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# M E M O R A N D U M



May 9, 2017

**To:** Governor Kate Brown
Secretary of State Dennis Richardson
State Treasurer Tobias Read

**From:** James T. Paul, Director

**Subject:** Annual Report on Common School Fund Real Property for Fiscal Year 2016 (July 1, 2015 to June 30, 2016).

The primary purpose of this report is to provide the State Land Board a year-end summary of the financial performance of the Common School Fund (CSF) trust lands under the Department of State Lands' oversight. Included in the summary are the overall revenues and expenditures associated with these lands, which are the result of a broad range of real property management activities including leases, easements, licenses, special uses, and land sales and exchanges. This annual report presents outcomes from the 2016 fiscal year (July 1, 2015 to June 30, 2016), and includes discussion of future real property management direction and priorities.

## Status of Real Property Asset Classes

Under the direction of the 2012 Real Estate Asset Management Plan, the Department of State Lands (DSL) manages approximately 2.8 million acres of state-owned lands, which includes both "trust" and "statutory" lands. These lands are further categorized into seven different real property land classifications: Forestlands; Agricultural Lands; Rangelands; Industrial, Commercial, Residential (ICR) Lands; Mineral and Energy Resource Lands; Waterways; and Special Stewardship Lands (Appendix A shows a map of the distribution of these across the state):

**Table 1.** Summary of total acres of state land ownership administered by DSL, by land classification and land type (trust vs. statutory lands),

| | Trust Lands (acres) | Statutory Lands (acres) | Total |
|---|---|---|---|
| Forestlands | 121,032 | 119 | **121,151** |
| Agricultural Lands | 7,848 | 111 | **7,959** |
| Rangelands | 596,784 | 23,569 | **620,353** |
| Industrial/Commercial/Residential | 6,468 | 369 | **6,837** |
| Mineral and Energy Resources | 767,092 | | **767,092** |
| Waterways | | 1,264,558 | **1,264,558** |
| Special Stewardship Lands | 5,480 | 7,686 | **13,166** |
| Total | 1,504,704 | 1,296,412 | **2,801,116** |

*Trust Lands*

Trust lands (Table 1) are those lands granted by the federal government to Oregon "for the use of schools" upon its admission into the Union – also known as "Admission Act" lands. Trust lands make up 98% of all the uplands managed by DSL for the Land Board, and also include sub-surface minerals and energy resources. The Land Board is directed by Oregon's Constitution to manage these lands for the primary purpose of generating revenues for K-12 public education. This mandate places a trust obligation on the Board to maximize revenue to benefit multiple generations of K-12 students, and requires obtaining market value from the sale, rental or use of Admission Act lands.

*Statutory Lands*

Statutory lands (Table 1) – also referred to as "non-trust" lands – includes 1,264,558 acres of waterways (navigable waters, tidally influenced waters, and the territorial sea). These lands are held and managed by the Land Board for the greatest benefit of all Oregonians. The Land Board has considerably more latitude in managing statutory lands than it does in managing trust lands. Neither the Oregon Constitution nor statutes require that statutory lands be managed principally for generating revenue for the Common School Fund, and allows such lands to be used for a variety of purposes. Revenues produced from statutory lands, however, are used to protect the public trust values on these lands, in accordance with the Oregon Public Use Doctrine. Additionally, the state's management of these waterways is conducted so as to avoid unreasonable interference with public navigation, recreation, fisheries and commerce[1].

## FY 2016 Revenue and Expenditures By Land Class from Authorizations

Appendix B includes a summary of revenues and expenditures organized by land classification for Fiscal Year 2016 (FY2016).

## FY 2016 Land Sales and Exchanges

In FY2016, the Department conducted a total of three land sale transactions, generating a total of $1,149,022 in gross revenues. These transactions resulted in a total net divestment of 161 acres of Common School Fund trust lands.

## 2012 REAMP Asset Management Performance Measures

Summarized below are the four different financial performance measures identified in the 2012 Real Estate Asset Management Plan (REAMP). The stated aim of the REAMP is to show improvement in these measures over the ten-year timeframe of the plan. In addition, the REAMP recognizes that year-to-year fluctuations will likely occur that may deviate from a long-term positive trend for these measures:

[1] DSL's Aquatic Resource Management Program is responsible for managing all authorizations in the "statutory" category of state-owned lands, and for updating the State Land Board regarding activities on these lands separate from this report.

### 1. Return on Asset Value (ROAV)

Appendix C includes an estimate (by land class) of total asset value for the Common School trust lands. Market value estimates allow for a Return on Asset Value (ROAV) calculation for four trust land classes (forestlands, agricultural lands, rangelands, and ICR lands), and for these land classes combined. In FY2016, the ROAV for all trust lands averaged 0.4%. This measure was primarily influenced this year by a combination of rangeland fire suppression costs and forestland revenues.

### 2. Annual Increase in Net Operating Income (NOI)

The total NOI for FY2016 was about $1.90 million, an increase of $1.26 million (or 195%) from FY2015 primarily due to an increase in revenues from forestlands. When considering land classifications other than forestland, the NOI for FY2016 decreased by about $1.01 million (or –222%) as compared to FY2015. (Appendix B)

### 3. Annual Increase in Gross Annual Revenue (AR)

The FY2016 Gross Annual Revenue was approximately $9.13 million, an increase of about $2.63 million (or 40%) as compared to FY2015. An increase of about $0.40 million (or 22%) occurred for all land classifications when excluding forestlands. The increase on non-forestlands was primarily due to an increase in gross revenues from rangelands. (Appendix B)

### 4. Annual Land Value Appreciation (LVA)

This performance measure is not reported for FY2016 due to the frequency and general nature of the methodology used by DSL to assess land values for the different land classifications. (Appendix C)

## 2012 Real Estate Asset Management Plan (REAMP) Implementation

Information on the general implementation categories defined in the 2012 REAMP and the distribution of the trust lands across these categories is summarized in Table 2 (excludes waterways and sub-surface mineral rights).

Approximately 118,000 acres of trust lands (or 15%) are currently not generating positive revenues for the Common School Fund, and it’s estimated these acres make up about 60% of the total asset value of the Common School Fund trust lands. The large majority of these acres are forestlands managed for DSL by the Oregon Department of Forestry, also referred to as “certified” forestlands, which include lands within the Elliott State Forest. Current projections do not anticipate a change in the performance of these lands in the future.

The 2012 REAMP Implementation Outcomes include “a rebalanced portfolio through acquisition of assets with high performance potential and the strategic disposal of selected non- or lower-performing assets.” DSL will continue to evaluate these non-performing lands in the “none/minimal” category for potential divestment. Net proceeds from trust land sales are deposited into the land revolving account (a sub-account within the Common School Fund), unless otherwise directed by the State Land Board.

**Table 2.** Summary of revenue potential for lands managed by DSL, by land classification and asset performance category (APC), excluding mineral and energy resources and waterways ownership.

| **LAND CLASSIFICATION** | **PROPERTY REVENUE POTENTIAL (acres)** | | | | |
|---|---|---|---|---|---|
| | Long-term[1] Potential | Short-term[2] Potential | Current[3] | None/ Minimal[4] | **Total Acres** |
| Forestlands | | 120 | 19,153 | 102,878 | **122,151** |
| Agricultural Lands | | 275 | 7,491 | 193 | **7,959** |
| Rangelands[5] | 3,508 | 2,696 | 612,412 | 1,737 | **620,353** |
| Industrial/Commercial/ Residential | 1,260 | 1,180 | 3,033 | 1,364 | **6,837** |
| Special Stewardship Lands | 278 | | 891 | 11,997 | **13,166** |
| **Total Acres** | 5,046 | 4,271 | 642,980 | 118,169 | **770,466** |

[1] Not currently producing revenue, but with strong potential to produce revenue within 10 years.
[2] A strong potential to produce revenue within two years, but not presently generating revenue.
[3] Currently producing annual revenues for the Common School Fund.
[4] Generating minimal or no annual revenue, and low potential for generating revenue in the future.
[5] Included here are the statutory rangelands (see Table 1), managed by the Real Property program with the trust lands.

About 9,300 acres across all five upland land classes are currently classified as having either short- or long-term potential to generate revenues. DSL will continue to actively evaluate potential opportunities to manage those lands in the future in order to improve revenue performance. If at a future point in time it’s determined these acres are unlikely to be able to generate revenues, they would then be reclassified as “none/minimal” category lands and shifted into the pool of acres to be evaluated for possible divestment.

The balance of the remaining lands – about 643,000 acres – are currently generating revenue, and DSL will continue to manage these lands accordingly (also see Appendix B, and three-year average net revenues). DSL will look for opportunities to increase revenues and decrease expenditures from these lands, consistent with the REAMP Implementation Outcome for “a more aggressively managed portfolio, including evaluation of all lands, with a focus on ICR and agricultural lands and mineral and energy resources to generate new revenues.” A current example of this is the Eastern Region’s continued efforts to identify opportunities to develop rangelands into irrigated agricultural production, which can result in as much as a 30-fold increase in per-acre income.

The primary factor affecting the reduced performance on rangelands (see Appendix B) was payment of fire suppression expenditures totaling $1.8 million dollars from wildfires in 2014 and 2015 that were invoiced in 2016. Fluctuations in leasing rates and drought conditions are also important factors that affect the financial performance of these lands. Uncertainty in future conditions relative to these three factors will impact their potential performance. Fire protection costs are unique in that there are steps DSL can take to potentially reduce such costs in the future, and thereby improve the performance of these lands. The Department currently has an agreement with the Bureau of Land Management for providing fire protection for rangelands, and that agreement is up for renewal in 2017. The Department will be exploring various options towards reducing fire protection costs as part of the agreement-renewal process. The goal will be to explore options for reducing fire protection costs, while still maintaining an appropriate level of resource protection across these lands in the future.

Finally, DSL will continuously re-evaluate the entire portfolio of trust lands to ensure the revenue generating status is properly categorized (Table 2). The Real Property program will make on-going adjustments as needed to reflect changes in our knowledge of the lands, any physical changes to the lands (ex. infrastructure investments), and any changes to potential revenue-generating opportunities.

## Current and Future Real Property Management Priorities

Moving forward, the Department will continue implementing the 2012 REAMP's General Management Principles, which include the following (pp.17-18):

1. The Land Board and Department will continue to meet their obligations on trust lands.
2. The Land Board and Department will continue to manage CSF lands to create a sustained and consistent stream of revenue to assist in building the principal of the CSF, thereby increasing annual distributions to schools.
3. The plan balances revenue enhancement and resource stewardship.
4. Consistent with the legacy of the Admission Act, the Land Board will maintain a real property asset portfolio of CSF lands. The allocation of land among land classifications may change over time based on management, reinvestment and disposal [i.e. divestment] strategies.
5. The Land Board and Department will actively strive to increase the total annual revenues from the real property asset portion of the CSF portfolio through the disposal of trust lands that are not actively managed or are low revenue producers.

The Common School Fund trust land property portfolio, with an estimated value of approximately $538 million (Appendix C), is a substantial asset of the Common School Fund as a whole. This $538 million value is equivalent to about one-third of the Common School Fund investment holdings, currently valued at approximately $1.5 billion.

Common School trust lands hold a unique position with the primary role of providing revenue for Oregon's public schools. A key element of meeting this mandate is maintaining an accurate and comprehensive inventory of all real property assets and asset values, and continually evaluating their current and potential revenue-generating status. The primary framework for this will be the regular asset performance category (APC) review as discussed in the previous section of this report. These reviews are intended to further fine-tune the evaluation of the various APCs for these lands over time.

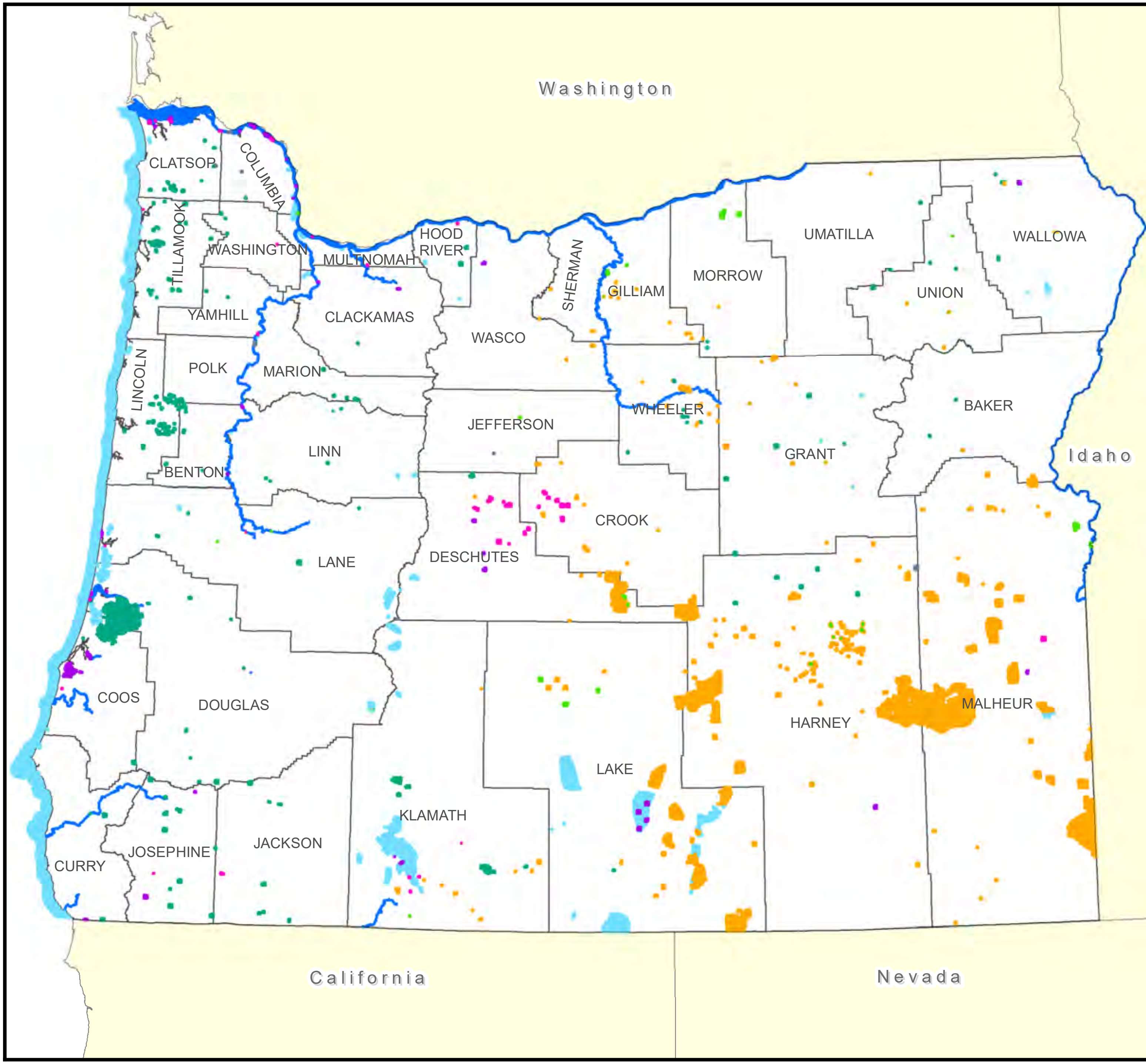
For example, consider the overall performance of lands in the “current” category (Table 2). Although they are providing a positive benefit to the Common School Fund over time, the relative performance of these lands is currently low. In FY2016, the three-year average return on asset value for agricultural, rangelands and ICR lands is 0.6%, -0.3%, and 0.4%, respectively. Given these are averages, there are parcels performing at both higher and lower levels than this, and some potentially at a net deficit to the Common School Fund. To the extent that DSL can conduct a more sophisticated approach to the asset performance category review of these lands in the future, there is the potential to parse out sub-categories within land classification categories to allow for a more refined assessment of specific lands that are higher- versus lower-performing. This would better inform future Department and Land Board decision-making concerning land retention and divestment.

## Summary

The Department continues to work through finding a resolution to the revenue challenges associated with trust lands within the Elliott State Forest. Revenue streams from some of the rangeland properties continue to improve by converting several hundred acres of rangeland to irrigated agriculture by construction of wells and placement of irrigation pivots. Additional property improvement efforts include noxious weed treatment and removal of juniper trees. These activities result in increased site productivity of the property, which in turn result in the potential for a higher rate of revenue as well as property value. The Department will continue to focus on identification of low revenue-producing properties for transferring out of the Common School Fund portfolio, and where possible improve the potential for revenues to be generated from those lands that are retained in the portfolio.

## APPENDICES

A. Map of all lands under the authority of the Department of State Lands, by Land Use Class
B. FY 2014 – 2016 Real Property Revenue, Expenditures, and Net Operating Income by Land Class
C. FY 2016 Financial Performance by Land Class




# State of Oregon Department of State Lands

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Map Projection:
Oregon Lambert Conformal Conic
Datum NAD 83
International Feet

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APPENDIX B

## FY2014-FY2016 Real Property Revenues, Expenditures (Direct only) and Net Operating Income by Land Class

(Does not include land sales/exchanges, South Slough expenditures/revenues, or capital expenditures. Also excludes associated agency adimistrative expenditures.)

| Land Classification | Fiscal Year 2014 | | | Fiscal Year 2015 | | | Fiscal Year 2016 | | | ***3-Year Avg.*** |
|---|---|---|---|---|---|---|---|---|---|---|
| | Gross Revenue ($) | Expenditures ($) | Net Operating Income ($) | Gross Revenue ($) | Expenditures ($) | Net Operating Income ($) | Gross Revenue ($) | Expenditures ($) | Net Operating Income ($) | ***Annual Net Operating Income ($)*** |
| Agricultural Land | $ 225,398 | $ 119,772 | $ 105,626 | $ 237,244 | $ 127,229 | $ 110,015 | $ 242,752 | $ 127,449 | $ 115,303 | ***$ 110,315*** |
| Rangeland | $ 578,940 | $ 420,391 | $ 158,549 | $ 586,907 | $ 716,223 | $ (129,316) | $ 919,624 | $ 2,165,581 | $ (1,245,957) | ***$ (405,575)*** |
| ICR* | $ 1,139,053 | $ 826,819 | $ 312,234 | $ 1,037,108 | $ 849,944 | $ 187,164 | $ 1,112,497 | $ 865,370 | $ 247,127 | ***$ 248,842*** |
| Forestland | $ 3,573,368 | 4,208,891 | $ (635,523) | $ 4,270,904 | 4,080,482 | $ 190,422 | $ 6,499,393 | 4,037,200 | $ 2,462,193 | ***$ 672,364*** |
| Mineral & Energy Resource** | $ 559,291 | $ 86,650 | $ 472,641 | $ 352,726 | $ 70,509 | $ 282,217 | $ 342,569 | $ 30,681 | $ 311,888 | ***$ 355,582*** |
| Special Stewardship** | $ 13,672 | $ 10,511 | $ 3,161 | $ 14,875 | $ 9,481 | $ 5,394 | $ 14,172 | $ 374 | $ 13,798 | ***$ 7,451*** |
| | Revenues do not include land sales or mineral releases. | | | | | | | | | |
| **Totals** | **6,089,722** | **5,673,034** | **416,688** | **6,499,764** | **5,853,868** | **645,896** | **9,131,007** | **7,226,655** | **1,904,352** | ***$ 988,979*** |
| ***Totals without Forestlands*** | ***2,516,354*** | ***1,464,143*** | ***1,052,211*** | ***2,228,860*** | ***1,773,386*** | ***455,474*** | ***2,631,614*** | ***3,189,455*** | ***(557,841)*** | ***$ 316,615*** |

*Figure reported for FY 2016 expenditures reflects an accouting adjustment of $523,117, to ensure reporting is comparable to previous years.

** Figure reported for FY2016 expenditures relfects an adjustment in payroll expense allocation, in addition other miscelaneous reduced costs.

## Appendix C: FY 2016 Market Value and Performance by Land Class

| Land Classification | *Total Acres* | Approximate Market Value (millions) | % of Total Market Value | Annual Net Operating Income (NOI) | Return on Asset Value (ROAV) |
|---|---|---|---|---|---|
| Forestlands: Elliott State Forest | *82,500* | $220.8 (1) | 41% | $1,378,936 | 0.6% |
| Forestlands: Other than Elliott SF | *38,000* | $103.3 – 113.9 (2) | 20% | $1,083,257 | 1.0% |
| Agricultural Lands | *8,000* | $18.0 – 19.0 (3) | 3% | $115,303 | 0.6% |
| Rangelands | *620,000* | $117.8 – 136.4 (4) | 24% | ($1,245,957) | -1.0% |
| ICR Lands | *6,800* | $59.7 – 65.7 (5) | 12% | $247,127 | 0.4% |
| Special Stewardship Lands | *13,200* | (6) | - | $13,798 | - |
| Mineral and Energy Resources | *767,100* | (6) | - | $311,888 | - |
| Totals | ***1,540,000*** | **$538** | **100%** | **$1,904,352** | **0.4% (7)** |

Notes:

(1) Final appraised value as determined by a Department-contracted appraisal process in 2016.

(2) Values reported in the FY 2011 Annual Report, using the per-acre equivalent. These are the most recent estimated values with documented DSL methodology.

(3) Value estimate is based on figures provided by USDA's report on land sales of Oregon's farm land. The 2016 average price per acre for Oregon's farm land is $2,200 as determined by USDA which collects land sales information. This includes all types of farming from dry farming to irrigated produce farming which is very lucrative. Irrigated farm land sales reflect values of $2,500 to $6,600 per acre in the areas in which DSL owns agricultural land. Most of DSL's agricultural land has water rights but does not own the irrigation equipment so the USDA average value has been adjusted to $2,500 to $2,700 per acre for the range of values.

(4) Blocked ranch values per acre are increasing ($500 per acre for ranches over 3,000 acres with recreational appeal is typical) but can take years to market successfully with a very limited number of these selling annually. Individual properties with smaller acreage average around $200 to $300 per acre. An average individual tract value was designated for each county. DSL's rangeland ownership would take over 50 years to sell and would depress rangeland values because of the large supply. To reflect this, a discount of 30% to 35% has been used to create the value range. The values in LAS reflect a more individual tract value.

(5) Each property was valued individually through research of comparable sale properties and those properties with lease income were valued by the income approach. DSL's land in Bend is still rebounding in value despite the addition of the Stevens Road tract to the UGB. The Forked Horn property was sold last year. The Eugene motorpool property and the Helvetia property were valued with full USPAP-compliant appraisals.

(6) Data not available.

(7) The total ROAV does *not* include NOI derived from special stewardship lands, since the asset value of those lands are not reported here. The NOI for mineral and energy resources is included here because those revenues are derived from parcels in one of the other surface land classifications.