

# Staff Report 50

## **PARTY:**

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California State Lands Commission

## **PROPOSED ACTION:**

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Request delegation of authority for the Executive Officer or designee to solicit offers and negotiate a fair and reasonable price, and award and execute agreements for professional real estate broker services, to assist with real estate property acquisitions utilizing the School Land Bank Fund (Fund).

## **BACKGROUND:**

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School lands were granted to the State of California by the federal government under the Act of March 3, 1853 (Ch. 145, 10 Stat. 244), and consisted of the 16th and 36th sections of land in each township (with the exceptions of lands reserved for public use, lands taken by private land claims, and lands known to be mineral in character). In cases of preemption due to the exceptions described above, the State was given the opportunity to select replacement lands from the United States in lieu of a Section 16 or a Section 36. These replacement lands are now known as indemnity school lands or lieu lands.

School lands were placed into a statutory trust in 1984 when the Legislature enacted the School Land Bank Act and created the Fund. The Commission is the Fund's trustee and manages it on behalf of the Fund's beneficiary, the State Teachers' Retirement System. Proceeds gained through past transfer and sale of school lands is held in the Fund. As the Legislature declared, "school lands and attendant interests are to be proactively managed and enhanced to provide an economic base in support of the public school system" (Pub. Resources Code, § 8701, subd. (b)). The Legislature further declared that the Commission "shall take all action necessary to fully develop school lands, indemnity interests, and attendant mineral interests into a permanent and productive resource base" (Investment Program; Pub. Resources Code, § 8701, subd. (d)).

Acting in its capacity as trustee, the Commission manages approximately 458,843 acres of fee-owned school lands. Public Resources Code section 8712 authorizes the Commission to acquire real property or interests therein for revenue-generating purposes. Net revenues received from the leasing of school lands are deposited into the State Treasury to the credit of the State Teachers' Retirement Fund (STRF) pursuant to Public Resources Code section 6217.5. The Fund is distinct and separate from the STRF; as discussed above, proceeds from the sale and transfer of school lands are deposited in the Fund, whereas net revenue generated from rent and royalties paid for development, use, and occupation of school land and mineral development are deposited in the STRF.

In Fiscal Year 2008-09, the Legislature borrowed \$59 million from the Fund to help balance the state budget. This loan left a balance in the Fund of less than \$2 million and severely limited staff's ability to pursue an active Investment Program for many years. In June 2017, the loan was repaid to the Fund, with interest. Following the 2017 loan repayment, staff sought to reactivate the Investment Program. On November 29, 2017, the Commission authorized staff to solicit bids and hire a consultant to develop an investment strategy ([Item C63, November 29, 2017](#)).

AgInvest International (AgInvest) was hired as a consultant contractor in 2018 and prepared a school lands investment report entitled "Strategic Land Investment Considerations for the School Land Bank Fund" (Report). The Report describes a strategy to emphasize California-based real estate investments capable of generating acceptable rates of return to the STRF while also minimizing risk and considering other important public issues, including statewide environmental, social, and macro-economic goals. The Report also describes a methodology and provides tools to help the Commission with the comparison, analysis, and selection of suitable agricultural and commercial real property investments to achieve a higher financial return for the SLBF, particularly a current revenue stream, coupled with potential asset appreciation.

At the close of Fiscal Year 2020-2021, the Fund contained a balance of \$68,872,955. However, in 2020 the Governor announced that the COVID-19 pandemic had caused a \$54 billion budget deficit. To help close this deficit, the Fiscal Year 2020-21 budget borrowed \$49 million from the Fund, bifurcated into two loans. One is a \$17 million loan to the California Earthquake Safety Fund. The other is a \$32 million loan to the General Fund, which will be repaid at the end of Fiscal Year 2024-25. Accrued interest will be paid out of the Pooled Money Investment Account when the borrowed money is transferred back to the Fund.

## **SCHOOL LAND INVESTMENT REPORT:**

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### **REPORT RECOMMENDATIONS:**

To provide context for its investment recommendations, the Report discusses the underlying nature of and differences between agricultural and commercial land investment in California, including in-depth discussions on the types of real estate investments recommended, benefits and risks associated with each, historic and potential future returns, and social, economic, and physical characteristics to consider when making any investment decision. The Report also makes specific recommendations on investments within the categories of commercial and agricultural property, including target price ranges, locations, and property uses, and provides evaluation matrices for each. The matrices are designed to apply available data addressing the above discussion points to develop objective criteria in comparing similar properties with each other and in analyzing a potential investment property's suitability for potential Commission purchase.

### **INVESTMENT MATRIX DISCUSSION:**

The two sectors recommended in the Report, agricultural and commercial property investments, each have distinctly different characteristics as well as important similarities that highlight the benefits and risks associated with different investment opportunities. The Report provides two matrices, each tailored to capture and evaluate the commercial and agricultural sector's unique and relevant characteristics. The matrices will be used to compare individual properties and aid in investment decisions based on a range of metrics falling within the categories of key economic performance indicators, environmental and property characteristics, and social considerations. Each matrix uses a five-point scale or range applied to both objective and subjective metrics. In addition to a numerical 1-to-5 score, each metric is also assigned a weight to show the degree of importance. While specific metrics for agricultural properties and commercial properties differ, the matrices yield a final score for a given property that can be used to directly compare the relative investment potential for similar property types and may be used over time to establish a baseline minimum score for purchase consideration. High scores are intended to highlight available properties that meet the Investment Program's purpose and the Commission's priorities, while also yielding the strongest investment potential and the best outlook for long-term returns after taking all criteria into account.

**AFFORDABLE HOUSING ALTERNATIVE:**

The Report includes a discussion on investment in the affordable housing sub-sector. A determination as to whether affordable housing investments fit within the legal framework of the School Land Bank Act will take further research.

As an extremely complex investment category, fully developing a strategy and matrix for affordable housing investment is beyond the Report’s scope, but the discussion provides options for additional research to assist staff with gaining a better understanding of this real property category if the Commission chooses to pursue affordable housing investments in the future.

**STAFF ANALYSIS AND RECOMMENDATION:**

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**AUTHORITY:**

Public Resources Code sections 6005, 6106, 6216, 6217.5, 8701, 8705, 8709.5, 8711, and 8712; Public Contract Code section 10295 (Consultant services contracts), and 10335 et seq.; State Administrative Manual section 1200; State Contracting Manual Volume I (rev. 6/2017) and Volume II (2022).

**STATE’S BEST INTERESTS:**

Investing in commercial or agricultural real estate is a highly complex and inherently risky endeavor. Commission staff recognizes that investments of the magnitude and nature that the Report recommends should be made with the utmost diligence and expertise applied to help minimize risk and maximize investment returns. Utilizing the Report as a starting point, staff believes that engaging real estate brokers with specialized knowledge and experience to help select property within the Report’s investment scope is essential for a successful Investment Program. Professional broker assistance will ensure that thorough analysis and well-informed decisions support staff recommendations and Commission consideration for any potential property purchase and will help facilitate those authorized purchase transactions.

Contracted services may include but are not limited to using specialized professional knowledge and experience identifying suitable investment property, facilitating transactions for real estate property purchases for school lands, and assisting Commission staff with using the tools and implementing the strategy described in the Report.

**CONCLUSION:**

Staff recommends activating the Investment Program and implementing the Report strategy once sufficient funds are available to actively consider real property purchases. To address the considerations described above, staff requests authorization to solicit bids at a future date for broker services, to minimize delays in Investment Program implementation following loan repayment.

**OTHER PERTINENT INFORMATION:**

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1. Approval of the recommended action by the Commission does not constitute approval of or a commitment to make real property purchases; it authorizes solicitation of proposals for real estate broker services and authorizes a consultant contract for professional assistance with implementing the investment strategy and recommendations made in the Report prepared for the School Land Bank Fund Investment Program.
2. This action is consistent with addressing the challenges and opportunities described in the Commission’s 2021-25 Strategic Plan to “Embrace and safeguard multi-benefit School Lands and resource management stewardship that equitably balances responsible local and regional economic development, supports living wages, environmental protection, and revenue generation.
3. Authorization to solicit offers for real estate broker services is not a project as defined by the California Environmental Quality Act because it is an administrative action that will not result in direct or indirect physical changes in the environment.

Authority: Public Resources Code section 21065 and California Code of Regulations, title 14, section 15378, subdivision (b)(5).

**EXHIBIT:**

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- A. School Lands Investment Report – *Executive Summary and Matricies*

**RECOMMENDED ACTION:**

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It is recommended that the Commission:

1. Find that bid solicitation and contracting for professional real estate broker services are incidental to a contract for the purchase of real property, are permissible to protect against a conflict of interest or to ensure independent

and unbiased findings in cases where there is a clear need for a different, outside perspective, will provide equipment, materials, facilities, or support services that could not feasibly be provided by the state in the location where the services are to be performed, and are of such an urgent, temporary, or occasional nature that the delay incumbent in their implementation under civil service would frustrate their very purpose as specified in Government Code section 19130, subdivisions (b)(4), (5), (8), and (10).

2. Find that the selection of consultant contractors under this process does not affect small businesses as defined in California Government Code section 14837, subdivision (d)(1)(B) because they will be accorded equal opportunity to submit statements of qualifications and performance data.

**AUTHORIZATION:**

Authorize the Executive Officer or her designee, in accordance with applicable State contracting laws and regulations, to solicit offers for consultant contractor services, negotiate fair and reasonable prices, award and execute agreements, and take any other steps reasonably necessary to secure professional real estate broker services to facilitate real estate property purchases for school lands and to assist staff with implementing the investment strategy and recommendations made in the consultant-prepared Report for the School Land Bank Fund Investment Program.

## Strategic Land Investment Considerations for the School Land Bank Fund

**EXECUTIVE SUMMARY & RECOMMENDATIONS**

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*“The State Lands Commission manages approximately 458,843 acres of school lands held in fee ownership and the reserved mineral interests on approximately 790,000 acres of school lands where the surface estate has been sold. These interests are what remain of the 5.5 million acres granted by Congress in 1853. The state sold most of the original school lands during the first 130 years of statehood.”*

*2017-18 Annual Staff Report on the Management of State School Lands*

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School lands were placed into a statutory trust in 1984 when the legislature enacted the School Land Bank Act (ACT), which created the School Land Bank Fund (Fund). The Commission is examining an investment strategy for the Fund, created through the past transfer and sale of School Land. To date, the Fund is close to \$70 million, generating financial returns of 1% to 1.50% with no long-term inflation protection. Investment of funds in California property are being explored to support the Commission’s fiduciary mission to enhance current income and provide stewardship. The size and vibrancy of the California economy has made investment in commercial property, and more recently agricultural property, an attractive long-term investment. This report discusses the characteristics of property acquisition and ownership. It compares the investment of agricultural versus commercial property and recommends a property acquisition strategy.

Land used for agriculture and commercial purposes is an investment in land and improvements, although their overall characteristics differ significantly. This is particularly the case when considering a long-term investment. Commercial property has long been considered an attractive investment, particularly in an expanding economy. Agricultural land has only recently been defined as an asset class for investment. The following chart summarizes key differences between the two.

Table 1. Agriculture and Commercial Property Characteristics

Property Characteristics	Agriculture	Commercial
Asset Class	Resource	Real Property
Asset	Land & Trees / Vines	Land & Structures
Useful Life	Sustainable	Prescribed
Location	Rural	Urban
Primary Valuation Drivers	Resource and Management	Location
Income / Net Lease	Fixed & Performance Incentive	Fixed & Rent Escalators
Primary Economic Output	Food Supply	Service

**Agricultural Real Estate Investment Summary**

**Opportunities: Investment Recommendations**

The California economy provides many opportunities for land and property investment. The state’s unique and predominantly irrigated agricultural land—increasingly planted to permanent plantings of fruit, nut, and vineyard crops—has proved to be a good long-term investment. California farms are important suppliers to the domestic market and globally; over 30% of California’s crops are exported. California’s irrigated cropland is a relatively new investment category for institutional and absentee investors. The two primary categories of irrigated cropland include (1) annual cropland and (2) land planted with permanent crops.

The management of agricultural land is a very important component of ownership, and opportunities exist for landowners to enter short- and long-term net leases with established farm managers. A common net lease involving land and a permanent crop includes a fixed base rent, plus a performance bonus based on annual income shared between the landowner and farm management.

Net lease properties in the \$5 to \$15 million price range should be the target. Opportunities also exist to merge a group of smaller properties into a more efficient management unit. This capital range is chosen because such deals are (1) large enough to justify resource allocation associated with individual property acquisition, (2) well sized to attract established farm management firms, (3) small enough to preserve capital for additional investments to create a balanced, diversified portfolio and (4) face limited competition from large institutional and foreign capital sources which generally focus on larger deals.

### **Performance Measures: The Triple Bottom Line**

An investment in agricultural land is a resource investment. California's irrigated land is a unique combination of climate, land, and water resources, which in turn supports a wide variety of crops.

The primary measure for investment decisions is financial performance. Irrigated agricultural land is divided into long-term investments in (1) annual cropland and (2) land planted to a permanent tree or vine crop. Currently, a return on a triple net lease for cropland is 3% to 4%. The return on land planted to a permanent crop—with bonus payments tied to net income—can be above 9%. Another less available alternative is a long-term net lease on land with a permanent crop owned by a third party, usually a farm management firm. The financial return can range from 5% to 9%. The higher the land quality, uniqueness, and water reliability, the higher the financial return.

California's expanding population and industrial base impact its resources. Therefore, environmental and social factors are increasingly considered in making property investment decisions. Issues such as climate, land quality, and water availability are key variables and important factors in land investment decisions. Preservation of the best agriculture land has strong support. The availability and reliability of irrigation water is also a very important consideration in agricultural property selection and acquisition. The importance of water is more meaningful recently given the regulation and potential restriction of groundwater.

Other environmental factors, such as gradual global warming, are projected to impact climate, available water resources, and crop production. Affordable housing, not only for California's general workforce, but specifically for agricultural workers, is a continuing issue. California employs an estimated 420,000 agriculture workers out of 1,300,000 nationally.

### **Benefits & Risks**

The principal method for investors or absentee owners to maximize financial performance and minimize risk is the use of short or long-term net leases with established farm operators or tenants. Based on current land value—and utilizing an investment of \$5 to \$15 million as the target—the appropriate parcel size of irrigated annual cropland is 640 to 1,300 acres and permanent cropland is 280 to 500 acres. There are also opportunities to consolidate agricultural land parcels to increase farming efficiency.

Land ownership can achieve social and environmental goals, such as conserving prime agricultural land and increasing irrigation efficiency or establishing improved and sustainable water sources.

Properties with permanent crops—such as almonds, pistachios, walnuts, and wine grapes—yield the highest return. However, annual income from long-term leases with incentive

payment clauses are likely to fluctuate year to year due to changes in crop size and market prices.

Leaseback properties acquired from long-term farming families, corporations, or food processor/marketers reduce risks and provide reliable and experienced long-term management.

In the final analysis, ownership of agricultural land with the highest quality land, water, and climatic resources minimizes long-term ownership risk.

Financial performance is the key factor for evaluating the benefits and risks associated with investment in a specific land parcel. The acquisition cap rate and the standard deviation of returns are the main variables used to measure financial performance. In addition, several resource factors such as climate, soil, and water must be assessed to minimize acquisition risk. Ownership risk is minimized by using net leases to well-established and well-financed farm managers.

Summary tables are provided comparing the primary characteristics of agricultural land and commercial property investment.

### **Commercial Real Estate Investment Summary**

#### **Opportunities: Investment Recommendations**

The large and diverse commercial real estate investment universe within California provides potentially attractive investment opportunities across multiple property sectors. A deep demand base and significant supply constraints bode well for long-term value preservation. However, strong investor interest for a limited inventory also creates significant competition for commercial property in the state.

Passive investment options with the steadiest long-term income generation potential should be the focus within each sector to align with the Commission's goals for stable, long-term income generation and minimal property management. Single-tenant, triple net opportunities in the retail, industrial and office sectors, commonly referred to as net lease investments, provide the most opportunities among major property types. Single-tenant net lease investments are typically freestanding buildings leased to well-known businesses under triple net lease structures. They pass building operations costs—property taxes, insurance, and maintenance—to tenants in exchange for fixed lease payments over a long time period.

Recommended investment targets include net lease properties in the \$5 to \$15 million price range in well-located buildings with strong credit tenants in stable sectors.

This capital range is chosen because deals of this size are (1) large enough to justify resource allocation associated with individual property acquisition, (2) within a reasonable range to target properties with high credit tenants with corporate backing, (3) small enough to preserve

capital for additional investments to create a balanced, diversified portfolio, and (4) face limited competition from institutional and foreign capital sources which generally focus on larger deals.

The single-tenant net lease asset class is recommended because it (1) best meets the Commission's requirements for long-term income stability with minimal management responsibilities, (2) offers a lower risk alternative to conventional multi-tenant gross lease investment, (3) consists of a sizable investment pool which meets the Commission's investment criteria, (4) includes a large number of properties with lease terms less than the 49-year maximum that ground net leases generally do not, and (5) has less risk and resource commitment to re-tenant at the end of long lease terms when the locations are carefully chosen and desirable, which characterize attractive net lease deals.

Retail properties offer the most opportunities within the target range. Necessity-based segments, such as grocery stores and pharmacies are the most desirable. They can withstand business cycle fluctuations and are more resistant to Internet cannibalization. Office and industrial properties with credit-worthy tenants in stable sectors with strong long-term prospects—such as healthcare, education, logistics and e-commerce—should also be considered.

Attractive deals with strong credit tenants in the \$5 to \$15 million range are more abundant in smaller markets outside of major urban centers. Limited supply and heightened competition characterize desirable properties in primary cities, although opportunities do exist.

### **Performance Measures: The Triple Bottom Line**

The primary measure for investment decisions is financial performance. A wide range of office, industrial, and retail categories are likely to offer opportunities for long-term investment. They historically offer stable income returns averaging in the high-4% to mid-5% range. While historical data is very limited, income returns for the recommended triple net lease structure on single-tenant facilities are somewhat lower than the overall market but would provide more stability in cash flows on an ongoing basis. This is because rental increases for net lease properties are fixed and typically tied to inflation rather than more volatile market-wide rental appreciation. Acquisition cap rates for single-tenant properties are in the 5% range and yields for well-chosen properties meet the Commission's criteria for steady, long-term annual income generation. However, peak pricing in the current cycle heightens the need for careful due diligence to ensure that in-place lease terms and rent schedules justify the acquisition prices at historically low cap rates.

Volatility of returns also needs to be considered to assess the potential risk associated with achieving a certain level of return. For commercial investment, volatility is largely a function of economic activity. While industry drivers vary from property type to property type, performance is generally tied to national, regional, and local economic health. Cyclical trends related to business cycle fluctuations have a direct impact on businesses and consumers, which

in turn influence their space usage decisions. Total returns for California commercial real estate are more volatile than the national average. However, income returns—especially those of net lease properties—exhibit very low volatility. This bodes well for investors focused on long-term, stable revenue generation strategies.

Commercial buildings have significant environmental and social impacts which should be considered when making investment decisions. Energy use, water use, emissions, traffic congestion, jobs-housing balance, and gentrification effect overall returns for commercial real estate beyond the financial return of an investment. A variety of quantitative and qualitative measures are used to determine environment and social returns on investment.

### **Benefits & Risks**

A framework is provided to compare the benefits and risks of commercial real estate alternate investments given the goal of maximizing financial, environmental, and social returns. This includes indicators which effect the entire sector, as well those specifically important for single-tenant net lease investment.

Financial performance is the key factor for evaluating the benefits and risks associated with investing in a particular asset. Acquisition cap rate and the standard deviation of returns are the main variables used to measure financial performance. Time remaining on the lease and provisions for guaranteed rental increases should also be determined to ensure they are reflected in pricing.

Major risk factors for general commercial real estate investment include local economic conditions and larger business cycle fluctuations. These can positively or negatively impact demand for space. Supply constraints in each market determine risks for overbuilding and unanticipated events such as natural disasters. Government action can have out-sized consequences on a particular geography, property category, or the commercial real estate market more broadly. Social and environmental impacts associated with broad specific property sectors (i.e., energy usage in office buildings versus retail buildings, etc.) also fall in this category.

Major risk factors for single-tenant net lease investments include tenant credit (the key determinant to ensuring a solid revenue stream); location (the key determinant of re-leasing potential); and any property/location-specific social and environmental impacts (i.e., the positive effect of a grocery store investment in an underserved community or the negative impact of a retail franchise investment on local small businesses, etc.)

### **Recommendations & Action Plan**

Investments in commercial and agricultural property have several distinct characteristics. Ownership of agricultural property is an investment in the combination of climate, land and water coupled with growing food crops. Commercial property is a combination of land

ownership and most often a building or structure. Property income and value is tied closely to market forces and the performance of the overall economy or segments within the economy.

The size of the California economy provides a large and wide range of commercial property investments which attracts national and international investment. Third-party investment in California's agricultural land is a more recent trend. It is increasingly focused on investment in land planted to a permanent crop or a combination ownership of land and a permanent crop.

To minimize the Commission's management time and effort and to reduce risk, it is recommended that investment be made in single-tenant properties, with 5 to 25-year leases, managed by a creditworthy experienced management team or company.

### **Agriculture vs. Commercial Property**

The characteristics of different types of agriculture and commercial property are discussed in the body of the report. They are summarized in the following charts.

Table 2. Investment Alternative Comparison: Recommended Agricultural Land Category - Economic

Economics	Measurement Metric	Commission Criteria / Goals	Ground-Net Lease	Land Net Lease Under Permanent Crop	Land and Permanent Crop Net Lease	Unimproved Range Land
Yield	Cap Rate from NCREIF Data	Annual Cash Return Above 2% and Appreciation at or Above Inflation	2% to 4%	5% to 7%	8% to 12%	Minimal
Volatility	Standard Deviation	Stable Revenue Generation Through Economic Cycles	Low	Low	Medium	High
Total Investment Pool in Designated Capital Range	Variable	Stable Investment Pool in \$5 To \$15 Million Range	High	Limited	Limited	Medium
Credit Tenant Pool in Designated Capital Range	Establish Farm Owner/Managers and Professional Managers	Minimum 10 Years' Experience	High	High	High	Low
Lease Terms	Average Lease Term	Long-Term with 45-Year Maximum	5 to 10 Years	20 to 25 Years	20 to 30 Years	Unknown
Management Intensity	Qualitative Score Based on Lease Terms	Minimal Management Role	Low	Low	Medium	Medium

Table 3. Investment Alternative Comparison: Recommended Agricultural Land Category - Environment

<b>Environment</b>	<b>Measurement Metric</b>	<b>Commission Criteria / Goals</b>	<b>Ground-Net Lease</b>	<b>Land Net Lease Under Permanent Crop</b>	<b>Land and Permanent Crop Net Lease</b>	<b>Unimproved Range Land</b>
<b>Climate</b>	Adaptability of Crop	Minimal Impact from Climate Change	Property Specific	Property Specific	Property Specific	Property Specific

Table 4. Investment Alternative Comparison: Recommended Agricultural Land Category - Soil

<b>Soil</b>	<b>Measurement Metric</b>	<b>Commission Criteria / Goals</b>	<b>Ground-Net Lease</b>	<b>Land Net Lease Under Permanent Crop</b>	<b>Land and Permanent Crop Net Lease</b>	<b>Unimproved Range Land</b>
<b>Soil</b>	Soil Quality	Sustainable, Class 1 or 2 Soils Preferred	Property Specific	Property Specific	Property Specific	Property Specific
<b>Water</b>	Availability and Quality	Sustainable in Periods of Drought	Property Specific	Property Specific	Property Specific	Property Specific
<b>Hazards</b>	Historical Records of Hazards	Minimize Risk	Property Specific	Property Specific	Property Specific	Property Specific

Table 5. Investment Alternative Comparison: Recommended Agricultural Land Category - Social

Social	Measurement Metric	Commission Criteria/Goals	Ground-Net Lease	Land Net Lease Under Permanent Crop	Land and Permanent Crop Net Lease	Unimproved Range Land
Farm Worker Availability	Agriculture Extension Service Estimate	Preference for Mechanized Crops	Not a Concern	Not a Concern	Consideration	Not a Concern
Farm Worker Housing	Agriculture Extension Service Estimate	Local Availability	County Specific	County Specific	County Specific	Not a Concern

Table 6. Investment Alternative Comparison: Recommended Commercial Categories - Economic

Economics	Measurement Metric	Commission Criteria / Goals	Single Tenant Net Lease Retail	Single Tenant Net Lease Industrial	Single Tenant Net Lease Office	Ground Net Lease
<b>Yield</b>	Cap Rate from Real Capital Analytics (RCA): 2020 to First Half 2021	Annual Cash Return Above 2% and Appreciation at or Above Inflation	High-5%	Low-5%	High-5%	Specific Data Unavailable, But Less Than 5%
<b>Volatility</b>	NCREIF Income Return Standard Deviation 2004 to 2019	Stable Revenue Generation Through Economic Cycles	0.8%	0.9%	0.9%	Specific Data Unavailable, But Less Than 5%
<b>Total Investment Pool in Designated Capital Range</b>	RCA Deal Volume (2010 to 2020)	Sizable Investment Pool in \$5 to \$15 Million Range with Limited Competition from Institutional	\$9.7 Billion in 1,226 Deals	\$10.9 Billion in 1,249 Deals	\$4.2 Billion in 475 Deals	Less Than \$6 Billion

<b>Economics</b>	<b>Measurement Metric</b>	<b>Commission Criteria / Goals</b>	<b>Single Tenant Net Lease Retail</b>	<b>Single Tenant Net Lease Industrial</b>	<b>Single Tenant Net Lease Office</b>	<b>Ground Net Lease</b>
		Investors				
<b>High Credit Tenant Pool in Designated Capital Range</b>	Qualitative Based on RCA Database for \$5 to \$15 Million Historical Transactions	Sizable Investment Pool in \$5 to \$15 Million Range with Desirable, Low-Risk Tenants	Large	Medium	Medium	Small
<b>Lease Terms</b>	Avg. Lease Term	Long-Term with 49-Year Maximum	10 to 25 Years	10 to 25 Years	10 to 25 Years	50 to 99 Years
<b>Management Intensity</b>	Qualitative Score Based on Operational Obligations Related to Lease Structure	Minimize Management Role	Low	Low	Low	Very Low

Table 7. Investment Alternative Comparison: Recommended Commercial Category - Environmental

<b>Environmental</b>	<b>Measurement Metric</b>	<b>Commission Criteria / Goals</b>	<b>Net Lease</b>
<b>Energy Consumption / CO2 Emissions</b>	Qualitative Score Based on LEED Certification and Other Environmental Impact Factors	Minimize Carbon Footprint, Promote Sustainable Practices	Property Specific, but major positive impacts can include Public Transit and Walkability, Enhancement, Green Building Practices which promote resource usage efficiencies and Worker Health. Negative impacts can include Traffic congestion, Production-Related Emissions, Inefficient Energy Usage.

Table 8. Investment Alternative Comparison: Recommended Commercial Category - Social

Social	Measurement Metric	Commission Criteria / Goals	Single Tenant Net Lease Retail	Single Tenant Net Lease Industrial	Single Tenant Net Lease Office	Ground Net Lease
<b>Job Impacts</b>	Qualitative	Promote High-Quality Job Creation	Tenant Specific, But Sector Has Weaker Potentials	Tenant Specific, But Sector Has Moderate Potential	Tenant Specific, But Sector Has Stronger Potential	Tenant Specific, But Sector Has Stronger Potential

Table 9. Investment Alternative Comparison: Recommended Commercial Category - Social Continued

Social	Measurement Metric	Commission Criteria / Goals	Net Lease
<b>Affordability / Community Impact</b>	Qualitative	Provide and Enhance Benefits to Local Community	Property and Market-Location Specific but major positive impacts can include provides needed goods / services for underserved community. Major negative impacts can include contributing to gentrification by diminishing housing affordability or pricing out local businesses.

### **Property Section Recommendations**

The following recommendations are made under today's conditions and should be modified dependent on current market and economic conditions. The Commission can view selecting property in several stages, as experience is gained in finding and evaluating potential investments. It is recommended that the Commission select 3 or 4 individuals to be designated an "Investment Committee" to focus on potential investment property, commence evaluations, and make acquisition recommendations.

It is noted that, for the past 2 to 3 years, the cap rate on cropland and premium single-tenant commercial property declined due, in part, to low interest rates and lower farm crop prices than the previous 4 to 6 years. Increasing interest rates and an improved farm economy result in higher cap rates.

### **Primary Phase – Initial Property Acquisition Action Plan**

As the Commission initiates a new program, it is recommended that several agricultural properties are acquired, as the Commission's primary activities and expertise involve the management of California lands. This can be followed by considering appropriate commercial property. It should be noted that there may be a larger selection of commercial properties than appropriate agricultural property. In any case it takes time to find appropriate property. Agricultural land with these characteristics should be sought:

Agricultural land classification of 1 and 2.

Land parcel of \$5 to \$15 million in size or an aggregation of similar smaller parcels into one operating unit.

Irrigated row cropland with the potential to be planted with permanent crops or multi-purpose land planted to rice in the Sacramento Valley.

Land located within irrigation districts with the most secure and lowest cost irrigation water. Suggested irrigation districts include Modesto and Tulare Irrigation Districts.

Leases to established farm managers on a net lease basis, thereby minimizing the Commission's management time and expense.

Properties may be evaluated and compared using the property selection methodology and matrixes in Section 8.

It will prove difficult to find a land-only component under commercial buildings in the \$5 to \$15 million range on a long-term net lease basis.

In the next phase, based on experience gained in the initial property acquisitions, consider broader land categories.

**Secondary Phase – Action Plan**

As experience in the California real estate market is gained, consider both agricultural and commercial property with an emphasis on property that has been, or can be, leased to strong tenants on a long-term net lease basis.

Consider agricultural land planted to permanent crops coupled with 10 to 25-year fixed income farm management leases whereby the management company pays all operating costs, along with appropriate inflation adjustments and performance bonuses based on higher-than-average market prices and crop production. The addition of a variety of long-term permanent crop leases, coupled with performance bonuses, likely requires allocating staff time to select and monitor the portfolio. Alternatively, the Commission could hire a staff member or contract with a third-party property management firm to evaluate acquisitions and monitor assets.

Seek land investments under prime commercial or industrial property. Consider single-tenant commercial property leased to a creditworthy tenant for 10 to 25 years with appropriate inflation adjustments.

Strategic Land Investment Considerations for the School Land Bank Fund

Data Input for Property Selection Tool: Agricultural Investments						
Property: Asking Price: Size (Acres): Market:			Property Type: Crop: Tenant:			
Considerations	Quality Parameters					
	Poor	Good	Excellent	Score	Weight	Weighted Score
<b>Economic</b>				<b>40%</b>		
Financial	Cap Rate	Below Market Average	At Market Average	Above Market Average	10%	
	Total Return	Below Market Average	At Market Average	Above Market Average	5%	
	Volatility	Below Market Average	At Market Average	Above Market Average	5%	
	Crop Market Growth Projections	Below 2%	2% to 4%	Above 4%	5%	
	Crop Market Prospects	1 to 2 Buyers	2 to 4 Buyers	Over 4 Buyers	5%	
	Management	Less than 10 Years' Experience	10 to 20 Years' Experience	Over 20 Years' Experience	10%	
<b>Environmental</b>				<b>55%</b>		
Location	Close to Same or Similar Productive Crops	No Plantings Within 20 Miles	Planting Within 20 Miles or Less	Plantings Within 10 Miles or Less	3%	
	Climate Fit to Targeted Crops	Not Known	Appropriate	Optimum Condition	5%	
	Crop Yield	Below State Average by 15%	State Average +/- 15%	Above State Average by 15% or More	10%	
	Government Interference/ Control		Government Controls on Price/Volume/ Payments	Free Market	1%	
Soil	Soil Quality	Class 4 or Lower	Class 1, 2, 3 and 4	Mix Class 1 to 2	4%	
	Soil Condition		Only For Row Crops	For Both Row and Permanent Crops	4%	
	Soil Depth	2 feet or less	2 to 3 feet	3 feet or more	4%	
	Soil Texture	> 60% Clay	50% to 60% Clay	< than 50% Clay	2%	
Water	Water Sources	1 Source but Unreliable	1 Reliable Source	2 Reliable Sources	9%	
	Affordability	\$80 plus/acre/foot	\$40 to 80 acre/foot	Below \$40 acre/foot	5%	
	Reliability History	Not Reliable	Do Not Have to Follow in Drought Year	Reliable in Drought Year	3%	
	Irrigation System		Flood Irrigation	Drip or Sprinkler Irrigation	2%	
Hazards	Hail and/or Frost Risk, Wind Damage, Flooding or Major Diseases	History of Problem in Last 10 Years		No History Last 10 Years	3%	
<b>Social</b>				<b>5%</b>		
	Farm Worker Availability		Shortages	Acceptable/Available	3%	
	Farm Worker Housing	Poor Living Conditions Locally	Conditions Are Good	Portion Available at Farm	2%	
Scoring: Not Acceptable = 0, Poor = 1, Good = 3, Excellent = 5				<b>Total Score</b>	<b>100%</b>	

Strategic Land Investment Considerations for the School Land Bank Fund

Page 1 of 2		Data Input Entry for Property Selection Tool: Commercial Investments					
<b>Property:</b>		<b>Property Type:</b>					
<b>Asking Price:</b>		<b>Sector (Industry):</b>					
<b>Size (Sq. Ft.):</b>		<b>Tenant:</b>					
<b>Market:</b>							
Considerations		Quality Parameters			Score	Weight	Weighted Score
		Poor	Good	Excellent			
<b>Economic</b>					<b>70%</b>		
Financial	RCA Cap Rate	Below Market Average	At Market Average	Above Market Average		10%	
	NCREIF Income Return	Below Market Average	At Market Average	Above Market Average		8%	
	NCREIF Income Return Volatility	Below Market Average	At Market Average	Above Market Average		1%	
	Years Left on Lease/ Renewal Provisions	Less Than 15 Years	15 to 25 Years	25+ Years		7%	
	S&P Tenant Credit Rating	Below High Grade	AA+ -AA- (High Grade)	AAA (Prime)		10%	
Market-Level	Tenant Industry	Highly Volatile/Highly Correlated with GDP Growth	Moderate Volatility and Correlation	Least Volatile and Correlated to GDP Growth		5%	
	Market Employment Growth	Below State Average	At State Average	Above State Average		5%	
	Market Employment Growth Volatility	Above State Average	At State Average	Below State Average		5%	
	Market Rent Growth	Below State Average	At State Average	Above State Average		1%	
	Market Vacancy Rate	Above State Average	At State Average	Below State Average		1%	
	Market Supply Constraints	Minimal Supply Constraints	Moderate Supply Constraints	Significant Supply Constraints		2%	
Property-Level	Building Location Quality	Sub-Standard Location, Very Difficult to Re-Tenant	Good Location, Easy to Re-Tenant	Prime Location with Best Access/Irreplaceable Sites		10%	
	Building Specialization	High Level of Specialization, Very Expensive to Upgrade	Low Level of Specialization, Minor Expense to Upgrade	Virtually No Specialization and Expense to Upgrade		5%	
Scoring: Not Acceptable = 0, Poor = 1, Good = 3, Excellent = 5							

Strategic Land Investment Considerations for the School Land Bank Fund

Page 2 of 2		Data Input Entry for Property Selection Tool: Commercial Investments				
Property: Asking Price: Size (Sq. Ft.): Market:		Property Type: Sector (Industry): Tenant:				
Considerations	Quality Parameters			Score	Weight	Weighted Score
	Poor	Good	Excellent			
<b>Environmental</b>					<b>15%</b>	
	LEED Certification	Not Applicable	Not Applicable	Investment Has LEED Certification (All Other Projects Receive a "0")	4%	
	Public Transit/Walkability Impact	Negative Impact	No Impact	Positive Impact*	4%	
	Traffic Congestion Impact	Negative Impact	No Impact	Positive Impact*	4%	
	Other Environmental Impacts	Negative Impact	No Impact	Positive Impact*	3%	
<b>Social</b>					<b>15%</b>	
	Benefits To Underserved Community	Negative Impact	No Impact	Positive Impact*	4%	
	Gentrification Impact	Negative Impact	No Impact	Positive Impact*	4%	
	Jobs Impact	Negative Impact	No Impact	Positive Impact*	4%	
	Other Social Impacts	Negative Impact	No Impact	Positive Impact*	3%	
<b>Total Score</b>					<b>100%</b>	
*Based on qualitative assessment Scoring: Not Acceptable = 0, Poor = 1, Good = 3, Excellent = 5						