.
- Create and sustain an asset acquisition and divesture strategy, accompanied by appropriate governance and representation from trustees.
- Investigate public/private partnerships to increase marketing and investment opportunities for agriculture lands.

- Develop a sophisticated water accounting tool to monitor water right use. Analyze if water can be shifted around in different pool areas to increase operable land area.
- Invest with lessees in technology improvements to monitor soil health, water use, and plant yield using remote sensors and centralized analytic tools.
- Partner with organizations on marketing and education. For example, the Potato Commission's "Washington Grown" campaign tells the story of integrated thinking and value-added chains linked to sustainable practices.
- Formalize right-of-access permits for organized recreation, which could take the form of facilitated access across DNR lands to federal ownerships, guided recreation like Cypress Island kayaking, and outfitter permits for hunting and fishing.
- Research and deploy fee schedules for organized recreation. For example, King County charges 7-10 percent of gate fees for the permit cost to have events on county sites.
- Increase the management fee for a short period to build the seed money for a permanent fund-like account that would be distributed to the counties based on proportioned acres. Governance and distribution changes can be managed by the Board of Natural Resources.
- Research and analyze highest and best use values for properties and appropriately develop or divest them, depending upon the greatest return to the trusts.
- Work with counties (such as Klickitat) to develop green energy zones in which DNR could pre- identify areas for development and negotiate interconnection agreements with utility companies.
- Create a monetary portfolio management strategy and associated governance that address short- and long-term revenue, risk, and cost.
- Implement administrative cost recovery for DNR business areas that grant access or services, for example when state lands management dollars are spent on granting easements to private parties with limited benefit to DNR. Set fee structures like county government.
- Research and analyze opportunities for eco-resort development on state trust lands. Create a public/private partnership in which DNR issues the ground lease and private monies fund the development. Look at the National Park/Forest models. Example may be state trust lands at Elbe Hills, Toutle Ridge, Twisp, et cetera.
- For eco-resort development and commercial recreation development, create an integrated marketing system with premier mountain bike, rally car, or sport events that could attract major sponsors like Red Bull for world championship-like events.