

The Headwaters Fund Charter

SUMMARY

The 2014-2015 Humboldt County Grand Jury reviewed the reports published by previous Humboldt County Grand Juries. The Grand Jury discovered extensive work done by past Grand Juries focusing on the Headwaters Fund, the Headwaters Fund Board and the Headwaters Fund Charter (2009-2010, 2010-2011). The current Grand Jury decided to follow up on the work started by those past Grand Juries.

After a careful analysis of the Headwaters Fund Charter, the current Headwaters Fund investment portfolio and interviews with relevant community representatives, the Humboldt County Grand Jury comes to the following conclusions:

- 1) The Headwaters Fund Charter clearly mandates that the Headwaters Fund Board draft a charter review every three years and the public will have an opportunity to have input in the drafting of that review. From the last paragraph of the Headwaters Fund Charter—"The public and participants in Fund activities will be given an opportunity to provide comment and participate in the drafting of the review."

The Humboldt County Grand Jury finds no evidence to support that any such public input has ever occurred or any drafting of a charter review.

- 2) The Headwaters Fund Charter is currently, by choice, set up to support and mandate that funds work in the community "in perpetuity." From the Headwaters Fund Charter—"Keep the funds working in the community in perpetuity."

The Humboldt County Grand Jury finds the current Headwaters Fund investment portfolio, managed and invested by the Humboldt County Treasurer to be inconsistent with the Charters mandated "in perpetuity."

- 3) Volunteers and one part time staff position currently manage the Headwaters Fund. Humboldt County governance currently restricts the Headwaters Fund investment portfolio. The Humboldt Area Foundation is a local, professionally staffed, nonprofit funding/granting organization that currently manages over 100 million dollars and is not limited by the same restrictions.

The Humboldt County Grand Jury recommends, for oversight, management and investment reasons, that the Board of Supervisors (BOS) amend the Headwaters Fund Charter to allow the transfer of their investment portfolio to the Humboldt Area Foundation.

The Humboldt County Grand Jury can find no contractual or legal reason why such a transfer could not be accomplished. The consequent increase in charter oversight, public input and less restrictive investment options would serve the citizens of Humboldt County and would truly "keep the funds working in the community in perpetuity."

BACKGROUND

While reviewing previous Grand Jury Reports for historical perspective, the present Grand Jury found a Grand Jury report on the Headwaters Fund dated 2011, which itself was a continuance of the 2009-2010 Grand Jury report on the Headwaters Fund. It was noted in the 2010-2011 report that a comprehensive review of their charter was required every three years. Recommendation H from the 2010-2011 report stated:

“The Board of Supervisors should use the Grand Jury recommendations to fulfill the requirements of the charter review and follow this by immediately preparing and maintaining a schedule of review as was originally requested.”

At their June 21, 2011 meeting, the Board of Supervisors approved a modification of this recommendation stating “This recommendation has been implemented and will continue to be implemented.” As part of their response they declared “the next comprehensive charter review will occur in 2014.”

The Grand Jury investigated to see whether or not the Headwaters Board had completed the required 2014 review. After extensive interviews the Grand Jury concluded that the Headwaters Board had not done “the next comprehensive charter review.” Based on the results of the initial assessments, the Grand Jury decided an investigation into the Headwaters Fund Charter, including the comprehensive review process, board functions, financial structure and investment strategies was warranted.

METHODOLOGY

The Humboldt County Grand Jury did a review and study of the 2010-2011 Grand Jury Report titled: *The Headwaters Fund: Charter versus Reality*.

The Humboldt County Grand Jury interviewed past and present representatives of The Headwaters Fund Board, The Arcata Economic Development Corporation, The Redwood Regional Economic Development Commission, the Humboldt Area Foundation and the Humboldt County Treasurers Office.

The Humboldt County Grand Jury did a review and analysis of the current Headwaters Fund Charter, the current Headwaters Fund agreement with the Arcata Economic Development Corporation, the current agreement with the Redwood Regional Economic Development Commission, the current Headwaters Fund investment portfolio, and current Humboldt Area Foundation Investment Strategies.

The Humboldt County Grand Jury read and examined all published Headwaters Fund Annual Reports.

The Humboldt County Grand Jury familiarized itself with various investment strategies and portfolios, including those that protect “in perpetuity” and those that do not.

DISCUSSION

History

The Headwaters Forest Reserve is a group of old growth coast redwood groves managed by the Bureau of Land Management (BLM) as part of the National Landscape Conservation System. It is comprised of approximately 7,500 acres and is located six miles southeast of Eureka in the Northern California coastal forest ecoregion.

Historically, most of the reserve was owned by the now defunct Pacific Lumber Company (PALCO). Beginning in the 1920s, PALCO, a family owned business, had a positive relationship with conservationists. In 1985, Charles Hurwitz and Maxxam, Inc. purchased the company as the result of a hostile takeover. Maxxam changed long standing PALCO policies of sustained-yield logging with clear cutting to finance the debt they incurred in the junk bonds used to purchase the company. As a result of the changed logging practices, the Headwaters Forest became the site of many tree sit-ins and demonstrations. The clash between timber interests and environmentalist became known as the Timber Wars.

In the early to mid-1990s, the conflict over logging the Headwaters Forest moved through the courts, and state and federal processes. In 1996, PALCO agreed to sell the 3,000-acre Headwaters Grove and a 4,500-acre buffer for \$380 million of public funds. It was to be a joint federal/state acquisition with BLM the managing agency. In 1997, the United States Congress approved the government's share of \$250 million. The following year California approved its \$130 million portion. As part of the California authorization, \$12 million was to be provided to Humboldt County for economic assistance. The federal government supplemented the California payment with an additional \$10 million, categorized as a direct payment. Neither payment had guidelines attached to the money. In 1999 the acquisition was completed with the combined properties making up the Humboldt Forest Reserve.

Leading up to the sale, local county officials and community leaders contended that the Headwaters purchase should include an appropriation to offset local economic losses. A July 1997 Board of Supervisors (BOS) resolution supported a Memorandum of Understanding (MOU) between the County of Humboldt, the City of Eureka, the Humboldt Bay Harbor District, and Northwestern Pacific Railroad that requested a \$118 million mitigation package. The entities agreed the money should be used to construct a marine terminal, fund watershed rehabilitation, build economic development projects including the Humboldt Bay Harbor District's Capital Improvement Plan, offset lost taxes and establish retraining programs. This local effort in concert with state and congressional legislators' assistance resulted in the combined \$22 million federal and state appropriation to the county. It was less than 20 per cent of what they requested.

At the same time, local timber owners and environmental leaders met privately in search of ways to reduce conflict and build areas of agreement. A witness described the proceedings as “painful and slow.” On the day the \$22 million payment to the county was announced, an advertisement appeared in the Times-Standard. The ad recommended rules for developing and governing this new influx of money to the county. The ad recommended that an open process available to all county residents should determine the use of the money; that anyone should be able to apply for the funds under clear guidelines; and that no self-interested person should be involved in determining the use of the funds. The ad's recommendations were created and signed by the timber and environmental participants present in those private meetings.

When a member of the Board of Supervisors asked the Humboldt Area Foundation (HAF) to consider managing the soon to be acquired funds, the Humboldt Area Foundation refused. The timber and environmental leaders who created the recommendations had used the HAF office to meet. HAF had designed the ad for them. HAF had also designed and assisted in the process of inclusion for those with pronounced disagreements. At the time, HAF believed, that as a community foundation concerned with public perception, that refusal was necessary.

In late 1999, based in large part upon recommendations negotiated by the timber and environmental leaders showcased in the ad, a Board of Supervisors subcommittee recommended to the full Board that the bulk of the \$22 million be reserved for the “economic prosperity and quality of life for all Humboldt County residents.” The BOS approved the recommendation. They also approved using a small portion of the funds to offset certain Humboldt County costs related to the acquisition of Headwaters. The BOS further instructed the Community Development Services Department staff to work with citizens and organizations to develop recommendations for the long-term management and use of the funds.

In the summer of 2000, the BOS approved a plan to acquire public input. Public meetings were held at different locations in the county and over 300 people provided input at those meetings. Following that process, individual interviews were conducted with people having specific expertise or representing specific areas of interest. Also, many organizations and individuals submitted written comments. A consulting firm was hired to assist County staff in the analysis of public input and the development of fund options.

In analyzing the public input, a discussion draft of options was written and released in November 2001. Though there were many opinions expressed during the public process, several areas of consensus were noted. First, there was a near unanimous opinion that the funds should be used to improve the economy and to most that meant creating new jobs. Second, there was a strong consensus that the principal amount of the funds should be preserved to the greatest extent possible, meaning only the use of interest for funding grants. Third, there was a strong sense that the funds should be preserved for future generations. Fourth, most agreed it was better to maximize local investment of principal, through loans or other vehicles. Fifth, most believed the funds should be leveraged with other funds.

The following month a public workshop was held to present initial feedback based on the public meetings and individual interviews contained in the discussion draft. Input was gathered through the workshop to be incorporated in an *Alternatives Report* that would delineate the various fund options for the BOS to consider in providing direction for drafting a fund charter.

Based on the public input presented in the discussion draft and the follow-up workshop, the *Alternatives Report* was presented to the BOS in the spring of 2002. A range of alternatives, covering six areas, was presented to the Board. The areas were Goals, Control and Oversight, Staffing, Financial Management, Community Investment Opportunities and Name. Staff noted their recommended alternatives in each category. Of interest: under Goals, the 1997 MOU was listed but not selected; under Control and Oversight, granting the management of the funds to a foundation was listed but also not selected.

On May 6, 2002 the BOS voted to approve all staff recommended alternatives and directed them to finalize the charter consistent with those alternatives. The official name of the fund was approved – *Headwaters Fund*. The Headwaters Fund Charter was completed on December 2, 2002 and adopted by the Board of Supervisors on December 17, 2002.

The Charter

The last paragraph of the Headwaters Fund Charter that was approved by the Humboldt County Board of Supervisors on December 17, 2002 states:

“The comprehensive reviews of the Charter and Program Manuals will include an evaluation of the Fund’s effectiveness and recommendations for revisions or amendments. The public and participants in Fund activities will be given an opportunity to provide comment and participate in the drafting of the review. The review will be prepared by staff and incorporated in the annual Community Benefits Report. The report will be reviewed and approved by the Headwaters Fund Board and forwarded, with recommendations, to the Board of Supervisors.“

Although the Charter states that the Headwaters Fund Board shall draft a review, the Humboldt County Grand Jury could find no evidence of the existence of any such draft. Representatives of the Headwaters Fund Board verified that no such written documents existed. The Charter also states that the “review will be prepared by staff and incorporated in the annual Community Benefits Report.” Reading and studying the relevant annual reports, the Humboldt County Grand Jury could find no evidence that any “drafted” charter review was ever “incorporated” into an annual report.

The Charter also states that the public will be given an opportunity to provide comment and participate in the drafting of the review. The Humboldt County Grand Jury made note of the fact that the Charter mandates public participation into the drafting of a Charter review and not merely the participation in an after the fact Charter review. The Humboldt County Grand Jury could find no evidence that any such public participation ever occurred or that any plan to invite such public input ever existed.

Perpetuity

From a high of 20,792,475 on 6/30/09, the Headwaters Fund balance declined in four of the following five years. On 6/30/14, the ending balance was 16,543,072. That is a drop of approximately 20% in five years.

From December 17, 2002, the day on which the Humboldt County Board of Supervisors approved the newly created Headwaters Fund Charter until the writing of this Humboldt County Grand Jury report, there has only been one major change to the charter.

In February 2014, the Headwaters Fund Board (HFB) gave their annual report on the status of the Headwaters Fund for the 2012-13 fiscal year. As of 6/30/2013 the ending balance had dropped approximately \$3,300,000 in three years. The Headwaters Fund Charter states that HFB must: keep the funds working in the community in perpetuity (1.b.ii.b.) and manage the funds efficiently and cost effectively (1.b.ii.e)

In November 2012, HFB created the Headwaters Fund Board Operating Committee as an ad hoc committee to look into the financial structure of the fund. Analysis of the structure, returns and commitments of the Fund lead the Operating Committee to conclude that some changes had to

be made to ensure the continuation of the mission of the Fund. They found that expected revenues from investments over time had not materialized. The reality at that time was the Fund was only earning .48% on the corpus in the Humboldt County Investment Pool. Also, the Community Investment Fund (CIF) had granted over two million dollars for large infrastructure projects over the first eight years of the CIF with no replenishment mechanism in place. There was also an unexpected lower demand for money borrowed through the eight million dollar Revolving Loan Fund (RLF). Lower demand led to lower returns.

As a result of the previously stated financial issues, the Operating Committee recommended five operational changes to the Headwaters Fund. One of the recommendations required a change to the Fund Charter. That recommendation was to allow the Humboldt County Treasurer to invest up to ten million dollars outside the Humboldt County Investment Pool. This change was approved at the 2/25/14 Humboldt County Board of Supervisors meeting.

The Headwaters Fund Charter is currently, by choice set up to support and mandate that funds work in the community in perpetuity. The Humboldt County Treasurer is currently the de facto Headwaters Liquidity Fund and The Headwaters Investment Portfolio Fund manager.

It is the fiduciary duty of the Headwaters Investment Portfolio Fund manager to protect the *real value* (actual purchasing power that keeps pace with inflation) not to simply protect the nominal value (a fixed dollar amount that will lose purchasing power as inflation occurs).

In order to protect the *real value*, the fund manager must take a reasonable amount of risk, so that earnings over time will be sufficient to fund the causes for which the Liquidity Fund exists plus enough to add to the principal, so that the principal will keep pace with the cost-of-living index. The cost-of-living index average for the last ten years is 2.67%. The current Headwaters Fund investment portfolio for the next ten years ending on December 9th, 2024 shows a mean average return of 2.37%. The current strategy is protecting only the initial fixed dollar amount. The consequence will be over time an erosion of the funds ability to serve its original purpose.

The Headwaters Fund Charter Board has done an admirable job given the conditions and restrictions under which they have worked. The Humboldt County Grand Jury also recognizes the disciplined and restricted work of the Humboldt County Treasurer for his oversight of the Headwaters Fund Investment portfolio.

Humboldt Area Foundation

Humboldt Area Foundation was founded in 1972 by Vera Perrott Vietor. From an original \$2.4 million Fund balance 1972, the Humboldt Area Foundation has grown to over \$106 million in 2014.

From the Humboldt Area Foundation website:

“HAF works to connect donors that invest in our community with projects in their area of interest to put local capital to work for local priorities and the public good. HAF strives to be a good partner with other organizations serving the community and help community groups locate funding that will enable them to find solutions and seize opportunities to build on this region’s strengths and assets. In 40 years, nearly \$60 million dollars have been granted to support the community through the generosity of our donors. The diversity of our giving reflects the diversity of our donors and the creativity of our community.”

Humboldt Area Foundation's Board is a volunteer board. Directors serve four-year terms and may serve for a maximum of three consecutive full terms of office, with a mandatory one-year hiatus following three consecutive terms of office.

Humboldt Area Foundation staff consists of an executive director and 21 employees working in four areas: Donor Services, Grantmaking, Community Strategies, and Administrative Services.

Humboldt Area Foundation has made loans and commitments to various local agencies, including the following: Open Door Clinic, Arcata Fire Department, Sequoia Zoo Foundation and the Northern California Indian Development Corporations.

Humboldt Area Foundation, even with the economic downturn of 2008-2009, has over the last ten years been able to achieve a 6.7% return on over \$90 million in investments.

FINDINGS

- F1. The Headwaters Fund Charter mandates a drafting of a review, and by interpretation, a written charter review every three years. There is no evidence any such reviews were ever drafted or written.
- F2. The Headwaters Fund Charter mandates public participation in the drafting of charter reviews every three years. There is no evidence that public participation was ever a part of the drafting of a charter review.
- F3. The Headwaters Fund Charter mandates that the funds are kept working in the community in perpetuity. The current Headwaters Fund Charter investment portfolio managed by the Humboldt County Treasurer does not meet the necessary requirement of lasting in perpetuity and over time will erode the fund's ability to serve its stated purpose.

RECOMMENDATIONS

- R1. The Humboldt County Grand Jury recommends that the Humboldt Board of Supervisors direct the Headwaters Fund Board to begin the process of drafting a full and thorough charter review. (F1)
- R2. The Humboldt County Grand Jury recommends that the Humboldt Board of Supervisors direct the Headwaters Fund Board to create and implement a plan for public input into the drafting of a charter review. (F2)
- R3. The Humboldt County Grand Jury recommends that the Humboldt County Board of Supervisors amend the Headwaters Fund Charter, Section 3 - Control and Oversight, to allow the Humboldt Area Foundation to manage the Headwaters Fund investment portfolio. (F3)
- R4. The Humboldt County Grand Jury recommends that the Humboldt Board of Supervisors or their appointed proxy begin the contract negotiations necessary to transfer the management and oversight of the Headwaters Fund Investment Portfolio to the Humboldt Area Foundation. (F3)

REQUEST FOR RESPONSES

Pursuant to Penal Code section 933.05, the grand jury requests responses as follows:

Humboldt Board of Supervisors (R1, 2, 3, 4)

Humboldt County Treasurer (R3, 4)

INVITED RESPONSES

* Humboldt Area Foundation (R3, 4)

* Headwaters Fund Board (R1, 2, 3, 4)

Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code section 929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Grand Jury.

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