

Minnesota's School Trust Lands



Biennial Report

Fiscal Years 2008-2009
(7/1/2007 - 6/30/2009)

Minnesota Department of Natural Resources

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[Cover Photo: Taconite mine blast on school trust lands.]

Executive Summary

The Department of Natural Resources (DNR) manages 2.5 million acres of school trust lands, and an additional one million acres of school trust mineral rights. Revenue derived from these lands and minerals is deposited in the Permanent School Fund, with mining royalties and timber sales providing most of the revenue. In FY08, gross revenue derived from these lands totaled \$35.3 million, and net revenue was \$24.0 million. In FY09, gross revenue was \$28.4 million, and net revenue was \$15.2 million.

Starting in FY05, the DNR began a program looking at the management of school trust lands and clarifying additional options to meet fiduciary obligations in generating revenue from the lands. One result has been the removal of all remaining school trust lands from state parks and state recreation areas where management prevents the generation of revenue. The DNR will continue to work on exchanging parcels of land that have diminished revenue generating potential because of management practices. Management activities to enhance future revenues from timber sales on school trust lands will be a project during the FY10-11 biennium. Also, completing soft improvements prior to land sales will be a project during the FY10-11 biennium.

The trends reflect a taconite industry and a timber industry going through difficult times. The revenue from minerals will likely decrease and the timber revenue will likely not improve during the FY10-11 biennium.

1. History of Minnesota’s trust land.

Lands set aside in trust for the support of schools are a long established tradition in the United States. The roots of this extend back to colonial practice and to English tradition¹. The new United States passed a General Land Ordinance in 1785, which allowed for the sale of western lands and provided for section 16 of each public land survey township to be set aside “for the maintenance of public schools, within the said township.”² With the formation of states from the western territories, these reserved lands would become state trust lands. This was first put into practice with the admission of Ohio to the Union in 1802. All states admitted to the Union since then have received some amount of school trust land,³ except those few cases where the federal government owned no land.

The federal Organic Act of 1849 created the Territory of Minnesota and reserved sections 16 and 36 of each public land survey township “for the purpose of being applied to the schools in said territory.”⁴ The federal Enabling Act of 1857 granted Minnesota these reserved lands, and the state’s citizens accepted this grant with the adoption of a Constitution in October of the same year.⁵

Allowances were made for conditions in which sections 16 and 36 had already been claimed, did not exist in partial townships, or were under water. The grant ultimately resulted in 2.9 million acres being given the state for the support of the public schools. Also included in school trust lands today are the consolidation of remaining lands from two other federal land grants: the Swampland grant of about 4.7 million acres in 1860, and the Internal Improvement grant of 500,000 acres in 1866 (Table 1).

A State Land Office was established in 1863 to manage the trust lands; this office did so until 1931. In 1931 the State Land Office was replaced by the Department of Conservation as manager of trust lands. This agency was renamed the Department of Natural Resources in 1969.

Minnesota, like many other states, sought to translate this land into cash for the schools; the first sale of land took place in 1862. By 1900 much of the best agricultural, timber,

Table 1. School trust land by type of grant.

Type of grant	Original ^A acres granted	Acres
School	2,900,000	957,818
Swamp	4,706,503	1,550,818
Internal Improvement	500,000	6,508
Total	8,106,503	2,515,144

^A Office of the Legislative Auditor (footnote 3), p. 15.

¹ Matthias Nordberf Orfield, Federal Land Grants to the States with Special Reference to Minnesota. (Minneapolis, University of Minnesota, 1915). p. 7-13.

² Ibid., p. 37

³ Minnesota’s Legislature, Office of the Legislative Auditor, School Trust Land, A Program Evaluation Report (St. Paul, 1998), p.3; Orfield. p. 42-44.

⁴ Act of Congress, March 3, 1849, 9 Stat. ch. 121, section 18.

⁵ Act of Congress, February 26, 1857, 11 Stat. ch. 60, section 5, first paragraph.

and mineral lands – especially in the southern part of the state – had been sold to private interests, with mixed results for the schools.⁶ The wisdom of this quick sale policy for the best interests of the trust gradually came to be questioned. Other options, including retention of ownership with leasing for specified purposes, were considered. By 1901, for instance, the legislature directed that any sales of land would not include the underlying mineral rights, which would be retained in trust status by the state. From the turn of the century on, the trust lands would be managed with the idea of “selective retention” of lands that could best be managed by the state.⁷

2. Minnesota’s trust land today.

Today Minnesota has approximately 2.5 million acres of surface and minerals in school trust land status (as defined in Minnesota Statutes, sec. 92.025; Figure 1), plus an additional one million acres of severed mineral rights (Figure 2). Most school trust lands are located in the northern part of the state (Figure 3, Table 2).

Minnesota’s substantial trust lands, and the income they generate, make Minnesota more like western states (which generally still manage significant amounts of land and mineral resources for a variety of trusts) than eastern states (which generally disposed of trust lands permanently). For example, of Minnesota’s immediate neighbors, as of 1997 Iowa had no school trust lands, and Wisconsin has less than 5,000 acres. The Dakotas each manage over 600,000 acres of school trust land.⁸

3. Revenue from school trust lands, FY08-09.

With the acceptance of the land grant, the Constitution created the Permanent School Fund (PSF).⁹ Revenue for the PSF is generated from many activities, including sale of timber, wild rice leases, aggregate mining leases, state forest campground fees, lakeshore leases, easements across state trust land, the sale of a few parcels of land, and several other types of surface use. In addition, revenue is generated from rents and royalties on taconite iron ore removed from trust land, leases to remove peat, non-ferrous metallic mineral leases, and several other types of mineral rights use.

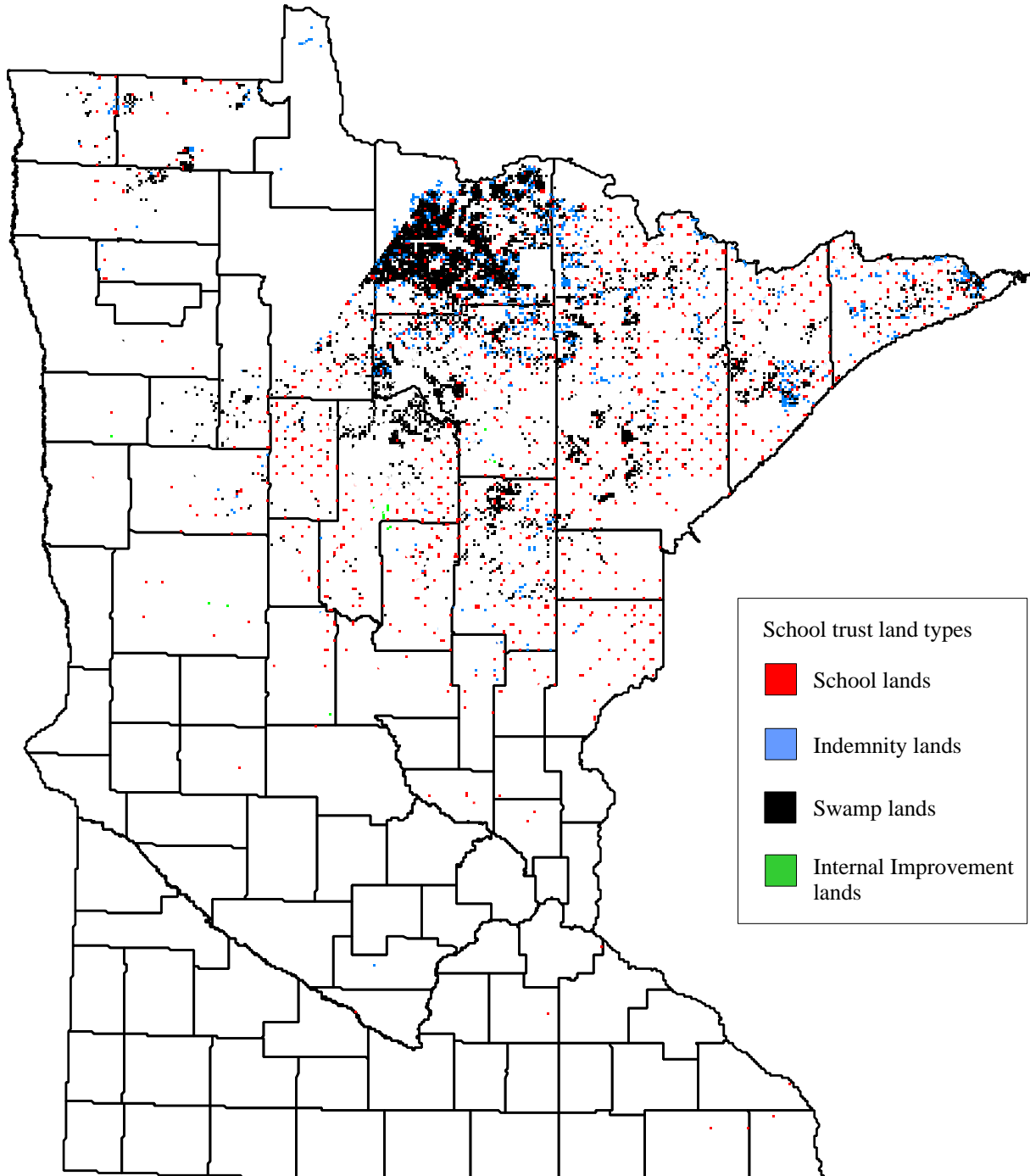
⁶ Minnesota Department of Natural Resources, School Trust Land Management Report, St. Paul, 1983. p. 10-12.

⁷ Ibid., p. 14-15.

⁸ Office of the Legislative Auditor, p. 18.

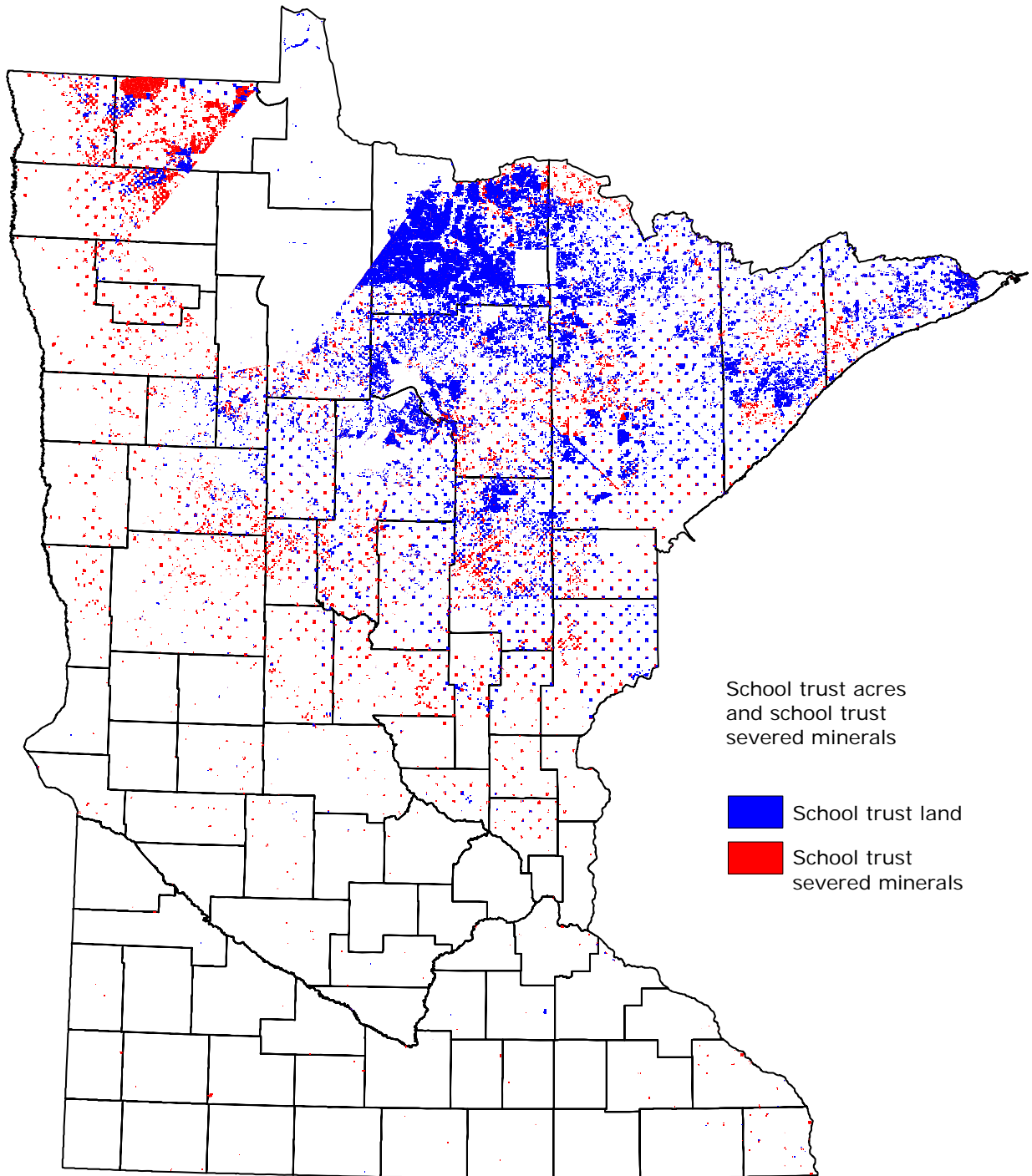
⁹ The Constitutional provisions are now found in Article 11, Section 8.

Figure 1. Map of Minnesota's school trust lands, by type of grant.



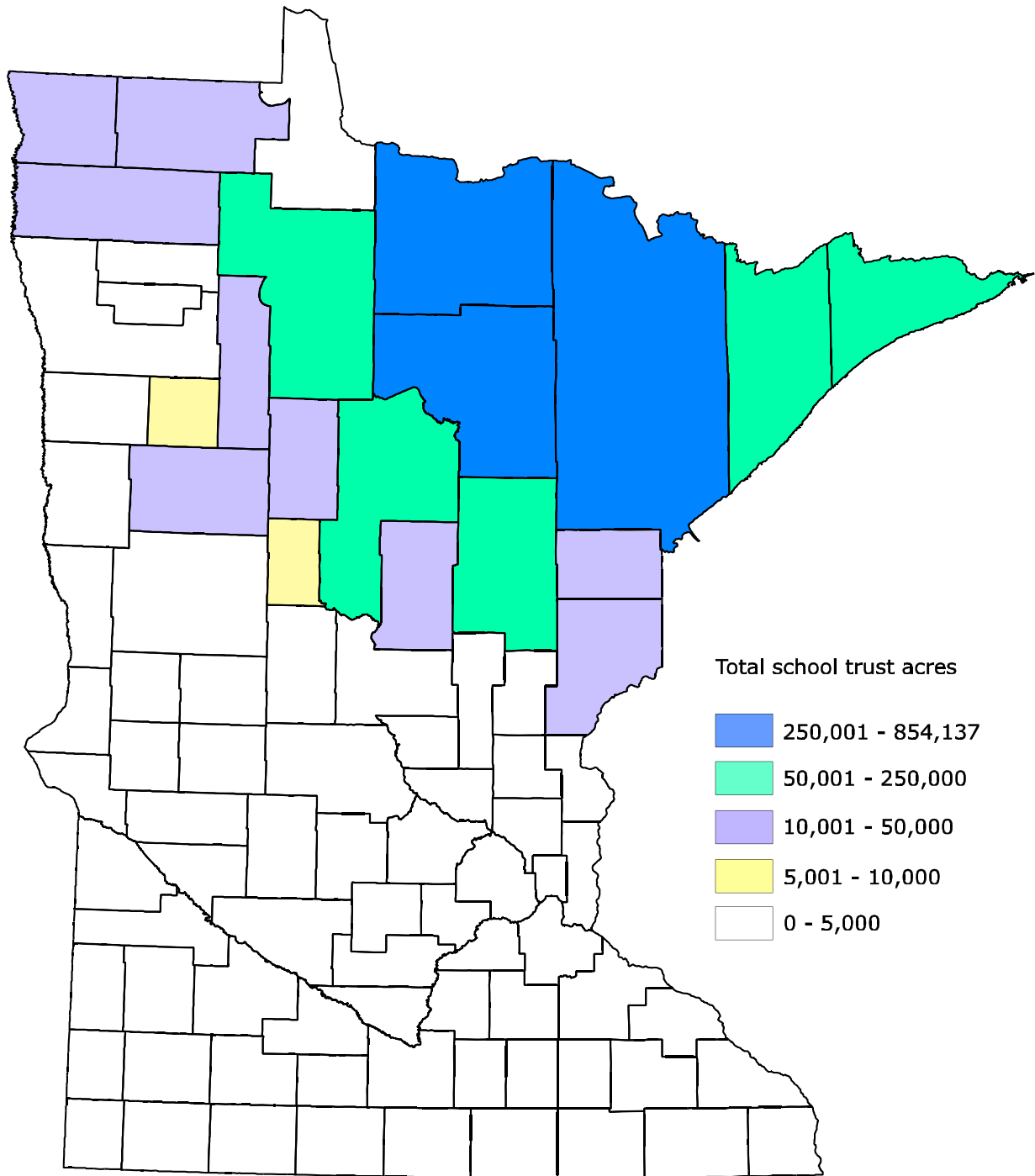
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Figure 2. Map of Minnesota school trust land and school trust severed mineral rights.



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Figure 3. Map of Minnesota's school trust lands, summarized by county.



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Table 2. Minnesota's school trust lands by county.

County	School Trust Land Acres	County	School Trust Land Acres
AITKIN	134,849	LAKE OF THE WOODS	4,636
ANOKA	644	LESUEUR	80
BECKER	16,081	MAHNOMEN	7,307
BELTRAMI	60,843	MARSHALL	22,398
BENTON	120	MARTIN	51
BIG STONE	94	MCLEOD	1
BLUE EARTH	7	MEEKER	41
CARLTON	21,851	MILLE LACS	4,478
CASS	150,753	MORRISON	2,884
CHIPPEWA	11	NICOLLET	1
CHISAGO	120	NORMAN	320
CLAY	321	OTTER TAIL	2,562
CLEARWATER	21,558	PENNINGTON	2,340
COOK	121,635	PINE	22,985
CROW WING	24,013	POLK	1,135
DAKOTA	110	POPE	80
DOUGLAS	160	RED LAKE	760
FILLMORE	120	ROSEAU	46,569
GOODHUE	227	SAINT LOUIS	481,828
HOUSTON	220	SCOTT	1
HUBBARD	29,346	SHERBURNE	1,156
ISANTI	200	SIBLEY	41
ITASCA	293,646	STEARNS	495
KANABEC	3,731	TODD	3,267
KANDIYOHI	200	TRAVERSE	40
KITTSOON	14,929	WADENA	6,128
KOOCHICHING	854,137	WINONA	122
LAKE	159,251	YELLOW MEDICINE	2

Note: The 31 counties not listed in this table do not contain school trust land.

3.1 Total gross revenue.

In **FY08** (7/1/07 - 6/30/08), the gross revenue from activities on school trust lands was about **\$35.3 million** (Figure 4).

- Timber sales contributed a total of \$12.26 million.
- Leases accounted for \$21.99 million. Included in this category were mineral leases (\$20.97 million), surface leases/licenses/easements (\$0.83 million), and forest campground fees (\$0.15 million).
- Sale of trust land totaled \$1.03 million, including installment payments on land sold in previous years.

In **FY09** (7/1/08-6/30/09), the gross revenue from activities on school trust lands was about **\$28.4 million** (Figure 4).

- Timber sales contributed a total of about \$10.20 million.
- Leases accounted for \$18.06 million. Included in this category were surface leases/licenses/easements (\$1.03 million), forest campground fees (\$0.15 million), and mineral leases (\$16.87 million).
- Sale of trust land totaled \$0.17 million, including installment payments on land sold in previous years.

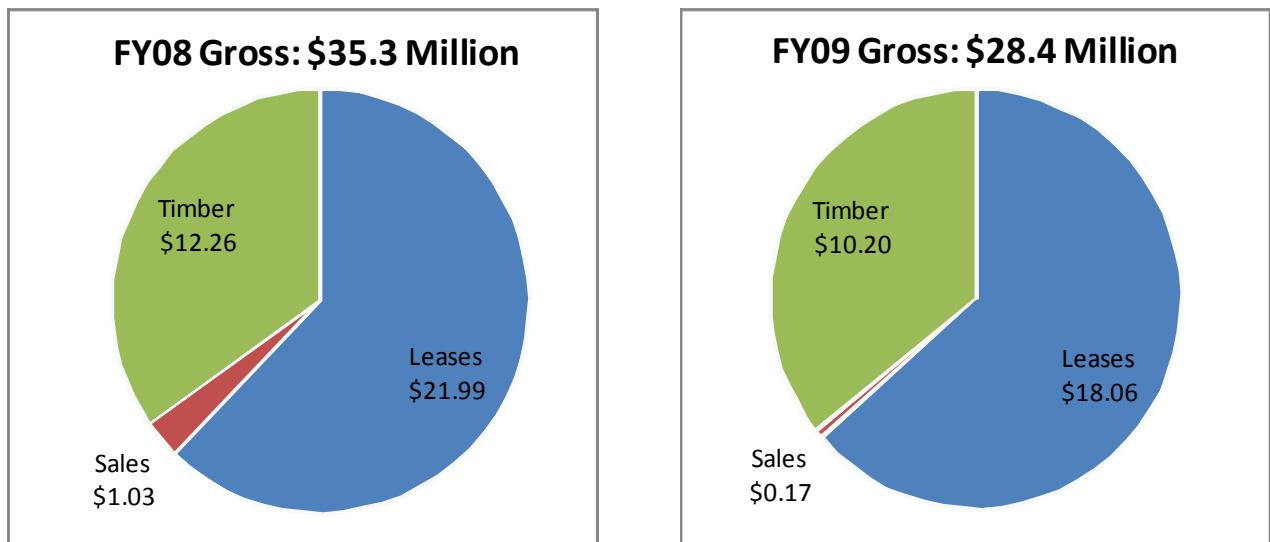


Figure 4. Gross revenue from school trust lands, FY08-09 (figures in millions).

3.2 Total net revenue.

As explained further in section 4, some surface management costs can be certified against certain revenues to determine the net revenue deposited into the PSF. Timber sales and surface lease revenue can be used toward certified costs and is first deposited into the State Forest Suspense Account. Beginning in FY06, the legislature changed the way some mineral management costs were handled (see page 16). Prior to these changes, management costs could not be deducted from revenue derived from mineral activities.

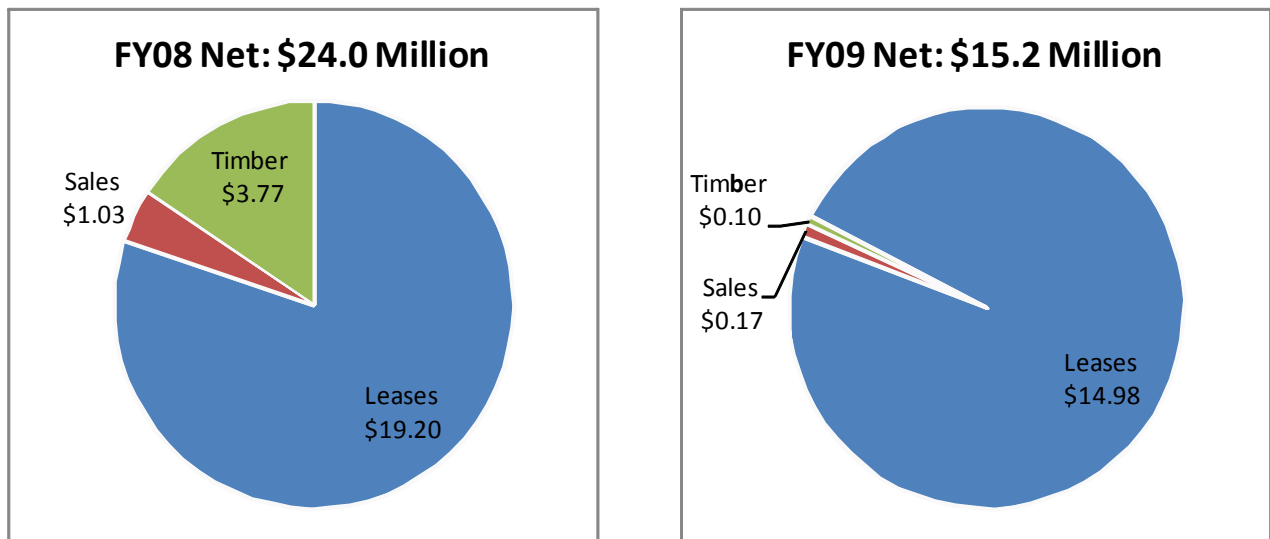
In **FY08** (7/1/07 - 6/30/08), net revenue to the school trust fund was about **\$24.0 million** (Figure 5).

- About \$3.77 million came from the State Forest Suspense Account.
- About \$19.20 million came from mineral leasing activities. This is the gross revenue minus \$1,768,933 or 8.4% of the mineral revenue generated from school trust lands.
- About \$1.03 million came from trust land sales. (This includes about \$56,000 from standing timber on sold lands.)

In **FY09** (7/1/08-6/30/09), net revenue to the school trust fund was about **\$15.2 million** (Figure 5).

- About **\$0.10** million came from the State Forest Suspense Account.
- About \$14.98 million came from mineral leasing activities. This is the gross revenue minus \$1,901,296 or 11.3% of the mineral revenue generated from school trust lands.
- About \$0.17 million came from trust land sales. (This included about \$7,400 from standing timber on sold lands.)

Figure 5. Net revenue from school trust fund, FY08-09.



3.3 Revenue from minerals activities on school trust lands.

In **FY08**, gross revenue generated from minerals activities on school trust lands was **\$20.97 million** (Table 3). The largest contributor was \$20,729,068 from iron ore/taconite rents and royalties (and interest). Other contributing categories were non-ferrous metallic minerals leases (\$178,421), stockpiling/surface leases (\$30,049), peat leases (\$1,020), industrial mineral leases (\$2,189), and M-leases (leases for stockpiled, low-grade iron materials (\$31,528). Twenty percent of the revenue from iron ore/taconite and non-ferrous metallic minerals rent and royalties (\$4,154,194) went to the minerals management account and the remainder of the minerals revenue (\$16,818,080) went to the school trust fund. After \$2.39 million of the twenty percent was returned to the school trust fund from the minerals management account, a total of 8.4% of the mineral revenue generated from school trust lands was used to manage the minerals on school trust lands.

In **FY09**, gross revenue generated from minerals activities on school trust lands was **\$16.88 million** (Table 3). The largest contributor was \$16,106,868 from taconite iron ore rents and royalties (and interest). Other contributing categories were non-ferrous metallic minerals leases (\$249,891), stockpiling/surface leases (\$10,530), peat leases (\$81,214), industrial mineral leases (\$4,719), and M-leases (leases for stockpiled, low-grade iron materials (\$339,651). Twenty percent of the revenue from iron ore/taconite and non-ferrous metallic minerals rent and royalties (\$3,254,808) went to the minerals management account and the remainder of the minerals revenue (\$13,626,024) went to the school trust fund. After \$1.36 million of the twenty percent was returned to the school trust fund from the minerals management account, a total of 11.3% of the mineral revenue generated from school trust lands was used to manage the minerals on school trust lands.

	FY08	FY09
Taconite and Iron ore rents/royalties	\$20,729,068	\$16,106,868
Non-ferrous metallic minerals	\$178,421	\$249,891
Stockpiling/Surface leases	\$30,049	\$10,530
Peat	\$1,020	\$81,214
M-leases	\$31,528	\$339,651
Industrial Minerals	\$2,189	\$4,719
Taconite Encumbrance*		\$87,957
Total	\$20,972,274	\$16,880,832

*See section 6.3

Table 3. Revenue from mineral leases, FY08-09.

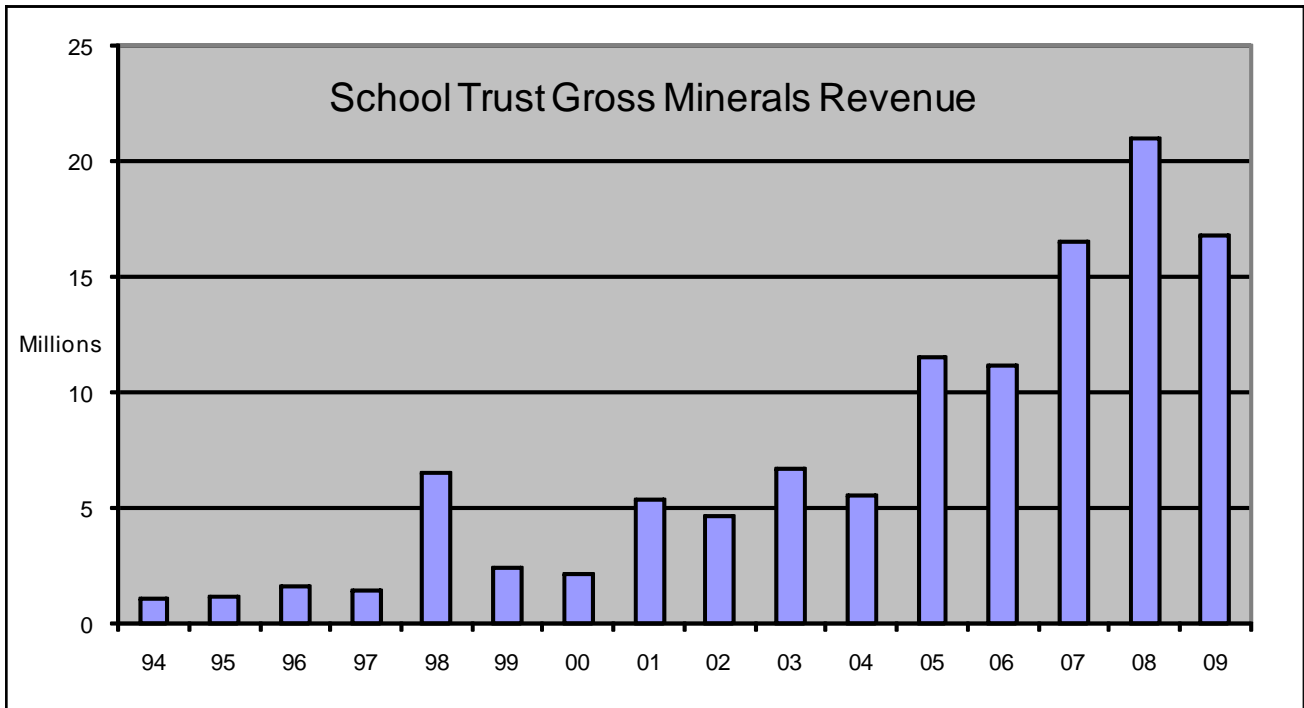


Figure 6. School trust fund gross minerals revenue, FY94-09.

Trends in revenue from mineral leasing

The taconite industry has been greatly affected by the worldwide economic downturn. A dramatic decrease in steel production and iron ore consumption has caused a significant drop in the royalty projections for **FY10**.

3.4 Revenue from land sales.

In **FY08**, the sale of trust land generated a total of **\$1,028,848** (Table 4). This included sale of land payments (down payments and paid-in-fulls) of \$236,649 and installment payments of \$716,313, and loan interest payments of \$19,629. When a school trust parcel being sold has standing timber, the timber value is included in the sales price. (This is separate from the sales of standing timber for utility licenses which is presented in Table 5). The timber value for sold trust fund land contributed \$56,257. In **FY08**, 18 parcels of 564.85 acres were offered and 5 parcels of 160.53 acres were sold.

In **FY09**, the sale of trust land generated a total of **\$169,367** (Table 4). This included sale of land payments (down payments and paid-in-fulls) of \$1,122, and land sale installment payments of \$131,691. There were also loan interest payments of \$12,951. The timber value of sold trust land brought in \$23,604. In **FY09**, 29 parcels of 1,029.46 acres were offered and 5 parcels of 119.80 acres were sold.

Since 1999 the DNR no longer sells land by installment payments. Therefore, the amount of revenue generated by installments payments will continue to decrease as the final installments are paid.

Table 4. Revenue from land sales, FY08-09.

	FY08	FY09
Sale of land (down payments and paid-in-fulls)	\$236,649	\$1,122
Sale of land (installment payments)	\$716,313	\$131,691
Sale of timber ^A	\$56,257	\$23,604
Loan interest	\$19,629	\$12,951
Total	\$1,028,848	\$169,367

^A This is for timber located on sold lands, and is separate from sales of standing timber conducted by the Division of Forestry, which is shown in Table 5.

3.5 Revenue from timber sales and surface leasing activities.

Timber sales and surface lease revenue is first deposited into the State Forest Suspense Account. Except for a few exceptions (eg. sale of standing timber, wild rice farming leases, late fees on DNR surface leases), the revenue is subject to the forestry cost certification.

3.5.1 Timber sales.

In **FY08** and **FY09**, timber revenues included timber sales and timber sales interest.

1. In **FY08**, timber sales revenues totaled more than **\$12.26 million**, with timber sale interest bringing in \$249,048. All of this revenue was deposited into the State Forest Suspense Account (Table 5).
2. In **FY09**, timber sale revenues totaled more than **\$10.20 million**, with timber sale interest bringing in \$48,978. All of this revenue was deposited into the State Forest Suspense Account (Table 5).

Table 5. Revenue from timber sales and surface leasing activities, FY08-09.

	FY08	FY09
Timber sales	\$12,000,289	\$10,148,451
Timber sales interest	\$249,048	\$48,978
Sale of standing timber ^A	\$8,680	\$7,422
Subtotal; timber sales:	\$12,258,017	\$10,204,851
Leases, licenses, easements ^B	\$863,597	\$1,031,977
Campground fees	\$150,172	\$154,593
Subtotal; surface leasing:	\$1,013,769	\$1,186,570
Total:	\$13,271,785	\$11,391,420

^A This is for removal of timber in path of utility line installation, and is distinct from sales of timber on lands sold, which is presented in Table 4. Standing timber revenue is deposited into the State Forest Suspense Account, but is not subject to cost certification.

^B See Table 6 for details.

Note: totals may not add due to independent rounding.

3.5.2 Campground fees.

Campground fees from school trust lands totaled \$150,172 in **FY08**, and totaled \$154,593 in **FY09** (Table 5).

3.5.3 Surface leases, licences and easements.

In **FY08**, a gross total of about \$863,597 was collected on active surface contracts that included some portion of trust land (Tables 5 and 6). (Because many of the agreements involve a one-time payment in the year of issue, only some of the active contracts generated revenue in **FY08**.) The surface contracts include:

- Leases: Aggregates; agriculture; hunting cabins; miscellaneous (commercial, government and private); lakeshore
- Permits: Resource Management Access (RMA), Grant-In-Aid (GIA)
- Easements: Permanent and temporary easements (primarily road) on trust fund land
- Licenses: Water crossings and land crossings by utilities

In **FY09**, a gross total of about \$1,031,977 was collected on active surface contracts that included some portion of trust land (Tables 5 and 6). As was the case in **FY08**, many of the active agreements generated revenue only in their year of issue.

Table 6. Revenue by contract type, FY08-09.

Contract type	FY08	FY09
Easements	\$57,875	\$92,315
Land crossings	\$35,145	\$23,986
Water crossings	\$154,724	\$224,807
Leases: aggregate	\$219,416	\$344,294
Leases: agricultural	\$12,795	\$16,114
Leases: miscellaneous	\$294,978	\$282,481
Leases: other (boathouse, lakeshore, etc.)	\$6,189	\$12,615
Leases: hunting cabins	\$15,627	\$16,864
Wild rice farming ^A	\$3,693	\$3,693
Late fees on DNR land leases ^A	\$94	\$98
Permits	\$63,060	\$13,710
Resource Management Access Permits	\$0	\$1,000
Total	\$863,597	\$1,031,977

Trends in revenue from surface leases, licenses and easements

Revenue from surface leases, licenses and easements is variable. New contracts are signed each year while others expire or are cancelled. Some contracts involve annual fees while others involve a one-time payment in the year of issue. And two or more payments are sometimes received in a fiscal year for a given contract, followed by no payments in the subsequent fiscal year.

^A Deposited into the State Forest Suspense Account, but is not subject to cost certification (see section 4).

Note: Totals may not add up due to independent rounding.

4. Management costs of school lands.

4.1 Forestry trust land cost certification process.

The Minnesota State Constitution, Article XI (Appropriations and Finances), Section 11 (Timber lands set apart as state forests; disposition of revenue) reads:

“School and other public lands of the state better adapted for production of timber than for agriculture may be set apart as state school forests, or other state forests as the legislature may provide. The legislature may also provide for their management on forestry principles. *The net revenue therefrom shall be used for the purposes for which the lands were granted to the state*” (emphasis added).

Minnesota Statutes, sec.16A.125 controls which surface management costs can be certified against revenues from trust fund lands, and how the certified costs and net revenues from the trust fund lands are distributed.

The allowable costs are for the protection, improvement, administration and management of forest lands, and for the construction and maintenance of forest roads (Figure 7).

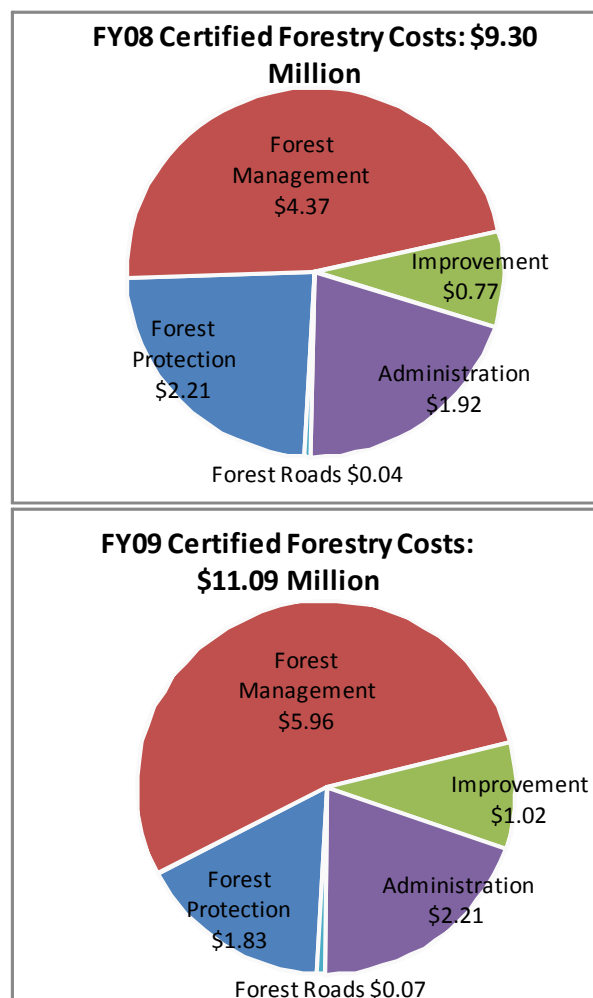
Only those charges that were paid from the state’s General Fund accounts appropriated for forestry are included. Costs charged to dedicated funds and federal funds are excluded from the cost certification process.

The DNR identifies hours of paid staff time and dollars expended using a set of cost codes for staff time and dollars expended on forestry activities. These cost codes identify charges based on the

type of activity (e.g. forest improvements, forest inventory, timber sales), and on the land type on which the activity took place.

Permanent School and University Trust Fund lands are treated as a group, and that group’s costs are recorded separately from all other state land costs. Applicable costs are prorated on a uniform per acre basis between school and university trust lands, and certified accordingly.

Figure 7. Certified Forestry Costs, FY08-09.



Note: totals may be different from sum of subtotals due to rounding.

The process only applies to trust lands that may be capable of generating forestry related revenues. Trust lands in wilderness areas, state parks, mines and in developed land uses (i.e. leased “urban” building sites) are excluded from the process.

Four specific types of activities (or costs) have a more involved allocation process:

1. **Annual fire protection** (pre-suppression and suppression) costs are spread across all 22.8 million acres of public and private lands receiving our protection services. The resulting per acre charge, similar to a municipal tax levy for fire services, is then applied to the acres of trust fund lands that qualify for cost certification.
2. **Forest road costs** are allocated on a per acre basis to all lands within one-quarter mile of the centerline of the 2,200 mile state forest road system. The cost per acre is then multiplied by the trust land acres within that zone, and that cost total is certified against the trust.
3. **Timber sales costs** are allocated to all lands in proportion to the revenues received from those lands. In both FY08 and FY09, **53%** of state timber sales revenues were from PSF lands, so 53% of all state timber sales costs were attributed to the PSF lands.
4. **Forestry administrative costs** (e.g. bill paying, payroll processing, clerical support services, fleet management charges) are prorated in a step-wise fashion based on dollars expended. The first step prorates those costs to each fund from which forestry expenditures are made. The second step prorates the General Fund’s share of those administrative costs to the various cost activities on each class of land. Finally, only the portion of those administrative costs that apply to trust fund land activities are certified against trust fund revenues.

Gross revenues received through management of trust lands for forestry (see Table 5) are deposited in the State Forest Suspense Account. (Non-forestry revenues, such as mineral royalties, are excluded from the process.) Certified costs of management are deducted from the gross, and the net is deposited into the PSF after the close of each fiscal year.

The trust land cost certification process has been reviewed twice in recent years (FY93 and FY97) by the Office of the Legislative Auditor (OLA). In the reports issued by the OLA, the methods and process used were found “to be reasonable.” In the case of each audit, directives and suggestions for change and improvement in the process were made by the OLA. All of the directives and applicable suggestions have been implemented.

4.2 Mineral management costs on school lands.

The current practice as to mineral management costs started in Fiscal Year 2006. The 2005 Minnesota Legislature enacted a law (Laws of MN 2005, First Special Session, Chapter 1) that created a minerals management account. Twenty percent of the payments made under state mineral leases is credited to the minerals management account as costs for the administration and management of the state mineral resources by the commissioner of natural resources. Money in the minerals management account is appropriated by the legislature to the commissioner of natural resources for mineral resource management and projects to enhance future mineral income and promote new mineral resource opportunities.

The minerals management account was designed to create a \$3 million principal that could be drawn upon in the event that future income generation drops. The \$3 million level was reached in Fiscal Year 2007. At the end of each fiscal year the amount exceeding \$3 million will be distributed to the Permanent School Fund and Permanent University Fund in proportion to the revenue contributed to the minerals management account by these two land types. For **FY08**, the Permanent School Fund received **\$2,385,261 transfer from the minerals management account. For FY09, the Permanent School Fund received \$1,353,512 transfer from the minerals management account** (Table 7). These transfers from the minerals management account are in addition to the 80% that goes directly to the Permanent School Fund.

Each year the legislature appropriates money from the minerals management account to the DNR for minerals management activities. In **FY08** the legislature appropriated \$3.00 million from the minerals management account for mineral management on state lands. Of this amount, \$1,768,933 (8.4% of mineral revenues generated from school trust lands) came from the revenues generated from mineral leases on school trust lands. In **FY09** the legislature appropriated \$2.896 million from the minerals management account for mineral management on state lands. Of this amount, \$1,901,296 (11.3% of mineral revenues generated from school trust lands) came from the revenues generated from mineral leases on school trust lands.

Table 7. School trust revenue transferred to the school trust from the minerals management account.

	Mineral lease revenue sent directly to the school trust fund (80% of the total)	Mineral lease revenue to the Minerals Management Account (20% of revenue)			Transferred back to the school trust fund *	Total revenue to the school trust fund
		Iron ore / taconite	Metallic minerals	Total [†]		
FY 2008	\$16,818,080	\$4,118,072	\$35,684	\$4,154,194	\$2,385,261	\$19,203,341
FY 2009	\$13,626,024	\$3,203,885	\$49,978	\$3,254,808	\$1,353,512	\$14,979,536

* At the end of each FY, the amount in the minerals management account exceeding \$3,000,000 is returned to the school and university trust funds in proportion to the amount that each paid in to the account. (The \$2,385,261 transfer from the management account occurred in FY09 but is counted with FY08 revenue. The \$1,353,512 transfer from the management account occurred in FY10 but is counted with FY09 revenue.)

[†] Total includes \$438 in FY08 and \$944 in FY09 of Industrial Minerals revenues on trust lands.

4.3 School trust fund revenue enhancement program and aggregate evaluation.

For FY08-09, the legislature appropriated **\$400,000** from the State Forest Suspense Account to accelerate land exchanges, land sales, and commercial leasing of school trust lands, and to identify and sell sand and gravel or crushed stone from school lands. **\$208,442** of this appropriation was returned to the permanent school fund.

5. Review of FY08-09 forestry activities and metallic minerals leases.

5.1 Forestry activities, FY08-09

In FY08, the Division of Forestry sold 1,144,532 cords of timber. This is a large increase over FY07 because 401,767 cords of it were resold volumes from permits that were forfeited due to the timber market collapse that began in August 2006. A Timber Relief Program was passed by the legislature in CY2007 which resulted in many timber sales being forfeited back to the state and these were resold in FY07 and FY08 at lower prices. In FY09, the volume sold on timber sales was 956,620 cords, which included 136,725 cords of re-offered timber from forfeited permits and previously unsold permits. With continued depressed timber markets, the average price of timber sold on state sales continued to decline. In FY05, the average price per cord (cord equivalent of all units of measure) sold was \$50.80, in FY06 it was \$40.15, in FY07 it was \$22.50, FY08 it was \$21.80, and in FY09 it was \$19.80.

In FY08, the volume harvested from state timber sales was 815,000 cords (a recent history record) and in FY09 a volume of 744,000 cords was harvested. At the end of FY09, there were 2.4 million cords of timber sold but not harvested on state timber sales. The value of this uncut timber is \$54.5 million. Approximately 50% of this timber value is from timber sold on school trust lands.

5.2 Metallic minerals leases, FY08-09

Three processes are used to issue non-ferrous metallic mineral leases in Minnesota; public auction, negotiation, and an application process (called preference rights) for leases offered at public auction but not bid upon at the auction. For the first few years, the lessees conduct exploration work. As is common with this endeavor, most leases are terminated by lessees within a few years of issuance; only a small number remain in effect for more extensive exploration and evaluation.

During the FY08-09 biennium, a total of 98 metallic mineral leases were issued. 52 of them were awarded to bidders at the 2007 Metallic Minerals Lease Sale auction, 18 were awarded at the 2009 Metallic Minerals Lease Sale auction, 19 were negotiated leases, and 9 were preference rights leases. These 98 leases were awarded to seven companies (Agate Lake Resources LLC., Duluth Metals Corp., Encampment Minerals, Inc., Kennecott Exploration Co., Lehmann Exploration Management, Inc., Minerals Processing Corp., and Prime Meridian Resources LLC) and covered a total of 34,129 acres. Four of the 98 leases (covering 1960 acres) were in Aitkin County, eleven (3,263 acres) were in Carlton County, one (479 acres) was in Itasca County, four (2,088 acres) were in Koochiching County, four (1960 acres) were in Kanabec County, 42 (13,408 acres) were in Lake County, two

(440 acres) were in Mille Lacs County, and 30 (10,531 acres) were in St. Louis County. Of the 34,129 acres covered by new leases, 10,655 acres (31.2% of the total) is school trust land.

6. Review of FY08-09 projects and preview of FY10-11 projects.

6.1 Legislation

Laws of Minnesota 2009, Chapter 176, Article 3, Section 12, requires the DNR to enter into a state land lease on school trust lands with Mountain Iron Economic Development Authority for installation of up to four wind turbines and access roads by August 30, 2009. The DNR submitted a lease that they were willing to issue by the deadline. However, Mountain Iron Economic Development was unable to accept the DNR lease. The provision that the parties have differences on involves the rights of potential lenders. The DNR is continuing to work with Mountain Iron Economic Development Authority to come to an agreement.

Laws of Minnesota 2009, Chapter 176, Article 3, Section 13, requires the commissioner of natural resources to grant easements across state land administered by the commissioner to private landowners on Bass Bay on the north shore of Lake Vermilion to access Mud Creek Road (County Highway 408). This easement will cross school trust lands. A landowner granted an easement under this law shall grant a reciprocal easement to the state. This easement is still in the process of being negotiated by the DNR. The DNR has offered an easement to Breitung Township, but the easement will not be signed until payment for the easement is received.

Minnesota Statutes 2008, Section 84.415, pertains to the granting of utility crossing licenses across DNR administered lands and waters. Laws of Minnesota 2009, Chapter 37, Article 1, Section 12, amends Minnesota Statutes 2008, Section 84.415, to require that money received from licenses and permits for the use of the beds of navigable waters, issued under Section 84.415, be credited directly to the permanent school fund. Before this amendment, the money received for the use of the beds of navigable waters was credited to the State Forest Suspense Account.

6.2 Exchanges

In accordance with Minnesota Statutes 92.121, the DNR is working on exchanging non-revenue generating school trust lands for revenue generating state lands. The DNR has identified old growth lands, water access sites, Wildlife Management Areas(WMA), and Scientific and Natural Areas(SNA) on school trust lands, which are at least partially non-revenue generating.

Approximately 20,000 acres of school trust lands have been identified as having old growth forest on them. An exchange of approximately 1,000 acres of trust land containing old growth and approximately 1,500 acres of non-trust lands have been identified for exchange. The exchange process has also begun for WMA lands. Approximately 280 acres of trust land have been identified and 280 acres of non-trust have been identified for exchange. The appraisals on these lands have been completed. The parcels that have been selected for exchange are currently going through the process of a regional review. The regional review process will take a close look at the replacement lands to assure that these lands are able to generate revenue for the school trust fund.

With regard to water access sites, the DNR is identifying revenue generating state lands for exchange, and hopes to exchange some of these sites in the near future.

The DNR has some concerns that the cost of conducting exchanges are borne entirely by the trust and not shared by the divisions administering the school trust lands. Also, as the DNR works through these exchanges they will be looking for ways to improve efficiency and alternative ways to compensate the trust without completing exchanges.

6.3 New Sources of Revenue to the School Trust Fund

Enbridge Energy is in the process of constructing pipelines across the state to expand its existing liquid petroleum pipeline system. The Enbridge Energy project stretches from the North Dakota border through Clearbrook, Bemidji, and Grand Rapids to Superior, Wisconsin, including the Chippewa National Forest. The project crosses school trust lands. The Permanent School Trust Fund received \$874,155 in FY10 for aggregate resources that would be precluded from mining as a result of the pipelines. The funds were deposited directly into the Permanent School Trust Fund.

In March 2009, the Department of Natural Resources, issued a 40-year state surface lease to the Itasca County Regional Railroad Authority (ICRRA). This lease is for the construction and operation of a short line railroad to service a steel plant to be built by Essar Steel Minnesota LLC in Itasca County. The proposed 40-year lease covers 37.21 acres in Itasca County. Of the parcels to be leased, 1.76 acres are School Trust Fund lands. In addition to lease fees, the DNR required the ICRRA to pay \$87,957 to the State of Minnesota on behalf of the Permanent School Fund for mineral resources precluded from mining during the 40-year term of the lease. The mineral encumbrance of \$87,957 was deposited directly into the Permanent School Trust Fund as mineral revenue.

6.4 Construction Aggregate Resources Inventory Project

This project essentially funds a geologist to identify construction aggregate resources on school trust lands, to designate those lands as having aggregate resource value, and to work through the procedures to get the sites leased to generate revenue. There were a number of positive outcomes for this project, including marketing of certain resource sites, new revenue from new leases, identification of more sites, inventory fieldwork to classify the values to be able to market them, work to solve road access issues, and protection of the interest of the trust in various land transactions.

This project played a big part in enabling the DNR to aggressively negotiate the Enbridge pipeline deal that is set forth in Paragraph 6.3. This project allowed the DNR to develop a reasonable model of the encumbrance from the Enbridge pipeline, sound technical documentation of the volume of aggregate to be encumbered, and price information.

Five new aggregate resource deposits were identified on school trust lands and those lands are now, for the first time, designated as having aggregate resource value. Two more sites with existing leases are now designated as having significantly more aggregate resources present. Based upon this new information, the goal is to increase future sales. Field investigations are essential to create an inventory of the aggregate resources on school trust lands.

Three aggregate sites have been marketed for road construction projects as opportunities have arose. Marketing at one site was successful--resulting in additional revenue to the school trust.

As part of this project, land transactions are reviewed to prevent the inadvertent loss of value of aggregate resources that are not recognized by other resource specialists. Review of proposed land exchanges and sales, and other types of leases has allowed for the protection of aggregate resources for future mining. Protection of aggregate resources helps to increase revenue to the Permanent School Fund.

6.5 Cost Reductions

To reduce costs charged against the minerals management account, the Lands & Minerals Division of the DNR laid-off two full time employees. One employee that was laid-off was staff that monitored the taconite operations on school trust lands, and other lands, and the other employee was in a staff support position.

6.6 Land Sales

Minnesota Statutes, Section 92.45 withdraws state lands that border water from sale. In order to sell land parcels that border water, the DNR is required to obtain special legislation. In 2009, legislation was enacted that authorized the DNR to sell five parcels that border water. The DNR proposed legislation to sell two other parcels that border water in Cass and Anoka Counties. However, the legislation for these parcels was not passed and therefore the parcels could not be offered for sale.

At the Fall 2009 (**FY10**) land sale, 12 school trust fund parcels were offered and 5 parcels totaling 115.35 acres were sold, for a combined total price of \$321,550. The following parcels were sold: 1.) Part of the SENE Section 36, Township 43N, Range 23W (Aitkin County); 2.) The NWSW Section 10, Township 142N, Range 36W (Becker County); 3.) Part of the SESE Section 16, Township 149N, Range 31W (Beltrami County); 4.) Government Lot 7 Section 25, Township 149N, Range 33W (Beltrami County); and 5.) The NESW Section 16, Township 33N, Range 27W (Sherburne County).

6.7 Saint Mary's Lake Parcel

The DNR is considering platting a 26.5 acre parcel on the east side of St. Mary's Lake. A plat would create about 16 small lots out of the parcel. The parcel is south of Eveleth just west of the Eveleth-Virginia Municipal Airport. Currently the DNR has created two possible plat designs for the parcel and is working on a third possibility. The third possibility being considered is a conservation design plat. After all plat designs have been completed, the DNR will determine which plan, if any, will be most beneficial to the school trust. The DNR will work with the St. Louis County Planning & Development Department while developing this project.

6.8 Hill Annex State Park

The Hill Annex State Park is an inactive natural ore mine located on Minnesota's Mesabi Iron Range in Calumet, Minnesota. The mine is located on one of the section 16 parcels of school trust land that was granted to the state by the federal government upon statehood. The history of mining at the Hill Annex dates back more than a century. The land was originally leased for

mineral exploration in 1892. Mining began in 1913 and continued until 1978. The Hill Annex Mine produced 63 million tons of iron ore, and was the sixth largest producer in the state.

The Hill Annex State Park was created in 1988. The legislation creating the Park recognized that mining could again be conducted on property within the Park. In 2004 the DNR leased 160 acres of school trust land within the Park for the mining of taconite. In addition, the DNR may also lease stockpiled lean natural iron ore materials from these school trust lands for the ultimate production of steel.

Within the Park there are also stockpiles that can be used for building roads and other construction projects. In order to enhance revenue generation for the school trust, public funds were used in 2008 to build an access road, allowing aggregate materials within the stockpiles to be more readily removed, without interfering with the public's use of the State Park.

The DNR is currently working with the Minnesota Historical Society to ensure that the historic designation for property within the park recognizes that the mining of taconite ore and removal of stockpiles is likely to occur in the future. The DNR believes that the Hill Annex properties should be treated in the same manner as the Hull Rust Mine located in Hibbing, Minnesota, where active mining is conducted even though those lands also carry historical designation. The Minnesota Historical Society believes that the DNR must comply with Minnesota Statutes, section 138.665, which would require the DNR to avoid and mitigate any adverse effects on the Hill Annex property. A legislative solution may increase school trust fund revenue.

6.9 Timber Sale Packaging, Marketing, and Operational Enhancements

A.) Increase Harvest Volume

Forestry has been looking at ways to increase annual harvest volumes to increase revenue to the school trust fund. Below are some possible ways to accomplish this goal:

1. *Maximize summer harvest opportunities.* Opportunities for expansion of summer harvest are likely to be limited, but numbers 3 and 4 below are two examples of ways that could potentially allow greater access to summer wood.
2. *Additional marketing efforts.* Increasing revenue to the school trust fund may be possible by increasing marketing efforts for sales in low demand areas and by expansion of marketing of some higher value product categories. It will be critical to develop and execute marketing plans, especially in current market conditions.
3. *Make greater use of temporary crossings (bridges, etc).* Although it will be difficult to determine the economic value of this work prior to implementation, it should be noted that there is limited opportunity to offer more summer access wood with greater use of temporary crossing structures to get over wet access routes to upland sites.

4. *Explore greater use of unique logging techniques (shovel logging systems, etc).* This is a long-term concept. This would most likely require a demonstration project; primary application is summer harvesting of lowland black spruce. Some 365,000 acres or 25% of trust timberland is commercially viable black spruce. The basic concept is to build skid trails with wood mats using a tracked shovel and to use the shovel to move cut trees to the skid trails. Revenue potential is based on harvesting more total black spruce volume than winter-only operations. Consuming mills may be willing to pay for higher logging costs to secure all-season spruce supply.

B) Stumpage Permit Price Indexing

Forestry is considering indexing stumpage permits to account for inflation. Indexing 3-5 year scaled stumpage permits to inflation would reduce purchaser risk and create an incentive to harvest sooner as opposed to later. On the revenue side, indexing would mitigate a portion of the reduced bidding activity due to poor market conditions.

C) Increase size/volume on a portion of sales

Empirical evidence indicates that corporate purchasers prefer larger sales while independent loggers require modest sized sales. Corporate purchasers are willing to pay a premium for larger sales. For example, using the past 12 months of sales data, regular auctions, which average larger sale sizes and are the only auction method available to corporations, brought in a 13% premium as compared to intermediate auctions that average somewhat smaller sales. There are numerous reasons, including statutory, that a mixture of sale sizes and characteristics is best. Current direction is to combine poor tracts with better tracts from planned/exam lists to improve marketability.

6.10 Forest Stand Improvements to Increase Forest Health, Productivity and Capital Value

A) Extended Rotation Forest (ERF) aspen thinning. School trust lands include approximately 400,000 acres of aspen on good/excellent sites. Assuming a 60-year minimum ERF rotation age and 10% effective ERF acres, approximately 20,000 acres of ERF aspen are available for thinning in a given 10-year planning cycle. Thinning the aspen forests will increase the annual harvest amount and improve forest health. Improved forest health should increase future revenue to the school trust fund.

B) Non-commercial release/cleaning. Opportunities exist to improve growth rate, yield, and quality through investments in non-commercial thinning/cleaning/release of immature overstocked stands, especially in red pine, white spruce, and upland hardwoods managed for sawtimber production. Investments made to improve growth rate, yield, and quality should increase revenue to the school trust fund.

C) Regenerate/treat high risk low volume (HRLV) stands. Initial DNR estimates indicate trust lands may include approximately 3,500 acres of HRLV upland forest cover types that are at least age 50 but not commercially viable for a traditional timber sale due to low volume per acre (less than seven cords per acre) and/or poor quality. Current net growth is zero to negative for many of these stands, meaning there is no annual increase in asset value. Stand removal and regeneration would require an initial investment. This initial investment would immediately produce a net annual growth increase.

7. Management of the PSF and income payments to public schools.¹²

The State Board of Investment (SBI) is the agency that manages the PSF. Income earned from the school trust lands is added to the PSF principal, which is then invested by the SBI. In accordance with the Minnesota Constitution, the principal of the PSF cannot be spent, and instead must remain perpetual and inviolate. Each year the SBI distributes interest and dividends earned from investment of the PSF to the public schools.

About \$28 million of spendable income was generated by the PSF fund in **FY08** and distributed to the public schools (i.e. less than 1% of the total school aid amount appropriated by the legislature). In **FY09**, payments to schools totaled about \$27 million. As of June 30, 2007 (the beginning of the **FY08-09** biennium) the market value of the PSF was \$714 million, the majority of which was generated from land and timber sales, land leases, and mineral taxes and royalties collected since the time of statehood. Reflecting the general decline in the stock market over the **FY08-09** time period, the market value of the PSF principal declined from \$714 million to \$690 million during **FY08**, and had decreased to \$614 million by the end of **FY09**.

¹² Data from the State Board of Investment Annual Report

Minnesota Department of Natural Resources

For more information contact:

DNR Information Center

500 Lafayette Road
St. Paul, MN 55155-4040
(651) 296-6157 (metro area)
1-888-MINNDNR (646-6367)

TTY (651) 296-5484 (metro area)
1-800-657-3929

<http://www.dnr.state.mn.us>

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Report preparation costs

The report cost about \$1,200 to prepare. Funds that the legislature appropriated for real estate management activities were used to prepare this report.