

# Minnesota's School Trust Lands



## Biennial Report

Fiscal Years 2010-2011  
(7/1/2009 - 6/30/2011)

Minnesota Department of Natural Resources

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[Cover Photo: Finland State Forest – where there is significant school trust lands as well as forestry acquired 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 the school trust lands is deposited in the permanent school fund, with mining royalties and timber sales providing most of the revenue. In FY10, gross revenue derived from these lands totaled \$21.3 million, and net revenue was \$10.5 million. In FY11, gross revenue was \$32.7 million, and net revenue was \$23.2 million.

Approximately 86,000 acres of school trust lands are inside the BWCAW and unable to generate revenue because of the wilderness designation. In FY10-11 the DNR and the USFS identified approximately 41,000 acres that were acceptable as candidates for exchange. In FY12-13, the focus of the DNR's exchange efforts will continue to be on the exchange and sale of school trust lands inside the BWCAW.

The revenue is generated from mineral leases, timber sales, surface contracts, and land sales. The rents and royalties from iron ore/taconite leases is the primary revenue source from school trust lands. The trends reflect an iron ore/taconite industry that is projected to remain strong in the coming years with increased revenues forecasted in the FY12-13 biennium. With a stalled economic recovery negatively affecting forest product demand and pricing, timber revenue from school trust land in the FY12-13 biennium is expected to be similar to FY10-11 revenues.

### Revenues and Costs:

<b>Gross Revenues</b>	<b>FY10</b>	<b>FY11</b>
Minerals	\$10,487,159	\$21,448,108
Timber and Surface	\$10,555,723	\$10,681,270
Timber	\$8,372,136	\$9,120,917
Surface	\$2,183,587	\$1,560,353
Land Sales	<u>\$248,610</u>	<u>\$530,538</u>
<b>Total</b>	<b>\$21,291,492</b>	<b>\$32,659,916</b>
<b>Costs</b>		
Minerals	\$2,051,959	\$1,495,994
Timber and Surface	\$8,722,217	\$7,998,016
Land Sales	<u>\$0</u>	<u>\$0</u>
<b>Total</b>	<b>\$10,774,176</b>	<b>\$9,494,010</b>
<b>Net Revenues</b>		
Minerals	\$8,435,200	\$19,952,114
Timber and Surface	\$1,833,506	\$2,683,254
Land Sales	<u>\$248,610</u>	<u>\$530,538</u>
<b>Total</b>	<b>\$10,517,316</b>	<b>\$23,165,906</b>

## 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 tradition<sup>a</sup>. 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.”<sup>b</sup> 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,<sup>c</sup> 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.”<sup>d</sup> 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.<sup>e</sup>

Allowances were made for conditions in which sections 16 and 36 had already been claimed, were reserved for an Indian reservation, 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, and mineral lands – especially in the southern part of the state – had been sold to private interests, with mixed results for the schools.<sup>f</sup>

Table 1. School trust land by type of grant

Type of grant	Original <sup>A</sup> acres granted	Acres
School	2,900,000	957,818
Swamp	4,706,503	1,550,818
Internal Improvement	500,000	6,510
Total	8,106,503	2,515,146

<sup>A</sup> Office of the Legislative Auditor (footnote 3), p. 15.

<sup>a</sup> Matthias Nordberf Orfield, *Federal Land Grants to the States with Special Reference to Minnesota*. (Minneapolis, University of Minnesota, 1915). p. 7-13.

<sup>b</sup> *Ibid.*, p. 37

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

<sup>d</sup> Act of Congress, March 3, 1849, 9 Stat. ch. 121, section 18.

<sup>e</sup> Act of Congress, February 26, 1857, 11 Stat. ch. 60, section 5, first paragraph.

<sup>f</sup> Minnesota Department of Natural Resources, *School Trust Land Management Report*, St. Paul, 1983. p. 10-12.

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.<sup>g</sup>

## **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.<sup>h</sup>

## **3. Revenue from school trust lands.**

With the acceptance of the land grant, the Constitution created the permanent school fund.<sup>i</sup> Revenue for the permanent school fund is generated from many activities, including sale of timber, gravel mining leases, state forest campground fees, lakeshore leases, easements and utility licenses across school 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.

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<sup>g</sup> Ibid., p. 14-15.

<sup>h</sup> Office of the Legislative Auditor, p. 18.

<sup>i</sup> The Constitutional provisions are now found in Article 11, Section 8.

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

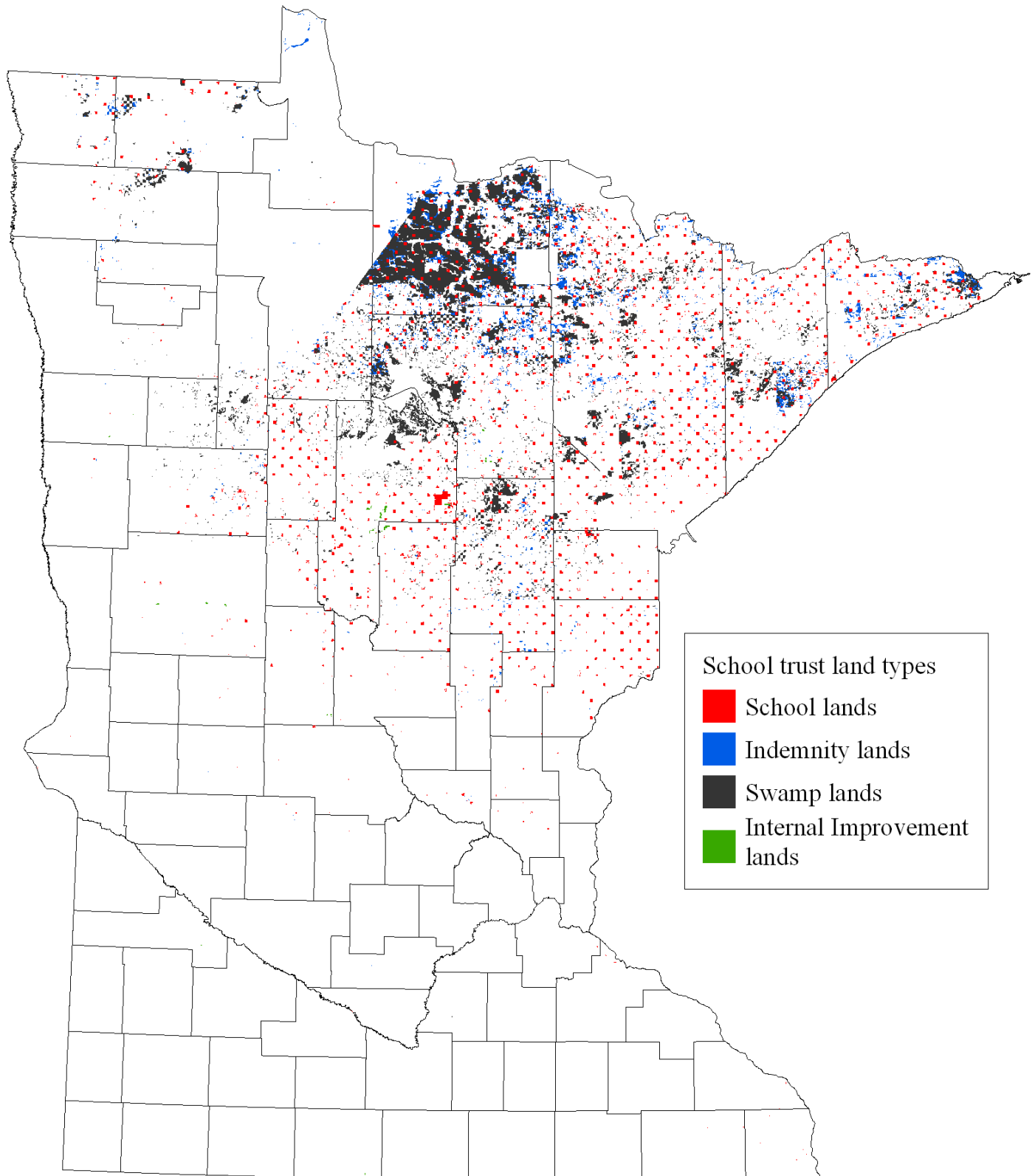
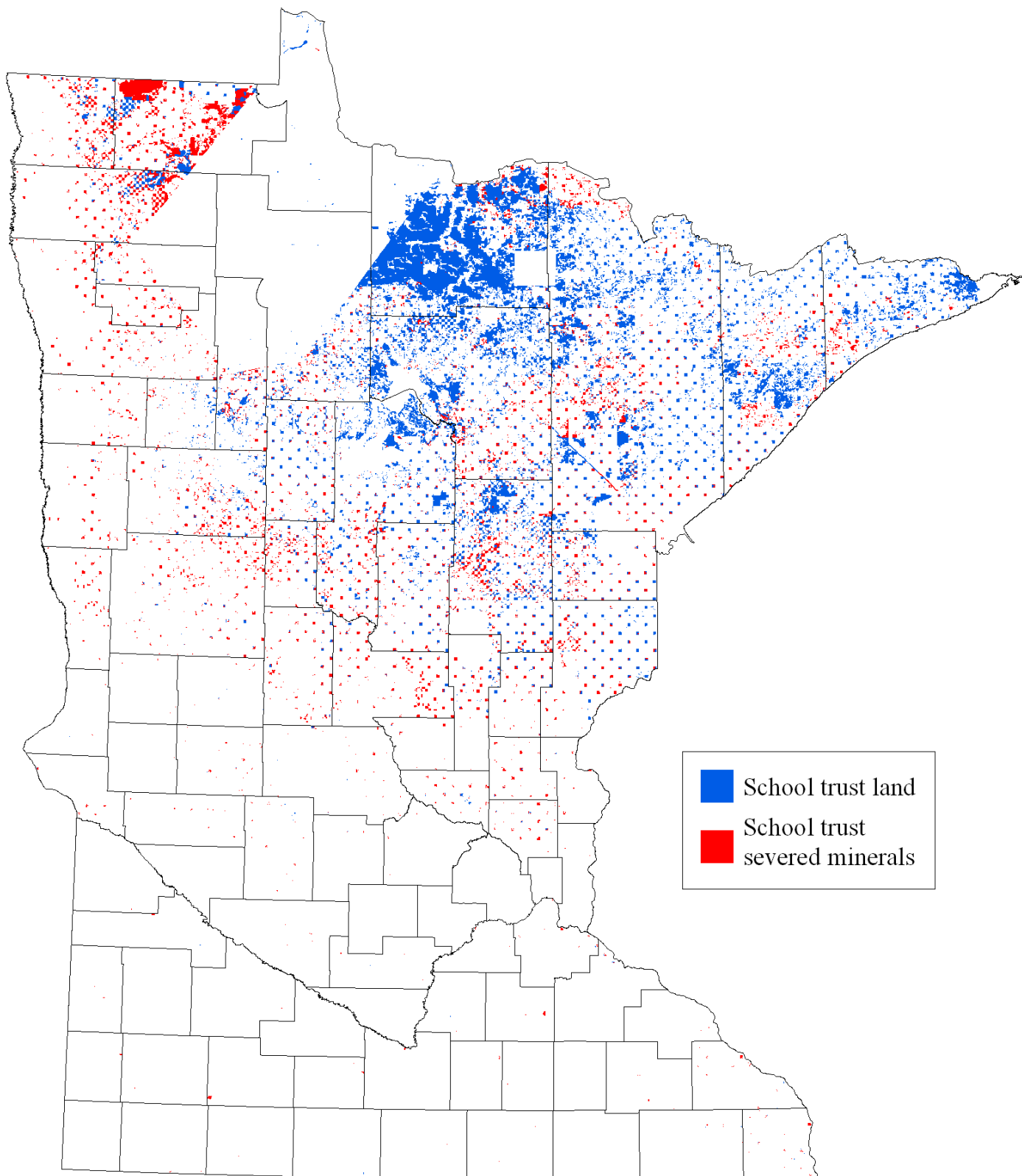


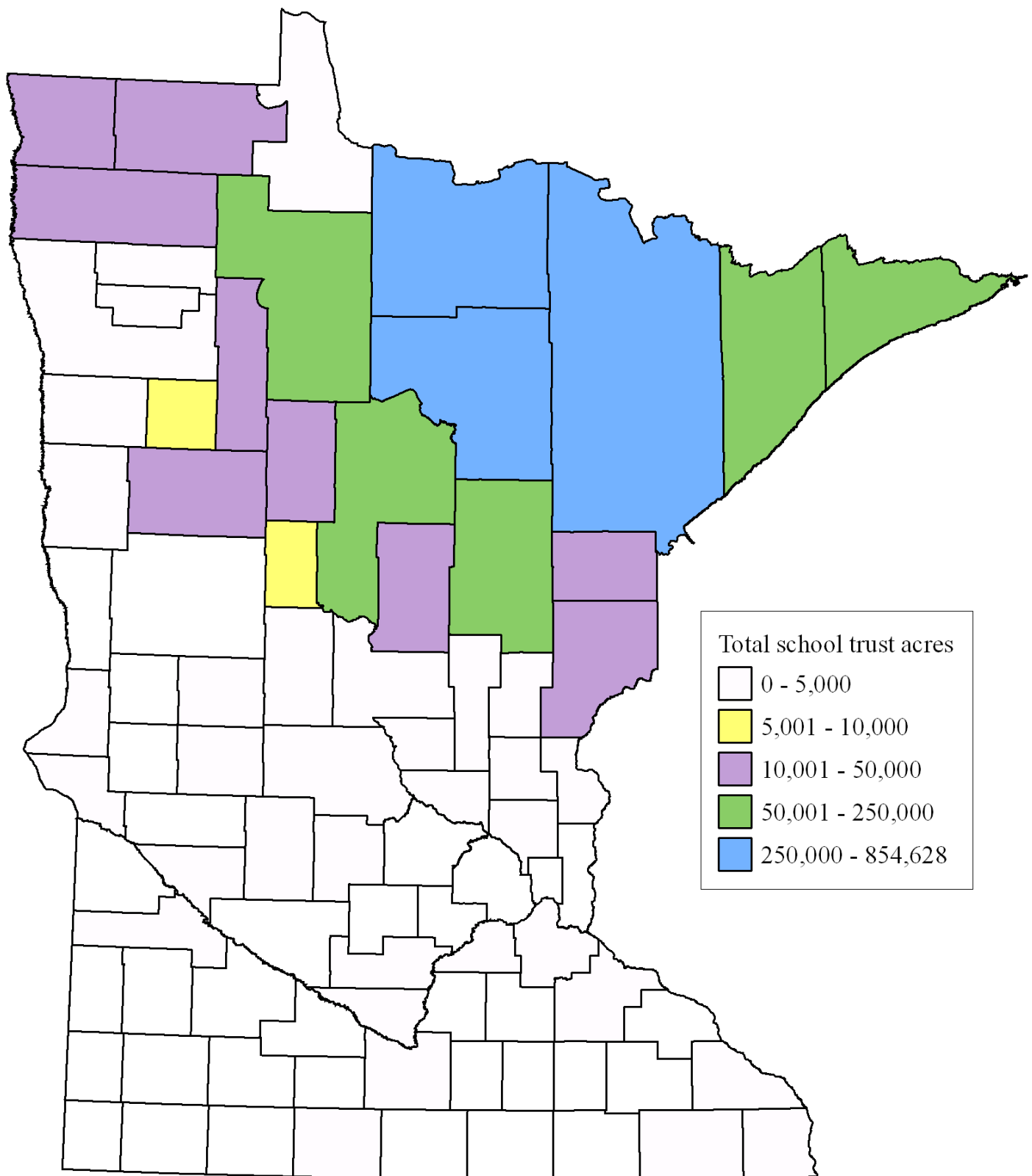
Figure 2. Map of Minnesota school trust land and school trust severed mineral rights.



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



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

<b>County</b>	<b>School Trust Land Acres</b>	<b>County</b>	<b>School Trust Land Acres</b>
Aitkin	134,645	Lake of the Woods	4,636
Anoka	644	Lesueur	80
Becker	16,041	Mahnomen	7,267
Beltrami	60,777	Marshall	22,363
Benton	120	Martin	51
Big Stone	94	McLeod	1
Blue Earth	7	Meeker	41
Carlton	21,851	Mille Lacs	4,478
Cass	150,901	Morrison	2,884
Chippewa	11	Nicollet	1
Chisago	120	Norman	320
Clay	321	Ottertail	2,562
Clearwater	21,558	Pennington	2,340
Cook	121,756	Pine	22,985
Crow Wing	24,013	Polk	1,095
Dakota	110	Pope	80
Douglas	160	Red Lake	760
Fillmore	120	Roseau	46,529
Goodhue	227	St. Louis	481,727
Houston	220	Scott	1
Hubbard	29,344	Sherburne	1,116
Isanti	200	Sibley	41
Itasca	293,644	Stearns	495
Kanabec	3,731	Todd	3,267
Kandiyohi	200	Traverse	40
Kittson	14,929	Wadena	6,128
Koochiching	854,628	Winona	122
Lake	159,231	Yellow Medicine	2

Note: Table 2 shows acres as of December 2011. The 31 counties not listed in this table do not contain school trust land.

### 3.1 Total gross revenue.

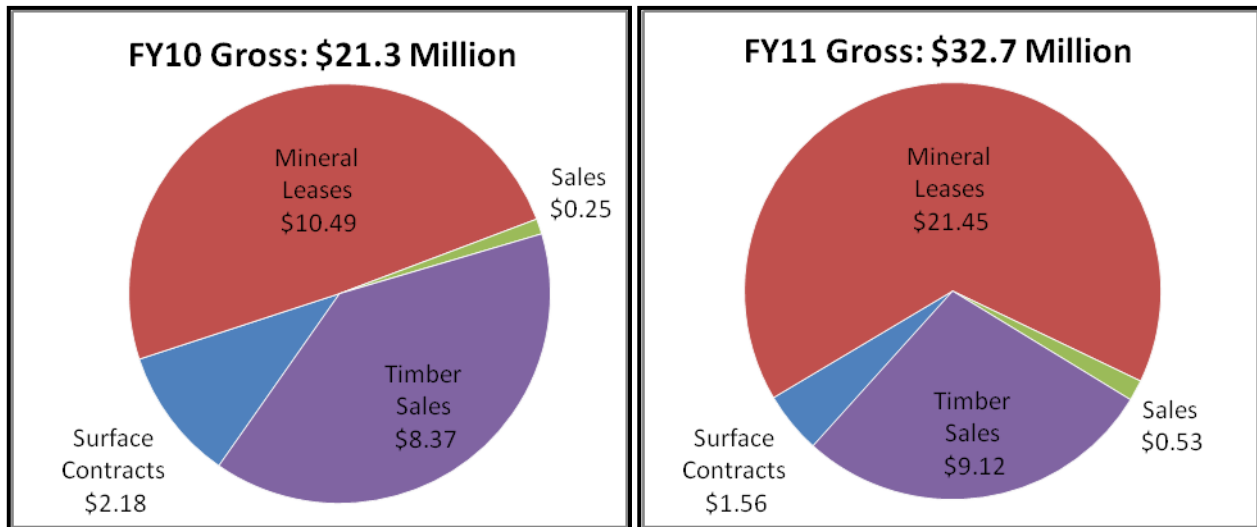
In **FY10** (7/1/09-6/30/10), the gross revenue from activities on school trust lands was about **\$21.3 million** (Figure 4).

- Timber sales contributed a total of \$8.37 million.
- Surface contracts contributed a total of \$2.18 million. Included in this category are campground fees, lease, licenses, and easements.
- Mineral leases accounted for \$10.49 million.
- Sale of trust land totaled \$0.25 million, including installment payments on land sold in previous years.

In **FY11** (7/1/10-6/30/11), the gross revenue from activities on school trust lands was about **\$32.7 million** (Figure 4).

- Timber sales contributed a total of about \$9.12 million.
- Surface contracts contributed a total of \$1.56 million. Included in this category are campground fees, lease, licenses, and easements.
- Mineral leases accounted for \$21.45 million.
- Sale of trust land totaled \$0.53 million, including installment payments on land sold in previous years.

**Figure 4. Gross revenue from school trust lands, FY10-11.**



### 3.2 Total management costs.

In **FY10** (7/1/09-6/30/10), the cost to manage school trust lands and minerals was about **\$10.77 million**.

- About \$2.05 million was for mineral management.
- About \$8.72 million was for timber and surface management.

In **FY11** (7/1/10-6/30/11), the cost to manage school trust lands and mineral was about **\$9.49 million**.

- About \$1.49 million was for mineral management.
- About \$7.99 million was for timber and surface management.

### 3.3 Total net revenue.

Some costs are deducted from the school trust land revenue for the management of the lands. The net revenue is the amount after the deduction of costs that is deposited in the corpus of the permanent school fund. Section 4 below provides details on how costs charged against the school trust revenues are determined.

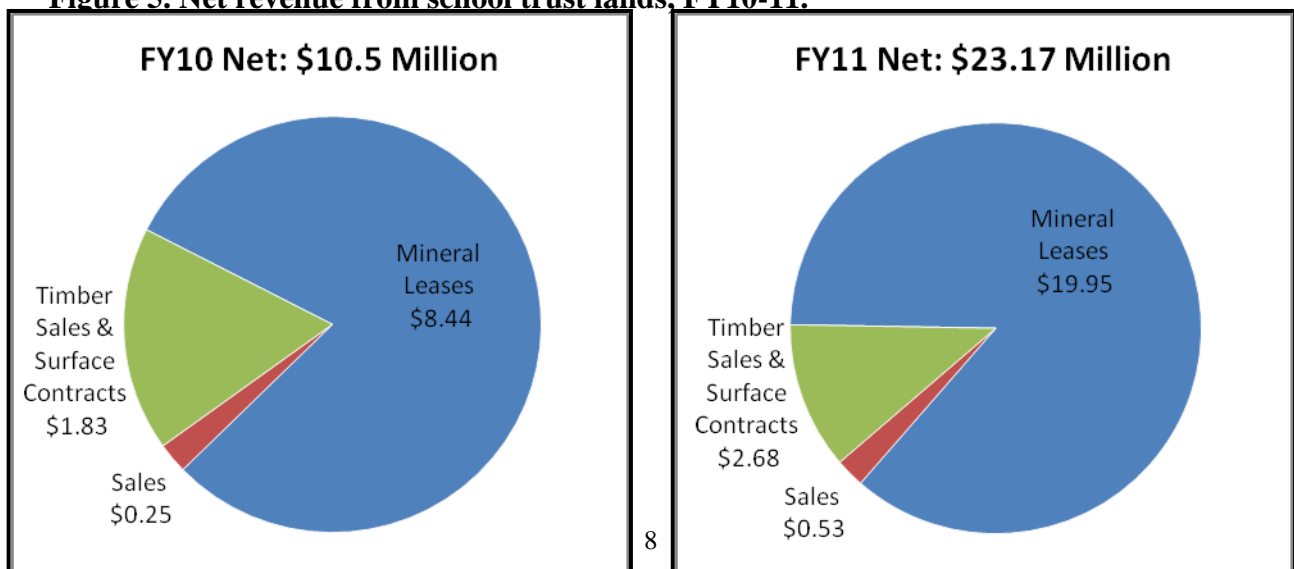
In **FY10** (7/1/09-6/30/10), net revenue to the school trust fund was about **\$10.5 million** (Figure 5).

- About \$1.83 million came from timber sales and surface contracts.
- About \$8.44 million came from mineral leasing activities.
- About \$0.25 million came from trust land sales. (This includes about \$5,700 from standing timber on sold lands.)

In **FY11** (7/1/10-6/30/11), net revenue to the school trust fund was about **\$23.17 million** (Figure 5).

- About \$2.68 million came from timber sales and surface contracts.
- About \$19.95 million came from mineral leasing activities.
- About \$0.53 million came from trust land sales. (This includes about \$21,900 from standing timber on sold lands.)

**Figure 5. Net revenue from school trust lands, FY10-11.**



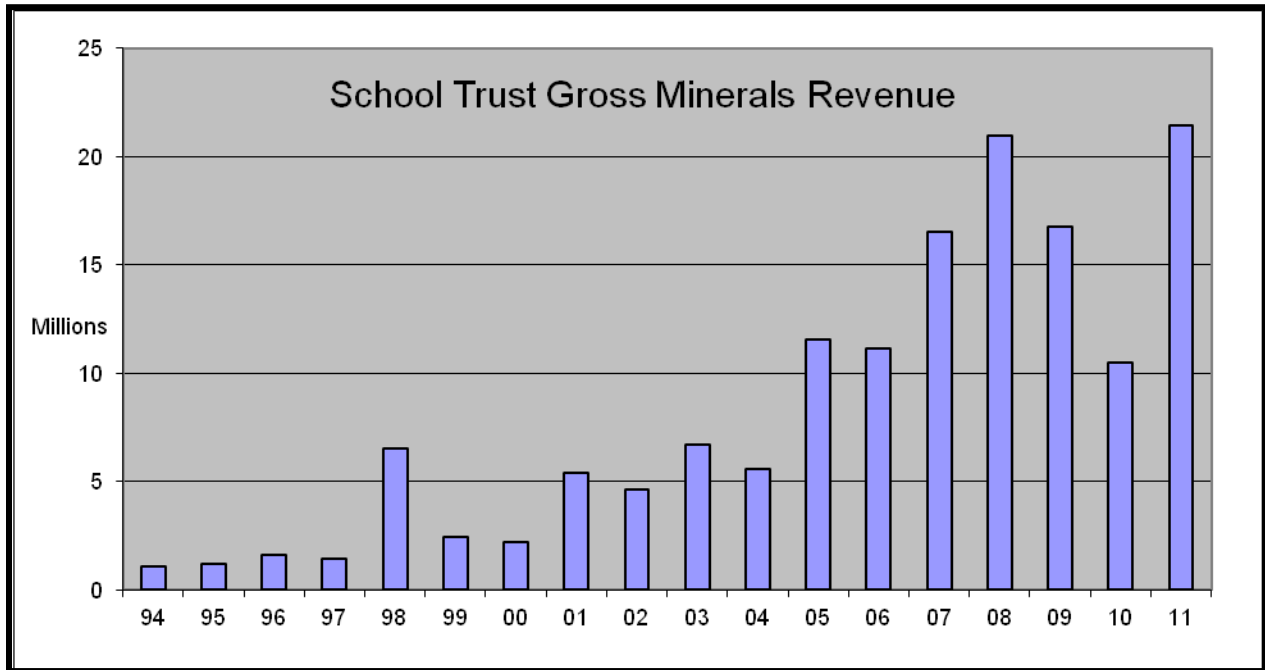
### 3.4 Revenue from minerals activities and related costs.

In **FY10**, gross revenue generated from minerals activities on school trust lands was **\$10,487,159** (Table 3). The largest contributor was \$10,101,699 from iron ore/taconite rents and royalties (and interest). Other contributing categories were non-ferrous metallic minerals leases (\$290,069), stockpiling/surface leases (\$4,320), peat leases (\$77,319), and M-leases (leases for stockpiled, low-grade iron materials; \$13,752). The management costs for FY10 equaled \$2,051,959 or 19.57% of the gross revenues. (Twenty percent of the revenue from iron ore/taconite and nonferrous metallic minerals rent and royalties (\$2,071,993) went to the minerals management account and the remainder of the minerals revenue (\$8,415,166) was distributed directly to the permanent school fund. Pursuant to Minnesota Statutes, section 93.2236, \$20,034 was transferred from the minerals management account back to the school trust fund in FY10. See Section 4.2 below.)

In **FY11**, gross revenue generated from minerals activities on school trust lands was **\$21,448,108**. The largest contributor was \$20,921,168 from iron ore/taconite rents and royalties (and interest). Other contributing categories were non-ferrous metallic minerals leases (\$329,436), stockpiling/surface leases (\$4,320), peat leases (\$137,601), M-leases (leases for stockpiled, low-grade iron materials; \$42,481), and industrial mineral leases (\$13,102). The management costs for FY11 equaled \$1,495,994 or 6.97% of the gross revenues. (Twenty percent of the revenue from iron ore/taconite and nonferrous metallic minerals rent and royalties (\$4,248,279) was distributed to the minerals management account and the remainder of the minerals revenue (\$17,199,829) was distributed directly to the permanent school fund. Pursuant to Minnesota Statutes, section 93.2236, \$2,752,285 was transferred from the minerals management account back to the school trust fund in FY11. See Section 4.2 below.)

	FY10	FY11
Taconite and Iron ore rents/royalties	\$10,101,699	\$20,921,168
Non-ferrous metallic minerals	\$290,069	\$329,436
Stockpiling/Surface leases	\$4,320	\$4,320
Peat	\$77,319	\$137,601
M-leases	\$13,752	\$42,481
Industrial Minerals	\$0	\$13,102
<b>Total</b>	<b>\$10,487,159</b>	<b>\$21,448,108</b>

**Table 3. Revenue from mineral leases, FY10-11.**



**Figure 6. School trust fund gross minerals revenue, FY94-11.**

#### Trends in revenue from mineral leasing

The taconite industry was greatly affected by the worldwide economic downturn and recovery. A dramatic decrease in steel production and iron ore consumption caused a significant drop in the iron ore royalties for FY10. However, increased demand in FY11 created a record year for mineral revenues.

### 3.5 Revenue from land sales.

In **FY10**, the sale of school trust land generated a total of **\$248,610** (Table 4). This included sale of land payments of \$234,996 and loan interest payments of \$7,872. 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 \$5,742. At the Fall 2009 land sale, 12 school trust parcels were offered and five parcels sold. At the Spring 2010 land sale, three school trust parcels were offered and one parcel was sold.

In **FY11**, the sale of trust land generated a total of **\$530,538** (Table 4). This included sale of land payments of \$272,194 and condemnation payments of \$231,900. When the revenue generating capability of the school trust lands is prohibited by the DNR's management practices, the DNR will commence a condemnation action through the court system. The condemnation payments are made by the DNR to the school trust fund. There were also loan interest payments of \$4,513. The timber value of sold school trust land brought in \$21,931. At the Fall 2010 land sale, 27 parcels were offered and 10 parcels were sold. No school trust parcels were offered at the Spring 2011 land sale.

Since 1999 the DNR no longer sells land by certificates of sales. Certificates of sales provided for installment payments over 10 or 20 years. Therefore, the amount of revenue generated by older sales will continue to decrease as the final certificates of sale are paid. The current sale requires a 10% down payment at the time of the auction and a 90% payment within 90 days of the auction.

**Table 4. Revenue from land sales, FY10-11.**

	FY10	FY11
Sale of land (installment payments from certificates of sale, 10% down payments, 90% payment, and paid-in-fulls at the time of auction)	\$234,996	\$272,194
Condemnations <sup>A</sup>	\$0	\$231,900
Loan interest (from certificates of sale)	\$7,872	\$4,513
Sale of timber <sup>B</sup>	\$5,742	\$21,931
Total	\$248,610	\$530,538

<sup>A</sup> Three condemnations of school trust lands by the DNR were completed in FY11: 1.) Little Hill River WMA (120 acres - \$144,000); 2.) Cormant Cemetery (0.43 acres - \$1,000); and 3.) Myhr Creek Ridge SNA (40 acres - \$86,900).

<sup>B</sup> 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.

### **3.6 Gross revenue from timber sales and surface contracts.**

Timber sales and surface contract revenue (except for water crossing license revenues and the Enbridge Pipeline aggregate encumbrance) are first deposited into the State Forest Suspense Account. Aside from a few exceptions (e.g. sale of standing timber, wild rice farming leases, late fees on DNR surface leases), the revenue deposited in the State Forest Suspense Account, unlike revenues deposited directly into the permanent school fund, is subject to forestry cost certification (see Minnesota Statutes, section 16A.125).

#### **3.6.1 Timber sales.**

In **FY10**, timber sales revenues totaled more than **\$8.37 million**, with timber sale interest bringing in \$37,937. All of this revenue was deposited into the State Forest Suspense Account (Table 5).

In **FY11**, timber sale revenues totaled more than **\$9.12 million**, with timber sale interest bringing in \$27,840. All of this revenue was deposited into the State Forest Suspense Account (Table 5).

**Table 5. Revenue from timber sales and surface contracts, FY10-11.**

	FY10	FY11
Timber sales	\$8,307,980	\$9,075,229
Timber sales interest	\$37,937	\$27,840
Sale of standing timber <sup>A</sup>	\$26,219	\$17,848
Subtotal:	\$8,372,136	\$9,120,917
Leases, licenses, easements <sup>B</sup>	\$2,031,326	\$1,033,661
Campground fees	\$152,261	\$526,692 <sup>C</sup>
Subtotal:	\$2,183,587	\$1,560,353
Total:	\$10,555,723	\$10,681,270

<sup>A</sup> 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.

<sup>B</sup> See Table 6 for details.

<sup>C</sup> See Section 3.6.2 below for explanation of increase from FY10.

Note: totals may not add due to independent rounding.

### **3.6.2 Campground fees.**

Campground fees from school trust lands totaled \$152,261 in **FY10**, and totaled \$526,692 in **FY11** (Table 5). Campground fees are deposited in the State Forest Suspense Account, but costs are not certified against these revenues.

Of the FY11 revenue, \$153,803 was deposited into the State Forest Suspense Account and \$372,889 was deposited directly into the permanent school fund. During a review of forest campground revenues it was determined that revenue from two campgrounds on school trust lands was not being distributed to the permanent school fund. To correct this and assure that the trust was fully compensated, the \$372,889 of revenue generated from these campgrounds in past years was deposited directly into the permanent school fund.

### **3.6.3 Surface contracts.**

In **FY10**, a gross total of about \$2,031,326 was collected from surface contracts on school 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 FY10.

In **FY11**, a gross total of about \$1,033,661 was collected from surface contracts on school trust land (Tables 5 and 6). As was the case in FY10, many of the active agreements generated revenue only in their year of issue.



The surface contracts include:

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

Water Crossing Licenses

Laws of Minnesota 2009, Chapter 37, Article 1, Section 12, amended Minnesota Statutes, section 84.415, to require that money received from licenses and permits for the use of the beds of public 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 public waters was credited to the State Forest Suspense Account and subject to forestry cost certification.

Enbridge Aggregate Encumbrance

In FY10, a lump sum payment of \$874,155 was paid by Enbridge for deposit directly into the permanent school fund. This payment was made for the aggregate that will not be available for mining during the existence of the pipeline, however this aggregate may still be sold in the future after the pipeline is no longer in use. This aggregate encumbrance payment is in addition to the utility license fees paid by Enbridge.

**Table 6. Revenue by surface contract type, FY10-11.**

Contract type	FY10	FY11
Easements	\$172,978	\$24,157
Land crossing license	\$153,519	\$95,540
Water crossing license <sup>B</sup>	\$122,133	\$142,240
Leases: aggregate	\$211,631	\$381,117
Leases: agricultural	\$17,404	\$15,544
Leases: miscellaneous	\$383,587	\$284,662
Leases: other (lakeshore, etc.)	\$15,095	\$13,955
Leases: hunting cabins	\$23,079	\$22,440
Leases: wild rice farming <sup>A</sup>	\$3,448	\$3,939
Late fees on DNR land leases <sup>A</sup>	\$175	\$29
GIA Permits	\$52,102	\$48,513
Resource Management Access Permits	\$2,020	\$1,525
Aggregate Encumbrance <sup>B</sup>	\$874,155	\$0
<b>Total</b>	<b>\$2,031,326</b>	<b>\$1,033,661</b>

**Revenue from surface contracts**

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.

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

<sup>B</sup> Deposited directly into the permanent school fund; no costs certified against these revenues.

#### 4. Management costs.

##### 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, section 16A.125 provides 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.

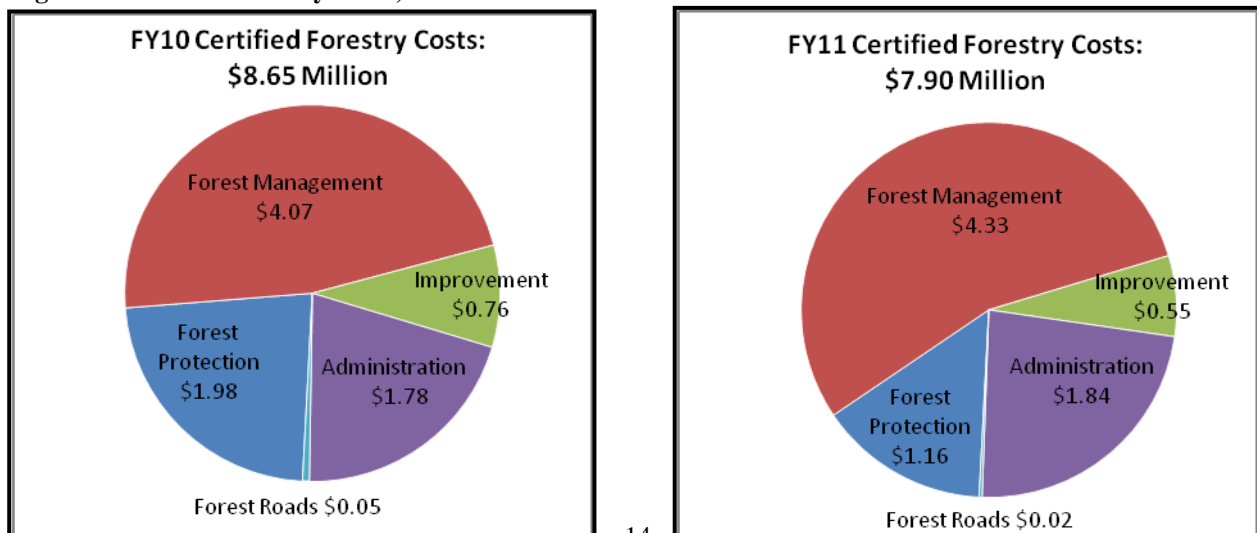
The allowable costs are for the protection, improvement, administration and management of forest lands, and for the construction and maintenance of forest roads (Figure 7).

Only those charges that were paid from the state’s General Fund and Forest Management Investment accounts appropriated for forestry are included. Costs charged to other 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.

School and university trust lands are treated as a group, and that group’s costs are recorded separately from all other management costs. Applicable costs are prorated on a uniform per acre basis between school and university trust lands, and certified accordingly. In FY11, costs were certified by administrative area to more closely reflect costs to manage school trust lands.

Figure 7. Certified Forestry Costs, FY10-11



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. In FY11, this was modified to allocate suppression costs by administrative area, relating costs more closely to the trust lands protected.
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. In FY11, road costs were tracked by administrative area and allocated to the trust based on the percentage of trust land served by that area’s roads.
3. **Timber sales costs** are allocated to all lands in proportion to the revenues received from those lands. In FY10, 46% of state timber sales revenues were from school trust lands, so 46% of all state timber sales costs were attributed to the school trust lands. In FY11, costs were allocated by administrative area based on school trust land acres in each area as were Forest Management and Forest Improvement costs.
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. In FY11, these costs were further allocated by administrative area based on school trust land acres in each area.

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 permanent school fund after the close of each fiscal year.

The trust land cost certification process has been reviewed twice in recent years (FY93 and FY98) by the Office of the Legislative Auditor (OLA). In the 1998 report, the OLA found that overall the methods used to allocate forestry management costs to school trust lands were reasonable.

## 4.2 Mineral management costs.

The current practice as to mineral management costs started in Fiscal Year 2006. Twenty percent of the payments made under state mineral leases are 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 is 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 **FY10**, the permanent school fund received a \$20,034 transfer from the minerals management account. For **FY11**, the permanent school fund received a \$2,752,285 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 **FY10** the legislature appropriated \$2.896 million from the minerals management account for mineral management on state lands. Of this amount, \$2,051,959 (19.57% of mineral revenues generated from school trust lands) came from the revenues generated from mineral leases on school trust lands. In **FY11** the legislature appropriated \$2.896 million from the minerals management account for mineral management on state lands. Of this amount, \$1,495,994 (6.97% 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 permanent school fund from the minerals management account.**

	Gross mineral lease revenue	Mineral lease revenue sent directly to the permanent school fund*	Mineral lease revenue to the Minerals Management Account (20% of revenue)			Transferred back to the permanent school fund **	Costs charged against the school trust mineral lease revenue	Net revenue to the permanent school fund
			Iron ore / taconite	Metallic minerals	Total***			
FY 2010	\$10,487,159	\$8,415,166	\$2,013,979	\$58,014	\$2,071,993	\$20,034	\$2,051,959	\$8,435,200
FY 2011	\$21,448,108	\$17,199,829	\$4,179,772	\$65,887	\$4,248,279	\$2,752,285	\$1,495,994	\$19,952,114

\* Includes 80% of taconite/iron ore, metallic mineral, and industrial mineral lease revenues and 100% of all other mineral lease revenues.

\*\* 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 into the account in the previous biennium.

\*\*\* FY11, total includes \$2,620 of Industrial Minerals revenues on school trust lands.

### **4.3 School trust fund revenue enhancement program and aggregate evaluation.**

For FY10-11, 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. The Division of Lands & Minerals decided to fund some of the exchange and sale work out of its general fund appropriation, therefore the full appropriation was not expended. In FY 10, \$71,163 was expended from this account. In FY11, \$98,807 was expended from this appropriation. Of this appropriation, \$230,030 was not expended and was returned to the permanent school fund.

## **5. Review of FY10-11 forestry activities and metallic minerals leases.**

### **5.1 Forestry activities, FY10-11.**

Due to the global economic downturn and housing market decline affecting wood demand, timber revenue from school trust land declined in FY10 but began to recover in FY11. In FY 10 volume sold on school trust land was 322,000 cords on 17,700 acres, down from 458,000 cords on 23,500 acres in 2009. Volume sold rebounded in FY11 to 382,000 cords on 19,300 acres.

### **5.2 Metallic minerals leasing, FY10-11.**

Three processes are used to issue non-ferrous metallic mineral leases in Minnesota: 1.) public auction, 2.) negotiation, and 3.) 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 FY10-11 biennium, a total of 123 metallic mineral leases were issued. Of these 112 leases were awarded to bidders at the 2010 Metallic Minerals Lease Sale auction, 9 were negotiated leases, and 2 were preference rights leases. The 123 leases were awarded to eight companies (Duluth Metals Corp., Encampment Minerals, Inc., HTX Minerals Corp, Kennecott Exploration Co., Lehmann Exploration Management, Minerals Processing Corp, Prime Meridian Resources Inc., and Vermillion Gold, LLC) and covered a total of 50,762 acres. Fifty-five of the 123 leases (covering 25,993 acres) were in Aitkin County, 15 (4,123 acres) were in Carlton County, seven (3,592 acres) were in Itasca County, three (1,016 acres) were in Koochiching County, and 43 (16,038 acres) were in St. Louis County. Of the 50,762 acres covered by new leases, 16,305 acres (32.1% of the total) is school trust land.

In April 2011, the DNR held an auction for metallic mineral leases. At this auction 110,603 acres of school trust land were offered and 9,141 acres were bid on. Forty-two percent of the acres bid on were school trust lands. Before these leases can be issued, the State Executive Council is required to approve the leases. The DNR recommended approval of all the leases covering the bid upon acres at the June 2011 and October 2011 Executive Council meetings. The Executive Council did not approve the leases at either meeting and at the October meeting it decided to reconsider approval of the leases again in six months. The primary reason that the leases were not approved is because of concerns expressed by surface owners of severed estates

where the state owned the minerals and was requesting approval to lease the minerals of the severed estate.

## **6. Review of FY10-11 projects and preview of FY12-13 projects.**

### **6.1 Legislation.**

Some legislation related to the school trust lands was passed during the 2010 and 2011 Legislative Sessions. Laws of Minnesota 2010 - Resolution #1 is a joint resolution adopted by the Minnesota Legislature, memorializing Congress and the Secretary of Agriculture to appropriate money and negotiate with the State of Minnesota on the sale and exchange of school trust lands located within the Boundary Waters Canoe Area Wilderness.

Laws of Minnesota 2010, Chapter 361, Article 4, Section 70, required the Commissioner of Natural Resources to provide the chairs of the house and senate committees and divisions with jurisdiction over natural resources and education finance, information necessary to evaluate the DNR's management of school trust lands (by July 15, 2010), and the advantages and disadvantages of a funding mechanism for compensating the permanent school trust fund for the private and public use of school trust lands (by January 15, 2011). Both reports have been submitted.

Laws of Minnesota 2011, Chapter 107, Section 46, amended Minnesota Statutes, section 89.17. Minnesota Statutes, section 89.17, is one of the laws that authorize the DNR to lease state lands, including school trust lands. Prior to this amendment, lease revenue from road leases on school trust lands was directed to the State Forest Suspense Account. The amendment requires that reasonable costs be deducted for preparing and issuing a road lease and that the remaining proceeds be deposited directly into the permanent school fund.

Laws of Minnesota 2011, First Special Session, Chapter 11, Article 1, Section 1, amended Minnesota Statutes, section 11A.16. Minnesota Statutes, section 11A.16, provides the method for calculation of the funds distributed to the schools from the permanent school fund. The amendment adds "interest earned on certified monthly earnings prior to the transfer to the Department of Education," to this calculation.

Laws of Minnesota 2011, First Special Session, Chapter 11, Article 1, Section 26, amended Minnesota Statutes, section 127A.33. Minnesota Statutes, section 127A.33, provides the method for apportionment of the funds distributed to the schools from the permanent school fund. Following is the amendment: "The apportionment shall be in proportion to the number of pupils in each district's adjusted average daily membership during the preceding year."

Laws of Minnesota 2011, Chapter 3, Section 5, amended Minnesota Statutes, section 94.342. Minnesota Statutes, section 94.342, in part, requires that when state land with water frontage is exchanged, that the replacement lands have similar water frontage. The amendment removes this restriction when lands in the BWCAW are being exchanged.

## **6.2 BWCAW.**

Since mid-2009 the DNR has been working with the Permanent School Fund Advisory Committee (PSFAC) and the U.S. Forest Service to develop a plan to fully compensate the permanent school fund for the lands within the BWCAW. The efforts of these parties lead to the Minnesota Legislature passing Minnesota Session Laws 2010 - Resolution #1. This resolution adopted the recommendation of the PSFAC to pursue the sale and exchange of the school trust lands inside the BWCAW with the U.S. Forest Service. The PSFAC recommended that this hybrid model consist of a 1/3rd exchange and 2/3rd sale.

A work group that includes the DNR, U.S. Forest Service, and other interested stakeholders (i.e. education, environment, counties, mining, and timber interest groups) was formed to work on this project. The initial goal of the work group was to facilitate the DNR's and U.S. Forest Service's selection of parcels for exchange. The DNR reviewed over 100,000 acres of U.S. Forest Service lands for potential exchange. The DNR and U.S. Forest Service currently agree on approximately 41,000 acres of U.S. Forest Service land outside of the BWCAW that are acceptable as candidates for exchange. The work group has reviewed the 41,000 acres and generally found the candidate parcels to be acceptable. The selection of over 41,000 acres is a big step in the right direction, but a lot of work is still needed to complete the exchange and sale. The DNR has made this project a work priority in FY12 and FY13.

## **6.3 Exchanges.**

In the Fall of 2010 the DNR completed two internal exchanges of school trust lands. Exchange #886 exchanged 998 acres of school trust land with designated old growth for 1,429 acres of other DNR administered land. Exchange #890 exchanged 89 acres of school trust land, which had diminished revenue generating potential because of its use as a school forest by the Longville School District, for 160 acres of other DNR administered land.

## **6.4 Construction Aggregate Resources Inventory Project.**

The construction aggregate resources inventory project is designed to identify construction aggregate resources on school trust lands, to designate those lands as having aggregate resource value, and to work to get the sites leased to generate revenue. There have been a number of positive outcomes from this project, including marketing of certain resource sites, new revenue from new leases, identification of more aggregate resource sites, inventory fieldwork to estimated resources values to be able to better market the resource, and protection of school trust aggregate resources.

As part of this project, proposed land transactions are reviewed to prevent the inadvertent loss of valuable of aggregate resources. Review of proposed land transactions has allowed for the protection of aggregate resources for future mining. Protection of aggregate resources helps to increase revenue to the permanent school fund. This project played a big part in enabling the DNR to aggressively negotiate the Enbridge pipeline deal that is set forth in Paragraph 3.6.3 above. This project allowed the DNR to develop a reasonable model of the aggregate resource encumbered by the pipeline, determine the volume of aggregate that would be encumbered, and determine the price to be charged for the encumbered aggregate.

Field investigations are essential to create an inventory of the aggregate resources on school trust lands. Twenty-five new aggregate resource deposits were identified on school trust lands through field inspections in the region just north of Duluth. These sites will be flagged in the DNR land records to assure the aggregate resources are protected against encumbrance or loss of access. These parcels will also be actively marketed for leasing to increase revenue to the permanent school fund.

#### **6.5 DNR Operational Order.**

The DNR has completed an Operational Order that clarifies its policy on management of school trust lands. The Operational Order sets forth the clear priority that school trust lands are to be managed to maximize long term economic return and it clarifies the application of the statutory language requiring the DNR to manage the lands consistent with sound natural resource conservation and management principles. The Operational Order also requires the agency to implement a number of business best practices related to managing and reporting revenues and costs. Lastly, the Operational Order sets up a management structure and action items to be executed to ensure accountability, greater transparency and oversight.

#### **7. Management of the permanent school fund and income payments to public schools.**

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

About \$23 million of spendable income was generated by permanent school fund in **FY10** and distributed to the public schools (i.e. less than 1% of the total school aid amount appropriated by the legislature). In **FY11**, payments to schools totaled about \$23 million. As of June 30, 2009 (the beginning of the **FY10-11** biennium) the market value of the permanent school fund was \$614 million. Reflecting the general gains in the stock market over the **FY10-11** time period, the market value of the permanent school fund principal increased from \$614 million to \$674 million during **FY10**, and had increased to \$785 million by the end of **FY11**.



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

TTY (651) 296-5484 (metro area)

TTY 1-800-657-3929

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### Report preparation costs

The report cost about \$1,200 to prepare. Funds that the legislature appropriated for the school trust fund revenue enhancement program were used to prepare this report.