ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990 8672
6533 SENATE RESOURCES

937

by independent economic consultants such as the Center for Mineral Resource Science in Arizona (Ibid. page 10). Ironically, these recommendations by DNR's mineral valuation expert consultant coincide with the recommendations of the Commission Chairman made in a memo over two years previously, June 19, 1987.

In Search of a Resolution:

The task of valuation was far more complex, controversial and time consuming than anyone had contemplated beforehand. The public Commission members entered the effort, more than three years ago, with the belief that fair resolution of the Trust valuation was in the best interests of Alaska. To not resolve the issue and continue the legal battle could be disastrous to the well-being of all Alaskans, not just the primary beneficiaries of the trust. The Commission believed at the outset that it had the latitude to craft a resolution that could be recommended to the Legislature. This goal was pursued until mid-1989 when it became apparent DNR and the public members of the Commission could not achieve accord on the methodology to be used in implementing the approved procedures.

Only at this point did the Commission contemplate amending the originally approved procedures. At its May 16, 1989 meeting the Commission discussed (but did not adopt) a draft report submitted by the three lawyers in the case which noted "Continuing with the Commission's currently approved valuation procedures no longer appears possible" and also recommending amended procedures. These would attempt to narrow the range of values calculated by use of the two sets of methodology and the Commissioner of DNR would determine a value within the narrowed ranges.

No progress was made toward narrowing the range and a team composed of the three lawyers in the Weiss case and a DNR staff member explored the possibility of using negotiation to arrive at an acceptable value for purposes of settlement. The defendants made a token increase (mineral value from $16 to $73 million) and the plaintiffs decreased their value by $200 million. At the October 1989 Commission meeting the team announced an impasse leaving a difference of more than $1.5 billion.

At this point Designee Swope agreed that a resolution setting forth procedures should be placed before the Commission for a vote. This was done on November 7th, 1989. The public members and their alternates stand firm on their final approved recommendations. We followed the law. We recognize a divergence of opinion exists. We see it as unfortunate complete consensus was not achieved. However, complete consensus may never be reached. We feel it is essential to

complete the task of reconstituting the Trust and removing the threat of continued litigation and resulting disruption.

We urge the Commissioner of the Department of Natural Resources to use the Commission procedures in establishing a fair market value for the Mental Health Trust.

Senate Resources Committee Briefing: by Alaska Mental Health Board Lands Committee, February 14, 1990

- PURPOSE FOR AMHB APPEARING BEFORE RESOURCE COMMITTEES
- STATUS OF THE VALUATION PROCESS & STATUS OF THE LAND
- History of the Selections: Multiple Estates for Income Production
- A Review and Critique of the Process of Valuation
- "The Linking of the Appraisal Process"
- The TRUST
- Chapter 48 SLA 1987, The Legislature's Settlement Proposal
- The Opportunity for Legislative Action

PURPOSE FOR AMHB APPEARING BEFORE RESOURCE COMMITTEES

- REVIEW REPORTS FROM THE DEPARTMENT OF NATURAL RESOURCES REGARDING THE VALUATION OF THE MENTAL HEALTH LAND TRUST AND THE STATUS OF MENTAL HEALTH TRUST LAND
- MEET WITH APPROPRIATE LEGISLATIVE COMMITTEES CONCERNING THE BOARD'S ACTIVITIES

STATUS OF THE VALUATION PROCESS & STATUS OF THE LAND

- IMHTC Final Approved Procedures, November 7th, 1989
- IMHTC Majority Report, (Final Draft), December 20th, 1989
- Minority Report by Designee Swope, Febraury 1, 1990
- Senate Special Committee on Mental Health Report, January 1990
- Impasse
- Final IMHTC Resolution, January 24, 1990

History of the Selections: Multiple Estates for Income Production

- Surface Estate: Municipal Expansion
- Forrest
- Mineral

A Review and Critique of the Process of Valuation

- Envisioned mutuality of purpose: fair market value
- The reality of IMHTC dealing with a matter in litigation

THE LINKING OF THE APPRAISAL PROCESS

- VALUE THEORY
- VALUATION THEORY
- APPRAISAL THEORY
- VALUE PREMISE

VALUE THEORY

- A. Answers why a particular property, or an interest therein, has worth
- B. Defines the sources and bases of an asset's worth
- C. Currently recognized elements of an asset's worth include:
- ---Utility (both as the ability to satisfy needs and for practical use)
- ---Scarcity (of supply)
- ---Demand
- ---Ratio of exchange
- ---Ability to transfer ownership

VALUATION THEORY

- A. Valuation theory is the method of estimating, measuring and predicting a defined worth.
- B. Valuation theory enables us to focus on the various methods that are used to arrive at a value estimate.
- C. Valuation theory further allows and recognizes that there is a distinction between value and price that may be commanded in a market at a given point in time. This suggests the following:

C. Valuation theory further allows and recognizes that there is a distinction between value and price that may be commanded in a market at a given point in time. This suggests the following:

1. Value is a collection of elements that comprise worth, each of which must be defined.
2. Price is an historical fact that may or may not coincide with an assets recognized worth at the same point in time.
    a. Some examples of Price not being representative of Value are seen during periods of economic depression and recession and in liquidation sales.

APPRAISAL THEORY

- A. Appraisal theory is the logic format by which Value Theory is linked to Valuation Theory as it relates to a specific defined interest, i.e. any one of several estates subject to ownership in any given parcel of real property at a specific point in time.
- 1. Appraisal theory is the logical relationship between the Source of Value and its estimation.
- B. It is perhaps the failure to recognize the theoretical underpinnings of this analysis that results in the inability to link different value concepts, such as sales comparison, income capitalization or cost approach, to an assets worth.
- 1. There is still a lingering perception that within the many land estates that are the subject of valuation, that these approaches somehow constitute equivalent value measures. They do not.

VALUE PREMISE

- A. DEFINITION OF VALUE PREMISE
- B. EXAMPLES OF VALUE CHARACTERISTICS
- C. POSITIONING THE VALUE PREMISE
- D. THE NATURE OF THE DEBATE

A. DEFINITION OF VALUE PREMISE

- The emphasis of the appraisal logic placed on the **characteristics of value** as they relate to an identified estate, i.e. timber, mineral, surface etc..

B. EXAMPLES OF VALUE CHARACTERISTICS

1. Surface estate: Dependent on size, location and market activity may be valued by all three methods. Comparable sales would only be appropriate where such a market within a comparable context exists for the subject being valued.

a. Surface estates are unique in that demand must be created in place. Commodity estates (minerals, oil & gas, etc.) in theory can respond to demand anywhere within the global market place.

2. Large mineral estate: Typically by income approach

a. Large mineral estates have a very limited market of qualified developers.

b. Large mineral estates are usually developed via Joint Venture and leasing arrangements, not outright purchase.

c. Large mineral estates are usually promoted into development by their owners.

C. POSITIONING THE VALUE PREMISE

Identifying the varying value premises and the different emphasis that can be placed on each value characteristic, leads to a valuation process that supports the appropriate positioning of the value premise.

1. Here is where Highest and Best Use analysis focuses.

   a. The considerations in such analysis generally are:
      - Is the use legally permissible?
      - Is the use currently feasible?
      - Is the use functionally compatible?
      - Is the use most profitable?

   b. Current management practices are not a consideration in this evaluation. It is assumed that a property shall be managed to its highest and best use.

2. Highest and Best Use is not a fact to be found. It is a judgment decision on the part of the valuator.

D. THE NATURE OF THE DEBATE

- The foregoing considerations applied to the IMHTC/DNR rendering of value for Mental Health Trust Lands shows that the debate is not one of Value or Valuation Theory, but where the parties asserted a different value premise for several estates under consideration that led to different appraisal methodologies being applied. The failure of DNR to accept the value characteristics of the mineral estate, as approved by the majority of the IMHTC, led to the most serious value diminution of the trust corpus.

The TRUST

- The Supreme Court stated there is a Trust.
- To have a Trust there must be a Corpus.
- There appears to be no Statutory Authority to manage the Trust properly.
- Reserving: No provision for reserving for the depletion of non-renewable resorces.

Chapter 48 SLA 1987, The Legislature's Settlement Proposal

- Purpose: To reconstitute a mental health trust through identification of land in legislatively designated areas that is equal in value to the land selected by and patented to the state under section 202 of the Alaska Mental Health Enabling Act.

The Opportunity for Legislative Action

- Return to the Courts
- SB493/ HB548

[redacted]

[redacted] OF
ALASKA [redacted] TRUST LANDS

BY

PAUL [redacted] METZ and COLIN DIXON

December 31, 1988

[redacted]

Part IV -- Summary and Conclusions

The expected fair market value of the Alaska Mental Health Lands with respect to metallic minerals, coal, and sand and gravel is $1,506 million, $3.2 million, and $13 million, respectively. Thus, the corpus of the Trust is rounded out at $1,522 million.

The value for metallic minerals is considered a conservative estimate. The value attributable from coal and sand and gravel is highly dependent on development of markets for these commodities. The development of markets is in part a function of public policy which in turn increases the level of uncertainty in the value estimates.

As defined in state law, the fair market value of the Mental Health Trust corpus is 8 percent of the fair market rental value of the land. From the above, the fair market annual rental value of the corpus of the Trust is calculated at $121.8 million.

Older Alaskans Commission

Box C
Juneau, Alaska 99811-0209
907/465-3250

POSITION PAPER ON CS FOR SENATE BILL 493 (HESS)

The Older Alaskans Commission supports CS for Senate Bill 493 (HESS), which would finish the process started in 1987, of reconstituting the mental health lands trust.

The OAC was appointed by Governor Cowper to represent the interests of one of the mental health "beneficiary" groups as declared by Judge Greene's April 1988 decision in the second part of the Weiss v. State lawsuit, namely "senile seriously mentally ill" persons (known today as Alzheimers and related disorders).

Since mid-1988, the OAC has worked extensively with the Alaska Mental Health Board on issues related to the mental health trust. We have become acutely aware of the need to get the lands trust reconstituted and the valuation of the lands settled, so that the present "interim settlement" of the Weiss litigation can come to final resolution--and remove the overshadowing threat of more court battles.

The OAC would also urge legislators to remember that the 8% fair "rental value" which the State would pay each year into the Mental Health Trust Income Account is a compromise figure already adopted in Chapter 48 of the 1987 Session Laws. As we understand the situation, the 1987 Legislature wrote Chapter 48 to avoid continued litigation over all the various trust lands which had been disposed of by the state for less than full market value, or otherwise in contradiction of the state's trust duties.

The Older Alaskans Commission does not have expertise on these land valuation matters. However, the OAC feels that the 1987 Legislature set up the Interim Mental Health Lands Commission, in Chapter 48, and that the current Legislature should give great weight and deference to the majority report of that Commission, a report which would support the system and valuation contained in CSSB 493 (HESS).

The Older Alaskans Commission urges your early and favorable action on this bill.

APPROVED:

Peggy A. Burgin

Peggy A. Burgin, Chair
Older Alaskans Commission

DATED: March 27, 1990

REVIEWED AND "no comment":

Frank S. Baxter, Commissioner
Department of Administration

DATED: 3/25/90

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400

April 17, 1990

Ms. Thelma Langdon
Chair
Alaska Mental Health Board
2363 Captain Cook Drive
Anchorage, AK 99517

Dear Ms. Langdon:

In accord with AS 38.05.800(a), the commissioner of natural resources is charged with determining the fair market value of the original one million acre mental health land grant under procedures approved by the Interim Mental Health Trust Commission (commission). In addition, the commissioner, with the approval of the commission, is to identify land within legislative designations that is equal in value to the original mental health trust lands.

On February 1, 1990, my designee to the commission submitted a minority report regarding procedures to determine the fair market value of the mental health trust and replacement lands. The report detailed the reasons for his dissent from the majority report, and outlined procedures used by the Department of Natural Resources (department) to produce a fair market value of $564,700,782.82 for the total original mental health trust lands.

On March 20, 1990, I received the final majority report of the commission. The report critiqued the minority report and confirmed a December 20, 1989 draft as the commission's final report. The December 20, 1989 report of the commission specifically approved procedures for determining the fair market value of the original mental health trust lands. The procedures produced a value of $2,243,000,000 for all land selected by or patented to the state under the Alaska Mental Health Enabling Act.

After reviewing the two reports and their respective valuation procedures, I have concluded that I cannot use either set of procedures and still act consistently with the law. Therefore, I have no choice but to declare an impasse as I am prevented from

fulfilling my statutory mandate of determining the fair market value of the mental health land grant, as well as to identify equal value replacement land.

In retrospect, I believe Chapter 48, SLA 1987 set an unrealistic goal when it contemplated that all parties could work together on a consensus basis to implement the law. Initially, it appeared as though the consensus approach would be successful. Later in the process, particularly after initial land values began to emerge, the consensus process began to deteriorate as the parties began to disagree over valuation approaches. Since the legislation provided no specific mechanism to resolve such disagreements other than through the commission, the process soon became unworkable as the parties gravitated to their respective positions.

The Commission's Report

Chapter 48, SLA 1987 specifically required a determination of "fair market value." However, my reading of the commission's December 20, 1989 report causes me to conclude that fair market value is not what is produced by the procedures the commission majority approved.

For example, the review appraisers (who examined the work of the three opinion of value geo-panels valuing the surface estate) were instructed in writing by the lawyers for the plaintiffs and intervenors to determine "the highest value that can be supported in the market." Under the procedures approved by the commission majority, the resultant value was later averaged with the final adjusted fair market value determined by the geo-panels. These same review appraisers were also instructed by the same lawyers to look only at those individual mental health parcels which might have been "undervalued" by the geo-panels. As there was no corresponding search or review of any "overvalued" parcels, I believe this approach was disproportionately weighted to the high value end of the spectrum. I also conclude the commission acted arbitrarily when it decided to establish a final value of the surface estate by simply splitting the difference between the revised parcel values determined by the geo-panels and the unadjusted values determined by the review appraisers. In my opinion, the resultant compromise value bears no relationship to fair market value.

The most significant problem in the procedures approved by the commission majority in the December 20, 1989 report, however, lies with the hard rock mineral valuation. The commission

majority based its hard rock mineral value on the work and recommendations of two consultants hired independently by the lawyers for the plaintiffs and intervenors. The consultants used a discounted cash flow approach, producing a hard rock mineral value of $1.51 billion for the original mental health land grant. The minority member used a comparable sales approach, the standard for determining fair market value, producing a value of $73.5 million.

While I do not necessarily disagree with the income value approach, several assumptions used in that approach were incorrect. Dr. DeVerle Harris, a nationally recognized expert on valuation procedures and the discounted cash flow approach, noted several incorrect assumptions used by the consultants which resulted in a gross overestimation of the hardrock mineral value, as did the University of Alaska's Institute for Social and Ecoromic Research. One such assumption was that there was full mineral production from all one million acres of the original grant on the date of valuation. The reality is that there is little if any production even today. The unreasonableness of the $1.5 billion value is clear when it is recognized that more than $4 billion in annual mineral production would be required to support that figure. Annual statewide production in 1987 was only $200 million.

Finally, in my view, the majority report also fails to adhere to the statutory requirement that there be consensus on the valuation procedures used. Section 2 of chapter 132, SLA 1986, as amended by section 9 of chapter 48, requires the commission to review valuation procedures proposed by the commissioner. AS 38.05.800(a), also enacted as part of chapter 48, requires the commissioner to use valuation procedures approved by the commission. Section 2 of chapter 132, as amended, requires the commission to then review the value thus determined. Particularly when it is remembered that chapter 48 was viewed by all parties as a framework for settlement, the only reasonable construction of these provisions is that neither the plaintiffs and intervenors nor the department can adopt valuation procedures over the other's objection. Yet that is what the commission majority has done. The December 20, 1989 majority report reflects the use of numerous procedures which were not proposed by the commissioner and are unacceptable to the department.

The Minority Report

AS 38.05.800(a) requires the commissioner to determine "fair market value" based on procedures approved by the commission. Several of the procedures included in the minority report were not approved by the commission.

I do believe, however, that the department took very seriously its charge to determine the fair market value of the mental health lands. Under the statutes the department normally operates under, there are numerous references to "fair market value" (i.e. AS 38.05.055, 38.05.057, 38.05.067, 38.05.068, 38.05.075, 38.05.087, 38.05.102, 38.05.105, etc.). The department has operated most of its disposal and lease programs using this appraisal standard. The interpretation of fair market value has been consistently interpreted and applied by the department over the years. I also believe that the values provided in the minority report accurately reflect fair market value.

Among the first procedural decisions made by the commission in September, 1987 was its adoption of the definition of "fair market value" proposed by the department. This definition was the same as that used by the American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, and the same one used over the years by the department. Based upon this action, the department consistently used this definition while the commission later departed from its use.

Summary

Although I have no recourse but to declare an impasse, I believe there are ways to break this procedural logjam so as to achieve the primary goal of all affected parties--namely **to ensure that there is a guaranteed source of state funds from which the legislature would first appropriate to cover the needs of the state's mental health programs:**

1. Request that the court issue instructions prior to any further legislative action. There are several legal questions which could be answered before policy options are pursued. The Department of Law has advised that the court will issue advisory opinions which involve a trust, and trustees can obtain such instructions as they relate to their trust administration powers and responsibilities. I believe these instructions could be timely obtained and pledge to assist in their

development. The interim provision in Chapter 48, SLA 1987 that pays the trust five percent of the state's unrestricted general fund per annum could remain in effect until an advisory opinion is rendered.

2. Replace "fair market value" with "value" as it appears in AS 38.05.800(a).

3. Remove the requirement in AS 38.05.800(a) that the commission approve the procedures to be used to value the original grant and the replacement lands.

4. Again, consistent with #1 above, another possibility (although one which would not provide a guaranteed source of funds for the state's mental health program in perpetuity) would be to purchase the lands from the trust at fair market value over time and appropriate the proceeds for the state's mental health program. Over time, this would result in all the mental health lands being purchased from the trust and removed from trust status, with the proceeds of the sales going to the state's mental health income trust account. The Alaska Supreme Court seemed to authorize this approach in the Weiss decision when it stated that the remedy for lands which the state has sold is to pay the trust the fair market value of the lands at the time of sale, but that the state should receive a set-off against that liability for money it has spent for the state's mental health program, and that this could result in the state having no monetary liability to the trust (In pointing out this alternative, I am not suggesting that this is an appropriate policy for funding the state's mental health program. As the state's land manager, however, I feel compelled to point it out as a possible option for removing mental health lands from trust status so they can be managed for their highest and best use and not merely to raise revenue).

5. Replace the five year reappraisal requirement in Chapter 48, SLA 1987 with a simple index formula which accounts for inflation and appreciation. This index could then be implemented automatically, with the mental health income trust account adjusted on an annual basis.

I appreciate the immense importance and timely resolution of this very complex and sensitive matter. Accordingly, the department is prepared to offer any assistance that may be required to resolve this dilemma consistent with the Alaska Mental Health Enabling Act.

Sincerely,

Lennie Gorsuch

Lennie Gorsuch
Commissioner

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

MEMORANDUM April 25, 1990

SUBJECT: Mental health trust
(CSSB 493 (HESS))

TO: Senator Jack Coghill

FROM: Richard A. Bradley
Legislative Counsel

Bruce Geraghty has requested a sectional analysis that points out the differences between SB 493 as introduced and CSSB 493 (HESS).

Section 1 of both bills repeals and reenacts AS 37.14.011(c).

In the introductory paragraph of (c), the words "fair market" are deleted in CSSB 493 from the phrase "fair market value of the land" on lines 11 - 12 of SB 493. Similarly, after the "value of the land" on line 12 in SB 493, the phrase "selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" is added in the CS.

In (c)(1), after the phrase "acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" in SB 493 at line 20 is added the phrase "that is located in municipalities that assess land for property tax purposes" in the CS.

In (c)(2), after the phrase "the average percentage change in assessed values for that municipality" in SB 493 at line 24 is added the phrase "since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act;" in the CS.

There are no other revisions from SB 493 to the CS.

If I may be of further assistance, please advise.

RAB:gc
G14/032

INTERIM MENTAL HEALTH TRUST COMMISSION

FINAL REPORT

(December 20, 1989)*

on

Approved Procedures for Determining the Fair Market Value
of
Alaska's Mental Health Trust Lands

George Rogers, Ph.D.,
Chair

Lidia Selkregg, Ph.D.,
Commissioner

K.J. Metcalf,
Alternate

Dennis Scholl, Ph.D.,
Alternate

*Appendix D is a copy of Minority Recommendations submitted February 1, 1990, and Appendix E is the Response to the Minority Recommendations, dated March 20, 1990. Other than these additions and minor corrections, this Final Report is identical to the Draft Final Report of the same date.

I. INTRODUCTION AND BACKGROUND

In 1956, the Congress granted the Territory of Alaska the right to select one million acres of land to be managed as a public trust to produce income that would be, "applied first for the necessary expenses of the mental health program of Alaska." However, after selecting the most promising income producing potential lands available at the time, the State never actively managed these lands as a trust. There was no effort to protect the corpus from dissipation or to generate maximum income in the interest of the primary beneficiaries.

To the contrary and from the beginning, lands were conveyed from the trust at, frequently, less than fair market value and for purposes not allowed in the 1956 legislation. The Alaska Legislature even attempted to dissolve the trust in 1978. (Ch. 181, 182, SLA 1978) By October 4, 1985, of the original one million acres, only 194,672 acres of land remained in unencumbered grant land status. (Interim Mental Health Trust Commission, Report to the Legislature, February 1987, "APPENDIX C: THE MENTAL HEALTH LAND TRUST")

In 1982, beneficiaries of the trust sued the state for breach of its trust responsibilities. In October, 1985, the Alaska Supreme Court agreed the state had breached its trust responsibilities and ordered that, "the trust must be reconstituted to match as nearly as possible the holdings which comprised the trust when the 1978 law became effective." State v. Weiss

706 P.2d 681 (1985). This reconstitution was deemed impracticable at best by the State and it strenuously resisted the reversal of previous actions taken on mental health trust lands that would be required. Therefore, to help devise an acceptable method of alternative or constructive reconstitution of the trust, and to assure proper trust management in the interim, the legislature in 1986 created this Interim Mental Health Trust Lands Commission (Commission). See Ch. 132 SLA 1986. Under legislative auspices, discussions thereafter took place between all interested parties to seek acceptable alternative means of reconstituting the trust.

In its February, 1987 report to the Legislature, at page 20, the Commission concluded that, "[t]he number, complexity and importance of the questions raised by the Weiss Opinion's trust reconstitution instructions urges a negotiated settlement." The concurrent work of special legislative committees also all supported and adopted the concept of a negotiated resolution. This unanimity culminated in the passage of Chapter 48, SLA 1987 (Chapter 48). Chapter 48 directed a replacement trust corpus be created from lands currently in legislatively designated areas equal in value to the September, 1987, value of the original one million acres received by the State under the 1956 legislation, with the state then to pay "rent" at 8% per year on this value into the mental health trust income account.

Under Chapter 48, this Commission, composed of the Commissioner of the Department of Natural Resources (or her designee),

and two public member, Dr. George Rogers, and Dr. Lidia Selkregg[1] was directly charged with approving procedures on behalf of the Commissioner of the Department of Natural Resources for determining the 1987 fair market value of the original one million acres of mental health trust lands and, also, of identifying lands of equal value among eight million acres of potential replacement lands within legislatively designated areas.

Commencing with its June 9, 1987 meeting and continuing through its meeting of November 7, 1989, the Commission held over thirty public meetings or work sessions in order to evolve its finally approved procedures for determining the fair market value of the original mental health trust lands. Each meeting was public and its subject matter was noticed to all interested parties and an opportunity allowed for all to present and argue their views both orally and in writing[2].

1.The chairman of the Commission, Dr. George Rogers, is a professional resource and general economist, having his first contact with Alaska resources in 1937 while working in the economics department of Standard oil of California. He has been an Alaska resident since 1945, serving as an economist with the Department of Interior, Resources for the Future and the University of Alaska where he established its Institute of Social and Economic Research in 1960-61 and is Professor Emeritus. The other public member of the Commission, Dr. Lidia Selkregg, a professional geologist and planner has been involved in land and resources issues in Alaska since 1958. She is the author of the 6 volume "Alaska Regional Profiles" and a Professor Emeritus of the School of Public Affairs at the University of Alaska, Anchorage. Both of these members have served on many State and Federal land use and natural resources commissions and committees and bring decades of experience in many of the issues being addressed by the Commission.

2.References to documents herein that have not been published, are to documents presented to or prepared by the Commission and kept on file by DNR, acting as the Commission's staff.

At its November 7, 1989 meeting, the Commission (with one dissent) adopted final valuation procedures in conformity with the legislative intent (copy attached as Appendix A). In all instances, standard and specific industry methodologies were adopted, as necessarily modified for use within rather severe constraints of available time and money. The procedures were then forwarded on the same date to the Commissioner of Natural Resources to make the resulting determination of fair market value for the one million acres of mental health trust lands, as required by Chapter 48. This Report is intended to provide in one document the background and rationale supporting adoption of these procedures.

II. DISCUSSION

A. FAIR MARKET VALUE

Chapter 48 requires the determination of the "fair market value" of the original corpus and replacement lands. While there was consensus on the general approach and procedures to be followed, the precise definition and means of determining the fair market value has caused continuing disagreement.

In legal memoranda to the Commission, attorneys for the Plaintiffs and the State agreed that "fair market value is the highest price which a hypothetical willing buyer would pay a hypothetical willing seller in a free and open market." (Gottstein, May 4, 1989, Re: Definition of Fair Market Value;" Koest-

er, May 9, 1989, "Fair Market Value.", emphasis added) Additionally, they agreed "that there is no 'inexorable rule' by which fair market value is to be determined, and that the comparable sales method is not the only one which may be used." (Koester, op. cit., page 4) All parties also agreed on the following statement at the July 12, 1989 Commission meeting:

> Fair Market Value for purposes of Chapter 48 means utilization of the best information and methodology available within time and funding constraints to arrive at fair market value.

(Transcript, page 54)

While recognizing the income approach was an appropriate methodology for valuing resources, DNR applied only the market or "comparable sales" approach in valuing the mineral endowment. As late as the September 5, 1989, meeting, the lead staff member for DNR, Mr. Gustafson, stated: "The market approach [comparable sales] is what we always felt is required under terms of the legislation. There are a lot of other ways that you could put a value on this thing. We could have done that too, but we have been faithful to the market approach because that is what the Legislature required." (Transcript, page 55). The Commission does not agree that the Legislature required use of only the "comparable sales" ("market") approach for valuation.

Under Congress' intent in the 1956 legislation and subsequent selection of the lands by Alaska, mental health trust lands were to be managed as a public trust for income production rather

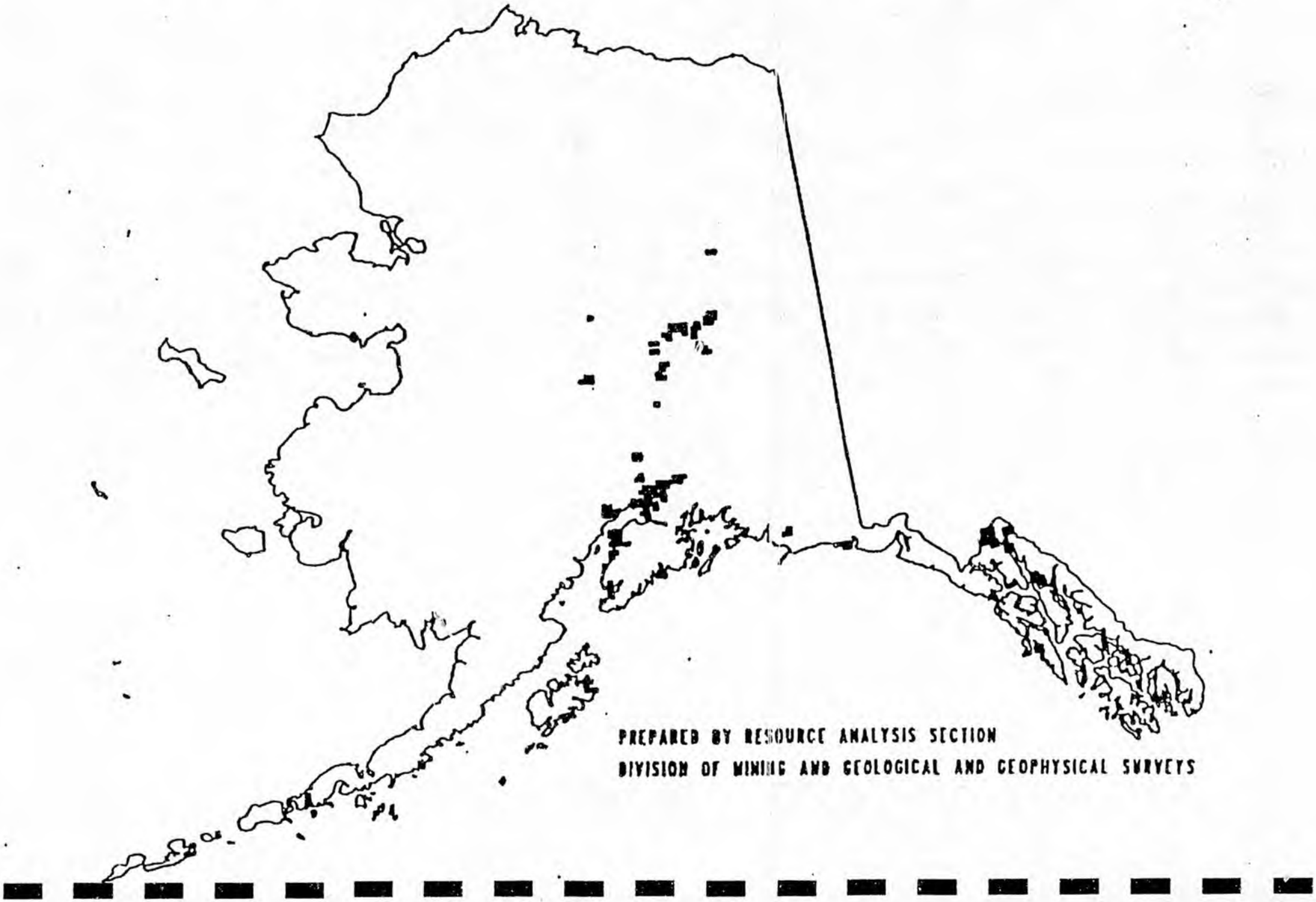
than as a repository of land for resale. Pursuant to that intent, the land selections made by the Territory and State of Alaska between 1956 and 1965 were based upon income analysis. Selections were anticipated to be suitable for development and targeted lands surrounding the principal urban centers and known commercially valuable natural resource lands along or adjacent to the main rail, water, highway and road transportation systems. (Refer to Figure 1).

Approximately half the mental health trust lands were urban and sub-urban lands, selected because their values would appreciate at a high rate in response to community growth. Timber lands were selected with the view that they would become the core of the State's forest system (which they are) and hydrocarbon and mineral lands were selected from the major active mining areas of the State.

These selection methodologies are inherently inconsistent with an intent to base mineral value on comparable sales, as value or income would have been derived from these lands without any sales, but through mineral leases, joint ventures, and similar transactions between the trust and developers. Accordingly, rather than being restricted to the comparable sales approach, the Commission adopted procedures that are most appropriate to the valuation being performed. As noted, these are in all instances those used in practice by industry, with appropriate adjustments dictated by lack of funds and time.

FIGURE 1.

TRUST LANDS: MENTAL HEALTH GRANT (1956)



B. ESTABLISHING PROCEDURES

In his June 1987 Review, Commission Chairman Dr. George Rogers recommended that:

> Rather than use one appraisal approach (market data) as was done in 1985 and 1986, the accepted approaches most appropriate to each classification should be used. For example the market approach would appear suited to urban residential and commercial lands while the income discounting approach would be best for. . . lands which were selected not for resale but income production management. . . [these] should be valued by contract with a firm experienced in natural resource analysis and valuation rather than another panel of real estate appraisers.

This was not acceptable to DNR but, since consensus was desired, a compromise was reached. The surface estate of the entire corpus would be valued by means of three geographic opinion-of-value panels of three appraisers each, with provision for review, questioning and mediation of any remaining differences. The "review process" of Plaintiffs submitting questions regarding valuations through their review appraisers and the subsequent consideration and resolution of these questions, was deemed

essential to the legitimacy of the process and to overcoming the demonstrated shortcomings of the opinion-of-value process[3].

The natural resource endowment and value estimates would be accomplished by the natural resources division of DNR, with input

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3.In 1985 the State attempted to put a value on the trust corpus in response to the initial lower court decision in the Weiss litigation. This effort is an illuminating case study of the role of procedure design and implementing methodology in determining the outcome of a process. A rough opinion of value process was used for the surface, a token value for only part of the sub-surface endowment, and addition of 10.5% interest annually from July 1978 to July 1985. (Alaska Department of Natural Resources, May 1985, "Value Summary Mental Health Land Retained in State Ownership.") To this was added the estimated value of conveyances from the trust prior to July, 1978, giving a total estimate of approximately $600 million as of July 1985.

There was a great deal of criticism of this 1985 opinion of value panel process, and the majority of the Commission as well as others believed the figure arrived at was too low. During their study of settlement options, for example, the 1986 special legislative joint committee and the Commission used a proxy value for the trust of $2 Billion. According to the Commission's chairman, the low 1985 estimate was due to an inadequate and incomplete value definition and use of inappropriate methodology. (Rogers, June 19, 1987, "Analysis of Valuations and Appraisals of Mental Health Trust Lands.") Coal, oil and gas subsurface values were limited to token estimates based only on proven reserves, and no value was assigned to other resources with development potential. The surface value panel's instructions were that "only the Market Data Approach [comparable sales] will be used" as the "subject property is being valued as vacant [and unimproved] and no income stream is projected." This further biased the results toward a low value. Value of improvements on MHTL and much of the income producing values were lost without the cost and income approaches.

DNR staff did not agree with the conclusion that the 1985 opinion of value panel results were invalid and defended its exclusive use of the comparable sales approach on grounds of practicality -- it was used customarily by the State, would cost less than other approaches, and the results would not significantly differ (Gustafson letter to Rogers, July 24,1 987). Other methodologies were also deemed by the State to be speculation.

from the beneficiaries. Where it was not possible to arrive at a value in-house, this task would be contracted to a consultant.

The actual task of implementation was much bigger, complicated and controversial than anyone envisioned initially and for a brief period between its April and July, 1989 meetings, the Commission explored alternative paths to valuation.[4] However, recognizing that none of these approaches might prove feasible, the Commission remained oriented towards completion of its mandate in Chapter 48 to approve procedures to determine the fair market value of the original mental health trust lands. In this

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4.At its May 16, 1989 meeting the Commission discussed (but did not adopt) a draft report to the Legislature which concluded: "Continuing with the Commission's currently approved valuation procedures no longer appears possible." It was proposed, alternatively, that (1) a range of values be determined for each category, (2) mediation between Commission members would attempt to narrow this range "to the maximum extent possible," (3) these values would be integrated into two sets of values, and (4) the Commissioner of Natural Resources would determine a value within these ranges (Draft of "Interim Mental Health Trust Commission Report Sixteenth Alaska Legislature", dated April 1989, submitted by G. Thomas Koester in response to a "Discussion Draft", dated April 13, 1989 with the same title submitted by J. Gottstein).

By the July 1989 meeting no significant progress had been made in narrowing the range and the Commissioner of Natural Resources indicated she would not necessarily determine the value between the range established by the procedures. Further options were then examined. The first was to go beyond Chapter 48 and negotiate a value for settlement purposes only. The Commission appointed a team (the three attorneys active in its work and the chief DNR staff member) to explore the feasibility of negotiation. The final report of the negotiating team of October 27, 1989 stated that "the parties are at impasse" and the remaining difference of more than $1.5 billion can not be resolved through negotiation at this time."

connection, the attorney for the State advised the Commission[5] that these procedures,

> could be as general as . . . [saying] the Commissioner will come up with a value based on all the information of record and justify it. . . or they could be as detailed and specific as to say, with respect to mineral valuation, the Commissioner shall determine the value of the subsurface estate by employing a ten percent discount factor, assuming production begins in year five, you know, all those assumptions that go into that kind of an economic analysis. Those can be specified. It seems to me those are part of the procedures that the Commission can approve.

(July, 12, 1989, Commission Meeting Transcript, P. 59). And as observed earlier, all parties agreed such procedures could reflect compromises and abbreviations necessitated by funding and time constraints.

C. IMPLEMENTING THE PROCEDURES

The procedures approved match as closely as possible accepted valuation methodology for the various estates and result in an appropriate determination of fair market value for the purposes

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5.The Attorney General's office, at its insistence, represents, through the same Assistant Attorney General, both the State as the Defendant in the Weiss litigation and the Commission in performing its duties under Chapter 48.

of Chapter 48. This is so despite the lack of a completed surface estate valuation and despite the lack of formal "appraisals" occasioned by the previously noted funding and time constraints.

The surface estate valuation was terminated before the first review step was completed because funds and time were exhausted. This was due, in large part, to the approximately 4,000 parcels questioned by the review appraisers[6]. The total fair market value of the original mental health trust lands recommended by the review appraisers was $833.3 million. The total fair market value of the original mental health trust lands found by the panels, after adjustment to reflect as much of the review process that did occur was $499.8 million. Recognizing that differences of this percentage magnitude between appraisers' opinions of value were not uncommon[7], the Commission determined that the only reasonable procedure to approve was simply to "split the difference" between these two figures, as is more fully discussed in Appendix B.

With respect to the mineral endowment, the Alaska Division of Geological and Geophysical Services, (DGGS) provided an esti-

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6.All of the parcels questioned by the Plaintiffs' review appraisers that were looked at by the Commission appeared to have a reasonable basis for the question.

7.Even where formal "appraisals" have been commissioned, the appraiser's "appraisal" is that appraiser's opinion of the value of the subject property. The percentage difference between the panels opinions' of value and the review appraisers' would not be unusual if full appraisals had been used in both instances. Appraisals are simply an "estimate" or "approximation" of "the highest price a willing buyer would pay a willing seller, . . .",

mate of the physical endowment for the mineral estate of mental health trust lands. However, instead of pursuing the industry standard discounted cash flow ("income") approach as agreed, DNR reverted to use of the comparable sales approach. DNR's use of the comparable sales approach first produced a zero value, as in 1985, and was later revised to approximately $16 million on the basis of three alleged comparable sales.

The use of the comparable sales approach for valuing the mineral estate was summarily rejected by the majority of the Commission as not being in accordance with accepted industry valuation practices and, moreover, as being manifestly unreasonable and unrealistic. These lands were all within the three major active mining districts of Alaska and had been selected by a team of experts as representing the most promising lands in these areas.[8] (See Appendix C).

In the absence of a viable valuation of the mineral estate, a team of consultants was commissioned by the Plaintiffs to estimate the mineral endowment value using accepted industry methodology, i.e., the income approach, as originally proposed in June of 1987. Their report (Paul Metz and Colin Dixon, December 31, 1988, "Mineral, Coal and Aggregate Resource Appraisal of

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8.The reason offered by DNR for failing to utilize the income approach was DGGS's estimated cost of providing a value estimate at $53 million, which involved a surveying and drilling program. In this connection, it may be worth noting that D. Harris, the State's consultant later estimated the cost of estimating a value at $350,000 using essentially the same data that the Commission ultimately approved (Harris, Sept. 1989).

Alaska Mental Health Trust Lands") discussed their methodology, data and assumptions and the decisions they made, based upon their professional judgments, regarding the best way to value the mineral estate under the circumstances. At the presentation of their Report to the Commission at its February 24, 1989, meeting, Metz and Dixon also reviewed for the Commission the areas of uncertainty and the "safety factors" they used to insure the value was not overstated. Their analysis resulted in an estimated $1.5 Billion value for the mineral estate of mental health trust lands. Following intensive critical review by DNR staff and others, an independent study commissioned by DNR concluded that although not always following "best practices," the methods and assumptions were acceptable " . . . if only approximations were required and that their methods were consistent with the data available through DGGS's mineral endowment assessment" (Harris, May 30, 1989).

In the follow-up study by Harris issued in September, 1989, "Activities and Costs for the Estimation of Market Value of Mineral Resources of Alaska Mental Health Trust Lands," and the earlier study by Bradford Tuck and Matthew Berman commissioned by DNR entitled, "Review and Analysis of 'Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands' by Paul A. Metz and Colin Dixon" (March 1989), there was also agreement as to utilization of the income approach as being the appropriate methodology. DNR nevertheless remains insistent, but without any expert having indicated it was a valid methodology, that they would only accept their comparable sales approach.

Since the State's approach had no expert support, resulted in an unrealistically low value, was not pursued with any sort of rigor by the State, and was not even supported by its own independent study, it was rejected by the Commission. On the other hand, there was general agreement by all experts that the income approach used by Metz/Dixon to arrive at their valuation was the appropriate one and that, while perhaps "best practices" were not used for every element because of time and funding constraints, the methodology, data, assumptions and judgment utilized were the result of informed decisions by knowledgeable experts. Therefore, the Commission approved the procedures used in the Metz/Dixon valuation (see Appendix C for a complete description).

For the remaining land categories, the dollar differences were not so great and the Commission's basis for resolving the differences has therefore not been as controversial. The Commission approved the report of the Division of Forestry in its valuation of timber resources (August 1988). Plaintiffs argued that reforestation costs (approximately $31 million) should not have been deducted from the value because the timber should be valued as if "sold" to the State as "standing timber." The Commission rejected their approach and agreed with DNR's position that these costs were essential to sustained yield forest management and that the original mental health trust lands selections were made with the intention that they would become the core of a State forest system (which they are).

The Division of Oil and Gas proposed a plan for valuing hydrocarbon (oil, gas and coal) potential which was accepted by the Commission (October 13, 1987). A preliminary report (July 1988) and a revised report (November 2, 1988) were criticized because they did not accomplish what the accepted plan proposed to do, and because they considered only known reserves (Vreeman, March, 1989). The range of values presented ($135,953 to $856,040) appears grossly low in light of the State having received over $25 million for exploration and development rights on mental health trust lands. Although clearly needed, no attempt by the Plaintiffs was made to produce an alternative estimate. In light of the lack of any alternative estimate and the necessity of arriving at procedures for determining the fair market value of the oil & gas resources, the Commission approved as its procedures those presented by DNR, using the midpoint between the high and low range.

DNR staff bogged down in an effort to put a value on aggregate (sand, gravel and crushed rock) by first attempting to estimate the quantity and quality of the resource. The Commission ordered this halted because the task was approached from the wrong side (the supply side). Aggregate in Alaska is ubiquitous and its economic value determined by demand. DNR staff were directed to estimate demand and value this, possibly using Department of Revenue's methodology for estimating State revenues from this resource. This was not done by DNR and the Plaintiff's consultants included the task in their assignment.

There was full agreement that integration of surface and resource values would be achieved by adding the values to produce the total fair market value of the trust and replacement lands. The forest lands have been valued on the basis of sustained yield management. Metz and Dixon, while not quantifying the "multiplier" or "knock on" effects of mineral development, informed the Commission that any loss of surface value for particular acreage actually being mined, would be more than offset by increasing values of lands in the vicinity due to the increase in demand as a result of the economic activity generated by the mine. Additionally, it was noted the Surface Mining Act of 1977 requires restoration of land after completion of mineral extraction. Mineral and timber values and surface values were therefore treated as additive rather than one exclusive of the other.

III. SUMMARY AND CONCLUSION

In presenting the final approved procedures to the Commissioner of Natural Resources, the majority of the Commission agree that they follow the law, will be fair to all parties, and accomplish the objectives of providing a reconstituted trust and removing the threat of continued litigation and resulting disruption.

APPENDIX A

INTERIM MENTAL HEALTH TRUST COMMISSION

RESOLUTION

(Final Approval of Procedures for
Determining Fair Market Value)

BE IT RESOLVED, the Interim Mental Health Trust Commission hereby approves the following final procedures for determining the fair market value of mental health trust lands under AS 38.05.800(a):

1. Surface. The Commission previously approved procedures for determining the fair market value of the surface estate. Because of insufficient funding to conduct appraisals, these procedures provided for an opinion of value process by three geo-panels of appraisers; an opportunity for review and questioning by interested parties; referral back to the panels for reevaluation of their original values when necessary; and mediation, including the possibility of site visits.

Due to the large number of questioned values and limited funding, a sampling strategy was used for the review. The State's method of applying the southeast region's sampling results to all three regions results in a figure of $499.8 million. The Plaintiffs' appraisers assigned a value of $833,280,096.

The Commission is fully aware that appraisers often have such large differences in their opinions. Such differences are resolved through mediation but because of lack of funds and time, mediation of the fair market value as the original procedures contemplated was not possible. Therefore, the Commission approves as the final procedure for determining the fair market value of the surface estate that the difference between these two figures be split equally between the two values.

2. Timber. The Commission has approved as the procedures for arriving at the fair market value of the timber resource, the methodology, data, assumptions and judgments which were utilized in "An Economic Evaluation of Timber Potential on Mental Health Grant Lands and Legislatively Designated Replacement Lands - Final Report", by McMahon, Wallingford, and Wehrman, August, 1988. The Plaintiffs dispute the appropriateness of deducting reforestation costs, but the Commission has rejected their view.

3. Oil and Gas. The State has estimated the value of oil and gas resources on mental health trust lands after consultation with the Commission regarding appropriate procedures to be in a range from $135,953 to $856,040. The Plaintiffs have not submitted their own valuation, but assert the State's analysis did not follow the procedures approved by the Commission, and the value range appears to be grossly low in light of the State having received over $25 million for exploration and development rights on mental health trust lands. In light of the lack of any specific valuation from the Plaintiffs

and the necessity of arriving at procedures for determining the fair market value of the oil and gas resources of mental health trust lands, the Commission hereby approves as its procedures, the methodology, data, assumptions and judgments utilized in the "Hydrocarbon Potential of Mental Health Grant (Trust) Lands and Legislatively Designated Replacement Pool Lands in Alaska", by Ariey, Hansen, Kornbrath, Phillips, Ryherd and Smith, July, 1988, with the fair market value being the midpoint between the low to the high range.

4. Minerals, Coal, and Aggregate. After review of proposals by both sides, and much consideration, the Commission approves as the procedures for determining the fair market value of the mineral, coal and aggregate resources on mental health trust lands, the methodology, data, assumptions, and judgments utilized in "Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands," by Paul Metz and Colin Dixon, dated December 31, 1988.

5. Integration of Values. The Commission has approved adding the values as its procedure for integrating the surface and resource values to arrive at the total fair market value of mental health trust lands.

Approving	Disapproving	Abstaining
Commissioner Rogers	Commissioner Swope	
Commissioner Selkregg		

Date: November 7, 1989

George W. Rogers, Chairman
Interim Mental Health Trust Commission

APPENDIX B: SURFACE VALUATION

SUMMARY

When the Mental Health Lands Trust was originally selected at least half of the million acres were specifically selected for their proximity to communities. It was believed by those selecting the trust that these lands would be in demand for community expansion and the surface value would appreciate at a greater rate than more remote lands. It was also expected that active trust management of these community expansion lands would add substantially to the value of the trust.

The fair market value of the surface estate of the original one million acre Mental Health Lands Trust is thus a major component of the overall trust value. Different strategies have been tried to place a dollar value on this estate. In 1985, in response to the trial court's directive to value the land, the State used a modified opinion of value approach to establish a cash value for purposes of compensating the trust for the illegal redesignation of the Mental Health Trust Lands as general grant lands by the Legislature in 1978 (This effort is discussed in the Report above, at page 8, footnote 3).

In 1986 the State used a similar approach to value some 55,000 acres of Mental Health Trust Lands that had been approved for conveyance or conveyed to Municipalities. A value of some $100 million resulted from that effort. Traditional appraisals were done in 1987 on 15 of these parcels as a "validity check" on

the opinion of value effort. For Anchorage the appraisals ranged from 47% below to 30% above the panel's value for the same parcels. For Juneau the range of variation was from 467% above to 214% below, and in Fairbanks from 76% above to 798% below! The totals ended up within 4% of each other, however, and DNR asserted this demonstrated the opinion of value process created "offsetting errors". The plaintiffs' review appraiser reviewed these appraisals and found that where the appraisal valuation was substantially below the opinion of value valuation, the appraisal was in error. Due to the change in direction with the enactment of Chapter 48, these differences were never addressed by the Commission. In any event 800% differences in values for specific parcels are clearly cause for concern about the validity of the opinion of value panel process that does not allow for adequate review. The entire exercise reinforced the Commission's appreciation of the subjective nature of appraisals as well as the wide variation of opinions of value even of qualified appraisers.

The task of valuing the entire million acre mental health surface estate using standard appraisals was beyond the resources of funds and time available to the Commission. The previous efforts to value the surface estate of the trust had proven so unreliable that the Commission was faced with quite a challenge. To develop a surface value the Commission approved a set of procedures that relied on a panel of three expert appraisals for each of the SouthEast, SouthCentral and Northern regions in which Mental Health Trust Lands (and the replacement lands) were locat-

ed. Due to the funding and time constraints an "opinion of value" approach had to be utilized. However, in fashioning the opinion of value panel process to be utilized, certain safeguards not present in the earlier attempts were created, in an attempt to arrive at valid results.

The approach adopted by the Commission was designed to use the appraisers' regional knowledge of property values as in past opinion of value panels, with the very important check that interested parties (primarily the plaintiffs) could raise questions which would be resolved through a review and mediation process that would include site visits where necessary. The three member panels were required to value a total of approximately 8,000 parcels of which approximately 5,700 were Mental Health Trust Lands and 2,300 were replacement lands. Only 10 minutes could be spent on each parcel. The panels were not allowed any site visits -- their examination consisting of reviewing a written description of the parcel, referencing available maps, aerial photos, plus any comparable sales information provided by DNR or the appraisers brought with them. In assigning a value to a parcel agreement between two of the three panel members was required. When the parcel was completed a written form was used to document the decision, but the basis of the valuation was normally not provided because DNR insisted the panels did not have time to do so. However, the panels' deliberations were tape recorded to provide a complete record.

Once the panels had submitted their opinions of value and

they were reviewed by the State's review appraiser, the plaintiffs were provided an opportunity to review the values and raise questions by submitting a written form outlining the question and basis for a different value. These "Questioned Values" were to be submitted to the panels for a "collegial" discussion with the plaintiffs' review appraiser(s) and, hopefully, resolved at that point. Failing resolution at that point, mediation could be directed by the Commission where it deemed it warranted, including the possibility of site visit(s).

As they neared completion of their work, the SouthCentral panel sent a letter to the DNR review appraiser itemizing the limitations on their product. The first was that "our value estimates are not appraisals, and in fact they are not even 'preliminary opinions of value' as commonly understood in the appraisal profession, wherein the appraiser states that an appraisal would conclude within a stated range or near a given figure and material to support this conclusion is on file." Other comments noted the limited time, that the work was performed "within the confines of State offices", the problem with finding large parcel comparable sales, and the like (April 22, 1988).

The results of the opinion of value panels, before review, was a total of $407,668,683, for a per acre value of $407.67. A total of just over 4,000 parcel values were questioned by the plaintiffs' review appraisers. The result of accepting the

review appraisers' opinions with respect to the Questioned Values was to more than double the value of the surface estate by adding some $426 million to the value for a total of $833.28 million[1].

To address all of the Questioned Values in the manner initially approved by the Commission would have required far more time and funds than available. Therefore, in order to obtain information about the validity of the opinion of value panel valuations and the validity of the Questioned Values, the Commission directed that a sample of 387 of the 2,103 Questioned Values for SouthEast proceed through the process. Another goal of this sampling process was to determine if the results could be applied to the rest of SouthEast, and perhaps the other regions. Even without any mediation the SouthEast panel increased their total value by 42% for the parcels that were questioned on the basis of comparable sales (excluding large parcels). All categories of SouthEast values questioned increased an average of 22%.

Unfortunately, the process could not even be carried through to completion with respect to these 387 parcels because of lack of time and funds. However, what did occur was illuminating. A number of Questioned Values focused on consideration of site

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1.In addition to the "Questioned Values" submitted by the Plaintiffs through their review appraisers, well over one hundred "Technical Corrections" were submitted by the Plaintiffs to correct mathematical and other errors identified through their computerized "error checking routines". In many case, although the validity of the corrections was not challenged, DNR did not make the corrections saying that only the panels could do so. Since the panels were never called together for this purpose most of these errors were never corrected.

improvements and the proper way to value rights-of-ways (given no value by the panel). Additionally, there were a number of Questioned Values where comparable sales data presented by the review appraiser(s) seemed to support a higher value than accepted by the SouthEast panel. Perhaps the most difficult valuation problem was handling the "large parcels", that is those parcels that were larger than normally sold in the market place. Because of continuing disagreements, some 25 or so parcels were addressed by the panel members and review appraisers before the Commission in order for it to have first hand knowledge of the nature of the continuing differences. Without ever attempting to decide what the fair market value of any particular parcel was, the Commission did not find any Questioned Value that did not have a reasonable basis for the questions. While 207 parcels were recommended for mediation, a mediator was never engaged for any parcels because of lack of funds.

Because the SouthCentral region had the most large parcels, the SouthCentral panel was reconvened, with the Commission and panel members in attendance to consider the review appraiser's presentation of information developed regarding large parcels. Unfortunately, due to an oversight by DNR staff, the Review Appraiser was not invited. He was, however able to briefly attend a short morning session. During his brief appearance he presented numerous large parcel comparables, including three very important large parcel sales occurring in late 1988 -- early 1989. Until compiled by the plaintiffs' review appraiser(s),

the panel members were apparently unaware of the relatively few comparables for large parcels that did exist when the panel was doing its work. When reconvened, the SouthCentral panel agreed the market information provided by the review appraiser shed new light on large parcels and increased their opinion of five of the six parcels reexamined an average of 68%.

An issue never adequately addressed was the difficult one of "parcelization." In order to initiate the valuation process it was necessary to determine what parcels were to be presented to the panels for their consideration. The decision was made to simply use the parcels that in fact existed, which was a matter of historical happenstance, with the largest tract being a township. In many cases the parcel presented to the panel was a township of 22,000+ acres. While the panels were allowed to "reparcel" tracts, they did not do so, apparently due to lack of time and misunderstanding of its appropriateness. The panels thus concluded that if an entire township, or other large parcel was sold as a single parcel, the per acre value would be quite low. The plaintiffs' review appraisers, in such instances, in addition to the market information they had for some large parcels, suggested that since township size (and other large parcel) sales normally do not occur, the parcels should be valued on the size that the land involved would normally sell, taking into consideration platting requirements (or the lack of a platting requirement).

The Plaintiffs supported this approach by reference to an

Alaska condemnation case where the Special Master accepted the approach and rejected the condemnor's (the State) objections to it (Report of Master, Alaska v. 17.183 Acres and Sloboda, 3VA 86-145 Civ.). However, DNR strenuously objected. When appraisers were asked about the issue, they replied it was not up to them to decide -- that they could do it either way, but would need direction. The only other apparent method of resolving the issue was litigation. Since the Commission did not desire to be in the position of directing the panel members how to decide the issue, and litigation of the issue considered undesirable, "parcelization" was never decided. However, if resolved in plaintiffs favor, there is no doubt but that substantial additional increases in the surface value would have resulted.

In analyzing the results of the relatively small percentage of Questioned Values addressed by the panels, the State applied a 45% increase for all SouthEast parcels questioned by the review appraisers. For the other regions, the state applied a 21% increase to all Questioned Values where the acreage was under 1,000 acres and 67% where the acreage was greater than 1,000 acres. These adjustments resulted in a total increase of $91.6 million for a new total of $499.8 million. However, this increase does not reflect the additional increase that would have necessarily occurred if mediation had taken place (leaving aside the increase that would have occurred if parcelization had been allowed). The Plaintiffs contend that their estimate of $833.28 million is closer to the actual total fair market value for the

surface estate, and may even be low because their review appraisers also did not have an adequate opportunity to perform their work.

The Commission, lacking the necessary funds to resolve the Questioned Values, and recognizing that pursuing the process initially approved would have necessarily increased the values, approved as its final procedures for determining the fair market value of the surface estate that the difference between the $499.8 million figure and the $833.28 million figure should be split equally.

The Commission recognizes that in approving procedures that "split the difference" it may be perceived as having crossed over the line from approving "procedures" to approving "values" as directed by Chapter 48. However, it is the Commission's belief that "splitting the difference" was the only procedure that could logically be utilized under the circumstances. It must be remembered the original procedures promulgated called for a review and mediation process for every parcel's value that was questioned. This procedure could not be carried out due to funding deficiencies. It was clear that following the procedures as originally promulgated would have necessarily increased the surface value. Since, there was absolutely no basis to determine where the final value would have ended up between the $499.8 million and $833.3 million, the Commission believes "splitting the difference" was the only objective approach.

The alternative would have been to fail to achieve the

legislative mandate to value the land, and more importantly, defeated Chapter 48's entire purpose of resolving the litigation. However, in the event it is determined such a "splitting the difference" is not a procedure, the Commission strongly recommends that it be adopted as the basis for the final valuation of the surface estate.

APPENDIX C: MINERAL ENDOWMENT VALUATION

To accomplish the mineral endowment valuation for Mental Health Trust Lands, following the August 19-20, 1987, meeting of the Commission, the Commissioner of Natural Resources directed "DGGS to assess the quantity and quality of known and potential hard rock minerals... The assessment reports will then be followed by a resource valuation process....The value of the minerals will be determined by an independent entity, likely retained under contract to the department." (Emphasis added, Brady, Sept. 29, 1987. The deleted material refers to other natural resources.)

Mineral Endowment Estimation

In the process of discharging the task of mineral endowment estimation, DNR informed the Commission that serious budgetary data and time constraints "will result in the deletion of numerous tracts from the mineral valuation process" (Gustafson, "Outline of Mineral Valuation Process", November 23, 1987). The first deletions were in the inventory of mineral types to be evaluated. A number of available mineral deposit models were not projected and the DGGS inventory did not include industrial and heavy minerals. Although these deletions may have had low unit values, they did constitute a deletion from the valuation of the total mineral endowment.

In its second step, DGGS ranked the Mental Health Trust Lands (MHTL) from 5 to 1 by their favorability for mineral deposits and, secondly, from 5 to 1 by the amount and quality of information available. In April, 1988, DGGS presented maps of mineral potentials of the MHTL by these rankings. A further major short-cut introduced at this point was to consider only areas with favorability rankings of 4, 5 and "super-5's" (an added sub-category) for classification by deposit types and for valuation. In discussions with staff, furthermore, it was learned that the low rankings included areas that had simply not been evaluated yet, as well as areas that had been given evaluations that their potential was low.

It was noted by Plaintiffs that the combination of these deletions and short-cuts would significantly impact the mineral valuation process and result in a lower value. "While having no solution within the budgetary constraints that exist, we must repeat our oft-stated observation that lack of sufficient appropriations and an unrealistically short time frame does not reduce the state's legal obligation to fairly value mental health lands. Please be assured, this does not change our approach which is to try and work with the administration to develop the absolutely best valuation process possible within budgetary constraints." (Gottstein, December 14, 1987, "Re: Outline of Mineral Valuation Process").

Staff compiled the following statistics for use in valuations:

"Mental Health Grant Lands -- Mineral potential

93,213 acres have high mineral potential	("4's")
15,221 acres have very high mineral potential	("5's")
47,565 acres have super high mineral potential	("Super 5's")

155,999 acres total"

Similar statistics were compiled for the replacement lands. (McMahon, August 23, 1988).

Mineral Endowment Valuation by DNR

With this data DNR was prepared to attempt the actual valuation, but "assuming it proves impossible to complete an in-house mineral valuation (for whatever reason), we will be prepared to proceed with contract solicitation to complete the work "(Gustafson, November 23, 1987, "Outline of Mineral Valuation). The Division of Geological and Geophysical Services (DGGS) then, however, said that they could not use the information they had compiled to value the mineral endowment without an exploration program consisting of surveying and drilling all MHTLs that received mineral potential rankings of 4 or 5. DGGS proposed a program for doing so and estimating the value of the mineral endowment that cost $53 million. (Wiltse, March 1988, "Cost of

generating valid gross metal value estimates for mineral-potential Category 4 and 5 Mental Health Trust and Replacement Pool lands").

Instead of following the agreed upon procedure to contract out the mineral valuation to qualified experts in the event DNR could not do it in-house, DNR made a valuation using only the total acres (i.e ignoring the breakdown given by rankings) and the "comparable sales" approach. DNR valued the trust's highest ranked mineral lands as having no value because they could not find any comparable sales! Later they announced that diligent search had discovered three sales which when applied to the "4's", "5's" and "Super 5's" yielded a total value of $16,040,000 for the mineral endowment of MHTL. The MHTL mineral lands are undoubtedly the most promising in the State. Furthermore, the areas selected from this larger pool by DGGs for actual valuation were only in the high to super-high potential classifications.

The value of $16 million did not appear to be near, let alone "in the ball park". The disclosure of the actual basis for DNR's calculation raised further basis for rejection (letter and attachments to J.B. Gottstein from G.T. Koester, August 23, 1989). The "sales" cited by the State were too small in size and few in number (three) to be statistically significant. Furthermore, their comparability was questionable. One purchase appeared to be for recovery of "construction and road gravel" from tailings. Although traces of gold were present, production was

reported as uneconomic. Another was the purchase of adjacent land by an active miner for "site expansion" and overburden disposal. In addition, other comparable sales not used by DNR, but that were identified by Metz and Dixon (October 1989) supported the Metz/Dixon valuation arrived at by the income approach.

In any event, the "comparable sales" approach for valuing mineral values for MHTLs was not supported by any economist or other mineral valuation expert and was rejected by the Commission. All the experts agreed that the comparable sales approach for valuation was inappropriate for valuing mineral endowment because of problems of comparability and the limited use of sales in large mineral transactions. Valid comparable sales are not normally available due to differences in grade, tonnage and similar factors. As noted previously, mineral rights to lands are typically subject to agreements in which the seller receives a a share on production, whether through a lease, a joint venture or some other arrangement rather than simply a sale of the land or the mineral rights. All the experts agreed that a discounted cash flow method (the "income approach") was the industry standard method.

Several recent mineral discoveries and resultant mines lend additional support to the Commission's conclusion to reject comparable sales in favor of the income approach as a method of mineral valuation. The Greens Creek silver discovery 20 miles west of Juneau has proven and estimated reserves worth $3.6

billion. As of this date the Greens Creek mine is the largest silver mine in North America. The Red Dog Mine has much greater reserves with a gross value of $20 Billion at current market prices. Both were developed without any direct sales of surface or subsurface estates. The Greens Creek discovery was on Federal land and patented land resulted. Red Dog is a joint venture involving a Native corporation with no sale involved. These and a number of other significant discoveries have occurred and are being developed without "sales". In fact, active management of the original trust would have utilized these types of transactions to generate income.

Mineral Endowment Valuation by Plaintiff's Consultants

To complete the mineral valuation in accordance with the procedures originally accepted by the Commission (Brady, September 29, 1987; Gustafson, November 23, 1987), the Plaintiffs commissioned a study of the mineral, aggregate and coal potential of the MHTL by an internationally known consultant and an Alaskan mineral consultant. The consultants (Professor Paul Metz of UAF and Colin Dixon, Senior Lecturer in Mining Geology, Imperial College of Science and Technology, London) were instructed to follow as closely as data (that provided by DGGS) and time available (two months) allowed, the normal methods used by the minerals industry in determining the fair market value.

Their report (Metz and Dixon, December 11, 1988) produced within the specified time and data constraints a range of probable values for mineral resulting in a final estimated value of $1.5 billion. After preliminary review by DNR staff and the Institute of Social and Economic Research, DNR contracted with a methodology expert (Professor DeVerle Harris of the University of Arizona) to critique the report using "best practices" as the standard of criticism without allowance being made for cost, time or data limitations.

Harris fully stated the restricted nature of his charge at the outset. Although finding that it did not always follow "best practices", he noted "such analysis is very difficult and usually entails compromises of best practices.. and approximations" and that the less than best practices used by Metz/Dixon might be accepted "if a rough estimate of value is adequate". Harris goes on to say "In fairness to Metz and Dixon, the use of net smelter return methods is consistent with the simplistic treatment of mineral potential and exploration [provided by DGGS]." (Harris, May, 1989, p 16).

He further noted that "replacing [the Metz/Dixon] estimate by best practice will require a much greater effort" and still would result in an estimate based upon professional judgment (Harris, May 23, 1989, p. 33). Apparently this was too inconclusive for DNR and a second contract was entered into with Harris in which

he presented the design of a best practices undertaking and estimated the price at $350,000 (report September 1989)[1].

"Best practices", however, under Harris' proposal would require much more than money. "Much of the geologic analysis by ADGGS personnel will have to be redone for the estimation of mineral endowment". (Harris Sept., 1989, p 3). The product of the DGGS effort was a ranking of MHTL by their favorability for mineral deposits, not probabilities for number of deposits required by "best-practices". Metz/Dixon, having no alternative but to use this data, introduced an additional step converting the DGGS rankings into probabilities. They would have preferred to have had the best practices version advocated by Harris (Metz/Dixon, October 1989, pp. 6-7). Harris also noted shortcomings and gaps in the basic data collection and compilations requiring that "the geologic analysis for endowment estimation would have to repeat this initial data and information acquisition" (Harris, September 1989, pp. 3-4)[2]. However, at the November 7, 1989, Commission meeting, which Harris declined to attend, C. Dixon explained how they used generally accepted "rules of thumb" that would not be seriously in error and built in "safety factors" at each step to insure that the valuation would not be overstated.

1.DGGS had previously advised DNR and the Commission that a $53 million surveying and exploration program would be necessary before they could attempt a valuation.

2.This would not involve acquiring new geologic data, but reworking the same data that DGGS utilized.

In discussing the kinds of expertise required (geoscience of mineral resource formation, regional knowledge of geology, and estimation methodology), Harris rated some of DGGS personnel as "well qualified' for the first expertise, at least as to certain deposit types", as "especially well qualified for the second expertise", and "not highly experienced in expertise three". Beyond expertise, Harris noted the appearance of conflict of interest because of the litigation (Harris, Sept., 1989, pp. 8-9). He recommended contracting with the USGS for mineral endowment estimate and with an outside contractor (such as his Center for Mineral Resource Science) for other phases. (Ibid, p. 10).

Commission Decision

On the basis of the two Harris reports, the ISER study commissioned by DNR ("Review and Analysis of 'Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands," Tuck and Berman, March, 1989), and the Metz/Dixon Reply (October 12, 1989) important areas of broad agreement between all the mineral valuation experts emerged. There was consensus that: (1) a value can be estimated for undiscovered mineral deposits (Harris devoted an entire book to appraisal of undiscovered mineral resources, Mineral Resources Appraisal, Clarendon Press, Oxford, 1984), (2) the comparable sales approach was not an appropriate method to value the mineral endowment of MHTLs, (3) the use of a discounted net income stream is the appropriate means of estimating the fair market value, and (4) the dominant mineral production from a district comes from a few very large

deposits (Harris, p. 17, Metz/Dixon, p. 12), . The areas of disagreement were related to degree of refinement of the analysis and estimates, on techniques used at each point of procedure (i.e costly econometric modeling vs. accepted industry practices).

Given (1) the unanimity that the discounted cash flow approach utilized by Metz/Dixon was the appropriate methodology; (2) that compromises made from "best-practices" for other portions of the total valuation process were far more serious than for the minerals valuation (e.g. surface and oil & gas), and (3) the complete lack of any viable alternative, the Commission approved the Metz/Dixon approach and methodology for determining fair market value for the mineral endowment of MHTL.

While not approving the values per se, the Commission also notes that the estimate of $1.5 Billion, as a "reality check" of the processes generating the figure, is a reasonable and conservative one. That the Greens Creek mine has a $3.6 billion estimated reserve and Red Dog $20 Billion, lends ample supports that the $1.5 billion advanced by Metz/Dixon for <u>all</u> MHTL is reasonable. Other new projects in stages of exploration and/or initial development are the Fort Knox near Fairbanks, the Kensington Mine project in the Juneau area, and the Golden Zone between Anchorage and Fairbanks.

MINORITY RECOMMENDATION

TO THE COMMISSIONER OF NATURAL RESOURCES

Regarding Procedures to Determine the
Fair Market Value of Alaska's Mental Health
Trust and Replacement Lands

Submitted by: Rod Swope
Commissioner's Designee to the
Interim Mental Health Trust Commission
February 1, 1990

APPENDIX D

CONTENTS

EXECUTIVE SUMMARY

This minority report documents my dissent from the majority report of the Interim Mental Health Trust Commission (IMHTC) regarding procedures to be used by the Commissioner of the Department of Natural Resources (Commissioner) to determine the fair market value of both the original one million acre mental health trust land grant and the replacement lands in accord with Chapter 48, SLA 1987. In addition, I have set out the procedures which I believe should be used in order to comply with Chapter 48 and the land and resource values which those procedures produce.

I do not take this step lightly. Since joining the IMHTC as the Commissioner's designee in January, 1988, my goal has been to reach consensus with my fellow IMHTC members if and whenever possible.

While I believe my fellow IMHTC members also shared this goal, that approach was abandoned with respect to the valuation procedures finally adopted in the IMHTC majority report. By adopting, in large measure, valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48, the majority left me with no alternative but to dissent.

I dissent from the IMHTC majority report for the following reasons:

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving only those procedures proposed by the Commissioner.**

Chapter 48 specifies that the IMHTC is to review and approve valuation procedures proposed by the Commissioner. As contemplated by the Legislature, the valuation procedures accordingly would be acceptable to both the plaintiffs' and intervenors' representatives on the IMHTC and to the Department of Natural Resources ("department"). Certain procedures contained in the majority report, however, were not proposed by the Commissioner, are unacceptable to the department, and therefore should not have been approved by the IMHTC majority. By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not produce fair market value, as required by Chapter 48; instead, they produce a value substantially greater than fair market value.**

The importance of the value determinations used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC, the total value of the original one million acre mental health trust land grant would exceed $2.2 billion. Under AS 37.14.021(c), this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account. Under the valuation procedures I believe should be employed, the fair market value of the original one million acre grant equals just over $564 million, resulting in more than $45 million annually in the Mental Health Trust Income Account.

While the remainder of this minority report documents the fact that the procedures adopted by the IMHTC in the majority report do not produce fair market value, the point can be illustrated with three examples.

> Example 1: Surface Estate. The IMHTC initially defined "fair market value," the value required by Chapter 48, as "the most probable selling price in a free and open market," a standard definition in the real estate business. Panels of independent expert appraisers were then given instructions (prepared jointly by the majority of the IMHTC, the lawyers for the plaintiffs and intervenors and the department) to determine fair market value as defined. The lawyers for the plaintiffs and intervenors retained consultants (at state expense and without formal approval of the IMHTC) who were not asked to determine fair market value as defined by the IMHTC and required by Chapter 48. Instead, they were directed to determine "the highest value that can be supported in the market." Following review by those consultants, the panels increased their initial values, on the average, by about 20 percent. The procedures adopted by the IMHTC majority require that those values be further increased by splitting the difference between the final fair market values as determined by the panels and "the highest values that can be supported in the market" as determined by the consultants for the plaintiffs and intervenors.

Example 2: Hardrock Minerals. The procedures adopted by the IMHTC majority to determine the fair market value of the hardrock mineral estate, among many other shortcomings, begin with the assumption that all mineral deposits on mental health lands were developed on the date of valuation. That, of course, is not the case. In fact, there is very little mineral production from mental health lands even today. The consultants hired by the lawyers for the plaintiffs and intervenors acknowledge that this assumption alone produces value many times higher than would be produced if it was assumed that mineral deposits on mental health lands are not developed until sometime in the future:

A. Deposits are developed as of 2006 - the net present value (NPV) is $225 million.

B. Deposits are developed as of 1996 - the NPV is $585 million.

C. Deposits are developed as of 1987 - the NPV is $1.5 billion.

The procedures adopted by the IMHTC majority value the mineral estate at the $1.5 billion figure. It's also conceivable that major deposits will never be discovered in which case the NPV would be zero.

Example 3: Integration. The procedures adopted by the IMHTC combine the various value components -- surface estate, timber, oil and gas, hardrock minerals, coal, and sand and gravel--by simply adding them up. A prospective purchaser in the real world, of course, would not simply add up all the values. He or she would instead determine which uses, if any, are compatible. For example, residential subdivision development and strip mining for coal are not compatible.

3. **The procedures proposed and adopted by the IMHTC in the majority report create substantial problems with respect to reconstituting the trust and periodically redetermining its value.**

Chapter 48 contemplated an exchange of some original mental health lands for other state lands on the basis of equal value. The procedures adopted by the majority of the IMHTC have been used to value the original mental health lands, but they have not been used to value the pool of potential exchange lands. This precludes the exchange contemplated by the Legislature. In

addition, Chapter 48 contemplated periodic revaluation of the lands following the exchange. If the exchange cannot go forward, the legislatively contemplated revaluation also cannot go forward.

In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48. The procedures approved by the IMHTC majority were not proposed by the Commissioner as required by law; the procedures I believe should be used have not been approved by the IMHTC as required by law. For this reason, I believe the Commissioner should transmit both the majority and minority IMHTC reports to the Legislature, explain that she is unable to comply with Chapter 48 at present, and list three options for legislative consideration: (1) change the law to accept the value determined under the procedures adopted by the IMHTC majority; or (2) change the law to accept the value under the procedures I believe should be used to comply with Chapter 48; or (3) appropriate additional funds to permit the IMHTC to continue seeking consensus. I believe the Commissioner should recommend that the Legislature choose option (2), accepting the value determined under the procedures I believe should be used to comply with Chapter 48.

BACKGROUND

The IMHTC was created by the Legislature in Chapter 132, SLA 1986, to oversee state management of mental health trust lands. In Chapter 48, SLA 1987, the Legislature established a statutory framework for resolving the mental health trust land issue. The three main elements of that resolution are: (1) valuing the original one million acre land grant and all lands in legislatively designated areas (parks, wildlife refuge, etc.) under procedures proposed by the Commissioner and approved by the IMHTC; (2) "exchanging" those original mental health trust lands not in legislatively designated areas for "replacement" lands of equal value in such areas; and (3) "renting" the original mental health trust lands in such areas and the equal value "replacement" lands for 8 percent of their fair market value annually.

Following the passage of Chapter 48, SLA 1987, the Governor appointed Dr. George Rogers of Juneau and Dr. Lidia Selkregg of Anchorage to join the Commissioner to compose the membership of the IMHTC. Dr. Rogers was then selected chairman of the IMHTC. Originally, Deputy Commissioner Lennie Gorsuch represented the Commissioner on the IMHTC, followed later (after January, 1988) by Deputy Commissioner Rod Swope. Assistant Attorney General Tom Koester of the Department of Law served as legal counsel to the IMHTC, while representatives of the Department of Natural Resources (department) provided staff support.

The IMHTC met on August 19 and 20, 1987, and continued to meet regularly through January, 1990. Since passage of Chapter 48, a total of thirty-five (35) IMHTC meetings have been held in either Anchorage or Juneau following at least fourteen (14) days prior public notice.

Although not part of the IMHTC, the attorneys for the plaintiffs and intervenors in the Weiss lawsuit, David Walker and Jim Gottstein, attended almost every IMHTC meeting and actively participated in all aspects of the discussions and valuation process, even to the point of proposing valuation procedures and resultant values. The IMHTC allowed the plaintiffs and intervenors to join in all discussions during IMHTC meetings.

At times, this degree of participation made it extremely difficult to differentiate between IMHTC conclusions and those of the lawyers for the plaintiffs and intervenors. The plaintiffs' and intervenors' lawyers also independently hired appraisal

consultants to review the work of contractual appraisers, retained by the department under procedures developed by the department, the IMHTC, and the lawyers for the plaintiffs and intervenors, and working under instructions developed in the same way, to compose the opinion of value panels for the surface estate valuation. In addition, the plaintiffs and intervenors, acting without formal IMHTC authorization, hired independent mineral consultants, Paul Metz and Colin Dixon, to compile a value for hardrock minerals, coal, and material sources (within the mental health trust land portfolio) using a procedure not previously recommended by the Commissioner or formally discussed or approved by the IMHTC. Mr. Metz and Mr. Dixon also attended several meetings of the IMHTC to present their information and viewpoints.

The most difficult aspect of the entire valuation process proved to be the development and approval of specific procedures under which the department would value mental health trust lands. On several occasions the IMHTC chose to adopt a new valuation methodology even after the department had already completed, at considerable time and expense, the valuation process using the original IMHTC approved methodology. Development of a new valuation methodology frequently seemed to be motivated more by the desire to produce a higher value than to correct the original methodology. As a result, procedures were adopted by the IMHTC that were not proposed by the Commissioner (as required under Chapter 48) and which do not produce fair market value (as Chapter 48 also requires).

Throughout my participation in this process, I strived toward achieving consensus and a common resolution of the various issues with my fellow IMHTC members. However, as it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values, the consensus approach began to erode. This became particularly apparent in discussions regarding the results of the opinion of values for the surface estate and values for the mineral estate. Thus, as a dissenting member of the IMHTC, I felt it was necessary to submit a minority report.

FINDINGS

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own procedures instead of reviewing and approving only those procedures proposed by the Commissioner.**

The Legislature contemplated and specified that the Commissioner propose valuation procedures which then would be approved by the IMHTC. Section 90 of Chapter 48, SLA 1987 repealed and reenacted section 2(a) of Chapter 132, SLA 1986 to read: "The commission shall approve procedures proposed by the Commissioner of Natural Resources to determine the fair market value, as of the effective date of AS 38.05.800, of all lands selected by and patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, and review the final determination of the fair market value determined under those procedures." (Emphasis added.)

Under AS 38.05.800(a), also enacted as part of Chapter 48, the Commissioner is to determine the fair market value of the original mental health land grant "under procedures approved by the Interim Mental Health Trust Commission."

Simply stated, the Commissioner is to propose valuation procedures to be reviewed and approved by the IMHTC. Once a set of procedures have been approved by the IMHTC, the application of those procedures to the valuation of the mental health land grant and replacement lands is the responsibility of the Commissioner, with the results then reviewed by the IMHTC. The Legislature thus contemplated a three-step process: (1) consensus would be reached as to the procedures to be followed; and (2) the Commissioner would unilaterally implement those procedures to determine fair market value; and (3) the IMHTC would review the final fair market value determined by the Commissioner.

Although the IMHTC initially approved certain valuation procedures proposed by the Commissioner, the IMHTC majority eventually proposed and adopted many of its own procedures not proposed by the Commissioner. Specifically, the procedures adopted by the IMHTC majority for the surface valuation and for the mineral valuation were not proposed by the Commissioner. These actions removed from the Commissioner all discretion and thereby effectively excluded the Commissioner from the valuation process, a result certainly not intended by the Legislature.

Furthermore, the IMHTC in its majority report adopted not only procedures, but also an actual set of resultant values. As mentioned above, only the Commissioner has the authority and responsibility to determine the fair market value of the land. Therefore, the IMHTC again clearly exceeded its statutory authority.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not result in fair market value, as required by Chapter 48; initially they produce a value substantially greater than fair market value.**

AS 38.05.800(a) requires the Commissioner to "determine the fair market value, as of September 6, 1987 of all land selected by and patented to the state under the Alaska Mental Health Enabling Act." At its September 21-22, 1987 meeting, the IMHTC initiated the valuation process by adopting, as proposed by the department, the definition of fair market value found in American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology (rev. ed. 1981). This definition specifies "The most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale." Employing that definition and procedures, the department determined the fair market values for the surface estate and resources associated with the mental health and replacement lands (timber, oil and gas, coal, material sources, and hard rock minerals). Those procedures and values are outlined in this section.

The surface estate of all mental health trust and replacement land was valued by the department using the opinion of value approach. This approach, as amended by the IMHTC to make adjustments for certain disputed values submitted by the lawyers for the plaintiffs and intervenors, was approved by the Commissioner and became the accepted procedure for valuing the surface estate. However, the IMHTC majority report reflects a surface estate valuation procedure and value different from that developed by the IMHTC, approved by the Commissioner, and employed by the department. As a result of this significant departure from accepted and approved procedures, the resulting value does not reflect fair market value and is inconsistent with the fair market value requirement. Once the opinion of value panels completed their work, the plaintiffs and intervenors hired their own appraisal consultants to examine the results. The review appraisers, however, did not employ the same valuation approach used by the department. Instead, the plaintiffs' and intervenors' appraisal consultants were given the following

written instruction: "For all parcels that appear to have been undervalued, provide your estimate of the highest value that can supported in the market." [Walker letter to MacSwain, Olson, Sopp, dated July 19, 1988.] In State v. Alaska Continental Development Corp., 630 p.2d 977, 991 (Alaska, 1980), the Alaska Supreme Court specifically disapproved of a valuation process reflecting "the high end of the market spectrum," stating that such an approach "is contrary to the law in Alaska" that fair market value," or the price a willing buyer would pay a willing seller for the property, is the appropriate measure of just compensation. There was no mention in the instructions to the appraisal consultants of fair market value or most probable selling price. The values determined by the review appraisers, therefore, have no relevance to the task with which the Legislature charged the Commissioner, that of determining the fair market value and not "the highest value that can be supported in the market" of the original one million acre mental health land grant.

The IMHTC also approved the department's recommendation that determination of resource values would employ a two step approach. The first step was to quantify the particular resource(s) in place. The second step was to determine the value to the landowner of that quantity of the particular resource(s) in place.

For the hardrock portion of the mineral valuation, the IMHTC majority report simply adopted the procedures and value contained in the Report by Paul Metz and Colin Dixon ("MDA Report"). The MDA approach employed procedures not recommended by the Commissioner or previously discussed or approved by the IMHTC. Furthermore, it produced a value which is substantially too high for the hardrock mineral component, and suggests a hardrock mineral endowment considerably greater than the facts support.

The resultant surface and resource values then were integrated by the department, recognizing that values could be added where use of the surface was compatible with other resource development, but not where surface use was incompatible with resource development. This was in accord with integration procedures already approved by the IMHTC. However, the majority report uses a different integration approach which involves simple addition of all values--a process totally inconsistent with standard valuation procedures. The issues of parcelization, integration,

replacement lands, redetermination of values, and the valuation process used to determine fair market value for the various resources, are described in more detail in the sections that follow.

Parcelization

The department began the valuation process by proposing procedures for the parcelization of all land. After review by the lawyers for the plaintiffs and intervenors and their "expert appraisers" regarding the parcelization procedures, the department's proposed parcelization procedures were approved by the Commissioner and the IMHTC. Department personnel then parcelized approximately 7.5 million acres of land (mental health trust and replacement land) into over 10,000 parcels.

This parcelization process used the standard larger parcel criteria set out by the courts for determining fair market value in condemnation litigation. The criteria include: unity of ownership, unity of use, and contiguity. There was one exception to this rule. Where an approved survey was in existence identifying separate lots, tracts, or metes and bounds surveys, those surveyed tracts were segregated out from the larger into separate individual parcels.

Surface Estate Valuation

In accordance with the intent of the Legislature, as reflected in the fiscal note accompanying the bill that became Chapter 48, an opinion of value process was to be used to determine the value of the surface estate.

During the legislative discussion concerning Ch. 48, SLA 1987, the department explained the opinion of value process to the Legislature and submitted two different fiscal notes, one to cover the cost of individual standard appraisals and one for the opinion of value process. The Legislature recognized the potential costs and lack of available money to fund individual appraisals for all mental health and replacement lands. Therefore, money was appropriated for the department to conduct the fair market valuation through an opinion of value process, consisting of three panels of appraisers. In other words, funds were appropriated to cover only the cost of an opinion of value process.

This opinion of value process involved three panels comprised of three very experienced and knowledgeable independent appraisers from each of three geographic areas of the state (Southeast, Southcentral, and Northern). These appraisers sat as a panel according to geographic area, examined plats, maps and legal descriptions of mental health land, and rendered an opinion of value for each parcel of property examined. They brought a variety of work experience and market knowledge with them to contribute to the opinion of value panel process. The use of a three member panel for each geographic area provided an optimum cross section of local market conditions, market demand, and varied sales data. The comprehensive appraisal files of the department were also made available to each panel.

The IMHTC and the lawyers for the plaintiffs and intervenors approved, word by word, the "Request for Proposal" (RFP) sent out by the department to all appraisers in the state in order to solicit interest in being a member of one of the opinion of value panels. Two department employees and the two IMHTC members representing the plaintiffs and intervenors, after consultation with their respective attorneys, evaluated all of the RFP's submitted. They scored each proposal and selected nine appraisers to compose the three separate panels of the most qualified appraisers in the respective regions (i.e, Southeast, Southcentral and Northern).

The process used by the panels was not an "appraisal" in the strictest accepted definition of the term. Appraisal reports were not required nor were field inspections conducted for every parcel. However, this was fully recognized by both the Legislature and IMHTC.

The theory of the opinion of value process is that some parcels may be valued high and some parcels may be valued low, but they average themselves out. This theory was given credibility when the IMHTC conducted a check of the results of an earlier opinion of value process (one panel of three appraisers for all three regions of the state with only one appraiser representing each region) on all original mental health land that had been selected by the state or conveyed to municipalities. The IMHTC selected parcels, in the Northern, Southcentral and Southeast regions, that it felt were most likely to be valued too low, and had them appraised under standard appraisal procedures. The result of this exercise was that, on total, the actual appraised values and the opinions of value for the parcels the IMHTC believed were the most undervalued were within 4 percent. While some differences were dramatic--the IMHTC majority report notes one 800 percent difference (interestingly, the high value was produced by the opinion of value process) they balanced out overall as expected. This is contrary to the IMHTC majority report which infers that the opinion of value process produces values which are uniformly too low.

As soon as contracts were awarded, the department convened the three opinion of value panels for each region to render their best collective professional opinions of fair market value for each parcel. The opinion of value panels were instructed to determine fair market value using the definition found in the American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology, adopted by the IMHTC at its September, 1987 meeting. The opinion of value panels also were instructed to consider reparcelizing if, in their best professional judgement, reparcelization was necessary to enable them to determine the land's fair market value.

The panel's findings were recorded on forms provided by the department and approved by the IMHTC and attorneys for the plaintiffs and intervenors. The forms contained all available information relative to the parcels and were supplemented by land status plats and maps. At least two members of each three member panel signed signature blocks on each form indicating panel concurrence with the specific value for each parcel.