ARIZONA STATE LEGISLATURE
Forty-sixth Legislature – Second Regular Session

AD HOC COMMITTEE ON STATE TRUST LAND REFORM

Minutes of Meeting
Tuesday, June 22, 2004
House Hearing Room 4 -- 1:00 p.m.

Chairman Flake called the meeting to order at 1:23 p.m. and attendance was noted by the secretary.

Members Present

Senator Allen	Representative Gray
Senator Blendu	Representative Landrum Taylor
Senator Brown	Representative Lopez
Senator Cannell	Representative Nelson
Senator Mitchell (alternate)	Representative Flake, Cochair

Members Absent

Senator Bee	Representative Boone
Senator Bennett, Cochair (excused)	

Speakers Present

Michael Braun, Executive Director, Arizona Legislative Council
David Petersen, Arizona State Treasurer
Richard R. Hubbard, Deputy Commissioner, State Land Department
Jay Hogan, Flagstaff, representing himself
Richard Stavneak, Director, Joint Legislative Budget Committee (JLBC)
Janice Palmer, Lobbyist, Arizona School Boards Association (ASBA)
Karan Nie, Phoenix, representing herself

Chairman Flake voiced appreciation for the thousands of hours that have been put into the reform effort by the stakeholders, and added that there is still much to do.

Presentation by Arizona Legislative Council

Michael E. Braun, Executive Director, Arizona Legislative Council, distributed and reviewed a memo dated June 22, 2004 outlining the Arizona-New Mexico Enabling Act (see Attachment 1).

He reviewed those sections of the United States Constitution, the New Mexico-Arizona Enabling Act and the Arizona Constitution that pertain to the issue, including examples of amendments from 1936 and 1999. He pointed out that no firm process is outlined in the U.S. Constitution by which new states may be admitted.

Mr. Braun described the Oklahoma Enabling Act that in 1911 provided for a state capital that could not be moved. A state must accept the Enabling Act provisions in order to be admitted to the union. Following admission, the capital was moved, the move challenged by the U.S. government, and ultimately upheld by the United States Supreme Court on the ground that once a state is admitted to the union it is on an equal footing with other states and is not bound by the provisions, if the issue is within the scope of the state's jurisdiction. However, a matter within the scope of federal power is bound by the provisions of the Enabling Act. When the federal government gives land to a state, it has the power to set requirements in the Enabling Act that the state must follow.

Mr. Braun explained that some provisions of the 1910 New Mexico-Arizona Enabling Act are valid and of concern today, including a restriction that the sale or lease of trust land and natural products can only be to the "highest and best bidder" at public auction, and that lands and products offered for sale must be appraised at and sold for not less than "true value" (see Attachment 1, page 2, paragraph 3.d.). Moreover, specific limitations were placed on the land when Arizona and New Mexico were admitted, although comparable limitations were not imposed on the 23 states admitted immediately prior. He noted that there is considerable anecdotal evidence that this was done because of experiences with the New Mexico territory.

Senator Blendu asked if the federal government has the power to take back land it has *granted* to the state if the issue is opened up. Mr. Braun pointed out that the Enabling Act is never really closed and cannot therefore be "opened up." He added that Congress has the ability to deal with federal lands, and he is not aware of any circumstances under which it has been litigated.

Responding to a query from Chairman Flake, Mr. Braun observed that there are minimal restrictions on the 23 states admitted prior to Arizona and New Mexico, and he has found no cases that have challenged this. He related a brief history of Arizona's Constitutional Convention that was ratified by the voters, and eventual admission to the union. However, because President Taft did not believe recall of judges was proper, the first acceptance was vetoed. After Arizona was admitted without that language, recall of judges was added to the State's Constitution.

Mr. Braun advised that the Enabling Act is superior to the Constitution of the State of Arizona; however the State Constitution may establish more stringent fiduciary requirements (see Attachment 1, page 3, paragraphs 3.a. and 4.a.). Moreover, a change to the Enabling Act does not automatically change the Arizona Constitution (*ibid*, paragraph 1.c.). He remarked that there are many interesting interplays between the Enabling Act and the State Constitution.

Chairman Flake observed that if the Enabling Act allows an exchange of land, and supercedes the State Constitution which does not permit it, then it should be possible to go ahead. Mr. Braun explained that there was no authority prior to 1936 to exchange lands in the Enabling Act. Although Congress took out the restriction by providing for the exchange, the Arizona Constitution still prohibits the exchange of lands and must be changed to allow it to happen.

Mr. Gray questioned if, absent any new federal legislation, the State Constitution is amended, then land exchanges could be allowed without going to Congress and asking for a change in the Enabling Act. Mr. Braun responded in the affirmative.

Senator Allen remarked that, to her recollection, the issue has gone to the ballot five times, four of which included exchanges of private lands, and has never been approved.

Mr. Braun reviewed the 1957, 1998 and 1999 amendments (Attachment 1, page 4) in regard to investments and earnings distribution. He noted that the Arizona Enabling Act was amended in 1999 to allow for use of "miners' hospitals" trust funds for operation of the Pioneers' Home. This amendment was made retroactive to 1910 to ratify the longstanding practice of using the trust funds to operate the Pioneers' Home, which had traditionally cared for disabled miners. Responding to questions, he noted that prior to the 1998 amendment, earnings were distributed under a different formula, and in answer to a query to that point from Mr. Nelson, he advised that this appears to have been legal, but inefficient. Chairman Flake said he recalled a desire in 1998 to get a better return, which was achieved.

Mr. Gray asked if the State could decide to disperse less than 100 percent of the proceeds without Congressional approval. Mr. Braun said he believes the authority is there to make that amendment. He responded to further questions and concluded his presentation.

State Treasurer's Position

David Petersen, Arizona State Treasurer, distributed a copy of a letter dated June 21, 2004 addressed to the Honorable Ken Bennett in regard to State Trust Land Reform (Attachment 2). He said while he commends the efforts to date, the proposal is one of the most significant changes to Arizona government since statehood, and it is essential that it be scrutinized in great detail, particularly in light of Proposition 105 which prevents the Legislature from altering what the voters have approved. Mr. Peterson said the monies realized from the sale of state trust lands are managed by his office, amounting at this time to almost $2 billion. He discussed his concern over the following issues:

- Creation of a separate Board of Investment for state trust land
- Addition of a sixth member, which could create an opportunity for deadlock
- Lack of legislative oversight of the budget

Mr. Petersen described the existing Board membership, and said he would prefer to add two new members, including someone with investment experience. He urged adoption of a working draft and solicitation of public comments, before submitting a final version to the voters.

Senator Cannell said there was discussion of a subcommittee rather than a change to the Board. Mr. Petersen observed that the current Board discusses investment pools as well as state trust land investments.

Mrs. Landrum Taylor voiced concern over Proposition 105, as well as the provision to give away state trust lands without receiving fair market value. She suggested that this could be an opportunity to look at the investments for education. Mr. Petersen offered to provide a projection of the income to the different organizations for the next five years. He cautioned that there has been considerable fluctuation in the investments as a result of the downturn in the market, which, for example, reduced the Classroom Site fund from approximately $60 million to almost $20 million in one year.

Following continued discussion, Mr. Petersen confirmed that the distribution formula is based on revenues, and advised that the purpose of the formula is to spread out a significant downturn. Mr. Nelson remarked that there will be some risk if the State is striving for a better return.

Senator Blendu, a stockbroker, said the real issue is accountability, and he sees no reason to establish a separate Board. Following discussion of the bond rating, Mr. Petersen noted that the State's bond rating has a lot to do with the Legislature's handling of the budget and the debt, and said he does not believe it will impact the current negotiations.

Senator Allen urged caution over establishing too many Boards, as well as putting the change in the Constitution because of potential long-term ramifications.

Arizona State Land Department

Richard R. Hubbard, Deputy Commissioner, State Land Department, distributed a copy of the State Trust Land Reform proposal that was provided at the June 18, 2004 meeting (see Attachment 3), together with updated material based on an effective date of July 1, 2007. The materials include graphs and information on commercial leases, term sales, revenue assumptions with and without state trust land reform, and participation agreements.

For the benefit of those who were not present at the June 18 meeting, Ms. Lopez explained that an extensive presentation was made on the issues, including staffing. Following discussion, Senator Blendu remarked that the participation agreements represent a policy change, and he is not sure how the risk can be quantified. He urged caution in moving forward. Mr. Hubbard pointed out that there are built-in safeguards, and that open meetings would be required.

After further discussion, Senator Allen stated that she is not comfortable with an un-elected board weighted by the beneficiaries. Chairman Flake pointed out that at the present time one person, the State Land Commissioner, makes the decisions. Senator Blendu commented that the proposal appears to allow the Land Commissioner to make decisions without Board consensus. Mr. Flake noted that state trust land is currently going on the market under the guidance of the State Land Commissioner, and that this proposal provides some oversight. He opined that the State is fortunate to have done as well as it has; however, changes need to be made because of the potential liability.

Mr. Gray contended that the process has been working to date, and, with additional tools such as participation agreements, the risk will go up. He said he believes the safeguards will be insufficient when the State hits a downturn if the Board is weighted with educators. Mr. Flake pointed out that the State is approaching a magnitude heretofore unseen, now that state trust land is worth $50,000, $60,000 or even $70,000 per acre.

Mr. Hubbard noted that gross sales exceeded $300 million for the current fiscal year.

Chairman Flake continued that Arizona must be ready for a new era, including providing stewards for the 8.5 million acres still on hold, as well as conservation. In that regard, he believes the proposal under consideration is a good beginning.

Senator Allen cautioned that it is the responsibility of the Legislature to comb through the proposal and to stay together, otherwise everyone will lose. Mr. Flake agreed that the mission of the state trust land to be the highest and best use for Arizona's school children must remain paramount.

In regard to revenue estimates, Mr. Hubbard called attention to the fact that carbon dioxide (CO_2) gas and helium are emerging assets.

Jay Hogan, Flagstaff, representing himself, said he is a retired Legislative Finance Director of the Alaska Legislature and is familiar with trust land management in New Mexico, as well as the restrictions contained in the New Mexico and Arizona Enabling Acts. He related in some detail what he described as a "modest disaster" in Alaska with mental health trust litigation, which arose out of the Alaska Mental Health Enabling Act granted by Congress in 1956 (see *History of Mental Health Trust Litigation*, Attachment 4). Mr. Hogan recommended that changes of the magnitude proposed be brought before the first session of the new Legislature rather than taken up in a special session.

Senator Blendu asked Mr. Hogan if he believes the Arizona Legislature could be sued if the change is made through Congress. Mr. Hogan said while he cannot answer the question directly, he believes a 2-tier pricing mechanism could create problems. Senator Blendu noted that the proposal would give away or set aside state land for conservation, and questioned if the Legislature could be sued for taking value away. Chairman Flake queried the assertion that land will be given away. Mr. Hubbard advised that the first 300,000 acres, the conservation lands in the urban areas, would be conveyed to the cities, towns and counties, a majority of which are in rural areas. Grazing, rights-of-way, cell towers, and other revenue-generating compatible uses will continue. Following further discussion, Mr. Hubbard described conveyance of lands, and observed that the Land Department does not want the obligation, liability or expense.

Mr. Gray asked if the municipalities could start making money right away from the state trust land conveyed to them. Mr. Hubbard said revenue-producing uses would be addressed in the urban planning process, and the Commissioner has the discretion to determine when those conservation lands could be conveyed, as well as the terms. He added that he believes they would be able to charge access fees. He noted that conservation option lands are a second category in urban and rural areas. The Commissioner has the option when to release them for conveyance at fair market value, but they do not have to be purchased at auction.

Chairman Flake asked if this could subject the State to a lawsuit. Mr. Hubbard responded that the matter has been considered and is expected to withstand a legal challenge.

Joint Legislative Budget Committee (JLBC)

Richard Stavneak, Director, Joint Legislative Budget Committee (JLBC), distributed and reviewed a *Revised Presentation of State Trust Land Financing with Land Department Long-*

Range Projections (Attachment 5), that includes an update of the presentation made at the June 16, 2004 meeting to include fiscal year (FY) 2015 projections.

He reviewed the two categories of trust land monies:

- Permanent Fund (revenue mostly from trust land sales); and
- Expendable Earnings (distributed to beneficiaries)

He noted that the Permanent Fund grew by $86 million in FY 2003 and, as of June, 2003, has a total value of $1.1 billion. Without the proposal the Fund is projected to grow to $4.3 billion by FY 2015. With the proposal the projected amount is $6.6 billion.

Total Expendable Earnings are projected to grow from $64 million to $284 million in FY 2015 without the proposal, and to $472 million with the proposal. Public schools (K-12) receive 90 percent of the expendable funds.

Mr. Stavneak discussed the drop in Treasurer's earnings from $102 million in FY 2003 to $64 million in FY 2004, which is expected to recover to $110 million in FY 2005 (Attachment 5, page 12), and said he does not believe this will jeopardize future revenue bonds. Following a brief review of Proposition 102 and the Hold Harmless Provision that ended in FY 2003, he reviewed a chart (*ibid*, page 16) of the projected growth in Extra Classroom Site Funds in FY 2015. Without the proposal this fund is expected to grow to $184 million; with the proposal to $353 million.

The Land Department's Trust Land Activity budget is projected to increase from $11.6 million to $29.0 million in FY 2015 (*ibid*, page 18).

In response to a query by Chairman Flake, Mr. Hubbard asserted that the figures are conservative and take sales fluctuations into account. He noted that the reform proposal would significantly increase land resources.

<u>Janice Palmer, Lobbyist, Arizona School Boards Association (ASBA)</u>, responded to questions about the 15 percent estimate allowed the Land Department. She noted that it has been concluded that this estimate is too high and that 5 percent is more than adequate.

Senator Blendu said he is not comfortable with formula funding, and asked if the Board can make budget recommendations that would move toward a self-sufficient mode. Senator Allen opined that the Land Department has never have been adequately funded during the appropriation process. Ms. Palmer responded that the coalition looked at Senator Blendu's suggestion and agreed that it would provide greater transparency. Mr. Flake pointed out that this is a business decision, and the Land Department will need money in order to make money.

Following further discussion, Mr. Braun advised that self-sufficiency is one portion addressed in the Enabling Act and requires a State Constitutional change.

Senator Blendu asked Mr. Braun to clarify if there would be any reason to end up in litigation if the grantor (the federal government) changes the terms of the trust. Mr. Braun said there would be no reason to end up in federal or state court, provided there is a Constitutional change in addition to the Enabling Act change.

Ms. Palmer distributed a handout titled *State Land Department Funding Analysis – Trust Land Management Fund – Land Sales v. Expendable Earnings* (Attachment 6). She called attention to the fact that land sales result in a higher percentage than expendable earnings, and that the figures are conservative estimates. After reviewing the examples provided and a chart of revenue estimates based on the reform proposal, she advised that there is a possible doubling of the amount of money flowing to teachers' salaries.

Chairman Flake pointed out that it is currently illegal to take monies from the expendable earnings account without a vote of the people. Senator Allen cautioned that it is important to keep the money in the classroom.

Public Testimony

Karan Nie, Phoenix, representing herself, voiced concern about the proposal in its current form. She said while she supports conservation and open spaces, it is important to give careful consideration to any proposal to change the Arizona Constitution. Ms. Nie asked Legislators to consider the following questions:

1. Is the package as presented fair to the citizens of Arizona?
2. Is the proposal simple?
3. Why will some people get free land?
4. Is it good use of the land to allow developers to increase density rather than sell to others who would pay but cannot compete with land developers?
5. Why are small business people excluded from the process?
6. Why must the State Constitution be amended to deal with land reform?
7. How can the proposed package be considered when it does not meet the necessary criteria and form for consideration of the people?

Ms. Nie said she believes the proposal is seriously deficient and as presented is not in the best interests of the citizens of Arizona.

Without objection, the meeting adjourned at 4:24 p.m.

Carole Price, Committee Secretary
June 25, 2004

(Original minutes, attachments and tape are on file in the Office of the Chief Clerk.)