

**Minnesota Department of Natural Resources
Division of Forestry**

**M.S. 16A.125, Subd 5(1) Transfer Certification Report
2012**

| | | <u>School Susp. Fund: 3800 Appr: R290242</u> | <u>Univ. Susp. Fund: 6000 Appr: R290248</u> | <u>Trust Land Totals ⁽¹⁾</u> |
|--------------------------|---|--|---|---|
| 12 Month Revenues | Net Revenue associated with Forest Management | \$8,466,352 | \$110,679 | \$8,577,031 |
| 12 Month Costs | Protection | \$1,506,274 | \$11,749 | \$1,518,024 |
| | Management | \$4,209,695 | \$32,837 | \$4,242,532 |
| | Improvement | \$658,574 | \$5,137 | \$663,711 |
| | Administration | \$1,264,731 | \$9,865 | \$1,274,596 |
| | Forest Roads | <u>\$24,234</u> | <u>\$189</u> | <u>\$24,423</u> |
| | Certified Forestry Costs ⁽¹⁾ | \$7,663,509 | \$59,778 | \$7,723,287 |

| 12 Month M.S. 16A.125 Subd. 5(d) Transfers to Other Accounts ⁽²⁾ | | | | |
|--|---|---------------------------|------------------------|---------------------------|
| 12 Month Transfer to the Forest Management Investment Account | | | | |
| | M.S. 16A.125, Subd. 5(d)(1) Transfer ⁽³⁾ | \$4,892,504 | \$38,163 | \$4,930,667 |
| 12 Month Transfer to the State General Fund | | | | |
| | M.S. 16A.125, Subd. 5(d)(2) Transfer ⁽⁴⁾ | \$2,771,005 | \$21,615 | \$2,792,620 |
| | Total M.S. 16A.125 Transfers ⁽³⁾ | <u>\$7,663,509</u> | <u>\$59,778</u> | <u>\$7,723,287</u> |

12 Month Net to Permanent Trust Funds

| | | | |
|--|-------------------------|------------------------|-------------------------|
| Net Revenues associated with Forest Management minus Certified Costs | \$802,843 | \$50,901 | \$853,744 |
| Revenues not associated with Forest Management | \$231,956 | \$0 | \$231,956 |
| Less Transfer to St Forest Suspense-Land Sales Laws 09, Chapt. 37, Art. 1, Sec. 4, Subd. 2 | (\$200,000) | | (\$200,000) |
| Net Revenue to Trust Funds ⁽¹⁾ | <u>\$834,799</u> | <u>\$50,901</u> | <u>\$885,700</u> |

Notes:

- ⁽¹⁾ Totals may not add due to rounding
- ⁽²⁾ Total of all transfers is limited to the lesser of: (a) certified costs or (b) forestry revenues
- ⁽³⁾ Total of forest management, forest improvement, forest road costs
- ⁽⁴⁾ Total of protection and administration costs

Submitted By:

Reviewed By:

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Exec Bdgt Officer
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Date: 2/22/13

Date: 2/26/13

Date: 3/1/13

2012

MN Dept Of Natural Resources

Division of Forestry

[M.S. 16A.125 TRANSFER CERTIFICATION REPORT]

The contents of this report identify costs certified against trust fund lands and how the certified costs and net revenues from trust fund lands are distributed

Contents include:

- Forestry Transfer Certification Process
- M.S. 16A.125 Transfer Certification Report

Department of Natural Resources Division of Forestry

Trust Cost Certification – Executive Summary

This certification report provides details on timber revenue and forest management costs for Trust Fund lands in Fiscal Year 2012. The net revenue to the Trust is \$885,700 down from \$2,402,814 in FY2011, due entirely to the drop in timber revenue. Trust land timber revenue was \$8,589,321, down from \$10,060,494 in FY 2011 due to declining markets from mill closings and the effects on trust land timber prices and volumes due to the July 2011 windstorm in Pine County. Prices of timber damaged from windstorms are substantially lower than timber harvested under normal conditions. In addition, the windstorm timber must be salvaged quickly to minimize the deterioration of the wood. This further affects the prices of timber on the market because of the large volumes coming to market in smaller localized areas.

There was a slight decrease in management costs (from 7,960,825 in FY2011 to \$7,723,287), mostly in administrative costs due to the month-long state shutdown. Investments made over the past year (expenses) are not directly related to revenue collected for several reasons. For example, there is lag time between timber sold and harvested (up to 5 years), and there are long-term investments that are not realized for the life span of the timber species (50-120 years).

As defined by M.S. 16A.125, Forest management costs are based on five general activities: Fire Protection (\$1,518,024), Forest Roads (\$24,423), Management (\$4,242,532), Improvement (\$663,711) and Administration (\$1,274,596). Costs are tracked by administrative area for accuracy and transparency.

Under M.S. 16A.125, subd. 5d, this report certifies the transfer of funds from the forest suspense account to the Forest Management Investment Account (FMIA - \$4,930,667), to the General Fund (\$2,792,620), and the balance to the corpus of the trust (\$885,700).

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M.S.16A.125 Transfer Certification Process

Minnesota Statutes, section 16A.125, Subd. 5 direct which costs are certified against trust fund lands and how the certified costs and net revenues from trust fund lands are distributed. Only those costs paid from the General Fund and Forest Management Investment Fund are included in cost certification. Costs charged to dedicated funds and federal funds are excluded from the cost certification process. In addition, only revenues derived from Forestry activities are included in the process. Non-forestry revenues, such as mineral royalties are excluded.

Minn. Stat., Sec. 16A.125, Subd 5 states:

Subd. 5. Forest trust lands.

(a) The term "state forest trust fund lands" as used in this subdivision, means public land in trust under the Constitution set apart as "forest lands under the authority of the commissioner" of natural resources as defined by section [89.001, subdivision 13](#).

(b) The commissioner of management and budget shall credit the revenue from the forest trust fund lands to the forest suspense account. The account must specify the trust funds interested in the lands and the respective receipts of the lands.

(c) After a fiscal year, the commissioner of management and budget shall certify the total costs incurred for forestry during that year under appropriations for the protection, improvement, administration, and management of state forest trust fund lands and construction and improvement of forest roads to enhance the forest value of the lands. The certificate must specify the trust funds interested in the lands. The commissioner of natural resources shall supply the commissioner of management and budget with the information needed for the certificate.

(d) After a fiscal year, the commissioner shall distribute the receipts credited to the suspense account during that fiscal year as follows:

(1) the amount of the certified costs incurred by the state for forest management, forest improvement, and road improvement during the fiscal year shall be transferred to the forest management investment account established under section [89.039](#);

(2) the balance of the certified costs incurred by the state during the fiscal year shall be transferred to the general fund; and

(3) the balance of the receipts shall then be returned prorated to the trust funds in proportion to their respective interests in the lands which produced the receipts.

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The Division of Forestry identifies hours paid and dollars expended using a set of cost codes. The cost codes identify charges based on a specific activity (e.g. fire suppression, forest inventory, etc.) that created the expenditure. These activities are grouped into five main categories; protection, improvement, roads, management, and administration. Once costs are determined, they are allocated between trust and non-trust by acreage in each administrative area. Trust costs are prorated on a per acre basis between school and university. Total state acres subject to forest management activities are ~5.4 million. Of this amount, ~2.4 million acres is attributable to trust fund lands. The certification process only applies to activities that generate forestry related net revenues. Activities, such as recreation and private land management are excluded from the process.

Five types of activities have an allocation process.

1. Fire Protection (\$1,518,024): The DNR protects 22.8 million acres against wildfires. The cost of protecting trust fund lands against wildfire is determined by multiplying trust fund land acreage on a cost per acre basis. Prevention and pre-suppression costs are not specific to any land base, but provide general protection to all lands equally, so costs are allocated on a statewide acreage percentage. Suppression costs however, can be tracked to a specific administrative area so costs are allocated on an area acreage percentage basis.

As with the general public, all citizens pay a portion of taxes in their local community to support the fire and police departments whether one particular citizen uses those services or not. In order to return maximum revenue to the trust and to consider OLA recommendations, a better method to charge appropriate costs to fire suppression activities on trust fund lands was implemented in the FY11 certification. All fire suppression costs are stratified by area. For example, if trust fund lands in one particular area are composed of 20% trust fund lands, the trust is responsible for 20% of suppression costs. Therefore, in all future years, if more fire suppression activities occur on trust fund lands; this may result in a lower return to the corpus of the trust.

2. Forest Roads (\$24,423): State forest roads provide access to some trust fund lands. Road costs are tracked by administrative area and allocated to the trust based on the percentage of trust fund land served by that area's roads. Approximately 2.5% of trust acres are subject to road costs on a statewide basis.
3. Management (\$4,242,532): Management costs are divided into two main categories; forest management and timber sales. Forest management costs are the costs of maintaining forests for future revenue, including activities like inventory and insect and disease management. Timber activities consist of timber sales preparation and administration. These timber activities can be directly tied to the revenue generated on

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trust fund lands. Management costs are tracked by administrative area and allocated by area based on the percentage of trust fund land managed in each area. On a statewide basis, the trust allocation averages 44 percent.

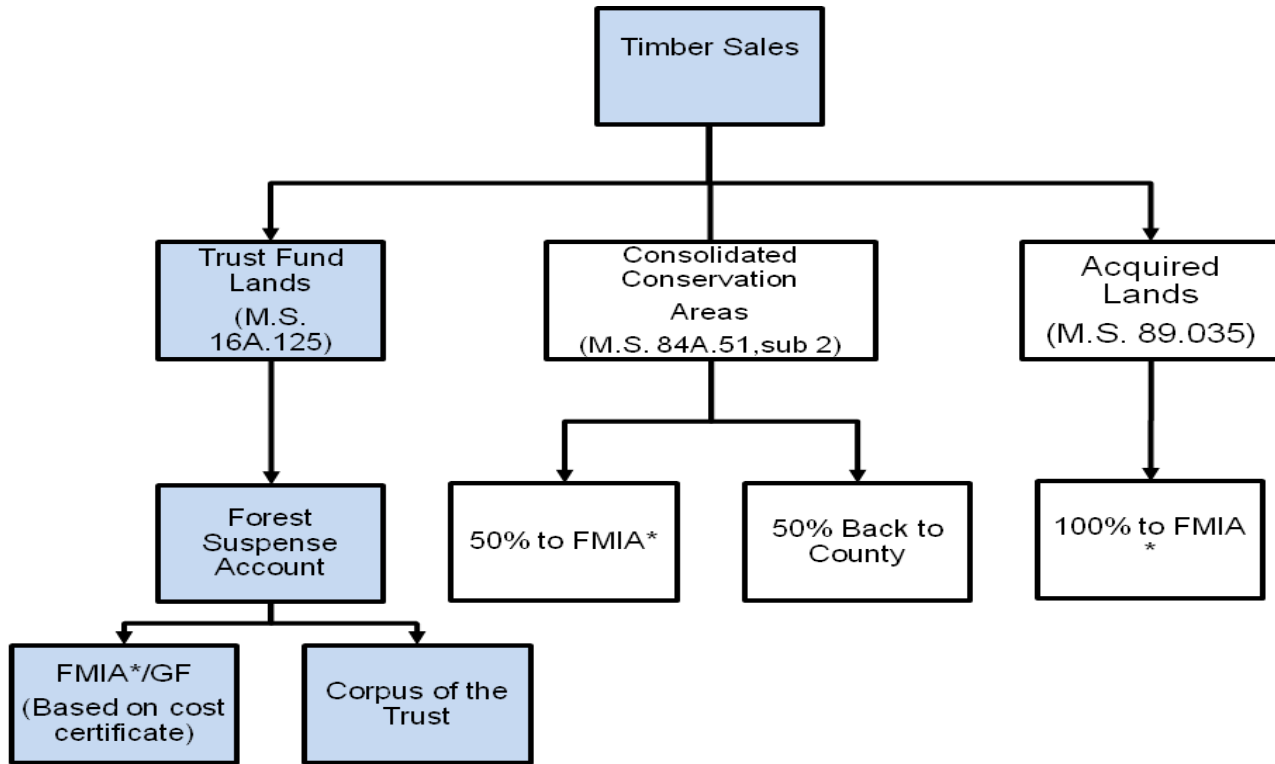
4. Forest Improvement (\$663,711): Forest improvement activities include site preparation and stand improvement that establish and improve forests for future revenue. Improvement costs are tracked by administrative area and allocated by area based on the percentage of trust fund land in each area. On a statewide basis, the trust allocation averages 46 percent.
5. Administration (\$1,274,596): Administrative costs are direct and necessary costs related to the support of staff that generates revenue. Administrative costs are tracked by administrative area and allocated by area based on the percentage of trust fund land in each area.

General Operations: In addition, general operations costs are “the cost of doing business”, the record keeping and other activities that support day-to-day operations. Support services, such as bill paying, hiring, training, and personnel management allow the certifiable activities above to be performed. Costs for support services, however, are difficult to tie to any specific activity. Therefore, general operations costs are prorated back to activities based on the percent of expenditures in each activity (ie: management, improvement, roads, and administration). Thus, if maintaining forest roads accounts for five percent of all expenditures, five percent of general operations costs are included in the cost of maintaining forest roads. Fire Protection is excluded from this calculation because these activities are charged directly to fire.

Finally, the trust fund land certification process was reviewed in FY1998 by the Office of Legislative Auditor (OLA). In the final reports issued by the OLA, the methods and process used were found “to be reasonable”. Directives and suggestions for change and improvement have been implemented.

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The purpose of this graph is to identify how Timber Sales revenue on Trust fund lands flows through the suspense account and to provide a historical summary on the account. Per Minn. Stat., sec. 16A.125, Subd 5., certified costs for administration and protection are transferred to the general fund. Costs for management, improvement and roads are transferred to FMIA. The balance is transferred to the corpus of the trust.

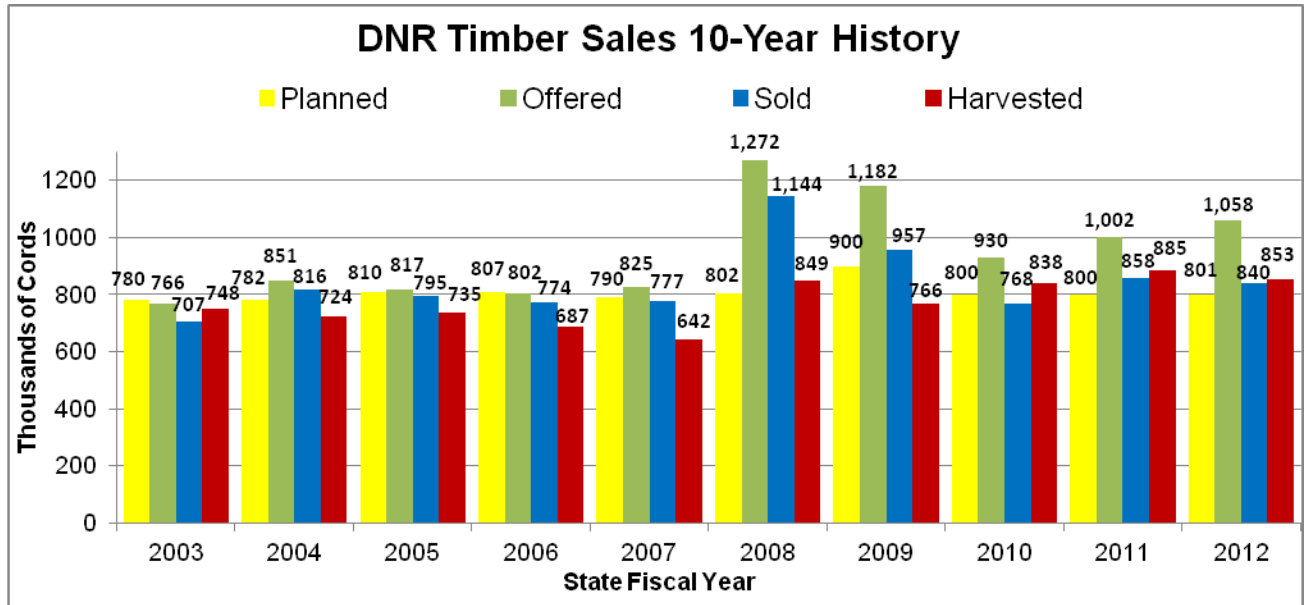


| | 2008 | 2009 | 2010 | 2011 | 2012 | 5 Yr Avg |
|-----------------------------|--------|--------|--------|--------|--------|----------|
| Total Timber Revenue | 25,315 | 19,561 | 18,946 | 19,564 | 17,114 | 20,100 |
| Revenue on Trust Fund Lands | 13,226 | 11,430 | 9,713 | 10,060 | 8,589 | 10,604 |
| Cost Transfer to GF | 4,154 | 4,067 | 3,793 | 3,026 | 2,793 | 3,567 |
| Cost Transfer to FMIA | 5,221 | 7,110 | 4,926 | 4,934 | 4,931 | 5,424 |
| Transfer to Trust | 3,813 | 231 | 980 | 2,403 | 885 | 1,662 |

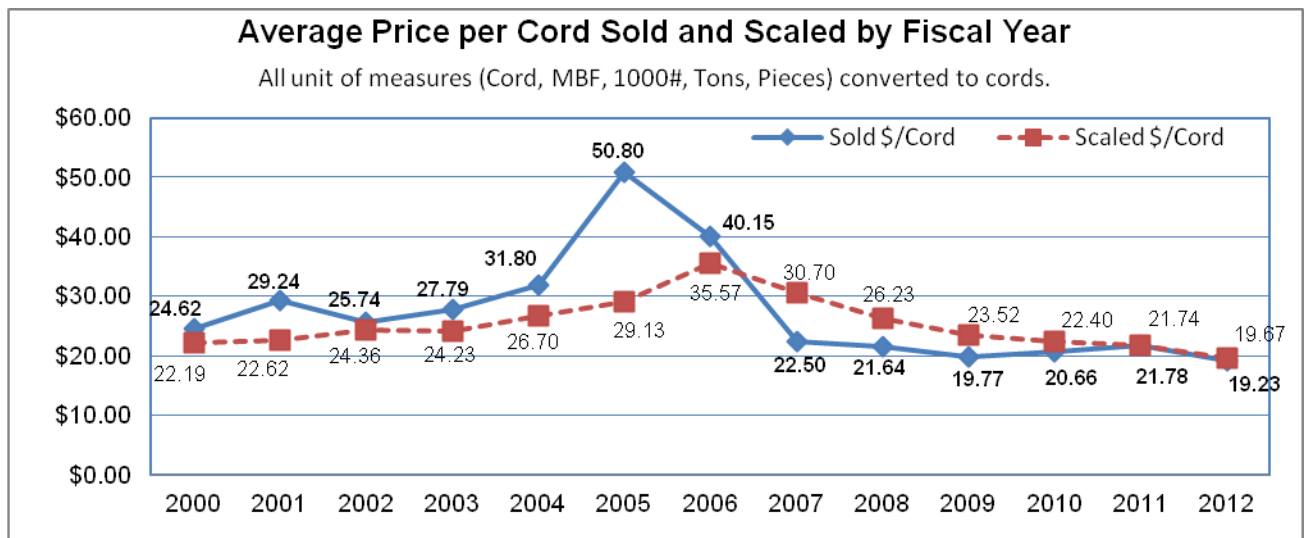
M.S.16A.125, Subd.5(d)-Costs certified in FY12 are actually transferred in FY13.

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The purpose of the top graph is to show the historical trend for cords planned, offered, sold and harvested. The bottom graph shows the historical trend of the average price sold per cord and the average price received for cords scaled (harvested).



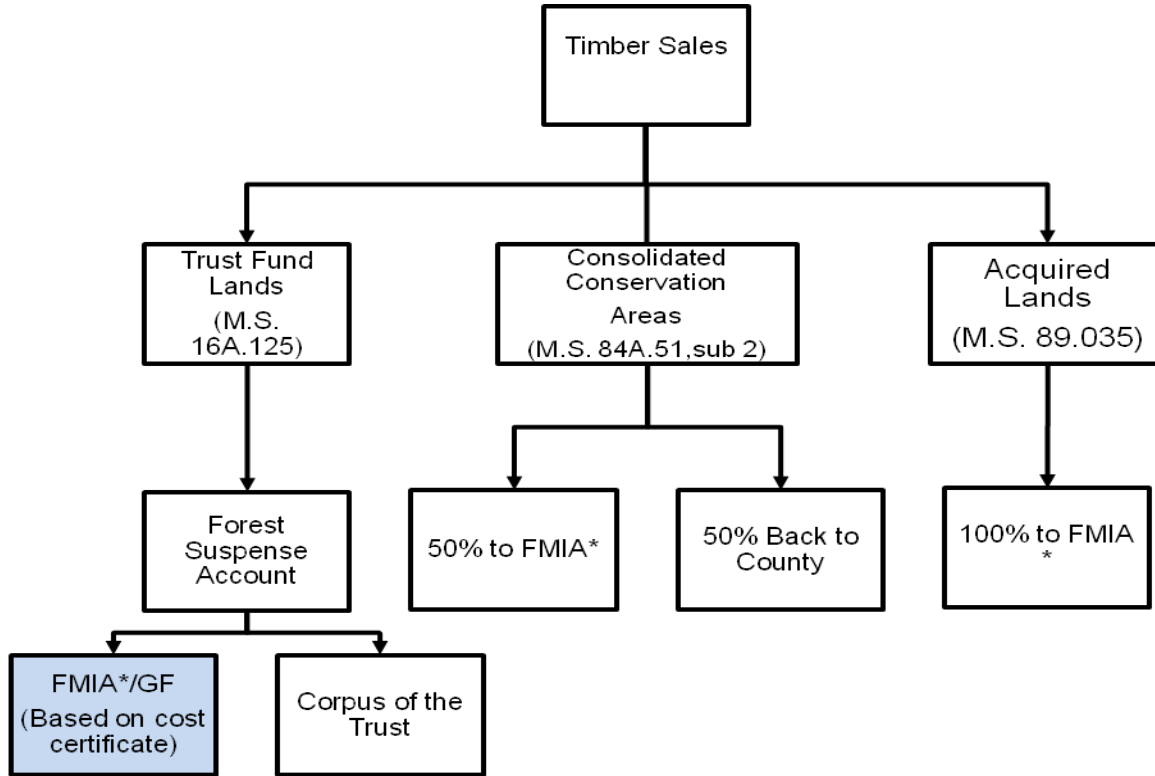
The large increase in volume offered and sold in FY2008-9 was due to the re-offering of sales forfeited in 2007. The 885,000 cord equivalents harvested in FY2011 was a record harvest level from state lands.



Due to the timber market collapse that began in August 2006, the average price per cord sold for state timber dropped 60% in FY2009 compared to the value received in FY2005. Many of the sales that were sold in FY2005-06 for \$40+ per cord were forfeited and then resold in subsequent years at a lower price. Due to timber markets and the 260,000 cords of windstorm-damaged salvage timber sales in the Sandstone Area, the average price/cord of timber sold and harvested both decreased in FY2012.

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*The purpose of this chart is to identify a historical perspective on certified costs.



| Forestry Certified Costs | | | | | | |
|---------------------------------|--------------|---------------|--------------|--------------|--------------|-----------------|
| (in thousands) | | | | | | |
| FY 2008-2012 | | | | | | |
| | 2008 | 2009 | 2010 | 2011 | 2012 | 5 Yr Avg |
| Protection | 2,224 | 1,844 | 2,000 | 1,169 | 1,518 | 1,751 |
| Forest Management | 4,400 | 6,010 | 4,100 | 4,361 | 4,242 | 4,623 |
| Forest Improvement | 780 | 1,026 | 771 | 557 | 664 | 760 |
| Administration | 1,930 | 2,223 | 1,793 | 1,857 | 1,275 | 1,816 |
| Forest Roads | 41 | 74 | 55 | 16 | 24 | 42 |
| Total | 9,375 | 11,177 | 8,719 | 7,960 | 7,723 | 8,991 |

M.S.16A.125, Subd 5(d)

**Department of Natural Resources
Division of Forestry**

Determination of MS 16A.125 Costs for Fiscal Year 2012

A Base Data from Division of Lands and Minerals, Division of Forestry and MMB Records

This includes base data to calculate costs for management, improvement, roads, administration, and protection

| | |
|---|--------------|
| Acres of Permanent School Fund Land Subject to Cost Certification | 2,373,698 |
| Acres of University Trust Fund Land Subject to Cost Certification | 18,516 |
| Total Acres of Trust Fund Land Subject to Cost Certification | 2,392,214 |
| Total Acres of State Land Subject to Forest Management Activities | 5,404,117 |
| Total Acres of Land Receiving Fire Protection | 22,829,589 |
| | |
| Total Eligible Forestry Expenditures Paid From the General Fund and FMIA Fund | \$41,734,188 |
| Forestry General Operations-FMIA (non-fire) | \$3,948,698 |
| Forestry General Operations-General Fund (non-fire) | \$6,403,750 |
| Direct Costs of Forest Management Activities (Management, Improvement, Roads) | \$7,508,456 |

B Protection Costs for Trust Lands

Protection includes fire prevention, readiness, and costs to fight wildfires. Federal fire reimbursements are excluded. Prevention and presuppressions costs are based on statewide efforts and identified separately from direct suppression. Costs are allocated by local effort through area stratification.

| | |
|---|--------------|
| Current Year General Fund Costs for Protection (as of 11/14/12) | 24,370,555 |
| Prior Year General Fund Costs for Protection Paid After Close | - |
| Total Current Year and Prior Year General Fund Costs for Protection | 24,370,555 |
| Current Year Allowable Forestry General Fund Direct Costs for Protection Stratified by Area | \$23,389,522 |

1 Prevention and Presuppression Cost Determination:

| | |
|---|-------------|
| Net Allowable Forestry General Fund Direct Costs for Prevention & Presuppression | \$6,390,387 |
| Prevention & Presuppression costs allocated by the percentage of protected trust to all protected acres (~10.5%) | \$669,621 |
| Prevention & presuppression cost per acre / Suppression Cost per acre | \$0.28 |
| Allocated School Trust Prevention & Presuppression / Suppression Cost ⁽¹⁾ (cost per acre times school acres) | \$664,438 |
| Allocated University Trust Prevention & Presuppression / Suppression Cost ⁽¹⁾ (cost per acre times university acres) | \$5,183 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

2 Suppression Costs Stratified by Area:

| | |
|--|------------|
| Current Year Allowable Forestry General Fund Direct Costs for Suppression Stratified by Area (\$16.9M) | \$866,566 |
| Prorated Fire Protection (suppression) Cost Collections which reduce General Fund Costs | (\$18,163) |
| Net Allowable Forestry General Fund Direct Costs for Suppression | \$848,403 |
| Suppression Cost per acre | \$0.35 |
| Allocated School Trust Suppression Cost ⁽¹⁾ (cost per acre times school acres) | \$841,836 |
| Allocated University Trust Suppression Cost ⁽¹⁾ (cost per acre times university acres) | \$6,567 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

Total Protection Costs for Prevention, Pre-suppression, and Suppression:

| | |
|---|--------------------|
| Sum of Protection Costs for School Trust Lands | \$1,506,274 |
| Sum of Protection Costs for University Trust Lands | \$11,749 |

C Management Costs for Trust Lands

Management includes preparing and administering timber sales, supervising harvests, maintaining up to date information on timber resources, and controlling forest pests and disease. Costs are allocated by local effort through area stratification.

1 Forest Management Cost Determination:

| | |
|---|-------------|
| Sum of Allowable Forestry General Fund/FMIA Direct Costs for Forest Mgmt | \$1,534,612 |
| Management Portion of Forestry General Operating-FMIA Costs | \$807,053 |
| Total Forest Mgmt Costs to be Allocated | \$2,341,664 |
| Forest Management Costs Stratified by Area Allocated to Trust | \$1,018,988 |
| Forest Management Cost Per Acre Stratified by Area ⁽¹⁾ | \$0.43 |
| School Trust Acres times Forest Mgmt Cost Per Acre (cost per acre times school trust acres) | \$1,011,101 |
| University Trust Acres times Forest Mgmt Cost Per Acre (cost per acre times university acres) | \$7,887 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

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Determination of MS 16A.125 Costs for Fiscal Year 2012

2 Timber Sales Cost Determination:

| | |
|--|--------------------|
| Sum of Allowable Forestry General Fund/FMIA Direct Costs for Timber Sales | 4,430,748 |
| Timber Sales Portion of Forestry General Operating-FMIA Costs | \$2,330,131 |
| Total Timber Sales Costs | \$6,760,879 |
| Timber Costs Stratified by Area Allocated to Trust | \$3,223,544 |
| Trust Land Timber Sales Cost Per Acre Stratified by Area ⁽¹⁾ | \$1.35 |
| School Trust Acres times Timber Sales Cost Per Acre (cost per acre times school acres) | \$3,198,594 |
| University Trust Acres times Timber Sales Cost Per Acre (cost per acre times university acres) | \$24,950 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

3 Total General Fund/FMIA Forest Management Costs for Trust Lands:

| | |
|---|--------------------|
| Sum of Mgmt Costs for School Trust Lands | \$4,209,695 |
| Sum of Mgmt Costs for University Trust Lands | \$32,837 |

D Forest Improvement Costs for Trust Lands

Improving the forest includes ensuring regrowth following harvest, developing better varieties of trees, and promoting tree growth by thinning and removing competing vegetation. Costs are allocated by local effort through area stratification.

| | |
|--|--------------------|
| Sum of Allowable Forestry General Fund/FMIA Forest Improvement Costs | \$948,573 |
| Forest Improvement Portion of Forestry General Operating Costs-FMIA portion | \$498,855 |
| Total Forest Improvement Costs | \$1,447,428 |
| Improvement Costs Stratified by Area Allocated to Trust | \$663,711 |
| Trust Land Forest Improvement Cost Per Acre Stratified by Area ⁽¹⁾ | \$0.28 |
| School Trust Forest Improvement Cost (cost per acre times school trust acres) | \$658,574 |
| University Trust Forest Improvement Cost (cost per acre times university trust acres) | \$5,137 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

E Administrative Costs for Trust Lands

Administration includes many support activities that maintain efficiency and allow foresters to concentrate on managing the state's forests.

| | |
|---|--------------------|
| Sum of Allowable Forestry General Fund/FMIA Administrative Costs | \$483,763 |
| Administrative Portion of Forestry General Operating-GF Costs | \$6,403,750 |
| Administrative Costs Attributed to General Fund/FMIA Activities | \$6,887,513 |
| Total Direct Trust Land Costs | \$6,448,691 |
| Total General Fund/FMIA Direct Costs | \$34,846,675 |
| Trust Direct Costs as a Percent of Total General Fund/FMIA Direct Costs | 19% |
| Trust Portion of Administrative Costs | \$1,274,596 |
| Trust Land Administrative Cost Per Acre ⁽¹⁾ | \$0.53 |
| School Trust Administrative Costs (cost per acre times school trust acres) | \$1,264,731 |
| University Trust Administrative Costs (cost per acre times university trust acres) | \$9,865 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

F Forest Road Costs for Trust Lands

Maintaining the forest road systems includes maintaining bridges, road surfaces, and right-of-way, and installing and maintaining culverts and signs. Costs are allocated by local road miles through area stratification.

| | |
|--|------------------|
| Sum of Allowable Forestry General Fund/FMIA State Forest Road Costs | \$594,523 |
| State Forest Roads Portion of Forestry General Operating-FMIA Costs | \$312,659 |
| Total State Forest Road Costs | \$907,182 |
| Trust Land Acreage as a Percent of Total Acres Served by Forest Roads | 2.69% |
| State Forest Road Costs Allocated to Trust Lands | \$24,423 |
| Trust Land Forest Road Cost Per Acre Stratified by Area ⁽¹⁾ | \$0.010 |
| School Trust Forest Improvement Cost (cost per acre times school trust acres) | \$24,234 |
| University Trust Forest Improvement Cost (cost per acre times university trust acres) | \$189 |

⁽¹⁾ The totals charged against school and university acres may be off due to rounding of the cost per acre.

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Date: 2/22/13